US Rates Strategy

Joseph Abate
joseph.abate@smbcnikko-si.com
1 212 893-1592

January 7, 2026

Gradations of ampleness

The December FOMC minutes provide some insight into how the Committee sees ample reserves and its expectations for SRP use. "Various" FOMC members would like a more exact definition of ampleness. And they expect the SRP to be used when it makes economic sense. Specifically:

- While FOMC participants felt that reserves where in an ample "range" last month, they acknowledged the difficulty in defining ample given their uncertainty about reserve demand.

- **Our sense is that there are gradations of reserve ampleness**. Thus, even though tri-party rates climbed to 5bp above IORB ahead of the December meeting, balances were still ample.[1]

- **Ampleness may depend more on the *volatility* of market rates than their level**. The Fed also appears to be sensitive to how quickly rates increase as well as their sensitivity to changes in coupon settlements.

- **Low SRP use despite high market rates reflected "misperceptions" about the program and operational issues**. The Fed moved to address these by changing the program name and removing its cap. It continues to consider centrally clearing the borrowing.

- **Some FOMC members argued for a more active role for the SRP in managing interest rates.** Higher interest rates would induce "lean and hungry" banks to satisfy their reserve demand through SRP borrowing. This would allow the Fed to reduce its reliance on RMPs while fine tuning its balance sheet. In December, the FOMC opted to increase the supply of reserves through RMPs.

Refining ample

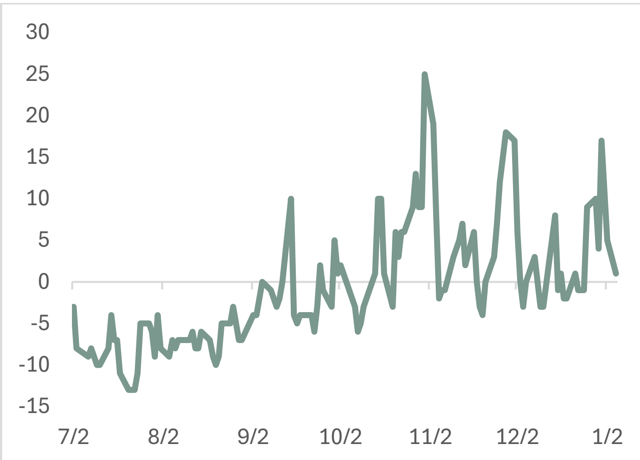
We gained a couple of new insights about the Fed's balance sheet management from the minutes of its December FOMC meeting. **We learned more about the Committee's views on defining reserve ampleness and its expectations for the now-renamed standing repo program (SRP).**

FOMC members felt that bank reserves were still ample last month although overnight tri-party rates traded an average of 5bp *above* IORB between mid-October and the FOMC meeting (Figure 1). Previously, we assumed there was a sharper distinction between ample and scarce balances. Reserves were ample when overnight rates traded close to and just slightly below IORB. In equilibrium, ample

[1] Albeit at the lower end of the range.

reserves meant that the cost of liquidity (overnight market rates) and its return (IORB) were nearly equal. If overnight repo rates were above IORB, the cost of liquidity exceeded its return and reserves were scarce.

Figure 1: Tri-party less IORB (bp)



Source: Federal Reserve, SMBC Nikko

Figure 2: Reserves (% daily Fedwire payments)

Source: Federal Reserve, SMBC Nikko

The FOMC's discussion highlights two related points regarding ampleness. **First, ample is a zone and second there are 'gradations' of ampleness**. "The (Board) staff emphasized that a range of levels of reserve balances was consistent with ample."[2] The Fed's objective is to keep the supply of reserves in this roughly defined range so that balances are sufficient to meet bank demand on most days. Banks use the SRP to temporarily "top up" their desired cushions on other days. This borrowing is meant to temporarily push balances from *less to more ample within the zone*. As a result, reserve sufficiency measures such as the RDE (reserve demand elasticity) or the ratio of balances to Fedwire payments may still broadly signal an ample supply even as repo rates trade above IORB (Figure 2).

Nevertheless, at the December meeting, "various" FOMC members were looking for a more precise definition of ample to "help clarify the Committee's intentions in implementing an ample-reserves framework".[3] In Fedspeak, "various" likely means between 4 and 6 of the 19 meeting participants. **"Some" (or 5-7 participants) felt that ample was best defined as a spread between "money market rates" and IORB**.[4] But a "couple" of FOMC participants warned that too broad a definition of ample – one that resulted in a "larger supply of reserves than necessary to implement" policy - could result in a build-up in hedge fund leverage. **However, the Minutes do not provide any details about what interest rate spread reflects a just ample supply and one that is unnecessarily large.**

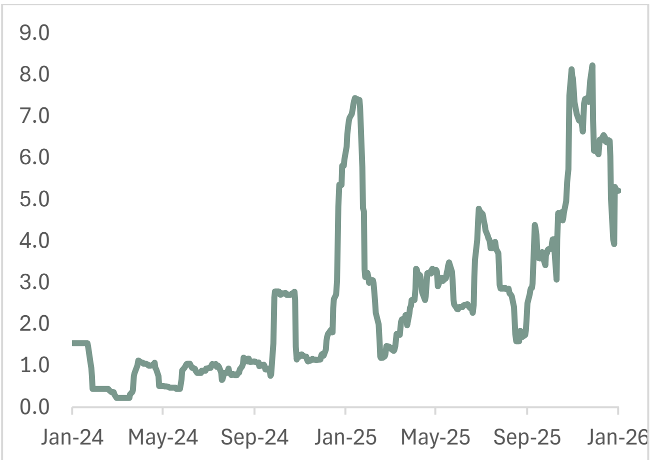
This reflects the fact that while the Fed controls the supply of balances, the demand for reserves reflects bank preferences. And this in turn is sensitive to their willingness to tap Fed-provided liquidity facilities like the SRP and the discount window.

But it may be that the ample zone may is defined less by the *level* of overnight rates and *more* by their volatility. **The FOMC's decision to begin RMPs may have been prompted by three factors – the volatility in repo rates, the suddenness of their increase and finally, their increased sensitivity to**

[2] December FOMC meeting minutes, page 3.
[3] December FOMC meeting minutes, page 5.
[4] Notably the reference is to money market rates – fed funds and repo.

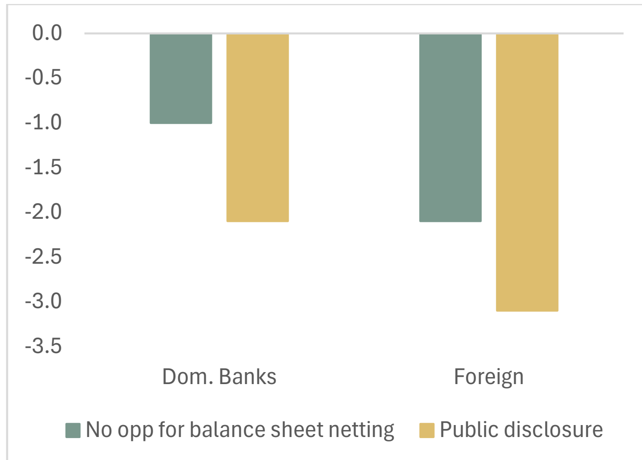
coupon settlements. Indeed, the daily standard deviation in the tri-party-IORB spread increased to 7bp after mid-October compared with less than 4bp in prior months (Figure 3). And, tri-party rates – which averaged 8bp below IORB before mid-October – traded as much as 15bp above IORB or more on coupon settlement and reporting dates. Compared to the Fed's last balance sheet normalization between 2017-19, the fed funds-IORB spread narrowed much faster.

Figure 3: Tri-party less IORB (bp)



Note: Trailing 20d standard deviation. Source: Federal Reserve, SMBC Nikko

Figure 4: SRP relative use preferences (scaled)



Note: See text for the scale. Source: Federal Reserve, SMBC Nikko

Adapting the SRP

The December FOMC minutes also helped to clarify some of the FOMC's thinking around the SRP. The Fed was puzzled by the market's reluctance to use this facility despite higher rates. This is particularly clear from the month-end data. On month-ends, at least 25% of the tri-party market traded above the SRP's minimum bid rate, meaning that dealers and banks could have borrowed perhaps as much as $325bn from the Fed's program to relend at a profitable spread. Yet, use of the SRP was much lower than that potential amount on those days – generally between $25-$75bn. **The Board attributed this reluctance to two causes – misperceptions about the program and operational issues**.

The misperceptions appear tied to the market's sense of the program's intent; some market participants saw the program as a "lender of last resort" *facility* meant to be tapped solely in a firm-specific liquidity emergency. Accordingly, managers may have instructed their staff not to use the program to arb market rates. This may be reinforced by reputational concerns about name disclosure. Dodd-Frank requires the publication of participant names after a lag of 2y. Our sense is that the 2y lag is only part of this concern. Heavy – or, more accurately, *outlier* use – might trigger a flurry of market speculation about who the borrower might be. Not only does this make eligible counterparties leery of participating in the SRP auctions, but it may also dampen their bidding; it may be better to borrow a little (or not at all) to avoid the risk of showing up on the market's radar. In Figure 4 we plot responses to the Fed's March 2025 Senior Financial Officer's Survey about the factors that determine the willingness to use the SRP on a scale from -4 (strongly discourages) to +4 (strongly encourages). While both domestic and non-US banks express concerns about disclosure, the concern is higher at non-US institutions. Disclosure concerns are felt more keenly than the inability to net SRP transactions off with other counterparties.

The Fed is working to clarify its expectations regarding program use. It expects banks and dealers to use the program when it makes "economic sense" – that is, when market rates exceed the program's minimum bid rate. The program is meant to be part of their normal liquidity management. To that end, the Fed replaced "facility" with "program" in the name. The sense is that "facility" conjures recollections of the Fed's emergency liquidity operations during the financial crisis and COVID. In addition to the renaming the Fed may need to remind bank supervision staffs that program use is a business-as-usual occurrence and does not reflect liquidity issues.

Similarly, the FOMC minutes highlighted operational issues that might be impeding use. Some of these the Fed has already addressed such as the introduction of morning operations to reduce the cost of daylight overdrafts. **At the December meeting, the Fed removed the $500bn/day cap on the program**. It also indicated that it was studying centrally clearing these transactions. Although we expect these transactions will eventually be cleared it is a little puzzling that the Fed needs additional study time. After all, our sense is that the liquidity redistribution benefits from clearing these transactions have been well understood for several years. We also think that remote access models like the FICC's collateral-in-lieu (CiL) program might work to centrally clear the SRP. Likewise, if balance sheet constraints (on the uncleared transactions) are limiting program use, removing the $500bn cap may not help much. After all, the Fed's issue is not with program overuse. Removing the cap *and* centrally clearing the transactions would increase the SRP's attraction.

Finally, there was some discussion at the December FOMC about a potentially broader role for the SRP. "Some" participants argued for the SRP to be used more actively to control interest rates as opposed permanently increasing reserve supply through RMPs. Regular SRP borrowing would allow the Fed to fine tune its balance sheet – supplying just enough reserves to control interest rates while reducing the risk that an oversupply creates a buildup of hedge fund leverage. This *laissez faire* approach would be similar to the Fed's pre-financial crisis interest rate management strategy. Back then, the Fed deliberately kept banks slightly undersupplied for reserves – i.e., lean and hungry - and banks met their marginal demand by borrowing in the fed funds market.[5] In the current version, the SRP would take the place of the fed funds market. Higher interest rates would induce banks to top up their demand by borrowing from the SRP. This borrowing would increase the supply of bank reserves enough to bring interest rates back down.

Encouraging a more active role for the SRP has the advantage of allowing the market to self-correct. But it requires borrower willingness to use the program when it makes economic sense. Up to now, banks have shown some reluctance to use the SRP. Last month, the Fed decided to accommodate reserve demand through reserve management bill purchases although it still expects borrowers to tap the SRP when economically attractive.

[5] This is a little different from the *ancien régime* as the fed funds market merely moved the same volume of reserves from surplus to deficit institutions. SRP temporarily increase the supply of reserves.

Disclaimers

This document is provided by SMBC Group (including, collectively or individually, Sumitomo Mitsui Banking Corporation, SMBC Nikko Securities America, Inc., and their affiliates, as applicable) for informational purposes only, solely for use by the client(s) or potential client(s) to whom such document is directly addressed and delivered. This document was prepared by SMBC Group's economist(s). The views, statements, assumptions, and forecasts expressed herein are those of the author(s) and do not reflect the judgment of any other person or of SMBC Group. This document does not constitute an offer or solicitation of the sale or purchase of securities or other investments. The information contained herein is obtained or derived from sources believed to be reliable, but SMBC Group and the author(s) make no representations as to its accuracy or completeness. In some cases, such information may be incomplete or summarized. This document has been prepared based on assumptions and parameters determined by SMBC Group's economist(s) in good faith. The assumptions and parameters used are not the only ones that could have been selected, and therefore no guarantee is given as to the accuracy, completeness, or reasonableness of any such quotations, disclosures, or analyses. Past performance is not a reliable indicator of any future results.

This document has been prepared for and is directed at institutional investors and other market professionals, and is not intended for use by retail customers. It does not take into account any specific investment objective, financial situation, or particular need of any recipient. The information contained herein should, for whatever purpose, be used solely at the discretion and responsibility of the recipient. SMBC Group does not accept any liability or responsibility for any results in connection with the use of the information. Recipients are responsible for making final investment decisions and should do so at their own discretion following their own independent analysis and assessment of the merits of any transaction prior to execution, after conducting a careful examination of all documentation delivered, explanatory documents pertaining to listed securities, prospectuses, and other relevant documents. Financial instruments discussed in this document may be speculative and may involve risks to principal and interest.

Conflicts of Interest Disclosures

The views, statements, assumptions, and forecasts expressed herein may differ from those expressed in globally branded research produced by SMBC Group. The trading desks of SMBC Group trade or may trade as principal in financial instruments that are the subject of this document, and the author(s) of this document may have consulted with the trading desks while preparing the document. The proprietary interests of SMBC Group may conflict with those of the recipient. SMBC Group may seek to do business with companies mentioned in this material and the trading desks may accumulate, be in the process of accumulating or have accumulated, long or short positions in financial instruments mentioned and may have acquired them at prices no longer available. The trading desks may also have or take positions inconsistent with the views expressed in this document or may have already traded on those views.

This document is not a research report, and neither the document nor its author(s) is subject to policies and procedures that apply to the globally branded research reports and research analysts of SMBC Group or to legal requirements designed to promote the independence of investment research. This document is not subject to any prohibition on dealing ahead of the dissemination of investment research. This means that SMBC Group, and its directors, representatives, or employees, may have a long or short position in any of financial instruments mentioned in this document and may make a market or trade in financial instruments economically related to the securities, derivatives or other underlying assets mentioned herein, in each case either as principal or as agent, at any time.

No part of the author's compensation was, is, or will be, directly or indirectly related to the specific recommendations or views expressed herein. The personal views of the author(s) may differ from one another.

.