

August 20, 1942

Honorable Daniel W. Bell,
Under Secretary of the Treasury,
Washington, D. C.

Dear Dan:

For your confidential information I am
attaching hereto a copy of a letter sent to the
Secretary covering a suggested program for the
September and October financing.

Very truly yours,

M. S. Eccles,
Chairman.

Attachment

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August 20, 1942

Honorable Henry Morgenthau, Jr.,
Secretary of the Treasury,
Washington, D. C.

Dear Henry:

Since I am leaving at the end of the week and expect to be away when the September financing is being discussed and may be away at the time of the preliminary discussions of the October financing, I am submitting tentative suggestions covering the September and October financing as I see the situation at the present time.

The following program for September would raise 2.5 to 3.0 billion dollars of funds:

1. The offering on September 1 of the modified form of tax notes in line with the general ideas suggested by Haas except for the rates, which should be higher, would raise 0.5 to 1.0 billion dollars in September in excess of the usual sales of tax notes if the sale of the modified notes is vigorously promoted by the Victory Fund Committees. In order to sell this amount it would be necessary for the rates on the notes to approximate market yields for the earlier periods. A suggested schedule of rates is compared in the following table with current market yields:

(Per cent per annum)

Period held	Modified tax notes		Approximate current market
	Rate per annum	Yield during period held	
1/2 year	.60	.60	.62
1 year	1.08	.84	.86
1 1/2 years	1.20	.96	.95
2 years	1.32	1.05	1.04
2 1/2 years	1.32	1.10	1.14
3 years	1.32	1.14	1.23

2. Continuation of the weekly bill offering at 350 million dollars would raise about 300 million dollars of funds in September. An ideal time to increase the weekly offering to 400 million dollars would be for the issue dated September 9, since this is the date when the amount

of maturing bills increases from 250 to 300 million dollars. An additional 200 million dollars would be raised by this means in September bringing the total amount of funds from bills during the month to 500 million dollars.

3. The two small issues that mature in September and October should be redeemed in cash on their maturity dates. These issues include 342 million dollars of September Treasury notes and 320 million dollars of October Reconstruction Finance Corporation notes.

4. The remaining needs in September could be met by offering an issue of 1.5 billion dollars of 2 to 3 year notes carrying a coupon rate of $1\frac{1}{4}$ per cent. If sales of the modified tax notes should exceed the maximum of 1.0 billion dollars, the amount of this offering could be reduced. If they should not reach the minimum, it might be preferable to offer two note issues.

The following program for October would raise 4.5 to 5.0 billion dollars of funds:

1. The modified tax notes might raise an additional 500 million dollars in October.

2. Continuation of the weekly bill offering at 400 million dollars would provide 300 million in October. The weekly offering could be increased to 450 million dollars for the issue dated October 21, which is the date when the amount of the maturity increases from 300 to 350 million dollars. An additional 100 million dollars would be raised by this means or a total of 400 million in bills in October.

3. An open-end offering of 2 per cent bonds around the middle of October accompanied by a vigorous campaign on the part of the Victory Fund Committees might raise 2.5 billion dollars. This would be the fourth offering this year of 2 per cent bonds. It would establish the offering of 2 per cent bonds on a quarterly basis and would accustom the market to 7 - 9 year 2 per cent bonds with the call and maturity dates moved forward by three months each time. I think that it would be a mistake to offer 2 per cent bonds before October.

4. It is estimated that an offering around the middle of October of 2 1/2 per cent bonds, which would not be available for commercial banks, would raise 1.5 billion dollars if the bonds were issued in coupon form. Coupon obligations would attract some funds that are not obtained by registered bonds, and sales could be further stimulated by the Victory Fund Committees. The existing registered 1962-67s should be made available for conversion into coupon bonds with banks prohibited from purchasing them. The maturity of the coupon issue need not be extended by more than a few months beyond that of the registered issue. An issue of perhaps December 1962-67 would not seriously affect the market for the 1967-72s. The two offerings of registered 2 1/2s have resulted in very little selling in the 1967-72s and in only small declines in quotations.

There seems to be some strong support for a large open-end market offering in October of 2 1/4 per cent bonds available to all investors including banks. I think that this would be a mistake. An offering of 2 1/4 per cent bonds would result in a substantial amount of selling of 2 per cent bonds by banks, would increase the cost to the Treasury, would add another type of issue, and would bring in no additional funds that are not reached by the 2 and 2 1/2 per cent bonds. I think that it is important to distinguish between banking and non-banking funds. This has been clearly done up to the present by prohibiting banks from taking the 2 1/2s, but to raise the rate from 2 per cent and to lengthen the maturity would seem to me to be contrary to the original conception. I think that it would be undesirable to offer for bank investment securities having as long a maturity as would be placed on 2 1/4 per cent bonds. Banks invest out of funds that are obtained from the Federal Reserve System either by reductions in reserve requirements or by open-market purchases. I believe that it is unnecessary to pay on bank investments rates in excess of 2 per cent. Banks generally will make adequate earnings at this rate. The only exception might be the smaller banks with a large proportion of savings deposits. These banks could be provided for in some special manner and should be paid 2 1/2 rather than 2 1/4 per cent. Otherwise there would be discrimination against commercial banks and in favor of mutual savings banks and other savings institutions, which at present are allowed to subscribe to 2 1/2 per cent bonds.

In connection with the program to increase the amount of the weekly bill offering and to obtain a wider distribution of bills arrangements should be made for either the Treasury or the Federal Reserve Banks

Honorable Henry Morgenthau, Jr.

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to accept in full bill tenders at a rate of $\frac{3}{8}$ of 1 per cent up to perhaps \$100,000 on each individual subscription. This provision would be attractive to many of the smaller banks who are unfamiliar with the bidding method and who have had their bids rejected in part or in full.

Very truly yours,

M. S. Eccles,
Chairman.

LMP:lee