

INTERNATIONAL MONETARY FUND

Secretary's Journal of Executive Board  
Informal Session 87/4

10:00 a.m., July 15, 1987

M. Camdessus, Chairman

Executive Directors

Dai Q.

J. de Groote

A. Donoso

M. Finaish

G. Grosche

A. Kafka

M. Massé

Mwakani Samba

Y. A. Amatallah

G. Ortiz

J. Ovi

G. Salehkhov

A. K. Sengupta

K. Yamazaki

S. Zecchini

Alternate Executive Directors

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M. K. Bush

J. Prader

A. M. Othman

B. Goos

J. Reddy

M. Foot

D. McCormack

I. A. Al-Assaf

M. Fogelholm

G. Pineau, Temporary

J. de Beaufort Wijnholds

C.-Y. Lim

O. Kabbaj

L. E. N. Fernando

M. Sugita

N. Kyriazidis

L. Van Houtven, Secretary and Counsellor

A. Akanda, Assistant

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Also Present

African Department: M. G. Kuhn. Asian Department: P. R. Narvekar, Director; B. B. Aghevli. European Department: M. Russo, Director; M. Guitián, Deputy Director. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; W. A. Beveridge, Deputy Director; E. Brau. Legal Department: W. E. Holder, Deputy General Counsel; R. H. Munzberg. Research Department: J. A. Frenkel, Economic Counsellor and Director; M. Goldstein, Deputy Director; M. P. Dooley, R. D. Haas, G. Hacche. Treasurer's Department: F. G. Laske, Treasurer; D. Williams, Deputy Treasurer; Y. Kawakami, S. E. Nocera, O. Roncesvalles. Western Hemisphere Department: S. T. Beza, Director; Y. Horiguchi. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: P. E. Archibong, I. Sliper, N. Toé, J. E. Zeas. Assistants to Executive Directors: R. Comotto, E. C. Demaestri, S. K. Fayyad, D. V. Nhien, C. Noriega, G. Seyler, G. Schurr, Yang W., I. Zaidi.

1. REPORT BY MANAGING DIRECTOR

The Managing Director made the following statement on the meeting of the Group of Ten held on July 10:

Mr. Qureshi and I met with representatives of the Group of Ten on July 10 to discuss both the proposal to enhance the resources under the structural adjustment facility and initiatives put forward by the World Bank. The participants in the discussion included representatives of treasuries and, on this occasion, of aid agencies of donor countries.

The sense of the meeting was strongly supportive of the proposal to enhance the structural adjustment facility, which was thought to be timely and appropriate. Support was expressed not only by the representatives of the G-7 countries that attended the Venice Economic Summit meeting, but also by the representatives of all the other countries. In particular, there was widespread agreement that the proposals of the Fund and the World Bank were complementary, not competitive, and there was a clear perception that the structural adjustment facility can become a strategic element in the provision of financial assistance to low-income countries.

The representatives at the meeting agreed that a large increase in the resources available under the structural adjustment facility was required. I was pleased to observe that a number of delegations, without tying themselves to specific amounts, considered that the targeted increase of SDR 6 billion was an appropriate figure or was of the order of magnitude required.

There was a broad consensus among the delegations that the increased resources under the structural adjustment facility would have to be used in support of strong and credible programs. Some of them insisted that there should be clear-cut conditions on the use of the enhanced resources of the facility, and in response I stressed that the greater the financing that was available, the stronger the programs could be. I also stressed that if the countries using the enhanced structural adjustment facility resources are to take meaningful action to implement programs successfully, the authorities in those countries must be willing to make a strong political commitment. I said that such factors would have to be reflected in an appropriate set of conditions on the use of the enhanced resources of the structural adjustment facility.

There were important differences of view on the question of risk bearing by potential contributors. Some stated that it would be preferable to establish a trust account administered by the Fund; the account could borrow or receive grants from contributing countries and on-lend these funds to eligible countries. Under

that arrangement, any repayment risk would fall on the administered account and, therefore, on the account's creditors. Others took the view that, if a large amount of resources were to be tapped rapidly, this could be done only through the use of central bank reserves, in which event it would be imperative that the Fund itself should be the borrower. Both points of view are understandable, and as I told the participants in the meeting, we in the Fund will need to consider whether we can devise an approach that, without requiring the General Resources Account to be the borrower, would ease the risk-related problems facing some potential creditors.

Given the budgetary constraints of all the countries represented at the meeting, there were understandably questions about alternative sources of financing. In that connection, the possibility of selling some of the Fund's gold and of making a special allocation of SDRs was mentioned. I explained the reasons why it would not be appropriate to sell the Fund's gold and I said that it was my perception that there is not at present enough support in the Board for an allocation of SDRs. I emphasized that we need resources that could be lent on terms and conditions that are similar to those that now apply under the structural adjustment facility. I said that I recognized that, at least for several potential contributors, this money could be made available only by tapping the budgets of those countries.

Let me take a moment to elaborate on my position on sales of gold by the Fund. The Fund's gold holdings are one of the institution's main sources of strength. As long as there is no certainty that the difficulties that the Fund will face in fulfilling its responsibilities in coming years will be any less demanding than those the Fund has faced in the past, the Fund must keep its gold holdings to ensure that the institution's financial position will remain strong. We must not reduce the Fund's capital base to solve a particular problem of the moment when in all likelihood the Fund will continue to face serious challenges in the years to come. Selling the Fund's gold holdings might well weaken the institution's ability to help its members, including--perhaps especially--the poorest countries.

I also told the meeting that we would use July and August to prepare for the further meetings on this matter that will need to be held in September, and that the Fund would continue to keep in touch with all potential creditors through their Executive Directors.

In sum, the meeting of July 10 was a welcome occasion on which to explain what we have in mind to the aid agency representatives as well as to others with a more direct responsibility for budgetary matters. I am confident that the participants in the meeting appreciated the evidence of strong cooperation between

the World Bank and the Fund. I appreciate Mr. Qureshi's friendly and supportive attitude toward the Fund's initiative, and I am sure that he welcomes the support that I expressed for the World Bank's initiative. I hope that our statements have helped to offset the incorrect impression in some circles that we are not doing enough to improve the cooperation between the World Bank and the Fund.

During my visit to Europe, I also attended the monthly meeting of central bank governors in Basle. I took that opportunity to emphasize that while creditor countries could make an important contribution out of their budgetary resources to the augmentation of the financing available under the structural adjustment facility, we in the Fund are determined to preserve the monetary character of the institution. At the same time, however, we must ensure that the Fund continues to be able to discharge its mission for the benefit of the entire membership.

## 2. EXCHANGE RATES - RECENT DEVELOPMENTS

The Executive Directors met informally, in restricted session, to exchange views on recent developments in exchange markets. They had before them charts providing background material (EBD/87/191, 7/14/87).

The staff representative from the Treasurer's Department made the following statement:

Directors will recall that the effective exchange value of the U.S. dollar was broadly stable through most of May. The dollar appreciated very sharply during the last week of May but fell by almost as much in the first part of June, following the announcement that Mr. Volcker had resigned as Chairman of the Federal Reserve Board. In the second week of June, the currency resumed its rise, which continued during the rest of June and until this morning in Europe. The dollar had eased sharply that morning in early trading in New York following the release of U.S. trade data which showed a widening of the trade deficit from \$13.3 billion in April to \$14.4 billion in May, contrary to market expectations. The performance of the U.S. dollar has generally been strong since the last week of April and on a weighted average basis the dollar has now risen to approximately 1 percent below its level at the time of the Louvre accord in February.

The strong upward movement in the value of the dollar over the last six weeks has of course been reflected in changes in the exchange rates of other major currencies, although the pattern of change has not been uniform among the currencies. In particular, the dollar has appreciated strongly against the Japanese yen, rising by about 4 percent from ¥ 143 at the end of

May to ¥ 149 today. The dollar appreciated much less sharply against the deutsche mark, rising by slightly more than 1 percent during the last six weeks. The movement of the European Monetary System (EMS) currencies against the dollar over this period matched rather closely the change in the dollar/mark rate, with the spread within the band tending to narrow from June to mid-July, and with relatively little tension among these currencies. The exchange rates for the EMS currencies against the U.S. dollar today are in fact quite close to those obtaining at the time of the Louvre accord while the U.S. dollar rate against the Japanese yen, at ¥ 148, is about 3 percent below that at the end of February. In the run up to the U.K. election on June 11, the pound appreciated sharply against the dollar and other major currencies, but subsequently lost strength. On balance, there was not much change in the bilateral dollar/sterling exchange rate during the last six weeks, with the pound sterling quoted today at \$1.63, about 6 percent above its level at the end of February.

The sustained rise of the dollar may be attributed to a number of factors that have contributed to an apparently growing sentiment in the foreign exchange markets that the value of the U.S. currency has "bottomed out." This sentiment drew strength, in particular, from a belief that the U.S. trade position was improving, in response to the depreciation of the dollar in the period from February 1985 to April this year. Data released on June 12 indicated that the U.S. trade deficit declined to \$13.3 billion in April--from \$13.6 billion in March and \$15.1 billion in February. Also, the narrowing of Japan's trade surplus to \$6.4 billion in May from \$7.6 billion in April helped market sentiment toward the dollar. The positive impact of the trade figures through yesterday before the renewed deterioration announced this morning was enhanced by data showing that U.S. producer prices in May had risen by only 0.3 percent, much less than generally expected and down from 0.7 percent in April. The announcement last week that U.S. producer prices rose by only 0.2 percent in June also served to calm inflationary expectations in the United States.

It would also appear that the strength of the dollar reflected a somewhat tighter monetary policy on the part of the Federal Reserve in April and May. This shift, which was revealed by remarks made by Chairman Volcker at the end of April, was confirmed in the report released last Friday describing the policy actions taken by the Federal Open Market Committee (FOMC) at its meeting on May 19. At that meeting, the FOMC agreed that open market operations would be directed toward some increase in the degree of pressure on banks' reserves beyond that sought in recent weeks. While interest rates have risen recently in both Japan and the United Kingdom, there did not appear to be any overt shift toward tighter monetary conditions in these countries.

There were no changes in official interest rates in Germany, whereas both the Bank of France and the National Bank of Belgium reduced their administered rates in the last six weeks.

The shift in sentiment in favor of the dollar was accompanied by a significant narrowing in the differential between yields on U.S. securities and those on similar assets denominated in other currencies. In the period from May 28 to July 14, the interest differential in favor of the U.S. 30-year treasury bond over the Japanese benchmark bond and the Bundesbank's average of long-term public authority bonds narrowed from 5.6 percentage points to 4.3 percentage points, and from 3.5 percentage points to 2.9 percentage points, respectively. Despite the narrowing, the differential remained large, particularly against investment in yen-denominated assets, and Japanese investors were again reportedly large-scale purchasers of U.S. bonds. The comparatively large long-term interest rate differentials gave added support to the strength of the U.S. dollar on the exchange markets. In June, government sources reported a record outflow from Japan of \$11 billion, of which a substantial portion is believed to have been accounted for by the acquisition of dollar assets. The differential in favor of the sterling benchmark gilt over the U.S. long-term bond rose slightly from about one quarter of a percentage point to just over one half a percentage point during the same period. At the short-term end of the market, the yield on U.K. three-month treasury bills, after falling to a low of 8.5 percent on June 12, moved back above 9 percent during the first half of July. Short-term interest rates rose marginally in Germany, and in the United States they were somewhat lower in mid-July than at the beginning of June. In Japan, the two-month private bill declined slightly over this period, but other more market-determined short-term rates rose somewhat.

As regards intervention, in the period from the Louvre agreement to the end of April, central banks reportedly intervened on a large scale to stem the decline of the dollar, but intervention has reportedly been much less since the period of initial stability in the U.S. dollar rate during May. The Federal Reserve Bank of New York reported that in the February-April period, intervention by the U.S. monetary authorities totaled slightly over \$4 billion, nearly all of which took the form of sales of yen. The recent strengthening of the dollar over the last six weeks has essentially reflected a change in market sentiment and a relatively large, if narrowing, differential on long-term investments in favor of the U.S. dollar, rather than any major changes in policies or sustained intervention; indeed there were some recent reports of intervention sales of U.S. dollars.

During the last six weeks, gold prices moved in generally quiet trading within a range of about \$20-25, with this morning's price of \$448 per ounce only slightly higher than at the beginning of June.

The Executive Directors then held an exchange of views on recent exchange market developments.

LEO VAN HOUTVEN  
Secretary

U.S. EFFECTIVE EXCHANGE RATE: 1980=100  
(APRIL 1, 1987 TO JULY 15, 1987)

