REPORT OF OPEN
MARKET OPERATIONS

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

During the period since the October meeting of the Committee, open market operations have been directed steadily at maintaining reserve conditions consistent with a Federal funds rate of around 5 percent. Initially, it was the plan of the Account Management, as instructed by the Committee, to edge down, in about a week, from the 5 percent rate prevailing at the time of the October meeting to the 4 7/8 percent midpoint of the Committee's 4 1/2 to 5 1/4 percent funds range. The period was barely a few days old, however, when the monetary aggregates began to show surprising strength--with projected two-month growth close to or above the upper bounds of their ranges. Since it seemed likely that carrying through the planned funds rate reduction would have to be reversed soon afterwards, the Chairman recommended, and other members concurred, that the Desk continue aiming for a 5 percent funds rate.

By the final days of October the aggregates looked a shade stronger, with M_1 growth in the October-November period expected to top the desired range and M_2 expected to be close to or above its upper bound. A further complication was the Treasury's coupon financing operation which had just been announced on October 27. In response to the Desk's request for guidance, the Chairman advised that a significant firming in the Desk's approach to reserve availability seemed inconsistent at that point in light of the Committee's leaning toward a slightly easier stance at the October meeting. It was also indicated that any firming would be inadvisable in the midst of market underwriting of the new Treasury issues. By last Friday, when monetary aggregates were reviewed again, the current meeting was only a few days away and the Desk continued to aim for reserve conditions consonant with a 5 percent Federal funds rate.

As events worked out, Federal funds averaged very close to the desired 5 percent in each week of the period, although with some occasional daily departures, particularly on weekly settlement dates. Outright open market operations were modest in scale during the period, and included sales of bills to foreign accounts on one occasion, and purchases from them on another. Also in the "outright" category, the Desk arranged to absorb reserves by running off a total of $800 million of Treasury bills in three different auctions during the interval. Sizable use was made of short-term reserve adjustments through repurchase agreements and matched sale purchase transactions, though these operations were on a smaller scale than in the preceding intermeeting period.

Yields on Government securities rose somewhat during the period, especially in the latter part of October as market participants concluded that the System's move to slightly easier money market conditions in early October was not being extended for the time being. The Treasury's November refunding issues, which raised a net of $2.5 billion, were well received, with bidding for the $2 billion 7-year note eliciting particular enthusiasm. Markets backed and filled after the auctions and prices of the new issues have fluctuated close to those paid in the auctions, closing the period toward the higher end of the range of variation. Dealers took down sizable amounts of the new issues in the auctions and they have made fairly good progress in distributing the issues subsequently, although they still have considerable amounts on the shelf.

In yesterday's auction of 3- and 6-month bills, average issuing rates of about 4.89 and 5.02 percent compared with about 4.80 and 4.91 percent the day before the October meeting. Dealers' inventories of bills are also running quite high, as longer maturities can be financed profitably and shorter issues are turned over fairly quickly. Total primary dealer inventories of Treasury issues last Friday, at $10.6 billion, were up from $7.1 billion four weeks earlier--though below the recent peak of $12.7 billion.

In the corporate market, there was moderate new issue activity and not much change in rates. The municipal sector experienced relatively heavy new issue activity and some modest net rise in rates--with the exception of New York City and State related issues which have done better since early this month. A $256 million issue for New York's Municipal Assistance Corporation initially was to be placed largely in the somewhat reluctant hands of major banks and public pension funds with only $110 million slated for the general public. In the recently improved atmosphere, the entire issue was sold to the public and the rate was pared to 10 1/4 percent from the earlier talk of 10 1/2 percent. This is still a very high tax exempt rate, and markets for New York City issues are still far from normal.

In brief comment on the nonborrowed reserve tracking exercise in the past period, the strength of required reserves would have led to a quick move to the 5 1/4 percent upper bound of the Federal funds range--but even so hypothetical nonborrowed reserves would have substantially exceeded the targeted level. As it is, making an assumption about the current week, we estimate that nonborrowed reserves will exceed the target level by some $210 million. Under nonborrowed reserve targeting, the overshoot would have been an estimated $140 million.