Treasury and Federal Reserve Foreign Exchange Operations Interim Report*

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After an unprecedented rush into foreign currencies on March 1, all major exchange markets were officially closed and a series of emergency meetings was called to resolve the crisis. On March 11, six of the members of the European Community (EC) and, later, Norway and Sweden agreed to maintain fixed exchange rate relationships among themselves within a 2¼ percent band, which would be permitted to float as a bloc against the dollar. In conjunction with the decision to establish a fixed-rate bloc, the German authorities revalued the mark by 3 percent. In addition, to guard against large new inflows of funds, most countries participating in the joint float tightened and extended their existing exchange controls. The Japanese yen, Swiss franc, sterling, and the Italian lira each continued to float independently.

The markets were officially reopened on March 19 and, after a brief burst of trading as the backlog of commercial orders was cleared away, activity thinned as dealers paused to assess the radically altered market trading arrangements. Through the first week in May, the dollar improved hesitantly as earlier adverse leads and lags were partially reversed. The February devaluation and subsequent flight from the dollar had been a shattering blow to confidence, however, and there was no large sustained covering of short dollar positions or reflow of funds. Despite an improving trend in the United States balance of payments and the frequently voiced view that the dollar was, if anything, now undervalued, the market became increasingly concerned over the worsening United States inflation, forecasts of vastly higher energy imports, and possible ramifications of the Watergate affair. Consequently, the tendency to shift out of dollars continued.

In early May, the dollar began to depreciate once more against most of the European currencies. By midmonth a new speculative attack had broken out in which soaring gold prices, sliding United States equity prices, and a weakening dollar interacted to reinforce each other. Movements in exchange rates were abnormally large and erratic, with spot rates fluctuating as much as 2 percent during a single day. The German mark advanced the most sharply in response to progressive tightening of Germany's anti-inflationary fiscal and monetary policies. After moving from the bottom to the top of the European band, the mark began by early June to exert upward pressure on the entire band.

The dollar was driven down in sporadic bouts of nervous and, at times, heavy trading to levels unjustified and undesirable on any reasonable assessment of the longer run outlook for the United States payments position. By June 28, the dollar had dropped 16½ percent against the mark, some 8 to 13 percent against most other Continental currencies, and the gold price in London had shot up

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FEDERAL RESERVE SYSTEM DRAWINGS AND REPAYMENTS UNDER RECIPROCAL CURRENCY ARRANGEMENTS

In millions of dollars equivalent

Transactions with	System swap drawings outstanding on March 9, 1973	Subsequent drawings (+) or repayments (—) through May 31, 1973	System swap drawings outstanding on May 31, 1973
National Bank of Belgium	390	—0—	390
Swiss National Bank	565	—0—	565
Bank for International Settlements (Swiss francs)	600	—0—	600
Total	1,555	—0—	1,555

from $90 to a peak of $127. The dollar also weakened against sterling and the Italian lira, though by much smaller amounts. Sterling advanced along with Continental currencies in May but, as British interest rates eased, held steady during most of June. The Italian lira, which fluctuated widely in response to domestic political developments, was advancing by the end of June. Dollar rates for the currencies of Japan and Canada, two of the United States major trading partners, in contrast, were little affected by developments elsewhere in the exchanges and at the end of June were still at last March levels. Indeed, the Japanese authorities sold considerable amounts of dollars to prevent a depreciation of the yen.

During the three months to the end of May, there were no Federal Reserve operations in the exchange markets. Debt outstanding under swap lines remained unchanged at $1,555 million (see table). There were no Treasury exchange market operations in this period, apart from small purchases of foreign exchange to meet scheduled expenditures.