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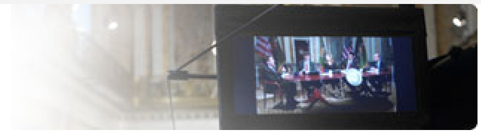

Minutes of the Meeting of the Treasury Borrowing Advisory Committee of the Securities Industry and Financial Markets Association

1/30/2008

The Committee convened in closed session at the Hay-Adams Hotel at 10:35 a.m. All Committee members were present except Gary Cohn. Undersecretary for Domestic Finance Robert Steel, Assistant Secretary for Financial Markets Anthony Ryan, Deputy Assistant Secretary for Federal Finance Matthew Abbott, and Office of Debt Management Director Karthik Ramanathan welcomed the Committee and gave them the charge.

A series of charts related to the fiscal situation, and noting current trends, including increased year over year growth in revenues (though slower than last year), increased growth in outlays, and decreased (negative) issuance in State and Local Government Securities (non-marketable debt) issuance, was presented by Abbott . The charts also highlighted the trend in Treasury cash balances as well as additional information outlining increased net purchases of Treasury securities by international investors.

Several themes related to the economy, the fiscal outlook, and Treasury debt issuance as a whole also emerged from the charts. The slides showed that Treasury would need to increase its marketable borrowing in fiscal year 2008 given the potential for less gradual shifts in revenues and outlays in FY 2008, a larger debt maturity profile, decreased issuance of non-marketable securities fiscal year to date, and any potential fiscal stimulus.

In this vein, Treasury will most likely rely on bills and shorter term nominal coupons to address these issues. Moreover, Treasury will need to issue longer dated cash management bills than recently issued to address issues related to the timing of tax refunds (given that a larger portion of refunds will be electronic rather than in paper form this year versus last year) as well as to potentially manage any fiscal stimulus. As coupons were gradually increased, the dependence on bills would lessen towards the end of the fiscal year barring any surprises. Financing decisions will continue to be made in a transparent manner and in consultation with market participants

Before commenting on the series of charts presented in the first item on the charge, the Committee Chair suggested that Treasury consider the second item regarding Treasury financing patterns. In particular, this charge item referred to the lead/lag effects of revenues and outlays on Treasury debt issuance in various economic cycles, and the potential issuance patterns Treasury should be cognizant of moving forward given such trends. The Committee Chair suggested that the discussion of the second item would provide good background prior to discussion of the first item.

A Committee member was asked to address this item and presented a series of slides showing cyclical influences on federal finance. According to the presenting Committee member, economic cycles generally produce larger than anticipated swings in federal budget balances, and the volatility seems to have increased even as the economy has become less cyclical.

In the 2001 recession, the percentage change in the budget deficit was 6.2 percent of GDP compared to an average change of 2.1 percent of GDP in other recessionary periods between 1954 and 1995. In addition, errors in budget projections tend to be serially correlated, i.e., forecasts tend to over-predict deficits when the economy is expanding and under-predict deficits when the economy is contracting.

Tax receipts are highly cyclical, and according to the presenting member, non-withheld and corporate tax revenues pose a greater risk to Treasury than withheld taxes. The presenting Committee member noted that corporate taxes over the near to intermediate term may remain stable given the increased presence of US corporations abroad, but that a significant driver on non-withheld receipts - equity markets - was likely to be less robust as compared to the previous cycle.

In addition, the presenting Committee member noted that receipts are generally more volatile than outlays, and this trend was particularly relevant in the last economic cycle. Weakness in receipts also tends to continue well into recovery periods because counter-cyclical policy responses tend to be implemented belatedly causing revenues to lag.

The presenting Committee member stated that debt managers generally had an extremely challenging role in the current environment given the uncertainty present in the economy. While recent tax data does not yet suggest significant weakness, Treasury should closely monitor the tax season in March and April for greater clarity. The risks to the deficit were higher in fiscal year 2009 rather than fiscal year 2008, and that a deteriorating economic outlook could lead to significantly larger deficits.

The presenting Committee member then considered fiscal stimulus proposals, noting the difficulty with such proposals to be timely, targeted, and temporary. The presenting Committee member stated that monetary policy may be more effective than fiscal policy, and that fiscal stimulus often is too little, too late. The presenting Committee member noted that if fiscal stimulus were to occur, a larger and quickly implemented package would be more effective than a phased approach given the potential positive feedback mechanism within the economy. The presentation concluded with a recommendation by the presenting Committee member on how Treasury may want to proceed given some of the lead/lag issues related to receipts, and suggested that Treasury needed to be vigilant of even higher deficits if the economy weakened.

In the discussion that followed the presentation, the Committee began by agreeing that larger deficits could materialize in fiscal years 2008 and 2009, and that it may be prudent to begin to plan for such deficits. Issuance decisions by debt managers at turning points in the economic cycle are extremely challenging, and Treasury needs to maintain flexibility. One member opined that in a worse case scenario, deficits could double over the next few years, even before the expected secular increases in budget deficits are expected in the 2013 to 2017 period. This member stated that treasury should plan now for such scenarios to preserve its flexibility and to have a form of "insurance".

Several members agreed with this perspective with one member suggesting that Treasury needed to start thinking more strategically about the funding issues by not only considering financing quarter-by-quarter but also financing over an entire economic cycle. A few members noted that while theoretically appealing, planning for more than one year – even one quarter - was extremely difficult given very large projection errors.

A brief discussion ensued about whether the stimulus package would create temporary or secular deficits, with members suggesting it was a difficult dynamic modeling question given that such stimulus could increase revenues. One member suggested that Treasury should consider extending its duration by increasing issuance of longer-term maturities. Several members questioned whether such longer-dated issuance would constitute an overreaction since little is known about whether economic growth over the intermediate term was prolonged or temporary (i.e. will the recovery going to be "V-shaped", "U-shaped" or "L-shaped"). Another member stated that for the time being, Treasury could finance deficits in FY 2008 with its current auction calendar, but that if the economy should weaken materially or appear to be headed towards a prolonged recession, increasing nominal issuance in the 10-year and 30-year sectors may be prudent at that point.

A member opined that Treasury that cash management was just as important as debt management, and that as part of a comprehensive strategic plan, Treasury needed to utilize more of its existing tools including the repurchase of securities (buybacks). A few members stated that Treasury should consider the repurchase of Treasury securities during particularly large debt maturity periods using seasonal large cash balances.

These repurchases, done in a transparent manner, could be used to lessen the impact of large debt maturity dates (such as those in May, August, and November), reduce the size of cash management bills, and provide greater flexibility to the Treasury. Another member agreed and suggested that Treasury study using debt purchases in the market to minimize cash balances and reduce the risk associated with very large cash management bills or bill issuance during periods of increased debt maturities. Director Ramanathan agreed to examine Treasury's use of debt repurchases for cash management purposes.

The Committee then turned to the discussion of the first question in the charge concerning thoughts on fiscal outlook and financing the proposed fiscal stimulus. Several members noted that given the current deficit projections, the use of bills including the use of long-dated cash management bills as well as increasing short-term coupon sizes would be sufficient to financing in fiscal year 2008. One member suggested that between $80 billion and $100 billion of stimulus would need to be financed in the current fiscal year, and that Treasury was sufficiently prepared to meet this need.

A few members noted that the market could easily absorb another $100 billion in bill issuance if it occurred gradually. Some members noted that there was a renewed appetite for risk-free credit assets from both traditional and non-traditional accounts, and that issuing more bills as well as longer dated cash management bills in this environment may be beneficial for both investors and the Treasury.

A couple of members pointed out that such a strategy of using bills and increasing issue sizes of shorter maturity coupons would only work if current deficits projections were realized and there were no surprises to the economy. The member cautioned that Treasury should be more cognizant of potential upside risks to the deficit or "fat tail" events, including further slowing in the economy or the potential for some other unforeseen policy responses such as additional stimulus packages. Prudent risk management suggested a cautious approach including some increase in coupons. One member noted that the economic outlook had changed dramatically with the introduction of a stimulus package and that reintroducing the 3-year note would be readily accepted by market participants.

The Committee concluded the discussion by stating that Treasury should be prudent and continue to monitor risks to a larger deficit. Increased issuance in bills and shorter dated nominal coupons would be sufficient barring nay unforeseen circumstances. In addition, the issuance of longer dated cash management bills to bridge temporary cash outflows related to the tax refund season as well as any stimulus package would be wise. If financing needs were to increase, Treasury should first consider addressing these needs through increases in auction sizes, then increases in auction frequencies, and finally, consider adding maturity points. In all of these choices, Treasury should consider cost trade offs between the three actions.

In the final item of the charge, the Committee was asked about their thoughts regarding the low-interest rate environment and its implications on systemic fails. In particular, the Committee was asked if current market conditions, coupled with the potential for lower interest rates, raise the potential risk of systemic fails. The Committee was asked if any additional steps should be taken to minimize the likelihood or impact of systemic fails so that overall market liquidity is not negatively impacted by Treasury repo financing.

A series of charts related to this matter were presented including a chart of the relation of low rates to Treasury fails to deliver, as well as recent actions in the market which have improved overall liquidity. Private sector efforts initiated by such as the Securities Industry and Financial Markets Association (SIFMA) and the Treasury Markets Practice Group (TMPG) have looked at these issues since the last episode of systemic fails, but Treasury asked the Committee if more could be done. In particular, Treasury asked if other methods such as negative rate trading, strengthening the buy-in rule, and/or promoting greater coordination among financial institutions were worth considering.

Committee members generally agreed that more work needed to be done in a fairly rapid time frame regarding this issue to assure continued market efficiency in a low-interest rate environment. Several members did not realize that these specific actions had not been fully implemented since the last serious wave of fails. Another member cautioned that any solution still had the potential to be "gamed," and one had to always be aware of the law of unintended consequences. Another member suggested that reopening issues was a tool that should be considered despite Treasury's firmly stated reluctance to add permanent supply. Several members noted that private sector groups needed to focus their attention on this issue given the speed in which fails could become elevated, and those suggestions such as negative rate trading and or other netting measures needed to be introduced.

Moral suasion was also emphasized as another method to deal with systemic fails. Specifically, determining which market participants are holding securities back from market and encouraging those players to lend during times of protracted shortages and systemic fails was critical. Another member suggested that Treasury reconsider providing temporary supply via a securities lending facility.

Several members noted that the publishing of the Treasury Market Best Practices by the TMPG was well received by market participants, but that specific, complementary solutions needed to be implemented in a compressed time frame to prevent another episode with prolonged fails. A member asked if major central banks were aware of the TMPG and the opportunities in lending in the financing market. Director Ramanathan stated that reserve managers at major central banks as well as international investors which Treasury regularly spoke to felt that the Treasury Best Practices document was a positive development, and looked forward to continued efforts by all stakeholders.

The committee agreed that the TMPG, in conjunction with SIFMA and other private sector entities, should draft recommendations on effective, practical methods which could be quickly implemented to address systemic fails. The Committee agreed that this issue need to be managed in a timely manner given the speed in which rates have decreased and the global nature of the Treasury market.

Director Ramanathan agreed that Treasury would continue to follow the work of SIFMA, the TMPG, and other private sector parties, and suggested that any such recommendations and responses be presented to the Committee at a subsequent meeting.

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

The meeting adjourned at 11:55 a.m.

The Committee reconvened at the Hay-Adams Hotel at 6:00 p.m. All the Committee members except Gary Cohn were present. The Chairman presented the Committee report to Assistant Secretary Ryan. A brief discussion followed the Chairman's presentation but did not raise significant questions regarding the report's content.

The meeting adjourned at 6:15 p.m.

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Karthik Ramanathan, Director
Office of Debt Management, United States Department of the Treasury
January 29, 2008

Certified by:

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Keith T. Anderson, Chairman
Treasury Borrowing Advisory Committee
of The Securities Industry and Financial Markets Association
January 29, 2008

Treasury Borrowing Advisory Committee Quarterly Meeting
Committee Charge – January 29, 2008

Fiscal Outlook

Given recent trends in the fiscal outlook, what are the TBAC's thoughts on Treasury's debt issuance? In addition, Treasury would like the Committee's views on the proposed fiscal stimulus and how such stimulus could be financed by Treasury.

Treasury Financing Patterns

Treasury would like the Committee's perspective on the lead/lag effects of revenues and outlays on Treasury debt issuance in various economic cycles, and the potential issuance patterns Treasury should be cognizant of moving forward, given such trends.

Low Interest Rate Environment

Current market conditions, coupled with the potential for lower interest rates raises the potential risk of systemic fails, a risk that we believe could impair liquidity and raise our cost of borrowing. Should any additional steps be taken to minimize the likelihood or impact of systemic fails so that overall market liquidity is not negatively impacted by Treasury repo financing?

Financing this Quarter

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

- The composition of Treasury notes and bonds to refund approximately $54.5 billion of privately held notes maturing on February 15, 2008.
- The composition of Treasury marketable financing for the remainder of the January-March quarter, including cash management bills.
- The composition of Treasury marketable financing for the April-June quarter.

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