BNY
iFlow
SHORT THOUGHTS

**September 24, 2024**

# Same Destination, Different Routes

- Markets and the Fed's Summary of Economic Projections agree on a terminal rate just below 3%
- They differ however on how quickly rates fall to that level
- Cross-border buying of USTs is now slightly positive, after selling in August

## Market Versus the Fed, Yet Again

It’s been a few days since the most consequential Fed meeting in over two years, at which the FOMC cut rates by 50bp last Wednesday. We had been anticipating a smaller 25bp cut, although the market reaction to the jumbo move (which was a 50-50 proposition going into the meeting) was rather contained. We attribute the lack of market breakout either way to the circumspect tone Chair Powell took in his post-meeting press conference, where he managed market expectations and couched the cut as a recalibration of monetary policy, reflecting both a better outlook on inflation and a more concerning view of the labor market.

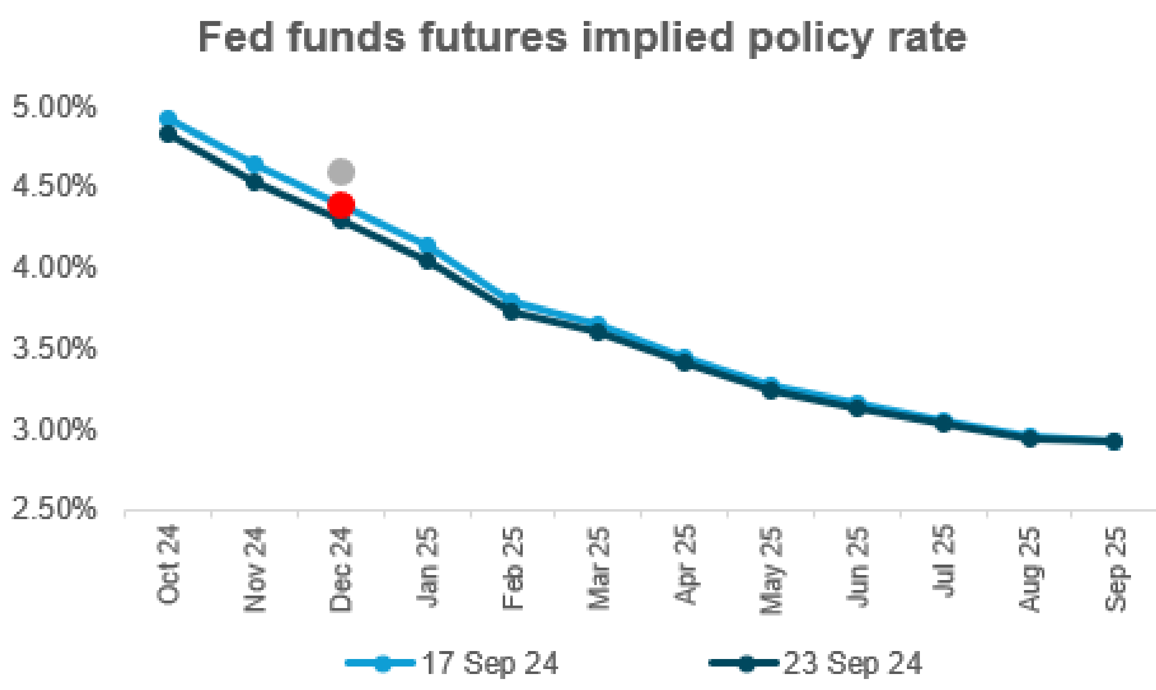
As we examine Exhibit #1 below, we are struck by how little market pricing has moved since the meeting. The lighter of the two lines displays federal funds futures’ implied policy rate out to next September. The darker line shows where the market is as of Monday afternoon. Only a slight move lower is seen, and only for the first few months of the forecast sample. This underscores how little the narrative has changed since the rate move last week.

Note in the figure that the terminal rate expectations stabilizes around 2.9%, not too far off that indicated by the Fed in its updated Summary of Economic Projections released Wednesday, which pinpointed the terminal rate at 2.875%. The difference is that the Fed doesn’t see this low level being achieved until the end of 2026, over two years away. The market sees the terminal rate being realized by the middle of 2025.

We find it noteworthy that the terminal rate is seen to be rather higher than we have been accustomed to seeing it, and that market expectation matches that of the Fed, even if there is a significant difference in timing. The Fed's projections for this variable had remained steady from mid-2019 through the end of 2023. This year, however, the longer run fed funds rate projected by the Committee has risen steady, and now stands nearly a half percentage point above where it ended last year. As Chair Powell conceded in his post-meeting press conference: "… it feels to me [...] that the neutral rate is probably significantly higher than it was back then…"

So now the market and the Fed are divided not about how low rates will go in this cycle, but rather about how soon we'll get there. The Fed sees rates moving lower over a longer period of time – essentially a very gradual easing cycle. This could speed up and be closer to the market's view if the labor market continues to weaken, which we think it could. We covered the nexus between the labor data and the rates outlook in Monday's Macro Morning Briefing (see here). The market might be ahead of the Fed, but the Fed might be well behind the market.

**Exhibit #1: Markets Have Barely Budged – Still Quick to Price 3%**




Source: BNY Markets, Bloomberg

## Cross-Border Treasury Demand Returns

About a month ago, we noted that cross-border US Treasury flows were negative, especially the longer out the curve one went (see here). We noted that our iFlow data by UST maturity bucket was registering significant selling by overseas investors, both in an absolute sense as well as relative to total flows. A lack of foreign buying is always something we look out for, especially if the trend were to persist, as it would indicate waning coupon demand – important for a fiscal authority to note when issuing new debt.

The good news is that in recent weeks cross-border selling of longer-dated USTs has pretty much ceased and in recent days has turned slightly positive. In Exhibit #2 below, we update our chart from a month ago, and we can see some non-trivial buying across the middle of the curve, between 1y and 10y in maturity. It’s still quite low compared to total buying, but the heavy selling has ceased.

We continue to track these cross-border flows, as we believe they are important information for overall demand in the longer-dated coupon market. There were two important periods in the last 12 months when foreign selling dominated total flows, as Exhibit #3 shows. The last two months of 2023 saw significant overseas sales, as did most of August 2025. In the first instance, we think that the peak in yields that occurred last autumn after the 10y note reached a post-GFC high of nearly 5%. The second case occurred in August around the time of the excessive market volatility early that month, and likely chased offshore investors back home. They seem to have called time on their retreat and are reentering the market – for now.

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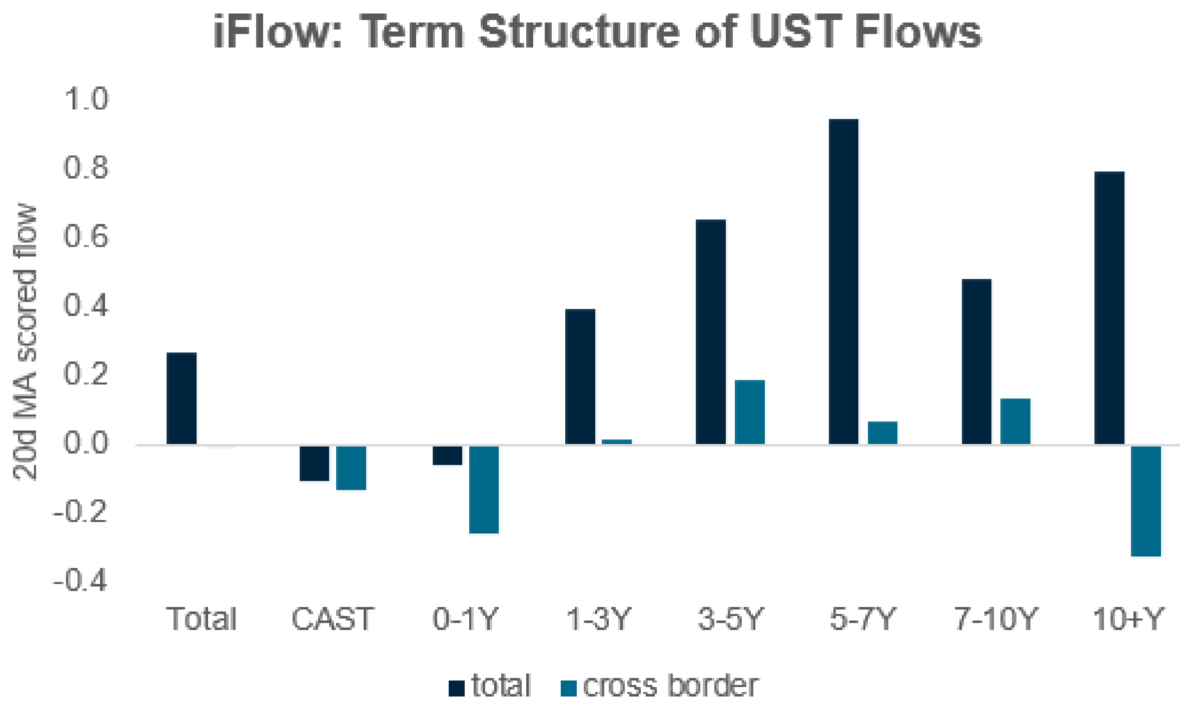
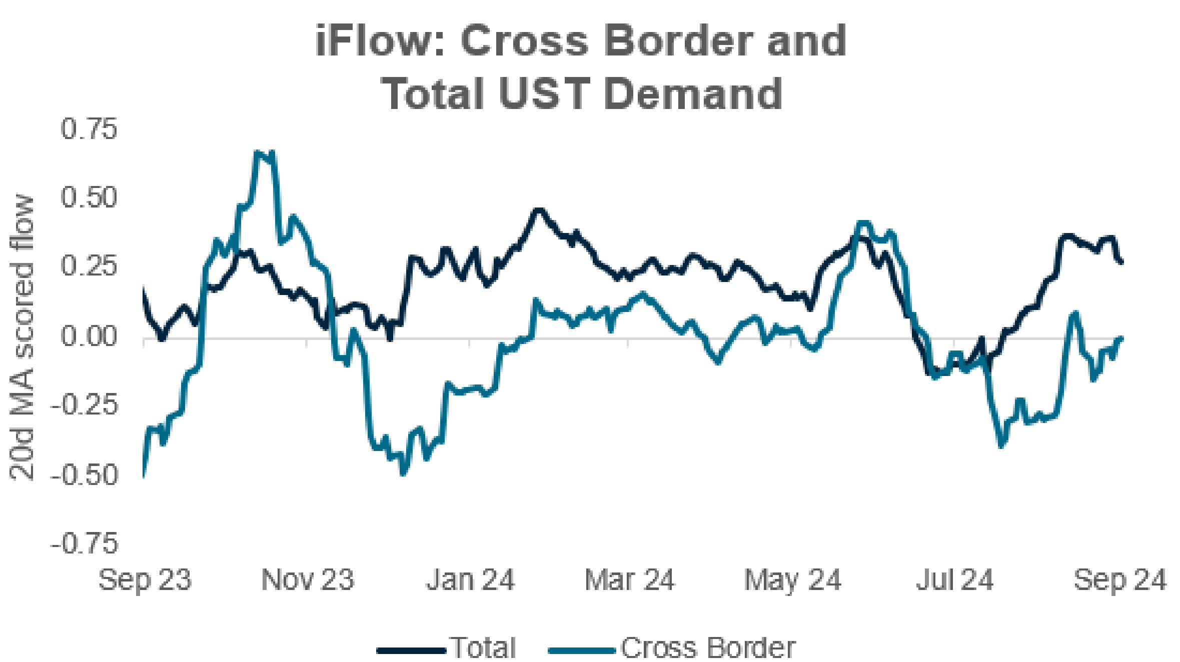
**Exhibit #2: Return of Cross-Border Buying**




Source: BNY Markets, iFlow

**Exhibit #3: Longer-Term Story Reveals Periods of Selling**




Source: BNY Markets, iFlow

**Please direct questions or comments to:** iFlow@BNY.com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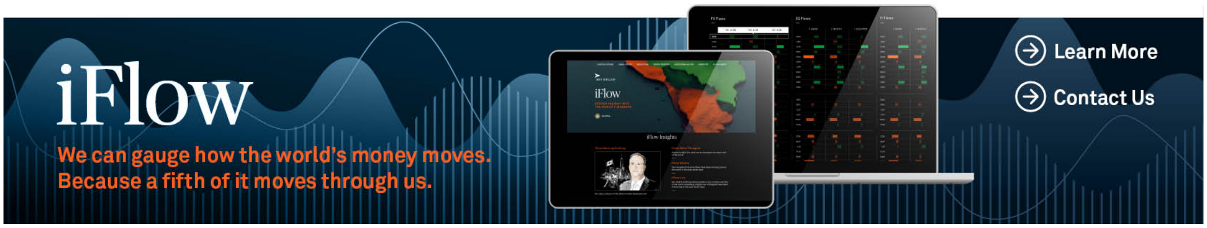



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