February-April 1984 Interim Report
*(This report was released to the Congress and to the press on June 8, 1984.)*

# Treasury and Federal Reserve Foreign Exchange Operations

The dollar declined modestly on balance over the three months ended in April. It dropped through the first five weeks of the period but later rose against the major foreign currencies to offset much of its earlier move

The dollar's fall early in the period occurred amid indications that the incentives for capital flows might be shifting away from dollar-denominated assets. News of strengthening foreign industrial activity and orders, especially in Germany, generated expectations of rising earnings abroad where inflation remained low Thus the climate for growth and investment abroad was improving. At the same time, the U.S. economy showed unexpected buoyancy well into 1984 and market participants came to focus on the risks for the dollar of a potential overheating of the domestic economy. Following the President's State of the Union address and budget message, participants in the financial markets increasingly questioned the implications of growing U.S. fiscal deficits Market participants also questioned the financing of the U S. current account deficit, especially after public officials expressed concern about extended dependence on foreign capital inflows and the vulnerability of the dollar to a potential shift in investor sentiment.

Against this background, reports circulated in February that some internationally oriented investors were already reducing the share of dollar-denominated assets in their portfolios in favor of the German mark and other foreign currencies Earlier in the year, when U.S. stock prices faltered while stock markets in Germany and Japan were experiencing net inflows and rising to set new records, talk spread that investors had made substantial net sales of U S. equities. Doubts were voiced whether the dollar's exchange rate could be sustained without a sharp rise in U S. interest yields. Although U.S. interest rates rose modestly in February in response to strong credit demand, market participants were uncertain how the Federal Reserve would respond if the demand for credit continued to mount. Under these circumstances, the increases in interest rates already underway were viewed in the market more as a sign of pressure against the dollar than as a source of support

In this context, the belief spread that the dollar had begun a long-awaited and potentially sustained decline, encouraging a pronounced shift of both professional positions and commercial leads and lags in favor of foreign currencies. These shifts added to the momentum of the dollar's decline throughout February and early March, which by the first week in March brought the dollar down 13 percent compared with its high in early January against the German mark, and about 7 percent lower in terms of a trade-weighted average.

After early March, the dollar's fall came to an abrupt halt, and dollar exchange rates rose more or less steadily until the end of the period under review Reports of progress in efforts by Congress and the Administration to agree on a "down payment" package of budget cuts lent some support to the dollar Also, as U.S. market interest rates climbed during March and April, observers concluded that the increases were unlikely to be resisted by the monetary authorities inasmuch as they reflected a continuing buildup

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of credit demands generated by the strong domestic expansion. By the time the Federal Reserve announced a one-half percentage point rise in its discount rate to 9 percent, effective April 9, market participants had become convinced that the U.S. authorities were prepared to accept yet higher rates

Meanwhile, yields in foreign centers remained steady. With little or no acceleration in U S price indexes, real interest differentials were perceived to be widening in favor of the United States and these perceptions were a factor underpinning the dollar in the exchanges Concerns over the financing of U S. current account deficits receded and the announcement of two more record monthly deficits in U S. international trade received little notice in the exchange markets.

In addition, the dollar was supported by labor conflicts in several countries in Europe which received increasing attention during April and brought into question the immediate outlook for continued economic recovery there In particular the prospect of strikes in Germany, resulting from a major union's call for shorter hours and higher pay, raised new worries about the investment climate there and contributed to a weakening of German stock prices Talk of shifting out of U S. assets subsided and inflows to U S equities resumed

As the dollar rose in April, its movement gained momentum from professional positioning based on technical models and a reversal of commercial leads and lags. It closed the period under review only 3 to 3½ percent lower against EMS currencies and the Japanese yen. In terms of the Swiss franc, the dollar's value was little changed compared to end-January, against the pound sterling and Canadian dollar it closed somewhat higher on balance. The dollar's average decline in trade-weighted terms came to about 2 percent for the three months as a whole

The U S. authorities did not intervene in the exchange markets during the period under review and extended no new credits through foreign exchange swap arrangements The Bank of Jamaica repaid on March 2 the $10 million it had drawn against the U.S Treasury temporary swap facility on December 29, 1983, and this facility then expired.

On March 30 the U S Treasury announced that it would participate in an arrangement to support the efforts of the Government of Argentina to put into place an economic adjustment program backed by the International Monetary Fund (IMF). The Treasury's participation consisted of agreeing to extend temporary swap credits of up to $300 million to Argentina when agreement on an economic adjustment program is reached between Argentina and the IMF Argentina would repay any such drawings on the

Table 1

**Federal Reserve Reciprocal Currency Arrangements**

In millions of dollars

| Institution | Amount of facility April 30, 1983 | Amount of facility April 30, 1984 |
|---|---|---|
| Austrian National Bank | 250 | 250 |
| National Bank of Belgium | 1,000 | 1,000 |
| Bank of Canada | 2,000 | 2,000 |
| National Bank of Denmark | 250 | 250 |
| Bank of England | 3,000 | 3,000 |
| Bank of France | 2 000 | 2,000 |
| German Federal Bank | 6,000 | 6,000 |
| Bank of Italy | 3,000 | 3,000 |
| Bank of Japan | 5,000 | 5,000 |
| Bank of Mexico | | |
| Regular facility | 700 | 700 |
| Special facility | 325 | * |
| Netherlands Bank | 500 | 500 |
| Bank of Norway | 250 | 250 |
| Bank of Sweden | 300 | 300 |
| Swiss National Bank | 4,000 | 4,000 |
| Bank for International Settlements | | |
| Swiss francs-dollars | 600 | 600 |
| Other authorized European currencies-dollars | 1,250 | 1,250 |
| Total | 30,425 | 30,100 |

*Facility, which became effective August 30, 1982, expired on August 23, 1983

Treasury using proceeds of IMF drawings. This undertaking was part of a $500 million financing package that was used to pay certain interest arrears. The $500 million package consisted of: $300 million credits extended to Argentina by the governments of Mexico, Venezuela, Brazil and Colombia, to be repaid upon Argentina's drawing from the U.S. Treasury; $100 million additional credits extended by certain of Argentina's commercial bank creditors and $100 million provided from Argentina's resources.

In the period from February through April, the Federal Reserve and the Exchange Stabilization Fund (ESF) of the Treasury realized no profits or losses from exchange transactions. As of April 30, cumulative bookkeeping, or valuation, losses on outstanding foreign currency balances were $860.6 million for the Federal Reserve and $586.1 million for the ESF. (Valuation gains and losses represent the increase or decrease in the dollar value of outstanding currency assets and liabilities, using end-of-period exchange rates as compared with rates of acquisition.) These valuation losses reflect the fact that the dollar has appreciated since the foreign currencies were acquired

The Federal Reserve and the Treasury invest foreign currency balances acquired in the market as a result of their foreign exchange operations in a variety of instruments that yield market-related rates of return and that have a high degree of quality and liquidity Under the authority provided by the Monetary Control Act of 1980, the Federal Reserve had invested $1,528.0 million of its foreign currency resources in securities issued by foreign governments as of April 30. In addition, the Treasury held the equivalent of $1,852.4 million in such securities as of end-April.

Table 2

**Net Profits (+) or Losses (−) on United States Treasury and Federal Reserve Current Foreign Exchange Operations**

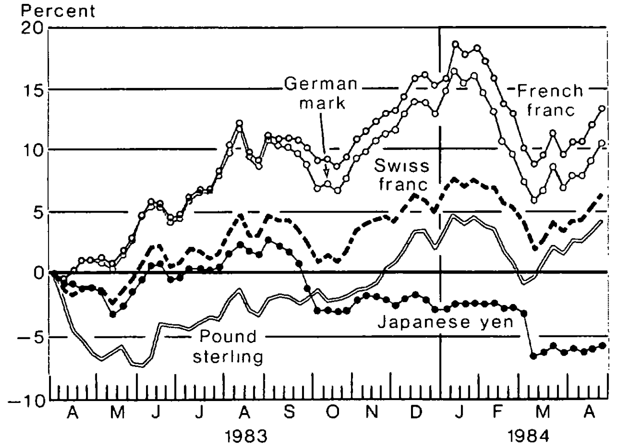
In millions of dollars

| Period | Federal Reserve | United States Treasury: Exchange Stabilization Fund | United States Treasury: General Account |
|---|---|---|---|
| February 1 through April 30, 1984 | -0- | -0- | -0- |
| Valuation profits and losses on outstanding assets and liabilities as of April 30, 1984 | −860 6 | −586 1 | -0- |

Data are on a value-date basis

Chart 1

**The Dollar against Selected Foreign Currencies**

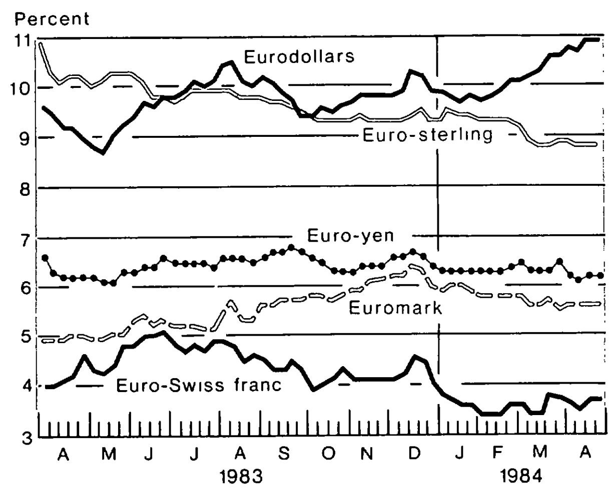



Percentage change of weekly average bid rates for dollars from the average rate for the week of March 26-31, 1983 Figures calculated from New York noon quotations

Chart 2

**Selected Interest Rates**

Three-month maturities *




*Weekly averages of daily rates