US Rates Watch

Bill surge update: issuance to remain substantial

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UST = Treasury

QT= quantitative tightening

TBAC= Treasury Borrowing Advisory Committee

FY= fiscal year

WAM= weighted average maturity

August refunding: coupon sizes higher, bills still growing

Treasury coupon auction sizes surprised to the upside & will continue growing; despite the higher coupons we still forecast bill supply growing $815b through year end. We are now forecasting $1.89tn in net bills to the public for CY'23 with $371b in Aug, $43b in Sept, and $402b for Q4'23 (Exhibit 1, Exhibit 2). For more detail, see August refunding.

In CY '24, we are only forecasting $184bn as coupon auction sizes grow through April '24. We had previously forecasted roughly $70b less bill supply in CY'23 but over $300b more in CY '24. The reason for this adjustment was driven by UST's projection for higher financing needs due to (1) higher deficit and (2) higher TGA forecast as well as coupon auction sizes ramping up. The higher deficit and TGA means UST needs to borrow more via marketable debt but coupon issuance takes time to ramp up, therefore UST will need to ramp up bill issuance until coupon supply can meet the remaining financing need.

Our forecasts for the next two quarters are conservative relative to TBAC's recommendation (Exhibit 3) largely because TBAC recommended lower coupon auction sizes vs what Treasury has decided to issue.

Bill supply >20% of marketable debt through FY '24

We forecast bill supply to exceed the 20% upper bound on bills as a share of marketable debt now in FY '23 and peak in FY '24 (Exhibit 4). The increase in bills as a share of marketable debt is a result of the higher financing need due to a growing deficit and higher TGA forecast. Despite coupon auction sizes growing, due to higher financing needs and TGA forecast, Treasury will need to issue more bills until coupon issuance has time to ramp up. The higher bill supply as a % of marketable debt creates more scope for UST to increase coupon auction sizes higher near term. However, bills dip below 20% again by the end of FY '25, making us comfortable penciling in this temporary breach.

Bill takedown absorbed by money funds

Treasury has issued $1.14tn YTD, including $745b since the debt limit resolution in June. The large wave of supply over a short period of time has been well absorbed by money market funds (MMFs) which has so far limited the scope for material cheapening (Exhibit 5). Money funds have absorbed two thirds of all the bills issued post debt limit.

This may also mean Treasury is comfortable with a temporary bill supply overshoot. Going forward, as Treasury continues to issue debt, we expect MMFs to continue to take-down bills given they still have over $1.77tn in excess cash at the ON RRP.

Primary dealer holdings of Treasury bills also increased significantly post debt limit resolution though holdings have recently trended downward (Exhibit 6). When primary dealers hold more Treasuries on their balance sheet, it crowds out other securities and their market intermediation capacity. This typically leads to upward pressure on front-end rates, including repo.

Rate impact: likely cheaper over time

Treasury bill richness peaked in March of '23 post bank stress but cheapened leading up to the debt limit as investors tried to keep away from potentially impacted bills. Post debt limit, despite $725b in bill issuance, 3m bills are only 2bp cheap to OIS (Exhibit 5). We had expected this large wave of bill supply would need 3m bill to trade 5-20bp cheap vs OIS to encourage MMFs to extend out of ON RRP. MMF have settled for less.

The extent of bill cheapening has been capped due to paydowns of FHLB debt and willingness of MMFs to extend. We expect cheapening will continue but at a limited pace with more bill supply. We still suspect 3m bills-OIS will likely move to 5bps cheap as the additional supply builds.

Bottom line: bill supply will remain substantial in coming months even with higher coupon sizes. We expect $371b bills in Aug, $43b in Sept, & $402b in Q4 '23. This supply will likely place modest cheapening pressure on bills over coming months but recent MMF willingness to take down the supply will likely result in much less cheapening than we envisioned prior to debt limit resolution & bill supply surge.

Exhibit 1: Bill and coupon issuance estimates by month

Marketable borrowing needs are growing to meet higher financing need and TGA projections

	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 = 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	316	49	-267	49	0	43	6	60	0	103	6
Jun-23	212	402	353	565	0	77	488	48	12	125	500
Jul-23	148	502	100	248	0	-56	304	50	10	-6	314
Aug-23	403	500	-2	401	0	30	371	60	0	90	371
Sep-23	-30	650	150	121	0	98	22	39	21	137	43
Oct-23	200	650	0	200	0	33	167	52	8	85	175
Nov-23	257	700	50	307	0	49	258	60	0	109	258
Dec-23	30	750	50	80	0	125	-45	46	14	171	-31
Jan-24	-64	750	0	-64	0	4	-68	52	8	56	-60
Feb-24	446	750	0	446	10	61	385	60	0	121	385
Mar-24	301	750	0	301	10	132	169	45	15	176	185
Apr-24	-356	750	0	-356	10	35	-391	60	0	95	-391
May-24	252	750	0	252	10	82	170	60	0	142	170
Jun-24	51	750	0	51	10	145	-94	36	24	181	-70
Jul-24	218	750	0	218	10	77	141	0	0	77	141
Aug-24	301	750	0	301	10	120	181	0	0	120	181
Sep-24	-145	750	0	-145	10	176	-321	0	0	176	-321
Oct-24	223	750	0	223	10	190	33	0	0	190	33
Nov-24	287	750	0	287	10	171	116	0	0	171	116
Dec-24	37	750	0	37	10	223	-186	0	0	223	-186

Source: BofA Global Research, US Treasury, Federal Reserve

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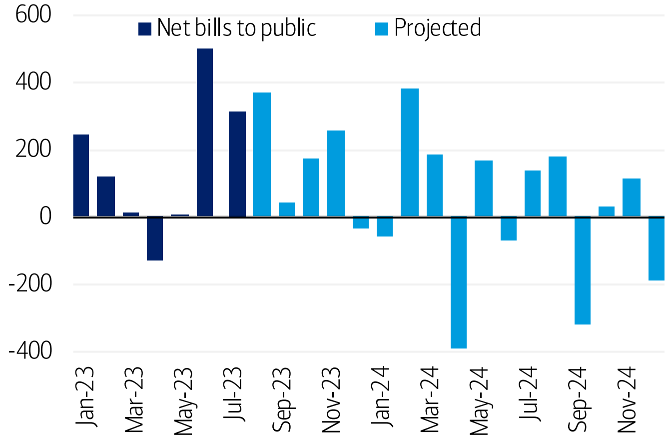
Exhibit 2: Monthly net bill issuance and projections ($bn)

We forecast $728b in bill issuance in Q3 2023, $402bn in Q4 2023



Source: BofA Global Research, US Treasury

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Exhibit 3: BofA bill forecast vs TBAC recommended ($bn)

Our T-bill forecast is below TBAC recommended net bill issuance over the next 2 quarters

	Q3'23	Q4'23	Total
BofA Bill forecast	728	402	1129
TBAC recommended bill issuance	829	513	1342
Difference	-101	-112	-213

Source: BofA Global Research, US Treasury

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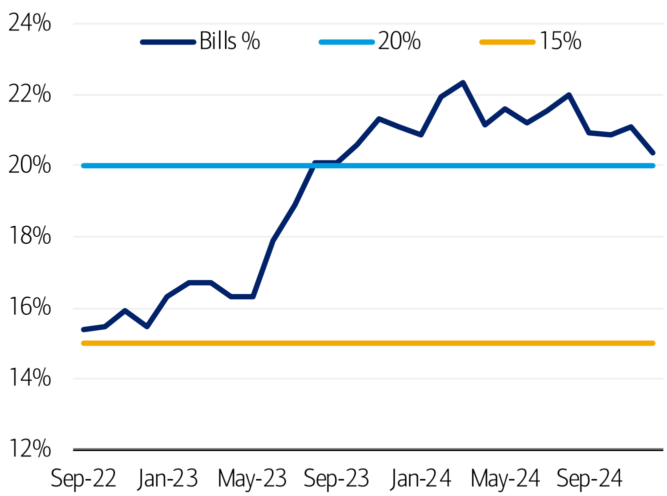
Exhibit 4: Bills as a % of marketable debt

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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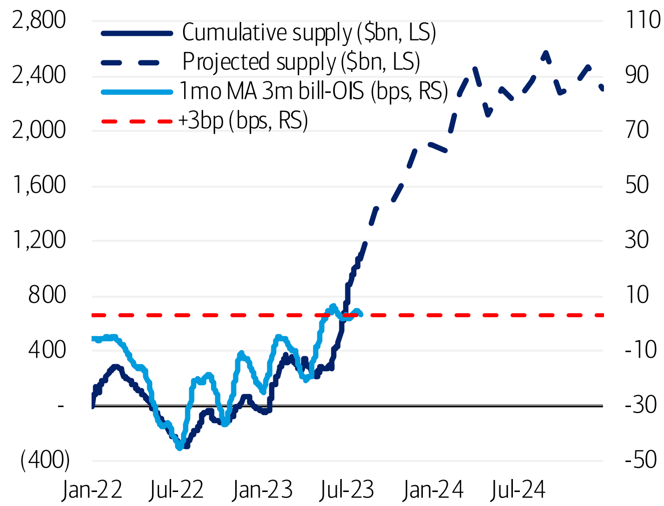
Exhibit 5: Projected bill supply vs 1mo moving avg of 3m bill-OIS

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



Source: BofA Global Research, Treasury

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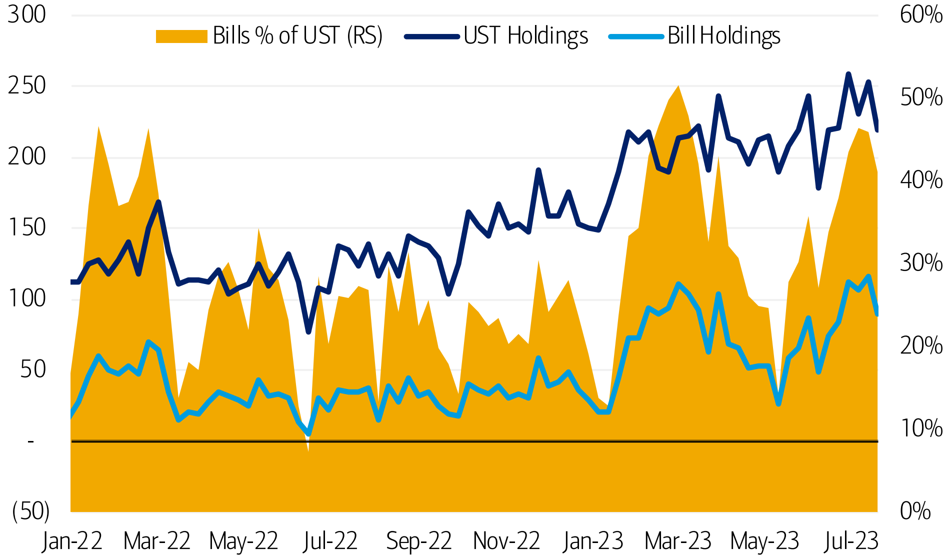
Exhibit 6: Primary dealer Treasury holdings ($bn)

PD bill holdings are currently 41% of total PD Treasury holdings, down from a recent peak of 46%



Source: BofA Global Research, Bloomberg

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