Minutes of the Meeting of the Treasury Borrowing Advisory Committee of the Securities Industry and Financial Markets Association May 1

May 2, 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 Financial Markets Clay Berry, Deputy Assistant Secretary for Federal Finance Laura Lipscomb, Director of the Office of Debt Management Fred Pietrangeli, and Deputy Director of the Office of Debt Management Nick Steele welcomed the Committee, including the newest member to the Committee, Gagan Singh. Other members of Treasury staff present were Ayeh Bandeh-Ahmadi, Chris Cameron, Dave Chung, Stephen Clinton, Sarah Hirsch, Tom Katzenbach, Jerry Kelly, Amyn Moolji, Ken Phelan, Renee Tang, and Brandon Taylor. Federal Reserve Bank of New York staff members Nathaniel Wuerffel, Susan McLaughlin, and Ellen Correia Golay were also present.

Counselor Phillips began by announcing that Elizabeth Hammack and Daniel Dufresne will become the new Chair and Vice Chair of the Committee later this year. Phillips thanked Jason Cummins and Stuart Spodek for their leadership as Chair and Vice Chair over the past two years.

Next, the Committee turned to a charge on the potential benefits of 2-month bill issuance and an additional weekly settlement cycle for bills. The presenting member began by discussing projections for increased borrowing needs over the next several years, expectations for significant and sustainable future demand for bills, and concentrations of bill auction settlements on Thursdays.

The presenting member noted that Congressional Budget Office (CBO) estimates indicate considerable increased borrowing needs over the 10-year forecast window. As discussed at the November 2017 TBAC meeting, the Committee agreed that between one-quarter and one-third of cumulative future financing gaps should be met by bill issuance.

Next, the presenting member noted several characteristics of the market that indicate sustained demand for bills. Bill holdings by investor class indicate that foreign investors and money market funds own the largest proportion of the outstanding supply. MMFs, in particular, have increased bill holdings since regulatory changes were enacted in 2016. Moreover, the associated re-allocation from prime to government MMFs has remained durable despite an increase in yield premium for prime MMFs.

The presenting member noted recent portfolio allocations by government MMFs to repo and argued that if the yield spread between repo and bills were to narrow, it would likely drive additional flow from repo to bills. Furthermore, an analysis was presented showing the persistence of a bill issuance premium, which tends to be greatest at the short-end of the bill curve, thereby supporting the idea of increasing issuance in that sector. Lastly, the introduction of a 2-month bill would allow for smaller auction sizes in other tenors, allowing for greater flexibility in funding future projected financing gaps.

Finally, the presenting member detailed the concentration of funding on Thursdays and the potential benefits of an additional weekly settlement cycle. Specifically, the presenting member recommended that a new 2-month bill program settle on Tuesdays, and argued in favor of moving the existing 1-month bill to the same Tuesday cycle. Adding a 2-month bill on a new settlement day would both reduce concentration on Thursdays and allow for smaller bill auction sizes, all else equal. Moving the 1-month bill would support liquidity at the short-end and allow investors to ladder maturities in this segment of the market. Moreover, diversifying settlement volumes across days helps mitigate the intraday operational requirements for clearing and settling. Treasury also benefits from an additional bills settlement day by allowing for greater ability to manage the 5-day cash balance target.

The presenting member noted that the additional settlement day could also alleviate pressure in repo funding markets around the concentrated Thursday settlement days, and indicated that ample liquidity exists for investors to reinvest between settlement cycles.

The Committee then discussed current bill market dynamics and agreed that demand should remain strong, while potentially increasing among some types of investors. In addition, the Committee agreed that the amount of net bill issuance should increase, given the CBO's projections for increased borrowing needs over the next several years. Furthermore, all Committee members agreed that a new 2-month bill could be introduced to fill that funding gap based on evidence for strong short-end demand. In addition, the Committee generally agreed that further study was warranted to assess a Tuesday settlement cycle as a means to reduce funding congestion and increase operational resiliency. The Committee recommended that Treasury evaluate ways to facilitate the introduction of a new 2-month bill, paired potentially with a 1-month bill, on a Tuesday settlement cycle.

The meeting then continued with a review of the TBAC charter and Committee guidelines by Treasury counsel.

Next, Director Pietrangeli provided an overview of the fiscal situation. Pietrangeli noted that for the first half of FY2018, receipts totaled $1,497 billion, an increase of two percent year-over-year, led by a $47 billion increase in withheld taxes and an $11 billion increase in non-withheld taxes. The gains were partially offset by a $14 billion decrease in corporate taxes. Outlays totaled $2,097 billion over the same timeframe, an increase of five percent. Notable increases include $32 billion for interest on the public debt as well as payments made to Government-Sponsored Enterprises related to valuation of Deferred Tax Assets as a result of the Tax Cuts and Jobs Act (TCJA), $19 billion for increased enrollment and increased average benefit payments for Social Security, $16 billion for Medicare, and $15 billion for the Department of Homeland Security including increased payments for disaster relief.

Pietrangeli also commented on issuance of State and Local Government Securities (SLGS) over the past quarter. Issuance was down, partly due to a suspension of SLGS issuance during the debt limit impasse, as well as lower demand for SLGS as rules for advanced refundings were modified in the TCJA.

Based on the near-term fiscal outlook, Treasury recently announced privately-held net marketable borrowing estimates of $75 billion for the April to June 2018 quarter, assuming an end-of-June cash balance of $360 billion, and $273 billion for the July to September quarter, assuming an end-of-September cash balance of $350 billion. The privately-held net marketable borrowing estimates take into account the Federal Reserve's normalization of its System Open Market Account (SOMA) portfolio. Specifically, the estimates exclude SOMA rollovers (auction "add-ons") and include private financing required due to SOMA redemptions. For FY2018, total privately-held net marketable borrowing is estimated at $1,118 billion. Pietrangeli noted that the Office of Management and Budget (OMB) and CBO do not provide a "privately-held" estimate of net marketable borrowing.

Pietrangeli then acknowledged that recent projections by OMB and CBO indicate borrowing needs will increase over the ten-year forecast window. As a result, these projections create a funding gap that Treasury will need to fill with increased issuance. Finally, Pietrangeli discussed demand for Treasury securities, citing stable bid-to-cover ratios and a rebound of foreign demand in FY2018 Q2.

Next, Deputy Assistant Secretary Lipscomb commented on bill issuance over the last several months. Following the resolution of the debt limit impasse, Treasury began to issue more bills to rebuild its cash balance to meet the stated policy target of a minimum of five days of future outflows, with a floor of $150 billion, and to address seasonal borrowing needs associated with tax refund payments. Between February 9 and the end of March, aggregate Treasury bill supply increased more than $300 billion. Lipscomb noted that bill supply generally fluctuates over the short-term in line with seasonal needs, thereby enabling Treasury to maintain its policy of regular and predictable coupon issuance. Given the circumstances, bill issuance increased at a faster than ordinary pace, which some market commentators have cited as one factor affecting broader money market rates over the period, particularly because bill issuance was easily quantifiable compared to other factors.

The Committee began a discussion of short-term rates and the effect of rapidly increasing bill issuance over the recent period. The Committee agreed that recent increases in broader money market rates are due to a confluence of factors, including but not limited to, the increase in bill issuance. The Committee also remarked that restoring the cash buffer is a prudent policy objective.

Closing the discussion on bills, Lipscomb noted that, in April, Treasury has paid down more than $100 billion in bills. Feedback from market participants indicate that expectations are for relatively stable net bill issuance moving forward until seasonal needs require an uptick in issuance later in the year. By the end of FY2018, however, the level of bills outstanding is expected to be below the peak observed in March 2018, given current fiscal forecasts.

Lipscomb also provided the Committee with feedback from primary dealers in response to the recent quarterly refunding agenda discussion topics. Primary dealers generally responded that foreign demand has remained robust, as the Treasury market is the deepest and most liquid in the world. Foreign official demand is expected to remain steady in the year ahead, while foreign private demand will continue to fluctuate with various factors, including investment mandates, cross-border funding costs, and exchange rate expectations.

Pietrangeli then provided the Committee with feedback from the primary dealers on the Treasury Inflation-Protected Securities (TIPS) program. In particular, primary dealers indicated expectations for strong demand moving forward and that an increase in current TIPS issuance sizes would be well received, particularly at the 5-year tenor. Many primary dealers were also supportive of the potential for a new 5-year TIPS issuance in the second half of the year. Pietrangeli noted that Treasury was pleased by the positive feedback on the current issuance calendar and will continue to study the potential introduction of a new 5-year TIPS, as well as other potential adjustments to the TIPS program to support liquidity and meet investor demand.

The Committee then turned to a discussion around financing for the upcoming quarter. The Committee agreed that a recommended financing plan should take into account several portfolio metrics. In particular, the TBAC's debt optimization model suggests Treasury would benefit by focusing new issuance in the belly of the curve, defined by the model as the 2- to 5-year nominal coupon tenors.

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

The Committee reconvened at 1:30 p.m., with Committee members providing an update on the development of the debt issuance optimization model, indicating that TIPS may soon be incorporated into the optimization.

The Committee then proceeded to finalize its issuance recommendations for the upcoming quarter. Given current estimates for funding needs over the medium-term, as well as the benefits of issuing proportionally more in the belly of the yield curve, the Committee recommended that Treasury increase 2-, 3-, and 5-year nominal coupon auction sizes proportionally more than the 7-, 10-, and 30-year nominal coupon securities during the remainder of the May-July period.

The Committee adjourned at 2:30 p.m.

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Laura Lipscomb
Deputy Assistant Secretary for Federal Finance
United States Department of the Treasury
May 1, 2018

Certified by:

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Jason Cummins, Chairman

Treasury Borrowing Advisory Committee

Of The Securities Industry and Financial Markets Association

May 1, 2018

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Stuart Spodek, Vice Chairman

Treasury Borrowing Advisory Committee

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TREASURY BORROWING ADVISORY COMMITTEE QUARTERLY MEETING COMMITTEE CHARGE – MAY 1, 2018

FISCAL OUTLOOK

Taking into consideration Treasury's short, intermediate, and long-term financing requirements, as well as the variability in financing needs from-quarter to quarter, what changes to Treasury's coupon auctions do you recommend at this time, if any?

ASSESSMENT OF POTENTIAL 2-MONTH BILL ISSUANCE AND POSSIBLE ALTERNATIVE SETTLEMENT CYCLE

We would like the Committee to comment on potential demand for a 2-month bill tenor, as well as the effect a 2-month bill would have on pricing and liquidity of other T-bill tenors. Please also comment on the potential advantages and disadvantages to having some Treasury bill tenors settle and mature outside of the typical Thursday-to-Thursday cycle.

FINANCING THIS QUARTER

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

- The composition of Treasury notes and bonds to refund approximately $39.1 billion of privately-held notes maturing on May 15, 2018.
- The composition of Treasury marketable financing for the remainder of the April-June 2018 quarter, including cash management bills.
- The composition of Treasury marketable financing for the July-September 2018 quarter, including cash management bills.