February-April 1983 Interim Report
(This report was released to the Congress and to the press on June 9, 1983.)

Treasury and Federal Reserve Foreign Exchange Operations

During the February-April period under review, the decline in global economic activity appeared to have ended, but questions remained about the breadth and scope of recovery and the prospects for a resumption in growth of world trade. Demand for oil remained weak and oil prices softened to the point of challenging the ability of OPEC (Organization of Petroleum Exporting Countries) to set production quotas and price differentials and thereby effectively to limit price declines. Meanwhile, persistent concern about the divergence of economic performances within Europe generated a major speculative attack against the exchange rate relationships within the European Monetary System (EMS). This speculation prompted the heaviest central bank intervention in support of the EMS rate structure in the four-year history of the EMS before the rates were realigned on March 21.

As the exchange markets reacted to the cross-currents of these developments, the dollar generally held steady against most currencies. On balance, between end-January and end-April the dollar was little changed against the German mark and narrowly mixed *vis-à-vis* other currencies. Although trading below its highs of late 1982 against the major foreign currencies, the dollar remained well above its lows reached immediately preceding the reporting period, in January 1983. This firm performance was contrary to the forecasts of the many experts and market observers who were anticipating a significant further easing of the dollar through early 1983.

The dollar's firmer than expected tone first emerged in response to definite signs that recession in the United States was giving way to a significant recovery. However, for a period after mid-February, those initial signs of a strong industrial upturn were superseded by later indications that the expansion was likely to be more moderately paced, confined largely to increased activity in a few sectors of the economy and to a turnaround in inventory investment. Thus, some skepticism reappeared that the recovery would prove durable in the face of continued high real interest rates.

Nevertheless, the economic outlook remained more promising for the United States than for most other industrialized countries. Moreover, shortly after the President's State of the Union and budget messages, the Administration's economic advisers were suggesting that the projections for real output growth for 1983, then estimated at 1.4 percent, should be revised strongly upward. By comparison, European officials forecast little or no growth of Continental economies, and Japan's forecast growth rate of 3.4 percent for fiscal 1983-84 looked modest as compared with that country's presumed potential.

The dollar was sustained in the market as a number of concerns subsided that had weighed against the currency during the late fall and early winter. In particular, the fear that economic recovery would necessarily be accompanied by a rekindling of inflation tended to dissipate as prospects for substantial gains

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in productivity improved. Market observers also became less concerned about cost pressures from basic materials, as expectations grew of a substantial reduction of world oil prices. The U.S. trade account turned out to be in smaller deficit during the first quarter than had generally been expected, and the deficit even narrowed somewhat from that recorded in the last three months of 1982. This result reflected a sharp drop in the oil import bill, which was expected to be largely temporary and was associated with reduced demand in response to the relatively warm winter and liquidation of inventories in anticipation of lower prices later. Market forecasts of a very large U.S. current account deficit for the year as a whole were not significantly revised. Nevertheless, the temporary respite from monthly releases of large deficit figures seemed to defuse what had been an important negative factor for the dollar previously, so that considerations of relative trade and current account performances received little attention in the exchange markets during this period.

The exchange markets were also influenced at times

Table 1

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

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

Bank drawing on Federal Reserve System	Outstanding January 1, 1982	1982 I	1982 II	1982 III	1982 IV	1983 I	1983 April	Outstanding April 30, 1983
Bank of Mexico	-0-	-0-	+800.0 −600.0	+1,400.0 − 900.0	−217.4	−482.6	-0-	-0-
*Bank for International Settlements (against German marks)	-0-	-0-	-0-	-0-	+124.0 −124.0	-0-	-0-	-0-

Data are on a value-date basis

*BIS drawings and repayments of dollars against European currencies other than Swiss francs to meet temporary cash requirements.

Table 2

Drawings and Repayments by the Bank of Mexico under Special Swap Arrangements

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

Drawings on	Outstanding January 1, 1982	1982 I	1982 II	1982 III	1982 IV	1983 I	1983 April	Outstanding April 30, 1983
U.S. Treasury special temporary facility for $1,000 million	*	*	*	+ 825.0 − 825.0	*	*	*	*
Drawings on special combined credit facility								
Federal Reserve special facility for $325 million	*	*	*	+ 89.8 − 43.8	+211.2	+ 67.8	-0-	325.0
U.S. Treasury special facility for $600 million	*	*	*	+ 166.8 − 81.3	+392.2	+122.3	-0-	600.0
Total	*	*	*	+1,081.6 − 950.0	+603.5	+190.0	-0-	925.0

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

*Not applicable

by shifting assessments of the prospects for dollar interest rates. During February the improving scenario for inflation, together with the prospect for only a moderate recovery, gave a lift to U.S. credit markets, and long-term interest rates began to turn down. In this environment, market operators considered the possibility that the Federal Reserve would not resist a decline in short-term interest rates and might lower its discount rate, both to lend support to the recovery at home and to help foster an international economic climate in which heavily indebted countries might be better able to meet the objectives of their stabilization programs. In fact, short-term rates held steady through April, and the Federal Reserve kept its discount rate at the 8½ percent level established in December. But long-term rates did continue to ease, moving down in two stages—first during February and again in April. It appears that, as long-term rates eased, substantial amounts of funds were moved into the United States by investors hoping to realize further capital gains. At the same time, real interest rates remained relatively high, and foreign investment was

Table 3

Drawings and Repayments by the Central Bank of Brazil under Special Swap Arrangements with the U.S. Treasury

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

Drawings on U S. Treasury special facilities for	Outstanding January 1, 1982	1982 I	1982 II	1982 III	1982 IV	1983 I	1983 April	Outstanding April 30, 1983
$500 million	*	*	*	*	+ 500 0 − 500 0	*	*	*
$280 million	*	*	*	*	+ 280 0	− 280 0	*	*
$450 million	*	*	*	*	+ 450 0	− 450 0	*	*
$250 million	*	*	*	*	+ 250 0 − 104 2	− 145 8	*	*
$200 million	*	*	*	*	*	+ 200 0 − 200 0	*	*
$200 million	*	*	*	*	*	+ 200 0 − 200 0	*	*
Total	*	*	*	*	+1,480 0 − 604.2	+ 400 0 −1,275 8	*	*

Data are on a value-date basis

*Not applicable

Table 4

U.S. Treasury Securities, Foreign Currency Denominated

In millions of dollars equivalent at Treasury book value; issues (+) or redemptions (−)

Issues	Amount of commitments January 1, 1982	1982 I	1982 II	1982 III	1982 IV	1983 I	1983 April	Amount of commitments April 30, 1983
Public series:								
Germany	3,622.3	-0-	−451.0	−1,231.9	−664.1	-0-	-0-	1,275.2
Switzerland	458 5	-0-	-0-	-0-	-0-	−458 5	-0-	-0-
Total	4,080 8	-0-	−451.0	−1,231.9	−664.1	−458 5	-0-	1,275.2

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

Table 5

Net Profits (+) and Losses (−) on U.S. 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 through April 30, 1983	-0-	-0-	-0-
Valuation profits and losses on outstanding assets and liabilities as of April 30, 1983	−578 1	−951 3	+360 9

Data are on a value-date basis.

attracted also by the bullish U.S. stock market, continuing safe-haven considerations, and the apparently better growth prospects in the United States than abroad.

In addition, the dollar frequently became caught up in developments primarily involving European currencies, particularly the events surrounding the realignment on March 21 of parities in the EMS From early February, sentiment became increasingly favorable toward the German mark, which strengthened against other European currencies as well as the dollar, as market participants speculated first about the outcome of coming national elections in Germany and then about the likelihood that a long-anticipated realignment of EMS parities would take place shortly thereafter. Speculative buying of German marks and Dutch guilders, both considered virtually certain to be revalued in any restructuring of the EMS, intensified while the weaker currencies in the European joint float, including particularly the French and Belgian francs, came on offer. The French franc, after having been maintained around the middle of the EMS band for some weeks, was allowed to drop to its mandatory lower intervention point after March 6 and, subsequently, Euro-French franc interest rates soared to unprecedented levels. The Belgian authorities, also faced with intensifying pressures, imposed stringent new foreign exchange controls. With speculation against these two currencies becoming prohibitively expensive, positioning in favor of the stronger EMS currencies increasingly took the form of sales of non-EMS currencies, including the dollar. At the same time, official intervention to defend the EMS parities, while primarily conducted in European currencies, also involved substantial sales of dollars by the central banks whose currencies were weak within the system. EMS-related sales by both private and official parties thus contributed to a tendency of the dollar to decline moderately during the first three weeks of March, particularly against the German mark. The reversal of these flows after the March 21 realignment similarly contributed to the dollar's subsequent recovery

By April, as the new quarter opened and many of the reflows into dollars associated with the recent EMS realignment were completed, exchange market activity settled down to a subdued pace, and the dollar traded in a relatively narrow range Some uncertainty was generated by the persistent divergence between the dollar's apparent firmness and the still widely held view that the medium-term trend of the dollar would be downward because of the outlook for interest rates and current accounts. Adding to the uncertainty were concerns that trade protectionist pressures might be deepening in response to two years of declining world growth. In this context, talk spread among market participants that the major industrial countries might be preparing a coordinated intervention effort—now that the intervention study commissioned at last year's summit meeting had been completed and on speculation that exchange rates would be a major point of discussion at the Williamsburg summit By late April, however, expectations of substantial changes in official intervention policy faded, and on April 29 the intervention study was released by the summit ministers, accompanied by a statement on intervention and related matters. But, in the cautious atmosphere that had prevailed during much of April, market professionals were prepared to sell dollars, thereby stemming any marked upward movement of the dollar, while commercial participants often were substantial buyers when the dollar eased. As a result, the dollar market was well balanced. There was a marked change in the dollar only against the pound sterling which, in an environment of stabilizing oil prices, recovered nearly 7 percent from an earlier decline.

By the close of the period the dollar traded at DM2.4615 in terms of the German mark and ¥237 80 against the yen, some ½ percent and 1 percent respectively below the levels of three months earlier. Against the pound sterling, the dollar ended the period down nearly 3 percent as compared with three months earlier, while it increased by 2 percent against the Swiss franc. In terms of a trade-weighted average, the dollar rose by about 1 percent to close the period only slightly below the historically high levels it had reached in November 1982. The U.S. authorities did not intervene in the exchange markets during the period under review.

In other operations during the three-month period, the U.S. monetary authorities continued to provide credits to Mexico and Brazil. At the same time, both countries made repayments on earlier bridging credits provided by the U.S. monetary authorities as they drew on other financing arrangements.

As discussed in the previous report, both the Federal Reserve and the U.S. Treasury's Exchange Stabilization Fund had provided credits to Mexico during 1982-83. Funding was provided through the Bank of Mexico's regular swap facility of $700 million with the Federal Reserve, and also through special swap facilities in cooperation with other central banks through the Bank for International Settlements (BIS). In February, Mexico drew the remaining portion of the special facility, receiving $44.25 million from the Treasury and $25.75 million from the Federal Reserve. As of April 30, drawings of $325 million and $600 million were outstanding from the Federal Reserve and the Treasury, respectively, representing the entire $925 million available under the U.S. portion of the multilateral swap facility. On February 28, the Bank of Mexico fully repaid the remaining $373 million outstanding on its swap line under the Federal Reserve's regular reciprocal currency arrangement, which had been drawn last August before other arrangements had been put in place. Thus, on balance, during this three-month period, Mexico reduced its net outstanding borrowing from the Federal Reserve and the Treasury under these facilities by $303.0 million.

The Central Bank of Brazil repaid on February 1 $280 million of the $730 million outstanding on facilities made available to it earlier by the Treasury. The remaining $450 million facility was repaid on March 3. On February 28, the Treasury agreed to provide Brazil with two additional swap facilities of $200 million each in anticipation of Brazil's drawings under the compensatory financing facility and extended Fund facility of the International Monetary Fund. These swaps were drawn on February 28 and March 3 and were repaid by March 11. Thus, at that point Brazil had repaid in full all Treasury swaps made available to it since October 1982.

In April, the Bank for International Settlements, acting with the support of the U.S. Treasury and the monetary authorities in other countries, agreed to participate in an international financial support package for Yugoslavia. The Treasury, through the Exchange Stabilization Fund, as part of the liquidity-support arrangement for the BIS provided by the participating monetary authorities agreed to be substituted for the BIS for $75 million in the unlikely event of delayed repayment by Yugoslavia.

In the period from February through April, the Federal Reserve and the Treasury realized no profits or losses from exchange transactions. As of April 30, cumulative bookkeeping or valuation losses on outstanding foreign currency balances were $578.1 million for the Federal Reserve and $951.3 million for the Treasury Exchange Stabilization Fund, while the Treasury general account showed valuation gains of $360.9 million related to outstanding issues of securities denominated in foreign currencies. These valuation gains and losses represent the decrease in the dollar value of outstanding currency assets and liabilities valued at end-of-period exchange rates, compared with the rates prevailing at the time the foreign currencies were acquired.

The Federal Reserve and the Treasury have invested foreign currency balances they had acquired in the market as a result of their foreign exchange operations in a variety of investments that yield market-related rates of return and have a high degree of quality and liquidity. Under the authority provided by the Monetary Control Act of 1980, the Federal Reserve had invested some of its own foreign currency resources and those held under warehousing agreements with the Treasury in securities issued by foreign governments. As of April 30, the Federal Reserve's holdings of such securities were equivalent to $1,509 million. In addition, the Treasury directly held the equivalent of $2,589 million in these securities as of end-April.