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

March 20, 1972

CONFIDENTIAL (FR)

TO: Federal Open Market Committee

FROM: Mr. Broida

Enclosed is a copy of a memorandum from the Special Manager, dated today and entitled "Activation of revaluation clause in Belgian Swap arrangement." It is contemplated that this memorandum will be discussed at the meeting of the Committee tomorrow.

Arthur L. Broida

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

Enclosure

CONFIDENTIAL (FR) March 20, 1972

TO: Federal Open Market Committee
FROM: Charles A. Coombs
Subject: Activation of revaluation clause in Belgian Swap arrangement

As the Committee is aware, the System currently has outstanding swap commitments to the Belgian National Bank totaling some BF24.1 billion equivalent to $490 million at the exchange rate at which they were undertaken (the former ceiling rate of BF49.625 per dollar). Since the Belgian franc will be revalued when the dollar is formally devalued, the Account Management has been discussing with the Belgian authorities various ways in which the revaluation clause protection given to the System under the swap arrangement could be effected. The Belgians have now made the following proposal which we would recommend that the Committee approve.

The original dollar equivalent of our outstanding commitment in Belgian francs was, as noted above, $490 million. In order for the Belgian National Bank to be compensated for the 8.57 per cent devaluation of the dollar, they should receive in settlement of the swap commitment a total of $532 million. This many dollars is equivalent to our commitment of BF24.1 billion at a rate of 45.7072 francs per dollar. Thus in the first instance we would buy the Belgian francs we need directly from the National Bank at that rate at a cost of $532 million, involving for the System an interim loss of $42 million.[1/] Since the proposed transaction does

1/ This loss would be an "interim" loss because under current account procedures the System Account does not take profits and losses on rollovers of outstanding commitments. Profits and losses are only taken and distributed among the Reserve Banks upon final liquidation of a commitment, for it is only at that time that the true profit or loss is known.

not represent a final settlement of the swap but only a rewriting at new rates in order to appropriately reflect the devaluation of the dollar and revaluation of the Belgian franc, the second step in this operation is for the System to simultaneously redraw the $532 million under the swap line. This new drawing would be effected at a rate of 44.4795 francs per dollar. This rate is 2.76 per cent below the rate used in the first part of the transaction (45.7072), the difference representing the amount of the Belgian franc revaluation. Thus it is a rate that, relative to the rate calculated in the first part of the transaction, protects the System against the Belgian revaluation and gives effect to the revaluation clause in the swap agreement. In effect, the outstanding swaps would have been shifted from a rate of 49.625 (the old ceiling) to 44.4795 (approximately 3/4 per cent above the new par), the total move representing the sum of dollar devaluation and the franc revaluation.

Under the terms of the agreement reached last year with the Belgians, a standing order would be given to the System by the National Bank at the new swap rate. Assuming that over the course of the coming months there is some reflow of funds back into dollars and the Belgian franc weakens, it may be possible to finally pay off the swap at rates favorable to the System relative to the new drawing rate. In that case we would accrue a profit that would provide a partial offset to the interim loss taken on the initial rewriting of the contracts. Consequently, the net loss finally realized by the System might be less than the $42 million representing the 8.57 per cent devaluation of the dollar.