BLOG POST
Repos Creating Havoc
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The internal plumbing of the U.S. banking system rarely makes headlines since the collapse of Bear Stearns and the 2008 financial crisis. That is, until last week when the IOER (Interest on Excess Reserves) rate spiked to as high as 15% at one point. This is a rate typically synonymous with the upper range of the Fed Funds rate. While some commentators panicked, believing another crash was imminent, that does not appear to be the case. Banks loan to each other overnight to meet their reserve requirements. In 2018 the repo rate went slightly above the IOER rate, so billions were funded into that market. In mid-September, when corporate taxes were due, $100 billion was removed from the repo market creating a massive imbalance between supply and demand.The total value of negative yielding bonds has exceeded $15T as of August 2019. According to BAML analysts, the blended yield on the $28T non-U.S. global investment-grade bond market is just 0.11%.

- The spike in repo rates was the result of a short-term technical issue (Treasury auction settlement and corporate tax due date), and not a long-term fundamental problem.
- The Fed has many tools at its disposal to correct any imbalance between the IOER and repo rates, including giving primary dealers the ability to use repos as primary collateral at the Fed.
- Too much collateral at the Fed, not too little collateral, is the problem. If the Fed succeeds at increasing loan demand for banks, excess reserves will diminish and balance will be restored.