Minutes of the Meeting of the Treasury Borrowing Advisory Committee of the Securities Industry and Financial Markets Association July 30, 2019

July 31, 2019

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The Committee convened in a closed session at the Department of the Treasury at 9:15 a.m. All members were present. Deputy Secretary Justin Muzinich, Deputy Assistant Secretary for Small Business, Community Development, and Affordable Housing Policy Kipp Kranbuhl, 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, Courtney Demartini, Bernadette Goodwin, Brendan Griffiths, Daniel Harty, Sarah Hirsch, Tom Katzenbach, Tim Khang, Mary Kolesar, Devin O'Malley, Peter Phelan, Samira Salha, Renee Tang, and Brandon Taylor. Federal Reserve Bank of New York staff members Nathaniel Wuerffel, Susan McLaughlin, and Matt Lieber were also present.

Director Pietrangeli began by providing an overview of the fiscal situation. Pietrangeli noted that FY2019 year-to-date receipts totaled $2.6 trillion, or $68 billion (3%) higher than the comparable period last year. The increase reflected gains in withheld and non-withheld taxes, excise taxes and customs duties, and reduced tax refunds, partially offset by declines in Federal Reserve earnings and corporate taxes. Meanwhile, year-to-date outlays totaled $3.4 trillion, or $205 billion (7%) higher relative to the comparable period last year.

Next, Pietrangeli discussed borrowing estimates recently released by Treasury. He began by noting that bill issuance had gradually declined in the April-to-June 2019 quarter in response to seasonal factors, as well as constraints on marketable borrowing resulting from the recent debt limit impasse. As a result, bill supply had fallen by nearly $180 billion since the May refunding announcement.

Looking ahead to the July-to-September 2019 quarter, Pietrangeli highlighted the recent agreement and legislation approved by the House of Representatives to suspend the debt limit through July 2021. As a result, Treasury increased its cash balance target for the end of September to $350 billion. Treasury plans to rebuild its cash balance back to levels consistent with its prudent cash balance policy, primarily through increases in bill issuance. Assuming that coupon sizes remain unchanged, and given the paydown in bills since the end of June, bill issuance through the end of September is projected to increase on net by roughly $160 billion. He noted that this change in bill supply is about half that during Q1 CY2018, when the Treasury replenished its cash balance following debt ceiling-related negotiations. It was also noted that while some primary dealers expect redemptions from the System Open Market Account (SOMA) portfolio to cease in August, sooner than the previously announced cessation in October, such a change would reduce Treasury's need to borrow from the private sector by about $28 billion in Q4 FY2019.

Pietrangeli next reviewed the longer term financing outlook, highlighting the most recent annual marketable borrowing estimates from the Office of Management and Budget (OMB), the Congressional Budget Office (CBO), and the primary dealers. Pietrangeli also discussed the potential effects of the legislation to increase spending caps on the various estimates.
He noted that Treasury is well funded for the remainder of FY2019 and into the first part of FY2020, but that significant funding gaps are projected starting in FY2021. The substantial increase in funding needs in FY2021 reflects, in part, large amounts of maturing 2-year and 3-year notes that need to be refinanced. Pietrangeli acknowledged the importance of monitoring the Federal Reserve's balance sheet policy announcements and their potential implications for Treasury financing plans. Pietrangeli estimated that reinvestment of maturing MBS proceeds into Treasuries and potential Federal Reserve balance sheet growth could reduce financing needs from the public by an additional $100 to $200 billion annually over the next several years.

Deputy Assistant Secretary Smith then summarized for the Committee the feedback from primary dealers on Treasury's financing needs and the outlook for Federal Reserve policy. The consensus from primary dealers was that Treasury was well funded for the rest of the year, and primary dealers did not expect any change to coupon sizes this quarter. Some speculated about the need to increase auction sizes towards the end of FY2020, but there was no consensus on the timing. The majority of primary dealers expected the Federal Reserve to make a 25 basis point cut to the target range for the federal funds rate and to end balance sheet normalization early.

Debt Manager Katzenbach then summarized Treasury's cash balance policy and primary dealers' views on bill supply following the resolution of the current debt ceiling impasse. He began by reiterating Treasury's cash balance policy, which was introduced in May 2015. Under the policy, Treasury holds a level of cash generally sufficient to cover one week of expected outflows in the Treasury General Account to help protect against a potential interruption in market access. As part of the policy, Treasury has set a minimum balance of roughly $150 billion in cases where expected outflows are less than that amount. He noted that over the 12-month period ending June 30, 2019, the minimum cash balance that would be consistent with this policy was, on average, about $232 billion, with the top 20% of instances averaging $365 billion.

With this cash management policy in mind, Katzenbach then reviewed feedback from primary dealers on bill supply. A trimmed mean of primary dealer responses indicated that Treasury is anticipated to increase the supply of Treasury bills outstanding by $178 billion over the eight-week period following resolution of the current debt ceiling impasse. In comparison, primary dealers estimated market capacity to digest bill issuance without a significant price adjustment or deviation from fair value over the same period to be $210 billion. Furthermore, the primary dealers generally expected Treasury to resume meeting its cash balance policy at some point between September mid-month, related to the receipt of corporate taxes, and the end of the month. Committee members discussed the Treasury's cash management policy, noting both the policy's benefits related to risk management as well as the potential market disruptions that could occur if bill supply were increased too rapidly. Smith emphasized that Treasury carefully balances these considerations when making its issuance decisions. The Committee generally agreed that Treasury's projected measured increases in bill supply balanced these factors well.

Deputy Director Steele then discussed primary dealers' responses to a quarterly refunding survey question regarding the appropriate role for the official sector in considering increased central clearing for Treasury securities. Primary dealers broadly acknowledged the risks associated with bilateral clearing identified by the Treasury Market Practices Group (TMPG) in their updated best practices document and supported efforts to mitigate these risks. Many primary dealers expressed support for expanded central clearing in the Treasury market and suggested the official sector consider playing a role in encouraging central clearing. Other primary dealers expressed concerns about such policies and their costs, including the potential for higher trading costs, potential differential effects on different types of Treasury market participants, and concentration of risk in larger dealers and central counterparties. Steele noted that Treasury is sensitive to these potential costs and appreciates the wide range of market participants in the Treasury market. The Committee noted that Treasury should continue to gather feedback from a range of market participants and evaluate this topic.

Next, Steele led a discussion on the ongoing enhancements to the Treasury Inflation Protected Securities (TIPS) issuance calendar, noting that feedback from market participants continued to be positive. He then reviewed primary dealers' views on TIPS auction sizes noting that dealer recommendations were consistent with previous Committee recommendations for a gradual increase of $20-30 billion in the annual TIPS issuance calendar in CY2019. After discussion, the Committee recommended a $7 billion August 30-year reopening in order to partially offset the decrease in overall 30-year TIPS issuance this year. The Committee viewed a $12 billion 10-year TIPS September reopening as consistent with the July 10-year new issue size of $14 billion. Lastly, a $17 billion 5-year TIPS new issue in October was viewed as prudent for the inaugural October 5-year maturity, keeping it the same size as the April new 5-year TIPS issue. The Committee viewed these sizes as maintaining sufficient flexibility to continue to assess the supply and demand dynamics into FY2020.

The Committee then turned to a presentation on the potential introduction of a 1-year final maturity floating rate note (FRN). The presenting member considered demand, pricing, and secondary market liquidity for a hypothetical 1-year FRN indexed to the Secured Overnight Finance Rate (SOFR), a 1-year FRN indexed to the 3-month Treasury bill, and an increase in 1-year Treasury bill issuance. Treasury's FRN program has been a success, and growth in money market funds and other cash balances has generated increased demand for both FRN and Treasury bill issuance in recent years. The presenting member's analysis of expected investor demand argued for adding a 1-year FRN issuance point. Furthermore, the analysis suggested that demand is expected to be highest for a 1-year FRN indexed to SOFR relative to a 1-year FRN indexed to the 3-month Treasury bill or a 1-year Treasury bill. This analysis identified securities lending participants and investors looking for a repo alternative as potential sources of new demand.

The presenting member argued that a 1-year SOFR FRN should price similarly to a 1-year Treasury bill FRN and may diversify the Treasury's funding costs. While the mission of lowest cost of financing was the primary consideration, it was seen as an additional positive that a 1-year SOFR FRN would likely support the development of the SOFR issuance market and an orderly transition away from LIBOR in the market overall. However, it was noted that the introduction of a 1-year SOFR FRN may affect existing demand for the 2-year FRN indexed to the 3-month Treasury bill. The Committee recommended that Treasury should consider issuing a 1-year FRN indexed to the SOFR, but that the potential effects on the 3-month Treasury bill FRN should be studied further.

In the subsequent discussion of the presenting member's presentation, Smith noted that the Treasury has not made any decisions regarding such a product and will continue to evaluate this recommendation.

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

The Committee reconvened at 1:45 p.m. and briefly discussed several market developments, including recent changes in relative pricing of Treasuries versus swaps, futures, and other asset classes. It was suggested by some members of the Committee that Treasury further study the drivers of these pricing relationships.

The Committee adjourned at 2:15 p.m.

The Committee reconvened at the Department of the Treasury at 4:30 p.m. All Committee members were present. The Chair presented the Committee report to Deputy Secretary Muzinich. A brief discussion followed the Chair's presentation, but did not raise significant questions regarding the report's content.

The Committee adjourned at 5:20 p.m.

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Brian Smith
Deputy Assistant Secretary for Federal Finance
United States Department of the Treasury

July 30, 2019

Certified by:

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Elizabeth Hammack, Chair
Treasury Borrowing Advisory Committee
Of The Securities Industry and Financial Markets Association
July 30, 2019

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Daniel Dufresne, Vice Chair
Treasury Borrowing Advisory Committee
Of The Securities Industry and Financial Markets Association
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TREASURY BORROWING ADVISORY COMMITTEE QUARTERLY MEETING

COMMITTEE CHARGE – JULY 30, 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?

Potential 1-Year Final Maturity Treasury FRN

Treasury is actively evaluating the potential introduction of a 1-year final maturity FRN. Treasury is interested in a comparison of a hypothetical introduction of 1-year SOFR FRN or 1-year T-bill FRN, and an increase in 1-year T-bill issuance. Please evaluate how investor demand might vary across these products. Additionally, because any such change would be undertaken as part of Treasury's regular and predictable issuance strategy, please estimate the relative interest cost and risk to Treasury across the interest rate cycle of these three potential product choices.

Financing this Quarter

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

- The composition of Treasury notes and bonds to refund approximately $57.3 billion of privately-held notes maturing on August 15, 2019.
- The composition of Treasury marketable financing for the remainder of the July-September 2019 quarter, including cash management bills.
- The composition of Treasury marketable financing for the October-December 2019 quarter, including cash management bills.