August 7, 1946

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

Dear John:

As requested by Mr. Bartelt, I am pleased to give you the views of the executive committee of the Federal Open Market Committee with respect to the maturing September certificates and the debt retirement program.

A vigorous debt retirement program would result in an interest saving to the Treasury and a reduction in the earnings of banks which are at high levels. By restricting further credit expansion, it would also be helpful in combating the current inflationary pressures. We recommend, therefore, that 2.5 billion dollars of the September certificates and 2 billion of the October and November issues be redeemed for cash. We estimate that this would still leave an ample cash balance of from 2 to 3 billion dollars at the end of November.

It is unnecessary for the Treasury to carry a large cash balance. The Treasury can go into the market at any time and borrow at low rates by offering additional certificates. The Federal Reserve stands ready to assure the successful flotation at existing rates of any amount that might be needed by the Treasury. There is practically no limit on the amount of outstanding securities that the Federal Reserve can purchase in the market thus enabling the Treasury to successfully raise funds if needed. In addition, the Federal Reserve can lend up to 5 billion dollars directly to the Treasury under the direct buying authority. In other words, the Treasury is in a flexible position to pay off debt or borrow according to needs, thus making it unnecessary to maintain a large cash balance.

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The debt retirement program is not inflationary—on the contrary, it has been mildly deflationary. The maturing securities that are being paid off are held largely by the banking system. Of the 12.2 billion dollars that have been paid off since the first of March, 6.5 billion were held by commercial banks, 2 billion by the Federal Reserve Banks, and 3.7 billion by nonbank investors. Of the 12 billion dollars which will mature between now and November 1, all but 2 billion are held by the banking system. The effect of the debt retirement program by classes of holders is as follows:

1. Retirement of securities held by commercial banks. This reduces war loan deposits and bank holdings of short-term securities. It tends to check the sale of further short-term securities to the Federal Reserve Banks which expands bank reserves—the basis for credit expansion.

2. Retirement of securities held by Federal Reserve Banks. As war loan accounts are drawn upon to redeem in cash securities held by the Federal Reserve Banks, member bank reserve balances with Federal Reserve Banks are reduced in a like amount. As a result, the lending and investing capacity of commercial banks is effectively curtailed. Banks are placed under pressure to meet this loss of funds and they are required to sell securities to or borrow from the Federal Reserve Banks. As a result, less short-term securities are likely to be sold to the Federal Reserve Banks for the purpose of reinvesting in longer issues.

3. Retirement of securities held by nonbank investors. The securities being redeemed are held by large corporations and not by consumers who might spend the proceeds of redeemed securities. The corporations are in a highly liquid position and will hold the funds in the form of deposits or will purchase additional securities from the banking system. When the proceeds of the securities redeemed are deposited in commercial banks reserves are required against these deposits. This increase in reserve requirements curtails the investing and lending capacity of banks.

Sincerely yours,

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

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