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FM BONN  
TO IMMEDIATE FCO  
TELNO 84D  
OF 051740Z OCTOBER 87  
AND TO IMMEDIATE WASHINGTON, TOKYO  
AND TO PRIORITY PARIS, ROME, OTTAWA, UKDEL OECD  
INFO SAVING CONSULATES-GENERAL IN FRG AND BERLIN

FRG ECONOMY: INTEREST RATES

SUMMARY

1. THE CENTRAL BANK COUNCIL TODAY AGREED TO LOWER GERMAN INTERST RATES. THE LOMBARD RATE HAS BEEN CUT BY 0.5 PERCENT TO 4.5 PERCENT AND THE RATE FOR REPURCHASE ARRANGEMENTS BY 0.3 PERCENT TO 3.5 PERCENT. THESE MOVES MAY BE MORE PSYCHOLOGICAL THAN PRACTICAL, BUT ARE DESIGNED TO COUNTER INTERNATIONAL CRITICISM IN RECENT WEEKS OF GERMAN INTERST RATE POLICY.

DETAIL

2. THE MEETING OF THE BUNDESBANK CENTRAL BANK COUNCIL TODAY, WHICH WAS ATTENDED BY THE FEDERAL FINANCE MINISTER, AGREED TO LOWER THE OFFICIAL LOMBARD RATE TO 4.5 PERCENT FROM 5 PERCENT AND THE OFFICIAL RATE FOR REPURCHASE ARRANGEMENTS FOR FIXED INTEREST SECURITIES FROM 3.8 PERCENT TO 3.5 PERCENT. THE NEW LOMBARD RATE, WHICH TAKES EFFECT FROM TOMORROW, AND THE REPURCHASE RATE WILL COME INTO OPERATION AT THE NEXT REFINANCING TRANSACTION, PROBABLY ON 11 NOVEMBER.

3. THE BUNDESBANK HAS TWO FORMAL INTEREST RATES FOR LENDING TO BANKS AND CREDIT INSTITUTIONS: ONE IS APPLIED TO THE RE-DISCOUNTING OF COMMERCIAL AND TREASURY BILLS AT A RATE DETERMINED BY THE BUNDESBANK (THE DISCOUNT RATE). THE OTHER IS CHARGED ON LOANS GRANTED AGAINST THE COLLATERAL OF CERTAIN LEGALLY SPECIFIED SECURITIES SUCH AS BILLS OF EXCHANGE AND TREASURY DISCOUNT PAPER (THE LOMBARD RATE). LOMBARD LOANS ARE INTENDED AS AN EXCEPTIONAL FACILITY TO CATER FOR PEAK SHORT TERM LIQUIDITY NEEDS. AS SUCH, THE RATE IS A DIRECT INFLUENCE ON CALL MONEY RATES. IF THE BUNDESBANK IS PREPARED TO PROVIDE LIQUIDITY TO THE MARKET, AS IT HAS SHOWN ITSELF WILLING TO DO IN RECENT WEEKS, THE LOMBARD RATE CAN ACT EFFECTIVELY AS AN UPPER LIMIT FOR DAY TO DAY MONEY MARKET RATES OF INTEREST. THE EFFECT IS REVERSED WHEN LIQUIDITY IS SHORT.

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4. THE LOMBARD RATE WAS LAST CHANGED ON 23 JANUARY 1987 WHEN IT WAS LOWERED FROM 5.5 PERCENT AND THE DISCOUNT RATE WAS ALSO REDUCED BY 0.5 PERCENT TO 3 PERCENT. THE CENTRAL BANK COUNCIL TODAY LEFT THE DISCOUNT RATE AT ITS PREVIOUS LEVEL. AT 4.5 PERCENT THE LOMBARD RATE IS NOW AT ITS LOWEST SINCE JANUARY TO MARCH 1979 WHEN IT STOOD AT 4 PERCENT. THE REPURCHASE RATE, WHICH IS CHANGED MORE FREQUENTLY, IS NOW AT THE LEVEL USED BETWEEN 13 MAY AND 22 JULY BEFORE IT WAS HIKED UP TO 3.85 PERCENT, INCURRING THE PUBLIC DISPLEASURE OF THE US TREASURY SECRETARY.

5. THE MOVE IS OBVIOUSLY INTENDED TO REASSURE THE FINANCIAL MARKETS AND THE AMERICANS ABOUT GERMAN INTEREST RATE POLICY BUT ITS PRACTICAL EFFECT MAY BE LIMITED BY OTHER FACTORS. THE LOMBARD RATE IS THE EASIEST OF THE TWO FORMAL LENDING RATES TO CHANGE. BEFORE THE DECISION, THE DOLLAR FELL TODAY IN FRANKFURT TO A NEW HISTORICAL LOW POINT AGAINST THE D.MARK OF 1.6950. THE BUNDESBANK STEPPED INTO THE MARKET TO BUY 70.9 MILLION DOLLARS AT THE MID-DAY FIXING. THERE HAS AS YET BEEN NO REACTION ON THE FINANCIAL MARKETS TO THE CHANGE IN INTEREST RATES.

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