Treasury and Federal Reserve Foreign Exchange Operations Interim Report*

By CHARLES A. COOMBS

As related in the previous *Report,* on July 10 the Federal Reserve resumed intervention in the exchange markets and by the end of July had sold a total of $273 million equivalent of foreign currencies—$220 million of German marks, $47 million of French francs, and $6 million of Belgian francs. These operations were financed by drawings under the swap arrangements with the respective central banks. Over the first two weeks of August the dollar strengthened, as a liquidity squeeze in Germany eased, interest rates in New York rose, and the market responded to favorable United States trade figures for June. With this shift in the international flow of funds, the Federal Reserve readily acquired through the market the foreign currencies needed to repay the entire $273 million equivalent of swap drawings incurred in July. The only intervention by the Federal Reserve during early August was the sale of $4.2 million of marks, using existing balances, when the dollar had a temporary setback on August 7.

The dollar's rise stalled in mid-August, when market worries over price trends and political uncertainties in the United States surfaced once again. As more bad news generated new selling pressure on the dollar on August 20-21, the Federal Reserve reentered the market as a seller of German marks in order to maintain an orderly market and moderate any serious erosion of dollar rates. Over these two days and again briefly later in the month, the System sold a total of $54.5 million equivalent of marks drawn under the swap line with the Bundesbank, while the German central bank made modest purchases of dollars in Frankfurt. The dollar then firmed, and the Federal Reserve was able to repurchase in the market the German marks needed to liquidate the swap drawings on the Bundesbank.

By late August and early September, trading conditions had become more orderly, with much narrower fluctuations in rates from day to day as well as during trading sessions. In this atmosphere of greater stability the market showed much improved resilience in absorbing the shocks of adverse political and economic news here and abroad. During this period the Federal Reserve stood ready to intervene on a number of occasions, but operations were required only once. On September 6, just ahead of official announcement of the August wholesale price figures, the dollar came under some pressure and the Federal Reserve sold $8.2 million equivalent of marks, of

FEDERAL RESERVE SYSTEM DRAWINGS AND REPAYMENTS UNDER RECIPROCAL CURRENCY ARRANGEMENTS

In millions of dollars equivalent

Transactions with	System swap commitments, July 31, 1973	Drawings(+) or repayments(—) August 1 through October 31	System swap commitments, October 31, 1973
National Bank of Belgium	396.0	—123.8	272.2
Bank of France	47.0	— 47.0	-0-
German Federal Bank	220.5	{+236.1 —456.6	-0-
Netherlands Bank	-0-	± 2.9	-0-
Swiss National Bank	565.0	-0-	565.0
Bank for International Settlements (Swiss francs)	600.0	-0-	600.0
Total	1,828.4	{+238.9 —630.2	1,437.2

Note: Discrepancies in totals are due to rounding.

* This interim report, covering the period August through October 1973, is the second of a series providing information on Treasury and System foreign exchange operations to supplement the regular series of semiannual reports appearing in this *Review*. Mr. Coombs is the Senior Vice President in charge of the Foreign function of the Federal Reserve Bank of New York and Special Manager, System Open Market Account. The Bank acts as agent for both the Treasury and the Federal Reserve System in the conduct of foreign exchange operations.

which $3.9 million was drawn under the swap line. The dollar then quickly rebounded, and the System was able to repurchase the marks needed to repay this swap commitment.

On September 15, the Netherlands revalued the guilder by 5 percent against other European Community (EC) currencies in the fixed-rate bloc. This move came as a surprise to the markets, and speculation soon developed over possible revaluations or devaluations of other EC currencies. Consequently, there were heavy flows into the German mark and Belgian franc and out of the French franc, leading to substantial intervention by the central banks involved in the EC "snake". Such speculation in the European currency exchanges soon spilled over into the dollar market. As the dollar began to drop, the Federal Reserve again stepped in, in coordination with the Bundesbank, to moderate the decline of the dollar-mark rate. At the same time, the Belgian and French authorities took monetary and exchange control measures to curb the pressures on the EC band. This firm official response effectively broke the speculative wave and, as dollar rates bottomed out and began to rise, the Federal Reserve continued to intervene to help along the recovery. In this sequence of operations, between September 17 and 26 the Federal Reserve sold $156.7 million equivalent of German marks drawn under the swap line, while the Bundesbank intervened in Frankfurt by buying nearly $140 million.

The exchange markets again turned quiet through late September and early October. Underlying trade and investment flows tended to buoy the dollar and, as the dollar firmed, the Federal Reserve was able to purchase sufficient marks to repay $86.1 million of the outstanding swap debt to the Bundesbank. The improvement in the dollar was again interrupted, however, as short-term interest rates in this country fell sharply, political uncertainties heightened, and war broke out in the Mideast. On October 10, when the news of Vice President Agnew's resignation hit the markets in the early afternoon, selling pressure on the dollar intensified. At this point, the Federal Reserve again intervened with an unusually heavy offering of marks, of which $21 million equivalent was sold. These sales were financed by a further drawing under the swap line with the Bundesbank, bringing the outstanding swap debt to $91.5 million equivalent. The dollar then steadied, and no further intervention in marks was required through the month end.

During October, the Dutch guilder moved to the top of the EC band. The guilder's rise stemmed mainly from a liquidity squeeze in Amsterdam, but revaluation rumors began to circulate once again. In conjunction with the Netherlands Bank's own sizable purchases of dollars in Amsterdam, on October 23 the Federal Reserve offered guilders in New York, selling $2.9 million equivalent drawn under the swap line with the Dutch central bank.

Late in October, the dramatic shift in the basic United States trading position was underscored by the announcement of an $873 million trade surplus for September. By that time, also, interest rates in the United States were on the rebound and a cease-fire had been negotiated in the Mideast. Consequently, the dollar came into strong demand, advancing across the board against the major European currencies. By the end of October, the Federal Reserve was able to purchase in the market sufficient marks and Dutch guilders to repay fully the $91.5 million and $2.9 million, respectively, of swap drawings outstanding in those currencies. Thus, for the period August through October, System intervention totaled $247.5 million, of which $238.9 million was drawn and repaid under swap lines. In summary, since the resumption of exchange market intervention in July, the System had drawn and repaid a total of $512.4 million of German marks, French francs, Belgian francs, and Dutch guilders. Coordinated intervention in the dollar market by the Bundesbank over the same period amounted to nearly $500 million.

In other operations, beginning in August the Federal Reserve resumed modest daily purchases of Belgian francs in the market to repay swap drawings outstanding from the National Bank of Belgium since August 1971. By October 31, some $117.8 million of those drawings had been repaid, leaving $272.2 million equivalent remaining. Combined with the $1,165 million of Swiss franc swap drawings also outstanding since August 1971, this brought total System swap obligations to $1,437 million at the end of October, compared with $3,045 million outstanding on August 15, 1971.

Finally, the United States Treasury redeemed at maturity the last of its mark-denominated securities, a $172.4 million equivalent security held by the Bundesbank. The Treasury also refinanced with the Swiss National Bank a Swiss-franc-denominated security amounting to $63.6 million equivalent originally held by the Bank for International Settlements.