Minutes of the Meeting of the Treasury Borrowing Advisory Committee May 3, 2022

May 4, 2022

The Committee convened in a closed session at the Department of the Treasury at 9:00 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 Chris Cameron, Dave Chung, Alexander Demyanets, Joshua Frost, Tom Katzenbach, Chris Kubeluis, Kyle Lee, Brett Solimine, Renee Tang, and Brandon Taylor. Federal Reserve Bank of New York staff members Susan McLaughlin, Monica Scheid, and Nathaniel Wuerffel were also present.

Under Secretary Liang began the meeting by summarizing recent developments in debt management and outlining other related Treasury priorities. Liang then noted that this would be Ajay Rajadhyaksha's last meeting as a member of the Committee and thanked him for his service.

Next, Director Pietrangeli provided brief highlights of changes in receipts and outlays for Q2 FY2022. Receipts totaled $2.12 trillion, an increase of $418 billion (25%) compared to Q2 FY2021, largely reflecting the strong economy. Adjusted withheld and FICA taxes rose $285 billion (21%) and gross corporate taxes increased $20 billion (16%). Outlays totaled $2.79 trillion, a decrease of $620 billion (-18%) compared to the same period of the previous year. The largest decrease in outlays came from the Department of Treasury, which were $326 billion (-38%) lower. The decrease was attributable predominantly to lower (-$510 billion) Economic Impact Payments and Covid-related relief payments, partially offset by higher tax credits, such as the Child Tax Credit ($86 billion), and higher interest on the public debt ($62 billion).

Pietrangeli noted surprisingly strong growth in tax receipts for the first half of FY2022, indicating that the fiscal outlook had improved by about $250 billion since the Committee last met. Based on preliminary analysis, the largest surprise was in the non-withheld category, but it was too early to determine if this surprise was idiosyncratic or the beginning of a trend toward stronger non-withheld receipts.

Pietrangeli then turned to deficit and privately-held net marketable borrowing projections, noting that estimates from the Office of Fiscal Projections (OFP), the Congressional Budget Office (CBO), the Office of Management and Budget (OMB), and the primary dealers differ in their assumptions about Treasury's cash balance and redemptions from the Federal Reserve System Open Market Account (SOMA). The primary dealer survey occurred while April tax receipts were still being processed, and as a result the primary dealer responses may not fully reflect the strong growth in receipts evident in Treasury's announcement of borrowing estimates on Monday, May 2. Adjusting for the differences, most FY2022 estimates of privately-held net marketable borrowing were around $1.7 trillion. Primary dealers broadly expected lower deficits over the next three fiscal years compared to the previous two, but also noted that SOMA redemptions of Treasury securities are expected to increase Treasury's privately-held marketable borrowing needs, particularly in future fiscal years.

Pietrangeli noted that these forecasts would suggest that current coupon auction sizes provide Treasury with financing capacity that exceeds expected borrowing needs in the near term and there appears to be scope to continue to reduce nominal coupon issuance in the current fiscal year. Noting the range of primary dealers' estimates, Pietrangeli stressed that there remains significant uncertainty in forecasted deficits and borrowing needs, warranting gradual adjustments under the regular and predictable paradigm while continuing to evaluate the financing outlook.

Next, Debt Manager Taylor summarized primary dealers' outlooks for Treasury nominal coupon and floating rate note (FRN) auction sizes. Given their expectation that current auction sizes will provide Treasury with financing capacity that exceeds borrowing needs in the near term most primary dealers expect another round of reductions to coupon auctions, though they expect these reductions to be smaller than those implemented in the prior two quarters. They noted that SOMA redemptions of Treasury securities would result in additional Treasury borrowing needs from the private sector, but they consider Treasury well positioned to address redemptions over the near term. On the composition of reductions in nominal coupons, primary dealers' expectations were split between adjustments across the curve versus focusing decreases on the 7-, 10-, 20-, and 30-year tenors. In addition, roughly half of the primary dealers expected relatively larger reductions for the 7-year compared to other tenors, while most expected a relatively larger reduction for the 20-year compared to other tenors, though in both cases the reductions for these tenors expected by dealers were still smaller than those implemented in the past two quarters. Finally, for the FRN, a slight majority of primary dealers expected no change in auction sizes, with the remainder expecting either the same or slightly smaller reductions from last quarter. Primary dealers noted demand for FRNs has been high based on market participants' expectations for interest rates to increase over the course of the year.

Debt Manager Lee then reviewed primary dealers' views on the Federal Reserve's balance sheet reduction in light of the minutes of the March meeting of the Federal Open Market Committee (FOMC). Primary dealers thought that SOMA redemptions would begin in May or June this year with a maximum redemption cap of $60 billion for Treasury securities, with most expecting the caps to be phased in over three months. There was a wide range of views and low conviction for when balance sheet reduction would end. Given FOMC communication on its intention to hold primarily Treasury securities in the SOMA in the long run, primary dealers expected the FOMC, at some future point, to consider sales of mortgage-backed securities (MBS) and reinvestments of MBS principal payments into Treasury securities. Primary dealers thought Treasury was well positioned to meet additional borrowing needs due to SOMA redemptions in the near term but may need to consider increases to coupon issuance in future fiscal years depending on the total size of SOMA redemptions.

Next, Deputy Director Steele summarized primary dealers' responses regarding whether Treasury should continue modest increases in Treasury Inflation-Protected Securities (TIPS) auction sizes for the rest of calendar year 2022. Most primary dealers were supportive of continued gradual increases this year, in order to further stabilize or to slightly increase TIPS as a percentage of debt outstanding. Primary dealers suggested that TIPS auction size increases should be focused in the 5- and 10-year tenors, with some recommending increases only in the 5-year tenor given higher demand in the short-end. A few primary dealers noted risks that lower realized inflation outcomes could affect TIPS demand and suggested that Treasury consider only gradual increases in TIPS auctions sizes. While most primary dealers noted recent liquidity strains in the TIPS market, they attributed lower liquidity to factors unrelated to recent increases in issuance sizes and expected additional modest increases in TIPS auction sizes to have little impact on trading conditions.

Next, the Committee turned to a presentation on Treasury market trading conditions since the beginning of the year and how evolving inflation and monetary policy expectations, as well as heightened geopolitical tensions, affected market volatility and liquidity. The presenting member stated that while liquidity conditions since the beginning of the year appeared worse based on some metrics, other metrics showed no significant deterioration. Funding markets were functioning properly and were not a factor contributing to strained liquidity conditions. The lower liquidity was largely due to elevated volatility as a result of the elevated uncertainty around the inflation, monetary policy, and geopolitical outlook. The Committee then discussed the presentation, with several members noting that liquidity conditions could also be affected by the Federal Reserve's balance sheet reduction.

Next, the Committee turned to a presentation on the 4-month, or 17-week, cash management bill (CMB). The presenting member noted that Treasury should take into account the trajectory of future bill issuance, current and future demand for the 4-month CMB compared to benchmark bills, and whether this benchmark offering would complement the current debt management process. Based on the projected growth in bill issuance in the longer term, strong expected future demand, and the compatibility of the 4-month bill issuance patterns and maturities for both investors and Treasury, the presenting member recommended that Treasury should consider moving the 4-month CMB to benchmark status.

For additional context, Debt Manager Katzenbach then reviewed prior primary dealer feedback on the topic. Katzenbach reminded the Committee that, in October 2021, most primary dealers suggested that Treasury should consider making the 4-month CMB a benchmark tenor and commonly cited robust investor demand. At that time, primary dealers also provided estimates for existing benchmark bill auction sizes that would not cause significant yield deviations from fair value, and the median response implied that existing benchmarks could accommodate no more than $3.8 trillion in privately-held bill supply. Katzenbach reiterated that this feedback suggests that issuing bills via existing benchmarks alone, without issuing 4-month bills, might limit Treasury's flexibility in meeting projected bill supply needs.

The Committee unanimously supported the recommendation to make the 4-month bill a benchmark tenor.

Finally, the Committee discussed its financing recommendation for the upcoming quarters. In light of the strength in federal tax receipts as well as the prospect for Federal Reserve balance sheet reductions, 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, but at a slower pace than cuts announced in November and February. The Committee noted that these reductions to nominal coupon issuance would likely maintain the share of bills within, but towards the lower end of, its recommended 15 to 20 percent range over time. Furthermore, the Committee emphasized the need for Treasury to remain nimble in its debt management decisions, given the ongoing uncertainty in borrowing needs; the strength in receipts should be monitored to determine if it is more of an anomaly or a trend that could warrant additional cut to coupons in the subsequent quarters.

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 6:00 p.m.

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Brian Smith

Deputy Assistant Secretary for Federal Finance

United States Department of the Treasury

May 3, 2022

Certified by:

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Elizabeth Hammack, Chair

Treasury Borrowing Advisory Committee

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TREASURY BORROWING ADVISORY COMMITTEE QUARTERLY MEETING

COMMITTEE CHARGE – MAY 3, 2022

Recent Liquidity Conditions

Please discuss Treasury market trading conditions since the beginning of the year. How have evolving monetary policy expectations and heightened geopolitical tensions affected Treasury market volatility and liquidity conditions? Has the change in liquidity conditions been consistent with change in volatility? How have different types of liquidity providers been affected by these conditions, and to what extent have they changed their liquidity provision in response?

17-Week Bill as Benchmark

Treasury has regularly been issuing the 17-week cash management bill since April 2020 and last refunding stated it would announce a decision on whether to change the 17-week to benchmark status at an upcoming refunding. Based on your recommendations for the appropriate level of bills outstanding in the medium to long term, should Treasury change the 17-week to benchmark status? What factors should Treasury consider before making a decision on the 17-week?

Financing this Quarter

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

- The composition of Treasury notes and bonds to refund approximately $47.8 billion of privately-held notes maturing on May 15, 2022.

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