February-April 1979 Interim Report
(This report was released to the Congress and to the press on June 4, 1979.)

Treasury and Federal Reserve Foreign Exchange Operations

During the February-April period under review, the dollar came into increasingly heavy demand against most major foreign currencies. This demand largely took the form of unwinding previously adverse leads and lags, covering of speculative positions, and the reversal of portfolio shifts out of the dollar which had built up last year.

At first, the reflux of funds mainly reflected growing confidence in the measures taken by United States and foreign authorities in late 1978 to correct what had become an excessive decline in the dollar. The measures had included a sharp tightening of Federal Reserve monetary policy, coordinated intervention in the exchange market by the United States, German, Swiss, and Japanese authorities, and provision for up to $30 billion of foreign currency resources to finance United States participation in that intervention. The authorities had intervened in substantial amounts to blunt selling pressure on the dollar through the year-end. Although many market participants expected renewed downward pressure on the dollar in early 1979, such pressure failed to materialize. On occasions when the dollar came on offer in January and February, the authorities quickly met the pressures, helping restore a sense of two-way risk to the market. Moreover, as part of the broad effort of the United States authorities to deal with the inflation and dollar problems, the Federal Reserve kept interest rates firm even as the growth of the monetary aggregates remained sluggish in February and March.

A report by Alan R Holmes and Scott E Pardee
Mr Holmes is the Executive Vice President in charge of the Foreign Function of the Federal Reserve Bank of New York and Manager, System Open Market Account Mr Pardee is Senior Vice President in the Foreign Function and Deputy Manager for Foreign Operations of the 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

Once market participants no longer expected dollar rates to decline, traders began to respond to the relatively high interest rates in the United States, compared with rates in many other industrial countries. Substantial amounts of funds began to move out of Germany, Switzerland, and Japan. The central banks of those countries took the opportunity to mop up liquidity by purchasing their own currencies against dollars sold out of reserves, in effect unwinding part of their intervention of last year. The United States authorities also purchased German marks, Swiss francs, and Japanese yen to repay borrowings which had arisen out of previous operations and to restore depleted balances.

The flow into dollars slowed at times as market participants reacted to the political upheavals in Iran, the associated shortfall in world oil production, the sharp rise in the international prices of oil and other key commodities, and evidence of generally more rapid inflation in the United States. Adverse news for the United States occasionally sparked some selling of dollars, but the pressures did not cumulate. Moreover, many of these developments were seen as serious for other countries as well, particularly as inflation rates began to rise sharply abroad. Indeed, as oil supplies became short, leading to a scramble for spot crude around the world

Table 1

Federal Reserve System Drawings and Repayments under Reciprocal Currency Arrangements

In millions of dollars equivalent, drawings (+) or repayments (−)

Transactions with	System swap commitments January 31, 1979	February through April 30, 1979	System swap commitments April 30, 1979
German Federal Bank ..	4,168.2	+ 145 5 −4,355 2*	-0-
Swiss National Bank ...	446.7	+ 40.4 − 487.1	-0-
Total	4,614 9	+ 185 9 −4,842.3*	-0-

Data are on a transaction-date basis

* Repayments include revaluation adjustments from swap renewals, which amounted to $41.5 million for drawings on the German Federal Bank renewed during the period.

Table 2

Federal Reserve System Repayments under Special Swap Arrangement with the Swiss National Bank

In millions of dollars equivalent

System swap commitments January 31, 1979	February through April 30, 1979	System swap commitments April 30, 1979
139 3	−139 3	-0-

Data are on a value-date basis.

Table 3

United States Treasury Drawings and Repayments under Swap Arrangement with the German Federal Bank

In millions of dollars equivalent, drawings (+) or repayments (−)

Amount of commitments January 31, 1979	February through April 30, 1979	Amount of commitments April 30, 1979
613.0	−613.3*	-0-

Data are on a transaction-date basis

* Repayments include revaluation adjustments from swap renewals, which amounted to $0 3 million for drawings on the German Federal Bank renewed during the period.

and prompting OPEC (Organization of Petroleum Exporting Countries) members to jack up their prices, exchange market sentiment turned bearish for currencies of countries which were most heavily dependent on oil imports for their energy needs. These included Japan, especially, and several European countries. The United States was viewed as better able to cope with oil-supply and price problems, and the dollar was one of the currencies, along with the pound sterling and Canadian dollar, that came into demand as concerns heightened in March and April over the world energy outlook generally.

By that time, also, the market was responding to clear evidence of an improvement in current account positions. In particular, Japan's current account surplus virtually disappeared in the early months of the year. For our part, a rapid acceleration in United States exports and a slowing in import growth led to a further narrowing of the United States trade and current account deficits and bolstered expectations that further progress toward reducing those deficits was likely over the rest of the year. In view of concerns over the price outlook for the United States, indications that the United States economy was cooling down somewhat were taken postively by the market, as was the further firming of United States interest rates by the Federal Reserve when the monetary aggregates began to grow more sharply in April. By the end of the month, the dollar was very strongly bid in the exchange market and the authorities of the United States, Germany, Switzerland, and Japan intervened vigorously to contain the demand pressures. On balance, for the three-month period, the dollar advanced by about 1 percent against the German mark and Swiss franc and by 10 percent against the Japanese yen.

During the period the United States authorities intervened as a seller of foreign currencies only in February. That intervention amounted to some $656 million equivalent of German marks, Swiss francs, and Japanese yen. The bulk of this intervention—$535.0 million equivalent—was in marks, of which $323.5 million equivalent was by the Treasury out of balances and $211.5 million equivalent was by the Federal Reserve. The System operations in marks were financed partly out of balances and partly by drawings of $145.5 million equivalent under the swap arrangement with the Bundesbank. The Federal Reserve sold $45.8 million equivalent of Swiss francs financed by drawings on the swap line with the Swiss National Bank and from balances. For its part the Treasury sold $24.8 million equivalent of francs from balances. In addition, the Federal Reserve and the Treasury, respectively, sold $33.8 million equivalent and $16.6 million equivalent of Japanese yen out of balances. In early March the

Table 4

United States Treasury Securities, Foreign Currency Denominated

In millions of dollars equivalent; issues (+) or redemptions (−)

Issues	Amount of commitments January 31, 1979	February through April 30, 1979	Amount of commitments April 30, 1979
Government series:			
Swiss National Bank	531 2	− 531.2	-0-
Public series:			
Switzerland	1,203 0	-0-	1,203 0
Germany	1,595 2	+1,351.5	2,946 7
Total	3,329 3	− 531 2 +1,351 5	4,149 7

Because of rounding, figures may not add to totals
Data are on a value-date basis

Table 5

Net Profits (+) and 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, 1979 through April 30, 1979	+21 6	+ 4 6	+8 5
Valuation profits and losses on outstanding assets and liabilities as of April 30, 1979	−14 4	−285 3	−0 3

Data are on a value-date basis

Table 6

Net Profits (+) and Losses (−) on United States Treasury and Federal Reserve Liquidations of Foreign Currency Debts Outstanding as of August 15, 1971

In millions of dollars

Period	Federal Reserve	Exchange Stabilization Fund
February 1, 1979 through April 30, 1979	−123 5	−471.2

Data are on a value-date basis.

Treasury placed another $1,351.5 million equivalent of mark-denominated notes, bringing the total amount of marks raised in the German capital market to $2,946.7 million equivalent since December 1978. As with earlier such issues, the Treasury then warehoused the proceeds of this new borrowing with the Federal Reserve.

With the dollar strengthening in the exchanges, the United States authorities bought $2,218.7 million equivalent of foreign currencies in the New York market. In addition, the United States authorities purchased $4,972.8 million equivalent of currencies from correspondents, mainly from the Bundesbank and Swiss National Bank in connection with their own sales of dollars. These acquisitions were used by the Federal Reserve and the Treasury to repay all outstanding swap debt to foreign central banks. The Federal Reserve repaid $4,355.2 million equivalent of mark debt to the Bundesbank, $487.1 million equivalent of Swiss franc debt to the Swiss National Bank, and $139.3 million equivalent of pre-August 1971 swap debt to the Swiss central bank. For its part, the Exchange Stabilization Fund (ESF) repaid $613.3 million equivalent of marks to the Bundesbank and liquidated $531.2 million equivalent of pre-August 1971 Swiss franc-denominated obligations. The remaining foreign currency acquisitions were added to System and ESF balances, which rose by $1,088 million equivalent to $6,286 million equivalent as of April 30.

During the period under review, the Federal Reserve and the United States Treasury realized net profits from current operations. Table 5 presents these profit figures as well as figures on valuation profits and losses. The table presents the results of ESF operations separately from those of the Treasury general account which issued the foreign currency-denominated securities The realized profits on current operations reflect liquidation of current swap debts and sales of currencies out of the balances held by the System, the ESF, and the Treasury general account. The valuation profits and losses reflect revaluation of System and Treasury foreign currency assets and liabilities as of April 30. Losses on the final liquidation of pre-August 1971 Swiss franc debts, undertaken to protect the United States gold stock, are shown in Table 6.