FEDERAL RESERVE BANK OF NEW YORK

Fiscal Agent of the United States

[Circular No. 5383
September 5, 1963]

TREASURY STATEMENT ON ADVANCE REFUNDING

*To All Banking Institutions, and Others Concerned,
in the Second Federal Reserve District:*

There is printed below a Treasury Department statement, dated September 4, 1963, covering the background and details of its current advance refunding offer. This statement supplements the Treasury statement of the same date sent to you with our Circular No. 5382.

ALFRED HAYES,
President.

ADVANCE REFUNDING OFFER

The Treasury today announced that it will offer holders of seven issues of outstanding Treasury securities an opportunity to extend their holdings at attractive yields. $23.0 billion of these securities are held by the public. Including $9.1 billion of holdings by official accounts, there are $32.1 billion of these issues outstanding.

The current offering combines a "junior" advance refunding of certain securities maturing in 1966 and 1967 with a "pre-refunding" of all securities maturing on May 15, 1964.

Holders of securities eligible for exchange will have the option through all of next week of exchanging them for three new issues as follows:

Securities eligible for exchange and their maturity dates	*Securities offered in exchange and their maturity dates*	
	PREREFUNDING	
3¼% certificates, 5/15/64	3⅞% bonds, 1968 (new)	11/15/68
3¾% notes, 5/15/64	4% bonds, 1973 (new)	8/15/73
4¾% notes, 5/15/64	4⅛% bonds, 1989-94 (additional issue)	5/15/89-94
	JUNIOR ADVANCE REFUNDING	
3¾% bonds, 5/15/66		
4% notes, 8/15/66	4% bonds, 1973 (new)	8/15/73
3⅝% notes, 2/15/67	4⅛% bonds, 1989-94 (additional issue)	5/15/89-94
3¾% notes, 8/15/67		

The Background of this Advance Refunding

This advance refunding is another part of a continuing debt management program designed to finance the Government's requirements at the lowest practicable cost, while also furthering the growth and expansion of the American economy, helping to restore balance of payments equilibrium, and developing a maturity structure of the debt itself that will contribute to flexible operations at minimum cost in the future. By offering holders of outstanding issues with coupons of 3¼% to 4¾% an opportunity to invest for longer periods at coupon yields of 3⅞% to 4⅛%, the Treasury will accomplish further needed restructuring of the outstanding debt as a coordinate part of its program for carrying out these inter-related objectives.

During the remainder of calendar 1963, the Treasury must raise a net amount of approximately $6 billion in cash. The present intention is that the great bulk of this cash financing will be accomplished through offerings of Treasury bills, possibly including tax anticipation bills. The Treasury will, of course, adjust the timing and magnitude of these borrowing operations with a view not only to the pattern of its cash requirements and the needs of the balance of payments situation, but also to assure that the growth of the very short-term debt does not exceed the needs of the economy. The Treasury must also attempt, from time to time, to reduce the debt in the one-to-five-year maturity area, in order for the market to be able to absorb readily future borrowing within that area.

In the pre-refunding portion of this operation, the Treasury is seeking to reduce the total size of the security issues maturing on May 15, 1964, of which $8.0 billion are held by the public. This is a larger quarterly maturity than any other now outstanding. The junior advance refunding, by reducing the amount of debt maturing in 1966 and 1967, will help to simplify the Treasury's problems of refunding maturing obligations in the years immediately ahead.

With the economy still operating well below capacity levels, the Treasury has a continuing concern that its actions shall not reduce the availability of capital for constructive investment nor place upward pressures on long-term interest rates. Past experience with advance refundings which were conducted under comparable market conditions suggest that such operations may have a helpful catalytic effect in testing and clarifying the absorptive capacity of the long-term market without any appreciable effect on long-term interest rates.

Debt management operations during the first seven months of calendar 1963 have laid a strong foundation for the achievement of the Treasury's objective of non-inflationary financing of the budget deficit. Despite increasing use of Treasury bills during the January-July period of this year, the Treasury has reduced the total debt maturing within one year by $2.0 billion over the same period. The debt maturing in one-to-five years has been reduced by $3.6 billion. During the same span of time, the debt maturing beyond five years has been increased by $6.1 billion.

This change in structure has been accompanied by a sharply reduced reliance on the banking system in financing the deficit. The estimated holdings of Government securities by all commercial banks have actually declined by $4.3 billion during the first seven months of calendar 1963. Perhaps even more significant, commercial bank holdings of Government securities on July 31, 1963 were only about $100 million higher than they were at the end of 1960, despite the fact that the total outstanding Government debt has risen by $15.1 billion during that period.

In short, the debt restructuring accomplished thus far in calendar 1963, together with the restructuring which will be accomplished by this advance refunding, should assure that the budget deficit will be financed in a non-inflationary manner, and should contribute further toward this country's economic growth and its external balance.

Advance Refunding of High Coupon Issues

Typically, advance refundings have involved the exchange of outstanding securities for new issues carrying higher coupon rates of interest. However, as advance refunding continues to evolve as a debt management tool, there will be occasions in which holders of outstanding high-coupon securities will be offered exchange options involving new issues with lower coupon rates of interest. It is important, therefore, that investors become fully aware of the advantages which can accrue to them in an advance refunding exchange of relatively high coupon issues for issues carrying lower coupons.

In the present advance refunding, holders of the 4¾% notes of May 1964, for example, are being offered an attractive opportunity to exchange their holdings in this issue for longer-term securities bearing lower coupon rates of interest—ranging from 3⅞% for the 1968 maturity to 4⅛% for the 1989-94 maturity. The financial advantage which will accrue to the holders of the 4¾% notes in making this exchange is, however, as great as the financial advantage offered to the other, lower coupon eligible issues maturing in May 1964, the 3¼% certificates and the 3¾% notes. This comparability among the various options is accomplished by the establishment of different adjustment payments to be paid by the Treasury. In the present case, full allowance has been made for the differences in interest over the period from now until next May as between the 4¾% issue and any of the 3⅞%, 4% and 4⅛% issues offered in exchange. These adjustments are based on the differences between the current market values of the eligible securities and the indicated current market values of those being offered in exchange. In addition, the adjustment payment also includes an amount sufficient to improve substantially the effective yield on the new issues over the current market level of yields for the maturities involved.

As an illustration, a holder of the 4¾% notes of May 1964 who exercises the option to exchange into the 4% bonds of August 1973 will receive, in the form of an immediate payment from the Treasury, not only the full value of the coupon difference from now until the maturity of the 4¾'s next May, but, *in addition,* an investment yield of more than 4⅛% on a security which will mature in 9 years and 11 months.

Details of the Advance Refunding

The subscription books for this offering will be open beginning Monday, September 9, and will remain open through Friday, September 13, 1963, for all classes of subscribers. Payment date is Wednesday, September 18, 1963, with interest adjustments as of September 15.

The amounts of cash payments due to subscribers under each possible exchange, the amounts of accrued interest adjustments, and the investment yields and reinvestment rates are set forth in the attached tables. Other details relating to this advance refunding may be found in the formal offering circulars.

Table 1. Payments to and by the Subscriber in the September 1963 Advance Refunding

(In dollars per $100 of face value)

Securities eligible for exchange	Adjustment payments to subscriber (on account of purchase price of offered issues)	Accrued interest to September 15, 1963: Payable to subscriber on issues to be exchanged	Accrued interest to September 15, 1963: Payable by subscriber on offered issues	Accrued interest to September 15, 1963: Net accrued interest payable to subscriber[1]	Net amount to be paid: To Subscriber	Net amount to be paid: By Subscriber
"PREREFUNDING":		For the 3⅞% bond, November 15, 1968				
3¼% Certificate, 5/15/64	.650000	1.086277		1.086277	1.736277	
4¾% Note, 5/15/64......	1.600000	1.587636		1.587636	3.187636	
3¾% Note, 5/15/64......	.950000	1.253397		1.253397	2.203397	
		For the 4% bond, August 15, 1973				
3¼% Certificate, 5/15/64	1.150000	1.086277		1.086277	2.236277	
4¾% Note, 5/15/64......	2.100000	1.587636		1.587636	3.687636	
3¾% Note, 5/15/64......	1.450000	1.253397		1.253397	2.703397	
		For the 4⅛% bond, May 15, 1989-94				
3¼% Certificate, 5/15/64	1.350000	1.086277	1.686402	–.600125	.749875	
4¾% Note, 5/15/64......	2.300000	1.587636	1.686402	–.098766	2.201234	
3¾% Note, 5/15/64......	1.650000	1.253397	1.686402	–.433005	1.216995	
"JUNIOR" REFUNDING:		For the 4% bond, August 15, 1973				
3¾% Bond, 5/15/66.....	1.150000	1.253397		1.253397	2.403397	
4% Note, 8/15/66......	1.800000	.336957		.336957	2.136957	
3⅝% Note, 2/15/67......	.400000	.305367		.305367	.705367	
3¾% Note, 8/15/67......	.700000	.315897		.315897	1.015897	
		For the 4⅛% bond, May 15, 1989-94				
3¾% Bond, 5/15/66.....	1.350000	1.253397	1.686402	–.433005	.916995	
4% Note, 8/15/66......	2.000000	.336957	1.686402	–1.349445	.650555	
3⅝% Note, 2/15/67......	.600000	.305367	1.686402	–1.381035		.781035
3¾% Note, 8/15/67......	.900000	.315897	1.686402	–1.370505		.470505

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[1] Minus sign indicates net accrued interest payable by the subscriber.

Table 2. Investment Returns in the September 1963 Advance Refunding

Securities eligible for exchange	Approximate investment yield from 9/15/63 to maturity[1]: 3⅞% Bond 11/15/68	Approximate investment yield: 4% Bond 8/15/73	Approximate investment yield: 4⅛% Bond 5/15/89-94[3]	Approximate reinvestment rate for extension period[2]: 3⅞% Bond 11/15/68	Approximate reinvestment rate: 4% Bond 8/15/73	Approximate reinvestment rate: 4⅛% Bond 5/15/89-94[3]
"PREREFUNDING":						
3¼% Certificate, 5/15/64	4.02%	4.15%	4.21%	4.14%	4.22%	4.24%
4¾% Note, 5/15/64......	4.02	4.14	4.20	4.13	4.22	4.24
3¾% Note, 5/15/64......	4.02	4.14	4.20	4.13	4.22	4.24
"JUNIOR" REFUNDING:						
3¾% Bond, 5/15/66.....	Not eligible	4.15	4.21	Not eligible	4.32	4.28
4% Note, 8/15/66......	"	4.15	4.21	"	4.34	4.29
3⅝% Note, 2/15/67......	"	4.15	4.21	"	4.32	4.28
3¾% Note, 8/15/67......	"	4.14	4.20	"	4.36	4.29

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[1] Yields to nontaxable holders (or before tax) on issues offered in exchange based on prices of eligible issues (adjusted for payments on account of issue price). Prices are the mean of bid and ask quotations at noon on September 3, 1963.

[2] Rate for nontaxable holders (or before tax).

[3] Reopening of an existing security.