Rodney's Take

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Will the Fed's Latest Gift to Banks End?

Last March, the Federal Reserve unveiled its latest gift to banks, the Bank Term Funding Program (BTFP), which is a borrower's dream. Under the BTFP, banks can take out one-year loans against high-quality collateral, like Treasury bonds, at par, not at the current market rate. Chances are, if a bank bought a 30-year U.S. Treasury bond over the past decade, then the bank is sitting on a loss on that position. While the bank might get just 80% of the face value if it tried to sell it today, the Fed is willing to loan the bank 100% of the face value. What's more, the Fed charges just the overnight index swap (OIS) rate plus 0.10%.

The BTFP rolled out just as Silicon Valley Bank and a few others went bust last March. The program gave banks with large, uninsured deposits a lifeline, allowing them to meet withdrawal requests even if the securities they owned were underwater.

Granted, the terms of the loan are fixed when the loan is originated, so the rate of OIS plus 0.10% could be bad for the banks, but the Fed thought of that. The loans cost nothing to initiate, can be repaid early, and can be refinanced. The BTFP program is a one-way benefit for banks that costs almost nothing. This violates the first priority of central banking, lending against quality assets at penalty rates. Instead, the Fed is lending against underwater assets and charging almost nothing.

Banks took advantage of the program in its early days, borrowing almost $120 billion. Banks have tacked on another $20 billion since then. The program is supposed to sunset in March of this year, with the last applications accepted that month and the loans due in 2025. But if banks are limping along in 2025 with impaired assets (like regional banks holding commercial real estate, CRE), we can expect the Fed to come to their rescue by extending or reopening the BTFP. Regional banks won't be able to pledge CRE, but they can pledge U.S. Treasury bonds and mortgage-backed bonds that are trading well below face value and get face value loans. I wonder if central bankers and bank executives wink and nod on Zoom as they make these deals.

The upshot is that the Fed has taken more risk onto its balance sheet, and it eased monetary conditions in the process. When banks aren't held accountable for managing deposit risk, then they are rewarded by maximizing that risk. It pays to remember that the Fed is owned by banks, not taxpayers, and the central bank has never met a problem that couldn't be solved by easy money conditions or a new program that amounts to the same thing. The problem is that easy money conditions only work when they move value from savers to borrowers. If you're in the former category, the Fed is counting on you to kick in by watching your value erode while the central bank rewards those who played fast and loose. Remember, taxpayers and savers are always the ones who pay.

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