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Treasury Bills in the news

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A mundane instrument used by governments all over the world for cash management received considerable attention last week.

The Public Accounts Committee chaired by Professor Biman Prasad heard government officials explaining the use of treasury bills (T-bills). The T-bills are short-term, (less than one year), typically three months maturity promissory notes. Issued by governments, they help governments borrow funds for managing temporary shortfalls in revenue inflows for meeting housekeeping expenditures. For investment financing, such as infrastructure construction, governments float long term bonds for periods ranging from 10 to 30 years.

Students are often intrigued by the purposes behind the use of these two short term instruments, when resorted to by government and central bank.

While government uses the proceeds from short term T-Bills for temporary accommodation, the central bank uses the 91-day instrument for influencing short term market interest rate. The Reserve Bank of Fiji (RBF) was the first amongst the Pacific island countries to issue its own paper, called RBF Notes. The yield to maturity of its 91-day RBF Notes was called policy indicator rate (PIR), signaling the monetary policy stance of RBF.

The short term T-Bills or RBF Notes function like zero-coupon bonds. Investors buy them at a discount from the par value, and then receive the full amount when it matures. For example, an individual could buy a 91-day RBF Note that paid the full $1,000 at maturity for $990 at the time of purchase, effectively earning an annualized yield of 4.1 percent. Through tendering process RBF would fix the price at which they would have reach the targeted the PIR. After discontinuing OMO, RBF now announces the rate each month, known overnight policy rate.

The operations of sale of RBF notes for the purpose of controlling money supply through changes in monetary base, are similar to open market operations by US. The US Federal Reserve (the Fed) conducts OMO only in government or government agencies- issued bonds. The sale proceeds are kept within by monetary authorities and not handed over to government.

Fiscal operations

Issue of T-Bills by governments is for fiscal purposes. Britain was the first to introduce T-Bills in 1877. The US followed suit in 1929. Revenue inflows from taxes and non-taxes are not steady, depending upon seasonal fluctuations in economic activities. In lean months, revenue inflows are insufficient to cover budgeted recurrent expenditures. The T- Bills as short term instruments are issued by governments to meet deficits.

Despite the lower yields compared to those from similar short term securities issued by private sector, government issued T-Bills are most popular with investors, including commercial banks because they are risk free investment. Further, T-Bill market is highly liquid. Investors big or small can quickly convert them into cash.

Fiji's T-Bills

The T-Bills outstanding were at the highest at F$ 281 million in 2003, around 14 percent of total domestic debt of F$ 1963. Thereafter, T-bills were on the decline. They were F$65 million in 2008 (3 percent of total domestic debt of F$2411 million). After hovering around F$ 75 million in next three years, T-bills climbed to F$103 million in 2013 (around 4 percent of total domestic debt of F$2738 million). The latest figures (September 2014) show outstanding T-Bills were $122 million or 4 percent of total domestic debt.

Because of the low short term interest rate environment, debt burden imposed by T-bills is relatively low compared to the early 2000s.

Contrary to general expectations, the proportion of T-Bills held by FNPF has been decreasing over the last 12 year period. In 2003, FNPF holding was about 50 percent out of F$281 million. It declined to zero percent in 2009 and 2010. In September 2014, it was F$15 million out of F$122 million, or just around 12 percent.

On the other hand, banks are major holders of T-Bills: 84 percent of total T-Bills of F$122 million.

The US Regulation

The US financial crisis has highlighted the need for banks to hold liquid assets. The US banks have been ordered under a new rule that they should hold an additional US $100 billion dollars of liquid assets. The US Treasury securities are on the top category for qualifying as liquid assets.

The new rule, becoming effective from January 1, 2016 is designed to prevent taxpayer-funded bailouts and another financial crash. No wonder, US Fed Chair Janet Yellen welcomed the new rule.

No longer, a mundane instrument: The US Fed now looks upon T-Bills as a saviour, to keep troubled banks afloat.

You heard this before: *A drowning man will clutch at a straw!*

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