

# Liquidity & Funding Strategies for the Current Environment



September 26, 2024

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# Presenters



**Andrew Paolillo**

Vice President, Director of Member Strategies + Solutions



**Derek Hamilton**

Senior Financial Strategist

# Overview

- Macro Thoughts at the Start of the Cutting Cycle
- Stay Short or Go Long? What Does the Yield Curve Tell Us?
- Funding Strategies

## Poll Question

Where will the Fed Funds range be at the end of December **2025**?

A: Upper limit at 2.00% or lower (12 or more cuts)

B: Upper limit at 2.25-3.00% (8-11 more cuts)

C: Upper limit at 3.25-4.00% (4-7 more cuts)

D: Upper limit at 4.25% or higher (3 or less cuts)

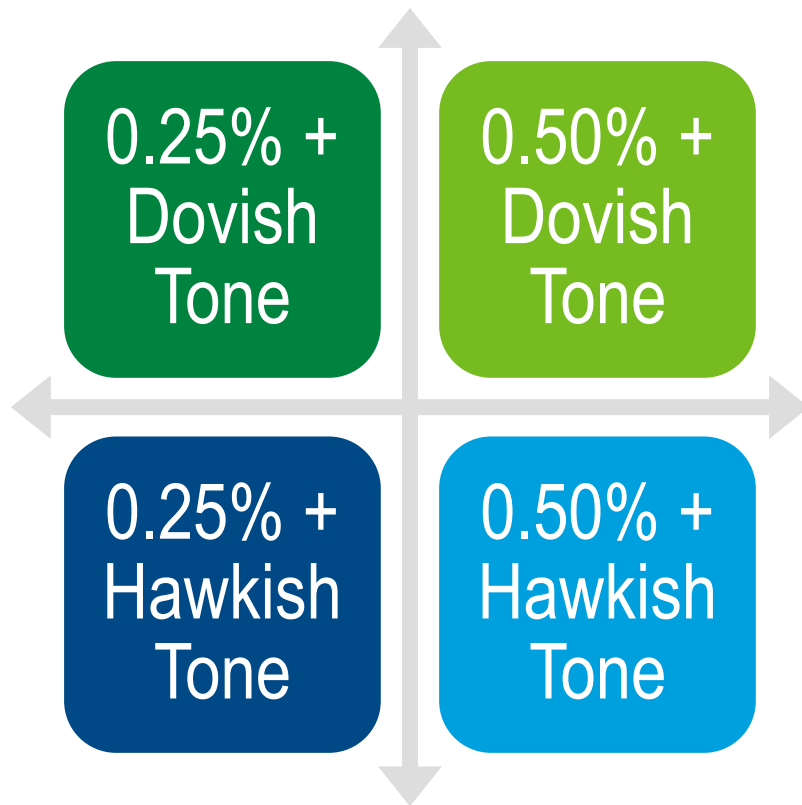
# Macro Thoughts at the Start of the Cutting Cycle



# Recapping Last Week's FOMC Decision

There was genuine uncertainty going into a Fed meeting for the first time in nearly two decades.

## Hawkish comments Dovish comments



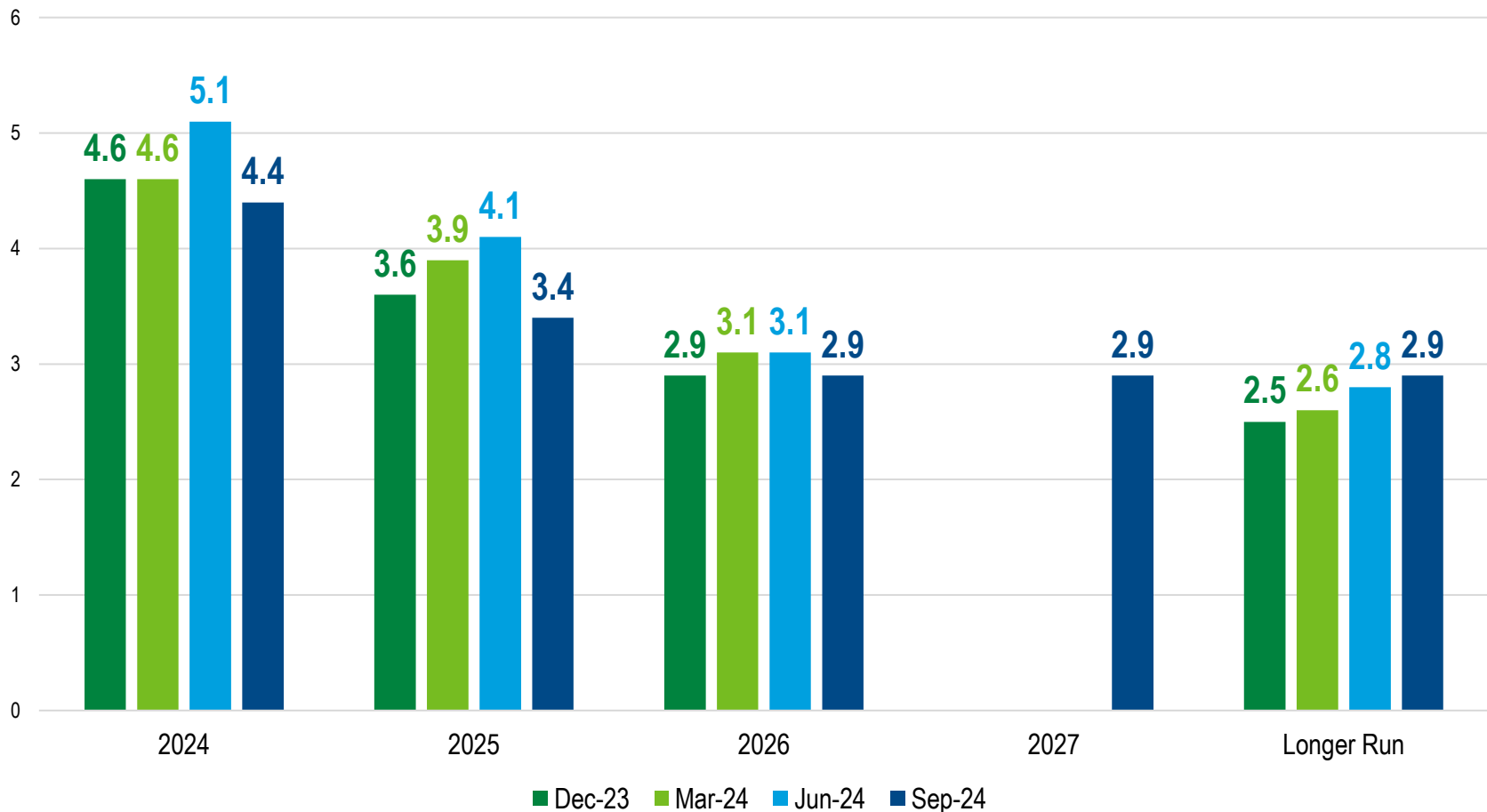
- *"Economy is strong"*
- *"Labor market has cooled"*
- *"Inflation has eased substantially"*
- *Expecting 2% GDP growth over the next couple of years"*
- *"Conditions in labor market are less tight than before the pandemic"*
- *"Inflation remains above 2% goal- total projection is 2.3% this year, 2.1% next year"*
- *"We have been hyper focused on inflation...patient approach has been successful for moving inflation to 2%."*
- *"Continue making decisions meeting to meeting- no preset path"*
- *"Will adjust projections if job market or inflation change unexpectedly"*
- *"Dissent on vote for the first time since 2005"*
- *"Don't look at today's cut as the new pace"*
- ***"We don't think we're behind on rate cuts, and the 50 bps shows we're committed to not fall behind"***

Source: Federal Reserve

# The Dot Plot Progression

The biggest recent change was in the expectation for year-end 2025- however, the market had already begun pricing that in. Take note of the trend in the longer-run forecast, which continues to slowly increase.

**Median Federal Funds Rate Projection**

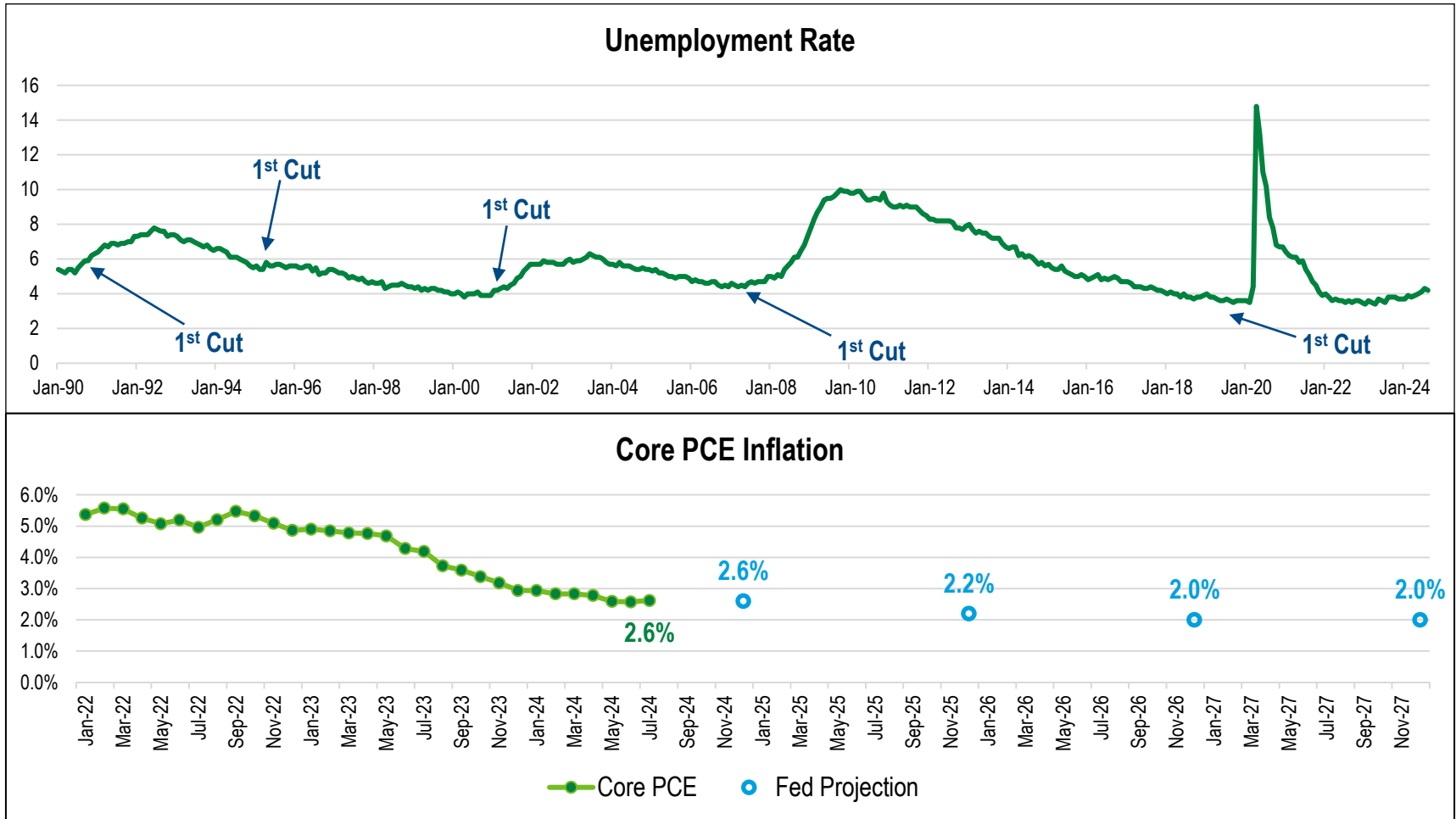


Source: Federal Reserve



# What Indicators are the Fed Watching?

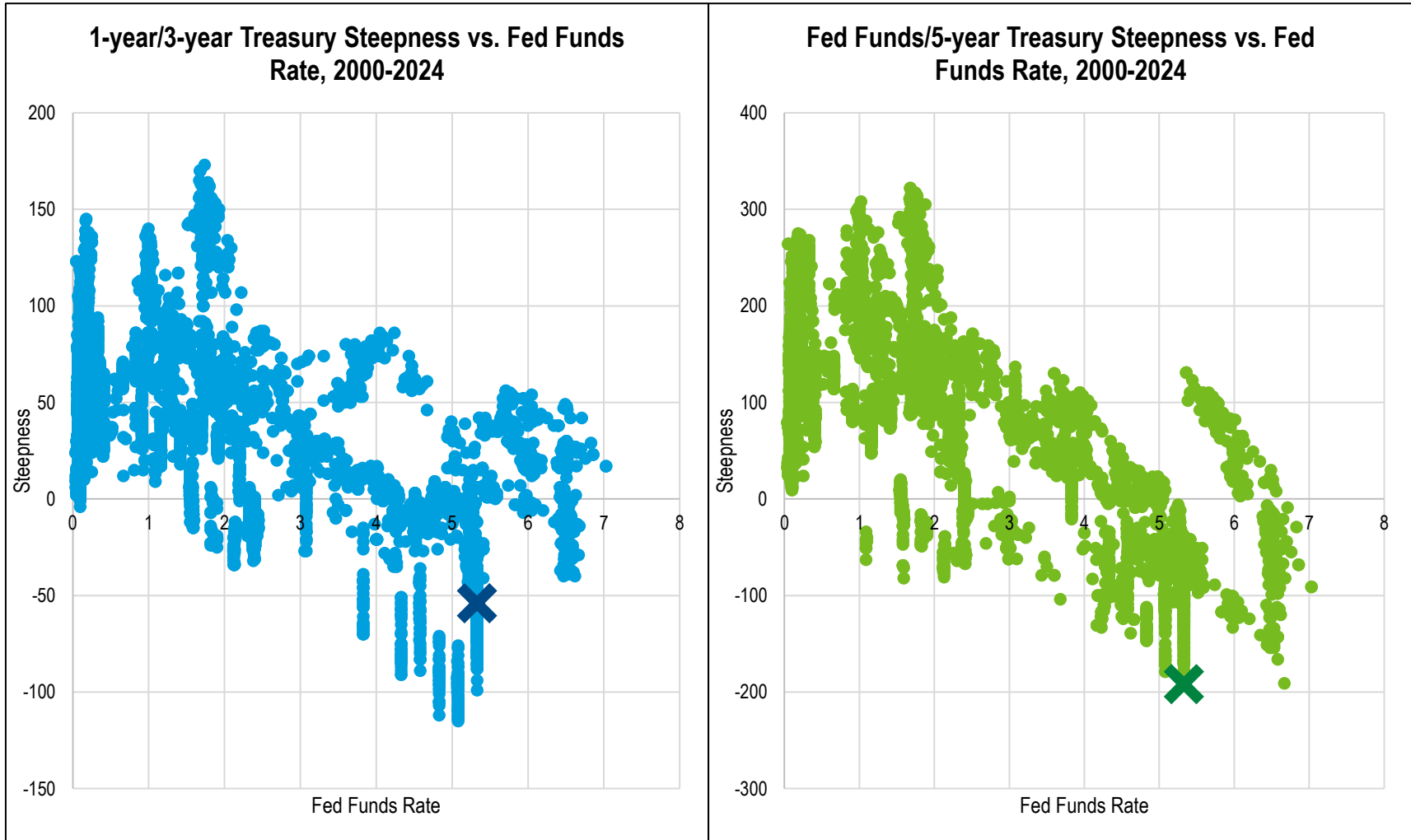
Emphasis appears to be shifting towards watching the unemployment rate as opposed to monitoring inflation trends.



Source: U.S. Bureau of Labor Statistics, FHLBank Boston

# Has the Belly of the Curve Already Made Its Move?

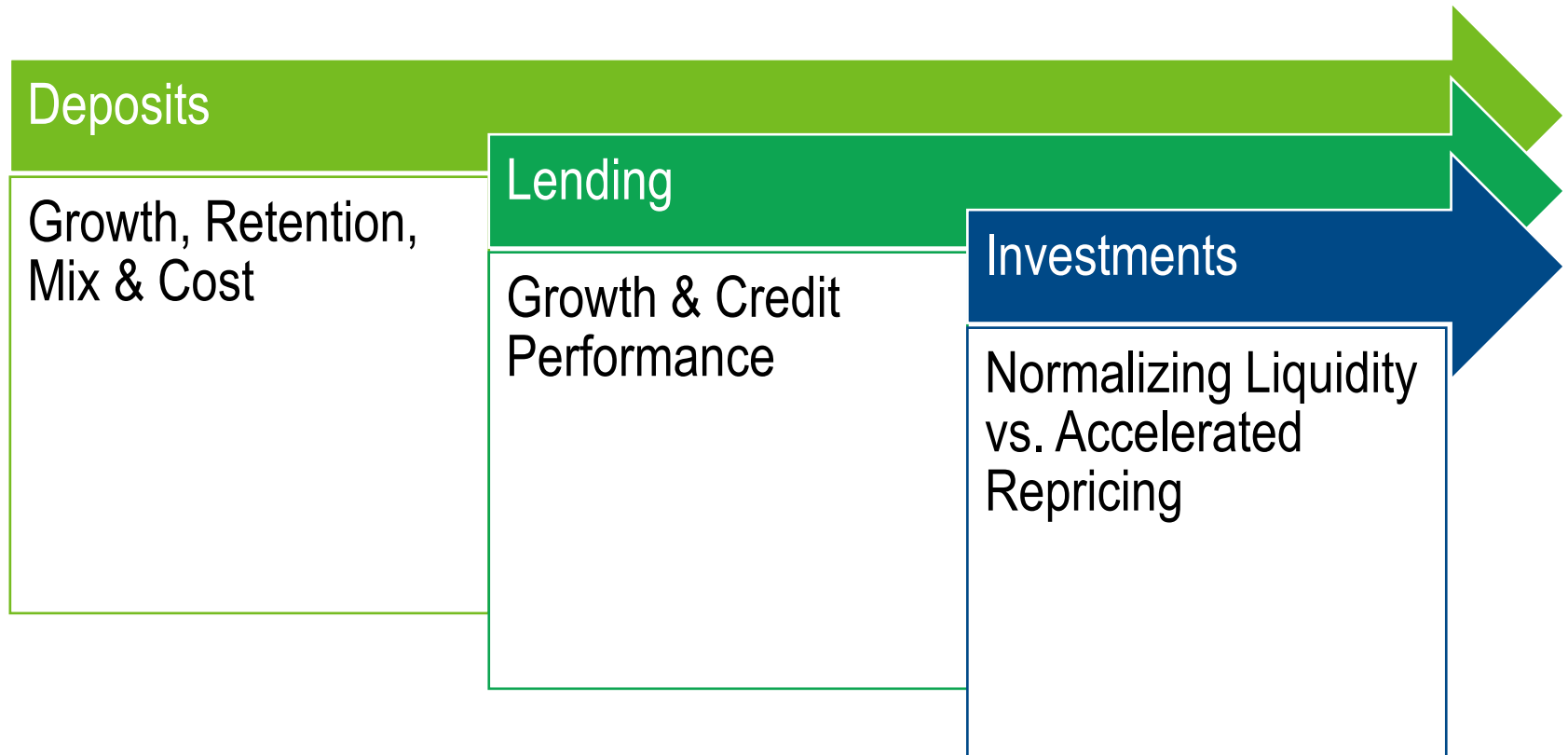
As is often the case, the belly of the yield curve anticipates the future path of short-term rates.



Source: U.S. Bureau of Labor Statistics, FHLBank Boston

# Impact on Loans, Deposits & Investments

How will the lower rate environment influence both existing exposures as well as prospective opportunities?



# Stay Short or Go Long? What Does the Yield Curve Tell Us?



# Market Rates Moved Down in 2019

Term rates moved in lock-step with overnight rates throughout 2019 and the downrate environment benefited members staying short.

Daily Cash Manager Advance vs. Short Term Advance Rates



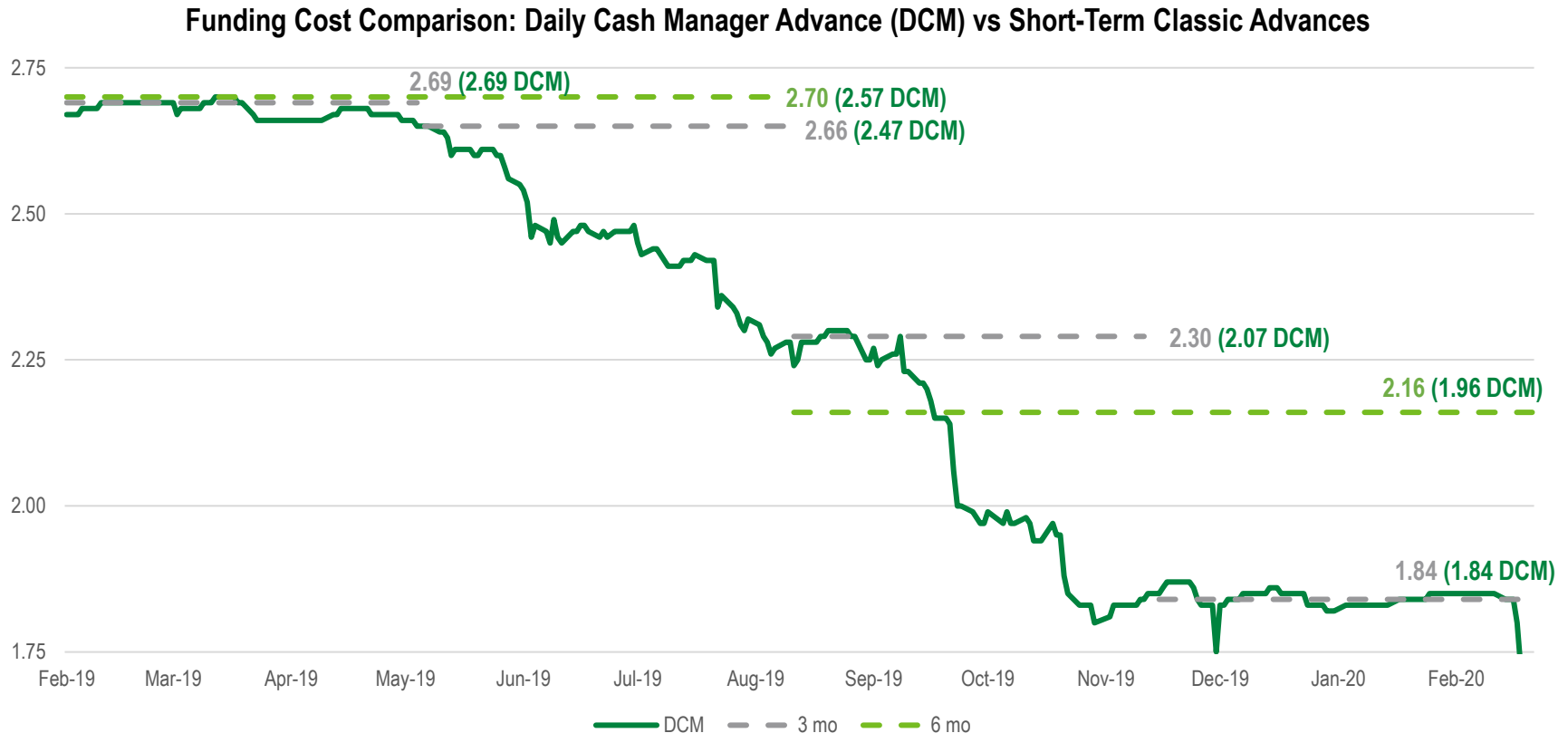
## Summary

- Short-term rates declined almost 100bps over eight months
- 3-month and 6-month advance rates followed the DCM rate path closely
- 9-month and 12-month advance rates experienced steeper drops throughout the eight months, but eventually met shorter-term rates

Source: FHLBank Boston

# Rolling Short Outperformed in 2019

Members utilizing DCM experienced lower average borrowing rates than locking-in other short-term advance options.



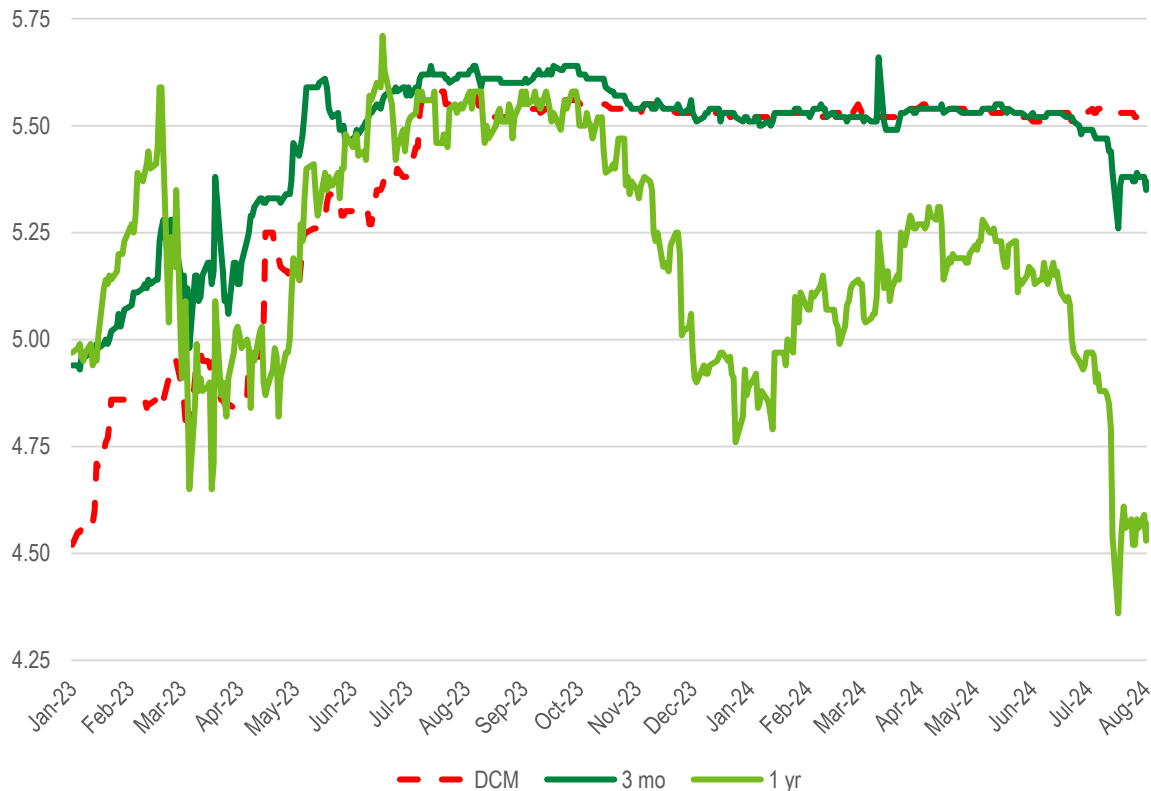
- At each funding point, DCM's average rate continued to be lower than other short-term advance options
- Rolling 3-month advances would have **incurred** an additional 42bps
- Rolling 6-month advances would have **incurred** an additional 33bps

Source: FHLBank Boston

# Market Rates Rose Throughout 2023

Decline of longer-term rates and steady pace of overnight rates provided cost savings opportunities for members.

Daily Cash Manager Advance vs. Short-Term Advance Rates



## Summary

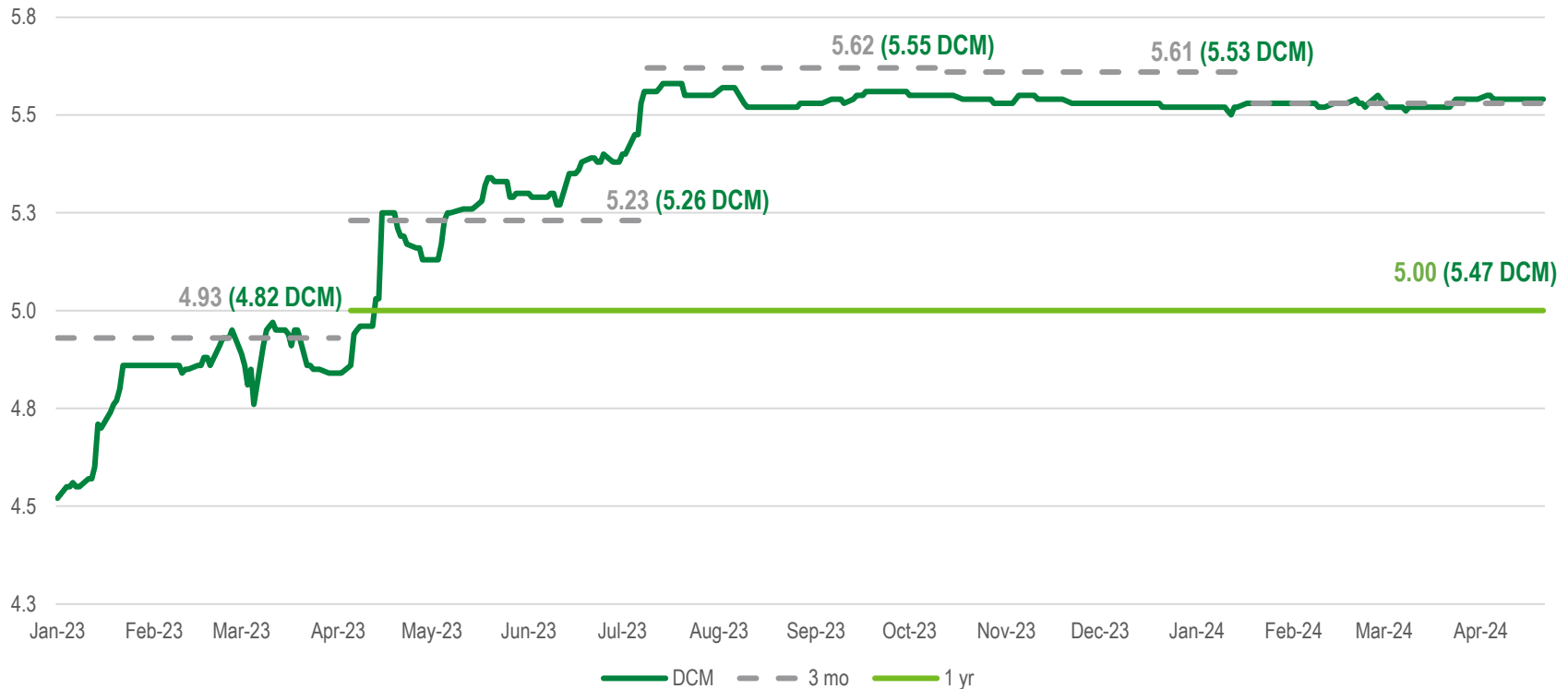
- Rates rose roughly 100 bps in seven months to start 2023
- As the Treasury yield curve inverted, longer-term rates began to decrease
- Throughout the remainder of 2023 and through 2024, DCM rates remained flat, just above 5.5%
- Longer-term rates of 9-month and 12-months dropped roughly 100bps over ten months

Source: FHLBank Boston

# Extending Funding Outperformed in 2023

Given that the market priced in rate cuts that ultimately never materialized, longer-term funding proved favorable in 2023.

**Funding Cost Comparison: Daily Cash Manager Advance (DCM) vs Short-Term Classic Advances**



- During a period of yield curve inversion, members benefit by utilizing longer-term advances
- Rolling 3-month advances would have **incurred** an additional 23bps
- Rolling 6-month advances would have **saved** 47bps

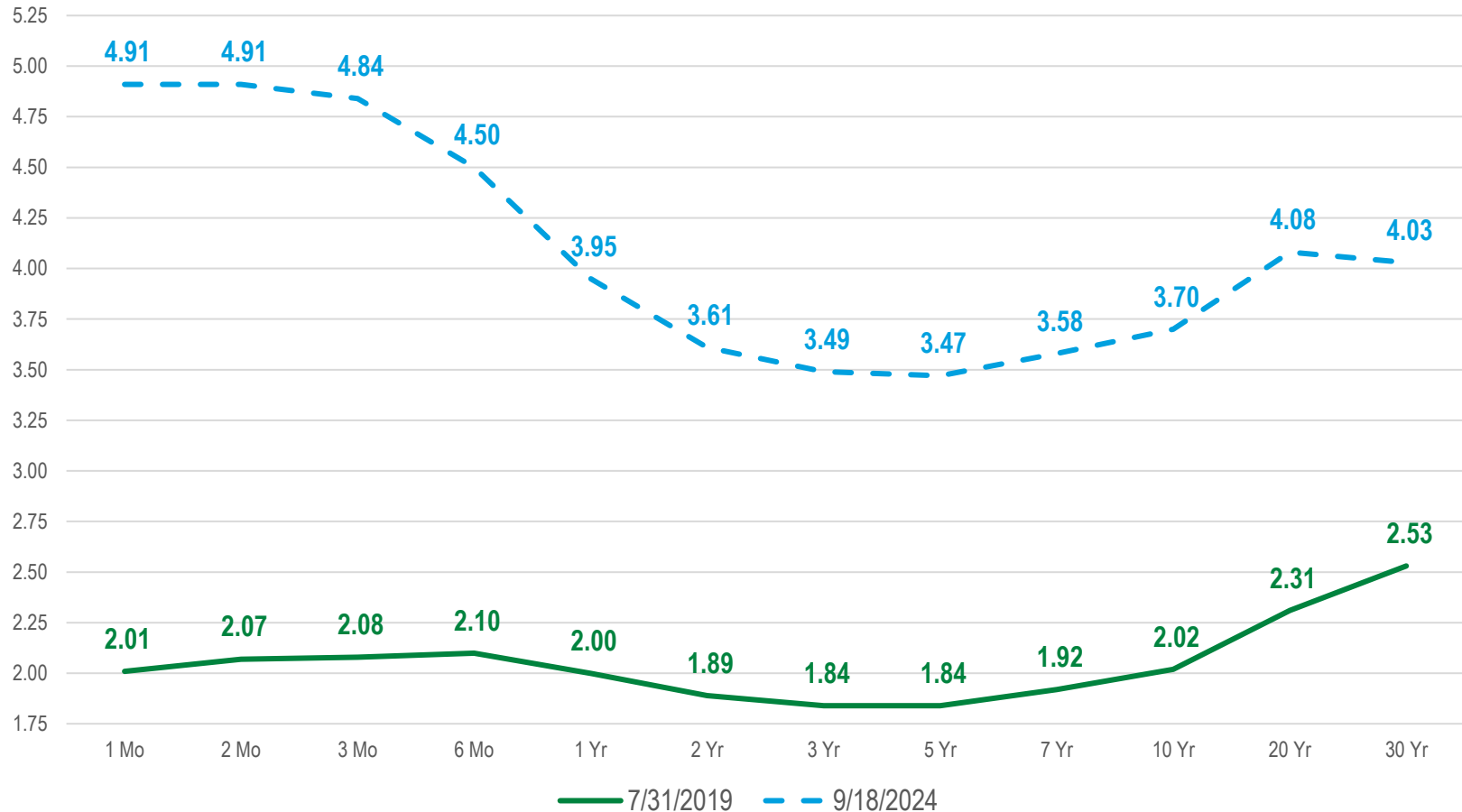
Source: FHLBank Boston



# 2024's Yield Curve is Significantly More Inverted than 2019

Today's yield curve is inverted by more than 100 basis points, where in 2019 that spread was less than 25 basis points.

Treasury Yield Curve Following the First Rate Cut



Source: Federal Reserve Bank of St. Louis

# Funding Strategies

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# Strategic & Tactical Balance

Interest rates are changing, and so too are balance sheet concerns. The appeal of specific strategies, as is often the case, will be largely dependent on the fit with the unique needs on an institution-by-institution basis.



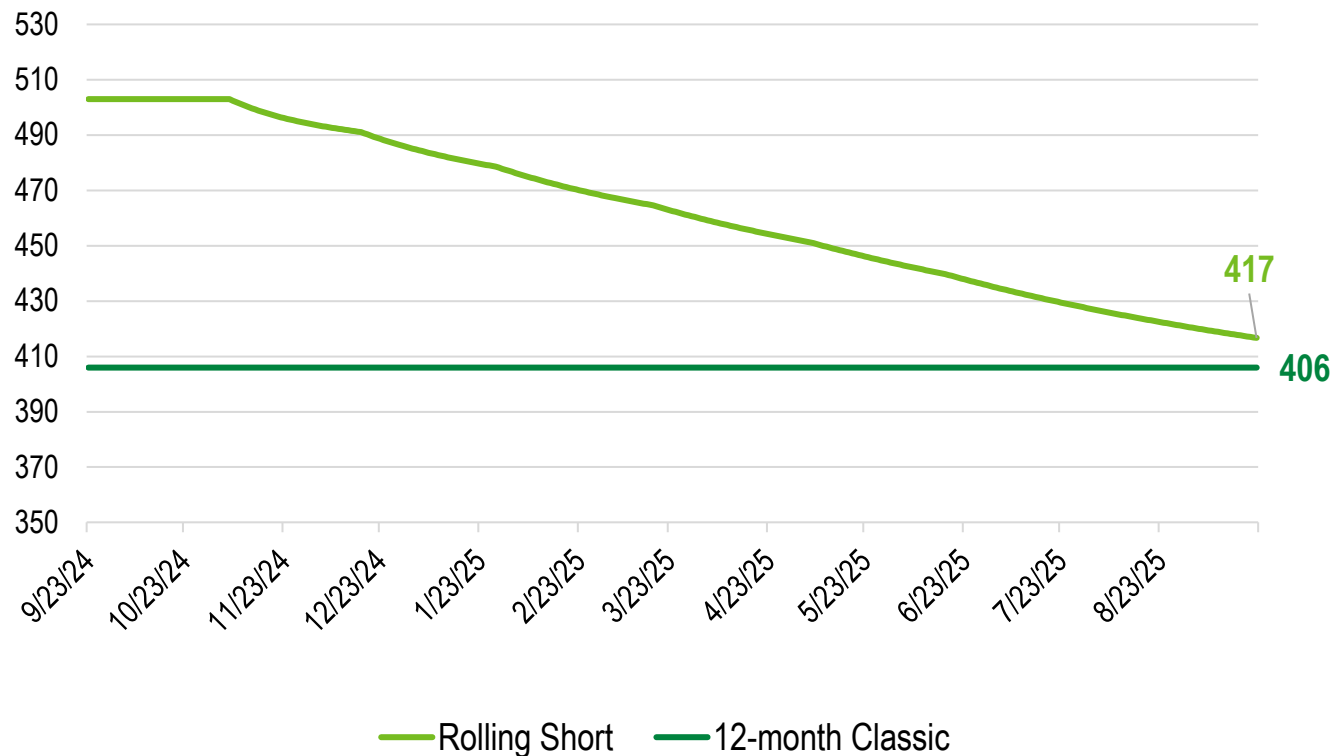
# Scenario Analysis: Base Case

Even with rate cuts pending, classic longer-term advances may cost less over the next year

## Rate Cut Assumptions

November	25
December	25
January	25
March	25
May	25
June	25
July	0
September	0
<b>Total</b>	<b>150</b>

## Scenario Analysis: Rolling Funding Costs



Source: FHLBank Boston

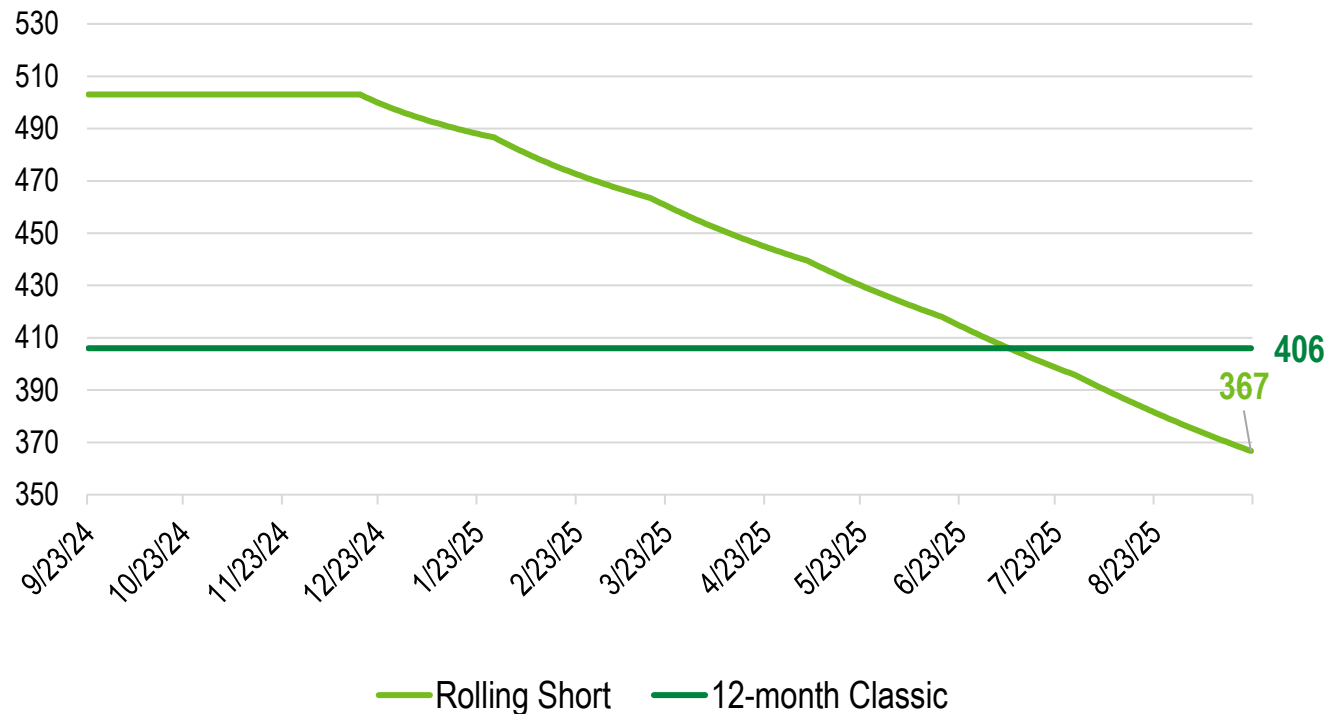
# Scenario Analysis: Aggressive Rate Cuts

In this scenario, rate cuts come sooner and in a greater amount than what is currently being forecast.

## Rate Cut Assumptions

November	0
December	50
January	50
March	50
May	50
June	50
July	50
September	0
<b>Total</b>	<b>300</b>

## Scenario Analysis: Rolling Funding Costs



Source: FHLBank Boston

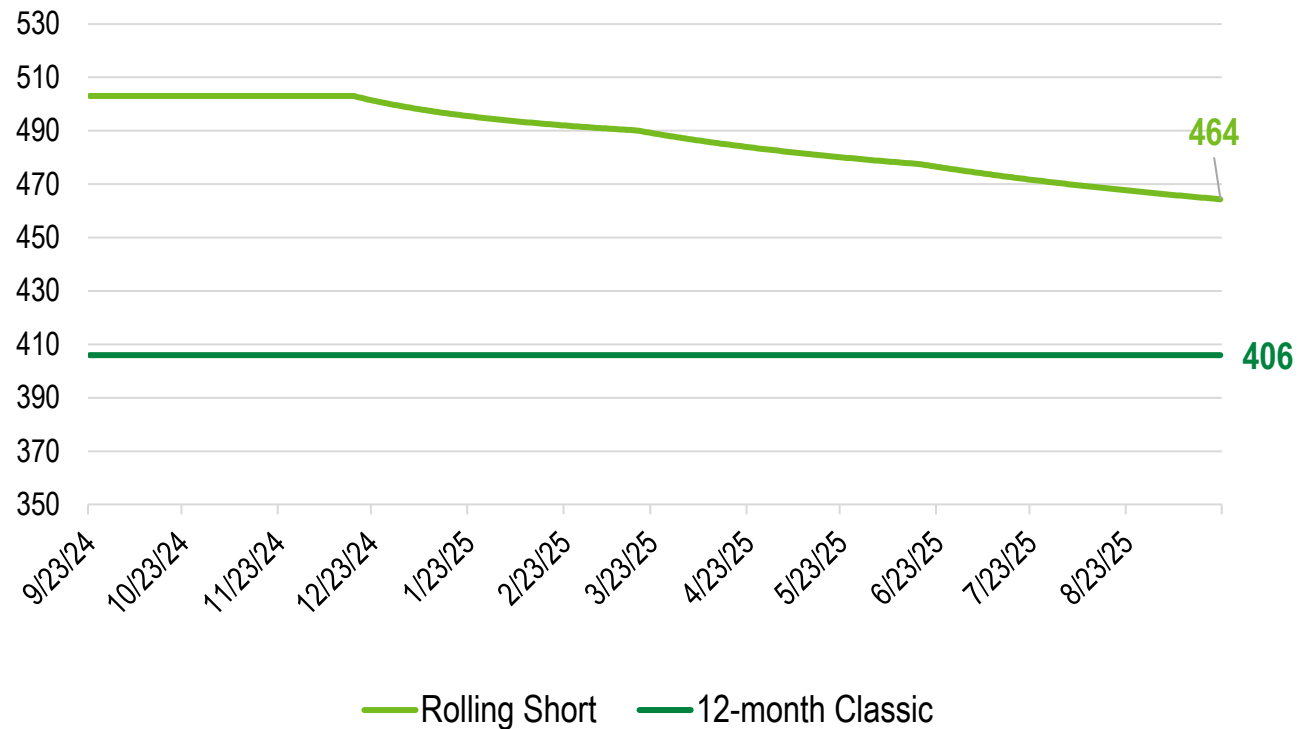
# Scenario Analysis: Soft Landing

In this scenario, the Fed doesn't cut rates at the pace or magnitude that is currently implied.

## Rate Cut Assumptions

November	0
December	25
January	0
March	25
May	0
June	25
July	0
September	0
<b>Total</b>	<b>75</b>

## Scenario Analysis: Rolling Funding Costs

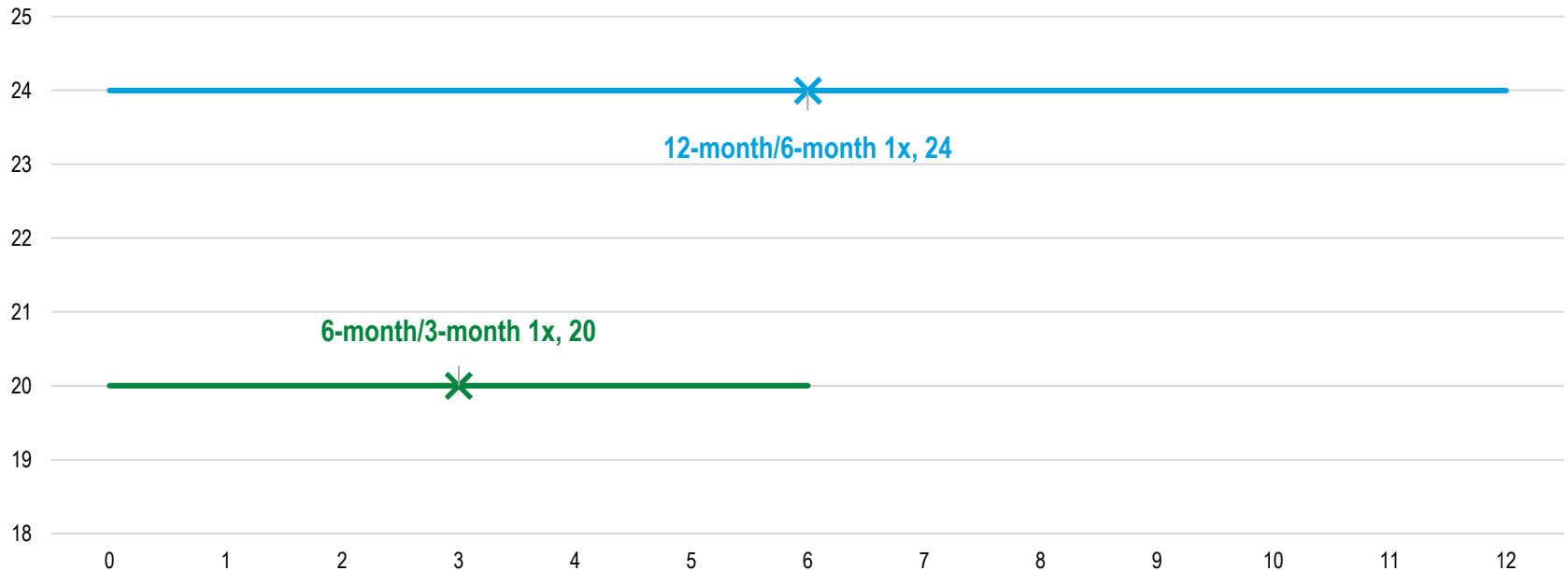


Source: FHLBank Boston

# Callable SOFR-Indexed Floater Advance

Floating rate funding with the ability to pay down the advance early with no prepayment fee.

## Callable SOFR-Indexed Floater Advance Spreads



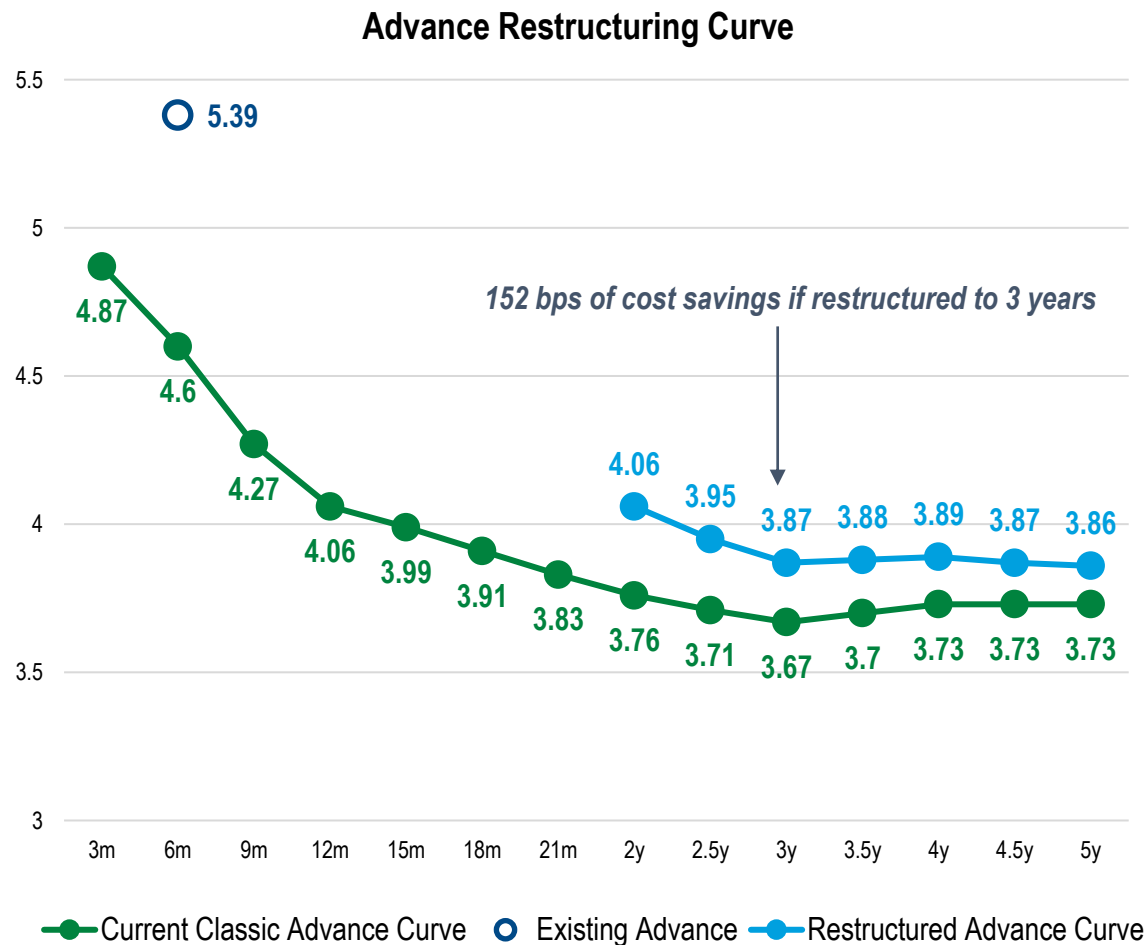
## Potential Drivers for Exercising the Option on a Callable SOFR-Indexed Floater Advance

Outperformance on loan growth	Underperformance on deposit growth	Acceleration in prepayment speeds	Sales of investments or loans	Inclined to shift into a long-term fixed rate advance
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Source: FHLBank Boston

# Advance Restructures

The path of interest rates has created opportunities for modifying existing borrowings to reduce risk and enhance margin.



## Advance Restructuring Example

Member has an existing advance with 6 months left to go, initiated originally when rates were higher as an 18-month advance at a rate of 5.39%.

Because rates have moved lower, there is now an implied prepayment fee of ~0.60%.

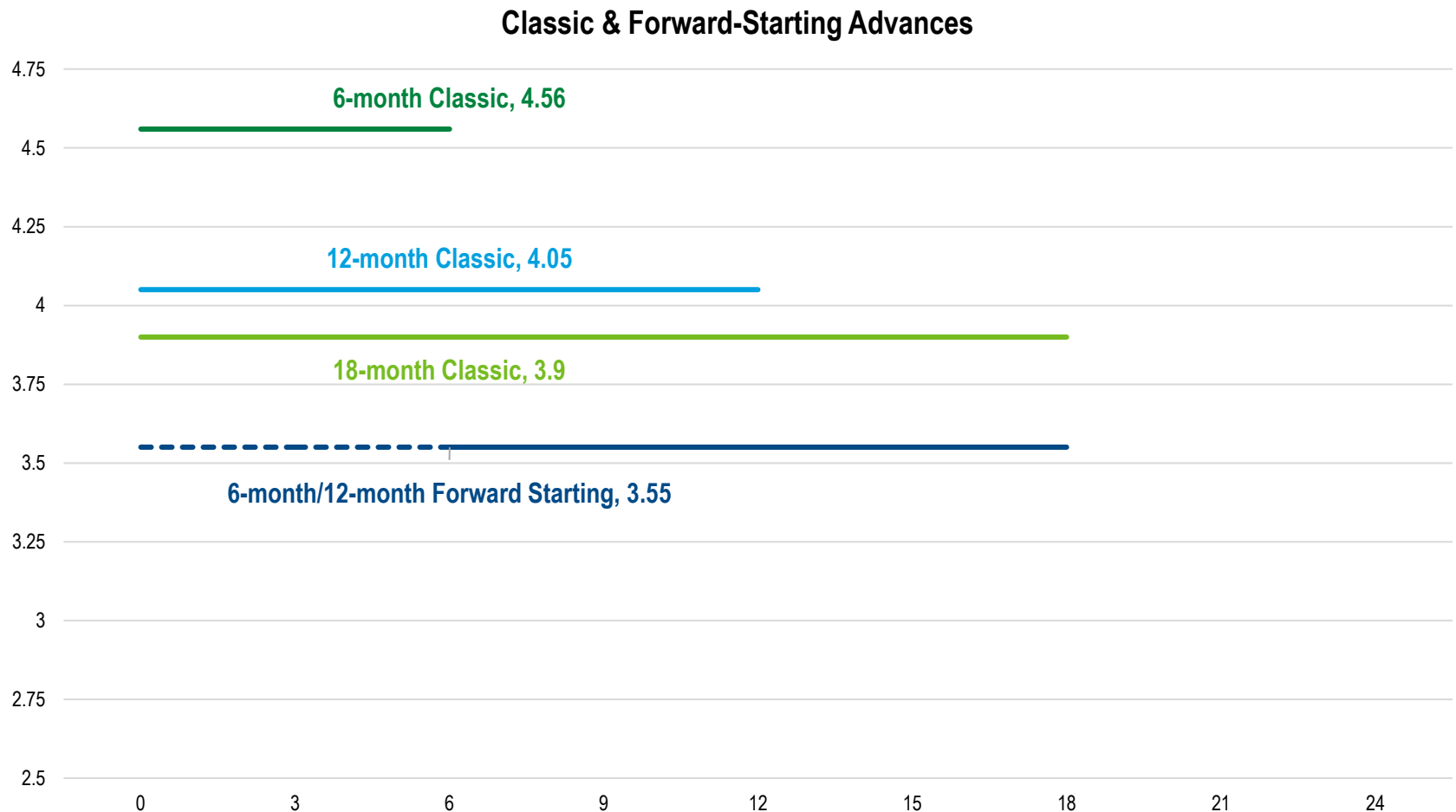
- Restructuring the advance allows the member to:
- Extend liability duration
  - Lower cost of funds
  - Not add additional borrowings
  - Do the above with no one-time hit to the income statement

Source: FHLBank Boston



# Forward Starting Advances

The inverted yield curve creates the potential for forward-starting funding that is priced below current levels, incorporating market expectations for the path of short-term interest rates.

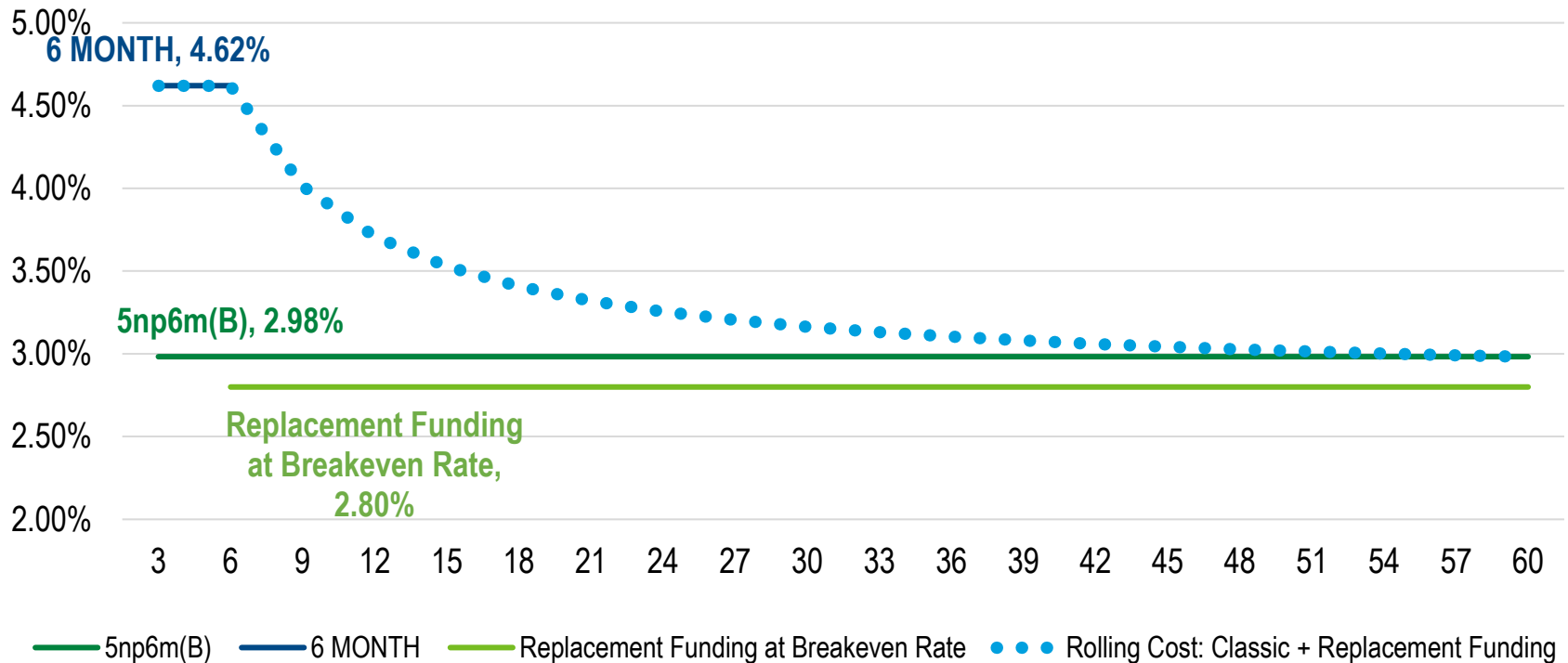


Source: FHLBank Boston

# HLB-Option Advance

With the move in market rates, coupon rates for HLB-Option Advances have moved lower- and so have the breakeven rates for comparing the advance vs. matched lockout Classic Advances.

## Breakeven Analysis



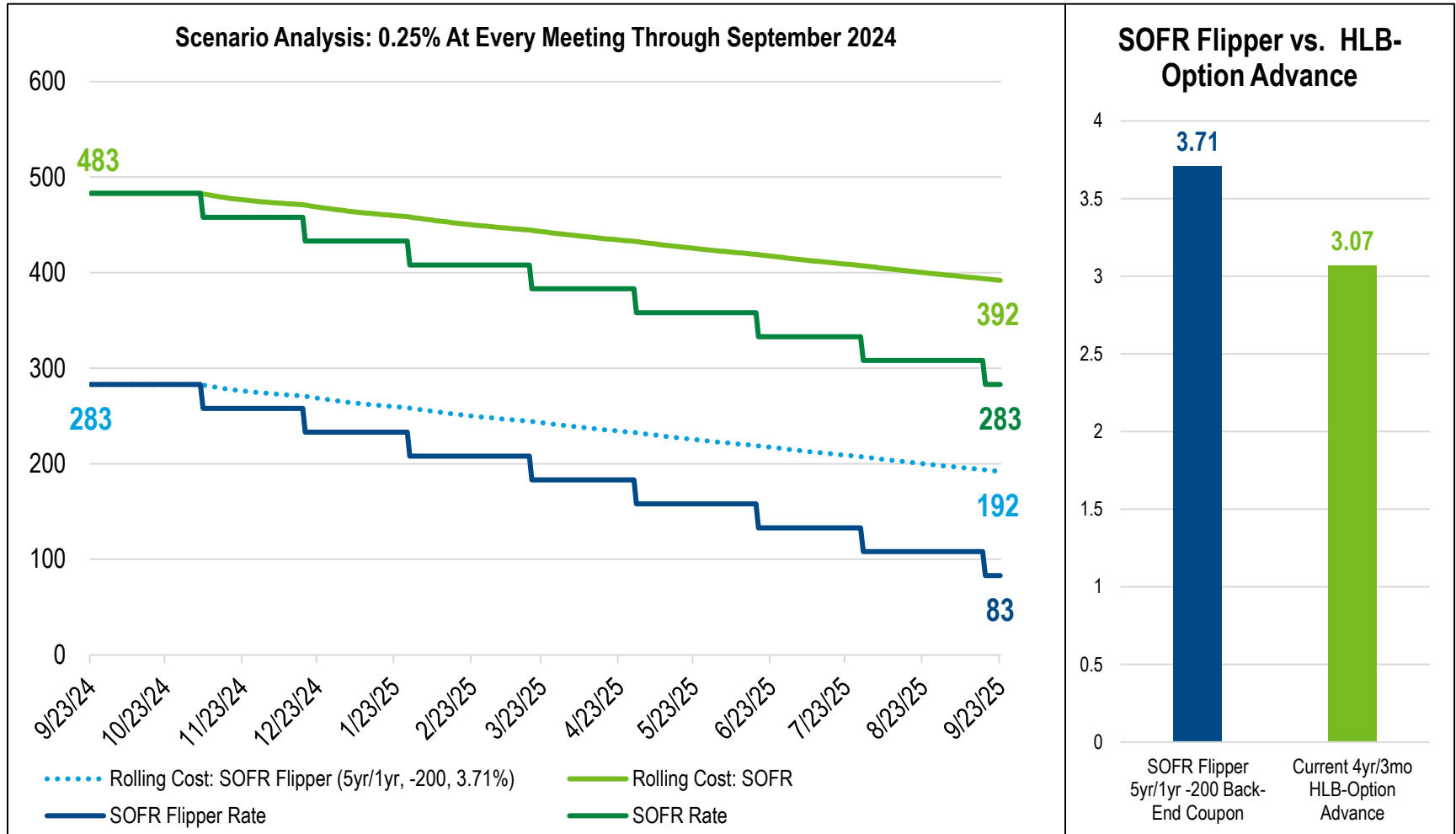
## Scenario Analysis & Stress Test

If market rates go DOWN and the HLB-Option Advance EXTENDS, what rate would the replacement funding need to be for the Classic + Replacement strategy to equal the coupon of the HLB-Option?

Source: FHLBank Boston

# SOFR Flipper Advance

The float to fixed feature of the SOFR Flipper Advance would likely benefit from scenarios where short rates go down and the intermediate part of the yield curve is flat to higher.

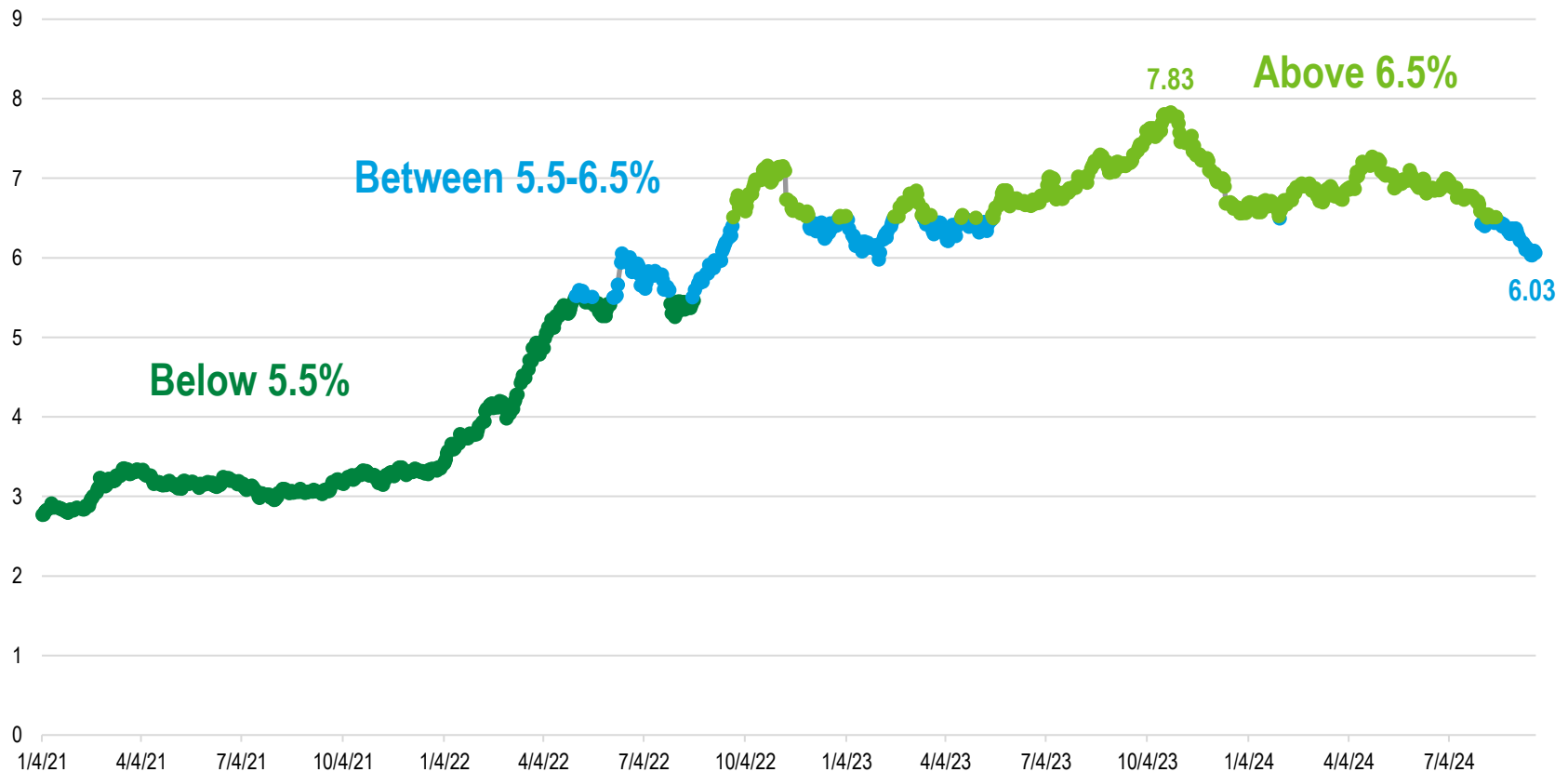


Source: Federal Reserve Bank of New York, FHLBank Boston

# Seasoned Loan Sales

The rally in long-term rates has softened some of the unrealized losses in low-coupon mortgages, and it remains to be seen if there was enough volume in mid- and high-coupon issuance to lead to a meaningful acceleration in prepayments.

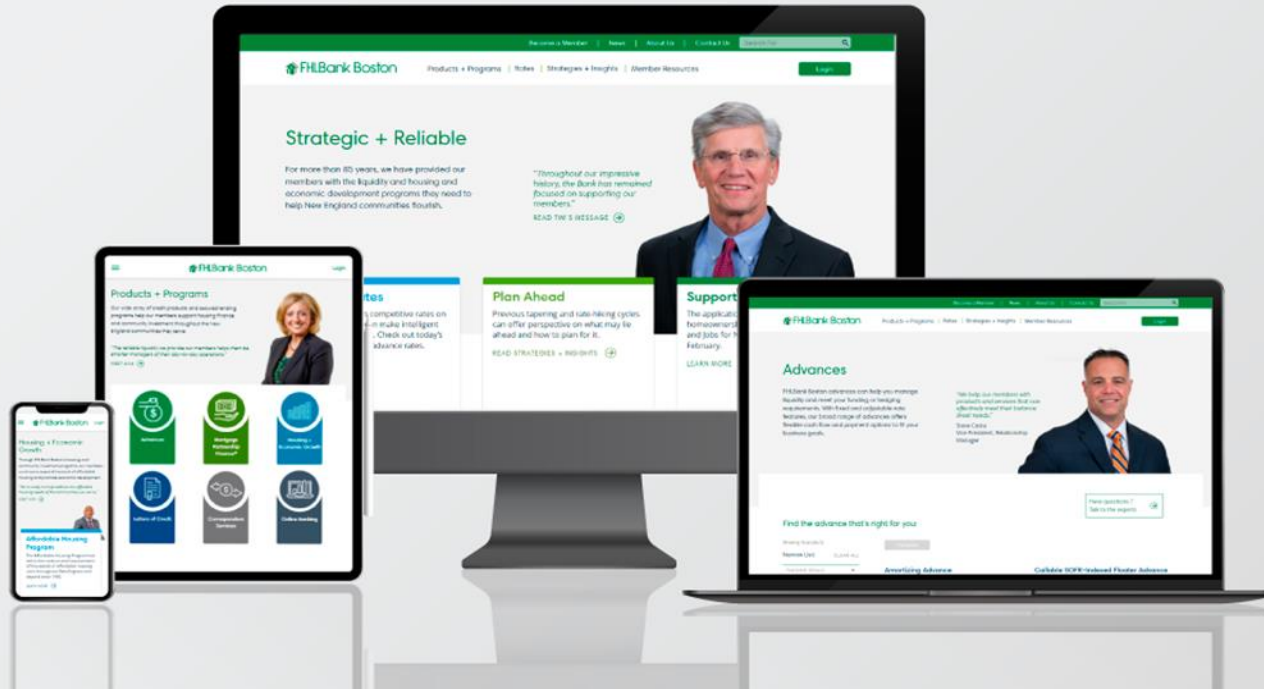
## 30-Year Mortgage Rate



Source: Optimal Blue, Federal Reserve Bank of St. Louis, FHLBank Boston

# Questions?





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# Thank You



Andrew Paolillo

Andrew.Paolillo@fhlbboston.com

617-292-9644



Derek Hamilton

Derek.Hamilton@fhlbboston.com

617-292-9680

