Minutes of the Meeting of the Treasury Borrowing Advisory Committee of the Securities Industry and Financial Markets Association October 31

November 1, 2017

The Committee convened in a closed session at the Hay Adams Hotel at 9:30 a.m. All members, with the exception of Daniel Dufresne, were present. Counselor to the Secretary Craig Phillips, Acting Assistant Secretary for Financial Markets Monique Rollins, Director of the Office of Debt Management Fred Pietrangeli, and Deputy Director of the Office of Debt Management John Dolan welcomed the Committee. Other members of Treasury staff present were Clay Berry, Chris Cameron, Dave Chung, Tom Dickason, Whitney Goss, Kevin Hawkins, Tom Katzenbach, Matthew Kellogg, Amyn Moolji, Ken Phelan, Renee Tang, and Brandon Taylor. Federal Reserve Bank of New York staff members Frank Keane, Matthew Raskin, Nick Steele, and Nathaniel Wuerffel were also present, as was Laura Lipscomb of the Federal Reserve Board of Governors.

Counselor Phillips began by discussing personnel changes at Treasury, including that Acting Assistant Secretary Rollins would be leaving the Treasury in the coming weeks and thanked her for her government service. Phillips announced that Clay Berry, currently the Deputy Assistant Secretary for Europe and Eurasia, would be taking over Rollins' duties as Acting Assistant Secretary for Financial Markets.

The Committee began with a presentation on sizing considerations for Treasury bills given the context of an increase in projected borrowing needs. The presenting member began by reiterating prior observations that bills as a share of marketable debt remain at historically low levels, though on a percent of GDP basis they are slightly above the long-run average. However, regulatory changes may suggest there is capacity for bills as a percent of GDP to increase above the long-run average. In addition, while demand for bills from foreign official accounts and money market funds is significant, the allocation toward bills within those investor classes is still relatively small. Furthermore, when compared to imperfect bill substitutes or fixed income securities more broadly, bills outstanding have increased at a slower pace.

Regarding supply changes, the presenting member noted a sizable financing need over the next ten years as a result of SOMA redemptions and primary dealer estimates for widening deficits.

Several scenarios for increased bill issuance were presented, highlighting the effects on bills as a percentage of marketable debt and the overall weighted average maturity (WAM). The applicable changes to auction sizes that would be necessary were also discussed within the context of recent primary dealer estimates for the maximum offering sizes that would not have a meaningful effect on fair value. Given various scenarios to address the financing gap, the Committee generally agreed that allocating between one-quarter and one-third of new issuance to bills would be appropriate given the size of funding needs and the demand for bills. However, the presenting members concluded that allocating more than one-third of the financing gap to bills might bring bill auction sizes above desired levels and shorten the WAM.

Next, the Committee turned to a presentation on debt issuance optimization models as an update to an earlier presentation from the January 2017 meeting. It was again emphasized that the modeling results do not constitute a specific recommendation but rather provide an approach to analyze cost and risk trade-offs under various assumptions. Given the objective of funding at the lowest risk-adjusted cost over time, the presenting member summarized various strategies, including: focusing issuance on bills, the belly of the curve, or the long-end. In general, the optimal strategy depends on the preferred measure of risk, as well as the projections for deficits, short rates, and term premia assumed in the model. However, the model generally suggests that a skew towards increased issuance in the 2-, 3-, and 5-year sector is attractive. The model also suggests that the marginal benefit in risk and cost reduction of further increasing WAM has diminished compared to the attractiveness of increasing WAM after the financial crisis. As the model is still in development, the Committee discussed using it to test different economic assumptions and stated its interest in incorporating Treasury Inflation-Protected Securities (TIPS) into the model at a future date.

Taking both presentations into account, the Committee discussed potential issuance strategies going forward, and agreed that changes in coupon sizes should be announced at the February 2018 refunding in order to address the upcoming financing gap. Given the current fiscal outlook, the Committee agreed that Treasury should focus on increasing issuance in bills and the 2-, 3-, and 5-year sectors, while maintaining issuance at the long-end such that the WAM does not materially change from current levels. However, the Committee noted that WAM is an outcome of the issuance strategy and not a goal in itself, though it remains a useful way to assess the results of issuance changes.

The Committee adjourned at 12:00 p.m. for lunch.

The Committee reconvened at 1:30 p.m. and Director Pietrangeli began with an overview of the fiscal situation. Pietrangeli noted that for FY 2017, tax receipts increased by one percent while outlays increased by three percent. In addition, net issuance of State and Local Government Securities (SLGS) was negative over the past quarter as a result of the closed window during the debt limit impasse. Finally, Pietrangeli noted that net marketable borrowing amounts were just announced at $275 billion for the current quarter and $512 billion for the upcoming quarter. Nevertheless, the fiscal outlook going forward is uncertain as seen by the wide range of estimates for both deficits and the marketable borrowing needs.

Turning to auction demand, Pietrangeli pointed to bid-to-cover ratios for bills, which remain above pre-crisis levels. For 2-, 3-, and 5-year securities, bid-to-cover ratios remain stable or are increasing, while they are generally flat for longer-dated securities.

Pietrangeli then provided presentations focused on the FRN and TIPS programs. Based on analysis of matured FRNs, these securities have provided a savings in interest expense of approximately $1.3 billion compared to the 2-year fixed-rate note. In general, matured FRNs have been less costly to issue than the 2-year note, more expensive than the 3-month and 6-month bills, and about the same as the 1-year bill. In addition, investor class auction allotment data indicates that the investor base for Treasury securities has broadened with the introduction of the FRN.

Shifting to TIPS, Pietrangeli provided a brief overview of the program and noted that Treasury has benefited from the diversification of risk that result from issuing a security that does not require the payment of an inflation risk premium. As a result of lower-than-expected inflation, when compared to equivalent nominal securities, analysis showed that TIPS have saved the Treasury approximately $49 billion since inception.

The Committee briefly discussed the TIPS program and agreed that further study regarding the program overall and potential changes to sizing would be appropriate at their next meeting.

The Committee adjourned at 2:15 p.m.

The Committee reconvened at 3:45 p.m. All Committee members, with the exception of Daniel Dufresne and Christine Hurtsellers, were present. The Chair presented the Committee report to Secretary Mnuchin.

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

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

The meeting adjourned at 4:30 p.m.

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Fred Pietrangeli
Director of the Office of Debt Management
United States Department of the Treasury
October 31, 2017

Certified by:

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Jason Cummins, Chairman
Treasury Borrowing Advisory Committee

Of The Securities Industry and Financial Markets Association

October 31, 2017

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Stuart Spodek, Vice Chairman

Treasury Borrowing Advisory Committee

Of The Securities Industry and Financial Markets Association

October 31, 2017

Treasury Borrowing Advisory Committee Quarterly Meeting

Committee Charge – October 31, 2017

<u>Fiscal Outlook</u>

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?

Issuance Modeling

The primary objective of Treasury's debt management strategy is to finance the government's borrowing needs at the lowest risk-adjusted cost over time. To accomplish this, Treasury strives to issue debt in a regular and predictable pattern, but that approach leaves open a wide range of potential outcomes for the maturity structure of the debt. The interest expense associated with any issuance strategy will depend on a variety of factors that are not under the control of the debt manager, including the behavior of interest rates, the business cycle, and the federal government's fiscal policy.

Pursuant to the TBAC charge and discussion at the January 2017 meeting, please provide an update on efforts the Committee is making with regard to the development of issuance models. Please comment on any revisions to or extensions of the modeling work that was presented in January. Provide an analysis of results from these models and how aspects of these models can complement or be incorporated with ODM's existing issuance model framework. Comment on the degree to which the updated modeling efforts can help to inform potential increases to nominal coupon auction issuance.

Optimizing the Amount of Treasury Bills Outstanding

Treasury would like the Committee to comment on sizing considerations related to the issuance of Treasury bills over the short-, medium-, and long-term. What factors should Treasury consider when optimizing the size of bills outstanding over the coming years? Specifically, comment on expected drivers of demand, the investor base, auction sizing, and market pricing relative to other short-term money market instruments.

Financing this Quarter

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

- The composition of Treasury notes and bonds to refund approximately $42.7 billion of privately-held notes maturing on November 15, 2017.
- The composition of Treasury marketable financing for the remainder of the October-December 2017 quarter, including cash management bills.
- The composition of Treasury marketable financing for the January-March 2018 quarter, including cash management bills.

TBAC Recommended Financing Table Q4 2017 and TBAC Recommended Financing Table Q1 2018