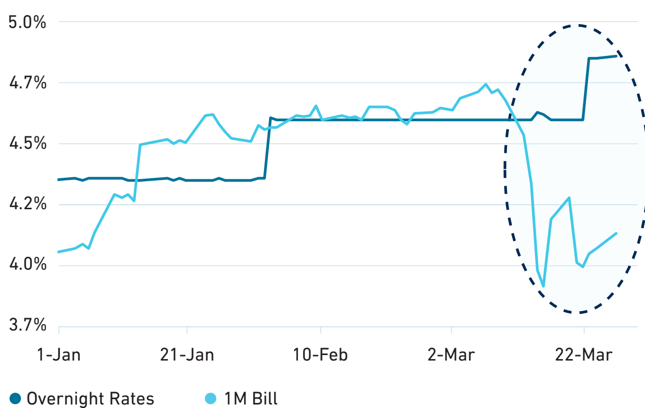
Centrally Cleared Repo Market Brief

As 50bps of rate hikes and quantitative tightening continued this quarter, overnight repo demand increased and SOFR consistently printed above RRP. The failures of Silicon Valley Bank and Signature Bank put pressure on markets and further exacerbated the move towards repo as investors sought out secure, short-term outlets.

Repo traded favorably or closely in-line with competing investible products (e.g., 1M Bill) for much of the quarter. This trend was exacerbated directly after the SVB and Signature failures, when the 1M bill richened significantly relative to overnight repo (Figure 1).

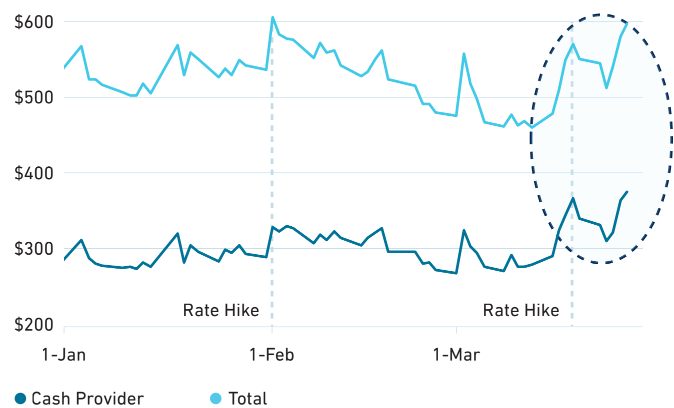
In the initial days of the crisis, FHLBs who typically serve as key collateral buyers in overnight markets were instead issuing discount notes to generate liquidity in support of regional banks preparing for potential deposit runs. This GSE activity provided an important stopgap until the Fed's comprehensive aid program took effect, but also pulled cash from markets – pushing up rates significantly. As some concerned depositors began bypassing banks completely and moving into money market funds, this cash found its way into the repo market. As dealers were able to offer repo above RRP, FICC sponsored cash investor balances experienced a significant uptick, with balances rising as high as $375B – the highest on record (Figure 2). On average, daily FICC sponsored cash balances increased 56% QoQ, compared to a 29% increase in Q4 and a 14% decline in Q3.

Figure 1: Rates



Source: Federal Reserve Bank of New York, Bloomberg

Figure 2: FICC Sponsored Repo Balances ($B)



Source: DTCC

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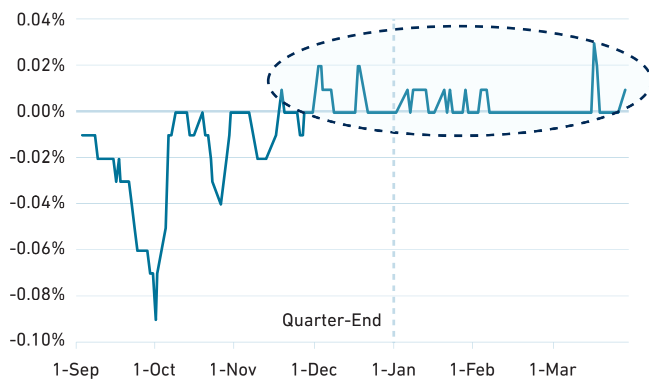
The Fed RRP facility continues to be impacted by money market inflows (12% increase over the quarter) however overnight repo rates that generally cleared RRP and heightened cash flows due to market stress from the aforementioned bank failures drove volatility in RRP prints. RRP facility usage is still decidedly high ($2.12T average daily balances on the quarter) as money market inflows driven by a changing T-bill supply dynamic and banking concerns drew cash into repo. However, dealer repo alternatives showed signs of becoming more attractive relative to the RRP – particularly towards the end of March when the flight to quality inundated overnight repo markets with cash. Even with elevated inflows to private repo, rates continued to clear the RRP as defensive funding positions from banks and other market participants looking to finance long positions added GC to the market. The SOFR-RRP spread, signifying the difference between general overnight private financing rates and the rate offered by the RRP facility, was neutral or positive for most of the quarter, in contrast to its primarily negative values in Q4 (Figure 3). Average daily RRP balances edged lower by 3% on the quarter, down from a 1% decrease in Q4 and a 13% increase in Q3. RRP balances even ticked down to $2T during the quarter – the lowest level since May of '22 (Figure 4).

Figure 3: SOFR – RRP Spread



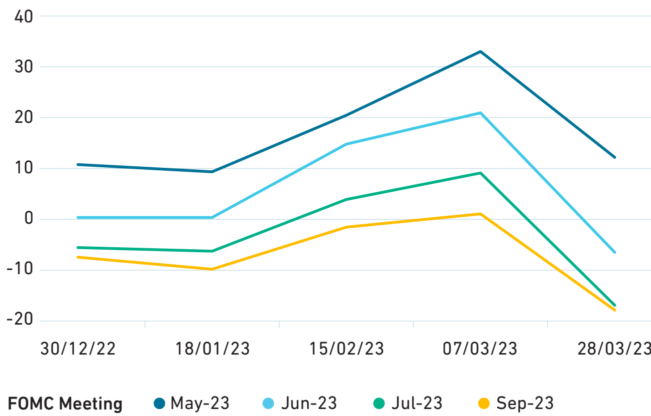
Source: Fed Reserve Bank of New York, Bloomberg

Figure 4: RRP Balances ($B)

Source: Federal Reserve Bank of New York

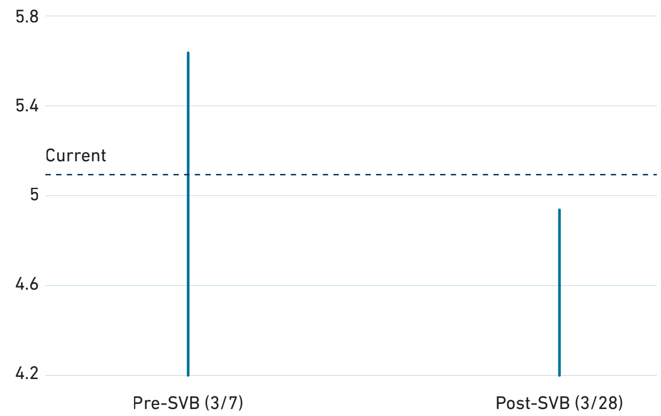
Market perception of future Fed activity remains highly tied to economic data, although tremors from the bank failures in March rapidly shifted expectations. Rate hike expectations ticked up over the first few months of the quarter as inflation remained sticky. After the January CPI print (released in mid-Feb) clocked in over expectations, the market turned increasingly hawkish, pricing as many as 32bp of hikes for the May Fed meeting (Figure 5). Sentiment shifted post-bank failures: in late March, the market was no longer pricing a hike for the May Fed meeting. Terminal rate expectations plummeted from 5.6% in early March to 4.9% at the end of the quarter. As conditions have stabilized and the Fed re-iterated its goal to hamper inflation, rate expectations have drifted back up. At the time of this writing, terminal rate expectation sit just below 5.1% - more or less in line with the Fed dot plot's expectation from the beginning of this year. The market is pricing a 70-80% chance of a hike in May.

Figure 5: Priced in Market by Fed Meeting (bps)



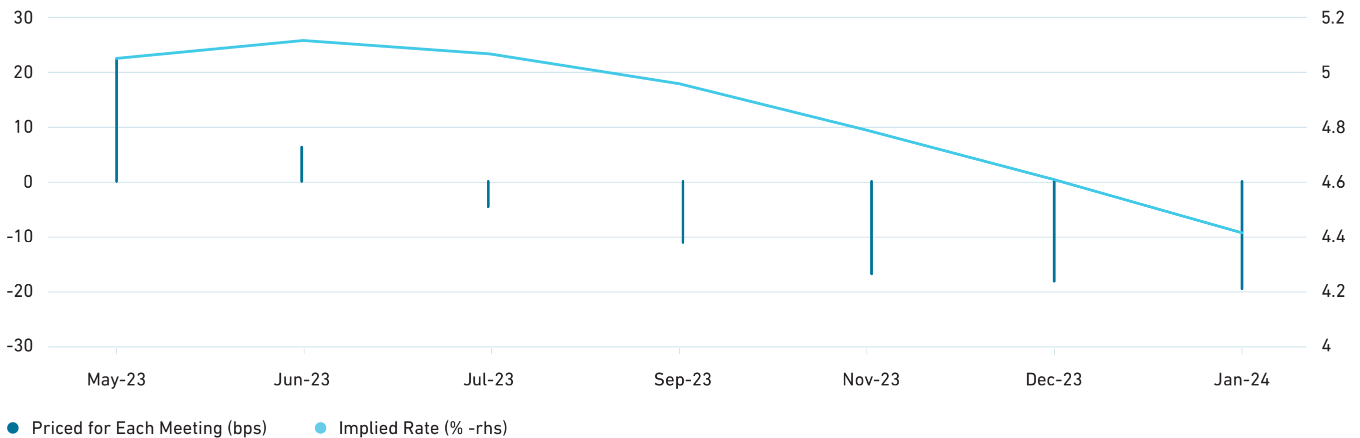
Source: Bloomberg

Figure 6: Terminal Rate (%)



Source: Bloomberg

Figure 7: Rate Hike Expectations (4/18)



Source: Bloomberg

While market perception of future Fed activity has stabilized back to levels we saw earlier in Q1, the market is still not convinced of another hike in May – or for the rest of the year. With just days until the May 2nd meeting at the time of this writing, additional jobs and inflation data may move the needle if they diverge significantly from expectations. Even if the Fed does raise rates again in May, it is possible we may not see another hike for the rest of this cycle, which is expected to begin reversing the dynamic of rapid cash inflows into overnight markets that we experienced for much of the last year. Short T-bill supply driven by continued Fed balance sheet tightening will help to keep repo relatively attractive even as rate hikes cool off, although recent targeted actions around debt ceiling and banking unrest responses have temporarily reversed this trend. Additionally, tax receipts in April are expected to lift this level further as TGA balances rise. Should the debt ceiling be resolved, significant Treasury issuances to build the TGA back up could drive cheapening in repo rates as financing demand increases.

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