

US Rates Alpha

Close Nov '23 SOFR/FF futures widener

Close Nov SOFR/FF futures at 2bps

We close out our Nov SOFR/FF basis widener at 2bps. In November of last year, we put out a note stating our expectations for SOFR/FF basis to tighten as a result of the Fed's quantitative tightening (QT) program (see: [US front end in '23: hikes, supply, & reform 11 November 2022](#)). In a follow-up note in March, we felt the market had overestimated how quickly SOFR would exceed FF (see: [SOFR/FF basis: biased wider 03 March 2023](#)). The market has subsequently evolved as we expected: even with the extremely large surge of UST supply the front end has been able to well digest this. We now think the market is adequately pricing in the expected evolution of SOFR/FF & expecting SOFR to remain relatively low vs FF through Nov '23.

SOFR/FF basis outlook: FF risks pulling higher

As noted in [Fed funds: lower volume, higher tail 28 July 2023](#), we expect upward pressure in the effective Fed funds rate to result from the liquidity drain via QT. This should place upward pressure on bank funding needs, especially for smaller banks with a lower cash buffer. This should lead to FF moving up sooner and more consistently than SOFR as we have seen in prior tightening cycles. Though we expect SOFR/FF to eventually tighten, SOFR is likely to remain well anchored around the ON RRP rate until cash in the system & ON RRP use has been sufficiently drained.

SOFR/FF basis forecast: market expect fast SOFR rise

Our projections for SOFR/FF still see SOFR well below funds with elevated ON RRP use (see Exhibit 1 & [Monthly rates models: August '23 edition](#)). We do not forecast ON RRP use to fall to \$500b until Jun '24 or zero until Dec '24 (see: [Fed balance sheet: August update](#)). As a result, we believe the market is likely over-estimating the extent of SOFR-FF tightening by April '24 (market pricing SOFR/FF basis at -1bp). We believe clients should fade the extent of this tightening, especially since bill supply is typically cut ahead of the April tax date which could pressure repo lower. We recommend clients position for wider April SOFR/FF basis initiating the trade at -1bps with a target of +2bps and a stop of -3bps.

24 August 2023Rates Research
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SOFR: secured overnight financing rate

FF: fed funds

RRP: reverse repo

ON: overnight

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Timestamp: 24 August 2023 05:14PM EDT

Exhibit 1: SOFR & EFR spread to IORB projections under high & low ON RRP scenarios (bps)

Under the high RRP scenario FF moves up faster than SOFR but slower in the low RRP scenario

Date	Low ON RRP take-up			High ON RRP take-up		
	SOFR-IORB	EFFR-IORB	FF-SOFR	SOFR-IORB	EFFR-IORB	FF-SOFR
Sep-2023	-8	-3	5	-9	-6	3
Dec-2023	-4	-2	2	-8	-5	3
Mar-2024	-1	-1	0	-8	-5	3
Jun-2024	2	0	-2	-8	-4	4
Sep-2024	4	0	-4	-8	-4	4
Dec-2024	5	0	-5	-8	-4	4

Source: BofA Global Research, Bloomberg, Haver Analytics

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