REPORT OF OPEN
MARKET OPERATIONS

Reporting on open market operations, Mr. Sternlight made the following statement:

Desk operations since the last meeting of the Committee have been aimed steadily at maintaining reserve availability consistent with Federal funds remaining around 5 1/4 percent--which indeed has been the System's posture since about mid-July. This course was pursued against a background of growth in the monetary aggregates that was estimated to be falling within the ranges set by the Committee a month ago. As the period progressed, the estimates of M_1 tended to weaken, especially the New York staff projections, while the estimates of M_2 tended to strengthen particularly for the Board staff--but taking together both sets of estimates of both aggregates, things were reasonably well on course. Through most of the period, market observers had no difficulty in perceiving the Desk's steady-state intentions, but after the publication of a third successive decline in the weekly M_1 statistic late last week, some market participants began to anticipate--and hence to bring about--a bit easier money market environment; hence, the Desk registered prompt resistance to the easing tendency last Friday in order to avert significant misinterpretations of the current System posture. The market's anticipation of easing was not unreasonable given that market observers are not aware of the sharp rebound in M_1 now estimated to have occurred in mid-September.

As usual, the Desk bought securities at the beginning and toward the end of the epriod, to offset the impact of rising Treasury balances, and sold some securities midway through the interval when Treasury balances were being run down. Outright purchases were largely made in coupon issues--a total of about $1.1 billion. Bill purchases came to about $350 million and sales to some $170 million. Holdings of Federal agency issues were pared by nearly $50 million through partial redemptions of maturities and acceptance holdings worked down by about $66 million. The acceptance portfolio is now about $230 million down from over $750 million early in the year. Once again, heavy use was made of short-term repurchase agreements and matched sale-purchase transactions, chiefly to cope with the massive ebb and flow of reserves in the wake of shifting Treasury deposits.

Interest rates were unchanged to moderately lower over the past month. Much of the decrease was in the last few days, in reaction to the drop in the latest published M_1 figure. In yesterday's auction of 3- and 6-month bills, the average issuing rates were about 5.03 and 5.24 percent, respectively, down from 5.14 and 5.39 percent just before the August meeting. In the two-year maturity area the rate decline was more pronounced;

a two-year Treasury note was sold shortly after the August meeting to yield 6.67 percent, while today's auction of a similar maturity is expected to produce a yield around 6 1/4 - 6 3/8 percent. For intermediate-term coupon issues, yield declines over the period were around 20-35 basis points, while longer maturities were down about 10-20 basis points.

Yield declines in the corporate sector have produced for some types of issues the lowest rates in over two years. A noteworthy feature of the tax-exempt market was the ability of New York State's Housing Finance Agency to sell about $150 million of bonds. The sale required a high rate-- 8 1/2 percent on the 30-year portion--but this followed a year-long period when the State's agencies were denied access to the market at any rate.

As for tracking nonborrowed reserves in the past month, we have a somewhat paradoxical result. Making an assumption about how the current week will turn out, it appears that nonborrowed reserves for the five weeks ending tomorrow will be very close--within a few million dollars--of the average path level set at the time of the last meeting. However, we estimate that if the Desk had been pursuing that nonborrowed path week by week as we went through the past month, the results would not have been so close. Early in the interval, it was estimated that required reserves were turning out above path levels for the period. This would have caused the Desk to hold back on the provision of reserves and produced a bit firmer money market conditions. Higher-than-expected demand for excess reserves also would have worked in a firming direction early in the interval. By early September, estimates of required reserves for the full period were reduced significantly, and this would have caused the Desk to aim for more ample reserve availability as nonborrowed reserves were provided with a view to meeting path levels. Indeed, by the final week, we estimate that after allowing for the actions that would have been taken earlier in pursuit of the nonborrowed target, the Desk would have aimed at substantially easier money market conditions, with a Federal funds rate around 5 percent--the Committee's lower bound. And even then, nonborrowed reserves for the full five-week period might have come out some $80 million below path.