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SHORT THOUGHTS

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Increased Supply Cheapens T-Bill Curve

Stalled or Stabilized?

Since June 1, cumulative net T-bill issuance has amounted to just under $900bn, reflecting a combination of the Treasury Department's desire to replenish its General Account (TGA) and to fund increased borrowing needs for fiscal policy. Issuance will proceed apace.

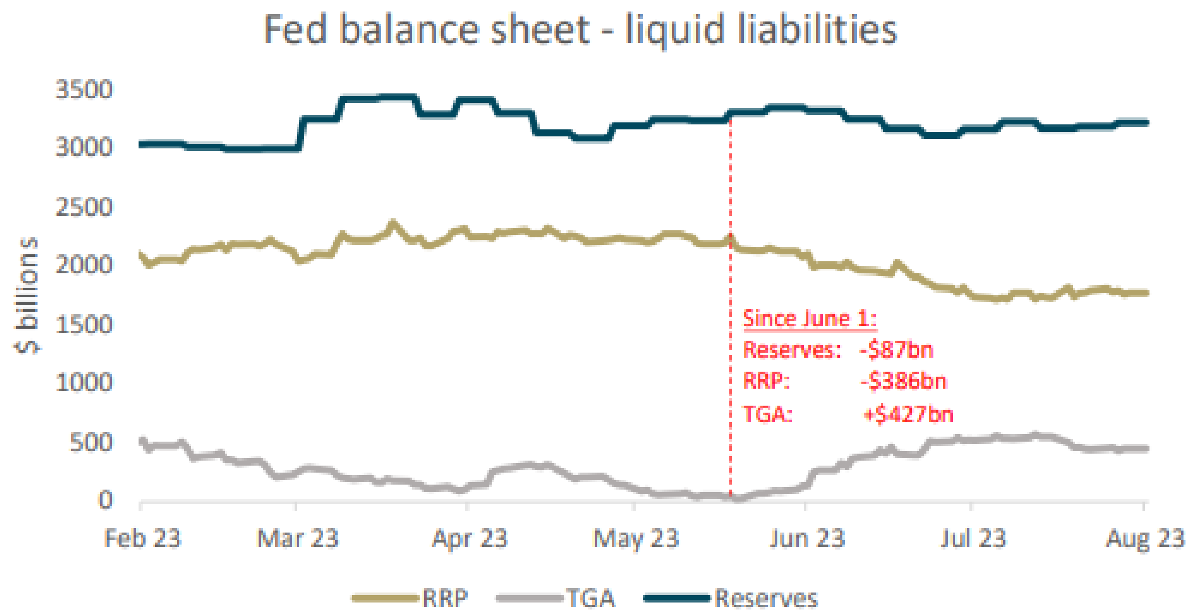
For going on three months now, the market has been told to expect a significant decline in usage of the Fed’s overnight reverse repurchase facility (RRP) on a combination of Fed rate hikes and increased bill supply pulling funds out of the facility. In short, the idea was that money would flow from RRP into a well-supplied bills market. That has happened to some degree, with the TGA increasing from a low of $23bn on June 1 to $450bn recently. Overall, the TGA has grown by $427bn from June 1, while RRP balances have declined by a similar amount, $386bn. It appears that the TGA rebuild has gone very much as planned, i.e., most of the money coming out of RRP, but in recent weeks RRP drainage has stalled and the TGA has remained more or less steady. Indeed, the TGA was at its post-debt ceiling peak of $574bn on June 25. Furthermore, inventories of bills on the books of primary dealers have also declined. Their holdings peaked at $116bn on July 12 and are down to just $54.7bn through Aug. 2. While it appears that primary dealers have not been accumulating bills, this also suggests that there is new capacity for dealers to take on more paper.

The chart below shows the main liquid balance sheet liabilities for the Federal Reserve,

with a table describing the changes in these items since June 1. Note that reserves have been relatively stable in that period, declining by just $87bn. If we use $400bn as a round number to approximate both the TGA rebuild and the RRP decline, that means approximately $450-500bn in bill purchases have taken place outside of these balance sheet items. As the bills curve has cheapened – thanks to the FOMC's 25bp rate hike in late July, as well as the deluge of new supply – end-users have been, presumably, the buyers of these extra bills.

With coupon supply and bill supply expected to stay ramped-up, we wonder if this "external" demand will be able to take down supply as seamlessly going forward as it has in the last month-and-a-half. The Treasury curve has both steepened and cheapened over this period. We expect that to continue, putting upward pressure on bill and longer-term note yields.

Steady At The Moment



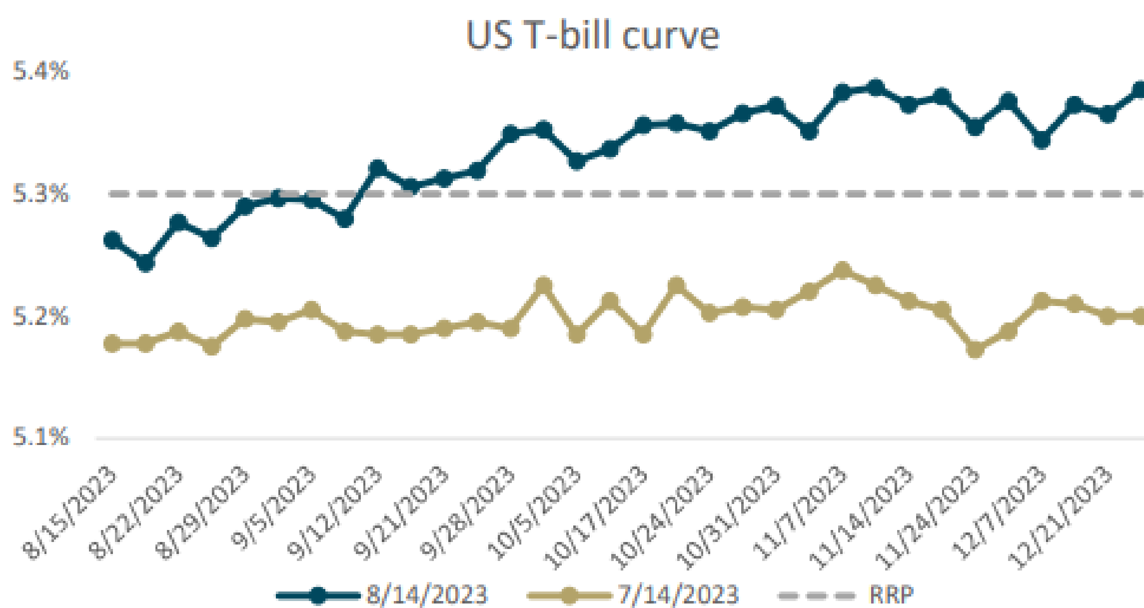
Source: BNY Mellon, Federal Reserve Board of Governors

We plot T-bill yields below, summarizing their move across the curve. Bills maturing before Sept. 12 trade below the 5.3% RRP offering rate. Those further out, to Sept. 26, are just a hair over the RRP rate. Furthermore, GC repo rates are also quite close to the RRP rate, making repo less attractive on the margin for money market mutual funds, even as AUM for MMFs, now just above $550bn (per Investment Company Institute data), is

some $100bn above June 1 levels. The question is whether increased supply (and a Fed which has, in our view, finished raising rates) can make bills cheapen enough to be attractive to MMFs.

The (stalled) TGA rebuild will go on, according to Treasury, which targets $750bn by year-end. That could mean an additional $325bn RRP drain between now and Dec. 31. Given that Treasury expects to issue a total of $852bn in the fourth quarter, with less than $300bn in coupons, that leaves well over $550bn in presumed bill issuance between October and December. The difference between the TGA rebuild and expected bill issuance is nontrivial. We expect the curve to cheapen and steepen further given these numbers.

Cheaper Bills Curve - But Not Cheap Enough



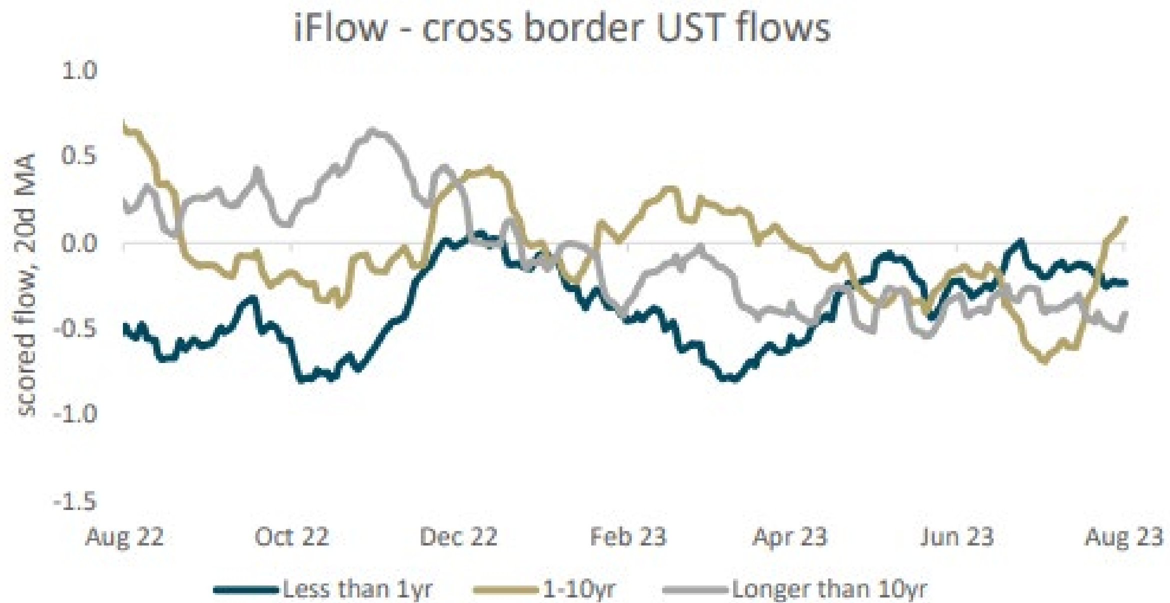
Source: BNY Mellon Markets, Bloomberg

Relevant to the process described above, there might be some relief in supply-demand dynamics for US government paper from a heretofore unlikely source: foreign demand.

We had been discussing for several months that cross-border flows out of US government paper had been exceptional and persistent. We can illustrate this by posting an updated chart of foreign flows into/out of Treasuries. The chart below plots cross-border flows for the asset class, broken down by three coarse buckets: less than 1y in maturity, 1y-10y, and 10y+. The largest, medium-term bucket shows a dramatic turnaround in foreign

demand. It had been, as we have been documenting, negative and long-lasting, since at least the end of August last year, with a brief interlude in December 2023 – probably due to year-end dynamics. Outflows from the 1y-10y maturity bucket bottomed on June 12 and flows became positive in early August. We presume this pickup in demand is due to rising US yields, making even hedged US bond holdings attractive. This pickup in foreign demand is favorable for the prospect of sufficient demand for the supply to come in Q3 and Q4.

Cross Border Flows Return!



Source: BNY Mellon Markets, iFlow

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

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