CONFIDENTIAL (F.R.)

To Federal Open Market Committee

From Manager, System Open Market Account

Subject: The planning and execution of Open Market operations in the wake of the devaluation of sterling.

The following is a record of the planning and actions taken by the Manager of the System Open Market Account and his staff before and after the devaluation of sterling on Saturday, November 18, 1967.

Rumors related to sterling began circulating in the United States securities markets early in the November 13-17 week. For a while, prices of United States securities reacted favorably, as the possibility of a large credit package for the British, among other factors, somewhat buoyed sentiment. Pressures on sterling increased toward the end of the week, however, culminating in talk of possible devaluation over the weekend and very heavy losses of dollars by the British on Friday, November 17, in supporting the pound. Considerable nervousness pervaded the United States securities markets and prices fell away, closing off 5/8 of a point or more on Friday.

In view of these developments, the officers of the Open Market and Treasury Issues Function met late Friday afternoon, November 17, to discuss what specific courses of open market action might be taken after the weekend, if international developments should lead to further unsettlement of the securities markets or threaten the emergence of disorderly conditions. These discussions started from the contingency planning memoranda submitted to the Federal Open Market Committee, including the latest version presented by the Committee Staff at the meeting of November 14, 1967 and sought to work out appropriate actions to meet specific conditions which appeared likely to develop. It was recognized that the particular response of open market operations would depend upon the shape of foreign developments and of domestic policy responses to them.

Attention was centered on how the Trading Desk might temper the sharp decline in prices of Treasury securities likely to stem from a devaluation, if it occurred, and thus forestall the emergence of disorderly market conditions. It was agreed that the objective would be to help the market find its way to a new viable structure of prices through an orderly adjustment wherein dealers would not feel constrained to dump their trading portfolios in an unreceptive market and mark prices down aggressively. Though aggregate dealer positions were not unduly large, those with net long positions in longer issues had considerable exposure to loss and the natural tendency to withdraw from the market could aggravate the price decline and create serious disorder. Thus the key could be for the System to relieve the dealers with net long positions of enough of their portfolios to limit their losses and encourage their continued functioning as dealers.

One approach suggested was to bid the dealers at an early hour for specific amounts of coupon securities. In such an operation, it was agreed that the amount each dealer would be bid for should be related to the size of his position and that the prices paid should be somewhat lower than the preceding night's close. An alternative course suggested would be to conduct a routine go-around in coupon issues, permitting dealers to offer whatever amounts they wished at prices of their own choosing. This approach would have the advantage of avoiding any possible suggestion that the System was interested in maintaining a particular level of prices, though it was recognized that in a highly uncertain market some dealers might seek to bail out at very low prices, leading possibly to accentuated price declines and disappointment on the part of dealers who were not able to make sales to the System because their offerings were at higher prices. There was also discussion of the possibility of a go-around in Treasury bills to facilitate orderly rate adjustments in that sector prior to the Treasury's weekly auction on Monday.

In the wake of the sterling devaluation on Saturday, November 18, and the Federal Reserve action on Sunday, November 19, to raise the discount rate to 4 1/2 per cent, several of the officers met in the Securities Department shortly after 4:00 p.m. on Sunday. They undertook to contact the senior representatives of each dealer firm with whom the Desk trades to read to them the text of the Board's announcement on the discount rate, which was released at 2:00 p.m. (See attached text.) In addition, each dealer was informed that the System was hopeful that the dealer market in Government securities would function on Monday as smoothly as possible under the difficult conditions created by the British action. Members of the dealer community were also told that the officers of the Securities Department would be in the office early on Monday and it was assumed that this would be true in the dealer community as well. A list of the individuals contacted in the various dealer firms on November 19 is attached.

In view of the sharp increase in the British bank rate from 6 1/2 per cent to 8 per cent and the prompt increase of the Federal Reserve discount rate, the officers agreed that the market reaction was likely to be quite sharp on Monday, and that the System should take a firm hand by bidding dealers for coupon issues early on Monday. Accordingly, a detailed plan was developed whereby each dealer with a net long position would be bid for up to about 40 per cent of his net position in 1-to-5 year Treasury coupon securities and for up to about two-thirds of his net long position in Government securities maturing in over 5 years. Dealers with net short positions in the 1-to-5 year area would be given an opportunity to sell $1 million of such securities to the System. Dealers with net short positions in issues maturing in over 5 years would not be given an opportunity to sell such securities. Under these guidelines the System would be bidding for about $125 million of 1-to-5 year securities and about $75 million of securities maturing beyond 5 years. This buying would be designed to moderate the losses that could be experienced by dealers with net long positions, to preserve the capacity of the dealers to make markets effectively in coupon securities, and to encourage the adjustment of market prices to viable levels. It was agreed that System leadership in the market, at least to this extent, was appropriate since disorderly conditions might otherwise develop in the market on Monday.

In pursuance of these objectives, it was decided to set the prices that would be paid the dealers at differentials ranging from 2/32 to 8/32 below the bid prices at which the market had closed on Friday, November 17, as shown in the attached Table I. It was recognized that market prices on Monday would be likely to fall below these levels. However, it was felt that the prices paid would effectively underscore the twin objectives of helping the market to function and avoiding any suggestion of System price support.

Also on November 19 a text was prepared to be used in contacting the dealer firms on Monday, November 20, to bid them for securities. (See attachment.) On Monday, November 20, the officers and one senior trader of the Securities Department using this statement, contacted each of the dealer firms shortly after 9:15 a.m. and bid for Treasury issues for Wednesday delivery in the amounts set forth in Table II at the prices stipulated in Table I. The operation was essentially completed by 9:45 a.m., although a brief extension was permitted the United California Bank because of problems its New York Office encountered in reaching the management in Los Angeles.

Total purchases amounted to $121 million of 1-to-5 year issues and $65.2 million of longer securities. (Further detail is given in Table II.) This early leadership by the System Open Market Account before the market opened did much to insure that the market's adjustment would be orderly. By 11:00 a.m. Treasury coupon prices had almost reached the low for the day with prices of issues due in less than 5 years declining by as much as 5/8 of a point while some longer issues fell as much as 1 5/8; by the close the market had regained as much as 5/8 of a point in the longer end and 1/4 point in the shorter maturities.

It was evident from the start on Monday that the System would need to operate in Treasury bills as well, if the short-term market was to adjust to weekend developments promptly and stabilize before the weekly auction of $2.5 billion Treasury bills at 1:30 p.m. Accordingly, the Desk conducted a go-around to buy all issues of Treasury bills for regular delivery on Tuesday, November 21. Dealers offered about $1 billion in Treasury bills to the Desk at rates that ranged generally 20 to 30 basis points above those prevailing at Friday night's close. The System purchased $437 million of these offerings and the bill market stabilized with rates generally 20 to 30 basis points higher than those at Friday's close. Subsequently, a good interest developed in the regular weekly auction for bills at the higher rate levels prevailing. Average issuing rates of 4.989 and 5.517 per cent were set on the three- and six-month bills, respectively, up 34 basis points and 36 basis points from rates set in the previous weekly auction.

As a result of the System purchases of coupon issues and bills described above, and other dealer transactions, over-all dealer positions were substantially reduced by the close of business Monday, November 20, as shown in the following tabulation:

DEALER TRADING POSITIONS
(In millions of dollars)

	Bills	1-5 yr.	Over 5-yr.	Total Coupons over 1-year
Net positions as on Friday 11/17/67	$2,581	$ 195	$ 60	$ 255
System purchases Monday a.m. 11/20/67	- 427	- 121	- 65	- 186
	$2,154	$ 74	-$ 5	$ 69
Other transactions net	+ 105	+ 7	- 6	+ 1
Net positions as of Monday 11/20/67	$2,259	$ 81	-$ 11 (short)	$ 70
Net decrease	- 322	- 114	- 71	- 185
% Decrease	12.5%	58.5%	119%	72.5%

Since the System did not buy as many coupon issues from dealers who had short or even positions in such issues on November 17, the effect of the purchases on the positions of those dealers was different from the effect on the positions of the other dealers as shown in the following tabulation:

	Dealers with short or even positions on 11/17/67		Dealers with net long positions on 11/17/67	
	1-5 yr.	Over 5 yr.	1-5 yr.	Over 5 yr.
Net positions as of Friday 11/17/67	-83.2	-35.0	+278.3	+94.5
System purchases Monday a.m. 11/20/67	- 5.8	- .5	-115.2	-64.7
	-89.0	-35.5	163.1	29.8
Other transactions net	- 4.5	- 1.0	+ 11.6	- 4.7
Net positions as of Monday 11/20/67	-93.5	-36.5	174.7	25.1
Net decrease	10.3*	1.5*	103.6	69.4
% of change	12.4%	4.3%	37.3%	73.5%

* Increased short positions.

All in all, the Government securities market adjusted with remarkable speed to the major change in international currency values and the rise in the discount rate, neither of which had been generally expected. Dealers indicated that the promptness and firmness of the System's actions at the opening were largely responsible for the rapidity with which the prices and rates of Government securities shifted and then settled down. There were indications that the action helped to moderate the adjustments in markets for other securities as well.

Federal Reserve Bank of New York
December 6, 1967

**FEDERAL RESERVE BANK
OF NEW YORK**

[Circular No. 6063
November 19, 1967]

DISCOUNT RATES

*To All Member Banks, and Others Concerned,
in the Second Federal Reserve District:*

With the approval of the Board of Governors of the Federal Reserve System, the directors of this Bank today increased the Bank's discount rate from 4 to 4½ per cent, effective Monday, November 20, 1967.

Following is the text of a statement issued today by the Board of Governors of the Federal Reserve System:

> In the light of the action of the British Government to change the parity of the pound, the Federal Reserve System announced today that it had taken actions to assure the continued orderly functioning of U. S. financial markets and to maintain the availability of reserves to the banking system on terms and conditions that will foster sustainable economic growth at home and a sound international position for the dollar.
>
> The Board of Governors unanimously approved actions by the directors of the Federal Reserve Banks of Boston, New York, Cleveland, Richmond, Atlanta, Chicago, Minneapolis, Kansas City, Dallas, and San Francisco, increasing the discount rates at those Banks to 4½ per cent, from 4 per cent, effective Monday, November 20, 1967. In addition, the Board affirmed that borrowing by member banks for purposes of making adjustments to market pressures is an appropriate use of the discount mechanism.
>
> At the same time, the Federal Reserve Board expressed its confidence in the basic economic and financial strength of the United States and pledged to do its full share in maintaining the soundness of the dollar, both domestically and internationally.

Enclosed is a copy of this Bank's Operating Circular No. 13, regarding discount rates. Additional copies of the enclosure will be furnished upon request.

Alfred Hayes,
President.

DEALER FIRMS CONTACTED
SUNDAY, NOVEMBER 19, 1967

FIRM:	INDIVIDUAL & TITLE:
Bankers Trust Company	Herman E. Frenzel Vice President
Blyth & Co., Inc.	*James Kelly Government Bond Trader
Briggs, Schaedle & Co., Inc.	Robert Britton Executive Vice President
Chemical Bank New York Trust Co.	Alfred H. Hauser Executive Vice President
Discount Corporation of New York	Charles E. Dunbar Chairman of the Board
The First Boston Corporation	Carl F. Cooke Senior Vice President
First National City Bank	*Edward Mahony Vice President
Aubrey G. Lanston & Co., Inc.	C. Richard Youngdahl President
Merrill Lynch, Pierce Fenner & Smith, Inc.	Carl Kreitler Senior Vice President
Morgan Guaranty Trust Company of New York	Ralph F. Leach, Executive Vice President and Treasurer
New York Hanseatic Corporation	Timothy Donovan Vice President
Wm. E. Pollock & Co., Inc.	John B. Hansen Vice President
Chas. E. Quincey & Co.	Maurice Gilmartin Senior Partner
The First National Bank of Chicago	*Cornelius O'Keefe Assistant Vice President
D. W. Rich & Company, Inc.	Arthur Combe Vice President

*Not contacted until Monday a.m.

FIRM:	INDIVIDUAL & TITLE:
Salomon Brothers & Hutzler	William Simon Partner
Second District Securities Co.	Frederick C. Farnsworth Vice President
Continental Illinois National Bank and Trust Company of Chicago	Donald C. Miller Vice President
Harris Trust & Savings Bank	Clarence C. Hill Vice President
United California Bank	Paul Uhl Senior Vice President

TEXT OF STATEMENT READ
TO DEALERS ON MONDAY, NOVEMBER 20, 1967

We will bid you for up to $ million of coupon issues maturing from 1 to 5 years and for $ million of securities maturing in more than 5 years for delivery on Wednesday, November 22. The amounts are based on your net positions shown in these maturity categories as of Thursday, November 16. The prices we will pay range from 2/32 to 8/32 below our composite bid prices at Friday night's close. Please let us know the issues which you wish to sell and we will indicate the prices we are willing to pay. You should not feel any obligation to accept our bids, but we expect to complete the trades within 15 minutes.

FEDERAL RESERVE BANK
OF NEW YORK

TABLE 1

SECURITIES DEPARTMENT

QUOTATIONS ON UNITED STATES GOVERNMENT SECURITIES

DATE November 20, 1967

SECURITY	YIELD VALUE OF 1/32	% YIELD ON BID PREVIOUS CLOSE	QUOTATION PREVIOUS CLOSE		PRICES PAID MONDAY	DIFFERENCE IN PRICE		DIFFERENCE IN YIELD	
			BID	ASKED		BID	ASKED	BID	ASKED
5 5/8% FEB. 1968 TN		4.88	100.5	7					
1 1/2% E.A. 1968 TN		5.38	98.20	26					
3 7/8% MAY 1968		5.33	99.10	12					
4 3/4% MAY 1968 TN		5.28	99.24	26					
3 3/4% AUG. 1968		5.51	98.24	26					
4 1/4% AUG. 1968TN		5.48	99.4	6					
1 1/2% E.O. 1968 TN		4.95	97.4	8					
3 7/8% NOV. 1968		5.56	98.13	15					
5 1/4% NOV. 1968 TN		5.51	99.23	25					
2 1/2% DEC. 1963-68		5.34	97.3	7	97.1	-2	-6	+ 6	+ 18
4 % FEB. 1969		5.50	98.7	11	98.5	-2	-6	+ 5	+ 16
5 5/8% FEB. 1969 TN		5.65	99.31	3	99.29	-2	-4	+ 5	+ 10
1 1/2% E.A. 1969 TN		5.21	95.6	14	95.4	-2	-10	+ 5	+ 24
2 1/2% JUNE 1964-69		5.15	96.2	6	96.0	-2	-6	+ 4	+ 13
4 % OCT. 1,1969		5.60	97.6	10	97.4	-2	-6	+ 4	+ 11
1 1/2% EO. 1969 TN		5.13	93.20	28	93.18	-2	-10	+ 4	+ 18
2 1/2% DEC. 1964-69		5.15	94.28	0	94.24	-4	-8	+ 6	+ 12
4 % FEB. 1970		5.63	96.20	24	96.16	-4	-8	+ 6	+ 11
2 1/2% MAR. 1965-70		5.25	94.2	6	93.30	-4	-8	+ 6	+ 11
4 % AUG. 1970		5.66	95.27	31	95.23	-4	-8	+ 5	+ 10
5 % NOV. 1970 TN		5.69	98.4	8	98.0	-4	-8	+ 4	+ 9
5 3/8% FEB. 1971 TN		5.66	99.5	9	99.1	-4	-8	+ 4	+ 9
2 1/2% MAR. 1966-71		5.40	91.10	14	91.6	-4	-8	+ 4	+ 8
5 1/4% MAY 1971 TN		5.62	98.27	31	98.23	-4	-8	+ 4	+ 7
4 % AUG. 1971		5.73	94.8	12	94.4	-4	-8	+ 4	+ 7
3 7/8% NOV. 1971		5.78	93.10	14	93.6	-4	-8	+ 3	+ 6
5 3/8% NOV. 1971 TN		5.61	99.5	9	99.1	-4	-8	+ 3	+ 6
4 % FEB. 1972		5.75	93.16	20	93.12	-4	-8	+ 3	+ 6
4 3/4% FEB. 1972 TN		5.69	96.16	20	96.12	-4	-8	+ 3	+ 6
4 3/4% MAY 1972 TN		5.69	96.10	14	96.6	-4	-8	+ 3	+ 6
2 1/2% JUNE 1967-72		5.37	88.16	24	88.12	-4	-12	+ 3	+ 10
4 % AUG. 1972		5.76	92.26	2	92.22	-4	-12	+ 3	+ 8
2 1/2% SEPT. 1967-72		5.41	87.26	2	87.22	-4	-12	+ 3	+ 8
1 1/2% E.O. 1972 TN		5.06	84.26	26	84.22	-4	-36	+ 3	+ 25
2 1/2% DEC. 1967-72		5.40	87.10	18	87.4	-6	-14	+ 3	+ 10
4 % AUG. 1973		5.72	91.22	28	91.16	-6	-12	+ 4	+ 7
4 1/8% NOV. 1973		5.79	91.26	2	91.20	-6	-14	+ 4	+ 8
4 1/8% FEB. 1974		5.74	91.20	28	91.14	-6	-14	+ 4	+ 8
4 1/4% MAY 1974		5.77	91.28	4	91.22	-6	-14	+ 4	+ 8
3 7/8% NOV. 1974		5.73	89.14	22	89.8	-6	-14	+ 3	+ 7
5 3/4% NOV. 1974 TN		5.76	99.30	2	99.24	-6	-10	+ 4	+ 6
4 % FEB. 1980		5.80	84.12	28	84.4	-8	-24	+ 2	+ 7
3 1/2% NOV. 1980		5.76	79.18	2	79.10	-8	-24	+ 2	+ 7
3 1/4% JUNE 1978-83		5.57	76.2	18	75.26	-8	-24	+ 2	+ 7
3 1/4% MAY 1985		5.41	75.26	10	75.18	-8	-24	+ 2	+ 7
4 1/4% MAY 1975-85		5.73	83.24	8	83.16	-8	-24	+ 2	+ 7
3 1/2% FEB. 1990		5.41	75.14	30	75.6	-8	-24	+ 2	+ 7
4 1/4% AUG. 1987-92		5.68	81.4	20	80.28	-8	-24	+ 2	+ 7
4 % FEB. 1988-93		5.59	78.20	4	73.12	-8	-24	+ 2	+ 7
4 1/8% MAY 1989-94		5.66	79.2	18	78.26	-8	-24	+ 2	+ 5
3 % FEB. 1995		4.62	75.2	18	74.26	-8	-24	+ 2	+ 5
3 1/2% NOV. 1998		5.09	75.10	26	75.2	-8	-24	+ 2	+ 5

TABLE II

SYSTEM'S BIDS AND DEALERS' SALES OF COUPON ISSUES IN GO-AROUND CONDUCTED AT 9:15 A.M. ON NOVEMBER 20, 1967

	BIDS		SALES	
FIRM:	1-5 yrs.	Over 5 yrs.	1-5 yrs.	Over 5 yrs.
Bankers Trust Company	7.0	1.0	7.0	1.0
Blyth & Co., Inc.	1.0	-	1.0	-
Briggs, Schaedle & Co., Inc.	2.5	1.5	2.5	1.5
Chemical Bank New York Trust	1.0	6.0	.8	6.0
Discount Corporation of N. Y.	1.0	6.0	1.0	-
First Boston Corporation	1.0	-	1.0	-
First National City Bank	20.0	6.0	20.0	6.0
Aubrey G. Lanston & Co., Inc.	35.0	28.0	35.0	28.0
Merrill Lynch, Pierce, Fenner & Smith, Inc.	6.0	3.0	6.0	3.0
Morgan Guaranty Trust Company of New York	7.0	-	7.0	-
New York Hanseatic Corporation	1.0	(.5)	-	.5
Wm. E. Pollock & Co., Inc.	4.5	.3	4.5	.3
Chas. E. Quincey & Co.	1.0	-	1.0	-
D. W. Rich & Co., Inc.	1.0	-	-	-
Salomon Brothers & Hutzler	3.0	12.0	3.0	12.0
Second District Securities Co., Inc.	23.0	1.0	23.0	1.0
Continental Illinois National Bank & Trust Co., Chicago	1.5	1.0	.2	-
First National Bank, Chicago	1.0	2.5	1.0	2.4
Harris Trust & Savings Bank Chicago	1.0	-	1.0	-
United California Bank Los Angeles	6.0	3.5	6.0	3.5
TOTAL:	124.5	72.3	121.0	65.2