

Mr. Eccles

July 1, 1947

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

Dear John:

In accordance with my commitment, I am sending to you with this letter a statement containing the substance of the comments which Mr. Sproul and I made when we met with you yesterday.

I am also enclosing a copy of a press statement which it is proposed to release for the morning papers of Thursday, July 3, with respect to the elimination of the posted rate and repurchase option on Treasury bills.

Sincerely yours,

(Signed) M. S. Eccles

M. S. Eccles,
Chairman.

Enclosures

July 1, 1947

In the program submitted to the Treasury on the 18th of April, three steps were suggested with respect to revision in the present policy relating to Treasury bills. The first two steps, imposing an interest charge on Federal Reserve notes and providing for the direct exchange of maturing bills, have since been carried out. No action has been taken with respect to the third step in the program -- discontinuing the fixed buying rate and repurchase option on new Treasury bills and permitting the bill rate to find its market level relative to the certificate rate.

This third step is primarily the responsibility of the Federal Open Market Committee and the Committee is prepared to take such action immediately. The buying rate and option agreement were established to facilitate bank participation in war financing and are no longer necessary or desirable. On the contrary, their elimination will serve a useful purpose in restoring the bill as a market instrument and giving added flexibility to the Treasury's debt-management program. This action does not necessarily lead to an increase in the certificate but it does prepare the way for such an increase at the proper time.

That time seems to us to be near at hand, since present estimates of Treasury receipts, expenditures, and changes in nonmarketable debt indicate that funds will not be available to retire maturing issues during the next six months. Accordingly, these securities will have to be re-funded through offers of new issues. With continuation of the existing level of security prices and the established pattern of rates, it will be

difficult to devise a refunding program that will not result in further downward pressure on the rate structure and additional credit expansion.

If maturing issues are refunded into 7/8 per cent certificates, bank shifting into longer issues will be accentuated. If refunding is into intermediate-term issues with coupon rates fitting the rate pattern of 7/8 to 2 1/2 per cent established for war financing, the new issues will immediately sell at an excessive premium, because market yields have fallen below the previously established pattern of coupon rates. If, on the other hand, the terms of the new issues are set to fit the present market yields, a new pattern of rates below that in line with the agreed long-term rate of 2 1/2 per cent will be given official sanction. This would be directly contrary to the established policy which we have jointly pursued during the past year.

In order to avoid this dilemma, it seems to us necessary to reach a decision on the rate question before determining the September financing. It is proposed for consideration that part of the issues maturing in September and October be refunded into a somewhat higher yield certificate. In so doing, a beginning should be made toward consolidation of the 11 certificate issues now outstanding into 4 to 6 maturities. This spacing process would permit raising the certificate rate gradually while minimizing the effect of the rising rate upon prices of outstanding certificates. We shall be glad to discuss with you the details of this proposal.

As part of an integrated program we also believe that prompt action should be taken to offer a restricted G type bond along the line suggested in recent communications of the Open Market Committee. Such an issue would relieve the downward pressure on the long-term yield to the extent that it arises from demands by nonbank investors. It would also supply additional funds with which to meet maturities of bank-held issues in September and October.

FEDERAL OPEN MARKET COMMITTEE

Statement for the Press

For release in morning papers
of Thursday, July 3, 1947.

July 2, 1947

The Federal Open Market Committee of the Federal Reserve System has directed the Federal Reserve Banks to terminate the policy of buying all Treasury bills offered to them at a fixed rate of $3/8$ per cent per annum and to terminate the repurchase option privilege on Treasury bills. The new policy will apply to bills issued after July 4. Existing policy will continue to apply to bills issued prior to that date.

The so-called posted rate on Treasury bills was a wartime measure adopted in 1942 to facilitate war financing and to stabilize the market for Government securities. It was designed primarily to encourage banks to make fuller use of their excess reserves and thus bring about a wider distribution of Treasury bills. Under current peacetime conditions these arrangements no longer serve their original purpose and tend to distort conditions in the money market and the securities market. Certificates of indebtedness, which bear a higher rate than Treasury bills, have largely replaced bills in the market, not only as a medium for the investment of short-term funds but also as a means by which banks adjust their reserve positions. Increased amounts of Treasury bills have been sold to the Federal Reserve Banks by the market, and bills have gradually ceased to be a market instrument. Currently, only about one billion dollars of the nearly 16 billion total of Treasury bills outstanding are held outside the Federal Reserve Banks. The Treasury bill rate has thus been

eliminated as a factor in the money market. The need for large-scale borrowing of new money by the Treasury ceased with the completion of the Victory Loan Drive and since that time the public debt has been reduced substantially. Consequently there is no reason for continuing this wartime mechanism.

Under the new policy the Treasury bill rate will be expected to find its level in the market in proper relation to the yields on certificates of indebtedness. The Federal Reserve System will continue to purchase and hold Treasury bills as well as other Government securities in amounts deemed necessary in the maintenance of an orderly Government security market and the discharge of the System's responsibility with regard to the general credit situation of the country.

As a result of the action taken by the Board of Governors of the Federal Reserve System in April to transfer to the Treasury the excess earnings of the Federal Reserve Banks, the Reserve Banks are now paying into the Treasury approximately 90 per cent of their net earnings after dividends. Since most of the Treasury bills now outstanding are held by the Federal Reserve Banks, whatever increase in interest cost to the Treasury results from the termination of the posted buying rate and repurchase option will be largely offset by increased Reserve Bank payments to the Treasury.