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iFlow

SHORT THOUGHTS

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US Household Credit Tightening

Monetary Policy Transmission Mechanism Is Working

On Monday, the New York Federal Reserve released its monthly Survey of Consumer Expectations for August. One of the most widely watched items among a panoply of data is one-year ahead inflation expectations. They nudged slightly higher, to 3.6% from 3.5% in July. Three- and five-year ahead expectations were 2.8% and 3.0%, respectively. Those have been behaving well in recent months.

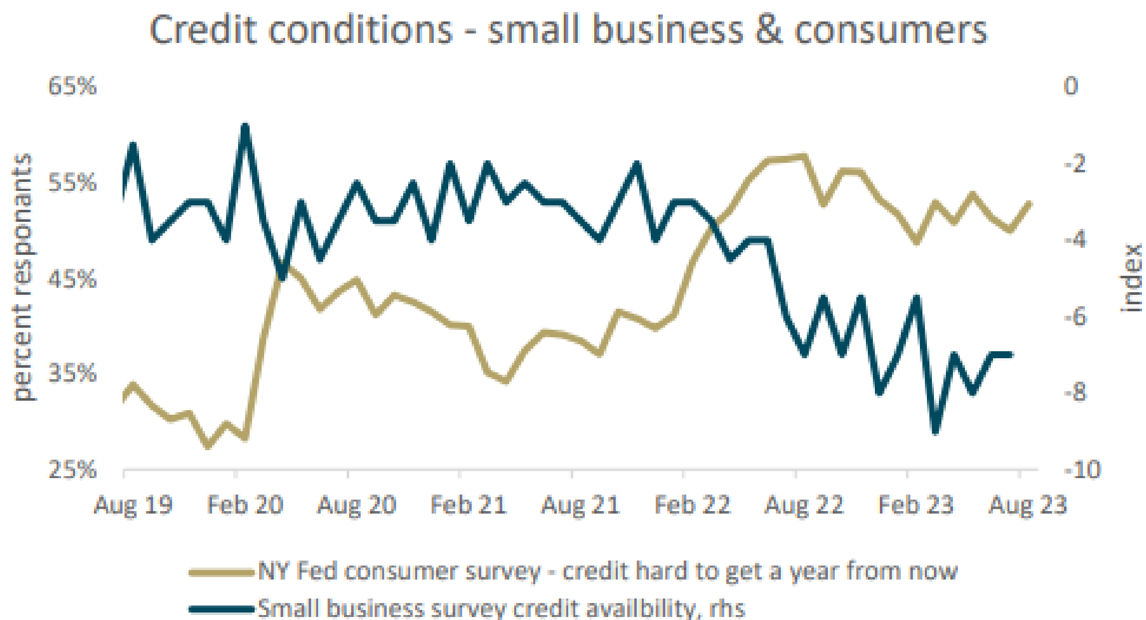
More interesting to us are the data on household finance. Combined with other indicators of credit growth in the economy – many of which we have discussed in prior Short Thoughts – the SCE shows deterioration in year-ahead expectations for credit availability. In other words, households are not optimistic that credit will be easy to obtain in a year's time: 39% expect that credit will be "somewhat harder" to obtain over the next 12 months, and 13.7% expect it to be "much harder" to obtain. Combined, that makes nearly 53% of households surveyed which expect to have a harder time getting credit. That is slightly lower than the recent peak of 57.8% last August, but the trend is clear. The chart below plots this figure over time (amber line), alongside another measure of credit availability for small businesses from National Federation of Independent Businesses monthly survey (blue line).

In addition, we are aware of a number of survey indicators from other sources (e.g., the Senior Loan Officer Opinion Survey on Bank Lending) that show tightening credit standards and waning demand for loans. We have been arguing that one of the channels

for monetary policy transmission through to the real economy is for credit across the economy to become restricted, reducing demand and slowing growth. These data suggest that this is happening, albeit rather slowly. That pace is a good thing – a gradual decline in credit usage across the economy is better than a “sudden stop” in lending, as happens when the economy is hit by a shock (like COVID or the GFC). We continue to expect no rate hikes from the Fed for the remainder of this cycle, although the market is still placing a not insignificant probability, currently around 37%, on a hike in November.

We think that as the next couple of months unfold, the labor market, household consumption, and credit growth will slow, precluding another rate hike, even as core inflation only stubbornly recedes. Given higher energy prices over the last month, we expect headline CPI for August, released Wednesday, to print higher than the 3.2% for July. We expect the Fed to look through these energy-induced increases in headline inflation and focus on core inflation instead. We discussed the main drivers of core inflation (PCE deflator, the Fed’s preferred measure of prices) in a recent piece (see here), and concluded that although core services ex-housing prices – the so-called “Powell supercore” – remain sticky, core goods continue to disinflate and housing costs appear to have peaked.

Households And Small Business Feeling The Squeeze



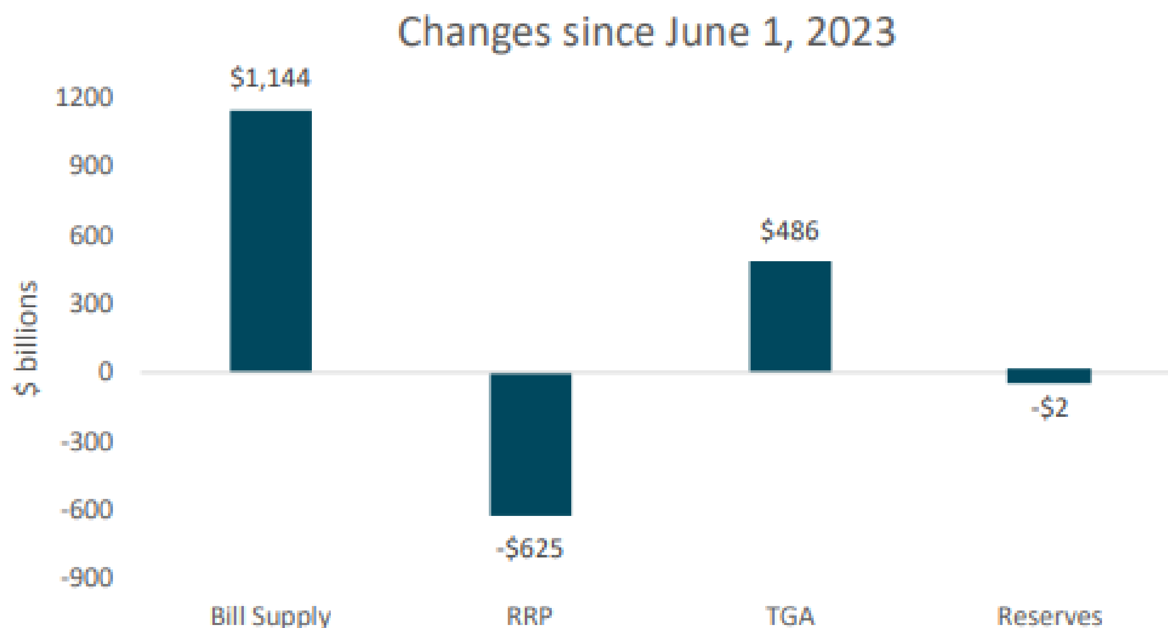
Source: BNY Mellon, Federal Reserve Bank of New York, Bloomberg

Less Concerned About Reserves Shortage

We continue to see encouraging signs that the decline in the Fed's overnight reverse repurchase (RRP) balances is yet ongoing, and that the massive – and also ongoing – bill issuance by the US Treasury since the debt ceiling was resolved in early June is being absorbed by the market fairly smoothly. Since June 1, net T-bill issuance has topped $1.1 trillion dollars, leaving an estimated $400-500bn to go over the remainder of this year. Also since June 1, RRP balances have declined by nearly $625bn and the Treasury General Account (TGA) has been refilled from a low of $22bn to $509bn as of last Friday. Interestingly, the sum of the decline in RRP balances and the increase in the TGA is also slightly above $1.1trn. As a result, bank reserves in the system remained nearly identical between May 31 and Sept. 6, declining by just $2bn.

Our fear of reserve shrinkage has been assuaged by these developments. We're also encouraged that the TGA rebuild can proceed as planned (Treasury has indicated a target of $600bn for end-September), while the RRP facility continues to shrink without running down reserves too quickly and creating fears or a shortage of reserves by the end of the year.

Much Has Happened Since Early June



Source: BNY Mellon Markets, Federal Reserve Board of Governors, Bloomberg

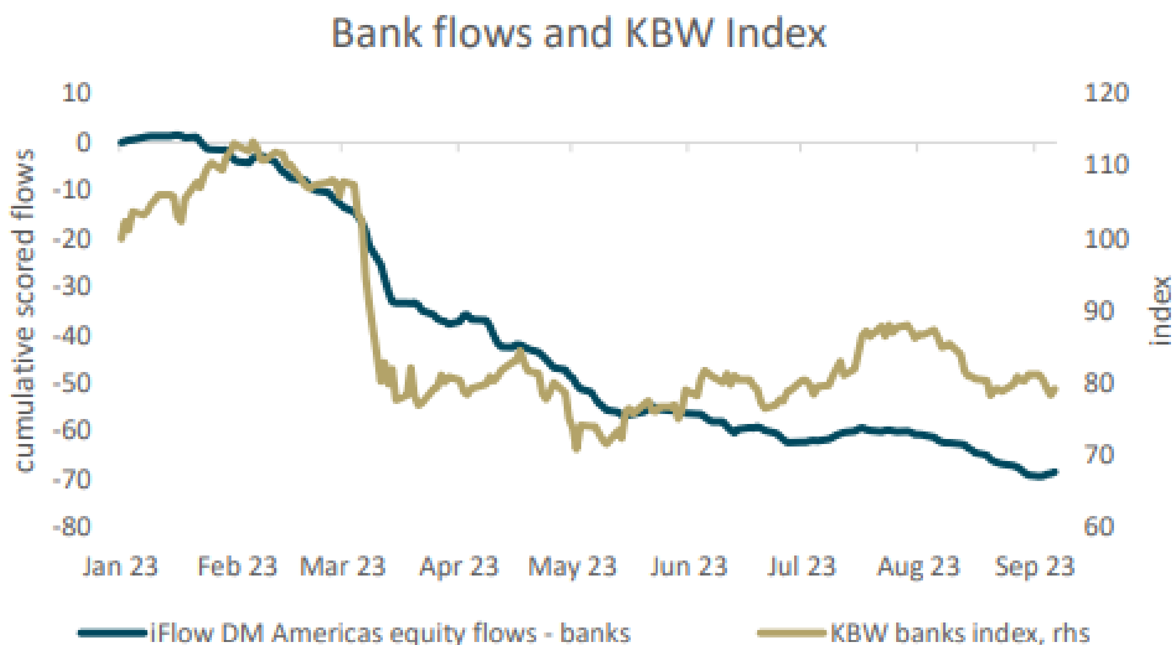
What iFlow Says About Bank Stocks

iFlow allows us to examine, at a regional level, flows into specific equity groups. In particular, we note that for the DM Americas region, which is dominated by the US, bank

stocks are still not drawing significant investor demand. The chart below plots cumulative scored flows for DM Americas banks alongside the KBW banking index. After declining quickly in March through May, the selling in bank shares has continued, but at a much slower pace. There have been some episodes of buying, such as between July and August this past summer, and not surprisingly the banking stock index (amber line) rose along with this incremental increase in demand. Nevertheless, we still see the sector as broadly being shunned, and a recovery in the KBW index some time off.

We acknowledge that some of the risks facing the banking sector remain. Namely, banks' exposure to interest-rate sensitive assets – not least Treasury securities, but also loans, commercial real estate exposures, and other forms of financing. Furthermore, funding costs have increased, and deposits are stable – not rising. Add in renewed regulatory scrutiny and impending increases in capital and liquidity requirements, and you have a sector that is facing a profitability challenge, rather than solvency or liquidity problems. This appears reflected in investors avoiding taking large equity exposures to banks in general.

Demand Still Lacking For Bank Shares



Source: BNY Mellon Markets, Bloomberg, iFlow

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

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