Commentary
**Cash**

**May 2021**

# Monthly Cash Review

The economic outlook has become more positive over the past month as the US continues to move towards a full economic reopening. Unfortunately for cash investors, the Fed has no intention of easing their accommodative monetary policy any time soon.

## Policy

We've aggregated various comments from Federal Reserve (Fed) officials and the Secretary of the US Treasury describing their views on inflation and policy rates.

- Treasury secretary Yellen said the jobs report is stronger than the numbers suggest, and she doesn't think that unemployment benefits are hurting hiring. She noted chip and lumber shortages affected jobs last month, as well as health concerns and lack of child care being other noteworthy issues. She added one should never take one month of data as an underlying trend.

- Fed's Evans said that he expects continued strong employment growth over the rest of the year, with the hope that the April jobs report is a one-off. He warned that we should distinguish between persistent and transient inflation and remarked that inflation rates of 2.5% do not bother him as long as it's consistent with an overall average of 2% over some period of time.

- Fed's Kaplan said he still expects strong job growth this year, and that the economy needs to make substantial progress before the Fed begins tapering. He said it would be healthy to start the taper debate sooner rather than later.

- Fed's Daly indicated we have a deep hole to dig out of regarding joblessness and we are in a transition state. She remains bullish, however, and held out that we are not there yet. The labor market is in a state of flux with many constraints, though she prefers to use the term bottleneck not shortage. She also said it was not yet time to talk about tapering and she sees stock market valuations as fairly high.

- Fed's Barkin divulged he does not hear of changes in medium- to long-term inflation expectations from various business contacts. He said that spending has come back faster than employment and that he expects a strong spring and summer.

- Fed's Waller sees the Fed maintaining its accommodative policy for some time with inflation above 2% in 2021 and 2022 but back at goal in 2023. He remarked that the economy is "going gangbusters" despite a weak jobs report but that the Fed can't be "head-faked" by poor jobs data and high inflation in April.

- Fed's Clarida said that the Fed will give advance warning before tapering bond buying and that the upward pressure on inflation is likely to be transitory.

- Fed's Bullard said that he is an 'inflation hawk' and expects inflation to remain above 2% in 2022. On tapering, he said that it is still too soon to open talks about mortgage-backed securities tapering.

- Fed's Quarles, in his testimony before the House Financial Services Panel, said the strong economic recovery is underway but not yet complete. He expects dislocations in the economy to cause temporary increases in prices.

- Fed's Brainard said she expects short-term spikes in inflation associated with the reopening and bottlenecks to subside after seeing further increases in the coming months.

- Fed's Bostic said the US economy has been more resilient than expected and that demand is responding quicker than supply, leading to price effects. He said, however, that he does not see inflation rises to be enduring.

- The FOMC minutes revealed that "a number" of participants brought up the possibility of discussing a plan for asset tapering "at some point over its upcoming meetings" if data warrants. However, the minutes also stressed that it would likely be "some time" before "substantial further progress" on its mandates is seen. Rates rose and the USD rallied on the FOMC minutes release.

## Outlook

The economic outlook has grown increasingly more positive over the past month as the US continues to progress on to a full economic reopening. Even the most cautious states (Massachusetts and New York, for example) have almost fully reopened, and with the loosening of restrictions we have seen a surge in demand. Airports are once again crowded, stadiums full, restaurants bustling. Unfortunately for cash investors, as noted repeatedly above, the Fed has no intention of easing their uber accommodative monetary policy any time soon. US Treasury rates are pinned at zero and credit spreads continue to compress. Three-month Libor versus 3-month OIS has reached a tight of 5bps. Three-month Libor set at 0.13%, a record low never seen in the history of the index.

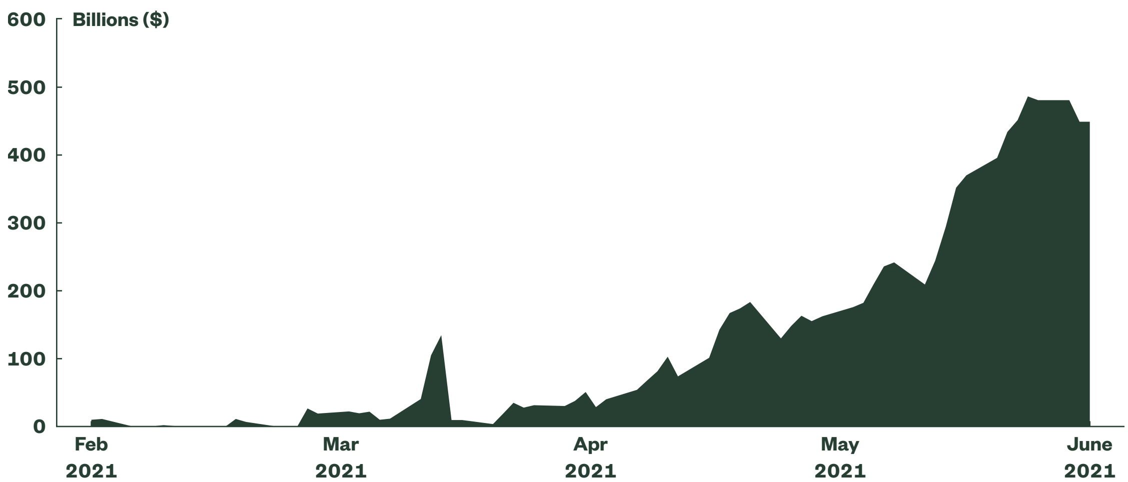
## Economic Data

US jobless claims fell for a fourth straight week to a fresh pandemic low at 406k (est. 425k). Declines are set to steepen further in the coming weeks as states plan to cut enhanced unemployment benefits. Orders placed with US factories for business equipment rose in April by the most in eight months, with the core measure increasing 2.3% after a 1.6% gain a month earlier. Meanwhile, the broader measure unexpectedly decreased 1.3% from the prior month, reflecting declines in orders for motor vehicles and military aircraft. The economy's rebound from the pandemic, solid business investment and lean inventories have powered non-defense capital goods orders in all but one of the last 12 months. However, shortages of materials and delivery bottlenecks have driven prices up and hindered factories' ability to keep up with demand. Unfilled orders for durable goods rose for a second straight month. Personal spending rose at a steady, yet moderate pace in April after a stimulus-fueled spike a month earlier. Purchases of goods and services increased 0.5% following an upwardly revised 4.7% in March that was the largest reading since June. The core gauge (excluding food and fuel) increased 0.7%, its biggest monthly advance since October 2001. Retail sales stalled in April following a sharp advance in the prior month when pandemic-relief checks allowed for increased spending. March data was upwardly revised to a 10.7% gain, the second-largest in record, going back to 1992.

## Markets

Each month the Fed injects another $120 billion into the market through their QE program, causing the cash markets to be completely overwhelmed by the amount of cash in the system. The Fed's balance sheet of assets is currently $4 trillion higher than it was in January 2020. Commercial bank deposits are over $17 trillion (almost $4 trillion higher from January 2020) and money market fund balances are now $4.6 trillion, closing in on their previous high of $4.8 trillion in May 2020. The continued stimulus provided by the Fed's fiscal support has both state and local governments flush with cash. All of this excess cash has helped push yields to historic lows: 1–3 year investment grade credit spreads are at 31bps while Tier 1 (A1P1) 3-month commercial paper rates are 0.07%. The current market environment is proving to be a substantial challenge for the cash investor. The stress on the system is reflected in the amount of cash the Fed has been taking back out of the market through their Reverse Repurchase Program (RRP). Those balances reached a high over the May month-end (Figure 1).

Figure 1
**RRP Allocation**




Source: Bloomberg, as of June 2, 2021.

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**State Street Global Advisors,**
One IronStreet, Boston MA 02210
T: +1 617 786 3000.

**State Street Global Advisors Worldwide Entities**

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