

February 2, 1943

Chairman Eccles

L. M. Piser

Pattern of rates

Regarding the maintenance of the pattern of rates on short certificates it seems to me that the System cannot completely ignore the market for these issues. Dealers and investors recognize that the Federal Reserve now controls the Government security market, and trading takes place only at prices that are near those at which the Federal Reserve will buy or sell. The development from time to time of lower rates on short bills reflects principally the fact that the Federal Reserve is competing in the market. This situation developed in December.

If the Federal Reserve bought certificates on a yield basis no lower than $7/8$ of 1 per cent, the market quotations on all certificate issues would promptly adjust to about that level. It would then be impossible to maintain an adequate demand for bills at $3/8$ of 1 per cent. If the Federal Reserve bought only three-month certificates at $3/8$ of 1 per cent and other certificates at $7/8$ of 1 per cent, a substantial profit would be assured to traders who purchased certificates a short time before they came within the three-month range.

It seems to me that yields on new issues can be maintained only if the System makes a market on the intervening issues. The System can rightly discourage profit-taking and swaps but not at the expense of allowing the market to fluctuate freely. This policy does not preclude, however, the making of price adjustments in particular sections of the market such as short-term partially tax-exempt bonds whenever the System finds that purchases are unusually large in those particular sections. Even these adjustments should be kept within limits that will not disturb the quotations on the key issues.