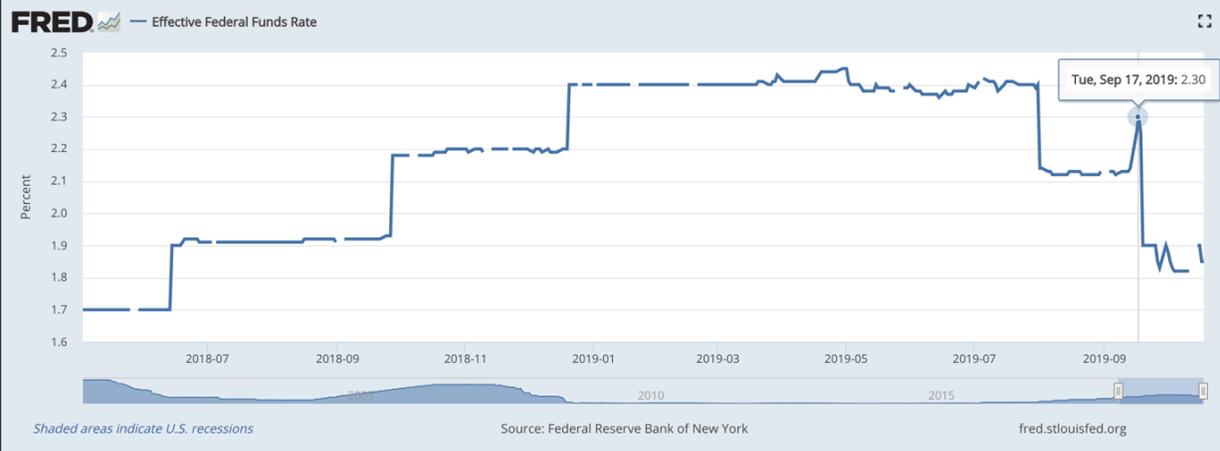


## Examining recent developments in Fed monetary policy

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Fed Chair Powell said that “It is important to note that the open market operations we have announced are technical, ‘Central Banking 101’ operations and should not be conflated with the large-scale asset purchase programs that the Federal Reserve deployed after the financial crisis”, and that the purchase of these assets was to “maintain levels of bank reserves, sufficiently ample enough to ensure the federal funds rate was maintained.”





Federal Reserve Effective Federal Funds Rate (FFR)

The level of Repurchase agreements on the Fed's books as of October 16th 2019, was \$197.7 billion. At the beginning of September that figure stood at \$0.00.

FEDERAL RESERVE statistical release

H.4.1

Factors Affecting Reserve Balances of Depository Institutions and Condition Statement of Federal Reserve Banks

October 17, 2019

Millions of dollars Reserve Bank credit, related items, and reserve balances of depository institutions at Federal Reserve Banks	Averages of daily figures		Wednesday
	Week ended Oct 16, 2019	Change from week ended Oct 9, 2019	Oct 17, 2018
Reserve Bank credit	3,959,671	+ 346	3,927,709
Securities held outright (1)	3,593,000	+ 3,500	3,589,599
U.S. Treasury securities	2,121,713	+ 1,824	2,123,085
Bills (2)	6,002	0	6,002
Notes and bonds, nominal (2)	1,970,194	+ 572	1,971,567
Notes and bonds, inflation-indexed (2)	120,593	+ 1,143	120,993
Inflation compensation (3)	24,523	+ 108	24,523
Federal agency debt securities (2)	2,347	0	2,347
Mortgage-backed securities (4)	1,468,940	+ 1,676	1,463,137
Unamortized premiums on securities held outright (5)	127,845	- 45	127,617
Unamortized discounts on securities held outright (5)	-12,538	+ 49	-12,526
Repurchase agreements (6)	174,364	- 4,957	197,700
Loans	65	- 12	60
Primary credit	2	0	6
Secondary credit	0	0	0
Seasonal credit	63	- 11	121
Other credit extensions	0	0	60
Net portfolio holdings of Maiden Lane LLC (7)	0	0	0
Floater	-117	- 5	-140
Central bank liquidity swaps (8)	43	+ 4	46
Other Federal Reserve assets (9)	27,008	+ 1,811	26,385
Foreign currency denominated assets (10)	20,601	- 50	20,622
Gold stock	11,041	0	11,041
Special drawing rights certificate account	5,200	0	5,200
Treasury currency outstanding (11)	50,053	+ 14	347
Total factors supplying reserve funds	3,996,566	+ 311	4,014,624

Note: Components may not sum to totals because of rounding. Footnotes appear at the end of the table.

H.4.1

Factors Affecting Reserve Balances of Depository Institutions and Condition Statement of Federal Reserve Banks

September 5, 2019

Millions of dollars Reserve Bank credit, related items, and reserve balances of depository institutions at Federal Reserve Banks	Averages of daily figures		Wednesday
	Week ended Sep 4, 2019	Change from week ended Aug 28, 2019	Sep 5, 2018
Reserve Bank credit	3,721,962	- 1,849	447,347
Securities held outright (1)	3,587,092	- 2,455	427,152
U.S. Treasury securities	2,095,140	+ 3,871	219,689
Bills (2)	5,001	0	2,901
Notes and bonds, nominal (2)	1,951,802	+ 3,859	225,572
Notes and bonds, inflation-indexed (2)	116,545	0	1,107
Inflation compensation (3)	23,792	+ 13	1,875
Federal agency debt securities (2)	2,347	0	62
Mortgage-backed securities (4)	1,489,605	- 6,326	207,401
Unamortized premiums on securities held outright (5)	127,667	- 302	16,724
Unamortized discounts on securities held outright (5)	-12,926	+ 77	864
Repurchase agreements (6)	0	0	0
Loans	97	- 43	142
Primary credit	1	- 34	9
Secondary credit	0	0	0
Seasonal credit	97	- 8	132
Other credit extensions	0	0	0
Net portfolio holdings of Maiden Lane LLC (7)	0	0	1,719
Floater	-522	- 349	18
Central bank liquidity swaps (8)	872	+ 803	782
Other Federal Reserve assets (9)	19,661	+ 418	1,275
Foreign currency denominated assets (10)	20,798	- 119	259
Gold stock	11,041	0	11,041
Special drawing rights certificate account	5,200	0	5,200
Treasury currency outstanding (11)	50,025	+ 14	358
Total factors supplying reserve funds	3,809,026	- 1,954	447,248

Note: Components may not sum to totals because of rounding. Footnotes appear at the end of the table.

## But is it QE4?

The insistence by Fed Chair Powell that this new monetary policy was not quantitative easing did not find acceptance within a lot of the financial commentariat as the liquidity provided in the Repo market was done through the purchase of short-term US Treasuries. Previous incarnations of quantitative easing targeted the purchase of bank debt, mortgage-backed securities and US Treasury notes.

If the Fed had not acted so decisively at this most recent of market disruptions the reserve drain on the financial system would have been of such magnitude, that the entire lending facility would have indeed frozen up, the overnight rates would have spiked much higher and maybe it would have finally been the death knell in this decade long equity bull run as the banks would need to sell any liquid asset such as stock in the equity markets.

## What is a reserve?

A reserve requirement is the amount of cash a bank must keep overnight. It's set by the Fed and is a percentage of the bank's deposits. The current top reserve requirement is 10% for banks with more than \$124.2 million on deposit.

Banks with excess reserves can deposit their cash with the Fed and earn interest. The total amount of reserve balances peaked around 2015 and until recently had been reduced by the Fed as part of their Quantitative Tightening policy. This stopped in July, a couple of months earlier than had been scheduled but added extra strain on reserves held at the depository banks.

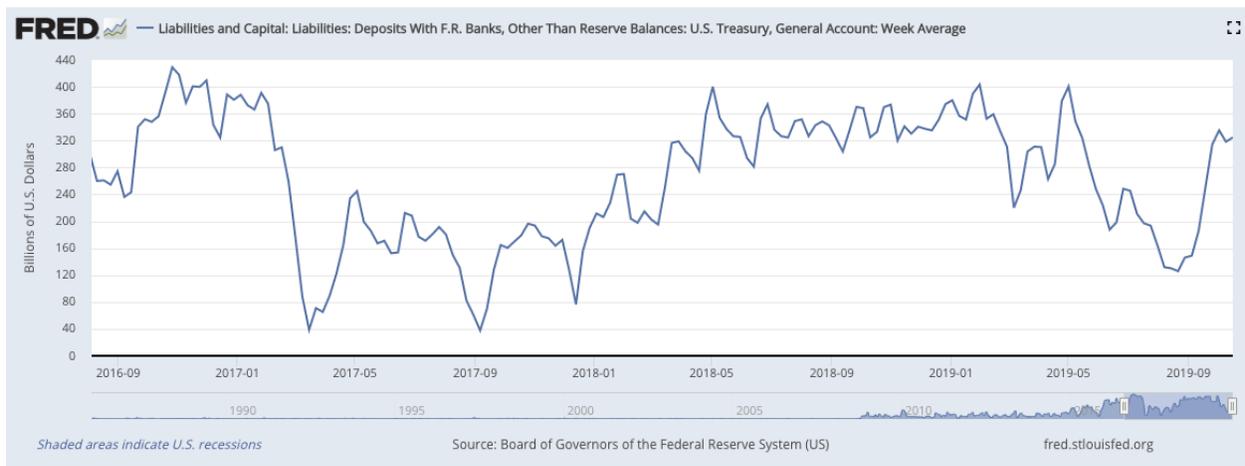


*Reserve Balances With Federal Reserve Banks*

The Fed have said that “the large settlements of Treasury auctions were at the root of the disturbance – along with payment of corporate income taxes” and these two factors drained the bank reserves to a level where

the banks needed to secure short term overnight loans to meet their required bank leverage ratios.

When the US Treasury sells notes and bonds, the sales are reflected in the deposits at the US General Account and make up part of the peaks of the chart below, when the US Treasury pays out Social Security and other liabilities this is a drain on the US Treasury reserves and so they issue more debt. The US Treasury has a target of around \$350 billion, to service its liabilities.



*US Treasury General Account*

## Why were the Treasury auctions large and problematic?

For an explanation of why the Treasury auctions in September were so negative to the interbank lending facilities we would have to look at the bond market and also the implications of a US debt ceiling.

When the US congress sets the debt ceiling, they are literally stating that at some point no more new Treasuries can be issued to pay for the ongoing US governments liabilities.

As can be seen by looking at what happened to the US bond market between March 2019 and August 2019 when the debt ceiling was reached and suspended respectively, having fewer bonds in the market

drove the prices up due to a limited supply and an actual demand from the banks to hold Tier 1 assets, for regulatory purposes.



US TBOND DEC19

With the debt ceiling suspended for 2 years the US Treasury was able to issue more debt into the market, which it did so, but not any great pace. Considering the market had been starved of new issuance for 5 months there was a hole that would need to be filled. The expenditure of the US government in the fiscal year 2018-2019 reached a record \$5 trillion and this is largely funded by the issuance of the US Treasuries.

## So how successful has the Fed been at stabilising the repo market?

As of October 17th, 2019, the reserves were hovering around \$1.469Trn which is approximately the level they were at in the first

weeks of September. So, the first step in their approach has worked. The interest rates have settled, though should they creep up higher, pressure would be put on the Fed funds rate targets.

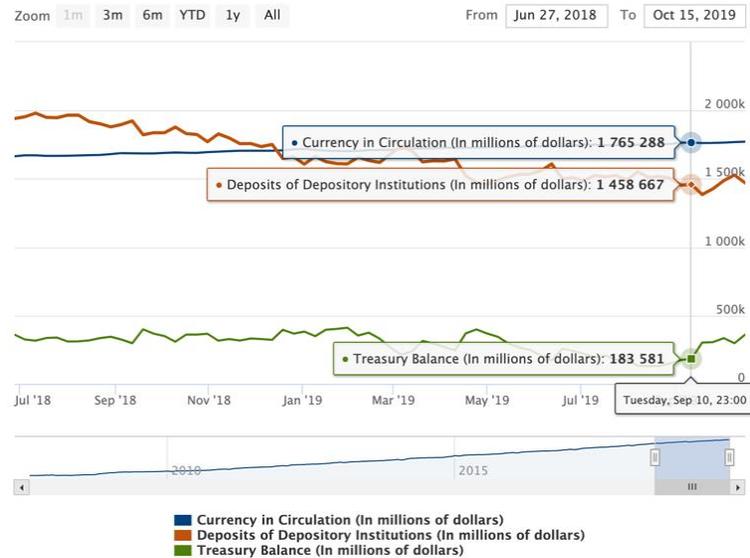
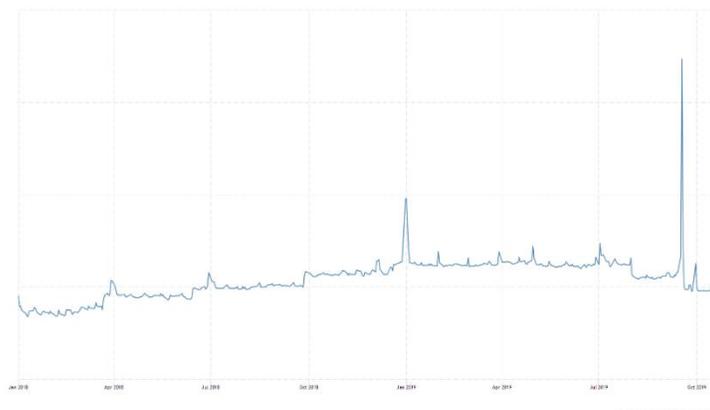


Chart showing Deposits of Depository Institutions at the beginning of September totalling \$1.4 trillion. SLR @ 10% = \$1.4 billion of reserves required.



Federal Reserve Repo rate

On 23rd October 2019 the Fed have said they will increase the size of the overnight operations and some market participants who agreed with their first course of actions maybe worried that they are starting to go beyond what is necessary. Too much liquidity into the reserve accounts would mean the banks having to adjust for the other side of their supplementary leverage ratio.

$$\text{SLR} = \frac{\text{Bank Capital}}{\text{Consolidated Assets}}$$

(repo goes in here)

In the first half of October 2019 the offerings were only fully taken by the banks on two occasions but with further drains to the reserves ahead, maybe the Fed are trying to prevent rather than react to fast moving scenarios. This program will continue at least into the second quarter of next year and is designed to achieve —and, over time, maintain the ample requirement in reserve balances.

## Where to trade these events?



Activtrader USDJPY H4

Traders who would like to take advantage of the markets during distress should look to trade the Japanese yen, Swiss franc and Gold. If the Federal Reserve cannot keep the FFR or REPO rates at their desired levels traders will look to place their money into safer currencies.

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