

US Rates Watch

Funding notes: bill supply, demand buffer, & MMF shifts in supply surges

The Treasury supply surge is now imminent as discussed in detail in: [Bill supply surge FAQ](#) &: [Bills on parade](#). In this note we elaborate on topics not fully addressed in prior publications and some of the client questions we have recently received.

Timing, tenor, & size of bill supply surge

We expect Treasury to announce a wave of bill supply as soon the debt limit bill passes the Senate. Treasury has already announced tentative plans to upsize next week's 3m bill sizes to \$65b from \$63b and the 6m bill size from \$56 to \$58b, conditional on a debt limit resolution. We expect a number of bill CMB auctions on Monday or Tuesday next week, with some potentially settling on the same day. Treasury will need new cash in the door on Monday & this should see unusual & urgent auctions + settlements of new short-dated issuance. Treasury already highlighted in a special announcement this week that "several CMBs will be necessary in coming days".

We continue to believe the overall tenor of the bill supply surge will be relatively short to target MMF demand. The recent weighted average maturity of bill issuance was 3.5 months. We expect Treasury to shorten this WAM somewhat to target money fund demand. Our best guess is that WAM of the upcoming bill supply surge will be in the 2-3m tenor or around 2.5m. Treasury will increase bill sizes across the curve with the shortest tenors seeing the largest increase.

Bill demand buffer may be thin outside of MMF

Clients have also asked: "how much additional demand exists for bills from non-money fund demand." This is a difficult question to estimate but our short answer is: not much.

To estimate incremental additional non-money fund bill demand we considered potential demand from corporates & state + local governments. Our findings suggest these potential demand pools are not sitting on many "excess deposits" in relation to their pre-COVID levels, according to Fed Flow of Funds data.

Specifically, we looked at non-financial corporate & state + local government deposits to total financial assets. Deposits vs total assets for non-financial corporates are little changed from 2019 (at 6.9%), while the ratio for state & local governments has declined (23% in '19 vs 16% as of end '22). This implies that these potential demand sources are not sitting on large scale excess deposits that could be easily shifted to bills. Additionally, these investor types are already sitting on higher UST to total asset holdings vs 2019 (Exhibit 1).

The limited number of deposits to financial assets suggest that corporates & local governments are unlikely to materially buffer the UST bill supply surge. This analysis also reinforces our view that the marginal demand source for the bill supply surge will be money market mutual funds, especially those funds sitting with cash parked at ON RRP.

02 June 2023

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Tsy: Treasury

MMF: Money market fund

CMB: Cash Management Bill

WAM: weighted average maturity

UST: US Treasury

ON RRP: overnight reverse repo facility

CP: commercial paper

CD: certificates of deposit

TGA: Treasury General Account

OIS: Overnight Index Swap

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Timestamp: 02 June 2023 05:45AM EDT

MMF behavior around bill supply wave

We have long been arguing that MMFs will likely shift their holdings from ON RRP to Treasury debt as this bill supply wave emerges and bills cheapen. This should also mean some extension of MMF WAM, despite continued uncertainty around Fed hikes. In talking to MMFs, they do not disagree with our assessment, but we do see some divergence from historical trends.

Historically, when looking at the 2018 debt limit resolution, Treasury issued \$641b in bills between Sept '17 and Nov '18. At the same time, ON RRP take-up declined \$250b-\$300b. During that period, 1m bills vs OIS cheapened from a trough of -41bps in Q3'17 to a peak of 9bps in Q1'18, for a 50bp swing. Similarly, 3m bills cheapened 30bps over roughly the same period.

In response to the bill issuance, Gov't MMFs increased their Treasury holdings by \$150bn between Sep '17 and Nov '18 month-ends (Exhibit 2), while their Treasury repo declined \$19b. At the same time, Gov't funds saw \$103b in inflows, primarily into retail. During the period, Gov't fund WAMs peaked on month-end March '18 at 33.98 days, growing 3.63 days from the Dec '17 trough. Gov't fund WALs peaked at 84.1 days around April '18 month-end, extending from a trough of 77.3 days in Dec '17.

Prime fund AUM grew \$128b over the period, primarily shifting their holdings out of Treasury repo & non-negotiable TD and into financial CP, CD, and agency repo (Exhibit 3). Prime fund WAMs actually peaked around the trough in the TGA and shorted by 2.3 days over the '18 bill supply period.

Overall, there was not a significant extension in MMF WAM over the period of bill supply growth in '18. Gov't MMFs are still likely to take down a lot of the upcoming bill supply if bills cheapen sufficiently, while reducing their allocation to Treasury repo.

Bottom line: With the upcoming passage of the debt limit in the Senate the Treasury supply surge is imminent. The timing of the supply is upcoming and we expect it to be reasonably aggressive and fast. We do not think there is much of a buffer from Treasury bill demand between the supply surge and the money funds and most of the money will be coming out of ON RRP. MMFs are likely to allocate more holdings into Treasury debt and out of Treasury repo, based on prior debt limit rebuild episodes.

Exhibit 1: Nonfinancial corporate and State & Local Gov't assets (

Non-financial corps and S&L gov'ts are sitting on larger treasury holdings than in '19

		Total Deposits	Total Treasuries	Total Assets	Deposits / Assets	Treasuries / Assets
Nonfinancial	Q4 2019	1,510	64	48,436	3.1%	0.1%
Corporates	Q4 2022	1,844	118	56,977	3.2%	0.2%
State & Local	Q4 2019	562	715	15,512	3.6%	4.6%
Gov't	Q4 2022	731	1,449	20,436	3.6%	7.1%

Source: BofA Global Research, Federal Reserve Z1

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Exhibit 2: Domestic MMF holdings, government funds (\$bn)

Gov't fund AUM increased in November, primarily allocating to repo

	Government		Government Institutional		Government Retail	
	Nov-18	Chg Sep 17	Nov-18	Chg Sep 17	Nov-18	Chg Sep 17
Cash	20.2	(13)	14.8	(9)	5.4	(3)
Treasury Debt	784.5	150	440.5	100	344.0	50
Treasury Repo	565.9	(19)	219.3	(64)	346.7	46
Govt Agency Debt	600.9	(47)	399.9	(17)	201.0	(30)
Govt Agency Repo	307.5	29	241.0	26	66.5	3
Other Repo	1.2	1	1.2	1	0.0	0
Investment Co Funding Agrmnt	3.0	1	2.7	1	0.3	(0)
VRDN	0.2	(1)	0.1	(0)	0.1	(0)
Other Instrument	2.3	2	0.6	0	1.7	2
Total	2286	103	1320	38	966	66

Source: BofA Global Research, iMoneyNet Analyzer

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Exhibit 3: Domestic MMF holdings, prime funds (\$bn)

Prime MMF AUM increased in November drawing primarily from UST repo

	Prime		Prime Institutional		Prime Retail	
	Nov-18	Chg Sep 17	Nov-18	Chg Sep 17	Nov-18	Chg Sep 17
Cash	1.0	(1)	1.0	(0)	0.1	(0)
Treasury Debt	63.1	11	4.5	4	58.6	8
Treasury Repo	26.3	(5)	12.9	12	13.4	(17)
Govt Agency Debt	4.4	(0)	0.0	(0)	4.4	(0)
Govt Agency Repo	36.5	30	18.8	17	17.7	13
Other Repo	40.5	14	27.3	11	13.2	3
CD	207.3	32	69.0	6	138.3	27
Financial Co CP	162.2	49	50.3	15	111.9	34
ABCP	50.2	13	23.8	7	26.4	6
Other CP	28.9	10	4.4	(2)	24.6	12
Non-Negotiable TD	48.1	(20)	32.2	(17)	15.9	(4)
VRDN	6.1	(1)	2.4	1	3.6	(1)
Other	9.8	(4)	0.0	0	0.0	0
Total	685	128	250	51	435	77

Source: BofA Global Research, iMoneyNet Analyzer

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