Statement for FOMC Meeting
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Trading Desk operations during the past month were conducted against a background of sharp growth in monetary aggregates and a large Treasury financing operation. Responding to the evidence of outsize monetary expansion, the Account Management sought to restrain growth of nonborrowed reserves and aim for firmer money market conditions within the bounds set by the Committee. At the same time, because of the Treasury coupon financing, which included a major 10-year note offering sold at a fixed price, the Desk sought to move gradually and cautiously--but with sufficient clarity to avoid misleading the market.

At the outset of the period, following the Committee's desire to aim for slightly firmer money market conditions prior to the Treasury's financing announcement on April 28, the Desk began seeking conditions of reserve availability consistent with a Federal funds rate around 4 7/8 percent, the midpoint of the new 4 1/2 to 5 1/4 percent range, compared with a 4 3/4 percent objective earlier. By April 23rd, it was clear that April monetary growth was very strong, but the outlook for May was unclear and the Desk retained a 4 7/8 percent funds rate objective. At the end of April, the extent of excessive growth in April was even clearer. Recognizing this, but also noting the continuing uncertainty about May growth and the upcoming Treasury financing for which the market woud be making commitments in the first few days of May, the Desk sought to achieve a slight -- but clear-- further firming in reserve availability conditions, with Federal funds around 5 percent.

By May 6, monetary growth estimates were pointing unambiguously to excessive growth for the April-May period, especially for M_1, but with the market then midway in the Treasury financing operation the Desk proceeded very cautiously; the objective was to reach a 5 1/8 percent funds rate by the end of the May 12 statement week, provided this could be done without undue disruption to the market's job of underwriting and digesting the Treasury issues. It was possible to achieve this objective because distribution of the financing issues was moving well as market participants sensed the general drift, if not the precise timing, of System objectives. In the last few days, the Desk has sought, and achieved further firming of reserve availability, bringing the funds rate up to around the 5 1/4 percent top of the Committee's range. This final step, too, was implemented cautiously, as the market remained sensitive about the extent and timing of our moves.

Early in the period, and again toward its close, the Desk provided reserves through sizable purchases of Treasury bills, including about $1,580 million in the market and some $650 million from foreign accounts. In the middle of the interval, when a seasonal drop in Treasury balances provided reserves, the Desk sold about $1 billion of bills to foreign accounts and redeemed about $400 million of bills. As usual, substantial day-to-day use was made of repurchase agreements and matched-sale purchase transactions to effect temporary reserve adjustments.

Interest rates rose across a broad front during the recent period, chiefly in response to the System's less accommodative posture, but the move was orderly and the Treasury accomplished a major refinancing operation. While the Federal funds rate was gradually working higher by about 50 basis points, Treasury bill rates have risen roughly 45 to 60 basis points. Three- and six-month bills were auctioned yesterday at average rates of about 5.25 and 5.73 percent, compared with 4.76 and 5.09 percent just before the last Committee meeting.

Yield increases in the 1 to 3 year area were on the order of 55 to 65 basis points, reflecting concern about increased Treasury supplies and anticipations of still further moves toward restraint by the System. The $2 billion 2-year issue offered in the Treasury refunding early in the period sold at an average rate of 6.61 percent. By the close of the period this issue was bid to yield about 7.00 percent, equivalent to a price drop of about 5/8 point. Dealers managed to distribute the bulk of their takings of the issue, though the process was somewhat painful.

In the first use of their authority to sell notes with a maturity as long as 10 years, the Treasury placed $4.7 billion of 7 7/8's of 1986, at a fixed price at par. When first offered by the Treasury, the issue was considered to yield some 40 basis points more than comparable issues, but after initial trading with a premium as high as 5/8 point, the price declined in the las few days to about 99 1/2, for a yield of 7.95 percent. Although the 15 percent allotment on large subscriptions exceeded the expectations of many market participants, the dealers made good progress in distributing the issue--ending the period with virtually no net position.

Long-term yields also worked considerably higher, by some 40 basis points, but here too the market displayed excellent distributive capacity in digesting the $750 million auction sale of additional 7 7/8's of 2000. It should be noted that by the time the bonds were auctioned the market had made most of its price adjustment. By the close of the period, dealers' positions in the bonds were very light and the bonds were trading close to the auction average.

As in the previous intermeeting period, the Desk has kept an eye on how it might have operated under a nonborrowed reserve (NBR) targetting procedure. The Manager's weekly and three-week reports provide detailed comments on the actions that might have been followed. Given the constraints imposed by the Committee's Federal funds range and considerations related to the behavior of markets, especially during the Treasury financing, it seems likely that operations in the recent period would not have been greatly different under NBR targetting. As of now, we estimate that NBR for the four weeks ending May 19 will turn out some 260 million above the path envisaged at the time of the April meeting. Under NBR targetting, after making allowances for the Committee's funds rate constraints and for market considerations related to Treasury financing, it is estimated that NBR might have been slightly less--perhaps $240 million above path. At the same time, pursuit of an NBR approach would have caused the Desk to be a bit firmer as we went through the period.

Finally, it should be noted that the Desk commenced trading with another dealer--White, Weld and Co.--on May 3. This brings the number of dealers trading with the Desk to 28.