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US Rates Strategy | North America

How Big Could Treasury Buybacks Be?

MORGAN STANLEY & CO. LLC

Martin W Tobias, CFA

Eli P Carter

Matthew Hornbach

Shaun Zhou

Aryaman Singh

Treasury is set to announce larger long-end buybacks on 9/9, but we think expansion has limits. Under existing TGA policy and absent bill funding, Treasury's historical buffer above 5d outflows suggests $10bn per operation is the upper bound; UST swap spreads should see the most visible reaction.

Key Takeaways

- Treasury is set to announce larger long-end buyback sizes at 11am ET on September 9; we do not think this announcement will consist of uncapped buybacks.
- Larger buybacks should not be interpreted as QE; liquidity support buybacks have a defined funding need, whether via bills, coupons, or a TGA drawdown.
- With a modernization of Treasury's cash balance policy, we think it ultimately could provide scope for $80bn - $200bn of cash to fund buybacks over time.
- Under existing policy and without more bill financing, Treasury's historical buffer above expected 5d outflows suggests $10bn per operation is the upper bound.
- We think UST swap spreads – not outright yield levels – are the transmission mechanism to view investor expectations for the buyback size announcement.

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Short Duration Strategy

United States | How big could treasury buybacks be?

MORGAN STANLEY & CO. LLC

Martin Tobias, CFA, CMT
Martin.Tobias@morganstanley.com +1 212 761-6076

Eli Carter
Eli.Carter@morganstanley.com +1 212 761-4703

Matthew Hornbach, CMT
Matthew.Hornbach@morganstanley.com +1 212 761-1863

Shaun Zhou
Shaun.Zhou@morganstanley.com +1 212 761-3348

Aryaman Singh
Aryaman@morganstanley.com +1 212 761-1993

Buyback technicals ahead of upsized operations

The September 10 long-end buyback (10Y to 20Y sector) will be the first operation conducted under Treasury's recent guidance for larger operation sizes.

- Ahead of the operation, we review the **key technical details**, including when the size is likely to be announced, what to expect for the remainder of the quarter, and Treasury's flexibility to alter the operation terms.

As laid out in Intraday Buyback Effect, we show the typical timeline of a single Treasury buyback operation (see Exhibit 1). The process works as follows:

- In its quarterly refunding materials, Treasury releases the tentative buyback schedule for the upcoming quarter.
- At 11:00am ET on the day before a buyback, Treasury releases a preliminary list of CUSIPs within the buyback window that may be accepted in the operation.
- At 11:00am ET on the operation date, Treasury releases the final eligible-CUSIP list, typically with few changes.
- The Treasury then accepts offers in those eligible CUSIPs from 1:40pm to 2:00pm ET on the operation date.
- A few minutes after the operation concludes, Treasury publishes the accepted CUSIPs, sizes, and prices.

Typically, the maximum buyback purchase size does not change from when the quarterly schedule is released. However, on August 19, Treasury announced changes to the program for the remainder of the quarter.

- The notice did not specify the new sizes, stating only that the maximum would be at least $4bn per long-end operation (10Y to 20Y and 20Y to 30Y).
- In Exhibit 2, we show the maximum purchase size per operation for 10Y to 20Y buybacks since program inception.

We expect Treasury to announce the maximum purchase size of the upcoming buyback by September 9, consistent with its regular and predictable practice of including the maximum operation size in the preliminary announcement.

- According to the Code of Federal Regulations, Treasury is required to release a redemption operation announcement ahead of the operation specifying the maximum amount to be redeemed.
  - **We think this effectively rules out both an uncapped buyback and purchases above the maximum amount stated in the announcement.**
- Treasury retains flexibility to amend the operation terms, but the regulations require public notice of any such changes.

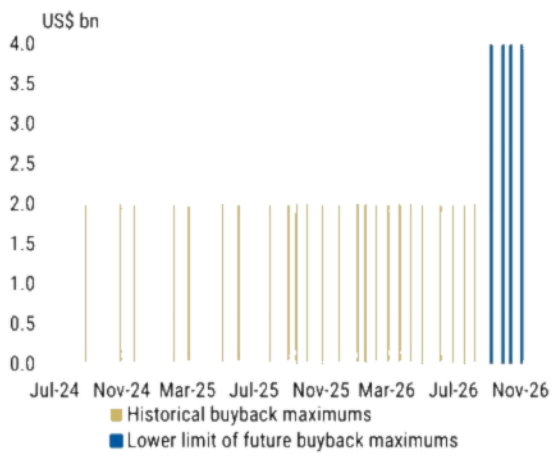
Additionally, we expect Treasury to announce sizes for the remaining long-end buybacks this quarter at the same time. We do not expect sizes to be adjusted on an operation-by-operation basis. Treasury stated that a new tentative schedule would be released, suggesting that sizes for the remainder of the quarter will be published in advance.

- Though, it is within Treasury's authority to subsequently alter those sizes, as it did with the unexpected August 19 increase.

Exhibit 1: Timeline of a Treasury buyback



Exhibit 2: Maximum amount per operation for 10Y to 20Y buybacks since program inception



We also note that Treasury is not required to buy back the full maximum amount in these operations. Just because Treasury states it can buy the maximum, does not mean it will.

- In fact, they rarely do (see Exhibit 3). Most operations, especially those in the belly of the curve, see Treasury purchase less than the maximum.

This reflects Treasury's evaluation of the relative value of offers submitted in each operation. When possible, Treasury accepts offers that allow it to repurchase securities at a discount to prevailing market levels.

- In Exhibit 4, we show the weighted-average discount to market at which Treasury has executed its purchases by operation since inception of the program.

Long-end securities, notably the 10Y to 20Y sector, have been offered at attractive levels. This helps explain why Treasury has purchased the maximum in every operation to date.

- Put differently, Treasury is not a price-insensitive buyer in these operations, but rather a value-sensitive market participant. Therefore, we believe there is a low likelihood that Treasury would buy back securities offered rich to prevailing mids.

Exhibit 3: Average buyback ratio by maturity sector

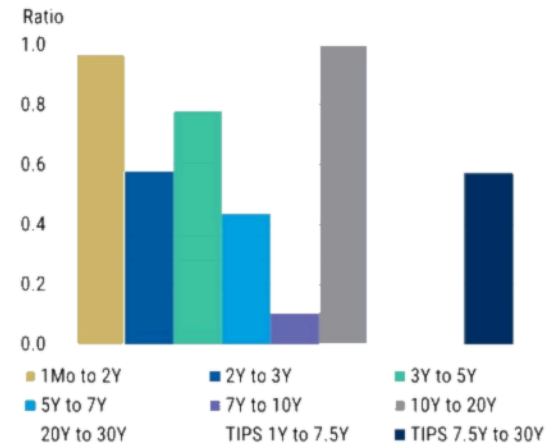
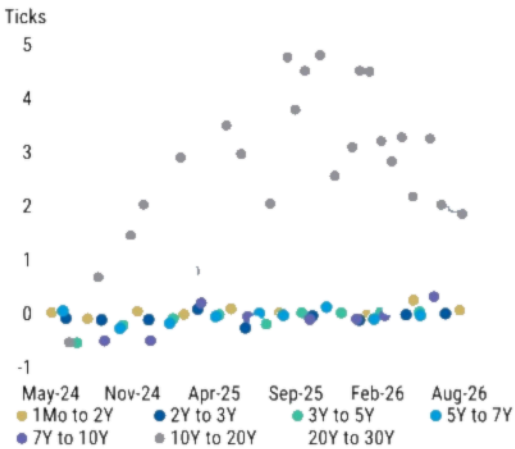


Exhibit 4: Weighted-average price discount at buybacks compared to market price by operation



A framework to assess expanded buyback sizes

There are many possible outcomes for these expanded buybacks, as Treasury Secretary Bessent stated, Treasury "has a big toolkit".

- Below, we layout a framework for assessing the maximum size Treasury could comfortably implement, without making meaningful changes to their operating cash balance policy or issuance pattern.

Liquidity support buybacks are treated as an ordinary cash outflow from the TGA, which means the announced larger buybacks have to be funded in the following ways:

- More issuance of T-bills;
- More issuance of on-the-run coupons;
- Use of existing cash in the Treasury General Account (TGA)

This highlights a key constraint in the manner with which Treasury buybacks can cap long-end yields when comparing them to Federal Reserve Large Scale Asset Purchases (LSAPs), notwithstanding the fact that buybacks are not intended to materially alter WAM.

- For more on the size of duration extraction and the signal from expanded buybacks, see Our Views After Treasury Announced Larger Buybacks.

We think these incrementally larger buybacks will be funded with more bill issuance - which does not pose risk of a significant deterioration in funding conditions - although media reports have suggested the TGA could be tapped to fund larger buybacks.

Over the course of the year, Treasury has sought input from the Treasury Borrowing Advisory Committee (TBAC) and primary dealers on ways to utilize its "excess" TGA cash.

Under different definitions of "excess" cash - using two approaches measured around 3-day outflows - TBAC concluded that $80bn to $200bn could be invested in the repo market.

- Given limited economic benefit and significant costs, we continue to believe funding liquidity support buybacks with "excess" TGA cash would be a much better use in lowering costs for the taxpayer than investing in the repo market.

Therefore, provided a modernization in Treasury's cash balance policy, we think it ultimately provides scope for $80bn to $200bn to be utilized to fund buybacks over time.

But since the TGA is still managed according to the policy adopted in May 2015, outlined below, that amount is not readily available to fund larger buybacks this quarter:

> *"To help protect against a potential interruption in market access, Treasury will hold a level of cash generally sufficient to cover one week of outflows in the Treasury General Account, subject to a minimum balance of roughly $150 billion."*

In practice, for each business day, Treasury calculates the expected outflows from the TGA for one week following that day. This calculation includes both net fiscal outflows as well as the gross volume of maturing marketable Treasury debt.

Treasury also takes into account cash flow uncertainty that can result from changes in economic activity influencing tax revenue, irregular outlays from federal programs, and the potential for legislative changes that affect short-term cash flows.

- We think this buffer in the TGA, above 5-day (5d) outflows, informs how much the TGA could be tapped to fund buybacks and thus provides a logical framework to assess how large long-end buybacks could be this quarter.

In Exhibit 5, we show the TGA balance and its 20-day moving average (20dma) over the past four years. The gray shaded areas represent debt issuance suspension (debt ceiling) periods, where the TGA had to be drawn down below levels consistent with policy.

As shown in Exhibit 6, 5d outflows can exceed the levels that Treasury announces at quarterly refundings as an end-of-period TGA target due to larger gross maturities or larger outlays associated with government spending programs.

- Because of this consideration, we think the 20dma of 5d outflows better captures the trend in required cash needs over time.
- Over the last year, this trend has been relatively stable with a required cash maintenance of around $800bn.

Exhibit 5: Treasury General Account (TGA) and TGA 20 day moving average; shaded area denotes debt ceiling period

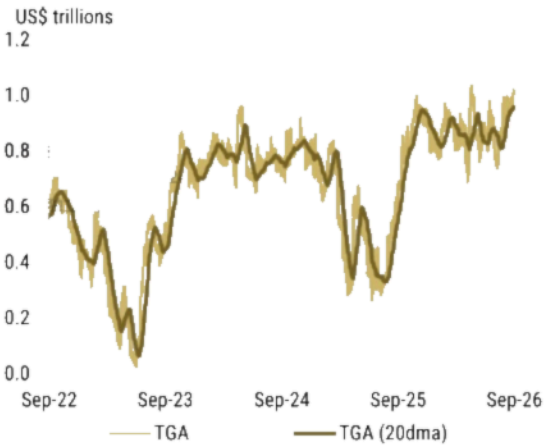
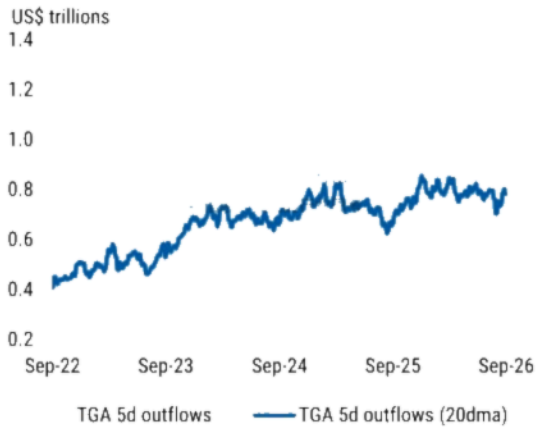


Exhibit 6: Treasury General Account (TGA) 5-day outflows and 20 day moving average of TGA 5 day outflows; shaded area denotes debt ceiling period



We then compare the 20dma of the TGA to the 20dma of 5d outflows to assess how the buffer - above expected 5d outflows - in the TGA has fluctuated over time (see Exhibit 7).

In Exhibit 8, we show this difference and find Treasury has managed the TGA at a long-run average level that is $55bn above expected 5d outflows, outside of debt limit periods.

- This buffer has remained consistent with its long-run average level over the course of this current fiscal year, which suggests Treasury has not become more precautionary or is accumulating cash for cybersecurity or natural disaster reasons.

Exhibit 7: Treasury General Account (TGA) 20-day moving average and 20-day moving average of TGA 5 day outflows; shaded area denotes debt ceiling period

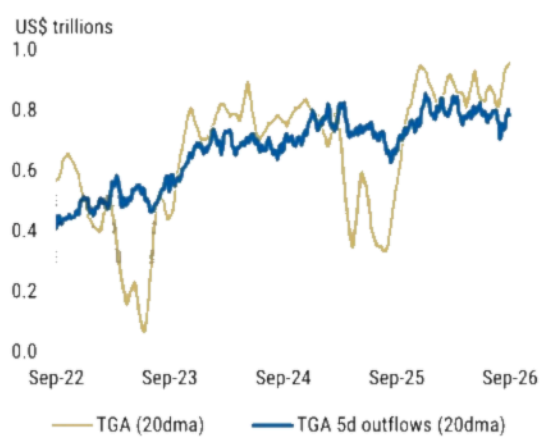
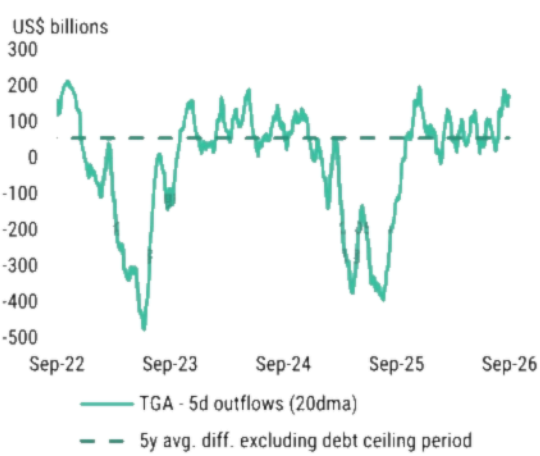


Exhibit 8: Difference between Treasury General Account (TGA) 20-day moving average and 20-day moving average of TGA 5 day outflows; shaded area denotes debt ceiling period



The historical ~$55bn cushion provides an empirical upper bound on how much Treasury may deploy without moving the TGA materially below its recent risk management norm.

We highlight two main conclusions:

- Absent a change in cash balance policy, Treasury is still fairly constrained even if it were to choose to fund buybacks out of this buffer in the TGA.
- A defined source of funds underscores why unlimited or uncapped buyback operations are not realistic.

We think the ceiling that this buffer could provide is for the remaining 7 long-end buyback operations this quarter to have a purchase size of $10bn operation (7 operations x $8bn incremental compared to last quarter = $56bn total funding need).

- The language "at least double the size" suggests Treasury will accept $4bn in offers, but we think they are likely more price-sensitive above that threshold.
- Put differently, even if a maximum purchase size of $10bn per operation Treasury has discretion to not accept the full $10bn in offers.

We believe UST swap spreads – not outright yield levels – are the transmission mechanism to view investor expectations around buyback size announcement.

- By comparing cash Treasury yields with matched-maturity SOFR swap rates, they provide a measure of Treasury relative value.

This lens better isolates where changes in expectations of Treasury supply appear more directly than in outright yields, which are influenced by fundamental factors, such as energy prices and central bank reaction function.

As shown in Exhibit 9 , 30y UST SOFR swap spreads - where Treasury supply expectations matters most directly - have widened ~5bp since the announcement of the larger buyback program on August 19 while 30y nominal UST yields are unchanged.

- Announcement of long-end buybacks at just $4bn creates scope for short-term weakness in long-end spreads provided where they trading relative to their recent levels over the last three months (see Exhibit 10).

By November refunding, Treasury will have a broader set of financing levers available through the refunding and issuance forward guidance process, reducing the need to rely on expanded buyback operations to reduce net supply in the long-end.

Exhibit 9: UST 30y yield and 30y UST SOFR swap spread (5 day moving average) over the last year

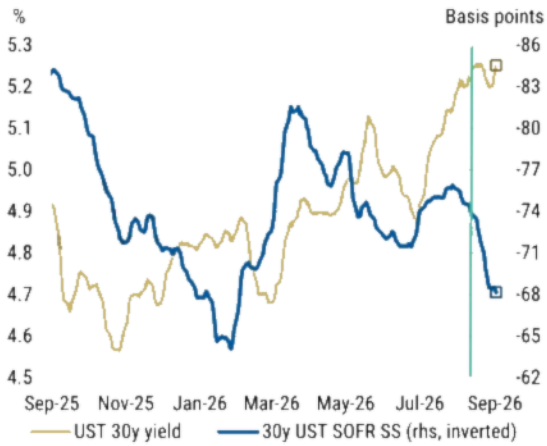


Exhibit 10: Rolling 63-day z-score: 30y UST SOFR swap spread over the last year



- **Trade idea: Maintain pay fixed September FOMC OIS vs. receive fixed October FOMC OIS at +7bp (FOMC OIS flattener), PV01 neutral (initial target 0bp, initial stop loss at +12bp)**
- **Trade idea: Maintain long 2-year (Sep '27) UST SOFR swap spreads at -7.9bp with a target of -7bp and a trailing stop of -13bp.**

Valuation Methodology and Risks

Below you will find a list of our current trade ideas, entry levels, entry dates, rationales, and risks.

Interest Rate Strategy

TRADE	ENTRY LEVEL	ENTRY DATE	RATIONALE	RISKS
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

Global Macro Strategy Team

MORGAN STANLEY & CO. LLC	**Matthew Hornbach, CMT** Matthew.Hornbach@morganstanley.com	Global Head of Macro Strategy	+1 212 761-1837
	Bradley Tian	Global Macro Commentary	+1 212 761-0826
	Martin Tobias, CFA, CMT	US Rates Strategist	+1 212 761-6076
	Shaun Zhou	US Rates Strategist	+1 212 761-3348
	Aryaman Singh	US Rates Strategist	+1 212 761-1993
	Eli Carter	US Rates Strategist	+1 212 761-4703
MORGAN STANLEY & CO. LLC	**Andrew Watrous**	G10 FX Strategist	+1 212 761-5287
	Molly Nickolin	G10 FX Strategist	+1 212 761 3592
	Simon Waever Simon.Waever@morganstanley.com	Head of EM Sovereign Credit and Latin America Fixed Income Strategy	+1 212 296-8101
	Ioana Zamfir	Head of Latin America Macro Strategy	+1 212 761-4012
	Emma Cerda	Latin America Sovereign Credit	+1 212 761-2344
	Sofia Palacios	Latin America Macro Strategist	+1 212 761-0428
MORGAN STANLEY & CO. INTERNATIONAL PLC	**James K. Lord** James.Lord@morganstanley.com	Global Head of FXEM Strategy	+44 20 7677-3254
	Gianluca Salford Luca.Salford@morganstanley.com	Head of European Rates Strategy	+44 20 7677-1337
	Maria Chiara Russo	Euro Area Rates Strategist	+44 20 7425-3499
	Fabio Bassanin, CFA	UK Rates Strategist	+44 20 7425-1869
	David S. Adams, CFA David.S.Adams@morganstanley.com	Head of G10 FX Strategy	+44 20 7425-3518
	Neville Mandimika	CEEMEA Sovereign Credit Strategist	+44 20 7425-2509
	Arnav Gupta	CEEMEA Rates Strategist	+44 20 7677-0382
MORGAN STANLEY ASIA LIMITED+	**Gek Teng Khoo**	AXJ Macro Strategist	+852 3963-0303
MORGAN STANLEY INDIA COMPANY PRIVATE LIMITED	**Nimish Prabhune**	AXJ Macro Strategist	+91 22 6996 1862
MORGAN STANLEY MUFG SECURITIES CO., LTD.	**Koichi Sugisaki** Koichi.Sugisaki@morganstanleymufg.com	Head of Japan Macro Strategy	+81 3 6836-8428
	Hiromu Uezato	Japan Macro Strategist	+81 3 6836-8431