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Money market outlook 2025: trends and dynamics in the eurozone, US, and UK

We delve into the world of money market funds. Distinct dynamics are at play in the US, eurozone, and UK. In the US, repo rates are more attractive, and bills are expected to appreciate. It's also worth noting that the Fed might cut rates more than anticipated, similar to the UK. In the eurozone, unsecured rates remain elevated

Eurozone: A gradual tightening from the ECB's shrinking balance sheet

There remains a structural tightening trend as the European Central Bank (ECB) shrinks its balance sheet and drains reserves. Up to now liquidity conditions have been ample, and the impact has been mainly felt in repo markets where rates have drifted towards the ECB’s deposit facility rate.

Unsecured overnight rates are still fixed noticeably below the depo rate, and thus, counterintuitively, below secured rates – market fragmentation is part of the reason. The minimum level of reserves at which banks want to operate is still some distance off.

US: Term and Repo more in vogue

Absolute rates attainable in the money market funds space remain attractive and will stay this way even if the Fed cuts some more (we think two 25bp cuts in the second half of 2025). Money curves have generally dis-inverted, which generates the opportunity to term out where feasible, to get today's rates (or at least close to them) for longer. The Fed's reserve repurchase agreement facility will increasingly be used just at turns, broadly ending routine usage. Market repo is more attractive here in relative value terms.

As quantitative tightening concludes by mid-year, idle liquidity is expected to decrease, potentially pushing generic money market rates higher. Although these changes are marginal, they create a more natural environment compared to the peak period in 2022-23, when approximately $2.5tr was directed to the Fed's reverse repo facility.

UK: Transitioning to a new monetary policy regime

The Bank of England is pursuing a relatively rapid pace of quantitative tightening compared to its peers, but is also focused on assuring adequate liquidity conditions in the system at the right places. A recalibration of the Indexed Long Term Repo facility, for instance, offers relatively attractive liquidity to banks over six-month horizons.

In the meantime, money market rates are mirroring the normalisation of monetary policy and are performing as expected. Overnight deposit rates could, however, remain relatively low-yielding due to market segmentation. The steepening of curves will continue to incentivise investors to move out of money market funds and allocate cash to longer tenors. While overnight rates may still look attractive at first sight, we are already inclined to move further out the curve for better value.

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