April 27, 1944

Hon. Daniel W. Bell,
Under Secretary of the Treasury,
Washington, D. C.

Dear Dan:

I am enclosing six copies of the supplementary recommendation by the Executive Committee to the Secretary. I regret that I was unable to get this memorandum to you sooner.

Sincerely yours,

M. S. Eccles, Chairman,
Federal Open Market Committee.

Enclosures

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April 27, 1944

SUPPLEMENTARY RECOMMENDATION
BY THE EXECUTIVE COMMITTEE OF THE FEDERAL OPEN MARKET COMMITTEE
TO THE SECRETARY OF THE TREASURY

In our memorandum of March 29, 1944, we recommended that the rate on Treasury bills be increased to 1/2 of one per cent and the maturity extended to four months. At the meeting of our representatives with you, concern was expressed by your associates as to the effect on the whole interest rate structure of the abandonment of the 3/8 of one per cent rate. At the same time, our representatives referred to the fact that an increase in rate would mean an increase in earnings on the large holdings of bills by the System and expressed the view that, while this circumstance should not be a determinant of financing policy, ways could be devised to overcome it, if necessary.

Renewed consideration of our recommendation has further convinced us that it is sound in principle. Renewed consideration of the Treasury's views has suggested an adaptation of our proposal that should make it acceptable without detracting essentially from its advantages. In brief, we now propose that there be two issues of Treasury bills, one of three-month maturity, which would be largely if not wholly taken by the Federal Reserve Banks, and one of five-month maturity, which would achieve the wider distribution we seek in the market. In order to make this proposal effective, we would recommend that:

1. The Treasury plan to raise funds between drives largely by means of five-month bills instead of certificates or longer-term securities.

2. The Treasury offer initially 1.2 billion dollars of bills each week, including 600 million of three-month bills and 600 million of five-month bills. At the end of each three-month period, the Treasury would increase the weekly offering of three-month bills, in order to enable the System to provide banks with such reserves as are needed on the basis of 3/8 instead of 5/8 of one per cent.

3. The Federal Open Market Committee direct the Federal Reserve Banks to establish a buying rate of 5/8 of one per cent and a repurchase option on the new bills.

4. The Federal Open Market Committee direct the Federal Reserve Banks to offer each week to purchase from dealers the amount of the offering of new three-month bills and to maintain the present buying and repurchase rate of 3/8 of one per cent on such bills, the rate being maintained initially to protect existing holders and subsequently to avoid its disappearance from the market.

This proposal has the following advantages:

a. By offering 1.2 billion dollars of bills a week, the Treasury could raise 8.0 billion of funds. Following the completion of both cycles, there would be outstanding 7.8 billion dollars of three-month bills (600 million a week for 13 weeks) and

13.2 billion of five-month bills (600 million a week for 22 weeks), making a total of 21 billion, compared with the present 13 billion. This amount of new funds would cover the maximum necessary interim bank financing in 1944.

b. The rate on the new five-month bills would be in line with the present pattern of rates as indicated by the market for certificates of indebtedness that mature in five months, but the difficult task of maintaining a market pattern between 3/8 and 7/8 of one per cent would be relieved in considerable measure.

c. The net cost to the Treasury would probably be no larger than if the financing were done partly with 3/8 of one per cent bills and partly with 7/8 of one per cent certificates or higher-rate securities. What the Treasury would lose by shifting some of the bills from 3/8 to 5/8 of one per cent would be regained by shifting from certificates at 7/8 of one per cent to bills at 5/8 of one per cent. To the extent, moreover, that the higher-rate bills proved attractive to nonbank investors, so that they could be used to reduce materially the amount of Treasury financing to be done indirectly through the banks, the net cost of the Treasury's borrowing would be less than under the present program.

d. It would eliminate the offering of certificates or longer-term securities between drives. Such offerings require special announcements that call attention to direct bank financing and are an indication that the Treasury has not obtained sufficient funds from nonbank investors. Such offerings, moreover, involve problems of handling subscriptions and making allotments and in the case of certificates necessitate annual refunding offerings. Offerings of bills, however, are more or less routine and can be used to provide whatever amount of residual financing is needed and whenever it is needed.

e. Treasury bills would regain some of the character of market obligations, whereas now they are tending to become almost solely a medium for Federal Reserve financing. Banks are now keeping their holdings of three-month bills at low levels, because of the unattractive rate, and are purchasing certificates for their shortest-term investments. The higher rate on bills would result in an increase in commercial bank buying and holding of bills and would encourage banks to meet fluctuations in reserves through changes in their bill portfolios rather than through buying and selling certificates, notes, and bonds.

f. More important, there would also be an increase in the buying and holding of bills by business concerns, which are now holding large amounts of cash on deposit with banks. Since bills are as liquid as deposits, business concerns could reduce their deposits substantially and meet some of their fluctuating needs for cash by changes in their bill holdings rather than through bank deposits. By this process, the amount of nonbank investment in Government securities would be increased, and the amount of necessary bank financing would be reduced.

It is suggested that these recommendations be put into effect as soon as possible so that they will immediately become a part of the Treasury's financing program for the remainder of the year.

April 27, 1944

Chairman Eccles
Governor McKee
Governor Draper

Attached is a copy of the supplementary recommendation as it was sent to the Treasury this afternoon. I am also sending copies to Mr. Sproul and Mr. Leach.

L. M. P.