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Treasury and Federal Reserve Foreign Exchange Operations and the Gold Pool*

By CHARLES A. COOMBS

During the six-month period September 1963 through February 1964, the volume of foreign exchange operations conducted by the Federal Reserve Bank of New York, as agent for both the Federal Reserve and for the United States Treasury, expanded still further. Coming against the background of a sharp improvement in the United States balance of payments, this increase in exchange operations reflected both the ebb and flow of international payments, marked in recent months by sharp swings in the net dollar position of foreign countries, and greater use of the available facilities by foreign central banks.

The bulk of the transactions executed for Federal Reserve account was financed through the network of central bank reciprocal currency agreements, the so-called "swap network". From the first use of the Federal Reserve swap program in March 1962 through the end of February 1964, total drawings on these swap lines by the Federal Reserve and other central banks amounted to $1,608 million. Over the same period, total repayments of $1,263 million were made, each generally within six months from the date of the drawing. As of the end of February 1964, the net debtor position of the Federal Reserve under all these agreements combined was $145 million, compared with a 1963 peak of $342 million on December 13, 1963. Further substantial progress in reducing this net debtor position is expected during the next few months.

Supplementing their cooperation in foreign exchange markets, the monetary authorities on both sides of the Atlantic have in recent years developed informal arrangements for coordinated action in the London gold market. The markets for gold and foreign exchange are closely linked, and orderly conditions in both are essential for a smooth functioning of the world monetary system. The history and nature of official operations in the London gold market are described in the second part of this report.

FOREIGN EXCHANGE OPERATIONS SINCE AUGUST 1963

Since August 1963, the Federal Reserve swap network has been broadened to include a $150 million swap arrangement with the Bank of Japan, while the swap facilities with the central banks of Italy and Germany have each been increased from $150 million to $250 million, and those with the Swiss National Bank and the Bank for International Settlements have both been enlarged from $100 million to $150 million. The very existence of this central bank network, now embracing twelve national currencies and providing mutual credit facilities of $2,050 million, exerted a strongly stabilizing influence on the gold and foreign exchange markets, which remained calm in the face of a number of potentially dangerous developments.

During the period under review, drawings by the Federal Reserve upon the swap lines were made primarily for the purpose of absorbing through direct transactions temporary accumulations of dollars on the books of certain foreign central banks, mainly those of Germany, Switzerland, and the Netherlands. There were also occasions, however, when the Federal Reserve intervened directly in the New York foreign exchange market as well as through foreign central banks in their markets in order to cushion the potentially disturbing effects of short-term capital movements arising out of seasonal fluctuations, changing money market conditions abroad, and speculative pressures.

The most striking operation of the latter type occurred

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at the time of the assassination of President Kennedy on Friday, November 22. The initial shock of the news from Dallas temporarily paralyzed the New York exchange market and, as ominous rumors concerning the condition of both the President and the Vice President began to flood the financial markets, there was a clear risk that the panic selling which had hit the stock market might spread to the gold and foreign exchange markets as well.

To provide firm assurance of the continuity of United States international financial policy, the Federal Reserve Bank of New York immediately placed in the New York market for System account sizable offers of most of the major foreign currencies at the rates prevailing just prior to the tragedy. The Bank of Canada simultaneously and on its own initiative took similar steps, which were then reinforced by Federal Reserve actions in New York, to stabilize the Canadian dollar-United States dollar rate. As the market realized that the Federal Reserve with the cooperation of foreign central banks was fully prepared to defend the existing rate levels, speculative reactions subsided and the market closed with a firm tone. By the end of the day, total Federal Reserve intervention in the New York market had amounted to no more than $23 million in all currencies. Intervention by the Bank of Canada to support the United States dollar on November 22 amounted to $24 million; half of these acquisitions were subsequently taken over by the Federal Reserve.

Although the European markets were already closed at the time of the assassination, telephone contacts were swiftly made with officials of the major European central banks, and well before the close of Friday afternoon arrangements had been completed for a joint program of official intervention on both sides of the Atlantic to deal with any speculative developments either in New York or abroad. As this coordinated intervention became clear to the European markets, trading remained quiet and orderly at stable rates on the following Saturday morning as well as on Monday (when the New York market remained closed on the national day of mourning). No further Federal Reserve intervention, and only limited intervention by foreign central banks, was required.

The Federal Reserve Bank of New York also continued to intervene in the foreign exchange markets here and abroad on behalf of the United States Treasury. Treasury operations were concentrated in the forward markets in an effort to influence the timing and direction of short-term capital flows between money market centers. In addition to such market transactions, the Treasury expanded its issues of foreign currency securities from $705 million to $760 million equivalent. On March 9 the Treasury repaid at maturity a $50 million equivalent lira bond issued to the Bank of Italy. This was the first such repayment of a Treasury medium-term foreign currency bond and points up the reversibility of such Treasury medium-term credit operations.

Table I

FEDERAL RESERVE SYSTEM RECIPROCAL CURRENCY ARRANGEMENTS

February 29, 1964

Institution	Amount of facility (in millions of dollars)	Term (in months)
Bank of France	100	3
Bank of England	500	12
Netherlands Bank	100	3
National Bank of Belgium	50	6
Bank of Canada	250	12
Bank for International Settlements	150	3
Swiss National Bank	150	3
German Federal Bank	250	3
Bank of Italy	250	6
Austrian National Bank	50	3
Bank of Sweden	50	3
Bank of Japan	150	3
Total	$2,050	

One other development during the period under review that deserves particular mention was the United States drawing on the International Monetary Fund (IMF) on February 13. This drawing in the amount of $125 million equivalent—mainly in German marks and French francs—was made under the $500 million stand-by agreement with the Fund announced by President Kennedy last July 18. The foreign currency proceeds of this drawing are being sold to other member countries for their use in making repayments to the Fund since, with the Fund's holdings of dollars now equal to the dollar portion of the United States subscription, the Fund cannot at this time accept further dollars in repayment. While this first drawing upon the Fund by the United States was essentially of a technical nature, it nevertheless demonstrated that the resources of the Fund can be called upon by both large and small countries, not only in times of emergency but also in a more or less routine way. Use of the Fund by other countries in such a manner would help to integrate further its large resources into the usable foreign assets of member countries.

There is thus emerging in even sharper focus a spectrum of more or less formalized international credit facilities, ranging from the central bank swap network at the short end to foreign currency bonds and IMF credit facilities in the intermediate area. Each of these credit facilities is complementary to the others. Each may be selectively employed, depending on whether the operational problem calls for immediate action to deal with a temporary situation or a more studied resort to medium-term credit,

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either from one government to another or from the international pool of credit provided by the IMF. Further development and refinement of such mutual credit facilities to deal with problems that may lie ahead afford a most useful means for strengthening the world's payments system.

GERMAN MARKS. Since January 1963 there has been almost continuous buying pressure on the German mark, mainly reflecting a substantial improvement in the German foreign trading position, large inflows of long-term capital, and occasional inflows of short-term funds in response to tight money market conditions or hedging operations.

In May and June of 1963, as noted in the preceding report in this series, the Federal Reserve drew the entire $150 million equivalent of marks available under its mark swap line with the German Federal Bank. In the face of continuing pressure, it then appeared advisable to shift to medium-term United States Treasury financing through a $25 million issue on July 11 of a two-year mark bond, which provided funds for further intervention during the remainder of July. This issue brought total Treasury issues of mark-denominated bonds to $225 million equivalent.

Despite this shift in the financing of United States operations in marks, the System still was faced with the problem of early liquidation of its commitments under the fully drawn $150 million swap arrangement. As this appeared likely to take some time, however, the Federal Reserve and the Treasury—in line with the general policy of reserving swap facilities for countering flows that give evidence of being quickly reversible—felt it desirable at this point to substitute, for a portion of short-term obligations of the Federal Reserve to the German Federal Bank, a medium-term United States Treasury borrowing in the form of a further $50 million issue of two-year mark bonds. The mark proceeds of this issue were immediately sold by the Treasury to the Federal Reserve System and were used to reduce the Federal Reserve swap drawing to $100 million. This was the first instance of a refunding of a Federal Reserve swap drawing through medium-term Treasury borrowing.

During August and early September, when buying pressure on the mark tapered off, the Federal Reserve System purchased $25 million of marks which were employed to reduce the swap drawing to $75 million. The remainder was fully liquidated by October 28, mainly with marks acquired from the German Federal Bank in conjunction with the German Defense Ministry's need for dollars to purchase United States military equipment.

In November the German Federal Bank once again took in substantial amounts of dollars, as German banks began repatriating funds for the year end. Consequently, the Federal Reserve made new drawings on the swap line —which had been expanded to $250 million on October 10—both to mop up dollars from the German Federal Bank and to acquire marks to sell in the New York market. Marks were also sold in the New York market for United States Treasury account.

The inflow of funds to Germany persisted through mid-December, by which time Federal Reserve drawings under the swap line had risen to $136 million (including $10 million drawn to cover spot sales made in New York on November 22, following the assassination of President Kennedy). Once again, however, the German Defense Ministry's need for dollars enabled the Federal Reserve to acquire marks, in this case totaling the equivalent of $70 million, during the remainder of December. These marks, supplemented by market acquisitions through the German Federal Bank, were used to reduce the net commitments under the swap to $59 million at the close of the year. A further reversal of the year-end window dressing early in January enabled the Federal Reserve to acquire through the German Federal Bank sufficient additional marks to liquidate the remainder of the mark swap drawings by January 9, 1964.

Once the post-year-end short-term capital outflow ended, the mark strengthened again as the growing German trade surplus and a continuing inflow of capital for investment in German securities created a heavy demand for marks. Late in February, this demand became further swollen by speculative money movements, mainly within Europe. In order to counter these pressures, the German Federal Bank took in dollars at rates just below the ceiling for the mark and the Federal Reserve Bank of New York intervened in the New York spot market as well as the forward market.

SWISS FRANCS. As has been pointed out by both United States and Swiss officials, the strength of the Swiss franc in recent years has been mainly attributable to recurrent inflows of short-term capital funds associated with international tensions. Whenever these short-term inflows have tapered off, the underlying deficit in the Swiss balance of payments has emerged and generated sizable demands for dollars to finance imports and other payments. During the spring and early summer of 1963, such a demand for dollars reappeared and brought about a strengthening of both the spot and forward dollar rates against the Swiss franc. Under these conditions, the Federal Reserve and Treasury made rapid progress in reducing their short-term debt in Swiss francs, which had totaled $188 million at the begin-

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ing of the year. By June 20, the debt had been fully liquidated.

In late July, however, the Swiss franc strengthened once more, as the Swiss money market became somewhat tighter. To counter the liquidity squeeze, Swiss commercial banks repatriated funds placed abroad, and this inflow—combined with some renewed speculative pressures—created a heavy demand for Swiss francs. In closely coordinated operations in New York and Zurich, the Swiss and United States authorities tempered these market pressures and prevented unduly sharp rate movements. Intervention took the form mainly of United States Treasury sales of Swiss francs for forward delivery and market purchases of spot dollars by the Swiss National Bank, both on a moderate scale.

In September the Swiss franc strengthened still further as a result of inflows of funds associated with the usual market gossip surrounding the annual IMF meeting and also because of a flow of funds from Italy. To help counter these pressures and reduce Swiss official reserve gains, the forward sale of Swiss francs for Treasury account in the Swiss market was resumed and during September some $72 million equivalent was committed, raising to $105 million equivalent the Treasury's forward Swiss franc commitments. Nevertheless, the Swiss National Bank had to absorb substantial amounts of dollars. In order to acquire Swiss francs to mop up these excess Swiss National Bank dollar holdings, the Federal Reserve reactivated the swap arrangement with the Bank for International Settlements (BIS), drawing $50 million on September 30 and $30 million on October 7. Although there was a temporary easing of the influx when the IMF meeting came to a close, further heavy flows of funds from Italy occurred. To cope with these pressures, the Treasury sold during the first half of October $44 million additional of forward Swiss francs and the Federal Reserve on October 22 drew the remaining $20 million of Swiss francs available under the $100 million swap arrangement with the BIS. Later in the month the Federal Reserve activated its swap arrangement with the Swiss National Bank by drawing $60 million equivalent, while the Treasury funded $30 million of its maturing forward contracts through the sale of a Swiss franc-denominated certificate of indebtedness to the Swiss Confederation. In early November, the Swiss franc came off its ceiling as a result both of a slowing-down in the influx of funds from Italy and of an easing in the Swiss money market, and the Federal Reserve was able to acquire sufficient francs to reduce its drawings on the Swiss National Bank and BIS by $5 million each—to $55 million and $95 million, respectively.

In the latter part of November the Swiss franc again advanced toward the ceiling as Swiss banks began to repatriate funds for year-end needs. By November 22 the rate was just below the ceiling and, after the assassination of President Kennedy, moved to the ceiling, at which level the Federal Reserve sold some $2 million of francs. On the same day, the swap lines between the Federal Reserve and the BIS and Swiss National Bank were each increased by $50 million to $150 million. The franc then remained at, or just below, its ceiling through the end of the year. During December, the Swiss National Bank engaged in a large volume of swap transactions—buying United States dollars spot and selling them forward—with the Swiss commercial banks to provide accommodation for the year-end repatriation of funds. In addition, the Swiss National Bank had to absorb a substantial volume of dollars in the spot market on an outright basis. Most of these excess dollar holdings were mopped up on December 31 by a Federal Reserve drawing of $70 million of Swiss francs on the swap arrangements with the BIS and the Swiss National Bank. Thus, at the year end the Federal Reserve's swap commitments in Swiss francs totaled $220 million while the Treasury's forward contracts totaled $120 million.

In February 1964 the Swiss franc rate eased as the heavy net capital inflows of earlier months began to taper off, thus exposing the underlying Swiss current account payments deficit. Later in the month it was possible for the Federal Reserve Bank of New York to acquire Swiss francs against dollars from the Swiss National Bank. The latter required the dollars so purchased to cover current needs. It is anticipated that sizable reductions will be made over the next few months in the outstanding Federal Reserve and Treasury short-term commitments in Swiss francs.

NETHERLANDS GUILDERS. Buying pressure on the guilder developed in mid-March 1963 and continued for more than two months thereafter. Part of the dollar influx into the Netherlands apparently originated in foreign direct investment. But a more important cause was a gradual tightening of money market conditions in the Netherlands. To bolster their strained domestic liquidity positions, Dutch commercial banks repatriated short-term investments from abroad. In these circumstances, it seemed appropriate to prevent through central bank swap operations the potential unloading of such repatriations on the Netherlands Bank. Accordingly, from April 10 through May 28, the Federal Reserve gradually disbursed a total of $44 million equivalent in guilders acquired through drawings upon the $50 million swap line with the Netherlands Bank.

By early June the tide began to turn, as the Netherlands Bank again reduced the commercial banks' cash reserve

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requirements and money market conditions eased. With the decline in Dutch money rates and the strengthening of their liquidity positions, Dutch commercial banks resumed placements of short-term funds abroad. Throughout the summer months the guilder market was quiet, and by July 28 the Federal Reserve was able to acquire sufficient guilders—both from the market and directly from the Netherlands Bank in connection with a prepayment of Netherlands Government debt to the United States—to liquidate all outstanding swap drawings on the Netherlands Bank.

In September the guilder rate again turned upward, as a general debate in the Netherlands over credit and wage policy gave rise to widespread rumors that the guilder might be revalued. This in turn set off brief but heavy speculative demand for guilders, and the guilder rate rose sharply until eary October when the revaluation rumors died down. During this preiod, the Federal Reserve drew $100 million of guilders under the swap line with the Netherlands Bank—the arrangement was increased from $50 million to $100 million on October 2 as the heavy movement of funds to the Netherlands persisted—and sold $15 million of guilders in the New York market while also absorbing $80 million of surplus dollars on the books of the Netherlands Bank. In addition, the Federal Reserve Bank of New York sold for United States Treasury account through the Netherlands Bank $38.7 million of guilders forward for one-month delivery in order to encourage an outflow of funds from the Netherlands.

The guilder eased somewhat in October and November, as funds previously repatriated were reinvested abroad. The Federal Reserve Bank of New York was thereby enabled to acquire sufficient guilders to reduce the System's swap commitment by $20 million to $80 million and to liquidate $21.7 million of the Treasury's forward contracts. The remainder of the guilders needed to meet the Treasury's commitment was acquired through a swap with the BIS of $17 million of the Treasury's holdings of marks for guilders. (These marks had been acquired for possible market intervention in October through the reversal of an outstanding Treasury swap with the BIS of marks against Swiss francs. The Swiss francs needed for this latter operation were in turn acquired by swapping into Swiss francs part of the lira balances which the Treasury was building up in anticipation of future maturities of lira bonds issued to the Bank of Italy in 1962.)

In the latter part of November, the guilder strengthened again, reflecting the tightening effects in the money market of a bond issue by the Netherlands Government. Then on November 22, following the assassination of President Kennedy, the Federal Reserve sold in the New York market $3.2 million equivalent of guilders out of existing balances.

As the guilder again eased at the turn of the year, the Federal Reserve was able to resume sizable purchases of guilders and by the end of February the Federal Reserve's swap commitment had been reduced by $55 million to $25 million. In addition, the Federal Reserve Bank of New York acquired from the Netherlands Bank $17 million of guilders for the account of the United States Treasury and used the guilders to repay the Treasury's outstanding German mark-guilder swap with the BIS when a need for marks arose in early March. This transaction once again demonstrated the flexibility of the third currency swaps in enabling the United States to shift from one foreign currency to another. Thus, of the $138.7 million short-term guilder debt incurred by the Federal Reserve and the Treasury in September and October 1963, all but $25 million had been repaid in less than six months.

STERLING. Perhaps the most important single development in the sterling-dollar relationship during the past year was the increase in the swap line between the Federal Reserve and the Bank of England from $50 million to $500 million, announced on May 29. The magnitude of this increase in the reciprocal credit arrangement has greatly reinforced market confidence in the stability of the sterling-dollar parity.

In July, the Federal Reserve Bank of New York acquired for Treasury account $10 million equivalent of sterling, which was immediately swapped into Swiss francs to cope with buying pressure on the Swiss franc. In August, the Bank purchased in the market additional sterling balances of £2.7 million, or $7.5 million, for the Federal Open Market Account and the Treasury. There were no further Federal Reserve or Treasury operations in sterling until November 22, when the Federal Reserve sold $8 million equivalent of sterling in the New York market following the assassination of President Kennedy. These sales were covered by a Federal Reserve drawing of $10 million equivalent of sterling on the swap line with the Bank of England. An easing of sterling in December, as continental commercial banks repatriated funds from the United Kingdom for year-end positioning, enabled the Federal Reserve to purchase sufficient sterling to repay the swap drawing in advance of maturity.

The sterling market was quiet at the beginning of 1964, but in late February sterling came under some speculative selling. On February 27 the Bank of England's discount rate was increased from 4 per cent to 5 per cent. Prior to the increase, some support for sterling had been provided by the Bank of England through intervention in the ex-

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change markets and, in a minor way, by Federal Reserve purchases of sterling in New York. Following the bank rate action, these pressures subsided quickly.

CANADIAN DOLLARS. Throughout 1963 both the Canadian and United States authorities kept a close watch on potentially disturbing flows of short-term capital between the two countries. The desire to minimize such flows appears to have been reflected in part in adjustments in the Bank of Canada's discount rate in May, when it was reduced to 3½ per cent, and again in August, when it was raised to 4 per cent following the increase in Federal Reserve discount rate and the change in Regulation Q ceilings. With Canadian short-term rates thus running only slightly above United States rates and the forward Canadian dollar at a small discount, the incentive to move funds on a covered basis was relatively minor.

The completion in September of a $500 million Canadian wheat sale to the Soviet Union introduced a new technical problem, which was quickly resolved. The wheat sale naturally created heavy demands for Canadian dollars for future delivery against United States dollars since the sales contracts between the Soviet Union and the international grain companies—which were acting as intermediaries—called for settlement in United States dollars, whereas the grain companies had to purchase the wheat from the Canadian Grain Board with Canadian dollars. Consequently, the forward Canadian dollar moved to a premium vis-à-vis the United States dollar. Such a premium on the forward Canadian dollar, coupled with the existing interest differential in favor of Canadian money market instruments, might well have generated a sizable flow of arbitrage funds from the United States to Canada. In these circumstances, acting in close cooperation, the United States and Canadian authorities intervened to eliminate the forward premium on the Canadian dollar and thus reduced the covered interest arbitrage incentive in favor of Canada. In this connection, the Federal Reserve Bank of New York engaged in swap transactions for United States Treasury account, buying Canadian dollars spot and selling them forward against United States dollars. Such operations helped to meet market demands for forward Canadian dollars, and reduced to a minimum the flow of interest arbitrage funds during this period.

On Friday, November 22, the Federal Reserve sold $2.3 million of Canadian dollars in the New York market following the assassination of President Kennedy. Early in the following week, the Federal Open Market Account sold $14 million equivalent of Canadian dollars to the Bank of Canada to mop up some of the latter's United States dollar acquisitions during the crisis period. The Canadian dollar resources for these operations were acquired through a $20 million equivalent drawing on the Federal Reserve swap line with the Bank of Canada. In mid-December, when the Canadian dollar weakened as a result of the usual year-end pressures arising from heavy interest and dividend payments abroad, the Federal Reserve was able to purchase from the Bank of Canada the Canadian dollars necessary to cover these swap commitments and it repaid the $20 million drawing in advance of maturity.

BELGIAN FRANCS. As previous reports in this series have pointed out, the Federal Reserve-National Bank of Belgium swap has been fully drawn at all times and the mutual balances thereby created have been employed regularly to finance swings in Belgium's dollar position. In July and August the Belgian franc market was quiet, and there was no need for either party to employ the swap balances. In September, however, the National Bank of Belgium disbursed $10 million of the swap proceeds, as there was some downward pressure on the franc rate. Subsequently, the Belgian money market tightened (on October 31 the National Bank raised its discount rate from 4 per cent to 4¼ per cent) and the franc strengthened, thus permitting the National Bank to reconstitute the $10 million disbursed in September plus $5 million disbursed earlier in the year. As Belgian accumulations of dollars continued through December, the Federal Reserve used $15 million of the francs drawn under the swap to mop up excess dollars from the National Bank of Belgium, but in February 1964 was able to reconstitute its Belgian franc balances when the National Bank needed dollars. Thus, during the period the continuing mutual use of the swap facility made it possible for the Federal Reserve and the National Bank of Belgium to smooth out fluctuations totaling $55 million in Belgium's dollar balances. These operations brought to $200 million the total swings in the Belgian position financed in this manner, rather than through purchases and sales of gold, since the inception of this arrangement. As previously pointed out, these operations demonstrate how flexibly the recently developed international financial machinery can help finance the payments swings that inevitably accompany even a balanced growth of trade and payments.

FRENCH FRANCS. The French franc remained firmly at its ceiling throughout the first half of 1963 as the French balance of payments continued in substantial surplus, and there was no occasion for Federal Reserve intervention in the

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market. The French surplus moderated during the second half of the year, however, and the Federal Reserve was able for the first time to engage in some exploratory operations in French francs. Between July 19 and 23, in an effort to test the market, the Federal Reserve drew and disbursed a total of $12.5 million equivalent of French francs under the swap line with the Bank of France that had been increased to $100 million on March 4. This intervention lifted the dollar slightly off the floor, but it quickly became apparent that very sizable disbursements would be required to bring about any appreciable improvement of the dollar rate, and intervention was accordingly suspended. Later in the month the Federal Reserve readily acquired in the forward market through the Bank of France sufficient francs to cover the outstanding swap drawings.

No further opportunity for operations in French francs presented itself until October, when an active two-way market developed in Paris. In order to induce further improvement in the dollar rate, the Federal Reserve asked the Bank of France to sell at its discretion spot francs for Federal Reserve account, any sales to be covered by simultaneous drawings on the swap arrangements. A total of $9 million equivalent of francs was sold in this manner. These small scale commitments were quickly covered through forward purchases of francs. Since the turn of the year, French international payments have moved closer to equilibrium and the dollar has moved off the floor without official assistance.

ITALIAN LIRE. On January 21, 1963 the Federal Reserve repaid $50 million drawn in December 1962 under the swap arrangement with the Bank of Italy. Thereafter, there were no operations in lire until the fall when the lira came under pressure as a result of the Italian cabinet crisis and the continued deterioration in Italy's balance of payments. In order to bolster its reserves, which were being depleted by operations needed to support the lira rate, the Bank of Italy in October drew $50 million on the swap line with the Federal Open Market Account. This stand-by swap facility had been increased meanwhile to $250 million.

In order to provide further support for the Italian reserve position and in anticipation of its future need for lire to meet obligations arising out of the issuance to the Bank of Italy of $200 million in lira-denominated bonds, the United States Treasury in September and October purchased a total of $67 million equivalent of lire from the Bank of Italy. As described earlier in this report, the Federal Reserve Bank of New York for Treasury account then swapped $17 million of these lire against Swiss francs with the BIS in order to reverse an equivalent swap of German marks against Swiss francs. In December, as the Italian deficit persisted, the Federal Reserve bought an additional $50 million of lire from the Bank of Italy, simultaneously selling the lire forward to the United States Treasury, which thereby further reduced its uncovered lira bond liabilities. Then in January the Bank of Italy drew a second $50 million under the swap arrangement with the Federal Reserve, which at the same time purchased a further $50 million of lire from the Bank of Italy and again simultaneously sold the lire forward to the United States Treasury. Part of the Treasury's lira acquisitions were used on March 9 to pay off a maturing $50 million equivalent lira bond issued to the Bank of Italy on December 7, 1962.

AUSTRIAN SCHILLINGS. The Austrian balance of payments has remained in surplus, and there has been no occasion for Federal Reserve operations in Austrian schillings since January 1963 when an earlier $50 million equivalent swap drawing from the Austrian National Bank was repaid. However in order to absorb some of the Austrian National Bank's growing dollar holdings, the United States Treasury in April and December issued to the Austrian National Bank two $25 million equivalent eighteen-month bonds denominated in Austrian schillings.

SWEDISH KRONOR AND JAPANESE YEN. A stand-by swap line of $50 million equivalent was negotiated with the Bank of Sweden in January 1963, and one for $150 million was negotiated in October with the Bank of Japan. There have been no Federal Reserve System or Treasury operations in Swedish kronor or Japanese yen.

THE GOLD POOL

Since its reopening in 1954, the free market for gold in London has re-emerged as the largest and most important center in the world for such gold transactions.[1] The annual flow of gold to the London market, from new production and Russian sales, generally exceeds by a substantial margin both industrial and speculative demand. This residual supply has been regularly absorbed by central bank purchases of gold at prices ranging fairly closely around the

[1] For a description of the London gold market, see "The London Gold Market", Bank of England, *Quarterly Bulletin*, March 1964, an excerpt from which is reprinted as a supplement to this *Review*.

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fixed United States parity of $35 per ounce. The lower limit of the free market price range is approximately $34.83, which derives from the United States parity of $35 per ounce, less the Treasury charge of $0.0875 and shipping costs from London to New York ranging around $0.08. Conversely, the upper price limit at which central banks would be prepared to buy gold in London is set by the cost of buying gold in New York plus shipping charges from New York to London.

Over the long run, the London market price of gold is thus heavily dependent on the support of central bank demand and, ultimately, on the United States Treasury as the buyer of last resort. Since the reopening of the market in 1954, official demand for London gold has varied considerably, reflecting mainly changes in the dollar reserve position of foreign central banks. In each of the years 1954 through 1957, the London gold price fell below $35, and dropped as low as $34.85 in 1957 as the United States balance of payments moved into surplus.

In the short run, nevertheless, sudden surges of speculative demand for gold may substantially exceed the current flow of new gold from South Africa and other sources. Such a temporary shortfall of gold supplies occurred in October 1960, when an outburst of speculative demand was generated by a succession of heavy gold losses by the United States and aggravated by market uncertainty brought on by the approaching Presidential election. This explosive situation culminated in an abrupt rise of the London gold market price to around $40 per ounce on October 20 and aroused world-wide panicky apprehension of a general breakdown in the exchange rate structure of the Western world. In these circumstances, the Bank of England, with the full support of the United States monetary authorities, intervened in the market on a substantial scale in order to bring the price down to more appropriate levels.

Following the pledge by President Kennedy in January 1961 to maintain the official United States gold parity, earlier speculation on a breakdown in international currency parities faded away and the London gold price declined rapidly, stabilizing in March 1961 at about $35.08. During the second quarter of 1961, market supplies were increased by Russian sales, by offerings from private United States holders required under President Eisenhower's Executive Order to dispose of gold stocks held overseas, and by very large sales out of the British gold reserves during the sterling crisis touched off by the German and Dutch revaluations.

But these temporary additions to the flow of gold reaching the market tapered off during the summer months at about the same time that the main Western producer, South Africa, began to build up its official gold reserves

from domestic production. Simultaneously, the gold and exchange markets became increasingly apprehensive, as the United States deficit worsened and the Berlin crisis began to build up toward its climax later in the year.

By the end of August 1961, the London market price had risen once more to nearly $35.20 and held close to this level until mid-November (see chart). As the price approached $35.20, European central banks refrained from market purchases since London gold at these prices exceeded the shipping parity from New York. While this withdrawal of central bank demand brought the market into better balance, there remained the risk that a sudden upsurge of speculative demand might confront the British and United States financial authorities with an unpleasant dilemma: If, on the one hand, the free market price were allowed to rise, there was a clear risk that speculation might feed upon itself and result in a new wave of apprehension such as occurred in October 1960. If, on the other hand, the full brunt of a speculative attack were to be absorbed by drafts upon the United States gold reserves, the subsequent weekly publication of such United States gold losses might also have unsettling consequences.

In view of the mutuality of interest among the central banks and treasuries on both sides of the Atlantic in maintaining orderly conditions in the gold and exchange markets, the United States financial authorities approached the BIS group of central banks in October 1961 with a proposal to establish on an informal basis a central bank sell-

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ing arrangement which would share the burden of intervention on the London gold market to keep the price within bounds. Under the informal arrangements subsequently approved by the central banks of Belgium, France, Germany, Italy, the Netherlands, Switzerland, and the United Kingdom, and by the United States, each member of the group undertook to supply an agreed proportion—the United States share being 50 per cent—of such net gold sales to stabilize the market as the Bank of England, as agent for the group, determined to be appropriate. This selling arrangement was given a trial run in November 1961 and then deactivated in early December when an easing of market conditions brought the London gold market price down to $35.15. By the end of February 1962, the relatively small net sales effected during this trial run in late 1961 had been fully recovered through purchases in the market.

Early in 1962, as it began to appear that a surplus of gold might soon develop in the market, the United States again approached the BIS group of central banks with a second proposal, this time for a gold-buying arrangement. Under this arrangement, which was adopted experimentally in February 1962 and renewed in April 1962, the participants agreed to coordinate their purchases in the London market. Individual purchases by the central banks participating in the Gold Pool have thus been replaced by Bank of England buying for the joint account of the entire group, with such purchases by the Bank of England being subsequently distributed among the members in agreed proportions.

By late May 1962 the Bank of England, as agent for the Pool, had bought somewhat more than $80 million of gold. But before any of these acquisitions by the Pool had been distributed to the participating central banks, gold market conditions were abruptly reversed through speculation engendered by the sharp fall of prices in the New York and other securities markets and the flight from the Canadian dollar. By mid-July, when quotations reached $35.12, the Pool's surplus had all been used to stabilize the market.

The selling arrangement was then reactivated effective July 20, 1962. Although President Kennedy's Telstar broadcast on July 23 temporarily relieved nervousness about the dollar, by the time of the IMF annual meeting in September the Pool had put a net amount of nearly $50 million in the market. After a lull in the first part of October, the Cuban crisis erupted and produced a record turnover in the market. For a very short period the Pool intervened on a substantial scale, but the tension ended quickly as the international crisis receded and the Pool began to recoup its sales through market purchases. In November the selling arrangement was deactivated and has not been put into operation since. By the end of 1962, the Pool's market acquisitions more than matched its earlier heavy disbursements.

Throughout 1963 the gold market was relatively stable, prices never exceeding $35.12, and the Pool continued to acquire gold. Private demand for gold, it is true, persisted with little evidence of dishoarding, and for brief periods was felt quite strongly in the market. On balance, however, private absorption of gold appears to have fallen off considerably from the very high 1962 levels. At the same time, the volume of newly produced gold coming on the market increased over the year as a whole, particularly in the second half, and Russian gold sales were substantial, especially after early September when the Soviet Union became a heavy buyer of grain in the West. Over the last four months of 1963, prices rarely exceeded $35.09, and the Gold Pool's market acquisitions accelerated. During the entire year the Pool bought in the market and distributed among the participants well over $600 million of gold.

In essence, therefore, the Gold Pool consists of two kinds of arrangements, each subject to informal revision and renewal from month to month as agreed upon by the participating representatives. First, there is a selling arrangement designed to share the burden of stabilizing the market. This arrangement is not in operation all the time but may be quickly activated in case of need. Second, there is a buying arrangement which has unified the market purchases of the major monetary authorities and which moves in and out on both sides of the market as needed to help maintain orderly conditions and to encourage the flow of gold into official hands. The Gold Pool originated pragmatically and developed in response to the behavior of the markets and in accordance with the spirit of cooperation existing between a group of central banks whose interests lie close together. The entire operation is carried out in

Table II

LONDON GOLD MARKET "FIXING" PRICES 1954-63

In United States dollars per fine ounce

Year	Highest	Lowest	Range
1954	35.1129	34.9606	0.1523
1955	35.0673	34.9569	0.1104
1956	35.0830	34.8726	0.2104
1957	35.0317	34.8522	0.1795
1958	35.1405	34.9835	0.1570
1959	35.1451	35.0429	0.1022
1960	37.9863	35.0629	2.9234
1961	35.7788	35.0561	0.7227
1962	35.1867	35.0670	0.1197
1963	35.1204	35.0512	0.0692

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an extremely flexible and informal manner, so as best to achieve the Gold Pool's objectives.

As the accompanying table shows, the Gold Pool has stabilized prices within the range that had been customary before the October 1960 flare-up. Such price stability and the maintenance of orderly market conditions have brought substantial benefits to the entire international financial system. Speculative demand has diminished and more gold has gone into official reserves than would otherwise have been the case. The main point, however, is simply this: the very fact that the central banks are working together in the gold market, as well as in the foreign exchange markets, has strongly reinforced confidence in the existing international financial structure.

The Business Situation

The economy continued to operate at a high level in early 1964, and the existing uncertainties in the business outlook related mostly to the likely pace of future advance. To be sure, industrial production and retail sales were about unchanged in January and nonfarm payroll employment rose only moderately. Personal income moved up, but mainly because of a concentration into January of veterans' annual insurance dividend payments and the effects of the second stage of a Federal pay increase. Partial data for February suggest only slight increases in auto and steel production and little change in new-car sales or over-all retail volume. On the other hand, the tax cut has finally been enacted, with the reduction in withholding rates becoming effective on wages and salaries paid on or after March 5, and some of the leading business indicators point toward increased strength. In particular, nonfarm housing starts and new orders for durable manufactured goods rose substantially in January, and a Census survey taken that month suggests that consumer buying plans were generally stronger than a year earlier. Moreover, a special McGraw-Hill survey conducted in January confirmed impressions that prospects for a substantial rise in plant and equipment spending by business were decidedly better than had been indicated in plans reported last fall.

PRODUCTION AND EMPLOYMENT

The seasonally adjusted index of industrial production in January remained at the record level of 127 per cent of its 1957-59 average (see Chart I). Output declined slightly in the case of nondurable goods, but climbed a bit in utilities, mining, and durables manufacturing. The rise in the durables sector largely reflected a sizable step-up in steel ingot production—to the highest level since June—and expanded output of furniture and television sets (for which the continued widening of interest in color receivers may account in part). Equipment production also moved up again, bringing to 7 per cent the increase in this component since the 1963 low of last April. On the other hand, the rate of auto assemblies declined somewhat in January, although it remained substantially above the year-ago pace.

Preliminary data for February indicate that cars were rolling off the assembly lines at a modestly higher rate than in the previous month. Seasonally adjusted steel ingot production continued to rise, reflecting broadly based increases in customer demand. The Commerce Department has estimated that steel manufacturers may produce 114 million tons of ingots in 1964—well above the 1963 figure of 109 million tons but about in line with early 1964 rates of output.

Nonfarm payroll employment showed a moderate expansion of 87,000 in January, after adjustment for normal seasonal variations (see Chart I). This was a somewhat smaller rise than in December, mainly because payroll employment in the building trades fell by some 70,000, influenced by snowstorms during the survey week in January. On the other hand, employment in trade, services, and

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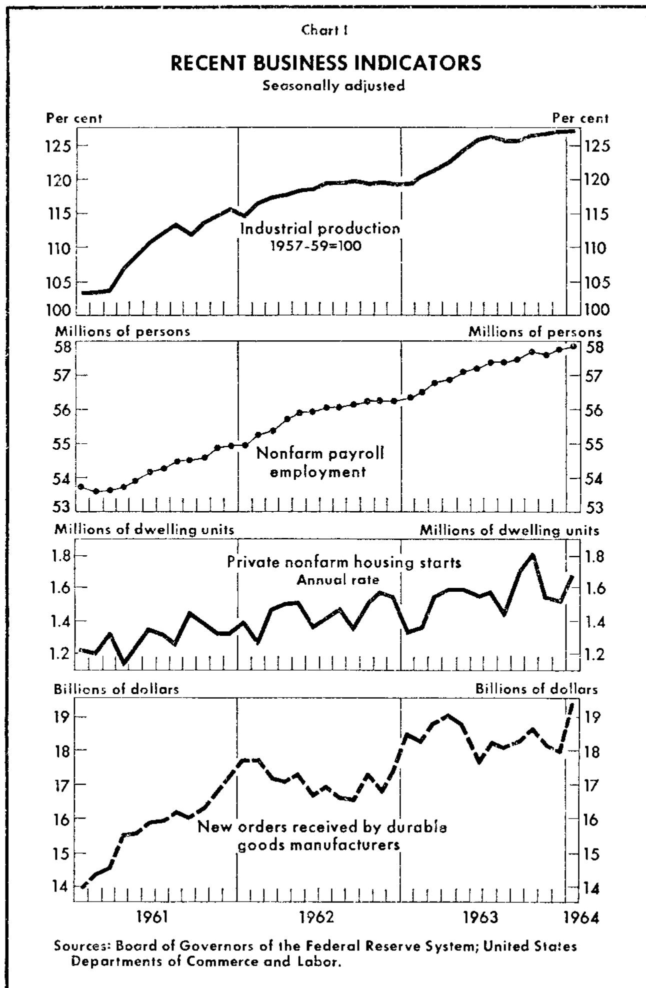


Sources: Board of Governors of the Federal Reserve System; United States Departments of Commerce and Labor.

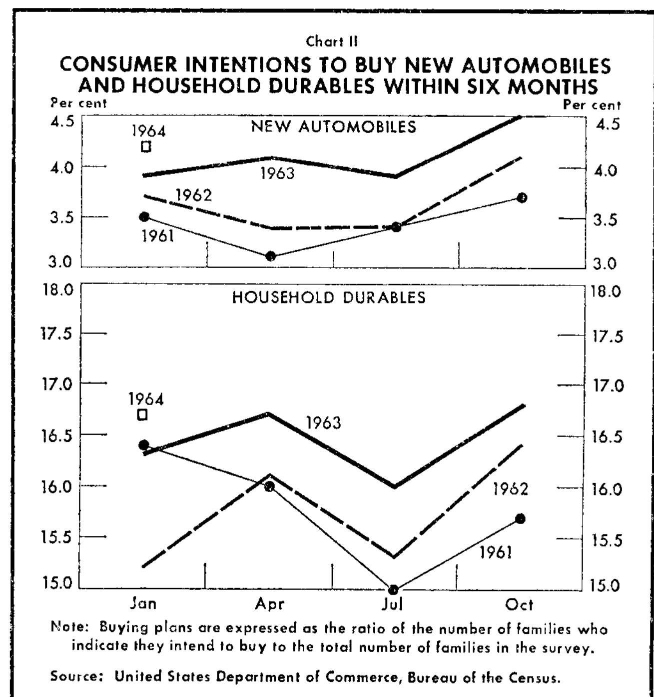
state and local government—the sectors in which job growth has been greatest during the past year and, indeed, during the past decade—continued to rise significantly. State and local government payrolls have shown a sharp over-the-year increase, primarily as a result of the increased hiring of educational personnel to meet the needs of the expanding school population.

INDICATIONS OF FUTURE DEMAND

After a sizable rise in December, retail sales remained about the same in January and apparently also in February. The likelihood of future strength in consumer spending is suggested by the latest quarterly survey of consumer buying intentions taken by the Census Bureau in January, when the tax cut appeared likely but may not yet have been viewed as a certainty. That survey indicated that the proportion of respondents planning to purchase a new car within six months was somewhat above the already high rate reported in the January 1963 survey (see Chart II). Intentions to buy household durables also showed some rise from a year earlier, but plans to buy used cars fell below the high level reached in January 1963. Buying intentions are, of course, never a precise predictor of sales in the months ahead. Nevertheless, they do at times suggest the direction of year-to-year changes in sales. This was the case in the January 1963 survey, although the estimated degree of rise over the year earlier turned out to be somewhat conservative for new-car purchases and a little optimistic for household durables.

The near-term outlook for residential construction also appears rather favorable in view of a considerable increase in January in the number of nonfarm housing units started (see Chart I). Such an advance was not totally unexpected in light of the very high fourth-quarter rate of building permits issued, which largely reflected the continued uptrend in planned apartment construction. Although permits for new apartment houses fell off somewhat in January—more than offsetting the slight increases for smaller structures—the backlog of unused permits apparently continues to be quite sizable.

New orders received by manufacturers of durable goods advanced substantially in January, thus more than recoup-



Note: Buying plans are expressed as the ratio of the number of families who indicate they intend to buy to the total number of families in the survey.

Source: United States Department of Commerce, Bureau of the Census.

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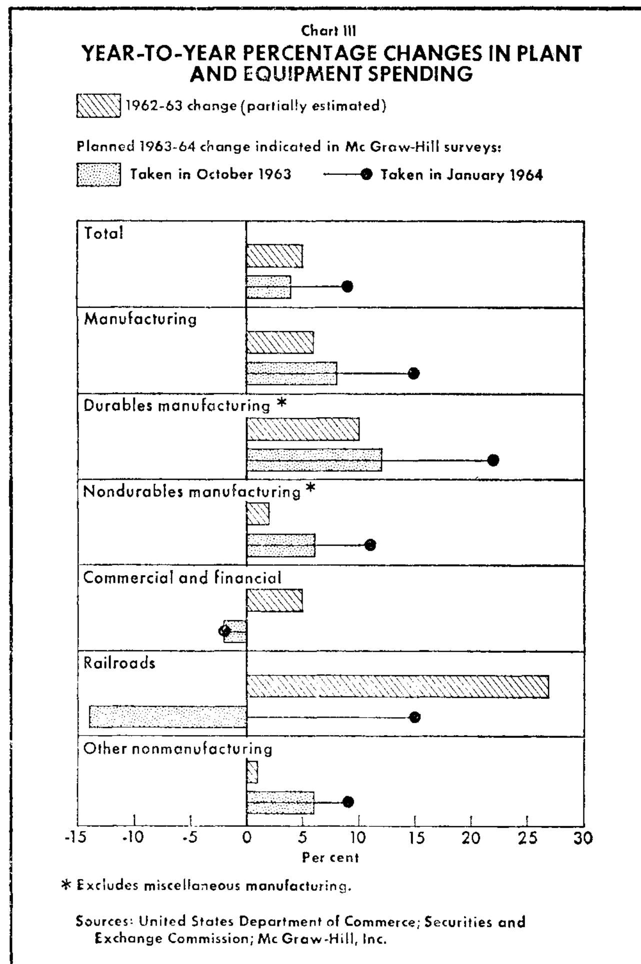
ing the declines of the preceding two months (see Chart I). The January rise was widespread, although much of the gain came in the aircraft industry—which had experienced a rather sharp decline in the preceding three months—and in the primary metals industry. Orders received by machinery and equipment manufacturers were about maintained at December's record level, following a sizable advance from November. This strong showing, coupled with the December-January strengthening in contract awards for commercial and industrial construction, points to impending rises in plant and equipment expenditures.

A strengthening in the outlook for capital spending this year appears to be corroborated by a special McGraw-Hill survey, conducted in January, which shows that businessmen's capital spending plans have been revised substantially upward since last fall. Thus, it seems likely that business fixed investment may provide more push to the economy this year than it did in 1963 (see Chart III). The new survey indicated that businessmen plan an 8.7 per cent year-to-year increase in plant and equipment expenditures in 1964, rather than only the 4.2 per cent rise suggested in McGraw-Hill's fall survey taken last October. The upward revisions were widespread, with the largest step-ups occurring in the durables manufacturing sector and the railroad industry. In the commercial sector, however, plans continued to point to some weakness, with outlays here scheduled to slip slightly below 1963 levels. The over-all rise now planned for 1964 compares favorably with the increases in capital spending actually achieved in most recent years of economic expansion, though it falls far short of the 22 per cent advance registered in the investment boom year of 1956.

While the results of the latest McGraw-Hill survey are encouraging, it is difficult to assess precisely what they mean for capital spending in the year ahead. Some step-up in over-all plans since last October might have been expected, given the generally optimistic business sentiment associated with the tax cut and rising corporate profits as well as the above-noted recent strengthening in machinery and equipment orders and in construction contract awards. Indeed, when the fall survey has pointed to an increase in capital expenditures, it has tended to underestimate the actual extent of the rise—and at times by a sizable amount. On the other hand, the other regular McGraw-Hill survey—usually taken in March and early April—has generally been somewhat too optimistic. Since this year's January survey is the first conducted in that month, it has no antecedents to suggest its performance as a predictive guide.

Chart III
YEAR-TO-YEAR PERCENTAGE CHANGES IN PLANT AND EQUIPMENT SPENDING



* Excludes miscellaneous manufacturing.

Sources: United States Department of Commerce; Securities and Exchange Commission; Mc Graw-Hill, Inc.

The need for some continued caution in interpreting the outlook for capital spending is highlighted by the fourth-quarter decline in capital appropriations of large manufacturing corporations, as reported by the National Industrial Conference Board. Even with the decline, however, appropriations were still at the second highest level reached in recent years, though somewhat below the 1955-56 record. Additional information on plant and equipment spending prospects will be provided in the quarterly survey by the Commerce Department and the Securities and Exchange Commission, taken in February, which is to be released shortly.

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The Money Market in February

The money market was steady and generally firm in February, with a good supply of Federal funds available at 3½ per cent on most days. Average member bank borrowings from the Federal Reserve Banks remained near the January level, while average free reserves receded somewhat from the levels to which they had risen in December and January. Rates posted by the major New York City banks on new and renewal call loans to Government securities dealers were predominantly in a 3¾ to 3⅞ per cent range during the month. Offering rates for new time certificates of deposit issued by the leading New York City banks were little changed, while the range of rates at which such certificates were offered in the secondary market declined slightly. Treasury bill rates, which had moved lower in January, rose irregularly during February, in part reflecting market reaction after midmonth to press comments suggesting the likelihood of an early increase in the British bank rate. After that rate was raised from 4 per cent to 5 per cent effective February 27, bill rates rose further to close about 4 to 15 basis points higher over the month, on bills of comparable maturities.

Prices of outstanding Treasury notes and bonds edged higher through the early part of the month in the wake of the favorable reception accorded the Treasury's February exchange refunding. After midmonth, prices drifted lower, as market uncertainty over the outlook for bond prices that had prevailed in earlier months revived amid discussion of a possible shift in monetary policy toward less ease and of the implications of a possible British bank rate move. After the announcement of the British action, prices declined somewhat further, closing ⅛2 to ¹⁴⁄₃₂ lower for the month. Prices of corporate and tax-exempt bonds were steady during most of the month but tended to be easier at the close.

CHANGES IN FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, FEBRUARY 1964

In millions of dollars; (+) denotes increase, (—) decrease in excess reserves

Factor	Daily averages—week ended				Net changes
	Feb. 5	Feb. 12	Feb. 19	Feb. 26	
Operating transactions					
Treasury operations*	+ 96	— 215	—	+ 62	— 57
Federal Reserve float	— 347	+ 79	+ 350	— 11	+ 71
Currency in circulation	+ 77	— 175	— 7	+ 161	+ 56
Gold and foreign account	+ 11	— 35	— 9	— 23	— 56
Other deposits, etc.	+ 75	+ 15	— 8	— 79	+ 1
Total	— 89	— 331	+ 326	+ 111	+ 17
Direct Federal Reserve credit transactions					
Government securities:					
Direct market purchases or sales	+ 240	+ 235	— 352	— 112	+ 11
Held under repurchase agreements	+ 30	+ 31	— 36	— 25	—
Loans, discounts, and advances:					
Member bank borrowings	+ 65	+ 125	— 76	— 91	+ 23
Other	+ 3	— 30	— 5	—	— 32
Bankers' acceptances:					
Bought outright	— 1	— 2	—	— 3	— 6
Under repurchase agreements	+ 1	+ 1	— 2	—	—
Total	+ 338	+ 358	— 470	— 231	— 5
Member bank reserves					
With Federal Reserve Banks	+ 249	+ 27	— 144	— 120	+ 12
Cash allowed as reserves†	— 229	— 70	+ 140	— 19	— 178
Total reserves†	+ 20	— 43	— 4	— 139	— 166
Effect of change in required reserves†	— 27	+ 77	+ 28	+ 38	+ 116
Excess reserves†	— 7	+ 34	+ 24	— 101	— 50
Daily average level of member bank:					
Borrowings from Reserve Banks	212	367	291	200	275‡
Excess reserves†	366	400	424	323	378‡
Free reserves†	124	33	133	123	103‡

Note: Because of rounding, figures do not necessarily add to totals.

* Includes changes in Treasury currency and cash.

† These figures are estimated.

‡ Average for four weeks ended February 26, 1964.

BANK RESERVES

Market factors absorbed reserves on balance from the last statement period in January through the final statement week in February. Drains—primarily reflecting an increase in currency outside the banking system[1]—were only partly counterbalanced by a decline in required reserves.

System open market operations supplied $5 million of reserves over the period as a whole, while $45 million

[1] "Currency in circulation" less "cash allowed as reserves".

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of reserves was absorbed by market factors. System outright holdings of Government securities rose on average by $11 million from the last statement period in January through the final statement week in February. As in January, no System holdings of Government securities under repurchase agreements were outstanding in the final statement period of the month. From Wednesday, January 29, through Wednesday, February 26, System holdings of Government securities maturing in less than one year contracted by $3,200 million, and holdings maturing in more than one year expanded by $3,411 million; this maturity shift largely reflected the effects of the Treasury's February exchange refunding operation.

THE GOVERNMENT SECURITIES MARKET

Prices of most Treasury notes and bonds advanced at the beginning of the month in the favorable atmosphere surrounding the Treasury's February refunding operation. The refinancing of $8.4 billion of securities maturing on February 15—$4.3 billion of which was publicly held—proceeded routinely. Moderate offerings of "rights" issues (the maturing 3¼ per cent certificates and 3 per cent bonds eligible for exchange) were readily absorbed by broadly based investor and professional demand. Considerable investor interest also developed for the "when-issued" securities (the new 3⅞ per cent notes of August 1965 and the reopened 4 per cent notes of August 1966 offered in the refunding). After the conclusion of the February 3 to 5 subscription period, the Treasury announced that all but $362 million—or about 8 per cent of the two maturing issues held by the public—would be converted, with public exchanges into the 3⅞ per cent notes and 4 per cent notes totaling approximately $2.2 billion and $1.8 billion, respectively.

The fact that the refunding offerings were confined to the relative short-term maturity area bolstered the intermediate- and long-term sectors of the market. In addition, the strength of the corporate bond market and the resultant narrowing of the spread between yields on Government and corporate bonds of comparable maturities reinforced confidence in the immediate outlook for Treasury bond prices. Against this background, prices of most outstanding Treasury coupon issues rose through February 7 in response to good investment demand and professional short covering. Prices drifted progressively lower over the balance of the month, however, as press comments suggested the possibility of a shift in monetary policy toward less ease during 1964 should the tax cut have inflationary repercussions. At the same time, the market was influenced by more frequent discussion of the likelihood of a change in the British bank rate. In the last calendar week of the month, a market letter report that the Treasury might offer a long-term bond in its April financing operations contributed to the heavier atmosphere. Investment demand was generally good, however, at lower prices, and considerable progress was made in distributing to investors the 4's of 1970 and 4¼'s of 1975-85 acquired by the dealers in the Treasury's January advance refunding. Progress was also made in distributing the issues acquired in the February exchange refunding. After the British rate was increased by 1 percentage point to 5 per cent on February 27, prices declined $\frac{2}{32}$ to $\frac{5}{32}$ in moderately active trading. At the close of the month, prices were generally $\frac{1}{32}$ to $\frac{14}{32}$ below the end-of-January levels.

Treasury bill rates, after having declined moderately in January, edged upward in February. Investor demand, which had been very strong in January, tapered off somewhat and tended to favor the shorter maturities. The reduced demand for longer bills led to some increase in rates on these maturities, as dealers sought to lighten their holdings amid press comments about the possibility of higher interest rates. After the increase in the British bank rate was announced, Treasury bill rates increased generally by 3 to 5 basis points. Over the month as a whole, rates for outstanding bills maturing in three months or less were generally 7 to 14 basis points higher, while rates for longer bills were about 4 to 15 basis points higher. At the last regular weekly auction of the month held on February 24, average issuing rates were 3.547 per cent for the new three-month issue and 3.703 per cent for the new six-month bill —5 and 9 basis points, respectively, above the rates established in the final auction in January. The February 25 auction of $1 billion of new one-year bills resulted in an average issuing rate of 3.765 per cent, compared with an average issuing rate of 3.680 per cent at the preceding month's one-year bill auction. The newest outstanding three-month bill closed the month at 3.60 per cent (bid), as against 3.50 per cent (bid) at the end of January, while the newest outstanding six-month bill was quoted at 3.77 per cent (bid) on February 28, compared with 3.61 per cent (bid) on January 31.

OTHER SECURITIES MARKETS

Prices of corporate bonds registered further gains early in February, under the impact of persisting demand from institutional investors, and then steadied as new-issue activity increased. Following the British bank rate increase, however, the market was somewhat easier. In the tax-exempt sector, where dealer inventories were sizable and the calendar of scheduled flotations was large, investor

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resistance to further markups developed and prices eased back from the higher levels reached in January. Over the period as a whole, the average yield on Moody's seasoned Aaa-rated corporate bonds declined by 2 basis points to 4.35 per cent and the average yield on similarly rated tax-exempt bonds rose by 1 basis point to 3.09 per cent.

The total volume of new corporate bonds reaching the market in February amounted to approximately $270 million, compared with $335 million in the preceding month and $275 million in February 1963. The largest new corporate bond flotation marketed during the month was a $75 million Baa-rated issue of sinking fund debentures maturing in 1992. The debentures, which were offered to yield 4.967 per cent and are not refundable for eight years, were well received. New tax-exempt bond flotations in February totaled approximately $740 million, as against $915 million in January 1964 and $710 million in February 1963. The Blue List of tax-exempt securities advertised for sale rose by $124 million to $633 million on February 28. The largest new tax-exempt bond issue marketed in February was a $100 million Aa-rated issue of state water bonds. Reoffered to yield from 2.85 per cent in 1973 to 3.625 per cent in 2012, the bonds attracted broad investor demand and were quickly sold. Other new corporate and tax-exempt bonds floated in February were accorded mixed receptions by investors.

Fiftieth Anniversary of the Federal Reserve System—Immediate Origins of the System

In the decades prior to the establishment of the Federal Reserve System, it became increasingly apparent that the country's financial system failed to meet fully the needs of a growing economy. These shortcomings were most dramatically revealed in fairly frequent "money panics".

New York City was the fulcrum of the banking system operating under the National Bank Act. Many out-of-town banks kept large deposits with New York banks, which in turn employed a large part of these funds in stock market call loans. In most years, seasonal currency withdrawals from the New York banks during the autumn harvest time were met without major difficulty. Occasionally, however, the withdrawals were so great or came at such a time that they triggered a money panic. In the absence of a "lender of last resort", the New York banks, undergoing heavy demands for currency—which constituted their legally required reserves against demand deposits—would restrain withdrawals by their correspondent banks. Failure by out-of-town banks to meet demands for cash would then often follow. With the outflow of currency from New York, moreover, banks would withdraw funds from stock market financing, interest rates would rise to extraordinary levels, and prices of stocks and bonds would drop sharply.

The nation experienced some or all of these conditions in 1873, 1884, 1893, 1901, 1903, and 1907, but each occurrence except the last led to only minor legislative changes. In 1907, the economy was in a recession and stock prices were trending downward over much of the year. As the seasonal demand for currency and credit built up at crop-harvesting time, a large trust company in New York experienced difficulties and suspended operations on October 23. Runs developed on two other New York trust companies, and correspondent banks stepped up their withdrawals of currency from national banks. The net losses of currency from New York banks to the rest of the country increased fourfold over seasonal norms during October and remained at peak levels through November. New York banks strongly discouraged or even rationed currency payments to correspondents, and the usual widespread disruption of payments followed. Call loan rates at one point were reported at 125 per cent per annum, and price declines in the securities markets worsened rapidly.

* The third in a series of historical vignettes appearing during the System's anniversary year.

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Eventually, the panic was stemmed. Gold flowed in from abroad, partially reflecting a balance-of-trade improvement and higher interest rates. Treasury deposits of currency in New York banks reduced the pressure on the central money market. Clearing houses served as self-assistance groups for local banks by placing the credit of the group behind each member. Nevertheless, in New York City alone three national banks, eight state banks, and four trust companies, with total deposits and other liabilities of about $110 million, had either failed or temporarily suspended operations.

The panic of 1907 spurred serious study of the basic problem. By May 30, 1908, a means of creating an emergency currency to stem panics had been provided in the Aldrich-Vreeland Act. This act of Congress also established the National Monetary Commission, to consist of nine Senators and nine Representatives, for the purpose of examining the monetary and banking system and reporting on needed changes. The monumental study of this commission (twenty-four volumes of published material) and its recommendations for a central banking system became —in a greatly modified form—the basis for the Federal Reserve Act of 1913 which was "to furnish an elastic currency, to afford means of rediscounting commercial paper, [and] to establish a more effective supervision of banking in the United States".

ANNUAL REPORT—1963

The Federal Reserve Bank of New York has just published its forty-ninth *Annual Report,* which reviews the economic and financial developments of 1963. The *Report* discusses the shift toward less ease in monetary policy last year and relates this shift to domestic economic developments and the balance of payments. The broadening and strengthening of international financial cooperation is also discussed. Major attention is devoted to the economic tasks that lie ahead at home and in the international arena. Copies of the *Annual Report* are available from the Public Information Department, Federal Reserve Bank of New York, 33 Liberty Street, New York, N.Y. 10045.

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The London Gold Market

An Excerpt from

the Bank of England's

Quarterly Bulletin, March 1964

FEDERAL RESERVE BANK OF NEW YORK

SPECIAL SUPPLEMENT TO

MONTHLY REVIEW, MARCH 1964

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The London Gold Market*

BACKGROUND

London is the largest and most important gold market in the world. Its origins lie not too clearly defined in the history of the development of London as a financial centre. The firm of Mocatta and Goldsmid was founded in 1684, ten years before the granting of the Bank of England's Royal Charter. It was not until the nineteenth century, however, that London achieved its eminence, both for the refining and marketing of gold bullion and also for the exchange and disposal of gold coins of various countries. That eminence was in fact achieved before the discoveries of gold in Australia and South Africa, which made London's position ultimately even stronger.

CONSTITUTION

In the English way, the London gold market has no written or formal constitution. Like so many other institutions which are now a normal part of London's daily life, it has developed in response to changing needs and demands over the years and has adapted and modified its rules and procedures as it went along.

There are at present five members of the London gold market:

Johnson, Matthey & Co., Ltd.
Mocatta & Goldsmid Ltd.
Samuel Montagu & Co., Ltd.
N. M. Rothschild & Sons.
Sharps, Pixley & Co.

Two (Montagus and Rothschilds) are merchant banks, one (Mocattas) is wholly owned by a merchant bank, one (Sharps Pixley) is a pure broker, and the fifth (Johnson Matthey) is a metallurgical firm of international repute. Two of the members (Johnson Matthey and Rothschilds) melt, refine, assay, and process gold. Rothschilds act as chairman of the market and have done so since the market was constituted in its present form after the First World War, and the daily gold price fixing takes place on their premises.

All authorised banks under the Exchange Control Act, 1947, are also authorised to deal in gold. But in practice dealings are largely concentrated in the hands of members of the gold market, plus one or two others. The significance of membership of the market is that it confers the right to be present at the daily price fixing which is described below.

In an active market, gold changes hands in considerable quantities; and for this to be done efficiently there must be a recognized specification for bars which are regarded as "good delivery". The requirements of the London market list of good delivery bars are that the bar has been melted and stamped by one of the forty or fifty refiners or mints situated all over the world which have been approved by the market. It must also carry a similarly acceptable assay shown either by an impressed stamp or by an assay certificate which must accompany the bar. The bar must assay at least 995, that is to say, at least 995 parts in 1,000 must be pure gold, and it must contain between 350 and 430 troy ounces of fine gold (the fine gold content is the product of the gross weight multiplied by the assay).

Changes are made from time to time in the London market list of acceptable melters and assayers by way of either addition or deletion. The former occur only after stringent tests have been made on sample bars by two London refiners independently which have satisfied the members of the market that the bars produced by a melter can be relied upon to conform to London's standards. Deletions happen very seldom but have occurred, for example, as the outcome of war. History and the technical expertise to be found here have resulted in the London market's standards being the basis of acceptability for gold bars in most countries in the world. One exception is the

*This is an excerpt from an article appearing in the Bank of England's *Quarterly Bulletin* for March 1964.

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United States, where the authorities will accept, without melting and assaying, only unmutilated United States Government-stamped bars when tendered in the exact form in which originally issued.

Bars of sizes smaller than the good delivery bars described above are also produced by British refiners to meet the requirements of customers on the Continent of Europe and in other places throughout the world. Dealings in all kinds of gold coins also take place.

THE LONDON FIXING PRICE

The daily fixing of the gold price, which takes place at Rothschilds beginning at 10:30 each morning, is the only daily international gold price fixing of its kind in the world. There is no fixing on Saturday or on New Year's Day; but on all other working days a representative of each of the five members of the gold market attends in person at the "fixing room" at Rothschilds, a member of which firm takes the chair. Each of the five persons present is in communication, by direct telephone, throughout the course of the fixing with his own trading room, where, again, there may be direct communication by telephone or telex with operators in foreign centres who may be interested in dealing at the fixing if the price is right. The chairman will suggest a price, in terms of shillings and pence down to a farthing; this price will be chosen at the level where it is thought that buyers and sellers are likely to be prepared to do business. When the tentative price is proposed, all present declare the nature of their interest at that price, *i.e.,* as sellers or as buyers (or having no interest either way) with the sellers stating their amount but without, at this stage, the buyers declaring their actual requirements. If all present should declare themselves as buyers and no selling interest appears, business clearly cannot be done and the price is then moved up; conversely if all are sellers and there is no buying interest the price is moved down. At the new tentative price interests are again declared and this goes on until there are the possibilities of business, that is to say until there are both buyers and sellers in evidence. At this stage the extent of the buying interest is declared and a count is taken. If, for example, there are buyers of 400 bars and sellers of 250 bars those present must decide whether the 250 bars will be shared out amongst the buyers or whether the price shall be bid higher. Anyone has the right to bid a higher price or, if the selling interest is uppermost, to offer at a lower price. Finally a point is reached where buyers and sellers come together at a price, and that is the fixing price of the day.

It may be sensed from the foregoing that there is a subtle difference between the attitude towards the seller and that towards the buyer. This difference stems from a tradition that, while a large buyer may have to face a sharp increase in price if he wants to see his demands satisfied in full at the first time of asking, the market should always be slightly biased in favour of endeavouring to absorb all new production or other gold which may be offered at the fixing.

OPERATIONS ON THE LONDON MARKET

Operations on the London market are not confined to the amount of gold changing hands at the fixing price in the fixing room. It frequently happens that any one or all of the five members of the market have in hand both buying and selling orders to be executed at the fixing price; if so each member will offset buying orders against selling orders and will only go into the fixing room to transact the net balance of purchases or sales. There is no obligation for any member to declare or fulfil all his orders in hand at the fixing; he may, if he judges it to be more advantageous, execute part at the fixing and postpone the balance until later. A good deal of business is frequently done after the fixing has taken place at prices which may vary considerably during the course of a day. The amount turned over at the fixing can represent as much as 90 per cent of the day's business or as little as 10 per cent. Some international dealers prefer to operate at the fixing; others prefer to wait until the fixing has taken place and they can see what is the trend of the price for the day before doing their business. Operations whether at the fixing or afterwards are ordinarily for delivery of gold loco London and for payment two working days later. A commission of ¼ per mille (minimum ten shillings) is charged on all deals at the fixing. Transactions effected at times other than the fixing, transactions for value dates other than the normal two working days ahead, and those in currencies other than sterling are a matter of negotiation and may be dealt in at net prices without commission being charged separately. There is no organised or regular market in gold for forward delivery as there is in foreign exchange, though forward operations do take place, often for large amounts: those are, however, a matter of negotiation each time. While ordinary transactions are in gold for delivery loco London, deals can be arranged in the London market for delivery in other centres; (conversely a good deal of international business transacted in other centres or on the international telephone is in gold for delivery loco London).

The factors operating in the London market are broadly the following:

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On the supply side

New production
Central bank sales
Other sales (including from time to time important amounts on Russian account)
Dis-hoarding

On the demand side

Central bank purchases
Purchases for industry and the arts
Hoarding purchases

The line of distinction between industrial and artistic consumption on the one hand and hoarding on the other is one which is not very clearly defined since increased demand for gold jewellery can, varying from one country to another, be either a disguised form of hoarding or a normal concomitant of inflation or just a result of a rising standard of living.

Hoarding is a term of art. In certain countries in the East, gold is the traditional manner of storing wealth, while in conservative-minded agricultural communities in various parts of the world it is a normal method of saving. Furthermore, in a number of countries throughout the world, a holding of gold has come to be regarded as a status symbol. In other countries, particularly on the Continent, gold may be held as an alternative to cash for balance-sheet purposes. So hoarding has come to mean all demand for gold which does not derive from central banks for reserve purposes or from industry and the arts in the stricter and literal sense of those terms.

THE BANK OF ENGLAND'S PART

The Bank of England are not physically represented at the fixing. But they are able, like any other operator, effectively to participate in the fixing by passing orders by telephone through their bullion broker and at the fixing they use exclusively the services of the chairman of the market, namely, Rothschilds. The Bank operate for a number of different parties; they are first the managers of the Exchange Equalisation Account, which may be a natural buyer or seller of gold: secondly, they are the agent for the largest single regular seller of gold in the world, namely, the South African Reserve Bank, which is responsible for the disposal of new production in South Africa: thirdly, they execute orders for their many other central bank customers: fourthly, the Bank aim, as in the case of the foreign exchange and gilt-edged markets, to exercise, so far as they are able, a moderating influence on the market, in order to avoid violent and unnecessary movements in the price and thus to assist the market in the carrying on of its business.

OTHER MARKETS

There are gold markets in other places. Leaving aside Paris, which is a domestic market, and Bombay which, since gold dealings were banned at the end of 1962, is no more than a black market, markets of varying importance exist in Switzerland, Belgium, Beirut, Aden, Cairo, Kuwait, Bahrain, Dubai, Bangkok, Saigon, Macao, Hong Kong, and in a number of other places as well, including more recently Johannesburg. During the period when the London gold market was closed (from September 1939 to March 1954) most of the international gold traffic was centred in Switzerland, Beirut, and Tangier—which has now lost its international status and no longer has an organised gold market—or in the East. The effect of reopening the London gold market in 1954 was to introduce a greater degree of stability into international dealings and to moderate fluctuations in the price of gold.

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