

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date December 11, 1947

To Chairman Eccles

Subject: Attached Memoranda

From Thomas Lee Smith

T. L. S.

The two attached memoranda concerning Series C Savings Notes were not discussed at the meeting of the Open Market Committee.

A longer memorandum prepared at the time of your request of a month ago proved too long, and then was held up because of the developing pressure on your time of work in connection with the short-term reserve plan and your testimony before Congress.

Attachments

C
O
P
Y

November 19, 1947

Mr. Rouse

Current status of Treasury
savings notes

A. H. Willis

Treasury Savings Notes Series "C", initially designated as Tax Savings Notes, were originally offered early in the war and were intended for the accumulation of tax reserves and for the temporary or short-term investment of idle cash balances. Subsequently, minor changes were made in terms of this issue with respect to redemption notice, denominations, etc., in order to increase their appeal. This instrument served a valuable purpose during the war as a source of funds to the Treasury and as an outlet for the investment of short-term funds on the part of corporations and others, with the result that the amount outstanding increased fairly steadily until the early part of 1944, when a leveling off occurred. In 1945 and 1946, however, redemptions ran ahead of sales and the amount outstanding declined. In the first ten months of this year sales have fallen slightly short of redemptions so that the amount outstanding recently has shown little material change although this experience has probably been influenced to some extent by large purchases of Savings Notes in June by the State of Illinois (which was precluded from buying obligations selling at a premium) with funds raised through the sale of its own securities.

The increased disparity between rates on short-term market issues of Treasury obligations and United States Tax Savings Notes which has come about chiefly since July 1947 as a result of the short-term rate policy of the Treasury and the Federal Reserve System, now raises the question of whether or not some further revision in the terms of Tax Savings Notes should be made looking toward a restoration of their former status in relation to market issues. A further, more basic, question also arises as to whether or not

there is a continuing need for this instrument on the part of the public and the Treasury Department. The role of Tax Savings Notes as a recent source of new funds to the Treasury and the degree to which taxpayers have tendered them to meet tax liabilities, has, however, not been altogether reassuring when considered in terms of the Treasury's original purpose in introducing this issue.

From the standpoint of debt management and credit policy, it is well to keep in mind that we are now in a period of substantial budgetary surplus and are continuing a program involving substantial increases in short-term rates. The development of a broader short-term market, especially for Treasury bills, is one of the collateral objectives of current policy. The chief appeal of the Tax Savings Note lies in the freedom from market risk and the wide choice of monthly maturities which it provides. With 0.94 per cent as the going rate for a three-months' Treasury bill and a 1 1/8 per cent rate a near-term prospect for a one-year certificate, it would seem that taxpayers and investors with short-term funds to invest have available ample supplies of short-term instruments at attractive rates adequate for their purpose, particularly as the increase in the three-months' rate has been proportionately greater than in the case of the one-year rate. There seems to be no offsetting advantage to the Treasury in catering at this time to short-term investors on the grounds of freedom from risk and special maturities. A three months' Treasury bill now offers a return almost equal to that on a Savings Note held for two years and it is questionable whether the case for reviving a lagging response to the notes is entirely clear. The validity of this view, however, depends on the degree to which a broader demand for Treasury bills would be met by sales from System Account since utilization of cash balances for Savings Note redemptions would

limit funds available to the Treasury for retirement of debt held by the Federal Reserve System. There appears, however, to be a better basis for continuing the sale of Tax Savings Notes either on current or slightly more favorable terms as a means of tax anticipation. The Treasury Department, under these circumstances, obtains the use of tax money before tax payment dates at a slight cost, with the result that tax receipts tend to be more evenly distributed throughout the year. The United States Government security market, on the other hand, is spared those adjustments which might be occasioned by sales of securities bought in substitution for Tax Savings Notes while some money market distortions which might otherwise add to the supply of short Treasury obligations at or near tax dates could also be avoided. Purely as a means of tax anticipation, there is a continuing place for the Series "C" Savings Note with advantage to both the Treasury and the Federal Reserve System in facilitating the handling of fiscal and credit policy and debt management operations.

In conclusion, it may be said that the role of the Treasury Savings Notes is less important in the current situation and we might continue their sale with terms unchanged until the upper limit of rate policy is more clearly indicated, regardless of what happens to the amount outstanding. Later, in the light of that experience consideration might be given to improving the terms relative to market rates, at least to the extent that the notes are used in payment of taxes.

ARW:fd

TREASURY SAVINGS NOTES SERIES "C"

(In millions of dollars)

Calendar Years	<u>Sales</u>	<u>Redemptions</u>		
		<u>Total</u>	<u>For Cash</u>	<u>For Taxes</u>
1943	7,958	3,331	223	3,108
1944	8,533	7,087	590	6,497
1945	5,504	6,966	1,637	5,329
1946	2,789	5,287	2,332	2,955
Months				
1947				
Jan.	218	370	227	143
Feb.	209	234	175	60
Mar.	275	410	128	283
April	174	143	92	52
May	164	119	90	29
June	570	538	330	208
July	231	201	133	68
Aug.	154	105	67	38
Sept.	170	285	83	202
Oct.	<u>215</u>	<u>129</u>	<u>81</u>	<u>48</u>
First 10 months 1947	2,380	2,534	1,406	1,131
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R&S 100-2536

To: Executive Committee

December 3, 1947

From: Thomas Lee Smith

Subject: Savings Notes

As a result of the recent rise in rates on short-term marketable securities, Series C Treasury savings notes are now a less attractive medium for the investment of corporate funds. If held six months, the yields on these notes is currently only .60 per cent, and if held three years to maturity, it is only 1.07 per cent. The yield on new Treasury bills, in contrast, is now .94 per cent, and on the 13-month notes just announced is 1 1/8 per cent. The recent upward adjustment in short-term market rates has not yet had any marked effect on the sales of savings notes, but corporations may be encouraged by this development increasingly to prefer bills or certificates over savings.

This situation poses the following questions to the Committee:

- (1) Should a new issue of savings notes bearing an interest rate in line with market rates be offered?
- (2) Should the issue of the savings notes at present rates be continued?
- (3) Should the issuance of savings notes be discontinued altogether?

Adjustment of yield with market rates would have little effect upon savings notes sales

Sales of Series C savings notes declined rapidly from their wartime peak of 8.5 billion dollars in 1944 to 2.8 billion in 1946. The main factors in this decline were (1) reduced corporate income tax liabilities and (2) increased corporate needs and uses for available funds. Use of savings notes for tax payments has declined from an estimated 41 per cent of corporate income and profits taxes paid in 1944 to about 15 per cent of such taxes in 1946. Also, estimated funds invested in savings notes for holding to maturity have dropped from 2 billion dollars of amounts issued in 1943, the peak year, to less than 1 billion of sales in 1946.

Sales of savings notes in 1947 have so far held up fairly well in comparison with 1946. Not enough time has yet elapsed, however, to determine the full effects of current readjustments in the pattern of market interest rates. Experience to date seems to indicate that sales have not been much affected by higher rates on bills and certificates, but they might be adversely affected at somewhat higher rates. Alignment of the rate on savings notes with market rates would protect against such a development, but it would

not protect against further decreases in sales resulting from the current pressure for funds that confronts many corporations.

Net sales of savings notes an unimportant source of future Treasury funds

Sales of savings notes are now running about equal to redemptions. Redemptions, however, are expected to exceed sales in the next few years whether the yield on savings notes is increased or not. Even with an alignment of the yield with market rates, net redemptions under present pressures on corporate rates are likely to average at least .8 billion dollars over the next three years. If the present yield is held, a reasonable expectation for average net redemptions is possibly 1.3 billion.

Structure and ownership of Government debt little affected

The total debt and the bank-held share of the debt would be little affected by the choice of alternatives. The total debt would be unaffected, other things being equal, since any decrease in the nonmarketable debt because of smaller sales of savings notes would be offset by an increase in the marketable debt. Furthermore, the bank-held debt would not change much because any increase in marketable debt resulting from smaller debt retirement would tend to be offset by additional purchases of bills and certificates by corporations.

The development of a broader short-term market, especially for Treasury bills, which is an objective of current policy, would receive assistance from a shift in corporate demand away from savings notes.

On the other hand, two disadvantages may result from reduced sales of savings notes or their elimination, both of which are of relatively minor importance: (1) The additional corporate holdings of bills and certificates could be more easily monetized than holdings of savings notes, and (2) sales around tax dates of securities bought in substitution for savings notes might cause some money market distortion.

Savings notes might be continued partly as an accommodation

The savings notes might continue to be issued partly as an accommodation to those investors who still prefer the notes to higher yielding securities. There will probably continue to be a small demand for the notes to be held against taxes and other liabilities because the notes are free from price fluctuation and afford the investor a wide choice of monthly maturities. It would seem reasonable in case of their continued issuance to revise the rate upward in line with changed market yields, say, to a 1 1/4 or 1 1/2 yield.

Though savings notes are unimportant in the present situation, their continued sale affords the Treasury the use of some tax money before tax payment dates, tending toward a more even distribution of tax receipts during the year.