# Treasury and Federal Reserve Foreign Exchange Operations Interim Report*

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As previously reported, the Federal Reserve had repaid by the end of July 1974 all but $64.6 million of swap debt to the Bundesbank incurred during the first half of the year. The dollar remained generally buoyant in August during the transition of presidential authority from the Nixon to the Ford administration, rising against the mark to a level 10 percent above the lows reached in early May. In this favorable market situation, the Federal Reserve was able to acquire through a series of market purchases sufficient marks to liquidate the remainder of its swap debt to the Bundesbank and accumulate working balances as well. In two instances, however, the Federal Reserve found it desirable to intervene to restrain sudden selling pressure on the dollar. On August 8-9, when market uneasiness over the political uncertainties was compounded by release of discouraging United States wholesale price figures for July, the Federal Reserve sold $20.8 million of marks from balances, $5.3 million of Dutch guilders drawn on the swap line with the Netherlands Bank, and $2.5 million of Belgian francs, of which $0.8 million was financed from balances and $1.7 million drawn under the swap line with the National Bank of Belgium. These swap drawings of guilders and Belgian francs were quickly repaid through market purchases as the dollar recovered. Again, on September 3, after the German authorities announced the proposed lifting of their reserve requirement on German residents' borrowings abroad (the "bardepot"), a sharp decline in the dollar was checked by Federal Reserve sales of $16.2 million of marks from balances.

The buoyancy of the dollar during the summer months reflected primarily the pull of unusually high interest rates in New York and the Euro-dollar market, reinforced by a revival of expectations that surplus oil revenues would accumulate in United States financial markets after saturating investment outlets elsewhere. By September, however, New York and Euro-dollar interest rates were slipping back from their peaks. Disappointing trade figures for both July and August and news of further rapid inflation of United States prices also tended to weaken the dollar rate.

By early October, the exchange markets were showing signs of nervousness as the decline of dollar interest rates continued amid mounting evidence of a slackening pace

Table I

**FEDERAL RESERVE SYSTEM DRAWINGS AND REPAYMENTS UNDER RECIPROCAL CURRENCY ARRANGEMENTS**

In millions of dollars equivalent

| Transactions with | System swap commitments, July 31, 1974 | Drawings (+) or repayments (−) August 1 through October 31, 1974 | System swap commitments, October 31, 1974 |
|---|---|---|---|
| National Bank of Belgium | 261.8 | {+ 1.7<br>{− 1.7 | 261.8 |
| German Federal Bank | 64.6 | {+103.6<br>{− 64.6 | 103.6 |
| Netherlands Bank | -0- | {+ 5.3<br>{− 5.3 | -0- |
| Swiss National Bank | 371.2 | -0- | 371.2 |
| Bank for International Settlements (Swiss francs) | 600.0 | -0- | 600.0 |
| **Total** | 1,297.5 | {+110.6<br>{− 71.6 | 1,336.5 |

Note: Discrepancies in totals are due to rounding.

* This interim report, covering the period August through October 1974, is the fourth 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.

of United States business activity. Reported diversification of surplus oil revenues from dollars and sterling into continental European currencies, and the pessimistic mood at the International Monetary Fund annual meeting, heightened market fears of renewed exchange rate volatility. Moderately heavy selling of dollars developed in early October, and the Federal Reserve resisted an excessive slippage in the rate by selling a total of $36.1 million equivalent of marks from balances on October 3-4. The dollar briefly steadied, but on October 9, as the market assessed President Ford's anti-inflation proposals, a large buy order for marks pushed the dollar down sharply, setting off more generalized speculative selling of dollars. To maintain orderly market conditions, the Federal Reserve sold $104.4 million of marks; of these, $26 million was financed from balances and $78.4 million was drawn on the swap line with the Bundesbank, which followed up by buying an even larger amount of dollars the next day. This coordinated operation helped the market to settle down and, to consolidate the improvement, the Federal Reserve sold later that day an additional $15.5 million of marks drawn on the swap line.

The dollar then steadied against the mark and other major European currencies about 3 percent below early-September levels, and the Federal Reserve intervened on only two other occasions in October. On October 15, the continued easing of dollar interest rates and rumors of further diversification of surplus oil revenues provoked some selling of dollars, and the Federal Reserve sold $5.8 million of marks to cushion the dollar's decline. On October 23, market expectations of a still bigger German trade surplus for September sparked a renewed flurry of dollar sales, and $3.9 million of marks was sold to help stabilize the market. Both of these Federal Reserve intervention operations were financed by further drawings on the swap line with the Bundesbank. Late in the month, when the dollar firmed somewhat following discount rate cuts in Germany and the Netherlands, the Federal Reserve System began to acquire in the market moderate amounts of marks against outstanding swap indebtedness.

In summary, Federal Reserve sales of foreign currencies totaled $210.5 million equivalent over the three-month period. Sales of German marks amounted to $202.7 million, of which $99.1 million was financed from System balances. The remaining $103.6 million represented drawings under the swap line with the Bundesbank and remained outstanding as of October 31, 1974. In addition, the Federal Reserve sold $5.3 million of Dutch guilders drawn on the swap line with the Netherlands Bank and $2.5 million of Belgian francs, of which $1.7 million was financed by a drawing on the swap line with the National Bank of Belgium; both of these drawings were quickly liquidated.

Table II

**DRAWINGS AND REPAYMENTS BY FOREIGN CENTRAL BANKS AND THE BANK FOR INTERNATIONAL SETTLEMENTS UNDER RECIPROCAL CURRENCY ARRANGEMENTS**

In millions of dollars

| Banks drawing on Federal Reserve System | Drawings on Federal Reserve System outstanding July 31, 1974 | Drawings (+) or repayments (—) August 1 through October 31, 1974 | Drawings on Federal Reserve System outstanding October 31, 1974 |
|---|---|---|---|
| Bank of Mexico | -0- | +180.0 | 180.0 |
| Bank for International Settlements (against German marks) | -0- | +128.0<br>—128.0 | -0- |
| Total | -0- | +308.0<br>—128.0 | 180.0 |

Also during the period, on August 21, the Bank of Mexico drew the full $180 million available under the swap arrangement with the Federal Reserve to cover a temporary shortfall in reserves. This drawing was repaid in November, prior to maturity.

On September 26, the Federal Reserve Bank of New York, after consultations with the Board of Governors of the Federal Reserve System, the United States Treasury, and other Government agencies, acquired the foreign exchange commitments of the Franklin National Bank. Since disclosure in May of substantial foreign exchange losses, Franklin had found it increasingly difficult to fulfill its maturing contracts as other banks limited exchange dealings with it. By late September, the situation had worsened and there was a significant risk that Franklin might be unable to meet all its remaining commitments. To avoid a serious weakening of confidence in the exchange markets and in the dollar that could have resulted from a failure to honor such exchange commitments, this Bank acquired Franklin's foreign exchange book, which at the time included approximately 300 forward contracts for purchases and sales of several foreign currencies totaling about $725 million. This action was greeted with relief by market participants in this country and abroad, and the subsequent news of Franklin's insolvency was taken in stride by the market with no adverse impact on dollar rates.