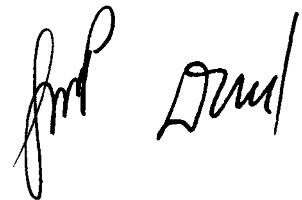
July 19, 1943

Chairman Eccles

L. M. Piser and D. M. Kennedy

One of the memoranda that you sent on Saturday was a copy of a letter from Mr. M. J. Fleming, enclosing a communication from Mr. Stanley, President of the Union Trust Company of Pittsburgh, that we had received a week previously and that contained no recommendation for the inclusion of certificates in the basket. The other was a memorandum from Mr. Haas, recommending the inclusion of certificates. We assume that it was the latter memorandum to which you wished a reply and that the former was sent only for our information.

We are in agreement with all except the second paragraph of the attached reply. We believe that the maintenance of the weekly offering of bills at a billion dollars and the offering of some additional amounts of certificates would help to bring the market into balance, since it would tend to adjust the supply to the demand. We do not think that there is serious danger that banks will shift from bills to certificates on any large scale; bills are much more useful than certificates for the adjustment of reserve positions, because bills can be sold to the Reserve Banks at any time for immediate delivery, while certificates usually can be sold only for regular delivery and often it takes several days to complete a transaction. We do not think that corporations are likely to play the pattern of rates on certificates to a large extent, because (1) they have held practically all of the issues that they have purchased in previous drives, (2) their quota in the September drive will be slightly less than their accumulation of funds since the last drive, and (3) they have no knowledge of or experience in speculating in the Government security market, the low rate of interest on Government securities is not particularly attractive to them, and the slight additional return that they would obtain would not be worth the bother. While we feel that the issuance of a large amount of certificates would help to bring the market into balance, we are in agreement that the proposed 9-month bill would be a better solution.



Attachment.

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July 19, 1943

MR. HAAS' MEMORANDUM ON THE THIRD WAR LOAN

Mr. Haas memorandum of July 14 on the Third War Loan contains two recommendations to which exception may be taken. First, the memorandum recommends that 7/8 of 1 per cent certificates be included in the basket. Second, it recommends that subscriptions from institutions such as corporations and insurance companies be deferred until September 27.

The first recommendation is subject to the important objection that the issuance of a large amount of additional certificates would not meet the difficulties with which we are faced in maintaining the pattern of rates. With corporations under pressure in the next drive, they would buy new certificates by selling shorter-term certificates. The System would need to purchase a large amount of the shorter-term certificates. If banks purchased some of them, the banks would sell bills to the System. The process would merely play into the hands of the banks and encourage them to shift from bills to certificates. With a continuation of the wide disparity between three-month paper at 3/8 of 1 per cent and 1-year paper at 7/8 of 1 per cent, the issuance of even many billions of dollars of certificates would not bring the market into balance. If it were decided to issue 9-month bills after this became fully evident, there would be too many issues of certificates in too large amounts to permit of a ready conversion into the new bill issues.

In addition, the first recommendation is subject to the objection that a 1-year security is not a proper instrument to include in a drive. Mr. Haas' arguments are largely on the grounds (1) that most corporations prefer to invest in certificates rather than in either marketable notes or savings notes and (2) that if they were sold marketable notes the liquidation of these notes prior to maturity would give rise to a market problem. It is not difficult to understand the reason that corporations prefer certificates. They can purchase 1-year certificates at a rate of 7/8 of 1 per cent, hold them for six months, sell them at a premium that gives a return of between 1 1/8 and 1 1/4 per cent on a six-month investment, and then repeat the process. It is necessary for the System to maintain a premium on short-term certificates in order to keep them in proper relation with 3-month bills at 3/8 of 1 per cent. The premium and yield on holding certificates for various periods is shown in the following table:

Period held	Yield to maturity	Price	Yield from issue
At issue	.88	100.00	.88
3 months	.71	100.12	1.32
6 months	.54	100.17	1.22
9 months	.38	100.12	1.04
1 year	--	100.00	.88

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Although corporations would prefer to purchase certificates, they can be sold other issues. Tax savings notes are the fairest of all issues, because the return to the investor depends on the length of time that the Treasury has used the funds and no profit is derived from playing the pattern of rates. Even if corporations purchase longer-term issues and sell them before maturity, the future market problem is not likely to be serious; the liquidation will be spread over a period of time, because corporations will find that they will not need a large amount of cash immediately upon the termination of the war or at any other one time.

The reasons given for the second recommendation are (1) that the coincident appeal to individuals and to institutions would be confusing and (2) that the large early subscriptions from institutions would indicate little need for strong efforts by the selling group and little need for sacrifice by individuals. Regarding the first point, there is no reason for confusion, because the selling technique is entirely different for individuals than it is for institutions. The disturbing effect of large early subscriptions can be eliminated by establishing separate quotas for individuals and by placing the entire emphasis on reaching these quotas. Insurance companies and other institutions should be permitted to subscribe from the beginning of the drive. They have been anxious to invest accumulating funds for some time, and a further postponement would be unfair to them.

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