# A G E N D A

(Document of Reference as a Guide to the Discussion)

ROUND TABLE DISCUSSION

EXPLORING THE GOVERNMENT SECURITIES OUTLOOK

(Economic Aspects)

Metropolitan Club
Washington, D. C.

Monday, February 26, 1940 - Five P. M.

Dinner (Informal) at 6:30 P. M.

Moderator

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# EXPLORING THE GOVERNMENT SECURITIES OUTLOOK
## (Economic Aspects)

From the economic aspect, holders of Government bonds are interested primarily in three things:

I. The future price of their holdings, which is the same as saying the future course of money rates.

II. The marketability of their holdings.

III. The preservation of the purchasing power of the principal invested in the bonds and in the interest income derived therefrom.

## I. The Price of Bonds or the Future Course of Interest Rates.

### A. Excess Reserves:

1. Over the near term prospect of, say, the next twelve months, is there any likelihood of a substantial reduction in excess reserves as a result of -

   (a) Gold exports?

   (b) Increase in reserve requirements?

   (c) Free use of gold?

   (d) Expansion in the currency?

   (e) Substantial increase in bank loans?

   (f) Additional government borrowing?

   (g) The opening up of the capital market for "new money" borrowing?

   (h) Sales or maturities of Government securities held by Federal Reserve banks?

1[1]. Over the near term prospect of, say, the next twelve months, is there any likelihood of a substantial increase in excess reserves as a result of -

   (a) The release of gold from earmark?

   (b) Further gold shipments from abroad?

   (c) Decline in bank loans?

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(d) Decline in circulation?

(e) Decrease in commercial bank bond holdings through sales to the Federal Reserve Bank or to other purchasers

2. At the present time, the reserve requirements of member banks are between 12 and 22-3/4%. Are these requirements likely to be increased during the next twelve months? To what extent would it be possible for the Federal Reserve System to reduce excess reserves through increasing reserve requirements?

3. Through the sale of Government securities, the Federal Reserve Bank could reduce reserves by $2,477,000,000. If these bonds were all bought by member banks, excess reserves would then be reduced by a similar amount; if bought by others than member banks and paid for with deposits in member banks, excess reserves would be reduced by the amount so purchased less the reserves required on these deposits, which would be somewhere between 12 and 22-3/4 per cent. Do you think that over the next year the System will attempt to raise money rates through the sale of Government securities?

4. To what extent are excess reserves reaching a level where they are losing their potency as a bond market factor? Are the reserves growing in the case of individual banks to the point where the banks simply will not invest them? To what extent is this due to the fact that these banks may be carrying large bank and foreign deposits against which they may feel they should be reserved substantially 100%? To what degree is it due to the declining capital-deposit ratio or other pertinent ratios?

5. In your judgment, is the price of bonds so high that even a slight tendency of excess reserves to fall would give rise to psychological or panicky selling of bonds by institutions and other holders desiring to "beat the other fellow to the trough"? What factors might set this sort of thing off? Would the result be anything more than temporary - that is to say, might we not expect a rebound upward in the market?

6. Will excess reserves have to be practically totally exhausted before we arrive at a position where we might say that we are definitely headed for higher money rates and lower bond prices?

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B. The Gold and Silver Question:

1. To what extent may the Treasury use discretion in purchasing gold and silver under existing law? As a practical matter, does it contemplate indefinitely taking at $35 an ounce all gold tendered from whatever source? What is its position in this regard with respect to silver?

2. At the present time, this country holds $18,035,000,000 out of a total estimated world gold monetary stock of $26,000,000,000, or 69%. Since the devaluation of the dollar and the fixation of the price of gold at $35 an ounce, the net imports of gold have amounted to $11,120,820,000. In 1939, such net imports amounted to $3,574,151,000 and so far in 1940 they have amounted to $383,370,000. In 1939, exclusive of Russia, the world production of gold amounted to over $1,200,000,000. It has increased since we established the gold price of $35 an ounce approximately $750,000,000 per year. Are there any foreseeable limits as to the amount of gold which the United States Treasury will purchase?

3. Is it likely that a substantial rise in the commodity price level in the United States would tend to make gold flow from the United States rather than into it, or are there other factors, such as the need of warring nations for supplies and the general foreign unrest, which are likely to induce the continued flow of gold to this country, almost irrespective of the course of commodity prices?

4. In the light of past experience, is the Treasury likely to resort again to the sterilization of gold imports? Would such a course of action appear to be advisable from the standpoint of our banking system?

5. Would it be advisable to circulate gold again within the country, and what would be the means of effectuating such a policy? What would be the result upon excess reserves and interest rates? Are there any fears in your mind that the concentration of monetary gold in this country is likely to militate against the ultimate resumption of the gold standard internationally? What would be the means at our disposal of bringing about a redistribution of gold?

6. Would it be inadvisable to take off the fixed price of $35 an ounce for gold or place an import duty

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upon gold? Would such action tend to curtail the importation of the metal into this country? What would be the effect on world gold price? On the dollar? On Commodity prices?

7. What means are there at our disposal of preventing the further taking into our monetary system of further gold importations into the country?

8. What are the prospects for further devaluation of the dollar, and what would be the effect of such devaluation upon excess reserves and the interest rate level?

C. Fiscal Policy of the Government:

1. What means are available to the Government, including the Treasury, the Federal Reserve System and governmental agencies to control or influence the money market? To what extent can that control or influence be exercised? To what degree is there uniformity of action or coordination among those various bodies?

2. In what way does the financing of governmental deficits affect the money market?

3. On the basis of the recent budget submitted by the President, to what extent will the Treasury have to sell bonds in the general market during the next fiscal year?

4. What are the prospects for reduced governmental expenditures and increased taxation? Is the debt limit likely to be raised during the next fiscal year?

5. What consideration has been given to the effect upon money rates and bond prices in the eventuality of our being drawn into the war, and what have been the results of such consideration?

6. To what extent can the government finance its requirements through the sale of Baby Bonds? Should the demand for these bonds continue to expand at the rate experienced during the past twelve months, how great a deficit could be financed by the Government within the next year or two upon the assumption that governmental expenditures and governmental receipts (from sources other than the sale of Baby Bonds and other borrowings) remain the same?

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7. Is there danger in building up a large potential demand liability in the form of Baby Bonds? Under what circumstances do you think a "run" might materialize?

8. What, generally, are the prospects of a reduction in governmental expenditures or an increase in governmental receipts, or both; that is to say, what prospects are there for an approach to the balancing of the national budget?

9. To what extent has Treasury policy in retiring the supply of short maturities by refunding into longer bonds affected rates?

10. Would you approve the use by the Treasury of long term, non-market securities, similar in type, for example, to savings bonds - which securities would be issued to savings banks, insurance companies, and similar holders? Would you approve of the issuance of perpetual obligations of the type of British Consols?

D. Expansion of Commercial Loans and Improvement in General Business:

1. Commercial loans of member banks show a net increase of approximately $500,000,000 since early in the Spring of 1939 and have reached a total of $4,330,000,000. In the previous business expansion of 1936-1937, the total expansion from the lowest point to the highest point was approximately $1,700,000,000. Can we expect or should we make plans for an expansion during the year 1940 of as great an amount from the present level to the peak of total loans or equal to the total expansion seen in the previous period or greater? In short, is it likely that excess reserves may be materially drawn upon to meet the requirements of an expansion of business?

2. If we actively participate in the war, what are the prospects that substantial commercial and governmental credits will be extended?

3. Will American manufacturers borrow to invest substantial amounts in additional plants or production of war materials for the United States or belligerants? To what extent do you foresee American industry in general entering the capital market for new financing?

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4. Should we allow for an advance in commodity prices at least equal to the level that existed in 1936-1937? To what extent do you think we may expect an advance in commodity prices?

5. Is there any probability that there will be a substantial increase in the public's interest in security markets which will create a large increase in loans on securities?

E. General Questions:

1. If we should be drawn into the war, what would be the proximate and more or less long term effect upon money rates and Government bond prices?

2. How low can bond yields go before Government bonds simply cease to be attractive investments to commercial banks, savings banks, and insurance companies - with due regard to the maturities which are acceptable to those types of investors? How many years interest income will have to be represented by bond profits before holders will be induced to take those profits and hold cash idle in anticipation of getting back into the market at a lower level at some future time?

3. Can trustees justify the purchase of twenty-five year Government bonds to yield less than 2½% to maturity?

4. In the event of our participation in the war bringing with it a selling wave in Government bonds, would the long bonds or the short bonds feel the effects first or would they both go down together? In the event of business expansion, would the banks sell their short Government securities, and would this be a tip-off to holders of long bonds that the prices of such bonds might likewise shortly be depressed?

5. If substantial amounts of bonds were offered in the open market, with the consequent lowering of bond prices generally, at what level would bonds having maturities of 5 years - 10 years - over 10 years appear to be attractive purchases to commercial banks, savings banks, and life insurance companies? (It would be of considerable interest if each person present could be polled on his current guess as to the possible yield that would be available on the long term Governments (now 2.35%) at the end of 1940. These guesses would be treated as confidential.)

6. Let us assume that a conservative is nominated by

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both parties at the forthcoming conventions. Would institutional investors be thinking along the lines of further building up or of decreasing their total Government holdings?

(a) Would chances of a decreased supply of Governments and better outlook for a balanced budget cause buying?

(b) Would possible big business expansion, development of loans, and consequent inflationary effects tend toward the taking of profits in Governments and reduction in total holdings?

(c) Or would little material change occur, given interest rates like those now prevailing?

Would actual buying or selling depend on whether bonds were available at rates which yielded a profit over the cost of the money, or vice versa?

(d) Would the feeling be that Baby Bond sales and proceeds from trust funds would provide the needed cash from then on?

(e) Would any conservative government be expected to apply the stabilization fund toward the reduction of the debt?

(f) Is it possible that present expectations (for nothing better than tapering deficits through 1942) will disappear during 1940?

(g) If institutions such as savings banks and insurance companies, by some means, have their confidence restored, what mediums of investment are open to them through which they can more actively employ their funds at rates that will make it a good business operation?

(h) Suppose the ultimate in confidence could be generally agreed upon, what new action along investment lines could be taken by trustees of savings banks or trust committees that is not being undertaken today?

1. Life Insurance companies?
2. Fiduciaries?
3. Commercial banks?

II. The Marketability of Government Bonds

A. Certain Technical Questions:

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1. Should the present practice of giving exchange privileges to maturing obligations be continued? Would it be sounder practice and would better distribution be obtained by the use of partial "right" privileges?

2. Is it desirable to stop the practice of padding subscriptions? What steps could be taken to stop the padding of such subscriptions?

3. Why should notes be tax exempt?

4. Should the Treasury discontinue the use of special issues in trust funds?

5. Is there sound policy behind the distribution of the Government debt in money bills, notes, medium and long term bonds?

6. Why should the Treasury continue the use of split maturities?

7. Is it sound fiscal policy for the Government to do its financing through the issuance of securities by governmental agencies? Is not the effect of this to disguise the true situation with respect to the national budget and the total national government debt?

B. General Questions:

1. How large can the Federal debt safely grow? It is said that we might go considerably farther than we have up to this time in discounting the future growth of the country and therefore the ability of the country to "grow up to" a Government debt structure expanded far beyond its present proportions. Do you subscribe to the economic soundness of this statement?

2. Will commercial banks soon find themselves in a position where they will refuse to expand their deposits further, as will be necessary through the continued purchase of new Government bond issues? That is to say, they will not buy new bonds and expand their deposits if by so doing they are likely to impair seriously their capital-deposits ratio. Will the commercial banks be willing to accept new capital funds from the Reconstruction Finance Corporation in order to be able to continue to buy Government bonds without distorting their capital-deposits ratio, provided those capital funds are offered on such a low interest basis that the

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investment of those funds by the banks in Government bonds could be done profitably?

3. Are the banks' supervisory authorities, in the event of a decline in Government bonds, likely to permit banking institutions and insurance companies to carry Government bonds at so-called conventional values? Is this sound?

4. Should the Federal Reserve banks lend the equivalent of par on Government bonds if the market is lower than par?

5. At present levels is not the Government bond market exceptionally vulnerable and is there not a general feeling among holders that such a condition of vulnerability exists?

6. Is it a fact that the low yields on Government bonds and other prime credits have discouraged savers and lenders?

7. Is it true that the Federal Reserve banks are, practically speaking, ineffective as an agency for controlling the supply of money and credit under existing conditions?

8. What resources would be open to the Treasury if the commercial banks of the country should in general feel that they can absorb safely no more Government securities? Would the Treasury have to resort then to the direct sale of its bonds to the Federal Reserve System? If so, what would be the effect upon Government bond prices and interest rates?

9. What are the theoretical limits within which the Federal Reserve system could absorb the existing Government debt and/or additions thereto?

10. Is it true that the market for Government bonds is really a liquid market or is it true that with respect to long Government bonds in particular the large institutional holders really have a frozen asset - an asset of which no great number of them could divest themselves at any one time? In short, are not the institutional holders in the position of having to take, willy-nilly, whatever amount of new Government bonds may be offered to them out of the fear that their refusal to do so would bring about such a break in the Government bond market as to cause very heavy losses through Government bond depreciation? In short, they must buy new issues to support the market for the ones they already hold.

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11. In the event we are brought into the war, to whom would the Treasury look for the absorption of the large amount of new bonds that would have to be issued? Has consideration been given to instituting a system of forced savings to be used for the purchase of such Government bonds?

12. Approximately $52,326,000,000 of deposits are in banks insured by the Federal Deposit Insurance Corporation. Its net worth is $424,000,000 and it can borrow an additional $975,000,000, of which only $500,000,000 would come from the United States Treasury and the R. F. C., and the balance from open market borrowing. Will the Corporation be a material protection in preventing public distrust in the face of a drastic decline in bond prices?

## III. Intrinsic Value of Government Bonds

### A. General Questions:

1. Are there fears in the minds of bond holders that the Government's fiscal policies are definitely out of hand and that only through forced inflation of commodity prices and wage levels can tax receipts be brought up to a point where the budget can be definitely balanced? Will not this bring with it a reduction in the purchasing power of the principal invested in the bonds and the interest collected thereon, with the consequent forcing of the prices of such bonds downward?

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