ASEAN CULTURAL FUND
PORTFOLIO SUMMARY & ANALYSIS
AS AT 31 MAY 1987

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ASEAN CULTURAL FUND

PORTFOLIO SUMMARY AND ANALYSIS IN US DOLLARS AS AT 31 MAY 1987

Category	Original Currency	Original Cost US$	Current Value US$	Interest Accrued US$	Current Value Inclusive of Interest Accrued US$	Yield On Cost %	Yield On Current Value %	% Holding on Current Value
US DOLLARS								
Bonds	2,505,250	2,505,250	2,602,202	110,512	2,712,714	10.75	10.78	16.38
FRCDs	998,400	998,400	996,650	10,802	1,007,452	6.39	6.39	6.09
Deposits & Cash	2,479,539	2,479,539	2,479,539	5,010	2,484,549	6.95	6.95	15.01
Accounts Payable	(1,338)	(1,338)	(1,338)	0	(1,338)	0.00	0.00	0.00
	5,981,851	5,981,851	6,077,053	126,324	6,203,377	8.45	8.50	37.47
DEUTSCHEMARK								
Bonds	7,753,500	4,264,851	4,356,072	117,322	4,473,394	7.56	7.55	27.02
Deposits & Cash	1,482,480	815,445	815,445	1,456	816,901	3.51	3.51	4.93
	9,235,980	5,080,296	5,171,517	118,778	5,290,295	6.91	6.91	31.95
YEN								
Bonds	513,166,000	3,569,850	3,805,735	52,833	3,858,568	6.58	6.59	23.30
Deposits & Cash	172,881,619	1,202,655	1,202,655	2,273	1,204,928	3.36	3.36	7.28
	686,047,619	4,772,505	5,008,390	55,106	5,063,496	5.77	5.81	30.58
TOTAL US$		15,834,652	16,256,960	300,208	16,557,168			100.00

ASEAN CULTURAL FUND

VALUATION OF INVESTMENTS AS AT 31 May 1987

Nominal Value	Security Description			Current Coupon (%)	Original Cost Price (%)	Original Cost Value (US$)	Current Price (%)	Current Value (US$)	Accrued Interest (US$)	Current Value inclusive of Interest Accrued (US$)	Current Yield (%) On Original Cost	Current Yield (%) On Value	Yield to Maturity % At Cost Price	Yield to Maturity % At Current Price	% Holding On Current Value	Interest Payment Date	Source
	US DOLLAR																
	STRAIGHTS																
500,000	World Bank	US$100M	14/10/88	11.500	99.500	497,500	105.500	527,500	36,097	563,597	11.56	10.90	11.64	7.08	3.40	14/10	Euroclea
200,000	Sweden	US$200M	26/4/89	12.375	99.000	198,000	105.020	210,040	2,337	212,377	12.50	11.78	12.66	9.41	1.28	26/4	Euroclea
500,000	EIB	US$125M	9/3/91	11.000	103.625	518,125	106.039	530,195	12,375	542,570	10.62	10.37	10.06	9.01	3.28	9/3	Euroclea
300,000	SEK	US$200M	12/3/91	8.625	98.875	296,625	98.879	296,637	5,606	302,243	8.72	8.72	8.91	8.97	1.83	12/3	Euroclea
1,000,000	Sweden	US$250M	20/11/92	10.250	99.500	995,000	103.783	1,037,830	54,097	1,091,927	10.30	9.88	10.35	9.31	6.59	20/11	Euroclea
					US$	2,505,250		2,602,202	110,512	2,712,714	10.75	10.78			16.38		
	FLOATING RATE CERTIFICATE OF DEPOSIT																
1,000,000	3M LIBID Taiyo Kobe Bank Ltd (Ldn)	US$100M	26/6/89	6.3750	99.840	998,400	99.665	996,650	10,802	1,007,452	6.39	6.39			6.08	30/6	Chemical Sanwa

ASEAN CULTURAL FUND

VALUATION OF INVESTMENTS AS AT 31 May 1987

Nominal Value	Security Description			Current Coupon (%)	Original Cost Price (%)	Original Cost Value (DM)	Current Price (%)	Current Value (DM)	Accrued Interest (DM)	Current Value inclusive of Interest Accrued (DM)	Current Yield (%) On Original Cost	Current Yield (%) On Value	Yield to Maturity % At Cost Price	Yield to Maturity % At Current Price	% Holding On Current Value	Interest Payment Date	Source
	DEUTSCHEMARKS																
	STRAIGHTS																
500,000	EIB	DM150M	1/2/89	10.000	109.800	549,000	107.530	537,650	16,528	554,178	9.11	9.30	6.54	5.15	1.84	1/2	Euroclear
500,000	Finland	DM150M	1/4/89	9.750	108.000	540,000	107.832	539,160	7,990	547,150	9.03	9.04	7.01	5.15	1.82	1/4	Euroclear
500,000	World Bank	DM700M	1/8/90	8.000	107.500	537,500	107.897	539,485	33,222	572,707	7.44	7.41	6.15	5.22	1.90	1/8	Euroclear
500,000	OKB	DM150M	14/2/91	6.125	99.750	498,750	101.722	508,610	9,017	517,627	6.14	6.02	6.18	5.59	1.72	14/2	Euroclear
1,000,000	ADB	DM150M	15/11/92	8.250	106.000	1,060,000	111.700	1,117,000	44,687	1,161,687	7.78	7.39	7.13	5.69	3.86	15/11	Euroclear
2,000,000	World Bank	DM350M	19/11/92	6.750	100.375	2,007,500	104.593	2,091,860	71,625	2,163,485	6.72	6.45	6.62	5.74	7.19	19/11	Euroclear
1,000,000	EIB	DM300M	23/2/93	7.500	108.000	1,080,000	109.018	1,090,180	20,208	1,110,388	6.94	6.88	6.08	5.61	3.69	23/2	Euroclear
500,000	World Bank	DM250M	28/5/93	5.750	98.250	491,250	99.297	496,485	160	496,645	5.85	5.79	6.06	5.89	1.65	28/5	Euroclear
1,000,000	EEC	DM300M	4/1/93	5.375	98.95	989,500	99.891	998,910	9,854	1,008,764	5.43	5.38	5.59	5.39	3.35	4/1	Euroclear
						7,753,500		7,919,340	213,291	8,132,631	7.56	7.55			27.02		
						OR		OR	OR	OR							
	Exchange Rate as at 31-05-87																
	US$/DM = 1.8180		US$			4,264,851		4,356,072	117,322	4,473,394							

ASEAN CULTURAL FUND

VALUATION OF INVESTMENTS AS AT 31 May 1987

Nominal Value	Security Description			Current Coupon (%)	Original Cost Price (%)	Original Cost Value (Yen)	Current Price (%)	Current Value (Yen)	Accrued Interest (Yen)	Current Value inclusive of Interest Accrued (Yen)	Current Yield (%) On Original Cost	Current Yield (%) On Value	Yield to Maturity % At Cost Price	Yield to Maturity % At Current Price	% Holding On Current Value	Interest Payment Date	Source
	YEN																
	STRAIGHTS																
100,000,000	World Bank	Yen25B	23/4/90	6.625	98.500	98,500,000	105.063	105,063,000	680,903	105,743,903	6.73	6.31	6.99	4.71	4.44	23/4	Euroclea
100,000,000	Postippanki	Yen20B	14/2/91	6.500	99.875	99,875,000	106.718	106,718,000	1,913,889	108,631,889	6.51	6.09	6.53	4.49	4.56	14/2	Euroclea
50,000,000	Canada	Yen80B	20/2/91	6.125	99.875	49,937,500	105.993	52,996,500	850,694	53,847,194	6.13	5.78	6.16	4.34	2.26	20/2	Euroclea
200,000,000	World Bank	Yen20B	10/3/92	8.375	107.333	214,666,000	115.542	231,084,000	3,722,222	234,806,222	7.80	7.25	6.88	4.66	9.87	10/3	Euroclea
50,000,000	EDF	Yen20B	30/3/94	5.125	100.375	50,187,500	102.426	51,213,000	427,083	51,640,083	5.11	5.00	5.06	4.70	2.17	30/3	Euroclea
						513,166,000		547,074,500	7,594,791	554,669,291	6.58	6.59			23.30		
						OR		OR	OR	OR							
	Exchange Rate as at 31-05-87																
	US$/Yen = 143.75		US$			3,569,850		3,805,735	52,833	3,858,568							

ASEAN CULTURAL FUND

DEPOSITS AS AT 31 MAY 1987

Placed	Maturity	Period (days)	Rate (%)	Bank	Principal	Interest Accrued	Principal Plus Interest Accrued	Value in US$	% Holding on Current Value
					US$	US$	US$		
31/05/87	-	On demand	-	BOT	18,877.68	0.00	18,877.68	18,877.68	0.11
22/05/87	5/06/87	14	6-3/4	Barclays Bank PLC	885,000.00	1,659.38	886,659.38	886,659.38	5.36
20/05/87	19/06/87	30	6-7/8	Citibank NA	575,661.28	1,319.22	576,980.50	576,980.50	3.48
22/05/87	22/06/87	31	7-5/16	BOT (S)	1,000,000.00	2,031.25	1,002,031.25	1,002,031.25	6.05
					2,479,538.96	5,009.85	2,484,548.81	2,484,548.81	15.00
					DM	DM	DM		
31/05/87	-	On demand	-	BOT	683.35	0.00	683.35	375.88	0.00
31/05/87	-	On demand	-	Euroclear	326.82	0.00	326.82	179.77	0.00
12/05/87	12/06/87	31	3-5/8	BOT (S)	1,071,192.62	2,157.26	1,073,349.88	590,401.47	3.57
29/05/87	12/06/87	14	3	BOT (S)	28,750.00	7.19	28,757.19	15,818.04	0.09
18/05/87	18/06/87	31	3-1/4	Citibank NA	381,527.37	482.21	382,009.58	210,126.28	1.27
					1,482,480.16	2,646.66	1,485,126.82	816,901.44	4.93
					Yen	Yen	Yen		
31/05/87	-	On demand	-	Euroclear	7,424	0	7,424	51.65	0.00
11/05/87	11/06/87	31	3-1/4	Barclays Bank PLC	112,229,594	212,769	112,442,363	782,207.74	4.73
13/05/87	12/06/87	30	3-9/16	BOT (S)	60,644,601	114,024	60,758,625	422,668.69	2.55
					172,881,619	326,793	173,208,412	1,204,928.08	7.28
					Sfr	Sfr	Sfr		
					Nil		0.00	0.00	0.00

Exchange Rates as at 28-02-87

US$/DM	1.818
US$/Yen	143.75
US$/Sfr	1.506

ASEAN CULTURAL FUND

INCOME SUMMARY

			March - May	Since Appointment
INCOME				
Interest on Deposits	-	US$	29,517	82,761
	-	DM	9,301	41,265
	-	Yen	11,824	28,144
	-	Sfr	0	78
Interest on FRCDs	-	US$	0	0
Interest on FRNs	-	US$	0	0
Interest on Straights	-	US$	87,994	296,317
	-	DM	72,024	221,287
	-	Yen	62,510	207,722
	-	Sfr	4,910	25,311
Interest Income - Euroclear			0	0
			278,080	902,885
EXPENSES				
Management Fee			0	0
Telephone & Telexes			0	0
Euroclear Charges			675	1,674
Bank Charges			21	2,319
Transportation & Travel			0	0
Legal Expenses			0	0
Audit Fee			0	0
Handling Charges			822	2,231
General Expenses			1,037	1,037
			2,555	7,261
NET INCOME			275,525	895,624

ASEAN CULTURAL FUND

STATEMENT OF AFFAIRS

ASSETS (Note 1)	31 May 1987
Deposits	4,505,040
Floating Rate Certificate of Deposit	1,007,452
Floating Rate Notes	0
Straights	11,044,676
	16,557,168

FINANCED BY	
Capital Advanced (2)	15,058,054
Realised Profit	57,514
Income Account	895,624
Price Fluctuation Accounts (3)	773,280
Difference in exchange a/c (4)	272,696
ACF Operational a/c (5)	(500,000)
Provision for audit fee	0
	16,557,168

Notes :

(1) Value of all assets is inclusive of interest accrued up to the valuation date.

(2) Capital advanced - US$12,167,774 being valuation of bonds plus accrued interest up to 31-7-86 and cash injections of US$2,891,697 less remittance to Yamaichi US$1,417.00

(3) Price fluctuation account shows the difference between actual cost and market value (excluding interest accrued) of all bonds and FRCDs on the valuation date.

(4) Difference on exchange account. All non-US$ investments are booked in US$ based on the prevailing rates of exchange on the transaction day. Any difference between the booked cost and the cost converted at the rates on the valuation date is shown as a gain/(loss) in the difference on exchange account.

(5) Amount remitted to the ASEAN Cultural Fund, Operational Account, a/c no. 210583, The Bank of Tokyo, Ltd., Jakarta.

ASEAN CULTURAL FUND

SUMMARY OF CASH MOVEMENTS DURING THE PERIOD

MARCH 1987 - MAY 1987

		US$
US DOLLAR		
Balance as at 28 February 1987		1,347,159.60
Add :		
Interest received on deposits		25,402.02
Interest received on securities		122,529.51
Sale of nominal amount US$500,000 of 11-3/8% World Bank US$200 mn 1/2/89		
- Principal	US$536,875.00	
- Accrued Interest	US$ 9,795.14	546,670.14
Conversion of Swiss Francs into US$		439,469.18
Less :		
Expenses and charges		654.75
Travel reimbursement		1,036.74
Balance as at 31 May 1987 (cash & deposits)		2,479,538.96

		DM
DEUTSCHEMARK		
Balance as at 28 February 1987		2,925,870.15
Add :		
Interest received on deposits		15,622.17
Interest received on securities		77,500.00
Less :		
Purchase of nominal amount DM1,000,000 of 5-3/8% EEC DM 300 mn due 4/1/93		
- Principal	DM989,500.00	
- Accrued Interest	DM 74.66	989,574.66
Purchase of nominal amount DM500,000 of 7-1/2% EIB DM 300 mn due 23/2/93		
- Principal	DM543,500.00	
- Accrued Interest	DM 3,437.50	546,937.50
Balance as at 31 May 1987 (cash & deposits)		1,482,480.16

JAPANESE YEN

	Yen
Balance as at 28 February 1987 as reported in the last quarter's statement	147,955,297
Adjustment for :	
Amount payable on nominal amount of Yen50 mn of 5-1/8% EDF Yen20 bn due 30/3/94	50,187,500
Amount payable for handling charges	72,779
Adjusted balance as at 28 February 1987	198,215,576
Add :	
Interest received on deposits	1,478,543
Interest received on securities	23,375,000
Less :	
Payment for purchase of nominal amount of Yen50 mn of 5-1/8% EDF Yen20 bn due 30/3/94	50,187,500
Balance as at 31 May 1987 (cash & deposits)	172,881,619

SWISS FRANCS

	SFR
Balance as at 28 February 1987	0.00
Add :	
Sales of nominal amt of Sfr600,000 of 5-3/4% IBRD Sfr 200 mn due 15/2/94	
- Principal Amount Sfr633,000	
- Accrued Interest Sfr 8,625	641,625.00
Less :	
Coversion of Swiss Francs into US$	641,625.00
Balance as at 31 May 1987 (cash & deposits)	0

1. *To measure the returns achieved by the managers on the available funds*

a) Rate of return since the transfer of the fund

FORMULA

$$\frac{\text{End Value} - \text{Start Value} + \text{Withdrawals}}{\text{Time Weighted Start Value} - \text{Time Weighted Withdrawals}}$$

End Value as at 31-5-87 = US$16,557,168

The start value has been detailed as :

	Description		Transfer Value (US$)	Date	*No of Days from* Transfer Date to Evaluation Date	Time-Weighted Value (US$)		
(i)	Securities (Part of Capital Advanced)	- US$	3,670,025	31-7-86	304	$\frac{304}{304}$ x 3,670,025	=	3,670,025
		- DM	3,336,967	31-7-86	304	$\frac{304}{304}$ x 3,336,967	=	3,336,967
		- Yen	4,520,820	31-7-86	304	$\frac{304}{304}$ x 4,520,820	=	4,520,820
		- Sfr	639,962	31-7-86	304	$\frac{304}{304}$ x 639,962	=	639,962
			12,167,774					12,167,774

Description		Transfer Value	Date	No of Days from Transfer Date to Evaluation Date	Time-Weighted Value
		(US$)			(US$)
(ii) Cash (Part of Capital Advanced)	- US$	1,844,960.98	7-8-86	297	297/304 x 1,844,960.98 = 1,802,478.33
		87.46	21-8-86	283	283/304 x 87.46 = 81.42
	- DM	994,910.72	8-8-86	296	296/304 x 994,910.72 = 968,728.86
	- Yen	51,678.43	8-8-86	296	296/304 x 51,678.43 = 50,318.47
	- Sfr	59.67	8-8-86	296	296/304 x 59.67 = 58.10
		2,891,697.26			2,821,665.18
(iii) Cash Withdrawals					
(a) To ACF Operational Centre	- US$	250,000.00	30-9-86	243	243/304 x 250,000.00 = 199,835.53
	- US$	250,000.00	31-12-86	151	151/304 x 250,000.00 = 124,177.63
					324,013.16
(b) To Yamaichi Merchant Bank (S) Ltd	- US$	1,416.45	22-12-86	160	160/304 x 1,416.45 = 745.50

$$\text{Rate of return} = \frac{US\$(16,557,168 - 15,059,471 + 500,000 + 1,416.45)}{US\$(14,989,439.18 - 324,013.16 - 745.50)} = 13.63\%$$

b) Annualised Rate of Return = $13.63\% \times \frac{12}{10} = 16.36\%$

2. <u>To measure the manager's performance in preserving the capital of the fund</u>

$$\text{a) Rate of return} = \frac{\text{End Value - Start Value}}{\text{Time Weighted Start Value - Time Weighted Withdrawals}}$$

$$= \frac{US\$(16,557,168 - 15,059,471)}{US\$(14,989,439 - 324,758.66)} \times 100$$

$$= 10.21\%$$

b) Annualised Rate of Return = $10.21\% \times \frac{12}{10} = 12.25\%$ p.a.

<u>Notes :</u>

1. <u>Sources</u>

   Euroclear - Euroclear Clearance System Ltd
   Chemical Sanwa - Chemical Sanwa Merchant Bank Ltd, S'pore

2. <u>Yield to Maturity</u>

a. The yield to maturity at cost price for securities transferred from Yamaichi Merchant Bank (S) Ltd to ourselves were obtained from their portfolio valuation as at 31 July 1986. This is because the yield -to-maturity is calculated based on the original purchase price of the security and for the period from the time of purchase.
   Future straight issues purchased by us have been and would be calculated using the Association of International Bond Dealers (AIBD) methods.
b. The yield-to-maturity at current price has been calculated using the Association of International Bond Dealers method.

ASEAN CULTURAL FUND

SUMMARY OF SECURITIES TRANSACTIONS FOR THE PERIOD MAR 1987 - MAY 1987

(on a Trade Date Basis)

A. PURCHASES

Trade Date	Settlement Date	Name of Security	Nominal Amount	Purchase Price	Purchase Cost
5-3-87	24-3-87	5-3/8% EEC DM 300mn due 4/1/93	DM250,000	98.85%	DM247,125.00
5-3-87	25-3-87	5-3/8% EEC DM 300mn due 4/1/93	DM250,000	99%	DM247,500.00
6-3-87	24-3-87	5-3/8% EEC DM 300mn due 4/1/93	DM250,000	98.85%	DM247,125.00
19-3-87	26-5-87	7-1/2% EIB DM 300mn due 23/2/93	DM500,000	108.70%	DM543,500.00
19-3-87	25-3-87	5-3/8% EEC DM 300mn due 4/1/93	DM250,000	99.10%	DM247,750.00

B. SALES

Trade Date	Settlement Date	Name of Security	Nominal Amount	Sales Price	Profit/(loss) on capital based on original Book Cost	Profit/(loss) on capital based on 31-7-86 Revalued price	* Exchange Profit/(Loss)	Net Profit/(loss) on capital based on original Book Cost	Net Profit/(loss) on capital based on 31-7-86 Revalued price
							(US$)		
27-3-87	3-4-87	11-3/8% IBRD US$ 200mn due 1/2/89	US$500,000	107.375%	US$39,375	US$1,040	-	39,375.00	1,040.00
8-5-87	15-5-87	5-3/4% World Bank Sfr 200mn due 15/2/94	Sfr600,000	105.50%	Sfr38,105	0	47,115.96	72,937.60	50,133.89
							47,115.96	112,312.60	51,173.89

* Notes

Exchange rates used were that as on settlement date of the sale. For the original book cost and the revalued cost as at 31 July 1986, the exchange rates as of 31 July 1986 was used since these were part of the securities transferred from Yamaichi.

ASEAN CULTURAL FUND

INVESTMENT STRATEGY

Our expectations are that interest rates in the US, West Germany, Japan and Switzerland are likely to remain stable during the next quarter. Inflation is likely to remain under control, although an uptick in inflation is expected over the longer term. Some stability with a bias towards a slightly firmer US Dollar is expected even after the Venice Summit. However, the upside potential of the US Dollar will be limited by its sluggish economic fundamentals and huge trade and budget deficits. As a result, the US Bond market is likely to rebound, whilst a correction may be expected in the West German and Yen Bond markets.

During the last quarter, the 11-3/8% World Bank Euro-Dollar bond due 1/2/89 was sold. In addition, the only remaining Swiss Franc bond namely, 5-3/4% World Bank due 15/2/94 was sold and the proceeds were converted into US Dollars. Due to the yield attractiveness, two Euro Deutschemark bond issues were added to the portfolio, whilst there were no purchases of Euro Yen bonds. Over the next quarter, we would be lightening the position of the Deutschemark and Yen bonds, and we would gradually raise the investment in US Dollar assets to 40% to 50%.

The list of securities transacted are on page 13.

ASEAN CULTURAL FUND

REPORT ON DEVELOPMENTS IN THE MAJOR FINANCIAL MARKETS DURING THE PERIOD MARCH 1987 TO MAY 1987 AND THE SHORT TERM OUTLOOK

1. THE UNITED STATES MARKET

During the period under review, with the exception of the official Discount Rate which remained at 5.50%, almost all other interest rates rose. The Prime Lending Rate was raised from 7.50% to 8.25%. The upward pressure on interest rates was a result of two main factors. Firstly, capital inflows into the US have been declining sharply against the continued huge twin deficits and the bottoming out of the long term interest rates. The US Dollar was as a result declining sharply, triggering fears of rising inflation. Ahead of the Treasury's Quarterly Refunding, the US officials began to voice their opinion that the US Dollar had fallen enough, and the Fed also began to tighten the availability of reserves slightly. Short term interest rates rose from 6.25% to 7.50%, widening the interest differential between the US and Japanese interest rates from 2.5% to 4%. These factors helped to stabilise the currency and bond markets.

One of the crucial factors to the direction and level of the US short term interest rates is the US dollar. Ahead of the Venice Summit in June, the US Dollar and interest rates can be expected to remain steady. Although the Summit is not likely to produce any suprises, agreement on currency stabilisation and policy co-ordination is likely to continue. Whilst the US may try to avoid sharply higher interest rates, the Fed is expected to pursue a moderate monetary policy raising money market rates gradually if necessary, to respond to the weak US Dollar and rising inflation. Pressure will continue on Japan and West Germany to continue to pursue an easier monetary policy and to further stimulate domestic expansion, leading to the stabilisation of exchange rates. The already higher US interest rates are likely to hurt the sluggish US economy. Growth in the second half can be expected to slow down, and the forecast growth target of 3% may not be attainable for the year. This, and the thrid world debt problems, will prevent US interest rates from rising sharply. Thus, in the near term, stable to slightly firmer interest rates may be expected.

The US Dollar has come under selling pressure since March as the market believed that the G5 meeting in Paris did not produce sustainable levels for the US Dollar against that of other major currencies. In addition, the seemingly intractable huge US trade deficit, heightened US-Japan trade tensions and increased protectionist pressures from Congress, weighed on the US unit. The Dollar declined sharply in April to US$/DM1.78 and US$/Yen139 approximately, despite central bank intervention. In May however, the US Dollar staged a small technical rebound. The currency remained fairly stable thereafter, supported by official statements that a further decline of the dollar would be "counterproductive". Widening interest rate differentials between the US and its major trading partners, and pressures by the Japanese government to reduce speculative dollar selling, also helped to support the dollar. The US Dollar ended the period at the levels of US$/DM1.8180, US$/Yen143.75 and US$/Sfr1.5060.

In the near term, the US Dollar is likely to remain steady ahead of the Venice Summit. Although little is expected to emerge from this meeting, further talk of currency stabilisation and policy co-ordination may be expected thus lending some support to the US Dollar. While some factors continue to suggest that further support of the US Dollar is likely to continue, the upside potential appears limited. Although the trade deficit has narrowed to US$13.6 billion in March from US$15.1 billion in February, it is nevertheless still high. An improvement in the trade deficit is likely to continue, but the process is expected to be slow. The budget deficit still remains huge. In addition, the outlook for the US economy is sluggish. Although it grew by 4.4% in the first quarter of this year, the increase was due mainly to a build-up of inventories. Final demand was weak with declines in business sales, consumer spending, business investment and housing construction. Thus, with the prospects of higher inflation, interest rates could remain firm, leading to slower growth in the months ahead. However if it is decided that it is necessary to stabilise exchange rates, Japan and Germany may be forced to lower their interest rates as it would be difficult for the US to raise interest rates much further. The recent release of the Yen6 trillion domestic expansion package may help to stabilise the US$/Yen exchange rate. In the near term, some stability in exchange rates may be observed.

The bond market was fairly quiet in March. In April, following the sharp decline of the US Dollar leading to a surge in US interest rates, the bond market plunged. With the exception of the three months' Treasury Bills, yields on Treasury securities and Euro Dollar bonds increased across the entire maturity spectrum. Yields on Treasury securities in the two to seven years' maturities rose 75 basis points, whilst yields on longer maturities increased 50 to 60 basis points. In May, the market was once again concerned over the extent of Japanese participation in the forthcoming quarterly Treasury auction. The bond market remained nervous despite suggestions from US officials that the US Dollar had fallen enough and that uncertainty over the US-Japan trade tensions seemed to have improved. Although the thirty years' maturity US Treasury refunding was a success, scepticism prevailed as to the reasons behind the Japanese participation. Sharp movements in the CRB Commodity Price Index worsened inflationary fears, and Citicorp's loan provision for third world debt, which had a bearish impact on the US Dollar, raised fears of rising interest rates in the US. These factors together resulted in a bearish bond market. Over the period under review, yields on Eurobonds and Treasury securities rose an average 150 to 200 basis points. At the end of the period, the key thirty years US Treasuries yielded 8.76%, whilst the 5 to 10 years Eurobonds yielded 8.94% to 9.29% respectively.

Based on the outlook for currency stability, a near term rebound in the US Bond market may be expected. Cautiousness is expected to prevail over the sustainability of the improved optimism in the bond market and some volatility, may be expected. There is the possibility that further sharp rises in interest rates can be controlled. Japan and West Germany are likely to continue to lead their respective money market rates lower, and this could help avert a hike in the US Official Discount Rate. Also, whilst the Venice Summit is unlikely to produce concrete results, the Centrals Banks' awareness of the dangers of the continued sharp decline of the US dollar and the G5 attempts to co-ordinate policies are encouraging. Thus, widening interest differentials and hopefully stability in exchange rates could result in capital inflows into the US market, adding fuel to the bond market in the short term.

2. THE WEST GERMAN MARKET

During the period under review, although money market rates continued to drift lower, the key interest rates, the Official Discount Rate and Prime Lending Rate, remained at 3% and 5% respectively. Against the backdrop of a still weak economy, low domestic inflation and a strong Deutschemark, the prospects for further monetary easing were encouraging. However, given the above target growth of money supply and the latest reduction in the Official Discount Rate in January 1987, the prospects for another reduction of the key interest rate were dim. Instead, the Bundesbank led interest rates lower by reducing its securities repurchase rate from 3.8% to 3.5%. This reduction was an attempt to stabilise the exchange rate movements, and with the approach of the Venice Summit, pressure from the US was building for another cut in German interest rates, both to support the dollar and in the belief that such a move would support economic activity in Europe. The three months Euro-Deutschemark interest rates moved down 25 basis points during the period under review, ending at the level of 3.63% approximately.

The German economy remains sluggish, confirmed by the Government's downward revision of the GNP growth rate from 2.5% to 2%. Consumer spending remained squeezed by the slower growth in real disposable income. Contributing to the slower growth is also the strength of the Deutschemark impacting negatively on exports and the relatively tight monetary policy. Fiscal policy was also not expansionary as evidenced by the unwillingness to bring forward tax reductions. This could be in part due to the expected overshoot of the budget deficit. An uptick in inflation later in the year is likely, and there are continued fears of high money supply growth and uncertainty over the outlook for oil prices. Thus in the near term, interest rates cannot be expected to decline sharply, but rather stabilise with a slightly easier bias.

During the period under review, the Deutschemark strengthened less against the US Dollar than the Japanese Yen. Nevertheless, it rose above DM1.80/US$ in late April and remained above this level throughout May. At one stage, the Deutschemark traded to a high of almost DM1.77/US$. Though strong, the performance of the Deutschemark was relatively lacklustre reflecting largely the deterioration of the economy due to the slowing of Germany's exports as a result of the strong appreciation of the currency since February 1985. However, the US unit gained some strength towards the end of May and breached the psychological level of US$/DM1.80, ending the period at US$/DM1.8180.

In the near term, the Deutschemark is expected to stabilise, trading within a narrow range. Although growth of the US economy is expected to be weak, the fundamentals of the German economy are also weakening. The strength of the Deutschemark has impacted negatively on exports, and there is increasing concern that domestic demand may not be strong enough to compensate the decline in exports. Although the tax cuts proposed in 1988 have been raised to DM15 billion from DM10 billion, the fiscal stimulus still appears inadequate. The Bundesbank has thus shifted its priority towards stabilising exchange rates from money supply growth targetting, despite evidence of a resurgence in money supply growth to 7.8% in April, well above the 3 - 6% target. In addition, there is likely to be less downward pressure on the US Dollar as the trade figures have shown signs of improving. In April, Germany's trade surplus fell to DM8.89 billion from DM10.45 billion in March. These factors, combined with the expected continued co-ordination of the Central Banks is likely to result in currency stability in the near term.

In March, the German bond market was firm as the Deutschemark strengthened slightly and money market rates continued to edge downwards. Yields on the key 10 years Bundesrepublic bonds declined approximately 40 basis points to 5.56%, whilst Euro-Deutschemark bonds' yields declined by only 5 basis points approximately. In early April, the German bond market was somewhat affected by the bearish sentiment in the US Bond Market, where there was concern over the flow of Japanese investments to the US following rising tension over protectionism. Interest rates in the US were consequently rising, and this led to fears that this could prevent further declines in Deutschemark bond yields. However, by May, this fear proved shortlived as the US Dollar fell below US$/DM1.80 and interest was refocussed on the Deutschmark bonds again. The yields on the key 10 years Bundesreplublic bonds broke through 5.50% to hit a low of 5.42% before ending the period at 5.49%. Yields on the Euro-Deutschemark bonds declined some 25 basis points, with the 5 and 10 years maturities ending the period at 5.25% and 6.08% respectively.

In the near term, no change in the Bundesbank's monetary policy is expected. With the expected stability of the Deutschemark against the US Dollar underpinned by the weak fundamentals of Germany, and the expected co-ordination from the G5 to continue their efforts to stabilise exchange rates after the Venice Summit, some correction in the German bond market is likely. However, because of the sluggishness of the economy, it is likely that the Bundesbank will continue its policy of leading the shorter term interest rates lower. Thus, short dated bonds may be focussed upon and the yield curve may become steeper.

3. THE JAPANESE MARKET

During the period under review, interest rates continued their declining trend. Faced with uncertainty in the foreign exchange market, funds continued to remain in Japan. Liquidity was high and money supply growth at 8.5% was well above the target of nominal GNP growth plus 2%. Inflation was nevertheless still non-existent. The Bank of Japan, faced with further upward pressure on the yen in April, decided to lead interest rates lower rather than to lower the Official Discount Rate which was at a post-war low of 2.5%. Despite the already easy monetary conditions, there was little sign of an increase in investment in real assets. Thus, the bank of Japan injected funds into the money market through repos, reducing the CD rates instead. Call rates declined from 3.875% to 3.125%, and three months Euro-Yen rates declined from 4.25% to 3.80% during the last quarter.

Based on the better than expected economic data for the first quarter, a firmer outlook for domestic demand, coupled with the aggressive Yen6 tri domestic stimulation package, expectations are that the worst experienced by the Japanese economy is almost over. With expectations of a pick up in growth, the scope of further declines in interest rates can be expected to be limited. Any near term stability of exchange rates is likely to put in question the prospects of a further reduction in the Official Discount Rate. In addition, the Government is likely to relax fiscal policy further, rather than to lower its key interest rates. On the other hand, in the event that the yen surges once again, the Bank of Japan may be more inclined to further relax its monetary stance and lower the Official Discount Rate. However, under present circumstances following the release of the Yen6 tri package, and recent remarks by both US and Japanese Officials indicating that a further sharp fall in the US dollar would be "counterproductive", some stability may be achieved in the US$/Yen exchange rate. As such, the near term domestic interest rates can be expected to remain fairly stable.

The Japanese yen, after having traded within a Yen150-Yen155/US$ range for more than two months, broke through the psychological Yen150/US$ barrier. Despite heavy intervention by the Bank of Japan, the yen reached a post-war high of Yen137.25/US$ on 27 April 1987, before easing to the Yen140/US$ level. The single most important factor accounting for the yen's appreciation has been the country's huge current account surplus which have yet to show signs of diminishing. Japan attained a record merchandise trade surplus of US$89.8 billion in FY86/87, up from US$58.6 billion in FY85/86. In March alone, Japan's total surplus, although having narrowed slightly to US$3.8 billion from US$4 billion with the US, widened overall to US$8.1 billion from February's $7.1 billion. This led to a further heightening of trade tensions, and the imposition of tariffs on Japanese electronic imports put upward pressure on the yen. In May, widening interest differentials and the Japanese government's instructions to domestic institutions to refrain from speculative foreign exchange transactions, helped to stabilise the yen. The yen ended the period at Yen140/US$.

Near term, the yen is expected to trade in the range of Yen140-Yen144/US$. This stability can be expected to extend further in the coming months based on the prospects that US and Japanese officials can be expected to co-ordinate their efforts towards achieving this stability. Remarks from US officials that a further dollar decline could be "counterproductive" and recent rises in US interest rates have helped to support the dollar. Although further sharp rises in US interest rates to support the US unit may not be expected, in the event of sharp US dollar declines, the Bank of Japan might be more inclined to lower its key interest rates instead. Such policy co-ordination and the efforts by Japan to stimulate its domestic economy, will help to stabilise exchange rates in the short term.

During the last quarter, the Japanese bond market was strong in fairly volatile trading. In March, the strength of the yen and the release of economic indicators pointing to a fairly sluggish economy, raised hopes of lower interest rates. Yields on the benchmark No. 89 JGB moved down 25 basis points to 4.20%. Trading in the Euro-Yen issue was however sluggish, responding to the mixed movement of the side issues in the JGB market. Despite repeated warnings from the Bank of Japan of an overheated bond market, the benchmark No. 89 JGB continued to rise in active trading. The marked appreciation of the yen in April and early May led to increasing expectation of another reduction in the Official Discount Rate. This and the favourable demand and supply of funds pushed yields on the benchmark No. 89 JGB to 2.55% in mid May. Thereafter, as a result of the stabilisation of the US$/Yen exchange rate together with the proposal of a 4-day settlement period for bonds, the JGB market declined. Bond prices declined and yields on the No. 89 JGB rose above 3%. Consequently, Euro-Yen issues also fell on profit-taking.

In the near term, ahead of the Venice Summit meeting, the Japanese Bond is expected to remain sluggish. The release of the Yen6 tri domestic package appears to signify the Japanese Government's intention of using fiscal policy rather than monetary policy to stabilise the yen and improve trade relations. This, the prospect that the trade surplus is peaking and the widened interest rate differentials are likely to keep the US$/Yen exchange rate stable in the short term. The prospect of a near term discount rate reduction is likely to be dim, leading to a correction and consolidation of the bond market in the short term.

4. THE SWISS MARKET

During the period under review, the Swiss National Bank continued to maintain an accommodative monetary policy (though restrictive by international standards). Despite a noticeable easing in German interest rates, and a strong uptrend of the Swiss Franc, Swiss interest rates held steady. Three-month interest rates only declined some 10 - 15 basis points compared to a decline of 40 - 50 basis points in West German interest rates. The nominal interest rate differential between these two countries is now close to zero. The steady interest rate movement has been underpinned by the fundamental strength of the economy. In addition, monetary growth has been above the target of 2% and inflation has picked up from -0.1% in November to 1.2% in April. Thus, the official Discount Rate and Lombard Rate remained unchanged at 3-1/2% and 5% respectively, whilst the three months' deposit rate was marginally lower at 3.80%.

The economic fundamentals of the Swiss economy remain strong, although there are indications of a marginal slowdown in growth this year. The momentum for growth will come from private consumer demand as the outlook for export-growth remains uncertain. Fiscal policy is likely to be minimal and the Swiss National Bank may continue to stick to its present monetary policy which tends to be restrictive by international comparison. Despite the rise in inflation in April, inflation is likely to remain under control, helped by the strong currency. As a result of present stability of the US$/Sfr exchange rate, further monetary easing is not expected in the near term and interest rates are likely to remain fairly stable.

During the period under review, the movement of the Swiss Franc was somewhat similar to the Deutschemark. After stabilising at around Swiss Franc 1.55/US$, the Swiss Franc resumed its uptrend in late March and even strengthened against the Deutschmark. The Swiss Franc rose above the level of Swiss Franc 1.50/US$ in April touching a high of Swiss Franc 1.45/US$ at the end of May. While doubts may be raised over the performance of the German economy, the outlook of the Swiss economy remains relatively bullish, underpinning the currency's strength. Also, the April merchandise trade deficit narrowed to Sfr0.8 bn from a revised Sfr1.1 bn in March, reflecting the impact of the strength of the Swiss Franc. This reduction in the trade deficit, coupled with an increase in invisibles, pushed the current account surplus to an estimated Sfr13.5 bn last year from Sfr11.1 bn in 1985. These factors combined, helped to underpin the currency.

In the near term, ahead of the Venice Summit in June, the US$/Swiss Franc exchange rate is expected to remain stable. Thereafter, upon the expected release of improved US economic and trade data, further stability in exchange rates may be expected. Whilst the healthy economy, favourable trade balance, relatively low inflation and steady monetary policy of the Swiss National Bank are likely to underpin the currency, further marked appreciation of the Swiss Franc currency is not expected.

Despite the strength of the Swiss Franc, interest rates were held steady resulting in an almost unchanged bond market during the last quarter. Yields on foreign Swiss Franc bonds fell marginally from 4.53% to 4.45% on the 5 years' maturity whilst yields on the 10 years maturity were unchanged. In the primary market, new issue activity was fairly brisk with some good investor demand.

The near term stability of the US$/Swiss Franc currency is likely to result in pessimism over further interest rate declines and prevent large capital inflow into the Swiss Franc bond market. A short term correction may be expected.