The New Treasury Market Ecosystem

Integrating Monetary Plumbing, Market Stress, and the Rise of the Shadow Cash Market

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Executive Summary: A New Paradigm

- **The Problem:** Traditional analysis of Treasury markets and monetary plumbing is necessary, but no longer sufficient. Foundational pillars of demand are weakening while dealer capacity is strained.

- **The Innovation:** In response to post-2008 regulations, a parallel, non-bank ecosystem known as the 'shadow cash market' has emerged, centered on ETFs and swaps.

- **The Thesis:** This shadow market is now a critical source of 'bond-like' liquidity. Understanding its mechanics is essential for a complete view of Treasury market health and risk.

- **The EquiLend Opportunity:** Our data on securities lending and short interest in bond ETFs provides a unique, high-frequency lens to measure sentiment and stress in this opaque but vital market.

Foundation: Monetary Plumbing Dashboard

PLI Component Weights

Funding Spreads and Dealer Inventory are the most heavily weighted components in our Plumbing Liquidity Index (PLI), which currently reads at an elevated 49.2.

Key Market Participants

The Fed and Primary Dealers exert the most influence on market plumbing, followed by Money Market Funds and Hedge Funds.

Funding Market Stress

The SOFR-EFFR spread, a key gauge of interbank credit risk, remains low, but overall repo rate volatility has been increasing, signaling potential underlying stress.

Impact on Securities Finance

Shifts in the plumbing have the largest impact on Regulatory Pressure and Collateral Availability, directly affecting the cost and ease of securities finance.

Cracks in the Foundation: Treasury Market Dashboard

Changing Buyer Composition

The share of Foreign Central Banks has steadily declined since 2020, while Domestic Banks and Primary Dealers have been forced to absorb more supply.

Dealer Inventory Surge

Dealers' gross inventory is approaching the crisis levels of late 2019, indicating significant balance sheet is being used to warehouse Treasuries, increasing funding risk.

10-Year Auction Performance

45% of Treasury auctions have tailed in 2025, with the August auction tailing by 1.1bps, a clear sign of weakening demand at the long end of the curve.

Composite Stress Indicators

Stress from weakening Foreign Demand and rising Dealer Inventory is high, while stress from Auction Tails and Funding is moderate but rising.

The Market Adapts: The Shadow Cash Market

- **What is it?:** A 'bond-like' ecosystem outside of traditional cash markets, enabling players to gain Treasury exposure and provide liquidity using ETFs and Total Return Swaps (TRS).

- **Why does it exist?:** Post-2008 regulations (e.g., the Supplementary Leverage Ratio) made it less profitable for traditional banks to hold and trade bonds, creating a gap.

- **Who are the players?:** Non-bank trading firms (HFTs), Authorized Participants (APs), ETF Issuers (e.g., BlackRock, Vanguard), and Hedge Funds have stepped in to fill the void.

- **The Impact:** This parallel market has become a crucial, often overlooked, source of liquidity, especially during periods of stress in the primary market.

Shadow Market Mechanisms

- **ETF Arbitrage:** The core mechanism. Authorized Participants (APs) create or redeem ETF shares by exchanging them for the underlying bonds. This keeps the ETF's price in line with its Net Asset Value (NAV) and provides a non-cash market way to source or offload bonds.

- **Dealer Hedging:** When a dealer takes on a large bond position, instead of selling it in the cash market, they can hedge their interest rate risk by shorting a bond ETF. This transforms a directional risk into a basis risk, using less balance sheet.

- **Total Return Swaps (TRS):** A synthetic way to gain exposure. A hedge fund can enter a TRS with a dealer to receive the total return of a bond (or basket of bonds) without actually owning it, further freeing up balance sheet for all parties.

The EquiLend Opportunity: Data-Driven Insights

Shadow Market Size

Our data shows the top 10 ETFs used in the shadow market have over $26B on loan, led by LQD and HYG, demonstrating the significant scale of this activity.

Activity Distribution

The majority of activity is concentrated in a handful of ETFs, with over 50% utilization in the most popular funds, indicating high demand for these specific hedging tools.

Pricing Dynamics

There is a clear positive correlation between an ETF's utilization and its lending fee. This allows us to use lending fees as a real-time proxy for stress and demand in the shadow market.

Market Concentration

The top 5 ETFs account for over 72% of the total on-loan value, making it possible to create a concentrated, yet representative, 'Shadow Market Stress Index' using our data.

Conclusion: A Unified Framework

- **A Two-Tiered Market:** The Treasury market now operates on two interconnected tiers: the traditional, bank-centric cash market and the parallel, ETF-driven shadow market.

- **Interconnected Risks:** Stress in one system inevitably spills into the other. Weakening demand in the cash market forces more activity into the shadow market, which has its own unique constraints.

- **A New Analytical Edge:** By combining traditional plumbing analysis with our proprietary data on the shadow market, we can offer a more complete and actionable picture of Treasury market risk and liquidity.

- **Next Steps:** Develop and backtest proprietary indicators to build a 'Shadow Market Stress Dashboard' for internal analysis and future client-facing research.