December 28, 1938

Memorandum to: Secretary Morgenthau

From: Chairman Eccles

Subject: Proposed Reconstruction Finance Corporation financing

It has been suggested that the Reconstruction Finance Corporation sell a $500,000,000 issue of notes during January or February.

I wish to recommend for your consideration that the proposed issue of Reconstruction Finance Corporation notes be delayed until April or May, but that, if it should be decided to float it at an earlier time, the proceeds be not used further to reduce the available supply of Treasury bills. A reduction in the supply of bills would further disrupt the bill market and would seriously add to the difficulties of managing the System Account.

One consideration in connection with the proposed Reconstruction Finance Corporation issue is that, if the Treasury wishes to keep its balance above $1,000,000,000 at all times between now and the end of the fiscal year, it will need to raise about $600,000,000 of cash before the end of May. The period of March financing may not be propitious for raising this cash, because it is likely that you may wish to refund the $1,300,000,000 of June notes at that time. Two alternative ways of raising these funds would be through a Reconstruction Finance Corporation issue or through additional Treasury bills. Either of these alternatives would have the advantage of providing short-term securities for bank investment, of keeping the Treasury's interest cost at a low figure, and of preventing a further pressure of funds on the already over-loaded short-term market. From the point of view of facilitating the replacement of maturities in the System Account additional

Treasury bills would be more satisfactory. The System Account has found it impossible to complete its weekly replacements in bills and has been forced to take notes in each of the last three weeks.

As regards the timing of these flotations, it would seem that the issue of either the Reconstruction Finance Corporation notes or the Treasury bills should be postponed until April or May. If a Reconstruction Finance Corporation issue of $500,000,000 is floated in January, the working balance will rise to $2,500,000,000. Such a large balance does not seem either necessary or desirable, as it might be interpreted as an indication of nervousness by the Treasury.

Of course, it would be possible to use the proceeds of the Reconstruction Finance Corporation issue to retire an equal amount of Treasury bills, but in view of the low level of outstanding bills this would not appear to be a wise thing to do. To be sure, it would represent a replacement of one kind of short-term Government security with another, but the two markets are not identical. While 85 percent of Reconstruction Finance Corporation obligations are held by member banks, less than 25 percent of outstanding bills are held by member banks, the Reserve banks holding 45 percent and individuals and corporations most of the remainder. Individuals and corporations would be unlikely to purchase the Reconstruction Finance Corporation notes. The Treasury bill market consequently would be squeezed further and the System would have even greater difficulty in replacing its weekly maturities without driving up the note market.