The Wall Street Examiner

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Professional Edition

Treasury Update – Saturday, July 28, 2012 [1]

This report covers Treasury auctions, federal revenues, and the outlook for Treasury supply, Treasury yields, and the dollar. It should be read in conjunction with the next Fed Report normally posted over the weekend or Monday (*). The housing data is posted in a separate report that is updated whenever relevant data is published. Check the Housing category of the Wall Street Examiner regularly for the most recent update of that report.

Here are the key bullet points in this report.

- Net new Treasury supply for the July 31 settlement will be the heaviest it has been since July 15, 2011. The shift in sentiment on Friday suggests that it will be more of a problem for bonds than stocks.

- After Tuesday, supply will be light until the end of August. The markets will not have to face that as an obstacle.

- The 10 year Treasury Yield has been at a major inflection point as it set a minor new low at a key technical level. Friday's action suggests a turn, but confirmation is needed.

- Withholding tax collections reached a 4 week average real gain of 3.75% year to year, suggesting for a second week that economic data may come in better than consensus expectations for weak growth. That could be the Treasury bubble's death star.

- Withholding tax collections weakened over the past 10 days, but it looks like a normal fluctuation so far. If the 4 week average drops below a 2% real gain, that could be trouble.

- With revenues up, outlays are running slightly below last year. Spending has not kept pace with revenue gains. No unexpected increases are likely in Treasury supply. If anything, supply going forward could be slightly lower than expected. The impact would not be material.

- Bond fund inflows picked up again but are still down 30% from the April peak.

- FCB buying of Treasury paper increased last week, triggering a possible buy signal, but the recent pattern has been choppy, so I expect that this too will not be sustained.

- Primary Dealers sold Treasuries in the week ended July 18. The Primary Dealer Treasury buying panic reached a crescendo in the week ended June 6, leading to them mostly selling since then. The indicator is nearing a significant trendline. If broken, that could be an important signal that the Treasury market buying panic is ending.

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[1] **Format notes** - Currently updated sections are in this font. Material that was updated recently and due to be updated weekly or monthly is in this brown font. Material in this font is infrequently updated ackground information for review or for the benefit of new subscribers. [1]

- Commercial banks had been heavy buyers of Treasuries in two of the previous 3 weeks, with purchases hitting record levels. In the week ended July 18, they were sellers again, leading to the question of whether that buying surge was another sign of the final blowoff of the Treasury market.

- The dollar pulled back after reaching intermediate price objectives as well as a trend resistance line. The trend still looks bullish longer term as the medium of exchange of the Last Ponzi Game standing, but if key support in the 81 area breaks, that game could be over, with negative repercussions for Treasuries, and positive implications for gold and other money substitutes like oil. The question is whether stocks would also be seen as one of those.

As usual, the Fed Report to follow will look at more of the data to help fill in the blanks.

5/5/12 By holding short term rates at zero, Bernanke is forcing old people to take ever increasing duration and credit risk. The first wave of Bernankecide through the forced drawdown of savings accounts and money market funds will be followed by a second wave when the elderly face massive capital losses in their bond mutual funds. This massive ongoing loss of purchasing power is a drag on the economy. Bernanke has never addressed the issue because reporters who have access to him have not asked the question in those terms. This is the Gentle on Ben journalistic approach. It shows the near total abdication of responsibility of modern "journalists."

5/5/12 If the Fed and ECB do not start pumping again soon, the forthcoming economic data is likely to disappoint, which will be good for the Treasury market, but probably not so good for stocks and commodities, which may be exactly what the US Government wants. The Obama Administration could be betting on Red, with the view that lower energy prices could provide all the economic, and particularly electoral stimulus that it needs, in spite of the fact that stock prices could also take a hit.

Bernanke is not likely to do anything drastic before the election. He'll keep some form of MBS purchase program, or something similar, that will keep the balance sheet at least flat. That won't be enough to spur more growth but it could starve stocks and commodities enough that they'll fall and Treasuries will continue to rally.

4/28/12 Last year the Fed exacerbated the problem by taking a wait and see attitude after QE2 wound up. Ben will not make the same mistake this year. Operation Twist is a non issue. That has always been a wash in terms of injecting cash into the trading accounts of the dealers. The MBS purchase program is the means by which the Fed has kept the Primary Dealers liquid. While the program is supposed to end in June, the settlements will continue into August. The Fed is virtually certain to announce an extension or replacement of the program. To stop would be to shrink the balance sheet, since the paydowns of the Fed's MBS holdings will continue (see discussion in Fed Report). Bernanke knows better by now.

So even though the Treasury supply situation will be turning unfavorable for the markets, don't expect a double whammy from the Fed this year. It will be there to maintain the bid.

FCBs have been doing less buying for several years, and everyone, including me, expected that to hurt the market. One of the reasons that it hasn't done so finally dawned on me this morning (better late than never). A major part of their buying has always been GSE paper. But there's less of that around as Fannie and Freddie shrink. The FCBs are apparently facing heavy maturities in their GSE holdings, which have dropped from $740 billion to $717 billion since late February. That cash isn't all needed at home, so it needs to be reinvested. With less GSE supply to roll that cash into, they buy Treasuries. So even though they are buying less in total than they were a couple of years back, they are still buying Treasury paper.

The combination of reduced GSE supply and excess cash forces the FCBs back into Uncle Sam's sweaty arms. Ironically one of the benefits of the collapse of the housing market is that there's less mortgage paper supply. That boosts Treasuries and all other forms of financial assets. The Fed is also helping to remove the supply of mortgage paper from the market.

However, the FCBs will continue to have increased cash needs at home. The trend toward lower buying of Treasuries is secular. The trend of constantly increasing Treasury supply is still in place. It may or may not slow, but it will be around for long time. Eventually the demand and supply curves will cross. We're just not there yet. The charts of Treasury yields suggest that yields may still have a few basis points to go on the downside.

3/22/12 Sure, the Fed and the Obama Administration want stocks to rise, but keeping the Treasury market from falling apart always has been and always will be Job One. As long as there's a Treasury buying panic still under way in most of the usual sources of demand, it's unlikely that yields will have a hair-on-fire breakout. It may be coming, but it could take months to get there, based on current indications.

The "as good as it gets" demand profile in the Treasury market is beginning to fray around the edges as banks and FCBs pull in their horns a little, but public buying has picked up, and the government has helped by cutting way back on outlays this month. It has also had the good fortune of a sizable increase in tax collections, including a small uptick in withholding taxes.

Meanwhile the Fed will continue the settle the bulk of its forward purchases of MBS around mid month to help the dealers absorb mid month supply. If new supply is as light as forecast for the mid month Treasury settlement, the period immediately after that could be particularly bullish. But Treasury supply will increase in May. That will coincide with cyclical and seasonal propensities for stocks to top out. Selling of stocks would give Treasuries another boost for a month or two, pushing yields back down in their now familiar range around 2% or slightly below. Bond bears will be thwarted and frustrated one more time, but their time is coming. The forces of "as good as it gets" are beginning to wane, but it will take months for this to play out and ultimately result in a breakout in Treasury yields.

3/10/12 There are hints that that trend has gone as far as it can go. The Fed and ECB have made noises that they don't intend to print any more money. I think that they may have to stick to that pledge for a while, because any time the Fed floats a trial balloon about more QE or modified QE, oil and other commodities pop. The threat of more increases in energy prices etc will tie the central banks' hands. That means that all the free money that has been propping up the Treasury market will begin to wane in the months ahead.

3/2/12 This is as good as it gets for the Treasury market. Primary dealer purchases of Treasuries are running at record levels. So are bank purchases. So are fund purchases. And foreign central bank purchases have been running at the highest levels in 14 months. Finally, this week the ECB flooded the European banking system with over €300 billion in net new money. Much of that went to US Primary Dealers and other banks who invest in US Treasuries. Yet, in spite of that, the Treasury market did not reach record lows in yields. Instead, the 10 year yield bobbed its head above 2% on a couple of occasions. When conditions slip from less than "as good as it gets," what do you suppose will happen to Treasury yields?

The markets faced an enormous slug of Treasury supply that settled Wednesday and Thursday but those who would absorb it had the good fortune of having the ECB's El Toro Grande, or Long Term Refinancing Operation (LTRO) at the same time. What could have been a very rough week turned into the non event I had postulated as a result. The banks got hundreds of billions in nearly free money from the ECB, so what better way to invest it than in the "safest of safe" paper, US Treasuries?

But what about afterwards? It's now afterwards.

I doubt that the equivalent of $425 billion hitting the market in one fell swoop would be fully invested quickly. The reserves have been created, they're sitting at the ECB and can be leveraged, but given the insolvency and inadequate capital of the banking system, not much of it is likely to be deployed anywhere but central bank depositories. The markets did plenty of front running in advance of the event. Seeing how wild the buying has been from virtually every market segment, the after effects of the ECBs money bomb may turn into a non event.

Treasury Borrowing Advisory Committee TBAC

5/5/12 The TBAC released its Report to the Secretary and meeting minutes last week. You can read these items at:

http://www.treasury.gov/press-center/press-releases/Pages/tg1560.aspx and
http://www.treasury.gov/press-center/press-releases/Pages/tg1561.aspx

he updated schedule of Treasury auctions is little changed from the first estimate for the second quarter released in early February. That can be accessed at:
http://www.treasury.gov/press-center/press-releases/Documents/TBAC_FIN_TABLE_Q2_CY2012.pdf

Treasury Auctions

(9/22/11) One difference in the new program (Operation Twist) versus the one that has been in place since July is that the Fed will no longer be purchasing Treasuries outright. In September it had scheduled $16 billion of those purchases, which is a drop in the bucket compared to the $100 billion plus under QE2. But in October, that will drop to zero as the Fed begins to replace its maturing GSE holdings and MBS holdings being prepaid with purchases of GSE MBS securities directly from the PDs. That will give them minimal help in absorbing the $100-150 billion a month in new Treasury supply that they must partially absorb and distribute. Under the circumstances we can look forward to continuing market dislocations.

If revenues continue to fall short of projections and the Treasury needs to borrow more than forecast, it would seem that it will do so by increasing the size of the bill auctions, where panic demand seems insatiable. The larger the 4 week bill sizes, the less cash will be left over to be parked short term in high dividend stocks, removing yet another prop from stock prices.

(9/9/11) To put this in perspective, prior to 2007 the mid to late September period always had paydowns because there was enough cash coming in from quarterly tax remittances to pay off some short term paper for a few weeks. That’s no longer the case.

(11/27/11) Corporate quarterly estimated taxes are due on December 15. They have increased due to the expiration of favorable depreciation rules. Quarterly tax collections reduce net new borrowing for this month. Prior to 2008, there were normally paydowns for a week or two following the December tax collections, but with the larger deficits since then, there have been no such windfalls. The government will still need to borrow money on balance, even with those tax collections.

(10/7/11) The indirect bid at bill auctions is less indicative of foreign central bank buying. A Fed research study which I recently came across concluded that the indirect bid was a good proxy for the FCBs, as far as the longer term paper was concerned, but not in the bills, where investment funds and other large institutions make up a considerable portion of the indirect bid. An additional problem with using this data as an indication of FCB activity is that it does not reflect anything about what they are doing in the secondary market. It is has recently become clear from the Fed custodial data that one or more FCBs are furiously dumping Treasuries. The indirect bid at the auctions is no longer a reflection of the state of FCB accumulation of Treasuries.

Continued on next page

Week Just Ended

Type	13 Week	26 Week	4 Week	52 Week	10Yr TIPS	2 Yr Note	5 Yr Note	7 Yr Note	Total
Auction Date	7/23/12	7/23/12	7/24/12	7/24/12	7/19/12	7/24/12	7/25/12	7/26/12	
Settlement Date	7/26/12	7/26/12	7/26/12	7/26/12	7/31/12	7/31/12	7/2/12	7/2/12	
Amount (Billions)	30	27	30	25	13	35	35	29	224
TBAC Estimated	30	28	30	25	15	35	35	29	227
Difference	0	-1	0	0	-2	0	0	0	-3
Amount Maturing*	30	27	30	20	53 <----------------------------	included			160
New Cash or (Paydown)	-	-	-	5	61 <----------------------------	included			66
Held by Fed in SOMA	0	0	5.938	0	0.000	0.800	1.638	0.000	8.376
Bought by Fed	0	0	0.000	0	0	0	0	0	
Rate	0.095	0.140	0.080	0.175	-0.637	0.220	0.584	0.954	
Rate Previous Auction	0.095	0.135	0.075	0.205	-0.391	0.313	0.752	1.075	
Bid/Cover	4.46	5.17	4.50	4.71	2.62	4.00	2.71	2.64	3.85
Last Auction Bid/Cover	4.25	4.99	4.53	4.15	3.01	3.62	2.61	2.64	3.73
Indirect Bid	4.58	11.71	4.01	4.29	6.58	10.71	14.91	13.42	8.78
Maturing Indirect Bid*	8.17	8.93	4.43	5.84	0.00	12.30	2.56	0.00	42.23
Indirect Bid Last Auction	5.34	7.71	3.86	3.51	6.57	11.00	12.28	12.17	62.44
Change from Last Auction	-0.76	4.00	0.15	0.78	0.01	-0.29	2.63	1.25	7.77

* Total amount maturing include maturing CMBs, if any. Bid/Cover in total column represents unweighted average.

The calendar was huge this week, with the 13, 26, and 4 week bills, plus the monthly offering of 52 week bills, 2, 5, and 7 year notes. The notes will settle this Tuesday, July 31, with the TIPS issue auctioned on Thursday 7/19. That size of the settlement, at $61 billion in new paper, is the biggest since July 15 last year. It should cause problems (although it didn't that week last year), but whether it will be mostly for stocks or bonds depends on the rapidly shifting sands of sentiment. Bonds have been at a critical inflection point and took it on the chin on Friday. With this sentiment shift, bonds could take an additional hit early in the week due to the liquidation pressure caused by the new supply.

The bid/cover ratios at these auctions were slightly above the last rounds of the same auctions, reversing the pattern of the prior two weeks. The indirect bid taken was also up, and the indirect bid tendered was up 11% versus the last round of the same auctions, and up 12.6% from the same week last year.

7/20/12 The panic out of European banks and assets, with investors trying to buy anything stamped by the US Treasury, runs in waves, receding for a week or two, then surging again. The absurdity of this panic driven bubble again reached new heights--or depths, depending on your point of view--driving long yields back to test the lows.

I wrote last week that this was a critical inflection point. After the auctions were complete, ECB head Draghi came out on Friday and said the ECB would take whatever steps necessary to save the Euro, and the sentiment reversed on a dime. As opposed to all the piling in earlier in the week, suddenly it seemed that everyone rushed for the exits. Actually, it was probably just a few, but that's all it takes at the margin.

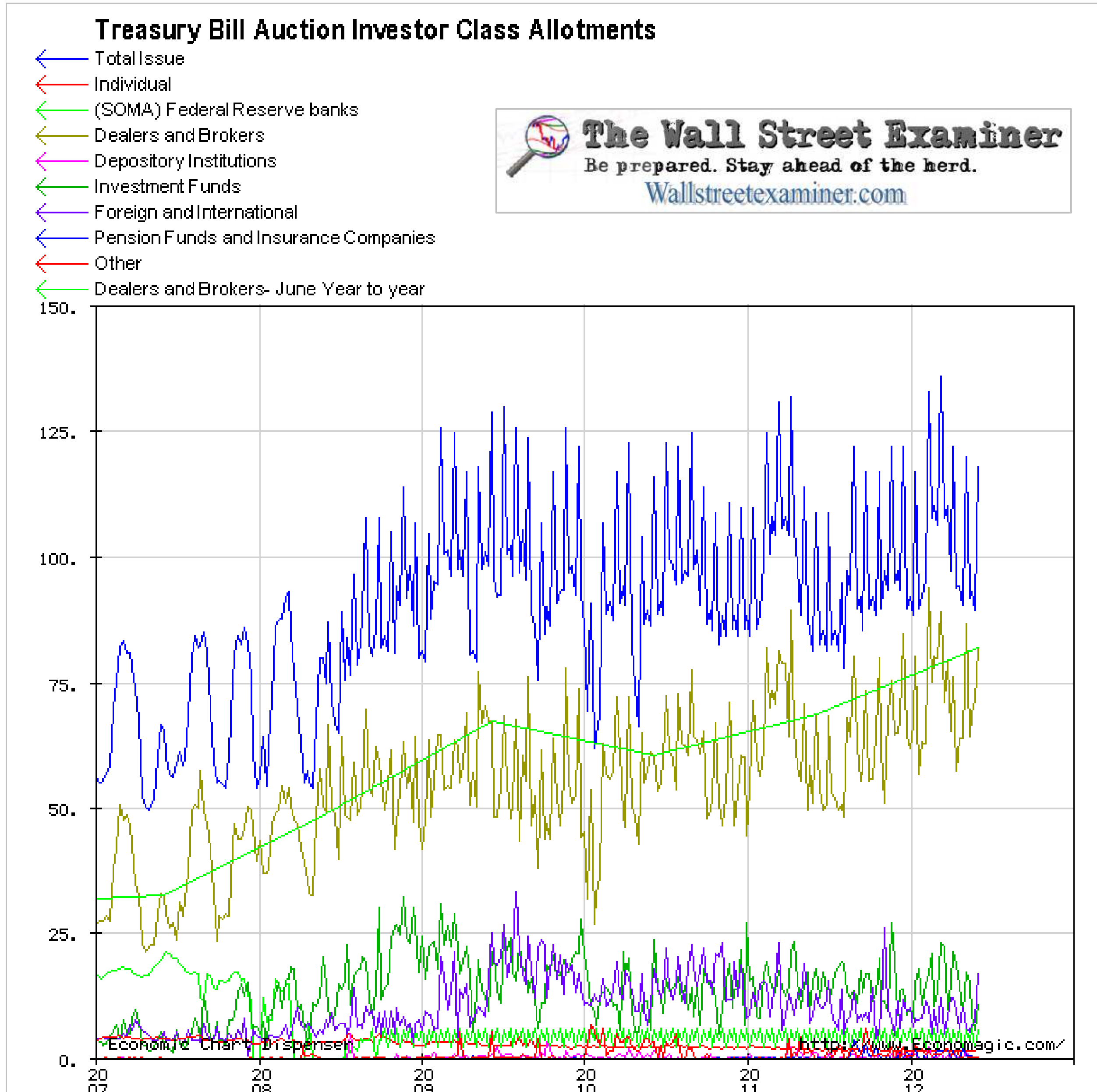
If European investors stop fleeing that system for the "safety" of the US Treasury market, we will see a sea change in the bond market. All it will take is for the flood of European capital into the US to slow. That should be enough to end the panic driven bubble in Treasuries. Over the next few days and weeks, we should keep a close eye on the bond market technical indicators for signs of the turn.

5/24/12 Reuters just revealed that the Treasury gave China status as a direct bidder in June of last year. That partly explains why the indirect bid dropped around that time and has been running lower ever since. The typical 20-25% drop in the indirect bid that took place in the second half of last year versus the year before is an indication of the size of the role that China plays in this market, however, it may not be the whole story. China may still be bidding through the Primary Dealers indirectly, in addition to buying as a direct bidder.

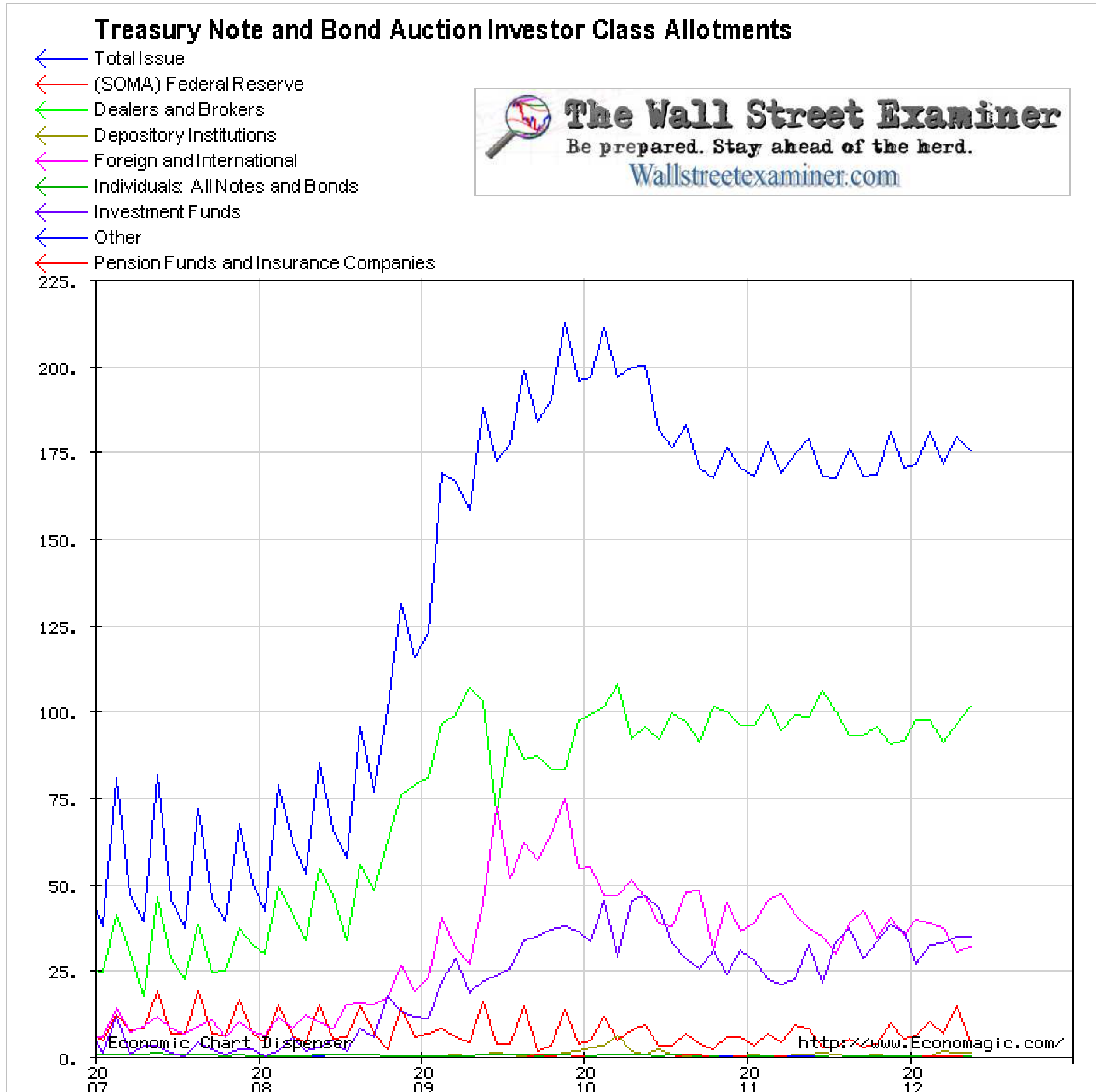
The size of the indirect bid can give us information as to how much liquidity is available to the markets, but it won't tell us how much will be confined to Treasuries or will overflow to stocks. For that we depend on the technical analysis. If you are not a subscriber to the Professional Edition technical market updates and would like to add them to your subscription at the combined discounted rate, just email me at admin@wallstreetexaminer.com with your request.

5/12/12 Fear is good for the Treasury market, and that was in evidence as bond yields fell to new lows for this downtrend. The European situation certainly helped drive liquidity into the Treasury market, and at the end of the week the JPM news spurred even more buying of Treasuries. Over the longer run however, the trend of shrinking bank capital that we have been following in the Fed Reports will *not* help.
5/6/12 The most bullish seasonal period for both stocks and bonds has ended. The market must now face the heaviest months of new supply until the mid June quarterly tax collections briefly enable a week or two of paydowns. The market should begin to be impacted by increasing Treasury supply in the months ahead now that the big annual tax windfall is in the books.

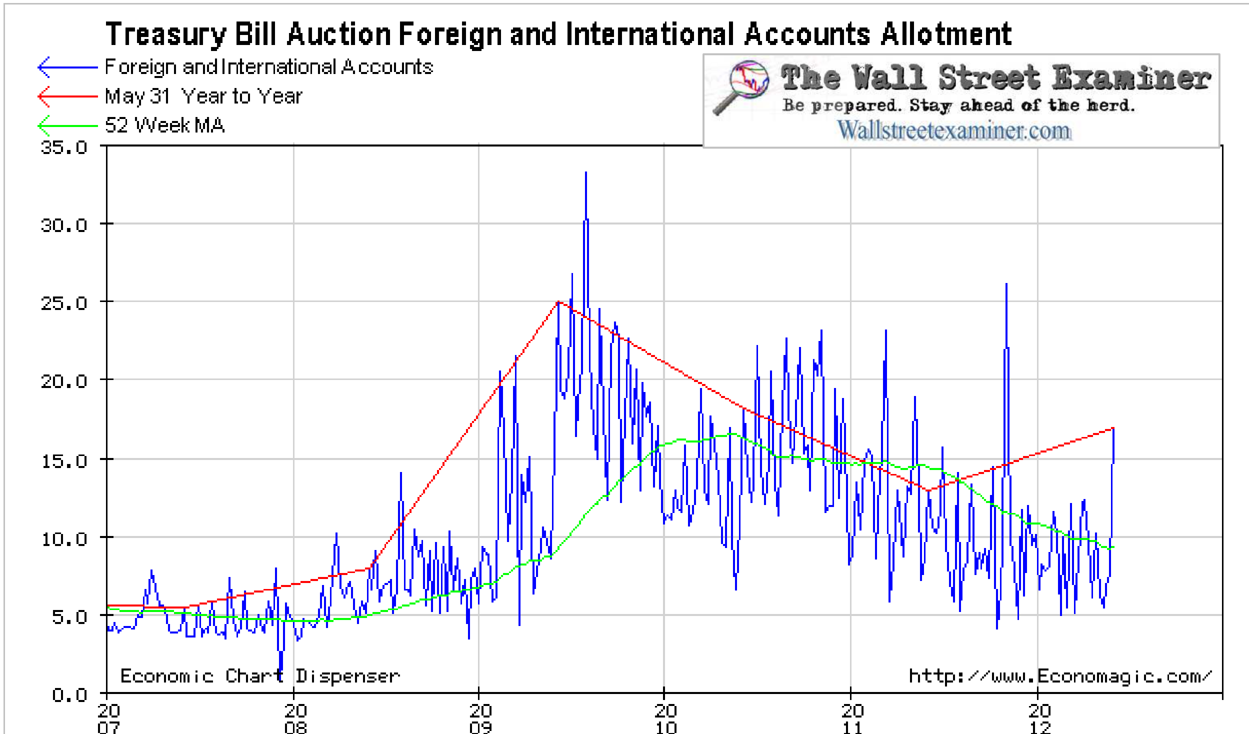
4/28/12 Last year, stocks topped out during the second half of April. The ending of the seasonal period of heavy Treasury paydowns probably had a lot to do with that. However, last year the Fed was about to go into hibernation for a few months. This year the MBS purchase program will continue to boost the market at least through July, due to the delayed settlements, and I believe that the program must be continued. The Fed knows that it cannot allow the balance sheet to shrink. So while the ending of the paydowns will remove one prop from the market, the Fed isn't likely to make the same mistake twice. See the Fed Report for more discussion of this.

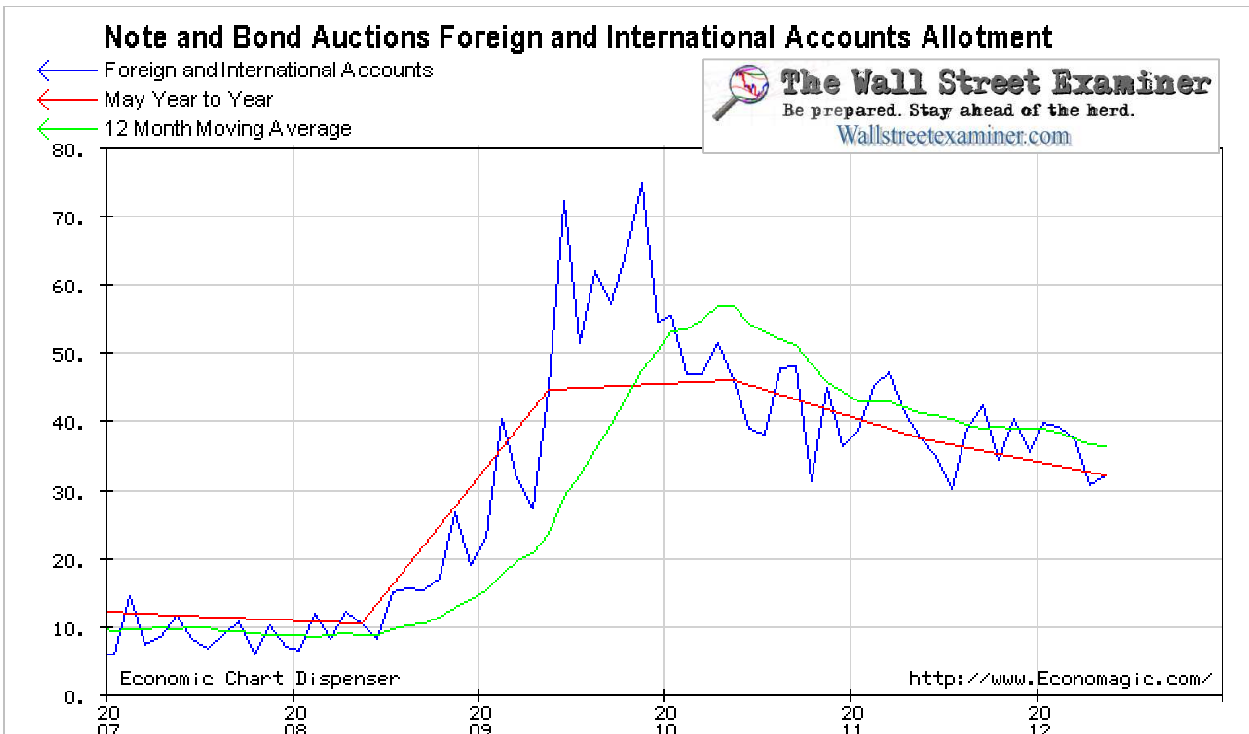


6/22/12 Dealers are taking the lion's share of the T-bill auctions, and that share is steadily growing. It is followed by foreign and international accounts and investment funds. Both of those are in long term downtrends. Individuals, banks, and pension funds are not major players. Charts through 5/31/12.



6/22/12 The Fed's share of the note and bond auctions, while small, has been rising irregularly since late 2010. When the Fed did QE1 and QE2 it increased its total holdings by buying existing paper. As that paper matures the Fed must roll it over. These increased rollovers show up as the Fed taking an increasing share of the auctions. With foreign buying declining, Primary Dealer buying flat, and investment fund buying showing signs of weakening, in order to prevent a rise in long term yields, the Fed may need to sharply increase its buying in the not too distant future. QE3 anyone?





Foreign accounts have been taking a steadily shrinking share of the auctions since 2009. The blip up in their share of the bills in May was temporary. Indirect bids, which are partly indicative of foreign buying, have been sharply lower in June.

Week Ahead

Type	13 Week	26 Week	4 Week	Total
Auction Date	7/30/12	7/30/12	7/31/12	
Settlement Date	8/2/12	8/2/12	8/2/12	
Amount (Billions)	32	28	30	90
TBAC Estimated	30	28	30	88
Difference	2	0	0	2
Amount Maturing*	30	29	30	89
New Cash or (Paydown)	2	(1)	-	1
Held by Fed in SOMA	0	0	0.000	0.000
Bought by Fed				
Rate				
Rate Previous Auction	0.095	0.140	0.080	
Bid/Cover				
Last Auction Bid/Cover	4.46	5.17	4.50	4.71
Indirect Bid				
Maturing Indirect Bid*	7.70	9.57	4.65	21.92
Indirect Bid Last Auction	4.58	11.71	4.01	20.30
Change from Last Auction				

* Total amount maturing include maturing CMBs, if any. Bid/Cover in total column represents unweighted average.

The calendar will be very light next week, with just the 13, 26, and 4 week bills. After Monday's big settlement is absorbed, the market will have it easy for the rest of the week and for the rest of the month, relatively speaking. The TBAC estimate for the mid month note and bond settlement is for less than $20 billion in new paper. That will seem like a piece of cake for a market accustomed to absorbing double or triple that. Overall, August will be a month where the market faces very little pressure from new Treasury supply until the end of the month.

Whether the greater benefit accrues to stocks or bonds remains to be seen, but Friday's action suggests that the stock market will be the beneficiary. Again, the technicals rule and, as always, I'll be watching those signs closely in the nightly stock market updates. *[If you do not subscribe to that service and would like to follow those reports, just email me at admin@wallstreetexaminer.com and I will add that service for you at the discounted combined rate.]*

Tax collections have been strong in July, while outlays are now about unchanged for the same point in July 2011 (see Federal Revenue discussion below). So there should be no supply surprises in the weeks ahead. The Treasury has paid back the Fed for the Fed's redemptions of its 4 week bill holdings, so it will not need to add to supply to pay for any additional bill redemptions. A non-material amount of the Fed's 2 year holdings remain to be redeemed. With the raging buying panic in Treasury paper, no one noticed the $20 billion in scheduled redemptions of the Fed's holdings that the Treasury had to raise. It was helped by strong revenue flows.

7/20/12 You probably have seen my free reports on the economic data in the Wall Street Examiner. If not, check them out here. http://wallstreetexaminer.com/category/wall-street-examiner-exclusives/ The actual economic data underlying the financial news reports in the US isn't nearly as negative as the media and market reactions have generally been.

Seasonal adjustments and hysterical headlines have tilted mostly negative, while the actual data, not seasonally finagled, has been right on trend approximately consistent with the 2% growth rate indicated by the real time federal withholding tax data through June and early July. Lately tax collection gains have upticked toward 3.5%. Sooner or later the seasonally adjusted numbers will get back in line with the trend. Given the generally negative tilt in reporting, I expect that positive surprises may be coming in the next month.

Here's the economic data calendar for the week ahead from Briefing.com- http://www.briefing.com/investor/calendars/economic/2012/07/30-03 As with last week, I continue to suspect that some, if not most, of the numbers will come in better than expected. Based on the withholding tax collections for the week of the non-farm payrolls data, they could come in well ahead of the consensus expectation http://wallstreetexaminer.com/2012/07/27/strong-july-withholding-taxes-suggest-huge-job-gains/ . With claims you never know, due to the vicissitudes of the weekly seasonal adjustments.

Date	ET	Release	For	Briefing.com Forecast	Consensus
31-Jul	8:30	Personal Income	Jun	0.90%	0.40%
31-Jul	8:30	Personal Spending	Jun	0.10%	0.10%
31-Jul	8:30	PCE Prices - Core	Jun	0.10%	0.10%
31-Jul	8:30	Employment Cost Index	Q2	0.50%	0.50%
31-Jul	**9:00**	**Case-Shiller 20-city Index**	**May**	**-1.80%**	**-1.80%**
31-Jul	9:45	Chicago PMI	Jul	51	52.5
31-Jul	10:00	Consumer Confidence	Jul	61	61
1-Aug	7:00	MBA Mortgage Index	28-Jul	NA	NA
1-Aug	8:15	ADP Employment Change	Jul	125K	125K
1-Aug	**10:00**	**ISM Index**	**Jul**	**49**	**49.9**
1-Aug	10:00	Construction Spending	Jun	0.70%	0.50%
1-Aug	10:30	Crude Inventories	28-Jul	NA	NA
1-Aug	14:00	Auto Sales	Jul	NA	NA
1-Aug	14:00	Truck Sales	Jul	NA	NA
1-Aug	14:15	FOMC Rate Decision	Jul	0.25%	0.25%
2-Aug	7:30	Challenger Job Cuts	Jul	NA	NA
2-Aug	**8:30**	**Initial Claims**	**28-Jul**	**385K**	**365K**
2-Aug	8:30	Continuing Claims	21-Jul	3300K	3298K
2-Aug	10:00	Factory Orders	Jun	1.00%	0.60%
3-Aug	**8:30**	**Nonfarm Payrolls**	**Jul**	**85K**	**100K**
3-Aug	8:30	Nonfarm Private Payrolls	July	100K	105K
3-Aug	**8:30**	**Unemployment Rate**	**Jul**	**8.20%**	**8.20%**
3-Aug	8:30	Hourly Earnings	Jul	0.10%	0.20%
3-Aug	8:30	Average Workweek	Jul	34.5	34.5

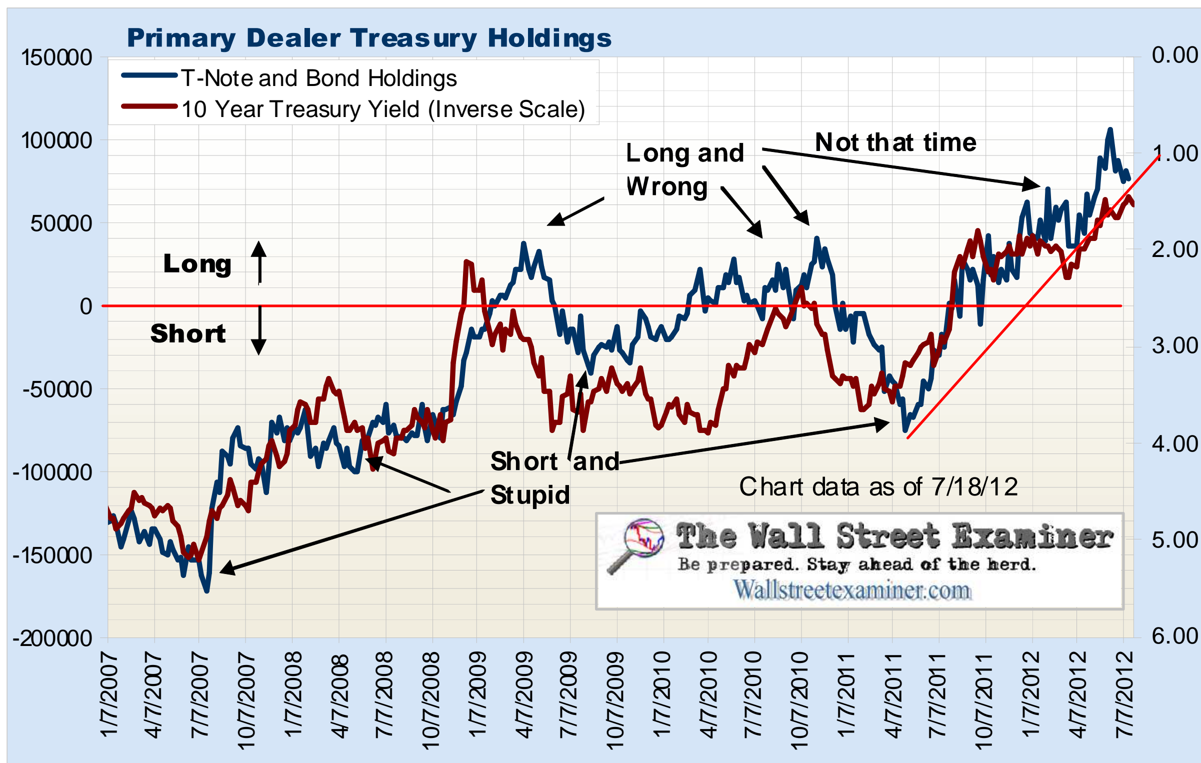
7/6/12 The first data release to surprise on the positive side should be claims. Whether that comes this week or not I have not a clue. It depends entirely on the seasonal adjustment hocus pocus. Looking back over the past 20 years, when the week has ended on July 7 as this week does, the SA factor has been around .765. Weeks ending on July 8 or 9 have typically had an SA factor around .80-86, and when the week ends on July 5 the factor has been around .90. A change in the factor from .76 to .90, depending on the date the week ends, would result in differences in the final number of up to 50,000. That gives you an idea of how arbitrary and ridiculous the SA numbers are. They bear no resemblance to reality. Whether they beat or miss is purely a function of the adjustment, not the actual rate of change.

See http://wallstreetexaminer.com/2012/07/12/false-claims-and-absurdities-of-mainstream-media-reports-on-initial-unemployment-claims/ if you haven't already.

Primary Dealer Treasury Holdings

Primary Dealers sold Treasuries in the week ended July 18. Their holdings have been downtrending since reaching an all time record long position in the week of June 13. Is this the beginning of the end of the Treasury bubble? If the Primary Dealer selling continues and breaks the uptrend line, that would be a signal I would take seriously.

6/17/12 If Treasury yields were driven down by panic in May, Primary Dealers led the way. They furiously bought longer term Treasuries again in the week ended June 6 (reported with a one week lag) setting another new record level set the week before. Based on the long term chart of the 10 year yield (next page), Treasuries remain at an extreme level of extension from the trend. In fact, every move of 15 to 17 points in 10 Year Treasury prices over the course of a year or so has led to a severe correction. This move just reached 17 points. That suggests that this is the end of the blowoff.



3/29/12Their sudden dumping came after, not before or during the Treasury market shock treatment of March 7-14 when prices plunged and yields surged. The dealers were caught with their pants down. This is not new. I have documented their past embarrassments. Lest we forget, it was their stupidity, greed, and venality that caused the system to crash in the first place. Having gotten away with it with nary a slap on the wrist, it *will* happen again, only in not quite the same way.

The panic buying of Treasuries has taken on the kind of shape often seen in the final stages of a parabolic bubble blowoff. Throughout history, a 5 year time frame from liftoff to blowoff has been typical of many bubbles. Momentum has started to weaken from the extreme overbought parameter indicated by the 12 month rate of change, which had been consistent with past major highs in bond prices.

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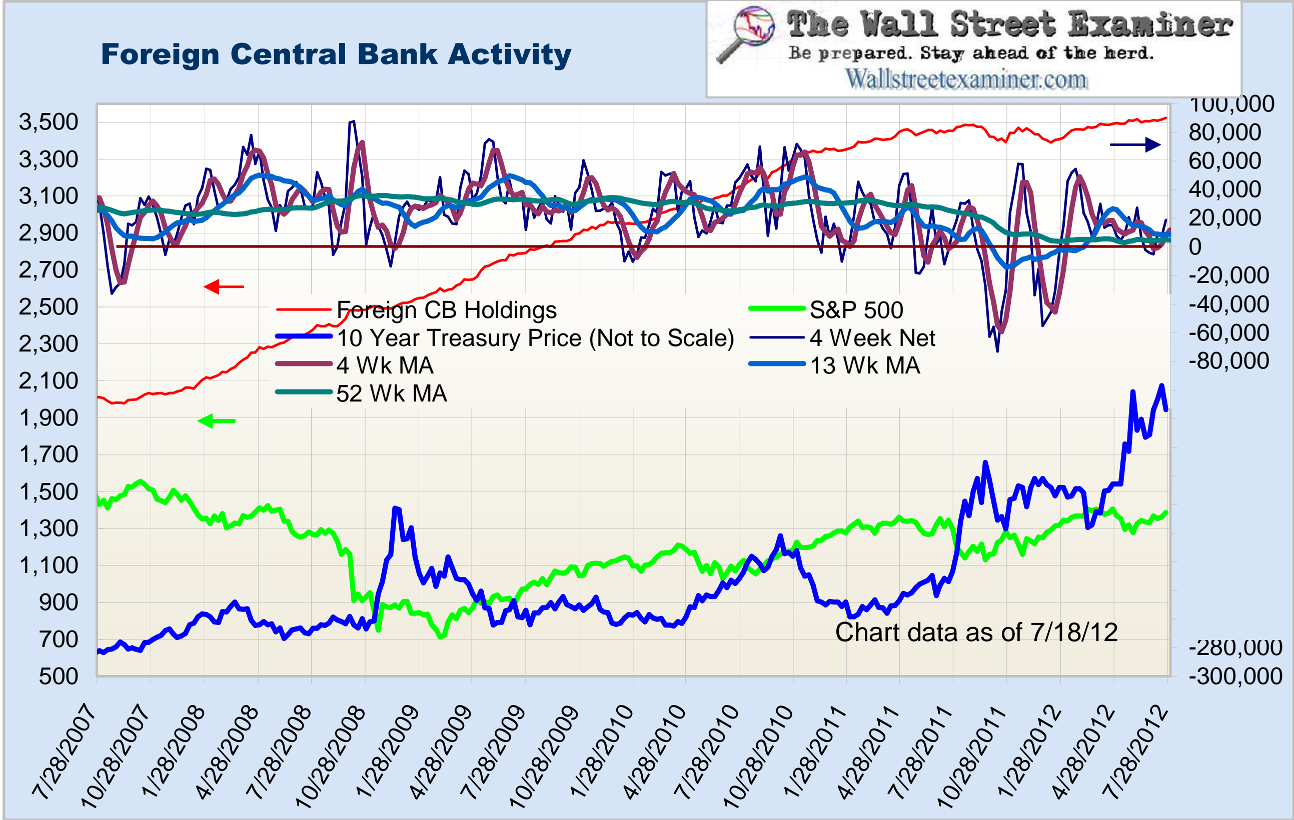
Foreign Central Banks



Periods of increased FCB buying are cyclical, and prior to 2008 they were usually associated with rising stock prices as some of the liquidity generated from them flows into the stock market. That correlation began to break in 2007 as the Fed's micromanagement ballooned. Today there's still a strong correlation with bond price movments, while the correlation with stocks seems broken, but if the FCBs are selling, then a rise in securities prices will not be sustainable for long.

FCB combined holdings of Treasuries and Agencies (GSEs) rose by $8.8 billion after the previous week's gain of $7.4 billion. GSE holdings rose by $0.6 billion, while Treasury holdings rose by $8.2 billion. There were no big Treasury settlements that week, so it appears that the FCBs would have purchased this paper in the market. This was only the third time since March 7 that GSE holdings rose.

This looks like a short term and intermediate cycle buy signal on the chart. The last buy signal back in May whipsawed. I suspect that this choppy pattern will continue and that this signal will fail as well. We'll know better next week.

7/13/12 FCB combined Treasury and Agency holdings have been virtually flat since last August. FCBs are no longer funding the US government's monthly deficits. If they actually do begin to liquidate their holdings to meet needs at home, or for other reasons, that would be a sea change and would require the Fed to restart QE, if US commercial banks don't step up their buying. They did two weeks ago, in a mysterious and unprecedented surge of buying (discussion and charts below), but in the following week they were once again reducing their holdings.

Even bond mutual fund inflows have declined lately. None of this bodes particularly well for the Treasury market.

6/22/12 The Fed has picked up where the FCBs have left off by purchasing MBS from the Primary Dealers. That cashes out the dealers so that they can buy more Treasuries each month. Other buyers, including presumably many foreign accounts fleeing Europe and China, possibly acting through US straw parties and investment funds, have picked up the slack. The FCBs have not been missed. But panics burn out, and once this one does, the market will need to face the absence of the FCB subsidy which had played such a huge role in suppressing long term yields for so long.

5/20/12 GSE supply is shrinking overall as Fannie and Freddie's balance sheets shrink. Most of the time, there apparently is not enough paper for the GSEs to roll over their holdings. The redemptions of maturing GSE paper thus force the FCBs to reinvest some of that cash into Treasuries. So even though the GSEs have been buying less paper overall, they continue to buy plenty of Treasuries. The reduced overall rate of FCB purchases has not hurt the bond market, but the reduction in total liquidity is probably contributing to the recent weakness in stocks.

The 4 week net change of total FCB holdings rose to +$18.7 billion from +$7.4 billion the previous week. That total was equivalent to 38.1% of new Treasury supply over the past 4 weeks. That's well above the historical norm of 25% prior to the past year, when the FCB takedown averaged 6% of new Treasury supply. This excess liquidity can boost either bond or stock prices depending on market sentiment. Based on Friday's action, it looks like stocks will be favored but we need to track the stock market on the technical side daily for any sign of change.

3/17/12 Lately the short term cycle upswings and downswings have been roughly equal in time. Prior to last year the advancing weeks far outnumbered the decliners. FCBs actually stopped accumulating Treasuries in Q3 of 2011.

4/14/12 The 13 week moving average continued to uptick. This is the most positive this intermediate buying cycle indicator has been since a year ago. Last year the indicator topped out in May at just above current levels. The stock market top was concurrent, while Treasuries continued to rally until September. The current level of FCB buying would not be bullish for Treasuries, but if stocks sell off sharply like they did last year when the Fed briefly withheld liquidity, investors might again have the kneejerk reaction of selling stocks and buying Treasuries.

When the intermediate FCB buying cycle turns down this time, the Fed won't be as restrictive as it was last spring and summer when it was in wait and see mode and it allowed its balance sheet to shrink. That was a double whammy the markets couldn't handle. The Fed will probably at least continue its MBS replacement purchase program or some other minor program to keep a minimum level of cash flowing into Primary Dealer accounts, trying to at least support the Treasury market. The normal FCB pullback will still have a negative impact, but unless that pullback is unusually severe the negative market impact should be less pronounced than it was last year. On the other hand if we start seeing real negative numbers in the FCB data, look out below.

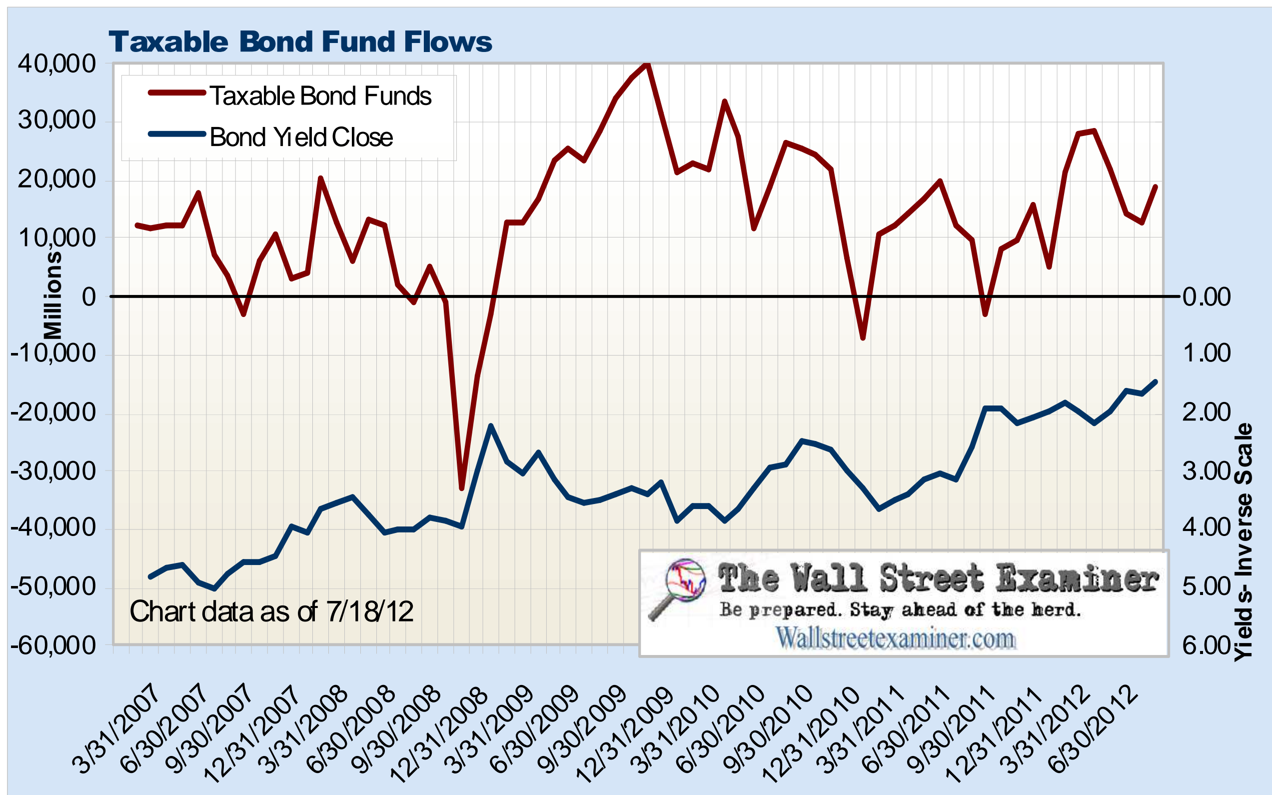
12/9/11 That was the highest level since November 2010. A somewhat smaller spike also occurred in November 2009. After each of these episodes, FCB buying declined precipitously for a couple of months. That would not be a good thing for US markets under normal circumstances. In the current mess, so much cash is flowing out of Europe that it is making US markets look good, hiding the fact of weak FCB support. The result is a false facade on a sand foundation.

(12/03/10) It is still an open question whether the central banks are backing their recent complaints about the Fed's QE2 program with actions. This may just be a normal cyclical cutback in their buying. Any extended cutbacks, especially if they reduce their holdings outright, could ultimately negate the Fed's program. Talk is one thing. Actions are another. We'll see. Since they are still running trade surpluses it seems unlikely that they would become sellers. They still need to be buyers of something until they find somewhere else to put all the dollars they continue to accumulate. Once the dollar flows stop, then we can talk for real about the FCBs selling Treasuries.

Historical background discussion of the FCBs in 2009 and 2010:
http://wallstreetexaminer.com/money/fcb2009-10.pdf

Bond Fund Flows

The ICI reports mutual fund inflows weekly with a one week lag. Investors put a net of $5.1 billion into taxable bond funds in the week ended 7/18 versus $5.2 billion the prior week. These were the biggest weekly inflows since May 16, but still well below the record $9.1 billion of inflows the week of April 4. Buying remains well below those levels in a sign that investors may be losing the will, if not the ability, to continue buying at that pace. Domestic equity funds saw a tiny inflow in the July 18 week, in a change from the usual patterns of outflows.



Monthly data actual through May. June estimated and July projected based on weekly rates.

The drop in bond fund buying has not translated to any meaningful increase in stock fund purchases. Small investors remain in a forced march out of the markets thanks to ZIRP Bernankecide. They have no choice but to liquidate to pay the bills.

4/7/12 These huge inflows followed on the heels of Bernanke's pledge to keep short term rates at zero until hell freezes over. The unbroken string of inflows is now up to 25 weeks. The buying panic by fund investors has been intensifying. The March 7 data may represent the final blowoff of that panic. But for as long as it lasts it will help to keep a bid under Treasuries.

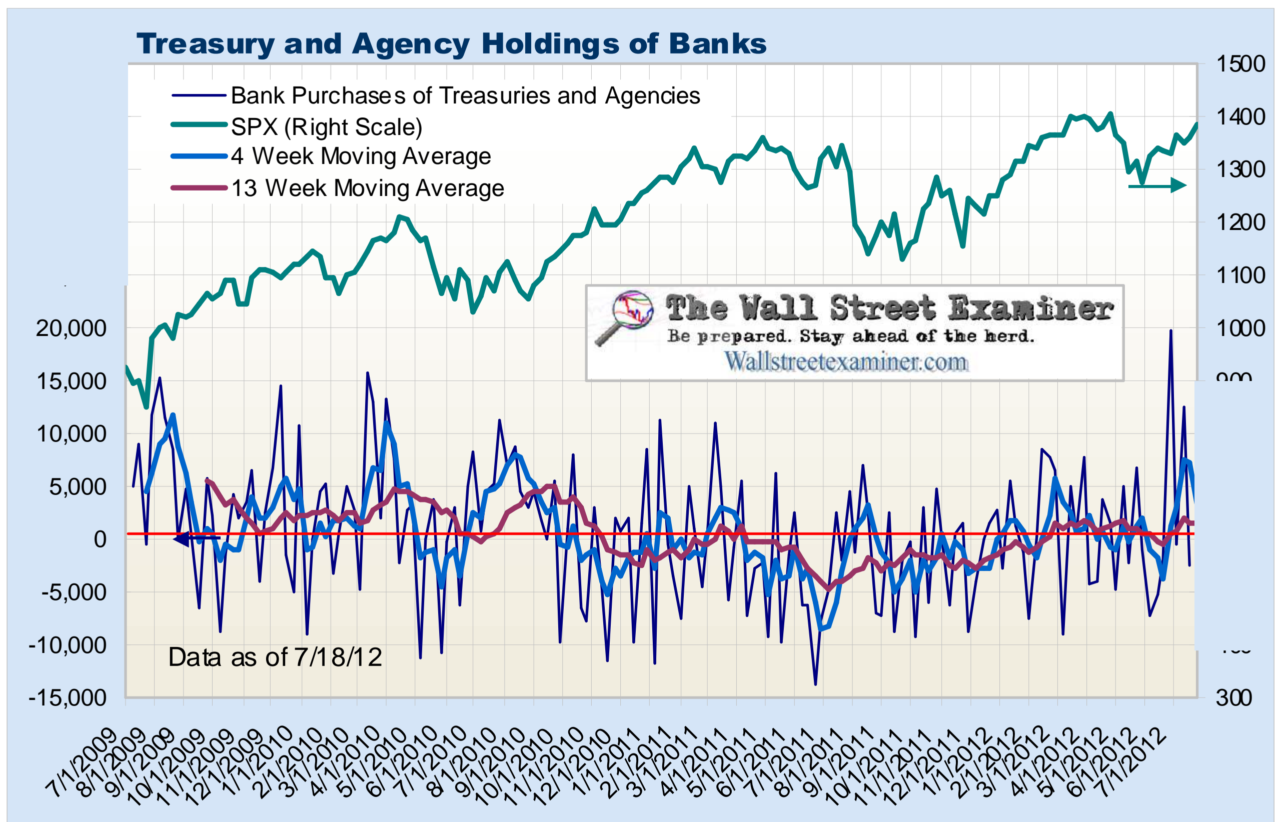
3/17/12 These inflows are now running at about a quarter of total monthly Treasury supply or more if the rate of the first week in March is sustained through the month, so that their impact can be significant as long as they are running at these levels. Weekly flows at these levels are almost as high as primary dealer or FCB purchases in some weeks, although at other times the PDs and FCBs are far more significant. There's no doubt that bond fund inflows have recently been a stabilizing factor as the trend of FCB buying has waned. However, I doubt that the buying can be sustained at this level for long. This seems like a buying climax.

Bank Holdings of Treasuries The Fed reports bank trading activities weekly with a 10 day lag in its H8 report on Friday evening.

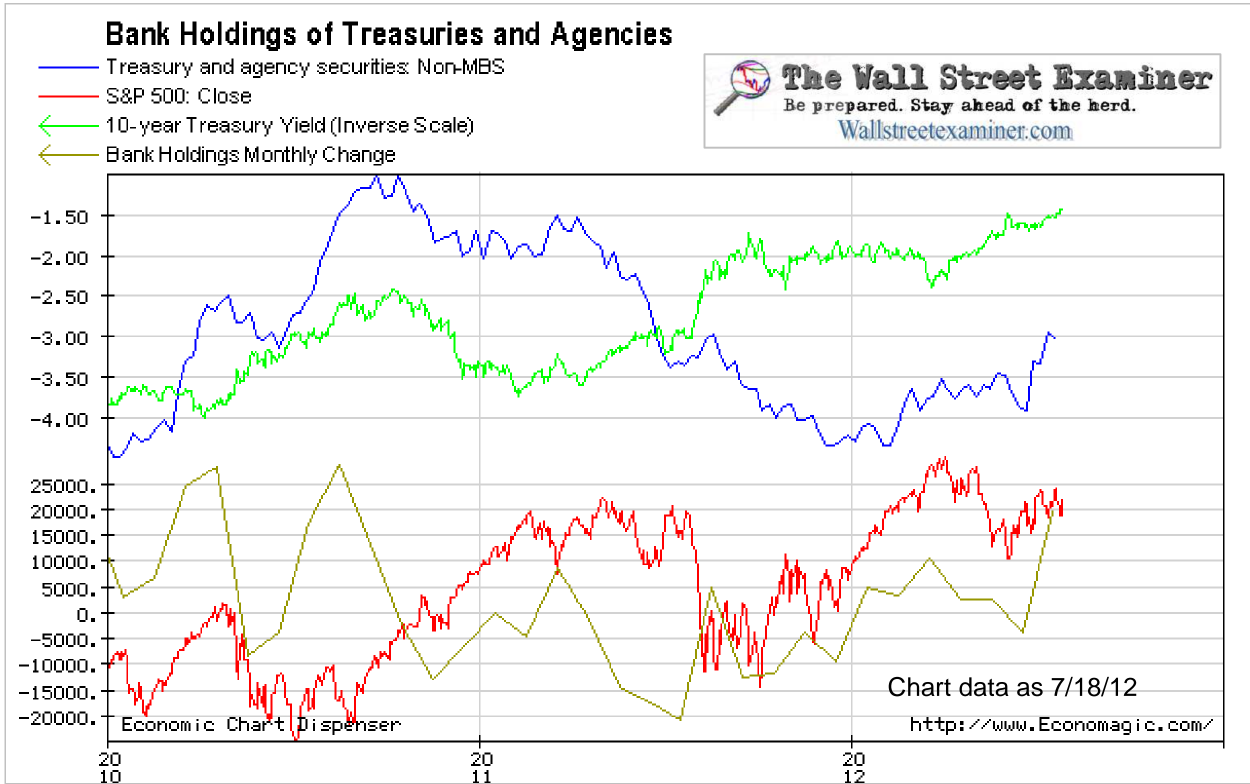
Commercial banks' Treasury and Agency (GSE) holdings dropped by $2.5 billion in the week ended July 18. That followed a jump of $12.5 billion the previous week, and a record surge of $19.8 billion in the week ended June 27. That was a stunning and mysterious reversal in the typical pattern of small sales or purchases each week. I did not think that this buying surge was sustainable, but perhaps I'm wrong about that. It's too soon to know for sure. Given what happened in the market on Friday, with bonds taking a huge hit, I have to wonder if that surge somehow marked the final blowoff of the bond market buying panic. We should have an answer from the technical indicators soon.

7/6/12 Buying can not be sustained at this level, but at the same time, it turns the moving average indicators upward. We'll have to wait a few weeks to see whether this is a one shot deal or a sign of more buying to come.

What this means about systemic health or stress is also unknown. The H8 statement for that week contained no notes of any non bank acquisitions that could have caused this. Therefore it would most likely be a large purchase by a single large institution.



Note: The current week's ticks on the 4 week and 13 week average lines represent projections by the Excel program, not the actual level of the line. The prior week is the actual level at present.



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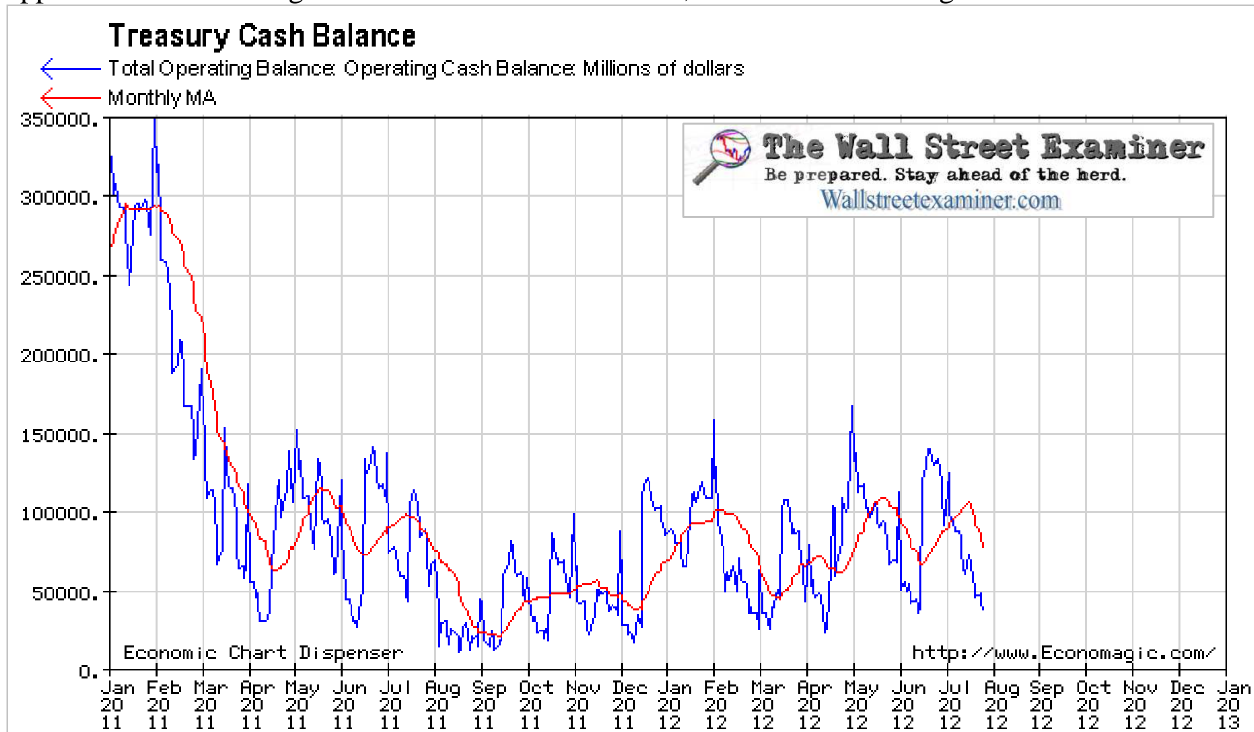
Federal Revenues

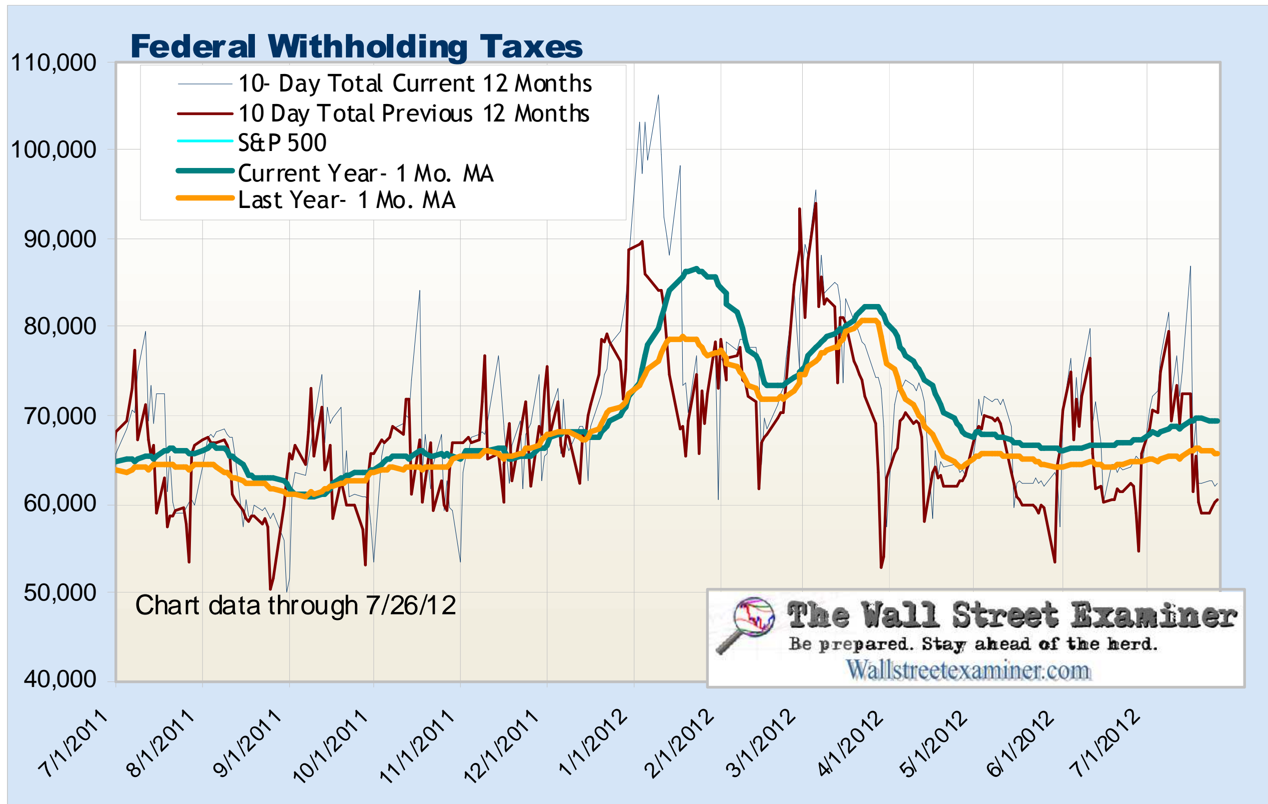
Total withholding tax collections are available to us virtually in real time in the US Treasury's Daily Treasury Statements, released with just a one day lag, which makes them an excellent analytical resource. However, they are extremely volatile day to day so I rely more on a monthly moving average of the 10 day total collections, comparing that with the prior year. Smoothing sacrifices a bit of timeliness to get a clearer picture of the trend without losing too much of the edge that the daily data provides. Unfortunately, I have found even the 10 day total data too noisy for meaningful comparison so I've had to resort to additional smoothing, which ordinarily I don't like to do. As a result the smoothed data is a little slow, so I also look at raw month to date data after mid month.

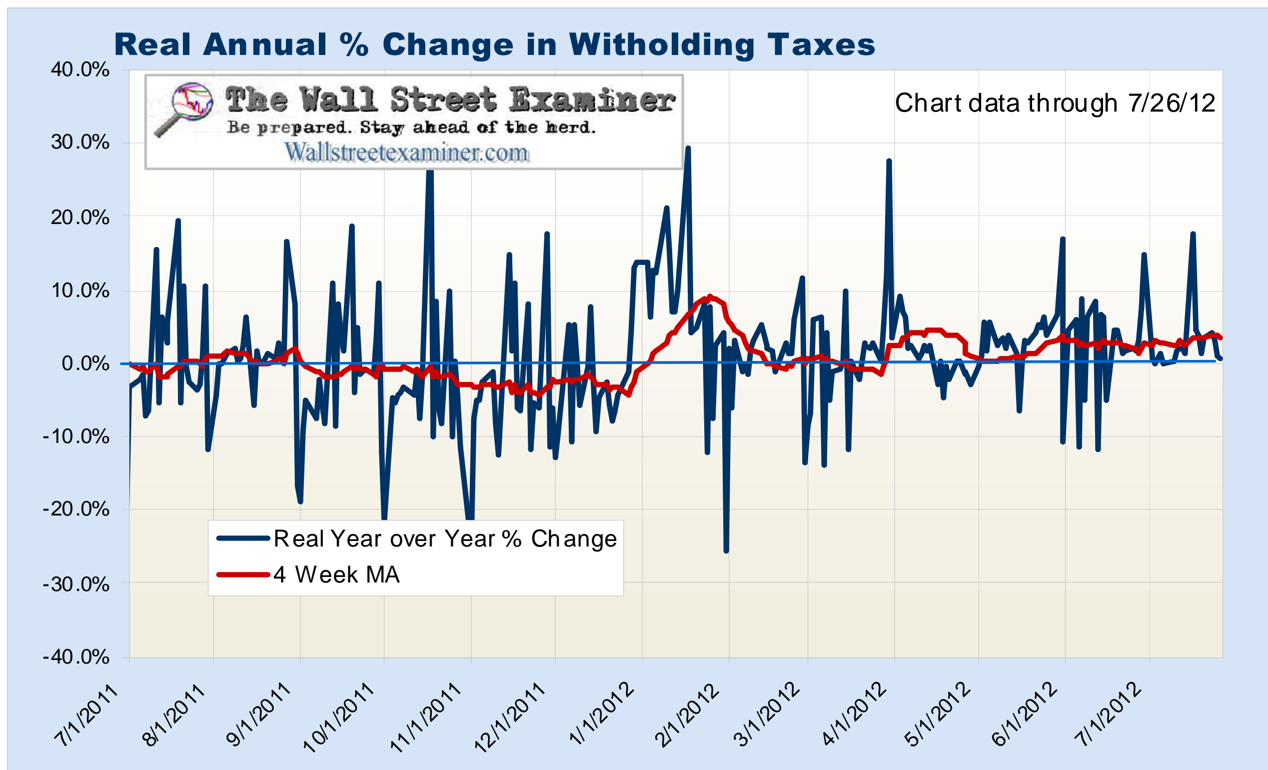
4/21/12 Tax season is finished and I reviewed how Uncle Sam did overall in this article, http://wallstreetexaminer.com/2012/04/19/uncle-sam-has-a-bang-up-tax-season/ .

The Treasury's cash balances are extremely volatile from day to day, so year to year comparisons are tricky. On a monthly moving average basis, they are now running below last year at the same time. Withholding tax collections have been strengthening and there has been no increase in outlays. This appears due to an intergovernmental transfer. For now, I'll treat this as insignificant.



As of July 26, the 4 week average of the 10 day total of withholding taxes is now up 5.8% in nominal terms and 3.6% in real terms versus the same period in 2011 (adjusted by the monthly BLS data on average weekly employee compensation which in June rose by 2.2% year to year). This indicator had been in the +1% to +3.5% range since mid May, with most of that time above +2% suggesting that that is the economy's current rate of growth. In the past week the real growth rate was as high as 3.8%.





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(7/13/12) Last week was the benchmark week for the BLS labor market data. At a growth rate of 1.8% versus last year, non farm payrolls, not seasonally adjusted (NSA)--in other words, actual--would grow from last year's July level of 131.038 million to approximately 133.4 million. As we saw in June, such a straightforward analysis doesn't always match the seasonally adjusted headline number because seasonal adjustment factors have a significant variance for the same period in each year. The resulting seasonally adjusted number is therefore somewhat arbitrary, and anything but real. Unfortunately, the markets don't really care about that when the data is initially released. It only cares whether the number beat or fell short of equally arbitrary consensus estimates, which in turn depend almost entirely on the seasonal adjustment variance.

If the withholding tax growth rate is applied to the SA payrolls data for July 2011, (1.0183 x 131.407 million) the SA number for July would be 133.812 million. That would be an increase of over 720,000 from the current June figure. Wouldn't that be an August surprise (when released? But we know that's not going to happen. The growth rate of withholding and the growth rate of jobs will remain at odds. But unless economists are forecasting very strong gains, the July number would beat if it tracks near the withholding data.

July Month to Date Tax Comparison

	7/26/2011	7/26/2012	Change	% Change
Withheld	117,069	124,665	7,596	6.5%
Non Withheld	385	511	126	32.7%
Excise	3,419	4,096	677	19.8%
Corporate	7,993	8,448	455	5.7%
Gross Taxes	129,444	138,226	8,782	6.8%
-Refunds*	7,245	5,993	(1,252)	-17.3%
Net Collected	122,199	132,233	10,034	8.2%
Net Outlays	257,624	256,864	(760)	-0.3%
Net Deficit	(135,425)	(124,631)	10,794	-8.0%
Cash On Hand	81,993	30,768	(51,225)	-62.5%

*Mostly attributed to previous year	Compiled by Lee Adler, The Wall Street Examiner http://wallstreetexaminer.com

As of July 26, month to date withholding showed a strong gain versus last year, but that's misleading. The last pay period in June was paid on July 2. June end of month was extremely weak, but the July 2 payment was huge, making July as a whole stronger than it otherwise would have been. The 6.5% gain overstates the strength. The best measure is the past 10 days which ran at a nominal gain of 2.9%. I don't want to put too much weight on that either, given the volatility of the 10 day totals, but it's equivalent to just a 0.7% real rate of gain at the June earnings inflation rate of 2.2%.

If this stays consistently below the 4 week MA next week, it could mean that the growth spurt seen in June and through mid-July has transitioned to a resting period or worse. The growth rate normally does fluctuate but the 4 week average has been steadily gaining since March. If the real growth rate of the 4 week average drops below 2%, then that could be significant. Any fluctuations between 2% and the recent peak of 3.75% probably would not be.

7/6/12 As of June 29, the last business day of the month, month to date withholding tax receipts for the full month were up by 0.9% over the same period last year but that is misleading because there was one more calendar day in which taxes could be reported last year, as well as one more business day in which more people would have been at work. Looking at collections on a per diem basis, they were up 4.4% this June versus June 2011. On a per workday basis, the gain was 5.7%. This further supports the thesis that the seasonally adjusted jobs data for June was grossly misleading.

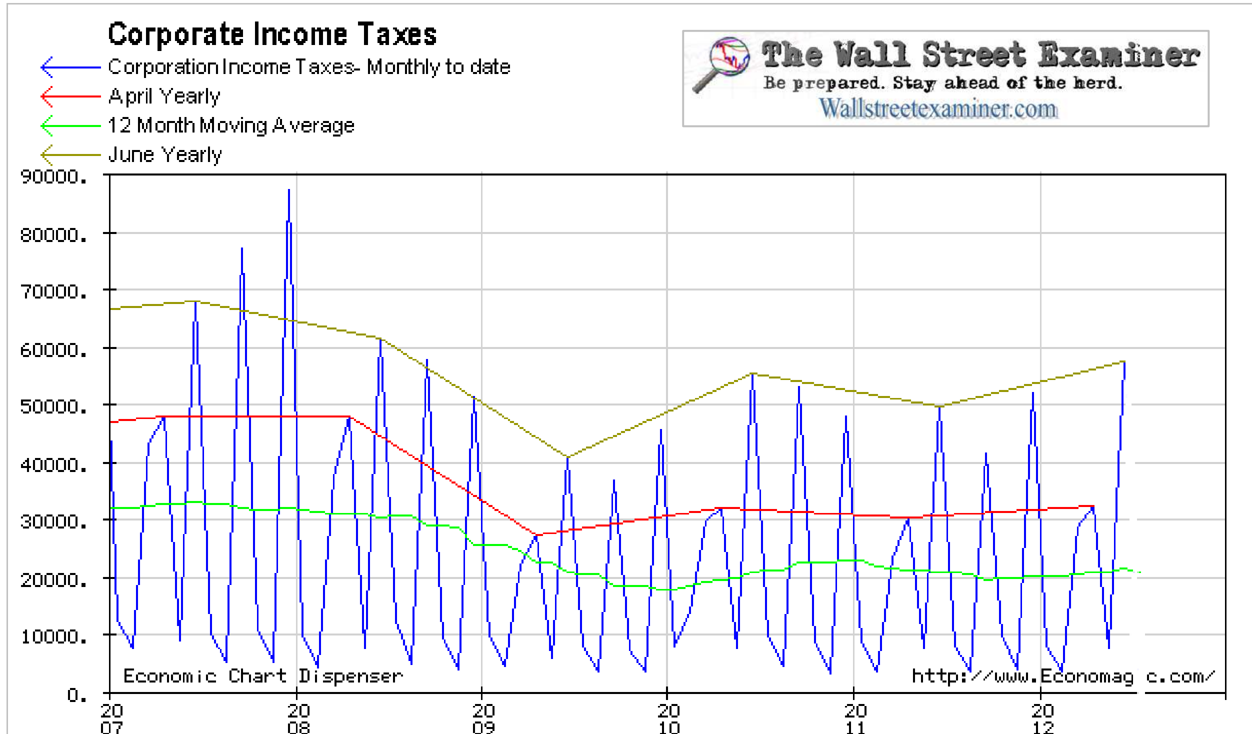
Month to date outlays for July 26 were slightly below last year. The amount isn't material. But I am surprised that the Administration did not spend like a drunken sailor last week. I was expecting that it would until the end of this month and every month until the election. They may hold back a little to tout the shrinking defecate. I'm not sure how much leeway they have with spending, but one of our readers is one of a handful of people in the world who know first hand how that works. I should check with him to find out whether they really can do what I'm supposing given that they seem to have some extra tax revenues.

7/6/12 Month to date outlays for the full month as of June 29 were up by $9.7 billion, absorbing nearly all of the revenue gain. The Administration will continue to spend as much as possible to boost its chances of getting rehired.

June 15 was quarterly corporate tax collection day. Corporate taxes for the month were 16% ahead of last June's collections. Some of this is due to improved business conditions, but if corporations are achieving this by cutting labor costs, that would be counterproductive over the long haul. The withholding tax data and raw unadjusted jobs data suggests that businesses were hiring.

Excise taxes are due for the quarter at the end of June. This year they were up 5.9% over 2011. I was mistaken about the aviation tax which briefly expired last year. The affected period was July and the tax was collected retroactively. That would have had no impact on the June collections.

July is not a collection month for corporate and excise taxes, so the current comparisons are probably not meaningful.



Federal Tax Receipts		(millions)	
Fiscal Year	2010	2011	
October	135,238	145,951	7.9%
November	133,588	148,960	11.5%
December	218,919	236,875	8.2%
January	205,242	226,553	10.4%
February	107,521	110,656	2.9%
March	153,358	150,894	-1.6%
April	245,272	289,543	18.0%
May	146,795	174,911	19.2%
June	251,048	249,658	-0.6%
July	155,546	159,063	2.3%
August	163,998	169,251	3.2%
September	245,207	240,153	-2.1%
Fiscal Year	2011	2012	
October	145,951	163,072	11.7%
November	148,960	152,402	2.3%
December	236,875	239,963	1.3%
January	226,553	234,319	3.4%
February	110,656	103,413	-6.5%
March	150,894	171,215	13.5%
April	289,543	318,807	10.1%
May	174,911	180,713	3.3%
June	249,658	260,177	4.2%

7/13/12 The Treasury's monthly statement for June showed a net revenue increase in nominal terms of 4.2% year over year. These are net revenues after refunds. Refunds for June are mostly tied to the prior year. Gross collections are more representative of the current period. The comparisons by category on a net and gross basis are shown on the next page.

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	Year over Year			
	Jun-12	Jun-11	Difference	% Difference
Individual Income Taxes (Net after refunds)	109,189	113,072	-3,883	-3.43%
Corporation Income Taxes	56,875	23,918	32,957	137.79%
Total--Social Insurance and Retirement Receipts	54,916	68,035	-13,119	-19.28%
Unemployment Insurance	1,341	682	659	96.63%
Excise Taxes	7,235	6,752	483	7.15%
Estate and Gift Taxes	860	190	670	352.63%
Customs Duties	2,497	2,511	-14	-0.56%
Miscellaneous	8,202	9,662	-1,460	-15.11%
Total	241,115	224,822	16,293	7.25%
Deposits of Earnings by Federal Reserve Banks	6,857	8,298	(1,441)	-17.37%
	Jun-12	Jun-11	Difference	% Difference
Income Taxes Withheld (Gross before refunds)	70,886	75,013	-4,127	-5.50%
Proprietors' and Other Income Taxes	43,320	41,971	1,349	3.21%
Social Security and Medicare (ex self employed)	65,920	63,563	2,357	3.71%
Corporate Taxes (Gross before refunds)	58,278	50,594	7,684	15.19%
Total	238,404	231,141	7,263	3.14%
	Month to Month			
	Jun-12	May-12	Difference	% Difference
Income Taxes Withheld (Gross before refunds)	70,886	80,698	-9,812	-12.16%
Social Security and Medicare (ex self employed)	65,920	60,528	5,392	8.91%
Total	136,806	141,226	(4,420)	-3.13%
Unemployment Insurance	1,341	20,393	-19,052	-93.42%
Excise Taxes	7,235	6,275	960	15.30%
Estate and Gift Taxes	860	932	-72	-7.73%
Customs Duties	2,497	2,199	298	13.55%
Deposits of Earnings by Federal Reserve Banks	6,857	10,700	-3,843	-35.92%

Wage withholding was down 5.5% in June versus June 2011, falsely suggesting a weakening economy. That was completely due to the last business day of the month falling on June 29. Semi weekly, and twice monthly withholding for the end of June would be delayed into July. In fact, $23.3 billion in withholding taxes were remitted on July 2. That's one third of all the withholding taxes previously collected in June. Conversely, July will look like a blockbuster month because of that. We'll have to keep that in mind when reviewing next month's statement.

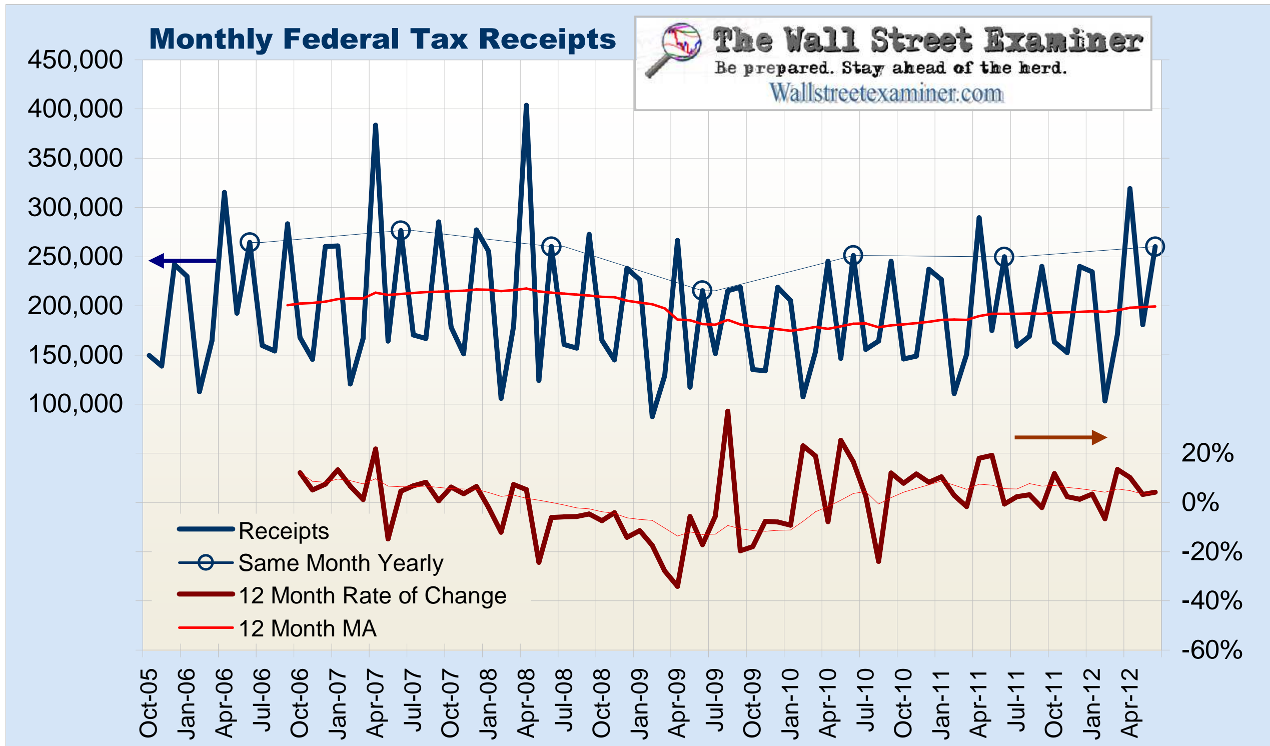
Social security taxes were up 3.7%, which is really impressive considering the calendar effect.

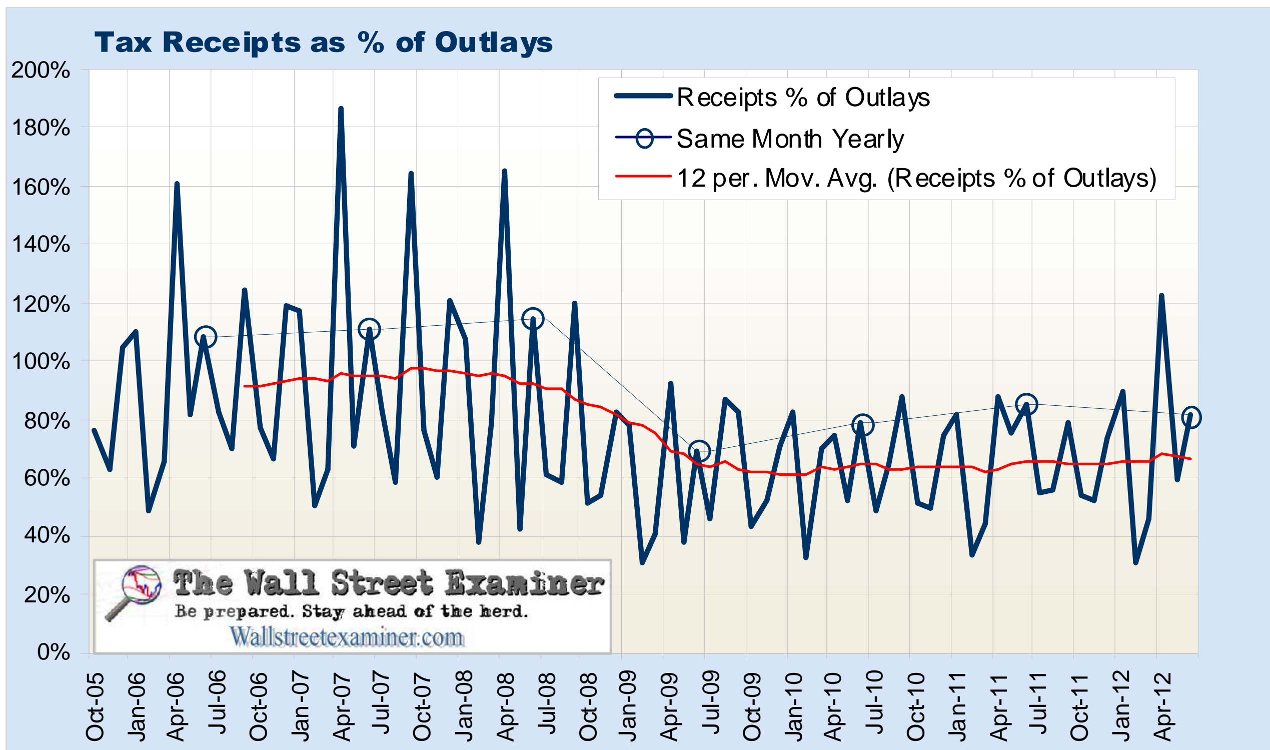
June is a quarterly estimated tax collection month. Self employment tax collections were up 3.2%. Those were due on June 15, so there are no calendar issues involved. That's a decent indication of the strength of the economy in the second quarter, but it implies nothing about July. Considering inflation, it suggests real growth of around 1-1.5%.

The Fed earned and paid the Treasury less than last year as interest rates plunged. The Fed does not mark to market. The surplus it returns to the Treasury is a result of interest income and sales. It made money in May when it closed sales of some of its Maiden Lane holdings.

The charts below are graphic representations of the trends of net receipts.

Year to year, revenues had been uptrending slightly suggesting modest economic growth. Meanwhile the deficit, which had been narrowing, grew materially wider in June. It had also widened in May. While revenues are climbing, the Obama administration has spent all of that and then some. It is, after all, election season, time to buy votes with strategic, economy boosting, government spending.

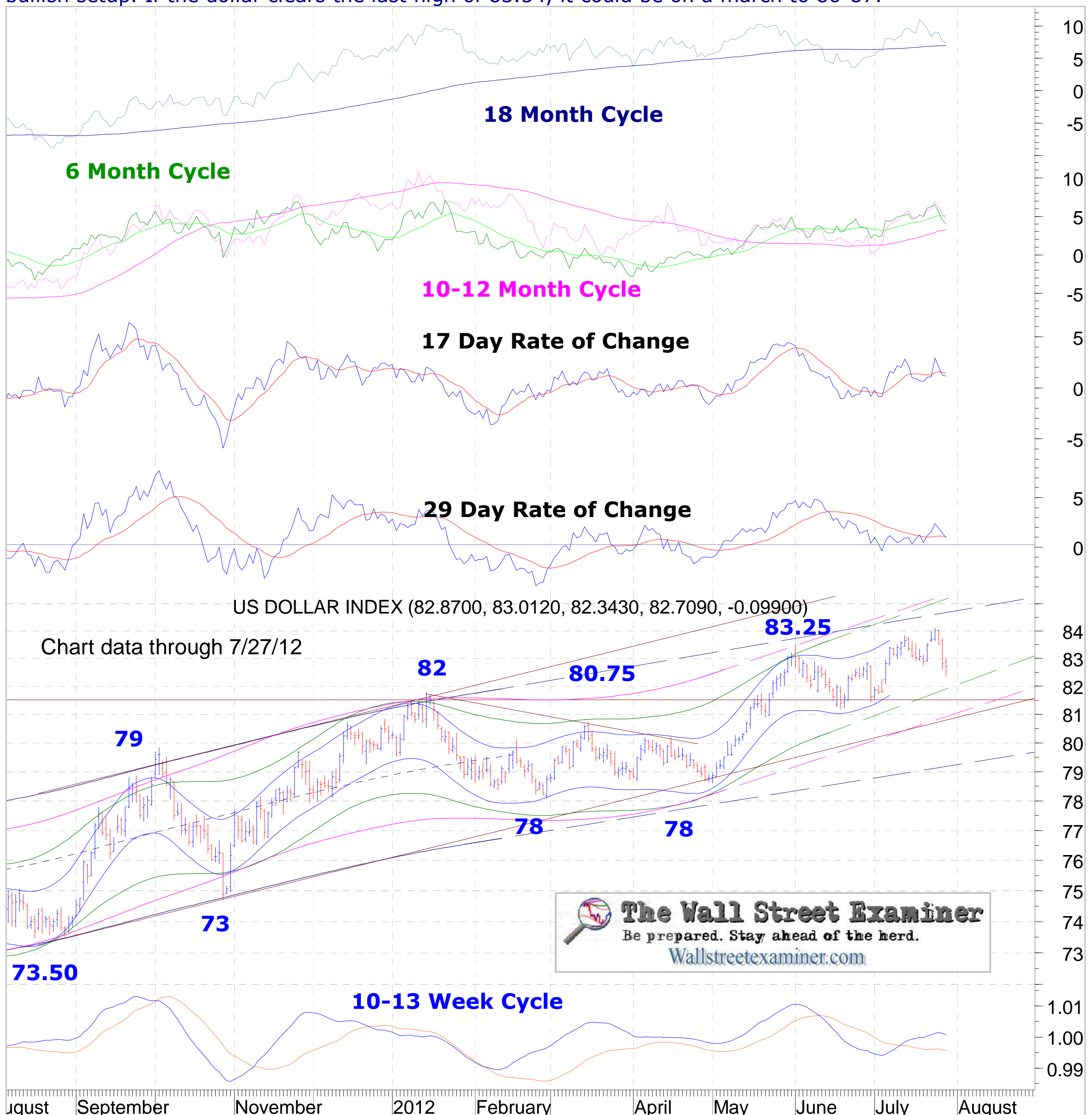




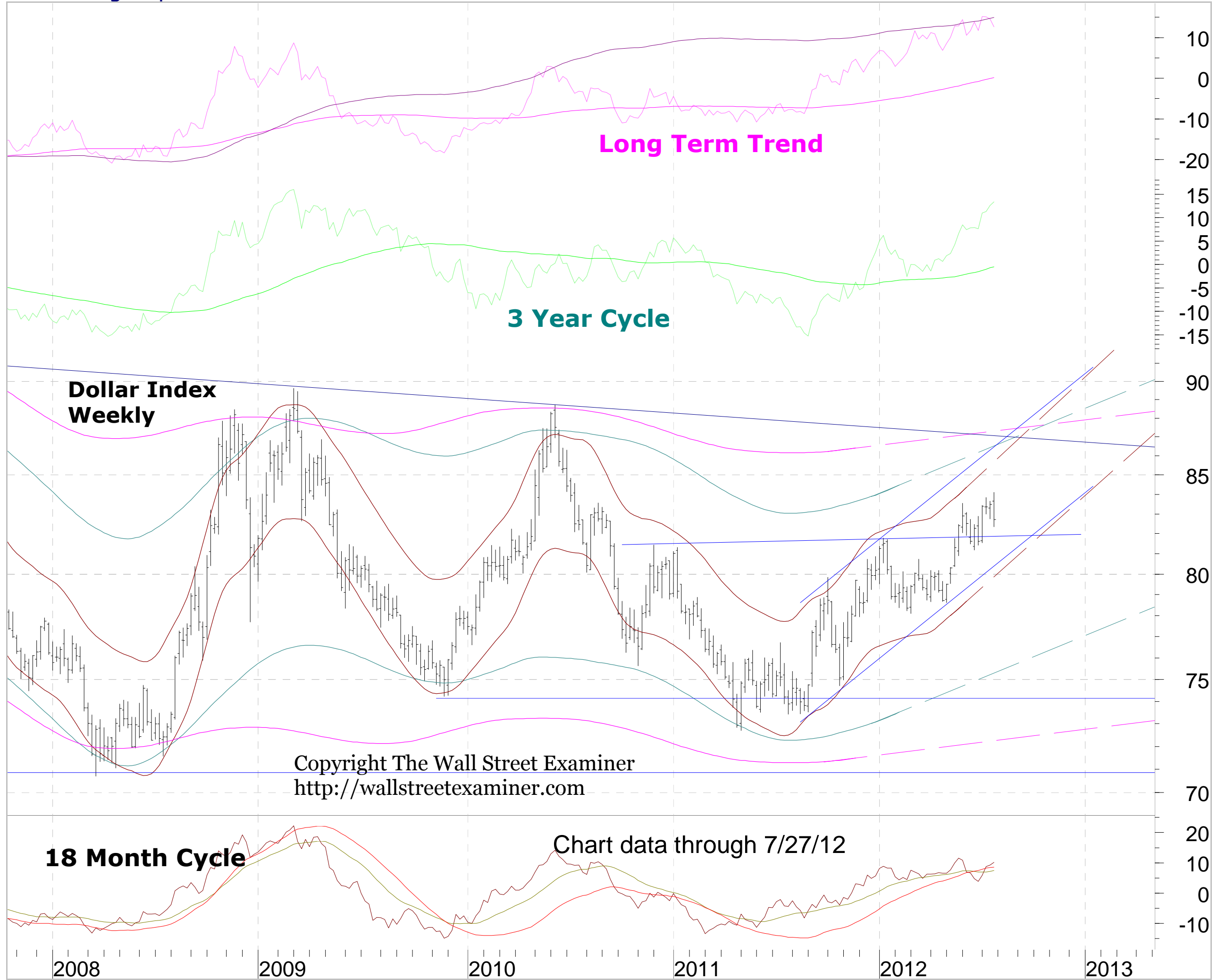
10 Year Treasury Yield After yields established a minor new all time low, Friday's surge broke a 4 month downtrend line. However, the move stopped short of violating the cycle channels. This looks like at least a significant intermediate turn, but more confirmation is needed. They still need to break out above 1.64 first, then 1.70 to confirm a major reversal.

7/13/12 The 10-12 month cycle momentum indicator was signaling an upturn, but that signal whipsawed two weeks ago signaling more downside. If there is to be a major reversal, the first step would need to be to break the downtrend line now at 1.56. 6/15/12 All of the long term indicators are pointing down. The all time low has broken down but the 10 year yield has found support at a cluster of long term channel lines around 1.50-.60. Both long term trend momentum and 3 year cycle momentum are at or near trend levels where intermediate bottoms have formed in the past. This could give rise to a rebound back to the 2.40 area over the next 6-9 months. Whether there's a bullish correlation for stock prices would depend on overall levels of liquidity, which I will cover in the Fed Report to follow.

US($) Dolor Index- The dollar reversed after repeatedly hitting the upper 18 month cycle channel projection. There were negative divergences in 13 week cycle indicators and the 29 day rate of change, that suggest a significant correction if these indicators turn down. 7/20/12 The dollar has surged to break the May-June high after pulling back to the base of the major bottom pattern from which it broke out in May. This is a bullish pattern, but the dollar has reached the 6 month cycle projection of 83.50 and also the upper range of the 10-12 month cycle channel suggesting that a period of consolidation or pullback is likely. If the dollar should clear 84, it should run into longer term resistance around 85. 7/6/12 13 week cycle indicators have begun to turn up, but that looks out of synch with the time count. Also, the 6 month cycle is due for a top, and the upside projection of 83.10 was hit, but its momentum indicator just whipsawed back to the buy side. So did 18 month cycle momentum. The lynchpin of all the ambiguity may be the 10-12 month cycle, which is due to turn up. Its momentum indicator has gone to the buy side from a bullish setup. If the dollar clears the last high of 83.54, it could be on a march to 86-87.



The major trend channel lower line is now at 80.75. A pullback to the 81.50 area would be normal after a base breakout, but if the trendline is broken, that could mean trouble. 6/17/12 As long as that channel remains intact, there's a strong probability of the dollar moving toward at least the 87 area. 5/24/12 The 18 month cycle down phase has not materialized and the dollar has broken out of a major base, confirming the 3 year cycle up phase and suggesting a move to the 87-88 area. The conventional measuring implication of the base breakout is 90.



Format notes - Look for text in this font for currently updated sections. Material that was updated recently is in this font and color.

I am doing my best to prune some of the dark blue background sections which consist of older background material, but I have been fighting a losing game. Hopefully, those parts of the report will continue to help people just starting their subscriptions and long time subscribers who want to review.

If you see a paragraph that is obviously stale, please copy and paste it into an email and send it to admin@wallstreetexaminer.com. That will help me greatly to help you. If you note any typographical, syntax or factual errors, please let me know.

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