

DIARY

Book 87 .

September 1 - September 9, 1937

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TREASURY DEPARTMENT

WASHINGTON

CONFERENCE BY DR. BURGESS, MR. TAYLOR,
MR. MATTHEWSON AND MR. BELL WITH THE FOLLOW-
ING REPRESENTATIVES OF THE NEW YORK FINAN-
CIAL INSTITUTIONS ON THE FORTHCOMING TREASURY
FINANCING

Mr. Garner and Mr. Kraft,
Guaranty Trust Company,
September 1, 1937,
10:10 a.m.

Essential that we have two issues. Indications are that the Treasury will have to issue one fairly short maturity and can possibly go into an intermediate bond for the second. They prefer a two-year note but realize that September, 1939, is already filled up so they suggest a three-year (September 15, 1940) at a rate of 1-5/8%. They figure that this would sell on about a 1.55% basis or 10/32. They say that we could also sell a five-year note (September 15, 1942) at 3% but that possibly the Treasury would not want to go this high on a note which is fully tax exempt. They do not hesitate to recommend a 7-1/2 year bond (March 15, 1945) with a coupon of 2-1/2%. They believe that the banks would buy the five-year 2% note and they also believe that the banks would buy the 7-1/2 year bond. They are quite certain that the insurance companies would buy the bond and that possibly the country banks would be interested. They do not feel that a ten-year 2-3/4% would go at all.

Commenting on general market conditions, they feel that the market recession in the late spring went too far and then on the recovery it went too far the other way so that this present market is more of an adjustment. There has been no extreme liquidation in the present market but it is more of a complete lack of interest which has created a thin market. They think there might be some preparation at this time for fall trade; they are not concerned with the present Reserve situation. There is no indication that the present Reserve situation is causing any pressure on the market.

There was then quite a discussion on the present Treasury bill policy of six and nine months. This is not so important in this financing but for the record, they are much in favor of adjusting our present maturity to sixty days and tax payment dates and ridding the market of the nine-month bills. They feel that if the Treasury wants security of this kind, it should resort to one-year Treasury certificates.

Colonel Pope and Mr. Love,
First National Corporation,
11:00 a.m.

There was a general discussion of the market situation and the attitude of certain investment policies of institutions with which they had come in contact. They feel that the market at this time has a much better tone and that it will no doubt improve. They have been in touch with some New England institutions and many of them were following a policy of investing 90% of their money in governments and after a meeting of the Board of Directors as to what to do with the other 10%, would wind up by investing it also in governments.

They thought it was a mistake for the Treasury to consider putting out only a two or three-year note. This would have the tendency of forcing the longer term bonds up through scarcity. They believed in the policy of extending the debt over as long a period as possible. While in Chicago two weeks ago there was some talk of a ten-year 2-1/2% bond, and at that time they thought it was worth consideration; now, however, the period of maturity will have to be reduced. They thought that a 7-1/2 year 2-1/2% bond was highly desirable and would help the market. There should be a choice of two securities, one the bond and the other a short-term of two or three years. It would be very difficult to put all of the refunding into one issue. It was their thought that a three-year note at 1-5/8% would go well.

They had contacted one prominent banker in the West who usually leans toward a short-term security, but this time said he would exchange his 3-1/4's for a 7-1/2 year 2-1/2% bond rather than a three-year 1-5/8% note, but that he would much prefer to either of these a five-year 2% note. Obviously he was thinking of his earnings.

In their inquiries as to the present market situation they have received divided opinions. Some have the opinion that the market is still going down and others that it will go up after the September financing. The consensus of opinion is, however, that there will not be very much activity in the market for some months. Colonel Pope expressed a personal opinion to the effect that he thought the market would be dull for some months to come.

They estimated that about \$75,000,000 of the maturing issue is held by corporations. They know that General Motors holds \$26,000,000 and are satisfied that it will not go into any security with a maturity longer than two years, but if this corporation or others do not like the issue offered they will, no doubt, sell their holdings in the market and take advantage of the premium on rights. They feel that a five-year 2% note would pull more subscriptions than a 7-1/2 year 2-1/2% bond, but they believe that from the standpoint of the Treasury the issuance of a bond at this time would look much better and that we could expect as many as \$300,000,000 in subscriptions for this security. They feel that the insurance companies will buy the bond. They said that there was a great deal of talk in the Street about a one-year 1% security but it was their opinion that this would look weak from the standpoint of the Treasury and might interfere with the nine-month bills.

There was then some discussion of Treasury bills. They also indicated that the Treasury bill program should be changed some time in the near future. They are of the opinion that the Treasury should put out a security like a one-year certificate for which the country banks can subscribe. These banks are not now familiar with the bidding on discount bills and the discount on the bills is so small that the city banks will not go to the expense and trouble of telephoning the country banks about this security.

Mr. Ihlfeldt and Mr. Johnson,
Savings Banks Association in New York State,
12:00 o'clock.

They said that there was about \$10,000,000 of the maturing security held by the Savings Banks of New York State; That there was about \$5,000,000 held by the Central Savings and Trust Company. They said that the Savings Banks were not at the present time buying governments and what few they are buying are for a term averaging less than ten years. They say that their deposits have not increased during the past year because they believe a lot of the Savings Banks' funds are going into building and loan association Government guaranteed

shares; that there was very little money now being loaned on mortgages. They do have some excess funds for investment but they are unwilling buyers of governments. They indicated that it was their belief that all of the Savings Banks which hold the maturing issue would take anything offered in exchange rather than sell the rights. They seem to be waiting for an increase in interest rates. They thought that probably the Savings Banks would prefer a seven or eight-year bond over a five-year note. Certainly they would prefer this over a three-year note. Savings Banks of the State of New York now hold \$1,100,000,000 of Government securities, of which approximately 12% is in the various note issues. They thought that if the banks would take any bond offered they would hold it and it would not find its way back on the market immediately after its issuance. They thought the Treasury could issue a three-year 1-5/8% note and that it would sell for about par and 10/32. An additional issue of the notes issued last June would also go (1-3/4's of 1942 or 1-3/8's of 1939).

Upon being asked what other factors in the situation were operating to reduce savings deposits, they named the Savings and Loan guaranteed shares, United States Savings Bonds and the increase in the sale of life annuities.

Speaking for the Central Savings Trust Company, they would prefer the three-year 1-5/8% note for the \$5,000,000 which it holds. They were of the opinion that the Treasury could get no secondary market from the savings institutions.

Luncheon Conference,
1:00 p.m.

With Governor Harrison, Mr. Benson
of the Dime Savings Bank, and
Mr. Parkinson of the Equitable Life
Insurance Company.

Just prior to luncheon and while we were waiting for Mr. Parkinson, we had quite a discussion with Mr. Benson and he gave about the same story as Mr. Ihlfeldt and Mr. Johnson on the savings bank situation. He has \$1,500,000 of the maturing notes and would prefer a five-year note or less. He says that the only investment money that he is now getting are the funds coming in from the liquidation of mortgages and, of course, their earnings. There are no increases of deposits. His mortgage rate is now 5% and he is losing

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some of his investments to life insurance companies which are offering a 4 to 4-1/2% rate. He, of course, would like to convert some of his cheap Government bonds into 5% mortgages, but this apparently is not working out very well. He has \$14,000,000 in cash and says that most savings banks are in the same position. They have lots of cash but will not go into long term maturities. He thought that a seven or 7-1/2 year 2-1/2% bond would go and that the savings banks might buy some of them; but that a five-year 2% note or less would be preferred - more as a temporary investment.

At the luncheon Mr. Parkinson said that he would not want notes for his company. He has none of the maturing issue. If we were offering a bond for cash, he would subscribe to the bond and he would probably buy a seven-year 2-1/2% bond if it is issued. He thought other life insurance companies might also furnish secondary markets for such a security. He explained that while insurance companies would go into a security of this kind at this time, it does not meet their required earning minimum; that his company is on a minimum earning requirement of about 3.08. He thought other insurance companies were on no less and probably a higher basis. It can be seen, therefore, that any investments of insurance companies in a 2-1/2% security is more or less of a stop-gap and something to give them liquidity and a small return while awaiting other investment possibilities. There was no question but what the insurance companies had plenty of cash ~~to invest~~ as insurance business had increased and they were getting large receipts from repayments of loans on policies. He was asked what he thought of the present situation in the money market. He replied that the present dullness of the bond market was due to bad news from abroad, the continued unbalanced budget, and continued rumor concerning the policies of the Administration on reducing the price of gold. He said this rumor was still prevalent and only this morning he had heard about it again from St. Louis.

Mr. Tompkins,
Bankers Trust Company,
2:15 p.m.

Mr. Tompkins started out by saying that the Treasury should have two issues. He feels that we should venture into the longer term - say seven or eight years, ~~issued~~ as he thinks there is a present demand for this kind of security. Then we should have a short-term note which would be a sure thing. He would prefer a two-year 1-3/8%

or possibly 1-1/2%. He thought that the combination suggested of a two-year note and a seven-year bond would assure success in this refunding operation. He felt that the reserve situation at the present time is a factor in this market and that the fall demand is now beginning to show up. Indications are that it will require about \$500,000,000 cash over present requirements to take care of it. There is also some talk about the call rate being increased to 2%. *Another* The factor in this situation is the world condition which makes the market nervous as they expect bad news at any moment.

He believes that there is a sufficient demand for the seven-year bond; that the banks will hold them as an investment, and we need not expect many of them to be thrown back on the market. He thought a three-year 1-5/8% note would go but would not be as sure as the two-year 1-1/2%. His definite recommendation is a two-year 1-1/2% and a seven-year 2-1/2% bond.

Mr. Morgan and Mr. Young,
Morgan-Stanley Company,
3:00 p.m.

They explained that they were corporation security dealers and that they did not know that they could give us much information about the Government bond market. They were willing, however, to comment on the present market as they see it from the standpoint of dealers in corporate securities. At the present time there is no tone whatever to the market. There are no corporate issues of any consequence pending because most people are waiting for the June 30 Audited Earnings Statements of corporations. They have found that the insurance companies will buy corporate securities but they must be attractively priced before they will be interested. The peculiar thing about it is that the insurance companies will buy a long-term corporation bond but apparently would not go into Government bonds of a maturity longer than ten years. Another factor in the situation at the present time is that private investors are buying good preferred stocks instead of bonds. They refer to commercial bankers as "scalpers" in most any bonds at this time. In other words, commercial bankers do not want bonds for investment purposes but they merely buy these securities for the immediate profit and then the securities soon find their way back onto the market, thus having a depressing effect. They find that the demand for loans is increasing although there are no large volumes of issues at the present under consideration. There are some refunding operations coming up before the first of the year which aggregate over \$100,000,000.

In this forthcoming Government financing they have asked themselves the question: Who would buy the two securities talked about in the Street - one a 5-year 2% note and the other a 7-year 2-1/2% bond. They say the banks will certainly take the notes and possibly individuals because of the tax-exempt feature. They thought that the insurance companies and some banks would take the bonds because of the rather attractive coupon for a short-term security. There is no doubt but what there will be substantial buying in the market of the bond. They both agreed on this.

Mr. Aldrich and Mr. Green,
Chase National Bank,
3:30 p.m.

Mr. Aldrich thought the Treasury might try additional issues of the 1-3/4% of last June and, say, the 2-3/4% bonds of 1945-47. He said it had been suggested in the Street that we have a 15-month 1% but he feels that this would not go and if it was tried should be 1-1/8%. He also said that from the standpoint of the Treasury this looks weak to issue such a short-term security. As to a 5-year 2% note the banks would certainly come in rather heavily. If there is to be a bond, he would prefer the period 1943 to 1945. He called attention to the fact that the 3-3/4% of 1943-45 are selling on about a 2.29% basis; that any security put in 1944 or 1945 would probably, after a few days, sell on a basis of 2.40% to 2.45% at the present market.

He has found no tendency in his bank to increase loans and there are some indications that loans are actually decreasing. He is not alarmed about the reserve position as a reduction in the discount rate has made it a simple matter for the banks to borrow from the Federal Reserve Banks.

He finally wound up by saying that he thought that a 3-year 1-5/8% note would go well and the Treasury might do the whole job with that.

Conference between Mr. Taylor and
Mr. Bell and Mr. Gordon Renschler,
President of the National City Bank,
and Mr. Blair, Vice-President, at
Mr. Renschler's home.
9:00 P.M.

Mr. Renschler was enthusiastic for a 7-year 2-1/2% bond. He called attention to his previous recommendations that the Treasury

should try to put all of its long-term financing on a basis of 10 years at 2-1/2%, constantly rolling over the maturing issues for a 10-year period. In view of his recommendation in this connection, he feels that a 7-year 2-1/2% bond is even better than the one he had previously suggested. He also is in favor of a 3-year 1-5/8% note which would give the holders of the maturing issue a choice of securities. He told us that not only would his bank subscribe to the bond for the amount of its holdings of the maturing issue but that it would buy rights in the market to exchange for the bonds. He also said that the Home ~~State~~ Insurance Company, of which he is director, would buy \$10,000,000 of these bonds. Said that he thought the bonds would be ideal for the insurance companies. There was some discussion of the 1-year 1-1/8% or 1-1/4% but he did not have the feeling that some of the others had on the next day about the short-term security. He thought that it was not necessary for the Treasury to go down as low as the one year or 15 months.

His bond man, Mr. Leo Kane, had submitted to him a memorandum in which he stated that 7-year 2-1/2% bond and the 3-year 1-5/8% note would suit the requirements of the National City Bank.

* * * *

Mr. Devins,
Devins and Company,
September 2, 1937,
9:30 a.m.

Mr. Devins said that he would prefer two issues of any one of the following Treasury notes:

- 15 months at 1-1/8%
- 2 years at 1-1/2%
- 3 years at 1-5/8%
- 4 years at 1-3/4%, questioning the latter and

that this might have to be increased to 1-7/8%. He thought that the one and four years are the best; possibly you could do a two-year and a four-year. After all, they are close together. He stated that the General Motors Corporation has approximately \$27,000,000 of the maturing notes. He is quite certain that it will want cash. The First of Baltimore has about \$30,000,000 and it will probably want an issue of 1940 and not longer than 1941. He named certain banks in New York City which had more than \$100,000,000 and he doubts very much whether they would take anything beyond the 4-year period. (The banks named, however, indicated that they would be interested in a 7-year bond.) He says he just can not see a bond or a 1942 note. We have got to be careful not to issue a security that will hang heavy on the market and then it will be the unpleasant duty of the Federal Reserve System or the Treasury to support the whole market. He says he has shopped around in the last two or three days among several of the banks and dealers and he gets a very definite sentiment for the short note. He thinks the Treasury has got to put out a 15-month security in order to be sure that its offering will be a success.

Mr. Swihart,
C. F. Childs Company,
9:45 a.m.

Mr. Swihart says that he can not see anything beyond three years. In his talks all over New York and throughout the country only one has mentioned a bond. Few have talked 1-7/8% and a 2% five-year note and he only had one suggestion of a 7-year 2-1/2% bond. There are no buyers of Government securities in the present market. He suggests the following Treasury notes for consideration:

- 15 months at 1-1/4%
- 2 years at 1-1/2%
- 3 years at 1-5/8%
- 5 years at 1-7/8%

He feels that the banks would take a 7-year 2-1/2% bond but that the bonds would soon be back on the market and then we would see

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further declines in Government securities. He feels that short term rates are definitely going higher and questions whether we can hold the higher rate securities from declining when the short term rate advances. He does not question but what we can convert the whole amount of the maturing issue into a 3-year note. He knows of one banker who has \$50,000,000 of the maturing issue who will not go over a 3-year note. He has talked with the Metropolitan Insurance people and he said they would not be interested in anything over three years.

Baker
Mr. Parker and Mr. Oill,
Bank of Manhattan,
10:00 a.m.

They said there are two thoughts at the present time: The New York attitude is for a short term security and the outside New York attitude is for a longer security. Their feeling is that the Treasury should stick to one issue, say a three-year 1-5/8% note. This is a generous rate and they thought that the whole market would go up with that issue, whereas if we offer two issues the lower premium will bring the higher premium down to it and thus have a tendency to depress the whole market. Their bank has a feeling that rates are going up. There is now a definite tendency for commercial loans to increase and their bank's loans are now up 31% over last year.

Mr. Park,
Manufacturers Trust
10:45 a.m.

He feels that the Treasury should issue one or two notes. He does not think that a bond issue would be received very well. He thought that a 15-month 1% note would sell on about a 6/32 premium and that a 1-5/8% 3-year note would sell on a 15/32 base. When he came into this conference he was definitely of the opinion that we could not go over 1940, but when he was asked his opinion as to a short note and a 7-year 2-1/2% bond, giving the holders of the maturing issue a choice, he replied that he had not looked at it from that standpoint but thought that that was a good suggestion and had a lot of merit in it. As the conference progressed he became more enthused about the short note and intermediate bond. He thought we might get as much as \$250,000,000 or \$300,000,000 in bonds. He does not feel that the bond would depress the market and he did not feel that any of them

would take the bond merely for the profit involved. He thought the insurance companies and larger banks would certainly take the bond to a limited extent and the insurance companies, in view of their large cash balances, might even furnish some secondary market for them. He concluded by saying that he was definitely of the opinion that the Treasury should issue a 1-year 1% or a 3-year 1-5/8% note and a 7-year 2-1/2% bond. He thought the combination of either of these short notes and the bond of this maturity and coupon would be ideal for the market.

Mr. Traphagan,
Bank of New York and Trust Company,
11:30 a.m.

He feels that the Treasury is forced to do something short this time. A long term bond would completely disrupt the bond market. He thought that a 3-year note at 1-5/8% would go and that we should offer but one issue. He does not feel that the money market is going to get tight as many in New York do. He finds that the average banker of today is trying to find a way to get out of long bonds, certainly those with a maturity of beyond 10 years. He is afraid that if we give an option to take a 3-year note or a 7-year bond and if the bonds do not go well, it would hurt the whole market. He does not hesitate to recommend one issue of 3-year Treasury notes at 1-5/8%.

Incidentally, he is very much in favor of the 9-month Treasury bills and he has found that some out-of-town banks like them. He feels that short term rates may go up some and as more Treasury bills are put out corporations may come into the market for these bills. This would cause a temporary deflation in bank deposits but as the proceeds of the bills are put out by the Treasury this situation would be corrected.

Mr. Baker,
Travelers Insurance Company,
12:10 p.m.

He feels that the Treasury is compelled to resort to very short maturities. His first suggestion would be to issue additional amounts of the securities offered in June with an option. He said the Treasury might go to a 5-year note at 1-7/8%. He feels, however, that the insurance companies do not want any more governments and that they will not buy them only as a stop-gap. He had some figures which showed that the cash balances in the life insurance companies at the present

time are about \$500,000,000, down about \$250,000,000 from last year, and that the investments in government securities are up about \$800,000,000. This cash balance is below normal for the past 3 years but prior to that time two to three hundred million dollars was about the average balance.

He says that there are other investments coming along now with much more attractive yield than governments and that the insurance companies are turning to this field. They are not, therefore, much interested in anything that the Treasury does on September 15. Dr. Burgess asked him if he would be interested in the bond of 7 years at 2-1/2% which had been suggested. He said that he might be interested in this and he thought it might attract some of the insurance companies' cash. He said that on the way to the bank he was looking at the list and thought that a 1-year 1-1/8% or a 4-year 1-3/4% or 5-year 1-7/8% would go. In conclusion he said that he thought the choice of the bonds and a short note would represent a good program. He did not feel that the bond would be a depressing factor and that we might expect as much as \$300,000,000 in exchanges on the bond alone, the balance of the issue going to notes.

Mr. Davison and Hollingsworth
Central Hanover Trust Company.
12:15 p.m.

These were the most pessimistic representatives that we interviewed. They were very definitely of the opinion that a bond would completely upset the market. They thought we must confine our offering to two issues of a short-term character, one a 15-month note at 1-1/4%. He said that yesterday they would have said 15-months at 1-1/8% but the change overnight would make the rate 1-1/4% in order to insure its success. They thought that the 5-year note of last June was a mistake. It has clearly been a speculative issue from the very start. They thought one very good suggestion was to put the whole issue into a 15-month note at 1-1/4%. The corporations that hold the maturing securities, such as General Motors, would exchange it for the 15-month security and hold them until maturity, but he did not feel that any of the corporations, particularly General Motors, would go over 2 years. As far as their bank is concerned they have no particular choice as between the 15-month 1-1/4% and the 3-year 1-5/8% and that they probably would go 50-50 on the two issues. Mr. Davison wound up by saying, however, that it would be less disturbing to the whole bond and security market if we would have just one issue.

Mr. Hutchins,
Irving Trust Company,
2:30 p.m.

He said his bank has none of the maturing issue but they have about \$100,000,000 maturing in 1939. While he realizes that for the Treasury to issue a security around this date would conflict with their holdings, it seems clear that there will have to be two issues put out. He prefers a 15-month 1-1/4% and 3-year 1-3/4%. He is quite certain that a bond would depress the present market, probably as much as a half a point. He says that the Government securities which the bank holds averages a maturity of about 2 years. He is quite strong against a bond at this time and is also against a 5-year note. He thought that the insurance companies, trust estates and some of the banks would take a bond and that if the Treasury is insistent upon an intermediate bond he would suggest that it be a 15-month note and a 7-year bond. Because of its policy, his bank would very definitely not buy these bonds, but he would recommend them to his customers.

Note: In considering the statement of the representative of the Irving Trust Company we should not lose sight of the fact that the policy of this bank is to hold government securities of an average maturity of not more than 2 years and that it is definitely against holding any bonds at all.

Mr. Levy
Solomon Brothers and Hutzler
2:00 p.m.

Mr. Levy feels it has got to be short, a choice of the 3-year 1-5/8% or a 4-year 1-3/4% note. He does not know who would buy a 7-year bond and if the Treasury wants something longer he would be more in favor of a 5-year 2% note than a 7-year bond. He would issue two securities, giving the holders a choice at the rate and term above indicated.

Mr. Mills and Mr. Repp,
Discount Corporation,
3:30 p.m.

Their conversations with the various banks indicate that the opposition to the suggested bond issue does not come from those who have the maturing issue, but comes from those who hold those bonds that mature around 1943 to 1945. The last hour of the market

- 14 -

today has turned against these issues, which indicates that the market is reflecting some of the discussions. He thought that there was one very important factor in this whole situation which no one is talking about in their discussions of this subject, and that is that the Treasury is paying off \$350,000,000 maturing Treasury bills around September 15 with cash. This certainly will create a tremendous vacuum in the market and will make that money available for investment. They can not see what the banks are going to do with this except to buy Treasury notes and the shorter term bonds, and that any bond that we issue at this time would come in for its share of that investment. They feel that the Treasury will be surprised at the number of banks which will take a seven-year 2-1/2% bond. They also feel that the savings banks will come in much heavier than indicated by the representatives of New York Savings Banks, as they are light on maturities around 1944.

Another very definite factor in the situation is that the maturing security has a 3-1/4% coupon and the institutions that have that security will want to replace it with as high a coupon as it is possible to obtain. Therefore, the 2-1/2% bond will be attractive to them from an earning standpoint.

They feel very definitely that the issue has got to be a double header. We are now exposed to foreign news, much of which is bad, and the Street is very blue. They feel, therefore, that we have got to have one short term note which will be certain of success and to which all the banks can run in case we get extremely bad news over Labor Day. In their opinion this should be a 15-month 1-1/4% note. They feel that no matter what happens in the world situation while this security is open for subscription, this issue will be safe. They feel that a 2-year 1-1/2% note is bad because it falls on the same date as the 1-3/8% of September, 1939, and may have a tendency to throw this security below par. The other security to be offered would be the 2-1/2% seven-year bond. They feel that the shorter maturity will sell on about par and nine to fourteen thirty-seconds, whereas the 2-1/2% seven-year bond will sell on about a 3.40 basis, or about 21/32. They say that the maturing issue is fairly well scattered over the country with about seventy million dollars in the hands of insurance companies, thirty million dollars in Baltimore, three hundred million dollars in New York City banks and a great deal of it is in the hands of small country banks. They feel that the small country banks will certainly want the 2-1/2% earnings. The corporations that hold the maturing security will, of course, want the 15-month note. They were enthusiastic for these two issues, that is, a 15-month 1-1/4% note and a seven-year 2-1/2% bond.

SUMMARY

At the beginning of these conferences I believe that we had a very definite feeling that a short note issue of fifteen months' maturity was objectionable and that it would be a very definite sign of weakness on the part of the Treasury. In view of the fact that some of those interviewed stressed the foreign news as a factor in the market and for this reason made a suggestion that we have a 15-month issue for safety purposes and that in addition we offer a seven-year 2-1/2% bond with the idea that whatever goes into this maturity will be just that much advantage to the Treasury, many of our first objections were removed.

The consensus of opinion seemed to be that the Treasury could issue a short term note of between one and three years, the one-year or 15-month note at 1-1/4% and the three-year at 1-5/8%, and a seven to 7 1/2-year bond at 2-1/2%, preference leaning towards the seven-year bond. The first day of our conferences brought only one or two suggestions for the 15-month 1-1/4% note, but at the second day's conferences, probably because of the turn in the market overnight, it was the consensus of those interviewed that a 15-month 1-1/4% note would have to be one of the securities to be offered. There was a strong feeling that whatever was issued of the notes and the bonds that the larger proportion of the subscriptions would go into the note, but that we would get anywhere from \$200,000,000 to \$350,000,000 in the bond.

Handwritten initials

- 16 -

Preference of banking institutions listed

	1 yr. to 15 mo.	3 year	4 year	5 year	7 year
Guaranty Trust Co.		1-5/8%			2-1/2%
First National Corp.		1-5/8%			2-1/2%
Savings Banks Assn. of NY		1-5/8%			2-1/2%
Dime Savings Bank				Prefer 2%	2-1/2%
Equitable Life Ins. Co.		(No notes desired)			2-1/2%
Bankers Trust Co.		Prefer 3-yr 1-1/2: 3-yr 1-5/8 will go			2-1/2%
Morgan-Stanley Co.		(Some short note)			2-1/2%
Chase Natl. Bank		1-5/8%			
Devine & Co.	1-1/8%		1-3/4 to 1-7/8		
Child & Co.	1-1/4%	1-5/8%	(one is- sue)		
Bank of Manhattan		1-5/8%			
Manufacturers Trust		1-5/8%			2-1/2%
Bk. of NY & Trust Co.		1-5/8%			
Travelers Ins. Co.					2-1/2%
Central Hanover Tr.	1-1/4%				
Irving Trust Co.	1-1/4%	1-3/4%			
Solomon Bros. & Hutzler		1-5/8%	1-3/4%		
Discount Corp.	1-1/4%				2-1/2%
Natl. City Bank		1-5/8%			2-1/2%

Suggested for September 15 Financing

	One Year	15 Months	2 Year	3 Year	4 Year	5 Year	7 Year	7½ Year	Note	Preference	Bond
Guaranty Trust Co.				1-5/8%		2%		2-1/2%	3 yr. 1-5/8%	7½ yr. 2-1/2%	
First National Corp.				1-5/8%				2-1/2%	" "	" "	
Savings Banks Assn. of N.Y.				1-5/8%					-	-	
Dime Savings Bank						2%	2-1/2%		5 yr. 2%	7 yr. 2-1/2%	
Equitable Life Ins. Co.							2-1/2%		-	-	
Bankers Trust Co.			1-3/8%	1-5/8%			2-1/2%		2 yr. 1-1/2%	" "	
Morgan-Stanley Co.						2%	2-1/2%		-	-	
Chase Natl. Bank				1-5/8%					3 yr. 1-5/8%	-	
Devine & Co.				1-5/8%			2-1/2%		" "	7 yr. 2-1/2%	
Child & Co.		1-1/8%	1-1/2%	1-5/8%	1-3/4% to 1-7/8%				1 yr. 1-1/2% and	-	
Bank of Manhattan		1-1/4%	1-1/2%	1-5/8%		1-7/8%			4 yr. 1-7/8%	-	
Manufacturers Trust				1-5/8%					3 yr. 1-5/8%	-	
Bk. of NY & Trust Co.		1%		1-5/8%			2-1/2%		3 yr. 1-5/8%	7 yr. 2-1/2%	
Travelers Ins. Co.				1-5/8%					" "	-	
Central Hanover Tr.	1-1/8%				1-3/4%	1-7/8%	2-1/2%		-	-	
Irving Trust Co.		1-1/4%		1-5/8%					either one		
Solomon Bros. & Hutzler		1-1/4%		1-3/4%					1 yr. 1-1/4% and		
Discount Corp.				1-5/8%	1-3/4%				3 yr. 1-3/4%		
									3 yr. 1-5/8% and		
									4 yr. 1-3/4%		
Natl. City Bank		1-1/4%					2-1/2%		1 yr. 1-1/4%	7 yr. 2-1/2%	

Story from "Paradise of the Pacific" - September, 1937.

"Henry Morgenthau, Jr., Secretary of the Treasury, Mrs. Morgenthau and their three children--Robert, Joan and Henry III--arrived in Honolulu aboard the 'Lurline,' July 29. 'I'm here for a vacation, and have nothing to say,' explained Mr. Morgenthau. He kept his promise. Seldom have as affable and attractive visitors sojourned in Hawaii. Governor Poindexter honored Hawaii's distinguished guests on August 2 with a dinner-party; Mrs. Morgenthau was luncheon-guest of Mrs. W. F. Dillingham, August 3; on August 4 the Secretary sent nationwide congratulations to the Coast Guard on its 147th Birthday; Mr. and Mrs. Alexander G. Budge entertained the Morgenthaus with dinner and dance at Waialae Golf Club on August 4; Mr. Morgenthau and his two sons sailed August 5 aboard the Coast Guard Cutter 'Taney,' for the Big Island of Hawaii, while Mrs. Morgenthau and Joan aviated to the same destination. The Morgenthaus were guests at Kona Inn for several days, hiking, fishing, and visiting points of interest from August 6. Visited Forbe's Kukaiau Ranch; on August 7, a wild pig hunt; next day they were guests at Ronald K. von Holt's Kahau Ranch; spent eleven hours fishing off the Kona Coast and landed a small one, laughingly remarking that he had made as good a fish-

ing record in Kona waters as President Roosevelt; on the 11th motored to Kawaihae to view the cattle loading of Parker Ranch beef; next day to Volcano House and luncheon guest of George Lycurgus; while in Hawaii the Secretary sent his heartiest good wishes to the American Legion assembled at Hilo; after about a week returned to Honolulu; on the 10th Mrs. Morgenthau was honored with a luncheon by Mrs. W. F. Dillingham at La Pietra; Pearl Harbor Yacht Club had the Morgenthaus as guests at a luncheon, Commodore C. W. Dickey, Past Commodore Earl Thacker and Vice Commodore R. Alexander Anderson being the hosts; August 15 found them as luncheon guests of Mr. and Mrs. W. F. Dillingham at their Mokuleia home where they spent the week-end; on Friday, August 20, Major General Andrew Moses held a magnificent review in honor of Secretary Morgenthau at Schofield. The Morgenthaus were guests of Shirley Temple and her mother and father at the Royal Hawaiian Hotel and the Secretary danced with Shirley. Secretary Morgenthau and his family visited the Pearl Harbor (Waimomi) Navy Yard and Ford Island (Mokuumeume) on August 18 as the guest of Rear-Admiral Orin G. Murfin. All the activities of the Yard, Submarine Base, and Fleet Air Base were inspected. Admiral and Mrs. Murfin were hosts to the distinguished guests at luncheon the same day. Only a few of the many courtesies, entertainments, and other ceremonies held in honor of the welcome guests are listed above. Their schedule called for them to depart on the 'Lurline' on

August 28. We enjoyed their visit and know they did.

Come again Mr. Secretary and your family."

RB

CODAT

Paris

Dated September 1, 1937

Rec'd 2:15 p. m.

Secretary of State

Washington.

1230, September 1, 5 p. m.

FROM COCHRAN.

Paris exchange market rather active. French Control acquired some sterling at 132.82 and 81. Dollar very much bid against sterling and British Control yielded dollars. Due to political crisis centering around National Bank of Belgium with prospect of a special session of Parliament next Tuesday to hear Premier Van Zeeland's story, belga has been further offered and gold export point to New York reached. French Control has been buying belgas. Rentes irregular; Internationals upset by Far East situation. Market expects reduction of Bank of France discount rate tomorrow from four to three and one-half percent.

In the JOURNAL OFFICIEL today Chautemps Government published last series of about thirty decrees under financial powers

RB

-2-#1230, September 1, 5 p. m. from
Paris

powers granted by Parliament June 30 which expired
August 31st.

(END OF SECTION ONE)

BULLITT

DDM

PEG

RE

CODAT

Paris

Dated September 1, 1937

Rec'd 3:45 p. m.

Secretary of State

Washington.

1230, September 1, 5 p. m. (SECTION TWO)

Many of the new measures are of secondary interest. Those of importance provide for the reorganization of the French railway companies through the creation of a national company, for the extension of the suppression of the ten percent levy on interest payments to such other public security issues as the postal administration, Credit National, railways, etc., for the approval of a convention with the Credit National and for certain fiscal attenuations.

The conditions relating to the creation of the national company to administer the different railway lines are embodied in a convention between representatives of the latter and the Government dated August 31. Under its terms the national company will commence to administer the different lines dating from January 1, 1938. The concessionary companies will turn over all of their assets to the national company "except private domain". At the expiration of the life of the company in 1982 its assets will

be

RB

-2- #1230, September 1, 5 p. m.
from Paris (SECTION TWO)

be turned over to the state without compensation. The concessionary companies will receive from the national company annuities corresponding to the statutory interest, to guaranteed dividends and amortization and to shares. Furthermore the concessionary companies will receive shares of a nominal value of about six hundred ninety-five million francs in return for assets transferred by them. The State will receive shares and will possess fifty-one percent of the capital. In the board of directors the State also will have the majority of votes and the merged railways will be under the control of the Ministry of Public Works.

END SECTION TWO.

BULLITT

SMS

EMB

RB

CODAT

Paris

Dated September 1, 1937

Rec'd 3:15 p. m.

Secretary of State

Washington.

1230, September 1, 5 p. m. SECTION THREE.

The convention with the Credit National is of importance and interest. It will be recalled that this institution was organized under the terms of the law promulgated on October 10, 1919 to facilitate payments to those who had suffered damage from the war (See Embassy's despatch No. 716 of June 9, 1937). Under the terms of present arrangement Credit National will pay over to the Treasury from proceeds of loan issues one billion francs in 1937 and three billion francs in 1938 to meet outlays for public works.

The decree relating to fiscal attenuations is obviously intended to encourage the return of French capital from abroad in that as concerns increase in revenue from securities and movable capital the State undertakes not to compare general income tax declarations made in 1938 with those furnished for earlier years. Furthermore that holdings abroad repatriated before January 1, 1938 will not be

subject

RB

-2-#1230, September 1, 5 p. m. from
Paris SECTION THREE

subject to any penalization or inquiry on the part of the
administration.

END OF MESSAGE.

BULLITT

SMS

NPL

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SEP 1 1950
INFORMATION COMPANY
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WASHINGTON, D.C.

MBo

GRAY

London

Dated September 2, 1937

Rec'd 9:11 a.m.

Secretary of State,
Washington.

571, September 2, 1 p.m.

FOR SECRETARY MORGENTHAU FROM BUTTERWORTH.

CONFIDENTIAL.

I had a word about possible publicity with Sir Frederick Phillips who sails as previously reported on the EMPRESS OF BRITAIN September 4. Phillips hopes successfully to avoid any publicity but should he be called upon to make some explanatory statement to the press prior to his arrival in Washington he intends to say something to the effect it is considered by both treasuries desirable that there should be direct contacts from time to time between officials having no specific mission in order to facilitate the work which we have in common.

JOHNSON

KLP

FEDERAL RESERVE BANK
OF NEW YORK

M. F. L. Head
28

OFFICE CORRESPONDENCE

DATE September 2, 1937.

CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION

L. W. Knobe

WITH BANK OF ENGLAND.

I called Mr. Bolton at 9:30 today. Briefly reviewing the past month, he said that things had been very quiet except for the last few days. The dollar had been steady partly because they had taken all the Russian gold off the market in the last fortnight as well as the dollars offered by the Japanese against gold shipments from Tokyo to San Francisco. Today, he continued, the position looked quite different. Whereas London had up to now shown really very little anxiety over the international situation, although it had been worried from time to time, yesterday and this morning it got a real fit of the blues due to the attack by a torpedo on a British warship and this morning on a British tanker. For the time being the situation in the Mediterranean entirely overshadowed that in the Far East and there was a very definitely pessimistic outlook developing in England. This would, in his opinion, undoubtedly mean an increase in demand for dollars.

The situation in Paris, Bolton said, was a little bit better. During the month of August Cariguel seemed to have lost practically no foreign exchange but, on the contrary, probably gained small amounts. The Government's decrees had been taken fairly well and it was largely a question of whether the Chautemp Government would hang together or not. London, so far, had no decided feeling as to whether any progress had been made in France with regard to political stability. No great developments need be expected in France until the Chamber met again, which would probably be the first week in November. French elections, scheduled to

FEDERAL RESERVE BANK
OF NEW YORK

OFFICE CORRESPONDENCE

DATE September 2, 1937.

CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION

FROM L. W. Knoka

WITH BANK OF ENGLAND.

- 2 -

take place the middle of October might give quite an indication as to the political trend, particularly so because the Electoral College would be drawn at practically the same time. ^AThe movement away from Blum's socialist party would surprise nobody although there were no indications as to the direction in which such movement would be.

LW
LWK:KMG

RECEIVED

SEP 3 1937

TREASURY DEPARTMENT
DIVISION OF BANKING
FEDERAL RESERVE BANK OF NEW YORK

FS

GRAY

London

Dated September 2, 1937

Rec'd 2 p.m.

Secretary of State,
Washington.

572, September 2, 6 p.m.

FOR TREASURY FROM BUTTERWORTH.

Due to political developments, real and imagined, little business was transacted in the foreign exchange market although there was a tendency to sell sterling for dollars over and above the usual seasonal movement.

In a conversation with Clay at the Bank of England it was ironically emphasized that the declines in the American security markets today were occasioned by nervousness over the Far East situation while the London markets were similarly moved by the Mediterranean situation. Clay stressed the fact that there was little speculation on either side of the Atlantic, that commercial and industrial and employment reports were uniformly good and that the only major obstacle lay in the political field. While not disturbed at the moment he thought it possible that if a long period of nervousness was engendered by European or Far Eastern political developments the course of recovery might be decidedly affected; that

"the

FS 2-No. 572, September 2, 6 p.m. from London

"the markets probably could not stand a long period of nervousness of the type, for example, felt a few months ago during the gold scare".

I gather that the pessimism of Governor Norman over the international political situation is due not so much to any apprehension of immediate adverse developments but by reason of the fact that in his opinion there are hardly any favorable signs on the political horizon to indicate progress towards pacification in the near or intermediate future.

KLP:WWC

JOHNSON

EDA

CODAT

PARIS

Dated September 2, 1937

Received 6:19 p.m.

Secretary of State

Washington

1236, September 2, 5 p.m.

FROM COCHRAN.

Paris exchange market nervous today on news of torpedo attacks on British ships in Mediterranean. French control had bad day, one Paris American bank alone selling 400,000 pounds sterling at 132.88 for the controls account. Rentes down about 70 centimes and market unsatisfactory in spite of announcement this noon of reduction of Bank of France discount rate from four to three and a half percent, rate against securities from five to four and a half and thirty day advances from four to three and a half.

Bank of France statement as of August 26 showed increase of 1,340,000,000 francs in advances to government under authority decreed June 30, 1937. At same time Treasury current account amounts to only about 20,000,000 francs more than preceding week. Coverage 52.35 versus 53.14.

SMS:NPL

BULLITT

FEDERAL RESERVE BANK
OF NEW YORK

200 Franchises

33

OFFICE CORRESPONDENCE

DATE September 8, 1937.

CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION

FROM: L. W. Knoke

WITH BANK OF FRANCE

I called Mr. Cariguel at 10:07 today but found him very uncommunicative. Things were not as good as before, he said. Yesterday he had to support the franc by the sale of about £400,000, today of about £500,000. Nevertheless, on balance since the beginning of July, he had gained and was satisfied. I asked how the future looked to him and he replied not so very good; the external situation, as well as the internal, was a little disturbing although the internal situation was better than it had been some months ago. Nothing of such importance was likely to happen in France before the Chamber met early in November. I tried to sound him on the political situation in France but had no success at all. Their stock market was heavy; the money market continued to find it difficult to supply the Treasury with its regular requirements. "That is the old trouble."

LWK:KMC

FS

CODAT

Paris

Dated September 3, 1937

Rec'd 1:40 p.m.

Secretary of State,
Washington.

1244, September 3, 5 p.m.

FROM COCHRAN.

I called this morning at Bank of France on Cariguel who had just returned from two weeks holiday. I found that Mediterranean situation had resulted in considerable pressure on both franc and sterling. Up until 11 o'clock the French control had today yielded approximately four hundred thousand pounds and the British control had lost two million dollars. My friend added that the Paris market had been adversely affected by the release yesterday of information to the effect that the state had drawn upon its account with the bank to the extent of one billion three hundred forty million francs.

During the past two and one half weeks the French stabilization fund gains on foreign exchange were just about offset by losses but the general condition of the fund is good since it contains close to the limit of ten billion francs in gold and foreign exchange. As has been seen in the past this amount is not, however,

sufficient

FS 2-No. 1244, September 3, 5 p.m. from Paris

sufficient to hold the market very long in the face of international or domestic disturbances or heavy speculation.

KLP

BULLITT

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SEP 3 1944

THOMSON SECURITY
CORPORATION
WASHINGTON, D. C.

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris

DATE: September 3, 5 p.m.

NO.: 1244

SECTION TWO FROM COCHRAN

It is expected that shortly there will be an announcement of a five, ten, fifteen year offer of French Treasury bonds at 94 bearing five percent and totalling two and a half billion francs. There are preliminary indications that in part this operation will consolidate recently issued Bonnet bonds and perhaps raise some new funds to apply on paying off unconverted balance of Germain Martin bonds which mature on the fifth of October. On rumor of above prospect rentes opened weak today and in order to hold the market, heavy intervention was required.

Throughout the day spot franc continued weak, with forward discount widened and French control losing sterling at 132.92 to 95. Nervousness is being caused by the possibility of Fiat strike spreading to other automotive works. The National Bank of Switzerland continues to lose gold slightly and to gain foreign exchange. Although no definite clarification of the Belgian situation can be expected before the end of next week, the Belga has improved in sympathy with the dollar.

Referring

-2-

Referring editorially to Secretary Hull's declaration to the effect that the opening of international trade should relieve situation now giving rise to armaments and war, AGENCE ECONOMIQUE says that the financially and economically strong United States could help in this direction by a generous solution of war debt problem and by again opening the American money market to foreign issues.

BULLITT

EA:FL:DJW

PS

PLAIN

London

Dated September 3, 1937

Rec'd 1:50 p.m.

Secretary of State,
Washington.

578, September 3, 7 p.m.

FOR TREASURY FROM BUTTERWORTH.

Although the London security market exhibited less nervousness than yesterday the foreign exchange market continued under the influence of political developments and consequently again dollars were more than seasonally in demand. The French fund supported both the spot and forward franc through sales of sterling.

There is quoted below an article by the city editor of the TIMES inasmuch as his expressed attitude is not dissimilar from that of British Treasury and the city generally.

"The Bank of France yesterday further reduced its discount rate by one half per cent to three and one half per cent. This cheapening of money had no observable effect on the exchange and it was looked upon like the last reduction on August 3 as another gesture of official confidence. The French bourse like the London stock exchange was more affected yesterday by the incidents in the Mediterranean and the Far East than by domestic

events;

Regraded Unclassified

FS 2-No. 578, September 3, 7 p.m. from London

events; indeed French rentes were lower on the day. The emergency powers to legislate by decree which were given to the French Government have now expired and the Chautemps-Bonnet programme of financial rehabilitation may therefore be said to have entered upon its second and more important phase. The first phase has involved the passing of a great many decrees covering practically the whole range of French economic life and the Government may certainly claim to have made the most serious attempt yet seen to secure a complete rehabilitation of French finance. The Government can also claim to have met with some success. They have arrested the flight of capital and they have laid down a comprehensive policy which if faithfully pursued will undoubtedly vastly improve the condition of French finance. The programme has involved a further devaluation of the franc to about 133 though further devaluation may be necessary, for the wholesale price level in France has risen in the past fifteen months from 372 to 589--the imposition of new taxes direct and indirect, wide economies, a drastic cutting down of public works schemes and a plan for railway nationalization which was certainly necessary in order to reduce the heavy and growing railway burden on the budget.

Government securities have made only a relatively slight response to all these measures of recovery though they

FS 3-No. 578, September 3, 7 p.m. from London

they have included the establishment of a rentes equalization fund and the removal of the ten per cent Laval tax on the interest derived from rentes. On June 28 when M. Bonnet actually took office three per cent rentes stood at 69.60; the current quotation of 74.45 shows a rise of only seven per cent. This indicates that it is still too soon to judge the results of the Chautemps-Bonnet plan. Of course the programme would be completely upset if under political pressure the Government had to resume their social reform and restriction policy for that would wreck the plans for restoring equilibrium in French economic life and stimulating her production and trade on sound lines. So far there has been no return worth mentioning of French capital and if the programme of rehabilitation in the second phase succeeds in bringing any substantial amount of capital back to France then it will be possible to say that the great problem of restoring confidence has been solved. Meanwhile French capitalists have been given to understand that if they bring back their capital by the end of the year no penal measures will be taken against them. But clearly the capital that has been sent abroad will be in no hurry to return pending a clearer indication than it is possible to obtain today of the results of the Government's policy."

KLP

JOHNSON

Fin

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE: September 3, 1937

To Secretary Morgenthau

FROM M. A. Harris

Suggested Issues

Market Basis

Premium

NOTES

1-1/4% (12-15-38) (1-1/4 years)	1.02	9/32nds
1-5/8% (9-15-40) (3 years)	1.50	12/32nds
1-3/4% (9-15-40) (3 years)	1.50	23/32nds
1-3/4% (9-15-42) (4 years)	1.62	16/32nds
2% (9-15-43) (5 years)	-	24/32 to 30/32nds

BONDS

3-1/2% (9-15-44) (7 years)	2.40	20/32nds
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<u>Treasury Bonds</u>	<u>Closing Bid Prices Aug. 9th*</u>	<u>Closing Bid Prices Sept. 3rd</u>	<u>Net Change for period</u>	<u>Current Yield</u>
3-3/8s 1940-43 (Jun)	105.28	105.7	-.21	1.44
2-3/8s 1941-43 (Mar)	106.22	105.18	-1.4	1.74
3-1/4s 1941	106.20	105.20	-1.0	1.75
3-3/8s 1943-47	107.19	106.2	-1.17	2.25
3-1/4s 1943-45	106.31	105.14	-1.17	2.28
3-1/4s 1944-46	106.30	105.9	-1.21	2.38
4s 1944-54	112.16	110.20	-1.28	2.40
2-3/4s 1945-47	103.11	101.25	-1.18	2.50
3-3/4s 1946-56	111.	109.2	-1.30	2.56
3s 1946-48	104.30	103.14	-1.16	2.56
3-1/8s 1946-49	105.25	103.31	-1.26	2.61
4-1/4s 1947-52	117.	115.16	-1.16	2.50
2-3/4s 1948-51	101.18	99.30	-1.20	2.75
3-1/8s 1949-52	105.19	104.	-1.19	2.74
2-1/2s 1949-53	99.3	97.14	-1.21	2.69
2-3/4s 1951-54	100.20	99.4	-1.16	2.82
3s 1951-55	103.20	102.4	-1.16	2.82
2-7/8s 1955-60	101.15	100	-1.15	2.87
2-3/4s 1956-59	100.15	98.30	-1.17	2.82

Treasury Notes

3-1/4s 9/15/37	100.20	100.8	-.12	-
2-5/8s 2/ 1/38	101.5	100.27	-.10	0.51
3s 3/15/38	101.22	101.11	-.11	0.42
2-7/8s 6/15/38	102.4	101.22	-.14	0.67
2-1/2s 9/15/38	102.5	101.24	-.13	0.78
1-1/2s 3/15/39	100.30	100.12	-.18	1.25
2-1/8s 6/15/39	102.1	101.15	-.18	1.28
1-3/8s 9/15/39	100.21	100.3	-.18	1.32
1-3/8s 12/15/39	100.21	100.2	-.19	1.35
1-5/8s 3/15/40	101.	100.12	-.20	1.47
1-1/2s 6/15/40	100.20	100.2	-.18	1.47
1-1/2s 12/15/40	100.18	99.30	-.20	1.52
1-1/2s 3/15/41	100.16	99.28	-.20	1.54
1-3/8s 6/15/41	100.1	99.16	-.17	1.51
1-1/4s 12/15/41	99.26	99.	-.25	1.49
1-3/4s 3/15/42	100.23	100.	-.23	1.75

*Closing prices the day before the recent decline began.

	<u>Av. price of Treasury Bonds</u>	<u>Av. yield on Treasury Bonds</u>
April 1 (year's low point)	103.04	2.70
June 5 (Saturday before announcement of June financing)	104.74	2.51
August 9 (recent high point)	105.54	2.40
September 2	104.12	2.56

TREASURY DEPARTMENT

43

INTER OFFICE COMMUNICATION

DATE SEP 3 1937

TO The Secretary
FROM Herman Oliphant

Re: Legislative Report

Summary of This Report. Attached is the final chart on the progress of our legislation (other than internal revenue) in the first session of the 75th Congress, which indicates that out of 32 bills recommended to Congress during the session 22 have been enacted into law and 10 are still pending. This compares favorably with the 1936 session when 21 bills were enacted and the 1935 session when 19 bills were enacted. The status of the Government Reorganization Bills is also indicated on the chart because the Legislative Section of this office expended a great amount of time and effort in performing the legal work (drafting bills, preparing supporting data, committee reports, etc.) in connection with those bills. Of the 10 Treasury-sponsored bills which were left pending in Congress, 6 have passed one House and two of those six have been reported in the other House. These pending bills, of course, do not die as they would at the end of the last session of a Congress, but continue next session from the point they reached at the end of the session just completed.

Detailed statement of status of pending bills.

(1) The Omnibus Customs Bill. This bill contains many complicated and technical amendments to certain administrative provisions of the Tariff Act of 1930. H. R. 6738 was introduced by Mr. Doughton on April 28. Thereafter extensive public hearings and executive sessions were held before the Ways and Means Committee lasting over five weeks. On August 3 the Committee

reported a clean bill (H. R. 8099) which was passed by the House on August 19 and sent to the Senate where it is now pending before the Senate Finance Committee.

(2) Increase the Efficiency of the Coast Guard. This bill is designed to provide a selective system for weeding out incompetent Coast Guard officers. The Senate bill (S. 2575) passed the Senate on August 7. The House bill (H. R. 7486) was reported by the House Merchant Marine and Fisheries Committee on August 10. Attempts by Chairman Bland during the closing days of Congress to secure the passage of the bill by unanimous consent and by suspension of the rules were unsuccessful, but he informs us that the bill will be passed by the House on his Committee's first calendar Wednesday call after Congress convenes in January.

(3) Forfeiture Bill. This bill provides for the seizure and forfeiture of vessels, vehicles, and aircraft used to transport narcotic drugs, counterfeiting materials, and firearms. The House bill (H. R. 6281) was referred to a subcommittee of the Judiciary Committee which reported the bill favorably to the full committee. The full committee considered the bill but failed to report it out principally, we believe, because the bill vests the power to remit and mitigate forfeitures in an administrative officer, the Secretary of the Treasury. The sentiment in the House Judiciary Committee has for a long time been opposed to administrative remission and mitigation. After a bitter fight in 1935, the Committee amended our proposed Liquor Law Repeal and Enforcement Act so as to vest in the courts the power to remit and mitigate forfeitures incurred under the internal revenue liquor laws. It may be necessary to agree to a similar amendment to the present bill in

order to get it out of the House Committee. We were somewhat unfortunate in having the companion Senate bill (S. 2389) referred to a subcommittee of the Judiciary Committee headed by Senator Burke who was in the thick of the court fight throughout the entire session. We do not anticipate such difficulty next session on the Senate side as Senator Burke has virtually assured us that he will get prompt action on the bill.

(4) Extension of the Keyes-Elliott Area. The Senate bill (S. 2339) was opposed by the District Commissioners who desired an amendment which would have required the Secretary of the Treasury to obtain their approval before closing any streets in connection with the acquisition of land and the construction of Federal buildings thereon. Senator King refused to report the bill unless an agreement could be reached between the District Commissioners and the Treasury Department. Shortly before the end of the session a compromise amendment was agreed to. Thereupon Senator King reported the bill and secured its passage. The House bill (H. R. 1653) was introduced on January 5, but in view of the controversy over the Senate bill it was not considered advisable to attempt to secure action on it.

(5) Preference in United States Proceedings. This bill provides for the granting of preference on Federal district court dockets to customs and internal revenue fraud cases. The Senate bill (S. 2386) was passed on August 6. The House bill (H. R. 6282) was referred to a subcommittee of the Judiciary Committee and several executive sessions were devoted to consideration of the bill. The sentiment of the subcommittee was not favorable to the bill and no action was taken upon it. However, it is felt that it may be possible during the next session of Congress to persuade the committee to

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report this legislation favorably.

(6) Commemorative Coins. This bill (H. R. 8036), which was introduced by Congressman Cochran of the House Coinage Committee, may be considered as a substitute for the Treasury-sponsored bill (S. 1895) which provides for the striking of commemorative medals in lieu of coins. The Cochran bill, in effect, repeals (with three exceptions, including Representative Lewis' Antietam bill and Senator Glass' Norfolk bill) all coin acts enacted prior to the effective date of the bill. This bill passed the House on August 2 and is now pending before the Senate Banking and Currency Committee.

(7) Checks on Philippine and Puerto Rico Trust Funds. This bill exempts public debt funds of the Philippine Islands and Puerto Rico from the operation of section 21 of the Permanent Appropriations Repeal Act, 1934. It was not introduced in the House because of the strenuous objection voiced last year by the House Committee on Expenditures in the Executive Departments to the identical bill which was then pending. The bill was introduced in the Senate (S. 1644) but the Banking and Currency Committee took no action on the bill.

(8) Philately Bill. This bill would permit, with certain limitations, the reproduction of illustrations of foreign and United States postage stamps and would provide for the publication by the Government of a stamp catalogue. The Senate bill (S. 2550) passed the Senate on August 14 but the House bill (H. R. 8235) was not reported until August 20, too late to be acted upon by the House.

(9) Replacement of Federal Reserve Notes. This bill would authorize the destruction of the Federal Reserve notes of the Series of 1928 and

their replacement at the expense of the United States with Federal Reserve notes of the Series of 1934. The House bill (H. J. Res. 377) was introduced on May 24 and was referred to the House Banking and Currency Committee. Numerous public hearings were held on the bill at which the legislative representatives of the Treasury appeared and, upon the request of the Committee, Chairman Eccles of the Federal Reserve Board testified. The hearings were marked by bitter political controversy among the members of the Committee upon the gold policy of the Administration and the Republican members of the Committee warned the Chairman that they would carry the fight to the floor of the House. Moreover, certain Democratic members of the Committee contended that the Federal Reserve Banks should pay for the 1934 notes out of their surplus. Because of this conflict in the Committee, Chairman Steagall was reluctant to attempt to secure action on the bill and after some months delay, the bill was crowded into the background by the Committee's consideration of the Housing bill.

(10) District of Columbia Credit Unions. This bill would transfer the jurisdiction of District of Columbia Credit Unions from the District Commissioners and the Comptroller of the Currency to the Farm Credit Administration. The House bill (H. R. 7265) was introduced on May 27 but it was impossible to secure action on the bill because the District Committee was heavily loaded with District legislation. In addition, the transfer of Mrs. Norton from the chairmanship of the District Committee to the chairmanship of the Committee on Labor resulted in temporary disorganization of the District Committee.

-6-

During the past session the Department conducted legislative business with about 23 of the 43 committees in the House and about 19 of the 33 committees in the Senate, and representatives of this office appeared before 13 committees of the House and 10 of the Senate.

Herman Oliphant

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TREASURY LEGISLATION

(other than internal revenue)

75TH CONGRESS, 1st SESSION

A. Bills Enacted

STATUS

- | | |
|--|--|
| 1. <u>STABILIZATION FUND, Extension of</u> | Approved January 23, 1937; Public No. 1. |
| 2. <u>FLOOD AREAS, Allocation of funds for</u> | Approved February 24, 1937; Public Res. No. 7. |
| 3. <u>C. F. POTTS AND C. H. BARKER, Relief of</u>
To authorize payment to Potts and Barker of the Coast Guard, the sums of \$150.26 and \$125.73, respectively, for damage to personal property resulting from fire. | Approved April 1, 1937; Private No. 19. |
| 4. <u>ORDNANCE MATERIAL, Purchase of by C. G. Officers</u>
To authorize Coast Guard Officers to purchase articles of ordnance material (small arms) in the same manner as such articles may be purchased by officers of the Army, Navy, and Marine Corps and others. | Approved April 15, 1937; Public No. 34. |
| 5. <u>GUY F. ALLEN, Relief of</u>
To allow credit to the accounts of Allen for \$126.40, representing the disallowed portion of \$138 paid by him for certain air transportation. | Approved April 15, 1937; Private No. 43. |
| 6. <u>PROFESSORS BILL</u>
To establish a permanent instruction staff (five professors and three civilian instructors) for the Coast Guard Academy; and to create a Board of Visitors to consist of members of committees handling Coast Guard matters. | Approved April 16, 1937; Public No. 38. |
| 7. <u>CAPTAIN EUGENE BLAKE, COAST GUARD, Relief of</u>
To authorize the Secretary to pay to Phillip Hudson Phillips, the sum of \$750 in satisfaction of a judgment in that sum secured by Phillips against Captain Blake on October 12, 1934. | Approved April 16, 1937; Private No. 44. |
| 8. <u>FOREIGN DECORATIONS, Acceptance of by C. G. Officers</u>
To authorize various Coast Guard officers to accept certain foreign decorations and diplomas. | Approved May 14, 1937; Private Res. No. 1. |
| 9. <u>EXCHANGE OF LAND, DALLAS, TEXAS</u>
To provide for the exchange between the United States and the Union Terminal Company of certain properties in connection with the Parcel Post Building site at Dallas, Texas. | Approved May 25, 1937; Public No. 115. |
| 10. <u>RETIRED COAST GUARD OFFICERS, Adjust rank of</u>
(1) To abolish the rank of commandant on the retired list and substitute in lieu thereof the rank of rear admiral (upper half) or (lower half) depending on whether the officer involved served actively with upper half or lower half rank and pay, and (2) to abolish the rank of commodore on the retired list and substitute in lieu thereof the rank of rear admiral (lower half). | Approved June 9, 1937; Public No. 142. |
| 11. <u>INSURANCE BILL</u>
To provide a revolving fund for reimbursement of losses on shipments of valuables by Government agencies. | Approved July 8, 1937; Public No. 192. |
| 12. <u>APPROPRIATION FOR INSURANCE BILL</u>
Joint Resolution appropriating \$500,000 for the establishment of "The Fund for the Payment of Government Losses in Shipments", authorized by the Insurance Bill. | Approved July 1, 1937; Public Res. No. 50. |
| 13. <u>JOHN L. SUMMERS ET AL., Relief of</u>
To allow in the accounts of Summers, former disbursing clerk, Frank White, C. F. Allen, R. T. Tate, and W. O. Woods, former Treasurers, the sums of \$5,241.47, \$57,507.72, \$643.00, \$14,664.94, and \$107,333.29, respectively, representing disallowances in their accounts. | Approved July 8, 1937; Private No. 208. |
| 14. <u>STEEL STAMP BILL</u>
To amend the stamp provisions of the Bottling in Bond Act. | Approved July 9, 1937; Public No. 198. |

STATUS

15. ENLISTMENTS IN THE COAST GUARD, ETC.
To authorize extensions of enlistments for 1, 2, or 3 years; to permit detention of enlisted men beyond their terms of enlistment when necessary in the public interests; to extend to personnel (not civil) the facilities of the Public Health Service; additional minor provisions. Approved July 30, 1937; Public No. 234.
16. MARIJUANA BILL
To control the sale, possession, etc. of marijuana. Approved August 2; Public No. 238.
17. SECOND OFFENDERS BILL
To increase the punishment of second, third, and subsequent offenders against the narcotic laws. Approved August 12; Public No. 267.
18. OATHS, Renewals of
To dispense with renewals of oaths of office for every change in status where the public interests will not be jeopardized. Approved August 14; Public No. 284.
19. JAMES R. SMITH BEQUEST
To authorize the acceptance of the bequest to the United States contained in the will of the late James Reuel Smith of Yonkers, N. Y. Approved August 14; Public Res. No. 59.
20. MINOR COINAGE METAL FUND
To increase from \$400,000 to \$600,000 the Minor Coinage Metal Fund, a revolving fund available for the purchase of metal for minor coins. Approved August 14; Public No. 291.
21. ESCHEAT BILL
To amend the Adjusted Compensation Payment Act, 1936, to provide for the escheat to the United States of payments to deceased veterans, which payments would otherwise escheat to the particular State or country. Approved August 14; Public No. 288.
22. SILVER DEPOSITORY AT WEST POINT
To authorize the construction of a silver depository at West Point. Approved August 21; Public No. 335.

H. Bills Pending in Congress

STATUS

- | | <u>Committee</u> | <u>Action taken</u> |
|---|--|--|
| 1. <u>OMNIBUS CUSTOMS BILL</u>
To amend certain administrative provisions of the Tariff Act of 1930; to remedy existing defects in Customs laws, etc. | Ways and Means | H.R. 6738 intro. Apr. 28, extensive public hearings and executive sessions before subcommittee; bill reintroduced as H.R. 8099 on Aug. 2 and reported out on Aug. 3; passed House Aug. 19. |
| 2. <u>INCREASE EFFICIENCY OF COAST GUARD</u>
To provide for voluntary and involuntary retirement of officers of the Coast Guard. Involuntary retirement is to be brought about by action of the President upon the recommendation of a Personnel Board convened for that purpose. | Senate Commerce;
House Merchant Marine
and Fisheries | S. 2575 reported July 22, passed Senate Aug. 7; H.R. 7486 intro. June 11, pub. hearings and executive sessions, reported Aug. 10. |
| 3. <u>FORFEITURE BILL</u>
To provide for the seizure and forfeiture of vessels, vehicles, and aircraft used to transport narcotic drugs, counterfeiting material, firearms, etc. | Judiciary, both Houses | H.R. 6281 intro. April 9, pub. hearings and executive sessions before subcommittee, reported by subcommittee to full committee; S. 2389 intro. May 10. |
| 4. <u>KEYES-ELLIOTT AREA, Extension of</u>
To amend the Public Buildings Act to include within the N.W. area (within which bldg. sites may be acquired by the Secy.) the area west of 19th St., N.W., bounded by New York Ave., N.W., E. St., N.W., and the Potomac River; also squares 122, 104, 81, 59, 58, 44 and 33. | House Pub. Bldgs.
and Grounds
Senate District of
Columbia | S. 2399 intro. May 3, pub. hearings, reported and passed Senate Aug. 14; H.R. 1653 intro. Jan. 5. |
| 5. <u>PREFERENCE, UNITED STATES PROCEEDINGS</u>
To grant preference, as to hearing and trial, to proceedings involving fraud upon the revenue of the United States. | Judiciary, both Houses | S. 2386 passed Senate August 6; H.R. 6282 intro. April 9, executive sessions before subcommittee. |

	<u>Committee</u>	<u>Action Taken</u>
6. <u>COMMEMORATIVE COINS</u> To prohibit the further coinage of commemorative coins. (This may be considered as a substitute for the bill (S. 1895) providing for the striking of commemorative medals in lieu of coins).	House Coinage Senate Banking and Currency	H. N. 8036 passed House Aug. 2, referred to Senate Banking and Currency.
7. <u>CHECKS, PHILIPPINE AND PUERTO RICO TRUST FUND</u> To amend section 21, Permanent Appropriation Repeal Act, in order to prevent the covering into the Treasury of amounts of checks on account of public debt operations of the Philippine Islands and Puerto Rico, which are not presented for payment within the prescribed period (end of fiscal year following fiscal year of issue).	Senate Banking and Currency	S. 1644 introduced February 19.
8. <u>PHILATELIT BILL (Stamp Catalogue)</u> To permit, within certain limitations, the reproduction of illustrations of foreign and U.S. postage stamps; to provide for the publishing by the Government of a stamp catalogue; and to prohibit the sale of plates.	Judiciary, both Houses	S. 2550 intro. June 19; passed Senate Aug. 14; H.R. 8233 re- ported Aug. 20.
9. <u>REPLACEMENT OF FEDERAL RESERVE NOTES</u> Authorizing the destruction of Federal reserve notes of the Series of 1928; and their replacement by Federal reserve notes of the Series of 1934, or a later series, at the expense of the United States.	House Banking and Currency	H.J.Res. 377 intro. May 24, public hearings.
10. <u>DISTRICT OF COLUMBIA CREDIT UNIONS</u> To transfer the jurisdiction of District of Columbia Credit Unions from the Commissioners of the District of Columbia and the Comptroller of the Currency to the Farm Credit Administration.	House District of Columbia	H.R. 7265 intro. May 27.

GOVERNMENT REORGANIZATION BILLS

75TH CONGRESS, 1st SESSION

1. <u>ADMINISTRATIVE ASSISTANTS TO PRESIDENT</u> To authorize the President to appoint not to exceed six administrative assistants.	House Select Committee on Government Organiza- tion.	H.R. 7730 intro. June 30 and reported July 1. Passed House July 27 and referred to Senate Select Committee on Government Organization.
2. <u>REORGANIZATION ACT OF 1937</u> To authorize the President to reorganize agencies of the Government; to establish the Department of Welfare; and to bring the independent regulatory commissions within the President's budgetary control.	House Select Committee on Government Organiza- tion.	H.R. 8202 intro. Aug. 9 and re- ported Aug. 10. Passed House Aug. 13 and referred to Senate Select Committee on Government Organization.
3. <u>REORGANIZATION OF ACCOUNTING AND AUDITING AGENCIES</u> To amend the Budget and Accounting Act, 1921, by bringing the General Accounting Office within the executive branch of the Government, clarifying jurisdiction of General Accounting Office, authorizing Attorney General to render opinions as to jurisdiction of General Accounting Office, and establishing the office of Auditor General with power to make an independent audit of the fiscal transactions of the Government as an agent of Congress.	House Select Committee on Government Organiza- tion.	H.R. 8276 intro. Aug. 18 and reported Aug. 19.
4. <u>CIVIL SERVICE ACT OF 1937</u> To abolish the Civil Service Commission, and establish a Civil Service Administration and to provide for the extension of the classified civil service and the provisions of the Classification Act of 1923.	House Select Comm ittee on Government Organiza- tion.	H.R. 8277 introduced and re- ported August 18.
5. <u>REORGANIZATION ACT OF 1937 (SENATE)</u> This is an omnibus bill which deals with all of the subjects covered by the four House bills above, there being, however, some variation in detail between its provisions and those of the House bills.	Senate Select Committee on Government Organiza- tion.	S. 2970 introduced and repor- ted August 16.

September 3, 1937

Oliphant's memo of this date on possible situations in event the Neutrality Act were invoked is attached to diary entry of December 2, 1937.

See also his memo of July 15, 1937 (filed that date in the diary) on the same subject. (8K 79: p. 51)



DEPARTMENT OF STATE
WASHINGTON

September 3, 1937

In reply refer to
Eu 861.6341/89

My dear Mr. Taylor:

With reference to my letter of July 30, 1937,
and previous letters transmitting certain information
in regard to conditions in the Soviet gold industry,
I am enclosing a copy of a further confidential des-
patch on that subject which has been received from
our Embassy in Moscow.

Sincerely yours,

For the Secretary of State:

Francis B. Sayre
Assistant Secretary

Enclosure:

No. 466, from Moscow,
August 3, 1937.

The Honorable

Wayne Taylor,

Acting Secretary of the Treasury.

Department of State

○
BUREAU
DIVISION

Eu

ENCLOSURE
TO

Letter drafted 9/2/37

ADDRESSED TO

Hon. Wayne Taylor

FOR SECRETARY MORGENTHAU

54

No. 486

Moscow, August 8, 1937.

Subject: Transmitting Memorandum Regarding
the Soviet Gold Industry.

STRICTLY CONFIDENTIAL.

The Honorable
The Secretary of State,
Washington.

Sir:

I have the honor to forward as an enclosure to
1/ this despatch, a memorandum on the Soviet gold industry
based on statements made by Mr. August Chopp, who, un-
til recently, had worked for the Soviet gold mining in-
dustry for approximately seven years. Reference is
made, in this connection, to the Embassy's despatches
No. 401, of June 23, 1937, No. 418, of July 3, 1937,
and No. 445, of July 23, 1937, relative to the same

subject.

Regraded Unclassified

- 2 -

subject.

It will be noted that Mr. Chopp states that the Soviet authorities calculate that the theoretical average cost of production for one gram of gold should amount to 12.40 paper rubles.* If this figure is correct, it is believed that it will be of considerable interest in connection with calculating gold mining costs in this country, which are naturally paid for in paper rubles.

The Department's attention is drawn to the statement made by Mr. Chopp in the memorandum to the effect that the ZAPSIBZOLOTO did not submit a completely accurate report on its 1936 production and that this trust did not actually complete the year's plan until about the middle of January, 1937, despite the fact that they had reported to the central authorities that the plan had been completed earlier. Reference is made, in this connection, to the statement in the Moscow PRAVDA of July 5, 1937, to the effect that a false annual report had been submitted by the ORMEDZOLOTO (ORSK State Trust for Copper and Gold Mining). A translation of this article was enclosed with the Embassy's despatch No. 445 of July 23, 1937.

Furthermore, it will be noted that Mr. Chopp stated that the BALEI gold mining trust was the largest

producer

* It will be recalled that the world price for gold is about \$1.18 per gram.

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producer in the Soviet Union at this time.

Respectfully yours,

Joseph E. Davies

Enclosures:

1. Memorandum, as noted.

863.4

ED:ows

Original and four copies to the Department.

A true copy of
the signed original
has *OWS*

Enclosure No. 1 to despatch
No. 418 of August 3, 1937,
from the American Embassy,
Moscow, U.S.S.R.

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July 14, 1937.

STRICTLY CONFIDENTIAL.

MEMORANDUM OF STATEMENTS MADE BY MR. AUGUST CHOPP, AN AMERICAN CITIZEN WHO HAS BEEN WORKING FOR THE SOVIET GOLD TRUST FOR A NUMBER OF YEARS, TO MR. DURBROW, THIRD SECRETARY OF THE EMBASSY.

The following is a summary of the statements made by Mr. August Chopp, an American citizen who has been working for the Soviet gold industry for over seven years, when he called at the Embassy on July 14, 1937. Reference is made, in this connection, to the statements made by Mr. Chopp at the Embassy on June 30, 1937, regarding the difficulties in the Soviet gold mining industry, which were forwarded under cover of the Embassy's despatch No. 418 of July 3, 1937:

In connection with his previous statements regarding the cost of production of gold in the Krasnoyarsk district, Mr. Chopp on this occasion explained in more detail regarding the production costs at the Berikuli mines, where he was last employed.

According to Mr. Chopp, the Soviet authorities calculate the value of gold at 1.29 gold rubles, and 12.40 paper rubles, per gram. The former figure being, of course, approximately the world price for gold, that is, about \$35.00 per fine ounce. The second figure, according to Mr. Chopp, represents the value of a gram of gold in paper rubles as used by the Soviet authorities.

in calculating the theoretical production costs in paper rubles of a gram of gold.

In connection with the second figure, he explained that it represents the calculated theoretical average cost in paper rubles for producing one gram of gold in the Soviet Union based on the average costs of production for all gold mining enterprises in the country. He added, for instance, that the cost of producing a gram of gold at the Balei mines east of Lake Baikal, which, he states, are the largest producers in the Soviet Union at the present time, is much lower than the above quoted figure, while the cost of production in the Krasnoyarsk district is higher than the average. In this connection he again pointed out that, according to the 1937 plan, the cost of production of gold at the Berikuli mines was fixed at 17.60 rubles per gram, but because of the fact that the yield from this mine fell off considerably, the actual cost during the first part of 1937 amounted to approximately 51 rubles per gram. Because of this large increase in cost, the chief engineer and his assistants had been accused of wrecking activities, and arrested.

Mr. Chopp further explained that what he terms the official rate of exchange for purchases at the so-called "Gold Stores;" namely, 9.60 paper rubles for one gold ruble, is based on the above-mentioned gold and paper ruble values for one gram of gold which give a ratio of approximately 9.60 paper rubles for one gold

- 3 -

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ruble. In this regard he added that the advantage in buying commodities in the "Gold Stores" is that the quality is usually much higher in these shops than in the ordinary State stores and that the selection is invariably much greater, thus explaining why the holders of coupons good for purchases in the "Gold Stores" usually demand approximately 15 paper rubles for one gold ruble worth of goods when buying commodities for others not in possession of such coupons.

Commenting on the article which appeared in the Moscow PRAVDA on July 5, 1937, regarding the difficulties in the gold industry and in which it was stated that the ORMEDZOLOTO (ORSK State Trust for Copper and Gold Mining) had submitted a false annual report for 1936, Mr. Chopp stated that to his certain knowledge the ZAPSIBZOLOTO (Western Siberian Gold Trust), the trust for which he was working, had also not submitted a completely accurate report on its 1936 production. According to Mr. Chopp the head of the trust, under pressure from the authorities in Moscow who demanded and expected an early report that the trust had completed its 1936 plan, submitted a report indicating that the plan had been fulfilled when in reality such was not the case. The report was based on ore "in sight" but which had not actually been mined or had not actually been brought to the surface. He added that the discrepancy was not very great but that actually the plan had not been fulfilled until about the middle of January, 1937. In connection with this matter he pointed

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out that the present head of the GLAVZOLOTO (The Chief Gold Administration), Mr. Peryshkin, was until recently the head of ZAPSIBZOLOTO, and was one of the party members who had been taken to task in the above-mentioned article in PRAVDA.

Regarding his statement that the Balei mines are the largest producers of gold in the country, Mr. Chopp stated that although he had never visited or worked in these mines, he had been reliably informed that they had now surpassed the production of the Alden and Lena fields. According to information received from a foreign colleague who had recently worked in these mines, some of the veins in the Balei district contained pockets of ore which yielded 1.6 percent gold per ton.

ED:ows

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1937

TREASURY DEPARTMENT
DIVISION OF REVENUE
WASHINGTON, D. C.

RE SEPTEMBER 15 FINANCING

September 4, 1937
9:35 A.M.

Present: Mr. Taylor
Mr. Bell
Mr. Haas
Mr. Lochhead
Mrs Klotz
Mr. Harris

H.M.Jr: Now Mr. Bell, I think before we get to New York - would you mind sketching for me, bringing me up-to-date as to where we are, with the present bill program; you know, just what the financial picture is, and the balances.

Bell: O.K. Well, we estimated that we'd go out of August with 304 million dollars with the bill program that we carried through; we had about 320 million.

H.M.Jr: Yes.

Bell: This contemplates that we put 150 million dollars in Treasury bills out in September, with maturities....

H.M.Jr: September, how much - 150?

Bell: 150.

H.M.Jr: Yes.

Bell:maturing in December. That will make a total of 500 million maturing in December.

H.M.Jr: Oh, these are December bills.

Bell: Yes, sir.

H.M.Jr: Right.

Taylor: We've got one more of those to go.

H.M.Jr: Yes.

Bell: Well, one more to announce, two more to be paid for - 8th and 15th.

Taylor: Yes.

Bell: This schedule that I have here also contemplates going right on with Treasury bills after the 15th and continuing through October, which would make 300 million additional money maturing in March.

H.M.Jr: Yes.

Bell: And I believe maybe - and I think Wayne probably will agree to this - that that schedule ought to be pushed forward two weeks.

H.M.Jr: A lapse?

Bell: Yes, sir, get two vacant dates in there so it will give the market a chance to absorb what we have put out, plus a chance to reinvest the 350 million we are paying off; and that will certainly help the market for those two weeks.

Taylor: We can stay out for two weeks - be very helpful.

Bell: I think so.

H.M.Jr: I'm going to raise the thought that we don't announce any more than 450, unless you fellows are committed to it.

Taylor: We're committed publicly to do five hundred into December.

Bell: That's right.

H.M.Jr: Supposing we say that after my return, when I see the figures, I change the - my mind. Would that let you fellows down?

Taylor: Not a bit.

H.M.Jr: Huh?

Taylor: Not a bit.

H.M.Jr: Because if it's 300 into March I'd rather build that up a little bit; we'll need it more in March.

Bell: Yes, sir, that's right.

H.M.Jr: We'll need it more in March. Let's just keep that in our mind.

Bell: I think we could very well eliminate the 15th. I don't think it would go against what you (Taylor) have already said. You said "contemplated."

Taylor: No, I said it definitely.

H.M.Jr: Think it over. I don't want to do the slightest thing that would embarrass either of you.

Bell: It might help the market some.

H.M.Jr: Think it over, Wayne. If I said anything, I'd say "after consultation with Taylor and Bell, the three of us have come to the conclusion that...." - see? What?

Bell: Well, anyway, that program....

Taylor: It is something to - I think that Burgess and Harrison and those fellows would be better judges of that than I am.

H.M.Jr: The main thing - I don't want to do anything publicly to undo anything that you have done. See what I mean? You get me.

Bell: Well, with that program I estimated that our balances would be, end of September, 819 million,

H.M.Jr: Just a minute. End of September, how much?

Bell: 819 million.

H.M.Jr: 819.

Bell: End of October, 784 million.

H.M.Jr: 784.

Bell: End of November, 644 million.

H.M.Jr: 644 million.

Bell: Now, that contemplates 75 million dollars a month for gold.

H.M.Jr: It's been running more than that.

Bell: Around 115, 120 million in August. Now it looks as though there might be a little coming from the East - I mean England.

H.M.Jr: I sent you (Taylor) that radio.....

Taylor: Yes, sir, the boys have got that for you.

H.M.Jr: Incidentally, does anybody know whether, if the President invoked the Neutrality Act, could we still continue buying gold from Japan?

Taylor: Yes. We can do really what we want to on that. We've got a legal opinion - memorandum for you on that subject. You can call it off if you want to, not do it, but it is entirely discretionary.

H.M.Jr: Well, if we took 50 million less now, that wouldn't be - just build that up into March. As a matter of fact, it'd be nice to have 500 million dollars worth of bills coming due in March, wouldn't it?

Bell: Yes, sir.

H.M.Jr: What?

Bell: Yes, it would. And you could extend your bill issues into November rather than stopping them at the end of October. See?

H.M.Jr: Now, with the exception of gold you have figured everything at its worst?

Bell: Well, figured about the way it runs. We hit it pretty close in August. Emergency was about the same. Got a little more unemployment trust than we figured; that's where the balance went up.

H.M.Jr: Your free gold, I see, is 161 million. That has nothing to do with the gold from devaluation, has it?

Bell: Yes, some of it.

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H.M.Jr: Well, you've got down 141.

Bell: Oh no, that's the gold that was piled - part of it is the increment, but as we redeem National Bank notes it comes out of the increment and goes into free gold. You see, up under the first one there you have 141 million; that will be reduced and your 161 increased as your National Bank notes are redeemed.

H.M.Jr: If I spend the 161, that wouldn't be spending the gold resulting from the devaluation, would it?

Bell: Well, to the extent that we redeem National Bank notes out of the General Fund.

H.M.Jr: How much would that be?

Bell: Well, let's see now; I think there is possibly 60 million dollars of National Bank note gold in that 161 million, since December 22.

H.M.Jr: December?

Bell: That's the day you started your sterilization policy.

H.M.Jr: About a hundred million dollars.....

Bell: As I recall, there was a hundred million dollars free gold at the time we started this policy.

H.M.Jr: Has anybody advocated spending that?

Taylor: I think before the fall is over you're going to have to look at the gold thing again as far as the reserve picture goes.

H.M.Jr: You mean it's a little too close?

Taylor: In spots it is very close.

Bell: I'd like to see you, while this gold is lagging - the imports of gold are lagging, stop the sterilization policy; say that what is coming in is more or less normal.

Taylor: I think you'd get quite a lot of sympathy for that.

Bell: We've got a billion....

H.M.Jr:three.

Bell: A billion, 335 million, plus your billion eight in the Stabilization Fund - three billion dollars in gold locked up, which certainly can meet any export demand.

Taylor: They've got a damn tight potential situation up in that New York district there.

Bell: Well, they won't admit it.

Taylor: Well, I don't know.

Bell: One or two of the banks are in.....

H.M.Jr: Would a hundred million dollars help any?

Taylor: I think if you do what Dan is talking about...

Bell: ...first...

Taylor: ...first, which is to say, "All right, this is enough sterilization, and then let's see what happens" - just let it ease in.

H.M.Jr: I think it would help everything a lot. Well, we'll kind of - I mean I don't know how bad the business recession is, but it certainly - the stock market indicates it was pretty bad.

Taylor: Not getting any new orders; I don't say not getting any, but it's slowed up. Your price structure, of course, has encouraged that, because you've had falling commodity prices and the boys aren't replacing. But inventories - I mean your retail trade is good; there hasn't been any slowing up in that appreciably at all.

H.M.Jr: Where's George?

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Taylor: He's here.

Bell: I haven't seen George for a week.

Taylor: I've been seeing him.

H.M.Jr: Might as well sit in on this, huh?

Bell: He has a memorandum here.

H.M.Jr: (On phone) Ask Mr. Haas to come in - and Mr. Lochhead, please.

Nobody else, is there?

Taylor: Larry Seltzer, etc.

H.M.Jr: I don't want too many here.

Well now, do you want to give me what you heard in New York?

Taylor: I think the best thing on that is just to have Dan read these notes.

Bell: If you want me to.

H.M.Jr: All right.

Bell: The first conference we had was on the morning of September 1, with Mr. Garner and Mr. Kraft, of the Guaranty Trust Company. They said that it was essential that we have two issues. Indications are that the Treasury will have to issue one fairly short maturity and can possibly go into an intermediate bond for the second. They prefer a two-year note but realize that September, 1939, is already filled up, so they suggest a three-year (September 15, 1940) at a rate of 1-5/8%. They figure that this would sell on about a 1.55% basis or 10/32. They say that we could also sell a five-year note (September 15, 1942) at 2% but that possibly the Treasury would not want to go this high on a note which is fully tax exempt. They do not hesitate to recommend a 7-1/2 year bond (March 15, 1945) with a coupon of 2-1/2%. They believe that the banks would buy the five-year 2% note and they also believe

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that the banks would buy the 7-1/2 year bond. They are quite certain that the insurance companies would buy the bond and that possibly the country banks would be interested. They do not feel that a ten-year 2-3/4% would go at all.

"Commenting on general market conditions, they feel that the market recession in the late spring went too far and then on the recovery it went too far the other way so that this present market is more of an adjustment." That was on the morning of the first, see?

H.M.Jr: What bank is this?

Taylor: Guaranty Trust.

Bell: "There has been no extreme liquidation in the present market but it is more of a complete lack of interest which has created a thin market. They think there might be some preparation at this time for fall trade; they are not concerned with the present reserve situation. There is no indication that the present reserve situation is causing any pressure on the market.

"There was then quite a discussion on the present Treasury bill policy of six and nine months. This is not so important in this financing, but for the record they are much in favor of adjusting our present maturity to ninety days and tax payment dates and ridding the market of the nine-month bills. They feel that if the Treasury wants a security of this kind, it should resort to one-year Treasury certificates."

H.M.Jr: Excuse me - why did they say 7-1/2 years?

Taylor: Started off saying 7-1/2, then they changed to 7.

Bell: You'll see that at the next day's conferences they all drift into a 7-year bond.

Taylor: The reason for it being that you've got '44 a rather heavy optional year, see?

H.M.Jr: Wasn't.....

(Lochhead and Haas come in)

Bell: And too, the 7-1/2 was sweet enough on the first day.

H.M.Jr: What was the bonus year? '45, wasn't it?

Bell: That will only be about four or five hundred million; by the time you reach '45 it will probably be all out.

(Mrs Klotz comes in)

Bell: This is Colonel Pope and Mr. Love, of First National Corporation.

"There was a general discussion of the market situation and the attitude of certain investment policies of institutions with which they had come in contact. They feel that the market at this time has a much better tone and that it will no doubt improve. They have been in touch with some New England institutions and many of them were following a policy of investing 90% of their money in governments and after a meeting of the Board of Directors as to what to do with the other 10%, would wind up by investing it also in governments.

"They thought it was a mistake for the Treasury to consider putting out only a two or three-year note. This would have the tendency of forcing the longer term bonds up through scarcity. They believe in the policy of extending the debt over as long a period as possible. While in Chicago two weeks ago there was some talk of a ten-year 2-1/2% bond, and at that time they thought it was worth consideration; now, however, the period of maturity will have to be reduced. They thought that a 7-1/2 year 2-1/2% bond was highly desirable and would help the market. There should be a choice of two securities, one the bond and the other a short-term of two or three years. It would be very difficult to put all of the refunding into one issue. It was their thought that a three-year note at 1-5/8% would go well.

"They had contacted one prominent banker in the West who usually leans toward a short-term security, but this time said he would exchange his 3-1/4's

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for a 7-1/2 year 2-1/2% bond rather than a three-year 1-5/8% note, but that he would much prefer to either of these a five-year 2% note. Obviously he was thinking of his earnings.

"In their inquiries as to the present market situation they have received divided opinions. Some have the opinion that the market is still going down and others that it will go up after the September financing. The concensus of opinion is, however, that there will not be very much activity in the market for some months. Colonel Pope expressed a personal opinion to the effect that he thought the market would be dull for some months to come.

"They estimated that about \$75,000,000 of the maturing issue is held by corporations. They know that General Motors holds \$26,000,000 and are satisfied that it will not go into any security with a maturity longer than two years, but if this corporation or others do not like the issue offered they will, no doubt, sell their holdings in the market and take advantage of the premium on rights. They feel that a five-year 2% note would pull more subscriptions than a 7-1/2 year 2-1/2% bond, but they believe that from the standpoint of the Treasury the issuance of a bond at this time would look much better and that we could expect as many as \$300,000,000 in subscriptions for this security. They feel that the insurance companies will buy the bond. They said that there was a great deal of talk in the Street about a one-year 1% security but it was their opinion that this would look weak from the standpoint of the Treasury and might interfere with the nine-month bills.

"There was then some discussion of Treasury bills. They also indicated that the Treasury bill program should be changed some time in the near future. They are of the opinion that the Treasury should put out a security like a one-year certificate for which the country banks can subscribe. These banks are not now familiar with the bidding on discount bills and the discount on the bills is so small that the city banks will not go to the expense and trouble of

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telephoning the country banks about this security." In other words, they lack information because the city banks will not telephone.

Taylor: That ought to be "dealers."

Bell: What?

Taylor: That ought to be "dealers" instead of "city banks."

Bell: "City dealers," huh? I guess you're right.

This is Mr. Ihlfeldt and Mr. Johnson, who represent the Savings Banks of the State of New York, and took Mr. Miller's place, who was sick.

H.M. Jr: Oh, Miller, yes.

Bell: And they also represent the Central Savings Trust.

Taylor: Yes, that's what they are.

Bell: But they were taking Miller's place.

"They said that there was about \$10,000,000 of the maturing security held by the Savings Banks of New York State; that there was about \$5,000,000 held by the Central Savings and Trust Company."

H.M. Jr: How much?

Bell: Ten million dollars. Very small.

"They said that the Savings Banks were not at the present time buying governments and what few they are buying are for a term averaging less than ten years. They say that their deposits have not increased during the past year because they believe a lot of the Savings Banks' funds are going into building and loan association Government guaranteed shares; that there was very little money now being loaned on mortgages. They do have some excess funds for investment but they are unwilling buyers of governments. They indicated that it was their belief that all of the Savings Banks which hold the maturing issue would take anything offered in exchange rather than sell the rights. They seem to be waiting for an

increase in interest rates. They thought that probably the Savings Banks would prefer a seven or eight year bond over a five-year note. Certainly they would prefer this over a three-year note. Savings Banks of the State of New York now hold \$1,100,000,000 of Government securities, of which approximately 12% is in the various note issues. They thought that if the banks would take any bond offered they would hold it and it would not find its way back on the market immediately after its issuance. They thought the Treasury could issue a three-year 1-5/8% note and that it would sell for about par and 10/32. An additional issue of the notes issued last June would also go (1-3/4's of 1942 or 1-3/8's of 1939).

"Upon being asked what other factors in the situation were operating to reduce savings deposits, they named the Savings and Loan guaranteed shares, United States Savings Bonds and the increase in the sale of life annuities.

"Speaking for the Central Savings Trust Company, they would prefer the three-year 1-5/8% note for the \$5,000,000 which it holds. They were of the opinion that the Treasury could get no secondary market from the savings institutions."

H.M.Jr: Excuse me just a second. How are our Baby Bonds going?

Taylor: All right.

H.M.Jr: What rate?

Taylor: We did just over 31 million in August.

H.M.Jr: What did we do last year?

Taylor: 26.

Bell: Running about 7 million a week, aren't they, Wayne - a little better.

Taylor: Yes. August was pretty good; I mean considering everything. Considering everything, it was as good a month for a dull period, with a bad market, as we

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have had.

H.M.Jr: Please don't - I haven't asked today what the foreign exchange is doing. Not interested in today's market. I'll learn about it tonight.

Go ahead. - - How is it?

Lochnead: Quiet.

Bell: This is the luncheon conference with Governor Harrison and Mr. Benson of the Dime Savings Bank and Mr. Parkinson of the Equitable Life Insurance Company.

"Just prior to luncheon and while we were waiting for Mr. Parkinson, we had quite a discussion with Mr. Benson and he gave about the same story as Mr. Inlfeldt and Mr. Johnson on the savings bank situation."

H.M.Jr: Is that Parkinson?

Bell: No, this is Benson of the Dime Savings. We were waiting for Parkinson to show up and we had this little discussion.

"He has \$1,500,000 of the maturing notes and would prefer a five-year note or less. He says that the only investment money that he is now getting are the funds coming in from the liquidation of mortgages and, of course, their earnings. There are no increases of deposits. His mortgage rate is now 5% and he is losing some of his investments to life insurance companies which are offering a 4 to 4-1/2% rate. He, of course, would like to convert some of his cheap Government bonds into 5% mortgages, but this apparently is not working out very well. He has \$14,000,000 in cash and says that most savings banks are in the same position. They have lots of cash but will not go into long term maturities. He thought that a seven or 7-1/2 year 2-1/2% bond would go and that the savings banks might buy some of them; but that a five-year 2% note or less would be preferred - more as a temporary investment.

"At the luncheon Mr. Parkinson said that he would not

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want notes for his company. He has none of the maturing issue. If we were offering a bond for cash, he would subscribe to the bond and he would probably buy a seven-year 2-1/2% bond if it is issued. He thought other life insurance companies might also furnish secondary markets for such a security. He explained that while insurance companies would go into a security of this kind at this time, it does not meet their required earning minimum; that his company is on a minimum earning requirement of about 3.08. He thought other insurance companies were on no less and probably a higher basis. It can be seen, therefore, that any investment of insurance companies in a 2-1/2% security is more or less of a stop-gap and something to give them liquidity and a small return while awaiting other investment possibilities. There was no question but what the insurance companies had plenty of cash as insurance business had increased and they were getting large receipts from repayments of loans on policies. He was asked what he thought of the present situation in the money market. He replied that the present dullness of the bond market was due to bad news from abroad, the continued unbalanced budget, and continued rumor concerning the policies of the Administration on reducing the price of gold. He said this rumor was still prevalent and only this morning he had heard about it again from St. Louis."

Taylor: That's the only person who mentioned gold all the time we were there.

Bell: I don't know whether you (Taylor) told the Secretary the story, but you probably did.

This is Mr. Tompkins, of the Bankers Trust. He "started out by saying that the Treasury should have two issues. He feels that we should venture into the longer term -- say seven or eight years, as he thinks there is a present demand for this kind of security. Then we should have a short-term note which would be a sure thing. He would prefer a two-year 1-3/8% or possibly 1-1/2%. He thought that the combination suggested of a two-year note and a seven-year bond would assure success in this refunding operation. He felt that the reserve situation at the present time is a factor in this market and that

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the fall demand is now beginning to show up. Indications are that it will require about \$500,000,000 cash over present requirements to take care of it. There is also some talk about the call rate being increased to 2%. Another factor in this situation is the world condition which makes the market nervous as they expect bad news at any moment.

"He believes that there is a sufficient demand for the seven-year bond; that the banks will hold them as an investment, and we need not expect many of them to be thrown back on the market. He thought a three-year 1-5/8% note would go but would not be as sure as the two-year 1-1/2%. His definite recommendation is a two-year 1-1/2% and a seven-year 2-1/2% bond."

Now this is Mr. Morgan and Mr. Young.

H.M.Jr: How old is Morgan?
Bell: How old is he? I'd say 55.
Taylor: No, he's about - he might be 35.
Bell: 35?
Taylor: Yes.
Bell: Oh, is he the younger fellow? He looked older.
H.M.Jr: He's a son; he should be young.
Taylor: 35 is the maximum, Dan.
Bell: Which one was Morgan?
Taylor: The one with the black coat.
Bell: The one that sat next to me?
Taylor: Yes.
Bell: I wouldn't take that man to be 35. Would you, looking at him?

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Taylor: Well, he'd just been to a funeral and was all dressed up in a black coat.

Bell: I'd put him in - I'd say the fellow Young was 35. Maybe I had them mixed.

Taylor: Both about the same age, be my guess.

Bell: "They explained that they were corporation security dealers and that they did not know that they could give us much information about the Government bond market. They were willing, however, to comment on the present market as they see it from the standpoint of dealers in corporate securities. At the present time there is no tone whatever to the market. There are no corporate issues of any consequence pending because most people are waiting for the June 30 Audited Earnings Statements of corporations. They have found that the insurance companies will buy corporate securities but they must be attractively priced before they will be interested. The peculiar thing about it is that the insurance companies will buy a long-term corporation bond but apparently would not go into Government bonds of a maturity longer than ten years. Another factor in the situation at the present time is that private investors are buying good preferred stocks instead of bonds. They refer to commercial bankers as "scalpers" in most any bonds at this time. In other words, commercial bankers do not want bonds for investment purposes but they merely buy these securities for the immediate profit and then the securities soon find their way back onto the market, thus having a depressing effect. They find that the demand for loans is increasing although there are no large volumes of issues at the present under consideration. There are some refunding operations coming up before the first of the year which aggregate over \$100,000,000.

"In this forthcoming Government financing they have asked themselves the question: Who would buy the two securities talked about in the Street - one a 5-year 2% note and the other a 7-year 2-1/2% bond. They say the banks will certainly take the notes and possibly individuals because of the tax-exempt feature. They thought that the insurance

companies and some banks would take the bonds because of the rather attractive coupon for a short-term security. There is no doubt but what there will be substantial buying in the market of the bond. They both agreed on this."

Next, Mr. Aldrich and Mr. Green, of the Chase.

H.M.Jr: Winthrop?

Bell: Yes.

H.M.Jr: Did he come around? Where did you see all these fellows?

Taylor: In the Federal Reserve Bank, Dr. Burgess's office.

H.M.Jr: Burgess present?

Bell: Yes, all the time.

"Mr. Aldrich thought the Treasury might try additional issues of the 1-3/4% of last June and, say, the 2-3/4% bonds of 1945-47. He said it had been suggested in the Street that we have a 15-month 1% but he feels that this would not go and if it was tried should be 1-1/8%. He also said that from the standpoint of the Treasury this looks weak to issue such a short-term security. As to a 5-year 2% note the banks would certainly come in rather heavily. If there is to be a bond, he would prefer the period 1943 to 1945. He called attention to the fact that the 3-3/4% of 1943-45 are selling on about a 2.29% basis; that any security put in 1944 or 1945 would probably, after a few days, sell on a basis of 2.40% to 2.45% at the present market.

"He has found no tendency in his bank to increase loans and there are some indications that loans are actually decreasing. He is not alarmed about the reserve position as a reduction in the discount rate has made it a simple matter for the banks to borrow from the Federal Reserve Banks.

"He finally wound up by saying that he thought that a 3-year 1-5/8% note would go well and the Treasury might do the whole job with that."

H.M.Jr: 3-year?

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Bell: 3-year 1-5/8.

H.M.Jr: That's '40.

Bell: September '40.

H.M.Jr: Yes.

Bell: This is a conference with Gordon Rentschler and his Mr. Blair in Rentschler's home.

H.M.Jr: Was Rentschler ill?

Bell: No, we went there to eat.

Taylor: We went out there to spend the night out there.

H.M.Jr: Burgess too?

Taylor: No.

H.M.Jr: Where is his place?

Taylor: Out at Long Island.

H.M.Jr: What sort of a place has he got?

Taylor: Very nice.

H.M.Jr: Must be a rather big one.

Taylor: 54 acres.

H.M.Jr: Family around?

Taylor: Yes. Really got a lovely place out there.

Bell: "Mr. Rentschler was enthusiastic for a 7-year 2½% bond. He called attention to his previous recommendations that the Treasury should try to put all of its long-term financing on a basis of 10 years at 2½%, constantly rolling over the maturing issues for a 10-year period. In view of his recommendation in this connection, he feels that a 7-year 2½% bond is even better than the one he had previously suggested.

H.M.Jr: He never told us that.

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Bell: What?

H.M.Jr: He never told us that.

Bell: I didn't remember it either. I thought perhaps he'd told it to you some other....

H.M.Jr: No.

Taylor: He says that awful hard - that he told somebody.

Bell: Yes, but I don't ever recall.

"He also is in favor of a 3-year 1-5/8% note which would give the holders of the maturing issue a choice of securities. He told us that not only would his bank subscribe to the bond for the amount of its holdings of the maturing issue, but that it would buy rights in the market to exchange for the bonds. He also said that the Home Insurance Company, of which he is director, would buy \$10,000,000 of these bonds. Said that he thought the bonds would be ideal for the insurance companies. There was some discussion of the 1-year 1-1/8% or 1-1/4% but he did not have the feeling that some of the others had on the next day about the short-term security. He thought that it was not necessary for the Treasury to go down as low as the one year or 15 months.

"His bond man, Mr. Leo Kane, had submitted to him a memorandum in which he stated that 7-year 2-1/2% bond and the 3-year 1-5/8% note would suit the requirements of the National City Bank."

He said he'd also go out in the market and get the rights.

H.M.Jr: I didn't get the impression of what Mr. Aldrich said they'd do.

Bell: They have none of the notes.

H.M.Jr: Oh. But he wouldn't go out and buy?

Bell: No, and he wanted you to do a 3-year 1-5/8 for the whole refunding operation, and then - well, the impression was that he wouldn't have the

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fluctuation around, that he would bring the two securities together.

Taylor: Frankly, he was the least impressive of any of the people we talked to.

H.M.Jr: I was going to ask you.

Bell: That's right.

H.M.Jr: I was going to ask you. I've never talked to him about a market. I mean I've talked to Rentschler; Rentschler is always on his toes; but I wonder what sort of impression Aldrich made.

Bell: He wouldn't let his bond man talk very much. He did most of the talking.

Taylor: No, that bond man finally talked some.

H.M.Jr: No, but you didn't feel Aldrich was on his toes.

Taylor: No, and it's the one bank up there that's not getting any new business. I have his statement here, which is very interesting to me. I didn't see any new loans coming in, and so on and so on; in fact, they were losing some.

Bell: Everybody else had the other feeling, that loans are going to increase this fall.

Taylor: I read that with the meaning that they are just not getting the business.

H.M.Jr: But Rentschler, on a 3-year and a 7-year - he'd go right after it.

Bell: That's what he said.

Taylor: That was the first day.

H.M.Jr: Did you see him again?

Bell: No. This is the end of the first day's conference now. Now we begin with the second day, and your market had changed. The first one was Devine in the

morning, and he had just gotten back from a vacation and only been in the market two days, and he chopped around quite a bit.

"Mr. Devine said that he would prefer two issues of any one of the following Treasury notes: 15 months at 1-1/8%, 2 years at 1-1/2%, 3 years at 1-5/8%, 4 years at 1-3/4%, questioning the latter and that this might have to be increased to 1-7/8%. He thought that the one and four years are the best; possibly you could do a two-year and a four-year. After all, they are close together. He stated that the General Motors Corporation has approximately \$27,000,000 of the maturing notes. He is quite certain that it will want cash. The First of Baltimore has about \$30,000,000 and it will probably want an issue of 1940 and not longer than 1941. He named certain banks in New York City which had more than \$100,000,000 and he doubts very much whether they would take anything beyond the 4-year period. (The banks named, however, indicated that they would be interested in a 7-year bond)." One of them was the National City Bank, which he knew wouldn't want anything.

"He says he just can not see a bond or a 1942 note. We have got to be careful not to issue a security that will hang heavy on the market and then it will be the unpleasant duty of the Federal Reserve System or the Treasury to support the whole market. He says he has shopped around in the last two or three days among several of the banks and dealers and he gets a very definite sentiment for the short note. He thinks the Treasury has got to put out a 15-month security in order to be sure that its offering will be a success."

This is Swihart, of C. F. Childs Company.

"Mr. Swihart says that he can not see anything beyond three years. In his talks all over New York and throughout the country only one has mentioned a bond. Few have talked 1-7/8% and a 2% five-year note and he only had one suggestion of a 7-year 2-1/2% bond. There are no buyers of Government securities in the present market. He suggests the following Treasury notes for consideration: 15 months at 1-1/4%, 2 years at 1-1/2%, 3 years at

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1-5/8%, 5 years at 1-7/8%. He feels that the banks would take a 7-year 2-1/2% bond but that the bonds would soon be back on the market and then we would see further declines in Government securities. He feels that short term rates are definitely going higher and questions whether we can hold the higher rate securities from declining when the short term rate advances. He does not question but what we can convert the whole amount of the maturing issue into a 3-year note. He knows of one banker who has \$50,000,000 of the maturing issue who will not go over a 3-year note. He has talked with the Metropolitan Insurance people and he said they would not be interested in anything over three years.

"Mr. Baker and Mr. Gill, Bank of Manhattan.

"They said there are two thoughts at the present time: The New York attitude is for a short term security and the outside New York attitude is for a longer security. Their feeling is that the Treasury should stick to one issue, say a three-year 1-5/8% note. This is a generous rate and they thought that the whole market would go up with that issue, whereas if we offer two issues the lower premium will bring the higher premium down to it and thus have a tendency to depress the whole market. Their bank has a feeling that rates are going up. There is now a definite tendency for commercial loans to increase and their bank's loans are now up 31% over last year."

This is Park, of Manufacturers Trust.

"He feels that the Treasury should issue one or two notes. He does not think that a bond issue would be received very well."

H.M.Jr: Who's this?
 Bell: Park, of Manufacturers Trust.
 H.M.Jr: He's a smart fellow.
 Taylor: Yes.

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Bell: Wait till you get this now. "He thought that a 15-month 1% note would sell on about a 6/32 premium and that a 1-5/8% 3-year note would sell on a 16/32 base. When he came into this conference he was definitely of the opinion that we could not go over 1940, but when he was asked his opinion as to a short note and a 7-year 2-1/2% bond, giving the holders of the maturing issue a choice, he replied that he had not looked at it from that standpoint but thought that that was a good suggestion and had a lot of merit in it. As the conference progressed he became more enthused about the short note and intermediate bond. He thought we might get as much as \$250,000,000 or \$300,000,000 in bonds. He does not feel that the bond would depress the market and he did not feel that any of them would take the bond merely for the profit involved. He thought the insurance companies and larger banks would certainly take the bond to a limited extent and the insurance companies, in view of their large cash balances, might even furnish some secondary market for them. He concluded by saying that he was definitely of the opinion that the Treasury should issue a 1-year 1% or a 3-year 1-5/8% note and a 7-year 2-1/2% bond. He thought the combination of either of these short notes and the bond of this maturity and coupon would be ideal for the market."

In the conference he completely switched.

Taylor: That happened quite a few times.

Bell: Mr. Trapnagan, of Bank of New York and Trust.

"He feels

H.M.Jr: I've never met him.

Lochhead: He's a bond man.

Bell: He was a bond man - now Vice President.

Lochhead: Yes, but a bond man primarily.

Bell: "He feels that the Treasury is forced to do something short this time. A long term bond would completely disrupt the bond market. He thought that a 3-year

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note at 1-5/8% would go and that we should offer but one issue. He does not feel that the money market is going to get tight as many in New York do. He finds that the average banker of today is trying to find a way to get out of long bonds, certainly those with a maturity of beyond 10 years. He is afraid that if we give an option to take a 3-year note or a 7-year bond and if the bonds do not go well, it would hurt the whole market. He does not hesitate to recommend one issue of 3-year Treasury notes at 1-5/8%."

H.M.Jr: Three years, 1-5/8.

Bell: That's the general recommendation.

"Incidentally, he is very much in favor of the 9-month Treasury bills and he has found that some out-of-town banks like them. He feels that short term rates may go up some and as more Treasury bills are put out corporations may come into the market for these bills. This would cause a temporary deflation in bank deposits but as the proceeds of the bills are put out by the Treasury this situation would be corrected."

We add those there just for your information; has very little to do with the financing.

Next is Baker, of Travelers Insurance.

"He feels that the Treasury is compelled to resort to very short maturities. His first suggestion would be to issue additional amounts of the securities offered in June with an option. He said the Treasury might go to a 5-year note at 1-7/8%. He feels, however, that the insurance companies do not want any more governments and that they will not buy them only as a stop-gap. He had some figures which showed that the cash balances in the life insurance companies at the present time are about \$500,000,000, down about \$250,000,000 from last year, and that the investments in government securities are up about \$800,000,000."

That's an interesting figure.

H.M.Jr: Say that again.

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Bell: That the cash balances of all the life companies now are about \$500,000,000 and last year they were about \$750,000,000, and that their investments in governments have gone up about \$800,000,000 in a year.

H.M.Jr: That's where our stuff has gone.

Bell: Somewhat.

H.M.Jr: Yes.

Taylor: The banks have liquidated, and here's \$300,000,000 of it. It's something that the banks have liquidated, and here is approximately \$300,000,000 of it.

H.M.Jr: Which would make you think that the insurance companies might take a 7-year at $2\frac{1}{2}$.

Bell: Yes, I think they might.

Taylor: Wait till you hear what this fellow says.

H.M.Jr: Who's this?

Taylor: This is Baker of the Travelers.

Bell: He's pretty smart too.

"This cash balance is below normal for the past 3 years but prior to that time two to three hundred million dollars was about the average balance.

"He says that there are other investments coming along now with much more attractive yield than governments and that the insurance companies are turning to this field. They are not, therefore, much interested in anything that the Treasury does on September 15. Dr. Burgess asked him if he would be interested in the bond of 7 years at $2\frac{1}{2}$ which had been suggested. He said that he might be interested in this and he thought it might attract some of the insurance companies' cash. He said that on the way to the bank he was looking at the list and thought that a 1-year $1-1/8$ or a 4-year $1-3/4$ or 5-year $1-7/8$ would go. In conclusion he said that he thought the choice of the bonds and a short note would represent a good program. He did not feel that the bond would be a depressing factor and that we might expect as much as \$300,000,000 in exchanges on the bond alone, the

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balance of the issue going to notes."

Taylor: And he afterwards said to Matteson, whom he had lunch with, that he'd buy the bond and that he would switch out of some of his short stuff into the 2 $\frac{1}{2}$ % bond.

Bell: Oh, he did?

Taylor: Yes.

Bell: I didn't get that.

Davison and Hollingsworth, of the Central Hanover Trust.

"These were the most pessimistic representatives that we interviewed. They were very definitely of the opinion that a bond would completely upset the market. They thought we must confine our offering to two issues of a short-term character, one a 15-month note at 1-1/4%. He said that yesterday they would have said 15-months at 1-1/8% but the change overnight would make the rate 1-1/4% in order to insure its success. They thought that the 5-year note of last June was a mistake."

H.M.Jr: Which was?

Bell: The 5-year note last June - 1-3/4.

"It has clearly been a speculative issue from the very start. They thought one very good suggestion was to put the whole issue into a 15-month note at 1-1/4%. The corporations that hold the maturing securities, such as General Motors, would exchange it for the 15-month security and hold them until maturity, but he did not feel that any of the corporations, particularly General Motors, would go over 2 years. As far as their bank is concerned they have no particular choice as between the 15-month 1-1/4% and the 3-year 1-5/8% and that they probably would go 50-50 on the two issues. Mr. Davison wound up by saying, however, that it would be less disturbing to the whole bond and security market if we would have just one issue."

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Hutchins, of Irving Trust.

"He said his bank has none of the maturing issue but they have about \$100,000,000 maturing in 1939. While he realizes that for the Treasury to issue a security around this date would conflict with their holdings, it seems clear that there will have to be two issues put out. He prefers a 15-month 1-1/4% and 3-year 1-3/4%. He is quite certain that a bond would depress the present market, probably as much as a half a point. He says that the Government securities which the bank holds average a maturity of about 2 years. He is quite strong against a bond at this time and is also against a 5-year note. He thought that the insurance companies, trust estates and some of the banks would take a bond and that if the Treasury is insistent upon an intermediate bond he would suggest that it be a 15-month note and a 7-year bond. Because of its policy, his bank would very definitely not buy these bonds, but he would recommend them to his customers."

And I add a note here: "In considering the statement of the representative of the Irving Trust Company we should not lose sight of the fact that the policy of this bank is to hold government securities of an average maturity of not more than 2 years and that it is definitely against holding any bonds at all."

Mr. Levy of Solomon Brothers. He was very snort.

"Mr. Levy feels it has got to be short, a choice of the 3-year 1-5/8% or a 4-year 1-3/4% note. He does not know who would buy a 7-year bond and if the Treasury wants something longer he would be more in favor of a 5-year 2% note than a 7-year bond. He would issue two securities, giving the holders a choice at the rate and term above indicated."

H.M.Jr: How many more pages have you got?

Bell: I've got one or two more.

Mills and Repp, of Discount.

"Their conversations with the various banks indicate

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that the opposition to the suggested bond issue does not come from those who have the maturing issue, but.....

H.M. Jr: The opposition to what?

Bell: Well, the suggested 7-year bond.

".....does not come from those who have the maturing issue, but comes from those who hold those bonds that mature around 1943 to 1945. The last hour of the market today has turned against these issues, which indicates that the market is reflecting some of the discussions. He thought that there was one very important factor in this whole situation which no one is talking about in their discussions of this subject, and that is that the Treasury is paying off \$350,000,000 maturing Treasury bills around September 15 with cash. This certainly will create a tremendous vacuum in the market and will make that money available for investment. They can not see what the banks are going to do with this except to buy Treasury notes and the shorter term bonds, and that any bond that we issue at this time would come in for its share of that investment. They feel that the Treasury will be surprised at the number of banks which will take a seven-year 2-1/2% bond. They also feel that the savings banks will come in much heavier than indicated by the representatives of New York Savings Banks, as they are light on maturities around 1944.

"Another very definite factor in the situation is that the maturing security has a 3-1/4% coupon and the institutions that have that security will want to replace it with as high a coupon as it is possible to obtain. Therefore, the 2-1/2% bond will be attractive to them from an earning standpoint.

"They feel very definitely that the issue has got to be a double header. We are now exposed to foreign news, much of which is bad, and the Street is very blue. They feel, therefore, that we have got to have one short term note which will be certain of success and to which all the banks can run in case we get extremely bad news over Labor Day. In their opinion this should be a 15-month 1-1/4% note. They feel that no matter what happens....."

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H.M.Jr: Excuse me; what rate did they give the 15-months?

Bell: One and a quarter.

"They feel that no matter what happens in the world situation, while this security is open for subscription this issue will be safe. They feel that a 2-year 1-1/2% note is bad because it falls on the same date as the 1-3/8% of September, 1939, and may have a tendency to throw this security below par. The other security to be offered would be the 2-1/2% seven-year bond. They feel that the shorter maturity will sell on about par and nine to fourteen thirty-seconds, whereas the 2-1/2% seven-year bond will sell on about a 2.40 basis, or about 21/32. They say that the maturing issue is fairly well scattered over the country with about seventy million dollars in the hands of insurance companies, thirty million dollars in Baltimore, three hundred million dollars in New York City banks and a great deal of it is in the hands of small country banks. They feel that the small country banks will certainly want the 2-1/2% earnings. The corporations that hold the maturing security will, of course, want the 15-month note. They were enthusiastic for these two issues, that is, a 15-month 1-1/4% note and a seven-year 2-1/2% bond."

This is just a summary: "At the beginning of these conferences I believe that we had a very definite feeling that a short note issue of fifteen months' maturity was objectionable and that it would be a very definite sign of weakness on the part of the Treasury. In view of the fact that some of those interviewed stressed the foreign news as a factor in the market and for this reason made a suggestion that we have a 15-month issue for safety purposes and that in addition we offer a seven-year 2-1/2% bond with the idea that whatever goes into this maturity will be just that much advantage to the Treasury, many of our first objections were removed.

"The concensus of opinion seemed to be that the Treasury could issue a short term note of between one and three years, the one-year or 15-month note at 1-1/4% and the three-year at 1-5/8%, and a seven to 7 1/2-year bond at 2-1/2%, preference leaning towards the seven-year bond."

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H.M.Jr: Repeat that.

Bell: "The concensus of opinion seemed to be that the Treasury could issue a short term note of between one and three years, the one-year or 15-month note at 1-1/4% and the three-year at 1-5/8%, and a seven to 7 1/2-year bond at 2-1/2%, preference leaning towards the seven-year bond. The first day of our conferences brought only one or two suggestions for the 15-month 1-1/4% note, but at the second day's conferences, probably because of the turn in the market overnight, it was the concensus of those interviewed that a 15-month 1-1/4% note would have to be one of the securities to be offered. There was a strong feeling that whatever was issued of the notes and the bonds that the larger proportion of the subscriptions would go into the note, but that we would get anywhere from \$200,000,000 to \$350,000,000 in the bond."

H.M.Jr: Finis?

Bell: That finishes it.

H.M.Jr: That's a very good report. You certainly saw everybody.

Bell: We saw about 19 people.

H.M.Jr: There's only one person you didn't see, and that's Ecker, the Chairman of Metropolitan.

Bell: He isn't in town.

H.M.Jr: No, but he'll talk to me; he's a very intelligent fellow. He controls the largest block of capital in America.

Bell: We were going to see him.

Taylor: Burgess and Matteson talked to his man.

H.M.Jr: Well, the old man himself came down here - I've only seen him once - and that boy is smart.

Taylor: The other one that isn't included in here, whom we didn't talk to but who talked to Burgess, is the First National, and they are all for a 7-year bond.

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They were the first people that thought of it.

Bell: Jeff Coolidge telephoned down and suggested...

Taylor: A bond.

Bell: A bond.

H.M.Jr: I think that's a very comprehensive report. Must have been hard work.

Taylor: Very interesting.

Bell: Very tiresome, but interesting too.

H.M.Jr: They stuck right to the issue, didn't throw in a lot of other stuff.

Taylor: There was a lot of other conversation.

Bell: I ignored that.

Taylor: Which Dan didn't include here for obvious purposes.

Bell: There was a mention of a balanced budget once in a while.

(Five minute intermission)

Haas: Here is our memorandum.

H.M.Jr: How long is that?

Haas: Oh, you can jump down to here (page 8). The other is just a sort of review.

H.M.Jr: While I'm reading this, who do we want in here at all of our own people? Seltzer?

Haas: I suppose so.

Taylor: Harris. Henry Murphy?

H.M.Jr: I don't think so.

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H.M.Jr: (On phone) Have Mr. Seltzer and Mr. Harris, who is with Mr. Lochhead, both in here at 11 o'clock.

I don't think we want Murphy.

Haas: Don't want to get too big a crowd.

H.M.Jr: I think I'm going to read this, if you don't mind. You've all read this, have you?

Haas: Wayne has had the first edition.

H.M.Jr: You read it out loud. Then everybody will get the benefit of it.

Haas: "The September financing will consist entirely of the refunding of \$317 millions of maturing notes. These notes are held very largely by banks, principally the larger banks, with a fair sprinkling of holdings by other financial institutions, dealers, and corporations. There is a normal tendency for maturing notes to be concentrated in the larger financial institutions, but this issue has the reputation of being very well distributed.

"An attempt to replace these notes entirely by a bond issue would tend to force the pace of the transfer of Government obligations from banking to non-banking holders, and might result, at worst, in a further break in the market, and at best, in a soggy technical position. It is concluded, therefore, that a large part, at least, of the securities offered in exchange for the September notes should be of a character definitely suitable for retention by the banks now holding the maturing issue.

"It appears to be clear that a bond issue offered in exchange for the maturing notes would not prove attractive for continued retention by all of the present holders, many of whom, it is believed, would particularly welcome a rather short-term note. A 5-year note issue would be unlikely either to attract the latter type of holder, or institutions seeking the higher coupon rate that would be associated with a bond offering. While the 4 $\frac{3}{4}$ year note issue sold in June has behaved relatively well, it was originally priced rather liberally in view of the yields then available on adjacent issues."

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Then we go through and discuss the various alternatives and what we are really doing is just running through our thinking on the thing.

H.M.Jr: Well, I wouldn't do that. I'd rather - do you mind giving me your conclusions?

Haas: The conclusions? Well, I can do that orally.

H.M.Jr: I think it would be much better. Is there stuff in there I should read? Let me keep it on my desk.

Taylor: I think there is.

H.M.Jr: ~~All right.~~ All right.

Haas: We fussed around with it in our shop. As a matter of fact, I think it is the most difficult financing situation that we have had any experience with. Unlike some of the other situations, there doesn't seem to be any answer which is crystal clear, or any two alternatives. If you take the different possibilities, each one of them has some advantage. However, as we weighed over the different possibilities, particularly in view of the information which Mr. Taylor and Dan received from New York, we began leaning towards that short note, that 15-months note, and the 7-year 2 1/2% bond. It has some real advantages. When you give that option it practically assures success, and you've got so many uncertain factors that you don't know which way they're going to swing. If you get a break, it certainly will look better for the Treasury if you have offered a bond, and you may get several hundred million dollars in the bond offering. If you take the longer term notes rather than the short one, you take on some additional risk. In addition to that, you have the great piling up of maturities in the two and three year position.

H.M.Jr: You're open in September '40.

Haas: Well, in that year you already have almost three billion. Then you have to put this on top of that.

H.M.Jr: Why do you fellows all pick 15 months. What's that date?

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Bell: That's open.

Taylor: It's the only open date.

H.M.Jr: Oh, it's the only open date. How much have we got coming due in '38 already?

Bell: We've got a billion nine now; that's of notes, and this would make - if we put it all in there, would make it two million seven.

Haas: And the two and three - each of those would run - both of them are now around three billion dollars. With this 817 on top, if you just offered one note.....

H.M.Jr: Well, I don't think anybody would want to offer one. I think that's out. I'd give an option. I mean I wouldn't make it one. That would be a mistake, don't you think?

Lochhead: Right.

Haas: I think the real advantage here is to provide an offering which on the face of it looks better for the Treasury and you've got a snuttle basis so that if the situation gets tight you swing over to the note. The worst that can happen is that you sell very few bonds, but the issue goes. If the situation clears over, it allows you to sell more bonds. It's not ideal, but all in all it seems to me that that is the combination which I'd favor.

H.M.Jr: Just to digress a minute, do we know whether that last German issue went over? Last I saw, it was one-seventh subscribed.

Taylor: The State Department cabled yesterday to get a report on it. They hadn't had one.

H.M.Jr: Of course the last British issue wasn't subscribed.

Haas: We at first, Mr. Secretary, abandoned all consideration of a bond. We thought it was out.

Bell: (Handing Secretary paper) This is giving the banks notice that they may not expect the information before

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12 o'clock tomorrow. Give them a rest.

(Secretary signs)

H.M.Jr: Of course, perfectly frankly, a 15-month note - I mean to me it seems so....

Taylor: If it was that alone, without the other one, it would look awful.

Haas: Look awful bad.

Taylor: If you do the 15-month note in combination with another note, it looks bad; but if you do it with the bond, it gives you about as good a picture as you can get out of a very messy situation.

H.M.Jr: Well, as of last night's closing of $1\frac{1}{4}$ 15-months, how much sweetness is there in that?

Taylor: 8 or 9.

Lochhead: 8 or 9 32ds.

Taylor: Now, there is one other thing that I think is important in this choice.

H.M.Jr: Yes.

Bell: I'd say from 7 to 10.

Haas: Yes, that's what it is.

Taylor: Until they have actually made their turn-ins, your premium is going to be controlled by the short one, see?

Bell: On your rights.

Taylor: Yes.

H.M.Jr: What are the rights selling at now?

Bell: 8 to 10.

H.M.Jr: Well, I wouldn't expect too much.

Taylor: In other words, that's going to hold it down. Then,

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when they have actually made the shift, all other things being equal, the bond's going to go away from you, you know.

H.M.Jr: You mean go up?

(Harris comes in)

Taylor: Go up. And that would be the best of all the things that could happen - would work well.

Bell: That's exactly what you want.

H.M.Jr: Harris, on a $1\frac{1}{4}$ 15-months note, how much do you figure there is in it?

Harris: Nine thirty-seconds. I have some figures on it.
(Hands paper to Secretary)

Bell: When we started these conferences, I think Wayne and I both thought the 15-months issue was out, but as we swung around to a short note and a bond, we could see a lot of advantages in the 15-months for safety purposes.

Taylor: The other thing is you've got to have this open for three days.

H.M.Jr: Have we - we did it before.

Taylor: If we can shorten it to two days, it would be very desirable.

H.M.Jr: We did that once.

Bell: I don't recall. I think we did.

Taylor: We talked to Burgess about shortening it to two days, and he said he'd think it over before he came down.

Bell: He didn't like it very well.

Taylor: If you get bad foreign news on the last day, if you had a three-year note, you'd have some cash turn-ins.

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turn-ins.

H.M.Jr: Three-year note?

Taylor: But on the one and a quarter you wouldn't.

H.M.Jr: Two days is plenty. What the hell - only need one day to make up their mind.

Taylor: But if the news happens to be good, you're going to have quite a swing to the bonds on the last day. But it's going to be entirely dependent on the news of that particular day.

H.M.Jr: Well, the time to announce when we close is Tuesday night. Tuesday night we'll have to say when the thing will be closed.

Bell: I'd like to see it two days.

H.M.Jr: But you boys think today that the market is so shaky that we have to have that safety factor of the 15-months.

Haas: Not that it is so shaky, but the market is sensitive to developments and there is a possibility for some developments taking place.

Bell: There just isn't any market now.

H.M.Jr: You don't give much sweetness to that note, do you?

Taylor: You don't need to.

H.M.Jr: What we're thinking of doing - what we announced - is to cut the present bill series, issue no more.

Harris: I might say that there is a very good demand for those maturing notes. This morning they are up two thirty-seconds, quoted 10-12.

H.M.Jr: Which maturing notes?

Harris: The September 1-3/8s.

H.M.Jr: The September what?

Harris: The September 1-3/8s.

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H.M.Jr: They're up what?

Harris: Up two thirty-seconds, quoted 10-12.

H.M.Jr: That's good.

Taylor: Damn right. That's the first time that there's been any such indication.

Harris: It has a premium of about eight thirty-seconds that they place on the privilege to exchange them.

H.M.Jr: I didn't know there was any market. Is the stock market open today?

Haas: Oh yes, this morning.

Bell: I think the Board turned down the idea of closing it.

H.M.Jr: Is Reynolds back? What's her married name?

Lochhead: Was it Mrs. Betts?

Harris: Betts. B-e-t-t-s.

(Mrs. Betts brings in chart and clippings)

H.M.Jr: Good morning, Mrs. Betts.

This is why the market went up - "Secretary Morgenthau, bronzed by a month in Hawaii,"

Taylor: Yes, sir.

H.M.Jr: The Federal Reserve - are they still on our switchboard, or have they moved off?

Harris: They've moved off.

H.M.Jr: Have they?

Harris: Yes, so now we're down on our own trunk lines.

H.M.Jr: I sent Marriner a congratulatory telegram on the opening of the building. I happened to remember it. But he never acknowledged it. August 5th, wasn't it?

Bell: Looks nice at night. Fountains running on each side, lights and grill work in front of the door.

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Taylor: It's about as well-designed a building as I've ever seen.

H.M.Jr: What I like about them is that they spent sufficient money to landscape it. Most buildings in Washington aren't landscaped.

(Secretary reads bond chart)

Harris: I'd say the market is really unchanged this morning. There's nothing doing at all. The bid quotes are practically unchanged.

H.M.Jr: I wonder what the price of gold is today?

Lochhead: In London?

H.M.Jr: Yes.

Lochhead: Slightly under parity - 8476. We got something from London yesterday - I mean it came in today - about three million dollars worth, through the Fund.

H.M.Jr: Well, it's just as well to have the market open. But you say it's unchanged? What are the maturing notes again?

Harris: The 3-1/4's are up two thirty-seconds.

H.M.Jr: They do some little business, though.

Bell: That's a little above what the premium would be on the 15-month note.

Harris: Not after you discount your interest.

Bell: Take off your interest for 15 days, it's about right.

H.M.Jr: Now about the privately - the commercial bonds? How are they acting?

Haas: A little bit better than ours.

H.M.Jr: A little bit better than the Governments?

Haas: Uh-huh.

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H.M.Jr: Is that a good or bad sign?

Haas: Well, I'd say it was.....

Harris: There are no prospects for any corporate financing next week at all - any large issues coming out.

Haas: I'd say that's a plus sign.

Taylor: Well, it gives you a better technical condition, if that means anything.

H.M.Jr: How are the holdings of the - shelves of the bond dealers?

Bell: Very good. Burgess said the technical position of the dealers was fine.

Harris: They are short on the notes.

Taylor: They are all even on the bonds - slight short position in notes.

H.M.Jr: And now is the buying of securities by foreigners?

Lochhead: Still slightly on the buying side, but there is not enough to make much difference; it can swing to one side or the other without making more than a million dollars difference. But still slightly buying.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

Fin

101

DATE September 4, 1937

TO Secretary Morgenthau
 FROM Mr. Haas *MA*
 Subject: September Financing

I. Money Market Developments During the Past Quarter

A. Changes in Prices and Yields

There has been surprisingly little net change in money rates and bond yields during the past three months. Moderate June declines in the prices of both short- and long-term obligations were followed by substantially greater increases in the month of July; but since the first week in August, the market has turned down again abruptly (see accompanying charts). The negligible character of net changes during the past three months may be seen in the following comparisons:

Rate or security	Yield or price	
	June 1*	September 2
90-day bankers' acceptances	1/2	7/16
4-6 months prime commercial paper	1	1
Call money	1	1
273-day Treasury bills	.56	.62
Treasury notes, 1-3/8 percent, September 15, 1939	1.30 **	1.31
Price	(100-5/32)**	(100-4/32)
Treasury notes, 1-3/4 percent, March 15, 1942	1.71 **	1.72
Price	(100-6/32)**	(100-4/32)
Long-term Treasurys	2.63	2.67
High grade corporates	3.32	3.28

* Or date closest thereto for which the data are available.
 ** June 15.

B. Bank Loans and Investments

Bank loans during the past quarter have continued the expansion renewed last spring. The commercial, industrial, and agricultural loans of weekly reporting member banks increased by \$346 millions, and their total loans by \$387 millions, between June 2 and August 25, 1937.

This loan expansion took place at the expense of the bond holdings of banks, in substantial measure. The total investments of weekly reporting member banks between the two dates previously cited declined by \$230 millions, of which \$55 millions was accounted for by declines in holdings of direct interest-bearing public debt, \$22 millions of guaranteed Federal obligations, and \$153 millions of other securities. This decline in holdings of direct interest-bearing Federal obligations took place during a period when the aggregate volume of such securities available for bank investment increased by approximately \$895 millions.*

During the week ended September 1, reporting member banks in New York City recorded an increase of \$31 millions in brokers' loans, and \$17 millions in commercial, agricultural, and industrial loans. The latter increase is the fifth successive weekly expansion in such loans reported by these banks. During the week, they reduced their holdings of United States Government securities by \$7 millions.

C. Excess Reserves

Bank liquidation of investments in amounts equal to a large proportion of their increases in loans (60 percent for weekly reporting member banks) took place despite the maintenance during the quarter of excess member bank reserves varying between \$700 millions and \$960 millions. The distribution of excess reserves, however, was notably uneven during most of the quarter. The excess reserves of New York City banks, in particular, were drawn down to relatively small proportions on several occasions.

Banks have done very little rediscounting with the Federal Reserve banks in order to obtain more reserves, for they have found it cheaper to meet temporary requirements by

* Includes aggregate increase in direct interest-bearing public debt except United States Savings Bonds, Adjusted Service Bonds, Postal Savings Bonds, and special issues to Government agencies and trust funds.

borrowing the excess reserves of other banks -- so-called Federal funds. Nevertheless, during the week ended September 1, there was an increase of \$5.2 millions in bills rediscounted, bringing the total for the twelve Federal Reserve banks to \$23.7 millions on September 1.

D. Discount Rate Reductions by Federal Reserve Banks

On August 21, the Board of Governors of the Federal Reserve System announced reductions from 2 to 1-1/2 percent in the discount rates of the Chicago and Atlanta Federal Reserve banks, to take effect immediately; on August 23 and August 26, similar reductions were announced for the Minneapolis and Richmond Reserve banks, respectively; on the latter date, a reduction from 1-1/2 to 1 percent was announced in the discount rate of the Federal Reserve Bank of New York; and reductions from 2 to 1-1/2 percent were announced for the Dallas, St. Louis, Boston, San Francisco, and Kansas City Reserve banks during the past few days. In connection with the first of these announcements, the Board issued the following statement:

"The Board of Governors has approved the action of the directors of the Federal Reserve banks at Atlanta and Chicago in reducing the discount rate from 2 percent to 1-1/2 percent, effective in the Sixth and Seventh Federal Reserve Districts, respectively on August 21, 1937.

"The Board's approval was based upon the view that the reduction of discount rates at this time would assist in carrying out the System's policy of monetary ease and make Federal Reserve bank credit readily available to member banks for the accommodation of commerce, business, and agriculture, without encouraging member banks to borrow outside of their districts or to liquidate their portfolios in order to be in a position to meet the needs of present or prospective borrowers.

"The reduction in discount rates, which has had little or no practical effect during the period when excess reserves were abnormally large and widely distributed throughout the System, brings the rates into closer relation with the interest rate structure generally prevailing, and affords to member banks the benefit of rates, on advances made by the Federal

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Reserve bank, which are in line with those available in the money market. During the extended period when excess reserves of the banking system were between two and three billions of dollars, the occasion did not arise except in rare instances for member banks to borrow from the Federal Reserve banks, and the discount rates were accordingly inoperative as a practical matter.

"As a result of the continued progress of the recovery movement, demands of agriculture, industry, and commerce for bank accommodation have steadily increased and at the present time are augmented by seasonal requirements, particularly with relation to crop movements. While excess reserves, following the action of the Board in increasing reserve requirements, remain at an unusually high level ~~of~~ approximately \$750,000,000 at present for the System as a whole, they are distributed preponderantly among the country banks and not in the money centers.

"The reduction of the discount rates in the two large agricultural districts of Atlanta and Chicago should serve to assist the member banks to utilize credit directly available in these districts in order to meet banking requirements in connection with crop movements and business needs.

"It is the Board's view, therefore, that at this time the Federal Reserve System can best discharge its public responsibility and promote the continuance of recovery by making it possible for member banks to obtain accommodation from Federal Reserve banks at rates which will encourage them to employ their funds to meet the needs of agriculture, industry, and commerce."

E. Federal Reserve Open-Market Portfolio

During the 14 weeks ended September 1, the Federal Reserve banks reduced their holdings of Treasury bills by \$12 millions, and increased their holdings of Treasury notes and bonds by \$6 millions each. During the last week of this period, Treasury bill holdings were reduced by approximately \$1 million and bond holdings were increased in the same amount.

II. Current Situation in the Money Market

As has been pointed out, the market for short- and long-term Governments, as well as other obligations, has turned sharply weaker during the past few weeks, and current sentiment appears to be pessimistic. The recent weakness in the market and the accompanying pessimism are, no doubt, due in part to the conflict in China and to the absence of visible improvement in the Federal budgetary situation. In our opinion, however, the more important causal influences are to be found in the prospective play of supply and demand in the short- and long-term money markets during the next several months.

(1) Excess reserves of all member banks, which amounted to about \$1,816 millions immediately after the increase in reserve requirements in August of last year, had been reduced to about \$750 millions on September 1 of this year. While the latter figure is large relative to any experience prior to 1933, it is small relative to the experience of the past several years. Banks, by and large, moreover, have not recovered from the liquidity complex engendered by the depression and the banking collapse. The fact that the relation between their capital funds and their deposit liabilities is now at the lowest point recorded since 1920 (see Table I) provides a cogent practical consideration that supports and accentuates their desire for liquidity.

The existing amount of excess reserves, moreover, is very unevenly distributed in the banking system. Most of such reserves are held by country banks, where they have been relatively sterile, while excess reserves in the primary money markets are very low. On August 4, the excess reserves of the principal New York City banks reached a low of only \$40 millions and the rate on Federal funds rose for a time from one-fourth to one-half of 1 percent. On September 1, the excess reserves of the principal New York City member banks aggregated \$133 millions.

(2) From January 1934 until December 1936, gold acquisitions by the United States Treasury constituted the principal source of increase in member bank reserve accounts. Since the institution of the Inactive Gold Account on December 21, 1936, this source of increase for member bank reserves has been cut off, and the banks are, therefore, the more inclined to husband their present excess reserves, at least until money rates become definitely more attractive. Moreover, full sterilization of newly

acquired gold acts positively to reduce excess reserves because such acquisitions increase the deposit liabilities of banks without adding at all to their reserves.

(3) During the year ended June 30, 1937, the total loans of all member banks increased by \$1,743 millions. The total loans and investments of the banks, however, increased by only \$481 millions. The difference was in large part due to a decrease of \$981 millions in their holdings of United States Government securities (direct and fully guaranteed).

The tendency for loans to increase and for such increase to be offset by a decrease in investments, principally Governments, has been much greater in the larger-size banks, and has been most important in the New York banks. The reporting member banks in New York City increased their total loans by \$761 millions between June 30, 1936, and September 1, 1937, but decreased their total loans and investments by \$686 millions, the offsetting items being a decrease of \$1,251 millions in United States Government obligations (direct and fully guaranteed) and \$196 millions in other securities.

This expansion in loans is still continuing and should be seasonally accelerated in the fall. It is most vigorous in New York City, where excess reserves are relatively the least. The prospective continuing expansion in loans, while possibly exaggerated by many bankers, provides an additional and important incentive to member banks to conserve their free reserves.

(4) Many bankers expect a substantial reduction in their reserves as a result of the normal seasonal expansion in money in circulation this fall and winter. Last year, money in circulation rose by approximately \$500 millions between the middle of August and Christmas week. During the week ended September 1, currency in circulation increased by \$37 millions and may show a further increase this week because of the Labor Day holiday requirements. The greatest increases will occur in the Christmas shopping season. This year promises to see an exceptionally heavy crop movement at good prices, and the seasonal expansion in circulation may easily exceed last year's increase. Such an expansion, unless offset by other factors, would result in a dollar-for-dollar decrease in bank reserves, and, as previously noted, total excess reserves of all member banks approximate only \$750 millions at this time.

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(5) While insurance companies, savings banks, and other institutional investors possess considerable funds available for investment, their demand is being met in part by the securities liquidated by commercial banks. The latter, we have seen, have been sellers, rather than buyers, on balance, for some time, of Governments and other securities; and it appears likely that this will continue to be the case during the next several months. Further, these institutional and private investors have been absorbing not only the securities liquidated by commercial banks, but they have also been absorbing the continuing increase in the interest-bearing public debt. It should be noted that this absorption has been taking place in fairly satisfactory fashion. This source of investment demand cannot be relied upon to counteract short-term market weakness, however, because these investors tend to invest their funds most freely during periods of market stability or even strength.

III. Alternative Financing Media

The September financing will consist entirely of the re-funding of \$817 millions of maturing notes. These notes are held very largely by banks, principally the larger banks, with a fair sprinkling of holdings by other financial institutions, dealers, and corporations. There is a normal tendency for maturing notes to be concentrated in the larger financial institutions, but this issue has the reputation of being very well distributed.

An attempt to replace these notes entirely by a bond issue would tend to force the pace of the transfer of Government obligations from banking to non-banking holders, and might result, at worst, in a further break in the market, and at best, in a soggy technical position. It is concluded, therefore, that a large part, at least, of the securities offered in exchange for the September notes should be of a character definitely suitable for retention by the banks now holding the maturing issue.

It appears to be clear that a bond issue offered in exchange for the maturing notes would not prove attractive for continued retention by all of the present holders, many of whom, it is believed, would particularly welcome a rather short-term note. A 5-year note issue would be unlikely either to attract the latter type of holder, or institutions seeking the higher coupon rate that would be associated with a bond offering. While the 4-3/4-year note issue sold in June has behaved relatively well, it was originally priced rather liberally in view of the yields then available on adjacent issues.

A. 15-month 1-1/4 percent note:

On the basis of the present market, or one somewhat worse, the issue that would appear to have the clearest sailing would be a 15-month 1-1/4 percent note maturing December 15, 1938. The outstanding 2-1/2 percent notes that mature three months earlier are selling to yield .77 percent*, and the 1-1/2 percent notes that mature three months later are selling to yield 1.23 percent. If the subject issue were to sell on a yield basis midway between those of the two adjacent issues -- 1.00 percent -- it would command a premium of 10/32, a very liberal premium for such a short-term note issue. It would

* All current quotations and yields are as of the close of September 3.

command a premium of 6/32 even if a worsening of the market caused it to sell on a 1.10 percent basis. On the other hand, limiting the exchange offering to a 15-month note might arouse unfavorable comment to the effect that the Treasury had been forced to confine its offering to a very short-term note issue because of the unsatisfactory condition of the money market.

B. Joint offering of 1-1/4 percent 15-month note and 2-1/2 percent 7-year bond:

The possibility immediately arises to mind, therefore, of making a joint offering of a 15-month note and a longer obligation.

Many non-banking institutional investors, particularly insurance companies, are likely to be more attracted to a 2-1/2 percent short-term bond issue than to either a low-coupon short-term note or a 5-year note. In the eight offerings for cash of Treasury bonds and notes (four of each) beginning with those of March 1936, the direct subscriptions of insurance companies have shown a distinct preference for bonds (see Table II), a preference which is more marked when consideration is also given to their purchases of these offerings from banks and dealers on secondary distribution. These investors may not participate substantially in the direct exchange subscriptions for the September offering, but the knowledge of their demand for bonds should tend to make a medium-term bond offering attractive to those note holders who expect to resell the new securities which they obtain on exchange subscriptions. This consideration would not hold nearly so well for a long-term bond because many investors doubt the maintenance of the present relatively low level of interest rates.

The joint offering, if the relative amounts of each security were made optional with the subscribers, would retain for the Treasury that section of the demand which is confined to a very short-term instrument, and would nevertheless leave open the opportunity for the refunding of a considerable portion of the maturing notes into bonds. The relative pricing of the jointly offered issues would naturally be such as to encourage subscriptions for the bonds; for a distinctly lesser premium is ordinarily required for short-term notes than for longer obligations. The greater probable premium offered to the bond subscribers may be considered in the nature of an underwriting and distributing fee to those subscribers who make their subscriptions with the intention of reselling the securities to other investors.

A 7-year 2-1/2 percent bond issue, maturing September 15, 1944, should sell, in the present market, on a yield basis between 2.30 and 2.40 percent. The current yields of the outstanding issues of nearest comparable maturities are the following:

3-1/4's of October 1943-45	-	2.28
3-1/4's of April 1944-46	-	2.36
4's of December 1944-54	-	2.37

On a 2.30 percent yield basis, the premium would be 1-9/32; on a 2.35 percent yield basis, 31/32; on a 2.40 percent yield basis, 21/32; and on a 2.45 percent yield basis, 10/32.

The year 1944 now contains no maturities, although the 3-1/4's of 1944-46 and the 4's of 1944-54 begin their callable periods in that year. Because the preceding several years will probably contain substantial note maturities, and because an issue with a single fixed maturity date is likely to prove especially attractive to the market under present conditions, there would appear to be no adequate reason for making the bonds callable prior to the final maturity date.

The principal risks in a joint offering of this character are that a preponderantly large proportion of the subscriptions might be made for the notes, which would occasion adverse comment; or that the bonds might be priced so much more attractively than the notes as to cause a greater volume of subscriptions for the former than could readily be digested during secondary distribution.

C. A 2-year or 3-year note:

The principal objection to a 3-year note issue at this time is the fact that the existing note maturities of 1940 already amount to nearly \$3 billions; and would be raised to \$3,670 millions if they were increased by an additional \$817 millions. The situation with respect to a 2-year note is even worse in this regard; for the existing note maturities of 1939 would be raised to more than \$4 billions if increased by \$817 millions.

As between a 2-year and a 3-year note, the advantage would appear to be altogether in favor of the 3-year note. In

addition to the greater concentration of note maturities in 1939 than in 1940, there is the further fact that no open quarterly financing date exists in 1939, whereas September 15, 1940, is now open. Further, the note issue maturing September 15, 1939, which is outstanding in the amount of \$427 millions, is selling at too small a premium ($\frac{4}{32}$) to permit the use of additional notes of this issue to refund the notes maturing next month. Despite the increase in aggregate note maturities involved, the use of a 3-year note maturing September 15, 1940, for the September refunding operation merits very careful consideration. Such an issue would require a coupon rate of $1\frac{3}{4}$ percent and in the present market should command a handsome premium. The outstanding $1\frac{1}{2}$ percent notes that mature three months earlier are selling to yield 1.47 percent; and the outstanding $1\frac{1}{2}$ percent notes that mature three months later are selling to yield 1.51 percent. At the midpoint between the yields of these two issues, a 3-year $1\frac{3}{4}$ percent note would sell to yield 1.49 percent; and on this basis would command the ample premium of $\frac{24}{32}$. On a yield basis of 1.55 percent, the premium would still be $\frac{19}{32}$; and on a 1.60 percent yield basis the premium would be $\frac{14}{32}$. It would appear, therefore, that a 3-year $1\frac{3}{4}$ percent note, unless the market suffers a very drastic break, would command a sufficient premium to assure the success of the issue. As indicated above, its principal drawback is that it would involve a further concentration of the heavy note maturities now scheduled for 1940.

D. A 4-year note either alone or optionally with 15-month note:

A 4-year note maturing in 1941 would obviously be a more desirable financing medium for the Treasury than a 15-month note maturing December 15, 1938 -- other things being equal; the difficulty is that other things in this case are very different indeed. A 4-year note is not likely to be welcomed with much greater enthusiasm than a 5-year note. It would not meet the demands of those who seek a note of near-term maturity, who would be attracted to a 15-month note; and, on the other hand, it would not carry a coupon rate, such as would be borne by a 7-year bond, which would attract institutions and others seeking higher yield.

The outstanding $1\frac{3}{4}$'s of March 1942, are selling to yield 1.74 percent. Between this issue and that of June 15, 1940, all the intervening note maturities are currently selling below par, and this fact makes their market yields

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unreliable as a measure of a probable premium of a new issue designed to mature during this period. The effect of the discounts at which the 1941 note maturities are selling in obscuring the relationship between maturity and yield may be seen in the fact that the December 1940 maturity, selling at 99-31/32, yields 1.51 percent, whereas the notes maturing one year later, which are quoted at 99-2/32, are selling to yield only 1.48 percent. It would appear that the probable yield basis for a 4-year note issue could not be safely estimated at anything under the market yield of the March 15, 1942, note maturity -- currently 1.74 percent. A 1-7/8 percent 4-year note would command a premium of only 16/32 on this yield basis -- which would be rather thin in view of the character of the issue and the present market.

If a 2 percent coupon were to be employed, the probable premium, on a yield basis of 1.74 percent, would be 1 point which would be ample in the absence of strikingly unfavorable international news.

There remains the alternative of a joint offering of 1-1/4 percent 15-month notes and 1-7/8 or 2 percent 4-year notes. This alternative merits consideration. If, however, further assurances can be had from New York with respect to the receptivity of the market to a 7-year 2-1/2 percent bond, it would appear that the joint offering of the 15-month note and the 7-year bond would be preferable. The latter type of offering is apt to provide a better secondary distribution; and the fact that the entire refunding operation is not confined to notes would be interpreted by the market as an indication of confidence.

Attachments

Table I
Total Deposits and Total Capital Funds
All Member Banks

June 30	:	Total	:	Total	:	Capital funds
	:	deposits	:	capital	:	per dollar of
	:		:	funds	:	deposits
		(Millions of dollars)				(Cents)
1920		25,372		3,853		15.2
1921		23,325		4,133		17.7
1922		25,517		4,214		16.5
1923		27,053		4,367		16.1
1924		29,530		4,486		15.2
1925		32,420		4,690		14.5
1926		33,724		4,832		14.3
1927		35,351		5,147		14.6
1928		36,060		5,625		15.6
1929		35,893		6,180		17.2
1930		38,139		6,543		17.2
1931		36,268		6,166		17.0
1932		27,864		5,317		19.1
1933		26,587		4,441		16.7
1934		31,012		4,731		15.3
1935		34,938		4,770		13.7
1936		40,706		4,904		12.1
1937		41,490		5,019		12.1

Table II.

Allotments on Cash Subscriptions to Treasury Offerings of Bonds and Notes,
March 1936 to June 1937, Inclusive, by Classes of Subscribers

(millions of dollars)

	Treasury Notes				Treasury Bonds			
	1-1/2's A-1941 (3/15/36)	1-3/8's B-1941 (6/15/36)	1-3/8's D-1939 (6/15/37)	1-3/4's A-1942 (6/15/37)	2-3/4's 1948-51 (3/15/36)	2-3/4's 1951-54 (6/15/36)	2-3/4's 1956-59 (9/15/36)	2-1/2's 1949-53 (12/15/36)
Banks and Trust Companies	354.9	295.3	281.3	248.8	273.9	280.0	164.7	321.4
Dealers and Brokers	76.0	27.8	29.2	56.3	115.3	83.2	51.0	85.5
Individuals	31.2	14.9	7.0	19.4	83.2	77.7	90.7	51.6
Savings Banks	28.2	14.2	18.3	18.0	38.9	33.6	22.7	42.6
Insurance Companies	43.5	25.5	32.5	45.8	101.9	85.8	62.7	107.5
Other Financial Institutions and Investment Corporations		7.9	11.1	6.9		20.7	12.7	29.2
Corporations organized for profit		38.3	35.9	17.1		45.1	32.2	74.8
Trust Accounts		4.5	5.7	5.2		17.2	12.8	11.6
All Others	94.5 *	6.5	5.4	8.7	113.3 *	27.2	20.2	26.3
Total	628.3	434.9	426.4	426.2	726.5	670.5	469.7	750.5

* More complete breakdown not available.

MEETING WITH EXECUTIVE COMMITTEE OF
FEDERAL RESERVE OPEN MARKET COMMITTEESeptember 4, 1937
11:00 a.m.

Present: Mr. Taylor
Mr. Bell
Mr. Loanehead
Mr. Seltzer
Mr. Harris
Mr. Haas
Mr. Ransom
Mr. Harrison
Mr. Burgess
Mr. Piser
Mr. Broderick
Mr. Williams
Mr. Thomas
Mr. Szymczak

H.M.Jr: Well, I've been getting all the rosy reports about Government financing.

Szymczak: Everything is lovely.

H.M.Jr: Everything lovely. Things are picking up.

I think we usually start - open our meeting with a prayer from Brother Bell.

Bell: It will be a prayer, I think, this time.

We are going into September with about 820 million dollars in our balance, and the present schedule of Treasury bills contemplates 150 million dollars additional money in September for maturity in December. That would make a total of 500 million dollars of Treasury bills maturing around the 15th of December. That schedule will permit us to go out of September with 700 million dollars in our balance. Then, contemplating that we would have about 300 million dollars of additional Treasury bills some time between now and the first of December for maturity in March, we would go into December with about 640 million dollars in our balances. And that contemplates 75 million dollars a month for gold and the paying off of 350 million dollars of Treasury bills on September 15. That is about the picture.

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Do you want to mention anything about the Treasury bill program at this time?

- H.M.Jr: Yes. In talking it over with the men this morning, I want to suggest that we don't offer any more December bills - I mean stop now, leave it at 450.
- Burgess: That is, not offer any more next week.
- H.M.Jr: Not offer any more next week.
- Bell: That would be one issue less.
- H.M.Jr: We've got enough money, and the way the program is now we only figured on 300 million for March 15, and we could use more money on March 15, because the tax receipts will be heavier and we could handle it better there. And this would run the rate up pretty high on us. We could say we didn't need the money just now - might help a little bit.
- Burgess: I think you're right.
- Harrison: I'm in favor of that.
- H.M.Jr: I mean I - I wonder if anybody can see anything - any objections to doing it.
- Bell: We have announced a program up to September 15.
- Burgess: You can always say your cash position is such that you don't need the additional amount.
- H.M.Jr: I want to say for the men here in the Treasury that it was my suggestion to make it 500, so I'm simply reversing myself, nobody else.
- Burgess: I think it is undoubtedly true that the pressure of these additional bills the last couple weeks, which is a little more than the market anticipated, has been a very important factor in pushing those rates up, and if the market learns now, or at the same time you make this announcement about the financing, that you aren't taking any bills, I think it would be helpful.

Taylor: How long would you stay out? To the first of October?

Burgess: That is not necessary. I think you can judge a good deal by the market. I wouldn't commit myself on that.

H.M.Jr: But I just thought the thing seems to be kind of - a little uncertain, and if we could just - I mean 50 million dollars less we're going to take out might give it a little bit better tone. How do you people - Board members feel?

Szymczak: I think that is quite sound.

Ransom: All right.

Broderick: It will help.

H.M.Jr: We don't need the cash. We really don't. As a matter of fact - I think I'm right - Bell, didn't about 50 million more come in, something like that?

Bell: About 20 million. We contemplated an 800 million dollar balance and we got about 20 million dollars more.

H.M.Jr: Well then, shall we decide that we'll have no more of these December bills? Anybody object to that?

Ransom: I think it would be very helpful.

H.M.Jr: All right, that is Decision Number One.

Burgess: That's a good start.

Bell: Excellent.

H.M.Jr: Well now, do you want to add anything?

Bell: No, I think that's all.

H.M.Jr: Well, George, you and Randolph are going to give a report.

Harrison: I think Randolph better give it. I'd like to say - no, I'd rather reserve my comments until after he reports factually on what has been happening in the markets, which would be a good way to start.

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- H.M.Jr: Before he starts, I want to say that Mr. Taylor and Mr. Bell gave me their report. They met with 19 different groups in two days. And it has helped me a lot to get that report this morning. So - I mean I've got that picture; but I wouldn't say the picture was a unanimous one. What?
- Burgess: No.
- H.M.Jr: I mean it didn't....
- Burgess: There is rather more difference of opinion than usual.
- H.M.Jr: If you would....
- Burgess: Well, about the condition of the market. I think that in the language of the marketplace, one might say that in the second half of August we have had a secondary reaction from the decline which took place in the spring. In the spring we had a general liquidation of the Government market and of the general bond market, a severe general liquidation. From early in May or late April we had a recovery from that liquidation over an extended period, which reached a peak along early in August. And then we had - which is rather natural in markets, if you think of it in those terms - a secondary reaction.
- Now, as to the character of that reaction, it was more an absence of buying than it was pressure of selling. There were some sales, but in general it was an absence of buyers. The insurance companies have been out of the market for a long time, and will only come in sporadically; they have talked about waiting for a three percent rate. The out-of-town banks - there have been a few buyers, but the banks in principal cities have tended to reduce their Government holdings. That is, the tendency of the past year for banks to work out gradually has been continued, but not in any such precipitation - that is, this secondary reaction has not been a severe reaction of the type of last spring.
- H.M.Jr: May I interrupt you? What do you feel the motivating factor has been?

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Burgess: Well, I think there are two, Mr. Secretary.

H.M.Jr: I'd like to go into a little bit more detail than I have usually, because I've got to soak this stuff up.

Burgess: It seems to me there are two major bases for this secondary reaction. Of course, the background picture is that whenever any market has behaved as the bond market did last spring and then has recovered a good part of the way, you look for a secondary reaction; but there is always some specific cause of it. I think in this case primarily it is sympathetic with a general reaction in all markets, including commodity markets, bond market, and stock markets. Your stock market reaction was delayed later than your bond market somewhat, and reached great severity and liquidation - again in a very quiet market, but with quotations slipping away because there weren't buyers. You had war news from Spain and from China. You had a generally pessimistic atmosphere, partly due to the fact that security dealers had not been able to make profits; they made continuous losses, and under that atmosphere they are afraid to make commitments - one of fear. So there is extremely little speculative commitment in securities; there is very little in the way of speculative commitments in anything right now. In real estate, in commodities, it is a period of reaction, if you will, from two years of generally rising security markets and optimism and so on.

Now I think that is the fundamental basis of this market.

H.M.Jr: Does that go for inventories too?

Burgess: Yes, that goes for inventories. You have had a period of accumulation of inventories. Now I think you've got a period where those inventories are piled up and people want to work them off - certainly true in textiles, probably true in a lot of other lines - reluctance to go ahead. Also in terms of the marketplace, it is perfectly natural that after a period of two years of upward movement you get a period of pause, even though, in fact, the business picture seems to be coming along pretty well.

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- H.M.Jr: Well, what is the latest figure on the Federal Reserve index?
- Hses: 114, isn't it?
- Thomas: 114 - that's for the month of July; probably will be not much - probably be about the same in August; can't tell yet, because we don't know about the textile situation.
- H.M.Jr: As I remember, Goldenweiser gave me a guarantee it wouldn't go below 115. That's close enough.
- Thomas: I think his statement was that no three months would average below 115. Probably will be slightly below - may round off to 114½ or something like that.
- Burgess: Now, that general background seems to me to be the primary cause of this secondary reaction - the primary cause. Now, the second seems to me to be the money position. Almost every autumn since 1931, over every autumn, really, we have had some hesitation in the markets at this point because of banks looking ahead to the autumn season and wondering how they are coming out on their reserve position, etc.; and that has been true this year. Perhaps that factor has been more effective this year than usual; as a matter of fact, the effect on the market has been less than it was in '34 and '35. We had very little in '36.
- But there has been a good deal of discussion about the autumn requirements for funds - a good deal of talk among the banks of putting themselves in a position so they could meet whatever demand develops. I think that has probably been overplayed somewhat, and that the requirements for funds have been accentuated - over-accentuated in advance. But that is the second item - motivating immediate factor, I think, in the market.
- Now, as to the character of the decline, as I said before....
- H.M.Jr: May I interrupt you at that point? When you are talking about your money needs, is there any particular spot or any particular banks who are

operating - I mean pretty close up to reserves?

Burgess: Well, the New York banks in general are operating reasonably close.

H.M.Jr: "Reasonably" - what do you call "reasonably"?

Burgess: Well, some days they are over, some days they are under. In general they have averaged, most of them, a little over. At times they have bought Federal funds. Now, they haven't been tight enough so that they have had to sell bank bills. They have a portfolio of some 200 million of bank bills which they would sell if the pressure were severe. But so far the bank that was under has always been able to buy Federal funds at a quarter of one percent.

Harrison: Or a half.

Burgess: Well, a few times, but not many.

H.M.Jr: But are any of them - what are the total rediscounts with the Federal Reserve System?

Piser: 25 million, I think, is the latest figure.

Harrison: Ours went up 2 million dollars last week. There is a tendency toward increase.

Thomas: 24 million was the latest figure.

H.M.Jr: What was it about a month ago?

Thomas: About 15 - four weeks ago it was 15.

H.M.Jr: And four weeks before that.

Thomas: Well, roughly....

Piser: Around 10, I think.

Harrison: Of which about 3 million was New York. But there has been real evidence, certainly in our district, and I think in some other districts, of an expansion of loans. Having in mind a discussion of the New York money market, I made a survey of the 25 largest banks in New York, and the figures showed that so-called commercial loans (and it's pretty hard definitely to define them) have gone up from a billion four to a

billion nine in twelve months; that is an increase of about 39 percent. That increase is fairly well distributed throughout the New York banks. The increase is probably more than that in percentage, because of the fact that our figures of a year ago included certain items that are now excluded from the same figures. But each of the individual banks is reporting increasing demand, especially from larger companies, national corporations, for funds - companies that haven't borrowed for five, six, seven years.

H.M.Jr: What do they do with the money?

Harrison: Buying inventory, due to increased volume of business. The Endicott-Johnson people are borrowing now to buy for the first time in six years; borrowed, I think, ten million dollars last week. The tobacco companies are all buying tobacco; business is holding up pretty well. Some of the chocolate companies are buying cocoa because their business has been good. And all through the whole list that seems to hold good.

H.M.Jr: Well, that's helpful.

Harrison: Oh, very, very helpful. But looking at it as one of the factors in the market, you are approaching the fall season with the New York banks realizing, and all banks realizing, that we will have an increase in currency demand between now and Christmas of some five hundred million dollars; probably that's about what it was last year for the same period. There is evidence of increased demand for harvesting crops; due to the fact that crops are so much larger, they are requiring more help to harvest. They are borrowing from their banks to harvest and move their crops.

And then, on top of that, is this very definite widespread evidence of an increase in demand for commercial loans. All of which is good. But they form a part of the banking mind as to what their position may be at the end of this year.

The System has made some estimates that, whereas excess reserves right now are around seven hundred to 750 million dollars - I forget the exact figure

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now - it is not impossible they may be reduced to around 300 or 350 million before the end of the year, for the System as a whole. You might find New York going down to a pretty nearly even basis possibly before Christmas. But that's not bad. It is a seasonal pressure which you always have, that the banks expect, and that corrects itself immediately after the turn of the year, when currency begins to come back again. The problem therefore is, how should the money market take care of itself during what we call a temporary period, taking care of the seasonal demand for credit and for currency?

I think it is very clear that if the New York market reserves do go down, say, to an even basis and certain banks need funds, they will not then be in a position to buy reserves from another member bank, and it is likely that they will have to borrow. I hope they will. It would be in my judgment a healthy situation if they do.

- Ransom: There has also already been some inter-bank borrowing from correspondent banks in some districts other than New York; I don't know what the situation is there.
- H.M.Jr: Well, with that in the offing - they make their money by that - I mean if they see something like that three months off, it must make them very cautious as to their commitments about Governments.
- Harrison: I think our reduction in rediscount rate will be helpful in assuring them that they can go ahead with their commercial business, because they won't be so uneasy about the necessity for borrowing if it should arise.
- Szymczak: In that connection, George, haven't you talked to some New York banks and haven't they promised you that they would borrow instead of selling Governments?
- Harrison: I have talked to practically all the banks in New York, trying to make them see the picture as a money market rather than as an individual bank. For instance, the National City said, "We have

accumulated a large volume of short Treasury bills hoping that we will be able to take care of our requirements, allowing bills to run off." I said, "That's quite right and proper from the point of view of an individual bank, but suppose that every bank in New York is in the same situation; are you all going to allow bills to run off or sell Governments, or are you going to borrow?" And the quite unanimous judgment of all of them was that if and when that situation should develop, they'd be perfectly willing and free and glad about borrowing, especially now that we've got our rate down, rather than to liquidate assets. And I am very encouraged about the situation, because what has happened is what we have expected and hoped would happen at some time. Be much more healthy. And as long as they realize that they've got a central bank to which they can go to take care of a purely temporary dip, realizing that they will get out of it again after the turn of the year, there shouldn't be any substantial disturbance to the money market as a result of it.

H.M.Jr: Burgess?

Burgess: Well, I think a word further might be said about the technical position of the market. First, as to the character of the selling. There is some evidence in what we have had to do, - as you know, we have stood by to try to keep an orderly market.

H.M.Jr: I don't know what you've been doing.

Burgess: During this period we have had only to go into the bond market for approximately seven million dollars; and we were able to sell - that's all for longer bonds - against that, we were able to sell two million dollars of shorter bonds; so that we have only had to extend our bond position by five million dollars.

H.M.Jr: Does that show up that you own five million dollars more?

Burgess: No, we let Treasury bills go to that amount.

H.M.Jr: No.

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Burgess: So that indicates it wasn't a very severe, precipitous, disorderly occasion, because our operations have been thus limited, and I think we have had all the time a reasonably orderly market.

Now, this chart here is very interesting on the technical position, comparing the yield on Governments with the yield on corporate bonds, - the second chart and the third chart - showing that the spread between the yields on Governments and the yields on other bonds is narrower than it has been for a good many months. You can put it another way by saying that early in March the market was in a poor technical position in relation to other bonds, and now it is in a very good technical position; that is, Governments are cheap compared with the other bonds at the moment.

Now, also bearing on the technical position is the dealer position; that position is very well liquidated. They hold nothing in the way of bonds or long notes. They are just zero.

H.M.Jr: Are they short on anything?

Burgess: Well, they were a little short on notes - about 10 million dollars short on notes.

H.M.Jr: Harris tells me this morning that the maturing 3-1/4's are up two thirty-seconds.

Burgess: (Nods yes)

H.M.Jr: You (Harris) might get the close on that. Which is better than having it go off two thirty-seconds. What?

Harrison: Very.

Burgess: Been very quiet this morning, but up, as you say, two thirty-seconds.

H.M.Jr: That, as I say, doesn't do any harm. What?

Burgess: No, I think that's all right.

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Harris: They closed 12-10, the other notes unchanged, and the bonds one thirty-second up to two thirty-seconds off. Volume is two hundred thousand.

Burgess: That's the smallest volume on a Saturday for a long time.

H.M.Jr: Practically frozen, isn't it?

Burgess: Just stopped - people have practically stopped trading until the issue comes out.

I think I ought to add - I was naming these causes a minute ago - I think I ought to add some other things that are mentioned in the market pretty frequently. One is the budget, and the market has been a little discouraged about that lately. I don't know how big a factor it's been, but they mention it. Another I was rather surprised to get from the President of an insurance company was uncertainty about gold as the cause of lack of buyers in the Government market. All of which, I think, are factors in the effect that this spread between the yields on Governments and corporates is not as wide.

H.M.Jr: Well, the rumors on gold was one of the things that wore me down to a nervous minimum - one of the things they do not worry about in Hawaii.

Sinclair: Your pants were renewed.

H.M.Jr: Well, I think one of the things that somebody has to do, and when I see the President I'm going to talk to him about it, is that we ought to give out an A-B-C statement on the budget in language so a high school child can understand it; because certainly in the papers that I have been reading, if I didn't know the facts, the impression that it gives - it's just so complicated that people don't understand it.

Harrison: I think there's a lot of truth in that.

H.M.Jr: I think a very careful statement has to be prepared. If the President doesn't want to do it, I'd be delighted to do it. Very, very simple - not more than 15 minutes - give it very simply. After all,

these different funds and everything else - it's impossible for the newspapermen to understand it. Huh?

Bell: I think the usual newspaperman, particularly A. P., is confined to a few words in his story, and it hits the high spots and the totals, and he never explains why a total is up, which was what should have been explained in the July figure.

H.M.Jr: Well, the falling off in our emergency expenditures is over a third, isn't it?

Bell: That's right, and that's a factor in the July figure never mentioned.

Harrison: Mr. Secretary, one or two fellows say an interesting thing, that the rumors about the budget are somewhat substantiated by the fact that the Treasury hasn't seen fit to somewhat reduce its balances; that the fact that you still continue to run such big balances indicates a measure of, not nervousness, but caution on your part which you wouldn't need to exercise were you so sure about the budget. Now, there might be something in that. You're going to reduce it fifty million dollars; I'm glad to hear that.

H.M.Jr: Well, of course, June 15 we cut down so close that they might have thought the budget was balanced.

(Hearty laughter)

But they didn't interpret it that way.

Szymczak: Didn't think that way.

H.M.Jr: No. There you are.

Szymczak: Mr. Secretary, you don't want to get out a statement on the gold question, the price of gold?

H.M.Jr: I don't think it's necessary. I haven't seen gold mentioned.

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Szymczak: Well, they are still talking about it.

Lochhead: The gold figures that came out last week - the headlines said that there was high production; then when you went back and looked at the percentages you saw the percentage was very moderate, and the Russian situation seemed to have quieted down considerably.

H.M.Jr: I think I'm very fortunate in the period I've been away as far as gold went - extremely quiet.

Szymczak: Starting to come in some now, mostly from Japan.

Taylor: No.

Lochhead: Well, Japan is still - about 22 or 23 million on the water from Japan.

H.M.Jr: How much have they got left?

Lochhead: Well, I don't know, of course, how much they can take off.....

H.M.Jr: What are your (Haas) figures on that?

Haas: About 340 million or something like that figure; that's very rough.

H.M.Jr: Left?

Haas: Uh-huh.

Lochhead: Besides that, they've got the other; haven't devalued at all.

H.M.Jr: Do they still maintain their Financial Commissioner in New York?

Lochhead: Yes.

H.M.Jr: But this Financial Attaché is located in London, isn't he?

Taylor: He covers, supposedly, three places.

Harrison: They have a representative of the Bank of Japan in

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New York first, and then the Yokohama Specie acts for the Government.

H.M.Jr: Who?

Harrison: Yokohama Specie.

H.M.Jr: Well now, with that very brief summary, have you - has it jelled in your mind what you think we ought to do?

Burgess: Well, I think it's one of the toughest questions we have had; there's more difference of opinion. The market hasn't coordinated on a single recommendation, as it sometimes has, and I think the same is true of the rest of us - more difference of view. I think even at the New York Bank there is more difference of opinion between our officers than usual.

My own leaning is toward - well, first, I think everybody agrees on one thing, or most everybody agrees - there wasn't complete agreement - that we ought to give these holders an option of two obligations. \$817,000,000, which is a good substantial figure - we could do it all in a very short note; that would probably be a mistake, be too conservative, be depressing on the market. We ought to give an option. Then we can have an anchor in a short note so we know we will complete the conversion; then we could step out beyond that into some longer obligation.

Now, as to the thing that would be sure-fire for your first option. The two things that we discussed were a 15-month note, where there is a free date - that's December, 1938 - or a September '40, a three-year note. I think the market has felt that anything up to three years would go very well, and our feeling - I think as we started this, our feeling was that a three-year note could be used as the anchor, that that would be perfectly safe as the anchor issue, and then go out beyond for the other issue, confident that no matter what happened the three-year note would be taken. Since we had that view, the market has weakened some, it has slipped away a little bit, there's been a good deal of uncertainty, and I think

the view now is that our anchor issue should be shorter than three years.

Now, what are the options on that? The two-year maturity is a little difficult, because we have on each tax date within two years or in that environment another fairly substantial maturity up to four or five hundred million dollars. We have just sold - that is, in June - a two-year note maturing in September, 1939, and that is all not fully digested as yet. You can see it in the quotation; the yield basis indicates, in comparison with the nearby maturities, that it isn't quite digested. So that while a two-year maturity would be pretty safe, it just happens that that two-year one isn't very good, and that drives us back a little further, and you'd be perfectly sure-fire for your anchor issue on a 15-month note.

Now, if you take that as the pivot, say, with that you are sure of the conversion, then the question is what other option you can offer that would be reasonably attractive in the market, that would attract the people that want a little more yield, would attract the investors a little more, that you could take a chance on, wouldn't care perhaps just how many took it. And the options on that, I think, are a three-year note as the most conservative thing, the four-year note as the next most conservative, a five-year note at 2% as stepping out a little further, and then, stepping out further, say, a 7-year bond.

Now, the appeal as you lengthen your maturity and raise your coupon - the appeal to investors is a little greater, the appeal to banks is a little bit less, so you take a little more of a chance. On the other hand, you make an appeal to a little different type of buyer, and you - of course, looking backward, you affect the Treasury position by refunding it longer or shorter. Generally speaking, there is a good body of opinion that the Treasury short-dated debt is pretty nusky and you want to step out as far as you can.

My own personal leaning has been that you could afford to take a chance on the bond plus the short

note, and if you only got conversions of two or three hundred million, why, all well and good, you've done that much stepping out and that would furnish some leadership in the market. Be a much stronger program than to do it all in short.

H.M.Jr: Well, if we only got two or three hundred, wouldn't they consider that pretty poor?

Burgess: Well, it wouldn't be brilliant, but it might be better than doing the whole thing short, which they would say was a confession of weakness. Now, I think there's room for a good deal of difference of opinion on that and much to be said for the next most courageous thing; that would be a 15-months and a five-year note.

H.M.Jr: A what?

Burgess: A five-year note.

Szymczak: What's the rate on the 15-month?

Burgess: One and a quarter. That's a generous coupon, but it would guarantee the success of the issue.

H.M.Jr: There isn't much margin there. The boys figured it nine thirty-seconds.

Burgess: Yes, but on a short obligation that's pretty good. Your yield has to change a good deal for each thirty-second in price. So that isn't cutting it thin. The market suggested anywhere from 1-1/8 to 1-3/8, but I think more mentioned 1-1/4 than any other figure.

If you want to be still more conservative, do a one-year and a four-year. If you want to go to the last breastworks and make it sure and doubly sure, take a 15-month and a three-year. Just a question of....

H.M.Jr: How much weight can the market give to this 350 million dollars we're going to pay off?

Burgess: I don't think very much.

H.M.Jr: What are they going to do with that money?

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- Burgess: Well, I don't think we've got very much light on that.
- H.M.Jr: Of course, we're talking almost as though we were going after new money instead of a refunding.
- Burgess: Yes. I think it is very important that this is a 3-1/4 coupon and that a lot of people are dependent on this for earnings.
- H.M.Jr: well, of course, that is something we can't help.
- Burgess: Yes. Well, that is an argument for the success of a longer issue with a higher coupon.
- H.M.Jr: Let's go around a little bit and see - put the Treasury people last. Professor Williams?
- Williams: I don't feel that my opinion is really worth very much.
- H.M.Jr: Well, let us decide that.
- Williams: You're talking about the market and the feel of things. I almost feel that I don't know too much about it. I don't know how to judge between, say, a five-year note and a 7-year bond. I have a little leaning for the note as against the bond. I think it is primarily on the score that under these conditions I am rather afraid of putting any more bonds into the banks; if we have trouble, it will be in the bonds. I think I am looking at it from a central bank point of view; that is, frankly, so far as our function is concerned, I feel that the more bonds the banks have, the less freedom of action we have. And from that point of view, I would rather not feed the banks any more bonds, under these conditions. If your budget were balanced and you were reducing your debt, I think I'd feel differently about it. If I felt that the bonds were going to investors rather than to banks, I'd be all for the bond. But I don't know if that would be the case or not. I don't know enough about the market.
- H.M.Jr: You know those figures that the men picked up on the increase in the holdings of the insurance companies - have you heard those figures?

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Williams: No.

Taylor: 800 million in a year.

H. M. R.: In their Government portfolio - increase.

Thomas: Figured 500 million in the first half of this year.

Broderick: Bonds or notes, Wayne?

Taylor: Didn't say.

Williams: I think in my thinking about it, much depends on that - as to who would be the buyer. I don't like to think of banks taking bonds that they might feel afterwards they'd have to dump. Now, if we knew the banks would take the bonds and lock them up, again, I'd feel differently. All other things being equal, I think I would be in favor of the Treasury's seeking out as long maturities as possible. I think that is desirable from the Treasury point of view. Otherwise, you've got a large volume of financing that you are continually confronted with. If you put out a bond, you can more or less forget it. But I don't know whether the banks, in so far as they would be the buyers, would lock the bonds up or not, or whether they would tend to come back on the market. I've heard a great deal of discussion in University circles about the difficulties of central banking under these conditions, where the banks have large portfolios of bonds, and I think there is a lot in it. And I was much concerned about that last spring, and that, I think, is my reason for being somewhat afraid of the bonds.

As I said, my fear would be entirely removed if the buyers were non-bank investors or if the banks would lock them up, and I would feel differently at a little later stage, after we have balanced the budget and there is some prospect of reduction of debt. But with this uncertainty about money rates ahead of us, I wouldn't like to put the - let us say the Federal Reserve System in the position of having recommended a thing which would then more or less compel them to take actions in support which they might not otherwise have to take or want to take.

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H.A.Jr: Well, let me ask you this. Looking forward not just for the next two or three days, but looking forward as far as you reasonably can into the future, do you see anything, as far as general business conditions go, that we should worry about? I don't mean today; I mean looking forward for ten, twelve months.

Williams: Well, since getting back from vacation the first of the week, I've been thinking about that a good deal. I think that the business feeling is somewhat less confident than it was. They were looking for a dip in the summer, then a pretty strong revival. Now there seems to be some feeling of uncertainty. I think it is natural enough right now, between seasons. They are looking for new orders. If the new orders come in, why, they'll feel fine. In perhaps another month, if they don't come in, I think they'll feel quite a bit sicker than they do now. Right now they feel uncertain, more than I think they would normally.

H.A.Jr: Did we have more than a normal summer recession?

Williams: I don't think so. I think the summer recession was perhaps less than the people feared. But whether the recession is going to continue, I don't know. There is some reason for thinking that it might. We had, as I picture it, about a six months period of undue accumulation of inventories during the winter season and until the early spring, and we were, I think, all of us rather concerned about the price spirals appearing and inventories accumulating. And we thought, well, if that went on, we'd have to stop it either by monetary or non-monetary means. There was a good deal of discussion. Then it did stop. It went into a period, I think, of liquidation of inventories, which is still going on. People are working off old orders and trying to work off their inventories.

Now, how long that is going to run, nobody is able to say; you can't prophesy, any more than you could prophesy last September what was going to happen in the last six months. We used to talk about it, whether it would run for a month or two, or for a longer period; we just couldn't say.

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That's the feeling that I have now. I think the fundamentals in the business situation are perfectly all right. I mentioned two broad fundamentals: that, prior to the beginning of this year, or, say, last fall, we had been having a pretty strong revival in business, accompanied by a good deal of stability of prices and wages, and then that gave way to the price spirals accompanied by wage increases, and the wage increases went beyond the price increases; there's been a very sharp upward movement of wages this year. I think business is now beginning to think more than before about profit margins, whether they are in danger of being cut down; of course, they have been in some industries. On the whole I don't think it's happened, because volume has kept up and they have been able to absorb the cost increases. That, I think, is the fundamental situation, and I don't see that there is anything especially to worry about, if volumes are sustained.

Then there is the position in some of the heavy industries. It seems as though right now you are having some hesitation in railroad buying because of their wage situation and the fact that you're going to have some discussion of wages there; there may be a rather protracted period of negotiation. And it seems as though there is some hesitation in the building industries, owing to a run-up of costs. I think the demand is there and that sooner or later it will break through, and if we got it in any one of those major fields, or in a combination of them - building, railroads, public utilities - that we'd ride right along. But there is enough of a question now, take it all in all, so that I don't think people are so confident about the next three months as they thought last June, looking forward, they were going to be. Now, maybe that will change in a month; so much depends on whether or not new orders come in.

A. J. Jr: Thank you.

Broderick: Mr. Secretary, the note issue appeals to me - the 15-months, with the option for a longer period - three, four, or five years. While there is something to say in favor of a bond, seven or eight years, in order to give the permanent investors an opportunity to get a diversification in their portfolios, while

it would appeal to quite a few institutional investors, I think the psychological effect of a bond issue at this time would not be good, because there is a very general feeling that there will be a gradual transfer of long-term issues, of bonds, from banks to investors, and by adding to the longer-term bond issues now it would simply reduce the prospect of that transfer being made. Personally I think the note issue would go over better and would be more successful and have a better effect on the market.

H.M.Jr: You know this note issue maturity isn't owned entirely by the banks.

Broderick: I know that.

H.M.Jr: General Motors, for instance, has considerable.

Broderick: As the issues are put out, I think they are taking the note issue, but I think those who want diversification in their portfolios will take a three, four or five year issue just as quick as they'll take a seven or eight year issue. And the use of bonds would not have a very good effect marketwise at this time. For that reason the notes appeal to me.

H.M.Jr: One or two notes?

Broderick: One or two - 15-months with the option of three, four, or five years; that is, either three years or four years or five years. I don't know the rates; a three-year would be 1-5/8, I guess.

Burgess: Four-year, 1-3/4, five-year, two.

H.M.Jr: Thank you.

Do you (Thomas) want to say something?

Thomas: I'd rather wait until the Board members....

Ransom: I have a very decided opinion, Mr. Secretary, that this is not an opportune time for a bond issue. It seems to me the suggested bond issue, which is in fact only two years longer than the longest note issue which has been suggested, would not be construed

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as a sign of strength. It would appear to me as evidence rather of weakness than of strength. And the only argument that I have heard advanced in favor of a bond issue which makes any impression on me at all is the fact that it would cost the Treasury more and offer better earnings to investors. And it does not seem to me at the present time that there is any necessity in the world for the Treasury getting out of the area of note issue in order to do this refinancing. And I think that, as a matter of fact, if you adhere to your field of note issues, you can give the holders of this maturity an option. I think that the 15-month note would certainly be desirable. I was rather surprised at the rate that Dr. Burgess suggested of 1-1/4. That's gone up considerably since the last meeting of the Committee. But of course, I realize that there has been a definite firming and it might be necessary to put it at that point.

Then I think it is a question as between the four or five year note. It would seem to me that perhaps a four and three-quarter year note would land it on a very safe place.

Now, I am also impressed with the feeling that we might have a more difficult situation to take care of if we get into the bond field at the present time, in preventing disorderly conditions which may result from the tighter excess reserve position of the New York banks over the period between now and the first of the year. I think we must recognize the fact that they are getting closer to what they consider a tight position; it doesn't seem to me to be a tight one at all. Of course, the System has recently made a reduction in its rediscount rate which will tend to help that situation; perhaps it may be more, if Mr. Harrison's powers of persuasion are as potent as I hope they will be. At the same time, I do not think that a 7-year bond at this time would do much more than to disturb the situation, and I think we've got to recognize the fact that banks are liquidating their bonds as the demands for commercial loans come in, which is good and desirable, what we all want. But I don't think that this is the time or the situation in which it is necessary for you to get out of the

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note issue. It just doesn't appeal to me at all, and I was tremendously surprised when the suggestion was made.

H.M.Jr: That adds a little bit more pepper to the pot. I mean I - I can hear these fellows - I'll hear some of them this afternoon - two and a half percent - it's the coupon that attracts.

Ransom: I don't think it will reach that point.

Sinclair: Well, I think that the sure - probably the conservative thing to do would be to keep within the five-year note issue. I think in our district, as was the case in June, we probably would have a possible demand of two characters - shorter note and longer note. It is interesting to me to note that within our district in the last year our country banks have increased their Government holdings, and in the shorter term Government bonds even in the last six months our country banks have increased their holdings slightly. Our city banks have within the year - their holdings of Governments are about the same they were a year ago - little bit greater - but within the last six months they have increased somewhat. Our country banks' excess reserve position is still comfortable, on the average - about 25 percent reserves. There is a tendency in our city banks for their excess reserves to decrease, go down from around 20 percent to 12 - 10 or 12 percent.

I feel, on the other hand, that there would be in our district probably some small amount of investor demand for a bond of seven or eight years' maturity, and I think that is probably primarily because of the rate.

Our business conditions indicate an uncertain situation in the fall. I think already there is some indication of a slight hesitation in our retail and our distribution figures. So far, industrial figures show - are being maintained primarily upon past orders. There is a little uncertainty as to future orders; whether that will change in the next month or so remains to be seen.

Take our insurance companies. I think one of our insurance companies would be interested only in a short-term; two others would be interested either in a long-term or possibly in the short. I think our savings funds would be interested in notes, four or five year notes. So that our own view is to keep within the note issue of the two characters, although I do believe that the bond would meet some demand.

Szymczak: It seems to me if we have positive assurance that the banks would borrow at the Federal Reserve Bank rather than sell their holdings when the reserves decreased, or if we had positive assurance that they would hold the bonds to be sold if they were 7-year bonds, then, of course, it is quite logical to presume that the Treasury would want to go into the longer term obligations rather than the shorter term obligations. But it seems next to impossible to get that positive assurance, and a 7-year bond would seem to me to depress the bond market so that, even though we may have a verbal assurance from the banks that they would hold these 7-year bonds, they would perhaps be selling the other bonds, which would depress the general bond market and naturally depress these bonds. And it seems, therefore, that the two notes, either a four or five year note together with a 15-month note, would be most logical.

H.A.Jr: Harrison?

Harrison: Well, I think that in the pronouncement of principle I agree with John Williams that if the Treasury can extend its maturity by selling bonds to investors who will hold them, it should do so rather than pile up any more short-dated debt. I agree also with him that it is a mistake to have banks take any more bonds than is necessary, for this reason: that while you might get an agreement or an understanding that through a given period they wouldn't unload bonds to adjust their reserve position - whether you got the agreement or not, they can't do it all at once anyway - nevertheless, looking ahead over a long period of time, I think it is clear that the banks want gradually to reduce their holdings of long-term bonds, especially as their demand for commercial credit goes up. We have been through a period of years when we have had huge excess reserves and no commercial demand. The result

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was the banks just had to employ their funds in bonds to make a living. But as they see an opportunity to make a living as bankers doing a commercial banking business, they would prefer to do it that way, and we, as central banks, would rather have them do it that way. And I should think the Treasury would rather see investors take bonds than the banks anyway.

Now, ten days ago I wouldn't even have thought of a bond, I didn't hear anybody thinking of that. I have been very much surprised, frankly, that there has been so much discussion of a bond, even though there is considerable difference of opinion about this 7-year 2-1/2% bond. In view of that preponderance of opinion, or to the extent of that opinion, I think it is fairly safe to say that you would sell a respectable amount of the bonds if you put them out. The only question in my mind is how long they would stay put and how much of a secondary market you would have. And if there is that secondary demand for a seven or eight year bond, isn't there now adequate opportunity for those investors to buy them in outstanding issues? So I don't think you can justify the opinion that there is now a huge investment demand for a 7-year bond at par. Query, therefore, whether if the great percentage of these notes are held by banks and banks do take them because of the premium, whether they would over a long period of time be expected to hold onto them or whether when the first opportunity comes of a strengthening bond market they wouldn't unload; and we have found by experience that whenever the bond market goes up, recognizing the general desire of banks ultimately to get out of long-time bonds, somebody begins to sell, and the minute they do it it gets out in the market and it spreads out to the country that New York is unloading bonds. It is a very unfair criticism of New York, because I think they are doing what any bank investor might be expected to do. But nevertheless, it is a fact and you have these periodic depressions started by the fact that somebody in New York, we'll say, starts to sell a particular issue of Government bonds for some reason.

H.M.Jr: Can I interrupt you? I personally would consider it

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a great sign of weakness if we were to try to hold the banks to any such agreement. I'd consider it a

Harrison: A great mistake.

H.M.Jr: ...a great mistake, and since I've been here we haven't attempted to do anything like that, and I wouldn't want to.

Harrison: You shouldn't, and nothing I've said this morning should be construed as favoring it.

H.M.Jr: Just as soon as they feel the Governments are frozen assets, I'd begin to worry.

Harrison: You can see what happens. They've got all these bonds now, some 14 or 15 billions of them, and....

H.M.Jr: Look what they sold since July 1 - I mean look at the number of bonds they've sold.

Harrison: Sold about a billion.

H.M.Jr: Oh, more than that.

Bell: About a billion.

Harrison: It's a lot, and I think it's extraordinary now the Government bonds have held up in the face of that liquidation. I think it's the insurance companies - they're the fellows that stepped in and saved the day.

H.M.Jr: Again, as a matter of policy, as Secretary of the Treasury, I never would want any agreement with anybody that they couldn't sell.

Harrison: My only attempt - I just say that as a money market they've got to realize that when there is a scraping of the box in the market as a whole, then the market has got to consider whether they want to disorganize themselves as a financial community by trying to liquidate long-term investments rather than trying to use the natural resource of going to the Federal Reserve to borrow for a short period.

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- H.M.Jr: But you can not drive them into it.
- Harrison: No, you can not, and that does not mean either that the minute they get a chance on a rising bond market they won't gradually tend to liquidate.
- H.M.Jr: Isn't there that old prejudiced belief that borrowing from the Federal Reserve is a sort of sign of weakness?
- Harrison: When Federal Reserve was first organized, we thought they'd never get them to borrow, and then there was a period, through the war and subsequently, when it became quite the thing. Now we've just got through a period of excess reserves where nobody had to borrow, and on my trip I found a general reluctance on the part of the banks to consider borrowing again. But I think they've got to consider it and it should become the fashion, and as soon as that comes about the System and the country will be much healthier.
- H.M.Jr: But you and I can not make it the fashion.
- Harrison: That's right. I can say this with some degree of assurance, though: that, without any commitments, they may change their minds - the New York banking community as a whole, assuming excess reserves get to zero and they can not buy reserve funds from one another. I think that at that point, rather than try to force long-term assets on an unwilling market, they will borrow, for two reasons: first, because very quickly they'd find they couldn't dispose of their long-term assets all at once, and second, because whether as a result of our talks or their own consideration of it, they do accept a certain responsibility for the money market, that they've got to take care of it in the right fashion rather than the wrong fashion over a temporary period.
- Well, that being so, I've got great question about the long-time bond myself. I really think you'll sell it and you'll sell a respectable amount, if you issue it. I don't know how long it would stay put, and when they begin to liquidate, query, whether you wouldn't start another period of the liquidation of Governments that causes all the heartaches. And I'd rather not add to that situation unless it were necessary to do it. That being so, I should think

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the more conservative attitude would be to stick to the notes this time. In spite of my agreement with John Williams that if we could only be sure they were going out in the hands of investors the bonds would be the logical issue, I don't think they would go in the hands of enough investors, as opposed to banks, to try the risk.

H.M.Jr: I don't think in this general discussion we've taken note of the fact that, including Sunday, we're selling a million dollars worth of ten-year bonds every day, in the Baby Bonds. I mean Taylor tells me we're averaging about seven million dollars worth a week. That's going out like clockwork.

Harrison: It may be, though, that that very thing means you haven't got as much of a demand for these proposed bonds.

H.M.Jr: But I mean this idea of putting money in the hands of permanent investors. How many of those come back on us?

Taylor: It's a very small percentage. Of course, the very nature of them, the fact that they are fully registered, that you have to go through this rather elaborate performance, means....

Ransom: What is the total outstanding now?

Taylor: Billion two plus.

Sinclair: Lot of that in banks?

Taylor: No; there was a time when as high as six percent was, and it's a little less than that now.

Harrison: I wonder how much bank demand there might be for it if you raised the limit.

Bell: 4 million came back in July - 4 or 5 million a month, on the average.

H.M.Jr: Well now, let's see, who hasn't had a chance? Are you through, George?

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- Harrison: Yes, that's all. I think this is a devil of a decision. I would love to put out a bond issue if I thought it would stick. But we have had such recent evidence of the desire of banks to get rid of bonds as soon as they can that I am a little worried about dumping any more bonds/the market, because I think they are still anxious to dump them as soon as the opportunity affords itself of trying to get rid of them.
- H.M.Jr: Of course, this one-year note and 7-year bond remind me of trying to sell a woman a long petticoat and a knee-length skirt. I mean the things don't seem to kind of match up. It looks as though we're trying to get our styles kind of....
- Harrison: Except that you're selling to entirely different age women.
- Burgess: You're feeding a different market.
- H.M.Jr: That's what we're hoping for; that's our hope.
- Harrison: That we don't know. If I were really sure that you had a broad market....
- H.M.Jr: That's a pious nope.
- Ransom: Mr. Secretary, I'd like to ask Mr. Thomas and Mr. Piser if they....
- H.M.Jr: Please. We'll keep our nome talent for the last.
- Thomas: On the recent money market situation we have been impressed by certain developments, particularly the tendency of the large New York City banks to sell their bonds, their long-term obligations; they have done so every time they have gotten short of reserves or anywhere near short of reserves. And those banks that are short might sell them to adjust their reserve position. Other banks don't buy them because they know this pressure is on the market. Whereas you can say that they are selling them in order to get funds to make loans, the fact is that they have sold more investments than they have made loans. So that the total loans and investments of these large city

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banks have been going down and their deposits have been going down. This decline in deposits hasn't been true for the country as a whole, and it isn't as bad as it looks from the weekly bank figures, but there has been a decline in deposits, which is a sort of depressing factor, at least psychologically. It is not so bad when it represents simply investors holding the money idle, buying bonds from banks, but it has been the situation.

Harrison: Due to the fact, is it not, that banks have sold more investments than they have increased loans.

Thomas: Yes, they have sold more investments than they have increased loans; that is, the large city banks. Not true of the country banks. One factor in that is that the large city banks, as Governor Harrison pointed out, bought very heavily of long bonds in '36 at a time when short money rates were so low and they were worried about their earnings. They went out and got all they could get of the bonds, practically all the Treasury was issuing at the time. They bought them rather heavily. Now that short rates have gotten up a little bit, they are rather less inclined to buy bonds and they are more willing to shift from the long to the short. And whereas the lowering of the discount rate is a factor, still short rates have to rise quite a little bit more before there will be any inducement from the rate standpoint to borrow. They might borrow temporarily, but they might still be a little hesitant about that.

Harrison: That is not necessarily true, is it, Mr. Thomas, with commercial loans at one and a half.

Thomas: Not true with commercial loans, no, but as long as they've got these short bills....

Harrison: Put it differently. It is not true so long as their average yield on all investments and loans is over the bank rate.

Thomas: Well, I don't know; I think they'd rather get rid of the short stuff which was below the bank rate, rather than borrow at the bank rate.

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Harrison: If it were for the long rate, but not for the short.

Thomas: Your judgment on that would be much better than mine. Now, you can't expect banks to borrow rather than sell long-term securities when their long-term securities are low in price. At a time like this, when they've got a profit on them, there is a tendency for money rates to rise; it is a little too much to expect them to borrow in order to hold them when they've got more of them than they think they ought to have anyhow. So it looks to me as though there is going to be a continuation of this tendency to reduce their holdings of bonds. And if there is an investment demand for bonds, then let the investors buy those, it seems to me, rather than have the Treasury issue more of those at this time, because what will happen is that the banks who hold these notes will exchange them and there will be a tendency for them to turn around and sell them on the market.

H.M.Jr: The notes?

Thomas: No, the bonds; if they exchange the notes for bonds, they are likely to want to sell them, and that will be another depressing factor on the bond market. So I should think whereas the banks might be more willing to hold notes - difference between five and seven years - I don't know whether it makes a great difference, but it is a step in what seems to me to be the wrong direction at this time.

H.M.Jr: To go to the 7-years.

Thomas: Yes, to go to the 7-year bond.

As to the business situation, I think Professor Williams' analysis is correct and I have great confidence in the future of business. But I think the next two or three months are going to be very uncertain, particularly in the textiles. With a decline in the price of cotton, I can't see much buying of cotton goods and therefore some hesitation in production until the price of cotton goods has adjusted itself to the new level of all cotton prices. So that we are likely to get a temporary recession

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there in the textiles, which will hold things back only for a short while. In the long run that ought to work out, but it does look like a factor that will bring down our indexes and make the situation look not so favorable in the next month or two, if not longer.

Harrison: One of my directors is head of a textile business. He says that he went to a bank only last week to borrow money to carry goods which he had already manufactured and had sold to other dealers, distributors who were not in a position to take them. Had he forced the contracts, he would probably have forced them into bankruptcy, so he borrowed money to carry the goods for a temporary period - something that he had contracted for, but can't liquidate.

H.M.Jr: On which he will lose money.

Harrison: He doesn't know yet, but he thinks it will work out all right.

H.M.Jr: Are you (Thomas) through?

Thomas: Yes.

H.M.Jr: Well, to sum up, you wouldn't go beyond the five years.

Thomas: I would not.

Piser: As has been said before, we are in a period where banks have been rather steadily liquidating Government securities, particularly bonds, in the last few months. And banks still hold very large amounts of Treasury bonds; I think it is something like two billion dollars more than they held a year and a half ago. With those large amounts of Treasury bonds, they are apparently anxious to sell on every opportunity. It seems to me, with this substantial amount that is overhanging the market, it would be particularly unfortunate to add to the supply of Treasury bonds at this time. I think that might lead to a wave of liquidation of Government bonds perhaps not of the magnitude we had last March, but at least of substantial proportions.

The other point I would like to make is that if a

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bond issue should be subscribed in small amount, I think that might be taken as a sign of weakness and that there was not a substantial market for that type of bond. On the other hand, if a large amount is subscribed, say three or four hundred million dollars, it seems to me a substantial portion of that might come into the market immediately on the part of those banks or others who had bought the bond for an immediate profit.

So I think in either event it might lead to a rather weak market for all Treasury bonds. So I would be in favor of the 15-year note and either a four or five year note, and preferably I should think a four year note.

Ransom: 15-months note.

Piser: 15-months note and four or five year note, preferably the four-year note.

Harrison: That's a bad price, though, isn't it - the four-year note?

H.M.Jr: What's four years and nine months now?

Burgess: That would be within three months of the issue you put out last June. That's my objection to that. Plaster the market immediately.

H.M.Jr: Would you rather have five years?

Burgess: Rather have the five; it's much less damaging to the market.

H.M.Jr: What's the rate on five years?

Burgess: Two percent.

H.M.Jr: How does that figure out - five year, two, or seven year, two and a half - which way is it cheaper to the Government?

Burgess: When you figure the tax exemption to the states and private holders who would get some portion of the note, you don't know how much, I don't think there is as much difference as it looks on the surface; nobody can quite tell.

H.M.Jr: Which way does it look?

Burgess: I think undoubtedly the seven year money would cost you something more than the five year money, but it is less than half of one percent.

H.M.Jr: Now, before I ask, is there anybody - Ransom, do you want to call....

Ransom: No one else, Mr. Secretary.

H.M.Jr: Taylor?

Taylor: I think that your 15-month note is indicated and that has to be your pivot issue. After listening to the various people that we talked to up in New York, I became convinced that there is a market for this 7-year 2-1/2. I am very surprised to find that that was so. I think that for those particular people who go into that bond it will stick, that any liquidation which comes along in the future - and I entirely agree with the things that have been said about the tendency to liquidate long-term bonds - will be in the longer-term Treasuries; it won't be in this particular maturity.

H.M.Jr: It will what?

Taylor: It will be in the long-term Treasuries, it won't be in whatever is done in this. So that I don't think you will have a messy market situation on this particular 2-1/2, if you do it.

H.M.Jr: Bell?

Bell: Well, I agree on what Mr. Taylor said. I'd prefer a three-year 1-5/8 and a 7-year 2-1/2, but I think for safety reasons we are forced into a 15-month 1-1/4. We did get from the New York people statements that they would buy a substantial part of this 7-year bond, and one bank went so far as to say it would not only exchange its notes for the bond, but it would go out and buy the rights, and that it would lock them up and hold them.

The only thing that worries me about the 7-year bond is, supposing we only get 200 million dollars of exchanges, now will the market interpret that? If

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we could arrange some way so that the market would interpret it the other way, that it is a distinct advantage to the Treasury to have even 200 million in the 7-year bond ... That does worry me a little, as to just how the market will interpret that. I do hate to see two notes - 15 and five.

Harrison: You mentioned a minute ago General Motors. Didn't someone of those bankers advise us that they had heard that the General Motors bloc of 20 millions, whatever it was....

Taylor: They wouldn't buy anything longer than two years. We got that from four or five different places.

Bell: And that is only natural. They've got that money in there for short-term purposes.

Broderick: They carry it merely to get interest on their deposits; same as a time deposit.

Thomas: To what extent does that permit them relief from the undistributed profits tax?

Bell: I don't know, but I assume General Motors had it in these short notes for a purpose of that kind.

Piser: In regard to intermediate maturities, there is two and a half billion of Treasury bonds callable in '44. One of those bonds...

H.M.Jr: How much?

Piser: Two and a half billion. One of them is a four percent issue, which I think you will undoubtedly want to take up at that time, and the other is a 3-1/4, which may be refunded at that time. This would, of course, add to that large amount of callable stuff.

Harrison: There may be cheap money then.

H.M.Jr: George?

Haas: I haven't got very much to add, Mr. Secretary. My leaning is toward Mr. Taylor's and Mr. Bell's

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version, except that I don't feel very strongly towards the bond. I think it is a very close decision; I don't think it would make very much difference which was done. I think from the Treasury point of view, particularly when you have this 1-1/4 note as your option, that if there is a market for the 7-year 2-1/2 bond, my preference would be to take the bond. But I don't feel strongly. I'd just as soon have two notes. I think the key to the whole situation is this question whether or not there is an investment market for this short-term bond, and I switched over - I was first thinking in terms of a combination of notes - and after hearing Mr. Taylor's and Mr. Bell's discussion that they had in New York, I was willing to go over to a - to take a combination of the short note with the bond. I don't think it's close - I think it's close.

H.M.Jr: You mean the decision.

Haas: Yes.

H.M.Jr: Archie?

Lochhead: Well, I don't know; of course, since Mr. Taylor came back and spoke about that 7-year bond - that hadn't entered much into my calculations before. I thought that after all this is only a refunding issue, we're not borrowing new money, and my leaning was toward a straight five-year note - not split it up. However, if you're going to split between two notes, I would rather split to a note and a bond - I mean I'd rather see the whole amount in the five-year issue, or else, if you were going to split, then I think there is sufficient investors' demand for a 2-1/2% bond. After all, the maturing notes carry 3-1/4%; lots of people have been carrying it for a long time and are probably looking for the yield, and it may be that we should consider them and give them an opportunity. I don't think the banks will buy them if they don't want to buy them. I wouldn't issue the 7-year bond for the whole 300. I think if the banks are trying to liquidate, they're not going to bid for more bonds, and they'll take the notes.

Ransom: Unless they have a temporary profit in them.

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- Lochhead: But you can't tell just where the profit will be. There's not necessarily going to be a bigger profit on the bonds than on the notes, and I think they'll probably take the notes.
- H.M.Jr: Is that all, Archie?
- Lochhead: That's all.
- H.M.Jr: Seltzer?
- Seltzer: If Mr. Harrison had been as receptive to a 7-year bond as Dr. Burgess - that is, been as confident of the receptivity of the market to it - I'd be in favor of that combined with a 15-month note issue, because the Treasury would be in a much stronger position with that kind of a joint offering than with two notes, and because I think a fixed maturity of 7 years would have a special attraction to the market; we haven't issued any such for quite a while. But with all this doubt about the reception of a 7-year bond, I think we have to play it safe and try a 15-month plus a four-year note.
- H.M.Jr: You're going to be very safe.
- Seltzer: What?
- H.M.Jr: I say you're going to be very safe.
- (Hearty laughter)
- Harrison: I must confess that my reluctance about the bond is not one of principle but more of a hunch that you are apt to get a secondary reaction. Now maybe I'm all wrong. These gentlemen have been much closer in touch with those fellows they were conferring with on Wednesday and Thursday than I was; I wasn't in with them much. But query, whether there is enough difference to the Treasury to justify the uncertainty as to where those bonds are going. In other words, I think there is something in Piser's point of view that you might lose either way. If you don't sell many of them, it is a reflection on the offering; if you sell too many of them, then you are under the risk of the unloading afterwards.

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H.M.Jr: Harris?

Harris: Well, for once I don't have any definite opinion about it; but I rather lean to the note in preference to the bond - five-year note. I think it fits in with the Treasury maturities very well; we only have that one issue in '42. And the bond market, for once, since the recent decline started - I've never seen such a uniform decline throughout the bond market; it's been a point and a half, a point and three-quarters, through all the bonds, which to me indicates not so much selling as lack of buying. It's a general markdown.

H.M.Jr: Have the notes gone down a point?

Harris: Gone down anywhere between 20 and 30 thirty-seconds.

H.M.Jr: Who has some afterthoughts?

Harrison: I have those on the 15th.

H.M.Jr: Last time we were so good we absolutely within a dollar got a fifty-fifty division, didn't we?

Burgess: I don't think you'll get that this time, even with the five-year note.

H.M.Jr: What would you guess if you had a 15-month and a five-year - what would be the division?

Burgess: 350 and 450.

H.M.Jr: Which is the 450?

Burgess: The shorter one. I think you'd get more of the shorter.

H.M.Jr: And if we had 15-months and a 7-year bond?

Burgess: 300 million of your longs.

H.M.Jr: That many?

Bell: That would be a huge success.

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Burgess: Pretty nearly that many.

H.M.Jr: Anybody got any afterthoughts?

Bell: Supposing we only got a hundred million of the bonds, Doctor, how would the market interpret it?

Burgess: Think it was kind of sour.

Bell: Personally, I'd think it was to the Treasury's advantage. But I don't know how the market....

Harrison: That's just the point.

Bell: That wouldn't worry me any - I mean from our standpoint.

Broderick: Dan, is this the time for an experiment?

Ransom: That would be our worry, wouldn't it?

Bell: (Laughs)

H.M.Jr: Well now, do you (Burgess) have some appointments for me this afternoon?

Burgess: Three, four, and six o'clock.

H.M.Jr: Well, I tell you. Mr. Ransom, you're Acting Governor, aren't you - I mean Chairman.

Ransom: Mr. Harrison is Chairman of the Executive Committee in place of Mr. Eccles.

H.M.Jr: Are you (Harrison) going to be in town tomorrow?

Harrison: I wasn't, but I will.

H.M.Jr: I thought if you and Mr. Ransom could come around, say, 10:30 tomorrow morning - could you?

Ransom: Yes, indeed.

H.M.Jr: Burgess, will you be here?

Burgess: I'll be here continuously.

H.M.Jr: Then I think if you gentlemen will come at 10:30 tomorrow morning - it gives us about an hour and a half to talk things over once more.

September 4th, 1937

Today HM, Jr conferred with Mr. Levey of Solomon Bros. on the September 15th financing.

Mr. Levey recommended a 3-year 1/58% bond maturing in 1940 and a 7-year 2 1/2% bond. As an alternate, he recommended adding to the present issue of the 2-3/4s 45-47.

Mr. Devine, of C. J. Devine & Co., Inc., recommended a 15-months and 3-year bond; and, as an alternate, a 5-year 2% or a 4-year 1/78s. As an alternate, he recommended a 5-year 2% or a 4-year 1/78s bond.

TREASURY DEPARTMENT

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INTER OFFICE COMMUNICATION

DATE September 4, 1937.

TO Secretary Morgenthau
FROM Mr. Haas
Subject: The Sino-Japanese situation.

The Chinese-Japanese war is on. It is no longer a local conflict as was the 1931 seizure of Manchuria, the 1932 battle in Shanghai, the 1933 seizure of Jehol, and the 1935 grab of portions of Hopei and Chahar. For the first time the Central Government of China is using its armies to resist Japanese aggression.

Japan is now treating the situation not as a series of isolated local incidents, but as a large scale campaign involving the use of her military forces along a thousand-mile front extending from Kalgan in the North to Shanghai in the South. Japan probably has over 200,000 troops on Chinese soil exclusive of 200,000 Manchoukuan troops, and has already called to the colors sections of her reservists.

Though war has not yet been declared, Japan has ordered a blockade of all Chinese official and private shipping along the entire Chinese coast, and is bombing numerous cities several hundred miles in the interior.

- I. What is likely to happen in China before next summer?
- II. How will the economic interests of the United States be affected during the struggle?
- III. What will be the effect of the application of the Neutrality Act?
- IV. What role will the interested powers play in the war?

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I. WHAT IS GOING TO HAPPEN IN CHINA BEFORE NEXT SUMMER?

There are four possible eventualities:

1. The rapid conquest by Japan of the whole of North China and of all the important cities in the East of China, with a peace settlement imposed upon the Central Government of China.
2. The rapid conquest of those areas but non-acceptance of peace conditions by the Central Government of China, with a continuation of the warfare, though in a less acute form, in the West, Central and South of China.

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3. Failure of the Japanese to attain their military objectives with anything like the rapidity they expected. Spring will find Japan with her whole army and navy involved in the Chinese war.

4. Entrance of other foreign powers into the war. ..

Which of these alternatives is most likely depends in part on the relative military effectiveness of the two contending forces and on the military strategy involved. On that subject the judgment of economists is of little value and we venture no opinion. There are, however, other factors — economic and political — which are at least as important as purely technical military considerations in shaping the final outcome. These are considered below:

1. Can Japan finance the war?

Japan must have both domestic and foreign funds to finance the war.

(a) Internal financing.

Internal financing of the war presents no insuperable problem for Japan for at least a year. If the war with China spreads to wider fronts, as it gives every indication of doing, the cost of such a war during the next twelve months can not be less than 5 billion yen and may rise to 8 billions. Japan already has appropriated 2½ billion yen for the conduct of the war in addition to the ordinary military budget of 1.5 billion yen, and it is very doubtful whether they expected operations on a very large scale to last more than a few months.

The Government will have to borrow the major portion of the additional 5 to 8 billion yen needed. Revenue from taxes will increase, both because of heightened business activity at rising prices and higher, as well as new, taxes. But the Government would never finance the war through taxation. No government in modern times every has; nor is any government likely to do so. To finance a major war chiefly through taxes is a most cumbersome and inefficient device, and for Japan would after a short time go a long way toward stirring up serious trouble at home.

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The total national revenue from taxes last year was about 2.5 billion yen, or almost one-sixth of her national income. To raise an additional 5 to 8 billions by taxes would be preposterous. The real burden of the expenditures cannot be shifted - except in so far as foreign credits are obtained - but the imposition of that burden must be camouflaged by borrowing and the printing press.

Japan will be able to raise 5 to 8 billions in the next year without the least danger of either financial collapse or wild inflation. Some rise in prices there will be, since the diversion of savings from non-military to military production will not be nearly enough, and since Japan will not be able to greatly increase production, even under the stimulus of war demand. She already was experiencing a scarcity of labor this summer and additional men under arms will in large part offset additional labor hours. Prices therefore will rise, but not enough to justify fears of a runaway inflation. The note issue and deposits in Japan total about 13.5 billion yen, indicating roughly that the velocity of income circulation is around 1. If, therefore, Japan borrows via the Central Bank and printing presses as much as 5 billion yen this year, prices will at most rise several percent a month. It may have even a lesser effect. In France during the first six months of the Great War the note circulation rose from 6 to 10 billion francs without causing any such rise in prices. But even if prices did rise at the rate of five percent a month in Japan, for the next year at least such a price rise will not seriously interfere with Japan's ability to conduct the war in China.

Nor will Japan have any trouble this next year insuring the absorption by the banks and by the public of another 5 or 10 billion yen. She now has a total national debt of about 11 billion yen, which is a little less than her national annual income. The national debt of the United Kingdom is considerably greater than her national income, while that of France is double her income. A country during wartime can easily bear what might justly be regarded during times of peace as intolerable financial burdens. With strict exchange controls, patriotic appeals, increasing control over industry and prices and complete control over the banking system, Japan can and will, virtually, force the absorption by the Central Bank and the public of government securities.

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(b) External financing

In order to conduct a major military offensive in China, Japan must import certain basic war materials and finished military goods. Japan has already accumulated large stores of oil, iron, steel, cotton and other materials. Her import surplus during the first seven months of 1937 has jumped to 700 million yen as compared with 250 million for a comparable period last year. But if the war is to continue, Japan will need to purchase considerable quantities of war materials. More than that, Japan will have to continue to import raw materials which are necessary to produce the goods she expects to export. An examination of the character of her exports and of her needed raw materials leads to the conclusion that Japan must import between two and three billion yen (at current prices) of goods during the next twelve months in order to conduct her war without important shortages.

Can she pay for three billion yen imports during the next twelve months?

Yes, easily.

(a) She has approximately 1,200,000,000 yen in gold.

(b) To this must be added foreign exchange held by various Japanese banks; probably between 100 and 200 million yen.

(c) She will produce about 100 million yen of gold during the next twelve months.

(d) She can likewise liquidate that portion of her foreign holdings that is not in war areas and thereby raise another hundred million.

That totals about 1.5 billion yen and leaves about $\frac{1}{2}$ to $1\frac{1}{2}$ billion yen to be raised with her exports. During the first seven months of 1937 Japan exported goods to the amount of 1.7 billion yen. Even allowing for loss of China's market — only 6 percent of her exports go to China — and for increased prices due to the increased cost of imported raw materials, Japan will have little difficulty selling a billion and a half yen of exports during the next twelve months. Japan will, if necessary, heavily subsidize her exports in order to procure essential imports.

There is no doubt that even if Japan is unable to borrow to finance any of her needed imports she will be able to import what she must have during the next twelve months and pay for it. Not only will she be able to pay for her needs during the coming year, but she will most likely not have to use up all her gold and foreign exchange in the process.

In addition to her cash foreign resources, Japan may be able to secure credits from Germany and from England. Germany will doubtless be eager to help Japan by selling her surplus and obsolescent war material which can be of use to Japan. Germany would probably be willing to sell a large portion of such material on credit. Even if Germany were to obtain 50 percent of the proceeds of the sale in gold or foreign exchange for some of her exports to Japan it would definitely be to her economic advantage to do so.

As for England, her ability to extend credit to Japan will not be the limiting factor. Political considerations will be paramount, whether or not Japan will be able to obtain credit in England is at present uncertain. Everything depends upon the direction which British policy in the Far East takes.

Japan begins the war with a Government foreign debt of 1.3 billion yen and a total foreign debt of 1.8 billion yen. Annual interest payments on the external debt amount to \$25 million which Japan ought to be able to maintain. If the worst comes to worst, it can cease payment of interest on foreign loans, though it would not do so if there were any chance of its raising further loans from abroad.

Therefore, it may be concluded that Japan can finance a major war with China for at least a year.

2. Can China finance a major war?

(a) China has, and will have, sufficient foreign exchange to buy all of the foreign goods that she will be able to bring in through the Japanese blockade for at least the next twelve months. Government of China banks now have probably about 500 million yuan of gold and foreign exchange and about 340 million yuan of silver. In addition to the silver bullion held by banks, it has been estimated that there are more than 1,100 million ounces of silver in China, of which 500 million ounces are in non-monetary form and 600 million ounces in silver dollars. Although it is true that all of this silver will not be available to the Government, because a part of it will be in

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territory occupied by the Japanese, and because a part of it will not be dehoarded even under the patriotic stimulus of defending China, a good proportion will be made available.

The foreign value of China's silver stocks depends upon the United States Secretary of the Treasury. Were China to attempt to sell any substantial portion of her silver stocks on the London market without the co-operation of the U. S. Treasury, the price of silver would drop precipitously.

However, even without including the potential foreign value of her silver stocks, China will have adequate supply of foreign exchange to purchase such imports as she will be able to obtain through the Japanese blockade. The supply of foreign exchange arising from her remittances from Chinese living abroad will doubtless be well over a half billion yuan. Last year they amounted to 320 million yuan. It is reasonable to expect that the remittances will be much larger under the patriotic appeals for assistance, combined with money-raising by non-Chinese throughout the world.

In addition to this supply of foreign exchange is the amount she can obtain from her exports - at least another 100 million yuan. In 1936 Chinese exports amounted to slightly more than 800 million yuan. Under war conditions, with a blockade of the Chinese coast, it is unlikely that China will be able to export more than one-fifth of this amount. The minimum total of foreign funds thus available to China during the next year is about one billion yuan. It is extremely unlikely that China will be able to import that much. The imports of China during 1936, including an estimate of smuggled imports, amounted to only 1,100 million yuan. 68 percent of the recorded imports entered China through the ports of Shanghai and Tientsin. A part of this trade can be diverted to other points of entry which may remain open, but owing to the effectiveness of the Japanese naval blockade of the coastline, and the army blockade of the Northeast border, imports will be greatly reduced over the level of last year.

Japan may permit the entry of non-essentials on foreign boats, but China is in no position to spend its foreign funds on non-essentials.

Even should China be able to import more than 1 billion yuan of goods she will doubtless be able to finance it. In the first place, she will be able to get something out of her silver stocks. In case of dire need she would, as a last resort, throw it on the

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market with or without the co-operation of the U. S. Treasury. Or she could pledge it for credits obtained in foreign countries. (It is reported that she already has a hundred million franc loan in France to be secured by silver pledged in London.) Lastly, an unknown amount of financial assistance can be and doubtless will be supplied China by Soviet Russia. Russia will probably extend unlimited credit to China for the purchase of munitions of war. The extension of credit may well cover both purchases from Russia and purchases which China may be able to make in other countries.

Altogether, China will be able to pay for or finance all the imports she can run through the Japanese blockade or obtain through other avenues of transportation.

(b) Will China be able to finance the domestic needs of war for the next twelve-month period without difficulty?

China, incomparably less than Japan, cannot rely upon voluntary public loans and taxes to finance the war over a twelve-month period. She will doubtless soon resort to borrowing from the Government banks without any intent of maintaining a sound currency. Sound currency practices must inevitably give way in China in the face of her critical struggle for national existence. There is danger of a rapid rise in prices after the first few months of the war. While the sharp inflationary movement cannot be controlled indefinitely, control during the first year of warfare should not be difficult, particularly since both the Central Government and provincial governments will soon resort to requisitions of supplies for the army at fixed prices.

In conclusion, it can be stated that with China, as with Japan, the war will not stop for lack of funds - at least during the next year.

3. Can Japan obtain raw materials necessary to conduct an effective major war?

Yes, she can, so long as she is fighting only China.

Japan mines 90 percent of her coal, but she must import petroleum, iron ore, rubber, copper, tin, zinc, aluminum, phosphates, nickel and some other less important raw materials. But not only must Japan import raw materials for articles consumed at home; she also

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needs raw materials for her exports — primarily raw cotton, raw wool, and wood pulp for her rayon industry. Without the maintenance of her exports she would be unable to carry on the war.

Japan imported 1.7 billion yen of raw materials in 1936 and 1.1 billion in the first five months of 1937. Much of these enormous imports in 1937 were for the purpose of accumulating stocks. She has six to eight months' stock of oil, at least a two months' stock of cotton, and has been accumulating stocks of essential metals. Her stocks of antimony and tungsten are unknown, but as she must have been anticipating war with China, she must have sufficient stocks of these metals on hand. It is true she is facing a world market in which prices of many, though not all, raw materials are rising. But on the basis of a 2 to 3 billion total import for the next twelve months, together with her present stock of material, Japan will have no difficulty in procuring all the raw materials she needs for the prosecution of the war in China.

4. Can China obtain materials necessary to conduct the war?

Herein lies China's chief weakness in her fight with Japan. China is largely dependent upon foreign sources for the basic raw materials, particularly iron and steel, but will not be able to get much through the blockade. The existing stocks of raw materials in China is probably not enough to keep its army supplied with even a fair degree of efficiency for more than a few months. The technical equipment of the Chinese armies is low at the present time, and may be expected to deteriorate rapidly as the war progresses.

If the war extends over a period longer than a year, and if China is able to retain the major part of its territory, she may be able to develop some hitherto unexploited natural resources in the interior and in the West. Such a development is problematic; at best, it would be relatively primitive in its methods and slow in showing results. Industrialization is a slow process, and the development from primitive conditions cannot be a major factor within a year.

Unless China is able to obtain equipment and war material from outside sources she will be fighting against greatly increasing odds after a few months. Almost all of her enormous resources of man power will be virtually ineffective against Japan before next spring unless she imports substantial amounts of war material. Since

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she will be unable to obtain such imports by sea, the crucial question for China if the fighting does not end before spring is the amount of material that can be transported overland from the Northwest and from the South. On this the information of the War and Navy Departments should be of great significance.

5. Can Japan provide an adequate supply of foodstuffs for her population and for the army?

Yes. The Japanese Empire is virtually self-sufficient in food. Manchoukuo exports enough food to Japan to more than make up for the small food import surplus. It exports large amounts of beans and bean oil to Japan proper and millet to Korea which sends most of its rice product to the mainland. The small excess of food imports over food exports is thus not a serious matter from Japan's point of view.

The main foods of the Japanese are rice, barley, soya beans and marine products. Rice is by far the most important ingredient in the Japanese diet — accounts for 60 percent of the total food consumption and the Government starts the war with a stock of rice of over 2,000,000 tons. All the cereals needed by Japan are produced in the Japanese Empire except for wheat, one-third of which is imported.

Japan is the largest producer of fish in the world. In fact, it exports one-fourth of its total catch. Although Japan produces only 100,000 tons of meat a year, it doesn't consume much meat in peace time. The army ration of meat has already been increased. This increase can easily be obtained by substitution of more fish for meat in the civilian diet, or, if necessary, by slaughter of a portion of her stock of cattle.

However, there are several factors operating to create difficulties for the Japanese in the maintenance of food supplies which will operate within a year to reduce the already very low food diet of the Japanese people to a serious minimum.

(a) Soldiers have to eat much more than the scanty average food allowance.

(b) With the conscription of so many thousand peasants, agricultural production and the yield of the fishing industries would probably fall. Germany which had a much more advanced

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agricultural techniques found that during the war years, its wheat harvests and potato yield decreased considerably.

(c) Much of Japan's fishing is conducted in Russian waters where there it has been a fruitful source of disension in the past. In view of the Sino-Soviet Pact, the Soviets are not likely to become more lenient in the terms they grant Japanese fishing men.

(d) If Manchoukuo became at all involved in the war, the Manchoukuo supply to Japan would be in danger.

Nevertheless, there is little ground for expecting that there would be any acute food problem in a war in which an army of from one-half a million to a million men were involved. But the greater the number of troops Japan enrolls, the greater Japanese food consumption and the smaller Japanese food production will be. If the war becomes protracted beyond a year, the food problem will become much more serious as depletion of stocks, diminution of productivity and rising prices would almost certainly lead to a significant lowering of the standard of living in the rear and in such circumstances morale would be more difficult to maintain.

6. Can China obtain enough food to continue military resistance to the Japanese invasion?

Yes, though there are bound to be severe food shortages among the non-combatants in and near the areas of fighting. China normally imports only a small proportion of its food supply -- 100 million yuan in 1936. China has large food-growing areas away from the coast, and the sources of supply will not be interfered with until next year at least by the Japanese military advance enough to seriously weaken China's ability to fight this winter. Almost the whole of the interior of China is locally self-sufficient in the matter of food. The Chinese population can, if necessary, subsist on smaller quantities of food, as they have frequently in the past. Widespread famine over large areas is so common in China that a reduction in the food supply is not so serious as it would be in Japan.

7. Will the conduct of the war impose so great an economic burden as to create serious internal instability in Japan?

The burden of the war on the Japanese people will be great. The total national income is less than 15 billion yen.

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Under the stimulus of war demands that income will probably increase somewhat (after allowance has been made for price increases). Labor hours can be lengthened; the reserves of labor -- older and younger persons -- can be drawn upon, and obsolete equipment can be employed. Yet for Japan the increased output from these sources will not be great. There already was a scarcity of labor this summer, and a half million men will soon be called to the colors. Therefore, the 5 to 8 billion yen added expenditure for the war will cut the real national income consumed by the people by anywhere from a fifth to a third, no matter how such expenditure is financed at home. So large a cut from a standard of living already extremely low constitutes a terrific burden, but it has been amply demonstrated that a people during time of stress will accept such burdens for a long period without creating serious disturbances. As long as the army in the field is not suffering heavy defeats and has some spectacular victories to show, serious domestic disturbances are unlikely for some time to come.

8. Will the morale of the Chinese people be maintained under the increasing economic burden imposed by the war?

Yes. Accustomed as the Chinese people are to an extremely low standard of living they will tolerate even further reductions in a war against Japan. Numerous press reports from China comment on the growing strength of anti-Japanese feeling among the coolies, who in the past have been usually indifferent to China's military activities.

The Central Government for the first time is embarking on a popular war of national liberation in which she has the active backing of the vast majority of the population. The process of political and economic unification will be hastened in the conduct of such a war, and with a few battles such as the present battle for Shanghai to show to her credit, the prestige of the Central Government will increase more and more. If Chinese opposition disintegrates it will not be because of the effect of the burden of the war on the standard of living of the masses. It will be either as a consequence of continued Japanese victories, or terrific destruction of Chinese life and property, or treachery on the part of pro-Japanese Chinese leaders.

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9. How will Japan's foreign trade be affected by war?

The value of her total trade is more likely to increase than decrease. Although she will attempt to restrict her imports to those raw materials which are essential for the conduct of the war and for the maintenance of her export materials the net effect on the total will be small. Her imports of raw cotton, wool, iron, steel, oil and rubber alone accounted for two-thirds of her total imports in 1936. To these items must be added numerous others which would bring the total of absolutely necessary imports not far from 80 percent of the total. Furthermore, Japan will wish to purchase additional war materials for the conduct of the war. It is reasonable to assume, therefore, that Japan's net purchases during the next twelve months will not be below 2½ billion yen.

So far as her exports are concerned, little change from present amounts need be expected. China's purchases, which will, of course, cease, only amount to about 6 percent of Japan's total exports. Japan will make every effort to maintain her export market, even by subsidizing her exports.

It is very doubtful whether Japan will attempt to depreciate the yen in order to increase her exports. (1) A depreciated yen will proportionately increase the price of her imported raw materials and war materials; (2) with a system of strict exchange controls she can promote her exports more efficiently through subsidies than through the cruder method of depreciation; (3) it would likely engender retaliation in the form of increased barriers to her goods.

10. How will China's foreign trade be affected?

The normal foreign trade of China will practically disappear. The occupation of the Northern cities by the Japanese and the destruction of the industrial commercial center of Shanghai will in itself seriously curtail China's ability to produce export commodities. The naval blockade of all her ports and the Japanese army control over a large portion of the Northern border will complete the process. China's exports will be reduced to those few goods which can be sent over land to the South and the West. At most this will amount to about 150 million yuan a year.

Her normal imports likewise will almost disappear. In addition to the physical handicaps of obtaining goods through the Japanese

blockade and through the extensive land routes which will remain open there will be the restriction imposed upon the importation of goods not needed for the conduct of the war. China will have little money to spend on non-essential foreign imports, while Japan will prevent the importation of goods which are essential. How much of an import trade can be developed through the overland routes which will remain open from Soviet Russia and from French Indo-China and Tibet is uncertain, but their total during the next year is not likely to be large. This question has far greater military significance than economic.

II. HOW WILL THE ECONOMIC INTERESTS OF THE UNITED STATES BE AFFECTED DURING THE STRUGGLE?

1. How would our trade with Japan be affected?

If Neutrality legislation is not applied, or widespread boycott not inaugurated, our trade with Japan will not suffer. In fact, our exports to Japan will probably increase as a consequence of the war. During the first six months of 1937 our exports to Japan were \$165 million, or an increase of almost 80 percent. The kind of goods which Japan buys from the United States — raw cotton, oil, iron, copper, and machinery — are those which Japan would use in greater abundance during wartime.

Our imports from Japan will presumably remain unaffected. Japan's need to obtain foreign exchange will insure no interference with the production and sale of export commodities. Our imports, therefore, will depend upon the domestic situation within the United States. Our imports from Japan, therefore, may increase during the next year along with our increasing national income.

2. What will happen to our trade with China?

With respect to our trade with China, the situation will differ radically. Our sales to China last year were about \$47 million. Our imports were about \$75 million. With a Japanese blockade in effect in all the ports, our exports to China will drop sharply. China will have neither the purchasing power nor the desire to import anything but food and materials absolutely necessary for the conduct of the war, while Japan will unquestionably prevent war materials from entering through the Eastern ports. Possibly some of the exports can elude the embargo by being shipped through French Indo-China, but the total of such amounts must inevitably be small because of the transportation difficulties. Our imports from China will likewise be greatly reduced, though possibly not to the same extent because the limiting factor would be transportation difficulties and not a lack of demand for Chinese products.

3. How much will American investors lose?

The loss to American investors from a continuation of the struggle will not be negligible. Americans have about \$200 million invested in China -- most of it represents investment in plants and equipment. If the war spreads much more the bulk of that will disappear.

Our investments in Japan are double those in China, but in the case of these investments the bulk consists of obligations of the Japanese Government and corporations. The value of these is for the time threatened. Should the fighting be prolonged into next year without substantial victories by the Japanese, these securities will unquestionably fall heavily in value.

In addition to the loss to American industry incurred by curtailment of exports to China, and to the American investor by the reduction in the value of his foreign holdings in the Far East, there must be added the potential loss to the United States Treasury through the possible effect on the price of silver as a consequence of China's need for foreign exchange. Should the war continue for another year we will be confronted with two unpleasant alternatives. China will be forced to liquidate some of her silver holdings and we, then, will be faced with the choice of purchasing such amounts of silver as are necessary to maintain the price, or of permitting the price of silver to decline precipitously.

British investors have much more to lose from the continuation of the war than American. British investments in China total about 1 1/2 billion dollars, while her holdings in Japan are probably much greater than ours. In addition China's trade is at least as important to the British Empire as it is to us.

III. WHAT WILL BE THE EFFECT OF THE APPLICATION OF THE NEUTRALITY ACT?

The conclusion reached above that our trade with Japan will not be affected is based upon the assumption that there occurs no boycott of Japanese goods and that the President does not declare a state of war between China and Japan. Neither of these possibilities are remote. There is already on foot a demand that Japanese goods be boycotted and it is entirely possible that the sympathy which Americans feel for China's struggle to maintain her national independence is such that a reduction of the purchase of Japanese commodities to the extent of 10 to 20 percent of our imports may result. In the event of such a development it is to be expected

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that Japan will retaliate by shifting some portion of her purchases from the United States to countries that are less unfriendly. A more serious development and one that is even more likely is the proclamation of a state of war by the President between China and Japan.

The Neutrality Act may impose three major restrictions on commercial relations with belligerent countries:

- (1) It prohibits the exportation of certain goods;
- (2) It may introduce the "cash and carry" plan of shipments;
- (3) It prohibits the extension of loans or the financing of other than those transactions regarded as normal commercial transactions.

1. The importance of the first restriction depends upon the list of commodities included in the embargo of the export of arms, ammunition or "implements of war" to belligerent countries. A large portion of our exports to Japan consist of commodities which do not necessarily fall in those categories, e.g., raw cotton accounts for almost half of the total; oil, iron, copper, and machinery constitute another large portion of our exports to Japan. How much of these items will be included depends upon the extent to which the President regards them as "implements of war". It is therefore impossible to say how much the invocation of the Neutrality Act will curtail our exports to Japan. The possible range of prohibition is very great, inasmuch as the definition of the term "implements of war" may be either broadly or narrowly interpreted by the President.

2. The "cash and carry" provision of the Neutrality Act will be ineffective in creating transportation difficulties. China has no navy with which to interfere with the shipment of goods to Japan and China's air force will be able to accomplish little in that direction. Japan will have little difficulty importing whatever goods she cares to buy from the United States.

3. The third prohibition is likewise unimportant. The financing of normal and ordinary commercial transactions through the extension of credit by Americans can be excepted by the President. Neither Japan nor China has in recent times borrowed substantial sums in the United States. Therefore, the prohibition will bring about no

reduction in the amount of goods sold to either country or any significant loss of interest.

Even had Japan the right to borrow here, it is very doubtful whether her credit during the period of war would be sufficient for purposes other than usual commercial transactions. It is very doubtful whether American investors would be willing to lend any large sums to the Japanese Government or to Japanese concerns during the period of hostility. It therefore may be stated that whether we lose much or little by application of neutrality legislation depends entirely upon the President's interpretation of the phrase "implements of war".

IV. WHAT ROLE WILL THE INTERESTED POWERS PLAY IN THE WAR?

1. How far will Soviet Russia go in assisting China?

Soviet Russia is much more involved in the Far East than it is in Spain. The assistance which it has given to the Spanish Government in her conflict with the rebel forces will unquestionably be very small compared to the assistance she is ready to give to help China defeat Japan. China is in effect fighting Russia's war and Russia fully realizes that every additional blow administered to Japan will make her own position that much stronger. Not only is Russia desirous of gaining China's friendship but she is obviously eager to inflict as much damage upon Japan as possible. Soviet Russia may, therefore, be expected to give all the aid that she possibly can short of being brought into the war. The limitation upon Soviet Russia's support of China will be the physical one of transportation of material. How much material Russia can transport to China through the lines of communication that will exist during the next six months we do not know. Doubtless our Army and Navy Departments are informed on this point.

2. Will Japan tolerate such assistance as Soviet Russia will give to China?

She will, of course, do everything she can to prevent shipment of material from Soviet Russia to China short of carrying the campaign into Russian territory. It would be absurd for her to declare war on Soviet Russia because of assistance to China unless the Japanese army leaders regarded their position as so desperate they would have nothing to lose by attempting to bring about a world war in which they might gain effective allies in Europe.

3. What assistance can Japan expect from Germany?

(a) Economic. As was indicated above, Germany will be only too willing to sell to Japan her surplus and obsolescent war materials, and to provide much of these materials on credit in return for gold or foreign exchange on part of such sales. Such assistance may be considerable, but will not in any case be decisive.

(b) Political. In view of the fact that Russian assistance to China may have a crucial effect on the war, there is nothing Japan would like better than to see Germany increasing her pressure in Eastern Europe. The more Russia's attention is diverted from the Far East, the easier Japan's task in China will become.

No matter what the secret terms of the German-Japanese Agreement of 1936 were, it is unlikely that Germany will go to war with Russia at this juncture. But it is probable that the tension in Central Europe will increase in the near future, though not enough to divert all Russian assistance from China.

German political assistance to Japan will thus take the form of still further complicating the European picture, thereby leaving Russia and England less free to act in the Far East.

4. Where does England really stand?

England's Far Eastern policy has not yet crystallized sufficiently for us to answer this question with the information available. Doubtless the State Department is in a better position to judge the trend of English foreign policy. Some indications are the comparatively mild note of protest sent to Japan after the Japanese shooting of its Ambassador to China, and the passive acceptance of the destruction of the property of its nationals in Shanghai.

It appears that at most England's policy will be negative; it will not press China's appeal to the League of Nations, if anything the reverse; it will not make loans to China. It is in a position where it must concentrate all its attention on Europe and the Empire.

If England does not adopt a purely negative policy, the most likely alternative is that it will come to a secret agreement with Japan, in which her interests in China and the Far East will be

nominally protected. In return for this protection she may allow Japan to get credits in England and also sabotage Chinese appeals for diplomatic action at Geneva and elsewhere.

The adoption of a negative policy by England would, of course, help Japan much more than China.

5. Is the war likely to spread?

The possibility of the spread of the war to include a foreign power exists, of course, but the probabilities do not yet appear great.

England and the United States will go to great lengths to stay out, even to the extent of overlooking numerous "incidents" which could easily provide the apparent justification for the use of military force. It is Soviet Russia and Germany who are the likely entrants.

Soviet Russia has everything to gain by postponing war with Japan so long as China is putting up an effective fight. However, should the Chinese defense disintegrate rapidly, whether because of the lack of material, or other causes, Soviet Russia will be faced with the difficult choice of helping China with her military forces or being confronted with a victorious and more aggressive and more effective Japan. So long, however, as China is making an effective resistance, Soviet Russia will much prefer to aid her in any way she can, short of going to war herself with Japan. An attack on Japanese forces by Soviet Russia will in the present world situation most likely bring Germany in the picture. Before Soviet Russia would seriously contemplate running that risk, Chinese resistance would have to be on the verge of collapse.

The situation with the other likely entrant - Germany - is likewise dependent upon the course of events in China. Germany is not directly involved in the hostilities with China. She has much to gain so long as Japan is waging a successful campaign, but there is no danger that she will assist Japan in China with military forces. There is danger, however, that with continued Japanese successes the possibility for a successful venture of her own in Europe will become increasingly attractive. Germany is quite prepared to fish in troubled waters, and should Japan be achieving success in her Chinese venture the probabilities of a German move against

Secretary Morgenthau - 18 -

Czechoslovakia and/or Austria become great. If Japan achieves a decisive and rapid victory the moment may be propitious, in Germany's opinion, for a joint attack with Japan against Soviet Russia.

It would appear then that the peace of the world is tied up with China's ability to win or to prolong its resistance to Japanese aggression. It is our opinion that a Japanese victory increases greatly the chances of a general world war.

Fortunately for the peace of the world, events of the past week in Shanghai give promise of a more effective Chinese resistance than was anticipated in most quarters.

TREASURY DEPARTMENT

1/5

INTER OFFICE COMMUNICATION

DATE September 4, 1937

TO Secretary Morgenthau

FROM Mr. Haas 

The Sino-Japanese Situation

Summary

The Chinese-Japanese war is on.

1. What is likely to happen in China before next summer?

The answer to this question depends on economic and political as well as on military factors. Some of these economic and political factors are considered below.

1. Can Japan finance the war? Yes.

(a) Internal financing.

The cost of the war may be anything from 5 to 8 billion yen, whereas Japan's national income is not more than 15 billion yen. Even so, the burden will not be intolerable for the first year of the war and the Government can, if necessary, resort to the printing press and to forced loans, as well as to increased taxes.

(b) External financing.

Japan will have to import between 2 and 3 billion yen for the next year but she will be able to do so because she will have a gold and foreign exchange reserve of a billion and a half yen and she will be able to export enough to more than cover the remainder.

2. Can China finance a major war?

(a) China will have adequate supplies of foreign exchange to purchase such imports as she will be able to obtain through the Japanese blockade.

(b) China will have to resort to the printing press and the requisitioning of supplies at fixed prices; but she will not stop the war for lack of internal funds-- at least during the next year.

3. Can Japan obtain raw materials necessary to conduct an effective major war?

Yes, she can so long as she is fighting only China. Japan has been accumulating stocks of raw materials and will have no difficulty in procuring all the raw materials she needs for the prosecution of the war with China during the next year.

4. Can China obtain the materials necessary to conduct a war?

Herein lies China's chief weakness as she is largely dependent on foreign sources for basic raw materials and her access to them is cut off by the blockade. Her only hope is to be able to get sufficient war material over difficult land routes.

5. Can Japan provide an adequate supply of food stuffs for her population and the Army?

Yes. The Japanese Empire is almost self-sufficient in food and can for the next year at least purchase abroad such additional amounts as she may need to keep the population from dire want.

6. Can China obtain enough food to continue fighting?

Yes. The interior of China is locally self-sufficient and if the worst comes to the worst the Chinese people will live on even smaller quantities of food than they have been. Many thousands may die of starvation as they frequently have in the past but the war will not be checked by virtue of any lack of food.

7. Will the conduct of the war impose so great an economic burden as to create serious instability in Japan?

No. The drop in the Japanese standard of living will be considerable but as long as there are no serious military setbacks the decline in the standard of living will be accepted by the majority of the population.

8. Will the Chinese people continue to fight under the increasing economic burden imposed by the war?

Yes. The Central Government is fighting a popular war and most of the Chinese are accustomed to frequent long periods of critical distress -- famines, floods, civil wars.

9. How will Japan's foreign trade be affected by war?

Japan's net purchases during the next twelve months will not be below 2½ million yen in spite of the elimination of all imports not essential to the waging of the war or to the maintenance of the export market. Japan is not likely to depreciate the yen in order to increase her exports. She will prefer stricter exchange control and export subsidies to depreciation.

10. How will China's foreign trade be affected?

The normal foreign trade of China will almost disappear.

II. How will the economic interests of the United States be affected during the struggle?

1. How would our trade with Japan be affected?

Without neutrality legislation or boycott our trade with Japan will not suffer. Japan will buy just as much, if not more, from us.

2. What will happen to our trade with China?

It will drop precipitously.

3. How much will American investors lose?

American investors have about \$600 million invested in Japan and China and the longer the war lasts the smaller the value of these investments will become.

III. What will be the effect of the application of the Neutrality Act?

Boycott. Widespread boycott imposed by public opinion may cut our purchases of Japanese imports.

The extent to which the application of the Neutrality Act would affect our trade with Japan would depend on the President's discretionary interpretation of what goods fall into the category of "implements of war".

Secretary Morgenthau - 4

IV. What role will interested powers play in the war?

1. How far will Soviet Russia go in assisting China?

As far as she can short of being directly involved in the war.

2. Will Japan tolerate such assistance as Soviet Russia will give to China?

Yes. Unless her position becomes desperate.

3. What assistance can Japan expect from Germany?

Some economic assistance and political assistance in the form of diverting Russia's attention from the Far East to Central Europe.

4. Where does England really stand?

Nobody knows. She is most likely to adopt a purely negative policy which would help Japan much more than China.

5. Is the war likely to spread?

Not for the present. The two most likely entrants are Soviet Russia and Germany and Soviet Russia prefers to help China without going to war, whereas Germany is more likely to make trouble in Central Europe than begin a direct attack on Soviet Russia.

It would appear then that the peace of the world is tied up with China's ability to win or to prolong its resistance to Japanese aggression. It is our opinion that a Japanese victory increases greatly the chances of a general world war.

London, September 4, 1937.

MEMORANDUM

Sir Frederick Phillips, K.C.M.G., C.B., is fifty-three years of age, having entered the British Treasury twenty-nine years ago. His official position is termed "Under Secretary of His Majesty's Treasury."

In commenting on the British representation on the Economic Committee of the League, it was once said in Geneva that the British Government had first sent Sir Basil Blackett who had the face of an angel and the manners of a tank, then substituted Sir Otto Niemeyer who had the manners of a tank, and has now sent Sir Frederick Phillips!

It is true that Phillips is as blunt and taciturn as he is honest and intelligent. He can be lucid, facile and even brilliant on paper but, despite occasional attempts to overcome it, he is usually reserved, inarticulate and often commonplace in conversation. His colleagues in the British Treasury and in the other British Government departments understand, even if at times they do not particularly like, these characteristics /

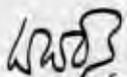
istics and respect him for his judgment and consistent ability. In many ways Phillips is the "roast beef of Old England" and possesses the tenacious virtues and narrow defects of his type. He himself is quite class conscious and thinks of himself not at all as Knight Commander of St. Michael and St. George but rather as the son of an obscure teacher in an equally obscure secondary school. At the same time he is a decided individualist in his thoughts and in the conduct of his work; his approach to people is straightforward and sincere and his approach to problems is straightforward and empirical.

There is good reason to believe that Mr. Neville Chamberlain has the highest regard for Phillips' judgment and there is no reason to believe that Sir John Simon will not be equally appreciative of his services. Because of his steadiness, his consistency and reticence he is more highly regarded by his fellow permanent officials than the more brilliant but erratic Economic Adviser to the British Government, Sir Frederick Leith-Ross who, incidentally, is not technically an official of the British Treasury but of the Board of Trade. It is even said that the basis of the cordial relationship between Phillips and Montagu Norman lies in their mutual dislike and distrust of Leith-Ross, but it is hard to determine whether Phillips really /

-3-

really dislikes Leith-Ross or merely regards him with contemptuous amusement. In any case, it is evident that although they work together a good deal, they do so of necessity. The above has a bearing on the fact that this trip to the United States is the type of journey which in the past Leith-Ross has more frequently than not undertaken as the representative of the British Government. It is therefore an opportunity for Phillips to obtain open recognition of the responsibilities which are his in fact.

As regards the United States, Phillips knows but little that he has not read in books. As a result of perhaps a painful intellectual process, he has in recent times convinced himself that it is in the best interests of his own country that there should be close collaboration between the United Kingdom and the United States, and he will do what he can to promote it in his own field.


W. W. Butterworth.

COPY

September 5, 1937

My dear Mr. President:

It was extremely difficult this time to make up my mind as to what was the best kind of securities to offer the holders of the maturing notes, as the advice that I received was very muddled. However, having made the decision, I now feel confident that the financing will be a success.

The money market in New York is extremely tight and will get more so as the crops begin to move. I have reason to believe that this is not displeasing to the New York bankers. Mr. Ransom, Acting Chairman of the Federal Reserve Board, approached me today in behalf of Mr. Eccles and himself, and they both feel that we must do something to ease the money market at once. I am in complete agreement with them as to the need of some action on the part of the Federal Government. I am hopeful that by the end of the week we will be in agreement as to what the best program should be. I would like to have an opportunity to lay it before you on Friday, the 10th, as I think we should announce it on Monday, the 13th.

When I see you I also would like to have a general talk with you and have you bring me up-to-date as to what has happened during my absence. Possibly you will find time to take me for a drive, and we can go and look at our Washington Hollow property.

With kind regards, I remain, as ever,

Very sincerely yours,

(Signed) Henry Morgenthau, Jr.

Honorable Franklin D. Roosevelt,
The President,
c/o Mr. Rudolph Forster,
The White House,
Washington, D. C.

HMJr:bn

COPY

September 5, 1937

CONFIDENTIAL

Dear Mr. President:

On September 15, 1937, about \$817,000,000 of Treasury notes will mature, and to provide for that maturity, I propose, subject to your approval, under authority of the Second Liberty Bond Act, approved September 24, 1917, as amended, to offer for subscription two series of Treasury notes, both to be dated September 15, 1937. The offering will consist of fifteen-month 1-1/4 percent notes and five-year 2 percent notes. These issues will be open only for the exchange of the maturing notes and cash subscriptions will not be invited.

The authorizing act provides that notes may be issued only with the approval of the President. Accordingly, I trust that the proposed issues will meet with your approval. It is my intention to make public announcement of the offering on Tuesday, September 7.

Faithfully yours,

(Signed) Henry Morgenthau, Jr.

Secretary of the Treasury

The President,

The White House.

APPROVED:

ELK:M

September 5, 1937

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With kind regards, I remain, as ever,

Very sincerely yours,

Honorable Franklin D. Roosevelt, (φ)
The President,
c/o Mr. Rudolph Forster,
The White House,
Washington, D. C.

HJr:bn

NAVAL MESSAGE
(NAVY DEPARTMENT)

185

From PRESIDENT OF US	ACTION	To	SECRETARY OF THE TREASURY	Write ACK. w/true address requiring acknowledgment
Released by X - R; Y - R. <small>(signature)</small>				
Date 5 SEPTEMBER	INFORMATION	To		
NITE to				
ROUTINE to				
PRIORITY to				

~~995~~ FEEL SURE FINANCING WILL GO THROUGH SATISFACTORY DOMESTIC
SITUATION EXCELLENT SORRY NO STATEMENT POSSIBLE 1945

TOR IN CODE ROOM 1945 5 SEPTEMBER 1937

*Telephoned
Secretary
Morganthau
8:50 pm
Cory*

CONFIDENTIAL

NAVAL MESSAGE
(NAVY DEPARTMENT)

186

From PRESIDENT OF US	ACTION	To SECRETARY OF THE TREASURY	Write A.C.K. after address requiring acknowledgment
Released by X - R; Y - R. <small>(signature)</small>			
Date 5 SEPTEMBER 1937	INFORMATION	To <i>Telephoned to The Secretary 12:20 a.m. ab. 9/6/37. copy of reply attached.</i>	
NITE to			
ROUTINE to XXXXX			
PRIORITY to			

4+
0005 ON ACCOUNT OF STORM DOUBT IF POUCH WILL REACH ME BEFORE
MONDAY AFTERNOON I WILL SEND RADIO OK AND LATER SIGN APPROVAL
IF YOU WILL SEND CODE MESSAGE OF TERMS BOND OFFERING 2135

TOR IN CODE ROOM 2310 5 SEPTEMBER

WHITE 17

CONFIDENTIAL

September 5, 1937

TO THE PRESIDENT
S S POTOMAC
VIA NAVAL COMMUNICATIONS

THE NEWSPAPERS TUESDAY MORNING WILL CARRY ANNOUNCEMENT
OF TREASURY FINANCING PERIOD THE FINANCIAL COMMUNITY
HAS ONE OF THE WORST ATTACKS OF THE JITTERS THAT I HAVE
SEEN IN A LONG TIME PERIOD IF YOU HAVE MADE UP YOUR MIND
THAT YOU ARE NOT GOING TO CALL AN EXTRA SESSION OF
CONGRESS AN ANNOUNCEMENT FROM YOU TO THIS EFFECT IN
MONDAY'S MORNING NEWSPAPERS WOULD COME PSYCHOLOGICALLY
AT THE RIGHT TIME PERIOD WOULD APPRECIATE ANSWER KINDEST
REGARDS

✓
HENRY MORGENTHAU JR

September 5, 1937.
11:25 a.m.

H.M.Jr: Hello

Viner: Hello Henry.

H.M.Jr: How are you?

V: How are you?

H.M.Jr: Oh I'm simply fine.

V: That 's grand.

H.M. Jr: I - I'm a new man.

V: That's grand. You need to be.

H.M.Jr: Well I am.

V: That's fine.

H.M.Jr: Where are you?

V: I'm at Westchester County.

H.M.Jr: Are you on a party line.

V: No, a private wire.

H.M.Jr: Ah-ha. I - I'd like very much to see you Tuesday.

V: I'll be there at 9 o'clock. I'm coming in - I'll be in - ah - in fact Monday evening.

H.M.Jr: Do you want us to have a room for you?

V: At the Hay-Adams Monday night.

H.M.Jr: (Aside to someone: "Hay-Adams - a room for Dr. Viner Monday night)

H.M.Jr: Wayne Taylor says would you like to stay with him.

- 2 -

V: Ah - well I'm arriving - ah - you mean - ah - yes - that would be nice.

H.M.Jr: He says would you like to go out there?

V: Yes, I surely would

H.M.Jr: (Aside to Taylor: He accepts.)

H.M.Jr: He says his rates are cheaper.

V: His rates are cheaper?

H.M.Jr: Yes.

V: Well that's fine. Ask - ask him if I'll be able to match for dinner there?

H.M.Jr: (Aside to Taylor: "He said he'll match you for the dinner".)

H.M.Jr: All right - I'm - I'm - we'll have an interesting week. I've got some stuff that we want to do this week.

V: I'm sure.

H.M.Jr: I'm afraid to say about it over the phone but you can.....

V: All right, well it's a private wire.

H.M.Jr: Well you can be thinking about it.

V: All right.

H.M.Jr: The - ah - Fed's fortunately approached me - they're worried about the tightening money market, see?

V: Yes.

H.M.Jr: And what I'd like to do is - ah - discontinue, for the time being, sterilization of gold.

V: Ah-ha - all right, I'll be thinking about that.

H.M.Jr: See?

V: Yes.

H.M.Jr: And we want to stop selling nine months and six months.....

V: Yes.

H.M.Jr:and sell 90 days and one year certificates.....

V: Ah-ha.

H.M.Jr:and tax bills.

V: Ah-ha.

H.M.Jr: See?

V: All right, I'll be thinking about that.

H.M.Jr: That's - that's what we've got in mind.

V: All right, well you tell Wayne Taylor that I - I arrive about half past eight and I'll - I'll take a taxi right out.

H.M.Jr: You'll be there about 9 o'clock.

V: Yes. Now what's his address again?

H.M.Jr: (Aside to Taylor: "What's your address?")

H.M.Jr: 5101 Tilden Street.

V: 5101 Tilden Street.

H.M.Jr: It's beyond the American University.

V: Yes. All right, I know.

H.M.Jr: All right.

V: All right, I'll be there Monday evening and be at - at the Treasury Tuesday morning.

H.M.Jr: Swell.

V: All right.

H.M.Jr: Goodbye.

V: Goodbye .

September 5, 1937.
11:27 a.m.

H.M.Jr: Hello
Hello

H.M.Jr: Hello - Winn Riefler.

R: Yes. Did you have a good vacation?

H.M.Jr: Oh fine.

R: That's grand.

H.M.Jr: I'm feeling very well.

R: Good.

H.M.Jr: Ah - look - do you suppose you could be down here first thing Tuesday morning?

R: Ah - what day?

H. M.Jr: Tuesday.

R: Tuesday.

H.M.Jr: Yes.

R: Well I don't think so - I can get there Wednesday morning. I'm packing the books and the car tomorrow morning and starting - chauffeuring them down to Princeton.

H.M.Jr: I see.

R: Would Wednesday do?

H.M.Jr: Yes, but - ah - where - where are you now?

R: I'm up in Cape Cod.

H.M.Jr: I see.

R: It's a two day trip.

H.M.Jr: Oh yes. Well.....

R: There's nobody else that can take them.

H.M.Jr: Pardon me?

R: There's nobody else that can take them.

H.M.Jr: Why, you mean nobody can drive them?

R: Yes.

H.M.Jr: Ah-ha. Well - ah - Wednesday will be all right.

R: All right.

H.M.Jr: If you could get here fairly early.

R: Yes, I'll get there - just as soon as I get to Princeton I'll come on.

H.M.Jr: Listen, are you on a private wire?

R: Yes.

H.M.Jr: Let me tell you confidentially what I've got in mind - hello

R: Yes.

H.M.Jr: Ah - the money market situation is very bad; it's getting tighter all the time. Ah - the Fed's (Federal Reserve) worried about it - I mean it looks as though they'd run down December to only two or three hundred million excess reserves, see? - for the country - hello

R: Yes.

H.M.Jr: Now what I want to take up and decide this week is -
1. Shall we, for the time being, discontinue the sterilization of gold.

R: Yes.

H.M.Jr: Two.....

R: Yes.

H.M.Jr: Stop selling our nine months' and six months' bills and sell 90 day bills.....

R: Yes.

H.M.Jr:ah - bills due on the tax date.....

R: Yes.

H.M.Jr:and for the country banks the one year certificates.

R: What month for the country banks?

H.M.Jr: A one year certificate.

R: Yes, one year.

H.M.Jr: See? And - ah - the Fed has approached me and they're very anxious to do something and - ah - they want to - they're going to make up their mind this week because I told them if we're going to do it and have any effect we ought to - ah - announce it on the 13th - Monday.

R: Yes.

H.M.Jr: Ah - the - the money market in New York is very bad and it will get worse steadily and I think it's up to the federal government to do something.

R: Yes.

H.M.Jr: So you might be turning that over in your mind.

R: Yes I will.

H.M.Jr: Ah - they're willing to go in and use the open market operations but - ah - ah - ah - Ransom agrees with me that he doesn't think it would be effective.....

R: Yes.

H.M.Jr:and - ah - I think that for the time being if we just stop sterilizing gold - ah - I think it would have a very good psychological effect.....

R: Yes.

H.M.Jr:with the big crop movements on just at this time. What's your curbstome opinion?

R: Well I'll think it over; I think it may be the thing to do; I'll think it over.

H.M.Jr: Well you turn it over, will you?

R: I'll give you my best.

H.M.Jr: And - ah - when you come down figure on spending a couple of days, will you?

R: Yes.

H.M.Jr: How do you feel?

R: Oh I'm grand.

H.M.Jr: Have a good summer?

R: Had a grand summer.

H.M.Jr: All right, well

R: We're in the midst of a Northeaster right now.

H.M.Jr: Oh really?

R: Oh a terrific storm just beating around us here.

H.M.Jr: Well there's no disagreement as to the - ah - money market situation, see?

R: Yes.

H.M.Jr: It's a question of "What can the federal government do"?

R: Yes.

H.M.Jr: When I speak of the federal government I mean Federal Reserve and ourselves. All right?

R: All right.

- 5 -

H.M.Jr: O.K.
R: O.K.
H.M.Jr: Goodbye.
R: Goodbye.

RE SEPTEMBER 15 FINANCING

September 5, 1937
10:30 a.m.

Present: Mr. Taylor
Mr. Bell
Mr. Lochhead
Mr. Haas
Mr. Gaston
Mr. Seltzer
Mr. Murphy
Mr. Harris
Mr. Ransom
Mr. Harrison
Mr. Burgess

H.M.Jr: Well, for the benefit of those who were not here yesterday afternoon, Mr. Levy came in, from Solomon Brothers and Hutzler, and said that if New York had its choice, it wouldn't want to buy anything.

Burgess: Didn't he say his customers?

H.M.Jr: Well, his customers.

Burgess: He meant all over the country, not just New York.

H.M.Jr: He recommended a 15-month 1-1/4 and a 7-year 2-1/2. But for the first time that I have ever seen him down here, he was wobbly in what he did believe. I mean usually he comes in here and in about 15 or 20 words - "I'd do this" - but he was quite wobbly in what he did think, and he stayed the longest he had ever been here; he was here an hour, and when he left I didn't really know what he thought.

Mr. Devine came in next and he was extremely emphatic that we shouldn't do anything over five years; said it would be just suicide to do anything - no advantage, nothing in it for the Treasury to do anything over five years. He said that he spent a great deal of time on it, stayed awake until three o'clock, trying to make up his own mind; he came to the decision that under no circumstances do anything over five years.

For dinner we had the president and secretary of Discount Corporation, and they were wildly enthusiastic that we do a 7-year 2-1/2. Go over big! Unheard of that we shouldn't; that they talked to the three or four most conservative banks in New York and they'd all buy 2-1/2s; that if the conservative banks didn't buy 2-1/2s it would be a great mistake.

-2-

Now, I took the position from the start that I didn't want to sell a 7-year, and as the evening went on they dropped little remarks like, "Well, whatever you do, when you sell a 7-year, you've got to leave it open four days." "Why?" "Well, give them plenty of time."

Well, little things like that which they dropped as the evening went on made us feel that maybe 7-year 2-1/2 wasn't so hot. I think we shook them a little bit. But certainly before they talked to us they were very much for it.

I talked for half an hour to Mr. Rentschler. He wanted a 15-month and a 7-year. I went over the whole business situation with him, and he said, looking ahead six months, that he felt pretty confident on business. Little bit worried about the railroad situation and the building. But to my great surprise he said that his customers were in excellent shape as far as inventories were concerned; in fact, inventories were low. He said the inventory position of his customers was in excellent shape. I asked him about China. He said American business men stood to lose no money as far as capital investments were concerned, but they would lose expected profits.

I then told him what I had in mind on a five-year. He said a seven. I didn't want to do seven and told him I didn't want a 7-year hitting me in the face on the first of December, when I was considering the next financing. He said, "Well, all I can do - tell you is that if you decide to do a five-year two you will have an excellent secondary market. All your trust funds will go into it, and they should consider it an attractive security. We'll put all our trust funds into that security - for them." And when I got through talking to him, he felt that the 15-month and the five-year would be an excellent program.

So that brings it down to this morning. Maybe somebody else's brains have been working during the night; if so, I'd be glad to hear them.

-3-

Harrison: I haven't changed on the questions of principle involved at all. On the practicalities, there is a pretty even split. That being so, you've got a choice, from the market point of view, whether you do the seven or the five-year note. And in weighing that decision, I should think you would try to figure out what if any additional advantage or how much additional advantage there is to the Treasury in putting out a 7-year bond, even if it would go. My own opinion still is that if I were in your position I think that I would figure that there is not enough additional advantage to you in putting out the 7-year bond to run some risks involved and to go counter to pretty definite advice of half your market that that won't go as well as a note. I think that if I had to decide right now I would decide on the 15-month note and the five-year note. I'm not sold on a five-year note particularly - the experts know better whether it should be a four-year or five-year - but I should think a five-year note would go, and if you got a good rate for it - fits in well - I'd prefer the five-year to a four-year.

H.M.Jr: You prefer which, the five-year?

Harrison: I would prefer the five-year to a four-year, provided the experts here feel that that rate fits in properly with the rest of the rate structure; as it appears to me, it does.

H.M.Jr: Anybody talk if you like. Seltzer?

Seltzer: Well, I would prefer a 7-year bond to a five-year note. I think the real choice is between a four-year note and - a 1-7/8 four-year note, and the 7-year bond, for this reason. If you shy away from the bond, it is because you are doubtful, the market doesn't look promising. Well, I don't think the five-year note is so very attractive either, and if I am going to play for safety, I'd play a little more for safety with a four-year note. Further, it is easier to price. We haven't got any fixed point there to price a five-year two percent. Our longest note maturity is a four and a half year note. If we price a four-year note at about a little better than what the four and a half year note is selling, we're sure to command an adequate premium.

-4-

Bell: What will your four-year 1-7/8 note sell for?

Seltzer: About a half point.

Bell: What would your two percent sell for?

Harris: I estimate somewhere between 24 and 30 thirty-seconds.

Murphy: You'd be much surer of your premium on the four, wouldn't you, Mr. Harris?

H.M.Jr: Sure of what?

Murphy: I think you'd be much surer of your estimate of the premium on the four than on the five.

Burgess: I don't think you would.

Harris: No, I don't either.

Burgess: I think the longer note, with the larger coupon, attracts the type of customer who doesn't care whether it's four or five particularly, and I think that putting the 1-7/8% note in there at the autumn of '41 would have a much more unfortunate effect on the '41 notes and on the March '42. You see, you've got a 1-3/4 selling at par. If you put in something with a three months' or six months' earlier maturity at that rate, that 1-7/8 is going to wreck that March '42. Now, this other would be six months beyond that, which justifies a considerable difference in rate, so I think it would affect it much less severely.

Then, your program of maturities fits a five-year note very much better. You've got in '41 maturities of two and a quarter billion, and as you count the callable stuff, much of it carries 3-3/8, and you've got nearly three billion dollars already in '41, whereas '42 is very small both on the maturity and the callable amount. It is your one open year.

I think the primary question is what is going to be the effect on the market.

Seltzer: What premium do you think a five-year two would command?

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- Burgess: Well, at the start, a half point. I think after it had been out a while it would have some spring in it, might do a little better.
- Harrison: Randy, what premium would the 7-year 2-1/2 carry?
- Burgess: Well, it figures about three-quarters, but of course it wouldn't do that quite.
- Bell: 21, the Discount boys figure.
- H.M.Jr: God, they were good last night.
- Bell: I've never seen them better.
- H.M.Jr: You know, Mills can't stand much and I always give him one extra cocktail; then he gets good, begins to tell stories out of school; always tells us a few stories out of school.
- Harrison: Mr. Secretary, on the basis of the information you've got now, do those who favor the 7-year bond think that the program of a 15-month note and a five-year note would not go?
- H.M.Jr: Oh, everybody thinks a 15-month and a five-year would go.
- Harrison: Would go?
- H.M.Jr: Oh yes.
- Harrison: And what are their arguments against that program?
- H.M.Jr: Well, you do it, Burgess. You can do it better than I can.
- Burgess: Well, first that the 7-year bond refunds some of the short-dated debt into something longer than five years - a very considerable school of thought in the market that thinks that is very desirable, is a little worried about the five, and the amount of the short-dated debt. And that is based on a lot of fiscal experience, of course. When a government gets a closely piled up short-dated debt, it's a dangerous thing.

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Secondly, I think, the feeling that over a term of years the government is going to need to distribute this debt to others than banks, and a 7-year bond is more apt to get distribution over a period of years than a note is. The note is more apt to be held by the banks and keep them loaded down. I think those are the two major reasons.

The third is that we have been piling notes into that note market pretty fast; we have been putting them in there steadily, and there are a lot of notes outstanding - there's the four and a half years, two of the four and a half years; whereas that intermediate bond market is quite a separate market from the long-term bond market and has had nothing put into it for a year and a half, and is probably in shape to receive something. The investment banker fellows tell us that that is a maturity which investors are rather looking for in there. I think those are the arguments for it. Now...

- Harrison: Put it the other way around. Do those who favor the 7-year bond feel that there is any less likelihood of the five-year note going well?
- Burgess: No.
- Harrison: I mean putting it - there is so much talk now about a 7-year bond; would there be apt to be disappointment to the point where it would reflect on the five-year note?
- Burgess: I think we've got evidence along that line, but I would say the bulk of the evidence was that a five-year note would go a little better.
- Bell: I think they feel that a 7-year bond is the more courageous step for the Treasury to take.
- Burgess: That's another point. They....
- Taylor: I think there's a question, if it's 300 of one and 350 of the other - in other words, a difference of about 50 million - that your chances of selling 50 million more 2-1/2s are about that way; in other words, - well, it isn't any more than that.

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Harrison: I see.

Burgess: I think two points ought to be made. Levy thought that you'd sell more of the bond than you would of the note. Most of the others have felt the other way....

Harrison: That's what I wanted to get.

Burgess: ...that there's a little better chance for the note.

Another point of view is that expressed by Parkinson, president of the Equitable Life. He said to me some time before he left the office - I guess you fellows weren't there at that time - he said, "You fellows always put out what the banks want; I hope some day you'll put out what the investors want. I know what you'll do. The bankers will get at you, make you put out some short stuff. But the insurance companies would like something adapted to their needs, and the bond would be of that character."

I think that always the pressure comes on us most strongly to do what the banks want, rather than what the investors want.

Harrison: I agree.

H.M.Jr: Well, there is no pressure on us to do a five-year.

Burgess: Well, there is a pressure against the 7-year, though.

H.M.Jr: Is against it?

Burgess: I say there is some pressure against the bond. I'm not presenting those arguments as mine, although I think my own judgment is....

Ransom: Is that banker pressure against the bond?

Burgess: Yes, I think so.

Harrison: Well, isn't Parkinson really answered by the opportunity to buy '44-'46s, even though they are at a premium? If he is determined that the Treasury ought to give him an opportunity to get a bond about that year, about that maturity and that yield, is the fact that that issue is selling at five points

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premium, or whatever it is, such a deterrent that he wouldn't buy those, but would buy the seven 2-1/2s?

Burgess: It isn't just that. If he went out on the market and tried to get that maturity... - you can't get large blocks of those readily on the market. For an insurance company to go out and try to get blocks.....

Harrison: We could get them. I know where to get some blocks.

Burgess: That is, of course, the obvious answer to make to them - that there are some bonds available on the market, to go and get them there. I am convinced that the five-year note will go a little better than the bond. I think it is a little safer program. I think that either would go, but that the note is the safer and the more conservative thing to do.

H.M.Jr: Just repeat that again.

Burgess: I say I think the five-year note will go a little better than the bond will. I think you can do either, but if you want to make the program a little safer, a little more conservative, in view of this autumn's problems, I think the five-year note is the one to pick.

Harrison: Well now, making a prognosis for the future, what have we got ahead of us? Some uncertainty, which both Williams and Thomas referred to yesterday, in business; the likelihood that it will go along pretty well through the spring - leveled out now, but will probably pick up in the spring; but we all know that there is apt to be some pressure upon the money market during the next few months, if only on account of the demand for currency. In addition to the possible influence of that demand for currency on the money market, you have great political uncertainties all over the world, and nobody can anticipate them. I don't think anything very much dreadful is going to happen myself. But if there isn't any great difference between the 7-year bond and five-year note and the five-year note is much more conservative, I think you've got a pretty important factor in

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making your decision that way rather than the less conservative way.

- H.M.Jr: One thing I forgot to mention - the fact that we were not going to ask for any more money, we were going to stop selling the December bills; I was surprised how enthusiastic they were about that information, particularly the Discount boys.
- Burgess: (Laughs)
- Taylor: They had special reasons.
- Harrison: Were they more enthusiastic than the Federal Reserve?
- H.M.Jr: Yes. They've got 78 or 79 million dollars worth of those bills. But it seemed to - I mean they're so hungry for a little good news - I mean it's almost pitiful. God, these fellows in New York - they're always either in the cellar or on the roof; I never saw anything like it; and there is never a particularly good reason why they're either in the cellar or on the roof.
- Harrison: And there is always an express elevator between the two.
- H.M.Jr: And the express elevator seems to go down faster than it goes up.
- Burgess: That's right; that's historically accurate.
- Harrison: I never expected to hear myself in this room arguing against a bond as against a note, or against a bond in favor of a note, when there is a basis of opinion that would support the bond. But with all these other factors, apart from the money return to those who would be getting the 7-year bond, it seems to me that you've got enough influences against the bond to justify your discounting a little of the opinion that advises you to issue the bond.
- H.M.Jr: Of course, we save money on the note.

Harrison: What's that?

H.M.Jr: We save money on the note.

Harrison: And you save money on it. I don't think that is necessarily a deciding factor if you've got a real market that will stick on your bond.

H.M.Jr: And another deciding factor is that the Federal Reserve Board here in Washington seems to be unanimous in favor of a note.

Harrison: Well, I'm in agreement with the Board, but for, I think, probably different reasons.

Ransom: That might simply mean that there were more than one set of good reasons, George.

H.M.Jr: But I want to - I don't see any particular reason at this time to disagree with the Board. In fact, I think there are a good many reasons why the Treasury and the Board think alike at this time.

Ransom: Certainly that's our opinion, Mr. Secretary.

H.M.Jr: Pardon me?

Ransom: I say that is certainly our opinion.

H.M.Jr: Well, I can't - unless somebody has something new to offer - Wayne?

Taylor: No, I'm for it. I'm for the 1-1/4 and the five. I think the other one would go, but, all other things being equal, I am certainly for the 15-month and the five.

H.M.Jr: Dan?

Bell: That's the way I feel; I switched last night.

H.M.Jr: George?

Haas: I'm happy with the five-year note and the short.

H.M.Jr: Archie?

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Lochhead: I'm agreeable on the five.

Murphy: I'm agreeable to the five.

Seltzer: Why, five-year doesn't sound as good to me as a four-year note if you're going into notes; and as against the five-year note I'd prefer the 7-year bond.

Harrison: Can you price a four-year note as well as you can price a five-year note?

Seltzer: Better, I think.

Harrison: I thought the other way around. And I think that would be the deciding factor in my mind; I'd take whichever one you could price easier.

Lochhead: Statistically you might be able to price the four-year better, but as a practical matter you might be able to price the five-year better.

H.M.Jr: Let's see, I've asked everybody but Harris.

Harris: It's agreeable to me. I prefer the 1-1/4 and the five-year note.

Harrison: You prefer the what?

Harris: Five-year note.

H.M.Jr: Well, let's decide now; we might as well get to work on this thing. Be a five-year two and a 15-months, and if you (Bell) give me the letter I'll sign it, and Forster is waiting at the White House.

Harrison: Randy, you're not disappointed, are you?

Burgess: No, I'm entirely satisfied. I'm amused that a week and a half ago, ten days ago, the Secretary asked me, two days after I got back from my holiday, to give him a preliminary bet on what the financing should be, and I talked to Wayne about it and we finally sent him a cablegram suggesting that it should be a one-year one and a five-year two.

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- H.M.Jr: One-year one....
- Taylor: One-year one and a five-year two.
- Harrison: And I don't think enough has happened between then and now to justify a sound change.
- Burgess: Judgment is better probably in the Adirondacks than it is in New York.
- H.M.Jr: I'd say that was that. Now, if you all will get in touch with the Chinese and the Japanese and ask them to be good....
- Burgess: Nothing material has happened overnight, apparently.
- Seltzer: You want an armistice over the weekend.
- H.M.Jr: Personally, I would say that this is as near bombproof as any issue could be. I don't see - I'm not going to worry about it.
- Burgess: I'm glad, Mr. Secretary, that we explored the question of bonds, at least made a sally into it, although we had to fall back on the first lines of defense, because I think there is a good deal to be said for it.
- Taylor: And I tell you what it's going to do; it's going to make that two go better, other things being equal.
- Burgess: They're going to say, "This is a very conservative program." Everybody will be for it. If we had done the other, a lot of them would have been for it, but half of them would have been against it; they would have said, "The Treasury is stepping out a bit and taking a chance." This way they'll like it.
- H.M.Jr: They don't expect it, but they'll like it.
- Taylor: I was thinking of it from another aspect, that you have had so much conversation about a 15-month 1-1/4 and a three-year 1-5/8 that all this talk that you could sell the 2-1/2 whereas these others thought you couldn't go beyond three years - they will have been conscious of the possibility of the 2-1/2 and they'll go for the two, where otherwise they wouldn't have.

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Harrison: I think that is true. I think it's been very helpful propaganda. There's only one fellow going to be wholly disappointed, and that's George Davison.

Taylor: You kind of helped him too.

Harrison: But he might well feel this is better than what he might have got, just as you say.

H.M.Jr: I think so far as I'm concerned I'm entirely satisfied.

Burgess: I think your bond market will get a little lift out of it too. You see, the bond market has discounted having another short bond put in there. I think that intermediate market will get a little lift from it.

H.M.Jr: Well.....

Harrison: Are we dismissed, sir?

H.M.Jr: That's right. Thank you very much.

MEMORANDUM

(Dictated in presence of Messrs. Taylor,
Hass, and Lockhead)

Sunday
September 5, 1937

Mr. Ransom asked to see me alone this morning. He said that he and Mr. Eccles were in complete agreement that, in view of the tightening money situation which we were facing this fall, some action would have to be taken, and they were ready to cooperate in any way with the Treasury that we both thought best. I think he said that yesterday or in the last day or two the Board has just passed a resolution authorizing Federal Reserve of New York to buy 200 million dollars worth of ~~Government~~ securities, as an open market operation, with the idea of easing the tension.

Again talking for himself and Eccles, he said that they were unalterably opposed to a 7-year bond.

I told him that in the short time I have been back I felt that something must be done, and done very promptly, with regard to the tightening of the money situation; that I doubted that any open market operation would take care of the situation, as the Federal Reserve of New York would not carry it out with sufficient enthusiasm to convince anybody.

He said that Eccles had in mind setting for six months or a year a price at which bills could be rediscounted. I said that that would all be helpful over a long period, but that it wouldn't take care of the immediate situation. I furthermore said that their reducing their discount rate from $1\frac{1}{2}$ to 1 percent, for reasons which I couldn't understand, was interpreted as a bearish move, and that people as a result had sold their bonds; that it might be helpful some months hence, but certainly as far as the immediate situation was concerned it was ineffective. He agreed absolutely with me.

I said that I had been giving this matter some thought and talking it over with my people here, and that we believed the thing to do was to discontinue the sterilization of gold for the time being; that if we did that from now until the first of January, I believe somewhere between 250 and 350 million dollars worth of

9-5-37

gold would come in during that period, that is, between the 15th of September and the 1st of January; that whatever we did, we should do it together jointly, and promptly.

He said, "Talking for myself only, I believe that your suggestion would be more effective than an open market operation." I said, "If we're going to do it, we ought to do it on the 13th of September. Can you get ready by then?" He said, "Yes." I said, "Are you sure?" He said, "Absolutely. I'll start Tuesday."

He said, "What about your bill program?" I said, "Well, we're ready to discontinue the 9-months and 6-months and sell sufficient 90-day bills and tax bills."

He said, "What about one-year certificates?" I said, "We're ready to do that." I said, "You know on what date the country banks would like to have them fall due." He said, "No, I don't know, but I'll find out."

He again repeated; he said, "Something has to be done about the money market." And I repeated that "if it is going to be done, it ought to be done this coming week," and again asked him if he could get ready, and he again assured me he could.

I said this to him: "Now, I believe that if we make this move promptly, it may make a difference of one cent in cotton and it might make as much difference as ten cents in corn and ten cents in wheat at this time."

H. E. Jr.

NAVAL MESSAGE
(NAVY DEPARTMENT)

Fin

211

From PRESIDENT U.S.	ACTION	To SECRETARY OF THE TREASURY	Write on this form for addressee requiring acknowledgment
Released by X-M X-M (Signature)		INFORMATION	
Date 6 SEPTEMBER 1937			
NITE to			
ROUTINE to XXXX			
PRIORITY to			

**I HEREBY APPROVE YOUR OFFERING TWO SERIES NOTES ONE
FIFTEEN MONTHS THE OTHER FIVE YEARS FRANKLIN D ROOSEVELT 1935**

FOR CODE ROOM 1015 6 SEPTEMBER

WHITE 13

CONFIDENTIAL

NAVAL MESSAGE
(NAVY DEPARTMENT)

From PRESIDENT U.S.	ACTION	To SECRETARY OF THE TREASURY	PLACE, after address, requiring acknowledgment
Released by X-M Y-M (Signature)			
Date 6 SEPTEMBER 1937	INFORMATION	<i>To Telephoned to Secretary 3:05 pm Sept 6-1937 JEL</i>	
NITE to			
ROUTINE to			
PRIORITY to XXX			

NOTES

0006 TWO SERIES OF TREASURY ~~XXXX~~ PROPOSED YOUR LETTER OF FIVE SEPTEMBER, 1937 DULY APPROVED 1:00 P.M. MONDAY 6 SEPTEMBER, 1937 1355

TOR CODE ROOM 1415 6 SEPTEMBER

WHITE 20

CONFIDENTIAL

PRIORITY

VIA NAVAL COMMUNICATIONS

FROM

The White House

Washington

213

TELEGRAM

OFFICIAL BUSINESS—GOVERNMENT RATES

"SEND CONFIDENTIAL CODE"

TO: THE PRESIDENT;
FROM SECTY. MORGENTHAU.

U. S. GOVERNMENT PRINTING OFFICE 121254

TO: THE PRESIDENT:
ON BOARD THE U.S.S. POTOMAC:

SEPT, 6, 1937.

TREASURY OFFERING TWO SERIES OF TREASURY NOTES, BOTH IN EXCHANGE FOR THE THREE AND ONE QUARTER PERCENT TREASURY NOTES OF SERIES "A NINETEEN THIRTYSEVEN".

ONE SERIES DESIGNATED "E NINETEEN THIRTYEIGHT" WILL BEAR INTEREST AT THE RATE OF ONE AND ONE QUARTER PERCENT AND WILL MATURE IN FIFTEEN MONTHS ON DECEMBER FIFTEEN, NINETEEN THIRTY EIGHT.

THE OTHER SERIES, DESIGNATED "SERIES B NINETEEN FORTYTWO" WILL BEAR INTEREST AT THE RATE OF TWO PERCENT, AND WILL MATURE IN FIVE YEARS ON SEPTEMBER FIFTEEN, NINETEEN FORTYTWO.

MORGENTHAU.

12:59 a.m.

September 5, 1937

CONFIDENTIAL

Dear Mr. President:

On September 15, 1937, about \$817,000,000 of Treasury notes will mature, and to provide for that maturity, I propose, subject to your approval, under authority of the Second Liberty Bond Act, approved September 24, 1917, as amended, to offer for subscription two series of Treasury notes, both to be dated September 15, 1937. The offering will consist of fifteen-month 1-1/4 percent notes and five-year 2 percent notes. These issues will be open only for the exchange of the maturing notes and cash subscriptions will not be invited.

The authorizing act provides that notes may be issued only with the approval of the President. Accordingly, I trust that the proposed issues will meet with your approval. It is my intention to make public announcement of the offering on Tuesday, September 7.

Faithfully yours,

(s) Henry Morgenthau, Jr.

Secretary of the Treasury

The President,

The White House.

APPROVED:

(signed) Franklin D. Roosevelt
Sept. 6 - 1 p.m.

ELK:W

TREASURY DEPARTMENT
Washington

FOR RELEASE, MORNING NEWSPAPERS,
Tuesday, September 7, 1937

Press Service
No. 11-9

9/5/37

Secretary of the Treasury Morgenthau announced today the offering, through the Federal Reserve banks, of two series of Treasury notes, both in exchange for 3-1/4 percent Treasury notes of Series A-1937, of which \$817,483,500 mature on September 15, 1937. Both series of notes will be dated and bear interest from September 15, 1937. One series, designated Series E-1938, will bear interest at the rate of 1-1/4 percent, and will mature in 15 months on December 15, 1938. The other series, designated Series B-1942, will bear interest at the rate of two percent, and will mature in five years on September 15, 1942. The notes will not be subject to call for redemption before maturity.

Exchanges will be made par for par, and the offering of each series of notes will be limited to the amount of maturing notes tendered and accepted in exchange therefor. Cash subscriptions will not be received.

The Treasury notes will be accorded the same exemptions from taxation as are accorded other issues of Treasury notes now outstanding. These provisions are specifically set forth in the official circular issued today. The notes will be issued only in bearer form with coupons attached, in the denominations of \$100, \$500, \$1,000, \$5,000, \$10,000 and \$100,000.

Subscriptions will be received at the Federal Reserve banks and branches, and at the Treasury Department, Washington, and should be accompanied by a like face amount of Treasury

notes of Series A-1937, maturing September 15, 1937, with the final coupon due on September 15 detached.

The right is reserved to close the books as to any or all subscriptions at any time without notice, and, subject to the reservations set forth in the official circular, all subscriptions will be allotted in full.

Special Treasury bills aggregating \$350,600,000, which mature immediately after September 15, and about \$168,400,000 interest on the public debt, which becomes due on September 15, will be paid from the cash balance.

The text of the official circular follows:

UNITED STATES OF AMERICA
TREASURY NOTES

1-1/4 percent	Series E-1938	Due December 15, 1938
2 percent	Series B-1942	Due September 15, 1942

Both series dated and bearing interest from September 15, 1937

1937
Department Circular No. 578
Public Debt Service

TREASURY DEPARTMENT.
Office of the Secretary,
Washington, September 7, 1937.

I. OFFERING OF NOTES

1. The Secretary of the Treasury, pursuant to the authority of the Second Liberty Bond Act, approved September 24, 1917, as amended, invites subscriptions, at par, from the people of the United States for notes of the United States in two series, designated 1-1/4 percent Treasury Notes of Series E-1938 and 2 percent Treasury Notes of Series B-1942 respectively, in payment of which only Treasury Notes of Series A-1937, maturing September 15, 1937, may be tendered. The amount of the offering under this circular will be limited to the amount of Treasury Notes of Series A-1937 tendered and accepted.

II. DESCRIPTION OF NOTES

1. The notes of Series E-1938 will be dated September 15, 1937, and will bear interest from that date at the rate of 1-1/4 percent per annum, payable on a semiannual basis on December 15, 1937, and on June 15 and December 15, 1938. They will mature December 15, 1938, and will not be subject to call for redemption prior to maturity.

2. The notes of Series B-1942 will be dated September 15, 1937, and will bear interest from that date at the rate of 2 percent per annum, payable semiannually on March 15 and September 15 in each year. They will mature September 15, 1942, and will not be subject to call for redemption prior to maturity.

3. The notes shall be exempt, both as to principal and interest, from all taxation (except estate or inheritance taxes, or gift taxes) now or hereafter

imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority.

4. The notes will be accepted at par during such time and under such rules and regulations as shall be prescribed or approved by the Secretary of the Treasury in payment of income and profits taxes payable at the maturity of the notes.

5. The notes will be acceptable to secure deposits of public moneys, but will not bear the circulation privilege.

6. Bearer notes with interest coupons attached will be issued in denominations of \$100, \$500, \$1,000, \$5,000, \$10,000 and \$100,000. The notes will not be issued in registered form.

III. SUBSCRIPTION AND ALLOTMENT

1. Subscriptions will be received at the Federal Reserve banks and branches and at the Treasury Department, Washington. Banking institutions generally may submit subscriptions for account of customers, but only the Federal Reserve banks and the Treasury Department are authorized to act as official agencies. The Secretary of the Treasury reserves the right to close the books as to any or all subscriptions or classes of subscriptions at any time without notice.

2. The Secretary of the Treasury reserves the right to reject any subscription, in whole or in part, to allot less than the amount of notes applied for, to make allotments in full upon applications for smaller amounts and to make reduced allotments upon, or to reject, applications for larger amounts, or to adopt any or all of said methods or such other methods of allotment and classification of allotments as shall be deemed by him to be in the public interest; and his action in any or all of these respects shall be final. Subject to these reservations, all subscriptions will be allotted in full. Allotment notices will be sent out promptly upon allotment.

IV. PAYMENT

1. Payment at par for notes allotted hereunder must be made or completed on or before September 15, 1937, or on later allotment, and may be made only in Treasury Notes of Series A-1937, maturing September 15, 1937, which will be accepted at par, and should accompany the subscription.

V. GENERAL PROVISIONS

1. As fiscal agents of the United States, Federal Reserve banks are authorized and requested to receive subscriptions, to make allotments on the basis and up to the amounts indicated by the Secretary of the Treasury to the Federal Reserve banks of the respective districts, to issue allotment notices, to receive payment for notes allotted, to make delivery of notes on full-paid subscriptions allotted, and they may issue interim receipts pending delivery of the definitive notes.

2. The Secretary of the Treasury may at any time, or from time to time, prescribe supplemental or amendatory rules and regulations governing the offering, which will be communicated promptly to the Federal Reserve banks.

HENRY MORGENTHAU, JR.,
Secretary of the Treasury.



TREASURY DEPARTMENT

WASHINGTON

September 7, 1937

CONFERENCE BY THE SECRETARY OF THE
TREASURY, ASSISTANT SECRETARY TAYLOR
AND MR. BELL.

With Mr. Levy,
Solomon Bros. & Rutzler,
September 4, 1937.

Mr. Levy said that he had been feeling out the market. He had seen a great many people since he had talked with Mr. Taylor and me in New York on Friday. He had found a great deal of sentiment for the 7-year 2-1/2% bond. There had been some discussion on the 15-month 1-1/4% note but he felt that this was ridiculous. He would certainly issue the 7-year bond and he feels that we would get a minimum of \$200,000,000 which would be all to the good. Says that it does not make much difference what you do, if news from abroad is bad, you will be criticized for the offerings. On the other hand, if the news from abroad is of a better tone than we have been getting in the past few days, there will be more conversion into the bonds than into notes.

He says we cannot go on putting out short dated debt and feels that this is the time to step out a little further. The Street is talking about a 3-year 1-5/8% note and has a strong feeling for the 7-year 2-1/2% bond. The Secretary asked him if he would underwrite a program of this kind and he said he would very definitely. He stated that as an indication as to how the bonds will go, there is some guide in the fact that there is considerable buying at this time in the Home Owners' Loan 2-1/2% 1942-44's. These bonds can be looked upon as a 1944 maturity and in view of the low coupon would be about the same as the suggested 7-year 2-1/2%. He feels that there has been very little liquidation in the intermediate market. The fact that the bonds went off on Thursday and Friday should not scare the Treasury as they went off while talks were on in New York about the financing. This was perfectly natural and under conditions of this kind bonds always go off more than the notes.

He then suggested that we might consider putting out an additional issue of 2-3/4% 1945-47's at 101 which is now selling on the market at around 101-3/4. We all thought this a good suggestion. There are two arguments against it, one, the reluctance on the part of the banks to put a premium on their books and, two, the optional call date. It does, however, take care of the matter of a small amount of subscriptions on the bonds. If there is a small subscription or a new issue, it might be bad from the standpoint of the market; whereas, if there is a small subscription on the part of an outstanding issue, it would not look so bad. Before he left he said that a 15-month 1-1/4% note would be sure to go. The banks and some corporations want this maturity.

With Mr. Devine of
Devine and Company,
September 4, 1937.

He said that he thought the Treasury should not attempt a bond at this time. The long-term market is very thin and the volume is very small. He cannot at the present time sell a block of bonds. Any offering of bonds of intermediate maturity date would hurt the present premium bonds. His suggestion is that we issue a 15-month 1-1/4% and a 3-year 1-5/8%. We can go to a 4-year with a coupon of 1-7/8% or a 5-year with a coupon of 2%. Checking with large New York banks he feels that the sentiment is for the 15-month 1-1/4% and a 5-year 2%. The Metropolitan Insurance Company has \$35,000,000 of the maturing securities and he believes that it would take a 5-year 2% note but that it would not take a 7-year 2-1/2% bond. He only found one bank in Chicago and only one in St. Louis interested in the 5-year 2%. When asked as to how he felt the subscriptions would be divided, he said that \$500,000,000 would go into the short and \$300,000,000 would go into the 5-year 2% note. If he had the decision to make, he would not go beyond 1942 for this operation; he certainly would not go into the 1945-47 period. He does not feel that it would be fair to the market and to the Treasury to issue a 7-year bond. This market is not over-sold but it is just plain rotten. Everyone seems to be waiting for money rates to tighten. Says that the 7-year 2-1/2% is preferable to the additional issue of 2-3/4% of 1945-47 at 101 because of the objections on the part of the banks to the premium and to the optional call date.

He feels that if you offered a 15-month 1-1/4% note and a 7-year 2-1/2% bond, you would get more bonds under this proposal than if you substituted an additional issue of 2-3/4% 1945-47 at 101. He definitely recommends a 15-month 1-1/4% and a 5-year 2%. He insists these will go and go well. That we will get \$500,000,000 subscriptions to the 15-month and \$300,000,000 of subscriptions to the longer.

3 -

Dinner conference Saturday
with Mr. Mills and Mr. Repp
of the Discount Corporation.

They were very enthusiastic for the 15-month 1-1/4% note and 7-year 2-1/2% bond. They were even stronger for this proposal than they were on Friday at the conference with Mr. Taylor and me. They argued at some length that this proposal if adopted by the Treasury would help the market immensely and would be a courageous step on the part of the Treasury. The Secretary then told them that we were not offering any additional bills for a while and that the issue sold on Friday last would be the end for some time of the issue of \$50,000,000 each week. They said that this would be excellent news for the market and they were now even stronger for the 7-year bond.

While they were strong for this security throughout the conference, they always came back to some qualification or some protective measures which would be necessary to adopt in order to insure complete success of the whole operation. This, I believe, threw some doubt into our minds as to whether we should adopt the bond at this time. I believe as we came out of that conference, we were more certain that a bond should not be offered but that it should be a 15-month and a 5-year note.

sub B

Fin

September 7, 1937.
8:50 a.m.

223

H.M.Jr: Hello

O: Dr. Burgess.

H.M.Jr: Thank you.

O: Go ahead.

H.M.Jr: Good morning.

Burgess: Good morning, sir.

H.M.Jr: Well I thought the papers treated us very nicely.

B: I thought they handled things very well.

H.M.Jr: Yes.

B: It's too early to tell much yet. The dealers I've talked with like it all right; they say they won't make trouble about it.

H.M.Jr: Ah-ha.

B: It's too early to say what the rights will be.

H.M.Jr: Well supposing I call you about 10:15 your time.

B: That's a good time.

H.M.Jr: Would you have something?

B: Yep, I'll have something.

H.M.Jr: 10:15.

B: Yep.

H.M.Jr: Thank you.

B: Very good.

Fin

September 7, 1937.
9:30 a.m.

224

H.M.Jr: Hello.

O: Dr. Burgess.

H.M.Jr: Hello.

B: Hello sir.

H.M.Jr: Yes.

B: Well they - they all certainly like it.

H.M.Jr: Yes.

B: They're still indeterminate yet as to the rights - they're quoted anywhere from - ah - nine on the big side to 10 or 12 or 13.

H.M.Jr: Which is that - for the 15 months?

B: No, that's the rights. That's maturing.....

H.M.Jr: Oh yes.

B: That was quoted Saturday 10 and 12.....

H.M.Jr: Yes.

B:but it's right around the same as what it was Saturday.....

H.M.Jr: Ah-ha.

B:and - ah - it isn't really possible to size it up yet.

H.M.Jr: Ah-ha.

B: The stock market you know is off a point and a quarter.....

H.M.Jr: Ah-ha.

B:on - on the European news.

H.M.Jr: Yes.

B: Ah.....

H.M.Jr: Well I'll call you a little later.

B: It's really pretty hard to tell very much now.

H.M.Jr: All right.

B: It seems to be all right, as far as you can tell.

H.M.Jr: All right. Thank you.

B: Very good.

September 7, 1937.
10:34 a.m.

H.M.Jr: Hello

O: Dr. Burgess.

H.M.Jr: Hello Burgess, how is she going?

B: Well it's a little bit softer than I could wish.

H.M.Jr: Ah-ha.

B: The - ah - the rights are quoted 7.9 which is about 3/32ds off from Saturday.

H.M.Jr: Yes.

B: There's - ah - there's been quite an active market in rights;.....

H.M.Jr: Ah-ha.

B:some selling but always somebody to buy them.

H.M.Jr: Good.

B: At least there is a firm bid at these prices.

H.M.Jr: You haven't had to do anything?

B: No, we haven 't done a thing.

H.M.Jr: Good.

B: Now the bond market is just slightly off.....

H.M.Jr: Ah-ha.

B:a thirty-second or two; one or two issues more than that and the notes are off a little bit.

H.M.Jr: Ah-ha.

B: Of course, that was bound to be true.

H.M.Jr: Yes.

B: Of course, this - ah - this Russian and Italian thing didn't do the market any particular good.

H.M.Jr: No. What are the old 3-1/4 notes selling at?

B: Oh that's - that 79 premium.

H.M.Jr: Well that's all right.

B: Yes that's enough - it's - it's a premium.

H.M.Jr: Yes.

B: Now - ah - you get all kinds of gossip - ah - one - one conversation is that General Motors is talking about converting their 25 million into 1-1/4.

H.M.Jr: Yes, well that would be.....

B: Ah - those people are just waiting and studying the market.....

H.M.Jr: Ah-ha.

B:and trying to decide what to do.

H.M.Jr: Well I'm anxious to close the books tomorrow night.

B: Ah - I think that's awful close.

H.M.Jr: Well you were thinking about it.

B: The market feels that it needs three days, I think.

H.M.Jr: Well.....

B: I was just talking to - to Mills about that.....

H.M.Jr: Well I - I won't decide until after the market closes.

B: O.K. well we'll talk it over here right carefully then.....

H.M.Jr: All right.

B:and see what we think.

H.M.Jr: All right.

B: Very good.

H.M.Jr: Goodbye.