

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM

# Office Correspondence

Date October 10, 1947

To Chairman Eccles

Subject: \_\_\_\_\_

From Woodlief Thomas

Attached are: (1) copies of three proposed drafts of a letter to the Secretary of the Treasury, one prepared here and two prepared in New York; (2) a memorandum from Mr. Smith regarding interest savings and the various refunding programs for the next five years; and (3) a tabulation showing commercial bank and other holdings of various issues of Government securities callable or maturing within one year, one to five years, five to ten years, ten to fifteen years, and over fifteen years.

The three drafts of the proposed letter differ considerably in structure but very little in substance. Our draft is probably somewhat more specific as to the immediate program, while the New York drafts contain more discussion of the current situation. There are a few minor differences in details which will have to be ironed out.

Mr. Rouse, I understand, has gone on vacation. I telephoned Mr. Sproul and told him what the program is and have also notified Sam Carpenter and have given him copies of these various documents.

M. T.

## Attachments

P.S. The New York drafts of the proposed letter, you will note, contain no reference to the savings bond program. Mr. Sproul thought it might be better to discuss this in a separate communication, but I judge he had no strong feeling on the subject.

Reasons why Treasury refunding into one-year issues is preferable  
to refunding into two to five-year issues

It has been suggested that if the Treasury would offer two to five-year notes at interest rates of 1-1/8 to 1-1/2 bank demand for securities at higher yields would be satisfied and shifting from short-term into long-term securities would cease. It would then be possible to maintain short rates at present levels. Following are some reasons why it is preferable to refund into shorter term issues at rates somewhat higher than present levels.

1. The issuance of medium term securities at a higher rate and maintenance of a lower rate on short-term securities would eventually encourage further shifting. As the longer securities approach maturity they would rise to a premium and banks would be encouraged to sell them, particularly if the policy of issuing medium-term higher-rate issues were continued.

2. New medium-term securities issued at the present time would either have to be offered at a coupon, which would give the purchaser an immediate premium, or would result in a freezing of the present market pattern of rates, which is below the announced coupon pattern. The only other alternative would be to issue notes at present market pattern and, in case a change in the pattern were desirable, to permit them to go below par.

3. Banks do not need additional securities in the two to five-year range because of the large volume of bonds approaching maturity already in that range. Approximately ~~20~~ billion dollars of securities mature in two to five years, of which banks now own some ~~30~~ billion.

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4. Issuance of these medium-term securities would not satisfy the market demand for them. It would simply stimulate shifting from short-term securities to purchase the medium-term higher-rate issues. This would create additional reserves and leave a large unsatisfied demand, as well as encourage unnecessary credit expansion.

5. Since practically all Government securities are demand obligations at par, there is no reason why the Treasury should pay a higher rate of interest on longer marketable issues held by banks than on shorter issues.

CHANGE IN THE ANNUAL INTEREST COST TO THE TREASURY ON MARKETABLE  
PUBLIC DEBT MATURING OR CALLABLE BETWEEN OCTOBER 31, 1947 AND OCTOBER 31, 1952 1/

(In millions of dollars)

Assuming Refunding of All Issues into:

	<u>1% Issues</u>	<u>1 1/8% Issues</u>	<u>1 1/4% Issues</u>
Dec. 31, 1948	- 64	- 20	+ 23
Dec. 31, 1949	- 113	- 91	- 39
Dec. 31, 1950	- 243	- 178	- 112
Dec. 31, 1951	- 384	- 304	- 223
Oct. 31, 1952	- 476	- 385	- 295

	<u>1% Issues</u>	<u>1 1/8% Issues</u>	<u>1 1/4% Issues</u>
Dec. 31, 1948	+ 6	+ 40	+ 74
Dec. 31, 1949	- 7	+ 27	+ 61
Dec. 31, 1950	- 1	+ 33	+ 67
Dec. 31, 1951	- 23	+ 11	+ 45
Oct. 31, 1952	- 32	+ 2	+ 36

1/ The total interest cost on these issues at present rates is 1,368 million dollars, or 1.47 per cent of the estimated amount outstanding October 31, 1947, 93.3 billion dollars. The net cost after allowance for earnings on Federal Reserve Bank holdings returned to the Treasury is 1,268 million dollars, or 1.36 per cent of the amount outstanding. The estimated amounts returned by the Federal Reserve to the Treasury per annum are about 100 million dollars at present rates, 140 million dollars at a 1 per cent rate, and 190 million at a 1 1/4 per cent rate. At a 2 per cent rate on bonds, the amounts returned by the Federal Reserve would be in each case about 10 million dollars more per annum than the amounts indicated.

These figures assume no change in the amount outstanding or in Federal Reserve Bank holdings after October 31, and assume that all issues are refunded on the earliest callable or due date.