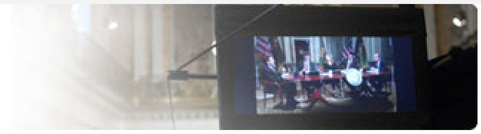
U.S. DEPARTMENT OF THE TREASURY

## Press Center



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

8/3/2011

The Committee convened in closed session at the Hay Adams Hotel at 9:35a.m. All Committee members were present. Assistant Secretary for Financial Markets Mary Miller, Deputy Assistant Secretary (DAS) for Federal Finance Matthew Rutherford and Director of the Office of Debt Management Colin Kim welcomed the Committee. Other members of Treasury staff present were Fred Pietrangeli, Jennifer Imler, Amar Reganti, Allen Zhang, Leonard Tchuindjo, Daleep Singh, Larissa Garbade, and Brian Zakutansky. Federal Reserve Bank of New York members Brian Sack and Joshua Frost were also present.

DAS Rutherford provided a brief overview of the budget deal, including: the mechanism for the debt limit increase, the up-front discretionary cuts, the formation of a special committee to develop legislative proposals to reduce the deficit, and the automatic sequester.

DAS Rutherford then turned to an update on tax receipts. He noted that corporate taxes rebounded in the second quarter of Fiscal Year (FY) 2011. Withheld tax growth slowed due to weak employment conditions, while non-withheld taxes continued to show growth.

Rutherford noted that public non-marketable security redemptions continued into the third quarter of FY 2011. Budget outlays for the first three quarters of FY 2011 were 24 percent of GDP, nearly identical in percentage terms to the comparable period last year. The five largest outlay categories were defense, Social Security, Medicaid, Medicare and interest on the debt.

DAS Rutherford then turned to deficit forecasts. A recent survey of the primary dealers revealed that they expect the deficit in FY 2011 to total $1.358 trillion, more than $70 billion below their estimates during the last refunding. It was noted that many forecasters are expected to change their figures after enactment of the budget deal. Generally, however, most estimates assume the deficit will fall to below $1 trillion by FY 2013.

Director Kim then discussed demand for Treasuries. He commented that auction coverage ratios remain very high for all of Treasury's products. Treasury bill bid-to-cover ratios have averaged 4.64 for this fiscal year, while coupon bid-to-cover ratios were around 3.0. He also noted that Treasury's investor class data, which is released twice a month, continues to show healthy participation by a variety of accounts.

Kim then turned to Treasury's debt portfolio. He highlighted that the share of bills in the portfolio has fallen to 16 percent, with nominal coupons now comprising approximately 76 percent of outstanding marketable debt. Next, Director Kim discussed the Supplementary Financing Program (SFP), noting that Treasury suspended the program due to the debt limit negotiations.

Director Kim then turned to a discussion of the Treasury Inflation Protected Securities (TIPS) program. He noted that Treasury remains pleased with demand for inflation protection, particularly given Treasury's goal to gradually increase TIPS supply. For the calendar year, Treasury expects to issue over $125 billion in TIPS. As a percentage of the portfolio, TIPS have stabilized at approximately 7 percent.

Kim next reviewed measures of rollover risk. The average maturity of the portfolio continues to extend. Currently this measure stands at 61.9 months, above the long-term average of around 58 months. Additionally, on a percentage basis, the amount of Treasury debt maturing in the next 1, 2 and 3 years remains at historic lows. That being said, Kim noted that refinancing needs will be elevated in the coming years. He mentioned that Treasury continues to study both term premium and alternative products that may assist in reducing rollover risk.

Following DAS Rutherford and Director Kim's presentation, a member of the Committee noted that there may be room to reduce issuance based on recent budget forecasts. In thinking about coupon issuance reductions, Committee members noted that it could counter Treasury's desire to extend the average maturity. In addition they noted that bill supply as a percentage of the overall portfolio was at historically low levels.

Several members asked if Treasury was going to bring back the supplementary financing program (SFP) in light of the debt limit increase. DAS Rutherford explained that no decision had been made at this point regarding the SFP, but he noted that the implementation of the debt limit increase over the next several months would make it difficult to bring the program back in the near term. Rutherford explained that much of the initial increase in the debt limit would be used to restore the accounts affected by the extraordinary measures used by Treasury since May 16.

The discussion then turned to whether the reduction in Treasury bill supply over the last several months had contributed to the decline in bill rates. Several members highlighted that it was likely a contributing factor, although some noted that short-term rates for a variety of bill-like substitutes, including general collateral (GC) and agency debt, were also trading at extremely low levels. Members debated whether the absolute stock of bills was more meaningful than bills as a percent of the debt portfolio. On balance, most members agreed that the stock of bills was a more relevant metric.

Overall, a number of members continued to advocate extending the average maturity of the portfolio as a means of reducing rollover risk, while providing maximum flexibility to Treasury.

The Committee then discussed the implications of a potential downgrade of the U.S. sovereign credit rating. None of the members thought that a downgrade was imminent. However, the Committee thought that the discussion validated its recommendation to continue to focus on interest rate risk and the merits of extending the average maturity of the portfolio.

The Committee then turned to the next charge, which discussed the costs and benefits of extending the average maturity.

The presenting member noted that debt service is a function of many variables, some of which Treasury controls and some of which are beyond Treasury's control. The variables Treasury can control include current debt issuance and communication of debt management policy. The variables that Treasury cannot control are the outstanding stock of debt, the current deficit, rates, GDP growth and inflation.

The member next presented a linear regression model for debt service costs where the dependent variable was debt service costs to GDP and the independent variables were year-over-year GDP growth, the Fed Funds rate, the average maturity of debt outstanding and the debt-to-GDP ratio.

The model suggested that debt service costs would: a) decline 5 basis points for every 1 percent rise in GDP growth; b) increase 16 basis points for every 1 percent rise in the Fed Funds rate; c) increase 5 basis points for every 1 month increase in average maturity; and d) rise 4 basis points for every 1 percent increase in debt-to-GDP ratio.

Based on analysis of the net duration impact associated with the Federal Reserve's Large Scale Asset Purchase program (also known as "QE2"), the presenter estimated that if Treasury were to extend the average maturity of the portfolio to 70 months, this would increase term premium an estimated 19 to 24 basis points.

The presenting member next outlined a historical cost and volatility analysis of long- vs. short-term debt issuance strategies. The presenter concluded that since 1962, a strategy of issuing short-term debt has been cheaper than issuing long-term debt. The presenter said that locking in long-term rates only reduces cost when rates rise beyond the term premium.

The presenter next turned the discussion to how to measure term premium.

The presenter began by defining term premium as "the additional return investors require over and above the average of expected future short-term interest rates."

The presenter indicated that various models suggest that term premiums are currently elevated. Drivers of high term premiums include risk appetite, inflation expectations and the DV01 of outstanding debt and new issuance. The presenter discussed a series of scatter plots to demonstrate the relationship of these various drivers to term premiums. The charts suggested that since 2008, the factors that were most positively correlated with changes in term premiums were the DV01 of outstanding debt and new issuance.

The presenting member next turned to a discussion about the benefits of extending maturity.

The presenter noted that nominal rates are historically low despite elevated term premiums. The outlook for the dollar's continued reserve currency status was also discussed. The member noted that other large sovereigns have longer average maturities than Treasury.

Turning to rollover risk, the presenter stated that the risk is likely low since Treasury debt is denominated in dollars. The presenter suggested that floating rate notes could reduce rollover risk.

In conclusion, members agreed that there was much more work that needed to be done with regard to maturity extension and the optimal distribution of debt. This was recommended for discussion at the November quarterly refunding.

The meeting adjourned at 12:00 PM.

The Committee reconvened at the Department of the Treasury at 5:00 p.m. The Chairman presented the Committee report to Secretary Geithner.

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

The Committee then reviewed the projected financing for the remainder of the July through September quarter (see attached).

The meeting adjourned at 5:45 p.m.

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Matthew Rutherford
Deputy Assistant Secretary for Federal Finance
United States Department of the Treasury
August 2, 2011

Certified by:

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Matthew E. Zames, Chairman
Treasury Borrowing Advisory Committee
Of The Securities Industry and Financial Markets Association
August 2, 2011

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Ashok Varadhan, Vice Chairman
Treasury Borrowing Advisory Committee
Of The Securities Industry and Financial Markets Association
August 2, 2011

**Treasury Borrowing Advisory Committee Quarterly Meeting**
**Committee Charge – August 2, 2011**

Fiscal Outlook

Taking into consideration Treasury's short, intermediate, and long-term financing requirements, as well as uncertainties about the economy and revenue outlook for the next few quarters, what changes to Treasury's coupon auctions do you recommend at this time, if any?

Costs and Benefits of Extending Average Maturity

In past meetings, the Committee has expressed a desire for Treasury to continue to lengthen the average maturity of debt outstanding. Please discuss the costs and benefits of extending the average maturity and frameworks for quantifying those costs and benefits.

Financing this Quarter

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

- The composition of Treasury notes and bonds to be issued on August 15, 2011.
- The composition of Treasury marketable financing for the remainder of the July 2011- September 2011 quarter, including cash management bills.
- The composition of Treasury marketable financing for the October 2011-December 2011 quarter, including cash management bills.

TBAC Recommended Financing Tables for 2011: Q3 , Q4