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INTERNATIONAL MONETARY FUND

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Foreign Exchange and Financial Markets in May 1986

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In May, the value of the U.S. dollar rose sharply after declining over the past 15 months. Statements by policy-makers in the key industrial countries in the first half of the month, although sometimes conflicting, appeared in general to convey the view that a further depreciation of the U.S. dollar was not necessary. U.S. economic data released during the latter half of the month indicating greater-than-expected strength in the U.S. economy also contributed to the strength of the U.S. dollar. Early in the month, the G-7 countries agreed at the Tokyo Summit to improve the coordination of their economic policies, but no action was taken to initiate a new round of interest rate reductions, as some market analysts had predicted. Interest rate movements were mixed in May; rates firmed in the United States and Germany, were little changed in Japan, and eased in France and the United Kingdom.

I. Foreign Exchange Markets

The value of the U.S. dollar rose by 3.75 percent in effective (MERM) terms in May (see Table 1). The currencies participating in the exchange arrangements of the European Monetary System (EMS) posted sharp declines of 6.44-6.97 percent against the U.S. dollar. Other currencies reported in Table 1 also eased against the U.S. dollar, in many cases by over 5 percent. The principal exception was the Canadian dollar which eased by less than 0.5 percent, and the Norwegian krone which was devalued early in the month.

Through the end of May, the dollar's cumulative effective (MERM) depreciation since last year's G-5 meeting in late September amounted to about 16 percent, and to about 25 percent since its peak in February 1985 (see Table 2). As of the end of May of this year, the non-dollar currencies in the SDR basket had appreciated by 40-51 percent against the U.S. dollar from their lows in February of last year and by 8-38 percent since the G-5 meeting.

Table 1. Changes in Exchange Rates during May 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 May 1985
Belgium	-6.93	-2.66	-1.11	+5.92
Denmark	-6.81	-2.59	-1.68	+9.49
France	-6.91	-2.70	-1.73	+5.18
Germany	-6.88	-2.74	-1.74	+9.54
Ireland	-6.97	-2.79	-2.14	+10.09
Italy	-6.44	-2.57	-2.10	+0.88
Netherlands	-6.67	-2.99	-1.78	+10.10
Austria	-6.85	-2.70	-2.01	+10.75
Canada	-0.43	+2.45	+1.27	-9.05
Japan	-3.96	+0.77	+0.55	+31.31
Norway	-11.26	-8.28	-7.84	-4.84
Sweden	-5.19	-1.57	-0.33	+1.68
Switzerland	-6.26	-1.87	-1.19	+12.36
United Kingdom	-5.07	-1.36	-0.48	-4.88
United States	--	+2.87	+3.75	-19.27

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-May 1986	
	From February 1985 2/	From September 20, 1985 3/
U.S. dollar effective exchange rate (MERM)	-24.50	-15.93
Deutsche mark	+48.49	+22.46
Pound sterling	+39.93	+7.68
French franc	+42.55	+17.20
Japanese yen	+50.80	+37.60

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.

Statements by policymakers in the key industrial countries dominated the dollar's movement during the first half of the month, generally reversing the bearish sentiment toward the dollar that had prevailed during April. In the week prior to the Tokyo Economic Summit held on May 4-6, the President of the Bundesbank indicated that in his view the dollar had fallen far enough. This statement, taken together with intervention in support of the dollar by the Bundesbank and the Bank of Japan during that week, apparently led to the expectation in the market that an agreement might be reached at the Summit to slow the dollar's decline. However, the market again turned bearish against the dollar after the Summit, apparently disappointed with the lack of any concrete agreement at the meeting. A key statement during the Summit was a comment by the U.K. Chancellor of the Exchequer on May 5 that the majority of the G-5 nations still expected the Japanese yen to rise in the medium-term. Following the Summit, new support for the U.S. dollar came from statements by several officials. On May 13, senior U.S. officials were interpreted as indicating that a further decline in the dollar was no longer welcome. On May 15, the President of the Bundesbank said that

coordinated central bank intervention could be useful against further dollar declines. On May 16, the Japanese Prime Minister said that the time for intervention in support of the dollar was near. These statements were interpreted by the market as suggesting that Japan and West Germany might agree to urge the United States to undertake coordinated intervention to support the dollar. As a result of these and other, sometimes conflicting, statements, the dollar reversed its declining trend and returned by mid-May to its level at the beginning of the month.

Further support for the dollar was provided by U.S. economic data released later in the month. GNP data released on May 20 revised upwards real GNP growth in the first quarter, contrary to market expectations, from the previously estimated 3.2 percent seasonally adjusted annual rate to 3.7 percent. On May 29, there was an announcement of a 1.5 percent rise in the U.S. index of leading indicators in April, an increase about twice as large as had been expected. In addition, President Reagan on that same day commented that the dollar had now reached "a more competitive level". The dollar received an added boost the following day when it was reported that the U.S. trade deficit narrowed to $12.07 billion in April from $12.18 billion (revised down from $14.52 billion) in March. The dollar ended the month at seven-week highs against the German and Japanese currencies.

The Japanese yen was again highlighted in exchange markets during the month, as was evidenced by market attention paid to statements pertaining to the yen/dollar exchange rate. Following the U.K. Chancellor of the Exchequer's comment during the Summit that the majority of the G-5 nations expected the Japanese yen to rise in the medium-term, the Japanese yen hit successive record highs against the dollar, reaching a peak of ¥ 159.99 per dollar at one point in Tokyo on May 12. During this period the Bank of Japan intervened in support of the dollar. It was not until Prime Minister Nakasone's statement on May 16 that the time for support of the dollar was near, that the trend finally took a marked turn, bringing the yen sharply back down by the end of the month. On balance, the yen eased by 3.96 percent against the U.S. dollar during the month. Nevertheless, the yen continued to firm (by 0.55 percent) in effective (MERM) terms during May, and thus remained the currency posting the largest appreciation (+31 percent) in effective terms over the year. In other developments, the trade surplus continued to rise to a record $7.66 billion in April from $7.42 billion in March; the unemployment rate rose to 2.9 percent from 2.7 percent during the same period.

The currencies participating in the European Monetary System eased by 6.44-6.97 percent against the U.S. dollar. The French franc remained the strongest currency in the EMS throughout the month, except on May 2 when it was replaced by the Italian lira. The divergence indicator for the French franc continued to be above

its upper threshold while the other currencies were within their thresholds, with the minor exception of the Irish pound being over its upper threshold on May 6 (see Chart 3). The weakest currency during the month rotated among the Netherlands guilder, the Danish krone, the Belgian franc, and the Deutsche mark. The EMS currencies eased by 1.11-2.14 percent in effective (MERM) terms.

Among other currencies in Table 1, the Norwegian krone depreciated sharply (by 11.26 percent against the U.S. dollar, and by 7.84 percent in MERM terms) as the currency index to which it is pegged (with margins of 2.25 percent) was devalued by 12 percent on May 12. The Canadian dollar posted the smallest decline against the U.S. dollar, easing only by 0.43 percent; it firmed by 1.27 percent in MERM terms.

The volatility of exchange rates against the U.S. dollar decreased for most major currencies in terms of the measures given in Table 3. For the EMS currencies, the high-low spreads declined markedly to 6.6-7.1 percent in May from 10.3-13.3 percent in April, and the average of absolute daily percentage changes (MAC in Table 3) also fell for most of these currencies, averaging 0.65 percent in May compared with 0.79 percent in the preceding month. The high-low spreads also fell for each of the other major currencies except the Norwegian krone, but the MAC was mixed and averaged 0.64 percent in May compared with 0.58 percent in April.

Changes in gross foreign exchange reserves were mixed in May (see Table 4). Italy recorded the largest increase, while Germany and Norway registered the largest declines. Over the latest 12-month period, most major industrial countries experienced increases in their gross foreign exchange reserves, with the United States recording a gain of over $11 billion. This increase in U.S. reserves primarily reflected the revaluation of foreign exchange reserves associated with the depreciation of the dollar over this period, as well as foreign exchange acquired in the course of exchange market intervention. Italy and Ireland, however, registered small foreign exchange losses.

Among other developments pertaining to foreign exchange markets, the Heads of State and the Finance Ministers of the G-7 countries convened in Tokyo on May 4-6 for the Annual Economic Summit and agreed to improve the coordination of their economic policies. To this end, they reaffirmed the undertaking at the 1982 Versailles Summit to cooperate with the International Monetary Fund to strengthen multilateral surveillance, taking into account principal economic indicators such as GNP growth rates, inflation rates, interest rates, unemployment rates, fiscal deficit ratios, current account and trade balances, monetary growth rates, reserves and exchange rates. They also agreed that improved coordination should include fostering greater stability in exchange rates.

Table 3. 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	44.455	47.455	12.2	6.7	0.85	0.61
Denmark	8.0450	8.6005	10.3	6.9	0.68	0.68
France	6.9250	7.4045	10.6	6.9	0.84	0.66
Germany	2.1735	2.3245	10.7	6.9	0.70	0.68
Ireland	1.39925	1.30700	13.3	7.1	0.89	0.64
Italy	1492.50	1591.50	11.7	6.6	0.84	0.61
Netherlands	2.4485	2.6140	10.7	6.8	0.70	0.67
Austria	15.293	16.345	10.6	6.9	0.70	0.70
Canada	0.73327	0.72466	1.9	1.2	0.27	0.19
Japan	161.100	174.450	9.4	8.3	0.61	0.76
Norway	6.9280	7.8350	7.9	13.1	0.60	0.98
Sweden	7.0100	7.3855	7.4	5.4	0.51	0.51
Switzerland	1.8040	1.9325	11.3	7.1	0.85	0.75
United Kingdom	1.54650	1.47280	7.2	5.0	0.52	0.56

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 May 1986 1/

(In millions of U.S. dollars)

	End-month reserve level	Change in May	Change over 12 months
Belgium	5,222	+1,006	+1,084
Denmark	3,799	-403	+245
France (March)	24,135	-55	+4,533
Germany	37,726	-2,204	+3,945
Ireland	2,638	-88	-344
Italy	17,336	+1,674	-275
Netherlands	9,156	-394	+1,634
Austria	4,702	-44	+1,559
Canada	1,791	+59	+113
Japan	28,197	+1,511	+5,006
Norway	11,313	-1,105	+248
Sweden	6,093	+44	+2,228
Switzerland	15,966	+358	+3,564
United Kingdom	12,487	+1,126	+5,019
United States (April)	15,062	+1,097	+11,010

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 May, short-term interest rates declined in Canada, the United Kingdom, France and Italy, but firmed somewhat in most other major countries. The Economic Summit in Tokyo at the beginning of the month did not trigger the coordinated round of interest rate reductions that some analysts had predicted. Official rates in some countries were reduced during the course of the month to bring them into line with money market rates. Inflation rates continued to fall; in many countries, wholesale price indices registered actual declines and consumer prices continued to rise at the slowest pace for many years (see Table 5). The OECD reported that consumer prices in its 24 industrial country members rose by an average of 2.6 percent in the twelve months to April, the smallest increase since January 1965.

After declining each month since the beginning of the year, short-term interest rates in the United States firmed somewhat during May as the view became more widespread among market participants that the Federal Reserve Board was likely to adopt a less accommodative monetary policy. Contributing to this view were expectations that oil and commodity prices would not decline further, that actions would need to be taken to restrict the recent rapid growth of the M1 monetary aggregate, and that there would be a pick-up in growth in the U.S. economy without the stimulus of further interest rate cuts. At the short-term end of the market, the yield on three-month Treasury bills continued its decline in early May, but then began to rise, ending the month at 6.49 percent, 0.21 percentage point higher than end-April. Rates firmed across the board at the long-term end of the market. The yield on 30-year maturities firmed by 0.27 percentage point to 7.74 percent. However, the slope on the yield curve steepened only marginally. The differential between the yield on three-month Treasury bills and that on 30-year Treasury securities rose from 1.19 percentage points at end-April to 1.25 percentage points at end-May.

The M1 measure of the U.S. money supply, seasonally adjusted, averaged $660.5 billion in the week ended May 26. During the six weeks ended May 26, M1 rose by $19.2 billion for an annual growth rate of 21.2 percent, which was far above the upper end of the Federal Reserve's target range of 3-8 percent annual growth for M1 during 1986. Most market analysts were of the opinion that despite the rapidity of this increase, the Federal Reserve Board was unlikely to tighten monetary policy significantly, unless such moves were justified by the performance of the dollar in the foreign exchange markets or by the general state of the economy.

Table 5. Inflation Rates and Short-Term Interest Rates

	Month 2/	Inflation rates 1/ (year-on-year percent changes): Wholesale price index 3/	Consumer price index 4/	Short-term interest rates 5/ (end-of-month): April	May
Austria	Mar./Apr.	-5.8 (-3.0)	1.4 (1.8)	4.00	4.00
Belgium	Mar./May	-2.9 (-6.3)	1.1 (1.4)	8.00	8.00
Canada	Feb./Apr.	5.36 (5.1)	3.9 (4.1)	8.78	8.42
Denmark	April	-7.4 (-6.3)	4.0 (1.8)	7.00	7.00
France	.../Apr.	... (...)	2.6 (3.0)	7.48	7.35
Germany	Apr./May	-7.1 (-7.1)	-0.2 (-0.2)	4.64	4.66
Italy	Mar./May	0.3 (2.5)	6.4 (6.6)	12.69	11.94
Japan	April	-9.0 (-8.1)	0.9 (1.1)	4.60	4.66
Netherlands	Feb./May	-4.0 (...)	0.5 (0.6)	5.50	5.94
Norway	Feb./Apr.	2.2 (3.2)	5.8 (5.5)	13.84	14.04
Spain	Feb./Apr.	3.0 (...)	7.7 (8.7)	11.98	11.35
Sweden	April	1.5 (1.9)	4.5 (4.3)	8.00	8.00
Switzerland	April	-3.9 (-3.5)	1.0 (0.9)	4.13	4.75
United Kingdom	Mar./Apr.	5.0 (5.1)	3.0 (4.2)	10.16	9.55
United States	April	-2.1 (-1.4)	1.6 (2.3)	6.28	6.49

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/ Industrial price index for Spain.

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

5/ 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, Norway, and Spain; 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.

Money market conditions were mixed in May in the countries participating in the EMS. In France, the three-month interbank money rate fell from 7.48 percent to as low as 7.10 percent at mid-month, but closed the month at 7.35 percent. On May 14, the Bank of France lowered its money market intervention rate by 0.25 percentage point to 7.25 percent. During the month, the major banks cut base lending rates by 0.5 percentage point to 9.6 percent.

In mid-May a package of economic measures was announced. As part of this package, the interest rates on small-saver deposit-book accounts and housing savings accounts and savings paper issued by the Treasury and the Post Office were cut by 1.5 percentage points to 4.5 percent. In addition, banks were permitted to set interest rates for deposits of more than three months maturity on a competitive basis. The authorities also announced that: the minimum maturity of certificates of deposit would be reduced to three months from six months with immediate effect, and to 10 days from March 1987; the maximum maturity of commercial paper would be raised to two years from six months; and a new category of negotiable paper called financial company bills would be created with maturities ranging from two to seven years. In the same package of economic measures, foreign exchange controls were considerably relaxed. Companies were permitted to hedge their currency exposure by using forward foreign exchange contracts of up to six months for the imports of goods instead of three months. In addition, forward cover was permitted on the import of services, on commodities and futures trading, and on foreign debt service. It was also announced that exporters would be permitted to hold foreign currency earnings for up to one month instead of eight days, and that private residents would be allowed to carry out portfolio and residential investments abroad without going through the Investment Currency Pool. This liberalization of capital movements brought French policies closer to those of the United Kingdom and Germany and in closer conformity with the provisions of the Treaty of Rome.

In Germany, the three-month interbank rate moved very little and ended the month at 4.66 percent, up only 0.02 percentage point from end-April. With the Deutsche Mark near the bottom of the EMS currency band and with the central bank money supply exceeding the 3.5-5.5 percent target range for 1986, the Bundesbank decided at its regular monthly meeting to leave its discount and Lombard rates unchanged. The Kreditanstalt Fuer Wiederaufbau (KFW), the German state-owned reconstruction loan agency, raised interest rates on lending from its own resources by 0.25 percentage point which was in line with the rise in capital market yields; for example, the yield on notes and bonds of the Federal Railways and the Post Office with a remaining period to maturity of five years rose from 5.38 percent at end-April to 5.79 percent at end-May.

In Italy, the three-month interbank rate ended the month at 11.94 percent, down 0.75 percentage point from end-April. On May 27, the Bank of Italy reduced its official discount rate by 1 percentage point to 12 percent, the fourth reduction in the past seven months and 7 percentage points below the historical high of 19 percent reached in 1981. Several major banks reduced their prime lending rates from 14.5 percent to 13.5 percent during the course of the month. In Belgium, the four-month fonds des rentes remained stable at 8 percent throughout May. The relative strength of the Belgian franc in the EMS, after the realignment of the previous month, permitted the Belgian National Bank to cut its discount rate and Lombard rate on two occasions during May, first by 0.25 percentage point to 8.5 percent and 8.75 percent, respectively, and then on May 27 by a further 0.5 percentage point to 8 percent and 8.25 percent, respectively. During the course of the month, rates on one- to three-month Treasury certificates were reduced in stages from 8.25 percent to 7.6 percent.

In the Netherlands, the rate on three-month interbank money rose 0.44 percentage point to 5.94 percent over the course of the month as the guilder came under some pressure following its revaluation within the EMS during the previous month and the uncertainties about the expected outcome of the general elections held on May 21. On May 20, the Nederlandsche Bank cut the average daily amount that banks could borrow from it at the regular secured loan rate of 5 percent from f. 4.6 billion to f. 3.8 billion, and imposed a surcharge of 1 percentage point on borrowings beyond that limit. It raised the maximum average daily amount that could be borrowed only slightly from f. 5.7 billion to f. 6.1 billion for the coming three-month period. This was the first time in four years that the Central Bank had resorted to the imposition of a surcharge over the secured loans rate.

In Ireland, the Central Bank twice cut its short-term facility rate at which it lends to the main clearing banks; at end-May this rate stood at 11.5 percent, 1.0 percentage point lower than end-April. In Japan, interest rates remained fairly stable during May. The interest rate on two-month private bills firmed slightly by 0.06 percentage point and ended May at 4.66 percent.

Short-term interest rates remained firm in the United Kingdom during the first half of May and then declined markedly. The rate on the three-month Treasury bills ended the month at 9.55 percent, 0.76 percentage point lower than its mid-month peak. The three-month interbank money rate declined from 10.47 percent to 9.84 percent over the course of the month. Late on May 22, the National Westminster Bank cut its base lending rate by 0.5 percentage point to 10 percent. Identical reductions were made by the other clearing banks on the following day, and the Bank of England endorsed the reductions by cutting all of its money market intervention rates by 0.5 percentage

point. In May a commercial paper market was opened in London. This market will enable large companies to borrow and lend among themselves through the medium- of short-term unsecured paper, thus bypassing the banking system. The opening of this market was generally greeted with enthusiasm, but some concerns were expressed about the possible effects on the U.K. banking system.

With regard to monetary aggregates, the latest Bank of England data showed that on a provisional, seasonally-adjusted basis, sterling M3 rose by 3 percent in the banking month of May. The reason for this rise, which was more than double what most market participants had expected, was not immediately obvious. The year-on-year growth rate of 19.5 percent was 3 percentage points higher than in the banking month of April, and thus was further above the upper limit of the 11-15 percent annual growth target. M0 grew by about 0.25 percent in banking May and by 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 0.36 percentage point to 8.42 percent during the course of May. Reflecting the continued restrictive monetary policy of the Swiss National Bank, the rate on three-month euro-Swiss francs firmed markedly from 4.13 percent at end-April to 4.75 percent at end-May. Major Swiss banks raised rates on customer time-deposits on two occasions during the month--first to 3.5 percent and subsequently to 3.75 percent. On May 29, the Swiss National Bank relaxed various capital export controls; particularly noteworthy was the ending of many of the legal distinctions between public bond issues and privately placed notes. At the beginning of the month, the Central Bank of Norway raised the key rate at which it lends to commercial banks by 1 percentage point to 14 percent. The Bank of Spain decided that from June onward, it would reduce the interest rate it pays on the required reserves that it holds for commercial and savings banks from 9 percent to 8.5 percent. This move reflected easier conditions in the country's money markets; during May the rate on three-month interbank money eased from 11.98 percent to 11.35 percent.

Three-month interest rates in the eurocurrency markets were mixed during May. Rates on euro-sterling and on euro-French francs eased by 0.75 percentage point and 0.25 percentage point, respectively, to 9.81 percent and 7.38 percent. Rates on euro-Swiss francs and eurodollars firmed by 0.62 percentage point and 0.25 percentage point, respectively, to 4.75 percent and 7.06 percent. Rates on euro-Deutsche mark and euro-Japanese yen were little changed at 4.63 percent and 4.84 percent, respectively.

Reflecting movements in eurodollar and domestic interest rates, uncovered interest differentials between investments in eurodollars and in other major currencies generally narrowed during May except for Japan and Germany, where the differential favoring eurodollar investments widened somewhat. Much the same pattern was evident in the forward exchange markets; with the exception of Japan and Germany, both premia and discounts against the U.S. dollar narrowed. As a result of these movements in interest differentials and forward exchange quotations, covered interest differentials tended to widen slightly; the most significant movement was in Belgium where the small differential in favor of eurodollar investment recorded in April changed into a marked differential in favor of domestic investment (see Table 6 and Charts 8 and 9).

Table 6. 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)	
	April	May	April	May	April	May
Belgium	-1.19	-0.94	-1.33	-0.20	+0.14	-0.74
France	-0.67	-0.29	-0.80	-0.34	+0.13	+0.05
Germany	+2.17	+2.40	+2.31	+2.56	-0.14	-0.16
Italy	-5.88	-4.88	-5.23	-4.13	-0.65	-0.75
Japan	+2.21	+2.40	+2.15	+2.32	+0.06	+0.08
Netherlands	+1.31	+1.12	+1.35	+1.18	-0.04	-0.06
United Kingdom	-3.35	-2.49	-3.45	-2.72	+0.10	+0.23

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

After sharp declines in the two previous months, the SDR interest rate eased only slightly during the month of May, reflecting mainly declining yields on the French and U.K. instruments in the SDR interest rate basket. The yield on three-month interbank money against private paper in France eased by 0.26 percentage point to 7.22 percent, and the yield on three-month Treasury bills in the United Kingdom declined by 0.43 percentage point to 9.76 percent. Rates on the other instruments in the basket firmed only slightly: the discount rate on two-month private bills in Japan rose by 0.06 percentage point to 4.66 percent; and the yields on the relevant U.S. and German instruments firmed by 0.03 percentage point and 0.02 percentage point, respectively, to 6.36 percent and 4.66 percent (Table 7).

Table 7. The SDR Interest Rate and the Rate of Remuneration 1/

		May			
	April 28	5	12	19	26
SDR interest rate	6.27	6.28	6.24	6.26	6.23
Rate of remuneration	5.77 2/	6.12	6.08	6.10	6.07

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 8 (April 30-May 28), combined domestic rates firmed by 0.06-0.25 percentage point for maturities of six months or more and were virtually unchanged for the three-month maturity. Rates on U.S. dollar, Deutsche Mark and Japanese yen instruments were generally firmer, with the greatest increases recorded for the longer maturities. Rates on pound sterling and French franc instruments were mostly lower, with the largest rate reductions on three-month maturities. In the eurocurrency markets, the marked decline in rates on euro-sterling and the euro-French franc helped to reduce the three-month combined eurocurrency (offered) rate by 0.12 percentage point to 6.63 percent. The six-month combined rate was unchanged at 6.63 percent. Rates on

the other SDR component currencies in the eurocurrency markets were generally firmer. During the same period, average interest rates on SDR-denominated deposits of selected commercial banks for maturities of three months or more firmed by 0.01-0.15 percentage point.

Table 8. Yields on Selected SDR-Denominated Assets 1/

	April	May
Combined market interest rates: 2/		
a. Based on domestic rates		
3-month maturity (Rule T-1)	6.26	6.25
6-month maturity	6.25	6.31
12-month maturity	6.19	6.31
2-1/2 year maturity	6.50	6.75
5-year maturity	6.69	6.94
b. Based on eurocurrency offered rates		
3-month maturity	6.75	6.63
6-month maturity	6.63	6.63
Average commercial bank deposit rates 3/		
1-month deposits	6.48	6.40
3-month deposits	6.39	6.40
6-month deposits	6.28	6.40
12-month deposits	6.27	6.42

1/ Rates pertain to last Wednesday of the month.

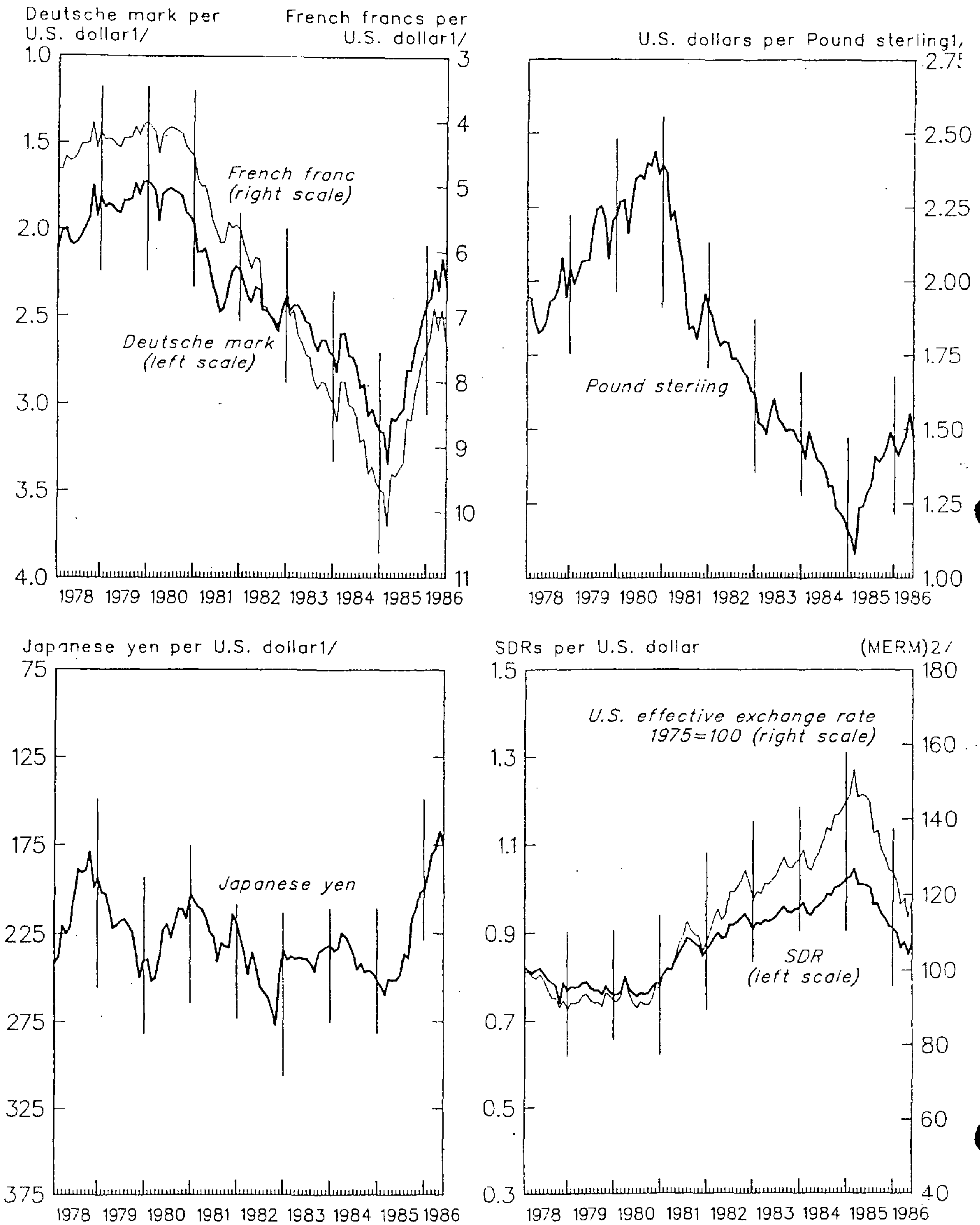
2/ Combined market rates (according to the Rule T-1) are calculated by multiplying the yields or rates of each of the respective instruments by the number of units of the corresponding currency listed in Rule O-1 and the value in terms of the SDR of a unit of that currency as determined by the Fund under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

3/ Average of rates quoted by selected commercial banks.

CHART 1

SPOT EXCHANGE RATES 1978–1986

(end of month)

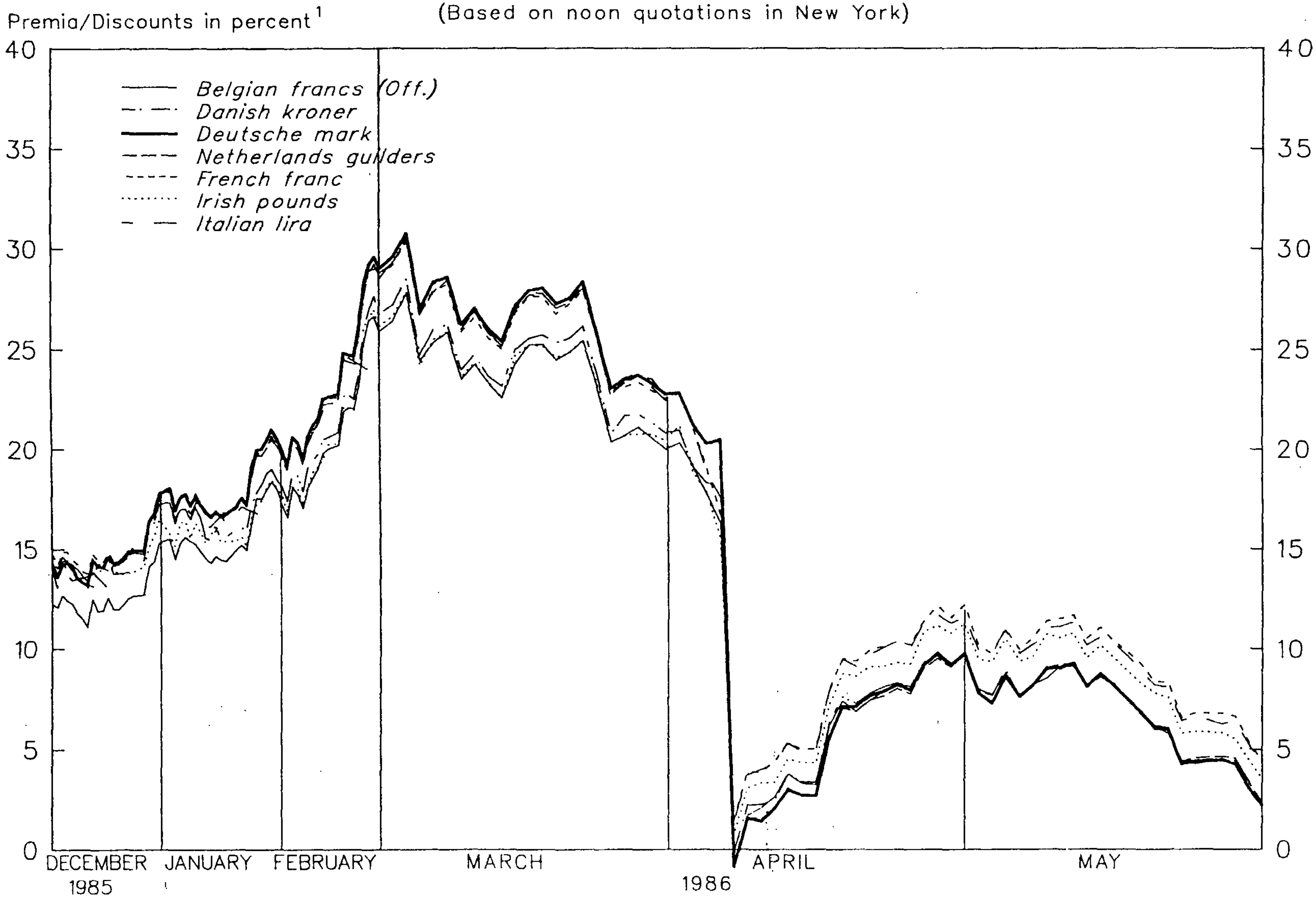


1/ New York quotations.
2/ IMF's multilateral rate model. Increase in the index means appreciation.

CHART 2

SPOT EXCHANGE RATES: EUROPEAN MONETARY SYSTEM

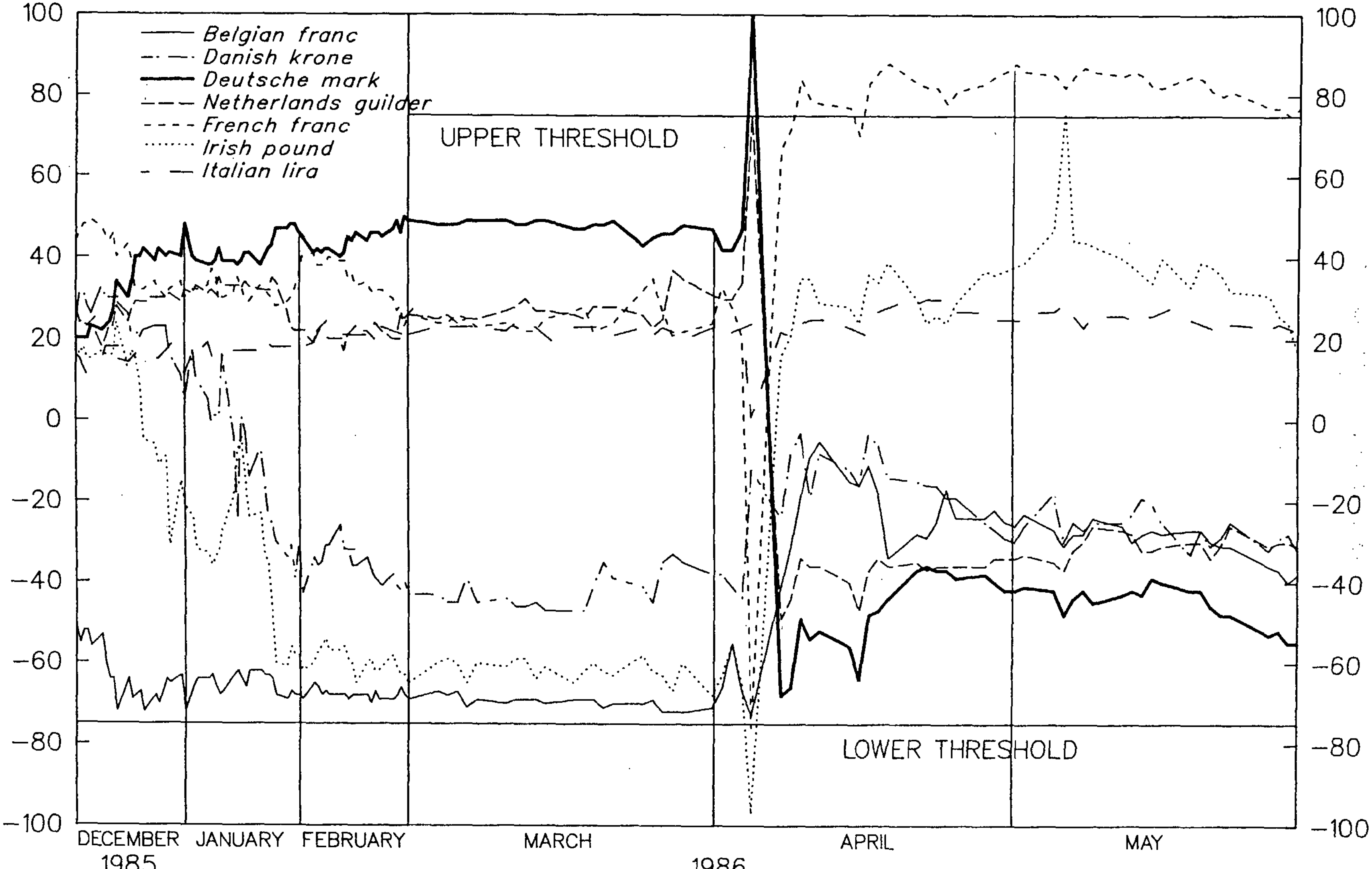
(Based on noon quotations in New York)



[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



[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 Belgium 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)

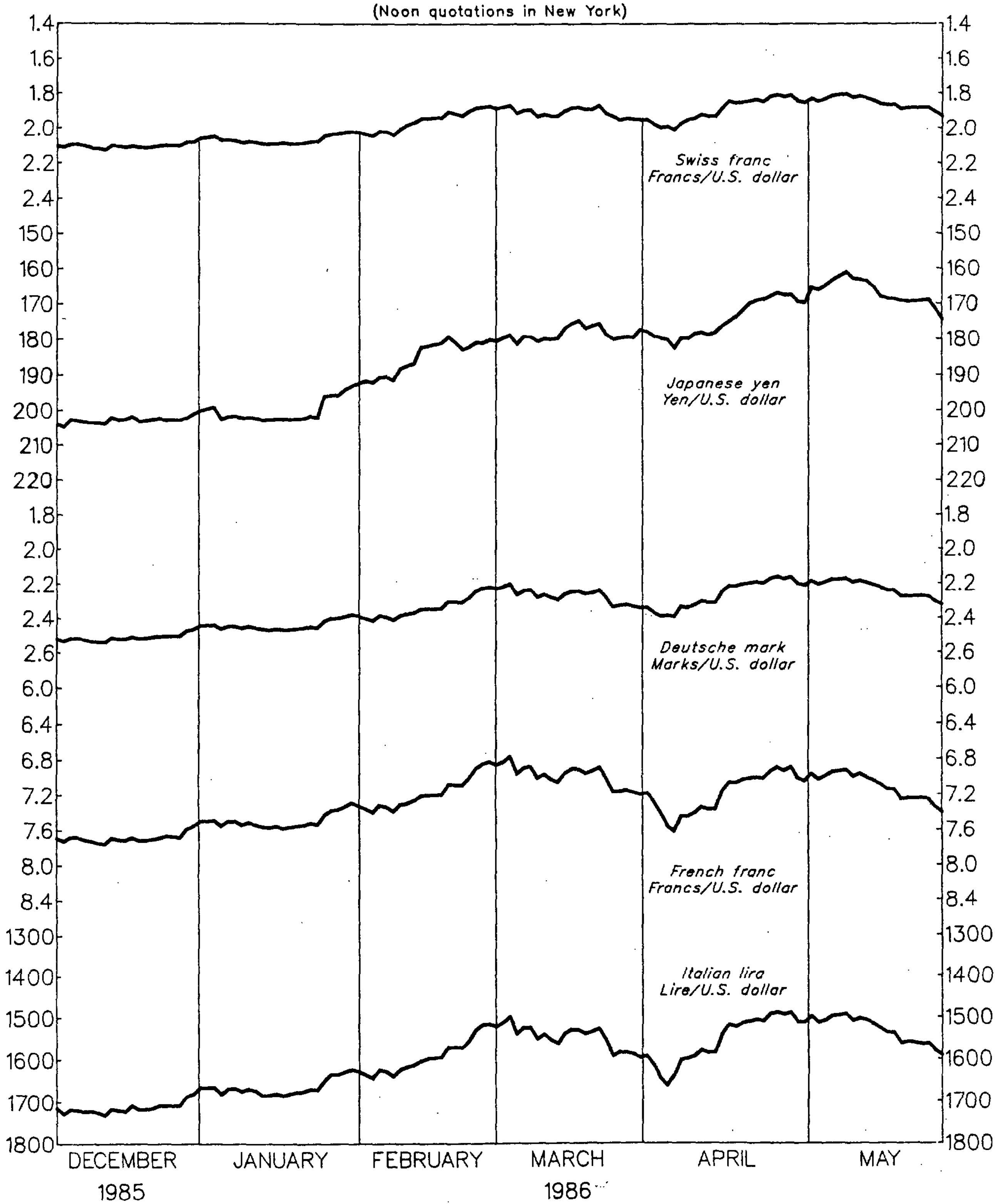


CHART 5

SPOT EXCHANGE RATES

(Noon quotations in New York)

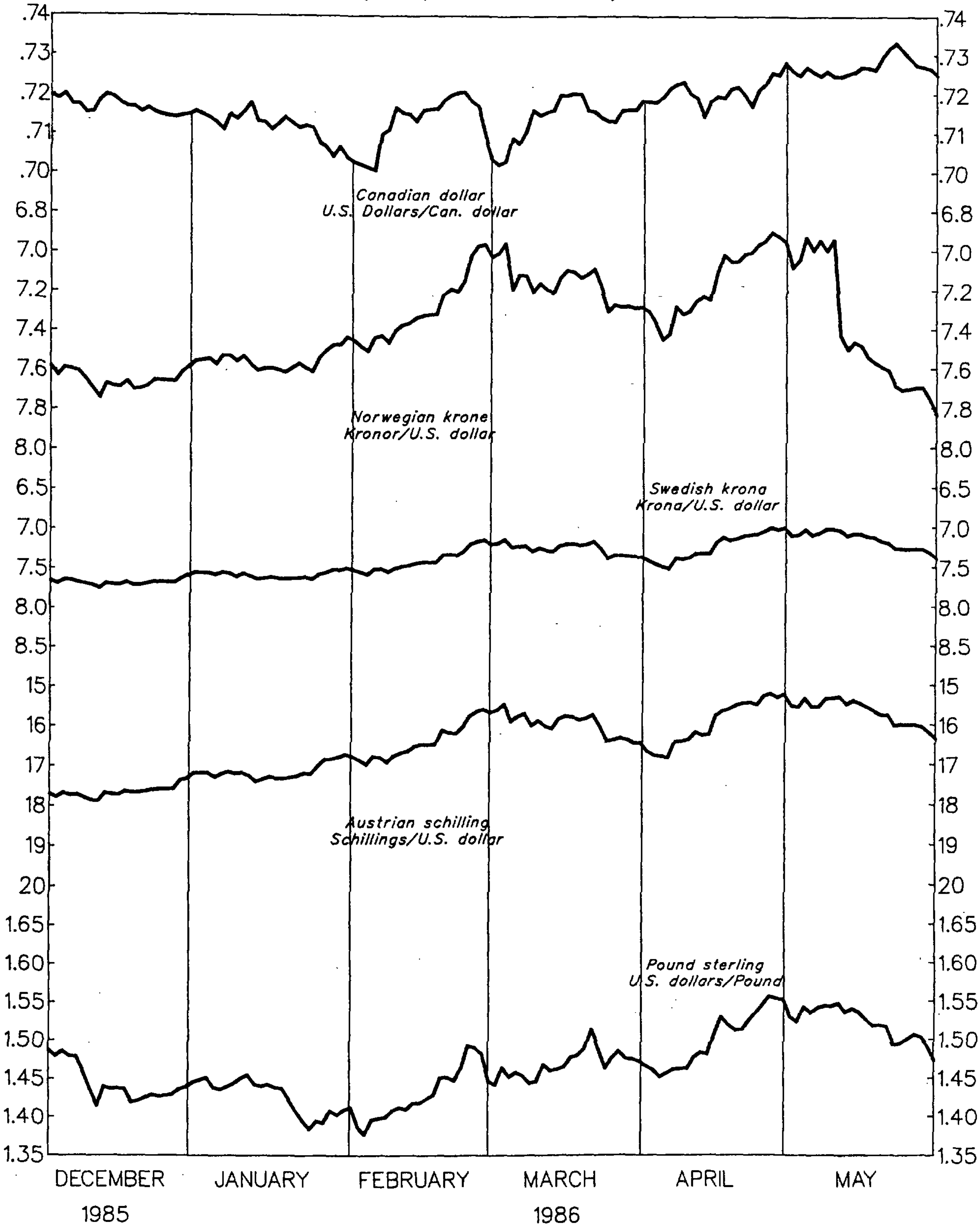


CHART 6

INDEXES OF EXCHANGE RATES OF FIVE MAJOR CURRENCIES AGAINST THE SDR

JUNE 1974 - MAY 1986

(June 28, 1974=100)

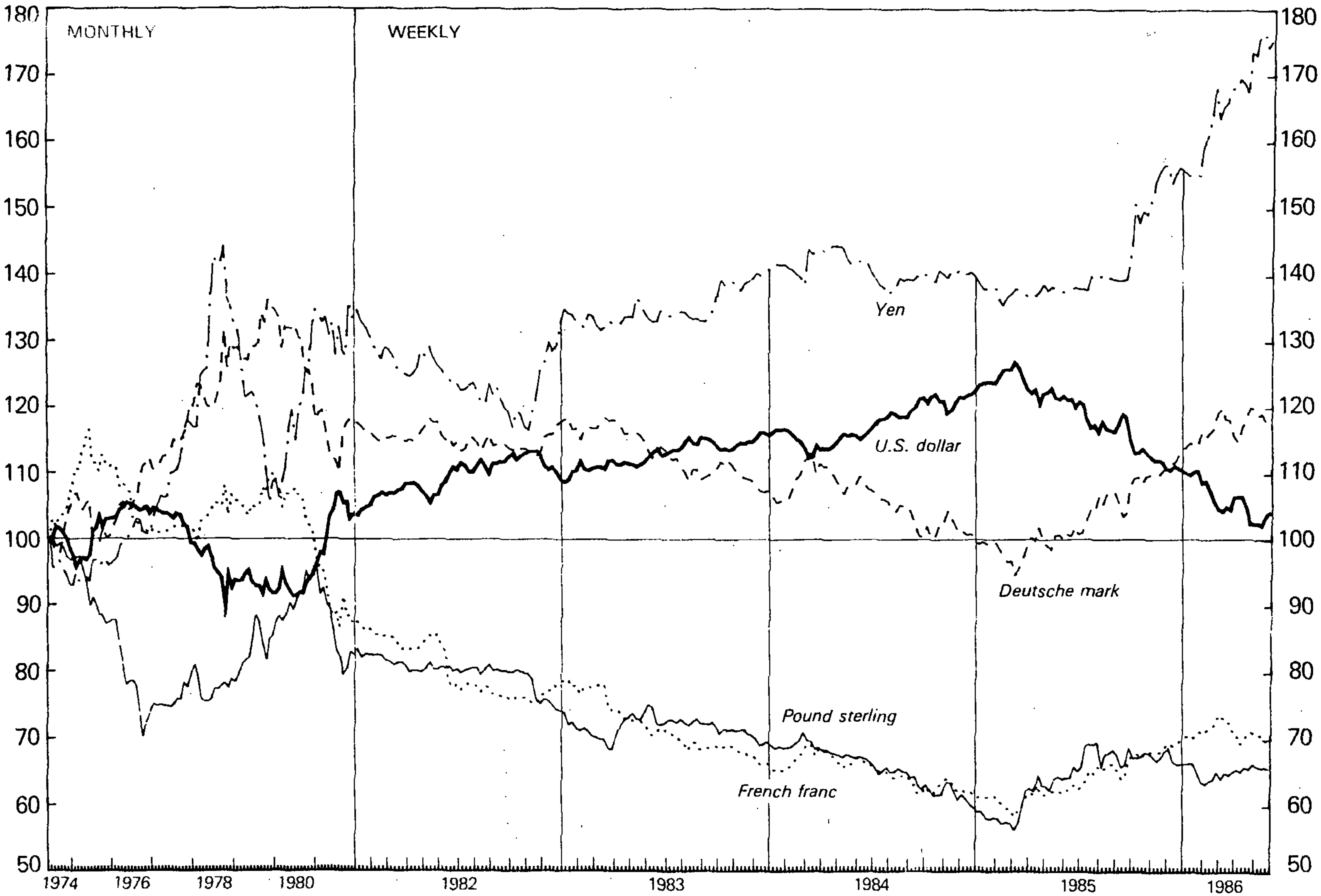


CHART 7
SHORT-TERM MONEY MARKET RATES

(Percent per annum)

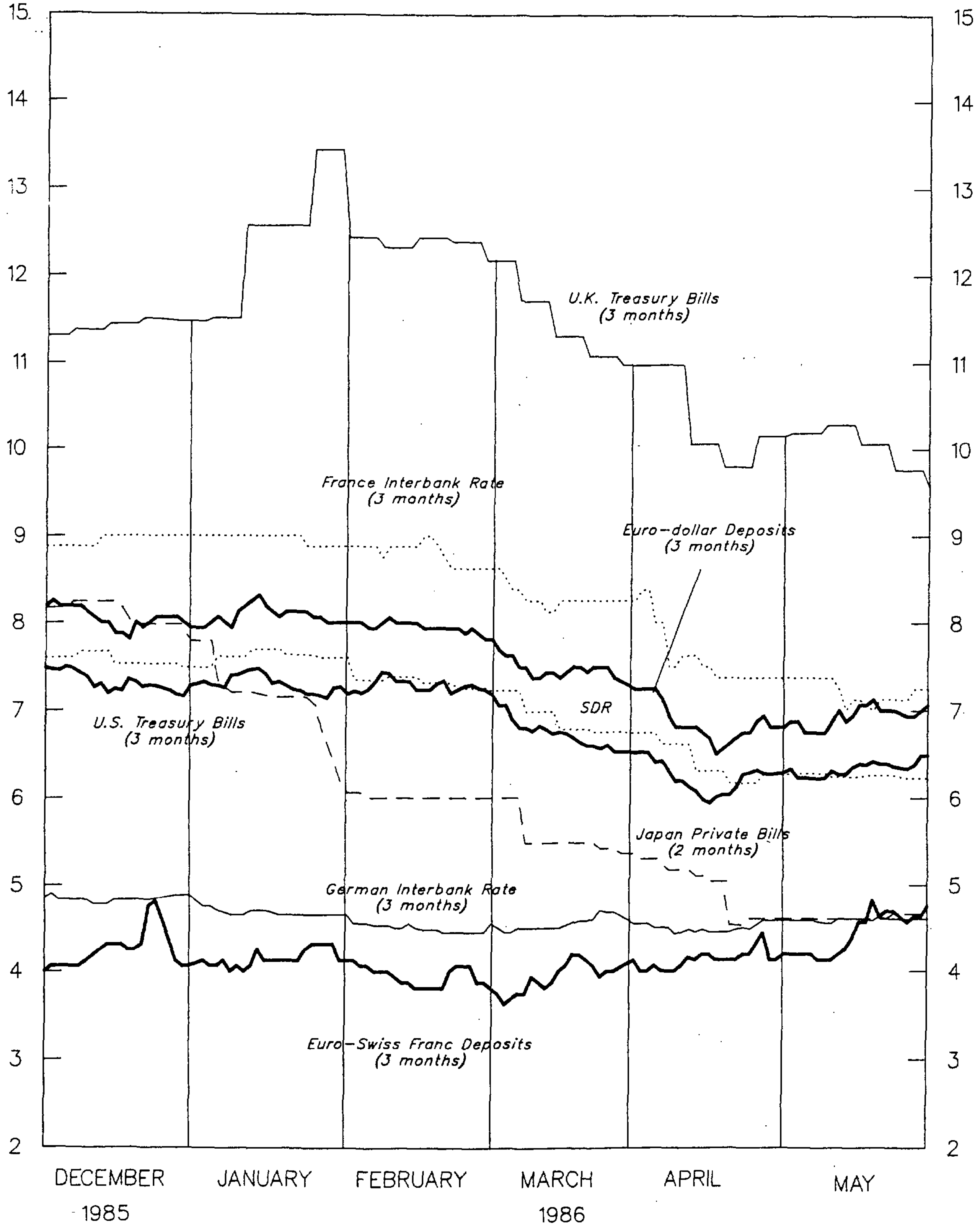


CHART 8

THREE–MONTH FORWARD RATES

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

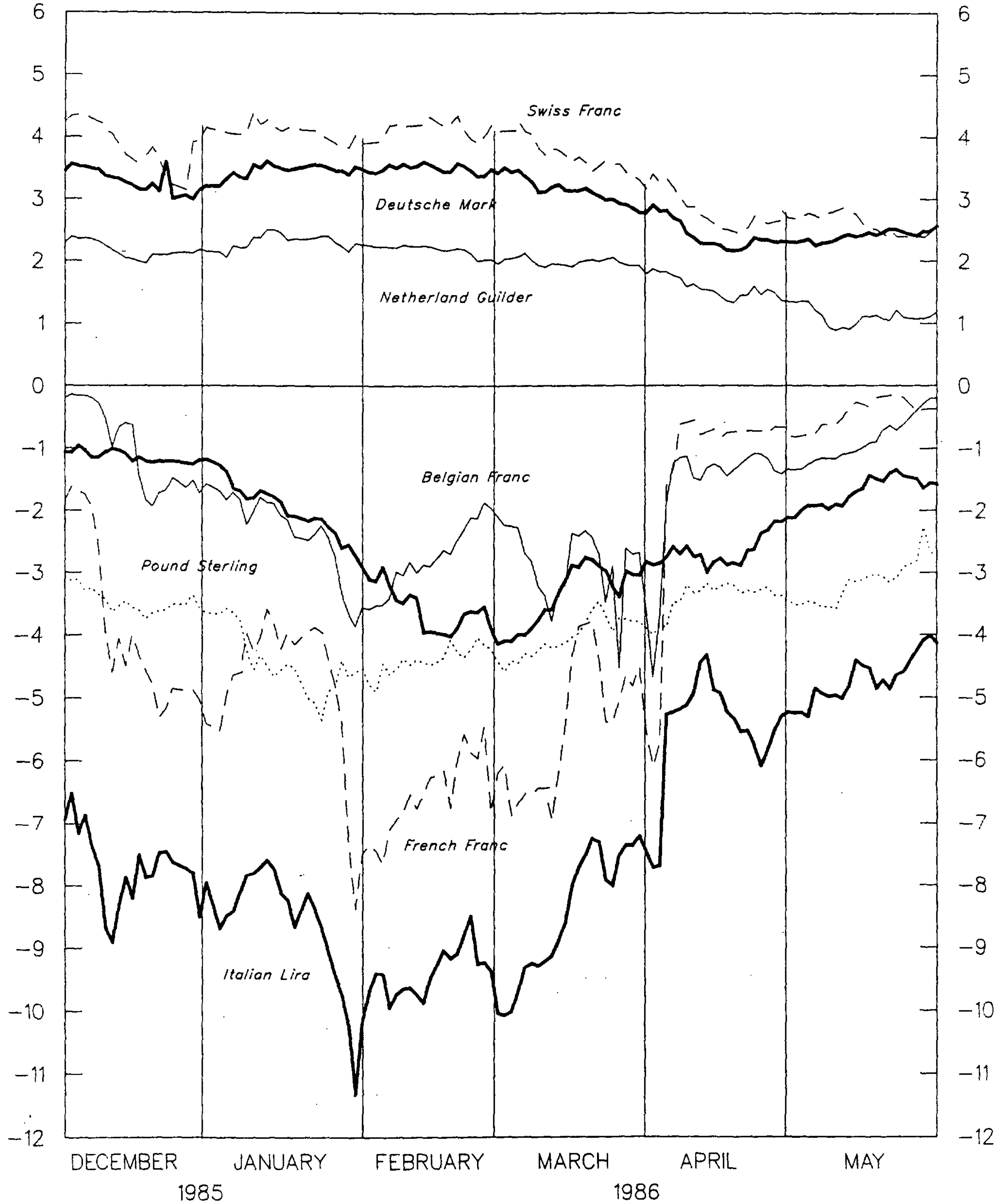


CHART 9

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)

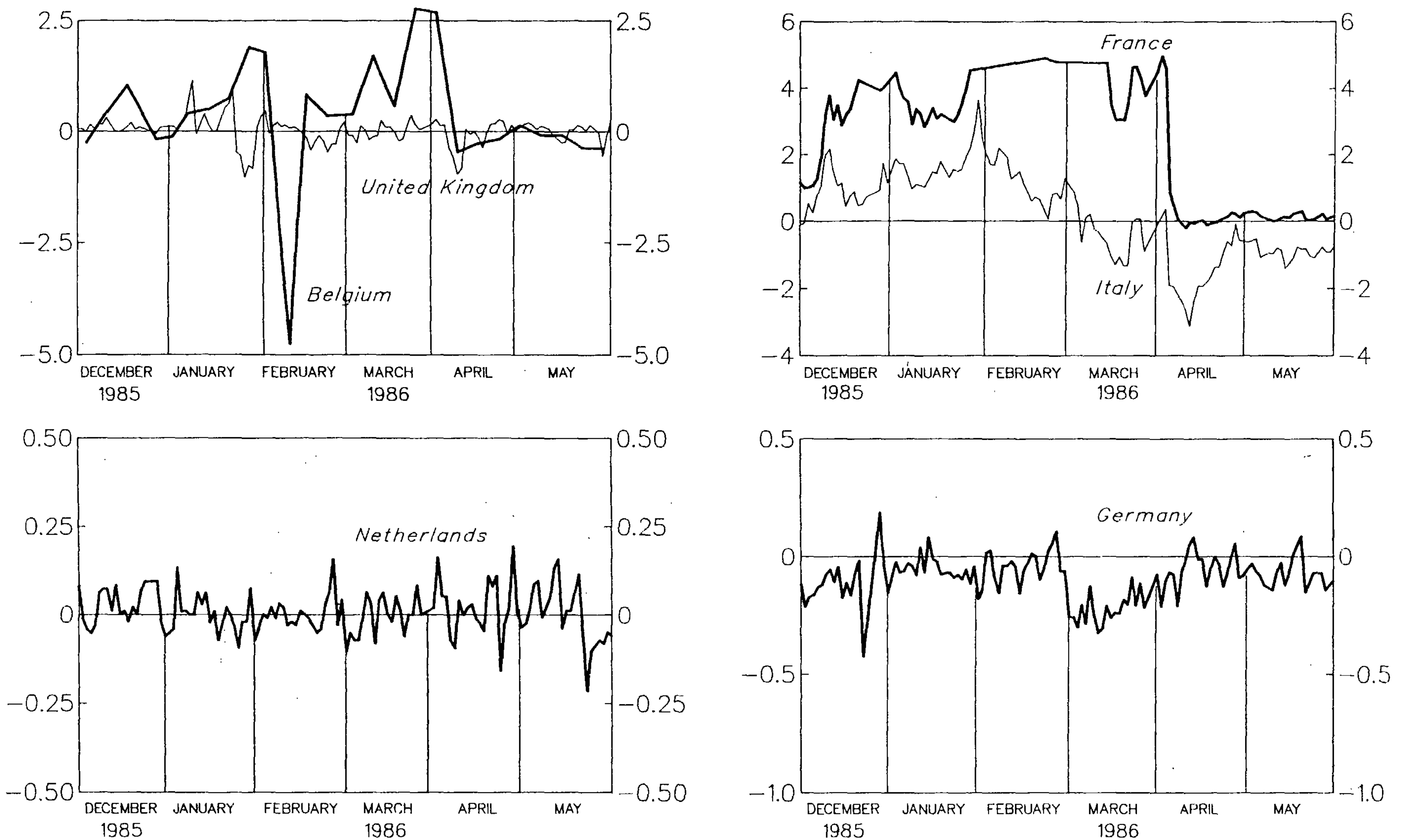
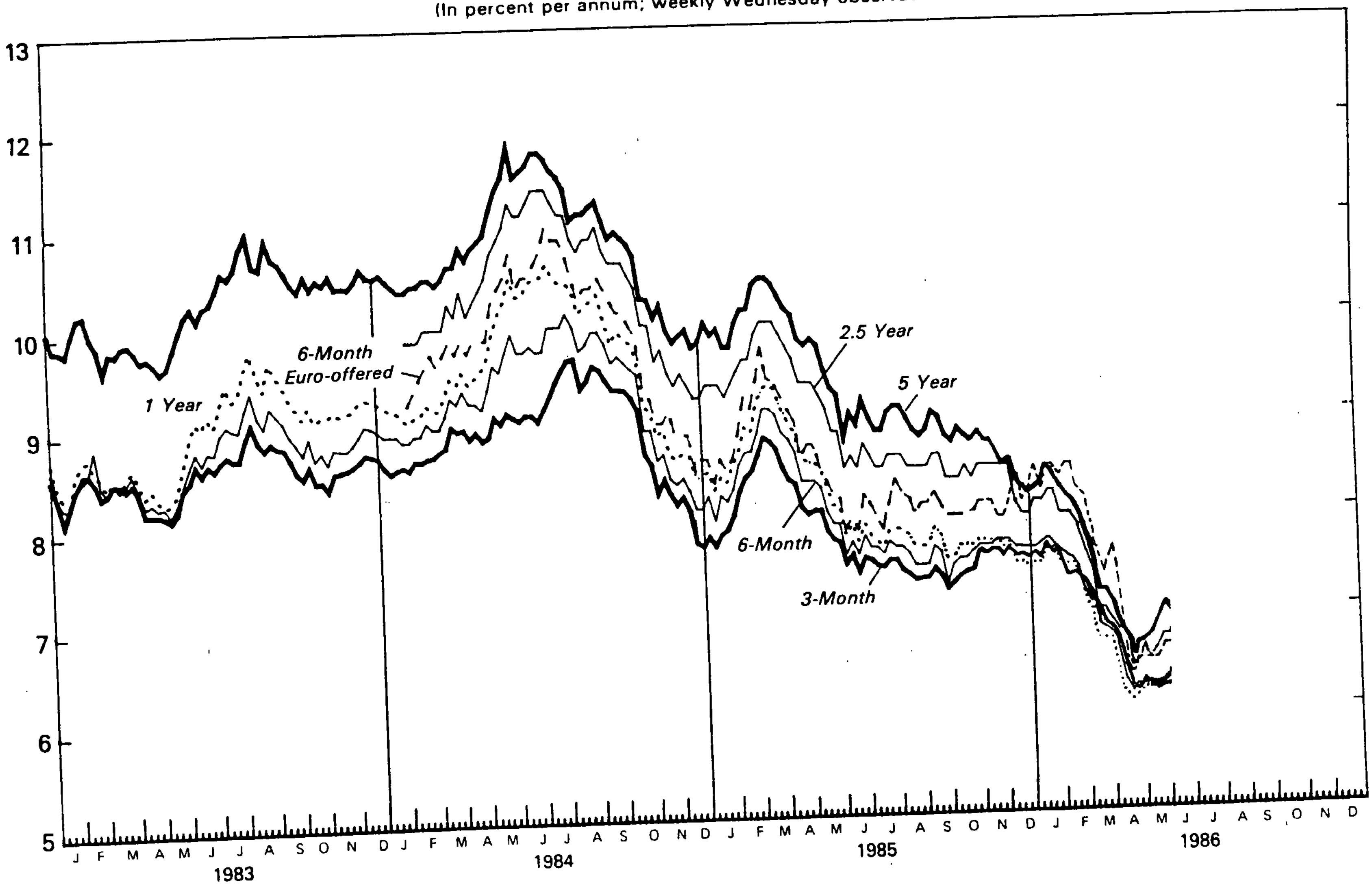


CHART 10

INTEREST RATES ON FUND-RELATED SDR ASSETS

(In percent per annum; weekly Wednesday observations)



Foreign Exchange Rates, April 1986 - May 1986 1/

	April					May			
	2	9	16	23	30	7	14	21	28
Austrian schilling	16.6550	16.4050	15.7650	15.4320	15.2250	15.5200	15.3725	15.7450	16.0500
Belgian franc									
Official	48.375	47.520	45.685	44.815	44.165	44.835	44.675	45.755	46.565
Financial	49.250	48.025	46.000	45.175	44.500	45.125	45.025	45.995	46.935
Canadian dollars	0.71826	0.72325	0.71955	0.71687	0.72804	0.72477	0.72582	0.73193	0.72714
Danish kroner	8.77100	8.60250	8.27500	8.12200	8.01500	8.1325	8.0915	8.3170	8.4240
Deutsche mark	2.37350	2.34225	2.24900	2.19550	2.16450	2.19575	2.18400	2.24200	2.27915
French francs	7.28450	7.44600	7.16250	7.00750	6.89300	6.9950	6.9625	7.1415	7.2545
Irish pounds	1.27600	1.30500	1.35350	1.38050	1.40495	1.3843	1.3915	1.3580	1.3320
Italian lire	1614.000	1598.000	1540.000	1505.500	1489.000	1507.750	1502.500	1538.000	1562.500
Japanese yen	179.450	180.000	176.450	169.300	167.550	165.050	163.250	168.720	168.950
Netherlands guilder	2.67350	2.63525	2.53475	2.47800	2.43975	2.4738	2.4618	2.5253	2.5605
Norwegian kroner	7.30800	7.32250	7.11000	7.00500	6.95250	6.9450	7.4600	7.6060	7.6900
Pounds sterling	1.46500	1.46150	1.50700	1.52400	1.55150	1.5410	1.5400	1.5167	1.5025
Swedish kronor	7.41000	7.39250	7.18500	7.09000	7.00200	7.0600	7.0675	7.1860	7.2640
Swiss francs	1.98050	1.95550	1.88750	1.83600	1.81150	1.83125	1.81675	1.86300	1.88275

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.

APPENDIX A

Option Premiums on the Philadelphia Stock Exchange 1/

I. Deutsche Mark Contracts Expiring on June 14, 1986 2/

	Striking price				
	42	43	44	45	46
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
April	4.01	--	2.08	1.65	0.95
May	1.18	0.50	0.18	--	0.02
			(Put option premiums)		
February	0.32	0.60	0.88	1.26	1.80
March	0.76	1.30	--	2.59	--
April	0.12	0.20	0.32	0.55	1.22
May	0.16	0.46	1.07	2.00	2.96

II. Deutsche Mark Contracts Expiring on September 13, 1986 2/

	Striking price				
	42	43	44	45	46
End-of-month observations:					
			(Call option premiums)		
April	--	--	3.00	2.50	1.73
May	2.10	1.56	1.09	0.70	0.50
			(Put option premiums)		
April	0.36	0.56	--	--	1.55
May	0.86	1.26	1.80	2.46	--

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.

Option Premiums on the Philadelphia Stock Exchange 1/

III. Japanese Yen Contracts Expiring on June 14, 1986 2/

	Striking price				
	55	56	57	58	59
End-of-month observations:					
	(Call option premiums)				
February	1.82	1.48	1.00	0.83	--
March	--	1.47	0.80	--	0.38
April	4.67	--	3.01	2.26	1.62
May	2.36	--	0.85	0.38	0.15
	(Put option premiums)				
February	1.16	1.40	--	--	--
March	0.50	--	1.70	--	--
April	--	0.19	0.32	0.55	0.86
May	0.08	0.22	0.50	1.02	1.85

IV. Japanese Yen Contracts Expiring on September 13, 1986 2/

	Striking price				
	55	56	57	58	59
End-of-month observations:					
	(Call option premiums)				
April	5.25	4.50	--	3.00	2.33
May	3.38	--	--	1.66	1.24
	(Put option premiums)				
April	0.40	--	--	1.10	--
May	0.81	1.20	1.44	1.95	2.58

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 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/ securities (five-year)
	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)	(15)
1985															
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
May	6.33	4.66	10.05	7.31	4.62	6.25	6.93	4.57	10.19	7.36	4.76	4.41	6.99	8.50	7.53
1986 Week ending:															
May 2	6.29	4.64	10.16	7.48	4.60	6.27	6.85	4.56	10.46	7.61	4.77	4.22	6.90	8.50	7.21
9	6.23	4.64	10.21	7.48	4.60	6.24	6.78	4.55	10.42	7.50	4.68	4.17	6.84	8.50	7.19
16	6.32	4.65	10.24	7.27	4.60	6.26	6.95	4.56	10.22	7.24	4.66	4.30	7.01	8.50	7.58
23	6.39	4.69	10.00	7.19	4.61	6.26	7.04	4.60	10.17	7.21	4.89	4.68	7.10	8.50	7.78
30	6.41	4.66	9.72	7.30	4.66	6.26	6.99	4.58	9.85	7.38	4.83	4.64	7.08	8.50	7.70

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.