



The Treasury Department's "Quarterly Refunding Announcement" or QRA]

April 30, 2024

What is it?

Why is it important?

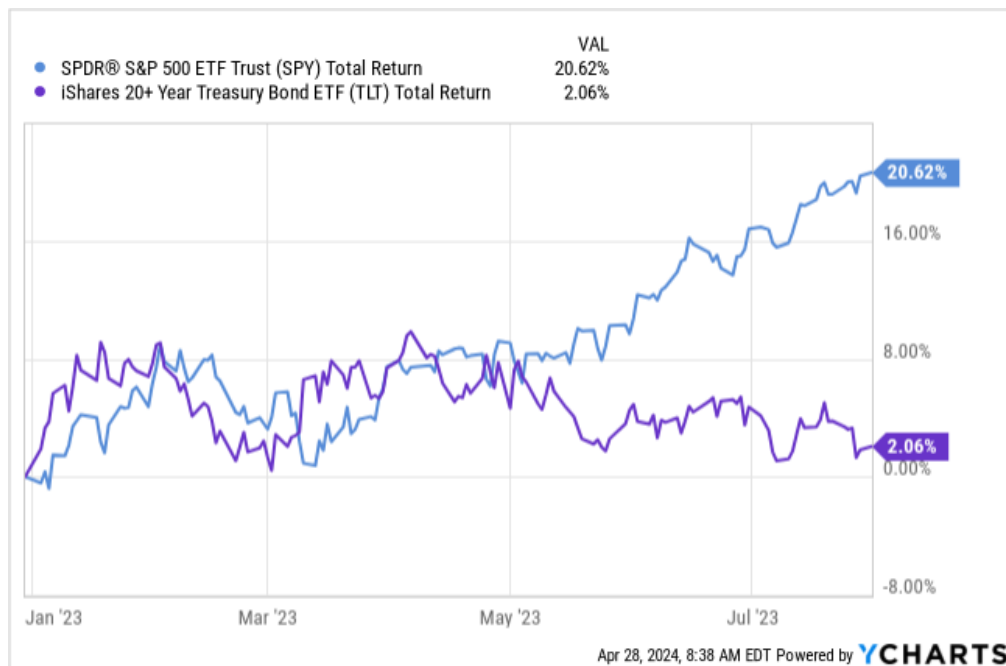
Will it continue to be the primary catalyst setting the direction for risk assets?

On **April 29 at 3pm**, the Treasury Dept. announced its financing needs for the coming quarter, the amount it will need to borrow from the private sector. On **May 1 at 8:30am**, it will announce the composition of the specific securities it plans to sell.

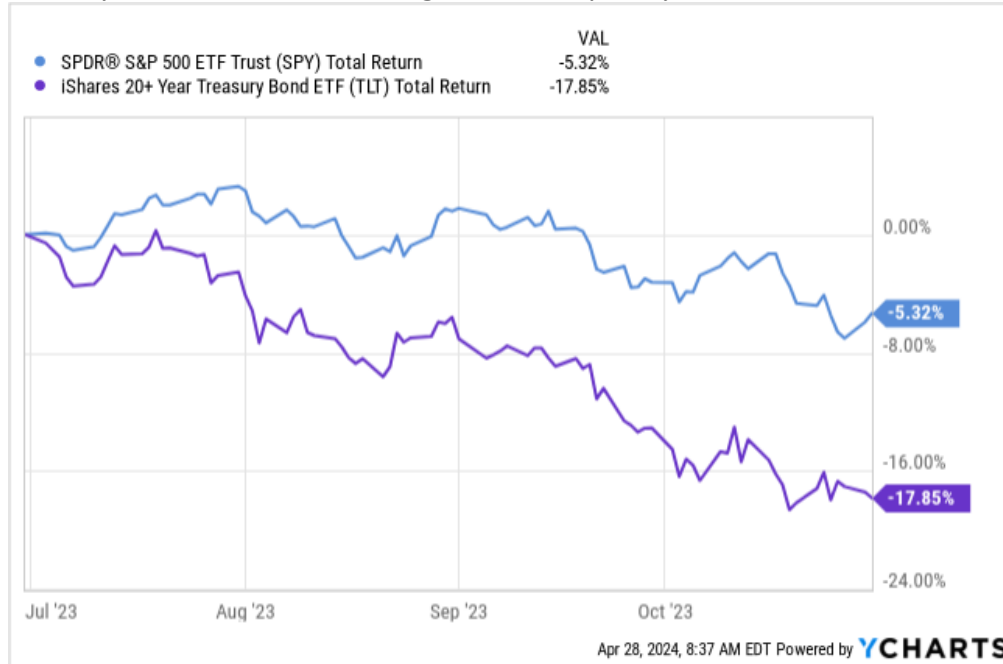
This Quarterly Refunding Announcement (QRA) as it is known has been the main driver of risk assets for over a year:

The Timeline

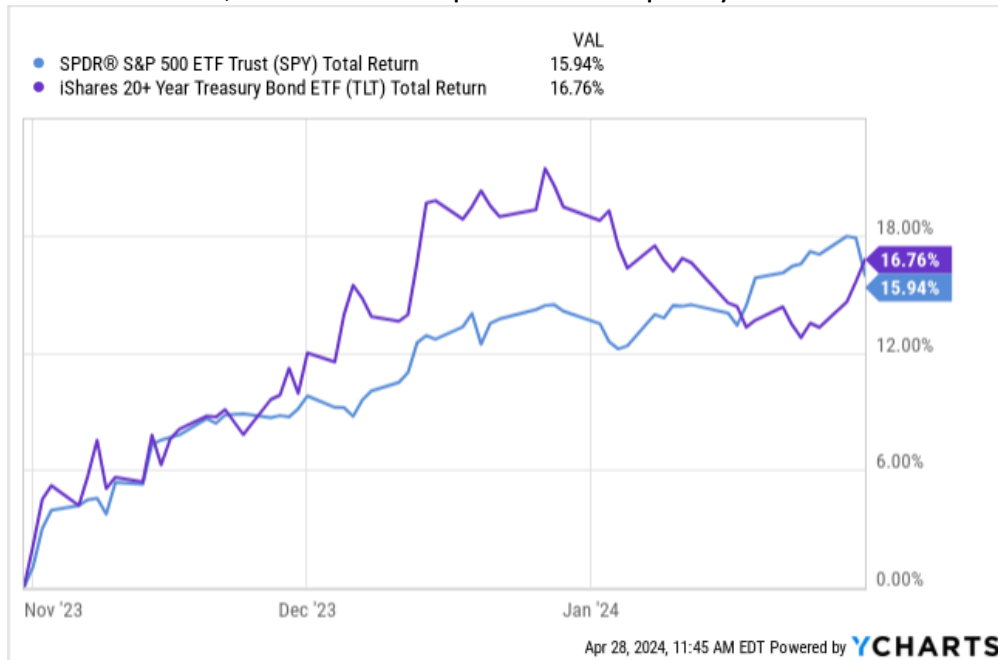
The January 31, 2023 QRA was positive for liquidity and stocks and bonds rose.



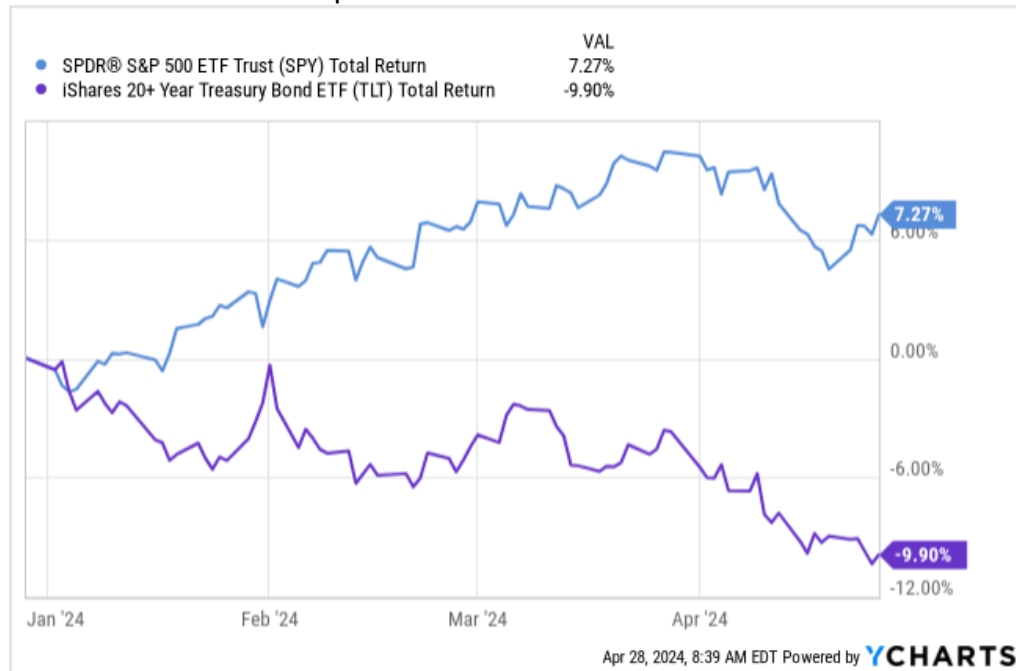
The July 31, 2023 QRA was negative for liquidity and stocks and bonds fell.



The October 31, 2023 QRA was positive for liquidity and stocks and bonds rose.

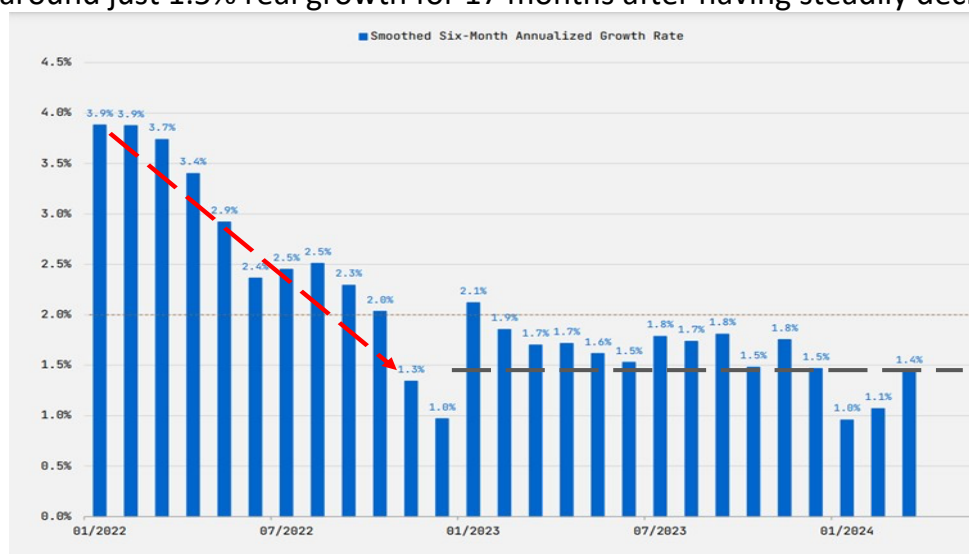


The January 31, 2024 QRA was neutral to slightly negative for liquidity and risk assets are mixed with stocks up and bonds down.



Why it matters

As shown below, a composite of coincident indicators over this span has flatlined at around just 1.5% real growth for 17 months after having steadily declined through 2022.



(Source: EPB Macro Research)

Typically, acceleration/deceleration of growth and inflation generate the primary impulses that drive risk assets. Flatlining is absent those impulses.

As such, the liquidity impulse becomes dominant. While the Fed is usually the main driver of liquidity, rates have been on hold and although Quantitative Tightening (QT) continues to shrink the Fed's balance sheet (negative for liquidity), the pace has been steady, pre-programmed, and predictable which offers no surprise factor (impulse) to markets.

The Treasury has been in the driver's seat and their actions have either **accentuated** the Fed's QT (Jul 31, 2023 QRA), **more than offset it** (Oct 31, 2023 QRA), or merely **muted** it (Jan 31, 2024 QRA). Some call this "*fiscal dominance*."

Why now?

Haven't the Federal debt, the budget deficit that drives it, and the resulting share of Federal spending on interest expense been problems for a long time? Hasn't the Treasury been issuing QRAs for decades with little fanfare? Why does this matter so much now?

Federal debt already exceeds GDP and the budget deficits that must be financed with even more debt are at record levels (excluding emergency levels during WWII and Covid). Deficits are projected to grow even larger and the political will to address them appears to be at record lows. All the while interest rates are much higher than the recent past, meaning not only present and future debt will cost that much more, but as past debt comes due and is refinanced, it too will further drive interest expense higher, setting up the potential that we will have to issue even more debt to cover the added interest expense.

Who will buy all this debt? The usual large, indiscriminate buyers of Treasuries are not buying. The Fed is not buying, they're allowing bonds to mature instead (QT). The Treasury therefore must sell additional debt beyond the deficit to pay the Fed. Foreign central banks are not buying. Commercial banks are not buying, they are up to their eyeballs in deeply underwater bonds purchased before the rate spike.

That leaves private sector buyers, folks like you and us, to pick up the slack. We buy because we **want** to, not because we **have** to. It's a classic supply / demand mismatch: in the face of unusually large issuance there simply aren't enough buyers.

This creates upward pressure on rates, which in the first order is bad for bonds, and in the second order potentially bad for stocks if such pressure is intense enough.

Mechanics

Treasury **Bond** issuance drains reserves and therefore is liquidity-negative for markets. Although the spending that occurs on the flip-side pushes reserves back into the system, the pace and timing of the flows cause ripples in system-wide liquidity and hence markets.

For the time being, the issuance of Treasury **Bills** does not impact liquidity. That is because institutional investors consider the Fed's Reverse Repo facility (RRP) and T-Bills to be substitutes; both offer a competitive short-term risk-free rate. Thus T-Bill issuance ends up draining the RRP instead of bank reserves, and the \$400 billion remaining balance in RRP represents reserves that have already been drained. In terms of liquidity, it's a wash. If/when RRP is exhausted, then further T-Bill issuance will begin to drain reserves just as bond issuance does.

Revisiting the Timeline

Why was the January 31, 2023 QRA positive for liquidity?

- The debt ceiling constrained issuance (removing a negative liquidity impulse).
- The Treasury spent down its bank account to fund government (adding a positive liquidity impulse)

Why was the July 31, 2023 QRA negative for liquidity?

- With debt ceiling raised, massive issuance followed to fund the deficit, replenish the Treasury's bank account, and pay the Fed for its maturing bonds (negative impulse).
- Composition leaned towards bonds over bills (negative impulse).

This resulted in financial conditions tightening meaningfully, something Fed officials cheered as "markets are doing some of our work for us," which led to sustained, solid disinflation.

Why was the October 31, 2023 QRA positive for liquidity?

- Composition of issuance favored T-Bills over bonds (positive impulse).

This resulted in a rapid and dramatic easing of financial conditions, but it also led to a new uptrend in inflation during Jan, Feb, and Mar.

Why was the January 31, 2024 QRA neutral to slightly negative for liquidity?

- The overall size of issuance increased only modestly with a small increase in bonds over bills.

This was enough of a headwind to push bond prices down but not enough to hurt stocks.

What next?

Being an election year, many assume politics are involved. Perhaps. Even if we assume political motivations, it doesn't necessarily clarify the picture. Yes, a liquidity "pump" by Secretary Yellen this week (issuing a larger amount of T-Bills to further drain RRP not reserves) would indeed help stocks and bonds. The "Halloween Pump" did exactly that. However, the current 3-4 month uptrend in inflation also stems directly from that Oct 31, 2023 QRA.

If one wanted to act purely politically, is it best to choose higher stock prices or lower gas prices to influence the election? The QRA alone can't achieve both.

Meanwhile "term premiums" on Treasury bonds are historically low saying, at least from a theoretical standpoint, the Treasury should be locking in today's long term financing rates. Term premiums can change as quickly as investors can change their minds. Allowing politics to enter the equation would be playing a game of chicken with markets.

What to do?

Buy and hold investors, predetermined to ride everything out, and who possess time horizons long enough to recover from anything, don't need to care about this.

For everyone else, this has mattered and likely will continue to. Given we are in a new era of "fiscal dominance" this may well matter for the foreseeable future.

The size of total issuance for the coming quarter is bearish for risk assets. It is unlikely that tomorrow's composition announcement can shift towards T-Bills by enough to offset this.

If you would like to discuss how the QRA may impact your portfolio or to schedule a consultation, please email info@parkedgeadvisors.com

Park Edge Advisors LLC is a registered investment adviser. Registration does not imply a certain level of skill or training. Information presented is for educational purposes only and does not intend to make an offer or solicitation for the sale or purchase of any specific securities, investments, or investment strategies. Investments involve risk and, unless otherwise stated, are not guaranteed.