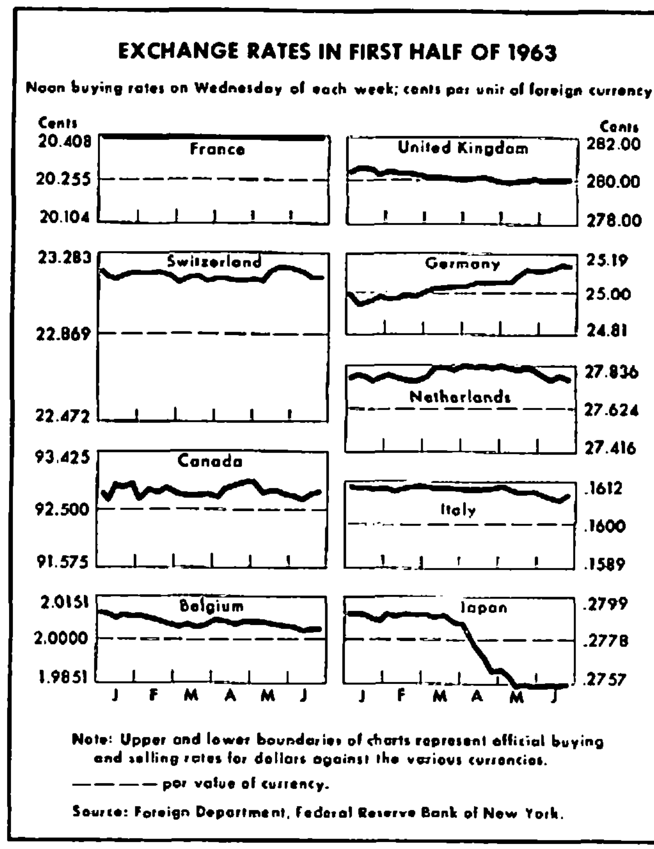
Foreign Exchange Markets, January-June 1963*

With the occasional exception of sterling and the German mark, the leading European currencies and the Canadian dollar all remained above their par values against the United States dollar during the first six months of 1963 (see chart). This strength of most major currencies vis-à-vis the United States dollar reflected the continuing deficit in the United States balance of payments. Preliminary estimates indicate that the United States payments deficit in the first quarter of 1963—the latest period for which comprehensive figures are available—was at a seasonally adjusted annual rate of $3.2 billion, as against a deficit of $2.2 billion for the year 1962. While it is not yet possible to sort out all of the factors underlying this deficit, it is clear that this country's traditional surplus on current account was again more than offset by outlays abroad to meet defense and aid commitments and by the outflow of United States capital. More specifically, there was a heavy concentration of foreign long-term securities issues in the New York market, especially of obligations issued by Canadian public and private borrowers, which continued into the second quarter of the year.

Capital movements in general played an important role in influencing exchange rate movements during the first half of 1963, as was the case in most of 1962. Under conditions of convertibility among major currencies, the commercial banking systems as well as the business communities of various countries have found it possible and convenient to adjust to changing liquidity conditions through operations in foreign or international money markets, in addition to using the established domestic adjustment processes. During early 1963, tight money market conditions prevailed from time to time in a number of European financial centers—Frankfurt, Amsterdam, Paris, and Rome—partly as a consequence of seasonal and other temporary factors. Therefore, Continental commercial banks and major business firms frequently resorted to bor-



* Articles in this *Review* covering previous developments are "Foreign Exchange Markets, January-June 1961", July 1961, pp. 114-16; "Foreign Exchange Markets, July-December 1961", January 1962, pp. 2-5; and "Foreign Exchange Markets, January-June 1962", August 1962, pp. 106-9.

Official United States exchange operations, and exchange market developments during 1962 and early 1963 as they relate to such operations, are discussed in two reports by Charles A. Coombs, Vice President in charge of the Foreign Department of the New York Reserve Bank and Special Manager, System Open Market Account: "Treasury and Federal Reserve Foreign Exchange Operations", this *Review*, October 1962, pp. 131-40, and "Treasury and Federal Reserve Foreign Exchange Operations", this *Review*, March 1963, pp. 39-45. Further information on Treasury and Federal Reserve foreign exchange operations will be presented in this *Review* from time to time. The present article deals mainly with exchange market developments and not with official operations and policies.

rowing in the Euro-dollar market to satisfy their liquidity needs. The borrowed Euro-dollars were often converted in the exchanges for the required local currencies, thereby tending to strengthen these currencies against the dollar. The reverse of such movements—i.e., sales of temporary excess local currency funds for investment in short-term Euro-dollar deposits—also took place occasionally.

As in other recent periods, movements of funds through the exchange markets frequently occurred in response to political events. Following the rejection in January of the British application for membership in the European Economic Community, uneasiness over the future prospects for sterling led to two speculative attacks on the pound, which were readily repulsed by the Bank of England, backed by assistance from other central banks. In the case of Canada, the Cabinet crisis early in the year contributed to an easing of the rate from late January through early April; this influence ceased after the April 8 election.

Throughout the first half of 1963, however, the exchange markets remained orderly and, for most of the period, they were calm. The stability of the exchanges in the face of many potentially disturbing events could be traced in good part to the markets' awareness of the extensive and still expanding cooperation among central banks, which was thus proving a successful deterrent to sustained speculation against any of the major currencies. The Federal Reserve's own network of swap agreements—mutual credit facilities—had grown by mid-1963 to include ten foreign central banks and the Bank for International Settlements, with total credit lines amounting to $1,550 million.

STERLING

During the first six months of 1963 the United Kingdom's balance of payments on current account appears to have improved, compared with the last half of 1962; the British trade deficit was generally smaller on a seasonally adjusted basis, markedly so in March. Fluctuations in the sterling rate, however, also reflected short-term capital flows in and out of Britain over the period. Thus, sterling firmed early in January despite a reduction to 4 per cent from 4½ per cent in the Bank of England's discount rate, partly because Continental commercial banks were reinvesting funds in sterling assets following their usual repatriation of funds to meet year-end liquidity needs. This advance was reversed later in the month, when the British bid to join the Common Market proved unsuccessful and substantial selling of sterling by Continental interests developed. The British authorities firmly resisted this selling wave, and the speculative pressure on sterling diminished.

Nevertheless, uncertainty over future political and economic relations between Britain and the Common Market led to a persistently soft undertone in the sterling market even during February and March, when sterling is normally seasonally strong. In particular, a brief but intensive speculative attack on sterling developed in mid-March; and during the remainder of the month the spot rate dipped below parity on several occasions, while the discounts on forward sterling widened. Once again, the Bank of England forcefully counteracted the speculative selling, reinforced by the cooperation of other central banks. As Chancellor of the Exchequer Maudling stated in his budget address to Parliament on April 3, the Bank of England obtained $250 million in assistance from other central banks in February and March to backstop its defense of sterling at that time. The Chancellor also expressed the determination of the British Government to retain the present par value of the pound, and he added that if necessary the Government not only would rely on Britain's own reserves but also would have recourse to its arrangements with the International Monetary Fund and foreign central banks to counter any further attacks on sterling. Thereafter, much of the uneasiness in the market disappeared. Spot sterling fluctuated narrowly above parity in April, while the discounts on forward sterling narrowed gradually.

During May, with tight money market conditions in several Continental countries and a developing tightness in the Euro-dollar market, Continental commercial banks borrowed at short term in the Euro-sterling market. The sterling funds thus borrowed were swapped—sold spot and bought forward—against dollars and local currencies to meet the liquidity requirements of the Continental commercial banks. These operations weakened spot sterling somewhat while strengthening forward sterling significantly (through the forward covering of the spot sales).

Some market uneasiness again developed briefly in June over the political difficulties of the British Government. Nevertheless, the sterling rate remained at par or better as the exchange markets placed confidence in the ability of the Bank of England to defend the pound, possibly because of the large resources known to be available to that bank. (These resources were further enlarged when the swap arrangement between the Bank of England and the Federal Reserve System was raised from $50 million to $500 million on May 29.) During June, the Bank of England was able to pay off the $250 million of assistance received from foreign central banks earlier in the year. At midyear, spot sterling was quoted at $2.8009, and the discount on three-month forward sterling was equivalent to only 0.5 per cent per annum, after having been as high as 1.4 per cent late in March. Thus, sterling closed the first half of 1963 on a steady note.

CANADIAN DOLLAR

Canadian long-term borrowing in the United States provided much of the strength to the Canadian dollar during the first half of 1963. This flow of long-term capital, particularly heavy in January and May, affected both the spot and forward rates for the Canadian dollar, as some part of the loans was converted from United States to Canadian dollars in the spot market while the conversions of other parts were spread out over various delivery dates in the forward market. A moderate amount of United States short-term funds also continued to flow into Canada, as Canadian interest rates remained somewhat above comparable United States rates even after allowing for the cost of forward cover.

Although Canada's trade balance showed a significant first-quarter surplus for the first time since 1952, the Canadian dollar rate declined somewhat during the initial three months of this year, when uncertainty over the Canadian political situation was reflected in the exchange market. As the general election of April 8 approached, the exchange market turned very quiet, with traders on both sides of the border deferring all but essential transactions. After the election, the Canadian dollar strengthened; the spot rate advanced to \$0.92$^{61}/_{64}$—its high for the first half of the year—and discounts on forward Canadian dollars narrowed. Following the reduction of the Bank of Canada's discount rate to 3½ per cent from 4 per cent on May 6, the discounts on forward Canadian dollars became even smaller, partly in a technical adjustment to slightly lower Canadian money market rates. In late May and through June, forward Canadian dollars were traded at virtually the same rate as spot Canadian dollars. Meanwhile, the spot rate edged down through early June, but this decline was reversed before the end of the month, and the Canadian dollar closed the first half of the year firm at \$0.92$^{25}/_{32}$.

CONTINENTAL CURRENCIES

Among the major Continental currencies, the French franc, in particular, continued strong against the dollar. Although French customs data indicate that the French trade deficit widened in early 1963, France's over-all balance of payments remained in substantial surplus as a result of continuing capital inflows. Consequently, the French franc remained at its upper limit virtually throughout the period and, through the end of May, official French gold and foreign exchange reserves had increased by \$590 million.

The German mark eased below parity early in January, reflecting an outflow of liquid funds from Germany for investment in short-term foreign currency assets. The mark rate fluctuated narrowly through early March and then edged steadily upward in an active market during the rest of the period. Substantial demand for marks developed—particularly in May and June—as German businesses and banks borrowed abroad in view of tight money market conditions in Germany. Also, foreign interest in German stocks and bonds was especially strong in the first half of the year. The dollars acquired by the German Federal Bank in tempering the rise in the mark rate through intervention in the exchange market contributed to the official German reserve gain of \$395 million in March-May.

The Swiss franc remained well above its par value and fluctuated within a relatively narrow range. Early in the year, some types of short-term capital inflows were reversed while others began to taper off. Thus, by March and through April the Swiss franc moved to a lower level, reflecting a further enlargement of Switzerland's trade deficit as well as foreign capital issues in the Swiss market and foreign workers' remittances to their home countries. In mid-May, the rate advanced somewhat when Swiss commercial banks began their midyear repatriations early and a capital inflow from Italy developed. Neither in May nor at any other time during the first half of 1963, however, did the Swiss franc reach the Swiss National Bank's buying rate for dollars, as it had for prolonged periods of 1962. Toward midyear, in fact, the rate gradually eased once more as inflows into Switzerland again diminished.

The Dutch guilder moved within a narrow range just below its upper limit. Figures for the first quarter of the year show that the Netherlands continued to have a substantial surplus on current account; in addition, a sizable long-term capital inflow took place during most of the half-year period, and during most of the second quarter Dutch commercial banks were meeting domestic liquidity needs by repatriating short-term investments previously placed in foreign centers. The guilder was particularly strong between mid-March and the end of May because of tightness in the Amsterdam money market at that time. The Netherlands Bank acted to reduce the stringency in the money market, especially by lowering in two steps the cash reserve requirement for Dutch commercial banks, from 5 per cent in March to 3 per cent in June. The money market turned easier by early June, and Dutch commercial banks moved to reacquire liquid foreign currency assets on a covered basis, with the result that the spot guilder declined slightly while the premium on the forward guilder widened.

The Italian lira also fluctuated narrowly below its upper limit. Italians were important borrowers in Euro-currency markets to satisfy domestic liquidity requirements, which partly arose from an enlarged trade deficit. Such borrowings also helped counter the influence of short-term capital outflows connected with the April election and its aftermath as well as the effects of new regulations in January and April governing portfolio investment by Italian residents. Nevertheless, the lira softened somewhat late in May and June.

The Belgian franc, although remaining above its par value, declined gradually during the first quarter of the year. Belgian exports and imports were both reduced in the early months because of the severe winter in Europe; exports were at a particularly low level in February, resulting in a relatively large trade deficit in that month. In March and April, the volume of Belgian trade increased and the trade balance improved, accompanied by some firming in the Belgian franc rate. Thereafter, the Belgian trade balance again became less favorable, and this factor —in combination with some moderate capital outflow— led to a renewed easing of the franc in May and June.

OTHER CURRENCIES

The Japanese yen remained strong during the first quarter of the year, with the rate approximately at its upper limit, 0.5 per cent above the par value of $0.002778. During April, the Japanese authorities took measures to bring Japan's international practices more closely in line with those of other major currency centers. On April 1, regulations regarding the repatriation of foreign capital invested in Japanese securities were liberalized; and, on April 22, the official support limits of the yen were widened to 0.75 per cent on either side of parity. An outflow of capital from Japan developed that month and, with a partly seasonal increase in the trade deficit, the yen rate declined in the second quarter of the year, reaching its newly established lower limit.

Indonesia moved to simplify its multiple exchange rate structure late in May, with the net effect of a further devaluation of the rupiah. The Brazilian cruzeiro was devalued by about 30 per cent late in April, when the Bank of Brazil raised its official buying and selling rates from 460-475 cruzeiros to the dollar to 600-620 cruzeiros. In May, the Uruguayan peso was also devalued, and the market rate moved from 10.98 to the dollar to 16.50 to the dollar.