

C O P Y

July 31, 1944

Honorable Daniel W. Bell,
Under Secretary of the Treasury,
Treasury Department,
Washington, D. C.

Dear Dan:

I am enclosing a memorandum regarding the suggestion that the Treasury increase its offering of Treasury bills by 200 million dollars a week beginning with the weekly offering to be dated August 10. This memorandum has been prepared following a full discussion of the question by the Executive Committee on July 28. I believe that the memorandum is in line with the conclusions reached at that time, but there has not as yet been sufficient time to clear the memorandum with all of the members of the Executive Committee. If any revisions are to be made, however, I shall get in touch with you regarding them.

Sincerely yours,

(Signed) M. S. Eccles,
Chairman.

Enclosure

STRICTLY CONFIDENTIAL

MEMORANDUM FROM THE EXECUTIVE COMMITTEE OF THE FEDERAL
OPEN MARKET COMMITTEE TO THE SECRETARY OF THE TREASURY

The Executive Committee of the Federal Open Market Committee discussed at a meeting held July 28, 1944, the suggestion that the Treasury increase its offering of Treasury bills by 200 million dollars a week beginning with the weekly offering to be dated August 10. After discussion, the Committee voted unanimously to recommend that the Treasury make no further increase at this time in outstanding Treasury bills. The principal reasons for the Committee's recommendation are as follows:

1. There is no net market demand for bills. Between the end of October 1943 and the end of February 1944, marking in both cases the end of war loan drives, Federal Reserve holdings of bills increased by about 800 million dollars, while holdings by other investors declined by about the same amount. Between the end of February 1944 and the end of July 1944, Federal Reserve holdings of bills increased by 2.6 billion dollars, while holdings by others declined by about 100 million. Holdings outside the Federal Reserve Banks are likely to decline further between now and the next war loan drive.

2. A further increase in outstanding bills would be inflationary, in that it would call Reserve Bank credit into use regardless of the needs of individual banks and thus would tend to swell the amount of financing done through the banks. In supplying bank reserves, it is generally preferable for the Federal Reserve to purchase securities from banks that are short of reserves and that need to replenish them. When the Federal Reserve purchases new offerings of bills, the reserves thus created go in part to banks that already have sufficient reserves. These banks are, therefore, encouraged to expand credit. During the recent drive, the shift of deposits to war loan accounts released nearly 3 billion dollars of funds to banks. They utilized these funds in part by increasing their holdings of Government securities by large amounts. At weekly reporting member banks, the increase was 5.4 billion dollars, of which bills accounted for 1.6 billion. All banks needing reserves before the next drive can obtain them by selling to the Federal Reserve from their existing holdings of Government securities or by borrowing from the Reserve Banks.

3. A further increase in outstanding bills would increase the existing difficulty in maintaining the pattern of rates, in that it would tend to force up prices and to reduce yields of longer-term securities for which the banks are showing a growing appetite. A premium has been established on the new issues included in the drive, and this premium has created substantial profits for speculators in Government securities. The existing pressure has made it necessary for the Federal Reserve to sell bonds and notes in the market. If the Federal Reserve forces reserves into the market by purchasing the increase in outstanding bills rather than purchasing from the banks' existing holdings, banks will be encouraged to add further to their holdings of longer-term securities. In our opinion, the proper time to issue additional bills is

when they are needed by the Federal Reserve for purposes of supplying reserves and of maintaining the pattern of rates. This time will arrive when banks have reduced their portfolio of bills to the smallest amount that they wish to hold and are finding it necessary to sell bonds and notes.

4. A further increase in outstanding bills at this time would unnecessarily diminish the Treasury's capacity to use in time of need its best instrument for emergency financing. We understand that the Treasury's present estimates show that at the end of October the Treasury's balance will be 9.3 billion dollars if there is a further increase of 200 million a week in outstanding bills. If no further increase is made, the balance will be 6.9 billion. In our opinion, the latter balance would be adequate to carry the Treasury through to payment date on whatever securities are offered in the sixth war loan drive and to meet any emergencies. If, however, a greater need for funds did arise, the Treasury would still be able to raise sufficient funds by offering additional bills at the time. In the interim, the Treasury would save interest costs.

We feel strongly that the Treasury should permit all holders of maturing bills to exchange their holdings for newly-issued bills. We understand counsel has agreed that it is within the authority of the Treasury to provide for such exchange and that the exercise of such rights by the Federal Reserve would not come within the statutory limitation on direct purchases. The increase in outstanding bills is going to the Federal Reserve through the medium of Government security dealers, who place tenders at the request of the Treasury, such request being conveyed to the dealers by the Federal Reserve. In our opinion, this procedure is open to the criticism that, in substance, the bills are not being sold in the open market and that their purchase by the Federal Reserve is, in the circumstances, at least an avoidance of the intent and spirit of the law.

July 31, 1944

Items for consideration at the meeting of the executive committee of the Federal Open Market Committee on July 28, 1944

- ✓ 1. Approval of the minutes of the meeting of the executive committee of the Federal Open Market Committee held on May 4, 1944.
- ✓ 2. Report of operations in the System account since the last meeting of the executive committee. Approval and ratification of all transactions in the account since the period covered by similar action of the executive committee at its meeting on May 4, 1944.
- ✓ 3. Letter dated May 31, 1944, from Mr. Sproul reporting on steps taken by the New York Bank to qualify brokers and dealers under the terms on which the Bank will transact business for System account.
- ✓ 4. Formula for the allocation of securities in the System open market account. At the last meeting of the full Committee the executive committee was authorized to work out a procedure which would be recommended to the Reserve Banks and, if approved by them, put into effect.
5. Action to be taken with respect to the long-range problem of reserve ratios. At the last meeting of the full Committee the executive committee was requested to study and make a report to the full Committee on the action to be taken, its timing, and the public preparation necessary for its successful execution, it being understood that in the meantime the reserve ratio of a Reserve Bank should not be allowed to go below 45.
6. Treasury financing:
 - a. Review of the Fifth War Loan Drive.
 - b. Increase in the weekly Treasury bill offering.
 - c. Issuance of Treasury bills at an increased rate. At the meeting of the executive committee on May 4, Chairman Eccles said that following the submission to the Treasury of the supplemental memorandum dated April 28, 1944, Mr. Bell stated that after the Fifth War Loan Drive the matter would be given further consideration.
 - d. September refunding.
 - e. The next war loan drive.
- ✓ 7. Instructions to be issued to the Federal Reserve Bank of New York to effect transactions in the System open market account. (See attached copy of direction issued at the meeting of the executive committee on May 4, 1944.)
8. Reply to be made by the Board of Governors to request from the Chairman of the Senate Banking and Currency Committee for a report on the Thomas bill which provides that U. S. obligations owned by banks, etc., shall be deemed to have a value equal to par and requires the Reserve Banks to purchase such obligations at not less than par.

Attachment

Excerpt from the minutes of the meeting of the executive committee of the Federal Open Market Committee on May 4, 1944

Thereupon, upon motion duly made and seconded, and by unanimous vote, the executive committee directed the Federal Reserve Bank of New York, until otherwise directed by the executive committee,

(1) To make such purchases; sales, or exchanges (including replacement of maturing securities and allowing maturities to run off without replacement) for the System account, either in the open market or directly from, to, or with the Treasury, as may be necessary in the practical administration of the account, or for the purpose of maintaining about the present general level of prices and yields of Government securities, or of maintaining an adequate supply of funds in the market; provided (a) that the total amount of securities in the account at the close of May 4, 1944, shall not be increased or decreased by more than \$750,000,000 /exclusive of bills purchased outright in the market on a discount basis at the rate of 3/8 per cent per annum and bills redeemed at maturity, and special short-term certificates of indebtedness purchased for the temporary accommodation of the Treasury pursuant to paragraph (2) of this direction⁷, and (b) that this paragraph shall not limit the amount of Treasury bills purchased pursuant to the directions of the Federal Open Market Committee issued under dates of June 28, 1943, and March 1, 1944, or the redemption of such bills;

(2) To purchase direct from the Treasury for the System open market account such amounts of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury; provided that the total amount of such certificates held in the account at any one time shall not exceed \$750,000,000; and

(3) Upon approval by a majority of the members of the executive committee, which may be obtained by telephone, telegraph, or mail, to make such other purchases, sales, or exchanges for the account as may be found to be desirable within the limits of the authority granted to the executive committee by the Federal Open Market Committee.