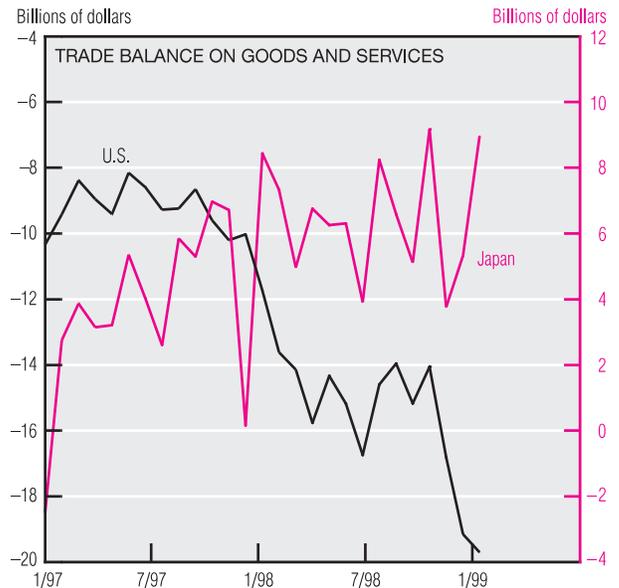
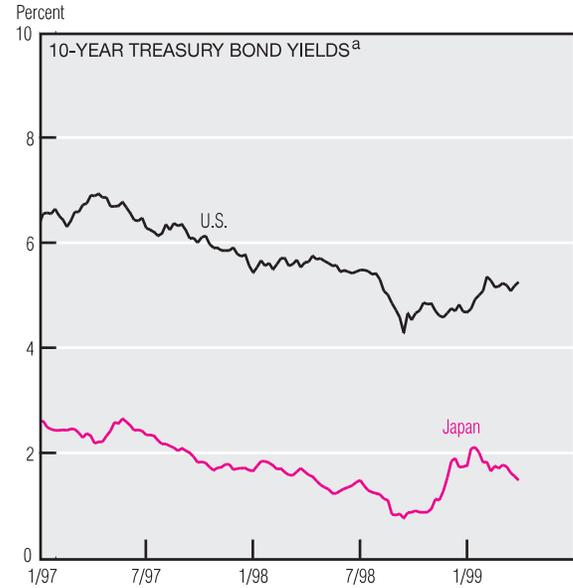


The Yen Exchange Rate



a. Ten-year constant-maturity U.S. Treasury bond and 10-year Japanese government bond.

b. Three-month CD rate for U.S. and 3-month interbank loan rate for Japan.

SOURCES: Board of Governors of the Federal Reserve System; Federal Reserve Bank of New York; and DRI/McGraw-Hill.

The dollar strengthened against the yen in the past month, continuing a trend that began early this year. The yield on Japan's 10-year government bonds declined as the country's prospects for recovery remained dim. The Organisation for Economic Co-operation and Development has lowered its forecasts of Japanese growth for 1999 and 2000. In contrast, long-term yields in the U.S. have been increasing since last fall, as the economy's continued strength became apparent. April's

record net capital outflow from Japan is consistent with the increased relative attractiveness of U.S. assets.

Although long-term yields are much lower in Japan than in the U.S., the 10-year, 3-month spread is higher. However, that spread has decreased recently as long-term yields declined relative to short-term rates that already were close to zero. In the U.S., on the other hand, the spread has increased, consistent with anticipated higher U.S. short-

term rates.

In March, the surplus in Japan's trade balance on goods and services continued to grow, while the U.S. balance plummeted. The weakening gives Japan's economy a boost; for a more sustained recovery, however, additional stimulus measures from its government might be needed. In the U.S., a stronger dollar dampens domestic price pressures, but a worsening trade balance with Japan always threatens to bring political pressure to moderate the weakening of the yen.