FEDERAL RESERVE

press release

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The Board of Governors of the Federal Reserve System and the Federal Open Market Committee today released the attached records of policy actions taken by the Federal Open Market Commitee at its meetings on November 27 and December 12, 1967. These records will be published in the Board's Annual Report for 1967 and in the Federal Reserve Bulletin.

Attachments

RECORD OF POLICY ACTIONS
OF THE FEDERAL OPEN MARKET COMMITTEE

Meeting held on November 27, 1967

1. Authority to effect transactions in System Account.

On Saturday, November 18, 1967, the par value of the pound sterling was reduced by 14.3 per cent, from $2.80 to $2.40. The British authorities simultaneously announced a broad series of measures designed to reduce domestic demands and in general to facilitate the economic adjustments required to achieve a substantial improvement in the balance of payments of the United Kingdom. These measures included an increase in the discount rate of the Bank of England from 6-1/2 to 8 per cent, its highest level in 53 years. On November 19 the Federal Reserve announced an increase in its discount rate from 4 to 4-1/2 per cent, effective the next day. Today's meeting had been called for the purposes of reviewing the latest developments and making such revisions in the Open Market Committee's policy instruments as were needed in the light of recent events.

Following the British devaluation, all of the other major industrial countries comprising the "Group of Ten" announced promptly that the par values of their currencies would not be changed. The announcement for the United States took the form of a statement on November 18 by President Johnson, unequivocally reaffirming the U.S. commitment to the existing price of $35 per ounce for gold.

Some countries did devalue after the British action, but together they accounted in 1966 for only about 6 per cent of world trade, less than Britain alone. Among the countries devaluing, Spain, Ireland, and Israel reduced the par values of their currencies by the same percentage as Britain had; New Zealand by more; and Denmark and Hong Kong by less.

Conditions in markets for foreign exchange and gold had been turbulent since the Committee's preceding meeting on November 14. Pressures on sterling had increased after publication that day of British foreign trade figures for October, which indicated that a deficit of record proportions had been incurred. The pressures eased over most of the next 2 days, when there were rumors regarding negotiations for foreign central bank credit assistance to the United Kingdom, but they resumed late on Thursday, November 16. On Friday there were press reports that a devaluation of the pound was imminent, and the markets were flooded by offers of sterling. Demands for gold in the London market and other foreign centers increased substantially, and some central banks in continental Europe acquired sizable amounts of dollar reserves as a result of shifts by market participants from sterling into continental European currencies.

The British authorities declared a bank holiday for the Monday following devaluation. When foreign exchange trading resumed in London on Tuesday, November 21, spot sterling was quoted at its new ceiling rate of $2.42, where it remained for the rest of the week. Market demands for gold continued to mount, however, and reached unprecedented levels during the week. Continental central banks experienced only small changes in their dollar reserves during most of the week, but made sizable acquisitions on Friday.

On Sunday, November 26, the following statement was issued in Washington:

> "The Secretary of the Treasury and the Chairman of the Federal Reserve Board made available a communique issued in Frankfurt, Germany, today which reads as follows:
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> > "The Governors of the Central Banks of Belgium, Germany, Italy, Netherlands, Switzerland, United Kingdom and the United States convened in Frankfurt on November 26, 1967.
> >
> > "They noted that the President of the United States has stated:
> >
> > "'I reaffirm unequivocally the commitment of the United States to buy and sell gold at the existing price of $35 per ounce.'
> >
> > "They took decisions on specific measures to ensure by coordinated action orderly conditions in the exchange markets and to support the present pattern of exchange rates based on the fixed price of $35 per ounce of gold.
> >
> > "They concluded that the volume of gold and foreign exchange reserves at their disposal guarantees the success of these actions; at the same time they indicated that they would welcome the participation of other central banks."

On the following day--the day of this Committee meeting--the market demand for gold was considerably below its levels during the preceding week.

In domestic financial markets both short- and long-term interest rates had fluctuated widely since the Committee's November 14 meeting. Yields initially declined, following the postponement of a large bond issue by a major U.S. corporation and the reports concerning negotiations for credit assistance to Britain. They advanced on Friday, November 17, however, in the wake of the mounting pressures on sterling and rumors of imminent devaluation. On Monday, November 20, both short- and long-term interest rates rose sharply in the initial reaction to the events of the preceding weekend. A large commercial bank increased its prime lending rate from 5-1/2 to 6 per cent that day, and various other banks followed shortly.

The securities markets began to rally on Monday afternoon and they strengthened further on the following 2 days. Factors underlying the rally included large-scale purchases of Government securities by the System, the postponement of a number of corporate and municipal bond issues, and an announcement that the House Ways and Means Committee would reopen hearings shortly on the administration's proposals for increased fiscal restraint.

Market interest rates rose sharply again on Friday, November 24, however, when uncertainties were increasing in foreign exchange and gold markets. Yields on municipal and seasoned corporate bonds advanced to new record levels, but yields on intermediate- and long-term Government securities did not reattain the highs they had reached on the day before the Committee's preceding meeting. Most short-term yields had increased considerably, on balance, since that time; the market rate on 3-month Treasury bills, at about 4.90 per cent, was up approximately 30 basis points over the period. Major banks raised their offering rates on large-denomination CD's, and rates on CD's maturing in 3 months or more were now generally at the 5-1/2 per cent ceiling established by Regulation Q.

The System conducted large-scale open market operations on the Monday after the devaluation of sterling and the announcement of the increase in Federal Reserve discount rates, with a view to facilitating orderly adjustments to the new circumstances brought about by these events. Early in the day the System placed bids with Government securities dealers for a substantial volume of securities maturing in more than 1 year. After purchasing $186 million of such securities it also bought $427 million of Treasury bills. These operations absorbed some of the overhanging supply of securities that might otherwise have been pressed onto an unreceptive market; and as sentiment improved, market conditions quickly became relatively normal. No further System operations were carried out in the market during the rest of the week, although on Friday $191 million of Treasury bills were purchased directly from foreign accounts.

Free reserves of member banks were at the relatively low level of about $90 million in the statement week ending November 22, despite the large volume of reserves provided by both the System's security purchases on Monday and by various international transactions. Interest rates on Federal funds and on bank loans to Government securities dealers, like other market rates, had fluctuated widely in recent weeks. By the Friday before this meeting, however, money market rates had moved into closer alignment with the new level of the discount rate; the effective rate on Federal funds that day, at 4-1/2 per cent, was equal to the discount rate, and dealer loan rates also had risen.

In considering the domestic open market policy to be followed in the period until its next meeting, the Committee took note of the various cross-currents that were likely to be at work as a consequence of the increase in Federal Reserve discount rates and of recent events abroad, and of the continuing uncertainties with respect to international developments and their possible impact on domestic financial markets. At the conclusion of the discussion the following current economic policy directive was issued to the Federal Reserve Bank of New York:

> System open market operations until the next meeting of the Committee shall be conducted with a view to facilitating orderly market adjustments to the increase in Federal Reserve discount rates; but operations may be modified as needed to moderate any unusual pressures stemming from international financial uncertainties.

> Votes for this action: Messrs. Martin, Brimmer, Francis, Maisel, Mitchell, Robertson, Scanlon, Sherrill, Swan, and Ellis. Votes against this action: None.

2. Amendments to authorization for System foreign currency operations.

At this meeting the Committee amended its authorization for System foreign currency operations in a number of respects, against the background of the discussions by the central bank governors at their meeting in Frankfurt. The amendments included an increase in the limit, specified in paragraph 1C(3) of the authorization, on forward commitments by the System Account to deliver foreign currencies; and enlargements of the swap arrangements, specified in paragraph 2, with a number of central banks and the Bank for International Settlements. In a further action, related to the change approved in the size of the swap arrangement with the Bank of England, the limit on authorized System Account holdings of sterling purchased on a covered or guaranteed basis, specified in paragraph 1B(3), was reduced to the level prevailing prior to the amendment to that paragraph that was approved on November 14, 1967.

With respect to the first of these actions, one of the agreements reached at the Frankfurt meeting was that the foreign central banks represented there, in collaboration with U.S. monetary authorities, would undertake coordinated operations in forward markets. In these operations the central banks would sell their own currencies forward against dollars, to discourage further large accruals of dollar reserves such as had occurred on the Fridays before and after the sterling devaluation and, if possible, to encourage some reflows from European currencies to the Euro-dollar market. The U.S. Treasury had agreed to cooperate in this program, and forward operations in certain currencies had already begun, with the System Account participating on the basis of the authority contained in paragraph 1C(3) of the authorization for System foreign currency operations. It was noted that the existing authority to undertake forward commitments up to $275 million equivalent might well prove adequate to the System's needs in this connection. However, the Committee concurred in the recommendation of the Account Management that the limit contained in paragraph 1C(3) be doubled, to $550 million equivalent, to provide against the possibility of larger needs.

The increases in a number of System swap arrangements, which were for the purpose of providing a broader margin of safety for the stability of the international monetary system, were approved on the understanding that enlargements of certain additional swap arrangements might be proposed subsequently. Paragraph 2 of the authorization was amended to change the size of the reciprocal currency arrangements with (1) the National Bank of Belgium, from $150 million to $225 million equivalent; (2) the Bank of Italy, from $600 million to $750 million equivalent; (3) the Netherlands Bank, from $150 million to $225 million equivalent; (4) the Bank of Sweden, from $100 million to $200 million equivalent; (5) the Bank for International Settlements (the arrangement providing for System drawings in authorized European currencies other than Swiss francs) from $300 million to $600 million equivalent; (6) the Bank of England, from $1,350 million to $1,500 million equivalent; (7) the Bank of Japan, from $450 million to $750 million equivalent; and (8) the German Federal Bank, from $400 million to $750 million equivalent. On advice that negotiations looking toward the indicated increases had already been conducted with the first five foreign banks listed above, the corresponding changes in the authorization were approved effective immediately. The changes relating to the swap arrangements with the central banks of England, Japan, and Germany were approved on the basis that they would become effective upon a determination by Chairman Martin that preliminary negotiations had been satisfactorily completed. The Chairman made such a determination with regard to the swap arrangements with the central banks of England and Japan on November 28, and with regard to the arrangement with the German Federal Bank on November 30.

With respect to the amendment to paragraph 1B(3), an increase in the limit specified there on System holdings of sterling had been approved at the preceding meeting of the Committee, at a time when it appeared that the United Kingdom might find it possible to maintain the par value of the pound at $2.80. In light of the subsequent devaluation, the Committee concluded that any expansion of credit facilities between the Federal Reserve and the Bank of England would more appropriately take the form of an increase in the size of the swap arrangement between the two central banks. Accordingly, the language of the affected paragraph was restored to the form in effect before the November 14 action.

> Votes for these actions: Messrs. Martin, Brimmer, Francis, Maisel, Mitchell, Robertson, Scanlon, Sherrill, Swan, and Wayne. Votes against these actions: None.

Subsequent to this meeting, on November 30, the Special Manager recommended that paragraph 2 of the authorization for System foreign currency operations be further amended to change the size of the swap arrangement with the Bank of Canada from $500 million to $750 million equivalent. This recommendation was unanimously approved by available members of the Committee, namely, Messrs. Martin, Hayes, Brimmer, Maisel, Mitchell, Robertson, Scanlon, Sherrill, Swan, and Wayne.

As a result of these several actions, the first two paragraphs of the authorization for System foreign currency operations read as follows:

> 1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, for System Open Market Account, to the extent necessary to carry out the Committee's foreign currency directive:
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> A. To purchase and sell the following foreign currencies in the form of cable transfers through spot or forward transactions on the open market at home and abroad, including transactions with the U.S. Stabilization Fund established by Section 10 of the Gold Reserve Act of 1934, with foreign monetary authorities, and with the Bank for International Settlements:

Austrian schillings
Belgian francs
Canadian dollars
Danish kroner
Pounds sterling
French francs
German marks
Italian lire
Japanese yen
Mexican pesos
Netherlands guilders
Norwegian kroner
Swedish kronor
Swiss francs

B. To hold foreign currencies listed in paragraph A above, up to the following limits:

(1) Currencies held spot or purchased forward, up to the amounts necessary to fulfill outstanding forward commitments;

(2) Additional currencies held spot or purchased forward, up to the amount necessary for System operations to exert a market influence but not exceeding $150 million equivalent; and

(3) Sterling purchased on a covered or guaranteed basis in terms of the dollar, under agreement with the Bank of England, up to $200 million equivalent.

C. To have outstanding forward commitments undertaken under paragraph A above to deliver foreign currencies, up to the following limits:

(1) Commitments to deliver foreign currencies to the Stabilization Fund, up to $350 million equivalent;

(2) Commitments to deliver Italian lire, under special arrangements with the Bank of Italy, up to $500 million equivalent; and

(3) Other forward commitments to deliver foreign currencies, up to $550 million equivalent.

D. To draw foreign currencies and to permit foreign banks to draw dollars under the reciprocal currency arrangements listed in paragraph 2 below, provided that drawings by either party to any such arrangement shall be fully liquidated within 12 months after any amount outstanding at that time was first drawn, unless the Committee, because of exceptional circumstances, specifically authorizes a delay.

2. The Federal Open Market Committee directs the Federal Reserve Bank of New York to maintain reciprocal currency arrangements ("swap" arrangements) for System Open Market Account for periods up to a maximum of 12 months with the following foreign banks, which are among those designated by the Board of Governors of the Federal Reserve System under Section 214.5 of Regulation N, Relations with Foreign Banks and Bankers, and with the approval of the Committee to renew such arrangements on maturity:

Foreign bank	Amount of arrangement (millions of dollars equivalent)
Austrian National Bank	100
National Bank of Belgium	225
Bank of Canada	750
National Bank of Denmark	100
Bank of England	1,500
Bank of France	100
German Federal Bank	750
Bank of Italy	750
Bank of Japan	750
Bank of Mexico	130
Netherlands Bank	225
Bank of Norway	100
Bank of Sweden	200
Swiss National Bank	250
Bank for International Settlements	
System drawings in Swiss francs	250
System drawings in authorized European currencies other than Swiss francs	600

At this meeting the Committee also reviewed certain transactions in sterling that had been made during the preceding week by the Federal Reserve Bank of New York with a number of U.S. commercial banks. Specifically, the New York Bank had sold sterling from System Account holdings to the U.S. commercial banks, for delivery on Tuesday, November 21, and had concurrently repurchased forward an equivalent amount of sterling from each bank for delivery on Friday, November 24. Similar transactions were conducted for Treasury account, with sales for delivery on Wednesday and repurchases for delivery on Friday.

These transactions were carried out to enable the U.S. commercial banks to make deliveries of sterling on Tuesday and Wednesday, under contracts they had made on Friday, November 17. The commercial banks involved had originally entered into those contracts in order to balance their positions in sterling, in accordance with their customary practice, after accommodating commercial customers and correspondent banks that had desired to sell sterling forward. At the time they made the spot contracts, the commercial banks had expected to acquire the necessary sterling in the market on Monday, November 20, but were unable to do so because the British authorities had declared that day to be a bank holiday.

The New York Bank took measures to insure that such transactions did not provide relief to any commercial bank to the extent that it was short sterling as a result of operations on its own initiative. In cases where the banks had over-all short positions in sterling as of Friday, November 17, an amount equal to that short position was deducted from the amount made available by the New York Bank, except where the short position could be explicitly justified by the bank in question.

The broad purpose of these transactions, from the System's point of view, was to avoid the disorder in the foreign exchange market that might have resulted from widespread defaults on foreign exchange contracts. The transactions were carried out with the concurrence of a majority of the Subcommittee authorized, under the terms of paragraph 6 of the authorization for System foreign currency operations, to act on behalf of the Federal Open Market Committee when necessary to enable the New York Bank to engage in foreign currency operations before the Committee could be consulted. After discussion at this meeting, the Committee unanimously approved, ratified, and confirmed these transactions, along with other System transactions in foreign currencies since the previous meeting.