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FED SHADOW

In the Dead of Night, the Fed Ends the Bank Term Lending Program

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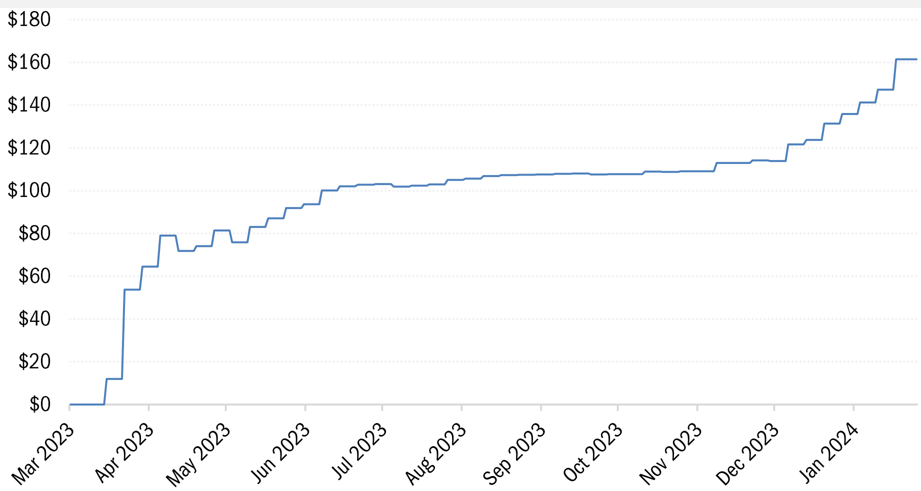
Donald Luskin

It was never QE, and ending it isn't QT. In fact, it's just become an arb for banks.

Well, not the dead of night exactly. But 7:00 pm ET last night was an odd time of day for the Fed Board of Governors to announce that the Bank Term Lending Program, *the systemic rescue thrown together over the weekend after Silicon Valley Bank's failure last March, would not be continued after its scheduled end this March 11*.

- *To be clear, the "end" of the program only means that after March 11 banks can no longer initiate new borrowings. Existing borrowings, or any new ones made up to March 11, can stay in effect for up to a year* (any borrowing can also be prepaid early with no penalty, at the borrower's option).
- *The BTLP is not "quantitative easing." Its scheduled end is not "quantitative tightening."*
- *This is a bank rescue program. The program worked, apparently. To let it end as scheduled, the Fed must see it that way. The Fed could be right or wrong about that.*
- The program was to designed to deal with one of the several failure factors that took out SVB, and threatened to take out other large regional banks (see "It's Over For SVB – And the Fed" March 13, 2023). The rapid run-up in interest rates and long-term yields after the Fed lifted off from a zero policy rate in March 2022 caused bank

Bank Term Lending Program, outstanding balance (USD billions)



Source: FRB, TrendMacro calculations

Update to strategic view

FEDERAL RESERVE, US MACRO: Last night the Fed announced that the Bank Term Lending Program, an emergency bank lending facility set up days after Silicon Valley Bank failed, will terminate as scheduled on March 11. This was never quantitative easing, and its end is not quantitative tightening. Until March 11, banks will still be able to lock in new borrowings for up to a year under the program. A surge of recent utilization creates the impression that banks are still fragile. But as markets have become confident that rate cuts are coming soon, the program in fact is an arbitrage in which banks can borrow from the Fed at a lower one-year rate and lend back to the Fed at a higher overnight rate. Last night's announcement adjusts the terms of the program to prevent that arbitrage going forward. This suggests that the program is indeed no longer necessary, and indeed that banks are alive and well and gaming the Fed.

[Strategy dashboard]

holdings of long-term Treasuries and MBS to depreciate sharply on a mark-to-market basis. If they needed to be sold to meet depositor withdrawals, large losses would be realized. The program allowed banks to borrow cash against such securities at par value, locking in such borrowings for up to a year.

- One indication the program is still necessary to stabilize the banking system, at least on the surface, is its increasing utilization. Outstanding program balances keep rising, and have been accelerating, now at $165.5 billion (please see the chart on the previous page).
- But this may well be not a sign of bank fragility, but rather *evidence that markets are becoming increasingly confident that the Fed's rate-hiking cycle is over and that cuts are on the way soon*.
- Under the program, banks have been able to lock in borrowings from the Fed at the one-year overnight index swap rate plus 10 bp. As the curve has become more confident about coming rate cuts, that one-year rate has fallen below the fed funds rate – which creates an arbitrage in which banks can borrow from the Fed at a low rate and lend back to the Fed at a high rate.
- Part of last night's announcement was a revision to the program's terms limiting the borrowing rate to the interest rate on bank reserve balances on the day the loan is made, closing up the arbitrage.
- *This is likely part of the Fed's thinking that the program, while seemingly increasingly utilized, is in fact no longer essential to bank stabilization. Indeed those crafty banks are alive and well, and gaming the Fed.*

Bottom line

Last night the Fed announced that the Bank Term Lending Program, an emergency bank lending facility set up days after Silicon Valley Bank failed, will terminate as scheduled on March 11. This was never quantitative easing, and its end is not quantitative tightening. Until March 11, banks will still be able to lock in new borrowings for up to a year under the program. A surge of recent utilization creates the impression that banks are still fragile. But as markets have become confident that rate cuts are coming soon, the program in fact is an arbitrage in which banks can borrow from the Fed at a lower one-year rate and lend back to the Fed at a higher overnight rate. Last night's announcement adjusts the terms of the program to prevent that arbitrage going forward. This suggests that the program is indeed no longer necessary, and indeed that banks are alive and well and gaming the Fed.

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