The Bank Treasury Newsletter
The Chart Deck
June 2023

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In This Month's Chart Deck

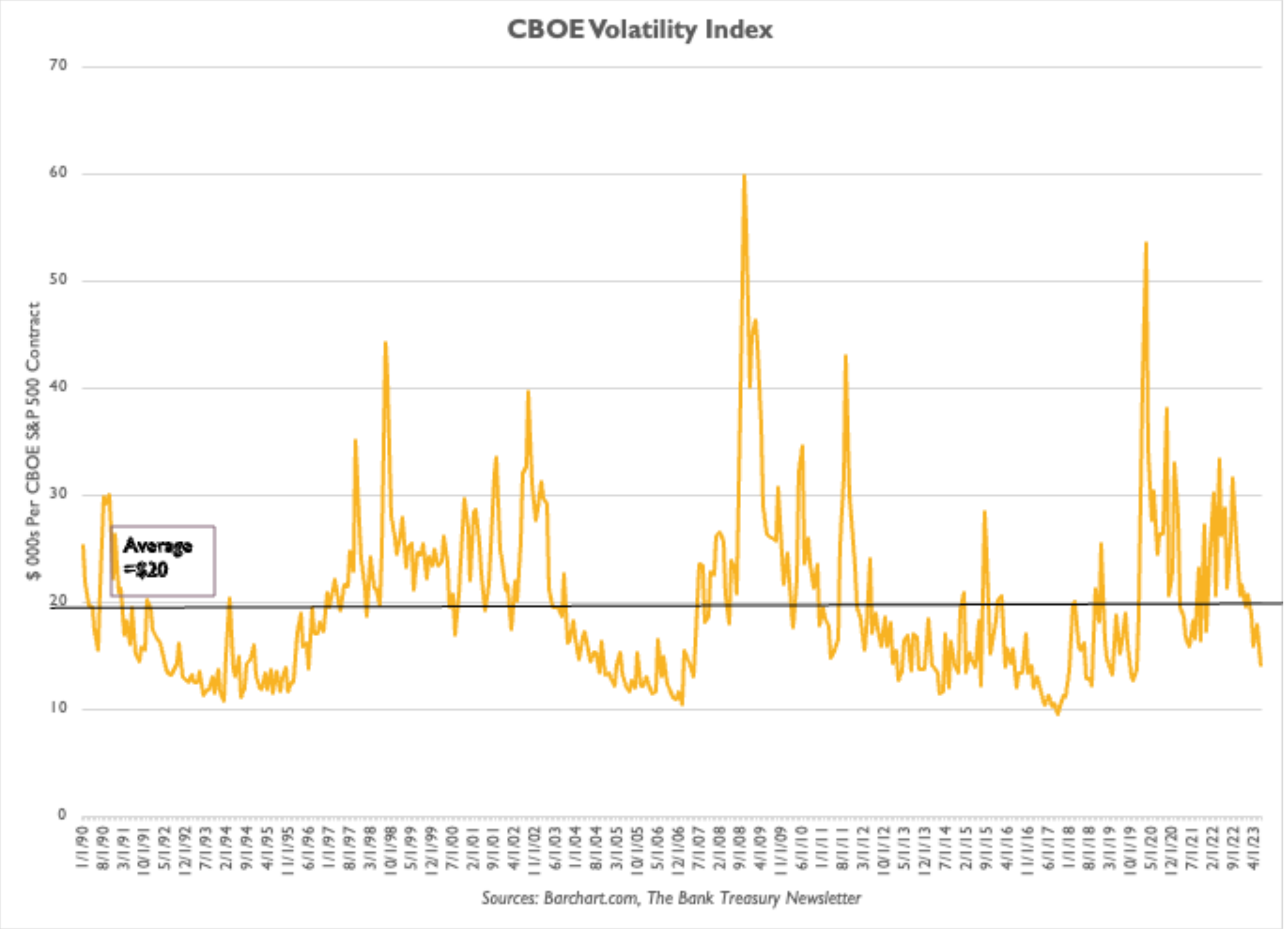
- Since the Fed began to raise rates last year, through four successive 75-basis point hikes, despite the the turmoil caused by the failure of Silicon Valley Bank (SVB), Signature Bank, New York (SBNY), and First Republic Bank (FRB), the drama over the debt ceiling, and despite growing concerns in the market about the economy and persistent geopolitical uncertainty, price volatility in the equity markets is now down to levels last seen before the pandemic (Slide 4). Meanwhile, the Treasury yield curve has been anything but quiet, with the spread between the 3-month and 5-year Treasurys swinging over the last year by more than 300 basis points, from positively sloped to deeply inverted. Since the failure of FRB in the beginning of May through the middle of this month, the spread narrowed from minus-200 basis points to minus 130 basis points, and the continuous steepening and flattening of the curve over one-month intervals has not stopped since the beginning of Covid. The front-end of the yield curve has not been this volatile since the Global Financial Crisis (Slide 5).
- One reason for its continued volatility could be related to general tightening in the short-term markets, reflected in the change in the average spread between the Secured Overnight Financing Rate (SOFR) and the rate on the Fed's Reverse Repo Facility (RRP) (Slide 6). Before November 2022, SOFR was setting on average 1-2 basis points through the RRP rate, and now is setting 1 basis point above the RRP, an indication that the Fed has reached a neutral to slightly restrictive level on Fed funds. The money market funds remain a significant participant in the repo markets, and their $2.2 trillion investment in the Fed's RRP, which increased by under $0.2 trillion since the start of Quantitative Tightening (QT) last year, compares to their $2.7 trillion total investment in Treasury repo. Almost the entire reduction in the Fed's System Open Market Account (SOMA) portfolio was offset by the Treasury General Account (TGA) during the stand-off of the debt ceiling (Slide 7). The remainder was offset by the Fed's new Bank Term Funding Program (BTFP).
- Since the bank failures, the public has pulled $0.4 trillion of deposits out of banks, bringing the balance down to $15.9 trillion. A large chunk of the cash went into the money market funds (Slide 8), much of of which came from uninsured deposit accounts (Slide 9). But while higher rates have encouraged depositors to shift cash from noninterest-earning deposits to interest-earning deposits, Slide 10 suggests that households are still maintaining larger checking accounts than they did before Covid, even as they have increased money market fund investments and investments in Treasurys. Notably, households tripled their investment in Treasurys over the last year, while still holding above-average balances in checking and a record level in money market funds. Even after the banking system sustained over $1 trillion in deposit outflows since the Fed's first hike back in March 2022, excess deposits over loans are still over $5 trillion, down from $7 trillion at its peak last year, but still at historically high levels (Slide 11). Bank treasurers continue to fret over deposits and how to fund loans. Banks that were under market stress after the bank failures this year worked to shore up their liquidity, tapping advance lines they had with the Federal Home Loan Banks (FHLBs), brokered CDs, and the Fed's new emergency credit line, the BTFP. Some institutions also ramped up funding from reciprocal deposits, although five institutions accounted for half of the total balance of those deposits in the system (Slide 12).
- The banking industry is bracing for tightening of regulation in response to the failure of SVB, SBNY, and FRB. The treatment of Accumulated Other Comprehensive Income (AOCI) in regulatory capital is among the rules that is widely expected to change. Banks reported slightly improved marks against their Available-for-Sale (AFS) portfolios in Q1 2023 (Slide 13), although they remain deeply underwater.

List of Slides

- Chicago Board Option Exchange (CBOE)Volatility Index, *Sources: Barchart.com, The Bank Treasury Newsletter*
- Rolling 1-Month Change in the 3-Month-5-Year Treasury Spread, *Sources: H.15 Report, Federal Reserve, The Bank Treasury Newsletter*
- SOFR-RRP Spread, *Sources: FRED, St. Louis Fed, The Bank Treasury Newsletter*
- Changes in the Sources and Uses of Reserves on the Fed's Balance Sheet, June 2022-June 2023, *Sources: H.4 Report, Federal Reserve, The Bank Treasury Newsletter*
- Uninsured Deposits, *Sources: Call Reports, Fis FedFis, LLC, The Bank Treasury Newsletter*
- Money Market Funds, *Sources: Money Market Monitor, Office of Financial Research, The Bank Treasury Newsletter*
- Financial Assets Held By Households and Non-Profits, *Sources: Flow of Funds Report, Federal Reserve, The Bank Treasury Newsletter*
- Excess Deposits, *Sources: H.8 Report, Federal Reserve, The Bank Treasury Newsletter*
- Reciprocal Deposits, *Sources: Call Reports, Fis FedFis, LLC, The Bank Treasury Newsletter*
- AOCI (35% Tax-Adjusted)/AFS, *Sources: Quarterly Banking Profile, FDIC, The Bank Treasury Newsletter*

Equity Volatility Plunges To Pre-Covid Lows

Equity volatility hit a peak in April 2022 and continued to fall ever since then.



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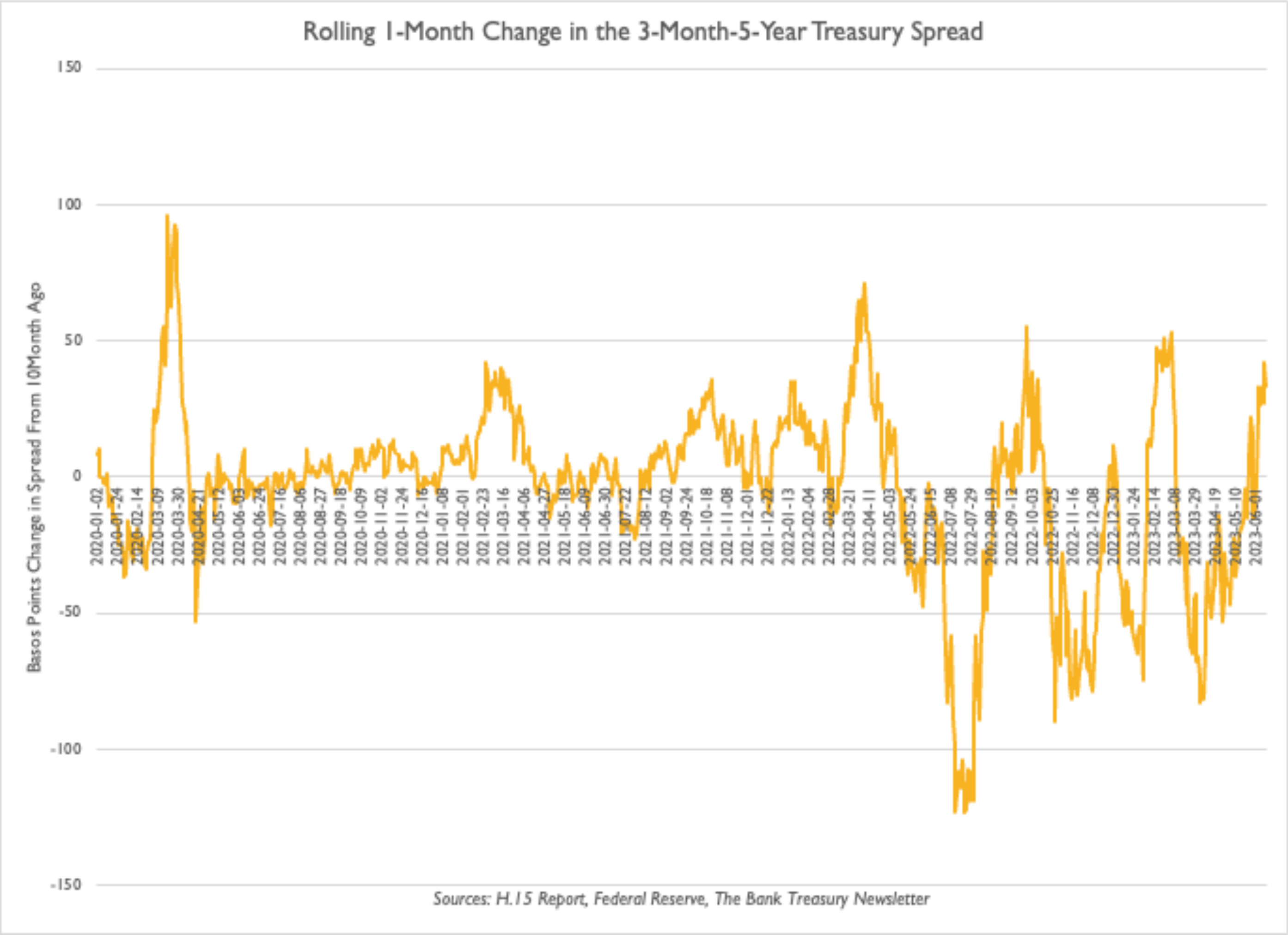
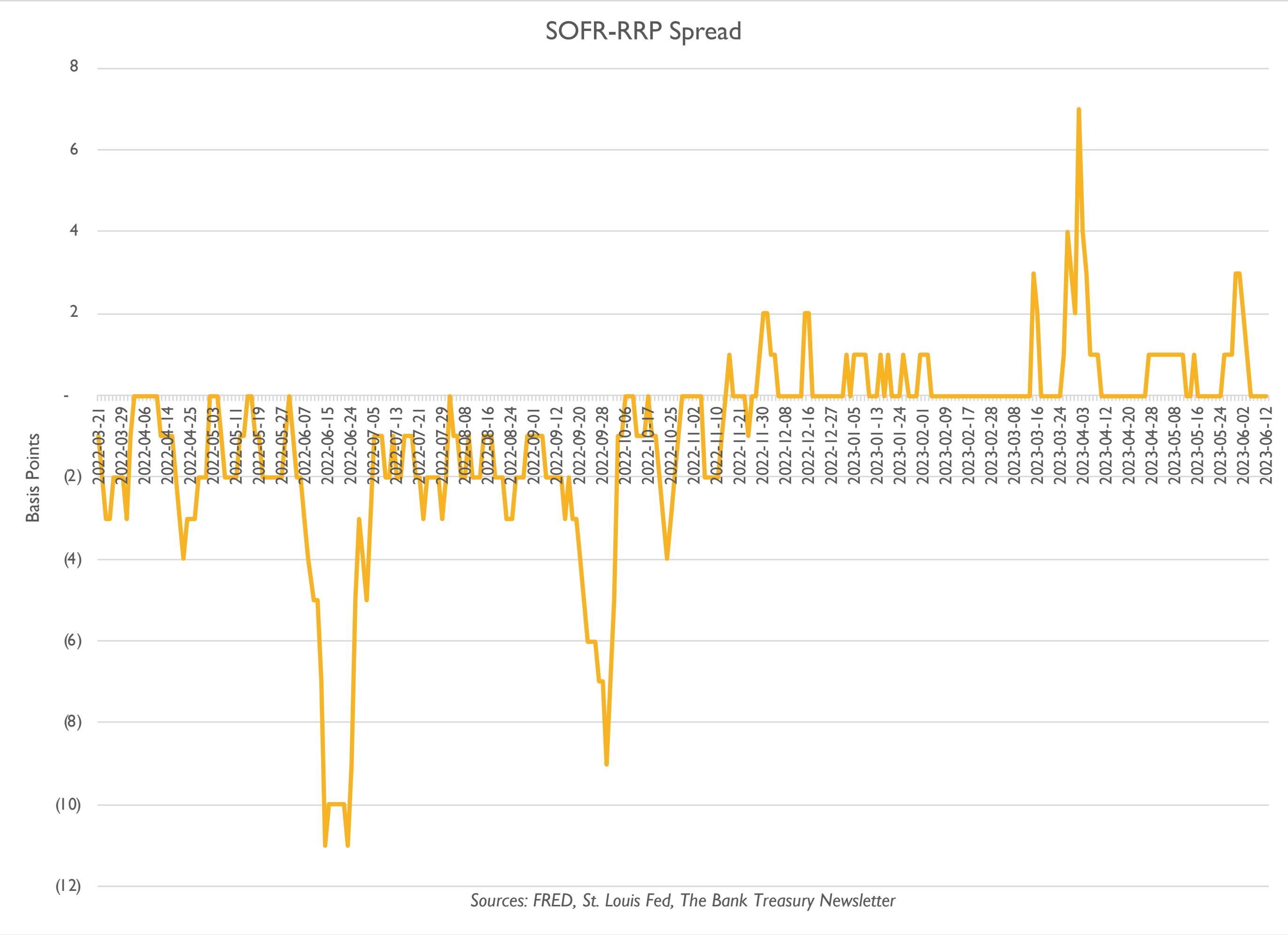
Yield Curve Swings Back And Forth



At its most recent extreme on May 2nd, the spread between the 3-month and 5-year Treasury was inverted by nearly 200 basis points, and now post this month's Fed meeting, the spread is 70 basis points flatter.

Cash Supply/Demand Dynamics Shift In Repo

Although the rate paid on the RRP should act as a floor for SOFR, when there is more cash supply in the repo market than collateral supply that cannot be met through the Fed's RRP facility, the SOFR rate has set through the RRP. Since November 2022, the imbalance reversed to the advantage of the cash suppliers, who are now earning more outside the facility in tri-party repo than they would in the RRP.



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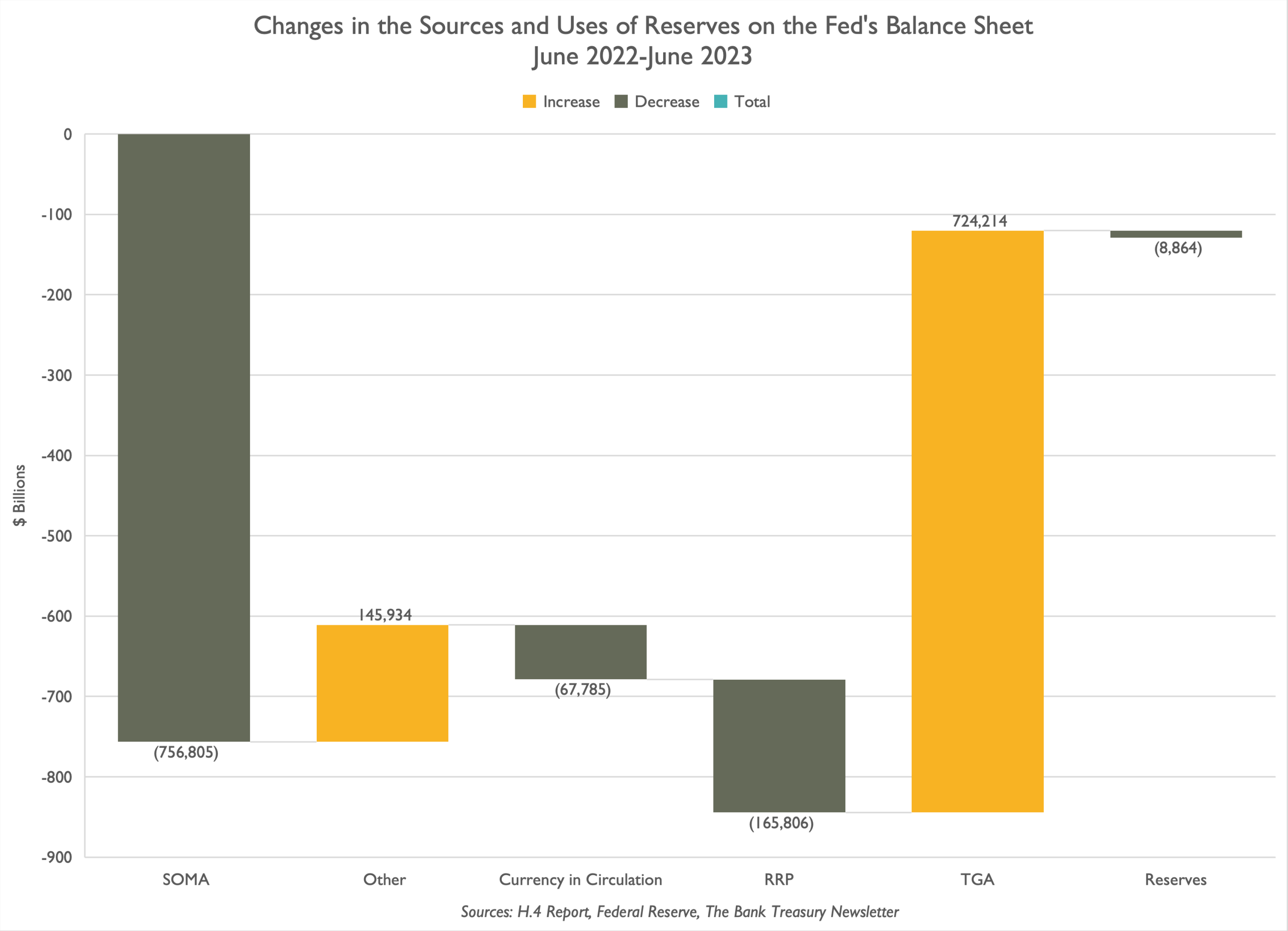
TGA Balances Out SOMA

SOMA fell by over $700 billion in the last year as a result of QT, but this was entirely offset by the TGA, which fell as the Treasury was engaged in extraordinary measures during the debt ceiling negotiations than concluded earlier this month. As the Treasury now proceeds to replenish the TGA, with QT still on-going, the effect of both will cut into the balance of both the RRP and reserves. Continued growth in currency in circulation also reduces the supply of reserves.



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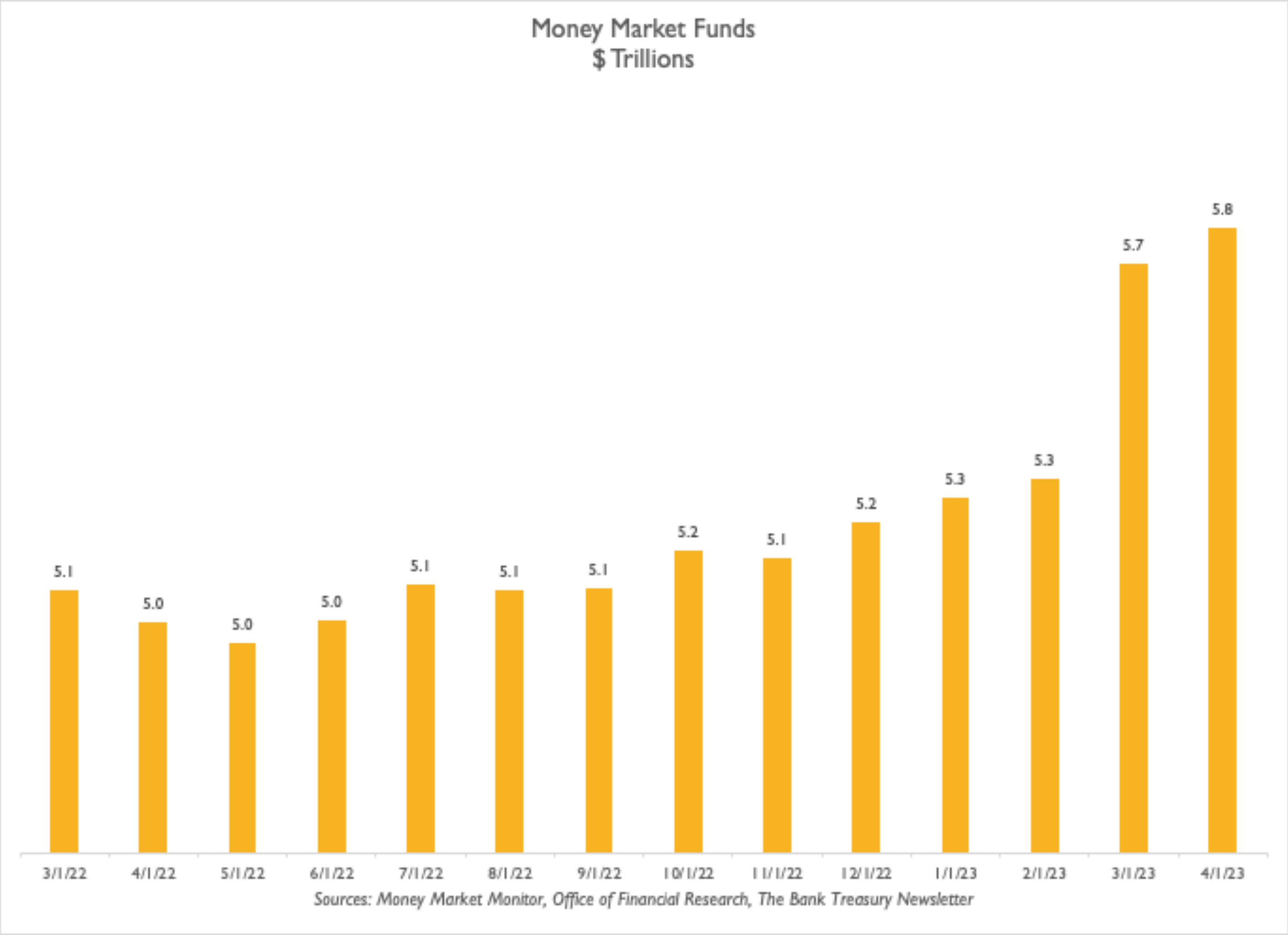
Money Market Funds Surge

Uninsured depositors sought refuge in the money market funds in the wake of the failure of SVB, SBNY, and FRB.



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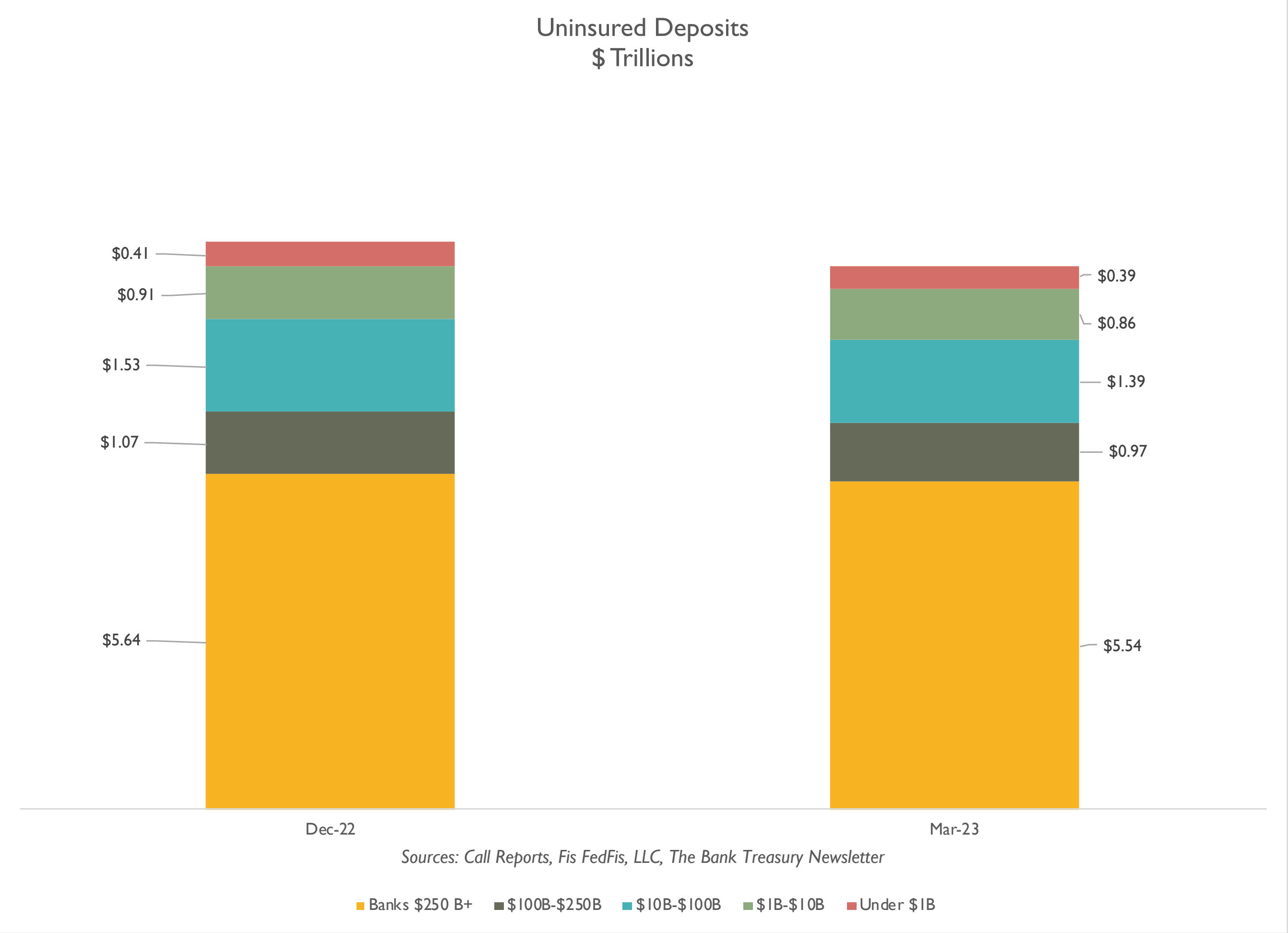
Large Deposits Exit Regional Banks

Banks with total assets between $10 billion to $100 billion, and between $100 billion and $250 billion sustained the largest relative outflow of uninsured deposits in Q1 2023.



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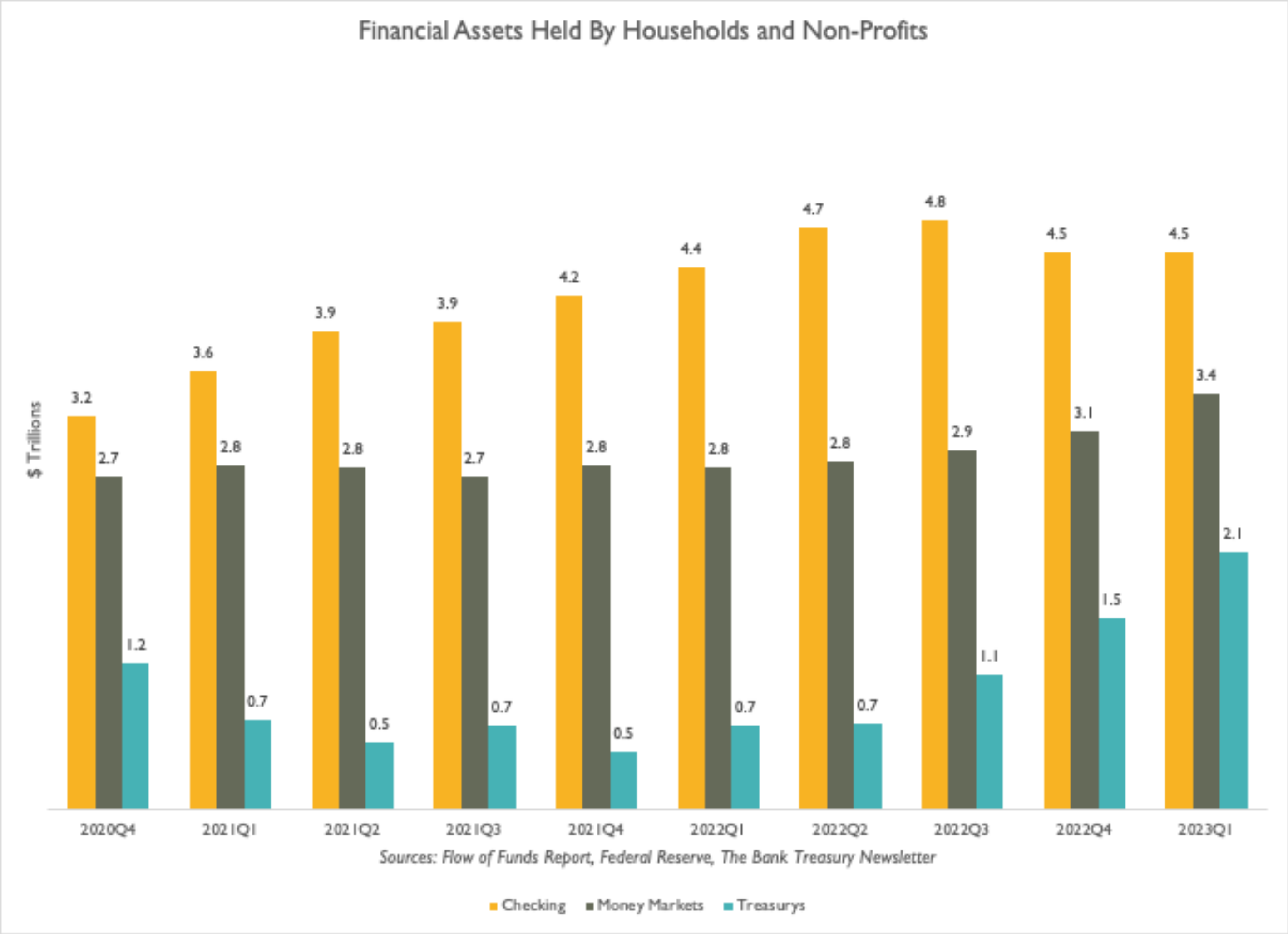
Households Seek Security Through Diversity

Rather than trade a checking account for an investment in money market funds or Treasurys, households and non-profit organizations are holding more of each category, maintaining checking account balances that are higher than they were pre-Covid, while tripling their investment in Treasurys to $2.1 trillion in Q1 2023.



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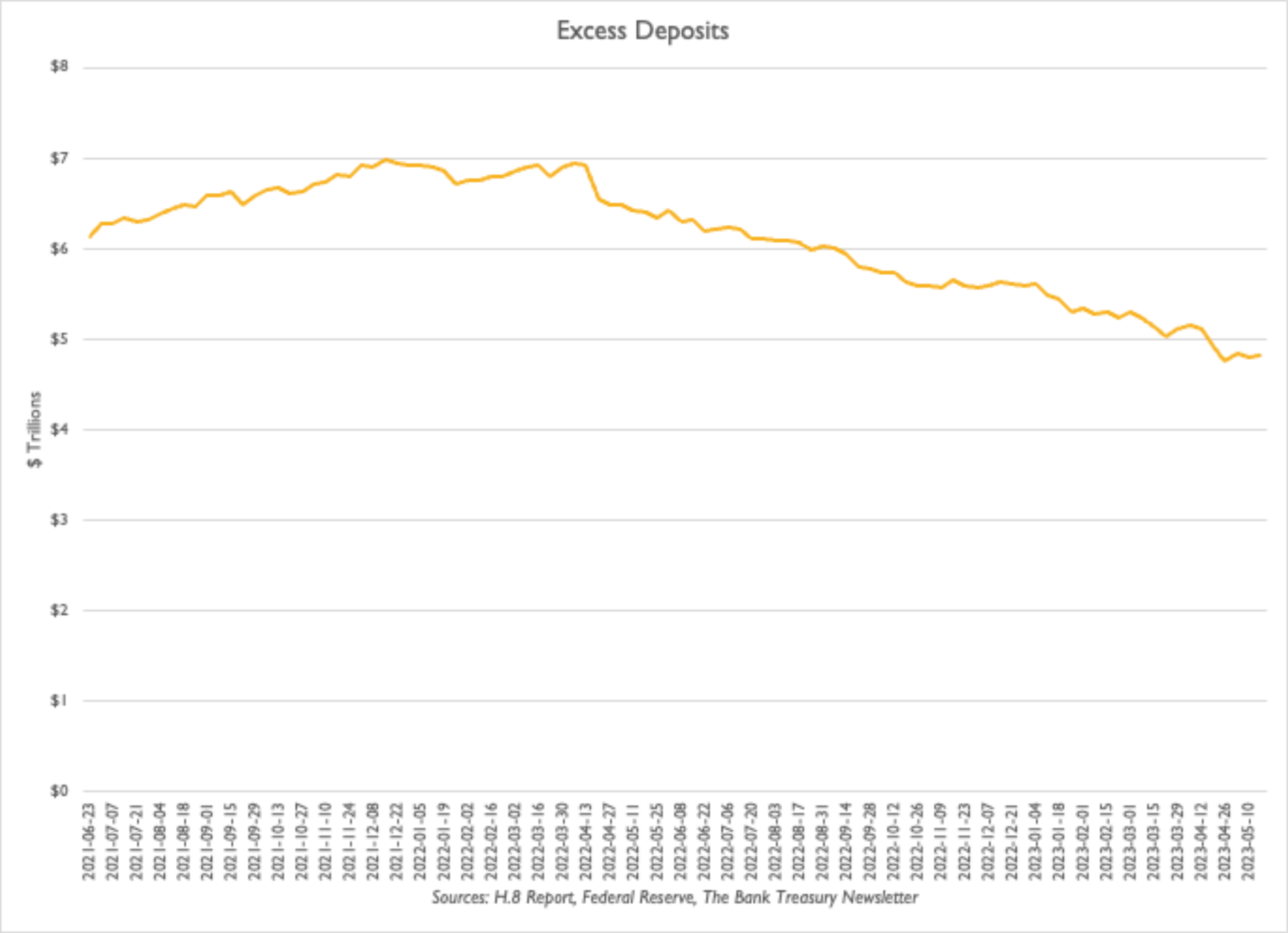
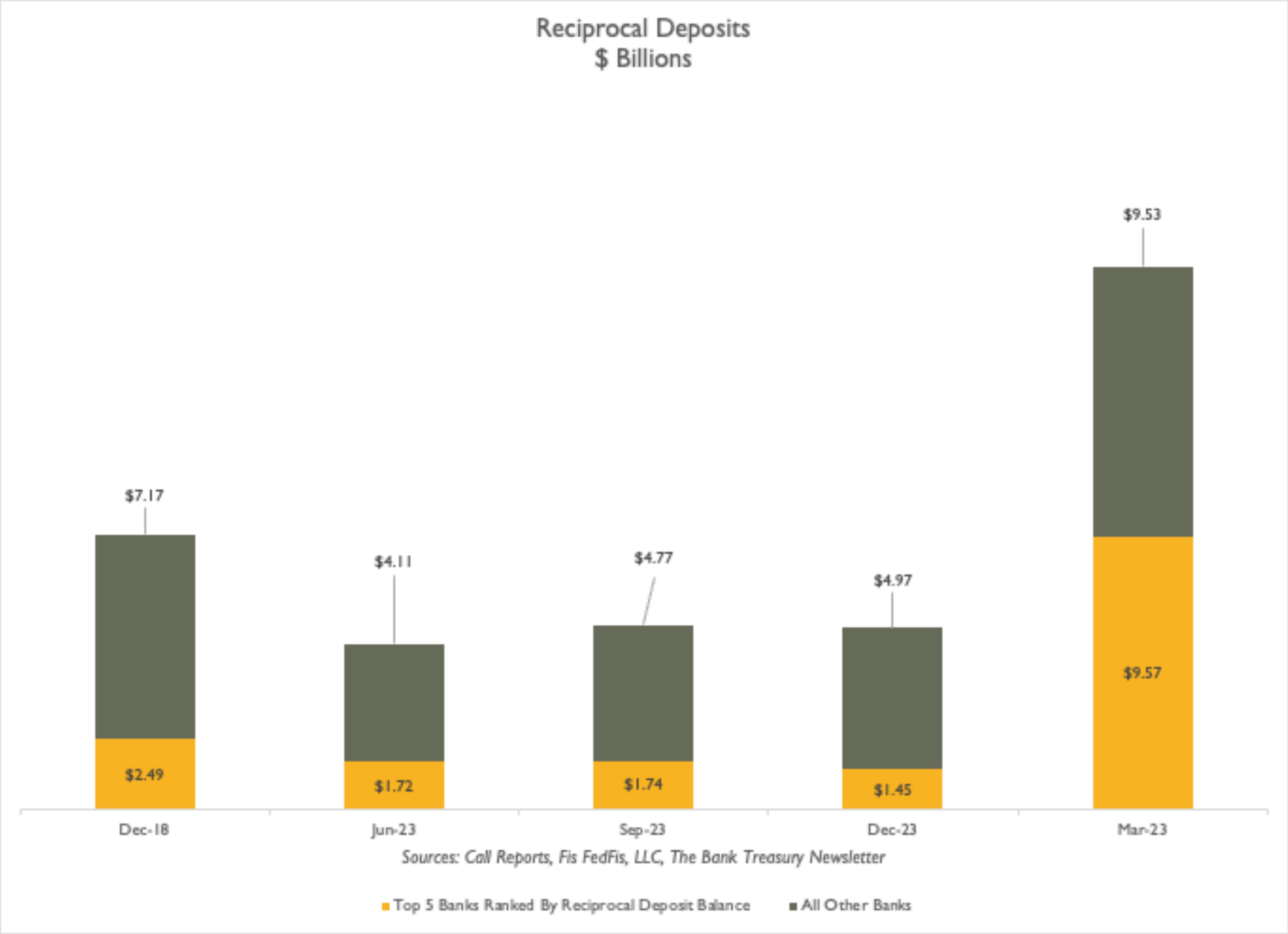
Still More Deposits Than Needed

Loans increased by $1 trillion, and deposits fell in equal measure over the last year, cutting excess deposits by $2 trillion, as the Fed raised rates faster than it has done in 40 years.



Banks Bolster Liquidity In Reciprocal Deposits

Reciprocal deposits became a key liquidity tool for publicly-traded regional banks whose stock prices were getting pummeled in Q1 2023.



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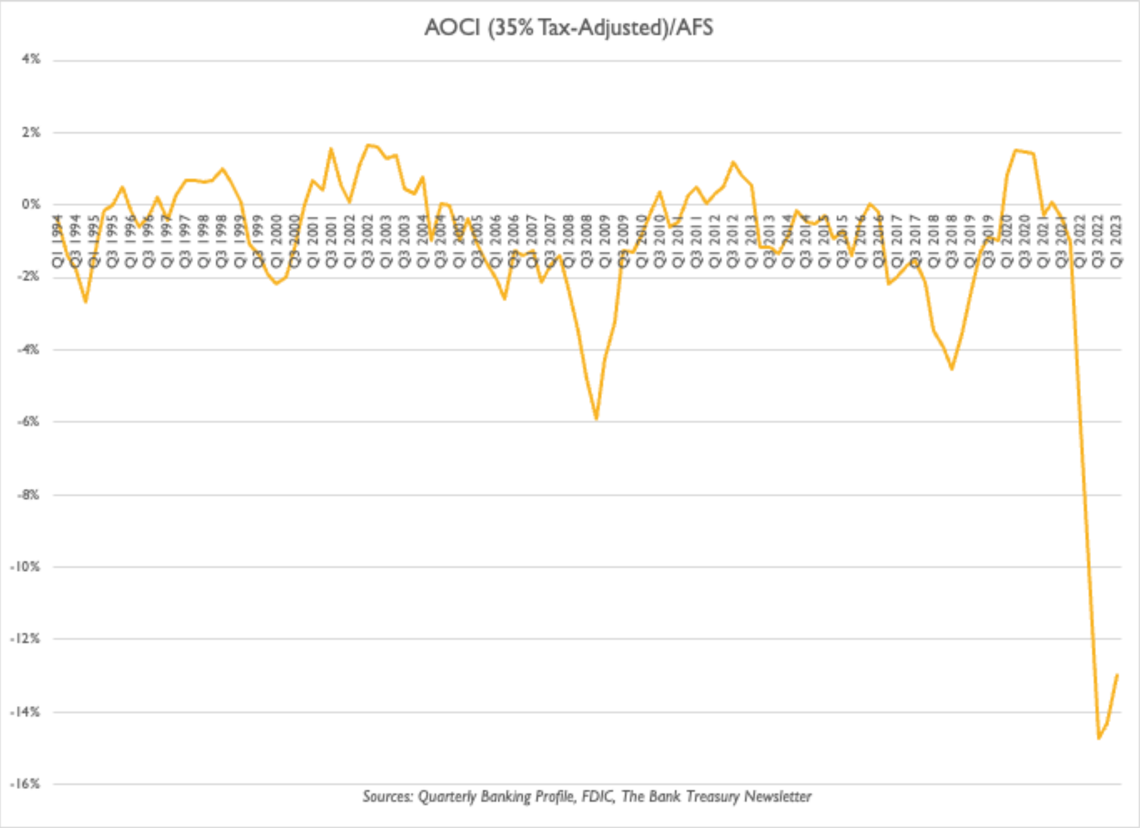
AOCI Improves Ever So Slightly

Bank investment portfolios recovered slightly in Q1 2023 as rates rallied after the failure of SVB and SBNY. But at minus-13% of AFS, banks would sustain a significant hit to capital to restructure their portfolios right now. Most plan on waiting to bleed their unrealized losses through earnings over time rather than sell underwater bond now and take the losses right away.



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