

**FEDERAL RESERVE BANK  
OF NEW YORK**

July 16, 1942.

The Honorable Marriner S. Eccles,  
Chairman, Federal Open Market Committee,  
Board of Governors of the Federal  
Reserve System,  
Washington, D.C.

Dear Marriner:

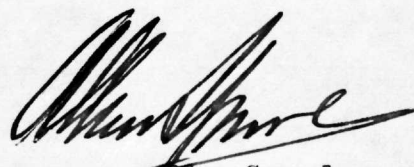
I tried to reach you by telephone this afternoon, but found you were attending a meeting away from the Board building and probably would not be back today.

Since you called me on Tuesday, I have given some thought to the question of our practice in buying Treasury bills. Enclosed is a memorandum setting forth the results of this thinking. I am sending copies of the memorandum to the other members of the Executive Committee.

As I say at the end of the memorandum, this question involves matters of market practice fully as much as System policy, it seems to me, and I should like to have Mr. Rouse, as Manager of the System Open Market Account, in on its discussion. He is away this week, but will be back next week, and I would suggest that we have a meeting of the Executive Committee on Tuesday or Wednesday of next week (Wednesday would be better for me than Tuesday, if it can be arranged), at which time this question could be discussed.

More important than a discussion of this question, of course, would be another discussion of the Treasury's financing program with the Treasury people, which I also think should be arranged. It seems to me that within the next three or four weeks we shall have to have some decision on questions of reserve requirements, short term interest rates, preferential rates for borrowing collateralized by short term government securities, etc.

Yours faithfully,



Allen Sproul,  
Vice Chairman, Federal  
Open Market Committee.

## BUYING RATES FOR TREASURY BILLS

The Federal Reserve Banks have been directed by the Federal Open Market Committee to purchase for System Open Market Account all Treasury bills that may be offered to such banks, on a discount basis, at the rate of  $\frac{3}{8}$  of 1% per annum. In addition, the Federal Reserve Bank of New York, acting for the System Open Market Account, from time to time purchases in the market and in order to put funds into the market, bills of shorter maturities than three months, at rates of discount less than  $\frac{3}{8}$  of 1%.

This practice of the New York Bank has been questioned on two or three grounds:

1. In other districts than the New York District, banks not in touch with the bill market are selling, or may sell, Treasury bills to the Federal Reserve Bank of their district at  $\frac{3}{8}$  of 1% discount, regardless of the maturity of the bills. It is undesirable that different Federal Reserve Banks pay different prices for the same bills, and it is unfair that lack of touch with the market should result in some commercial banks (and other holders of Treasury bills) receiving a lower price for bills sold to Federal Reserve Banks than do banks and others who sell their bills in the market.
2. It is not really accurate to say that bills of shorter maturities than 90 days, when purchased at lesser rates of discount than  $\frac{3}{8}$  of 1% per annum, are being purchased at "market prices" because under present circumstances the Federal Reserve Banks are really making the market and the market is whatever they make it.
3. At a time when it is deemed desirable by the Federal Reserve System that there be a further increase in short-term rates of interest, it is not desirable to establish rates lower than the rate of  $\frac{3}{8}$  of 1% fixed for 90 day Treasury bills.

Taking up these questions in order, it must be admitted that it would be desirable for all holders of Treasury bills to have equal access to the market at approximately the same prices. It may still be questioned, however, whether the way to accomplish this is by having all Federal Reserve Banks, including the Federal Reserve Bank of New York acting for the System Open Market Account, buy bills of all maturities at a fixed rate, on a discount basis, of  $\frac{3}{8}$  of 1% per annum. An alternative method would be for the Federal Reserve Banks to buy all bills of, say, 61 to 90 days maturity which are offered to them at the  $\frac{3}{8}$  of 1% rate, and to suggest to sellers of bills of shorter maturities that they probably can obtain a better price in the market; at the same time, the prospective sellers could be put in touch with dealers in Treasury bills.\* The market would then have a chance to perform its function of finding other buyers for the bills, outside the Federal Reserve System, but if such buyers could not be found, it could sell the bills to the Federal Reserve Bank of New York acting for the System Open Market Account. This would seem to be in accord with our desire to develop a broad and active market for Treasury bills.

\*As a matter of fact, we have been informed, upon inquiry, that in several cases sale of bills of short maturities to Federal Reserve Banks at the  $\frac{3}{8}$  of 1% rate were consummated because the selling bank needed funds immediately and had discovered its need too late in the day to sell the bills in the market for cash delivery; in other words it was not a case of remoteness from or lack of familiarity with the market. In other cases, the amount of bills to be sold was so small that the sellers may well have thought it not worth while to bother about the rate.

To keep a sense of proportion, it should be remembered that it still takes more than \$100,000 to earn \$100 in three months time on Treasury bills at  $\frac{3}{8}$  of 1%.

The question of whether there really is a market for Treasury bills other than the market made by the Federal Reserve Banks can perhaps best be answered by the statement that such a market does exist. It is supported, to be sure, by the absolute commitment of the Federal Reserve Banks to purchase all bills offered to them, on a discount basis, at the rate of  $\frac{3}{8}$  of 1% per annum, but there is no such commitment with respect to purchases of bills of shorter maturities at lesser rates. It is known, of course, that we have purchased bills of shorter maturities at lesser rates from time to time, but this has been on our initiative when we wished to put funds into the market. The market has done its own trading at rates, on a discount basis, below  $\frac{3}{8}$  of 1% per annum, without absolute reliance on us. It may be argued that buyers of bills are foolish to take any lesser return than  $\frac{3}{8}$  of 1% per annum on Treasury bills when this income can now be obtained on what is practically a demand obligation. Nevertheless, the market with its desire for particular maturities and its ingrained habits of meeting its requirements, is in many cases willing to take a smaller return on 30 or 60 day bills than it could obtain on 90 day bills even under present arrangements. It might be argued also that if, by our action, we can fix a rate of  $\frac{3}{8}$  of 1% per annum, on a discount basis, for Treasury bills of whatever maturity, the sale of new 90 day bills might be interfered with, temporarily, from time to time. The buyer, if 30 or 60 day bills were obtainable in the market, could buy these bills rather than bid for new 90 day bills at the same rate. Query: Is there anything to be gained by trying to force the market to change its habits, by a change in our buying practice?

This query brings up the question of whether or not we are working against a further rise in short-term rates of interest by buying Treasury bills of shorter maturities, on a discount basis, at lesser rates than  $\frac{3}{8}$  of 1% per annum. We believe that just the opposite case can be made, bearing in mind that rates on Treasury bills are quoted on a discount basis. If we purchase Treasury bills having 30 days to run, at  $\frac{1}{4}$  of 1%, on a discount basis, we are paying a higher price for the bill than if we purchased them at  $\frac{3}{8}$  of 1%. The seller, therefore, (assuming he obtained the bills at a  $\frac{3}{8}$ % rate or thereabouts) not only receives about  $\frac{3}{8}$  of 1% for the period he has held the bills, but he also realizes some appreciation in price. His net income for the period the bills are held, therefore, may be something more than  $\frac{3}{8}$  of 1%. (This is another aspect of the old dilemma of maintaining a pattern of rates without encouraging holders at short-term to obtain long-term rates of interest. Our present practice in buying Treasury bills, therefore, may be said to tend toward higher short-term rates, rather than the reverse. This fact has facilitated our purchases of bills when we wished to put funds into the market by expanding the bill portfolio and without waiting for bills to be offered to us at the  $\frac{3}{8}$  of 1% rate. A seller who might not sell Treasury bills of shorter maturities at the  $\frac{3}{8}$  of 1% rate, because that rate is available at any time, could be persuaded to sell at a lower rate (on a discount basis) or higher price because the opportunity to do so might not immediately recur.

The whole question involves market practice and psychology as well as System policy. Our present judgment would be to continue on the existing basis, with the modification that all Federal Reserve Banks refer sellers of Treasury bills of shorter maturities to the market for a possible higher price than the Federal Reserve Bank guaranteed buying rate.

July 16, 1942.