1969 RPMS Conference

SUMMARY of Paper Presented by Dr. A.N. McLeod,

Governor of the Central Bank of Trinidad

and Tobago.

"New Sterling Area Agreements: Some Implications

for Monetary Management."

There are in fact two separate agreements involving Sterling, namely:

(1) The Sterling Area Agreement between the U.K. and individual sterling area countries.

(2) The Basle Facility between the U.K. and the group of countries represented by the Bank for International Settlements.

While there is no mention of the Basle Agreement in the Sterling Area Agreement, there is a strong connection between the two.

The Sterling Area Agreement provides for the maintenance of a minimum proportion of official reserves in Sterling in return for a guarantee as an insurance against any future devaluation.

The Sterling Area Countries had good reason for entering into the new sterling agreement, because they had an important self-interest in maintaining the strength of sterling.

The $2 billion backing did not provide help to the U.K. Balance of Payments but was a mechanism for reducing the tendency for people to get out of sterling. Our reserves kept in sterling is lending money to the U.K. The Guaranteed Sterling is more nearly like the U.S. dollar but it is not the dollar.

There were some operational problems namely:

(1) Problem of late returns from Crown Agents necessitates higher than required sterling proportions. It had been proposed to the U.K. authorities that the previous month's information from the Crown Agents should be used. As yet, there has been no reply.

(2) Further diversification of reserves has been halted. Any conscious movement to diversify its foreign exchange holdings will definitely be impeded by the terms of the agreement.

(3) All dollar drawings from reserves must be made pari passu with sterling drawings.

(4) Sterling investments should be limited to securities with a maturity of not more than five years. We are gambling on success of the U.K. economy. If it gets back on its feet, we may not need to move out of sterling, but we must be cautious in investing our reserves.

(5) MSP applies only to official reserves. There is need for domestic instruments to provide for investments of the commercial banks thereby providing an opportunity for the development of a money and capital market. When Trinidad and Tobago ran out of Treasury Bills, the facility of Special Deposits was introduced.

(6) The Definition of Reserves does not include equities. The guarantee could be maximised by cooperation among Caribbean Governments in supporting London issues of securities in sinking funds.

There were some broader policy implications, viz:

(a) Access to the London capital market. There is no obligation by the U.K. to grant access to the London Capital Market, Borrowing in the New York Market may involve the holding of dollar balances as collateral for institutional and private loan placements. It follows that there may be a need for some dispensation from the requirements of the MSP.

(b) The Basle facility may be undermined by large drawings to cover a fall in private sterling holdings. If this occurs it may become necessary to extend the exchange guarantee to private holdings, or to provide a specific underwriting arrangement limited to official balances.

Future developments

(a) There may be no need for the continuation of the guarantee if sterling's strength improves after five years; if it does not a new crisis could emerge.

The exchange guarantee is a significant departure in guarantees in the International Monetary System. They are more powerful than SDRs. There is a possibility that other reserve countries may offer similar guarantees. If this is done, it is predicted that a purchasing power or a gold guarantee for the U.S. dollar and the Pound may be sought.

In presentation, the Governor elaborated a number of ideas only implied in the paper. He argued, for example, that the interval inflation in most reserve countries and the high interest rate structures could lead to depreciation and a breakdown of confidence in such reserve currencies. Hence the need therefore to have a purchasing power guarantee.