

**REPORT TO THE SECRETARY OF THE TREASURY
FROM THE
TREASURY ADVISORY COMMITTEE
OF THE
BOND MARKET ASSOCIATION**

February 4, 1998

Dear Mr. Secretary:

Since the Committee's last meeting on October 29, 1997, the pace of economic activity has continued to be relatively brisk. However, the situation in Asia and the accompanying appreciation in the dollar are widely expected to have a negative effect on U.S. trade performance leading to some moderation in economic growth during 1998. On the inflation front, the news continues to be quite favorable. While job growth has accelerated of late and labor market conditions appear to be extremely tight, wage pressures have been slow to build and the rate of increase in both consumer and producer prices has been trending lower.

The Asian crisis and credit quality concerns prompted strong demand for the US dollar and Treasuries which drove yields as much as 50 basis points lower in early December. Recently, the stabilization in Asia has reversed this trend somewhat with yields now 25-35 basis points lower and the yield curve somewhat flatter than at the time of the Committee's last meeting. While the Federal Reserve is widely expected to leave policy unchanged in the near term, forward rate structures are priced for a modest easing over the next several months.

Within this context, to refund \$25.9 billion of privately-held notes maturing on February 15, 1998 and to raise \$9.1 billion of new cash, the Committee recommends that the Treasury auction \$35.0 billion of the following securities:

- \$13.0 billion 3-year notes due February 15, 2001;
- \$12.0 billion 10-year notes due February 15, 2008;
- \$10.0 billion 29 3/4-year bonds due November 15, 2027.

The Committee recommends, by an 18-1 majority, a reopening of the 6 1/8% bond of November 15, 2027. The Committee felt that a reopening would enhance the benchmark status of the bond by creating a larger, more liquid issue. This could be especially useful with a six month interval before the next expected bond offering. There has also been increased investor activity in the bond sector, and some accompanying increase in financing market pressures. All members felt that the size of the long bond offering should remain at \$10 billion in this refunding.

In its refunding recommendation, a sizable majority of 13 Committee members felt that the Treasury should reinforce the benchmark status of the 10-year note by offering \$12 billion. This majority believed that the 2 and 3 year maturity areas offer the best alternatives for future reductions in coupon sizes, and recommends a \$13 billion 3-year security in this refunding. Three members felt that the most recent auction sizes of \$14 billion 3-years and \$11 billion 10-years would be preferable, believing that stability would be desirable in the near term, with the uncertainty over potential future surpluses and financing requirements. Finally, 3 members supported a smaller refunding offering of \$34 billion, with a reduction in the 3-year offering to \$13 billion.

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