

Federal Reserve Intervention Policy

By Richard K Abrams

On November 1, 1978, the Federal Reserve and the U.S. Treasury announced a new and expanded program to defend the foreign exchange value of the dollar. The program included an increase in the Federal Reserve's discount rate, the imposition of reserve requirements on large time deposits, and an expansion of U.S. intervention capabilities in the foreign exchange markets. A major aspect of the expanded intervention capability was an increase in the size of Federal Reserve's swap lines with several key central banks, thereby allowing greater foreign exchange borrowings for purposes of intervention. As a result of the November action, increased attention has been focused on the importance of the swap network and intervention policies in foreign exchange markets.

This article will examine Federal Reserve intervention policy, giving special emphasis to the swap network.¹ The first section discusses the mechanics of swap intervention. The second reviews U.S. intervention activities and the evolution of intervention policy through the fixed and floating rate periods.

¹ The Exchange Stabilization Fund (ESF) of the U.S. Treasury may participate with the Federal Reserve in its intervention activities, with the Federal Reserve Bank of New York acting as the Treasury's agent.

THE NATURE AND WORKINGS OF THE SWAP NETWORK

Federal Reserve intervention is normally undertaken to ease selling pressure against the dollar in the foreign exchange markets. Such intervention requires that the Federal Reserve act as a seller of foreign exchange and a buyer of dollars. If the Federal Reserve already holds the required foreign exchange as a result of past borrowings or dollar sales, these funds are sold directly to the market; otherwise, the funds must be borrowed. Historically, almost all such borrowing has been through the swap network.² This network is a set of short-term reciprocal currency agreements the Federal Reserve maintains with 14 foreign central banks and the Bank of International Settlements (**BIS**). Each agreement allows the Federal Reserve and the partner bank short-term access to the other's currency up to a specified limit. At present, the total size of the swap network is \$29.8 billion.

² The Treasury can obtain foreign exchange by borrowing from the International Monetary Fund (**IMF**), by selling foreign-denominated securities, and by selling Special Drawing Rights (**SDR's**), which are effectively central bank money issued by the IMF. However, it did not exercise this option during the floating rate period prior to November 1, 1978. The value of the SDR is based on a geometrically weighted average of 16 currencies, with the weights based on the country's quota at the IMF.

A swap contract is written at the end of each day that Federal Reserve swap intervention takes place. To write a contract, the Federal Reserve calculates the dollar amount of the intervention, and the average exchange rate at which trades took place. The Federal Reserve gives the foreign central bank a dollar account equal to the size of the intervention and receives sufficient foreign exchange to cover its dollar purchases. The foreign bank's dollars are then invested in a nonnegotiable U.S. Treasury certificate of indebtedness until the swap is retired.

Swaps mature in 90 days. They are retired by repurchasing the foreign bank's dollars at the original exchange rate. If the dollar has appreciated in the interim, the Federal Reserve will realize a profit on the swap because the foreign exchange will cost fewer dollars. However, if the dollar has declined, a loss will occur. Furthermore, if the dollar has remained weak throughout the period, the swap may be renewed in order to prevent additional dollar sales from causing the dollar to decline further.

U.S. intervention is carried out on a day-to-day basis by officers at the foreign exchange desk at the Federal Reserve Bank of New York.³ If intervention is planned for any day, the officers discuss the intervention limits for the day with the central banks whose swap lines they plan to use. Sometimes the foreign bank will suggest intervention limits that differ from those suggested by Federal Reserve officials.⁴ Because swap lines can only be drawn upon by mutual consent, negotiations must

³ If the **planned** intervention is greater than the limits specified in the Federal Open Market Committee's (FOMC's) procedural instructions, the Foreign **Currency** Subcommittee of the FOMC and the **officials** of the Treasury must **first** be consulted. **Oversight of the Effect of Floating Exchange Rates on U.S. Exports**, Hearing Before the Subcommittee on International Finance of the Committee on Banking, Housing and Urban Affairs, U.S. Senate, 95th Cong., 2d sess., February 6, 1978, p. 56.

then take place, with the smaller of the two proposed **limits** being accepted.

Given the intervention limits, intervention can be either indirect or direct. In the indirect approach, the Federal Reserve uses a commercial bank as an agent to buy funds according to conditions set by the Federal **Reserve**.⁵ In the direct approach, which relies heavily on the "announcement" effect, the Federal Reserve contacts banks directly with offers to buy dollars. At times almost every major trading bank may receive offers to buy dollars.

The purpose of both approaches is to ease selling pressure against the dollar and to alter the short-run expectations of the traders in the foreign exchange markets. Because the time horizon of traders is sometimes very short, a moderate change in market behavior can sometimes encourage **traders** to replenish their dollar portfolios, causing the dollar to appreciate. However, if the traders believe strongly that the decline will continue, the market is large enough to render almost any central bank intervention **ineffective**.⁶

⁴ **Anatol B. Balbach** showed in his paper, "The **Mechanics** of Intervention in Exchange Markets," Federal Reserve Bank of St. Louis **Review**, Vol. 60, No. 2, February 1978, that drawing of the swap line, other things equal, expands the money supply of the accommodating country during the life of the swap, while leaving the money supply of the initiating country unchanged. Therefore, the foreign central bank may oppose a swap drawing because of domestic **monetary** considerations.

⁵ Conversations with traders at commercial banks have shown that they sometimes guess incorrectly as to whether or not the Federal Reserve has been intervening. Further, when they correctly guessed the intervention, their estimates of the size of the action were often very inaccurate.

⁶ The estimated volume of foreign exchange transactions was over \$100 billion a month in New York City alone in April 1977. **Roger M. Kubarych**, **Foreign Exchange Markets in the United States** (New York: Federal Reserve Bank of New York, 1978), p. 5.

U.S. INTERVENTION DURING THE FIXED RATE PERIOD

From 1944 until early 1973, most of the world's currencies functioned under a regime of fixed exchange rates known as the Bretton Woods system. During most of this period, the United States needed no intervention policy, for the dollar acted as the cornerstone of the system. The other currencies floated **within** narrow bands against the dollar, while the dollar maintained convertibility into gold at a fixed rate. If a country's currency approached the lower end of its band, it had to either devalue or sell dollars to defend its parity range. If the currency rose to the upper end, it either had to revalue or buy dollars.

This system worked well until the early **1960's**. Throughout this period, the United States often had balance of payments deficits. These deficits provided central banks with the reserves required to defend their parity range against the dollar. However, because of the deficits, concern arose that the United States would be unable to maintain its exchange rate. As a result, in March 1961 the German mark was revalued by 5 per cent, with the Netherlands guilder soon following. This action made all currencies candidates for upward revaluation or devaluation, for it was now felt the other countries would be unwilling to maintain their under- or overvalued exchange rates. As a result, while central banks were able to defend their parities in the spot market, many were unable to prevent the exchange rates on contracts for future delivery, or forward rates, from diverging from acceptable ranges.

In March 1961, to maintain appropriate forward rates, the U.S. Treasury began to intervene in the forward markets in German marks, Swiss francs, and Netherlands guilders. The purpose of this action was to bring forward exchange rates back into alignment and restore confidence in the dollar. The operation proved

successful, and its success led U.S. authorities to believe that future intervention might provide added stability to the foreign exchange markets. Accordingly, in February **1962**, the FOMC authorized foreign currency operations. By August of that year, the Federal Reserve had negotiated \$700 million in swap lines with seven central banks and the BIS. (See Table 1.)

The purpose of the swap network was to allow central banks to defend the exchange rate of their country's currency while economizing on foreign exchange holdings. Swaps also allowed foreign countries to protect the gold value of their dollar reserves against a dollar devaluation. By activating their swap line, they could avoid converting their dollars into gold as in the past.

While it is difficult to judge the performance of the swap network during the fixed rate period, central banks found it a useful mechanism. First, central bankers thought the network sufficiently worthwhile that they expanded it from **\$700** million in June **1962** to \$11.7 billion in March 1973. (See Table 1.) Second, the network was used actively, with the United States initiating **\$11.9** billion in swaps during the period, while foreign central bank drawings totaled **\$15.4** billion. Finally, the Federal Reserve made profits each year on its swap transactions. (See Table 2.) Total realized profits came to \$27.3 million between 1962 and March 1973.

It has been argued that the losses from the swap debt outstanding on August 15, 1971, should be included in the profitability calculations for swaps during the fixed rate period.⁷ These losses, which were brought about by subsequent declines in the exchange value of the dollar, totaled **\$847.8** million through the end

⁷ Milton Friedman, "Back to the Gaming Table," *Newsweek*, January 30, 1978, p. 65.

Table 1
FEDERAL RESERVE RECIPROCAL CURRENCY AGREEMENTS
(In Millions of Dollars).

	<u>Aug. 2,</u> <u>1962</u>	<u>March 9,</u> <u>1973</u>	<u>July 10,</u> <u>1973</u>	<u>March 13,</u> <u>1978</u>	<u>Nov. 1,</u> <u>1978</u>
National Bank of Belgium	50	600	1,000	1,000	1,000
Bank of Canada	250	1,000	2,000	2,000	2,000
Bank of England	50	2,000	2,000	3,000	3,000
Bank of France	50	1,000	2,000	2,000	2,000
German Federal Bank	50	1,000	2,000	4,000	6,000
Netherlands Bank	50	300	500	500	500
Swiss National Bank	100	1,000	1,400	1,400	4,000
B.I.S. (Swiss francs)	100	600	600	600	600
(Other authorized European currencies)	—	1,000	1,250	1,250	1,250
Austrian National Bank	—	200	250	250	250
Bank of Denmark	—	200	250	250	250
Bank of Italy	—	1,250	2,000	3,000	3,000
Bank of Japan	—	1,000	2,000	2,000	5,000
Bank of Mexico	—	130	180	360	360
Bank of Norway	—	200	250	250	250
Bank of Sweden	—	250	300	300	300
Total	700	11,730	17,980	22,160	29,760

*SOURCE: Federal Reserve Bank of New York, Monthly **Review**, and Federal Reserve Board Press Release, November 1, 1978, p. 2.

of 1978, with another \$150 million in losses yet to be realized. It may also be argued that the swap debt was incurred to prevent gold outflows to foreign central banks prior to the dollar's first devaluation. Therefore, the swap liquidation losses could be at least partly offset by unrealized profits from the gold saving that resulted from the original swap drawing. In fact, if all such drawings prevented gold outflows, the \$1 billion loss actually can be viewed as a net unrealized gain of over \$5 billion.⁸ However, since it is likely that the United States would have devalued sooner had these lines been unavailable, the actual gold saving was probably considerably smaller.

U.S. INTERVENTION DURING THE FLOATING RATE PERIOD

By August 1971, with the U.S. balance of payments deficits creating an excess supply of dollars, some central banks began demanding

⁸ The limit value of the gold saving was estimated by calculating the price that would have been received for the gold if the swap debt was retired by selling the gold that was saved when the original debt was incurred. The gold price used was the official price until March 1973 and the average quarterly market price of gold for all other periods. Thus, for each quarter: Potential Profits = (Retirement/\$35) x (Avg. Gold Price - \$35) - (losses on Currency Liquidation).

Table 2
NET REALIZED PROFITS (+)
AND LOSSES (-) ON
FEDERAL RESERVE
CURRENT FOREIGN EXCHANGE
OPERATIONS
1962 THROUGH MARCH 1973
(Millions of Dollars)

<u>Year</u>	<u>Federal Reserve Net Profits</u>
1962	+0.3
1963	+0.3
1964	+0.1
1965	+1.0
1966	+1.4
1967	+1.3
1968	+8.1
1969	+6.4
1970	+3.0
1971	+3.7
1972	+1.4
1973*	+0.3
Total Net Profits	+27.3

*One-fourth of 1973 profits.

SOURCE: Federal Reserve Bank of New York Quarterly Review, Summer 1978, p. 54.

gold for their excess dollar holdings. As a consequence, the United States found it necessary to suspend the dollar's convertibility into gold, and several major currencies were allowed to float against the dollar. The general float continued until December 18, 1971, when the Smithsonian Agreement was signed. The new agreement accepted a new set of exchange rates, while allowing the value of currencies to float in a band of 2% per cent on either side of the official parity, rather than plus or minus 1 per cent as in the past. The dollar was also formally devalued by raising the official price of gold from \$35 to

\$38 an ounce. Still, the system remained unstable, and despite an additional dollar devaluation on February 12, 1973, the system collapsed. On March 13, 1973, the United States formally announced the dollar was a floating currency, starting a new era in Federal Reserve intervention policy.

In the new floating rate era, some central banks felt that larger swap lines were needed because the foreign exchange markets were growing rapidly and official limits on exchange fluctuations had been removed. Therefore, on July 10, 1973, the United States **expanded its** swap lines 53 per cent to \$18 billion. (See Table 1.) **However**, the expansion of the swap lines gave no guarantee that intervention would be successful, or even appropriate, because of uncertainty that existed about the appropriate value of currencies in the new system.

The new problem of intervention policy was that it was now more **difficult** to identify the market conditions in which intervention might be appropriate. Previously, a market had been considered disorderly when exchange rates were at their intervention limits. But with no official limits, an exchange rate movement based on a change in economic conditions or in the relative desirability of a given currency could be an orderly movement. The new question became whether or not the rate had been changing faster or by more than it should. The appropriate value of an exchange rate at any point, present or future, is not always **clear**⁹. Thus, intervention has become risky and difficult. The Federal Reserve's

⁹ No model of exchange rate determination has forecasted exchange rate movements very successfully. The modeling problems probably stem from three sources. First, the generalized, managed float is a rather new phenomenon, and the adaptation of market transactors has been gradual. Second, expectations and portfolio considerations are often more important than underlying economic considerations. At various times, differing groups of transactors will dominate the market. Finally, central banks try to make their intervention seem as random as possible to avoid traders forecasting it and capitalizing on it.

response to the problem has been to attempt to calm disorders in foreign exchange markets, rather than defend any exchange rate or range of rates.

Determining what constitutes a disorderly market has been both difficult and highly subjective. Further, using a rigid decision rule or set of rules seems inappropriate because disorders appear to vary across time. There are, however, certain circumstances in which intervention is likely to occur. One case is in response to major exchange market fluctuations that do not appear to be based on new information about the underlying economic relationships. These fluctuations can either be large exchange rate movements, or a marked widening of the bid and asked quotations for a given currency, for either would indicate that traders are unwilling to acquire a given **currency**.¹⁰ If the Federal Reserve believes these fluctuations are not based on underlying conditions, or that they are an overreaction to some change in conditions, intervention often occurs. In this way, the Federal Reserve tries to persuade traders that there is a two-way risk in the market."

The other major cause for intervention occurs when the Federal Reserve tries to smooth exchange rate adjustments. The Federal Reserve attempts these smoothing actions when it believes that exchange rate movements, while based on underlying economic conditions, are either too large or too rapid. The purpose of this

¹⁰ Intervention is especially likely to occur when the market appears to have become severely one-sided—such as when large exchange rate movements are taking place on little or no trading volume and/or traders are becoming unwilling to give bid or asked quotations for certain currencies.

¹¹ Slowing or countering exchange rate movements acts to reduce the expected variance and volatility of exchange rates which may lessen the uncertainty of exporters, potential exporters, and people in import-competing industries. This, in turn, may help to stimulate production and trade.

intervention is to keep the foreign exchange markets functioning smoothly, and to help prevent "runs" on the dollar. Intervention of this type is sometimes costly. If the market does not readjust quickly and allow the Federal Reserve to retire the swaps, losses can occur as the exchange rates move along their longer run trend.

Analyzing the success of Federal Reserve swap policy during the period from March 1973 to October 1978 is difficult. However, some indirect observations can be made about swap policy. During most of this period, the swap network was used sparingly. From March 1973 through October 1978 only about \$5.9 billion in swaps were initiated by the United States and \$2.8 billion by foreign banks. Thus, on an annual basis, the network has been less active during the floating rate period than during the **fixed** rate period. Despite a large growth of the foreign exchange market, the size of the swap network was increased only about 25 per cent. (See Table 1.) The swap network was inactive because the dollar was a generally weak currency during most of this period and the United States preferred to keep intervention to a minimum. Until late 1977, the Federal Reserve's policy stance was one of leaning "gently" against the wind. Therefore, since U.S. intervention was modest and foreign banks generally did not need dollars, the swap lines were not heavily used.

Another measure can be used to judge success of Federal Reserve intervention policy—the profitability of its current foreign exchange operations. However, this measure has two weaknesses. First, the Federal Reserve does not view intervention as a speculative activity; therefore, its policy is to retire swaps as soon as practicable. As a result, the Federal Reserve may accept an exchange loss and retire a swap at a time when the dollar is expected to appreciate. Second, the Federal Reserve sometimes intervenes in a falling market to smooth the dollar's decline; as a result, losses sometimes occur. While intervention directed at short-run market

Table 3
NET REALIZED PROFITS (+)
AND LOSSES (-) ON
FEDERAL RESERVE
CURRENT FOREIGN
EXCHANGE OPERATIONS
MARCH 1973 THROUGH
DECEMBER 1978
(Millions of Dollars)

Year	Profitability
1973 ^{**}	+1.0
1974	+4.1
1975	+8.0
1976	+6.2
1977	+4.6
1978 [†]	-33.4
Total	-9.5

*Three-fourths of 1973 profits.

†The Federal Reserve also had \$58.4 million in unrealized losses from the revaluation of its swap debt at the end of 1978. However, a January 20 estimate of the effects of the dollar's appreciation since January 1, 1979, showed these losses to be eliminated at current exchange rates.

SOURCE: Federal Reserve Bank of New York, Quarterly Bulletin, Summer 1978, p. 54; Federal Reserve Bank of New York, Quarterly Bulletin, Autumn 1978, p. 10; Federal Reserve Press Release, January 8, 1979.

disorders should be generally profitable, the "rear guard" defenses of a falling dollar sometimes results in losses. Table 3 shows the results for the floating rate period. During the first four years of the float, the dollar was not subjected to major speculative attacks; as a result, intervention was slightly profitable. Then, in 1978, with the massive attack on the dollar, the Federal Reserve's job became one of keeping the market from becoming highly disorderly. In the short run, some losses had to be taken."

Prior to October 1977, floating rate intervention policy appeared to be generally successful in preventing disorderly markets. However, U.S.

authorities were unable to counter the movement against the dollar during the next 13 months. From October 1977 through October 1978, the dollar fell sharply in the foreign exchange markets. In fact, the dollar fell rapidly against every major currency except the Canadian dollar, with the fall in the effective exchange rate totaling over 11 per cent.¹³ By late October, U.S. authorities felt that the decline in the dollar was greater than was justified by fundamental factors.

In late 1977 and early 1978, the decline of the dollar appeared to be based on economic fundamentals. During 1976 and 1977, the U.S. economy not only grew and inflated faster than most other industrial nations, but the U.S. trade balance also turned negative in 1976, and seriously so in 1977, with a deficit of \$31 billion. However, by mid-1978 the trade balance, while still in deficit, was gradually improving and U.S. interest rates were rising relative to foreign rates.

Still, despite the improvement of these fundamental economic factors, the dollar's decline was accelerating. The continued decline stemmed from a general belief that the dollar would continue to fall faster than international interest rate differentials would indicate, causing people to diversify away from the

¹² One can argue that interest costs should be included when measuring the profitability of swaps. However, placing swap funds in nonnegotiable Treasury certificates of indebtedness merely results in the Treasury borrowing funds from foreign central banks rather than in the open market. The only difference is that, in this case, the recipient of the interest is predetermined rather than being determined by the highest bidder in the market.

¹³ The "effective exchange rate" used by Morgan Guaranty Trust Company of New York measures the change in our exchange rate relative to the currencies of our 15 primary trading partners using a geometric average. Weighting is based on each country's share of U.S. exports and imports. Thus, since Canada accounts for almost 40 per cent of U.S. trade, the weakness of the Canadian dollar prevented the effective exchange rate from declining further.

dollar.¹⁴ By mid-October, it became evident that the dollar's decline was likely to continue unless some action was taken by U.S. authorities.

Since the dollar's decline was inflationary, as well as being damaging to a climate of growth and investment, U.S. authorities decided that confidence in the dollar should be **restored.**¹⁵ On November 1, the Federal Reserve and the Treasury announced a joint program directed at combating inflation and strengthening the dollar.

The new program acted to strengthen the dollar in three **ways.** The Federal Reserve's discount rate was raised from **8%** per cent to 9% per cent, and domestic banks were encouraged to borrow from the Eurodollar market through the imposition of a **2** per cent supplementary reserve requirement on all domestic time deposits of **\$100,000 or more.**¹⁶ Also, plans were announced for a major expansion of the intervention capabilities of both the Federal Reserve and the Treasury.

A four-part program was instituted to expand U.S. intervention capabilities. First, the U.S. Treasury made use of some of the reserves which were unconditionally available from the International Monetary Fund (**IMF**). This included an immediate **\$2** billion drawing in marks and yen from its reserve tranche, and the sale of **SDR's** valued at \$1.4 billion. The Treasury also made a **\$1** billion reserve tranche drawing in

marks and yen, through the **IMF's** General Agreement to Borrow (GAB) facility." While these facilities had long been available, the United States had chosen not to use them. However, including these actions in this program helped to reaffirm the seriousness of the current policy stance.

Second, the U.S. intervention potential was expanded by increasing the Federal Reserve's swap lines with the Japanese, German, and Swiss central banks. These three lines were expanded by **\$7.6** billion to **\$15** billion. (See Table 1.) In conjunction with this act was an implicit statement that rather freer access would be given to these lines, and the explicit statement that the yen line would be activated by the U.S. for the first time.

Third, the Treasury announced plans to issue up to **\$10** billion in foreign-denominated securities in the German, Swiss, and Japanese capital markets to obtain additional foreign exchange for intervention purposes. The first sale was of **\$1.6** billion in mark-denominated two- and four-year notes which were sold in the German capital markets on December **12, 1978.** A **\$1.2** billion Swiss franc issue of two and one-half- and four-year notes was sold in Switzerland on January **18.**

Finally, in December, the monthly Treasury gold sale was increased from 300,000 ounces to a minimum of **1.5** million ounces to expand the supply of publicly available gold and help relieve pressure on the **dollar.**¹⁶ The action also was expected to improve the U.S. trade balance, since much of the gold would be sold to foreigners.¹⁹

The new program also indicated that U.S.

¹⁴ Theoretically, a person would not object to **holding** a depreciating **currency** if the interest premium on that currency, relative to the alternative currencies, was equal to the rate of depreciation.

¹⁵ Estimates of the inflationary effect of the dollar's decline range from a one-quarter of 1 per cent to a 2 per cent Consumer Price Index increase per 10 per cent decline of the dollar on a trade-weighted basis. The latter estimate is probably closer to the truth.

¹⁶ The encouragement was doubly effective because of the August removal of reserve requirements on funds raised in the Eurodollar market. It is also noteworthy, however, that the Federal Reserve sterilized the **\$3** billion reserve contraction that this new rule would have caused.

¹⁷ The GAB is a **lending** arrangement between the **IMF** and seven industrial IMF members and Switzerland. The purpose of the GAB is to lend specific currencies to the Fund should the need arise.

¹⁸ The United States also had previously announced plans to increase its gold sale to 750,000 ounces in November.

intervention was to become more aggressive. Prior to the November announcement, intervention generally had been directed solely at exchange market conditions. Now, as indicated by the Federal Reserve and the Treasury, the United States would counter a decline in the dollar that had "exceeded any decline related to fundamental **factors.**"²⁰ Further, the release indicated that the United States would intervene "in a forceful and coordinated manner" directed at the "**correction** of recent excessive exchange rate **movements.**"²¹ Thus, rather than leaning against the wind, the new program tried to bring about some realignment of exchange rates.

While it is too early to judge the success of this program, the early results are promising. The initial actions to reverse market sentiment about the dollar were highly successful. In the first two days of the **program**, the dollar rose appreciably against most major currencies. Moreover, a major test of the dollar came after the December 17 announcement of the OPEC oil price increase. The market discounted this information quickly, and conditions were again

quiet by the middle of the next business day, although the dollar did remain somewhat weak for the rest of December. Since then, the market has been stable and the dollar has generally firmed. From October 30 through the end of February, the dollar has risen almost 5 per cent on a trade-weighted basis, while rising 7.5 per cent against the German mark, 14.5 per cent against the Japanese yen, and 13.8 per cent against the Swiss franc.

CONCLUSION

Since the early **1960's**, U.S. authorities have intervened from time to time in the foreign exchange markets in support of the U.S. dollar. This intervention, conducted mainly through the swap network, has proven to be a useful tool for helping achieve the nation's international monetary goals. These goals have included defending the Bretton Woods system, preserving orderly foreign exchange markets, and maintaining confidence in the dollar's role as a key international currency. Experience has shown that intervention in foreign exchange markets has been a useful and low-cost instrument of short-run international policy. However, in the longer run, the achievement of international policy goals depends primarily on basic underlying economic conditions. Thus, it is important that the United States tie its intervention activity to policies designed to reduce the internal rate of price inflation and improve the nation's international balance of payments position.

¹⁹ It is also noteworthy that between October 27 and October 31, the limit on the Federal Reserve's net open position in foreign exchange was raised from \$1.5 to \$5 billion. This increased the ability of the Federal Reserve to incur swap debt to obtain foreign exchange with which to intervene to support the dollar.

²⁰ Joint Statement of Secretary of the Treasury, W. Michael Blumenthal, and Federal Reserve Board Chairman, G. William Miller, Federal Reserve Press Release, November 1, 1978, p. 1.

²¹ Joint Statement, pp. 1-2.