

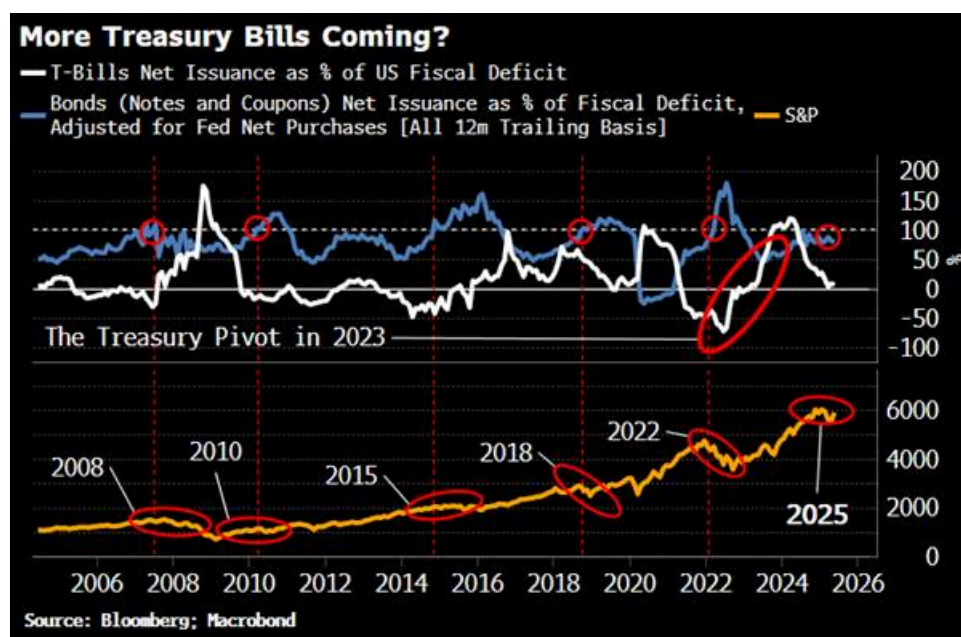
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Treasury Might Soon Go Big on Bill Issuance: MacroScope

By Simon White

(Bloomberg) -- The Treasury may soon opt to ramp up issuance of bills again to maintain the bull market for stocks. That would likely result in a steeper yield curve and increased rate volatility.

- Stocks have climbed to within a couple of percentage points of their all-time highs in an impressive recovery. But the good news is wearing thin and the market's vulnerabilities are becoming apparent. The conflict in the Middle East has been adding to the rally's fragility, even as the market appears to be moving on from it (prematurely perhaps).
- Yet stocks were already facing a fiscal backdrop that is especially inhibitive to the bull market's continuation. If the Treasury wishes to keep animal spirits alive, it may decide to increase its bill issuance, exactly as it did under Janet Yellen's stewardship in 2023.



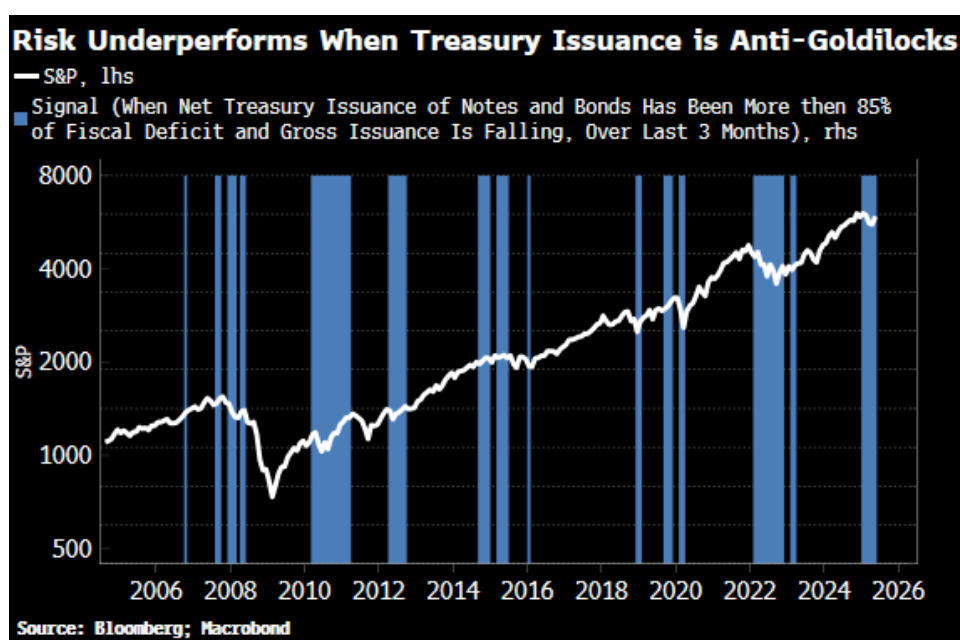
- Back then, the market was faltering, the deficit was huge and the supply of longer-dated Treasuries was sucking liquidity from the market. But with over \$2 trillion dollars of idle money parked at the Federal Reserve's reverse repo facility, a massive increase in the issuance of bills gave (mainly) money market funds the wherewithal to draw down on the RRP and fund the deficit while keeping the liquidity flame burning.
- As the liquidity held by the funds is of lower velocity and its loss thus less problematic for risk assets than that wielded by the buyers of longer-term bonds, the market could rise even as the Treasury ran large fiscal deficits. Problem solved.
- Look again at the blue line in the chart above. Whenever the net issuance of bonds and notes (ie longer-term debt) gets close to or exceeds 100% of the fiscal deficit, the stock market moves sideways or drops.

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We saw that in 2008, 2010, 2015, 2018, 2022, and now – ie each and every time the stock market has underperformed since the GFC except for the pandemic.

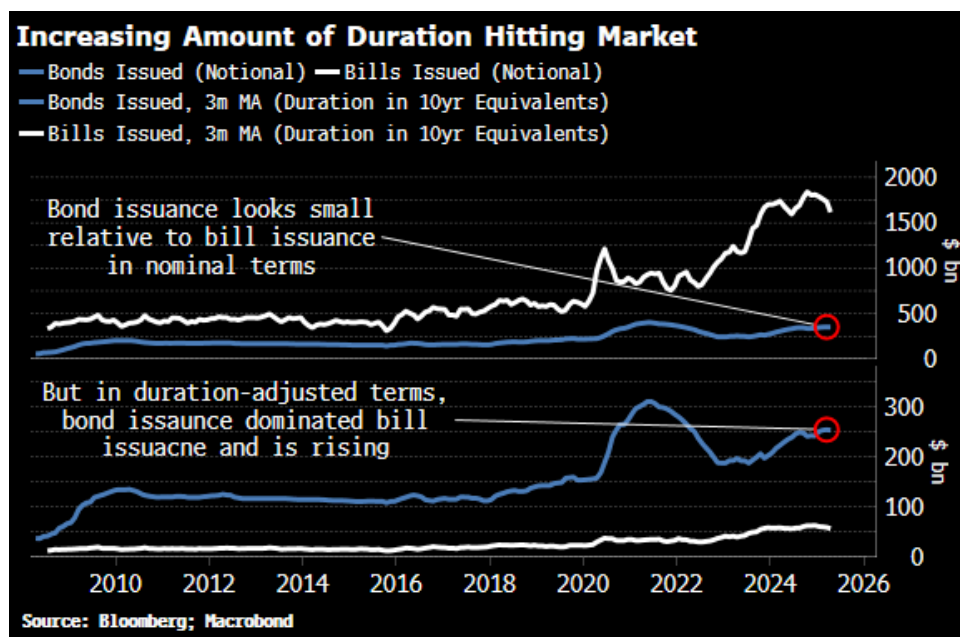
- When the Treasury ramped up bill issuance in 2023 (white line in the chart above), bond and note issuance concomitantly fell as a proportion of the deficit, and stocks were able to recover, embarking on a two-year rally.
- But now the situation is the worst of all worlds for the market. Not only is the *net* issuance of bonds and notes still uncomfortably close to 100% of the fiscal deficit, but the growth in the *gross* issuance of all debt - bills and bonds - is falling.
- The chart below shows those occasions. At a glance we can see this is categorically not a “best time to invest.” And the numbers back it up. The S&P notably underperforms its average over one, three, six and 12 months when net issuance of notes and bonds as a percentage of the fiscal deficit has been above 85% in the preceding three months, and gross issuance is falling on a three-month basis.



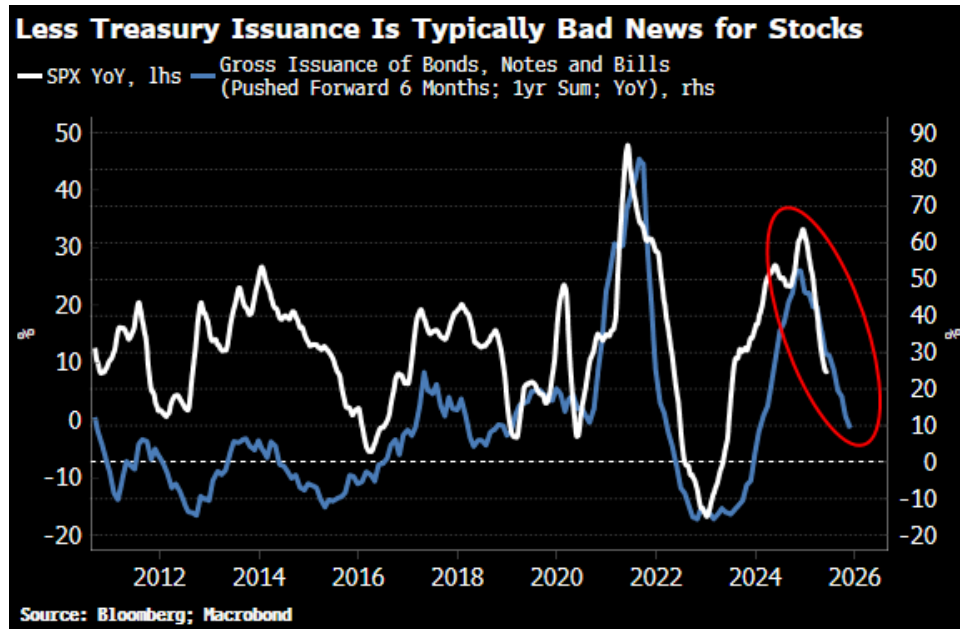
- Why does this matter? There are three key moving parts in Treasury issuance and stock-market dynamics aside from yields: 1) the liquidity-sapping and crowding-out impact from purchases of Treasury bonds; 2) the benefit to stocks from higher growth due to government spending; and 3) the increase in supply of collateral from fiscal deficits, supporting the market through the creation of quasi-money via repo.
- On the first two, with net bond issuance still 80% of the fiscal deficit, the market is likely to continue to hit resistance as the positive impact from the growth impulse is overwhelmed by the crowding out of stocks due to the large and growing supply of higher-duration debt.

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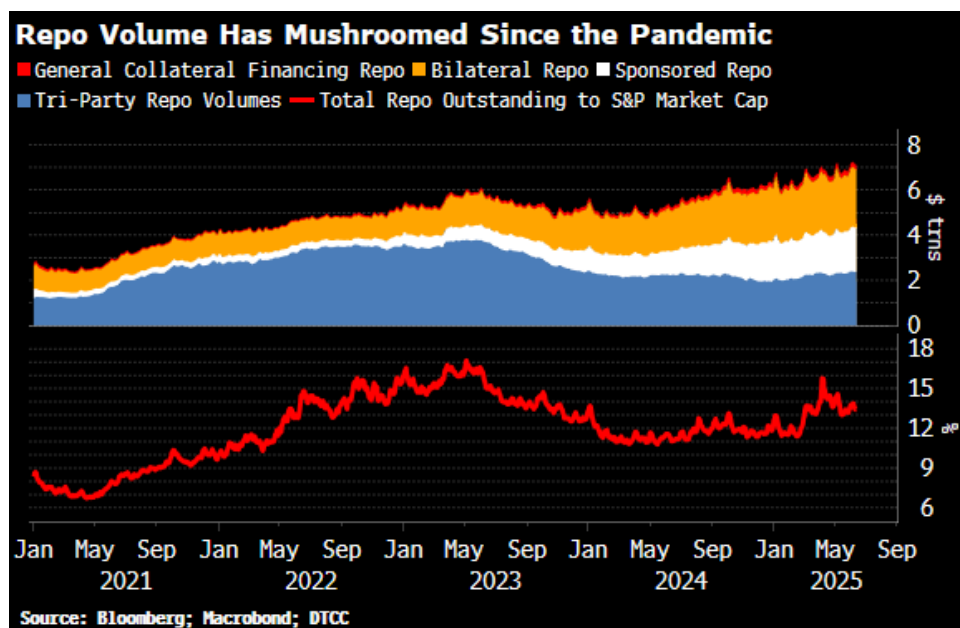
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- Yet that also comes as growth in the gross issuance of government debt is slowing, which typically leads to a weaker growth rate for stocks.



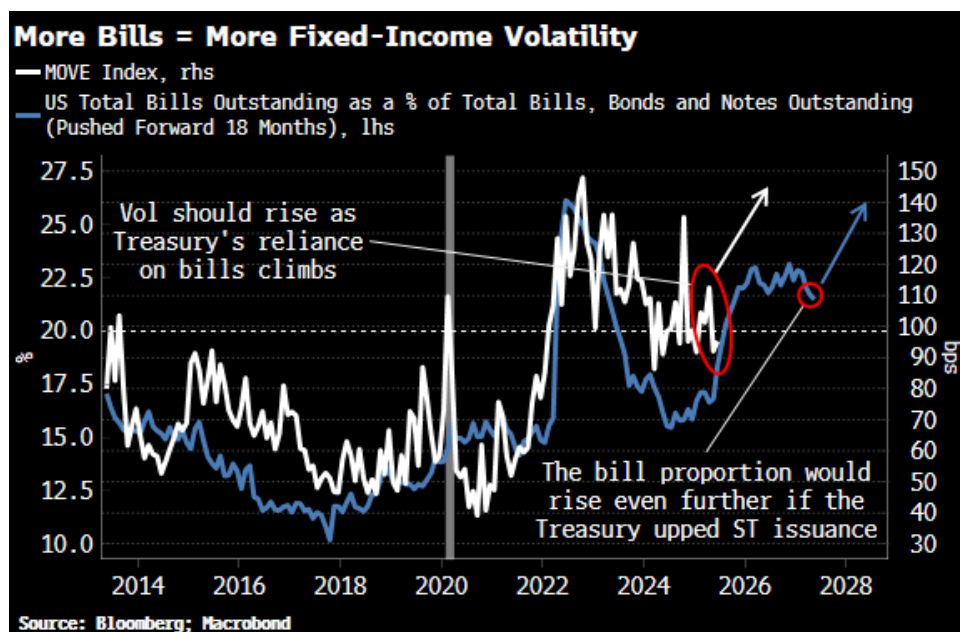
- The dynamics behind that are likely explained by the explosion in repo in recent years. Repo has become more money-like due to increasingly sophisticated collateral-valuation systems, better clearing, and greater liquidity. Rather than sitting idle on balance sheets, Treasury debt now has a higher velocity as it can very easily be repoed out with a minimal haircut in a highly liquid market.



- As repo trading has increased, the relationship between the growth in government issuance - ie the amount of collateral available for repo - and the performance of stocks has strengthened.
- The relationship is only apparent with gross, not net, issuance, however. That is likely explained by the preference for recently issued debt in repo operations, and the ineligibility for repo of debt close to its maturity.
- The mix of issuance is currently “anti-Goldilocks” for stocks: not enough bills to ease crowding-out pressures, but too much issuance overall relative to the growth impulse coming from the fiscal deficit.
- What can be done? One solution is simple: increase bill issuance. The Treasury needs to decrease net issuance of bonds and notes relative to the fiscal deficit, while ensuring gross issuance overall starts rising again.
- Yet this would come as the total volume of bills outstanding is still high relative to the total debt. The Treasury would have to take the proportion of bills even further away from the 20% that has been an unofficial ceiling.
- Before taking office, Treasury Secretary Scott Bessent lambasted his predecessor for showering the market with bills in 2023. He has yet to bring the Treasury’s reliance on bills down, so it’s far from inconceivable he might yet find it expedient to go the other way and *increase* net bill issuance.
- It becomes a more attractive proposition as foreign demand for Treasury bonds is slipping, and there are now other sources of demand for bills, such as from stablecoins, to partially offset demand from the near-depleted RRP
- Upping bill issuance comes with risks, not least those highlighted by Bessent himself prior to his appointment: higher interest expense and greater exposure to inflation. The gross interest expense is already ticking over at \$1 trillion year, and reducing the weighted-average maturity of the debt leaves the Treasury open to rising inflation, as looks more likely than not.
- Fixed-income vol would likely rise and the curve would steepen as funds gravitate toward the front of the curve to elastically absorb the increased supply of bills.

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- An expansion in bill issuance worked before, which makes it easier to justify trying it again. Whether the Treasury should be engaging in quasi-monetary policy to support the stock market is another matter altogether.
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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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