MEMORANDUM OF MATTERS TO BE

DISCUSSED WITH THE TREASURY

April 24, 1941.

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The Federal Reserve System has given renewed consideration to the problem of Government financing, to the services that the System could render to the Treasury in carrying out its program, and to the ways and means of combining most effective methods of financing with such safeguards against inflationary developments as it may be possible to adopt.

In all of these matters the objectives of the Treasury and of the System are the same, namely, to finance defense as cheaply and effectively as possible and to do what is feasible to facilitate post-defense readjustment by preventing rapid price advances and disruption of the price structure.

SYSTEM'S COOPERATION

The System wishes to be guided by the Treasury's decision as to the manner and extent to which the System shall participate in the distribution of U.S. Government obligations, shall undertake to stabilize the market for these securities, and shall for that purpose engage in open-market operations. There are three possible alternatives:

1. To follow the practice of recent years by maintaining orderly conditions in the market, through operations often on a 50-50 basis with the Treasury.

2. To have the Treasury handle the stabilization of the market out of its own resources.

3. To have the System take a much more active part in the market by buying or selling U.S. Government securities at all times in amounts sufficient to maintain price and yield fluctuations within a narrow range.

If the Treasury wishes the System to pursue the third of these alternatives, the System is prepared to do the following:

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1. To help sell and distribute new issues of United States Government obligations.

2. To stabilize prices of intermediate and long-term issues, by keeping market fluctuations within narrow limits; and to reduce to a minimum speculation in that market.

3. To stand ready, when any issue is offered, to keep that issue up to par during the subscription period and to take up or buy in the market any part of the issue that may be necessary for that purpose.

4. For these purposes, if deemed desirable, to organize Government securities divisions in the twelve Federal Reserve Banks and possibly in their branches and to authorize them to buy and sell Government securities at prices and in amounts to be controlled by the Federal Open Market Committee.

SUGGESTIONS AS TO FINANCING PROGRAM

Tapping of idle funds

Methods for tapping individual savings, particularly in small and moderate amounts, have already been adopted through the various forms of savings bonds. It is suggested that consideration be given to offering one or more additional non-negotiable issues designed especially to obtain idle funds from corporations and large individual investors -- for example, a two-year tap issue carrying a higher coupon for each semiannual period that the security is held, redeemable by the holders on thirty days' advance notice. Such an issue may possibly attract as much as two billion dollars a year.

Short-term issues

The short-term market would presumably be used, by issues of bills and notes, for the purpose of compensating for possible irregularities in the inflow of funds from long-term issues. Short-term rates probably would increase somewhat in due time but the Treasury might wish little support from

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the System in that market except to prevent disorderly conditions and to smooth any advance in short-term rates that may occur.

Long-term issues

With respect to long-term financing, of which there will have to be a large amount in the next few years, the following specific suggestions are offered for consideration:

1. That a rate structure be selected for intermediate and long-term borrowing, such as, for example, 2-1/2 per cent for 15-year money and 2-3/4 per cent for 34-40-year money.

2. That the number and variety of issues in the maturity structure of intermediate and long-term issues be kept to a minimum consistent with the long-term needs of the different classes of investors.

3. That the issues have conversion privileges into possible future issues at more favorable rates. This would make it clear to prospective investors that they have nothing to gain by waiting.

4. That the amount the Treasury wishes to raise at the time of offering an issue be not announced but that the Treasury reserve the right to accept any part or all of any subscription. This would do away with over-subscriptions and would eliminate the question of whether or not the issue turns out to be a success.

The Federal Reserve System would stand ready to take up any part of the issue that might be needed with a view to disposing of it when and if market conditions would permit.

5. That consideration be given to the feasibility of having market issues of certain maturities available on tap at any time at par plus accrued interest.

6. That in the refunding of maturing issues by exchange into new issues, the issues offered in exchange be so priced as gradually to eliminate the value of the "rights", and that successive refundings be so handled as to reduce the number and variety of outstanding issues.

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7. That consideration be given to making long-term market issues non-negotiable for an initial period of, say, six months or a year.

SAFEGUARDS AGAINST INFLATION

It is believed that taxation, financing out of savings, and various non-monetary devices, such as priorities, rationing, and price controls, will do a great deal to avoid the dangers of inflation. The possibility of selective controls over terms of installment sales is also under consideration as a means of regulating the expansion of credit. At the same time it is recognized that there is now in existence a large volume of member bank deposits and reserves and that deposits will be further increased through the expansion of loans by banks to industry. Additional expansion of both deposits and reserves would result if the Federal Reserve System was to undertake large-scale operations for the purpose of keeping yields on Government securities within a narrow range. Under the impact of pressure for increased output these reserves and deposits are likely to become more active and it may become desirable to supplement regulatory actions of a non-monetary nature by the adoption of measures of restraint on the expansion of bank credit. It is believed that such measures can be put into effect without interfering with the financing program.

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