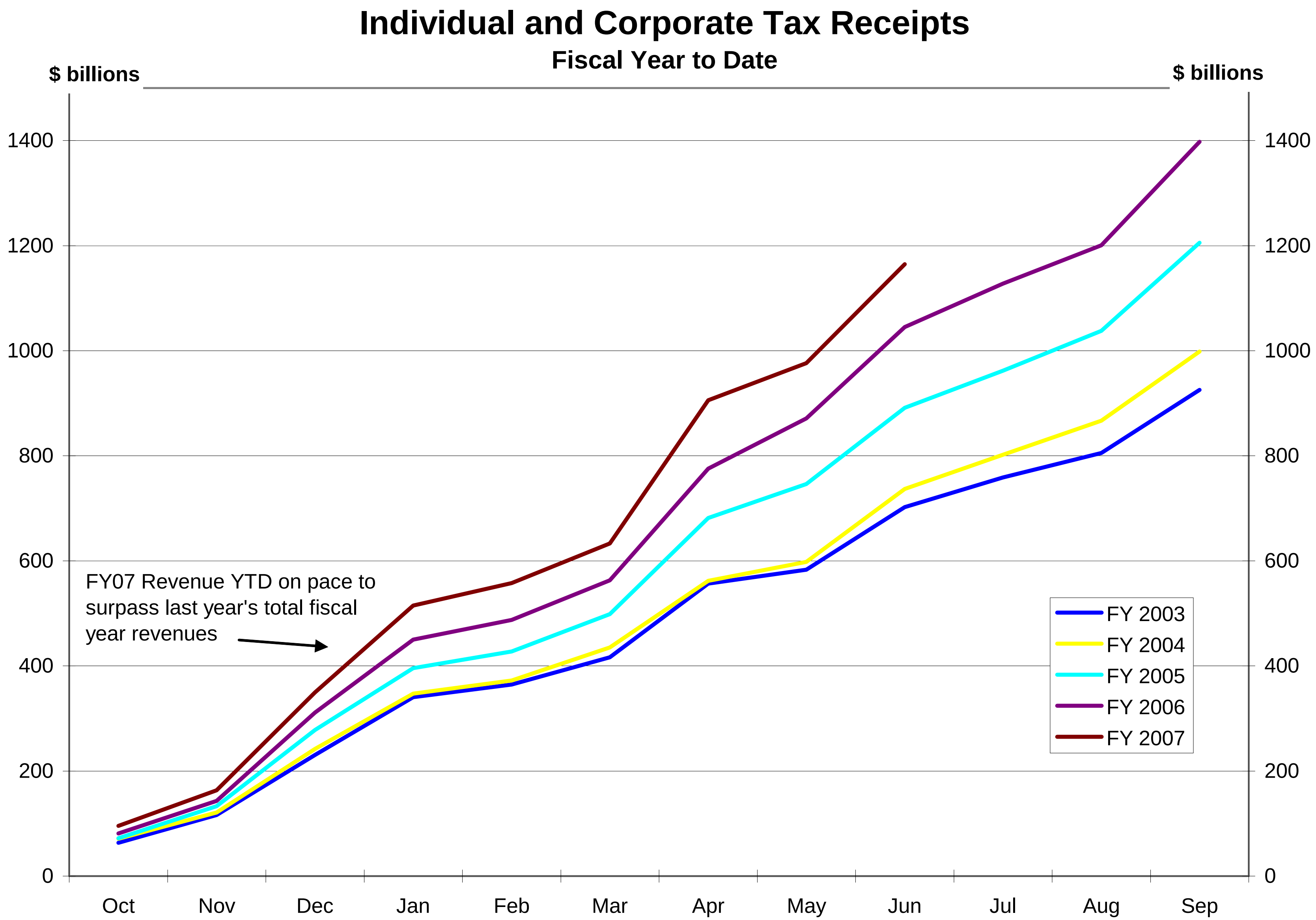
Presentation to the
Treasury Borrowing Advisory Committee

U.S. Department of the Treasury
Office of Debt Management
July 31, 2007

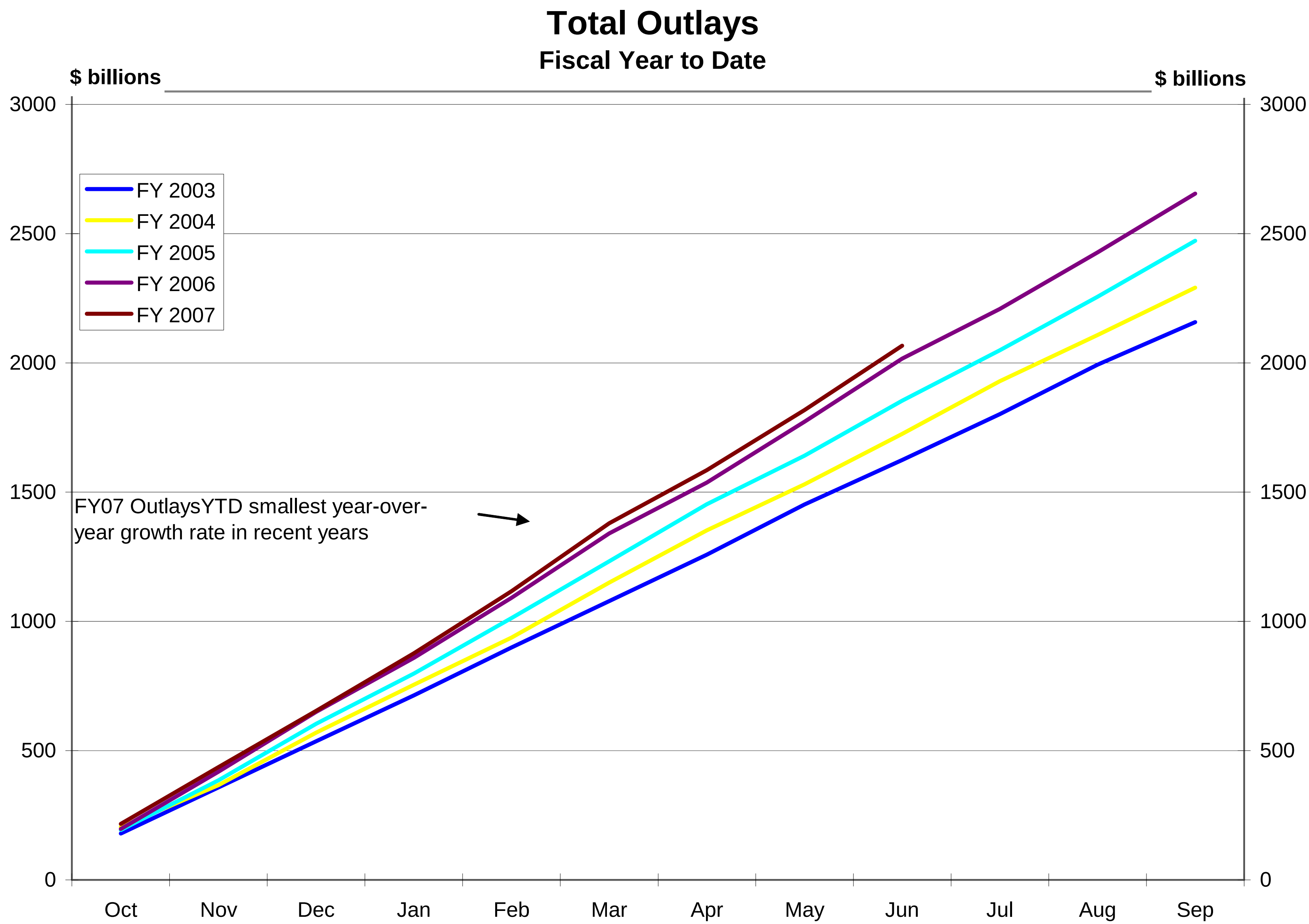
Notable items since May 2007

- OMB released its Mid-Session Review in mid-July:
  - Revised down its FY 2007 budget deficit forecast from $244 billion to $205 billion
  - Marginally revised up its FY 2008 budget deficit forecast to $258 billion
  - Continues to forecast a budget surplus in 2012
- SLGS issuance has slowed from very high levels
- Discontinued issuance of the 3-year note
- Experienced another strong April tax season

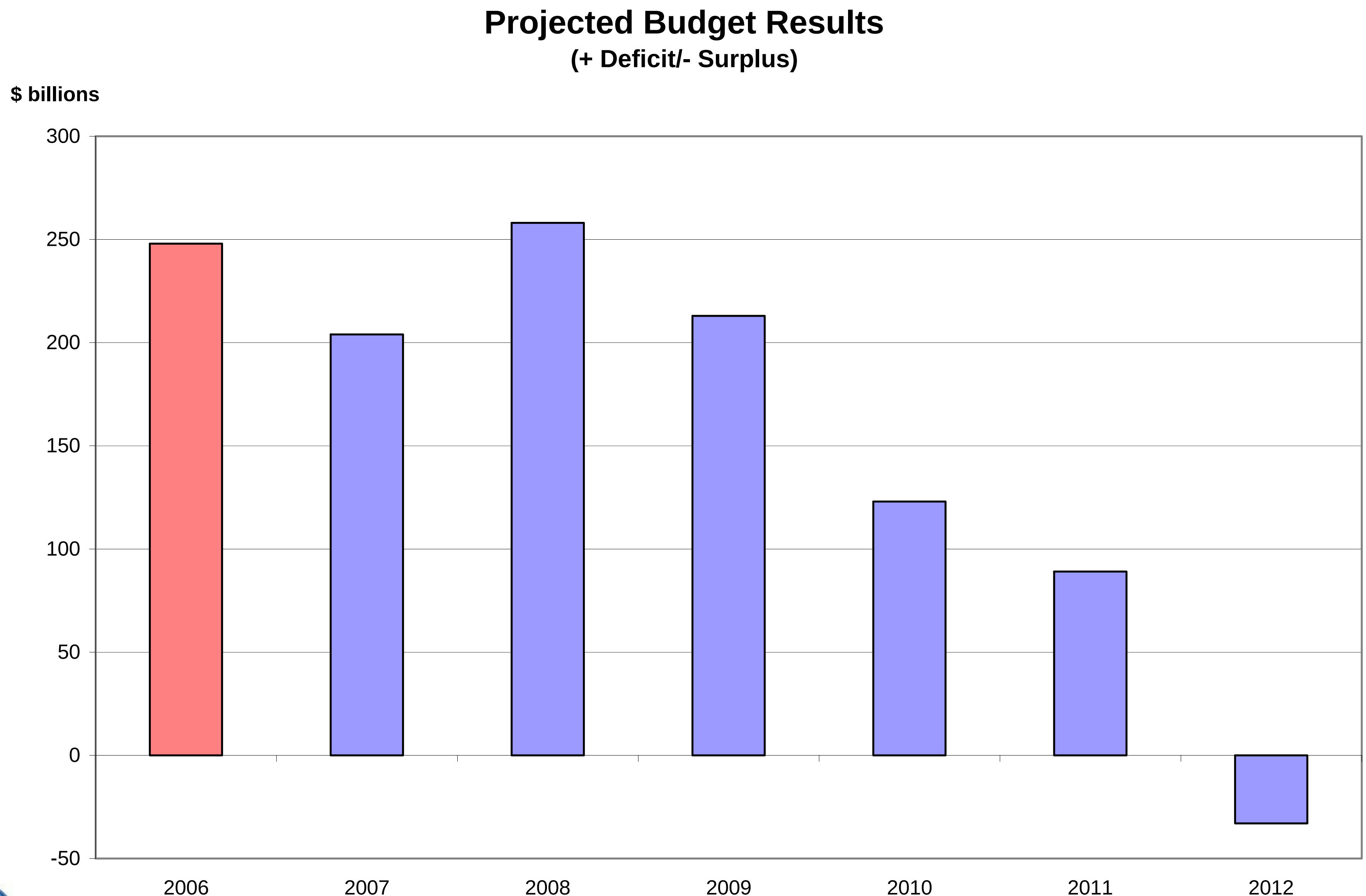
Year to date tax receipts continue to grow



YTD outlay growth continues at slower pace than in recent years

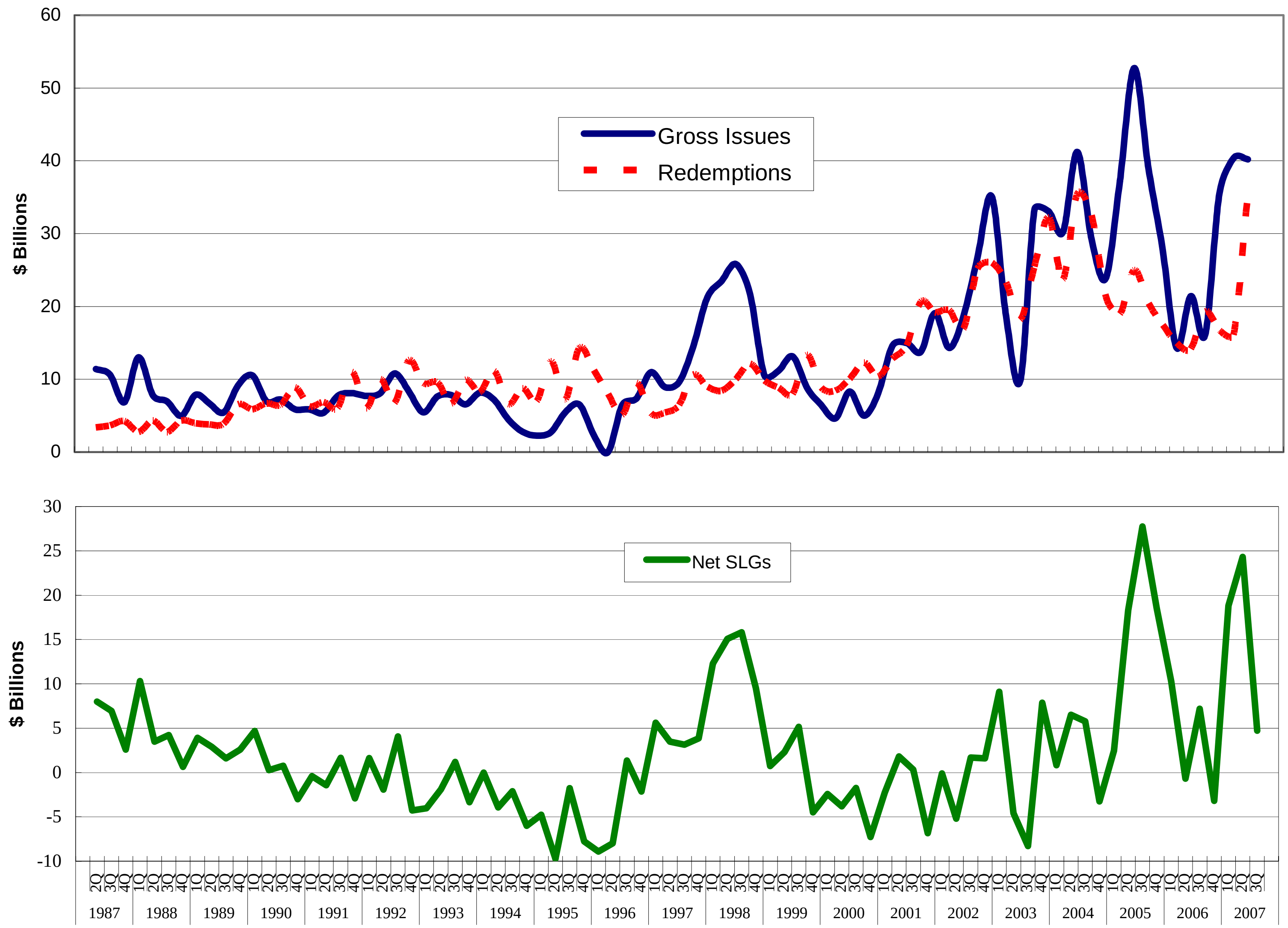


OMB expects improvement to budget deficits after FY 2008

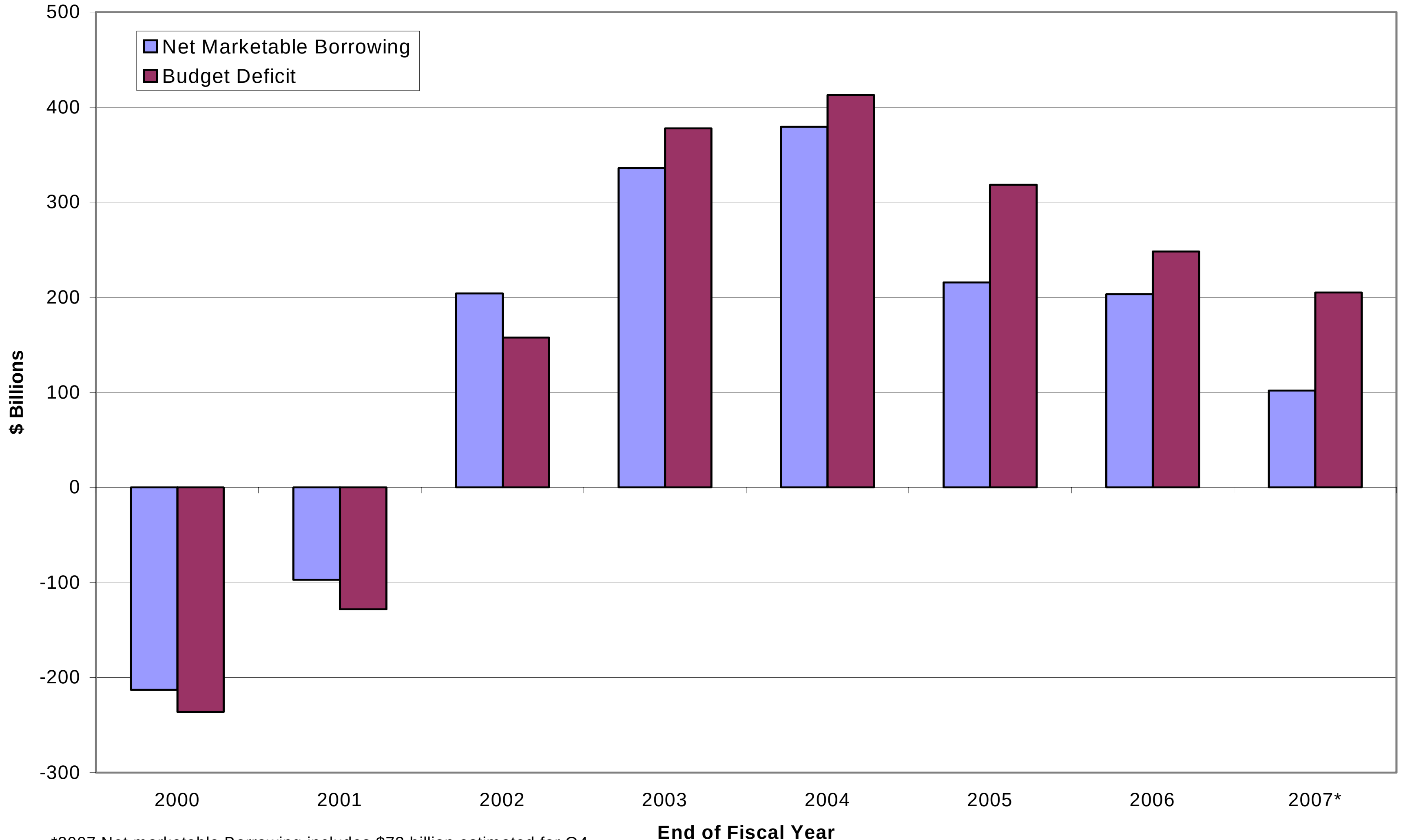


Net SLGS Issuance in FY 2007 has been very high, but slowed recently

State and Local Governments (SLGS)

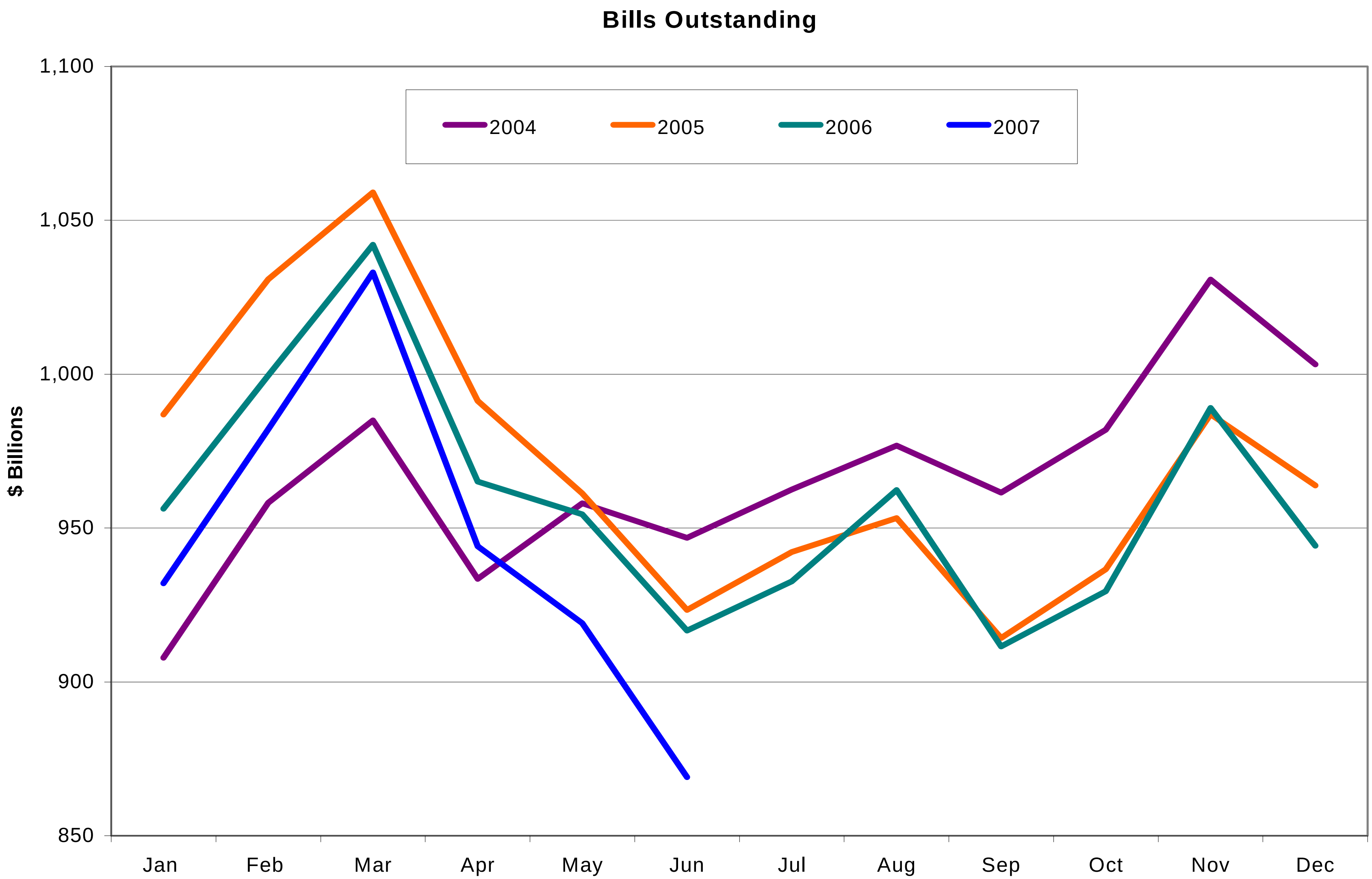


Marketable Debt Net Issuance Historically Low

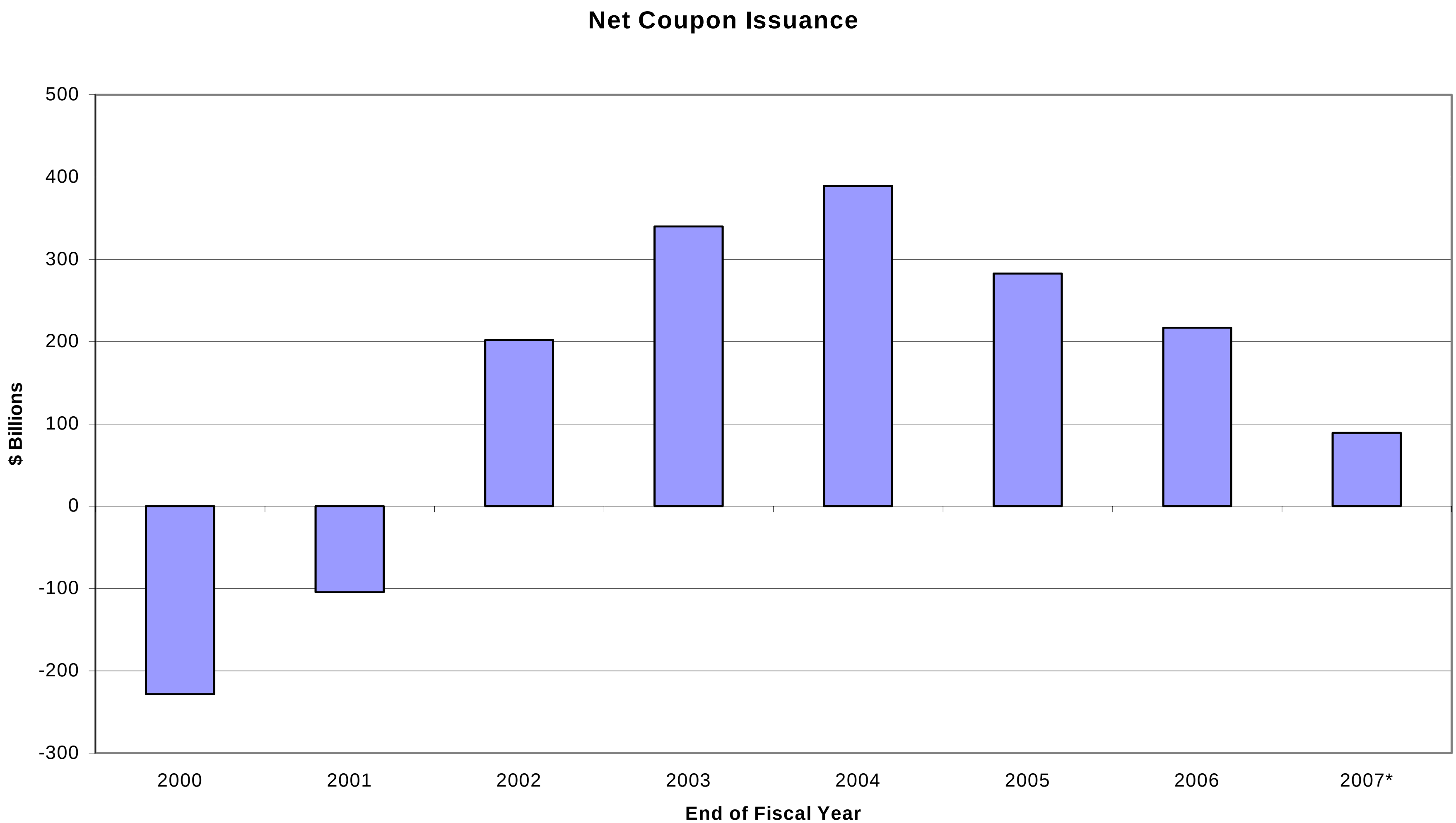


*2007 Net marketable Borrowing includes $73 billion estimated for Q4.
2007 Budget Deficit from OMB's Mid Session Review.

Leading to Decline in Bills Outstanding



And Reduced Coupon Issuance



Net financing projections for FY 2007 are based on internal FY 2007 deficit estimate. Future residual financing needs are spread proportionally across auctioned securities, based on coupon auction sizes in the prior quarter and September 30, 2006 bills outstanding.

Future Financing and Portfolio Considerations

- Market participants suggest that current auction sizes of benchmark coupon securities are at or near minimum sizes to ensure liquidity
- The deficit has been cut in half ahead of schedule, and the OMB forecasts a balanced budget by 2012
- From February to July, the deficit forecast has dropped by almost $40 billion
- We aim to preserve flexibility to address a range of fiscal outcomes

- In light of intermediate and longer-term fiscal trends as well as recent economic and market conditions, what advice would the Committee give in terms of Treasury's debt issuance?

The Costs of Inaction Regarding Entitlement Reform:
Potential Implications for Treasury Debt Issuance, Interest Costs, and Overall Market Dynamics

Treasury Borrowing Advisory Committee Presentation to the US Treasury

July 31, 2007

Executive Summary

- A long run Treasury financing model has been used to attempt to quantify the potential implications of rising entitlement spending.

- The output is based on three alternative baseline budget scenarios originally developed by the Congressional Budget Office.

- The findings imply a very large future financing need under each of CBO's scenarios.
    - For example, even under the most optimistic budget outlook, 2-year note issuance will be nearly $380 billion per <u>month</u> by 2050.

    - In the most pessimistic scenario, 2-year note issuance reaches $1.9 trillion per <u>month</u>.

- In relation to the size of the economy, it is estimated that gross coupon issuance will need to be between four and fifteen times as large as at present by 2050.

- The sharp elevation in the financing needs starts to become apparent as early as 2020.

Long Run Treasury Financing Model Assumptions

1) Budget deficit forecast of $170 billion in FY 2007.

2) CBO long range alternative budget scenarios A, B and C for FY 2012 to FY 2050 (an interpolation was used for the FY 2008-2011 period). A description of these scenarios appears on the next page.

3) Hold Treasury bills at 25% of debt outstanding.

4) Increase coupon sizes in proportion to their current share of gross issuance.

5) End of FY cash balance target remains at $45 billion.

6) Net Non-marketable issuance and Miscellaneous Means of Financing are set equal to zero after FY 2008.

7) **No** Entitlement Reform

Source: CBO, The Long Term Budget Outlook, December 2005

Scenario Analysis based on CBO Assumptions

Scenario A (Intermediate Spending/High Revenue)

Medicare & Medicare Spending	Excess cost growth of 1 percentage point
Defense	Gradual phase down through 2024, then grow at CPI
Individual Income Taxes	Current law (i.e., higher rates after 2010)

Scenario B (High Spending/High Revenue)

Medicare & Medicare Spending	Excess cost growth of 2.5 percentage points
Defense	FYDP[1] through 2024, then grow at CPI
Individual Income Taxes	Current law (i.e., higher rates after 2010)

Scenario C (High Spending/Low Revenue)

Medicare & Medicare Spending	Excess cost growth of 2.5 percentage points
Defense	FYDP[1] through 2024, then grow at CPI
Individual Income Taxes	Hold at long run average (18.3% of GDP)

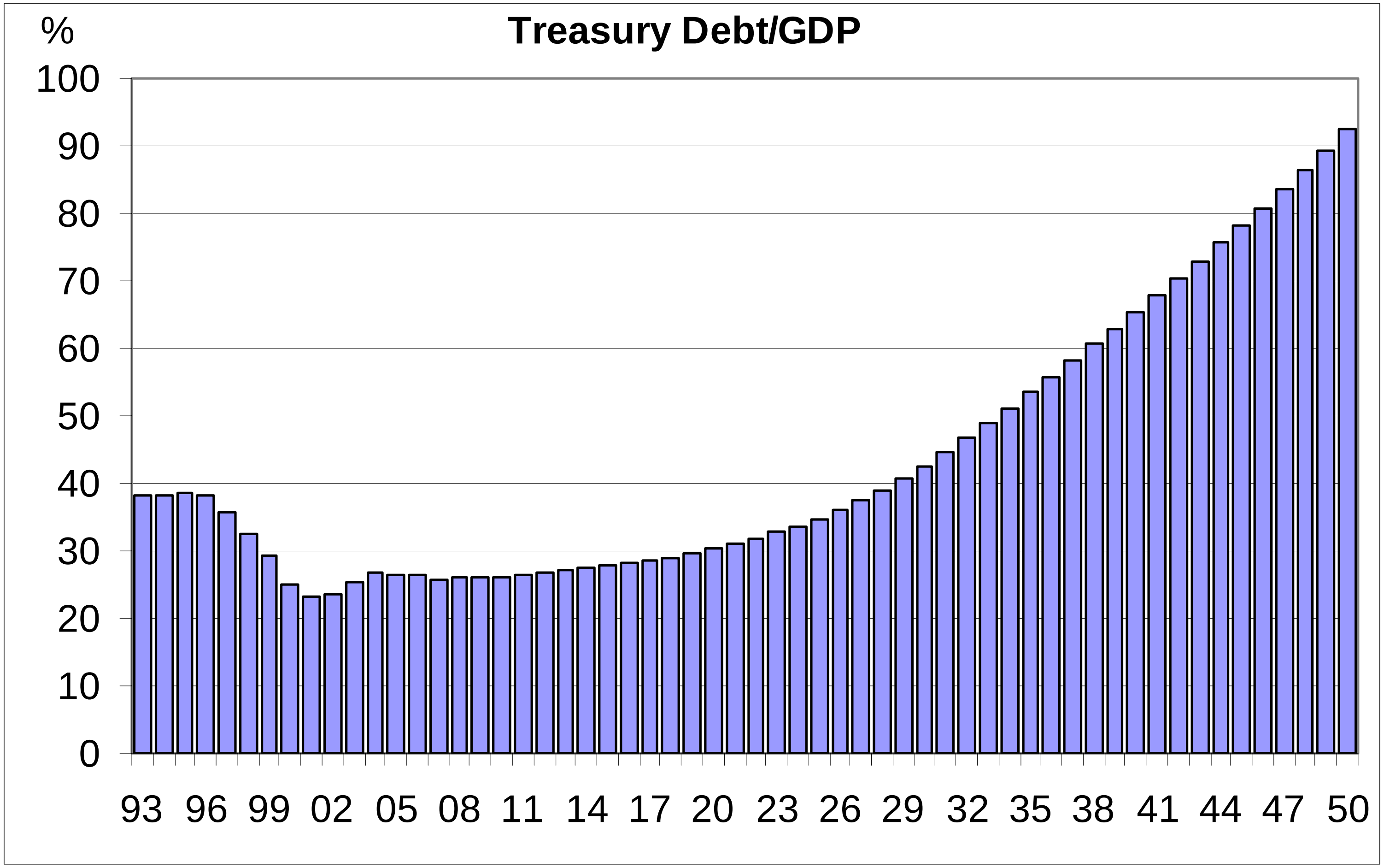
Common Assumptions for All Scenarios

No Entitlement Reform

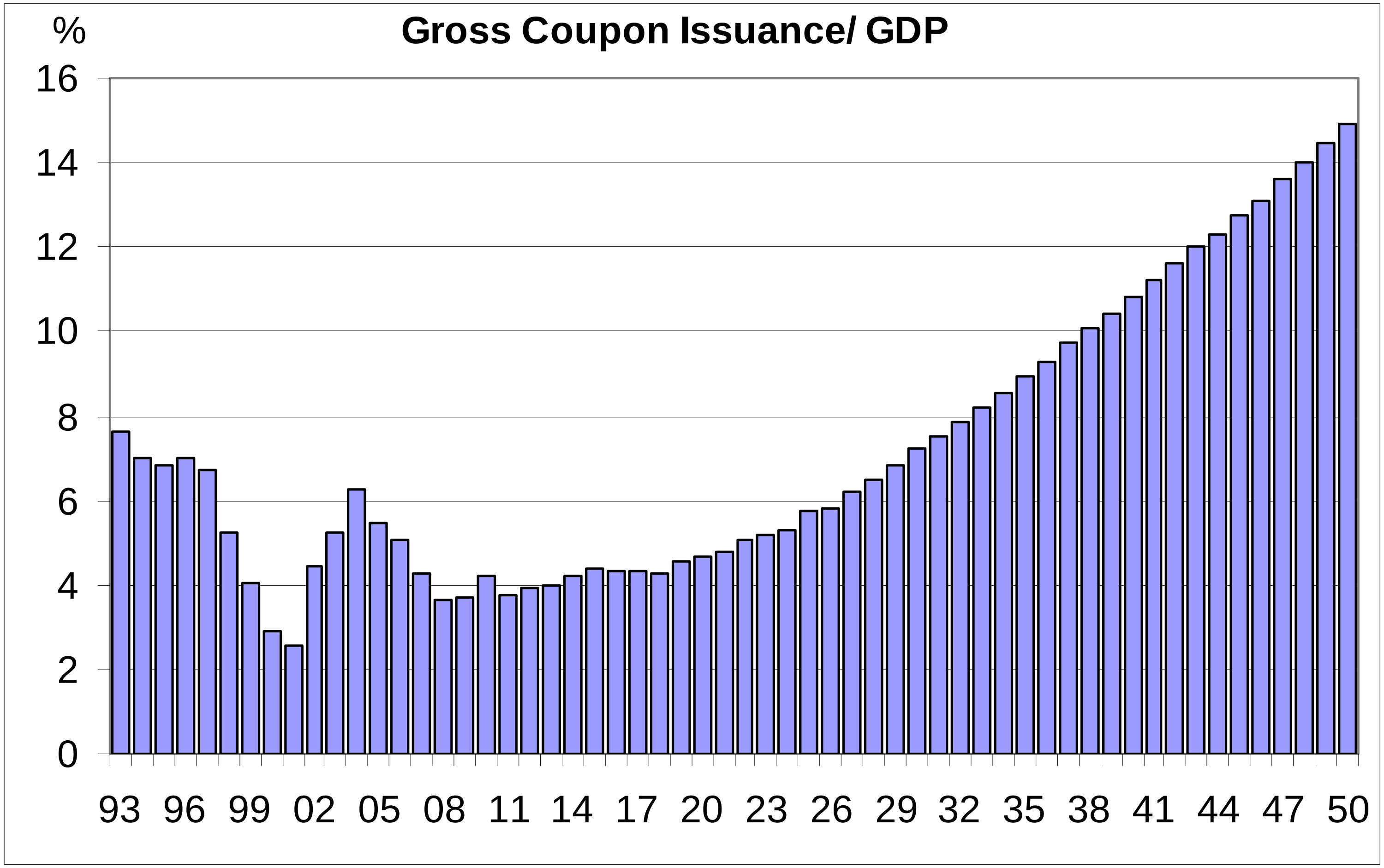
Social Security	Benefits paid as scheduled under current law
Other Nondiscretionary Spending	Hold at 2005 level as % of GDP
Other Discretionary Spending	Hold at historical share of GDP (3.6%)
Payroll Taxes	Current law
Other Taxes	Hold at 2014 level as share of GDP

1. FYDP - Future Years Defense Program (with allowances for cost risks and additional spending to support the war on terrorism).
Source: CBO, The Long Term Budget Outlook, December 2005.

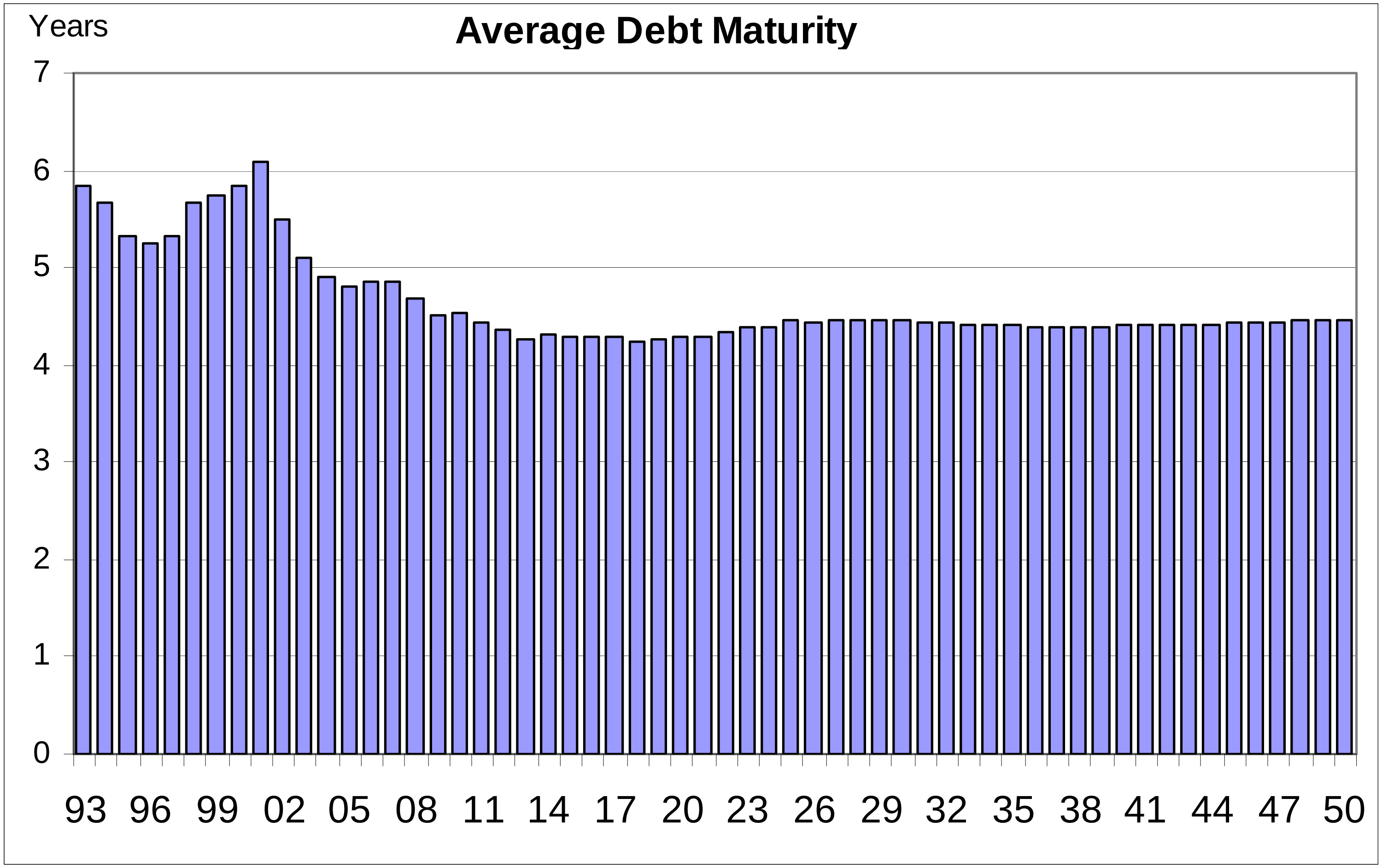
Scenario A - Intermediate Spending/High Revenue
Debt/GDP Implications



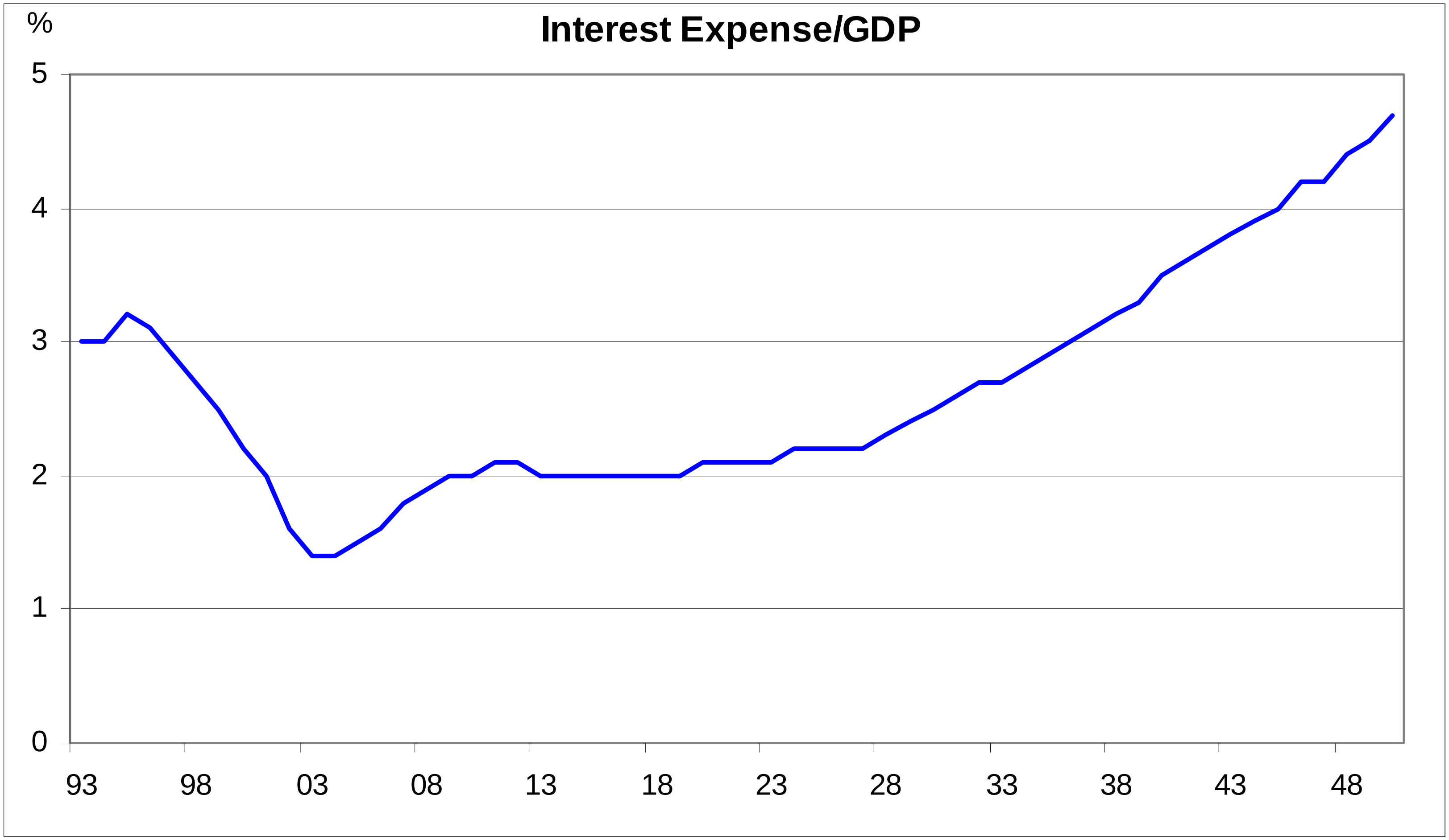
Scenario A - Intermediate Spending/High Revenue
Gross Coupon Issuance/GDP Implications



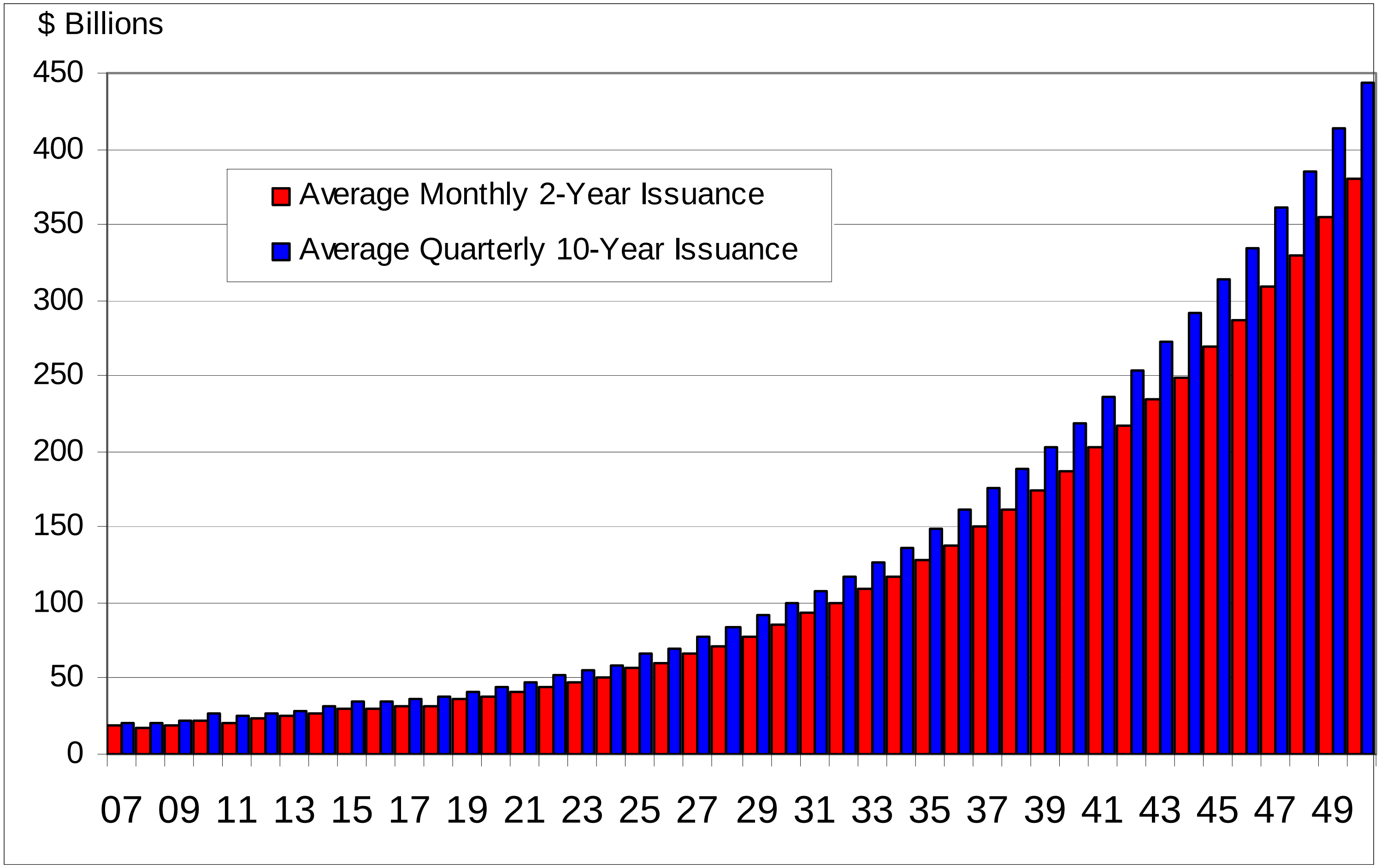
Scenario A - Intermediate Spending/High Revenue
Average Maturity of Debt Outstanding Implications



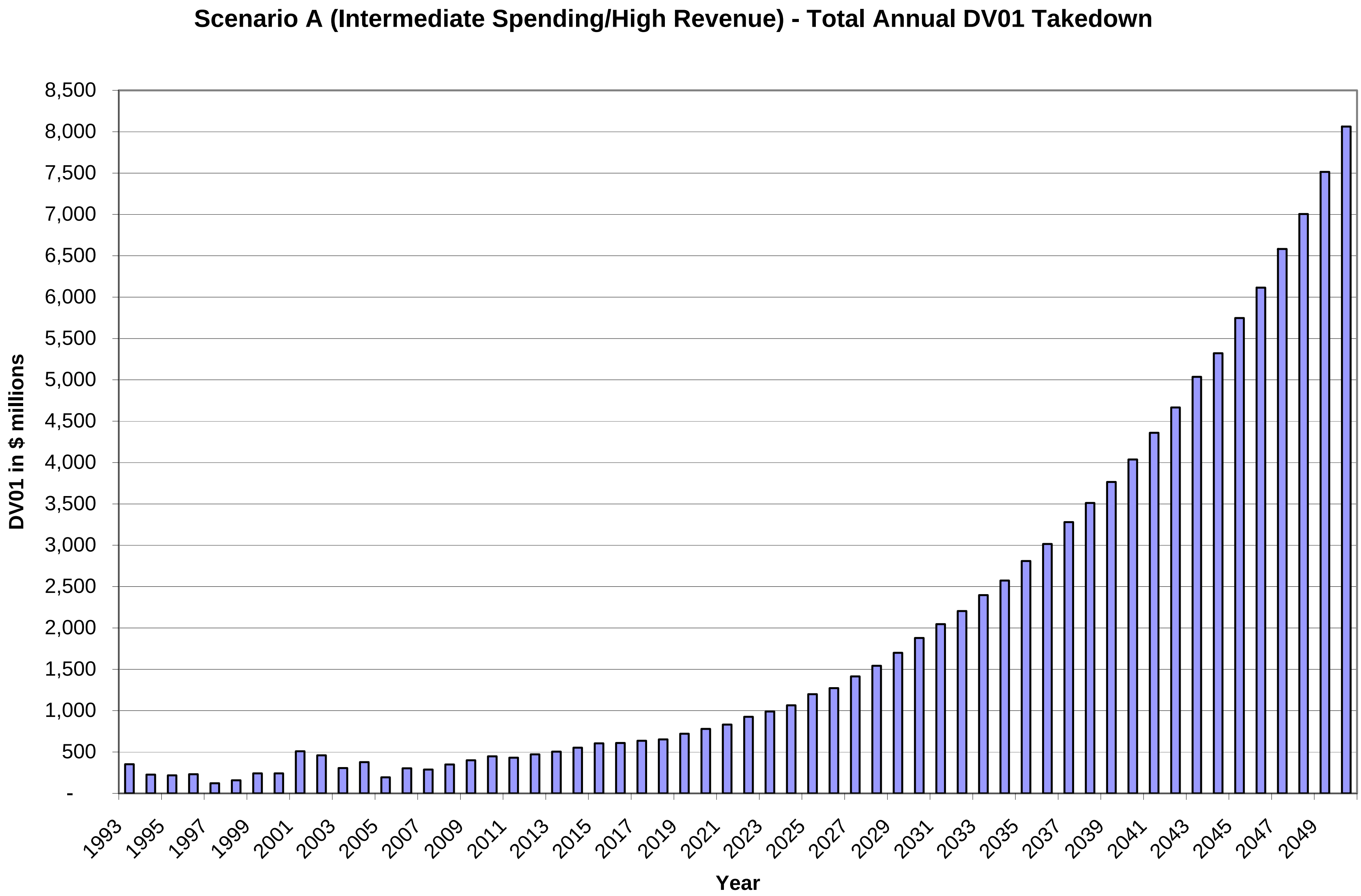
Scenario A - Intermediate Spending/High Revenue
Potential Interest Cost as a Percent of GDP



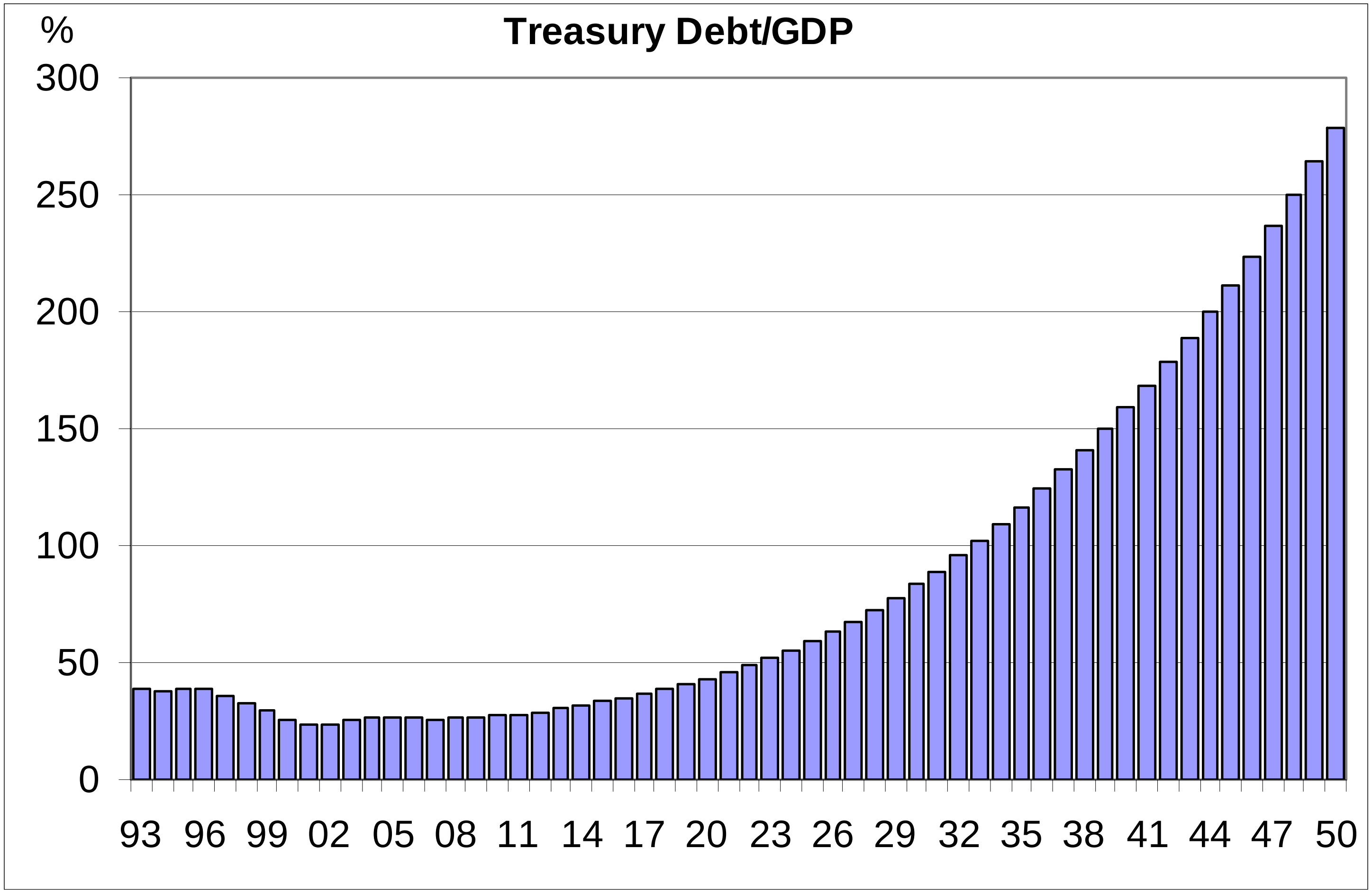
Scenario A - Intermediate Spending/High Revenue
Potential Size of Average Monthly 2-Year and Quarterly 10-Year Note



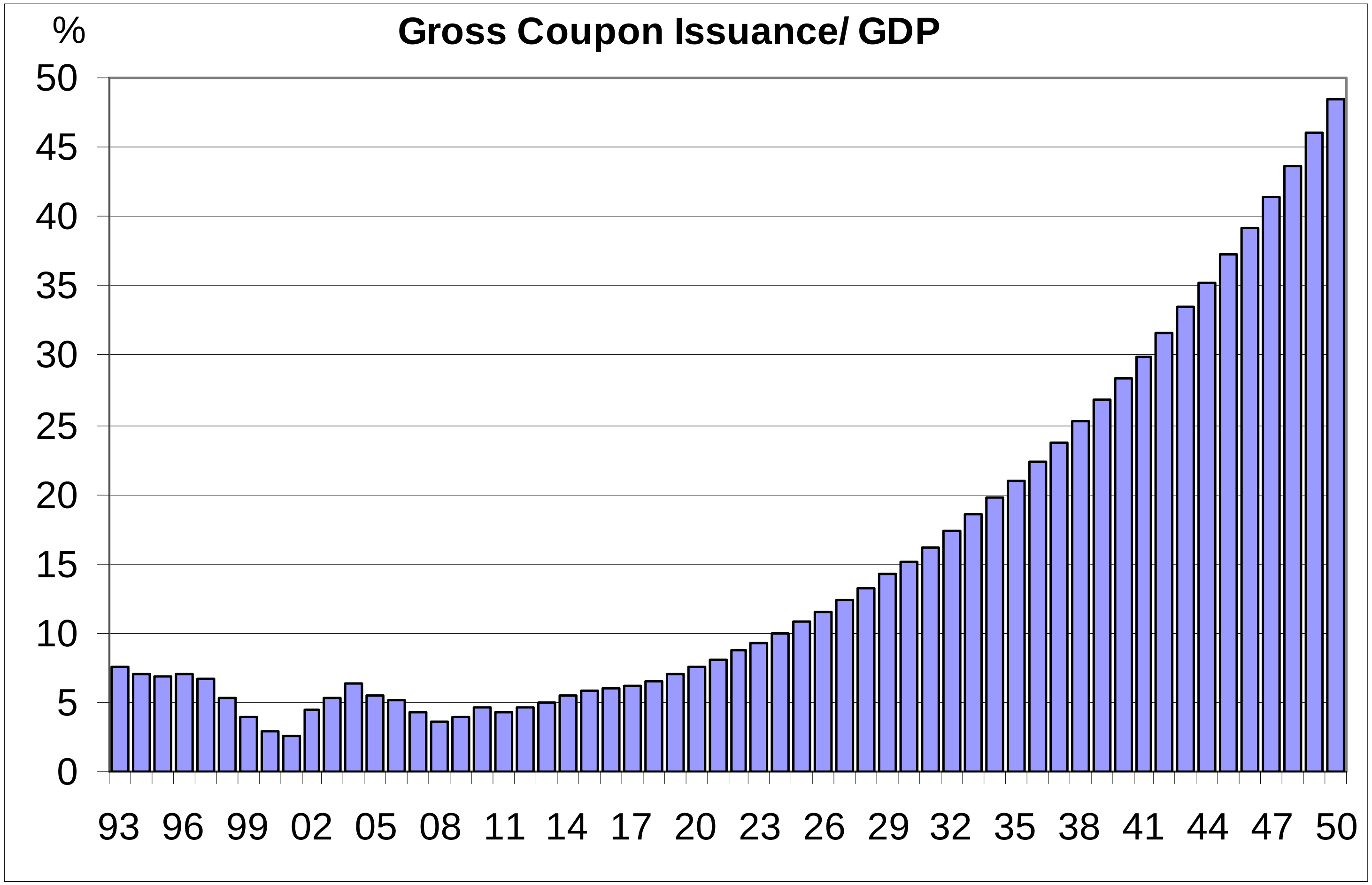
Scenario A - Intermediate Spending/High Revenue
Potential Annual DV01 of Issuance



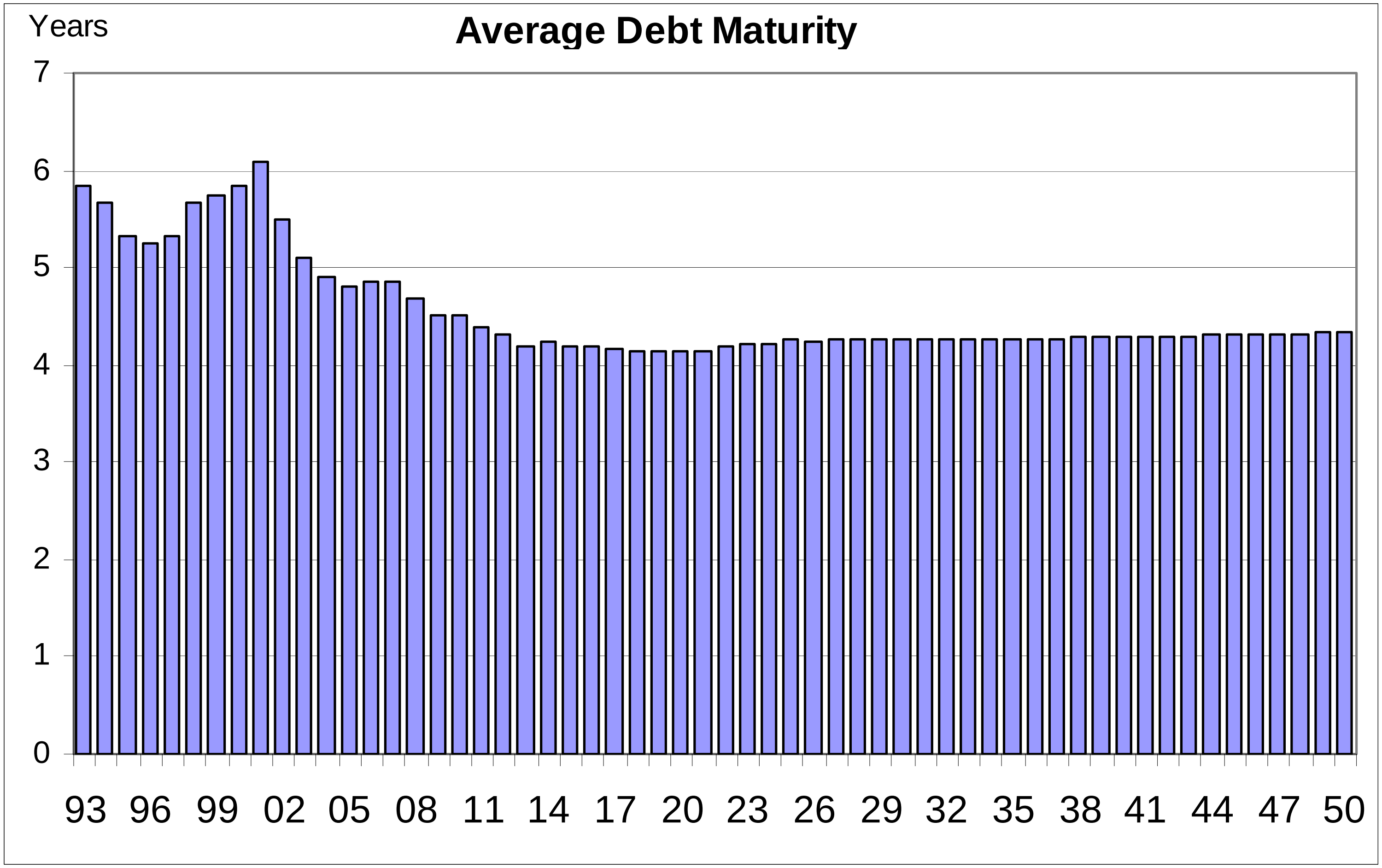
Scenario B - High Spending/High Revenue
Debt/GDP Implications



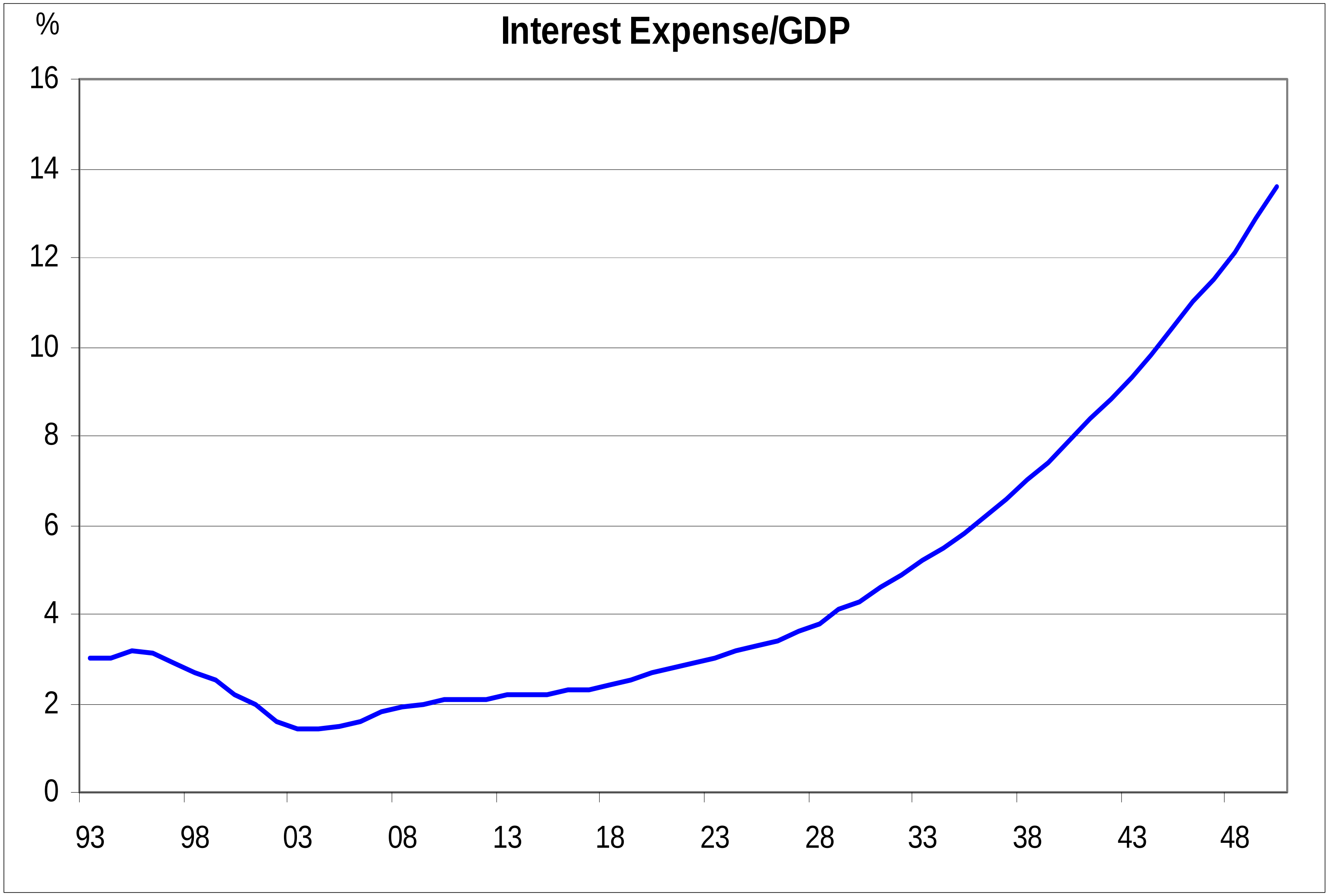
Scenario B - High Spending/High Revenue
Gross Coupon Issuance/GDP Implications



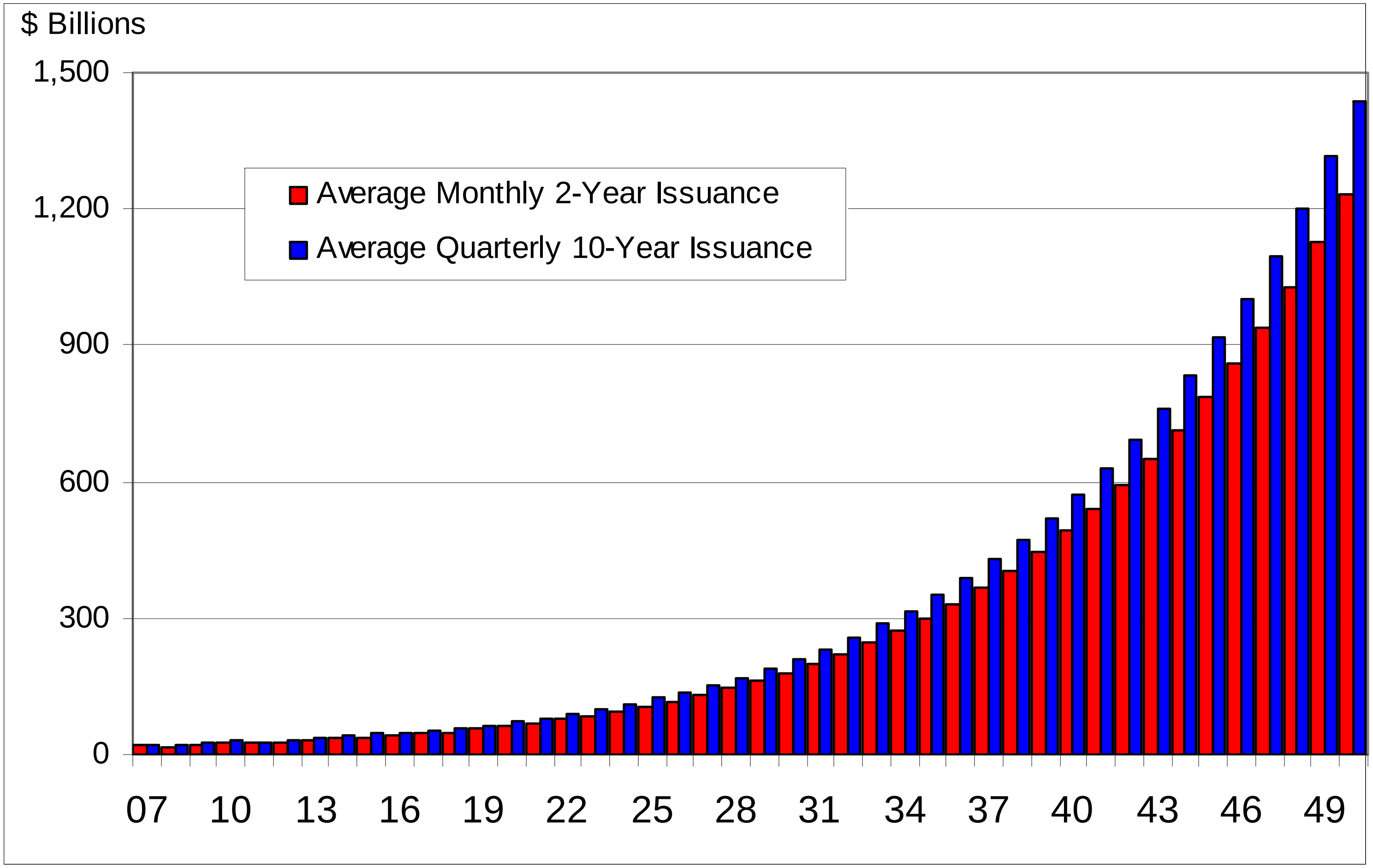
Scenario B - High Spending/High Revenue
Average Maturity of Debt Outstanding Implications



Scenario B - High Spending/High Revenue
Potential Interest Expense as a Percent of GDP



Scenario B - High Spending/High Revenue
Potential Size of Average Monthly 2-Year and Quarterly 10-Year Note



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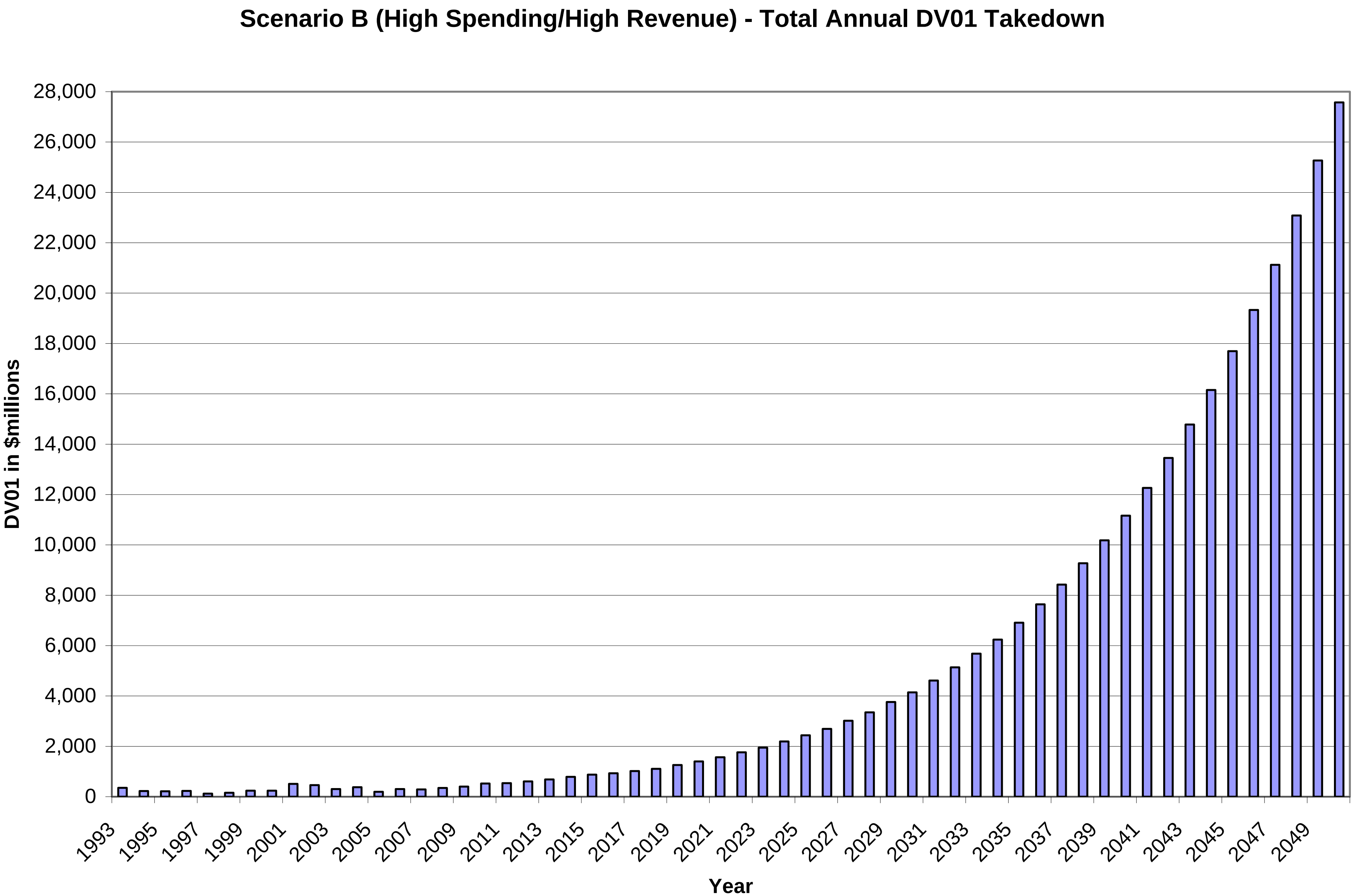
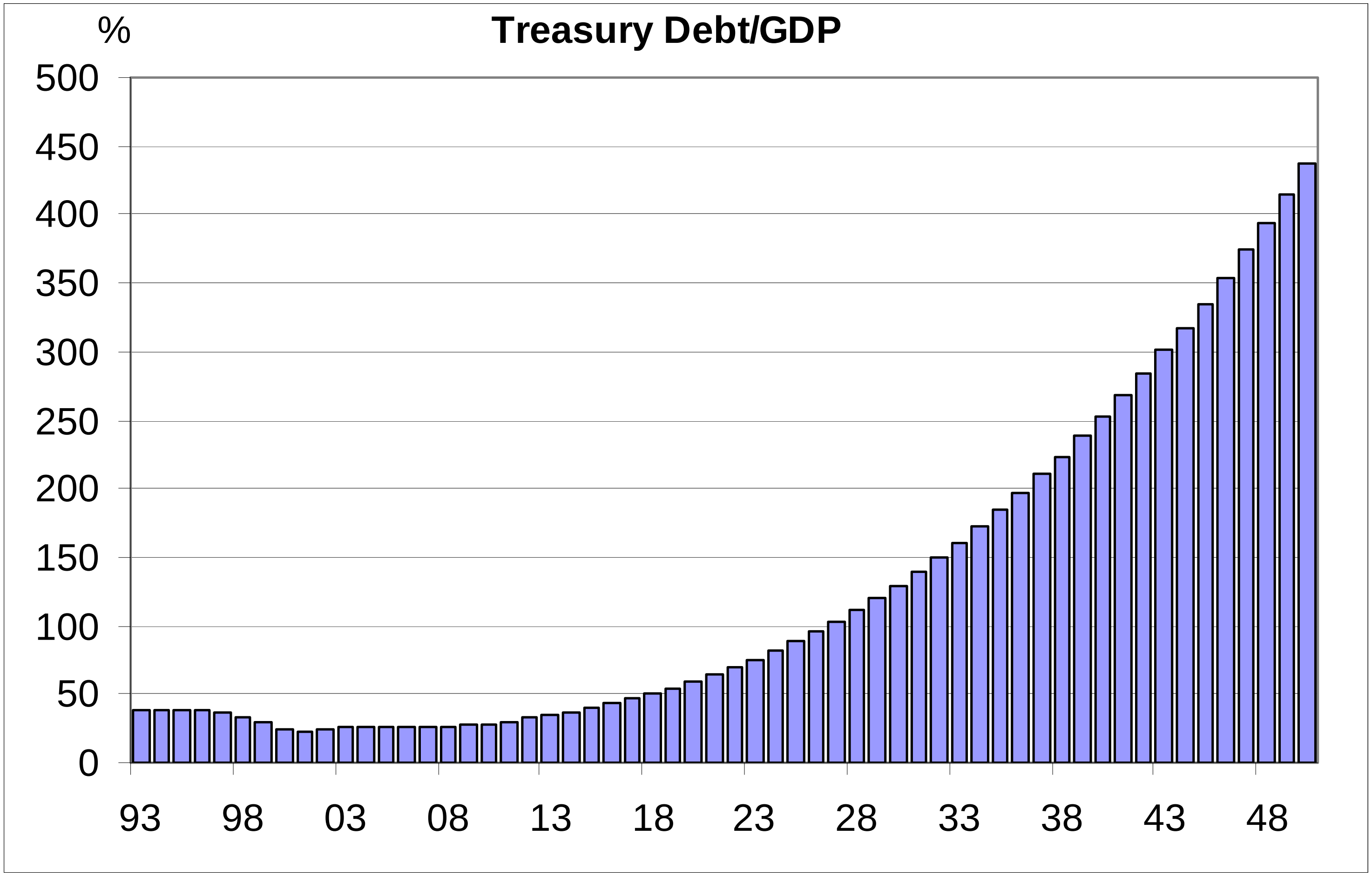


Scenario C - High Spending/Low Revenue
Debt/GDP Implications



Scenario C - High Spending/Low Revenue
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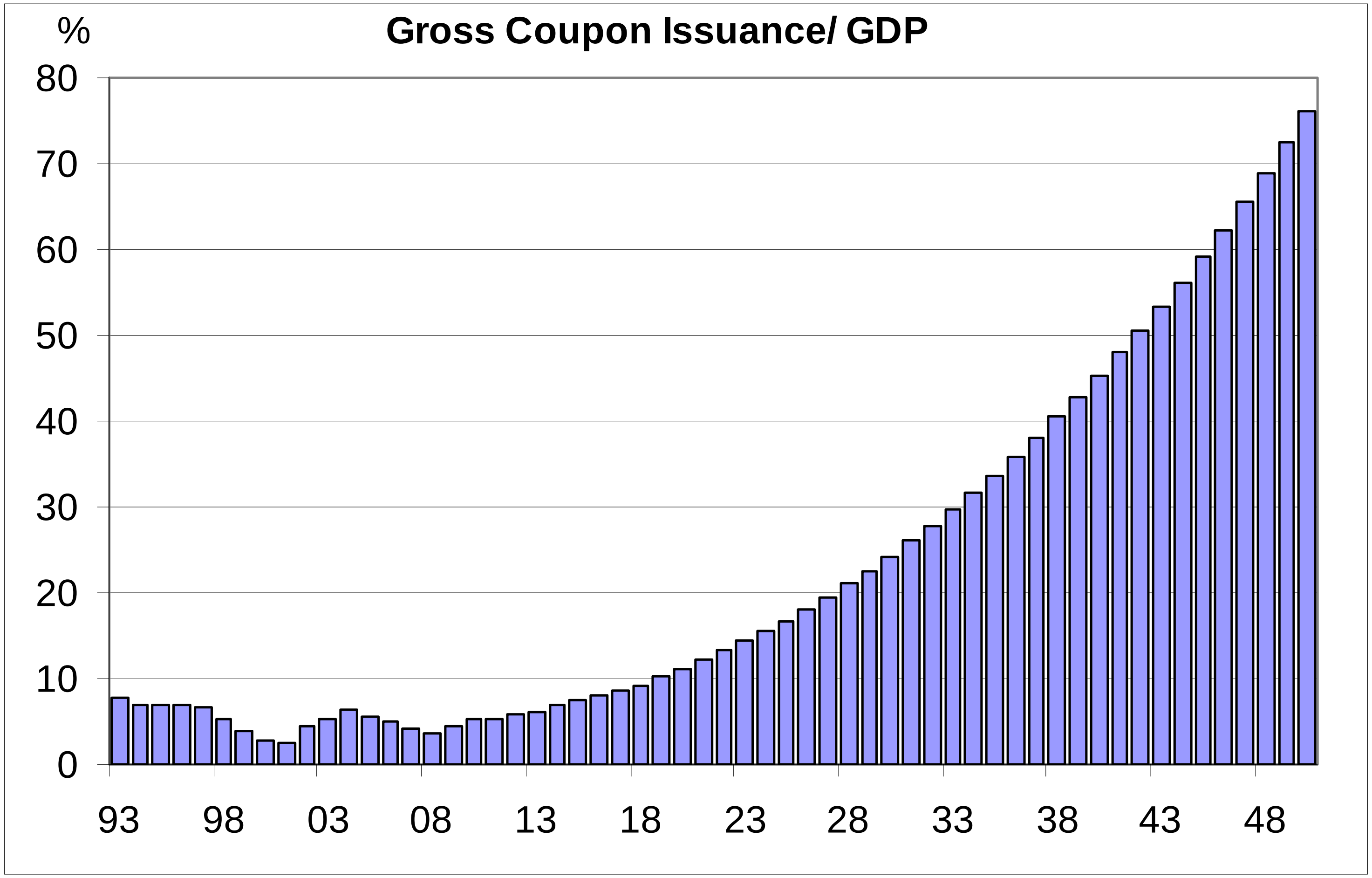
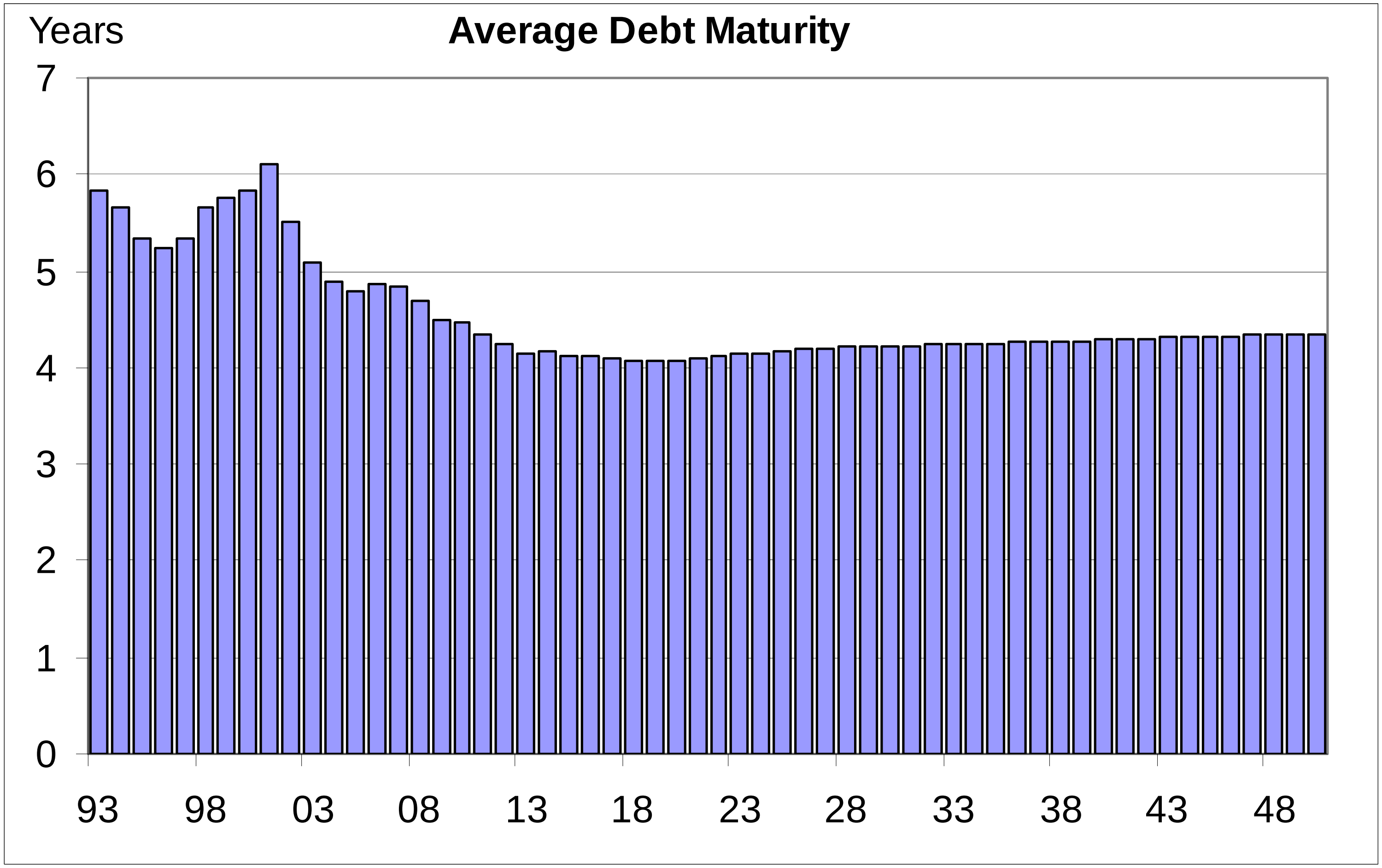
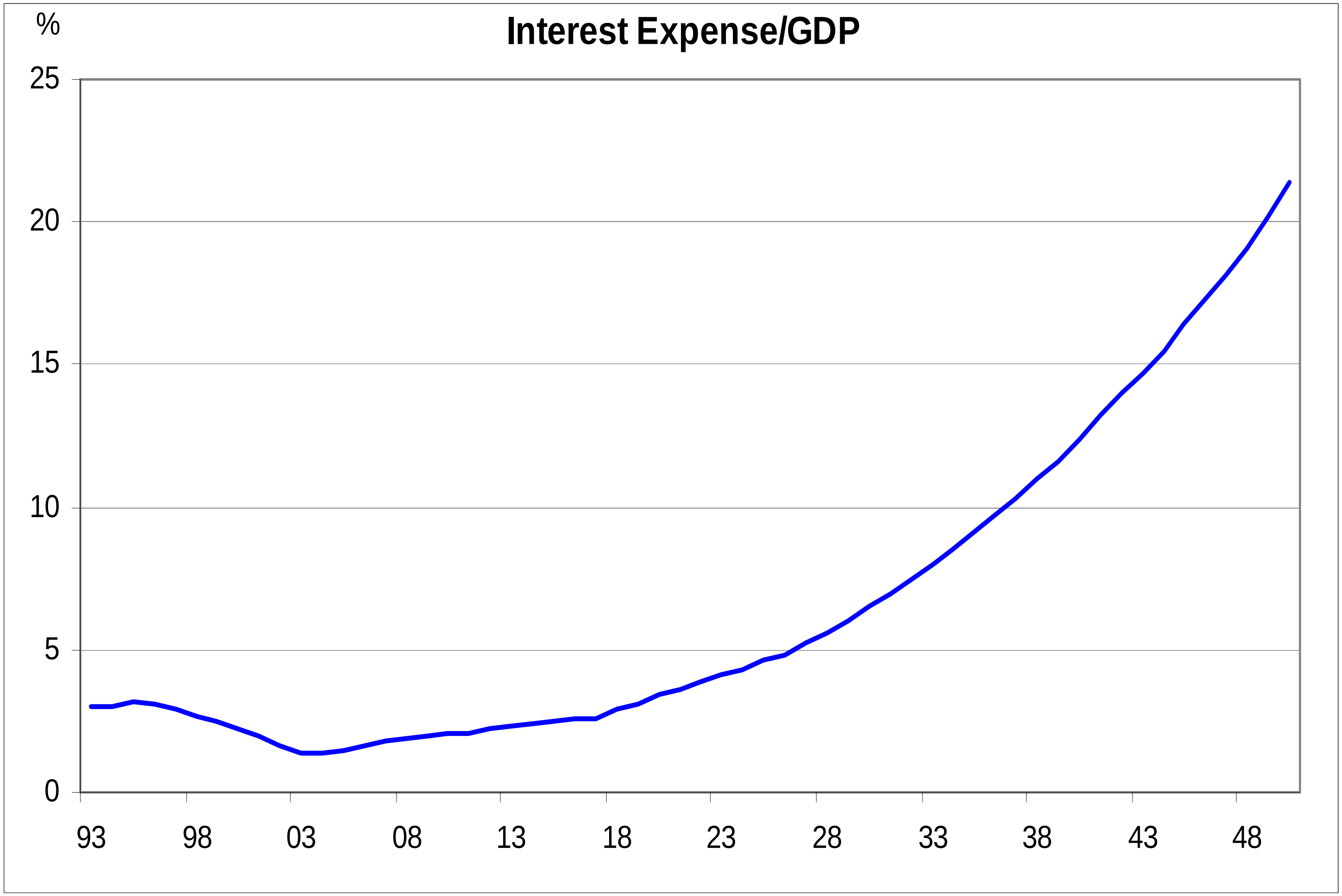


Scenario C - High Spending/High Revenue
Average Maturity of Debt Outstanding Implications



Scenario C - High Spending/Low Revenue
Potential Interest Cost as a Percent of GDP



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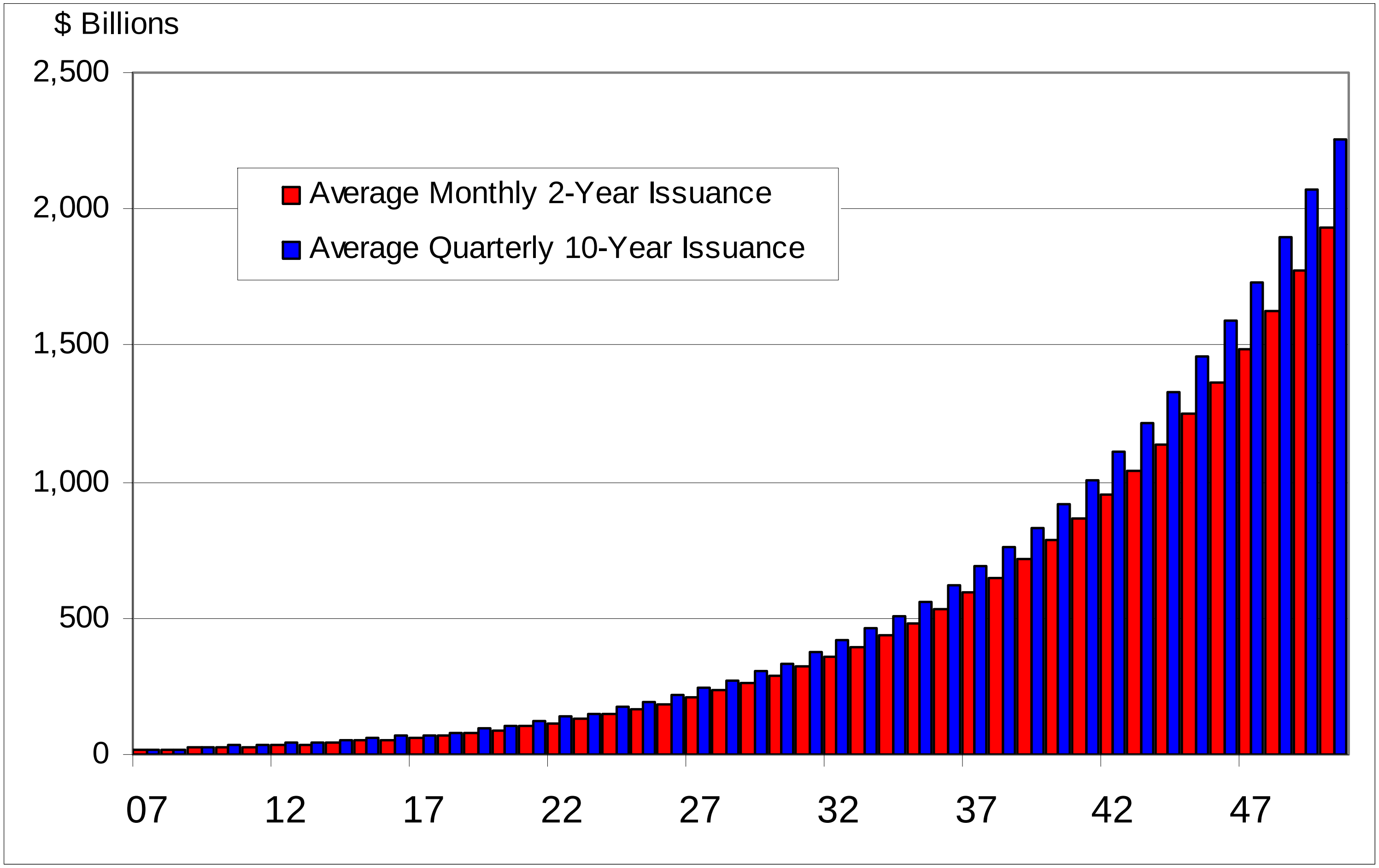
Potential Size of Average Monthly 2-Year and Quarterly 10-Year Note



Scenario C - High Spending/Low Revenue
Potential Annual DV01 of Issuance