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 sought to maintain Federal funds in the 4 5/8 - 4 3/4 percent area--but with a leaning in the past ten days or so toward the 4 5/8 percent side. Early in the interval it looked as though the aggregates were growing in about the middle or even slightly above the middle of their indicated ranges, but growth estimates were steadily reduced as the period progressed--especially for M_1. By early March it looked as though February-March growth would be in the lower part of the range for both aggregates--not so weak as to call for a pronounced response from the Desk but soft enough to warrant the recent leaning toward 4 5/8 percent funds trading. For the whole period, the funds rate averaged about 4.68 percent, with rates closer to 4 3/4 percent in the earlier portion and to 4 5/8 percent in recent days.

Outright purchase and sale transactions were relatively modest in size and approximately offsetting in amount during the period. Early in the interval, the System Account bought $587 million of Treasury coupon issues in the market and an additional $100 million such issues from foreign accounts. Later in the period, about $620 million of Treasury bills were sold to foreign accounts. Holdings of Federal agency issues declined by $46 million through small net redemptions. The System's outright holdings of bankers' acceptances edged off by about $17 million to $174 million. Active use was made of repurchase agreements and matched sale-purchase transactions to cope with short-term ebbs and flows of reserves, chiefly caused by swings in the Treasury balance at the Federal Reserve Banks. The Congress, incidentally, is again considering legislation that would permit the Treasury to earn interest directly by investing funds with commercial banks. Once that authority is provided, and used, it could lead to a considerable reduction in day-to-day reserve adjustments at the Trading Desk.

Short-term interest rates held about steady during the past month, in concert with the approximate stability of the Federal funds rate. Treasury bills were auctioned yesterday at rates of about 4.55 and 4.81 percent for the 3- and 6-month issues, down slightly from 4.63 and 4.86 percent the day before the last meeting. Intermediate and longer-term rates increased a bit, however, amid a continuing cautious attitude about prospects for holding back inflationary pressures as business strengthens and credit demands expand in the months ahead. Yields on most intermediate and longer-term Treasury issues were higher by about 5 to 15 basis points over the period--modest changes compared with the sharp increases early in the year, but still indicative of lingering market concern. Also indicative of that concern was the willingness of dealers to reduce inventories of Government securities. Dealers' holdings of over-1-year Treasury maturities fell from about $1 3/4 billion just before the last meeting to a small net short position in the middle of last week, followed by a modest recovery to a long position of around $200 million last Friday.

The market atmosphere improved somewhat in the latter part of the period, reflecting reaction to slower growth in money supply, relief that the funds rate was not moving higher, and a sense of lesser Treasury demands on the market as spending has lagged behind earlier official estimates. Following a Treasury 2-year note auction next Tuesday, which raises just $1/2 billion from the public, the market is looking forward to another coupon issue for payment in early April, which would be all new cash. If the Treasury follows recent patterns, this would be a 5-year issue, but the possibility of a longer maturity cannot be ruled out. Sizable short-term borrowing is also expected before mid-April, most likely through cash management bills. Total new Treasury cash raised in the next month could be on the order of $6 billion.

Activity was on the light side in the corporate new issue market, but receptions were unenthusiastic and yields worked slightly higher over the interval. The tax-exempt market was fairly active, with mixed receptions for new issues and also a slight rise in yields. The market as a whole seemed to pay little attention to the negotiations among New York City, its municipal unions, New York banks, and other governmental bodies including the U. S. Treasury. As you know, the Treasury agreed late last week to make a $255 million seasonal loan to the City, following the presentation of a plan by the City to meet the court-ordered repayment of $1 billion in notes that had been under moratorium. The City's plan was patched together following a breakdown of negotiations with the banks over the question of what sort of outside monitoring set-up there would be over the City's finances after the Emergency Financial Control Board expires in June 1978.

Finally, I should report that the Committee's action a month ago to narrow the list of Federal agency securities eligible for outright purchase by the System Account, by excluding those issues eligible for purchase by the Federal Financing Bank, has caused little market comment. So far, we have observed no effect on market quotations for those issues that are now ineligible.

Lending of Securities

As stated in the March 4 memorandum to the Committee on lending of securities from the System Account, the Account Management continues to find the lending program reasonably necessary to the effective functioning of the Government securities market, and hence to our open market operations. Dollar volume of lending was up in the past year, but much less than in proportion to total trading activity in the market. Without System lending, the fail situation could have been much worse, and the market would not have functioned as well.

The System's charge for lending, which exceeds the charge set by other lenders, far more than covers costs. Earnings from lending securities at the New York Fed in 1976 were nearly $2 million. Expenses attributable to lending are estimated at less than 10 percent of the earnings figure.