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Foreign Exchange and Financial Markets in August 1984

Prepared by Mark A. Lumsden and Robert A. Feldman

Approved by Muhammad N. Bhuiyan

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The U.S. dollar eased moderately against most other major currencies over the month of August; it eased 0.84 percent in effective (MERM) terms and 0.32 percent against the SDR. There were, however, considerable fluctuations in the first half of the month amid signals that the pace of U.S. economic growth was slowing down and changing expectations about the course of future U.S. interest rate movement. The only major currency to ease against the U.S. dollar in August was the Italian lira which, however, continued as the strongest currency in the European Monetary System (EMS). The Swiss franc strengthened most among the major currencies, firming 2.63 percent against the U.S. dollar and 1.95 percent in effective (MERM) terms, attributed mainly to a narrowing of interest rate differentials vis-a-vis the currencies of neighboring countries. The pound sterling was essentially unchanged; it remained adversely affected by industrial work stoppages and was affected in addition by a significant decline in the U.K. interest rates. Other major currencies firmed by 0.49-1.41 percent against the U.S. dollar over the month (see Table 1 and Charts 1, 3, and 4). In effective (MERM) terms, the Belgian franc, the Danish krone, and the Netherlands guilder firmed slightly within the EMS while the French franc, the Deutsche mark, the Irish pound, and the Italian lira eased by 0.08-1.00 percent. Except for the Austrian schilling and the pound sterling, other currencies firmed in effective (MERM) terms by 0.02-1.95 percent. Marked appreciations in effective (MERM) exchange rates over the past twelve months were recorded by the Japanese yen and the U.S. dollar while the Italian lira, the Norwegian krone, the Swiss franc, and the pound sterling recorded significant depreciations. The twelve-month effective (MERM) depreciation of 5 percent for the lira was the largest among the EMS currencies.

Table 1. Changes in Exchange Rates in August 1984 <sup>1/</sup>

(In percent)

	Monthly exchange rate changes			Changes in effective exchange rate since August 1983 <sup>3/</sup>
	Against U.S. dollar <sup>2/</sup>	Against SDR <sup>3/</sup>	Effective exchange rate <sup>3/</sup>	
Belgium	+0.70	+0.15	+0.10	-0.93
Denmark	+1.00	+0.28	+0.17	-2.51
France	+0.54	-0.03	-0.08	-3.20
Germany	+0.58	0.00	-0.12	-1.93
Ireland	+0.94	-0.04	-0.12	-2.87
Italy	-0.42	-0.81	-1.00	-5.06
Netherlands	+0.54	+0.12	+0.07	-1.69
Austria	+0.49	-0.12	-0.31	-1.81
Canada	+1.09	+0.75	+0.79	-2.96
Japan	+1.41	+1.41	+1.50	+6.30
Norway	+0.81	+0.19	+0.02	-5.12
Sweden	+1.29	+0.61	+0.45	+0.55
Switzerland	+2.63	+2.07	+1.95	-4.90
United Kingdom	+0.02	+0.03	-0.15	-8.25
United States	--	-0.32	-0.84	+5.35

<sup>1/</sup> Positive sign indicates appreciation of the currency.

<sup>2/</sup> Based on New York noon quotations.

<sup>3/</sup> Based on the Fund's multilateral exchange rate model (MERM). Effective rates and rates against the SDR are based on representative exchange rates in the domestic markets, as officially advised to the Fund.

The movement of the U.S. dollar was rather erratic in the first half of August. The dollar weakened against other major currencies early in August, following the announcement of a higher-than-expected unemployment rate for July, a decline in the M1 money supply, and a decline in the index of leading economic indicators announced earlier. The dollar, however, strengthened on August 6-7 on reports that Federal Reserve Board Chairman, Paul Volcker, was still concerned about resurging inflation and that his views on the prospect for Federal Reserve action on interest rates had been misinterpreted by the news media. This was, however, short-lived as U.S. interest rates tended to decline, following indications from Volcker that there would not be any near term tightening of monetary policy and the report of an unexpectedly large decline in the M1 measure of U.S. money supply. Demand for the

U.S. dollar recovered somewhat on August 13 only to be reversed quickly following the announcement on August 14 of a decline in U.S. retail sales for July. During the first half of the month to August 16, the dollar eased by 1.25-2.08 percent against the EMS currencies, by 1.54 percent against the pound sterling, and by 1.87 percent against the Japanese yen. From mid-August onwards, the U.S. dollar traded less erratically around a moderately firming trend against most major currencies.

Notwithstanding the highly erratic movement of the dollar, especially the first half of August, overall volatility of the exchange markets, as indicated by certain statistical measures, appeared to have declined in the month of August (see Table 2 and Chart 5). The range within which major currencies traded against the dollar was markedly lower in August than in July when the dollar appreciated steadily with only two minor interruptions. The trading range of the EMS currencies against the U.S. dollar narrowed considerably as reflected in the high-low spread of 1.8-2.4 percent compared with that of 3.1-4.1 percent in July. The average of absolute daily percentage changes for August (MAC in Table 2 and Chart 5) were also smaller for almost all currencies, the exceptions being the Swiss franc, for which the mean average daily change increased to 0.58 percent from 0.51 percent in July, and the Swedish krona, for which the MAC measure was unchanged. For the EMS currencies the average daily change declined from 0.49 percent in July to 0.44 percent in August and for Canada the measure declined to a more normal 0.13 percent from the unusually high level of 0.23 percent recorded in July. The average change for the remaining currencies declined to 0.40 percent from 0.45 percent in July.

Within the European Monetary System (EMS), the currencies in the narrow band of the parity grid remained closely clustered throughout the month; the spread ranged from 1.31 percent to 0.64 percent and ended the month at 0.68 percent, compared to the maximum permitted margin of 2.25 percent. The Belgian franc continued at the bottom of the narrow band and the Deutsche mark was at the top for most of the month, being replaced on occasions by the Netherlands guilder and the Irish pound. The Bundesbank continued to intervene to support the Deutsche mark against the U.S. dollar; it sold approximately \$500 million during the month, significantly less than the amounts sold in each of the preceding three months. The Italian lira continued to be the strongest currency in the EMS in terms of ECU central parities but its margin over the Belgian franc narrowed from 2.73 percent at the end of July to 1.58 percent at the end of August. <sup>1/</sup> The Bank of Italy bought small amounts of dollars and Deutsche mark in the first half of the month but then became a seller of foreign exchange in the second half. The divergence indicators for all the EMS currencies remained well within the thresholds (see Chart 2).

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<sup>1/</sup> The Italian lira is permitted a maximum margin of 6.0 percent above (below) the weakest (strongest) currency in the EMS exchange arrangements.

Table 2. Intra-Month Variations of Exchange Rates of Major Currencies 1/

	August <u>2/</u>		High-low spread in percent <u>3/</u>		MAC <u>4/</u>	
	High	Low	July	Aug.	July	Aug.
Belgium	57.700	58.885	3.1	2.1	0.46	0.43
Denmark	10.4335	10.6525	3.3	2.1	0.49	0.42
France	8.7650	8.9545	4.1	2.2	0.51	0.45
Germany	2.8567	2.9175	4.1	2.1	0.52	0.46
Ireland	1.0805	1.0568	3.2	2.2	0.54	0.45
Italy	1761.0	1792.5	4.0	1.8	0.43	0.40
Netherlands	3.2180	3.29425	3.9	2.4	0.51	0.47
Austria	20.05	20.75	4.1	3.5	0.47	0.43
Canada	0.77086	0.76374	1.8	0.9	0.23	0.13
Japan	240.55	245.675	3.5	2.1	0.47	0.38
Norway	8.2420	8.3825	4.2	1.7	0.41	0.36
Sweden	8.2890	8.4365	2.9	1.8	0.34	0.34
Switzerland	2.37475	2.4645	5.6	3.8	0.51	0.58
United Kingdom	1.3280	1.3015	3.4	2.0	0.56	0.47

- 1/ Exchange rates against the U.S. dollar in the New York market.  
2/ Domestic currency units per U.S. dollar except for the pound sterling, the Irish pound and the Canadian dollar, which are in U.S. dollars per domestic currency unit.  
3/ Intra-month variation in percent.  
4/ Monthly average of absolute daily changes in spot exchange rates in percentage terms.

Among the countries registering changes in foreign exchange reserves in August (see Table 3), the sharp rise in Canada's reserves in July was partly reversed in August as short-term borrowing of about \$1.2 billion was repaid, following some recovery of the Canadian dollar in the exchange markets. Significant increases in reserves were recorded by Denmark, Italy, and France (July). Denmark completed a program of refinancing outstanding public debt wherever it extended maturities and lowered interest rates compared with the previous debt. Reserve changes in August for most other countries were moderate. Over the latest twelve-month period, substantial reserve increases were recorded by France, Germany, Japan, Norway and Sweden while substantial declines were recorded by Canada, the United Kingdom, and the United States.

The Federal Reserve Bank of New York revealed in September that on May 24 it sold the equivalent of \$135 million in Deutsche mark to stabilize the disorderly market condition associated with rumors that a second major U.S. bank was facing liquidity problems similar to those of Continental Illinois National Bank. This was the first time in more than three years that the Federal Reserve had intervened to buy dollars; the previous occasion was on March 30, 1981 following an assassination attempt on President Reagan. The Federal Reserve Bank estimated that gross intervention by the central banks of the G-10 countries in the February-July period amounted to the equivalent of \$34.6 billion, compared with \$30 billion in the preceding six months and \$44 billion in the same period of 1983.

Table 3. Foreign Exchange Reserves in August 1984 1/  
(In millions of U.S. dollars)

	End-month reserve level	Change in July	Change over 12 months
Belgium	3,258	+122	-947
Denmark	3,822	+908	+989
France (July)	20,058	+639	+1,599
Germany	38,361	-61	+1,643
Ireland	2,206	+43	-34
Italy	19,035	+504	+929
Netherlands	8,417	-91	-305
Austria	3,517	-171	-579
Canada	2,105	-589	-1,136
Japan	21,266	+273	+1,028
Norway	7,623	+359	+2,395
Sweden	3,917	+150	+1,081
Switzerland	12,140	+135	+608
United Kingdom (July)	7,000	-57	-2,013
United States (July)	6,105	-224	-1,165

1/ Includes ECU holdings but excludes gold, SDRs and reserve position in the Fund. Foreign exchange reserves are gross and include balances drawn on short-term swap agreements and proceeds from other official borrowings.

I. Developments in Major Factors Affecting  
the Exchange Market

The U.S. dollar eased moderately in August, thus providing a brief pause in the trend of strong appreciation of the currency since early June; it eased by 0.84 percent in effective (MERM) terms and 0.32 percent against the SDR over the month. The dollar's twelve-month effective (MERM) appreciation was reduced from 8.00 percent to 5.35 percent. Trading in the first half of the month was, as noted earlier, erratic, reflecting market reactions to various reports on the performance of the U.S. economy and changing expectation about the future course of U.S. interest rates. Some of the indicators of economic activity for July indicated strong real growth; the growth rate in the U.S. real GNP in the second quarter was revised slightly upwards to an annual rate of 7.6 percent from the original estimate of 7.5 percent and capacity utilization increased to 82.5 percent from 82.0 percent in June. Some other announcements, however, indicated that the pace of growth might be slowing; the index of leading economic indicators fell 0.8 percent in July and the decline in June was revised from 0.9 percent to 1.3 percent, the unemployment rate was unchanged at 7.5 percent in August after rising from 7.2 percent in June, and the index of industrial production rose 0.2 percent in August for a 9.5 percent year-on-year rise compared with 10.6 percent in July. The budget deficit narrowed to \$16.4 billion in July from \$21.4 billion in July 1983 while the trade deficit widened to a record \$14.06 billion from \$8.91 billion in June due mainly to a sharp rise in imports. The inflation rate continued to be low; the producer price index declined 0.1 percent in August but was up 2.0 percent year-on-year.

The Deutsche mark firmed by 0.58 percent against the U.S. dollar but eased by 0.12 percent in effective (MERM) terms. The currency was at the top of the narrow band of the EMS parity grid for most of the month and needed considerable Bundesbank support but at a lower scale than in the preceding three months. Total sales of U.S. dollars by the Bundesbank in the open market and at the fixings in Frankfurt were estimated to be about \$500 million, compared with about \$800 million in July. Industrial production in Germany, seasonally adjusted, rose 13.6 percent in July, after falling 9.6 percent in June because of industrial disruption, and was up 8.0 percent year-on-year. The unemployment rate in August was unchanged at 8.9 percent. The current account deficit narrowed sharply in July to DM 200 million from DM 3.2 billion in June and DM 3.3 billion in July 1983. The wholesale price index fell 1.3 percent in August but was 1.6 percent higher year-on-year while the producer price index was unchanged but rose 2.6 percent compared with August 1983.

The French franc firmed by 0.54 percent against the U.S. dollar but eased marginally in effective (MERM) terms. The Government relaxed some exchange controls during the month with respect to French residents' use of credit cards outside the country and the ceilings for small and medium-sized businesses' foreign exchange transactions carried out

through banks. France's industrial production fell 1.5 percent in June following a 3.1 percent rise in May but was up 1.6 percent year-on-year. The number of persons unemployed, seasonally adjusted, rose 0.7 percent in August after rising 0.8 percent in July and was up 15.9 percent year-on-year. The trade deficit, seasonally adjusted, narrowed markedly in July to F 595 million from F 5.25 billion in June. Industrial wholesale prices rose 0.1 percent in July, the same as in June, but the year-on-year increase remained relatively high at 12.9 percent.

The Belgian franc firmed by 0.70 percent against the U.S. dollar and 0.10 percent in effective (MERM) terms. The Belgian franc remained the weakest currency in the EMS with the discount of the financial franc from the commercial franc remaining low at about 1.0 percent. The Belgian Government announced its plans to reduce the budget deficit in 1985 to the equivalent of 10.3 percent of GNP. Belgium's unemployment rate rose to 12.5 percent at the end of August from 12.4 percent at the end of July. The wholesale price index fell 0.8 percent in July but was 8.3 percent higher year-on-year.

The Netherlands guilder firmed by 0.54 percent against the U.S. dollar and was marginally firmer in effective (MERM) terms. The guilder was occasionally the strongest currency in the EMS in the first half of the month. The Netherlands' index of industrial production fell 1.0 percent in June but was up 7.4 percent year-on-year. The number of persons unemployed, seasonally adjusted, rose 1.3 percent in August and was higher by the same margin year-on-year; the unemployment rate at the end of July was 17.6 percent. The trade surplus widened to f. 1.1 billion in June from f. 500 million in June 1983 but was narrower than the surplus of f. 2.2 billion recorded in May; for the first six months of 1984 the surplus widened to f. 9.3 billion from f. 7.6 billion in the first half of 1983. The producer price index for consumer and investment goods rose 0.2 percent in June and was up 5.0 percent year-on-year.

The Danish krone firmed by 1.00 percent against the U.S. dollar and 0.17 percent in effective (MERM) terms. Denmark's trade deficit rose to DKr 900 million in July from a revised deficit of DKr 279 million in June. The wholesale price index fell 0.9 percent in July but was up 7.7 percent year-on-year.

The Irish pound firmed by 0.94 percent against the U.S. dollar but eased by 0.12 percent in effective (MERM) terms. It occupied the position of the strongest currency in the narrow band of the EMS on one occasion early in the month. The number of persons unemployed in Ireland, seasonally adjusted, rose 0.7 percent in August and was up 10.4 percent year-on-year; the unemployment rate is unofficially estimated at over 16.0 percent.

The Italian lira was the only EMS currency to ease against the U.S. dollar in August and its margin over the Belgian franc in the EMS parity grid narrowed markedly; it eased 0.42 percent against the dollar and 1.00 percent in effective (MERM) terms. The lira's twelve-month effective (MERM) depreciation of 5 percent was the largest among the EMS currencies. Italy's trade deficit in June more than doubled to Lit 1,131 billion from Lit 446 billion in June 1983; for the first six months of the year, the deficit widened to Lit 10,109 billion from Lit 6,731 billion in the same period of 1983. The wholesale price index rose 0.1 percent in July and 10.8 percent year-on-year.

The pound sterling was essentially unchanged against the U.S. dollar in August but eased by 0.15 percent in effective (MERM) terms. The pound's twelve-month effective (MERM) depreciation remained steady at just over 8 percent. The U.K. unemployment rate, seasonally adjusted, rose to 12.8 percent in August from 12.7 percent in July. Industrial production fell by 0.7 percent in July after a revised 0.5 percent rise in June and was down by 2.2 percent year-on-year. The current account surplus, seasonally adjusted, narrowed to £113 million in July from a revised £153 million in June. The Public Sector Borrowing Requirement narrowed in July to £570 million from £709 million in July 1983. The index of producer output prices rose 0.2 percent in August and was up 6.3 percent year-on-year, the same rates as in July.

The Swiss franc recovered approximately half of the depreciation it experienced in July; it firmed by 2.63 percent against the U.S. dollar and 1.95 percent in effective (MERM) terms. The franc's twelve-month effective (MERM) depreciation declined from 8 percent to nearly 5 percent. Switzerland's trade deficit widened to Sw F 992.9 million in August from Sw F 867.8 million in July. The wholesale price index was unchanged in August but rose 2.9 percent year-on-year.

The Japanese yen firmed by 1.41 percent against the U.S. dollar and 1.50 percent in effective (MERM) terms. Japan's industrial production index, seasonally adjusted, rose 0.3 percent in July and was 12.8 percent higher year-on-year. The unemployment rate, seasonally adjusted, declined slightly in July to 2.79 percent from 2.81 percent in June. The current account surplus narrowed in July to \$3.21 billion from a record \$4.38 billion in June but widened from the \$2.90 billion surplus recorded in July 1983; the trade surplus in August narrowed to \$1.12 billion from \$1.67 billion in August 1983. The wholesale price index was unchanged in August but was up 0.2 percent year-on-year.

The Canadian dollar firmed by 1.09 percent against the U.S. dollar and 0.79 percent in effective (MERM) terms. Canada repaid \$1.2 billion in bank debt incurred in July to support the currency. Canada's industrial production rose 0.4 percent in June, the fourth consecutive monthly gain, and was up 9.0 percent year-on-year while real GDP, seasonally adjusted, rose 0.4 percent and was up 3.3 percent over June 1983. Some other indicators seem to point toward a slowing down of the

economy, as in the United States; the unemployment rate, seasonally adjusted, increased to 11.2 percent in August from 11.0 percent in July while the index of leading economic indicators rose 0.9 percent in May, the smallest increase since November 1982. The budget deficit narrowed in June to Can\$3.63 billion from Can\$3.79 billion a year earlier while the trade surplus narrowed marginally to Can\$2.06 billion in July from Can\$2.07 billion in June.

The Austrian schilling firmed by 0.49 percent against the U.S. dollar but eased by 0.31 percent in effective (MERM) terms. The Norwegian krone firmed by 0.81 percent against the U.S. dollar but was essentially unchanged in effective (MERM) terms. The Swedish krona firmed by 1.29 percent against the U.S. dollar and 0.45 percent in effective (MERM) terms.

## II. Monetary Developments, Forward Exchange Quotations and Covered Interest Differentials

Short-term interest rates eased in most major industrial countries in August, after a more diverse pattern shown in the previous month. Interest rates declined in France, Germany, Belgium, Canada, and markedly in the United Kingdom but they continued to firm in the United States and rose modestly in Japan.

In the United States, short-term interest rates firmed moderately in August. Shifting perceptions about the short-term economic outlook and associated credit demands and the perceived thrust of Federal Reserve policy were major influences on the credit market and intra-month movements in interest rates. Most of the economic indicators released during the month appeared to point toward some moderation of the pace of economic growth in the United States, which together with problems faced by some major U.S. financial institutions raised expectations at times that the Federal Reserve might ease its monetary stance. On the other hand, some statements by Federal Reserve Chairman Paul Volcker were interpreted by the market as indications that credit conditions could become tighter and interest rates could rise in the future. The Federal funds rate was generally firmer in August than in July, remaining over 11 1/2 percent during most of August and averaging 11.64 percent for the month; the rate was mostly below 11 1/2 percent and averaged 11.23 percent in July. The bond-equivalent yield on three-month Treasury bills also firmed, rising from 10.83 percent at the end of July to 11.06 percent at the end of August. The rate on three-month CDs rose similarly from 11.39 percent to 11.53 percent over the month. At longer maturities, however, interest rates eased a bit. The five-year constant maturity rate on U.S. Treasury bills, for example, declined by 0.08 percentage point in August to 12.77 percent. The M1 measure of the U.S. money supply, seasonally adjusted, averaged \$547.1 billion in the week ended August 27, moderately higher than \$542.1 billion in the week ended July 30. The annual growth rate from

Table 4. Inflation Rates and Short-Term Interest Rates

	Month <u>2/</u>	Inflation rates <u>1/</u> (year-on-year percent changes)				Short-term interest rates <u>4/</u> (end-of-month)	
		Wholesale price index		Consumer price index <u>3/</u>		July	Aug.
Austria	August	3.3	(5.3)	6.0	(5.6)	4.50	4.50
Belgium	July/Aug.	8.3	(9.6)	5.7	(6.3)	11.90	11.45
Canada	June/July	3.9	(4.1)	4.2	(4.1)	12.60	12.12
Denmark	June/July	9.7	(9.7)	6.6	(6.9)	7.00	7.00
France	July/Aug.	12.9	(13.6)	7.4	(7.5)	11.91	11.41
Germany	August	1.6	(3.8)	1.7	(2.2)	6.19	5.98
Italy	July/Aug.	10.8	(11.5)	10.4	(10.5)	16.63	16.63
Japan	July	0.0	(-0.4)	2.6	(1.9)	6.31	6.38
Netherlands	June/Aug.	5.0	(5.0)	2.8	(3.1)	6.38	6.25
Norway	May/Aug.	6.4	(7.0)	6.4	(6.1)	8.00	8.00
Sweden	August	--	(--)	7.8	(7.5)	9.50	9.50
Switzerland	July/Aug.	3.4	(3.1)	2.9	(2.8)	4.94	4.75
United Kingdom	August	6.3	(6.3)	5.0	(4.5)	11.61	10.16
United States	Aug./July	2.0	(2.4)	4.1	(4.2)	10.83	11.06

1/ Rates appearing in parentheses are those for the preceding month.

2/ In case of double entry (month/month), the first entry applies to the wholesale price index and the second entry applies to the consumer price index.

3/ Retail price index for France and the United Kingdom, and cost of living index for Germany, the Netherlands, and Switzerland.

4/ Three-month rates are: Market yields on Treasury bills for the United States and the United Kingdom; Treasury bill rate for Canada; inter-bank rates for Germany, France, Italy, and the Netherlands; three-month euro-franc rate for Switzerland; discount rate on two-month private bills for Japan; four-month certificates of the Government Securities Stabilization Fund for Belgium; central bank discount rates for Austria, Denmark, Norway and Sweden.

the fourth quarter of 1983 base period was about 5 3/4 percent, compared with the target range of 4-8 percent for the year.

Among the countries participating in the European Monetary System, as noted earlier, short-term domestic interest rates eased in France, Belgium, and Germany. The three-month interbank money rate in France fell from 11.91 percent at the end of July to 11.41 percent at the end of August. Some major French banks also cut their base rate by 0.25 percentage point around midmonth to 12 percent, the first such cut since January 1983. The base rate cut followed the Government's move to lower by up to one percentage point interest rates on certain savings accounts and on certain state-subsidized loans to businesses and individuals. These cuts in interest rates were reportedly part of measures to ease credit conditions and bolster the economy, and they were apparently facilitated by the deceleration in France's inflation rate and by the relatively stable position of the French franc within the European Monetary System. In Belgium, the rate on four-month Fonds des Rentes certificates was cut by 0.15 percentage point on August 14, by 0.25 percentage point on August 21, and by 0.05 percentage point on August 28 to end the month at 11.45 percent. The cuts were reportedly designed to bring the rate on these certificates in line with the prevailing money market rates. The central bank also reduced the rates on one-, two-, and three-month Treasury bills. An absence of any significant pressure on the Belgian franc within the European Monetary System reportedly facilitated the easing of interest rates. In Germany, the three-month interbank deposit rate eased to 5.98 percent at the end of August from 6.19 percent at the end of July. Germany's central bank money stock, seasonally adjusted, grew at a 4.9 percent annual rate through August from the fourth quarter of 1983 base period, compared with 4.2 percent growth through July and the 4-6 percent target through the end of 1984.

Interest rates also eased in the United Kingdom in August, but more markedly than elsewhere, thus partially offsetting the sharp increases recorded in the previous month. Major U.K. banks lowered their base lending rate three times during the month: on August 8 they lowered their base lending rate from 12 percent to 11 1/2 percent, then on August 10 to 11 percent, and finally to 10 1/2 percent on August 17. The rate on the three-month U.K. Treasury bills eased in August, to 10.16 percent from 11.61 percent at end-July, but the rate at end-August remained well above its end-June level of 9.01 percent. The latest Bank of England data show that sterling M3, seasonally adjusted, rose by 0.7 percent in the four weeks to August 15 and that sterling M3 growth since mid-February remained around 9.0 percent at an annual rate, within the target range of 6-10 percent annual rate growth for the period from February 1984 to April 1985.

Among the other countries, short-term interest rates eased in Canada in August after firming in the previous two months while they rose modestly in Japan. The three-month Canadian Treasury bill rate closed August at 12.12 percent from 12.60 percent at the end of July. In Japan, the rate for two-month private bills was 6.38 percent at the end of August, 0.07 percentage point higher than the level at the end of July. Japan's broadly defined money supply, M2 and CDs, rose 7.7 percent in July from a year earlier, after a 7.5 percent year-on-year rise in June.

Short-term interest rates in the eurocurrency markets tended to move with rates in domestic markets in August. The three-month euro-dollar deposit rate firmed by 0.06 percentage point to 11.94 percent in August and the euro-yen rate firmed by a similar margin to 6.38 percent. Other rates eased. The euro-sterling rate eased sharply by 1.59 percentage point to 10.75 percent while the euro-French franc rate eased by 0.57 percentage point to 11.31 percent. The euro-Swiss franc and euro-Deutsche mark rates eased by 0.19 percentage point each to 4.75 percent and 5.56 percent respectively.

As a result of the movements of domestic and eurodollar rates from the end of July to the end of August, the uncovered interest differentials favoring domestic investment narrowed for Italy and switched in favor of eurodollar investment for Belgium and France. Uncovered interest differentials favoring eurodollar investment widened for Germany, the Netherlands, and the United Kingdom, but narrowed slightly for Japan (see Table 5).

In the forward markets, the premia against the U.S. dollar widened for Belgium, Germany, Japan, and the Netherlands. The discount against the dollar narrowed for Italy, while the discounts for the French franc and pound sterling at end-July switched to a premia at end-August. As a result of these movements in interest rates and forward exchange quotations, the covered interest differentials favoring domestic investment narrowed for Belgium but widened for Germany, Italy, Japan, and the Netherlands. Those favoring eurodollar investment narrowed for France and the United Kingdom.

Table 5. Covered Interest Differentials for  
Three-Month Investments (End-month)

	Uncovered interest differentials <u>1/</u>		Forward exchange quotations <u>2/</u>		Covered interest differentials <u>1/</u>	
	(1)		(2)		(3) = (1)-(2)	
	July	August	July	August	July	August
Belgium	-0.02	+0.49	+0.50	+0.92	-0.52	-0.43
France	-0.03	+0.53	-0.05	+0.53	+0.02	0.00
Germany	+5.70	+5.96	+6.43	+6.72	-0.73	-0.76
Italy	-4.75	-4.69	-3.06	-2.30	-1.69	-2.39
Japan	+5.57	+5.56	+5.80	+5.84	-0.23	-0.28
Netherlands	+5.51	+5.69	+5.66	+5.91	-0.15	-0.22
United Kingdom	+0.27	+1.78	-0.31	+1.41	+0.58	+0.37

1/ Positive sign indicates differential in favor of eurodollar investment relative to domestic investment, while negative sign indicates the reverse. Domestic interest rates for France, Germany, Italy and the Netherlands are interbank rates. For Japan the discount rate for two-month private bills is used, for the United Kingdom the three-month Treasury bill rate, and for Belgium the rate on four-month certificates of the Government Securities Stabilization Fund.

2/ Positive sign indicates three-month forward premium of domestic currency against the U.S. dollar, while negative sign indicates forward discount.

### III. Yields on the SDR and Other SDR-Denominated Assets

The SDR interest rate declined to 9.47 percent for the week beginning August 27 from 9.56 percent for the week beginning July 30 (see Table 6). Among the component instruments, the yield on three-month U.K. Treasury bills recorded the largest change, easing by 1.42 percentage point. This decline in the United Kingdom yield combined with a 0.63 percentage point fall in the three-month interbank rate in France and a 0.15 percentage point fall in the three-month interbank rate in Germany more than offset the effect of firming by 0.21 percentage point of the three-month U.S. Treasury bill rate and by 0.07 percentage point of the Japanese rate. The rate of remuneration paid on creditor positions in the Fund (88.33 percent of the SDR interest rate) fell to 8.36 percent in the last week of August from 8.44 percent in the last week of July.

Table 6. The SDR Interest Rate and the Rate of Remuneration 1/

	July 30	August			
		6	13	20	27
SDR interest rate	9.56	9.67	9.50	9.39	9.47
Rate of remuneration	8.44	8.54	8.39	8.29	8.36

1/ The rate pertains to the week beginning on the date indicated above.

The combined domestic interest rates for maturities longer than six months eased by 0.19-0.31 percentage point while those for the three- and six-month maturities were little changed (see Table 7). For maturities longer than six months, yields on the relevant U.K. instruments eased sharply by 1.17-1.20 percentage point and those on the other relevant instruments eased by 0.14-0.70 percentage point except for the twelve-month U.S. yield which firmed by 0.11 percentage point. The component yields were, however, mixed for the three- and six-month maturities, with firmer rates in the United States and Japan and easier rates in Germany, the United Kingdom, and France.

The combined eurocurrency offered rates eased by 0.25-0.50 percentage point for the three- and six-month maturities respectively. For the three-month maturity, the euro-sterling interest rate eased sharply by 1.44 percentage point, and the euro-Deutsche mark and euro-French franc eased by 0.25 and 0.69 percentage point respectively. Eurocurrency rates for the other currencies in the SDR basket recorded little or no change. For the six-month maturity, euro-sterling rates eased sharply by 1.31 percentage point, and the euro-French franc rate eased by 1.00 percentage point. Other rates eased by 0.31 percentage point except for the euro-yen rate which was unchanged.

Average interest rates on SDR-denominated deposits of selected commercial banks eased by progressively larger amounts as maturities lengthened. Deposit rates declined by 0.05 percentage point for the one-month maturity, by 0.25 percentage point for the three-month maturity and by 0.30 and 0.35 percentage points for the six- and twelve-month maturities respectively. The yield curve in August, however, remained monotonically rising from 9.67 percent for the one-month maturity to 10.44 percent for the twelve-month maturity.

Table 7. Yields on Alternative SDR-Denominated Assets 1/

	July	August
Combined market interest rates: <u>2/</u>		
a. Based on domestic rates		
3-month maturity (Rule T-1)	9.56	9.60
6-month maturity	10.00	9.94
12-month maturity	10.44	10.25
2-1/2 year maturity	11.13	10.88
5-year maturity	11.50	11.19
b. Based on eurocurrency offered rates		
3-month maturity	10.38	10.13
6-month maturity	10.88	10.38
Average commercial bank deposit rates <u>3/</u>		
1-month deposits	9.72	9.67
3-month deposits	10.11	9.86
6-month deposits	10.41	10.11
12-month deposits	10.79	10.44

1/ Rates pertain to last Wednesday of the month.

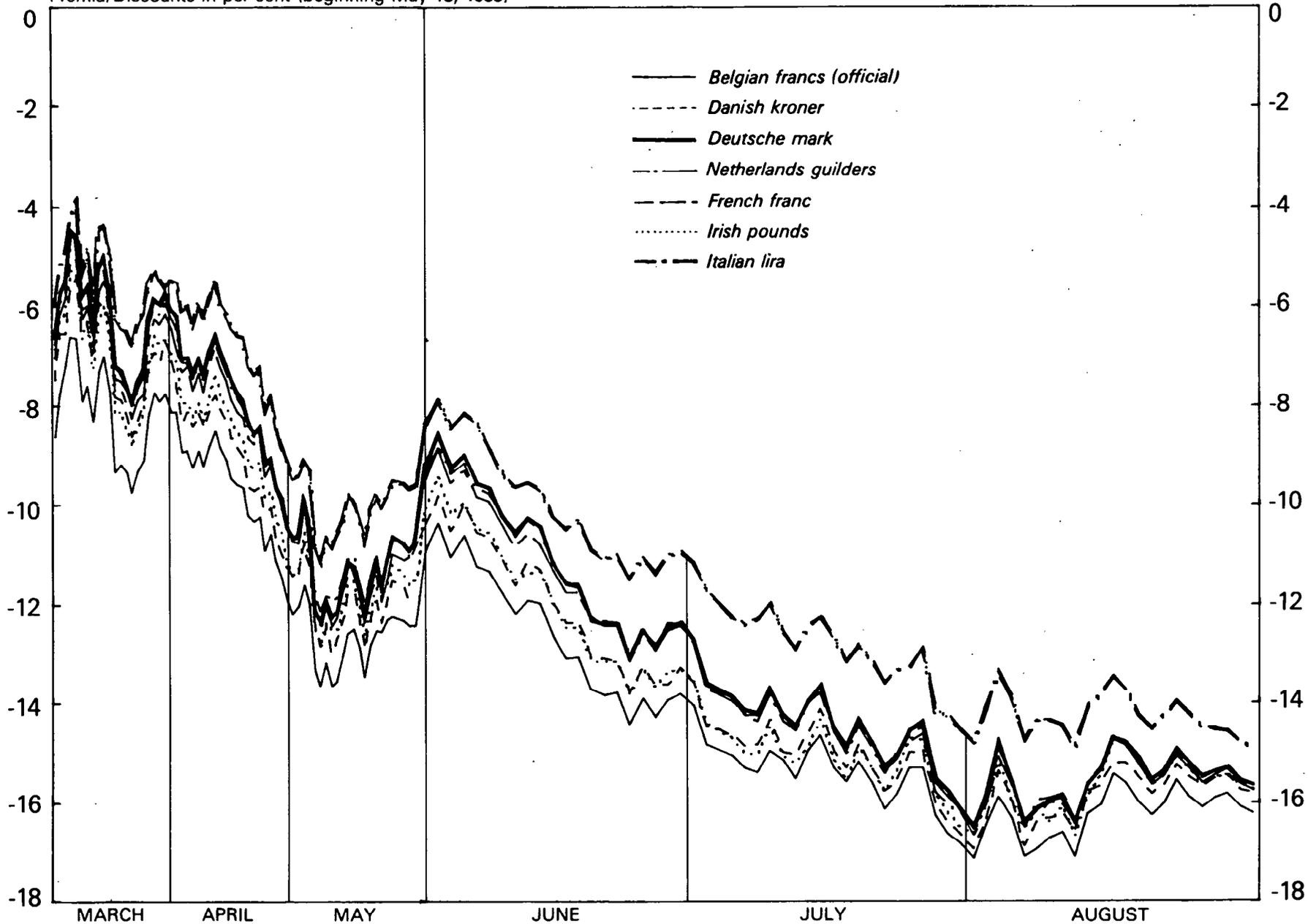
2/ Combined market rates (according to the Rule T-1) are calculated by multiplying the yields or rates of each of the respective instrument by the number of units of the corresponding currency listed in Rule 0-1 and the value in terms of the SDR of a unit of that currency as determined by the Fund under Rule 0-2(a) and (b). Combined interest rates are those that are applicable to Fund-related assets, appropriately rounded.

3/ Average of rates quoted by selected commercial banks.

# CHART 1 SPOT EXCHANGE RATES: EUROPEAN MONETARY SYSTEM

(Based on noon quotations in New York)

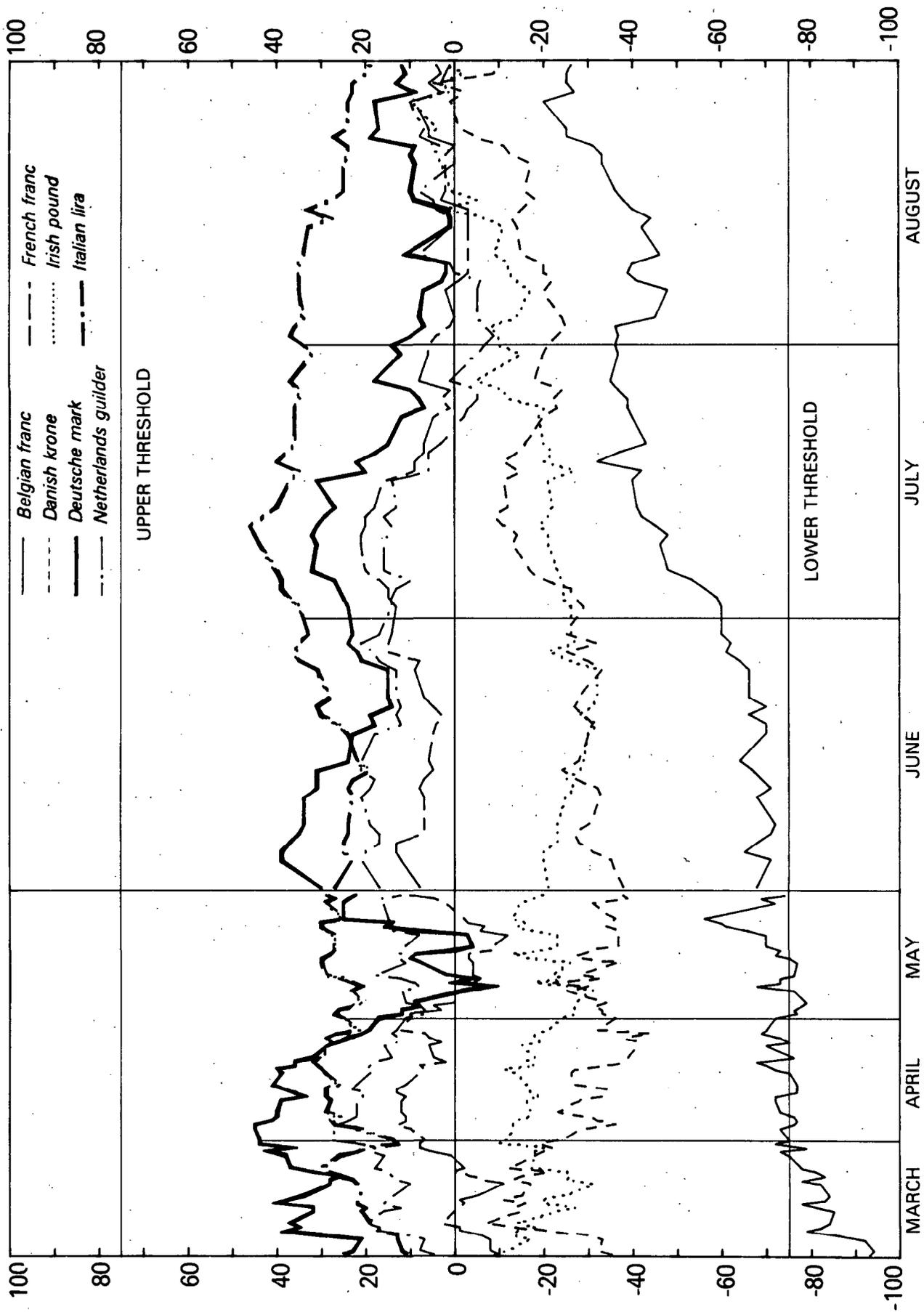
Premia/Discounts in per cent (beginning May 18, 1983)<sup>1</sup>



<sup>1</sup>Effective March 1, 1983 the central ECU rate of the pound sterling was appreciated and those of the other participants depreciated in connection with the Common Agricultural Policy. Premia/discounts over declared ECU central rates have been converted into U.S. dollar terms at the rate of 1 ECU = .920041.

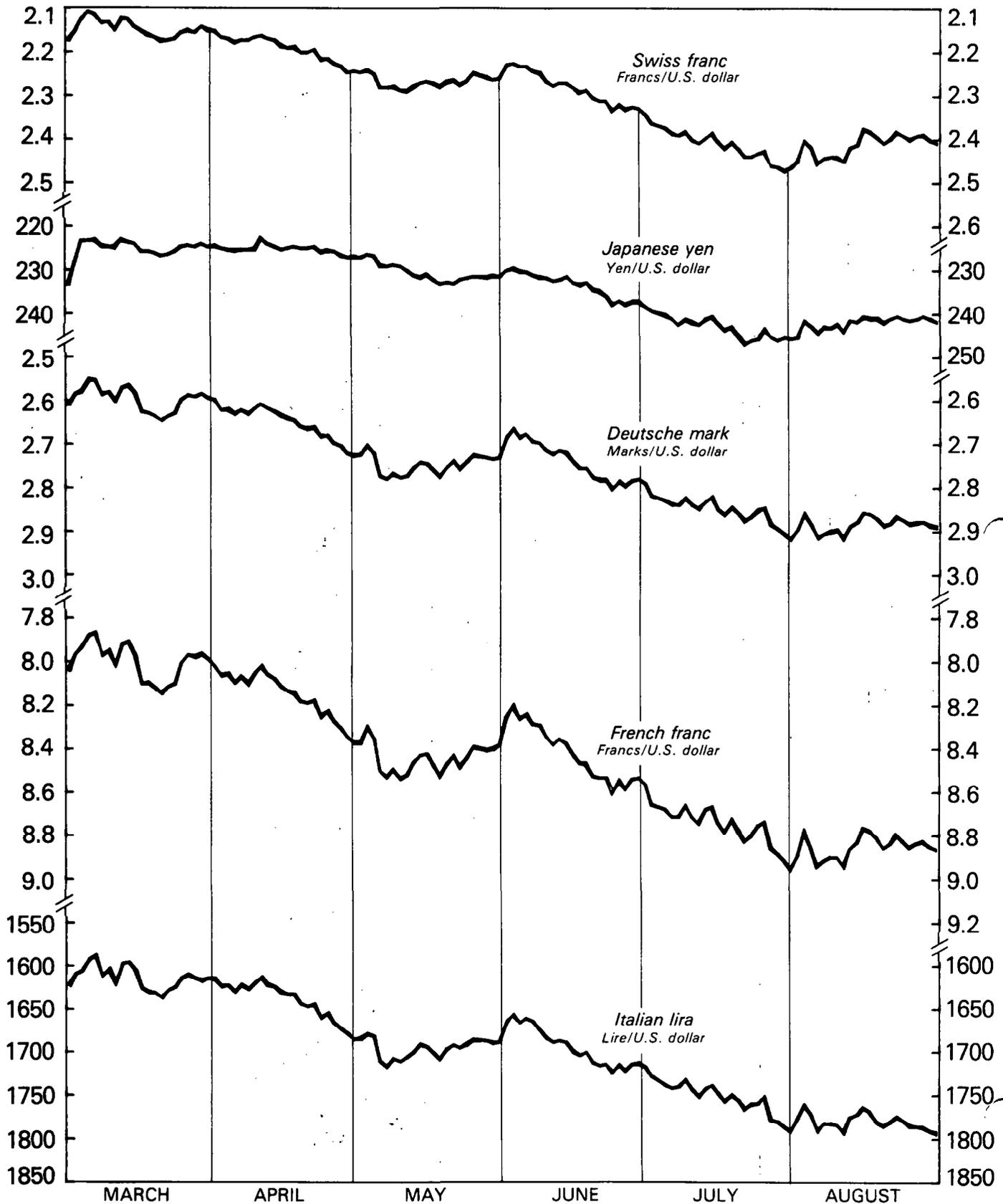
# CHART 2 EUROPEAN MONETARY SYSTEM: DIVERGENCE INDICATORS

(Based on noon quotations in London)



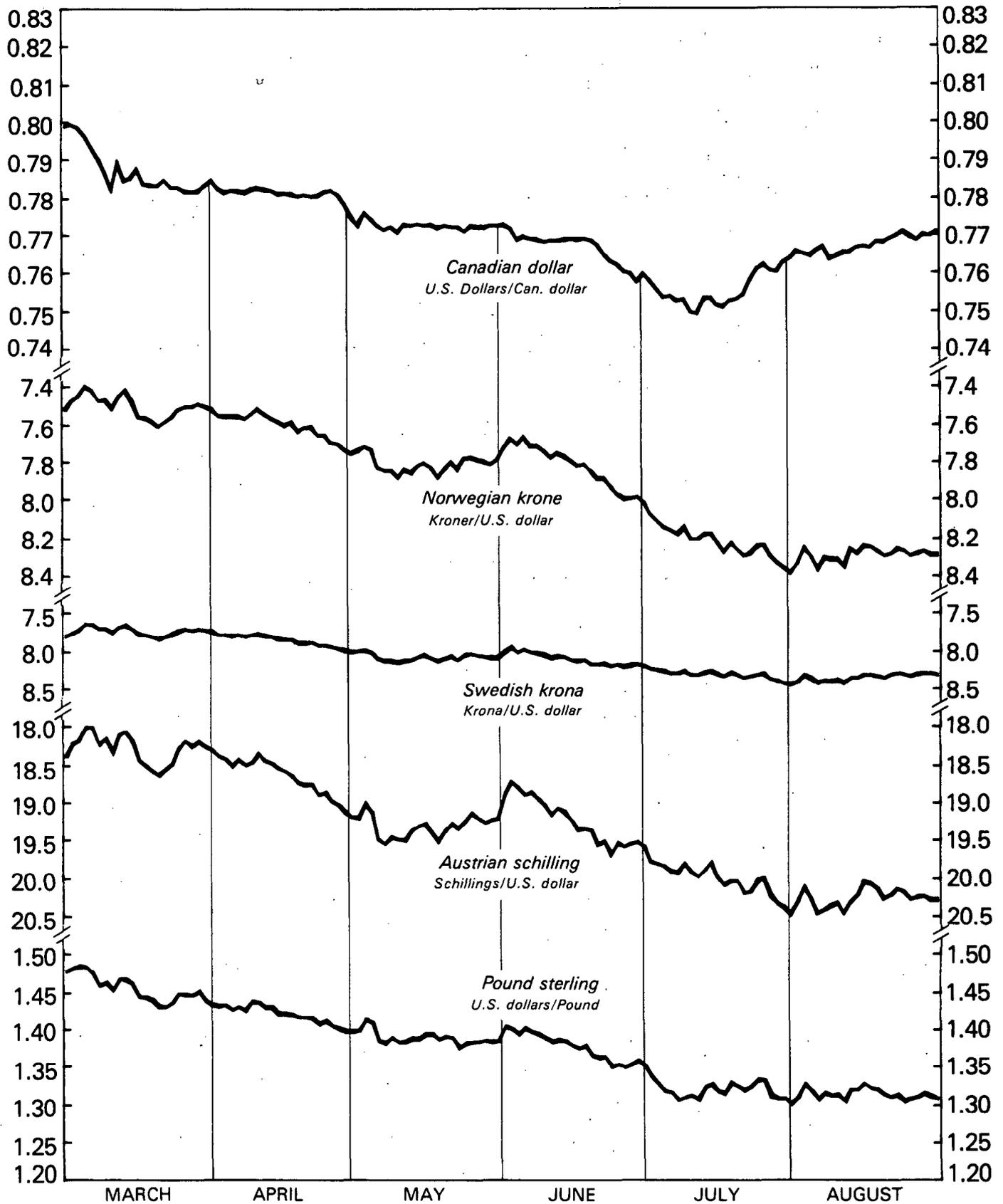
### CHART 3 SPOT EXCHANGE RATES

(Noon quotations in New York)



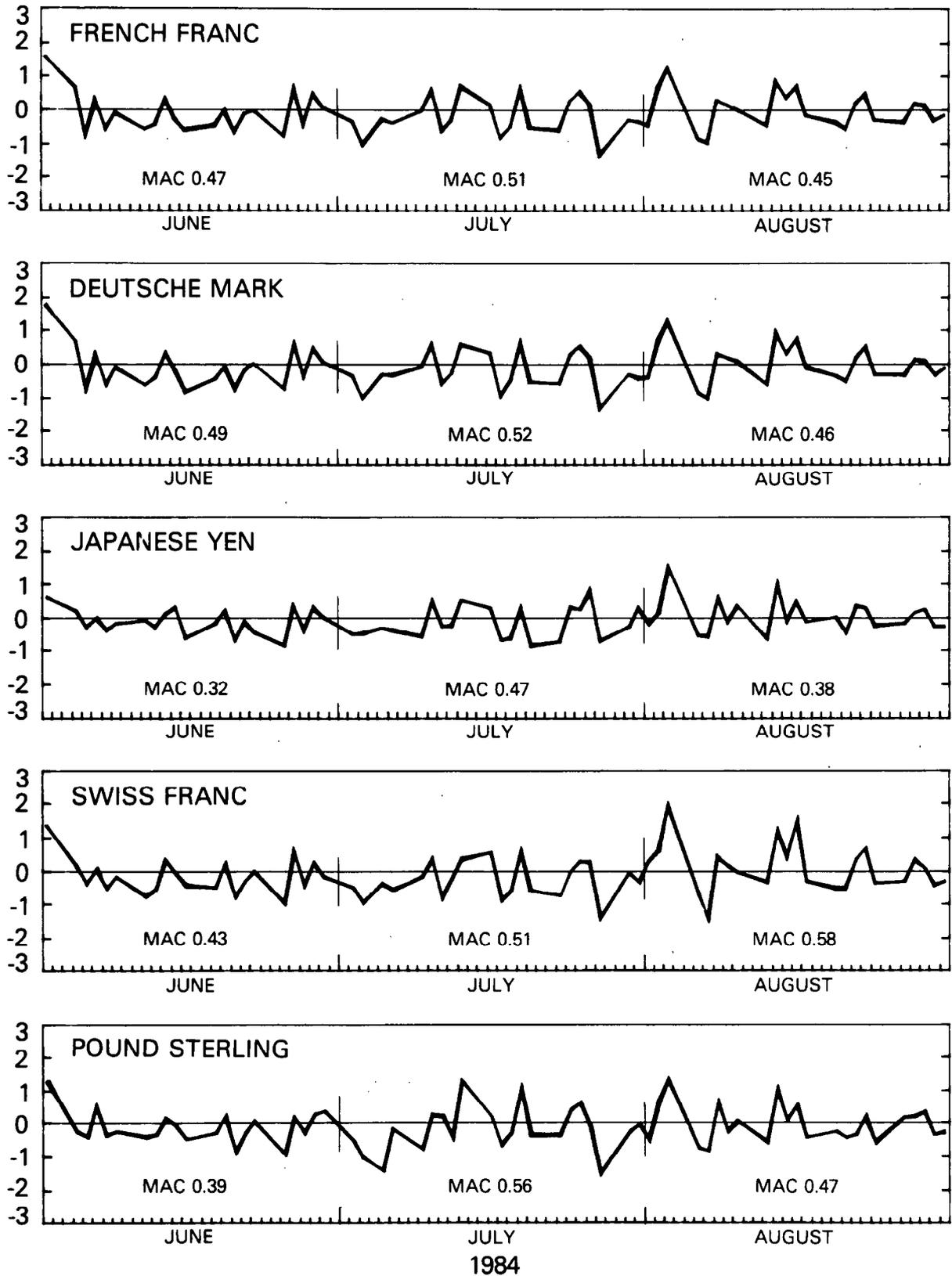
# CHART 4 SPOT EXCHANGE RATES

(Noon quotations in New York)



### CHART 5 DAILY CHANGES IN SPOT EXCHANGE RATES

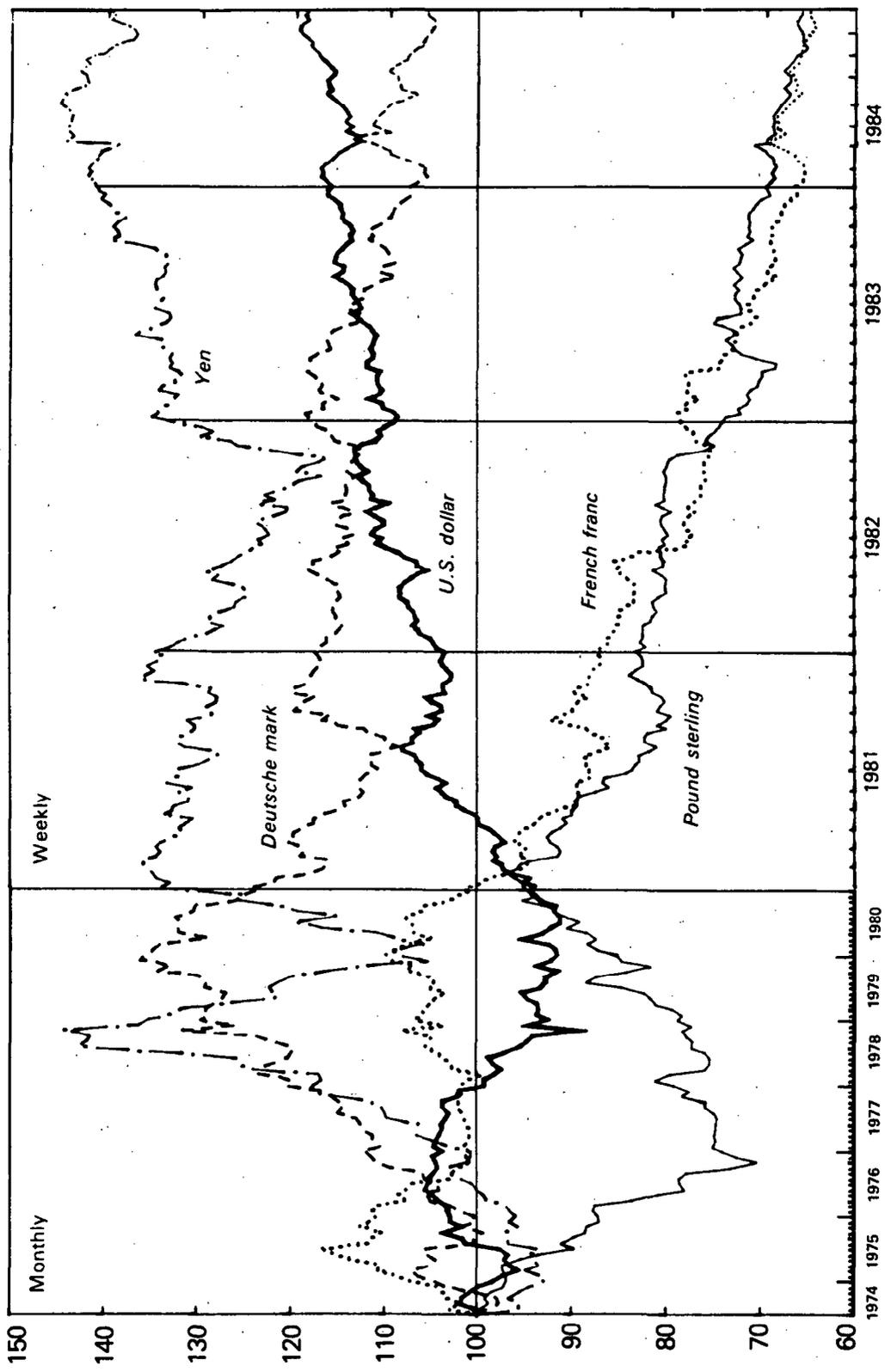
(In per cent against the U.S. dollar, based on noon quotations in New York)<sup>1</sup>



<sup>1</sup>Monthly averages of absolute percentage changes (MAC) are also indicated.

# CHART 6 INDEXES OF EXCHANGE RATES OF FIVE MAJOR CURRENCIES AGAINST THE SDR

JUN. 1974 - AUG. 1984  
(June 28, 1974=100)



# CHART 7 SHORT-TERM MONEY MARKET RATES

(Per cent per annum)

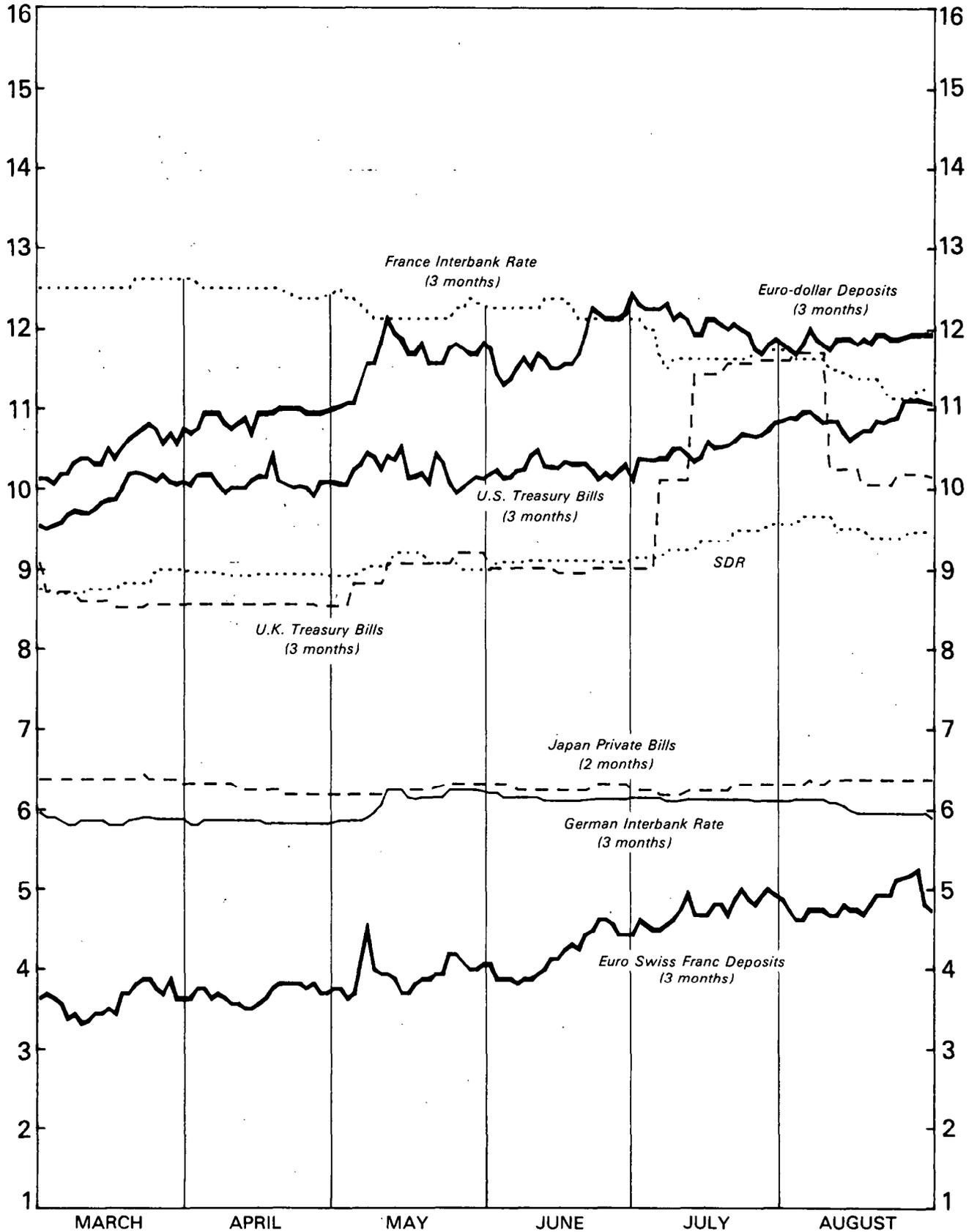


CHART 8  
**THREE-MONTH FORWARD RATES**  
Margins from Spot Rates based on noon quotations in New York  
(Per cent per annum)

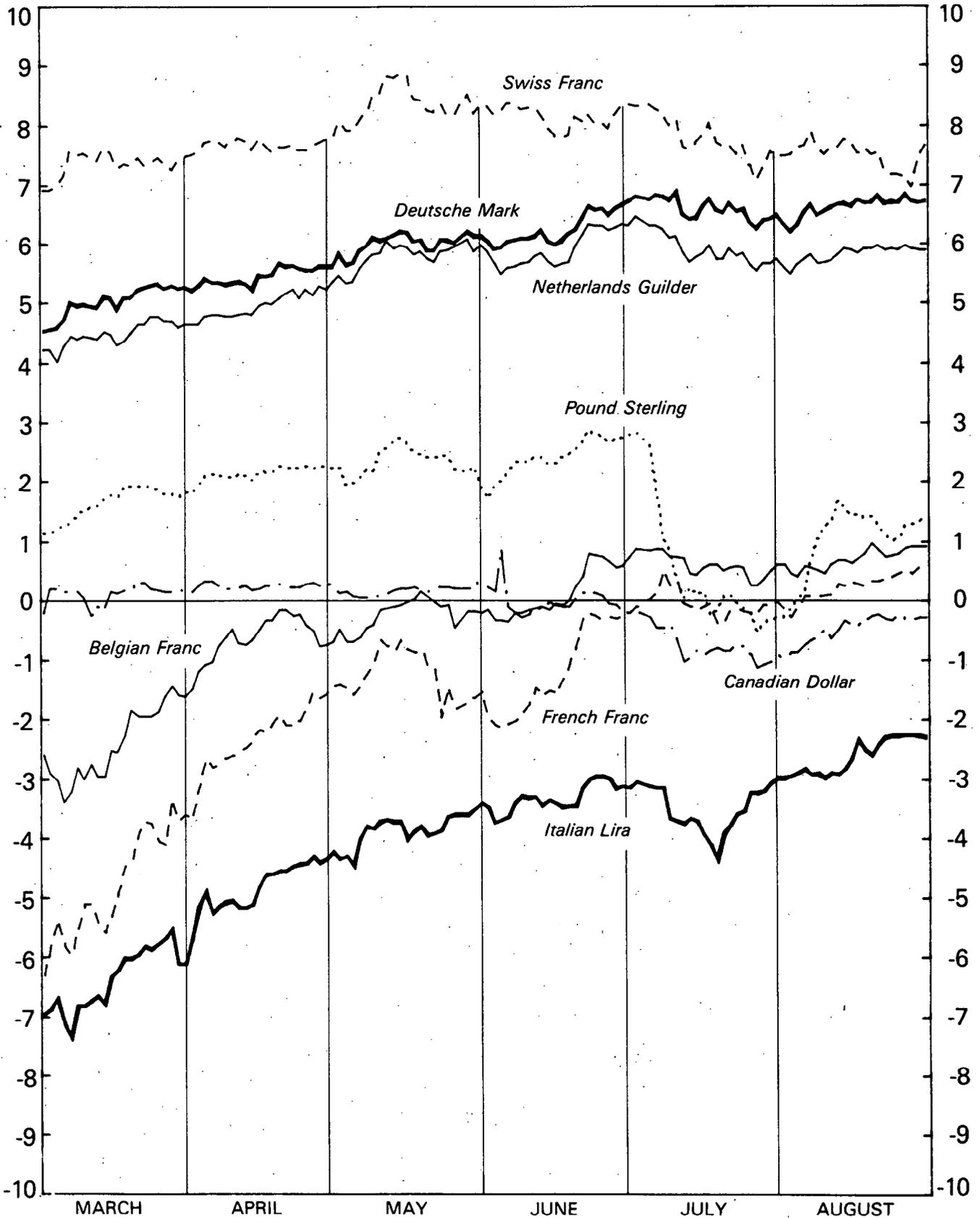
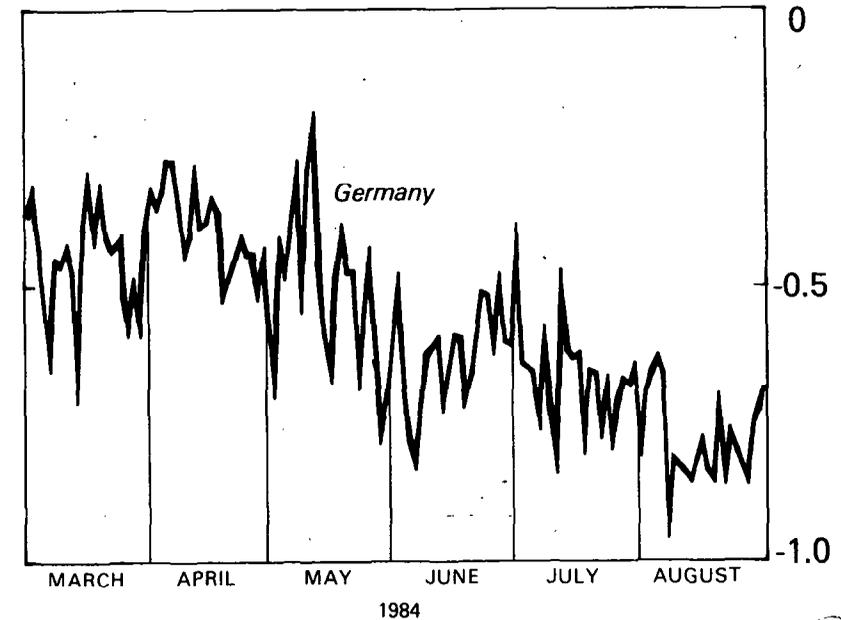
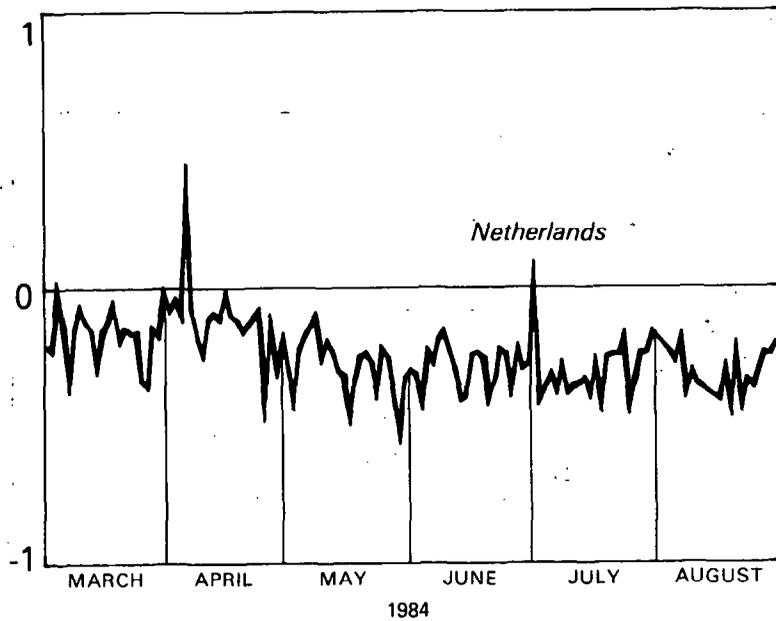
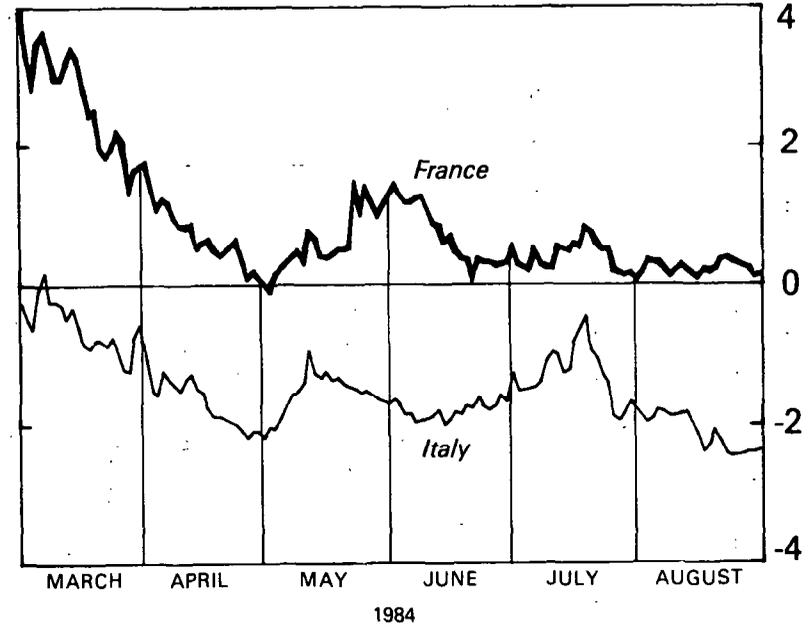
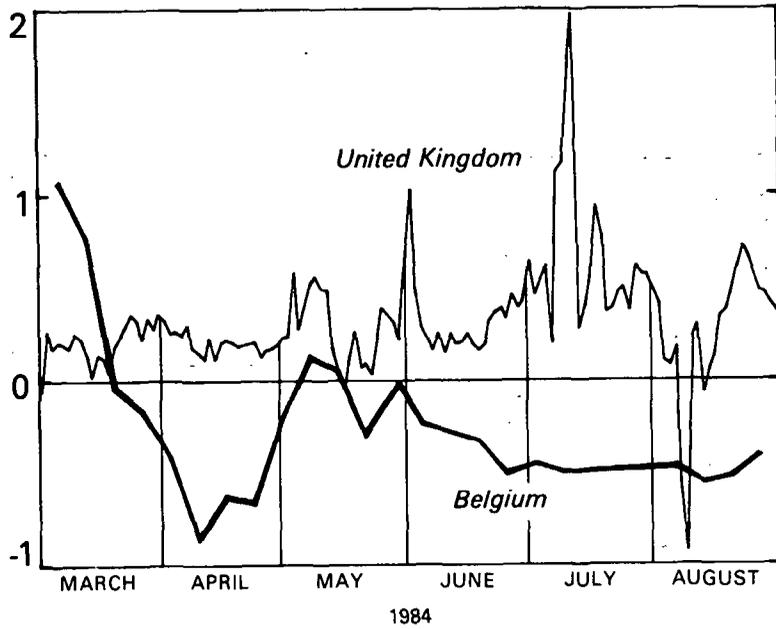


CHART 9

# COVERED INTEREST DIFFERENTIALS BETWEEN THREE-MONTH EURO-DOLLAR DEPOSITS AND LOCAL SHORT-TERM INVESTMENTS

(+ IN FAVOR OF EURO-DOLLAR AND - IN FAVOR OF DOMESTIC INVESTMENT)



Foreign Exchange Rates, July-August 1984

	J u l y				A u g u s t				
	3	11	18	25	1	8	15	22	29
Austrian schilling	19.7850	19.9200	20.0875	20.0250	20.4675	20.4050	20.2150	20.2200	20.2300
Belgian franc									
Official	57.300	57.520	57.795	57.615	58.885	58.765	58.125	58.110	57.980
Financial	57.925	58.325	57.925	58.375	59.475	59.450	58.675	58.700	58.435
Canadian dollars	0.75812	0.74982	0.75103	0.76106	0.76406	0.76702	0.76675	0.76908	0.76997
Danish kroner	10.3425	10.4075	10.4475	10.4100	10.6525	10.5750	10.4888	10.4895	10.4650
Deutsche mark	2.82000	2.84050	2.86250	2.85150	2.91750	2.90500	2.87800	2.87950	2.87650
French francs	8.6545	8.7160	8.7845	8.7535	8.9545	8.9135	8.8275	8.8387	8.8250
Irish pounds	1.0853	1.0770	1.0706	1.0813	1.0568	1.0630	1.0719	1.0722	1.0718
Italian lire	1727.50	1744.00	1756.50	1758.50	1790.50	1781.00	1770.50	1779.00	1785.50
Japanese yen	239.58	242.05	243.80	245.55	245.68	243.03	241.85	241.25	240.55
Netherlands guilder	3.1810	3.2055	3.2305	3.2213	3.2943	3.2668	3.2403	3.2468	3.2458
Norwegian kroner	8.0760	8.2035	8.2715	8.2415	8.3825	8.3050	8.2785	8.2850	8.2680
Pounds sterling	1.3373	1.3125	1.3145	1.3329	1.3015	1.3150	1.3207	1.3100	1.3155
Swedish kroner	8.2350	8.3095	8.3315	8.3095	8.4365	8.3850	8.3445	8.3175	8.2975
Swiss francs	2.36400	2.40225	2.42100	2.43300	2.46450	2.44425	2.41075	2.39975	2.39000

1/ Wednesday noon spot quotations in New York, expressed in terms of currency units per U.S. dollar, except for the Canadian dollar, the Irish pound, and the pound sterling which are expressed in U.S. dollars per currency unit.

Short- and Medium-Term Interest Rates

APPENDIX B

(Monthly and weekly averages)

	National Money Markets 1/						Eurocurrency Markets 2/					Lending Rate		U.S. Treasury 5/ Securities (15)	
	United States (1)	Germany (2)	United Kingdom (3)	France (4)	Japan (5)	Weighted average (6)	U.S. dollar (7)	Deutsche mark (8)	Pound sterling (9)	French franc (10)	Japanese yen (11)	Swiss franc (12)	LIBOR 3/ (13)		U.S. prime 4/ (14)
<b>1983</b>															
Sept.	9.34	5.95	9.41	12.61	6.86	8.74	9.88	5.70	9.64	14.71	6.81	4.41	10.19	11.00	11.43
Oct.	8.97	6.27	9.06	12.62	6.69	8.54	9.60	5.80	9.37	14.29	6.51	4.13	9.78	11.00	11.28
Nov.	9.11	6.38	9.03	12.50	6.38	8.57	9.84	6.07	9.32	13.06	6.49	4.15	10.06	11.00	11.41
Dec.	9.35	6.57	9.08	12.36	6.38	8.71	10.14	6.29	9.42	13.27	6.63	4.35	10.38	11.00	11.54
<b>1984</b>															
Jan.	9.25	6.21	9.06	12.42	6.22	8.59	9.83	5.98	9.45	13.25	6.35	3.71	10.09	11.00	11.37
Feb.	9.45	6.04	9.06	12.62	6.34	8.69	9.96	5.84	9.38	15.78	6.45	3.54	10.21	11.00	11.54
Mar.	9.88	5.94	8.61	12.72	6.38	8.85	10.45	5.67	8.98	15.57	6.38	3.61	10.81	11.21	12.02
Apr.	10.07	5.92	8.55	12.65	6.25	8.92	10.89	5.66	8.87	13.36	6.23	3.67	11.22	11.93	12.37
May	10.22	6.18	8.97	12.37	6.24	9.07	11.60	5.93	9.37	12.77	6.35	3.92	12.18	12.39	13.17
June	10.26	6.22	8.99	12.39	6.28	9.11	11.94	5.86	9.53	12.91	6.29	4.19	12.44	12.60	13.48
July	10.52	6.21	10.84	11.87	6.27	9.39	12.07	5.83	11.38	12.13	6.31	4.75	12.73	13.00	13.27
Aug.	10.89	6.10	10.65	11.57	6.36	9.56	11.87	5.63	11.11	11.62	6.37	4.83	12.21	13.00	12.68
<b>1983 Weekly</b>															
Sept. 2	9.63	5.90	9.53	12.52	6.84	8.90	10.28	5.63	9.83	15.08	6.71	4.53	10.74	11.00	11.73
9	9.50	6.02	9.53	12.58	6.89	8.85	10.10	5.68	9.72	14.94	6.79	4.35	10.50	11.00	11.53
16	9.45	5.94	9.53	12.62	6.88	8.82	9.96	5.70	9.64	15.06	6.84	4.35	10.25	11.00	11.46
23	9.30	5.93	9.40	12.62	6.83	8.72	9.79	5.71	9.64	14.49	6.90	4.48	10.06	11.00	11.37
30	9.10	5.92	9.14	12.64	6.83	8.58	9.52	5.71	9.46	14.24	6.76	4.29	9.77	11.00	11.22
Oct. 7	8.95	6.27	9.12	12.78	6.83	8.56	9.50	5.81	9.47	14.68	6.71	3.94	9.69	11.00	11.15
14	9.14	6.28	9.02	12.74	6.83	8.65	9.71	5.81	9.38	14.89	6.56	4.02	9.85	11.00	11.36
21	8.86	6.27	9.04	12.57	6.89	8.50	9.56	5.76	9.28	14.35	6.43	4.17	9.75	11.00	11.20
28	8.99	6.26	9.04	12.42	6.38	8.48	9.65	5.81	9.37	13.16	6.42	4.34	9.84	11.00	11.39
Nov. 4	8.92	6.28	9.04	12.50	6.38	8.46	9.75	5.89	9.31	13.23	6.42	4.14	9.94	11.00	11.42
11	9.11	6.35	9.01	12.55	6.38	8.57	9.90	5.98	9.31	13.12	6.45	4.14	10.11	11.00	11.50
18	9.15	6.38	9.02	12.55	6.38	8.60	9.85	6.14	9.34	13.05	6.44	4.13	10.06	11.00	11.42
25	9.13	6.43	9.06	12.55	6.38	8.60	9.80	6.89	9.33	13.02	6.45	4.13	10.06	11.00	11.35
Dec. 2	9.23	6.52	9.05	12.32	6.38	8.64	9.84	6.21	9.32	13.06	6.68	4.15	10.09	11.00	11.38
9	9.32	6.55	9.07	12.29	6.38	8.70	10.01	6.30	9.32	12.93	6.61	4.21	10.31	11.00	11.52
16	9.45	6.58	9.09	12.34	6.38	8.79	10.39	6.43	9.49	13.14	6.70	4.63	10.59	11.00	11.62
23	9.35	6.61	9.11	12.42	6.38	8.73	10.29	6.33	9.51	13.74	6.67	4.56	10.46	11.00	11.55
30	9.31	6.56	9.03	12.42	6.38	8.70	9.92	6.03	9.39	13.44	6.41	3.96	10.21	11.00	11.54
<b>1984 Weekly</b>															
Jan. 6	9.30	6.11	9.03	12.42	6.25	8.60	9.94	5.91	9.39	13.36	6.38	3.81	10.24	11.00	11.50
13	9.21	6.24	9.08	12.42	6.19	8.57	9.90	6.08	9.51	13.17	6.33	3.81	10.14	11.00	11.42
20	9.23	6.24	9.07	12.42	6.19	8.58	9.76	6.01	9.45	13.36	6.31	3.70	10.02	11.00	11.29
27	9.28	6.24	9.07	12.42	6.23	8.61	9.79	5.94	9.44	13.18	6.38	3.63	10.02	11.00	11.31
Feb. 3	9.26	6.17	9.06	12.47	6.11	8.60	9.70	5.90	9.44	13.39	6.39	3.50	9.96	11.00	11.31
10	9.24	6.09	9.05	12.55	6.31	8.68	9.85	5.84	9.39	14.68	6.38	3.45	10.05	11.00	11.43
17	9.46	6.01	9.06	12.60	6.31	8.69	7.96	5.80	9.42	15.37	6.39	3.48	10.18	11.00	11.55
24	9.54	5.96	9.06	12.74	6.38	8.74	10.12	5.86	9.38	17.52	6.50	3.64	10.39	11.00	11.67
Mar. 2	9.53	5.98	8.99	12.70	6.40	8.73	10.12	5.83	9.24	17.24	6.59	3.68	10.48	11.00	11.75
9	9.64	5.92	8.68	12.67	6.38	8.72	10.23	5.62	9.06	16.14	6.39	3.46	10.56	11.00	11.85
16	9.79	5.91	8.57	12.67	6.38	8.79	10.38	5.64	8.90	15.93	6.44	3.43	10.75	11.00	11.98
23	10.14	5.95	8.53	12.75	6.40	8.99	10.67	5.73	8.89	15.00	6.37	3.79	11.04	11.21	12.17
30	10.10	5.96	8.55	12.80	6.37	8.97	10.66	5.63	8.95	14.72	6.29	3.72	11.00	11.50	12.20
Apr. 6	10.13	5.91	8.55	12.71	6.31	8.96	10.85	5.71	8.93	14.03	6.26	3.69	11.17	11.50	12.36
13	10.02	5.93	8.55	12.67	6.27	8.90	10.79	5.65	8.85	13.45	6.21	3.55	11.12	12.00	12.24
20	10.14	5.91	8.55	12.67	6.24	8.95	10.96	5.66	8.83	13.22	6.19	3.69	11.28	12.00	12.38
27	10.01	5.91	8.54	12.55	6.19	8.87	10.96	5.63	8.88	12.77	6.25	3.76	11.29	12.00	12.47
May 4	10.11	5.93	8.59	12.59	6.19	8.94	11.03	5.67	8.95	12.51	6.23	3.70	11.34	12.00	12.65
11	10.36	6.08	8.88	12.29	6.20	9.11	11.76	5.98	9.50	12.61	6.28	4.09	12.25	12.14	12.99
18	10.27	6.27	9.08	12.29	6.25	9.12	11.80	5.99	9.34	12.58	6.37	3.79	12.36	12.50	13.24
25	10.17	6.28	9.10	12.32	6.29	9.08	11.65	5.98	9.41	12.98	6.44	4.03	12.35	12.50	13.35
June 1	10.14	6.32	9.16	12.48	6.31	9.09	11.74	6.00	10.13	13.34	6.45	4.03	12.55	12.50	13.69
8	10.20	6.25	9.01	12.42	6.29	9.08	11.45	5.79	9.54	13.54	6.31	3.87	12.20	12.50	13.34
15	10.34	6.20	9.00	12.52	6.25	9.15	11.56	5.87	9.38	13.17	6.30	4.02	12.36	12.50	13.36
22	10.30	6.19	8.96	12.37	6.25	9.12	11.80	5.85	9.39	12.51	6.29	4.35	12.46	12.50	13.49
29	10.20	6.22	9.01	12.29	6.31	9.09	12.15	5.92	9.50	12.31	6.25	4.54	12.69	12.71	13.72
July 6	10.31	6.24	9.29	12.10	6.24	9.15	12.30	5.93	9.65	12.36	6.25	4.54	13.00	13.00	13.67
13	10.44	6.20	10.39	11.75	6.21	9.29	12.14	5.89	11.34	12.08	6.27	4.71	12.84	13.00	13.39
20	10.52	6.22	11.47	11.79	6.25	9.44	12.05	5.81	12.16	12.10	6.31	4.74	12.70	13.00	13.23
27	10.67	6.20	11.58	11.84	6.31	9.55	11.89	5.73	12.14	12.05	6.40	4.90	12.53	13.00	13.03
Aug. 3	10.84	6.19	11.63	11.89	6.31	9.65	11.79	5.76	12.28	11.88	6.34	4.84	12.24	13.00	12.77
10	10.90	6.21	11.42	11.76	6.34	9.65	11.85	5.71	11.42	11.79	6.35	4.71	12.18	13.00	12.63
17	10.72	6.09	10.22	11.58	6.38	9.43	11.87	5.64	10.58	11.64	6.38	4.74	12.17	13.00	12.67
24	10.84	6.03	10.09	11.41	6.38	9.44	11.89	5.55	10.79	11.51	6.38	4.95	12.25	13.00	12.66
31	11.09	6.02	10.18	11.36	6.38	9.59	11.94	5.52	10.87	11.33	6.40	5.00	12.28	13.00	12.79

1/ As of January 1, 1981, the combined market interest rate under the amended Rule T-1 is calculated by multiplying the yield or rate on each of the respective instruments listed below by the number of units of the corresponding currency listed in Rule O-1 and the value in terms of the SDR of a unit of that currency as determined by the Fund under Rule O-2(a) and (b). The interest rates and the respective currency units (shown in parentheses) are as follows: market yield for three-month U.S. Treasury bills (0.54), three-month interbank deposit rate in Germany (0.46), three-month interbank money rate against private paper in France (0.74), discount rate on two-month (private) bills in Japan (34), and market yield for three-month U.K. Treasury bills (0.071).

2/ Eurocurrency interest rates are those on three-month deposits for the U.S. dollar, the Deutsche mark, the Swiss franc, and the French franc (in London), and for the pound sterling (in Paris).

3/ LIBOR is six-month euro-dollar offered rate in London.

4/ Prime lending rate of major New York banks.

5/ Yield is adjusted to constant five-year maturity by the U.S. Treasury and is based on only recently issued, actively traded securities. The interest rate paid to lenders and charges on drawings under the Supplementary Financing Facility are based on this rate.