STRICTLY CONFIDENTIAL

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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 make no increase in the weekly offering before the end of the Sixth War Loan. In making this recommendation, the Committee has taken into account the following considerations:

1. Under present conditions, any increased amount of outstanding bills will be purchased by the Federal Reserve. In the opinion of the Committee, there should be no increase to raise funds when the market for notes and bonds is strong, but increases should be postponed until bills are needed by the Federal Reserve for supplying reserves and for maintaining the pattern of rates. Otherwise, part of the reserves created by Federal Reserve purchases of bills would go to banks that already have sufficient reserves, with the result that these banks would be enabled to hold the large amount of securities that they purchased during the Fifth War Loan and would be encouraged to expand credit further by purchasing additional amounts. The existing difficulty in maintaining the pattern of rates would thereby be increased, and the continued strength in the note and bond market would encourage banks to purchase an even larger amount of securities during the Sixth War Loan than they purchased during the Fifth War Loan.

2. Banks hold sufficient securities to meet their needs for reserves without strain on the pattern of rates. Between August 30 and November 15, the Federal Reserve will need to supply 2.7 billion dollars of reserves, comprising 1.3 billion to meet increased reserve requirements, 1.2 billion to meet an increase in money in circulation, and about 200 million to meet a gold outflow. Weekly reporting member banks on August 30 still held 792 million dollars more of bills than they held on June 7, just before the beginning of the Fifth War Loan. Between June 7 and the peak in their holdings, reporting member banks increased their holdings of certificates by 2.3 billion dollars, their holdings of notes by about 400 million, and their holdings of bonds by 1.3 billion, a total of 4.0 billion. Since the peak, they have reduced their holdings of certificates by 78 million dollars and their holdings of notes by 100 million, a total of 178 million. Their holdings of bonds are still at the peak. They still hold, therefore, 3.8 billion dollars more of certificates, notes, and bonds than they held before the beginning of the Fifth War Loan. It is apparent, therefore, that banks can readily meet their reserve needs by selling only part of these acquisitions. It is the opinion of the Committee that they should be required to do so rather than supplied with reserves by an increase in the bill offering. Such a policy would reduce the demand for notes and bonds and permit them to recede in price. This development is necessary if excessive speculation is to be avoided during the Sixth War Loan. Since bank earnings are now at very high levels, there is no need from this point of view of maintaining their present holdings.

3. In maintaining the pattern of rates, Federal Reserve holdings of notes and bonds have declined by about 300 million dollars since early in July. Unless notes and bonds are restored to the Federal Reserve to replace the notes and bonds that have recently been sold, the Federal Reserve will find it increasingly difficult, if not impossible, to maintain the present pattern of rates.

If the Treasury is unwilling to accept this recommendation, the Committee recommends that the increase in outstanding bills not exceed 1.5 billion dollars. In this event, the weekly offering could be increased from 1.2 to 1.5 billion dollars beginning perhaps with the issue dated October 13 and concluding with the issue dated November 9. The weekly offering would then revert to 1.2 billion dollars, since it would be undesirable to increase the amount of outstanding bills during the Sixth War Loan, when excess reserves will be rapidly increasing because of shifts to war loan accounts and should not be further increased by the offering of additional bills, which would be taken by the Federal Reserve. 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 statutory 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 with the knowledge that they can sell to the Federal Reserve under the buying rate provision. The reason for the arrangement is that otherwise the present amount of bills could not be sold. It is difficult to characterize the arrangement as other than a direct placement of the bills with dealers, and the same authority which would permit the Treasury to make a direct placement would also permit the Treasury to authorize the exchange of maturing bills. Since the arrangement serves only to maintain an illusion of an open market bid and purchase of bills, it is the Committee's opinion that it invites criticism that the illusion is created in order to avoid the intent and spirit of the law.