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Headline: Regs Will Increase Until Liquidity Improves

Article Link: https://fedguy.com/regs-will-increase-until-liquidity-improves/

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Tweet: .@FedGuy12 writes that a recent SEC proposal for mandatory repo clearing will likely reduce Treasury liquidity by increasing the cost of repo.

Summary: The Fed's recent Treasury market conference offered three notable insights that suggest Treasury market liquidity will continue its structural decline. First, dealer balance sheet constraints have moved from ones that could be solved through central clearing to those that would require other adjustments. Secondly, mandatory Treasury repo clearing may reduce market liquidity by raising the cost of financing due to higher collateral haircuts. Lastly, mutual funds may not become significant marginal investors in cash Treasuries as regulations encourage them to invest using Treasury futures. The official sector appears to be making adjustments that will make it more difficult for the market to absorb the upcoming deluge of Treasury issuance. At a high level, cash Treasuries can be held by investors using borrowed money or cash investors. The leveraged investors are more nimble participants as cash investor participation depend on asset inflows or the liquidation of other asset holdings. Going forward it looks like the costs of leveraged financing will increase due to mandatory cleared repo and a limited supply of repo financing that is constrained by regulatory costs. Major investors that could participate in the cash market remain incentivized to instead use Treasury futures. The Treasury market looks to continue its trend of becoming less liquid and more volatile. Related: Resilience Redux in the US Treasury Market and How Has Treasury Market Liquidity Evolved in 2023? and Liquidity Event

Primary Topic: Banking

Topics: Banking, Financial Markets, GDP, Monetary Policy, Op-Ed/Blog Post, Weekly

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