Debt Limit Will Complicate Bill Supply Normalization, BofA Says

By Alexandra Harris

(Bloomberg) --

Treasury bill supply could rise by $1 trillion by the end of 2023, but the impending debt ceiling episode will complicate the timing, according to Bank of America strategists.

- Strategists Mark Cabana and Katie Craig estimate Treasury will issue about $193 billion of bills in 4Q 2022 and $257 billion in 1Q 2023, with particularly strong months of supply in November, February and March because they are typically heavy deficit months that require additional issuance to sustain the cash balance
- However, bill supply projections and the associated market impact are complicated by uncertainty around the timing of the debt limit, another round of money-market reform and the Federal Reserve's quantitative tightening
- Positive quarters of bill supply should help cheapen bills relative to overnight index swaps, and strategists estimate spreads should narrow by 10 basis points or more
- Still, the monthly path of bill issuance is "much less clear" because of the debt ceiling, which could become constraining as early as December 2022
    - At that point Treasury would enter a debt issuance suspension period, which would restrict their ability to issue debt -- likely cutting bills to keep coupon sizes unchanged
- Strategists project the potential default, or x-date, would be in August or September 2023. After that, there would be a surge of bill supply to replenish the cash balance
- Elsewhere, overnight general collateral repo first traded at 3.83% with a bid-ask of 3.83%/3.82%
- This week's uptick in balances at the overnight reverse repo facility, may have been related to recent inflows into government money-market funds, according to Wrightson ICAP
- Government money-funds saw inflows of $36.1 billion in the week ended Nov. 2, Investment Company Institute data show. That snapped four straight weeks of outflows that totaled about $52.5 billion
- Meanwhile, Fed-dated swaps are pricing in slightly higher policy peak, reaching around 5.25% by the middle of next year after October jobs report printed above expectations for headline number

FED OPERATIONS AND PUBLISHED RATES

- Fed funds effective rate 3.83% on Nov. 3, up from 3.08% on Nov. 2; compares with interest on reserve balances rate of 3.90%
- Fed funds traded in a 3.80%-4.05% range, according to data posted on the New York Fed's website
    - Volume fell to $97b
    - 75th percentile rate rose to 3.84%
- Overnight Bank Funding Rate 3.82% on Nov. 3 vs 3.07% prior trading day
    - OBFR volume $284b on Nov. 3 vs $292b prior trading day
- Repo operations:

- N.Y. Fed accepted $1.00m in bids at o/n repo op on Nov. 3
- Reverse Repo operations:
  - There were 105 participants in the overnight RRP action on Nov. 3
  - Facility tapped for $2.22t

SECURED RATES

- Secured Overnight Financing Rate set at 3.80% as of Nov. 3 vs 3.05% the prior session
- Overnight repo 3.85%/3.81%
- 1-week repo 3.84%/3.80%
- 2-week repo 3.84%/3.80%
- 1-month repo 3.84%/3.80%
- Daily total US Treasury repo fails fell to $36.8b on Nov. 3 from $43b prior session, DTCC data show

TREASURY CASH BALANCE AND BILLS

- The US Treasury's cash balance rose to $552b on Nov. 2 from $551b prior session
- Market bill rates as of 9:05 am New York
  - 1-month Treasury bills 3.384%
  - 3-month Treasury bills 4.03%
  - 6-month Treasury bills 4.435%
  - 3-month T-bill-OIS spread was minus 11.9 bp from minus 10.1 bp the prior session

UNSECURED RATES

- Dollar Libor rates
  - 1-month 3.8581% on Nov. 4 vs 3.8466% on Nov. 3
  - 3-month 4.5503% vs 4.5316%
  - 6-month 5.0113% vs 4.9973%
  - Spread between 3-month Libor and OIS 30.5 bps from 30.3 bps the prior session
- For the second straight session, there were no issues with 81+ days to maturity on Nov. 2
- Total outstanding commercial paper rose to $1.301 trillion in week ended Nov. 2, vs $1.301 trillion the week prior; foreign financial CP outstanding rose to $447.8b from $435.9b

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This story was produced with the assistance of Bloomberg Automation.