US Rates Viewpoint

Bill supply surge FAQ

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Bills on parade

Once the debt ceiling passes focus will quickly turn to increased bill supply. We expect a large surge of Treasury bill supply after the debt limit is raised, likely in the next week or two. Treasury bill supply will likely rise $1tn in the 3m after a debt limit increase. For context, the average annual bill supply increase in the 5Y prior to COVID = $200b (years 2015-2019). The market will receive 5x the pre-COVID average annual bill supply in 3m.

Bill surge = money market rate hike (or two)

We believe the surge in Treasury bill supply will translate into a shift in money market rates of between 25-40bps, similar to a money market rate hike (or two). The market is already factoring in some of this move, but likely not all of it. The bill supply surge will mean cheaper bills vs Fed funds OIS, higher rates on CP / CD, increased competition of bank deposits, tighter funding in XCCY basis, and greater dealer balance sheet constraints. In essence, the US gov't will be crowding out the private sector with supply.

FAQs: you ask, we answer

Clients have asked several questions on the expected bill supply surge. In this FAQ we will answer questions on the speed, size, tenor, and buyers of the impending supply as well as its impact on front-end rates and the Fed's balance sheet. Specifically, we answer the following:

- Why is there a surge in bill supply? Why not coupons?
- When will bill supply hit the market?
- What if there is only a short-term debt limit extension?
- Where will the supply be targeted? What bill tenors?
- Who will buy the bills?
- Where will the TGA drain come from: reserves or ON RRP?
- What is the market impact?
- What is the repo impact? How much will SOFR move?
- Does the Fed know? Will the Fed care?

Acronyms

TGA = Treasury General Account, aka Treasury cash balance

OIS: Overnight Index Swap

CP: Commercial Paper

CD: Certificate of Deposit

XCCY: Cross-currency

Timestamp: 25 May 2023 04:16PM EDT

Why is there a surge in bill supply? Why not coupons?

We expect a surge in bill supply after the debt limit (DL) is increased. Using our base case of a DL resolution by June 1, we expect over $1tn of bill supply from Jun through Aug and $1.4tn from Jun to end Dec '23 (Exhibit 1, Exhibit 2). For reference, the average annual net bill supply in the 5Y that preceded COVID (2015-2019) was $200b/y. The expected vs historic supply is 5x during the summer and 7x from today until end '23.

Treasury is raising the supply for 2 reasons: (1) TGA rebuild (2) deficit financing. TGA will be rebuilt from the most recent level of $77b or lower to $600b by end Sept (May refunding suggested Treasury sees TGA at $600b by end Sept; we assume an extra $100b build from Sept to Dec (Exhibit 1). Deficits are also elevated and require additional bill financing even after factoring in coupon supply increases in August.

The Treasury will likely want to return its TGA to a comfortable level as quickly as possible. Treasury Borrowing Advisory Council (TBAC) has recommended the TGA should remain above 5 days of expected outflows, which has averaged roughly $500b YTD. Given their float has been depressed and Treasury is a prudent liquidity manager, we expect them to want to raise cash quickly and add an additional $200b cash buffer by year-end. Following the debt limit resolution in 2021, the Treasury quickly brought the TGA up from near $0 to almost $700b in less than 2 months (Exhibit 3).

Exhibit 1: Bill and coupon issuance estimates by month

We expect bills to the public to increase over the quarter

	Financing Need	TGA EOP	TGA Change	Marketable Borrowing	Net Coupon	Net Bills	Fed Coupon maturities	Fed Bill maturities	Net Coupons to the Public	Net Bills to the Public
	1		2	3 = 1 +2	4	5	6	7	4+6	5+7
Jan-23	71	568	121	192	-49	241	55	5	6	246
Feb-23	313	415	-153	160	41	119	60	0	101	119
Mar-23	322	178	-237	85	74	11	56	4	130	15
Apr-23	-305	316	138	-167	-41	-126	60	0	19	-126
May-23	299	70	-246	53	43	10	60	0	103	10
Jun-23	118	350	280	398	77	321	48	12	125	333
Jul-23	230	400	50	280	-56	335	50	10	-6	346
Aug-23	305	500	100	405	25	380	60	0	85	380
Sep-23	-96	600	100	4	91	-87	39	21	130	-67
Oct-23	196	600	0	196	26	170	52	8	78	178
Nov-23	252	650	50	302	35	267	60	0	95	267
Dec-23	32	700	50	82	108	-26	46	14	154	-12

Source: BofA Global Research, US Treasury, Federal Reserve

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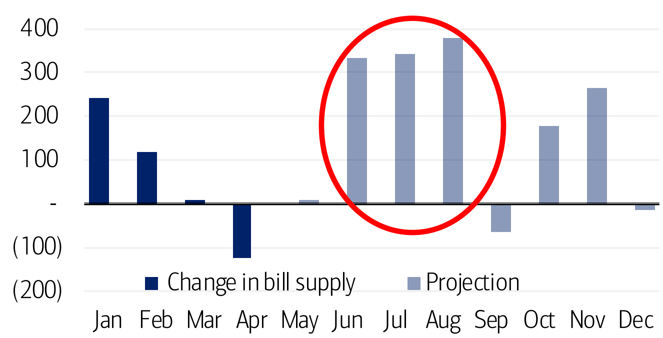
Exhibit 2: Monthly change in bill supply in 2023 ($bn)

We project $1,058b in bill supply between June and end of August



Source: BofA Global Research, Bloomberg

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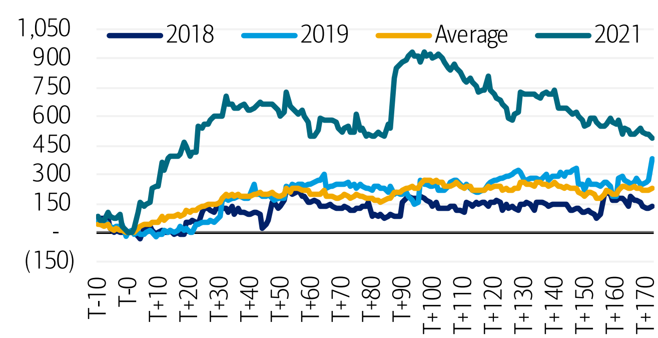
Exhibit 3: TGA surrounding DL resolution periods ($bn chg)

TGA refill happened quickly in '21



Source: BofA Global Research, Haver Analytics

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We are confident in our bill supply estimates due to our understanding of Treasury financing needs. Our forecasts are also supported by estimates from the Treasury

Borrowing Advisory Committee (TBAC). The TBAC financing estimates at the May refunding suggested $1,028b of bill supply over Q2 & Q3[1]. TBAC may have been assuming an earlier debt limit resolution, which explains their higher estimate. Our bill supply numbers appear conservative in relation to TBAC, which makes us think bill supply risks are skewed to the high side.

The Treasury likely will choose to raise short-tenor bills over longer-tenor coupons for 2 reasons: (1) bills act as the "shock absorber" (2) coupons take longer to ramp up. Treasury has traditionally used bills as an unexpected financing need "shock absorber"; bills have less duration risk and typically have a deeper buyer base vs coupons. Treasury has been less willing to make sudden changes in coupon supply because they have more price risk and not as deep of a buyer base.

Our bill supply estimates include an assumption of coupon auction size increases starting in August '23. These coupon increases are likely to be much smaller and slower in relation to the bill supply increases (for detail on coupon size increases see May refunding). We expect that coupon size increases will raise an additional $495b between Aug '23 & Aug '24; however, this net increase in cash will take place slowly.

Treasury will slowly grow coupons over time but the initial Treasury cash balance rebuild will be largely funded by higher bill supply.

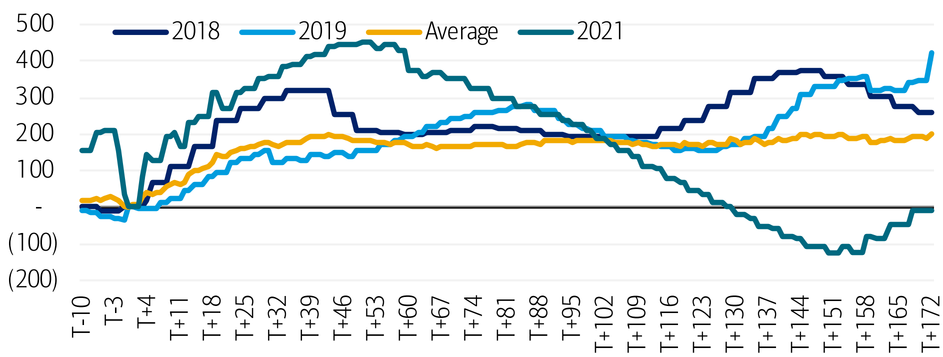
When will bill supply hit the market?

We expect bill supply will hit the market very quickly after a debt limit agreement is in place. Specifically, we expect Treasury to start announcing and auctioning increased bill supply very shortly after any bill is passed by both the House & Senate. Treasury does not need to wait for the President to sign the bill since the offering size increases and auctions can occur before settlement (the President would be required to sign a bill before the new bill supply can settle).

Historically, Treasury bill supply increases have averaged $65b in the 2 weeks after debt limit increased (Exhibit 4; including years '11, '13, '15, '17 '18, '19, '21). This average supply increase then rises to $194b 4-weeks after a debt limit resolution. The largest supply surge was in 2021 when net new bill supply reached $450b 5 weeks after the debt limit was increased.

We expect the 2023 supply surge to be the largest in debt limit history. The '23 supply surge is likely to be the largest due to a very low Treasury cash balance and large deficits.

Exhibit 4: Cumulative change in bill supply surrounding DL periods ($bn chg)
Treasury issued $450b in net new bills within 5 weeks after the 2021 DL resolution



Source: BofA Global Research, Haver Analytics

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1 Most Recent Quarterly Refunding Documents | U.S. Department of the Treasury

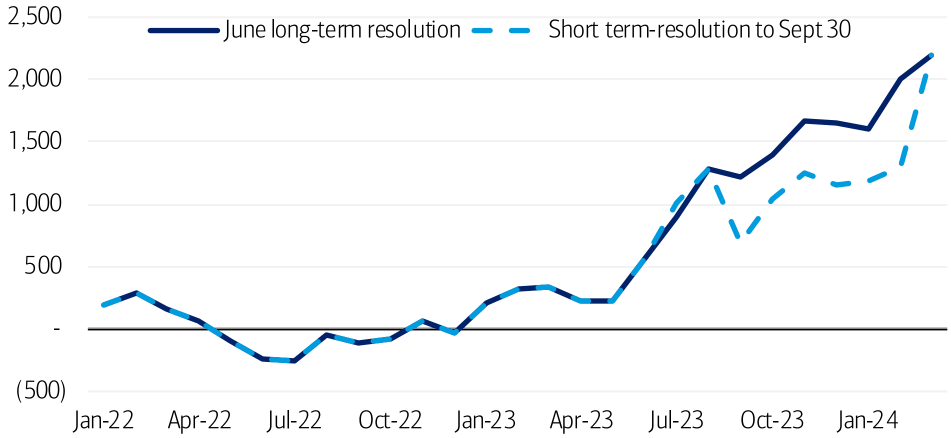
What if there is only a short-term debt limit extension?

Our read of current debt limit negotiations is that they favor a longer-term 2Y-ish suspension or $3tn-ish increase. It is possible that negotiators settle for a short-term increase, potentially through September 30th. A temporary debt limit push to Sept 30 means less bill supply through year-end.

To forecast bill supply based on this scenario, we assume a May 31 short-term resolution, TGA quickly ramping up to $500b over the summer, before falling back to ~$70b by Sept month-end to align with the assumed TGA level when the resolution was passed. Based on this, we see the X-date pushing back to Feb '24.

This temporary resolution would result in $530b lower bill supply than our base case over FY'23 (Exhibit 5). The lower relative bill supply forecast from Sept '23 - Feb '24 will likely result in less cheapening in bills vs OIS, a shallower drop in ON RRP, and less cheapening in broader money market rates. The larger bill market impact will be deferred until a larger debt limit increase is finalized.

Exhibit 5: Projected cumulative bill issuance in long-term and short-term resolutions ($bn)
We forecast that a short-term resolution results in $530b less bill supply in FY'23



Source: BofA Global Research, US Treasury

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Our comments below on expected tenor of bill issuance also apply in the event of a short-term debt limit increase.

Where will the supply be targeted? What bill tenors?

Bill supply over the past 1Y has averaged a 3.4m weighted average maturity. We expect the new bill supply will target a similar or shorter tenor. Treasury will likely target a relatively short tenor for its issuance so that it can tap into very strong money market fund (MMF) demand.

Treasury is aware of market demand and is willing to adjust issuance accordingly, especially in such a large supply surge. We suspect issuance will be targeted towards MMF demand & especially in tenors concentrated around 2 months.

We expect a sharp increase in Treasury cash management bills (CMBs) and 1-3m tenor weekly bill offerings. We do not provide specific estimates for CMB issues but strongly suspect they will be targeted towards MMF demand. Historically, we find that the largest change in bill auction sizes after a debt limit resolution have been concentrated in the 1 & 3m tenors (Exhibit 6).

Exhibit 6: Change in bill auction sizes by tenor before and after resolution ($bn)
Change is from the lowest amount in the weeks ahead of a resolution to the max in the weeks following

Bill tenor	1-month	2-month	3-month	6-month	12-month
Dec 2021	+40	+15	+3	-	-
Aug 2019	+20	+5	+9	+6	+2
Feb 2018	+50		+3	+3	+4
Sep 2017	+30		+3	+3	-
Nov 2015	+50		+10	+8	+4
Oct 2013	+25		+10	+5	+3
Aug 2011	+17		+2	+3	+5

Source: BofA Global Research, Bloomberg

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We suspect Treasury will be nimble in its bill issuance and shift auction sizes to tap into the strongest sources of demand. If Treasury finds that demand in the 6-12m tenor is soft, we suspect they will be willing to pull it forward to tap the latent MMF demand currently sitting at the Fed overnight reverse repo (ON RRP) facility.

Who will buy the bills?

There will be a wide range of bill buyers and we expect that the marginal source of demand will come from MMF. Recent Treasury bill allotment data suggests that investment funds remain the largest buyer, followed by dealers and foreigners (Exhibit 7). Individual investor auction take-down has increased but still comprise a relatively small portion of overall T-bill auctions.

Our base case is that the marginal source of bill demand will come from MMF currently invested at the Fed ON RRP. MMF will be willing to extend out the curve if they feel they are being adequately compensated for (1) risk around Fed policy path (2) term premium.

MMF have recently provided more specific guidance to us around the compensation they will require to extend out of ON RRP, which is conditioned on the Fed path. In an environment where the Fed is priced to be on hold and the MMF agree with this assessment, they will require a +5-10bps pickup to the expected Fed ON RRP path (aka fed funds OIS). In an environment where the MMF believe Fed hike risks are underpriced, they will require a +10-20bps pickup to the expected Fed ON RRP path. In essence, the MMF believe they need to pick at least 5-10bps vs OIS to extend out of ON RRP and this level of compensation increases if risks are to a more hawkish Fed path.

More detail below in the question on market pricing impact.

Exhibit 7: Avg auction allotment by investor and tenor over the last 6 months as a % of issuance
Dealers and investment funds are the largest investors in recent bill auctions

	SOMA	Depository institutions	Individuals	Dealers	Pensions	Investment funds	Foreign	Other
4-week	2%	0%	4%	43%	0%	34%	16%	0%
8-week	2%	0%	2%	53%	0%	41%	1%	0%
26-week	10%	0%	4%	53%	0%	21%	12%	0%

Source: BofA Global Research, US Treasury

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Where will the TGA drain come from: reserves or ON RRP?

The increase in the Treasury cash balance (TGA) represents a drain of liquidity from the financial system. Recall, the TGA is a liability on the Fed balance sheet. Assuming a stable Fed balance sheet, a TGA increase must drain liquidity from elsewhere. The most likely places for this drain are from reserves or ON RRP.

We strongly suspect the TGA rebuild will draw heavily from ON RRP. In our Fed balance sheet projections, we assume a 90/10 TGA drain distribution from ON RRP / reserves (Exhibit 13). Specifically, we think that 90% of the TGA drain will come from ON RRP. We acknowledge the 90/10 distribution implies a false sense of precision. However, we would be surprised if the TGA drain does not come 80-100% from ON RRP.

We also assume that ongoing quantitative tightening (QT) drain will come from ON RRP instead of reserves. We believe that MMF will continue to extend out the curve once the above-mentioned conditions for moving out of ON RRP are satisfied. We expect that front end Treasury paper will be cheap enough to justify this extension, which would mean that incremental QT will likely be mostly drawn from ON RRP vs reserves.

Our Fed balance sheet forecasts project an ON RRP decline this year of >$1tn (Exhibit 10). The decline assumes a $1.1tn decline from current levels with $1+tn still held at the facility by end '23. ON RRP will drop substantially with all the TGA rebuild but there will still be a very large amount left in ON RRP by end '23.

Clients have frequently asked why we are so confident in the TGA drain draw from ON RRP. Clients ask: why not from reserves? Our answer: (1) recent history (2) sensitivity of MMF behavior to bill rates around ON RRP.

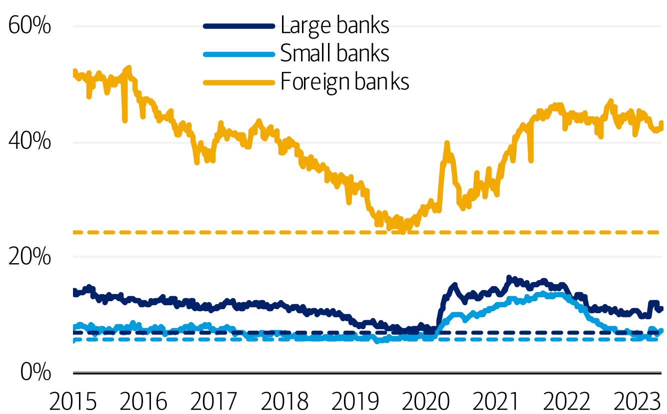
Recent history: in Jan '23 the US Treasury sharply increased their cash balance via bill supply after they employed a "debt issuance suspension period". In Jan, TGA increased $121b which included $241b of bill supply. The TGA increase of $121b was fully paid for by a $184b decline in ON RRP as reserves stayed flat. Our takeaway: TGA increase financed by bill supply and bill cheapening is likely to draw funds out of ON RRP.

Sensitivity of bill rates around ON RRP: the upcoming bill supply surge will likely see a material cheapening of bills vs ON RRP. From Mar '22 to Mar '23, 3m bills vs OIS traded 20bps rich. We expect they will likely trade 10 to 20bps cheap after the supply surge. We believe money market mutual funds will be more sensitive to this bill cheapening vs retail depositors. Retail depositors typically re-allocate out of bank deposits if the interest rate spread between deposits and money markets is several hundred basis points. Money funds are likely to cap the bill cheapening before retail materially shifts behavior.

We acknowledge there is uncertainty around this. We are confident in our view but recognize we could be wrong. If we are wrong and more cash comes out of reserves this would place additional strain on the banking system and it may drive reserve / liquidity scarcity at mid to large sized banks. We can see from Fed H8 data that small banks are already very close to their cash to asset ratio trough seen around the 2019 repo spike when the banking system faced reserve scarcity (Exhibit 8).

Exhibit 8: Bank cash to asset ratios vs 2019 trough

Small banks are very close to the 2019 trough around large repo spike



Source: BofA Global Research, Federal Reserve H.8; note: dashed line represents the cash / asset ratio across banks in Sept '19 when the banking system reached reserve scarcity

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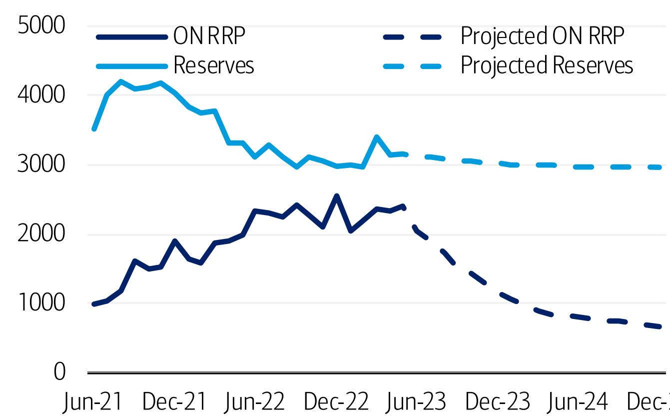
Exhibit 9: Projected ON RRP and Reserve balances ($bn)

We project ON RRP to absorb most of the TGA refill and QT drain



Source: BofA Global Research, Bloomberg

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Exhibit 10: Fed balance sheet projections ($bn)
We forecast ON RRP falling over $1tn from current levels to just above $1tn by year-end.

		Asset								Liabilities						
		UST	MBS	CMBS	Repo	Discount Window & PDCF	Fed Facilities	FX Swap Lines	Other	Currency	TGA	Foreign RRP	ON RRP	Other	Reserves	Total
	Apr-23	5266	2576	8	0	74	253	0	436	2324	296	359	2325	176	3132	8613
25% Reserves / 75% ON RRP from TGA & QT	May-23	5206	2551	8	0	5	301	0	437	2336	70	360	2405	177	3159	8508
10% reserve / 90% ON RRP drain from QT	Jun-23	5146	2525	8	0	5	291	0	438	2349	350	362	2055	178	3120	8413
	Jul-23	5086	2501	8	0	5	281	0	439	2362	400	363	1913	179	3104	8320
	Aug-23	5026	2474	8	0	5	271	0	440	2375	500	364	1723	180	3083	8224
	Sep-23	4966	2453	8	0	5	261	0	441	2387	600	365	1538	181	3062	8134
	Oct-23	4906	2431	8	0	5	251	0	442	2400	600	366	1442	182	3052	8043
	Nov-23	4846	2411	8	0	5	241	0	443	2413	650	368	1304	183	3036	7955
	Dec-23	4786	2392	8	0	5	231	0	444	2426	700	369	1166	184	3021	7866

Source: BofA Global Research, Bloomberg

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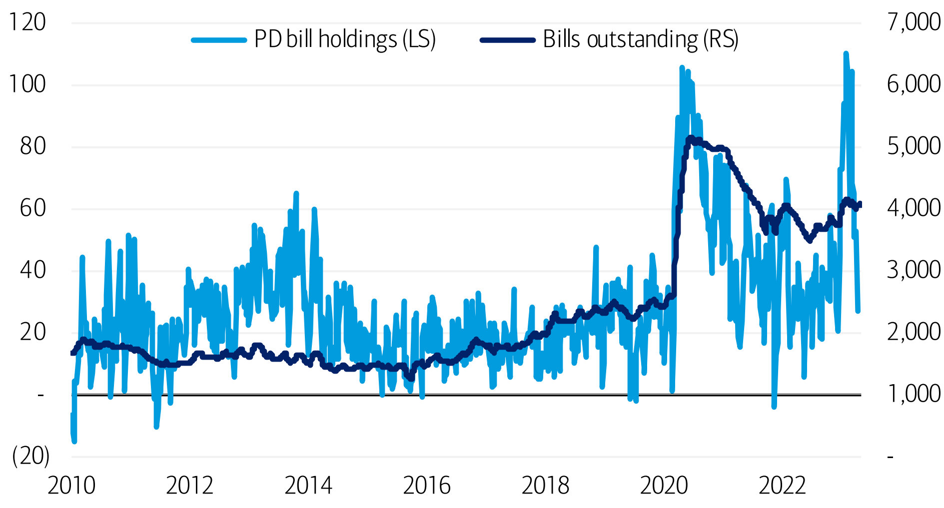
What is the market impact?

Essentially, the US government issuance surge will be crowding out other private funders at the US front end. Private funders can still get done but will need to raise their offering levels given the cheaper US government paper.

Dealer balance sheets will also be crowded out by the surge in Treasury supply. One of the core functions of US primary dealers is to underwrite US Treasury debt offerings. We suspect the dealer community will perform this responsibility admirably, but the dealer community is also likely to end up warehousing this supply until it can be moved to end investors. There has traditionally been a strong relationship between bill issuance and dealer bill holdings (Exhibit 11).

Exhibit 11: Primary dealer bill holdings and total UST bills outstanding ($bn)
PD bill holdings tracks bills outstanding closely



Source: BofA Global Research, Bloomberg

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As dealer balance sheets hold more UST supply, they will have less capacity to hold other securities. This should be clear in 2H '23 when dealers prepare their balance sheets for year-end. Increased UST holdings will likely make dealers less willing to hold other paper, which will lead to a modest deterioration in market functioning and higher overall "risk premium". This will especially be true in balance sheet intensive activities like cross currency basis. Market participants should anticipate a decline in market functioning from the UST supply surge and associated crowding out of dealer balance sheets.

Bill surge likely will be the seminal UST funding event in 2H '23. It would see: (1) material bill vs OIS cheapening, (2) higher dealer UST holdings => upward pressure on bi-lateral repo, (3) cheapening of money market rates, including CP / CD, (4) sharp drop in ON RRP use. We also expect increased USD funding pressure in XCCY basis due to higher CP / CD rates.

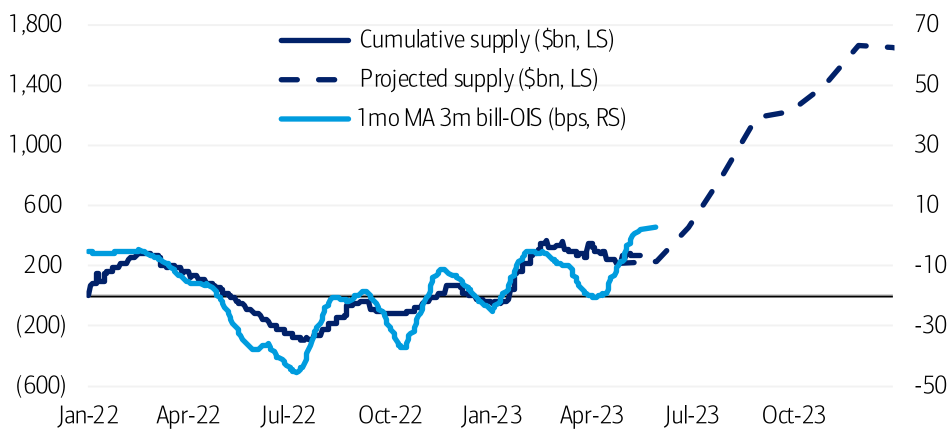
A similar bill supply surge was seen after the debt limit resolution in late '17 & early '18. During this period, bill supply increased $500b, 3m bills cheapened vs OIS by 20bps, SOFR + Fed funds shifted higher in the Fed's target range, and ON RRP use fell to near zero. The late '17 & early '18 period is a playbook for the large shift a debt limit supply surge can have on funding markets.

The large surge in bill supply may feel like an extra 25bp money market rate hike (or two). For most of '22, 3m bills-OIS was 20bps rich. Post DL bill supply, we expect 3m bills-OIS to trade 5-20bps cheap (this is the level required to encourage MMF investors to extend out of ON RRP). On net, this could be a 25-40bp money market increase. Some of this is likely already in the price of bills, but we doubt it is fully priced. Cheaper bill rates mean banks and other funders would have to pay up to retain funds.

Our analysis confirms the above-mentioned rule of thumb. We find that for every $100b of bill supply, 3m bills-OIS cheapens by ~5bps. A simple regression suggestion then suggest that the $1.4tn of bill supply by end '23 should see 3m bills-OIS near +70bps. We think this is extreme and will not be realized. MMF currently invested in Fed ON RRP will cap the extent of ON RRP cheapening. However, this regression speaks to the extent of cheapening pressure we anticipate on 3m bills-OIS.

Exhibit 12: Cumulative bill supply and 1mo moving avg of 3m bills vs OIS

Bills typically cheapen vs OIS with more bill supply



Source: BofA Global Research, Bloomberg, Treasury

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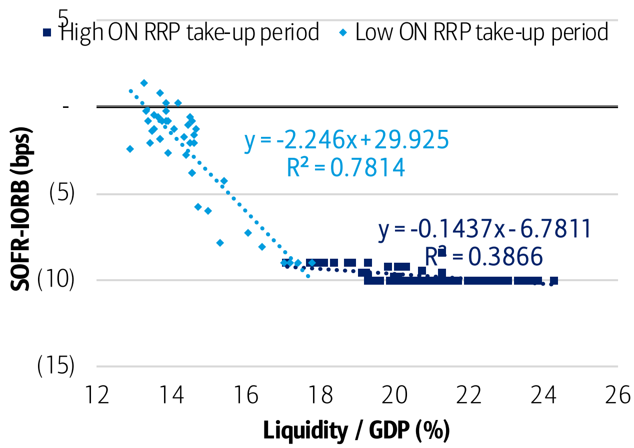
Despite a large wave of bill issuance, we project ON RRP take-up will remain elevated (>$500b) through CY'24, assuming QT ends in early '24 (our base case). We do not believe tri-party repo will likely lift notably off ON RRP until ON RRP has been sufficiently drained. As a result, SOFR is likely to move up slower than Fed funds (Exhibit 9, Exhibit 10, Exhibit 11). We discuss the impact on repo in more detail below.

Exhibit 13: SOFR-IORB spread vs Liquidity to GDP

We expect SOFR to remain close to ON RRP while ON RRP take-up is elevated



Source: BofA Global Research, Bloomberg, FRBNY

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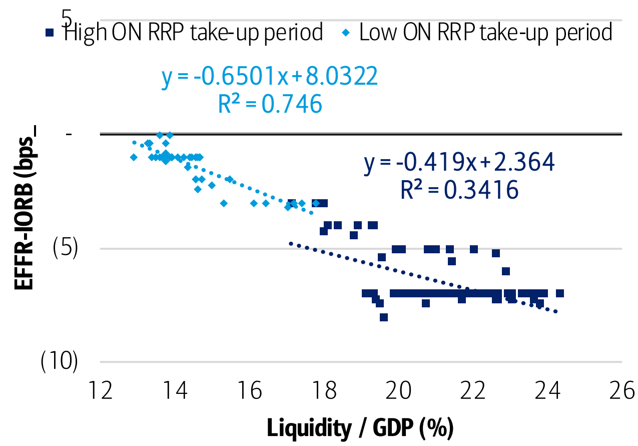
Exhibit 14: EFFR-IORB spread vs Liquidity to GDP

EFFR is likely to pick up faster than SOFR



Source: BofA Global Research, Bloomberg, FRBNY

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Exhibit 15: FF-SOFR projections under low and high ON RRP take-up scenarios (bps)

We project ON RRP will remain above $500b through the forecast window, so we focus on the "high ON RRP take-up" scenario

	Low ON RRP take-up			High ON RRP take-up		
Date	**SOFR-IORB**	**EFFR-IORB**	**FF-SOFR**	**SOFR-IORB**	**EFFR-IORB**	**FF-SOFR**
Dec-2022	-16	-5	11	-10	-6	4
Mar-2023	-18	-6	12	-9	-6	3
Jun-2023	-14	-5	9	-10	-6	4
Sep-2023	-9	-3	6	-9	-5	4
Dec-2023	-5	-2	3	-9	-4	5
Mar-2024	-1	-1	0	-8	-3	5
Jun-2024	-1	-1	0	-8	-3	5
Sep-2024	0	-1	-1	-8	-3	5
Dec-2024	1	0	-1	-8	-3	5

Source: BofA Global Research, Bloomberg, FRBNY

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What is the repo impact? How much will SOFR move?

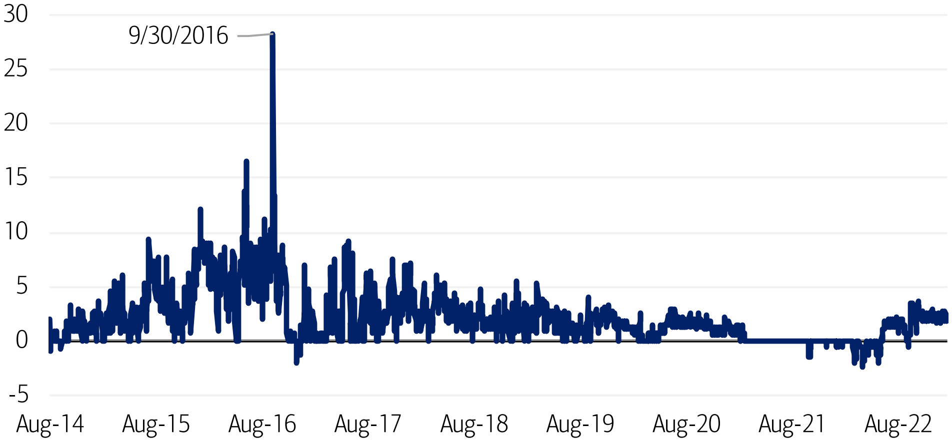
We expect a relatively limited impact in overnight SOFR but a more meaningful impact in term repo. Thoughts on each:

Overnight repo: we expect that overnight SOFR may only rise 2-5bps with the Treasury supply surge. Recall, SOFR is an amalgam of 3 different parts of the repo market: (1) tri-party repo, i.e. MMF lend to dealers (2) inter-dealer, i.e. dealers lend to dealers (3) bi-lateral, i.e. dealers lend to hedge funds. Tri-party and bi-lateral components dominate the SOFR composition; tri-party = 40% of SOFR, bi-lateral = 60% of SOFR (inter-dealer is currently <1%). For more detail see our Repo primer.

We expect that SOFR will only move marginally because the tri-party rate will remain very well anchored. The tri-party rate likely will remain very well anchored because we expect there will still be $1tn+ in Fed ON RRP by year end '23 (Exhibit 10). As long as MMF have elevated balances invested with the Fed, we suspect dealers can fund at tri-party rates equal to or below the Fed ON RRP rate.

Any increase in SOFR would need to come from a widening of the bi-lateral to tri-party repo spread. Historically, this spread has been remarkably stable even in period of repo market stress like September 2019 (Exhibit 16). The spread has historically averaged 2.1bps; the avg spread widened to 5.9bps in 2016 & was 2.3bps throughout the prior QT episode from 2017-2019. The material widening in this spread during 2016 was due to funding stresses following money market mutual fund reform and Brexit vote.

Exhibit 16: Bilateral – tri-party repo rate spread (bp)
Bilateral- - tri-party repo rate spread is 2.1bps on average



Source: BofA Global Research, FRBNY

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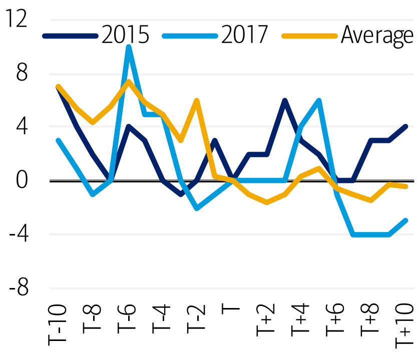
On net, we expect that tri-party repo will remain stable at ON RRP and that SOFR will be dragged modestly higher by the bi-lateral repo rate. Even if the tri-party to bi-lateral repo spread reaches the 90th percentile of historical observations (back to 2014) of 5bps, we would not expect SOFR to rise more than 3bps off ON RRP. Tri-party should help keep overnight SOFR well anchored.

The expected anchoring of overnight SOFR continues suggests to us that the SOFR/FF spread tightening priced by the market is too much. We continue to recommend clients position in Nov '23 SOFR/FF spread wideners (for detail see: [SOFR/FF basis: biased wider]).

Term repo: Term repo rates will likely rise more than overnight rates. We expect term repo rates to move in-line with bills rates. This means that 3m term repo rates could cheapen to OIS+20bps as bill rates sell off.

Exhibit 17: Change in SOFR vs DL resolution date (bps)
We expect SOFR to be anchored to ON RRP



Source: FRBNY. Avg includes '15, '17, '18, '19, & '21

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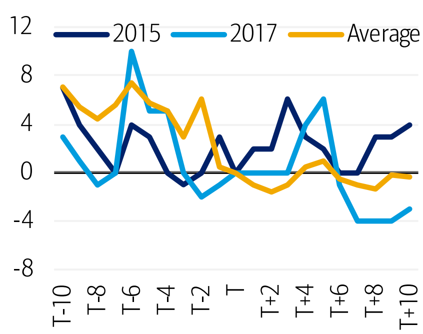
Exhibit 18: Change in tri-party repo vs DL resolution date (bps)
Tri-party will likely see minimal upward pressure post DL resolution



Source: FRBNY. Avg includes '15, '17, '18, '19, & '21

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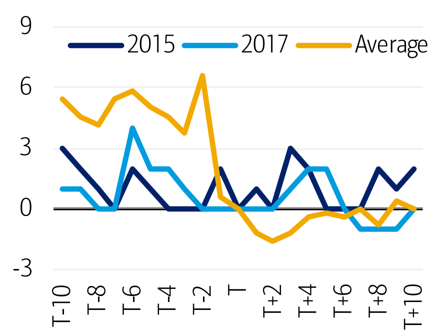
Exhibit 19: Change in bilateral repo vs DL resolution date (bps)
Bilateral repo could move up more than tri-party but spread remains around 2.5bp on avg



Source: FRBNY. Avg includes '15, '17, '18, '19, & '21

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Does the Fed know? Will the Fed care?

Yes, the Fed knows about the impending bill supply surge. Yes, we think they will care. However, we think they will only care marginally.

We are confident the Fed is aware of the impending bill supply surge. We don't know this with certainty, but Fed officials are very close to the Treasury quarterly refunding process and should be aware of TBAC financing estimates. We are confident the Fed is aware of the supply surge from their proximity to the refunding and TBAC.

We expect the Fed sees the impending supply surge and associated market impact like it is QT deferred. The Fed's QT program has been neutralized to a large extent by the TGA drawdown because of debt limit dynamics. The Treasury market impact of Fed QT would have been much clearer if not for the TGA decline. The TGA increase post debt limit represents a QT "catch up"; the Fed knows this and won't offset it. This is a part of the financial condition tightening expected with QT.

A UST supply surge and associated increase in money market rates would incentivize the Fed to remain on hold, all else equal. Our US economics team expects the Fed to respond to incoming economic information and will be cognizant of any sharp financial condition tightening. If incoming US economic data is mixed, a UST supply surge would encourage the Fed to stand pat. However, strong inflation and employment data would trump the UST supply surge impact on financial conditions. In sum, the UST supply surge is likely to be only a marginal consideration in the overall Fed policy stance.

Bottom line: after the debt limit is resolved, we expect to see a large Treasury bill supply surge. This surge is due to TGA rebuild and deficit financing needs. It would result a cheapening of money market rates and crowding out of dealer balance sheets; the total amount of bill rate cheapening will likely be between 25-40bps, similar to a money market rate hike (or two). The Fed is likely aware of the impending UST bill supply surge and won't offset it. The supply surge and financing condition tightening is a marginal consideration for the Fed to hold rates in June but could easily be outweighed by macro data.

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