BNY
iFlow
MACRO MORNING BRIEFING

August 12, 2024

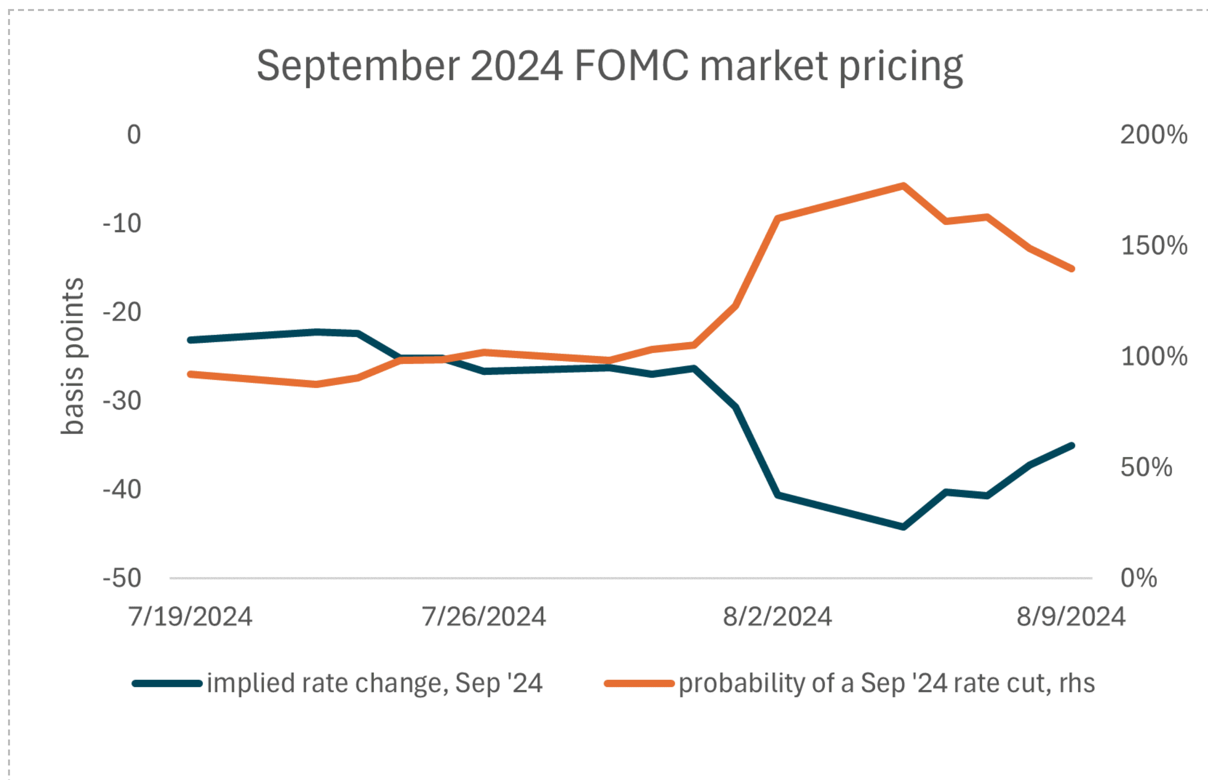
Still Only 25bp in September

- We require a weaker jobs report in early September before we change our rate call
- 50bp cuts aren't rare, but they're usually made in the context of a deep recession or financial emergency
- iFlow shows foreign selling of longer maturity bonds
- This could exacerbate liquidity concerns in the UST market

Why We're Not Expecting 50bp of Cuts in September

The market continues to price in a larger-than-25bp rate cut at the FOMC's September 18 meeting. During the market volatility of the past several days, the implied probabilities for a move at the meeting reached over 200% (intraday) on both August 5 and August 8, which would suggest a rate cut of over 50bp – or alternatively, a combination of an intermeeting cut and a jumbo cut on the meeting day. However, we still expect just a 25bp move at the next FOMC, and we stated so last Monday in our Macro Morning Briefing (see here).

Market Expects a Big Move



Source: BNY Markets, Bloomberg

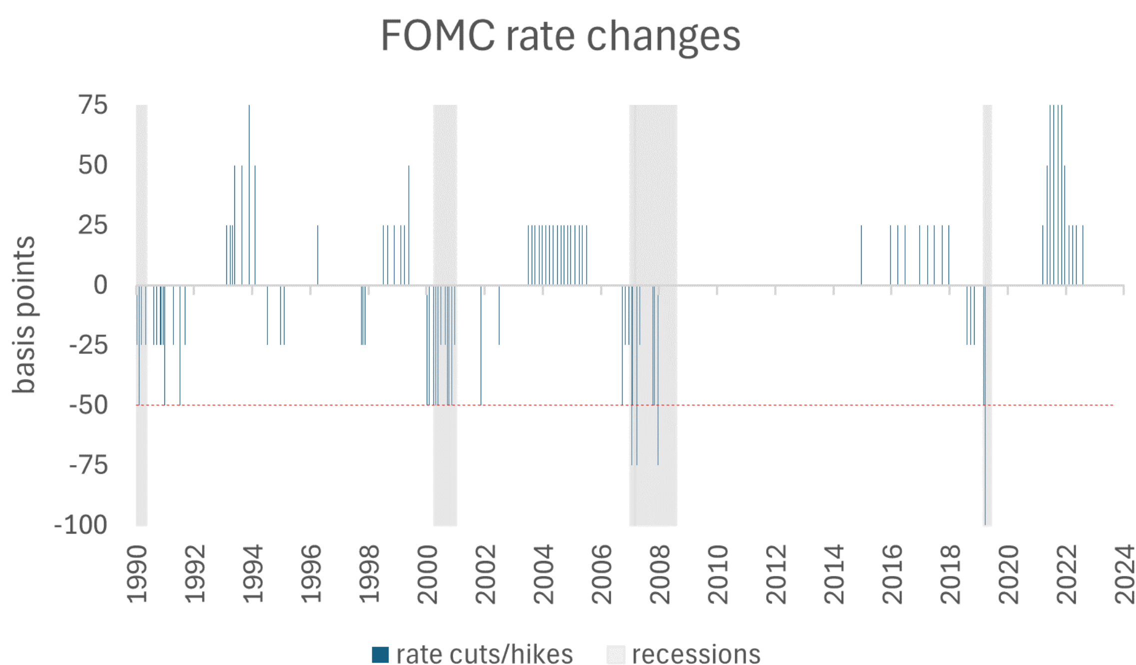
What would make us change our mind and expect 50bp next month? The initial jobless claims data helped calm markets at the end of last week, and we note with some surprise that a mere 7,000 miss to the downside in the claims number was such a salve to the markets. This underscores just how much markets are watching the Fed, and the data themselves for guidance. While we're encouraged that claims stayed somewhat modest last week, they aren't the key data we're watching to help us decide to stick with our 25bp call or move it to 50bp.

A look at the last 25 years of FOMC history suggest that 50bp cuts aren't entirely rare. The chart below shows every Fed rate move since 1990, along with recession bars. There have been numerous occasions on which the funds rate has been reduced by at least 50bp over that span. Most of them, however, coincided with recessions, particularly the severe one that accompanied the GFC, and of course the pandemic lockdowns.

Although the newly popular Sahm rule was triggered by the rising unemployment rate that was published on August 2, we're not convinced that the economy is yet in recession – indeed, we're pretty sure we're not. The rest of the macro data have been robust through now, and the jobs data were potentially exaggerated by the effects of Hurricane Beryl, which occurred during the data collection week in July. 436,000 persons reported being unable to work due to bad weather in the July report.

As we said last week, “the chances for a jumbo cut are poised on a knife’s edge, and so are our data watching antennae.” Yes, we have another four weeks’ worth of claims data, and surely if they deteriorate by a lot, we might have enough information to get more dovish on the FOMC outlook. Instead, the data we’re waiting for are probably obvious; the September 6 nonfarm payrolls release will probably be definitive. Our call for 25bp is in place at least until then and we think calls for 50bp are somewhat overreactive at present.

A History of Fed Rate Moves



Source: BNY Markets, Federal Reserve Board of Governors

What iFlow Tells Us about Bond Volatility

Bond markets were among the most volatile asset class during the recent period of market stress. The yield on the 2y note fell from 4.36% on July 30 to 3.88% just two days later, with a move back up above 4% by the end of last week. The 10y note saw its yield decline from 4.14% on the 30th to 3.79% on Monday last week. It more recently has moved back toward 4%. The yield slope between the 2y and 10y bonds fluctuated similarly, primarily experiencing a bull steepening. Reports of illiquid UST markets have increased with the volatility. Last week witnessed several disappointing auctions, both in bills and coupons.

iFlow can provide some interesting insights into what’s been happening from a real money lens. In the chart below we plot last week’s average daily scored flow into the UST market by

maturity bucket, as well as into cash. We can separate out cross-border flow from total flow as well, as is shown.

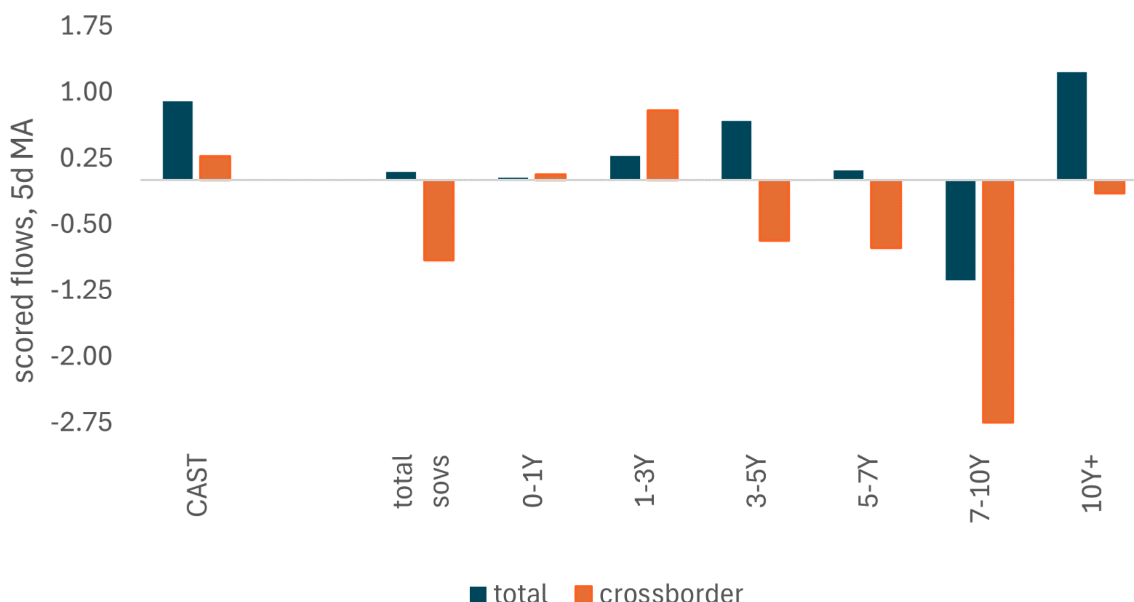
A number of observations emerge:

- Foreign demand for US sovereign bonds across the curve last week fell significantly, by nearly one standard deviation compared to the previous year's flows.
- This retreat by cross-border investors was most prevalent the further out the term structure one looks. Flows in the 7-10y sector saw a nearly 3 standard deviation move lower, while the 3-5y and 5-7y buckets registered outflows of -0.7 and -0.8 standard deviations, respectively.
- Generally speaking, the shorter maturities along the curve saw inflows, a result that confirms that real money participated in the bull steepening move.
- Flows into cash and short-term assets – as distinct from government paper – were high, again, almost a full standard deviation above normal, underscoring the move out of risk and into safe assets.

We view the cross-border sales out of longer-term Treasuries with some unease, especially if liquidity concerns at that end of the curve persist. With dealer holdings of USTs at record highs, and hedge funds reportedly staying out of duration, a lack of foreign buyers could exacerbate liquidity strains. It will be critical to keep an eye on these iFlow data in coming weeks, especially as we look for curve steepening and signs of offshore investors coming back into the market.

Term Structure of Foreign Flows Is Concerning

iFlow: US sovereign bond flows



Source: BNY Markets, iFlow

Disclaimer & Disclosures

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

John Velis
AMERICAS MACRO STRATEGIST

CONTACT JOHN

Can't see the email? View online

We take our data protection and privacy responsibilities seriously and our privacy notice explains how we collect, use, and share personal information in the course of our business activities. It can be accessed here.

This email was sent to email address, and was sent by The Bank of New York Mellon 240 Greenwich Street, New York NY 10286.

Your privacy is important to us. You can opt out from receiving future Newsletters by unsubscribing via this link at any time. You can also select the topics that you want to receive by managing your preferences.

This message was sent from an unmonitored email box. Please do not reply to this message.

Contact Us | iflow@bnymellon.com

© 2024 The Bank of New York Mellon Corporation. All rights reserved.

This message was sent from an unmonitored email box. Please do not reply to this message.

.