

3.1

3231

March 27, 1922.

My dear Governor:

Governor Harding has handed me your letter of March 22, 1922, to him on the subject of the purchase and sale of Government securities by the Federal Reserve Banks, with particular reference to transactions in Treasury notes and certificates by the Federal Reserve Bank of New York. I think it has always been clear that the Federal Reserve Bank of New York has taken care not to be itself a purchaser or seller for its own account when executing orders for the Treasury or for account of any of the funds under the control of the Treasury, and there has been no suggestion in my correspondence with Governor Harding of any criticism of the Federal Reserve Bank of New York on this score. I think it is also clear that at least until the beginning of the present calendar year the operations of the Federal Reserve Bank of New York in the market for Treasury notes and certificates have been helpful to the Treasury's program. Within the past three months, however, the character of the operations has somewhat changed, and the Federal Reserve Bank of New York, with other Federal Reserve Banks, has from time to time acquired large blocks of short-term Treasury securities for its own account, which are apparently being carried as investments for the purpose of earning money to meet expenses and dividends. Purchases and sales of Government obligations under Section 14 of the Federal Reserve Act are required to be made, as you know, under

rules and regulations prescribed by the Federal Reserve Board, and the question whether such purchases will be permitted in order to provide the Federal Reserve Banks with earning assets is doubtless a question of Federal Reserve policy which will have to be determined by the Federal Reserve Banks and the Federal Reserve Board. From the point of view of the Treasury, the matter is important, first, because of its relation to the market for short-term Government securities and its consequent effect upon new offerings, and second, because of its relation to investments which the Treasury must make for account of the several funds under its control. On the first point the Treasury is interested, of course, to avoid anything that may create an artificial situation and embarrass the Treasury in locating the investment basis on which its securities ought to sell. It is difficult to say what effect the holding of substantial blocks of securities by the Federal Reserve Banks for their own account may have on the market, but with the reduced amounts of Treasury certificates and Victory notes outstanding and the active demand for Treasury notes of all series, I am inclined myself to think that the holding of between \$250,000,000 and \$350,000,000 of these securities in the aggregate by the Federal Reserve Banks is not a negligible factor in the market, particularly when the probabilities are that this amount represents in substance the marginal supply. To some extent, the reaction is the same on the Treasury's investments of trust funds under its control, and the result of heavy purchases

by the Federal Reserve Banks is naturally to skim off most of the floating supply in the market, with the result that even though the Federal Reserve Banks may take care not to purchase for their own account in handling Treasury orders, their previous purchases may have made it next to impossible for the Treasury to accumulate the desired amount of securities. The present calendar year, moreover, has seen an important change in the attitude of the Federal Reserve Banks toward the disposition of the short-term Government securities purchased. Heretofore the Federal Reserve Banks have been willing to sell to the Treasury, at least at prevailing market prices, Government securities acquired for their own account, and from time to time have freely sold their holdings in the market whenever conditions made it seem advisable. But now that the policy of holding Government securities for investment has been adopted, the Federal Reserve Banks are apparently confining their operations to purchases and are not prepared to dispose of their holdings, except, of course, upon redemption at maturity.

I hope you will not get the impression from the recent correspondence and discussion on this subject that the Treasury is either critical or unappreciative of what has been done in the past. I have been concerned rather with what seemed to me the dangers involved in the rapidly mounting holdings of Government securities by the Federal Reserve Banks for their own account, to which the Federal Reserve Board itself had begun to call attention in its successive weekly statements as to the condition of the Federal Reserve Banks.

Very truly yours,

(Signed) S. P. Gilbert, Jr.

Benjamin Strong, Esq.,
Governor, Federal Reserve Bank,
New York, N. Y.