

STRICTLY CONFIDENTIALBOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

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Board of Governors

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Open market meeting

This memorandum presents a list of subjects that the Board may wish to have considered at the open market meeting on October 18. It also includes a number of points that might be considered in connection with each subject. No reference is made to the regulation of dealers, which subject will be covered in a separate memorandum.

1. The System Account should place a bill tender with the Treasury each week. The rate would be $\frac{3}{8}$ of 1 per cent, and the amount would be the amount of bills that mature in both the System Account and the option accounts. The System would obtain the same percentage of their tender as would other bidders.

- a. The System would thereby underwrite each issue of bills directly, instead of doing so indirectly through the dealers.
- b. The amount allotted to the System would depend upon the condition of the bill market. If there were a demand for bills at a price higher than the underwriting price, the System might obtain none of the tender. If there were no demand for bills at a higher price, the System might obtain all of the tender.
- c. By placing tenders, the System would avoid the necessity of entering into special negotiations with the Treasury regarding direct purchases.
- d. By establishing in advance a formula for the amount of each tender, the Executive Committee would not need to determine upon the amount each week.
- e. By including the maturities in the option accounts as well as in the System Account, the System would ensure that total tenders each week would be comfortably in excess of the offering.

2. The System Account should buy and sell certificates at yields designed to maintain a yield of $7/8$ of 1 per cent on one-year certificates. Three-month certificates would be bought and sold at about $3/4$ of 1 per cent, compared with $1/2$ of 1 per cent at present.

a. Speculators would obtain only a fraction of the profit that they now obtain from playing the pattern of rates on certificates.

b. The Treasury would be assured that offerings of certificates would be subscribed for on an investment and not a speculative basis.

(Note - I disagree with this proposal on the grounds that it would seriously interfere with the weekly offering of Treasury bills)

3. The Treasury should exclude certificates from future drives.

a.. The debt placed with investors other than commercial banks would be on a longer-term basis.

b. Playing of the pattern of rates would be reduced.

c. Subscriptions in the drives would not be padded by subscriptions for certificates, of which a considerable part are sooner or later purchased by the banking system.

d. Sales of Treasury savings notes would increase. These securities are the fairest type of issue, since the Treasury pays and the investor receives a return based solely on the length of time that the Treasury has used the funds.

e. The large refunding problem that now arises after only a year would be eliminated.

- f. Corporations would prefer to purchase certificates, but can be induced to purchase longer-term securities if certificates are not available in the drives and if corporations are under pressure to subscribe.
- g. Corporations might sell longer-term issues before maturity, but the resulting market problem is not likely to be serious. Corporations will find that their needs for cash will be spread over a period of time and will not be large immediately upon the termination of the war or at any other one time.

4. Securities for subscription by commercial banks should be offered by the Treasury only at such times as the working balance is nearly depleted and then only in such amounts as are necessary to meet requirements before the next drive.

- a. The Government's financing program would be clarified in the public mind.
- b. The Treasury would borrow from commercial banks only as the funds are needed and would avoid paying interest on excessive balances arising from commercial bank financing.
- c. Commercial banks would find it more difficult to invest in longer-term securities the large amount of funds released during the drives. Since these funds are only temporary, they should be invested in Treasury bills.
- d. The level of excess reserves should not be considered in determining upon commercial bank financing. Commercial banks pay for most new Treasury issues through war loan deposits, on which no reserves are required, and such financing consequently has little or no influence on excess reserves.

5. Quotations on and trading in the issues included in the drives and available for purchase in the market by commercial banks should be prohibited for at least 30 days and preferably for 60 days after the close of the drives rather than for only 10 days or less.

- a. After the longer period, excess reserves are smaller, and commercial banks have less incentive to purchase securities in the market.
- b. Speculators would be less willing to subscribe if they were unable to sell the securities for a relatively long period.
- c. Investors would not be deterred from purchasing Government securities.
- d. There would be no serious difficulty in prohibiting trading for such a period, because trading in the new issues was successfully prohibited during both the April and the September drives.

6. The Treasury should offer nine-month bills to replace the present bills and certificates. These bills should be issued in a total amount of not exceeding a billion dollars a week, unless a demand develops for a larger amount. Tenders for \$100,000 or less should be allotted in full at $\frac{3}{4}$ of 1 per cent, and other tenders should be allotted to the highest bidders. The Federal Reserve System would establish a buying rate and repurchase option at $\frac{3}{4}$ of 1 per cent on the new nine-month bills.

- a. The maintenance of a rate of $\frac{3}{8}$ of 1 per cent on bills will result in a reduction in the yields and coupon rates on longer-term issues.
- b. Despite the saturation of the bill market at $\frac{3}{8}$ of 1 per cent, the Treasury is not willing to have the bill rate raised. In these circumstances, the only real alternative is to eliminate the $\frac{3}{8}$ of 1 per cent rate by eliminating the securities to which it applies.

- c. Although the change would not be a complete solution to the problem of maintaining the present pattern of rates, it should help materially.
- d. The problem cannot be solved by the issuance of even many billions of dollars of certificates so long as the present disparity in yields between bills and certificates continues. If it were decided to issue nine-month bills after this fact became fully evident, there would be too many issues of certificates in too large amounts to permit of a ready conversion into the new bill issues.
- e. The number of kinds of Treasury issues would be reduced.
- f. Certificates would be automatically kept out of the drives.

7. The Treasury should restrict future offerings of marketable securities to $\frac{3}{4}$ of 1 per cent nine-month bills, $1\frac{1}{2}$ per cent notes, and 2 and $2\frac{1}{2}$ per cent bonds.

- a. The number of kinds of Treasury issues would be reduced.
- b. The System Account would no longer need to maintain yields within narrow limits on the intervening issues.
- c. No hardship on investors would result, since they could purchase the intervening issues in the market.