



BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

MAY 27 1968

CONFIDENTIAL (FR)

May 24, 1968

To: Federal Open Market Committee

From: Mr. Holland

Attached is a memorandum from the Secretariat dated today and entitled "Proposed revision of foreign currency directive." It is contemplated that this memorandum will be considered at the meeting of the Committee to be held on May 28, 1968.

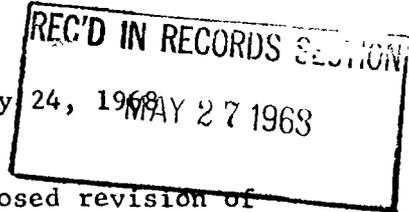
A handwritten signature in cursive script that reads "Robert C. Holland".

Robert C. Holland, Secretary,  
Federal Open Market Committee.

Attachment

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To: Federal Open Market Committee      Subject: Proposed revision of  
From: The Secretariat                      foreign currency directive

The purpose of this memorandum is to propose a revision in paragraph 4 of the Committee's foreign currency directive, in connection with possible System warehousing of guaranteed sterling acquired by the Stabilization Fund.

As noted in Mr. Coombs' memorandum of May 20, 1968, entitled "Present sterling position," one of the agreements in principle that was reached in recent negotiations with the Treasury by Chairman Martin and other System officials was that the Treasury and System combined should take on an additional \$400 million of guaranteed sterling. In such an event it might well prove necessary for the System to warehouse part of the Treasury's holdings of guaranteed sterling, for reasons similar to those discussed at the Committee's meeting of November 14, 1967. (See pages 17-34 of the memorandum of discussion for that meeting, particularly page 18.)

At that meeting, the Committee concurred in a recommendation of the Special Manager that the authorization for System foreign currency operations be revised in order to permit the warehousing of guaranteed sterling holdings of the Treasury, in an amount up to \$150 million. Specifically, paragraph 1C(1) of the authorization was amended by (a) deleting language that restricted System commitments to deliver foreign currencies to the Stabilization Fund to currencies in which the Treasury had outstanding indebtedness, and (b) increasing the dollar limit on such commitments from \$200 million to \$350 million.

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At the same time, paragraph 1B(3) of the authorization was amended to increase the limit on the System's own holdings of guaranteed sterling from \$200 million to \$300 million equivalent. On November 27, however, after the devaluation of sterling, the latter action was reversed concurrently with approval of a \$150 million increase in the System's swap line with the Bank of England. Although the November 14 amendment to paragraph 1C(1) was permitted to stand, no sterling warehousing operations for the Treasury have actually been undertaken to date.

It would appear that the foreign currency directive should also be amended if such warehousing operations are contemplated, because they would involve forward transactions for a purpose not specifically covered in the list of purposes, given in paragraph 4, for which transactions in forward exchange are authorized. That paragraph reads as follows:

4. Unless otherwise expressly authorized by the Committee, transactions in forward exchange, either outright or in conjunction with spot transactions, may be undertaken only (i) to prevent forward premiums or discounts from giving rise to disequilibrating movements of short-term funds; (ii) to minimize speculative disturbances; (iii) to supplement existing market supplies of forward cover, directly or indirectly, as a means of encouraging the retention or accumulation of dollar holdings by private foreign holders; (iv) to allow greater flexibility in covering System or Treasury commitments, including commitments under swap arrangements; (v) to facilitate the use of one currency for the settlement of System or Treasury commitments denominated in other currencies; and (vi) to provide cover for System holdings of foreign currencies.

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The Secretariat recommends that clause (iv) of this paragraph be revised to read as follows:

"(iv) to allow greater flexibility in covering System or Treasury commitments, including commitments under swap arrangements, AND TO FACILITATE OPERATIONS OF THE STABILIZATION FUND;"

The Special Manager and the Committee's General Counsel concur in this recommendation.

It might also be noted that when the limit on System commitments to deliver foreign currencies to the Treasury was raised from \$200 million to \$350 million on November 14, 1967, it was contemplated that only the additional \$150 million of such commitments so authorized would be used to warehouse Treasury holdings of guaranteed sterling, although language to that effect was not included in paragraph 1C(1) of the authorization as revised. Circumstances now, of course, are quite different from those prevailing on November 14, and it might be desirable to warehouse more than \$150 million of Treasury holdings of guaranteed sterling. Presumably it would be appropriate, unless the Committee directs otherwise, for the Special Manager to assume that he has authority to interpret the language of paragraph 1C(1) literally; i.e., that he has authority to undertake commitments to deliver foreign currencies to the Stabilization Fund up to the \$350 million limit specified, without applying a separate lower limit to sterling commitments, taken alone.