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TREASURY FINANCING PROGRAM

Background for recommendations

Herewith there are submitted recommendations for a Treasury financing program. These recommendations have been made with reference to the System's commitment to maintain the existing pattern of rates. As is pointed out below, this pattern can no longer be maintained, unless the spread of rates is somewhat reduced and the proportion of short-term issues to longer issues in the offerings is also reduced. The proposed program would, we believe, accomplish the desired purpose.

Since the end of April, the Federal Reserve System has increased its holdings of Treasury bills by 2.0 billion dollars; in other words, it has absorbed the total increase in outstanding bills during the period. Holdings of certificates have increased by 100 million dollars. On the other hand, there has been a substantial demand for bonds and a moderate demand for notes. Since the end of April, the System's holdings of bonds have declined by 560 million dollars and of notes by 230 million. This development is probably a reflection of (1) a growing confidence in the maintenance of approximately the present level of the market, resulting in a shift by investors to higher rate issues, (2) an extension of maturities by commercial banks because of a need for larger earnings, particularly by the smaller banks, and (3) the relatively large increase in the outstanding amount of bills and certificates. Changes in the System's holdings since the first of the year are shown in the attached chart.

Sales of bonds and notes by the System and additional sales by Treasury accounts have not been sufficient to meet the demand. At the same time the System holds no more of the longer taxable 2 per cent bonds or of other issues that have been in the largest demand. This development makes it increasingly difficult, if not impossible, to maintain the present pattern of rates without a change in the financing program.

Before the pattern of rates was established, the interest of the System and of the Treasury was solely in keeping the market orderly and not in influencing long-term movements. At present, however, when yields on all groups of taxable issues are to be maintained within narrow limits, it is becoming more and more apparent that the supply of new issues made available to the market by the Treasury must be adjusted to the demand. Such an adjustment can no longer be brought about by changes in yields alone and the System has great difficulty in living up to its commitment, particularly in certain areas of the market.

Recommendations

1. The basket should include:

   a. Series E savings bonds.
   b. Series C Treasury savings notes, with the 30-day notice eliminated but with the 6-month provision retained.
   c. 2 1/2 per cent Treasury bonds of December 1964-69.
   d. 2 per cent Treasury bonds.

It is suggested that the sale of Series F and G savings bonds should be discontinued immediately. If this is not done, these issues should be included in the drive and discontinued after the drive. No certificates are suggested for the basket, because (1) for the present, increases in the amount of short-term securities outstanding should be small, (2) a refunding problem arises after only a year, and (3) an additional supply should be made available in connection with the issue dated August 1, involving an increase of a billion dollars. If short-term securities are issued in the drive, it is suggested that they should be 1 1/2 per cent notes of December 1947 or March 1948 instead of certificates, but the inclusion of any short-term securities would increase the difficulty of selling Series C Treasury savings notes. If the basket is limited to the four issues mentioned, the selling problem would be considerably simplified.

2. Prevention of bank purchases during drive. Banks will want to purchase securities because of temporarily increasing excess reserves during the drive as a result of the shift of deposits to war loan accounts and of their need and desire for greater income. Means of preventing this development should include:

a. In view of changed conditions, with the extremely heavy needs of the Government and the decrease in free bank reserves, the spread in yields between short and long maturities should be reduced and the Treasury should increase the relative proportion of bonds and notes outstanding. The maturity on new issues of 2 per cent bonds should be extended to 8-10 years, and if that proves to be inadequate to 9-11 or 10-12 years. In addition, the number of new issues should be simplified and restricted because of the impossibility of maintaining a pattern on too many issues. New 9-month bills should be issued in a total amount of not exceeding a billion dollars a week to replace the present bills and certificates, with subscriptions for $100,000 or less allotted in full at 3/4 of 1 per cent and the remainder allotted on a bid basis. Outstanding certificates should be refunded into this issue. The amount of the new 9-month bills outstanding should not exceed the present amount of bills and certificates unless a demand develops. A buying rate of 3/4 of 1 per cent with repurchase option could be established on the new 9-month issue. Other Treasury issues should then be restricted to 1 1/2 per cent notes and 2 and 2 1/2 per cent bonds. Investors desiring to round out their portfolios could purchase intervening issues in the market, and it would not be necessary to maintain rates on those issues within narrow limits.

b. Prohibit quotations on and trading in the 2 per cent bonds included in the drive for at least 30 days and preferably for 60 days after the close of the drive, by which time excess reserves will be less plentiful. part

c. The Treasury should request banks not to buy the new issues during the nonbank drive and should announce that future financing available to banks will be provided by interim financing which will be open to banks only and that bank subscriptions will be limited so that total subscriptions will not greatly exceed allotments. This provision would curb speculative subscriptions sold to banks at premiums and would clarify in the public mind the separation of the financing. It would also be helpful to announce that the first bank financing after the drive will be in 2 per cent bonds.

d. The Federal Reserve should issue a circular to commercial banks saying that excess reserves will increase during the drive, giving the reason for the increase, explaining that it will be only temporary, and suggesting that the increase be invested in bills by subscribing for new issues, repurchasing bills held in the option account, or purchasing bills in the market.

3. Offer exchange of August 1 certificates into new one-year certificates and raise a billion dollars of new money exclusively from banks. As an alternative, the maturing issue might be paid off in cash, with the Treasury selling 2.5 billion dollars of new certificates to banks and the public. The cash down payment should be raised from 2 per cent to 10 per cent. Full allotments should be continued at $100,000 and should be accompanied by payment in full.

4. Offer exchange in October of 1943-45 bonds into the 2 and 2 1/2 per cent bonds sold in the drive. Only the 2 per cent bonds would be available to commercial banks, with the trading restrictions referred to above.

5. Insurance companies and savings banks should be permitted to subscribe from the beginning of the drive. These institutions have been anxious to invest accumulating funds for some time, and a further postponement would be unfair to them. The question of large subscriptions at the beginning of the drive should be handled in the following manner:

a. A separate quota should be established for individuals only and should be given the principal publicity.

b. A separate quota would be established for financial institutions and corporations.

6. Inaugurate instalment plan on the 2 1/2s. Subscriptions and periodic payments under the plan would be made to the Treasury. The plan would contemplate perhaps 4 or 5 monthly instalments of equal amount except for the last instalment, which would include an additional amount representing accrued interest on previously unpaid balances.

HOLDINGS OF U.S. GOVERNMENT SECURITIES BY FEDERAL RESERVE BANKS