

SYSTEM BILL REPLACEMENTS

It is estimated that between now and the end of the calendar year the System will need to supply about \$2 billion of reserve funds to member banks to offset an increase in required reserves and an increase in money in circulation. In this situation, the System will undoubtedly replace all of its maturing bills by new issues. The Federal Open Market Committee feels strongly, therefore, that the Federal Reserve Banks should be permitted to place a tender with the Treasury each week at whatever buying rate for bills is established in an amount not exceeding the amount of bills that mature in both the Open Market Account and the option accounts of the individual Reserve Banks and that the Treasury should give to the System the privilege of exchanging maturing bills for whatever amount of new bills are allotted to it, adjusting the discount in cash.

We have shared the Treasury's concern about the dangers of creating the impression that the Treasury is resorting to direct borrowing at the central banks to finance the deficit. Our present situation, however, is one in which the method used to avoid creating this impression is becoming more likely than not to bring censure on the Treasury and the System, whereas a change in method has the sanction of the procedure already followed in placing subscriptions for maturing issues of certificates of indebtedness, and can be clearly and adequately explained to the public.

A suggested draft of a statement to the press, which answers in advance the questions which might be asked, and meets the criticisms which otherwise might be made, follows:

Draft of Press Statement

The Treasury Department this week revised its Treasury bill offering circular so as to permit bidders for Treasury bills to obtain new Treasury bills by the exchange of an equivalent amount of maturing bills to the extent that their tenders are accepted. Concurrently the Federal Open Market Committee authorized the Federal Reserve Banks to place weekly tenders for bills at a price approximately equivalent to a yield of $3/8$ of 1% per annum (99.905 for 91 day bills), in an amount not exceeding the amount of their weekly maturities. The Federal Reserve Banks will receive the same percentage allotment of bills as will other bidders at the same price. Acquisitions of bills by the Federal Reserve Banks, in this manner, will represent the replacement of bills originally purchased in the market and, like other exchanges of maturing securities for new securities, will not be subject to the limitation contained in subsection (b) of Section 14 of the Federal Reserve Act (which limits to \$5 billion the aggregate amount of government securities acquired directly from the United States which can be held at any one time by the twelve Federal Reserve Banks).

No new credit will be made available to the Treasury by the Federal Reserve Banks, as a result of this change in procedure, nor will new reserve funds be placed at the disposal of the banks of the country. Reserves which have already been provided to support a rising currency circulation and rising member bank deposits will merely be maintained.

These related actions were taken to relieve a situation which has become mechanically more difficult, as weekly maturities of bills held by the Federal Reserve Banks have increased in recent months, until at times they are equal to half or more of the weekly offerings. In the past the market has taken all of each week's offerings of Treasury bills and has promptly sold to the Federal Reserve Banks that

portion of the offering which it did not wish to hold. Thus the Federal Reserve Banks indirectly replaced part or all of their Treasury bill maturities. This procedure worked well when the amount of maturing bills held by the Federal Reserve Banks was a relatively small proportion of the weekly offering, and allowed the market to determine directly the amount of the new issue of bills it wished to hold. Now that the amount of maturing bills held by the Federal Reserve Banks ranges up to and above \$500,000,000 each week, however, such a procedure means that the market must place tenders for new issues of bills in amounts substantially in excess of market requirements, the excess being taken for the purpose of almost immediate sale to the Federal Reserve Banks. In these circumstances, a more direct method of replacing maturing bills held by the Federal Reserve Banks has been deemed desirable.

The test of the bill market will now be found in the bids of investors other than the Federal Reserve Banks at prices slightly above the price tendered by the Federal Reserve Banks, and in the allotment to the Federal Reserve Banks and to others at the fixed price of the Federal Reserve Bank tenders. At times when there is reason to expect a substantial increase in market demand, of course, the Federal Reserve Banks can tender for less than the amount of their weekly maturities.

11/9/43.
A.S.