Form F. R. 511

TO Mr. Piser

FROM Chairman Eccles

REMARKS:

In accordance with telephone conversation just had with you, I will appreciate your having copies made of the attached letter and memorandum received this morning from Mr. Sproul, delivering them to the members of the Committee and others who should be furnished copies.

Kindly return Mr. Sproul's letter to me for my use.

Returned according to request. [signature]

CHAIRMAN'S OFFICE

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Chairman Eccles

COPY

FEDERAL RESERVE BANK
OF NEW YORK

April 25, 1944

Hon. M. S. Eccles, Chairman,
Federal Open Market Committee,
Washington 25, D. C.

Dear Marriner:

We have gone over Mr. Piser's latest draft of the supplementary memorandum on Treasury bills, which reached me today, and I am sending you another draft embodying our ideas, including enough copies for the other members of the Executive Committee at the Board. I have also sent a copy to Hugh Leach.

We suggest again that the issues of bills of the two maturities be in approximately fixed amounts, this to be achieved by having the Federal Reserve Banks purchase a fixed amount of new 3-months bills each week. There are really three possibilities:

1. Weekly issues of bills fluctuating in total amount as maturities fluctuate.

2. Weekly issues of bills regular in total amount but fluctuating as to the proportion of 3-months and 5-months bills issued in accordance with the varying tenders for 3-months and 5-months bills.

3. Weekly issues of bills regular in total amount and approximately regular in the proportion of 3-months and 5-months bills issued.

It seems to us that the latter method has much the better chance of being accepted by the Treasury (if all these proposals are not too complicated for the Treasury), because it has much the better chance of favorable public acceptance. It would be hard for the market to understand either a widely fluctuating total weekly issue of bills, or a widely fluctuating distribution of 5-months and 3-months issues, which had no logical relation either to the Treasury's need for money nor the market's need for funds. This is wholly aside from the question of whether the Treasury could adjust its position through changes in its balances or use of special certificates of indebtedness, or whether the market could adjust its position through the use of Treasury bill option accounts. I agree that both types of adjustment are possible.

We have also retained the 3/8 of 1% buying rate and repurchase option. It seems to us that an important part of our selling argument with the Treasury is the maintenance of the appearance of a 3/8 of 1% rate at the

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lower end of the rate pattern, and we are not aware of any offsetting advantages to be obtained by abandonment of this rate after 3 months, even though it will not have much meaning.

Yours sincerely,

(Signed) Allan Sproul

Allan Sproul, Vice Chairman,
Federal Open Market Committee.

P. S.

Incidentally, I still think the amount of possible fluctuations in maturities could be substantially larger than $200 million. That was the maximum figure on the basis of our bill holdings when Mr. Piser calculated it a week or so ago. On the basis of yesterday's holdings, I think the maximum fluctuation could be about $325 million. As we went forward, this maximum could well reach the $500 million figure I mentioned as a theoretical possibility.

A. S.

Encs.

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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 1% and the maturity extended to 4 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 1% 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. In brief, we now propose that there be two issues of Treasury bills, one of 3-months maturity which would be largely, if not wholly, taken by the Federal Reserve Banks, and one of 5-months maturity which would achieve the wider distribution we seek in the market. To make this proposal effective, we would recommend:

1. The Treasury plan to raise funds between drives largely by means of 5-months bills instead of certificates of indebtedness or longer term securities.

2. The Federal Open Market Committee direct the Federal Reserve Banks to establish a buying rate of 5/8 of 1% and a repurchase option on the new bills.

3. The Federal Open Market Committee direct the Federal Reserve Banks to purchase each week a fixed amount of new 3-months bills, and to maintain the present buying and repurchase rate of 3/8 of 1% on such bills, the rate being maintained initially to protect existing holders and subsequently to avoid its disappearance from the market.

This proposal has the following advantages:

a. While maintaining its weekly bill offerings at $1 billion, the Treasury would be able to obtain a substantial amount of new money ($4.5 billion) through sales of bills. When additional direct financing is necessary, the amount of the weekly bill offerings could be increased.

b. The rate on the new 5-months bills would be in line with the present pattern of rates as indicated by the market for certificates of indebtedness that mature in 5 months, but the difficult task of maintaining a market pattern between 3/8 and 7/8 of 1% would be relieved in considerable measure.

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c. 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 1% bills and partly with 7/8 of 1% certificates or higher rate securities. To the extent that the higher rate bills proved 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.

d. It would reduce, if it did not wholly avoid, the offering of certificates of indebtedness between drives. An 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. An offering of certificates, moreover, involves problems of handling subscriptions and making allotments, and necessitates annual refunding offerings. An 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.

e. 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 3-months bills at low levels, because of the unattractive rate, and are purchasing certificates for their shortest term investments. The higher rate on bills would result in an increase in commercial bank buying and holding of bills and would encourage banks to meet fluctuations in reserves through changes in their bill portfolios rather than through buying and selling certificates, notes and bonds.

f. 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, business concerns could reduce their deposits substantially and meet some of their fluctuating needs for cash by changes in their bill holdings rather than through bank 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.

Under this program the Treasury would offer a fixed amount of bills each week, including, say $500 million 3-months bills and $500 million 5-months bills. The Federal Reserve Banks would buy a fixed amount of 3-months bills each week, the market would know the amount of 5-months bills for which it was bidding, and fluctuations in weekly maturities would be avoided.

It is suggested that these recommendations be put into effect as soon as possible so that they will immediately become a part of the Treasury's financing program for the remainder of the year.

April 25, 1944.

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