Global Matters Weekly

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Another warning signal for financial markets

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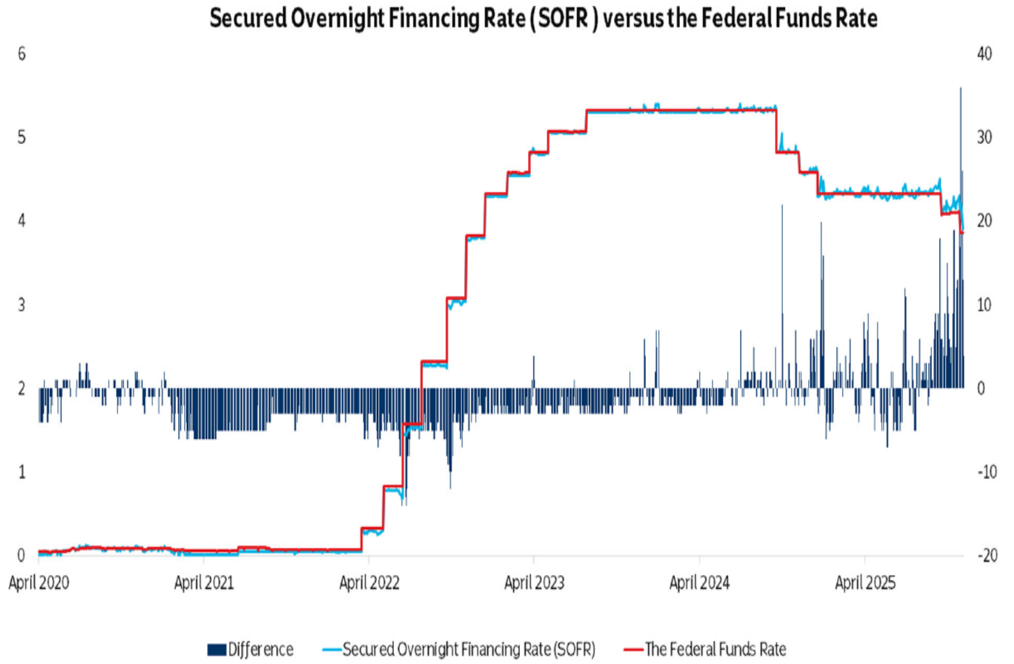

Source: Bloomberg Finance L.P. Data to 5 November 2025.

What this chart shows

The chart illustrates two key interest rates in the United States: The Federal Funds Rate and the Secured Overnight Financing Rate (SOFR).

Why this is important

SOFR, which replaced LIBOR (London Interbank Offered Rate) is widely used as the benchmark for short-term US dollar funding costs and serves as the primary reference rate for loans, derivatives, and other financial contracts.

From a fundamental perspective, SOFR should typically trade below the Federal Funds Rate, as it represents the least risky instrument from a credit standpoint. Data from 2020 to 2024 largely supports this assumption. However, readings from 2025 reveal a concerning divergence.

Recently, SOFR has risen significantly relative to the effective Federal Funds Rate. This shift reflects structural factors in short-term funding markets rather than changes in monetary policy. A key driver is the accumulation of large leveraged long positions in US Treasury cash bonds, financed through the repo market, as part of a popular futures arbitrage strategy. In this trade, investors buy Treasury securities and sell Treasury futures to exploit minor pricing discrepancies, relying heavily on repo financing.

The surge in demand for secured overnight funding has driven SOFR higher. In contrast, the Federal Funds Rate—an unsecured interbank rate less sensitive to collateralized leverage—has remained relatively stable. This divergence underscores how market positioning and liquidity dynamics within the repo market can temporarily distort the spread between SOFR and the Federal Funds Rate.

From a technical standpoint, a prolonged distortion in funding conditions may lead to forced liquidation of positions. This, in turn, could trigger a broader unwinding of leveraged trades across a wider range of asset classes.

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Important notes

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