

APOENA RESEARCH

A Temporary Bid for the Long End

Treasury buybacks can repair liquidity.
They cannot repair the fiscal path.

US rates, fiscal credibility, energy risk and global Treasury demand

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Independent student research. For educational purposes; not investment advice.

Executive thesis

BOTTOM LINE The Treasury can improve how the long end trades, but it cannot change why investors require a higher yield. Durable relief needs both lower inflation risk and a credible path for the primary deficit.

The present US policy mix is difficult, but the conflict is often described too loosely. The Federal Reserve is holding a restrictive policy rate because inflation remains above target. The Treasury, meanwhile, is issuing large volumes of debt while using buybacks to improve liquidity in older securities. These actions operate on different margins: the Fed determines the stance of monetary policy; the Treasury manages the composition and market functioning of government liabilities. A buyback financed with cash or new issuance is not quantitative easing, because the Treasury does not create reserves and does not necessarily reduce the net amount of debt the public must absorb.

The more defensible interpretation is that the long end reflects three overlapping forces. Expected short rates remain high because inflation has not returned to target. Real term premia have risen as investors demand compensation for duration, supply and policy uncertainty. Finally, liquidity in older, off-the-run bonds can deteriorate when volatility rises. Treasury buybacks can address the third force and, at the margin, relative-value distortions within the curve. They cannot by themselves address the first two.

Energy policy adds a conditional offset. The first US sanctions package announced on 24 August was forceful in rhetoric and broad in designations, but it stopped short of the maximum measures markets feared against buyers and financial intermediaries. That reduced the immediate probability of an abrupt loss of Iranian supply. Yet the disinflationary conclusion is not secure: flows through the Strait of Hormuz remain impaired, and distillate inventories are tight. Lower crude prices may therefore coexist with expensive diesel and elevated freight costs.

My central view is that the recent market reaction is not evidence that Treasuries have lost their safe-asset role. It is evidence that the clearing yield for long-duration government debt has risen. The distinction matters. A loss of safe-asset status would imply a broad breakdown in demand or monetary credibility; current data instead show strong demand at sufficiently attractive yields, high real rates, and a term premium sensitive to fiscal and supply risk. The policy question is not whether officials can force the long bond lower for a few sessions. It is whether they can reduce the compensation investors require to hold it for decades.

Market snapshot

Variable	Latest observation	Reference date
Policy rate	3.50%–3.75%	29 Jul 2026
2-year Treasury	4.24%	21 Aug 2026
10-year Treasury	4.74%	21 Aug 2026
30-year Treasury	5.27%	21 Aug 2026
10-year TIPS real yield	2.40%	21 Aug 2026
30-year TIPS real yield	3.00%	21 Aug 2026
PCE / core PCE	3.7% / 3.3% y/y	Jun 2026
Gross federal debt	\$40.03tn	20 Aug 2026
CBO FY2026 deficit	\$1.9tn; 5.8% of GDP	Feb 2026 projection

Sources: Federal Reserve, BEA, Treasury Fiscal Data and CBO. Nominal and real Treasury yields are constant-maturity series; observations and definitions are not perfectly synchronous. [1] [3] [4] [8] [9]

1. A hawkish hold, not a hidden liquidity pivot

At its 28–29 July meeting, the FOMC kept the federal funds target range at 3.50%–3.75% in a 9–3 vote; the three dissenters preferred a 25 basis-point increase. The minutes describe inflation as elevated and the risks to inflation as tilted to the upside. They also record that many participants would see further tightening as appropriate if inflation did not show a meaningful decline. This is a hawkish hold: policy is unchanged, but the reaction function remains asymmetric toward inflation persistence. [1]

The June data explain the caution. Headline PCE inflation was 3.7% year on year and core PCE 3.3%, both well above the Fed’s 2% objective. The July PCE report, due on 26 August, is therefore the next immediate test. A firm core reading would support higher-for-longer pricing or another increase. A softer print could relieve the front end, but one month would not establish a trend. [1] [3]

The minutes are also unusually useful for separating stance from implementation. Participants continued to describe the policy rate as the primary instrument for adjusting monetary policy. Balance-sheet and reserve-management operations are intended to keep the federal funds rate within the target range and preserve an ample-reserves framework. Reinvestment, bill purchases for reserve management and the standing repo facility can change market plumbing without changing the inflation objective. Treating every liquidity operation as an easing signal collapses this distinction. [1] [2]

There can still be a communication problem. If the Fed signals that rates may need to rise while the Treasury expands long-end buybacks, markets may perceive policy incoherence. In economic terms, however, the instruments are not necessarily contradictory. The Fed is influencing aggregate financial conditions; the Treasury is altering the liquidity and maturity mix of outstanding debt. The tension becomes substantive only if debt management is used persistently to suppress a market-clearing long yield or if financing choices materially loosen system liquidity.

2. The long end is telling a real-rate story

On 21 August, the 10-year Treasury yielded 4.74% and the 30-year 5.27%. Their inflation-protected counterparts yielded 2.40% and 3.00%. A simple subtraction implies inflation compensation of roughly 2.34% at ten years and 2.27% at thirty years. Breakevens contain inflation risk and liquidity premia and are not pure forecasts, but this decomposition still suggests that unusually high real yields are doing much of the work. [4]

That reading is consistent with Federal Reserve staff research. A February note attributes much of the rise in far-forward nominal Treasury rates in recent years to higher real risk premia associated with supply-shock and federal-deficit concerns, rather than to a comparable increase in far-ahead inflation risk. A separate May paper uses a natural experiment to estimate that a one-percentage-point increase in expected debt-to-GDP can raise the ten-year term premium by roughly two to three basis points. These are model-based estimates, not an official FOMC forecast, and they should not be extrapolated mechanically. They nevertheless support the direction of the argument: fiscal supply can affect discount rates even when inflation expectations remain broadly anchored. [10] [11]

Fixed-income theory helps organise the mechanisms. A long yield can be decomposed into expected short rates plus a term premium. Fiscal deficits increase the amount of debt the market must absorb, while the maturity structure determines where that supply appears on the curve. Investor demand, hedging costs and liquidity then determine the price at which each segment clears. The long-end sell-off therefore cannot be assigned to a single cause. Inflation, expected policy, debt supply, foreign demand and liquidity must be examined separately before drawing a fiscal conclusion.

3. What Treasury buybacks can and cannot do

The August refunding kept nominal coupon auction sizes broadly unchanged and stated that current sizes should be maintained for at least several quarters. The quarter's \$125 billion refunding comprised \$58 billion of three-year notes, \$42 billion of ten-year notes and \$25 billion of thirty-year bonds. Treasury also scheduled up to \$38 billion of liquidity-support buybacks and up to \$25 billion for cash

management. On 19 August, it said that operations in the 10–20 and 20–30 year buckets would be at least doubled, from a maximum of \$2 billion to at least \$4 billion per operation beginning in September. [5] [6]

The mechanics matter. A liquidity-support buyback gives dealers and investors a predictable exit from older, less liquid securities. It can reduce off-the-run price concessions, improve relative-value relationships and make intermediation easier. It does not cancel the deficit. Unless the Treasury permanently retires debt using a fiscal surplus, the cash used for the repurchase must ultimately come from its cash balance, tax receipts or other borrowing. Regular auctions continue, so the private sector still has to absorb substantial net issuance.

Recent market behaviour illustrates both sides. The 13 August thirty-year auction stopped at 5.22%, the highest auction yield since 2001, yet its bid-to-cover ratio was 2.39, above the average of the previous six auctions. That is not an absence of demand; it is demand at a higher price of duration. The thirty-year yield fell to 5.19% on the buyback announcement but was back at 5.27% by 21 August. Temporary relief was real, but it did not alter the underlying clearing conditions. [4] [7]

Stanley Druckenmiller's criticism should be read in this context. In a 25 August Reuters report summarising his Wall Street Journal opinion piece, he argued that the larger operations looked like "price management" and risked damaging Treasury-market credibility. His broader claim, that liquidity tools cannot resolve a primary-deficit problem, is analytically strong. The counterargument is that well-specified, predictable buybacks can improve functioning without targeting a yield. The boundary between those interpretations depends on programme design, timing and communication, not on the existence of buybacks alone. [12]

Repo: a plumbing question, not yet a stress signal

The repo consequences are ambiguous. Buybacks retire some off-the-run collateral and cash-management decisions can shift reserves and bill supply; continued auctions add new, highly liquid collateral. These flows may affect specialness, dealer balance sheets and the distribution of funding pressure, but they do not mechanically imply a repo shortage. The July FOMC minutes described money-market conditions as stable and reserves as ample. The standing repo facility also exists to place a ceiling on overnight secured funding pressure. For now, repo should be monitored as a transmission channel, not cited as evidence of dysfunction. [1] [2] [13]

4. The fiscal problem is arithmetic before it is narrative

Gross federal debt reached \$40.03 trillion on 20 August. Gross debt includes intragovernmental holdings and is not the best measure of market supply, so debt held by the public should anchor sustainability analysis. CBO projects the latter at about 101% of GDP in 2026, rising to 120% by 2036 under current law. It also projects a 2026 deficit of \$1.9 trillion, or 5.8% of GDP, with net interest above \$1 trillion. [8] [9]

Interest expense now rivals national-defence spending. The exact statement depends on whether one compares net or gross interest, fiscal-year outlays or national-accounts measures. The careful conclusion is not that an accounting threshold has triggered a crisis. It is that a growing share of federal revenue is pre-committed to servicing past borrowing, leaving less flexibility for public investment, stabilisation policy or geopolitical shocks. [8]

Debt sustainability depends on the primary balance, the effective interest rate and nominal GDP growth. When the interest rate persistently exceeds the growth rate, stabilising the debt ratio requires a stronger primary balance. The United States retains important advantages: debt is issued in its own currency, the Treasury market remains the world's core collateral pool, and the dollar remains the dominant reserve currency. Those advantages reduce rollover risk; they do not repeal the budget constraint.

What would a credible adjustment look like? It would be legislated, multi-year and large enough to stabilise debt held by the public relative to GDP under realistic rate and growth assumptions. It would improve the primary balance rather than relying on optimistic interest-cost forecasts. It would combine measures on spending and revenue instead of placing the entire burden on one category, and it would phase in changes to avoid unnecessary near-term contraction. Credible budget rules, transparent scoring and fewer temporary provisions would matter because the term premium reflects uncertainty as well as the central forecast. BIS analysis reaches a similar conclusion: high-debt economies need credible medium-term frameworks that preserve room to absorb future shocks. [14]

This is why tactical debt management cannot be the whole answer. A buyback may compress a liquidity premium in a particular security. A credible fiscal package can reduce the distribution of future issuance and refinancing outcomes across the entire curve. The second channel is slower and politically harder, but it is the one that addresses the structural source of the risk premium.

5. Gold and Bitcoin: consistent with concern, not proof of abandonment

Gold and Bitcoin have strengthened alongside the debate over Treasury credibility. As of 21 August, Financial Times reporting put Bitcoin near \$77,375 after a weekly gain of about 23%, while gold had risen roughly 13% in August to around \$4,612 per ounce. The price action is consistent with a “debasement” narrative: investors may want assets whose supply is not directly determined by a sovereign budget. [15]

Consistency is not causality. Gold is sensitive to real yields, the dollar, central-bank demand, ETF flows and geopolitical risk. Bitcoin is influenced by liquidity, regulation, ETF flows, leverage, positioning and its own high-beta risk characteristics. Their simultaneous rise does not prove that investors are abandoning Treasuries, especially when Treasury auctions continue to clear and long real yields are high. In my view, the better interpretation is that both assets are being used at the margin as hedges against policy-credibility risk, while retaining very different volatility, liquidity and valuation properties.

The distinction also prevents an exaggerated de-dollarisation claim. Foreign reserve managers and private investors can diversify incrementally without rejecting dollar assets. A change in the marginal portfolio allocation may move prices well before the core reserve architecture changes. The relevant signal is therefore the combination of gold, the dollar, real yields, auction demand and foreign custody data. Not any single asset in isolation.

6. Iran: near-term oil relief, persistent product risk

On 24 August, the US Treasury announced Operation Economic Outcast, designating more than 60 entities and vessels linked to Iranian oil and the shadow fleet, including networks connected to China and Hong Kong. Official language described the enforcement campaign as unprecedented. Reuters reported, however, that the initial package stopped short of the most punishing options and gave trading partners time to adjust. The accurate synthesis is therefore two-sided: the strategy is broader and more forceful, but its first implementation step was less disruptive to physical oil supply than the maximum case markets had feared. [16] [17]

That distinction explains why oil can fall on ostensibly tougher sanctions. Prices reflect the expected change in available barrels, not the adjective used in a press release. If enforcement avoids immediate penalties on major Chinese banks or large buyers, fewer barrels may be removed in the near term. Lower crude prices would reduce headline inflation and transportation costs and, all else equal, ease upward pressure on inflation compensation and nominal yields.

The complication lies downstream. EIA estimates show that disruptions around the Strait of Hormuz sharply reduced flows and caused large production shut-ins during the summer. Its August outlook projected Brent around \$85 per barrel in the third quarter and \$78 in the fourth, but with unusually wide uncertainty. Separately, US distillate inventories were 13% below their five-year average in the week ending 14 August, while distillate and jet-fuel crack spreads had been elevated. A fall in crude does not guarantee an equivalent fall in diesel if refining capacity, shipping routes or inventories remain constrained. [18] [19] [20]

The macro transmission channel is consequently conditional. A controlled enforcement regime that preserves enough Iranian supply could be disinflationary. A retaliation cycle, a renewed Hormuz disruption or sanctions on key Chinese intermediaries could reverse the sign quickly. Energy is therefore best treated as a scenario variable with asymmetric tails, not as a stable forecast input.

7. China and Japan connect energy security to duration demand

China matters in two distinct ways. First, it is the largest buyer of Iranian oil, often through intermediated or relabelled flows. Its willingness and ability to continue those purchases determine how much US enforcement removes from global supply. Second, China remains a major holder of dollar assets. Treasury International Capital data put its Treasury holdings at \$633.4 billion in June 2026, down from \$731.4 billion a year earlier. These data are based on custody location and are affected by valuation and financial centres, so the change should not automatically be labelled deliberate selling. [21] [22]

The channels can interact. Stronger sanctions may raise energy costs and increase geopolitical friction, while retaliation through trade or critical-mineral restrictions could damage growth and supply chains. Slower Chinese growth can reduce oil demand, but a political decision to diversify reserves can affect Treasury demand and the dollar. The direction of the net effect is not predetermined.

Japan matters through relative yields and hedging costs. TIC data show Japanese Treasury holdings of \$1.117 trillion in June, making Japan one of the largest foreign holders. The Bank of Japan kept its overnight call-rate target around 1.0% in July, while the 4 August ten-year JGB auction cleared near 2.84%–2.90%. Higher domestic yields reduce the unhedged yield advantage of Treasuries and can make currency-hedged US bonds less attractive, depending on the cross-currency basis and short-rate differential. [21] [23] [24] [25]

This does not imply a mechanical Japanese liquidation. Insurers, banks, pensions and reserve managers have different mandates, hedge ratios and liability structures. It does mean that US duration must

compete with an improving domestic alternative. When Treasury net supply is high, even a slower pace of foreign accumulation can matter at the margin.

8. Three scenarios for the next stage

Scenario	What would confirm it	Treasury curve	Cross-asset reading
Disinflation with fiscal credibility	Softer core PCE; easing product shortages; a credible medium-term primary-balance package	Front-end easing and lower real term premium; bull steepening first, then broader rally	Gold and Bitcoin may cool; dollar response depends on relative growth and rates
Fiscal-stagflation repricing	Persistent core inflation; higher energy costs; no fiscal adjustment; weak long-end auctions	Higher real and inflation premia; bear steepening; volatility remains elevated	Gold supported; Bitcoin direction less reliable because liquidity and risk appetite can dominate
Market-functioning stress	Wider bid-ask spreads; repo dislocation; dealer constraints; off-the-run discounts	Local curve distortions and abrupt volatility rather than a clean macro move	Buybacks and Fed facilities become more effective; safe-asset demand may coexist with poor liquidity

Author scenarios. They are conditional frameworks, not forecasts or investment recommendations.

Conclusion: liquidity can buy time, not credibility

Short-term interventions can stabilise parts of the Treasury market without resolving the structural fiscal outlook. That does not make them useless. In a market where older securities become difficult to trade, predictable buybacks can lower transaction costs and strengthen the benchmark curve. The mistake is to infer that improved liquidity changes the government's intertemporal budget constraint or that a brief decline in the thirty-year yield demonstrates restored confidence.

The same discipline should guide the geopolitical analysis. Milder-than-feared implementation of Iranian sanctions can lower crude prices and reduce near-term headline inflation, while diesel shortages and Hormuz risk can keep industrial and transport costs high. China can blunt sanctions through oil purchases and affect dollar demand, but its actions are constrained by trade and financial exposure. Japan can redirect marginal demand toward JGBs as domestic yields rise, but portfolio adjustment will be gradual and heterogeneous.

In my view, the durable route to a lower US term premium has two components. The first is evidence that inflation is returning to target without repeated supply shocks. The second is a credible, legislated improvement in the medium-term primary balance. Buybacks may create a cleaner bridge to that outcome. They cannot substitute for it.

WHAT WOULD CHANGE MY VIEW A sustained fall in real term-premium estimates despite unchanged fiscal projections would weaken the fiscal-risk interpretation. Conversely, repeated weak auctions, wider off-the-run spreads, deteriorating repo conditions or a renewed energy shock would argue that the market is moving from repricing toward dysfunction.

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