

US Rates Watch

Year-end USD funding: overly complacent

Market pricing stable USD funding into year end

The USD funding market is pricing relatively stable conditions into year-end. Term repo conditions have cheapened only modestly, term unsecured funding does not indicate material stress, & cross currency basis spreads are pricing less year-end premium vs '22 (Exhibit 1, Exhibit 2, Exhibit 3, Exhibit 4, Exhibit 5, Exhibit 6). We get worried when few others seem worried. We expect USD funding conditions to tighten modestly into end '23 & via both a funding supply & demand lens; we expect front end USTs cheaper.

USD funding supply: dealer capacity limited, FICC an outlet

We think about USD funding supply as the quantity of cash available to fund collateral & the capacity for repo intermediation. We know that the quantity of cash available will fall nearly \$700b through end '23 due to Fed QT (~\$85b/m) & TGA rebuild (~\$400b today to \$750b by end '23). Dealer capacity to intermediate is likely also already limited by (1) elevated net UST funding positions (Exhibit 7) (2) regulatory constraints including GSIB & RWA (Exhibit 8). We worry the largest increases in UST repo intermediation have come from dealers whose parents may face GSIB challenges (Exhibit 9, Exhibit 10). FICC sponsored repo will likely need to be increasingly relied on as a repo outlet given potential dealer intermediation constraints, though it is near all-time highs (Exhibit 11).

USD funding demand: collateral concern, leverage a risk

The collateral outlook will deteriorate in coming months, both the in US & Europe, which should see dealer funding positions rise. In the US, we expect an additional \$1.2t+ of UST issuance between now & end '23 (\$650b bills, \$580b coupons). This may be exacerbated by elevated positive net sovereign supply in Europe, which should total €80bn between now & by end '23 (see [European Rates Supply Preview](#)). Demand for funding is helped by reportedly limited leverage & USD borrowing need from overseas investors. We worry about leverage demand which has recently appeared stable (Exhibit 12); if the macro trading set improves HF may demand more leverage & increasingly draw on dealer balance sheet repo financing. Similar, if the UST curve keeps steepening there could be greater overseas UST demand & USD funding need along with it.

Bottom line: fade complacency, Y/E funding likely tighter

Our main message to clients: funding is likely to modestly tighten into year-end, don't be overly complacent due to current conditions. Our primary worry is that dealers may not have much capacity to expand funding books with increased UST supply. This is esp true if hedge fund leverage demand increases & dealers end up warehousing more sov supply on their balance sheets. We recommend clients position for more USD funding pressure into year-end & favor UST cheapening positions into end '23; cheaper USTs vs OIS & 2Y spread cheapening are likely the most liquid expressions.

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XCCY = cross currency basis

GSIB = Global systemically important
banking institution

RWA = risk weighted assets

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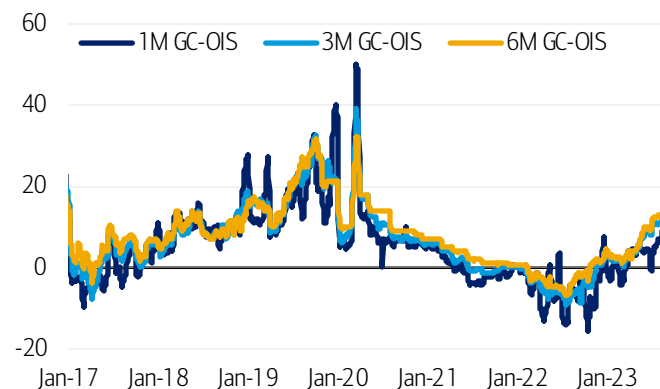
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Exhibit 1: Term UST GC repo to OIS spread (bps)

Term GC to OIS spreads have cheapened modestly over recent months



Source: BofA Global Research

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Exhibit 2: 3m AA financial CP to OIS spread (bps)

Unsecured funding levels to OIS do not indicate material funding pressure

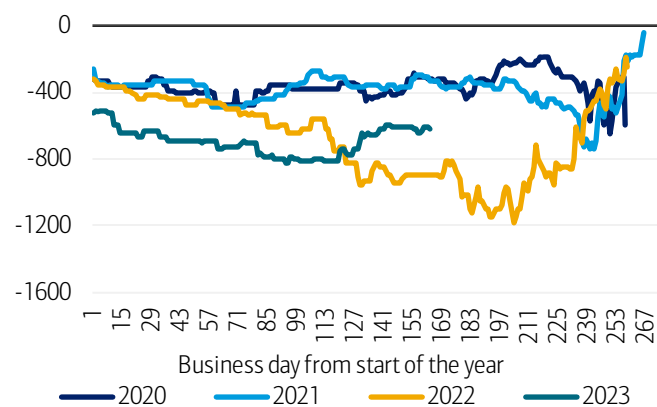


Source: Bloomberg

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Exhibit 3: EURUSD annualized premium to acquire USD on Y/E (bps)

USD year-end premium is lower than in '22 at this point of year

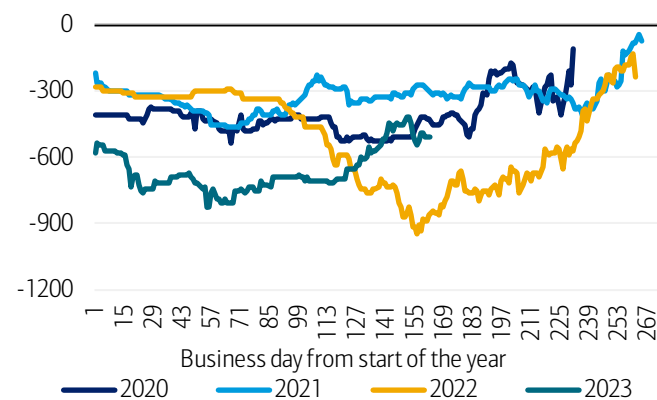


Source: BofA Global Research. Day-count adjusted to 4-day equivalent.

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Exhibit 4: USDJPY annualized premium to acquire USD on Y/E (bps)

USD year-end premium is lower than in '22 at this point of year

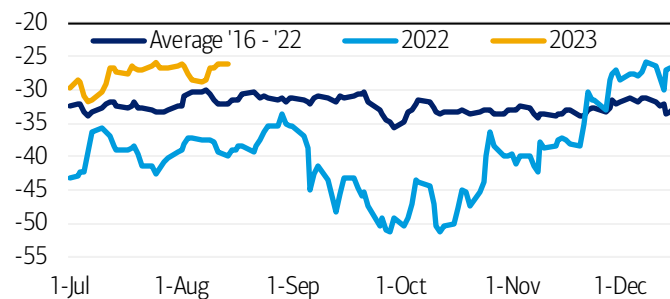


Source: BofA Global Research. Day-count adjusted to 6-day equivalent.

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Exhibit 5: EURUSD 6m XCCY basis spread (bps)

EURUSD 6m XCCY basis is not pricing much USD premium vs prior years

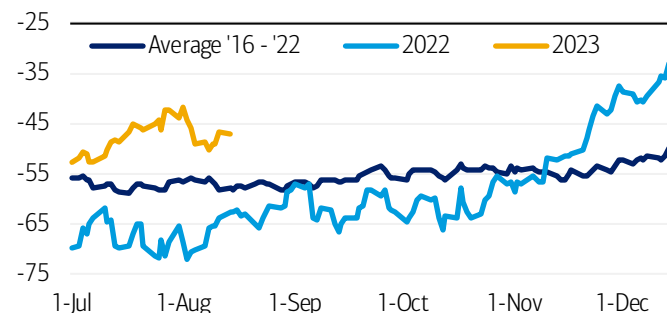


Source: Bloomberg; note: data adjusted based on historic SOFR – LIBOR spread

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Exhibit 6: USDJPY 6m XCCY basis spread (bps)

USDJPY 6m XCCY basis is not pricing much USD premium vs prior years



Source: Bloomberg; note: data adjusted based on historic SOFR – LIBOR spread

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Exhibit 7: Primary Dealer net financing position (securities out less securities in)

PD net financing positions are elevated



Source: BofA Global Research, Haver Analytics

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Exhibit 8: Method 2 GSIB score and surcharge update

Certain banks are nearing the top of their respective GSIB surcharge buckets

Score	JPM	C	WFC	BAC	GS	MS	BK	STT
4Q21	855	675	312	603	667	604	329	235
1Q22	935	697	302	652	681	615	317	224
2Q22	897	684	295	618	669	597	302	212
3Q22	882	677	290	603	660	581	293	207
4Q22	857	697	288	598	599	580	277	205
1Q23	925	717	289	626	658	601	275	216
4Q to 1Q Change	68	20	1	28	59	21	-2	12
Surcharge								
4Q21	4.5%	3.5%	1.5%	3.0%	3.5%	3.0%	1.5%	1.5%
1Q22	5.0%	3.5%	1.5%	3.5%	3.5%	3.0%	1.5%	1.0%
2Q22	4.5%	3.5%	1.5%	3.0%	3.5%	3.0%	1.5%	1.0%
3Q22	4.5%	3.5%	1.5%	3.0%	3.5%	3.0%	1.5%	1.0%
4Q22	4.5%	3.5%	1.5%	3.0%	3.0%	3.0%	1.5%	1.0%
1Q23	4.5%	3.5%	1.5%	3.0%	3.5%	3.0%	1.5%	1.0%
4Q to 1Q Change	0.0%	0.0%	0.0%	0.0%	0.5%	0.0%	0.0%	0.0%
Reference: GSIB score to surcharge								
Score bucket	130 - 229	230 - 329	330 - 429	430 - 529	530 - 629	630 - 729	730 - 829	830 - 929
Surcharge	1.0%	1.5%	2.0%	2.5%	3.0%	3.5%	4.0%	4.5%

Source: BofA Global Research, FFIEC, Bloomberg

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Exhibit 9: Largest increases in MMF repo activity by counterparty

Banks greatly increased their repo activity YTD

Largest increases in repo Nov '22 to Jul '23			Largest increases in repo Dec '22 to Jul '23		
	\$mn Change	% Change		\$mn Change	% Change
Citigroup	43,768	941%	Citigroup	43,768	1077%
Barclays	26,050	239%	Barclays	26,050	344%
Societe Generale	18,206	477%	Societe Generale	18,206	572%
Royal Bank of Canada	10,528	250%	Credit Agricole	10,528	731%
Goldman Sachs	13,717	530%	BNP Paribas	13,717	215%
Bank of America	17,416	489%	Royal Bank of Canada	17,416	224%
JP Morgan Chase	14,011	222%	JP Morgan Chase	14,011	211%
BNP Paribas	9,761	185%	Standard Chartered Bank	9,761	662%
ING Groep Nv	12,816	703%	ING Groep Nv	12,816	606%
Credit Agricole	14,170	434%	Bank of America	14,170	369%

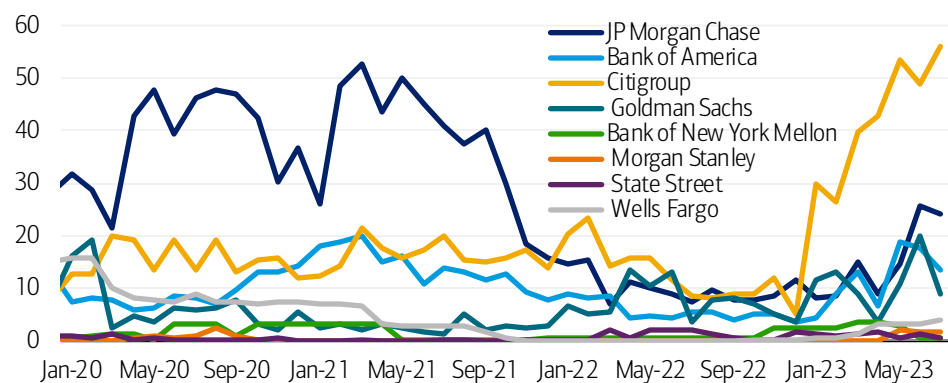
Source: BofA Global Research, OFR

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Exhibit 10: MMF repo activity with domestic GSIBs (\$bn)

Several domestic GSIBs greatly increased their repo activity YTD

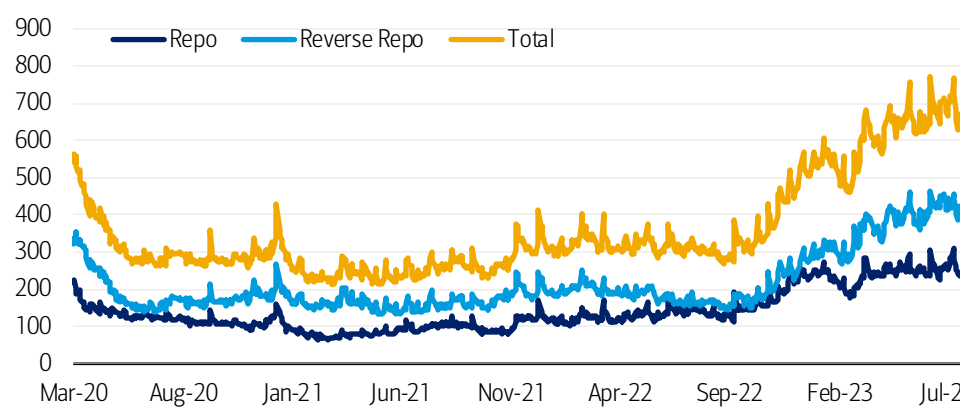


Source: BofA Global Research, OFR

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Exhibit 11: Sponsored repo activity (\$bn)

Sponsored repo activity has been increasing YTD

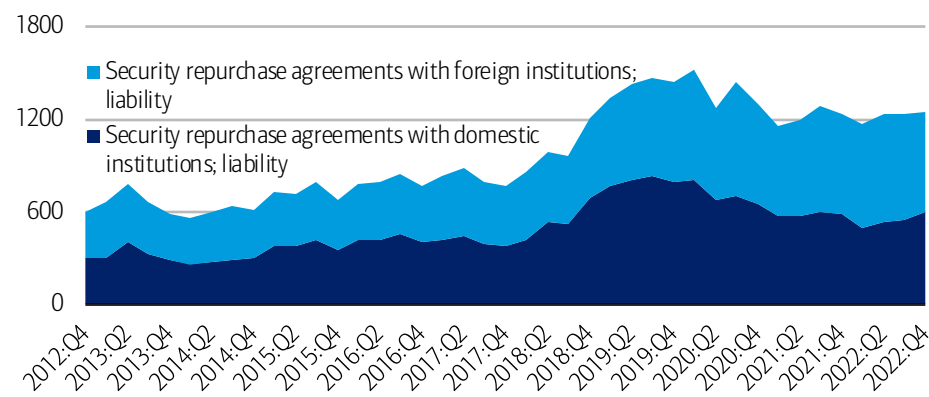


Source: BofA Global Research, FICC

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Exhibit 12: Hedge fund repo activity from domestic & foreign entities (\$bn)

Hedge fund repo activity was relatively stable according to the most recently available data



Source: Federal Reserve

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