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Treasurer's Department

Foreign Exchange and Financial Markets in June 1986

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The value of the U.S. dollar declined sharply in June as data released that month indicated weak economic activity in the United States and statements early in the month by U.S. officials suggested that the U.S. currency and U.S. interest rates could ease. Indeed, interest rates in the United States fell markedly in June, thus moving short-term interest rate differentials in the direction against the dollar as rates were little changed in most other major countries.

I. Foreign Exchange Markets

The value of the U.S. dollar declined in June by almost 3 percent in effective (MERM) terms, thereby offsetting most of the 3 3/4 percent rise in the previous month (see Table 1). June marked the twelfth monthly decline for the U.S. currency in the 16 months since February of last year, the month in which the dollar hit its recent peak level. As of the end of June, the dollar's cumulative effective (MERM) depreciation since last year's February peak amounted to 27 percent, of which 18 percentage points had taken place following last year's G-5 meeting in late September (see Table 2). The non-dollar currencies in the SDR basket as of end-June had appreciated by 46-61 percent against the U.S. dollar from their lows in February 1985 and by 12-47 percent since the G-5 meeting.

Several statements by U.S. officials tended to push the U.S. dollar lower in the first week of June and reversed the bullish sentiment toward the dollar prevailing in May. Among the statements, the U.S. Trade Representative, Mr. Yeutter, suggested that the dollar had derived most of its recent strength from intervention purchases by the Bank of Japan and that the dollar would fall again. Comments by Mr. Feldstein, a former Chairman of the U.S. Council of Economic Advisors, that the U.S. dollar would have to continue falling to enable



the United States to service its foreign debt, served to re-focus market attention on the size of the U.S. current account deficit and contributed to a further erosion in confidence in the dollar. Finally, the Federal Reserve Chairman, Mr. Volcker, said Germany and Japan would not necessarily have to cut their interest rates before such a reduction in the United States; this remark suggested to market participants the possibility of a unilateral U.S. interest rate cut, and thus added to the already bearish sentiment toward the dollar.

Table 1. Changes in Exchange Rates During June 1986 <sup>1/</sup>

(In percent)

	<u>Monthly exchange rate changes</u>			Changes in effective exchange rate since June 1985
	Against U.S. dollar <sup>2/</sup>	Against SDR <sup>3/</sup>	Effective exchange rate <sup>4/</sup>	
Belgium	+5.62	+1.99	+1.15	+6.97
Denmark	+5.53	+1.11	+1.26	+10.21
France	+5.45	+1.98	+1.66	+6.64
Germany	+5.64	+2.11	+1.67	+11.34
Ireland	+5.16	+1.66	+1.91	+11.92
Italy	+5.50	+1.82	+1.27	+1.96
Netherlands	+5.46	+1.92	+1.56	+11.65
Austria	+5.90	+2.12	+2.13	+12.74
Canada	-0.52	-3.42	-1.73	-11.22
Japan	+6.53	+1.08	+2.14	+33.31
Norway	+4.43	+0.61	+0.79	-4.10
Spain	+5.69	+2.00	+2.11	+2.32
Sweden	+3.69	+0.28	+0.37	+1.53
Switzerland	+7.62	+3.60	+3.89	+15.59
United Kingdom	+4.05	+0.25	--	-5.69
United States	--	-2.92	-2.94	-20.77

<sup>1/</sup> Positive signs indicates appreciation of the currency.

<sup>2/</sup> Based on New York noon quotations.

<sup>3/</sup> 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.

<sup>4/</sup> 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-June 1986	
	From February 1985 <u>2/</u>	From September 20, 1985 <u>3/</u>
U.S. dollar effective exchange rate (MERM)	-26.72	-18.40
Deutsche mark	+56.86	+29.36
Pound sterling	+45.61	+12.05
French franc	+50.32	+23.59
Japanese yen	+60.66	+46.60

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

2/ The date for the U.S. dollar effective exchange rate (MERM) is February 25 when it recorded its peak. Dates are February 12 for the Japanese yen, February 25 for the Deutsche mark and the French franc, and February 26 for the pound sterling, the dates when these currencies recorded lows against the U.S. dollar.

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

Against this background, the market was particularly inclined to push the dollar lower as economic news released during the month generally pointed to continued weakness in the U.S. economy and possible future U.S. interest rate declines. Moreover, a significant fraction of the data released turned out to be even weaker than expected. Indicators of economic weakness in the United States included the following: the seasonally adjusted unemployment rate rose to 7.3 percent in May from 7.1 percent in April; industrial production fell a seasonally adjusted 0.6 percent in May after a revised increase of 0.4 percent in April; retail sales fell a seasonally adjusted 0.1 percent in May after a revised increase of 0.4 percent in April; real GNP growth in the first quarter was revised downward to 2.9 percent at a seasonally adjusted annual rate from the previous estimate of 3.7 percent; new orders for durable goods, seasonally adjusted, rose 0.4 percent in May after a 0.9 percent decline in April (revised from



0.2 percent); and the U.S. trade deficit widened to \$14.21 billion in May from \$12.07 billion in April. The significance of the increase in the size of the U.S. trade deficit may have been heightened in the face of the current account and trade data also released during the month showing record surpluses for Germany and Japan. In Germany, the current account surplus widened to a record DM 8.5 billion (provisional) in April from DM 4.7 billion in March. In Japan, the trade surplus rose to a record \$8.30 billion in May from the previous record surplus of \$7.66 billion in April; in the first 20 days of June the customs-cleared trade surplus was \$3.88 billion, up from a surplus of \$3.61 billion in the same period in May.

Two other factors appeared to contribute to the negative sentiment toward the U.S. dollar. Concern over Mexico's ability to service its foreign debt may have generated some dollar selling, given the relatively high exposure of U.S. banks to that country and the size of U.S.-Mexican trade. The result of the West Germany state election in Lower Saxony around midmonth--a narrow victory for Chancellor Kohl's Christian Democratic Union--probably helped push the Deutsche mark up at the expense of the dollar, according to traders.

The main factor restraining the market from selling the U.S. dollar down even lower was the pervasive concern that some central banks, particularly the Japanese central bank, would intervene to support the dollar. In fact, the Bank of Japan was reportedly fairly active on a day-to-day basis, although not on a very large scale, with the possible exception of only a few days when dollar purchases were estimated at \$200 million or more. The market was nevertheless alert to the possibility of intervention on a larger scale, especially ahead of the parliamentary elections in Japan in early July. Economic data continued to indicate weakness in the Japanese economy: real GNP in Japan fell by 2.1 percent at an annual rate in the first quarter and industrial production recorded negative quarterly growth rates in the first quarter of this year as well as in the two preceding quarters. With concerns surfacing about the possible negative effects of the appreciation of the Japanese yen on the Japanese economy, market participants were quite watchful of any efforts to prevent the yen from moving higher.

The Japanese yen nevertheless posted a particularly large rise against the U.S. dollar in June, as did the Swiss franc. The Swiss franc and the Japanese yen rose by 7.62 percent and 6.53 percent, respectively, thereby recording the two largest increases against the U.S. currency. In effective (MERM) terms, these two currencies were also the strongest: the Swiss franc firmed by 3.89 percent in June and by almost 16 percent over the year, and the Japanese yen firmed by 2.14 percent in June and by over 33 percent over the year.

The currencies participating in the exchange arrangements of the European Monetary System (EMS) firmed by 5.16-5.64 percent against the U.S. dollar. The French franc remained the strongest currency in the





EMS throughout the month, except for two days when the Italian lira was slightly stronger. The divergence indicator for the French franc continued to be above its upper threshold while the other currencies were within their thresholds. The weakest currency included the Deutsche mark, the Danish krone, and the Belgium franc at different times during the month. Among the other currencies reported in Table 1, only the Canadian dollar eased, falling by 0.52 percent against the U.S. dollar, while the other currencies firmed by 3.69-5.90 percent against the dollar.

The volatility of exchange rates against the U.S. dollar, as indicated by the measures given in Table 3, declined for most major currencies in June. For the EMS currencies, the high-low spreads fell to 5.4-5.6 percent in June from 6.6-7.1 percent in May, and the average of absolute daily percentage changes (MAC in Table 3) fell for each of

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

	June 2/ High Low		High-low spread in percent 3/ May June		MAC 4/ May June	
	High	Low	May	June	May	June
Belgium	44.930	47.375	6.7	5.4	0.61	0.55
Denmark	8.1500	8.5920	6.9	5.4	0.68	0.54
France	7.0165	7.4005	6.9	5.5	0.66	0.56
Germany	2.2005	2.3240	6.9	5.6	0.68	0.57
Ireland	1.37730	1.30700	7.1	5.4	0.64	0.59
Italy	1508.50	1590.00	6.6	5.4	0.61	0.52
Netherlands	2.4788	2.6140	6.8	5.5	0.67	0.57
Austria	15.435	16.325	6.9	5.8	0.70	0.60
Canada	0.72267	0.71608	1.2	0.9	0.19	0.23
Japan	163.750	174.850	8.3	6.8	0.76	0.54
Norway	7.5025	7.8290	13.1	4.4	0.98	0.42
Sweden	7.1230	7.3820	5.4	3.6	0.51	0.41
Switzerland	1.7958	1.9285	7.1	7.4	0.75	0.64
United Kingdom	1.53250	1.47450	5.0	3.9	0.56	0.50

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.



these countries and averaged 0.56 percent in June compared with 0.65 percent in May. For most of the other major currencies, the high-low spreads and MAC also declined, with the exception of the Swiss franc (spread) and the Canadian dollar (MAC); on an average basis, MAC fell to 0.48 percent in June from 0.64 percent in May.

Gross foreign exchange reserves rose in most countries in June, with Germany, Japan, and Norway recording the largest increases (see Table 4). Over the latest 12-month period, most countries also registered increases in their gross reserves. The largest increases were recorded in France, Germany, Japan, and the United States, while only Denmark, Ireland, and Italy recorded declines.

Table 4. Gross Foreign Exchange Reserves  
in June 1986 <sup>1/</sup>

(In millions of U.S. dollars)

	End-month reserve level	Change in June	Change over 12 months
Belgium	4,836	-386	+755
Denmark	3,838	+38	-378
France (May)	29,510	+119	+8,542
Germany	38,946	+1,214	+4,534
Ireland	3,006	+368	-238
Italy	18,267	+931	-431
Netherlands	9,333	+177	+1,796
Austria	4,787	+85	+1,670
Canada	1,605	-185	+28
Japan	29,450	+1,253	+6,071
Norway	13,119	+1,806	+1,851
Sweden	5,993	-100	+711
Switzerland	16,461	+495	+3,203
United Kingdom	11,487	+315	+3,660
United States (May)	14,320	-742	+7,160

<sup>1/</sup> 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. Other Highlights in Foreign Exchange Markets

The Chicago Mercantile Exchange (CME) on June 18 started trading option contracts on Canadian dollar futures. The options give the right to buy (call option) or sell (put option) a Can\$100,000 futures contract. The expiration dates are in March, June, September, and December, and the options expire 12 days before the expiration of the underlying futures contract (on the third Wednesday of the contract month). Options on futures contracts traded on the CME are "American options," meaning that they can be exercised at any time on or before the maturity date. The Philadelphia Stock Exchange (PHLX) also trades American-style Canadian dollar options on the currency itself, while the Canadian dollar options traded on the Chicago Board Options Exchange (CBOE) are also on the currency itself but are instead "European options," meaning they can only be exercised on the maturity date of the contract.

Table 5 reports for the first five months of this year trading volumes in option contracts on the three U.S. exchanges as well as market shares. The PHLX presently dominates options trading in the Japanese yen and the pound sterling, the CME dominates trading in the Deutsche mark and the Swiss franc, and the CBOE dominates trading in the Canadian dollar. The most popular currencies for options trading are the Deutsche mark and the Japanese yen.

Table 5. U.S. Listed Currency Options Business: Trading Volume and Market Share, January through May, 1986

(Rounded to the nearest thousand contracts; numbers in parentheses are percentage shares of the U.S. market)

	PHLX <u>1/</u>	CBOE	CME	Total <u>2/</u>
Deutsche mark	766 (26)	35 (2)	1,076 (72)	1,493 (45)
Japanese yen	833 (58)	79 (11)	220 (31)	716 (22)
Swiss franc	479 (43)	16 (3)	298 (54)	553 (17)
Pound sterling	475 (57)	21 (5)	155 (38)	414 (13)
Canadian dollar	28 (38)	23 (62)	-- (--)	37 (1)
Total <u>3/</u>	<u>2,745 (42)</u>	<u>179 (5)</u>	<u>1,748 (53)</u>	<u>3,301</u>

Source: International Financing Review, Issue 626, June 14, 1986.

1/ Volume figures in this column are not adjusted for the size of the PHLX contracts, which is half that of the contracts traded on the other two exchanges. All percentage shares are size-adjusted.

2/ The PHLX contribution to the totals in this column is divided by two in order to reflect the relative sizes of contracts.

3/ Includes options on the French franc traded on the PHLX and the CBOE and options on the ECU traded on the PHLX.



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

In June, short-term interest rates declined markedly in the United States but were narrowly mixed in other major countries. There was some discussion in financial markets about the desirability of a further round of official interest rate reductions, but it was felt that any movement in this direction had to wait pending the results of general elections in Japan and also by the concern in several countries--particularly Germany and the United Kingdom--regarding money supply growth rates well above the upper end of their target ranges. Inflation rates edged up slightly in many countries during the month of June, but generally remained at the lowest levels for many years (see Table 6).

The declining trend in U.S. interest rates, which had been interrupted by rising yields during May, resumed in June. Declining rates were attributed mainly to the publication of economic data which pointed to a weaker-than-expected performance of the U.S. economy and which, in consequence, generated renewed speculation about an imminent reduction in the Federal Reserve's discount rate. Concern about the rapid increase in M1, which had helped push interest rates higher in May, was dissipated to some extent in June by predictions by some market analysts that a decision to change the base for M1 growth calculations--for example, from the fourth quarter of 1985 to the second quarter of 1986--might well be taken at the FOMC meeting to be held in early July. At the short-term end of the market, the yield on three-month Treasury bills rose during the first few days of June, but then began to decline, ending the month at 6.13 percent, 0.36 percentage point lower than end-May. Rates eased across the board at the long-term end of the market. The yield on 30-year Treasury securities eased by 0.50 percentage point to 7.24 percent, flattening the yield curve; the differential between the yield on three-month Treasury bills and that on 30-year Treasury securities fell from 1.25 percentage points at end-May to 1.11 percentage points at end-June.

The M1 measure of the U.S. money supply, seasonally adjusted, averaged \$666.3 billion in the week ended June 30 compared with \$660.6 billion in the week ended May 26. The annual growth rate of M1 through June from the fourth quarter of 1985 base period was about 12 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, however, that the Federal Reserve has de-emphasized M1 in formulating monetary policy.

Money market conditions were mixed in June in the countries participating in the EMS. In Germany, the three-month interbank rate moved very little and ended the month at 4.69 percent, up 0.03 percentage point from end-May. Against the background of the central bank money stock growing at an annual rate of about 7.0 percent (above the upper limit of the 3.5-5.5 percent target for 1986), the Bundesbank





Table 6. 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>5/</u> (end-of-month)	
		Wholesale	Consumer	May	June
		price index <u>3/</u>	price index <u>4/</u>		
Austria	Apr./May	-5.9 (-5.8)	1.6 (1.4)	4.00	4.00
Belgium	May/June	-7.1 (-7.4)	1.2 (1.1)	8.00	7.30
Canada	Feb./May	5.36 (5.1)	4.1 (3.9)	8.42	8.45
Denmark	April	-7.4 (-6.3)	4.0 (1.8)	7.00	7.00
France	.../May	... (...)	2.3 (2.6)	7.35	7.22
Germany	Apr./May	-7.1 (-7.1)	-0.2 (-0.2)	4.66	4.69
Italy	Mar./June	0.3 (2.5)	6.3 (6.4)	11.94	12.00
Japan	May	-9.8 (-9.0)	1.1 (0.9)	4.66	4.66
Netherlands	Feb./May	-4.0 (...)	0.5 (0.6)	5.94	6.06
Norway	May	1.4 (0.0)	5.6 (5.8)	14.04	14.09
Spain	Feb./May	3.0 (...)	7.8 (7.7)	11.35	12.65
Sweden	April	1.5 (1.9)	4.5 (4.3)	8.00	8.00
Switzerland	May	-4.0 (-3.9)	0.7 (1.0)	4.75	5.07
United Kingdom	May	4.5 (5.0)	2.8 (3.0)	9.55	9.50
United States	May	-1.7 (-2.1)	1.6 (1.6)	6.49	6.13

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; inter-bank 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 (converted to a bond equivalent yield); four-month certificates of the Government Securities Stabilization Fund for Belgium; central bank discount rates for Austria, Denmark, and Sweden.



again ruled out any reduction in its discount or Lombard rates. It later became known that the annualized rate of growth of central bank money stock remained above the target range during June, although, at 6.4 percent, by a lower margin than in May. In France, the three-month interbank money rate fell from 7.35 percent to 7.22 percent during June. On June 16, the Bank of France lowered its key money market intervention rate by 0.25 percentage point to 7.0 percent. This was the fourth time the rate has been cut since the EMS realignment of April 6 pushed the French franc to the top of the EMS currency band. Earlier in the month the Credit Foncier de France reduced its mortgage interest rates for private borrowers by up to 1.05 percentage points, bringing rates to their lowest levels since 1973.

In Belgium, the interest rate on four-month fonds des rentes dropped markedly by 0.70 percentage point to 7.30 percent during June, and the interest rate on one- to three-month Treasury bills was lowered by 0.25 percentage point to 7.35 percent. Three-month interbank rates firmed somewhat in the Netherlands and Italy, ending the month at 6.06 percent and 12.00 percent, respectively. In Ireland, the central bank on two occasions reduced the short-term facility rate at which it lends to the main clearing banks; at end-June this rate stood at 10.0 percent, 1.0 percentage point lower than end-May. Prime rates offered by some major banks were subsequently lowered to 10 percent.

Short-term interest rates in the United Kingdom continued to decline in the early part of June amid mounting speculation that bank base rates would be lowered. However, the announcement on June 10 that sterling M3 had increased by as much as 3.0 percent in banking-May halted the decline and rates rose above end-May levels, but toward the end of the month rates continued their downward trend. The rate on three-month Treasury bills ended the month at 9.50 percent, down 0.05 percentage point from end-May and down 0.25 percentage point from its midmonth peak. The three-month interbank money rate closed the month at 9.84 percent, unchanged from end-May.

With regard to monetary aggregates, the latest Bank of England data showed that on a provisional, seasonally adjusted basis, sterling M3 rose by 1.25 percent in the banking month of June. The year-on-year growth rate of 18.25 percent was 0.75 percentage point lower than in the banking month of May, but was still well above the upper limit of the 11-15 percent annual growth target range. M0 grew by about 0.50 percent in banking June and by about 3.25 percent year-on-year, near the lower end of the 2-6 percent target band.

In Japan, the interest rate on two-month private bills remained steady at 4.66 percent amid intermittent speculation that the Bank of Japan would announce a cut in the discount rate. Reflecting the continued restrictive monetary policy of the Swiss National Bank, the rate on three-month euro-Swiss franc instruments firmed markedly from 4.75 percent at end-May to 5.13 percent at end-June. Major Swiss



banks raised rates on customer time deposits on three occasions during the month; at end-June these rates stood at 4.5 percent compared with 3.75 percent at end-May. The Director of the National Bank attributed the rise in Swiss interest rates in part to the increase in notes circulating outside the banking system. In Sweden, on June 1 the Riksbank reduced the lowest and the highest of its five penalty borrowing rates by 2.5 percentage points. Later in the month the Bank further eased the country's exchange controls by abolishing regulations requiring companies to finance direct investment abroad with foreign currency loans.

Three-month interest rates in the eurocurrency market were mostly lower in June. Rates on eurodollars and on euro-Japanese yen eased by 0.25 percentage point and 0.15 percentage point, respectively, to 6.81 percent and 4.69 percent. Rates on euro-French francs and euro-Deutsche mark fell by a somewhat smaller amount to 7.25 percent and 4.56 percent, respectively. Rates on euro-sterling, after declining during the early part of June, ended the month unchanged at 9.81 percent, while rates on euro-Swiss francs rose from 4.75 percent at end-May to as high as 5.56 percent in the last week of June before declining to 5.13 percent at month-end.

Reflecting movements in eurodollar and domestic interest rates, uncovered interest differentials favoring investments in domestic currencies over investments in eurodollars tended to widen while those favoring investments in eurodollars tended to narrow. The same pattern was evident in forward exchange markets. As a result of these movements, covered interest differentials in favor of domestic investment narrowed for Belgium and Italy but widened for Germany. Differentials favoring eurodollar instruments widened for France but narrowed for the United Kingdom. In Japan, the differential switched from favoring eurodollar investment to favoring domestic investment, while in the Netherlands the reverse was true (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 <u>1/</u> (1)		Forward exchange quotations <u>2/</u> (2)		Covered interest differentials <u>1/</u> (3) = (1)-(2)	
	May	June	May	June	May	June
Belgium	-0.94	-0.49	-0.20	-0.25	-0.74	-0.24
France	-0.29	-0.41	-0.34	-0.62	+0.05	+0.21
Germany	+2.40	+2.12	+2.56	+2.34	-0.16	-0.22
Italy	-4.88	-5.19	-4.13	-4.83	-0.75	-0.36
Japan	+2.40	+2.15	+2.32	+2.29	+0.08	-0.14
Netherlands	+1.12	+0.75	+1.18	+0.69	-0.06	+0.06
United Kingdom	-2.49	-2.69	-2.72	-2.85	+0.23	+0.16

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.

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

During June, the SDR interest rate declined for the fifth consecutive month, reflecting mainly declining yields on the U.S. and U.K. instruments in the SDR interest rate basket. The yield on three-month Treasury bills declined 0.17 percentage point to 6.19 percent in the United States and by 0.26 percentage point to 9.50 percent in the United Kingdom. The yield on the relevant German instrument firmed marginally to 4.69 percent while yields on the relevant French and Japanese instruments remained unchanged.





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

	May 26	June				
		2	9	16	23	30
SDR interest rate	6.23	6.28	6.26	6.23	6.19	6.13
Rate of remuneration	6.07	6.12	6.10	6.07	6.03	5.98

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

During the period covered by Table 9, (May 28-June 25), combined domestic rates eased slightly for the three-month maturity, firmed slightly for the six-month maturity, but were otherwise unchanged. Rates on U.S. dollar instruments were lower across the board, those on French franc and Japanese yen instruments were mainly firmer, those on the pound sterling mixed and those on the Deutsche mark little changed. In the eurocurrency markets, rates on most SDR component currencies were somewhat lower; as a result, combined eurocurrency (offered) rates declined by 0.13 percentage point to 6.50 percent for both the three-month and six-month maturities. During the same period, average interest rates on SDR-denominated deposits of selected commercial banks eased across the board by 0.05-0.10 percentage point.



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

	May	June
<u>Combined market interest rates: 2/</u>		
a. Based on domestic rates		
3-month maturity (Rule T-1)	6.25	6.18
6-month maturity	6.31	6.25
12-month maturity	6.31	6.31
2-1/2 year maturity	6.75	6.75
5-year maturity	6.94	6.94
b. Based on eurocurrency offered rates		
3-month maturity	6.63	6.50
6-month maturity	6.63	6.50
<u>Average commercial bank deposit rates 3/</u>		
1-month deposits	6.40	6.35
3-month deposits	6.40	6.31
6-month deposits	6.40	6.30
12-month deposits	6.42	6.37

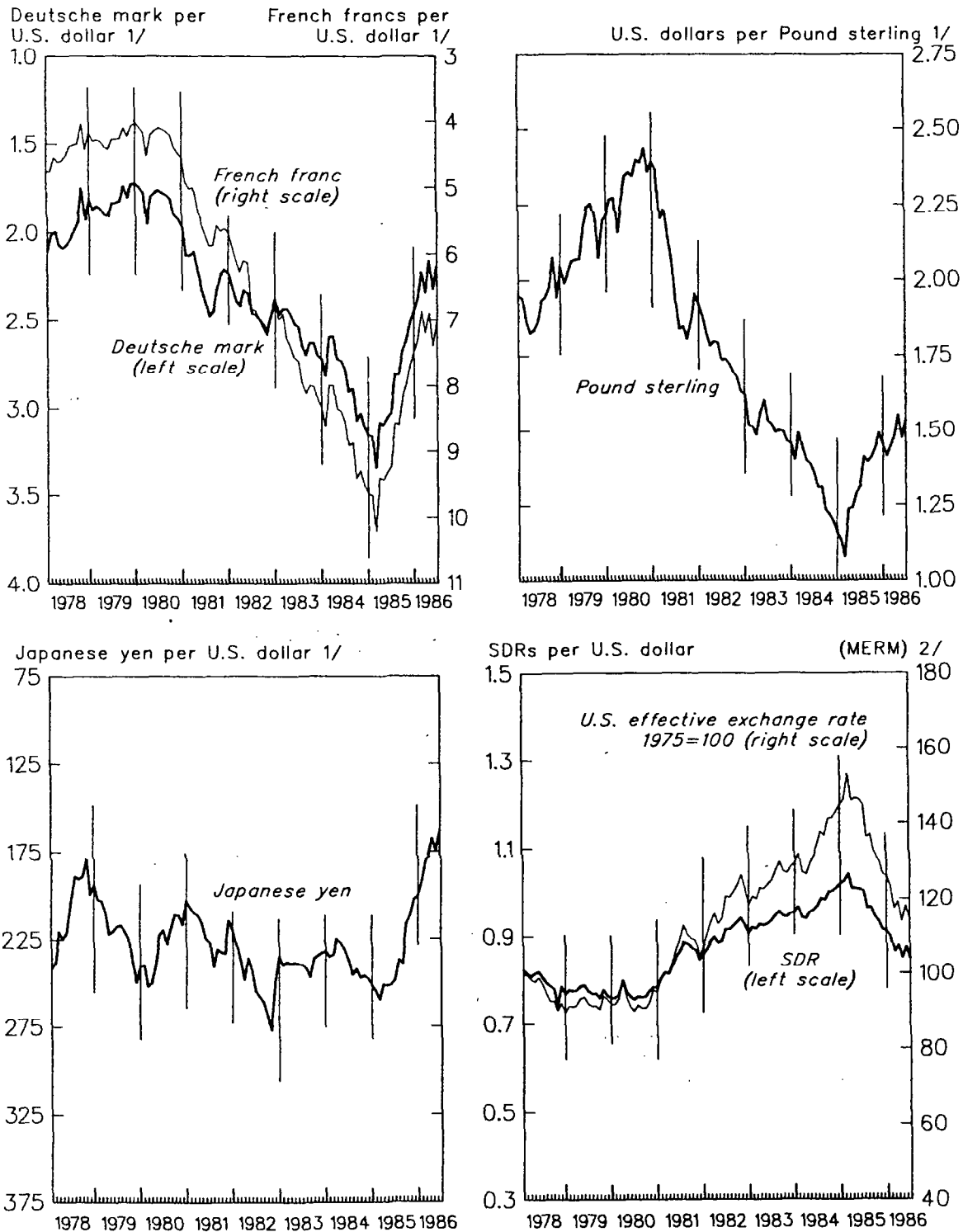
1/ Rates pertain to last Wednesday of the month.

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.

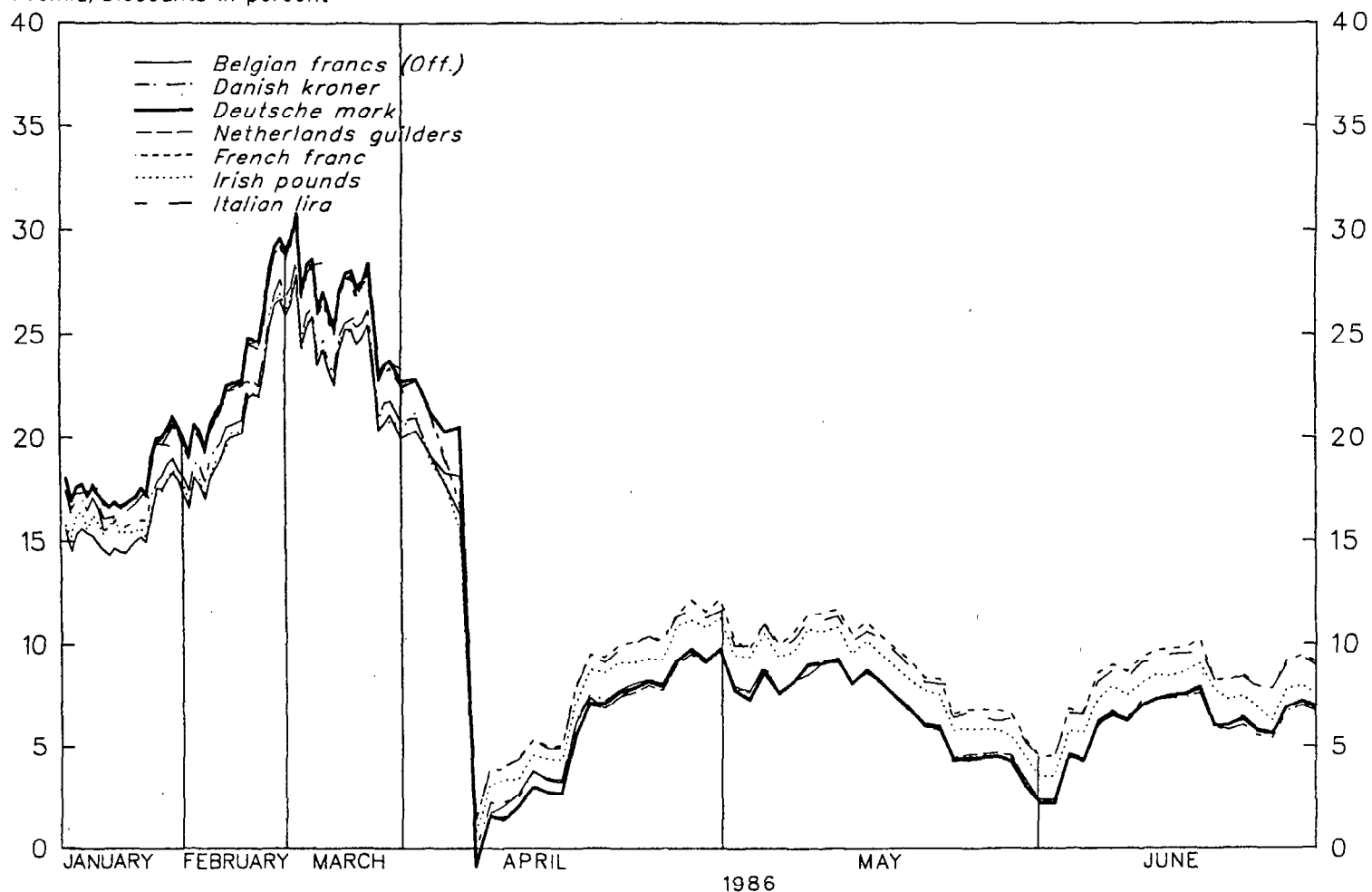
2/ IMF's multilateral exchange rate model. Increase in the index means appreciation.



# CHART 2 SPOT EXCHANGE RATES: EUROPEAN MONETARY SYSTEM

Premia/Discounts in percent<sup>1</sup>

(Based on noon quotations in New York)



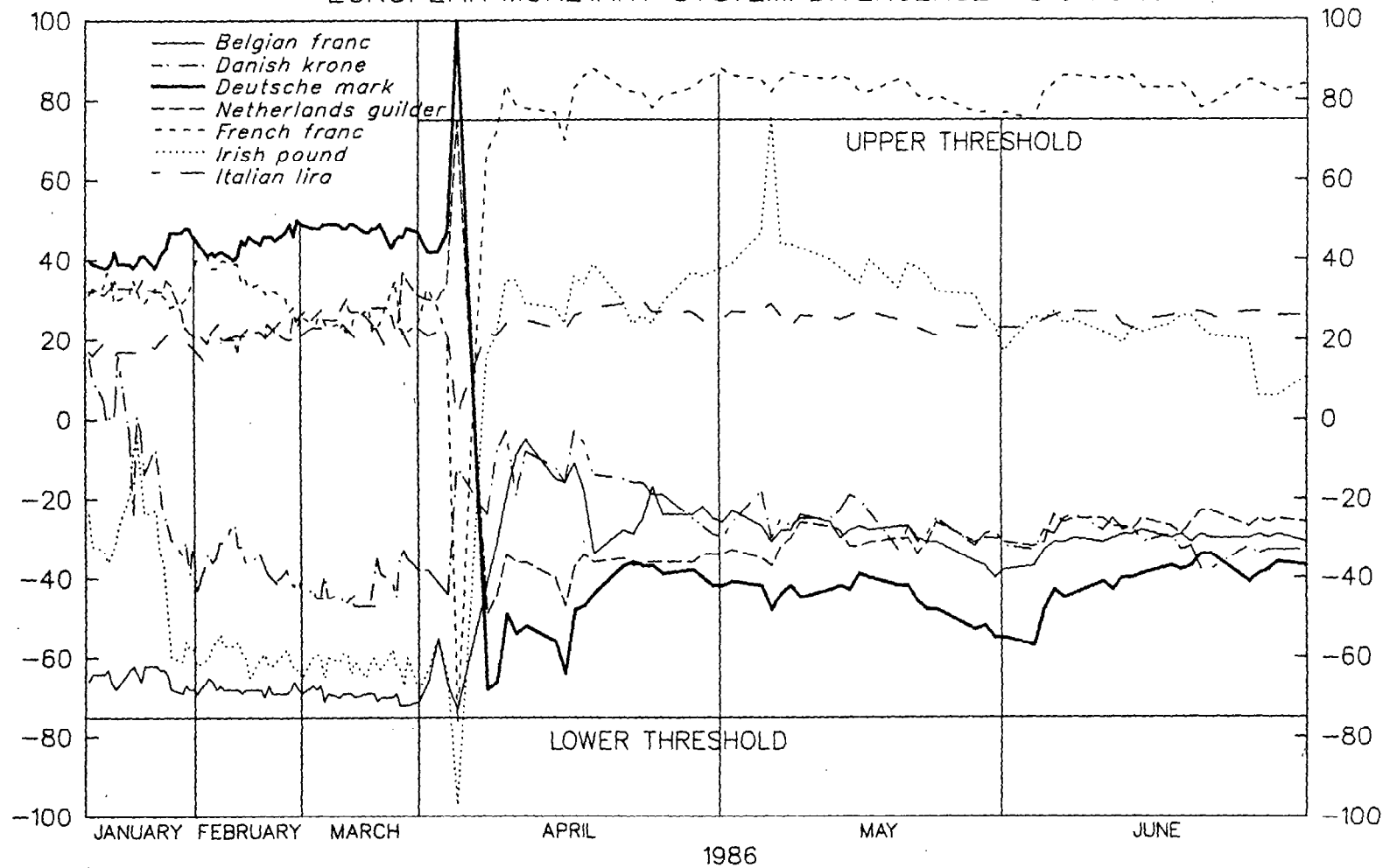
<sup>1</sup> Premia/Discounts over declared ECU central rates converted to U.S. dollar terms on the basis of 1 ECU=\$0.777846 effective July 22, 1985, and 1 ECU=\$0.900139 effective April 7, 1986.





CHART 3

## EUROPEAN MONETARY SYSTEM: DIVERGENCE INDICATORS

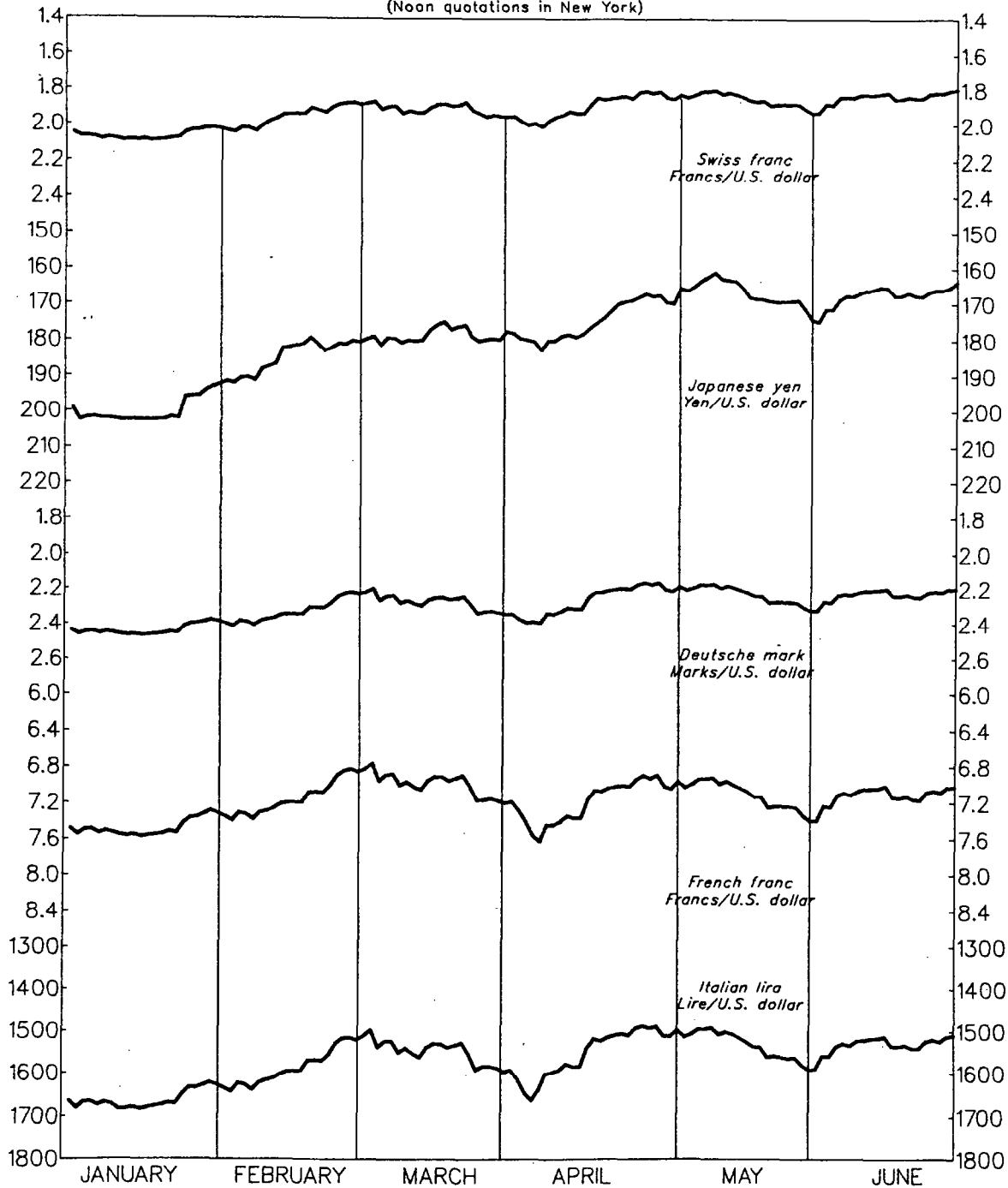


<sup>1</sup> On April 7, 1986, central parities were adjusted relative to each other by plus 3 percent for the Deutsche mark and the Netherlands guilder, plus 1 percent for the Belgian franc and the Danish krone, unchanged for the Italian lira and the Irish pound, and minus 3 percent for the French franc.



CHART 4  
SPOT EXCHANGE RATES

(Noon quotations in New York)

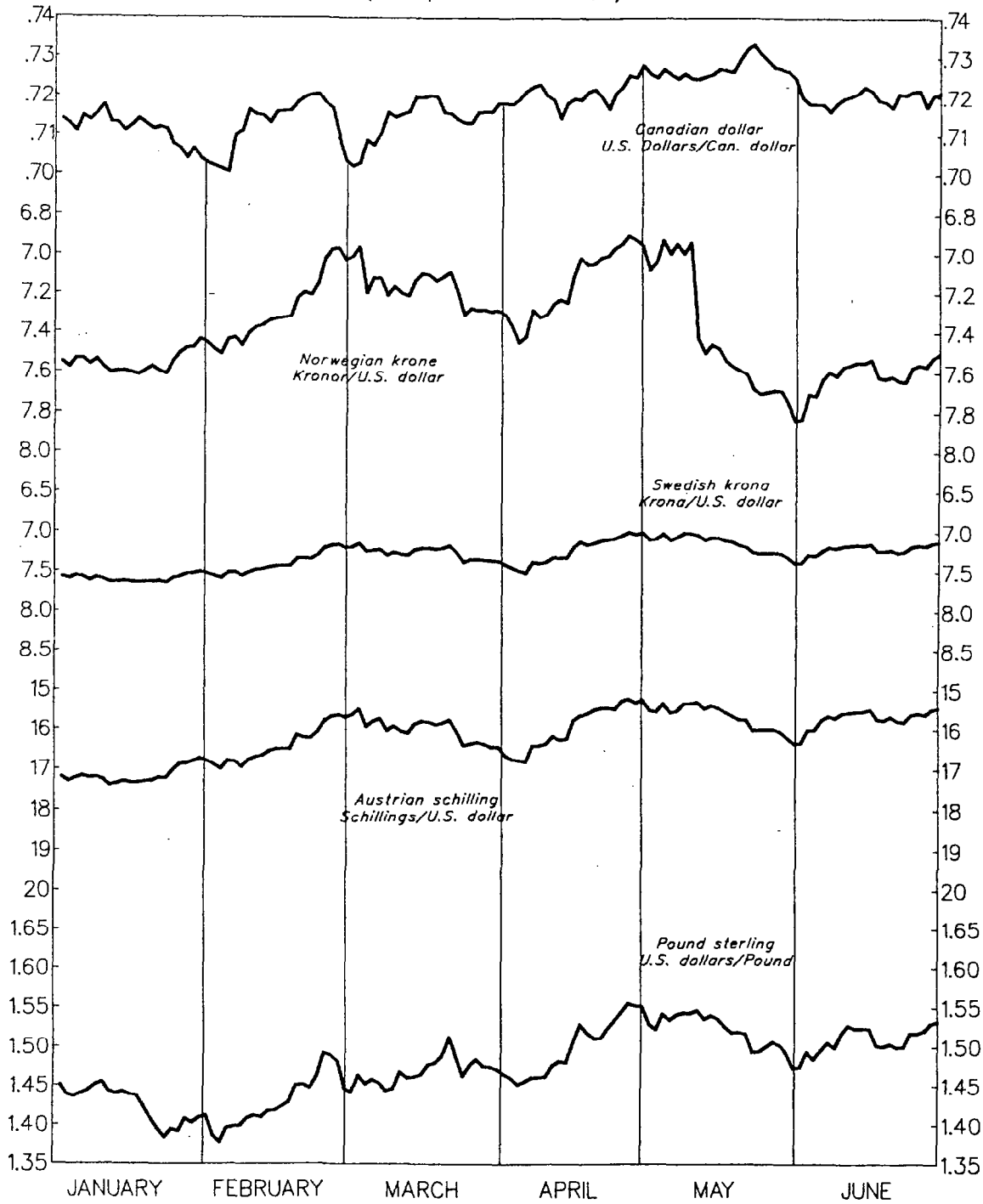


1986



CHART 5  
SPOT EXCHANGE RATES

(Noon quotations in New York)



1986



# INDEXES OF EXCHANGE RATES OF FIVE MAJOR CURRENCIES AGAINST THE SDR

JUNE 1974 - JUNE 1986

(June 28, 1974=100)

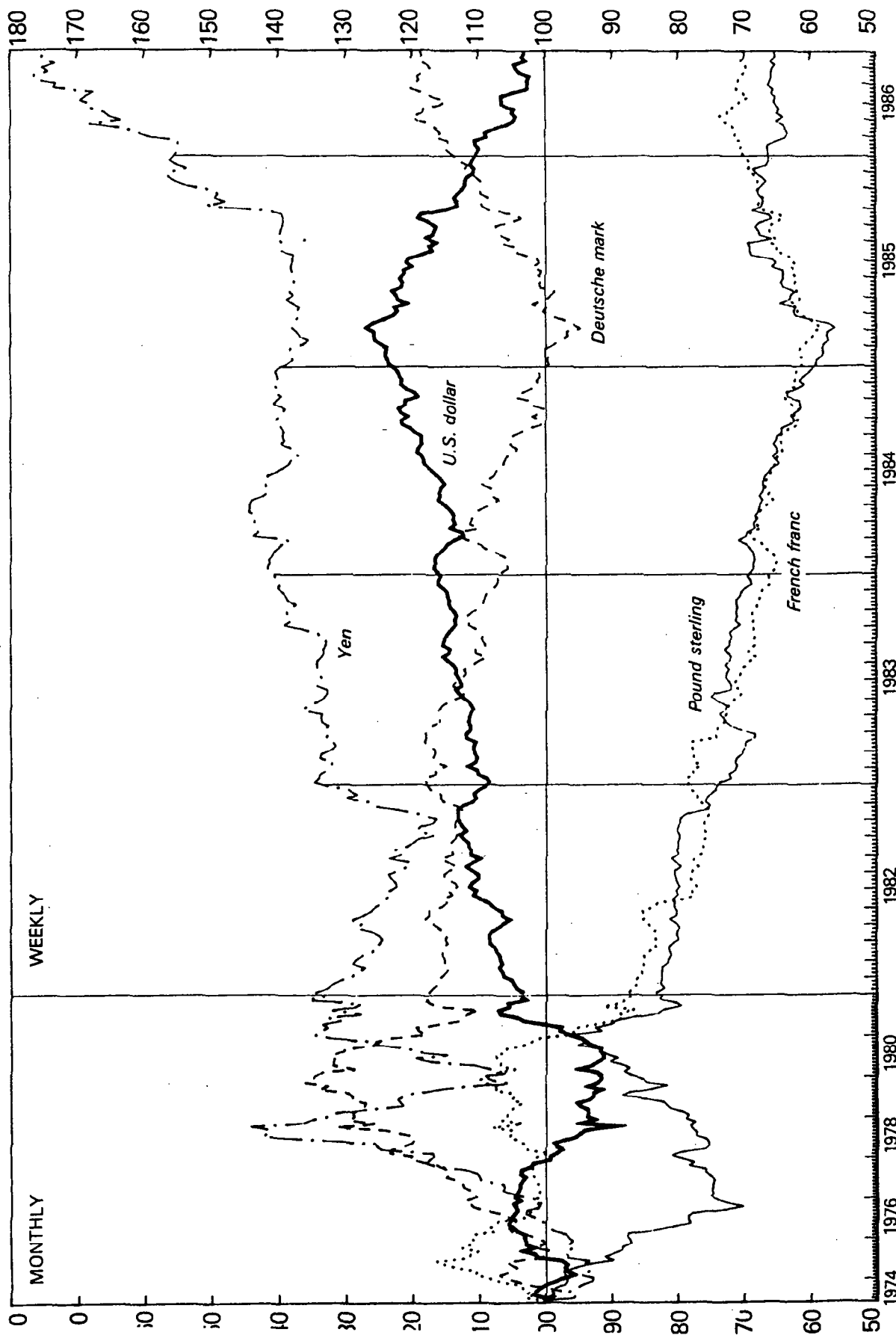






CHART 7  
SHORT-TERM MONEY MARKET RATES  
(Percent per annum)

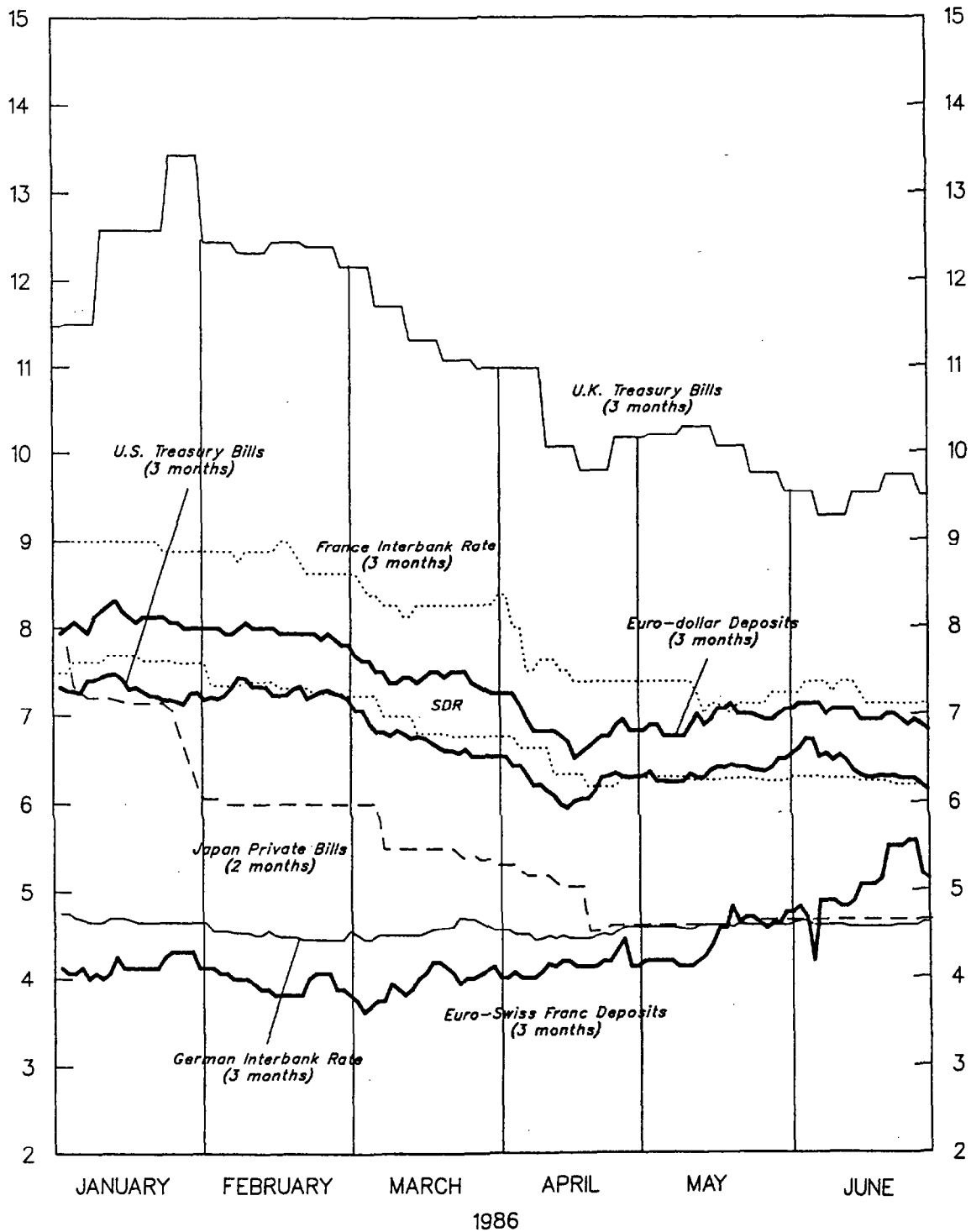




CHART 8  
THREE-MONTH FORWARD RATES

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

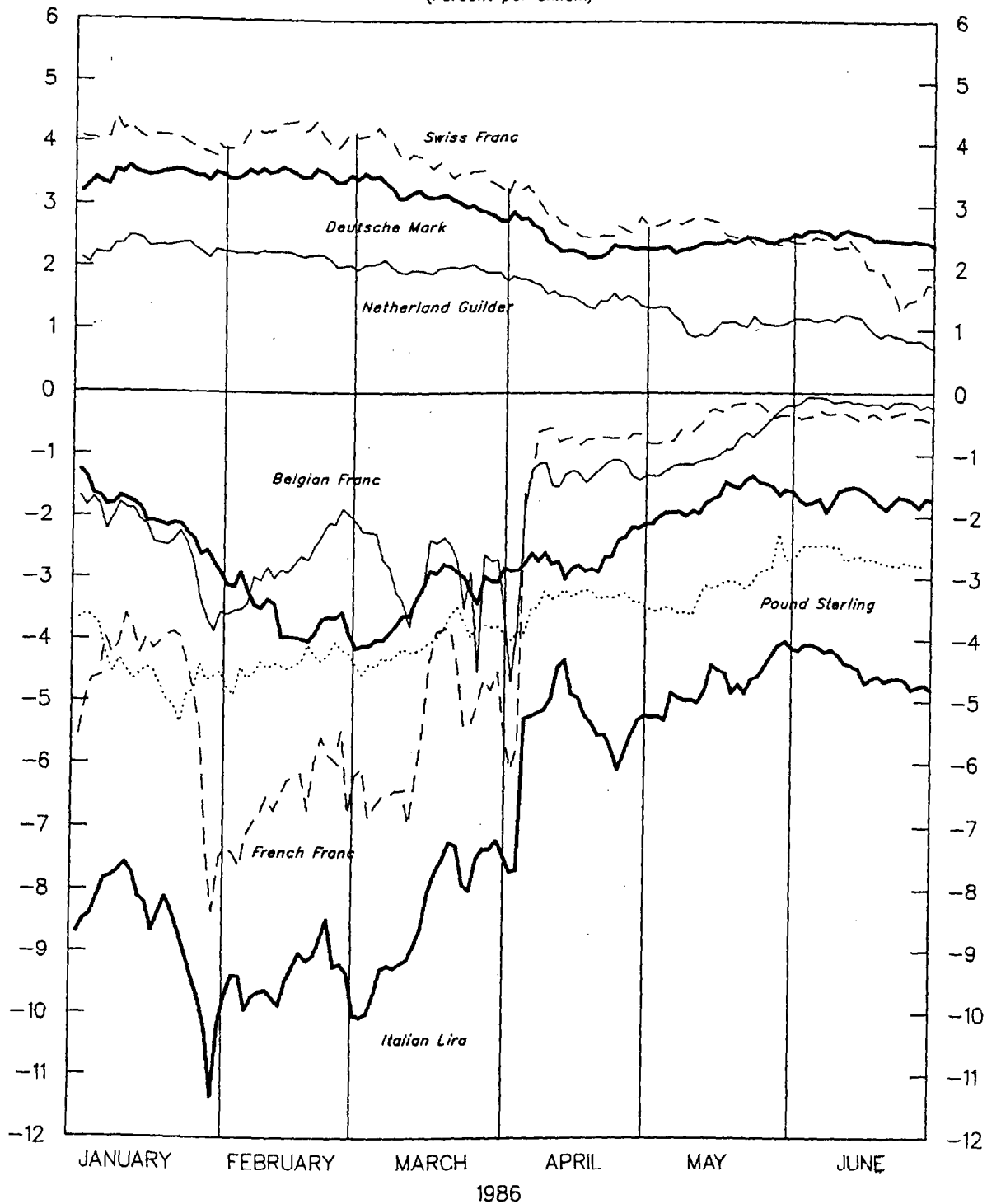
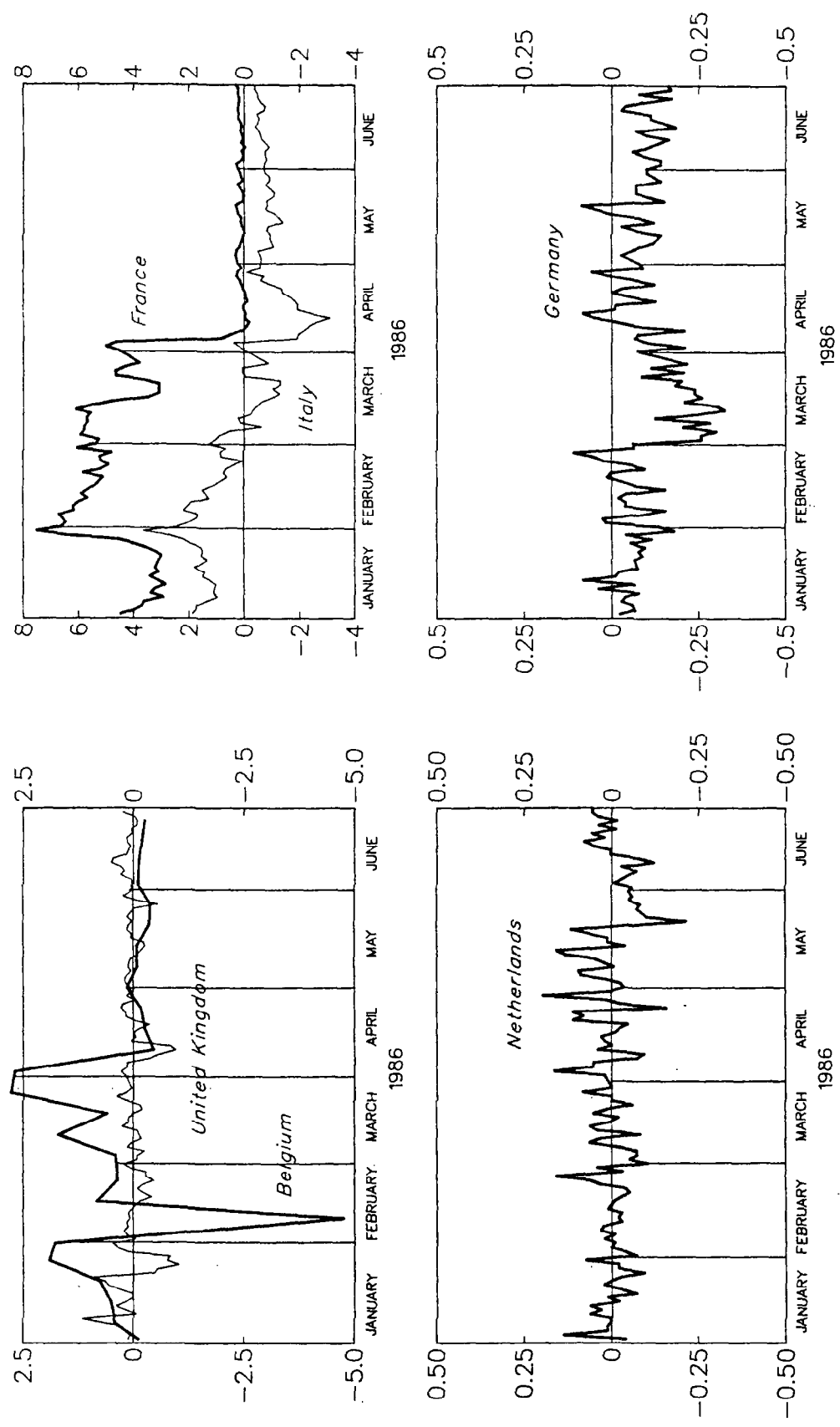




CHART 9  
COVERED INTEREST DIFFERENTIALS BETWEEN THREE-MONTH  
EURO-DOLLAR DEPOSITS AND LOCAL SHORT-TERM INVESTMENTS  
(+ IN FAVOR OF EURO-DOLLAR AND - IN FAVOR OF DOMESTIC INVESTMENT)





Foreign Exchange Rates, May 1986 - June 1986 1/

Currency	M a y					J u n e		
	7	14	21	28	4	11	18	25
Austrian schilling	15.5200	15.3725	15.7450	16.0500	16.0000	15.5550	15.7550	15.5750
Belgian franc								
Official	44.835	44.675	45.755	46.565	46.485	44.215	45.745	45.275
Financial	45.125	45.025	45.995	46.935	46.735	45.525	46.075	45.675
Canadian dollars	0.72477	0.72582	0.73193	0.72714	0.71800	0.72018	0.71867	0.72165
Danish kroner	8.1325	8.0915	8.3170	8.4240	8.43000	8.19650	8.31250	8.22000
Deutsche mark	2.19575	2.18400	2.24200	2.27915	2.27850	2.21300	2.24000	2.21550
French francs	6.9950	6.9625	7.1415	7.2545	7.25250	7.04950	7.14750	7.06650
Irish pounds	1.3843	1.3915	1.3580	1.3320	1.33400	1.37030	1.35500	1.36350
Italian lire	1507.750	1502.500	1538.000	1562.500	1559.500	1521.000	1536.000	1519.500
Japanese yen	165.050	163.250	168.720	168.950	171.490	166.300	167.600	166.050
Netherlands guilder	2.4738	2.4618	2.5253	2.5605	2.56425	2.49350	2.52350	2.49475
Norwegian kroner	6.9450	7.4600	7.6060	7.6900	7.71500	7.55900	7.63000	7.56000
Pounds sterling	1.5410	1.5400	1.5167	1.5025	1.48375	1.52750	1.50050	1.51700
Swedish kronor	7.0600	7.0675	7.1860	7.2640	7.29600	7.16300	7.23500	7.16500
Swiss francs	1.83125	1.81675	1.86300	1.88275	1.88500	1.82675	1.84925	1.81750

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 on September 13, 1986 2/

	Striking price			
	43	44	45	46
End-of-month observations:				
	(Call option premiums)			
April	--	3.00	2.50	1.73
May	1.56	1.09	0.70	0.50
June	2.94	2.27	1.59	1.11
	(Put option premiums)			
April	0.56	--	--	1.55
May	1.26	1.80	2.46	--
June	0.29	0.51	0.86	1.34

II. Japanese Yen Contracts Expiring on September 13, 1986 3/

	Striking price			
	58	59	60	62
End-of-month observations:				
	(Call option premiums)			
April	3.00	2.33	1.64	1.15
May	1.66	1.24	0.64	0.48
June	--	3.05	1.89	1.43
	(Put option premiums)			
April	1.10	--	--	--
May	1.95	2.58	4.02	--
June	--	0.94	1.80	--

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- 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)	
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
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
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
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
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
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
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
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
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
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
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
6.39	4.67	9.52	7.33	4.66	6.22	7.00	4.54	9.79	7.36	4.75	5.07	7.09	8.50	7.64
Week ending:														
6	6.62	4.69	9.49	7.43	4.66	6.33	7.12	4.56	9.75	7.49	4.77	4.78	7.25	8.02
13	6.47	4.66	9.32	7.45	4.66	6.24	7.05	4.50	9.79	7.38	4.74	4.85	7.16	7.83
20	6.28	4.64	9.58	7.25	4.66	6.17	6.95	4.55	9.79	7.32	4.75	5.16	7.01	7.45
27	6.25	4.67	9.70	7.22	4.66	6.17	6.93	4.56	9.84	7.25	4.73	5.46	6.98	7.33

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APPENDIX C

s of January 1, 1986. The combined market interest rate under the amended Rule T-1 is calculated by multiplying the yield or on each of the respective instruments listed below by the number of units of the corresponding currency listed in Rule O-1 he 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 and the respective currency units (shown in parentheses) are as follows: market yield for three month U.S. Treasury bills 452), three-month interbank deposit rates in Germany (DM 0.527), three-month interbank money rate against private paper in e (F 1.02), discount rates on two-month (private) bills in Japan (¥ 33.4), and market yield for three-month U.K. Treasury bills 0893). Before January 1, 1986, the respective currency units were \$ 0.54, DM 0.46, F 0.74, ¥ 34, and L 0.071. urocurrency interest rates are those on three-month deposits for the U.S. dollar, the Deutsche mark, the Swiss franc, and the h franc (in London), and for the pound sterling (in Paris). IBOR is six-month euro-dollar offered rate in London. rime lending rate of major New York banks. Weekly figures are averages of seven calendar days ending on Wednesday. ield is adjusted to constant five-year maturity by the U.S. Treasury and is based on only recently issued, actively traded ities. The interest rate paid to lenders and charges on drawings under the supplementary financing facility are based on rate.

