DM/86/34

INTERNATIONAL MONETARY FUND

Treasurer's Department

Foreign Exchange and Financial Markets in April 1986

Prepared by Robert A. Feldman and Michael Blackwell

Approved by Peter B. Clark

May 15, 1986

The value of the U.S. dollar, after rising somewhat in March, declined sharply in April amid indications of weak economic activity in the United States. Market interest rates continued to decline in most countries, in some cases falling to levels not recorded since the 1970s. In several countries official interest rates were reduced in line with market developments. Early in the month, the currencies in the European Monetary System were realigned.

I. Foreign Exchange Markets

The value of the U.S. dollar declined markedly during April, falling by 4.45 percent in effective (MERM) terms (see Table 1). The currencies participating in the exchange arrangements of the European Monetary System (EMS) posted particularly large increases of 7.22-8.76 percent against the U.S. dollar, except for the French franc which recorded a smaller rise of 4.49 percent. Initiated by a request from the French authorities, the EMS was realigned early in the month (see pages 4 and 5). The other currencies reported in Table 1 also firmed against the U.S. dollar, in many cases by well over 5 percent. The principal exception was the Canadian dollar which firmed by less than 2 percent.

The U.S. dollar's decline in April brought its cumulated effective (MERM) depreciation since last year's G-5 meeting in late September to about 19 percent, and to about 27 percent since its peak in February 1985. As of the end of April of this year, the non-dollar currencies in the SDR basket had appreciated by 47-60 percent against the U.S. dollar from their lows in February of last year (see Table 2). Most of the rise in the Japanese yen, and roughly half of the rise in the Deutsche mark and the French franc during this period took place after the September G-5 meeting; in contrast, the pound sterling recorded a comparatively small increase since the G-5 meeting.

Table 1. Changes in Exchange Rates during April 1986 1/

(In percent)

	Monthly exchange rate changes			
	Against U.S. dollar 2/	Against SDR 3/	Effective exchange rate 4/	Changes in effective exchange rate since April 1985
Belgium	+8.76	+2.88	+1.96	+6.80
Denmark	+7.91	+3.56	+3.15	+11.84
France	+4.49	-0.91	-1.95	+7.78
Germany	+8.29	+2.59	+2.00	+11.10
Ireland	+8.66	+3.25	+3.01	+11.90
Italy	+7.22	+1.94	+1.88	+2.94
Netherlands	+8.31	+3.21	+2.47	+13.28
Austria	+8.08	+2.42	+1.83	+12.74
Canada	+1.69	-1.56	-0.15	-10.80
Japan	+5.94	+3.29	+4.24	+30.50
Norway	+4.93	+1.81	+1.40	+3.46
Sweden	+5.18	+0.76	+0.16	+2.16
Switzerland	+7.89	+2.70	+2.16	+12.57
United Kingdom	+5.24	+0.71	-0.04	-2.36
United States	--	-3.21	-4.45	-22.36

1/ Positive signs 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.

Table 2. Changes in Selected Exchange Rates 1/

(In percent)

	Through end-April 1986	
	From February 1985 2/	From September 20, 1985 3/
U.S. dollar effective exchange rate (MERM)	-27.20	-18.93
Deutsche mark	+59.47	+31.51
Pound sterling	+47.41	+13.43
French franc	+53.13	+25.90
Japanese yen	+57.01	+43.27

1/ Based on New York noon quotations for the value of currencies in U.S. dollar terms, and on the Fund's multilateral exchange rate model (MERM) for the U.S. dollar effective exchange rate. Positive sign indicates appreciation of the currency.

2/ Dates are February 12 for the Japanese yen; February 25 for the Deutsche mark, the French franc and the U.S. dollar effective exchange rate (MERM); and February 26 for the pound sterling.

3/ Last business day prior to the G-5 statement on September 22, 1985.

News about economic developments in the United States was one of the main factors contributing to the dollar's decline in April. Most of the data released during the month tended to support expectations of both continued weakness in the U.S. economy and possible future interest rate declines. In fact, the U.S. Federal Reserve cut its discount rate by one-half percentage point near the middle of the month, fulfilling earlier expectations of such a move (see Part II). Indicators of economic weakness included the following: retail sales fell by a seasonally adjusted 0.8 percent in March after a 0.1 percent February increase; industrial production fell a seasonally adjusted 0.5 percent in March following a 0.7 percent decline in February; durable goods orders fell 2.1 percent in March after a 0.6 percent February drop, and excluding defense orders fell 5.7 percent in March; and the size of the merchandise trade deficit expanded to $14.5 billion in March from $12.5 billion in the preceding month. The announcement that real GNP rose 3.2 percent at a seasonally adjusted annual rate in the first quarter had little impact on the market, apparently because a number of components were estimated and likely to be revised in a downward direction.

Also influencing exchange rates were comments by policymakers in key industrial countries. Several statements by U.S. officials, for example, were taken as indicating that the United States would not be adverse to a drop in the dollar, especially in light of the large trade deficit and the economic sluggishness in the United States, and such statements appeared to reinforce the dollar's decline. The Chancellor of the Exchequer in the United Kingdom suggested that the Japanese yen must continue to appreciate, and this statement also appeared to reinforce the dollar's fall. Indeed, sentiment in favor of the yen was generated by the markets' perception that a further rise in that currency was needed in order to reduce the trade surplus in Japan and to dampen protectionist forces in the United States. Against this background, it was announced in April that Japan's trade surplus in March rose to a record $7.4 billion from $4.8 billion in February, and in the first 20 days of April the customs-cleared trade surplus expanded to $3.91 billion from $3.29 billion in the corresponding period in March. Various indications from Japanese officials that the yen should stabilize against the dollar provided a counterforce to the yen's rise, as did a cut in the Japanese discount rate and reported intervention on four occasions of support for the dollar by the Bank of Japan. Nevertheless, the yen reached a record high against the U.S. dollar of ¥ 167.10 per dollar near the end of the month; in effective (MERM) terms the yen rose by 4.24 percent in April, thus posting the largest monthly appreciation of the currencies included in this report.

The central banks participating in the exchange arrangements of the EMS suspended trading and intervention limits on Friday, April 4, at the request of France, and it was announced then that a European Community Monetary Committee meeting would take place to discuss a broad realignment of EMS parities. On previous occasions when the U.S. dollar had depreciated sharply, the EMS had come under pressure as the Deutsche mark together with the Netherlands guilder had tended to move sharply upward in the narrow band. In the months immediately preceding April, the Deutsche mark had in fact been the strongest currency and the spread in the EMS parity grid had frequently exceeded in New York the permitted maximum 2.25 percent margin maintained by the European central banks in the European market, thus suggesting some pressures on the system. The French franc had, however, also remained strong during that period, due in part to market expectations that no realignment would take place until after the parliamentary elections in France in March. After the elections, the franc came under increasing pressure, and the realignment then took place at the initiative of the French authorities, who sought a devaluation of their currency as part of a package of measures designed to liberalize the French economy and strengthen its competitiveness.

Over the weekend of April 5-6, finance ministers and central bank governors decided on a realignment, effective April 7. Central parties for the participating currencies were adjusted relative to each other by +3 percent for the Deutsche mark and the Netherlands guilder, +1 percent for the Belgian/Luxembourg franc and the Danish krone, unchanged for the Italian lira and the Irish pound, and -3 percent for the French franc. Following the realignment the French franc became the strongest currency in the EMS, and its spread in New York of 2.19-2.39 percent from the weakest currency frequently exceeded the permitted maximum 2.25 percent margin maintained by the European central banks in the European markets. The divergence indicator for the French franc was generally above its upper threshold after the realignment, while the other currencies were within their thresholds (see Chart 3). The weakest currency after the realignment alternated between the Netherlands guilder and the Deutsche mark, and these two currencies received significant official support. Initially, on April 7 and 8, the Bank of France reportedly intervened in sizeable amounts, estimated as high as DM 4 billion, in support of the Deutsche mark, and the Netherlands' Central Bank reportedly sold roughly f. 3.0 billion of foreign currency during the month in support of the guilder. The realignment in April was the first major change in central parities since March 1983; there was a realignment in July 1985 which changed only the relative position of the Italian lira within the parity grid.

Changes in the volatility of exchange rates for major currencies against the U.S. dollar, as indicated by the measures given in Table 3, were mixed. For the EMS currencies, the high-low spreads rose markedly to 10.3-13.3 percent in April from 6.2-6.6 percent in March; however, the average of absolute daily percentage changes (MAC in Table 3) fell for most of these currencies and averaged 0.79 percent in April compared with a somewhat higher average of 0.86 percent in the preceding month. The high-low spreads also rose for each of the other major currencies except the Canadian dollar, but the MAC fell for most of these currencies and averaged 0.58 percent in April compared with 0.64 percent in March.

Gross foreign exchange reserves rose in most major industrial countries in April, with Italy, Japan, and the United Kingdom recording the largest increases (see Table 4). Over the latest twelve-month period, these reserves also rose in most major countries. Germany and the United States recorded the biggest gains of around $7 billion, while only Italy, Ireland, and Canada registered declines.

Table 3. Intra-Month Variations of Exchange Rates of Major Currencies 1/

	April 2/		High-low spread in percent 3/		MAC 4/	
	High	Low	Mar.	Apr.	Mar.	Apr.
Belgium	44.1650	49.5500	6.5	12.2	0.87	0.85
Denmark	8.0150	8.8440	6.4	10.3	0.87	0.68
France	6.8930	7.6232	6.4	10.6	0.83	0.84
Germany	2.1640	2.3960	6.5	10.7	0.87	0.70
Ireland	1.40495	1.2400	6.2	13.3	0.83	0.89
Italy	1488.00	1662.50	6.6	11.7	0.87	0.84
Netherlands	2.4398	2.7000	6.3	10.7	0.90	0.70
Austria	15.2050	16.8180	6.4	10.6	0.85	0.70
Canada	0.72804	0.71441	2.6	1.9	0.24	0.27
Japan	167.10	182.80	3.7	9.4	0.66	0.61
Norway	6.9025	7.4500	5.0	7.9	0.68	0.60
Sweden	6.9975	7.5150	3.4	7.4	0.49	0.51
Switzerland	1.8080	2.0125	4.7	11.3	0.85	0.85
United Kingdom	1.5555	1.4515	4.9	7.2	0.73	0.52

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.

Table 4. Gross Foreign Exchange Reserves in April 1986 1/

(In millions of U.S. dollars)

	End-month reserve level	Change in April	Change over 12 months
Belgium	4,216	+235	+413
Denmark	4,202	+5	+1,139
France (January)	23,836	-483	+4,334
Germany	39,909	+44	+7,080
Ireland	2,727	-55	-251
Italy	15,662	+2,292	-1,208
Netherlands	9,550	+266	+2,146
Austria	4,746	+656	+1,536
Canada	1,731	+157	-253
Japan	26,686	+3,146	+3,904
Norway	12,418	-208	+1,622
Sweden	6,049	+117	+2,139
Switzerland	15,608	-651	+3,417
United Kingdom	12,648	+1,915	+5,172
United States (March)	13,965	-318	+6,930

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.

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

In April, short-term interest rates continued to decline, with particularly sharp falls recorded in Belgium, Canada and Italy. Official interest rates were reduced in several countries during the course of the month. These reductions reflected the desire to bring official rates in line with market rates and, to a certain extent, international agreement on the need for coordinated interest rate reductions. Inflation rates continued to fall; in many countries wholesale price indices registered actual declines and consumer prices rose at their slowest pace in many years.

Short-term interest rates in the United States continued to decline during the first part of April, but firmed as the month drew to a close. The month began with mounting speculation that the Federal Reserve would reduce its discount rate for the second consecutive month. This

Table 6. Inflation Rates and Short-Term Interest Rates

	Month 2/	Inflation rates 1/ (year-on-year percent changes): Wholesale price index	Inflation rates 1/ (year-on-year percent changes): Consumer price index 3/	Short-term interest rates 4/ (end-of-month): March	Short-term interest rates 4/ (end-of-month): April
Austria	March	-5.8 (-3.0)	1.8 (2.5)	4.00	4.00
Belgium	Mar./Apr.	-2.9 (-6.3)	1.4 (1.5)	9.25	8.00
Canada	Feb./Mar.	5.36 (5.1)	4.1 (4.1)	10.05	8.78
Denmark	March	-6.3 (-1.8)	1.8 (2.1)	7.00	7.00
France	Dec./Mar.	-1.8 (-1.4)	3.0 (3.4)	8.37	7.48
Germany	March	-7.1 (-5.2)	-0.2 (0.1)	4.75	4.64
Italy	Feb./Apr.	2.5 (4.8)	6.6 (7.2)	14.81	12.69
Japan	March	-8.1 (-6.3)	1.1 (1.8)	5.36	4.60
Netherlands	... /Mar.	... (...)	0.7 (1.2)	5.44	5.50
Norway	Feb./Mar.	2.2 (3.2)	5.5 (6.1)	13.14	13.84
Sweden	March	1.9 (2.6)	4.3 (5.3)	8.50	8.00
Switzerland	Mar./Apr.	-3.5 (-2.6)	1.0 (0.9)	4.00	4.13
United Kingdom	March	5.0 (5.1)	4.2 (5.1)	10.98	10.16
United States	Feb./Mar.	-0.1 (1.4)	2.3 (3.2)	6.53	6.28

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; interbank rates for Germany, France, Italy, the Netherlands, and Norway; 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, and Sweden.

speculation was fueled by disappointing domestic economic data, declines in money market rates, reductions in official interest rates in Europe, and an expectation that there would be a further coordinated round of interest rate cuts before the Tokyo summit. The decision to lower the discount rate by 0.5 percentage point to 6.5 percent--the lowest level in nearly 8 years--was announced on April 18. The Federal Reserve observed that the reduction had been made "to place the discount rate at a more appropriate alignment with the prevailing level of market rates" and that it was "consistent with international interest rate considerations."

At the short-term end of the market, the Federal funds rate fell from 8.06 percent on the last day of March to slightly below 7 percent during the first week of April and remained fairly close to that level for the remainder of the month; in terms of monthly averages, the Federal funds rate eased to 6.99 percent from 7.48 percent in March. The yield on three-month Treasury bills declined markedly during the first part of the month, reaching 5.94 percent on April 16, but then recovered somewhat and ended the month at 6.28 percent, 0.25 percentage point lower than end-March. The 90-day CD rate eased by 0.59 percentage point to 6.53 percent during the course of the month.

At the long-term end of the market, yields on assets were narrowly mixed. The yield on 30-year maturities firmed marginally to 7.47 percent during the month and, after its recent marked decline, the slope on the yield curve steepened somewhat. The differential between the yield on three-month Treasury bills and that on 30-year Treasury securities, which had fallen to 0.91 percentage point at end-March, rose to 1.19 percentage points. At the end of the month, the Treasury announced that it would cease issuing 20-year Treasury bonds.

The M1 measure of the U.S. money supply, seasonally adjusted, averaged $648.6 billion in the week ended April 28, compared with $640.1 billion in the week ended March 31 for an increase of almost 19 percent at an annual rate. The rise meant that M1 remained above the upper end of the Federal Reserve's target range of 3-8 percent annual growth for M1 during 1986. Some market analysts minimized the importance of this larger-than-expected increase on the grounds that in its conduct of monetary policy the Federal Reserve was less concerned with the level of M1 than with the performance of the dollar in the foreign exchange market and the general state of the economy.

Money market conditions generally eased in April in the countries participating in the EMS. The currency realignment of April 6 was followed by several reductions in official interest rates. In Germany, the three-month interbank rate moved very little and ended the month at 4.64 percent, down 0.10 percentage point from end-March. There was considerable speculation near the beginning of the month that Germany might join with the United States and Japan in reducing its discount rate. However, the Bundesbank was reportedly of the opinion that in view of the boost to real income in Germany provided by the decline in import prices in general, and energy prices in particular, there was no reason for monetary actions that would have a further expansionary effect. Nevertheless, some state-owned banks reduced interest rates on their loans to small- and medium-size enterprises by 0.25 percentage point to 5.50 percent, and lowered their rates on loans to local authorities and for environmental projects by the same amount to 5.00 percent. Germany's central bank money stock grew at an annual rate of 8 percent in April, faster than the 6.6 percent recorded in March and well above the target range of 3.5-5.5 percent growth for 1986.

In France, the realignment of the EMS currencies relieved the French franc of speculative pressures and facilitated the ability of the authorities to lower interest rates. The three-month interbank money rate fell from 8.37 percent to 7.48 percent at midmonth and then remained stable to the month-end. On April 14, the Bank of France reduced its intervention rate by 0.5 percentage point to 7.75 percent with the stated aim of encouraging domestic investment. Notwithstanding this interest rate reduction, the Bank of France announced that, effective April 26, it would increase the deposits of compulsory reserves it would require from the commercial banks. Specifically, the minimum reserve requirement on loans would be raised from 0.3 percent to 0.4 percent and that on sight deposits (excluding savings book accounts) from 3.5 percent to 4.5 percent. This action was apparently taken in order to correct the overshooting of the money supply and to avoid a surge in consumer credit. Following the reduction in the intervention rate, several major banks reduced their prime lending rate by 0.5 percentage point to 10.1 percent. On April 28, the Bank of France again cut its money market intervention rate, but this time by 0.25 percentage point to 7.50 percent. It was reported that the rate cut might have been designed to reduce the volume of capital inflows into France, which had increased greatly after the EMS realignment earlier in the month, and which was causing concern about the growth of the money supply. On the following day, a public long-term financing institution (Crédit National) announced that it would cut its prime rate from 11 percent to 9.75 percent.

In Italy, the three-month interbank interest rate fell sharply during April, ending the month at 12.69 percent, down 2.13 percentage points from end-March. On April 11, the Bank of Italy announced a package of measures aimed at liberalizing foreign exchange transactions and abolishing a number of restrictions on payments abroad that had been imposed in January of this year to counteract speculative pressures against the lira. On April 25, the official discount rate was cut by 1.0 percentage point to 13 percent. The Ministry of the Treasury stated that the cut had been made against a background of declining domestic inflation and falling interest rates abroad. Toward the end of the month, several commercial banks announced cuts of 0.75 percentage point in their prime rates, bringing them below 15 percent.

In Belgium, the four-month fonds des rentes fell from 9.25 percent to 8.00 percent over the course of the month. In the week following the EMS realignment, Belgium's National Bank reduced the official discount rate by 0.5 percentage point on two occasions, bringing it down to 8.75 percent, and reduced the Lombard rate in two steps from 10.25 percent to 9 percent. In addition, rates on one to three-month Treasury certificates were twice reduced by 0.5 percentage point and once by 0.25 percentage point, bringing them down to 8.25 percent. In the Netherlands, the three-month interbank money rate eased during the first part of the month but then firmed in the last ten days, ending the month at 5.50 percent, up 0.06 percentage point from end-March and 0.41 percentage point from the midmonth low. In Ireland, the Central Bank cut the interest rate on its short-term lending facility to the clearing banks by 1.25 percentage points to 12.5 percent. It also announced a cut of 3 percentage points in the prime lending rate that it determines for commercial banks, bringing the rate down to 12.5 percent--the level from which it had been raised in February to curb speculation against the pound.

The Bank of Japan cut its discount rate by 0.5 percentage point to 3.5 percent on April 21, the business day following a similar reduction by the U.S. Federal Reserve. The Bank expressed the hope that the reduction would contribute to exchange rate stability and that, in conjunction with the authorities' recently announced comprehensive economic measures, it would help to promote the expansion of domestic demand and the further adjustment of external imbalances. The interest rate on two-month private bills, which had declined gradually during the first part of the month, fell by the same amount as the discount rate cut on April 21; at the end of the month it was 4.60 percent, 0.76 percentage point down from end-March.

Short-term interest rates fell markedly in the United Kingdom during the first three weeks of April, with both the three-month Treasury bill and interbank money rates dipping below 10 percent. Rates then recovered somewhat but at the end of the month were well below their opening levels. The three-month interbank rate closed the month at 10.47 percent, down 0.91 percent from end-March, and the three-month Treasury bill rate eased by 0.82 percentage point to 10.16 percent. The Bank of England lowered its dealing rates on two occasions during the month following reductions in base rates by clearing banks. On April 8, the National Westminster Bank led the way by cutting its base rate by 0.5 percentage point to 11.0 percent, reportedly without any prior signal from the Bank of England. The Bank of England subsequently cut one of its money market dealing rates to 10.81 percent from 11.31 percent. Expectations of further interest rate reductions were reinforced over the following ten days as rates declined in other countries, speculation intensified regarding a further reduction in the United States discount rate, and sterling strengthened in the foreign exchange market. On April 18, expectations were fulfilled when, following the decision of Barclays Bank to reduce its base lending rate by 0.5 percentage point, the Bank of England reduced its dealing rates in the first three of its money market intervention bands by the same amount. On both April 8 and 18 all the clearing banks eventually reduced their base lending rates in identical fashion; these rates at end-April stood at 10.5 percent, down from 11.5 percent at end-March.

With regard to monetary aggregates, the latest Bank of England data showed that on a provisional, seasonally adjusted basis, sterling M3 rose somewhat more than 3 percent in the banking month of April. The year-on-year growth rate of about 16.5 percent was the same as in banking March, and thus was above the upper limit of the 11-15 percent annual growth target announced in the March budget statement. This larger-than-expected rise was generally attributed to exceptionally large borrowing by companies before the end of March to take advantage of capital allowances. M0 grew by about 0.25 percent in banking April and at about 3.25 percent year-on-year--at the lower end of the 2-6 percent target band.

In Canada, the three-month Treasury bill rate declined by 1.27 percentage points to 8.78 percent in April. The differential between this rate and its U.S. equivalent stood at 2.5 percentage points at end-April, lower than the 3.5 percentage points recorded at end-March, but still larger than the average in the recent past. In Sweden, in response to declining international interest rates and falling domestic money market rates, the Sveriges Riksbank lowered its discount rate by 0.5 percentage point to 8.0 percent, effective April 18. A few days later the Bank proposed a gradual phasing out of certain foreign exchange controls.

Three-month interest rates in the eurocurrency markets tended to decline during April, reflecting movements in domestic interest rates. The drop was largest for the euro-French franc, which declined by 4.87 percentage points to 7.63 percent. The rate had risen to 13.5 percent during the first week of the month, and had then fallen precipitately by almost 6 percentage points following the EMS realignment on April 6. Rates on euro-sterling fell by 1.0 percentage point, ending the month at 10.44 percent. Rates on the eurodollar and the euro-yen eased moderately by 0.57 percentage point and 0.50 percentage point, respectively, to 6.81 percent and 4.81 percent. In contrast, rates on the euro-Deutsche mark and the euro-Swiss franc firmed slightly, ending the month at 4.56 percent and 4.13 percent, respectively.

Reflecting movements in eurodollar and domestic interest rates, uncovered interest differentials between investments in U.S. dollars and in other major currencies generally narrowed during the month of April. The differential favoring eurodollar investment widened, however, for Japan. In the forward exchange market both premia and discounts against the U.S. dollar narrowed, with the discounts against the U.S. dollar for the French franc and the Italian lira narrowing significantly. Reflecting these movements in interest differentials and forward exchange quotations, covered interest differentials also tended to narrow. The differential favoring eurodollar investment declined sharply for France, while the differential favoring domestic investment widened somewhat in Italy and was little changed in the Netherlands (see Table 7 and Charts 8 and 9).

Table 7. *Covered Interest Differentials for* Three-Month Investments (End-month)

(In percentage points)

	Uncovered interest differentials 1/ (1)		Forward exchange quotations 2/ (2)		Covered interest differentials 1/ (3) = (1)-(2)	
	March	April	March	April	March	April
Belgium	-1.87	-1.19	-2.69	-1.33	+0.82	+0.14
France	-0.98	-0.67	-4.52	-0.80	+3.54	+0.13
Germany	+2.63	+2.17	+2.79	+2.31	-0.16	-0.14
Italy	-7.43	-5.75	-7.21	-5.23	-0.22	-0.52
Japan	+2.02	+2.21	+2.24	+2.15	-0.22	+0.06
Netherlands	+1.94	+1.37	+1.93	+1.35	+0.01	+0.02
United Kingdom	-3.60	-3.35	-3.79	-3.45	+0.19	+0.10

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

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

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

The SDR interest rate continued to ease quite sharply during the month of April, reflecting declining yields on all five of the instruments in the SDR interest rate basket. The yield on three-month interbank money against private paper in France eased by 0.89 percentage point to 7.48 percent, the yield on three-month Treasury bills in the United Kingdom eased by 0.82 percentage point to 10.16 percent, and the discount rate on two-month private bills in Japan eased by 0.76 percentage point to 4.60 percent. The yield on the relevant U.S. and German instruments eased by 0.21 percentage point and 0.15 percentage point, respectively, to 6.32 percent and 4.59 percent (Table 8).

Table 8. The SDR Interest Rate and the Rate of Remuneration 1/

	March 31	April 7	April 14	April 21	April 28
SDR interest rate	6.75	6.62	6.31	6.17	6.27
Rate of remuneration	6.21	6.09	5.81	5.68	5.77 2/

1/ The rates apply to the weeks beginning with the dates indicated.
2/ 5.77 percent applied through April 30 only. The rate for May 1-4 was 6.11 percent.

During the period covered by Table 9 (March 26-April 30), combined domestic rates eased by 0.37-0.52 percentage point as domestic interest rates on the SDR component currencies declined (see also Chart 10). The largest declines were on the U.K. and French instruments, which eased by 0.88-1.17 percentage points and 0.81-1.71 percentage points, respectively. Combined eurocurrency offered rates fell markedly by 1.00-1.13 percentage points, largely reflecting the sharp fall in interest rates on the euro-French franc, which declined by up to 5.38 percentage points after the EMS realignment early in the month. Rates on the other SDR component currencies in the eurocurrency markets eased markedly, except for those on the euro-Deutsche mark which were little changed. During the same period, average interest rates on SDR-denominated deposits of selected commercial banks eased by 0.71-1.33 percentage points.

Table 9. Yields on Selected SDR-Denominated Assets 1/

	March	April
Combined market interest rates: 2/		
a. Based on domestic rates		
3-month maturity (Rule T-1)	6.78	6.26
6-month maturity	6.75	6.25
12-month maturity	6.69	6.19
2-1/2 year maturity	6.88	6.50
5-year maturity	7.06	6.69
b. Based on eurocurrency offered rates		
3-month maturity	7.88	6.75
6-month maturity	7.63	6.63
Average commercial bank deposit rates 3/		
1-month deposits	7.81	6.48
3-month deposits	7.42	6.39
6-month deposits	7.15	6.28
12-month deposits	6.98	6.27

1/ Rates pertain to last Wednesday of the month.

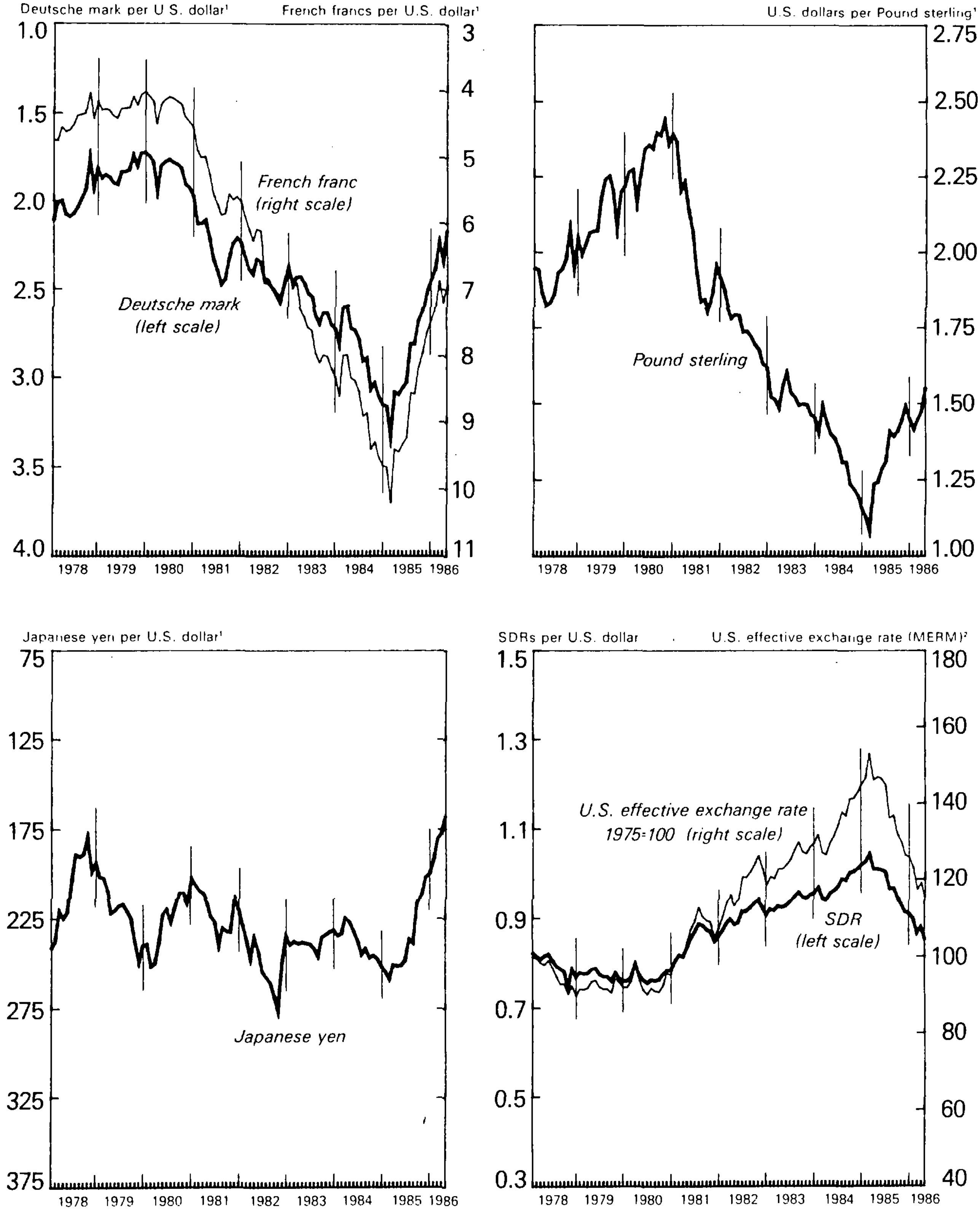
2/ Combined market rates (according to the Rule T-1) are calculated by multiplying the yields or rates of each of the respective instruments by the number of units of the corresponding currency listed in Rule 0-1 and the value in terms of the SDR of a unit of that currency as determined by the Fund under 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 1978-1986

(end of month)



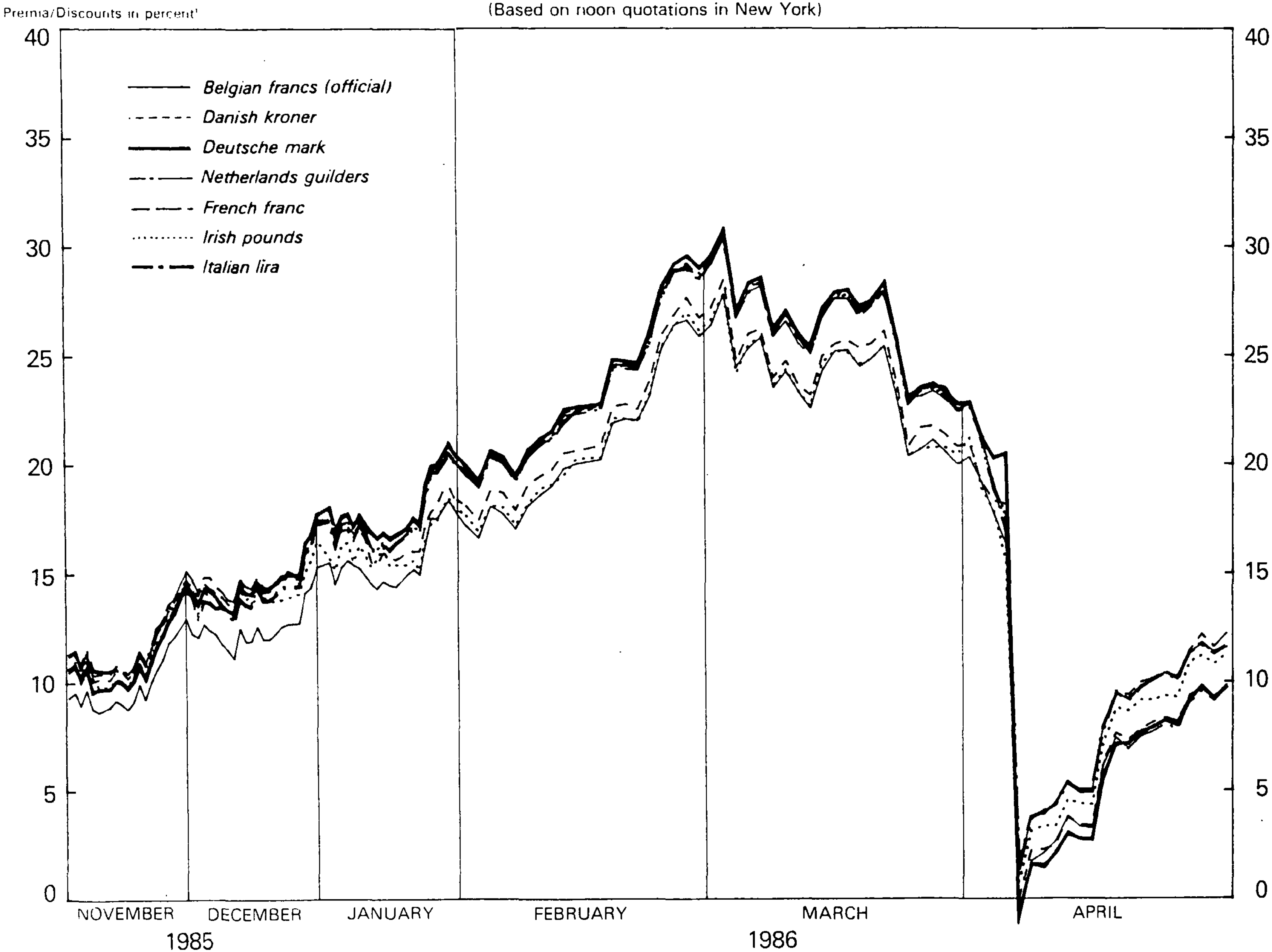
[1]New York noon quotations

[2]IMF's multilateral exchange rate model. Increase in the index means appreciation.

CHART 2

SPOT EXCHANGE RATES: EUROPEAN MONETARY SYSTEM

(Based on noon quotations in New York)

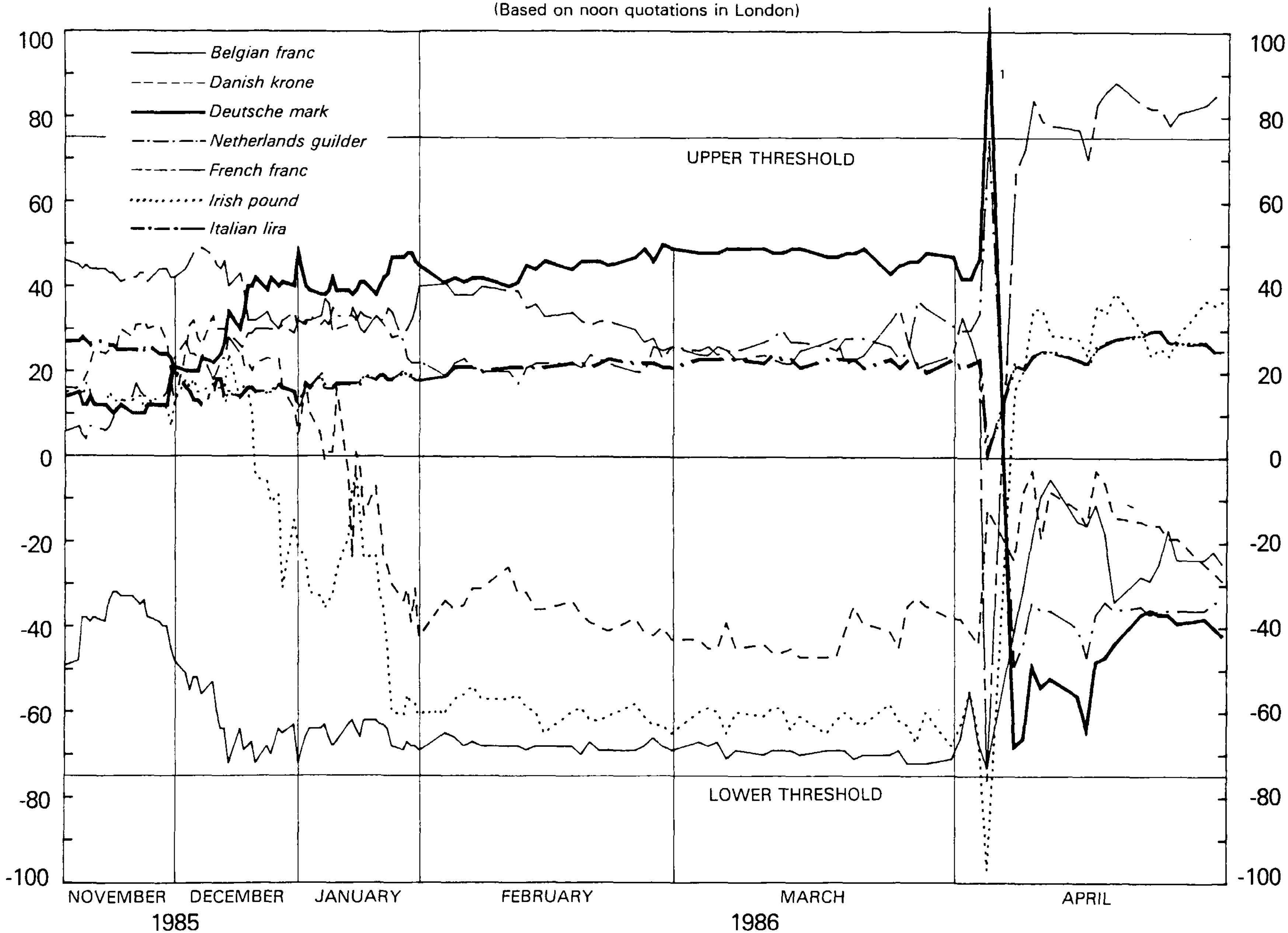


[1] Premia Discounts over declared ECU central rates converted to U.S. dollar terms on the basis of 1 ECU - $0.777846 effective July 22, 1985, and 1 ECU - $0.900139 effective April 7, 1986.

CHART 3

EUROPEAN MONETARY SYSTEM: DIVERGENCE INDICATORS

(Based on noon quotations in London)



[1]On April 7, 1986, central parities were adjusted relative to each other by plus 3 percent for the Deutsche mark and the Netherlands guilder, plus 1 percent for the Belgian franc and the Danish krone, unchanged for the Italian lira and the Irish pound, and minus 3 percent for the French franc.

CHART 4
SPOT EXCHANGE RATES
(Noon quotations in New York)

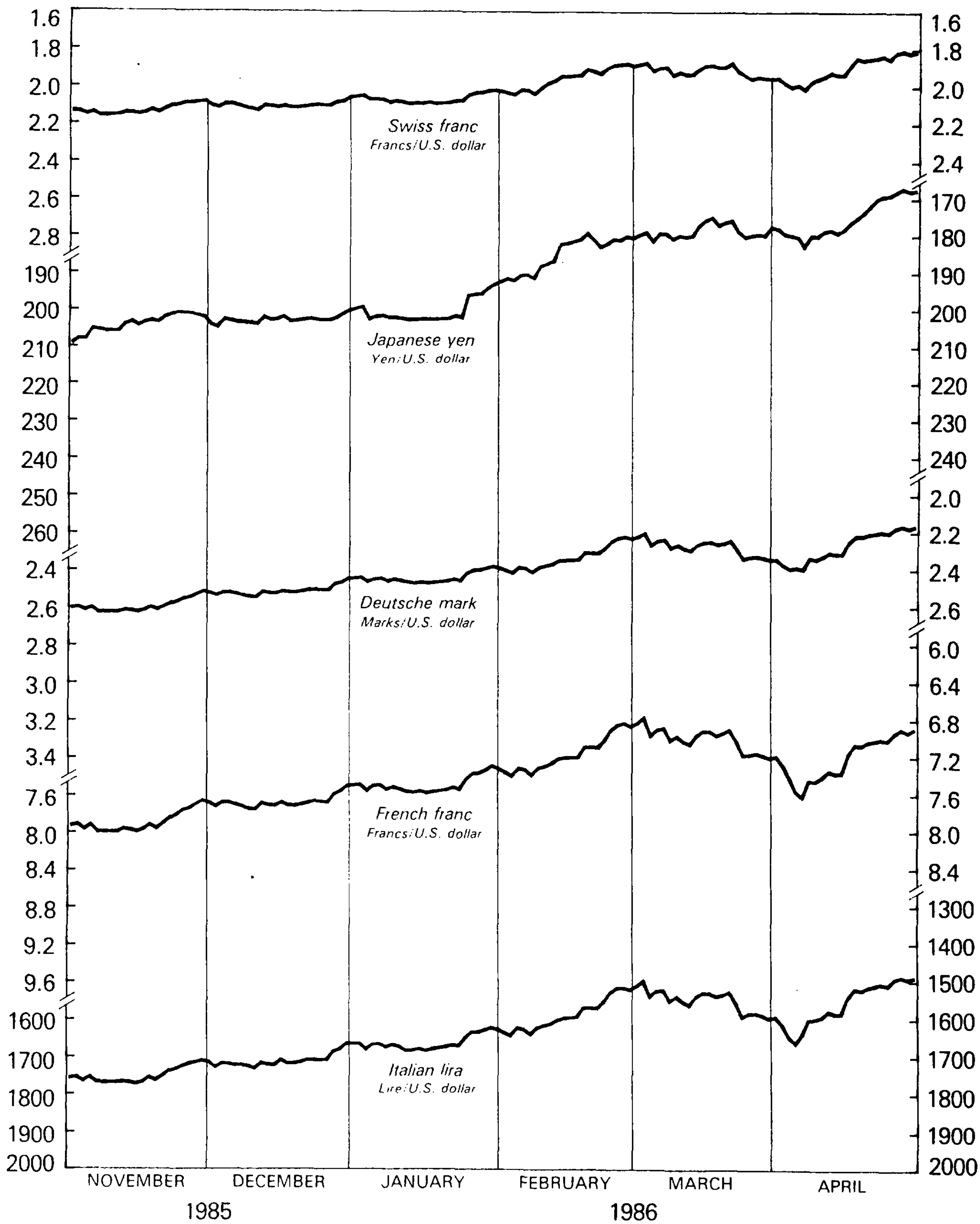


CHART 5
SPOT EXCHANGE RATES
(Noon quotations in New York)

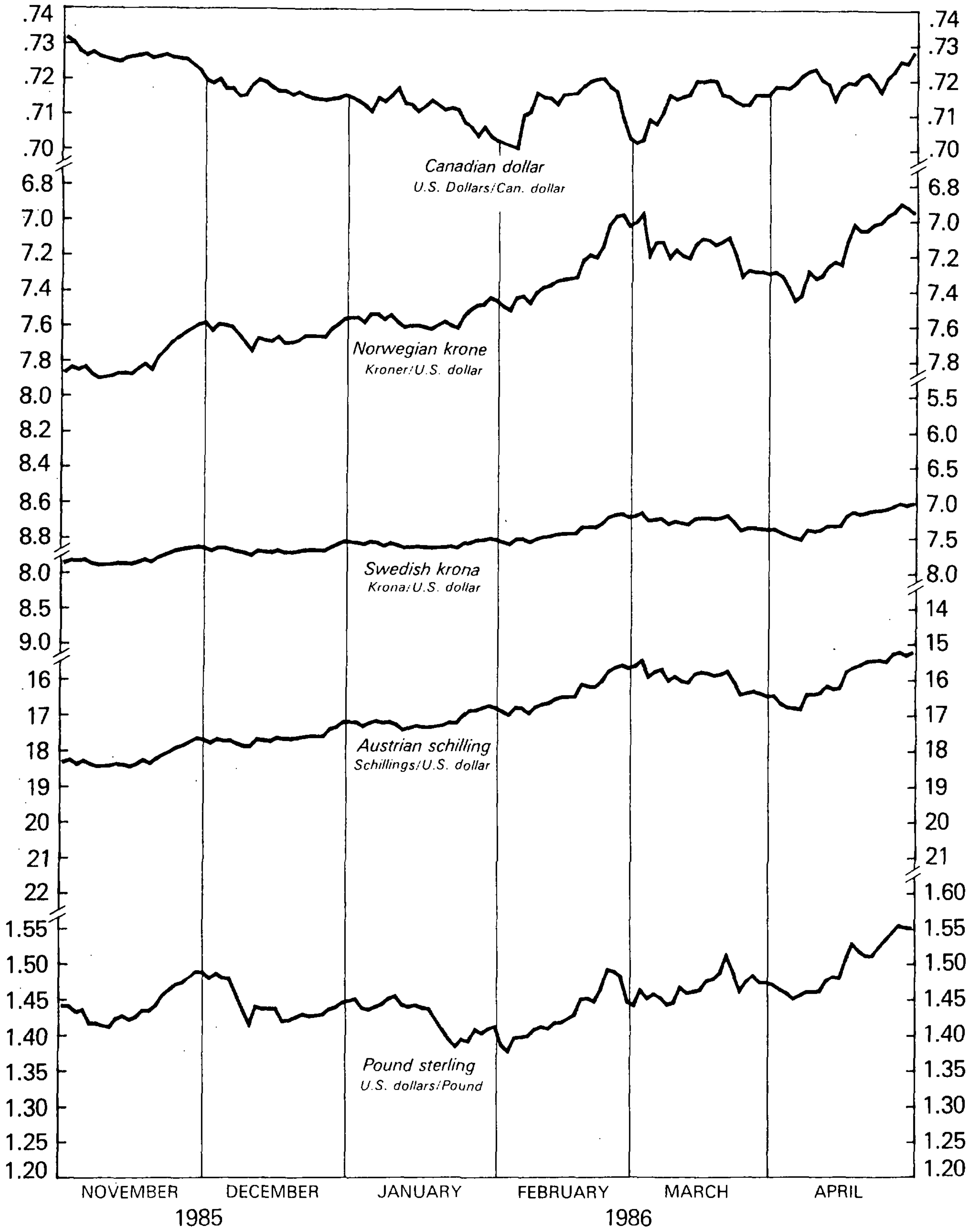


CHART 6

INDEXES OF EXCHANGE RATES OF FIVE MAJOR CURRENCIES AGAINST THE SDR

JUNE 1974 - APRIL 1986

(June 28, 1974=100)

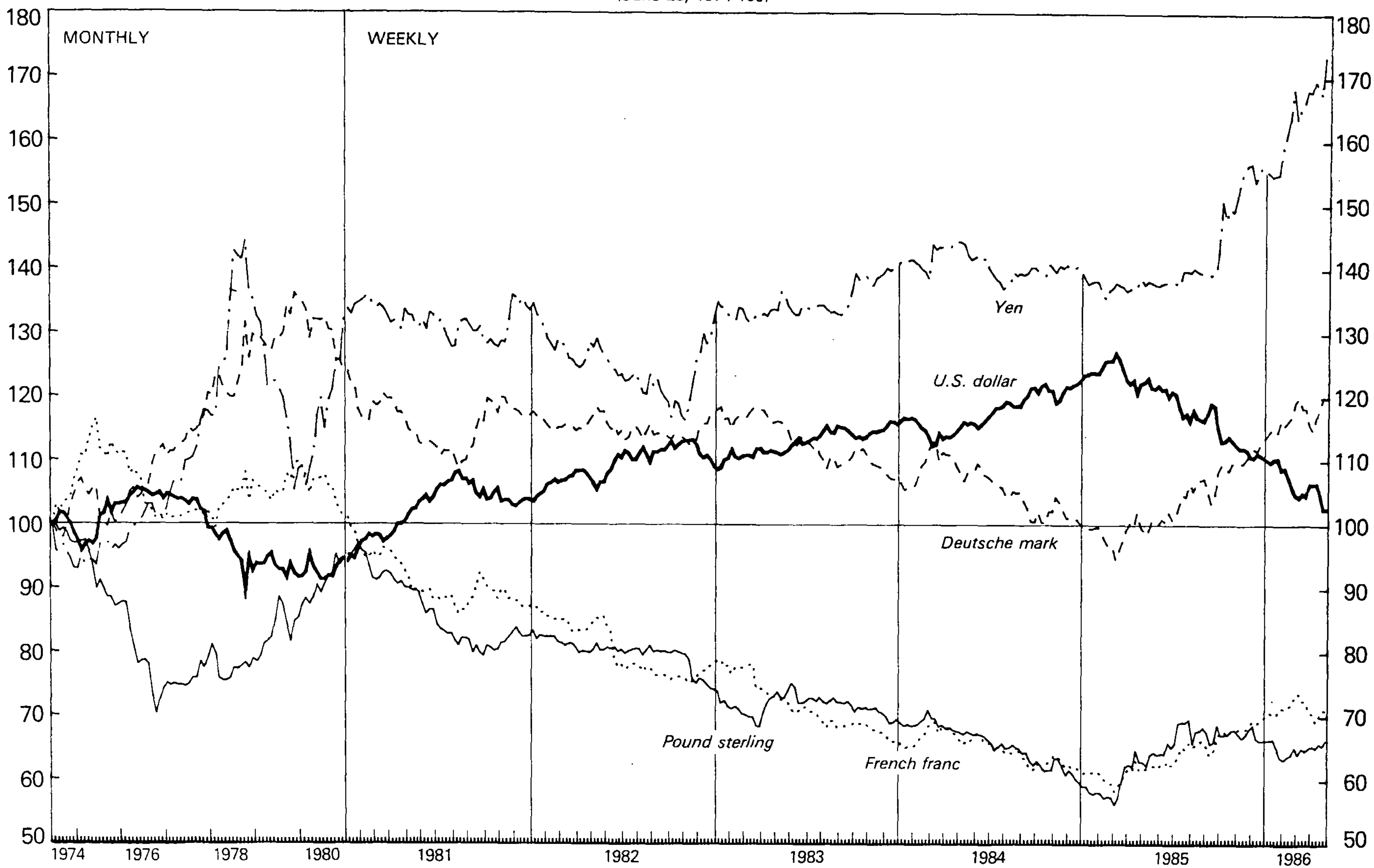


CHART 7

SHORT-TERM MONEY MARKET RATES

(Percent per annum)

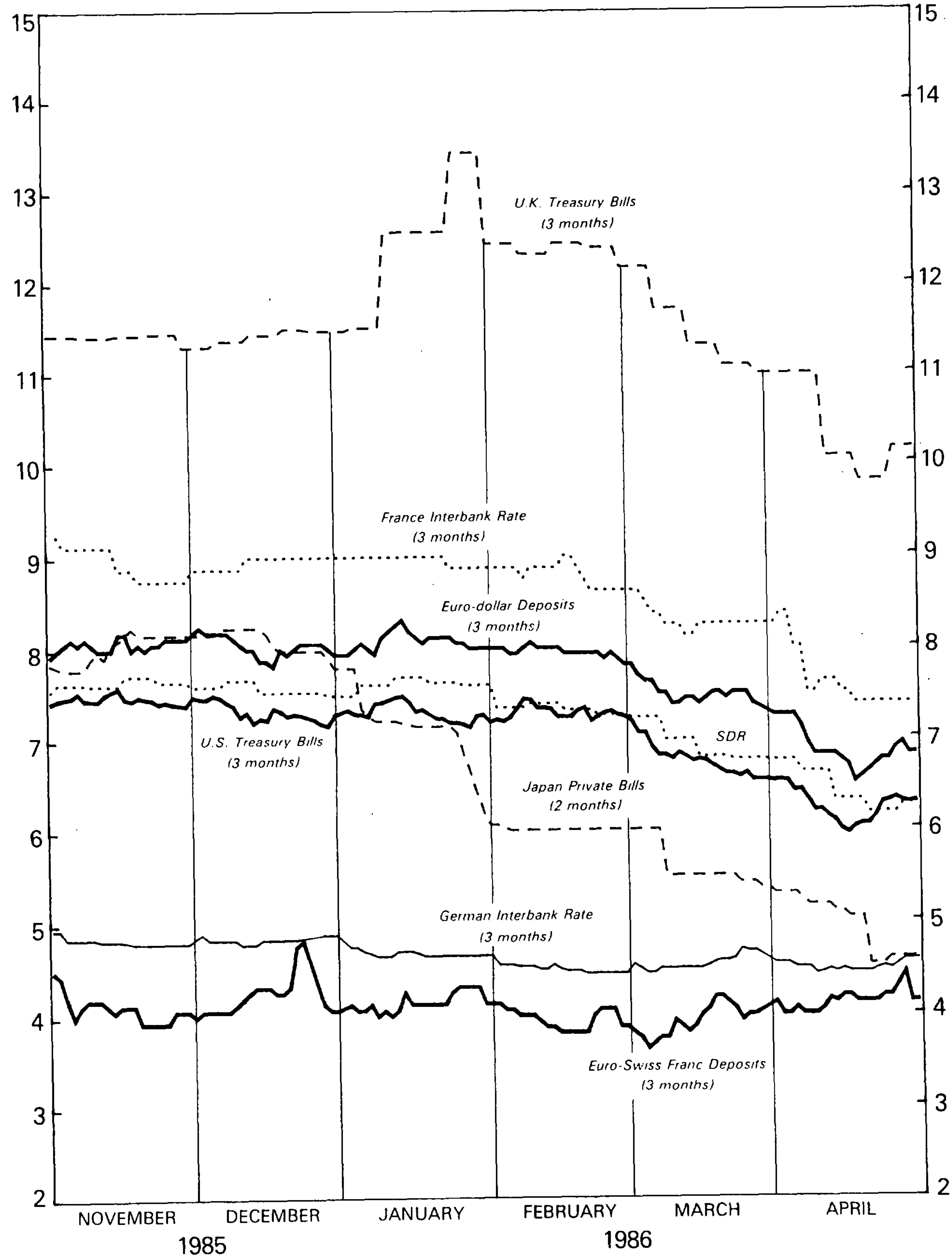


CHART 8

THREE-MONTH FORWARD RATES

Margins from Spot Rates based on noon quotations in New York

(Percent per annum)

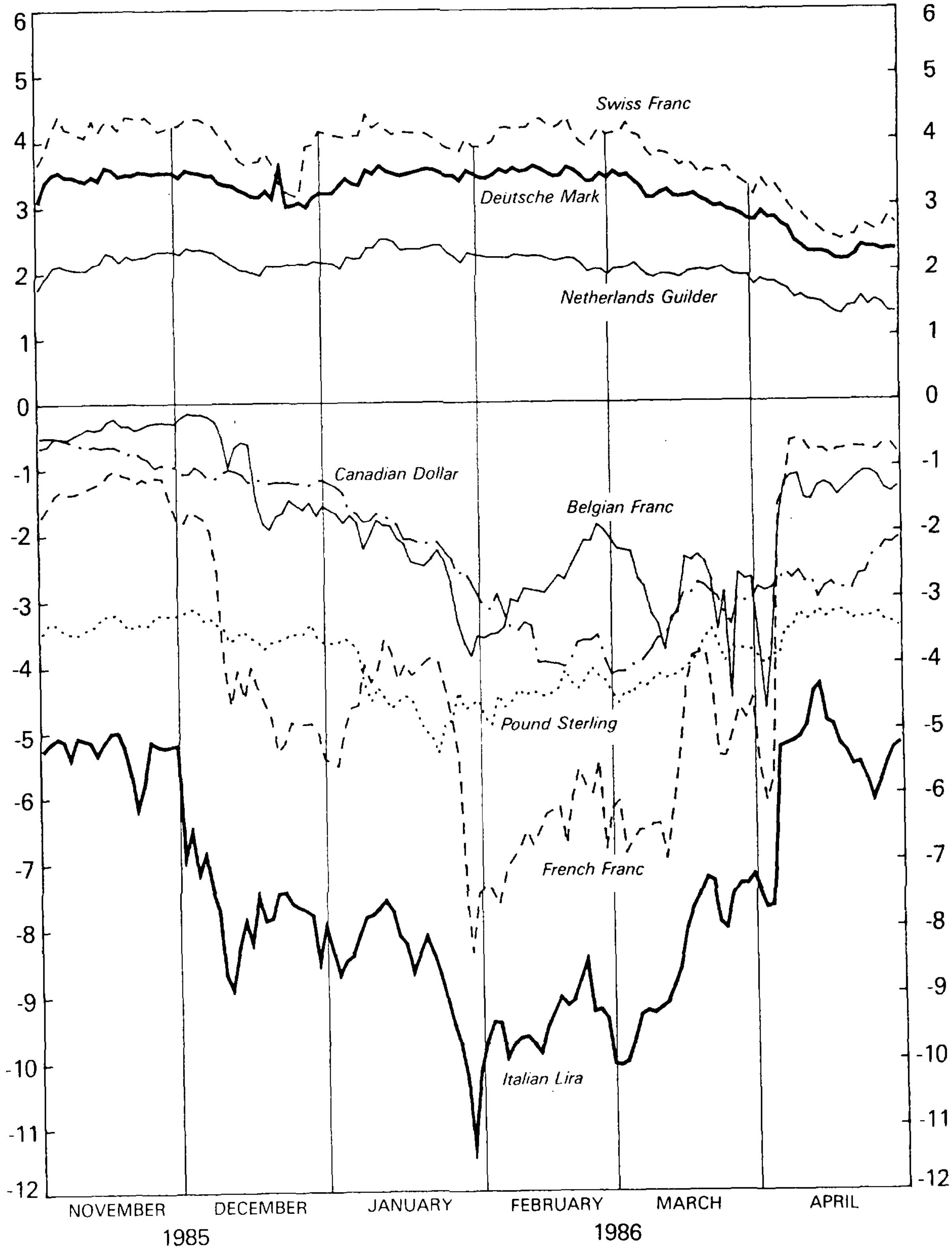


CHART 9

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)

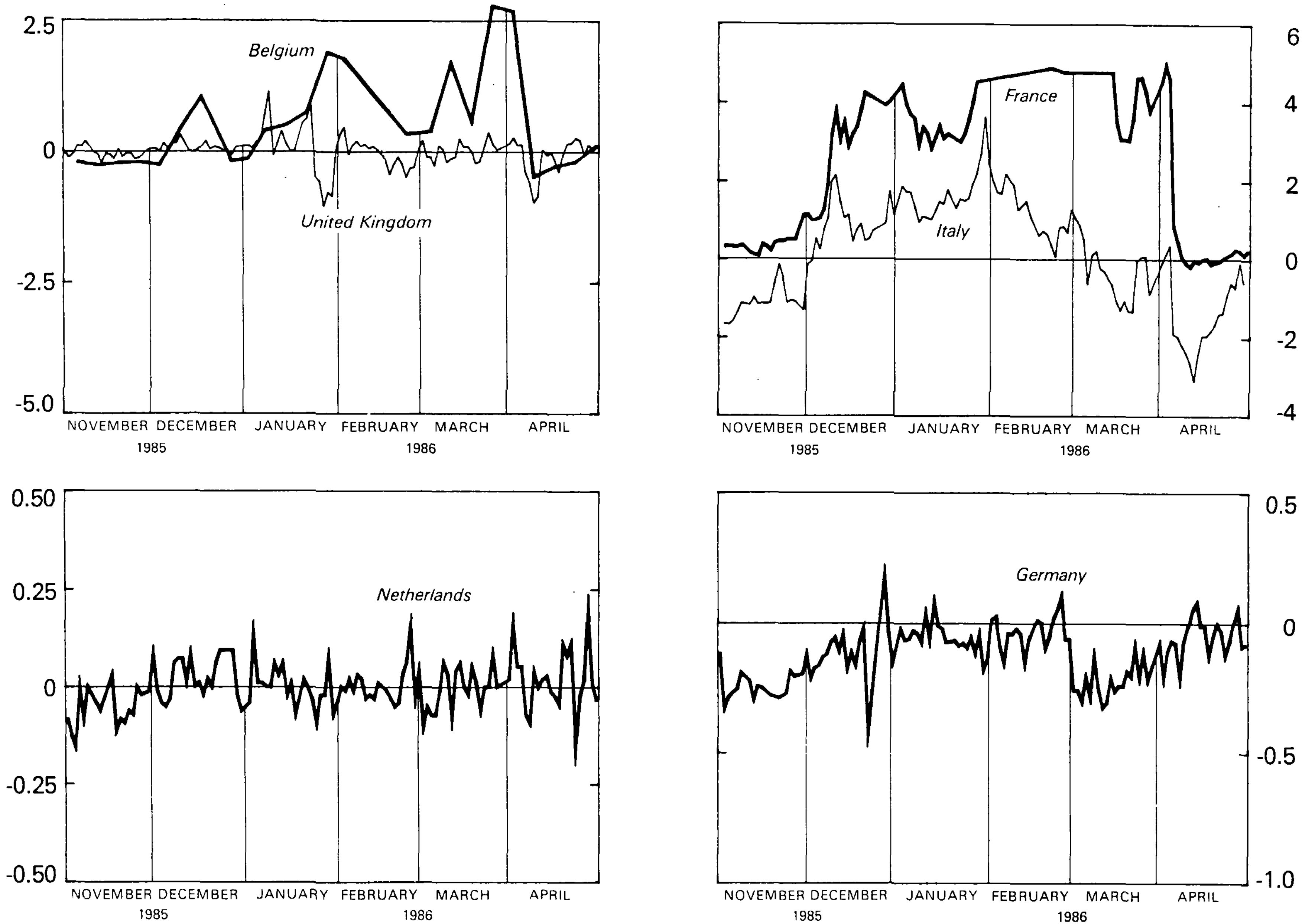
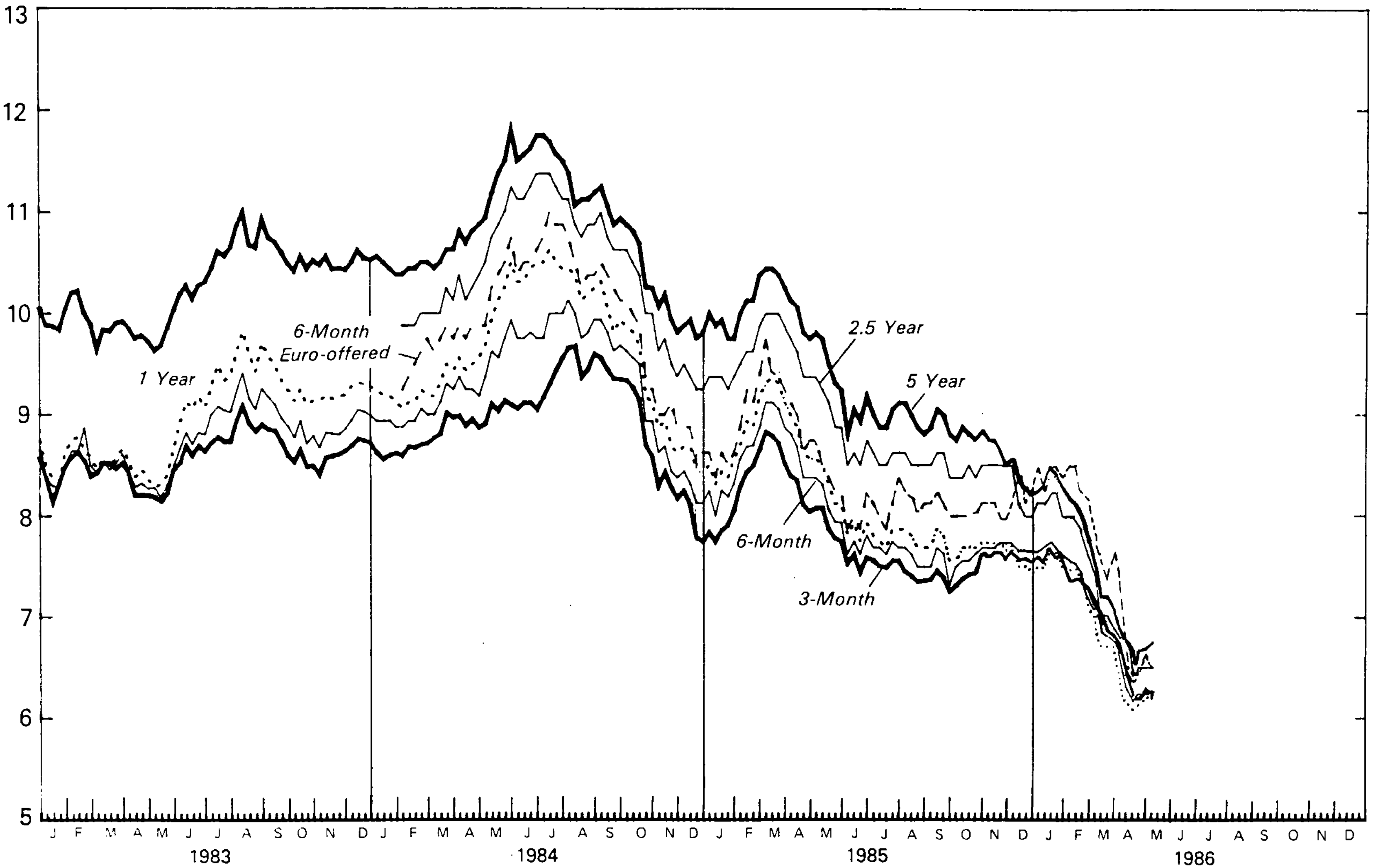


CHART 10

INTEREST RATES ON FUND-RELATED SDR ASSETS

(In percent per annum; weekly Wednesday observations)



Foreign Exchange Rates, March 1986 - April 1986 1/

	March				April				
	5	12	19	26	2	9	16	23	30
Austrian schilling	15.9150	16.0250	15.8700	16.3650	16.6550	16.4050	15.7650	15.4320	15.2250
Belgian franc									
Official	46.320	46.735	46.300	47.755	48.375	47.520	45.685	44.815	44.165
Financial	46.625	47.325	46.915	48.785	49.250	48.025	46.000	45.175	44.500
Canadian dollars	0.70884	0.71544	0.72007	0.71314	0.71826	0.72325	0.71955	0.71687	0.72804
Danish kroner	8.37750	8.45150	8.33750	8.58750	8.77100	8.60250	8.27500	8.12200	8.01500
Deutsche mark	2.26600	2.28350	2.26100	2.32950	2.37350	2.34225	2.24900	2.19550	2.16450
French francs	6.96250	7.02800	6.96150	7.16750	7.28450	7.44600	7.16250	7.00750	6.89300
Irish pounds	1.33325	1.32400	1.33770	1.29575	1.27600	1.30500	1.35350	1.38050	1.40495
Italian lire	1539.000	1553.000	1539.000	1583.500	1614.000	1598.000	1540.000	1505.500	1489.000
Japanese yen	181.375	180.150	177.050	179.750	179.450	180.000	176.450	169.300	167.550
Netherlands guilder	2.55850	2.57750	2.55200	2.62900	2.67350	2.63525	2.53475	2.47800	2.43975
Norwegian kroner	7.19500	7.19500	7.13500	7.27500	7.30800	7.32250	7.11000	7.00500	6.95250
Pounds sterling	1.45200	1.46750	1.47950	1.47550	1.46500	1.46150	1.50700	1.52400	1.55150
Swedish kronor	7.24000	7.27600	7.21500	7.34500	7.41000	7.39250	7.18500	7.09000	7.00200
Swiss francs	1.91450	1.93250	1.89450	1.95550	1.98050	1.95550	1.88750	1.83600	1.81150

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.

Option Premiums on the Philadelphia Stock Exchange 1/

I. Deutsche Mark Contracts Expiring in June 1986 2/

	Striking price							
	41	42	43	44	45	46	47	48
End-of-month observations:								
				(Call option premiums)				
February	--	3.65	3.01	2.25	1.69	1.30	--	--
March	--	--	1.18	0.65	0.51	0.27	0.20	0.13
April	5.12	4.01	--	2.08	1.65	0.95	0.57	0.45
				(Put option premiums)				
February	--	0.32	0.60	0.88	1.26	1.80	--	--
March	--	0.76	1.30	--	2.59	--	--	--
April	0.06	0.12	0.20	0.32	0.55	1.22	--	--

II. Japanese Yen Contracts Expiring in June 1986 3/

	Striking price							
	54	55	56	57	58	59	60	62
End-of-month observations:								
				(Call option premiums)				
February	2.80	1.82	1.48	1.00	0.83	--	--	--
March	--	--	1.47	0.80	--	0.38	--	--
April	--	4.67	--	3.01	2.26	1.62	0.71	0.43
				(Put option premiums)				
February	0.56	1.16	1.40	--	--	--	--	--
March	--	0.50	--	1.70	--	--	--	--
April	0.10	--	0.19	0.32	0.55	0.86	--	--

1/ Options traded on the Philadelphia Exchange are "American options," meaning that they can be exercised at any time on or before the maturity date; so-called "European options" can only be exercised on the maturity date.

2/ The size of the Deutsche mark contracts is DM 62,500 and the premiums and striking prices are expressed in terms of U.S. cents per Deutsche mark.

3/ The size of the Japanese yen contracts is ¥ 6,250,000 and the premiums and striking prices are expressed in terms of U.S. cents per hundred yen.

Short and Medium-Term Interest Rates

(Monthly and weekly averages)

	Domestic money markets 1/ (three-month)						Eurocurrency markets 2/ (three-month)						Lending rates		U.S. Treasury 5/
	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)	securities (five-year) (15)
1985															
May	7.73	5.92	12.31	10.31	6.38	7.89	8.17	5.61	12.65	10.28	6.33	5.16	8.54	10.31	10.34
Jun	7.17	5.75	12.18	10.35	6.32	7.55	7.65	5.51	12.44	10.37	6.30	5.19	7.95	9.78	9.60
Jul	7.31	5.42	11.79	10.12	6.35	7.54	7.95	5.13	12.08	10.51	6.33	5.11	8.17	9.50	9.70
Aug	7.36	4.85	11.24	9.95	6.41	7.42	8.08	4.65	11.50	11.86	6.37	4.66	8.33	9.50	9.81
Sep	7.33	4.75	11.33	9.75	6.45	7.38	8.20	4.52	11.52	10.23	6.43	4.62	8.46	9.50	9.81
Oct	7.39	4.87	11.34	9.46	6.80	7.44	8.15	4.71	11.54	10.17	6.78	4.57	8.32	9.50	9.69
Nov	7.47	4.90	11.44	9.06	8.04	7.65	8.07	4.74	11.57	9.35	7.91	4.11	8.15	9.50	9.28
Dec	7.33	4.90	11.41	9.07	8.10	7.58	8.05	4.83	11.73	11.79	7.59	4.22	8.11	9.50	8.73
1986															
Jan	7.30	4.74	12.47	9.08	7.10	7.59	8.08	4.59	12.87	12.96	6.66	4.15	8.17	9.50	8.68
Feb	7.29	4.56	12.38	8.92	6.00	7.32	7.95	4.51	12.72	14.81	6.07	3.95	8.03	9.50	8.34
Mar	6.76	4.61	11.48	8.42	5.59	6.89	7.50	4.46	11.76	13.27	5.53	3.92	7.54	9.10	7.46
Apr	6.23	4.56	10.35	7.73	4.97	6.35	6.87	4.47	10.53	8.38	4.88	4.13	6.90	8.83	7.05
1986 week ending															
Apr 4	6.50	4.60	10.98	8.36	5.31	6.68	7.25	4.47	11.36	12.13	5.17	4.05	7.21	9.00	7.22
11	6.25	4.53	10.80	7.76	5.18	6.44	6.90	4.43	10.55	7.64	4.95	4.04	6.95	9.00	7.04
18	6.01	4.52	10.01	7.58	5.06	6.21	6.66	4.42	10.23	7.51	4.74	4.15	6.71	9.00	6.80
25	6.21	4.55	9.87	7.48	4.56	6.17	6.74	4.49	10.21	7.48	4.75	4.19	6.80	8.79	7.10

1/ As of January 1, 1986, The combined market interest rate under the amended Rule T-1 is calculated by multiplying the yield or rate on each of the respective instruments listed below by the number of units of the corresponding currency listed in Rule O-1 and the value in terms of the SDR of a unit of that currency as determined by the Fund under Rule O-2(a) and (b). The interest rates and the respective currency units (shown in parentheses) are as follows: market yield for three-month U.S. Treasury bills ($ 0.452), three-month interbank deposit rates in Germany (DM 0.527), three-month interbank money rate against private paper in France (F 1.02), discount rates on two-month (private) bills in Japan (¥ 33.4), and market yield for three-month U.K. Treasury bills (£ 0.0893). Before January 1, 1986, the respective currency units were $ 0.54, DM 0.46, F 0.74, ¥ 34, and £ 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.