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

NOVEMBER 1, 1994

Dear Mr. Secretary:

During the three months since the Committee's last meeting with the Treasury in August 1994, economic activity has remained strong. While there is little evidence yet of a broadening of inflationary pressures to final goods, some generalized price increases are apparent in commodities and intermediate goods. In response, the Federal Reserve again tightened monetary policy, and the Federal funds rate now stands at 4.75%, 0.50% higher than in early August.

Yields on Treasury securities rose during the three-month interval by approximately 60 to 80 basis points. The increase was accompanied by a modest flattening of the yield curve. Market participants, as indicated by the yield curve's present shape and by forward prices for various fixed-income instruments, expect additional increases in interest rates in the coming months.

Within this context, to refund the $28.8 billion of notes and bonds maturing on November 15, 1994 that are privately held and to raise additional cash of $15.7 billion, the Committee recommends unanimously that the Treasury auction $44.5 billion of the following securities:

- $17.0 billion 3-year notes due November 15, 1997;
- $12.5 billion 10-year notes due November 15, 2004; and,
- $15.0 billion cash management bills due December 22, 1994.

With the aim of achieving a cash balance of $30 billion on December 31, the Committee unanimously recommends that for the remainder of the quarter the Treasury meet its borrowing requirements in the following manner:

- One 5-year note totaling $11.0 billion, to raise $11 billion of new cash;
- One 2-year note totaling $17.0 billion, to raise $1.6 billion of new cash;
- Two 1-year bills of $17.0 billion each, to raise $1.6 billion of new cash;

- Weekly 3- and 6-month bills totaling \$27.2 billion through December 1 and \$26.0 billion for the remainder of December, to raise \$14.7 billion of new cash;

- A cash management bill totaling \$8.0 billion to mature late in January to meet the seasonal cash need in early December; and,

- Redemption on December 22 of both the \$15 billion of outstanding cash management bills and the additional \$15.0 billion of cash management bills to be issued in conjunction with the mid-quarter refunding, to reduce cash by \$30.0 billion.

Including the \$15.7 billion raised in the mid-quarter refunding as well as anticipated foreign add-ons of \$3.0 billion, the proposed financing schedule will raise a total of \$25.6 billion. When added to the \$34.0 billion already raised or announced during quarter, this amount will accomplish the total net borrowing requirement of \$59.6 billion.

For the January-March 1995 quarter, the Treasury estimates its net market borrowing requirement in the range of \$65 to \$70 billion with a cash balance of \$20 billion at the end of March. In determining the composition of Treasury marketable financing for the January-March quarter, the Committee, as discussed later in this report, also considered the broader question of the appropriate mix of bills and coupons to raise new cash during the entire 1995 fiscal year. Although a formal vote was not taken on a recommended financing schedule for the January-March quarter, the following schedule is consistent with the Committee's view on the broader question:

Auctions	Size (billions)	Raising (billions)	
Refunding:			
3-year note	\$ 17.0		
10-year note	12.5		
30-year bond	11.5		
	\$ 41.0	\$ \$10.5	
5-year notes	4 x \$11.5	46.0	
2-year notes	4 x \$17.25	6.7	
1-year bills	3 x \$17.25	2.7	
3- and 6-month bills	13 x \$26.0	3.9	
Cash management bills (April maturity)		15.0	
Estimated foreign add-ons		8.0	
Subtotal			\$ 92.8

Less:		
Redemption of January cash management bills	$ 8.0	
Redemption of 4-year notes	8.5	
Redemption of 7-year notes	7.3	
Early redemption of 7 7/8% bonds due February 15, 1995	2.0	
Subtotal		25.8
Total Net Market Borrowing		$ 67.0

In response to the request for its view on the calendar for the auctions of Treasury securities during the holiday periods in November and December, the Committee unanimously recommends the following schedule:

Issues	Auction Dates
Cash management bill	Thursday, November 10 (at 11:30am)
2 year note	Monday, November 21
5 year note	Tuesday, November 22
2 year note	Wednesday, December 21
5 year note	Thursday, December 22

In addressing the request for the Committee's views on the appropriate mix between bills and coupons for the new cash to be raised in fiscal year 1995, the Committee stressed in its deliberations the need to focus on the longer-term implications of any shifts in the borrowing mix.

The drop in borrowing needs in fiscal 1995 as a result of the decline of the budget deficit is widely seen as temporary and to be followed by larger requirements in fiscal year 1996 and beyond. Further, the Committee recognized that the net redemption of nonmarketable securities issued to state and local governments may approximate $25 to $30 billion in fiscal year 1995. The increased market borrowing as a result of this short-fall offsets much of the reduction in borrowing associated with the expected decline in the deficit for fiscal year 1995.

The Committee also considered the significant impact that the completion of the monthly 5-year note cycle in December 1995 will have on the Treasury's prospective sources of new cash. First introduced in December 1990, this cycle has raised each year since substantial amounts of new cash and made as result a major contribution to the Treasury's annual borrowing requirement. Beginning with fiscal year 1996, the cash raising potential of the 5-year note cycle will decline dramatically. Consequently, it appears that new or expanded offering cycles will be, at the minimum, desirable and perhaps even necessary to meet the Treasury's needs for fiscal year 1996 and beyond. These longer-term needs, in the Committee's view, should importantly influence the formulation of the Treasury's borrowing strategy for fiscal year 1995.

The Committee considered three broad approaches to the current fiscal year: (a) modestly reducing the sizes of coupon issues and increasing commensurately the issuance of bills; (b) maintaining the sizes of coupon issues at current levels; and, (c) modestly increasing the sizes of coupon issues to help smooth the transition to fiscal year 1996 when the aggregate amount of maturing coupons rises substantially. Without in the circumstance being able to evaluate specific alternative strategies for meeting the borrowing needs in these later years, the Committee was unanimous in the view that there should not be any reduction in the size of net coupon issuance. Committee member were split on whether to hold the level of net coupon issuance steady through fiscal 1995, which three of the 14 members present favored, or to increase the amount modestly, which the remaining 11 members favored.

Several reasons were cited for maintaining or increasing modestly the level of coupon issuance in the borrowing mix for the coming fiscal year. First, the deceleration in the prospective growth in the deficit is likely to be temporary. Absorbing the temporary reduction in the issuance of bills was judged superior to the alternative of reducing the sizes of coupon issues only to began increasing them soon thereafter. Second, any reduction in coupon issuance in the current fiscal year would be inconsistent with the greater demands on coupon financing following the maturation of the 5-year note cycle. Third, reducing the proportion of borrowing in coupons would accelerate the decline in the average maturity of the debt and raise the portion of the debt that would need to be refinanced during the period when the borrowing requirement will be rising again.

Finally, the Committee addressed the question of whether the Treasury should divide the 3-year note into six issues per year to smooth cash flows, which based on the current levels would mean issues averaging $11.5 billion in size. The Committee was unanimous in the view that bills are more appropriate than coupons for managing cash flows. The Committee also notes that a change in the pattern of coupon issuance of this scale would likely surprise market participants and might raise unnecessary uncertainty about the prospective issuance pattern of other coupon cycles.

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

Respectfully submitted,

Stephen C. Francis
Chairman