

GRANT'S

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Putting the Fed in play

It was a circumspect Jerome Powell who last week addressed the annual summertime get-together of the International Society for the Propagation of Paper-Money Inflation (which AI better recognizes as the Jackson Hole Economic Policy Symposium).

"In the near term," the Federal Reserve chairman told his fellow central bankers, "risks to inflation are tilted to the upside, and risks to employment to the downside—a challenging situation. When our goals are in tension like this, our framework calls for us to balance both sides of our dual mandate."

Yes, the chairman allowed, the funds rate is 100 basis points "closer to neutral" than it was a year ago, 4.33% not 5.33%, and the unemployment rate is low and stable. It's a state of things, said he, that "allows us to proceed carefully as we consider changes in our policy stance." With policy in "restrictive territory," the "baseline outlook and the shifting balance of risks may warrant adjusting our policy stance."

Is Fed policy "restrictive" or even, as the chairman subsequently characterized it, "modestly [restrictive] in my view"? The words "in my view" are the giveaway. "Monetary policy," for all its invocation of higher mathematics, is a highfalutin guessing game. Whither the jobless rate? What surprises might the Consumer Price Index hold in store (with each datum, labor and price, under new MAGA management)? Or GDP, the rate of productivity growth, the dollar exchange rate? The central bankers are likely to be as surprised as the rest of us.

Powell's remarks, circumspect though they look on the page, point to a new, dovish tilt. Late in

July, less than a month before he spoke, the Federal Open Market Committee stood pat with the existing federal-funds target range of $4\frac{1}{4}\%$ to $4\frac{1}{2}\%$. The FOMC minutes allowed, as did Powell in Jackson Hole, that "the unemployment rate remains low [and] inflation remains somewhat elevated." A September cut, even a 25 basis-point nip-and-tuck, would constitute a statement of inflationary tolerance if not intent.

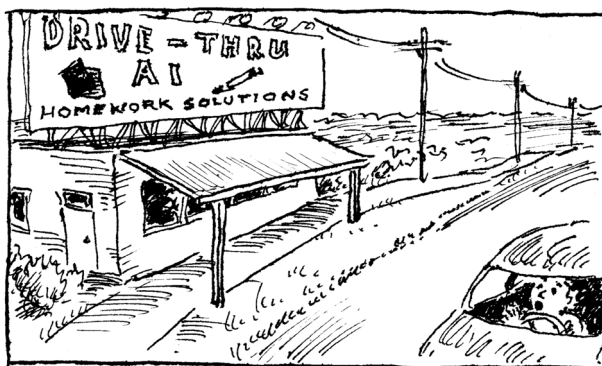
One could argue that the financial system cries out for it. Two decades of negative real money-market interest rates have raised up prodigious volumes of debt and vulnerable structures of leverage. Private equity, as well as the private credit that finances so much private equity, is straining to meet fixed charges even at today's not-towering rates of interest (see page 8). You know about the trials of America's public credit and the open secret of the Federal Reserve's negative net worth (except for the Treasury's open line of credit, the Bank of Powell, which has generated post-2022 operating losses of \$239.9 billion against capital of \$45.7 billion and would be as broke as the fallen institutions of the 2023 regional bank run).

You have likely heard, too, about Chicago's financial perils ("on the verge of fiscal collapse"—*City Journal*, Aug. 25).

Powell made no allusion to such things—no harking back, either, to William McChesney Martin's monetary punchbowl—in his Jackson Hole remarks, and, indeed, America's financial winds blow both hot and cold. The Dow made a closing high on Friday, Aug. 22, following the chairman's speech, with the other leading equity indices in fast pursuit. "Investors lose billions on penny stocks after 'pump and dump' scams multiply," the *Financial Times* reported on Aug. 19; "Downtrodden Biotechs Pile into Crypto to Win Back Wary Investors," Bloomberg reported on Aug. 25. In other speculative soundings, corporate credit spreads are holding at record tightness, the aforementioned debt difficulties notwithstanding, and Chamath Palihapitiya, the "SPAC King" of Covid-era memory, is back with a new blank-check offering, the American Exceptionalism Acquisition Corp.

Is, then, the Fed even "modestly restrictive"? Not by the reckoning of the Chicago Fed's National Financial Conditions Index, which registers it as strongly accommodative. Nor by the readings

of the so-called Taylor Rule for determining the ideal federal funds rate. Economists have sorted some 29 offshoots to the 1993 Taylor original by such measures as approaches to inflation, the natural rate of interest and resource gaps. The Federal Reserve Bank of Atlanta presents the 30 varieties in a heat map. "Only one version of the Taylor Rule actually suggests rates should be lower (and only by 25 basis points)," to borrow from the markets analyst James Bianco.



“Every other version suggests that the funds rate is either at the correct level or too low. One model suggests the funds rate should be above 6%.”

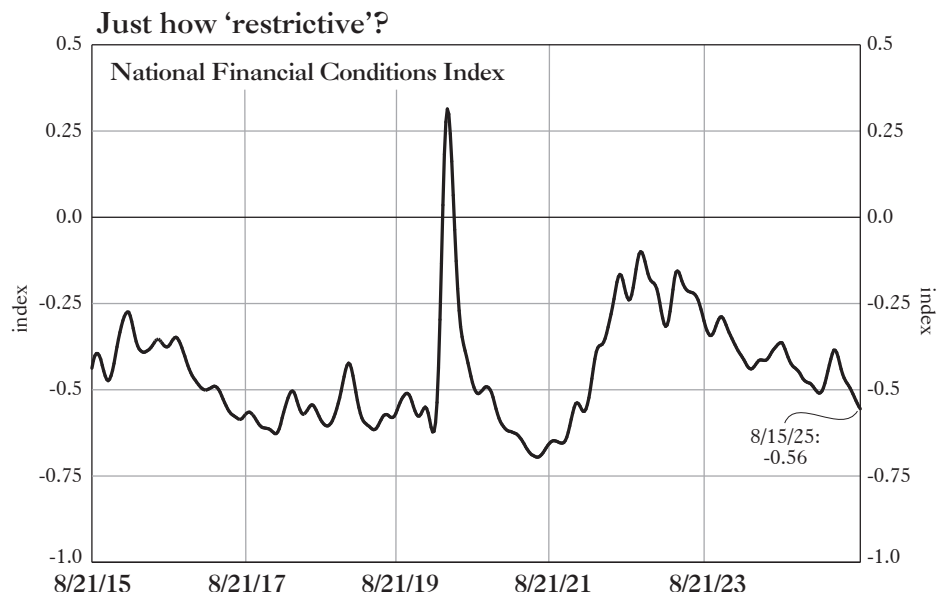
The White House and Eccles Building share little in the way of monetary thinking except for deep disdain toward the allied risks of asset inflation and malinvestment. Trump is not only a low-interest-rate man but also a bull-market, up-and-to-the-right man. Wealth is what he wants, for himself and his family and also, don't forget, for the United States. It drives him crazy that Powell has no eyes to see how fast a 1% or 2% funds rate would ignite engines of growth (without adverse repercussions to the CPI or the structure of production, as it almost goes without saying).

The commander-in-chief is not the first American to whistle past the graveyard of boom and bust. In 1838, Washington Irving, the celebrated author of works including the short stories “Rip Van Winkle” and “The Legend of Sleepy Hollow,” took the measure of the early damage of the Panic of 1837. “As to the excessive expansions of commerce and the extravagant land speculations,” he wrote from the home of his friend, the mogul John Jacob Astor,

I look upon these as incident to that spirit of enterprise natural to a young country in a state of rapid and prosperous developments; a spirit which, with all its occasional excesses, has given our nation an immense impulse in its onward career and promises to carry it ahead of all the nations of the globe. There are moral as well as physical phenomena incident to every state of things, which may at first appear evil but which are devised by an all-seeing Providence for some beneficent purpose. Such is the spirit of speculative enterprise which now and then rises to an extravagant height and sweeps throughout the land. It grows out of the very state of our country and its institutions and though sometimes productive of temporary mischief, yet leaves behind it lasting benefits.

AI could, indeed, fill that permanent transformative bill, though whether it's before or after the combustion of the data-center bubble is a topical question. The Powell Fed is opting for inflation—of assets, CPI or both—at the risk of some temporary mischief.

By the monetary rules, interest rates are too low, not too high, but credit Trump with understanding how a 5% or 6% funds rate would land in today's



source: Federal Reserve Bank of Chicago

ultra-leveraged American economy. And reciprocally debit him with ignorance of the probable consequences of the administration's bare-knuckle program to capture the central bank.

In Federalist Paper No. 69, Alexander Hamilton writes to convince his anglophobic fellow countrymen that the new office of the president of the United States would bear no likeness to the ancient throne on which sat George III. “The one,” Hamilton writes concerning the post that awaited George Washington, “can prescribe no rules concerning the commerce or currency of the country; the other [the British crown] is in several respects the arbiter of commerce [and of the power to coin money].”

We expect that President Trump will succeed in hammering short rates lower and that Mr. Market will have his way in pushing long yields higher. We likewise anticipate that, by the time the administration's ill-advised man-handling of the central bank has run its course, the president will be wishing he had spent more time in the White House library reading the works of the eponymous star of *Hamilton: An American Musical*.

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Inflation à la housing

Joel Wallenberg writes:

Easy money is the order of the day at the White House, and if the Federal Reserve won't oblige, the Federal National

Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) stand at the president's beck and call.

Each organization falls under the jurisdiction of the director of the Federal Housing Finance Agency, Bill Pulte, the Trump administration's perennial Employee of the Month. It was Pulte, you'll recall, who discovered the alleged mortgage irregularities of Federal Reserve Governor Lisa Cook and who, previously, had broken the news (which he announced on official FHFA letterhead) that Fed Chairman Jerome Powell was about to resign (he didn't).

And it was Pulte, too, who, in March, ousted 14 FHFA board members as well as Freddie's CEO, Diana Reid, and appointed himself chair of both Fannie and Freddie. He has since shaken up both institutions with a series of directives delivered via social media.

Among the most striking was his order of June 25, directing Fannie and Freddie to “prepare a proposal for [the] consideration of cryptocurrency as an asset for reserves” in their risk assessment for single-family home loans. Nor did the directive stipulate that a borrower-hodler convert his tokens into dollars to qualify for a federally subsidized loan.

For reference, mortgage reserve assets are liquid assets that a given borrower is required to hold, generally at a value that would allow the borrower to meet basic expenses plus mortgage payments for some months if he or she fell on hard times. Bitcoin in the raw will do.

Perhaps it's no surprise that William J. Pulte, namesake and grandson of the founder of the residential-home construction company PulteGroup, Inc., favors low rates and looser mortgage standards. Under his grandfather, the PulteGroup's net income rose by 4.95 times during George W. Bush's first term (2001–05). As pre-Millennial readers will recall, that administration encouraged home-buying through tax incentives, subsidized down payments and increased lending targets for Fannie and Freddie, before it suffered the consequences of the resulting bubble's pop (as did PulteGroup).

Somewhat less sensational is Pulte's July 8 directive, proclaimed on social media, that Fannie and Freddie are allowed, "effective today," to use either of two credit scores in their mortgage underwriting: the classic FICO score, produced by the Fair Isaac Corp., or the newer VantageScore 4.0, a score produced by a joint venture between the big three credit reference agencies, Transunion, Equifax and Experian.

VantageScore 4.0 is designed to be more "inclusive" than classic FICO. It achieves this inclusivity by incorporating much of the same basic credit history as classic FICO while factoring in measures of total credit usage and mix, patterns of debt repayments over time and some non-debt financial metrics, such as a borrower's rent and utility payments. It relies more heavily than the legacy measure on very recent credit history, considering periods as short as one month, compared with the mandated six months of history for FICO. A study by the Housing Finance Policy Center shows that VantageScore produces scores that, on average, are 14 points higher than FICO on the 300–850 scale and 21 points higher for second-home buyers. It produces, as well, a larger proportion of scores in the higher ranges, above 760, than FICO does: 58.4% vs. 48.9%.

A July 30 research note by Erica Adelberg and Viktoriia Adamova of Bloomberg Intelligence states that the higher figures from VantageScore could add 10% to the population of eligible Fannie and Freddie borrowers and increase GSE MBS supply. Higher scores on average would likely make consumer borrowing costs go down, as the GSEs adjust rates by credit score band, which also increases the incentive to refinance. The fact that the GSEs now allow lenders free choice between the two scores when they deliver

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and our full roster of speakers.*

loans for guarantee will presumably also work in the borrowers' favor.

This arrangement places lenders in the enviable position of college applicants in 2009, when the advent of "score choice" gave high school students the option to choose their favorite SAT score, out of all SAT attempts, to accompany their college applications. Students who applied after the SAT's 2016 revision, which limited its mathematical topics and yielded higher average scores, held a double advantage over their pre-2009 peers. Could MAGA be warming to DEI after all?

The Bloomberg study does not suggest that VantageScore performs worse than FICO in predicting 90-plus-day delinquencies; indeed, it suggests, under some circumstances, that it performs better. However, the credit-risk assessment comes with a caveat: The study considered only a sample of mortgages that had been originated on the basis of sufficient FICO scores, so it does not reveal how many borrowers VantageScore might admit who are not creditworthy according to FICO. The VantageScore venture estimates that an additional 33 million borrowers who are currently not scoreable by FICO can be scored under VantageScore, and that its score will bring 13 million borrowers above the 620 lower credit score cutoff for Fannie and Freddie mortgages. According to the Federal

Reserve Bank of New York's Household Debt and Credit Report for the second quarter, the current tally of consumer mortgage accounts stands at 86.47 million, so 13 million new loans would represent a 15% increase nationally.

Taking the more conservative figure, if GSE mortgages (guaranteed and originated) were to climb by 10%, this would amount to an expansion of bank credit on the order of \$773.6 billion, or 3.5% of current M-2. A staunch monetarist would need no further convincing that such a development would lead to inflation, but that school of thought has been much tarnished by the largely sub-2% inflation rates of 2009–20, despite Quantitative Easings 1-through-3.

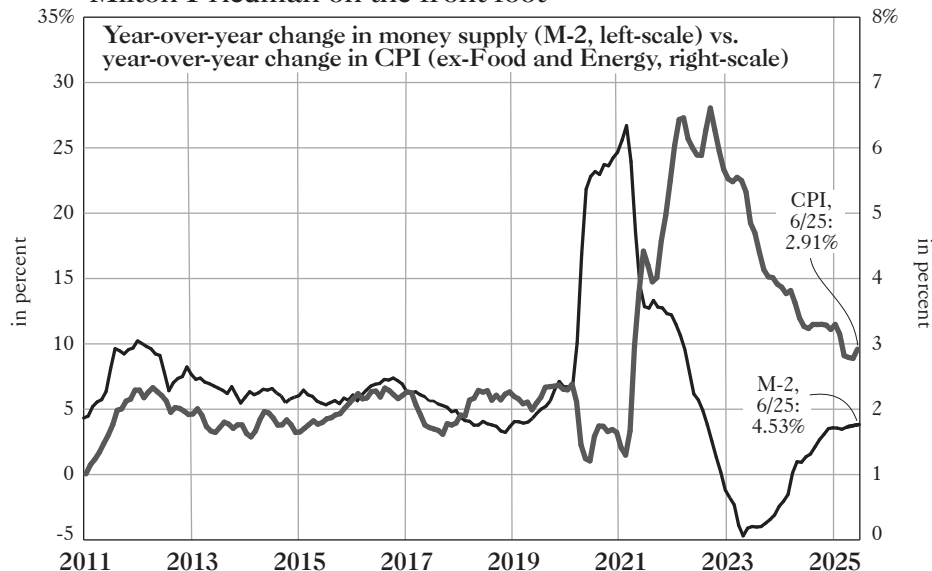
Still, monetarists may have had their revenge with QE4. An article by Christopher J. Neely, economist and senior economic policy advisor at the St. Louis Fed, shows that the relationship between M-2 and inflation has reasserted itself: Inflation, measured as the year-over-year change in the core Personal Consumption Expenditures index, has tracked M-2, at a lag, since 2020. Perhaps there has been a regime change?

Another way to consider the possible effects of greater mortgage borrowing is owners' equivalent rent. This Consumer Price Index item estimates the rent that owners theoretically would pay if they were renting their homes. It is the component that primarily passes home prices through to CPI, albeit imperfectly, and with the understanding that rising housing costs could certainly affect other CPI elements as well.

Suppose, for simplicity's sake, that a 10% rise in GSE mortgages proportionally increased housing demand, home prices and ultimately owners' equivalent rent. Fannie and Freddie's total guarantee book, including both held mortgages and MBS, sums to \$7.736 trillion according to their latest reports in June, or 59.8% of the New York Fed's reported \$12.94 trillion's worth of outstanding consumer mortgages. Thus, we might expect owners' equivalent rent to swell by 10% over a 59% share of the owner-occupied housing market, or 5.9% nationally. As the owners' equivalent rent component is weighted at 26.282% of the CPI calculation, such a scenario would increase total CPI by 1.57%.

An astute reader might object that housing supply will increase as well, and it's certainly likely. However, prices must rise first, as that is the mecha-

Milton Friedman on the front foot



source: Federal Reserve Bank of St. Louis

nism that motivates more building. In the meantime, additional funds with which to build will be finding their way into other components of the CPI. For housing supply to actually *deflate* CPI at a later date, removing all interim gains, another 2000s-style bubble would need to form (time will tell).

An August 18 report from Redfin News suggests that home prices are already on the upswing. “The median home sale price rose 1.4% year over year in July to \$443,867—the highest July level on record,” says Redfin, which attributes the figure to shrinking supply. Any rise in demand from buyers entering the market for the first time is set to exacerbate the current trend.

The inclusion of VantageScore 4.0 in GSE underwriting may expand the borrowing pool without increasing credit risk (as far as we know), but the same cannot be said of the inclusion of crypto assets in assessing borrower risk. Though Mr. Market has a notoriously short memory, we remind him (and Pulte) that bitcoin has a 30-day annualized volatility of 32.4%, down from 40.2% in February, but which has reached well over 100% in the past decade. The figure becomes 43.7% if one samples year-to-date 2025. In fact, the volatility of bitcoin’s volatility presents its own sort of problem in the assessment of mortgage reserve assets. Even if underwriters adjust the valuation of a hoard of bitcoins to incorporate price volatility, as well they should, it is not straightforward to arrive at a prudent estimate of that volatility.

But arguments for prudence in home-loan policy are likely to fall on deaf ears in the White House, as was the case in the early 2000s. Treasury Secretary Scott Bessent specifically mentioned the goal of boosting the housing market in remarks to CNBC on Aug. 19, arguing that a “big [rate] cut” by the Fed would ultimately *lower* inflation, by producing a boom in home construction. We humbly suggest the secretary has left out a step somewhere.

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A use case for AI

James Robertson, Jr. writes:

An Aug. 18 revelation from the Massachusetts Institute of Technology found that 95% of surveyed companies saw zero return on their generative AI investments. In quick reaction, the Nasdaq Composite plunged by 2%.

Oddly enough, the lusterless business of customer support and back-office operations was the standout exception. Though sales and marketing capture fully half of corporate AI budgets, it was customer service and document processing that delivered the most dramatic AI-enabled cost savings, the survey showed. American depository receipts of NiCE, Ltd. (NICE on the Nasdaq), a software and AI company catering to just those workaday functions, finished the deep-red August day in the black. In preview, *Grant's* is bullish.

Contact Center as a Service (CCaaS) is the clunkily named industry in which the star of this unfolding analysis features. Far from being pushed into extinction by AI, the call (or “contact”) center business will prove a practical beneficiary, and an early one, of inorganic intelligence, we are about to contend.

Rather than operate contact centers, NiCE provides software that routes calls, texts, emails and social media posts to the right agents. Its platform schedules and trains that staff, retrieves customer information, ensures regulatory compliance and analyzes harvested data. The customer-engagement division, which includes contact-center service CXone Mpower, delivered 83% of 2024 revenues. Financial-crime prevention and detection platform Actimize chipped in the rest.

The bear story describes a spectrum of concern. The extreme view is that generic, commoditized AI agents will solve customer service and contact centers will follow the fate of the telegraph office. A milder variation has it that the CCaaS industry will survive, but to the detriment of NiCE. The winners, instead, will be the Salesforces, Amazons and Microsofts of the world. Each is covetously scanning the horizon.

All three behemoths have developed their own CCaaS platforms, and some are worried that the Covid-era Zoom-Microsoft story will repeat. Maybe you remember it: By making its Teams platform free and integrating it into Outlook after the bug bit, Microsoft dealt Zoom a heavy blow and scooped up significant market share.

And there is the question of whether AI agents are up to the task of delivering the transformative change that the techno-enthusiasts have been banging on about. In December 2023, buy-now-pay-later firm Klarna Group plc went all in on laying off human agents in favor of the artificial kind. In May of this year, hat in hand, management reverted to homo sapiens after customers, also human, flooded the company with complaints.

NiCE, specifically, has lately fallen under suspicion. Just two weeks ago, its ADRs declined by 14% after management discussed integration issues with an acquisition and did not raise its forecasts after beating earnings. Revenue was another story. The front office reiterated expectations that the top line, having jumped by 15% in 2024, would grow by just 7% in 2025. Also, CEO

Scott Russell, who took the reins from retiring stalwart Barak Eilam early this year, announced an expensive new AI acquisition in July after previously touting NiCE's own, in-house AI prowess.

NiCE's revenue problems are symptomatic of an economy that has paused to reconsider its technology investments in the light of AI advances. Many companies are trying to avoid the reputational faceplants that others made by unleashing hallucinating AI agents on their customers. The holding pattern won't last forever. There are clear cost savings to be had for automating simple tasks. And those cost savings are likely to translate into not only greater growth but also pricing power for NiCE.

As leader of the CCaaS industry, NiCE stands to be a big beneficiary of the trends toward AI and cloud-based call centers. With AI agents displacing actual call-center employees, the revenues for CCaaS companies can increase, as saved labor costs will translate into software spending. On a normalized basis, NiCE can expand its top line by double digits, which, with profit margins of 26%, means a lot of free cash flow. The recent major acquisition of a German software business (of which more below) may prove the ignition key to NiCE's revival.

After tumbling by 18% this year, NiCE ADRs trade at 11.1 times forward earnings, a 65% discount to the wider Nasdaq, and a 8.2% free-cash-flow yield. "The market implies from the stock price right now negative growth in the upcoming three to five years," Orel Levy, managing partner and CIO of Tel-Aviv-headquartered ANEK Capital, L.P., tells me. "We see a very asymmetric formula here towards the upside." Among the 18 sell-side analysts covering the company, 13 say buy; none says sell.

...

Anyone who has ever called customer service knows there is at least some room for improvement. The horror stories are legion—being tortured by hold-music for hours on end or having to repeat your problem to several agents before connecting with someone able to help. You'd think that some dark, deep-state psychological testing organization was probing the limits of human patience.

The prosaic truth is that customer service is one of the most software-heavy departments in a corporate organization

chart, Donna Fluss, president of industry consultant DMG, tells me, usually second only to securities trading floors. And CCaaS software, as opposed to software-light video applications like Zoom, is far too complex and expensive for Microsoft or Amazon to simply give away.

The sophistication and deep integration of NiCE's platform means that once a customer inks a deal it's for keeps. Onboarding can take months, sometimes years. Who would want to go through it again? On its latest earnings call, NiCE reported a net revenue-retention rate of 111%, meaning it earned more money from existing customers than it lost from those that departed.

NiCE serves 85 of the Fortune 100 companies and holds a near duopoly at the larger end of the CCaaS market with closely held Genesys Cloud Services, Inc. With its deep roots in data wrangling and analysis, NiCE is well-positioned to capitalize on the age of AI.

It began life in 1986 as Neptune Intelligent Computer Engineering Ltd., a digital surveillance and analytics company whose founders included signal-intelligence veterans of the Israel Defense Forces. Five years later, the company expanded into the customer-service market with workforce-optimization software for contact centers. The well-timed acquisition of inContact, Inc. in 2016 reorientated the business towards transitioning brick-and-mortar call centers to ones built on the cloud.

The NiCE value proposition is to

go digital; it would economize on rent, servers, electricity and maintenance. With some of those savings, companies upgraded to premium software features, lifting the average per-user fee that NiCE received. As a result of upselling and shifting to a subscription model from a one-time license model, the Israeli company saw its recurring revenue grow by 3.5 times between 2016 and 2024. At last report, recurring revenue accounts for 89% of the total top line.

The move to the cloud is still in its early stages. Only 31.8% of contact centers, per Fluss's reckoning, have made the jump. Large enterprises tend to be the loafers, as CFOs try to wring the last nickels and dimes from physical centers and department heads resist changes that could cost them their jobs. The rapid advancements in AI and its implications for customer service give larger companies just one more reason to delay making any major decisions.

It may be worth the wait. As with the transition to the cloud, NiCE can sell AI integration as a win-win proposal. Adding AI agents will cut costs, primarily headcount. The average employee at a contact center costs roughly \$50,000 a year versus \$4,800 a year for a newfangled bot, Michael Funk, Bank of America's head of telecom and communication-software research, tells me. With those savings in mind, NiCE can command stronger prices for its products and better market its more advanced add-on technologies.

(Continued on page 8)



source: The Bloomberg



CREDIT CREATION

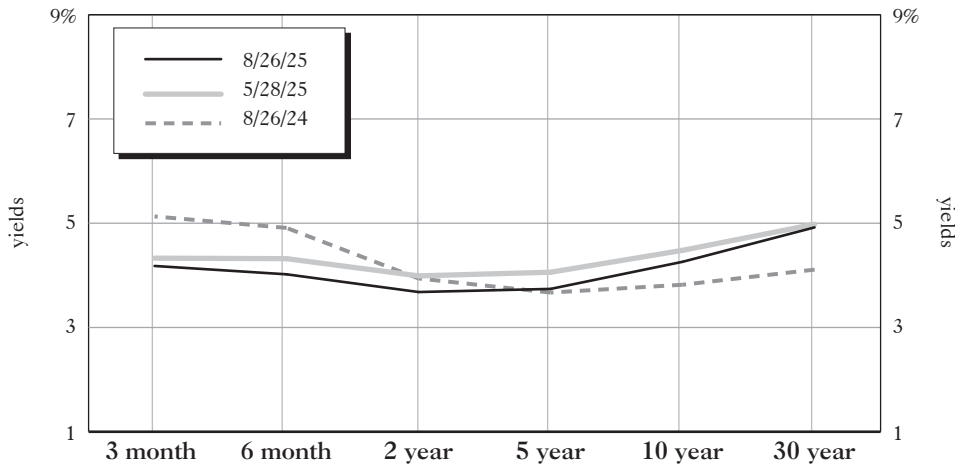
FEDERAL RESERVE BALANCE SHEET (in millions of dollars)

	Aug. 20, 2025	Aug. 13, 2025	Aug. 21, 2024
<i>The Fed buys and sells securities...</i>			
Securities held outright	\$6,324,626	\$6,327,715	\$6,717,909
Held under repurchase agreements	29	21	0
<i>and lends...</i>			
Borrowings—net	4,703	5,036	2,223
<i>and expands or contracts its other assets...</i>			
Maiden Lane, float and other assets	247,850	262,396	380,905
<i>The grand total of all its assets is:</i>			
Federal Reserve Bank credit	6,577,208	6,595,168	7,101,037
<i>Foreign central banks also buy, or monetize, governments:</i>			
Foreign central-bank holdings of Treasuries and agencies	\$3,166,502	\$3,203,755	\$3,298,306

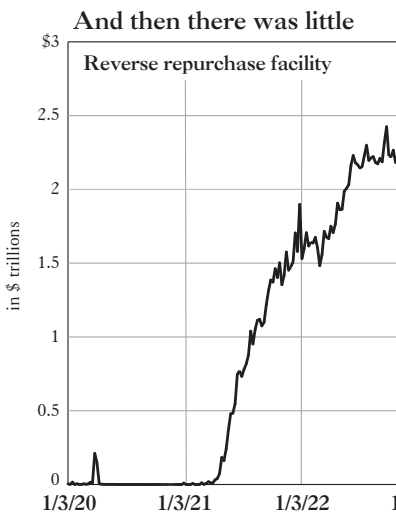
PEOPLE'S BANK OF CHINA BALANCE SHEET (in billions of renminbi)

	July 2025	June 2025	July 2024
Foreign exchange and other foreign assets	RMB 22,459	RMB 22,542	RMB 23,080
Gold	443	442	419
Claims on domestic economy	21,368	21,214	18,517
Other assets	1,682	1,587	1,633
Its assets total:	RMB 45,952	RMB 45,785	RMB 43,650

MOVEMENT OF THE YIELD CURVE



source: The Bloomberg



source: The Bloomberg

Liquidity dro

Evan Lorenz writes:

Between Jerome Powell's Jackson Hole swansong and President Donald Trump's efforts to evict Lisa Cook from the board of governors, we may be missing an important development in monetary policy: The reverse repo facility has almost drained dry.

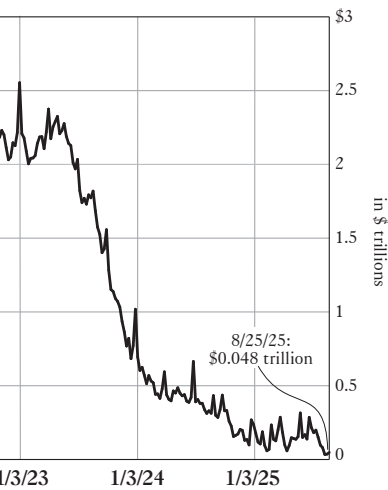
You'll recall that the RRP sets a floor under interest rates. The Fed, which holds trillions of dollars' worth of securities, peels off bills, notes or bonds to sell to cash-rich counterparties in need of a temporary investment parking place. So doing, the Fed pulls cash from the system.

The RRP facility, which peaked at \$2.55 trillion at year-end 2022 (recall the scale of the Fed's Covid-era bond-buying), stood at \$47.6 billion on Monday.

Another detail in the same vein: The Treasury has rebuilt its general account to \$526.1 billion from a recent low of \$277 billion on June 11. Funds held in the general account at the Fed are effectively removed from the financial system.

With less liquidity sloshing around, money markets may face some near-term turbulence. "We could see some temporary pressure around the tax date and quarter-end in September," Lorie Logan, president of the Dallas Fed, warned on Monday. Not that the Federal Reserve admits to worrying about a shortage of

• CAUSE & EFFECT



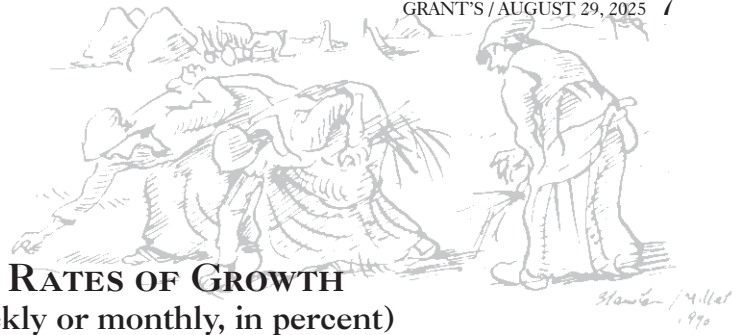
ought warning

funds leading to a repeat of the Sept. 17, 2019 liquidity famine, when overnight repo rates shot up as high as 10% ([Grant's, Oct. 4, 2019](#)).

Nobody seems to know how many dollars of bank reserves are required to keep the financial system ticking. In July, governor Christopher Waller guessed the figure may be around \$2.7 trillion versus the \$3.4 trillion currently outstanding. Anyway, the Fed has put into place the "standing repo facility" to backstop key activities when markets malfunction. Confident in its calculations, the central bank continues to shrink its balance-sheet footings by a targeted \$40 billion per month.

However, investors may care about the liquidity that the Fed is slowly removing. Markets are priced to near perfection, with investment-grade-rated corporate bond spreads of 76 basis points over Treasuries, their lowest pickup over Treasuries since 1998, and with the S&P 500 trading at 38.5 times its cyclically adjusted price-earnings ratio, a near record.

It may not be a coincidence that highly speculative securities, like the common stock of Palantir Technologies, Inc. and bitcoin, peaked in price on Aug. 12–13, around the date when RRP usage fell to its current level, and have subsequently lost altitude.



ANNUALIZED RATES OF GROWTH (latest data, weekly or monthly, in percent)

	3 months	6 months	12 months
Federal Reserve Bank credit	-4.1%	-5.2%	-7.6%
Foreign central-bank holdings of gov'ts	-7.2	-4.5	-2.7
People's Bank of China assets	3.8	-3.0	5.3
Commercial and industrial loans (July)	8.3	6.5	3.9
Commercial bank credit (July)	6.2	7.0	4.8
Asset-backed commercial paper	8.7	22.5	13.3
Currency	3.4	4.5	2.3
M-1 (July)	7.5	5.6	4.6
M-2 (July)	8.7	6.4	5.0

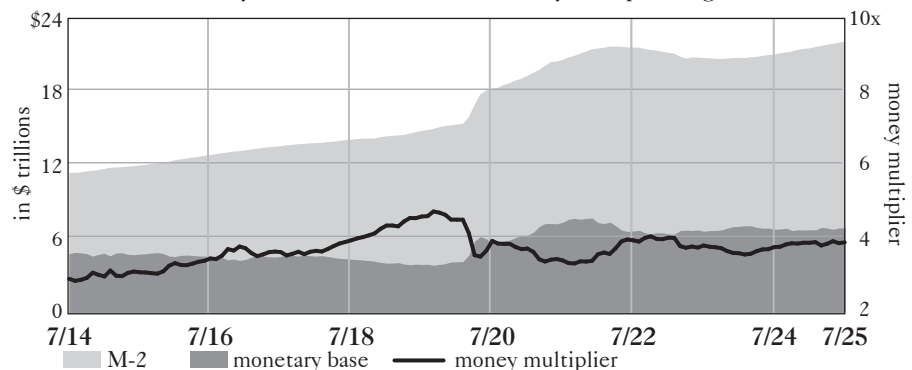
REFLATION/DEFLATION WATCH

	Latest week	Prior week	Year ago
FTSE Xinhua 600 Banks Index	18,513.49	18,176.34	14,601.83
Moody's Industrial Metals Index	3,011.19	3,051.55	2,963.50
Silver	\$39.05	\$37.98	\$29.05
Oil	\$63.66	\$62.80	\$73.01
Soybeans	\$10.37	\$10.22	\$9.41
Rogers Int'l Commodity Index	4,000.70	3,945.49	3,710.37
Gold (London p.m. fix)	\$3,334.25	\$3,335.50	\$2,483.00
CRB raw industrial spot index	571.28	571.95	547.74
ECRI Future Inflation Gauge	(July) 108.5	(June) 109.4	(July) 113.3
Factory capacity utilization rate	(July) 77.5	(June) 77.7	(July) 77.6
CUSIP requests	(July) 4,300	(June) 4,072	(July) 2,689
Fed's reverse repo facility (billions)	36.28	33.76	312.90
Grant's Bitcoin Treasury Index*	94.84	91.11	68.18

*Index=100 as of 6/27/2025

EFFECTIVENESS OF THE MONETARY POLICY

M-2 and the monetary base (left scale) vs. the money multiplier (right scale)



(Continued from page 5)

The contact-center and communication companies that failed to innovate would fill a graveyard. An important pipeline for NiCE is the remaining customers of the sick man of telecom, Avaya, Inc. But unlike the previously mentioned Klarna, NiCE is taking a step-by-step approach to AI. It doesn't count on humans entirely exiting the customer-service business. Emotional customers, or cool customers with a complex problem, will continue to require a human touch. The goal of NiCE's AI deployment is to let digital agents handle repetitive tasks and improve the human ones with co-pilot offerings.

In April, Verizon Communications, Inc. announced that AI customer-support bots, since their June 2024 introduction, had produced a nearly 40% jump in service-department sales. Google-developed artificial agents handled routine requests, freeing human agents to focus on selling new phone lines and devices. As opposed to previous AI-agent failures, Verizon used a tailored, small-language model trained on its own data trove to cut down on hallucinations. A spokesperson claimed a reported accuracy rate of 90% with only minor errors.

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The German software vendor Cognigy GmbH, whose AI-agent sophistication research firm Gartner ranks just behind Google, signed an agreement to sell itself to NiCE on July 28. The price is \$955 million, which NiCE says it will fund with cash on hand. So far from raising debt, management has declared its intention to clear the balance sheet of leverage when \$460 million's worth of outstanding notes mature in September. And investors need not fret over the company's \$500 million stock-repurchase plan, management declared on a July 28 conference call. Bringing in \$798 million in free cash flow in 2024, and with a five-year average free-cash-flow growth rate of 18%, NiCE can splurge. And its return on invested capital of 10.9% towers over that of its publicly traded competitors.

NiCE paid a price equivalent to 20.3 times Cognigy's expected 2025 revenues and 11 times 2026 revenues. Few emerging AI companies are cheap, but as James Fish, managing director and senior research analyst at Piper Sandler, points out, the acquiree's expected 80% recurring revenue growth next year

seems to whittle the \$955 million consideration down to size.

Or one may apply this post-Graham and Dodd valuation metric: Divide the price-to-sales ratio by the expected annual recurring revenue (ARR) growth rate. What you find is that NiCE bought Cognigy for a multiple of one quarter of one percentage point of ARR growth. "To give you an idea," says Fish, who rates the company a hold, "the average growth asset going back 20-plus years sits around 0.35% [of revenue growth]. So they're getting a discount to that. I don't actually hate the multiple here."

Another growth driver for NiCE is international expansion, particularly in Europe. Cognigy presents NiCE with bots it can upsell to the NiCE base as well as with new European customers to whom it can sell the NiCE CXone Mpower suite. The company expects its new subsidiary, once integrated, to add 150–250 basis points of growth on top of its guidance of 12% in cloud revenue expansion this year. Cognigy has already been integrated into the NiCE platform as a partner, which will ease the consolidation.

Cutting-edge AI agents further differentiate NiCE's well-tooled platform. Already synced into the major tech players' sales and cloud products, NiCE's software offering has clear advantages over those of its larger peers. Amazon Connect, for example, is a do-it-yourself product; the CXone Mpower is turnkey.

Ultimately, the new entrants, whether Microsoft or AI start-ups, currently appeal to smaller companies with less complex needs, muscling in on NiCE's down-market competitors, such as Five9, Inc. Since smaller customers don't move the needle for NiCE, it can focus more on companies with high-touch and diverse needs. "There are still a lot of large deals to win," Funk relates. "And we think NiCE and Genesys are the best-positioned to gain market share because of their scale, geographic reach and existing relationships with the largest enterprise customers."

Corporate giants cotton to NiCE, because it's devoted to customer-service applications. Microsoft offers CCaaS as an add-on and is careful about how much capital it invests. "We never hear about Salesforce or Microsoft," Levy says about his channel checks. "NiCE is just such a great technology. It's a matter of focus." If MSFT wants to seriously compete, there's always the option of acquiring NiCE. The price is surely not

demanding at this valuation for a market leader with a clean balance sheet.

So when might NiCE return to a growth rate that excites tech investors? "I think it's only a matter of time," Arjun Bhatia, co-head of tech equity research at William Blair and NiCE bull, tells me, "before those headwinds turn into tailwinds. We know on-premise customer-service contact centers are going to move to the cloud. And we know AI will get incorporated in contact centers."

The good thing for NiCE is that, in practice, deploying AI agents generally requires a shift to a cloud model. In this way, AI could push the remaining 70% of customers that continue to operate brick-and-mortar call centers into the digital model. As the two trends dovetail, the revenue bump will resound for NiCE. For customers adopting cloud and AI services together, NiCE announced at last years' investor day, management expects average revenue per user to increase by more than 50% and annual recurring revenue to jump four- to five-fold. And that was all before Cognigy.

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Private equity update

Evan Lorenz writes:

The situation in brief: Lending terms are improving while business fundamentals are disimproving. "I say to our first-year analysts on their first week of work," Ron Kahn, global co-head of valuations and opinions for Lincoln International, tells me, "You can't pay interest with pro forma earnings."

Each quarter, Kahn pores over the financial data of more than 6,250 private equity-sponsored companies to put together the Lincoln Private Market Index. In the latest edition, Kahn found that 24% of p.e. Ebitda came from adbacks rather than from operating earnings. There was nothing very new about that finding. Still, it may evoke a whistle of amazement.

Because of this dynamic, leverage as a multiple of Ebitda has increased by an average of 0.5 times for all deals between 2019 and 2023. "So your earnings are not translating into free cash flow," Kahn explains. "You're kind of just spinning your wheels with the company, and you're not creating any equity value. There's no IRR, which, again, is why

people are holding on to the companies rather than selling them.”

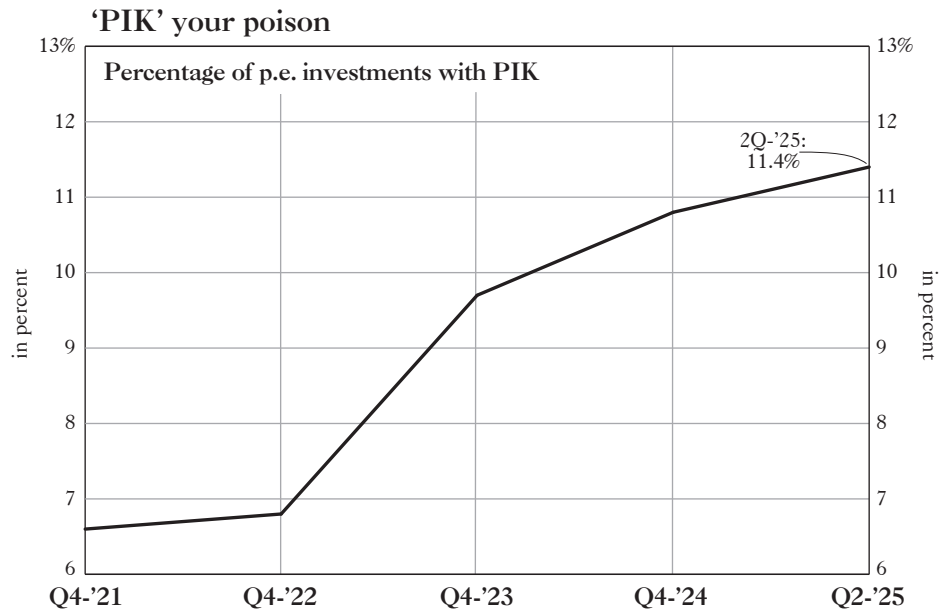
Meanwhile, the covenant default rate, as calculated by Lincoln, ticked up to 3.4% in the second quarter from 2.9% in the first. But that is only half of the story, as many private credit funds permit troubled borrowers to pay interest in kind rather than cash. In the second quarter, 11.4% of p.e.-sponsored investments availed themselves of PIK provisions, up from 6.6% in the fourth quarter of 2021. The proportion of “bad PIK,” i.e., loans paying in kind that did not come with that feature at the deal’s closing, rose to 53.3% of the PIK-paying total from 33.3% over the same span. That implies a shadow default rate of 6% (11.4% times 53.3%).

Even lenders are sometimes in the dark about their borrowers’ health. “If you look at free cash flow, it does not even come close to correlating to Ebitda in a lot of instances,” says an anonymity-seeking manager who oversees private credit portfolios. “It’s hard to decipher what free cash flow is because of the lack of disclosure that private equity guys are providing their lenders.”

The lack of disclosure is also a hurdle for investors who provide fresh capital to straitened companies. “In 2006,” Daniel Zwirn, CEO and CIO of Arena Investors, L.P., tells me, “I could call JPMorgan and say, ‘I see this is distressed. Can I sign an NDA and get all of the information?’ Now that’s on lockdown because none of the CLOs and other people involved want new investors getting ahold of it.”

You might think lenders would demand greater compensation for the increased risk in buyouts. You would be wrong. “Right now we see spreads tighter than we saw them at the peak of the market in 2021,” says Kahn. “If you look at a unitranche deal [which combines first-lien and second-lien loans into a single obligation], I would say it is probably 450 to 550 basis points today, with 450 for larger deals...and you didn’t really see ‘fours’ [even] back in 2021.”

Amid a dearth of initial public offerings, private equity is increasingly reliant on self-help to exit investments. In the first half of 2025, approximately 20% of p.e. exits were through continuation vehicles, i.e., a promoter selling a company from one fund to another. We are now beginning to see the rise of CV-squareds. Take Isolved, for example. Accel-KKR purchased the human-relations



source: Lincoln International

software company in a 2011 buyout and then bought it from itself in 2019 with a freshly formed CV. This year, Accel-KKR raised \$1.9 billion to buy Isolved a third time through a second continuation vehicle.

Continuation vehicles make up the majority of secondary transactions, i.e., deals when p.e. sells to itself. In the first six months of 2025, secondaries jumped by 51% year over year to \$103 billion, according to Jefferies Financial Group, Inc., and Verdun Perry, head of secondaries at Blackstone, Inc., predicts secondary volumes will top \$400 billion by 2030.

Lenders are only too happy to finance the shuffling of these ownership claims. According to an Aug. 22 Bloomberg dispatch, banks are offering to lend 20% to 25% of the value of limited-partner commitments to CVs at rates of “about 3 percentage points over benchmarks.”

Troubled companies have long used liability-management exercises, in which they secure new debt by removing collateral that creditors had thought was theirs or by subordinating existing claims to new, super-senior debt, to forestall a possible bankruptcy filing. Now, thanks to a new trend in loan documents, overleveraged buyouts can issue new debt that disadvantages existing creditors without going through an LME, which requires a borrower to secure a majority vote of creditors.

Historically, loan documents required a borrower to deleverage before issuing more debt without securing full lender

consent. That is changing. An Aug. 14 Moody’s Ratings report finds that companies are boosting day-one borrowing capacity by combining undrawn capacity from covenants like the “restricted payments builder basket”; the “general restricted payments,” investment and debt prepayments baskets; and/or unrestricted subsidiary investment baskets. Suffice it to say that these legal maneuvers enable buyouts to issue debt up to an additional 400% of Ebitda as soon as the ink dries on loan documents. The proceeds from this issuance can be used for anything from dividend payments to acquisitions.

“The notion was that the borrower wanted more and the lenders got comfortable with that, predicated on the understanding that the debt wouldn’t disadvantage them,” Derek Gluckman, a senior covenant officer at Moody’s, tells me. “It would be real *pari passu*: It shares the existing lien, it comes on the same documentation terms. It’s not going to have some covenant advantages.”

However, the white-hot competition between the bank syndicated-loan market and private credit has chipped away at those protections. Some of the incremental debt facilities permit shorter maturities, i.e., “priming in time” (“If there is going to be stress, the people that are going to have it are always going to be the last maturing debt,” notes Gluckman); allow new debt to pay higher coupons; and have recourse to additional collateral not available to existing creditors.

"To our knowledge, nobody has abused these kinds of privileges," says Gluckman. "This is just kind of latent capacity that's out there."

Buyer beware. Or is it a little late for that?

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Banking on Trump

The underwhelming stock market performance of the presumptive beneficiaries of a presumptively lower funds rate is a source of puzzlement and opportunity alike, observes Charles Peabody. In preview, the nonpareil bank analyst and longtime friend of *Grant's* is bullish on U.S. Bancorp (USB), Citizens Financial Group, Inc. (CFG) and M&T Bank Corp. (MTB; all on the New York Stock Exchange). He speculates that the administration might help push the bullish cause along.

On the banking beat since 1981, Peabody founded Portales Partners, LLC in 1999 to deliver research free and clear of the conflicts that stifle analytical objectivity on Wall Street. It's hard to speak from the heart while addressing the investment-banking sales force.

Banks have been making hay since the market's April lows. As a group, they passed the Federal Reserve's regulatory tests with scores high enough to allow them latitude for more share buybacks and higher dividend payouts. They reported better-than-anticipated earnings in the second quarter while posting stable credit performance and guiding for higher net interest income in the back half of 2025. They have good reason to expect regulatory relief, both from the internationally agreed upon Basel III rules and from the regulations set domestically.

"And yet," Peabody writes in an Aug. 9 client note, "despite all these positives, large-cap bank stocks underperformed during July, trade at only 50% of the market multiple and yield 3.2%, on average, or twice the yield on the S&P 500 Index. So, what gives?"

Possible recession risk, for one, though banks, on average, trade at a roughly 55% discount to the market during economic downturns, only slightly cheaper than they're priced today. "I really believe," Peabody tells colleague Evan Lorenz, "that the banking system will come through the next downturn without any capital impairments or hits to book value.

In other words, they will earn money throughout the recession, and that's very different from the past three downturns that I've lived through."

For once, Peabody ventures, banks won't be the cyclical bag-holders, a dubious honor that will rather fall next time around to private credit funds, business development companies and the investors in collateralized loan obligations—financiers, all, of private equity (see page 8).

In these speculations, the notoriously mercurial commander in chief of the United States figures as a known unknown. Lower interest rates are high on Trump's agenda, of course. There's persistent speculation, too, about White House plans to restore Fannie Mae and Freddie Mac to the private sector. To whom might the president award the opportunity to take the GSEs public? And—in the transactional spirit of the administration—what might the government get in return for that profitable piece of business? Not nothing, to judge by the almost 10% of Intel Corp. that the feds are about to secure in exchange for U.S. cash grants yet unallocated under the 2022 CHIPS and Science Act.

Emerging-market autocrats, like 1960s social democrats before them, regard commercial banks less as private property than as governmental auxiliaries in the cause of public-debt management. Not surprisingly, those commandeered institutions trade at low multiples of earnings and book value. The size and complexity of America's financial system would likely confound an attempt at overt government control, Peabody ventures, but "coercion or the promise of suppression may play a role in the future of [dollar-denominated] interest rates." Yield-curve control comes to mind.

Trump will eventually get his funds-rate reductions, Peabody told Lorenz (before Chairman Jerome Powell's dovish Jackson Hole speech last Friday, by the way), but perhaps at the risk of reciprocally higher long-dated yields. As banks borrow short and lend long, the steeper yield curve would tend to fatten the lenders' net interest margins.

If, Peabody sums up, the end result of the administration's interventions delivered a steep yield curve (without a governmental attempt to force-feed the banks with Treasuries), the banking business could rerate to a 30% discount to the overall market, compared with the prevailing 50%.

Our friend's picks-to-click are well-managed regional banks, which earn more from net interest income than from the capital markets: "Our feeling is that capital markets will peak sometime in the first half of 2026, whereas net interest income, assuming no recession, will accelerate higher throughout 2026," says Peabody.

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U.S. Bancorp may be classified as a regional bank, but its operations more closely comport with its name. National in scope, it boasts 2,081 branches in 26 states. In the second quarter, net interest income accounted for 58% of net revenues and non-interest income (e.g., payment processing and asset management) the remainder.

As of June 30, USB's \$380.2 billion loan book was invested in commercial and industrial loans (39% of the total), residential mortgage loans (30%), other retail loans (18%) and commercial real estate (13%) and was amply funded by \$518.7 billion in deposits. In the second quarter, 0.44% of the loan book was marked as nonperforming, against an allowance for credit losses covering 2.07% of the loan book.

Meager loan growth—up just 1% year over year—has sparked a heightened focus on cost-cutting. The efforts bore fruit in an improved efficiency ratio (i.e., the ratio of non-interest expenses to net revenues) of 59.2% from 61% in the second quarter measured year over year. And there are signs of life in the lending book. U.S. Bancorp's C&I loans expanded by 7.1% year over year in the second quarter, although this growth was negated by a 7.3% contraction in commercial real estate lending. However, "CRE is starting to turn the tide there in terms of not being as much of a drag" on growth, U.S. Bancorp CFO John Stern informed analysts on the July 17 earnings call.

With an 18% return on tangible equity in the June quarter, U.S. Bancorp is profitable and, with a common-equity Tier 1 ratio of 10.7%, well-capitalized. Shares are priced at 11.1 times estimated 2025 earnings and deliver a 4.1% dividend yield. Of the 27 analysts on the case, 15 say buy and only one says sell; short interest amounts to 1.3% of the equity float. Over the past 12 months, insiders have sold a net 323,988 shares for proceeds of \$15.4 million.

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Founded in 1856 as the Manufacturers and Traders Bank in Buffalo, N.Y., M&T Bank Corp. today does business in 12 Eastern states, from Maine to Virginia, as well in the District of Columbia, through a network of 960 branch offices. In the second quarter, net interest income contributed 71.5% of net revenues.

As of June 30, M&T's \$136.1 billion loan book was invested in commercial and industrial loans (45% of the total), consumer loans (19%), commercial real estate (18%) and residential mortgages (18%) and was funded by \$164.5 billion in deposits. As of the second quarter, management had marked 1.16% of loans as nonperforming against which loss provisions amounted to 1.61% of the loan book.

In the second quarter, M&T generated a respectable 15.5% return on tangible equity and showed a common-equity Tier 1 ratio of 10.98%. The strong capital position permitted \$1.7 billion's worth of share repurchases in the first half of 2025, retiring 5.7% of shares outstanding.

Like U.S. Bancorp, M&T is seeing early signs of recovery in commercial real estate loans, even though the lending category is registering a 17% year-over-year contraction in the second quarter. "The pipeline continues to build," said M&T CFO Daryl Bible on the July 16 earnings call. "We had our best month in June that we've had this year so far, [and] we have over \$5 billion in the pipeline right now."

M&T commands an 12.1 multiple on anticipated 2025 earnings, and shares offer a 3% dividend yield. The Street is friendly toward MTB, with 13 of the 23 analysts covering the stock saying buy versus one saying sell; short interest sums to 2.4% of the equity float. Insiders sold 183,733 shares over the past 12 months for proceeds of \$36.7 million.

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Citizens Financial Group can trace its history to 1828 with the founding of the High Street Bank in Providence, R.I., but it emerged in its current form only in 2014. That was the year when the Royal Bank of Scotland plc publicly listed its American banking operations.

Today, Citizens manages a 1,000-branch network across 14 states in New England, the Mid-Atlantic and

the Midwest. In the second quarter, net interest income made up 71% of net revenue with customer fees, capital-markets activities, wealth management and mortgage banking comprising the rest.

As of June 30, Citizens' \$141.4 billion loan portfolio was invested in commercial and industrial loans (33% of the total), residential mortgages (24%), other retail loans (24%) and commercial real estate (19%) and was adequately financed by \$175.1 billion in customer deposits. In the second quarter, nonperformers amounted to 1.09% of loans outstanding; loan-loss reserves covered 1.44% of the portfolio.

In the second quarter, Citizens presented a common-equity Tier 1 ratio of 10.6% but earned a subpar 11% return on tangible equity. Management has set a goal to boost returns to 16%–18% through an initiative it calls "Reimagining the Bank" and the expansion of the private bank by targeting wealthy customers left in the lurch by the disappearance of First Republic Bank figure prominently in the effort.

Citizens trades at 13.4 times estimated 2025 earnings, and shares offer a 3.3% dividend yield. Of the 25 analysts who cover CFG, 19 say buy and none says sell, and short interest sums to 2.1% of the equity float. Insiders have neither purchased nor sold a share in the open market over the past 12 months.

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There's more than one way to play a steepening yield curve and bank deregulation. Consider, for instance, the Quadratic Interest Rate Volatility & Inflation Hedge ETF (IVOL on the NYSE Arca). As constant readers may recall, IVOL owns Treasury Inflation Protected Securities (TIPS; 69% of AUM), cash (17%) and options on the difference between the 10-year and 2-year swap curve ([Grant's, May 17, 2019](#)). Owing to the recent steepening in the yield curve, the fund has generated a 15% year-to-date return versus a 6.2% gain for the Schwab U.S. TIPS ETF (both including reinvested dividends).

However, the difference between the 10-year and 2-year swap rates (26 basis points) is only about half that of the same tenors on the Treasury curve (58 basis points). "The Treasury curve should be less steep than the swap curve because the swap curve has counterparty risk," Nancy Davis, managing partner

and CIO of Quadratic Capital, tells Lorenz. "It's flatter because a lot of people use swaps for leverage, specifically banks, because of all the supplementary leverage rule regulations. Basically, if a bank owns a Treasury bond, they have a capital charge for it, whereas if they own swaps it's completely off-balance-sheet and there is no capital charge."

"You keep hearing about SLR reform," Davis goes on. "It makes no sense. Why would you pay a counterparty more interest to use their balance sheet than you would the U.S. government? It's just that banking regulation right now makes it cheaper for them to trade off-balance-sheet and use swaps."

A further steepening of the yield curve plus bank regulatory reform might just give IVOL additional torque to the upside.

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Liquidity drought warning

Evan Lorenz writes:

Between Jerome Powell's Jackson Hole swansong and President Donald Trump's efforts to evict Lisa Cook from the board of governors, we may be missing an important development in monetary policy: The reverse repo facility has almost drained dry.

You'll recall that the RRP sets a floor under interest rates. The Fed, which holds trillions of dollars' worth of securities, peels off bills, notes or bonds to sell to cash-rich counterparties in need of a temporary investment parking place. So doing, the Fed pulls cash from the system.

The RRP facility, which peaked at \$2.55 trillion at year-end 2022 (recall the scale of the Fed's Covid-era bond-buying), stood at \$47.6 billion on Monday.

Another detail in the same vein: The Treasury has rebuilt its general account to \$526.1 billion from a recent low of \$277 billion on June 11. Funds held in the general account at the Fed are effectively removed from the financial system.

With less liquidity sloshing around, money markets may face some near-term turbulence. "We could see some temporary pressure around the tax date and quarter-end in September," Lorie Logan, president of the Dallas Fed, warned on Monday. Not that the Federal Reserve admits to worrying about a shortage of funds leading to a repeat of the Sept. 17,

2019 liquidity famine, when overnight repo rates shot up as high as 10% (*Grant's*, Oct. 4, 2019).

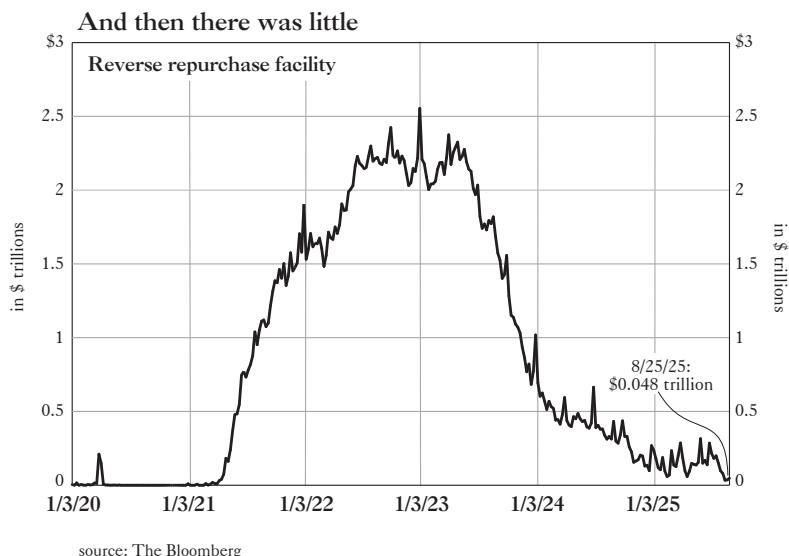
Nobody seems to know how many dollars of bank reserves are required to keep the financial system ticking. In July, governor Christopher Waller guessed the figure may be around \$2.7 trillion versus the \$3.4 trillion currently outstanding. Anyway, the Fed has put into place the "standing repo facility" to backstop key activities when markets malfunction. Confident in its calculations, the central bank continues to shrink its balance-sheet footings by a targeted \$40 billion per month.

However, investors may care about

the liquidity that the Fed is slowly removing. Markets are priced to near perfection, with investment-grade-rated corporate bond spreads of 76 basis points over Treasuries, their lowest pickup over Treasuries since 1998, and with the S&P 500 trading at 38.5 times its cyclically adjusted price-earnings ratio, a near record.

It may not be a coincidence that highly speculative securities, like the common stock of Palantir Technologies, Inc. and bitcoin, peaked in price on Aug. 12–13, around the date when RRP usage fell to its current level, and have subsequently lost altitude.

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