Morgan Stanley

INVESTMENT MANAGEMENT

# Policy Puzzle

**MARKET INSIGHTS** | GLOBAL LIQUIDITY TEAM | June 2025

## Federal Reserve Board[1]

In June, the Federal Open Market Committee (FOMC) decided to maintain the federal funds target rate at 4.25% to 4.50%. This decision reflects the ongoing solid pace of economic activity, low unemployment and still somewhat elevated inflation. The Federal Reserve (Fed) has committed to reducing its holdings of Treasury securities and agency debt, including mortgage-backed securities, to support its monetary policy goals. Currently, the Fed is in a "wait and see" mode, closely monitoring the impact of tariffs before making any adjustments to the interest rate policy. Looking forward, the Fed remains vigilant about the economic outlook and is prepared to adjust monetary policy as necessary to achieve its dual mandate.

## European Central Bank[1]

The European Central Bank (ECB) Governing Council lowered the key deposit rate by 25 basis points in June, decreasing the deposit facility rate to 2.00%. This decision is based on an updated assessment of the inflation outlook, underlying inflation dynamics, and the effectiveness of monetary policy transmission. While wage growth is still high, it is visibly slowing down, and profits are helping to soften its inflationary impact. In response to President Trump's "Liberation Day" tariffs, the ECB cut interest rates to counter the negative economic impact and is closely monitoring how trade dynamics evolve. In targeting a 2.00% inflation rate in the medium term, the Governing Council is not pre-committing to a particular rate path and is taking a "meeting-by-meeting and data-dependent" approach as the path ahead remains uncertain.

**DISPLAY 1**

**Monthly Interest Rate Summary**

*As of 6/30/2025*

| US TREASURY RATES | YIELD (%) | MOM CHANGE (%) |
|---|---|---|
| 1M UST | 4.21 | (0.05) |
| 3M UST | 4.29 | (0.04) |
| 6M UST | 4.25 | (0.06) |
| 12M UST | 3.97 | (0.13) |
| 2Y UST | 3.72 | (0.18) |
| 5Y UST | 3.80 | (0.16) |
| 10Y UST | 4.23 | (0.17) |
| 30Y UST | 4.77 | (0.16) |

Source: Bloomberg

## Bank of England

The Bank of England (BoE) Monetary Policy Committee (MPC) voted by a majority of 6-3 on June 19, to maintain the Bank Rate at 4.25%. Three members preferred to reduce the Bank Rate by 0.25% to 4.00%. The BoE has adopted a gradual approach to removing policy restraint in the absence of material developments. The 12-month Consumer Price Index (CPI) inflation rate has increased to 3.40% in May from 2.60% in March because of "a range of regulated prices and previous increases in energy prices." The CPI is expected to remain broadly at current levels for the rest of the year before falling back toward the target rate next year. MPC

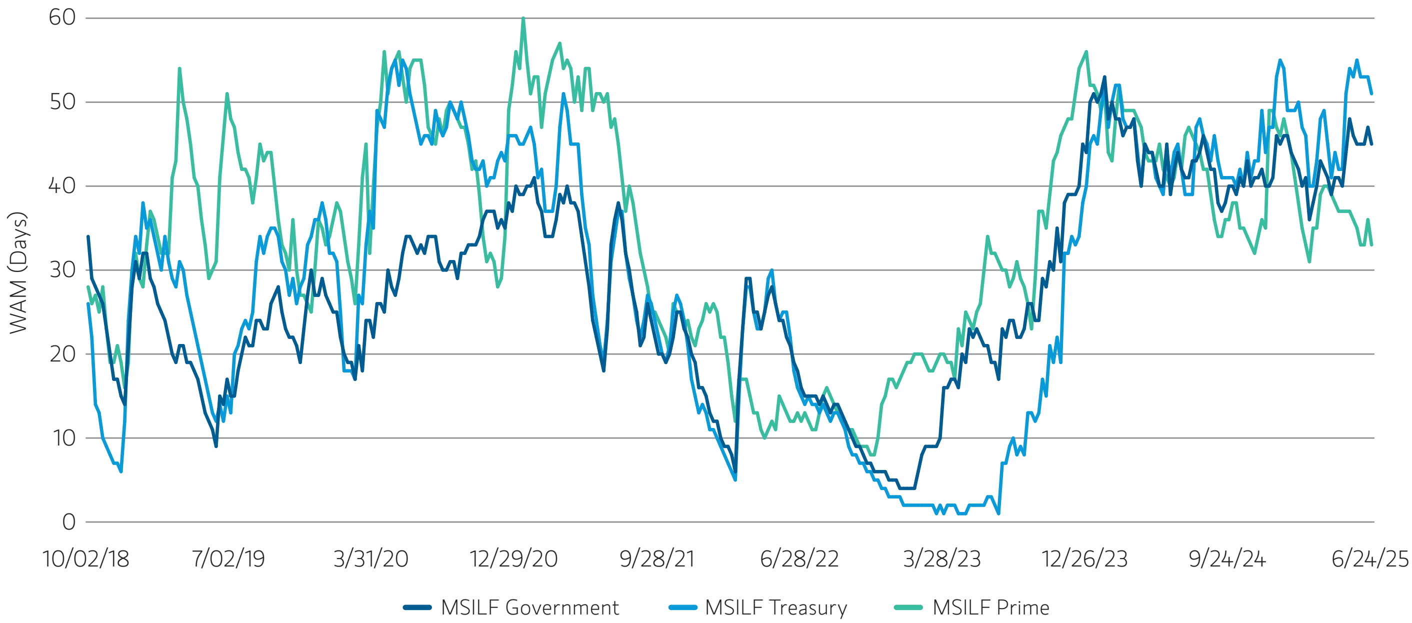
[1] Source: Bloomberg.

The views and opinions expressed are those of the Portfolio Management team as of June 30, 2025 and are subject to change based on market, economic and other conditions. **Past performance is not indicative of future results.**

**DISPLAY 2**

**Morgan Stanley Institutional Liquidity Funds (MSILF) Weighted Average Maturities (WAM) Summary**[2]

*As of 6/30/2025*




Source: iMoneyNet

members noted that President Trump's "Liberation Day" tariff announcement increased uncertainty surrounding global trade, which poses risks to global growth and potentially strains the relationship between the U.S. and U.K. In addition, energy prices have risen due to the escalating conflict in the Middle East. The MPC will continue to evaluate economic volatility and the risks of inflation when determining the appropriate degree of monetary policy easing.

## Portfolio Strategy

### GOVERNMENT/TREASURY STRATEGY

The June Fed meeting was uneventful as rates remained unchanged, leaving the benchmark short-term rate range at 4.25%-4.50%. We anticipate continued volatility in Treasury markets as incoming data provides some clarity to policy ahead. The market broadly anticipates rate cuts in the second half of 2025, and we have added exposure in longer-dated fixed-rate securities as appropriate. We maintained weighted average maturity (WAM) in the mid-40 days through active management of our positions in the 6-month segment of the yield curve, with improving inflation data and minimal tariff impact thus far remaining supportive. On weighted average life (WAL), we capitalized on adding some additional Treasury floating-rate notes that we believe offer a strong hedge in a higher-for-longer interest rate scenario.

While the market anticipates the first Fed rate cut to take place in September, the potential for the first cut occurring in December remains. The Trump administration continues to urge for rate cuts, while the Fed holds its "wait and see" approach, relying on key data prints such as inflation. After a mid-month slump in repo levels, the end of June experienced a spike in repo levels with SOFR (secured overnight financing rate) reaching 4.40% by month-end. This is causing us to favor a mix of attractive fixed-rate security exposures along with the balance of strong carry from floating-rate securities.

Auction participation for short Treasury bills maturing in the debt ceiling window has lagged as investors wait for more clarity surrounding the debt ceiling. We anticipate Treasury bill supply to increase as the Trump administration's proposed "Big Beautiful Bill" comes to fruition, with 4-week, 6-week and 8-week bills likely seeing the largest increases. We anticipate short-term bills maturing beyond the "X-date"

[2] **Weighted Average Maturity (WAM):** Measures the weighted average of the maturities of the portfolio's individual holdings, taking into account reset dates for floating rate securities.

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period, when the government is no longer able to pay its debt, to cheapen once we move past the debt ceiling window, which is now estimated around late July to August. In the meantime, we have no concerns on liquidity to note.

### PRIME STRATEGY[3]

We remained patient with adding duration as tariff negotiations and economic data continue to impact the timing of future Fed rate cuts. WAM and WAL decreased as the portfolios organically rolled down and we added shorter-dated securities in both fixed- and floating-rate investments given the continued uncertainty around the timing for rate cuts that are expected to materialize later this year.

Credit spreads widened 1-2 basis points across the curve throughout the month but still remain tight compared to their widened levels in April after President Trump's "Liberation Day" tariff announcement. Floating-rate paper continues to trade in high volumes versus fixed-rate alternatives as the upfront carry offers an attractive option while the timing of the implementation of Fed rate cuts remains uncertain. Corporate bonds continue to provide a yield pickup relative to their wholesale funding alternatives, though the pickup has tightened in recent months.

From a liquidity standpoint, dealer balance sheets remain unconstrained and typical quarter-end constraints did not prevent dealers from providing liquidity if needed.

[3] The Portfolio will be required to price and transact in their shares at a floating net asset value ("NAV").

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One basis point = 0.01%

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