



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

June 15, 1978

CONFIDENTIAL (FR)
CLASS II - FOMC

TO: Federal Open Market Committee

FROM: Arthur L. Broida *ALB*

Attached is a report of the Ad Hoc Subcommittee on Foreign Exchange, dated today and entitled "Recommendations with respect to Procedural Instructions." This memorandum will be considered by the Committee at its forthcoming meeting in connection with agenda item 2D.

Attachment



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To: Federal Open Market Committee Subject: Recommendations with
From: Ad Hoc Subcommittee on Respect to Procedural
Foreign Exchange Instructions.

The Ad Hoc Subcommittee^{1/} has been charged with making a recommendation to the FOMC on possible changes in the Procedural Instructions of the Foreign Currency Instruments with respect to the limit on gross transactions (paragraph 1.B.). The Desk believes that this limit is cumbersome and that consultations pursuant to it consume excessive amounts of time, both of the Desk and of the members of the Foreign Currency Subcommittee. Several of the members of the FOMC at the March meeting also expressed doubts as to whether any such limit was necessary.

Accordingly, after reviewing the Procedural Instructions, taking into account the various considerations mentioned above, the Subcommittee recommends the following:

(1) Retain the limit on the System's overall open position in paragraph 1.A. as well as in paragraph 2.A. --

The overall open position is the broadest indicator of the System's exposure to the risk of foreign exchange losses, and is particularly

^{1/} The Subcommittee consisted of Messrs. Black, Coldwell, Volcker, and Wallich (Chairman).

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appropriate when the System has substantial net positions in more than one currency. The size of the existing limits seems about right.

(2) Drop the existing limit on gross transactions in paragraph 1.B., and substitute a new limit on changes in the net positions in individual currencies and also (paragraph 1.C.) some general language calling for clearance of any large scale operations regardless of their effect on net positions.

Dropping the limit on gross transactions meets the Desk's objection to the amount of consultation in cases where the scale of operations may be large but where there is little change in the System's net positions, i.e., its risk. The limit on changes in net positions in individual currencies is a logical subsidiary limit to that on overall open position. (Both limits have their analogs in management controls on commercial banks' exchange operations.) Close track of net positions has to be maintained by the Desk in any event, since it is the net positions in individual currencies which are the elements of the overall open position. In most cases, operations are in only one currency, and the change in the net position in that currency is identical with the change in the overall open position.

The use of the two limits together cover certain situations which would not be covered by either limit alone. For example, operations in several currencies would be covered if, taken together, they exceeded the limit on overall open position, even though individually they were less than the limit on net position for each individual currency. Alternatively, operations which involved little change in overall open

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position but substantial changes in net positions in more than one currency would also be covered.

The use of general guideline language to cover situations where gross transactions may be large but net positions little changed seems appropriate. In this case, since there is little impact on the System's risk position, it is the entire operation of large-scale, two-way intervention about which consultation should occur.

(3) Substitute the word "operation" for the word "transaction" wherever the latter appears. --

The Desk contends, correctly, that consultation should be on the advisability of a line of operation, not a particular transaction. The sense of substituting the word operation implies that consultation would occur earlier in the course of a particular day's "operation" than might be the case if consultation were to occur only when the next transaction might breach the limit.

(4) Make minor, consequential changes in the language of the Authorization (paragraph 1.D.), substituting "net positions in individual currencies" for "open positions in each currency." --

This introduces the term "net position" into the Authorization. And using net position to apply to individual currencies, with sign attached, will minimize confusion with the overall open position in foreign currencies, which has no sign.

Attachments

Attachment A.

Proposed Amended
PROCEDURAL INSTRUCTIONS

In conducting operations pursuant to the authorization and direction of the Federal Open Market Committee as set forth in the Authorization for Foreign Currency Operations and the Foreign Currency Directive, the Federal Reserve Bank of New York, through the Manager of the System Open Market Account, shall be guided by the following procedural understandings with respect to consultations and clearance with the Committee, the Foreign Currency Subcommittee, and the Chairman of the Committee. All operations undertaken pursuant to such clearances shall be reported promptly to the Committee.

1. The Manager shall clear with the Subcommittee (or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

OPERATION

- A. Any ~~transaction~~ which would result in a change in the System's over-all open position in foreign currencies exceeding \$100 million on any day or \$300 million since the most recent regular meeting of the Committee.

OPERATION A CHANGE IN THE SYSTEM'S NET POSITION

- B. Any ~~transaction~~ which would result in/~~gross transactions (excluding swap drawings and repayments)~~ in a single foreign currency exceeding \$100 million on any day or \$300 million since the most recent regular meeting of the Committee.

- C. ANY OPERATION WHICH MIGHT GENERATE A SUBSTANTIAL VOLUME OF TRADING IN A PARTICULAR CURRENCY BY THE SYSTEM, EVEN THOUGH THE CHANGE IN THE SYSTEM'S NET POSITION IN THAT CURRENCY MIGHT BE LESS THAN THE LIMITS SPECIFIED IN 1.B.

- D. ~~C.~~ Any swap drawing proposed by a foreign bank not exceeding the larger of (i) \$200 million or (ii) 15 per cent of the size of the swap arrangement.

2. The Manager shall clear with the Committee (or with the Subcommittee, if the Subcommittee believes that consultation with the full Committee is not feasible in the time available, or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

OPERATION

- A. Any ~~transaction~~ which would result in a change in the System's over-all open position in foreign currencies exceeding \$500 million since the most recent regular meeting of the Committee.

- B. Any swap drawing proposed by a foreign bank exceeding the larger of (i) \$200 million or (ii) 15 per cent of the size of the swap arrangement.

Attachment A.

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3. The Manager shall also consult with the Subcommittee or the Chairman about proposed swap drawings by the System, and about any ~~transactions~~ that are not of a routine character.
OPERATIONS

Note: The language of 1.B., prior to the amendment by strike-throughs and additions, was the language adopted by the FOMC in December 1976. The limits in this paragraph were increased by the Committee to \$200 and \$500 million, respectively, as an interim measure in March 1978.

Attachment B.

Proposed Amended Paragraph 1.D. of the
Foreign Currency Authorization

1.D. To maintain an over-all open position in all foreign currencies not exceeding \$1.0 billion, unless a larger position is expressly authorized by the Committee. For this purpose, the over-all open position in all foreign currencies is defined as the sum (disregarding signs) of ~~open~~ NET positions in each INDIVIDUAL currency. ~~IES~~. The ~~open~~ NET position in a single foreign currency is defined as holdings of balances in that currency, plus outstanding contracts for future receipt, minus outstanding contracts for future delivery of that currency, i.e., as the sum of these elements with due regard to sign.