Treasury and Federal Reserve Foreign Exchange Operations

In contrast to much of last year, the markets for most foreign currencies were fairly free of strain during the February-April period under review. In part, the overall improvement in trading conditions reflected the greater stability of several currencies—mainly sterling, the Italian lira, and the French franc—which had come under varying degrees of selling pressure in 1976. In those cases, many of the policy measures that had been taken by the respective governments to restore internal and external balance in their economies were beginning to take effect. These signs of progress helped to bolster market confidence, stimulating reversals of earlier capital outflows and of previously adverse leads and lags in commercial payments. With their currencies now in demand, the respective central banks took the opportunity to buy dollars in the market and to rebuild their international reserves In part also, the improvement reflected the fact that participants in the European Community (EC) snake were able to avoid the kinds of tensions that had beset their exchange markets during the months preceding the October 1976 realignment of parities On April 1, before any significant speculative pressures had reemerged, the member countries agreed to a further realignment in which the parities of the three Scandinavian currencies within the arrangement were adjusted downward by 3 to 6 percent against the German mark, the Dutch guilder, and the Belgian franc.

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Under these more settled trading conditions, the German mark stayed at the bottom of the EC snake. Meanwhile, the continuing reversal of earlier hot money inflows to Switzerland contributed to a further easing of the Swiss franc. By contrast, the Japanese yen remained in heavy demand through mid-April, largely in reaction to a further widening of the Japanese current account suplus. The yen rate advanced 6¾ percent, for a total rise of 10 percent since last December's low, before settling back some 2½ percent by end-April.

At times during the three-month period the dollar came on offer against Continental currencies. By February, the severe winter weather in much of the United States had contributed to highly publicized reductions in industrial and agricultural output, higher prices, and a larger trade deficit. As these developments revived market uncertainties about our near-term economic prospects, the dollar was marked down against the German mark and other European currencies linked directly or indirectly to the mark. On occasion, the Bundesbank bought modest amounts of dollars in Frankfurt. In New York the Federal Reserve offered marks when trading became unsettled, selling $20.9 million equivalent from existing balances on three days during February 14-28.

As the weather improved and the broad expansion of the United States economy resumed, trading came into somewhat better balance through most of March.

Nevertheless, the market remained concerned over indications of a quickening of inflationary pressures in the United States and of an even sharper widening in the trade deficit than could be explained by adverse weather. For a while, the dollar held steady amid widespread expectations that interest rates would soon firm in the United States relative to rates abroad. As time passed, however, these expectations faded, and the dollar began to lose resiliency in the market. After the European close on Friday, April 1, when incomplete reports of an EC snake realignment reached the New York market ahead of the official announcement, trading became confused and the dollar suddenly came on offer. The Federal Reserve intervened with modest offers of marks, selling $15.3 million equivalent.

This nervousness quickly passed, but the dollar's generally easier tone persisted. Over subsequent weeks press reports that industrial countries with current account surpluses were being urged to let their currencies appreciate generated expectations that further exchange rate adjustments might occur in the near term. Consequently, even as United States interest rates were beginning to firm in late April, dealers were by then offering dollars virtually across the board against the possibility that an exchange rate realignment might emerge during the weekend of the London summit meeting, May 7-8. In this atmosphere, the New York market became unsettled on several occasions and the Federal Reserve intervened on three days during April 15-29, selling a total of $30.6 million of marks. By the end of the period, the dollar had declined by some 2 percent against the mark.

In sum, the Federal Reserve sold a total of $66.8 million of German marks during February-April. These sales were all financed from System balances, which were replenished in part by occasional purchases of marks from correspondents and in the market totaling $49 6 million equivalent.

During the period, the Federal Reserve and the United States Treasury made further progress in repaying debts in Swiss francs, outstanding since August 1971. Pursuant to an agreement in October 1976 between the United States authorities and the Swiss National Bank for orderly liquidation of these obligations over a three-year period, the Federal Reserve repaid $132.3 million equivalent of special swap indebtedness and the Treasury redeemed $79.3 million equivalent of Swiss franc-denominated securities by end-April. Most of the francs for these repayments were purchased directly from the Swiss National Bank against dollars. But the Federal Reserve also bought francs from the Swiss central bank against the sale of $29.2 million equivalent of marks and $26.1 million of French francs, which in turn where either acquired in

Table 1

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

In millions of dollars equivalent

System swap commitments January 31, 1977	Repayments February through April 30, 1977	System swap commitments April 30, 1977
992 5	−132 3	860 2

Data are on a transaction-date basis

Table 2

Drawings and Repayments by Foreign Central Banks and the Bank for International Settlements under Reciprocal Currency Arrangements

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

Banks drawing on Federal Reserve System	Outstanding January 31, 1977	February 1 through April 30, 1977	Outstanding April 30, 1977
Bank of Mexico	150 0	−150 0	-0-
Bank for International Settlements (against German marks)	-0-	+ 35 0 − 35 0	-0-
Total	150 0	+ 35 0 −185 0	-0-

Table 3

United States Treasury Securities Foreign Currency Series Issued to the Swiss National Bank

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

Amount of commitments January 31, 1977	February through April 30, 1977	Amount of commitments April 30, 1977
1,513 1	−79 3	1,433 8

Data are on a transaction-date basis

the market or drawn from existing balances. In addition, the System purchased $23.2 million equivalent of Swiss francs in the market or from other correspondents in late February-early March, when the franc was weakening in the exchanges. By end-April, the Federal Reserve's special swap debt to the Swiss National Bank had been reduced to $860.2 million equivalent, while the Treasury's Swiss franc-denominated obligations had been lowered to $1,433.8 million equivalent.

During the February-April period the Bank of Mexico repaid the remainder of last year's borrowings from the Federal Reserve and the United States Treasury. In February, the Mexican central bank liquidated at maturity the $150 million drawn under the swap line with the Federal Reserve. In April, it prepaid the $150 million in drawings under the Exchange Stabilization Agreement with the Treasury.

Finally, in February, the United States Treasury established short-term credit facilities for Portugal totaling $300 million. During the period, the Bank of Portugal drew a total of $125 million on these facilities and subsequently arranged to repay $50 million in early May.