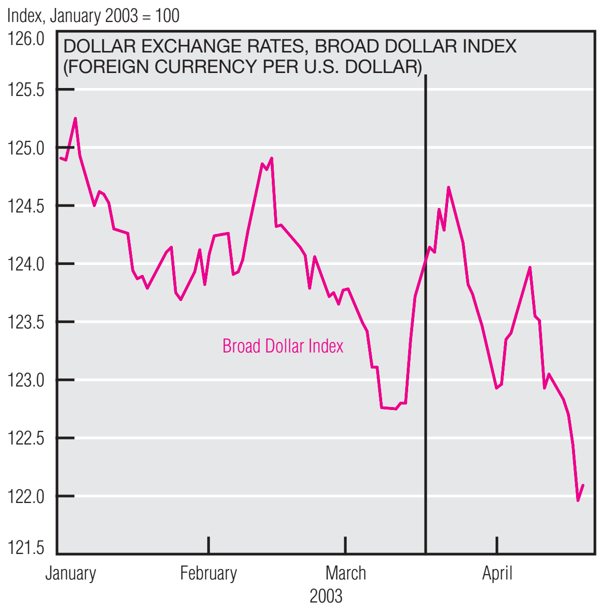
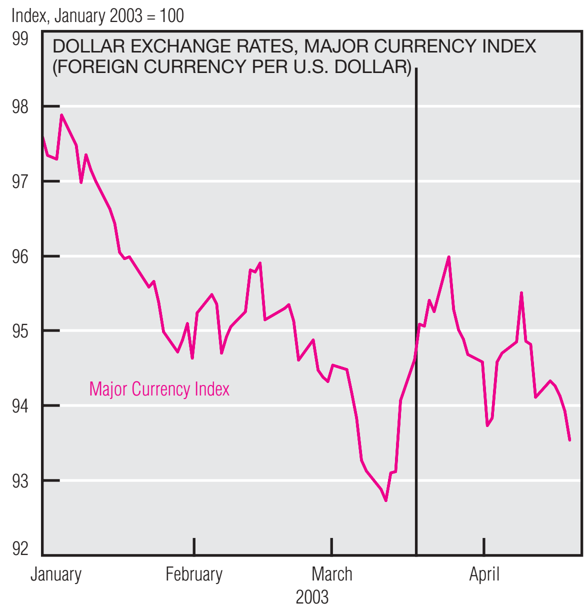
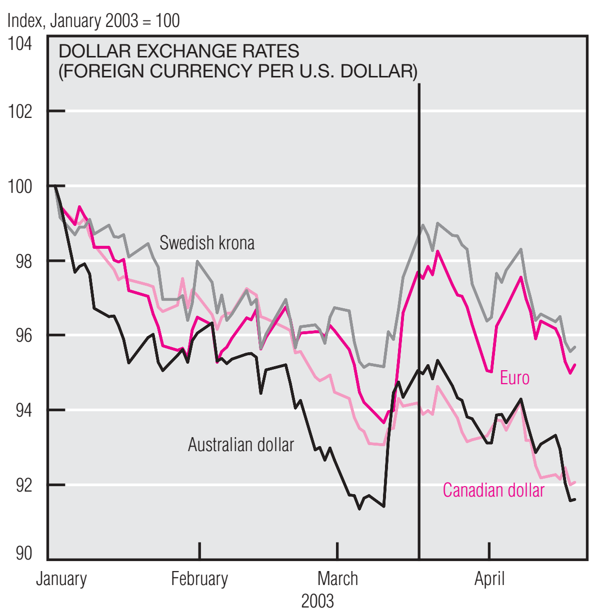
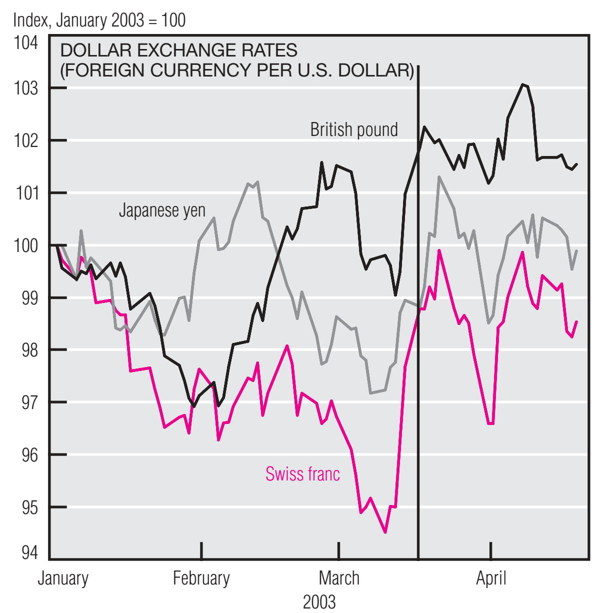
International Markets









NOTE: Vertical line marks start of war in Iraq.
SOURCES: Board of Governors of the Federal Reserve System; and Bloomberg Financial Information Services.

The Broad Dollar Index includes the currencies of 26 countries or regions that had a share of at least 0.5% in U.S. non-oil imports or nonagricultural exports in 1997. The Major Currency Index includes the currencies of countries or regions that are traded in liquid financial markets and for which there are both short- and long-term interest rates. Since the beginning of the year, these indexes have behaved alike. After depreciating since the year began, both of them appreciated significantly during a short period that included the starting date of the war in Iraq. From soon after the war's start until now, both have depreciated after experiencing a run-up around the beginning of April.

The countries or regions included in the Major Currency Index are Australia, Canada, the euro region, Japan, Sweden, Switzerland, and the U.K. With the exception of the British pound and the Japanese yen, the currencies in this index all have appreciated against the U.S. dollar since the beginning of the year. Since the Iraqi war started, the Australian dollar, the Canadian dollar, the Swedish krona, and the Swiss franc have appreciated against the U.S. dollar. Although the British and Swiss exchange rates have shown considerable movement, the U.S. dollar's value against these currencies is about the same as it was at the start of hostilities. Since then, the U.S. dollar has strengthened against the Japanese yen.

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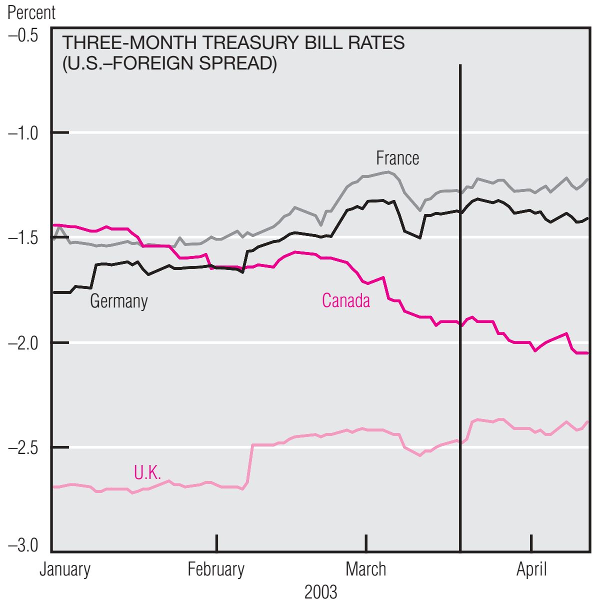
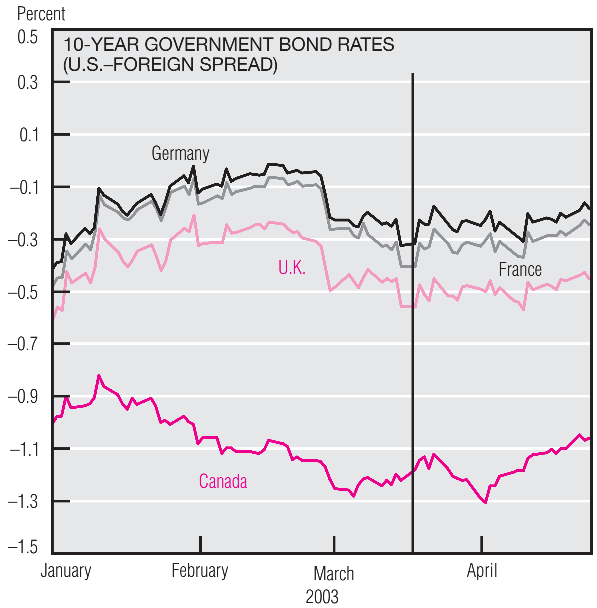
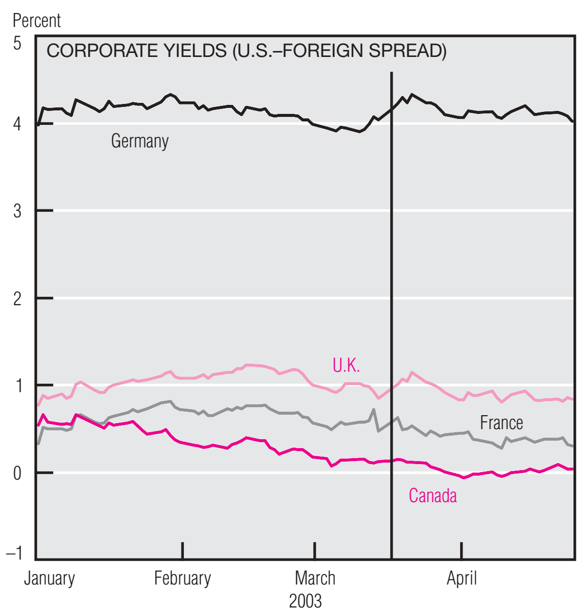
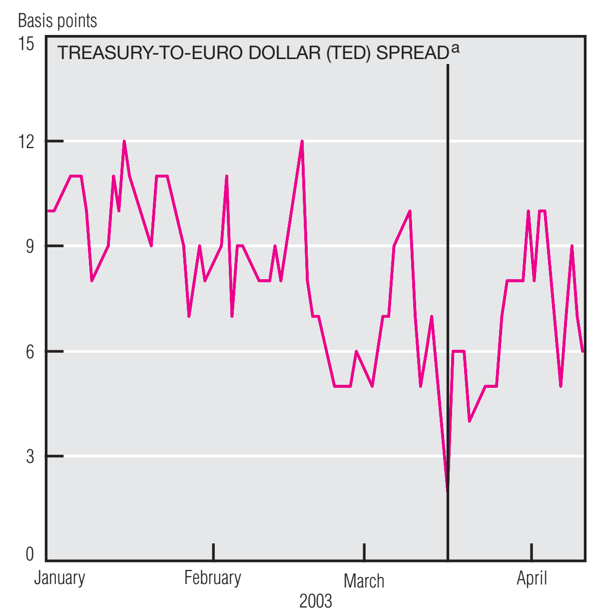
International Markets *(cont.)*









NOTE: Vertical line marks start of war in Iraq.
a. Yield spread: three-month euro minus three-month constant maturity Treasury bill.
SOURCES: Board of Governors of the Federal Reserve System; and Bloomberg Financial Information Services.

Both the short- and long-term U.S.–foreign interest rate spreads for France, Germany, and the U.K. have increased since the beginning of the year, but the short and long U.S.–Canada interest rate spreads have decreased. For all of these spreads, the movements were more pronounced at the short end than the long end. For example, the U.S.–Canada three-month Treasury bill rate spread decreased more than 50 basis points (bp), whereas the 10-year government bond rate spread decreased less than 20 bp. Short-term spreads did not appear to react to the start of war in Iraq, but long-term spreads for France, Germany, and the U.K. spiked down just before the start of the war and then back up when war broke out.

Corporate spreads for France, Germany, and the U.K. have remained comparatively stable since the beginning of the year, while the U.S.–Canada corporate spread decreased around 50 bp. None of these spreads appeared to react to the start of the war.

The Treasury-to-eurodollar (TED) spread compares the yield on three-month T-bills with three-month eurodollar deposit rates. Both assets pay off in U.S. dollars, so any difference in the rates reflects risk: A higher TED spread reflects a higher level of risk associated with eurodollar deposits. At the outbreak of the Iraqi war, the TED spread dropped to only 1.5 bp. By the end of March, however, the spread had reached levels like those seen earlier this year.