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# Global Money Dispatch

**CONTRIBUTORS**

**Zoltan Pozsar**
212 538 3779
zoltan.pozsar@credit-suisse.com

The re-priced RRP facility will become a problem for the banking system fast: the banking system is going from being asset constrained (deposits flooding in, but nowhere to lend them but to the Fed), to being liability constrained (deposits slipping away and nowhere to replace them but in the money market).

The RRP facility started to sterilize reserves today, with more to come. Sterilization is on because the Fed made a policy error: it's one thing to raise the rate on the RRP facility when an increase was not strictly speaking necessary, and it's another to raise it "unduly" high – as one money fund manager put it, "*yesterday we could not even get a basis points a year; to get endless paper at five basis points from the most trusted counterparty is a dream come true*".

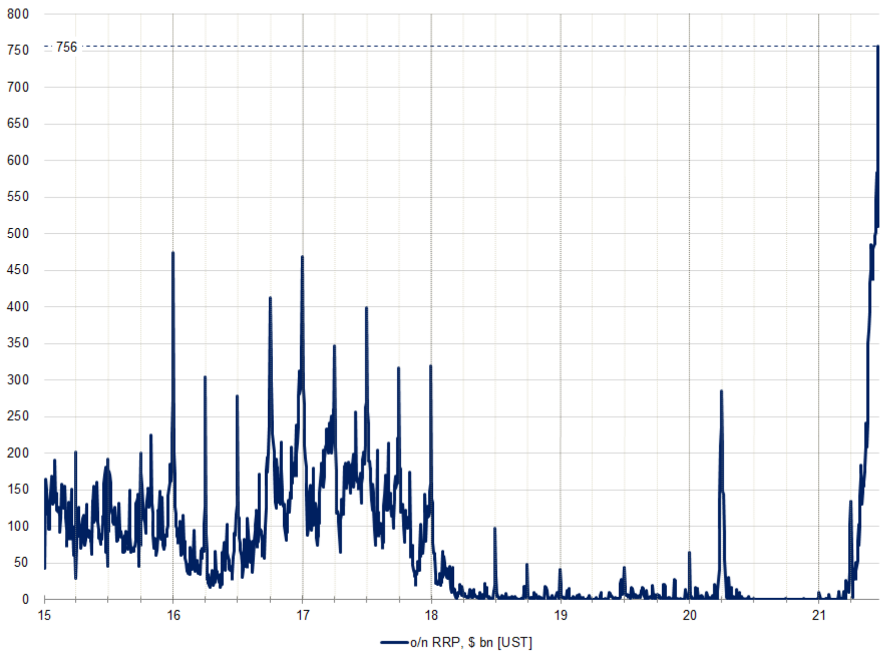
That about sums it up. 5 bps is too generous; it will upset the state of "singularity". Like heat-seeking missiles, money market investors move hundreds of billions, making sharp, 90º turns hunting for even a basis point of yield at the zero bound – at 5 bps, money funds have an incentive to trade out of all their Treasury bills and park cash at the RRP facility. Bills yield less than 5 bps out to 6 months, and money funds have over $2 trillion of bills. They got an the incentive to sell, and others have the incentive to buy: institutions whose deposits have been "tolerated" by banks until now earning zero interest have an incentive to harvest the 0-5 bps range the bill curve has to offer. Putting your cash at a basis point in bills is better than deposits at zero. So the sterilization of reserves begins, and so the o/n RRP facility turns from a largely passive tool that provided an interest rate floor to the deposits that large banks have been pushing away, into an active tool that "sucks" the deposits away that banks decided to retain.

Think about the extreme: most of the "Covid-19" deposits currently with banks go into the bill market where rates are better. Money funds sell bills to institutional investors that currently keep their cash at banks, and money funds swap bills for o/n RRPs. This process is not overnight. It will take a few weeks. Cash-rich banks can handle the outflows, but some bond-heavy banks cannot. Next you notice that some banks are borrowing advances from FHLBs, and cash-rich banks stop lending in the FX swap market as the RRP facility pulled reserves away from them and the Fed has to re-start the FX swap lines to offset. Libor-OIS will have to widen from here, unless the Fed lowers the o/n RRP rate!

It's either quantities or prices. In 2019 the Fed chose prices over quantities, which backfired. In February, it chose quantities over prices, which worked well. Yesterday, the Fed turned "unlimited" quantities into "money for free" and started to sterilize reserves. We are witnessing the dealer of last resort (DoLR) learning the art of dealing, making unforced errors – if the Fed sterilizes with an overpriced o/n RRP facility, it has to be ready to add liquidity via the swap lines…

## [Daily]: Use of the o/n RRP Facility

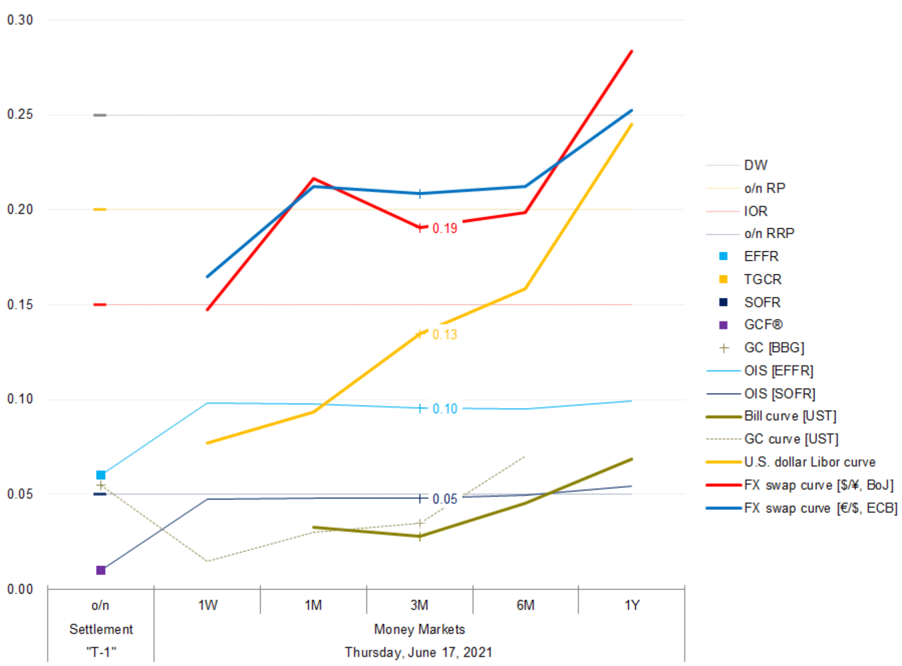
$ billion




Source: the BLOOMBERG PROFESSIONAL™ service, Credit Suisse

## [Daily]: The U.S. Dollar Money Market Today

percent




Source: the BLOOMBERG PROFESSIONAL™ service, Credit Suisse

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