Chairman Eccles

To: Board of Governors February 10, 1948

From: Woodlief Thomas

Attached is a chart and memorandum concerning the changes in the dealers' positions which have occurred during 1947 and 1948 to date.

Attachment

W. T.

To: Mr. Thomas February 9, 1948

From: Thomas Lee Smith Subject: Dealers' Position

Aside from fluctuations each month in the dealers' position associated with Treasury refunding operations (i.e., increased holdings through purchases of the new issue on a "when issued" basis and purchases of "rights" to subscribe to the new issue, followed by decreased holdings when holdings of the new issue are sold in the secondary market), there has been a fairly steady decline in holdings since the middle of the year. The sharpest declines occurred in July when the policy of increasing short-term rates commenced and in the months following September when the prices of all Government securities declined.

The total position of reporting dealers in Government securities, excluding Treasury bills, declined from nearly 900 million just before the July 1947 refunding to approximately 300 million just before the February 1948 refunding, and in mid-January, prior to the offering of February 1 certificates, dealers' total holdings were down to about 100 million. At their low point near the middle of January, certificates and notes held were only a little above 50 million compared with nearly 600 million at the end of June; holdings of bank eligible bonds were down to zero compared with approximately 200 million during July-September and over 200 million in June; and restricted bonds held were under 50 million compared with about 100 million in mid-November but were about the same as at the end of June.

The dealers, while able at some loss to take on a position in securities which are in supply for very short periods of time, could not afford to hold securities once the prospect of rising rates and declining prices on Government securities was established for months ahead. Furthermore, bank credit became more costly to dealers relative to the one-year rate on Government securities, even when the money market was not especially tight. Dealers in general found themselves less and less able to keep the cost of taking a position, that is, interest paid plus normal price depreciation as maturities shorten from day to day, down to the coupon interest received.

In the first half of the year, the usual monthly fluctuation around refunding dates, while present, was less pronounced. There was not the same speculative inducement to obtain a larger share of the new issues since no rate increase for a new issue above the 7/8 per cent one-year rate could be anticipated. Dealers' positions, like Federal Reserve holdings, fluctuated more in accordance with the state of the money market and outside demand, dropping to about 200 million including only 50 million of notes and certificates in March when the money market was easy and outside demand correspondingly stronger, and rising to an average of about 800 million in June, the peak month for the year.

Position of Reporting Dealers in Government Securities