By Global Markets | 20 August 2026

Interest Rates Thoughts

US Treasury buybacks

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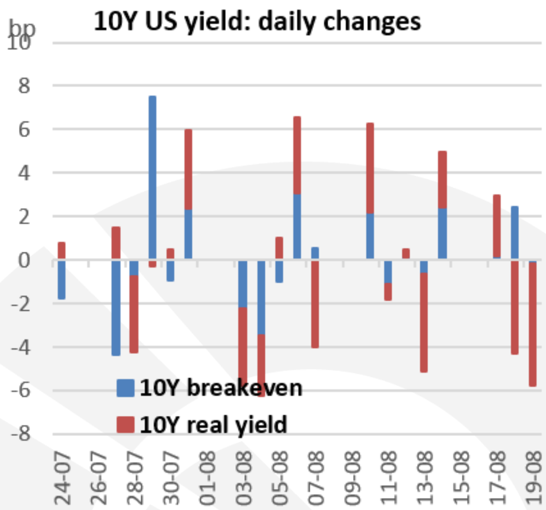
- **USD rates.** 20Y and 30Y USTs rallied by around 10bps overnight as US Treasury planned to increase the size of buybacks of long-end bonds while the 20Y coupon bond auction went well. We have flagged the possibility that the US Treasury may consider reducing the supply of long-end bonds, but the additional buybacks came earlier. Additional buybacks may amount to USD14bn or more for the remainder of the current quarter of 5 August – 4 November. The amount is not particularly big compared to supply, but nevertheless these add marginally to overall demand and represent the intention to provide support to the market. From a positive lens, the reaction in the market to this small size of support might reflect that there has been some pent-up demand for the bonds. 10Y UST yield fell to 4.63% driven by lower real yield, near the low end of our near-term expected trading range of 4.60-4.75% and we maintain this range for now. Granted, fiscal concerns linger, which may be more reflected at 20Y and 30Y tenors rather than the 10Y tenor.



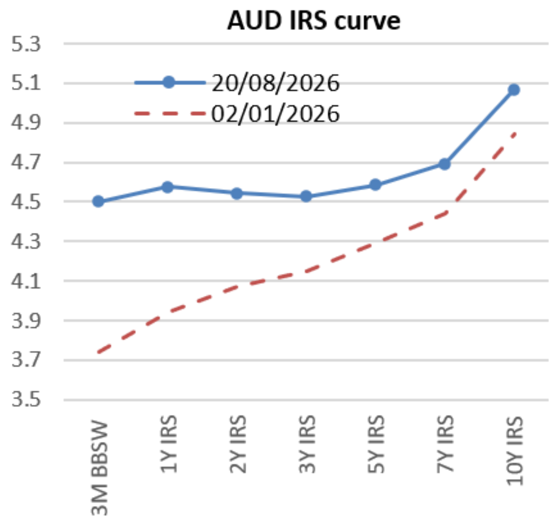
Source: Bloomberg, OCBC Group Research

- *US Treasury buybacks*. There are two types of buybacks defined by the purpose – liquidity support (US Treasury buy off-the-run securities across buckets) and cash management (1M-2Y bucket). On Wednesday, US Treasury said it is "increasing, by at least double, the size of liquidity support buyback operations for longer-dated nominal coupon securities", i.e. the 10Y-20Y and 20Y-30Y sectors. The original plan at the August quarterly refunding update was for USD2bn at each liquidity support operations for each of these sectors, totalling USD18bn for the quarter of 5 August – 4 November. Two operations have since been done. Hence, at least doubling the remaining USD14bn means an extra USD14bn or more. How do US Treasury fund these extra buybacks? It can reduce the sizes of buybacks for shorter tenors, including those done for cash management purpose. Or, it can further reduce its TGA cash balance target, although the room to do so has become narrower as they have already reduced the target from USD950bn to USD850bn for end-December.

- *Potential future changes in auction sizes*. We earlier noted that at the recent US Treasury's quarterly refunding update, there was a change in this sentence: Treasury continues to evaluate "potential future changes" to the sizes, instead of "potential future increases", which has raised expectations that varying changes in the auction sizes of different tenors are under consideration, i.e. potentially reducing long-end supply especially if demand is weak and increasing short- to mid-tenor auction sizes. The timeline is uncertain given that US Treasury has kept the guidance that it would keep auction sizes unchanged for "at least the next several quarters". That said, the decision to increase the buybacks suggests that the timeline is not fixed. Investors look forward to the next quarterly update in early November. For August, September and October, individual auction size of 30Y coupon bonds was/is USD25bn, USD22bn and USD22bn respectively. Any reduction in the auction sizes would potentially be of bigger amounts than the additional buybacks.

- **GBP rates.** Gilt yields fell by 2-4bps on Wednesday, as bond market sentiment improved, while July CPI printed mostly in line with expectations and PPI came in softer. Headline CPI inflation picked up in July as expected to 2.9%YoY versus 2.6% in June. Contributions from housing/water/electricity/gas/fuels rose to 0.6 percentage-point in July, from 0.15 percentage point in June, as Ofgem cap was higher in Q3 than in Q2 as we have previously noted. GBP OIS mildly pared back rate hike expectations, to 27bps by year end versus 29bps priced a day ago. We continue to see the room for BoE to tighten policy as limited, given where the Bank Rate is (being restrictive) and the softness in the labour market.

- **AUD rates**. Bank bills futures edged up (implied rates lower) upon the July employment change release but overall market reaction is muted. Employment change for July printed a negative 15.8K, with part-time employment down by 32.2K. The monthly employment data are volatile, more so with part-time employment series hence we usually do not read too much into a single month's outcome. Still, today's outcome supports our base-case for no more cash rate hike from the RBA, as the previous three rate hikes are still working their way through on inflation, and possibly on demand as well. Cash rate futures last priced 14bps of a hike before year end. The AUD IRS curve is mildly inverted across the 1s2s and 1s3s segment, while we have pencilled in two cuts for 2027. AUD rates appear toppish.



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