BNY MELLON

iFlow

SHORT THOUGHTS

May 21, 2024

US Treasury Market Inferences From iFlow

Foreign Demand, Duration Grab, Short Maturity Flows

- iFlow well-suited to examine US government bond market
- Foreigners generally shunning the market, real money buying longer duration
- Short duration real money flows mirror MMF behavior in the RRP/T-bill space

Locals Buying, Foreigners Not So Much

iFlow, which we often highlight in these pages, is a unique data product at BNY Mellon. Derived from our nearly $50trn in assets under custody, iFlow allows us, in an anonymized and aggregated fashion, to capture real money long-only investment flows across multiple markets around the world. We can see trends and market positioning for this investor type.

Under the iFlow umbrella we produce several useful data series related to the US Treasury (UST) market. We can segment UST flows by maturity and look at very short duration UST flows alongside cash and other short-term instruments (CAST). We can also examine cross-border appetite (alongside total demand) for USTs across maturity buckets and in total. Today we give some of the major insights on the UST market we currently observe across the iFlow suite. In particular, we look at total versus foreign demand for USTs, duration chasing among USTs, and the behavior of flows into short duration USTs and CAST.

Let’s first look at overall demand for USTs. The chart below illustrates cumulative scored flow for all USTs across the entire curve. We choose Dec. 30, 2022, for our starting point, or zero value. Then every day we add the flows on that day. This method of viewing flows allows us to see trends up and down in UST demand, via the changing slope of the line depicting this time series. We find this preferable to using daily or weekly flows (or other time spans), given the short-term volatility of the series. In addition to total cumulative flows (both domestic and foreign), we plot cross-border cumulative flow over the same time period.

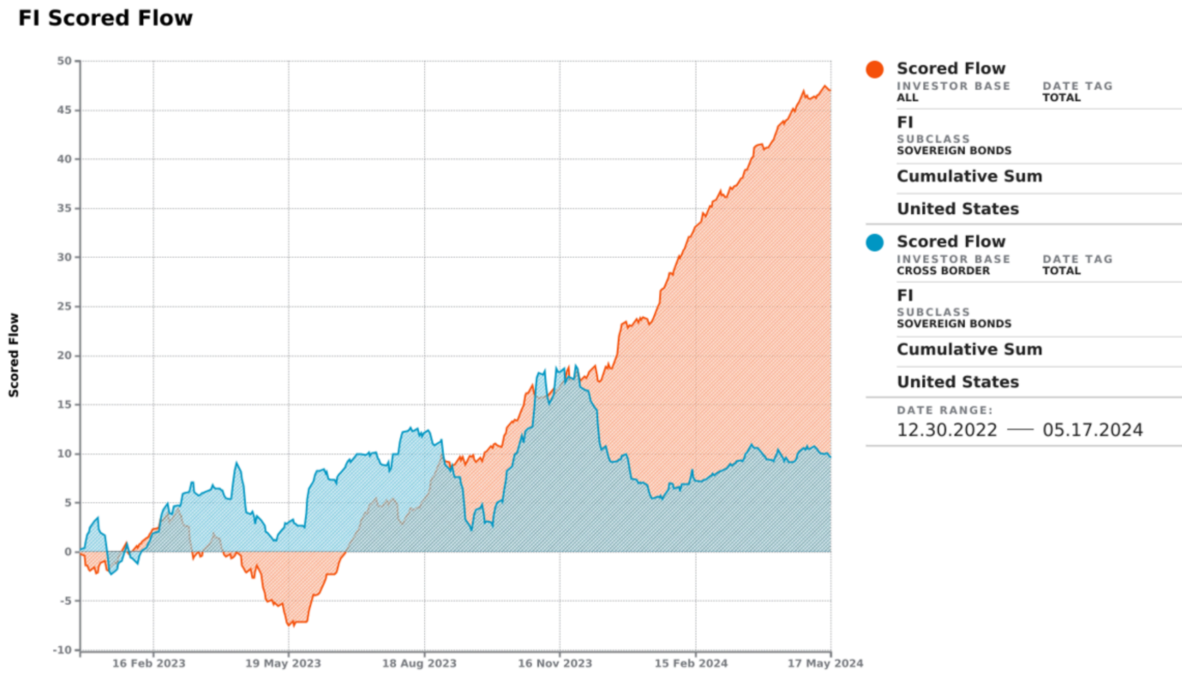
Several observations from the graph are noteworthy. Since the end of May 2023, we have seen an almost inexorable rise in UST buying by real money investors. That period coincides with the culmination of the latest debt limit process. Leading into the presumed X-date, UST flows (red area) were negative. Fears of a default presumably dissuaded investors from adding to positions, and we actually saw outflows from late April through the end of May. In addition, Treasury issuance slowed to a trickle as the debt ceiling neared.

From early June 2023 through the present, with the debt ceiling temporarily resolved, Treasury issuance resumed and the bond grab began in earnest. Since then, even while 10y yields flirted with 5% last autumn, UST demand soared and continued to, with only short breaks in the upward trajectory. Since the beginning of this month demand has flattened out.

More glaringly, foreign – or cross-border – demand for USTs has been flat lately. The time series show cumulative flow, so the relatively flat part of the cross-border graph since the end of February reveals that almost no new net buying by foreigners occurred.

Both these time series reveal some worry for us, regarding the rates outlook across the curve. We have been resolute in our concern of supply and demand dynamics over the next few years. With domestic holders' UST positions so full and foreign demand moribund, we have concerns over the ability of market participants to absorb what we expect to be heavy coupon issuance over (at least) the next several quarters. This is one of our workhorse charts and we will be keeping a wary eye on it in months to come.

Where Is The Foreign Demand?



Source: BNY Mellon Markets, iFlow

Duration Grab

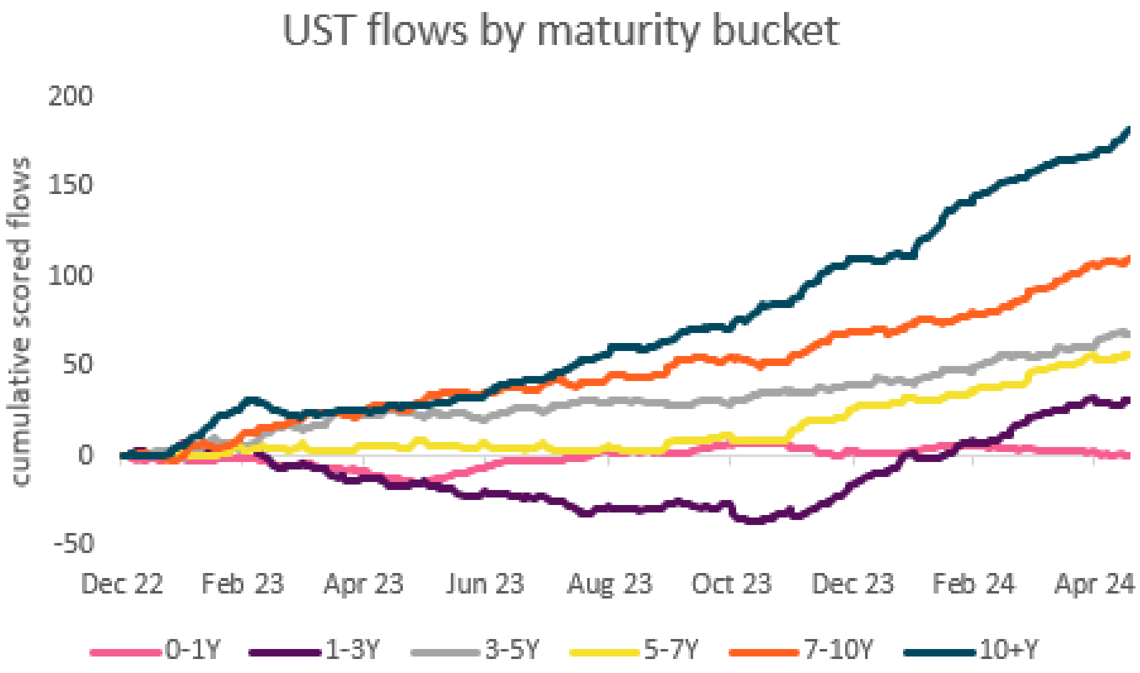
We referenced the market chasing yields higher after June 2023. Within that move by investors, the data shows us a duration grab taking place since then, as well. The (colorful) chart below shows cumulative flows, again with Dec. 30, 2022, as the starting point.

The long-maturity bucket, corresponding to 10y and longer maturities (dark blue line), suggests steady, consistent buying over the entire sample period. Similar behavior, but to a slightly lesser extent, is observed in the next longest maturity bucket shown, the 7-10y.

More recently, the 5-7y and even 3-5y portions of the curve have seen renewed demand. These time series had been rather flat through the end of 2023 but have increased notably since then. The frequently shunned belly of the curve, probably due to relative-value considerations and curve positioning, has long been eschewed, but since the beginning of 2024, our iFlow data suggest that this sector of the curve has recently become attractive to real money investors. Only the shortest maturity segments of the curve buck this buying trend. Flows in the 1-3y (purple line) and sub-1y (magenta) buckets have been tepid in the case of the latter, and quite negative until the beginning of this year for the former.

Duration positioning is getting longer, and any instrument that offers higher duration is seeing demand. This corroborates the overall message from the first graph but delineates where on the curve the buying is taking place – everywhere but the shortest parts.

Buying More Duration



Source: BNY Mellon Markets, iFlow

Short Duration Behavior Resembles MMFs RRP Behavior

Finally, we look more closely at short-term flows into bonds and/or cash and cash-like instruments. The chart below shows cumulative flows (again since the end of 2022) into US debt with less than one year to maturity (includes T-bills as well as longer-maturity issues that have less than one year left before maturing), and CAST.

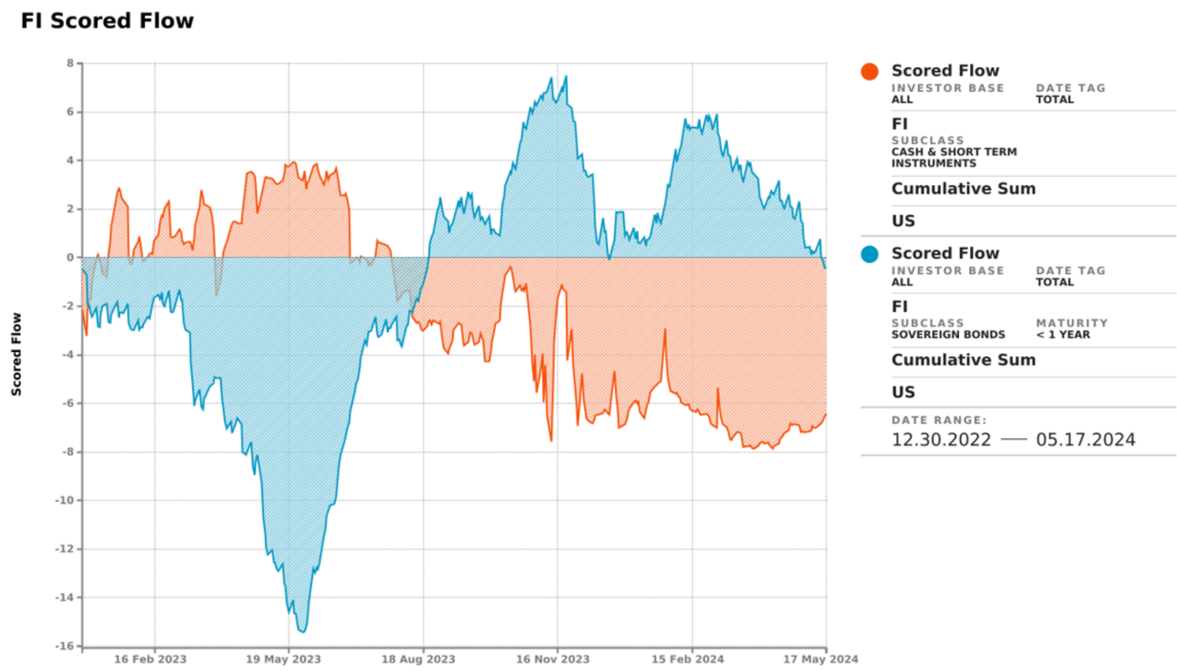
Again, we see (blue area graph below) that going into the debt ceiling, with T-bill issuance nearly fully curtailed in the lead up to the forecasted X-date, and buyers not interested in holding the shortest dated – and therefore more likely to be in default with a breach of the ceiling – paper, a deep drop in 0-1y maturity flows. Cash holdings increased over the same period. Since then, cash holdings have been run down, with a significant drop over the summer of 2023, and a steady, further erosion of demand persisting through the present.

We find the indifferent behavior of short sovereign debt flows most interesting. After the debt ceiling, short maturity flows increased, with the resumption of bill issuance and steadily rising T-bill yields as the Fed tightening cycle reached its apex last July. A big drop ensued from late November through the beginning of February this year, presumably as the Fed started to pivot its policy bias, confirmed at the December FOMC meeting. Then another leg up, and subsequent sustained and heavy selling.

In some ways, we view this behavior – out of cash and into short paper – as analogous to the behavior of money market funds (MMFs) after the suspension of the debt ceiling – draining cash parked in the Fed's overnight reverse repurchase facility and entering the newly resurgent bills market. It seems that the same trade is going on with real money, as well. MMF usage of RRP has broadly stabilized around $450bn, give or take, as negative net bill supply has impacted the asset allocation of such funds. Furthermore, Fed uncertainty on rates (when and will it cut?) has made extending weighted average maturities for MMFs less attractive. Our chart describes the real money equivalent of this behavior.

In conclusion, we feel that iFlow currently captures some interesting trends in the Treasury market on the part of real money institutional investors. We are most concerned with the recent flat lining of overall UST demand and the lack of foreign interest. We further view the duration grab as a potential problem – should yields spike from here, those positions could get burnt and result in significant selling from what we reckon are relatively full positions. The dynamics of cash and short-maturity debt purchases suggest that cash and cash-like demand is waning. If this money is being put to work in longer-duration instruments, it would exacerbate our concern of crowded real money positions in the Treasury market.

Out Of Cash, But No Longer Into Bills



Source: BNY Mellon Markets, iFlow

Disclaimer & Disclosures

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