Presentation to the Treasury Borrowing Advisory Committee

U.S. Department of the Treasury
Office of Debt Management
May 1, 2007
Intermediate to longer-term trends to consider

- Market considerations
- Portfolio considerations
- Economic outlook
- Non-marketable borrowing
- Potential legislative changes
Year to date tax receipts have grown versus last year.

FY07 Revenue YTD on pace to surpass last year's total fiscal year revenues.
Year to date outlay growth has been rising at a slower pace than in recent years

![Total Outlays Fiscal Year to Date](chart)

FY 2007 Outlays YTD smallest year-over-year growth rate in recent years
OMB is expecting continued improvement in the budget deficit after FY08

Projected Budget Results
(+ Deficit/- Surplus)

$ billions

2006 2007 2008 2009 2010 2011 2012
Net SLGS Issuance in FY 2007 may set a record
Given current issuance amounts and maturity patterns, TIPS and longer-term securities are projected to be the sources of financing as financing needs decline.
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
- Outstanding bills have been essentially flat
- Treasury continues to see strong receipts
- The deficit has been cut in half ahead of schedule, and the OMB forecasts a balanced budget by 2012

- Should additional financing become necessary:
  - Increased bill issuance could raise an additional $100 billion
  - Increased coupon issuance could raise and additional +$100 billion
How low can they go?

<table>
<thead>
<tr>
<th>Security</th>
<th>Announced Amount</th>
<th>Announcement Dates</th>
</tr>
</thead>
<tbody>
<tr>
<td>2-year Note</td>
<td>$10 billion</td>
<td>May 2000 - January 2001</td>
</tr>
<tr>
<td>3-Year Note</td>
<td>$16 billion</td>
<td>January 2007</td>
</tr>
<tr>
<td>5-Year Note</td>
<td>$13 billion</td>
<td>December 2006 - April 2007</td>
</tr>
<tr>
<td>10-Year Note</td>
<td>$13 billion</td>
<td>August 2005 - January 2007</td>
</tr>
<tr>
<td>-Reopening</td>
<td>$8 billion</td>
<td>June 2005 - March 2007</td>
</tr>
<tr>
<td>30-Year Bond</td>
<td>$9 billion</td>
<td>January 2007</td>
</tr>
<tr>
<td>5-Year TIPS</td>
<td>$8 billion</td>
<td>April 2007</td>
</tr>
<tr>
<td>-Reopening</td>
<td>$7 billion</td>
<td>October 2006</td>
</tr>
<tr>
<td>10-Year TIPS</td>
<td>$9 billion</td>
<td>July 2005 - January 2007</td>
</tr>
<tr>
<td>-Reopening</td>
<td>$6 billion</td>
<td>April 2007</td>
</tr>
<tr>
<td>20-Year TIPS</td>
<td>$8 billion</td>
<td>January 2007</td>
</tr>
<tr>
<td>-Reopening</td>
<td>$7 billion</td>
<td>July 2006</td>
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</table>
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?
Treasury Borrowing Advisory Committee
Presentation to the Treasury
Trends in International Investment

May 1, 2007
Foreign Purchases Roughly Cover New Treasury Supply

Net foreign purchases of US Treasury bonds, notes, and bills (12-month total)

Marketable Treasury securities outstanding (12-month change)

Source: US Treasury
Trends and Flows in Capital Markets

Foreign Purchases: Rising Share of New Supply of Private Debt

Foreign net purchases of US Agency/corporate debt as share of newly originated US net private borrowing*

*Net foreign purchases of US Agency and corporate debt as share of increase in US nonfinancial nonfederal debt outstanding, 4-quarter average

Sources: US Treasury, Federal Reserve
Trends and Flows in Capital Markets

Foreign Holdings of US Debt Outstanding Small but Growing

Foreign holdings of Treasuries as share of Treasuries outstanding

Foreign holdings of Treasury, Agency, and Corporate debt as share of total non financial debt outstanding

Sources: US Treasury, Federal Reserve
## Foreign Inflows Into US Equity Markets Still Relatively Small

Net Foreign Purchases of US Long Term Securities, by Type

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Treasury</th>
<th>Agency</th>
<th>Corporate</th>
<th>Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>916</td>
<td>352</td>
<td>226</td>
<td>310</td>
<td>28</td>
</tr>
<tr>
<td>2005</td>
<td>1012</td>
<td>338</td>
<td>219</td>
<td>372</td>
<td>82</td>
</tr>
<tr>
<td>2006</td>
<td>1138</td>
<td>198</td>
<td>290</td>
<td>501</td>
<td>150</td>
</tr>
</tbody>
</table>

Source: US Treasury
US Equity Outflows Trending Higher

Foreign purchases of US equities, net

US purchases of foreign equities, net

Source: US Treasury
Benefits to the U.S.

US Enjoys Healthy Investment Despite Low Savings

Source: International Monetary Fund, Bank of America calculations
**US Current Account Deficit Implies Growing Foreign Debt**

- **Current account balance** (annual flow of borrowing)
- **Net international investment position** (stock of net foreign debt) = US holdings of foreign assets minus foreign holdings of US assets

Source: US Commerce Department
US Registers Small Deficit on International Investment Income

2005 net foreign debt = $2,546 bn
(left axis)

2006 net payment of interest, dividends & earnings = $7 bn
(right axis)

Source: US Commerce Department
Net Investment Position

US Foreign Debt Within Range for Major Economies

Net international investment position as % GDP, 2005

Percent of GDP

Switzerland, China, Norway, Japan, Canada, UK, Eurozone, US, Sweden, Australia, NZ

Lower US Returns Justified by Lower Risk

US investment abroad generates higher average rates of return...

...but weighted average risk of investment abroad much higher than in US

<table>
<thead>
<tr>
<th>Location of US Direct Investment</th>
<th>Standard &amp; Poor's Average Country Rating</th>
<th>Share of US Direct Investment (Percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canada</td>
<td>AAA</td>
<td>11</td>
</tr>
<tr>
<td>Europe</td>
<td>AA +</td>
<td>54</td>
</tr>
<tr>
<td>Asia and Pacific</td>
<td>A -</td>
<td>16</td>
</tr>
<tr>
<td>Middle East</td>
<td>A -</td>
<td>1</td>
</tr>
<tr>
<td>Africa</td>
<td>BBB -</td>
<td>1</td>
</tr>
<tr>
<td>Latin America/Other Americas</td>
<td>BBB -</td>
<td>17</td>
</tr>
<tr>
<td>Total (Weighted Average)</td>
<td>BBB +</td>
<td>100</td>
</tr>
</tbody>
</table>

1995-'05 avg corporate bond spread: BBB vs AAA = 80 bps

Sources: Commerce Department, Congressional Budget Office, Bank of America calculations
Specific Trends of Concern

Private Long-Term Inflows a Declining Share of Total Inflows

Source: Commerce Department
Specific Trends of Concern

Global Investment Gains to Pull Savings Flows Away from US?

World Savings and Investment (Excluding US)

- Domestic savings
- Global excess savings

1984-2006 averages

Source: International Monetary Fund, Bank of America calculations
Specific Trends of Concern

US Investors Increasingly Moving into Foreign Securities

US net purchases of foreign long-term securities (equity and debt)

Source: US Treasury
Specific Trends of Concern

US Direct Investment Outflows Trending Higher, Above Inflows

Source: US Commerce Department
Specific Trends of Concern

Geographic Concentration of Suppliers to Capital to US

Current Account Surplus (+) or Deficit (-), by Country/Region, 2006

Abbreviations:
CEE=Central/Eastern Europe, ANZ=Australia/New Zealand, NICs=Newly Industrialized Countries (Hong Kong, Singapore, S. Korea, Taiwan)
Source: International Monetary Fund
Conclusions

• Foreign capital inflows provide rising share of US debt financing and allow stable US investment, despite low savings, at lower interest rates

• US net foreign investment position and associated flows still modest relative to GDP, but will grow significantly in coming years

• Share of private inflows has fallen recently, while rising overseas returns and investment may pull savings flows away from the US, posing risks to the US dollar and US asset markets

• Source of foreign inflows increasingly concentrated in China and Oil Exporters, raising risk of disruption due to protectionist legislation