Australian REPO Operations: What You Need To Know Before Monday.

Monetary Policy

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A Repurchase Agreement, or REPO, is an institutional-only form of short-term borrowing for buyers and sellers of Government Securities.

Sometimes also dubbed, RP's or Buybacks, they exist as both a widely relied upon money market investment vehicle and a practical instrument for Central Banks, such as the US Federal Reserve or Australia's Reserve Bank (RBA).

In practice, an institutional-only Government Securities Dealer, usually an Investment Bank, borrows from a corporate or superannuation conglomerate investor who has excess 'cash', to finance its inventory, using the securities as collateral.

These specialised dealers sell government securities to these investors, usually overnight and buy them back the following day at an incrementally higher price and typically specific time.

That small difference in price is the implicit overnight interest rate and thus the attraction of REPO's for corporates and institutional super funds is that they provide an alternative to 'Commercial Paper' or Treasury Notes.

Australian Office Of Financial Management:- The Role Of Treasury Notes

These short-term agreements afford flexibility when safe harbouring investable funds on a very temporary basis – they in effect, provide liquidity and lubricate the organs of the entire modern global monetary system.

Importantly, until recently, it was predominantly the US Federal Reserve that made extensive use of REPO's in its open market operations, as a method of fine tuning the US Dollar money supply (which is the entire amass of US currency and other liquid instruments circulating in the United States and since 1971, globally at any particular given moment in time).

As pre-empted last Tuesday – Australia Begins Quantitative Easing – Australia's Central Bank, did, in fact, begin it's first-ever Quantitative Easing, or QE programme on Thursday, 19 March 2020, indicating its intent to purchase five billion Australian Dollars of 3-to-4 and 7-to-8 year tenors via Australian open market operations.

Nevertheless, as well as announcing a sixty billion Australian to US Dollar overnight swap line with the US Federal Reserve – to militate US Dollar funding pressures – the RBA also announced, "*it will be conducting one-month and three-month repurchase (repo) operations until further notice. In addition, it will conduct repo operations of six-months maturity or longer at least weekly, as long as market conditions warrant.*"

This particular move should concern the astute global investor, heading into week beginning Monday 23 March, for the following reasons.

Australia's Reserve Bank ran a similar REPO duration extension during the early months of the Global Financial Crisis, or GFC, and the operations then were designed to buttress funding and mitigating upward pressure on Australia's Big Four bank's funding costs.

They did.

Fast-forward to March of 2016, when international Hedge Funds' "momentum trade" ground to a sudden stop – scroll back to 2016 across our Global Investing For Australians section – it became evident that global multi-asset class markets were entering an unnatural part of the cycle (Cite:- "Powell Brings Business as Usual" 01:23 minute-mark) and remained within emergency repair mode since the GFC.

Then in September 2019, the US Federal Reserve began ballooning their REPO operations to one trillion US Dollars per day and it is speculated that this was to rescue a large Wall Street bank who counterparties a plethora of gargantuan hedge funds engaging in highly-leveraged trades involving a relative value compression trade in Treasuries.

The small difference in price the implicit overnight interest rate that REPO's provide were not meant to be interest paid by Hedge Funds to access scalable gearing but as discussed in great detail last month, if the **Great Distortion**, now reveals that REPO's are nascent leverage lines in lieu of money market investment vehicles, the genesis of the speculated **GFC 2.0** may be revealing itself.

Forward guidance by RBA Governor Philp Lowe flagging no increase in the 'cash' rate, "*until progress is being made towards full employment and it is confident that inflation will be sustainably within the 2–3 per cent target band*", is not enough – clarity on whether Australian domiciled and regulated hedge funds are using borrowings from the Australian REPO market for relative value compression trades (siphoning the arbitrage between cash treasuries and futures or derivatives) is required.

The charter and core mission of the Reserve Bank Board of Australia is, "***within the limits of its powers, to ensure that the monetary and banking policy of the Bank is directed to the greatest advantage of the people of Australia and that the powers of the Bank ... are exercised in such a manner as, in the opinion of the Reserve Bank Board, will best contribute to: (1.) the stability of the currency of Australia; (2.) the maintenance of full employment in Australia; and (3.) the economic prosperity and welfare of the people of Australia.***"

The **economic prosperity and welfare of the people of Australia**. Well, the fullness of time will reveal all.

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