The U.S. Treasury's Biggest Short: Duration in the Shadows

Georgievska, Pegoraro & Saunders (2026)

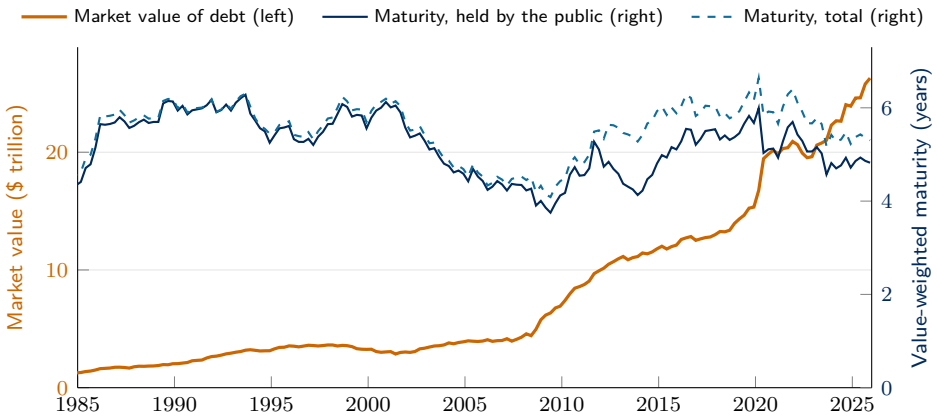
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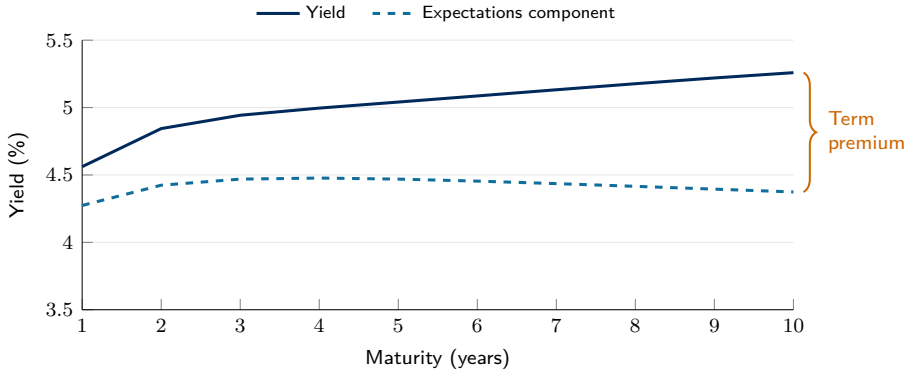
Background (1/2)

- Fiscal concerns have raised several questions about debt management and US borrowing costs.



Background (2/2)

- A positive term premium on long-term bonds raises yields, and so raises governments' interest spending.



Treasury yield curve on 30 September 2026, decomposed as in Adrian, Crump & Moench (2013). Data: Federal Reserve Bank of New York.

Overview: Very Important and Timely Paper

- **Headline**: The Treasury can lower debt servicing costs by managing the duration of its debt.
  $\Longrightarrow$ *Bills absorb fiscal shocks, coupons follow announced amounts: no response to financing conditions.*

- Evidence from auctions and buybacks points towards face value management, not duration.
- Core EU countries lowered borrowing costs through swaps while being "*regular and predictable*."

- **Implication**: Unmanaged duration is costly: taxpayers lose \$0.9tn if rates fall 1 pp.
- **Recommendation**: Manage duration: shorten maturity, issue FRNs, and hedge interest rate risk.

My discussion: What is the right objective for the government?

(1) When is minimizing government borrowing costs socially desirable?

(2) If cost minimization is socially desirable, at what frequency should the government respond?

Is minimizing borrowing costs always socially desirable?

Debt management principles and the government objective

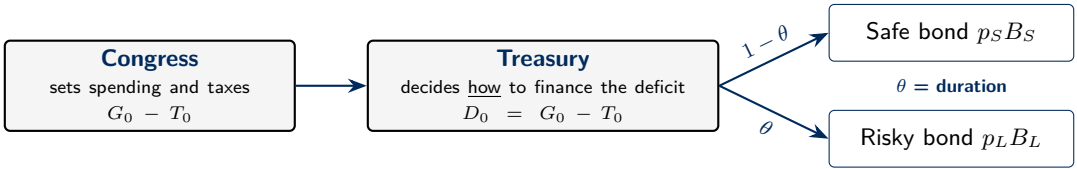
> *"Fund the government at the least cost to the taxpayer over time"* subject to risk and price impact constraints.
>
> U.S. Treasury

- Within this broader framework, the Treasury has adopted several key principles:
  - "*Treasury is a regular and predictable market participant, not a market timer*"
  - "*Treasury doesn't react to current rate levels or short-term fluctuations in demand*"

- **This paper**: The US Treasury can reduce expected debt servicing costs by managing the duration of its debt (bills, swaps, FRNs), and still be regular and predictable.

- *Are lower borrowing costs always desirable, or does it depend on what drives term premia?*

A Stylized Model of Optimal Debt Management



- Uncertainty: spending $G_1(s)$ and the payoff of the risky bond $X_L(s)$; endowments are fixed.
- A representative household pays taxes and buys the debt:

$$C_0 = Y_0 - G_0 - \underbrace{\frac{\phi_S}{2} B_S^2 + \frac{\phi_L}{2} B_L^2}_{\text{financial friction: holding costs}} \qquad C_1(s) = Y_1 - G_1(s) - \underbrace{\frac{\kappa}{2} T_1(s)^2}_{\text{real friction: deadweight loss}}$$

Minimize debt service costs

$$\min_{\theta} \ \mathbb{E}\left[B_L X_L(s) + B_S\right]$$

or

Maximize welfare

$$\max_{\theta} \ U(C_0) + \beta\, \mathbb{E}\left[U(C_1(s))\right]$$

A Ricardian Benchmark ($\kappa = 0$, $\phi_L = \phi_S = 0$)

- Consider a benchmark with neither **real frictions** nor **financial frictions**.
- In this economy, cost minimization and welfare maximization coincide vacuously.

Minimize debt service costs = **Maximize welfare**

- Ricardian equivalence: the maturity structure is irrelevant; cost minimization just picks one.



Summary: *Responding to the term premium does not hurt, but it does not help either! The Treasury cannot do anything to reduce the term premium, as it cannot affect the allocation of risk.*

Term Premia as Compensation for Risk ($\kappa > 0$, $\phi_L = \phi_S = 0$)

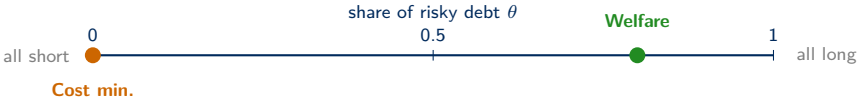
- Consider now a situation with **distortionary taxes** and without **financial frictions**.
- A welfare-maximizing government wants longer duration to smooth tax distortions. The cost-minimizer wants to shorten the duration but it does not internalize fiscal risks.

Minimize debt service costs
shorter duration

$\neq$

Maximize welfare
longer duration

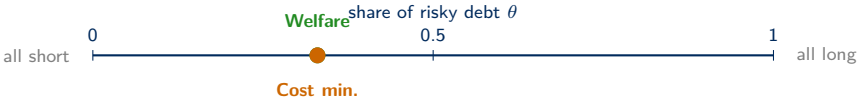
- A positive-beta asset is expensive to issue, but still valuable as a hedge against spending risk.



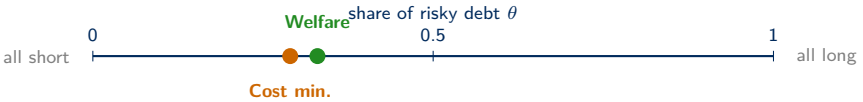
Summary: *If term premia come from macro/real frictions, cost minimization is a very bad idea.*

Financial Frictions ($\kappa = 0$, $\phi_L > \phi_S$)

- Suppose next that taxes are **lump-sum**, but there are **financial frictions** such that $\phi_L > \phi_S$.
- If $X_L(s)$ is uncorrelated with spending $G_1(s)$: **Cost minimization and welfare coincide!**



- If $X_L(s)$ and $G_1(s)$ correlated: welfare unchanged, but cost minimization tilts towards safe debt.



Summary: *If the term premium entirely comes from financial frictions, the Treasury can reduce financing costs without any effect on the allocation of risk and improve welfare.*

Implications for the Paper

	Cost min. picks	Respond to risk premia?
Ricardian benchmark	any	Indifferent
Real friction	too short	No
Financial friction	the optimum	**Yes ✓**
Financial friction + risk premium	too short	**Partly ✓**

- The Treasury should manage duration to save on the part of the term premium that originates from **financial frictions**, but should ignore the part that comes from the **real side**.
  $\Longrightarrow$ *Related arguments in Bohn (1999), Missale (1997), and Greenwood, Hanson & Stein (2015).*

- Are the Adrian, Crump & Moench (2013) term premium and swap spread measures different?
  $\Longrightarrow$ *Duration supply seems more responsive to the swap spread than to term premia: points in the right direction!*

How quickly should the Treasury adjust debt issuance?

Financial frictions and active debt management

- Cost minimization is a reasonable objective when term premia reflect financial frictions.
- Plenty of empirical evidence that **financial frictions** impact Treasury yields and term premia.
  $\Longrightarrow$ **Liquidity Premia**: *Krishnamurthy & Vissing-Jorgensen (2012); Nagel (2016); Greenwood, Hanson & Stein (2015).* **Habitat Demand**: *Greenwood & Vayanos (2014); D'Amico & King (2013).* **Price Pressure**: *Lou, Yan & Zhang (2013); Albuquerque, Cardoso-Costa & Faias (2024); Fleming, Nguyen & Rosenberg (2024).*

- The evidence is consistent with an economy in which both ϕ_L and ϕ_S are relevant.
- These parameters may capture constraints faced by intermediaries in the Treasury market.

- Intermediation capacity may depend on the Treasury's behavior over the longer run.
- What drives these frictions and how they respond to Treasury's actions **feed back** into them?
  $\Longrightarrow$ *Should the Treasury respond quickly or slowly? Within a quarter? Regular and predictable?*

Price Impact at Treasury Auctions

- Treasury bills, notes, and bonds are sold through regularly scheduled Treasury **auctions**.
- Price concession in the primary market typically associated with dealers' intermediation capacity.

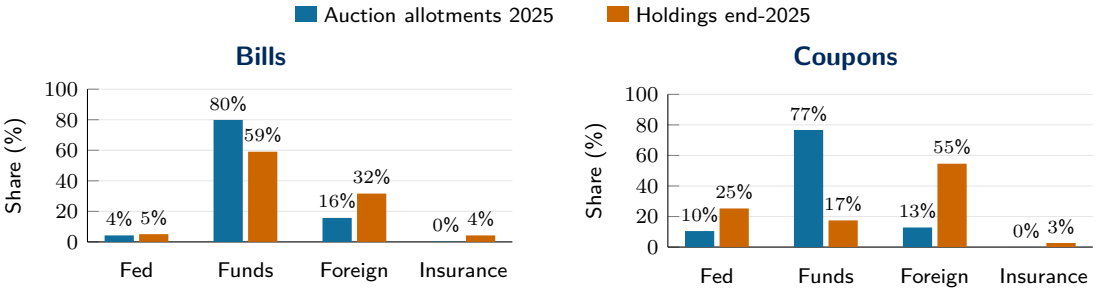
- The Treasury pays close attention to dealers' balance sheets and risk tolerance.
  - **2022 Q2** [jy0763]: "Some members are concerned about the limited elasticity of dealer balance sheets amidst increasing debt stock and elevated VAR levels."
  - **2015 Q2** [jl10044]: "[. . .] survey of primary dealers regarding their assessment of how quickly, and to what degree, the Treasury could adjust auction sizes without incurring significant pricing concessions [. . .]"
  - **2024 Q4** [jy2698]: "Dealer intermediation capacity has not kept pace with issuance"

- The impact of short-term surprises and active debt management could go in both directions.
  - ✓ Dealers anticipate the rule: less supply when constraints bind (see also Haddad et al. (2024))
  - ✗ Primary dealers face increased uncertainty about inventories and funding (Duffie (2020))

Why allocate surprises to bills and not coupons?

- **Bills**: bidders are **fast capital** and likely to be ultimate holders: natural role as shock absorber.
- **Coupons**: many buyers of long-term debt do not participate directly in the auction.

  $\Longrightarrow$ *Primary dealers deploy capital and carry inventories to resell later to insurance companies and pension funds.*



Matched sectors. Auction allotments: Treasury investor class data, 2025. Holdings: Financial Accounts Z.1, L.210, 2025:Q4.

The Treasury Responds to Term Premia, but Slowly

- The Treasury may adjust duration in response to term premia, but at lower frequencies.
  - **2015 Q3** [jl0141]: "[. . .] given the low level of rates and *term premium*, the Committee was supportive of issuing coupon debt in similar proportions to recent auctions to allow for a laddered debt *maturity* profile and a gradual lengthening of the average *maturity* of the debt outstanding."
  - **2020 Q3** [sm1080]: "[. . .] several measures indicate that the *term premium* on long-term Treasuries remains elevated relative to the belly of the curve. As a result, focusing the largest increases on issuance in *maturities* out to 10 years and in TIPS appears to be more desirable than concentrating issuance in longer instruments."
  - **2023 Q4** [jy1865]: "The charge suggested Treasury consider skewing increases in issuance towards tenors which have less sensitivity to *term premium* increases, and ones that benefit from greater liquidity."

- The US government has been able to create a funding advantage, but it took a very long time.
  $\Longrightarrow$ *See, for example, historical accounts of Lehner et al. (2025); Payne & Szőke (2026).*

Summary: *Opportunistically responding to short-term financing conditions may save money in the short run, but there it may increase risk and price impact over longer horizons.*

Outlook

Comments for the Authors

1. **Interpretation of Regression (5)**: There is a mechanical relation between duration share and term premia driven by maturity. What would the null of a passive government imply? ▸ Appendix

2. **Simultaneity in Regression (5)**: The term premium and duration supply are both equilibrium outcomes. OLS estimates may be biased if the Treasury internalizes its price impact. ▸ Appendix

3. **Elasticity measures**: Demand elasticities from Treasury auctions (Somogyi, Wallen & Xu 2026) may capture strategic incentives, information asymmetries, and market power. ▸ Discussion

4. **Minimization Objective (7)**: In the short run, treating elasticities as structural parameters may be appropriate. However, the objective does not hold revenue fixed.

5. **TIPS Issuance**: Could you say anything about whether the government could further reduce borrowing costs by responding to the inflation risk premium?

6. **Swaps and FRNs**: What can FRNs and swaps achieve that duration management alone cannot?

Conclusion

- **VERY** important and timely paper emphasizing the merits of duration management.
- **Policy recommendation**: Issue shorter duration, more FRNs, and use interest rate derivatives.

- Minimizing borrowing costs is socially desirable if term premia come from **financial frictions**.
  $\Longrightarrow$ *If term premia reflect risk compensation, responding to that may exacerbate budgetary risks.*
- Active debt management plausibly feeds back into price impact, so **timing matters**.
  $\Longrightarrow$ *Less clear whether short-term responses to financing conditions effectively lower price impact over time.*

- A very thought-provoking paper: I suggest everyone think about these questions!

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Appendix for the Authors

Interpretation of the Fixed-Effects Regression

- Consider the regression specification (5) with quarter fixed effect.

$$\text{Duration Supply Share}_{m,t} = \mu_t + \sum_k \beta_k X_{k,m,t} + \varepsilon_{m,t}$$

- The specification compares term premia across maturities within the same quarter.
- Consider a government that issues an equally weighted (market value) bond portfolio:
  - Given equal portfolio weights, duration supply share increases with maturity m.
  - Term structure models typically imply that expected excess returns (term premia) at maturity m satisfy $\text{TP}(m) = A_r(m)\lambda_t$ (Vayanos & Vila 2021; Greenwood & Vayanos 2014).
- If the price of risk λ_t is the same across all bonds, and the loading $A_r(m)$ increases with m, then there is a mechanical relation between the dependent and the independent variables.
- Under these restrictions across maturities, what does the null of a **passive** government imply?

Back

Simultaneity

- When is OLS a consistent estimator of the government supply response to term premia?
- Consider a demand-supply system in which the government internalizes price impact.

$$Q_t^D(m) = \alpha^D + \beta^D\, y_t(m) + \varepsilon_t^D \qquad \text{(demand)}$$
$$Q_t^S(m) = \alpha^S + \beta^S\, y_t(m) + \varepsilon_t^S \qquad \text{(supply)}$$

- Substituting $y_t(m) = \mathsf{EX}(m) + \mathsf{TP}(m)$ and solving for $\mathsf{TP}(m)$ taking expectations as given:

$$\mathsf{TP}(m) = \frac{\alpha^D - \alpha^S}{\beta^S - \beta^D} + \frac{\varepsilon_t^D - \varepsilon_t^S}{\beta^S - \beta^D} - \mathsf{EX}(m)$$

- Regressing duration supply at maturity m on the term premium at maturity m gives

$$Q_t^S(m) = \alpha^S + \beta^S \underbrace{\left(\frac{\alpha^D - \alpha^S}{\beta^S - \beta^D} + \frac{\varepsilon_t^D - \varepsilon_t^S}{\beta^S - \beta^D} - \mathsf{EX}(m) \right)}_{\mathsf{TP}(m)} + \varepsilon_t^S$$

Back