

August 7, 1946

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

Dear Ed:

Enclosed for your information is a copy of a
letter relating to the September maturity. Chairman Eccles
is leaving the original of this letter with the Secretary
this afternoon.

Sincerely yours,

David M. Kennedy,
Special Assistant to the Chairman.

Enclosure.

DMK:pb

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.

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 re-investing 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

MEMBER BANK PROFITS. 1945-1947

Member bank net profits reached an all-time high in 1945—788 million dollars, or 10.9 per cent of capital accounts. It is estimated that net profits in 1946 will be approximately the same as in 1945. There will probably be some decline in net profits in 1947.

Earnings from Government securities amounted to 997 million dollars in 1945, or nearly one-half of gross earnings. Earnings from Government securities will be somewhat larger in 1946 than in 1945, reflecting larger average holdings, and will probably decline in 1947, assuming a continuation of present policies.

Interest on loans will increase sharply in 1946 over 1945 and should increase further in 1947. Expenses will also be higher in 1946 and 1947, the principal increase being in salaries and wages which are estimated to increase from 580 million dollars in 1945 to 670 million in 1946 and further to 750 million in 1947.

Recoveries, profits on securities, etc., are difficult to estimate, but it is reasonable to expect a sharp decline in profits on securities following the end of war loan drives. Losses and charge-offs are likely also to decline. Taxes on net income, which amounted to 270 million dollars in 1945, are estimated at 200 million in 1946, reflecting the end of excess profits taxes, and 170 million in 1947.

Dividends will probably increase moderately and capital accounts will be built up at about the same rate as in war years. The final result will be large bank earnings in 1946 and 1947. The ratio of net profits to capital accounts will, however, decline. The reason for this is that capital accounts have increased through retained earnings, largely from Government securities, during the war years. For example, in 1940 total capital accounts amounted to 5.6 billion dollars and by 1945 these had increased through retained earnings (principally earnings on Government securities) to 7.2 billion. If the ratio of net profits to capital accounts were based on total capital accounts in 1940, the ratio for 1945 and 1946 would be 14.1 per cent and for 1947 the ratio would be 12.1 per cent.

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Member Bank Profits, 1945-1947
(In millions)

	1929 (Actual)	1940 (Actual)	1945 (Actual)	1946 (Estimated)	1947 (Estimated)
Earnings	2,399	1,323	2,102	2,350	2,400
On securities: U.S.Gov't.		229	997	1,050	975
Other	473	202	139	160	170
On loans	1,563	595	588	750	800
Other	363	297	378	390	455
Expenses	1,684	921	1,268	1,460	1,625
Salaries and wages	464	400	580	670	750
Interest on time deposits	445	147	183	220	235
Other	775	374	505	570	640
Net current earnings	715	402	834	890	775
Recoveries, profits on securities, etc.	137	303	454	300	250
Losses and charge-offs	295	356	230	200	175
Net profits before income taxes	—	—	1,058	990	850
Taxes on net income	—	—	270	200	170
Net profits	557	349	788	790	680
Cash dividends	387	210	246	265	275
Net profits as percent of capital accounts	11.2	7.2	10.9	10.0	8.1
Net profits as per cent of capital accounts in 1940	—	7.2	14.1	14.1	12.1
Capital accounts	6,360	5,597	7,243	7,800	8,200

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Commercial Bank Holdings of Government Securities
(In millions of dollars)

Item	Total marketable debt out- standing ^{1/}	Held by commercial banks	Securities held outside banks		
			Eligible for purchase by commercial banks	Restricted	
				Will be eligible to banks within 8 years	Will not be eligible to banks until after 8 years
Treasury bills	17.023	1.715	15.308	--	--
Certificates	37.720	18.157	19.563	--	--
Notes	13.351	11.828	1.523	--	--
Total bills, cer- tificates and notes	68.094	31.700	36.394	--	--
Bonds due or callable:					
Within 5 years	26.915	20.519	6.396	--	--
5 to 10 years	32.847	21.850	10.997	--	--
10 to 20 years	37.189	3.251	135	30.322	3.481
Over 20 years	22.372	2.536	180	--	19.656
Total bonds	119.323	48.156	17.708	30.322	23.137
Total marketable securities	187.417	79.856	54.102	30.322	23.137

^{1/} Excluding postal savings and prewar bonds and guaranteed securities.

Note: Amount outstanding in first column is as of July 31, 1946; commercial bank holdings as shown in May 31, 1946, Treasury survey of ownership.

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