Treasury and Federal Reserve Foreign Exchange Operations*

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As noted in the previous report covering the period March-August 1964, the Federal Reserve had completely liquidated its outstanding swap drawings by the end of June while drawings made by other central banks amounted to no more than $65 million. Such diminished use of international credit facilities reflected a reduced deficit in the United States balance of payments and a general narrowing of payments imbalances throughout the world. This general movement toward international payments equilibrium suffered a setback during the second half of 1964, however, mainly owing to the eruption of the sterling crisis, heavy outflows of United States bank credit and long-term investment, and the continuation and even further tightening of the credit squeeze in continental European markets. The risk of sudden, heavy strains upon the gold exchange system had been well anticipated by the central banks and treasuries of the major industrial countries, but the severity of the pressures developing in late 1964 required a further reinforcement of intergovernmental defenses against currency speculation.

During the reporting period September 1964-February 1965, the Federal Reserve swap network was strengthened by increases in the swap arrangement with the National Bank of Belgium from $50 million to $100 million and in the arrangement with the Bank of England from $500 million to $750 million. The swap network now covers reciprocal credit lines totaling $2,350 million, as shown in Table I. The short-term credits extended to the Bank of England by the central banks of Europe, Canada, and Japan in November 1964 provided further impressive evidence of the solidarity of central bank defenses when confronted with a currency crisis. Also during the period, the authority of the International Monetary Fund (IMF) to borrow from its member countries was invoked for the first time, and much progress was made toward the scheduled 25 per cent increase in IMF quotas during 1965. This process of challenge and timely response will no doubt continue to guide the further evolution of the international financial system.

The sterling emergency necessitated sizable drawings by the Bank of England upon the Federal Reserve which more or less concurrently drew heavily upon its swap lines with the continental European central banks in order to cushion the impact of heavy dollar inflows arising from both the British and United States deficits. Bank of

Table I

FEDERAL RESERVE RECIPROCAL CURRENCY ARRANGEMENTS

March 1, 1965

Institution	Amount of total facility (in millions of dollars)	Term of arrangement (in months)
Austrian National Bank	50	12
National Bank of Belgium	100	12
Bank of Canada	250	12
Bank of England	750	12
Bank of France	100	3
German Federal Bank	250	6
Bank of Italy	250	12
Bank of Japan	150	12
Netherlands Bank	100	3
Bank of Sweden	50	12
Swiss National Bank	150	6
Bank for International Settlements	150	6
Total swap facilities	2,350	

* This is the sixth in a series of reports by the Vice President in charge of the Foreign Department of the New York Reserve Bank and Special Manager, System Open Market Account. 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.

England drawings on the Federal Reserve swap line rose to a peak of $700 million on November 27 but have subsequently been greatly reduced. To absorb part of the dollar flows to the continental European central banks, the Federal Reserve made drawings upon the swap lines with the central banks of Switzerland, Germany, Belgium, the Netherlands, and Italy and with the Bank for International Settlements (BIS). Of these drawings, $380 million remained outstanding as of the end of February 1965. Further assisting the financing of both British and United States payments imbalances, the central banks and governments of other countries provided short- and medium-term financing through accumulations of dollars, extension of credits to the United Kingdom, purchases of United States Treasury foreign currency securities, and provision of credit through the IMF.

In addition to central bank swap operations, both the Treasury and Federal Reserve also engaged in forward operations in Dutch guilders and Swiss francs in order to calm market fears and encourage an outward flow of short-term funds from Amsterdam and Zurich. The Swiss National Bank took steps to help cushion the effects of anticipated year-end pressures on the Swiss franc. The German Federal Bank also made available swap facilities to German commercial banks for investments in United States Treasury bills in order to reduce or offset temporary pressures on the exchange market resulting from short-term capital flows. Similarly, extensive use of forward operations was made by the Bank of England in December 1964 to reassure the market and relieve pressure on the spot rate.

The foreign currency bonds issued by the United States Treasury rose from a total of $1,035 million outstanding as of the end of August 1964 to $1,137 million as of early March 1965 (see Table II). Additional issues of $50 million were made to the German Federal Bank and $50 million to the National Bank of Austria to absorb surplus dollars on the books of these central banks.

While these central bank and intergovernmental credit operations provided partial and temporary financing of the payments imbalances developing during the period, gold continued to play its traditional role. During the third and fourth quarters of 1964, sales of gold by the United States Treasury amounted to $442 million, against gold purchases of $338 million.

The international financial system was thus confronted with a major challenge in late 1964 which was successfully countered. The unprecedented mobilization of $4 billion of international liquidity in defense of sterling was a striking illustration of the strength and flexibility of the central bank and IMF defenses against currency crises.

Table II

UNITED STATES TREASURY BONDS DENOMINATED IN FOREIGN CURRENCIES

March 3, 1965

Issued to	Amount (in millions)	
	Foreign currency	United States dollar equivalent
Austrian National Bank	2,600 Austrian schillings	100.6
National Bank of Belgium	1,500 Belgian francs	30.1
German Federal Bank	2,700 German marks	679.0
Swiss National Bank	1,112 Swiss francs	257.5
Bank for International Settlements	300 Swiss francs	69.5
Total		1,136.7

Perhaps even more remarkable is the fact that the international defense of sterling was accomplished in the face of a serious deterioration in the balance of payments of the other major reserve currency center, the United States. Such a rallying of governmental and central bank support for the present system depended, however, upon one basic assumption: that both the British and the United States Governments would quickly put in motion forceful corrective programs to eliminate their payments deficits. These corrective programs are now under way and, if pursued with determination, will soon relieve the international financial mechanism of the enormous pressures generated by simultaneous deficits in the two major reserve currency countries. Under such conditions, the gold exchange standard, adapting as it has in the past to changing world conditions, can efficiently facilitate a continuing growth of world trade and payments.

The successful response to the challenge of the sterling crisis has unfortunately been marred by the widespread and exaggerated publicity given to the French Government's call for the return to the gold standard and the elimination of dollars and sterling from official reserves. This approach has found no support among central banks and treasuries of other countries. The main effect has been to stir up some previously dormant private speculation in the London gold market, to the detriment of official acquisitions of newly mined gold.

STERLING

Early in 1964 sterling showed weakening tendencies as a result of the deteriorating trade position of the United Kingdom and various uncertainties connected with the general election to be called sometime during the year. A timely increase of the Bank of England discount rate from 4 per cent to 5 per cent in late February temporarily relieved market pressures, while delay of the general election until October induced some short covering by commercial interests.

Late in May, however, tight conditions in several Continental money markets exerted new pressure on sterling. These pressures became strong toward the end of June because of heavier-than-usual midyear window dressing by Continental banks. To temper the impact of these movements of funds on official reserves, the Bank of England on June 30 drew $15 million against its $500 million swap line with the Federal Reserve; it repaid the drawing on July 13.

As the credit squeeze in the Continental money market centers extended into July, moderate selling of sterling continued, and the spot rate moved downward with a minimum of official support to a low for the month of $2.7874 on July 20. The decline in the spot rate was taken in stride by the market without any speculative reaction developing. Indeed, market confidence in the sterling parity at that time was such that the discount on forward sterling tended to narrow as the spot rate declined.

As the discount on forward sterling was reduced, the covered interest-arbitrage differential on Treasury bills in favor of London became correspondingly more attractive and by July 13 had reached 0.44 per cent per annum. To forestall private covered outflows in response to this arbitrage inducement, the Federal Reserve, with the agreement of the Bank of England, intervened in the market to reduce the arbitrage differential. This intervention, amounting to a total of $54 million equivalent in mid-July and again in late August, was accomplished by swap transactions in the New York market, with the Federal Reserve buying sterling spot and selling sterling forward against United States dollars. These operations had the dual effect of protecting the dollar against short-term flows of funds from New York to London while at the same time lending useful support to the spot rate on sterling.

In September, sterling came under increased pressure, mainly owing to increasingly widespread recognition of the mounting balance-of-payments deficit of the United Kingdom, which became further aggravated by the usual seasonal weakness during the autumn and early winter months. Uncertainties connected with the general election called for October 15 further unsettled the sterling exchange market, and the problem of maintaining confidence in sterling seemed likely to become increasingly difficult. In anticipation of reserve losses, the Bank of England in mid-September made timely arrangements to supplement the $500 million swap line with the Federal Reserve by another $500 million of short-term credit facilities with other central banks in Europe and with the Bank of Canada. This reinforcement of the British reserve position cushioned the impact of recurrent, and increasingly forceful, waves of selling during September and October. Net drawings by the Bank of England on the Federal Reserve swap line and on short-term facilities provided by other central banks rose to $415 million by the end of October.

The new Labor Government elected on October 15 was thus immediately confronted with a grave balance-of-payments situation. The announcement on October 26 of emergency surcharges of 15 per cent on a wide range of imports brought only brief relief as critical reactions appeared among Britain's trading partners world wide, more particularly the European Free Trade Association (EFTA) group. In a formal budget presented to Parliament on November 11, the government proposed certain new welfare benefits, to be financed by tax increases, and announced that it intended to introduce a capital gains tax and to substitute a new corporation tax for the existing application of the income tax to corporations. These proposals created uncertainty in business circles, in part because the immediate deflationary influence of the increased tax on fuel as well as the import surcharge was to some extent obscured by the other measures. These uncertainties in domestic financial markets were, in turn, communicated to the exchange market. During this period, the exchange market began to anticipate bank rate action on each successive Thursday, and thus a pattern developed of a strengthening of sterling prior to Thursday of each week, followed by a major selling wave on Friday as the bank rate remained unchanged. When the bank rate remained unchanged on Thursday, November 19, reserve losses by the Bank of England on the following day reached such proportions that action could no longer be postponed. On Monday, November 23, the Bank of England raised its discount rate from 5 per cent to 7 per cent.

Perversely enough, market reaction to such forceful use of monetary policy by the Labor Government quickly degenerated into fears that the threat to sterling must have reached a truly crisis stage. Whether these reactions might have been averted by earlier bank rate action, more particularly on the usual Thursday date for bank rate announcements, may be debated for some time to come. In any event, the market seized on rumors that the $1 billion of short-term central bank credits at the disposal of the Bank of England in September had now been exhausted; that the $1 billion standby credit from the IMF secured by the British Government in August had accordingly been fully committed to repayment of such central bank credits; and, hence, that the United Kingdom would have to fall back in defense of sterling upon its reserves of roughly $2 billion. (The still-substantial unused drawing rights on the IMF would have required longer to mobilize than events at that time allowed.)

This situation assumed increasingly grave significance on the London afternoon—and the New York morning—of November 24 when a virtual avalanche of selling developed. If sterling were to be rescued, it was clear that a major package of international credit assistance would be required. On the afternoon of the 24th, the Federal Open Market Committee—meeting through a telephone conference—committed itself to an increase in the Federal Reserve-Bank of England swap line from $500 million to $750 million if credit assistance on a roughly corresponding scale could be secured from other central banks. That evening the Export-Import Bank gave assurance of a $250 million standby facility. Beginning early on the morning of November 25, the Bank of England, the Federal Reserve Bank of New York, and the central banks of other major countries were in almost continuous telephone communication. At 2 p.m., New York time, it was announced that a $3 billion credit package provided by eleven countries and the BIS was at the disposal of the Bank of England.

As a result of the heavy reserve losses, the $500 million Federal Reserve swap and the additional $500 million of other central bank credit facilities made available to the Bank of England in September were not only fully exhausted, but immediate drawings of $200 million on the new credit facilities were also required. From the end-of-October figure of $415 million, recourse by the Bank of England to central bank credit facilities thus rose by $785 million during November to a total of $1.2 billion. Of this total, the Federal Reserve share was $675 million.

In early December the British Government drew the full amount of its $1 billion standby facility with the IMF and so repaid an equivalent amount of the central bank credits outstanding, including $500 million of the Federal Reserve credit. At the same time, Switzerland, which, although not a member of the IMF, is associated with the General Arrangements to Borrow, provided the United Kingdom with a three-year credit of $80 million; $50 million of the Swiss credit was used to repay an earlier loan from Switzerland, outstanding from the sterling crisis of 1961.

With its exchange reserves thus heavily reinforced, the British Government could face with confidence further temporary pressures on sterling during December. Selling was particularly heavy just prior to the long Christmas week end, and during the month the Bank of England increased its use of short-term central bank credit facilities from the $200 million outstanding early in December to $525 million at the year end. Of this $325 million increase, $25 million was secured by an increased use of the Federal Reserve swap line, raising the total outstanding from $175 million to $200 million, while $300 million was drawn from other central banks.

Beginning in late November heavy selling of sterling appeared in the forward market, mainly by commercial interests insuring their future exchange transactions. This selling threatened to move the forward sterling rate to an excessive discount and hence intensify sales of sterling in the spot market. Accordingly, the Bank of England gave firm support to the forward rate. This support not only served to lessen the drain on reserves from spot transactions at the time, but more generally helped to buttress confidence in sterling by providing official reassurance that the sterling parity would be maintained. The operation was comparable to the determined stand taken in the forward market by other central banks in recent years and promised to achieve the same useful results.

After the turn of the year, both the spot and forward markets for sterling returned to a more balanced position. Since then, sterling has shown an increasingly buoyant trend. On February 10 it was announced that those of the central bank credit facilities made available last November which were shortly due to expire would be replaced by new facilities, available to the end of May, thus reconstituting the entire $3 billion credit package. By the end of February the Bank of England was able to start repaying these debts.

In addition to direct swap transactions with the Bank of England, the Federal Reserve Bank of New York also moved into the market at various times during the autumn months to purchase sterling for both System and Treasury account. These acquisitions were made on both an outright and a swap basis; the particular technique used was determined by market conditions at the time, in consultation with the Bank of England.

SWISS FRANC

At the beginning of 1964, Federal Reserve swap drawings of Swiss francs under the swap lines of $150 million equivalent with both the Swiss National Bank and the BIS amounted to $220 million equivalent. By the end of June, these drawings had been completely liquidated through gold sales of $30 million to the Swiss National Bank, purchase from the Bank of Italy of the Swiss franc proceeds of a $100 million equivalent lira-Swiss franc swap, issuance by the United States Treasury of a $70 million equivalent Swiss franc bond to the BIS, and purchases of Swiss francs from the Swiss National Bank. United States Treasury market commitments in forward Swiss francs were reduced during the course of the year from $121 million to $51.5 million. At the outset of 1964, the United States Treasury and the Federal Reserve also had outstanding a combined total of $53 million in swaps of third currencies into Swiss francs. These contracts had been reduced to $15 million by the end of February 1965.

Despite the progress thus made in liquidating Treasury and Federal Reserve commitments in Swiss francs incurred in late 1963, new problems arose when sizable short-term funds—mainly repatriated Swiss assets—again flowed into Switzerland, both at midyear and particularly toward the close of the year as the pound sterling came under pressure. During the spring of 1964, interest rates in Switzerland continued to rise as the heavy demands imposed on the Swiss money and capital markets by the continuing high level of economic activity further squeezed the liquidity position of Swiss banks and firms. The interest rate on three-month deposits reached 3.50 per cent in June, an increase of about 0.75 per cent per annum over the previous year, while the average yield on government bonds moved up to 4.05 per cent, compared with 3.15 per cent a year earlier. To relieve the squeeze on their liquidity positions, and to satisfy midyear window-dressing needs, the Swiss commercial banks made sizable repatriations of funds during June.

These commercial bank operations caused the Swiss National Bank once again to take in substantial amounts of dollars. In July the reversing of some window-dressing operations and an easing of the Swiss money market brought about only a partial reversal of the previous inflows. In these circumstances the United States Treasury issued to the Swiss National Bank on August 4 an additional Swiss franc bond in the amount of $52 million equivalent and used the proceeds to absorb an equivalent amount of dollars on the books of the Swiss National Bank. (This issue brought the outstanding amount of United States Treasury securities denominated in Swiss francs to $327 million equivalent.)

Generally easier conditions prevailed in the market for Swiss francs from mid-August to mid-October, and the Swiss franc declined from its ceiling for a while, only to firm again in late October as the Swiss money market tightened. Then in the early part of November, funds began to move into Switzerland in quantity—some directly out of sterling, some through the Euro-currency markets in response to the general uneasiness that pervaded the exchanges. Throughout the rest of the year, sizable increases occurred in the dollar holdings of the Swiss National Bank.

To absorb part of this intake of dollars, the Federal Reserve reactivated its $150 million swap with the BIS in early December by drawing $100 million of Swiss francs, which was simultaneously employed to purchase dollars from the Swiss National Bank. A further Swiss franc drawing of $60 million equivalent on the Swiss National Bank was made on January 19 for the same purpose. In addition, to calm the market and to encourage Swiss banks to invest abroad dollars that they might otherwise have sold to the Swiss National Bank, the Federal Reserve began in December to sell Swiss francs forward to the market through the Swiss National Bank. By January 8, 1965, such forward sales reached a peak of $32.5 million equivalent. Most of these contracts had been paid off by the end of February through spot purchases of Swiss francs. (The Swiss franc began to ease shortly after the year end as Swiss banks, finding themselves liquid, started to place funds abroad.) During the second half of 1964, the dollar acquisitions of the Swiss National Bank were further reduced by purchases of $51 million of gold from the United States Treasury.

NETHERLANDS GUILDER

At the beginning of 1964, Federal Reserve commitments in guilders amounted to $80 million equivalent, all in the form of outstanding swap drawings. These were fully repaid by early April, as earlier inflows of funds into the Netherlands were reversed.

In May the Dutch money market began to tighten, and in early June the Netherlands Bank raised its discount rate from 4 per cent to 4½ per cent. In July Dutch commercial banks began to repatriate funds in substantial amounts. Moreover, the Netherlands balance of payments strengthened, owing to a better trade balance and an inflow of long-term capital. By November the intensified pressures on sterling and the ensuing movement of some funds out of sterling and into guilders helped push the guilder to its ceiling.

Meanwhile, the Netherlands Bank had been taking in dollars in an effort to moderate the rise in the guilder rate. During the first week of August the Federal Reserve drew $20 million equivalent of guilders under the swap line and immediately used the guilders to absorb some of the Netherlands Bank's accruals of dollars. Further Federal Reserve drawings and sales of guilders followed in rapid sequence, and by mid-October the $100 million swap facility had been fully drawn. Additional dollars were purchased by the Federal Reserve and the United States Treasury from the Netherlands Bank in September and

December with guilders acquired through three-month swaps of sterling for guilders with the BIS, for a total of \$50 million equivalent. As intensified buying pressures on the guilder developed in late December, a temporary swap arrangement for \$35 million between the Netherlands Bank and the United States Treasury was agreed upon and fully employed.

In mid-December recourse was also had to forward operations in Dutch guilders for both Federal Reserve and Treasury account in order to provide reassurance to the market and induce covered capital outflows from the Netherlands. These operations, together with Dutch provision of dollar credits to the Bank of England and purchases of gold from the United States Treasury, reduced the dollar holdings of the Netherlands Bank sufficiently to permit complete liquidation of the Treasury-Netherlands Bank \$35 million swap by early January and repayment of \$30 million of the Federal Reserve swap drawings in early February. As of the end of February, Federal Reserve drawings upon the swap line with the Netherlands Bank had thus been reduced to \$70 million equivalent. During the second half of 1964, gold purchases by the Netherlands Bank from the United States Treasury amounted to \$60 million.

GERMAN MARK

During 1963 and early 1964, there had been almost continuous upward pressure on the German mark. This pressure reflected a substantial increase in the German foreign trade surplus, large inflows of long-term capital, and occasional inflows of short-term funds in response to tight money market conditions or hedging operations. To ease the strain, the German Federal Bank, the Federal Reserve, and the United States Treasury jointly conducted various spot and forward exchange operations, as outlined in previous reports in this series.

On March 23, 1964, an important turning point occurred, as the German Government announced its intention to propose to Parliament the imposition of a 25 per cent withholding tax on income from German fixed-interest securities held by nonresidents. This action not only checked the long-term capital inflow, but also actually induced liquidation of a considerable volume of foreign investments in fixed-interest securities. Earlier surpluses on trade account also diminished as the year progressed and helped to restore a stable equilibrium in the exchange markets.

The effect on the exchange market of these basic shifts in the German balance of payments was reinforced by a number of technical measures initiated by the German authorities to reduce temporary pressures on the exchange market resulting from short-term capital flows. The special swap facilities made available by the German Federal Bank to German commercial banks for investments in United States Treasury bills were used flexibly throughout the second half of the year, with maturities providing the banks with liquidity at the year end. In addition, under a special temporary arrangement in December, German commercial banks were permitted to borrow against collateral from the central bank at an effective cost lower than the posted rate. Nevertheless, the sterling crisis led to some inflow of funds to Germany in late December. Consequently, the Federal Reserve reactivated its \$250 million swap facility with the German Federal Bank by drawing \$50 million equivalent of marks in order to absorb \$50 million of German dollar reserves. This drawing was reversed in late January 1965, as short-term outflows from Germany combined with German military purchases in the United States enabled the Federal Reserve to acquire \$50 million of marks from the German Federal Bank. Another small drawing of \$15 million equivalent was made by the Federal Reserve on February 4 to help control any speculative tendencies resulting from President de Gaulle's press conference on the same date.

During the six-month period through February, the United States Treasury issued to the German Federal Bank in October 1964 a \$50 million equivalent mark-denominated bond. This latest issue raised the total of such mark bonds outstanding to \$679 million equivalent. The mark proceeds of this bond, together with \$7 million of Treasury mark balances remaining from United States drawings of marks from the IMF, were sold to Canada to enable that country to make an IMF repayment. Subsequently, in early December when the United States Treasury drew \$125 million equivalent of marks from the IMF, it used \$50 million equivalent to purchase excess dollars from the German Federal Bank, in effect compensating for the fact that marks derived from the earlier bond issue had been used in conjunction with Canada's repayment to the IMF.

ITALIAN LIRA

Italy's balance-of-payments deficit had assumed major proportions in the fall of 1963, and the Federal Reserve and United States Treasury joined forces with the Bank of Italy in defense of the lira. As outlined in the previous report, Federal Reserve and Treasury operations in the autumn of 1963 and the first quarter of 1964 cushioned the decline in the Bank of Italy's reserves to the extent of some \$350 million and thereby helped to restrain speculative pressures against the lira.

During the week of March 9 through March 14, 1964, an Italian delegation headed by Governor Carli of the Bank of Italy visited Washington to discuss with the World Bank and the IMF various possible sources of financing for Italy's longer term investment requirements and its expected further balance-of-payments deficits. In the midst of these discussions, the lira was suddenly struck by a burst of speculation. This brought heavy pressures not only on the spot rate but also on the forward rate, which for a three-month maturity moved to a discount of 7 per cent per annum. In this dangerous situation, an immediate and massive reinforcement of the Italian reserve position was clearly called for. Within forty-eight hours the Italian authorities were able to announce that they had arranged for approximately $1 billion of external assistance provided by the United States, the Bank of England, and the German Federal Bank.

One of the most satisfactory aspects of this display of international cooperation in beating back a speculative attack on the Italian lira was that the provision of massive credit assistance to Italy more or less coincided with a turning point in the Italian economic and financial scene. During the first quarter of 1964 the Italian balance of payments had registered a deficit of $436 million. A surplus of $226 million was recorded in the second quarter, as corrective policy measures initiated by the Italian authorities began to take effect and as a reversal in the leads and lags in payments brought about the covering of short positions in lire. In early July, a governmental crisis generated a temporary speculative flurry, but forceful operations in the forward market by the Bank of Italy through the agency of the Federal Reserve Bank of New York provided reassurance, and the speculation quickly subsided.

Italy continued to run a payments surplus during the third and fourth quarters of 1964, and by the year end Italian official reserves, which had dipped $233 million during the first quarter, were $389 million higher than at the outset of 1964. The reappearance of political uncertainties in the late summer triggered some selling of forward lire, and discounts for three-month maturities tended to widen at times to 4 per cent per annum. In such instances, the Federal Reserve Bank of New York again intervened for account of the Bank of Italy to support the forward lira in the New York market and thus helped to relieve market uncertainties. By early October the discount on the three-month forward lira had narrowed to less than 1 per cent per annum.

Continuing heavy flows of dollars to Italy in the closing months of 1964 and early 1965 may have partially reflected the sterling crisis. To absorb part of these dollar inflows, the Federal Reserve on January 22 reactivated its $250 million swap arrangement with the Bank of Italy by drawing $50 million equivalent of lire.

CANADIAN DOLLAR

The spot market for Canadian dollars was relatively quiet through the first half of 1964, but there was considerable activity in the forward market as a result of grain sales to the Soviet Union beginning in the previous autumn. These sales generated heavy demands on the part of grain dealers for Canadian dollars for future delivery against United States dollars. In order to offset some of these pressures, the Bank of Canada sold United States dollars spot and purchased them forward, thus providing some counterpart to the commercial banks' swap needs, while the Federal Reserve also intervened on a small scale. By the end of July, Canadian grain shipments to the Soviet Union had been fairly well completed, and pressures on the forward market eased.

In August, heightening tensions in Vietnam generated some buying of spot Canadian dollars by Continental interests and, as the spot rate rose in a thin market, Canadian exporters began to sell out United States dollar balances. New grain purchases by several Eastern European countries exerted further upward pressure on the spot rate. At about the same time there was a tightening of the Canadian money market, which induced a temporary flow of short-term funds into Canada from the United States on a covered basis.

Substantial Canadian long-term borrowings in the United States market, the sterling crisis, and fiscal-year-end positioning by Canadian banks in October and November pushed the spot rate for the Canadian dollar to its effective ceiling by November. As the Canadian dollar strengthened, the Bank of Canada intervened to moderate the rise in the rate, with the result that Canadian reserves increased by $210 million during the August-November period despite repayments of $107 million to the IMF in September and October. By December the market had returned to a more balanced position.

In early February the Canadian dollar softened, as press discussion of prospective United States balance-of-payments measures lead to some apprehension in the markets that Canada might be unfavorably affected. The United States balance-of-payments program, announced on February 10, made it clear that there was no United States intention to deprive the Canadian economy of essential inflows of capital. Nevertheless, the Canadian dollar weakened somewhat further in the second half of the month, reportedly reflecting Canadian commercial buying of United States dollars and unfavorable seasonal factors.

BELGIAN FRANC

Early in July 1964 the Belgian franc strengthened, following the announcement of new measures designed to curb the growth of credit in Belgium. On July 3 the National Bank of Belgium raised its discount rate by ½ percentage point to 4¾ per cent and announced that, effective August 17, it would impose a cash reserve requirement against commercial bank deposits for the first time. Tighter money market conditions developed, and, in conjunction with long-term investment in Belgium, an improved trade balance beginning in the third quarter and the sterling crisis later in the year contributed to substantial dollar inflows into Belgium.

Early in August, the Federal Reserve used $7.5 million equivalent of Belgian francs drawn under the $50 million swap arrangement to absorb dollars on the books of the National Bank of Belgium. By mid-October the entire $50 million equivalent of franc balances had been so utilized. Effective October 22 the Federal Reserve and the National Bank of Belgium expanded the existing $50 million swap facility with an additional $50 million arrangement to be available on a standby basis. As dollars continued to flow into Belgium, the Federal Reserve made further drawings on this additional swap and by the end of November had used the full amount.

The Federal Reserve was able to reduce its swap commitments to Belgium to $25 million equivalent in early December, when the National Bank of Belgium purchased $75 million from the Federal Reserve to make special outpayments. On December 30, however, the Federal Reserve again drew $20 million equivalent of francs in order to absorb further inflows of dollars into Belgium, and further utilization of $40 million equivalent under the swap arrangement became necessary in January and February 1965. As of the end of February, total Federal Reserve use of the $100 million swap arrangement with the National Bank of Belgium amounted to $85 million equivalent. Meanwhile, during the second half of 1964, the National Bank of Belgium had purchased $40 million of gold from the United States.

OTHER CURRENCIES

JAPANESE YEN. On April 30, the Bank of Japan drew $50 million under the $150 million swap arrangement with the Federal Reserve in order to cushion a decline in Japanese reserves. This drawing was renewed on July 30, as reserve pressures continued, and a further drawing of $30 million was made on July 31. In August, however, domestic restraint measures began to take effect: import demand diminished and, with a continued growth in exports, the trade balance improved considerably. With this improvement in Japan's balance-of-payments and reserve position, the Bank of Japan began repaying its swap obligations at the end of September and, by early November, had liquidated them in full.

AUSTRIAN SCHILLING. There were no System operations in Austrian schillings during the period. Although the Austrian balance of payments registered a considerable deficit in the last quarter of 1964, the figures for 1964 as a whole continued to show a surplus. Therefore, on February 23 and March 3, 1965, the Treasury issued to the Austrian National Bank two $25 million equivalent eighteen-month bonds denominated in Austrian schillings, using the proceeds to absorb some of that bank's dollar holdings. These issues brought the outstanding total of United States Treasury Austrian schilling-denominated bonds to $100 million equivalent.

SWEDISH KRONA AND FRENCH FRANC. There were no Federal Reserve or Treasury operations in Swedish kronor or French francs during the period under review.

UNITED STATES DRAWING ON THE INTERNATIONAL MONETARY FUND

Over the course of several years before 1964, foreign countries had been repaying more dollars to the IMF than the IMF had been paying out in new drawings. As a result, the IMF's dollar holdings rose to a point where they equaled the amount that the United States had paid into the IMF as part of its quota. At this point the IMF, under its rules, could no longer accept dollars in repurchase, and countries having repurchase obligations could make repayments only with gold or with other eligible convertible currencies. So as to be able to sell such currencies to countries having repurchase obligations, the United States Treasury on February 13 and June 1 made two drawings on the IMF—predominantly in German marks and French francs—in the amount of $125 million equivalent each under the $500 million standby agreement with the IMF announced by President Kennedy in July 1963. By September 1, the bulk of these currencies had been sold to various countries effecting repayments to the IMF.

On July 23, 1964, the original standby arrangement expired, and the Treasury announced that it had made a further standby arrangement with the IMF for another year. This restored the amount available to $500 million. The first drawing under the new standby arrangement was made on September 1, when the United States drew $50 million in five European currencies. Unlike the first two drawings under the original arrangement, which were used to cover a number of transactions that took place during ensuing weeks, this drawing was occasioned by Italy's repurchase of $65 million equivalent of lire from the IMF. Again, on September 30, the United States Treasury drew equal amounts of Dutch guilders and German marks totaling $100 million equivalent, half of which was immediately sold to Canada in connection with a repayment to the IMF. The remaining balances were disbursed in subsequent weeks. On December 7 a third drawing of $125 million equivalent was made, this time solely in German marks.

Since this program was initiated, the United States Treasury has drawn $525 million equivalent of seven continental European currencies, of which some $15 million equivalent remained undisbursed as of the end of February 1965. The effect of these drawings on the United States position in the IMF has been offset to a considerable extent, however, by drawings of dollars by other countries. The largest single dollar drawing was $200 million, under the $1 billion equivalent multicurrency drawing in December by the United Kingdom. As a result, the United States repayment obligation to the IMF as of the end of February 1965 had been reduced to $256 million.

THE GOLD MARKET AND UNITED STATES GOLD TRANSACTIONS

Throughout the first eight months of 1964 the London gold market was generally stable, with the gold-fixing price ranging between $35.06 and $35.10. With the improvement in the United States balance of payments, and consequent strengthening of confidence in the dollar, speculative demand for gold receded and, as new production also increased, the Gold Pool regularly absorbed surpluses of output reaching the market. The Pool took in further sizable amounts of gold from Russian sales which were heavily concentrated over a few weeks' span in late March and early April.

Over the closing months of 1964, various political and financial disturbances tended to rekindle speculative buying of gold. International tensions arising out of the Vietnam conflict have continued to generate market apprehension. But renewed speculation in the gold market was also attributable to the increasing pressures on sterling during the latter part of the year. In addition, the sharp deterioration in the United States balance of payments during the closing months of 1964 contributed to market uncertainties, especially after the turn of the year. In February, various pronouncements emanating from Paris further stimulated speculative buying of gold by private interests. Both the United Kingdom and the United States have now taken forceful action to deal with their balance-of-payments deficits, and if these corrective programs are vigorously pursued, speculative pressures in the gold market may be expected to subside.

The Bank of England, on behalf of the Gold Pool, continued to exert a stabilizing influence on the market and to moderate price movements. Although private demand for gold increased during the closing months of 1964, over the year as a whole the Pool once again acquired and distributed to its members more than $600 million.

During the fourth quarter of 1964, Continental central banks took in sizable amounts of dollars and several sold part of their acquisitions to the United States Treasury for gold. These conversions, as well as the continued French monthly gold purchases, more than offset United States acquisitions from other sources. As a result, the United States became a net seller of gold in its international monetary transactions after having been a net purchaser earlier in the year (see Table III). For 1964 as a whole, taking into account sales of about $89 million to domestic users, total United States gold holdings—including Stabilization Fund holdings as well as the Treasury gold stock—declined by $125 million. During the first two months of 1965, the Treasury gold stock declined by an additional $450 million.

Table III

UNITED STATES NET MONETARY GOLD TRANSACTIONS WITH FOREIGN COUNTRIES AND INTERNATIONAL INSTITUTIONS

July-December 1964

In millions of dollars at $35 per fine troy ounce; United States net sales(—), net purchases(+)

Country	Third quarter	Fourth quarter
Belgium	—	− 40.1
Brazil	− 1.1	+ 28.2
France	− 101.4	− 101.4
Germany	− 25.0	—
Netherlands	—	− 60.0
Spain	—	− 30.0
Switzerland	—	− 51.0
Turkey	—	− 12.5
United Kingdom	+ 162.5	+ 125.0
All other	+ 6.0	− 2.8
Net sales or purchases	+ 41.0	− 144.6