Commentary
Cash

April 2021

Monthly Cash Review

The Federal Reserve stuck to their dovish plan, making no changes to their policy rate or asset purchases. All the while, money markets began to buckle under the strain of all the cash in the system.

As was widely anticipated, the Federal Reserve (Fed) made no changes to their policy rate or asset purchases at the latest April meeting. The accompanying FOMC statement was also in line with expectations of more balanced risks, albeit with a slightly more positive tone regarding the economy. The Fed acknowledged the pickup in inflation we have seen in the past months, but continued to describe it as representing "transitory factors," noting that sectors most affected by Covid-19 have "shown improvement."

While the Fed stuck to their dovish plan, money markets started to buckle under the strain of all the cash in the system. Repo rates continued to trade from 0.00% to 0.01% and overnight deposits traded in the mid- to high-single digits. We also witnessed Fed Fund Effective (FFE) trade down to 0.05% on the last day of the month. A prolonged period of FFE trading at or through 0.05% should be a signal to the Fed that an adjustment to the RRP and IOER is needed.

There were several other Fed speakers that confirmed their policy will be accommodative for the near term:

- Williams said the economy is coming back strong, though he sees the potential for bottlenecks (yet he also expects those risks to dissipate). He said the US should be able to pull through the pandemic without long-term damage and that conditions to adjust policy "are a long way off."

- Clarida said the Fed won't tighten solely because unemployment falls, but will react to data on inflation itself.

- Bostic said the economy can run a lot hotter than expected without causing inflation and reiterated that the Fed will wait to see inflation happening before they "start to slow down the economy."

These comments reconfirm the Fed's new policy framework will allow for much lower unemployment rates and longer periods of inflation running above 2% without a rate hike. The Fed's Kaplan and Waller also took time to comment:

- Kaplan said that "structural forces of technology-enabled disruption and an aging population" haven't gone away and may limit pricing power. He also noted that climate change has a significant effect on the economy.

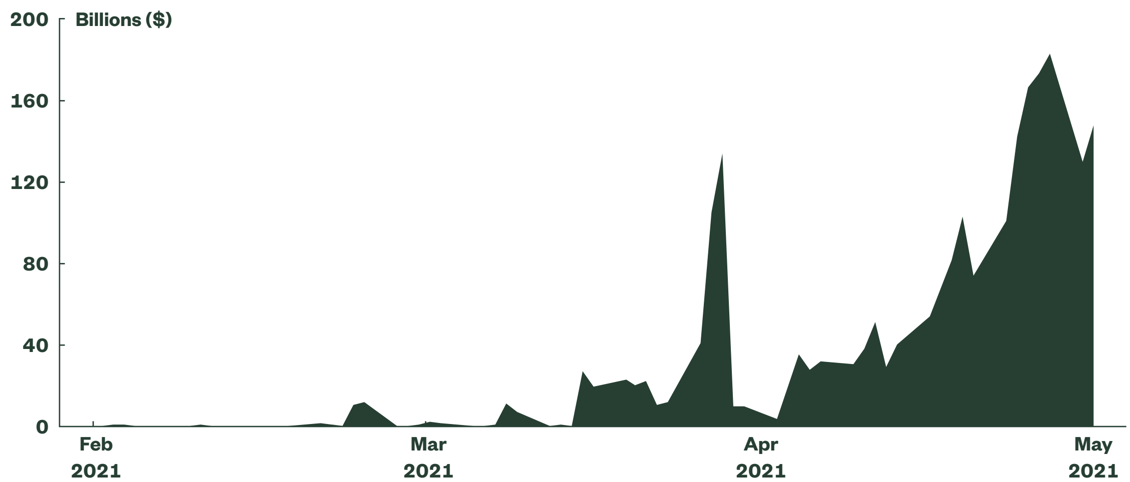
- Waller said the economy is ready to "rip" in the coming months, but cautioned that we still need to "make up a lot of ground" and there is "no reason to be pulling the plug on support until we're really through this."

To Waller's point, retail sales jumped 9.8% in March, confirming expectations for strong growth, while initial jobless claims fell to a pandemic-era low. Core CPI rose 0.3% with strength in services' prices and details of the report signaling we could see inflation move higher than we previously expected in coming months. However, we still expect the increase to be largely transitory in nature.

The Bank of Canada became the first major central bank to taper its asset purchase program by reducing their purchase target from at least $4 billion per week to at least $3 billion per week. The bank also upgraded its forecasts and noted that a rate hike may become appropriate as soon as the second half of 2022; positive news for the money markets. Conversely, across the pond the European Central Bank's (ECB) meeting was uneventful with ECB President Lagarde stating "any phasing out [of asset purchases] was not discussed and it is just premature."

New York Fed System Open Market Account Manager Lorie Logan noted adjustments to the QE program would likely be announced with the next schedule release on May 13th. Until then, money markets will be monitored and adjustments will be made to administered rates "as needed." We will keep a close eye on this, in hopes we see an adjustment before their June meeting. Of concern is the latest increase in utilization of the Fed's Reverse Repo Program. The program's volume surged in the last week of April and at the time of this writing continues to see increased demand.

Figure 1
Reverse Repo Program Allocation



Source: Bloomberg and Federal Reserve as of May 4, 2021.

For those looking for a bit more hawkish quotes from former and current Fed presidents, we will leave you with these two:

Former New York Fed President Dudley said that the Fed may need to raise rates under the new regime to at least 3.5%, even 4%, as it will be late to start hiking "by design."

Kaplan also said that he is observing excesses and imbalances in markets (specifically highlighting excesses in the housing market), and suggested the Fed should start talking about tapering bond purchases "soon."

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