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

July 15, 1974

CONFIDENTIAL (FR)

To: Federal Open Market Committee

From: Chairman Burns

Subject: Draft Letter to the Secretary of the Treasury Concerning Possible Use by Italy of the Federal Reserve Swap Line

Even though the Italian authorities now appear to be taking substantial actions toward bringing about needed adjustments in the Italian economy, Italy may well need several billion dollars of medium-term financing over the next year or so to cover its increased petroleum import costs.

The U.S. Government has indicated to the Italian Government that it would be prepared to contribute in some way to such financing, and the Secretary of the Treasury expects to be discussing this matter during his visit to Europe this month.

In these circumstances, it seems desirable for the Federal Reserve System to make clear to the Secretary the nature of the System's swap arrangement with the Bank of Italy, and in particular to stress that it is a short-term facility which cannot be relied on for longer-term financing needs.

A draft letter to the Secretary is attached for the Committee's consideration at its meeting on Tuesday. In the interest of expediting discussion of this matter, I hope that the members will concern themselves with substance rather than with precise phrasing.

Attachment

DRAFT

CONFIDENTIAL (FR)

Dear Bill:

In view of the possibility that you may be engaging in talks about the provision of financial assistance to Italy, I am writing on behalf of the Federal Open Market Committee to clarify the status of the $3 billion reciprocal currency arrangement (swap line) between the Federal Reserve System and the Bank of Italy.

The swap facility can be drawn on subject to the conditions and limitations arising from its nature and purpose. It has always been understood by both central bank parties to the swap arrangement that swap drawings are available only to meet short-term needs. Drawings are normally made for a period of three months, and while they may sometimes be renewed, it is in no case envisaged that they will remain outstanding for longer than one year. Therefore the swap line cannot be used to make any contribution to medium-term or long-term financing needs.

In present circumstances, recognizing that

(a) the Italian authorities now appear to be taking substantial actions toward bringing about needed adjustments in the domestic Italian economy and in the Italian balance of payments, and that

(b) some time may be needed to arrange an appropriate package of external financial assistance for Italy,

the Federal Reserve System would be prepared to allow the Bank of Italy to make some use of its swap line for interim, short-term financing purposes.

We have had no specific discussions with the Bank of Italy about this. But, for your information, the Federal Open Market Committee which decides these matters has been thinking along the following lines. It would be appropriate for the Bank of Italy to draw, say, $250 million freely, and to draw up to an additional $250 million subject to conditions to be specified, such as that Italy obtain commensurate amounts on comparable terms from other sources, including other central banks and particularly the U.S. Exchange Stabilization Fund. It would be expected that these drawings would be repaid within three months, subject to periodic extensions, if necessary, up to one year.

For any drawings by the Bank of Italy on the System beyond $500 million, the Committee would expect, in addition to commensurate Italian drawings on other sources, that firm take-out provisions would be negotiated (e.g., by the pledge of proceeds from prospective IMF drawings or of gold collateral), so that the repayment of such swap drawings within one year would be assured.

I am sure you will agree that it would be helpful if you were to note, should the subject of the System's swap arrangements arise in your talks, that decisions concerning these arrangements are in the province of the Federal Open Market Committee.

Sincerely yours,

Arthur F. Burns