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DM/85/41

INTERNATIONAL MONETARY FUND

Treasurer's Department

Foreign Exchange and Financial Markets in June 1985

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July 16, 1985

The U.S. dollar's easing trend continued in June, bringing the dollar to levels substantially below its peak in late February against other major leading currencies. The U.S. dollar has eased by about 14 percent against the Deutsche mark and the French franc from its peak, by almost 25 percent against the pound sterling, and by about 6 percent against the Japanese yen. Trading in June, however, was generally quieter and less volatile than in the previous four months despite continuing uncertainties about the strength of U.S. economic growth and about the prospect of reducing the Federal budget deficit. Market participants also focused on the extent to which the Federal Reserve might tolerate the recent above-target money supply (M1) growth in the light of the slackening overall economic activity and of the likely impact of a declining dollar on the international competitiveness of the U.S. industrial sector. Over the month, the dollar eased by 0.74-2.04 percent against other leading currencies, 0.53 percent against the SDR, and 1.10 percent in effective (MERM) terms; its 12-month effective appreciation was reduced from 11.5 percent in May to 7.7 percent in June. The pound sterling continued to show significant appreciation, attributed mainly to favorable interest rate differentials; it firmed by nearly 1.8 percent against the dollar over the month and by 2.35 percent in effective terms over the year through June. The 12-month effective changes for the Japanese yen and the Canadian dollar became marginally positive and these currencies joined the pound sterling and the U.S. dollar as currencies recording an effective appreciation over the past 12 months (see Table 1 and Charts 1, 3, and 4).

Speculative pressures remained absent within the EMS, whose participating currencies firmed by 0.78-1.42 percent over the month against the U.S. dollar with the Italian lira firming the most and the Irish pound firming the least. The spread in the narrow band of the parity grid remained well below the permitted 2.25 percent margin and the spread of the Italian lira from the strongest currency in the System narrowed from 3.85 percent at the end of May to 3.24 percent at the end of

June. 1/ The Bank of Italy bought a total of \$140 million and DM 560 million at the fixings in Milan during the month. The Belgian franc remained the weakest currency in the narrow band throughout the month while the Irish pound was occasionally replaced at the top of the band by the Danish krone. The divergence indicators for these currencies remained well within their thresholds (see Chart 2).

Table 1. Changes in Exchange Rates in June 1985 1/  
(In percent)

	Monthly exchange rate changes			Changes in effective exchange rate since June 1984
	Against U.S. dollar <u>2/</u>	Against SDR <u>3/</u>	Effective exchange rate <u>4/</u>	
Belgium	+1.03	+0.52	+0.16	-0.55
Denmark	+1.14	+0.92	+0.60	-0.19
France	+1.03	+0.58	+0.28	-1.51
Germany	+0.96	+0.39	+0.02	-2.63
Ireland	+0.78	+0.57	+0.25	-0.59
Italy	+1.42	+0.54	+0.20	-6.09
Netherlands	+0.86	+0.48	+0.15	-1.66
Austria	+2.04	+0.64	+0.33	-2.69
Canada	+0.74	+0.53	+0.67	+0.19
Japan	+1.13	+0.62	+0.61	+0.24
Norway	+0.86	+0.33	+0.01	-3.42
Sweden	+1.46	+0.81	+0.51	-0.54
Switzerland	+1.30	+1.23	+0.97	-2.52
United Kingdom	+1.79	+1.15	+0.86	+2.35
United States	--	-0.53	-1.10	+7.66

1/ Positive sign indicates appreciation of the currency.

2/ Based on New York noon quotations.

3/ SDR rates are derived from representative exchange rates advised to the Fund by members and the daily valuation of the SDR against the U.S. dollar.

4/ Based on the Fund's multilateral exchange rate model (MERM). Effective rates are based on representative exchange rates in the domestic markets, as officially advised to the Fund.

1/ The Italian lira is permitted a spread of 6 percent above (below) the weakest (strongest) currency in the EMS.

The volatility of exchange rates for major currencies against the U.S. dollar, as indicated by certain measures given in Table 2, declined significantly in June following four months of extremely high volatility. The high-low spreads for the month fell to 2.2-2.7 percent for the EMS currencies from 5.1-6.3 percent in May. For the other currencies this measure declined to 1.1-4.2 percent from 1.3-8.2 percent in May. The average of absolute daily percentage changes (MAC in Table 2 and Chart 5) against the U.S. dollar also declined markedly. For the EMS currencies it fell to an average of 0.56 percent from 0.83 percent in May while for the other currencies it fell to an average of 0.49 percent from 0.64 percent in May. The Canadian dollar and the Japanese yen continued to be the least volatile currencies against the U.S. dollar while the pound sterling and the Swiss franc remained the most volatile.

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

	<u>June 2/</u>		<u>High-low spread in percent 3/</u>		<u>MAC 4/</u>	
	High	Low	May	June	May	June
Belgium	60.875	62.500	5.8	2.7	0.86	0.58
Denmark	10.87125	11.1150	6.3	2.2	0.83	0.54
France	9.2375	9.4510	6.1	2.3	0.85	0.56
Germany	3.0285	3.1015	6.1	2.4	0.88	0.60
Ireland	1.0335	1.0087	6.2	2.5	0.91	0.56
Italy	1,934.0	1,977.0	5.1	2.2	0.64	0.53
Netherlands	3.4145	3.49725	6.1	2.4	0.86	0.58
Austria	21.280	21.820	6.1	2.5	0.77	0.67
Canada	0.73581	0.72799	1.3	1.1	0.21	0.18
Japan	247.525	250.475	2.0	1.2	0.31	0.30
Norway	8.7300	8.9025	5.2	2.0	0.69	0.41
Sweden	8.7375	8.9450	4.8	2.4	0.63	0.38
Switzerland	2.5375	2.6120	5.6	2.9	0.90	0.69
United Kingdom	1.3100	1.2575	8.2	4.2	0.99	0.82

1/ Exchange rates against the U.S. dollar at noon 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.

Gross foreign exchange reserves in June rose substantially in Italy, Switzerland, Denmark, and Germany, and moderately in most of the other countries issuing major currencies except for Austria, Belgium, and Canada. Sweden's reserve gain was associated with currency reflows in response to the mid-May package of measures (see DM/85/36) but does not appear to reflect receipt of the proceeds of a large government borrowing abroad. U.K. reserves in June (details not available) reportedly increased in part due to exchange market intervention by the Bank of England as the pound strengthened. Over the latest 12-month period, large reserve gains were posted by Norway, Japan, France, Denmark, Belgium, and Ireland. Large 12-month gross reserve declines were recorded for Germany, the Netherlands, and Austria.

Table 3. Gross Foreign Exchange Reserves in June 1985 <sup>1/</sup>

(In millions of U.S. dollars)

	End-month reserve level	Change in June	Change over 12 months
Belgium	4,081	-57	+922
Denmark	4,216	+662	+1,437
France (May)	20,968	+746	+1,664
Germany	34,415	+634	-4,387
Ireland	3,244	+262	+957
Italy	18,699	+1,082	+779
Netherlands	7,537	+15	-897
Austria	3,117	-26	-628
Canada	1,578	-100	+206
Japan	23,379	+188	+2,377
Norway	11,268	+203	+3,645
Sweden	4,099	+234	+641
Switzerland	13,258	+856	+393
United Kingdom (May)	7,468	-7	+312
United States (May)	7,158	+109	+728

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

I. Developments in Major Factors Affecting  
the Exchange Market in June

The U.S. dollar eased moderately against other major currencies in June; it eased by 0.53 percent against the SDR and 1.10 percent in effective (MERM) terms. Trading in the currency was generally quiet although activity occasionally picked up on the release of economic indicators that belied expectations of many market participants. The volatility of exchange rates against the U.S. dollar was markedly lower than in the preceding four months despite continuing uncertainties about U.S. economic growth, budget spending reductions, and the possible response of the U.S. Federal Reserve to these developments. The "flash" estimate of second quarter U.S. GNP indicated an annual growth rate of 3.1 percent compared with revised growth in the first quarter of 0.3 percent; industrial production fell 0.1 percent in May (up 1.5 percent year-on-year) while the civilian unemployment rate was 7.3 percent for the fifth consecutive month in June. The index of leading economic indicators rose 0.7 percent in May following a revised decline of 0.6 percent in April but the industrial capacity utilization rate declined to 80.3 percent from 80.7 percent in April and housing starts fell 13.7 percent in May although permits issued rose 3.0 percent in the same month. The trade deficit, seasonally adjusted, widened to \$12.67 billion in May from \$11.85 billion in April while the Federal budget deficit widened to \$40.5 billion from \$33.9 billion recorded in May 1984. The inflation rate continued to be subdued with the producer price index unchanged in June and rising 1.1 percent year-on-year and the preliminary estimate of the second quarter GNP deflator indicating an annual inflation rate of 3.2 percent compared with 5.4 percent in the first quarter.

The Deutsche mark firmed by 0.96 percent against the U.S. dollar but was essentially unchanged in effective terms. Germany's current account surplus widened to DM 5.9 billion in May from DM 3.9 billion in April. Industrial production, seasonally adjusted, rose 0.6 percent in May and 2.8 percent year-on-year while the unemployment rate declined to 8.7 percent in June from 8.8 percent in May but was higher than the 8.5 percent recorded in June last year. As in the United States, the inflation rate remained low with the wholesale price index falling by 0.8 percent in June (0.3 percent in May) and rising only 0.3 percent year-on-year.

The French franc firmed by 1.03 percent against the U.S. dollar and 0.28 percent in effective terms. France's industrial production, seasonally adjusted, fell 2.2 percent in April after a revised increase of 1.5 percent in March. The number of persons unemployed, seasonally adjusted, rose 0.5 percent in May, following three consecutive monthly declines, and was up 5.1 percent year-on-year. The trade deficit, seasonally adjusted, narrowed to F 1.24 billion in May from F 4.22 billion in April. Retail prices rose 0.4 percent in June and 6.4 percent year-on-year while industrial wholesale prices rose 0.6 percent in May and were up 5.7 percent year-on-year.

The Belgian franc also firmed by 1.03 percent against the U.S. dollar and firmed 0.16 percent in effective terms. The Belgian franc remained the weakest currency in the narrow band of the EMS parity grid in June but was not subject to any noticeable speculative pressures. Among favorable economic developments, Belgium's unemployment rate fell to 12.0 percent at end-June from 12.5 percent at end-May and the wholesale price index declined by 0.6 percent in May (up only 0.1 percent year-on-year).

The Netherlands guilder firmed by 0.86 percent against the U.S. dollar and 0.15 percent in effective terms. The Netherlands' industrial production declined by 3.7 percent in April, after rising by 1.9 percent in March, and was down 1.0 percent year-on-year. The trade surplus widened to f. 2.0 billion in April from f. 600 million in March and f. 1.4 billion in April 1984. The number of persons unemployed in the Netherlands, seasonally adjusted, fell 2.1 percent in June and 9.3 percent year-on-year.

The Danish krone firmed by 1.14 percent against the U.S. dollar and 0.60 percent in effective terms. A further modest liberalization of Denmark's foreign exchange regulations was implemented on June 1. The trade deficit widened to DKr 1.6 billion in May from DKr 1.4 billion in April and DKr 929 million in May 1984. The wholesale price index fell by 0.1 percent in May but was up 3.6 percent year-on-year.

The Irish pound firmed by 0.78 percent against the U.S. dollar and by 0.2 percent in effective terms. The Irish pound remained the strongest currency within the EMS in June except for a few occasions on which it was replaced by the Danish krone. The number of persons unemployed in Ireland, seasonally adjusted, rose 2.0 percent in June and 7.6 percent year-on-year partly because of a government campaign to encourage school leavers to enroll as unemployed; this brought the unemployment rate to 17 percent.

The Italian lira firmed by 1.42 percent against the U.S. dollar and 0.20 percent in effective terms but remained the weakest currency within the EMS. Italy's industrial production was up 0.5 percent year-on-year in May after a 7.8 percent year-on-year rise in April. Italy's trade deficit widened to Lit 3,345 billion in April from Lit 2,383 billion in March and Lit 1,759 billion recorded in April 1984. The wholesale price index rose 0.3 percent in May and was up 8.3 percent year-on-year.

The pound sterling firmed by 1.79 percent against the U.S. dollar and 0.86 percent in effective terms, supported by relatively high short-term interest rates and favorable economic developments. U.K. industrial production rose by 0.6 percent in April and was up 5.0 percent year-on-year while the unemployment rate, seasonally adjusted, was unchanged in June at 13.1 percent. The volume of U.K. retail sales rose by 1.3 percent in June and 5 percent year-on-year. The current account surplus,

seasonally adjusted, widened to £724 million in May from a revised £223 million in April. The Public Sector Borrowing Requirement narrowed to £999 million in May from £1.2 billion recorded in May 1984. Producer output prices rose 0.1 percent in June and were up 5.6 percent year-on-year while input costs fell 1.1 percent and were up only 2.2 percent year-on-year. Retail prices rose 0.2 percent in June and 7.0 percent year-on-year.

The Swiss franc firmed by 1.30 percent against the U.S. dollar and 0.97 percent in effective terms. Switzerland's unemployment rate declined to 0.9 percent in June from 1.0 percent in May and 1.1 percent in June 1984. The trade deficit narrowed to Sw F 660.2 million in May from Sw F 920.8 million in April but widened from Sw F 515.5 million recorded in May 1984. The wholesale price index fell by 0.2 percent in June but was up 2.8 percent year-on-year.

The Japanese yen firmed by 1.13 percent against the U.S. dollar and 0.61 percent in effective terms. The merchandise trade surplus widened to \$5.02 billion in June from \$3.36 billion in May and \$4.01 billion a year earlier, bringing the surplus to a record \$17.66 billion in the first half of this year compared with \$13.05 billion in the first half of 1984. Japan's industrial production rose a revised 2.4 percent in May and was up 7.5 percent year-on-year; production was up 2.8 percent in April (7.1 percent year-on-year). The unemployment rate, however, rose to 2.5 percent in May from 2.4 percent in April. The wholesale price index declined by 0.3 percent in June (following a fall of 0.2 percent in April) and was down 0.2 percent year-on-year.

The Canadian dollar firmed by 0.74 percent against the U.S. dollar and 0.67 percent in effective terms. Canada's real GDP, seasonally adjusted, rose 0.4 percent in April following an upward-revised rise of 0.5 percent in March, but the unemployment rate was unchanged at 10.5 percent in June. The trade surplus narrowed to Can\$1.80 billion in May from Can\$2.15 billion in April but was up from Can\$1.67 billion a year earlier. Industrial selling prices rose 0.2 percent in May (following a rise of 0.1 percent in April) and were up 2.6 percent year-on-year.

The Austrian schilling was the strongest major currency in June; it firmed by 2.04 percent against the U.S. dollar and 0.33 percent in effective terms. Austria's wholesale prices rose 1 percent in June (4.5 percent year-on-year) and its consumer prices rose 0.3 percent in June (3.2 percent year-on-year). The Norwegian krone firmed by 0.86 percent against the U.S. dollar but was essentially unchanged in effective terms. Norway's trade surplus narrowed to NKr 3.48 billion in May from NKr 3.67 billion in April but widened from NKr 2.55 billion recorded in May 1984. The unemployment rate was unchanged in June at 2.7 percent but declined from 3.6 percent in June 1984. The consumer price index rose 0.7 percent from mid-May to mid-June for a 5.9 percent year-on-year rise. The Swedish krona firmed by 1.46 percent against the U.S. dollar and 0.51 percent in effective terms as relatively high domestic interest

rates instituted in mid-May attracted considerable currency inflows. Sweden's industrial production fell 1.5 percent in May and 0.7 percent year-on-year while the unemployment rate declined to 2.5 percent in June for the lowest rate recorded for June since 1981. The current account deficit widened in May to SKr 2.5 billion from SKr 1.9 billion and compared with a surplus of SKr 100 million a year earlier. The producer price index rose 0.1 percent in May and 6.3 percent year-on-year.

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

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Money market conditions continued to ease in June in most of the major industrial countries, with short-term interest rates declining for three or more consecutive months in a number of countries. Compared with previous months, the decline in these rates in June was, however, relatively moderate. Major exceptions to the easing trend in June were France and the United Kingdom where rates firmed, but they did so only moderately.

Interest rates in the United States eased in general for the fourth consecutive month, with most of the decline taking place in the first three weeks of June. Economic data released through June 20 tended to indicate on balance that the U.S. economy was growing at a slower-than-expected pace. This, along with its effect in raising expectations that the Federal Reserve would cut its discount rate again after the reduction in May, helped push interest rates down, even as the M1 measure of the U.S. money supply, seasonally adjusted, averaged \$592.0 billion in the week ended June 24 (compared with \$585.0 billion in the week ended May 27), for an annual growth rate from the fourth quarter base period of over 11 percent, significantly above the 4-7 percent target range for the year. An easing Federal funds rate, which fell from an average of 7.60 percent for the week ended May 31 to an average of 7.13 percent for the week ended June 21, reinforced the downward pressure on other interest rates. While the "flash" estimate released on June 20 of second quarter U.S. GNP indicated somewhat stronger-than-expected economic growth, other data released toward the end of the month suggested that economic growth may not have been as strong as the "flash" estimate indicated. The yield on three-month U.S. Treasury bills fell from 7.37 percent at the end of May to a low of 6.87 percent on June 18 and to 7.04 percent at the end of the month. The decline in the Treasury bill yield was also attributed in part to a flight to quality towards the end of the month, induced by rumors that a U.S. bank was having funding problems. The rate on 90-day CDs moved similarly through mid-June but firmed thereafter to close the month little changed. In line with the marked easing in money market conditions through mid-month, major U.S. commercial banks cut their prime lending rates from 10 percent to 9.5 percent on June 18. Yields on U.S. Treasury securities with maturities from one year to ten years eased by 0.03-0.27 percentage point, generally doing so by progressively smaller margins as maturities increased, with the five-year constant maturity rate falling slightly from 9.68 percent at end-May to 9.65 percent at end-June.



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>		May	June
Austria	June	4.5	(2.4)	3.2	(3.8)	4.50	4.50
Belgium	May/June	0.1	(1.2)	5.1	(5.3)	9.30	8.90
Canada	May	2.6	(2.4)	3.9	(3.9)	9.44	9.32
Denmark	May	3.6	(4.8)	5.5	(5.8)	7.00	7.00
France	May/June	5.7	(6.5)	6.4	(6.5)	10.27	10.39
Germany	June	0.3	(1.8)	2.3	(2.5)	5.88	5.76
Italy	May/June	8.3	(8.7)	8.7	(8.8)	15.06	15.06
Japan	June/May	-0.2	(0.1)	1.6	(1.9)	6.38	6.31
Netherlands	Mar./June	2.6	(--)	2.6	(2.5)	6.94	6.69
Norway	Apr./June	6.3	(6.0)	5.9	(5.4)	8.00	8.00
Sweden	Apr./June	6.9	(7.3)	8.2	(8.3)	11.50	11.50
Switzerland	June	2.8	(2.9)	3.4	(3.8)	5.25	5.25
United Kingdom	June	5.6	(5.6)	7.0	(7.0)	12.07	12.27
United States	June/May	1.1	(1.1)	3.7	(3.7)	7.37	7.04

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 Belgium, 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.

Among the countries participating in the exchange arrangements of the European Monetary System, short-term interest rates in June continued to ease in Germany and Belgium but firmed in France. In Germany, the three-month interbank deposit rate fell by 0.12 percentage point in June to close the month at 5.76 percent, thus bringing its cumulative decline since end-March to 0.63 percentage point. The Bundesbank cut the rate at which it offers banks three-day Treasury bills twice during June, first by 0.30 percentage point to 5.3 percent on June 7 and then by 0.20 percentage point to 4.8 percent on June 20. The three-day Treasury bill rate is widely seen as setting a lower limit for the overnight call money rate in the domestic money market, and the last time this rate was cut was on March 29 when it was lowered to 5.3 percent from 5.5 percent. The President of the Bundesbank said in June that its policy of fostering a decline in German interest rates has been made easier by a number of factors, among them falling U.S. interest rates and a decline in the value of the U.S. dollar against the Deutsche mark from its highs of nearly DM 3.50 per U.S. dollar earlier in the year. Germany's central bank money stock, seasonally adjusted, grew at a 3.7 percent annual rate through June from the fourth quarter of 1984 base period, compared with 4.3 percent growth through May and a 3-5 percent target range through the fourth quarter of 1985. Short-term interest rates continued to ease in Belgium for the fourth consecutive month. The interest rate on Belgium's four-month Fonds des Rentes certificates was cut twice in June, first by 0.25 percentage point to 9 percent on June 6 and then to 8.9 percent on June 18, while the rate on two- and three-month Treasury certificates was also cut by 0.10 percentage point to 8.9 percent on the latter date. Short-term interest rates in France, by contrast, firmed in June after easing by 0.63 percentage point over the previous three months. The three-month French interbank money rate rose moderately from 10.27 percent at the end of May to 10.39 percent at the end of June. France's state-owned Credit National, however, cut on June 10 the interest rate it charges on long-term loans to industry by 0.75 percentage point to 13 percent. The rate was last changed on April 11 to 13.75 percent from 14 percent. In other developments in France, the government confirmed at the end of June its intentions to take measures to check the growth of the money supply and bank credit. M2 growth in France was reportedly up, according to the Finance Minister, 8.4 percent at the end of April over the previous 12 months compared with a government target for the year of 4-6 percent. Among the measures that are reportedly to be taken are an increase in reserves held with the central bank, an increase in the financing of the government deficit through the bond market, an increase in the equity required of banks, and a slowing down in French foreign borrowing abroad to limit the inflow of foreign exchange which has been boosting money growth. On the last business day in June the Economics Minister also announced a series of interest rate cuts, to take effect in July. Among them, the cost of state-subsidized loans from the fund for industrial modernization will be reduced by 0.50 percentage point to 8.75 percent and the interest paid on standard savings deposits will be reduced by 0.5 percent to 6 percent.

Among the other major countries, short-term interest rates eased moderately in Japan and Canada, but firmed moderately in the United Kingdom. The rate for two-month (private) bills in Japan eased from 6.38 percent at the end of May to 6.31 percent at the end of June. Japan's broadly defined money supply M2 + CDs rose 8.3 percent in May from its year-earlier level, after a 8.4 percent year-on-year rise in April. In Canada, the three-month Treasury bill rate fell from 9.44 percent at the end of May to 9.32 percent at the end of June, the fourth consecutive monthly fall in this rate. The three-month Treasury bills rate in the United Kingdom rose, however, by 0.20 percentage point in June to close the month at 12.27 percent. The three-month U.K. inter-bank rate rose by somewhat less, firming to 12.63 percent at end-June from 12.56 percent at end-May. Two major U.K. clearing banks cut their base lending rates from 12.75 percent to 12.5 percent on June 12, bringing their rates to the same level as the other major clearing banks. The latest Bank of England data (released in July) show that sterling M3, seasonally adjusted, rose by an estimated 2 percent in the five weeks to June 19, following a 0.5 percent rise in the four weeks to May 15. The year-on-year growth rate was 12 percent in banking June, compared with 11.6 percent in banking May. The year-on-year target for the year ending in March 1986 is 5-9 percent growth.

In other domestic interest rate developments, Ireland's central bank cut its short-term lending rate by 0.25 percentage point to 12.50 percent on June 17, and then to 12 percent on June 20. The central bank's short-term lending facility provides up to one week money to the banking system.

In the eurocurrency markets, three-month interest rates were little changed for most major currencies in June. The eurodollar and euro-Swiss franc rates were both unchanged at end-May and end-June, standing at 7.81 percent and 5.25 percent, respectively. The euro-yen rate eased by 0.03 percentage point to 6.31 percent and the euro-Deutsche mark and euro-pound sterling rates eased by 0.06 percentage point and 0.07 percentage point, respectively, to 5.50 percent and 12.56 percent. The euro-French franc rate firmed markedly, in contrast, by 0.69 percentage point to 11.00 percent. The euro-French franc rate was, however, little changed for most of June, but it rose very sharply on the last day of the month from 10.19 percent to 11 percent. The rise may have been in part an overly strong response to the French Government's confirmation (as discussed above) that it would be introducing measures to curb the growth of bank credit and to cut back on the money supply; the euro-French franc rate subsequently declined sharply in the first week of July, standing at 10.50 percent on July 5.

As a result of the movements of eurodollar and domestic interest rates from the end of May to the end of June, the uncovered interest differentials favoring eurodollar investment widened for Germany, Japan and the Netherlands. Those favoring domestic investments narrowed for Belgium but widened for France and the United Kingdom while remaining unchanged for Italy (see Table 5).

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

	Uncovered interest differentials <u>1/</u> (1)		Forward exchange quotations <u>2/</u> (2)		Covered interest differentials <u>1/</u> (3) = (1)-(2)	
	May	June	May	June	May	June
Belgium	-1.49	-1.09	-1.07	-0.87	-0.42	-0.22
France	-2.46	-2.58	-2.45	-2.98	-0.01	+0.40
Germany	+1.93	+2.05	+2.27	+2.35	-0.34	-0.30
Italy	-7.25	-7.25	-5.08	-5.80	-2.17	-1.45
Japan	+1.43	+1.50	+1.50	+1.50	-0.07	--
Netherlands	+0.87	+1.12	+0.87	+1.09	--	+0.03
United Kingdom	-4.26	-4.46	-4.52	-4.47	+0.26	+0.01

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.

In the forward exchange market, the premia against the U.S. dollar widened for the Deutsche mark and the Netherlands guilder but was unchanged for the Japanese yen. The discounts against the U.S. dollar widened for the French franc and the Italian lira but narrowed for the Belgian franc and the pound sterling. As a result of the above-mentioned movements in interest differentials and forward exchange quotations, the covered interest differential favoring eurodollar investment narrowed for the United Kingdom. The covered interest differentials favoring domestic investments narrowed for Belgium, Germany and Italy, switched in June to favoring eurodollar investment for France, and changed in June to a neutral position for Japan. The covered interest differential for the Netherlands changed from a neutral position in May to favoring eurodollar investment in June.

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

The SDR interest rate fell to 7.60 percent for the week beginning June 24 from 7.70 percent for the week beginning May 27 (see Table 6). The three-month U.S. Treasury bill rate fell by 0.15 percentage point while the three-month interbank rate in Germany fell by 0.13 percentage point. Yields on the relevant instruments for the United Kingdom and Japan also fell, each one easing by 0.07 percentage point, but the yield on the relevant French instrument firmed by 0.13 percentage point. The rate of remuneration paid on creditor positions in the Fund (91.66 percent of the SDR interest rate) fell to 6.97 percent in the last week of June from 7.06 percent in the last week of May.

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

	May 27	June			
		3	10	17	24
SDR interest rate	7.70	7.67	7.66	7.38	7.60
Rate of remuneration	7.06	7.03	7.02	6.76	6.97

<sup>1/</sup> The rates apply to the weeks beginning with the dates indicated above.

Combined domestic interest rates for the various maturities eased by 0.13-0.19 percentage point except for the five-year rate which was unchanged (see Table 7). For the maturities shorter than five years, yields on the relevant instruments in the United States eased by 0.08-0.27 percentage point while those in Germany and the United Kingdom eased by 0.12-0.28 percentage point and 0.07-0.25 percentage point, respectively, and those in Japan eased by 0.07-0.11 percentage point. For the five-year maturity, yields on the relevant Japanese, U.K. and German instruments also eased, by 0.11 percentage point, 0.14 percentage point and 0.17 percentage point, respectively, but the relevant U.S. yield firmed by 0.07 percentage point. Yields on the relevant French instruments for all the maturities firmed by 0.19-0.63 percentage point.

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

	May	June
Combined market interest rates: <u>2/</u>		
a. Based on domestic rates		
3-month maturity (Rule T-1)	7.75	7.59
6-month maturity	7.94	7.81
12-month maturity	8.13	7.94
2-1/2 year maturity	8.88	8.75
5-year maturity	9.25	9.25
b. Based on eurocurrency offered rates		
3-month maturity	8.00	8.00
6-month maturity	8.25	8.25
Average commercial bank deposit rates <u>3/</u>		
1-month deposits	7.69	7.75
3-month deposits	7.79	7.81
6-month deposits	7.95	7.94
12-month deposits	8.19	8.21

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 instruments 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.

Combined eurocurrency offered rates for the various maturities were unchanged. The component eurocurrency rates moved within a range of + 0.25 percentage point. The eurodollar and euro-French franc rates firmed while the euro-Deutsche mark, euro-French franc and six-month euro-yen rates eased; the three-month euro-yen rate was unchanged.

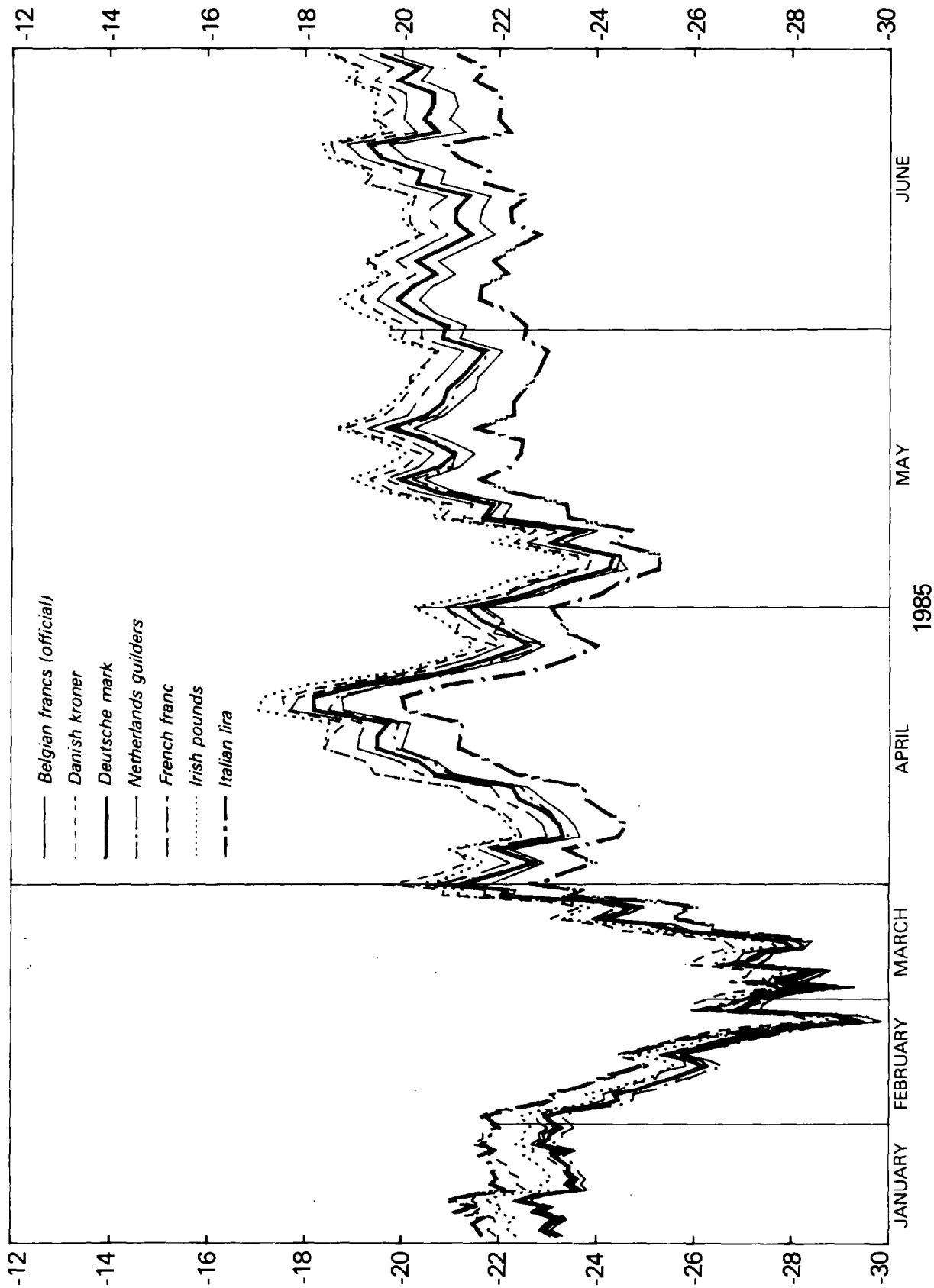
Average interest rates on SDR-denominated deposits of selected commercial banks were little changed, moving within a narrow range of -0.01 percentage point to +0.06 percentage point. Average deposit rates in June ranged from 7.75 percent for one-month deposits to 8.21 percent for 12-month deposits.

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 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.

# CHART 2 EUROPEAN MONETARY SYSTEM: DIVERGENCE INDICATORS

(Based on noon quotations in London)

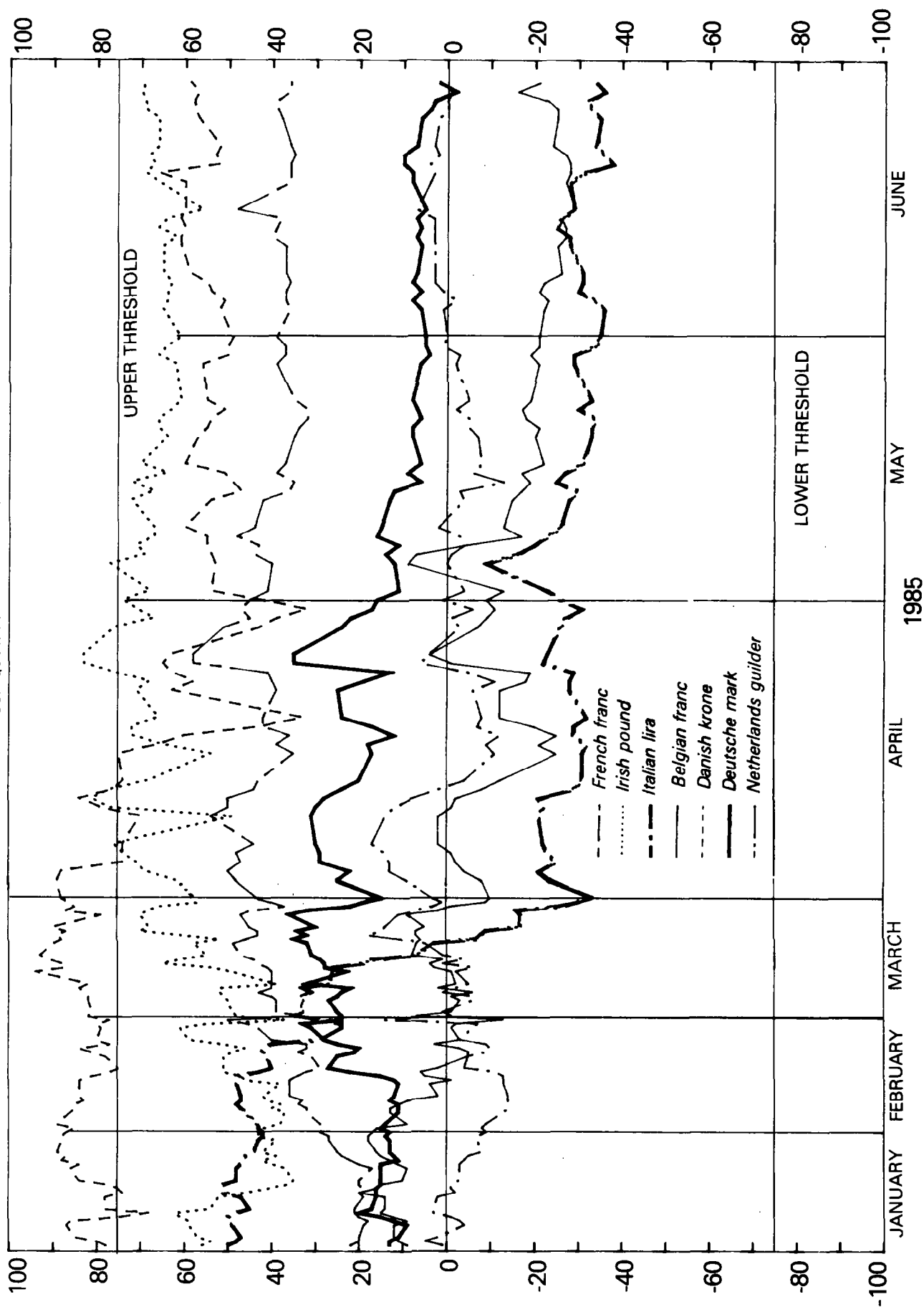
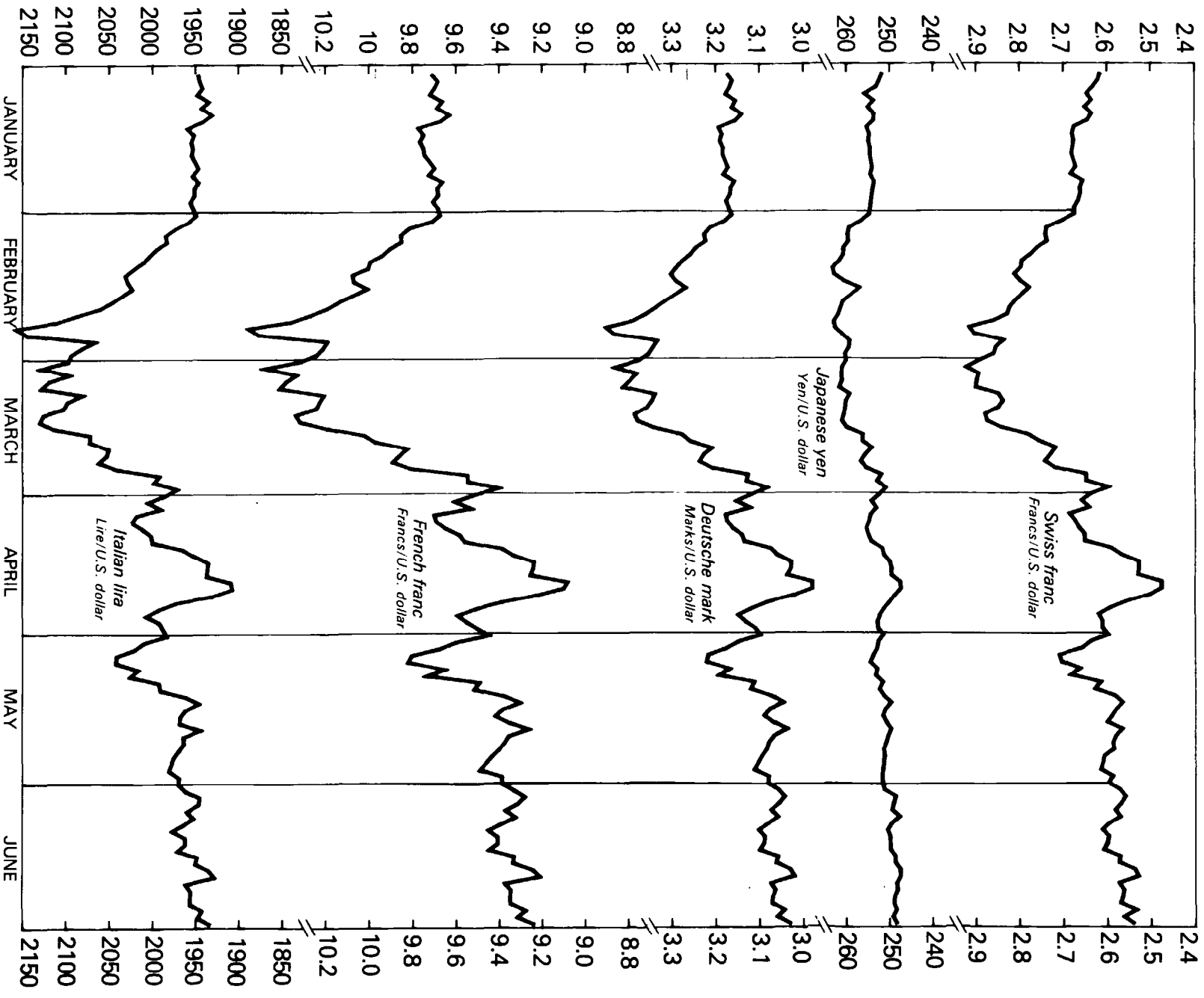








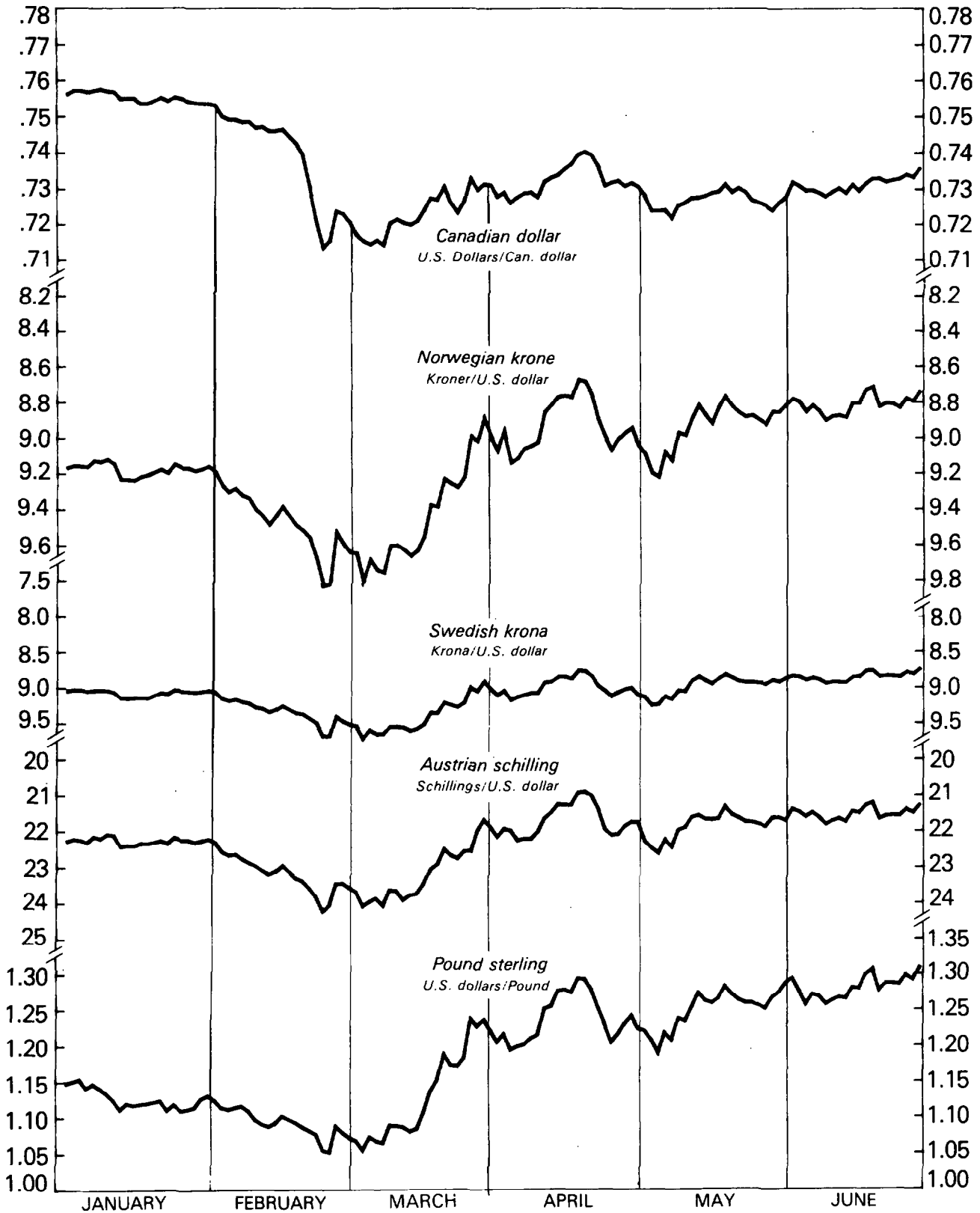
CHART 3  
SPOT EXCHANGE RATES  
(Noon quotations in New York)



1985

# CHART 4 SPOT EXCHANGE RATES

(Noon quotations in New York)

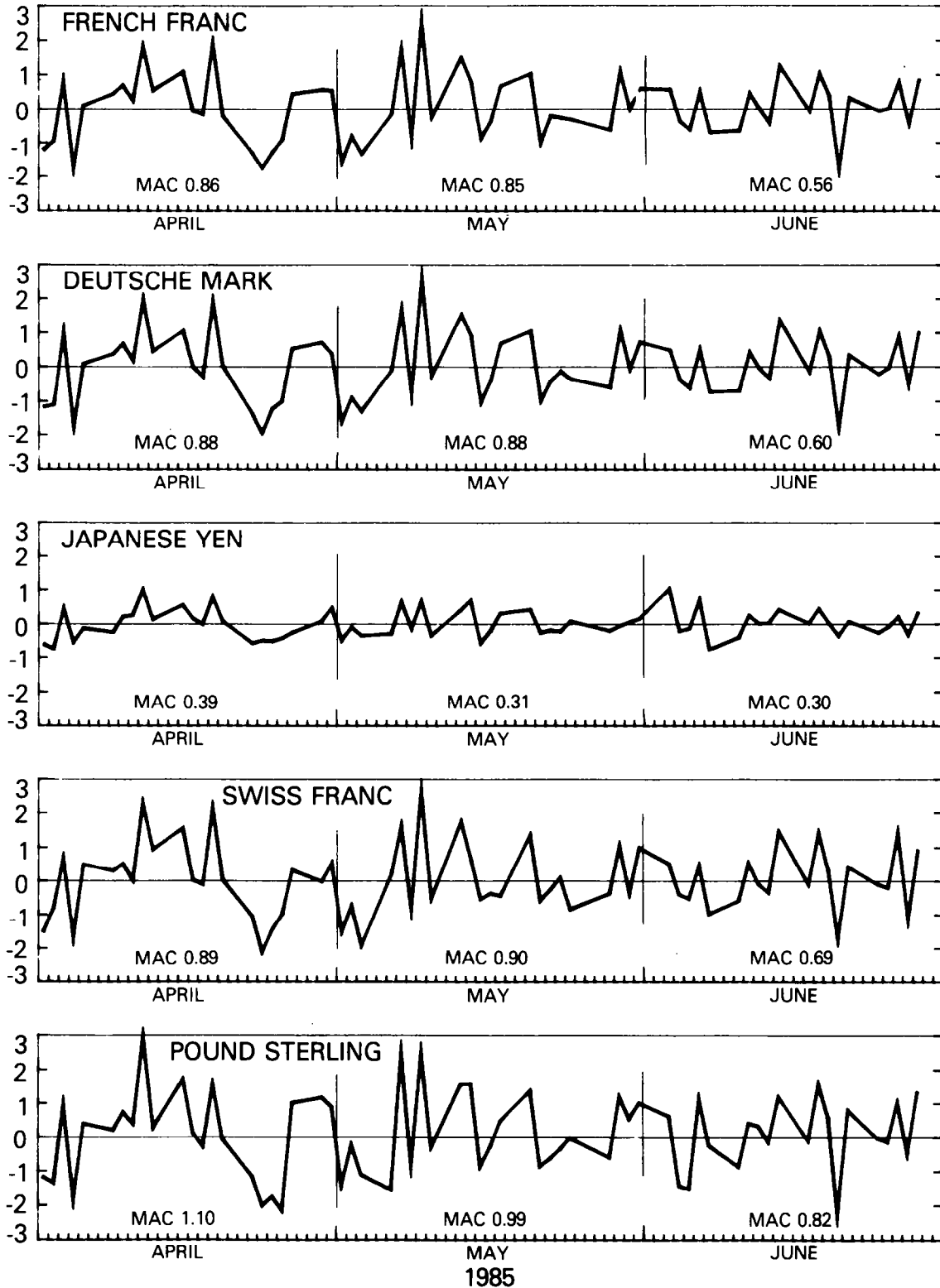


1985

CHART 5

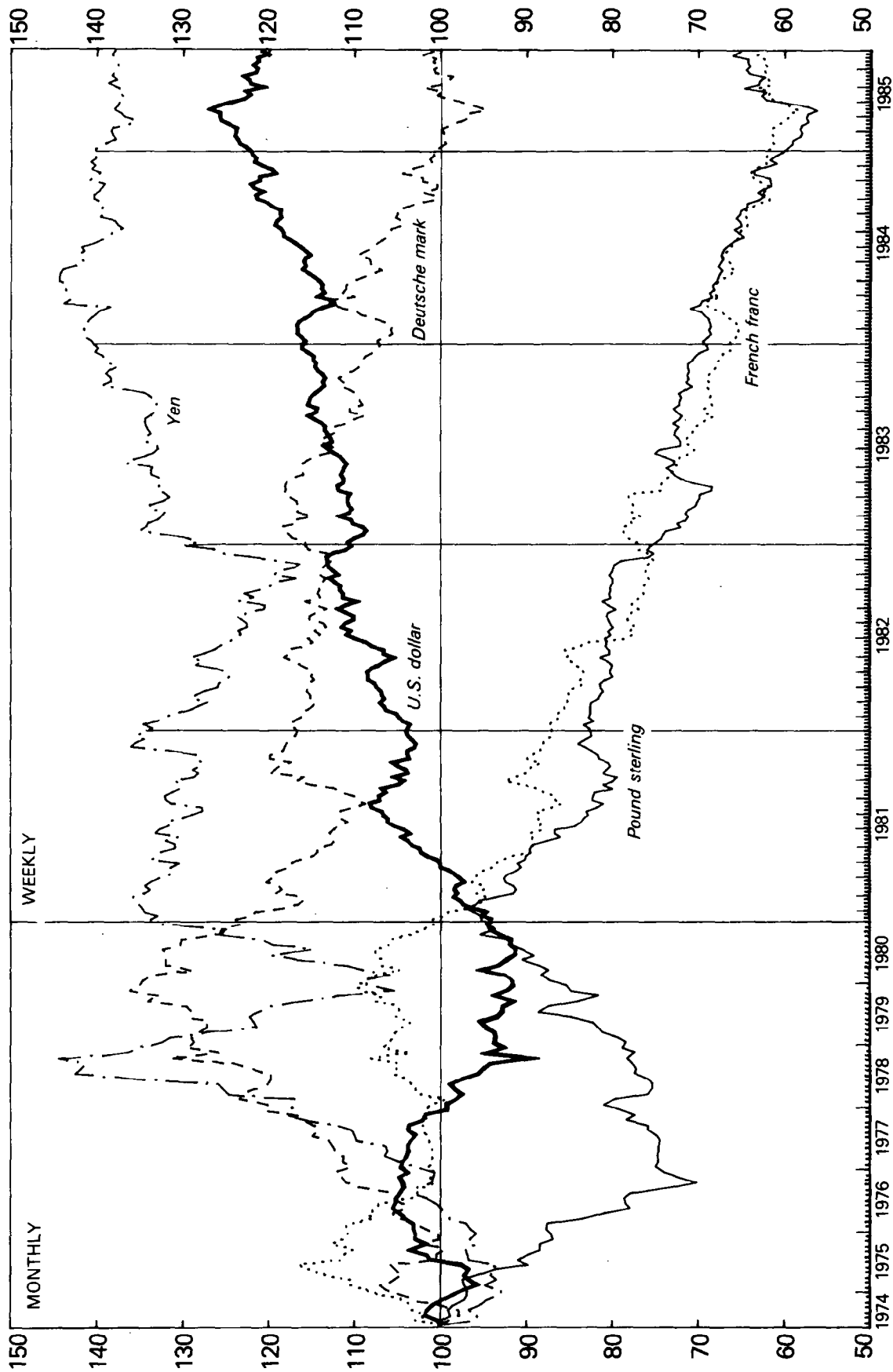
## DAILY CHANGES IN SPOT EXCHANGE RATES

(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  
JUNE 1974 - JUNE 1985  
(June 28, 1974=100)



# CHART 7 SHORT-TERM MONEY MARKET RATES

(Per cent per annum)

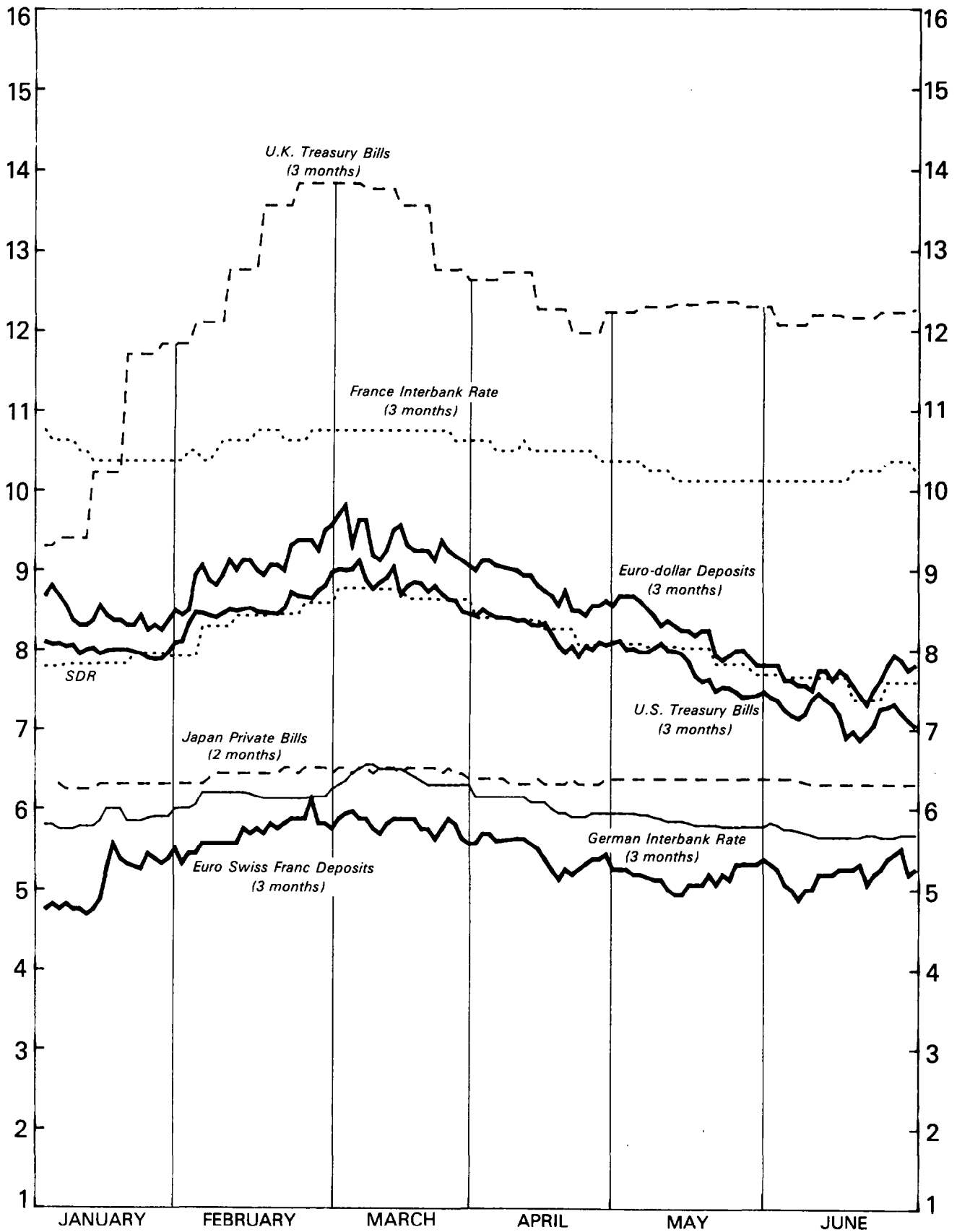


CHART 8  
**THREE-MONTH FORWARD RATES**  
Margins from Spot Rates based on noon quotations in New York  
(Per cent per annum)

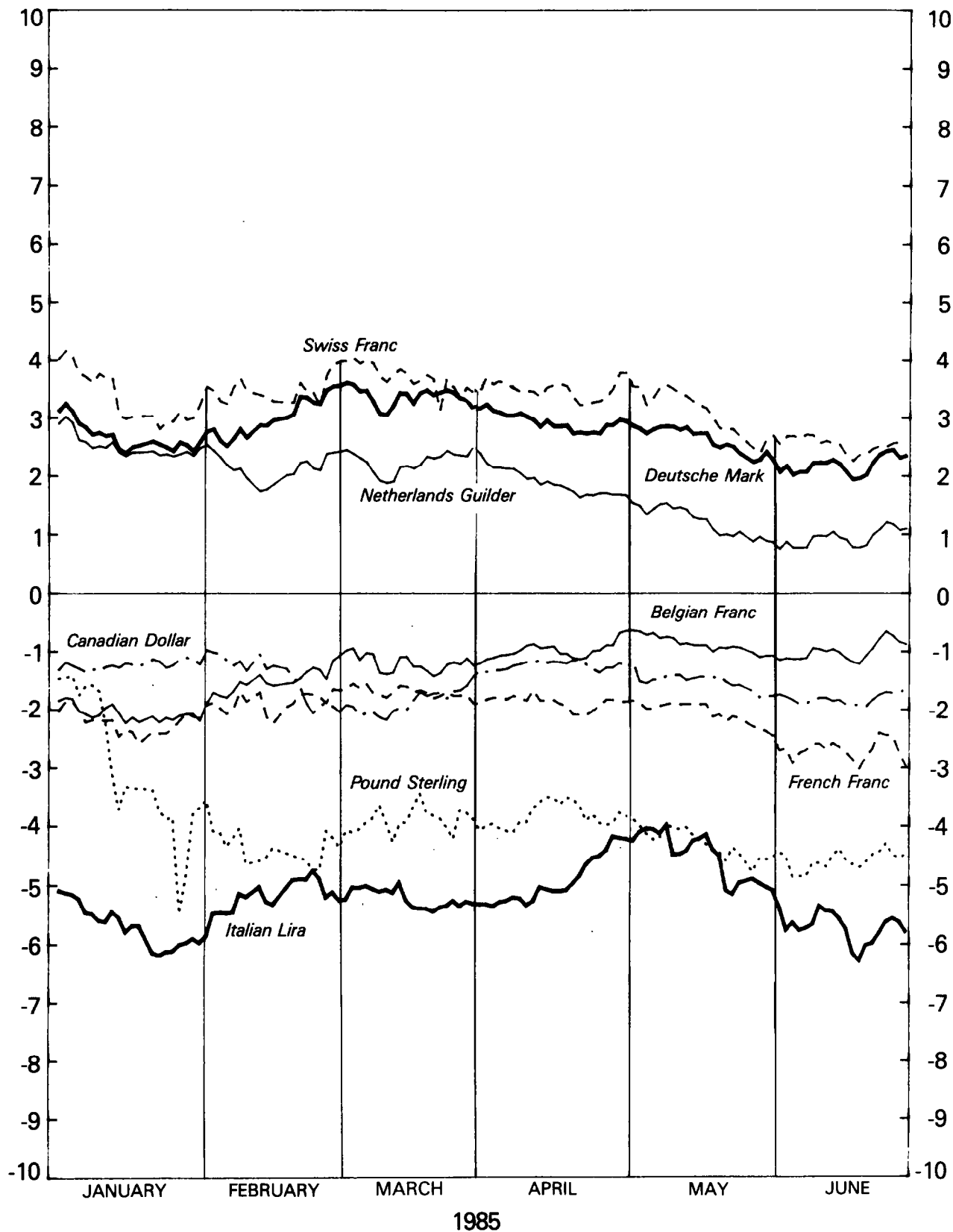




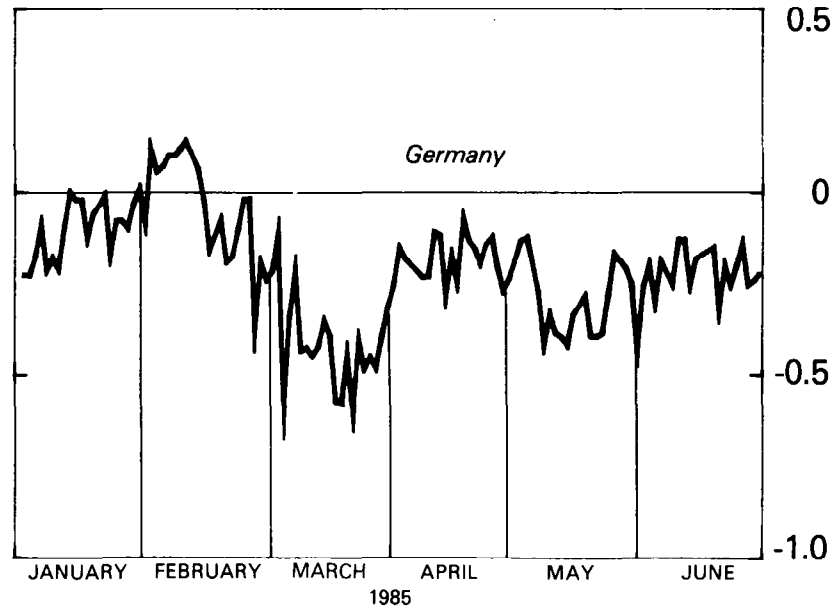
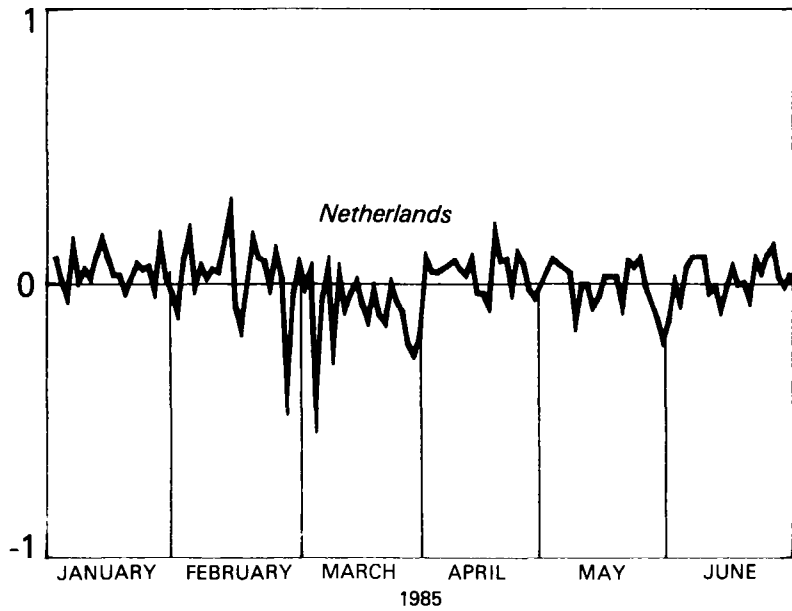
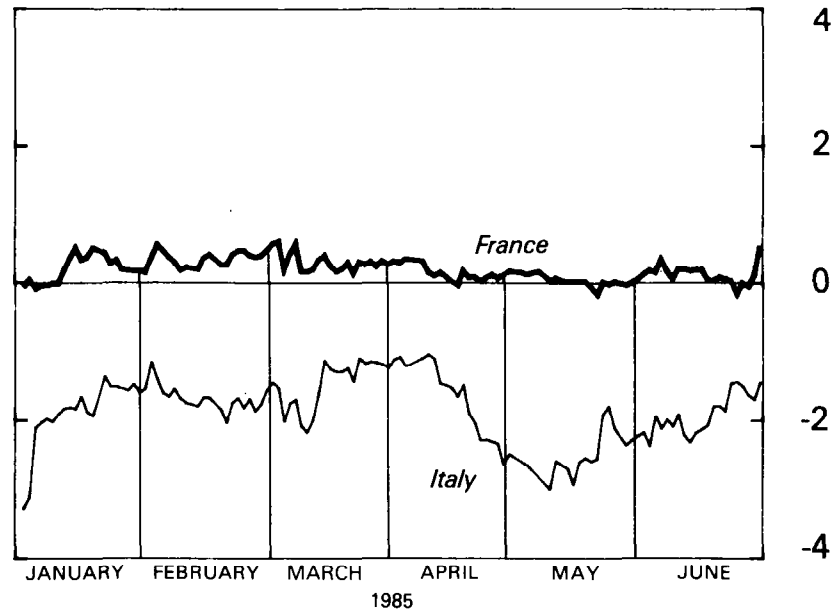
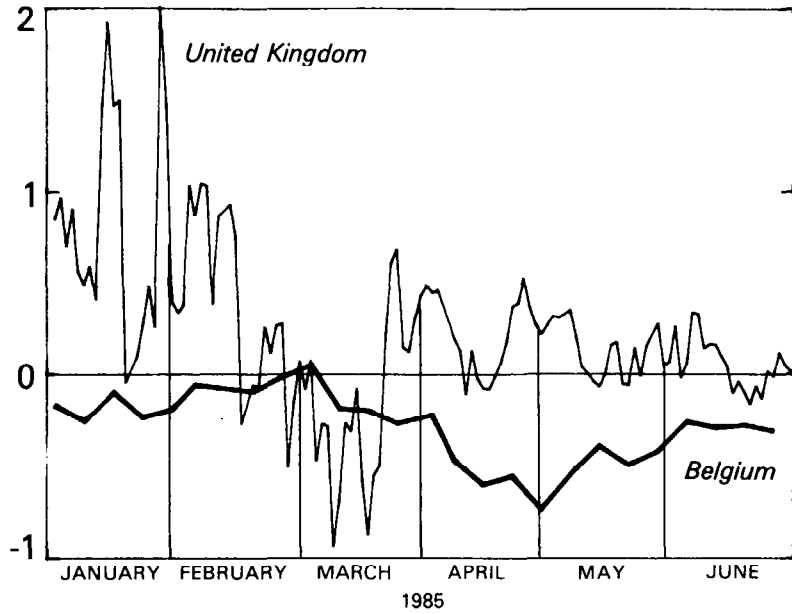




CHART 9

# 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, May-June 1985 <sup>1/</sup>

	M a y					J u n e			
	1	8	15	22	29	5	12	19	26
Austrian schilling	21.7575	22.4500	21.6675	21.6400	21.6300	21.5950	21.6550	21.2150	21.4050
Belgian franc									
Official	63.275	64.225	61.925	61.925	61.925	61.845	62.285	60.805	61.300
Financial	63.600	64.525	62.225	62.250	62.225	62.125	62.455	61.065	61.650
Canadian dollars	0.73070	0.72189	0.72815	0.73033	0.72411	0.72969	0.73033	0.73298	0.73392
Danish kroner	11.3575	11.4550	11.0700	11.0550	11.0600	11.0280	11.0840	10.8600	10.9270
Deutsche mark	3.14750	3.19275	3.07600	3.07825	3.07800	3.07300	3.08900	3.01950	3.04300
French francs	9.5975	9.7350	9.3825	9.3750	9.3862	9.3725	9.4075	9.2075	9.2755
Irish pounds	0.9943	0.9815	1.0188	1.0165	1.0175	1.0190	1.0141	1.0355	1.0294
Italian lire	2009.500	2026.000	1961.500	1963.000	1968.500	1960.000	1961.500	1928.000	1943.000
Japanese yen	252.650	253.200	250.950	250.700	251.700	249.400	249.810	247.450	248.425
Netherlands guilder	3.5580	3.6035	3.4770	3.4765	3.4715	3.4633	3.4785	3.4070	3.4288
Norwegian kroner	9.0400	9.1250	8.8710	8.8575	8.8525	8.8525	8.8750	8.7140	8.7810
Pounds sterling	1.2240	1.2083	1.2630	1.2640	1.2670	1.2570	1.2670	1.3070	1.2988
Swedish kroner	9.1075	9.1600	8.9030	8.9150	8.8950	8.8980	8.9290	8.7660	8.7900
Swiss francs	2.63750	2.68430	2.57950	2.58700	2.58850	2.58300	2.60025	2.52900	2.53350

<sup>1/</sup> 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)

	Domestic Money Markets 1/ (three-month)						Eurocurrency Markets 2/ (three-month)						Lending Rates		U.S. Treasury Securities (five-year) 5/ (15)
	United States (1)	Germany (2)	United Kingdom (3)	France (4)	Japan (5)	Combined rate (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)	
1984															
June	10.26	6.22	8.99	12.39	6.28	9.11	11.74	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	6.26	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	9.15	11.87	5.63	11.11	11.62	6.37	4.83	12.21	13.00	12.68
Sept.	10.79	5.90	10.25	11.21	6.39	9.42	11.73	5.58	10.87	11.35	6.39	5.11	12.01	12.97	12.53
Oct.	10.12	6.16	10.10	10.96	6.32	9.16	10.83	5.87	10.65	11.32	6.32	5.29	11.18	12.58	12.06
Nov.	8.92	6.04	9.50	10.69	6.43	8.32	9.56	5.76	9.91	11.12	6.42	5.07	9.90	11.77	11.33
Dec.	8.34	5.91	9.29	10.83	6.41	7.98	9.04	5.65	9.80	10.81	6.31	4.97	9.51	11.06	11.07
1985															
Jan.	8.02	5.95	10.61	10.60	6.29	7.89	8.44	5.77	11.64	10.71	6.31	5.12	8.91	10.61	10.93
Feb.	8.55	6.24	13.07	10.79	6.45	8.47	9.11	6.19	13.78	11.06	6.42	5.72	9.57	10.50	11.13
Mar.	8.82	6.48	13.45	10.88	6.48	8.70	9.36	6.18	13.62	11.11	6.41	5.80	10.04	10.50	11.52
Apr.	8.22	6.11	12.33	10.65	6.34	8.21	8.76	5.89	12.80	10.70	6.33	5.42	9.18	10.50	11.01
May	7.73	5.92	12.31	10.31	6.38	7.89	8.17	5.61	12.65	10.28	6.32	5.16	8.54	10.31	10.34
June	7.17	5.75	12.18	10.35	6.32	7.55	7.65	5.51	12.44	10.37	6.28	5.19	7.95	9.78	9.60
1984 Week ending:															
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	9.66	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	9.42	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	9.45	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
Sept. 7	11.05	5.92	10.20	11.28	6.37	9.55	12.01	5.50	10.95	11.36	6.38	4.79	12.35	13.00	12.84
14	10.80	5.92	10.34	11.33	6.35	9.44	11.82	5.56	10.78	11.34	6.38	5.02	12.13	13.00	12.55
21	10.71	5.88	10.19	11.13	6.40	9.37	11.60	5.62	10.91	11.34	6.40	5.33	11.83	13.00	12.34
28	10.65	5.90	10.28	11.10	6.44	9.35	11.46	5.65	10.85	11.36	6.41	5.33	11.75	13.00	12.46
Oct. 5	10.60	6.17	10.14	11.25	6.31	9.35	11.49	5.84	10.71	11.67	6.35	5.18	11.76	12.75	12.46
12	10.50	6.13	9.96	11.28	6.31	9.22	11.23	5.88	10.59	11.61	6.32	5.23	11.55	12.75	12.26
19	10.20	6.18	10.03	11.15	6.29	9.12	10.80	5.95	10.79	11.35	6.29	5.48	11.15	12.75	12.10
26	9.69	6.15	10.26	10.39	6.35	8.79	10.19	5.82	10.56	10.86	6.30	5.36	10.59	12.50	11.69
Nov. 2	9.44	6.13	10.06	10.39	6.38	8.64	10.09	5.85	10.53	10.97	6.34	5.11	10.43	12.29	11.58
9	8.96	6.10	9.77	10.54	6.38	8.36	9.75	5.76	10.03	11.05	6.43	4.88	10.03	12.00	11.47
16	8.99	6.08	9.59	10.75	6.41	8.37	9.66	5.85	9.91	11.14	6.41	5.10	9.99	11.79	11.53
23	8.65	5.99	9.26	10.77	6.46	8.27	9.51	5.77	9.74	11.30	6.46	5.24	9.88	11.75	11.21
30	8.71	5.93	9.21	10.77	6.51	8.19	9.16	5.64	9.77	11.08	6.40	5.06	9.60	11.68	11.09
Dec. 7	8.74	5.94	9.25	10.82	6.49	8.21	9.29	5.73	9.74	10.93	6.34	4.99	9.71	11.25	11.21
14	8.56	5.93	9.30	10.75	6.44	8.11	9.20	5.73	9.72	10.77	6.36	5.05	9.71	11.25	11.19
21	8.08	5.88	9.30	10.87	6.39	7.84	8.70	5.55	9.86	10.77	6.29	5.01	9.30	11.25	10.90
28	7.93	5.88	9.29	10.90	6.36	7.75	9.02	5.58	9.96	10.79	6.27	4.83	9.27	10.75	10.96
1985 Week ending:															
Jan. 4	8.09	5.86	9.33	10.81	6.31	7.83	8.73	5.61	10.27	10.72	6.19	4.77	9.27	10.75	11.16
11	8.01	5.85	9.57	10.67	6.25	7.79	8.39	5.60	10.23	10.60	6.22	4.75	8.94	10.75	11.07
18	7.99	6.02	10.52	10.52	6.31	7.87	8.41	5.90	12.05	10.81	6.33	5.28	8.93	10.68	11.01
25	7.91	5.96	11.74	10.52	6.31	7.91	8.31	5.77	12.17	10.77	6.39	5.35	8.75	10.50	10.70
Feb. 1	8.19	6.07	11.89	10.57	6.31	8.11	8.55	5.99	13.28	10.69	6.38	5.41	8.86	10.50	10.76
8	8.45	6.29	12.24	10.65	6.40	8.34	8.96	6.29	13.41	11.03	6.40	5.56	9.28	10.50	10.99
15	8.49	6.26	12.93	10.82	6.44	8.42	9.04	6.24	13.91	10.98	6.44	5.69	9.53	10.50	11.00
22	8.60	6.22	13.62	10.82	6.47	8.54	9.16	6.08	13.96	11.18	6.44	5.83	9.69	10.50	11.17
Mar. 1	8.77	6.26	13.84	10.87	6.50	8.66	9.41	6.15	14.07	11.14	6.43	5.88	10.02	10.50	11.47
8	9.00	6.52	13.82	10.90	6.50	8.83	8.61	6.31	14.01	11.33	6.43	5.91	10.40	10.50	11.51
15	8.85	6.60	13.73	10.90	6.48	8.75	9.33	6.31	13.59	11.15	6.43	5.80	10.01	10.50	11.54
22	8.81	6.45	13.41	10.90	6.51	8.70	9.24	6.09	13.32	11.01	6.42	5.78	9.93	10.50	11.60
29	8.58	6.39	12.74	10.82	6.44	8.50	9.20	6.00	13.47	10.95	6.38	5.73	9.78	10.50	11.43
Apr. 5	8.45	6.24	12.64	10.74	6.38	8.39	9.08	5.99	13.27	10.97	6.39	5.63	9.58	10.50	11.31
12	8.36	6.20	12.62	10.68	6.33	8.32	8.92	5.99	13.03	10.80	6.31	5.58	9.38	10.50	11.19
19	8.12	6.06	12.21	10.65	6.32	8.14	8.65	5.80	12.43	10.63	6.32	5.24	8.99	10.50	10.81
26	8.03	6.01	12.03	10.60	6.32	8.05	8.54	5.81	12.61	10.56	6.30	5.35	8.93	10.50	10.79
May 3	8.05	6.03	12.25	10.52	6.38	8.08	8.65	5.83	12.72	10.50	6.32	5.23	9.04	10.50	10.85
10	8.02	5.96	12.31	10.36	6.38	8.05	8.36	5.66	12.72	10.38	6.31	5.05	8.74	10.50	10.68
17	7.75	5.90	12.34	10.27	6.38	8.00	8.24	5.56	12.63	10.24	6.32	5.06	8.63	10.50	10.39
24	7.49	5.86	12.36	10.27	6.38	7.76	7.95	5.54	12.60	10.19	6.34	5.20	8.31	10.29	10.06
31	7.42	5.88	12.25	10.27	6.38	7.71	7.81	5.58	12.65	10.20	6.33	5.31	8.16	10.00	9.84
June 7	7.23	5.81	12.10	10.27	6.36	7.58	7.58	5.49	12.40	10.34	6.30	4.99	7.83	10.00	9.45
14	7.25	5.73	12.20	10.27	6.31	7.58	7.71	5.54	12.52	10.35	6.26	5.21	7.99	10.00	9.60
21	7.02	5.74	12.18	10.39	6.31	7.47	7.49	5.50	12.30	10.34	6.28	5.21	7.79	9.86	9.50
28	7.19	5.75	12.24	10.49	6.31	7.58	7.84	5.51	12.54	10.46	6.30	5.35	8.18	9.50	9.85

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 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). 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 money market 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).

