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SHORT THOUGHTS

November 26, 2024

New Treasury Secretary, New Issuance Patterns

Longer Maturities Could Meet Waning Demand

- Scott Bessent has been nominated as Trump's treasury secretary – a move viewed positively by markets
- Bessent has advocated extending the maturity of Treasury debt issuance
- We have observed waning demand at the long end of the curve – something to watch

Hedge fund boss Scott Bessent has been nominated as the incoming administration's pick for US treasury secretary. Seen as a relatively mainstream choice, Bessent has already coined a slogan for his policy priorities: "3-3-3." Pursuing a 3% budget deficit relative to GDP by 2028, increasing oil production by 3m barrels per day, and a 3% GDP growth rate. Markets cheered his nomination, with stocks higher and the USD and bond yields lower.

For us, it's still early days, and along with his 3-3-3 goals, Bessent has said his near-term priority is to make the 2017 income tax cuts permanent. It's hard for us to square a 3% budget deficit (it's currently 4.3% and rose from 3.1% in 2017 to 4.6% by the end of 2019) with a potential $5trn hit to government finances associated with extending the tax cuts, absent a severe contraction in government spending. We still await details of the new Department of Government Efficiency's plans to scale back spending, but we would be surprised to see savings equivalent to the size of the tax cuts, hence it is unlikely for fiscal policy to remain deficit neutral.

We expect details to emerge as we enter the new year and, of course, once the new administration is in place. We also point out that the treasury secretary doesn't have responsibility for changing the US tariff regime, this rest squarely with the president and his

advisors. No legislation is needed, as changes in trade policy of this type are already enshrined in law as within the executive's responsibilities.

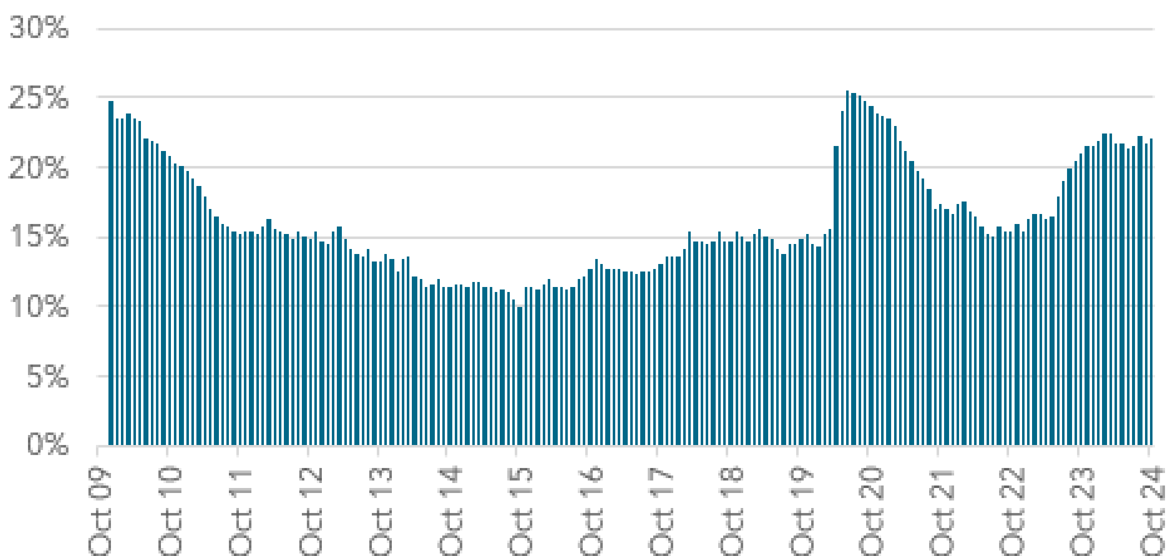
One power that the new SECTREAS will have relates to debt issuance policy. In recent years, the government has financed additional spending through bill issuance – going back to the COVID stimulus program enacted in the first Trump administration, continuing through the Biden administration's spending program to date. Since January of 2017, the first year of the first Trump administration, total T-bills outstanding increased from $1.8trn to $6.2trn, an increase of some 250%, while bonds outstanding rose from $1.9trn to $4.7trnm, up just over 150%.

In proportion to all marketable government debt, bills now comprise around 22% of the total. Exhibit #1 makes clear both in the early days of the pandemic as well as the second two years of the Biden administration this share has jumped twice to its historically high level currently. Figures around the incoming administration, including Bessent, have advocated increasing the average maturity of new debt issuance.

The Treasury Borrowing Advisory Committee (TBAC) has long recommended that the T-bill share comprise about 15% to 20% of total issuance, but have accepted higher levels lately, with the expectation that the share of bills relative to total supply ultimately return to 20%. With the new administration's preference for longer-dated issuance, this threshold could be back in sight in late 2025.

In response to a recent Treasury Department charge, members of TBAC argued that bill issuance served as an optimal shock absorber to allow regular and predictable coupon issuance. In other words, using T-bills to top up funds if spending and/or revenue needs change swiftly, and therefore not interfering with coupon issuance. We have shown in a previous Short Thoughts (see here) that bill supply in recent years has been met with almost inelastic demand, with issuance of short-maturity bills being fully snatched up by real money investors, according to iFlow.

Exhibit #1: Breaking Historical Thresholds



Source: BNY Markets, US Department of the Treasury

A change in the maturity structure of debt issuance could have implications across the curve and suggests that demand for longer-dated US debt would have to increase. We pointed out recently that cross-border investors, as detailed in our iFlow data have cut back on their UST buying across the curve (see here), and we are interested to see if changing issuance patterns – including potentially increasing coupon supply in absolute as well as relative sizes – can be met with sufficient demand in 2025.

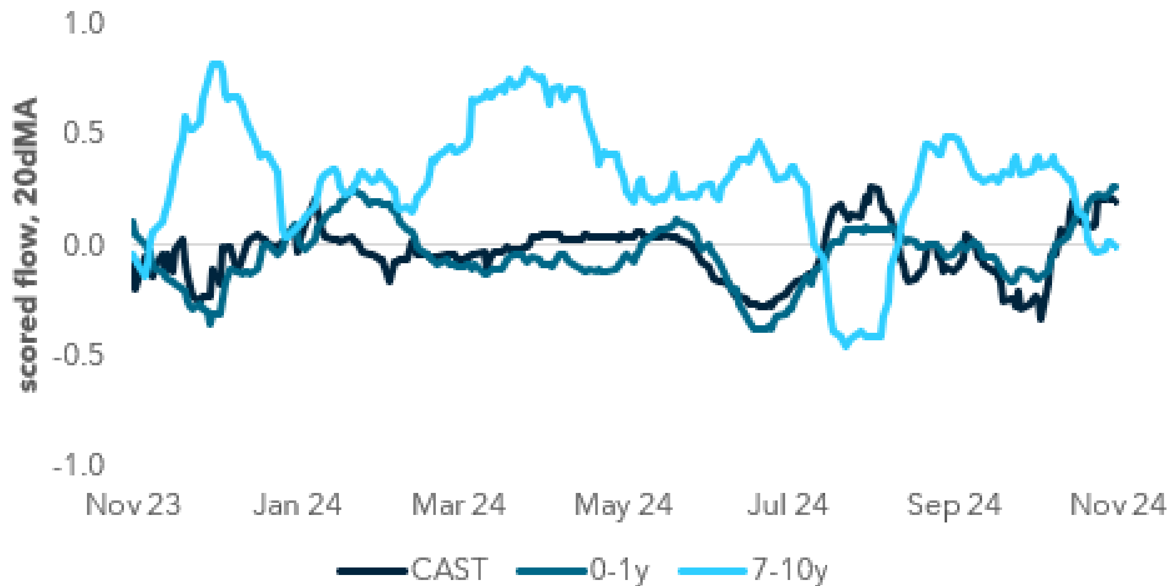
Exhibit #2 shows that total demand across the front end of the curve (0-1y maturity sovereign debt as well as cash and short-term assets) is generally strong and has been increasing for several months. Meanwhile, total (including both cross-border and domestic investors) demand for the longer part of the curve, in this case the 7-10y portion, is flat and has dropped over the same period.

The simplest implication of this pattern of UST flows is for curve steepening, buying the short end and selling the long end, but these could just be reflecting some short-term investor preferences resetting, both in response to the election as well as to changing expectations of FOMC policy going into 2025.

The nature of these flows could be temporary and policy changes could lead to different demand patterns, especially when considered as part of the new administration's overall economic policy. In Monday's piece, we expressed our concern about a wholescale retreat

from USTs in almost every sector of the curve and pledged to watch these data carefully for signs of a buyers' strike. We are also keen to hear about new borrowing and fiscal plans, while keeping an eye on the data shown below.

Exhibit #2: Selling Long Maturities, Buying Short Ones



Source: BNY Markets, iFlow

Please direct questions or comments to: iFlow@bny.com

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John Velis

AMERICAS MACRO STRATEGIST

CONTACT JOHN

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