March 29, 1944

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

Before making specific recommendations on the points mentioned by Under Secretary Bell in his letter of March 27, we should like to state certain general principles that are fundamental to our recommendations.

The main objectives of Treasury financing policy and of credit administration, of course, are still the borrowing of the maximum possible amount from nonbank investors while maintaining an interest rate structure with a maximum market borrowing rate of 2 1/2 per cent. There is no question of our ability to maintain the maximum borrowing rate of 2 1/2 per cent, but we are still measurably short of the goal of maximum borrowing from nonbank investors.

It seems to us that the Treasury's current estimates of sales to nonbank investors are too conservative in view of both the performance of the Treasury sales organization during the past two years and the amount of funds that are shown to be available by all estimates of current savings. The net absorption of Government securities by nonbank investors, exclusive of Federal agencies and trust funds, is forecast by the Treasury as 33.3 billion dollars for the calendar year 1944. Since 1944 will include three drives and will begin and end with a drive, it seems likely that a larger amount of funds should be raised than in previous annual periods. In the year ending October 1943, which included three drives, nonbank investors absorbed 34.7 billion dollars of Government securities, and in the year ending February 1944, which also included three drives, nonbank investors absorbed about 36.4 billion. It should be possible in 1944, therefore, for the Treasury to sell 36 billion dollars net to nonbank investors, and with continued improvement in the sales program this amount could be further increased. It is recognized that the figures given above include sales in the first and second drives, when some idle funds that are no longer available were reached. On the other hand, the organization of the drives has improved, and there has been considerable repayment of private debt, which is releasing funds and increasing the number of potential investors. The reduced rate of increase in national income this year should mean that nonbank investors will have less need to accumulate bank balances than in the past.

For these reasons, we believe that Treasury estimates of sales to nonbank investors in 1944 are unduly low. Regardless of the amounts that may be taken by nonbank investors, however, it is our opinion that sales to banks should be considered as residual financing, to which the Treasury should have recourse only as a matter of last resort. There is no question of the ability and the willingness of the Reserve System to provide the reserve funds needed to assure the success of this residual financing whenever necessary. We believe, however, that direct bank financing should not be countenanced until even more vigorous efforts have been made to sell an increased amount of securities to nonbank investors and until the Treasury is in need of funds to

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maintain its working balance at the minimum level that it considers advisable. In view of the figures submitted in the tabulation accompanying Under Secretary Bell's letter, it does not appear that the latter condition can arise until after the fifth dirve and there is, therefore, time further to test present estimates of nonbank buying.

In our opinion, the situation calls for

(a) enlargement and strengthening of the sales organization,

(b) changes in selling methods and security terms that will widen the nonbank market, and

(c) increase in the bill rate. In selling securities to commercial banks further emphasis should be placed on bills rather than certificates and longer-term securities. Additional bills can be sold to banks, however, only if there is some increase in the rate. As we have indicated before, we feel that the present rate on Treasury bills is out of line with the remainder of the pattern of rates and that an increase is justified in order to reestablish bills as a market instrument.

With this background in mind, we should like to make the following recommendations on the points mentioned by Under Secretary Bell:

1. The goal for the fifth drive has been set at 16 billion dollars, and no comment is required.

2. For the reasons outlined above, we believe the Treasury should do no direct bank financing, at least until after the fifth drive. Therefore, we recommend that there be no offering of certificates for cash in connection with the May 1 refunding. Decision as to a cash offering in connection with the August 1 refunding should be deferred until after the fifth drive.

3. In our opinion and for the reasons outlined above, the rate on Treasury bills should be increased to 1/2 of one per cent and the maturity extended to four months. By this means, not only would a more tenable market rate be established but the outstanding amount of bills could be increased by 4 billion dollars as funds are needed without increasing the present weekly offering of bills.

4. We recommend that the basket in the fifth drive be the same as in the fourth drive except for the substitution of 2 per cent fully marketable bonds for 2 1/4 per cent bonds of restricted marketability. We can see no point in placing restrictions on the eligibility of 2 per cent bonds for bank purchase. In order that these bonds may not become a vehicle for renewed speculative purchases, however, we recommend that the Treasury forcefully renew its stand on speculative subscriptions, loans by banks to finance such subscriptions, and on subscriptions by dealers. The Treasury may wish also to consider the inclusion of 1 1/4 per cent notes in the drive as an

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additional means of obtaining funds from nonbank investors who are not interested in the rate on certificates or in the form of Series C notes and who do not wish to invest in longer-term securities.

5. Our opinion would be that the drive should begin on May 23 or 29 and should cover a period of three weeks, but on this point we believe that the recommendations of the sales organization should be decisive.

6. We recommend that nonbank investors be permitted to purchase securities in the drive on a partial-payment plan. Such purchases by insurance companies, savings banks, and pension funds, which will be in relatively large amounts, could be handled by the Treasury. Such purchases by other investors (minimum $500) could be handled by commercial banks on the basis that the maximum rate charged would not exceed the rate on the securities.

We also recommend that the lowest denomination on marketable bonds be placed at $100 in order to meet the needs of small investors who for one reason or another do not wish to place all of their funds in savings bonds. As a corollary to this recommendation and in view of the manpower and paper shortage, we recommend that the lowest denomination on Series G bonds be increased to $500 and on Series E bonds to $50.

7. We recommend that each commercial bank be permitted to increase its holdings of otherwise ineligible bonds to the smaller of the following amounts: (1) $400,000 or (2) 20 per cent of its total of savings deposits and time certificates of deposit of individuals. The inclusion of individual certificates of deposit 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.

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