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

March 23, 1970

CONFIDENTIAL (FR)

TO: Federal Open Market Committee

FROM: Mr. Broida

There is enclosed a copy of a memorandum from Mr. Coombs, dated today and entitled "Recommended changes in paragraphs 1B(4) and 1C(2) of the authorization for System foreign currency operations." This memorandum was prepared pursuant to the Committee's request at the meeting on March 10, 1970, and it is contemplated that it will be discussed at the April 7 meeting.

Arthur L. Broida

Arthur L. Broida,
Deputy Secretary,
Federal Open Market Committee.

Enclosure

CONFIDENTIAL (FR)

March 23, 1970.

To: Federal Open Market Committee

From: Charles A. Coombs

Subject: Recommended changes in paragraphs 1B(4) and 1C(2) of the authorization for System foreign currency operations.

At the March 10, 1970 meeting of the Committee, President Coldwell inquired whether it might not be desirable to delete from the foreign currency authorization paragraph 1B(4) "Sterling purchased on a covered or guaranteed basis in terms of the dollar, under agreement with the Bank of England, up to $300 million equivalent," and paragraph 1C(2) "Commitments to deliver Italian lire, under special arrangements with the Bank of Italy, up to $500 million equivalent." President Coldwell questioned whether it was appropriate to have such special authorizations for individual currencies in a document which otherwise provided general authorizations covering all of the currencies approved for System operations. Chairman Burns requested that I prepare a memorandum for the Committee responding to President Coldwell's question.

With respect to paragraph 1C(2), the forward lire authorization, I see no difficulty whatsoever in deleting this paragraph from the authorization. I have also consulted with officials of the Bank of Italy who would have no objection to its deletion.

The problem with respect to paragraph 1B(4), the guaranteed sterling authorization, is somewhat different since we currently have on the books $206.4 million of such guaranteed sterling. As the

Committee will recall, on September 8, 1965, it approved an authorization for acquisition up to a maximum of $200 million of such guaranteed sterling, to permit the trading desk to launch the bear squeeze on short positions in sterling in September of that year. The System soon acquired $21.5 million of sterling under the guarantee, and took on another $50 million equivalent in February 1966. Further operations under this authorization followed the Labor Government's announcement on July 20, 1966 of an austerity program including a wage freeze. The System's holdings rose sharply and reached a temporary peak of $193.6 million at the end of October, including an overnight credit of $50 million; by the end of 1966 the Federal Reserve held $143.6 million of guaranteed sterling. With the recovery of sterling in the exchanges in late 1966 and early 1967, and the repayment by the Bank of England of many short-term credits, including swap drawings on the Federal Reserve, the System was able to reduce its holdings of guaranteed sterling to $89.6 million by June 1967. The balance remained at about that level through early 1968. Then, as part of a package deal worked out with the U.S. Treasury to clean up Bank of England's debt under the swap line, the guaranteed sterling authorization was increased by the Committee in two steps, on April 30 and May 28, 1968, to $300 million. The understanding was that the unutilized portion of the authorization, i.e., some $200 million, would be immediately used to acquire guaranteed sterling from the Bank of England. When this acquisition took place in June 1968, the System's holdings were raised to a peak of $292.5 million. Since then our holdings of guaranteed sterling have been progressively reduced through Bank of England quarterly repayments of debt under the so-called First Sterling Balance Arrangement and some sales to the United States Disbursing Officer in London.

We are now within striking distance of the original $200 million authorization and the Bank of England would have no objection if we cut back our holdings to $200 million by the time of the next Committee meeting on April 7, and, at that time, formally reduced the authorization from $300 million to $200 million. In coming months it may well prove possible to reduce still further our holdings of guaranteed sterling without objection from the Bank of England. I should be inclined, however, to favor such further liquidation of guaranteed sterling as a means of recreating scope for potentially useful market operations in support of sterling in the future rather than as a prelude to further reductions in the authorization itself, below the $200 million level.