

Economics and Rate Strategy

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Economics and Rate Strategy *Treasury Refunding Highlights*

- In its quarterly refunding statement this morning, Treasury announced no changes to its already-elevated slate of nominal coupon auctions. **Treasury also affirmed that it “currently anticipates no further changes in issuance sizes for nominal coupon and floating rate notes for the remainder of the 2019 calendar year.”**
- That said, the amount of maturing coupon securities is set to rise substantially over the next couple years. With current auction sizes raising less and less new money over time, and because we expect the deficit to continue growing over the next couple years, **we expect Treasury will eventually need to increase auction sizes. In our view, the increases will occur no sooner than the second half of 2020.**
- Updated quarter-end cash balance estimates released on Monday are somewhat higher than we had anticipated. **Consequently, we now expect net T-bill issuance to be just shy of \$200 billion for the second half of this year and \$202 billion in Q1-2020.**
- Despite some shifts in the timing, the overall story for T-bill supply has not changed on balance: **we expect an inflection point in bill supply is imminent, and is unlikely to reverse until next April’s tax receipts come in.**
- Treasury also announced what we expect to be the final adjustments for quite some time to its TIPS issuance schedule. The changes include a \$2 billion increase to the August 30y TIPS reopening and a \$1 billion increase to the September 10y TIPS reopening. **These changes to TIPS issuance were in line with what we had anticipated in our preview piece.**
- **For 2019 as a whole, we look for net Treasury issuance to be \$1.1 trillion, after accounting for changes in holdings by the Federal Reserve.** The coupons/bills split is about \$1 trillion and \$100 billion, respectively. In 2020, we look for \$629 billion in net coupons and \$259 in net bills, again after accounting for anticipated changes in Fed holdings.

**Please see page 4 for the rating definitions, important disclosures and required analyst certifications.
All estimates/forecasts are as of 07/31/19 unless otherwise stated.**



No Change to Nominal Coupon Auction Sizes

In its quarterly refunding statement this morning, Treasury announced no changes to its slate of nominal coupon auctions. [As we highlighted in our preview piece](#), our deficit forecasts already assumed a budget deal along the lines of what was agreed to last week. Large deficits should result in continued heavy Treasury supply, but the end to the Fed’s balance sheet runoff reduces the need to increase auction sizes in the immediate future. Based on our estimates, the Fed could purchase as much as \$291 billion of Treasury securities through auction add-ons (reinvesting maturing Treasuries) and \$234 billion in Treasuries through secondary market purchases (replacing MBS principal paydowns) in 2020 (Figure 1). On balance, this should help reduce the need for near-term changes to the auction schedule. Treasury affirmed this morning that it “currently anticipates no further changes in issuance sizes for nominal coupon and floating rate notes for the remainder of the 2019 calendar year.”

However, Treasury needs to cope with a wave of maturities. Treasury began a broad-based effort to ramp-up auction sizes early in 2018, and by Q1-2020 the first wave of this higher supply will begin to mature, since the shortest-dated nominal coupon security is a 2y note. This means that, all else equal, net issuance almost certainly will fall if coupon auctions hold steady in size. Figure 2 highlights the expected maturity schedule over the next two years for coupon-bearing Treasury securities.

We expect the U.S. federal budget deficit to continue growing over the next couple years, which will put additional pressure on Treasury to increase auction sizes at some point. While still a ways away at this point, we expect the increases to occur no sooner than the second half of 2020.

Figure 1

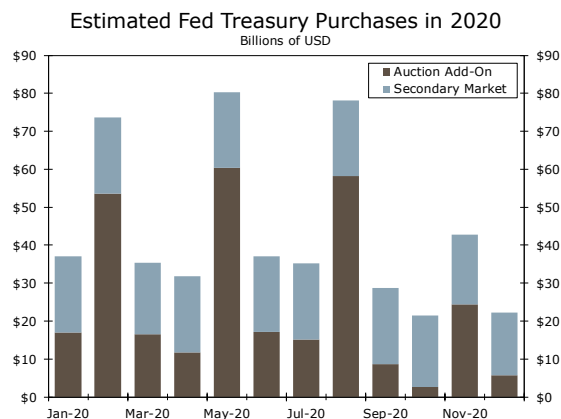
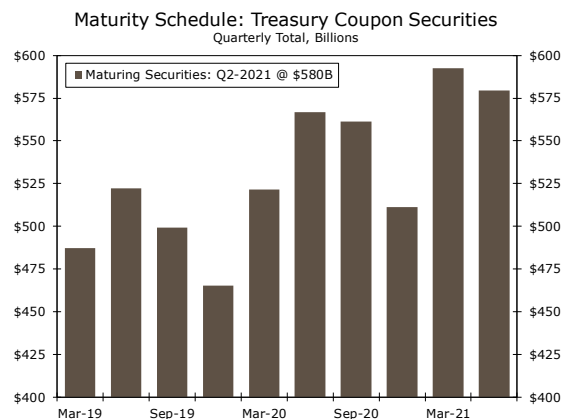


Figure 2



Source: U.S. Department of the Treasury, Bloomberg LP and Wells Fargo Securities

Bill Supply: More in the Near-Term, Less in Q1-2020

Updated quarter-end cash balance estimates released on Monday suggest the Treasury will rebuild its cash balance more aggressively than we expected. Treasury’s cash balance assumptions are \$350 billion at the end of Q3 and \$410 billion by the end of the year. Assuming Treasury hits these targets, some of the bill issuance we previously had penciled in for calendar Q1-2020 should be pulled forward. We now expect net bill issuance to be just shy of \$200 billion for the second half of this year and \$202 billion in Q1-2020 (Figure 4). Note that about \$40 billion of bills was paid down in July, meaning that the August-December period would see about \$240 billion in net bill supply.

In a surprise to some market participants, Treasury did not announce an increase to 1m and 2m bills set to be auctioned on Thursday August 1, holding them constant at \$35 billion each. Given that the recent budget agreement is yet to be formally signed into law, Treasury may simply be prudently waiting for the all-clear signal to ramp up issuance. With the Senate scheduled to leave for recess on Friday, the bill will likely be law by the end of the weekend. We look for Treasury to boost the 3m and 6m auctions slated for Monday August 5 (Figure 3). As we have previously noted,

increased bill supply could put further pressure on funding markets, and this pressure could be particularly pronounced at the end of Q3.

TIPS Adjustments Likely Complete... For A While

Treasury announced a few adjustments to its TIPS issuance schedule. The changes were a \$2 billion increase to the August 30y TIPS reopening and a \$1 billion increase to the September 10y TIPS reopening. With these changes fully phased in 2020, TIPS issuance on a gross basis will be \$155 billion, an increase of \$24 billion for the year.

Figure 3: WFS weekly bill issuance forecast, Q3-2019

week of	4-week	8-week	13-week	26-week	52-week	net supply
7/1/2019	40	35	36	36	0	-9
7/8/2019	40	35	36	36	0	-6
7/15/2019	35	35	36	36	26	-11
7/22/2019	35	35	36	36	0	-14
7/29/2019	35	35	36	36	0	-11
8/5/2019	35	35	39	39	0	-5
8/12/2019	55	35	42	39	26	23
8/19/2019	65	35	45	39	0	39
8/26/2019	65	35	45	39	0	39
9/2/2019	65	35	45	39	0	39
9/9/2019	65	35	45	39	26	19
9/16/2019	65	35	45	39	0	9
9/23/2019	60	35	45	39	0	4
Prior Quarter CMB						-
Current Quarter CMB (issued and mature in Q3)						50
Q3 total						116

Source: Bloomberg LP and Wells Fargo Securities

Figure 4: Gross and Net Treasury Issuance, 2019-2020

Security	Historical Q1 2019	Historical Q2 2019	Projected Q3 2019	Projected Q4 2019	Projected Q1 2020
Notes & Bonds					
2y	120	120	120	120	120
3y	114	114	114	114	114
5y	123	123	123	123	123
7y	96	96	96	96	96
10y	75	75	75	75	75
30y	51	51	51	51	51
2y FRN	56	56	56	56	56
TIPS					
5y TIPS	0	32	0	32	0
10y TIPS	24	11	26	12	26
30y TIPS	8	0	7	0	8
Total					
Net Coupons	180	209	230	288	235
Net Bills	140	-229	116	82	202
SOMA Redemptions	65	65	43	0	0
SOMA Purchases (-)	0	0	0	60	59
Coupons	0	0	0	51	50
Bills	0	0	0	9	9
Net Coupons to the Public	245	274	273	237	185
Net Bills to the Public	140	-229	116	73	193
Cash Balance (Quarter-End)	334	264	350	410	375
WAM	69	70	70	70	71

Source: Bloomberg LP and Wells Fargo Securities

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