They asked for it

Short-term interest rates didn’t wait for the Federal Open Market Committee to confer (the mandarins met on Wednesday, after Grant’s went to press). They decided to go up on their own. On Monday, the king of money rates, three-month Libor (for London interbank offered rate) put in a post-crisis high of 73.4 basis points, up from 61.3 basis points at year-end and 29.4 basis points one year ago.

It is not quite correct to say that Libor leapt independently of the government. It was the regulators who wrote the rules that caused the spike. Institutional prime money funds—the kind that invest in certificates of deposit, commercial paper and repurchase agreements, as well as government-issue paper—must switch to floating net asset values by Oct. 14 (Grant’s, April 8). The feds seem to wish that the prime funds would dry up and blow away. The market is trying to discover the rate of interest that’s high enough to hold prime investors in place.

Since the start of the year, investors have pulled $275.6 billion from the prime funds, bringing their assets to $1.008 trillion, just about the lowest level since 1998. Government-only funds are the favorite destination for refugees from the private sector. They have seen assets swell by $297.3 billion since the start of the year to a record $1.518 trillion. Not only will the government-only funds be allowed to maintain stable reported NAVs post the October deadline, but also they will enjoy the federally conferred privilege of imposing redemption fees or gates come the next crisis.

Regulation is shaking up the short-term funding markets in other ways that the authorities might not have planned on. Last week, JPMorgan Chase & Co. announced that it would exit the triparty general collateral financing (GCF) repo market by the end of 2017. No secret why. “Given bank regulation, daylight overdraft reform, tri-party reform, increased business complexity, client default risk, etc., the business has become increasingly expensive,” relates Wedbush Securities managing director Scott Skyrm.

This will leave Bank of New York Mellon Corp. as the sole intermediary in what has become a $275 billion market. Any problems that Mellon runs into—software glitches, Russian hackers, financing troubles—will likely infect the broker-dealers that rely on GCF repo funding.

“A few more competitors (like BMO Harris, State Street, and Citi) would help the market,” Skyrm concludes. “However, there’s still the issues of expenses and regulation, if clearing represented a profitable opportunity, we would certainly see other banks lining up to get in.”

Back over to you, federal overseers.

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Thank the regulators

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<tr>
<th>Three-month Libor</th>
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<tbody>
<tr>
<td>yield in %</td>
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<td>1/09</td>
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source: The Bloomberg

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