

U.S. DEPARTMENT OF THE TREASURY

Press Center



Remarks by Acting Assistant Secretary For Financial Markets Daleep Singh At The Evolving Structure Of The U.S. Treasury Market: Second Annual Conference

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As Prepared for Delivery

Good afternoon. Today, I would like to take the opportunity to discuss two topics with all of you: first, to highlight some of Treasury's recent debt management initiatives and second, to review our work on Treasury market liquidity.

Let me begin with debt management. Since the financial crisis, Treasury has executed one of its fastest maturity extensions in modern history by increasing the weighted average maturity of our marketable debt portfolio from 48 months to 70 months. In fact, the current weighted average maturity of the portfolio is within one month of multi-decade highs and is significantly above the 59 month average since 1980. This means that approximately 25 percent of our marketable debt stock rolls over each year, down from roughly 41 percent in 2008, and thereby reduces the potential volatility in debt servicing costs incurred by the taxpayer.

At the same time that we have extended maturities, Treasury has also taken action to balance the recent growth in demand for short-dated government assets with greater supply of short-term Treasury bills. Since the May 2015 quarterly refunding, the supply of Treasury bills outstanding has increased by nearly \$300 billion, and we will continue to evaluate incremental needs for bills supply – particularly as the lasting impact of recently implemented money market reform becomes more clear.

In addition to improving the debt portfolio's structure, Treasury has also taken several key steps to reduce operational risk in debt management. First, Treasury announced a change to its cash balance policy in May 2015. Under the previous framework, Treasury typically had enough cash to withstand a loss of market access for just two days, an insufficient buffer against unexpected shocks. Due to the revision of the cash balance policy – by targeting 5 days of cash, subject to a minimum balance of roughly \$150 billion – Treasury can now withstand a loss of market access for five business days in nearly 80 percent of projected scenarios, as compared to only 12 percent of the time under the old policy.

Second, Treasury has strengthened its contingency planning. For example, in 2015, Treasury coordinated with the Federal Reserve Bank of New York to add an additional physical auction site to diversify our capabilities across geographies. As a result, if the primary auction site were to become unavailable, Treasury's auction processing could continue seamlessly at any one of its other backup locations.

Another example is our contingency process for auctions. Historically, at least once a year, primary dealers participate in a test of Treasury's capability to execute a same-day manual auction, with primary dealers submitting bids over the phone to the Federal Reserve Bank of New York. While this largely manual process has been tested routinely over the last several years, TBAC recommended a live test when we raised this issue at the August 2016 Quarterly Refunding. Consistent with this recommendation, Treasury executed a successful small-value auction using a manual process on August 17.

Finally, Treasury has provided auction participants with additional guidelines to encourage clear information-handling policies, disclosure practices, and internal control programs. Treasury believes that these guidelines will increase transparency about how information is handled and support the fairness and integrity of the Treasury auction process for the benefit of all participants and the U.S. taxpayer. We encourage broad-based feedback on these guidelines so that we can incorporate appropriate improvements over time.

Shifting from our efforts in the primary market to our assessment of secondary market dynamics, let me now summarize our findings on fixed income liquidity since the financial crisis. Our purpose in this exercise has been to advance the public discourse on this actively debated topic with fact-based analysis. In this regard, we focused our analysis on the forward-looking implications for core policy objectives, including financial stability, well-functioning capital markets, and strong economic growth.

So let's first review some of the facts. Using price-based liquidity measures, such as transaction costs or the price impact of a given trade size, we observe favorable liquidity trends in Treasuries. The Federal Reserve Bank of New York estimates that the price impact for a \$100 million trade in 10-year Treasury notes is currently around 2 basis points, which is similar to pre-crisis levels and well below the 10 basis point impact estimated during the crisis. The data pattern is similar for bid-offer spreads.

At the same time, quantity-based measures of liquidity suggest a more nuanced story. The depth of the order book—measuring the size of the best bids and offers—and the prevalence of larger sized (“block”) transactions have both generally decreased in recent years, though not significantly relative to the pre-crisis baseline. For example, the 10-year Treasury average trade size is down from \$5 million pre-crisis to around \$3 million today. However, overall volumes in U.S. fixed income markets are generally steady or up. Average daily trading volumes in Treasuries have been steady at around \$500 billion per day, while corporate bond volumes in the secondary market are roughly two times higher than before the financial crisis. Taking these data together, while risk size per trade may have decreased, markets are facilitating ever larger aggregate risk transfer – against the backdrop of record primary issuance.

Familiar caveats apply—we have only a partial view of secondary market activity, and the available data are not easily disaggregated for periods of stress. Still, an objective reading does not provide convincing evidence of a broad-based deterioration of liquidity.

The clearer footprints in the data are those of structural change. The trend toward electronic trading—a market driven evolution that started in equities, then moved to foreign exchange, and has now broadened in fixed income—is fully consistent with data showing smaller trade sizes, higher trade volumes, and lower transaction costs. So, too, is the ongoing shift from inventory-based market-making to agency-based intermediation, and the dramatic growth of long-only asset management strategies.

It's true that this period of structural change has been punctuated by occasionally sharp re-pricings, even in some of the most liquid markets, and across geographies. We're all familiar with the episodes of outsized volatility in Treasuries, the euro, German bunds, JGBs, the Swiss franc, and most recently the British pound. The 2015 Joint Staff Report provided an important case study for the flash rally in Treasuries, and we need similar efforts across markets to advance our collective understanding of liquidity provision under stressed market conditions.

But as we do this work, it is critical to distinguish between sharp re-pricings that result from fundamental catalysts, and those without clear economic drivers that may be evidence of market-originated disruption.

An implicit objective is to foster liquidity that allows the market to function even in times of stress, allowing willing buyers to trade with willing sellers. As we learned quite painfully from the financial crisis, abundant liquidity in calm periods does not mean it will be resilient during times of stress. In fact, plentiful but fleeting liquidity likely contributed to the run dynamics that accelerated the crisis. Let's not forget the terrible consequences of the crisis for millions of Americans: nearly 9 million jobs were lost, unemployment reached 10 percent, and more than \$10 trillion in household wealth was wiped out.

Stable liquidity, by contrast, can benefit the financial system and real economy through several important channels:

First, stable liquidity facilitates primary debt issuance and capital raising for consumers and businesses. Without stable liquidity, primary market investors would likely demand greater returns, raising the cost of capital and potentially reducing investment.

Second, stable liquidity protects millions of savers that use financial markets as a reliable store of value. The willingness to enter a financial position in the present likely has something to do with the confidence to reduce or exit the position when needed in the future.

Third, stable liquidity enhances the effectiveness of a number of core public sector objectives, including prudently financing the federal government, promoting affordable access to mortgage credit, transmitting monetary policy, and promoting financial stability, especially through the orderly repricing of risk during stress scenarios.

With this notion of liquidity in mind, where are our efforts focused? Our priority since the crisis has been to strengthen the core of the system—if we have more resilient intermediaries, funding mechanisms, and infrastructure, we should have more stable liquidity. Remember, the financial crisis was the least liquid period in living memory. Troubled institutions were selling their own assets rather than providing liquidity, and nearly all liquidity metrics—bid-offer, price impact, depth, trade size—charted into unprecedented territory.

Post-crisis reform has created more resilient financial institutions through stronger capital buffers, safer funding profiles, robust stress testing, better managed and more transparent counterparty risk, and credible resolution tools.

Traditional market makers are not the only intermediaries that need to be resilient. We, in coordination with regulatory agencies, are focused on the growing importance of PTFs as liquidity providers. We need a diverse and reliable set of institutions that can be pillars of strength in times of stress.

The market infrastructure itself—exchanges, platforms, and clearing and settlement mechanisms—needs to be resilient as well. The SEC's Regulation SCI on critical market infrastructure, the CFTC's Regulation AT on algorithmic trading and futures markets, and the work across the regulatory community to improve the resilience of CCPs are all examples of these efforts.

Though there is still work to do, we have made great progress towards making our financial system, and our financial markets, more resilient. It is worth noting that more recent episodes of sharp volatility, in contrast to the experience of the financial crisis, have not threatened the health of our financial institutions or the functioning of our markets.

As a concluding thought -- it's not just public policy that can encourage stable liquidity. The private sector – through new forms of innovation, vibrant competition, and continual adaptation – has a central role to play as well.

Together, we can be more confident that Treasury market structure will continue to evolve in ways that promote a well-functioning, resilient financial system, and a stronger economy. Thank you.

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