

iFlow

SHORT THOUGHTS

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US Debt Deadline Draws Closer

Treasury warns of an early-June X-date; negotiations start this week; T-bill curve reflects concern

Deposit flight from small banks halts and emergency borrowing stabilizes. Yet, stresses roll on

With deposit flight stabilized, money market fund inflows have also slowed

Early June X-date

Last week's letter from US Treasury Secretary Yellen to Congressional leaders has sharpened focus on the debt ceiling debate. Yellen identified June 1 as Treasury's "best estimate" as to when it "will be unable to continue to satisfy all of the government's obligations." The Congressional Budget Office followed up soon after with a similar estimate.

We caution that there is great uncertainty around these projections and that they could prove overly conservative. If Treasury's funds can last until June 15 (quarterly corporate taxes due), the X-date could be pushed deeper into the summer months. To us that seems like too large a gap – two weeks – to hope to be filled by some overly cautious accounting.

Investors in T-bills seem to be becoming believers in the early-June scenario. At the very front end of the bills curve, May maturities are quite expensive, with yields as low as 4.3% during the month. Things change in June, however. The June 6 maturity yields 5.3% - fully

100bp cheaper. As we said above, minds are being focused on that early-June window.

An early-June X-date is focusing attention, both in Washington, DC and on Wall Street

This is also the case in Washington DC, where on Tuesday President Biden will be hosting leaders of both of Houses of Congress to discuss the matter. Political lines have been well established. House Republicans have passed an increase in the debt ceiling but have attached \$4.8trn in spending cuts over the next ten years as the price. This has been labelled a non-starter in the Democrat-controlled Senate, as well as by the White House, which demands a “clean” increase in the limit. For their part, Senate Republicans have indicated they will not support a clean increase and would require spending cuts, as well.

The Treasury General Account recently peaked at \$316bn on April 28, as personal income tax receipts rolled in during the month, but is now down to just over \$200bn. One temporary solution that could be struck before early June would be an agreement to pass a short-term (perhaps two or three months) extension of the ceiling, aligning the new X-date with the appropriations process, where spending can be addressed as part of the usual budget cycle.

Cash On Hand



Source: BNY Mellon Markets, Bloomberg

Deposits Stabilizing

Data at the end of last week bore some encouraging signs regarding the ongoing banking-sector stresses. Deposit flight from smaller banks has ceased and has been relatively stable for the past six weeks. In addition, borrowing from the Fed via the discount window and its emergency facility, the BTFP, has actually declined modestly.

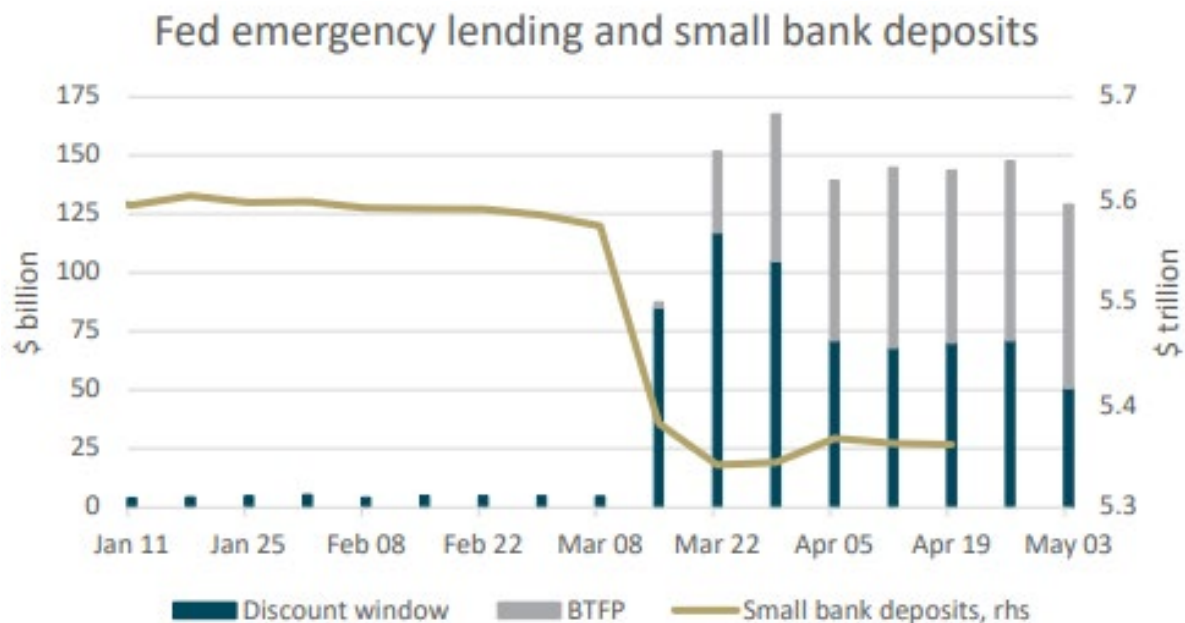
The Fed's H.8 tables for the week ending Wednesday April 26 show that deposits in small banks, after having fallen by over \$230bn in the middle two weeks of March, have been steady since that episode. Total small bank deposits have averaged \$5.35trn since March 22, compared to a recent high of \$5.61trn, back in early December 2022.

Better news on banking stresses: deposits stabilize, emergency borrowing declines

The Fed's H.4.1 tables show that emergency lending has also declined a bit in the last week. Between April 26 and May 5, combined usage of the Fed's financial stability tools fell from a post-SVB high of \$147bn to \$129bn, with discount window borrowing off \$21bn over that time. The banks' liquidity issues seem to have stabilized, and deposit flight has ceased.

Nevertheless, recent events remind us that stresses are still present in the banking sector. We note the near-8% drop in the KBW regional bank index month-to-date, on top of a 27% drop between Feb. 7 and April 30. We commented yesterday that equity flows as reported by our iFlow data remain volatile and quite negative, indicating still-very-poor sentiment around the profitability issues that are now confronting these smaller lenders that have had to curtail credit and shrink balance sheet.

Stabilizing



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

Breaking Down Deposit And Money Fund Flows

We mentioned above that deposit flight from small banks has stabilized over the past several weeks. It’s interesting to compare the behavior of deposits – for both small and large banks – as well as in two other short-term liquidity facilities, money market funds (MMFs) and the Fed’s overnight reverse repurchase facility.

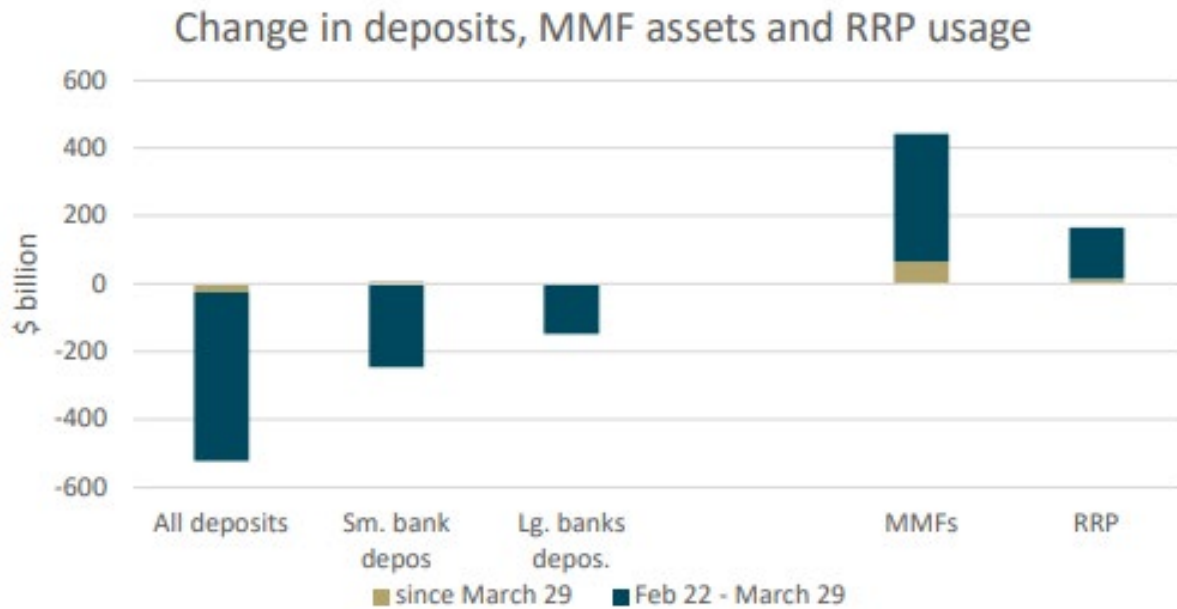
The chart below compare level changes across all five of these instruments since Feb. 22, just before the banking-sector stresses emerged. Each bar has two sections, dark blue indicating the period between Feb. 22 and March 29, and amber since March 29. Most of the deposit flight for both large and small banks had stabilized by the end of March, and movements of cash among instruments had been minimal over that period.

Most large movements in cash instruments have stabilized in the last four weeks

It’s also noteworthy that even for MMFs, inflows have slowed over the last four weeks; they have still been gathering assets, just at a much slower pace. In all, according to Investment Company Institute data, RRP balances have been steady – if high, \$2.2-\$2.3trn.

The common perception has been that MMFs have been accumulating assets at the expense of deposits from both large and small banks and turning around and parking that money in RRP. While some of that has been happening, especially between deposits and money funds, it is not going on in a large way between MMFs and RRP.

Money Funds Grab The Spoils



Source: BNY Mellon Markets, Bloomberg

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