

The Liquidity ‘Air Pocket’

Short Update



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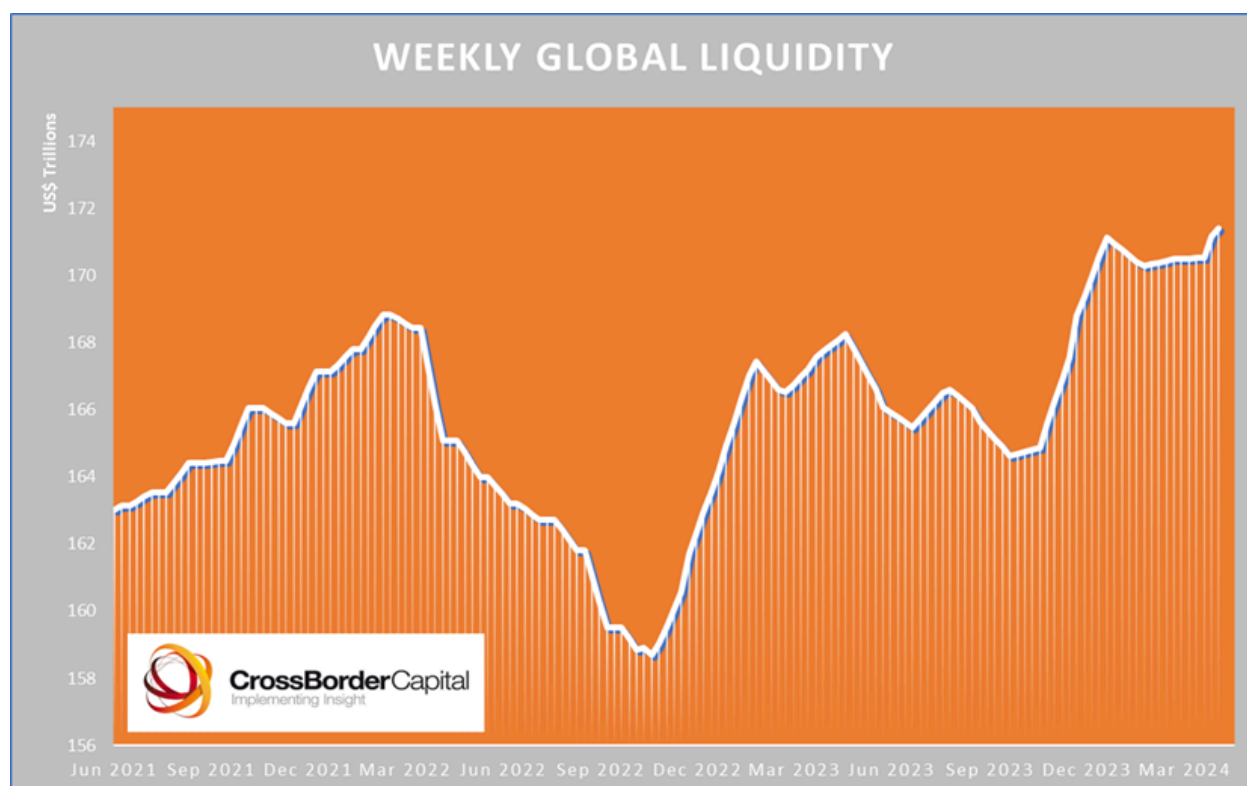
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For several weeks we have been projecting an **air pocket in *Global Liquidity*** around now for three key reasons:

- Large expected jump in tax receipts post-May 15th tax filing deadline could push TGA (Treasury General Account) to test US\$1 trillion and so reduce *Fed Liquidity*
- Restart of more active US coupon issuance could force up bond term premia and cause MOVE volatility to increase. This hits the *collateral multiplier*
- Pressure on Chinese Yuan from ‘weaponized’ weak Japanese Yen could curtail near-term *liquidity injections* by China’s People’s Bank (PBoC)

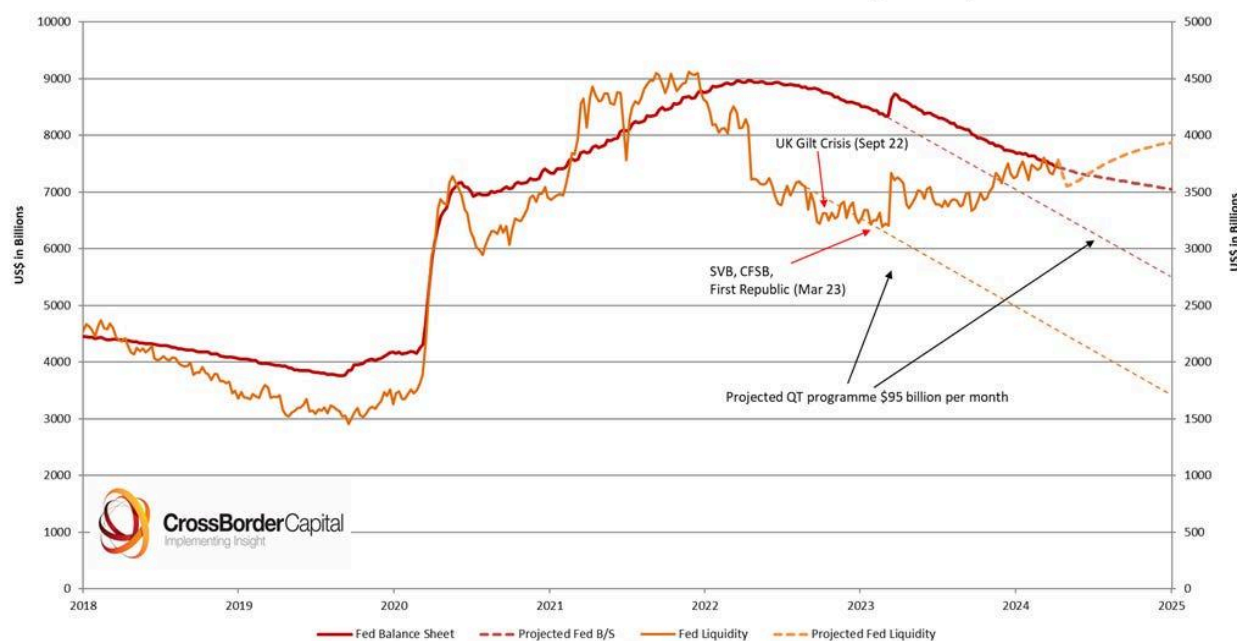
These bullets spell out why Global Liquidity could edge lower from recent highs – the **World monetary base is being hit by weaker Central Bank liquidity and the multiplier on this overall pool of Central Bank money and collateral pool is getting smaller.**

Already latest data evidence a **topping in Global Liquidity** according to our weekly tracking shown in the chart below. We fear more pain in the short-term. Thereafter Global Liquidity should revive. Hopefully it is a pause that refreshes?

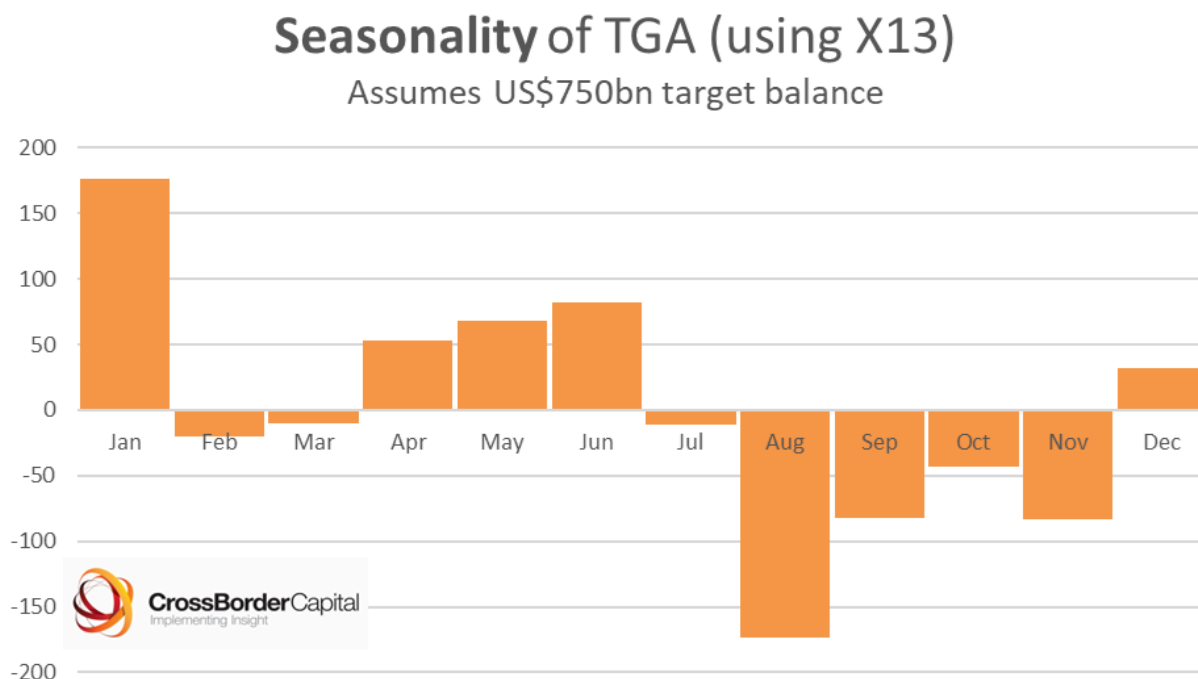


The latest **Fed balance sheet** and underlying *Fed Liquidity* is reported in the next chart. The chart shows forward projections, including the short-lived step down in Fed Liquidity caused by the coming surge in the TGA from tax inflows.

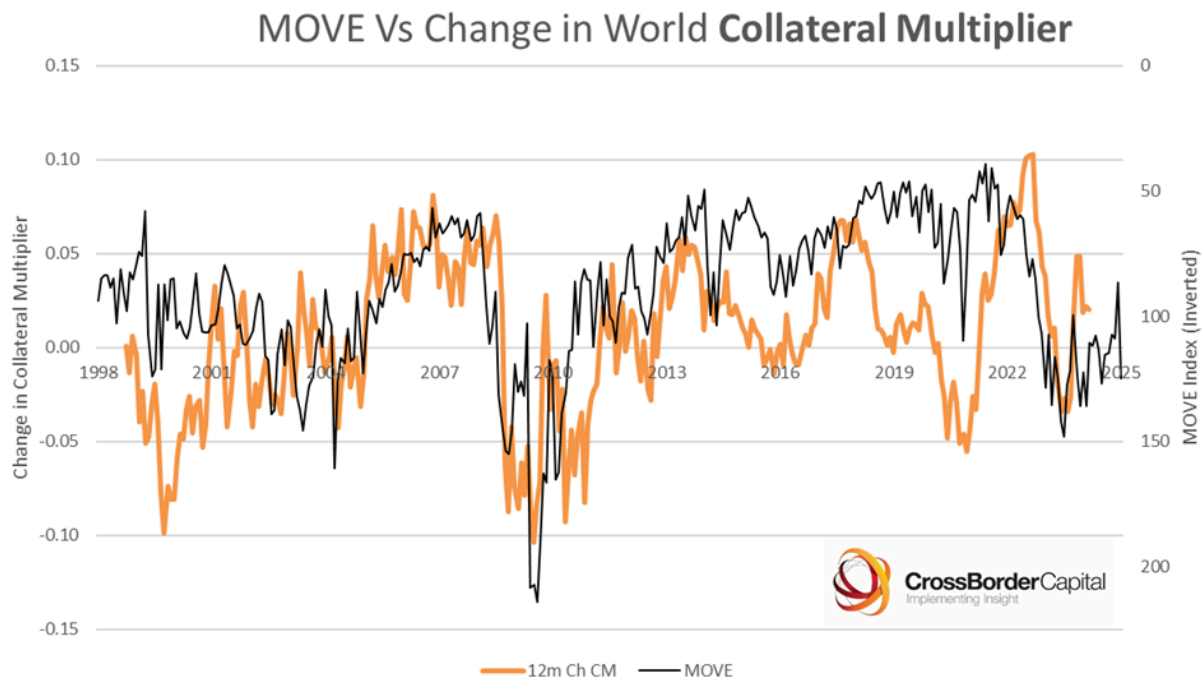
US Fed Balance Sheet: Actual and Net Liquidity



Many cite the potential offset from the recent US\$70 billion fall in the *Reverse Repo facility* (RRP) as a reason to be hopeful. Unfortunately this is part of the same tax story. The RRP was drawn-down to fund tax payments, which so far have jumped by US\$120 billion (using latest data). However, the TGA is highly seasonal as the chart below highlights. The bars show how much the actual lies (below) above the 'true' underlying trend. **This suggests that through the next few months we could see a US\$300-400 billion swing of liquidity coming back into markets as the TGA seasonally falls.** On top, Treasury Secretary Janet Yellen may quicken the pace of outlays.

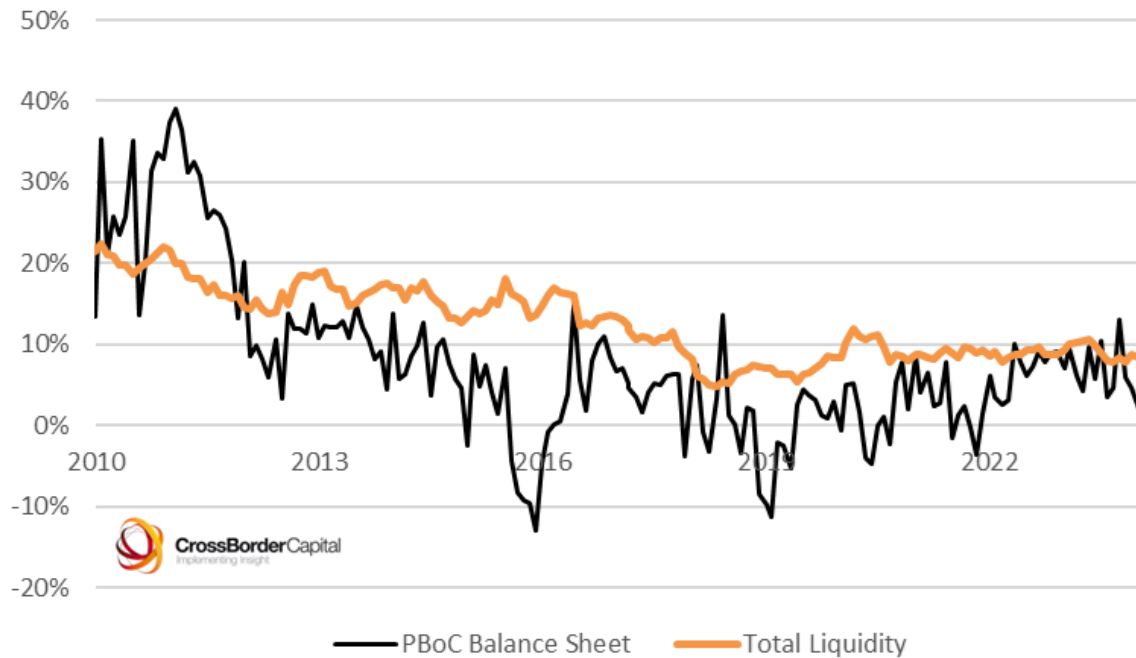


The jump in the MOVE index of bond volatility from the low 80s to 120 is a concern. The collateral multiplier will be hit as cautious credit providers demand large 'haircuts' to compensate for this volatility. The next chart shows that this is not yet a major issue but it is not bullish for liquidity near-term.



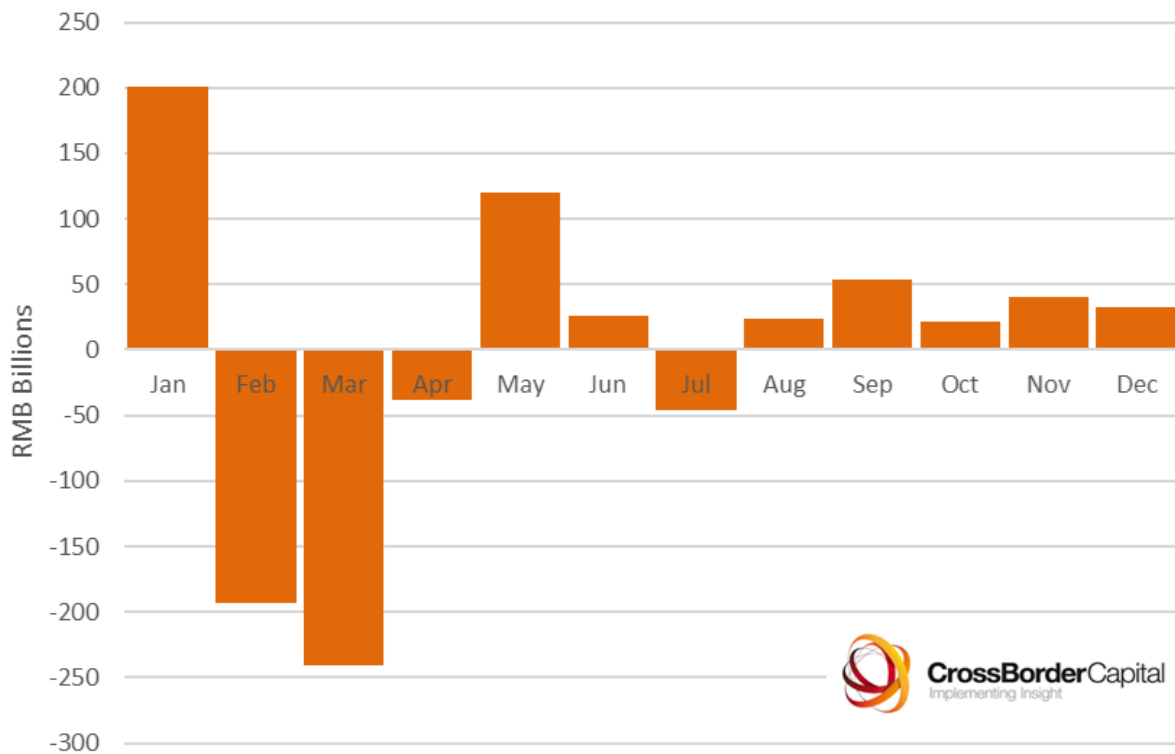
Third, consider China. China's People's Bank is, in our view, the second most important Central Bank Worldwide. Its liquidity injections have lately been curtailed to defend the weakening Yuan, which has been under pressure from a stronger US dollar but more specifically from the skidding Japanese Yen. The next chart highlights the slowdown in Chinese Liquidity.

China: Liquidity Growth



Trying to catch a few positive straws, we should note that **China's money markets are also highly seasonal**. The following chart gives hope that the next few months could see some seasonal revival in liquidity. What's more, the Yen's fall must surely soon subside?

Seasonality in Chinese Money Markets



What to do? **Sit back and wait....** The next weekly H4.1 release by the Fed on Thursday 4.30pm EST is well-worth watching. But a 5-10% correction is just what these markets need. **Global Liquidity will come back. It must.**