

US Rates Watch

ON RRP drop: like a rock

ON RRP: falling fast with higher TGA & reserve holdings

The Fed's ON RRP facility is dropping like a rock. We expected a very rapid decline post debt limit, but not this fast. The recent ON RRP decline is due to higher TGA; recent M&A activity may have exacerbated it. The broader ON RRP decline has been sped up by bank reserve holding. ON RRP will keep falling to near zero; QT should stop soon after.

ON RRP & TGA: near mirror image

The recent ON RRP drop can largely be explained by (1) higher TGA, (2) Fed QT (Exhibit 1). In many ways, ON RRP & TGA have been near mirror images (Exhibit 2, Exhibit 3). Higher TGA pulls cash out of ON RRP via higher short-dated UST supply (bills & repo) & tax receipts. Recent TGA spike has likely been driven by large UST settlements (Exhibit 4) and mid-October California tax payments (Cali tax payments were delayed due to severe winter storms, Exhibit 5). We expect TGA to decline modestly from current levels.

ON RRP & reserves: pulling from the well

The broader ON RRP drop has been supported by commercial banks. Banks have offset their small deposit outflows by issuing large time deposits or other term debt (Exhibit 6). In essence, banks are offsetting their small / retail deposit outflow by sourcing other forms of financing. Some of this financing is likely being pulled from ON RRP. Although gov't MMF cannot buy bank credit directly, we believe bank CD issuance likely displaces investors that would have otherwise been holding bills / other gov't MMF assets.

Another temporary factor supporting lower ON RRP may be recent M&A activity. Last Friday there was a large M&A deal for nearly \$70b. We don't know where these M&A funds were held but it would not surprise us if these funds were parked in a MMF and then withdrawn to finance the transaction. MMFs likely held that cash at ON RRP.

ON RRP outlook: headed to zero

The ON RRP will fall to near zero with continued Fed QT. MMF want to hold zero at ON RRP, assuming they have higher yielding alternatives. Fed QT will support greater UST & MBS supply that needs to be financed in the market. MMF will fund it at the right price.

Market chatter says ON RRP will stabilize near \$1tn b/c limited bill supply. We strongly disagree. ON RRP drains with all money market supply, not just bills. Not only do we expect \$600-800b bills in FY '24 but we also expect increased sponsored repo offering, \$2-3tn of UST short coupons rolling down curve, and greater bank issuance of CD / TD / CP. Increased money market supply will cheapen front end paper & drain ON RRP. In Exhibit 7 & Exhibit 8 we show various scenarios for ON RRP, all falling to zero by 1H '25.

Fed view for ON RRP: good riddance

The Fed wants ON RRP to be near zero. It implies a reduction of excess liquidity in the financial system. Shortly after ON RRP is near zero, QT should stop (see [Fed QT](#)).

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ON RRP: Overnight reverse repo facility

TGA: Treasury General Account

M&A: Mergers & acquisitions

QT: Quantitative tightening

UST: US Treasury

MMF: Money market funds

CD: Certificate of deposit

MBS: Mortgage backed security

TD: Time deposit

CP: Commercial paper

Exhibit 1: Fed balance sheet reduction since debt limit resolution (\$bn)

ON RRP decline has largely been driven by higher TGA & Fed balance sheet reduction

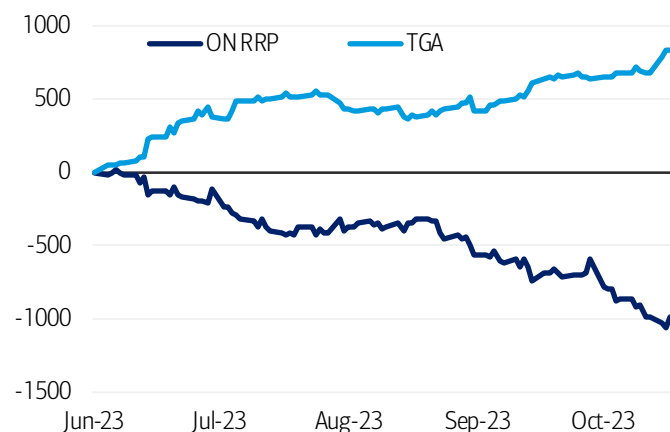
	Total	Assets			Liabilities					
		USTs	Agy MBS	Other	Reserves	UST Cash Balance	ON RRP	Foreign RRP	Currency	Other
5/31/2023	8436	5164	2558	714	3206	49	2255	361	2344	222
10/18/2023	7984	4913	2480	591	3250	841	1151	298	2324	119
Post DL Δ	-452	-251	-79	-123	45	793	-1104	-63	-20	-103

Source: BofA Global Research, Bloomberg

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Exhibit 2: Change in ON RRP & TGA post debt limit (\$bn)

TGA rebuild has largely been funded by ON RRP

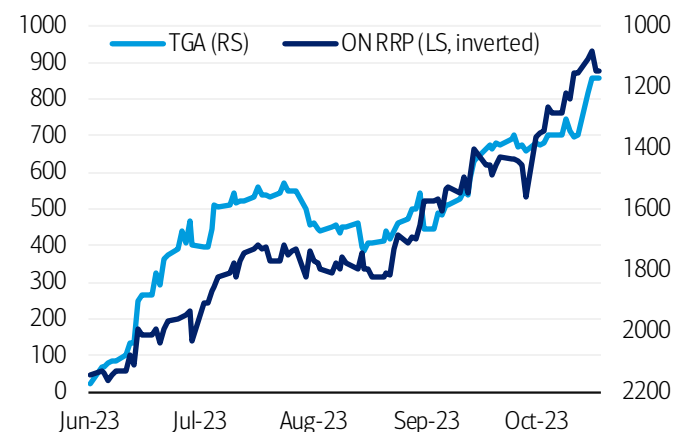


Source: BofA Global Research, Bloomberg

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Exhibit 3: ON RRP & TGA levels post debt limit

ON RRP & TGA are near mirror images

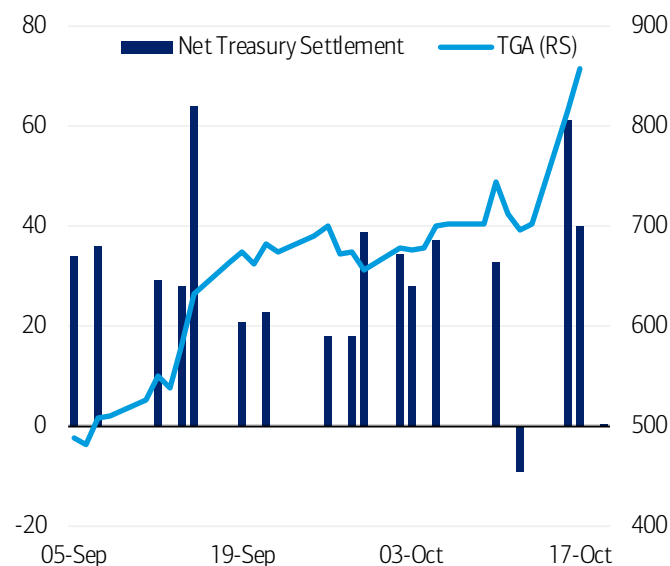


Source: Bloomberg

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Exhibit 4: Net UST settlements and TGA build-up (\$bn)

Recent TGA spike has been driven by large Treasury settlements

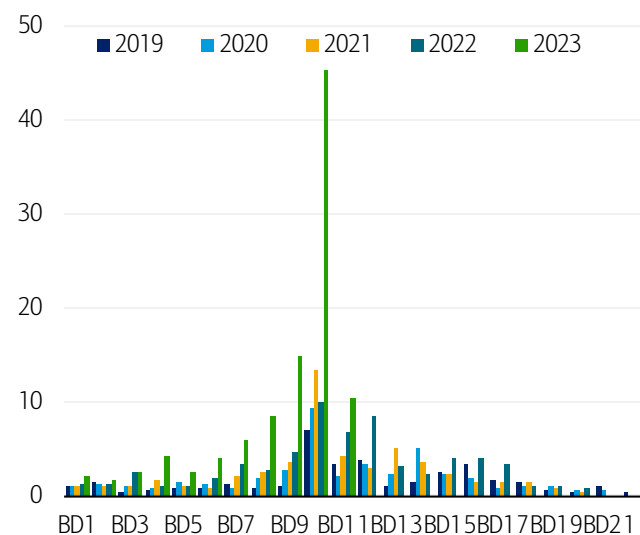


Source: Haver Analytics, Bloomberg

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Exhibit 5: Daily non-withheld individual & corp tax returns in Oct

Oct 2023 has higher tax returns due to the California tax payment delay

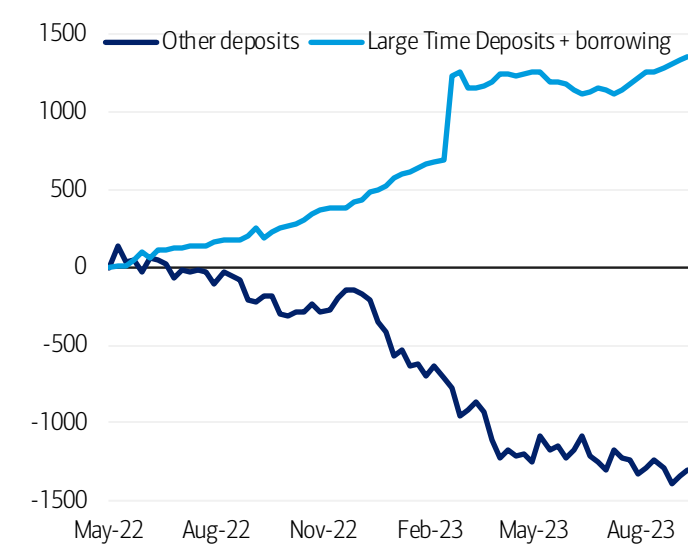


Source: BofA Global Research, Haver Analytics

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Exhibit 6: Cumulative change in small bank deposits vs large time deposits and other borrowing (\$bn)

Banks have offset the decline in other deposits by issuing large time deposits and other borrowing

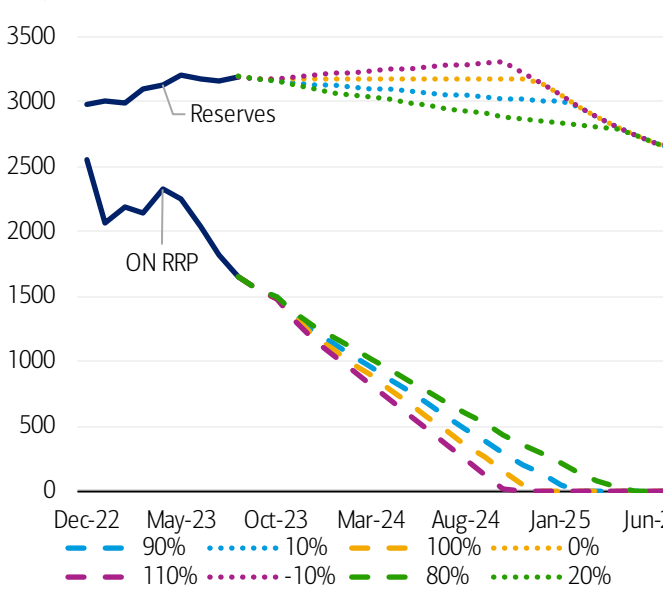


Source: BofA Global Research, Bloomberg

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Exhibit 7: ON RRP & reserves in different drain composition scenarios

We expect ON RRP to continue absorbing most of the QT drain but the composition could differ from our 90/10 ON RRP / reserves base case



Source: BofA Global Research, Bloomberg

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Exhibit 8: ON RRP & Reserve drain scenario analysis

When RRP falls below \$200b could have a significant impact on funding

Scenario analysis	ON RRP/Reserve drain			
	80/20	90/10	100/0	110/-10
When will RRP hit \$200b?	Feb '25	Dec '24	Oct '24	Sep '24
When will RRP hit \$0?	May '25	Feb '25	Dec '24	Nov '24

Source: BofA Global Research

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