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November 1, 1988

To: Members of the Executive Board  
From: The Secretary  
Subject: Background Material on Exchange Rate Developments

The attached set of charts and tables is intended to serve as background material for the informal Board discussion of exchange rate developments scheduled for Wednesday, November 2, 1988. In addition to the usual review of exchange rate developments, the discussion is expected to refer to stock market developments in the seven major industrial countries in 1987-88, and particularly since the collapse of equity markets in October last year. The main focus, however, is expected to be on movements in global foreign exchange reserves and recent developments in the financing of the current account imbalances of the three largest industrial countries.

Mr. Hacche (ext. 7409) is available to answer technical or factual questions relating to the attached material.

Att: (9)

Other Distribution:  
Department Heads

# Chart A

## Major Industrial Countries

### Nominal Effective Exchange Rates

January 1987 to October 1988 (weekly data)

Index, Jan. 1987=100

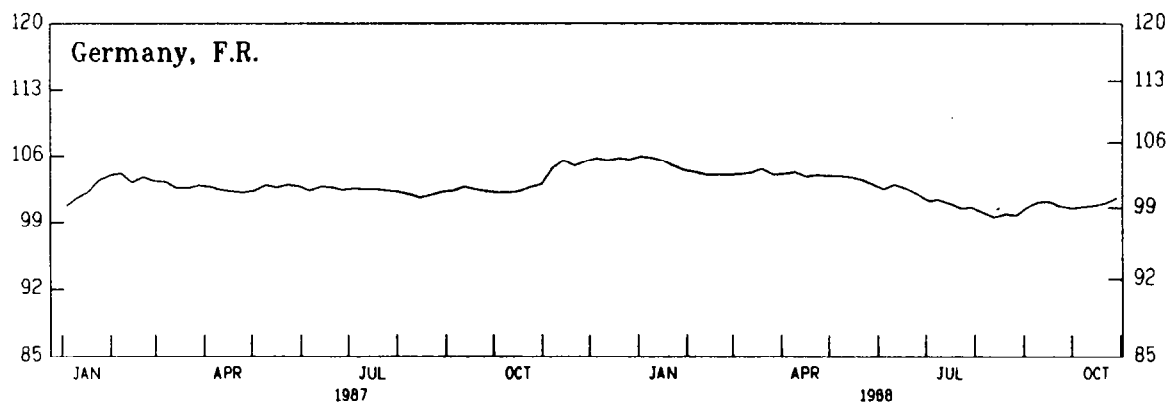
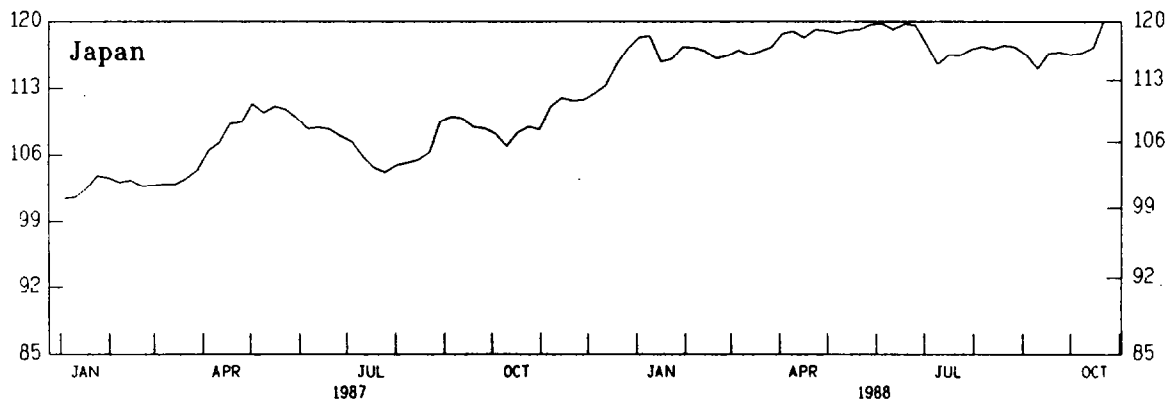
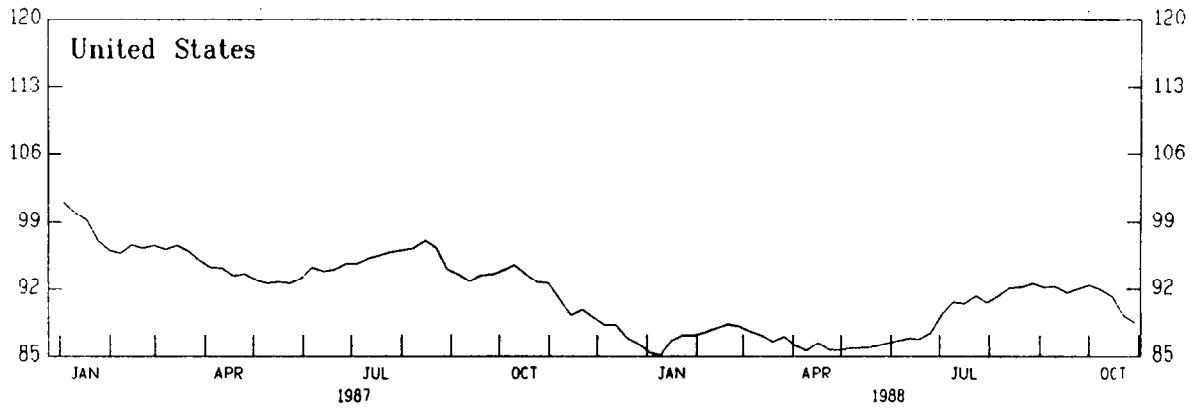


Chart A (continued)  
Major Industrial Countries  
Nominal Effective Exchange Rates  
January 1987 to October 1988 (weekly data)

Index, Jan. 1987=100

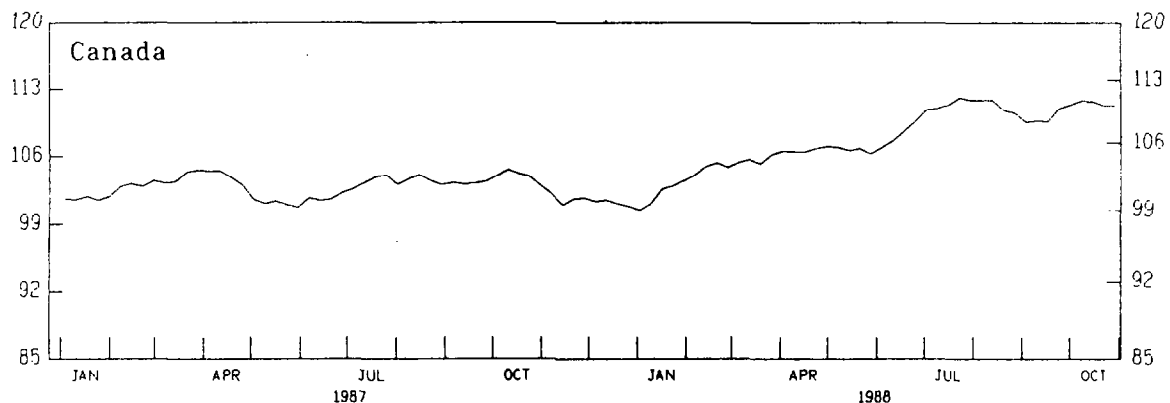
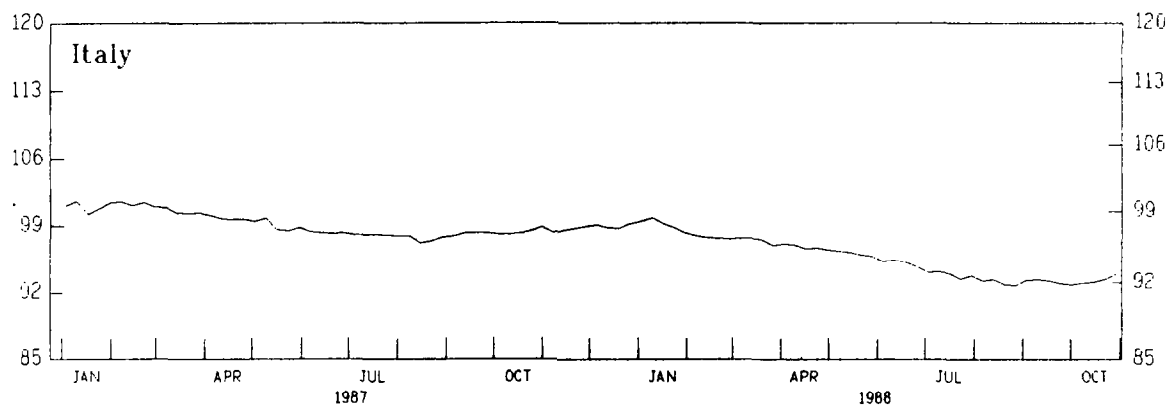
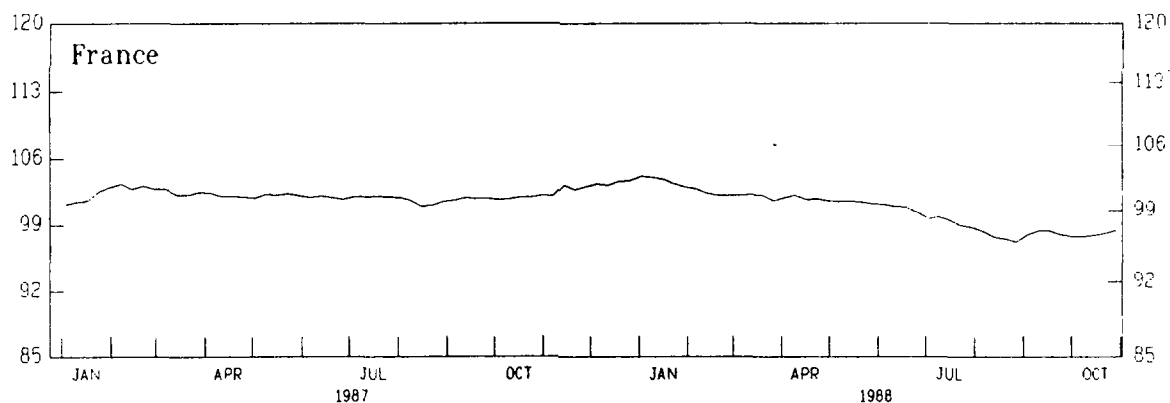
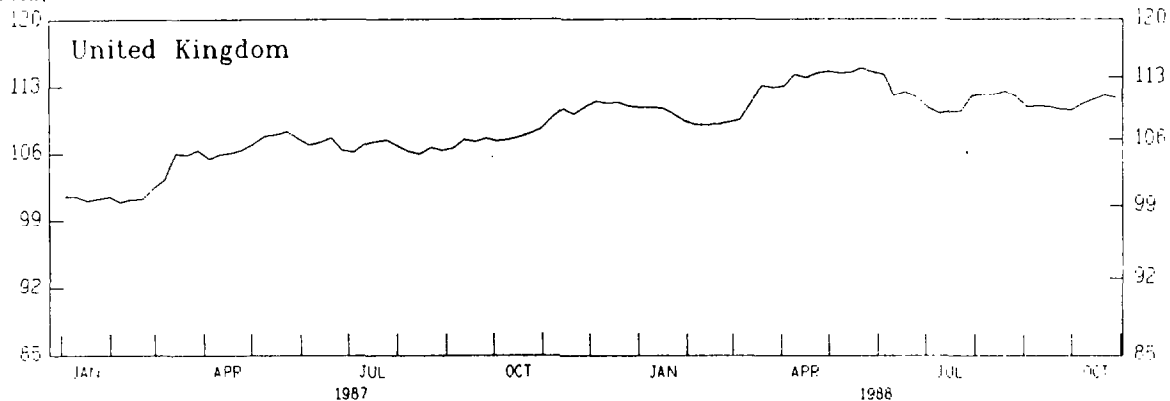


Table 1. Seven Major Industrial Countries: Stock Market Price Indices, 1983-88 1/

	United States	Japan	Germany, Fed. Rep. of	United Kingdom	France	Italy	Canada
<u>Averages</u> (percent change from line above in parentheses)							
Oct.-Dec 1983 (percent change from year earlier)	1,252 (+23)	9,442 (+24)	1,008 (+24)	726 (+19)	145.5 (...)	188.3 (...)	2,479 (...)
Oct.-Dec. 1984	1,198 (-4)	11,204 (+19)	1,085 (+8)	903 (+24)	181.2 (+25)	215.5 (+14)	2,380 (-4)
Oct.-Dec. 1985	1,435 (+20)	12,879 (+15)	1,740 (+60)	1,084 (+20)	232.9 (+29)	421.9 (+96)	2,765 (+16)
Oct.-Dec. 1986	1,880 (+31)	17,732 (+38)	2,020 (+16)	1,279 (+18)	392.2 (+68)	731.5 (+73)	3,042 (+10)
August 1987	2,657 (+41)	24,457 (+44)	2,031 (+1)	1,750 (+37)	413.1 (+5)	631.8 (-14)	4,034 (+33)
September 1987	2,566 (-3)	25,128 (-1)	1,967 (-3)	1,803 (+3)	429.0 (+4)	615.5 (-3)	3,937 (-2)
October 1987	2,263 (-12)	24,907 (-1)	1,803 (-8)	1,660 (-8)	365.8 (-15)	617.7 (-)	3,474 (-12)
November 1987	1,930 (-15)	22,804 (-8)	1,368 (-24)	1,296 (-22)	293.5 (-20)	505.4 (-18)	2,974 (-14)
September 1988	2,085 (+8)	27,596 (+21)	1,525 (+11)	1,430 (+10)	362.4 (+23)	527.8 (+4)	3,273 (+10)

Source: DRI

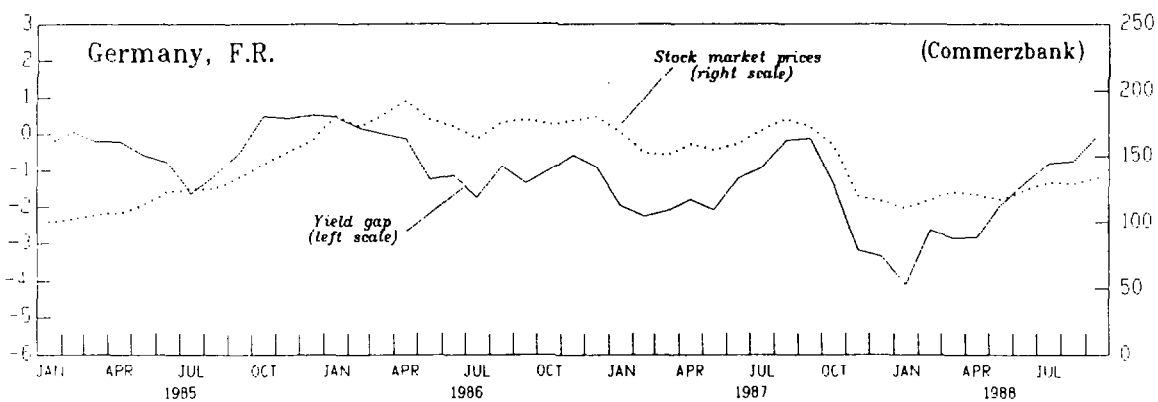
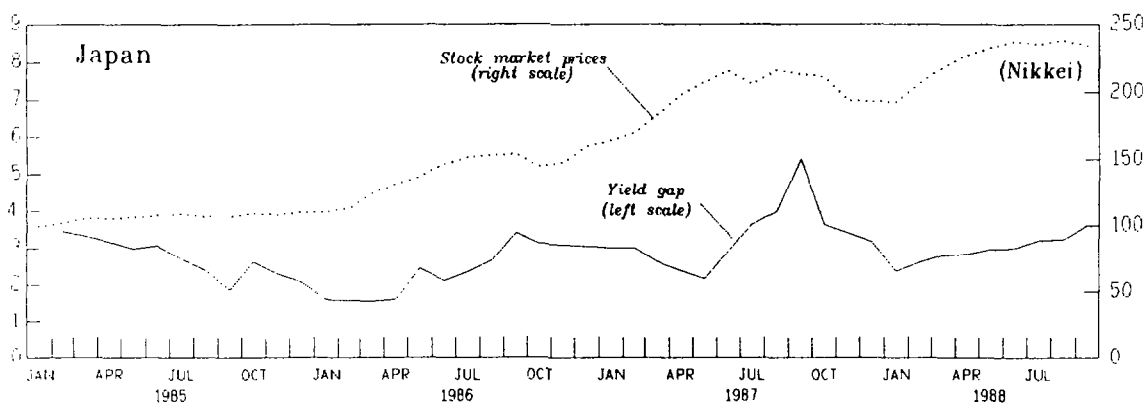
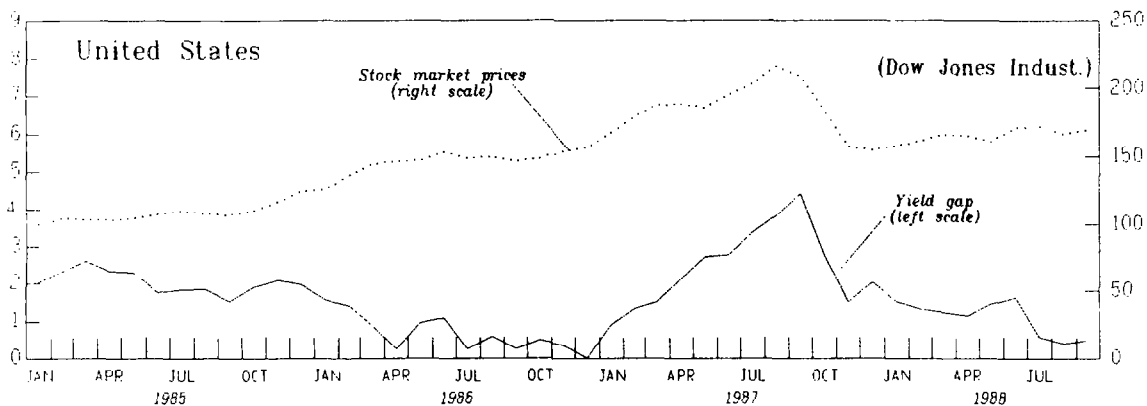
1/ The indices shown are as follows: United States--Dow-Jones Industrial Average; Japan--Nikkei Stock Average; Federal Republic of Germany--Commerzbank Index; United Kingdom--F.T. Industrial Ordinary Index; France--General CAC; Italy--Banca Commerciale; Canada--Toronto S.E. Composite.



Chart B1  
Major Industrial Countries  
Equity Yield Gaps<sup>1</sup> and Stock Market Prices  
January 1985 to September 1988

Percent per annum

Index, Jan. 1985=100



<sup>1</sup> The equity yield gap is defined as the difference between the yield on long-term government bonds and the inverse of the price-earnings ratio of stocks.

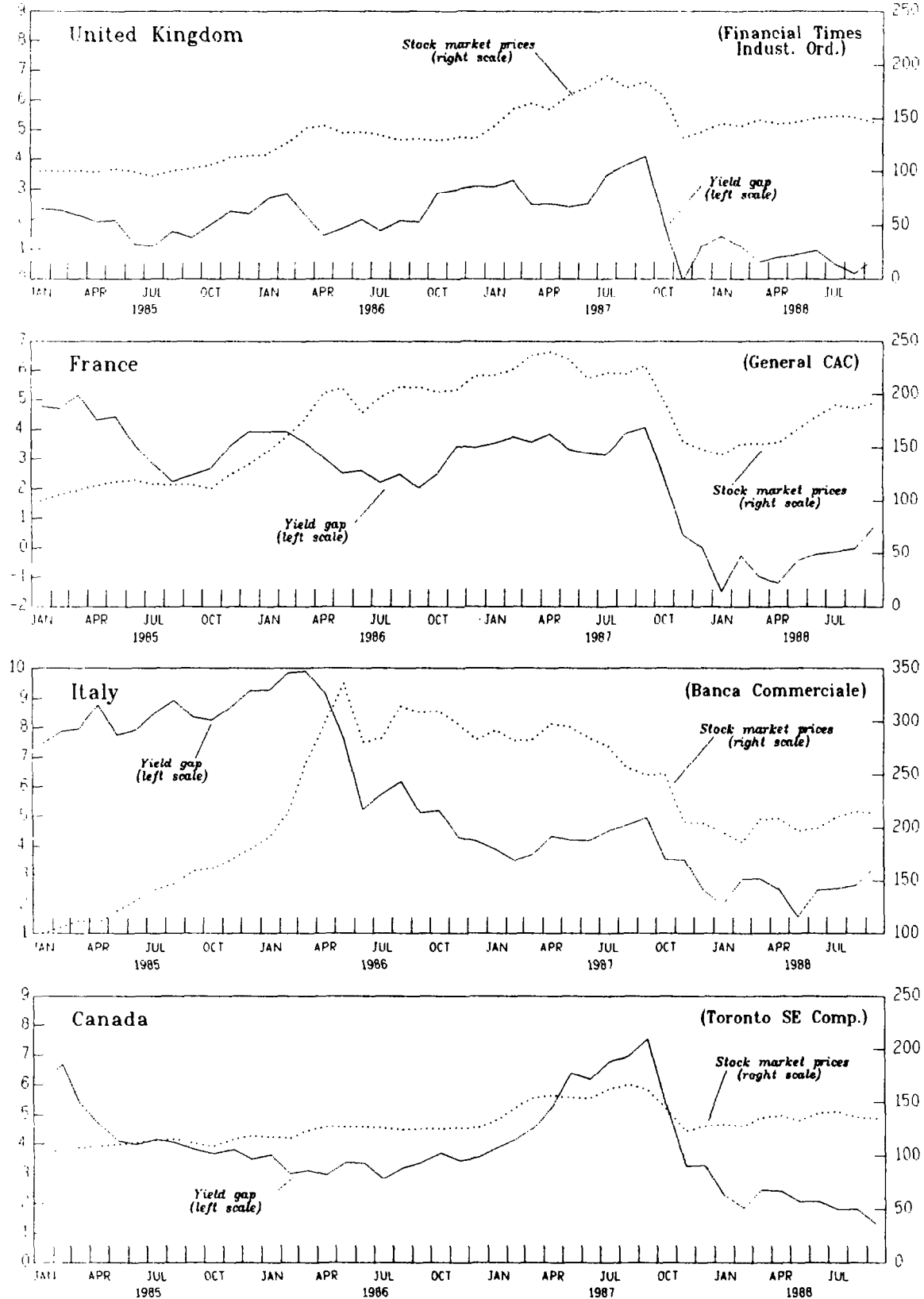
Source: DRI, Treasurer's Dept.



Chart B1 (continued)  
Major Industrial Countries  
Equity Yield Gaps<sup>1</sup> and Stock Market Prices  
January 1985 to September 1988

Percent per annum

Index, Jan. 1985=100



<sup>1</sup> The equity yield gap is defined as the difference between the yield on long-term government bonds and the inverse of the price-earnings ratio of stocks.  
Source: DRI, Treasurer's Dept.





Chart B2  
Major Industrial Countries  
Earnings-Price Ratios and Nominal Short- and Long-Term Interest Rates  
January 1985 to September 1988

Percent per annum

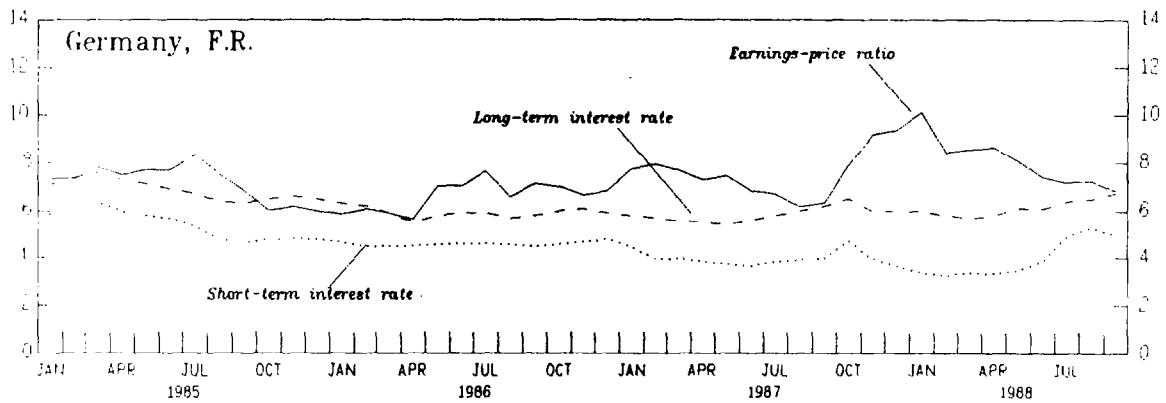
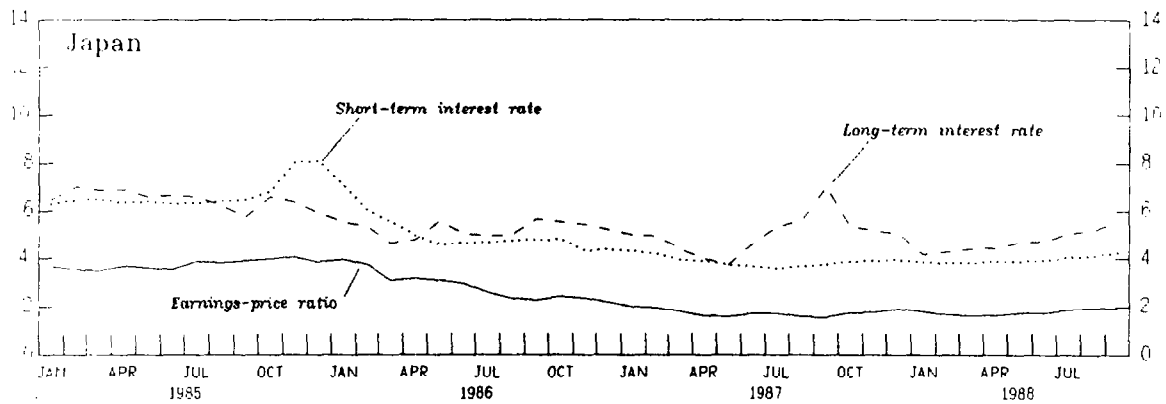
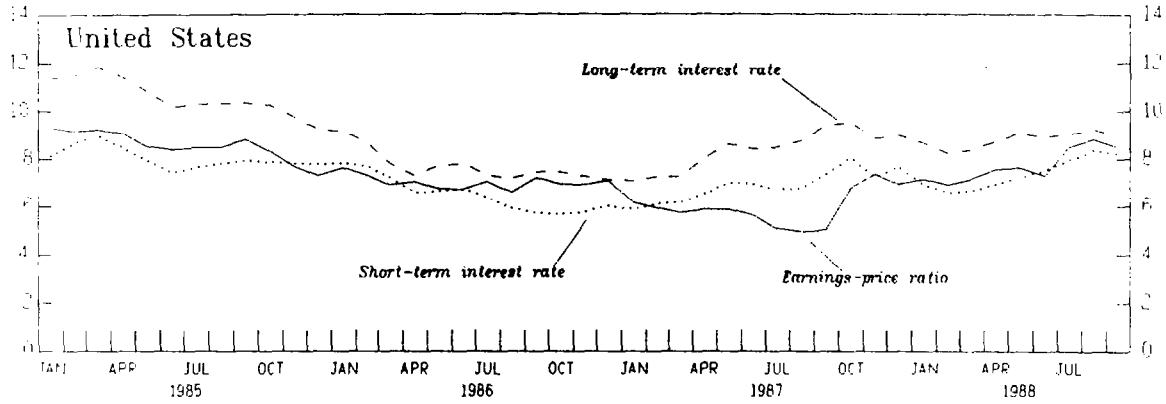




Chart B2 (continued)  
Major Industrial Countries  
Earnings-Price Ratios and Nominal Short- and Long-Term Interest Rates  
January 1985 to September 1988  
Percent per annum

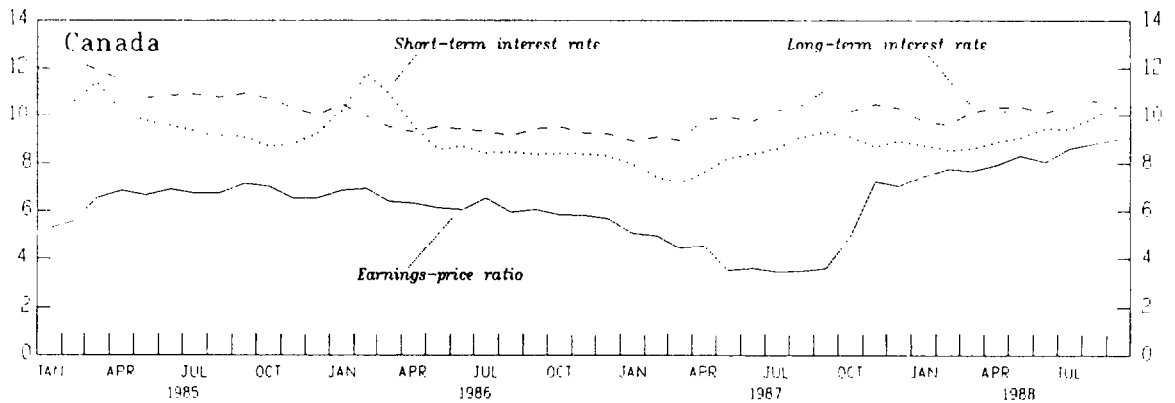
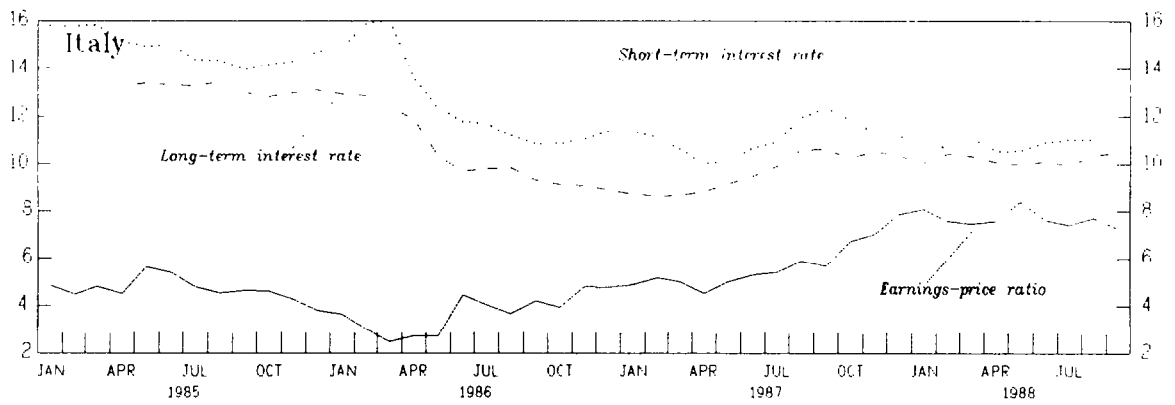
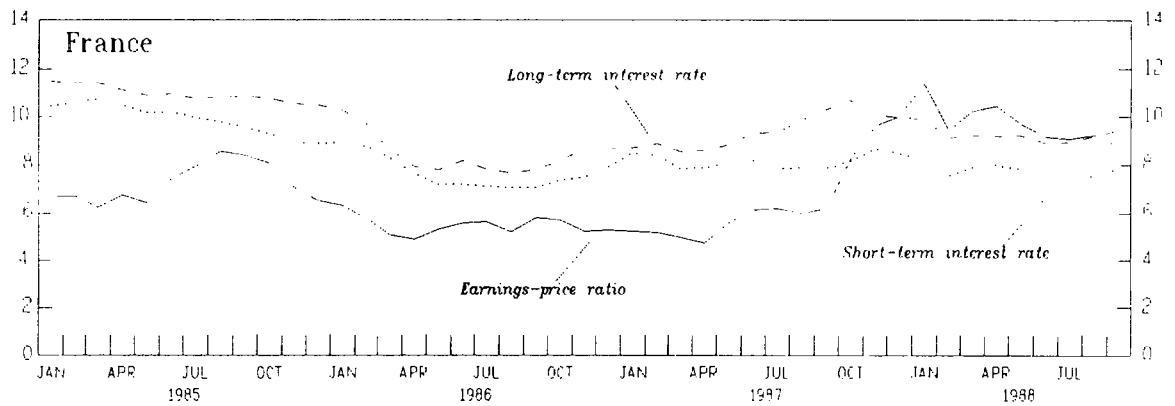
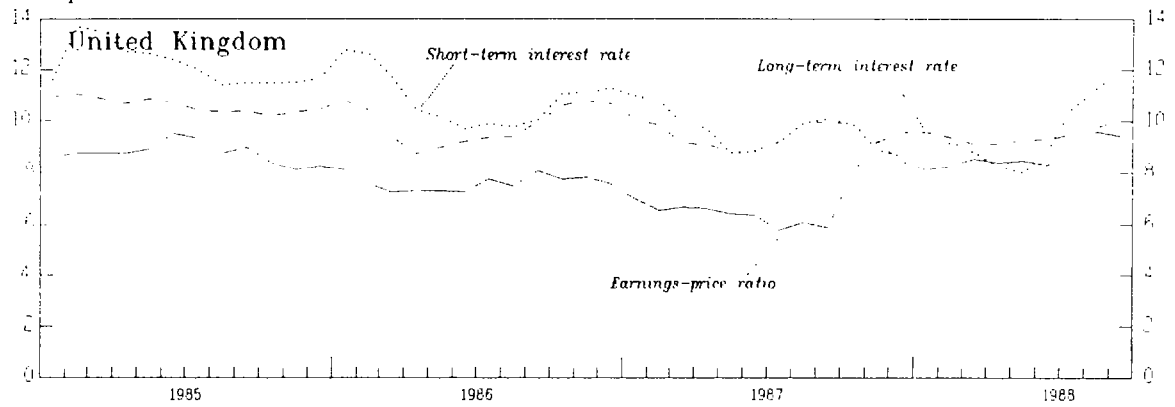
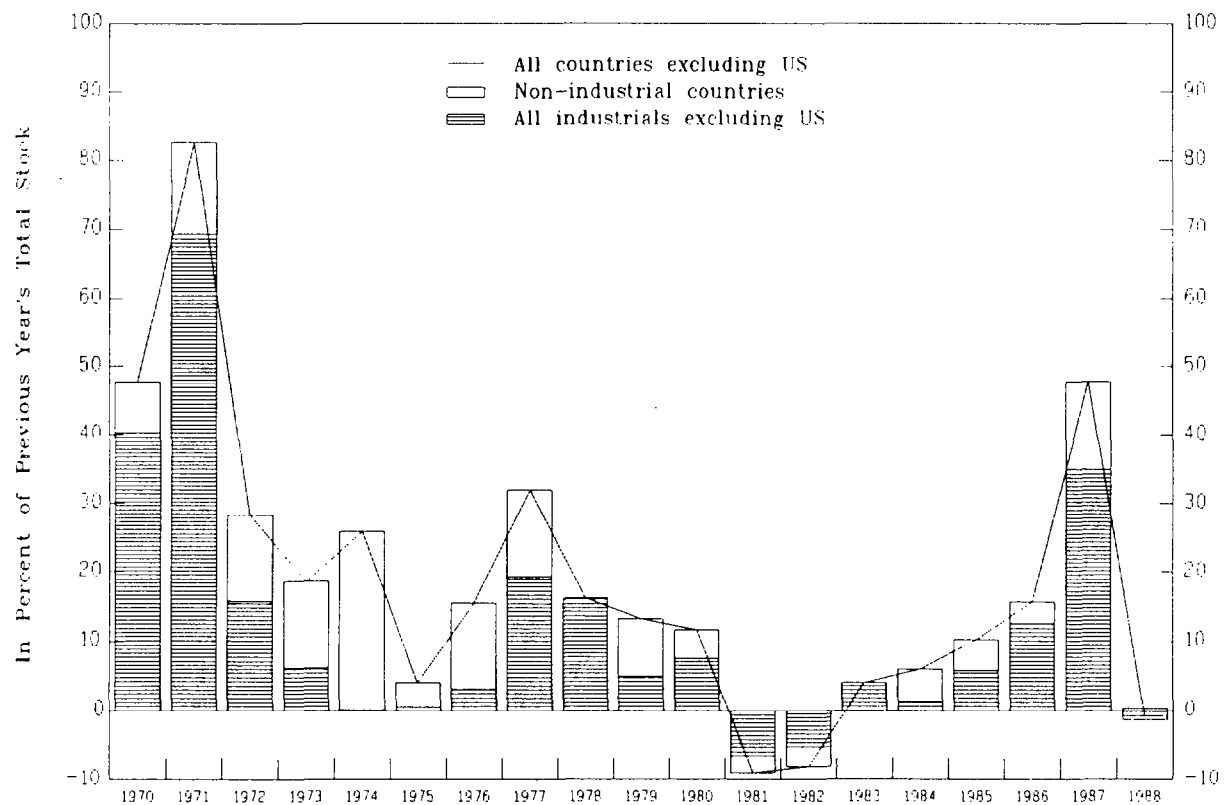
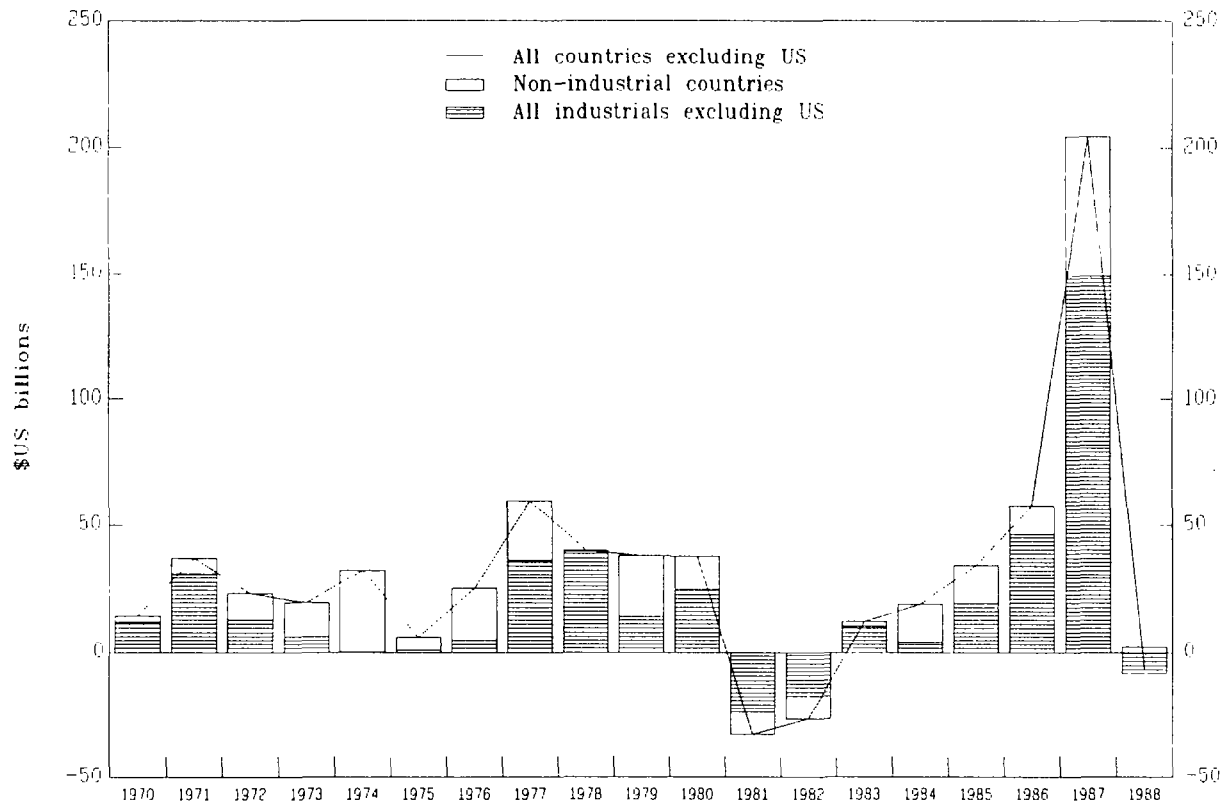




Chart C1  
Changes in Foreign Exchange Reserves  
1970 to 1988<sup>1</sup>



<sup>1</sup> Change shown for 1988 refers to the period January to August 1988.



Chart C2  
Changes in Foreign Exchange Reserves  
January 1985 to August 1988

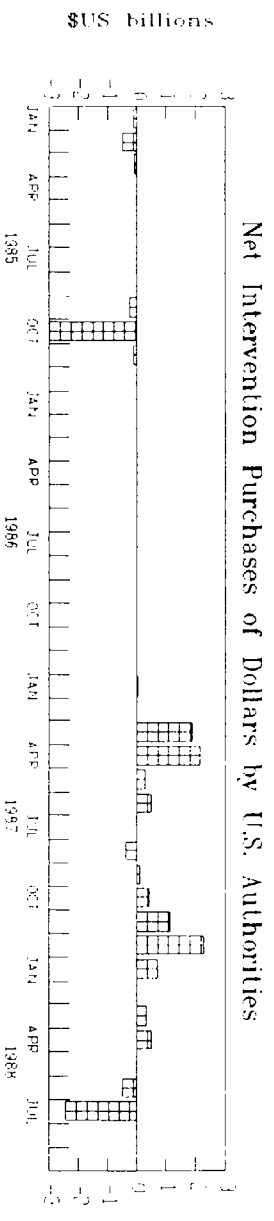
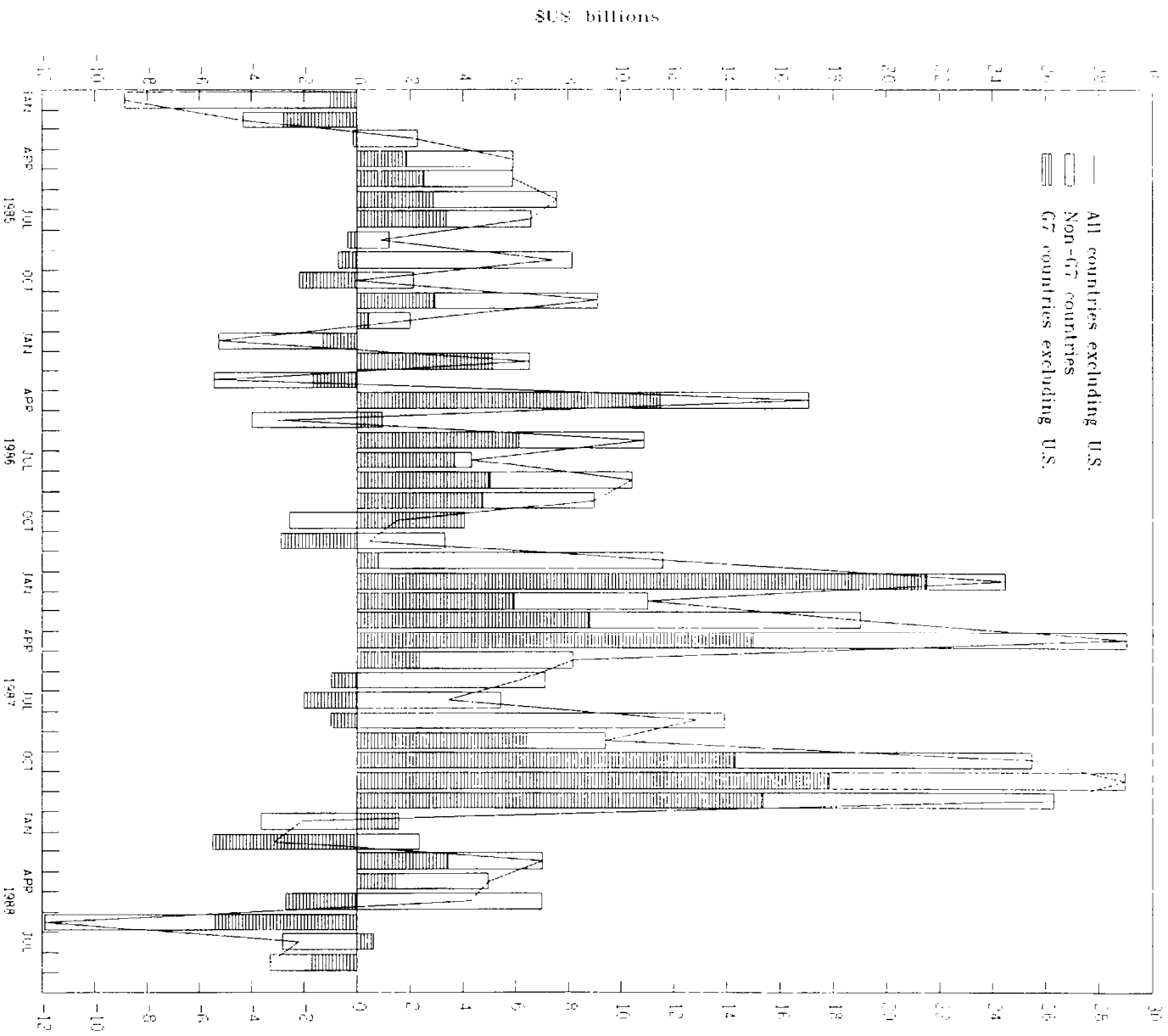






Chart C3  
Changes in Foreign Exchange Reserves  
January 1985 to August 1988

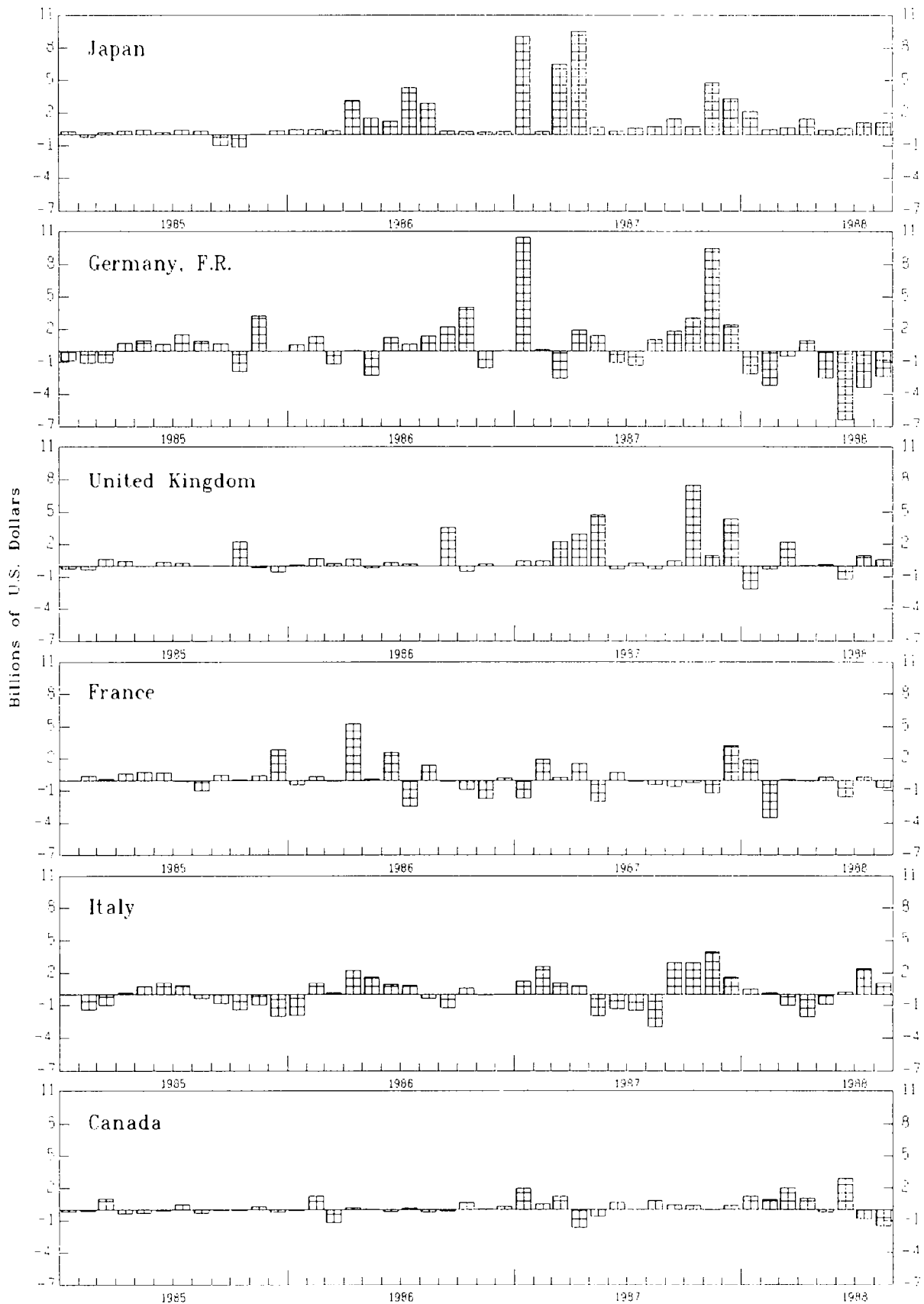




Table 2. United States, Japan, and the Federal Republic of Germany:  
Current Account Financing, 1987 and the First Half of 1988

(In billions of U.S. dollars, seasonally adjusted)

	<u>United States</u>		<u>Japan</u>		<u>Germany, Fed. Rep. of</u>	
	1987	1988 HI	1987	1988 HI	1987	1988 HI
Current account balance	-154	-70	87	40	45	25
Capital account, net	81	50	-41	-36	-24	-34
Official transactions, net	54	32	-39	-6	-18	7
Foreign official assets <u>1/</u>	45	31	...	...	...	...
Change in official reserves (increase -)	9	2	-39	-6	-18	7
Statistical discrepancy	18	-11	-7	2	-3	2
<u>Memo Item</u>						
Official financing as percent of current balance	35	46	45	16	40	-29

Sources: U.S. Department of Commerce, Survey of Current Business; Bank of Japan, Balance of Payments Monthly; Deutsche Bundesbank, Monthly Report, Supplement 3; and staff estimates.

1/ The composition of the change in foreign official assets in the United States is as follows:

	<u>1987</u>	<u>1988 HI</u>
Total	<u>45</u>	<u>31</u>
Industrial countries	49	28
Members of OPEC	-10	-3
Other countries	6	6



Table 3. Changes in Foreign Exchange Reserves,  
1987 and first half of 1988 1/

(In billions of U.S. dollars)

	1987	1988 H1
Increase in foreign exchange reserves--		
All countries excl. U.S. <u>2/ 3/</u>	<u>204</u>	<u>-5</u>
Dollar reserves	136	-6
Industrial countries (excl. U.S.)	102	-3
Developing countries <u>2/</u>	34	-3
Non-dollar foreign exchange reserves <u>3/</u>	68	1
Industrial countries (excl. U.S.)	48	1
Valuation gains	27	-20
New reserve assets	21	21
of which:		
deutsche mark	14	13
yen	3	2
Developing countries <u>2/</u>	20	--
Valuation gain	15	-9
New reserve assets	5	9
of which:		
deutsche mark	3	4
yen	2	2

Source: IFS; Bureau of Statistics data for the currency composition of reserves of aggregated groups of countries (viz., industrial countries, oil exporters, non-oil exporting developing countries); press report of currency composition of reserves of Taiwan Province of China; and staff estimates.

1/ The decomposition of reserve changes by currency of denomination is estimated from partial information and shows rough orders of magnitude only. The same is true, a fortiori, of the estimates of valuation gains and losses arising from changes in exchange rates and the price of gold used in gold-ECU swaps.

2/ Includes Taiwan Province of China.

3/ Includes ECUs issued against both gold and dollar swaps.