April 29, 1942

To Board of Governors

From Mr. Rouse and Mr. Piser

Attached is the memorandum sent to the Treasury yesterday morning revised in the light of yesterday afternoon's discussion. There is also attached a summary of the agreement reached with the Treasury representatives as we understand it. These two memoranda have been prepared at the Chairman's suggestion.

Attachments.

Financing Program Agreed upon at Meeting at the Federal Reserve Board on the Afternoon of April 28, 1942, with Suggested Modifications

1. Offer on Monday or Wednesday of next week a 7-9 year (1949-51) 2% bond in the amount of $1,250,000,000. Rules governing basis of subscription would be eliminated.

> <u>Suggested Modifications:</u> It is suggested that the rules governing basis of subscription be retained with respect to this issue.

2. Offer a 20-25 year 2-1/2% bond without limit as to amount, to be registered but non-transferable for first 60 days. Commercial banks accepting demand deposits would be prohibited from subscribing or purchasing such security in the market for a period of ten years. It is estimated that this will produce $500,000,000 during the month of May.

> <u>Suggested Modifications:</u> It is suggested that these bonds be made eligible as collateral for bank loans. It is also suggested that the Secretary should announce that this issue will be open for one week and may then be closed at the option of the Secretary. It should not be open for longer than two weeks. The Secretary might announce that there would be other issues of similar securities from time to time.

3. Issue 90-day bills for an additional $100,000,000 a week (total $250 a week). The Federal Reserve System would post a maximum rate of 3/8% on bills at which it would buy all offerings. This would produce $400,000,000 during the month of May.

This would make a total of approximately $2,100,000,000 in new cash for the month of May.

4. Announce that the Treasury will soon issue a 5-year tap security with graduated rates of interest along the lines of our previous memorandum on this subject. (It may be possible to offer this security at same time as others.)

> <u>Suggested Modifications:</u> It is suggested that consideration of this issue be postponed.

5. Call the HOLC 2-1/4% bonds for payment on July 1 and, in the latter part of May, offer a refunding security for these, the RFC notes maturing on July 1, 1942, and the Treasury notes maturing on September 15, 1942. As most of these securities are held by banks, this should be a bank security. Because of this, it was suggested that it be in the 5-year range.

It is understood that before a part of this program can be completely adopted, it will be necessary for the Federal Reserve Board to call a meeting of the Executive Committee of the Open Market Committee to get its approval of the open market operation proposed under No. 3.

April 28, 1942
Revised

TREASURY FINANCING

The magnitude of the war financing program is increasing enormously as we are successful in the war production program. The most recent budget estimates for the fiscal year 1943 indicate that expenditures by the Federal Government will be 76 billion dollars instead of 62 billion as was estimated in January. The Federal debt, taking account of the income from proposed new taxes, will increase by 54 billion dollars instead of 40 billion. Exclusive of sales of war savings bonds at the hoped for rate of one billion dollars per month, 35 billion dollars will have to be borrowed from banks and other lenders and investors.

The size of this task alone emphasizes the necessity of adopting a comprehensive long range financing program. Yesterday's Presidential message requires the support of such a program, if monetary policy is to support fiscal policy in combating a rise in the cost of living. There is a danger in feeling our way along without a program; the danger that we shall drift into a program which does not measure up to the requirements of our situation. The views of various groups of lenders and investors should be taken into account but they should not control policy, nor be allowed to delay too long the adoption of a program. Financing a war of the present magnitude involves a judicious but very substantial amount of telling the buyer what he is to take, as well as finding out what he wants to buy.

General Principles

1. The program should not be cast in the last war pattern of rising rates of interest as the war progresses.

2. Maintenance or increase of the present volume of excess reserves as such in the country outside of New York or in New York is not necessary to the program and might be detrimental - it would continue pressure upon banks to invest whereas banks should have less inducement to invest and others should have more inducement.

3. There is need for an additional amount of short-term Treasury paper, such as bills and certificates of indebtedness, so that excess

reserves can be shifted readily from market to market and bank to bank, through the purchase and sale of these obligations. This mobility of funds will not be achieved, however, if short-term rates are so low as to repel demand for such maturities outside the principal money markets.

4. Borrowing from non-bank investors must be increased to the fullest possible extent in order to avoid the inflationary implications of an unrestrained increase in the volume of bank credit.

5. Borrowing from commercial banks, in so far as it is necessary, should be for periods not exceeding ten years.

6. Federal Reserve System purchases of Government securities in substantial amounts will be necessary in order to maintain adequate bank reserves, and to facilitate the Treasury's financing program.

Methods

The problem relates to methods of putting these principles into effect, and most particularly to methods of selling and keeping as large a volume of securities as possible outside the banking system.

There are various ways of carrying forward the financing program (exclusive of War Savings Bonds, etc.), including:

1. Continuance of present method of offerings for general subscription.

2. Periodic offerings of very large issues to be sold by campaign methods (Canadian program).

3. The Tap Issue Method (British program).

4. A method which combines offerings of regular and special issues in order to provide securities to attract every available investment dollar.

The fourth method appears to be the most appropriate for our situation. It is imperative that we have an organization separate from the War Savings Bond organization(which is working in a special field) available to sell whatever securities are offered; that is, an organization of the commercial banks, as well as the investment bankers and others, that will reach investors everywhere and sell Government securities. Such an organization can and should be set up in each Federal Reserve District centering around the Federal Reserve Bank.

Specific Suggestions for May Financing

1. Begin immediately to increase the weekly offering of Treasury bills from 150 million dollars to 250 million. The Federal Open Market Committee will be asked to direct the Federal Reserve Banks to post a buying rate of 3/8 of 1 per cent for Treasury bills.

2. Issue a 7-9 year 2 per cent bond which will be primarily a bank investment. Such an issue in the amount of 1 1/4 billion dollars could be readily sold.

3. Offer a registered 2 1/2 per cent, 20-25 year market bond which could not be registered in the name of commercial banks for 10 years and which could not be transferred for 60 days. The amount of this offering would not be fixed, the books would be left open for as long as desired, and a special canvass of insurance companies and other similar investors would be made. It is expected that the amount which would be sold in May would not be less than 500 million dollars nor more than 1,000 million dollars.

4. Discard subscription rules except the preferred allotment on small subscriptions ($10,000). The reasons for the other rules have now disappeared and subscribers should be permitted and encouraged to subscribe for whatever amount of Government securities they desire.

The Federal Reserve System in this serious situation must, of course, do whatever it can to assist in the Treasury's program. It can be of greatest help if a comprehensive program is now adopted. It is ready and willing to support such a program in whatever ways are necessary by whatever means are at its disposal.

April 29, 1942

Agreement on Comprehensive Financing Program

The following agreement was reached in discussion with Treasury representatives subject to approval of the Secretary:

1. The weekly offering of bills will be increased immediately by 100 million dollars to a total of 250 million dollars. Over a full 13-week period this will raise 1,300 million dollars of cash and will bring the outstanding amount of bills to 3,250 million dollars.

2. The Federal Reserve will post a buying rate of 3/8 of 1 per cent for all offerings of Treasury bills, subject to the approval of the Federal Open Market Committee.

3. In the May financing the Treasury will offer for subscription subject to allotment 1,250 million dollars of 2 per cent bonds of 1949-51.

4. Subscription rules will be discarded except for preferred allotment on small subscriptions.

5. The May financing will also include the offering of 2 1/2 per cent bonds of 1962-67, which will be in registered form, will not be available for purchase by commercial banks for a period of 10 years, and will be non-transferable for 60 days. Subscriptions to this issue will be accepted in full. The amount of the offering will not be announced in advance, but the books will remain open until a satisfactory amount of subscriptions is received. The amounts mentioned range from 500 million dollars to 1,000 million. The issue will be subject to reopening.

   This issue, together with the increased offering of bills and the offering of 2 per cent bonds, will provide the Treasury with sufficient cash to meet requirements through the month of May. reduce the cash borrowing,

6. Throughout the discussion those present seemed to be in agreement that the long-term rate for war financing would be 2 1/2 per cent based on a term of about 20 years.

7. The Treasury will announce the offering of an open-end issue of 5-year registered, redeemable, non-transferable notes, which will be available for subscription only by investors other than commercial banks.

8. The Federal Reserve System will proceed immediately to the organization of each district through the Federal Reserve bank of that district for the purpose of promoting the sale of all types of Government securities, except Series E bonds.

9. The Treasury will call the 875 million dollars of HOLC 2 1/4s and will refund in the latter part of May this issue, as well as the 276 million of RFC notes due July 1 and probably the 342 million dollars of Treasury notes due September 15.

10. A meeting of the Federal Open Market Committee and of the Presidents of the Reserve banks not members of the Committee will be called for Monday, May 4, to consider all aspects of the program and to make plans for the organization of the Federal Reserve districts. This entire financing program will be announced on Wednesday, May 6.

11. The rates and maturities of the various issues described above will be subject to refinement by the group.