ECOINSIGHT

Issue 7
28 August 2025

THE US TREASURIES MARKET: AN IDOL WITH FEET OF CLAY

US FEDERAL DEBT: THE RISKS OF ABUNDANCE

Anis Bensaidani & Céline Choulet

Considered the safest and most liquid assets in the world, US Treasuries are the first choice of investors seeking security. However, the turmoil that hit their market last April, in the wake of the announcement of new US tariffs, revived memories of the dysfunction caused by the COVID-19 pandemic in March 2020. Despite the magnitude of the shock, the market's loss of liquidity at the time came as a surprise, given Treasuries' safe-haven status. As a matter of fact, more than the shock per se, this fragility is due to structural factors.

This first part of our EcoInsight series on Treasuries analyses how the US administration's fiscal plans threaten to exacerbate this fragility. The second part will focus on the types of creditors of the federal government and the harmful effect of President Trump's excesses. The third part will explain why relaxing leverage standards will only provide short-term relief.

ECONOMIC RESEARCH

BNP PARIBAS

The bank for a changing world

THE US TREASURIES MARKET: AN IDOL WITH FEET OF CLAY

US FEDERAL DEBT: THE RISKS OF ABUNDANCE

Considered the safest and most liquid assets in the world, US Treasuries are the first choice of investors seeking security. However, the turmoil that hit their market last April, in the wake of the announcement of new US tariffs, revived memories of the dysfunction caused by the COVID-19 pandemic in March 2020. Despite the magnitude of the shock, the market's loss of liquidity at the time came as a surprise, given Treasuries' safe-haven status. As a matter of fact, more than the shock per se, this fragility is due to structural factors. This first part of our EcoInsight series on Treasuries analyses how the US administration's fiscal plans threaten to exacerbate this fragility.

The upheaval triggered by the announcement of US tariffs on 2 April has also affected the US Treasury market.

Although the safe-haven status of US federal debt was confirmed in the early days of the tariff shock, its greater sensitivity to stress episodes was then confirmed. Liquidity in the Treasuries market deteriorated sharply, and bond yields and their volatility rose steeply (*Chart 1*). Admittedly, this episode was not as intense as the COVID-19 pandemic (Liang, 2025; Perli, 2025) but concerns about the vulnerability of this essential market remain high.

US Treasury securities fulfil several important functions. Firstly, they serve as a benchmark for the valuation of many financial assets and for setting borrowing conditions in the United States. Secondly, they are the most widely used collateral by financial institutions to finance themselves and to manage their liquidity risk. They are also an essential instrument in the monetary policy of the Federal Reserve (Fed).

VOLATILITY OF BOND YIELDS MEASURED BY THE MOVE INDEX

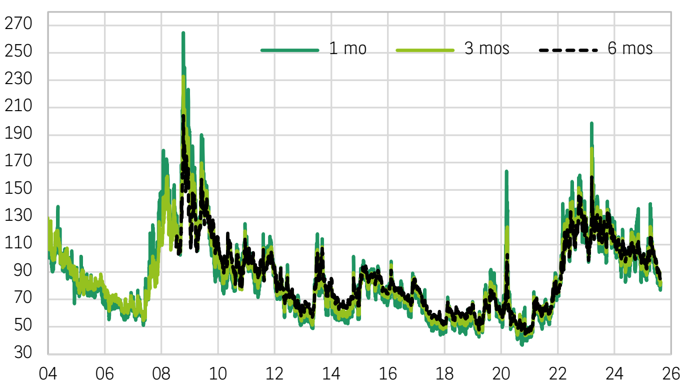

CHART 1 SOURCE: MACROBOND, BNP PARIBAS

Finally, they are by far the first choice of investors looking for security, as their value can hold or even increase if there are financial tensions, and they can be sold quickly without any losses. In fact, their safe-haven status has been a major factor in the development of the US capital markets and is a key advantage for financing the US economy. However, confidence in the stability and liquidity of this market, even in times of stress, is essential if this status is to be maintained.

However, three factors have gradually reduced the reliability of the world's leading safe-haven asset: the colossal size of the US federal debt; the shift in the types of federal government creditors towards more short-termist investors; banking regulation, which has worsened intermediation conditions on the Treasuries market.

The expected effects of current US policy in these three areas are hardly reassuring. The Trump administration's fiscal plans (*Part 1*) do not address the issue of the sustainability of public finances, and both the supply and the interest burden on debt are set to increase. This area, which will be discussed in more detail below, is covered in the first of three parts in this series of articles on Treasuries. While demand for short-term Treasury securities, from money market funds and stablecoin issuers, could be sustained, the unpredictability of the new administration and the repeated threats and challenges to the Fed's independence have created a climate of fear and uncertainty that is likely to undermine the confidence of foreign investors (*Part 2*). The relaxation of the leverage standard could reassure banks that they are able to fully play their role as intermediaries, but this will only provide a short-lived respite in view of the projected growth in federal debt (*Part 3*).

On the contrary, in order to preserve the status of Treasuries, the US authorities should endeavour to dispel concerns. If they fail to do so, Treasuries will certainly remain central to investors' portfolios, but will see their value depreciated and accompanied by a higher risk and term premium.

SIGNS OF TENSION IN 2025

The questions raised by the United States' debt trajectory are nothing new (*see "Ever-increasing supply" below*). The downgrade of the country's sovereign rating by Moody's on 16 May 2025 marked the end of a fourteen-year period (2011, 2023 and 2025) which saw the three main rating agencies withdrew the triple A rating from the United States (Moody's Ratings, 2025). The current administration's fiscal plans are heightening these concerns by failing to address the issue of the sustainability of public finances. The analysis that these plans are unlikely to result in 'multi-year reductions in mandatory spending and deficits' also played a role in Moody's decision.

Furthermore, these plans were unveiled against a backdrop of considerable uncertainty and even institutional risks. In turn, the perception of long-term risk on Treasuries is increasing, which could undermine their safe-haven status. This risk is reflected in the widening spread between 30-year and 10-year yields since the start of the year (*Chart 2*). The spread averaged 47 basis points (bps) in Q2 2025, rising to 55 bps in July/August, compared with 19 bps for 2024 as a whole. While this does not necessarily indicate a deterioration in the long-term fiscal outlook, the increase in the term premium on the 10-year yield supports this view. In Q2 2025, it reached a level not seen since the end of 2014 (*Chart 3*). This shows that long-term risk is becoming more expensive, including at very long maturities.

These doubts have been reinforced by other developments. A break in the positive correlation between the US dollar, illustrated by the ICE index (against a basket of major currencies), and Treasuries rates was observed at the start of Q2 2025, and to a lesser extent in mid-May (*Chart 4*). The US dollar weakened against a backdrop of subdued growth expectations, which should have had a downward effect on Treasuries rates. Furthermore, in July 2025, the 10-year yield was 70 bps above its level prior to the Fed's rate cuts (-100 bps between September and December 2024, *Chart 5*).

INCREASES IN THE SPREAD BETWEEN 30-YEAR AND 10-YEAR YIELDS AND IN THE TERM PREMIUM ON 10-YEAR BONDS

Change in the spread between 30-year and 10-year yields

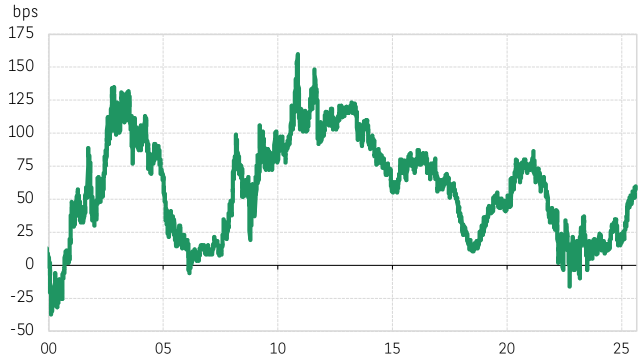

CHART 2 SOURCE: MACROBOND, BNP PARIBAS

Change in the term premium on 10-year yield

CHART 3 SOURCE: FED OF NEW YORK, BNP PARIBAS

BREAK IN THE CORRELATION BETWEEN THE DOLLAR AND BOND YIELDS IN Q2 2025 AND THE PROBLEM AROUND TRANSMISSION FROM SHORT RATES TO LONG RATES

Disruption in correlation between the US dollar and bond yields

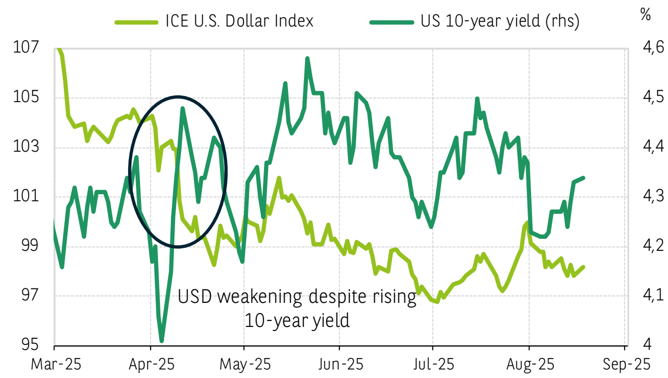

CHART 4 SOURCE: MACROBOND, BNP PARIBAS

10-year yield increase since monetary easing

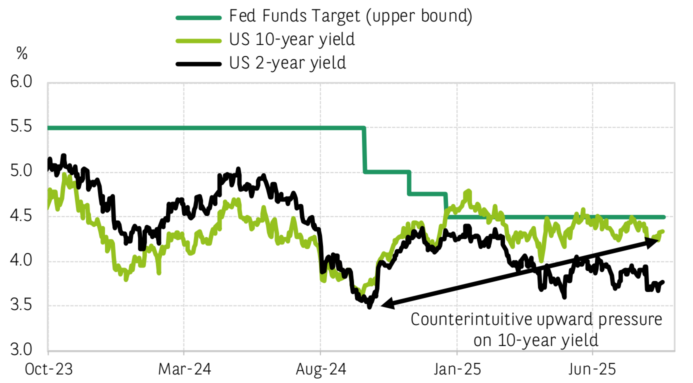

CHART 5 SOURCE: FEDERAL RESERVE, MACROBOND, BNP PARIBAS

This counter-intuitive upward pressure on US long rates poses a risk in terms of the diffusion of monetary policy decisions across the entire yield curve, and is now another signal to monitor. We have also seen a break in the inverse relationship between equity and bond prices following the Liberation Day announcements, as well as a lack of rally in Treasuries following the announcements, which eased the tensions.

These concerns were echoed on the primary market, with several disappointing auctions in 2025. These auctions featured a yield higher than the secondary market, a low bid-to-cover ratio[1] and an above-average proportion of securities that had to be absorbed by the primary dealers. The phenomenon was seen over numerous auctions, and on several maturities, ranging from 2 to 30 years. The consequences of an auction meeting insufficient demand are interpreted more broadly as a loss of attractiveness for the issuer's securities. On 21 May 2025, the disappointing auction of 20-year US Treasury securities took the associated yield on the secondary market to its highest level since the end of 2023. This came in the week of the introduction of the One, Big, Beautiful Bill in the House of Representatives and the downgrade by Moody's.

AN EVER-INCREASING SUPPLY

The US government has been running a systematic deficit since 2001. It currently stands at around 6% of GDP, an unprecedented level (excluding wartime or recession). The Congressional Budget Office (CBO) expects the situation to persist in its March projections (*Chart 6*), which are subject to downward revisions as part of its study of the impact of the One, Big, Beautiful Budget Act (OBBA). We believe that the adoption of the OBBA will not drastically alter the dynamics. In our view, the new tariff revenues should reduce the negative impact of the OBBA on public accounts. Therefore, we expect the public deficit to remain at around 6% until 2029. Under these conditions, the federal debt seems set to continue rising beyond its historic record (*Chart 7*).

These deficit figures require ever larger issues of Treasury securities. This raises issues of absorption at a time when new challenges are emerging, such as the higher level of interest rates, which means an increase in the stabilising government balance (*see: Stabilising public debt: primary budget surpluses will be needed in many countries*).

1 This is the total nominal amount of bids divided by the total nominal amount of securities allocated.

A SUSTAINED BUDGET DEFICIT (LEFT) LEADING TO A SIGNIFICANT INCREASE IN THE DEBT/GDP RATIO (RIGHT)

US Federal Deficit (March 2025 forecast)

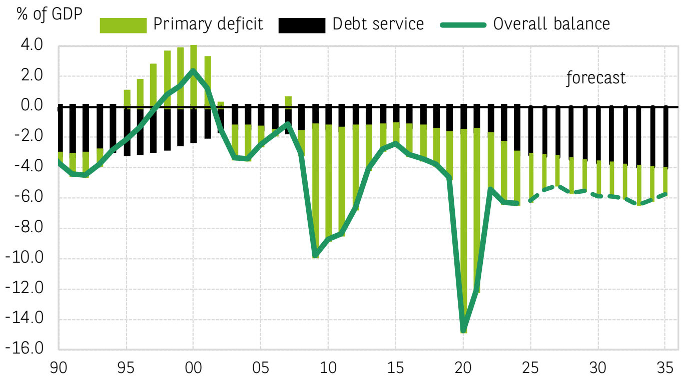

CHART 6

SOURCE: CBO, BNP PARIBAS

Upward trend in debt-to-GDP ratio (March 2025 forecast)

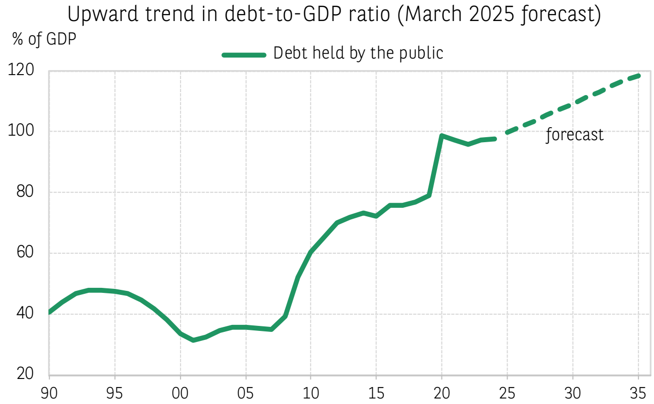

CHART 7

SOURCE: CBO, BNP PARIBAS

The 2021–2023 inflationary shock also brought the Fed's quantitative easing (QE) to an end, thereby increasing the quantity of bond issues that have to be absorbed by parties other than the central bank. Inflation may initially lead to a reduction in the ratio of debt-to-GDP through a nominal effect (reduction in the real value of the debt). However, if it persists once the shock has dissipated, the effect fades as the inflation premium demanded by investors to bear the risk of losses in real terms rises, thus increasing bond yields. In this respect, the 10-year breakeven inflation rate remains relatively contained (2.4% in August 2025) but significantly higher than in 2015–2019 (average of 1.8%).

Another reflection of the magnitude of the fiscal challenge is the weight of debt servicing (already the highest since 1991), which will exceed weight of the two components of discretionary spending (defence and non-defence, *Chart 8*) this year. Some political factors are leading the United States to wait for bond yields to fall. The current administration is unlikely to raise taxes (despite a low level of revenue, standing at 17.1% of GDP), or reduce the defence budget (3.0% of GDP).

THE GROWING WEIGHT OF THE INTEREST BURDEN COMPARED WITH DISCRETIONARY SPENDING (MARCH 2025 FORECASTS)

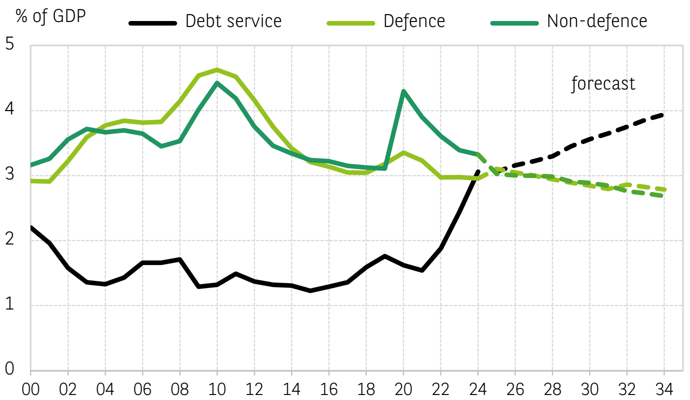

CHART 8

SOURCE: CBO, BNP PARIBAS

Although the OBBA will reduce Medicaid spending, it will be harder to reduce other mandatory spending (including pensions). Furthermore, these are set to rise in the coming years as the population ages.

In these conditions, the existing room for manoeuvre appears to be restricted to discretionary spending (excluding defence, *i.e.* 3.3% of GDP), which is reviewed annually by Congress. Moreover, these deficit levels imply that there will be less leeway should there be a recession. Furthermore, the upward trajectory of the debt-to-GDP ratio could create a vicious circle for bond yields. It is estimated that a 1 percentage point rise in the debt-to-GDP ratio would cause yields to rise by 3-4 bps (Rachel and Summers, 2019), which would in turn imply a rise in indebtedness.

Finally, the high level of political polarisation in the United States does not facilitate a bipartisan approach to the issue, which seems to be a prerequisite (*see "Managing supply without fuelling tensions?" below*). To make matters worse, this polarisation and the federal government's fiscal course give rise to the frequent risks of a shutdown and of the debt ceiling being reached, both of which are the subject of intense bargaining. So far, these conflicts have been resolved fairly quickly. The debt ceiling is certainly an artificial limit to the debt level, but it is better to avoid experiencing its practical consequences.

MANAGING SUPPLY WITHOUT FUELLING TENSIONS?

More than half of the outstanding federal debt held by the public will have to be refinanced by the end of 2028 (*Chart 9*). In this effort, the US Treasury can manage the match between supply and demand by playing with different maturities (liability management). By issuing more short-term bonds, it can meet investors' liquidity needs while avoiding locking in part of its debt at a long-term interest rate that is deemed too high. This strategy was adopted in response to the sharp post-pandemic rise in interest rates, with the average maturity of federal debt falling from 75 to 72 months between May 2023 and June 2025 (*Chart 8*).

However, this solution cuts both ways, as it exposes the issuer more to interest rate risk. The practice, initiated under the previous administration, has been extended by Scott Bessent, the current Treasury Secretary. Given the current high level of 10-year yields, he has indefinitely

HIGH SHORT-TERM REFINANCING REQUIREMENTS AND A DOWNWARD TREND IN AVERAGE MATURITY

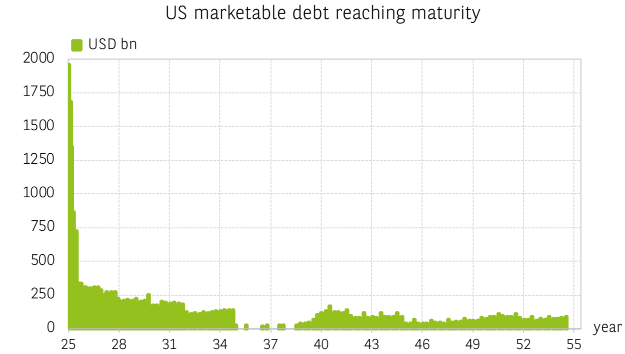

CHART 9 SOURCE: US TREASURY, BNP PARIBAS

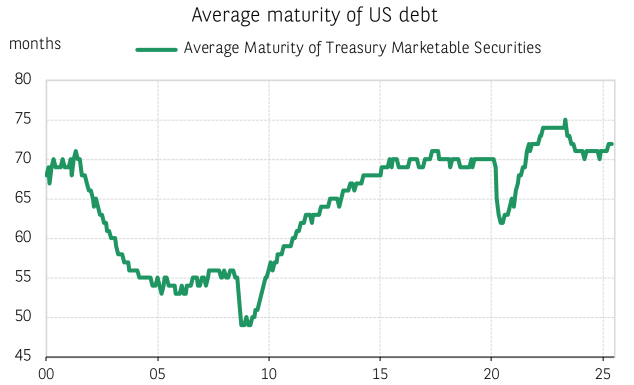

CHART 10 SOURCE: MACROBOND, BNP PARIBAS

postponed his plans to increase issues of long bonds (terming out). In a low-interest-rate environment, the strategy of lengthening the average maturity would have the advantage of stabilising the management of the federal debt and its servicing, which is positive from the point of view of preserving Treasuries' safe-haven status.

Another possibility, which the US Treasury is gradually exploring, is to operate directly on the secondary market. Treasury buyback programmes enable it to withdraw the least traded securities (the oldest, off-the-run) from the market at the same time as it auctions new securities (on-the-run). The aim is to reduce the stock of less liquid securities that could be sold to primary dealers in a race for liquidity, and even to reduce the cost of debt.

The pace and scale of buybacks has increased sharply from 2024 onwards, whereas previously the practice had been marginal (*see Chart 11*). This happened in two stages: first, from Q2 2024, under Janet Yellen, who put forward the traditional explanations of liquidity and cash management (Yellen, 2024), and then under the new administration. Since 20 January 2025, more than USD 122 bn of securities have been repurchased in this way (compared with USD 88 bn between May 2024 and that date, *Chart 11*), including two historic daily records of USD 10 bn in June. At this stage, however, the scale of buybacks remains modest in relation to the size of the market.

AN INCREASE IN THE PACE OF BUYBACKS

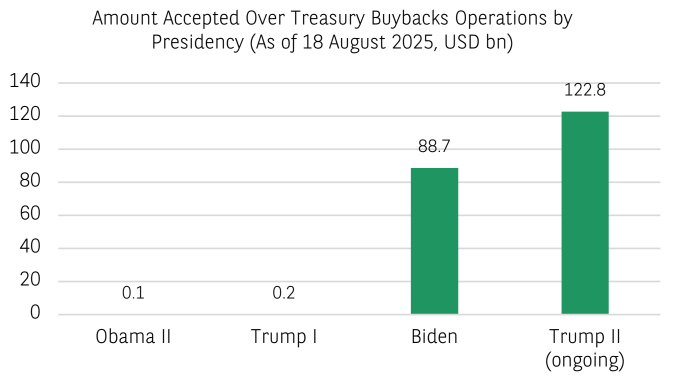

CHART 11 SOURCE: US TREASURY, BNP PARIBAS

Finally, the most effective way for the US administration to reinforce the stability of the Treasuries market would be to contain its supply of debt securities, in other words, to undertake fiscal consolidation. This would increase the attractiveness of US bonds and address concerns about the sustainability of US debt. The most recent example of successful massive consolidation dates back to the Clinton administration (D, 1993–2001).

The recommendations of a commission, made up of members of Congress from the two dominant parties and representatives of the public and private sectors, contributed to bipartisan acceptance of the need to reduce the deficit. In 1997, the Balanced Budget Act was passed by a Congress controlled by the opposing party with an overwhelming bipartisan consensus. Subsequently, the US federal budget was in surplus for four consecutive years (1998–2001). It should be noted, however, that this occurred in a climate that was conducive to accelerating growth, rising tax revenues as a percentage of GDP and bipartisan compromise[2]. The combination of these three factors seems unlikely today, unless a tipping point was reached, where the cards could be dealt out again.

Completed on 20 August 2025

Anis Bensaidani & Céline Choulet

REFERENCES

Liang N. (2025), What's going on in the US Treasury market, and why does it matter?, Brookings Commentary, 14 April 2025

Moody's Ratings (2025), Moody's Ratings downgrades United States ratings to Aa1 from Aaa; changes outlook to stable, 16 May 2025

Perli R. (2025), Recent Developments in Treasury Market Liquidity and Funding Conditions, FRBNY, Remarks at the 8th Short-Term Funding Markets Conference, Federal Reserve Board, Washington, DC

Rachel L. et Summers L. (2019), On Secular Stagnation in the Industrialized World, Brookings Papers on Economic Activity

Yellen J. (2024), Remarks by Secretary of the Treasury Janet L. Yellen at the 2024 U.S. Treasury Market Conference, U.S. Department of the Treasury, 24 September 2024

2 https://www.congress.gov/bill/105th-congress/house-bill/2015/all-actions?overview=closed&q=%7B%22roll-call-vote%22%3A%22all%22%7D

GROUP ECONOMIC RESEARCH

Isabelle Mateos y Lago Group Chief Economist	+33 1 87 74 01 97	isabelle.mateosylago@bnpparibas.com
Hélène Baudchon Deputy Chief Economist, Head of Global Macroeconomic Research	+33 1 58 16 03 63	helene.baudchon@bnpparibas.com
Stéphane Alby Maghreb, Middle East	+33 1 42 98 02 04	stephane.alby@bnpparibas.com
Lucie Barette Europe, Southern Europe	+33 1 87 74 02 08	lucie.barette@bnpparibas.com
Anis Bensaidani United States, Japan	+33 1 87 74 01 51	anis.bensaidani@bnpparibas.com
Céline Choulet Banking Economics	+33 1 43 16 95 54	celine.choulet@bnpparibas.com
Stéphane Colliac Head of Advanced economies – France	+33 1 42 98 26 77	stephane.colliac@bnpparibas.com
Guillaume Derrien Europe, Eurozone, United Kingdom – World Trade	+33 1 55 77 71 89	guillaume.a.derrien@bnpparibas.com
Pascal Devaux Middle East, Western Balkans – Energy	+33 1 43 16 95 51	pascal.devaux@bnpparibas.com
Hélène Drouot Latin America	+33 1 42 98 33 00	helene.drouot@bnpparibas.com
François Faure Head of Country Risk – Türkiye	+33 1 42 98 79 82	francois.faure@bnpparibas.com
Salim Hammad Head of Data & Analytics – Brazil	+33 1 42 98 74 26	salim.hammad@bnpparibas.com
Thomas Humblot Banking Economics	+33 1 40 14 30 77	thomas.humblot@bnpparibas.com
Cynthia Kalasopatan Antoine Central Europe, Ukraine, Russia, Kazakhstan	+33 1 53 31 59 32	cynthia.kalasopatanantoine@bnpparibas.com
Johanna Melka Asia	+33 1 58 16 05 84	johanna.melka@bnpparibas.com
Marianne Mueller Europe, Germany, Netherlands	+33 1 40 14 48 11	marianne.mueller@bnpparibas.com
Christine Peltier Head of Emerging economies – Asia	+33 1 42 98 56 27	christine.peltier@bnpparibas.com
Lucas Plé Sub-saharan Africa, Colombia, Central America	+33 1 40 14 50 18	lucas.ple@bnpparibas.com
Jean-Luc Proutat Head of Economic Projections	+33 1 58 16 73 32	jean-luc.proutat@bnpparibas.com
Laurent Quignon Head of Banking Economics	+33 1 42 98 56 54	laurent.quignon@bnpparibas.com
Tarik Rharrab Data scientist	+33 1 43 16 95 56	tarik.rharrab@bnpparibas.com

GROUP ECONOMIC RESEARCH

ECOINSIGHT
Structural or thematic topics

ECOPERSPECTIVES
Analyses and forecasts with a focus on developed and emerging economies.

ECOFLASH
Data releases, major economic events

ECOWEEK
Recent economic and policy developments, data comments, economic calendar, forecasts

ECOPULSE
Monthly barometer of key economic indicators of the main OECD countries

ECOCHARTS
Easy-to-read monthly overview of inflation dynamics

ECOATLAS
The key economic figures for France and major European economies

CHART OF THE WEEK
A weekly chart highlighting points of interest in the world economy

ECOTV
What is the key event of the month?
You will find the answer in our economy broadcast.

MACROWAVES
Our economic podcast

HOW TO RECEIVE OUR PUBLICATIONS

SUBSCRIBE ON OUR WEBSITE
see the Economic Research website

&

FOLLOW US ON LINKEDIN
see the Economic Research linkedin page

OR TWITTER
see the Economic Research Twitter page

Published by BNP PARIBAS Economic Research
Head office: 16 boulevard des Italiens – 75009 Paris France / Phone : +33 (0) 1.42.98.12.34
Internet: www.group.bnpparibas - www.economic-research.bnpparibas.com
Head of publication : Jean Lemierre / Chief editor: Isabelle Mateos y Lago
Copyright image: justit

Subscribe to our publications:
ECONOMIC RESEARCH

BNP PARIBAS

The bank
for a changing
world