

### Key Themes

- US Liquidity – treasury supply versus Fed normalization impact on markets
- FOMC – Signalling on rates from minutes & speeches this week
- Global growth v. US:
  - Prelim European & US PMI's for May
  - US Durable Goods
  - UK: retail sales & CPI, Carney speech

### US Treasury Issuance, Settlements & Fed Normalization

FED Holdings in SOMA - This month (May), \$54.71b in the Fed's holdings of US Treasury securities will mature (at mid-month and end of month). Of this total, and as a part of the balance sheet normalization process, the current monthly cap on the reduction of the Fed's holdings is \$18b. The \$18b reduction of holdings is split between mid-month (last week -\$8.6b) and end of month (next week -\$9.4b).

US Treasury - This week will see bill and note auctions of \$275b, with settlement of \$176b on 24<sup>th</sup> May. A total of \$24b in 'new money' to be raised this week.

WEEK	Auction Date	Settlement Date	Marketable Securities	Auction Amount \$B (TBAC)	Amount Maturing \$B	New Money \$B		
21-25 May 2018	21-May	24-May	4wk bill	45		<i>announced</i>		
			3mth bill	48		<i>announced</i>		
			6mth bill	42		<i>announced</i>		
			12mth bill	26		<i>announced</i>		
				161	152	9		
	24-May-18	26-May-18	2yr FRN	15	0	15		
				176	152	24		

WEEK	Auction Date	Settlement Date	Marketable Securities	Auction Amount \$B (TBAC)	Amount Maturing \$B	New Money \$B
28 May - 1 Jun 20	28-May-18	31-May-18	4wk bill	45		TBA
			3mth bill	45		TBA
			6mth bill	42		TBA
				132	132	0
	17-May-18	31-May-18	10yr TIPS (r/o)	11		results
	22-May-18	31-May-18	2yr Note	33		announced
	23-May-18	31-May-18	5yr Note	36		announced
	24-May-18	31-May-18	7yr Note	30		announced
				110	70.59	39.41
				<b>242</b>	<b>202.59</b>	<b>39.41</b>
Fed SOMA - Face Value of SOMA securities maturing 31 May 2018					28.479	
Proportion of mthly cap (\$18b total May)					9.37	
Amount to reinvest					19.11	

A key date to watch next week is 31 May 2018 – with settlement of \$242b in note and bill auctions, \$39b in ‘new money’ to be raised and SOMA holdings of \$28.479 maturing (\$19.1b reinvested, and \$9.4b in reduction of holdings).

Data is available at [https://www.newyorkfed.org/markets/soma/sysopen\\_accholdings.html](https://www.newyorkfed.org/markets/soma/sysopen_accholdings.html) and the face value of maturing securities (in Fed SOMA) is also provided on the Treasury Direct auction announcements.

## Monday 21 May 2018

Chicago Fed National Activity Index (Apr)

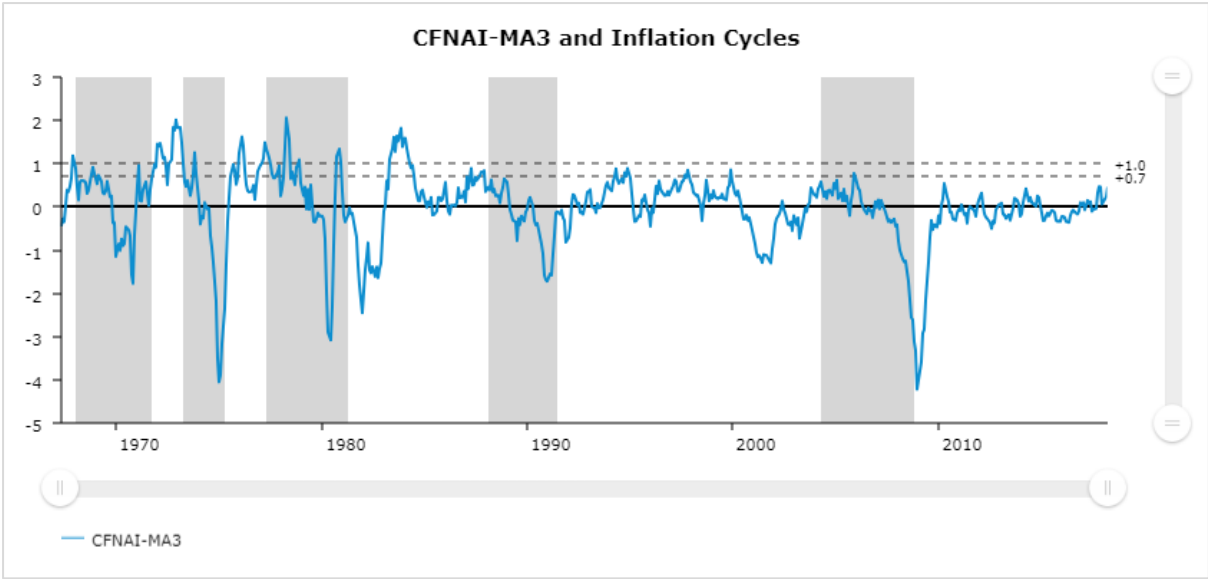
A gauge of overall economic activity and related inflationary pressure.

In the latest month, activity continued to grow above trend, but still at a modest pace:

April +0.34 versus March +0.32

The 3month moving average has moved up to +0.46 (cycling over the negative read for Jan) and shows a sustained growth in activity.

Of interest is though is the relationship between the 3mth moving average and inflation.

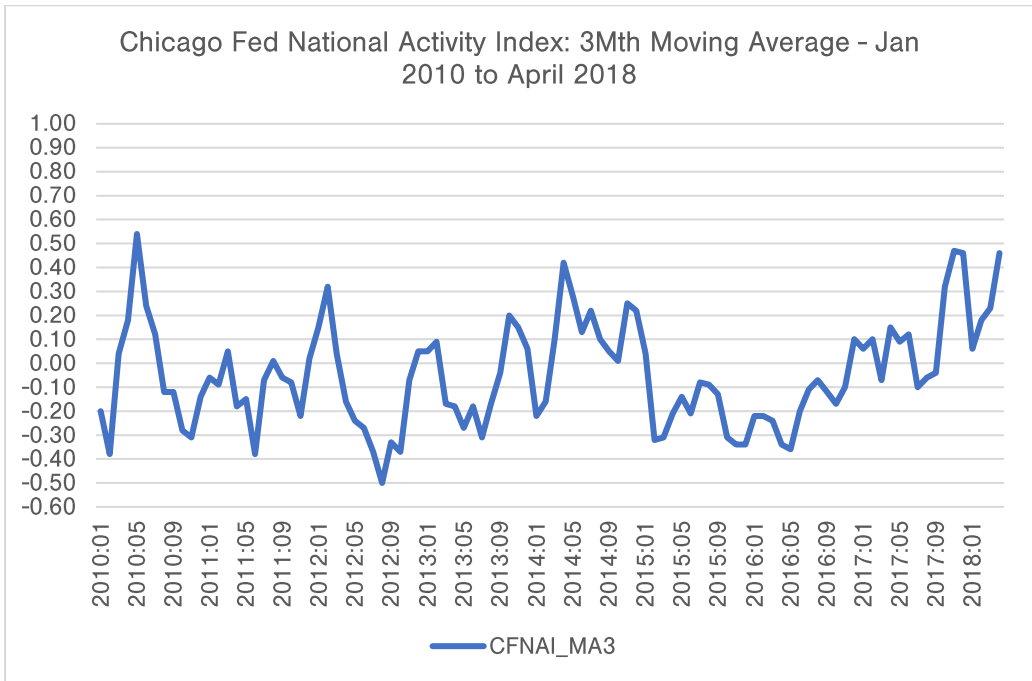


Source: Chicago Fed

“An increasing likelihood of a period of sustained increasing inflation has historically been associated with values of the CFNAI-MA3 above +0.70 more than two years into an economic expansion. Similarly, a substantial likelihood of a period of sustained increasing inflation has historically been associated with values of the CFNAI-MA3 above +1.00 more than two years into an economic expansion.”

<https://www.chicagofed.org/research/data/cfnai/current-data>

The current 3mth moving average for the activity index is +0.46 and is approaching recent highs again (expanding) but is still below levels historically associated with periods of ‘sustained inflation’.



Source: Chicago Fed

## FOMC speeches

Patrick Harker (President Philadelphia Fed) – Via Reuters:

“Harker, a centrist at the U.S. central bank, said that while he currently sees two more rate rises this year, after an initial policy-tightening in March, **“it is possible that we see an acceleration of inflation that I could be supportive of a third” rise.**”

“Inflation “does seem to be moving toward 2 percent ... and there is not much slack in the labor markets, so I think it’s appropriate to continue to move rates up judiciously.””

Back in February, Harker had been supportive of two hikes.

<https://www.reuters.com/article/us-usa-fed-harker/harker-could-back-3-more-fed-rate-hikes-in-face-of-u-s-inflation-idUSKCN1IM254>

The probabilities of an additional rate hike by the Dec meeting have been increasing recently. See: - [http://www.cmegroup.com/trading/interest-rates/countdown-to-fomc.html?utm\\_source=cmegroup&utm\\_medium=friendly&utm\\_campaign=fedwatch&utm\\_direct=/fedwatch](http://www.cmegroup.com/trading/interest-rates/countdown-to-fomc.html?utm_source=cmegroup&utm_medium=friendly&utm_campaign=fedwatch&utm_direct=/fedwatch)”

Raphael Bostic (President and CEO of Fed Reserve Bank of Atlanta) -

<https://www.frbatlanta.org/news/speeches/2018/05/21-bostic-views-on-the-economy-and-price-level-targeting>

Interesting speech regarding the role of price level targeting as a future framework for monetary policy. For the moment, the Fed is “as close as it has ever been over this expansion” to meeting its dual mandate.

”There is now a widespread belief that, once monetary policy has fully normalized, the federal funds rate—the FOMC’s reference policy rate—will settle at a level significantly below historical norms.” In other words, leaving little room to cut the benchmark rate in a crisis – supports a shift to ‘some form’ of flex price targeting.

Neel Kashkari (President, Minneapolis Fed):

Town Hall meeting [https://minneapolisfed.org/news-and-events/conversations-with-the-fed/town-hall-with-mpls-fed-president-neel-kashkari-in-escanaba-mi-video?sc\\_campaign=16C883BC3D314E2E899021FBD04A7AF9](https://minneapolisfed.org/news-and-events/conversations-with-the-fed/town-hall-with-mpls-fed-president-neel-kashkari-in-escanaba-mi-video?sc_campaign=16C883BC3D314E2E899021FBD04A7AF9)

Op-ed in the WSJ (<https://minneapolisfed.org/news-and-events/messages/wsj-op-ed>)

Op-ed in FT (<https://minneapolisfed.org/news-and-events/messages/financial-times-op-ed>) – (important) acknowledgement regarding the employment to population ratio as a measure of labour market ‘slack’, believes that it implies that the labour market not at full employment. Policy stance should return to neutral until **“we see evidence that wages are climbing and that we really are at maximum employment”** (this is inline with his view on a slower path to increasing rates).

---

**Tuesday 22 May 2018**

## UK – Inflation report hearings

Overall inflation is expected to hold steady compared to the previous period at 2.5% while core inflation is expected to contract slightly from 2.3% to 2.2%.

At the last policy meeting, the BoE kept rates on hold amid signs of slower growth.

**Gertjan Vlieghe speech** – “My own central projection will require one or two quarter point rate increases per year over the three-year forecast period”. The May Inflation Report forecast assumes just under three quarter point rate increases over the three-year forecast period.

The outlook is still clouded by Brexit – so while there is slightly more optimism from Vlieghe on rate hikes, there is still a lot of uncertainty around the forecasts.

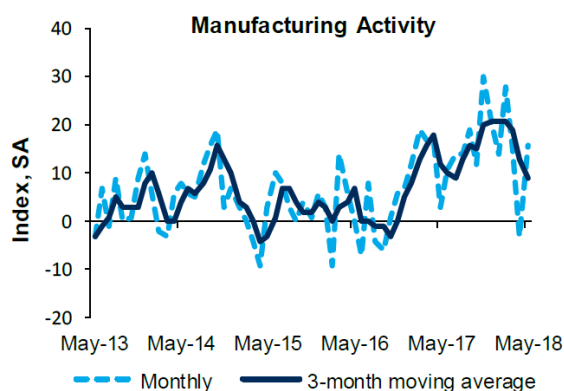
UK growth expected to pick up after a sharp drop in Q1 GDP, domestic risks to demand growth are Brexit related, looking for a decline in the inflation rate as weak currency effects fade. “As inflation falls back, and wage growth improves somewhat due to reduced labour market slack, household real income growth is set to pick up this year. That should support consumption growth”

<http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/treasury-committee/reappointment-of-dr-gertjan-vlieghe-to-the-bank-of-england-monetary-policy-committee/written/83255.pdf>

## Richmond Fed – Manufacturing Index (May)

Has followed the pattern of expansion seen in Philly Fed survey and “expected conditions” in the NY Empire State Mfg survey for May (last week) – a strong rebound after weakness in prior months. Stronger across most sub-indexes, especially prices received and prices paid.

May Index +16, prior month Apr Index -3



[https://www.richmondfed.org/-/media/richmondfedorg/research/regional\\_economy/surveys\\_of\\_business\\_conditions/manufacturing/2018/pdf/mfg\\_05\\_22\\_18.pdf](https://www.richmondfed.org/-/media/richmondfedorg/research/regional_economy/surveys_of_business_conditions/manufacturing/2018/pdf/mfg_05_22_18.pdf)

---

## **Wednesday 23 May 2018**

### Europe:

German – Q1 GDP (detailed results) and PMI (prelim) May

EU – PMI (prelim) May, Consumer Confidence (prelim) May

### Aus:

RBA Governor Phillip Lowe speech (6pm)

### UK:

PPI (Apr), CPI (Apr)

### US:

FOMC Minutes, PMI (prelim) May, New Home Sales (Apr), Kashkari

---

## **Thursday 24 May 2018**

### UK:

BoE's Carney speech, Retail Sales (first est) Apr

### US:

Fed's Dudley speech, House Price Index FHFA (Mar), Kansas Fed Manufacturing Activity (Apr), FOMC Harker speech

### ECB:

Monetary Policy Meetings

### Japan:

Tokyo CPI

---

## **Friday 25 May 2018**

### UK:

GDP Q1 (prelim)

### US:

Durable Goods Orders (Apr), Fed Powell speech, FOMC Kaplan, Bostic speeches, US Fed Evans speech

US – Fed Evans speech

---

## **Other**

**China trade negotiations** - Talks in Washington with Chinese officials last week – trade dispute with China “on hold for now”. China has agreed to ‘significantly increase’ its purchase of US agriculture and energy products – details still to be negotiated. No mention of whether the latest talks address the forced transfer of US intellectual property.

**NAFTA negotiations** ongoing, the initial May 17 deadline passed and Speaker Ryan extended that deadline by a week or two (end of May) in order to ensure that a deal can be approved by this current US congress (before mid-terms). Next few weeks should see more progress.

**Temporary tariff exemptions extended to 1<sup>st</sup> June 2018** – given that Chinese sanctions appear to be on-hold, awaiting an announcement on steel tariffs for other countries.

### **US Mid-terms**

**US Financial Regulations** - U.S. lawmakers are set to give Trump a chance to make good on his vow to “do a big number” on the Dodd-Frank Act. Legislation set for passage by the Republican-dominated House this week is the product of years of financial-industry lobbying to soften post-crisis rules, as well as sensitive negotiations on Capitol Hill to attract bipartisan support needed to get it through the narrowly divided Senate. The package may represent Congress’s last shot at dialing back Wall Street oversight before midterm elections in November that could have a significant impact on the future of bank regulation. (Source: Bloomberg)

**Italian Election (Mar 18)** – it’s been two months since the election and two winning populist parties have proposed Giuseppe Conte (a law professor) as PM – President Mattarella will need to confirm this nomination.

“The (PM) candidate is likely to be someone who will heed Mattarella’s (Italian President) thinly disguised warning to the coalition on Thursday against retreating from Europe. M5S has softened its stance on the EU, saying it would like to open discussions on “some treaties” rather than pull Italy out, while Salvini has said he wants to “defend Italy” within the bloc.”

<https://www.theguardian.com/world/2018/may/12/italy-m5s-league-verge-forming-coalition-government>

Italian 2year yields spiked as the two elected parties have outlined increased spending and watered down some of their original election proposals.