

US Rates Viewpoint

USTs: squeezing the supply balloon

Treasury supply & demand imbalance in focus

Clients have recently raised several questions about UST market supply & demand. Market focus on this topic was elevated amidst the UST April volatility and has been furthered by UST supply risks associated with the US fiscal package (Exhibit 1). The crux of the UST supply / demand issue is: (1) inflation, (2) economic policymaking, (3) deficit outlook (see: [UST confidence test](#)). Questions around tariffs and section 899 do not help (899 = discretionary taxes on foreign owned US assets, see [Section 899 FAQ](#)).

Limited potential solutions but risks remain

Potential solutions to the UST supply / demand imbalance: (1) lower US deficits, (2) reg changes, (3) shorten UST issuance. Lower deficits may not be politically palatable, and we are skeptical of low hanging reg changes (see [SLR & USTs](#)). Shorter UST issuance may work for a time but has limits; it is like squeezing a UST supply balloon. UST buybacks can signal support when needed but are not a UST supply / demand solution.

Shorter WAM faces front-end demand challenges

The market has increasingly focused on Treasury WAM shortening as the path of least resistance to support the UST market. We have sympathy for this view but acknowledge it only works until shorter tenor demand is exhausted. In this note we consider scenarios around shorter UST issuance and the extent of front-end demand. We also discuss risks around the front-end supply test to be seen later this year after debt limit increase.

Supply / demand imbalance will be tested post debt limit

Bottom line: shortening UST WAM is not a magic solution to the UST supply / demand imbalance and will be tested later this year, in our view. The front end is likely to cheapen amidst increased reliance on front end funding, especially post debt limit. We would not be surprised to see the UST supply balloon squeezed enough at the back end to ultimately trigger a backstop from the Fed at the front end through repo and bill purchases.

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UST: US Treasury

WAM: Weighted average maturity

DMO: Debt Management Office

MoF: Ministry of Finance

TBAC: Treasury Borrowing Advisory Committee

GFC: Global Financial Crisis

MMF: money market mutual fund

SRF: Standing Repo Facility

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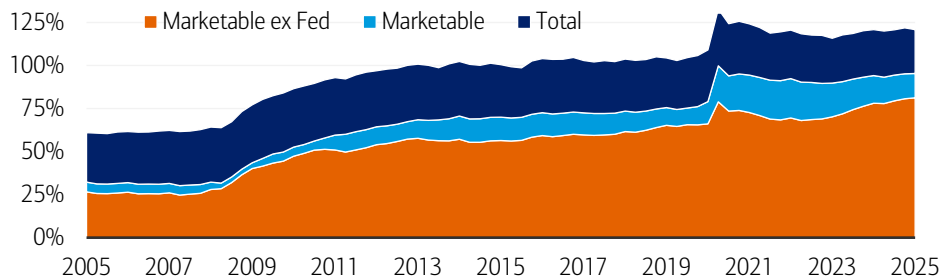
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Exhibit 1: Treasury debt outstanding by type (%)

Treasury marketable debt ex Fed is 80%+/GDP while total debt is >120%/GDP



Source: Bloomberg

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Signal on UST WAM shift may be further away

Investors have increasingly asked: what can be done to support the Treasury market. This comes in the context of recent UST volatility & curve steepening / cheapening.

The clearest solution resides with Congress via lower deficits, but this seems unlikely. Focus then shifts to the Fed & Treasury. The Fed is likely reluctant to support the UST market since inflation is still not back to 2% and they do not want to underwrite easy fiscal policy. The Treasury can assist in supporting the market via buybacks (which are small) or shortening debt issuance (which reduces duration risk in the market).

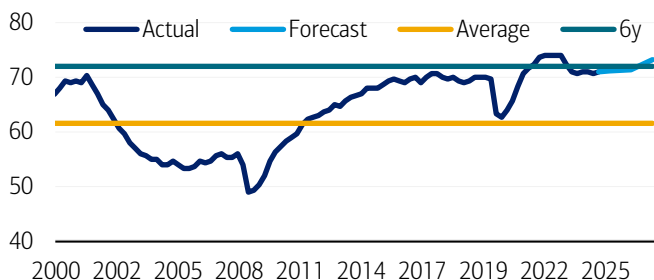
Following a WAM issuance reduction from the UK DMO (see: [Revised remit](#)) & signals that the Japanese MoF will reduce long end issuance in July, a WAM shift from UST is generally believed to be a matter of when, not if. We are hopeful that UST will increase long-end buyback operations at the August refunding after disappointing our expectations in May (see: [Signal miss](#)). We also believe it is inevitable that UST shortens their WAM & relies on more shorter-tenor funding given the back end supply / demand imbalance. However, a clear signal that UST will reduce WAM of issuance lower may not be explicit in August & UST acceptance of the policy shift may be further away than the market would like to believe.

UST has room to reduce WAM...

UST WAM is at historically elevated levels and is set to continue extending if supply continues to build across the curve (Exhibit 2). As discussed in [Seeking a signal](#), UST has options to reduce WAM of issuance going forward that will only modestly decrease WAM of debt outstanding. Historically, Treasury has not altered WAM of coupon issuance without an adjustment to total gross issuance. Therefore, we believe that a WAM adjustment would be most likely in February '26 refunding, when we expect UST to start growing auction sizes given our deficit forecasts.

Exhibit 2: Actual and expected WAM through FY '27 (months)

WAM expected to continue to rise unless Treasury adjusts issuance allocation

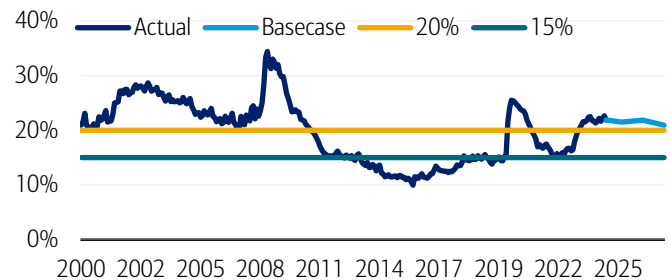


Source: BofA Global Research, US Treasury

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Exhibit 3: Bills as a % of marketable debt

We forecast Treasury will begin growing coupon auction sizes in Feb '26 to keep bills closer to 20% of marketable debt



Source: BofA Global Research, US Treasury

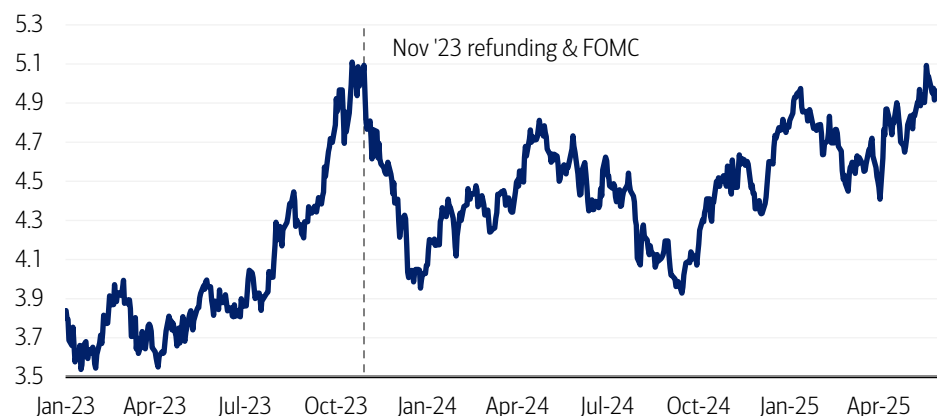
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Ahead of February, UST can take steps to set up this discussion. The market will be focused on the July 11 release of the dealer survey for any clues that UST is focused on making a WAM adjustment. A TBAC charge discussing options would also be a welcome signal for the market. Either could be a notable inflection for the long end and bring back buyer support as we saw in November '23 when Treasury increased back-end auctions by less than what TBAC had guided & many in market expected (Exhibit 4).

Exhibit 4: 30y UST yield (%)

Nov '23 refunding & FOMC meetings brought buyer confidence back to the market



Source: BofA Global Research, Bloomberg

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...but signal complicated with uncertain deficit trajectory

One complication with preliminary signals on WAM shift is that UST has yet to acknowledge a need to eventually grow issuance. The most recent refunding policy statement retained forward guidance on no change in coupon auction sizes over “next several quarters.” Bessent recent comments suggesting that the deficit will be lower over the next couple of years also push back on urgency of WAM discussion.

While this administration may take unprecedented action, we find it unlikely that TBAC would endorse raising auction sizes at the front-end & belly while cutting auctions at the long end of the curve. We think a WAM coupon issuance shift would most likely occur when UST grows auction sizes and would be implemented by concentrating growth across shorter tenors vs the back end of the curve. Without UST belief that auction size growth is imminent, it's hard to see them lay foundation for a shift in issuance.

Rather than UST guiding for an explicit shift lower in WAM at the August refunding, we see risk that Treasury simply accepts an implicit WAM shortening through higher bill issuance. Treasury Secretary Bessent is unlikely to signal a near-term increase in coupon sizes given his optimism that the upcoming tax bill will reduce the deficit. Instead, Treasury is likely to retain its signal of stable coupon sizes until the deficit proves otherwise (which may take several quarters after the tax law passage). Until auction sizes are increased, Treasury may rely on bill supply. Treasury is likely to accept an implicit WAM shortening until the tax law deficit impact is clear.

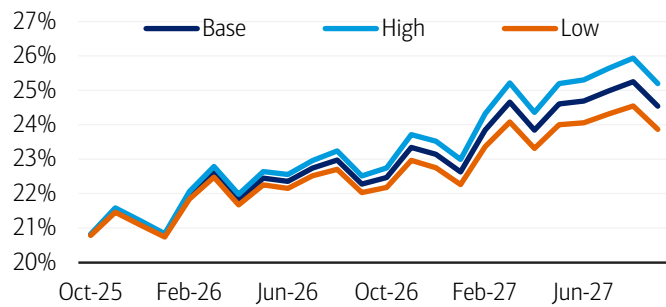
Run up the bills & test demand

A UST that does not account for higher deficits than realized will result in higher bill supply. As shown in Exhibit 3, bill supply as % of marketable debt has certainly exceeded current levels when there are large unplanned shocks in deficit financing such as during the GFC and COVID. Our baseline forecasts that stabilize bills as % of marketable debt assume \$280bn of coupon growth over four quarters starting in February 2026 (similar to \$300bn in four quarters in '23-'24).



Exhibit 5: Bills % marketable debt assuming no change in coupons

Bills rise through '26 above 22% without coupon increases under base & alternate deficit scenarios



Source: BofA Global Research

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If coupon increases do not materialize, bills as a share of marketable debt will continue climbing (Exhibit 5). Under our baseline deficit forecasts, bills exceed 23% of marketable debt in the second half of '26. These are levels last observed in early '21 when UST was growing coupon auction sizes to bring bill share lower. Our baseline forecast for coupon growth sees bills below 23% through FY '27 (Exhibit 6). The deficit scenarios we reflect are shown in Exhibit 7 (also see: [No respite for the deficit](#)).

Exhibit 7: Debt-to-GDP should continue to climb in the coming years

Summary table of our deficit scenarios

Scenario	Fiscal year	Deficit	Primary deficit	Interest	Revenues ex tariffs	New tariff revenue	Outlays ex interest	Debt-to-GDP
Low	FY 25	6.3%	3.1%	3.2%	16.7%	0.5%	20.2%	101%
	FY 26	6.2%	2.9%	3.3%	17.1%	0.9%	21.0%	104%
	FY 27	5.3%	2.1%	3.2%	18.1%	0.9%	21.1%	106%
Baseline	FY 25	6.3%	3.1%	3.2%	16.7%	0.5%	20.2%	101%
	FY 26	6.9%	3.5%	3.4%	16.6%	0.9%	21.2%	105%
	FY 27	6.8%	3.4%	3.5%	17.1%	0.9%	21.5%	108%
High	FY 25	6.3%	3.1%	3.2%	16.7%	0.5%	20.2%	101%
	FY 26	7.1%	3.8%	3.4%	16.6%	0.9%	21.3%	105%
	FY 27	7.1%	3.6%	3.5%	17.0%	0.9%	21.7%	108%

Source: BofA Global Research

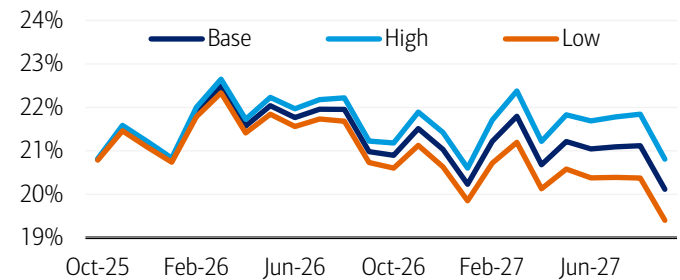
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Bill demand is strong but may not be unlimited

A Treasury that relies on more bill supply will test demand from front-end investors. Front end bill demand has been strong due to elevated US money market rates, money fund inflows, & recently restricted bill supply due to the debt limit. We expect bill demand will be tested amidst a large surge in bill supply after debt limit resolution (Exhibit 8, Exhibit 10). We expect ~\$950b bill supply from Aug to Nov '25.

Exhibit 6: Bills % marketable debt assuming baseline coupon growth across curve starting in February

Assuming coupon growth we expect, bills stay below 23% through FY '27 under base & alternate deficit scenarios



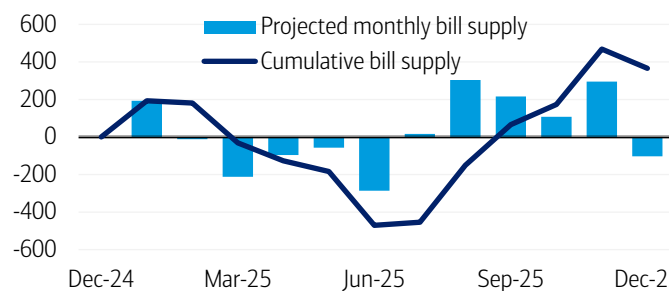
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Exhibit 8: Projected monthly bill supply and cumulative bill supply YTD (\$bn)

We forecast nearly \$950b in bills from August to November '25

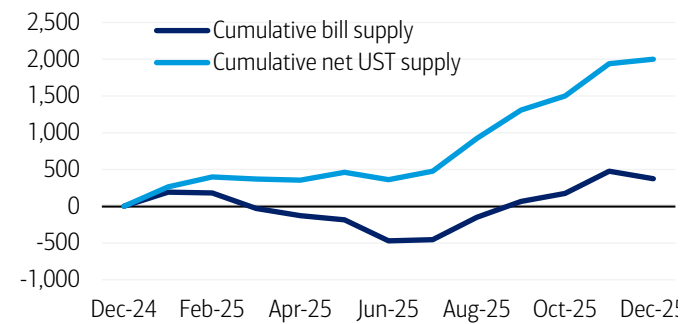


Source: BofA Global Research, US Treasury

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Exhibit 9: Projected cumulative net bill & total UST supply YTD (\$bn)

Cumulative UST issuance is forecasted to rise to \$2tn by year-end



Source: BofA Global Research, US Treasury

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Exhibit 10: Bill and coupon issuance estimates by month

We expect \$271b in bills in Q3, \$27b in Q4 as we head into another debt limit episode on Jan 1 2025

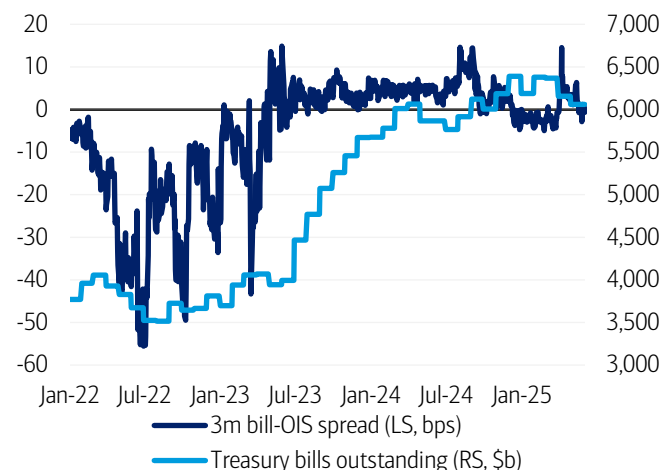
	Financing Need	TGA EOP	TGA Change	Other sources*	Marketable Borrowing	Net Buybacks	Net Coupon	Net Bills	Fed Coupon Maturities	Fed Bill Maturities	Net Coupons to the Public	Net Bills to the Public	Net Supply to the Public
	1	2	3		3 = 1 + 2	4	5	6	7	8	9 = 5 + 7	10 = 6 + 8	11 = 9 + 10
May-25	427	351	-327	-23	100	9	157	-57	5	0	162	-57	105
Jun-25	-152	400	49	-23	-103	31	183	-286	5	0	188	-286	-98
Jul-25	259	250	-150		109	9	93	16	5	0	98	16	114
Aug-25	242	450	200		442	9	138	304	5	0	143	304	447
Sep-25	-21	850	400		379	31	163	216	5	0	168	216	384
Oct-25	180	858	8		188	9	79	109	5	0	84	109	193
Nov-25	425	867	8		433	9	131	302	5	0	136	302	438
Dec-25	48	875	8		56	31	157	-101	5	0	162	-101	61
Jan-26	-109	883	8		-101	11	33	-134	0	0	33	-134	-101
Feb-26	571	892	8		579	9	125	455	0	0	125	455	579
Mar-26	472	900	8		480	9	193	287	0	0	193	287	480
Apr-26	-236	908	8		-228	31	76	-303	0	0	76	-303	-228
May-26	391	917	8		399	9	171	228	0	0	171	228	399
Jun-26	147	925	8		155	31	209	-53	0	0	209	-53	155
Jul-26	207	933	8		215	9	112	103	0	0	112	103	215
Aug-26	213	942	8		221	9	177	44	0	0	177	44	221
Sep-26	-110	950	8		-102	31	229	-331	0	0	229	-331	-102

Source: BofA Global Research, US Treasury, Federal Reserve

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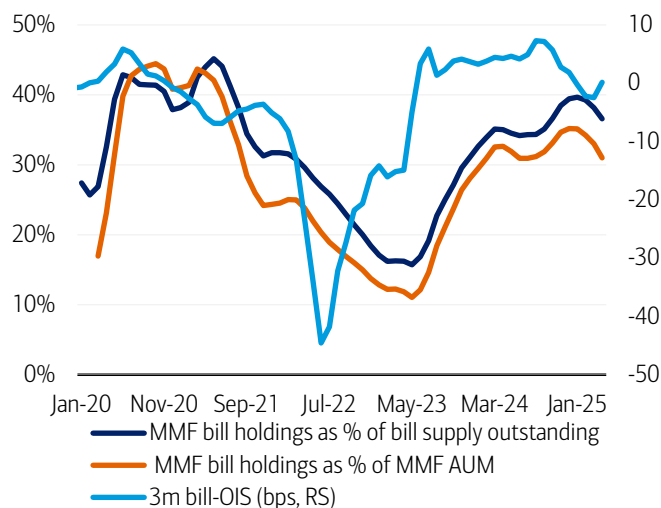
Exhibit 11: 3m bill-OIS spread and Treasury bills outstanding

\$950b of bills post debt limit resolution would imply 7bp of cheapening



Source: BofA Global Research, US Treasury, Bloomberg

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Exhibit 12: 3m avg MMF bill holdings vs 3m avg 3m bill-OIS spread
Historically, as bills cheapen vs OIS, MMFs increase bill holdings

Source: BofA Global Research, US Treasury, Bloomberg

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The nearly \$1tn of bill supply in 2H '25 will challenge the demand willingness of money market investors. To consider the impact on front end investors we look at the recent historic relationship of bills to (1) annual changes in bill supply (2) historic ownership of MMF in USTs. Thoughts on each:

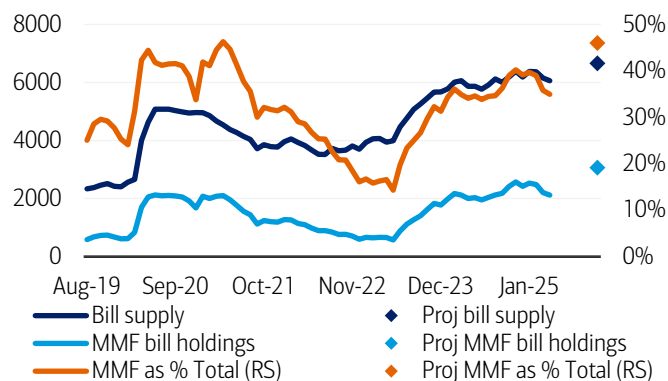
Bill supply swings: historically, large swings in bill supply have seen front end rates cheapen vs OIS (Exhibit 11); using the post '22 relationship between annual changes in bill supply & 3m bills-OIS would imply a cheapening of front-end USTs of 7bps as the \$950b of bill supply hits. These magnitudes are also consistent with levels that could be seen under a similar scenario to the '19 funding stress (Exhibit 14); other money market rates would also likely increase materially with elevated bill supply & limited excess liquidity. MMFs are often willing to increase bill holdings as bills cheapen vs OIS, which we saw in the post COVID bill supply wave (Exhibit 12) but they may be limited in capacity.

Historic ownership by MMFs: MMFs have historically owned a max of 46% of total fund AUM in UST bills. These funds currently own 35% in T-bills. If these funds were to return to their max allocation post debt limit resolution, it would imply total bill demand of \$950b, in-line with our supply estimates (Exhibit 13). We believe MMF could potentially absorb all the bill supply but it would crowd out repo.



Exhibit 13: MMF bill holdings vs total UST supply (\$bn)

We forecast MMFs will be able to take down most of the bill supply post DL



Source: BofA Global Research, US Treasury, Bloomberg

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Exhibit 14: Average level of key money market rates in prior repo periods vs current average level

We expect to see front-end rates move toward '19 levels

in bps	Pre Sep '19 avg (end April - end July '19)	Peak Funding Stress (end July - end Sept '19)	Normalization Period (end Sept '19 - end Jan '20)	Current Avg Level	Potential Move if Back to Peak Stress
3m Bill OIS	1.18	8.63	-0.18	-0.91	9.54
3m CP - bill spread	13.15	15.92	26.63	8.3	7.62
SOFR - IORB spread	7.24	15.14	2.06	-9.91	25.05
SOFR-FF spread	3.11	10.60	1.16	-3	13.60

Source: BofA Global Research, Bloomberg

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Bill holdings by investor base: We also looked at available data on T-bill holders as a % of assets across different investor bases using the last 5 years of data (see Exhibit 15). We found that the Fed's Z.1 data implies similar capacity for MMFs to take down bills when looking at bills as a % of total MMF assets, but to a slightly smaller magnitude. Insurance companies and pension funds are already at their max historical capacity, with additional capacity spread out across the remaining investor bases. Overall, the data implies the market has capacity to absorb up to \$1.9tn in additional bill supply if they're comfortable bringing bills back up to their prior max allocation. However, we note that some investors are already above their 5y historical average of bill holdings and this would imply the market has limited capacity to absorb supply without seeing rates cheapen.

Exhibit 15: Treasury bill holdings as percent of assets by investor base

Fed data suggests most of the capacity to take down additional bill supply will come from largely MMFs

	Nonfinancial business	ROTW	Foreign official	Private foreign	Insurance companies and pension funds	MMFs	Mutual funds	Issuers of ABS	Private Depositories	Monetary Authority	Total
Max	0.08%	2.81%	1.03%	1.80%	1.27%	43.75%	0.37%	0.72%	1.76%	5.31%	
Avg	0.05%	2.20%	0.67%	1.53%	0.80%	25.62%	0.19%	0.56%	1.28%	3.34%	
Current	0.05%	2.12%	0.54%	1.58%	1.27%	33.52%	0.04%	0.32%	1.44%	3.30%	
Current AUM (\$bn)	90,084	56,625	56,625	56,625	42,229	7,243	21,685	1,613	28,549	5,853	
Current - Max	-0.02%	-0.69%	-0.49%	-0.23%	0.00%	-10.23%	-0.33%	-0.40%	-0.32%	-2.00%	
Current - Avg	0.00%	-0.08%	-0.12%	0.04%	0.47%	7.91%	-0.14%	-0.23%	0.16%	-0.04%	
AUM * Max gap (\$bn)	20.09	392.44	277.70	128.28	-	740.78	71.80	6.41	90.80	117.28	1,845.60
AUM * Avg gap (\$bn)	(2.73)	44.69	69.67	(24.98)	(199.62)	(572.59)	30.82	3.76	(46.87)	2.40	(886.31)

Source: BofA Global Research, Fed Z.1

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Stablecoins could be another marginal source of bill demand

Another potential source of bill demand could come from stablecoins if proposed legislation on stablecoin reserve assets is passed (for detail, see [Stablecoins & USTs: demand & disruption](#)). Better regulation on stablecoin reserve assets will likely lead to increased demand for short-dated USTs over time. Treasury may lean on expected stablecoin demand to justify an increased reliance on bills in the near term. We expect stablecoin demand to evolve slowly in coming years but do not expect it to be enough to resolve the growing supply and demand imbalance for USTs as deficits continue to rise. We also do not expect this demand to prevent material bill cheapening as supply rises post debt limit.

Funding pressure post debt limit may require Fed support

In an extreme scenario post debt limit, money markets could see upward pressure akin to what was evidenced in '19. We think the '19 parallel is appropriate given relatively low levels of Fed ON RRP use & a highly uncertain amount of excess reserves with the Fed (our hypothesis = banks will not want to see their reserve holdings decline much below

\$3tn). To dimension how cheap US front end rates could re-price we show the average levels of key money market rates vs current levels today (Exhibit 14). The '19 levels are an extreme but we would not be surprised to see front end rates move in that direction & reach a generally similar magnitude.

If funding market rates become disorderly or trade above the top end of the target range, the Fed will step in to stabilize money markets. It may well be that UST supply is squeezed hard enough towards shorter-dated issuance tenors such that traditional private sector demand is exhausted & the Fed is required to provide support.

Overall, we would not be surprised to see Treasury implicitly rely more on bill supply over coming months until the deficit impact from the tax law is clear. If Treasury relies too much on bill supply, it will cause money market rates to reprice meaningfully. This re-pricing could force the Fed to intervene in money markets (initially vs SRF, eventually via outright bill buying) & provide the ultimate UST market backstop role. Said differently, Treasury may squeeze the UST supply balloon enough to ultimately trigger Fed support; Fed support is likely easier found at the front-end vs long end.

Market implications: a Treasury that implicitly accepts a WAM shortening & relies more heavily on bill supply will cheapen money market rates & front-end spreads. We expect this cheapening to be most evident after the debt limit is resolved & the bill supply flood gates are opened. We encourage patience in setting up for this trade until the debt limit is closer to resolution. Before the debt limit is resolved, front end spreads will continue richening with stable funding & limited bill supply. The front-end cheapening should be clearly evidenced after the debt limit is resolved,

Bottom line: clients have frequently asked what the official sector can do to support the Treasury market. We think the path of least resistance is for Treasury to shorten issuance, though they may only accept an implicit WAM shortening near term. A Treasury unwilling to grow coupon supply would mean increased reliance on bills. We expect to see bills and front-end spreads cheapen after debt limit resolution. We would not be surprised to see the UST supply balloon squeezed enough at the back end to eventually trigger a backstop from the Fed at the front end.



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