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

November 3, 1993

Dear Mr. Secretary:

Since the Committee's meeting with the Treasury in early August, concerns over the tepid 1.4% growth in GDP during the first half have been replaced by concerns over the confluence of substantial Treasury borrowing in the first fiscal quarter and improved economic vigor, as evidenced by the initial report of third quarter GDP growth which accelerated to 2.8% despite the dampening effects of the mid-west floods. Consensus thinking expects upward revisions and a fourth quarter GDP solidly above 3%, with trend inflation at or below 3%, excepting known tax increases. The recent dramatic drop in oil prices supports the case for a continuing favorable price outlook. Gains in automobile sales and production and in home sales and construction, together with improved borrower creditworthiness and the easing of debt servicing costs, have combined with growth in jobs and income and an increase in consumer confidence and spending to encourage conviction in the current strengthening trend. Future prospects, however, remain constrained by defense cutbacks, soft net exports, continuing corporate downsizing, inventory strategies and de-leveraging.

Over the three-month period, monetary policy remained stable. Treasury yields were unchanged for 2- and 3-year notes, while apart from the anomaly of the current 30-year bond in favor of the old bond, yields for 5-, 7-, and 10-year notes and the 30-year bond were approximately 20 basis points lower, resulting in a general flattening in the yield curve.

It is within this context that the Committee met to consider the composition of the quarterly financing to refund $32.2 billion of privately-held notes and bonds maturing November 15. Given the $85.250 billion financing requirement for the current fiscal quarter and the $36.250 previously issued or announced, there remains a net $49.000 billion to be done. The seventeen Committee members present voted unanimously in favor of a quarter-end balance of $35 billion and for the selling at competitive auction issues in the quarterly refunding totalling $29.500 billion:

-- $17.500 billion of 3-year notes maturing November 15, 1996; and
-- $12.000 billion of the 5 3/4% 9 3/4 year notes.

for a pay down of $2.7 billion. The Committee then voted unanimously in favor of the following summary schedule of borrowing for the remainder of the quarter:

Auctions	**Date**	**Size**	**Raising**
Refunding	November	$29.5 billion	-$ 2.7 billion
2-year Notes	November	$16.5	
	December	$16.5	$ 4.1
5-year Notes	November	$11.0	
	December	$11.0	$22.0
1-year Bills	November	$16.250	
	December	$16.250	$ 3.4
3 & 6 month bills	8 auctions	$27.6	$25.1
Less 7 5/8 12/31/93, four-year note maturity:			-$ 8.2
Net already issued or announced:			$36.250
Plus estimated foreign add-ons:			$ 5.300
Total Net Market Borrowing:			$85.250 billion

Concerning the unanimous vote not only to re-open the existing 10-year (5 3/4% note due 8/15/03) but also to increase its offering size, the Committee cites the following points:

1) The need for the 10-year issue to grow in size to meet prospective borrowing requirements was addressed in our a August 4 report.

2) Evidencing persistent shortages in the collateral markets, the current 10-year issue has been on "special" since its original sale, significantly differing from the pattern that characterized previous 10-year notes.

3) The historically low cost of longer-term borrowing could help offset the risks associated with the current focus on short maturity financing.

4) The cancellation of the 7- and 20-year cycles has significantly reduced previous supply in this sector.

5) Corporate underwriters, mortgage-backed departments and derivative swap desks often use the 7- and 10-year Treasuries for hedging.

6) The marketplace and investing public expect both an increase in the size of the 10-year issue and a re-opening of the outstanding issue.

7) Lastly, a new 10-year note would not likely command a significant liquidity premium. In fact, enlarging the outstanding 10-year should foster its development as the global benchmark issue for the U.S. and thus contribute to the attendant lower yield that a benchmark security typically commands.

As revealed in Treasury's chart presentation and the announcements of the increases in the weekly 3- and 6 month bill auctions to $27.6 billion and of the November 10 auction of $10 billion cash management bills to mature 12/16/93, the Treasury faces a number of intra and inter-quarter cash flow and balance management challenges linked to intra-quarter financing, Treasury cash flows, regular weekly 3- and 6-month bill sizes, concerns about a higher than desirable year-end balance, and the need in December to sell a late January 1994 cash management bill. First, the Committee notes that according to most private forecasts, the Treasury may need as much as $9 billion less in this financing quarter then its forecast indicate. Within the framework of holding 3- and 6-month bills at $27.6 billion for the quarter and the announced $10 billion December 16 cash management settling November 10, the Committee sees the potential need for an intra-quarter $14 billion December 23 cash management bill settling November 15 and a further $10 billion January 27, 1994, cash management bill to settle December 3. Given the usefulness of having a substantial January 27, 1994, maturity when Treasury cash should be high, the Committee recommends reducing the current size of the weekly 3- and 6-month bills sufficiently to accommodate approximately a $10 billion January 27, 1994 cash management bill and bringing the 3- and 6-month bills weekly more in line with the approximately $26.4 billion anticipated levels needed for the second fiscal quarter.

Concerning the follow-on January - March second fiscal quarter, the Committee concurs with the targeted $20 billion quarter-end balance which suggests the following summary of borrowing for the quarter.

Auctions	Size	Raising
Refunding:		
3-year	$17.5	
10-year	12.0	
30-year	11.0	$16.5 billion
2-year Notes	3 x 16.750	5.250
.5-year Notes	3 x 11.250	33.750
1-year Bills	1 x 16.250	
	2 x 16.500	4.800
3- and 6-month Bills	13 x 26.400	10.600

Cash Management Bills	Maturing 1/27	$10	
	New Issue 4/21	$11	1.0
Plus: Estimated foreign add-ons:			6.5
		TOTAL	$78.4 billion

Less:

Maturity of $7.3 billion 7% 1/15/94 7-year Note
and $8.1 billion 8 1/2% 3/31/94 4-year Note

	TOTAL	$15.4 billion
Total Net Market Borrowing:		$63.0 billion

Concerning the Treasury's request for the Committee's views on the schedule of auctions for November and December given the holidays, the Committee is pleased to attach its proposed calendar.

Lastly, the Committee discussed at some length the apparent anomaly surrounding the current 30-year bond. The decision of the Treasury announced in May to reduce its reliance on long-term borrowing, shifting to semi-annual 30-year offerings with the aim of borrowing current interest expense, may be seen by the market to conflict with the Treasury's policy of relieving, by means of a reopening, any "acute and protracted shortages" that develops in long-term issues. The Committee continues to support the view that only if all three of the following conditions exist is a reopening warranted:

1) The issue is experiencing lengthy financing pressure with financing costs significantly below general collateral.

2) There exists a known undue concentration of holdings.

3) The issue trades at an excessive price to surrounding issues.

In these circumstances, it would be appropriate to consider reopening the issue in order to retain orderly markets and, most importantly, investor confidence.

In this connection, the Committee notes that the current 30-year is trading some 25 basis points in yield lower than surrounding issues and is being financed to February 15, 1994 at rates well below normal levels. Although the Committee does not believe that the foregoing criteria for an "acute and protracted shortage" are fully met at present, a situation could possibly develop wherein Treasury's credibility in dealing with such situations might be challenged given the financing strategy announced last May.

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

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

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Attachments