MEMORANDUM BY E. R. KENZEL,
DEPUTY GOVERNOR, FEDERAL RESERVE BANK OF NEW YORK
RE OPEN MARKET RATES FOR BILLS PURCHASED

The minimum rate of 4 1/8% established for purchase by Federal reserve banks of 90-day bills has been in effect for about one year. It was advanced from 4% in April, 1923. At that time and since, until within about one month, it was also the prevailing rate for prime unindorsed bills available to investors in the market.

While these rates seem high as compared with a 4 1/2% rediscount rate for promissory notes, the rate was sustained in the market by reason of the substantial volume of short Treasury paper available at or slightly under 4 1/8%. Figuring the tax exemption on short Treasury paper, the yield on them was equal to or higher than the market rate for bills. Under these circumstances the Federal reserve banks naturally acquired a substantial proportion of the total volume of bills current from time to time.

With the changed money conditions since March 15, 1924, the floating supply of Treasury paper has been materially reduced, with the result that the demand by banks and other investors for bills caused the rate for 90-day unindorsed bills to recede to 3 7/8%. The rate has since recovered to 4% and it seems improbable that it will advance further in the near future; the contrary may be the fact.

Since January 1, 1924, the bill holdings of Federal reserve banks have declined from $347,000,000 to $176,000,000 on April 16. Of the latter amount $33,000,000 was held by New York under sales contract. During the past month the market has been entirely out of the Federal Reserve Bank of New York as to sales contracts on two occasions.

The volume of bills outstanding at the present time is probably a little less than it was at the first of the year, when cotton shipping was heavy, but is not importantly reduced. The discount market now holds about $67,000,000 of unsold bills, an increase of $6,000,000 over a week ago; their sales during last week were $25,000,000 as compared with $40,000,000 the week previous.

The distribution during the past several weeks has been principally through out-of-town banks, savings banks and foreign banks, the latter have been the most important buyers in the past few days, and there are inquiries for substantially additional amounts for account of foreign clients to be filled during the balance of this month. While this represents a fairly satisfactory condition in the market, there nevertheless is a lack of temporary employment of idle funds by the large city banks in the bill market because of the certain loss that would result from their resale to Federal reserve banks of bills bought at 3 7/8 and 4% at the present minimum rates maintained by Federal reserve banks. A spread of 1/8 to 1/4% has always had the effect of deterring the local employment of idle funds in the bill market.

In view of this condition and the prospective further ease in money, I would recommend a reduction in the minimum rates of Federal reserve banks at this time to 4% for three months' bills and a corresponding reduction of from 1/8 to 1/4% for short bills, the short rates, however, not to be put into effect immediately but in the discretion of the Federal reserve banks as conditions might arise in which the lower short rate would best serve their operations in the market, either as a stimulant to distribution or for the purpose of acquiring reasonable volume of short paper.

The sales contract rate, I believe, might well be left at 4% at the present time but with liberty, without formal action, to reduce it to rates current for the purchase of short paper in the discretion of the banks.

April 18, 1924.