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DM/86/62

INTERNATIONAL MONETARY FUND

Treasurer's Department

Foreign Exchange and Financial Markets in August 1986

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The value of the U.S. dollar remained on a downward trend during August as the release of economic data continued to indicate sluggishness in the U.S. economy. The U.S. Federal Reserve cut its discount rate for the second consecutive month to 5.5 percent, the lowest level in 9 1/2 years, but this move was not matched in other major countries. Short-term money market interest rates were mostly easier during August. Although inflation rates edged up slightly during the month, they remained at the lowest levels for many years.

I. Foreign Exchange Markets

The U.S. dollar continued to drift lower in August, declining in value by 0.39 percent in effective (MERM) terms, but its decline was much smaller than in June and July, when it depreciated in effective (MERM) terms by almost three percentage points each month. The U.S. dollar fell against all currencies in the European Monetary System in August except for the Irish pound, which was devalued at the beginning of the month. The dollar also declined against most other currencies reported in Table 1, but firmed against the Japanese yen, the pound sterling, and the Canadian dollar. As of the end of August, the dollar's cumulative effective (MERM) depreciation since its peak in February 1985 amounted to 29 percent; since the G-5 meeting in late September last year, the dollar depreciated in effective terms by 21 percent (see Table 2). The non-dollar currencies in the SDR basket as of end-August appreciated by 41-70 percent against the U.S. dollar from their lows in February 1985 and by 9-55 percent since the G-5 meeting.

Table 1. Changes in Exchange Rates During August 1986 ^{1/}
(In percent)

	<u>Monthly exchange rate changes</u>			Changes in effective exchange rate since August 1985
	Against U.S. dollar ^{2/}	Against SDR ^{3/}	Effective exchange rate ^{4/}	
Belgium	+2.88	+1.72	+0.91	+6.08
Denmark	+2.68	+1.47	+1.13	+10.31
France	+2.10	+0.88	+0.32	+2.99
Germany	+2.86	+1.78	+1.39	+10.68
Ireland	-4.56	-5.40	-5.74	+3.27
Italy	+2.42	+1.42	+0.91	+7.19
Netherlands	+2.74	+1.63	+0.95	+11.01
Austria	+2.86	+1.72	+1.33	+12.22
Canada	-0.62	-0.89	-0.92	-9.62
Japan	-0.45	-1.41	-1.75	+36.95
Norway	+1.63	+0.91	+0.65	-5.78
Spain	+1.55	+0.31	-0.10	+2.38
Sweden	+1.25	+0.55	+0.13	+0.69
Switzerland	+2.24	+1.28	+0.86	+13.41
United Kingdom	-0.23	-1.08	-1.32	-13.94
United States	--	-0.26	-0.39	-18.85

^{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 domestic markets, as officially advised to the Fund.

Economic developments in the United States remained the main factors contributing to the dollar's decline in August. Most of the data released during August continued to support expectations of both persistent sluggishness in the U.S. economy and lower U.S. interest rates. In the event, the U.S. Federal Reserve again cut its discount rate by one-half percentage point, effective August 21, a measure which the market had anticipated since the previous discount rate cut on July 11. Following this second reduction in the discount rate by the

Federal Reserve, there was strong speculation that the Bundesbank would follow the U.S. action and also cut interest rates. However, on August 28 the Bundesbank's Council made no change in either the Lombard or the discount rate. This development, together with the release of data showing a record U.S. trade deficit for July, appeared to contribute to the dollar's marked decline the last working day of the month.

Table 2. Changes in Selected Exchange Rates 1/
(In percent)

	Through end-August 1986	
	From February 1985 <u>2/</u>	From September 20, 1985 <u>3/</u>
U.S. dollar effective exchange rate (MERM)	-29.00	-20.94
Deutsche mark	+69.64	+39.91
Pound sterling	+41.43	+8.83
French franc	+58.31	+30.15
Japanese yen	+70.28	+55.37

1/ Based on New York 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/ 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.

Among the economic indicators that pointed to continued weakness in the U.S. economy were the following (data are for July unless noted otherwise): real GNP growth in the second quarter was revised downward to an annual rate of 0.6 percent from the previous estimate of 1.1 percent, bringing the annual growth rate for the first six months to 2.2 percent; the trade deficit rose considerably more than expected to a record \$18.04 billion from \$13.25 billion in June (revised from \$14.17 billion); industrial production fell 0.1 percent

after a revised decline of 0.3 percent in June; housing starts fell 1.8 percent after a revised 2.1 percent decline in June; and producer prices fell 0.4 percent after being unchanged in June.

Statements by U.S. officials continued to focus on the large U.S. trade deficit, although they did not appear to have a marked impact on the market. The Treasury Secretary warned against protectionist U.S. legislation in the absence of a reduction in the trade deficit in the near future, and the Chairman of the Council of Economic Advisors said that further adjustment in exchange rates was likely if major foreign economies failed to expand. However, comments by Germany's Finance Minister on August 5 that he would like to see the U.S. dollar above DM 2.1 seemed to have an immediate effect on the market that day, on speculation, soon to be dispelled, that the Bundesbank might intervene buying U.S. dollars.

The Japanese yen was generally stable against the U.S. dollar in August, fluctuating between ¥ 152-156 per U.S. dollar. However, the yen eased toward the end of the month as the market began to anticipate a Japanese discount rate cut in September following the reduction in the U.S. discount rate in August. As a result, the yen posted its first monthly decline since August 1985 (0.45 percent against the U.S. dollar), although it hit record highs of ¥ 152.80 per U.S. dollar on August 4 following the release of U.S. trade data for June, and of ¥ 152.55 on August 20 as the market awaited a cut in the U.S. discount rate. The Bank of Japan was reported to have intervened buying U.S. dollars in the foreign exchange markets on these occasions; however, the amount of intervention in August appears to have been considerably less important than in July when purchases of foreign exchange by the Bank of Japan are estimated to have been almost \$5 billion. The yen posted large declines against the SDR (1.41 percent) and in effective (MERM) terms (1.75 percent) among the currencies reported in Table 1 (except for the Irish pound which was devalued), but nevertheless remained the currency with the largest appreciation on a year-on-year basis.

The currencies participating in the exchange arrangements of the European Monetary System (EMS) firmed by 2.10-2.88 percent against the U.S. dollar in August, except for the Irish pound which depreciated by 4.56 percent as it was devalued by 8 percent, in terms of central parities within the EMS, over the weekend of August 2-3. The Irish pound replaced the French franc at the top of the narrow EMS band after the devaluation, as its immediate market depreciation was less than the change in its central rate, but was replaced by the Deutsche mark toward the end of the month. The weakest currency in the EMS was the Danish krone, except during the middle of the month when it was replaced by the Belgian franc. The Italian lira remained the strongest currency in the EMS throughout the month. All currencies remained within their thresholds of divergence during the month. However, the Bank of France reportedly sold small amounts of Deutsche mark at the

fixing in Paris on August 1 when the Deutsche mark approached the French franc at the top of the narrow band; and it also sold a few hundred million Deutsche mark to depress the German currency as it approached the ceiling against the French franc in the EMS at the end of the month. The Deutsche mark rose to a 5 1/2 year high of DM 2.0315 per U.S. dollar against the U.S. dollar on August 29.

The pound sterling eased by 0.23 percent against the U.S. dollar and had the second largest decline during the month (after the Japanese yen) against the SDR (1.08 percent) and in effective (MERM) terms (1.32 percent). Sterling was affected by lower oil prices and political uncertainties in the United Kingdom at the beginning of the month, and the Bank of England reportedly intervened buying small amounts of pounds sterling on August 4 and 5. Sterling recovered toward the middle of the month following OPEC's agreement on August 5 to limit oil production, but eased again toward the end of the month as uncertainties about the long-term direction of world oil prices depressed the currency, pushing it down to a record low against the Deutsche mark of DM 3.028 per pound on August 29. After the U.S. dollar, sterling was the currency with the largest decline on a year-on-year basis for the second consecutive month.

Other currencies reported in Table 1 firmed by 1.25-2.86 percent against the U.S. dollar during August, except for the Canadian dollar which eased for the fourth straight month. In effective (MERM) terms, these currencies firmed by 0.13-1.33 percent during the month, except for the Canadian dollar and the Spanish peseta, which eased.

The volatility of exchange rates against the U.S. dollar, as indicated by the measures given in Table 3, declined in August for most major currencies for the fourth consecutive month. For the EMS currencies, the high-low spreads fell to 1.7-2.8 percent from 2.9-4.6 percent in July, except for the Irish pound which showed a much larger spread of 6.6 percent because of its devaluation. The average of absolute daily percentage changes (MAC in Table 3) fell for each of these currencies except for the Irish pound, and averaged 0.33 percent in August compared with 0.49 percent in July excluding the Irish pound in both cases. The high-low spreads and the MAC declined for all but one of the other major currencies (the Canadian dollar). On an average basis, MAC fell to 0.32 percent in August from 0.47 percent in July.

Changes in gross foreign exchange reserves were mixed for major countries in August, with Japan and Germany continuing to register very large increases (Table 4). Over the latest 12-month period, most major countries also registered increases in their gross foreign exchange reserves. The largest increases were recorded in Japan, the United States, and France. Moderate declines were recorded in Ireland, Italy, and Canada.

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

	August 2/		High-low spread in percent 3/		MAC 4/	
	High	Low	July	Aug.	July	Aug.
Belgium	42.120	43.295	3.8	2.8	0.49	0.34
Denmark	7.6950	7.8675	3.5	2.2	0.45	0.31
France	6.6675	6.7795	3.2	1.7	0.47	0.32
Germany	2.0348	2.0895	4.6	2.7	0.54	0.36
Ireland	1.41800	1.33000	2.9	6.6	0.46	0.58
Italy	1404.00	1438.00	4.5	2.4	0.50	0.33
Netherlands	2.2955	2.3533	4.5	2.5	0.51	0.33
Austria	14.320	14.665	4.5	2.4	0.48	0.36
Canada	0.72477	0.71621	1.1	1.2	0.16	0.17
Japan	153.225	156.000	6.2	1.8	0.61	0.34
Norway	7.2950	7.4150	3.1	1.6	0.45	0.21
Sweden	6.8850	6.9850	2.5	1.5	0.32	0.19
Switzerland	1.6405	1.6870	6.7	2.8	0.70	0.53
United Kingdom	1.50450	1.47050	4.7	2.3	0.57	0.41

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 August 1986 ^{1/}

(In millions of U.S. dollars)

	End-month reserve level	Change in August	Change over 12 months
Belgium	4,500	-357	657
Denmark	4,093	-138	-1
France (July)	29,628	-2,456	+8,081
Germany	40,955	+1,348	+4,085
Ireland	2,794	-105	-607
Italy	18,734	-350	-469
Netherlands	10,590	+352	+2,154
Austria	4,351	-137	+790
Canada	1,510	-233	-229
Japan	36,646	+2,868	+12,540
Norway	13,524	+145	+1,215
Sweden	5,973	-24	+2,080
Switzerland	17,151	+725	+3,656
United Kingdom	11,689	+13	+3,552
United States	16,810	+663	+8,916

^{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 August, short-term interest rates declined in most major countries but firmed somewhat in Japan. The ongoing international debate on the level of official interest rates took on new vigor in August. In the latter part of the month, after the Federal Reserve had cut its discount rate for the fourth time this year, the U.S. authorities made a number of increasingly explicit statements suggesting that other central banks should do the same. Officials of the German and Japanese central banks, generally perceived as the principal intended recipients of this advice, responded with statements to the effect that discount rate cuts in their countries did not seem appropriate in the light of current domestic economic conditions. At the end of the month, several market analysts were predicting a coordinated round of interest rate reductions before the IMF Annual Meeting in late September, but this view was by no means unanimous. Annual inflation rates edged up slightly during the course of the month, but remained below 3.0 percent in most major countries (see Table 5).

In the United States, the Federal Reserve's decision to cut its discount rate by 0.5 percentage point to 5.5 percent, effective August 21, had been largely anticipated in the money markets following the publication earlier in the month of data pointing to weakening U.S. economic growth (see Section I). The reduction brought the rate down to its lowest level since August 1977 when it stood at 5.25 percent. The Federal Reserve observed that the reduction "appears consistent with the objective of sustaining orderly growth within a framework of greater price stability." However, a number of commentators questioned whether the objective of increasing pressure on Germany and Japan to reduce their discount rates was not equally important. According to this argument, such a stimulation of the German and Japanese economies would provide a visible response to those interests in the United States favoring trade protection as a means of reducing the U.S. trade deficit. Some days later, on August 26, commercial banks cut their prime lending rates from 8.0 percent to 7.5 percent. By the end of the month, with the German and Japanese central banks having failed to reduce their discount rates, and with the announcement of a record U.S. trade deficit, market sentiment appeared to be that a further discount rate reduction during the month of September was becoming increasingly likely.

Other U.S. interest rates declined across the board. At the short-term end of the market, the yield on three-month Treasury bills declined during August to 5.31 percent, 0.65 percentage point lower than at end-July. The Federal funds rate, expressed as a monthly average, fell

Table 5. 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		July	August
		price index <u>3/</u>		price index <u>4/</u>			
Austria	July	-4.7	(-7.1)	1.5	(1.5)	4.00	4.00
Belgium	May/Aug	-7.1	(-7.4)	0.8	(0.7)	7.30	7.30
Canada	July	0.3	(0.3)	4.2	(3.7)	8.33	8.37
Denmark	June	-8.7	(-7.3)	3.9	(3.8)	7.00	7.00
France	July	...	(...)	2.1	(2.3)	7.22	7.10
Germany	July/Aug	-8.7	(-7.9)	-0.4	(-0.5)	4.77	4.56
Italy	July	-1.8	(-1.8)	5.9	(5.9)	11.56	11.31
Japan	July	-10.7	(-10.1)	0.1	(0.5)	4.72	4.79
Netherlands	May/Aug	-6.9	(-5.5)	-0.5	(-0.7)	5.56	5.13
Norway	June/July	5.8	(5.5)	7.4	(6.7)	14.57	14.24
Spain	May/July	1.4	(1.8)	9.4	(8.9)	12.38	11.50
Sweden	July/June	1.6	(1.4)	3.4	(3.3)	8.00	8.00
Switzerland	June/July	-4.2	(-4.0)	0.5	(0.8)	4.69	4.19
United Kingdom	July	4.4	(4.5)	2.4	(2.5)	9.75	9.47
United States	July	-2.3	(-1.7)	1.6	(1.7)	5.96	5.31

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.

from 6.65 percent to 6.17 percent. At the long-term end of the market, yields on Treasury securities also declined but less sharply. In consequence, the yield curve continued to steepen; the differential between the yield on three-month Treasury bills and that on 30-year Treasury securities rose from 1.50 percentage points at end-July to 1.90 percentage points at end-August.

The M1 measure of the U.S. money supply, seasonally adjusted, averaged \$688.6 billion in the week ended August 25, compared with \$676.9 billion in the week ended July 28. The annual growth rate of M1 through August from the fourth quarter of the 1985 base period was about 14.0 percent, and thus considerably above the upper end of the Federal Reserve's target range of 3-8 percent annual growth.

Money market conditions eased in August in the countries participating in the EMS. From statements made by its officials, it seems evident that Germany's Bundesbank was under pressure to reduce its discount and Lombard rates. Pressure reportedly was exerted not only by the authorities of the United States, but also by those of some European countries that wished to lower their own interest rates for domestic economic reasons, but felt unable to do so without similar action in Germany. Within Germany itself, there were voices in favor of rate cuts, notably from commercial banking interests. Bundesbank officials, however, observed that a discount rate reduction did not seem appropriate as long as the rate of growth in central bank money stock--the key money supply indicator in Germany--was significantly above its target annual growth range, and while economic growth showed signs of picking up under existing monetary conditions. In the interbank market, the three-month interest rate declined by 0.21 percentage point during the month to 4.56 percent. During August, Germany's central bank money stock grew at an annual rate of 7.1 percent, compared with 6.7 percent in July, and thus moved further above the 5.5 percent target ceiling set for 1986.

In the Netherlands, money market conditions eased considerably during August as the Netherlands Bank cut interest rates for two of its money market borrowing facilities. First, it cut the rate on a new money market special advance by 0.5 percentage point to 5.5 percent and then, in a separate move, reduced to 0.25 percent from 0.75 percent the penalty surcharge on part of the commercial banks' borrowings within the new f. 3.1 billion three-month credit quota. In the interbank market the three-month rate eased by 0.44 percentage point to 5.13 percent. In Belgium the four-month fonds des rentes was unchanged at 7.30 percent for the second consecutive month. In France and in Italy, three-month interbank rates declined by 0.13 percentage point and 0.25 percentage point, respectively, to 7.10 percent and 11.31 percent.

Short-term interest rates firmed slightly in Japan during August. The interest rate on two-month private bills edged up 0.07 percentage point to 4.79 percent. During the month, the Bank of Japan was reported to have come under pressure from the U.S. authorities and also from domestic business interests to lower its discount rate. In response, bank officials made several statements indicating that domestic monetary conditions were already sufficiently accommodative and that, with M2 plus Certificates of Deposit rising at an annual rate of 8.7 percent in July and with surging real estate prices, a further reduction in the discount rate would be unlikely to bring positive results for the economy.

In the United Kingdom, the rise in short-term interest rates recorded in July was reversed in August. The interest rate on three-month Treasury bills eased by 0.28 percentage point to 9.47 percent. There was some speculation in the market that bank base rates might be cut, particularly after the reduction in the U.S. discount rate. However, the nature of the Bank of England's activity in the money markets was generally seen to indicate that hopes of such reductions were premature. 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 August. The year-on-year growth rate of 18.5 percent was somewhat lower than the 19.3 percent recorded in banking July, but was still significantly above the upper limit of the 11-15 percent annual growth target range for 1986. M0 grew by about 0.5 percent in banking August and by about 4.0 percent year-on-year, rising toward the middle of 2-6 percent target band.

In Switzerland, the relaxation of the recent tight money market conditions continued during August. The interest rate on three-month euro-Swiss franc deposits declined sharply from 4.69 percent at end-July to 4.19 percent at end-August. During the course of the month, major Swiss banks cut the rates for customer time deposits, for maturities from three to twelve months, from 4.25 percent to 3.75 percent. In Canada, the interest rate on the three-month Treasury bills moved narrowly during August, ending the month up 0.04 percentage point at 8.37 percent. In contrast, in Spain, the three-month inter-bank money rate declined sharply from 12.38 percent to 11.50 percent.

Three-month interest rates in the eurocurrency market were mostly lower in August. For the second consecutive month the largest declines were in rates on eurodollars and on euro-Swiss francs, which fell by 0.75 percentage point to 5.69 percent and by 0.50 percentage point to 4.19 percent, respectively. The rates on the euro-Deutsche mark and euro-sterling eased more modestly to 4.44 percent and 9.84 percent, respectively. In contrast, rates on euro-French francs and euro-yen firmed slightly to 7.31 percent and 4.84 percent, respectively.

Reflecting movements in eurodollar and domestic interest rates, uncovered interest differentials favoring investments in domestic currencies over investments in eurodollars widened and those favoring investments in eurodollars narrowed, in many cases quite sharply. In forward exchange markets, forward discounts and premia moved in a similar pattern. As a result of these movements, covered interest differentials favoring eurodollar instruments widened for France and the United Kingdom and narrowed slightly for the Netherlands. In Belgium and Italy, the differential switched from favoring domestic investment to favoring eurodollar investment and in Germany the differential favoring domestic investment narrowed slightly. In Japan, the differential in favor of domestic investment was reduced to zero (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 <u>1/</u> (1)		Forward exchange quotations <u>2/</u> (2)		Covered interest differentials <u>1/</u> (3) = (1)-(2)	
	July	Aug.	July	Aug.	July	Aug.
Belgium	-0.86	-1.61	-0.80	-1.81	-0.06	+0.20
France	-0.78	-1.41	-0.85	-1.77	+0.07	+0.36
Germany	+1.67	+1.13	+1.83	+1.26	-0.16	-0.13
Italy	-5.12	-5.62	-4.64	-5.65	-0.48	+0.03
Japan	+1.72	+0.90	+1.77	+0.90	-0.05	--
Netherlands	+0.88	+0.56	+0.91	+0.54	+0.06	+0.02
United Kingdom	-3.31	-3.78	-3.38	-4.03	+0.07	+0.25

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

During August, the SDR interest rate declined for the seventh consecutive month (See Table 7) reflecting mainly falling yields on U.S. and U.K. Treasury bills (down by 0.46 percentage point to 5.51 percent and by 0.35 percentage point to 9.40 percent, respectively). Yields on the other instruments in the SDR interest rate basket were mixed. The yield on the German instrument eased by 0.10 percentage point to 4.56 percent, while that on the Japanese instrument firmed by 0.07 percentage point to 4.79 percent. The yield on the French instrument was unchanged at 7.22 percent.

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

	July 28	August			
		4	11	18	25
SDR interest rate	6.06	6.04	6.00	5.93	5.82
Rate of remuneration	5.91	5.89	5.85	5.78	5.67

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

During the period covered by Table 8 (July 30-August 27), combined domestic rates eased markedly for all maturities (see also Chart 10). With the exception of those on the Japanese yen, interest rates on all the component currencies of the SDR eased across the board--by 0.55-0.57 percentage point for the U.S. dollar, by 0.08-0.53 percentage point for the pound sterling, by 0.13-0.20 percentage point for the Deutsche mark and by 0.12-0.26 percentage point for the French franc. Rates on Japanese yen instruments with maturities of six months or less firmed somewhat, while those with maturities of one to five years eased by 0.04-0.29 percentage point. In the eurocurrency market, interest rates declined for all the SDR-component currencies and, as a result, combined eurocurrency (offered) rates declined by 0.38 percentage point to 6.00 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 0.26-0.36 percentage point.

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

	July	August
<u>Combined market interest rates: 2/</u>		
a. Based on domestic rates		
3-month maturity (Rule T-1)	6.09	5.79
6-month maturity	6.13	5.81
12-month maturity	6.19	5.88
2-1/2 year maturity	6.63	6.25
5-year maturity	6.81	6.44
b. Based on eurocurrency offered rates		
3-month maturity	6.38	6.30
6-month maturity	6.38	6.30
<u>Average commercial bank deposit rates 3/</u>		
1-month deposits	6.14	5.88
3-month deposits	6.13	5.83
6-month deposits	6.13	5.78
12-month deposits	6.18	5.82

1/ Rates pertain to last Wednesday of the month.

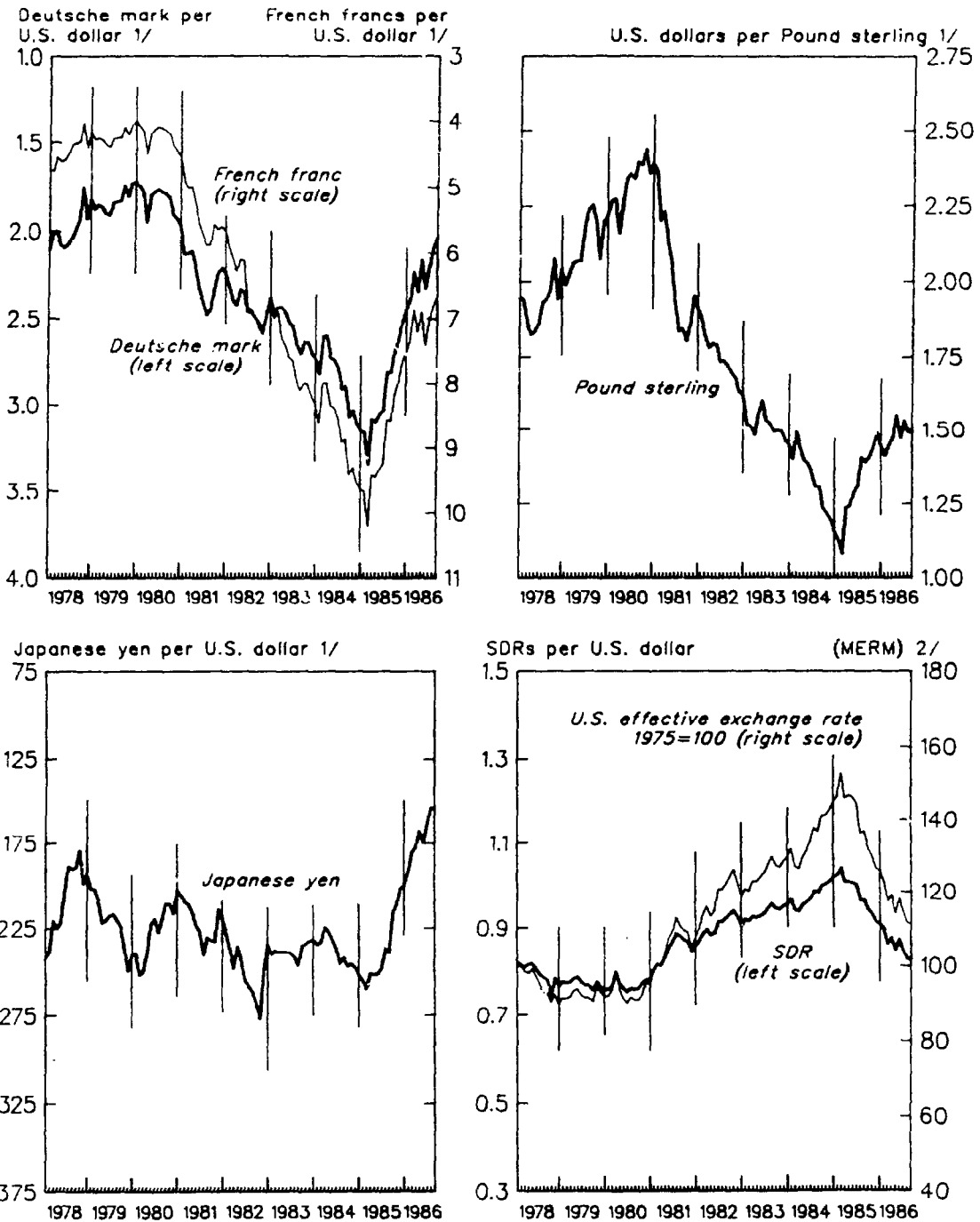
2/ Combined market rates (according to the Rule T-1) are calculated by multiplying the yields or rates of each of the respective instruments by the number of units of the corresponding currency listed in Rule 0-1 and the value in terms of the SDR of a unit of that currency as determined by the Fund under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

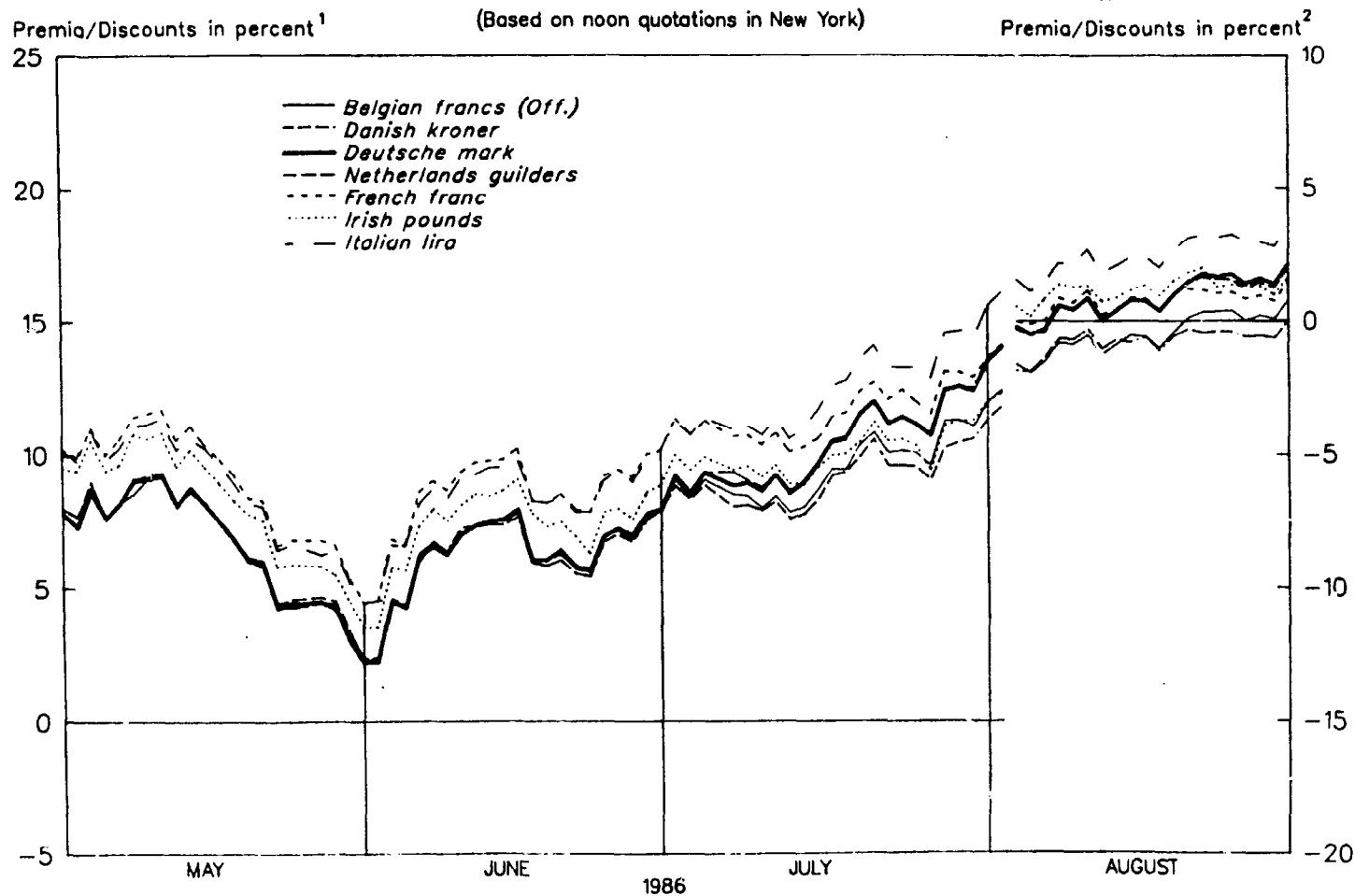
(end of month)



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

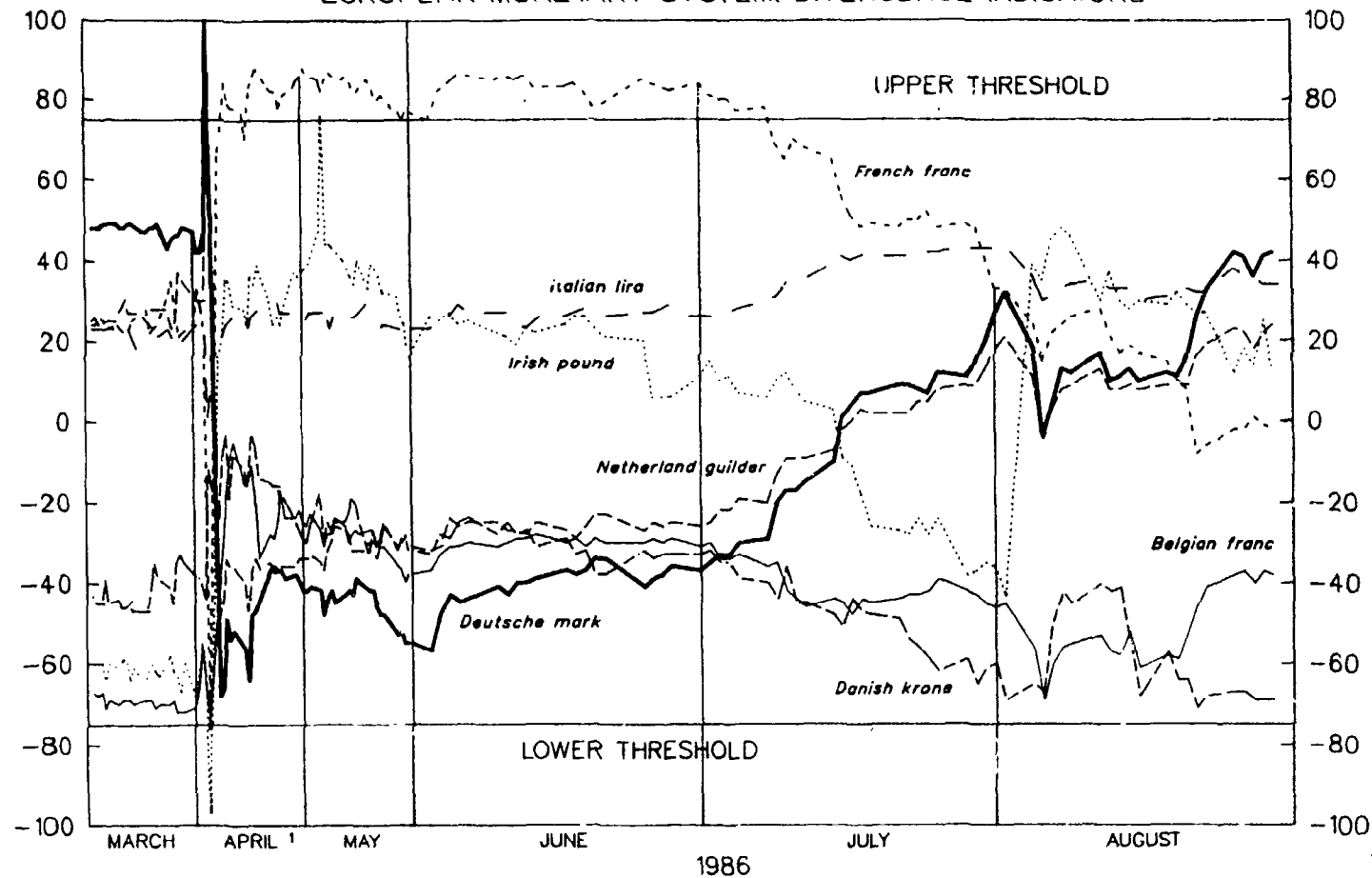


¹ Premia/Discounts over declared ECU central rates converted to U.S. dollar terms on the basis of 1 ECU=\$0.900139 effective April 7, 1986.

² Premia/Discounts over declared ECU central rates converted to U.S. dollar terms on the basis of 1 ECU=\$1.01564 effective August 4, 1985.

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)

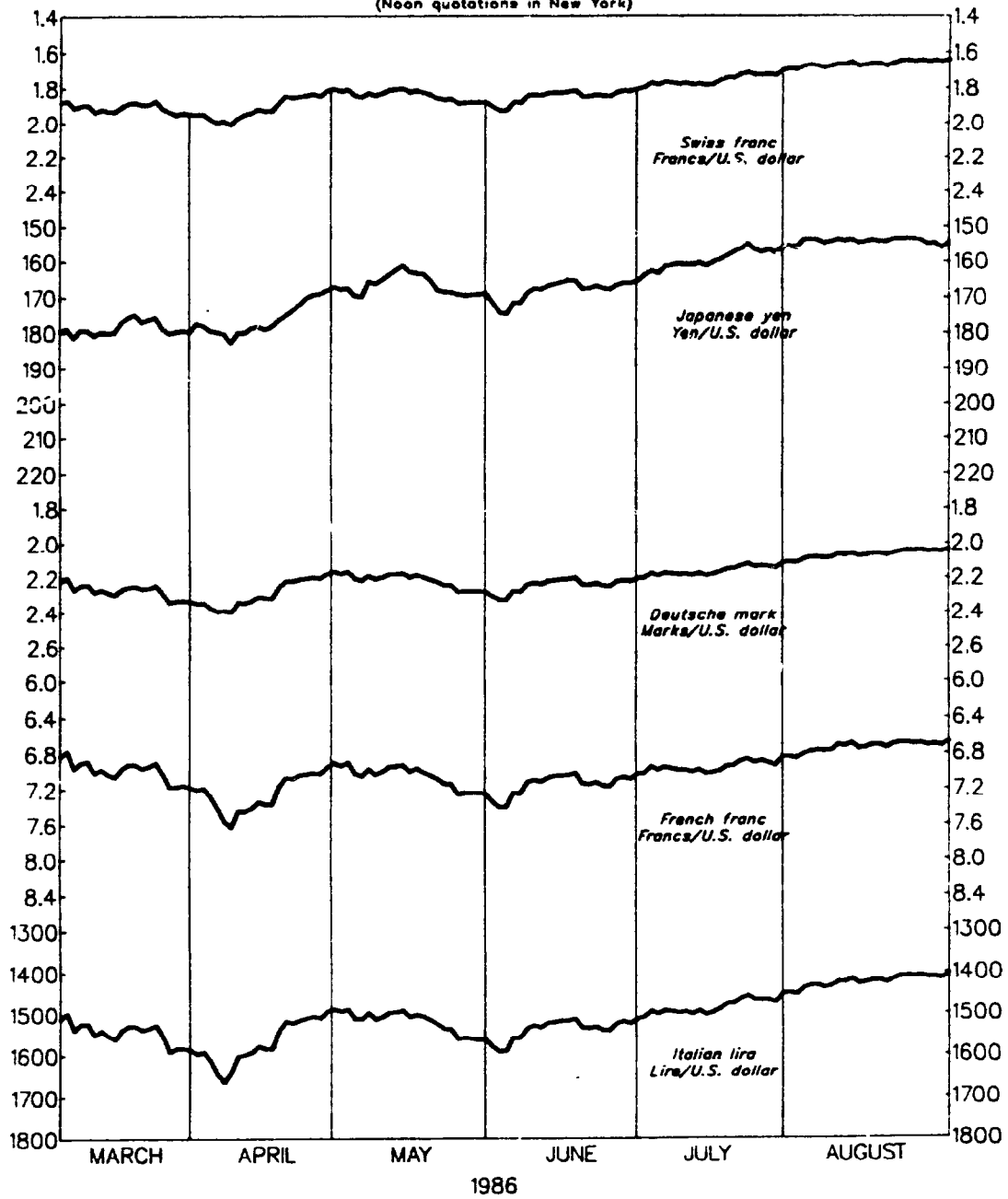
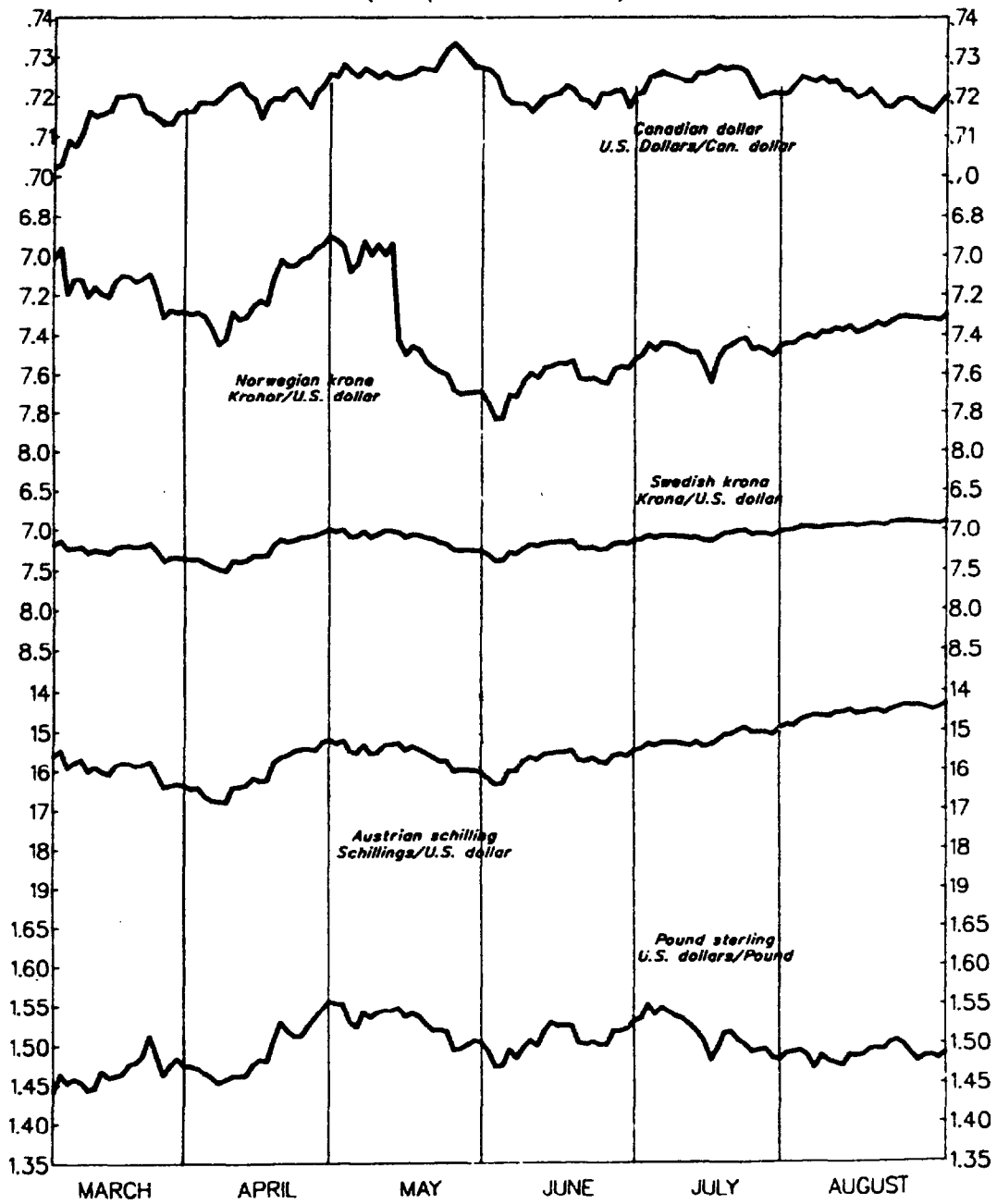


CHART 5
SPOT EXCHANGE RATES
(Noon quotations in New York)



1986

CHART 6
 INDEXES OF EXCHANGE RATES OF
 FIVE MAJOR CURRENCIES AGAINST THE SDR
 JUNE 1974 - AUGUST 1986
 (June 28, 1974=100)

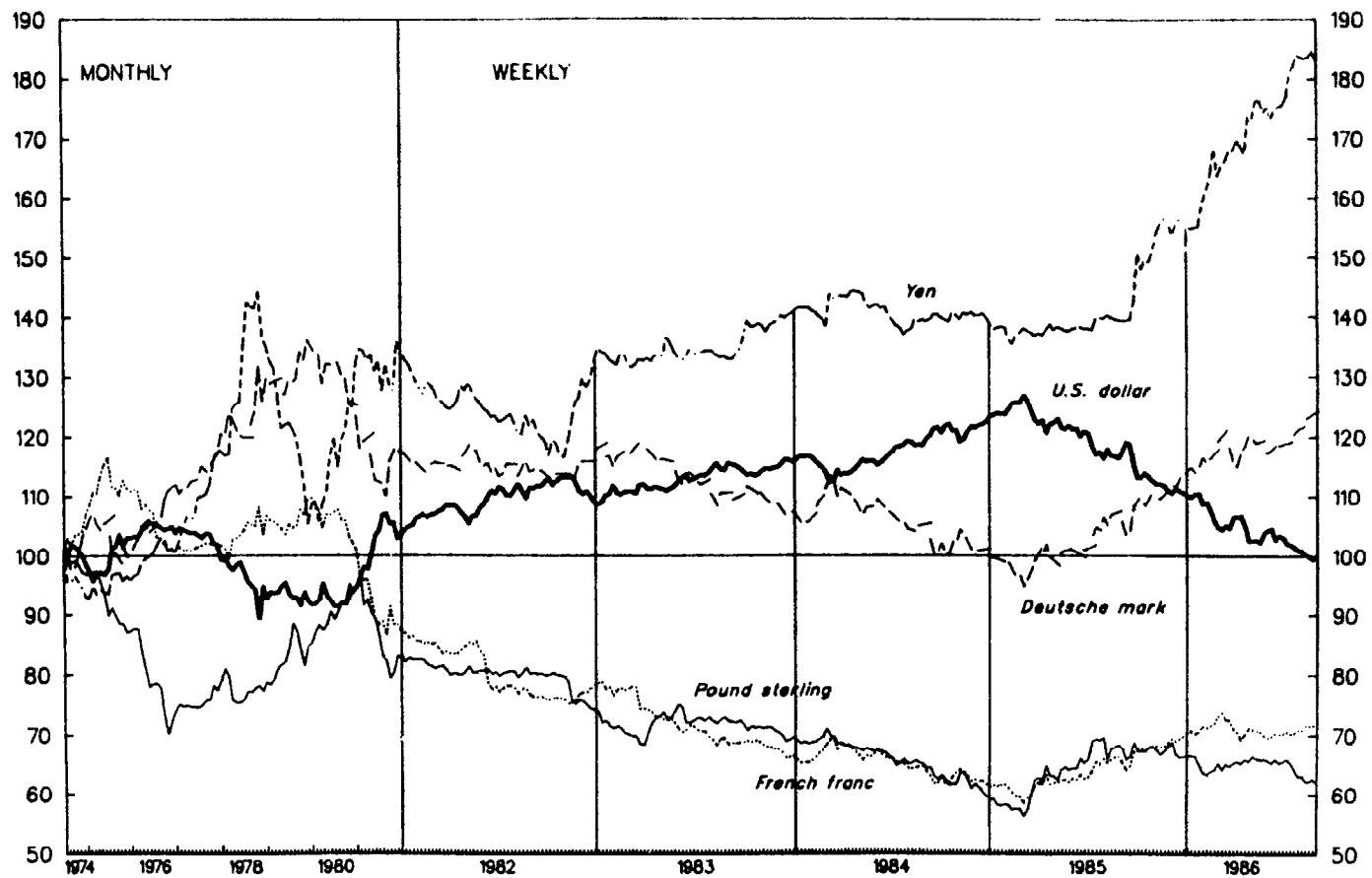


CHART 7
SHORT-TERM MONEY MARKET RATES
(Percent per annum)

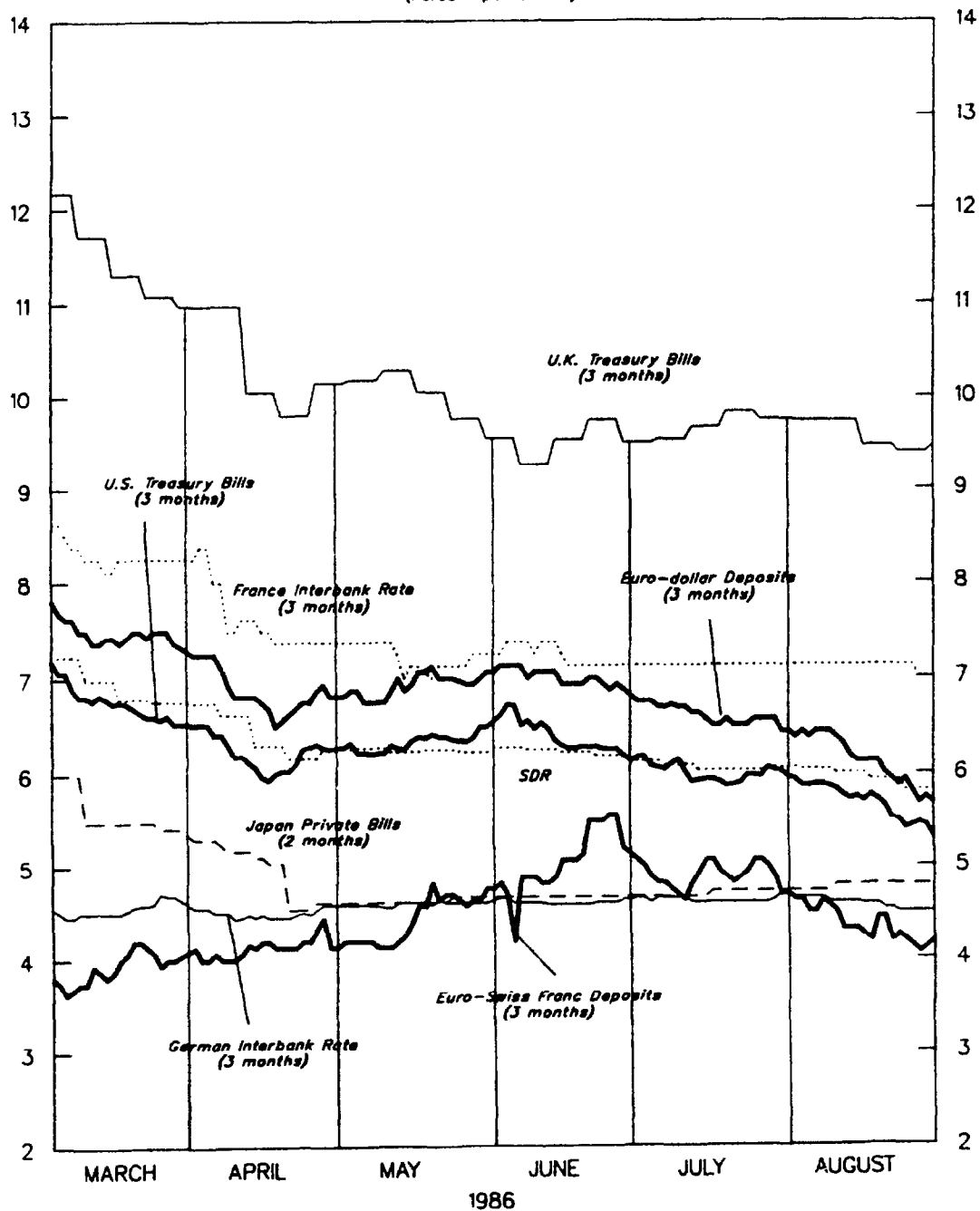


CHART 8
THREE-MONTH FORWARD RATES

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

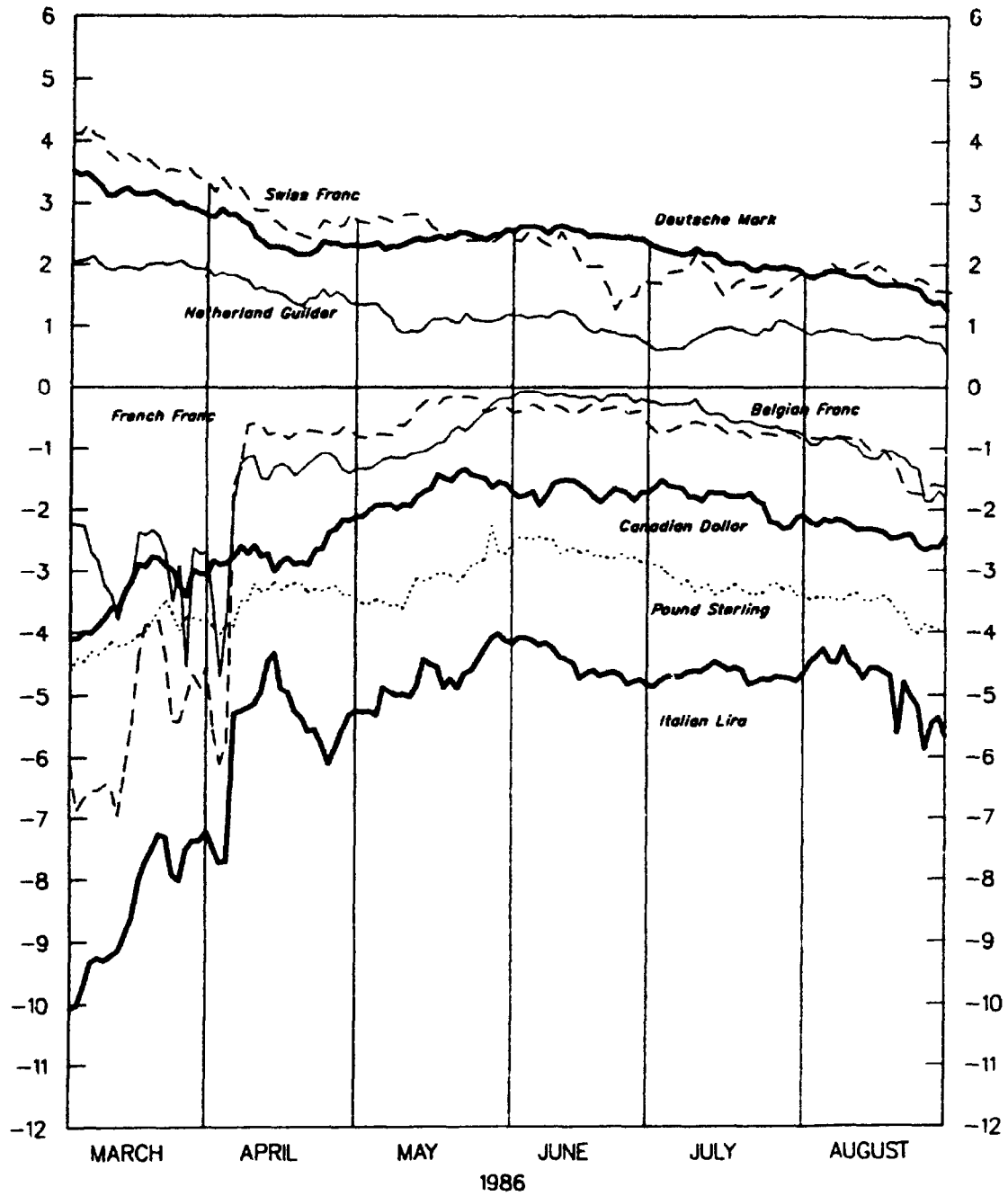


CHART 9
COVERED INTEREST DIFFERENTIALS BETWEEN THREE-MONTH
EURO-DOLLAR DEPOSITS AND LOCAL SHORT-TERM INVESTMENTS
(+ IN FAVOR OF EURO-DOLLAR AND - IN FAVOR OF DOMESTIC INVESTMENT)

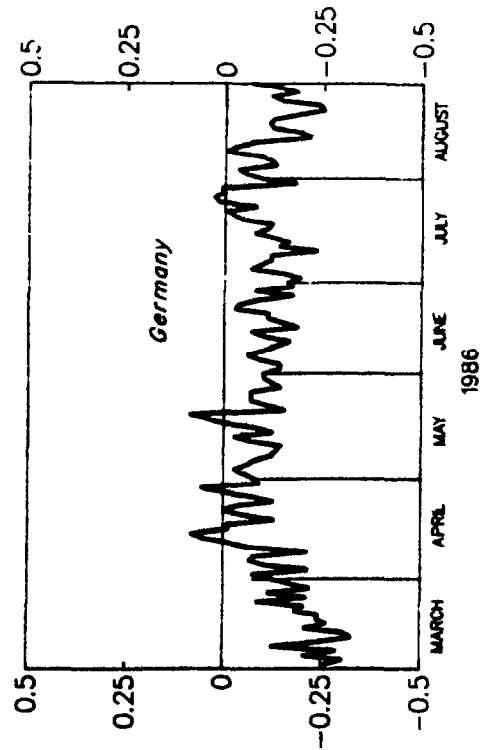
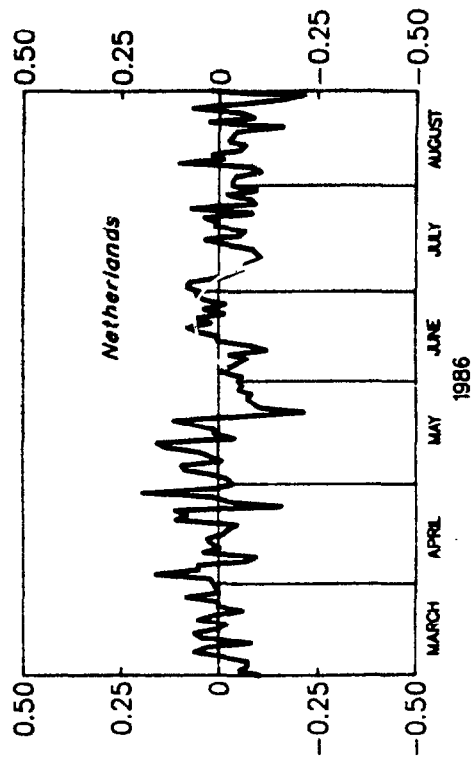
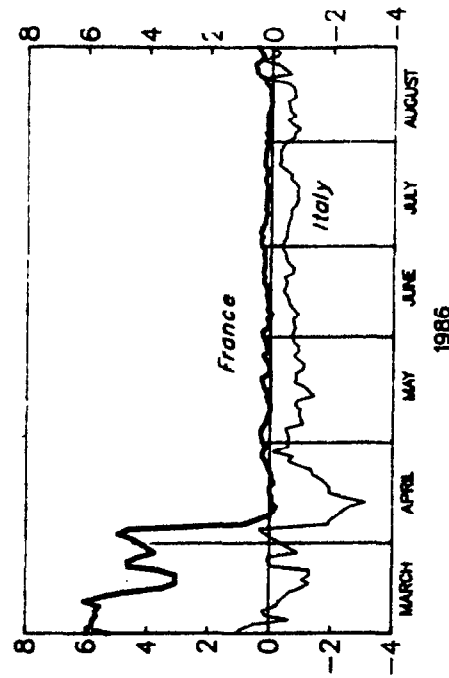
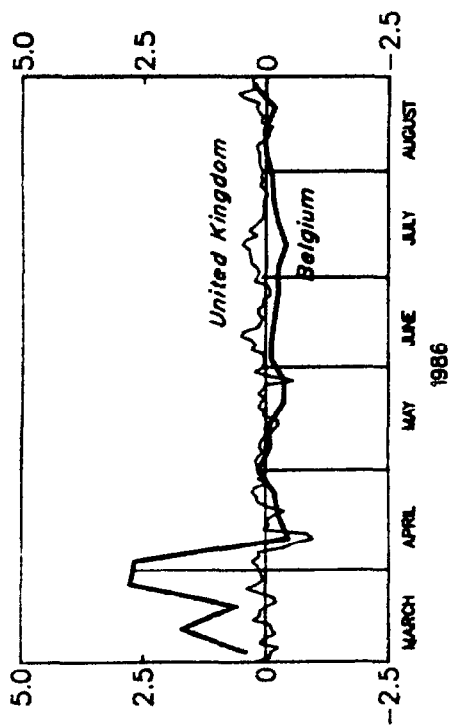
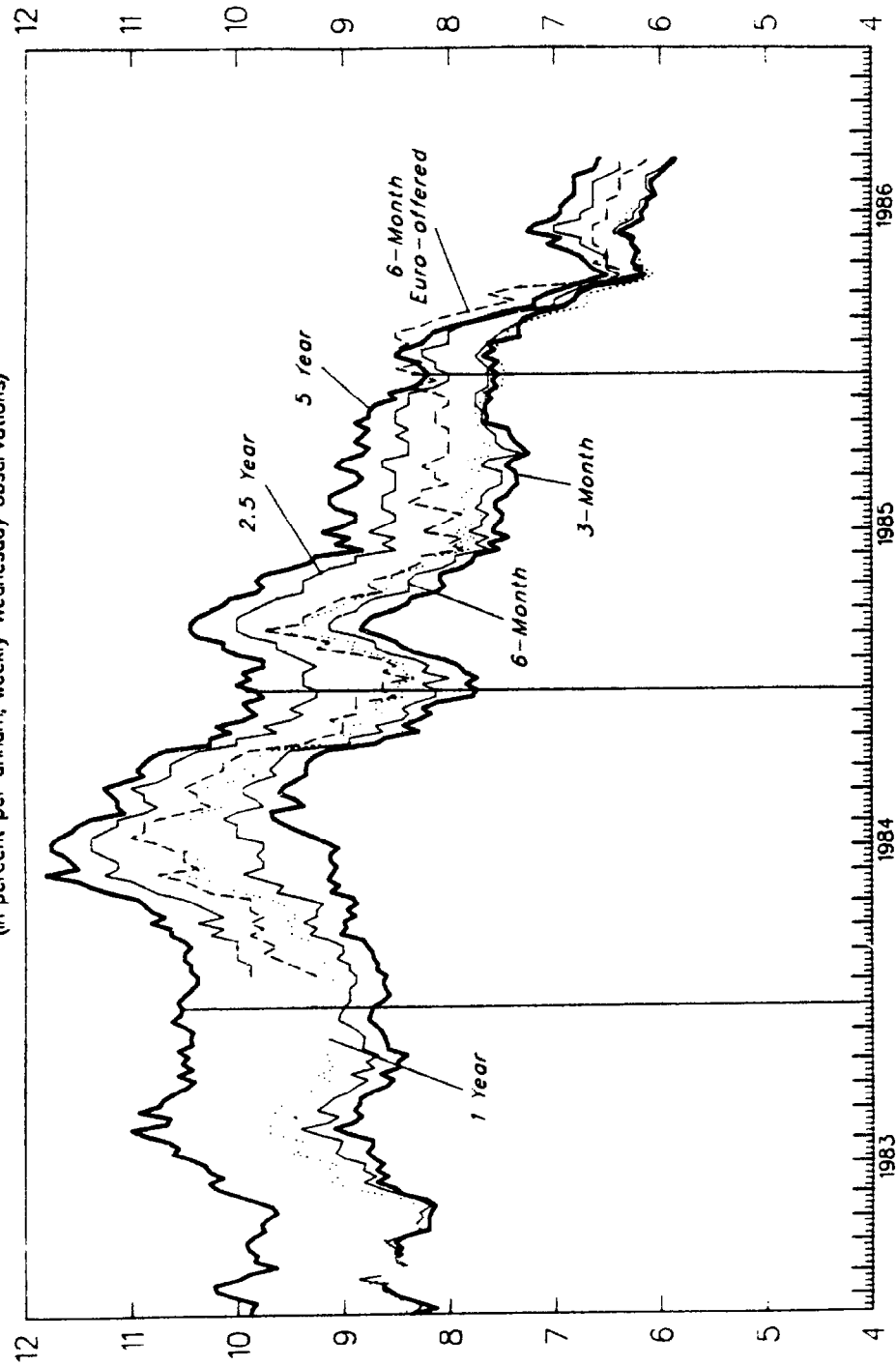


CHART 10
INTEREST RATES ON FUND-RELATED SDR ASSETS
(In percent per annum; weekly Wednesday observations)



Foreign Exchange Rates, July 1986 - August 1986 ^{1/}

Currency	J U L Y					A U G U S T			
	2	9	16	23	30	6	13	20	27
Austrian schilling	15.3613	15.3650	15.1005	15.0275	14.8650	14.6550	14.5550	14.4050	14.4750
Belgian franc									
Official	44.755	44.925	44.315	44.045	43.695	43.105	42.835	42.395	42.355
Financial	45.205	45.255	44.755	44.235	43.985	43.455	43.230	42.875	42.875
Canadian dollars	0.72555	0.72385	0.72685	0.71965	0.72273	0.72341	0.72033	0.71899	0.71621
Danish kroner	8.12000	8.15100	8.05350	8.02500	7.95500	7.80500	7.75150	7.71950	7.74000
Deutsche mark	2.18850	2.18650	2.14950	2.13200	2.11350	2.08450	2.07025	2.04800	2.04500
French francs	6.98450	7.00800	6.94050	6.88000	6.85250	6.76600	6.73700	6.68500	6.70250
Irish pounds	1.38150	1.37845	1.38875	1.39625	1.40500	1.33900	1.33950	1.35200	1.34550
Italian lire	1501.000	1501.000	1476.500	1467.500	1453.000	1433.000	1424.500	1410.000	1412.250
Japanese yen	163.300	161.030	158.360	157.400	156.075	154.375	153.250	153.350	154.655
Netherlands guilder	2.46425	2.46050	2.42350	2.40250	2.38300	2.35150	2.33300	2.30850	2.30750
Norwegian kroner	7.47750	7.49000	7.46850	7.46500	7.44300	7.38800	7.37300	7.31000	7.31600
Pounds sterling	1.53750	1.52450	1.51450	1.49250	1.48985	1.47925	1.48650	1.50450	1.48450
Swedish kronor	7.11000	7.11100	7.05100	7.05250	7.00500	6.96500	6.94350	6.89000	6.92200
Swiss francs	1.78350	1.78450	1.74200	1.72650	1.69650	1.67750	1.67030	1.64700	1.64500

^{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/

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

	Striking price				
	59	60	62	64	65
End-of-month observations:					
	(Call option premiums)				
May	1.24	0.64	0.48	0.25	0.20
June	3.05	1.89	1.43	0.78	0.52
July	--	5.05	3.26	1.90	1.28
August	--	5.00	2.98	1.22	0.54
	(Put option premiums)				
May	2.58	4.02	--	--	--
June	0.94	1.80	--	--	--
July	--	--	0.26	0.71	1.19
August	--	--	0.01	0.19	0.50

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

	Striking price				
	60	62	63	64	65
End-of-month observations:					
	(Call option premiums)				
August	5.02	3.61	3.04	2.10	1.67
	(Put option premiums)				
August	0.30	--	--	1.25	1.88

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)	
1985															
Sep	7.33	4.75	11.33	9.75	8.45	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	8.80	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	8.00	7.32	7.95	4.51	12.72	14.81	8.07	3.95	8.03	9.50	8.34
Mar	6.78	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
Jun	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
Jul	6.00	4.69	9.67	7.22	4.69	6.07	6.60	4.57	9.97	7.30	4.69	4.88	6.66	8.16	7.06
Aug	5.68	4.64	9.58	7.21	4.77	5.92	6.12	4.49	9.84	7.28	4.80	4.35	6.17	7.90	6.80
1986 Week ending:															
Aug 1	6.00	4.72	9.74	7.22	4.72	6.07	6.48	4.62	9.95	7.29	4.81	4.78	6.55	8.00	7.10
8	5.87	4.70	9.73	7.22	4.72	6.01	6.43	4.60	9.93	7.23	4.82	4.56	6.48		
15	5.76	4.66	9.68	7.22	4.79	5.97	6.23	4.48	9.84	7.15	4.76	4.34	6.26	8.00	5.97
22	5.64	4.61	9.46	7.22	4.79	5.89	6.02	4.43	9.73	7.35	4.80	4.30	6.08	8.00	6.70
29	5.41	4.56	9.42	7.15	4.79	5.78	5.78	4.42	9.85	7.41	4.83	4.11	5.81	7.86	6.55

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 0 1 and the value in terms of the SDR of a unit of that currency as determined by the Fund under Rule 0 2(a) and (b). The interest rates and the respective currency units (shown in parentheses) are as follows: market yield for three month U.S. Treasury bills (\$ 0.452), 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 (Y 33.4) and market yield for three month U.K. Treasury bills (L 0.0893). Before January 1, 1986, the respective currency units were \$ 0.54, DM 0.46, F 0.74, Y 34, and L 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.