January 10, 1941

The Secretary of the Treasury has been reported in the press as saying that U. S. Government securities have had an unwarranted decline since the publication of the special report to Congress made by the Federal Reserve System; that he sees no reason for a hardening of rates at this time, and that he does not believe in taking any artificial means at this time to increase rates.

In this connection Chairman Eccles of the Board of Governors of the Federal Reserve System, speaking for himself alone, made the following statement to the press:

Prices of U. S. Government obligations, even after their decline since the turn of the year, were still higher than at any time, except for the last few weeks. Treasury 2 3/4 bonds of 1960-1965 sold on January 8 at 109 1/4, or on a yield basis of 2.17 per cent; the latest issue of 5-year Defense notes was selling on 0.77 per cent yield basis; Treasury bills were issued this week at a premium above a no-yield basis.

Talk of hardening rates is, therefore, premature. If the Treasury will have to pay a fraction of one per cent more for the money it has to borrow, there are fifty millions of creditors in the country, holders of insurance policies and of savings accounts, who will benefit - if the steady decline of interest rates almost to the vanishing point will come to an end. One should be fair to creditors and debtors alike; they are an equally large part of the people.

If the Treasury's purpose is to raise money cheaply, it can do so by issuing bills or short-term notes. In fact, if that is the only purpose, it can print money to pay its bills.

We have a managed money system, not an automatic one, and the Government has means of influencing and practically determining the interest rate.

When business activity was declining and a deflation was under way - rates were artificially reduced: what else but an artificial means to that end is the increase of the price of gold, or the purchases of silver, or open-market purchases of the Federal Reserve System? They are all artificial means of increasing availability of money and have the effect of reducing ~~what is~~ interest rates. They were adopted and pursued at a time when this was necessary. We wanted to encourage spending when there was not enough of it. Now the situation has changed. The defense program provides a huge volume of spending. The interest rate will need to be adapted to the relation between existing savings and the demand for funds. With the vast volume of savings in the hands of individuals and corporations the rate is bound to remain low. But as things are now the demand for funds is met not only out of existing savings but also out of huge funds in the hands of the banks - held as excess reserves. So long as these excess reserves exist rates must remain abnormally low. Hence the System special report requesting authority to control excess reserves when the need will arise. Yet this recommendation for power to control these reserves has been called an artificial means of hardening rates. This is like calling artificial a suggestion to a man who has been walking on crutches that, now that his legs have mended, he could dispense with the crutches.

If we want to encourage investors to buy Government bonds, we must offer more attractive rates. Not high rates, but fair rates. And we must reduce the demand from banks by cutting down their excess reserves. So long as these reserves continue as large as they are the banks will outbid the investors. And rates will remain abnormally low.

If rates on 3-months bills rose to 1/4 of 1 per cent, they would attract a large amount of corporate funds that are lying idle now. These funds would go to work and would help to finance defense. As it is they do the country no good whatsoever.

Also, when banks buy governments - this creates deposits on top of the existing excessive supply. This further depresses rates. It is a vicious circle that leads to inflation. What we need to do is to use existing funds, since they are over-abundant, and not to create more.

To meet the Treasury's needs by issuing long-time bonds at excessively low rates is unfair to the public. Banks and individuals, who buy them at these rates, will suffer capital losses when interest rates begin to rise and the price of bonds to decline. Up to the present long-time bonds have not been issued at less than 2 3/4 per cent. Such bonds now sell at a 9 point premium and even after a big decline losses by holders would only affect paper profits. But long-time bonds issued on the present yield level of not much over 2 per cent might cause the purchasers serious losses of principal in the future.

Interest rates are not an end in themselves, they are a means to an end and must vary as conditions change, but always with the same objective. The objective is to achieve a more stable economy ~~an economy with stable prices~~ by a more ~~and an ever more~~ effective use of human and material resources for the common good.