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INTERNATIONAL MONETARY FUND

Treasurer's Department

Foreign Exchange and Financial Markets in July 1984

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The U.S. dollar continued to appreciate against most leading currencies in July, firming by 2.51 percent in effective (MERM) terms and by 1.76 percent in terms of the SDR. The strength of the dollar was attributed principally to interest rate differentials favoring U.S. dollar investments and expectations of further firming of U.S. interest rates in light of heavy borrowing demands and a possible tightening of monetary policy by the Federal Reserve. Other factors contributing to the strength of the dollar were the continuing tension in the Persian Gulf and increased industrial disruptions in the United Kingdom. Intervention by some central banks to restrain the appreciation of the U.S. dollar against their currencies continued in July. The Bundesbank sold about $800 million at the fixings in Frankfurt and in the open market (compared with sales totaling about $1,550 million in the previous two months), the Bank of Japan reportedly sold about $400 million, and the Bank of England was also reported to have intervened on occasions. The Bank of Italy continued its modest presence in the market, aimed mainly at maintaining the lira's position vis-a-vis the Deutsche mark. The pound sterling, despite a sharp rise in U.K. interest rates, came under considerable pressure during the month, reflecting in part increased industrial disruptions and weakening world oil prices. The only currency to firm against the U.S. dollar in July was the Canadian dollar; it firmed by 2.39 percent in effective (MERM) terms and by 0.64 percent against the U.S. dollar as Canada's trade balance continued to record surpluses and interest rates kept pace with those in the United States. The currency might have also been assisted by substantial official foreign borrowings. The Swiss franc was again the weakest of the major currencies, easing by 2.64 percent in effective (MERM) terms and by 5.73 percent against the U.S. dollar, principally because of low interest rates on Swiss franc-denominated assets. The Swedish krona depreciated the least among the remaining currencies and in fact appreciated in effective (MERM) terms (see Table 1 and Charts 1, 3, and 4).

Table 1. Changes in Exchange Rates in July 1984 1/

(In percent)

	Monthly exchange rate changes			Changes in effective exchange rate since July 1983 3/
	Against U.S. dollar 2/	Against SDR 3/	Effective exchange rate 3/	
Belgium	-3.50	-1.50	-0.04	-2.03
Denmark	-3.89	-1.83	-0.87	-3.53
France	-4.24	-2.19	-1.08	-3.84
Germany	-4.30	-2.18	-0.98	-1.62
Ireland	-3.69	-1.47	-0.49	-3.89
Italy	-4.03	-1.91	-0.72	-5.48
Netherlands	-4.33	-2.20	-1.19	-2.43
Austria	-4.23	-2.28	-1.23	-2.29
Canada	+0.64	+2.39	+1.51	-2.99
Japan	-3.26	-1.55	-1.26	+3.65
Norway	-4.42	-2.45	-1.66	-5.41
Sweden	-2.92	-0.81	+0.24	-1.02
Switzerland	-5.73	-3.75	-2.64	-8.03
United Kingdom	-3.70	-1.75	-0.70	-8.29
United States	--	+1.76	+2.51	+8.00

1/ Positive sign indicates appreciation of the currency.
2/ Based on New York noon quotations.
3/ 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 firming trend of the U.S. dollar was interrupted twice for brief periods during the month. The first occasion, around midmonth, followed a reduction in the U.S. M1 money supply that brought it within the Federal Reserve's target range and reports of continuing low inflation with some signs of a slowing of the pace of economic growth. These factors led many market participants to believe that the Federal Reserve was unlikely to tighten monetary conditions. Market sentiment changed, however, with the announcement of a record increase of $10.23 billion in outstanding consumer credit in May. The second significant break in the dollar's firming trend came late in the month when the U.S. Federal Reserve Board Chairman Volcker allayed fears of an imminent tightening of monetary policy in Congressional testimony that the Federal Reserve had decided to maintain the present money growth targets through the end of the year. This was also short-lived as uncertainties associated with rumors of an OPEC breakup and the announcement of a lower than expected trade deficit for June helped generate renewed dollar buying interest which was sustained during the rest of the month.

Within the European Monetary System (EMS), there was a significant convergence of exchange rates, and the spread in the narrow band declined from 1.64 percent at the end of June to 0.80 percent at the end of July. The Belgian franc continued at the bottom of the narrow band and the Deutsche mark was at the top for most of the month, except on one occasion when it was replaced by the French franc and on another when the Netherlands guilder rose to the top. The Bank of France reportedly sold Deutsche mark equivalent to about F 400 million in midmonth to steady the market amid uncertainties over France's Cabinet reshuffle. The Italian lira continued to be the strongest currency in the EMS in terms of ECU central parities, with a spread in the range of 2.41-3.68 percent from the Belgian franc. 1/ The lira benefited in July from high domestic interest rates and seasonal tourist inflows; the Bank of Italy bought small amounts of U.S. dollars and Deutsche mark throughout the month. The divergence indicators for all the EMS currencies remained well within the thresholds (see Chart 2). Against the U.S. dollar, the EMS currencies eased by 3.50-4.33 percent during the month.

The range within which most major currencies traded against the U.S. dollar narrowed markedly from June when the trading range was unusually large because of the sharp appreciation of the U.S. dollar in the period from June 5 to June 25. The range of fluctuations recorded by the EMS currencies was 3.1-4.1 percent, compared with 4.1-5.2 percent in June. The Swiss franc was the only currency to record a widening of the trading range (5.6 perent) while the range for the Canadian dollar narrowed slightly to 1.8 percent and continued to be the smallest. Trading ranges for other major currencies narrowed to 2.9-4.1 percent in July from 3.2-5.1 percent in June (see Table 2). The daily volatility, as reflected in the average of absolute daily percentage changes against the U.S. dollar (MAC in Table 2 and Chart 5), increased, however, for ten currencies and decreased for four (the Belgian franc, the Danish krone, the Austrian schilling, and the Swedish krona). For the EMS currencies, this measure increased from an average of 0.47 percent in June to 0.49 percent in July. The MAC measure for the Canadian dollar rose sharply from 0.12 percent to 0.23 percent but remained significantly smaller than those of other currencies for which the range widened to 0.34-0.56 percent from 0.32-0.50 percent in June.

1/ 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/

	July 2/		High-low spread in percent 3/		MAC 4/	
	High	Low	June	July	June	July
Belgium	56.775	58.540	4.7	3.1	0.49	0.46
Denmark	10.240	10.5825	4.6	3.3	0.51	0.49
France	8.5645	8.9125	4.9	4.1	0.47	0.51
Germany	2.7910	2.9058	5.2	4.1	0.49	0.52
Ireland	1.09635	1.06235	5.1	3.2	0.46	0.54
Italy	1717.00	1785.00	4.1	4.0	0.41	0.43
Netherlands	3.1470	3.27075	4.8	3.9	0.47	0.51
Austria	19.5800	20.380	5.1	4.1	0.50	0.47
Canada	0.7626	0.7493	2.0	1.8	0.12	0.23
Japan	238.45	246.90	3.6	3.5	0.32	0.47
Norway	8.0175	8.3550	4.3	4.2	0.37	0.41
Sweden	8.1905	8.4250	3.2	2.9	0.36	0.34
Switzerland	2.3418	2.4718	4.9	5.6	0.43	0.51
United Kingdom	1.3511	1.3065	4.0	3.4	0.39	0.56

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.

Major industrial countries recorded moderate changes in reserves in June-July (see Table 3). The sharp rise in reserves of Canada in July was mainly due to substantial official external borrowing. Italy also recorded a notable reserve increase, reflecting mainly seasonal tourist receipts. Switzerland recorded a significant decline in reserves in July as its trade deficit widened significantly. Over the latest 12-month period, significant declines in foreign exchange reserves were posted by Belgium, the United Kingdom, and the United States; while large increases were recorded by France, and Norway.

Table 3. Foreign Exchange Reserves in July 1984 1/

(In millions of U.S. dollars)

	End-month reserve level	Change in July	Change over 12 months
Belgium	3,136	-23	-1,306
Denmark	2,914	+135	+50
France (June)	19,419	+115	+3,502
Germany	38,416	-386	+202
Ireland	2,163	-124	-3
Italy	18,531	+611	-48
Netherlands	8,508	+74	-436
Austria	3,688	-57	-594
Canada	2,694	+1,322	-487
Japan	20,993	-9	+245
Norway	7,264	-368	+2,207
Sweden	3,767	+309	+574
Switzerland	12,005	-860	+181
United Kingdom (June)	7,057	-443	-1,956
United States	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 continued to firm markedly in July, rising by 2.51 percent in effective (MERM) terms (about the same as in June) and by 1.76 percent against the SDR. The 12-month effective (MERM) appreciation increased to 8.0 percent from 7.5 percent in June; the small rise in the 12-month effective appreciation was due mainly to the fact that the U.S. dollar firmed strongly also in July 1983. Interest rate factors and the strength of the U.S. economy were the main reason for the currency's appreciation in July 1984. The U.S. real GNP grew at an annual rate of 7.5 percent in the second quarter, compared with an upward-revised growth rate of 10.1 percent in the first quarter and the "flash" estimate of 5.7 percent made in June. Other major economic indicators, some of which were announced after the end of July, suggested that the pace of economic growth might be slowing down to a more

sustainable level. The index of leading economic indicators declined 0.9 percent in June, and the small decline originally estimated for May was revised to an increase of 0.4 percent. The civilian unemployment rate rose to 7.5 percent in July from 7.1 percent in June, partly attributed to an abnormal seasonal employment pattern that resulted in sharp declines in the seasonally adjusted unemployment rate in May and June. The index of industrial production rose 0.9 percent in July for a 10.6 percent year-on-year rise, compared with 12.3 percent in June. The trade deficit widened to $8.91 billion in June from $8.84 billion in May. The Federal budget recorded a deficit of $2.0 billion in June, compared with a surplus of $3.4 billion in June 1983. On the inflation front, the implicit GNP price deflator rose at an annual rate of 3.2 percent in the second quarter compared with the rate of 4.4 percent in the first quarter while the producer price index rose 0.3 percent in July following two months of no increases and was up 2.4 percent year-on-year.

The Deutsche mark eased by 4.30 percent against the U.S. dollar and by 0.98 percent in effective (MERM) terms, despite continuing intervention by the Bundesbank. The currency maintained its position at or near the top of the EMS narrow band throughout the month. Germany's industrial production, seasonally adjusted, fell 8.7 percent in June following an upward-revised increase of 2.1 percent in May and was down 8.9 percent year-on-year, principally reflecting the effect of the metal workers' strike. The current account balance swung into a deficit of DM 3.2 billion in June from an upward-revised surplus of DM 3.1 billion in May. The unemployment rate rose to 8.9 percent in July from 8.5 percent in June but was unchanged from July 1983. The wholesale price index declined 0.9 percent in July but was up 3.8 percent year-on-year while the producer price index rose 0.3 percent and was up 3.2 percent compared with July 1983.

The French franc eased by 4.24 percent against the U.S. dollar and by 1.08 percent in effective (MERM) terms. The franc remained near the top of the narrow band and replaced the Deutsche mark on one occasion in the first half of the month. The franc was adversely affected in midmonth by uncertainties following the change of the Prime Minister and the Cabinet; the Bank of France reportedly sold Deutsche mark equivalent to about F 400 million at that time to steady the market. France's industrial production, seasonally adjusted, rose 3.1 percent in May, thus offsetting a 3.0 percent decline in April, and recorded a 1.5 percent increase year-on-year. The number of persons unemployed, seasonally adjusted, rose 1.3 percent in June and was up 14.1 percent year-on-year; the unemployment rate was about 9.5 percent. The trade balance, seasonally adjusted, recorded a deficit of F 5.25 billion in June after a small surplus of F 83 million in May; the deficit in the first half of 1984 narrowed to F 20.2 billion from F 36.1 billion in the first half of 1983. Net external borrowing declined in the first half of 1984 to the equivalent of $1.9 billion from the equivalent of $6.4 billion in the second half of 1983; gross

external debt stood at the equivalent of $55.6 billion at the end of June 1984. Industrial wholesale prices declined 0.1 percent in June after an upward-revised increase of 1.1 percent in May but were up 13.6 percent year-on-year.

The Belgian franc eased by 3.50 percent against the U.S. dollar and was marginally easier in effective (MERM) terms. The discount of the financial franc from the commercial franc narrowed from about 1.2 percent in the last week of June to about 0.9 percent in the last week of July, reflecting in part the absence of speculative pressures within the EMS. The Belgian franc eased the least among the EMS currencies in July and consequently the spread of the Belgian franc from the Deutsche mark (at the top of the narrow band of the EMS parity grid) narrowed from 1.64 percent at the end of June to 0.80 percent at the end of July. The National Bank of Belgium bought small amounts of foreign currency in the second half of the month to repay short-term EMS liabilities. Belgium's industrial production rose 4.4 percent in May and was up 7.8 percent year-on-year. The unemployment rate rose to 12.4 percent in July from 11.8 percent in June and 12.3 percent in July 1983. The wholesale price index rose 0.4 percent in June and was up 9.6 percent year-on-year.

The Netherlands guilder eased by 4.33 percent against the U.S. dollar and by 1.19 percent in effective (MERM) terms. The guilder replaced the Deutsche mark at the top of the narrow band on one occasion in the second half of the month. The Netherlands' industrial production, seasonally adjusted, rose 2.0 percent in May and was up 3.0 percent year-on-year. The number of persons unemployed, seasonally adjusted, fell 1.3 percent in July after falling 1.7 percent in June; the unemployment rate in June was 17.8 percent. The trade surplus widened to f. 2.2 billion in May from f. 1.4 billion in April and f. 1.2 billion in May 1983. The producer price index for investment and consumption goods rose 0.2 percent in May and 4.8 percent year-on-year.

The Danish krone eased by 3.89 percent against the U.S. dollar and by 0.87 percent in effective (MERM) terms. Denmark's unemployment rate, seasonally adjusted, rose to 10.6 percent in June from 10.5 percent in May. The trade balance swung into a deficit in June of DKr 390 million from a surplus of DKr 120 million in June 1983; for the first half of the year the current account deficit widened to DKr 10.2 billion from DKr 5.2 billion in the first half of 1983. The wholesale price index rose 0.4 percent in June and was up 9.7 percent year-on-year.

The Irish pound eased by 3.69 percent against the U.S. dollar and by 0.49 percent in effective (MERM) terms. The number of persons unemployed in Ireland, seasonally adjusted, rose marginally in July and the unemployment rate was unofficially estimated at about 16.5 percent. The trade balance swung into a surplus of £Ir 157.8 million in June from deficits of £Ir 40.2 million in May and £Ir 43.9 million in June 1983. The wholesale price index for manufacturing industry rose 0.6 percent in April and was up 8.3 percent year-on-year.

The Italian lira eased by 4.03 percent against the U.S. dollar and by 0.72 percent in effective (MERM) terms; it remained the strongest currency in the EMS relative to ECU central rates and was outside the narrow band. The lira benefited in July from seasonal tourist inflows and relatively high domestic interest rates. The Bank of Italy bought small amounts of U.S. dollars and Deutsche mark throughout the month; it also restricted the net foreign indebtedness of Italian banks to the level prevailing at the end of June 1984. Italy's unemployment rate, seasonally adjusted, rose to 10.4 percent in April from 9.9 percent in January. Industrial output declined 2.9 percent in June but was 2.8 percent higher year-on-year. The trade deficit in May widened to a record Lit 3,077 billion from Lit 1,791 billion in April and Lit 396 billion in May 1983. The wholesale price index rose 0.3 percent in June and 11.5 percent year-on-year.

The pound sterling eased by 3.70 percent against the U.S. dollar and by 0.70 percent in effective (MERM) terms. The pound's 12-month effective (MERM) depreciation increased from 6.3 percent at the end of June to 8.3 percent at the end of July. The pound was adversely affected by industrial disruptions and weak oil prices resulting in part from uncertainties surrounding rumors that OPEC might break up. These factors were partially offset by a sharp rise in U.K. interest rates. The Bank of England was also reported to have intervened on occasions to support the pound sterling on the exchange market during the month. The U.K. unemployment rate, seasonally adjusted, rose to 12.7 percent in July from 12.6 percent in June. Industrial production rose 0.3 percent in June after three consecutive monthly declines and was up only 0.8 percent year-on-year. The 12-month index of leading economic indicators declined 2.0 percent in June, the third consecutive monthly decline. The current account balance, seasonally adjusted, turned into a surplus in June of £103 million from a deficit in May of £69 million; for the first six months of the year, the surplus narrowed to £285 million from £1.0 billion in the first half of 1983. The public sector borrowing requirement declined to £1.082 billion in June from £1.218 billion in May but widened from £783 million in June 1983. Producer output prices rose 0.2 percent in July and were up 6.3 percent year-on-year.

The Swiss franc was the weakest of the major currencies in July, principally because of unfavorable interest rate differentials for Swiss franc investments; it depreciated by 5.73 percent against the U.S. dollar and by 2.64 percent in effective (MERM) terms. The Swiss franc's 12-month effective (MERM) depreciation widened from 4.7 percent at the end of June to 8.0 percent at the end of July. Switzerland's unemployment rate was unchanged in July at 1.1 percent. The trade deficit widened in July to Sw F 867.8 million from Sw F 538.4 million in June and Sw F 408.0 million in July 1983. The wholesale price index rose 0.3 percent in July and was up 3.4 percent year-on-year.

The Japanese yen eased by 3.26 percent against the U.S. dollar and by 1.26 percent in effective (MERM) terms. The Bank of Japan reportedly intervened to support the currency on occasions and sold about $400 million. Japan's index of industrial production, seasonally adjusted, rose 0.1 percent in June, following an upward-revised rise of 2.4 percent in May, for a 12.1 percent rise year-on-year. The current account surplus, seasonally adjusted, widened in June to $3.131 billion from $2.477 billion in May while the trade surplus, seasonally adjusted, in July narrowed to $2.557 billion from $3.111 billion in June. The wholesale price index rose 0.6 percent in July after remaining unchanged in June and was unchanged year-on-year.

The Canadian dollar was the only major currency to firm against the U.S. dollar in July; it firmed by 0.64 percent against the U.S. dollar and by 1.51 percent in effective (MERM) terms. Canadian interest rates rose in July along with U.S. rates and the Bank of Canada undertook substantial borrowings to bolster its foreign exchange reserves. Canada's unemployment rate declined to 11.0 percent in July from 11.2 percent in June. Industrial production fell 0.4 percent in May, after a revised rise of 0.8 percent in April; but was 10.2 percent higher year-on-year. Real GDP, seasonally adjusted, rose 0.4 percent in May and was up 4.5 percent year-on-year. The trade surplus, seasonally adjusted, widened to Can$2.07 billion in June from Can$1.65 billion in May. The budget deficit widened to Can$1.93 billion in May from Can$404 million in May 1983. Industrial selling prices rose 0.1 percent in June, the same as in May, and were up 3.9 percent year-on-year.

The Austrian schilling eased by 4.23 percent against the U.S. dollar and by 1.23 percent in effective (MERM) terms. The Norwegian krone eased by 4.42 percent against the U.S. dollar and by 1.66 percent in effective (MERM) terms. The Swedish krona eased by 2.92 percent against the U.S. dollar but firmed by 0.24 percent in effective (MERM) terms. From June 28, when Sweden raised its official interest rates to arrest capital outflows, to July 31, the Bank of Sweden recorded a total currency inflow of SKr 910 million.

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

Monetary and credit conditions in the major industrial countries continued to diverge in July. Short-term money market interest rates rose in the United States, Canada, and the United Kingdom while those in France, Germany, and Japan either eased or held steady.

In the United States, short-term interest rates firmed in July, reflecting in part continued buildup of credit demands generated by strong economic expansion. Much of the economic data released during the month--such as the unemployment rate, housing starts, consumer credit, and GNP--indicated that the economy was growing more rapidly than expected, resulting in speculation that the Federal Reserve might tighten its monetary stance and that interest rates would increase further. A firming Federal funds rate, which rose from 10.51-11.08 percent in the last week of June to 11.02-11.49 percent in the fourth week of July and to 11.83 percent at end-month, tended to be viewed by the market as an indication that the Federal Reserve favored reserve restraint, especially when the Federal funds rate reached well over 11.50 percent and no Federal Reserve action was seen. The bond-equivalent yield on three-month Treasury bills firmed steadily from 10.30 percent at the end of June to 10.83 percent at the end of the month. The interest rate on three-month CDs rose from 11.67 percent at the end of June to over 11.70 percent in the second week of July but declined thereafter. The CD rate closed the month, amid some minor fluctuations, at 11.39 percent. The average rate in July at 11.56 percent was, however, 0.22 percentage point higher than in June. The M1 measure of the U.S. money supply, seasonally adjusted, averaged $542.1 billion in the week ended July 30 compared with $546.3 billion in the week ended June 25. The annual growth rate from the fourth quarter of 1983 base period was about 5 percent, compared with the target range of 4-8 percent for the year.

Among the countries participating in the European Monetary System, short-term domestic interest rates were little changed in Germany and lower in France. In Germany, the three-month interbank deposit rate moved in the narrow range of 6.19-6.24 percent in July and closed the month at 6.19 percent, compared with 6.22 percent at the end of June. Germany's central bank money stock, seasonally adjusted, grew at a 5.5 percent annual rate through June from the fourth quarter of 1983 base period, compared with 4.3 percent growth through May and the 4-6 percent target through the end of 1984. In France, the central bank lowered its money market intervention rate by 0.25 pecentage point to 11.25 percent effective July 5, the third cut since May 9 when the intervention rate stood at 12 percent. The recent reduction was apparently facilitated by the relatively strong performance of the French franc within the European Monetary System. The three-month interbank money rate fell from 12.29 percent in the last week of June to 11.66 percent in the second week of July but rose to 11.91 percent by end-July.

Table 4. Inflation Rates and Short-Term Interest Rates

	Month 2/	Inflation rates 1/ (year-on-year percent changes) Wholesale price index	Consumer price index 3/	Short-term interest rates 4/ (end-of-month) June	July
Austria	July	5.3 (4.2)	5.6 (6.3)	4.50	4.50
Belgium	June/July	9.6 (10.6)	6.3 (6.8)	11.90	11.90
Canada	June	3.9 (4.1)	4.1 (4.8)	12.15	12.60
Denmark	June	9.7 (9.7)	6.9 (6.5)	7.00	7.00
France	June	13.6 (14.9)	7.7 (7.8)	12.29	11.91
Germany	July	3.8 (4.2)	2.2 (2.8)	6.22	6.19
Italy	June/July	11.5 (11.6)	10.5 (11.2)	16.88	16.63
Japan	July/June	0.0 (-0.4)	1.9 (2.0)	6.31	6.31
Netherlands	May/July	4.8 (4.8)	3.1 (3.6)	6.13	6.38
Norway	May/July	6.4 (7.0)	6.1 (6.4)	8.00	8.00
Sweden	July	-- (--)	7.9 (8.1)	9.50	9.50
Switzerland	July	3.4 (3.1)	2.8 (2.8)	4.44	4.94
United Kingdom	May/June	6.4 (6.6)	5.1 (5.1)	9.01	11.61
United States	July/June	2.4 (2.6)	4.2 (4.2)	10.30	10.83

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.

Interest rates rose sharply in the United Kingdom in July. Major U.K. banks raised their base lending rates twice during the month. On July 6, they raised their base lending rate to 10 percent from 9 1/4 percent and to 12 percent on July 11. The rate on three-month U.K. Treasury bills firmed sharply, rising from 9.01 percent at end-June to 11.44 percent after the base rate hikes and to 11.61 percent by end-July. Money supply data released on July 10 showed that sterling M3, the broadly defined money supply, grew by 2.0 percent in the five weeks to June 20 and at an annualized rate of growth of 14 3/4 percent since the start of the target period in mid-February, well above the 6-10 percent official growth target. The latest Bank of England estimates released on August 7 show that £M3, seasonally adjusted, fell by one percent in the four weeks to July 18. Consequently, £M3 growth returned to within the official growth range target by slowing to 9.0 percent since mid-February.

Short-term interest rates were little changed in Japan while they continued to firm sharply in Canada. In Japan, the rate for two-month private bills stood at 6.31 percent at end-July, the same as in the last week of June. Japan's broadly defined money supply, M2 + CDs, rose an average 7.5 percent in June, after a 7.6 percent year-on-year rise in May. The Bank of Japan estimated that the broadly based money supply will grow at an average rate of around 8.0 percent in the July-September quarter from the year-earlier level. In Canada, the three-month Treasury bills rate closed July at 12.60 percent, after reaching 13.00 percent at midmonth, from 11.72 percent at the end of June.

In the eurocurrency markets, the three-month eurodollar deposit rate eased by 0.31 percentage point to 11.88 percent in July. The three-month euro-French franc and euro-Deutsche mark rates also eased, by 0.46 and 0.19 percentage points respectively. In contrast, the three-month euro-sterling rate firmed sharply by 2.84 percentage points to 12.34 percent and the euro-Swiss franc rate firmed by 0.50 percentage point to 4.94 percent. The euro-yen rate was little changed.

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

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

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

	Uncovered interest differentials 1/ (1)		Forward exchange quotations 2/ (2)		Covered interest differentials 1/ (3) = (1)-(2)	
	June	July	June	July	June	July
Belgium	+0.29	-0.02	+0.55	+0.50	-0.26	-0.52
France	-0.10	-0.03	-0.27	-0.05	+0.17	+0.02
Germany	+5.98	+5.70	+6.67	+6.43	-0.69	-0.73
Italy	-4.69	-4.75	-3.12	-3.06	-1.57	-1.69
Japan	+5.88	+5.57	+6.25	+5.80	-0.37	-0.23
Netherlands	+6.07	+5.51	+6.34	+5.66	-0.27	-0.15
United Kingdom	+3.18	+0.27	+2.75	-0.31	+0.43	+0.58

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 rose steadily to 9.56 percent for the week beginning July 30 from 9.09 percent for the week beginning June 25 (see Table 6), reflecting mainly higher yields on three-month U.K. and U.S. Treasury bills. They firmed by 2.60 percentage points and 0.47 percentage point respectively and were partially offset by the 0.38 percentage point decline on the three-month interbank rate in France. Yields on the relevant instruments for the other currencies in the SDR basket were little changed, firming by 0.06 percentage point in Japan while easing by 0.03 percentage point in Germany. The rate of remuneration paid on creditor positions in the Fund (88.33 percent of the SDR interest rate) rose to 8.44 percent in the last week of July from 8.03 percent in the last week of May.

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

	June	July				
	25	2	9	16	23	30
SDR interest rate	9.09	9.14	9.24	9.35	9.48	9.56
Rate of remuneration	8.03	8.07	8.16	8.26	8.37	8.44

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

The combined domestic interest rates for the three- and six-month maturities firmed by 0.51 and 0.25 percentage points respectively while the twelve-month rate eased by 0.06 percentage point and rates for both the two and a half-year and five-year maturities eased by 0.25 percentage point (see Table 7). The direction of changes in these combined domestic rates in July followed the direction of changes in U.S. domestic rates despite the opposite movement of most other rates for maturities over six months. Yields on the relevant U.S. instruments moved up for maturities up to six months (by 0.11-0.54 percentage point) but eased for longer maturities (by 0.39-0.75 percentage point). Among the other component yields, those on the relevant U.K. instruments recorded the largest changes, firming sharply by 2.16-2.57 percentage points for the three- and six-month maturities. For maturities longer than six months, U.K. yields also rose but by smaller margins of 0.98-1.33 percentage points. Yields on the instruments in Germany and Japan changed by less than 0.10 percentage point except for German yields for the one- and two and a half-year maturities which firmed by 0.10-0.17 percentage point. French yields were mixed, easing by 0.32-0.51 percentage point for maturities of one year or less, changing little for the two and a half-year maturity and firming by 0.30 percentage point for the five-year maturity.

The combined eurocurrency offered rates firmed by 0.13 percentage point for the three-month maturity and by 0.25 percentage point for the six-month maturity. For the three-month maturity, the euro-sterling interest rate firmed sharply by 2.69 percentage points and the euro-yen rate firmed by 0.13 percentage point, more than offsetting lower eurocurrency rates for the other currencies in the SDR basket which eased by 0.13-0.56 percentage point between the end of June and the end of July. For the six-month maturity, euro-sterling interest rates firmed sharply again, this time by 2.13 percentage points, and euro-Deutsche mark rates firmed by 0.06 percentage point. Other rates eased by 0.13-0.50 percentage point except for the euro-yen rate which was unchanged.

Average interest rates on SDR-denominated deposits of selected commercial banks rose modestly for maturities of six months or less, but eased for the twelve-month maturity. Deposit rates rose by 0.03, 0.13, and 0.05 percentage points for the one-, three-, and six-month maturities respectively but fell by 0.27 percentage point for the twelve-month maturity.

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

	June	July
Combined market interest rates 2/		
Based on domestic rates		
3-month maturity (Rule T-1)	9.05	9.56
6-month maturity	9.75	10.00
12-month maturity	10.50	10.44
2-1/2 year maturity	11.38	11.13
5-year maturity	11.75	11.50
Based on eurocurrency offered rates		
3-month maturity	10.25	10.38
6-month maturity	10.63	10.88
Average commercial bank deposit rates 3/		
1-month deposits	9.69	9.72
3-month deposits	9.98	10.11
6-month deposits	10.36	10.41
12-month deposits	11.06	10.79

1/ Rates pertain to last Wednesday of the month.

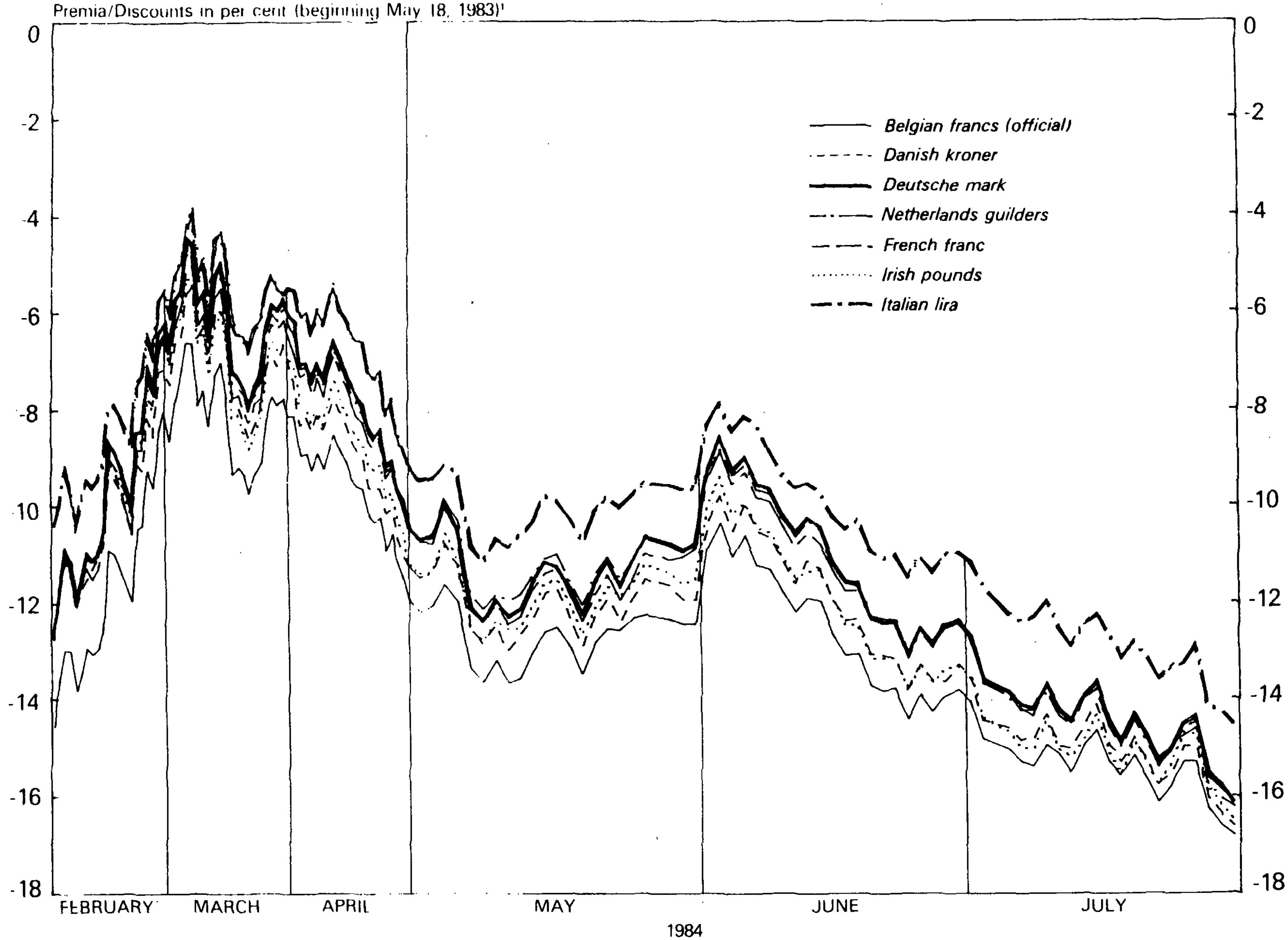
2/ Combined market rates (according to the Rule T-1) are calculated by multiplying the yields or rates of each of the respective instrument by the number of units of the corresponding currency listed in Rule O-1 and the value in terms of the SDR of a unit of that currency as determined by the Fund under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



[1]Effective May 18, 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.

EUROPEAN MONETARY SYSTEM: DIVERGENCE INDICATORS

(Based on noon quotations in London)

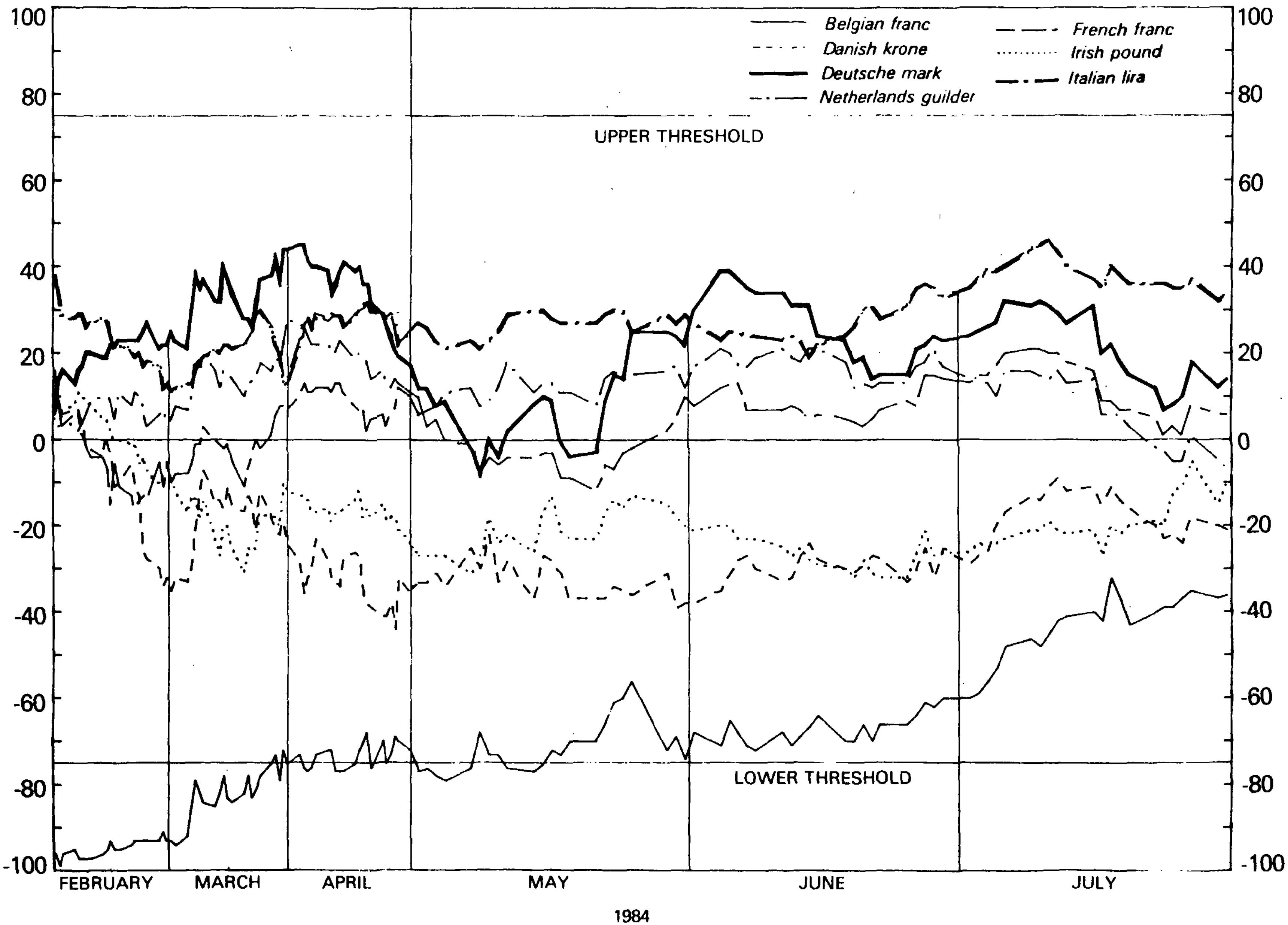


CHART 3
SPOT EXCHANGE RATES
(Noon quotations in New York)

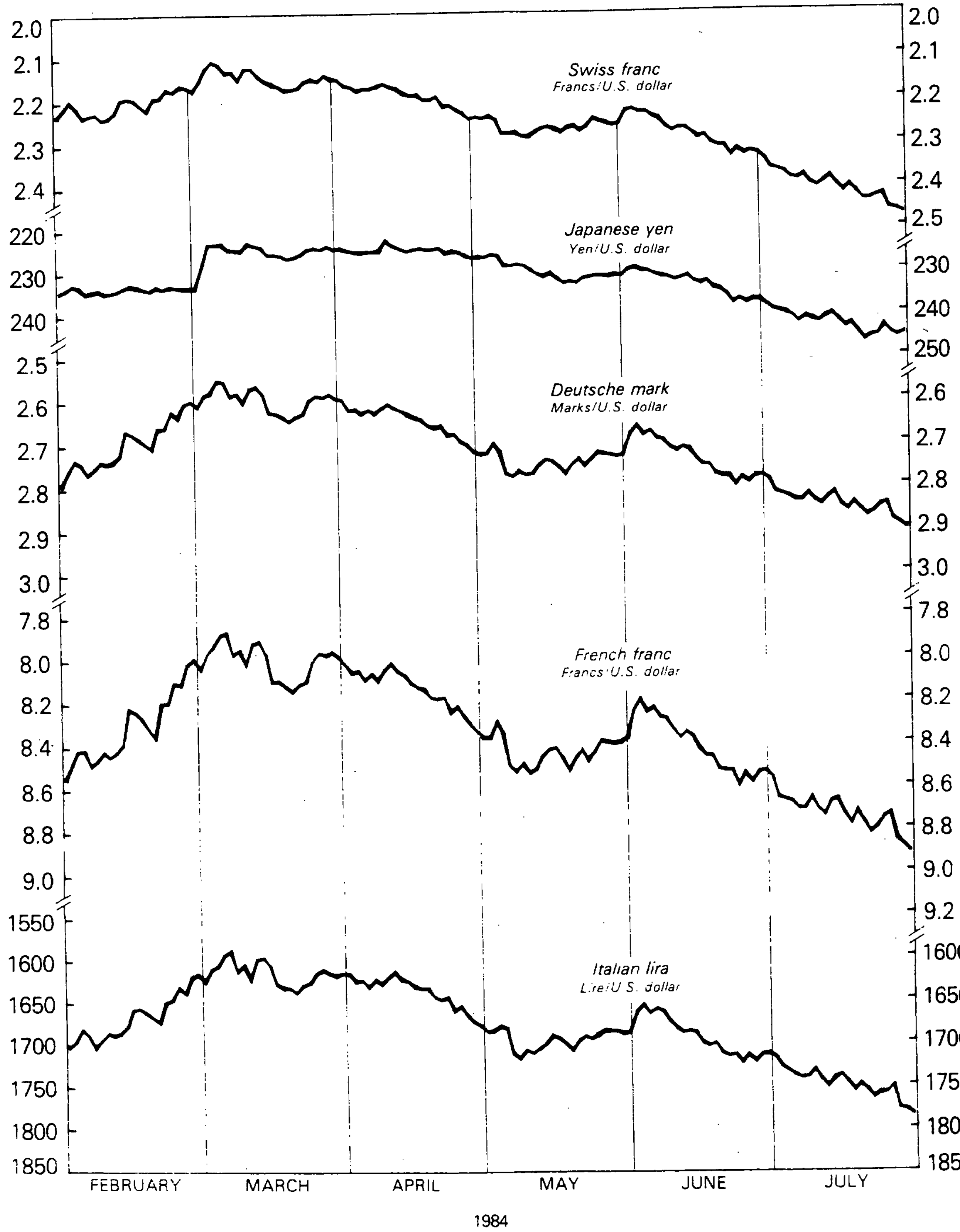


CHART 4

SPOT EXCHANGE RATES

(Noon quotations in New York)

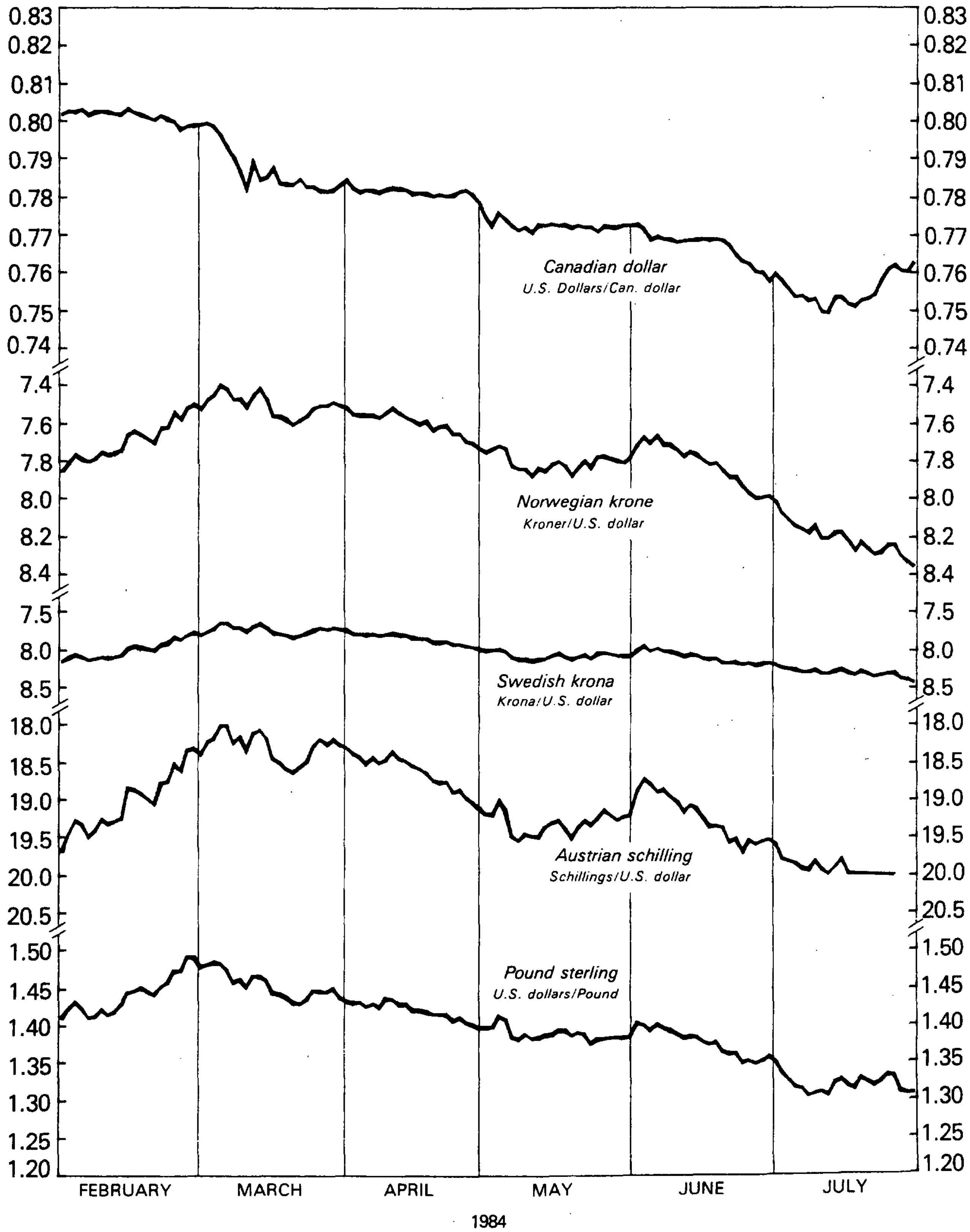
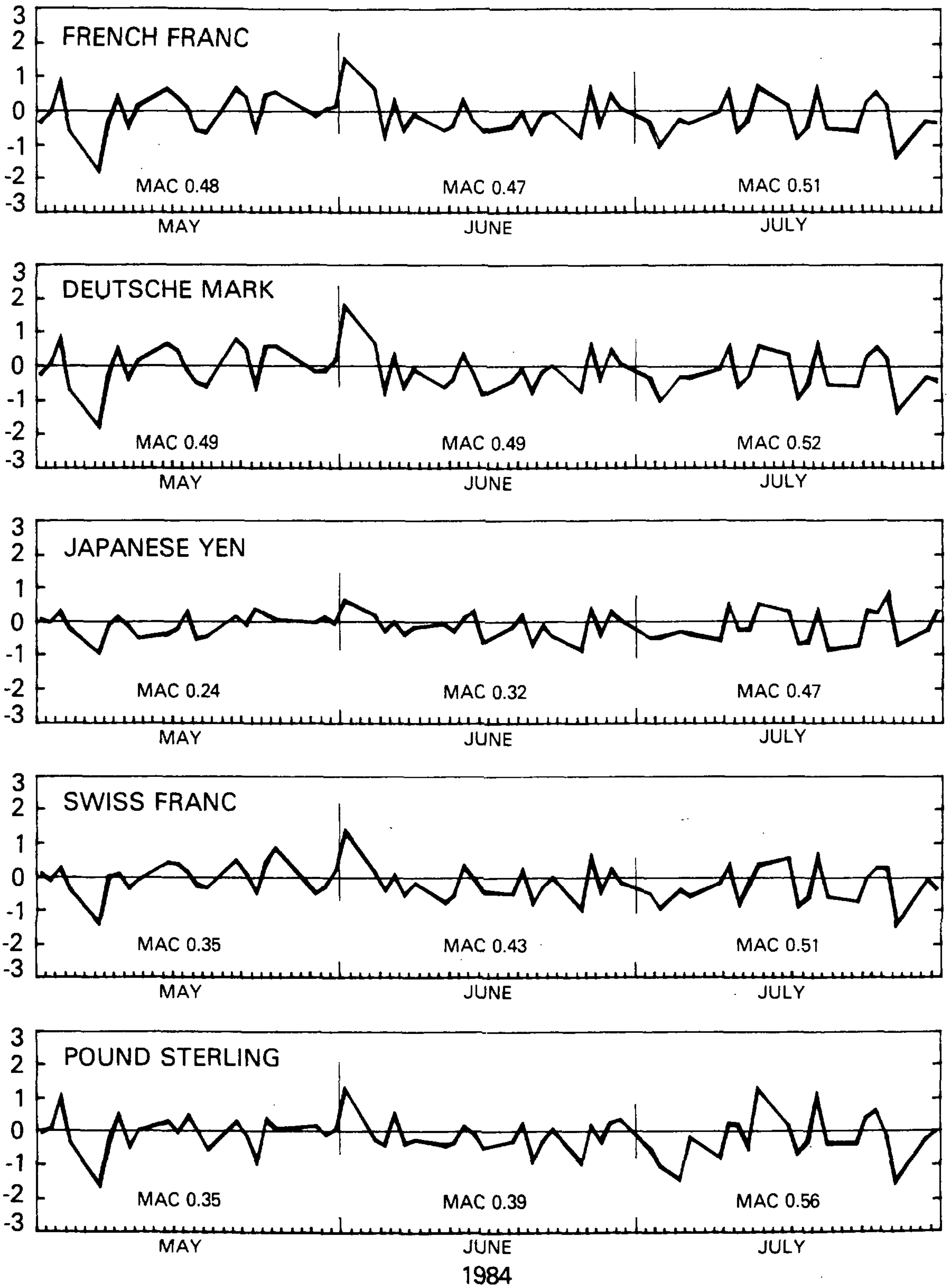


CHART 5

DAILY CHANGES IN SPOT EXCHANGE RATES

(In per cent against the U.S. dollar, based on noon quotations in New York)[1]



[1]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 - JUL. 1984

(June 28, 1974=100)

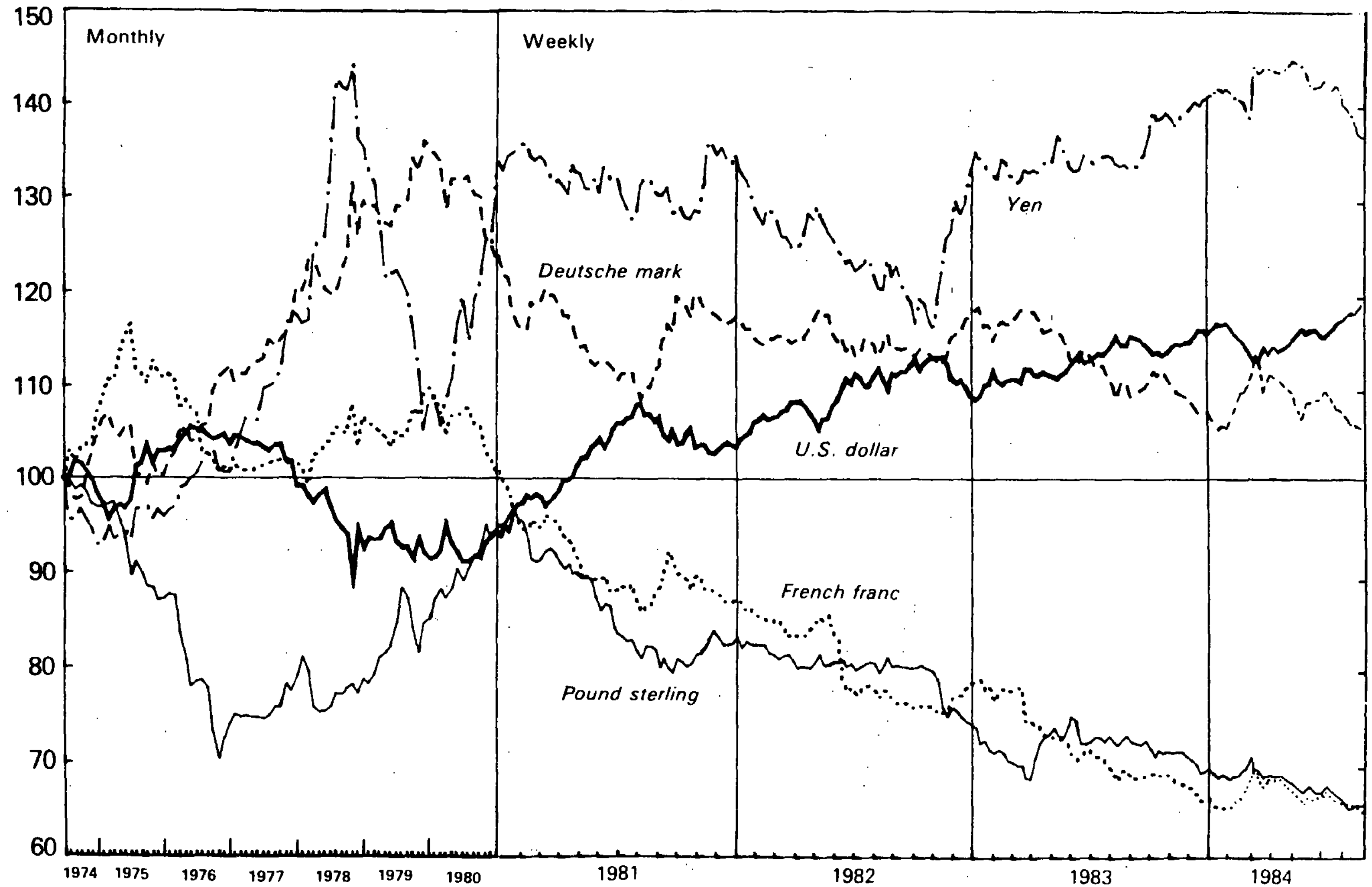


CHART 7

SHORT-TERM MONEY MARKET RATES

(Per cent per annum)

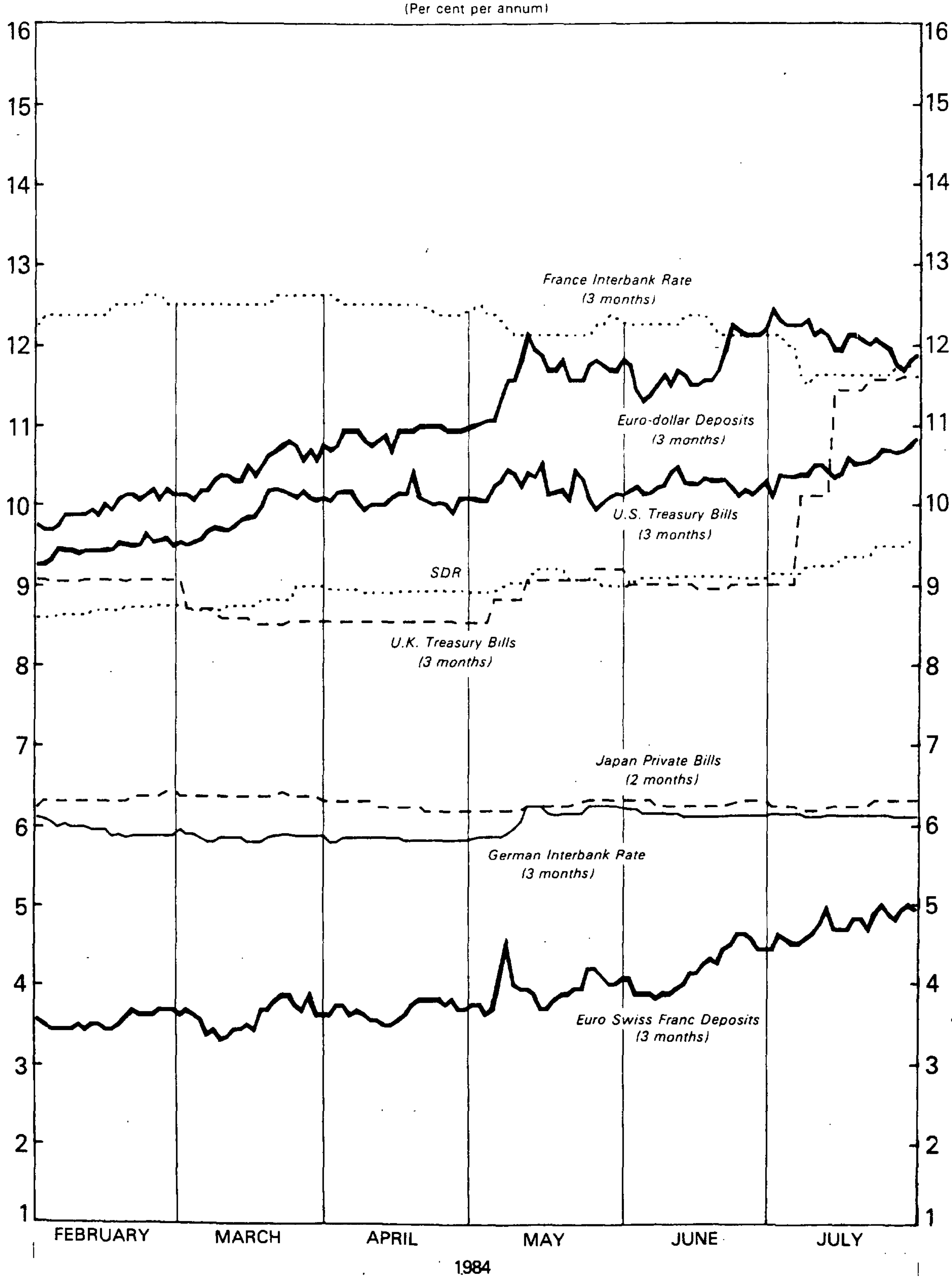


CHART 8

THREE-MONTH FORWARD RATES

Margins from Spot Rates based on noon quotations in New York
(Per cent per annum)

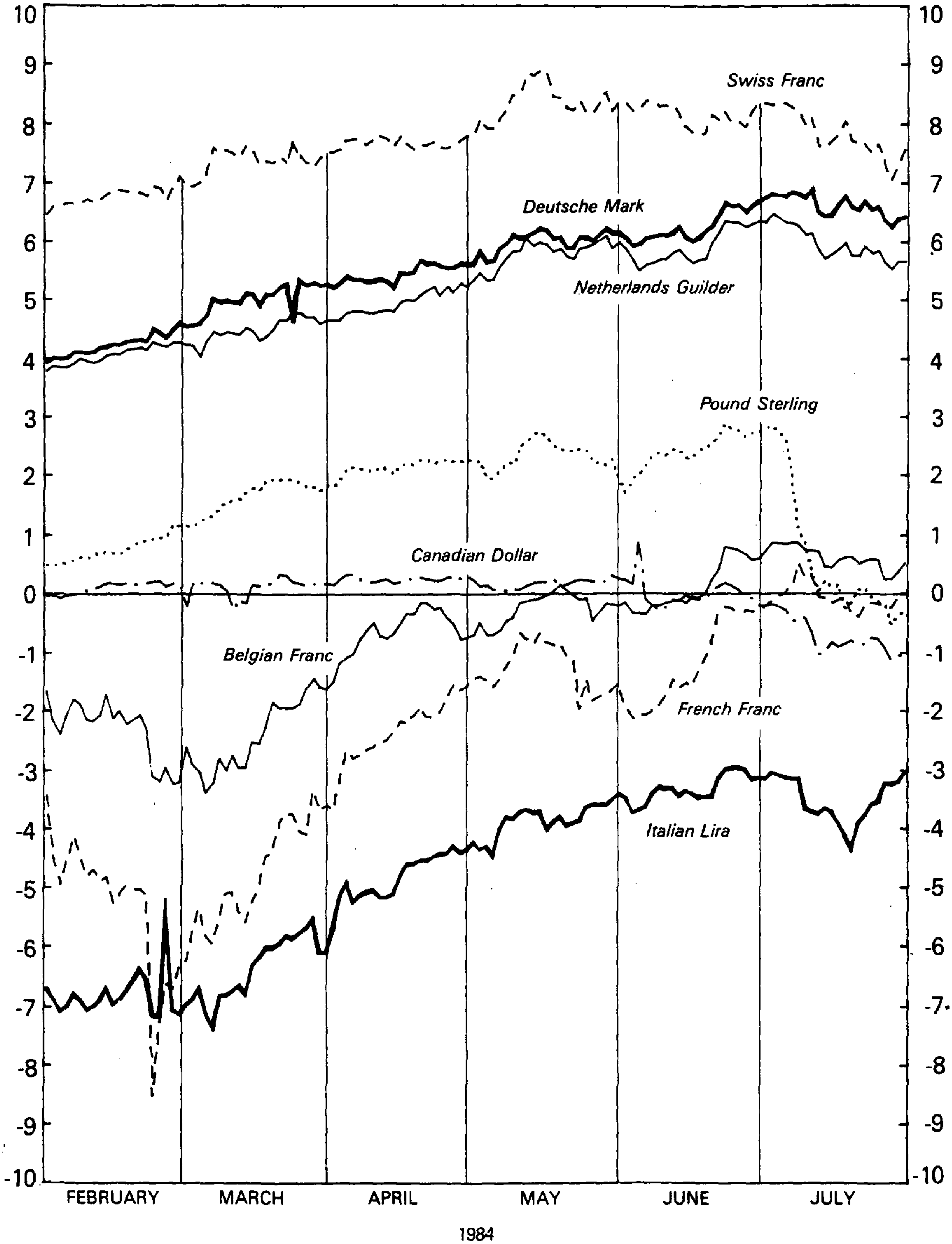
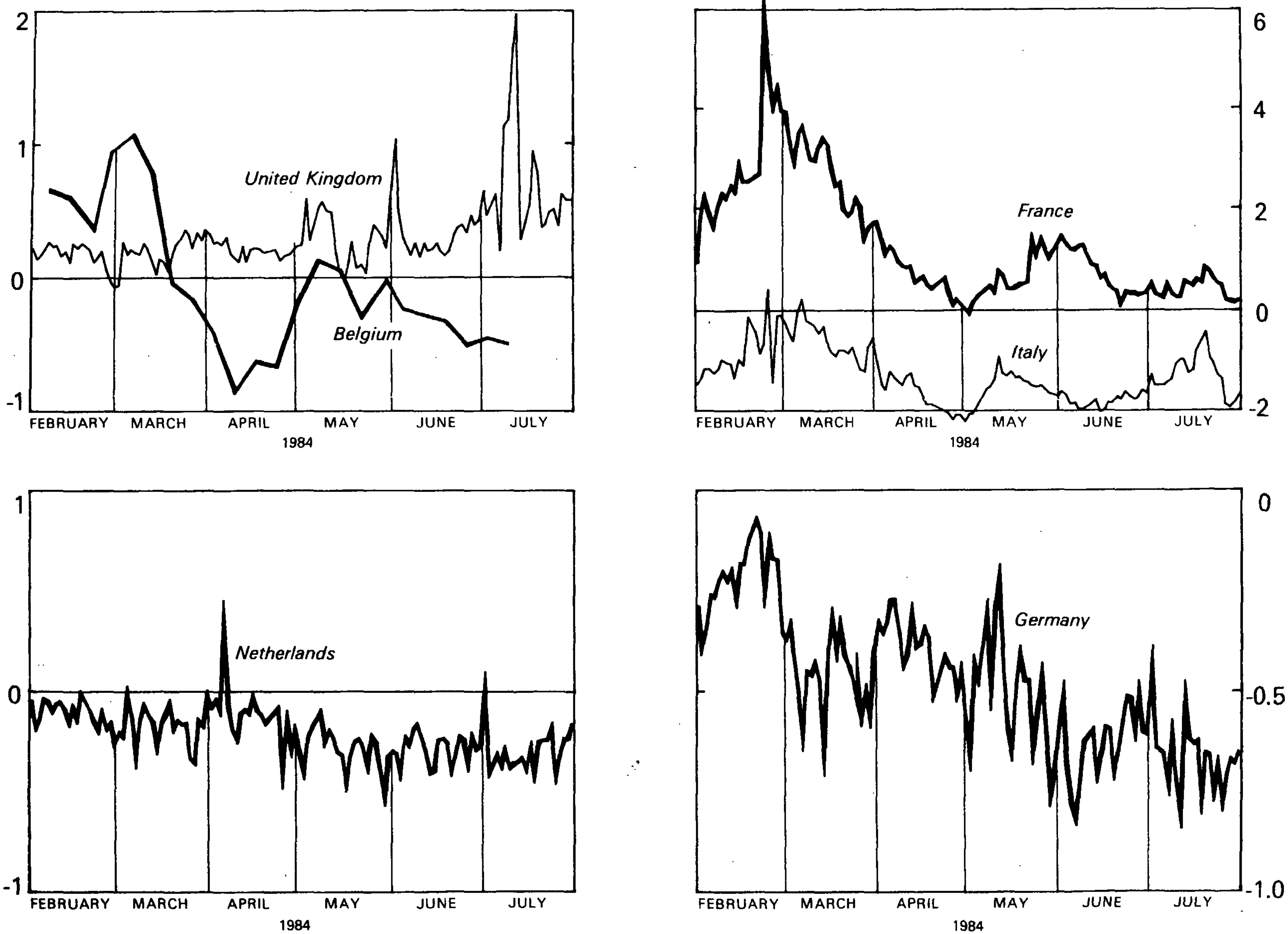


CHART 9

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, June-July 1984

	June				July			
	6	13	20	27	3	11	18	25
Austrian schilling	18.8885	19.0700	19.3715	19.5825	19.7850	19.9200	20.0875	20.0250
Belgian franc								
Official	54.605	55.410	56.550	56.920	57.300	57.520	57.795	57.615
Financial	55.735	56.265	56.945	57.445	57.925	58.325	57.925	58.375
Canadian dollars	0.76962	0.76873	0.76873	0.76031	0.75812	0.74982	0.75103	0.76106
Danish kroner	9.8295	9.9575	10.1765	10.2445	10.3425	10.4075	10.4475	10.4100
Deutsche mark	2.67750	2.71515	2.77850	2.79610	2.82000	2.84050	2.86250	2.85150
French francs	8.2385	8.3545	8.5235	8.5835	8.6545	8.7160	8.7845	8.7535
Irish pounds	1.1418	1.1238	1.1012	1.0945	1.0853	1.0770	1.0706	1.0813
Italian lire	1661.00	1686.50	1712.00	1721.25	1727.50	1744.00	1756.50	1758.50
Japanese yen	230.45	232.35	234.50	237.95	239.58	242.05	243.80	245.55
Netherlands guilder	3.0225	3.0608	3.1295	3.1523	3.1810	3.2055	3.2305	3.2213
Norwegian kroner	7.6685	7.7525	7.8535	7.9965	8.0760	8.2035	8.2715	8.2415
Pounds sterling	1.4020	1.3859	1.3663	1.3495	1.3373	1.3125	1.3145	1.3329
Swedish kroner	7.9775	8.0605	8.1715	8.2065	8.2350	8.3095	8.3315	8.3095
Swiss francs	2.23275	2.27050	2.30550	2.33150	2.36400	2.40225	2.42100	2.43300

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

(Monthly and weekly averages)

	National Money Markets 1/						Eurocurrency Markets 2/						Lending Rate		U.S.
	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)	Treasury 5/ Securities (15)
1983															
Aug.	9.72	5.79	9.56	12.62	6.80	8.93	10.35	5.47	9.86	15.22	6.67	4.66	10.82	10.89	11.63
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
1984															
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	5.38	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
1983 Weekly															
Aug. 5	9.79	5.72	9.61	12.47	6.76	8.94	10.50	5.39	9.96	15.31	6.68	4.90	10.99	10.50	11.74
12	9.91	5.94	9.54	12.62	6.76	9.05	10.60	5.75	9.92	15.58	6.69	4.77	11.13	10.71	11.89
19	9.73	5.75	9.56	12.61	6.82	8.92	10.21	5.38	9.81	15.10	6.65	4.37	10.68	11.00	11.49
26	9.52	5.73	9.53	12.85	6.83	8.83	10.09	5.33	9.77	14.93	6.65	4.64	10.51	11.00	11.34
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	4.39	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
1984 Weekly															
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

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.