REPORT OF OPEN
MARKET OPERATIONS

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

In seeking moderate growth of the monetary aggregates during the period since the last meeting, Desk operations were aimed initially at maintaining reserve availability consistent with the 5 1/4 percent Federal funds rate that had prevailed since mid-July. By the closing days of September, however, it was estimated that growth in M_1 was falling short of the Committee's specified range, although M_2 was on track, and the Desk edged toward a more accommodative stance-aiming at funds in a 5 1/8 - 5 1/4 percent range. As evidence of weak growth in the aggregates accumulated in early October, the Desk gradually eased a little further and by October 12 a 5 percent objective was indicated. The most recent data on the aggregates appeared somewhat stronger, although it is still estimated that M_1 is slightly below its two-month range while M_2 is well within its range, and the Desk has continued to aim for reserve availability consistent with Federal funds around 5 percent.

Interpretation of aggregate data has been complicated in the recent period because of exceptionally large week-to-week swings. The size of these swings caused the Desk to be cautious in responding to new weekly information. As for the effects of these swings on financial markets, there were some gyrations of

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sentiment but the succession of large changes seems to be producing a layer of callus that may be reducing the market's sensitivity to outsized swings.

Outright Desk activity was all on the buy side during the recent period, and included the purchase of $456 million of coupon issues in late September, and purchases of some $1.5 billion of bills from foreign accounts. (Incidentally, this brought the System's outright holdings of Treasury and agency issues, on a commitment basis, to over $100 billion for the first time.) Holdings of bankers' acceptances were brought down to just under $200 million, as the Committee instructed last March.

The System's outright operations were dwarfed in size by the very heavy use of repurchase agreements and matched sale-purchase transactions to add or subtract reserves for a few days at a time. Major reliance on these short-term reserve adjustment techniques reflected not only the sizable swings in Treasury balances and other reserve factors, but also the need on some occasions to engage in large reserve supplying or draining operations to encourage desired effects on the market's perception of reserve availability and hence on the Federal funds rate. These operations were usually undertaken early in a reserve week, and then followed later in the week by actions to soak up some of the reserves provided earlier, or replenish reserves drained earlier.

During the recent period the Desk made its first use of repurchase contracts that provided no option for early termination. This appeared to work well as a supplement to the usual RP contract, relieving the Desk of some of the uncertainty as to how many agreements might be terminated early by dealers.

Market interest rates declined across a broad front during the recent period. While gyrations in weekly aggregates caused some backing and filling in the market, participants perceived, on balance, the slow growth in M_1 and they observed the Desk's responses in terms of fostering a gradually lower funds rate. Moreover, the markets reacted to several reports suggesting that the economic recovery was turning sluggish. In the case of Government securities, bank buying of intermediate term maturities--up to about 5 years--was a specially potent influence as banks sought to improve earnings in the face of modest loan demand. Yields on 1 - 5 year Treasury issues fell by some 50 to 60 basis points over the period.

Rate declines were more moderate for both shorter and longer maturities. Three- and six-month bills were auctioned yesterday at 4.80 and 4.91 percent, respectively, down from 5.03 and 5.24 percent the day before the last Committee meeting. For 5 - 10 year Treasury maturities, yield declines were roughly 20-40 basis points, while most long-term issues were down about 10 - 15 basis points in yield.

Turning to the nonborrowed reserve tracking exercise, we estimate at this point that nonborrowed reserves for the four weeks ending tomorrow will turn out roughly $150 million above path. This reflected higher than expected levels of both required and excess reserves. The strength in required reserves occurred despite the weakness in M_1 and reflected higher than expected levels of interbank and Government deposits, as well as strength in M_2. We estimate that if the Desk had been pursuing a nonborrowed reserve guide during this period, nonborrowed reserves might be turning out about $80 million above path. Since we would not have realized until the period was quite far along that a sizable overshoot was developing, it would have been necessary, in pursuit of a nonborrowed target, to tighten money market conditions rather sharply in the final two weeks of the period--in contrast to the slightly easier stance actually undertaken. The tightening would have had to be especially marked since in the second week of the period early data indicating weakness in required reserves would have caused us to undertake a slight temporary easing.

Finally, a housekeeping matter--the Desk last week added the Bank of America to the list of dealers with which it trades in bankers' acceptances. This is the first bank dealer in acceptances that we have traded with, although we formerly traded with a firm that was a subsidiary of a bank.

We plan to limit the trading with Bank of America to acceptances drawn on banks other than themselves, as this preserves a clear separation of the bank's role as dealer.