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INTERNATIONAL MONETARY FUND

Treasurer's Department

Foreign Exchange and Financial Markets in May 1985

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The foreign exchange market was characterized by nervous and erratic trading during May with the U.S. dollar on balance weakening against most major currencies over the month. The dollar's relative weakness was attributed mainly to declines in U.S. interest rates (including a cut in the Federal Reserve discount rate), further indications that U.S. economic growth had slowed down significantly, continued difficulties faced by a number of small privately insured U.S. savings banks, and indications of some progress by the Congress toward reducing U.S. Federal spending which was seen as having the potential to reduce interest rates in the future. The U.S. dollar eased by 0.23 percent in effective (MERM) terms and by 0.18 percent against the SDR; its 12-month effective (MERM) appreciation, however, remained substantial at 11.5 percent. The pound sterling strengthened the most among the other major currencies in May, principally reflecting high short-term interest rates in the United Kingdom: it firmed by 3.64 percent against the U.S. dollar and by 2.15 percent in effective (MERM) terms and was the only currency other than the U.S. dollar to record an effective (MERM) appreciation (0.5 percent) over the last 12 months. The Canadian dollar was the weakest of the major currencies, easing by 0.55 percent against the U.S. dollar and by 0.68 percent in effective (MERM) terms, attributed mainly to investor concern over the budget deficit (see Table 1 and Charts 1, 3, and 4).

The EMS currencies continued to remain free from speculative pressures from within the system; the spread in the narrow band of the parity grid remained well below the permitted maximum 2.25 percent margin. The Irish pound was at the top of the narrow band throughout the month, except for being replaced by the Danish krone on one occasion in late May, while the Belgian franc remained at the bottom, except on one occasion early in the month when it was replaced by the Netherlands guilder. The divergence indicator for the Irish pound exceeded its upper threshold on one occasion (see Chart 2). The Italian lira was the weakest of the EMS currencies and ended the month with a spread of

3.85 percent from the Irish pound. 1/ The Bank of Italy bought about \$70 million and DM 400 million at the fixings in Milan in the early part of the month, while intervention since then involved largely offsetting purchases and sales. The Bank of France was also reported to have bought unspecified amounts of Deutsche mark early in May in order to repay some of the debt to the EEC incurred two years ago, and the National Bank of Belgium bought modest amounts of foreign currencies during the month. The EMS currencies firmed by 1.10-1.71 percent against the U.S. dollar in May with the Italian lira firming the least and the Danish krone firming the most.

Table 1. Changes in Exchange Rates in May 1985 1/

(In percent)

	Monthly exchange rate changes			Changes in effective exchange rate since May 1984
	Against U.S. dollar <u>2/</u>	Against SDR <u>3/</u>	Effective exchange rate <u>4/</u>	
Belgium	+1.34	-0.09	-0.29	-0.89
Denmark	+1.71	+0.61	+0.43	-1.00
France	+1.21	+0.35	+0.70	-1.75
Germany	+1.29	-0.15	-0.34	-3.09
Ireland	+1.40	-0.25	-0.53	-1.37
Italy	+1.10	+0.02	-0.11	-6.27
Netherlands	+1.67	+0.77	+1.05	-2.29
Austria	+1.50	-0.17	-0.25	-3.29
Canada	-0.55	-0.70	-0.68	-1.15
Japan	+1.19	-0.02	-0.06	-2.19
Norway	+1.45	+0.38	+0.19	-4.51
Sweden	+1.61	+0.29	+0.15	-0.94
Switzerland	+0.97	-1.00	-1.03	-5.32
United Kingdom	+3.64	+2.16	+2.15	+0.53
United States	--	-0.18	-0.23	+11.53

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 6.0 percent above (below) the weakest (strongest) currency in the narrow band.

The volatility of exchange rates against the U.S. dollar, as indicated by certain measures in Table 2, remained substantial even though, as in the previous month, the changes in quotations over the month were not very large. The high-low spreads for the EMS currencies declined to 5.1-6.2 percent from 6.1-6.8 percent in April and those for other currencies also declined by similar margins. The largest spread continued to be recorded by the pound sterling and the smallest by the Canadian dollar and the Japanese yen. The averages of absolute daily percentage changes (MAC in Table 2 and Chart 5) declined for most major currencies except for the Irish pound and the Swiss franc: the average for the EMS currencies declined marginally to 0.83 percent from 0.84 percent in April while that for the other currencies declined to 0.64 percent from 0.70 percent. As with the high-low spread measure, the pound sterling was the most volatile currency on this measure in May while the Canadian dollar and the Japanese yen were the least volatile.

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

	May 2/		High-low spread in percent 3/		MAC 4/	
	High	Low	Apr.	May	Apr.	May
Belgium	61.190	64.750	6.4	5.8	0.86	0.86
Denmark	10.9000	11.585	6.3	6.3	0.85	0.83
France	9.2600	9.82125	6.8	6.1	0.86	0.85
Germany	3.0350	3.2210	6.7	6.1	0.88	0.88
Ireland	1.0315	0.9715	6.8	6.2	0.84	0.91
Italy	1,944.0	2,042.5	6.1	5.1	0.76	0.64
Netherlands	3.4285	3.6365	6.4	6.1	0.86	0.86
Austria	21.3225	22.620	6.5	6.1	0.84	0.77
Canada	0.73134	0.72189	1.9	1.3	0.23	0.21
Japan	249.55	254.50	3.3	2.0	0.39	0.31
Norway	8.7670	9.2200	5.3	5.2	0.75	0.69
Sweden	8.8200	9.2450	4.7	4.8	0.67	0.63
Switzerland	2.5655	2.7095	8.5	5.6	0.89	0.90
United Kingdom	1.2870	1.1890	8.4	8.2	1.10	0.99

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.

Moderate changes were recorded in gross foreign exchange reserves by the major industrial countries in May with most of the countries with available data recording increases in reserves. The largest increases were recorded by Germany and Italy while Canada recorded the only significant decline. Major changes over the past 12 months were substantial declines for Germany and the Netherlands and similar increases for Norway, Japan, and France (see Table 3). The Federal Reserve Bank of New York recently revealed that it intervened on the exchange markets on six occasions earlier this year, mostly in February, buying \$580 million worth of foreign currencies comprising the Deutsche mark (\$466 million), the Japanese yen (\$98 million), and the pound sterling (\$17 million).

Table 3. Foreign Exchange Reserves in May 1985 ^{1/}
(In millions of U.S. dollars)

	End-month reserve level	Change in May	Change over 12 months
Belgium	4,138	+335	+964
Denmark	3,554	+491	+445
France (April)	20,222	+620	+1,287
Germany	33,781	+952	-5,678
Ireland (April)	2,978	+254	+549
Italy	17,617	+723	+96
Netherlands	7,522	+118	-1,058
Austria	3,143	-67	-448
Canada	1,678	-307	-416
Japan	23,191	+409	+2,041
Norway	11,065	+269	+4,084
Sweden	3,865	-45	-150
Switzerland	12,402	+211	+150
United Kingdom	7,469	-7	-311
United States	7,158	+109	+728

^{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 in May

The U.S. dollar eased by 0.23 percent in effective (MERM) terms and 0.18 percent against the SDR amid continued fluctuations in quotations against other major currencies. The dollar firmed strongly in active trading in the first three days of May but then generally eased through to midmonth, occasionally sharply; for example the dollar eased against the European currencies by over 2.0 percent on May 9 and by about 1.5 percent on May 13. Movements in the value of the dollar were erratic and basically trendless for the remainder of the month in mostly quiet trading. The easing tendency of the dollar was attributed mainly to declines in U.S. interest rates (see Section II) amid indications that the U.S. economic growth was slowing down significantly. The first quarter real GNP growth was revised downward from 1.3 percent estimated earlier to an annual rate of 0.7 percent while the GNP deflator's rise was revised upward to an annual rate of 5.6 percent from 5.3 percent. The index of leading economic indicators fell 0.2 percent in April but the previously indicated decline for March was revised to an increase of 0.1 percent. Industrial production, seasonally adjusted, fell by 0.2 percent in April after rising by 0.3 percent in March and was up only 2.0 percent year-on-year while industrial capacity utilization declined to a rate of 80.6 percent in April from 81.1 percent in March. The civilian unemployment rate was unchanged in May at 7.3 percent; the rate has been 7.3 percent for four consecutive months although the number of persons employed continued to rise. The trade deficit widened to \$11.85 billion in April from \$11.05 billion in March but was essentially unchanged from April 1984.

The Deutsche mark firmed by 1.29 percent against the U.S. dollar but eased by 0.34 percent in effective (MERM) terms amid large fluctuations in the month. The range within which the currency was traded against the U.S. dollar in May was substantially larger at 6.1 percent than the end-month to end-month change. Germany's industrial production, seasonally adjusted, declined by 0.4 percent but was up by 4.3 percent year-on-year. The unemployment rate, however, declined to 8.8 percent in May from 9.3 percent in April due mainly to seasonal factors. The current account surplus widened to DM 3.7 billion in April from a downward-revised DM 2.6 billion in March and DM 200 million in April 1984. The inflation rate continued to be moderate; the producer price index rose by 0.2 percent in April and 2.8 percent year-on-year while the wholesale price index fell by 0.3 percent but was up by 1.9 percent over April 1984.

The French franc firmed by 1.21 percent against the U.S. dollar and by 0.70 percent in effective (MERM) terms. France's industrial production, seasonally adjusted, rose by 0.8 percent in March, following a rise of 3.9 percent in February; the index was unchanged year-on-year. The number of persons unemployed on a seasonally adjusted basis fell by 1.2 percent in March, the third consecutive monthly

decline. The trade deficit, seasonally adjusted, however, widened sharply to F 4.2 billion in April from F 567 million in March. Industrial wholesale prices were unchanged in April but rose 6.5 percent year-on-year.

The Belgian franc firmed by 1.34 percent against the U.S. dollar but eased by 0.29 percent in effective (MERM) terms; the currency remained the weakest in the narrow band of the EMS, except on one occasion early in the month. Belgium's unemployment rate declined to 12.5 percent at end-May from 13.0 percent at end-April and 13.1 percent at end-May 1984. Industrial production rose by 2.9 percent in March and was up 5.7 percent year-on-year. The wholesale price index fell by 0.1 percent in April but rose 1.2 percent year-on-year.

The Netherlands guilder firmed by 1.67 percent against the U.S. dollar and by 1.05 percent in effective (MERM) terms. The Netherlands industrial production, seasonally adjusted, rose by 1.9 percent in March and by 3.9 percent year-on-year. The number of persons unemployed, seasonally adjusted, declined by 0.2 percent in May and by 8.7 percent year-on-year. The trade surplus narrowed to f. 600 million in March from f. 1.4 billion in February and f. 2.1 billion in March 1984. The consumer price index rose by 0.1 percent in May and was up 2.6 percent year-on-year.

The Danish krone firmed by 1.71 percent against the U.S. dollar and by 0.43 percent in effective (MERM) terms. Denmark's unemployment rate, seasonally adjusted, declined to 9.7 percent in April from 9.8 percent in March. The trade deficit narrowed to DKr 1.57 billion in April from DKr 2.03 billion in March but widened from DKr 1.11 billion recorded in April 1984.

The Irish pound firmed by 1.40 percent against the U.S. dollar but eased 0.53 percent in effective (MERM) terms. The currency was the strongest in the EMS throughout May except for one occasion late in the month. Ireland's unemployment rate declined to 16.7 percent in May from 17.0 percent in April but was up from 15.7 percent recorded in May 1984. The wholesale price index rose by 0.9 percent in February and by 5.5 percent year-on-year.

The Italian lira firmed by 1.10 percent against the U.S. dollar but eased by 0.11 percent in effective (MERM) terms. The lira was the weakest currency in the EMS, trading significantly below the currencies in the narrow band of the parity grid; it ended the month with a spread of 3.85 percent from the Irish pound, compared with the maximum permitted spread of 6.0 percent. Italy's industrial production rose by 7.8 percent year-on-year in April, compared with a 3.1 percent year-on-year increase in March. The trade deficit narrowed to Lit 2,383 billion in March from Lit 3,157 billion in February but widened from Lit 1,769 billion recorded in March 1984. The wholesale price index rose by 1.6 percent in March and was up 8.9 percent year-on-year.

The pound sterling was the strongest major currency in May largely because of favorable short-term interest rate differentials; it firmed by 3.64 percent against the U.S. dollar and by 2.15 percent in effective (MERM) terms. The U.K. unemployment rate, seasonally adjusted, was unchanged at 13.1 percent in May while industrial production, seasonally adjusted, rose 1.9 percent in March and was up 3.7 percent year-on-year. The current account, seasonally adjusted, swung into a surplus of £123 million in April from a deficit of £555 million in March. The Public Sector Borrowing Requirement narrowed to £1.79 billion in April from £2.4 billion in April 1984. The producer price index rose 0.2 percent in May and 5.6 percent year-on-year while input costs fell 1.1 percent but rose 3.6 percent over May 1984.

The Swiss franc firmed by 0.97 percent against the U.S. dollar but eased by 1.03 percent in effective (MERM) terms. Switzerland's unemployment rate was unchanged at 1.1 percent in April while the wholesale price index rose by 0.1 percent in April and by 3.4 percent year-on-year.

The Japanese yen firmed by 1.19 percent against the U.S. dollar but was essentially unchanged in effective (MERM) terms. Japan's industrial production (revised) declined by 1.4 percent in March but was 5.2 percent higher year-on-year; the preliminary measurement for April shows a rise of 3.0 percent for a 7.3 percent year-on-year rise. The unemployment rate eased to 2.4 percent in April from 2.6 percent in March. The current account surplus, seasonally adjusted, widened to \$4.13 billion in April from \$3.46 billion in March, and the trade surplus in May widened to \$3.36 billion from \$3.26 billion in April and \$1.85 billion recorded in May 1984.

The Canadian dollar was the weakest major currency in May mainly because of investor concern about the budget deficit which widened to Can\$3.29 billion in March from Can\$2.87 billion recorded in March 1984. The Government announced proposals to reduce the deficit to Can\$33.8 billion in the current fiscal year from the earlier expectation of Can\$38 billion. The currency eased by 0.55 percent against the U.S. dollar and by 0.68 percent in effective (MERM) terms. Canada's index of leading economic indicators fell 0.4 percent in February, the seventh consecutive monthly decline. The economy, however, continues to show signs of growth; GDP rose 0.3 percent in March following a rise of 0.2 percent in each of the two preceeding months and the unemployment rate declined to 10.5 percent in May from 10.9 percent in April. The trade surplus, seasonally adjusted, narrowed to Can\$2.15 billion in April from Can\$2.23 billion in March. Industrial selling prices rose 0.3 percent in March and were up 4.5 percent year-on-year.

The Austrian schilling firmed by 1.50 percent against the U.S. dollar but eased by 0.25 percent in effective (MERM) terms. Austria's current account deficit widened in April to S 4.7 billion from S 2.5 billion recorded in April 1984. The wholesale price index fell 2.8

percent in May but was up 2.4 percent year-on-year. The Norwegian krone firmed by 1.45 percent against the U.S. dollar and by 0.19 percent in effective (MERM) terms. Norway's unemployment rate declined to 2.7 percent in May from 3.3 percent in April and 3.5 percent in May 1984. The trade surplus widened to Nkr 3.48 billion in May from Nkr 2.55 billion in May 1984. The wholesale price index rose by 0.6 percent in April and was up 6.3 percent year-on-year. The Swedish krona firmed by 1.61 percent against the U.S. dollar and by 0.15 percent in effective (MERM) terms. Sweden adopted a package of economic measures, including sharply higher interest rates to moderate domestic spending in order to help reduce the large current account deficit. The unemployment rate fell to 2.6 percent in May from 2.7 percent in April while industrial production, seasonally adjusted, rose by 4.0 percent in March and was up 8.9 percent year-on-year. The producer price index rose by 0.5 percent in April and was up by 6.9 percent year-on-year.

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

Money market conditions continued to ease in most of the major industrial countries in May with short-term interest rates easing in most major countries. The decline in short-term interest rates was particularly pronounced in the United States compared to other countries, with the Federal Reserve cutting its discount rate by one-half percentage point in May. Belgium and France also lowered their official rates.

Short-term interest rates in the United States eased markedly in May, the third consecutive month of decline. The Federal Reserve eased its monetary policy in the face of a significant slowdown in the economy, particularly in the industrial sector, lowering its discount rate on May 17 from 8 percent to 7.5 percent. As noted earlier, the revised U.S. real GNP data released on May 21 put first quarter growth, seasonally adjusted, at a 0.7 percent annual rate, lower than the 1.3 percent growth previously reported and the preliminary "flash" estimate of 2.1 percent; additional statistics released in May tended to indicate that economic growth could be quite sluggish in the second quarter as well. Other factors which exerted a downward influence on interest rates were signs of progress by the U.S. Congress in reducing the size of the U.S. Federal budget deficit and concerns about the soundness of the U.S. thrift industry. The Federal funds rate, which was mostly above 8 percent before the discount rate cut, fell to 7.54-7.87 percent over the May 20 to May 31 period. For May as a whole the average Federal funds rate was 7.97 percent compared with an average rate of 8.27 percent in the previous month. The yield on three-month U.S. Treasury bills fell from 8.12 percent at the end of April to 7.37 percent at the end of May. The rate on 90-day CDs eased similarly in May, falling from 8.33 percent at end-April to 7.55 percent at end-May.

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>		April	May
Austria	May/Apr.	2.4	(4.6)	3.8	(3.6)	4.50	4.50
Belgium	Apr./May	1.2	(1.7)	5.3	(5.5)	10.10	9.30
Canada	Mar./Apr.	4.5	(4.8)	3.9	(3.7)	9.85	9.44
Denmark	April	4.8	(6.0)	5.8	(5.7)	7.00	7.00
France	Mar./May	8.2	(9.0)	6.5	(6.5)	10.52	10.27
Germany	Mar./May	2.6	(1.5)	2.5	(2.5)	6.03	5.88
Italy	Mar./May	8.9	(7.9)	8.8	(8.8)	15.38	15.06
Japan	April	0.6	(0.9)	1.9	(1.6)	6.38	6.38
Netherlands	Dec./May	3.7	(4.1)	2.6	(2.5)	6.94	6.94
Norway	Apr./May	6.3	(6.0)	5.7	(5.4)	8.00	8.00
Sweden	April	6.9	(7.3)	7.8	(8.1)	9.50	11.50
Switzerland	Apr./May	3.4	(3.5)	3.8	(3.6)	5.25	5.25
United Kingdom	May/Apr.	5.6	(5.7)	6.9	(6.1)	12.24	12.07
United States	April	0.7	(0.3)	3.7	(4.0)	8.12	7.37

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.

In line with a marked decline in money market rates, one major U.S. commercial bank cut its prime lending rate from 10.5 percent to 10 percent on May 16 while other banks followed suit after the Federal Reserve cut the discount rate. Yields on U.S. Treasury securities with maturities from one year to ten years also eased significantly, declining by 0.99-1.33 percent, with the five-year constant maturity rate falling sharply from 10.91 percent at end-April to 9.58 percent at end-May. The M1 measure of the U.S. money supply, seasonally adjusted, averaged \$584.9 billion in the week ended May 27 compared with \$575.5 billion in the week ended April 29. The annual growth rate from the fourth quarter base period was about 10.5 percent, well above the 4-7 percent target range for the year.

Among the countries participating in the exchange arrangements of the European Monetary System, short-term interest rates in May continued to ease in France, Belgium and Germany. The three-month interbank money rate in France eased by 0.25 percentage point in May to close the month at 10.27 percent, thus extending the 0.38 percentage point decline over the previous two months. The Bank of France cut its money market intervention rate on May 13 to 10.125 percent from 10.25 percent, after the central bank's daily call money rate fell to 10 percent on the previous working day for the first time since July 1979. The relative strength of the French franc within the European Monetary System helped facilitate the drop in French interest rates. Over the week that followed the intervention rate cut, French commercial banks reduced their base lending rate by 0.25 percentage point to 11.25 percent. The last reduction in their base rate was in January when it was lowered by 0.50 percentage point to 11.50 percent while the last cut in the Bank of France's money market intervention rate was in late April when the rate was cut by 0.25 percentage point to 10.25 percent. Short-term interest rates also continued to ease in Belgium for the third consecutive month. The Belgian National Bank lowered its discount rate by 1.25 percentage points to 9.75 percent and its Lombard rate by 1.75 percentage points to 10.25 percent, effective May 9. The change in the discount rate coincided with the introduction of a new system aimed at making the rate more flexible and tying it more to market conditions. Under the new system, the discount rate will be fixed each Wednesday on the basis of the interest rate on three-month Treasury certificates on the previous day. The Bank has also been authorized to vary the discount rate between certain fixed limits (unpublished) during the week, if changes in short-term money market rates make it necessary. On May 14, the interest rate on three-month Treasury certificates was cut by 0.25 percentage point to 9.25 percent, followed by an announcement the next day that the central bank would cut its discount and Lombard rates by 0.25 percentage point to 9.5 percent and 10 percent respectively, effective May 20. During the last week of May, the rate on three-month Treasury certificates was again cut by 0.25 percentage point to 9 percent, and the discount and Lombard rates would be lowered by the same margin, to 9.25 percent and 9.75 percent respectively, effective June 3. The rate on four-month Fonds des Rentes certificates was also cut four times

during May, first by 0.50 percentage point, followed by 0.10 percentage point, 0.20 percentage point, and finally by 0.05 percentage point to close the month at 9.25 percent. In Germany, the three-month interbank deposit rate fell by 0.15 percentage point in May to close the month at 5.88 percent, compared with the 0.36 percentage point decline in the previous month. Germany's central bank money stock, seasonally adjusted, grew at a 4.3 percent annual rate through May from the fourth quarter of 1984 base period, within the 3-5 percent target range through the fourth quarter of 1985.

Among the other major countries, short-term interest rates eased in Canada and the United Kingdom but were unchanged in Japan. The rate for two-month (private) bills in Japan was 6.38 percent at the end of May, unchanged from the level at the end of the previous two months. Toward the end of May, however, Japanese long-term lending institutions announced a cut in their long-term prime rate to 7.5 percent from 7.7 percent; the last prime rate change was a 0.3 percentage point increase to 7.7 percent announced at the end of March. Japan's broadly defined money supply M2 + CDs rose 8.4 percent in April from its year-earlier level, after a 7.9 percent year-on-year rise in March. In Canada, the three-month Treasury bill rate fell from 9.85 percent at the end of April to 9.44 percent at the end of May; this was the third consecutive monthly fall in this rate. Some major Canadian banks lowered their prime lending rate by 0.25 percentage point to 10.5 percent, effective May 22. The three-month Treasury bill rate in the United Kingdom firmed moderately through most of May, rising from 12.24 percent at end-April to 12.30 percent on May 30, but declined then to 12.07 percent on the last day of the month for a 0.17 percentage point drop in May. The three-month U.K. interbank rate eased more steadily over the month from 12.75 percent at end-April to 12.56 percent at end-May. The latest Bank of England data (released in June) show that sterling M3, seasonally adjusted, rose by 0.5 percent in the four weeks to May 15, following a 2.9 percent rise in the four weeks to April 17. The year-on-year growth rate was 11.75 percent in banking May, compared with a 12 percent increase in banking April. The target for the 1985/86 year ending in March 1986 is 5-9 percent growth.

In other domestic interest rate developments, major Swiss banks cut their customer time deposit rates by 0.25 percentage point to 4.5 percent, effective May 10. Sweden's central bank raised its discount rate by two percentage points to 11.5 percent and also raised its penalty borrowing rate by two and a half percentage points to 16 percent, with effect from May 14. The rates were raised previously on June 29, 1984 by one percentage point and two percentage points, respectively, and the recent increase in official rates was reportedly designed to achieve a rise in interest rates in general, curb domestic consumption, and help curb the deterioration in the current account.

In the eurocurrency markets, three-month interest rates eased for most major currencies in May. The eurodollar rate fell by 0.88 percentage point to 7.81 percent which was significantly larger than the declines in other eurocurrency rates. The euro-Deutsche mark and euro-French franc rates eased by 0.32 percentage point and 0.25 percentage point, respectively, to 5.56 percent and 10.31 percent, followed by the euro-sterling rate which eased by 0.12 percentage point to 12.63 percent. The euro-yen rate firmed slightly, however, to 6.34 percent at end-May from 6.31 percent at end-April while the euro-Swiss franc rate at 5.25 percent was unchanged.

As a result of the movements of eurodollar and domestic interest rates from the end of April to the end of May, the uncovered interest differentials favoring eurodollar investment narrowed for Germany, Japan, and the Netherlands. Those favoring domestic investments widened for Belgium, France, Italy, and the United Kingdom (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)	
	April	May	April	May	April	May
Belgium	-1.41	-1.49	-0.68	-1.07	-0.73	-0.42
France	-1.83	-2.46	-1.86	-2.45	+0.03	-0.01
Germany	+2.66	+1.93	+2.98	+2.27	-0.32	-0.34
Italy	-6.69	-7.25	-4.20	-5.08	-2.49	-2.17
Japan	+2.31	+1.43	+2.50	+1.50	-0.19	-0.07
Netherlands	+1.75	+0.87	+1.68	+0.87	+0.07	--
United Kingdom	-3.55	-4.26	-3.77	-4.52	+0.22	+0.26

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

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

The SDR interest rate fell steadily to 7.70 percent for the week beginning May 27 from 8.09 percent for the week beginning April 29 (see Table 6). The three-month U.S. Treasury bill rate posted the largest decline, easing by 0.66 percentage point. Yields on the relevant instruments for France and Germany also eased, by 0.25 percentage point and 0.17 percentage point, respectively, while the yield on the relevant Japanese instrument was unchanged. The three-month U.K. Treasury bill rate firmed slightly by 0.07 percentage point. The rate of remuneration paid on creditor positions in the Fund (91.66 percent of the SDR interest rate) fell to 7.06 percent in the last week of May from 7.42 percent in the first five days of that month; the rate of remuneration rose from 7.28 percent in the last two days of April to 7.42 percent in the first five days of May as a result of raising the remuneration coefficient from 90 percent to 91.66 percent, effective May 1.

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

	April 29	May			
		6	13	20	27
SDR interest rate	8.09	8.05	8.03	7.83	7.70
Rate of remuneration	7.42 ^{2/}	7.38	7.36	7.18	7.06

^{1/} The rates apply to the weeks beginning with the dates indicated above.

^{2/} The 7.42 percent applies for May 1-5 only. The rate for April 29-30 was 7.28 percent.

Combined domestic interest rates for various maturities eased by 0.29-0.50 percentage point (see Table 7). Yields on the relevant instruments in the United States eased markedly by 0.53-0.87 percentage point while those in Germany and France eased by 0.15-0.48 percentage point and 0.19-0.38 percentage point respectively. In the United Kingdom, yields on the relevant instruments, however, firmed by 0.24-0.39 percentage point and Japanese rates were narrowly mixed, moving within a range of -0.12 to +0.07 percentage point.

Combined eurocurrency offered rates eased by 0.50 percentage point. Eurodollar rates eased by 0.75-0.81 percentage point, while euro-Deutsche mark and euro-French franc rates eased by 0.25-0.31 percentage point and 0.44-0.50 percentage point respectively. Euro-sterling rates firmed, however, by 0.13-0.25 percentage point, and the six-month euro-yen rate firmed by 0.06 percentage point; the three-month euro-yen rate was unchanged.

Average interest rates on SDR-denominated deposits of selected commercial banks eased by 0.39-0.55 percentage point. Average deposit rates in May ranged from 7.69 percent for one-month deposits to 8.19 percent for 12-month deposits.

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

	April	May
Combined market interest rates: <u>2/</u>		
a. Based on domestic rates		
3-month maturity (Rule T-1)	8.04	7.75
6-month maturity	8.38	7.94
12-month maturity	8.56	8.13
2-1/2 year maturity	9.38	8.88
5-year maturity	9.75	9.25
b. Based on eurocurrency offered rates		
3-month maturity	8.50	8.00
6-month maturity	8.75	8.25
Average commercial bank deposit rates <u>3/</u>		
1-month deposits	8.08	7.69
3-month deposits	8.23	7.79
6-month deposits	8.38	7.95
12-month deposits	8.74	8.19

1/ Rates pertain to last Wednesday of the month.

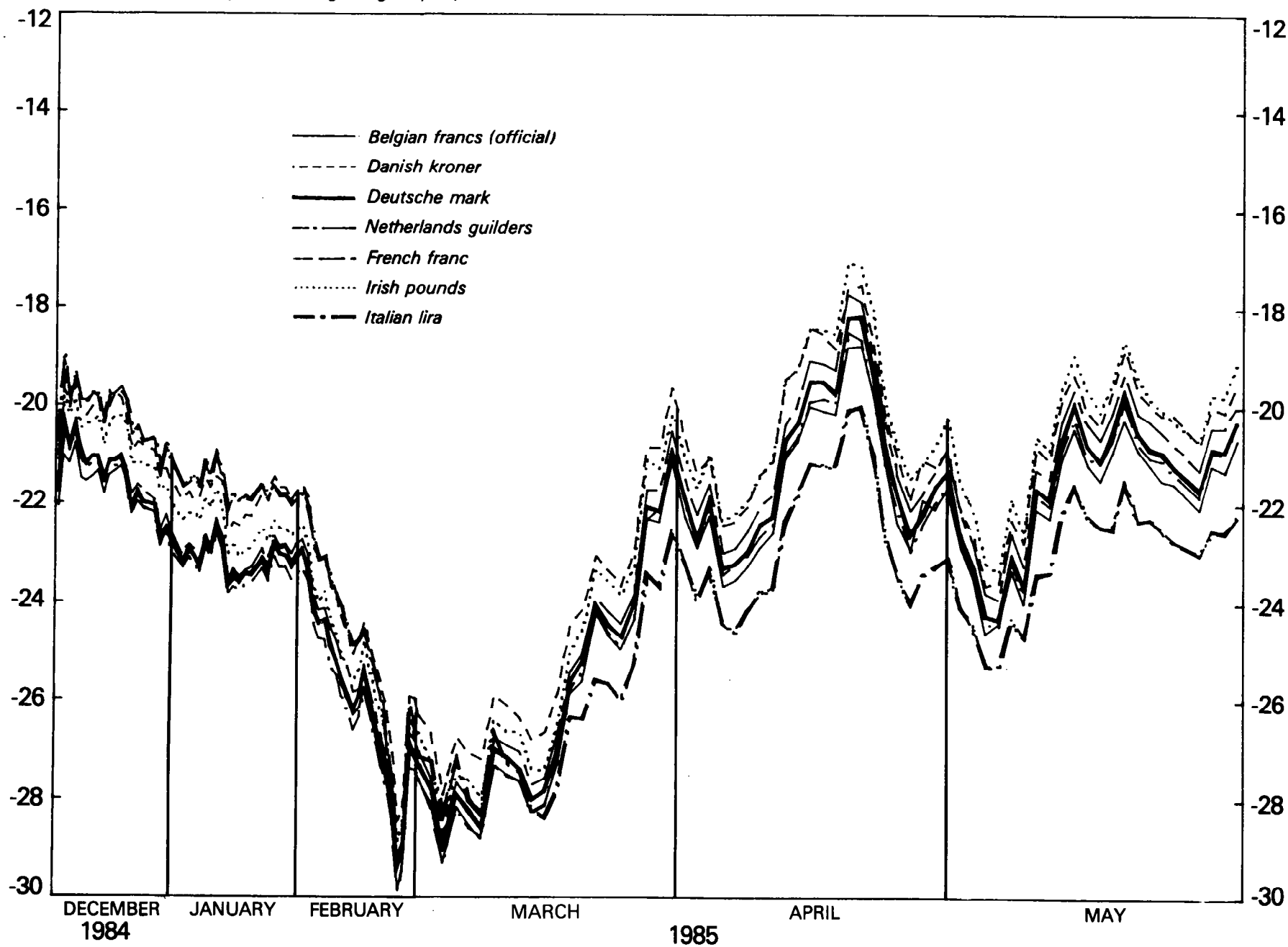
2/ Combined market rates (according to the Rule T-1) are calculated by multiplying the yields or rates of each of the respective instruments by the number of units of the corresponding currency listed in Rule 0-1 and the value in terms of the SDR of a unit of that currency as determined by the Fund under 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.

CHART 1

SPOT EXCHANGE RATES: EUROPEAN MONETARY SYSTEM

(Based on noon quotations in New York)

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

¹Effective 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)

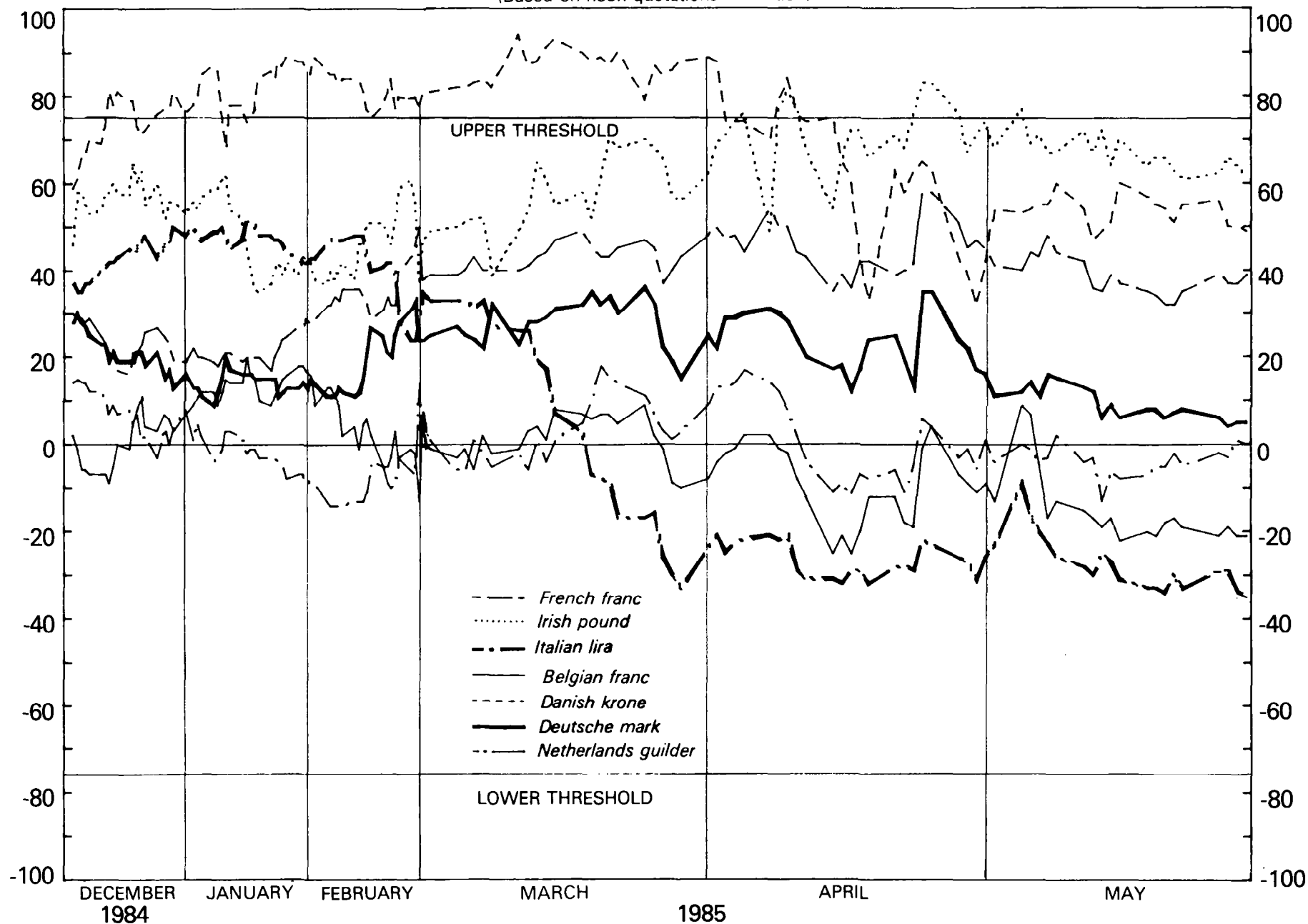


CHART 3 SPOT EXCHANGE RATES

(Noon quotations in New York)

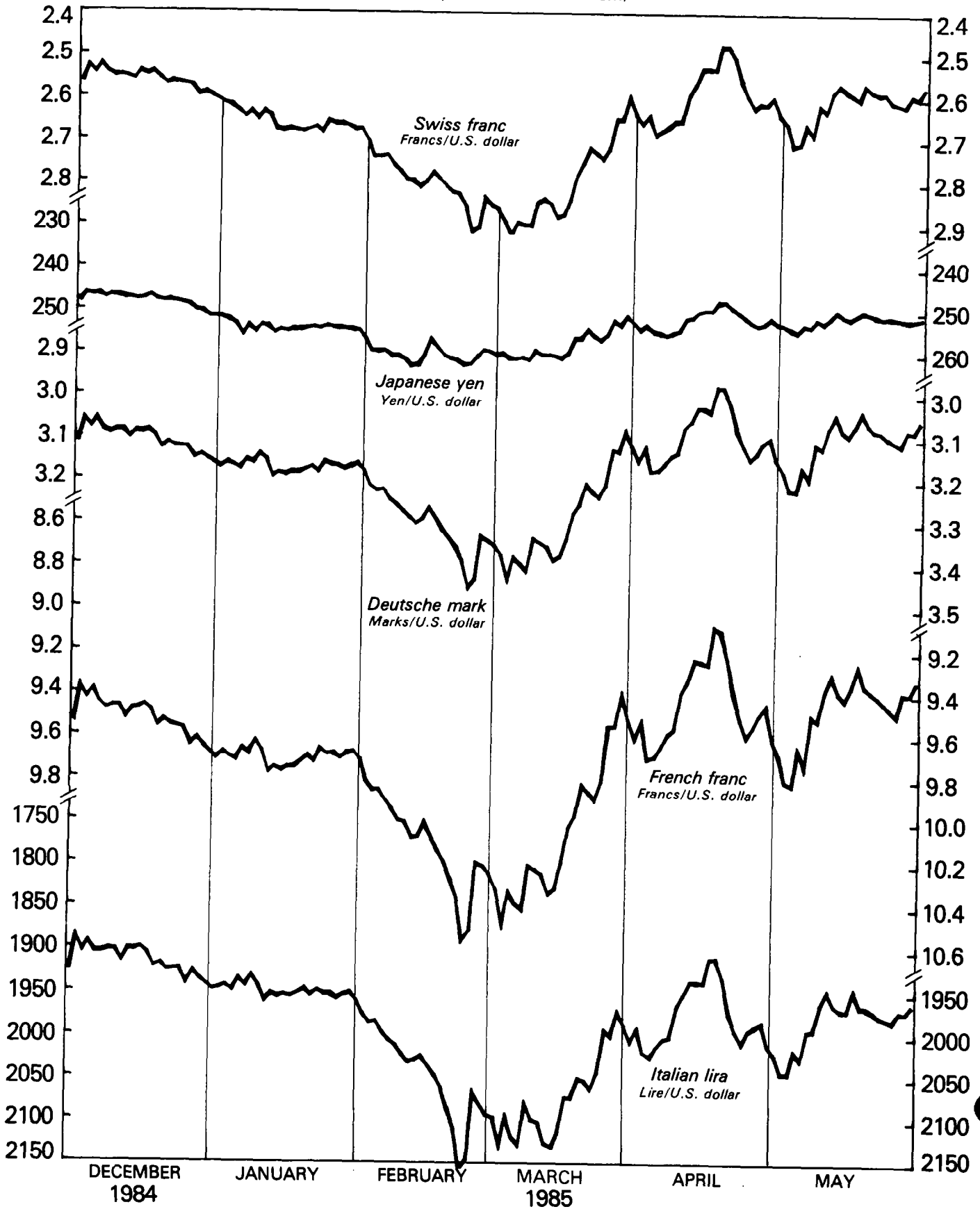


CHART 4 SPOT EXCHANGE RATES

(Noon quotations in New York)

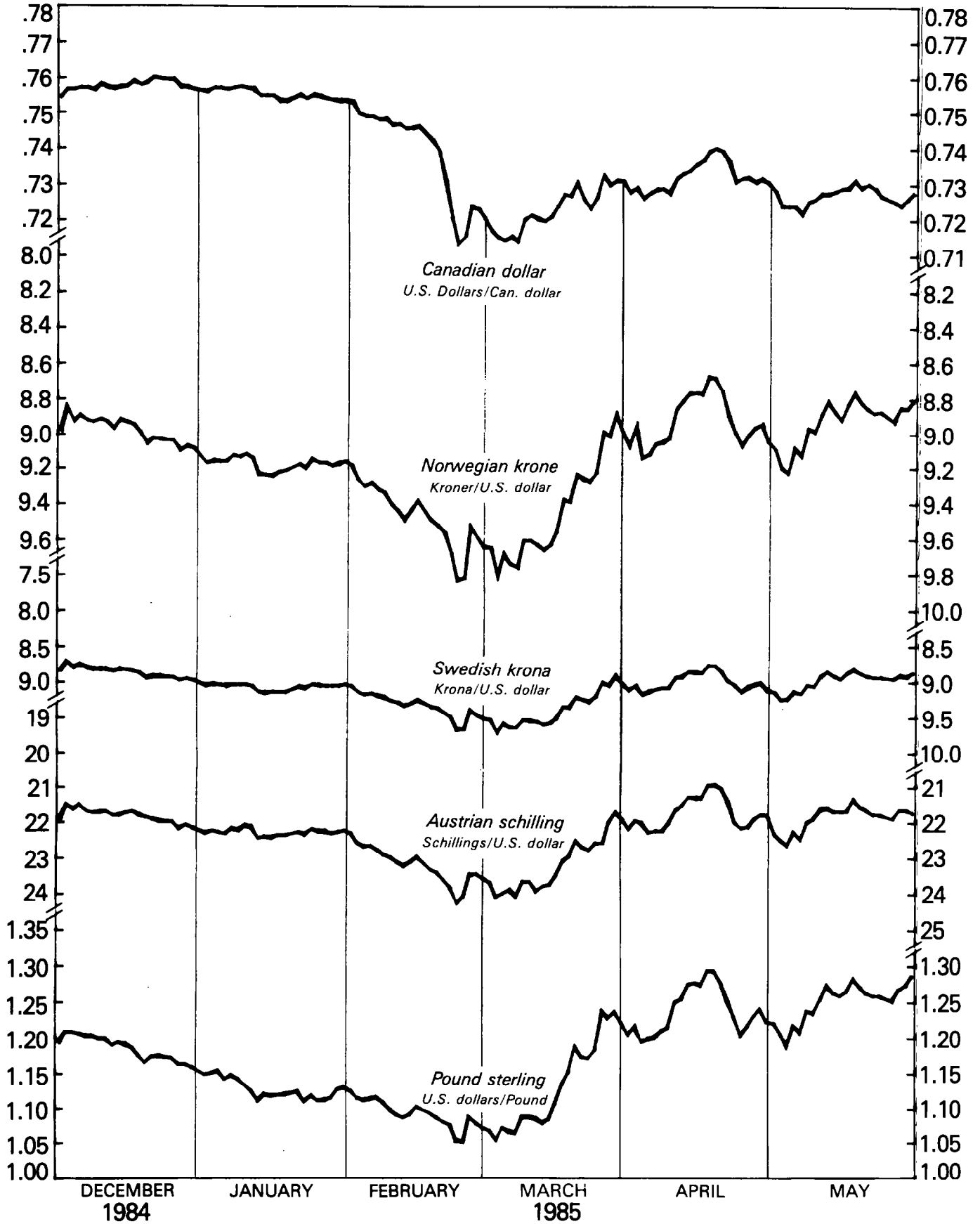
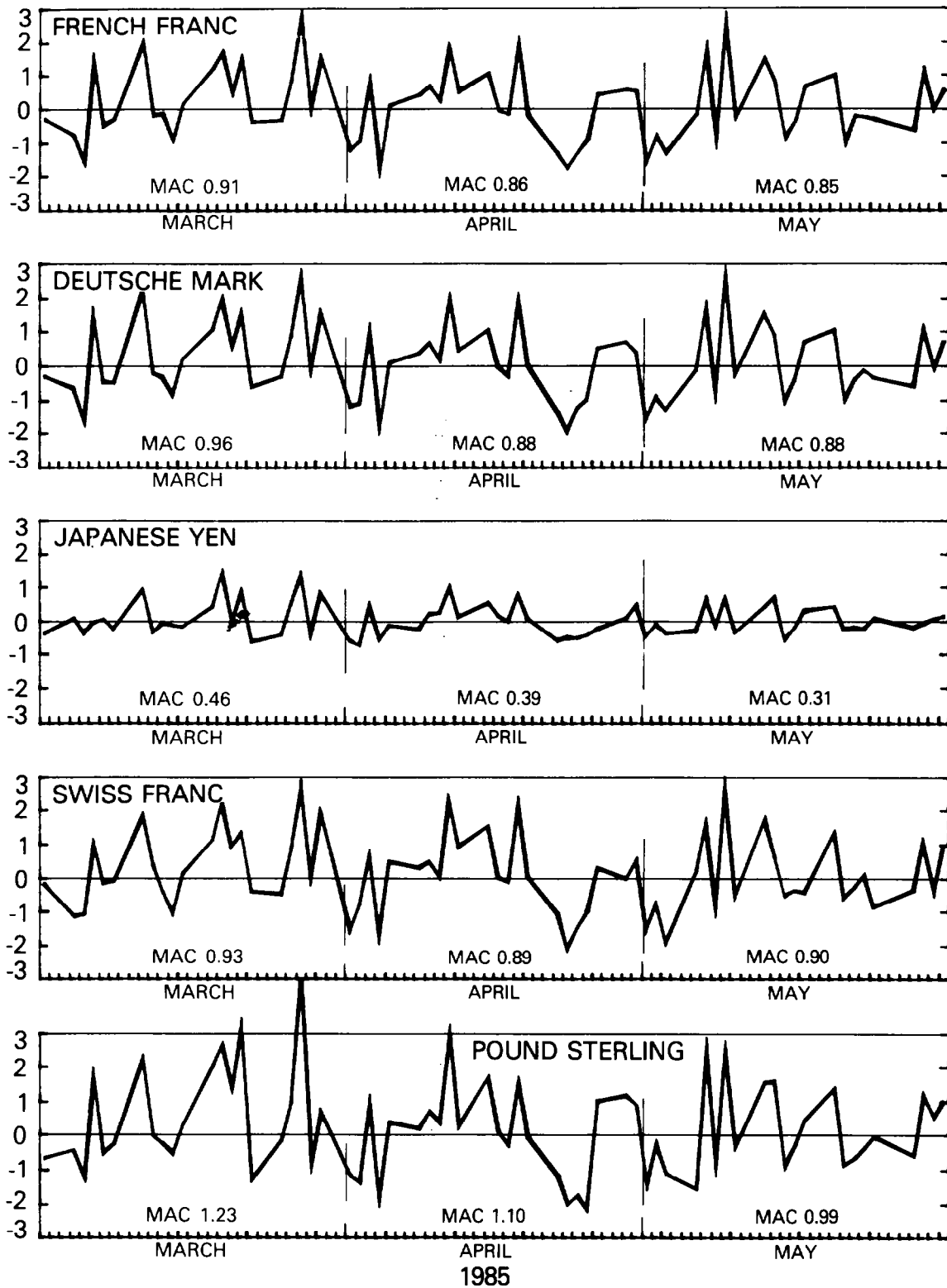


CHART 5

DAILY CHANGES IN SPOT EXCHANGE RATES

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



¹Monthly averages of absolute percentage changes (MAC) are also indicated.

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

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

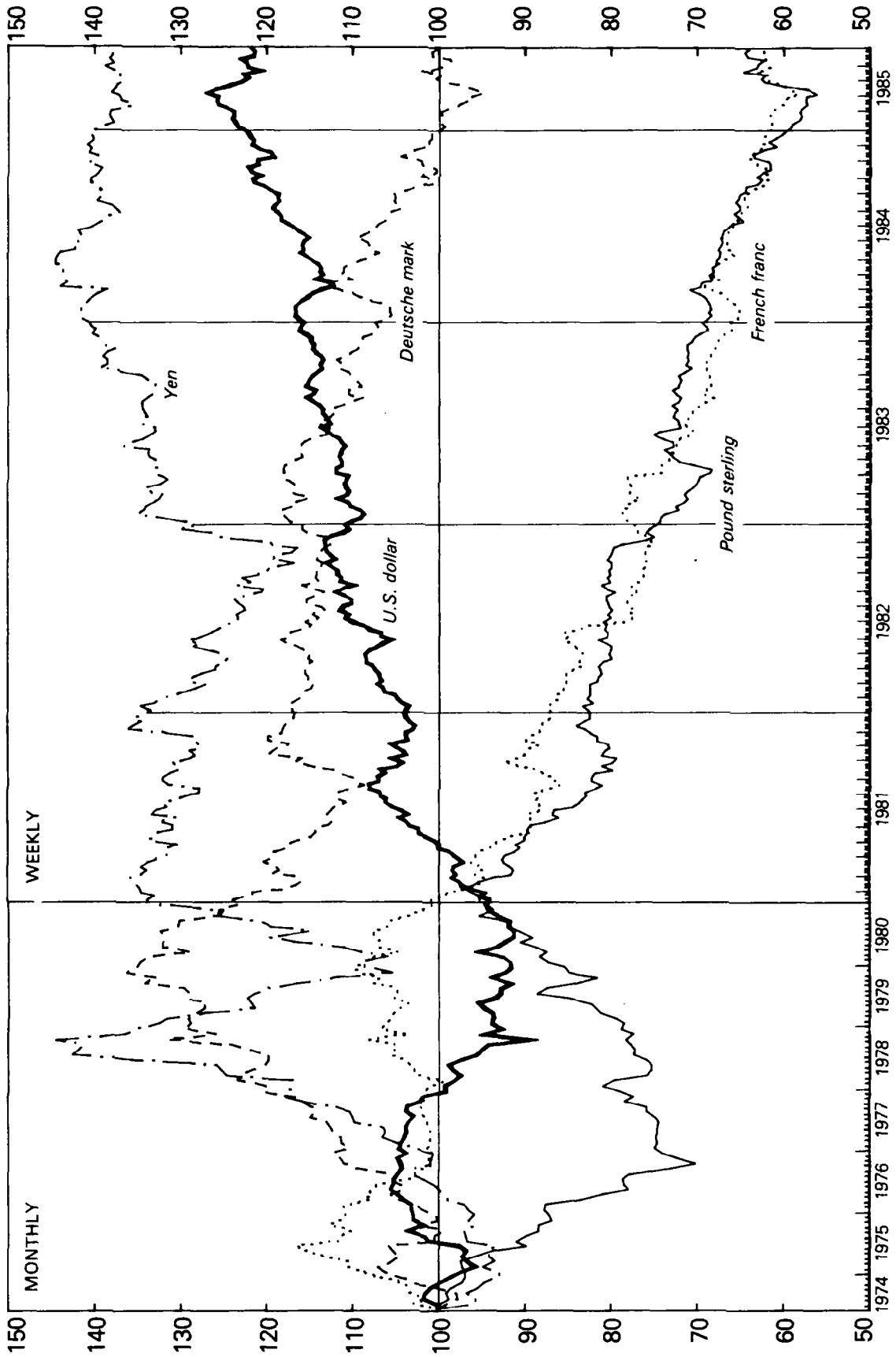


CHART 7 SHORT-TERM MONEY MARKET RATES

(Per cent per annum)

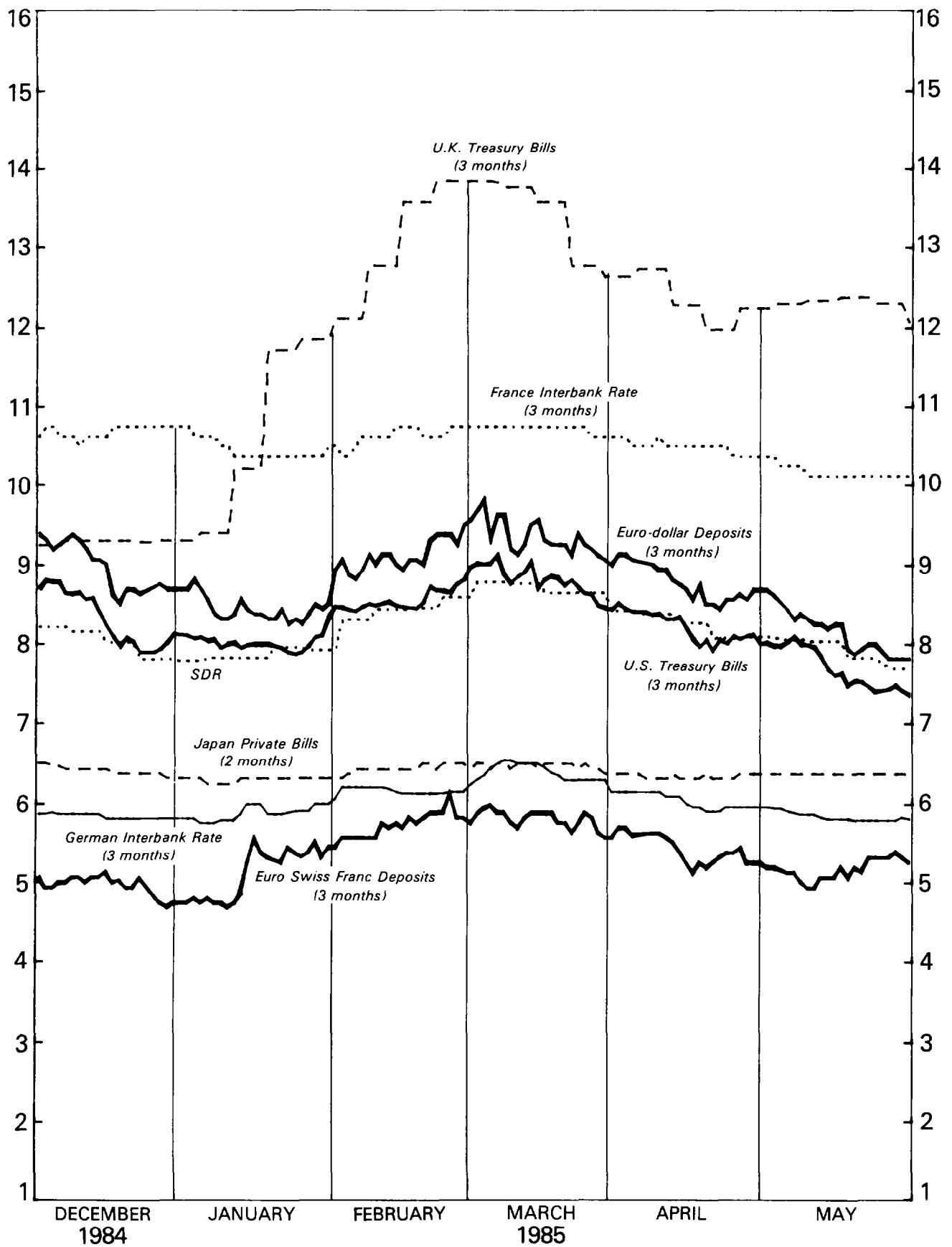


CHART 8

THREE-MONTH FORWARD RATES

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

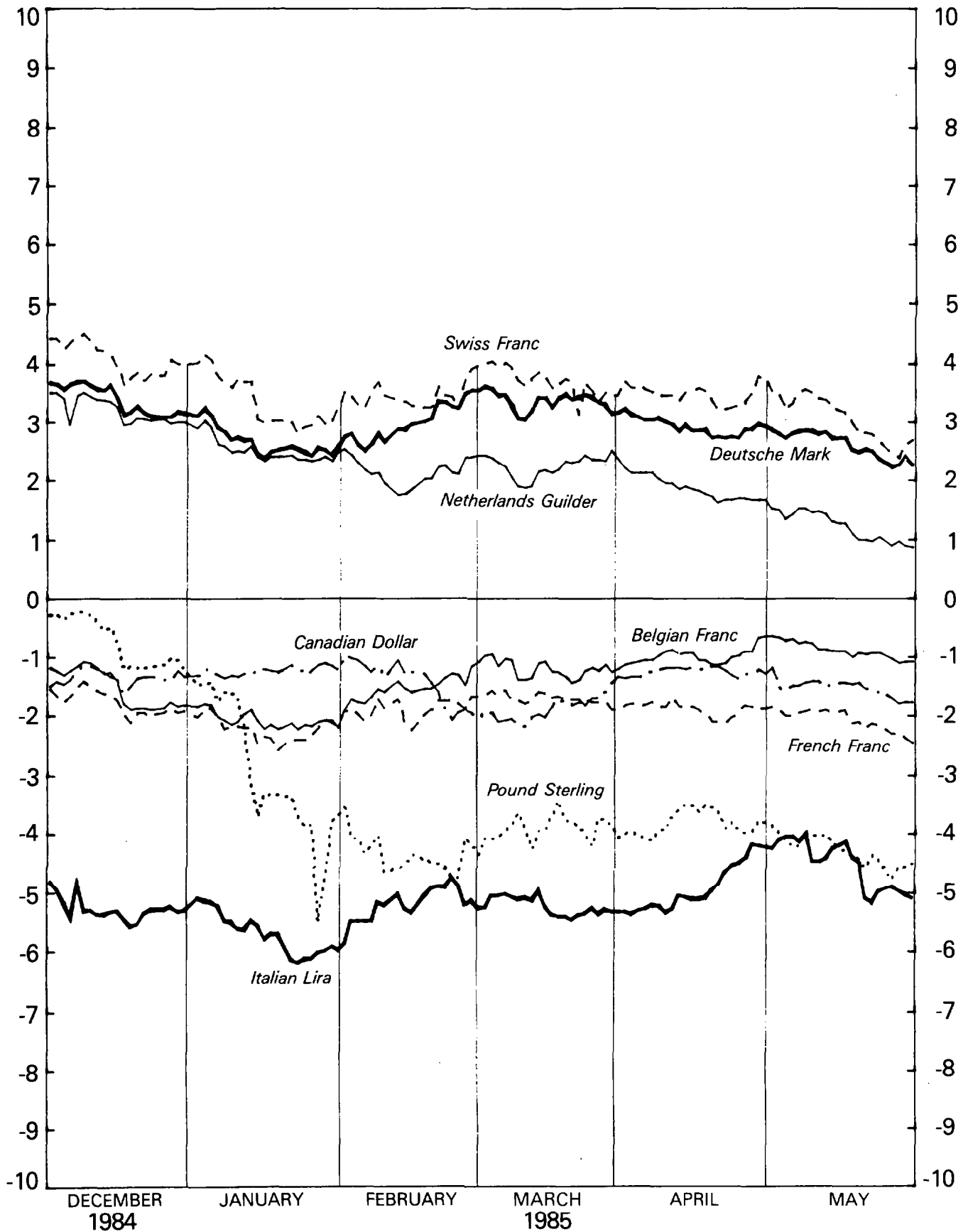
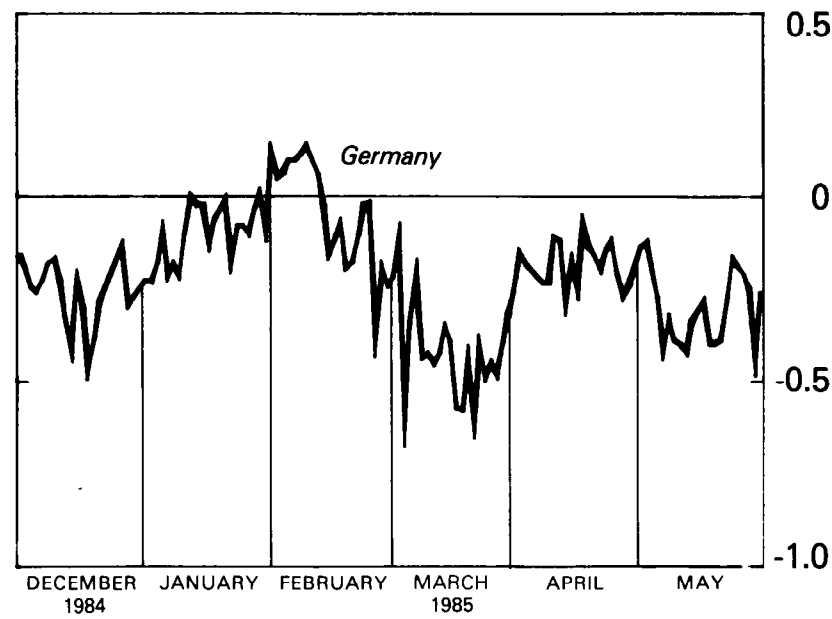
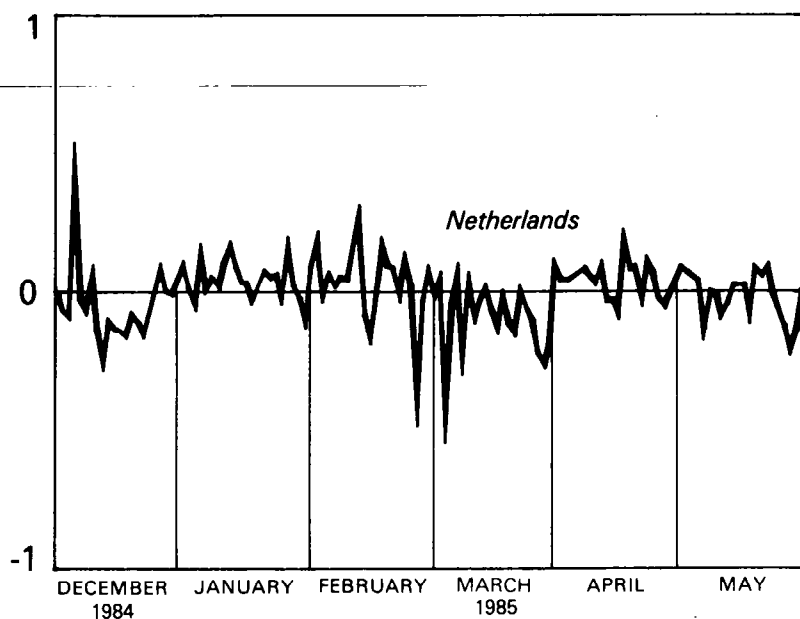
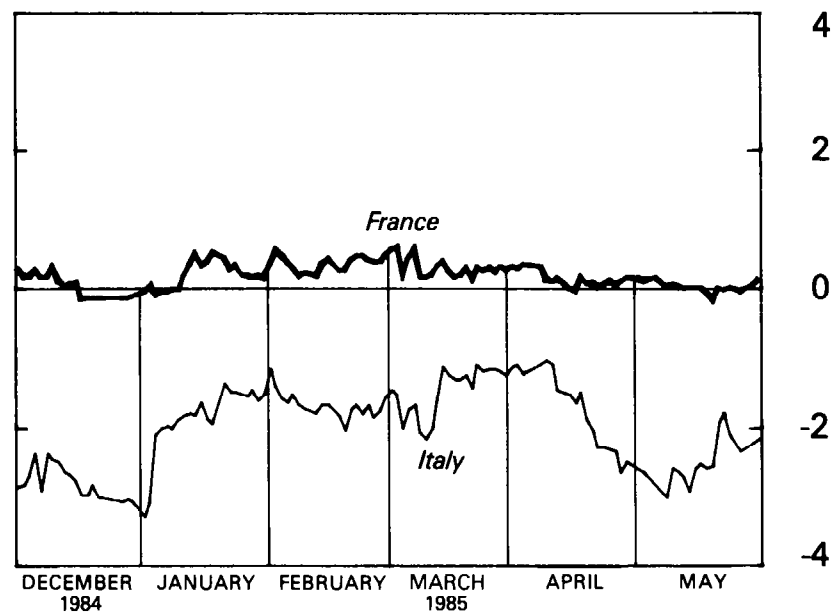
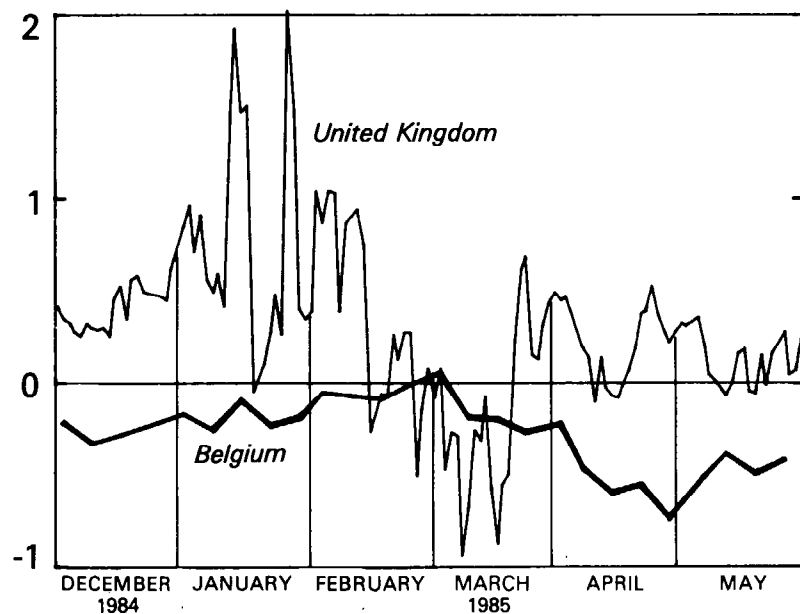


CHART 9

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, April-May 1985 1/

	A p r i l				M a y				
	3	10	17	24	1	8	15	22	29
Austrian schilling	21.9300	22.0200	21.2700	21.9550	21.7575	22.4500	21.6675	21.6400	21.6300
Belgian franc									
Official	62.750	63.025	61.135	62.850	63.275	64.225	61.925	61.925	61.925
Financial	63.000	63.400	61.425	63.170	63.600	64.525	62.225	62.250	62.225
Canadian dollars	0.72913	0.72780	0.73692	0.73099	0.73070	0.72189	0.72815	0.73033	0.72411
Danish kroner	11.2100	11.2190	10.9030	11.2000	11.3575	11.4550	11.0700	11.0550	11.0600
Deutsche mark	3.12050	3.13400	3.03600	3.11700	3.14750	3.19275	3.07600	3.07825	3.07800
French francs	9.5275	9.5585	9.2550	9.5050	9.5975	9.7350	9.3825	9.3750	9.3862
Irish pounds	1.0020	1.0005	1.0330	1.0038	0.9943	0.9815	1.0188	1.0165	1.0175
Italian lire	1990.000	2000.000	1937.000	1992.500	2009.500	2026.000	1961.500	1963.000	1968.500
Japanese yen	253.100	254.200	249.525	251.200	252.650	253.200	250.950	250.700	251.700
Netherlands guilder	3.5215	3.5395	3.4300	3.5240	3.5580	3.6035	3.4770	3.4765	3.4715
Norwegian kroner	8.9550	9.0260	8.7710	8.9925	9.0400	9.1250	8.8710	8.8575	8.8525
Pounds sterling	1.2170	1.2153	1.2743	1.2308	1.2240	1.2083	1.2630	1.2640	1.2670
Swedish kroner	9.0400	9.0755	8.8725	9.0450	9.1075	9.1600	8.9030	8.9150	8.8950
Swiss francs	2.64100	2.65150	2.53000	2.59350	2.63750	2.68430	2.57950	2.58700	2.58850

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

Short- and Medium-Term Interest Rates

APPENDIX B

(Monthly and weekly averages)

	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
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	10.40	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	8.85	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	10.76
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	11.33
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

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).

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

4/ Prime lending rate of major New York banks. Weekly figures are averages of seven calendar days ending on Wednesday.

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.