July 31, 1944

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

Dear Dan:

I am enclosing a memorandum regarding the suggestion that the Treasury increase its offering of Treasury bills by 200 million dollars a week beginning with the weekly offering to be dated August 10. This memorandum has been prepared following a full discussion of the question by the Executive Committee on July 28. I believe that the memorandum is in line with the conclusions reached at that time, but there has not as yet been sufficient time to clear the memorandum with all of the members of the Executive Committee. If any revisions are to be made, however, I shall get in touch with you regarding them.

Sincerely yours,

M. S. Eccles,
Chairman.

Enclosure

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MEMORANDUM FROM THE EXECUTIVE COMMITTEE OF THE FEDERAL OPEN MARKET COMMITTEE TO THE SECRETARY OF THE TREASURY

The Executive Committee of the Federal Open Market Committee discussed at a meeting held July 28, 1944, the suggestion that the Treasury increase its offering of Treasury bills by 200 million dollars a week beginning with the weekly offering to be dated August 10. After discussion, the Committee voted unanimously to recommend that the Treasury make no further increase at this time in outstanding Treasury bills. The principal reasons for the Committee's recommendation are as follows:

1. There is no net market demand for bills. Between the end of October 1943 and the end of February 1944, marking in both cases the end of war loan drives, Federal Reserve holdings of bills increased by about 800 million dollars, while holdings by other investors declined by about the same amount. Between the end of February 1944 and the end of July 1944, Federal Reserve holdings of bills increased by 2.6 billion dollars, while holdings by others declined by about 100 million. Holdings outside the Federal Reserve Banks are likely to decline further between now and the next war loan drive.

2. A further increase in outstanding bills would be inflationary, in that it would call Reserve Bank credit into use regardless of the needs of individual banks and thus would tend to swell the amount of financing done through the banks. In supplying bank reserves, it is generally preferable for the Federal Reserve to purchase securities from banks that are short of reserves and that need to replenish them. When the Federal Reserve purchases new offerings of bills, the reserves thus created go in part to banks that already have sufficient reserves. These banks are, therefore, encouraged to expand credit. During the recent drive, the shift of deposits to war loan accounts released nearly 3 billion dollars of funds to banks. They utilized these funds in part by increasing their holdings of Government securities by large amounts. At weekly reporting member banks, the increase was 5.4 billion dollars, of which bills accounted for 1.6 billion. All banks needing reserves before the next drive can obtain them by selling to the Federal Reserve from their existing holdings of Government securities or by borrowing from the Reserve Banks.

3. A further increase in outstanding bills would increase the existing difficulty in maintaining the pattern of rates, in that it would tend to force up prices and to reduce yields of longer-term securities for which the banks are showing a growing appetite. A premium has been established on the new issues included in the drive, and this premium has created substantial profits for speculators in Government securities. The existing pressure has made it necessary for the Federal Reserve to sell bonds and notes in the market. If the Federal Reserve forces reserves into the market by purchasing the increase in outstanding bills rather than purchasing from the banks' existing holdings, banks will be encouraged to add further to their holdings of longer-term securities. In our opinion, the proper time to issue additional bills is when they are needed by the Federal Reserve for purposes of supplying reserves and of maintaining the pattern of rates. This time will arrive when banks have reduced their portfolio of bills to the smallest amount that they wish to hold and are finding it necessary to sell bonds and notes.

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4. A further increase in outstanding bills at this time would unnecessarily diminish the Treasury's capacity to use in time of need its best instrument for emergency financing. We understand that the Treasury's present estimates show that at the end of October the Treasury's balance will be 9.3 billion dollars if there is a further increase of 200 million a week in outstanding bills. If no further increase is made, the balance will be 6.9 billion. In our opinion, the latter balance would be adequate to carry the Treasury through to payment date on whatever securities are offered in the sixth war loan drive and to meet any emergencies. If, however, a greater need for funds did arise, the Treasury would still be able to raise sufficient funds by offering additional bills at the time. In the interim, the Treasury would save interest costs.

We feel strongly that the Treasury should permit all holders of maturing bills to exchange their holdings for newly-issued bills. We understand counsel had agreed that it is within the authority of the Treasury to provide for such exchange and that the exercise of such rights by the Federal Reserve would not come within the statutory limitation on direct purchases. The increase in outstanding bills is going to the Federal Reserve through the medium of Government security dealers, who place tenders at the request of the Treasury, such request being conveyed to the dealers by the Federal Reserve. In our opinion, this procedure is open to the criticism that, in substance, the bills are not being sold in the open market and that their purchase by the Federal Reserve is, in the circumstances, at least an avoidance of the intent and spirit of the law.

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