



● UVA'S ECONOMIC INSIGHTS

Reverse Repos in 2025: When “Near Zero” Signals Systemic Vulnerability

 By Joshua Barone | Oct 9, 2025

While markets remain preoccupied with CPI surprises, payroll revisions, and the Fed’s next incremental cut, the deeper risks are unfolding in the plumbing of the financial system. The Federal Reserve’s **overnight reverse repurchase agreement facility (ON RRP)**—once a multi-trillion dollar liquidity absorber—has been reduced to near zero. This is not a benign milestone of normalization. It is the loss of a systemic stabilizer at a moment when deficits are surging, banks are fragile, and foreign demand for Treasuries is weakening.

The Role of Reverse Repos

At a glance, the ON RRP is straightforward: the Fed sells Treasuries overnight to counterparties such as money market funds, GSEs, and banks, with an agreement to repurchase them the following day. Counterparties earn the **RRP award rate** (currently ~4.00%), while the cash they provide is temporarily removed from circulation.¹

Yet the implications are far deeper. The facility enforces a floor under overnight interest rates, preventing repo and fed funds from trading below the policy corridor during periods of excess liquidity. It allows the Fed to absorb large surpluses of cash flexibly, without permanently shrinking its balance sheet. It shapes competition between banks and MMFs for institutional cash, thereby reallocating liquidity across sectors. And it acts as a **safety valve**—absorbing surpluses that might otherwise distort collateral markets or collapse rates into negative territory.

The ON RRP also sits at the junction of monetary and fiscal policy. When bill yields exceed the RRP rate, MMFs redirect liquidity into financing Treasury deficits rather than parking funds with the Fed. That trade-off matters more in 2025 than in past cycles because foreign sovereign demand—once the anchor of Treasury stability—is softening. Japan, the largest foreign creditor to the U.S., holds over **\$1.1 trillion in Treasuries** (Reuters, May 22, 2025). If Japanese institutions reduce holdings as domestic yields rise, the burden of absorbing U.S. debt issuance will fall even more heavily on domestic markets.

The Vanishing Buffer

The collapse of the RRP to near-zero balances is frequently described by policymakers as a sign of “normalization.” In this view, the facility was a temporary mechanism for unusual times, and its exhaustion proves conditions have normalized. But such an interpretation underestimates how central the RRP has become. Its disappearance fundamentally alters how shocks propagate through the financial system.

When balances were large—peaking above \$2.5 trillion in 2023—the RRP absorbed surplus cash, shielding reserves from volatility and allowing the Fed to maintain rate control.³ Now, every marginal liquidity shock, whether from heavy Treasury issuance, quarter-end balance sheet repositioning, or foreign capital flows, falls directly on reserves.

As Reuters reported on August 29, 2025:

“Cash flowing into the central bank’s overnight reverse repo facility has fallen very close to zero for the first time in years. The sharp decline in usage marks a new stage in the Fed’s balance sheet drawdown, but it has also raised worries among market participants about the availability of liquidity. With the RRP facility drained, any additional pressure on cash markets will now fall directly on reserves. That could make short-term funding more volatile and expose the financial system to sudden strains.”

Bloomberg added days later (Sept. 2, 2025):

“The [RRP] facility has dwindled to levels last seen before the pandemic ... Once it is effectively empty ... cash demand bears directly on reserves, leaving repo markets more vulnerable to swings in Treasury issuance or quarter-end dynamics.”

History illustrates why this matters. In September 2019, with no comparable facility in place, repo rates spiked from ~2% to as high as 10% overnight after corporate tax payments and large Treasury settlements unexpectedly drained reserves. The system seized, and the Fed was forced into emergency operations, pumping tens of billions daily into repo markets until stability returned.

By contrast, in 2021–22, when pandemic stimulus left trillions in excess cash, the RRP absorbed those surpluses and prevented repo rates from collapsing below zero. The facility provided a floor in one episode and could have provided a ceiling in the other. Its absence today leaves reserves alone to bear volatility at a time when QT is steadily reducing them.

The lesson is clear: funding markets appear calm until buffers run thin, at which point even modest liquidity events can trigger outsized disruptions. In 2025, with record Treasury issuance, softening foreign demand, and banks already weakened by deposit outflows and unrealized losses, the absence of the RRP raises the probability of another sudden liquidity seizure.

Why It Matters Beyond Plumbing

The consequences radiate across fiscal, banking, and global channels.

On the fiscal side, with deficits entrenched above 6% of GDP, Treasury issuance continues at historic scale. Foreign holdings of U.S. Treasuries remain large—over **\$9 trillion as of Q2 2025** (U.S. Treasury data)—but have stopped growing. Japan’s \$1.1 trillion exposure is pivotal. As Japanese yields rise and domestic financial pressures mount, the incentive to repatriate capital grows, leaving U.S. markets more vulnerable at the long end of the curve.

For banks, the loss of deposits to MMFs and the weight of HTM losses are twin vulnerabilities. Higher deposit rates squeeze margins, while latent losses become solvency risks if asset sales are forced. This dynamic—exposed in the collapse of Silicon Valley Bank in 2023—remains latent but unresolved. With no RRP buffer, deposit flight or auction-related liquidity shocks could bring such stresses to the surface quickly.

Meanwhile, money markets become more fragile. Quarter-end flows, Treasury auctions, and collateral imbalances that were once muted by the RRP will now manifest directly in repo spreads and reserves. Each episode of volatility has the potential to spill into broader credit and risk premia.

The Outlook

The path forward hinges on three interlinked forces: heavy Treasury issuance, fragile bank balance sheets, and international shifts in Treasury demand.

Domestic liquidity is already tight. The **M2 money supply** is growing only modestly—around 4–5% year-over-year—and in real terms, adjusted for inflation and debt expansion, it is effectively stagnant.² Historically, flat or contracting real money growth relative to GDP has preceded downturns. This points to a private sector already constrained before any additional stress emerges from markets.

Banks, especially regional and mid-sized institutions, remain at risk of liquidity-driven solvency events if deposit outflows accelerate. Repo markets, deprived of the RRP’s stabilizer, are primed for greater auction-driven volatility.

International dynamics heighten the risk. Japan’s \$1.1 trillion holdings anchor the long end of the curve, but policymakers have hinted they could leverage Treasuries as a strategic tool in trade talks (Reuters, May 1, 2025). Although officials later denied any intent to weaponize holdings (Reuters, May 4, 2025), the episode underscores how fragile investor confidence can be if foreign demand shifts even marginally. A material pullback by Japanese institutions would steepen the curve, raise term premia, and export tighter conditions globally.

Conclusion

The exhaustion of the ON RRP is not normalization—it is the removal of a systemic stabilizer. Liquidity imbalances that once settled quietly on the Fed’s balance sheet now spill directly into reserves, repo markets, and bank balance sheets. With Treasury issuance elevated, M2 growth stagnant, and banks nursing large unrealized losses, the domestic system already looks brittle.

Layered on top of that is a shifting global environment. Japan, holding over \$1.1 trillion in Treasuries, remains the largest foreign creditor. Should its institutions begin to unwind those positions, the result would be higher long-term yields, steeper curves, and stress rippling across dollar funding markets worldwide.

In 2019, the absence of buffers produced an overnight repo shock. In 2021–22, the presence of the RRP prevented one. In 2025, with the buffer drained and foreign official demand in question, the margin for error has narrowed to the thinnest in years. The key question is no longer whether the Fed cuts 25 or 50 basis points. It is whether the system can withstand the next liquidity shock without cascading into disorder.

Joshua Barone

Josh Barone is an investment adviser representative with Savvy Advisors, Inc. (“Savvy Advisors”). Savvy Advisors is an SEC registered investment advisor. The views and opinions expressed herein are those of the speakers and authors and do not necessarily reflect the views or positions of Savvy Advisors. Information contained herein has been obtained from sources believed to be reliable, but are not assured as to accuracy.

Material prepared herein has been created for informational purposes only and should not be considered investment advice or a recommendation. Information was obtained from sources believed to be reliable but was not verified for accuracy. All advisory services are offered through Savvy Advisors Inc., an investment advisor registered with the Securities and Exchange Commission (“SEC”).

Reference:

1 https://www.newyorkfed.org/markets/rrp_faq

2 <https://seekingalpha.com/article/4792374-m2-hits-record-highs-what-return-of-easy-money-means>

3 <https://home.treasury.gov/system/files/261/FSOC2023AnnualReport.pdf>