MISS BENTON

March 14, 1947

CONFIDENTIAL

Honorable John W. Snyder,
Secretary of the Treasury,
Washington, D. C.

Dear John:

With my letter of January 22, 1947, I sent you a copy of a memorandum which represented the tentative results of the thinking of the members of the executive committee of the Federal Open Market Committee and its staff with respect to the possible issuance by the Treasury of a long-term security.

Since that time we have given further consideration to this problem and I am attaching a copy of a statement which expresses the unanimous views of the members of the full Federal Open Market Committee who attended the recent meeting of the Committee in Washington. The statement strongly advises against the issuance of a marketable long-term security and proposes instead that at the proper time a non-marketable issue of the Series G type be made available.

Mr. Sproul and I will be glad to discuss the matter with you at a convenient time should you so desire.

Sincerely yours,

(Signed) Marriner

M. S. Eccles, Chairman,
Federal Open Market Committee.

Enclosure

cc: Mr. Bartelt
Mr. Musgrave

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Strictly Confidential February 27, 1947

ISSUANCE BY THE TREASURY OF A NEW LONG-TERM SECURITY

Proposals for the issuance of additional long-term securities, as part of the Treasury's refunding program, have been under discussion for the past year. Since replacement of maturing issues with long rather than short-term maturities will result in a higher cost of carrying the debt, any such program must be tested against broad objectives of credit and debt management policy.

Some Long-term Refunding Desirable

On this basis, some additional supply of long-term Government securities would be desirable when:

(1) new institutional and savings funds become available which are not being placed in private investment outlets;

(2) the increasing volume of such funds and the static supply of long-term maturities threatens to depress the issuing rate on long-term Government bonds below 2-1/2 per cent. (A decline in long-term rates from this cause must be distinguished from a decline due to debt monetization by commercial banks.)

(3) the funds raised by the issuance of additional long-term securities can be applied to the redemption of maturing obligations which are held by the banking system. The retirement of securities held by commercial banks would help to reduce demand deposits, while retirement of securities held by the Federal Reserve banks would assist in keeping member bank reserves under some pressure. This would contribute to preventing renewed inflationary credit expansion. Reliance on refunding operations for the transfer of bank-held bonds to nonbank investors is increasingly important at this time in view of the prospect for tax reduction and, in consequence, of reduction in budget surplus available for debt retirement.

At the recent meeting with Treasury officials, the representatives of insurance companies appeared to justify the issuance of long-term bonds by the Treasury, both from the standpoint of the amount of institutional funds currently available for investment, and from the standpoint of the stabilizing effect of such an issue upon investment yields in general. Even though their presentation may not have fully met the requirements of conditions (1) and (2) above, it does give support to condition (3). The Committee considers it desirable, therefore, to make a beginning in the direction of a long-term refunding program. In the future, this program may be adapted to new situations as they develop.

Marketable Issue Not Called For

While these considerations justify the issuance of some long-term securities, our objective would not be served by an offering of marketable securities.

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(1) A marketable security would provide renewed opportunity for investment institutions to "play the pattern of interest rates". At a coupon rate of 2-1/2 per cent, a market obligation would attain an immediate premium and a supplementary premium would develop as the issue moved toward maturity. In this way, holders of such an issue would be able to obtain a return considerably above 2-1/2 per cent by selling at a premium some time during the life of the obligation. Past experience indicates that this would be done by many purchasers of the new issue.

(2) Unless the new issue was quite small, it would be accompanied by substantial sales to commercial banks of securities (due or callable in more than one year), now held by institutional investors. Banks would sell short securities to the Reserve System. The "rollover" would be completed as institutional investors replaced holdings which they had sold by subscribing to the new issue. The result would be increased rather than reduced monetization of debt.

(3) With a stabilized level of interest rates on long-term Government securities, such issues are, in effect, demand obligations of the Federal Reserve System. If a market obligation is issued, the Treasury would pay long-term rates on bonds which the System would make it possible for investors to buy on a short-term basis.

For these and the following reasons, the Committee strongly advises against the issuance of a marketable long-term security at this time.

Non-marketable Issue Serves the Purpose

A non-marketable Treasury issue of the Series G type would be much superior in meeting the objectives of credit and debt management policy.

(1) If there are bona-fide investment funds seeking a safe and long-term placement, a bond of the G type should be as satisfactory as a marketable security.

(2) A market bond would require a fixed offering and a complicated system of allotment, the amount and timing of which would be difficult to gauge. A bond of the G type could be placed on sale for an undetermined period and an indefinite amount. Since these bonds would be registered, subscription, if necessary, could be limited to a percentage of new money accrued within a stated period.

(3) The G type issue would attract mostly bona-fide investors and minimize the "rollover" problem.

(4) The issuance of a G type bond would tend to stabilize all long-term interest rates.

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(5) In view of the present uncertain economic outlook, the Treasury needs to retain flexible control over the issuance of long-term securities to nonbank investors.

(6) Investors would receive a long-term rate of interest for long-term holdings only.

The apparent lack of interest in a restricted issue, on the part of institutional investors, may well reflect their hope of obtaining better terms. After it is evident that better terms will not become available in the near future, a non-marketable issue of the G type might be expected to find a satisfactory institutional demand. If not, this would be in itself an indication that there is no real surplus of funds for investment in long-term Government securities in excess of current opportunities for buying private issues. The availability of a restricted tap issue of Series G type bonds, at this time, would offer an adequate protection for maintaining the long-term rate at 2-1/2 per cent and the Committee recommends that such an issue be made available.

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MISS BENTON

March 14, 1947

CONFIDENTIAL

Honorable A. L. M. Wiggins,
Under Secretary of the Treasury,
Washington, D. C.

Dear Lee:

I am enclosing a copy of a letter and the memorandum referred to therein which I am sending to the Secretary today with further regard to the possible issuance by the Treasury of a long-term security.

Sincerely yours,

(Signed) Marriner

M. S. Eccles, Chairman,
Federal Open Market Committee.

Enclosures

mg

cc: Mr. Musgrave

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MISS BENTON

MAR 14 1947

CONFIDENTIAL

Mr. E. F. Bartelt,
Fiscal Assistant Secretary,
Treasury Department,
Washington, D. C.

Dear Ed:

I am enclosing a copy of a letter and the memorandum referred to therein which I am sending to the Secretary today with further regard to the possible issuance by the Treasury of a long-term security.

Sincerely yours,

(Signed) Marriner
M. S. Eccles, Chairman,
Federal Open Market Committee.

Enclosures

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