Minutes of the Meeting of the Treasury Borrowing Advisory Committee of the Securities Industry and Financial Markets Association February 4, 2020

February 5, 2020

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The Committee convened in a closed session at the Department of the Treasury at 8:00 a.m. All members were present. Principal Deputy Assistant Secretary for Financial Markets 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, including the newest members to the Committee, Scott Freidenrich and Bob Miller. Other members of Treasury staff present were Ayeh Bandeh-Ahmadi, Chris Cameron, Dave Chung, Tom Katzenbach, Tim Khang, Peter Phelan, Brett Solimine, Renee Tang, Brandon Taylor, Drew Teitelbaum, Tom Vannoy, and Paul Wolfteich. Federal Reserve Bank of New York staff members Susan McLaughlin, Kathryn Chen, Rania Perry, and Kyle Lee were also present. The meeting began with a review of Committee guidelines by Treasury counsel.

Director Pietrangeli provided brief highlights of Q1 FY2020 changes in receipts and outlays. Pietrangeli showed that Q1 FY2020 net receipts rose by $48 billion (6%) year-over-year, driven by increases in individual withheld and corporate taxes. These gains were partially offset by an $11 billion decline in excise taxes, reflecting the effect of a moratorium on the Health Insurance Provider fee collection in CY 2019. Q1 FY2020 outlays were up $72 billion (7%) year-over-year, mainly due to increased Medicare and Medicaid expenditures, higher defense spending, and larger Treasury and Social Security outlays.

Pietrangeli next noted that a surge in State and Local Government Series (SLGS) issuance reduced net marketable borrowing needs by $23.5 billion in Q1 FY2020, which was the largest quarterly net increase in SLGS issuance since 2007.

Pietrangeli then highlighted that marketable borrowing estimates from the Office of Management and Budget (OMB), the Congressional Budget Office (CBO), and the primary dealers ranged around $1.0 to $1.1 trillion for the next three fiscal years. Pietrangeli explained that Q1 FY2020 actuals and estimates for Q2 and Q3 FY2020 suggest near-term borrowing needs might be lower than generally expected, though there is still significant uncertainty because of the upcoming tax season.

Pietrangeli noted estimates for Q2 FY2020 suggest that total bills outstanding will increase from the end of December 2019 to the end of March 2020 by $131 billion, assuming an end of March cash balance of $400 billion. However, total bills outstanding, which are currently around $2.4 trillion outstanding, are likely to fall below these levels following the April tax period, when Treasury seasonally reduces bill issuance. The Federal Reserve's reserve management purchases, which primary dealers expect to continue at least through June 2020, combined with the seasonal contraction in bill issuance, could result in meaningful reductions to privately-held bill supply in Q3 FY2020 based on Treasury's current cash balance policy.

A Committee member asked whether Treasury was considering a higher cash balance and Deputy Assistant Secretary Smith confirmed that it was under consideration, reiterating Secretary Mnuchin's recent public statements on the topic. Pietrangeli added that Treasury's standard approach for addressing short-term or unexpected changes in financing needs is to use bills as a "shock absorber," which supports Treasury's long-standing "regular and predictable" issuance paradigm. Finally, Pietrangeli explained that while Federal Reserve actions modestly help to close the financing gap over time, the gap beginning in FY2021 nevertheless remains sizable.

Deputy Director Steele then reviewed responses from the primary dealers about the new 20-year bond, noting that there was a broad consensus that there would be strong demand for regular and predictable issuance in benchmark size, with new issues in quarterly refunding months followed by two re-openings in subsequent months. Dealers suggested that Treasury's current financing schedule provides flexibility to launch the security later in the first half of CY2020 with issuance sizes on the smaller end of the expected range, and then gradually increase these sizes as future financing needs and market demand dictates. However, it was broadly noted that Treasury should be mindful that an adequate initial offering size would support benchmark liquidity in the new product. Based on the dealers' responses, the interquartile range of minimum initial auction sizes for the 20-year to ensure benchmark liquidity was $10-13 billion for the new issue and $8-11 billion for each of the two re-openings, equivalent to $26-35 billion per CUSIP or $104-140 billion in annual issuance. Accordingly, most primary dealers did not expect Treasury to cut other coupon issuance sizes when introducing the 20-year bond.

There was broad consensus among dealers that the 20-year bond auction schedule should be similar to that of TIPS, where the auction occurs in the third week of the month, settles at the end of the month, and is dated and matures mid-month. This view is consistent with the prior Committee recommendation. This structure would maintain STRIPS fungibility with the 10- and 30-year nominal coupon securities, while more evenly spreading the supply of duration throughout each month. Although some noted the longer when-issued (WI) period resulting from this schedule, dealers agreed that TIPS have worked well under this structure and that the benefits outweigh any perceived risks related to an extended WI period. The Committee briefly discussed these results and suggested introducing the 20-year in May with an auction schedule similar to the current TIPS and initial auction sizes at the low end of the dealer ranges.

Next, Debt Manager Katzenbach provided the Committee with an overview of the current state of the Treasury bill market. Katzenbach began by summarizing the recent purchases of bills by the Federal Reserve Bank of New York, noting that purchases have skewed toward longer-dated bills with maturities of more than 3-months. Since reserve management purchases were announced, the spread between bills and matched-maturity overnight indexed swaps has narrowed, representing a richening of bills, though the spread remains within the one-year range. In addition, trading volumes from the Trade Reporting and Compliance Engine (provided to Treasury by the Financial Industry Regulatory Authority) suggest that liquidity in bills has remained robust. Average daily trading volumes of $86 billion since mid-October 2019 are comparable to the prior 1-year average. Furthermore, Katzenbach noted that most primary dealers agree there has been no material change to market liquidity since the introduction of reserve management purchases.

Looking ahead, the pace of Federal Reserve bill purchases expected by dealers through June 2020 could result in the supply of privately-held bills declining to the mid-$1.8 trillion range, which would be the lowest absolute level since October 2017. Katzenbach noted that this level is within the range of estimates for the minimum privately-held supply that would be necessary to maintain benchmark liquidity as implied from primary dealer feedback, but below some dealers' estimates. The Committee briefly discussed the bills market and agreed that Treasury should continue to monitor the implications of reserve management purchases on liquidity conditions and the level of privately-held bills outstanding.

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 FY2020 given its current financing schedule and the expected rollover of Treasury securities held in the Federal Reserve System Open Market Account (SOMA). The Committee briefly discussed whether introducing the 20-year bond would necessitate reducing issuance in other coupon securities, but decided that cutting coupon securities sizes this year only to expand them in subsequent years was not practical or desirable given Treasury's regular and predictable approach and the projected financing gaps in FY2021 and FY2022. The Committee also agreed that, all else equal, the 20-year bond is expected to marginally increase the weighted-average maturity (WAM) of the debt outstanding but does not represent a significant change to the Committee's prior recommendations.

The Committee then reviewed a presentation on the potential long-run composition of the SOMA portfolio and its implications for Treasury's financing strategy. For the purposes of this discussion, a stylized balance sheet was presented to illustrate that the interest paid by Treasury on securities held by the SOMA portfolio is remitted to the Treasury net of Federal Reserve liability costs. This can effectively be thought of as converting fixed-rate Treasury securities to lower duration floating rate notes, the effects of which can be evaluated using the Committee's debt issuance optimization model. The model shows that SOMA purchases of Treasury securities generally reduce both Treasury's interest costs and the variability of its interest costs. In addition, overall duration of the stylized balance sheet is reduced.

The presenting member then discussed a potential scenario where the maturity structure of the SOMA portfolio is shortened, noting that Treasury should be indifferent to SOMA's maturity structure because each tenor in the stylized framework is similar to a floating rate note and has the same duration. Moreover, the presenting member suggested that Treasury should adjust issuance in light of the shift in the SOMA maturity structure with a goal of maintaining an optimal maturity structure of the privately-held outstanding. However, Treasury should closely monitor the potential run-off of SOMA holdings if the maturity structure is shortened. The presenting member remarked that recent redemptions from the SOMA portfolio were conducted in a manner that reduced risks for Treasury, including advance notice of changes and capping redemptions each month. The presenting member recommended that Treasury should not attempt to mitigate run-off risks of shorter duration SOMA holdings by increasing longer-duration private issuance because such a strategy would not meaningfully reduce risks but would add additional costs to Treasury.

Turning to changes in the maturity structure of the SOMA portfolio induced by potential future quantitative easing (QE), the presenting member concluded that Treasury should not attempt to offset QE because (1) allowing maturity structure changes to outstanding debt does not appear to increase Treasury's interest costs or the variability of the deficit, and (2) doing so could dampen the intended economic benefits of QE. However, it was noted that in a future QE scenario, Treasury would have to carefully consider the circumstances and debt management needs when making issuance decisions.

The Committee adjourned at 11:15 a.m.

The Committee reconvened at the Department of the Treasury at 4:30 p.m. All Committee members except Christine Hurtsellers were present. The Chair summarized key elements of the Committee report for Secretary Mnuchin, and followed with a brief discussion of recent market developments.

The Committee adjourned at 5:15 p.m.

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Brian Smith

Deputy Assistant Secretary for Federal Finance

United States Department of the Treasury

February 4, 2020

Certified by:

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Elizabeth Hammack, 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 – FEBRUARY 4, 2020

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?   Please also provide feedback on market expectations for Treasury issuance, the effects of current SOMA reinvestment policy, the evolution of Treasury holdings by investor class, as well as auction calendar construction.

Long-run Composition of Treasury Securities in the Federal Reserve SOMA Portfolio

At its May 2019 meeting, the FOMC discussed two potential options for the long-run composition of Treasury securities in the Federal Reserve's SOMA portfolio: (1) a portfolio roughly proportional to Treasury securities outstanding, and (2) a portfolio focused on shorter maturity securities, such as Treasury bills and other securities with less than 3 years to maturity. Recognizing that the FOMC has not yet made a decision on this subject, Treasury would like the TBAC to begin thinking about how, if at all, these potential paths for the SOMA portfolio should affect Treasury's long-term issuance strategy.

Financing this Quarter

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

• The composition of Treasury notes and bonds to refund approximately $70.5 billion of privately-held notes maturing on February 15, 2020.

• The composition of Treasury marketable financing for the remainder of the January-March 2020 quarter, including cash management bills.

• The composition of Treasury marketable financing for the April-June 2020 quarter, including cash management bills.