Chairman Eccles

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

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Chairman Eccles

L. M. Piser

CONFIDENTIAL

It is estimated that in the next six months the System will add about 4 billion dollars to its holdings of Government securities in order to cover an increase of 2.5 billion dollars in money in circulation and of 1.5 billion in required reserves. Banks are starting to shift from meeting their reserve needs entirely through bills to meeting them at least in part through certificates. For their short-term fluctuations in reserves, they are likely to continue to use bills, but for their longer-term reserve needs they may turn to certificates. To the extent that they meet their reserve needs by selling short-term certificates to the System, the System will insure a return to them not only of 7/8 of 1 per cent but of an additional amount representing the premium on short-term certificates. If certificates are included in the basket, this trend is likely to be intensified, since corporations will purchase a large amount and part of their purchases will be offset by sales of short-term certificates in the market. Banks will have substantial excess reserves during the drive, and as a consequence they may provide a ready market for these short-term certificates, but they will later sell them to the System when their reserves decline following the drive. The System, therefore, will make it profitable to banks to create additional reserves and thereby to give further impetus to the expansion of bank credit. The issuance of 9-month bills at 3/4 of 1 per cent, however, would not give such an incentive, since the bills could not be sold to the System at an additional profit arising from the premium.