BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

June 9, 1967.

CONFIDENTIAL (FR)

TO: Federal Open Market Committee

FROM: Mr. Holland

Enclosed is a memorandum from Mr. Coombs, entitled, "Maturity Dates of Swap Lines with Common Market Central Banks." This memorandum was prepared in response to the Committee's request at the meeting held on May 23, 1967.

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

Enclosure

CONFIDENTIAL (FR)

June 9, 1967.

To: Federal Open Market Committee

From: Charles A. Coombs

Subject: Maturity Dates of Swap Lines with Common Market Central Banks.

At the FOMC meeting of May 2, 1967, I reported in some detail on efforts being made by officials of the Netherlands Bank and the National Bank of Belgium to bring about a realignment of the maturity dates of our swap lines with the Common Market central banks so as to facilitate consultation among themselves. In a closed session at the March BIS meeting, the Governors of the Common Market central banks had approved a Dutch recommendation, put forward at several previous meetings, that each central bank in the group should shift the maturity of its swap lines with the Federal to an end-of-quarter basis. We had not been officially informed of the Dutch proposal, nor of its acceptance at the March BIS meeting. Accordingly, we had agreed to a Belgian proposal, ascribed to "purely internal reasons," to shift the maturity date of a $50 million swap line renewal from June 13 to June 30. But, when the Netherlands Bank presented us, the day before our $150 million swap line with that bank reached its March 15 maturity, with a similar request to shift to a June 30 maturity for the renewal so as to "facilitate consultation," we had agreed only under protest and fully reserving our position as to subsequent maturity dates. Not until the April BIS meeting were we informed, first by a representative of the Bank of France and subsequently by President Holtrop, of the March decision of the

Common Market governors. The French took the position that they could renew a three-month swap line maturing on May 10 only until June 30, since they were bound by a group decision of the Common Market governors to move to a quarter-end maturity basis.

The firm stand taken by the Committee on this matter at the May 2 meeting greatly facilitated subsequent negotiations by Mr. Hayes and myself in Frankfurt and Basle. In our conversations in Frankfurt with President Blessing, Emminger and Tungeler, we noted, first of all, the impropriety of the Common Market central banks privately reaching a binding agreement regarding their swap lines with the Federal and then presenting us with a take-it-or-leave-it proposition. The swap lines, we pointed out, were reciprocally useful arrangements between the Federal and individual central banks which had been bilaterally negotiated, and any change in such arrangements was a matter for bilateral discussions between the Federal and its partner central bank. In such discussions, the Federal might very well wish to make certain counter proposals which could hardly be foreclosed by a binding agreement between two or more of our swap partners. Secondly, it was not clear to us what advantage was to be gained by the Common Market central banks forming a unification of swap-line maturities, although the phrase, "to facilitate consultation," seemed to suggest an unwarranted concern over possible Federal Reserve abuse of such credit facilities and a need for special surveillance by the Common Market central banks acting in concert.

More particularly, if such consultation on swap facilities were to move towards a joint effort to control actual Federal Reserve drawings on the swap lines, the reciprocal character of the swap lines would be seriously impaired. Finally, we noted that the procedural aspects of the whole episode had been somewhat unfortunate; the Federal had not been informed until the April BIS meeting of an agreement reached by the governors of the Six at the March meeting after having been discussed by them at several previous meetings. Meanwhile, the Federal had consented to a Belgian request to shift a swap maturity to June 30 to accommodate what the Belgians had described as "purely internal" considerations; the Dutch had given us no more than one day's notice of their decision to shift also to a June 30 basis for the explicit purpose of "facilitating consultation;" and now the Bank of France had told us that, being bound by a joint decision by the Common Market governors, they could agree to a renewal of their swap line only through June 30.

The FOMC had considered this whole matter at its May 2 meeting, had expressed considerable disappointment over what had transpired, and had authorized the Special Manager to negotiate a renewal of the French swap line for the usual three months' term. We were thus at an impasse, and the only way out we could see would be for the Common Market governors to set aside their March decision and, if they so wished, then initiate new discussions with the Federal regarding these swap maturities or any other aspect of these credit arrangements. In reply Blessing attributed the March agreement to the personal initiative of Holtrop and Ansiaux with which he had concurred in the thought that nothing of major importance was involved. He seemed genuinely embarrassed to find himself innocently involved in a breach of courtesy to the Federal and promised to do his best at the weekend Basle meeting to help untangle the situation. He was concerned over the possible political implications involved in dropping the swap line with the Bank of France, and he urged us to try to find some harmless compromise.

We next talked with Dr. Emminger, who also blamed Holtrop for mishandling the whole affair. He asserted that the end-of-quarter proposal had been accepted by the Bundesbank purely as a "matter of convenience" in order to lessen the frequency of discussion by the Common Market governors of a subject which remained essentially the business of the individual central banks concerned. He felt, however, that we could hardly contest the rights of the Common Market governors to consult among themselves on financial matters, including their swap lines with the Federal, since they were in effect required to do so by the Rome treaty. We replied that consultation was one thing--the Federal Reserve regularly consulted with its various swap network partners--but reaching binding agreements applicable to a third party was something else again. Emminger fully conceded this point, and we then suggested that if the end-of-quarter proposal involved no more than considerations of convenience, perhaps the most convenient arrangement would be to try to put the entire swap network on a one-year maturity basis, reaching more or less uniform maturity dates towards the latter part of the year. Specifically, we asked, would the Bundesbank be prepared to extend our present six-month swap line to one year with a maturity date near the year end. Emminger replied that he was sure the Bundesbank would do so and that our suggestion might well provide the basis for a satisfactory compromise all around.

In this connection, I would like to recall that at the May 2 meeting of the Committee, I made several suggestions to the effect that the Bank of Italy's proposal to shift our swap arrangement to a one-year maturity terminating near year end was a constructive approach which should present no problems to the System. Furthermore, immediately following Mr. Hayes' and my discussions with Dr. Emminger, we telephoned Governor Robertson to report on the progress of our negotiations, and mentioned in particular the possibility that moving the entire swap network to full-year maturities, reaching their term in December, might afford a useful compromise. Governor Robertson replied that he thought this might be a promising line to explore.

At Basle, Mr. Hayes spoke to Holtrop and Ansiaux along the same lines as our discussion with President Blessing. Holtrop reiterated his complaint against the bilateral way in which the September 1966 increases in the swap lines had been negotiated. Mr. Hayes replied that the subsequent calming of the international financial markets and the recovery of sterling had amply proved the usefulness of this operation. Regarding any possible future changes in the swap maturities, Holtrop was not in a position to comment officially since his term of office as President of the Nederlandsche Bank had just expired. In talking to Ansiaux, Mr. Hayes indicated that the System would be quite prepared to drop the $50 million increase in our swap line negotiated in September 1966 if Ansiaux felt that it no longer served any useful purpose. Ansiaux replied that he would think it over and, if he should conclude that the September swap increase was of lasting value, would be prepared to fold this $50 million, 3-month line into the $100 million, 1-year line maturing in December. In general, he was inclined to favor a shift of the entire swap network to a 1-year basis maturing in December.

Shortly thereafter we were approached by President Blessing who indicated that he felt we could count upon the Bank of France being released, so far as the other Common Market central banks were concerned, from the March agreement. We then called upon Governor Brunet and Clappier of the Bank of France, to whom we repeated the same story we had presented to Blessing. Brunet replied that he had been essentially neutral on the matter of a quarter-end maturity and that if he were released from the March agreement by the other governors he would have no hesitancy in renewing the swap line for another three months to mature August 10. If the Federal and the other central banks involved should subsequently decide to move to a full-year basis on the swap lines, with maturities clustered near the year end, the Bank of France-Federal Reserve swap line might then be moved into alignment with whatever year-end pattern might be adopted for the other swap lines. For example, the Bank of France-Federal swap line might be renewed for another three months on August 10, then for fifty days from November 10 through the year-end, and subsequently for the usual 90-day periods. We replied that we would have to discuss the problem with the Open Market Committee, and would let him know the outcome.

There remained only the problem of a formal meeting of the Common Market governors, normally held on the Monday morning following the BIS weekend, to set aside the decision taken at their March meeting. In view of the fact that our swap line with the Bank of France was due to reach its maturity on the following Wednesday, May 10, we suggested to President Blessing, who was serving as acting chairman of the Common Market governors, that a special meeting be held on Sunday afternoon. Blessing not only agreed to do so, but invited us to attend the meeting. We declined, since we did not wish to seem to deal directly with the Common Market governors acting in concert. A brief meeting was held without us after which we were informed that the March decision had been set aside.

As background to this new decision, it was the understanding of the Common Market governors that the Federal Reserve would consider the possibility of a 1-year pattern for all of the Common Market swap lines, with the possible exception of the French line which might be eventually realigned to a quarter-end basis.

The main significance of this whole episode, I think, is that we have won our point that the Common Market central bank governors should not reach binding agreements among themselves relating to the Federal Reserve, but must leave open full scope for prior discussion with the Federal by the individual central banks concerned with the matter in question. If the Committee so desires, I think we could now simply stand pat, reiterating our objections to any special surveillance by synchronizing swap line maturity dates with our central bank partners on a quarter-end basis. I suspect, however, that certain Dutch and Belgian officials, not to mention the Monetary Commission of the Common Market, may be smarting a bit over this setback, and if we hold rigidly to our position we might leave a certain residue of ill will which might prove disadvantageous at some future date.

Since returning from Basle, I have become even more persuaded that a general shifting of the entire swap network to a full-year basis, maturing in December, would represent only a minor concession by the Federal in exchange for a useful solidification and strengthening of the entire network. As it stands right now, the swap line of the Bank of Italy is already on such a basis, $100 million of the $150 million swap line with the Belgians also is on a one-year basis, maturing in December, while the Bundesbank would be prepared to move to a similar arrangement. If we were able to induce the Belgians to shift the remaining $50 million of our swap line, now on a three-month basis maturing at quarter-end, to a one-year basis maturing in December, and to make a similar shift in the $150 million of lines with the Dutch from the present quarter-end to a full-year basis, we would have reduced considerably the frequency of Common Market consultation and, in fact, converted the whole exercise into an innocuous annual ritual.