

Global Rates Notes: Q&A on Treasury's Long-End Buybacks

- Treasury announced it would at least double the size of its liquidity support buyback operations in the 10-to-20y and 20-to-30y sectors last week. We see little evidence that supply indigestion or impaired market function were key drivers of the move in long-end yields to multi-cycle highs. Removing additional long-end supply can alter the supply/demand balance, but buybacks do not address the fundamental drivers and macro risks that have been the primary factors behind higher long-end yields globally. To that end, this week's decline in UST yields has largely tracked lower energy prices, reinforcing the idea that more benign macro conditions can sustain lower yields across the curve.
- At the upsized amounts, long-end buybacks will offset about 30% of gross 20y and 30y UST supply and keep the 10y+ share of privately held UST debt outstanding about stable. We think that the impact is likely to be more micro than macro, with the effects more visible on swap spreads than outright yield levels and in outperformance of cheaper and/or less liquid parts of the long-end of the Treasury curve.
- Evidence from long-end supply reductions in the UK and Japan illustrate that while shifts in the issuance profile can help to relieve supply imbalances and lead to flatter curves or wider swap spreads, macro drivers still dominate in determining the overall level of yields. Given the absence of a clear long-end supply overhang in the US, we think that more aggressive efforts to limit long-end yields' ability to respond to macro developments would increase volatility further in on the curve and in the Dollar.

William Marshall
+1(212)357-0413 |
william.c.marshall@gs.com
Goldman Sachs & Co. LLC

Q: What was announced, and what was the motivation for increasing the buybacks?

On August 19, the US Treasury announced it would increase, "by at least double, the size of liquidity support buyback operations" for 10-to-20y and 20-to-30y sectors, taking the maximum size from \$2bn to at least \$4bn per operation. With the change slated to take effect from September 9, the boost to buybacks will likely impact the seven remaining long-end buybacks scheduled this refunding quarter, implying an incremental removal of at least \$14bn in 10-to-30y Treasury supply versus what was originally announced for the current refunding quarter (assuming the operation caps are used in full).

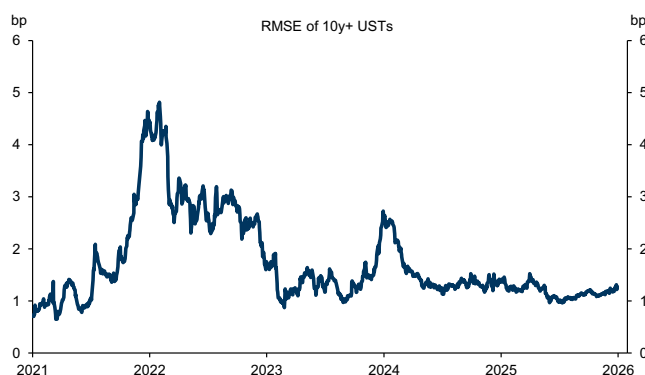
The "liquidity support" justification for the operation was justified by the "significant volume of high-quality offers Treasury routinely receives in longer-dated buyback operations." Despite the rise in the level of longer-term yields, there has been little to

suggest that the move reflects poor liquidity in the long-end or an imbalance between supply and demand for long-dated USTs. Measures such as market depth and the price impact of orderflow suggest relatively healthy market function, and the dispersion of 10-to-30y USTs versus the fitted curve has been relatively contained and stable ([Exhibit 1](#)). Further, the recent selloff has not been associated with the sort of deterioration in measures of Treasury convenience seen in [prior episodes](#), with long-end swap spreads about in line with their historical relationship to the privately held stock of debt outstanding prior to the announcement ([Exhibit 2](#)).

The recent rise in the level of long-end yields seems like the clearer catalyst, but we do not think buybacks are the right prescription. While there has been a decided lack of appetite for taking duration risk, the factors behind that are [fundamental drivers and macro risks](#) that removing long-end supply does little to address. This week's decline in yields has largely tracked lower energy prices, reinforcing the idea that more benign macro condition can sustain lower yields across the curve.

Exhibit 1: The dispersion of 10-to-30y USTs versus a fitted curve has been contained and stable

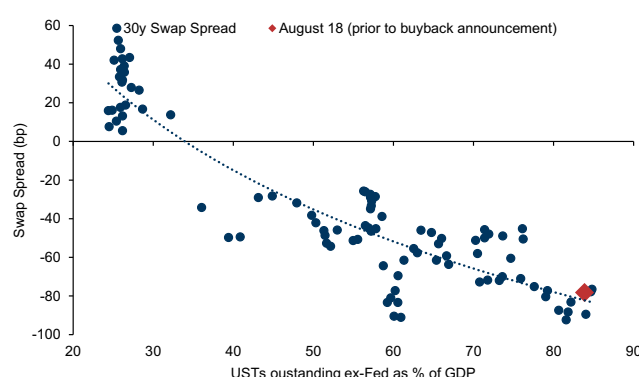
Root mean squared error of 10y+ UST yields versus fitted curve



Source: Goldman Sachs FICC and Equities, Goldman Sachs Global Investment Research

Exhibit 2: Long-end UST swap spreads were about aligned with their historical relationship to UST supply

30y UST-OIS swap spread vs USTs outstanding excluding Fed holdings as a % of GDP



Source: Treasury, Federal Reserve, Goldman Sachs Global Investment Research

Q: How do liquidity support buybacks work?

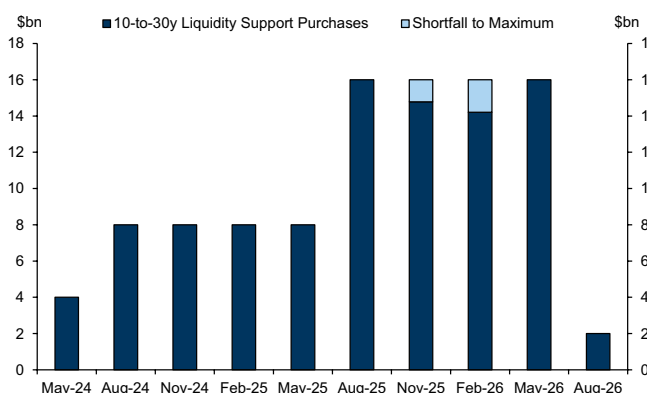
Introduced in 2024, the current buyback program features two types of buybacks—liquidity support and cash management. Liquidity support buybacks take place across the curve, with a schedule of operations typically published at the quarterly refunding announcement that specifies the date, security type and maturity range, and minimum and maximum purchase amounts of the operations. Primary dealers and approved entities offer eligible securities into the operation that Treasury evaluates “based on their proximity to prevailing market prices... as well as measures of relative value.” One of the notable aspects of last week’s announcement was that it came just a few weeks following the [latest refunding decision](#) at which buyback sizes were kept stable.

Treasury does not have to buy back any securities during an operation, though has often bought the maximum amount in long-end operations ([Exhibit 3](#)). For the most part recent long-end buybacks have been concentrated in 2041/2042 maturities for the 10-to-20y operations (with the largest buying in the May 2042 maturity) and a handful of securities maturing between 2048 and 2051 (with May 2048, Nov 2049, and May 2051 maturities the most purchased; [Exhibit 4](#)).

While not technically intended for “maturity management” purposes, these are not conducted as switch operations (i.e., replacing a less liquid, off-the-run bond for a more liquid, on-the-run bond). Since the 2024 introduction, nominal coupon auction sizes have remained constant even as buybacks have grown, meaning that the buybacks are effectively financed via bill supply and remove duration from the market.

Exhibit 3: Treasury has typically bought the maximum amount in its 10-to-20y and 20-to-30y buybacks

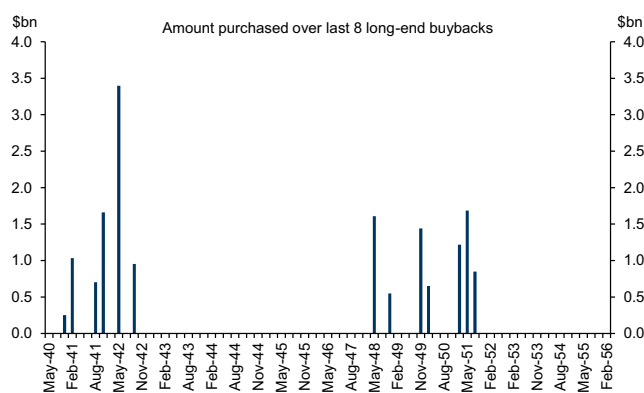
Combined 10-to-20y and 20-to-30y liquidity support purchases by refunding quarter (Aug-26 represents first operation of the quarter)



Source: Treasury, Goldman Sachs Global Investment Research

Exhibit 4: Treasury purchases have generally been concentrated in a handful of securities

Total amount purchased over last 8 long-end buybacks by maturity date (four 10-to-20y, four 20-to-30y)



Source: Treasury, Goldman Sachs Global Investment Research

Q: Is this not just QE?

Similar to QE, the buyback operations remove duration from the market. But they can differ in a few important ways. First, Treasury does not necessarily commit to using the entire envelope—the purchases may in practice be more price sensitive (though as noted above, historically Treasury has used the entire long-end envelope). Second, while the Fed finances its purchases by creating reserves, Treasury has two levers—it can deplete its cash balances, or issue more debt elsewhere on the curve. As detailed below, depleting the TGA will function similarly to QE by putting liquidity into the system; but it is a finite resource and risk management considerations likely limit the degree to which Treasury would willingly draw this down. Treasury bills, while reserve-like from a duration and general risk perspective, are typically subordinate to reserves from a supervisory perspective and can at times run into absorption constraints. Third, and perhaps most critical from a duration impact perspective, a significant portion of QE’s efficacy is attributable to the guidance channel—when the central bank is removing duration supply, the market can typically price with confidence that policy rates will remain on hold. Instead, we think heightened policy uncertainty has been a factor behind recent long-end volatility.

Q: What is the scale of long-end buybacks relative to the overall issuance and supply picture?

Annualizing the increased 10-to-30y buybacks implies at least \$128bn from \$64bn previously). Gross 20y and 30y nominal UST supply is \$444 meaning that long-end buybacks offset approximately 30% of gross issuance. Accounting for the privately held debt that will roll out of the 10-to-30y next year, net supply into the 10-to-30y sector—i.e., the change in private amount outstanding—would be about \$300bn assuming auction sizes at

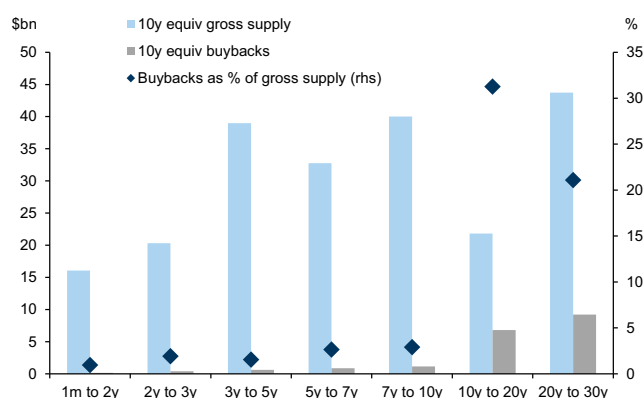


unchanged. From a duration supply perspective we estimate that monthly gross duration supply of nominal coupons amounts to \$215bn in 10y equivalents, with overall buybacks poised to offset \$20bn in 10y equivalents per month (with the bulk of that at the long-end; [Exhibit 5](#))

Excluding Fed ownership, the stock of UST debt with at least 10y to maturity is about \$4tn, which amounts to about 15% of privately held debt outstanding. Having steadily drifted higher over the last several decades, we estimate that the increased buyback amounts would keep the long-end share of total debt outstanding roughly stable over the coming years ([Exhibit 6](#)).

Exhibit 5: Buybacks would remove an average of about \$20bn in 10y equivalents per month, with the bulk at the long-end of the curve

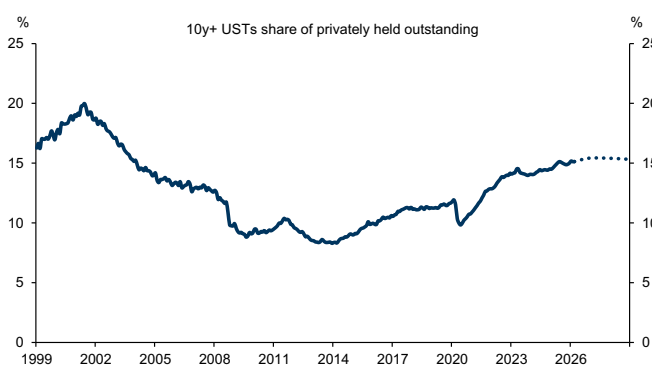
Monthly average nominal coupon auction and liquidity support buyback amounts in 10y equivalents; assumes buyback duration is the midpoint of the bucket



Source: Treasury, Goldman Sachs Global Investment Research

Exhibit 6: The long-end share of privately held debt has risen meaningfully over the last decade but should be relatively stable over the next year

10y+ Treasuries share of privately held (non-Fed) outstanding with projection



Assumes Fed purchases occur in Treasury bills until late 2028, that buybacks remain at current sizes, and that eventual auction size increases are limited to 2-to-7y maturities

Source: Treasury, Haver, Goldman Sachs Global Investment Research

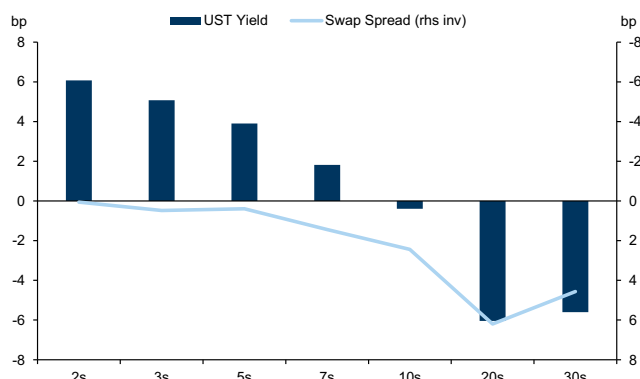
Q: What is the impact of the increase in buybacks from a market perspective?

The initial response has been long-end outperformance on the yield and spread curve (i.e., flatter nominal curve, steeper spread curve), with the 20y point outperforming on the yield and spread fly ([Exhibit 7](#)). Typical rules of thumb for the impact of duration removal on the level of yields argue for a relatively modest effect on the outright level of yields—assuming the Fed’s Operation Twist program lowered 10y yields by about 4bp per percent of GDP, with about half of the impact due to the guidance channel, duration removal worth \$150bn in 10y equivalents (more than the annualized “surprise” from last Wednesday’s announcement) would imply about a 1bp decline in 10y yield levels (potentially slightly more in the long-end).

Similarly, our estimates of the impact of a relative rotation in supply from longer-term debt towards bills implies relatively modest effect on swap spreads. That said, we would expect the swap spread impact to be somewhat more visible and durable than the impact on yield levels and curve shape. To a greater degree still, we think the prospect of more aggressive supply adjustments on additional signs of pressure or the emergence of challenges to liquidity should contain any dislocations along the 10-to-30y part of the curve, and see room for further 20y outperformance on the cash and spread fly ([Exhibit 8](#)).

Exhibit 7: The bulk of the move in long-end UST yields since the buyback announcement has reflected USTs richening versus swaps

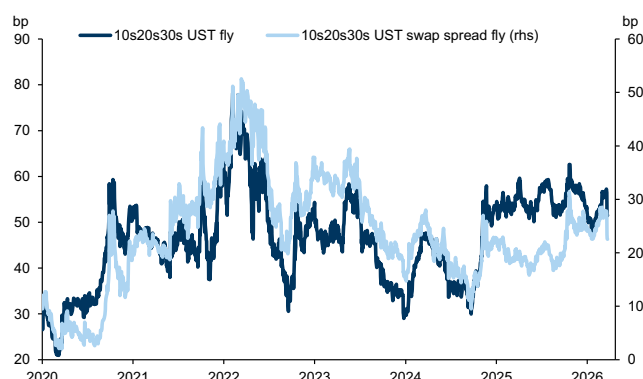
Change in UST yields and swap spreads from Aug 18 to Aug 24



Source: Goldman Sachs FICC and Equities, Goldman Sachs Global Investment Research

Exhibit 8: The 20y part of the UST curve remains relatively cheap versus 10s and 30s

10s20s30s UST fly and swap spread fly



Source: Goldman Sachs FICC and Equities, Goldman Sachs Global Investment Research

Q: Does the possibility that Treasury might draw down the TGA matter in terms of the buybacks' impact or efficacy?

In short, we do not think so. To the extent that willingness to deplete the TGA improves Treasury's ability to respond to shifts in market conditions by not requiring parallel issuance elsewhere on the curve to finance the operation, then on the margin it reinforces the "at least" portion of Treasury's announcement. But we do not think the need for TGA stability should have been seen as particularly binding—weekly TGA volatility is about \$70bn. We also do not see the likely scope and scale of the buybacks as running meaningful risk of creating an imbalance within the Treasury bill market if instead conducted on a cash neutral basis—i.e., financed via bill issuance.

The main impact for the market from Treasury drawing down the TGA instead of issuing bills should be felt at the front-end, where a lower TGA will at least temporarily boost reserves and could ease funding conditions. Assuming Treasury maintains its policy of holding a sufficient TGA balance to meet one week cash outflows, however, any decline would need to be replenished eventually. And if Treasury changed its TGA policy to reduce its steady-state cash balance—something we think risk management considerations make somewhat unlikely—we expect it would eventually result in a smaller Fed balance sheet versus our current baseline, ultimately limiting the long-run effect on privately held debt outstanding.

Q: If what's been announced so far does not work, what else can Treasury do?

We do not think that Treasury absorption is likely to be the limiting factor on how large the long-end supply adjustment can be. Treasury could scale buybacks up further, cut auction sizes, or consider doing away with the 20y point. While more aggressive shortening of the WAM of UST debt outstanding would bring other risks—namely rapidly increasing the potential variability of funding needs—we think more bills and/or increased short-term coupon supply should be digestible.

However, ever more aggressive efforts to limit long-end yields' ability to respond to macro developments will simply force pressure to come out elsewhere. A weaker currency and potentially more volatile short-term rates are two likely outcomes from

suppressed long-end rates volatility, both of which could become undesirable tradeoffs.

Steps like regulatory adjustments or changes to the tax treatment of USTs to attempt to spur demand would likely have limited efficacy. Last year's regulatory reforms increased bank leverage capacity already, with those benefits likely accruing to stability in funding markets and swap spreads. But we think that is the right way to consider those sorts of changes—they could alter the relative level of UST yields versus other forms of duration but in isolation are unlikely to durably lower yield volatility.

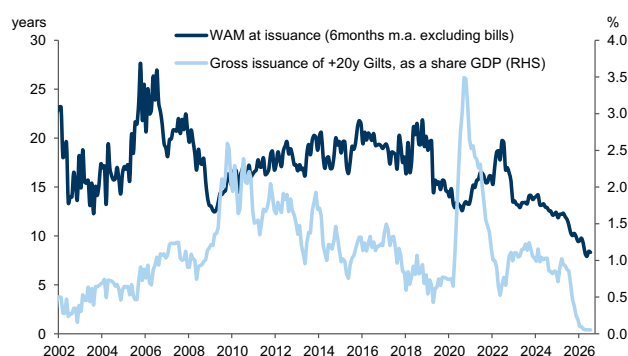
Q: What lessons can we take from other markets that have adjusted long-end supply?

Both the UK and Japan are recent examples of the impact of long-end supply adjustments. On a relative basis both markets faced clearer overhangs from elevated stocks of long-end debt, with significantly higher shares of 10y+ debt supply and imbalances visible in the relative slope of long-end curves and levels of swap spreads.

To some extent these markets do illustrate the scope for supply adjustments to be impactful—both saw meaningful long-end spread widening in response, and in the case of Japan the excess steepness at the long-end of the JGB curve has normalized. However, clear lessons have been paired with those positive developments—in both markets effective efforts to remedy localized issues have failed to arrest the macro pressures that have taken long-end yields to cycle highs. In the UK, the mix of weak growth and ongoing inflation risks has been an ongoing impediment to pricing an easier path for monetary policy, whereas in Japan the relative cheapness has migrated inward, with risk premia now more visibly priced through the belly of the curve.

Exhibit 9: Reductions to long-end Gilt supply have meaningfully lowered the WAM of issuance

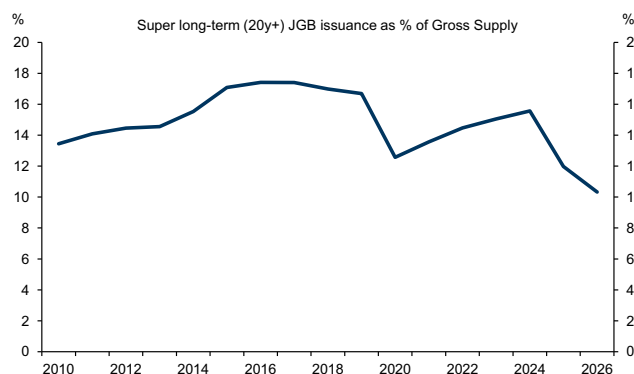
WAM at issuance and gross issuance of long-end Gilts as a share of GDP



Source: UK DMO, Goldman Sachs Global Investment Research

Exhibit 10: Japan's MOF has reduced the issuance of super long-term debt

20y+ share of total JGB issuance



Source: MoF, Haver, Goldman Sachs Global Investment Research

Global Interest Rates Strategy

George Cole
+44(20)7552-1214
george.cole@gs.com
Goldman Sachs International

William Marshall
+1(212)357-0413
william.c.marshall@gs.com
Goldman Sachs & Co. LLC

Simon Freyenet
+44(20)7774-5017
simon.freyenet@gs.com
Goldman Sachs Bank Europe SE - Paris Branch

Isabella Rosenberg
+1(212)357-7628
isabella.rosenberg@gs.com
Goldman Sachs & Co. LLC

Friedrich Schaper
+1(917)343-3214
friedrich.schaper@gs.com
Goldman Sachs & Co. LLC

Loic Mathys
+44(20)7051-1664
loic.mathys@gs.com
Goldman Sachs International