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

November 3, 1992

Dear Mr. Secretary:

When we met last, improving productivity, low inflation, and the strengthening of corporate and personal balance sheets all pointed to unwinding the excesses of the 1980s and, ultimately, a steady expansion of and, hence, a healthier economy. Now, notwithstanding six consecutive quarters of positive GDP growth, a decline in initial unemployment claims, and recent improved statistics for home sales, construction spending, the purchasing managers' index, and the prospect for fiscal stimulus, caution still dominates. Specific concerns include lack of growth in employment, the slow pace of cuts in European interest rates, the prospects of trade wars as a result of failed Gatt talks, and the uncertainty of government policy subsequent to today's national election.

Since our last meeting, bill rates, with the exception of the 3 month maturity, are essentially unchanged, while most coupon issues are 20 basis points higher in yield, and the spread between the 2 and 30 year maturities has widened 20 basis points to 325 basis points. Further, reflecting the 1% reduction in Fed Funds since year end, all bills and coupons out to 5 years are lower in yield, while rates from 7 years out to 30 years have either remained relatively unchanged or risen about 20 basis points, and the 2 to 30 year yield spread has increased by approximately 60 basis points.

It is within this framework that the Committee recommends that the following securities be sold to refund $23.1 billion of maturing privately-held securities and raise $13.9 billion of new cash for delivery November 15.

-- $15.250 billion 3-year notes due November 15, 1992
-- $11.750 billion 6 3/8% notes due August 15, 2002
-- $10 billion 7 1/4% bonds due August 15, 2022

The Committee's vote on the size and composition of the refunding was unanimous and, consistent with past recommendations to develop, where possible, a smaller number of larger and hence more liquid issues, the Committee was nearly unanimous in favoring a reopening of the outstanding 10 and 30 year maturities, rather than the creation of two new issues.

Present substantive uncertainties, such as today's national election and Friday's unemployment data, may cause significant changes in prices between the refunding announcement and the auctions of the 10 and 30 year issues. The Committee recognizes that to qualify under IRS notice 92-13 regarding Original Issue Discounts (OID), the Secretary of the Treasury may need to declare that one or both of the issues are being reopened "to alleviate an acute, protracted shortage".

At current price levels, such a declaration, in the case of the 30 year bond, would be neither necessary nor in the Committee's view required. The Committee nearly unanimously favored a reopening of this issue.

Opinion was more divided on the 10 year issue. A modest majority favored reopening the 10 year issue believing that "an acute, protracted shortage" does now, in fact, exist and such a declaration would be warranted as is required at present price levels by the IRS notice. Those in support of this position reached their judgement following a review of the criteria set forth in our March 11, 1992, report as well as other publicly discussed criteria. Those opposed believed that the extent to which the purported "shortage" exists is insufficient to be termed "acute and protracted" and cite as one bit of evidence of the insufficiency the near-even division of the Committee itself.

Given that reopening the 10 year would, at present price levels, require OID exemption, an early Treasury declaration is needed so as not to unnecessarily confuse the W.I. trading. Absent such a declaration by the Treasury, the Committee would recommend a yield auction of $11.750 billion new 10 year notes to mature November 15, 2002. If the Treasury decides against reopening the outstanding 30 year issue, the Committee recommends the issuance of $10 billion new 30 year bonds to mature November 15, 2022.

For the remainder of the current quarter, the Committee recommends that the Treasury sell at auction:

- Two 2 year notes of $15.250 billion, raising $3.9 billion new cash.
- Two 5 year notes of $11 billion, raising $22 billion new cash.
- Raising the weekly bill auction sizes to $24.4 billion and the year bills to $15.250 billion, raising $15.3 billion new cash.
- Three cash management bills, the first of which would be the intra-quarter bill of $15 billion already announced for the auction early in November to mature December 17, 1992. The second and third would need to be auctioned early in December, with $10 billion to mature January 21, 1993 and $16 billion to mature April 22, 1993, for net new cash of $26 billion.

<u>Summary of New Cash for the Quarter</u>

Refunding		$13.9 billion
Cash Management bills		26.0 billion
3 and 6 month bills		11.0 billion
52 week bills		4.3 billion
2 year notes		3.9 billion
5 year notes		22.0 billion
Less: 4 year note maturity		(7.6 billion)
Total		$73.5 billion
Plus:	Already raised	$11.5 billion
	Estimated Add-ons	2.0 billion
Net Market Borrowing		$87.0 billion

Lastly, while the Committee supports the resulting year-end balance of $30 billion, it notes most private forecasts have the Treasury's cash needs some $10 billion lower this quarter and similarly higher in the following quarter. Should these forecasts be borne out, the Committee recommends first reducing the January 21, 1993 Cash Management bill in order to shift as much new financing as is possible into the traditionally light third fiscal quarter.

For the January-March quarter, the Committee agrees with the targeted $20 billion end-of-quarter balance. To fund the anticipated $65-70 billion net marketable borrowing, the Committee sees the need for only modest increases in existing bills, coupons, and refunding cycles. Specifically, the Committee recommends increasing 3 and 6 month bills to $24.8 billion, 1 year bills to $16.250 billion, 2 year notes to $15.5 billion, 5 year notes to $11.250 billion, the 7 year note to $10 billion, and the refunding to $38 billion.

In response to the question regarding the single price auction, the Committee believes that with only four 2 and 5 year auctions completed under the experiment, it is far too early to reach lasting judgments. That said, the Committee commends the extended 12 month experiment which the Treasury has announced. Some preliminary observations drawn from the discussions of the experiment include:

-- Curiously, professional bidders seeking to cover short positions and true investors "requiring" the issue for their portfolio seem to have been prepared to bid lower in yield than existing trading market levels just prior to auction to assure their purchases.

-- Treasury interest savings remain unclear, however, with some believing the recent 2 year likely will save the Treasury a few basis points, while the prior 5 year may have cost the Treasury a like amount.

-- Market liquidity for the period from just before the auction through when the results are announced appeared somewhat reduced. From these limited samples there seems to be a reduction in late "set-up" trading which otherwise occurs over the final 30 minutes before an auction.

-- There seems to be greater uncertainty over the stop price in the single price auctions. The market impact can be mitigated by quicker release of the results, as is expected from automating the auction process.

-- Lastly, adding data from Cantor Fitzgerald would usefully augment the data from GOVPX.

Mr. Secretary, that concludes our report, and we welcome any questions and comment.

Morgan B. Stark

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Chairman