Minutes of the Meeting of the Treasury Borrowing Advisory Committee of the Securities Industry and Financial Markets Association January 29

January 30, 2019

The Treasury Borrowing Advisory Committee (TBAC) convened in a closed session at the Hay-Adams Hotel at 9:30 a.m. All members, with the exception of Michelle Neal, were present. Deputy Secretary Justin Muzinich, Counselor to the Secretary Craig Phillips, Deputy Assistant Secretary for Federal Finance Brian Smith, Director of the Office of Debt Management Fred Pietrangeli, and Deputy Director of the Office of Debt Management Nick Steele welcomed the Committee. Other members of Treasury staff present were Ayeh Bandeh-Ahmadi, Chris Cameron, Dave Chung, Tom Katzenbach, Devin O'Malley, Ken Phelan, Peter Phelan, Renee Tang, and Brandon Taylor. Federal Reserve Bank of New York staff members Nathaniel Wuerffel, Oliver Giannotti, Ellen Correia Golay, and Jake Schurmeier were also present. The meeting began with a review of Committee guidelines by Treasury counsel.

Director Pietrangeli then provided an overview of the fiscal situation. Pietrangeli noted that for Q1 FY2019 receipts were little changed year-over-year, rising just $17 billion. Increases in social insurance and excise and customs deposits were mostly offset by declines in individual and corporate taxes. Outlays increased $45 billion year-over-year, an increase of 4 percent.

Next, Pietrangeli turned to the near-term fiscal outlook by referencing the most recent annual marketable borrowing estimates from the Office of Management and Budget (OMB), the Congressional Budget Office (CBO), and the primary dealers. He highlighted that Treasury is projected to be either fully funded or slightly underfunded for FY2019, but that funding gaps are projected for FY2020 and subsequent years. Referencing the recently published current law forecasts from CBO, Pietrangeli noted a cumulative $1.4 trillion reduction in projected borrowing needs for the next ten years, which can largely be attributed to the return of the discretionary spending caps associated with the Budget Control Act of 2011 and a downward revision to its interest rate forecast. Pietrangeli also acknowledged that primary dealer estimates for Treasury's net privately-held marketable borrowing needs exhibited significant variability, reflecting a range of estimates for the end of SOMA portfolio normalization.

Addressing the prior quarter, Pietrangeli noted that during the October to December 2018 quarter, Treasury borrowed $426 billion in privately-held net marketable debt and ended the quarter with a cash balance of $402 billion. Looking ahead, Treasury's Office of Fiscal Projections announced a privately-held net marketable borrowing estimate of $365 billion for the January to March 2019 quarter with an end-of-March balance of $320 billion. Given Treasury bill auction sizes quarter-to-date, Pietrangeli indicated that net bill supply is expected to increase from current levels through the end-of-March by a similar magnitude as occurred between October and December 2018. In addition, Pietrangeli stated that Treasury expects to borrow $83 billion in privately-held net marketable debt during the April-June 2019 quarter, assuming an end-of-June cash balance of $300 billion. This $300 billion figure assumes some degree of constraint from the debt limit, preventing Treasury from maintaining its prudent cash balance policy.

Deputy Assistant Secretary Smith then summarized the feedback from primary dealers in response to recent quarterly refunding agenda discussion topics. Primary dealers noted that Treasury is well positioned to meet financing needs over FY2019 but would need to increase coupons further in FY2020. Additionally, primary dealers were broadly supportive of the use of an earlier auction time, particularly for bills, and believe that Treasury should consider using earlier auction times on an ad hoc or more regular basis going forward. The Committee agreed with this assessment. Smith then noted that primary dealers were generally supportive of Treasury evaluating the potential for a new product indexed to the Secured Overnight Financing Rate (SOFR). Many primary dealers indicated that issuance of a SOFR-linked product could support the market's transition from LIBOR to SOFR. However, several primary dealers believe that Treasury should allow the SOFR-linked market to develop further prior to making a determination about issuance. Smith also noted the importance of understanding prospective pricing of any potential SOFR-linked product.

Debt Manager Taylor then presented a brief overview of public data sources for foreign participation in the Treasury securities market. Data for the primary market includes investor class data and auction results. Data for the secondary market includes Treasury's International Capital (TIC) data and Treasury securities held in custody at the Federal Reserve for foreign official and international accounts. Taylor described how each data set is constructed and noted important differences between them. Taylor also pointed out that the categorization of competitive bidders released with the auction results data does not identify foreign entities and that foreign entities can participate in any of the three categories.

Next, Deputy Director Steele noted that on average, primary dealers suggested increasing TIPS issuance gradually, resulting in an increase of $24 billion over the remainder of CY2019. Primary dealer recommendations for auction size increases averaged $1 billion in the 5-year and 10-year maturities and $2 billion in the 30-year maturity. However, it was noted that these increases could be implemented gradually, and the 30-year could at first be increased by just $1 billion over the next quarter. The Committee agreed that the TIPS issuance increase should be gradual, with the bulk of the increase in net issuance originating from the introduction of the new 5-year October maturity.

Following the discussion, the Committee turned to its overall financing recommendation for the upcoming quarter. The Committee agreed that Treasury is well-suited to meet its financing needs in FY2019 given its current financing schedule. As a result, the Committee recommended that Treasury leave nominal coupon auction sizes unchanged for the coming quarter, while gradually increasing TIPS auction sizes by $1 billion per auction, starting with the 30-year TIPS in February and the 5-year TIPS in April, while considering increases in the 10-year at subsequent meetings. The Committee also noted that the timing of the end to SOMA normalization could have a significant impact on their outlook for additional coupon increases beyond FY2019.

The Committee then turned to a presentation on the potential for innovation in Treasury's suite of products and debt management tools. The presenting member outlined the potential for a significant financing gap over the next 10 years in the context of the potential need for domestic investors to participate more if foreign reserves were to grow at a slower pace. In a high level "blue sky" presentation, the committee discussed a list of potential products that might generate additional demand from untapped savings pools, widening Treasury's investor base, including: additional floating rate notes, inflation indexes, nominal coupon maturities, zero-coupon securities, and other structures. It was emphasized that any of these potential ideas would require additional review and analysis before the Committee would be prepared to make a recommendation.

Among the new products discussed, the Committee focused on the possibility of a SOFR-linked floating rate note. The Committee agreed that based on the feedback from the primary dealers and the ongoing market transition the product deserves further study.

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

The Committee reconvened at 1:30 p.m.

The presenting member described how the when-issued (WI) market has played an important role in price discovery and evolved over time. The presenting member then discussed the risk exposure for WI trading given the lack of margining, and offered comparisons between the WI market and the TBA market. The presenting member concluded by noting the different definitions are used to describe the pre- and post-auction periods in the WI market and that a standardization of the WI period definition could be useful for future studies. The Committee briefly discussed the charge and agreed that the WI market continues to play an important role and that Treasury market structure developments should continue to be studied further.

The Committee adjourned at 2:30 p.m.

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Brian Smith
Deputy Assistant Secretary for Federal Finance
United States Department of the Treasury
January 29, 2019

Certified by:

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Elizabeth Hammack, Chair

Treasury Borrowing Advisory Committee

Of The Securities Industry and Financial Markets Association

January 29, 2019

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Daniel Dufresne, Vice Chair

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Treasury Borrowing Advisory Committee Quarterly Meeting

Committee Charge – January 29, 2019

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?

INNOVATIONS IN SOVEREIGN DEBT MANAGEMENT

Treasury is always considering ways to minimize borrowing costs, better manage its liability profile, enhance market liquidity, and expand the investor base in Treasury securities. In light of these objectives, we would like the Committee to comment on the likely costs and benefits of potential new Treasury products that might assist Treasury in achieving some or all of these objectives. In addition, are there any other debt management tools or processes that Treasury should consider utilizing? In answering the question, please review the practices and products employed by debt management authorities around the world.

WHEN-ISSUED (WI) MARKET

The when-issued (WI) market plays a role in price formation in advance of Treasury auctions. We would like the Committee to provide an overview of the WI market including liquidity, trading venues, clearing and settling, major participants, linkages to the cash and futures markets, effects of market conditions, and counterparty risks. What, if any changes, should be considered to improve the WI market?

FINANCING THIS QUARTER

We would like the Committee's advice on the following:
• The composition of Treasury notes and bonds to refund approximately $54.1 billion of privately-held notes maturing on February 15, 2019.
• The composition of Treasury marketable financing for the remainder of the January-March 2019 quarter, including cash management bills.
• The composition of Treasury marketable financing for the April-June 2019 quarter, including cash management bills.