CONFIDENTIAL--(F.R.)

May 20, 1960

To Members of the Federal Open Market Committee and Federal Reserve Bank Presidents Not Presently Serving on the Committee

From Robert G. Rouse

Subject: System Open Market Account Transactions in July 15, 1960 Quarterly Treasury Bills

In accordance with the wishes of the Committee a further review of open market operations in July 15 Treasury bills has been prepared and is attached.

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To Members of the Federal Open Market Committee and Federal Reserve Bank Presidents Not Presently Serving on the Committee

From John J. Larkin

Subject: System Open Market Account Transactions in July 15, 1960 Quarterly Treasury Bills

Since the last meeting of the Federal Open Market Committee on May 3 purchases of $81.5 million Treasury bills due July 15, 1960 have been made for the System Open Market Account. Purchases made in the three weeks prior to that meeting amounted to $10 million. Thus, a total of $91.5 million Treasury bills due July 15, 1960 have been purchased for the System Open Market Account pursuant to the authorization granted by the Committee on April 12, and renewed on May 3, to purchase either outright or on swaps up to $150 million of those bills. This $91.5 million, together with prior holdings of $13.4 million bring total holdings of the issue to $104.9 million.

The earlier purchases of $10 million of the July 15 bills were reviewed in detail in a memorandum submitted to the Committee prior to the meeting on May 3. This report reviews the additional purchases of $81.5 million undertaken subsequent to that meeting. Most of those bills ($58 million) were acquired directly from foreign accounts that were selling July 15 bills either outright ($28 million) or on swaps ($30 million) against nearby bill maturities--one foreign account alone accounted for $50 million of July 15 bills. The remaining purchases of $23.5 million July 15 bills were undertaken in the market and represented outright transactions, i.e., they were not offset by sales of other Treasury bills for the System Account.

On the morning of May 3, when the Desk was buying Treasury bills (other than the quarterly bills) in the market for foreign accounts, several dealers called attention to an availability of July 15 bills. The Desk did not accept the offerings submitted by dealers since the Federal Open Market Committee meeting was in session and the Committee was expected to consider the special authorization of April 12 covering the purchase of July 15 bills. When it was learned in the afternoon that the Committee had renewed this special authorization, the Desk reactivated the earlier offerings of July 15 bills and, with a view to establishing the best prices, several other dealers were asked for offerings. In all, nine dealers were contacted and six submitted offerings that totaled $14 million. All of these were priced on the market and fell within a rate range of 3.05 to 3.00 per cent. The Desk accepted all offerings. No consideration was given to making offsetting sales of other Treasury bills since the release of reserves through outright purchases was regarded as consistent with reserve objectives of the Committee. An offering of $2 million of the July 15 bills was submitted to the Desk later in the day by another dealer at a rate of 2.95 per cent but this offering was off the market and was rejected.

On May 4, an order was received from a foreign account to sell outright $10 million July 15 Treasury bills. These bills were purchased directly for the System Account at a rate of 3.06 per cent which represented the midpoint between the composite bid and offered rates in the market. No attempt was made on this occasion to undertake offsetting sales of other Treasury bills since the net release of reserves was again consistent with policy objectives. An additional $5 million of the July 15 Treasury bills were purchased in the market on this day in response to dealer offerings. In order to establish the best price, seven dealers were contacted and purchases were made from three at rates ranging from 3.05 to 3.02 per cent. The remaining four dealers did not submit offerings.

On May 9, a block of $10 million of the July 15 bills was purchased outright from a foreign account that was selling on balance--the same account that had sold a similar amount on May 4. The rate on this transaction was 2.98 per cent, the midpoint between the composite bid and offered rates in the market. Since the reserve situation at the time indicated that reserves could be released (or the absorption of reserves could be avoided) no offsetting sales were undertaken for System Account.

On May 10, the same foreign account forwarded an order to the Desk to sell $30 million of July 15 bills but on this occasion that account wished to swap into an equivalent amount of late July or early August maturities at specified rate spreads. By this time in the statement week ended May 11 it appeared as though sufficient reserves were available in the market. (Average net borrowed reserves of $31 million were projected for that week.) Therefore, it was decided to undertake the reverse of this swap for the System Account. In order to establish that the rate spreads stipulated by the foreign account were on the market, five dealers were contacted for specific offerings of the late July or early August maturities of bills, for specific bids on the July 15 bills, for rates on a swap basis or for their closest trading markets. The rates submitted by those dealers indicated that the spreads specified by the foreign account for the swap transactions were in line with prevailing markets. The result was that the System Account purchased $30 million July 15 bills at 3.04 per cent on a swap against the sale of $10 million July 28 bills at 3.12 per cent and $20 million August 4 bills at 3.21 per cent. System Account holdings were relatively large in each of the bill maturities that were sold.

On May 17, an order was received from another foreign account to sell $8 million July 15 bills. These were purchased for the System Account at 3.08 per cent, the middle of the composite bid and asked quotations (bill rates had risen over the previous few days). Since the reserve situation did not call for any reserve injection (average net borrowed reserves of $29 million were projected for the statement week ended May 18), it was decided to offset this purchase through sales in the market of other Treasury bills. The June 23 maturity was chosen for sale because there was a good demand for this maturity in the market and because it constituted the largest ($123.5 million) holding of any bill maturity in the System Account. Seven dealers were requested to submit bids. (This was not the same group of seven dealers mentioned in connection with operations on May 4.) The bids ranged from a high rate of 2.90 per cent to a low rate of 2.77 per cent. The $8 million June 23 bills were sold for System Account at the latter rate of 2.77 per cent.

The final purchase of July 15 bills during this period was made on May 18 when $4.5 million were acquired during a "go-around" in which offerings of any maturities of bills were solicited from all dealers. Only one offering of July 15 bills was received and it was priced at a rate of 3.02 per cent. This offering was accepted.

The foregoing review covers the transactions that were undertaken in July 15 bills for the System Account. It does not cover several other opportunities that arose where operations in the July 15 bills could have been undertaken. These opportunities were not availed of primarily because of the Committee's preference to engage in swap transactions sparingly, at least during this experimental period. These offerings were outright and made by dealers on days when it seemed inconsistent with the Committee's reserve objectives to supply reserves to the market. The reserve effect could have been neutralized by suggesting swaps to the market but it was felt that this approach might appear more aggressive than the Committee would want to see at this stage. Another factor considered was the size of the offerings of July 15 bills. Most unaccepted offerings were small and, while small amounts were accepted at the start of this program, it was felt that they could occasionally be turned down after a reasonable amount of the July 15 bills had been acquired. In addition, the absorption of every offering was deemed unwise, for it was felt that by leaving a few offerings in the market the rate on the July 15 bills would not be forced out of alignment with other comparable maturities. As events turned out, the market rate has remained generally in line. It should be noted, however, that the largest blocks of July 15 bills have originated with foreign accounts and not with the market.