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Chairman Eccles September financing

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The central problem in the financing picture for the next 6 months is the refunding of 4.5 billion dollars of notes which will mature in September and of 1.4 billion dollars of bonds which will mature in October and December. Excluding funds which might be raised from a new G type bond, funds available for debt reduction during this 6-month period will not be above 2 billion dollars under the most favorable assumptions and this will be just about sufficient to take care of voluntary cash redemptions if maturissues are refunded in full. Little or nothing will be left for cash retirement during this period, especially if new financing is to be avoided in October.

With the existing level of security prices and the fixed pattern of rates, it is exceedingly difficult to undertake any refunding into securities of over one year maturity. If such securities are issued with coupon rates which fit the rate pattern of 7/8 per cent to 2 1/2 per cent, they will immediately go to a premium. If they are given a coupon rate and terms that fit the present yield curve, this would involve a lowering of the pattern of rates below that in line with a long-term rate at 2 1/2 per cent. Moreover, such a step would make it difficult to raise short-term rates in the future without permitting recent intermediate term issues to fall below par. For these reasons there is little flexibility in selecting the type of refunding issues as long as the present pegs on short-term rates are continued. If nothing was done with respect to rates prior to the September financing, refunding would probably have to be into 7/8 certificates, with the result that the tendency for bank shifting would be accentuated.

In order to avoid this and to prepare for the September financing, it is highly desirable to reach a prompt decision on the rate question and on the issuance of a nonmarketable bond. The following program is suggested for your consideration:

(1) Prompt action should be taken to discontinue the fixed buying rate and repurchase option on bills and to permit upward adjustment in the bill rate to its normal level in relation to the certificate rate. Pending agreement on a higher bill rate, the Open Market Committee might consider the desirability of discontinuing immediately the repurchase option on new bills. New bill issues in this case would flow into the Federal Reserve. Bills after a short period would disappear from the market and there would no longer be any need for a buying rate, except for the purpose of week to week exchanges.

(2) There would be little gain in the discontinuation of the buying rate, however, unless it was followed by the reintroduction of bills as a market instrument, that is, unless the bill rate was permitted to rise

to a level at which the market would purchase and hold bills. Market held bills are desirable in order to facilitate the functioning of the money market and to provide flexibility in Treasury financing from funds outside the Federal Reserve.

(3) A restricted G type bond should be offered. This would relieve the downward pressure on the long yield to the extent that it arises from nonbank sources. It would also supply additional funds, perhaps 1 billion dollars or more with which to redeem maturing issues of bank held debt.

(4) The certificate rate should be unpegged, or at any rate permitted to rise somewhat, and maturing notes and bonds, not retired with other funds, should be refunded into a higher yield certificate. The eleven certificate issues now outstanding might be concentrated into 4 to 6 maturities, which would provide elbow room after the certificate rate is permitted to fluctuate. This spacing process could be combined with raising the certificate rate gradually while minimizing the possibility of depressing the price of outstanding certificates below par.

In carrying out this program and if an agreement can be reached in time, the August 1 and September 1 maturities of certificates might be refunded into issues maturing next July 1 and bearing a coupon rate of 7/8 per cent which would involve some moderate rise in the rate. On September 15 a 12 month issue with a 1 per cent coupon could be offered in exchange for maturing notes, and more of the same issue could be offered in exchange for October 1 certificates. Additional bills could be sold to meet the October 15 bond maturities if necessary.

(5) In the future, maturing note and bond issues which are not paid in cash could then be refunded into the higher yield certificate. The higher certificate yield would take care of bank earnings without making it necessary to supply banks with new intermediate term issues. By narrowing the spread between certificates and eligible bonds, this action would tend to check debt monetization.