The shifting liquidity landscape: How corporate treasury is maximizing liquidity in the face of uncertain times

Over the past few years, the liquidity landscape has shifted dramatically. As a result of the pandemic in 2020, the U.S. Federal Reserve infused massive amounts of liquidity into the markets, primarily through the purchase of treasuries and mortgage-backed securities. This was paired with substantial fiscal stimulus. Since then, the environment has changed significantly, with a rise in inflation leading to interest rate increases starting in March 2022. The Fed then stopped quantitative easing and began quantitative tightening, leading to an overall decrease in liquidity.

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This scenario is playing out globally, as many of the central banks in developed markets around the world have been raising rates over the course of the past year and a half. That said, there appears to be a divergence in terms of economic activity in the U.S. versus the Euro-area and China. In the U.S., the economy has not yet fallen into recession, despite pundits' predictions. The unemployment rate has remained low by historical standards and gross domestic product (GDP) growth remains positive.

Conversely, the Euro-area has been more sluggish. While it is not yet conclusive, a recession may have already started in Europe. There has also been modest growth in China when compared to historical levels.

In the U.S., there is growing consensus amongst economists that the economy will experience a soft landing with a mild recession, or possibly no recession at all. Many economists expect that the Fed is now done hiking rates for this cycle, and the focus is on when rates will begin to be cut.

Corporate treasury perspective on liquidity

In the past year, there have been some changes in terms of corporate short-term investment behavior. Some of these changes were brought about by geopolitical concerns, safety and soundness of regional banks, and the current macro environment. According to the latest AFP® Liquidity Survey, safety of principal and liquidity remain the most important investment objective, with a continued emphasis on bank deposits.[1] The survey found that most investment maturities are still within 30 days.

Digging a little deeper into the survey, it revealed that large companies currently maintain 49% of short-term investments in bank deposits, which is nine percentage points lower than in 2022. This reduction is mainly driven by elevated deposits during COVID and banking-related cash diversification in the first quarter of 2023.[2] While bank deposits have remained relatively steady over the last several years, the survey revealed that short-term investments into money market funds were up slightly, with most of those investments going into government money market funds. Outside the U.S., corporate investments continue to favor bank deposits, followed by a similar trend toward money market funds.

In the U.S., the Security and Exchange Commission (SEC) has issued new guidance around money market fund reform proposals. Some of the key changes involve an increased requirement around liquidity. Liquid asset requirements will rise from 10% daily and 30% weekly to 25% and 50%, respectively.[3] This may result in a small reduction in yield for money market funds, but the changes overall are not viewed as overly negative for investors nor the funds.

A second change issued by the SEC was welcomed by the fund industry. This involves removing gates, which had been put in place to prevent runs. A third change, which is viewed as more challenging, will require mandatory liquidity fees in times of market stress on prime and tax-exempt money market funds. The exact amount of fees and how they will be calculated have yet to be determined. The new fees will be important for corporates to consider when thinking about the future of prime funds.

[1] Source: 2023 Association for Financial Professionals (AFP®) Liquidity Survey

[2] Source: 2023 Association for Financial Professionals (AFP®) Liquidity Survey

[3] Source: US Securities & Exchange Commission; MMF Stats; https://www.sec.gov/divisions/investment/mmf-statistics

"Managing risk and maximizing liquidity remain top priorities."

Options to optimizing liquidity

As corporate treasury professionals focus on optimizing liquidity, there are several solutions available that can help achieve critical objectives. As mentioned, these include time deposits, direct securities, and various other options to increase yield.

Another solution, which offers counterparty diversification, is Citi's IntraFi® Yankee Sweep®, a cash management product that can help corporates balance competing demands for returns, risk management, and daily liquidity. With this option, corporates can effectively replicate some of the counterparty diversification and yield benefits of a prime money market fund, but without the floating net asset value and the potential for liquidity fees.

Ensuring that corporates have the right amount of cash in the right place, at the right time, is getting easier with the advent of digital assets and real-time liquidity solutions. Funding payment flows seamlessly and intelligently will be further facilitated as real-time funding becomes widely available. Products such as real-time liquidity sharing will enable corporates to make payments on a real-time basis, leveraging cash from other accounts without the need for bank credit lines. This will involve sharing liquidity from one account to another.

Another important solution that Citi now offers in the U.S. and South Korea is seven-day target balancing, which facilitates instant payments any day of the week, including weekends and holidays, without the risk of an overdraft. Virtual accounts are another tool that has become available over the past couple of years to help streamline liquidity. These accounts enable treasury to notionally segment cash within an account across different business lines.

Given the global economic uncertainty today, it is no surprise that corporate treasury is shifting short-term investment strategies. Managing risk and maximizing liquidity remain top priorities. The good news is that highly effective liquidity solutions, combined with enhanced treasury workstation integration, can enable corporates to make the most of short-term investments while automating counterparty exposure management processes.

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