July 24, 1968.

Board Members

Arthur L. Broida

CONFIDENTIAL (FR)

For your information, Chairman Martin received today from Secretary Fowler the letter concerning Treasury backstop facilities for Federal Reserve swap arrangements that had been discussed at the FOMC meeting of July 16.

ALB:nlo

CMB

CONFIDENTIAL

THE SECRETARY OF THE TREASURY
WASHINGTON

JUL 23 1968

Dear Mr. Chairman:

On several occasions in recent months, representatives of the Federal Open Market Committee have discussed with the Treasury the problem that arises when drawings under reciprocal currency arrangements reach maturity without a reversal of the funds covered.

Federal Reserve drawings under its reciprocal credit facilities are made to provide foreign central banks who are unwilling to hold new dollar acquisitions on an uncovered basis with a temporary alternative to holding uncovered dollars on one hand or, on the other, purchasing gold from the United States or requiring the United States to purchase the surplus dollars through recourse to the International Monetary Fund. Drawings have generally been restricted to situations in which there was a reasonable hope for a reversal of the flows of funds so that the Federal Reserve would be able to acquire the necessary foreign exchange to liquidate the commitment in timely fashion. It has always been clearly established policy on both sides that Federal Reserve use of such credit arrangements is appropriate for only limited periods of time; current policy, as generally understood, calls for repayment within one year, if not earlier.

There have been occasions, however, when such reversals did not materialize. On these occasions, arrangements have regularly been made by the System and the Treasury under which the United States used its basic reserve resources of gold, drawings on the International Monetary Fund, and the issuance of Treasury foreign currency-denominated securities to meet the problem which arises when the cover granted by the swap drawing is withdrawn.

Naturally the Federal Reserve wishes to maintain the essentially short-term character of its swap drawings and must always be in a position to honor at maturity any commitments it has undertaken under its reciprocal currency arrangements in cases where flows of funds to its swap partners do not reverse themselves within the appropriate period. Accordingly, the Treasury will stand ready, as in the past, to use the basic reserve resources of the United States to the extent required and in the combination most suited to the interests of the United States that can be negotiated to obtain and provide to the Federal Reserve the foreign currencies needed.

In light of this understanding, and in view of the fact that swap drawings by the Federal Reserve, while initially conserving the reserves of the United States, may, if not reversible by market forces, necessitate a use of such reserves in connection with the repayment of such drawings, it is appropriate that there should continue to be consultation between the Treasury and the Federal Reserve on the use of swaps. This purpose can no doubt be accomplished through a continuation, and if necessary intensification, of the consultative procedures already developed by representatives of our two agencies concerning use of the swaps.

Sincerely yours,

Henry H. Fowler

Henry H. Fowler

The Honorable
William McChesney Martin, Jr.
Chairman
Federal Reserve Board
Washington, D. C. 20551