

iFlow

SHORT THOUGHTS

JOHN VELIS

FX AND MACRO STRATEGIST FOR THE AMERICAS



October 31 2023

FOMC & Treasury Refunding Previews

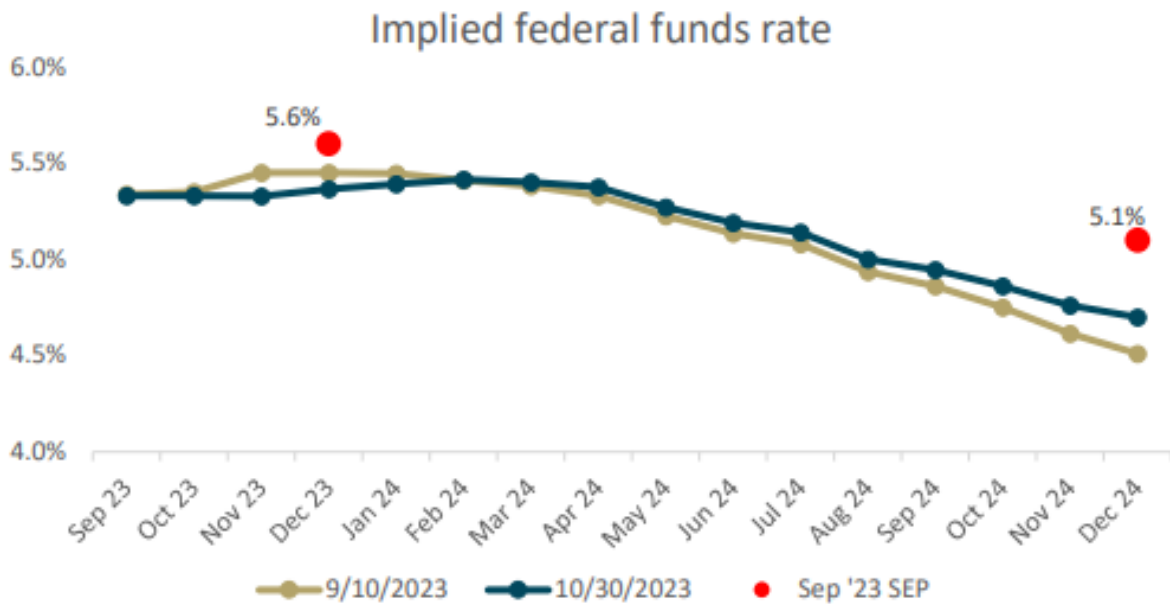
An Uncontroversial FOMC

There is almost no expectation of the FOMC announcing a rate move at the conclusion of its policy meeting Wednesday. Nearly every Fed speaker over the last few weeks (pre-blackout) telegraphed a hold or, if you prefer, a “wait and see”. Our view that the Fed was done after the July 2 hike doesn’t seem at risk. Yet, we expect the Fed to again err on the hawkish side rhetorically. The statement, as well as Chair Powell’s remarks after the meeting, should make reference to potential future policy firming, depending on the evolution of price pressures, domestic demand, and the labor market. We see no chance of the Fed signaling that it’s done, instead keeping the optionality of a potential hike further down the line. We don’t think the Fed will actually be able to pull another hike off in this cycle, however, setting up a long period during which policy rates will stay where they are.

Despite strong economic data, including blowout September nonfarm payrolls reported in early October and an equally impressive 4.9% increase in real GDP last week, we think that the strongest period of economic growth is just behind and expect the numbers will begin to trend weaker into end-2023 and early 2024. But not enough, we caution, to hasten rate cuts any time soon. Rather, just enough so that the Fed will let the already high funds rate – nearly 2% in real terms now – continue to work on slowing the economy, along with the nearly 125bp rise in yields at the long end of the curve. We see higher yields and tighter financial conditions slowing corporate investment demand – see yesterday’s dissection of the GDP and PCE inflation numbers here. Furthermore, inflation is beginning to ebb. Again, not so quickly as to bring rate cuts forward into early 2024, but by enough such that barring a resurgence in inflationary activity, rates won’t move until mid-2024, in our view.

In summary, this meeting is unlikely to be a significant market event. As we will discuss below, we think the real policy event on Wednesday will likely be the release of the Treasury's quarterly refunding announcement.

Almost No Movement In FF Futures Since Last FOMC



Source: BNY Mellon, Bloomberg

Treasury Announcement To Overshadow FOMC

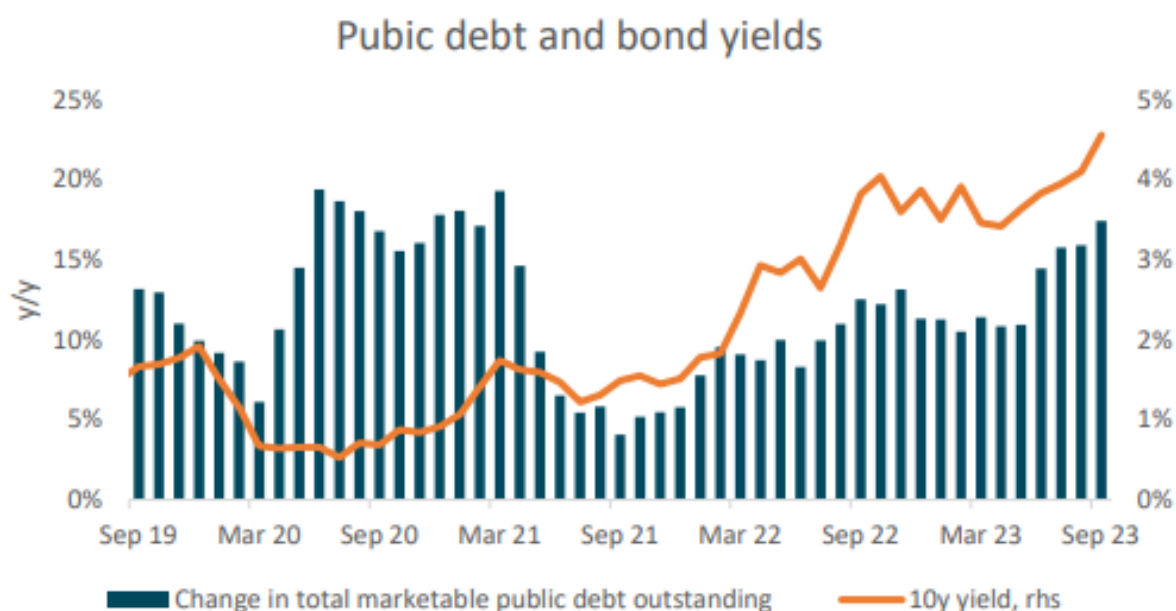
On Monday afternoon, the US Treasury published its borrowing estimates for the remainder of Q4 this year, and for Q1 next year. Both numbers represent records for the respective quarters, although the revised Q4 estimate, which came in at \$776bn, was lower than the initial estimate of \$852bn published in August. For Q1 next year, Treasury expects to borrow a net \$816bn. The combined \$1.592 trillion for Q4 2023 and Q1 2024 is a touch under the combined \$1.67 trillion issued during Q2 and Q3 earlier this year, but still represents the second largest two-quarter borrowing schedule since the early months of the COVID lockdowns. The US fiscal trajectory is still a concern.

Wednesday morning will bring publication of the quarterly refunding statement, detailing issuance plans at various points along the Treasury curve. Depending on the split between bills and coupons (and among coupons across the curve), we could see some notable moves in yields. Current bill issuance is right at the top of the range recommended by the Treasury Borrowers Advisory Committee (TBAC), which prefers total bill issuance to be between 15% and 20% of total borrowing. If Treasury – with TBAC's tacit acceptance – needs to increase the amount of coupon supply, yields could rise across most of the curve.

Indeed, Wednesday morning is likely to be of more relevance to the market than the FOMC meeting later that day. We have written a great deal on supply and demand dynamics in the Treasury market, arguing that these eye-watering levels of coupon supply will struggle to meet sufficient buyers at current prices. Bill issuance, if it breaches the 20% threshold recommended by TBAC, still looks like it can be absorbed within reasonable quantities. We wrote about the TGA drain a few weeks ago, commenting that it has been proceeding relatively smoothly as money market mutual funds (MMFs) have been happy to turn the extremely high levels of RRP usage into bill holdings, ever since the debt ceiling was temporarily resolved in early June (see [here](#)).

While Monday's announcement of borrowing needs for the rest of this year and into next year was not as large as could have been feared, it still represents a lot of supply to take down. The details on the issuance schedule, i.e., which maturities will be increased, will be required reading for the market on Wednesday morning.

Borrowing Rising



Source: BNY Mellon Markets, SIFMA, Bloomberg

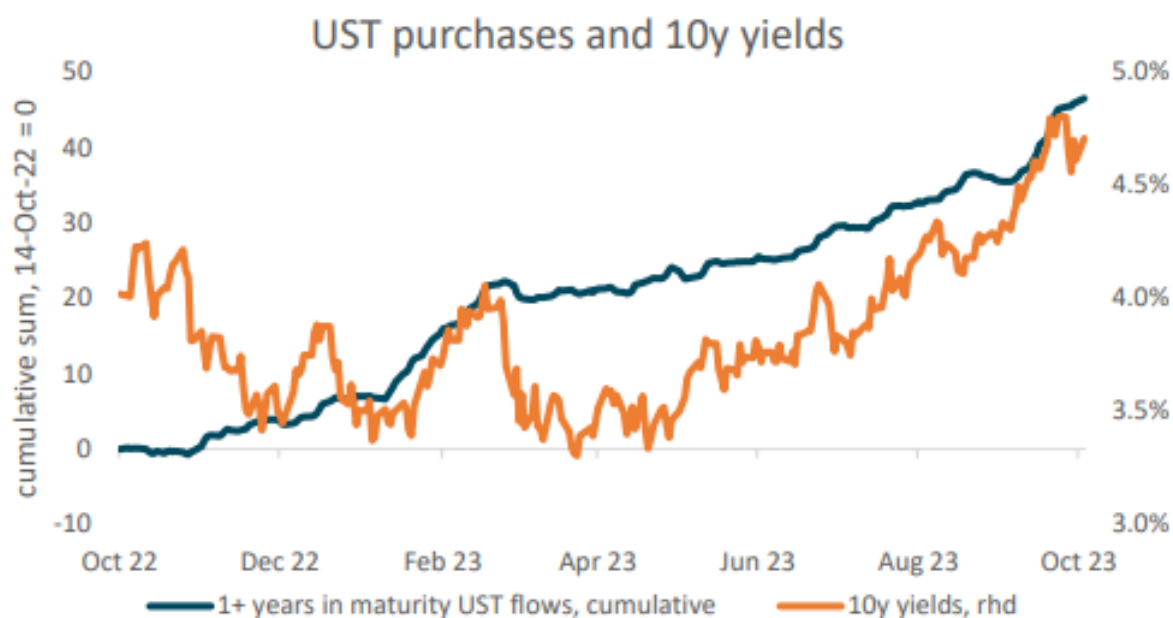
Buying USTs As Yields Rise

We have been concerned about the ability of the market to absorb all this looming, expected supply. We have pointed out that foreign demand for UST securities has been weakening – evidenced by both our iFlow data on real money, long-only institutional flows, as well as what can be gleaned from data on primary dealers and US commercial banks, both of which have not been materially increasing their exposure.

What we find interesting is that overall, iFlow shows that institutional buyers of Treasuries have been buying coupons all the while bond yields have been rising (bond prices falling). The chart below depicts cumulative flows into USTs of greater than 1y in maturity (i.e., ex bills). Note that from February this year until around the end of May, flows were fairly flat before picking up after June 1 when yields really started to move higher. There was also a period of consolidation during September, but a resumption of buying during October.

In short, real money has been long and wrong USTs for most of this year. This conforms to anecdotal evidence we have gathered from countless meeting with investors, including those same long-only real money accounts from whom the data in the chart is derived. We frequently hear that subsequent moves higher in yields and lower in bonds represent good buying opportunities, but also a lack of agreement on where yields go from here.

Long And Wrong



Source: BNY Mellon Markets, iFlow, Bloomberg

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.