

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 has further considered the question of increasing the weekly offering of Treasury bills. The Committee recommends that the Treasury increase the weekly offering from 1.2 to 1.5 billion dollars beginning not earlier than the issue dated September 21 and concluding with the issue dated November 9. In making this recommendation, the Committee has taken into account the following considerations:

1. From the point of view of market conditions by themselves, the weekly offering should be reduced instead of increased, since, except for Federal Reserve purchases, bills are in supply. Between the end of February 1944 and the end of July 1944, marking in both cases the end of War Loan drives, Federal Reserve holdings of bills increased by 2.7 billion dollars, while holdings by others declined by about 300 million, showing that all of the additional bills and more were taken by the Federal Reserve. So far in August, Federal Reserve holdings of bills have increased by about 800 million dollars, while holdings by others have declined by about 600 million.

2. From the point of view solely of supplying reserves, the Committee would recommend that outstanding bills be increased by not to exceed 1.1 billion dollars, with the increase concentrated in the weeks immediately preceding the beginning of the drive. In the opinion of the Committee, the proper time to increase the weekly offering is when bills are needed by the Federal Reserve for purposes of supplying reserves and of maintaining the pattern of rates. This time will not arrive until 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 in order to replenish reserves. In fact, it would be desirable for banks to find it necessary to sell at least a moderate amount of bonds and notes, from the point of view of discouraging future speculative purchases of these longer-term issues and also from the point of view of restoring securities to the Federal Reserve to replace the notes and bonds that have recently been sold in order to stabilize the market. The Federal Reserve cannot continue indefinitely to maintain the present pattern of rates if its holdings of notes and bonds continue to decline.

Under present conditions, any increased amount of outstanding bills will be purchased by the Federal Reserve. If the increase should be made before banks were short of bills and were selling other securities, the reserves thus created would go in part to banks that already had sufficient reserves and would encourage these banks to expand credit by purchasing notes and bonds. The existing difficulty in maintaining the pattern of rates would thereby be increased. Between now and the beginning of the next drive, the Federal Reserve will need to supply about 3.1 billion dollars of reserves, an average of about 300 million dollars a week. Of the total, 1.9 billion dollars will be needed to meet increased reserve requirements and 1.2 billion to meet an increase in money in circulation.

Weekly reporting member banks still hold 3.3 billion dollars of bills, or a billion more than they held at the beginning of the last drive, which is probably the smallest amount that they wish to hold in order to meet sudden drains; this billion dollars will be readily available for purchase by the Federal Reserve. Between the end of the Fourth War Loan and the beginning of the Fifth War Loan, Federal Reserve holdings of certificates increased by about 700 million dollars, representing principally purchases from banks that held no bills or only small amounts. In view of the large bank holdings of certificates and particularly of the substantial increase in holdings that occurred during the Fifth War Loan, it appears likely that at least 700 million dollars of certificates will be readily available for purchase by the Federal Reserve. In addition, Federal Reserve holdings of notes and bonds have declined by about 300 million dollars since early in July, and, for reasons previously given, the Federal Reserve would like to replenish its portfolio of these issues. In total, therefore, it appears that at least 2.0 billion dollars of the 3.1 billion of reserve needs can be readily supplied from the banks' present holdings of Government securities. The Committee believes that the remaining amount, 1.1 billion dollars or less, should be supplied by an increase in outstanding bills. Since Federal Reserve earnings are already large, there is no need for the Treasury to pay to the Federal Reserve more than a nominal rate of interest in supplying reserves.

3. From the point of view of maintaining the Treasury's cash balance at the level desired by the Treasury, the Committee recommends that outstanding bills be increased by no more than 2.4 billion dollars. The Committee understands that the Treasury would like to have a cash balance of perhaps 8 billion dollars at the beginning of the drive. Including bill financing of 1.1 billion dollars, it appears that the balance would be nearly 7 billion, which would be in excess of the actual balance at the beginning of the last drive. This balance, in the Committee's opinion, is adequate to meet any emergencies that may arise before the drive. If a larger need for funds did arise, the Treasury would still be able to raise sufficient funds to meet the emergency financing by offering additional bills at the time. In the interim, the Treasury would save interest costs.

The Committee recognizes, however, that it should defer to the judgment of the Treasury on matters such as the most desirable level of the Treasury cash balance. In view of the fact that the Treasury will not need funds until shortly before the beginning of the drive and in view of the fact that the additional securities will be taken largely by the banking system, the Committee believes that the funds should be raised by increasing the weekly bill offering. A sufficient amount of funds, 2.4 billion dollars, could be raised, according to present estimates, by increasing the weekly offering by 300 million, from 1.2 to 1.5 billion, from September 21 to November 9. These estimates assume a rather large amount of expenditures, and if actual expenditures are below the estimates the increase in the offering could be postponed. The Committee recommends that the weekly offering revert to 1.2 billion dollars during the drive, because at least part of an increase at that time would be taken by the Federal Reserve, thereby adding to excess reserves and consequently stimulating bank purchases. Subsequently, the program could be reconsidered in the light of intervening developments. The Committee can see no reason for completing the bill cycle or for having an equal amount of bills maturing each week, because bills are the most flexible financing instrument that the Treasury has and should be increased and decreased as occasion warrants.

The Committee again renews its recommendation that the Treasury permit all holders of maturing bills to exchange their holdings for newly-issued bills. The Committee understands that 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 the opinion of the Committee, 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.