February-April 1985 Interim Report
(This report was released to the Congress and to the press on June 7, 1985.)

Treasury and Federal Reserve Foreign Exchange Operations

The dollar rose strongly during February to record highs for the floating rate period against major European currencies, then fell unevenly until mid-April. At the end of April the dollar was trading somewhat above its lows for the three-month period, but was down on balance about 2 percent against most major currencies from end-January levels. Exchange markets were highly unsettled on a number of occasions during the period. Monetary authorities intervened heavily during February and early March following the January G-5 meeting at which the participating countries reaffirmed their commitment to promote convergence of economic policies, to remove structural rigidities, and to undertake coordinated intervention as necessary.

The dollar began to move up strongly as the period under review opened. The dollar's resilience in the face of declining U S. interest rates during the last quarter of 1984 had increased confidence in the currency But the main factor spurring the reacceleration of the dollar's rise was the market perception that the U.S economy was likely to pick up again and maintain strong growth with low inflation after the slowing late in 1984. The expected economic growth and the recent acceleration of the monetary aggregates were thought likely to limit the scope for any further easing of monetary policy

Moreover, economic recovery in Europe continued to be comparatively sluggish despite the strong contribution to world economic growth provided by the U S. expansion. Against this background, market sentiment toward the dollar became extremely bullish There was strong demand for dollars for both commercial and investment purposes as well as by market professionals, even as the dollar set record highs against several European currencies Markets became one-sided and unsettled as the dollar's rise gained momentum, particularly after it passed levels at which some central banks had intervened in the past. Through February 26, the dollar rose by nearly 10 percent against major European currencies—to about DM3 48 and $1 03 against the German mark and British pound, respectively—while rising 3 percent against the yen

On three occasions during the first three weeks of February the U S authorities intervened, selling a total of $208 6 million against marks, $97.6 million against yen, and $16 8 million against sterling to counter disorderly market conditions in operations coordinated with foreign monetary authorities But the exchange markets became more unsettled amid uncertainty over the high dollar exchange rates and the speed of the dollar's rise over the preceeding weeks The dollar started to ease back from its highs Then, coordinated intervention operations, considerably larger than those of the preceeding months, were undertaken by several monetary authorities. As for their part of these operations, the U S authorities intervened on two occasions at the end of February and one in early March, selling a total of $257 2 million against marks At the end of these operations the dollar was well below its highs of February 26th

The dollar moved higher during the following week before declining again as newly released U.S economic

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Table 1

Federal Reserve
Reciprocal Currency Arrangements
In millions of dollars

Institution	Amount of facility April 30, 1985	Amount of facility April 30, 1984
Austrian National Bank	250	250
National Bank of Belgium	1,000	1,000
Bank of Canada	2,000	2,000
National Bank of Denmark	250	250
Bank of England	3,000	3,000
Bank of France	2,000	2,000
German Federal Bank	6,000	6,000
Bank of Italy	3,000	3,000
Bank of Japan	5,000	5,000
Bank of Mexico	700	700
Netherlands Bank	500	500
Bank of Norway	250	250
Bank of Sweden	300	300
Swiss National Bank	4,000	4,000
Bank for International Settlements		
Swiss franc-dollars	600	600
Other authorized European currency-dollars	1,250	1,250
Total	30,100	30,100

Table 2

Net Profits (+) or 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
February 1 through April 30, 1985	-0-	-0-
Valuation profits and losses on outstanding assets and liabilities as of April 30, 1985*	−$1,294 6	−$841 2

Data are on a value-date basis

*Cumulative bookkeeping, or valuation, profits or losses represent the increase or decrease in the dollar value of outstanding currency assets and liabilities, using end-of-period exchange rates as compared with rates of acquisition Valuation losses reflect the dollar's appreciation since the foreign currencies were acquired

statistics indicated that growth in the first quarter might be lower than previously expected The pace of the dollar's decline accelerated during March and early April as exchange markets became concerned about the implications for monetary policy and, more generally, of the troubles of the Ohio thrift industry and the slowing of U.S. economic growth. As the market adjusted to these uncertainties, the dollar's decline at times was rapid, moving through levels at which resistance had been expected by some market participants.

By the middle of April, the dollar had fallen 15 percent from its highs of February to a low of DM2.95 against the mark Its drop in terms of the Japanese yen and the Canadian dollar was much smaller—about 6½ percent and 4 percent, respectively—just as the dollar's earlier rise relative to those two currencies had been more moderate. The dollar fell most dramatically, by over 20 percent, against sterling Following a sharp rise in British interest rates during late January, market participants had come to anticipate that the British authorities would maintain their anti-inflationary stance, with the result that sterling interest rates would remain substantially above those elsewhere. In these circumstances, sterling benefited more than other currencies from investment flows out of dollar-denominated assets as the dollar declined

The dollar found support at the lower levels reached in mid-April as professionals covered short positions and strong investment and commercial demand emerged The dollar closed April down slightly on balance from the opening of the period. In March and April, however, daily exchange rate movements were sharp and bid-offer spreads wider than normal as market perceptions about trends in the economy and likely official responses were in a constant state of flux Under these circumstances, the dollar-mark exchange rate, for example, fluctuated on average 2 percent each day during the two months.

In the period February through April, the Federal Reserve and the Exchange Stabilization Fund (ESF) realized no profits or losses from exchange transactions The Federal Reserve and the ESF invest foreign currency balances acquired in the market as a result of their foreign exchange operations in a variety of instruments that yield market-related rates of return and that have a high degree of quality and liquidity. Under the authority provided by the Monetary Control Act of 1980, the Federal Reserve had invested $927.0 million of its foreign currency holdings in securities issued by foreign governments as of April 30. In addition, the Treasury held the equivalent of $1,621.7 million in such securities as of the end of April.