

US Rates Watch

November refunding: rate sensitive

UST surprises with lower increase at long end

Treasury surprised us with lower than expected long-end supply at the November refunding. Treasury's actions indicate increased sensitivity to market conditions in their issuance strategy, which raises uncertainty around future auction sizes. Treasury grew 10 & 30Y sizes by only \$2bn and \$1bn respectively across the November new issue & re-opening; we expected a \$3bn and \$2bn increase across 10s and 30s. Treasury also kept 20Y auction sizes stable while we expected a \$1b increase. All other issuance size adjustments were in-line with our expectations.

Nov refunding recap: sensitive to market conditions

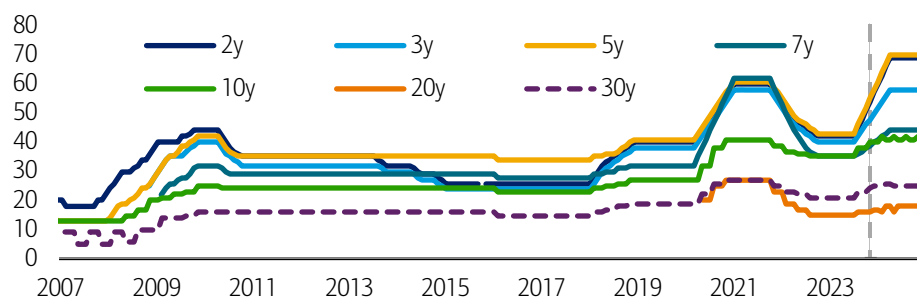
Treasury's announcement indicated greater issuance sensitivity to market conditions vs our expectation. Treasury appears concerned about the supply / demand balance and likely believes that this was a large driver of the bear steepening observed since the last refunding. Understanding recent market moves and the demand backdrop for Treasuries was a key topic discussed at the TBAC meeting. The minutes showed that one member "recommend[ed] Treasury approach future issuance decisions with greater flexibility within the construct of regular and predictable issuance". This approach leads us to be less confident in our coupon forecasts going forward as it implies that UST decisions will be more closely tied to market moves.

Spread curve steepener theme pulled forward

Treasury's issuance plans also mean a steeper spread curve (cheaper short-dated USTs vs long-dated USTs). UST will lean more heavily on bills to finance spending near-term. This should see front-end cash continue to cheapen vs swaps and put upward pressure on funding rates. At longer tenors, UST's decision to take a more tactical approach to issuance reduces tail risk of oversupply and limits how cheap spreads further out the curve might trade.

Exhibit 1: Treasury auction sizes by tenor with projections through YE '24 (\$bn)

We forecast that Treasury note auction sizes will grow through April '24



Source: BofA Global Research, US Treasury

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01 November 2023

Rates Research
United States

US Rates Research
BofAS
+1 646 855 8846

Mark Cabana, CFA
Rates Strategist
BofAS
mark.cabana@bofa.com

Meghan Swiber, CFA
Rates Strategist
BofAS
meghan.swiber@bofa.com

Katie Craig
Rates Strategist
BofAS
katie.craig@bofa.com

UST = US Treasury

QT = quantitative tightening

TBAC = Treasury Borrowing Advisory Committee

FY = fiscal year

CY = calendar year

WAM = weighted average maturity

RRP = reverse repo facility

TGA = Treasury General Account

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Risks to later coupon supply as deficits realize higher

We revise our forecasts to reflect a repeat of today's increase in auction sizes at the February refunding and a pause in May (Exhibit 2 and Exhibit 3). We had previously expected coupon supply increases to be more broad-based and continue through the May refunding. However, Treasury's actions and policy statement guiding towards a final increase in February alter our forecasts. We pencil in February as the last increase for now but see risks that auction sizes continue to grow should our deficit forecasts prove correct.

If UST indeed holds coupons steady in May, we see risks Treasury will need to increase coupon sizes again in 2H 24 or 1H 25 due to a worsening deficit outlook. As shown in Exhibit 13, if deficits continue to rise to \$2tn by FY 26, bills as a share of marketable debt will increase rather than trend down towards 20%. If instead deficits evolve as the median dealer expects, bill supply will remain elevated but stay around end FY 24 levels through FY 26. As discussed in [Interest expense boosts deficit & supply forecasts](#), our deficit figures reflect limited appetite and scope for Congress to meaningfully alter the spending trajectory as well as rising interest costs.

Bill supply: lower financing needs offsets smaller coupons

Treasury's financing estimates released Monday were below what we projected. The lower financing estimate likely reflects recent strong Treasury receipts, including recent California tax payments. We see risks Treasury receipts may not remain persistently strong and still project a \$1.8tn deficit in FY 24.

UST's lower expected financing needs roughly offset the smaller coupon sizes, which leaves our bill supply expectations roughly stable. We also revise our TGA estimates to be in line with Treasury's unchanged TGA for Q1'24 and hold it steady at \$750b for the rest of the CY. On net, these factors modestly reduce our expectations for bill supply over the CY; we now project bill supply of \$399b (prior forecast was \$436b in CY 24). After adjusting our coupon forecasts lower, bills in FY 25 increase \$144bn compared to - \$27bn using our prior expected coupon increases.

Bill demand strong today, much weaker tomorrow

We agree with UST's assumption that current demand is stronger for bills than coupons. However, this will not always be the case. We expect a material worsening of bill demand over '24, largely driven by an ongoing reduction in the Fed's ON RRP. We had previously anticipated a steeper spread curve to play out more in mid-24 (see: [Bill supply: higher despite coupon growth](#)), but Treasury's shift means the timing of this theme will play out sooner.

We expect the Fed's ON RRP to fall to zero in 2H '24 or early '25 (Exhibit 6). As the Fed's ON RRP reaches near zero, we expect material upward funding pressure and cheapening of bills vs OIS. A still elevated UST financing need in '24 & '25 will then likely mean Treasury needs to again increase coupon supply in 2H 24 or early '25.

Buybacks pushed to start May or August '24

There were few new details about buybacks. We were expecting more formal guidance around a February start, but instead UST will provide an update on implementation timing in the next quarterly refunding announcement. We take this to mean that buybacks will start later than February and incorporate a May start in our forecasts.

Bottom line: Bill demand is strong today, but it won't always be. Treasury's increased sensitivity to market conditions will mean more bills over time but risks further coupon increases in late '24 / early '25. Today's announcement pulls forward our view for a steeper spread curve driven by more front-end issuance and earlier short-dated UST cheapening.

Exhibit 2: Expected auction sizes through December 24 (\$bn)

Expect similar increases in notes at February refunding

	2y	3y	5y	7y	10y	20y	30y	5y II	10y II	30y II	2y FRN
8/31/2023	45	42	46	36	38	16	23			8	24
9/29/2023	48	44	49	37	35	13	20		15		24
10/31/2023	51	46	52	38	35	13	20	22			26
11/30/2023	54	48	55	39	40	16	24		15		26
12/29/2023	57	50	58	40	37	13	21	20			26
1/31/2024	60	52	61	41	37	13	21		18		28
2/29/2024	63	54	64	42	42	16	25			10	28
3/29/2024	66	56	67	43	39	13	22		16		28
4/30/2024	69	58	70	44	39	13	22	23			30
5/31/2024	69	58	70	44	42	16	25		16		28
6/28/2024	69	58	70	44	39	13	22	21			28
7/31/2024	69	58	70	44	39	13	22		18		30
8/30/2024	69	58	70	44	42	16	25			9	28
9/30/2024	69	58	70	44	39	13	22		16		28
10/31/2024	69	58	70	44	39	13	22	23			30
11/29/2024	69	58	70	44	42	16	25		16		28
12/31/2024	69	58	70	44	39	13	22	21			28

Source: BofA Global Research

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Exhibit 3: Expected change in auction sizes from August refunding quarter (\$bn)

Expect similar increases at Feb refunding meeting as Nov

	2y	3y	5y	7y	10y	20y	30y	5y II	10y II	30y II	2y FRN
11/30/2023	3	2	3	1	2	0	1		-		2
12/29/2023	6	4	6	2	2	0	1	-			2
1/31/2024	9	6	9	3	2	0	1		1		2
2/29/2024	12	8	12	4	4	0	2			1	4
3/29/2024	15	10	15	5	4	0	2		1		4
4/30/2024	18	12	18	6	4	0	2	1			4

Source: BofA Global Research

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Exhibit 4: Financing estimates by fiscal year (\$bn)

Bills as a share of marketable debt will be 22.1% by end of FY '00

	2024		2025		2026	
	QT ends Jun '24	QT ends in Jun '25	QT ends Jun '24	QT ends in Jun '25	QT ends Jun '24	QT ends in Jun '25
1 Baseline deficit	1,800	1,800	1,900	1,900	2,000	2,000
2 Other adjustment	(77)	(77)	-	-	-	-
3 Financing need (1 + 2)	1,723	1,723	1,900	1,900	2,000	2,000
4 Change in cash balance	93	93	35	35	65	65
5 Note: cash balance end period assumption	750	750	785	785	850	850
6 Marketable borrowing need (3 + 4)	1,816	1,816	1,935	1,935	2,065	2,065
7 Gross coupon auctioned	4,150	4,150	4,367	4,367	4,367	4,367
8 Total coupon maturing	3,085	3,085	3,035	3,035	3,381	3,381
9 Fed coupon rollover	207	59	578	187	465	465
10 Public coupon maturing (8 - 9)	2,878	3,026	2,456	2,847	2,916	2,916
11 Expected buybacks*	50	50	120	120	120	120
12 Net coupon supply (7 - 10 - 11)	1,222	1,074	1,791	1,400	1,331	1,331
13 Coupon runoff from Fed bal sheet	472	620	-	391	-	-
14 <i>Net coupon supply to public (12 + 13)</i>	<i>1,694</i>	<i>1,694</i>	<i>1,791</i>	<i>1,791</i>	<i>1,331</i>	<i>1,331</i>
15 Net bill supply (6 - 12)	594	742	144	535	734	734
16 Bill runoff from Fed bal sheet	68	100	-	-	-	-
17 <i>Net bill supply to public (15 + 16)</i>	<i>662</i>	<i>842</i>	<i>144</i>	<i>535</i>	<i>734</i>	<i>734</i>
18 Net supply issued (12 + 15)	1,816	1,816	1,935	1,935	2,065	2,065
19 <i>Net supply to public (14 + 17)</i>	<i>2,356</i>	<i>2,536</i>	<i>1,935</i>	<i>2,326</i>	<i>2,065</i>	<i>2,065</i>
20 Starting assumed coupons	20,488	20,488	21,562	21,562	23,353	22,962
21 Starting assumed bills	5,360	5,360	6,102	6,102	6,246	6,637
22 End assumed coupons (12 + 20)	21,710	21,562	23,353	22,962	24,684	24,293
23 End assumed bills (15 + 21)	5,954	6,102	6,246	6,637	6,980	7,371
26 Bills as % of coupons + bills (23 / (22 + 23))	21.5%	22.1%	21.1%	22.4%	22.0%	23.3%

BofA Global Research, US Treasury, Federal Reserve. *Expected buybacks at a \$10bn pace per month based on recent Treasury guidance to start in May '24

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Exhibit 5: Bill and coupon issuance estimates by month (\$bn)

Marketable borrowing needs will need to grow to meet higher deficits

	Financing Need	TGA EOP	TGA Change	Marketable Borrowing	Buybacks	Net Coupon	Net Bills	Fed Coupon maturities	Fed Bill maturities	Net Coupons to the Public	Net Bills to the Public
	1	2	3	3 = 1 + 2	4	5	6	7	8	9 = 5 + 7	10 = 6 + 8
Jan-23	71	568	121	192	0	-49	241	55	5	6	246
Feb-23	314	415	-153	161	0	42	119	60	0	102	119
Mar-23	322	178	-237	85	0	74	11	56	4	130	15
Apr-23	-305	316	138	-167	0	-41	-126	60	0	19	-126
May-23	361	49	-267	94	0	43	51	60	0	103	51
Jun-23	197	402	353	550	0	77	473	48	12	125	485
Jul-23	148	502	100	248	0	-56	304	50	10	-6	314
Aug-23	294	542	40	334	0	30	304	60	0	90	304
Sep-23	169	657	115	284	0	98	186	39	21	137	207
Oct-23	54	832	175	229	0	33	196	52	8	85	204
Nov-23	380	750	-82	298	0	49	249	60	0	109	249
Dec-23	108	750	0	108	0	127	-19	46	14	173	-5
Jan-24	-96	750	0	-96	0	7	-103	53	7	60	-96
Feb-24	366	750	0	366	0	81	285	60	0	141	285
Mar-24	367	750	0	367	0	157	210	45	15	201	226
Apr-24	-272	750	0	-272	0	66	-338	60	0	126	-338
May-24	283	750	0	283	10	103	180	60	0	163	180
Jun-24	67	750	0	67	10	166	-99	36	24	202	-75
Jul-24	267	750	0	267	10	98	169	0	0	98	169
Aug-24	267	750	0	267	10	141	126	0	0	141	126
Sep-24	-68	750	0	-68	10	196	-264	0	0	196	-264
Oct-24	257	750	0	257	10	100	157	0	0	100	157
Nov-24	330	750	0	330	10	143	187	0	0	143	187
Dec-24	42	750	0	42	10	202	-160	0	0	202	-160

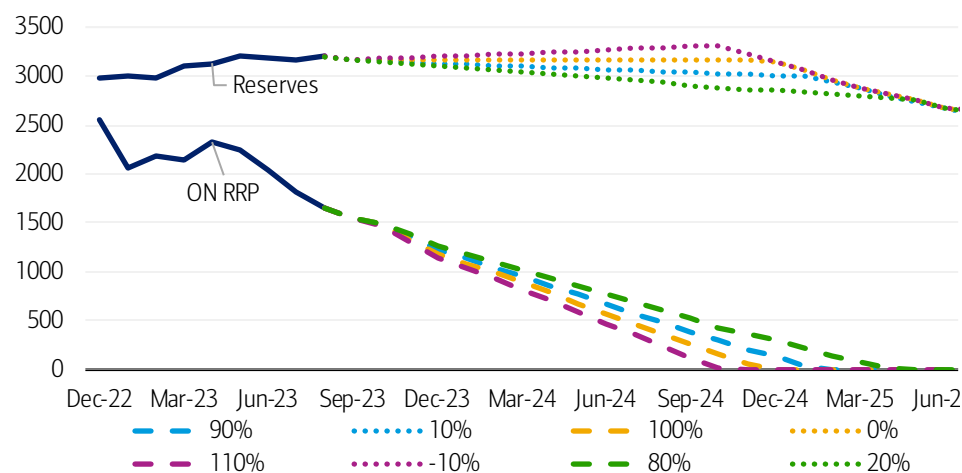
Source: BofA Global Research, US Treasury, Federal Reserve. Gray indicates projections.

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Exhibit 6: Projected Fed ON RRP and reserve balances (\$bn)

We forecast ON RRP to fall to \$0 sometime between Q4 '24 to Q2 '25

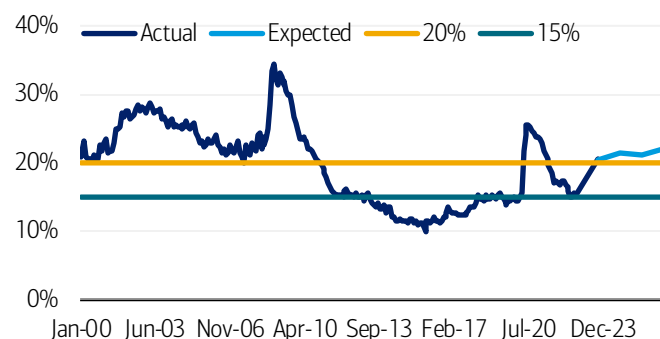


Source: BofA Global Research, Bloomberg

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Exhibit 7: Bills as a % of marketable debt

Given our expectations for deficit and QT ending in Apr '24, bills as a share of marketable debt should increase through FY '24

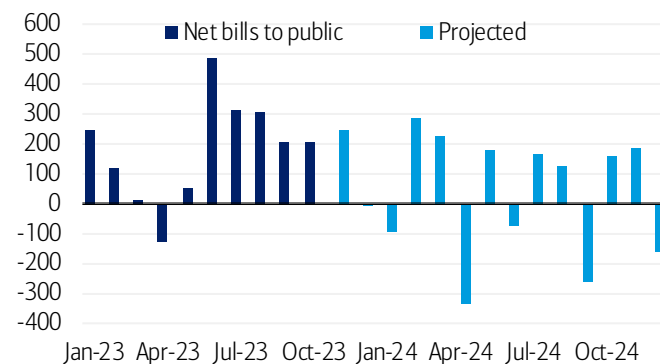


Source: BofA Global Research, US Treasury

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Exhibit 8: Monthly net bill issuance and projections (\$bn)

We forecast \$313b in bill issuance in Q4 '23, \$326bn in Q1 '24



Source: BofA Global Research, US Treasury

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Exhibit 9: BofA bill forecast vs TBAC recommended (\$bn)

Our T-bill forecast is roughly in line with TBAC's recommendation

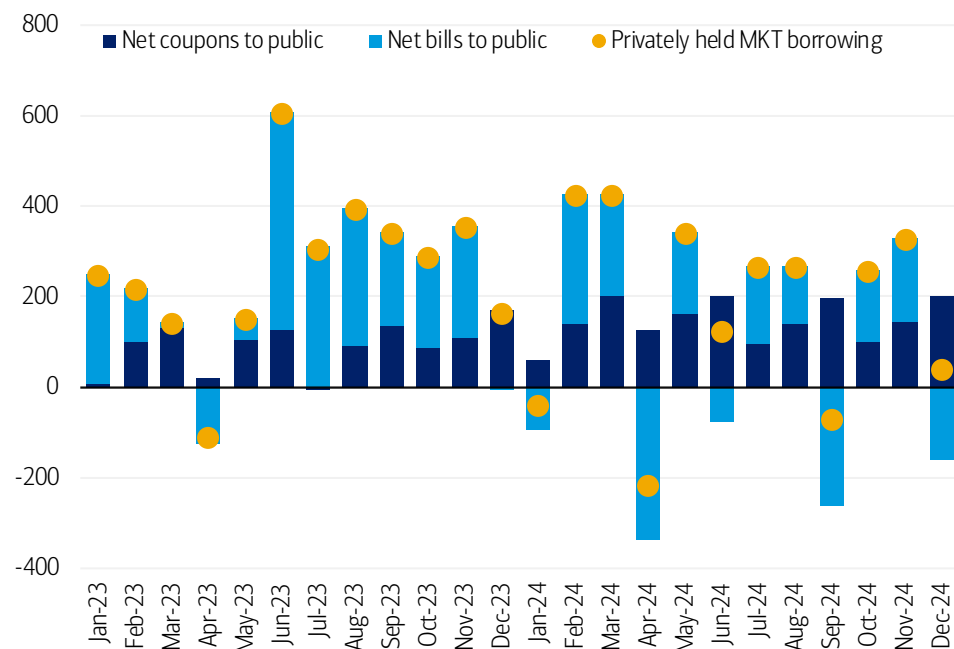
	Q4'23	Q1'24	Total
BofA Bill forecast	448	415	863
TBAC recommended bill issuance	437	468	905
Difference	11	-53	-42

Source: BofA Global Research, US Treasury

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Exhibit 10: Monthly change in coups, bills, marketable debt to public (\$bn)

Expect only 1 month of negative bill supply to public in FY '23

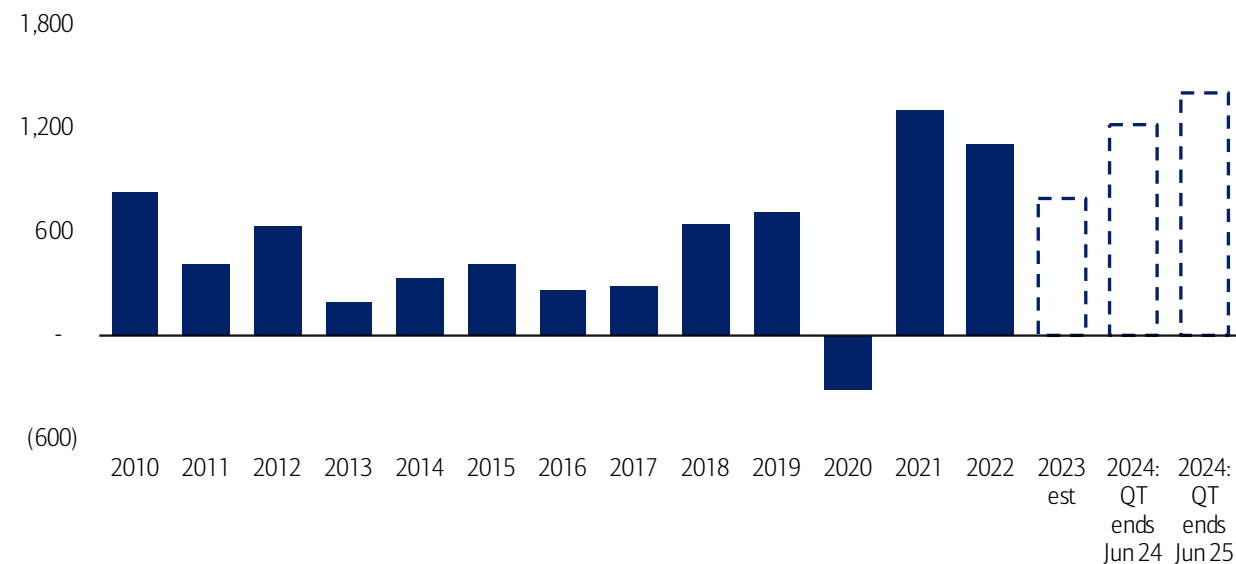


Source: BofA Global Research, US Treasury

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Exhibit 11: Net coupon supply ex Fed purchases and including Fed QT impact by FY (\$bn, 10y equivalent)

Our forecasts suggest elevated supply in 2024

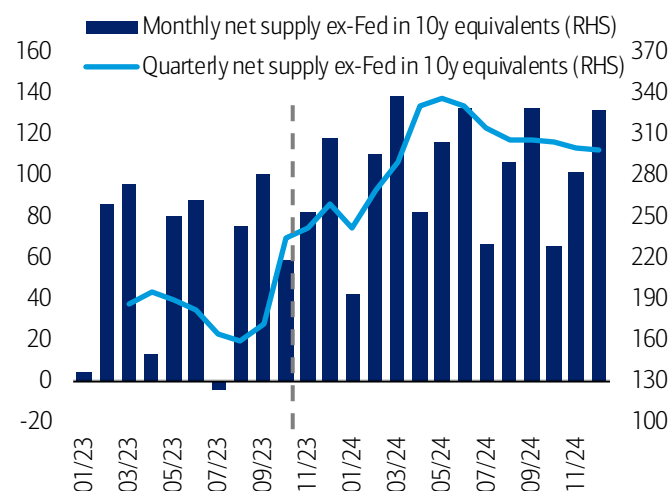


Source: BofA Global Research, US Treasury, Federal Reserve

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Exhibit 12: 10y equivalent net supply ex Fed (\$bn)

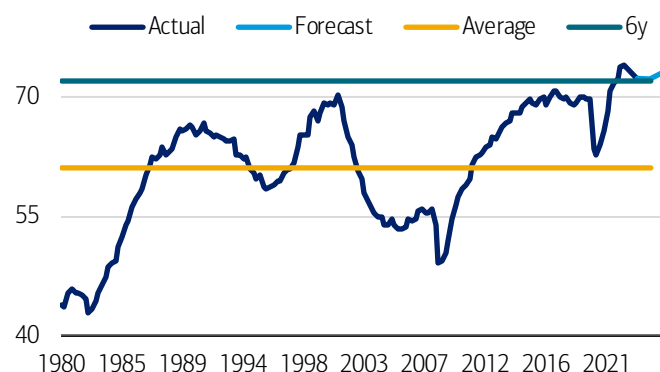
Despite revisions, coupon supply still picks up meaningfully in coming quarters



Source: BofA Global Research, US Treasury, Federal Reserve, Note: >1y maturities only
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Exhibit 14: Actual and expected weighted average maturity (WAM) through FY '24 (months)

WAM expected to stay elevated



Source: BofA Global Research, US Treasury

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Exhibit 16: SOMA reinvestments at UST auctions by tenor (\$bn)

Fed reinvestments will be limited until end of QT

	2y FRN	3y	10y	30y	2y	5y	7y	20y	5y II	10y II	30y II
Oct-23	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nov-23	0.3	1.0	0.7	0.4	0.5	0.5	0.4	0.1	0.2	0.0	0.0
Dec-23	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Jan-24	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Feb-24	1.1	4.2	3.0	1.7	2.3	2.3	1.6	0.5	0.0	0.7	0.0
Mar-24	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Apr-24	0.0	0.9	0.6	0.3	0.4	0.4	0.2	0.1	0.0	0.1	0.0
May-24	1.7	7.7	5.1	2.9	4.0	4.1	2.5	0.8	1.3	0.0	0.0
Jun-24	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: BofA Global Research, Federal Reserve

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Exhibit 13: Bills as % of marketable borrowing under different deficit assumptions

Our deficit assumptions suggest that bills will begin to rise again in FY 26 without additional coupon increases beyond Feb refunding

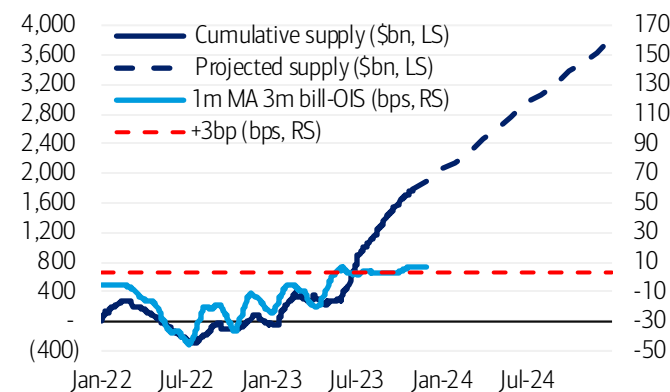
FY	BofA deficit forecast	Median dealer deficit forecast
24	21.5%	21.5%
25	21.1%	21.0%
26	22.0%	21.4%

Source: BofA Global Research

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Exhibit 15: Projected bill supply vs 1 mo moving avg of 3m bill-OIS

Investors have been buying up 3m bills at just 3bps cheap to OIS



Source: BofA Global Research, Treasury

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