Global Money Market Funds Outlook 2024

Fitch's Sector Outlook: Neutral

Fitch Ratings' 2024 sector outlook for global money market funds (MMFs) is neutral, reflecting generally neutral credit environment, an expectation of manageable industry flows, and limited impact from regulatory changes.

We expect MMFs to continue increasing weighted average maturity (WAM) and weighted average life (WAL) with managers selectively extending duration and maturity to lock in high yields in anticipation of rate cuts in the US and Europe. This may expose funds to valuation volatility from continued macroeconomic uncertainty, which may be exacerbated by geopolitical tensions.

Revision of a sizeable portion of key banking sectors' outlook to neutral from deteriorating, together with MMFs typical investment universe consisting of mostly high-quality banks which tend to carry stronger rating headroom, support a generally neutral credit environment for MMFs in 2024. We expect the macroeconomic environment to continue to be challenging due to the backdrop of tighter global credit conditions.

Fitch forecasts central banks in the major economies to hold rates at peak levels until 2H24, before reducing rates at different paces. We expect manageable industry flows for most of 2024 as MMFs tend to benefit from duration effect, allowing delays in policy rate cuts feeding through to funds' yields. As a result, there should be balanced industry flows at early stage of anticipated rate cuts across regions and we do not expect a meaningful acceleration of the MMF flows until late next year.

We expect overall limited impact from regulation reforms in the China and US MMF industry, with Chinese rules focusing on large MMFs and US rules introducing mandatory liquidity fees, which may result in flows out from US prime likely into treasury or government MMFs. In Europe, there are different stances. The EC's review on MMF regulation adequacy did not recommend reform to regulation at this stage and the UK Financial Conduct Authority recently published a consultation paper setting out proposals to update UK MMF regulatory regime.

What to Watch

- Increased geopolitical tensions catalysing wider market disruptions, worsening flow trends and credit fundamentals.
- Unexpected deterioration in banking sector credit drivers under tighter financial condition and challenging operating environment, triggering market volatility.
- Faster-than-expected future rate cuts, or a steepening yield curve, may trigger acceleration in MMF outflows.
- Regulatory divergence may introduce complexity in managing MMFs and differentiated flows.

Minyue Wang, CFA, Director

"Fitch's neutral sector outlook reflects generally neutral credit environment supported by outlooks in key banking sectors, as well as MMFs' investable universe consisting of mostly high-quality banks which tend to have stronger rating headroom. We also expect overall balanced industry flows for most of 2024 across regions, and limited impact from regulatory changes subsequent to their 2023 finalisation.

"We will continue watching the impact from changes in market conditions under the backdrop of funds selectively extending maturity while maintaining high liquidity levels."

Core Sector Outlook Drivers

Summary of Drivers	Impact
Credit environment	↔
Market condition impact	↘
Industry flows	↔
Regulatory landscape	↔
Sector outlook	**Neutral**

Note: ↔ Neutral. ↘ Deteriorating – moderate relevance
Source: Fitch Ratings

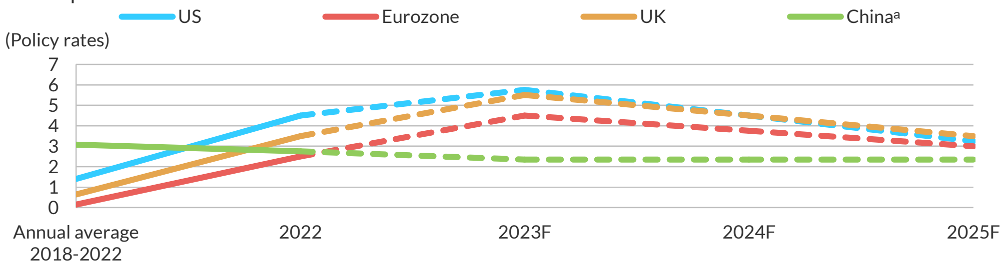
Key Sector Outlooks

Sector	Outlook (2024)	Outlook (2023)
French banks	Neutral	Neutral
US banks	Deteriorating	Deteriorating
Canadian banks	Neutral	Deteriorating
Japanese banks	Neutral	Neutral
UK banks	Neutral	Deteriorating
German banks	Neutral	Deteriorating
Western European banks	Neutral	Deteriorating
Chinese banks	Deteriorating	Neutral

Source: Fitch Ratings

Global Policy Rate Forecast Summary

As of September 2023



[a] One-year medium term lending facility rate - policy rates are expected at end-period.
Source: Fitch Ratings starting assumption as of 13 September 2023

US Money Market Funds

Federal Reserve Policy and Yield Remain in Focus

Fitch expects the Federal Reserve to maintain the policy rate until 2H24. In anticipation of rate cuts, we expect US MMF managers to selectively extend duration to lock in high yields, while maintaining sufficient liquidity to handle outflows that may result from rate cuts. US MMFs have seen substantial inflows from tightening monetary policy, with assets under management (AUM) in retail funds increasing nearly 40% in 2023.

Fitch expects the Fed to maintain the policy rate until 2H24. In anticipation of rate cuts, we expect US MMF managers to extend duration, while maintaining sufficient liquidity. Historically, outflows have not been triggered solely by rate cuts, but rather due to a steepening/normalising yield curve. We do not expect outflows due to yield considerations to meaningfully materialise in 2024.

MMF Regulation Takes Effect

The compliance date for mandatory liquidity fees and increased daily and weekly liquidity levels will be in July 2024. Prime institutional MMFs already maintain daily and weekly liquidity in excess of the new requirements. Unlike the implementation of the last round of '2a-7' reforms, there have been limited outflows from prime MMFs. If this were to materialise, we anticipate most outflows from prime institutional funds would result in inflows to treasury and government MMFs. Fund managers may also seek to merge their prime MMFs to maintain economies of scale.

Extending Maturities Increases Market Risk Sensitivity

We expect US MMFs managers to continue gradually and selectively extending their WAM and WAL to lock in high yields for investors in anticipation of rate cuts in the US and Europe. Increasing maturity rises the funds' market risk sensitivity. Unexpected events, such as a material acceleration in geopolitical tension, could lead to significant spread movements and market pricing volatility.

Neutral Credit Conditions

We expect a generally neutral credit environment for US MMF in 2024. While a continued challenging macroeconomic environment is anticipated globally, MMFs are still heavily invested in repo positions and US government securities, limiting their credit exposure, and credit exposure is primarily to the highest-quality banks which tend to carry stronger rating headroom.

ESG Regulatory Development Remains in Focus

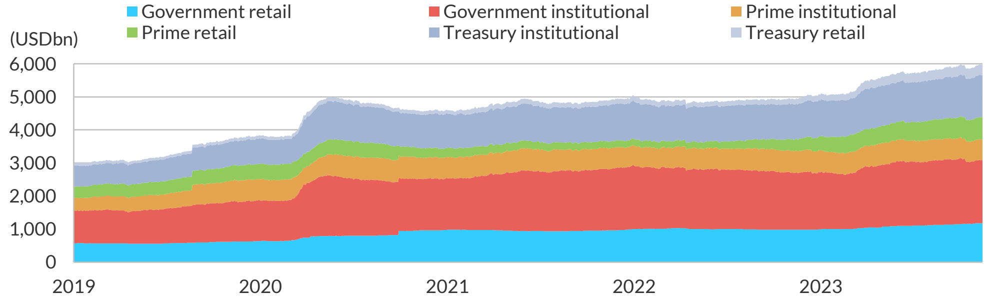
Fitch expects global regulators to continue tackling greenwashing. Further developments are likely to enhance clarity but may also increase reputational and regulatory risk in 2024.

In Europe, SFDR article 8 and 9 MMFs had more than EUR1.11 trillion in AUM at end-3Q23. About 17% of European MMFs in AUM had ESG or sustainability-related markers in names, stable from end-2022, despite the discussion around ESG fund name guidelines. In the US, AUM in ESG MMFs were USD7.6 billion at end-3Q23, down from its peak of USD10.5 billion in April 2022 following several funds leaving the ESG sector due to weak demand.

Summary of Drivers	Credit environment	Market condition impact	Industry flows	Regulatory landscape	Overall
US	↔	↘	↘	↔	↔

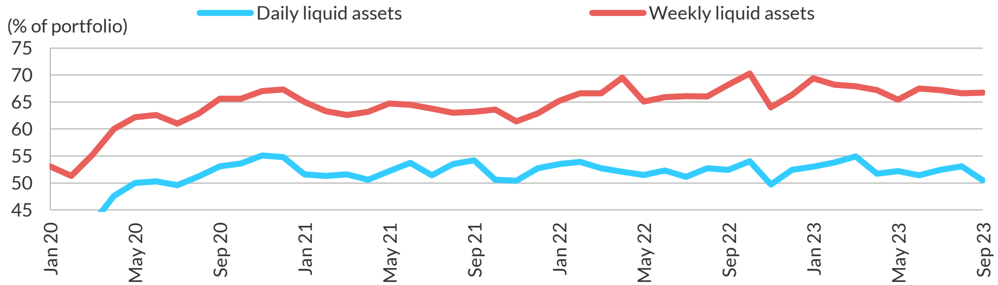
Source: Fitch Ratings

Taxable MMF Assets



Source: Fitch Ratings, Crane Data

Prime Institutional MMF Daily and Weekly Liquid Assets



Source: Fitch Ratings, SEC Market Fund Statistics

European Money Market Funds

Neutral Credit Environment

Fitch's stable outlooks for the French, Canadian, Japanese, UK and German banking sectors support a more stable credit environment, as MMF portfolios are concentrated in these sectors. The US banking sector still has a deteriorating outlook, which could have a knock-on effect on MMFs with high exposure to US banks. However, vulnerabilities will be assessed on a case-by-case basis, and MMFs' typically invest in high-quality banks, which tend to carry stronger rating headroom.

Overall Balanced Industry Flows

We expect overall balanced industry flows for most of 2024, in light of the anticipation of euro, sterling and US dollar policy rate cuts in 2H24. MMFs tend to benefit from the duration effect, allowing delays in policy rate cuts feeding through to funds' yields. As a result, we do not expect a meaningful acceleration of the MMF flows until late next year.

Extending Maturities Increases Market Risk Sensitivity

Fitch expects European MMFs managers to continue gradually and selectively extending their WAM and WAL to lock in high yields for investors in anticipation of rate cuts. Increasing maturity rises the funds' market risk sensitivity. Unexpected events such as material acceleration in geopolitical tension could lead to significant spread movements and market pricing volatility.

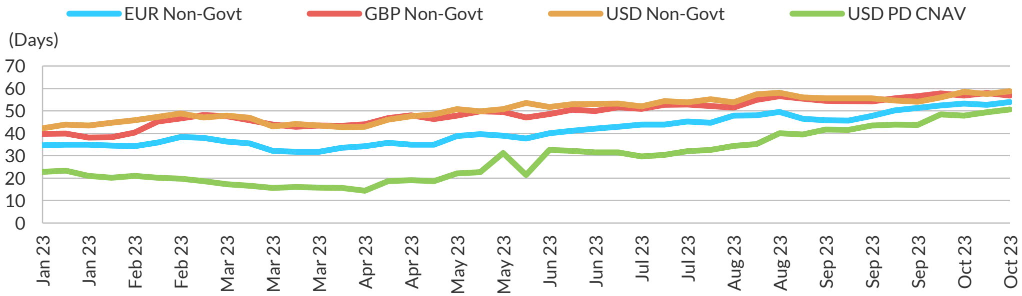
Regulation Divergence Emerging

We see divergent rules emerging across key European markets. The EC's review on MMF regulation adequacy did not recommend reform to regulation at this stage, whereas UK Financial Conduct Authority recently published a consultation paper setting out proposals to update UK MMF regulatory regime, including significantly increase minimum liquid asset requirements for MMFs.

Summary of Drivers	Credit environment	Market condition impact	Industry flows	Regulatory landscape	Overall
Europe	↔	↘	↔	↔	↔

Source: Fitch Ratings

Trend of Increasing WALs Is Expected to Continue in 2024
Of European MMFs



Source: Fitch Ratings IMoneyNet

Chinese Money Market Funds

Deteriorating Credit Environment

The economic environment in China remains challenging, reflected in continued property sector stress and pressure on local government financing vehicles. The deteriorating outlook on its banking sector indicates uncertainty about its credit quality. At end-3Q23, exposure to the banking sector accounted for about 70% of money funds market. Despite the deteriorating operating environment, MMFs are less affected given the nature of short duration and their focus on large banks.

Steady Growth in MMFs Assets

Chinese MMF assets totalled CNY11.4 trillion at end-3Q23. We expect AUM to continue to grow steadily with interest rates set to stay unchanged and monetary policy unlikely to tighten. Although MMFs yield has been at a record low, investors are inclined to stick to safer assets due to the weak environment and volatility of riskier assets. Real yields in MMFs have been rising due to low inflation.

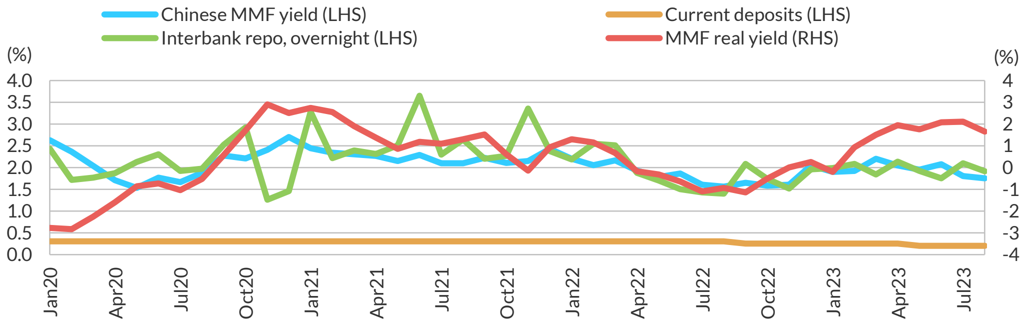
Limited Impact from Regulatory Changes

We do not expect ESG-related regulatory scrutiny in the near future. Rules targeting large MMFs were implemented in 2023, which had an impact on limited number of MMFs.

Summary of Drivers	Credit environment	Market condition impact	Industry flows	Regulatory landscape	Overall
China	↘	↔	↔	↔	↔

Source: Fitch Ratings

Nominal Yields Remain Low, Real Yields Picking Up



Source: Fitch Ratings, Wind Info, People's Bank of China, Federal Reserve Bank of St. Louis

Outlooks and Related Research

2024 Outlooks
Global Economic Outlook (December 2023)
Risk Headquarters (November 2023)

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