The Pause That Refreshes?

Latest Fed Liquidity data warns that April may be tricky

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MAR 29, 2024
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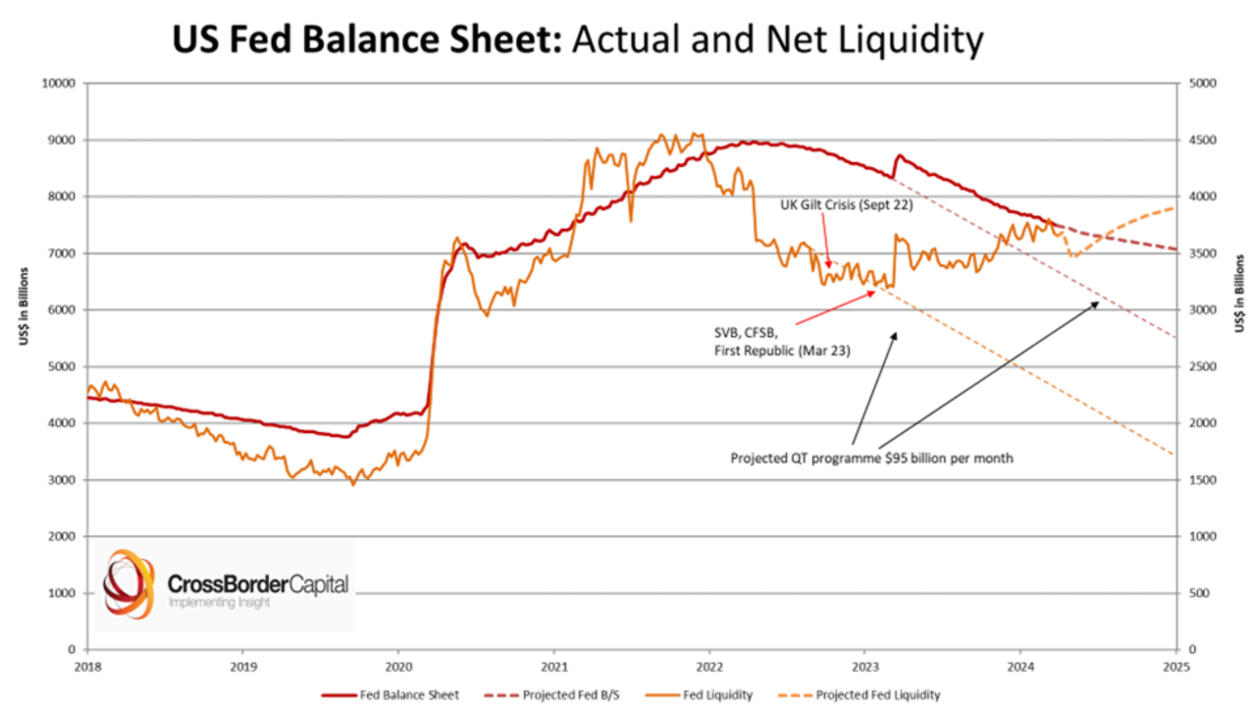
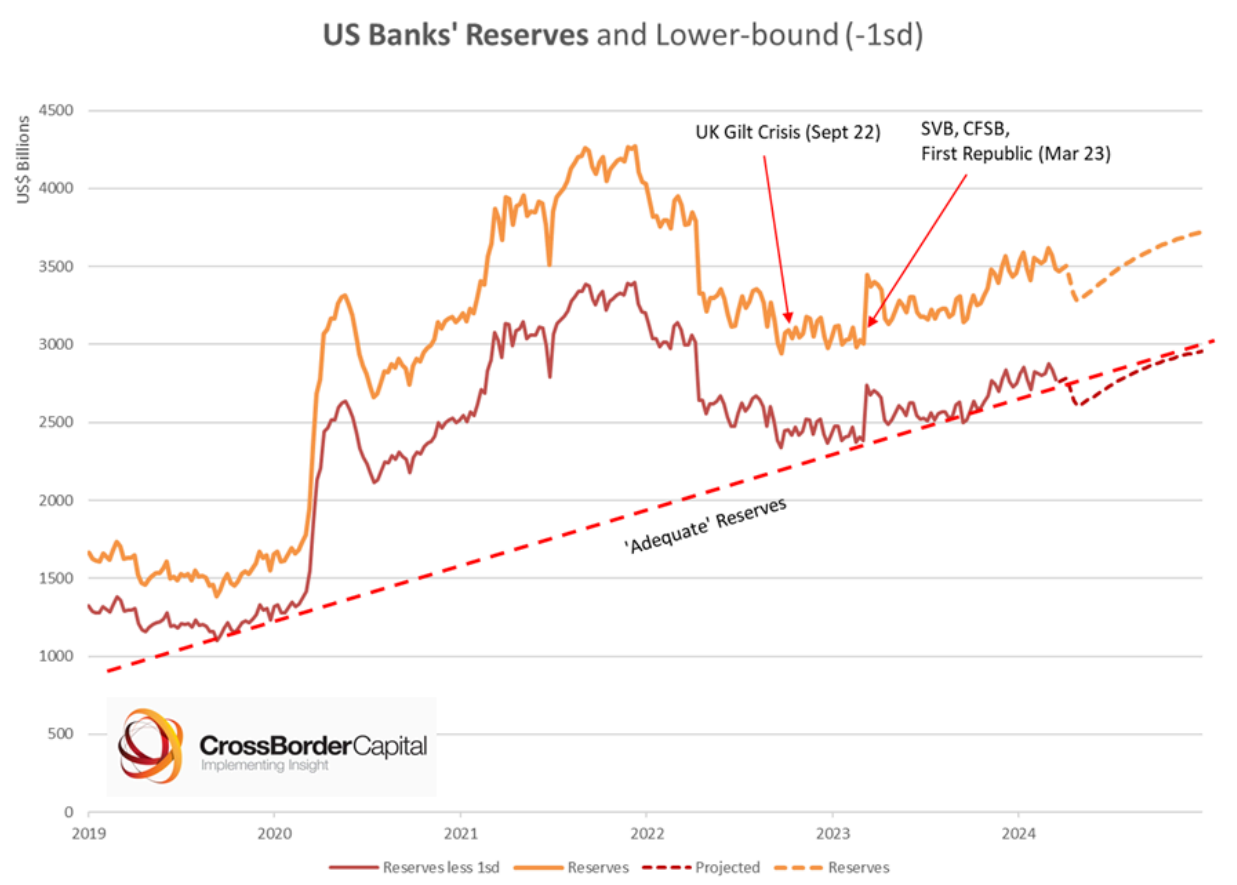
Balance sheet data released in the past few days shows that **US Federal Reserve** Liquidity injections, the backbone supporting recent market gains, is stalling. It may stall further over coming weeks unless US Treasury spending picks up (i.e. the TGA is run-down) or the roll-off of Treasury securities (i.e. the QT program) slows down. The chart below reports recent data to March 27th 2024. The Fed balance sheet (red line) continues to fall, although not as fast as once planned. Alongside, Fed liquidity injections (orange) are dipping and, according to our projections, seem set to dip further before rebounding through the rest of 2024.

Behind the dip are three factors: (1) continued roll-off of Treasury holdings on the Fed balance sheet; (2) a short-term jump in net inflows into the TGA (Treasury General Account) as tax receipts pick up pace, and (3) a flat-lining in the RRP (Reverse Repo facility) as Treasury bill issuance temporarily reverses in Q2.

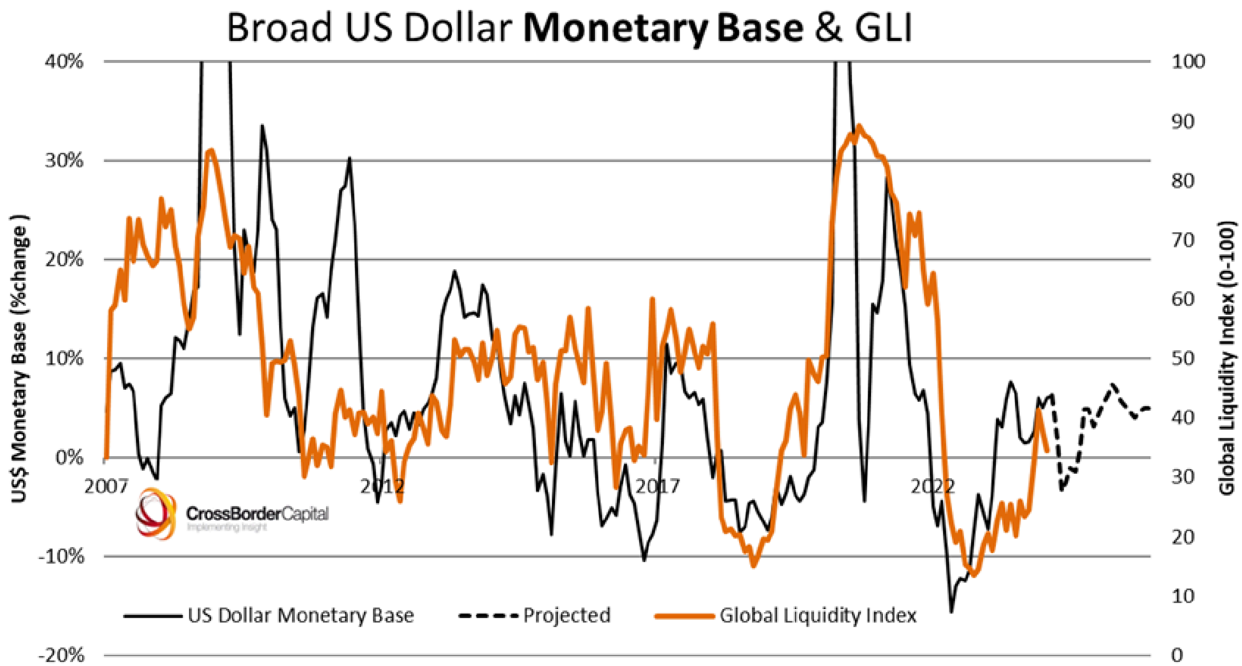


We have long thought that the Fed's balance sheet operations are constrained by financial stability concerns and, specifically, by the need to keep US banks' reserves above the critical 'adequate' threshold to avoid liquidity issues among the hard-pressed regional banks. However, no one has any idea what this threshold is!

We have made a stab at estimation in the following chart. We also show a one standard deviation lower bound on reserves to capture their mal-distribution among the smaller US banks. As we project, coming weeks may expose tensions because the threshold is set to be breached. Thereafter, mainly as the TGA is run-down ahead of the November Elections, more liquidity should come back into markets, but it may still prove a fine line unless the US Fed finds some new conduits or tricks to inject funds.



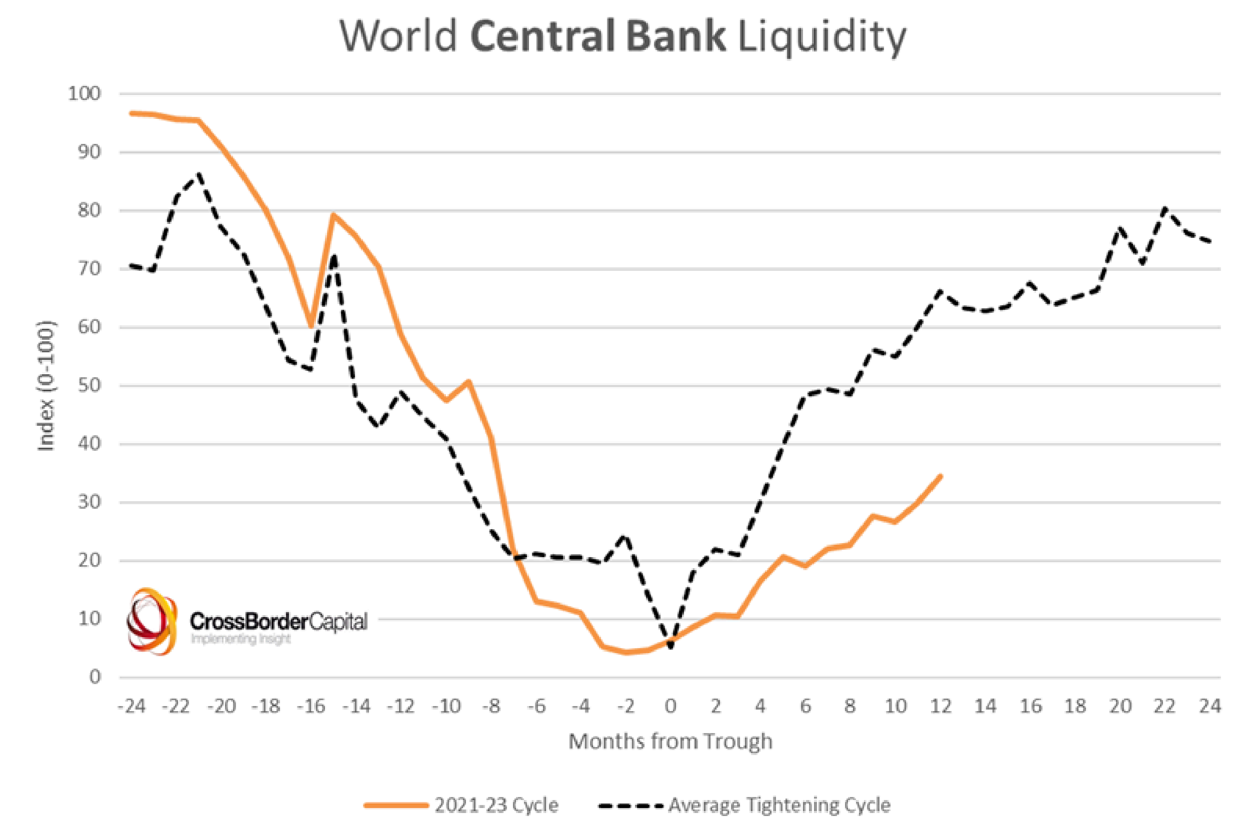
The implications for **Global Liquidity** are spelt out in the next chart. Here we show in orange our monthly Global Liquidity Index (GLI^{TM}) alongside the projected likely growth in the *US dollar monetary base*, a broader aggregate that includes US dollar foreign exchange holdings of international Central Banks. The implication is that Global Liquidity edges higher through the rest of 2024. **The reality may prove better.**



Although rise this appears consistent with our previous forecasts of a Global Liquidity peak in late-2025, the pace of policy easing should also start to accelerate. It may seem paradoxical and anomalous that policy-makers start to ease more aggressively given that it appears from recent data that the World real economy has already turned higher, but this is what typically occurs in practice. The men in black suits seem to learn nothing!

The chart below underscores that, compared to previous cycles since the early 1970s, the current Central Bank easing cycle has been relatively slow and measured. The data not only suggest that more easing is highly likely, but offers hope that we could even see some acceleration in Central Bank liquidity provision over coming months, once the April hiccup has passed.

Conclusion? **This still looks to us a very normal investment cycle, albeit a tad restrained, and investors should use any near-term setbacks to buy further risk asset exposure.**


World Central Bank Liquidity
Index (0-100)
100
90
80
70
60
50
40
30
20
10
0
-24 -22 -20 -18 -16 -14 -12 -10 -8 -6 -4 -2 0 2 4 6 8 10 12 14 16 18 20 22 24
Months from Trough
CrossBorderCapital
Implementing Insight
2021-23 Cycle
Average Tightening Cycle