Funding Markets Face 'Small Shock' From Fed Unwind

(Bloomberg) — Between the reinstatement of the debt ceiling in March and the unwind of the Fed's balance sheet, a "small shock is coming to the short-term funding markets," Cumberland Advisors Chief Investment Officer David Kotok says in note.

• The 2019 debt-limit fight will occur in the shadow of "recent nasty midterms" and as the 2020 presidential election cycle fires up
• Treasury has to reduce its cash balance to $200b when the debt ceiling is reinstated on March 1; the reduction acts as an increase in bank reserves since it's an actual transfer of cash from the Treasury to the banking system
o So the higher the Treasury cash balance at the Fed, the lower the excess reserves in the banking system and vice versa
• The Fed may also have to make another adjustment to the interest on excess reserves (IOER) rate; "note that for many technical reasons the Fed's task is becoming more and more difficult as the Fed shrinks the balance sheet"
• Cumberland expects that by March/April/May the Fed will reach a point where "short-term funding markets will no longer

have the luxury of those large balances of excess reserves”

o However, the timing is uncertain and the list of factors that could change things “stretches longer than a page”

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