BNY MELLON

iFlow

SHORT THOUGHTS

April 2, 2024

US Tax Day Approaches

- Some historical context on tax receipts and reserves during April
- Tax intake this year shaping up to be large; reserves will decline this month
- iFlow shows lingering doubts about foreign demand for US Treasuries

Some Historical Numbers

The calendar has switched to April, which among other things means it's US personal income tax filing season. We recently wrote about a looming fall in bank reserves linked to taxes, highlighting that personal tax payments this year (for 2023 tax year) will likely be much larger than last year owing to higher incomes, higher capital gains, and the inclusion of California in filings after it was given a reprieve last year due to natural disasters there. We have suggested that as money comes out of deposits to pay federal tax liabilities, reserves will likely drop not insignificantly in April, wondering if that could lead to funding stresses.

Let's put some numerical context around this issue. In the chart below, we provide both the fall in bank reserves every year between mid- and end-April (blue bars), as well as the monthly tax receipts into the Treasury (orange bars). The data go back to 2011, several years after the Global Financial Crisis, when the US economy was on the road to recovery.

Note the directional behavior of each series. Receipts obviously increase relative to other months, while reserves decline. The correspondence isn't quite 1-for-1, but it is consistent: high tax receipt years correspond with larger reserve drainage. Behavior after 2019, with the onset of the pandemic, is especially interesting. We exclude 2020 because tax collection then was disrupted by lockdowns, and because reserves were growing due to extraordinary quantitative easing by the Federal Reserve at the beginning of the pandemic.

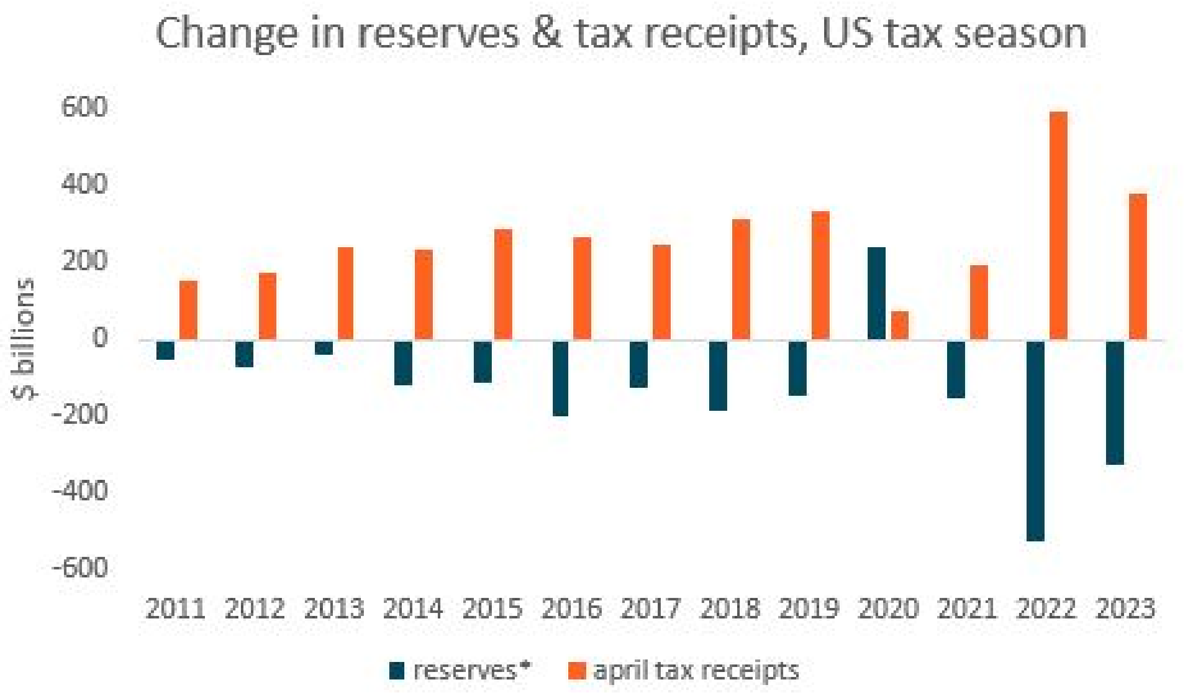
The unusually low tax take in 2021 reflects the impact on incomes as a consequence of the pandemic. In April of that year, tax receipts were below $200bn, compared to a pre-pandemic average of over $250bn. Reserves, for their part, declined by just $148bn. But by the time the calendar changed to 2022, a powerful recovery and ebullient stock market in 2021 resulted in the Treasury gathering nearly $600bn in revenues, while reserves took a hit of over $500bn on higher tax payments. Last year, both receipts and reserve drainage were lofty, but well below the 2022 observations thanks to the California and capital gains effects.

If tax payments this year behave more like in 2022 than in 2023, we could be looking at a drawdown in reserves of around $500bn. This would take reserves from around $3.5trn today down to just $3trn by the end of April – a potentially large decline that could strain funding markets if banks do not have sufficient reserve balances.

Although we don't know the exact number for the system-wide threshold for the lowest comfortable level of reserves (LCLoR), we wonder if a drain of the magnitude mentioned above could create shortages, if not in system-wide reserves at least on some bank balance sheets. We recently wrote that the Fed seems serious in its desire to slow the pace of quantitative tightening (QT) "fairly soon", perhaps fearing a reprise of September 2019, when funding stresses led the central bank to cease its QT from the post-GFC period altogether and actually expand its balance sheet to provide necessary liquidity to the banking system. We pointed out that in addition to fearing a do-over of that episode, Chair Powell commented in his March FOMC press conference that "liquidity is not evenly distributed in a system", suggesting concerns about some corners of the banking system.

To be sure, we are not predicting that funding markets will seize up. But any signs of strain in money markets rates could give the Fed discomfort. We will be watching for whether some banks – despite the stigma associated with doing so – tap the discount window (collateral should be plentiful) or the Standing Repo Facility. We will also be watching funding rates and repo markets for any signs of stress.

Tax Takes And Reserves Drawdowns



Source: BNY Mellon Markets, Bloomberg, Board of Governors of the Federal Reserve System, US Treasury
*change in system-wide reserves at the Fed between 1st and last weeks of April

---

iFlow On Foreign Demand For Treasuries

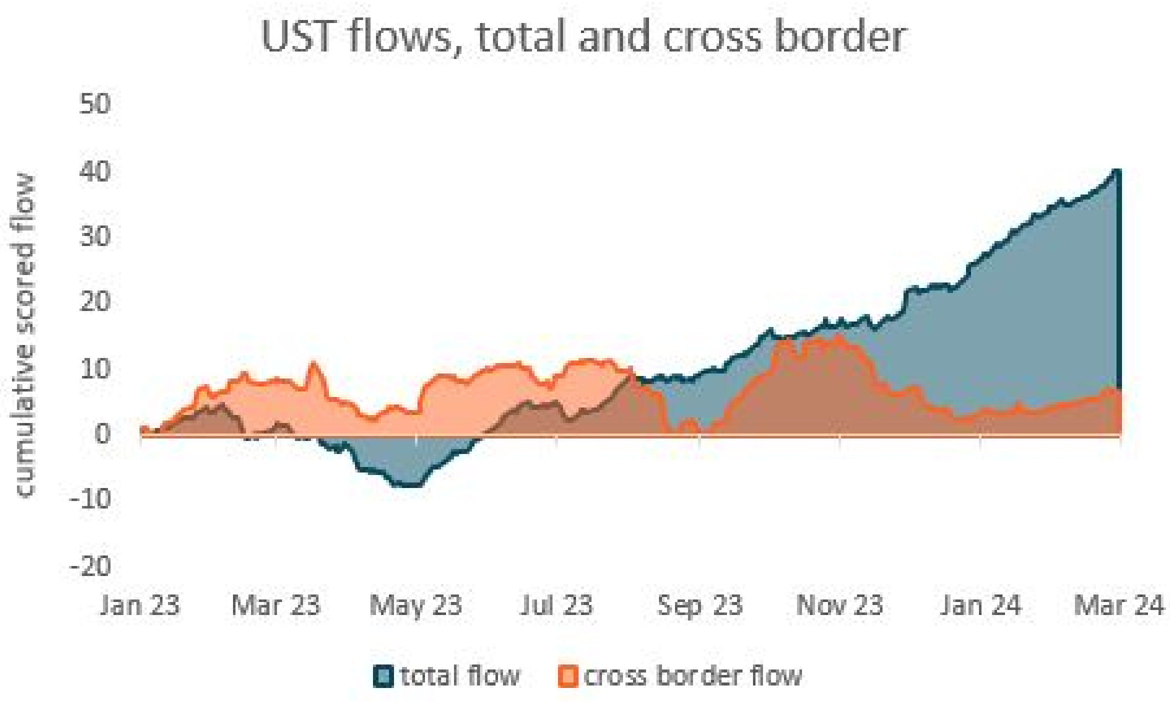
Changing tack, we continue to monitor foreign real money demand for US Treasuries. This has been a concern of ours for a while now, especially with heavy coupon issuance in the second half of the year as US fiscal indiscipline endures. Recall how 10y Treasury yields rose last autumn on similar circumstances around the fiscal and rates outlook.

From iFlow, we see that total demand for Treasuries – which includes both an on- and off-shore investor component – has been strong ever since last summer's debt ceiling crisis was averted (see the chart below). There has been almost inexorable demand for Treasuries (blue area segment). This shows real money demand is solid and strong, even as fiscal measures deteriorate and rates have generally been rising.

However, we've been observing less-steady demand from overseas investors. The orange segment shows cumulative purchases by just cross-border investors – again, all real money types. It has been much less consistent than the total flow, with several periods when they were shedding holdings. Since the beginning of 2024 cumulative flows have been flat, meaning no additional new flow. Indeed, if we look back to September 2023, most of the overseas flow into Treasuries has been negative or stable. Not a lot of new demand.

We're watching this as the rates cycle evolves – we still expect a June rate cut from the Fed – and, in our view more importantly, government funding needs in H2. If foreigners continue to eschew Treasuries, and domestic investors find themselves well overweight, demand might not meet supply. Hence our call for steepeners in the second half of the year.

Foreign Support Lacking



Source: BNY Mellon Markets, iFlow

Disclaimer & Disclosures

Please direct questions or comments to: iFlow@BNYMellon.com

John Velis
AMERICAS MACRO STRATEGIST

CONTACT JOHN