Chairman Eccles

STRICTLY CONFIDENTIAL

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

R&S 100-912
March 25, 1944

Board of Governors

L. M. Piser

The attached memorandum was prepared at the suggestion of Chairman Eccles. Although I believe that it represents his views he has not as yet had a chance to read it.

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R&S 100-912
(Draft of March 25, 1944)

RECOMMENDATIONS BY EXECUTIVE COMMITTEE OF FEDERAL OPEN MARKET COMMITTEE TO SECRETARY OF THE TREASURY

1. We believe that the individual and corporate parts of the fifth drive should be handled concurrently. The full advantages of a separation of these two parts can be realized only if there is a month or two between them, but such a separation appears to be impossible in view of the timing of the fifth drive. Another consideration is the amount of additional work that such a separation would place upon the selling organization. In our opinion, the individual goal should be increased to 6 billion dollars, in order to place the selling organization and the public under considerable, but not impossible, pressure. We believe that the Treasury should establish two quotas, one for individuals and one for other nonbank investors, and that the Treasury should consider each State as going over the top only if both quotas are exceeded. It would be impossible, therefore, for any State to reach its quota by the relatively easy method of selling to corporations when the individual quota is not reached.

2. In our opinion, the basket in the fifth drive should be the same as the basket in the fourth drive except for the substitution of 2 per cent for 2 1/4 per cent bonds. We suggest that the Treasury offer 2 1/2 per cent bonds in each drive, but alternate between 2 and 2 1/4 per cent bonds. If the Treasury does not provide an additional supply of 2 per cent bonds in connection with the next drive, it seems likely that the demand for 2 per cent bonds between the fifth and sixth drives will so far exceed the supply that the System will find it difficult from its own holdings of 2 per cent bonds to maintain the pattern of rates in this area of the market.

3. We believe that each commercial bank should be permitted to increase holdings of otherwise ineligible bonds to the smaller of the following amounts: (1) $400,000 or (2) 20 per cent of the total savings deposits and certificates of deposit of individuals. The inclusion of individual certificates of deposits is recommended because in some areas of the country it is customary to use this type of instrument instead of savings pass books. The $100,000 limit on holdings of Series F and G savings bonds would, of course, continue.

4. We believe that investors in the fifth drive should be permitted to purchase securities under a deferred payment plan involving a 20 per cent downpayment and an additional 20 per cent a month for four months. The loans would thereby be paid in full before the beginning of the sixth drive. We recommend that this plan be permitted for subscriptions down to $500. We further recommend that the loans be handled by commercial banks. Although this procedure would increase bank credit, it would to a considerable extent involve merely a substitution of loans for the increased holdings of Government securities that now occur during the drives. In addition, these loans would gradually be reduced and would largely disappear in four months. Such a provision would be particularly helpful in raising funds to cover the long period between the fifth and sixth drives and might be successful in preventing bank financing during that period.

5. In our opinion the lowest denomination of marketable bonds included in the drive should be reduced from $500 to $100. Although the $500 minimum is designed to force small investors into savings bonds and thereby to protect them from possible future fluctuations in the value of marketable securities, a number of small investors would prefer to hold at least part of their securities in marketable issues, because such issues can be disposed of without loss of interest.

6. We believe that the lowest denomination of Series G bonds should be increased from $100 to $500. These bonds are not purchased by small savers such as buy Series E bonds. Since they are registered, it is necessary to type and mail twice a year for $100 bonds about 2 million interest checks for $1.25. Discontinuance of the $100 denomination would result in a large saving of manpower. We also believe that the lowest denomination of Series E bonds should be increased from $25 to $50. More than 300 million individual $25 Series E bonds have been issued. In view of the manpower and paper shortage, the work involved in registration and redemption of the $25 denomination is unreasonable. We feel that with an explanation from the Treasury the change would not have any undesirable repercussions.

7. In our opinion, the Treasury should sell no securities for cash in connection with the refunding of the May 1 certificates. Commercial banks would purchase and hold most of the additional securities issued in connection with such a cash offering. The entire emphasis in the financing program should be placed on sales to nonbank investors. The estimates presented in the Treasury memorandum of March 8 indicate that there is a substantial amount of funds that has not as yet been reached. Every effort should be made to reach these funds before selling securities to commercial banks, and cash offerings for commercial banks should be delayed until it is absolutely necessary. Since the Treasury's balance probably will not decline below 3 or 4 billion dollars before the beginning of the fifth drive, even excluding the offering of additional bills, we believe that a cash offering before the drive is unnecessary. Finally, since it is likely that 5 billion dollars of certificates will be sold in the June drive, an additional 1 or 2 billion in May might run the danger of temporarily overloading the certificate market.

8. We believe that the Treasury should not plan on a program of increasing the amount of outstanding bills by 7 billion dollars during the calendar year, but should relate increases to the current situation as it develops. With some adjustment in the rate, the Treasury could increase the amount of outstanding bills more than would be the case with a retention of the present rate. There appear to be two methods by which such an increase could be realized. First, the Treasury might shift to four-month bills at a rate of 1/2 of one per cent. An increase in the bill cycle from 13 to 17 weeks would enable the Treasury to increase the outstanding amount of bills by 4 billion dollars, from 13 to 17 billion, while continuing the weekly offering at a billion. We have felt for some time that a rate of 3/8 of one per cent is out of line with the remainder of the pattern of rates and that a rate of 1/2 of one per cent would help to some extent in reconverting Treasury bills into a market piece of paper. Although such a change might

raise some question as to future action and might to some extent disturb the market, we believe that the change would be generally recognized as an adjustment within the present pattern of rates and would have no influence on the longer-term sections of the market. The System has no desire to obtain additional earnings from the higher rate of interest on bills and could give the Treasury credit against its fiscal agency costs for the difference between 1/2 and 3/8 of one per cent. We would recommend such a course to the Federal Reserve Banks. (Mr. Wyatt is now studying the legality of this proposal.)

Second, the rate on three-month bills might be increased to 1/2 of one per cent and the rate on one-year certificates to 1 per cent. Although an increase of 1/8 of one per cent in certificates might seem of little importance, it is likely that the psychological effect of an even one per cent rate as compared with 7/8 of one per cent would attract a considerable amount of additional funds.

If the Treasury is unwilling to follow either of these alternatives, we still recommend an increase in the amount of outstanding bills to the extent that the System needs to offset the outflow of currency. Since banks have few bills in excess of the smallest amount that they wish to hold, the System will offset currency in the next few months largely by purchasing certificates unless there is an increase in the outstanding amount of bills. Since the System's earnings are already large, there is no need for the Treasury to pay to the System more than a nominal rate of interest in offsetting currency. We believe, therefore, that the increase should be limited to 100 million dollars a week for the next month or two and that the program at the end of that time should be reconsidered in the light of the subsequent developments.