The Day Ahead: Bonds Partially Unwinding Yesterday's Liquidity Panic

By process of elimination and ongoing forensic efforts, it's becoming more and more clear that yesterday's mystery rally in the short end of the yield curve was a product of liquidity/reserve stress in short-term funding markets. While the regional bank drama may have added fuel to the fire in a roundabout way, it was neither the match nor the flame. Episodes like this happen from time to time, especially in April and October as corporate tax deadlines create large short-term funding needs that can put strain on reserve balances (already a topic of conversation for the Fed recently, as they ponder the timing of the end of QT). In short, the market briefly worried that reserves were going to run too thin and the Fed would be forced to address it in a way that benefited short-term rates. The shortest term rates (like day to day SOFR) couldn't benefit due to immense short-term borrowing needs and scarce reserves, so any market concern was forced to play out in the slightly longer term (a few months in the future vs a few days). With the more dire fears in the rearview (T, bonds are backing away from the panic trade a bit this morning, but the real catalyst was a 7:12AM newswires citing Trump saying Chinese tariffs will not be sustainable.

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