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US prime money funds raise eurozone exposure

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By Michael Mackenzie in New York

US prime money market funds have recently increased their exposure to banks in the eurozone after months of large reductions, but this key source of funding for the financial system remains vigilant about risk according to a new report by Fitch Ratings.

The exposure of the 10 largest US prime money funds to eurozone banks edged up to 11 per cent or $73.8bn of their $648bn of assets under management at the end of January from less than 10 per cent in December. US prime money market funds have a total of $1.44tn of assets.

Since May, top money market funds' exposure to eurozone institutions has dropped from a 31 per cent holding, or $234bn, as the sovereign debt crisis heightened concerns about the contagion to banks, who rely on US funding.

The rebound since the start of the year has come as concerns about the eurozones' financial system have been offset by the European Central Bank's provision of liquidity support via its Long Term Refinancing Operation.

The LTRO has eased investor concerns so far this year and the biggest beneficiary of that has been French banks, with money market funds increasing their exposure to $17.5bn from $7.1bn according to Fitch.

"Exposures to eurozone banks increased by 15 per cent on a dollar basis since end-December, driven by increased exposure to French banks," said Fitch on Thursday. "Recent ECB actions may have mitigated some investor concerns and helped to stem the money market funds outflows from eurozone banks."

US money market fund exposure to French banks, however, remains sharply below the $114bn figure seen last May according to Fitch's survey.

The funds in Fitch's sample historically allocated more than 30 per cent of their assets to eurozone banks between end-2006 and mid-2011.

"This may reflect a turning point or a new steady state, but some things continue to suggest a high degree of conservatism among the large prime money market funds," said Robert Grossman, analyst for macro credit research at Fitch and one of the report's three authors.

- Another factor that may limit a stronger rise in money market fund exposure to the eurozone is the desire of policy officials to reduce the reliance on short-term dollar financing.

"European financial supervisors are seeking to restrict their banks' reliance on short-term US dollar funding, particularly from MMFs," said Fitch.

US money market funds remain cautious with their holdings of Treasuries and agency debt at their highest level since the depths of the financial crisis in late 2008 and early 2009.

Based on data from money market funds and regulatory filings, Fitch estimates that 19 per cent of their total assets are held in top-rated US government-backed paper. That is up from 12.4 per cent last May and just shy of the 20.1 per cent peak during the first half of 2009.