Minutes of the Meeting of the Treasury Borrowing Advisory Committee of the Securities Industry and Financial Markets Association January 30

January 31, 2018

The Committee convened in a closed session at the Hay-Adams Hotel at 9:30 a.m. All members were present. Counselor to the Secretary Craig Phillips, Deputy Assistant Secretary for Capital Markets Clay Berry, Deputy Assistant Secretary for Federal Finance Laura Lipscomb, and Director of the Office of Debt Management Fred Pietrangeli welcomed the Committee, including the newest member to the Committee, Zachary Harl. Other members of Treasury staff present were Ayeh Bandeh-Ahmadi, Chris Cameron, Dave Chung, Barry Firebaugh, Tom Katzenbach, Amyn Moolji, Ken Phelan, Renee Tang, and Brandon Taylor. Federal Reserve Bank of New York staff members Joshua Frost, Nick Steele, and Nathaniel Wuerffel were also present.

Counselor Phillips opened the meeting with an overview of upcoming outreach efforts to gather views on potential public transparency of Treasury securities market transactions data. Since July 2017, the Financial Industry Regulatory Authority (FINRA) has been collecting Treasury securities market transactions data through its Trade Reporting and Compliance Engine (TRACE), and providing the data to the official sector only. Referencing Secretary Mnuchin's remarks at the Third Annual Conference on the Evolving Structure of the U.S. Treasury Market, Phillips reiterated that Treasury's first principle is to "do no harm" to market functioning and liquidity while supporting market transparency. In addition to the broad outreach, Phillips remarked that it may be prudent to charge the Committee with analyzing this topic at a subsequent meeting.

Next, Director Pietrangeli provided an overview of the fiscal situation. Pietrangeli noted that for Q1 FY 2018, tax receipts totaled $770 billion, representing an increase of four percent year-over-year, while outlays totaled $994 billion, an increase of five percent. Withheld taxes were up eight percent due to higher economic growth and increases in employment and wages, whereas corporate taxes were lower by 11 percent, which was potentially due to anticipation of tax reform legislation. The Department of Homeland Security saw a sizable increase of 78 percent (or $10 billion) due to payments related to disaster relief. The Department of Defense and the

Department of the Treasury each had increases of $9 billion and the Social Security Administration had an increase of $8 billion.

In addition, net issuance of State and Local Government Securities (SLGS) was approximately $11 billion in the past quarter. The uptick in issuance is attributed to state and local governments anticipating a closing of the window at the end of the debt limit suspension period on December 8th. In addition, some state and local governments may have accelerated advanced refunding deals before the repeal of the tax exemption for advanced refunds contained in the Tax Cut and Jobs Act. This would have resulted in an increase in SLGS issuance given that SLGS are commonly used by investors in defeasance portfolios.

Pietrangeli noted that net privately-held marketable borrowing amounts were just announced as $441 billion for the current quarter and $176 billion for the upcoming quarter. In addition, cash balance targets were announced as $210 billion for the end of the current quarter and $360 billion for the end of the upcoming quarter. Regarding the outlook for deficits and net marketable borrowing, Pietrangeli highlighted that more recent primary dealer estimates (surveyed in late January) are substantially higher than both their previous forecasts and estimates from official sources such as OMB and CBO, which are not expected to be released until sometime in February. Pietrangeli reiterated that the wide range of estimates for both deficits and marketable borrowing needs found in the primary dealers estimates are reflective of current fiscal uncertainty.

Regarding funding needs, Pietrangeli discussed the difference between primary dealers' projected net borrowing and the net borrowing assuming that Treasury does not change current issuance. In FY 2018, the remaining "funding gap" is projected to be $372 billion, which includes the expected $175 billion reduction in Treasury holdings in the Federal Reserve's System Open Market Account (SOMA). In FY 2019, the funding gap is projected to be $882 billion, of which $287 billion is attributed to SOMA reductions.

Next, Deputy Assistant Secretary Lipscomb began a discussion of potential issuance strategies to meet the need for additional financing, as exhibited in the increase in primary dealer estimates from the most recent dealer agenda responses. As discussed at the November 2017 TBAC meeting, the Committee agreed that in addition to changes in bill issuance sizes, coupon increases should be announced in the February 2018 refunding statement, with an emphasis on shorter-dated tenors. However, issuance at the long-end should also be adjusted, just to a lesser extent, resulting in an overall weighted-average maturity (WAM) around the current level.

One Committee member noted that some market participants were trying to “reverse engineer” Treasury’s future issuance based on the November 2017 Quarterly Refunding policy statement which stated that

> “Based on current fiscal forecasts and internal Treasury modeling, it is anticipated that these changes will likely result in a stabilization of the weighted average maturity (WAM) of debt outstanding at or around the current levels, with the caveat that unexpected large changes in borrowing needs could have an unforeseen impact on future issuance and ultimately the level of WAM. “

Committee members were reminded that WAM was an outcome of Treasury issuance decisions and not a goal in and of itself.

When asked about views on increasing issuance sizes, the Committee generally agreed that an increase in nominal sizes across all tenors is warranted, with an emphasis on the short-end, as defined by the Committee as including the 2- to 5-year nominal tenors. Increases in Floating Rate Notes (FRNs) were also deemed to be appropriate. The Committee noted that a focus on increases at the short-end would be consistent with past recommendations and would stabilize the WAM around current levels.

Deputy Assistant Secretary Berry noted that Treasury intended to announce increases in coupon sizes but that flexibility would need to be maintained over the coming months and quarters, particularly given that current official budget estimates had yet to be released.

Referencing the results of the most recent primary dealer agenda, Lipscomb also noted the positive reception from primary dealers to the potential for a 2-month bill and the possibility of an additional settlement date for bills. The Committee recommended further study of these issues for the next quarterly refunding in May.

Finally, Lipscomb remarked that Treasury is developing an upgrade to the existing Treasury Automated Auction Processing System (TAAPS). The new system will provide the same core functionality while taking advantage of technological improvements that have occurred since the current TAAPS was implemented in 2008. The new system will allow for enhanced operational support, improved flexibility for future system development, and strengthened system security. The new system is projected to be operational by 2020.

Next, the Committee turned to the charge on the Treasury Inflation-Protected Securities (TIPS) program. The presenting member reviewed performance of the TIPS program since inception more than twenty years ago, noting that overall the program had proved successful and that no major structural changes were deemed necessary at this time. Ex-post, TIPS have saved the Treasury an estimated $47 billion relative to an equivalent issuance of nominal securities due to lower than expected inflation so far over the life of the program. When incorporating an estimate for all future cash flows of currently issued TIPS using zero-coupon inflation swaps for inflation expectations, the cost savings estimate increases to $58 billion, and is consistent with the analysis presented by the Treasury at the November meeting regarding the relative cost of the TIPS program.

Looking forward, a comparison of TIPS breakeven rates and survey-based inflation expectations suggests the cost savings of the TIPS program may be diminished over the near-term. However, the ex-ante cost disadvantage of issuing TIPS will likely fade over time along with cyclical factors influencing inflation risk premium and expectations rather than potentially more permanent structural factors influencing liquidity premium. Over the long-term, the fluctuation in factors that affect the relative cost of issuing TIPS versus nominals should make Treasury relatively indifferent regarding which product to issue.

Regarding demand, the presenting member discussed the potential for strong future demand from continued growth in foreign ownership as well as domestic target-date funds and 401(k) plans. Inclusion of TIPS in an aggregate bond index or a more robust inflation derivatives market would also support increased demand.

The presenting member concluded that TIPS issuance should remain at roughly seven percent of gross issuance, which would allow for up to $26 billion in additional issuance over the next year or so. An additional 5-year tenor should be considered for addressing this new issuance, based on evidence of solid demand and liquidity in that sector as well as investor demand for a new 5-year TIPS issue later in the calendar year. The Committee agreed that further study of the TIPS program by Treasury was warranted in terms of new issuance needs and that potential increases in issuance should be revisited at future meetings.

The Committee adjourned at 12:30 p.m. for lunch.

The Committee reconvened at the Department of the Treasury at 5:00 p.m. All Committee members, with the exception of Michael Lillard, 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 a potential financing schedule for the remainder of the January through March quarter and the April through June quarter (see attached).

The meeting adjourned at 5:30 p.m.

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Laura Lipscomb

Deputy Assistant Secretary for Federal Finance

United States Department of the Treasury

January 30, 2018

Certified by:

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Jason Cummins, Chairman

Treasury Borrowing Advisory Committee

Of The Securities Industry and Financial Markets Association

January 30, 2018

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Stuart Spodek, Vice Chairman

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Treasury Borrowing Advisory Committee Quarterly Meeting

Committee Charge – January 31, 2018

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?

Assessment of TIPS Programs

Treasury has issued Treasury Inflation Protected Securities (TIPS) since 1997 and currently there are $1.3 trillion TIPS outstanding, representing about 9 percent of Treasury marketable debt outstanding. We would like the Committee to assess the TIPS issuance programs based on Treasury's regular and predictable issuance framework, liquidity, cost, investor-base diversification, borrowing needs, and risk. Please provide perspectives on the costs and benefits of any adjustments to the TIPS program in light of these considerations.

Financing this Quarter

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

- The composition of Treasury notes and bonds to refund approximately $46.6 billion of privately-held notes maturing on February 15, 2018.
- The composition of Treasury marketable financing for the remainder of the January-March 2018 quarter, including cash management bills.

- The composition of Treasury marketable financing for the April-June 2018 quarter, including cash management bills.