



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

CONFIDENTIAL (FR)
CLASS III - FOMC

TO: Federal Open Market Committee

DATE: March 15, 1985

FROM: Normand Bernard

The attached memorandum from Mr. Sternlight, dated today, recommends an increase in the intermeeting limit on changes in outright System holdings of U.S. Government and Federal agency securities. This recommendation will be considered at the March 26 meeting of the Committee.

Attachment

FEDERAL RESERVE BANK
OF NEW YORK

OFFICE MEMORANDUM

March 15, 1985

To Federal Open Market Committee
FROM Peter D. Sternlight *POS*
Manager for Domestic Operations,
System Open Market Account

DATE _____
SUBJECT Proposed Permanent Increase
in Leeway Authorization

I recommend that the Committee approve a permanent increase from \$4 billion to \$6 billion in the amount that outright holdings of Treasury and Federal agency securities in the System Open Market Account may rise or fall between meetings.^{1/} The seasonal swings in reserve needs have grown so large that requests for changes in leeway have become almost routine. There were six such requests in 1984, more than in any other recent year (see attached table). Indeed, half of the intermeeting periods last year were marked by one or two requests for expanded leeway. With a \$6 billion permanent leeway only two requests would have been needed in 1984.

The leeway limitation serves to call the Committee's attention to special circumstances that are apt to call for unusually large changes in outright holdings of securities. The Committee is well aware of the seasonal swings in reserve availability that dominate the requests for leeway changes in the fourth quarter (increases in required reserves and currency outflows) and in the first quarter (the reversal of the fourth quarter developments). At other times during the year, sharp fluctuations in the Treasury balance at the Federal Reserve have required large

^{1/} The last permanent increase in leeway, authorized in March 1983, increased the amount from \$3 billion to \$4 billion.

alterations in reserve supplies. The Committee's attention is properly called to these developments when they are unusually large, and perhaps supplemented by other factors. For example, increases in the leeway took place in late 1984 when decreases in extended credit borrowing and other factors reduced reserve availability at a time of expanding seasonal reserve needs. While in theory the larger reserve deficits or surpluses could be met with temporary transactions (which do not affect the leeway), the frequency and size of operations needed under such circumstances could lead to extra volatility in the money market and possibly confuse participants about the System's policy intentions.

There is little to suggest that the seasonal needs for sizable changes in the portfolio will diminish in 1985. The FOMC has already approved one leeway expansion to \$6 billion this year, and past experience suggests that additional leeway may be needed to counter a sharp rise in the Treasury balance in late April. While there has never been any difficulty in obtaining needed increases, frequent, routine requests for expanded leeway serve to divert the Committee's attention from the larger and more exceptional increases needed from time to time. The number of requests for increases to \$6 billion in the last year suggests that this amount would provide a useful threshold to occasion Committee action.

Table I: Leeway Amendments, 1978 - March 12, 1985

<u>Year</u>	<u>Number of FOMC Meetings</u>	<u>Leeway Amendments ^{1/}</u>				<u>Total</u>
		<u>1st Quarter</u>	<u>2nd Quarter</u>	<u>3rd Quarter</u>	<u>4th Quarter</u>	
1978	12	3 to 4		3 to 4	4 to 5 3 to 5	4
1979	9	3 to 5 5 to 6 6 to <u>5^{2/}</u>			3 to 4	4
1980	11		3 to 4.5	3 to 4	3 to 4	3
1981	8	3 to 4		3 to 4.5	3 to 4 4 to <u>4^{2/}</u>	4
1982	8		3 to 5 5 to 6		3 to 4 3 to 4	4
1983	8	4 to 5.5 ^{3/}	4 to <u>5^{4/}</u>		4 to 5 5 to <u>5^{5/}</u>	4
1984	8	4 to 6	6 to 7	4 to 6	4 to 6 6 to 8 8 to <u>6^{5/}</u>	6
1985	1	6 to <u>6^{5/}</u>				<u>1</u>
	<u>Total</u>	<u>8</u>	<u>5</u>	<u>4</u>	<u>13</u>	<u>30</u>

^{1/} Leeway levels before and after amendment in billions of dollars.

^{2/} Leeway would have reverted to \$3 billion without this amendment.

^{3/} Original limit of \$3 billion was raised temporarily to \$4 billion at the meeting held on December 20-21, 1982.

^{4/} Permanent leeway had been raised to \$4 billion in March 1983.

^{5/} Leeway would have reverted to \$4 billion without this amendment.