SUPPLEMENTARY RECOMMENDATION
BY THE EXECUTIVE COMMITTEE OF THE FEDERAL OPEN MARKET COMMITTEE
TO THE SECRETARY OF THE TREASURY.

In our memorandum of March 29, 1944, we recommended to you, for reasons which we then stated, that the Treasury replace the present 3-month 3/8 of 1% Treasury bill with a 4-month 1/2 of 1% bill. This recommendation was discussed at the meeting of our representatives with you and, although no decision was reached, concern was expressed by your associates as to the effect of the abandonment of the 3/8% rate on the whole interest rate structure in the Government security market. At the same time our representatives referred to the fact that such an increase in rate would mean an increase in yield on the large holdings of bills in Federal Reserve Bank portfolios and expressed the view that, while this circumstance should not be a determinant of financing policy, ways could be devised to overcome it, if necessary.

Renewed consideration of our recommendation has further convinced us that it is sound in principle. Renewed consideration of the Treasury's views has suggested an adaptation of our proposal, which should make it acceptable without detracting, essentially, from its contribution to better financing. In this supplement to our memorandum of March 29, 1944, therefore, (and as an alternative to recommendation 3 on page 2 of that memorandum) we make the following recommendations:

1. The weekly offering of 3-month bills be continued, but changed so that such bills will be offered at a 3/8% discount basis only in exchange for maturing bills.

2. A new weekly offering of 5-month bills be made for cash, the offering to be for a fixed amount less the amount of 3-month bills taken on exchange.

In order to maintain the existing liquidity in the bill market, the Federal Open Market Committee would direct the Federal Reserve Banks to establish a buying rate of 5/8 of 1%, with repurchase option, for the new 5-month bills, while retaining the present rate of 3/8% for the 3-month bills, to protect existing holders and to accommodate unlikely but possible future holders.

If our recommendation is adopted, the Federal Open Market Committee would be prepared, until conditions warrant a change, to direct the Federal Reserve Banks to hold a fixed minimum amount of Treasury bills to be maintained by exchange, on a constant and continuing basis, for 91-day Treasury bills.

This procedure would have the following advantages:

a. While maintaining its weekly bill offerings at a fixed figure of $1 billion, the Treasury would be able to obtain a substantial amount of new money ($4,500,000,000) through sales of bills, because of the increase in number of weekly offerings in a 5-month period as compared with a 3-month period. If additional direct financing is necessary, the amount of the weekly bill offerings could be increased.

b. This new money would all be obtained at a low rate, and the net cost to the Treasury would probably be no greater than if the financing were done partly with 3/8% bills and partly with 7/8% certificates of indebtedness. If the higher rate bills proved sufficiently attractive to nonbank investors, so that they could be used to reduce materially the amount of Treasury financing to be done indirectly through the banks, the net cost of the Treasury's borrowing would be less than under the present program.

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c. By the use of bill financing the burden of certificate funding and refunding would be reduced. Offerings of certificates between drives require special announcements which serve to call attention to direct bank financing; they involve the problems of handling subscriptions and making allotments; and they necessitate annual refunding offerings. Sales of bills, on the other hand, are more or less routine and can be used to provide whatever amount of residual financing is needed when it is needed.

d. The Treasury bill would regain some of the character of a market obligation whereas now it is tending to become almost solely a medium of Federal Reserve Bank financing. There would be some increase in commercial bank buying and holding of Treasury bills, both on the part of banks which now hold excess reserves and on the part of banks which now hold none or only the minimum quantities of bills (because of the low rate), and adjust their reserve positions by buying and selling certificates or longer term obligations. More important, there would also be an increase in the buying and holding of Treasury bills by business concerns, which are now holding large amounts of cash on deposit with banks. Since bills (with Federal Reserve Bank purchase and repurchase option) would be as liquid as bank deposits, such concerns could reduce their bank deposits substantially without prejudice to their cash position. By this process the amount of nonbank investment in Government securities would be increased and the amount of necessary bank financing would be reduced.

e. It would retain the present 3/8% rate at the lower end of the rate curve, but this rate would become largely the rate on Federal Reserve Bank holdings of bills, as very few, if any, other tenders for 3-month bills would be likely to be received. The difficult task of maintaining a market pattern between 3/8% and the 7/8 of 1% would thus be avoided in considerable measure.

It is our opinion that this question of rates on Treasury bills should be decided, preferably, before there is an increase in the weekly offering of bills. It is our recommendation, therefore, that this decision be made immediately, either on the basis of our first suggestion of one maturity of bills at a higher rate, which we prefer, or on the basis of two maturities of bills, one to be the existing 3-month bill, as suggested in this supplementary memorandum. A bill program for the remainder of the year could then be developed.

April 14, 1944.

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