WELLS FARGO

Special Commentary — July 24, 2024

Treasury Refunding Preview

Economist(s)

Michael Pugliese
Senior Economist | Wells Fargo Economics
Michael.D.Pugliese@wellsfargo.com | 212-214-5058

Aubrey George
Economic Analyst | Wells Fargo Economics
Aubrey.B.George@wellsfargo.com | 704-410-2911

Summary

- We do not anticipate any major surprises in the July 31 Treasury refunding announcement. We expect coupon auction sizes to remain unchanged for the second consecutive quarter.
- The federal budget deficit is tracking somewhat wider relative to our expectations at the last refunding on May 1. We forecast a budget deficit of $1.85 trillion in fiscal year (FY) 2024 and $1.95 trillion FY 2025. That said, the overarching story has not changed materially. The federal budget deficit is running on trend at roughly 6.5% of GDP, about two percentage points larger than its pre-pandemic level.
- A slowdown in the Federal Reserve's quantitative tightening program has helped keep growth in Treasury's financing need in check. Starting in June, the Federal Reserve reduced the cap on monthly balance sheet runoff for Treasury securities from $60 billion per month to $25 billion. The Federal Reserve reinvests the proceeds of maturities in excess of $25 billion, eliminating the need for Treasury to raise that money from private investors.
- We project net T-bill issuance of $286 billion in Q3 and $32 billion in Q4. If realized, this would bring net T-bill issuance up to $430 billion for 2024.
- One development we will be looking for on July 31 is guidance from Treasury on the debt ceiling. The debt ceiling is currently suspended, and absent Congressional action it will be reinstated on January 2, 2025. During some previous debt ceiling suspension episodes, Treasury felt legally obligated to reduce its cash balance down to the level that prevailed when the debt ceiling was last suspended. However, this was not the case during the last debt ceiling suspension in 2021.
- We expect Treasury to maintain business as usual when it comes to running its cash balance in the $700-$800 billion range through year-end. If Treasury uses a different operating framework, say a $500 billion cash balance target at year-end, this would imply significantly more T-bill paydowns in November/December and more T-bill issuance in January/February than we currently have forecast.

Wells Fargo Net Treasury Issuance Forecast
Billions of $

	2024				2023	2024
	Q1	Q2	Q3	Q4	CY	CY
Privately-held net marketable borrowing	748	243	845	509	3,100	2,346
Budget deficit	555	204	582	534	1,784	1,874
Δ in cash balance	7	3	72	-100	322	-19
SOMA coupon redemptions	150	168	91	75	615	485
SOMA T-bill redemptions	22	0	0	0	74	22
Other	15	-131	100	0	306	-17
Gross coupon auctions	975	1,121	1,280	1,103	3,314	4,479
Privately-held maturing coupons	636	581	721	626	2,266	2,564
Privately-held net coupon issuance	339	540	559	477	1,048	1,915
Privately-held net bill issuance	409	-297	286	32	2,052	430
End of quarter cash balance	775	778	850	750	769	750

Forecast as of: July 24, 2024

Source: U.S. Department of the Treasury, Bloomberg Finance L.P. and Wells Fargo Economics

A Quiet Summer for Treasury's Borrowing Plans

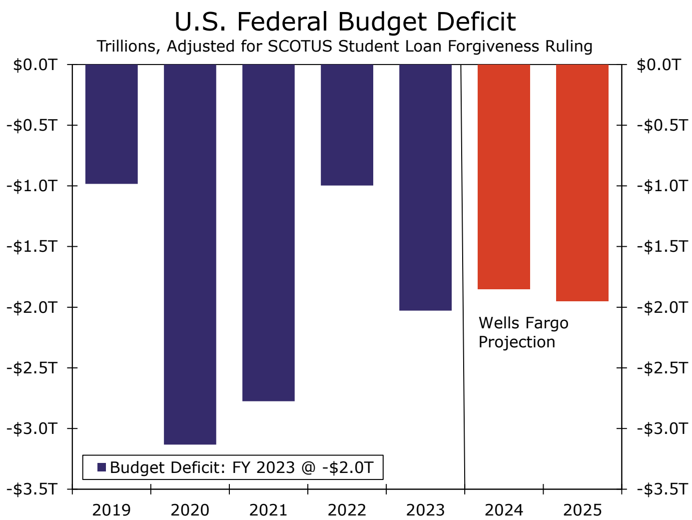
We expect it to be a relatively quiet Treasury refunding announcement on July 31. In our view, Treasury's current coupon auction schedule is well-suited to meet its financing needs for at least the next few quarters, and any unexpected swings in the financing need can be met by an expansion or contraction in Treasury bill supply.

The federal budget deficit is tracking somewhat wider relative to our expectations at the last refunding on May 1. We forecast a budget deficit of $1.85 trillion in fiscal year (FY) 2024 and $1.95 trillion FY 2025.

Budget Deficit Outlook

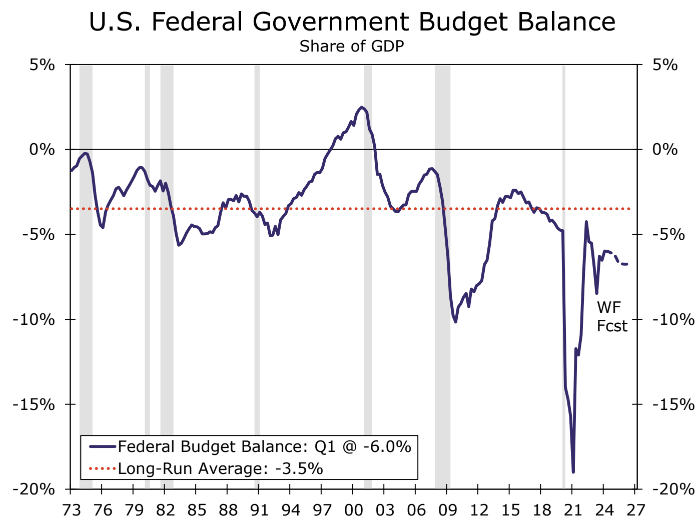
The federal budget deficit is tracking somewhat wider relative to our expectations at the last refunding on May 1. We forecast a budget deficit of $1.85 trillion in fiscal year (FY) 2024 and $1.95 trillion FY 2025 (Figure 1). The widening in deficit expectations have been driven by various factors. Federal tax revenues have come in a bit softer than we expected over the past few months, while spending on Medicaid, student loan forgiveness and a few other areas have been higher than we anticipated. That said, the overarching story has not changed materially. The federal budget deficit is running on trend at roughly 6.5% of GDP, about two percentage points larger than its pre-pandemic level and three percentage points larger than its long-run historical average (Figure 2).

Figure 1



Source: Congressional Budget Office and Wells Fargo Economics

Figure 2



Source: U.S. Department of the Treasury, U.S. Department of Commerce and Wells Fargo Economics

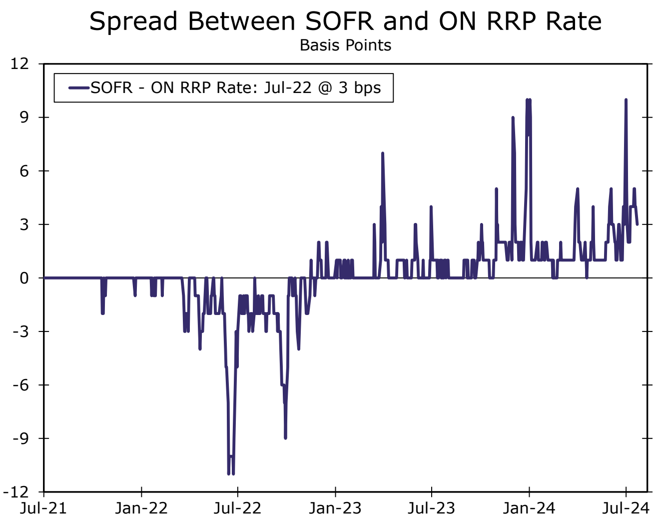
Quantitative Tightening Outlook

A slowdown in the Federal Reserve's quantitative tightening (QT) program has helped keep growth in Treasury's financing need in check. Starting in June, the Federal Reserve reduced the cap on monthly balance sheet runoff for Treasury securities from $60 billion per month to $25 billion per month. The Federal Reserve reinvests the proceeds of maturities in excess of $25 billion, eliminating the need for Treasury to raise that money from private investors.

A slowdown in the Federal Reserve's quantitative tightening program has helped keep growth in Treasury's financing need in check.

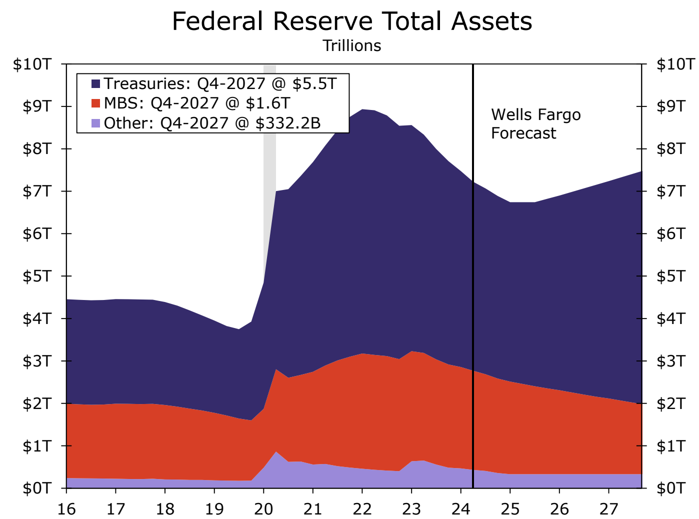
Our base case forecast assumes that QT will run at its current pace through Q1-2025. It is possible that QT could run a bit longer, but we are starting to see signs that the liquidity draining effects of QT are being felt. As we wrote in the Interest Rate Watch section of a recent weekly publication, repo rates are steadily climbing relative to the rate offered for parking money at the Federal Reserve's overnight reverse repurchase facility (Figure 3). This indicator and numerous others suggest to us that QT only has a few more quarters to run at its current pace before bank reserves decline from “abundant” to merely “ample." Starting in Q2-2025, we look for the Federal Reserve to hold the overall size of its balance sheet unchanged for a couple of quarters while letting MBS runoff continue, with MBS proceeds reinvested into Treasury securities (Figure 4). The cessation of Treasury security runoff and eventual return to Treasury security purchases in 2025 likely should help keep Treasury's financing need relatively flat over the next year despite continued growth in the federal budget deficit.

Figure 3



Source: Bloomberg Finance L.P. and Wells Fargo Economics

Figure 4



Source: Federal Reserve System and Wells Fargo Economics

Coupon Auction Sizes Once Again Likely to Remain Unchanged

On balance, existing gross coupon auction sizes are raising enough money on a net basis that changes are unlikely to be announced at the July 31 refunding (Figure 5). One very small exception is the auction for the 10-year Treasury Inflation-Protected Security (TIPS), which we expect to rise by $1 billion as Treasury seeks to keep TIPS stable as a share of the overall Treasury market. If current auction sizes are left unchanged through year-end, we project privately-held net coupon issuance will total $1.9 trillion in calendar year 2024, accounting for 82% of the net marketable borrowing for the year. The remaining 18% ($430 billion or so) would come from net issuance of Treasury bills.

Existing gross coupon auction sizes are raising enough money on a net basis that changes are unlikely to be announced at the July 31 refunding.

The outlook for 2025 is murkier, and we will have more to say about it in next quarter's Treasury refunding preview. The election outcome will play a major role in determining the medium-term federal fiscal outlook in the United States. Based on what we know now, there are a few reasons we suspect it will be mid-2025 at the earliest before coupon auction sizes start to rise again. First, our baseline projections for Treasury's financing need suggest that current coupon auction sizes are large enough to meet Treasury's borrowing need over the next 12 months without meaningfully increasing Treasury bills' share of the overall market. Second, the debt ceiling is currently set to be reinstated on January 2, 2025 (more on that later), and Treasury may be reluctant to start an auction cycle increase in the midst of a debt ceiling showdown. Third, we suspect that 2025 will involve a lengthy debate over how to handle the expiring provisions of the 2017 Tax Cuts and Jobs Act. Those tax cuts are slated to expire at year-end 2025, so fiscal policy uncertainty may remain elevated until late next year.

Figure 5

Wells Fargo Gross Coupon Issuance Forecast
Billions of $

	2024											
	Jan	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**
2y	60	63	66	69	69	69	69	69	69	69	69	69
3y	52	54	56	58	58	58	58	58	58	58	58	58
5y	61	64	67	70	70	70	70	70	70	70	70	70
7y	41	42	43	44	44	44	44	44	44	44	44	44
10y	37	42	39	39	42	39	39	42	39	39	42	39
20y	13	16	13	13	16	13	13	16	13	13	16	13
30y	21	25	22	22	25	22	22	25	22	22	25	22
2y FRN	28	28	28	30	28	28	30	28	28	30	28	28
5y TIPS	0	0	0	23	0	21	0	0	0	24	0	22
10y TIPS	18	0	16	0	16	0	19	0	17	0	17	0
30y TIPS	0	9	0	0	0	0	0	8	0	0	0	0
Gross Issuance	331	343	350	368	368	364	364	360	360	369	369	365

Forecast as of: July 24, 2024

Source: U.S. Department of the Treasury, Bloomberg Finance L.P. and Wells Fargo Economics

T-Bills Waxing and Waning, but Steady as a Share of the Market

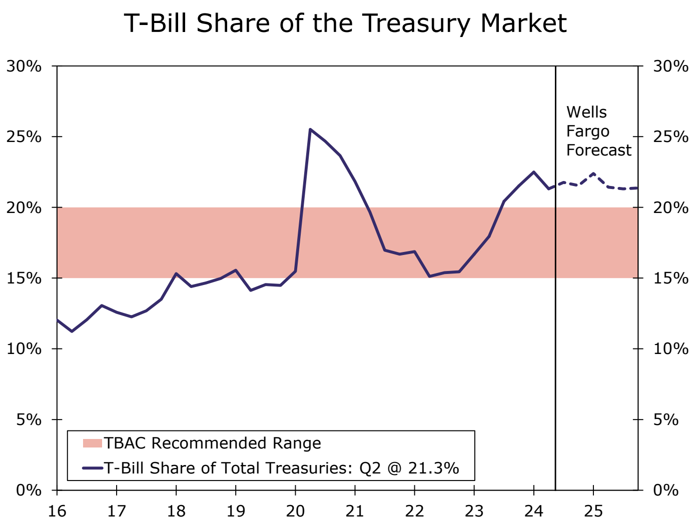
We project net T-bill issuance of $286 billion in Q3-2024 and $32 billion in Q4-2024.

We project net T-bill issuance of $286 billion in Q3-2024 and $32 billion in Q4-2024. This assumes an end-of-quarter cash balance for the Treasury of $850 billion for Q3 and $750 billion for Q4. If realized, this would bring net T-bill issuance up to $430 billion for 2024. A question we have been asked repeatedly in recent months is whether Treasury's pattern of bill issuance strikes us as unusual. Our response has been a firm no. The U.S. Treasury aims to be "regular and predictable" when making decisions about how to best meet its financing need. Coupon auction sizes tend to change slowly and gradually, and the forward guidance from Treasury officials can sometimes bear resemblance to how Fed officials communicate their expectations for the path of monetary policy. Of course, surprises happen when managing trillions of dollars of monthly inflows and outflows, and T-bills serve as the "shock absorber" to meet fluctuations in the financing need.

The Treasury Borrowing Advisory Committee (TBAC), an organization comprised of senior representatives from a variety of financial institutions that meets regularly with the Treasury Department, recommends that Treasury keep T-bills as a share of the Treasury market in the range of 15%-20%. At present, T-bills make up about 21% of the market, so the current deviation is not that large relative to the recommendation of Treasury's private sector advisors (Figure 6). Similarly, the weighted-average maturity of the U.S. Treasury market is currently about six years, more or less the same as it was at the end of 2019.

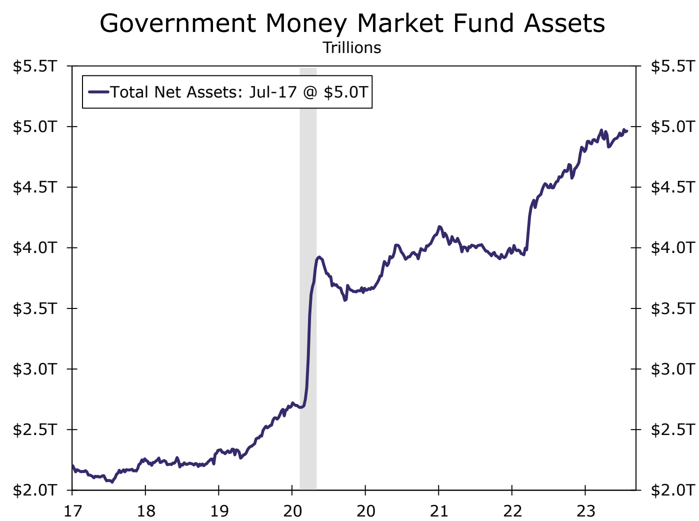
Our base case forecast estimates that the T-bill share of the Treasury market will remain near 21% over the next several quarters, with some seasonal fluctuations here and there. TBAC has “expressed continued comfort with the bill share of total marketable debt outstanding remaining temporarily above its recommended range given continued robust demand for bills and Treasury’s regular and predictable approach.”[1] The highest short-term interest rates in the United States in nearly 20 years have helped to drive significant inflows into money market funds, and this in turn has played a part in the robust demand for T-bills, a key asset for these funds (Figure 7).

Figure 6



Source: U.S. Department of the Treasury and Wells Fargo Economics

Figure 7



Source: Bloomberg Finance L.P. and Wells Fargo Economics

Debt Ceiling TGA Guidance Coming?

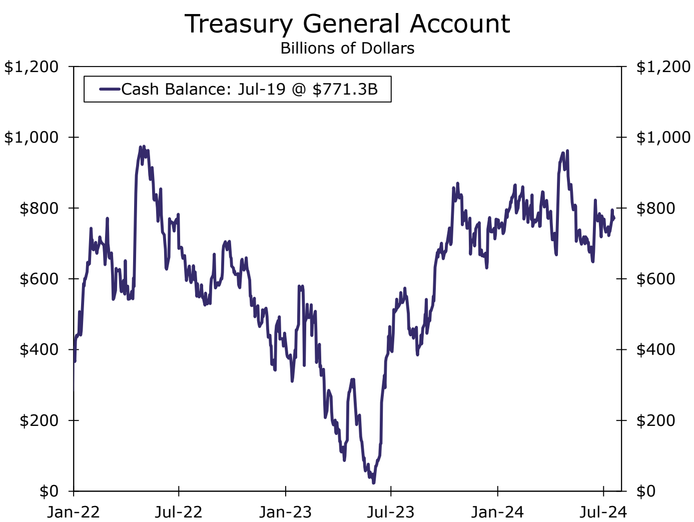
Our best guess is that Treasury will be able to maintain business as usual when it comes to running its cash balance in the $700-$800 billion range through year-end.

One development we will be looking for on July 31 is potential guidance from Treasury on the looming debt ceiling reinstatement. As we mentioned earlier, the debt ceiling is currently suspended, and absent Congressional action it will be reinstated on January 2, 2025. During some previous debt ceiling suspension episodes, Treasury felt legally obligated to reduce its cash balance (the Treasury General Account or TGA) down to the level that prevailed when the debt ceiling was last suspended. This practice has led to sharp swings in the TGA amounting to hundreds of billions of dollars as Treasury pays down debt to comply with the constraint and then rapidly re-issues said debt on the other side of the debt ceiling suspension. The TGA was less than $50 billion when the debt ceiling was last suspended in June 2023, a significant departure from its current standard operating balance of $750 billion or so (Figure 8).

We have written previously that our best guess is that Treasury will be able to maintain business as usual when it comes to running its cash balance in the $700-$800 billion range through year-end. The Fiscal Responsibility Act (FRA), which suspended the debt ceiling in June 2023, states that "the Treasury shall not issue debt for the purpose of increasing its cash balance above “normal operating balances.” A Department of Justice legal opinion ruling from July 8, 2021 seems to reinforce the idea that maintaining a prudential TGA buffer is compliant with the law.[2] As a result, our forecast assumes the TGA is $750 billion at year-end, not far from where it finished Q2. That said, we suspect Treasury will offer some additional guidance on this front at the upcoming refunding, and there is a chance it adopts a different policy with a lower TGA in the event the debt ceiling is not dealt with before January 2.

If Treasury uses a different operating framework, say a $500 billion cash balance target at year-end, this would imply significantly more T-bill paydowns in November/December and more T-bill issuance in January/February than we currently have forecast. That said, the overall trend in T-bill issuance would remain unchanged.

Figure 8



Source: U.S. Department of the Treasury and Wells Fargo Economics

Endnotes

1 – See the Minutes of the Meeting of the Treasury Borrowing Advisory Committee October 31, 2023. U.S. Department of the Treasury. November 1, 2023. (Return)

2 – U.S. Department of Justice. Treasury's Cash Balance and the August 1, 2021 Debt Limit. July 8, 2021. (Return)

Subscription Information

To subscribe please visit: www.wellsfargo.com/economicsemail

Via The Bloomberg Professional Services at WFRE

Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	704-410-3274	Jay.Bryson@wellsfargo.com
Sam Bullard	Senior Economist	704-410-3280	Sam.Bullard@wellsfargo.com
Nick Bennenbroek	International Economist	212-214-5636	Nicholas.Bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	704-410-3283	Tim.Quinlan@wellsfargo.com
Sarah House	Senior Economist	704-410-3282	Sarah.House@wellsfargo.com
Azhar Iqbal	Econometrician	212-214-2029	Azhar.Iqbal@wellsfargo.com
Charlie Dougherty	Senior Economist	212-214-8984	Charles.Dougherty@wellsfargo.com
Michael Pugliese	Senior Economist	212-214-5058	Michael.D.Pugliese@wellsfargo.com
Brendan McKenna	International Economist	212-214-5637	Brendan.Mckenna@wellsfargo.com
Jackie Benson	Economist	704-410-4468	Jackie.Benson@wellsfargo.com
Shannon Grein	Economist	704-410-0369	Shannon.Grein@wellsfargo.com
Nicole Cervi	Economist	704-410-3059	Nicole.Cervi@wellsfargo.com
Jeremiah Kohl	Economic Analyst	212-214-1164	Jeremiah.J.Kohl@wellsfargo.com
Aubrey George	Economic Analyst	704-410-2911	Aubrey.B.George@wellsfargo.com
Delaney Conner	Economic Analyst	704-374-2150	Delaney.Conner@wellsfargo.com
Anna Stein	Economic Analyst	212-214-1063	Anna.H.Stein@wellsfargo.com
Ali Hajibeigi	Economic Analyst	212-214-8253	Ali.Hajibeigi@wellsfargo.com
Coren Burton	Administrative Assistant	704-410-6010	Coren.Burton@wellsfargo.com

Required Disclosures