FEDERAL RESERVE BANK
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Fiscal Agent of the United States

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TREASURY SECRETARY KENNEDY PROPOSES
5 PERCENT RATE ON SAVINGS BONDS

To Issuing Agents for Series E Savings Bonds, and Others Concerned,
in the Second Federal Reserve District:

Following is the text of a statement issued July 11 by the Treasury Department:

Secretary of the Treasury David M. Kennedy today disclosed details of the Nixon Administration's request to Congress for legislation to permit the payment of a 5 percent rate of interest to investors in United States Savings Bonds. He said that in the same proposal the Administration would seek removal of the 4 1/4 percent interest ceiling on all Treasury bonds.

The maximum rate that may be paid on any Treasury bond, including savings bonds, is now 4 1/4 percent, a statutory limitation which has been unchanged since 1918.

Mr. Kennedy disclosed the intention to ask for this legislation during his testimony earlier this week before the Senate Finance Committee.

In submitting the proposal, the Secretary emphasized his hope that the House Ways and Means Committee consideration of the legislation would await the completion of work on tax reform. He said that Committee enactment of a meaningful tax reform proposal on the earliest practicable date is a matter of highest priority.

About $52 billion of Series E and H savings bonds are outstanding. Approximately 11 million people are now buying bonds through a payroll savings plan. The proposed 5 percent rate would apply to savings bonds purchased after June 1, 1969 and held to maturity. Holders of outstanding savings bonds would also receive a 5 percent rate for the remaining period to maturity after June 1, 1969.

Treasury is recommending the increase in rate because the current 4 1/4 percent return is not competitive with other investment and savings opportunities. Redemptions have been running ahead of sales for seven successive months. In June, redemptions were $483 million and sales were $383 million. The last time savings bond rates were raised was in June 1968 when they went to the permitted ceiling of 4 1/4 percent from 4.15 percent.

The 4 1/4 percent interest rate ceiling applies to all Treasury bonds, including longer term marketable securities with maturities of more than 7 years. In the past, such bonds played an important role in providing the flexibility for orderly management of the Federal debt.

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Treasury has been unable to sell any marketable bonds since May of 1965 because longer term interest rates have been above the 4 1/4 percent ceiling. Instead it has had to rely on short term instruments — bills and notes — on which there is no interest rate ceiling. As a result, the average maturity of the privately held marketable debt has dropped about 30 percent since mid-1965.

Treasury is seeking the removal of the ceiling in order to permit the orderly restructuring of the public debt in accordance with national objectives.

Subject to enabling legislation, the proposals affect Series E and H bonds and the Freedom Share as follows:

E and H bonds

The new rate of 5 percent to maturity will apply to all bonds sold on or after June 1, 1969. As in the past, bonds redeemed prior to maturity will earn a lesser yield but these interim rates have been improved over the current schedule. For example, in the case of E bonds, at 6 months the new rate will be 3.20 compared to the current 2.24. At 1 year the new rate will be 4.01 compared to the current 3.02 and at 3 years, 4.44 compared to 3.75 percent. The lower rate of return for short term holdings reflects the desire of the Treasury not to compete unduly with private savings institutions and to retain an incentive for purchasers to hold their bonds to maturity.

Beginning with the first semiannual interest period starting on or after June 1, 1969, rates on outstanding E and H bonds will be increased to yield 5 percent when held to maturity or extended maturity. These outstanding bonds will also benefit by an improved interim schedule in the case of earlier redemptions. Holders are assured there will be no advantage in redeeming currently outstanding bonds to purchase new bonds.

The dollar limit on annual purchases of E bonds by an individual will be reduced to $5,000 purchase price from the $20,000 face amount limit currently in force. The annual limit on H bonds will be reduced to $5,000 face amount from the current $30,000 (on H bonds the issue price is the same as the face amount). Nontaxable exchanges of Series E bonds for Series H bonds will not be counted against these new annual purchase limits.

The original maturity of the Series E bond will be shortened to 5 years 10 months from the current 7 years. The maturity of the Series H bonds will continue to 10 years. Both bonds will be extendible at the discretion of the Secretary of the Treasury.

Freedom Share

The Freedom Share will continue on sale for 6 months following Congressional approval of the proposed legislation. This continuation period will provide a reasonable time for subscribers to convert to the purchase of savings bonds and will also facilitate payroll and accounting changes. Legislation is being requested to provide authority for an extension of Freedom Shares similar to those available on savings bonds.

Additional copies of this circular will be furnished upon request.

Alfred Hayes,
President.

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