BNY MELLON

iFlow

SHORT THOUGHTS

JOHN VELIS
FX AND MACRO STRATEGIST FOR THE AMERICAS

August 1, 2023

US Funding Needs And Lending Standards

A Cool Trillion

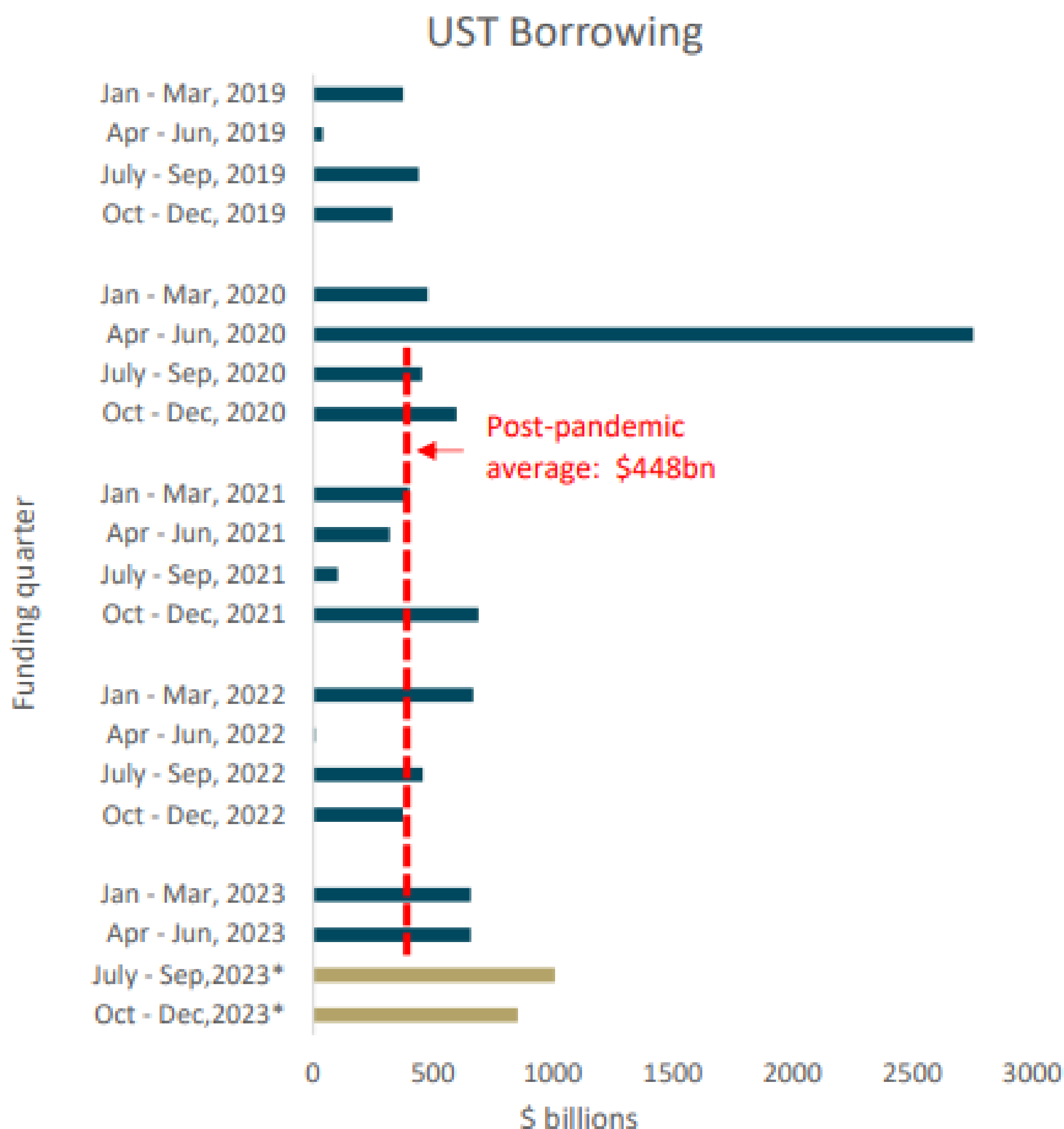
We wrote about some of the economic and market events of last week in our Monday *Morning Briefing* (see here). In a nutshell, we became more optimistic on the possibility of a soft landing in the US, or at least a slowdown delayed, if not cancelled outright towards the very end of the year. Now we move on to this week, which also features some important news – some of which has already arrived. The US Treasury on Monday unveiled updated financing estimates for the remainder of the third quarter and the fourth quarter of the year (discussed below). Furthermore, the July Senior Loan Officer Opinion Survey on Bank Lending Practices (SLOOS) was released on Monday as well and gave us a read on credit supply and demand. Following on from the borrowing estimates, the Treasury on Wednesday will announce the refunding plans, as well as issuance plans across maturities. We also get important labor market readings, starting with the Job Openings and Labor Turnover Survey (JOLTS) on Tuesday. Nonfarm payrolls for July follow on Friday.

As for Monday's financing estimates, the amount of borrowing that Treasury reckons is necessary for the remainder of this quarter was always expected to be revised higher and, indeed, the eye-popping amount of just over $1 trillion exceeded even the most aggressive expectations. The initial forecast in May foresaw $726bn in issuance in Q3, well below Monday’s number. The Treasury’s cash pile for the end of the quarter, or the Treasury General Account (TGA), was also seen swelling from an initial estimate in May of $600bn to $650bn. For Q4, Treasury expects (as of now) to borrow an initial $852bn

and finish the year with the TGA at $750bn. The $1 trillion target for Q3 and $852bn target for Q4 would represent the largest borrowing requirements since the throes of the pandemic, when the April-June quarter of 2020 brought $2.75 trillion in issuance. Borrowing expectations for Q3 and Q4 of 2023 reflect a higher fiscal deficit for H2 2023 and a higher TGA.

This Wednesday we'll get the actual proposed auction sizes for the portion of the borrowing requirement that will be fulfilled by coupon issuance. We expect these numbers to be large – and potentially surprise the market. We have warned of a bear steepening of the yield curve through the end of the year, and one of the driving factors was expected to be heavy coupon issuance. We expect these fears to be confirmed on Wednesday.

Two Quarters Of Heavy Issuance



Source: BNY Mellon and US Treasury

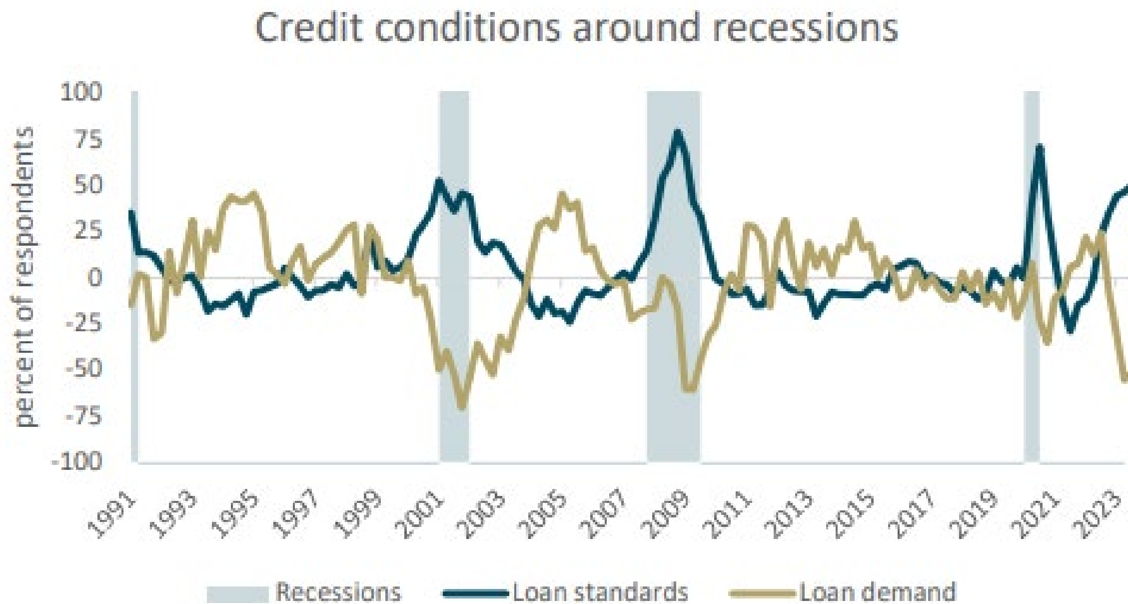
Hard To Find A Lender Or A Borrower

In addition to the funding announcement, Monday also brought the release of the July SLOOS, as mentioned above. We were afforded a "sneak preview" last Wednesday at Chair Powell's post-FOMC meeting press conference. He saw the data a few days before being released publicly and said: "it's broadly consistent with what you would expect. You've got lending conditions tight and getting a little tighter, you've got weak demand, and you know, it gives a picture of a pretty tight credit conditions in the economy."

Indeed, Powell's teaser was right on the money. Overall lending standards, already tight, became tighter across all credit products, borrower types, and lender types. As the chart below shows, standards for commercial and industrial loans for large- and medium-sized firms tightened further, although only slightly, since the April SLOOS. Exactly half of all banks reported tighter credit conditions. Loan demand, already negative, fell further. Moreover, reading through the press release, the qualitative assessment was similarly discouraging. "On balance, levels of standards are currently on the tighter end of the range for all loan categories. Compared with the July 2022 survey, banks reported tighter levels of standards in every loan category." Regarding the outlook for the rest of the year, the SLOOS offered that "banks reported expecting to further tighten standards on all loan categories. Banks most frequently cited a less favorable or more uncertain economic outlook and expected deterioration in collateral values and the credit quality of loans as reasons for expecting to tighten lending standards further over the remainder of 2023."

The SLOOS is important for two reasons. First, it describes an environment in which credit is shrinking and has been for a few quarters now – even before the banking sector stresses of March and April. This should work to slow the economy. Second, and following from our first point, it suggests that in a world where lending is contracting, banks will struggle to increase net interest income, something that also came to light in banks' quarterly earnings reports.

More Of The Same



Source: BNY Mellon Markets, Federal Reserve Board of Governors

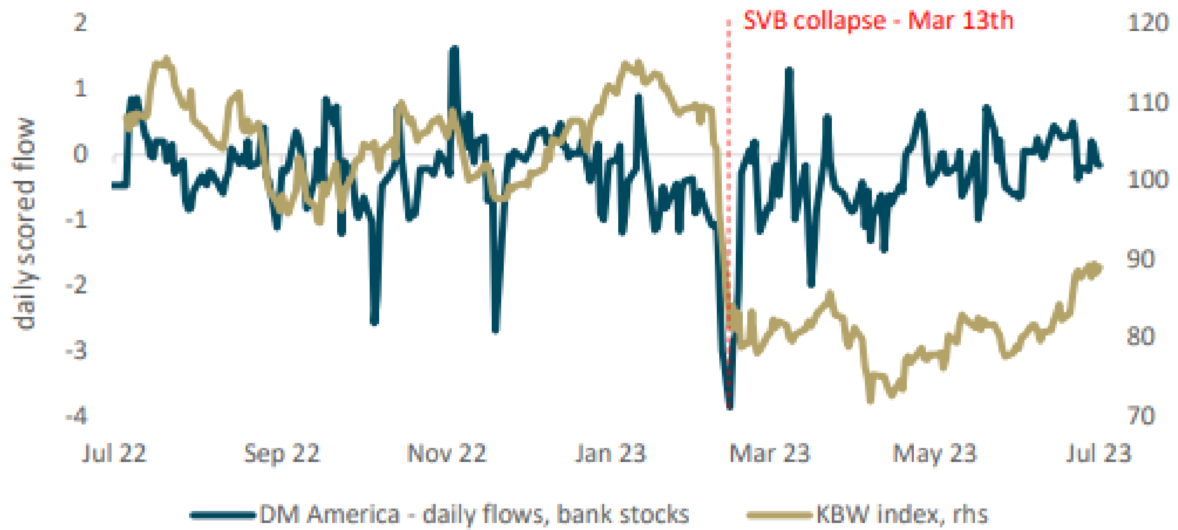
Looking For Some Demand

Regarding banks, we can see the behavior of real money investors toward this equity sector via iFlow data, which allows us to disaggregate flows down to the industry level (after sector and industry group) for major geographic regions. We can gauge investor behavior towards banks in the developed Americas region – essentially the US and Canada.

We can see that over the course of the last 12 months, bank stocks in North America have generally been shunned by investors in our database, with an exaggerated – but entirely understandable – collapse on March 13 reflecting the initial stages of the banking sector stresses this past spring. Since then, there has been somewhat of a recovery in bank equity flows, helping the KBW banks index to recover partially (gold line).

Given profitability concerns for the banking industry – e.g., declining loan growth, higher funding costs, lower net interest income, the prospect of increasing capital and regulatory requirements and provisions for credit losses – we would likely need to see some catalyst to really move bank equity flows into positive territory. So, while the flows don't point to future banking system concerns, they don't signal "all in" on the industry group, either.

Bank Flows Still Not Recovered



Source: BNY Mellon Markets, iFlow

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

John Velis

FX AND MACRO STRATEGIST FOR THE AMERICAS

CONTACT JOHN

bnymellon.com

BNY Mellon is the corporate brand of The Bank of New York Mellon Corporation and may be used as a generic term to reference the corporation as a whole and/or its various subsidiaries generally. This material and any products and services may be issued or provided under various brand names in various countries by duly authorized and regulated subsidiaries, affiliates, and joint ventures of BNY Mellon, which may include any of the following. The Bank of New York Mellon, at 225 Liberty St, NY, NY USA, 10286, a banking corporation organized pursuant to the laws of the State of New York, and operating in England through its branch at One Canada Square, London E14 5AL, UK, registered in England and Wales with numbers FC005522 and BR000818. The Bank of New York Mellon is supervised and regulated by the New York State Department of Financial Services and the US Federal Reserve and authorized by the Prudential Regulation Authority. The Bank of New York Mellon, London Branch is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request. The Bank of New York Mellon SA/NV, a Belgian public limited liability company, with company number 0806.743.159, whose registered office is at 46 Rue Montoyerstraat, B-1000 Brussels, Belgium, authorized and regulated as a significant credit institution by the European Central Bank (ECB), under the prudential supervision of the National Bank of Belgium (NBB) and under the supervision of the Belgian Financial Services and Markets Authority (FSMA) for conduct of business rules, and a subsidiary of The Bank of New York Mellon. The Bank of New York Mellon SA/NV operates in England through its branch at 160 Queen Victoria Street, London EC4V 4LA, UK, registered in England and Wales with numbers FC029379 and BR014361. The Bank of New York Mellon SA/NV (London Branch) is authorized by the ECB and subject to limited regulation by the Financial Conduct Authority and the Prudential Regulation Authority. Details about the extent of our regulation by the Financial Conduct Authority and Prudential Regulation Authority are available from us on request. The Bank of New York Mellon SA/NV operating in Ireland through its branch at 4th Floor Hanover Building, Windmill Lane, Dublin 2, Ireland trading as The Bank of New York Mellon SA/NV, Dublin Branch, is authorised by the ECB and is registered with the Companies Registration Office in Ireland No. 907126 & with VAT No. IE 9578054E. The Bank of New York Mellon, Singapore Branch, subject to regulation by the Monetary Authority of Singapore. The Bank of New York Mellon, Hong Kong Branch, subject to regulation by the Hong Kong Monetary Authority and the Securities & Futures Commission of Hong Kong. If this material is distributed in Japan, it is distributed by The Bank of New York Mellon Securities Company Japan Ltd, as intermediary for The Bank of New York Mellon. If this material is distributed in, or from, the Dubai International Financial Centre (“DIFC”), it is communicated by The Bank of New York Mellon, DIFC Branch, regulated by the DFSA and located at DIFC, The Exchange Building 5 North, Level 6, Room 601, P.O. Box 506723, Dubai, UAE, on behalf of The Bank of New York Mellon, which is a wholly-owned subsidiary of The Bank of New York Mellon Corporation. This material is intended for Professional Clients only and no other person should act upon it. Not all products and services are offered in all countries.

The information contained in this material is intended for use by wholesale/professional clients or the equivalent only and is not intended for use by retail clients. If distributed in the UK, this material is a financial promotion.

This material, which may be considered advertising, is for general information purposes only and is not intended to provide legal, tax, accounting, investment, financial or other professional advice on any matter. This material does not constitute a recommendation by BNY Mellon of any kind. Use of our products and services is subject to various regulations and regulatory oversight. You should discuss this material with appropriate advisors in the context of your circumstances before acting in any manner on this material or agreeing to use any of the referenced products or services and make your own independent assessment (based on such advice) as to whether the referenced products or services are appropriate or suitable for you. This material may not be comprehensive or up to date and there is no undertaking as to the accuracy, timeliness, completeness or fitness for a particular purpose of information given. BNY Mellon will not be responsible for updating any information contained within this material and opinions and information contained herein are subject to change without notice. BNY Mellon assumes no direct or consequential liability for any errors in or reliance upon this material.

This material may not be distributed or used for the purpose of providing any referenced products or services or making any offers or solicitations in any jurisdiction or in any circumstances in which such products, services, offers or solicitations are unlawful or not authorized, or where there would be, by virtue of such distribution, new or additional registration requirements.

The terms of any products or services provided by BNY Mellon to a client, including without limitation any administrative, valuation, trade execution or other services shall be solely determined by the definitive agreement relating to such products or services. Any products or services provided by BNY Mellon shall not be deemed to have been provided as fiduciary or adviser except as expressly provided in such definitive agreement. BNY Mellon may enter into a foreign exchange transaction, derivative transaction or collateral arrangement as a counterparty to a client, and its rights as counterparty or secured party under the applicable transactional agreement or collateral arrangement shall take precedence over any obligation it may have as fiduciary or adviser or as service provider under any other agreement.

Pursuant to Title VII of The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and the applicable rules thereunder, The Bank of New York Mellon is provisionally registered as a swap dealer with the Commodity Futures Trading Commission (“CFTC”) and is a swap dealer member of the National Futures Association (NFA ID 0420990).

BNY Mellon (including its broker-dealer affiliates) may have long or short positions in any currency, derivative or instrument discussed herein. BNY Mellon has included data in this material from information generally available to the public from sources believed to be reliable. Any price or other data used for illustrative purposes may not reflect actual current conditions. No representations or warranties are made, and BNY Mellon assumes no liability, as to the suitability of any products and services described herein for any particular purpose or the accuracy or completeness of any information or data contained in this material. Price and other data are subject to change at any time without notice.

Rates: neither BNY Mellon nor any other third party provider shall be liable for any errors in or delays in providing or making available the data (including rates, WM/Reuters Intra-Day Spot Rates and WM/Reuters Intra-Day Forward Rates) contained within this service or for any actions taken in reliance on the same, except to the extent that the same is directly caused by its or its employees’ negligence. The WM/Reuters Intra-Day Spot Rates and WM/Reuters Intra-Day Forward Rates are provided by The World Markets Company plc (“WM”) in conjunction with Reuters. WM shall not be liable for any errors in or delays in providing or making available the data contained within this service or for any actions taken in reliance on the same, except to the extent that the same is directly caused by its or its employees’ negligence.

The products and services described herein may contain or include certain “forecast” statements that may reflect possible future events based on current expectations. Forecast statements are neither historical facts nor assurances of future performance. Forecast statements typically include, and are not limited to, words such as “anticipate”, “believe”, “estimate”, “expect”, “future”, “intend”, “likely”, “may”, “plan”, “project”, “should”, “will”, or other similar terminology and should NOT be relied upon as accurate indications of future performance or events. Because forecast statements relate to the future, they are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict. iFlow® is a registered trademark of The Bank of New York Mellon Corporation under the laws of the United States of America and other countries.

This document is intended for private circulation. Persons accessing, or reading, this material are required to inform themselves about and to observe any restrictions that apply to the distribution of this information in their jurisdiction.

Currency Administration is provided under and subject to the terms of a definitive agreement between BNY Mellon and the client. BNY Mellon exercises no investment discretion thereunder, but acts solely pursuant to the instructions in such agreement or otherwise provided by the client. Unless provided by definitive agreement, BNY Mellon is not an agent or fiduciary thereunder, and acts solely as principal in connection with related foreign exchange transactions.

All references to dollars are in US dollars unless specified otherwise.

This material may not be reproduced or disseminated in any form without the prior written permission of BNY Mellon. Trademarks, logos and other intellectual property marks belong to their respective owners.

The Bank of New York Mellon, member FDIC.

© 2020 The Bank of New York Mellon Corporation. All rights reserved.