MINUTES OF THE MEETING OF THE
PSA TREASURY BORROWING ADVISORY COMMITTEE
FEBRUARY 4 AND 5, 1992

February 4

The Committee convened at 9:00 a.m. at the Treasury Department. All members were present, except Mr. Fuld and Mr. Napoli (see attached list).

I gave the Committee an informational background briefing on Treasury's most recent borrowing estimates and historical information relevant to the refunding. The Treasury's estimates and background information were released to the public on February 3, 1992.

The Committee also received a briefing by a Treasury staff member on recent events in the U.S. economy, which was followed by a question-and-answer period. Assistant Secretary Powell then "charged" the Committee to make recommendations on the February Treasury refunding and related matters (see attached charge). The meeting adjourned at 10:40 a.m.

The Committee reconvened at 2:15 p.m. at the Madison Hotel; all members were present, except Mr. Fuld and Mr. Napoli. The discussion began with a discussion of the amount of the long-term bond to be offered. The following points were made:

-- Given the size of Treasury's financing needs now and in the foreseeable period, the Treasury should not cut the size of any of the securities that are offered currently.

-- It probably will be necessary in the fourth fiscal quarter of 1992 or in FY 1993 to add cycles to Treasury's financing schedule. A change in cycles, including cutting the size of the long-term bond in the February refunding, is not appropriate at this time.

-- The Treasury could leave the size of the long-term bond unchanged from the August and November 1991 refundings ($12 billion each), thus reducing the size of the bond in proportion to Treasury's overall financing needs.

-- The Treasury already has reduced long-term financing in relation to total borrowing, particularly considering that 30- and 40-year Refcorp bonds are no longer being issued.

-- Market absorption of the long-term bonds in the August and November 1991 refundings was not strong. Market participants currently have built the expectation that Treasury will cut the long-term bond to $9 to $10 billion in the February refunding into the yield on the existing 30-

year bond. At $12 billion or higher, the announcement of a a long bond would be followed by a market correction, increasing the yield on the 30-year maturity.

-- The Treasury should follow a consistent, predictable debt management strategy to lessen market volatility. Cutting the long-term bond would create uncertainty in the market and increase price volatility.

-- Treasury's ability to sell 30-year bonds is unique. Treasury does not crowd other borrowers out of that maturity sector, because most corporations could not issue 30-year bonds (credit quality concerns of investors) or would not issue them (they don't fit into the corporation's business plans). The effective maturity of mortgages is shorter.

-- Shifting Treasury financing toward intermediate and short maturities would put pressure on corporate borrowers and the mortgage markets.

-- Cutting the Treasury 30-year bond by a few billion dollars is not going to have a noticeable impact on long-term yields.

-- Treasury should issue long-term bonds to take advantage of market rates, which are low compared to rates in the 1980s. Corporations, municipalities, and individuals are extending the maturity of their debts.

The Committee voted 17-0 for the size and composition of the refunding and to reopen the 7-1/2s of 11-15-01 and the 8s of 11-15-21. Reopenings were recommended to provide for larger, more liquid issues, which would be more difficult to squeeze. The recommended refunding totals $39 billion and consists of $14.5 billion of 3-year notes, $12.5 billion of 9-3/4-year notes, a reopening of the 7-1/2s of 11-15-01, and $12 billion of 29-3/4-year bonds, a reopening of the 8s of 11-15-21.

The Committee agreed by consensus to the financing package recommended by the Chairman for the remainder of the January-March quarter. That package appears in the Chairman's report to the Secretary. Several members believed that the Treasury should give more emphasis to 52-week bills, a recommendation that was made formally in July.

The Committee also agreed by consensus that the appropriate levels of the Treasury cash balance are $20 billion on March 31 and $30 billion on June 30. It was suggested that a balance of $40 billion would not be inappropriate, given the size of the Treasury's July-September borrowing requirement that is implied by the FY 1993 Federal Budget.

After deciding on the refunding recommendation, the Committee turned its attention to the portion of the Charge requesting advice on how to determine whether to reopen a security and how the price should be decided. The Committee listed the following as indicators of a squeeze:

-- Trading slows;

-- Increase in fails and other delivery problems;

-- Yield on security in cash market differs significantly from yields on recently issued Treasury securities of similar maturity;

It was noted that the fact that a security is available only at below-market "special" rates in the repo market does not necessarily indicate an acute shortage of the security.

A "Bond Bank" concept was discussed to deal with a shortage of a security. The Treasury would make an elastic supply of a security available temporarily to prevent potentially disruptive shortages of particular securities. The Treasury could charge a penalty interest rate (less stringent that the market price or repo market rate) to entities that borrowed the securities and in so doing earn money that would reduce the Treasury's cost of borrowing.

Opposing the Bond Bank concept, the view was expressed that on-the-run Treasury securities are often used for hedging activities. A Bond Bank could encourage further hedging, using the on-the-run securities, and extend the period of time during which a security is on special in the repo market.

The Committee turned briefly to a discussion of the way to distribute reopened issues. It was suggested that a reopening might be done like the go-rounds that the FRB-NY does in connection with open market operations. A public announcement would be made of the availablility of securities, although not the amount to be awarded. Primary dealers would be requested to bid; other entities could bid through primary dealers.

The Committee did not make any specific proposals regarding reopenings, preferring to discuss the subject in more depth at a special meeting at a later date (preference expressed by consensus).

Nor did the Committee have time to discuss in detail the proposed single-price, open auction technique that is proposed in the <u>Joint Report on the Government Securities Market</u>, prepared by the Treasury, Federal Reserve, and SEC. The Committee, by consensus, also expressed the view that this subject should be included as a topic for the same special meeting in which reopenings will be discussed.

Several points were raised, however, concerning the proposed single-price, open auction, including its potential implications for the when-issued market. If the technique resulted in a broader distribution of securities through the auction, WI trading might be diminished. This could lead to greater market volatility and make it hard for the Treasury to determine the appropriate level at which to begin an iterative auction. Also, market participants' risk exposure could be increased by the time it would take to conduct an auction in which bidding is conducted in several iterations.

The meeting adjourned at 4:45 p.m.

February 5

The Committee reconvened at 9:00 a.m. at the Treasury. All members were present, except Mr. Fuld and Mr. Napoli. The Chairman presented the Committee report to Assistant Secretary Powell. There was a question-and-answer period related to the Committee report. The Treasury expressed an interest in holding a special meeting to discuss reopenings and the auction technique late in March. The meeting adjourned at 9:40 a.m.

Attachments

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