STATEMENT OF CHAIRMAN MARTIN OF THE BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM
ON BILLS TO INCREASE THE MAXIMUM INTEREST RATE PERMITTED
ON UNITED STATES SAVINGS BONDS, BEFORE THE COMMITTEE ON WAYS
AND MEANS OF THE HOUSE OF REPRESENTATIVES
FEBRUARY 21, 1957

The importance of the proposal before you lies in the contribution it can make to the maintenance of the economic health and progress of the country. Savings currently are inadequate to meet the demands for funds sought by most sectors of the economy. All of these demands could only be met at present by creation of new supplies of money through the banking system. That is the high road to inflation. To the extent that United States savings bonds are made more attractive to investors, more saving and less spending should be encouraged. That is clearly in the public interest.

Carrying charges on the public debt are of concern to all of us. They will almost surely be increased unless more savings are drawn into and held in these securities. Otherwise, the Treasury will be obliged to go to the money markets for funds to replace these savings. And the floating of marketable issues at this time can hardly be accomplished at rates lower than those here proposed.

This move to increase the interest rate on Series E and H savings bonds is designed to maintain the position of these securities in our public debt structure and to maintain the traditional role of the small saver who purchases these bonds through the payroll savings plan. The savings bond program has been well established over a 20-year period. Some $41 billion are now held in the E and H series. This is an important and substantial part of our debt structure that should be maintained.

Persistent net liquidation of savings bonds has recently produced cash drains that have greatly complicated the task of managing the Treasury's cash position. Any substantial further reduction in savings bond holdings would add to the problems both of debt management and monetary policy.

Yield increases from 3 to 3-1/4 per cent as proposed for E and H bonds are needed if the investment returns available on these issues are not to lag too far behind returns obtainable from alternative uses of savings. Historically, savings bonds held for extended periods have typically provided yields above those paid on competitive forms of savings such as savings deposits and marketable U. S. Government securities.

In 1956, however, the relationship between yields on savings bonds and marketable U. S. Government securities was reversed. Yields on other marketable debt also rose sharply. As a result, the Treasury Department was confronted with the largest liquidation of outstanding savings bond debt in the history of the U. S. savings bond program, as well as with a decline in sales of new bonds.

In accordance with the general advance in interest yields during 1955 and 1956, many banks raised the rates paid on savings and other time deposits. In recognition of this trend and the need for additional savings at a time of inflationary pressure, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation at the end of 1956 raised the maximum permissible rates that commercial banks may pay on time deposits. Many banks announced increases in their rates--some for the first time and others on top of previous raises. Following this adjustment, rates paid by some other savings institutions such as savings and loan associations, which in most cases exceeded rates at commercial banks, also underwent further advances.

As a result, the competitive pressure on the Treasury savings bond program was greatly increased. Net redemptions rose still further. Without some adjustment in the relative returns obtainable from savings bonds as compared with other forms of investment, net liquidation of savings bond debt is likely to continue at an accelerated pace, further complicating the cash financing problems of the Treasury.

Normal experience with U. S. savings bonds indicates that although such issues are demand obligations, in the aggregate outstanding savings bond debt tends to remain fairly stable as long as interest returns are sufficiently favorable. This has been especially true of smaller denomination E bonds. On the other hand, examination of past data indicates that sales of Series J and K bonds and to a lesser extent sales of large denomination E and H bonds have been more sensitive to changes in flexible interest rates than has been true of smaller denomination bond sales. Thus, the Treasury proposal to lower the purchase limits on E and H bonds and to discontinue Series J and K bonds would tend to reduce holdings by large investors and make for greater stability in the over-all savings bond program.

The proposed revision represents an adjustment of fixed rates of return to advances that have already occurred in more flexible interest rates. As such it would be unlikely to create expectations of further general rate increases. General interest rate advances develop when the borrowing demands of businesses, consumers, and governments outrun the supply of savings. An increase in the overall volume of savings would certainly lessen upward pressures on interest rates.

With the adoption of the Treasury proposal, current uncertainty over the revision of terms would be eliminated and the declining trend in E and H bond sales so far this year should be reversed.