June 30, 1942.

Governor Ransom

Chairman Eccles

Attached is a copy of a memo briefly outlining the discussions we had with the Treasury staff last week. I had this prepared as a basis for the discussion which Allan Sproul and I had today with the Secretary of the Treasury. I am also attaching copy of a memorandum which I asked Mr. Sproul to prepare covering the same discussions.

There will be a meeting at the Treasury next Friday at 11:00 for the purpose of deciding on the July financing to be done next week. I suggest a meeting of the Committee be held at 9:30 Friday morning.

Attachments

MSE:VE:b

(Identical memorandum sent to each Board member and Mr. Morrill, together with attachments.)

June 29, 1942

SUMMARY OF DISCUSSION BETWEEN TREASURY AND FEDERAL
RESERVE REPRESENTATIVES ON JUNE 23

CONFIDENTIAL

The following general principles were agreed upon:

1. Every effort should be made to sell as large a part as possible of the increase in the Government debt to investors other than commercial banks. To the extent that this policy is made effective, the danger of inflation will be reduced during both the war and the post-war period. There is outstanding a large amount of idle funds in the form of deposits and currency, which it should be possible to reach to a considerable extent. The so-called inflationary gap should provide a substantial amount of current savings for investment in Government securities. Strong efforts should be made to reach these funds by offering types of securities that will be attractive to the holders of the funds and by the sales efforts of the Victory Fund Committees. It should be possible to reduce materially the amount that it is now estimated will be sold to commercial banks.

2. To the extent that it is necessary to sell securities to commercial banks, the issues should be primarily of short term. If the increase in commercial bank holdings is confined to short securities, the banking position will be sounder and the Federal Reserve will have a freer hand in the post-war period in exercising credit restraint, if that should become desirable. Another advantage is that the interest cost to the Treasury would be smaller than on longer securities. The amount of bills outstanding might be increased to about 5 billion dollars or 400 million dollars a week and the amount of certificates to 6 to 8 billion dollars or 1.5 to 2.0 billion in each quarter.

3. The existing pattern of rates should be maintained, but prices should be allowed to fluctuate moderately and should not be held rigid. Consideration might be given at a later time to an increase in the buying rate on bills from the present 3/8 of 1 per cent to 1/2 of 1 per cent. The higher rate would attract funds of commercial banks outside of the large cities and of investors other than commercial banks. The existing 2 1/2 per cent rate on long bonds should be maintained.

4. Excess reserves will not be allowed to decline to a point that would make it difficult for the Treasury to do its financing.

In view of the need to raise during the period from July to September about 6 billion dollars from sources other than savings bonds, tax notes, and an increase in the weekly bill offering to 350 million dollars the following specific financing program was outlined:

1. The weekly bill offering should be increased to 400 million dollars, which would provide an additional 650 million dollars in the three months.

2. A certificate issue in September would provide an additional 1.5 to 2.0 billion dollars.

3. An additional open-end issue of registered 2 1/2 per cent bonds should be announced before the beginning of trading in the present issue. This offering should be kept open during July and August and should be made redeemable upon demand within perhaps four months after the death of the original holder. This issue would provide between 500 and 750 million dollars in the two months.

4. A short open-end nonmarketable note issue should be announced as soon as practicable. Such an issue would reach funds that will not be invested in marketable securities, would relate the return to the length of time that the securities were held, and would avoid some of the problems connected with marketable issues, such as those of secondary distribution and of maintaining a market and that of the frequent refunding of short issues. If the securities were made assignable as collateral for borrowing, few of them would be redeemed. It is difficult to estimate the amount of funds that would be invested in such an issue, but if offered in August perhaps 1 to 2 billion dollars could be raised during the two months.

5. This program would leave about 1.5 billion dollars to be raised from other sources. In view of the rapid depletion of the Treasury balance in the early part of July and the delay that will be experienced in getting funds from the above sources, an offering of about 2 billion dollars may be necessary next week. Since funds of investors other than commercial banks would be attracted to the various types of securities mentioned above, this issue should be directed principally to commercial banks. Although 2 1/4 per cent bonds would fall in a period when maturities of Treasury bonds are relatively small, it is an issue somewhat longer than commercial banks want and should have. While a note offering would be desirable from the point of view of selling short securities to commercial banks, notes have been recently issued. It would be preferable, therefore, to offer 2 per cent bonds at this time.