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

STRICTLY CONFIDENTIAL (FR)
CLASS I - FOMC

TO: Federal Open Market Committee

DATE: June 20, 1989

FROM: Normand Bernard NB.

SUBJECT: Increases in Limits on System Holdings of Foreign Currencies and Further Activation of Warehousing Facility.

Effective June 14, 1989, all Committee members voted to approve a recommendation by Mr. Cross to increase the limit on overall System holdings of foreign curencies from $15.0 to $18.0 billion. Effective the same date, all Committee members also indicated that they found acceptable the Manager's recommendation to increase the intermeeting limit on changes in holdings of foreign currencies from $3.0 to $5.0 billion.

As anticipated in Mr. Cross' memorandum of June 13 to the Committee, the Treasury formally requested the System to warehouse an additional $2 billion equivalent of German marks for value on Friday, June 16, 1989. As reported to the Committee earlier, the warehousing facility was activated on June 1, 1989 in the amount of $1.0 billion (also in German marks). That activation was the first use of the $5.0 billion facility since July 1983.

Attached are copies of the message transmitted to FOMC members on Tuesday, June 13, 1989, and of Mr. Cross' related memorandum.

Attachments

TELEGRAM

FEDERAL RESERVE COMMUNICATIONS SYSTEM

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON

STRICTLY CONFIDENTIAL (FR)
CLASS I - FOMC

TO: CORRIGAN - NEW YORK
GUFFEY - KANSAS CITY
KEEHN - CHICAGO
MELZER - ST. LOUIS
SYRON - BOSTON

DATE: June 13, 1989

FROM: Normand Bernard NB

SUBJECT: Proposed Increases in Limits on Holdings of Foreign Currencies.

1. At its meeting on May 16, 1989, the Committee approved an increase from $12.0 billion to $15.0 billion in the limit on the System's overall open position in all foreign currencies contained in paragraph 1D of the Authorization for Foreign Currency Operations. In the attached memorandum, Mr. Cross recommends a further increase to $18 billion. Approval of this action requires a formal vote by the Committee.

2. Pursuant to the requirements of Section 2.A of the Committee's "Procedural Instructions with Respect to Foreign Currency Operations," the Manager for Foreign Currency Operations requests Committee clearance for an increase from $3.0 billion to $5.0 billion in the intermeeting limit on changes in System holdings of foreign currencies. This limit was previously increased from $1.5 billion to

$3.0 billion, effective May 24, 1989. This action is subject to clearance, rather than a formal vote, by the Committee.

The members of the Foreign Currency Subcommittee (Chairman Greenspan, Vice Chairman Corrigan, and Governor Johnson) have indicated that they concur with both of Mr. Cross' requests. The text of Mr. Cross' memorandum follows.

Please advise promptly whether you vote to approve the Manager's recommendation to increase the limit on the System's overall holdings of foreign currencies to $18.0 billion. Please indicate separately whether the Manager's request for an increase in the intermeeting limit to $5.0 billion is acceptable to you.

Attachment

6/13/89

To: FOMC

Subject: Foreign Currency Operations

From: Sam Y. Cross SYC

The dollar has remained under strong upward pressure for much of the time since your last meeting on May 16. We are still hearing of dollar buying by investors to purchase dollar assets and to reduce existing hedges on dollar securities. Corporate firms have continued to adjust leads and lags in a way that has lent support to dollar exchange rates.

The Treasury and the Federal Reserve have continued to intervene, most especially when the upward pressure intensified in mid-May, and by early June the dollar's rally seemed to be losing steam. The cumulative effects of the intervention, rising interest rates abroad, and mounting expectations that interest rates here would soon ease combined to moderate the dollar's strength. Indeed, at one point, the dollar appeared to be poised to move decisively lower.

During the past two weeks, however, the dollar received a strong new boost when reports of violence in China expanded interest in dollar investments. With the focus of attention now turned to Asia, the pressures have been more severe, and the intervention more sizable, in the market for dollar/yen than in that for dollar/mark. The Bank of Japan, together with the Bank of Canada and many of the European central banks, have also sold dollars in the foreign exchange market in line with our own operations.

From your last meeting until noon today, the Desk has sold $5,731 million, shared equally between the Treasury and the Federal Reserve. Of this amount, $2,520 million has been sold against German marks and $3,211 million has been sold against Japanese yen. As a result, the System's open position in all currencies has increased by $ 2,865.5 million since the last FOMC meeting. On May 23, the Committee raised the inter-meeting limit to $3,000 million, and we are now approaching that limit.

Since the level of intervention has been higher than was envisioned, we are approaching the Committee limits on our overall open position, and on changes in our overall open position during the present intermeeting period ending July 6.

With respect to the overall open position, you will recall that the Committee discussed at your last meeting whether that limit should be raised to $15 billion or, alternatively, to $18 billion. Our present open position is nearly $14 billion, and I wish to recommend that the Committee increase the limit to $18 billion.

With respect to the change in position for the present inter-meeting period, I wish to recommend that the limit be raised from $3 billion to $5 billion. This should allow sufficient latitude for intervention operations as well as any interest earnings on the FOMC balances until the Committee's next meeting.

Although the Treasury has not yet requested another warehousing operation formally, I expect they will be coming to us later this week with a proposal that the System warehouse another $1 to $2 billion equivalent of German marks.

The three members of the Foreign Currency Subcommittee concur in the recommendations concerning the System's open position.