BBGI GROUP Global Investments

ECONOMIC RESEARCH | May 1st, 2024

Investments - Flash

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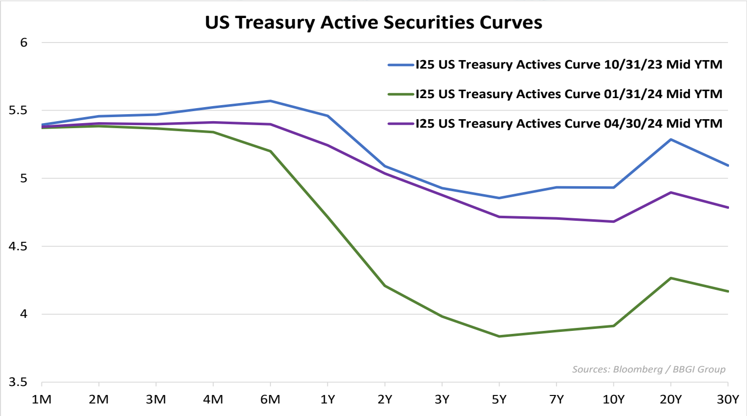
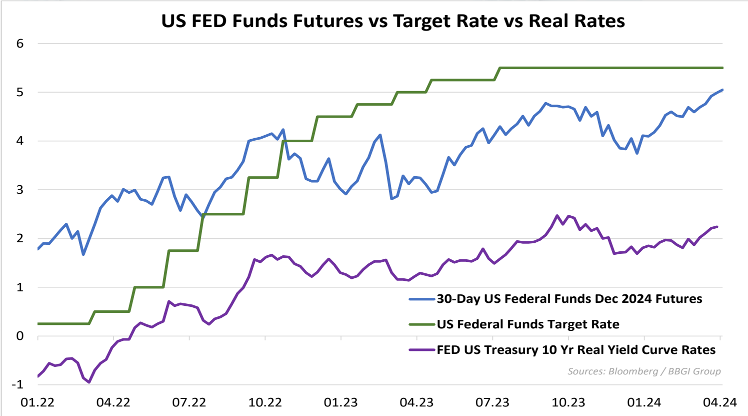
A DROP IN FED QT COULD REVERSE THE TREND

Nominal and real US Treasury yields are attractive

The USD bond market (-2%) will undoubtedly end the month with one of its worst performances since 2022, due to the contrary trend in inflation and the contraction in Fed rate cut expectations. Consensus now expects only a 50bp adjustment to December Fed funds (5.04%), whereas the outlook at the start of the year was for six potential cuts representing around -170bp to an expected level of 3.8%. However, this adjustment of the outlook may be too extreme, as the Fed will no doubt take into account the impact of higher rates on the cost of financing US Treasury debt when determining its monetary policy. The latter is approaching USD 34 trillion, and its auction refinancing in Q1 2024 was almost at pandemic record levels. As the budget deficit increases, so do financing requirements, while the Fed's quantitative tightening (QT) program, which began in 2022, is no longer a support for the latter. Without the Fed's contribution, the Treasury would have to refinance its debt a little more through the private sector at a higher cost. The Fed has in fact reduced the size of its balance sheet by -17% since 2022, increasing the volume of bonds sold to the private sector by around 80 billion per month. Good news for the fixed-income market would be if the Fed were to announce this week that it would reduce its sales of Treasury bonds from June 2024 onwards. We expect Wednesday's Fed meeting to be the occasion for such an announcement, which could compensate somewhat for the absence of a decision on rates. A cut from 80 to 30 billion would reduce overall supply and would certainly relieve the market by reducing the pressure on yield levels at the auctions for the various maturities, particularly those for ten-year bonds (4.6%). The real yield on 10-year TIPS is once again very attractive (2.2%) compared with that at the start of the year (1.6%) and its average (2.09%), particularly if we consider that inflation trends remain downwards. Perhaps an easing of the QT would be enough to revive investor interest in the USD bond market ahead of the next inflation figures on May 15.



Sources: Bloomberg / BBGI Group



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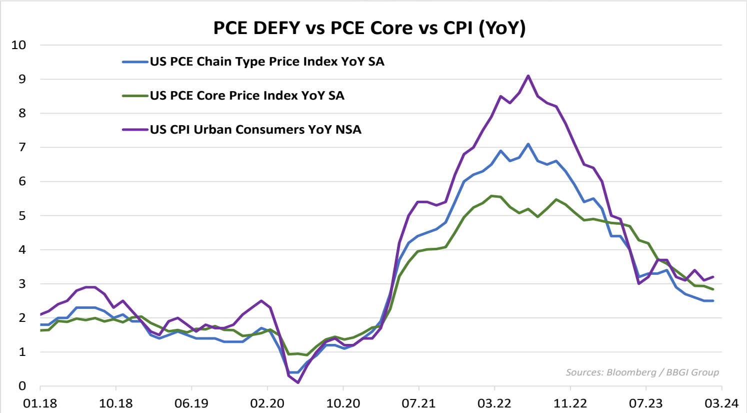

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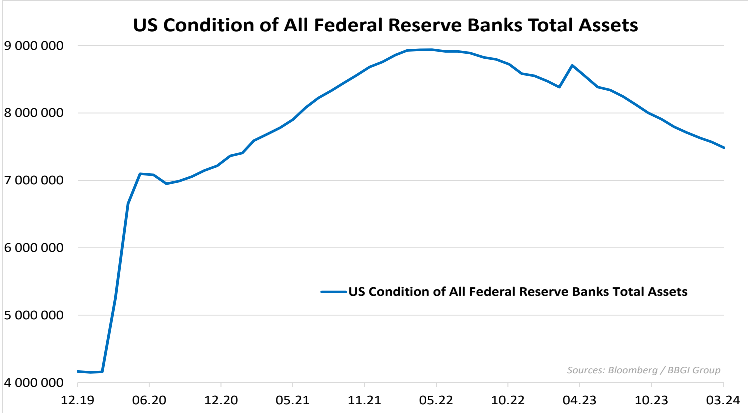

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