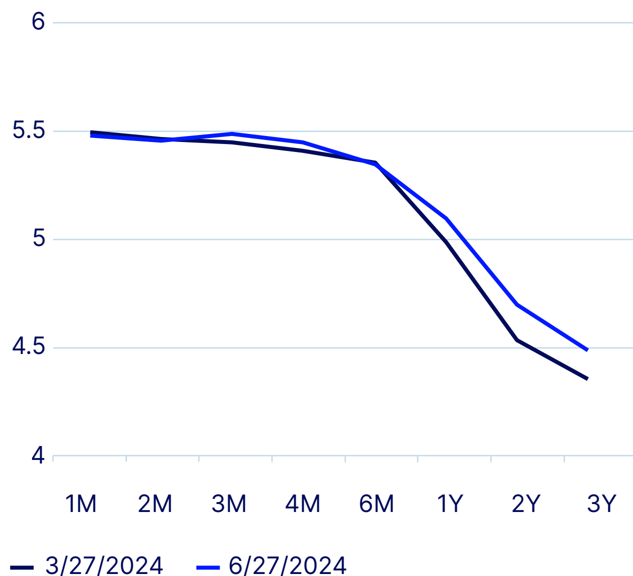
STATE STREET

Centrally cleared repo market brief

Overall front-end bias lingers and MMF balances remain elevated despite seasonal disruptions.

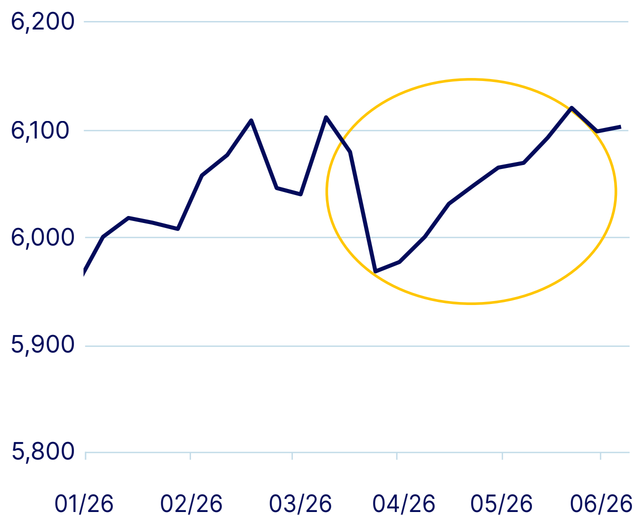
On a quarter-over-quarter basis, the Treasury yield curve remained largely unchanged and biased towards the front-end **(Figure 1)**. Significant cash (>$6T) remains in MMFs as investors await true conviction on the Fed's transition to rate cuts before extending further out on the curve. At the time of this writing, a soft June CPI print has invigorated the market with expectations of a September cut and at least two total by year-end – however the bulk of Q2 was dictated by lingering hawkish indicators that hampered the market's expectation for '24 rate cuts. This dynamic kept short-end balances elevated, although seasonal disruptions attributed to tax season and new Treasury issuances drove some intra-quarter movement in MMF balances **(Figure 2)**. Even as MMF's overall allocation to repo remains elevated ($2.4T, 40% of holdings), periodic cash outflows combined with collateral issuances created limited volatility in Q2 repo markets, in contrast to a much softer Q1.

Figure 1: Yield curve (%)



Source: US Treasury

Figure 2: MMF balances ($B)



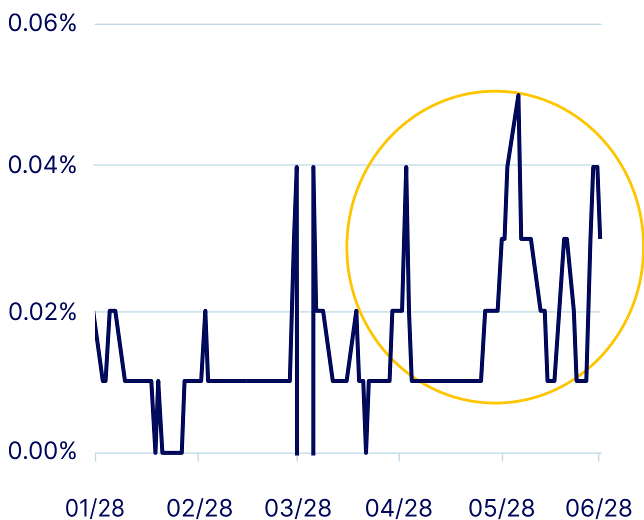
Source: Bloomberg

Intra-quarter volatility put upward pressure on rates, particularly around month-ends, and continued the flow of balances from the Fed RRP and into FICC Sponsored Repo.

The RRP-SOFR spread sat around 1-2 bps and jumped considerably around month-ends, in contrast to the more muted levels seen for most of Q1 **(Figure 3)**. Higher spikes around month-end highlight the extent to which elevated market repo balances are exerting a progressively greater strain on dealer balance sheets, which are typically scaled back around key period-end reporting dates. This dynamic along drove higher balances into FICC Sponsored Repo: average cash volumes of $629B increased 8% QoQ and overall volumes (cash + collateral) peaked over $1.2T at quarter-end **(Figure 4)**.

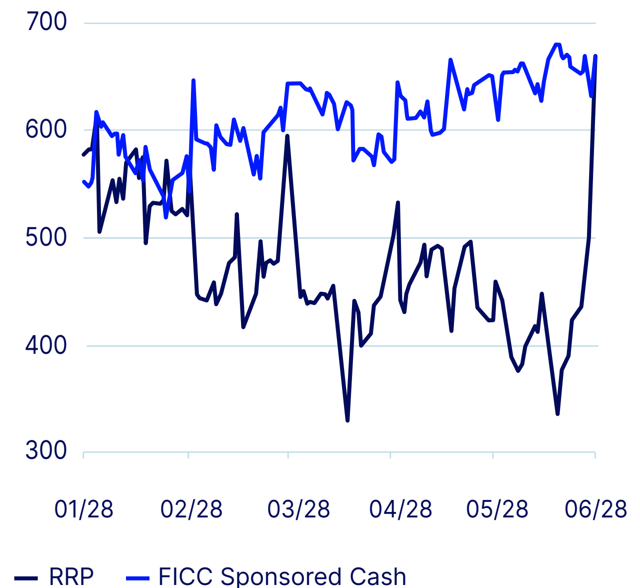
Outflows from the Fed RRP continued with average balances dropping 20% QoQ. RRP balances did tick up at quarter-end as dealers stepped away from the market, but have dropped back toward $400B as of early July. Just over a year ago, RRP balances sat over $2.2T and have since dropped precipitously as balances have migrated toward competing products, from private market repo to outright Treasury purchases. FICC Sponsored Repo has been a significant benefactor of this migration: balances have roughly doubled over the period (up ~$350B). Going forward, FICC Sponsored will have less supply to siphon from the dwindling RRP – however new industry tailwinds, driven by the SEC's US Treasury clearing mandate (fully effective for repo in 2026), are expected to pull significant balances into the FICC cleared repo space.

Figure 3: SOFR – RRP spread (%)



Source: Bloomberg

Figure 4: Fed RRP vs FICC Sponsored Cash ($B)

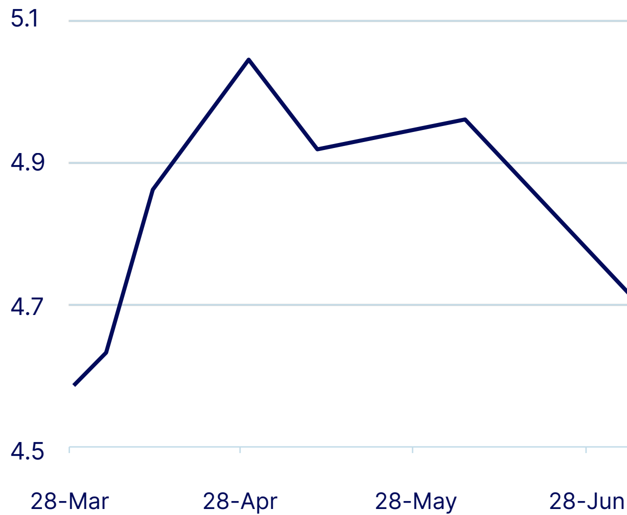


Source: DTCC, Federal Reserve

Market sentiment skewed hawkish for most of the period until quarter-end data suggested that the fight against inflation may be reaching an end.

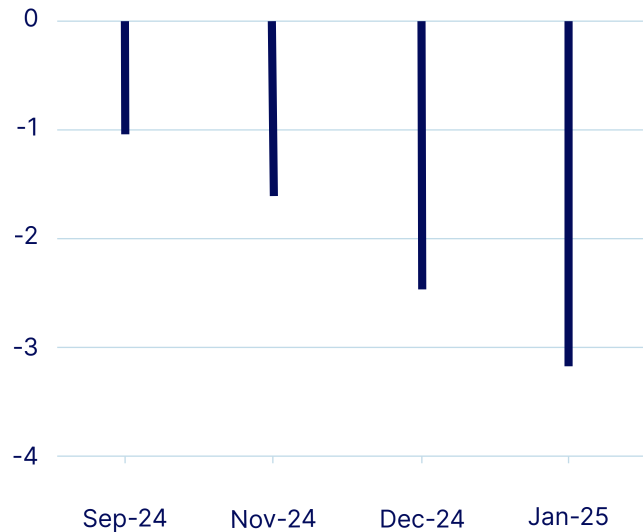
The market entered the quarter rather dovish after February PCE (released around March month-end) showed inflation in-line with expectations. At the time, the market was pricing a full cut in September and a second by January. As April progressed, hot jobs and CPI reports reverted market sentiment – pushing expectations for a September cut down to 50% and the year-end implied rate up over 5% **(Figure 5)**. The May FOMC meeting reinforced this sentiment when the Fed held rates firm and suggested that a "higher for longer" approach may be necessary to truly control inflation. Since May, data has gradually begun to suggest that key indicators are cooling – culminating in a June CPI report, which produced the lowest 12-month rate in more than three years. As of early July, the market is back to pricing a cut in September and expects a second by December **(Figure 6)**.

Figure 5: YE'24 Market implied rate (%)



Source: Bloomberg

Figure 6: Number of cuts priced in market – 4/11/24



Source: Bloomberg

Looking ahead, the market expects 2 rate cuts by year-end, which are expected to pull cash out of the front-end and drive repo rate volatility. More broadly, market participants on both the buy and sell-side are prepping to migrate balances into the cleared repo space to comply with the SEC's US Treasury clearing mandate (fully effective for repo in June 2026). DTCC projections indicate that up to $4T in cleared UST volumes could enter FICC[1]. FICC Sponsored repo is expected to see significant inflows as a result of this migration – however the extent of increases is yet to be fully understood given that FICC will be offering competing repo access models (e.g., Agent Clearing Model) and other exchanges are expected to enter the cleared repo space.

Updated access models will introduce new capabilities, like done-away trading and segregated margin, that could fundamentally change the ways in which market participants incur value from the repo market. Greater optionality could drive consolidation and specialization amongst sell-side repo providers, leading to expanded considerations for the buy-side when selecting an optimal provider. With more repo becoming cleared, market participants – particularly hedge funds on the cash borrower side of the trade – will likely look to recognize cross-product benefit with related cleared derivatives products.

DTCC projections indicate that up to $4T in cleared UST volumes could enter FICC[1]. FICC Sponsored repo is expected to see significant inflows as a result of this migration

[1] https://www.dtcc.com/news/2024/june/04/ficc-treasury-clearing-activity-expected-to-increase-by-over-us$4-trillion-daily

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