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REPORT TO THE SECRETARY OF THE TREASURY  
FROM THE U.S. GOVERNMENT AND FEDERAL  
AGENCIES SECURITIES COMMITTEE OF THE  
PUBLIC SECURITIES ASSOCIATION  
January 29, 1986

Dear Mr. Secretary:

Since the Committee last met in Washington in July, interest rates have declined across all maturities. The most significant reductions have occurred among the longest maturities where rates have fallen by about 1-1/2 percentage points. Short-term rates have declined in this period by nearly 50 basis points and intermediate-term rates are more than 1 percentage point lower. On balance, the yield curve has substantially flattened.

Several developments, both technical and fundamental, have been responsible for this decline. Concerns about the implications of rapid money supply growth in the first half of 1985 were allayed somewhat as the economy grew at a very moderate pace over the summer and fall months.

Whereas investors had grown pessimistic about the chances for meaningful deficit reduction following the breakdown of budget negotiations, the passage of the Gramm-Rudman-Hollings plan has reinvigorated hopes for redressing the serious fiscal imbalance.

Despite an acceleration in inflation in the fourth quarter of 1985 due mostly to higher food and energy costs, prices in both areas were expected to recede. In particular, investors have been encouraged by the prospect of lower oil prices and the ameliorating effects that could have on economic growth without stirring inflation.

The agreement in late September by the G-5 countries to better align the value of the world's major trading currencies with fundamental forces has resulted in a significant decline in the dollar in foreign exchange markets. This has improved chances that a larger share of domestic demands can be met by U.S. producers. At the same time, the monetary authorities have maintained a steady course in order to minimize the possibility of a destabilizing fall in the dollar's foreign exchange value.

Despite some slippage in economic growth in the fourth quarter of 1985, the new year has brought new momentum. December data on employment, production and income all showed strong improvement and portend an acceleration in growth in the current quarter, albeit to a pace that is sustainable without a pickup in inflation. Consequently, the mood of investors remains cautiously optimistic.

Against this background the Committee recommends the following securities be sold at yield auction to refund \$9.8 billion of maturing February 15 securities and raise \$13.2 billion of new cash:

- \$9 billion of 3 year notes due 2/15/89
- \$7 billion of 9 3/4 or 10 year notes
- \$7 billion of 29 3/4 or 30 year bonds

A motion to sell \$8 3/4 billion of 3 year, \$7 billion of 9 3/4 or 10 year and \$7 1/4 billion of 29 3/4 or 30 year securities was defeated by a vote of 14-6.

The Committee debated at some length the question of reopening the outstanding 9 1/2% notes of 11/15/95 and the outstanding 9 7/8% bonds of 11/15/2015. Arguments for included the scarcity value of outstanding securities, which it is believed would result in a lower interest cost to the Treasury in next week's auction. Arguments against focused on the high premiums associated with the outstanding issues and the possibility that this would discourage buyers.

The Committee voted 14 to 6 to reopen the outstanding 10 year note and 10 to 8 with two abstentions to reopen the outstanding 30 year bond. We will expand on these views in discussion following this report.

For the remainder of the quarter we recommend:

- Sell \$9 billion of year bills at two auctions raising \$1.0 billion.
- Sell \$9.5 billion of 2 year notes at two remaining auctions raising \$2.0 billion.
- Sell \$7.5 billion of a 5 year note to raise all new cash.
- Sell \$6.75 billion of a 4 year note raising \$3.0 billion.

The Committee also recommends that remaining 3 and 6 month bill sales be kept at \$14.4 billion, reducing cash receipts by \$2.4 billion.

Summary of Cash raised (net of foreign add-ons)

Refunding	\$13.2 billion
52 week bills	1.0
2 year notes	2.0
5 year notes	7.5
4 year notes	3.0
	<u>26.7</u>
Already raised	12.0
	<u>38.7</u>
Less reduction in 3 & 6 month bills	2.4
	<u>\$36.3 billion</u>
Decrease in cash balance	21
	<u>\$57.3 billion</u>
Cash balance 3/31/86	\$10.0 billion

Foreign add-ons of from \$1 to \$2 billion would slightly raise the cash balance. It is the Committee's understanding that the size of the refunding plus any other cash raised would negate the necessity of the issuance of any intraquarter cash management bills.

The Committee by a vote of 17-3 recommends a June 30 cash balance of \$20 billion. The 3 negative votes were for a \$15 billion cash balance.

The Committee took considerable time in deciding to respond to the request for comments on the market for a foreign targeted Treasury issue. By a vote of 11-9 we recommend against such an issue. The majority believes that there is little or no benefit in interest cost to the Treasury and has the view that the buyers will purchase regular Treasury issues as readily as targeted issues.

The others believe that there would be an interest rate savings, especially if the targeted issues were sold on a regular basis so the market knew what to expect.

With respect to the appropriate balance between bill and coupon issues in financing through June, the Committee retains its established stance of debt extension emphasizing longer dated securities at the expense of bills. However, the Committee is aware that the implementation of Gramm-Rudman could cause a change in its focus. In the past, with large continuing deficits, their focus has been on increasing longer term financing because of the burgeoning debt. If substantial reductions in deficits were to occur, the Committee would like the opportunity to review

these policies, possibly at a special meeting at the Secretary's request.

Finally, we would encourage the Treasury to reexamine the STRIPS program with a view toward putting into effect the final phase of the program -- that is, the ability to reconstitute the original security. In addition, because of uncertainty in foreign tax laws, the liquidity of the entire STRIPS sector has been impaired and many domestic market makers have become unwilling to carry large inventories resulting in inefficient markets and wide spreads in yield affecting the entire program. The issue is too complex to cover in this report, but we encourage the Treasury to study the question. We will, of course, help in any way we can.

Mr. Secretary, this concludes our report and we welcome questions and discussion.

Respectfully submitted,



Gedale B. Horowitz  
Chairman

REPORT TO THE SECRETARY OF THE TREASURY  
FROM THE U.S. GOVERNMENT AND FEDERAL  
AGENCIES SECURITIES COMMITTEE OF THE  
PUBLIC SECURITIES ASSOCIATION  
APRIL 30, 1986

Dear Mr. Secretary:

Since the Committee last met in Washington in January, the rally in financial markets has attained dramatic proportions. From already substantially reduced levels, long-term interest rates have dropped nearly two percentage points to some of their lowest levels in nine years. Short-term interest rates, encouraged by two 50 basis point reductions in the Federal Reserve's discount rate, have fallen by a percentage point over this period.

A number of developments beyond the easing in U.S. monetary policy have been responsible for the tremendous improvement in financial markets. The sharp decline in world oil prices since the start of the year and the prospect of continued financial constraints on major oil producers have dampened considerably investor expectations of inflation. That improvement adds to an already well-established tendency in the economy toward disinflation.

Economic expansion has also proceeded at a modest pace in the first part of 1986, though at a slightly higher rate than that which characterized much of 1985. Apart from encouraging bond market investors, this has meant that business short-term borrowing needs have been rather limited in this period. Nonetheless, corporations have taken advantage of the slide in long-term rates to float a record volume of corporate bonds. Over the first four months of this year, new issue activity in the U.S. corporate market has averaged more than \$16 billion or easily twice the pace of 1985.

The coordinated international effort to lower interest rates has allowed a continued reduction in the value of the dollar in foreign exchange markets in recent months. That decline has bolstered hopes for stronger economic growth in the United States. It has also introduced some uncertainty as to whether large inflows of foreign capital could be expected to continue at current or lower interest rates.

The tentative signs of stronger economic growth evident during the first quarter should become more tangible as the year unfolds. Declines in interest rates and oil prices promise to boost private domestic final demands, while a pickup in growth abroad and a lower dollar will raise U.S. exports. The lower dollar and a better balance between inventories and sales mean that an increasing share of U.S. demand will be satisfied out of current domestic production rather than from inventories or imports. That improvement may come

despite continuing efforts at slowing fiscal stimulus. It is against this economic and financial backdrop that investors are approaching the Treasury's upcoming mid-quarter financing-- guardedly optimistic.

With these developments in mind, the Committee recommends the following securities be sold at yield auction to refund \$14.2 billion of maturing May 15 securities and raise \$12 billion of new cash:

\$9 billion of 3-year notes due 5/15/89;  
\$8 1/2 billion of 10-year notes due 5/15/96;  
\$8 1/2 billion of 30-year bonds due 5/15/2016

This package assumes continuation of the 20-year bond cycle which the Committee voted 14 to 5 to retain. The majority felt that the 20-year bond was an effective long-term security which would not easily be replaced. The minority viewed the 20-year as more expensive and wanted to emphasize the mid-quarter refundings as a source of long term funds.

For the remainder of the quarter the Committee recommends:

Sell \$9.75 billion of 2-year notes at two remaining auctions raising \$2.0 billion of new cash;

Sell \$7.75 billion of 5-year notes to raise all new cash;

Sell \$7.25 billion of 4-year notes raising \$3.0 billion new funds.

The Committee also recommends rolling over all bill maturities for no net additional cash.

Summary of cash raised:

Refundings	\$11.80 billion
2-year notes	2.00
5-year notes	7.75
4-year notes	3.00
	<u>\$24.55</u>
Already raised	8.75
	<u>\$33.30</u>
Estimated Foreign Add-ons	1.20
	<u>\$34.50 billion</u>

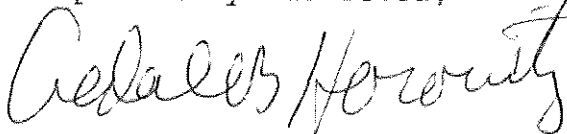
This would bring the projected cash balance on 6/30/86 to \$18.2 billion. The Committee voted unanimously to target a \$20 billion cash balance on 9/30/86.

As stated earlier, the Committee voted for the retention of the 20-year bond cycle. However, the Committee did consider what should be done if the cycle is discontinued. We discussed three alternatives. The first was a progressive phase-in of 10-year and 30-year issues as replacements for the 20-year bonds. The second was an immediate increase in 10- and 30-year issues to fully offset the \$5 billion lost through the elimination of the 20-year bonds. The third was the replacement of the 20-year cycle with a new 40-year bond, probably on a phased basis. Ten members of the Committee voted for the first alternative, 3 for the second and 6 for the third.

The Committee considered methods for adjusting to cash-flow problems at the beginning of the calendar quarters that would be caused by loss of funds from discontinuing the 20-year cycle. It was unanimously agreed that targetting quarter-end balances \$5 billion higher (\$20 billion on June 30 and \$25 billion on September 30) would alleviate this problem. Furthermore if the 20-year cycle was immediately discontinued, the appropriate level of the May refunding would be \$28 billion composed of \$9 billion 3-year notes and \$9 1/2 billion each of the 10-year and 30-year issues.

Mr. Secretary, this concludes our report and we welcome questions and discussion.

Respectfully submitted,



Gedale B. Horowitz  
Chairman

REPORT TO THE SECRETARY OF THE TREASURY  
FROM THE U.S. GOVERNMENT AND FEDERAL  
AGENCIES SECURITIES COMMITTEE OF THE  
PUBLIC SECURITIES ASSOCIATION  
July 30, 1986

Dear Mr. Secretary:

Since the Committee's last meeting in April, money market interest rates have fallen about one-half percentage point. This has reflected the sluggish trend of the economy and the attendant moderate pace of short-term credit demands. Rate declines have also been encouraged by an accommodative Federal Reserve, which has reduced the discount rate for the third time this year. Long-term interest rates, meanwhile, have traded in a volatile pattern around their lowest levels in nearly a decade. The disparate trends in these two markets is symbolic of market perceptions: financial market participants, as well as policymakers, sense that the economy lacks the momentum to produce strong credit needs but there is considerable uncertainty about the prospective course of events later this year and next.

That uncertainty is evident for a number of reasons. Three developments that had been the basis for considerable optimism about economic prospects earlier this year -- falling interest rates, lower oil prices and a weaker U.S. dollar -- are having mixed success in generating faster growth. Most notably, although the dollar's decline in foreign exchange markets promised to halt a deteriorating trade balance, disappointing growth abroad and only moderate increases in non-petroleum import prices to date have raised new doubts about the timing and extent of that improvement.

The continuing slide in interest rates has provided important support to housing activity where starts have been maintained at their strongest pace since 1978. Also, lower rates have spurred consumption of interest-sensitive durable goods such as autos in the face of moderate income growth. But some of the drop in interest rates has reflected declining inflation expectations, so that real interest rates have fallen far less than nominal interest rates.

The sharp decline in oil prices and the continuing moderation in food costs have kept consumer prices unchanged over the first half of 1986. That has bolstered real incomes. Nonetheless, lower oil prices have also prompted a dramatic cutback in investment in oil and gas extraction and related areas. Employment in this sector has fallen 20% this year.



Finally, although financial market participants have shown concern at times about the rapid growth of M1, the evidence from the modest growth of the broader monetary aggregates, as well as the economy and prices themselves, suggests that this does not represent an excessive buildup of liquidity. Thus, while several developments in the economy and with regard to policy have set the stage for faster economic growth, an acceleration from the modest expansion of the first half remains somewhat elusive. It is against this backdrop that investors approach the upcoming Treasury financing.

With these developments in mind, the Committee recommends that the following securities be sold at yield auction to refund \$14.3 billion of maturing August 15 securities and raise \$14.7 billion of new cash:

\$ 9 billion of 3-year notes due 8/15/89;  
10 billion of 9-3/4 year notes due 5/15/96;  
10 billion of 29-3/4 year bonds due 5/15/2016

This recommendation incorporates the reopening of the 7-3/8% notes due 5/15/96 and the 7-1/4% bonds due 5/15/2016. The vote of the Committee on reopening both issues was unanimous, a somewhat rare occurrence. The reason for this unanimity was the strong feeling that the elimination of the 20-year bond had decreased supply in the long bond market and made for considerable difficulty in maintaining a viable market place for long United States Treasury debt. With only four long bonds a year, a size vs. frequency situation occurs. Lack of frequency dictates greater size of issues for an effective market. Foreigners buying plus the stripping potentiality of these bonds can severely limit their availability. A side effect of this scarcity is the problem created in pricing corporate securities which for at least the last eight years have been priced off the Treasury curve.

Mr. Secretary, the Committee unanimously feels that the change in frequency of sales of long Treasury bonds, makes it absolutely essential that the 30-year and 10-year issues be reopened whenever possible. The suggested \$10 billion amounts of the 9-3/4 and 29-3/4 year issues are in line with the recommendation made by the Committee in its report of April 30, 1986 in which a progressive phase-in of the amounts lost by the elimination of the 20-year bond was favored by a majority of this Committee. We believe that the market can handle issues of the recommended size, especially if they are reopened.

For the other financing requirements in the remainder of the quarter, the Committee recommends:

- Maintain the 3- and 6-month Treasury bill auctions at the current \$15.2 billion level raising \$8.9 billion of new cash;
- Sell \$9.5 billion of year bills at the remaining auction raising \$1.4 billion new cash;
- Sell \$10 billion of 2-year rates at two remaining auctions raising \$2.1 billion of new cash;
- Sell \$8 billion of 5-year notes to raise all new cash;
- Sell \$7.5 billion of 4-year notes raising \$2 billion of new cash

Summary of Cash Raised

Refunding	\$14.70 billion
3 & 6 month bills	8.90
52 week bills	1.40
2-year notes	2.10
5-year notes	8.00
4-year notes	<u>2.00</u>
	\$37.10
Already raised	<u>13.00</u>
	\$50.10
Estimated Foreign Add-ons	<u>2.00</u>
Net Market Borrowings	\$52.00 billion

This would produce a projected cash balance on 9/30/86 of \$27 billion, an amount which the Committee, because of projected 4th and 1st calendar quarter financing needs, unanimously recommends. We also suggest a \$20 billion cash balance on 12/31/86.

In attempting to respond to the request in the Committee Charge as to the pattern of 2-year notes with relation to quarter end financings, a wider discussion ensued. We felt that, along with the elimination of the 20-year bond, the scheduling request of the current charge, the increasing amount of refunding of outstanding debt necessary especially in view of the maturities of the 5- and 7-year notes and the

reduction in frequency of sales of long term bonds to four times a year that a special meeting of this Committee might be required to give intensive study to the entire debt structure. There is some feeling in the group that selling 30-year bonds eight times a year might be desirable. If that is not possible, then selling 40-year bonds might be a proper vehicle for effective debt management. We therefore ask you, Mr. Secretary, to call such a meeting if you desire, with the only matter to be discussed, the Committee's opinion on proper debt structure for the next period of years. We would ask you to call the meeting, to be held in New York at the Federal Reserve Bank, as soon as possible. Hopefully, the Gramm-Rudman and tax bill questions will be settled shortly and we can make our recommendations based on some firm projections.

Because of our request for a special meeting, five members of the Committee felt no change in the scheduling of the two year bond should be made until after that meeting. However, sixteen members voted to incorporate the two year bond into the end of quarter financing. Therefore, our recommendation is that the two, four, and seven year bonds be announced on September 16, with the sale of the two year on Tuesday, September 23, the sale of the four year on Wednesday, September 24, and the sale of the seven year on Thursday, September 25. In view of this schedule, the fifty-two week bill should be sold on Tuesday, September 30.

If you should decide to make this scheduling change, we would encourage you to announce it this afternoon at the press conference.

Mr. Secretary, this concludes our report and we welcome questions and discussion.

Respectfully submitted,



Gedale B. Horowitz  
Chairman

REPORT TO THE SECRETARY OF THE TREASURY  
FROM THE U.S. GOVERNMENT AND FEDERAL  
AGENCIES SECURITIES COMMITTEE OF THE  
PUBLIC SECURITIES ASSOCIATION  
October 29, 1986

Dear Mr. Secretary:

Since the Committee last met in Washington in July, interest rates have displayed quite disparate trends. Whereas, short-term interest rates have declined by one-half of a percentage point or more, aided by the Federal Reserve's fourth discount rate reduction this year, longer-term interest rates have generally risen by one-quarter to one-half percentage point. The consequent sharp steepening in the overall yield curve has carried the spread from short-term bills to long-term bonds to its widest levels in a year. This shift has been characterized by the perception that monetary stimulus and a weaker dollar may fuel stronger economic growth with rising inflation pressures.

Several cross-currents in the economy and domestic and international financial markets are responsible for this development. Real economic growth in the United States has continued on the 2 1/2% track that has prevailed since the middle of 1984. This mildly subpar pattern has persisted despite increasing monetary accommodation, lower oil prices and further declines in the foreign exchange value of the dollar. Although each of these influences has served to stimulate demand in the economy, much of it has gone into increased imports rather than domestic production.

The lack of significant improvement in the U.S. trade deficit remains a key impediment to robust economic expansion. The dollar's fall has yet to trim the trade gap, as demand growth in the U.S. continued to outpace that of our trading partners. Moreover, the relative prices of tradeable goods have changed only little. In fact, in the September quarter, the ratio of nonoil import prices to nonoil producer prices actually declined.

One favorable consolation from the failed improvement in the trade balance is that inflation remains relatively subdued despite signs of bottoming out in oil prices. Competitive pressures among import-competing manufacturing industries remain intense while the growth in labor costs has continued to decelerate. An environment of sluggish economic growth is not one in which inflation is likely to accelerate meaningfully, while wage increases in the first six months of 1986 have run at their lowest levels in twenty years. These facts stand in contrast to the incipient fears in financial markets of rising inflation.

Those fears are rooted in part in the concern that monetary policy has tolerated too rapid expansion in the monetary aggregates. Much of this strength, however, has been concentrated in the primary M1 measure, while growth in the broader money stock components has remained within official target bands. Although the Federal Reserve has encouraged substantial declines in interest rates, key interest-sensitive areas of the economy are not poised for strong growth. Housing starts, for example, have slipped well below their early 1986 pace as new home sales have dropped 23% in recent months. Similarly, the nonresidential construction sector is cooling after several years of substantial investment in commercial property development.

Although the pace of private credit needs has been moderate in an environment of low inflation and subdued economic growth, financial markets have recently grown uncertain about the continued willingness of private foreign investors to aid in the financing of large U.S. budget deficits. Recent international payments statistics indicate a marked step up in foreign official purchases of U.S. Treasury securities paralleling continued strong private inflows. Should the composition of future inflows begin to shift to a reliance upon those official investments and a relative decline in private inflows, financial markets could become unsettled. Nonetheless, there is the promise of a measurable reduction in the U.S. budget deficit for the coming year, aided by new tax revenues and modest spending reductions. Indeed, any pickup in economic growth will aid in that process. Further, very recent signs of strength in the dollar in foreign exchange markets attest to the continued interest of foreign investors in U.S. securities.

Against this mixed pattern of economic and financial developments the Committee recommends that the following securities be sold at yield auctions to refund \$13.4 billion of publicly-held notes and bonds maturing November 15 and raise \$16.1 billion of new cash:

\$10 1/4 billion of 3 year notes due 11/15/89  
9 3/4 billion of 10 year notes due 11/15/96  
9 1/2 billion of 30 year bonds due 11/15/2016

The Committee discussed the possibility of reopening the 10 year note due 5/15/96 and the 30 year bond due 5/15/2016. It unanimously opposed the reopening of the thirty year bond and by a vote of 13 to 6 also opposed the reopening of the ten year note. The majority of the Committee felt that the benefit of market liquidity in larger issues was outweighed by the possible future debt management problems of extremely large maturities and the fact that a new issue would sell at a slightly lower yield than a reopened one. However, the Committee still believes that the liquidity and viability of the market for U.S. Government securities requires the reopening of outstanding issues when other circumstances do not make reopening impractical.

For the other financing requirements in the remainder of the quarter the Committee recommends:

- Increase the remaining 3 and 6 month Treasury bill auctions to \$16.4 billion raising \$12.6 billion of new cash;
- Increase the two remaining 52 week bills to \$10 1/2 billion raising \$2.6 billion;
- Sell \$7 billion of cash management bills maturing January 22, 1987 raising all new cash;
- Sell \$10 1/4 billion of 2 year notes at two remaining auctions raising \$1 1/2 billion new cash;
- Sell \$7 3/4 billion of 4 year notes raising \$2.2 billion of new cash;
- Sell \$8 1/4 billion of 5 year notes to raise all new cash.

Summary of Cash Needed

Refunding	\$16.1 Billion
3 & 6 month bills	12.6
52 week bills	2.6
2 year notes	1.5
4 year notes	2.2
5 year notes	8.3
Cash Management bills	7.0
already raised	10.0
	<u>60.3</u>
Estimated Foreign Add On	2.2
Net Market Borrowing	<u>\$62.5 Billion</u>

This would produce a projected cash balance on 12/31/86 of \$20 billion, an amount which the Committee unanimously recommends. We also suggest a \$15 billion cash balance on 3/31/87.

The Committee has taken into account the current slope of the yield curve in its recommendations. It does encourage the sale of the entire recommended amount of 30 year bonds as this is the only security larger than the 10 year sold by the Treasury. A viable long bond market is necessary for both future Treasury debt management and for market participants.

While the Committee reiterates its suggestion of July 30, 1986 that the 2, 4 and 7 year notes be sold in the same week, it understands the impracticality of doing this at the end of December.

It therefore recommends that the 2 and 4 year notes be announced on 12/10/86 with the 2 year being auctioned on 12/17/86 and the 4 year on 12/18/86. The seven-year note should be announced on 12/16/86 and sold on 12/30/86. The 52 week bill should be announced on 12/12/86 and sold on 12/23/86.


Mr. Secretary, this Committee stands ready to assist the Treasury in any way it can in the formulation of policies and rules for the regulation of the Government securities market. We believe that because of its fiduciary relationship to the Treasury this group could be used as an impartial resource to answer any inquiries that the Treasury might have. We stand ready to serve if asked, in this matter.

Finally, before responding to questions, we would be remiss in not noting two significant changes in the structure of this Committee. First, the Committee extends its deepest appreciation to Frank Cavanaugh for his guidance and assistance in the performance of our task. Frank has served both the Treasury and the Committee most faithfully and we wish him well in his new endeavor.

Today, marks the final meeting of the Dean of our group, Bob Stone. Bob has been on this Committee for 21 years and has served as its Chairman and Vice Chairman. More than these official titles, he has served as mentor for all of us in the workings of our group. His concern that we serve only to assist the United States Treasury has been deeply ingrained in all of us and if I may take a liberty, I believe that not only are all his fellow Committee people better for Bob's service, but so is our country.

Thank you, Mr. Secretary.

Respectfully submitted,



Gedale B. Horowitz  
Chairman