February US Treasury Refunding Estimate Preview

US Tsy announces quarterly refunding Wednesday, February 3 0830ET

The current dealer consensus regarding the next Treasury refunding needs: coupon sizes will remain at current record highs amid ongoing uncertainty over the next fiscal stimulus package. Borrowing estimates start to vary in the event President Biden's full $1.9T fiscal package is passed.

Bank of Montreal strategists posit "even with unchanged coupon auction sizes (and the previously communicated upsizing to TIPS) we are anticipating $1.7T in net issuance after the Fed's $960B in Treasury buying for 2021."

Note the progression in borrowing amounts since the last refunding on November 4, 2020 below. 2Y through 7Y notes climbed to new record highs, 10Y note off November's high as are 20- and 30Y Bonds.

	2-Year	3-Year	5-Year	7-Year	10-Year	20-Year	30-Year	FRN
Nov 2020	$56B	$54B	$57B	$56B	$41B	$27B	$27B	$24B
Dec 2020	$58B	$56B	$59B	$59B	$38B	$24B	$24B	$24B
Jan 2021	$60B	$58B	$61B	$62B	$38B	$24B	$24B	$28B

Dealers are also anticipating the debt limit suspension that ends July 31, 2021. "Debt limit constraints could force the Treasury to cut bill supply by more than the market can take if coupon issuance is lifted higher," Deutsche Bank strategist said, while Goldman Sachs cautioned "unless Congress either passes an extension or raises the debt limit well in advance, Treasury will face the difficult task of running down its cash balances to the level of the last suspension ($134B from about $1,641B currently)."

Sell-Side Analyst Previews:

Bank of Montreal: With fiscal stimulus still top-of mind, Wednesday's refunding announcement will offer valuable insight as to how the Treasury Department will approach the issuance landscape in its perpetual endeavor to finance a growing deficit. Particularly given the ongoing uncertainty related to the final size of the fiscal deal and accompanying error bands surrounding its ultimate price tag. While we have heard a wide range of estimates offered on what makes it through Congress, something in the area of an additional $1.25 trillion resonates.

- BMO expects coupon auction sizes "will be unchanged from the already significant increases throughout 2020, but readily acknowledge there is a significant probability that further up-sizings are in the offing. Even with unchanged coupon offering amounts (and the previously communicated increases to TIPS) we are anticipating $1.7 trillion in net issuance after the Fed's $960 bn in Treasury buying for 2021; the largest on record.
- Relatedly in the very front-end of the market, two themes will persist as a space to watch over the coming months. Especially after the downward pressure seen on repo rates over the past week as a result of what has widely been attributed to a large amount of GSE cash needing to be deployed. Firstly is any endeavor by Yellen to reduce net bill issuance as hinted at in the latest survey of primary dealers.
- Bills currently account for roughly 25% of marketable Treasury debt outstanding, and a reduction in line with more historical norms (15-20%) would imply a reduction of at least approximately $800B in net bill issuance. This is coming at a time when both prime and government money market funds'

holdings of bills have risen sharply, and any accompanying re-allocation of this capital to other front-end instruments such as repo runs the risk of greater downward pressure on funding costs.

- Add to this the concerns on the debt limit and the chance that even the delayed blue sweep will not preclude budget negotiations from running to the 11th hour and the necessity to the Treasury Department to run down their cash balance even more aggressively. We've heard anecdotal evidence of front-end investor concern in this regard and the degree to which an additional influx of cash would weigh on overnight rates. A technical adjustment to either IOER or the ON RRP rate would help preserve the integrity of the lower bound, and while Vice-Chair Clarida has offered a tweak to the former can wait, if consecutive EFFR reads <5 bp become a reality, a Fed response would likely follow.

Deutsche Bank: DB expects the U.S. Treasury to "temporarily halt coupon auction size increases for the February-April quarter. We laid out our reasoning last week: uncertainty around the size of next fiscal stimulus makes further increases not imminent; there are signs of weakening demand for the 20yr maturity; and debt limit constraints could force the Treasury to cut bill supply by more than the market can take if coupon issuance is lifted higher."

- For the February refunding auctions, we anticipate gross issuance of $126bn ($58B 3s, $41B 10s, $27B 30s), and for nominal coupon auctions for the rest of the month we expect sizes are unchanged from January. In TIPS, we expect a $2bn increase to 5yr (to $19B) and a $1bn increase to the 10yr ($13B) and 30yr ($9B) auctions.
- With unchanged nominal coupon sizes and modest increases to TIPS sizes, the Treasury should be able to net issue $2.7 trillion coupon debt for 2021 and $2.5 trillion for 2022. These issuance amounts should allow the Treasury to meet its financing obligations with minimal bill supply increase in 2021 (assuming the size of new stimulus comes reasonably close to our expectations), but it would not be able to make substantial progress toward paying down its bill supply until 2022. Given our current projected financing needs and issuance pattern, we expect the percentage of bills outstanding will remain above 20% until mid-2022.
- Bill issuance could be muted for the next 4-6 weeks barring the passing of new stimulus before March. We are forecasting relatively unchanged bill supply through March and an accelerated decline from April to July as the Treasury begins to reduce its cash pile. However, our forecast is subject to high uncertainty given the size and timing of the stimulus is not yet known.
- On the debt limit, it's worth noting that we do not expect Treasury cash balance to return to the August 2, 2019 level of $134bn prior to the reinstatement. The main reason is that such a low balance would not be prudent in today's operating environment with the Treasury facing much higher expected daily outflows compared to two years ago. Furthermore, the legislation text of the Bipartisan Budget Act of 2019 does not seem to contain the same provision prohibiting increases in cash reserves beyond normal operating levels that was in every past debt limit suspension bill. The omission may have been deliberately planned to help minimize the impact of bill issuance swings on the short-term rate market. Nevertheless, we think Treasury cash balance could fall to a more reasonable level of $350-400bn by the end of July.

Goldman Sachs: Refunding estimates tied to the fiscal stimulus outlook. "Our economists currently expect Congress to pass an additional $1.1tn or so of fiscal stimulus this year, with risks tilted to the upside. Over the next few years, fiscal spending assumptions translate into baseline deficit projections of $3.2tn, $2.0tn, and $1.45tn in FY21, 22, and 23 respectively. Earlier this week, we examined the range of possible sizes in stimulus packages and the resulting medium-term implications for Treasury's issuance decisions. In this note, we focus on the more immediate February refunding cycle and meeting.

- GS estimates the "current auction schedule (together with elevated cash balances) is sufficient in meeting Treasury's financing needs under our baseline $1.1tn fiscal stimulus assumption (on top of the $900B passed in December). While it's possible that a larger than anticipated stimulus package may necessitate changes to coupon supply, that won't be known ahead of the February refunding meeting. Given this, we expect Treasury to maintain its coupon auction schedule, and manage any volatility through bills until there is more clarity on the size of additional stimulus.

- Over the February refunding cycle, we expect Treasury will be able to raise $1,110B through nominal coupons, TIPS and FRN issuance on a gross basis over the February-April period. Net of Fed purchases, this will translate into about $646B in 10y equivalent supply. While we expect no changes to nominal UST supply, there are two areas of growth we expect near-term. First, on TIPS supply, we expect modest increases, consistent with Treasury guidance from the November refunding. Improving growth momentum, accommodative monetary and fiscal policy, and the Fed's flexible AIT framework are all factors that we see supporting TIPS demand over the medium term.
- We expect the Treasury to announce $1bn increases to 5y, 10y, and 30y TIPS auction sizes at this refunding meeting, with additional increases likely forthcoming. These increases in TIPS issuance likely still mean net supply to the market will be modestly negative again in 2021 (-$6bn vs. -$114B in 2020). Second, in line with TBAC recommendations, we expect Treasury to introduce a 1 year SOFR-linked floating rate note (FRN) this year, though we don't expect an announcement until the following refunding cycle in May. While it is possible that Treasury makes an announcement this meeting, given little guidance to this point on timing, we think risks are tilted to a later introduction.

JP Morgan: JPM forecasts "$2.454tn in net-privately held borrowing of Treasuries in 2021. With the increases Treasury made to auction sizes in 2020, it has created over $1tn in additional borrowing capacity in its suite of note, bonds, TIPS and FRN auctions compared with 2020, and is well positioned to meet its borrowing needs this year. The sheer amount of additional borrowing capacity created since mid-2020, indicates Treasury does not need to make any further increases to nominal auction sizes next week or for the balance of 2021."

- The only adjustment we see coming is to the TIPS program, where we project gradual increase in auction sizes, focused in the 5- to 10 year sector, as announced at the November refunding. In particular, we look for Treasury to announce $1bn increases in the February 30-year new-issue and March 10-year reopening TIPS auctions, as well as a $2bn increase in the April 5-year auction. In aggregate, we continue to project TIPS gross issuance to increase by $19bn in 2021 relative to 2020.
- JPM also discussed the "prospects for an ultra-long bond have been revived following Secretary Yellen's comments last week during her confirmation hearing. She acknowledged that "there is an advantage to funding the debt, especially when interest rates are very low, by issuing long-term debt."
- We think it's unlikely that we learn anything new next week, particularly because Yellen was only sworn in this week, and is building out her staff at Treasury now. Moreover, Treasury studied ultra-long issuance in the summer of 2019, and chose to bring back the 20-year bond instead.
- We conducted a survey on investor demand at the long end and wrote a research note on this topic at that time, and when given the choice between a 20-year bond, an ultra-long (30-year+) bond, and an ultra-long zero coupon bond, survey respondents preferred a 20-year. Since then, Treasury successfully reintroduced the 20 year bond, and the share of debt maturing in 10 to 30 years to remain near historic highs. The WAM of Treasury's debt did shorten sharply last year given that much of the emergency funding came in the form of bills, Treasury has created over $1tn in additional borrowing capacity through the adjustments in its coupon auction calendar, and we project the WAM will extend back to pre-pandemic levels by YE21, a record extension.
- Thus, introducing a new 50-year bond does not seem to fit with Treasury's debt management objectives in the current environment, but we would not rule out Treasury conducting another study on demand for a prospective ultra-long bond later this year.

Nomura: Our economists are expecting around $2.9trn deficit in FY2021, followed by another $2.5trn in FY2022.

- This outlook accounts for a $1trn stimulus package passing in March, and a $2tn infrastructure bill (spent out over four years) sometime in H2 2021. Obviously given the high level of uncertainly over virus situation, the risks are on upside.
- Record level of cash balance reduces any needs for immediate issuance increases. Given the desire to extend WAM and reduce bill % of overall debt, we expect more gradual pace of only modest

increases in coupon sizes this quarter. Those being said, we can see the Treasury to increase coupon supply at relatively same pace for another quarter as they did in Nov'20 (7s increases at a slower pace as it already has the largest notional issuance across curve). From there, uncertainty around auction sizes is high given new fiscal stimulus.

NatWest: NatWest does "not expect further increases in coupon auction sizes at this point, but note that the current pace of coupon issuance will still be at record highs."

- The paths for bill issuance and Treasury's cash balance (TGA) are much less clear given that they are both highly dependent on the outcome of the ongoing fiscal negotiations and the timing of a debt ceiling suspension. Further, we are still somewhat unsure of what minimum cash buffer Treasury might target in a steady state, once COVID fears start to die down, the fiscal path is a bit more evident, and they are not dealing with potential debt ceiling issues.
- Lastly, regarding TIPS, we expect Treasury to continue rolling out increases in TIPS auction sizes as previously announced.
- Given that bill supply is likely to bear the early brunt of any surge in funding needs on passage of a new relief bill, and the fact that bill supply could still get wrapped up in debt ceiling issues if a suspension is not passed well before the reinstatement date, we have pretty low conviction in our bill supply forecast right now.
- Under NatWest's base case, "with a $1.5bn stimulus bill in March, we would expect a ~$200-$300bn increase in bill supply after passage, peaking in mid-May. If we have a debt ceiling suspension by then, we assume Treasury will allow their cash balance to run back down to some new comfort level and for bill supply to return to current levels by the end of FY 2021 in September. If by some chance a debt ceiling deal is not done and/or a stimulus deal has not been completed, the decline in bill supply could be more severe this summer."

TD Securities: TD expects the "likely $3.3tn FY2021 deficit to be funded via the recent increase in net coupon supply (set to hit $2.8tn this year) and using Treasury's $1.6tn cash balance.

- Given the uncertainty over future funding and the need to wind down the $1.6tn cash balance ahead of the August 1 debt ceiling reinstatement, we expect Treasury to keep coupon auction sizes unchanged for the first time since the COVID crisis began. We look for Treasury to keep the 3y at $58bn, the new 10y at $41bn, and the 30y at $27bn. TIPS auction sizes should continue increasing by $1bn/month, but net supply will remain negative due to Fed purchases.
- Secretary Yellen may alter Treasury's decision-making, but only in the medium term. She promised to review Treasury debt issuance, the cash balance, and other practices. Given Yellen's reputation for being research- and consensus driven, we believe this could give greater weight to recommendations from the TBAC and market participants. This could bias Treasury to issue more in the 5-10y sector rather than the long-end of the curve.
- We expect Treasury to provide an update on their SOFR FRN issuance plans and to indicate that the first issue could come as soon as May.
- Given our view that Treasury is likely to decrease their cash balance in the months ahead, we expect to see downward pressure on bill yields and money market rates. On the long-end, a pause in auction size increases could flatten the curve in a knee-jerk fashion, but we expect the curve to remain directional. The threat of additional supply down the road and a Fed reluctant to extend QE WAM should bear steepen the curve, and we also continue to hold 30y swap spread wideners.

UBS: UBS does not expect an "increase in nominal auctions in February. However, we look for small increases in TIPS auctions to continue. $1.9T stimulus would need more funding; unchanged auctions give flexibility."

- The Treasury likes to be regular and predictable. If they increase coupon auction sizes and the stimulus is smaller, a larger bill paydown will be needed. That might create stress in the market, forcing the Treasury to make a sudden pivot in coupon auction sizes.

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- UBS thinks the "near-term stimulus will be around $500B. A very large package under a "regular order" approach would require 60 votes in the Senate. To move quickly enough to provide stimulus when cyclical risks are still high, we think a reconciliation approach that only needs 50 votes will be needed. But that will limit the size of the package.
- Our base case is a gradual decline in bills of $670bn this year. That would only reverse a small part of the $2.5T increase in bills in 2020, so we would expect bills to trade in the richer half of their range but not to be extremely rich. But there are four possible scenarios for bills There is the base case, a new Treasury staff that is uncomfortable running high cash balances so there is a Feb/March bill paydown, a substantial increase in bills if there is a huge stimulus package (unlikely), and a sharp drop in bills around a debt ceiling (unlikey). Overall we think the market is pricing in too much risk of very low RP rates that richen short Treasuries.
- We expect the Treasury to stop increasing nominal coupon auction sizes in February but continue with a modest increase in TIPS. Current coupon auction sizes put the Treasury on pace to raise about $2.7trn with coupons. If our economics' teams forecast of a $500bn stimulus package is correct, Treasury will pay down $670bn of bills in 2021 (bills were up $2.5T in 2020). In the unlikely event the Congress passes the full Biden $1.9T proposal, then the Treasury would have to raise about $650bn, likely first with bills and then with coupons. Stopping the coupon auction increases maximizes flexibility.