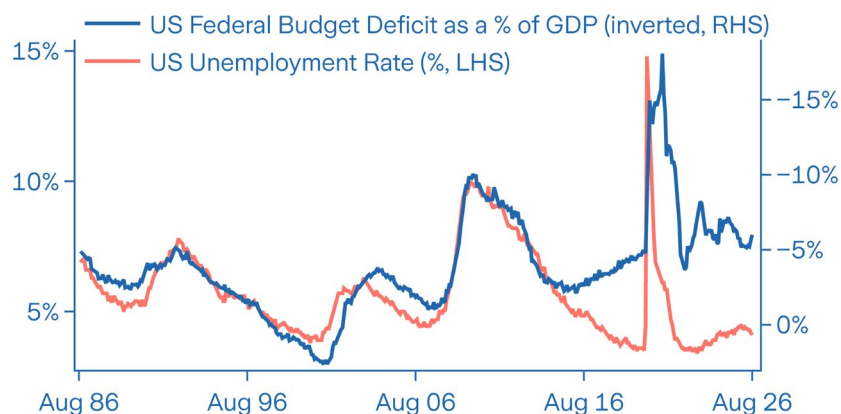


Let's twist again — the US Treasury puts a lid on longer-term bond yields



Long-term Treasury yields have been grinding higher since the beginning of this year. Growing concerns on the sustainability of the fiscal path, inflation worries, and increased borrowing to finance the AI investment boom have all contributed to the rise. For years, the US has been running budget deficits at levels that previously would have been unprecedented outside of a major recession or war. Now, however, investors are demanding a higher premium to fund the deficit, forcing the hand of the Treasury. Financial repression is back.

Chart 1: The fiscal deficit is not sustainable



Source: Bloomberg

Investors are becoming uneasy about the fiscal outlook

The debt pile has reached roughly the size of GDP, and the US is now spending more on servicing its debt than on defence. With the economy currently still expanding at a nominal rate of around 5%, the deficit looks manageable in the near term, but investors are becoming increasingly uneasy about the longer-term outlook and are demanding a higher premium to hold long-dated Treasury securities. The Fed's reluctance to provide any forward guidance has added another layer of uncertainty.

Chart 2: Longer-term yields have risen as investors demand a higher premium



Source: Bloomberg

The yield on 30yr Treasury bonds rose above 5.3% in mid-August, the highest level since 2007, reflecting investors' growing concerns about the direction of US fiscal policy. Against this backdrop, the US Treasury took the unusual step of announcing an increase in the size of its buyback programme for longer-dated Treasuries just two weeks after having announced its quarterly buyback plan. While modest in absolute terms, the move carries significance as it provides a strong signal that the administration has reached a pain point in regard to the level of yields it is willing to tolerate.

The US Treasury increases bond buybacks to put a lid on long-term yields

The Treasury recently announced that it would double the size of its long-end buybacks from USD 2bn to USD 4bn per operation. On the surface, this is a relatively small intervention in a Treasury market worth tens of trillions of dollars. By comparison, the Fed was purchasing more than a USD 100bn dollars' worth of bonds per month during the peak of quantitative easing following the pandemic. Yet markets reacted forcefully because investors viewed the announcement less as a liquidity operation and more as a signal of intent.

The timing of the announcement was particularly striking. Rather than introducing the measure through the Treasury's regular quarterly refunding process, where debt management changes are normally communicated, officials surprised markets with an unscheduled announcement ahead of the release of the Fed's meeting minutes. The decision appeared designed to maximise its impact and ensure investors understood that the Treasury is paying close attention to the rise in long-term yields.

Operation Twist is back

In practical terms, the operation resembles a modern version of “Operation Twist”, the policy tool used by the Fed in the past to alter the maturity structure of government debt. Since the Treasury has committed to keeping coupon issuance broadly unchanged, the additional purchases of long-dated bonds are expected to be financed through increased issuance of Treasury bills.

Effectively, the government will be replacing longer-term debt held by investors with shorter-term liabilities. The Treasury has been shortening the average maturity of its outstanding debt for some time but now, due to worry about the level of longer-term yields, is signalling that it wants to accelerate the process. While the impact on the overall maturity profile of outstanding debt is small, the direction of travel is clear: the Treasury is attempting to reduce the amount of duration that private investors need to absorb in order to reduce long-term borrowing costs.

The market's initial response suggested that investors understood the message. Long-term yields fell immediately following the announcement, with the 10yr Treasury yield declining several basis points and the 30yr yield recording an even larger drop. However, the relief proved short-lived. Within a day, much of the decline had been reversed, highlighting that the fundamental concerns driving yields higher remain firmly in place.

Fighting the symptoms with financial repression

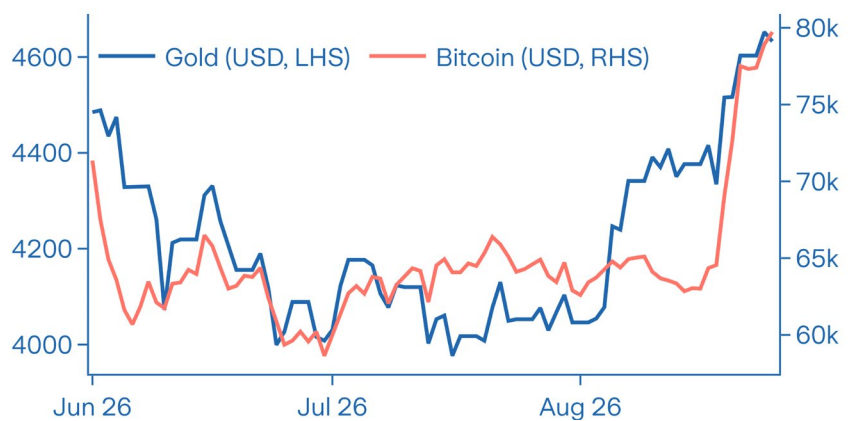
Investors' concerns focus on the growing mismatch between fiscal policy and the demands of the bond market. Investors are increasingly questioning whether the US can continue running such large deficits indefinitely without facing a permanent increase in borrowing costs. The Treasury's intervention may smooth market functioning and dampen volatility at the margin, but it does not alter the underlying trajectory of rising debt levels and persistent fiscal deficits. The Treasury is thus fighting the symptoms rather than the actual cause.

Putting a lid on bond yields by actively intervening in the Treasury market is a form of financial repression. Rather than allowing long-term bond prices to fully reflect investor concerns, policymakers are attempting to limit the rise in yields through balance-sheet management. Such financial engineering may ease financial conditions in the short run, but they can also carry unintended consequences. If Treasury yields are prevented from adjusting freely, pressure may instead emerge elsewhere, particularly in the foreign exchange market.

The debasement trade puts pressure on the dollar

Indeed, one of the most notable reactions to the announcement was a sharp decline in the US dollar. Investors rightly interpreted the accelerated buyback program as evidence that policymakers are becoming uncomfortable with rising bond yields but remain unwilling or unable to address the fiscal imbalances driving them. The Treasury's announcement therefore reinforced concerns that debt management rather than fiscal discipline is becoming the preferred policy response. Gold and cryptocurrencies rallied strongly, reflecting renewed demand for assets perceived as protection against monetary and fiscal instability.

Chart 3: Gold and Bitcoin soar as the debasement trade gains momentum



Source: Bloomberg

The development raises broader questions about the evolving balance between fiscal and monetary policy. Traditionally, managing financial conditions has been the responsibility of the Federal Reserve. Yet the Treasury's actions suggest that fiscal authorities are increasingly stepping into territory once occupied by central bankers. While the scale of the buybacks remains far too small to replicate quantitative easing, the symbolism is powerful. Markets are being reminded that debt management policy can influence financial conditions even without direct central bank involvement. Ironically, looser financial conditions could eventually trigger the Fed to tighten policy as inflation rates remain elevated. The Fed's balance sheet policy, which is currently under review, will become crucial in this context.

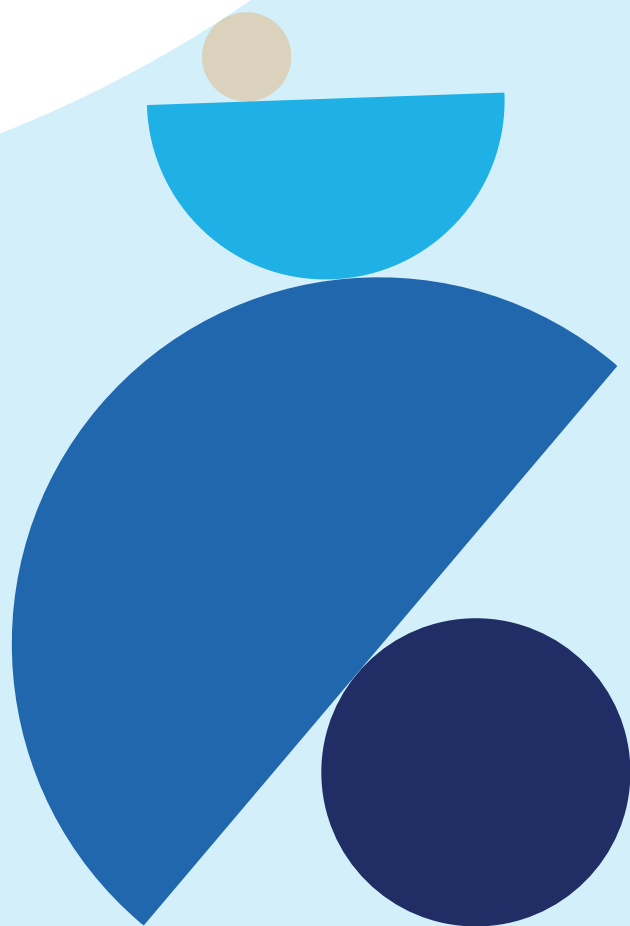
Fight the cause rather than the symptoms

For now, the Treasury's intervention is best viewed as a warning shot rather than a game-changing policy shift. It signals that policymakers are concerned by the rise in long-term borrowing costs and are willing to take unconventional steps to contain them. However, unless the underlying drivers of investor anxiety are addressed—namely persistent deficits, rising debt levels, and uncertainty about the long-term fiscal outlook—buybacks alone are unlikely to put significant pressure on Treasury yields. Investors could actually be encouraged to test the administration's resolve by pushing yields higher, adding more volatility to the bond market.

Bond market volatility is likely to increase

In the end, the announcement may be remembered less for its immediate market impact and more for what it revealed about the policy mindset in Washington. As debt burdens continue to rise and bond markets become increasingly sensitive to fiscal risks, the Treasury appears ready to play a more active role. Whether that proves sufficient to contain yields is another question entirely.

The bond market has a long history of testing the resolve of policymakers, and it is unlikely that debt management techniques can substitute for fiscal discipline. The administration is likely to intervene more aggressively to fight the symptoms rather than the cause, leading to more severe distortions and higher volatility, with the dollar potentially suffering the consequences.



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