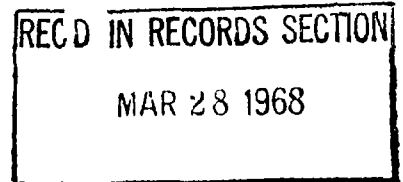




BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551



CONFIDENTIAL (FR)

March 27, 1968

To: Federal Open Market Committee

From: Mr. Holland

Attached is a memorandum from the Special Manager, dated today and entitled "Recent purchase of Swiss francs at rate other than market rate." This is the memorandum referred to under item 4 of the agenda for the Committee meeting to be held on April 2, 1968.

A handwritten signature in cursive script, appearing to read "Robert C. Holland".

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

Attachment

CONFIDENTIAL (FR)

March 27, 1968

TO: Federal Open Market Committee      Subject: Recent purchase of  
FROM: Charles A. Coombs                      Swiss francs at rate other  
   than market rate

On March 6, under paragraph 3 of the authorization for System foreign currency operations, I secured the approval of the Subcommittee of the FOMC provided for in paragraph 6 of the authorization to purchase from the Swiss National Bank (BNS) \$50 million equivalent of Swiss francs at a rate other than the prevailing market rate. This memorandum sets forth the reasons for this operation.

The System's Swiss franc swap lines with the BNS and the BIS have been in continuous use since June 1967. The System drew heavily on these lines in June - July 1967 in order to compensate for large flows to Switzerland following the Middle-East hostilities, and again in December in order to offset flows resulting from the sterling devaluation and year-end window dressing. By year-end, combined commitments to the BNS and the BIS amounted to \$650 million equivalent. Beginning in mid-January, the Swiss franc came on offer as a result of a better market atmosphere surrounding the dollar and the pound, reversal of year-end flows, and intermittent foreign exchange requirements of the Swiss Confederation. Under the circumstances, the Swiss National Bank began selling dollars on January 6, replenishing its losses by purchasing from the System a total of \$288 million against Swiss francs. By March 4,

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the System had used these francs, together with francs acquired from other sources, to reduce its swap commitments in that currency by \$333 million equivalent to \$317 million.

In early March, the U. S. Treasury agreed to make a drawing on the IMF and also to enter into a funding operation with the Swiss National Bank to help reduce System swap debt. In discussions with the Swiss authorities, a figure of \$175 million was agreed upon as a reasonable target for a Swiss-franc funding package. One hundred-twenty-five million dollars equivalent was to be repaid to the BIS with francs made available by the Swiss National Bank against issuance of a Swiss franc-denominated U. S. Treasury note (\$100 million equivalent) and a \$25 million Treasury sale of gold. The remaining \$50 million equivalent repayment was to be made through a System sale of dollars against Swiss francs to the Swiss National Bank which undertook to hold such dollars on an outright basis, pending eventual sale for Swiss Confederation requirements.

On March 6, Mr. MacLaury called Dr. Ikle of the Swiss National Bank to settle the final terms of the package. Dr. Ikle, while still ready to take \$50 million into his position, pointed out that if he bought dollars from the Federal Reserve at that day's market rate of SF 4.3450 per dollar, the Swiss National Bank would incur a loss of SF 1,500,000 (somewhat more than \$345,000) since the swap contract obligated the Swiss National

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Bank to sell dollars against Swiss francs at 4.1350, the rate of the drawing (i.e., the transaction would involve a purchase of \$50 million at 4.3450 at a cost to the Swiss National Bank of SF 217,250,000; the Swiss National Bank would receive on the swap repayment only SF 215,750,000). Moreover, the loss to the BNS would be exactly matched by a profit accruing to the Federal Reserve.

Ordinarily, the System would expect to make a profit on repayments of drawings since it draws and sells a foreign currency when the currency is expensive in terms of dollars (i.e., at its ceiling) and reacquires the currency and pays off the drawing when the currency is inexpensive in terms of the dollar.<sup>1/</sup> However, System profits are normally at the expense of the "market", not the foreign central bank. The System usually buys the needed currency in the market or, if the foreign central bank is selling dollars in the market, directly from it at the same rate. The problem in this case stemmed from the fact that the System was buying the needed foreign currency directly from the foreign central bank, not from the market, at a time when the central bank was not selling dollars to the market.

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<sup>1/</sup> Between January 19 and March 4, System repayments of Swiss franc drawings had resulted in profits of nearly \$2.6 million.

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In my judgment, it seemed inappropriate that the Swiss National Bank should incur a loss on a transaction involving a temporary (and possibly permanent) increase in its holdings of uncovered dollars. On March 6, 1968, I therefore recommended to the Subcommittee of the FOMC that I be authorized to purchase \$50 million equivalent of Swiss francs at 4.3150, the rate on the swap drawing, rather than at 4.3450, the market rate at the time. The Subcommittee gave its unanimous approval for this transaction.