The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE
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ICI VIEWPOINTS

JANUARY 20, 2015

European Banks Borrow Less from MMFs; the Federal Reserve Borrows More

By Chris Plantier

As we discussed in April and July of last year, due to regulatory pressures European banks generally have become less willing to borrow from U.S. money market funds (MMFs), especially at the end of the quarter. This quarter-end effect was particularly large at the end of December 2014.

In our latest release, Table 3 shows that the share of European holdings in prime money market funds' portfolios fell to 28.61 percent in December 2014 from 37.46 percent in November 2014. In addition, Table 2 shows that the share of European holdings in government money market funds' portfolios fell to 7.14 percent in December 2014 from 13.05 percent in November 2014, reflecting declines in repurchase agreement (repo) holdings with European counterparties. These monthly declines in the share allocated to European counterparties are larger than the decline seen in December 2013. In addition, the share settled at much lower levels at the end of 2014, suggesting that regulatory pressures continue to rise on European banks.

MMF Holdings of Fed Overnight and Term Reverse Repo Surge in December

In December, the Federal Reserve introduced a reverse repurchase agreement facility on a term basis, to augment its overnight reverse repo facility. Under the facility, eligible counterparties—including more than 90 MMFs—lend the Federal Reserve dollars for a specified period of time (the Fed's December term repos all matured on January 5, 2015).

The primary purpose of the reverse repo facilities is "to reduce potential volatility in money market rates," but they also enable the Federal Reserve to absorb excess liquidity, especially near the end of the quarter. MMFs used the new term facility to overcome the expected decline in short-term borrowing by European banks at the end of the year.

According to ICI's analysis of data provided by MMFs to the U.S. Securities and Exchange Commission onSEC Form N-MFP, prime and government MMFs held at least $332 billion combined in overnight and term reverse repo agreements on December 31, 2014. For government money market funds, 55.5 percent of repo agreements were attributable to the Federal Reserve as a counterparty in December. For prime money market funds, 51.6 percent of repo agreements were executed with the Fed in December. December 2014 marked the first month where the Federal Reserve was a repo counterparty for more than half the repurchase agreements entered into by taxable MMFs.

Table 3 also shows that the share of U.S. holdings in prime money market funds' portfolios rose to 37.86 percent in December 2014 from 28.75 percent in November. The increase in lending to U.S. counterparties was almost entirely due to the large increase in MMF lending to the Federal Reserve via the Fed's overnight and term reverse repo facilities.

Daily MMF Liquidity Falls as MMFs Use Fed Term Repo Facility

Money market fund use of the Federal Reserve's term reverse repo facility had a noticeable impact on daily liquidity ratios for both government and prime MMFs in December, but little impact on weekly liquidity.

Table 5 reports the daily and weekly liquidity ratios of government and prime money market funds. For government MMFs, daily liquidity fell to 51.52 percent of assets in December 2014 from 60.65 percent of assets in November. For prime MMFs, daily liquidity fell to 21.88 percent of assets in December 2014 from 25.81 percent of assets in November. By contrast, weekly liquidity ratios rose in December, because the Fed’s term repos all matured on January 5 and are included in the weekly liquidity ratio.

- For more on money market funds, please visit ICI’s Money Market Fund Resource Center.
- For more on Form N-MFP data, please visit the Taxable Money Market Fund Portfolio Data page.

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