August-October 1984 Interim Report
(This report was released to the Congress and to the press on December 6, 1984.)

Treasury and Federal Reserve Foreign Exchange Operations

During the three-month period August to October, the dollar continued to advance from the levels reached in mid-summer. After pausing in August, it resumed its rise to set new highs against many European currencies in September and again in October. Although it eased somewhat in the final weeks of the period, the dollar closed up on balance over 3 percent against the German mark and other European Monetary System currencies and 6 percent against sterling. Against the Japanese yen, the Canadian dollar, and the Swiss franc, however, the dollar registered little net change. On a trade-weighted basis the dollar closed up almost 3 percent.

Throughout this period, the dollar drew support from its role as a major medium of investment. Inflationary expectations worldwide moderated further in response both to price performance in the United States that was better than generally expected and to renewed weakness in several important commodity prices, especially petroleum This development enhanced the climate for investment in financial assets in general and in U.S. dollar-denominated securities in particular Dollar interest rates, after taking account of anticipated future inflation, were perceived to be relatively attractive, even though market interest rates declined almost continuously in the United States and by considerably more than in most other major countries. Moreover, investors remained impressed by the current economic strength of the United States relative to Europe, by the flexibility of our markets, and by the perceived lower level of labor management conflict. They expected the Administration's economic policies to be reaffirmed in the forthcoming election. The repeal of the withholding tax on foreign-held U S. securities and anticipation of the first of the Treasury's "foreign-targeted" issues were also cited at times as stimulating interest in U.S. securities.

In the weeks after Labor Day, the dollar was bid up further in response to a variety of shorter-term factors. With the dollar firm in the face of a record U.S. trade deficit reported for July, evidence of some slowing of the domestic economy, and easing U.S. interest rates, many market participants began to purchase dollars to meet their remaining requirements for the year. Recurrent reports of commercial demand for dollars, together with the investment interest, helped to turn sentiment toward the dollar decidedly more bullish. As the dollar rose to break through anticipated resistance levels, some market professionals began to position more aggressively The dollar moved above the DM 3.00 level against the German mark by September 11 and ten days later hit an 11½ year high of DM 3.1765.

In this atmosphere, market observers decided that foreign central banks were less likely than before to

A report presented by Sam Y Cross, Executive Vice President in charge of the Foreign Group at the Federal Reserve Bank of New York and Manager of Foreign Operations for the System Open Market Account Richard F Alford, Senior Economist, was primarily responsible for the preparation of this report esist depreciation of their currencies, either through ntervention or through a tightening of domestic mon-tary policy. The economic recovery in Europe was iewed as disappointingly weak, with unemployment ates holding near all-time highs. The further stimulus iven to these countries' export industries was thought o be welcome. And, with inflationary expectations more ubdued, the impact of a weakening of the European urrencies on their domestic prices was thought to resent less of a risk to the authorities' anti-inflation olicies. These perceptions appeared to be confirmed uring the first three weeks of September by the lack f forceful official action designed to curb the dollar's se. In addition, market professionals interpreted tatements of foreign officials as tolerating develop-ients in the exchange markets.

On September 21, however, the Bundesbank entered ie exchange market to sell aggressively a substantial mount of dollars, and the dollar fell sharply This was ie first of several highly visible Bundesbank operations iat took place during the remainder of the period under eview. The U.S. authorities had intervened on one ccasion earlier in September to buy $50 million quivalent of marks. Following the German operation of eptember 21, the U.S authorities again entered the arket, buying $135 million of marks during three days the subsequent week.

The dollar then moved back up in mid-October to test e highs reached in September. The Bundesbank again perated substantially to sell dollars. On October 17, the S authorities also entered the market and bought $95 illion equivalent of marks. All of these U.S operations, hich totaled $280 million during the three-month period id were evenly divided between the Federal Reserve id the Treasury, were undertaken to counter disorderly ading conditions.

In response to the operations during September and ctober by various central banks, market participants ere more sensitive to the possibility that the Bundes-ink and other central banks might intervene, either dividually or concertedly. They also came to believe at the central banks on the continent would be slow let short-term interest rates in their countries ease sympathy with the declines taking place in the United ates, preferring to let a narrowing of adverse interest te differentials give some further support to their cur-ncies Also, after mid-October the decline in U.S ort-term interest rates accelerated The Federal eserve was perceived as having room to be more commodative in its monetary policy given the decline GNP growth for the third quarter, slow monetary owth for the period under review, and further evidence weak oil prices and moderate inflation Market ofessionals were therefore more reluctant to buy dollars until they could gauge the extent that a narrowing of interest differentials would come to influence exchange rate relationships. As a result, the dollar eased somewhat in late October.

During the three-month period there were no drawings on credit facilities of the U.S. monetary authorities On

Table 1

Federal Reserve Reciprocal Currency Arrangements

In millions of dollars

Institution	Amount of facility October 31, 1983	Amount of facility October 31, 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	700	700
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 currency-dollars	1,250	1,250
Total	30,100	30,100

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
August 1 through October 31, 1984	-0-	-0-
Valuation profits and losses on outstanding assets and liabilities as of October 31, 1984	−1,233 6	−802 0

Data are on a value-date basis

October 12, however, the Treasury Department announced that it had joined with the Bank of Japan and the Bank of Korea in arrangements to provide short-term financing to the Central Bank of the Philippines totaling $80 million in support of the Philippine economic adjustment program which had been agreed upon with the management of the International Monetary Fund (IMF). The Treasury, through the Exchange Stabilization Fund (ESF), agreed to provide $45 million, the Bank of Japan $30 million, and the Bank of Korea $5 million. Drawings on the arrangements were to be made available when the Managing Director of the IMF confirmed that the IMF had received assurances of the availability of adequate financing in support of the Philippine economic adjustment program and had formally submitted the Philippine request for a standby arrangement to the Executive Board of the IMF. It was understood that the drawings would be repaid at the time the Philippines draws from the fund. Shortly after the end of the period, the conditions for the disbursement of the funds were met and the financing provided.

In the period August through October, the Federal Reserve and the ESF realized no profits or losses from exchange transactions. As of October 31 cumulative bookkeeping, or valuation, losses on outstanding foreign currency balances were $1,233.6 million for the Federal Reserve and $802.0 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 dollar's appreciation 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. As of October 31, under the authority provided by the Monetary Control Act of 1980, the Federal Reserve had invested the equivalent of $1,121.3 million of its foreign currency resources in securities issued by foreign governments. In addition, the ESF held the equivalent of $1,683.6 million in such securities.