

US Rates Watch

Debt limit: Yellen & Q2 financing need

Yellen guides to debt limit X-date of June 1

Yesterday Treasury Secretary Yellen guided the public to a potential June 1 “X-date” (date after which UST may not be able to meet all gov’t obligations). Yellen’s guidance was modestly earlier than we projected, likely due to more conservative estimates.

Recall, we have recently been flagging 2 key dates for Treasury debt limit guidance: (1) full exhaustion of cash & EM (2) Tsy loss of confidence to meet all outstanding obligations (see [X-date: low confidence vs run dry](#)). Importance of date 2 > date 1. We had expected the Yellen to guide the market to 1H June, potentially the second week.

Yellen’s guidance to June 1 is likely reflective of (1) naturally more conservative Treasury bias (2) higher Q2 financing estimates. We discuss in more detail below.

UST Secretaries must be conservative on DL timing

Treasury Secretaries have a natural bias to be more conservative in their DL estimates. They cannot risk an accidental or unexpected default by guiding Congress & public to a later X-date & then unexpectedly shifting that timing forward.

Higher Q2 Treasury financing estimates also likely factored into Yellen’s updated timing. Yesterday Treasury boosted their Q2 financing estimate by \$117b due to projections of lower receipts and higher outlays. These numbers also shifted our X-date timing a touch.

BofA X-date timing: now late July vs early Aug

Treasury published their updated financing estimates for 2023 on Monday. The important takeaway for us was the higher-than-expected financing needs in Q2 & Q3 which are important inputs into our X-date forecast. While the Treasury’s marketable borrowing and TGA forecasts are worth noting, we focus on their financing needs given they provide the best estimate of quarterly funding need (Exhibit 1).

Looking forward, Treasury’s +\$117b revision of their Q2 financing need and the \$122b higher financing need for Q3 than we had previously forecasted has pulled forward our date for when Treasury runs out of cash from Aug 1 to July 28. Our numbers suggest Treasury get precariously close to default in 1H June, consistent with Yellen’s guidance.

The higher financing need likely reflects a higher projected deficit than previously forecasted and lower tax inflows. We expect to see updated EM figures in the Treasury’s Monthly Statement of Public Debt later this week which may again impact our X-date projections. Currently we assume minimal drain on EM occurred in April.

... Next page has thoughts on Yellen’s June 1 guidance on DL progress & markets...

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EM = extraordinary measure

DL = debt limit

TGA = Treasury General Account

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Yellen guidance: impact on political & market timeline

Yellen's guidance pulls forward the political & market stress timeline. Updated thoughts:

Political timeline: time is of the essence since there is now <1m to reach resolution. We expect deliberation to accelerate in coming weeks. The longer it takes to achieve a deal, the greater the possibility of a short-term DL extension. Our base case has always been a DL resolution just prior to the X-date; the next most likely options is a short-term debt limit extension to potentially to Sept 30.

An extension to Sept 30 would align gov't spending & DL timing & could result in a short-term increase in bill supply & TGA. For more detail see: [Debt limit FAQ](#).

Market stress: Yellen's updated guidance has pulled forward market DL concern. The bill market clearly reflects this with a concentration of concerns in the first week of June (Exhibit 3). We flagged this on Friday (see: [X-date: low confidence vs run dry](#)). In coming weeks, we expect to see Treasury coupon securities with a coupon payment after the X-date start to cheapen vs securities with a May coupon date.

Historically, prior debt limit episodes imply that broader markets don't seem to price in debt limit scenarios until two weeks before the projected X date. In 2011, the debt limit was not resolved until the projected X-date, which weighed heavily on investor sentiment, leading to lower equity prices and higher volatility. However, in later debt limit scenarios, especially those in which the debt limit was resolved several days or weeks before the projected X-date, the impact on risk assets was less severe.

We expect this debt limit resolution will likely go down the wire which means risk of higher rate & broad market volatility in late May or early June.

Bottom line: Yellen's June 1 X-date guidance was slightly earlier than we expected but still in our base line 1H June projection. Treasury's Q2 financing estimates cause us to pull forward estimate for when Treasury runs out of cash to late July; we acknowledge UST is precariously close to default in early June. DL market concern will likely increase in coming weeks & be shown via a more acute hump in the UST bill curve, mid-June UST coupon cheapening, & potential risk off later in May.

Exhibit 1: Treasury financing need table as of May 1 (\$bn)

Treasury revised their Apr-Jun financing need higher by \$117bn

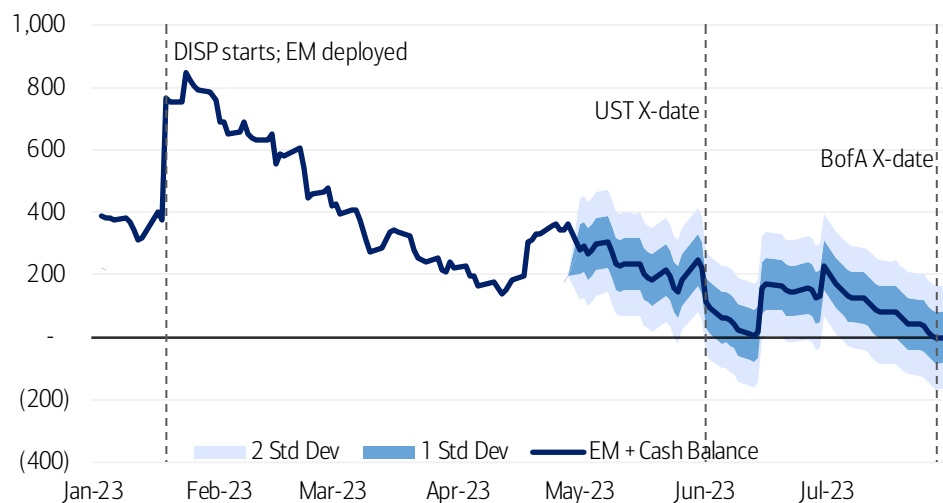
	Financing Need	Marketable Borrowing	All Other Sources	Total	Change in Cash Balance	End of Quarter Cash Balance	SOMA Redemptions
	1	2	3	4 = 2 + 3	5 = 4 - 1	6	7
Apr - Jun '23	112	726	-242	484	372	550	-180
Jul - Sep '23	438	733	-244	488	50	600	-158

Source: US Treasury

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Exhibit 2: Projected TGA and EM remaining (\$bn)

UST X-date: June 1; BofA X-date: July 28

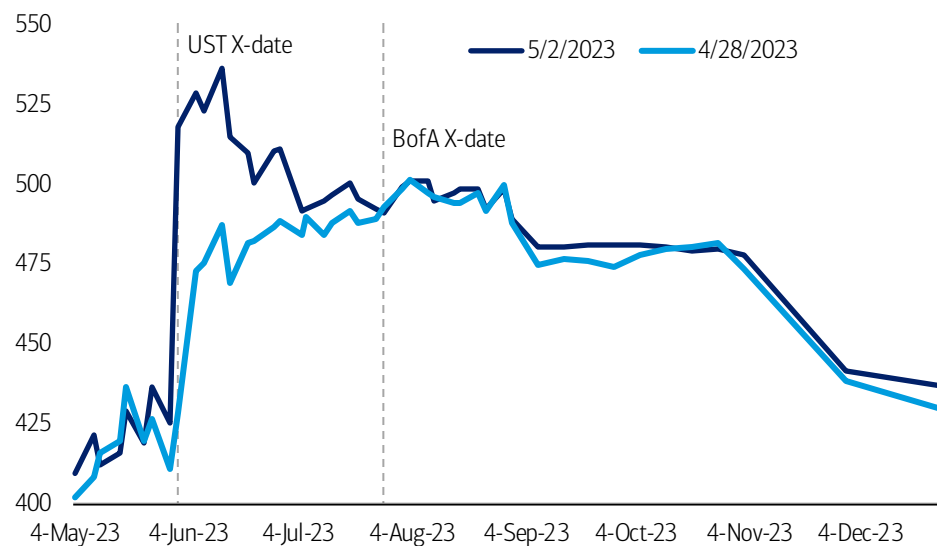


Source: BofA Global Research, Treasury

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Exhibit 3: Treasury Bill Curve (bp)

Market is not yet reflecting concentrated risk in any part of the curve



Source: BofA Global Research, Bloomberg

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