Commentary
Global Cash Management

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Market Forecast

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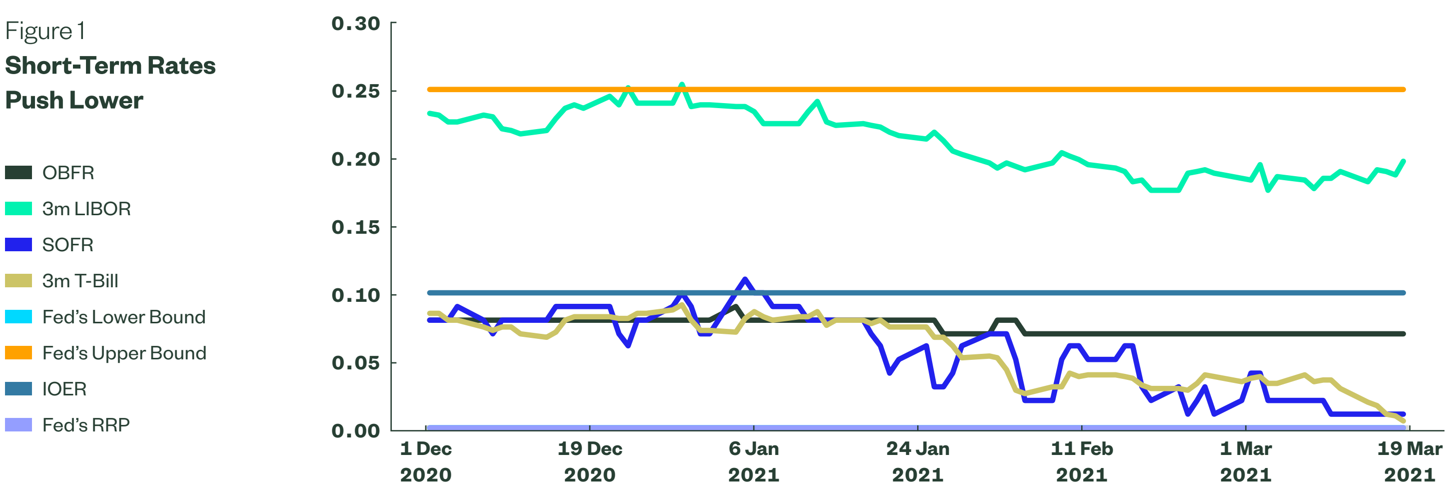
The past has shown us the Federal Reserve (Fed) does an excellent job of alleviating market stress but does not necessarily take actions to prevent it. The second quarter could, yet again, be one of those periods as short-term Treasury bill (T-bill) yields hover at zero and Overnight Repurchase Agreements trade at negative rates. Will the Fed make a technical adjustment to their Reverse Repurchase Program (RRP) rate to prevent prolonged negative market rates?

As we look towards the second quarter of 2021, the abundance of liquidity will continue to challenge very short-term rates. T-bill and overnight repurchase agreements (repo) yields are hovering at all-time lows and are poised to turn negative. The Fed is aware of this challenge but will be slow to react. As we have observed over time, the Fed does an excellent job of alleviating market stress but does not necessarily take actions to prevent it. At their March meeting, the Fed announced they would raise the allowable allocation of the RRP up to $80 billion from $30 billion, a move that was critical in order to accommodate the extraordinary growth in government money market funds. Currently, 12 of the largest government money market funds hold over $100 billion in assets under management, with four holding over $200 billion[1]. This latest allowance by the Fed should prevent yields from dropping into negative territory, but will have little additional effect on the market.

Figure 1
Short-Term Rates Push Lower



Source: Bloomberg March 26, 2021.

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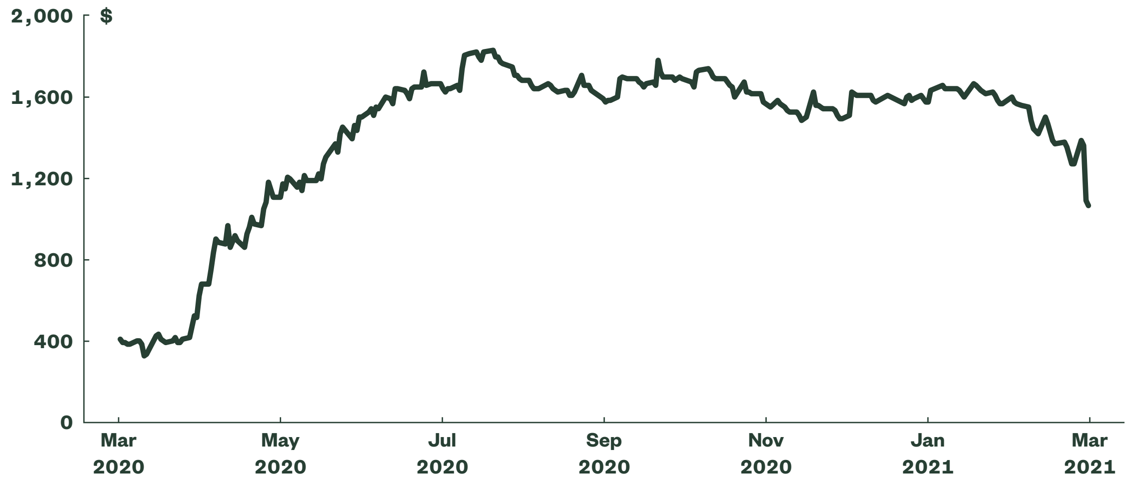
The US Treasury's most challenging problem: it has too much cash. The US Treasury's general account (TGA) had built up over $1.8 trillion by mid-2020. However, as the COVID-19 crisis abates and growth resumes the US Treasury has no need to hold that much cash. They have indicated they would ideally hold between $200 and $400 billion for normal operations. With expenditures already begun, the TGA is lower by almost $800 billion from its peak, and $600 billion since the beginning of February. This spending puts cash back into the banking system via stimulus checks and other direct payments. The cash needs a home and thus the increased demand for T-Bills and repo that further pushes rates lower.

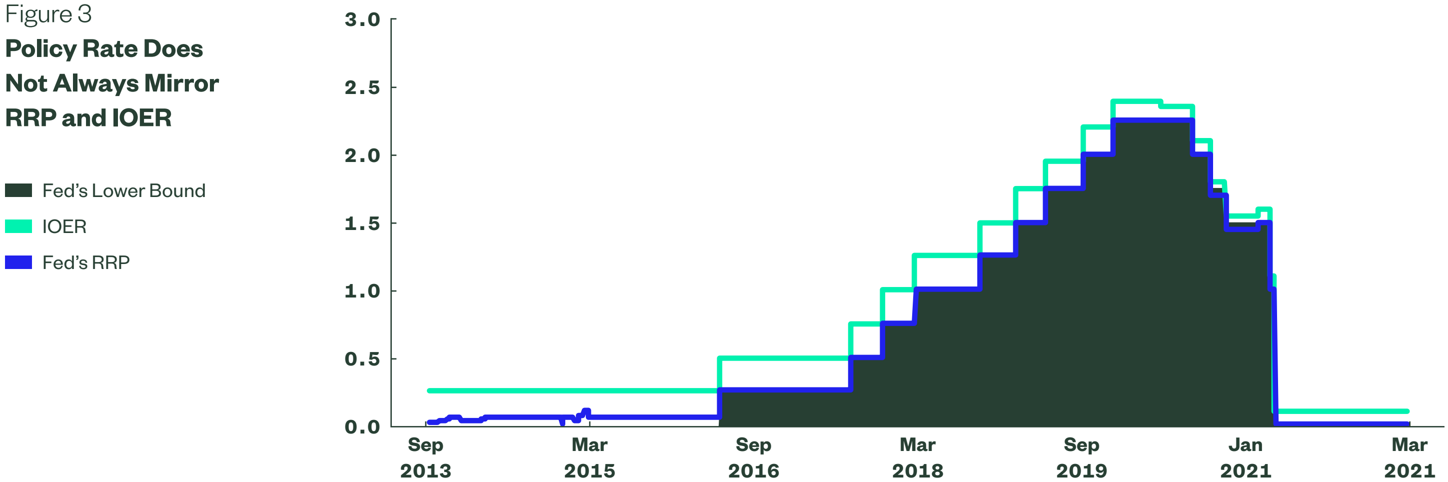
Figure 2
US Treasury General Account



Source: Federal Reserve US Treasury March 26, 2021.

If the Fed wants to prevent yields from turning negative, they have the perfect tool: the rate they pay on the RRP. As a reminder, the program borrows money from primary dealers, certain government agencies, and most importantly, US registered money market funds. The program pays lenders a specified rate and pledges US Treasury collateral against the loan. This program was introduced back in 2013 to help with the same problem: negative rates and too much liquidity in the system. Currently, the RRP rate is set at 0.00%. An adjustment higher would push other rates higher and keep T-Bill and repo yields off the 0.00% lower bound. We expect this adjustment, likely by 5 basis points (bps), during the second quarter, at either the April or June meeting. It's possible it's adjusted higher between those meetings but would require significant downward pressure on the Federal Funds Rate and as such is a much less likely scenario. Importantly, this is not an interest rate policy move but a technical adjustment and part of the Fed's normal operations to keep rates within their policy framework. As Figure 3 illustrates, there have been several instances when policy rates moved up or down at different times or different amounts than the RRP rate and/or the Interest On Excess Reserves (IOER) rate.

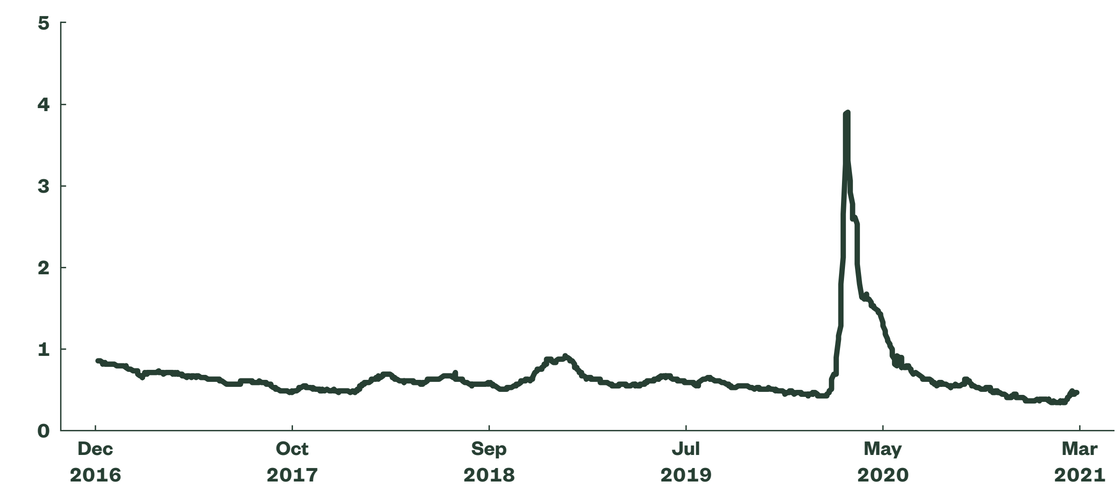
Figure 3
Policy Rate Does Not Always Mirror RRP and IOER



Source: Federal Reserve, Bloomberg March 26, 2021.

Credit yields are also at historically low levels. Yielding in the mid-teens, top tier (A1/P1) three-month commercial paper rates are at ten-year historical lows and 4 bps lower from the beginning of year. Credit conditions across the investment grade credit curve remain excellent, with the Bloomberg Barclays 1–3 Year- Credit Index back to the tighter levels it achieved pre-pandemic. As long as the Fed continues to support liquidity conditions through its quantitative easing measures and its uber-dovish monetary policy stance, we see little chance of any disruptions to the very favorable conditions for commercial paper issuers and the credit markets overall.

Figure 4
Bloomberg Barclays 1–3 Year Credit OAS over US Treasuries



Source: Bloomberg Barclays Indices, March 26, 2021. KEY: OAS: Option Adjusted Spread.

The next few months will be challenging for cash investors as excessive liquidity, modest supply of debt and favorable credit conditions make finding yield difficult. However, as we look to the second half of the year, expect some relief. By then we should have an adjustment of +5 bps higher in both the RRP and IOER rates. The third wave of stimulus should be absorbed into the real economy, lock downs should be lifted and spending should resume, reducing some of the excess liquidity in the system. The money market curve should steepen modestly. By no means will we see a steep curve but the inflation conversation will be replaced by discussion around the tapering of quantitative easing and an expectation of a rate hike.

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For four decades, these principles have helped us be the quiet power in a tumultuous investing world. Helping millions of people secure their financial futures. This takes each of our employees in 31 offices around the world, and a firm-wide conviction that we can always do it better. As a result, we are the world's third-largest asset manager with US $3.47 trillion* under our care.

* This figure is presented as of December 31, 2020 and includes approximately $75.17 billion of assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated.

Endnote

1 iMoney, JPMorgan as of Feb 28 2021.