

Global Money Dispatch

QE and Basel III have turned the global financial system into a [token system](#). Tokens – reserves – settle every transaction. Tokens need to be warehoused, warehousing uses balance sheet, and FRA-OIS shows the price of warehousing. FRA-OIS is a marginal price. In recent years, FRA-OIS tended to [widen](#) either due to a falling supply of reserves or disruptions to how reserves were circulated, and FRA-OIS was typically dragged wider by the pull of the FX swap market. Today, the issue is too many reserves and the risk is for FRA-OIS to [tighten](#). To have a view on FRA-OIS, we need to have a view on who will warehouse \$1 trillion of reserves that will flood the system by June. Large U.S. banks [won't be able to](#) unless they get SLR relief at the bank operating subsidiary level. [We don't think that SLR relief is coming](#), so as the stimulus checks go out, banks will have to turn away institutional non-operating deposits to money funds. The “natural” outlet for these institutional inflows will be at the o/n RRP facility, but the use of this facility is capped at \$30 billion per fund. The use of this facility will be tested not only by stimulus-driven inflows but also by bill paydowns: as bills mature, money funds will look to the RRP facility as a substitute for bills. [Uncapping the o/n RRP facility is more important than adjusting its price](#); the use of banks' reserve accounts, the foreign repo pool, or Treasury's account aren't capped, so why impose a per-counterparty cap on the o/n RRP facility? The RRP cap is a key piece of our [warehousing puzzle](#): the \$1 trillion of reserves we're trying to find a warehouse for are currently warehoused by the Treasury; U.S. banks can't add another \$1 trillion to their warehouses, and money funds can't warehouse \$1 trillion unless the Fed decides to uncap the RRP facility. Unless the RRP facility gets uncapped, bill and repo rates can trade negative and money funds may turn away inflows, as they won't invest at negative rates. J.P. Morgan's SLR problem points to negative deposit rates (see page 17 [here](#)), and money funds' RRP capacity problem points to negative bill and repo rates. The implications for FRA-OIS from here are obvious: if U.S. banks are full and money funds can't take new money either, foreign banks will warehouse reserves at rates below those of J.P. Morgan but above those available in the bill market – and both are [negative](#). The price of warehousing is a [fee](#), i.e. a [negative rate](#)... [Unless banks get SLR relief and the o/n RRP facility is uncapped](#), we expect U.S. dollar Libor-OIS spreads to reach [zero by June](#), with risks to the downside. Uncapping the o/n RRP facility is more important than raising its rate to 5 bps, and hiking IOR won't fix a [collateral problem](#) nor lift the price of [term](#) warehousing.

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