REPORT OF OPEN
MARKET OPERATIONS

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

The Account Management aimed at achieving steady conditions of reserve availability since the January Committee meeting, as monetary growth seemed to be well within the Committee's short-term ranges. Day-to-day policy implementation was conditioned to some extent by the unsettled state of the Government securities market, which was seeking to cope with large Treasury financing operations in the midst of sizable upward interest rate adjustments.

Based on Committee discussion last month, the Desk began aiming after the last meeting for a Federal funds rate around 4 5/8 - 4 3/4 percent. This objective was almost imperceptibly different from the Desk's posture just before the January meeting, which could be described as seeking funds around 4 5/8 percent with a bit more tolerance of variation slightly above than below that rate. As slight as this difference was, care was taken to avoid aggravating disturbed conditions in the Government securities market which had been reacting since early January with significant upward rate adjustments to market disappointment at the absence of further System easing, indications of a stronger economy in late 1976, and apprehension that Federal fiscal stimulus might produce unwieldy deficits and new inflationary pressures. By early February, about midway through the Treasury's financing operations, market sentiment turned better and prices recovered although the underlying atmosphere remained hesitant.

Early in the period, it was estimated that monetary growth would be somewhat above the midpoint of the M_1 range and very close to the midpoint for M_2. Incoming data during the interval were a little weaker than had been projected and the estimated growth rates were pared down to levels a little below the midpoints--but still within a zone of indifference--so there was no reason to revise the Desk's stance from its 4 5/8 - 4 3/4 percent objective. The funds rate has averaged about 4.66 percent for the period so far--with individual weeks falling in a close range of 4.60 to 4.72 percent.

The Desk undertook fairly sizable outright operations during the period, meeting indicated reserve needs and perhaps helping the market to regain some composure. Nearly $677 million of coupon bearing issues were bought on January 18, the day of the last meeting, for delivery January 20. Large bill-buying operations were undertaken in the market on January 24 and 27, in the total amount of $1,839 million. Outright bill and short coupon purchases from foreign accounts of $506 million were slightly more than offset by sales of $548 million of bills to those accounts. As usual, substantial use was made of repurchase agreements and matched sale purchase transactions in coping with short-term reserve needs and excesses.

At the high point of interest rates during the period, about February 2, yields on most Treasury coupon issues were some 25 to 50 basis points above the levels at the time of the last meeting, and some 50 to 100 basis points above year-end levels.

The sharp price declines in January took a severe toll on dealer profitability, and raised some question about dealer ability to participate in underwriting the Treasury's $5 3/4 billion sale of coupon issues in early February, which was raising $3.7 billion of new money. A very rough estimate of primary dealer losses in January might be around $100 million. At least among the primary dealers reporting to the Federal Reserve, it appears that the losses were not so great as to cripple any dealer's operations, although in some cases they were about equal to profits for all of 1976.

By February 2, the Treasury had sold its 3-year issue at 6.62 percent--perhaps 20 basis points above the rate anticipated a week earlier--and the new issue was already trading below issue price to yield closer to 6.70 percent. The 7-year note to be sold on February 3 was discussed in terms of a 7 3/8 - 7 1/2 percent yield, while talk on the 30-year bond to be sold on February 4 was as high as 7.90 or even 8 percent. The improved atmosphere on February 3 appeared to emerge in part because of Chairman Burns' congressional testimony that day--not only in that his remarks conveyed no imminent threat of monetary tightening but perhaps more significantly because his comments were seen as bolstering the case for holding any fiscal stimulus to modest proportions. The market got another strong boost late on February 3 when a sizable decline was reported in the money supply. In the improved atmosphere, the 7-year issue sold at 7.25 percent and the bond, which benefited from spirited bidding as dealers sought to cover short positions, went at 7.63 percent. At the end of the period, the 3- and 7-year notes were quoted at moderate premiums above issue price while the bond was at a moderate discount. For the whole intrameeting period, rates on most of the more actively traded intermediate and longer-term coupon issues were up about 5 to 15 basis points.

Short coupons and bills showed little net change over the period. Three- and six-month bills were auctioned yesterday at about 4.63 and 4.86 percent, compared with 4.67 and 4.87 percent four weeks earlier.

Treasury operations will remain sizable in the upcoming month, though less demanding on the long-term market. A $2.5 billion 2-year note is being sold on Thursday, raising a net of $1 billion. The Treasury's regular schedule of coupon issues would call for a 4-year note in early March, raising around $2.5 billion. There may also be additions to bill issues or sales of cash management bills by the time of the next meeting.