April 24, 1944

Chairman Eccles
Governor McKee
Governor Draper

Attached is a revised draft of the supplementary recommendation taking into account some of the suggestions made by Mr. Sproul and further conversations between Chairman Eccles and Mr. Sproul.

L. M. P.

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(Draft of April 24, 1944)

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 that the rate on Treasury bills be increased to 1/2 of one per cent and the maturity extended to four months. At the meeting of our representatives with you, concern was expressed by your associates as to the effect on the whole interest rate structure of the abandonment of the 3/8 of one per cent rate. At the same time, our representatives referred to the fact that an increase in rate would mean an increase in earnings on the large holdings of bills by the System 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 that should make it acceptable without detracting essentially from its advantages. We, therefore, recommend that (1) the Treasury plan to raise funds between drives largely by means of five-month bills instead of certificates or longer-term securities and (2) the Federal Open Market Committee establish a buying rate of 5/8 of one per cent and a repurchase option on the new bills and discontinue the present buying rate after three months. The rate on the new bills would be in line with the pattern of rates as indicated by the market for certificates that mature in five months.

The net cost to the Treasury would probably be no larger and might be less than if the financing were done partly with 3/8 of one per cent bills and partly with 7/8 of one per cent certificates or higher-rate securities. This policy would also avoid the offering of certificates between drives. The offering of certificates requires a special announcement that calls attention to direct bank financing and is an indication that the Treasury has not obtained sufficient funds from nonbank investors. The offering of certificates, moreover, involves the problems of handling subscriptions and making allotments and necessitates annual refunding offerings. The offering of bills, however, is more or less routine and can be used to provide whatever amount of residual financing is needed and whenever it is needed.

Treasury bills would regain some of the character of market obligations, whereas now they are tending to become almost solely a medium for Federal Reserve financing. Banks are now keeping their holdings of three-month bills at low levels, because of the unattractive rate, and are purchasing certificates. The higher rate would result in an increase in commercial bank buying and holding of bills and would enable banks to meet fluctuations in reserves through bills rather than through certificates, notes, and bonds.

More important, there would also be an increase in the buying and holding of bills by business concerns, which are now holding large amounts of cash on deposit with banks. Since bills are as liquid as deposits,

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business concerns could reduce their deposits substantially and could meet fluctuations in cash funds through bills rather than through deposits. By this process, the amount of nonbank investment in Government securities would be increased, and the amount of necessary bank financing would be reduced.

The continuation of the issuance of three-month bills at 3/8 of one per cent could be provided by the offering of a stated amount of bills each week, which would include both three-month and five-month bills. The amount of each maturity that would be issued would depend upon the amount of tenders. Tenders for three-month bills at 3/8 of one per cent would be allotted in full, and tenders for five-month bills would be allotted to the highest bidders, except that tenders for $100,000 or less would be allotted in full at 5/8 of one per cent. In order to prevent the placing of tenders for three-month bills at rates above 3/8 of one per cent, the Treasury would announce that all such tenders would be rejected.

The fluctuating distribution each week between issues of three-month and of five-month bills would result in fluctuations in the amount of bill maturities, making it impossible for the Treasury to maintain both a constant weekly offering of bills and a fixed total amount outstanding. With the present amount of outstandings and the present distribution of bills by maturities in the System's holdings, the fluctuations would amount to a maximum of 200 million dollars. Fluctuations of this or even larger magnitude would produce no problem for the System in handling reserves because of the flexibility that the buying rate provides to the market and the fact that much larger changes in reserves are readily handled at the present time. As larger offerings of bills were made, these fluctuations would probably increase somewhat, but the larger amount of bills outstanding by increasing the amount of securities subject to the buying rate would increase the ability of the banking system to meet changes in reserves. These fluctuations would create no problem for the Treasury because of the Treasury's large balance. By maintaining a fixed weekly offering, the Treasury could raise new money at times when maturities were relatively small.

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