Treasury and Federal Reserve Foreign Exchange Operations*

By CHARLES A. COOMBS

As of early March 1963 the Federal Reserve reciprocal credit, or "swap", network covered ten foreign central banks, plus the Bank for International Settlements, and involved a total amount of $1,100 million. In May 1963 the reciprocal currency agreement with the Bank of England was increased from $50 million to $500 million, thereby raising the total of these short-term swap lines to $1,550 million.

From the first use of the Federal Reserve swap program in March 1962 through the end of August 1963, total drawings on these swap lines by the Federal Reserve and other central banks amounted to $978 million. Over the same period, total repayments of $876 million were made, each generally within six months from the date of the drawing. The net debtor position of the Federal Reserve under all these agreements combined was $92 million as of the end of August 1963, compared with $65 million at the end of February 1963. During the first week of September, the net debtor position of the Federal Reserve was reduced to $73 million.

At the end of February 1963, there were outstanding United States Treasury issues of $481 million in foreign currency bonds and of $48 million in foreign currency certificates. During the next six months, all of the foreign currency certificate issues were converted into foreign currency bonds, while additional bonds were issued in the amount of $177 million. Of this total of $705 million of foreign currency bonds outstanding at the end of August 1963, $50 million has in one instance been employed to refund Federal Reserve swap drawings into medium-term obligations of the Treasury.

* This third joint interim report reflects the United States Treasury-Federal Reserve policy of making available additional information on foreign exchange operations from time to time. The Federal Reserve Bank of New York acts as agent for both the Treasury and the Federal Open Market Committee of the Federal Reserve System in the conduct of foreign exchange operations.

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BELGIAN FRANCS

Unlike the other swap arrangements, which are now on a stand-by basis, the Federal Reserve-National Bank of Belgium swap remains fully drawn, as it has been from the beginning. The swap thus provides the National Bank of Belgium with a supplementary dollar balance of $50 million and the Federal Reserve with an equivalent balance of 2½ billion Belgian francs.

During the period under review, disbursements of the

Table I

FEDERAL RESERVE RECIPROCAL CURRENCY AGREEMENTS

End of August 1963

Other party to agreement	Amount of facility (in millions of dollars)	Date (of original agreement)	Term (in months)
Bank of France*	100	1962: March 1	3
Bank of England†	500	May 31	12
Netherlands Bank	50	June 13	3
National Bank of Belgium	50	June 20	6
Bank of Canada	250	June 26	3
Bank for International Settlements‡	100	July 16	3
Swiss National Bank	100	July 16	3
German Federal Bank§	150	August 2	3
Bank of Italy‖	150	October 18	3
Austrian National Bank	50	October 25	3
Bank of Sweden	50	1963: January 17	3
Total for all banks	1,550		

* Increased from $50 million to $100 million on March 4, 1963.
† Increased from $50 million to $500 million on May 29, 1963.
‡ In Swiss francs.
§ Increased from $50 million to $150 million on January 17, 1963.
‖ Increased from $50 million to $150 million on December 6, 1962.

reciprocal balances created by the swap were made by both parties for a combined total of $25 million equivalent. These exchange operations were quickly reversed, as the payments balance of Belgium oscillated around equilibrium.

In May 1963 the United States Treasury issued to the National Bank of Belgium 24-month bonds denominated in Belgian francs in the amount of $30 million equivalent. These bond issues were timed to coincide with Belgian Government borrowings of dollars in London and New York, which would otherwise have resulted in an accrual of surplus dollars on the books of the National Bank of Belgium. These dollars were immediately absorbed, however, by the Treasury with the Belgian franc proceeds of the bond issues.

Over the past year, payments swings in the Belgian dollar position totaling $175 million have been financed through the Federal Reserve swap facility and the United States Treasury issue of Belgian franc bonds, thereby dispensing with the use of existing reserves by an equivalent amount. Although limited in scale, these coordinated exchange operations by the United States and Belgian exchange authorities provide a clear illustration of the technical feasibility of readily financing, through the flexible use of the international financial machinery that has recently been developed, the payments swings that inevitably accompany even a balanced growth of trade and payments.

Table III

FEDERAL RESERVE AND NATIONAL BANK OF BELGIUM RECIPROCAL CURRENCY AGREEMENT

Through August 1963

Date	Disbursements	Repurchases	Closing balances
Federal Reserve Operations in Belgian Francs* In millions of $ equivalent			
1962: June 20	—	—	50.0
August 7	10.5	—	39.5
September 17-21	—	10.5	50.0
October 11	10.0	—	40.0
November 19	10.0	—	30.0
December 19	—	5.0	35.0
1963: January 2-4	—	14.4	50.0
January 31	5.0	—	45.0
February 11	—	5.0	50.0
April 2	5.0	—	45.0
June 11	—	5.0	50.0
National Bank of Belgium Operations in United States Dollars In millions			
1963: January 16	5.0	—	45.0
January 31	—	5.0	50.0
February 21	10.0	—	40.0
March 11	10.0	—	30.0
March 27-April 2	—	20.0	50.0
June 27	10.0	—	40.0
August 2	—	5.0	45.0

* Closing balance includes interest earnings.

NETHERLANDS GUILDERS

From mid-November 1962 through February 1963 the dollar-guilder market remained quiet, with no need for intervention by the Federal Reserve Bank of New York for either the Federal Reserve System or the United States Treasury. Renewed buying pressure on the guilder developed, however, in mid-March 1963 and continued for over two months thereafter. Part of the dollar influx into the Netherlands apparently originated in foreign direct investment. But a more important cause appeared to be a gradual tightening of money market conditions in the Netherlands.

As Dutch commercial banks began to be squeezed for liquidity, the call money rate in the Netherlands rose sharply from 1 per cent to 3 per cent, and rates on Treasury paper also advanced. To ease the pressure on the banks, the Netherlands Bank in March agreed to accept certain Netherlands Treasury paper under repurchase agreements and, for the monthly reserve period ended April 21, reduced the banks' cash reserve requirements by one percentage point to 4 per cent. Nevertheless, the tightness continued, and Dutch commercial banks repatriated short-term investments from abroad in order to bolster their strained domestic liquidity positions. The return flow of short-term funds was reflected both in a strengthening of the spot guilder rate and in a narrowing of the forward guilder premium.

In these circumstances, it seemed appropriate to prevent through central bank swap operations the potential unloading of such repatriations on the Netherlands Bank. Accordingly, from April 10 through May 28, the Federal

Table II

UNITED STATES TREASURY FOREIGN CURRENCY BONDS

Outstanding at the end of August 1963

Investor	Amount (in millions of $ equivalent)	Original maturities (in months)	Currency
German Federal Bank	275	15 to 24	German mark
Bank of Italy	200	15 to 24	Italian lira
Swiss Confederation	127	15 to 18	Swiss franc
Swiss National Bank	48	15 to 18	Swiss franc
National Bank of Belgium	30	24	Belgian franc
Austrian National Bank	25	18	Austrian schilling
Total	705		

Reserve gradually disbursed a total of $44 million equivalent in guilders acquired through drawings upon the $50 million swap line with the Netherlands Bank. The great bulk of these disbursements was effected through exchange market operations, with the dual purpose of preventing the spot rate for the dollar from declining to the floor and of simultaneously absorbing dollars that would otherwise have flowed to the Netherlands Bank.

By early June the tide began to turn, as the Netherlands Bank again reduced the commercial banks' cash reserve requirements by one percentage point to 3 per cent and money market conditions eased in the Netherlands. With the decline in Dutch money rates and the strengthening of their liquidity positions, Dutch commercial banks resumed placements of short-term funds abroad, thereby pushing up the spot rate for the dollar and widening the forward premium on the guilder. Between July 1 and July 3 the Federal Reserve was able to acquire $5 million of guilders through market operations conducted by the Netherlands Bank, and the dollar rate continued to strengthen gradually throughout the summer months.

Although such favorable market conditions would probably have permitted further gradual liquidation of most of the swap drawing, the Netherlands Bank and the Federal Reserve both deemed it preferable to take advantage of a $70 million debt prepayment by the Netherlands Government to the United States Government on July 22. This debt prepayment, which resulted in an equivalent draft upon the dollar reserves of the Netherlands Bank, enabled the Federal Reserve to buy directly from the Netherlands Bank a sufficient amount of guilders to liquidate its remaining commitment under the swap drawing.

STERLING

Sterling strengthened in early January 1963, and there were numerous indications at that time that seasonal inflows of dollars might considerably augment British official reserves during the first half of 1963. Accordingly, the Federal Reserve drew £9 million, or $25 million equivalent, of its $50 million swap facility with the Bank of England and subsequently used £2 million, or $5.6 million equivalent, of this drawing to support the dollar rate.

Late in January, however, the exchange market situation was abruptly transformed when the British bid for Common Market membership was rejected. The Federal Reserve reversed gear and on February 1 purchased sufficient sterling to replenish its sterling balance to £9 million, or $25 million equivalent. Simultaneously, as speculative pressure on sterling gathered force, the Bank of England disbursed the $25 million credited to its account at the Federal Reserve under the initial swap drawing. Despite sizable intervention by the Bank of England, the sterling rate gradually declined during February and March and slipped below par. On March 29 the Federal Reserve Bank of New York purchased in the market for United States Treasury account £3 million, equivalent to $8.4 million, thereby reinforcing the support operations of the Bank of England.

The Bank of England might have readily drawn on the remaining $25 million of the $50 million swap line, which the Federal Reserve was prepared to increase, but the nature of the speculative selling of sterling suggested to the Bank of England that recourse to other short-term facilities would be more appropriate. As far as could be ascertained, the speculative outflow from London was directed largely to Continental financial centers rather than to New York. The Bank of England accordingly negotiated short-term credits of $250 million equivalent with several continental European central banks in order to reinforce British official reserves. These short-term credits, which cushioned the decline in British reserves during February and March, were reported early in April by Chancellor Maudling. This announcement immediately strengthened sterling, as the markets realized that cooperative action by central banks to defend sterling was under way, and the sterling rate stabilized slightly above par.

Between May 6 and 20 during temporary declines in the sterling rate to slightly below par, the Federal Reserve Bank of New York, on behalf of both the System and the Treasury, accumulated £6.5 million, equivalent to $18.2 million, in order to build up United States official holdings. No immediate need to employ these balances for intervention in the dollar-sterling market was anticipated, however, and several weeks later it appeared advantageous to swap £9.3 million, or $26.0 million, of the combined Treasury and Federal Reserve holdings into Swiss francs. This was done to accelerate repayment of earlier Federal Reserve drawings upon its swap line with the Swiss National Bank. In August, as sterling weakened again, the Federal Reserve Bank of New York acquired in the market additional sterling balances of £2.7 million, or $7.5 million, for the account of the Federal Reserve and the Treasury.

Perhaps the most important single development during the period under review, however, was the announcement on May 29 that the swap line between the Federal Reserve and the Bank of England had been increased from $50 million to $500 million. The magnitude of this increase in the reciprocal credit arrangement between the Federal Reserve and the Bank of England has greatly reinforced market confidence in the stability of the sterling-dollar

parity relationship and may well mark a milestone in the development of international financial cooperation. The $25 million swap operation initiated in January was fully liquidated on July 16, and the $500 million swap arrangement is consequently on a stand-by basis immediately available in its entirety to either party in case of need.

GERMAN MARKS

From early March through late July there was almost continuous buying pressure on the German mark, which strengthened from a quotation of $0.2500¼ on March 1 to a peak rate of $0.2515⅛ on June 20. Although some improvement in the German foreign trading position seemed to be involved, there were numerous indications of sizable inflows of capital. Throughout the period relatively tight money market conditions prevailed in Germany. In June in particular, the German banks found their reserve positions squeezed, owing to the coincidence of the quarterly tax date and the customary midyear "window-dressing" needs. Reflecting this tightness, the rate for call money traded among the banks remained above the central bank discount rate of 3 per cent, and on occasion rose to over 4 per cent. These relatively high short-term rates appeared to be pulling in funds from other European financial centers and from New York. In addition, there was evidence of quite substantial foreign investment in German bonds, on which yields were also relatively high, as well as in German equities. Subsequent statistical reports have confirmed these early impressions.

The pressures on the mark-dollar exchange market were resisted by closely coordinated action by the German Federal Bank and the Federal Reserve Bank of New York. From early March through August, the German Federal Bank took in a substantial amount of dollars at rates well below the ceiling on the mark and thus helped to maintain a calm and orderly atmosphere in the market. On the United States side, the Federal Reserve Bank of New York intervened heavily for both Treasury and Federal Reserve account. It used mark balances available at the beginning of the period and, in addition, drew on the Federal Reserve-German Federal Bank swap line and placed with the German Federal Bank additional issues of United States Treasury mark bonds.

In April, combined Treasury and Federal Reserve disbursements of previously accumulated mark balances amounted to $16.5 million equivalent. A further mark supply of $13.2 million equivalent became available and was disbursed in June and July, as a weakening of the Swiss franc facilitated a partial reversal of the $30 million Treasury swap of marks for Swiss francs that had been arranged in December 1962 following the Cuban crisis. Most of the intervention operations by the Federal Reserve Bank of New York for both the System and the Treasury, however, were financed by bilateral credit arrangements. In May and June the Federal Reserve drew the entire $150 million equivalent of marks available under its swap line with the German Federal Bank, and by July 5 it had disbursed $143 million of such drawings. At this point, in the face of continuing pressure, it appeared advisable to shift to medium-term United States Treasury financing through a $25 million issue on July 11 of a two-year mark bond, which provided funds for further intervention during the remainder of July.

Early in August, buying pressure on the mark tapered off considerably, partly because of an easing of the German money market, and over the next few weeks the Federal Reserve System was able to purchase a total of $25 million equivalent of marks, which was immediately employed to reduce the swap by that amount. The German Federal Bank would have been agreeable to an extension of the Federal Reserve Bank swap drawings pending the expected reversal of the flow of funds. As this appeared likely to take some time, however, the Federal Reserve and the Treasury, in line with the general policy of reserving swap facilities for countering flows that give evidence of being quickly reversible, felt it desirable at this point to substitute, for a portion of short-term obligations of the Federal Reserve to the German Federal Bank, a medium-term United States Treasury borrowing in the form of a further issue of two-year mark bonds. Accordingly, on August 28 the Treasury issued to the German Federal Bank a $50 million two-year mark bond, the proceeds of which were immediately sold by the Treasury to the Federal Reserve System and were used to reduce the Federal Reserve swap drawing to $75 million equivalent. This is the first instance of a refunding of a Federal Reserve swap drawing through medium-term Treasury borrowing.

SWISS FRANCS

On March 1, the short-term commitments of the United States in Swiss francs amounted to $153 million equivalent. These comprised Federal Reserve swap drawings of $100 million on the Swiss National Bank and the Bank for International Settlements, and Treasury forward contracts of $53 million. By June 20, these short-term commitments had been fully liquidated.

As pointed out in previous reports in this series, as well as by Swiss official spokesmen, the strength of the Swiss franc in recent years has been mainly attributable to re-

current inflows of short-term capital funds associated with international political tensions. Whenever these short-term inflows have tapered off, the underlying deficit in the Swiss balance of payments has emerged and generated sizable demands for dollars to finance imports and other payments. During the spring and early summer of 1963, such a demand for dollars reappeared and brought about a strengthening of both the spot and forward dollar rates against the Swiss franc. Under these conditions, the Federal Reserve and Treasury made more or less simultaneous progress in rapidly reducing their short-term debt in Swiss francs.

The Treasury accelerated the liquidation of the $53 million of forward contracts outstanding on March 1 by issuing to the Swiss Confederation an additional $46 million of Swiss franc bonds. By providing the Swiss Confederation with franc-denominated assets, these bonds correspondingly reduced the need for the Confederation to invest in dollar assets abroad and, consequently, its need to have recourse to the forward market to acquire Swiss franc cover for such investments.

The Federal Reserve System, for its part, liquidated $75 million of the $100 million of swap drawings outstanding in early March by buying Swiss francs, both from the market and directly from the Swiss National Bank, and by drawing down existing United States official balances in Swiss francs. To speed up liquidation of the final $25 million of the swap drawing, the Federal Reserve in co-operation with the Treasury made use of the technique of swapping outright holdings of one currency for another. As mentioned above, the System and the Treasury swapped with the Bank for International Settlements $26 million of previously acquired sterling for Swiss francs. This swap technique, discussed in the preceding report, was first employed in December 1962 to enable the United States Treasury to swap $30 million of marks for Swiss francs to deal with buying pressure on the Swiss franc resulting from the Cuban crisis. In such transactions involving third currencies, the Federal Reserve has worked out its operations in consultation also with the central bank responsible for that currency.

In late July, the Swiss franc strengthened once more as the Swiss money market became somewhat tighter. To counter the liquidity squeeze, Swiss commercial banks repatriated funds placed abroad, and this inflow—combined with some renewed speculative pressures—created a heavy demand for Swiss francs. In closely coordinated operations in New York and Zurich, the Swiss and United States authorities tempered these market pressures and prevented unduly sharp rate movements. Intervention took the form mainly of renewed United States Treasury placements of forward Swiss franc contracts and market purchases of dollars by the Swiss National Bank, both on a moderate scale. With some easing of the Swiss money market, the exchange market returned to a more balanced position in August and the dollar rate held slightly above the floor.

FRENCH FRANCS

Between July 19 and 23, in an effort to test the market, the Federal Reserve drew and disbursed for the first time a total of $12.5 million equivalent of French francs under the $100 million swap line with the Bank of France. This intervention lifted the dollar slightly off the floor, but it quickly became apparent that very sizable disbursements would be required to bring about any appreciable improvement of the dollar rate. Intervention was accordingly suspended to await a more favorable opportunity. Since then, the French franc obligation incurred by the Federal Reserve through the swap drawing in July has been fully covered by purchases of French francs in the forward market.

ITALIAN LIRE

During the period under review, no spot operations in lire were conducted by the Federal Reserve Bank of New York for either the Federal Reserve or the Treasury. Forward operations in lire for Treasury account were continued with satisfactory results and will be reported in detail in due course.

In March and June a total of $100 million equivalent of 15-month lira bonds issued to the Bank of Italy by the United States Treasury in 1962 was converted into 24-month obligations carrying the privilege of conversion into shorter maturities in case of need.

CANADIAN DOLLARS, SWEDISH KRONOR, AND AUSTRIAN SCHILLINGS

No exchange stabilization operations in Canadian dollars, Swedish kronor, or Austrian schillings were conducted during the period by the Federal Reserve Bank of New York for either the Federal Reserve or the Treasury. In April, however, the Treasury issued a $25 million equivalent 18-month bond denominated in Austrian schillings to the Austrian National Bank, and used the schilling proceeds to absorb dollar holdings of the Austrian National Bank which had been increasing, owing to Austria's balance-of-payments surplus.