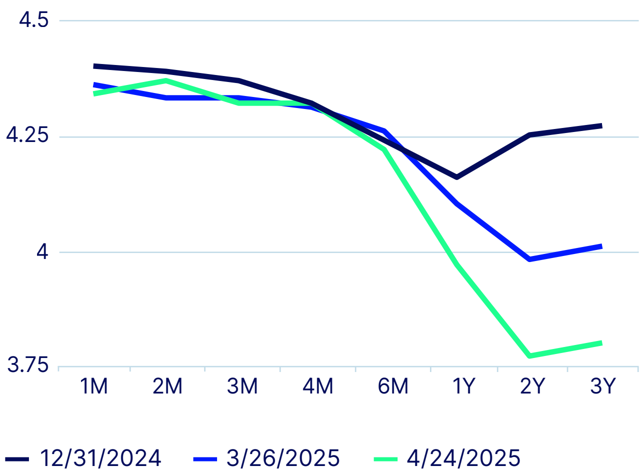
Centrally cleared repo market brief

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

Coming out of year-end, front-end focus lingered as the market wasn't fully convinced that the Fed had conquered inflation – despite meaningful progress toward target range. While December CPI data (released in January) was lower than expected, it was still above target range and investors were further concerned that the new administration's trade policy could add new inflationary pressures. Expectations for Fed easing ebbed further out, with the market expecting only one or even no 2025 cuts following the late January FOMC meeting.

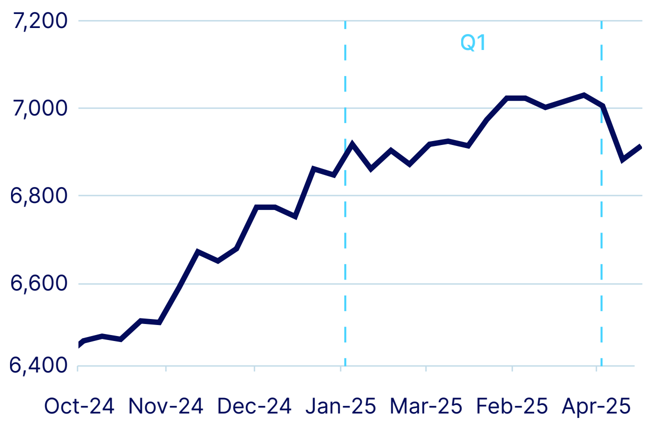
Hawkishness continued throughout the quarter as tariff-driven inflation concerns mounted, although recessionary fears also began to spring up as the full extent of intended tariff policy became more widely understood. Sentiment shifted drastically just after quarter-end when aggressive tariff proposals roiled the market with recessionary concerns that seemed to dwarf inflationary ones. The front-end of the Treasury yield curve inverted heavily **(Figure 1)** as the market began to price significantly more near-term cuts, expecting that the Fed would need to spur markets to avoid recession. In the face of equity volatility and an uncertain outlook on Fed activity, investors increased defensive cash positioning over the course of the quarter. MMFs saw incremental inflows (~$170B, **Figure 2**), but the rate was far lower than in Q4 (>$450B).

Figure 1: Treasury yield curve (%)



Source: US Treasury

Figure 2: MMF balances ($B)



Source: Bloomberg

Significant uncertainty remains in terms of the ultimate course of tariff and Fed policy, driving volatility in allocations. MMF volumes did ebb down in early April as they typically do around tax season, but have since begun ticking back up at the time of this writing.

The market seems to have somewhat moderated due to a perceived rollback in the extent of tariff policy – but immense uncertainty still remains.

FICC Sponsored activity continued to rise, particularly in the Cash Investor space – although volatility was slightly softer than Q4 and growth rates have slowed.

As MMFs saw increased volumes, they also increased allocations toward repo (up to 39% at March month-end compared to 36% in Jan). MMF re-positioning brought more cash to FICC Sponsored repo. Average daily FICC Sponsored Cash Provider volumes were over $1T throughout the quarter, up 12% from Q4 **(Figure 4)**.

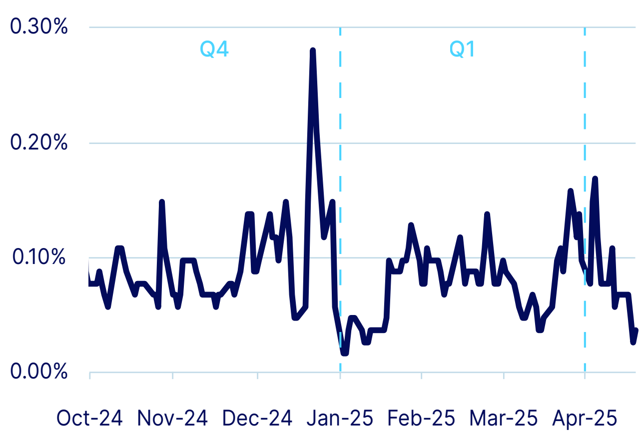
Volumes have continued to increase into April, rising another 2% since March. Repo cash inflows were met with net new Treasury issuances of ~$300B, lower than almost $550B in Q4 given material paydowns throughout the quarter.

Rising cash volumes coupled with softer net collateral supply served to modestly soften overall repo volatility QoQ. SOFT was still firmly above the Fed RRP level (now set at the bottom of the Fed range) but the average spread (excluding quarter-ends) edged down from 9 to 8 bps **(Figure 3)**.

Fed RRP volumes continued to decline, falling 38% QoQ. Following a typical spike at quarter-end, RRP volumes have settled well below $200B at the time of this writing.

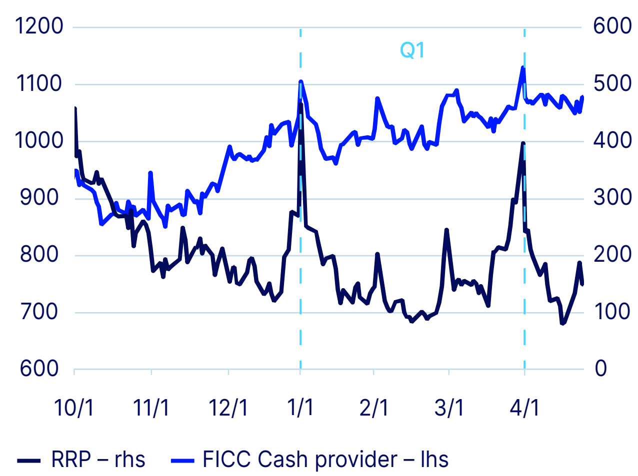
While FICC Sponsored Cash Provider volumes showed strong growth QoQ, FICC Cash Borrower average volumes (primarily hedge funds) rose just 1% QoQ. This trend was generally consistent with overall UST futures short interest, which edged down 4% on average QoQ **(Figure 5)**.

Figure 3: SOFT – Fed bottom (%)



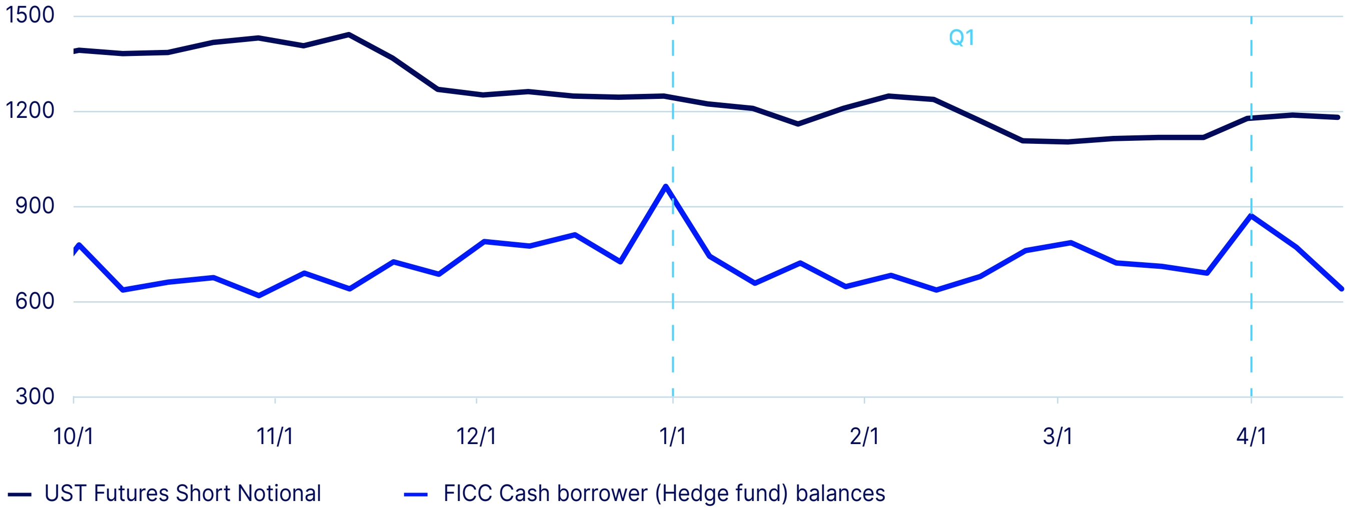
Source: Bloomberg

Figure 4: Fed RRP vs FICC ($B)



Source: DTCC, Federal Reserve

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



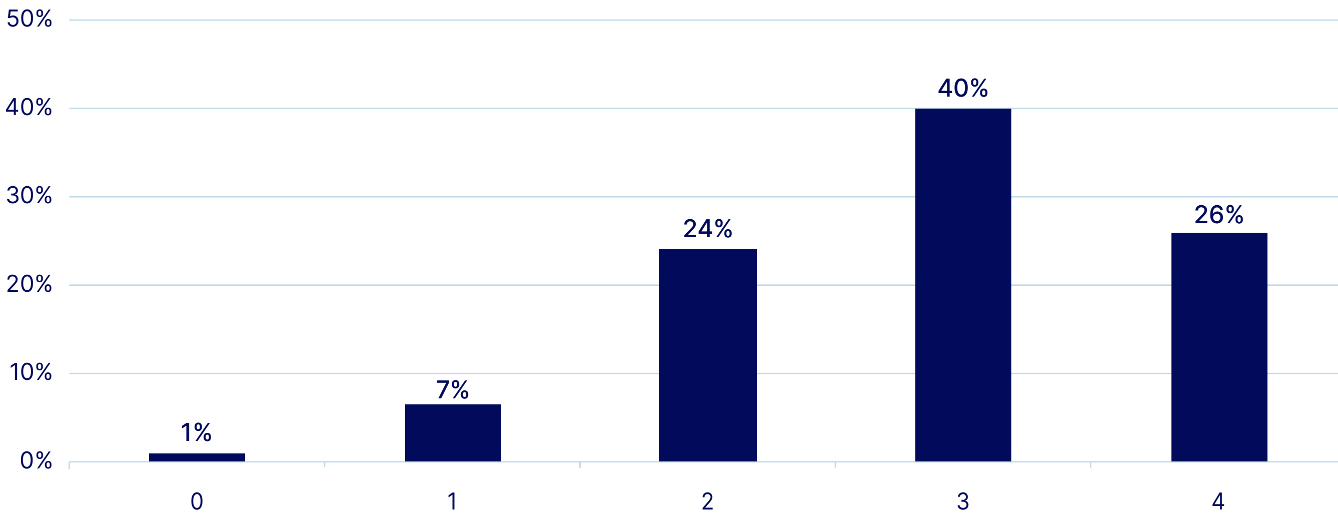
Source: Office of Financial Research

Inflation concerns and hawkish sentiment dominated the quarter until late March, when aggressive trade policy pronounced recessionary fears.

Following four total cuts in 2024 (100 bps), the market expected a transition to cuts in 2025 – but didn't price a first cut until June given that inflation had not yet reached target range. At the late January FOMC meeting, the Fed's statements were interpreted as a "hawkish tilt" with Powell iterating that inflation remains elevated and the committee didn't need to hurry to adjust policy given strong jobs data. Markets responded by pushing expectations for a first cut out to July.

As the quarter progressed, the Fed revised inflation projections upward at the March FOMC meeting and several policymakers shifted their expectations to no cuts in 2025. Nevertheless, hawkish trends were counterbalanced by mounting recessionary concerns, as the market began to price in potential for more front-loaded cuts to stave off a market slowdown. Recessionary pressures peaked just after quarter-end, when aggressive tariff proposals invigorated markets with a dovish tilt – pricing four cuts beginning as soon as June. While expectations have moderated slightly over the course of April, they still currently stand far more dovish than the beginning the year: the market now expects 3-4 total '25 cuts as compared to 0-1 in January.

Figure 6: Market expectations for ’25 Total Rate Cuts (4/29/25)



Source: CME

Looking ahead, Fed easing may begin to incentivize cash to leave the front-end or at least curb the rate of MMF inflows, which already began waning in Q1. Given recent recessionary concerns surrounding tariffs, the market now expects more overall cuts in ’25 than it did earlier in the year. Cash leaving the front-end could generally drive more volatility in repo markets, particularly as new collateral supply continues to be issued. However, net issuances were relatively light so far in Q1 and the rate of QT was slowed at the March FOMC meeting. Amidst this backdrop, market participants are continuing to assess and prepare for the SEC’s Treasury clearing mandate, which was pushed out by one year in February.

The effective date for eligible repo transactions is now June 30, 2027. While the dates have changed, the fundamentals of the mandate and market implications remain the same.

Effective September 30, 2025, FICC is updating its rulebook to expand cleared access, improve risk management, and further protect client assets. New indirect access models offered as part of rulebook changes will change the ways in which participants access and incur value from UST repo. Both buy and sell-side firms alike will need to continue assessing new optionality in order to best solution for a significant influx in activity.

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

www.statestreet.com