STRICTLY CONFIDENTIAL

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

November 5, 1943

Chairman Eccles

L. M. Piser

Attached is a revision of the memorandum on short-term Government securities along the lines that you mentioned yesterday.

Attachment

LMP:mlh

November 5, 1943

SHORT-TERM GOVERNMENT SECURITIES

Most of the banks in New York City and Chicago and some banks in other large cities now hold no more bills than they wish to hold for meeting day-to-day adjustments in their reserve positions. In the absence of any change in the situation, it is likely, therefore, that these banks will meet their needs for additional reserves largely by selling certificates and other short-term securities. The suggestion has been made that the Treasury increase the weekly offering of bills in order to enable the System to continue to provide reserves by purchasing bills. In view of the lack of demand for bills at 3/8 of one per cent, however, it would be necessary in this event for the System to arrange for dealers and banks to place tenders each week far in excess of their needs and to sell the bills immediately to the System. Such a solution to the problem would only aggravate the serious difficulties now being encountered in obtaining sufficient bill tenders each week.

The only really adequate solution to the problem is for the Treasury to adopt one of the proposed methods of increasing the rate on short-term securities and thereby to restore these securities to an investment status. If the Treasury is unwilling to do so, it should be recognized that Treasury bills at a rate of 3/8 of one per cent are no longer investments but are merely instruments that are used in adjusting the reserve positions of banks for day-to-day fluctuations and that the buying rate is really a discount rate. It should be the policy of the System to supply reserves by purchasing bills rather than other kinds of securities. As long as the System continues to pay large premiums on certificates, however, it will continue to purchase the certificates that are sold by the money market banks, whereas if the yields were higher outside banks would purchase the certificates and either sell bills to the System or utilize their excess reserves.

It is suggested, therefore, that the System permit the yields on short-term securities, including certificates, partially tax-exempt bonds, and guaranteeds, to advance to the level at which banks outside of the money centers would purchase such of these securities as the money market banks sell. The System, of course, would not permit the yields on these short-term securities to advance so rapidly as either to endanger a loss of confidence in the market, greatly to increase the difficulty of obtaining sufficient tenders for the weekly offering of bills, or to cause a flood of selling of bills to the System, and in no case would the System permit any certificates to decline below par. It cannot be said in advance at what yields outside banks would purchase short-term securities other than bills, but these yields would soon be determined by the action of the market. In this manner, the System for some time could supply reserves by purchasing bills rather than by purchasing other securities at premiums, and it would not be necessary to flood the market with bills, for which there is no outside demand at present rates.