BNY MELLON
iFlow
SHORT THOUGHTS

April 30, 2024

FOMC Preview -- Hawkishness Expected

- We expect a hawkish FOMC tomorrow, Chair Powell to echo recent comments
- We expect to hear that balance sheet rolloff will slow
- Quarterly funding estimates from US Treasury revised higher

Hawk Talk

The outcome of the Federal Reserve's Open Market Committee meeting Wednesday is likely to be hawkish, at least rhetorically. No change in rates is widely expected, but we do think the Fed is likely to announce a halving of the pace of US Treasuries rolloff of its securities portfolio (the so-called System Open Market Account, or SOMA). We don't think this will be a surprise to markets, though there is some question as to when the announcement will actually translate into action – this month or next.

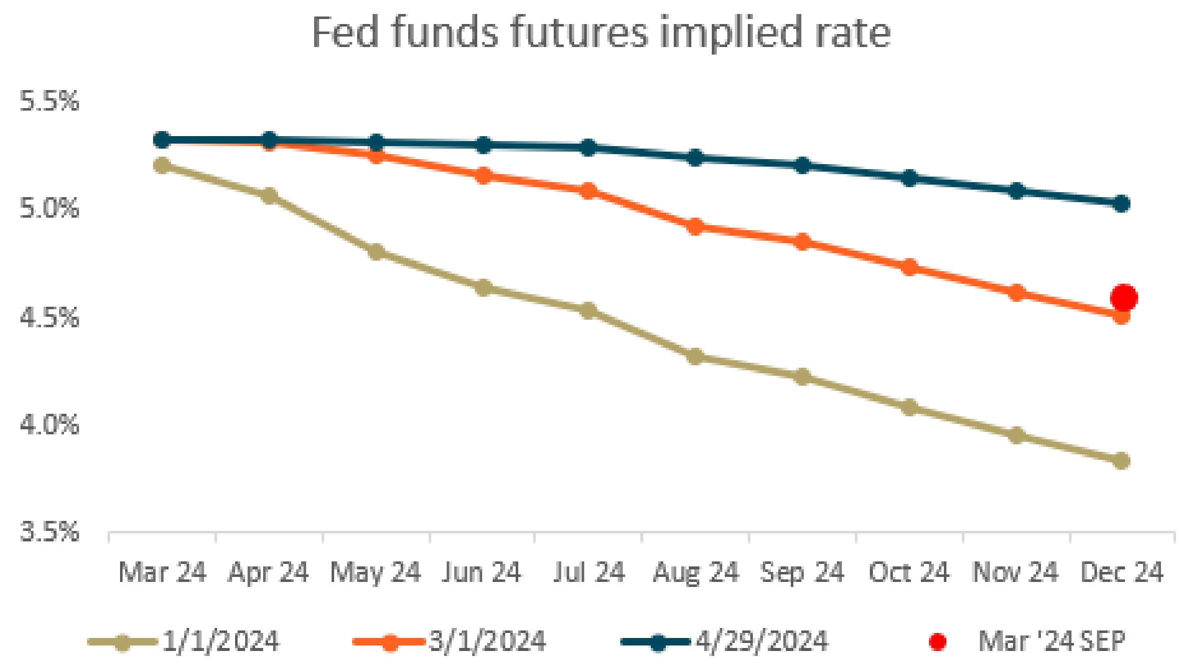
A crucial phrase in recent FOMC statements has been: "The Committee does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 percent," suggesting the Fed still views the next rate move to be a cut. If that phrase is removed in favor of a more balanced statement, we would view it as confirmation of a change in bias, hence guidance. This would be a hawkish surprise for us – and we think the market, as well.

To be sure, market expectations for cuts have been severely dialed back in recent months. The chart below shows just how much they have moved since the beginning of the year. As of yesterday, the market was pricing in just about 1.5 cuts (of 25bp each) by the end of the year, a marked change from the beginning of the year, when six cuts in 2024 were priced.

We still hold fast to our call that a September cut is on the cards, although we admit some attenuation in macro and – especially – inflation data is needed. Last week's releases indicate inflation is sticky, especially services prices, and the economy – especially domestic demand – is growing robustly. We wrote about the inflation and growth outlook yesterday.

We think Chair Powell's press conference will be worth listening to. In addition to being pushed on if rate cuts are still on the agenda (and even whether hikes could be countenanced going forward), we also expect a discussion of the balance sheet. With recent FOMC meetings, the press conference has typically been viewed as more dovish than the policy statement, but we're not sure there is much room for dovishness this time.

Market Expecting Just One-And-A-Half 25bp Rate Hikes



Source: BNY Mellon Markets, Bloomberg

QT To Be Slowed

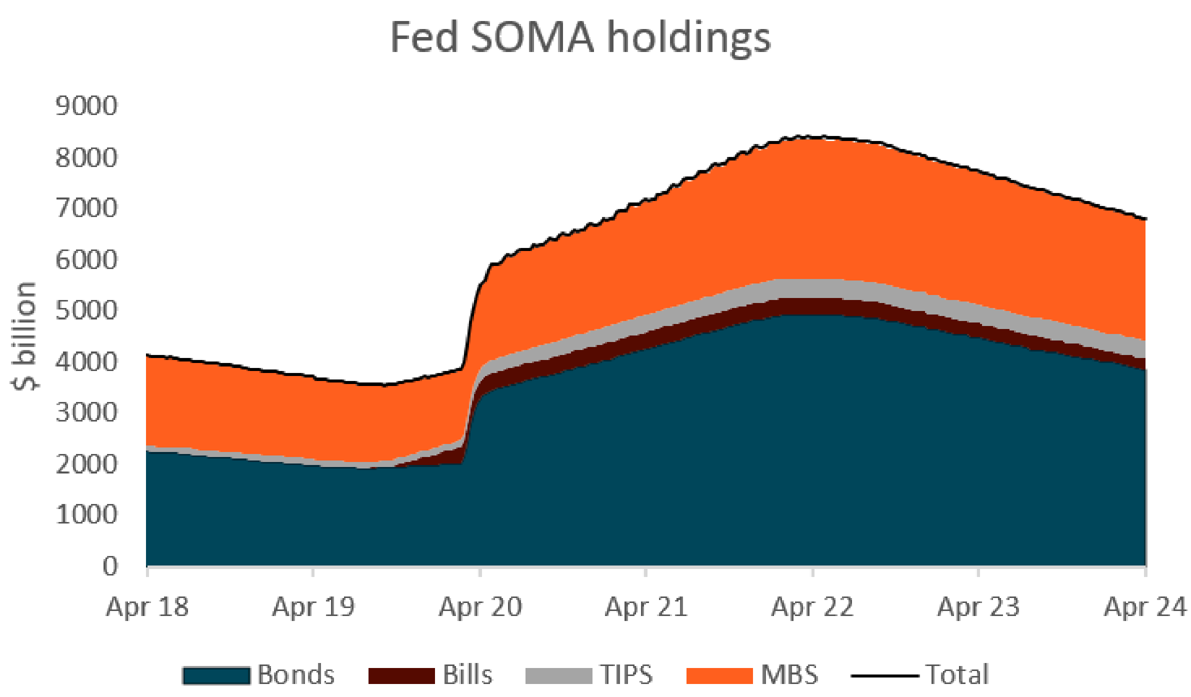
As mentioned above, we expect an announcement confirming that the Fed will slow the pace balance-sheet roll down, from $60bn of Treasuries per month to $30bn. The question is when that move, once announced, actually commences. We lean toward implementation in June but wouldn't be terribly surprised to see it begin immediately.

The chart below shows the evolution of the SOMA portfolio and its underlying securities. We note that despite a cap of $35bn per month on MBS roll-off, the actual pace at which these holdings are being reduced is only averaging around $16bn per month. We expect no announced action on this portion of the balance sheet tomorrow.

The Fed has and will continue to couch its balance-sheet policy as distinct from monetary policy and rates. However, the motivation behind a policy change here is related to funding markets, and to the Fed's recent focus on the distribution of reserves within the banking system. At $3.3trn, reserves in aggregate are surely abundant. However, we have heard Fed speakers muse that the distribution of these reserves may leave some banks short of liquidity and needing to turn to funding markets to fulfill financing needs.

We expect to hear more about that in the press conference. However, we note that in the New York Fed's SOMA annual report, reserves were seen to bottom at $2.5trn in the "lower reserves share scenario", or as high as $3trn in the "higher reserves share scenario". The scenarios are distinguished by uncertainty over the ultimate demand for reserves by banks, and by the associated level of reserves consistent with an 'ample' reserve regime.

SOMA Portfolio Shrinkage To Be Slowed



Source: BNY Mellon Markets, Federal Reserve Bank of New York

Quarterly Borrowing Estimates Slightly Higher

On Monday afternoon, the US Treasury released its borrowing estimates for the current (April-June) and subsequent (July-September) quarter. Through June, Treasury expects to borrow $243bn, up from an estimated $202bn three-months ago. Most of the market had been expecting smaller borrowing needs, so the announcement was something of a surprise. For the following quarter, Treasury posted an initial borrowing estimate of $847bn. That's down from the same quarter last year when financing needs were a little over $1trn.

Current-quarter funding needs were up due to "lower than expected cash receipts, partially offset by a higher beginning of quarter cash balance." We're more than mildly surprised by both the increase in expected borrowing needs and cash receipts having disappointed. We had been expecting the April tax season to lead to higher receipts. Nevertheless, it's a marginal increase and in raw dollars, the difference between $243 and $202bn is trivial.

The cash balance – aka Treasury General Account (TGA) – was anticipated to be $750bn by now. Instead, it closed last week at over $900bn. The chart below shows the TGA vs. quarterly estimates of the quarter-end cash balance. In the current borrowing estimate, the quarter-end TGA is anticipated to be $750bn in June and $850bn in September.

The Treasury's announcement did not incorporate the expected change to the Fed's quantitative tightening program, so in reality, borrowing could turn out to be even higher than the newly updated borrowing estimate for the quarter.

On Wednesday this week, we will watch the refunding announcement. No changes to the size or proportion of coupon issuance are expected, although we do anticipate details to the Treasury's buyback plan. If coupon sizes are adjusted upward, that would be a surprise and could see yields grind higher. At the same time, we expect the buyback announcement to indicate a smallish (approx. $60bn) number, concentrated at the front of the curve.

Our bigger concern is that the June-September estimate for borrowing will be revised higher, with additional coupon supply; we expect the early-August estimate for the October-December quarter to be higher, as well. Fiscal dynamics and supply concerns are reasons we have been advocating a view for yields to push higher in H2 2024.

TGA Flush, But Refinancing Needs Still Higher

Source: BNY Mellon Markets, US Treasury, Federal Reserve Bank Board of Governors

Disclaimer & Disclosures

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

John Velis

AMERICAS MACRO STRATEGIST

CONTACT JOHN