

BANK OF JAMAICA

REGIONAL MONETARY CONFERENCE

ST. AUGUSTINE, TRINIDAD

29th-30th March 1969

AGENDA ITEM I

THE NEW STERLING AGREEMENTS

1969 Regional monetary Studies Conference

THE NEW STERLING AGREEMENTS

Introduction

In this paper, the new sterling agreements between the U.K. and the overseas sterling area countries are examined. These agreements were concluded under pressure from the U.K. Authorities in order to protect sterling. Both sides however, gained something from these agreements. The U.K. Authorities by stabilising the sterling balances, were able to cordon off an area of potential danger to sterling while the overseas sterling area countries obtained a guarantee of some 90 per cent of their "official" reserves against a future devaluation of sterling.

These agreements will expire in the period 1971-73 and so far as the Commonwealth Caribbean is concerned, the question that has to be considered sooner or later, is what direction do we take when these arrangements come to an end.

The Sterling Balances

The sterling balances originated largely as debts to wartime creditors of the U.K. Working balances were always held in London, in sterling, but these rose from about £500mn. at the out-break of the second world war to about £3,570mn. at the end of the war. Since then the largest holders - India, Egypt, Argentina and several commonwealth countries - have run down their balances while other countries such as Australia, Hong Kong, Kuwait, the Persian Gulf States and the Caribbean Area have built theirs up.

These balances fall into three main categories:

(i) Balances held by residents of non-sterling area countries

The greater part of these are now privately held. Over the years these balances have increased in total but there have been marked short-term fluctuations, reflecting confidence in sterling and interest rate differentials.

(ii) Privately held sterling area balances

These have risen steadily since the war; they show little sensitivity to confidence and the rising trend is mainly a reflection of the strong balance of payments position of certain overseas sterling area countries and the growing value of trade done in sterling.

/(iii)

(iii) Official balances of the overseas sterling area (OSA) countries

The composition of these balances had under-gone much change since the war as some countries have run down their sterling reserves while others have built up theirs. Up to the early 1960s, the total was relatively stable and the sterling proportion of the total reserves of the OSA countries remained high and relatively constant. During the 1960s, an increase in sterling area countries' trading and political links with the non-sterling area and their growing reliance on non-sterling sources for investment and aid led to a diversification of their reserves. This took the form mainly of an accumulation of non-sterling assets when total reserves were rising and for the sterling area as a whole, there was no significant fall in officially held sterling.

The short-term fluctuations particularly in the balances of non-sterling holders could make heavy demands on the reserves of the U.K. and the strains which could be set up by these fluctuations were recognised as a potential source of instability for sterling and the international monetary system as a whole. In June 1966, a facility was made available by a number of central banks to offset the effect on the U.K.'s reserves of fluctuations in the sterling balances. This facility was not intended to help finance deficits in the U.K. balance of payments but solely to relieve stresses arising from the international use of sterling. Swap arrangements were made available to the Bank of England on a short-term basis, on which drawings could be made when the sterling balances fell below a fixed starting level.

In September 1967 gross sterling balances of the OSA countries amounted to £2,834mn. including £244mn. held by the Caribbean Area. In June 1968 these balances amounted to £2,796mn, including £257mn. held by the Caribbean Area. It should be noted that while some sterling area countries reduced their sterling balances before and after devaluation, the Caribbean Area built up theirs. In the period 1963 to 1967 the gross sterling balances of the Caribbean Area increased by £47mn.

Sterling after devaluation

The financial links between the U.K. and the rest of the sterling area were considered to have been loosened by the devaluation of 1967. The larger sterling area countries did not devalue and as a result they suffered losses both in terms of dollar purchasing power and in terms of their own currency. Since devaluation, sterling has not enjoyed the stability originally /anticipated.

anticipated. There have been frequent crises generated both by international monetary developments and developments in the U.K. economy. This has resulted in a good deal of uncertainty about the viability of sterling as a reserve currency and some OSA countries, wary of another sterling devaluation, began diversifying their reserves at an accelerated pace. There was a fall in officially held sterling balances as considerable sums were switched into other forms of reserves. Between March and June 1968, gross sterling balances of the OSA countries fell by £324mn. At the time of the sterling devaluation in November 1967, some 75 per cent of the Bank of Jamaica's external reserves were held in sterling but by the time the sterling area negotiations began in July, this proportion had fallen to 54 per cent. Diversification, if carried far enough, could have precipitated another crisis and perhaps another devaluation of sterling.

The Hong Kong Arrangement

Hong Kong, one of the large sterling holders suffered substantial losses as a result of the sterling devaluation; this territory followed sterling by devaluing the Hong Kong dollar to the full 14.3 per cent but subsequently re-valuing it by 10 per cent. Concern over its sterling reserves led Hong Kong to exert pressure on the U.K. Authorities for diversification of its reserves. This resulted in the "Hong Kong Arrangement" the main features of which are:

- (a) Up to 50 per cent of Hong Kong's official external reserves to a limit of £150mn. could be held in U.K. Government Bonds denominated in Hong Kong dollars,
- (b) Bonds would be issued with a seven-year maturity,
- (c) Bonds would be encashable by the Government of Hong Kong in case of liquidity need or balance of payments purposes or by agreement with H.M.G.,
- (d) The arrangement is subject to review by either side, or in any case in December 1969 if the Government of Hong Kong so requests.

This arrangement and the arrangements of June 1966, set the pattern of the subsequent "Sterling Agreements" but did not check the policy of diversification by other OSA countries. As the White Paper on the Basle Facility states -

"It therefore became obvious that it could no longer be assumed that even after the U.K. had achieved a surplus on its balance of payments that the sterling area countries would wish to hold as much sterling as previously. NEW means had therefore to be found to accommodate unavoidable reductions in the sterling balances and at the same time

/to ensure

to ensure that sterling would be willingly held in reserves at levels not significantly below the present."

The Basic Facility

In early 1968 the Bank of England began discussions in Basle with representatives of the central banks which participated in the arrangements of June 1966 and with the Bank for International Settlements. Early in July this group indicated its willingness to provide credits amounting to U.S. \$2,000mn. to offset fluctuations in the sterling area balances. At the same time, the U.K. Government proposed to undertake consultations with the governments of the OSA countries and the offer made by the Basle group was subject to the satisfactory outcome of these consultations. The Basle countries were concerned that the facility should be amply sufficient to cover any prospective rundown of the sterling balances during the next three to five years and they were also anxious that the sterling area itself should make a contribution to the financing of the facility. On 9th September 1968, final agreement was reached between the U.K. and the Basle group.

The countries participating together with the Bank for International Settlements were: Austria, Belgium, Canada, Denmark, the Federal Republic of Germany, Italy, Japan, the Netherlands, Norway, Sweden, Switzerland and the United States. Under the facility, the United Kingdom is able to draw United States dollars or other foreign currencies from the BIS as and to the extent that the sterling balances of the OSA countries fall below an agreed starting level. The facility will be usable to meet falls in both official and private balances held by residents of the sterling area countries. It will not however, be available to finance any deficit in the U.K. balance of payments. The facility has a 10-year life, but drawings may be made during the first three years. Amounts drawn under it will have to be repaid between the 6th and 10th years. The U.K. made a drawing on the facility towards the end of 1968.

The Sterling Guarantee

In early July, negotiations between the U.K. Authorities and the OSA countries began regarding the terms of the undertaking. The U.K. proposed a uniform system and in addition proposed a charge for the Guarantee. It very soon became clear that simple uniformity could not be achieved and that the circumstances of each sterling area country had to be considered separately. In addition, the proposed charge for the Guarantee proved unacceptable and this

/was withdrawn.

was withdrawn. Negotiation with some sterling area countries proved difficult and although the broad principles of the agreement were retained, there were areas of detail in which there was a good deal of bargaining. In the case of Australia, a provision was made whereby the net proceeds of official borrowings overseas in currencies other than in sterling, are not counted as part of total reserves for purposes of calculating the minimum sterling proportion until three months after the date of receipt.

The arrangement as finally agreed, involved an undertaking by the OSA countries to keep an agreed minimum proportion of their official reserves in sterling during the life of the agreements. The OSA countries were also urged to place some of their non-sterling holdings on deposit with the Bank for International Settlements in Basle. The U.K. on her part undertook to maintain the U.S. dollar value of eligible official sterling reserves of the OSA countries should there be a further devaluation of sterling.

As the White Paper states -

"The Guarantee applies to that part of each country's official sterling reserves which exceeds 10 per cent of its total reserves; that is to say, 10 per cent of each country's total reserves will be held in the form of unguaranteed sterling. The Guarantee in terms of U.S. dollars means that in the event of any devaluation of sterling against the U.S. dollar, the U.K. would make a payment in sterling to each country to restore the dollar value of the guaranteed portion of its sterling reserves. The Guarantee does not extend to private holdings or to equities held in official reserves. The Guarantee is conditional on each country maintaining at all times a Minimum Sterling Proportion in its reserves..... Although sterling proportions vary from country to country, the arrangements, combined with the Guarantee arrangements mean that the sterling area countries will hold 90 per cent of their reserves in the form of guaranteed sterling, non-sterling currencies or gold".

The agreements came into force on 25th September 1968 and will remain in force for 3 years with provision for extension to a further two years by mutual agreement.

In June 1968, the gross sterling balances of the OSA countries amounted to £2,796mn. and by the end of the year, these balances had increased to £2,869mn.

What of the Future?

As indicated above, negotiation with some sterling area countries proved difficult, Jamaica being a case in point. What the U.K. Authorities were asking in the beginning was that we should tie ourselves formally to sterling for a period of 7 years while at the same time, paying the U.K. a fee for guaranteeing our reserves. This was rather more than the Jamaican Authorities were prepared to accept. After consultation with other Caribbean

Monetary Authorities and joint negotiation with the U.K. representatives, the proposals were varied as set out on pages 4-5.

Acceptance of the agreement has resulted in slowing down the process of diversifying our reserves. When our sterling reserves approach the agreed minimum, we have to convert some of our non-sterling holdings to restore a safe margin. As indicated on page 3, some 54 per cent of the Bank of Jamaica's reserves were held in sterling when the negotiations began and at the end of 1968, this proportion stood at 56 per cent.

At bottom however, so long as we desired to remain in the sterling area, we had no real choice. It was implied in the discussions that if we did not accept the proposals in principle, we might not be able to continue enjoying the benefits of sterling area membership. At that point in time there was no well thought out alternative to membership in the sterling area. The agreements will expire in the period 1971-73 and we will then have to consider whether it is more beneficial to us to remain in the sterling area, or to work out some alternative arrangement.

Research Department
BANK OF JAMAICA
March 1969.

U.K. EXTERNAL LIABILITIES AND CLAIMS IN STERLING

£Mn.

Overseas Sterling Countries

U.K. Liabilities

	Total	Australia, N.Z. and S. Africa	India, Pakistan & Ceylon	Caribbean Area*	East Central and West Africa	Middle East†	Far East‡	Others§
<u>1967</u>								
Mar.	2,922	435	145	227	384	480	753	498
June	2,841	454	122	247	365	407	748	498
Sept.	2,834	428	118	244	349	394	738	533
Dec.	2,982	460	115	236	341	562	707	561
<u>1968</u>								
Mar.	3,120	525	154	261	360	598	679	543
June	2,796	516	150	257	349	413	617	494
Sept.	2,785	474	163	272	346	372	667	491
Dec.	2,869	451	197	272	358	411	712	468
<u>U.K. Claims</u>								
<u>1967</u>								
Mar.	477	132	54	38	136	17	36	64
June	520	152	58	38	153	20	36	63
Sept.	496	135	51	41	148	18	36	67
Dec.	529	160	56	42	149	25	34	63
<u>1968</u>								
Mar.	565	165	54	41	159	31	46	69
June	613	212	54	45	150	30	55	67
Sept.	531	154	49	39	145	31	45	68
Dec.	568	142	53	45	157	32	59	80

* Including Bahamas, Bermuda, British Honduras and Guyana.

† Jordan, Libya, Kuwait, Southern Yemen and other Persian Gulf States.

‡ Brunei, Hong Kong, Malaysia and Singapore.

§ Cyprus, Iceland, the Republic of Ireland, Malta and British dependent territories not elsewhere included.

Source: Bank of England Bulletin

Table 2

U.K. EXTERNAL LIABILITIES AND CLAIMS IN STERLING

£Mn.

Non-Sterling Countries

U.K. Liabilities

	Total	North America*	Latin America ⁺	Western Europe ^g			Eastern Europe	Middle East	Far East	Other ^h
				EFTA	EEC	OTHER				
<u>1967</u>										
Mar.	1,298	156	39	357	255	76	44	180	153	38
June	1,398	291	33	336	260	79	62	140	158	39
Sept.	1,723	491	32	503	214	73	44	155	171	40
Dec.	2,167	853	29	607	235	80	45	167	108	43
<u>1968</u>										
Mar.	2,464	1,061	26	665	291	72	40	176	90	43
June	2,280	886	26	670	285	69	40	159	99	46
Sept.	2,486	1,067	31	755	244	70	46	144	87	42
Dec.	2,708	1,250	28	874	224	71	39	102	76	44
<u>U.K. Claims</u>										
<u>1967</u>										
Mar.	772	38	114	88	70	103	113	63	147	39
June	804	33	128	99	63	112	111	65	154	39
Sept.	807	32	125	106	60	101	114	62	170	37
Dec.	814	31	136	108	58	95	127	61	161	37
<u>1968</u>										
Mar.	869	30	136	118	61	113	140	65	167	39
June	966	31	139	131	74	116	160	82	195	38
Sept.	1,017	50	146	145	66	111	174	96	194	35
Dec.	1,059	50	152	143	76	117	177	112	191	41

Notes

* United States and dependencies, and Canada.

+ Other independent non-sterling countries of the American continent.

g EFTA includes, with Switzerland, the B.I.S.; "other" comprises Andorra, Finland, Greece, Spain, Turkey and Yugoslavia.

h Egypt, Iran, Iraq, Israel, Lebanon, Saudi Arabia, Sudan, Syria and the Yemen.

/ Cambodia, China, Formosa, Indonesia, Japan, Korea, Laos, the Philippines, Thailand, Vietnam, and, from 1967, Burma.