Evaluating the Ample Reserve Framework in the US

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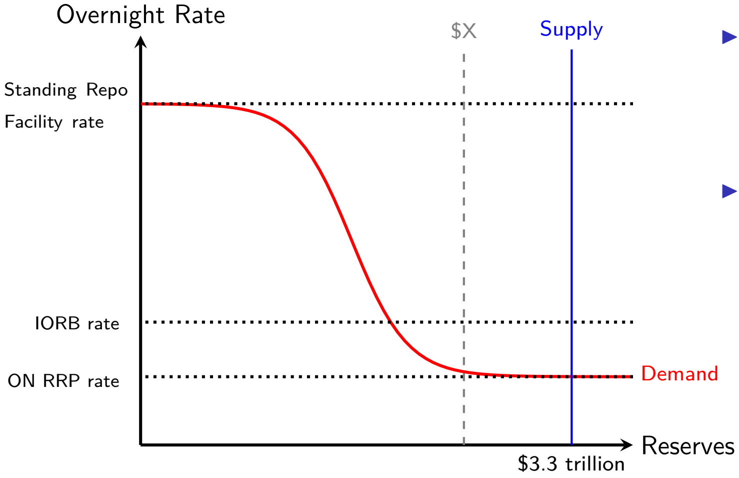
Ample Reserves Framework



- Banks deposit and receive the Interest on Reserve Balances (IORB) rate.
- Money market mutual funds (MMFs) deposit and receive the Overnight Reverse Repo Facility (ON RRP) rate.

Quantitative Tightening in Ample Reserves

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- Treasury securities mature.
- Mechanically reduces reserves + ON RRP balances.
- Dealers must finance the Treasury securities that are no longer on the Fed's balance sheet in the repo market.

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- Treasury securities mature.
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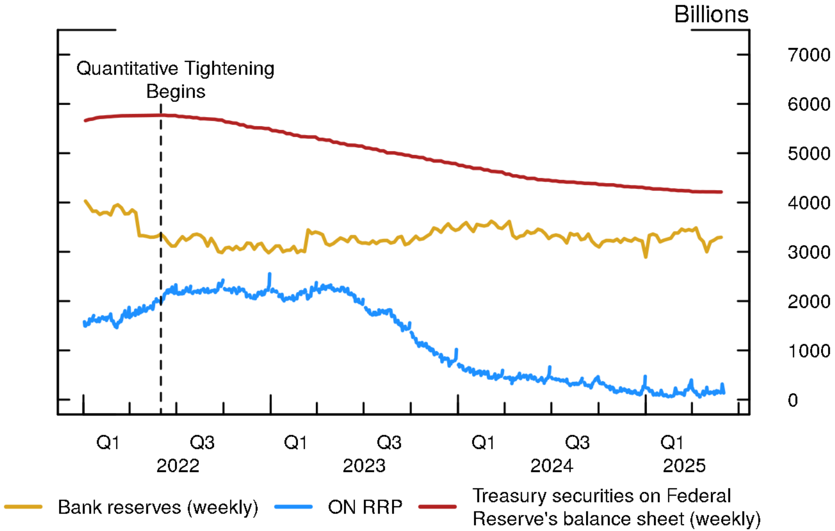
- At some level of $X, the overnight rate will respond to changes in reserves.

QT Thus Far



Billions
Quantitative Tightening
Begins
7000
6000
5000
4000
3000
2000
1000
0
Q1
Q3
Q1
Q3
Q1
Q3
Q1
2022
2023
2024
2025
Bank reserves (weekly)
ON RRP
Treasury securities on Federal Reserve's balance sheet (weekly)

The Overnight Rates

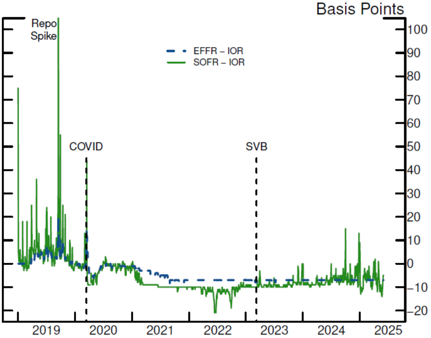
Effective Federal Funds Rate (EFFR)

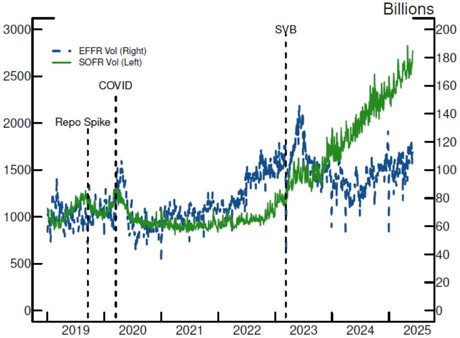
- The Fed's current policy rate.
- Reflects the cost of unsecured borrowing in the federal funds market and used to identify bank reserve demand.
- Main participants: Banks, Federal Home Loan Banks

Secured Overnight Financing Rate (SOFR)

- Published by the Federal Reserve Bank of New York daily starting in April 2018.
- Broad measure of the cost of financing Treasury securities overnight in the repo market.
- Main participants: broker-dealers, levered investors, asset managers, banks, MMFs.

Federal Funds versus Treasury Repo





The Federal Funds Market

The “interbank” market. Overnight unsecured funding market for banks.

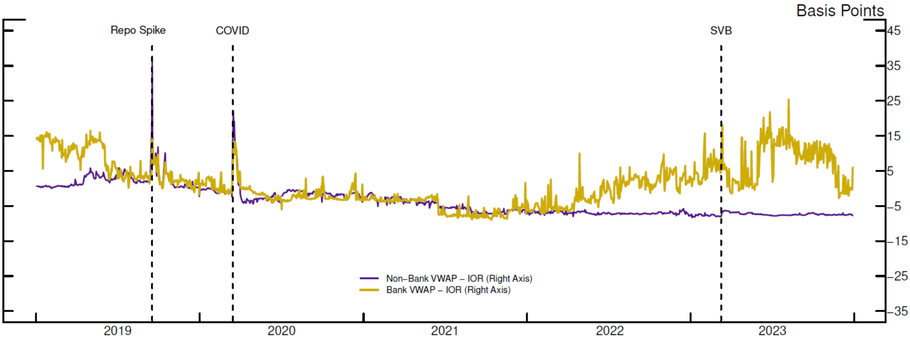
Two types of transactions:

- Federal Home Loan Banks lending to foreign banks to capture the “Fed arb” trade at lower rates.
- Banks lending to banks at higher rates.

The Interbank Market Is Small But Informative

- The FOMC has successfully used the federal funds rate as a policy rate for decades. Proven track record.
- Daily volume is comparable to the Treasury bill or commercial paper markets.
- Banks' demand for reserves is reasonably well understood.

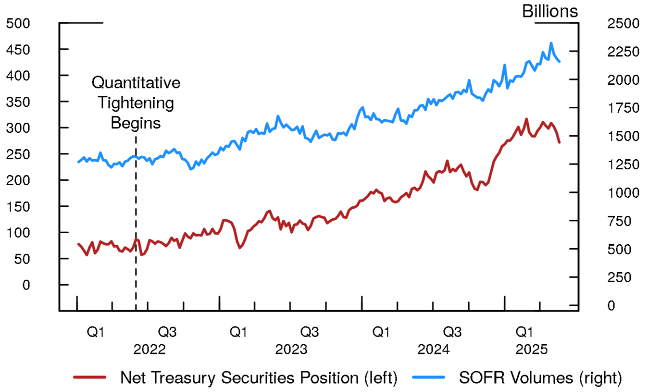
Bank Lending Rates Did Not Increase on Sept. 17, 2019



- FHLB lending rates increased due to frictions in the repo market.

Frictions in the Repo Market vs. Bank Reserve Demand

- The capacity of the repo market to absorb dealers' financing needs influences overnight rates.
- SOFR increases in response to dealer financing demand.
- Rates offered by bank lenders can be unaffected by dynamics in the repo market.



Repo Market Frictions $\neq$ Bank Reserve Demand Binds

- Rates offered by bank lenders indicate credit conditions among banks. Could be a good indicator of reserve demand for banks.

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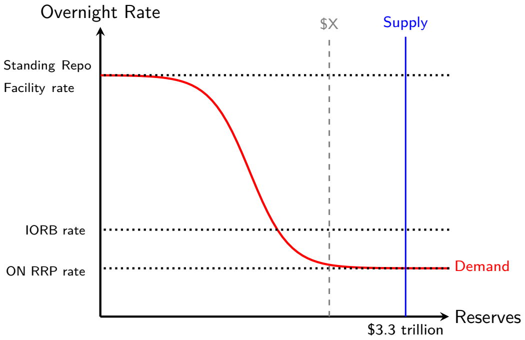
- Rates offered by bank lenders indicate credit conditions among banks. Could be a good indicator of reserve demand for banks.
- Upward pressure on SOFR from Quantitative Tightening.
- Rates offered by FHLBs in the federal funds market are influenced by dynamics in the repo market. This does not mean that bank reserve demand binds.

The Role of the Standing Repo Facility (SRF)

- Backstop lending facility to eligible broker-dealers and banks to provide secured funding against eligible collateral.
- Should dampen upward pressure on overnight rates and support market functioning from frictions in the repo market *and* bank reserve demand.



- Use of the SRF has been limited so far because it has rarely been "in-the-money".
- Concerns about settlement timing and lack of central clearing.

Conclusion

- Thus far, Quantitative Tightening has gone smoothly and overnight money markets are stable.
- Knowing that EFFR is affected by two demand curves is important to understand $X.
- Likely that non-bank reserve demand makes $X larger than only considering bank reserve demand.