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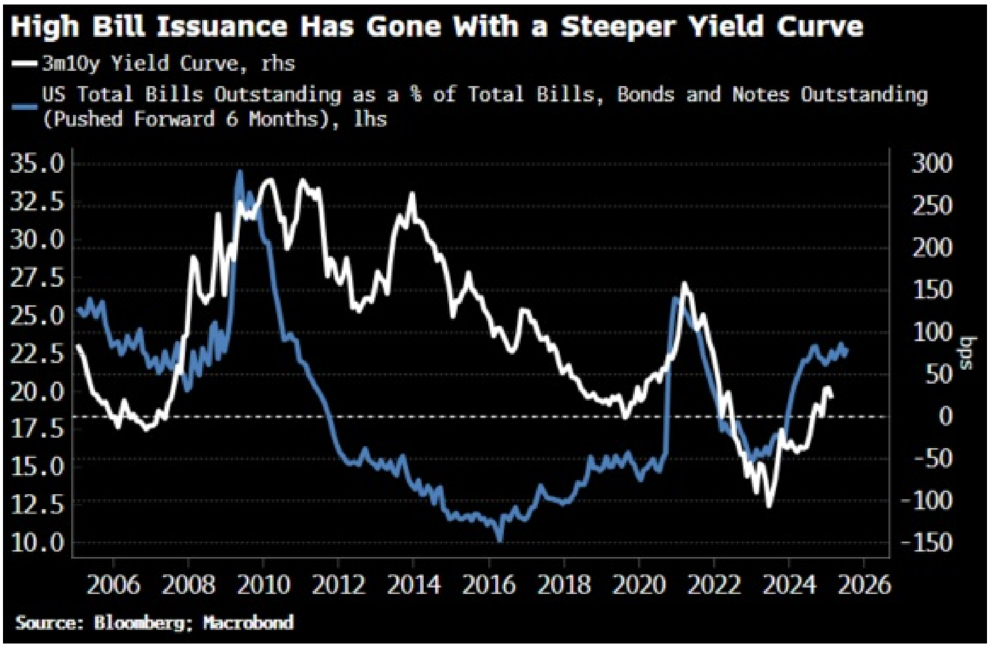
# Bessent Won't Get Lower Yields With This Many Bills: MacroScope

By Simon White

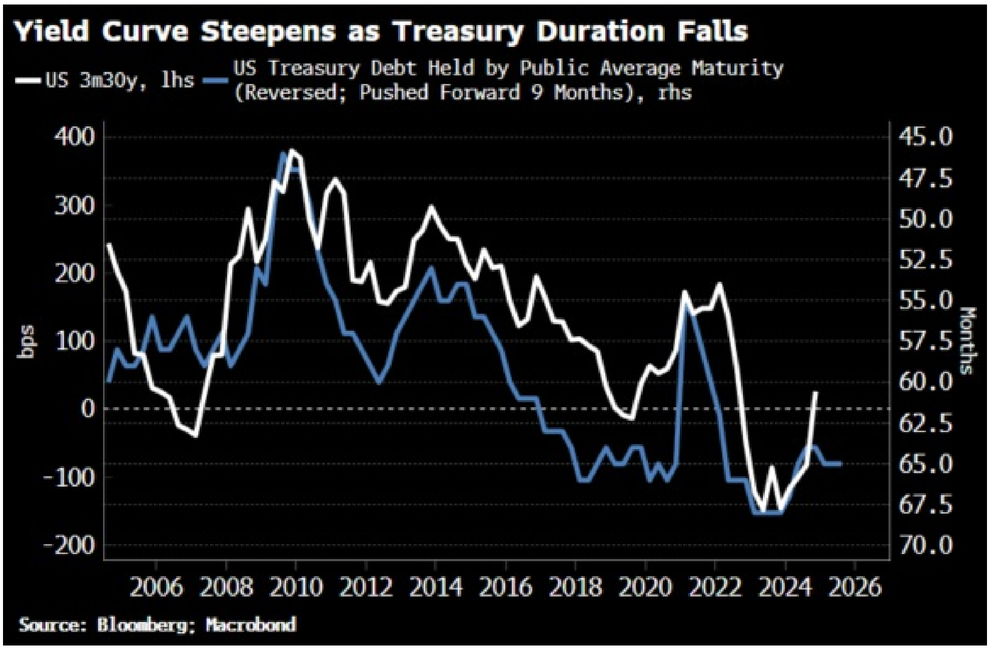
(Bloomberg) -- Treasury Secretary Scott Bessent's desire for lower long-term yields faces resistance as bills continue to make up a significant proportion of government debt, and money market fund assets grow far in excess of bank deposits.

- If you hadn't got the hint yet, the US administration is not focused on Wall Street at the moment. As explicitly stated by Bessent this week, Main Street is the priority. The key arrow of this rebalancing strategy is lower longer-term yields and thus, ex a recession, a flatter curve.
- A "defense of the realm" selloff in European bonds is hampering that strategy this week as it bleeds into the US bond market, but it also faces significant structural challenges.
- Most prominent is that the gross issuance of bills continues to be huge. In 2023 Bessent's predecessor, Janet Yellen, ramped up bills issuance in the "Yellen pivot," allowing money market funds to finance the deficit via liquidity parked at the Federal Reserve's reverse repo facility (RRP).
- Bessent, contrary to comments he made before taking office objecting to the government's reliance on short-term debt, has said he has no immediate plans to rein in bill issuance. But this might make his task more difficult. As the chart below shows, it's likely to lead to a steeper yield curve.

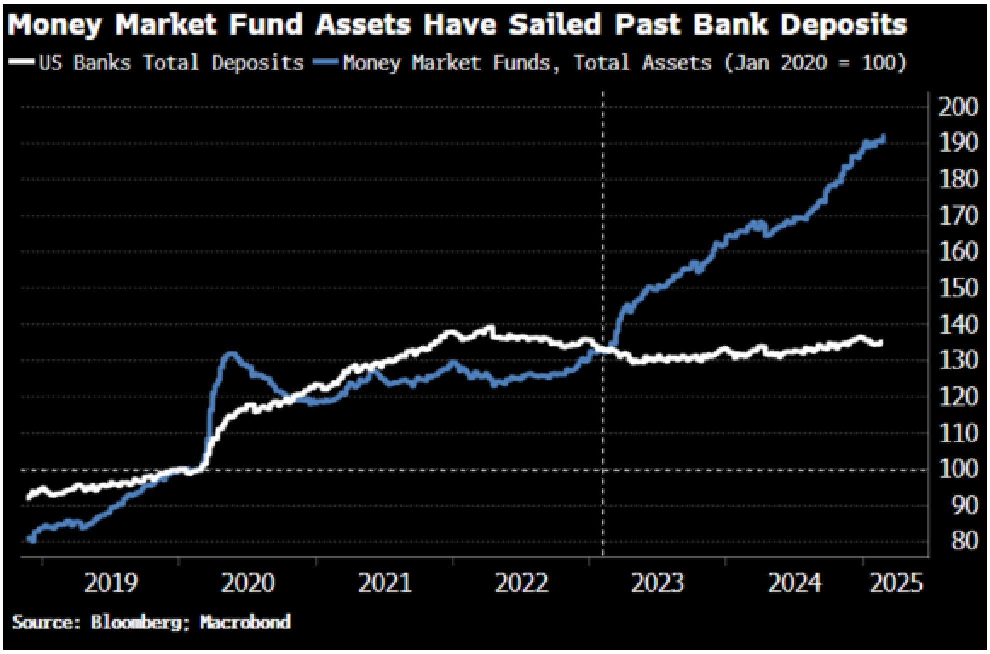



- The relationship is perhaps counter-intuitive, as normally the expectation is that more supply at the front-end would flatten the curve. But demand for bills is fairly elastic and therefore is absorbed by the market, while at the margin reducing the demand for longer-term bonds. At the same time, longer-term debt is also not in short

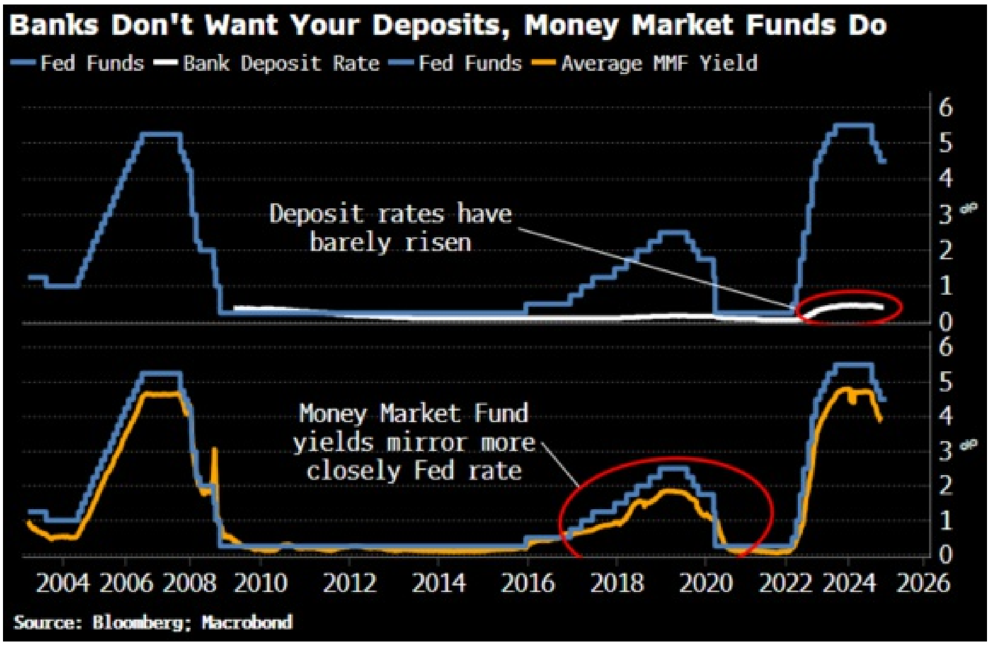
supply. Thus the curve has tended to steepen.
- That's corroborated by looking at the WAM (weighted-average maturity) of Treasury debt held by the public. As that falls, the curve typically steepens. Without a determined effort to raise the debt-pile's WAM, the curve is unlikely to be able to flatten on a sustained basis.



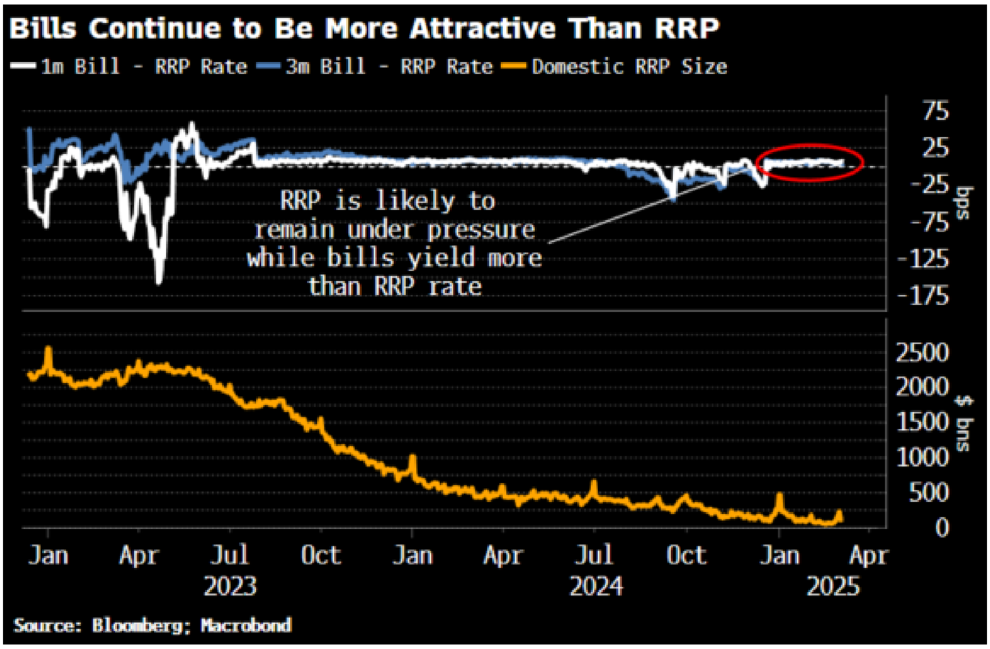

- That's not all though. The assets of money market funds have been growing at a rapid rate while bank-deposit growth has stagnated. MMFs' growth is likely to imply continued firm demand for bills and other short-end products such as repo, while lower deposit growth will reduce banks' need for Treasuries. That doesn't help reduce long-term yields or bring about a flatter curve.



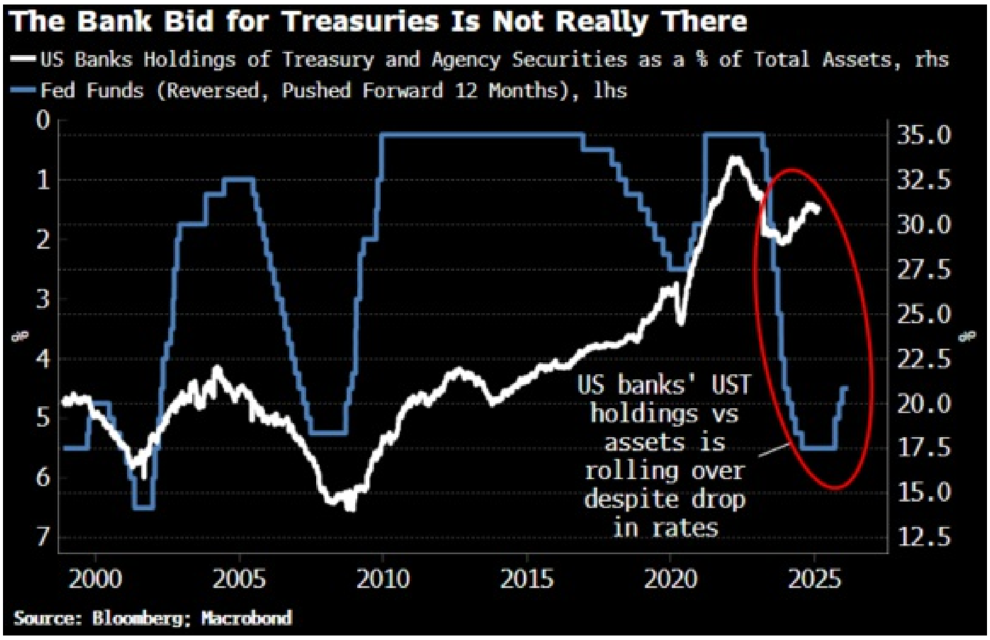

- A regime of abundant reserves meant many of the largest banks did not want more deposits due to the cost of carrying them on their balance sheets. They therefore did not raise deposit rates as the Fed hiked its policy rate. MMFs, however, did increase the yield on their products, and as the public got wise to miserly banks, MMF assets swelled.



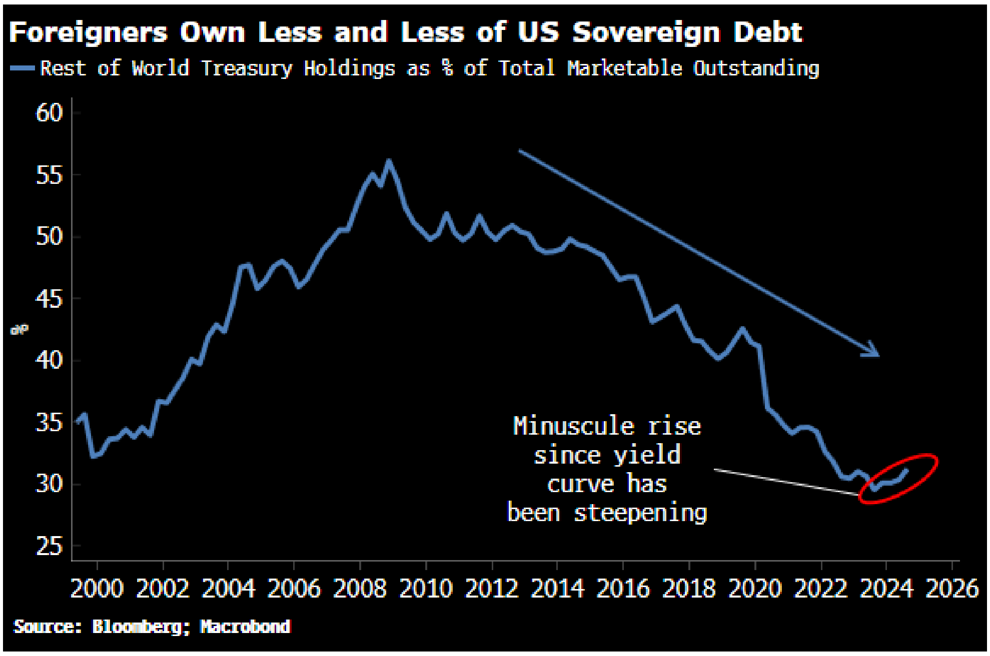

- MMFs could of course start to refill the ever-dwindling RRP, which hit a cycle-low of $59 billion recently, and buy fewer bills. But securities with one and three-month maturities continue to trade over the RRP rate, which was reduced by the Fed in December to match the lower bound of its target range. While that's the case, MMFs are likely to keep their bid for bills.



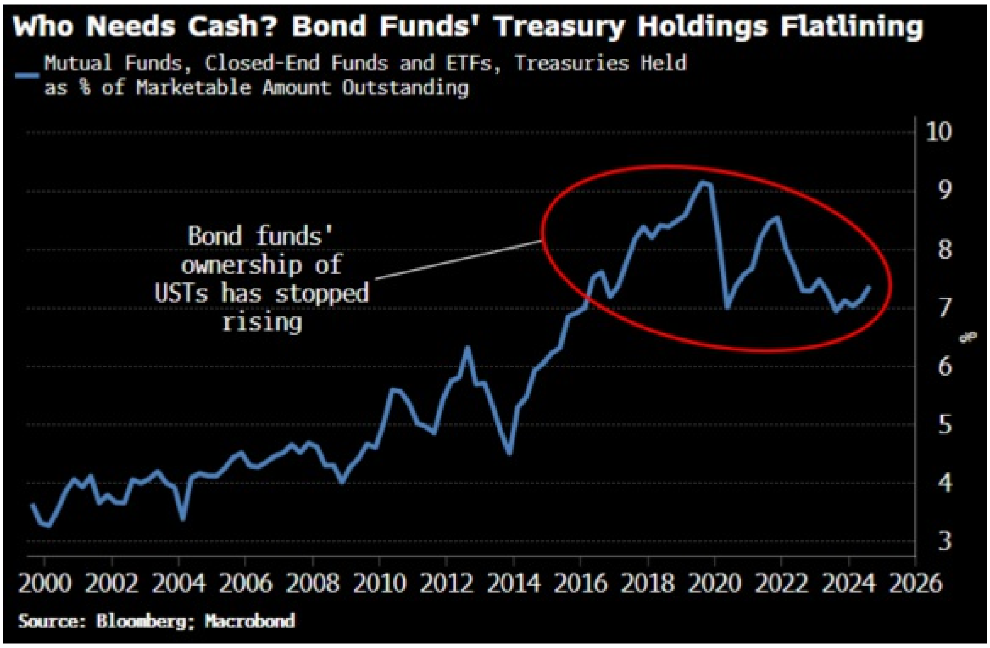

- We would need to see a significant rise in expected Fed rate cuts to make bills relatively less attractive. Given inflation remains stubborn, that would likely take a recession, and the data gives little hint that's on the cards in the near future.
- While MMFs *are* buying bills, banks *aren't* buying Treasuries in any notable size, with their holdings barely climbing despite the recent rise in the Fed's policy rate.




- Yet demand problems for Treasuries don't end there. Foreigners have not returned to the market in any size even as the curve steepens, which would typically encourage carry traders to buy. The largest holder of Treasuries, Japan, has seen its holdings drop by the most since 2022, a retreat exceeded only by China.
- Rumblings of a Mar-a-Lago accord are also scaring the horses. Central-bank holdings of Treasuries were already falling, especially since Russia invaded Ukraine, and private buyers are not so far picking up the slack.



- Some domestic buyers have stepped back too. Bond funds are using Treasury futures much more for their duration hedging, reducing their need to own cash Treasuries. Not only is that adding to risks of a disorderly basis-trade unwind, it is also potentially adding to reduced demand in the bond market by exacerbating illiquidity in off-the-run Treasuries.




- Along with inflation and the current volume of issuance, it's hard to see how yields can fall much. But if the status quo doesn't hold, here are four possible ways they could drop:
  - Recession
  - DOGE-led fiscal savings
  - QE or yield-curve control
  - Treasuries are carved out from the Supplementary Lending Ratio
- Obviously the first would not be desired, and the first and second are not necessarily mutually exclusive. The third is highly unlikely for now.
- The last one is probably the most painless, and is certainly a possibility as a part of bank deregulation. It was mentioned in the policy considerations section of a Treasury Borrowing Advisory Committee presentation from last year. Moreover, there is precedent as Treasuries were temporarily excluded from the SLR in 2020-21.
- That would at least allow banks to buy more of them. But other than getting WAM down, which takes time and is fraught with liquidity risks, or upending the post-GFC banking system and thus incentivizing banks to take on more deposits, it will be hard to keep long-term yields low without unpalatable co-effects. Bessent has an uphill struggle on his hands.
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- Simon White is a macro strategist who writes for Bloomberg. The observations he makes are his own and not intended as investment advice. For more markets commentary, see the MLIV blog

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