

US Rates Strategy

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Investing Treasury's cash

This month's quarterly refunding returns to a topic reviewed in May – should the Treasury invest a portion of its daily cash balance directly into the repo market? The Treasury's potential earnings are small and it is unclear that shifting daily volatility from the Treasury's account to repo rates is an improvement over the *status quo*.

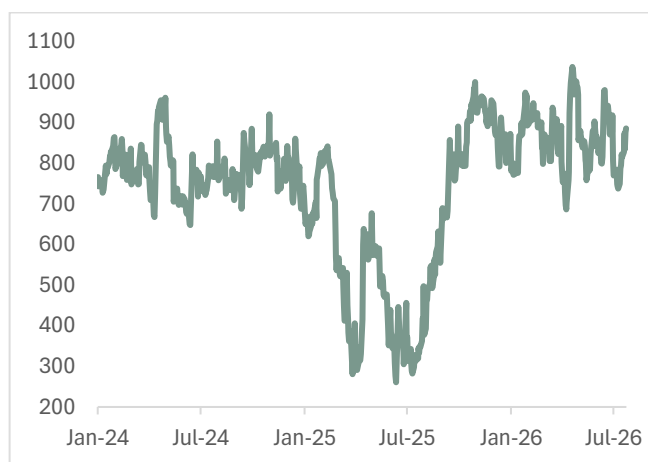
- The Fed does not remunerate the Treasury's cash balance. **The Treasury might be able to boost the returns on its cash if it invested it in the repo market.** But these earnings are offset by the resulting increase in bank reserves which reduces the Fed's Treasury remittances.
- The Treasury would likely invest only a portion of its 5d precautionary cash balance in the repo market. **But this shifts the volatility in the Treasury's account balance to the repo market.**
- **To minimize repo rate volatility, the Treasury would likely cap its daily repo cash investments to \$100bn or less.** That said, these operations would be large relative to the size of the overnight tri-party repo market and money market fund repo lending.
- The Treasury Borrowing Advisory Committee (TBAC) estimated that the Treasury might earn between \$60-100mn/y on its capped repo investments assuming bank reserves were scarce.
- Outside of the size of the Fed's balance sheet, Treasury's repo earnings would depend on how its cash auctions are structured as well as the Treasury's preference for early return unwinds.

Treasury's cash yield

The Treasury's cash balance held at the Fed is scaled to meet 5-7 days of expected cash outflows related to the payment of social security benefits, debt servicing and government payrolls. It needs this buffer in case it cannot settle Treasury securities because of an auction disruption or storm. The size is based on several Treasury market outages since 2000, the longest of which lasted three days (September 11, 2001). Over time, as the Treasury's auction sizes and its daily outlays have grown, this buffer has risen to an average of \$870bn/day in 2026 (Figure 1). On quarter-ends, the 5d expected outflow is considerably higher. The Treasury plans to end the current quarter with \$950bn sitting at the Fed and we expect its year-end balance to reach \$1trn.

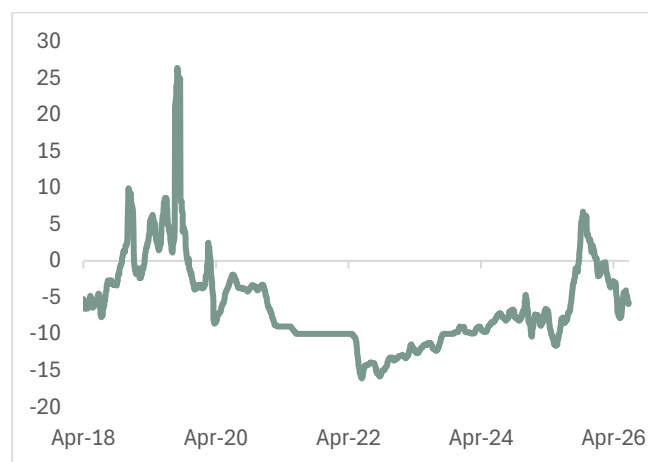
The balances sit at the Fed because they are immediately and always available. But the Fed does not remunerate the Treasury on these balances. Instead, the Fed remits all the earnings on its securities portfolio less its operating expenses to the Treasury. Since the Treasury's account is a non-interest Fed liability, increases in the Treasury's cash balance reduce the level of interest-bearing bank reserves and the RRP, lowering the Fed's operating expenses.¹ Since 2022, the Fed's portfolio yield has lagged behind its interest expenses on reserves (IORB) and RRP balances so it has been unable to remit its earnings to the Treasury. Once the Fed has earned back its negative earnings it will resume remitting its "profits" to the Treasury.

Figure 1: Treasury cash balance (\$bn)



Source: US Treasury, SMBC Nikko

Figure 2: Tri-party less IORB (bp)



Note: 20d average. Source: Federal Reserve, SMBC Nikko

Should the Treasury boost the earnings on its idle cash by investing some of it in the repo market?

In practice, the Treasury would not sacrifice much of the accessibility of its cash as its repo lending would have overnight maturities. That said, it is not a clear "money-maker" for the Treasury. While the cash invested in repo would earn a repo rate, the level of bank reserves would increase.² Since the Fed pays IORB on these balances, the Fed's Treasury remittances would fall. As the level of bank reserves has been ample to abundant for most of the past 20 years, overnight repo rates have traded below IORB (Figure 2). The Treasury's earnings would be higher if the Fed agreed to shrink its balance sheet so that level of bank reserves falls and becomes scarce enough to push repo rates above IORB.

Volatility tradeoff

How much of its cash could the Treasury divert into the repo market?³ In determining this amount, the Treasury faces a tradeoff. **It can exchange volatility in repo rates for stable reserve balances but it cannot achieve both stable reserve balances and steady repo rates by investing its cash in secured funding markets.** Strictly speaking, the size of the precautionary buffer and how it is held is the Treasury's decision; the Fed adjusts its operations to smooth out the effects on bank reserves. The

¹ Assuming no change in the size of the overall balance sheet the Treasury would earn more in remittances.

² We are assuming the Treasury earns a tri-party rate as a cash provider like a money market fund.

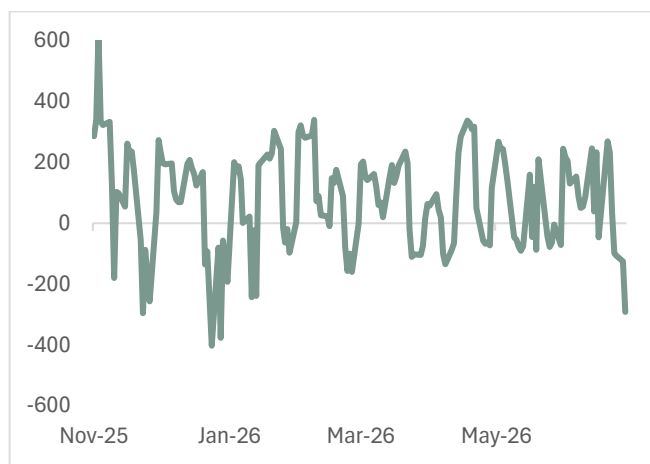
³ The primary dealer questionnaire simply identifies it as "excess" but as we describe below there are different definitions of "excess".

Treasury can reduce the variation in reserve balances by maintaining a steady balance in its account at the Fed. Any surplus balances would shift into the repo market where swings in the daily repo injections would push repo rates around. Alternatively, it can make the repo investments steady to prevent repo rates from swinging around too much. But this lets all the volatility in the Treasury's cash flow directly into bank reserves (as they do now).

Given this tradeoff, the Treasury needs to scale the size of its potential repo investments with how much variation in these flows the market is willing to accept without a significant change in tri-party rates. In May, the Treasury Borrowing Advisory Committee (TBAC) examined different estimates for the Treasury's repo investments. It began with sizing them to match any cash above the 5d buffer; E(1w).⁴ We plot the difference between the Treasury's actual cash balance and E(1w) in Figure 3. **Between January and June 2026, there were 81 days in which the Treasury's daily cash balance was greater than its expected 5d buffer.** On those days, the average surplus cash was \$165bn – but the standard deviation across those days was \$95bn. If this cap had been in place this year, the Treasury daily repo investments would have ranged from \$1bn to \$100bn – although most (70%) would have been at the cap (Figure 4). With such a large amount of cash regularly flowing into the market would likely lower tri-party rates (by more than 5bp on those days based on TBAC estimates).

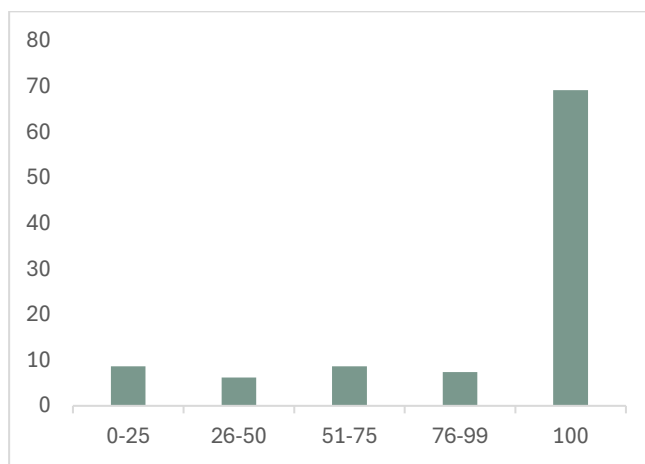
Alternatively, the Treasury could cap the size of its repo investments at \$100bn – all the surplus cash above E(1w) up to \$100bn would flow into the repo market. Such a cap would be binding on 85% of the days in which the Treasury had surplus cash this year. And, by capping the investments the Treasury would reduce their volatility. At a maximum of \$100bn, the Treasury's repo investments would roughly match the size of GSE activity.

Figure 3: Daily cash less E(1w) (\$bn)



Source: US Treasury, SMBC Nikko

Figure 4: Daily repo investments with cap (%)



Note: Percentage of days in which the Treasury's repo investment would fall in the indicated bucket. From January 1 to June 30, 2026.
Source: US Treasury, SMBC Nikko

⁴ E(1w) is the Treasury's expected cash outflow; in our analysis we assume the expected outflow equals the realized outflow. As a result, we are underestimating the potential volatility of the Treasury's repo cash investment due to forecasting errors.

Finally, the Treasury could maintain its 5d buffer but invest all the cash it expects to need at t+4 and t+5. An additional variant would be to cap this amount at say, \$200bn (\$100bn/day) to prevent overloading the repo market with Treasury cash. Such a strategy would be justified by the fact that since the Treasury's tri-party trades are overnight it is certain to have its cash returning the next morning, ready for redeployment to finance outlays. This would allow the Treasury to trim its cash balance at the Fed to a 3d buffer. In 2026, that would have meant reducing daily balance by \$300bn to around \$500bn. But like all its repo investments, this assumes there is no disruption in repo market functioning that could prevent the Treasury from accessing its cash.

Treasury earnings

But for all this shifting, capping and investing, how much might the Treasury earn from its repo investments? The May 2026 TBAC estimated that Treasury's repo revenues would be very small – even if the Fed reduced the size of its balance sheet to make reserves scarcer. **Assuming a \$100bn/day repo investment, the Treasury might earn as much as \$60-100mn/year if reserves are scarce.** If reserves are ample or abundant, it might earn nothing and could even lose \$100mn/y. By contrast, before the Fed's portfolio earnings became negative, it remitted nearly \$110bn to the Treasury in 2021.

We are skeptical that Treasury might even earn this amount even allowing for some reserve scarcity. At a \$100bn maximum (or an average of \$84bn/day this year), the Treasury's repo cash would be about 7% of the overnight Treasury tri-party market. Even capped at \$100bn, the Treasury's repo investment would make it a larger cash (repo) supplier than nearly all money market funds.

In an earlier piece we noted that the Treasury repo cash would vary throughout the month – the heaviest flows would be early in the month and around the third week. This does not line up well with dealers' financing needs. So, it is unclear how aggressively dealers might compete for off-cycle cash – especially as they prefer more stable and predictable balances from money funds that roll their overnight rates from day-to-day. While we expect the Treasury would earn a tri-party rate, it is possible that by supplying more cash to the market, it could pull funding rates lower.

Mechanically, we assume the Treasury would auction its repo cash every morning when liquidity is highest. But it is not clear if the Treasury would limit its transactions to just primary dealers as it does with its coupon auctions. It might, like it does with its coupon auctions, require dealers to borrow a *pro rata* share at its cash auctions. **This would influence where the auction clearing rate settles and adds a further complication to the Treasury's repo investment strategy.** There is no guarantee that the Treasury will be able to invest all its surplus cash if it allows participants to bid for what they wish to borrow. By contrast, mandatory participation may absorb all the Treasury's surplus cash although not necessarily at the highest tri-party rate. Finally, the Treasury's cash needs likely mean that it would prefer its repo trades to unwind early in the morning rather than the standard late afternoon tri-party time. The timing of when the Treasury money is returned will influence how expensive it is for dealers to replace.

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