



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

No. 33

January 17, 1977

STRICTLY CONFIDENTIAL (FR)  
CLASS I FOMC

TO: Federal Open Market Committee      SUBJECT: Materials relating  
FROM: Arthur L. Broida      *ALB*      to official sterling  
balances facility

It is contemplated that at its meeting beginning at 4:00 p.m. this afternoon the Committee will discuss the agreement reached in Basle last week regarding an official sterling balances facility and related arrangements between the Federal Reserve and the Treasury. The following documents are attached for use in this discussion:

1. The text of the Basle agreement.
2. A letter dated January 14, 1977, from Secretary Simon to Chairman Burns, setting forth the Secretary's understanding of arrangements agreed upon for the joint participation of the Treasury and the System in the sterling balances facility.
3. Chairman Burns' response of the same date, confirming the Secretary's understanding of these arrangements.
4. A second letter dated January 14, 1977, from the Secretary to the Chairman, relating to the possibility of the System's "warehousing" foreign currencies for the Exchange Stabilization Fund.
5. A draft response to this letter, for consideration by the FOMC.

Because of the sensitive nature of these materials, we ask that you guard their confidentiality and return them to a member of the Secretariat at the conclusion of the Monday afternoon session.

We are distributing under separate cover copies of a memorandum entitled "Background information on System 'warehousing' of foreign currency."

**Attachments**

10th January 1977

AGREEMENT OF PARTICIPATING CENTRAL BANKS ON  
MAIN COMPONENTS OF STERLING BALANCE FACILITY

1. Coverage of financing arrangements

Financing will be available to the UK in respect of reductions in official sterling balances, except reductions associated with sales of foreign currency bonds as described in section 6(b)(ii), below the level prevailing on December 8, 1976.

2. Amount of financing arrangement

The financing will be available in the amount of \$ 3 bn and will be provided as follows:

Belgium	150
Canada	100
Germany	600
Japan	450
Netherlands	150
Sweden	50
Switzerland	300
United States	1000
Other countries	80
BIS	<u>120</u>
	3000

3. Period of drawdown

The financing facility can be drawn upon by the UK during a period of two years. By the mutual agreement of all participants, including the UK, on terms and on conditionality, the period of drawdown could be extended for a third year.

4. Period of repayment

Repayments would begin at the end of the drawdown period and would be completed within four years thereafter.

5. Eligibility

Drawings by the UK shall not exceed 100% of any eligible reductions in official sterling balances in the first year of the facility, and shall not exceed 75% of any eligible reductions in the remainder of the drawdown period. "Eligible reductions" shall be defined by the Experts Group.

6. UK undertakings in connection with financing arrangements

The UK agrees:

- (a) That eligibility to draw on the facility will be conditional on continuing eligibility to draw upon the IMF standby that became effective January 3, 1977.
- (b) With respect to sterling balances:
  - (i) To reduce the official sterling balances over the drawdown period to working levels by sale of bonds as described in (ii) below and other appropriate means if necessary.
  - (ii) To offer foreign currency "funding" securities in exchange for official holdings of sterling. Such securities will be of 5 to 10 years maturity and will be negotiable bonds. Not more than 75% of such securities will be denominated in dollars, and the Experts Group will work out the means by which this result will be secured.
  - (iii) To exercise restraint with respect to future increases in private sterling balances, in order to prevent the financing of deficits through the creation of such balances, a future build-up of volatile short-term debt and the re-emergence of official sterling balances in nominally private form.

The UK will review regularly with the Managing Director of the IMF and with the governors of the participating central banks progress made in meeting the undertakings specified in (i) - (iii) above. If during the drawdown period the UK becomes ineligible to draw under the IMF standby, or in the judgment of the Managing Director is not making reasonable efforts to meet the undertakings set out in (i) - (iii) above, he will so notify the EIS as administrator of the facility. As a result eligibility to draw on the facility can be suspended, in which case drawings outstanding will be repaid within a 120 day period unless eligibility is restored within that period.

If after the drawdown period and notwithstanding the UK's continued efforts, the official sterling balances increased while any drawings were still outstanding, repayment of an amount equivalent to such increase would be made within 90 days.

The UK will not be eligible for financing in respect of reductions in official balances which, in the judgment of the Managing Director after consultation with the UK, represent a shift in balances from official to nominally private hands.



THE SECRETARY OF THE TREASURY  
WASHINGTON

JAN 14 1977

Dear Mr. Chairman:

With respect to the official sterling balances facility that has been the subject of extensive discussion among the U.S. Treasury, the Federal Reserve System, the Bank of England and the governors of the other central banks represented at the BIS in Basle, I should like to confirm the following agreement between the Treasury and the Federal Reserve.

In light of the agreement that has now been reached in Basle and of our existing mutual understanding about the prospective implementation of that agreement we agree to the following arrangements for joint Federal Reserve-U.S. Treasury participation in the facility.


-- If the U.S. is required to provide financing to the BIS in support of that facility, the funds will be provided initially by the Federal Reserve through its existing swap arrangement with the BIS, taking the form of a usual three-month swap renewable three times.

-- Should the Federal Reserve be called upon to provide financing under the terms of the facility continuously for more than one year, in light of the close cooperation between the Treasury and Federal Reserve, such financing will be provided to the Federal Reserve System by the U.S. Treasury, acting through the Exchange Stabilization Fund.

-- Risk associated with U.S. financing of the facility, whether such financing is provided by the Federal Reserve or the Exchange Stabilization Fund, will be borne equally by the Federal Reserve and the Exchange Stabilization Fund.

I understand that the BIS has agreed, as part of the sterling balance facility, to make every effort to finance any U.K. drawing by raising funds in other markets, thereby limiting the need for official financing for the facility.

Sincerely yours,

  
William E. Simon

The Honorable  
Arthur F. Burns  
Chairman, Federal Reserve Board  
Washington, D. C.



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

January 14, 1977

Dear Mr. Secretary:

Your letter of January 14, 1977 refers to the agreement reached in Basle this week for a medium-term facility relating to official sterling balances, and describes your understanding of the terms agreed upon between the Treasury and Federal Reserve for their joint participation in this facility. Your description of these terms conforms in every respect to my understanding.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "Arthur F. Burns".

Arthur F. Burns

The Honorable William E. Simon  
Secretary of the Treasury  
Department of the Treasury  
Washington, D. C. 20220



THE SECRETARY OF THE TREASURY  
WASHINGTON

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JAN 14 1977

Dear Arthur:

I have written to you today under separate cover a letter confirming our understandings with respect to United States participation in the official sterling balance facility agreed in principle at Basle on January 10.

I am very pleased that we have been able to work out arrangements for cooperation in this matter which meet the needs of both the Federal Reserve System and the Treasury. In view of the potential liquidity strains on the ESF arising from this and other claims on the ESF I would appreciate your willingness to work out, along the lines we had discussed, warehousing arrangements for the ESF of \$1-1/2 billion, \$750 million of which would be provided for periods of twelve months and the remainder for periods of six months. I understand that the recent modification in language in the FOMC guidelines did not change the authorization for such warehousing which has existed for a number of years.

Given our joint participation in the official sterling balances facility, and our sharing equally of the risks, I am sure you will agree that Treasury and the Federal Reserve will need to work out together any questions related to implementation of the Basle agreement. In this connection, it is my understanding, in the event the IMF Managing Director finds that the United Kingdom is not fulfilling the provisions of the agreement, that the Federal Reserve and the Treasury would jointly have to agree if U.S. financing were to be continued despite the Managing Director's findings. I am confident that our two institutions will be able to agree on this and other questions of implementation in the spirit of cooperation which has characterized our relationship and it is on this basis that I have agreed to the understandings set forth in our exchange of letters.

Sincerely,

William E. Simon

The Honorable  
Arthur F. Burns  
Chairman, Federal Reserve Board  
Washington, D. C.



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DRAFT



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

January 17, 1977

Dear Mr. Secretary:

At its meeting today the Federal Open Market Committee took note of the suggestion in your letter of January 14, 1977, that the Federal Reserve provide, along the lines we had discussed, warehousing arrangements for the ESF of \$1-1/2 billion, \$750 million of which would be available for periods of twelve months and the remainder for periods of six months.

I am pleased to inform you that the Federal Reserve will be prepared, if requested by the Treasury, to warehouse eligible foreign currencies for the ESF on the basis you have suggested.

I and my colleagues share your confidence that our two institutions will be able to work out together any questions related to the Basle agreement in the spirit of cooperation that has long characterized our relationship.

Sincerely yours,

Arthur F. Burns

The Honorable William E. Simon  
Secretary of the Treasury  
Department of the Treasury  
Washington, D. C. 20220