

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

**JANUARY 31, 1996**

Dear Mr. Secretary:

At the outset of this report, the Committee would again urge in its most forceful terms that legislative action to increase the statutory debt limit be taken promptly. In the Committee's judgment, raising the specter of default by failure to act on the debt limit as a means to support the political agenda of any constituency is inappropriate and counterproductive.

Since the Committee's last meeting in November 1995, the Secretary has taken a series of extraordinary actions to enable the Treasury to borrow the funds needed to meet the financial obligations of the Federal Government in a timely manner. These necessary measures were taken in the absence of an increase in the debt limit. Further, the Secretary has recently unveiled additional measures, if needed, to enable the Treasury to finance Government operations until February 29 or March 1. Thus, in the absence of action to increase the debt limit, the financial markets will once again confront the uncertainty and risk of the Treasury's inability to fulfill all of its financial obligations.

In our last report, dated November 1, 1995, the Committee addressed these risks, uncertainties and potential effects of default. It is our strong and unanimous view that there should never be any reason for the financial integrity of the United States Government to be questioned or doubted. Our Nation's creditworthiness is a precious asset which benefits all of us; it should not be bargained or compromised.

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Also, since the Committee's last meeting in November, 1995, the economy has continued to expand although at a somewhat slower pace than the third quarter. Inflationary pressures have remained generally subdued. As a result of some improvement in inflationary prospects, monetary policy was eased slightly in December.

Yields on Treasury securities extended the decline begun early last year. Short and intermediate-term rates declined 40 - 60 basis points, reflecting market perceptions of somewhat slower economic growth as well as the Fed's modest easing step. Currently, yield levels for short and intermediate maturities anticipate further easing moves by the monetary authorities. Yields for 30-year bonds fell about 25 basis points as the yield curve steepened. The more limited yield decline for longer-term securities reflected the cyclical nature of

slower economic growth, as well as some disappointment on the inability to reach agreement on balancing the budget in seven years.

Within this context, to refund the \$31.3 billion of privately-held notes maturing on February 15, 1996 and to raise \$21.2 billion of cash, the Committee recommends that the Treasury auction \$52.5 billion of the following securities:

- \$18.5 billion 3-year notes due February 15, 1999;
- \$14.0 billion 10-year notes due February 15, 2006;
- \$12.0 billion 30-year bonds due February 15, 2026; and,
- \$8.0 billion cash management bills due February 29, 1996.

The 16 Committee members present for the meeting were unanimous in their support of the composition of the refunding package.

In considering whether to recommend issuing a new 10-year note or reopening the 5 7/8 percent notes due November 15, 2005, Committee members observed that though the outstanding issue has recently been in short supply in the repurchase agreement market, there was no compelling evidence that the shortage was unusual. It seems likely that the shortage should be alleviated once a new 10-year note is auctioned. On this basis, the Committee voted 15 to 1 in favor of a new issue.

The Committee also considered whether to recommend issuing a new 30-year bond or reopening the 6 7/8 percent bonds due August 15, 2025. Generally, Committee members remain supportive of bond reopenings for the purpose of enhancing liquidity, particularly in view of the diminished level of activity in the secondary market for Treasury bonds which has occurred since the Treasury's reduced issuance in this maturity sector. However, the 11 point premium of the current 30-year bond, was viewed as a significant impediment to broad-based investor interest in a reopening. On this basis, the Committee voted unanimously in favor of a new 30-year bond.

With the aim of achieving a cash balance of \$20 billion on March 31, the Committee unanimously recommends that for the remainder of the quarter, the Treasury meet its borrowing requirement in the following manner:

- One 5-year note totaling \$12.5 billion, to raise \$4.1 billion of new cash;
- One 2-year note totaling \$18.75 billion, to raise \$0.3 billion of new cash;
- One 1-year bill totaling \$19.25 billion, to raise \$1.9 billion of new cash;
- Weekly issuance of 3- and 6-month bills through the remainder of the quarter, to raise \$20.8 billion of new cash; and
- Cash management bills totaling \$36.0 billion to mature in late April to refund the cash management bills which mature on February 29 as well as to meet the seasonal cash need in early March.

Including the \$21.2 billion raised in the mid-quarter refunding, the proposed financing schedule will raise a total of \$76.3 billion. This amount, when added to the \$9.0 billion already raised or announced in the quarter, will accomplish the total net borrowing requirement of \$85.3 billion.

In considering the Treasury's financing composition for the remainder of the January to March quarter, the Committee noted an abnormally large amount of uncertainty with respect to the timing of Federal expenditures. It is possible that the Treasury's borrowing requirement in the current quarter will be less than the estimated \$85.3 billion. In this circumstance, the Committee feels that heavy reliance on cash management bills with late April maturities will afford the Treasury maximum flexibility.

For the April-June quarter, the Treasury estimates a net borrowing requirement in the range of \$0 - 5 billion with a cash balance of \$35 billion at the end of June. To accomplish the anticipated net borrowing requirement, the Committee recommends the provisional financing schedule attached to this report.

In developing its financing recommendations, the Committee was mindful that the cash raising potential of the 5-year note has been substantially diminished. For this reason, and consistent with our last report, the Committee recommends modest increases in all coupon cycle offerings each quarter during 1996. However, even with modest and steady increases in the size of coupon issues this year, more than 50 percent of the Treasury's net market borrowing requirement will be achieved through the issuance of Treasury bills. This increased concentration of short-term financing, if continued, will ultimately become worrisome to investors. Thus, the Committee continues to advocate a debt management policy which avoids undue reliance on short-term financing and arrests the decline in the average length of the debt. Specifically, and as outlined in our last report, the Committee again recommends more frequent issuance of longer dated securities.

In response to a request for its views, the Committee considered the Treasury's role in overseeing and coordinating the scheduling of securities issues by Government sponsored agencies. However useful and necessary such a role might have been in the early stages of development of the Agency securities market, the Committee members generally felt that such a role was no longer needed at least insofar as the stability of the Treasury and Federal Agency securities markets was concerned. Moreover, with the advent of new financing techniques, including the development of medium-term note programs, there is some evidence that the requirements for prior review are contributing to inefficiencies, including artificial distortions of issue sizes. Finally, such a review process might be mistakenly viewed as connoting Treasury approval of the structural features of the debt being issued, the adequacy of information being provided to investors, or even the credit standing of the issuer. Accordingly, the Committee felt that the Treasury should consider procedural steps it might take, within the framework of the existing law, to streamline the process and minimize the Treasury's role as a reviewer.

Respectfully submitted,

*Richard M. Kelly*

Richard M. Kelly  
Chairman