

ICI VIEWPOINTS

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Seasonality, U.S. Money Market Funds, and the Borrower of Last Resort

The March money market fund holdings data indicate a large drop in the share of fund assets allocated to European counterparties and a large increase in the share of fund assets allocated to U.S. counterparties. This shift is likely temporary and reflects reduced willingness of European banks to borrow from money market funds at the end of the quarter, rather than reduced demand from money market funds. Also, the increase in lending to U.S. counterparties is almost entirely due to the large increase in money market fund lending to the Federal Reserve via its overnight reverse-repo (repurchase agreement) facility.

Large Drop in European Share Reflects Quarter-End Effect

In our [latest release](#), Table 3 shows that the share of European holdings in prime money market funds' portfolios fell to 32.94 percent in March 2014 from 38.42 percent in February 2014. In addition, Table 2 shows that the share of European holdings in government money market funds' portfolios fell to 10.19 percent in March 2014 from 14.90 percent in February 2014, primarily reflecting declines in repo holdings with European counterparties. These monthly declines in the share allocated to European counterparties are very similar to the declines seen in December 2013.

As stated above, it is not unusual for European banks to be less willing than normal to borrow from money market funds near the end of the quarter, especially given the increased [regulatory focus](#) on reducing bank reliance on short-term wholesale funding. These entities may prefer to use other funding sources at the end of the quarter, rather than borrow from money market funds. In this case, money market funds are not choosing to lend less to European banks; rather, these banks are deciding not to borrow as much from money market funds.

Setting a Floor on Short-term Rates Increases Quarter-End Effect

The monthly declines partly reflect a reduction in supply from European banks, but they also are related to the introduction and expansion of the Federal Reserve's overnight reverse-repo facility over the past year.

In 2013, in an effort to gradually implement and expand its ability to absorb excess liquidity from the financial system, the Federal Reserve began engaging in a new program of fixed-rate, full-allotment, overnight reverse repurchase agreements. Money market funds have been among the counterparties to this new program, and have actively participated in it. In early March, the Federal Reserve increased the effective size of its fixed-rate reverse-repo

operations, allowing each counterparty to lend the Fed up to \$7 billion overnight. It subsequently increased this maximum amount to \$10 billion in early April.

Though the overnight reverse-repo operation is technical in nature, its primary purpose is to put a floor under short-term interest rates so that the Fed can better control short-term interest rates. In practical terms, however, the Fed has become the borrower of last resort in short-term liquidity markets, sucking up excess liquidity via its reverse-repo operation, especially near the end of the quarter. On March 31, 2014, the Fed allotted \$242.1 billion in reverse repos (the highest amount ever), of which at least \$175 billion was allotted to money market funds, according to ICI's analysis of N-MFP data. The figure below shows how the size of the Fed's reverse-repo operations has varied since early November.

Federal Reserve Reverse Repo Operation Size

\$ billions

Going forward, we should expect to see similar large declines in the share of money market fund assets allocated to European counterparties at the end of each quarter, as well as recoveries the following month. These changes merely reflect seasonality in funding conditions and are therefore of little economic consequence.

- 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.