REPORT TO THE SECRETARY OF THE TREASURY
FROM THE TREASURY BORROWING ADVISORY COMMITTEE OF THE
PUBLIC SECURITIES ASSOCIATION

August 4, 1993

Dear Mr. Secretary:

Since the Committee's meeting with Treasury in early May, economic activity led by car sales, capital spending, and industrial production has improved. Growth prospects for the current and following quarter center around a solid 3% for GDP. Inflation is widely viewed as stable near a stubborn 3% floor. The rising cost of medical services, public transportation, and college tuition, coupled with Federal, state, and local tax increases on gasoline, cigarettes, and income, seem to assure little additional progress will be made in reducing inflation further.

Notwithstanding the debate over whether current lower interest rates will offset the drag of higher taxes on GDP growth, profits, and incentives to work and invest, near-term optimism is constrained by the effects of reduced defense spending, increased taxation and retroactivity, uncertain health costs, low consumer confidence, continued corporate downsizing and the increased recognition that growing economies in Europe and Asia are required for extended GDP growth here. Responding to the above and the recently articulated posture of monetary policy, the yield curve has flattened significantly since early May. Specifically, the 12 month to 30-year spread has narrowed by over 50 basis points, as the 30-year bond has declined in yield by 28 basis points to 6.52% and 12-month and 2-year yields have increased by 28 and 36 basis points to 3.53% and 4.14%, respectively.

Within this context, the Committee met to consider the composition of a financing to refund $26.7 billion of privately-held notes and bonds maturing on August 15 and to raise $11 to $12 billion of cash. Given the announced $58.3 billion financing for the current fiscal quarter and the $22.25 billion previously issued or announced, there remains a net $36 billion to be financed this quarter. The Committee voted unanimously, 19-0, in favor of a quarter-end balance of $40 billion and the selling at competitive auction of three new issues totalling $38.5 billion comprised of:

<u>Refunding</u>
$16.5 billion of 3-year notes, maturing 8/15/96;

$11.0 billion of 10-year notes, maturing 8/15/2003; and

$11.0 billion of 30-year bonds, maturing 8/15/2023

to raise $11.8 billion new cash.

Underlying the Committee's refunding recommendation is its belief that (1) the quarterly refunding should remain a central focus of Treasury financing; (2) that investors expect the Treasury to confirm in this refunding its commitment to issue $11 billion or more long bonds twice a year; and (3) that the 10-year note should be $11.0 billion to affirm its new role as a global benchmark security and to signal that it will need to grow in size above present levels in the next quarterly refunding.

Summary of Quarterly Financing to be Done

Auctions	Date	Size	Raising
Refunding	August	$38.5 billion	$11.8 billion
2-year notes	August	$16.5	
	September	$16.5	$6.0
5-year notes	August	$11.0	
	September	$11.0	$13.6
1-year bills	August	$15.750	
	September	$15.750	$2.0
3- & 6-month bills	8 auctions	$24.4	
		$24.6	
		6 x $24.8	$8.0
Net Cash Mgmt Bills			(10.0)
Net Already Issued			$22.250
Foreign Add-ons			$4.6
Total net market borrowing			$58.250 billion

The Committee sees the need for one cash management bill of $6 billion to be auctioned September 2 to mature January 20, 1994, an attractive maturity given the high Treasury cash balance anticipated for January 31, 1994. The Committee notes a further potential cash need for up to $4 billion intra-September, and recommends an intra-quarter cash management bill to be auctioned September 2 to mature September 16.

Concerning the follow-on October-December first fiscal quarter, the Committee concurs with the targeted $35 billion quarter-end balance. The $95-100 billion net market borrowing anticipated by the Treasury is, however, above most current private estimates of approximately $85 billion. Should actual needs evolve closer to the private estimates, the Committee recommends reducing the 3- and 6-month bill offerings set forth in the financing schedule below:

Summary of October-December Financing

Auctions	Size	Raising
Refunding		
3-year	$17.250 billion	
10-year	$11.750	($3.2 billion)
2-year notes	$16.500	
	$16.750	
	$16.750	$7.0
5-year notes	$11.500	
	$11.500	
	$11.500	$26.3
1-year bills	$16.000	
	$16.500	
	$16.500	$5.7
3- & 6-month bill	2 x 25.600	
	11 x 26.400	$29.8
Cash management bills	$16.000 to mature 4/21/94	
	$15.000 to mature 1/20/94	$31.0
7-year		($6.5)
Estimated Foreign Add-ons		$5.8
Total Net Market Borrowing		$95.9 billion

The first fiscal quarter financing will be unique inasmuch as Treasury will not only face high interest payments on the November 15 mid-quarter refunding date, but as well will no longer raise money via 7-year notes or 30-year bonds. As such, larger offering sizes for the 2-year and 5-year note cycles, as well as the 3- and 10-year notes in the refunding will play key roles. Also, longer dated cash management bills, moving maturities to the second fiscal and prospectively less demanding third fiscal quarters, will be central.

Concerning the question of extending the single-price auction experiment for 2- and 5-year notes for one year beyond the auctions in August 1993, the Committee voted 19-0 in favor of continuation. In support of this unanimous view, the Committee offers the following observations:

--- The marketplace and investors expect the single price auction agreement to continue;

--- There appear to be no major negative effects associated with the experiment;

--- The experiment has been conducted in a market environment characterized by low volatility, an accommodative monetary policy, a positively sloped yield curve providing substantial financing margins, and widespread global investor participation. Additional data, particularly if it happened to be gathered in more adverse and volatile conditions, would be useful in assessing the value of single price auctions to the Treasury.

--- While as yet there appears no clear evidence, either way, that single-price auctions have reduced Treasury financing costs, attracted new investors, or encouraged more aggressive bidding, compared to multiple price auctions, interestingly, immediate post-auction volatility appears to be less with the single-price auction.

--- Lastly, the Committee felt that more experimentation and more extensive analysis, especially if under different market conditions and with the new Treasury financing focus, would be helpful in aiding the Treasury's assessment.

The committee also discussed the potential attraction of including other Treasury cycles in the experiment at a later date but achieved no consensus.

Mr. Secretary, this concludes the Committee's report and we stand ready to address your questions or comments.

Sincerely,

Morgan B. Stark
Chairman of the Treasury Borrowing
Advisory Committee of the PSA