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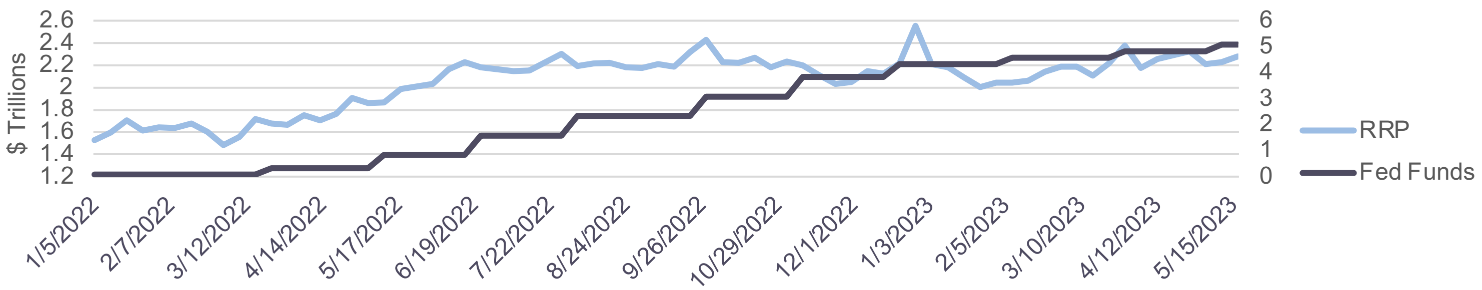
May 30, 2023

Flows to Watch: Treasury to Resume T-Bill Issuance on Debt Ceiling Pass

Looking Past the Debt Ceiling

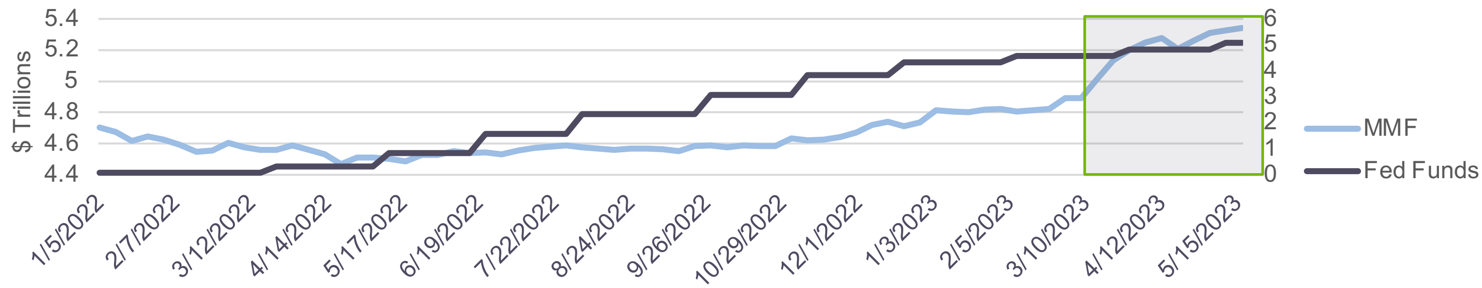
- Progress on the debt ceiling is lifting market sentiment. No respite is on offer should the debt ceiling pass. Liquidity and funding stresses from the Treasury restocking its coffers through a sizable resumption of T-Bill issuance YoY stands to deliver turbulence ahead.
- With $3.9tn in outstanding T-Bills, estimates for 2H'23 issuance range from $700bn to as high as $1.7tn to replenish funds from a de minimis balance today. This is all held at its bank, the Federal Reserve, in the Treasury General Account (TGA) - effectively the Treasury's checking account. Excess funds raised in the pandemic era allowed the Treasury to bypass T-Bill issuance in 2022.
- Just like any bank deposit, the TGA sits on the Federal Reserve's liabilities. Its liabilities also include bank reserves, which parallel the asset-side holdings of Treasuries and agency mortgage-backed securities (MBS), and reverse repurchases (RRP) that the Federal Reserve uses to maintain rates close to its targeted range. The RRP has grown as the Federal Reserve has started hiking rates (see Chart below[1]).

The Reverse Repo Purchase (RRP) balance has grown with higher rates



- Driving this increase is the deposit outflows from domestic banks that are chasing high yields offered at the very front end of the curve through money market funds (MMF), which deploy funds into the RRP. This inflow has ballooned since a year ago as rate hikes of 75bps created significantly higher returns relative to bank deposits. Bank failures since March have further accelerated MMF inflows (see Chart below[1]).

MMF balances have ballooned on rate hikes, channeled into the Fed's RRP



- The TGA and RRP growing, the latter occurring if rate hikes continue, could put a "squeeze" on bank reserves. This scarcity may trigger a scramble for reserves, used by banks to manage liquidity, putting upward pressure on short term interest rates.
- The flow to watch, given this backdrop, is the issuance of T-Bills, and the propensity of money-market funds staying ultra short duration. Will higher yields on T-Bills lead MMFs to shift into T-Bills? The path forward on monetary policy holds the key to this, from further rate hikes that could keep MMF inflows high to limits The Fed can place on RRP facilities.

1) Source: Bloomberg