REPORT OF OPEN
MARKET OPERATIONS

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

Open market operations have proceeded rather routinely since the Committee met five weeks ago. Under the Committee's instructions, the Account Management has aimed at maintaining the Federal funds rate around 5 3/8 percent and for once the funds rate has average 5.37 percent. The monetary aggregates appear to be coming in well within the Committee's tolerance ranges.

As the written reports indicate, the System operations were substantially affected by the rises and falls of the Treasury's balances at the Reserve Banks. In the first statement week of the period, the System Account's efforts to allow the funds rate to rise were aided by a build up in Treasury balances to a peak of $11.1 billion on May 20. Thereafter, the task for an extended period was to mop up the reserves released by the decline in those balances to their low point of $1.1 billion on June 10. More recently, the Treasury's balances are again on the rise after the June tax date with the June 30 balances at the Reserve Banks expected to be around $13 to 15 billion. You can appreciate that we are hopeful that the legislation to authorize the Treasury to invest its balances at commercial banks will continue to move smoothly through the Congress.

In managing reserves, the System Account reduced its outright holdings of Treasury bills by $2.6 billion during the period of decline in Treasury balances. These sales added to available bill supplies at a time when the Treasury was cutting its weekly offerings of bills substantially. More recently, we have reversed direction and bought $1.6 billion of Treasury securities and Federal agency issues.

The swings in reserves are, of course, too large to be dealt with primarily through outright transactions. We relied on repurchase agreements during short-term periods of pressure. But more importantly employed matched sale-purchase transactions with the market and with foreign accounts to deal with the substantial reserve excesses that prevailed during much of the period.

Since the Committee's last meeting, the securities markets have become mildly optimistic that interest rates may not have to rise as promptly, or perhaps as much as, market participants had thought earlier. Against this background Treasury bill rates after an early rise have backed down to about the levels prevailing in mid-May. At yesterday's auction, the 3- and 6-month issues were auctioned at average rates of 5.01 and 5.22 percent, up 1 and down 1 basis points from five weeks earlier. With the change in atmosphere, customer demand and dealer short covering led to a rise of prices of intermediate- and long-term issues sufficient to reduce yields by about 15 to 25 basis points over the interval. Yields of new corporate bond issues have also declined appreciably. Long-term municipal bonds were offered in heavy volume during the interval and investors took up the issues at declining yields. The Bond Buyer index is at the lowest level in three years. Stock prices, which had tumbled in late May, recovered to close above their month earlier level.

Among the key forces at work in the credit markets during the current quarter have been the net repayment of debt by the Treasury and the pattern of Treasury borrowing. The Treasury has reduced its marketable debt by about $5 billion during the quarter, the first quarterly net repayment of such debt since June 1974. In managing the debt the Treasury cut back sharply on its weekly and monthly Treasury bill offering, cutting the amount of bills outstanding by $9.6 billion. While Treasury bills were being run down, the Treasury continued to raise additional cash through coupon securities--about $5 billion during the quarter. As a result of its systematic financing in the coupon area, the Treasury has been able to extend the average maturity of the debt by 4 months to 2 years and 11 months over the past year. The Treasury will revert in the third quarter to being a net borrower of perhaps $11-15 billion, continuing to rely heavily on offerings of coupon issues. Offering of a new 15-year bond was announced yesterday for payment in early July. A regular offering of this maturity shoudl help develop the Treasury's market in this area.

A comparison of interest rates at the present time with their levels a year ago suggests that the inflation premium has perhaps declined somewhat. The Federal funds rate is now just a few basis points below where is was then. A five-year Treasury issue is about 80 basis points lower now at 6 3/4 percent, while a 20-year issue is 35 basis points lower at arounf 7 5/8 percent. Newly offered Aaa-rated corporate bonds are about 70 basis points lower in yield at 8 percent. Similarly rated municipal issues are down about 60 basis points. Baa-rated issues are down 170 basis points from a year ago as some of the great uncertainties then surrounding lower grade issues have been resolved and investors have reached out for yield.