

Nominal auction sizes unchanged, adjustment to TIPS

Nominals unchanged, TIPS adjusted

We continue to project a US fiscal deficit of \$995bn in FY '19 and look for net coupon & bill supply of \$827bn & \$248bn, respectively (Table 1). At the Feb refunding (on Jan 30) we believe Treasury will leave nominal coupon sizes unchanged but boost TIPS (Table 2). We expect:

- **Nominals & 2y FRN:** auction sizes unchanged
- **5y TIPS:** new October issue, auction sizes unchanged
- **10y & 30y TIPS:** one-time \$2bn increase to auction sizes

Treasury confirmed the new October 5y TIPS issue at the [November refunding](#). With this schedule, total TIPS issuance increases by \$25bn over the calendar year, in the middle of Treasury's guidance of \$20-30bn. We note risks to higher TIPS auction sizes given TBAC's recommendation that TIPS remain "around 7 percent of gross issuance." Based on our forecasts TIPS issuance hovers at around 6% of gross issuance in 2019 (Chart 1).

Tsy will likely also address the [debt limit](#) (DL) in the refunding statement. We expect a ~\$150bn bill supply boost after the Mar 1 DL suspension date and another large increase of bill issuance to rebuild Tsy's cash balance after DL resolution (Chart 2).

SOFR floaters likely in the works but benefits marginal

At the Nov refunding TBAC suggested Treasury begin study of SOFR linked issuance and the Treasury recently asked primary dealers for their thoughts on SOFR floaters. We expect Treasury to study and eventually issue SOFR FRNs, gradually shifting away from T-bill FRNs. However, we believe benefits of doing so only marginally outweigh costs.

Benefits: (1) support wider utilization of SOFR benchmark to facilitate LIBOR transition (2) provide a better match for gov't MMF de-facto benchmark of GC repo, esp since funds & MMF are the largest owners of UST & SOFR FRNs (Table 3, Table 4, Chart 3)

Costs: (1) cannibalization of existing demand for T-bill FRNs (2) potentially higher interest costs given lower 3m bill volatility & richer 3m bill levels vs OIS (Chart 4).

UST SOFR floaters offer an important "social benefit" by facilitating adoption of the repo index but we doubt they will allow for much, if any, Tsy interest cost savings over time. Government MMF may be willing to accept a marginally lower discount margin to gain exposure to SOFR but this will likely be offset by higher SOFR vs 3m bill values. The full history of SOFR since Aug '14 has averaged 0.6 bps higher vs 3m T-bills though the spread varies depending on where the Fed is in their rate cycle (SOFR > 3m bill when Fed on hold or cutting, SOFR < 3m bill when Fed hiking) (Chart 5).

Treasury will likely only commit to issuing FRNs referencing SOFR or bills, not both, as investors may shun SOFR FRNs in a hiking cycle & bill FRNs amidst cuts. Given the end '21 LIBOR transition we expect Tsy to gradually roll out SOFR FRNs starting towards end '19 / early '20 and, if successful, fully replace maturing bill FRNs with SOFR ones.

Note there is no MMF WAM benefit from owing a daily reset SOFR FRN b/c bill FRNs technically have 1 day WAMs (Tsy can reopen bills any time). 2Y UST SOFR floaters will likely price at SOFR +7-11 bps based on GSE issuance and bill to DN spread.

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Rates Research
United States

US Rates Research
MLI (UK)
+1 646 855 8846

Mark Cabana, CFA
Rates Strategist
MLPF&S
+1 646 855 9591
mark.cabana@baml.com

Olivia Lima
Rates Strategist
MLPF&S
+1 646 855 8742
olivia.lima@baml.com

SOFR-Secured Overnight Financing
Rate

DN-Discount Note

WAM-Weighted Average Maturity

Table 1: US Treasury financing estimates by fiscal year (\$bn)

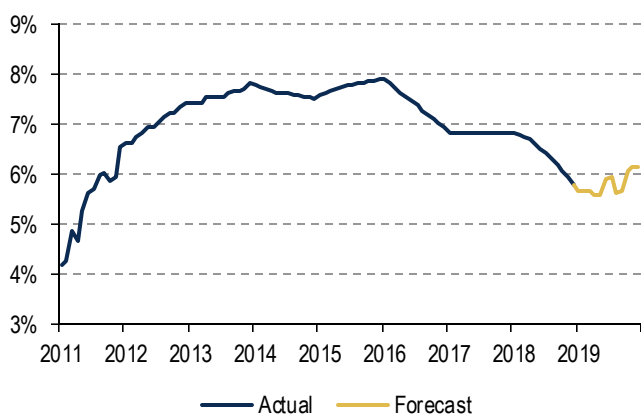
	2019	2020 Base	2020 Alt
1 Deficit	995	1,050	1,050
2 Fed rolloff	284	55	221
3 Change in cash balance	20	20	20
4 Other, mostly federal student loan financing	60	65	65
5 Total financing need (1+2+3+4)	1,359	1,190	1,356
6 Amount maturing (excluding Fed holdings)	1,559	1,794	1,794
7 Financing need + rollover (5+6)	2,918	2,984	3,150
8 Gross coupon issuance, current forecast	2,670	2,698	2,698
9 Bill supply need (7-8)	248	286	452
Memo:			
10 Net Coupon supply (8-6-2)	827	849	683
11 Net Bill Supply	248	286	452
12 Net Supply (10+11)	1,075	1,135	1,135
13 Bills as % of net supply (11/12)	23%	25%	40%

Source: Note: '20 baseline has Fed unwind end at end '19, alt '20 assumes unwind goes for full year;
source: BofA Merrill Lynch Global Research, US Treasury

Table 2: Expected increase in coupon auction sizes by month (\$bn)

	Expected Auction Size										Gross	Net
	2y	3y	5y	7y	10y	30y	5y II	10y II	30y II	2y FRN		
Jan-18	26	24	34	28	20	12		13		15	172	15
Feb-18	28	26	35	29	24	16			7	15	180	53
Mar-18	30	28	35	29	21	13		11		15	182	80
Apr-18	32	30	35	29	21	13	16			17	193	-11
May-18	33	31	36	30	25	17		11		16	199	72
Jun-18	34	32	36	30	22	14			5	16	189	82
Jul-18	35	33	36	30	22	14		13		18	201	31
Aug-18	36	34	37	31	26	18	14			17	213	79
Sep-18	37	35	38	31	23	15		11		17	207	91
Oct-18	38	36	39	31	23	15			5	19	206	47
Nov-18	39	37	40	32	27	19		11		18	223	69
Dec-18	40	38	41	32	24	16	14			18	223	105
Jan-19	40	38	41	32	24	16		13		20	224	47
Feb-19	40	38	41	32	27	19			9	18	224	58
Mar-19	40	38	41	32	24	16		13		18	222	104
Apr-19	40	38	41	32	24	16	16			20	227	10
May-19	40	38	41	32	27	19		13		18	228	70
Jun-19	40	38	41	32	24	16	14			18	223	106
Jul-19	40	38	41	32	24	16		15		20	226	47
Aug-19	40	38	41	32	27	19			7	18	222	58
Sep-19	40	38	41	32	24	16		13		18	222	105
Oct-19	40	38	41	32	24	16	16			20	227	71
Nov-19	40	38	41	32	27	19		13		18	228	54
Dec-19	40	38	41	32	24	16	14			18	223	106

Source: BofA Merrill Lynch Global Research, US Treasury

Chart 1: TIPS issuance still falling below recommended level


Note: shows gross TIPS issuance as percent of gross issuance of 2-30y nominals and 2y FRNs.
Source: BofA Merrill Lynch Global Research, Bloomberg

Chart 2: Bill supply to fluctuate due to debt limit (\$bn)


Source: BofA Merrill Lynch Global Research, Bloomberg

Table 3: SOFR linked debt issuance

	No. Issues	Total Issuance (\$bn)	MMF Holdings (\$bn, Dec30)
FHLB	8	15.9	10.3
Fannie Mae	6	11.0	8.6
Freddie Mac	7	6.4	2.4
Credit Suisse	9	3.6	0.3
MetLife	3	1.5	0.0
Other	13	7.8	1.0
TOTAL	46	46.1	22.6

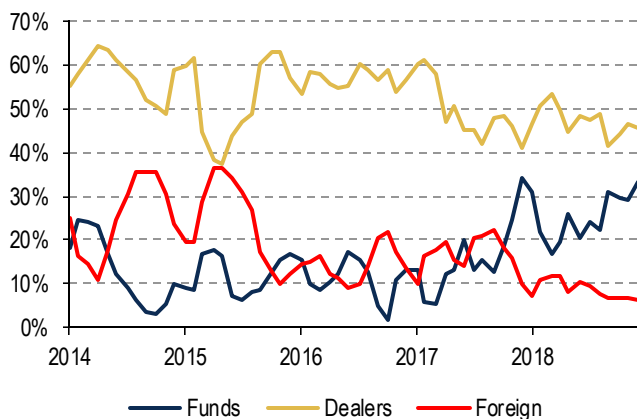
Source: BofA Merrill Lynch Global Research, Bloomberg, Crane Data

Table 4: MMF holdings of floating debt

	Total Outstanding	MMF Holdings (Dec30)	Ratio
UST FRNs	384	199	52%
SOFR FRNs	44	23	51%

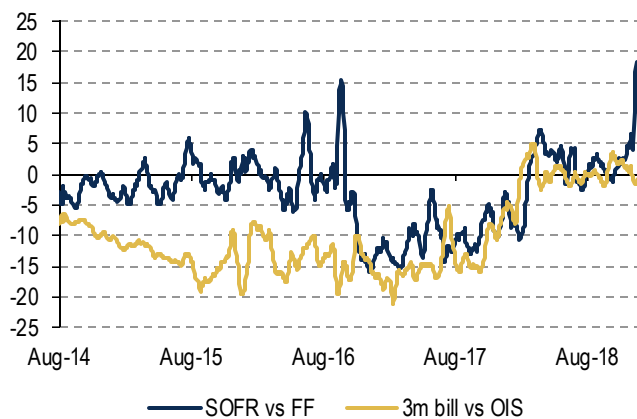
Source: BofA Merrill Lynch Global Research, Bloomberg, Crane Data

Chart 3: FRN auction allotments shows growing investment fund take down



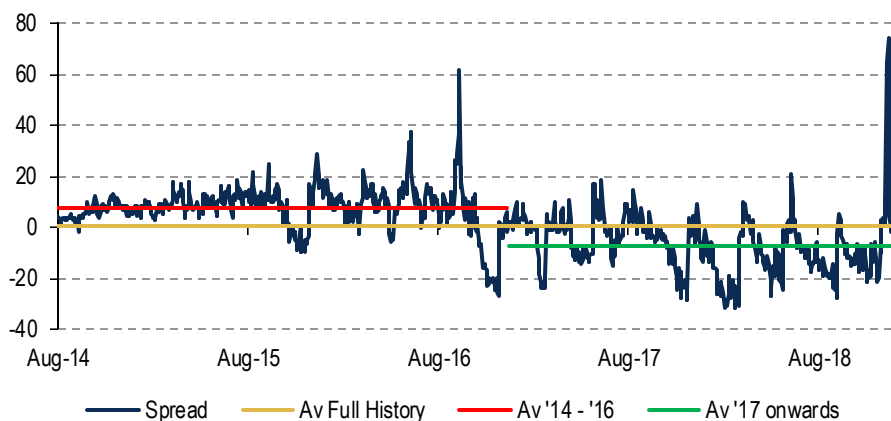
Note: 3m MA; source: BofA Merrill Lynch Global Research, US Treasury

Chart 4: 3m bill to OIS has historically traded lower vs SOFR to FF implying more negative term premium (bps)



Source: BofA Merrill Lynch Global Research, Bloomberg

Chart 5: SOFR less 3m bill spread positive when Fed on hold, negative when Fed is hiking (bps)



Source: BofA Merrill Lynch Global Research, Bloomberg

Table 5: Monthly SOMA reinvestment

	3y	10y	30y	Total Mid Month	2y	5y	7y	5Y II	10Y II	30Y II	2Y FRN	Total End Month
Jan-19	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Feb-19	9.2	6.5	4.6	20.2	1.9	2.0	1.5	0.0	0.0	0.4	0.0	5.8
Mar-19	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Apr-19	0.0	0.0	0.0	0.0	0.5	0.5	0.4	0.2	0.0	0.0	0.3	1.9
May-19	8.5	6.0	4.2	18.8	2.7	2.8	2.2	0.0	0.9	0.0	1.2	9.8
Jun-19	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Jul-19	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Aug-19	14.1	10.0	7.0	31.1	3.0	3.0	2.4	0.0	0.0	0.0	0.0	8.3
Sep-19	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Oct-19	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nov-19	6.8	4.8	3.4	15.0	1.1	1.1	0.9	0.0	0.0	0.0	0.0	3.2
Dec-19	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: BofA Merrill Lynch Global Research, US Treasury

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