**Goldman Sachs Exchanges: The Markets**

**What's next for U.S. Treasuries**

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**Sam Grobart:** As debt ceiling stress recedes, new trends appear. This is The Markets, a new series from Goldman Sachs Exchanges.

Hi, I'm Sam Grobart. Today I'm joined by Beth Hammack, co-head of the Global Financing group in Global Banking & Markets. And we're going to talk, hopefully for the very last time, about the debt ceiling, as well as the return to watching the Fed's next move and stock market performance around the world.

Beth, thanks for joining us today.

**Beth Hammack:** Thanks so much for having me.

**Sam Grobart:** So, listen, we've got a lot of news that's been coming out this week. Given the recent agreement in

Washington, it looks like the US Treasury is going to be issuing around $1 trillion of debt in the next six months. Who will be the buyers of that debt?

**Beth Hammack:** So, Treasury's going to have to rebuild its cash balance, what they call their Treasury General Account, the TGA. And so, to do that, you're exactly right. They're going to have to be issuing in the markets at a pretty rapid clip.

The market expectation is most of that issuance will be happening in T bills, so at the very short end of the yield curve. And so, the real debate that's going on in the marketplace is, is that funding going to come out of bank reserves? Or is it going to come out of the Fed's RRP program?

**Sam Grobart:** And what's the RRP program?

**Beth Hammack:** So, the RRP program is a place where money market funds typically can actually engage in reserves repo with the New York Fed. So, they essentially give the New York Fed cash, and the Fed gives them collateral. The Fed put this facility in place a number of

years ago to help maintain the floor on rates to keep rates above zero. They've kept this in place. And it's actually grown to over $2 trillion in size. As money market funds have become a popular instrument through this, this rate hiking cycle, banks haven't been raising their deposit rates quite as rapidly. And so, if you can get two basis points on your large money center bank checking account or you can get 5 percent in your money market fund, people generally have been preferring to be in money market funds. And so, you've seen that facility grow.

So, the expectation is that as Treasury starts issuing more in the front end of the market, a lot of that money that's sitting at the Fed will move out of that facility. And that will be a big buyer of those T bills that are going to be issued in the coming months.

**Sam Grobart:** A trillion dollars is not a small amount of money.

**Beth Hammack:** It's not a small amount of money.

**Sam Grobart:** No, never is. Is there the sufficient sort of plumbing and infrastructure to handle that volume?

**Beth Hammack:** Certainly, the system can handle it. Again, you've got 2.2 trillion that's sitting in this reverse repo facility. These money funds are going to move based on really just the level of yield that they can buy.

So, this faculty right now is paying 5.05. It's set at five basis points over the bottom of the Fed's target band. And so, to the extent that bills are yielding something higher than that, you'll see those money funds move pretty efficiently out of the RRP and into buying those Treasury bills. So, there will be a lot of capacity.

And if that facility moves down by a trillion dollars, and I don't think we expect all trillion is going to be in the very front end of the market, some of it will be further out the yield curve through normal course of Treasury issuance. And so, there'll be term buyers. You know, asset managers, insurance companies, corporates will be looking at those longer-term bonds.

**Sam Grobart:** You've been talking about money market funds. Probably due to some debt ceiling anxiety, I've seen massive inflows, just $40 billion in the last week. Does that

reverse now given that an agreement has been reached?

**Beth Hammack:** So, we'll be watching that closely to see exactly how investors want to behave through this environment. The stock market has held up reasonably well. And so, when you think about that $40 billion moving into money funds, you have to look at where did it come from and why are people moving and where do we think they'll go back to?

But I think the expectation is that $40 billion sounds like a really big number in the context of this flow of funds. But actually, it can pretty organically be absorbed by other markets. And so, coming out of money market funds as we've just talked about doesn't have a huge impact on broader markets because there are so many options available, particularly given that this RRP facility is unlimited in size. And so, that $40 billion coming out of money funds, if it's moving into other places like the equity markets or the corporate bond markets, we think, will be pretty absorbed. And will be supportive for those other asset classes.

**Sam Grobart:** Beth, we're beginning to see some

increased expectation that the Fed may have to raise rates in June, which is a bit of a change given that most people were expecting the Fed to take a pause. Is that debt ceiling related? Or is that due to other factors, like what you were just saying: strong US stock performance or the uptick in consumer spending?

**Beth Hammack:** The discussion around the Fed and whether or not they're going to hike at their next meeting is really not related to the debt ceiling. I think the broader issues that they're looking at have to do more with the strength that we've seen in inflation. And while we've seen inflation peak, it still is staying pretty persistently strong. And so, a lot of this is going to hinge on Friday's payroll number in terms of where that comes out.

When the Fed is looking at the full constellation of data, strength of the consumer, health of the banking system, where inflation numbers are coming, they're trying to make sure that they're getting conditions tight enough so they can start having an impact on inflation and start bringing it down. But they don't want to do it so rapidly that they're going to cause a big recession. And so, the expectation had been that they would take a pause for the June meeting.

Wait and see how much the credit tightening on the back of some of the banking stress that we've seen is going to come into play. Our house call, Jan's call, is that before the banking issues had expected maybe one or two more hikes. But the expectation now is that the credit tightening we're going to see on the back of tighter landing standards because of the banking stress will provide the same amount of tightening in that 25 to 50 basis point equivalent that you would have seen from tightening.

And so, you'll see rather than a rate hike, you'll see a credit tightening that will serve the same purpose to really get inflation under control and bring the economy back to where it needs to be.

And again, as you well know, Jan's view, which is an outlier view, is that we are going to have a soft landing and that we will not see a meaningful recession towards the end of this year.

**Sam Grobart:** Absolutely. We were talking earlier regarding sort of strong US stock performance. What do you see driving that? I know that obviously there's been a lot of interest in AI. That's been affecting a lot of tech

stocks. What else is going on out there that you're paying attention to?

**Beth Hammack:** Well, what we're really looking at is under the hood. Certainly, when you look at the broad index, when you look at the S&P 500 or the NASDAQ, you're seeing really good strength. But if you actually look under the hood, that's being driven by a very small number of stocks. As you rightly noted, the S&P 500 is really driven by five or six tech stocks at the very top of it that have enormous market caps. And that because of the AI and because of the tech sector and the chip sector in particular has been so well supported, that's really supporting the overall index.

But when you break it down and you try to look under the hood a little bit more, whether it's cyclicals versus defensives or whether you look at, you know, services versus industrials or different underlying baskets, you actually get a bit of a different story.

And so, it's important to look at not just the overlying index, but also look at some of those indicators below to see which sectors are investors really preferring.

**Sam Grobart:** If I can just drill down on that for a second. You were saying that you see a bit of a different story. What kind of story do you see right now?

**Beth Hammack:** Well, I think what you see is that investors are looking at this moment in time and you see a divergence in terms of these expectations of whether or not the US is going to enter into a recession. And so, looking at different sectors, you see different performance. And so, again, at the top of the market, you're seeing a lot of consolidation in the big tech area. And so, you're seeing a lot of support there.

But in these hyper growth companies that had been smaller, some of the newer IPOs, some of the newer issuances, you're not seeing the same level of growth there. Right? You're seeing a real advantage play out in these market dominant players. And that's really giving them a lot of the performance at the top of the market. But lower down, there's a little bit more stress, there's a little bit more concern about name by name, how are they going to thread the needle? And part of this theme that we've been looking at has really been which of these stocks, which of these

businesses are really inflation proof and recession proof? In 2021 it was growth, growth, growth. Growth at any cost. Which really works when you're in a zero percent interest rate environment. When you now have the cost of money as at 5 percent plus, growth is a lot more complicated. And so, you need to think about do these business models sustain these higher rates? And how are they going to manage through the recent inflationary pressures to make sure that they've been really disciplined about their business?

**Sam Grobart:** Okay, Beth, last question. What's going to be on your mind for next week?

**Beth Hammack:** So, in the week ahead we're going to be focused on, first and foremost, making sure that the debt ceiling deal actually gets signed. We've been down this road a number of times. It feels like we're in a really great place given how strongly the bill passed the House. But obviously, it's got to get through the Senate.

And then away from that, it's going to be looking at where these flows of funds are coming from. So, what you talked about. In terms of this treasury issuance, who are the buyers? Is this money coming out of RRP as we expect? Or

is it going to be coming out of bank reserves, which could present a bit of a different picture from a stability perspective for the overall market? And then we're going to look at how US investors are looking at the growth and the strength that we've seen in the equity market. So, over the past several weeks we've actually seen really good activity in terms of issuance in the equity markets largely through follow-ons and block trading. And we're going to look to see if that trend continues because that would be really supportive for getting us in a place where we could see IPOs beginning to happen again in September of this year, which would be very constructive for capital formation in the US markets.

**Sam Grobart:** Beth, thanks so much for joining us.

**Beth Hammack:** Thanks for having me.

**Sam Grobart:** That does it for another episode of The Markets.

As of June 16th, we'll be leaving The Exchanges feed. But we have our own new feed. So, subscribe to Goldman Sachs The Markets wherever you get your podcasts.

I'm Sam Grobart. Thanks for listening.

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