Global Equity Research
Industry Note

MONETARY POLICY RESEARCH

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The Treasury Shift from Bills and QT Taper Timing

KEY TAKEAWAYS

Predictably, given the TGA balance is now near target of $750B, Treasury expects to reduce bills in the issuance mix beginning late March/early April when: (i) RRP will likely have exhausted (reducing money fund demand for bills); and (ii) tax receipts start flowing (reducing Treasury need for cash).

Over time, we expect Treasury to reduce bills as a proportion of net marketable debt outstanding from the current 22% towards the lower end of the usual range of 15-20%. This will provide Treasury with the ability to use bills as a 'shock absorber' to raise cash during recessions as it has in the past.

Once RRP exhausts, QT will begin to impact bank reserves more directly. Reserves currently stand at $3.5T so $700B more than our estimate of $2.8T for the lowest comfortable level. At a monthly rate of $95B, this provides QT with runway of 7-8 months.

This runway begins once RRP exhausts in April and so puts the timing of QT termination late this year with taper likely to begin 3-6 months before that. Meanwhile, the standing repo facility (and, possibly, a de-stigmatized discount window) allows the system to address the fact that reserves are not distributed evenly through the banking system bur rather disproportionately held by SIFIs.

Ratings

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The Treasury Shift from Bills and QT Taper Timing

We do not expect any change to the rate of decline in reverse repo (RRP) balances even as Treasury shifts its funding mix to coupons from bills beginning in late March/early April (Ex 1).

Ex 1: Treasury Net Borrowing and Funding - $B

	Borrowing	Coupons	Bills
22Q1	668	509	159
22Q2	(24)	381	(405)
22Q3	337	216	121
22Q4	234	181	53
23Q1	436	65	371
23Q2	477	79	398
23Q3	852	58	794
23Q4	605	190	415
24Q1	760	318	442
24Q2	202	519	(317)

Source: SIFMA for Actuals and TBAC for 24Q1 and 24Q2 estimates

The shift was expected since, with its general account at the Fed near a target balance of $750B, Treasury will look to reduce the share of bills in its outstandings from the current 22% towards to a more usual range of 15-20%. This will allow the headroom for Treasury bills to act as 'shock absorbers' to fund financing needs during recessions and will reflect a likely decline in demand for bills from money funds once RRP is drained.

The normalization of funding mix is usual after periods of disproportionate bill supply that typically occurs during and coming out of recession: 84% in the 3-months after the CARES Act was passed in March 2020, 78% in the 2008 recession, and 117% in the 2001 recession. This time around the tilt was driven not by recession but by a desire to rebuild the balance at the Treasury General Account (TGA) at the Fed to its target of $750B from a low of <$50B just before the debt ceiling was suspended in June 2022.

Consistent with normalizing the funding mix, in its Quarterly Refunding Announcement (QRA) today, Treasury anticipates 'modestly reducing short-dated bill auction sizes … these reductions will likely lead to a

$100-150B reduction to privately-held supply during the month of April' versus a net increase of $300-350B over the next two months.

This timing of the reductions for early March/late April coincides with tax-filing season, so that Treasury has less need to supply bills, and with the likely exhaustion of the RRP balance (assuming it continues to decline from the current level of $640B at the rate of $225B/month over the last 7 months), so that money funds will have less demand.

Meantime, bills pay more than RRP (20bps more for 1-month paper) and we expect Treasury to increase net supply if there is excessive relative richening. Further, through the private repo market, coupon securities can increase the supply of synthetic bills in the form of repo loans.

Given we expect RRP to continue to drain, we do not expect quantitative tightening (QT) to end until late, if at all, this year. RRP has, of course, been important in buffering reserves from the impact of QT: indeed, reserves have increased over the period by $300B to the current level of $3.5T even as the Fed's securities portfolio has declined by $1.4T to the current balance of $7.1T. The reason is that RRP balances have fallen over the same period by $1.6T.

However, there are more than ample reserves so that QT can continue for some time even after RRP is exhausted. Specifically, reserves stand at $3.5T so $700B more than our estimate of $2.8T for the lowest comfortable level of reserves (LCLoR). This provides QT, at a monthly rate of $75B/month, with a runway of 7-8 months beginning once RRP exhausts in April.

Yes, reserves are not evenly distributed through the banking system with the SIFIs banks holding most of the more-than-ample amount and other banks holding nearer pre-pandemic levels. However, it is the SIFIs – particularly JPM – that drive the repo market so that a repeat of the dysfunction in September 2019 is unlikely while reserves are above LCLoR in aggregate.

Further, banks with uncomfortably low reserves can tap the Fed's standing repo facility established in July 2021 or the discount window particularly if regulators are successful in reducing any stigma attached to it through mandatory access requirements.

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