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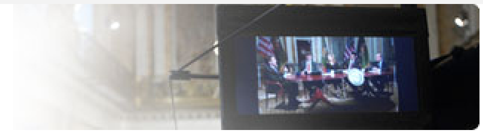

Minutes of the Meeting of the Treasury Borrowing Advisory Committee Of the Securities Industry and Financial Markets Association

2/3/2010

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from February 2, 2010

The Committee convened in closed session at the Hay-Adams Hotel at 8:00 a.m. All Committee members were present. Deputy Assistant Secretary (DAS) for Federal Finance Matthew Rutherford and Acting Directors of the Office of Debt Management Fred Pietrangeli and Stephen M. Vajs welcomed the Committee. The Chairman of the committee introduced one new member, Walter J. Muller III.

DAS Rutherford opened the discussion with a presentation to the Committee which highlighted current fiscal conditions and financing needs. The presentation began with a review of the budget outlook and projections for the upcoming year. DAS Rutherford noted that net receipts were expected to be 15% of GDP, while outlays were expected to be 25% of GDP.

Rutherford also noted that Administration's deficit estimate for FY2010 was expected to print at 11% of GDP, but is expected to moderate in coming years to 4% of GDP. Rutherford also said that the pace of decline in year-over-year corporate tax receipts had slowed in the first quarter of FY 2010. In the past, these receipts have led changes in other receipt categories. While the deceleration was favorable, there remains uncertainty about the timing and level of economic recovery. DAS Rutherford then turned to Treasury's financing over the past quarter and plans for future borrowing.

DAS Rutherford highlighted that cumulative net coupon issuance since FY 2007 had been significant, led by the 5-year point along the curve. Since the beginning of FY 2007 Treasury has increased nominal auction sizes consistently to address the sharp rise in financing needs. In addition, new securities and reopenings were added to the auction calendar.

Rutherford indicated that Treasury believes that the current auction calendar provides debt managers with sufficient flexibility to address a range of expected borrowing needs. As a result, barring any unexpected changes in financing needs, nominal auction sizes were not expected to rise further.

Going forward, as the fiscal outlook improves, DAS Rutherford indicated that debt managers are contemplating a reduction in coupon sizes. He indicated that the pace of cuts will largely depend on the strength of the economic recovery.

Rutherford indicated that bill supply had fallen over the past year as Treasury financing transitioned from bill to coupon supply. A significant portion of this reduction came with the fall in balances of the Supplementary Financing Program (SFP), although idiosyncratic factors in January exacerbated the reduction in bills outstanding. Significant TARP repayments that occurred in December and the need for Treasury to reduce its cash balances before reaching the debt limit also played a role in reducing bill supply.

DAS Rutherford acknowledged that a sharp reduction in bill supply in a short period of time is not in the best interests of the Treasury market. It was noted that Treasury will continue to monitor the bill market for any strains in market functioning. He further noted that the outlook for bill supply remains uncertain, particularly given uncertainty surrounding financing needs and the future of the SFP. The Treasury, however, retains the flexibility to increase the SFP program, assuming the debt limit is raised and the Federal Reserve requests such an action.

DAS Rutherford indicated that the average maturity of the debt continues to extend. The average maturity now stands at 55 months, below the historical average of 60 months. As a consequence of changes made to the auction calendar over the past year, it was noted that Treasury's current suite of issuance would continue to extend the average maturity of the debt in a gradual manner. Using OMB's budget forecasts, and assuming no change in issuance patterns over the coming decade, the average maturity of the debt would increase to the upper end of the historic range. Rutherford stressed, however, that this was simply a projection based on current issuance patterns, and that Treasury must remain flexible in order to respond to a range of financing scenarios.

The committee then briefly discussed the prospects for a reduction in auction sizes of nominal coupon securities. There was broad consensus about the potential for reduction; however there was no consensus regarding specific actions. This decision is expected to be discussed in further detail at upcoming meetings.

The committee next turned to the question in the charge concerning the challenges faced by global sovereign borrowers over the short, medium, and long-term and how these challenges compare to the case in the United States.

The presenting member stated that fiscal stress has shifted from emerging sovereigns to developed sovereigns and that such stress can impact borrowing costs. The presenter's analysis considered the ability of a sovereign to realize a stable debt-to-GDP ratio as a proxy for achieving fiscal consolidation.

Empirical evidence has shown that fiscal consolidation is possible in the developed world. According to the presenting member, sovereigns face two significant challenges when trying to consolidate their fiscal position. These include: 1) the political will to act despite potential economic pain, and 2) fostering growth drivers during the consolidation process. Growth drivers include foreign-exchange policies, monetary policy, global growth opportunities, and one-off opportunities such as privatization proceeds, lower interest rates, or peace dividends. In looking at the current economic landscape across the developed world, the presenter noted that achieving fiscal consolidation is much more difficult due to the dearth of growth drivers and constrained policy options.

The member then presented several statistics illustrating how ubiquity of fiscal stress among developed sovereigns and how conditions have worsened over the last ten years. The presenter then went through case histories of several representative sovereigns, briefly discussing conditions and policies that allowed each of the sovereigns to achieve fiscal consolidation in the past. For each of the countries, the presenter identified sovereign-specific growth drivers and policy tools that were used by these sovereigns, pointing out the effectiveness of some of these tools and noting the current availability of the tools. The presenter noted that historically it took between seven and twelve years for these countries to achieve fiscal consolidation. The presenter showed a matrix of analysis over 5-and 10-year horizons showing that fiscal consolidation was much less onerous if sovereigns attempted to achieve consolidation over longer-time horizons.

The member concluded the presentation by noting that fiscal consolidation can happen but it generally comes with lower growth. The presenter noted that for the US there were several hurdles or constraints to achieving fiscal consolidation going forward, including current easy monetary policy, a difficult political environment, modest global growth potential, and few, if any, idiosyncratic externalities (like a peace dividends or asset bubbles) that might create "one-off" growth opportunities. The presenter ended by concluding that political will, patience, and a rebalancing in global growth (countries that are net savers need to consume more and vice versa) were needed in order for the US to achieve fiscal consolidation.

A discussion followed with one member noting that historically when countries achieved fiscal consolidation, they often started from lower levels of debt-to-GDP. This member asked if that was important in the analysis and conclusions. The presenting member indicated that the level of debt-to-GDP was already discounted by markets and, as such, stabilizing the level of debt-to-GDP was more important from a sustainability perspective; that stabilizing debt-to-GDP ratios would ultimately reassure markets.

The committee then turned to a presentation by one of its members on the outlook for the demand structure for Treasury debt this year, along with the expected performance of spread products in 2010.

The presenting member began by examining the composition of the holders of Treasuries in nominal terms and as a percentage of debt outstanding. The member then pointed out that the Federal Reserve's data indicated that foreigners (both official and private sources) and households (a category which includes hedge funds) largely accounted for taking up the net increase in Treasury supply in the first 3 quarters of 2009.

The presenting member showed data which indicated that with a cyclical decline in loan demand, commercial banks were starting to buy more government securities. One member asked whether this impact of bank buying of Treasuries had not been exaggerated and whether there was potential for meaningful future demand. The presenting member responded that banks were being pushed by regulators to hold larger liquidity reserves and thus the potential bank demand for a 0% risk-weighted asset could be significant.

The presentation then turned to the prospects for issuance in 2010. The presenting member pointed out that most research indicated that net fixed income issuance net of Fed purchases in 2010 would more than double to $2.7 trillion from the $1.2 trillion level in 2009. The member then tackled the question of where the sources of marginal demand would come from for the projected $1.4 trillion in net 2010 Treasury issuance. With an assumption of no new Fed purchases, two possible breakdowns of how that net supply would be absorbed by various investor categories were presented.

The presenting member pointed out that under both scenarios the net purchase estimates for depository institutions seemed low. The member estimated that bank balance sheets contained about $500 billion in cash and about $180 billion in Treasuries and agency securities. The member estimated that there could be over $200 billion in Treasury purchases from banks this year.

Another member pointed out that one of the trends in fixed-income markets in the last decade had been the explosive growth in mortgage product, a trend which seemingly had come to an abrupt end for the foreseeable future. The question was raised if this portended a sizeable shift from mortgages to Treasuries. A member responded that as the size of mortgage assets stabilized as the amount of Treasuries outstanding expanded, Treasuries as a percentage of the fixed-income universe would continue to grow, necessitating further purchases by indexed investors.

The presenting member then concluded with expectations for spread products in 2010. A forecast was made that the swap spread curve would normalize with long-dated swap spreads richening from the current cheap LIBOR-plus levels, while short-dated swap spreads would remain stable or cheapen slightly.

Other members agreed that the spread curve would normalize over time. One member pointed out that the swap spread curve had reflected balance sheet constraints and the difficulty in financing cash products. During 2009, the swap spread curve has normalized somewhat commensurate with improvements in other fixed income relationships such as cash versus CDS spreads. Another member remarked that the shape of the Treasury asset swap spread curve was consistent with the observed steepening in corporate credit curves.

Several members stated that the dynamics of certain investors receiving fixed in long-dated swap had exacerbated the cheapness of swap spreads in the long end of Treasuries. Another member stated that recent trends of reallocation from swaps to cash corporate bonds by these same accounts promised to change the situation somewhat.

With respect to municipal bond spreads and CMBS spreads, the presenter noted technical factors that would outweigh deterioration in fundamentals. The tax-exempt status of municipal bonds and flows towards higher-risk assets would support the municipal bond sector, while tight supply would support CMBS.

The presenter turned last to mortgage markets. The member predicted that mortgage OAS levels could widen modestly by 10-20 basis points as the Fed exits the market but that the widening would be limited by small net issuance and sufficient demand from underweight investors.

The meeting adjourned at 9:40 AM.

The Committee reconvened at the Department of the Treasury at 5:35 p.m. All of the Committee members were present. The Chairman presented the Committee report to DAS Rutherford.

A brief discussion followed the Chairman's presentation but did not raise significant questions regarding the report's content.

The Committee then reviewed the financing for the remainder of the January through March quarter and the April through June quarter (see attached).

The meeting adjourned at 6:15 p.m.

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Matthew Rutherford
Deputy Assistant Secretary for Federal Finance
United States Department of the Treasury
February 2, 2010

Certified by:

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Matthew E. Zames, Chairman
Treasury Borrowing Advisory Committee
Of The Securities Industry and Financial Markets Association
February 2, 2010

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Ashok Varadhan, Vice Chairman
Treasury Borrowing Advisory Committee
Of The Securities Industry and Financial Markets Association
February 2, 2010

Treasury Borrowing Advisory Committee Quarterly Meeting
Committee Charge – February 2, 2010

Fiscal Outlook

In recognition of short, intermediate, and long-term financing needs, as well as recent estimates provided by the Office of Management and Budget and other agencies, what adjustments to debt issuance, if any, should Treasury make in consideration of each of these horizons in terms of adjustments to size, frequency, or debt instruments?

Demand for Treasury Securities and Credit Products

How, if at all, is the structure of demand for Treasury debt changing? What shifts took place in 2009 and what should we expect to see in 2010? What is the expected performance of spread products in 2010? Will spreads tighten further, move in tandem or widen relative to Treasury securities?

Global Sovereign Borrowers

Please assess the challenges faced by global sovereign borrowers over the short-, medium- and long-term. How are these challenges similar or different to the case of the United States?

Financing this Quarter

We would like the Committee's advice on the following:

- The composition of Treasury notes and bonds to refund approximately $48.3 billion of privately held notes called or maturing on February 15, 2010.
- The composition of Treasury marketable financing for the remainder of the January - March quarter, including cash management bills.
- The composition of Treasury marketable financing for the April - June quarter, including cash management bills.

TBAC Recommended Financing Tables: Q1
TBAC Recommended Financing Tables: Q2