STATE STREET

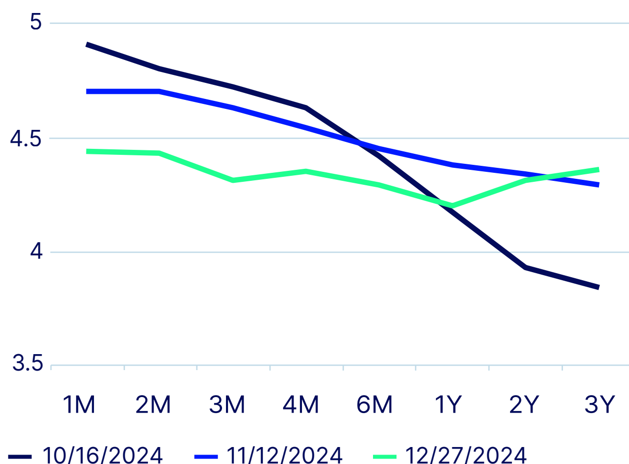
# Centrally cleared repo market brief

## Significant cash (money market fund) inflows continued as the Fed's transition to easing has unfolded more slowly than originally expected.

Even after the Fed's aggressive 50 bps cut closed Q3, the Treasury yield curve began Q4 heavily inverted, suggesting a strong tilt to the front-end lingers. Subsequent rate cuts (25 bps in Nov and Dec) altered the curve to mostly flat as of year-end **(Figure 1)** — however, it spent much of the quarter inverted and material transition toward a longer term focus has generally unfolded more slowly than originally expected. Despite Q4 cuts, the Fed has rolled back its expectations for future cuts given persistent inflation data above the target range.

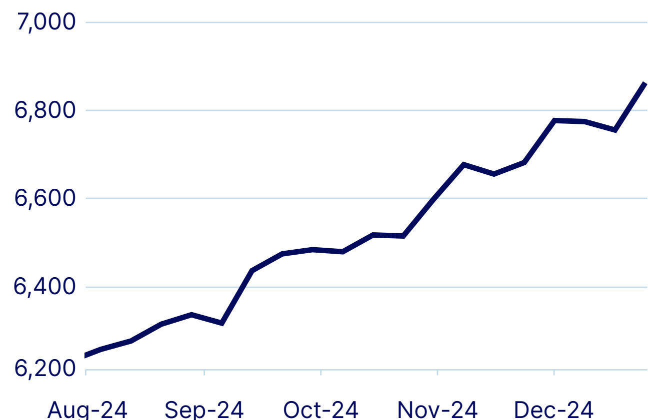
At the December FOMC meeting, the Fed raised its expectations for '25 and '26 policy rates by 50 bps. This hawkish tilt coupled with election season drove significant inflows to an already cash-rich short-end. Money market fund (MMF) balances rose >$450B to an all-time high of roughly $7T in overall AUM **(Figure 2)**. As volumes climb, MMFs are showing signs of shifting away from the very short-term with outright Treasury investments ticking up to 44% of overall holdings while allocation to repo edged down. Nevertheless, a third of MMF assets ($2.3T) still sit in repo — virtually all of which (>95%) is US Treasury or Agency repo.

### Figure 1: Treasury yield curve (%)




Source: US Treasury

### Figure 2: MMF balances ($B)




Source: Bloomberg

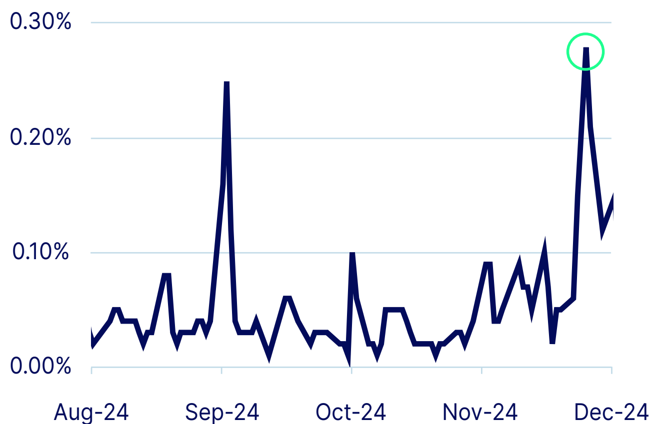
## FICC Sponsored activity continues to hit record-highs, accelerated by year-end funding pressures — although growth rates have cooled somewhat from their volatility-driven Q3 peaks.

A highly cash-rich quarter was met with similarly strong collateral supply as >$500B net new Treasury issuances hit the market. Persistent collateral supply continued the trend of repo rates (SOFR) elevated above the static Fed RRP level. The average SOFR-RRP spread rose to almost 6 bps, up from 4bps in Q3 **(Figure 3)** — primarily due to a volatile December when year-end typically drives heightened funding pressures. At the December FOMC meeting, the Fed also tweaked the RRP rate methodology to align with the target lower bound (5 bps decrease) going forward, which further widened the gap between SOFR and the RRP rate. Higher SOFR rates pulled cash out of the Fed RRP and into FICC Sponsored **(Figure 4)**. RRP volumes fell consistently into the $100-200B range (down 40% overall QoQ) then spiked up around year-end given seasonal funding pressures — only to fall back toward $200B in early January.

Even with the RRP rate tweak, it's possible that the remaining RRP balances are somewhat sticky since some firms value Fed exposure from a counterparty diversification perspective.

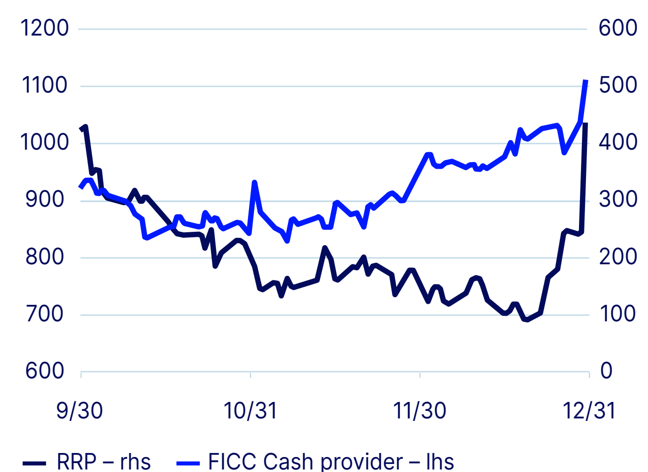
While the RRP languished, FICC Sponsored cash provider volumes hit an all-time high of >$1T in the last half of December and have remained above $1T for the first several days of the new year. On average, FICC cash provider volumes were up 17% QoQ — a strong increase but down from the 24% rise in Q3 suggesting that we may be reaching somewhat of a turning point as the Fed's easing cycle has fully kicked off — albeit more slowly than expected. FICC cash borrower (primarily hedge fund) volumes also hit a record-high (>$900B at year-end) although average volumes experienced a similar trend to the cash side, rising 30% on average in Q4 compared to 42% in Q3. This dynamic is also supported by overall UST shorting activity — which rose 6% QoQ on average, down from the 21% jump in Q3 **(Figure 5)**. Overall, US Treasury repo volumes are still decidedly strong and hitting record-highs — although the rampant, volatility-driven jumps of Q3 seems to be showing signs of coming back down to earth.

### Figure 3: SOFR – RRP spread (%)



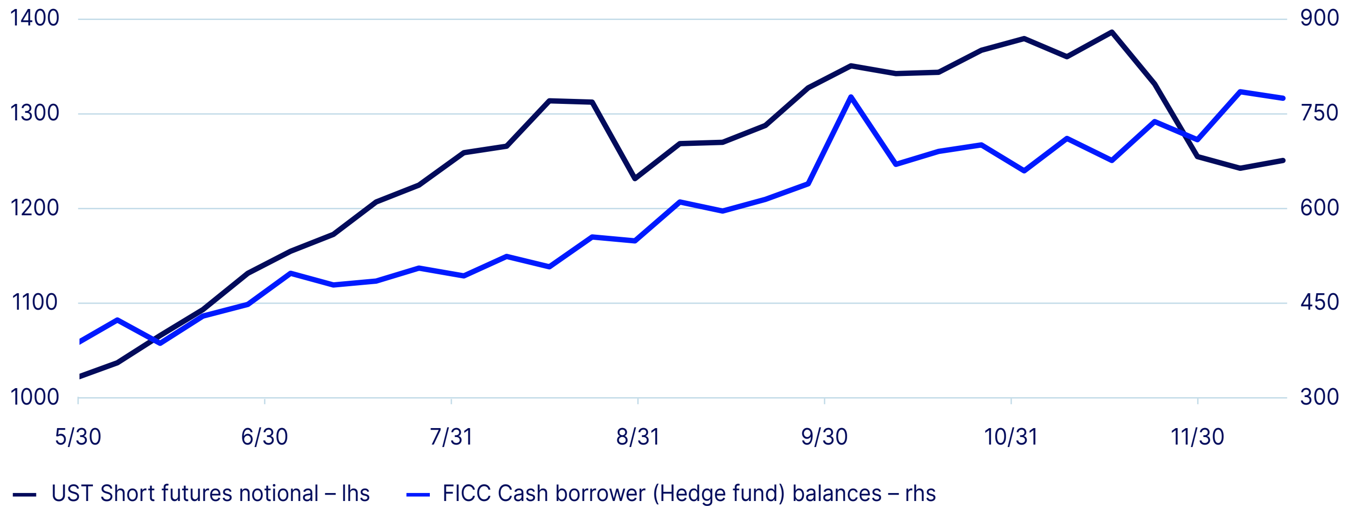

Source: Bloomberg

### Figure 4: Fed RRP vs FICC ($B)




Source: DTCC, Federal Reserve

**Figure 5: UST Futures shorting vs FICC Cash borrowing ($B)**




Source: Office of Financial Research

## The Fed cut rates twice this quarter (50 bps total) but overall sentiment for ’25 activity shifted hawkish as inflation remains persistent.

To start the quarter, repo markets settled in from the Fed’s September cut (50 bps) and a volatile month-end. The market — believing that the Fed’s aggressive cut signaled full-fledged easing — expected two cuts by year-end and an additional 4 in ’25, however economic data in October began to change that sentiment. The September jobs report (released October 4) clocked in far hotter than expectations and the September CPI print (released October 10) showed inflation edging down, but still above target range. This trend continued into November, when the subsequent CPI print showed inflation still above target range and actually ticking up YoY.

In response, the Fed still cut rates in November and December (50 bps total), but its December activity — in particular — was interpreted as a “hawkish cut” given that they raised target rate estimates for both ’25 and ’26 by 50 bps. At the time of this writing, the market only expects 1–2 total cuts in ’25, down from 4 at the beginning of the quarter.

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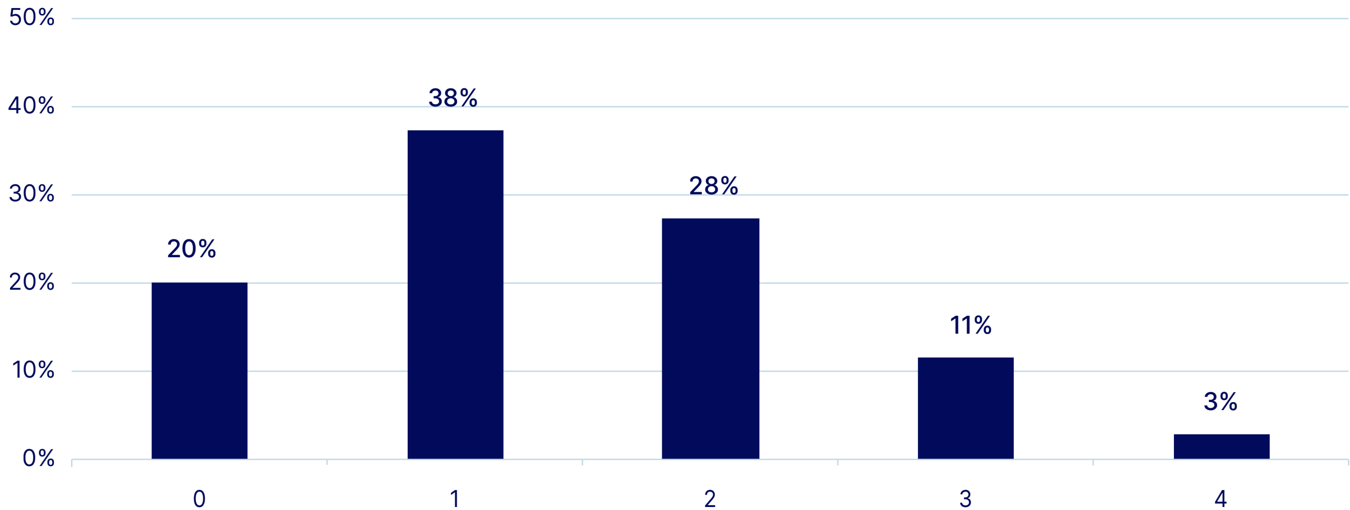
**Figure 6: Market expectations for ’25 Total rate cuts (1/7/25)**




Source: CME

Looking ahead, continued Fed easing may begin to incentivize cash to leave the front-end, or at least curb the rampant MMF inflows seen in ‘24 — although dampened expectations for ’25 rate cuts suggest that the pace and extent of this change may be slower than expected just months ago. Cash leaving the front-end could generally drive more volatility in repo markets, particularly as new collateral supply continues to be issued. Next year’s overall net Treasury supply is expected to be at least equal to or above 2024’s level (~$1.9T) and QT is expected to continue into H1’25.

Amidst this backdrop, market participants are continuing to assess and prepare for the SEC’s Treasury clearing mandate (fully effective for repo in June 2026). FICC Sponsored repo is expected to see significant inflows as a result of the mandate, far beyond the current record-highs. DTCC survey results suggest that up to $4T in new cleared volumes (cash and repo) could hit the market, some of which will find its way into FICC Sponsored.

New access models will also change the ways in which participants access and incur value from repo. Both buy and sell-side firms alike will need to fully assess new optionality in order to best solution for a significant influx in activity.

**FICC, including Sponsored repo, is expected to see significant inflows as a result of the mandate, far beyond the current record-highs (up to $4T according to recent projections).**

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State Street Corporation
One Congress Street, Boston, MA 02114-2016

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