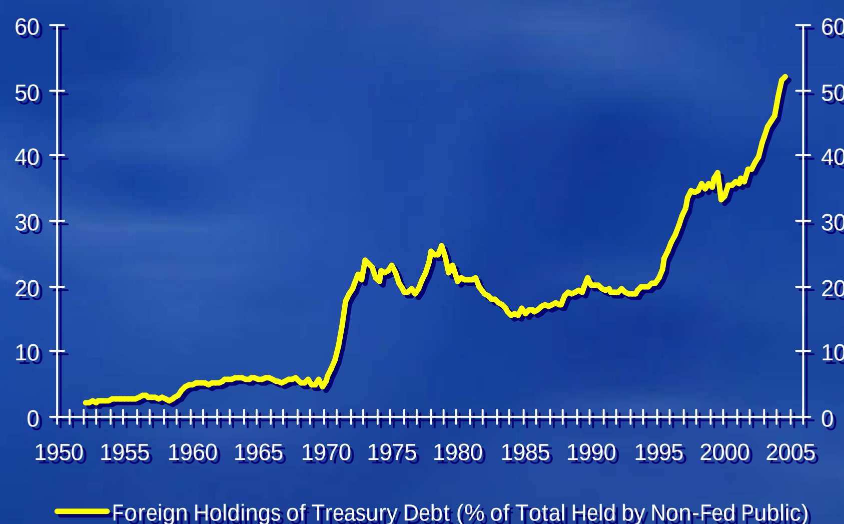
Presentation to the Treasury and the Treasury Borrowing Advisory Committee

February 1st, 2005

Question:

While the stock of Treasury debt is well within historical and international norms as a percentage of GDP, questions have been raised about whether the large proportion of total debt held by foreigners creates risk for the Treasury. We would like the Committee's views on whether the high percentage of foreign ownership of Treasuries outstanding creates risks for future Treasury financing, broader risks to the US economy, or, instead, reflects the efficient use of Treasury securities as a financing and investment vehicle.

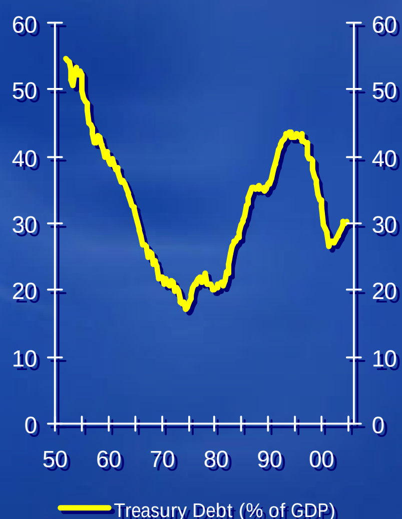
Foreign Holdings of Treasury Debt Pass 50% of the Total

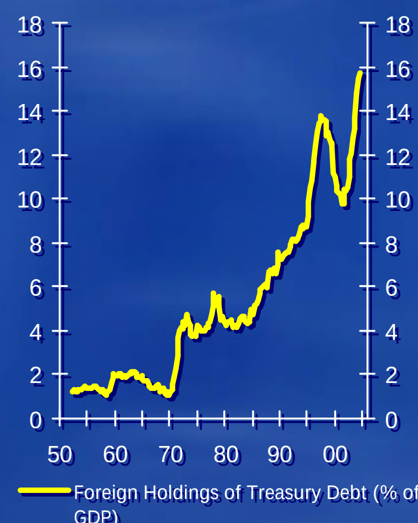


- In the past decade, foreign ownership of Treasury debt has risen from 20% to over 50%
- It had been stable at around 20% from 1970 to 1995

Source: Federal Reserve Board, Haver Analytics.

Foreign Ownership Up Despite Modest Growth of Treasury Debt



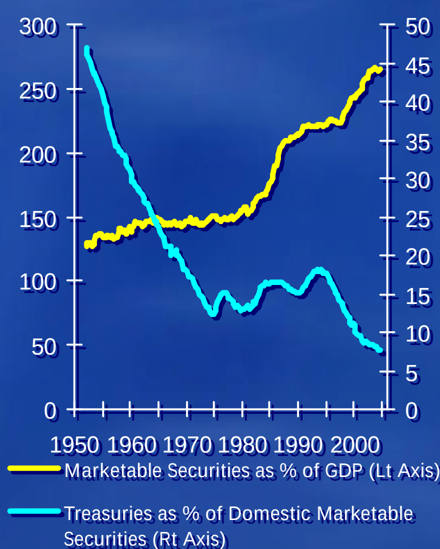


- During the past decade, growth in Treasury supply has been modest
  - Budget deficit has averaged under 1% of GDP
  - Treasuries outstanding have grown less than 2% per year
- Despite a decline in outstandings from 45% to 30% of GDP, foreign holdings have nearly doubled as a share of GDP

Source: Federal Reserve Board, Haver Analytics.

Treasuries Now a Smaller Proportion of US Financial Markets

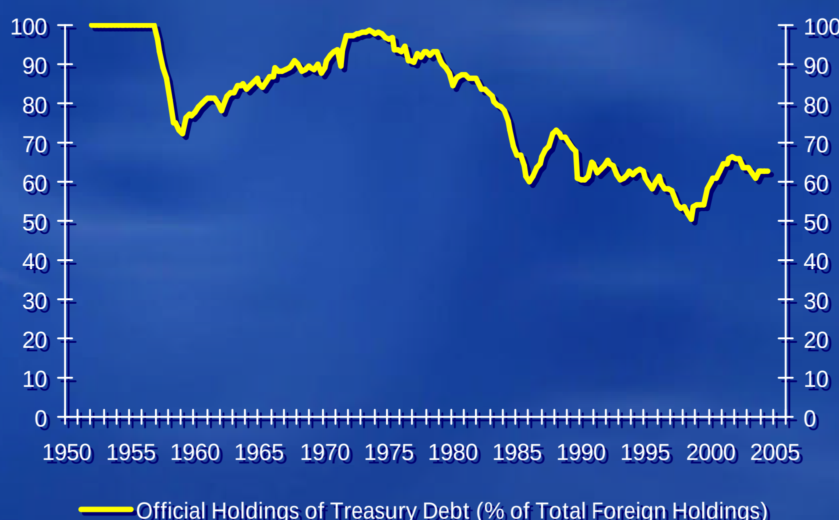
Domestically Held Treasury Debt (Bil. $)



- The result has been that domestic Treasury holdings have fallen as a share of GDP to a near post-WWII low
- Even as deficits have risen recently, domestic ownership has done no more than stabilize
- Given the increased size of financial markets relative to GDP, Treasuries are now a much smaller share of securities outstanding

Source: Federal Reserve Board, Haver Analytics.

Foreign Buying Has Come from both the Private and Official Sectors

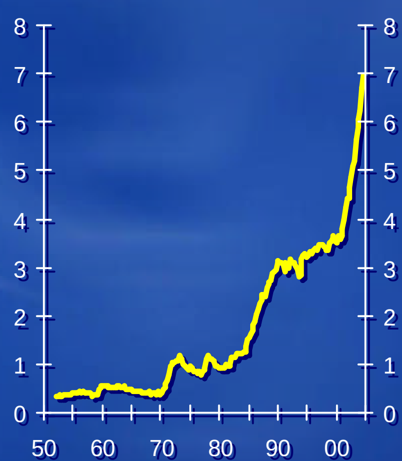


- Foreign private and official holdings have increased at about the same pace in the past two decades
- Both private and central bank demand reflect the "special" role of the dollar in the international financial system and increased global integration
- Treasuries play a special role for central banks

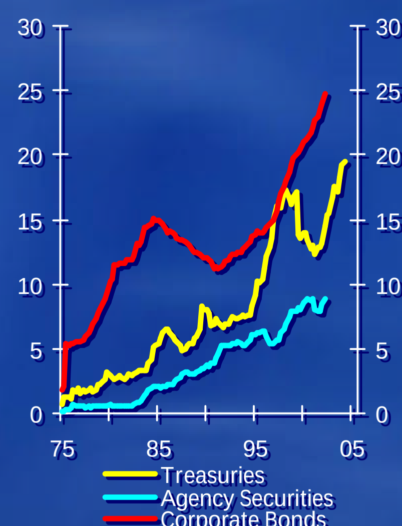
Source: Federal Reserve Board, Haver Analytics.

Foreign Private Investors are Similar to Domestic Investors

Ratio of Foreign-Held US Securities To US-Held Foreign Securities



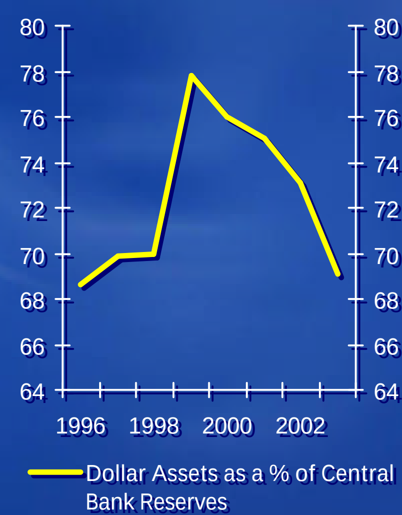
Private Foreign Share of Ownership

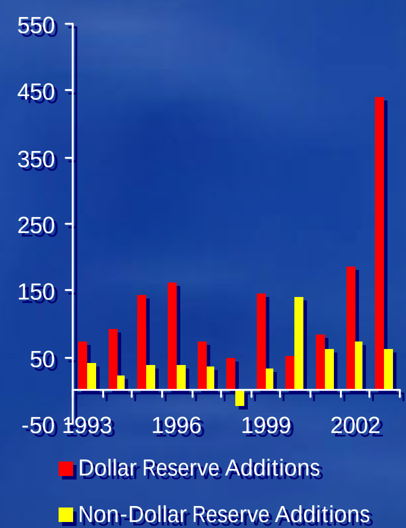


- The dollar still plays a unique role in the global financial system
- Non-official foreigners hold 7 times as much US marketable securities as private US entities hold of foreign securities
  - Reflects increased global integration, growth of financial markets, and "special" role of dollar in global financial system
  - Current account deficits have "accommodated" the asymmetry
- Private foreigners buy the full range of US securities: Treasuries are not "special"

Source: Federal Reserve Board, Haver Analytics.

The Dollar is Still the Key Reserve Currency

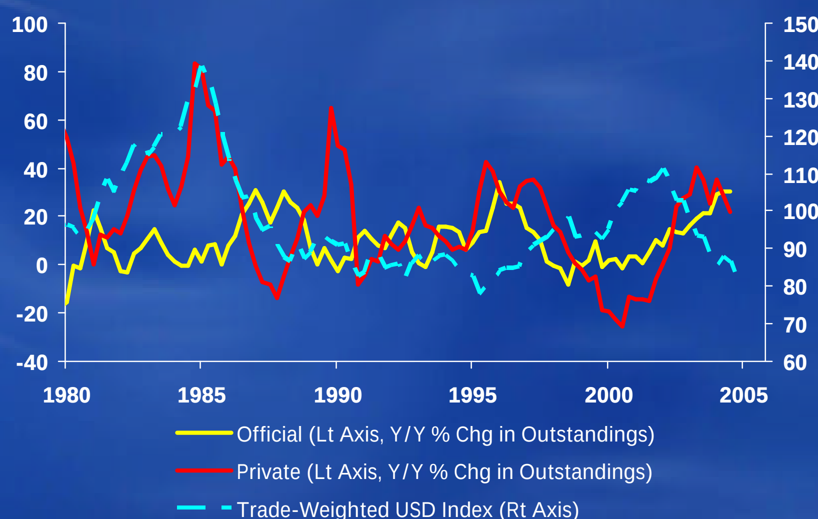




- The dollar remains the key reserve currency
- Roughly 70% of global FX reserves are held in dollars
  - The late 1990s rise and early 2000s fall was due entirely to revaluation effects due to the dollar's rise and fall
- In no year have foreign central banks been net sellers of dollar reserves
  - Most recent data is for 2003, which saw particularly strong dollar buying
  - Big increases in custody holdings of Treasuries at the Fed strongly suggest that the pattern was sustained in 2004

Source: Federal Reserve Board, Haver Analytics

Private and Official Buying Have Both Been Strong

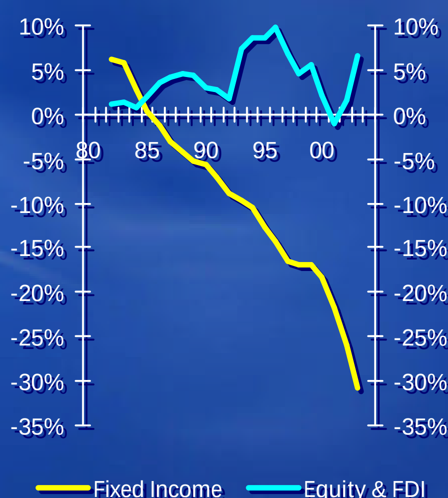


- Private and official buying tended to offset in the 1980s
  - When private buying dried up in late 1980s, official buying increased
- Since 1990, they have tended to move together and have been only imperfectly correlated with dollar moves
  - Heavy Treasury buying as the dollar stabilized and began to strengthen 1995-1998
  - Strong buying as dollar fell 2002-2004

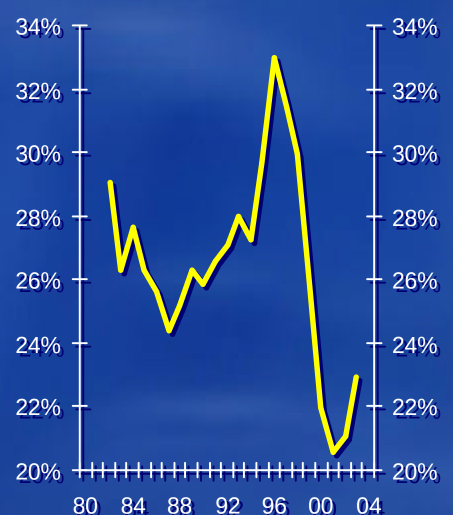
Source: Federal Reserve Board, Haver Analytics.

Foreign Treasury Holdings in the Context of the US as a Net Debtor

Net US External Financial Position
(By Type, % of GDP)

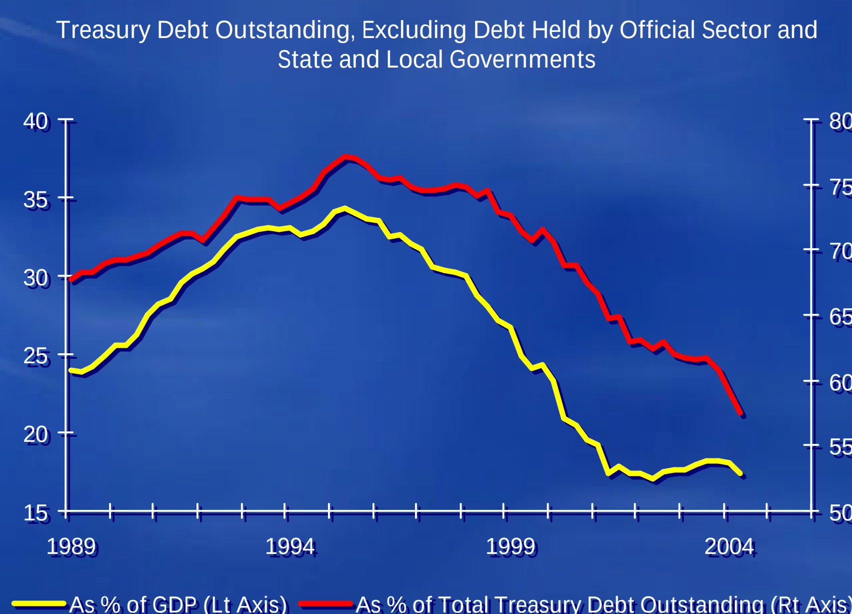


Treasuries as a % of Gross Foreign-Held
US Fixed Income Assets



- Sustained current account deficits have pushed the US into a growing net debtor position
  - Deterioration has come entirely through increased foreign ownership of fixed income securities
- Treasuries are now under a quarter of foreign-held fixed income assets

Foreign Official Holdings in the Context of Market Liquidity



- Budget deficits are boosting supply and easing earlier liquidity concerns caused by prospective budget surpluses
- But supply available for lending has lagged
- Foreign holdings per se are not a problem, but official holdings may not be as generally available for lending and can represent large percentages of individual issues
- Engagement by US officials with their foreign counterparts to encourage lending of their securities could alleviate potential shortages

Source: Federal Reserve Board, Haver Analytics.

Are There Risks to Future Treasury Financing?

- Heavy foreign buying has squeezed domestic buyers out of the Treasury market, and they could readily be brought back in.
  - Domestics now own $750bn fewer Treasuries than in 1995.
  - If foreign buying stopped or went into reverse, domestic ownership could be increased sharply and quickly given US market liquidity
- The US Treasury is in a particularly strong funding position relative to other countries:
  - The US has less debt outstanding:

Net Government Financial Liabilities (% of GDP)	
United States	43%
Euro Area	52%
Japan	79%

  - …and a broader, fully global investor base
  - A diverse investor base is a more stable investor base
  - Domestics have much smaller exposure to government debt than in other countries
- Foreign ownership does not present a risk to Treasury funding

Source: OECD

Are There Broader Risks to the US Economy?

- Treasury ownership by itself does not present a risk, but the “special” role of the dollar in private and official dealings has meant that:
  - The dollar has been stronger
  - The trade balance has been weaker
  - Econometric evidence suggests that recent heavy central bank buying has helped keep interest rates low
- If the dollar’s role were to fade, interest rates would be pushed up and the dollar down
  - Central banks would diversify reserve currencies away from dollars
  - US investors would increase exposure to foreign securities
- A decline in the role of the dollar, were it to occur, would likely be gradual…
  - Central banks are very conservative by nature
  - The institutional structure of global trade payment system would change gradually
- …and thus does not present a risk of a sharp or destabilizing financial market event