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

May 5, 1993

Dear Mr. Secretary:

Since the Committee's last meeting with Treasury in early February, the then steady stream of improving economic statistics and associated growing confidence in a sustainable recovery has recently given way to renewed caution and old concerns. First quarter GDP, though positive, was below expectations and sharply behind the fourth quarter pace. Shrinking military spending, unseasonably severe winter weather, low income tax refunds already spent because of reduced withholding, a prospect of significant tax increases, uncertain health care costs, continuing slow job growth, and further corporate down-sizing have joined to offset the initial enthusiasm for change under a new Administration, the stated goal of deficit reduction, and the eventual benefits of the continuing move to lower interest rates. Importantly, current views still favor positive GDP growth in the 2% range, with steady gains in productivity constraining core inflation to approximately 3%. Interest rate declines have been meaningful: 50 and 40 basis points for the two and thirty-year maturities, respectively, since the last refunding announcement, and even more impressively 81 and 53 basis points for the same two maturity sectors since year end. Disturbingly, however, the yield curve has continued to steepen between two year and ten year and ten year and thirty-year maturities.

More than the usual economic, budgetary, market and financing uncertainties, to which it is accustomed, confronted the Committee when it met yesterday to deliberate. Because the results of the Treasury's review of its debt management strategy will not be made public until this afternoon, the Committee met without the knowledge of the framework within which the Treasury plans to conduct its borrowing activities over the remainder of this quarter and beyond. Given this unfortunate timing, the Committee felt constrained in its ability to offer recommendations in the detail normally provided. The Committee's best thinking on debt management was extensively set forth in the report of its March 15, 1993 meeting. Our thoughts remain the same and therefore no useful purpose would be served by reiterating those views.

Given this circumstance, the Committee felt the most helpful course would be to assume a total refunding size consistent with recent quarterly refundings, current projections of cash needs, and market expectations. The Committee favored by a vote of 19-0 a total refunding amount of between $35.5 and $36.5 billion, and used $36 billion as its working assumption. Further, if the Treasury were to continue its traditional composition of three, ten and thirty-year offerings, the Committee favored, again by a vote of 19-0, reopening the existing ten and thirty-year issues. The recent reductions in the size of the longer-dated offerings -- cumulate some $3 billion per quarter for the thirty-year alone -- has contributed to financing "squeezes" and widening spreads between "active" and "seasoned" issues. Trading has become less orderly with occasional price discontinuities as risk capital and dealer and investor sponsorship has shifted elsewhere. Particularly true for the thirty-year, there is a growing concern that this erosion of trading patterns could spread to the ten year, the evolving new long bond, and a key capital markets hedging instrument. The Committee continues to believe that the quarterly refundings should be viewed as the center piece of all Treasury financing and, in fact, should grow in size relative to other cycle offerings.

With the announced $37 billion quarterly Treasury financing requirement and a net pay down of $750 million to date, $37.750 billion remains to be financed in the current quarter. Assuming a $36 billion refunding, net new cash raised in the quarter could be accomplished as follows:

Auctions	Date	Size	Raising
Refunding		$36 billion	$12.1 billion
2-year notes	May	15.5	
	June	15.75	4.900
5-year notes	May	11.00	
	June	11.00	22.000
4-year note	June	Maturity	(7.900)
1-year bill	June	15.0	.700
3- & 6-month bills		7 auctions of 22.4, 23.4, 24.0, 24.4 & 3 x 25.0	2.950
Foreign Add-ons			3.000
Total net market borrowing:			$37.750

The Committee sees the need for an intra-quarter cash management bill of approximately $15 billion to be auctioned in mid-May and to mature June 17. The Committee concurs with Treasury's quarter-end balance targets of $35 billion for June 30 and $40 billion for September 30. A higher June balance might be considered given the anticipated fourth fiscal quarter needs.

Mr. Secretary, the Committee recognizes the incomplete nature of this report. In common with financial market participants every where, the Committee awaits the release this afternoon of the results of the Treasury's review of its debt management strategy with the hope that the uncertainty of the past few months and the associated increased market volatility, and ultimately increased financing costs to the Treasury, will be brought to an end as its borrowing again assumes a more regular and predictable pattern. The Committee stands ready not only to respond to questions this morning, but also to reconvene if so asked to complete or modify its recommendations within the framework of the Treasury's new debt management strategy.

Morgan B. Stark
Chairman of the Treasury Borrowing
Advisory Committee of the
Public Securities Association