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

FEBRUARY 1, 1995

Dear Mr. Secretary:

During the three months since the Committee's last meeting with the Treasury in November 1994, economic activity has remained robust. Price increases for final goods are still subdued, but inflationary pressures in raw materials and intermediate goods are intensifying. In response, the Federal Reserve has continued to tightened monetary policy, and the Federal funds rate now stands at 5.5%, 0.75% higher than in early November.

Yields on Treasury securities have moved in divergent directions during the three-month interval. At the extremes, yields on maturities under six months rose by approximately 75 basis points, whereas yields on maturities of ten years and longer declined by approximately 20 basis points. The result was a substantial flattening of the yield curve. Its present shape and forward prices for various fixed-income instruments indicate market participants continue to expect further increases in interest rates in the coming months, but to a lesser extent and at a slower pace than previously.

Within this context, to refund the $30.5 billion of notes and bonds maturing on February 15, 1995 that are privately held and to raise additional cash of $16.5 billion, the Committee recommends that the Treasury auction $47.0 billion of the following securities:

- $17.0 billion 3-year notes due February 15, 1998;

- $12.0 billion 10-year notes due February 15, 2005;

- $11.0 billion 30 1/4-year bonds due May 15, 2025; and,

- $7.0 billion cash management bills due April 20, 1995.

The Committee was unanimous in its recommendation on the size of each of the refunding issues and on the maturity of the 3-year offering. With respect to the 10-year offering, 14 of the 16 Committee members present for the meeting favored a new issue rather than a reopening of the 7 7/8% note due November 15, 2004. The principal argument cited in favor of this position was that a reopening would raise the total amount maturing on that date to over $32 billion. The already uneven schedule of maturities in the years 2001 to 2004 would be exacerbated

while the February 15, 2005 maturity slot would be left vacant. The two remaining members of the Committee had no strong views on the matter and abstained.

With respect to the bond offering, three options were considered: a new 30 1/4-year issue, a new 30-year issue, and a reopening of the 7 1/2% bond due November 15, 2024. Nine members of the Committee favored a new 30 1/4-year issue, citing the belief that the longer issue with May and November coupons would be particularly attractive for stripping purposes and possibly as a consequence be issued at a modestly lower yield. The six members who favored a reopening of the 7 1/2% bond due November 15, 2024 concurred in the preference for an issue with May and November coupons but thought that the larger issue which would result from a reopening offered the prospect of greater liquidity and thus some potential saving in cost.

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:

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

- Two 2-year notes totaling $17.25 billion each, to raise $3.8 billion of new cash;

- One 1-year bill totaling $17.25 billion, to raise $750 million of new cash;

- Weekly 3- and 6-month bills totaling $27.6 billion through the remainder of the quarter, to raise $12.8 billion of new cash;

- A cash management bill totaling $14.0 billion to mature on April 20 to meet the seasonal cash need in early March; and,

- Redemption on February 15 of bonds called earlier, to reduce cash by $2.0 billion.

Including the $16.5 billion raised in the mid-quarter refunding as well as anticipated foreign add-ons of $4.9 billion, the proposed financing schedule will raise a total of $72.75 billion. When added to the $21.0 billion already raised or announced during quarter, this amount will accomplish the total net borrowing requirement of $93.75 billion.

For the April-June quarter, the Treasury estimates a paydown of $5 to $10 billion of marketable securities with a cash balance of $35 billion at the end of June. To accomplish the anticipated paydown, the Committee recommends the following provisional financing schedule:

Auctions		Size ($billions)	Raising ($billions)
Refunding:	3-year note	17.0	
	10-year note	12.0	
		29.0	(3.1)
Other:	5-year notes	3 x 11.0	33.0
	2-year notes	3 x 17.25	2.6
	1-year bills	4 x 17.25	2.1
	3- and 6-month bills	2 x 27.6	
		11 x 25.4	(20.1)
	Estimated foreign add-ons		6.0
	Subtotal		20.5
Less:	Redemption of April cash management bills		(21.0)
	Redemption of 7-year notes		(7.0)
	Total Net Market Paydown		(7.5)

The Committee also notes the likely need for the issuance of intra-quarter cash management bills to cover cash low points during the quarter.

In formulating its response to the request for the Committee's views on possible adjustments to the Treasury's borrowing pattern beginning in January 1996, when the 5-year note series will have come full cycle and no longer provide significant amounts of new cash, the Committee first sought to identify the basic principles which should guide its recommendations. Committee members agreed on two areas of major concern: the average length of the debt and the schedule of maturities.

Although the Committee is aware of no compelling study or argument that points to an optimal average length for the debt, the present pace of decline, if continued, will increase the Treasury's exposure to variations in the level of interest rates and could become a subject of worry to investors. From its recent peak of 6 years in June 1991, the average length of privately-held marketable debt has fallen to 5 years, 6 months. If the present borrowing strategy is continued into 1996 and beyond, the pace of the decline would continue unabated. Though it cannot say when, the Committee does believe that at some stage the trend will attract the notice of investors in the US and abroad and begin to raise concerns. The consequences are unknown, but it seems highly likely there would be a negative effect on the Treasury's cost of borrowing over the longer-term.

This concern led the Committee to the principle of having as one objective of its recommendations for adjustments to the Treasury's borrowing pattern

beginning in January 1996 a slowing or an arresting of the pace of decline in the average length of the debt.

Of comparable importance in the Committee's judgment is the schedule of maturities of the marketable debt. For the past several years, the proportion of the debt maturing under two years, for example, has been reasonably stable at levels under 50 per cent. With the current borrowing strategy, the proportion is destined to rise, as it has been recently. While again the Committee knows of no convincing case that points to some ideal schedule of maturities, a rise in the proportion of debt maturing within one or two years, especially in conjunction with a steady decline in the average length of the debt, seems bound ultimately to raise concerns among investors. In the inevitable periods of stress in the financial markets, it is likely that a heavy concentration of maturities to be refinanced in the near-term could add materially to the Treasury's cost of borrowing.

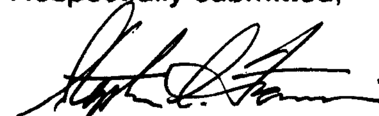
This concern led the Committee to the view that the second objective of its recommendations for adjustments to the Treasury's borrowing pattern beginning in January 1996 should be to ensure a more even spread in the schedule of maturities across the full maturity spectrum and a concomitant avoidance of undue reliance on short-term financing.

Given these principles and objectives, the Committee unanimously recommends that the sources of new borrowing be concentrated in longer-term maturities. Specifically, consideration should be given to increasing the cycle frequency of either the 10-year note or 30-year bond. For example, the frequency of issuance for the 10-year note could be increased to eight times a year, or the frequency of issuance for the 30-year bond could be returned to four times a year. To facilitate an increase in the cycle frequency, the size of individual offerings could be reduced from present levels while enlarging the total amount raised over the cycle.

In recommending that new borrowing stress longer-term coupon issues, the Committee rejected the alternative of increasing the frequency and proportionate sizes of either 52-week bills or 3-year notes or other shorter-term issues. However, the Committee remains in favor of pursuing the feasibility of issuing new types of securities, including variable rate notes, which offer the prospect of lowering the Treasury's cost of borrowing.

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

Respectfully submitted,



Stephen C. Francis
Chairman