

ICI VIEWPOINTS

April 27, 2023

Three Myths and Facts About Bank Deposits, Bank Lending, and Money Market Funds

What's the issue?

Following the difficulties at Silicon Valley Bank (SVB), Signature Bank, and Credit Suisse in early March 2023, a number of media reports cited analysts who suggested that money market funds (MMFs) are drawing deposits away from banks, adding to stresses at banks and preventing them from lending more to businesses and consumers.

The reports claim that this process has been abetted by MMFs being able to invest at favorable rates with the Federal Reserve's (Fed's) reverse repo (RRP) facility, something the Fed created almost a decade ago to absorb excess cash in funding markets. Since May 2021, the facility has grown by about \$2.2 trillion and MMFs are the biggest investors in the facility. This, it is suggested, is a concern the Fed could address by making the terms of the RRP facility less attractive to MMFs.

This narrative, though colorful and attention-grabbing, needs fact-checking.

Myths and Facts

Myth #1: In March 2023, \$422 billion flowed into government MMFs, which became "dead money" in the Fed's RRP facility that banks could otherwise have lent to businesses and households.

Fact #1: Government MMFs recycled over 70 percent of the \$422 billion back into the banking system, either directly or indirectly. As assets in government MMFs climbed in March, those funds invested an additional \$190.5 billion in debt issued by Federal Home Loan Banks, which in turn lent the proceeds to banks. Government MMFs also raised by \$112.4 billion their investments in repo, providing additional funding to banks or their broker subsidiaries. Only \$68.5 billion of the increase was invested in the Fed's RRP facility.

Figure 1

How Did Assets of Government MMFs Change in March 2023?

Changes in assets and investments, billions of dollars, March 2023

Source: ICI calculations based on SEC N-MFP data

Myth #2: Banks could lend a lot more to businesses and consumers if the Fed made terms of the RRP facility less attractive to MMFs.

Fact #2: Bank deposits, which have grown substantially since 2010, totaled about \$18 trillion by February 2023 but bank loans totaled only a fraction of that (Figure 2). Because of banking regulations, banks often must hold deposits in US government securities or in their accounts with the Fed, preventing them from lending the deposits to businesses and consumers. Thus, an extra dollar of bank deposits will not necessarily result in more lending to the real economy.

Figure 2
Deposits and Loans at US Commercial Banks
Trillions of dollars

Source: Federal Reserve Bank of St Louis FRED

Myth #3: MMFs increased their investments in the Fed’s RRP facility over the past two years, drawing deposits from banks.

Fact #3: Government MMFs did increase their investments in the Fed’s RRP facility substantially over the past two years, but this was not because their assets grew. Instead, they exchanged one type of federal government liability (Treasury bills) for another (investments in the Federal Reserve’s RRP facility), leaving their assets virtually unchanged. From March 31, 2021, to February 28, 2023—right before the difficulties at SVB surfaced publicly—government MMFs’ investments in the RRP facility rose by nearly \$1.7 trillion (Figure 3). However, their holdings of Treasury bills fell \$1.4 trillion, in large measure because the US Treasury pared issuance of Treasury bills (which, given their short maturities, MMFs can hold) in favor of greater issuance of Treasury bonds (which, given their longer maturities, MMFs generally cannot hold). On balance, the assets of government MMFs were virtually unchanged over this period.

Figure 3
How Did Assets of Government MMFs Change from March 2021 to February 2023?
Changes in assets and investments, billions of dollars, March 31, 2021, to February 28, 2023

Source: ICI calculations based on SEC N-MFP data

Targeting MMFs Misses the Mark

In light of the facts, the colorful narrative that MMFs are preventing increased lending to the real economy is strained at best and incorrect at worst. Sufficient financing to the real economy depends primarily on adroit monetary policy: sufficient financing will be forthcoming if the Fed can thread the needle of reducing inflation while avoiding a recession. Impugning MMFs as culpable in regional bank difficulties won’t help thread that needle.