

## Rates Spark: Chair Powell takes the crosswinds in his stride

Chair Powell's comfort on inflation, and tariffs was notable – he was remarkably relaxed on it. Upbeat on growth, with some risks, but very relaxed on inflation. That's why the 2yr yield gapped below 4% and the 10yr yield got down to 4.25%, a marked bullish steepening net reaction. The QT wind-down is an issue too, as that means the Fed is now a solid net buyer



### The Fed becomes a bigger net buyer of Treasuries from April

We had targeted an end of quantitative tightening (QT) by mid-year. The Fed has just snuck in a slowing from April, as a step. It comes against a backdrop where the Fed sees some evidence of liquidity tightening. They are being super cautious here, as they don't want to repeat 2019 when they overdid it with QT, resulting in some quite severe liquidity shortage issues to deal with.

Specifically, from April, the Fed will have a monthly redemption cap of US\$5bn. That's practically zero. It's not clear why the Fed did not just decide to go to zero, apart from not giving the market the news story that the QT in Treasuries was fully over. This is still big news. Remember, up till now, the redemption cap for Treasuries was US\$25bn. Before that, it was US\$60bn. What that means is

the Treasury has virtually no redemption cap. The redemption cap itself meant that the Fed would re-invest an amount equal to the full roll-off minus the redemption cap.

The full roll-off tends to be anywhere from US\$25bn to US\$75bn per month, but in many months it can be lower (averages around US\$35bn per month, but volatile). If there was no redemption cap at all, the Fed would simply reinvest these amounts back out the curve, broadly equating to the maturity profile of outstanding bonds. With the US\$5bn cap, the outcome is virtually the same, but adjusted by the US\$5bn (which is not a significant amount). Bottom line the equates to the Fed being a (bigger) net buyer of Treasuries from April onwards.

The Fed continues to have a redemption cap of US\$35bn for mortgage back securities. So, the overall redemption cap is \$40bn. This can mean that the QT programme can stretch a tad beyond our targeted end by mid-year, likely now drifting into the third quarter. The key floor here is US\$3tn for bank reserves. These are now around US\$3.5tn, but artificially inflated by the spend down by the US Treasury, as they are constrained from engaging in net issuance by the debt ceiling. By mid-year we expect this to have been resolved, and for bank reserves to be approaching US\$3tn. But that approach will be slowed by US\$20tn a month due to the cut in the cap on Treasury redemptions (from US\$25tn to US\$5tn).

Still, Treasuries are viewing this early move on QT as bullish, with an impact reaction for lower yields. It's not a dramatic reaction though, which makes sense. The notion of the Fed being a buyer of Treasuries is an important factor, but it's not unusual for the Fed to be active in the Treasury market, on both sides. And there are other bigger issues out there that can push Treasuries around. So don't expect this impact reaction to be the structural one. It's the right reaction. But should broadly be a one-day one, at least based off this factor alone.

The market aggregate reaction, though, was not so much about QT-wind-down-news. It's was more about Chair Powell's comfort on inflation, and tariffs – he was remarkably relaxed on it. Upbeat on growth, with some risks, but very relaxed on inflation. That's why the 2yr yield gapped below 4% and the 10yr yield got down to 4.25%, a marked bullish steepening net reaction.

## Markets see the Bank of England pausing on Thursday, but eventually delivering two cuts this year

The market is firmly priced for the Bank of England to stay on hold along with the established quarterly pattern for delivering cuts. Our economist expects the voting split to be a repeat of February's 7-2 vote in favour of no change, which also seems to be the majority view among observers, with a somewhat lower probability of a 6-3 split. Markets would probably not read too much into any of these outcomes though.

Our [economist's base case](#) is that the Bank continues on its current course of gradual rate cuts, with moves in May, August and November. The market is more reluctant and currently prices only 53bp easing by year-end.

### Thursday's events and market view

The UK will get some attention with the jobs market data in the morning and then the Bank of England decision later in the day.

But overall the UK for now is a sideshow, with the main drivers being Europe's incoming

spending splurge on the one hand and the growing US outlook concerns plus looming tariff decisions on the other. The former puts the European Central Bank in a tighter spot as rising yields have tightened financial conditions already – we will be hearing from Lagarde and Lane among others today while a European Union summit kicks off to further discuss the defence plans. The latter means that US releases like the weekly initial jobless claims can be more influential data – even as those are seen little changed on Thursday but any surprise could be more disruptive.

In primary markets Spain auctions 5y, 10y and 20y bonds for up to €6.5bn in total. France auctions short- to medium-term bonds for up to €13.5bn and inflation linked bonds for up to €2bn. Ireland taps two bonds for an overall €1bn.

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