

Minutes of the Meeting of the Treasury Borrowing Advisory Committee of the Securities Industry and Financial Markets Association November 3, 2020

November 4, 2020

The Committee convened in a closed session via teleconference at 9:30 a.m. All members were present, except for Bob Miller, Ajay Rajadhyaksha, and Irene Tse. 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.

Other members of Treasury staff present were Ayeh Bandeh-Ahmadi, Bobby Bishop, Margaretta Bradley, Chris Cameron, Dave Chung, David Copenhaver, Tammy Didier, Christine Graffunder, Tom Katzenbach, Chris Kubeluis, David Lebryk, Peter Phelan, Brett Solimine, Renee Tang, Brandon Taylor, Tom Vannoy, and Paul Wolfeich. Federal Reserve Bank of New York staff members Kathryn Chen, Kathryn Franklin, Kyle Lee, Susan McLaughlin, Rania Perry, and Nathaniel Wuerffel were also present.

Principal Deputy Assistant Secretary Kranbuhl opened the meeting by highlighting the continued uncertainty regarding Treasury's borrowing needs because of the federal government's response to COVID-19. In light of this, Kranbuhl highlighted that Treasury has continued to maintain financing flexibility as a matter of prudent risk management, including continued reliance on increased bill issuance through benchmark bills and a regular cadence of cash management bills since March. In the second half of FY2020, Treasury's borrowing needs increased by an unforeseen and unprecedented \$3.2 trillion. Two-thirds of that borrowing need, or about \$2.4 trillion, was addressed through increases in bills, representing a doubling of bills outstanding. This resulted in a reduced weighted average maturity of Treasury debt outstanding and an increased share of Treasury bills to an above-average level. Treasury continues to manage this maturity profile change by shifting issuance toward coupon securities across the curve over time.

Kranbuhl then updated the Committee on the ongoing efforts regarding the potential Treasury issuance of a floating rate note (FRN) indexed to the Secured Overnight Financing

Rate (SOFR). Kranbuhl noted that no decision has been made, but that Treasury continues to actively explore such a product and that ample notice would be provided to the market if it chooses to move forward. Kranbuhl emphasized that Treasury, as an ex-officio member of the Alternative Reference Rates Committee, is committed to supporting the transition away from the U.S. dollar London Interbank Offered Rate. The Committee briefly discussed and reiterated their strong support for Treasury issuance of a SOFR-indexed FRN.

Director Pietrangeli then provided brief highlights of changes in receipts and outlays through Q4 FY2020. Receipts declined slightly by \$42 billion (-1%) year-over-year, largely due to declines in income and corporate taxes following the COVID-19 outbreak. Outlays increased by \$2,105 billion (47%), driven by the Paycheck Protection Program, other stimulus payments, increased unemployment costs, and relief payments to hospitals. Pietrangeli noted that potential additional fiscal stimulus, as well as the trajectory of the COVID-19 outbreak and its economic effects, continue to add uncertainty to the outlook for outlays.

Pietrangeli next highlighted that deficit and privately-held net marketable borrowing projections by the Congressional Budget Office (CBO) and the primary dealers remain elevated for FY2021, which is likely to persist into FY2022. CBO estimates are based on current law and do not include any assumption about a change in the cash balance or future fiscal stimulus. Primary dealer borrowing estimates varied based on differing assumptions regarding the size of additional legislation as well as how much of that borrowing will be met by reductions in the Treasury cash balance. Furthermore, the range of primary dealer estimates indicates significant uncertainty and the risk that the borrowing amounts could be higher.

For the next two quarters, Treasury's Office of Fiscal Projections estimates privately-held net marketable borrowing of \$617 billion and \$1,127 billion, with an assumption of \$1 trillion of additional borrowing need from additional legislation. Assuming no change in coupon issuance sizes, the \$617 billion borrowing estimate implies net bill issuance will remain essentially unchanged during the current quarter.

Pietrangeli noted that Treasury continues to approach the cash balance from a precautionary, risk management framework, and that the elevated cash level continues to be based on the magnitude and uncertainty of upcoming outflows. Given that, the cash balance will likely continue to be high until the uncertainty around near-term outflows diminishes.

Pietrangeli turned to the financing gap, which suggests current coupon auction sizes would be sufficient to meet primary dealer median expected borrowing needs. However, the upper range of primary dealer estimates, which includes significant additional fiscal stimulus, would exceed financing generated by current coupon auction sizes.

Looking across trends in demand for Treasury securities, Pietrangeli noted that foreign demand at auction has recently shifted slightly from bills toward coupon securities. Earlier in the year, the dollar amount of bills held by foreign investors increased, though the share fell amidst significant bill issuance. Similarly, the dollar amount of coupon securities held by foreigners has remained steady while the share has declined somewhat.

Deputy Assistant Secretary Smith then summarized primary dealer expectations for Treasury issuance over the coming months. Based on the heightened uncertainty around Treasury's borrowing needs, most primary dealers anticipated further increases in coupon auction sizes, with increases across the curve, while several others anticipated no increases in coupon auction sizes until additional fiscal stimulus legislation is finalized. For primary dealers that anticipated increases in coupon auction sizes, more primary dealers expected longer-end increases to proceed at a slower pace than in previous refunding announcements, whereas shorter maturity coupon increases were expected to continue at the same pace.

Next, Debt Manager Katzenbach reviewed primary dealer comments on the recent increase in bank demand for Treasury securities. Primary dealers attributed the increase to the significant growth in bank deposits, coupled with limited loan demand and more stringent lending standards. Several primary dealers also suggested bank demand for Treasury securities as a means to offset the recent compression in net interest margins. Katzenbach highlighted that temporary relief from the Supplementary Leverage Ratio was typically assigned a secondary role, facilitating the increase in bank holdings of Treasury securities rather than driving demand. Finally, a few primary dealers highlighted increased bank demand for the 7- to 10-year sector, relative to prior years when bank demand was focused in the 5-year sector.

Deputy Director Steele then reviewed buy-side outreach and responses from the primary dealers regarding potential increases to auction sizes for Treasury Inflation-Protected Securities (TIPS). Buy-side investors and primary dealers broadly recommended that Treasury increase TIPS auctions sizes gradually over CY2021. The primary reasons cited were stabilizing TIPS as a percentage of total marketable debt outstanding as well as the

improved TIPS liquidity conditions now compared to the spring. Expectations for an economic rebound and an increase in inflation in the coming years, given fiscal stimulus and the Federal Reserve's recently announced flexible average inflation targeting, were also cited as a potential tailwind for TIPS demand.

In terms of TIPS auction sizes, Steele highlighted the median primary dealer recommended increasing the 10- and 30-year new issues in January and February, respectively, by \$1 billion each, with a similar size increase to the reopenings. The 10-year new issue in July and reopenings were recommended to be increased by another \$1 billion. For the 5-year, the median primary dealer recommended increasing the April new issue and reopening by \$2 billion and maintaining these sizes for the October new issue and reopening. Steele noted these suggested increases were consistent with the idea that demand exists across the curve but that adding lower duration supply would be more easily absorbed. In total, these changes would increase annual gross TIPS supply in CY2021 by \$19 billion and roughly stabilize TIPS as a percentage of outstanding.

The Committee then reviewed a presentation on factors that drive supply and demand in Treasury bills and the appropriate level of Treasury bill issuance for the medium- and long-term. The presenting member began by discussing how the significant rise in bill issuance this year has been met by equally robust demand, particularly from money market funds (MMFs). MMFs have increased their bill holdings as a result of overall MMF assets increasing significantly, a shift from prime to government funds, and an increase in allocations to bills within funds. As such, bills cheapened only modestly amid the dramatic increase in supply, unlike other short-term alternatives in the aftermath of the COVID-19 outbreak, indicating a strong investor preference for bills. Going forward, the presenting member expected MMF demand would remain robust, which would provide Treasury flexibility to increase bill issuance in the near-term if needed.

The presenting member next discussed bill issuance projections under different fiscal stimulus scenarios. The member highlighted that even in a large fiscal stimulus scenario, Treasury had significant capacity to increase bill issuance. The presenting member concluded that while Treasury bills should still be used as a shock absorber to meet unexpected short-term funding needs, Treasury should consider running down bill financing as a percentage of marketable debt outstanding in the medium- and long-term in favor of terming-out into coupon securities, especially between the 2- and 10-year sectors. Reasons

included the current relatively high percentage of bills outstanding, low term premia in those coupon sectors, and more flexibility to increase bill issuance in the future.

The Committee then turned to its financing recommendation for the upcoming quarters and recommended that Treasury continue to increase coupon issuance across maturities, albeit at a slower pace than previously. While auction size increases in prior quarters have positioned Treasury well to meet near-term borrowing needs, the Committee agreed that further coupon increases, and a corresponding decline in the share of bills outstanding, were prudent given significant uncertainty about future borrowing needs. The Committee recommended increases in auction sizes of short- and intermediate-term securities similar to changes in previous quarters, but smaller increases in the long-end. Moreover, the Committee debated whether the recent increases in long-end yields were driven by supply or fundamental factors, but nonetheless felt that long-end issuance size increases could be smaller. Finally, the Committee recommended increasing TIPS auction sizes gradually, in line with the primary dealer recommendations, given apparent TIPS demand and to stabilize TIPS as a percent of marketable debt outstanding.

The Committee adjourned at 1:00 p.m.

The Committee reconvened at 3:00 p.m. 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 3:30 p.m.

Brian Smith

Deputy Assistant Secretary for Federal Finance

United States Department of the Treasury

November 3, 2020

Certified by:

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 – AUGUST 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.

Treasury Bill Issuance

In light of unprecedented borrowing needs, Treasury has more than doubled the supply of T-bills over the past year amid a surge in demand for high-quality, short-term assets. T-bills currently represent approximately 25% of total Treasury debt outstanding, exceeding the historical average of 23%, and are at the highest proportion since 2009.

Please discuss the drivers of supply and demand across Treasury bills and other high-quality, short-dated investments (e.g., CP, repo, agency discount notes), and expectations for money market conditions going forward.

As outlined in the last two quarterly refunding announcements, Treasury has been gradually shifting its financing from bills to longer-dated tenors as a prudent means of managing its maturity profile. Please discuss considerations for Treasury as it evaluates the appropriate level of Treasury bills issuance for the medium- and long-term.

Financing this Quarter

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

- The composition of Treasury notes and bonds to refund approximately \$60.9 billion of privately-held notes and bonds maturing on November 15, 2020.
- The composition of Treasury marketable financing for the remainder of the October-December 2020 quarter, including cash management bills.
- The composition of Treasury marketable financing for the January-March 2021 quarter, including cash management bills.