

Research Department  
Federal Reserve  
Bank of  
San Francisco

August 13, 1976

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## Tiger By The Tail

What can you do if a tiger suddenly starts bounding through your small low-ceilinged house? Apparently you just tidy up as best you can. So it is with the Treasury's unglamorous but very necessary task of managing the fast-growing Federal debt, which at the end of this quarter may total about \$653 billion, with some \$504 billion being held in public hands.

The key fact dominating the Treasury's housekeeping chores is the rapid growth of Federal borrowing demands. Over the entire decade of the 1960's, the Treasury raised \$44 billion net in the nation's securities markets. Even as late as 1974, net cash borrowing was less than \$12 billion. But over the past six quarters, borrowing has soared to more than an \$85-billion annual rate (seasonally adjusted).

Low ceilings complicate the Treasury's task. At least once every year, Treasury officials have to ask Congress to raise the ceiling on the total debt, in a ritualized performance which doesn't generate newspaper headlines as much as it formerly did, but which remains a constant fact of life. An even greater complication from the standpoint of routine debt-management operations is the interest-rate ceiling on long-term Government bonds. Congress has liberalized this restriction considerably in recent years, but it still can hobble attempts to obtain funds in an important sector of the market.

### Good housekeeping

Last week's Treasury refunding represented a good example of skillful debt-management practice, permitting more financing outside the short-term bill area. The centerpiece of this sale was a \$4.0-billion offering of 8-percent 10-year notes, which the Treasury increased to \$7.6 billion after it received a massive \$24.4 billion in orders. The debt managers obtained a similar response last February with a \$3.5-billion offering of 8-percent 7-year notes. The over-subscription was even more startling on that occasion—\$29.0 billion in total—and the Treasury finally accepted \$6.0 billion in orders on that sale. The rip-roaring reception for "Magic 8's" can be explained in part by the attractive pricing of these issues, and in part by the fact that the Treasury until recently was effectively precluded from borrowing in that part of the maturity spectrum.

Separately, the Treasury has managed to gain better control over its massive financing task by regularizing its borrowing schedule for coupon issues, just as it has done for years with its bill offerings. Every week, the Treasury auctions about \$6.0 billion in three-month and six-month bills, and every month, it sells about \$5.5 billion in one-year bills and two-year notes. But now the debt managers are beginning to schedule longer-term issues in the same regular fashion. Present plans envision a five-year

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note sale in the first month of each quarter, a four-year note sale in the final month of each quarter, and sales of three issues of varying length in a mid-quarter refunding. Last week's refunding fit into this pattern, with \$6.1 billion in new cash raised through three-year notes, ten-year notes and 25-year bonds.

## **Ancient history**

All this is a far cry from the way the Treasury raised Government funds in its earlier days. Prior to 1917, every new offering of Treasury securities required specific Congressional authorization spelling out the terms and conditions of each individual issue. Then, in view of its heavy wartime borrowing requirements, Congress granted the Treasury some leeway in determining the terms of new issues. However, it still insisted on setting the maximum interest rate, originally at 3½ percent—reflecting the perennial Congressional desire for low interest rates and low debt-service costs. In 1919 Congress gave the Treasury a little more flexibility by removing the interest-rate limitation on those marketable securities with maturities of five years or less, but it retained a 4¼-percent coupon ceiling on new issues of longer-term securities.

That limitation provided little problem for most of the following half-century; after all, the cost of long-

term funds ranged between 2 percent and 6 percent during all the massive economic fluctuations which occurred between 1865 and 1965. But then, as interest rates on older issues soared during the inflationary 1965-75 decade, the Treasury could issue new longer-term issues only by getting Congress to ease the limitation, in 1967, 1971 and again in 1976. Today, Congress exempts a total amount of \$17 billion in long-term bonds from the 4¼-percent ceiling. Also, by changing the definition of "bond" maturity from five to seven years, and now to ten years, it effectively exempts a wider range of maturities from the ceiling.

Nonetheless, persistent Congressional restrictions on Treasury long-term borrowing, along with investors' unwillingness to lend long-term money during an inflationary period, have led to a prolonged decline in the maturity of the Federal debt. In 1946, the average maturity of the marketable debt was more than nine years, and longer-term issues (with maturities of five years or more) accounted for 54 percent of the total. In 1975, the average maturity was less than three years, and longer-term issues accounted for only 14 percent of the total. Before the recent turnaround, the average maturity declined this spring to an all-time low of two years, nine months.

## **Why it matters**

Does a decline in debt maturity really matter? Yes, because heavy reliance on short-term debt has

inflationary implications for the economy. A short-term instrument, by definition, is never too far away from maturity. As securities approach maturity—which they inexorably do with the passage of time—they become increasingly liquid, more and more like cash. After all, nothing prevents the holder of a maturing issue from redeeming his securities for cash, rather than rolling them over, and then placing the proceeds in inflationary spending channels.

Excessive reliance on short-term debt also inhibits the Treasury's maneuverability. The Treasury is precluded from tapping some important sources of savings, such as life-insurance firms and pension funds, which are interested primarily in long-term rather than short-term outlets. Moreover, as the outstanding debt becomes increasingly concentrated in the short-term area, the Treasury is forced to undertake more frequent refunding operations. Debt managers thus are unable to take advantage of favorable market conditions to refinance the debt, but instead are forced to borrow under whatever financial conditions are prevailing at any given time. In addition, frequent Treasury trips to market may at times inhibit Federal Reserve maneuverability, especially during cyclical upswings when the monetary authority may wish to move toward restraint.

### **Shift in policy**

Faced with all the limitations on its freedom of action, the Treasury

tried in past years to ease its task by "tailoring" securities to the apparent demands of special groups of potential purchasers, and by timing the issue of securities to fit into slack periods in the money market. But this approach generated a somewhat bewildering mixture of securities of different maturities and terms, as well as lumpiness and discontinuity in debt operations, with major refundings occurring on a few dates during each year. Many observers, such as Milton Friedman, have long argued that Treasury operations should be made as regular and simple as possible, so that debt management could at least be eliminated as a source of market instability and as a hindrance to Federal Reserve open-market operations.

The Treasury in 1976 is following this approach—partly by choice, and partly by necessity, what with a financing burden that has increased seven-fold in just two years' time. Treasury Undersecretary Yeo recently said, "What we are attempting to construct is a balanced debt structure, one that will not provide a legacy for the future in terms of massive amounts of short-term finance resulting from the Treasury being in the market constantly and on a very significant scale." The Treasury now has its tiger firmly by the tail, and providing the beast doesn't get any larger (a crucial proviso), it may yet gain greater control.

**William Burke**

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**BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT**  
(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding	Change from	Change from year ago	
	7/28/76	7/21/76	Dollar	Percent
Loans (gross, adjusted) and investments*	88,053	- 524	+ 2,766	+ 3.24
Loans (gross, adjusted)—total	66,455	- 230	+ 2,231	+ 3.47
Security loans	1,337	- 74	+ 644	+ 92.93
Commercial and industrial	21,839	- 145	- 1,149	- 5.00
Real estate	20,262	+ 51	+ 621	+ 3.16
Consumer instalment	11,295	+ 29	+ 1,235	+ 12.28
U.S. Treasury securities	9,399	- 208	+ 1,260	+ 15.48
Other securities	12,199	- 86	- 725	- 5.61
Deposits (less cash items)—total*	88,671	- 849	+ 3,394	+ 3.98
Demand deposits (adjusted)	24,981	+ 36	+ 1,321	+ 5.58
U.S. Government deposits	370	- 204	+ 159	+ 75.36
Time deposits—total*	61,828	- 461	+ 2,022	+ 3.38
States and political subdivisions	6,002	- 10	- 417	- 6.50
Savings deposits	26,495	+ 45	+ 5,771	+ 27.85
Other time deposits‡	26,957	- 280	- 2,022	- 6.98
Large negotiable CD's	11,534	- 536	- 3,693	- 24.25
<b>Weekly Averages of Daily Figures</b>	<b>Week ended 7/28/76</b>	<b>Week ended 7/21/76</b>	<b>Comparable year-ago period</b>	
<b>Member Bank Reserve Position</b>				
Excess Reserves	69	- 19		67
Borrowings	1	1		6
Net free(+)/Net borrowed (-)	+ 68	- 20		+ 61
<b>Federal Funds—Seven Large Banks</b>				
Interbank Federal fund transactions				
Net purchases (+)/Net sales (-)	- 121	+ 92		+ 1,123
Transactions of U.S. security dealers				
Net loans (+)/Net borrowings (-)	+ 18	+ 259		+ 144

\*Includes items not shown separately. ‡Individuals, partnerships and corporations.

Editorial comments may be addressed to the editor (William Burke) or to the author. . . .  
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