U.S. DEPARTMENT OF THE TREASURY

Minutes of the Meeting of the Treasury Borrowing Advisory Committee February 1, 2022

February 2, 2022

The Committee convened in a closed session via teleconference at 10:30 a.m. All members were present. Under Secretary for Domestic Finance Nellie Liang, Fiscal Assistant Secretary David Lebryk, 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 Dini Ajmani, Chris Cameron, Dave Chung, David Copenhaver, Alexander Demyanets, Tammy Didier, Joshua Frost, Chris Furey, Christine Graffunder, Tom Katzenbach, Chris Kubeluis, John Kunze, Kyle Lee, Jeffrey Rapp, James Smyth, Brett Solimine, Renee Tang, Brandon Taylor, Tom Vannoy, and Derick Wolfe. Federal Reserve Bank of New York staff members Kathryn Chen, Kathryn Franklin, Susan McLaughlin, Julie Remache, Monica Scheid, and Nathaniel Wuerffel were also present.

Under Secretary Liang began the meeting by welcoming three new members to the committee: Kevin Gaffney, Nancy Mueller Handal, and John Uglum. She also announced that Deirdre Dunn will be taking over as Vice Chair at the end of Brian Sack's term on the Committee. Liang then summarized recent developments in debt management and other related Treasury priorities. Following her remarks, Treasury counsel presented the annual review of Committee guidelines.

Director Pietrangeli then provided brief highlights of changes in receipts and outlays for Q1 FY 2022. Receipts totaled $1.05 trillion, an increase of $249 billion (31%) compared to Q1 FY 2021, chiefly reflecting the rebounding economy. Adjusted withheld and FICA taxes rose $186 billion (30%) and gross corporate taxes increased $25 billion (29%). With respect to withheld and FICA taxes, Pietrangeli noted that 50% of deferred CARES Act taxes were due by January 3, 2022. Outlays totaled $1.43 trillion, an increase of $74 billion (6%) compared to the same period of the previous year. The largest increase in outlays came from the Department of Treasury, which were $81 billion higher and attributable predominantly to larger tax credits ($57 billion), such as the Child Tax Credit ($47 billion).

Pietrangeli next turned to deficit and privately-held net marketable borrowing projections, noting that estimates from the primary dealers, the Congressional Budget Office (CBO), and the Office of Management and Budget (OMB) differ in their assumptions for future legislation, Treasury's cash balance, and redemptions from the Federal Reserve System Open Market Account (SOMA). Primary dealers broadly expected lower deficits the next three fiscal years compared to the previous two, but also noted the potential for earlier-than-previously-expected SOMA redemptions of Treasury securities to increase Treasury's privately-held net marketable borrowing needs.

Pietrangeli noted that based on the outlooks from the CBO, OMB, and primary dealers, current auction sizes provide Treasury with financing capacity that exceeds likely borrowing needs in the near to intermediate term. Based on the primary dealers' median net privately-held borrowing estimates and current auction sizes, there appears to be scope to reduce nominal coupon issuance by around $1.0 trillion over the next three fiscal years. Noting the range of primary dealers' estimates, Pietrangeli cautioned that there is significant uncertainty in forecasted deficits and SOMA redemptions, warranting gradual adjustments under the regular and predictable paradigm while continuing to evaluate the financing outlook.

Finally, Pietrangeli referenced Treasury's Office of Fiscal Projections estimates of privately-held net marketable borrowing of $729 billion and $66 billion over the next two quarters, based on current law and assuming a cash balance of $650 billion at the end of March and $700 billion at the end of June. Furthermore, these Treasury estimates do not incorporate any potential SOMA redemptions of Treasury securities.

Debt Manager Katzenbach then reviewed Treasury's cash management approach, reiterating that Treasury seeks to maintain funds sufficient to cover its one-week ahead cash need, which includes both net fiscal outflows and the gross volume of maturing marketable debt. Under this policy, Treasury also takes into consideration cash flow uncertainty that can result from a variety of factors, including changes in economic activity influencing tax revenue, irregular outlays from federal programs, and the potential for legislative changes that affect short-term cash flows. Katzenbach noted that variations in cash flows over time result in Treasury's liquidity needs differing significantly week-to-week, but that Treasury seeks to change auction sizes gradually to minimize any potential market disruption. This process often results in Treasury holding a cash balance above the minimum level necessary to meet its projected one-week ahead cash need. Katzenbach reported that, since May 2015, Treasury has maintained a median of 7 business days of liquidity. Katzenbach concluded with a case study from January to February 2020 as an illustrative example of Treasury's cash management approach.

Next, Debt Manager Taylor summarized primary dealers' outlooks for Treasury nominal coupon and floating rate note (FRN) auction sizes. Consistent with the forecasts that Treasury would be over-financed at current auction sizes, all primary dealers expected Treasury to continue reductions across nominal coupon and FRN auction sizes this upcoming quarter. Nearly all primary dealers expected Treasury to announce a repeat of the reductions announced in November for shorter tenors, the 2-year FRN, the 10-year note, and the 30-year bond. In contrast, views were split on the 7-year note and 20-year bond, with expectations for equal or slightly reduced cuts compared to November. A large number of primary dealers also noted that if coupon auction sizes were not reduced this quarter, bills as a percentage of debt outstanding would likely decline below the Committee's recommended range of 15 to 20 percent within the next few fiscal years. Beyond this upcoming quarter, primary dealers were less certain whether further auction size reductions would be necessary, noting several remaining questions about the timing, pace, and composition of the SOMA redemptions, which will increase net privately-held borrowing needs when they occur. Primary dealers generally expected Treasury to evaluate the need for additional reductions in nominal coupon and FRN auction sizes ahead of the May quarterly refunding.

Debt Manager Lee then reviewed primary dealers' views on how the Federal Reserve's reduced pace of asset purchases is affecting Treasury market functioning and liquidity and their expectations for the Federal Reserve's eventual policy normalization with respect to the balance sheet. Primary dealers broadly noted that the Treasury market continued to function smoothly amid the Federal Reserve's tapering of asset purchases and the effect on liquidity conditions had been minimal with some reduced liquidity in more seasoned off-the-runs. In regard to balance sheet runoff, most primary dealers thought the Federal Reserve would begin SOMA redemptions this summer, would cap monthly redemptions, and these caps would reach a maximum of $50 to $60 billion for Treasury securities by the end of this calendar year. However, several primary dealers noted that the risks to their base case expectations were skewed toward an earlier start date given the communication around the January Federal Open Market Committee meeting. Regarding composition, around half of the primary dealers thought the Federal Reserve may include bills in their redemptions. Finally, primary dealers thought redemptions could last several years, but noted estimates about the size of SOMA holdings when redemptions ended were still very uncertain.

Deputy Director Steele then summarized primary dealers' responses regarding whether Treasury should consider moderate increases in Treasury Inflation-Protected Securities (TIPS) auction sizes in the upcoming quarters. A majority of primary dealers were supportive of moderate increases this year, in order to further stabilize or to slightly increase TIPS as a percentage of debt outstanding. Several primary dealers also observed that the broadening of investor interest in the asset class is expected to be sustained even in an environment of lower realized inflation. Primary dealers suggested that TIPS auction size increases should be focused in the 5- and 10-year tenors. However, some advised caution about the pace of issuance changes given the uncertainty about the inflationary outlook and how TIPS demand may respond to the expected tightening of domestic monetary policy. The Committee then discussed TIPS issuance and reiterated their previous recommendation to incrementally increase TIPS auction sizes this year, particularly the 5- and 10-year TIPS auction sizes, and continue to monitor demand and liquidity conditions.

Next, the Committee turned to a presentation on the market's response to recent auction size changes and new developments that Treasury should consider as it evaluates to what extent auction sizes should be changed further. The presenting member stated that the market anticipated another round of coupon cuts in February, at the same pace as those announced in November. However, the presenting member noted that despite larger cuts in the 7-year note and 20-year bond, these tenors still showed signs of potential oversupply on a relative value basis. The presenting member then reviewed future auction size scenarios, given assumptions about future fiscal legislation, expectations for the cash balance, and expectations about the SOMA runoff. The presenting member concluded by advising Treasury to make further cuts in February that were equivalent to the cuts made in the prior quarter and consider making additional cuts in May. This recommendation would keep bills as a percentage of debt outstanding within the Committee's recommended range of 15 to 20 percent over the next few fiscal years, resulting in only modest increases in the weighted average maturity and duration of total debt outstanding, as well as further address the supply and demand imbalances in the 7-year note and 20-year bond.

Finally, the Committee discussed its financing recommendation for the upcoming quarters. The Committee recommended that Treasury continue with coupon auction size reductions across tenors during the upcoming refunding quarter with slightly larger reductions in the 7-year note and 20-year bond, maintaining the same sized cuts announced in November. Looking ahead to the next quarter, the Committee expects that further reductions may be necessary but likely at a slower pace, noting a high degree of uncertainty around future funding needs including those tied to evolving expectations for SOMA redemptions. The Committee then discussed various scenarios for future quarters in the context of the effect on portfolio measures such as the share of bills and WAM. For example, the Committee considered slowing reductions across the curve, or focusing future reductions on longer-end maturities. In both cases, the Committee emphasized the importance of Treasury being regular and predictable in its issuance decisions and noted the increased level of uncertainty regarding future financing needs.

The Committee adjourned at 2:00 p.m.

The Committee reconvened at 5:00 p.m. The Chair summarized key elements of the Committee report for Secretary Yellen and followed with a brief discussion of recent market developments.

The Committee adjourned at 5:30 p.m.

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Brian Smith

Deputy Assistant Secretary for Federal Finance

United States Department of the Treasury

February 1, 2022

Certified by:

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Elizabeth Hammack, Chair

Treasury Borrowing Advisory Committee

February 1, 2022

TREASURY BORROWING ADVISORY COMMITTEE QUARTERLY MEETING

COMMITTEE CHARGE – FEBRUARY 1, 2022

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, if any, do you recommend to Treasury issuance? Please also provide perspectives regarding market expectations for Treasury issuance, the effects of SOMA investments, the evolution of Treasury holdings by different types of investors, as well as auction calendar construction.

Considerations for Further Auction Size Changes

In November 2021, based on projected borrowing needs and consistent with the TBAC's recommendations, Treasury began reducing auction sizes across all nominal coupon securities. How has the market responded to these auction size changes? Looking ahead, what new developments or additional factors should Treasury consider as it evaluates to what extent auction sizes should be further changed?

Financing this Quarter

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

- The composition of Treasury notes and bonds to refund approximately $54.8 billion of privately-held notes and bonds maturing on February 15, 2022.
- The composition of Treasury marketable financing for the remainder of the January-March 2022 quarter.

- The composition of Treasury marketable financing for the April-June 2022 quarter.