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

MAY 4, 1994

Dear Mr. Secretary:

Since the Committee's last meeting with the Treasury three months ago in February 1994, the economy has continued to expand at a solid pace. The cyclical nadir in the rate of inflation almost certainly has been passed. Monetary policy has become less stimulative; in three separate increments, the Federal funds rate has been raised from 3.00% to 3.75%, and forward prices for various fixed-income instruments indicate market participants expect further increases in the coming months.

Over the three-month interval since early February yields on Treasury securities have increased by approximately 90 to 170 basis points. The largest increases have been for intermediate maturities of two to five years, while the very shortest and very longest maturities have increased the least in yield. As a consequence, the yield curve has steepened for short and intermediate maturities and flattened for longer maturities.

Within this context, to refund the $28.2 billion of securities maturing on May 15, 1994 that are privately held, the Committee recommends that the Treasury auction $29.0 billion of the following securities:

- $17.0 billion 3-year notes due May 15, 1997; and,

- $12.0 billion 10-year notes due May 15, 2004.

After extended discussion, 15 of the 18 members of the Committee present for the meeting voted in favor of this recommendation, while the other three favored reducing the three-year note to $16 billion and raising the ten-year note to $13.0 billion.

A number of arguments were presented in favor of the minority's position. Foremost was the concern, addressed by the Committee in previous reports, that the Treasury's borrowing strategy of reducing the reliance on maturities over seven years and increasing commensurately the reliance on maturities of three years and under will be judged over the longer run to be ill-advised. The significantly greater increase in yields which occurred in recent months for intermediate maturities was cited by some members as a consequence due in part to the present borrowing strategy. Another argument given in support of increasing the proportion of ten-year notes in this refunding while reducing the proportion of three-year notes was the need to signal to the market the prospective increases that will be required later in the year in the sizes of longer-term offerings, including both the ten-year and thirty-year issues.

The majority of the Committee, while sharing fully the view that it would have been preferable for the Treasury to rely more heavily in its borrowing on the ten- and thirty-year issues, opposed reducing the size of the three-year offering in this refunding since prospective borrowing needs ensure that the cycle will need to grow, perhaps as early as the upcoming refunding in August. The value of signaling to the market, through an increase in the size of the ten-year issue, the prospective growth in the size of longer offerings was considered minor since most forecasters were already aware of the need.

With the aim of achieving a cash balance of $40 billion on June 30, the Committee unanimously recommends that for the remainder of the quarter, the Treasury meet its borrowing requirements in the following manner:

- Two 5-year notes of $11.0 billion each, to raise $22 billion of new cash;

- Two 2-year notes of $17.0 billion each, to raise $3.9 billion of new cash;

- Two 1-year bills of $16.5 billion each, to raise $2.9 billion of new cash;

- Weekly 3- and 6-month bills totaling $24.8 billion for settlement on May 19 and then totaling $25.6 billion for each week during the remainder of the quarter, to reduce cash in aggregate by $7.9 billion;

- Redemption of the 3 1/2% 1994-1999 bond on May 15, 1994, to reduce cash by $1.0 billion; and,

- Redemption of the outstanding 4-year note on June 30, 1994, to reduce cash by $7.9 billion.

Including anticipated foreign add-ons of $5.0 billion and the $800 million raised in the mid-quarter refunding, this financing schedule will raise a total of $17.8 billion. In addition, intra-quarter cash management bills totaling approximately $20.0 billion will be needed to cover the cash low points in late May and early June.

For the July-September quarter, assuming an end-of-period cash balance of $40 billion, the Committee recommends the following provisional financing schedule:

Auctions		Size	Raising
Refunding: 3-year note		$ 17.0	
10-year note		12.0	
29 3/4-year bond		11.0	
		$ 40.0	$ 10.4 billion
5-year notes		3 x 11.0	33.0
2-year notes		3 x 17.0	4.9
1-year bill		3 x 17.0	5.1
3- and 6-month bills		13 x 26.2	12.3
Estimated foreign add-ons			7.3
	Subtotal		$ 73.0 billion
Less: 7-year note maturity			(7.2)
4-year note maturity			(8.3)
	Subtotal		$ (15.5) billion
Total Net Market Borrowing			$ 57.5 billion

The Committee also notes the likely need for the issuance of intra-quarter cash management bills to cover cash low points in late August and early September.

In response to the request for its views on the experiment to date with single-price auctions for two- and five-year notes, the Committee offers the following comments:

- Anecdotal evidence suggests that compared to the multiple-price auctions for three- and ten-year notes, the single-price auctions for two- and five-year notes has broadened the base of distribution and reduced the concentration of winning awards. If this impression is confirmed by further analysis of the data available to the Treasury, two important measures of success will have been met.

- Examination of the data presented to the Committee, combined with the observations of members from their own experience, suggests that while on occasion single-price auctions may have led to higher costs to the Treasury than might have occurred in multiple-price auctions, these occasions are balanced by others where there were apparent savings. The data to date reveal no consistent pattern. It is important to note, however, that most of the period covered by the data was, until recently, comparatively benign. Results for periods of high volatility are not yet available.

- In the instances where single-price auctions seemed to have resulted in yields materially above the levels prevailing in the when-issued market at the time of the auction, the difference appears related to the market environment at the time rather than to the auction technique. There is no clear basis for believing multiple-price auctions would produce systematic savings to the Treasury in these same environments.

- It would be useful to expand the analysis of when-issued trading to include not only the period immediately subsequent to the auctions but also the period immediately prior. Despite the difficulties of comparing auctions of securities of different maturities, an analysis of price patterns in the hour or two prior to single-price auctions with those in the comparable periods for multiple-price auctions may reveal whether there exist any significant differences.

- Market liquidity prior to single-price auctions may be greater than for multiple-price auctions because sellers have greater confidence that their sales can be successfully covered in the auctions at market levels prevailing at the time of the auctions. In addition, as noted in an earlier report by the Committee, there seems to be some evidence that post-auction trading in single-price auctions is less volatile.

On the basis of this assessment, which given the comparatively brief period is necessarily substantially subjective, the Committee recommends that the Treasury:

- Extend the experiment with single-price auctions for another year from August 31, 1994.

- Consider expanding the experiment to one or more additional maturities. There was no consensus among Committee members which maturity or maturities might be most suitable. Some members favored the three-note as being a natural extension from the present two- and five-year notes. Others expressed the view that since no major negatives with multiple-price auctions have been revealed so far, more might be learned from longer maturities, such as the ten-year or the thirty-year.

- Because it is the principal objective of single-price auctions, focus further analysis of the auction data on the extent to which single-price auctions encourage broader participation and less concentration among bidders.

Mr. Secretary, that concludes the Committee's report. We welcome any questions or comments.

Respectfully submitted,

Stephen C. Francis

Stephen C. Francis
Chairman