Minutes of the Meeting of the
Treasury Borrowing Advisory Committee
Of the Securities Industry and Financial Markets Association
April 28, 2009

The Committee convened in closed session at the Hay-Adams Hotel at 10:30 a.m. All Committee members were present. Acting Assistant Secretary for Financial Markets Karthik Ramanathan welcomed the Committee and gave them the charge.

The first item on the charge related to Treasury's short, intermediate, and long term financing needs given recent guidance provided by the Office of Management and Budget and estimates provided by other agencies. Treasury requested the Committee's perspective on debt issuance in consideration of each of these horizons in terms of adjustments to size, frequency, or debt instruments. Assistant Secretary Ramanathan delivered a presentation to the Committee which highlighted current fiscal conditions and potential factors to consider in addressing these issues.

Assistant Secretary Ramanathan stated that recent adjustments in the bill and coupon cycles created enough capacity to address market estimates of over $8 trillion in gross Treasury issuance and $2 trillion in net issuance in fiscal year 2009. For comparison, in fiscal year 2008, there was $5.5 trillion in gross issuance and $700 billion in net issuance.

Assistant Secretary Ramanathan clearly outlined the path which Treasury has taken over the past 18 months to manage the change in the fiscal situation. Specifically, Assistant Secretary Ramanathan stated that Treasury increased bill financing to address sudden outflows related to economic stability measures and Federal Reserve liquidity initiatives, while at the same layering in predictable increases in nominal coupon issuance to address budgetary trends. Securities were adjusted in terms of frequency on or added to the auction calendar after consultation with market participants regarding supply and demand dynamics and sensitizing financial market to these potential changes.

At the same time, Treasury sought to minimize market dislocations and remained mindful of portfolio considerations, particularly regarding the transition from bill financing to coupon financing over the medium to longer term. As a result, Treasury is confident of its ability to address these large financing needs with its current suite of securities and with minimal further adjustments to the auction calendar.

The most recent market estimates for the FY 2009 deficit averaged $1.75 trillion, nearly $150 billion higher than previous estimates at the February 2009 refunding. More importantly, marketable borrowing needs were both higher and had a wider dispersion, ranging between $1.6 trillion and $2.7 trillion, than estimates from three months ago.

The presentation noted that recent trends in the fiscal situation show a continued deterioration of receipts and an increase in outlays. Corporate and individual non withheld taxes were weaker while outlays were nearly 33% higher, reflecting nearly $350 billion in

expenditures related to the Troubled Assets Relief Program (TARP) and the Housing and Economic Recovery Act of 2008 (Senior Preferred Agreement investments and Agency MBS purchases related to Government Sponsored Enterprises) as well as other financial market stabilization efforts.

Current trends in both receipts and outlays, and the lag effects of economic activity related to employment, suggest that Treasury's borrowing needs will remain sizable for the remainder of this fiscal year and into next year.

Assistant Secretary Ramanathan stated that the average maturity of the overall marketable debt portfolio stabilized at 49 months in the previous quarter as a result of increased coupon issuance. While month over month duration continues to increase to accommodate this extension, Treasury considers this approach prudent to mitigate the need for significant additional issuance of bills to address cyclical and potentially structural shifts in the budget outlook.

To that end, Assistant Secretary Ramanathan stated that Treasury will continue to seek to extend the average maturity of the portfolio; however, this process will be gradual with potential decreases resulting from unexpected outlays or other liquidity initiatives. Moreover, Assistant Secretary Ramanathan, noting that break-even inflation rates were very low, stated that issuance sizes of TIPS would continue to grow at a slower pace than nominal coupons based on studies which show a higher cost of issuance relative to nominal issuance, particularly for shorter dated inflation-indexed issues.

Assistant Secretary Ramanathan concluded his presentation by stating that Treasury had built its capacity to address its potential borrowing needs in a manner consistent with its regular and predictable framework. Ramanathan noted that calendar issues, including dates for auctions and settlement dates, needed to be considered if additional securities were introduced.

At that point, a discussion followed regarding the best course of action for Treasury in the short, medium, and long term given its borrowing needs.

The Committee began by commending the efforts of Treasury in increasing capacity in a transparent, regular manner with minimal market dislocations or surprises given extremely challenging fiscal conditions.

Members then acknowledged that the fiscal outlook clearly suggested that more borrowing was necessary and that Treasury needed to consider increasing issuance sizes and frequencies of issuance before considering adding additional maturity points to address the financing shortfall.

Several members stated that the first sensible action that Treasury should take is to offer a second reopening of the 30-year bond, even before increasing issue sizes of existing offerings. With the auction calendar now complete on a monthly basis, Treasury would have more flexibility given its goals. Members then focused on how much issue sizes could be increased from current levels to meet the increased financing needs.

Members generally felt that over the near term there was still significant capacity to increase coupon issuance without creating sizable auction tails. Discussing a broader time horizon and also in consideration of economic trends, the Committee believed that on a monthly basis and in a deliberate manner, 2-year notes could be gradually increased to around $50 billion while the 3- and 5-year notes could be increased to at least $40 billion each. The 7-year note could go higher to at least $28 billion while 10-year notes could move to $75 billion per quarter. The 30-year bond could go as high as $45 billion per quarter if Treasury added a second reopening. These moves, if implemented in a consistent and transparent manner similar to Treasury current operating framework, would serve to extend the average maturity while potentially adding nearly $400 billion in new financing capacity.

A member suggested that there was strong demand for coupon debt and Treasury should accommodate the market by providing coupons. Several members agreed that given the guidance provided by OMB, increased coupon sizes were being expected by the market. Another member pointed out that Fed's secondary market purchases of Treasury debt may absorb some of this issuance. Other members stated that Treasury needed to address brrowing needs across multiple time horizons, and increased nominal coupon issuance best fit that objective

Regarding increasing the issuance of TIPS, the Committee thought that TIPS were a costly form of financing relative to nominal issuance and that increasing TIPS was not prudent for the Treasury. The Committee reiterated the view that Treasury should limit the issuance of TIPS in general, and consider eliminating the 5-year TIPS and other issues at some point and replace that issuance with nominal securities. One member stated that even if concessions were to occur, nominal coupons would represent cheaper funding than TIPS. Another member stated that the investor base for TIPS did not appear to be diversified. Another member countered that in recent months there had been an increase in TIPS appetite from retail accounts, and that some firms were beginning to offer TIPS funds as part of 401k plans for their workers. The Committee refocused the discussion then back to nominal issuance.

The Committee discussed whether there was demand for other maturity points such as the 4-year and 20-year maturity points. Many members stated that, aside from crowding the limited auction calendar further, the 4-year point would not really attract a new base of investors. Other members also felt that a 20-year bond had less appeal at this time, with one member stating that it was always a point that was difficult to sell and usually cheap. Several members stated that Treasury may need to consider this alternative, but should begin with a second reopening of the 30-year bond and monitor developments in the long end of the curve.

Another member raised the idea that at some point, Treasury might consider auctioning 2-year notes twice a month before moving to new maturity points. Several members agreed that maintaining existing points was preferable to adding new maturity points. While members thought it was premature for such a move, they generally thought that it was an idea worth further exploration by Treasury if fiscal events continue to deteriorate.

One member, citing low 10- and 30-year swap rates as a measure of demand for long-duration products, raised the idea of Treasury issuing ultra-long maturity debt. Another member

pointed out that derivatives markets beyond 30 years tended to be illiquid and that it was hard to issue in size beyond 30 years. Several members stated that while the idea seemed interesting from an academic perspective, such a move would raise very little new debt and would cost the taxpayer a significant concession. Most members felt that such long dated issue did not serve any purpose, and Treasury's objective would be better served through its current security offerings.

The Committee then moved on to the second item in the charge concerning the effects on Treasury auction dynamics of the issuance of Agency debt, Temporary Liquidity Guarantee Program (TLGP), other global sovereign debt issuance, as well as other potential debt issuance. A Committee member gave the presentation.

The member presented a slide indicating that debt issuance by sovereign issuers continues to rise. This was followed by a series of sides depicting flows into various asset classes. The member pointed out that Treasury issuance has benefited from a flight to quality and general risk aversion. Aggregate foreign inflows into US assets have shifted dramatically in favor of Treasuries.

The presenting member then showed a slide projecting that rising Treasury issuance relative to other debt issuance will likely cause the Treasury component of common benchmark indices to increase from 31% currently to 34% by the end of the calendar year, and perhaps even to 36% if the methodology is changed to account for Fed purchases, particularly of MBS. It was noted that the effect of such a change in methodology would be to increase inflows into Treasuries by passive investors that manage to a benchmark.

At that point, a discussion followed regarding the effect on demand for Treasuries posed by quasi-government or government-guaranteed debt issuance. It was noted that issuance of quasi-governmental debt was projected to increase dramatically. One member stated that many of these assets were directly competing with Treasuries and cited an expected $50 billion of issuance of Build America bonds as an example. Another member noted that FDIC-backed debt offered a significant pick-up in yield over comparable Treasury debt and that substitution by traditional Treasury investors was occurring.

Most members however felt that while these products offered higher yield, they were not directly comparable to Treasuries given their illiquidity and unique characteristics. However, the presenting member warned that policy makers should not assume that such issuance if indefinite would not have an impact on Treasuries.

The discussion then moved to the budget deficit over the next ten years. While highly uncertain, the presenting member noted the cyclical budget deficit was substantially greater than in previous recessionary periods. The member noted that even if spending related to recovery programs abated, the structural deficit could increase given entitlement expenditures. It was noted that despite projections for declining deficits, gross coupon issuance remains very large for years based on Congressional Budget Estimates.

This point led to the observation by a member that the impact on the Treasury market of improving economic conditions and the return of risk appetite should be considered in the future.

One member stated that the Federal Reserve's purchase program and exit strategy would drive market expectations.

Next, the presenter discussed technical challenges faced by debt managers and, in particular, choosing the best days of the week for holding coupon auctions given the sizable increase in the number of coupon auctions. The member noted that Monday auctions tended to tail, while auctions on Tuesday through Thursday came in under the when-issued rate. The member noted that while practical considerations made avoiding Monday auctions impossible, Treasury should continue to the best of its ability to avoid Friday auctions. If absolutely necessary to hold an auction on a Friday, the auction should be held early in the day to accommodate the broadest set of domestic and international investors.

The presenter then turned to the impact of the Federal Reserve's Treasury purchase program. The member stated that while it is difficult to isolate the impact of these operations, preliminary analysis indicated that six of the last nine operations led to a cheapening of the targeted section of the yield curve.

The discussion then turned to liquidity initiatives which Treasury conducted on behalf of the Federal Reserve. The presenter highlighted several options mentioned in the public domain that Treasury should be cognizant of including SFP bills not subject to the debt limit, bills issued by the Federal Reserve, and raising the interest rate on reserves. A member noted that Treasury needed to be mindful of the ultimate approach and how it may impact its portfolio and demand base.

The Committee then turned its attention to the third item in the charge regarding the impact of Treasury, Federal Reserve, and FDIC actions on the Treasury and credit markets. A Committee member gave the presentation.

The member began by noting the multitude of different actions taken by government entities since December 2007. These actions have improved conditions in some credit markets.

The member further noted that the Capital Purchase Program (CPP) and the Temporary Liquidity Guarantee Program (TLGP) along with the Federal Reserve's short-term credit market stabilization programs have helped to decrease the spread between LIBOR and OIS. The CPP has also substantially improved bank credit default swaps (CDS). Commercial mortgage backed securities (CMBS) and asset backed securities (ABS) have stabilized with TALF but new issuance has remained subdued in CMBS.

The members noted that Term Asset-Backed Loan Facility could be further enhanced by improvements in TALF loan transferability. Gross issuance of Auto, Credit Card and Student loan ABS has returned to levels from before the dramatic increase in leverage and subsequent correction. Home-equity loans, non-agency mortgage backed, and commercial mortgage backed securities markets remained under stress as does the high-yield market. The presenting member noted that financial debt issuance is virtually nonexistent except for TLGP.

Government money-market funds have begun to see withdrawals as government actions to support the broader credit markets have increased the cost of holding cash and near cash. The risk taking, however, has only returned to government supported sectors of the market. Treasury needed to monitor these developments as improved risk appetite reappears in the market.

While net loan growth has gone negative this is not different than many previous recessions. In fact loan growth has outperformed many previous recessionary periods. The presenting member noted that measures taken by the various government agencies – particularly the "direct" programs have had an impact, and continuing this momentum will be positive.

Several members agreed that the combined efforts of several agencies have led to improved conditions in the credit markets, and now the focus was really on the economy. One member stated that imminent Treasury and Federal Reserve programs if executed properly could lead to further broad based improvement.

The meeting adjourned at 12:20 PM.

The Committee reconvened at the Hay Adams at 6:00 p.m. All of the Committee members were present except for Ashok Varadhan. The Chairman presented the Committee report to Acting Assistant Secretary Ramanathan.

A brief discussion followed the Chairman's presentation but did not raise significant questions regarding the report's content.

The Committee then reviewed the financing for the remainder of the April through June quarter and the July through September quarter (see attached).

The meeting adjourned at 6:20 p.m.

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Karthik Ramanathan, Director
Acting Assistant Secretary for Financial Markets
Director, Office of Debt Management
United States Department of the Treasury
April 28, 2009

Certified by:

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Keith T. Anderson, Chairman
Treasury Borrowing Advisory Committee
Of The Securities Industry and Financial Markets Association
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Treasury Borrowing Advisory Committee Quarterly Meeting
Committee Charge – April 28, 2009

Fiscal Outlook

In recognition of short, intermediate, and long-term financing needs, as well as recent estimates provided by the Office of Management and Budget and other agencies, what adjustments to debt issuance, if any, should Treasury make in consideration of each of these horizons in terms of adjustments to size, frequency, or debt instruments?

Auction Dynamics

Given the issuance of Agency debt, Temporary Liquidity Guarantee Program, global sovereign debt, and other potential debt instruments, describe the dynamics surrounding Treasury auctions as well as potential methods to minimize the cost of borrowing while maximizing market liquidity.

Credit Market Conditions

The Treasury, Federal Reserve, and FDIC have undertaken a series of actions to foster the robust functioning of credit markets. Please discuss how these actions have impacted credit markets, what additional steps may be considered, and the implications of any current or additional steps on the Treasury market.

Financing this Quarter

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

- The composition of Treasury notes and bonds to refund approximately $52.2 billion of privately held notes called or maturing on May 15, 2009.
- The composition of Treasury marketable financing for the remainder of the April - June quarter, including cash management bills.
- The composition of Treasury marketable financing for the July – September quarter, including cash management bills.