Treasury and Federal Reserve Foreign Exchange Operations *

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During the period covered by this report, March-August 1965, the exchange markets reflected not only the shifts taking place in underlying balance of payments positions, but more particularly the speculative pressures focusing on the pound. During the summer months, the market became increasingly skeptical of the outlook for sterling, largely discounting each new measure taken by the British Government to right its payments position and thus failing to reflect the over-all improvement that was gradually taking place. For the first eight months of this year, compared with the same period in 1964, British exports, for example, rose by about 6 per cent while imports grew by 1 per cent, cutting the trade deficit by well over a third. On the other hand, the turnabout in the United States balance of payments following introduction of the Voluntary Foreign Credit Restraint Program and other measures in February was so sharp as to have a major effect on the exchanges. Lingering doubts about the stability of the dollar evaporated, and the United States Treasury and Federal Reserve were able to make good progress in reducing the foreign currency commitments that had been undertaken the previous fall and winter when a massive United States deficit had coincided with the sterling crisis. To be sure, gold sales by the United States Treasury reached very high levels despite the striking improvement in the United States payments position. These sales, however, to a large extent resulted from the overhang of dollars that had accumulated in official reserves in earlier months, as well as the persistent surplus position of France whose gold purchase policy has been widely publicized. Italy also continued to experience very large surpluses, but policies were adopted by the Italian authorities that minimized the impact of these surpluses on the exchanges and on official reserves.

It was against this background that the Federal Reserve swap network was further strengthened by increases in the swap arrangements with the Bank of Italy (from $250 million to $450 million), the Bank of Japan (from $150 million to $250 million), and the Bank for International Settlements (from $150 million to $300 million). The swap network now covers reciprocal credit lines totaling $2.8 billion, as shown in Table I.

Table I

FEDERAL RESERVE RECIPROCAL CURRENCY ARRANGEMENTS

September 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	450	12
Bank of Japan	250	12
Netherlands Bank	100	3
Bank of Sweden	50	12
Swiss National Bank	150	6
Bank for International Settlements	300	6
Total swap facilities	2,800	

* This is the seventh in a series of reports by the Vice President in charge of the Foreign Department 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 Open Market Committee of the Federal Reserve System in the conduct of foreign exchange operations.

Table II

DRAWINGS AND REPAYMENTS BY FEDERAL RESERVE SYSTEM UNDER RECIPROCAL CURRENCY ARRANGEMENTS

March 1962-August 1965

In millions of dollars equivalent

Institution Year	Amount	Repaid within				Outstanding on August 31, 1965
		3 months	3-6 months	6-9 months	9-12 months	
Austrian National Bank						
1962	50.0	50.0				
Total	50.0	50.0				—
National Bank of Belgium*						
1962	30.5	30.5				
1963	25.0	25.0				
1964	145.0	62.5	37.5	45.0		
1965†	140.0	45.0	35.0	5.0		
Total	340.5	163.0	72.5	50.0		55.0‡
Bank of Canada						
1963	20.0	20.0				
Total	20.0	20.0				—
Bank of England						
1962	50.0	50.0				
1963	35.0	35.0				
Total	85.0	85.0				—
Bank of France						
1962	50.0		50.0			
1963	21.5	21.5				
Total	71.5	21.5	50.0			—
German Federal Bank						
1963	286.0	143.5	142.5			
1964	105.0	105.0				
1965†	15.0	15.0				
Total	406.0	263.5	142.5			—
Bank of Italy						
1962	50.0	50.0				
1965†	350.0	82.0	168.0			
Total	400.0	132.0	168.0			100.0‡
Netherlands Bank						
1962	60.0	50.0	10.0			
1963	150.0	60.0	90.0			
1964	100.0		55.0	45.0		
1965†	25.0					
Total	335.0	110.0	155.0	45.0		25.0‡
Swiss National Bank						
1962	50.0				50.0	
1963	80.0	5.0	20.0	55.0		
1964	25.0	25.0				
1965†	150.0	90.0	12.0			
Total	305.0	120.0	32.0	55.0	50.0	48.0§
Bank for International Settlements						
1962	80.0	40.0	5.0	19.5	15.5	
1963	150.0	5.0	65.0	80.0		
1964	100.0		35.0	65.0		
Total	330.0	45.0	105.0	164.5	15.5	—
All banks						
1962	420.5	270.5	65.0	19.5	65.5	
1963	767.5	315.0	317.5	135.0		
1964	475.0	192.5	127.5	155.0		
1965†	680.0	232.0	215.0	5.0		
Total	2,343.0	1,010.0	725.0	314.5	65.5	228

* Data relate to disbursements and repayments under the $50 million fully drawn portion of the swap facility and to utilization of the $50 million standby portion available since December 1964.
† First eight months.
‡ Outstanding less than three months.
§ Outstanding more than six but less than nine months.

As noted in the previous report covering the period September 1964-February 1965, Federal Reserve drawings on the swap lines amounted to $380 million equivalent at the end of February 1965. Subsequently, such drawings rose to a peak of $585 million equivalent on April 6 but, by the end of July, all but $48 million had been repaid. However, partly as a result of intensified pressures on sterling, new Federal Reserve drawings on the swap network became necessary in August, and as of September 17 the System was indebted under the swap lines to the extent of $228 million, including $100 million to the Bank of Italy, $55 million to the National Bank of Belgium, $48 million to the Swiss National Bank, and $25 million to the Netherlands Bank.

During the period under review, the Bank of England was the only foreign central bank to draw on its swap facility with the Federal Reserve. Bank of England drawings had declined from a peak of $700 million on November 27, 1964 to only $105 million at the end of February 1965. Further drawings in March and April brought the net amount outstanding on May 25 to $230 million, which was completely repaid on that date out of the proceeds of the $1.4 billion equivalent British drawing on the International Monetary Fund (IMF). To offset speculative pressures developing during the summer months, the Bank of England made new drawings of $360 million during June, and had further recourse to the swap line in July and August.

On September 10 the Bank of England announced that new facilities for support of sterling had been provided by the United States monetary authorities together with nearly all the other central banks that had joined in the November 1964 rescue operation. This new assistance came at a time when further corrective measures had just been announced by the British Government and growing confidence in sterling was evident in the market. Rather than representing a defensive measure taken at a time of pressure on sterling, the current arrangements permit acceleration of a favorable trend. They demonstrate the solidarity of the cooperative arrangements linking the major central banks and treasuries of the Free World. Within this defensive network any government which is fully prepared to defend its currency should be able to mobilize sufficient financial resources to beat off any speculative attack.

A comprehensive view of drawings and repayments under reciprocal currency arrangements between the Federal Reserve System and foreign monetary institutions from March 1962 through the summer months of 1965 is provided in Tables II and III. As indicated in Table II, nearly half of all Federal Reserve drawings of $2.3 billion during the period was repaid within three months, and almost three quarters of such drawings were liquidated within six months. Similarly, nearly three quarters of foreign drawings of $3.1 billion under the arrangements were paid off within three months, thus confirming that in practice the swap network has been used—as intended—as a means of providing temporary financing.

In addition to central bank swap transactions, the monetary authorities in a number of countries continued to refine and develop further the use of forward exchange operations as an efficient instrument for dealing with pressures in their markets. The Bank of England continued to exert a strong stabilizing effect on the dollar-sterling forward market, while temporary cushioning operations were also undertaken by the Swiss National Bank, the German Federal Bank, and the Netherlands Bank. In addition, forward operations by the Italian authorities had the effect of reducing Italian reserve gains, and of simultaneously preventing an excessive buildup of domestic liquidity in Italy by channeling dollar inflows back into the Euro-dollar market. Otherwise a severe squeeze on

Table III

DRAWINGS AND REPAYMENTS BY FOREIGN CENTRAL BANKS UNDER RECIPROCAL CURRENCY ARRANGEMENTS

March 1962-June 1965

In millions of dollars equivalent

Institution Year	Amount	Repaid within: 3 months	Repaid within: 3-6 months	Outstanding on June 30, 1965
National Bank of Belgium				
1963	45.0	40.0	5.0	
Total	45.0	40.0	5.0	—
Bank of Canada				
1962	250.0		250.0	
Total	250.0		250.0	—
Bank of England				
1963	25.0	25.0		
1964	1,370.0	1,370.0		
1965*	1,215.0	855.0		
Total	2,610.0	2,250.0		360.0†
Bank of Italy				
1963	50.0		50.0	
1964	100.0		100.0	
Total	150.0		150.0	—
Bank of Japan				
1964	80.0	30.0	50.0	
Total	80.0	30.0	50.0	—
All banks				
1962	250.0		250.0	
1963	120.0	65.0	55.0	
1964	1,550.0	1,400.0	150.0	
1965*	1,215.0	855.0		
Total	3,135.0	2,320.0	455.0	360.0†

* First half only.
† Outstanding less than three months.

Euro-dollar credit availabilities might have been produced by the United States Voluntary Foreign Credit Restraint Program. In connection with this operation, the United States Treasury once again undertook to share with the Italian authorities sizable commitments in forward lire, which will subsequently be reported in some detail.

The foreign currency bonds issued by the United States Treasury rose from a total of $1,137 million as of early March to a new peak of $1,259 million as of September 17. Additional issues of $125 million were made to the Bank of Italy and $23 million to the Bank for International Settlements (BIS) for purposes of absorbing dollars on the books of the Italian and Swiss central banks. On the other hand, as the German balance of payments moved into deficit, it proved possible for the United States Treasury to accumulate marks and, on July 12, $25 million equivalent was employed to retire a maturing mark-denominated bond for that amount previously issued to the German Federal Bank.

Extensive use thus continued to be made by the United States and other major industrial countries of the spectrum of international credit facilities available for financing payments imbalances. One of the more significant developments during the period under review was the United States drawing from the IMF. This drawing, which provided medium-term financing, permitted repayment of earlier drawings under the swap network as well as the absorption of dollars temporarily accumulated by foreign central banks, thus economizing on the use of gold in international settlements.

STERLING

By mid-January 1965, sterling began to show signs of recovery from the speculative onslaught of late 1964, and this improvement continued through February. In March, however, the market once again became beset by doubts as to whether the British Government's pledge to defend the sterling parity would be matched by truly effective measures to curb excessive domestic demand and to restrain the inflationary trend of wage settlements. New complications arose as the United States Voluntary Foreign Credit Restraint Program led to some withdrawal of funds from London. Large forward commitments previously entered into by the Bank of England also began to mature, but firm defensive operations in both the spot and forward markets facilitated the rolling-over of most of these commitments. For those interested in the technical complexities of official intervention in the forward markets, a useful summary may be found in the Bank of England's *Quarterly Bulletin* for June 1965, pages 107-108.

With the announcement of new restraint measures in Chancellor Callaghan's budget message on April 6, sterling moved strongly upward and this trend was reinforced as the Bank of England on April 29 introduced special deposit requirements for the London clearing and Scottish banks and on May 5 requested the London clearing banks to limit the increase in their advances to the private sector to no more than 5 per cent during the year ending March 1966. The other banks operating in London and a wide range of other financial institutions were also asked to exercise comparable restraint. However, following the announcement in mid-May of disappointing trade figures for April, the sterling rate once more began to drift downward. The British drawing on May 25 of $1.4 billion equivalent from the IMF and full repayment with the proceeds of $1,097 million of short-term central bank credits did little to bolster market sentiment. On the contrary, publication of figures showing a continuing deterioration in the British trade position during the second quarter further undermined market confidence, and substantial support had to be given to both the spot and forward markets. By late July, the market had become convinced that a new crisis was shaping up for the autumn months. Against this ominous background, the British Government took further corrective action on July 27, announcing cutbacks and deferments in public sector spending programs and a further tightening of instalment credit.

Unfortunately, an initially favorable market reaction to the July 27 measures was quickly swamped by the report on August 3 of a reserve loss for July that was much larger than the market had anticipated. As a result, sterling was again heavily offered in both the spot and forward markets, requiring substantial official support. By mid-August, however, the market began to take on a more balanced look, no doubt reflecting in part the improved July trade figures but also suggesting that sterling had become grossly oversold. From time to time, the market gave clear evidence of a squeeze for sterling balances.

Against these mixed developments during August, the British Government on September 2 announced its intention to seek statutory authority to require advance notification and, if deemed appropriate, temporary deferment of wage and price increases. This basic policy action went a long way toward relieving the market's apprehension of a progressive undermining of the sterling parity by wage and price inflation. Meanwhile, negotiations were progressing among the central banks with the objective of providing additional facilities in order to further the recovery of confidence. On Friday, September 10, the Bank of England announced that these negotiations had been completed, stating that

There is increasing evidence that the measures taken by Her Majesty's Government to restore the United Kingdom balance of payments are having their effects. Sentiment towards sterling in the exchange markets is improving. To further this trend the Bank of England with the full authority of Her Majesty's Government has entered into new arrangements with the central banks of Austria, Belgium, Canada, Germany, Holland, Italy, Japan, Sweden, Switzerland, the United States, and the Bank for International Settlements who co-operated in the support of sterling last November.

These new arrangements take various forms and will enable appropriate action to be taken in the exchange markets with the full co-operation of the central banks concerned.

Immediately following this announcement concerted market action was initiated. As the spot rate for sterling moved up, short covering developed causing a further jump in the rate. The recent measures thus appeared to be yielding good results.

SWISS FRANC

In late 1964, the Swiss National Bank had taken in a sizable amount of dollars as funds moved into Switzerland during the sterling crisis. These dollars were partially absorbed by a Federal Reserve drawing of $100 million equivalent in Swiss francs in December under the System's swap line with the BIS. Further Swiss franc drawings, amounting to $60 million equivalent on January 19 and $90 million equivalent on March 1, were made for the same purpose—this time under the swap line with the Swiss National Bank. Thus, by March 1, the System had utilized $250 million of its $300 million credit facilities in Swiss francs. In addition, further dollars were absorbed through Swiss purchases of gold from the United States Treasury totaling $50 million during the first four months of the year.

The operations just mentioned, though carried out for the most part during the early months of 1965, were made necessary by the overhang of dollars accumulated by the Swiss National Bank during the latter part of 1964. In point of fact, the Swiss franc began to ease shortly after the year-end as Swiss banks, finding themselves liquid, started to place funds abroad, and the United States Treasury was able in February to purchase $10 million equivalent of Swiss francs in order to reduce by that amount a $25 million equivalent sterling-Swiss franc swap with the BIS. By March, the rate had moved below $0.2300 and the Swiss National Bank sold dollars to the market for the first time since 1962. Swiss commercial demand for dollars accentuated the effects of the continued ease in the money market, and this softness in the franc rate persisted through the early summer. Moreover, by the end of April, the Bank of Italy had fully repaid its $100 million equivalent Swiss franc-lira swap with the Swiss National Bank initiated in June 1964. The Swiss National Bank thus found itself in need of dollars to cover its lira requirements for remittances by Italian workers in Switzerland. Under these circumstances, the United States authorities were able to acquire a total of $175 million equivalent in Swiss francs during the period April-July, to some extent through market purchases but mainly through direct transactions with the Swiss National Bank. These acquisitions were used to reduce a variety of Swiss franc obligations of the System and the Treasury.

At the end of March a start was made on repayment of the System's Swiss franc drawings when $20 million equivalent of francs was acquired from the Bank of England in connection with a credit to the latter by the Swiss National Bank. These francs, along with $82 million equivalent purchased during subsequent months, were used to reduce the System's liability under its swap line with the Swiss National Bank from $150 million to $48 million equivalent. In addition, the System fully repaid its $100 million drawing on the BIS, partly with francs acquired through spot purchases and partly with the proceeds of a $40 million equivalent swap of German marks for Swiss francs with the BIS. (This latter transaction illustrated once again the flexibility of third-currency swaps, where available balances in one foreign currency can be used to acquire other needed currencies.)

Treasury commitments resulting from forward sales of Swiss francs in the Swiss market, which had been reduced from $121 million to $51.5 million equivalent during 1964, were paid down further by $29 million equivalent to $22.5 million equivalent by late June. In addition, System forward sales of Swiss francs were completely liquidated. These sales which had been initiated in December to calm the market and to encourage Swiss banks to invest abroad dollars they might otherwise have sold to the Swiss National Bank, reached a peak of $32.5 million equivalent by January 8. (The bulk of these contracts were paid off by mid-February through spot purchases of Swiss francs.) Through all these operations, official United States commitments in Swiss francs were thus reduced by a total of $233 million during January-July.

In June, the Swiss franc began to firm, rising to a range of $0.2307-10, in conjunction with the approach of mid-year positioning by Swiss commercial banks. The usual pressures associated with such operations were absent this year, however, as the Swiss authorities acted in both the money and foreign exchange markets to mitigate the seasonal liquidity squeeze. Swiss Confederation bonds falling due at the end of June were only partially refunded and the Swiss National Bank undertook substantial swap operations with Swiss commercial banks, buying United States dollars spot against Swiss francs and selling them back to the banks for delivery after midyear. Consequently, the Swiss franc remained below its effective ceiling during June, and United States authorities continued to acquire Swiss francs from the Swiss National Bank. Opportunities for further acquisitions diminished considerably after midyear, however, as the unwinding of the midyear swaps brought about a tightening in the Swiss money market and the Swiss franc advanced to its effective ceiling. Under the circumstances, the Swiss National Bank decided to repurchase part of the foreign exchange that it had sold on a covered basis to Swiss commercial banks earlier in the year when the domestic market had been excessively liquid. The liquidity thus injected into the market by the reversal of these earlier swaps helped to reduce dollar repatriations by these banks.

Renewed nervousness about sterling in the exchanges held the franc at its ceiling until the latter part of August. Under the circumstances, the Swiss National Bank had to buy additional dollars in the market, and the United States authorities in turn absorbed part of this inflow by purchasing dollars from the central bank against Swiss francs. The francs needed for this operation were obtained by sale to the BIS on July 30 of a $23 million equivalent fifteen-month Swiss franc-denominated United States Treasury bond. (This sale raised the Treasury's Swiss franc bond indebtedness to $350 million equivalent.) As the period closed, renewed Swiss commercial demand for dollars and easier Swiss money market conditions brought about a moderate decline of the franc below its ceiling.

NETHERLANDS GUILDER

Official United States commitments in Netherlands guilders reached a peak of $348 million equivalent on January 8 as a result of operations undertaken during August 1964-January 1965 when the basic Dutch payments position was strong and when, in addition, funds were moving into the Netherlands as a result of pressures on sterling. Thus, the $100 million Federal Reserve swap facility with the Netherlands Bank had been fully utilized, a temporary $35 million swap between the United States Treasury and the Netherlands Bank had been arranged, another $50 million of guilders had been acquired through sterling-guilder swaps with the BIS for sale to the Netherlands Bank to absorb dollars, and $163 million equivalent of guilders had been sold forward in the Netherlands market.

Early in January the $35 million United States Treasury-Netherlands Bank temporary swap was liquidated as Federal Reserve and Treasury sales of forward guilders, initiated in mid-December, induced covered outflows of funds from the Netherlands by the Dutch commercial banks, thus facilitating the acquisition of spot guilders by the United States authorities. Commitments on these forward contracts through the market reached a peak of $197 million equivalent on January 19, but by early February $10 million of short-dated contracts had been paid off at maturity. Moreover, in the early part of February, the Federal Reserve started to repay its drawings under the swap arrangement, reducing the amount outstanding to $70 million equivalent by the end of the month. However, major reductions in United States commitments had to wait until the early spring and summer months, when the Netherlands balance of payments was seasonally less strong and guilder purchases could be made in size. A Dutch payments deficit did begin to emerge in March, and by late July the United States authorities had acquired a sufficient amount of guilders, mainly through purchases from the Netherlands Bank as it sold dollars in its market, to reduce outstanding commitments by a total of $225 million equivalent. These acquisitions were made despite the persistence of generally tight money market conditions in the Netherlands and occasional pressures arising from shifts of funds out of sterling. Thus, during March and April, the System purchased enough guilders from the Netherlands Bank to repay a further $25 million equivalent of its swap drawings. The remaining $45 million equivalent of drawings was paid off in late May with guilders acquired in conjunction with the United Kingdom drawing from the IMF.

In addition to reducing Federal Reserve swap drawings, the United States authorities paid off at maturity a total of $68 million equivalent of forward contracts by late April. As the guilder continued on offer, another $62 million equivalent was acquired by the Federal Reserve and the Treasury in June and July to repay forward contracts at maturity, thereby reducing the total outstanding to $57 million equivalent. Some of these repayments, occurring as they did prior to midyear, helped relieve tight money market conditions in the Netherlands. In addition, in June the System and the Treasury liquidated a total of $25 million equivalent of sterling-guilder swaps. Finally, the Netherlands Bank also undertook exchange transactions in July to alleviate the money market pressures generated by a seasonal increase in currency in circulation, buying dollars spot from the Dutch commercial banks and selling them back forward, mainly for one-month maturities.

Toward midsummer, renewed nervousness regarding sterling contributed to flows of funds into the Netherlands. These flows coincided more or less with the abatement of seasonal pressure on the Netherlands' payments position, and the Netherlands Bank consequently began to buy dollars to prevent too rapid a rise in the guilder rate. Its dollar acquisitions soon raised its total holdings above usual levels, and some absorption of the excess dollar holdings accordingly was called for. Consequently, the United States Treasury purchased $25 million at the end of July with guilders drawn from the IMF under a $300 million equivalent multicurrency drawing (see section on United States drawings on the International Monetary Fund), and in August the Federal Reserve reactivated its swap arrangement with the Netherlands Bank to the extent of $25 million equivalent. By the end of August, buying pressure on the guilder diminished as the exchange markets calmed and the Dutch money market eased.

GERMAN MARK

In late December 1964, the Federal Reserve had drawn $50 million equivalent under its $250 million swap facility with the German Federal Bank to absorb dollars taken in by that bank at the time of the sterling crisis. This drawing was reversed in late January, 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 in February was likewise quickly reversed.

Beginning in May, the mark began to display an increasingly softer tone. For some time, German import demand had been outpacing export growth, with the result that the previously very sizable trade surplus that had helped to keep the mark close to its ceiling for nearly two years began to decline. Indeed, by June, the trade account had swung into deficit for the first time since 1958, and the mark was quoted below its par of $0.2500 for the first time since February 1963. Apart from the sharp shift in the German trade account and the related change in the pattern of leads and lags, there were some indications that the United States Voluntary Foreign Credit Restraint Program had had some influence on capital movements, reinforcing the downward pressure on the mark rate. Under these conditions, first the Treasury and then the Federal Reserve began in June to purchase marks systematically, in the market as well as from the German Federal Bank, with a view toward employing the marks to liquidate other foreign currency commitments. Thus, the Federal Reserve purchased $39 million of marks in June and early July and on July 8 swapped $40 million equivalent of marks for Swiss francs with the BIS in order to repay the remaining Federal Reserve Swiss franc commitment under the swap drawings from that institution. Additional marks were purchased by the Federal Reserve during July and August, part of which were used on two occasions to acquire a total of $12.5 million equivalent of Dutch guilders through a third-currency swap with the BIS; an equivalent amount of sterling which had been previously swapped with the BIS for Dutch guilders was simultaneously reacquired.

For its part, the Treasury also employed mark acquisitions to modify its third-currency swaps with the BIS. In late July, the Treasury swapped with that institution $15 million equivalent of marks for Swiss francs and $5 million equivalent for Dutch guilders, and used the francs and guilders to liquidate equivalent outstanding sterling-Swiss franc and sterling-Dutch guilder swaps with the BIS. At the end of August, the Treasury swapped an additional $7.5 million equivalent of marks for guilders with the BIS, similarly liquidating an equivalent sterling-guilder swap. Earlier, on July 12, the Treasury had redeemed at maturity a $25 million equivalent mark-denominated bond. This represented the first reduction in the Treasury's mark-denominated bonds, which were first issued to the German Federal Bank in January 1963 and which reached a total last year of $679 million equivalent.

BELGIAN FRANC

The diminished rate of growth of Belgian economic activity first evident in 1964 carried over into 1965 and contributed to a slowing-down in the rise of Belgian import demand. Belgium continued to run a surplus on its balance of payments during the first eight months of 1965, and with the Belgian franc generally at its ceiling Belgian official reserves increased by some $47 million. In addition, Belgium's position in the IMF improved by $108 million during the first seven months of the year.

At the end of 1964, System drawings under the $100 million swap arrangement with the National Bank of Belgium amounted to $45 million equivalent. Continued dollar inflows during January and February were partly absorbed through additional drawings of $40 million equivalent, and in early March the Federal Reserve utilized the remaining $15 million of its Belgian franc facility. In addition, the National Bank of Belgium purchased a total of $62 million in gold from the United States Treasury during the first half of the year.

In the latter part of March, demand for dollars in Belgium enabled the System to acquire $10 million of

Belgian francs and reduce its drawings by that amount. However, with the Belgian franc back at its ceiling in April, $10 million was again drawn to absorb dollars from the National Bank of Belgium. The first major reduction in the Federal Reserve's Belgian franc commitments occurred in late May when the Federal Reserve purchased $40 million equivalent of Belgian francs from the National Bank of Belgium, following a United Kingdom conversion into dollars of Belgian francs acquired under its $1.4 billion multicurrency drawing from the IMF.

During July and August, there was a succession of drawings and repayments, reflecting in part temporary swings in Belgium's balance of payments position and in part special transactions. In early July, the System once again increased its drawings in Belgian francs—from $60 million to $80 million equivalent—before a temporary demand for dollars in Belgium enabled the Federal Reserve to buy the equivalent of $40 million of Belgian francs from the National Bank of Belgium. In late July, the Federal Reserve liquidated its remaining uncovered Belgian franc position by purchasing from the United States Treasury $40 million equivalent of Belgian francs which the Treasury had acquired under its $300 million equivalent multicurrency drawing from the IMF. As indicated elsewhere, this operation represented the first funding of a System swap drawing through use by the United States of an IMF drawing. No sooner had the System reconstituted its franc position than dollars once again began to move into the reserves of the National Bank of Belgium on a substantial scale, mainly as a consequence of the renewed pressures on sterling, and the Federal Reserve during August utilized Belgian francs available under its swap facility with that bank to absorb a total of $55 million.

ITALIAN LIRA

During 1965, the Italian balance of payments continued to show the effects of the stabilization measures introduced during the two preceding years to deal with the severe payments deficit that had emerged in 1963. In fact, during the first seven months of this year Italy had a balance of payments surplus of over three fourths of a billion dollars, attributable to record high earnings on invisibles and a much reduced trade deficit. With the Italian financial markets relatively easy as a result of lagging internal demand and a consciously stimulative monetary policy, Italian banks purchased sizable amounts of foreign exchange from the Italian authorities on a swap basis and used the funds to reduce their indebtedness in the Euro-dollar market as well as to finance external trade. Nevertheless, Italian reserves increased, particularly during the summer months when seasonal factors are favorable to Italy. Under the circumstances, the United States authorities employed a variety of techniques to absorb official Italian holdings of dollars.

The Federal Reserve reactivated its $250 million swap arrangement with the Bank of Italy on January 22 by drawing $50 million equivalent in lire and selling the proceeds to that bank for dollars. An additional drawing of $50 million equivalent was made in March. With $100 million of the $250 million swap line already utilized and with the prospect of further increases of Italian holdings over the seasonally strong summer months, it was thought desirable to increase the size of the System's swap facility with the Bank of Italy. Thus, on April 1, it was announced that the arrangement had been expanded to $450 million, and a further $100 million was immediately drawn. (Of the $200 million increase in the swap line, $100 million replaced a standby swap facility for a like amount made available to Italy by the United States Treasury in March 1964 as part of a $1 billion credit package.) In May, the System increased its swap drawings by another $50 million equivalent in order to absorb additional dollars from the Bank of Italy.

As reported in previous articles, the United States Treasury in January 1962 had undertaken to share with the Bank of Italy contracts to purchase forward dollars which that institution had entered into with the Italian commercial banks in order to encourage a re-export of dollars during a period of heavy balance of payments surpluses. The last of these contracts had been reacquired by the Italian authorities in March 1964, thus fully liquidating the Treasury's forward lira commitments. In view of the reappearance of substantial Italian payments surpluses, the United States Treasury in 1965 began once again to share contracts to purchase forward dollars with the Bank of Italy. In addition, the Treasury sold to the Bank of Italy $80 million of gold in April, thus absorbing a further part of the dollar inflow and reconstituting part of the gold which Italy had sold to the United States the preceding year.

An opportunity to begin reducing the Federal Reserve's swap drawings became available in late May when the United Kingdom drew $82 million equivalent of lire from the IMF and sold them to the Federal Reserve, thus permitting the System to reduce its swap drawings by that amount on May 25. A similar operation in connection with a subsequent drawing of lire from the Fund by another member enabled the System to make an additional repayment of $5 million on July 2. However, as sizable Italian balance of payments surpluses continued, it seemed appropriate to fund the drawings still outstanding. Accordingly, in July the United States drew $180 million equivalent of lire as part of its $300 million multicurrency drawing from the IMF (see section on United States drawings on the International Monetary Fund). Of this amount, $163 million equivalent was employed to liquidate outstanding Federal Reserve swap drawings and the balance to absorb uncovered dollars from the Bank of Italy. Another $125 million was purchased from the Bank of Italy with proceeds from an eighteen-month lira-denominated bond which the Treasury issued to the Bank of Italy. In August, inflows partly associated with continuing pressures on sterling caused the Federal Reserve to reactivate its swap facility with the Bank of Italy by drawing $100 million of lire in order to absorb an equivalent amount of dollars.

CANADIAN DOLLAR

Canada's strong balance of payments performance in late 1964, sustained in part by long-term borrowing in the United States and repatriation of funds from the United Kingdom, gave way to a deficit early in 1965, and by March the spot Canadian dollar had fallen below par. This turnabout was in part related to seasonal factors and to a sharp deterioration in Canada's trade account. The United States Voluntary Foreign Credit Restraint Program left untouched essential long-term capital flows to Canada but did have the initial effect of inducing United States corporations to repatriate an important amount of previous short-term investments in Canada. The great bulk of their withdrawal of short-term funds was apparently met by reduced placement of funds by Canadian banks in New York or other foreign markets and, therefore, had little impact on Canadian reserves.

As a result of a deterioration in the trade and capital accounts, Canadian reserves dipped $120 million during the first quarter of 1965. However, during the second quarter if allowance is made for Canada's participation in the United Kingdom's IMF drawing, the net effect of which was to reduce Canadian reserves by $72.5 million in May, Canadian reserves remained steady on balance, helped by Canadian bond sales in the United States during April and May. (The British IMF drawing, together with net use of Canadian dollars by other IMF members brought about an improvement in Canada's Fund position of $129 million during the first six months of the year, thus compensating for a good part of the reserve drain during this period.)

Around midyear, demand for Canadian dollars once again subsided and the spot rate gradually declined to its low for the period by mid-July, before turning around once again. The renewed firmness in the Canadian dollar appeared linked primarily to the flotation of further bond issues in the United States and the successful negotiations for substantial Russian purchases of Canadian wheat and flour announced in mid-August. Grain houses, anticipating future United States dollar receipts from Russia, purchased Canadian dollars forward. In the spot market, the rate advanced to well above par as banks purchased Canadian dollars spot to cover forward commitments to the grain houses, and commercial interests moved into the market in anticipation of a further strengthening in the rate.

During the period under review, no official United States operations in Canadian dollars were undertaken.

OTHER CURRENCIES

JAPANESE YEN. The series of measures aimed at restraining domestic demand that were initiated by the Japanese authorities as early as October 1963 led to a noticeable improvement in Japan's trade position beginning in the latter part of 1964. While import demand this year has remained fairly steady at a high level, exports have set new records. This improved trade performance has largely offset the effects on Japan's reserves of diminished inflows of foreign capital, and has permitted the reversal of previous restrictive measures.

On April 1 the Federal Reserve and the Bank of Japan agreed to increase their reciprocal swap arrangement from $150 million to $250 million. In view of the above-mentioned balance of payments developments, no recourse to the swap facility has been necessary during the period under review.

FRENCH FRANC. France continued to register a substantial balance of payments surplus during the first eight months of 1965 under the influence of a strong export performance and lagging import demand. This development in the trade account reflected, to a considerable extent, the reduced rate of domestic economic expansion associated with the official stabilization program. Official French reserves rose $241 million during this period notwithstanding a debt prepayment of $179 million to the United States in July. (In addition, the French position in the IMF improved by $247 million during the same period.) Most of the dollar gains were used to purchase gold from the United States Treasury. Moreover, substantial amounts of dollars acquired prior to 1965 also were converted into gold. Total French gold purchases consequently constituted the largest single element in United States gold sales to foreign countries during the first half of the year, accounting for a little over one half of total sales. In August, the United States Treasury used the francs obtained from its $300 million equivalent multicurrency drawing from the IMF to purchase $40 million from the Bank of France, thus reducing French dollar reserves by that amount.

AUSTRIAN SCHILLING. As reported in the March 1965 *Monthly Review*, the Treasury on February 23 and March 3 issued to the Austrian National Bank two $25 million equivalent eighteen-month bonds denominated in Austrian schillings, and used the proceeds to absorb some of that bank's dollar holdings. Following these transactions, total Treasury bond indebtedness denominated in Austrian schillings amounted to $100 million equivalent.

SWEDISH KRONA. On July 30, the United States Treasury used kronor obtained from its $300 million equivalent multicurrency drawing from the IMF to purchase $15 million from the Bank of Sweden.

UNITED STATES DRAWINGS ON THE INTERNATIONAL MONETARY FUND

Over the course of several years prior to 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 Fund'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 Fund, under its rules, could no longer accept dollars in repurchase, and countries making repurchases could do so only with other eligible convertible currencies or with gold. In order to be able to sell eligible currencies to countries making repurchases, the United States Treasury has itself drawn such currencies from the IMF on a number of occasions beginning in February 1964. By the end of 1964, the Treasury had made five drawings totaling $525 million equivalent in seven continental European currencies. A sixth drawing of this type in the amount of $75 million equivalent ($25 million each in Canadian dollars, German marks, and Italian lire) was made on March 22. As in the case of previous drawings, the bulk of the currencies drawn was sold to countries making repurchases during the ensuing months. No further drawings for the technical purposes described above were made by the United States through the month of August.

As indicated elsewhere, dollars continued to accumulate in the official reserves of certain European countries during the first half of the year. Some of these dollars were temporarily absorbed by use of the Federal Reserve short-term swap arrangements. Since in certain cases there subsequently appeared to be little near-term prospect for any reversal in these dollar inflows, the United States authorities decided to draw on the Fund to acquire foreign exchange on a medium-term basis for use in paying off some of the short-term credits, and otherwise to reduce official holdings of dollars abroad by purchasing dollars with the currencies drawn. In this drawing on July 30, the first occasion on which the United States had made an ordinary, nontechnical drawing on the IMF, the Treasury acquired $300 million equivalent of five European currencies: Italian lire, $180 million; French francs, $40 million; Belgian francs, $40 million; Netherlands guilders, $25 million; and Swedish kronor, $15 million. As detailed elsewhere in this report, the Belgian francs and the bulk of the Italian lire were used to liquidate in full the Federal Reserve swap drawings in the respective currencies. The French francs, Netherlands guilders, Swedish kronor, and remaining lire were used to absorb dollars from the respective central banks.

The United States has thus drawn a total of $900 million equivalent in foreign currencies from the IMF during the last two years. During the same period, other Fund operations in dollars resulted in net disbursements of $508 million; consequently the United States repurchase obligation to the IMF as of the end of August was only $392 million.