BNY

iFlow
SHORT THOUGHTS

July 23, 2024

Will T-bill Supply Generate Its Own Demand?

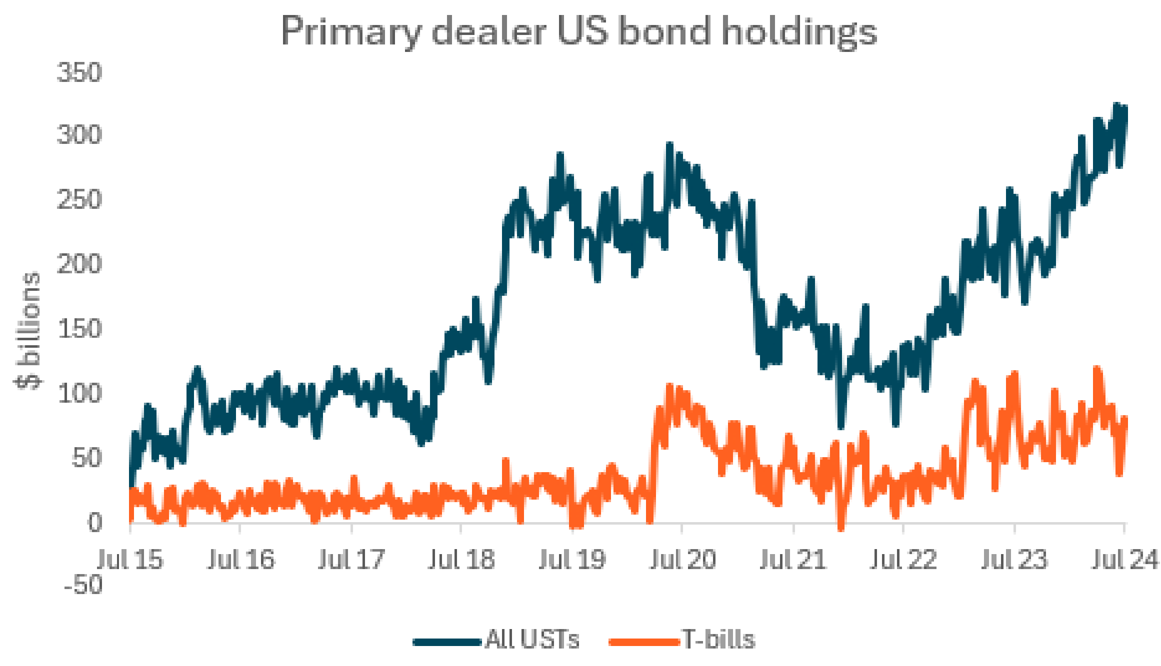
RRP Drainage and Real Money Demand a Function of Supply

- Dealer balance sheets at record holdings of USTs. Who will buy bills?
- We think T-bill supply will induce MMFs to reduce RRP usage and instead buy more paper
- The same argument applies to real money demand, as we see from iFlow

Net issuance of T-bills by the government fell nearly $300bn between the end of March and the end of June. Since the beginning of July, however, net supply grew by just under $84bn in a matter of a few weeks. There has been some concern that renewed bill issuance would struggle to meet adequate demand. We discussed this last week (see here).

Much of the concern was focused on dealers' balance sheets, where total US Treasury holdings are trending near a record high. With their coffers so full of USTs, will they have an appetite to help absorb renewed issuance? The chart below shows the evolution of dealer holdings since well before the pandemic. In addition to holdings of all USTs, we also plot positions in T-bills. The latter have increased inexorably since the end of 2021 and, at over $300bn, are nearly three times the level of holdings right before the pandemic. T-bill holdings alone are close to $100bn, also well above pre-pandemic norms.

Dealers Own a Lot of Treasurys Already



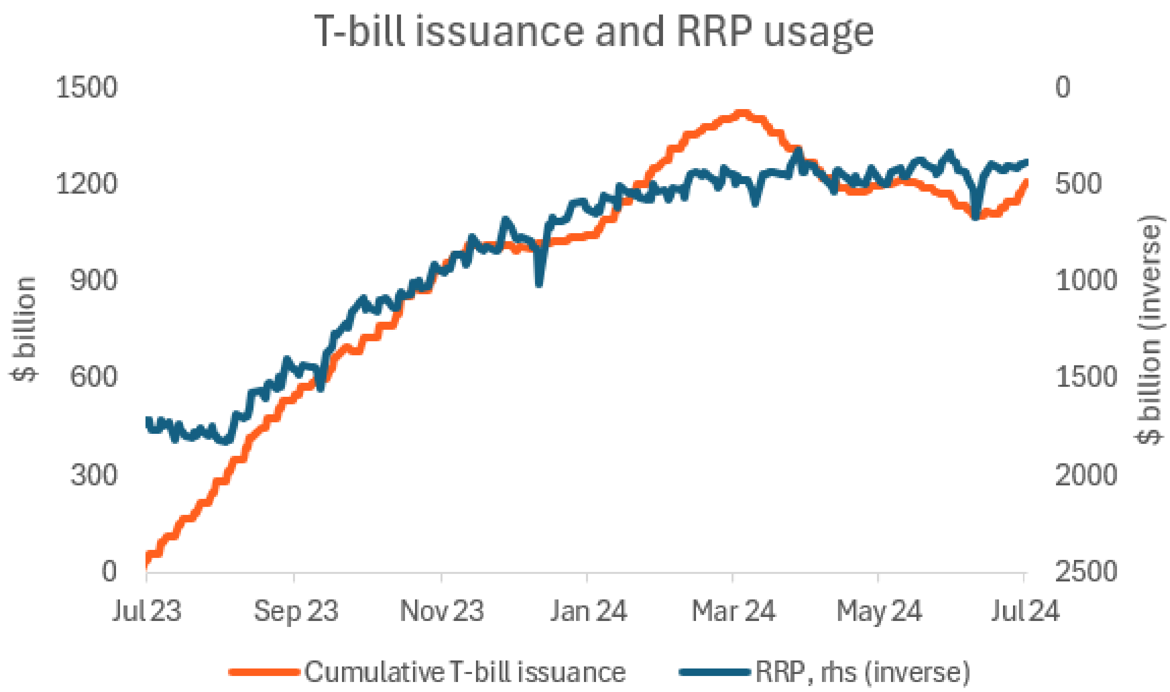
Source: BNY Markets, Federal Reserve Bank of New York

The other factor driving concerns about supply and demand imbalances in the bill market involve money market mutual funds (MMFs) and their demand for any additional bill issuance. The New York Fed's reverse repo facility (RRP), where MMFs had parked so much of their excess cash, began to drain in earnest starting in the summer of 2023. Daily usage of the facility had declined from over $2trn in July 2023 to just $440bn by the end of May 2024. It has been more or less stagnant since then, averaging over $400bn since the beginning of June.

This stabilization in RRP daily usage is well above where most observers thought it would be by now, even as MMF balances continue to reach record highs. If the money funds don't resume buying bills rather than putting their assets into RRP, this would be another missing element of T-bill demand. We will take the other side of that concern. We actually think the recent resumption of T-bill issuance will draw money out of RRP, causing daily take up in the facility to resume declining.

The chart below shows how RRP usage has tracked cumulative net issuance over the past 12 months. We think T-bill supply itself is one of the biggest determinants of changes in RRP utilization. Furthermore, we note that over the four days through Monday this week take up has been below $400bn, the first time in a while we have seen such low usage.

RRP Usage Moves Opposite to T-bill Supply



Source: BNY Mellon Markets, Federal Reserve Band of New York, US Treasury

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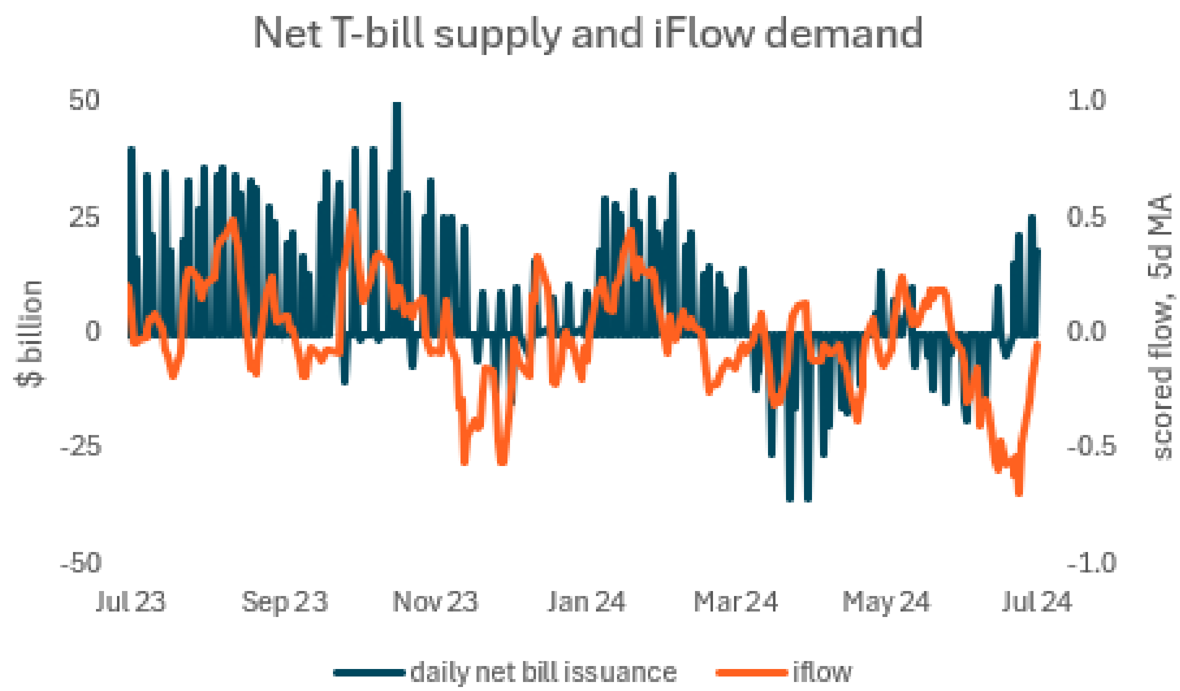
Real money flows also seem to be responding to the increase in net issuance. Our iFlow data allows us to look at asset manager flows into US Treasury securities with a maturity of under 1 year, a segment dominated by T-bills. It would appear that demand for bills is inelastic with supply – at least in the last year – and there is a pretty clear relationship between short-maturity sovereign debt flows and daily net T-bill issuance. In the most recent week, iFlow shows a reversal: investors are no longer selling, but beginning to buy, just as issuance has started to pick up. This is in contrast to just one week ago, when our data indicated net selling of short maturity paper – the turnaround has been sharp and quick.

In conclusion, we think that increased T-bill supply will not have trouble being absorbed by the market, as we think demand will actually increase with supply, even with primary dealers stuffed with Treasurys. There should be enough demand from MMFs to move money out of RRP and into bills, and we see a pick-up in domestic demand from real money.

Starting to Buy More Bills



Source: BNY Mellon Markets, iFlow*, US Treasury

*Flows into 0-1y maturity sovereign debt

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Please direct questions or comments to: iFlow@BNY.com

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