US Rates Strategy

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

December 11, 2025

Managing surplus reserves

The Fed's reserve management purchases (RMPs) will begin this month. The size and variability of these operations are meant to fine tune an efficiently sized balance sheet where overnight rates are close to IORB.

- **A key feature of the Fed's RMPs is their size and seasonality.** The monthly purchase pace will swell ahead of the April tax date and then contract as tax receipts boost the Treasury's cash account and drain the oversupply of reserves.

- **Our sense is that by fine tuning its RMPs the Fed is attempting to actively manage the oversupply of bank reserves.** Balances are intended to be just large enough to keep overnight rates close to IORB.

- **The success of this strategy may depend on the willingness of market participants to use the SRF.** The Fed removed the $500bn operational cap on the program.

- After the announcement, overnight rates fell. **We think pushing bank reserves back above $3trn by late January will pull SOFR closer to – but likely – still *above* IORB**. We expect it may lower the fed funds rate by 2bp or so.

RMP mechanics

The Fed's RMPs will begin this week. **These secondary market purchases of Treasuries are meant to offset the effect on reserves from growth in the Fed's non-reserve liabilities like currency and the Treasury's cash balance**. The purchases will be directed to bills although yesterday's announcement notes that the Fed could buy coupons out to 3y depending on market conditions. It will split its bill purchases into two maturity buckets – 75% in shorter maturities (1-4m) and the remainder in maturities out to 1y.

Recall in the October FOMC minutes there was some concern that the Fed's RMPs of bills might disrupt bill market functioning. Despite heavy issuance, the securities are frequently held by non-lending accounts which makes them occasionally difficult to borrow. The Fed's bill purchases, however, can be borrowed at its daily securities lending auction. That said, the Fed will not buy any bills (or coupons) with less than 4w remaining to maturity. It will also avoid purchasing any securities trading special in the repo market or that are the cheapest-to-deliver.[1] Finally, the Fed's holdings will be limited to 70% of any outstanding issue.

[1] It will also not buy securities in their when-issued period.

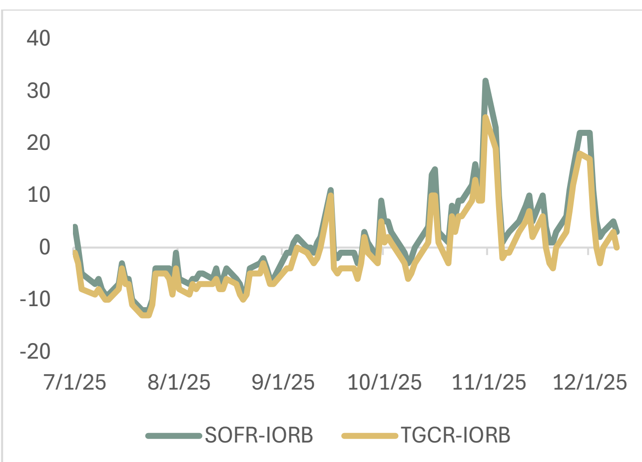
The Fed will publish a purchase schedule with the amount and dates of its intended RMPs. This will occur around the 9th business day of the month. Purchase amounts refer to the period from mid-month to mid-month. The Fed announced its RMPs will begin at $40bn this month.

Trends and seasonality

We assumed that the Fed's RMPs would match the trend growth in currency and the Treasury balance. In our forecasts this was between $5-$10bn/month.[2] So, on the surface, the Fed's $40bn announcement appears large. And, given the recent pressure in repo markets, it makes sense that the Fed's initial purchases would need to be large enough to correct for any reserve scarcity (Figure 1).

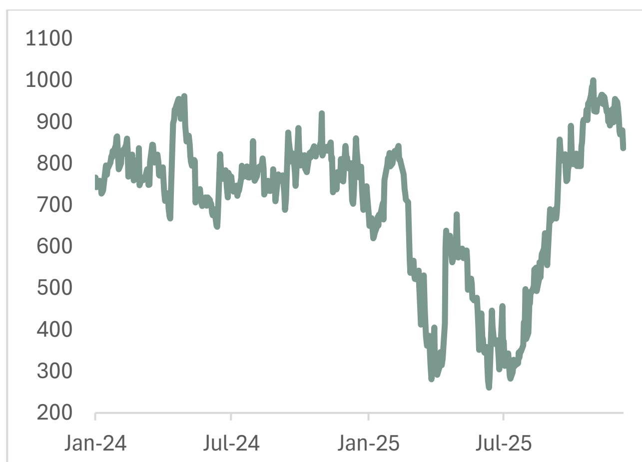
But what was surprising (to us) is the seasonality of the Fed's planned RMPs. The Fed intends to ramp the purchase pace up and down based on the seasonality in its non-reserve liabilities. Most of this comes from the Treasury's cash balance reflecting the timing of tax payments (Figure 2). There is some mild seasonality in currency – it tends to increase faster ahead of holidays and then fall or slow afterwards. **In effect, the Fed plans to scale up reserves ahead of the April tax date and then allow them to shrink back as the Treasury's cash balance swells.** Put differently, anticipatory RMPs of at least $40bn/mo in the next quarter are designed to temporarily oversupply reserves so that when they adjust lower after April 15, balances are closer to minimally ample. In April 2024, the Treasury's cash balance increased $160bn to $930bn at month-end.[3] Assuming a similarly scaled effect occurs next year, the Fed's anticipatory RMPs might need to be closer to $200bn – or $50bn/mo.

Figure 1: Repo rates less IORB (bp)



Source: Federal Reserve, SMBC Nikko

Figure 2: Treasury cash balance ($bn)



Source: Blick et al, SMBC Nikko

Fine tuning

The Fed's RMP plan suggests a bit of active management of surplus reserves. To work effectively, it requires accurate forecasts of the minimally ample level of reserves as well as estimates of the Treasury's cash flows. **We think this is a little different from the alternative strategy where the Fed's purchases are small but steady and build on a less tightly managed existing oversupply.** Maintaining an

[2] We are ignoring the MBS re-investments as these will keep the Fed's securities portfolio from shrinking; RMPs are meant to increase its size.
[3] We use 2024 for comparison as this year's balance was influenced by the debt ceiling.

oversupply absorbs the seasonality in tax receipts – any adjustment occurs in the buffer rather than across banks' desired minimums. This keeps overnight rates from rising. **However, the RMP plan suggests the Fed may be more inclined to fine tune its balance sheet while maintaining a more *targeted* oversupply of balances**. As a result, the Fed will need to carefully forecast the exogenous factors on its balance sheet.

The minimally ample level is not defined as a dollar amount but rather as the spread between overnight rates and IORB. An efficiently sized balance sheet is one in which the level of bank reserves is large enough to keep these rates *close* to (and slightly, below) IORB. SOFR may trade a few basis points above IORB given bilateral activity has a wider rate distribution. But regardless of the rate, the supply of reserves should be large enough so that the cost of liquidity equals its return (IORB) for both banks and non-banks. Since mid-October, however, tri-party repo (TGCR) has averaged 5bp *above* IORB and the fed funds rate is now only 1bp below the Fed's reserve remuneration rate.[4] We believe reserves (currently at $2.9trn and 12% of bank assets) have slipped below their minimally ample level. As a result, we expect the Fed's upcoming RMPs to take *some* of the pressure off overnight rates. **However, the expansion may not be large enough to bring these rates back to their summer spreads when TGCR and SOFR were trading 7bp and 5bp below IORB**. At the time, bank reserves were about $3.3trn. The RMPs may also bring the funds rate down by 2bp.

SRF

Actively managing surplus reserves may also require the Fed to consider ways to reduce bank demand for these balances **while increasing banks' willingness to use the SRF**. Yesterday, the Fed removed the operational cap on the SRF program. But, although daily use has been more frequent since mid-October, borrowing amounts have been modest – averaging just $6bn/day.[5] The Fed could reduce the demand for reserves if banks felt more comfortable monetizing the Treasuries they hold in their liquidity pools through the discount window or SRF. Increasing SRF willingness would give the Fed additional flexibility in managing the reserve surplus; when the oversupply becomes too thin, borrowers will tap the SRF and reserves will increase (temporarily) and bring rates down.

[4] SOFR has averaged 9bp above IORB over the period.
[5] Across both daily operations and Treasury and MBS collateral.

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.

This document is the property of SMBC Group, subject to copyright. Any reproduction of this document, in whole or in part, is prohibited and you may not release this document to any person, except to your advisors and professionals to assist you in evaluating the document, provided that they are obligated by law or agreement to keep the document confidential. Distribution, possession or delivery of this document in, to, or from certain jurisdictions may be restricted or prohibited by law. Recipients of this document are required to inform themselves of and comply with all such restrictions or prohibitions.

© 2025 SMBC Group. All rights reserved.

.