At the request of Mr. Jacobsson, I showed this to Mr. Altman, 4/12/61 D.H.F.S.

BANQUE NATIONALE SUISSE

LE PRÉSIDENT
DE LA DIRECTION GÉNÉRALE

ZURICH, ~~le~~

March 28, 1961.

Dear Mr. Jacobsson,

I take pleasure in sending you the following report on recent developments in the European foreign exchange market, as seen from Switzerland, and on measures taken by us to meet the situation in which I think you may be interested.

As you know, the revaluation of the German Mark and of the Dutch Guilder by 5% has produced foreign exchange speculation on an unprecedented and on an unexpectedly large scale. Taking the European Central Banks as a whole, the amount involved in capital movements reached almost 750 million \$. On March 6 alone, Switzerland absorbed approximately 180 million \$. This was due to the fact that a revaluation of the Swiss franc had been expected by various quarters abroad. Anticipating such a development, though not in its full weight, we directed Swiss foreign exchange dealers on Monday morning to accept any dollar amounts offered, at the rate of 4.31 3/8. They were given a guarantee to the effect that the buying rate of the dollar of the Swiss National Bank would under no circumstances drop below 4.3150. At the same time, we requested the banks concerned to keep the dollars which accrued to them, without passing these on to the Central Bank right away. This we did because we were of the opinion that the speculation against the Swiss franc would quickly die out. Following the official statement by both the Swiss Federal Council and the Swiss National Bank, refuting the rumours of a possible revaluation of the Swiss franc, speculation slowed down, and on Tuesday all we had to take up was 19 million \$ only. However, in the course of Tuesday, bears, speculating against the pound sterling appeared on the market and this led to sizeable transfers of funds to Germany, France, Italy and Switzerland. In Germany, the inflow of funds from abroad amounted to roughly 200 million $. Also France and Italy registered an accrual of foreign capital, though in a much lesser degree. Between March 8 and March 11, we received a further 115 million $. On the other hand, during the period of March 6 - March 10, the Bank of England felt compelled to intervene drastically by making available to the market approximately 350 million $.

When we recognised, toward the end of the week, that foreign exchange speculation had assumed proportions of such magnitude, we decided - notwithstanding the fact that this meant additional market liquidity - to recall from the banks the whole of their guaranteed dollar holdings in order to regain control over the foreign exchange market. Our monetary reserves thus showed an increase of 1244 million Swiss francs, i.e. 288 million $, within the period of March 6 to March 14. This growth would have been larger still, had we not employed funds in England to the extent of 70 million Swiss francs, which investment enabled us to give at the same time some assistance to the Bank of England in its intervention policy against speculation. In addition, we bought from the Bank of England gold to the equivalent of 60 million $ and also pledged further support.

Considering the heavy inflow of dollars, we have had to reflect upon what kind of policy we are going to pursue. In view of the fact that, simultaneously, bears operated against the pound sterling and bulls speculated against the Swiss franc, we thought it best to make dollars available to the Bank of England in some form or other. Two weeks ago, and as a result of discussions we had in Basle (BIS), we came to an agreement with the Bank of England, whereby the Swiss National Bank undertook to deposit with the Bank of England an amount of 200 million $ so as to ease the position and to enable it to counteract further attacks against the pound. This particular transaction was actually executed on March 14/15. It would appear that other European Central Banks, too, have followed the Swiss example and opened dollar and/or sterling deposits with the Bank of England. Furthermore, we concluded with the Bank of England a special deal in the form of a swap transaction, selling to them gold against sterling and re-purchasing the gold against sterling on a forward basis at two and three months' date respectively. The pounds sterling obtained in this way have been sold by us cash to three big Swiss banks and re-purchased from them on the same forward basis as above. We thus provided the Bank of England with some gold. At the same time, we made available to our big banks facilities for them to make sterling investments on a secured basis which, under present conditions, they are unable to do on their own account because of the high forward costs on the £. Finally, thanks to this transaction, we were also able to reduce somewhat our monetary reserves. The amount involved is 28 million $. A second operation on the same pattern, also for 28 million $, was effected on March 21, and a third one will be carried out in a few days' time.

Recent capital movements in Europe show roughly the following picture:

Accruals during the period of March 6 - March 11:

in Switzerland	320	million $
in Germany	200	" "
in France, Italy and the Netherlands	180	" "
various other Central Banks (estimated)	20- 50	" "
in all	720-750	" "
./. dollar drain on the resources of the Bank of England	350	" "
leaving	370-400	" "

unaccounted for.

As these figures reveal, an amount of approximately 370-400 million $ must have emanated from sources other than the European Central Banking System, such as possibly the existing dollar deposits, the so-called Euro-dollar market, the Euro-sterling market and credits granted by banks to European borrowers.

In order to solve the currency speculation problem, one of the important prerequisites is to bring the dollar market in Europe under control again and to have the financing of speculative transactions stopped. Dollar loans for speculative purposes, already made, should be withdrawn and fresh credits should not be granted any more. As we were informed by a reliable source, German banks, for instance, seem to have been granted dollar credits by American banks, and further loans are still being applied for. It is obvious that such borrowings are being used for the purpose of either upholding existing speculative balances or of entering into fresh speculative commitments. We consider it highly desirable that American banks and their Offices in London be urged most emphatically to discontinue the granting of these loans and to withdraw, as soon as possible, speculative credits already granted. Such transactions not only impair the position of the dollar but also help to undermine confidence in the European currencies. It would hardly be reasonable to expect of European Central Banks that they take measures for the stabilisation of the dollar if, at the same time, American banks, without being criticised for their action, are freely granting credits to European banks, enabling these latter to build up or to uphold speculative balances against European currencies. Only if and when such dollar loans by American banks and their London Offices can be prevented, and the dollar in Europe can be brought under the control of the Central Banks, will it be possible to stifle speculation and to force it to liquidate its balances.

This for your personal information. We have already been in touch with the Federal Reserve Bank of New York as regards this matter.

The fluctuating hot money which is being transferred from one country to another one, according to differing interest rates and based on expectations of a possible alteration in the rate of exchange, constitutes some sort of a headache to monetary authorities, as you well know. The events in Europe of the past weeks dwarf everything experienced so far. Never since the Suez crisis has England had such a heavy drain on her currency reserves, and never since the existence of the Swiss National Bank has there been registered an inflow of dollars of such magnitude within a week. If it is intended to curb such movements in future, it is essential that speculation be made to suffer heavy losses this time. As far as Switzerland is concerned, the chances for speculators to escape such a fate are becoming rather dim in view of the fact that we are keeping the dollar market tight and allow the dollar rate to rise. However, if this policy is to succeed within a reasonable period of time, it will be necessary to get the European dollar market under control and to see to it that speculation is forced to withdraw. We think this to be in the interest of all European currencies, as well as of the U.S. dollar.

With kind regards,

Yours very sincerely,

Schwegler

(Dr W. Schwegler)

March 30,1959

Dear Dr. Schwegler:

Two days ago I read in the NEUE ZURCHER ZEITUNG your speech at the Annual Meeting of the National Bank, and I wish to congratulate you on a most comprehensive and interesting review of the situation. When I again and again discover how much monetary wisdom is to be found in Switzerland, I regret very much that that country is not a member of the Fund.

I am afraid I never thanked you for your letter of the 2nd of January, and the interesting copy of the letter you had sent to Mr. Hayes in New York. It was very useful for us to receive this information, which enabled us to understand much better the measures taken in Switzerland.

So far it seems that the moves to external convertibility have been followed by a strengthening of reserves, and easing of credit conditions. They were taken from a position not of weakness but of strength, and that is important from many points of view.

It is my hope to be able to come to Basle for the annual meeting of the B.I.S., and I look forward then to having again a good talk with you. In the meantime, with kind personal regards, I am

Yours sincerely,

Per Jacobsson
Managing Director

Dr. W. Schwegler
Präsident des Direktoriums der
Schweizerischen Nationalbank
Zürich, Switzerland

Office Memorandum

TO : The Managing Director

DATE: January 12, 1959

FROM : Irving S. Friedman

SUBJECT : Switzerland -- Currency Changes

Thank you for allowing us to see the attached letters from Switserland. They are most interesting.

We would also be very interested to learn from the Swiss what changes have been made in their exchange control regulations as a consequence of the convertibility moves, and the reasons for these changes. Would it be possible for you to make inquiries on our behalf?

ISF

Attachments

SCHWEIZERISCHE NATIONALBANK
BANQUE NATIONALE SUISSE

DIREKTORIUM
DIRECTION GÉNÉRALE

Zürich, den 2. Januar 1959.

Herrn Dr. Per Jacobsson,
Präsident des International Monetary Fund,
19th and H Streets, N.W.,
W a s h i n g t o n 25 , D.C.

Sehr geehrter Herr Dr. Jacobsson,

Der Uebergang zur Konvertibilität der meisten europäischen Länder hat die Schweiz, wie Sie wissen, vor ein Sonderproblem gestellt, da es galt, die beiden bestehenden Kursebenen im EZU-Raum und im Dollarraum zu vereinheitlichen. Wir haben die Herren Martin und Hayes vom Federal Reserve Board bzw. von der Federal Reserve Bank New York über die Ueberlegungen unterrichtet, die zur Neufestsetzung des Dollarkurses in der Schweiz und zur Festlegung der Kurslimiten führten. Wir gestatten uns, Ihnen in der Beilage Kopie des diesbezüglichen Schreibens zu überreichen, in der Annahme, dass dieses für Sie von Interesse sein werde.

Gerne benützen wir die Gelegenheit, Ihnen zum neuen Jahr alles Gute zu wünschen und verbleiben mit dem Ausdruck unserer vorzüglichen Hochachtung

SCHWEIZERISCHE NATIONALBANK

Kind personal regards
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Beilage erw.

SCHWEIZERISCHE NATIONALBANK — BANQUE NATIONALE SUISSE
BANCA NAZIONALE SVIZZERA
ZÜRICH-BERN
AARAU, BASEL, GENÈVE, LAUSANNE, LUGANO, LUZERN, NEUCHÂTEL, ST. GALLEN,
BIEL, LA CHAUX-DE-FONDS, WINTERTHUR
ALTDORF, BELLINZONA, CHUR, FRIBOURG, HERISAU, LIESTAL, SCHAFFHAUSEN, SCHWYZ, SION, SOLOTHURN, WEINFELDEN, ZUG

DIREKTORIUM
III. DEPARTEMENT

TELEGRAMME: DIRECTIONAL
TELEPHON Nr. 23.47.40

Zurich, December 31, 1958

Mr. A.Hayes, President
Federal Reserve Bank of New York
New York 45, N.Y.

Dear Mr. President,

We sent you on the 29th December a telegram as per copy enclosed, from which you will have gathered that we have fixed the new buying rate for the dollar at 4.2950 and the selling rate at 4.45. This results in a margin of 1.78% either side of the parity, whereas the other members of the European Monetary Agreement have fixed their margins, as a rule, in the neighbourhood of 3/4 % either side, as you will have noticed in the meantime. Possibly the rather wide margin fixed by us may somewhat surprise you and we are anxious to acquaint you with the underlying factors and considerations which prompted us to act as we did.

As you know, the Swiss franc - as the only European currency - has already been convertible against the dollar. This may have been an added reason why there has always been a relatively large supply of dollars in the Swiss market. Consequently, the dollar rate moved mostly in the region of our lower buying rate of 4.2850. This buying rate was calculated on the basis of our buying price for gold of Fr 4869.80 and the price for gold of $ 35.- per ounce fine gold, plus 1/4 % handling charge, plus 3/4 % shipping and insurance charges. Hitherto, these latter had been somewhat overvalued, intentionally though. The actual expenses are in fact near 5 ‰. The foreign convertibility of the European countries having been reinstated and the surplus settlements in future taking place in convertible currency or gold, our dollar price is forced to adapt itself more closely to the actual gold price, so that on the basis of the New York gold price an adjustment from 4.2850 to 4.2950 was inevitable.

In the framework of the European Payments Union, the Swiss Franc was worked out on the basis of the parity of Fr 4.37282 per dollar, i.e. unit of account. Thus, two rate levels were created in Switzerland; the one of the EPU and the one of the dollar area and between the two there existed a rate difference of nearly 2 %. This rate structure could only work in view of the fact that the other European currencies were not convertible against the dollar and also because Switzerland, by means of strict control over in- and out-payments of EPU countries, screened the EPU area against the dollar area; in other words, the European countries were unable to change into dollars their Swiss Franc earnings from current transactions.

Upon the dissolution of the EPU and the coming into force of the European Monetary Agreement, the existing two rate-levels in Switzerland had to be unified owing to the new convertibility of the European currencies against the dollar. No similar problem did arise for any other European country.

We were therefore confronted with the question of whether we ought to allow the dollar rate in Switzerland to rise by 2 %, or whether we ought to allow the rates of the European currencies to drop by 2 %, or whether some half-way solution ought to be aimed at. In view of the favourable balance of payments of our country and the still existing latent danger of inflation, we considered it essential that the Swiss Franc against the dollar should drop to such an extent only as would appear inevitable for purely technical considerations. This led to the re-fixing of the buying rate at 4.2950 against 4.2850, taking the above mentioned calculation as a basis. Should this dollar rate remain firm in our market, the Swiss Franc against the other European currencies would quote higher by about 1½ - 1¾ %.

We assume, however, that a somewhat higher dollar rate will eventually evolve by the law of supply and demand. For the establishment of the dollar rate in Switzerland, not only the gold price in New York, but also the gold price in London, will be of importance. The present gold price in London of $ 35.08 per ounce corresponds to a dollar rate of 4.3134, shipping expenses taken into account. Should the price for gold in London drop, the corresponding dollar rate in Switzerland ought to be higher still. It is quite obvious, therefore, that with a dollar rate which is too low in Switzerland in comparison with the gold price, arbitrage transactions would level out the difference between gold price and dollar rate. In the same way, our associate countries would prefer to make surplus settlements in gold instead of in dollar. In order to prevent such gold sendings, we have to arrive, under the present circumstances, at a dollar rate in Switzerland which, according to the gold price on the London market, might vary between 4.31 and 4.33. In view of this adjustment in the rate, which is to be expected for certain, nothing could have prevented us to choose a somewhat higher buying rate for the dollar than we did, if it were not our preference for the solution to change as little as possible the present set-up and leave it to the market to determine the dollar rate itself.

We are anxious to explain the considerations which led us to the fixing of the above mentioned rate limits, and as you will gather from the foregoing, the changing over from the EPU to the EMA created a special problem for Switzerland and made it advisable, at least for the beginning, to fix a rather large margin between the buying rate and the selling rate.

We trust the above information will be of service to you, and remain,

Sincerely yours,
BANQUE NATIONALE SUISSE

Encl.

29.12.58.

SWISSFED NEWYORK

In view of the coming into force of the European Monetary Agreement the Bank for International Settlements, Basle, has been notified by us of a buying rate for dollars of 4.295 and a selling rate of 4.45 stop The new buying rate is calculated on the basis of the New York gold price plus ¼% handling charge plus five per mil shipping and insurance charges stop Owing to arbitrage transactions expect dollar rate in Switzerland will largely adapt itself to the price of gold in London so that on the basis of the present price of gold in London a dollar rate of 4.31 - 4.32 could be possible stop Letter follows.

DIRECTIONAL