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CONFIDENTIAL

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

R&S 100-692
April 28, 1943

Board of Governors

Open-market operations

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The instructions to the Federal Reserve Bank of New York are in brief to maintain the pattern of rates and to maintain an adequate amount of reserves. In following these instructions decisions must be made during the course of each day as to the timing of commitments and the issues, amounts, prices, and delivery dates involved. These decisions are made in accordance with certain general policies. The types of transactions to which the policies relate fall generally into several groups including (1) transactions at the buying rate, (2) other transactions in Treasury bills, (3) purchases to replenish or to increase bank reserves, (4) transactions to maintain the pattern of rates, and (5) the handling of speculative orders.

(1) Purchases and sales of Treasury bills at the buying rate require no policy decisions. Whenever bills of any issue or any amount are offered to the Reserve Banks at the buying rate, commitments are made promptly to purchase the bills for immediate or later delivery depending upon the wishes of the sellers. Whenever sellers wish to repurchase bills held under option, commitments similarly are made to sell the bills.

(2) Dealers place underwriting tenders for new issues of bills and sell in the market as much as possible of their allotments. Any bills that they are unable to sell in the market are generally purchased for the System Account at a rate of 0.36 per cent. Some of the large New York City banks also enter underwriting tenders. If they find it necessary to sell part or all of their allotments to the Reserve Bank, the bills are purchased at the buying rate.

(3) When it is necessary or desirable to replenish or to increase bank reserves, the New York Reserve Bank buys freely for the System Account. If offerings in the market are insufficient for the purpose, buying orders are placed in the market. The amounts of these orders are determined by advance estimates of changes in excess reserves, by current changes in the flow of funds, and by current market developments. The orders are generally for short issues, but may be for longer securities if the supply of short issues is limited. Whenever securities are offered by banks for the purpose of covering actual or anticipated reserve deficiencies, commitments are made promptly to purchase the securities for immediate or later delivery depending upon the needs of the sellers. These purchases generally consist of short issues, but other issues are purchased if the sellers do not hold short securities.

(4) When market orders at any time threaten the maintenance of the pattern of rates, commitments are made promptly to purchase or to sell the securities. When outstanding issues with due or callable dates that are comparable to those on issues that the Treasury contemplates offering in a new financing are selling out of line with the anticipated terms of the new issues, the outstanding issues are purchased or sold freely for the purpose of ensuring quotations of par or slightly above par on the new issues. New issues are purchased at prices no lower than 100 1/64, with the understanding that dealers will pay to sellers no less than par and will make their bid quotations no less than par. On other purchases and sales the prices may be varied slightly in order to give the market some flexibility. Commitments to maintain the pattern of rates are generally made for regular delivery.

(5) The New York Reserve Bank attempts to avoid purchasing securities that are offered in the market for the purpose of taking profits and of swapping into other outstanding issues; when securities are offered in the market for the purpose of subscribing for new issues, the policy is similar, but purchases are made more freely than is the case in the other two types of offerings. Dealers try to discourage customers from selling outstanding issues against subscriptions for new issues and from swapping in cases where it is obvious that there is no demand at that particular time for the issues to be sold or no supply of the issues to be bought. If dealers are not successful in this regard, they ask customers for firm orders, which they execute at current prices as they are able. Dealers are generally able to execute such orders gradually. When they are unable to do so or can execute only small amounts and the buying or selling affects the tone of the market, commitments are made to purchase or sell some of these securities for regular delivery in order to protect the pattern of rates and to give the market some flexibility.

The maintenance of a pattern of rates that results in declining yields and generally increasing prices as issues become shorter permits speculators to make a profit by purchasing any issue and selling it after a limited period. Many speculators are continually trying to realize profits by selling securities at premiums and buying other securities at smaller premiums or at par. If transactions of this type were facilitated by the System, speculators would be encouraged to take advantage of this inherent defect in the pattern of rates, and the System would in effect guarantee a profit on all transactions.