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THE SECRETARY OF THE TREASURY

WASHINGTON 25

July 27, 1945

Dear Mr. Ransom:

Since talking to you over the telephone on Monday, I have given careful consideration to the two letters which Chairman Eccles sent to Secretary Morgenthau on July 9, 1945, and to the memorandum prepared by the Executive Committee of the Federal Open Market Committee, which was attached to the letter which Mr. Eccles signed in his capacity as Chairman of that Committee.

The letters and the memorandum contain a number of recommendations with respect to the future conduct of Treasury borrowing operations, particularly the Eighth War Loan. They also state that the Board of Governors and the Federal Reserve Banks are considering the discontinuance, at an early date, of the preferential discount rate of 1/2 of one percent on Government securities maturing or callable in one year or less. The memorandum states that "a necessary corollary" of this action would be ". . . the discontinuance of attempts to maintain a pattern of rates between the 3/8 of one percent bill rate and the 7/8 of one percent certificate rate", substituting instead a uniform support price for all certificates -- irrespective of maturity -- at a 7/8 of one percent rate.

I expect to review thoroughly the whole picture of Government borrowing operations before making my decisions with respect to future war loans. In the course of this review, I shall give careful consideration to the changes in borrowing technique which are suggested in the Executive Committee's memorandum, and I look forward to discussing these proposals further with you and the Committee.

In the meantime, however, I do not believe that it would be wise to initiate an increase in short-term interest rates.

The preferential discount rate of 1/2 of one percent on member bank borrowing, secured by Government obligations maturing or callable in one year or less, was initiated in order to encourage banks to hold short - rather than long-term obligations. Its elimination would increase the rate of interest on member bank borrowings secured by such obligations from 1/2 of one percent to one percent; and, consequently, it would greatly weaken the incentive of banks to hold short-term Government obligations at a time when we are both agreed that such incentive is particularly necessary.

Practically all member bank borrowing now secures the benefit of the preferential rate, and this fact is generally known. The elimination of the preferential rate, therefore, would have the effect, both actually and psychologically, of doubling the effective discount rate of the Federal Reserve Banks. I am concerned that such action, particularly if it occurred at this juncture, might be interpreted by the market as an indication that the Government had abandoned its low-interest-rate policy and was now veering in the direction of higher rates.

I recognize, of course, that the fixing of discount rates is a statutory prerogative of the Board of Governors and of the Federal Reserve Banks. We have both always recognized, however, that it is necessary, for the duration, to work as a single team in financing the war in the best possible manner. I am sure, therefore, that you will be willing to continue the present preferential discount rate and the present policy with respect to short-term rates as long as it is required in the interest of sound war finance.

Sincerely yours,

(Sgd.) Fred M. Vinson

Honorable Ronald Ransom
Acting Chairman, Board of Governors
of the Federal Reserve System
Washington 25, D. C.