

US Rates Watch

BTFP to expire on schedule

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Fed Vice Chair for Supervision Michael Barr yesterday stated the Bank Term Funding Program (BTFP) will expire on schedule March 11, 2024. We had expected BTFP to expire at this time and believe the market impact should be minimal. Thoughts below.

BTFP background: emergency has eased

The BTFP was created as an emergency funding measure after the regional bank stress in March '23. The facility provided 1Y loans for open market eligible paper (USTs, agency MBS, agency debt) at par and funded at 1Y OIS +10bps. The facility is an emergency measure under the Fed's 13-3 clause, which requires approval from the US Treasury Secretary. BTFP usage was \$141bn as of January 4. Facility use spiked after its introduction and has risen another \$27bn since end Nov (Exhibit 1, Exhibit 2).

BTFP to cease w/ lower rates & funding stability

We had thought BTFP would expire on schedule given (1) recent bank funding stability (2) lower rates, which improved bank deposit stability and ameliorated bank securities unrealized losses. An unexpected increase in rates (potentially driven by inflation re-acceleration and higher expected Fed path) could rekindle bank liquidity concerns and raise questions about BTFP facility extension; this seems unlikely near term.

BTFP extension bar high b/c political considerations

The bar for BTFP extension is likely high due, in part, to politics. The BTFP is not at the sole discretion of the Fed: any extension would require approval from the US Treasury Secretary. UST Secretary approval ties BTFP extension to the Biden administration and may be more challenging to justify in a general election year. These considerations make BTFP extension a high bar unless banking system stress materially increases.

Recent BTFP use likely precautionary, not opportunistic

The recent uptick in BTFP use has likely been driven by precaution funding. Regulators have increased their supervisory oversight of bank liquidity and encouraged liquidity buffers. BTFP use is likely due to its attractive terms vs other sources of Fed liquidity (i.e. discount window, standing repo facility). We are skeptical recent BTFP use is driven solely by opportunistic funding arbitrage as regulators likely strongly discourage such activity.

BTFP expiration market impact likely minimal

BTFP expiration should result in minimal market reaction in our view. Liquidity strained banks can refresh BTFP borrowing until March 11 for new 1Y loans and prepay anytime. This should ensure near-term funding for liquidity strained banks. We would grow more concerned about bank liquidity if US rates were to increase sharply and unexpectedly after BTFP facility expiration. The market will likely know BTFP is an official sector tool that can be used when needed which may limit the extent of future bank liquidity stress.

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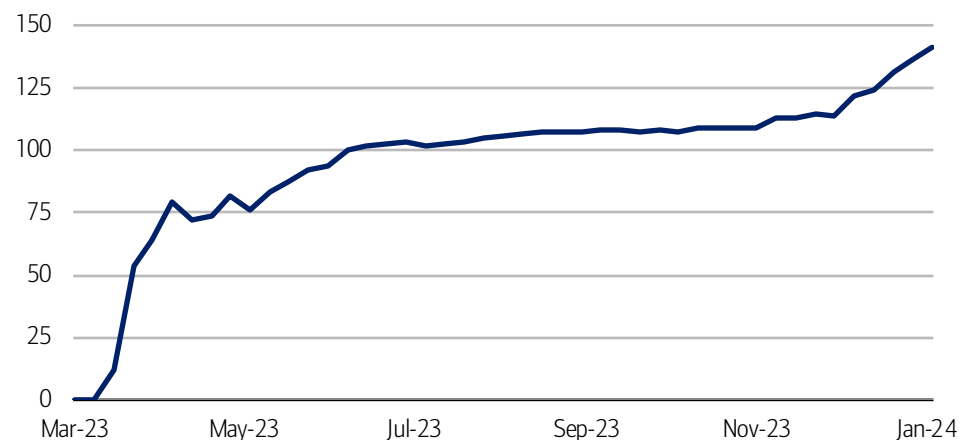
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Exhibit 1: Fed Bank Term Funding Program (BTFP) use (\$bn)

BTFP use has been rising in recent weeks

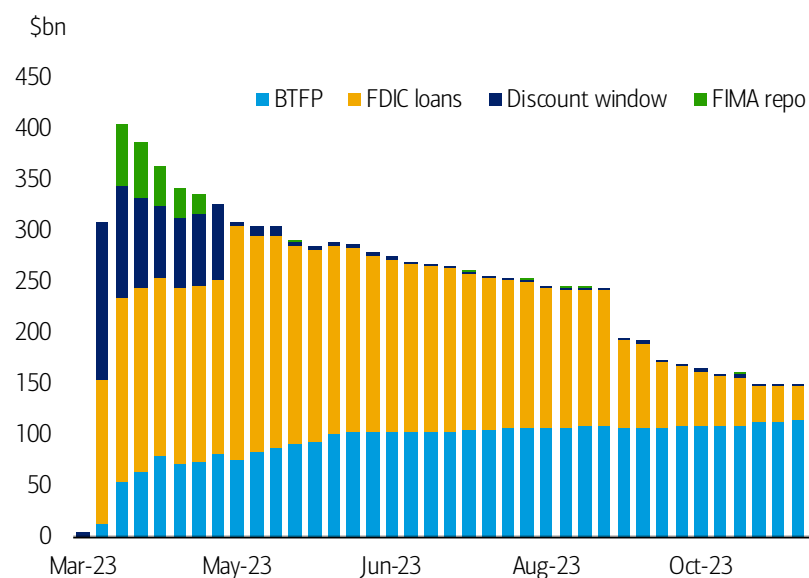


Source: Bloomberg

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Exhibit 2: BTFP lending has risen modestly to \$141bn as of January 4 while activity in other emergency lending facilities has waned.

Federal Reserve Emergency Lending Facilities (\$bn)



Source: Federal Reserve, Haver Analytics, BofA Global Research

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