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

October 31, 1990

Dear Mr. Secretary:

Let me begin today's report by noting that the Committee met on Monday, October 29, for most of the day to consider long-term Treasury finance issues in the context of a growing marketable borrowing requirement. The conclusions and recommendations with respect to these discussions will be presented, along with the Committee's working papers, to the Treasury in approximately 10 days. In light of the long-term focus taken in the special report, our recommendations for financing beyond the current quarter are not as relevant in today's report as our forthcoming views. After our longer term paper has been submitted, either a group from the Committee or I will be happy to respond to Treasury with respect to questions the Treasury might have concerning our report, including the composition of marketable financing for the January-March quarter.

Moving on to our quarterly report, since our last meeting at the beginning of August, the fixed-income securities markets have been roiled by shifting perceptions regarding future economic prospects and the risk that U.S. forces might become involved in a Middle East war. During the first several weeks following the Iraqi invasion of Kuwait on August 2, long-term Treasury issue yields rose sharply on speculation that hostilities might soon be engaged in that region, and in reaction to the inflationary implications of a steep rise in world crude oil prices. At the same time, anticipation of a further squeeze on real consumer incomes and business profitability heightened worries that the long economic expansion might soon end. These concerns about flagging business.activity buttressed demand for short-dated issues and prevented their yields from rising in tandem with those on longer maturities. As a consequence, the Treasury yield curve assumed a substantially more positive slope. Over recent weeks, however, fears of an imminent Persian Gulf conflict have gradually eased and crude oil prices have retraced a portion of their earlier gains. These developments have permitted an increased market focus on signs of economic weakness and escalating liquidity strains within the banking system. In addition, the successful completion of a long-term budget deficit reduction package spurred expectations that Federal Reserve monetary policy would be eased to offset a somewhat tighter fiscal stance. As a result, while long-term Treasury yields have declined back to roughly where they stood three months ago, the yield curve has retained its somewhat steeper posture. Since early August, discount rates on 3-month Treasury bills have fallen from 7.42 percent to 7.13 percent, while yields on 3-year notes have inched down from 8.00 percent to 7.92 percent. Over the same period, however, 30-year bond yields have risen from 8.36 percent to 8.75 percent.

In this financial context, the Committee recommends that the following securities be sold at yield auctions to refund $23.5 billion maturing securities and raise $11.00 billion of new cash:

-- $12.25 billion 3-year notes due 11/15/93;

-- $11.25 billion reopening of 9 3/4-year notes due 8/15/2000;

-- $11.00 billion reopening of 29 3/4-year bonds due 8/15/2020.

For the remainder of the current quarter, the Committee recommends:

-- Sell $12.5 billion and $12.75 billion 2-year notes at two remaining auctions, raising $5.2 billion of new cash;

-- Sell $9.5 billion 5-year notes raising all new cash;

-- Sell $11.25 billion and $11.75 billion 52-week bills at two remaining auctions raising $3.4 billion new cash;

-- Take the weekly 3- and 6-month bill auction size from $19.6 billion to $20.4 billion at the end of the quarter, raising a total of $18.3 billion; and

-- Issue $20 billion of cash management bills in two tranches with late April maturities, raising all new cash. =

Summary of New Cash for the October-December Quarter

| | |
|---|---|
| Refunding | $11.0 billion |
| 3- and 6-month bills | 18.3 |
| 52-week bills | 3.4 |
| April cash management bills | 20.0 |
| 2-year notes | 5.2 |
| 4-year notes | 0.5 |
| 5-year notes | 9.5 |
| Total to be raised | $67.9 |
| Already raised | 15.75 |
| Estimated Foreign Add-ons | 4.10 |
| Net Market Borrowing for the Quarter | $87.75 billion |

As an end-of-quarter cash balance, the Committee recommends $20 billion. We expect the more probable closing balance will be $30 billion given our proposed funding schedule and stated expected $105.75 billion cash deficit. The Treasury's cash deficit, however, may be lower due to slowed demands from RTC, reducing the deficit requirement by nearly $10 billion and resulting in a residual build-up of the cash balance.

With respect to the October-December quarter's financing, two specific recommendations should be noted. First, the Committee voted 14 to 4 to reopen both the most recently issued 10-year and 30-year securities. The majority view believes that market liquidity and efficiency are promoted by fewer and larger issues. These factors are felt to promote long-term savings to the Treasury with uncertain economic impact in an on-off situation. These long-term factors are more important to Treasury now that stripping has had such a successful impact on the float of many issues -- particularly in long-dated maturities. It is also important to emphasize the reopening of the most recent issue as the market looks to the largest and most recent issue as its bellwether or benchmark. This should be noted currently, as both of the most recently issued long-term bonds have 8 3/4 percent coupons.

Also, the Committee believes two auctions of April cash management bills would be better than one, if logistically possible, and if more than $13-$15 billion were required. Potentially supply imbalances could occur with a one-shot $20 billion cash management bill, which could, in turn, cost the Treasury some additional interest expense.

For the January-March quarter, assuming $25 billion of RTC funding, we're looking for $75 billion in net market financing and a $10 billion reduction in the cash balance to an end-of-quarter figure of $10 billion.

Summary of New Cash for the January-March Quarter

| | |
|---|---|
| Refunding | $18.7 |
| 3-and 6-month bills | 17.0 |
| 52-week bills | 7.4 |
| Cash management bills | 10.0 |
| 2-year notes | 5.8 |
| 5-year notes | 10.5 |
| 7-year notes | 3.9 |
| Total | $73.4 |
| Foreign Add-ons | 1.6 |
| Net market borrowing | $75.0 |

As previously noted, the Committee believes our forthcoming special report will adjust the schedule for the January-March and subsequent quarters' financing composition. The Committee is recommending in both our special report, as well as in today's report, a greater emphasis on one-year bills and five-year notes, as well as maintaining the quarterly refunding as the centerpiece of Treasury finance. The Committee believes both one-year bills and five-year notes have wide appeal among investors and hold a deep capacity for tapping additional funds.

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

Jon S. Corzine
Chairman