FRIEDBERG'S
COMMODITY & CURRENCY COMMENTS

347 Bay Street, Toronto Ontario Canada M5H 2R7 Telephone: (416) 364-2700 Cable: Friedco Toronto Telex: 06-23446

The Battle for the Dollar Jan.25th,1978

On January 6th, the Board of Governors of the Federal Reserve Board, in a split and most difficult decision, approved a 1/2% hike in the Discount Rate, to 6 1/2%. Two days earlier, the Treasury and the Federal Reserve had announced the activation of a swap agreement with the West German Bundesbank, so that the U.S. would be able to intervene in the foreign exchange market by selling DM against the purchase of Dollars. Similar arrangements were being activated with other Central Banks. Although the decision to intervene is useless in and of itself, it relieved foreign Central Banks, presumably our allies, from mounting pressure in that it transferred part of the foreign exchange risk back to the U.S. - where it belongs almost entirely. It also signalled, psychologically, the fact that the battle for the Dollar had begun. Now the U.S. had staked its reputation on the line and it would be committed to maintaining fair and equitable exchange levels and activity...

...The Fed has been agonizing over further tightening moves, fearful that the domestic economic recovery is still too fragile and that, perhaps, a domestic slump could spread and cause a worldwide depression. It need not worry. The recovery in the U.S. is robust and well balanced and its only enemy is inflation and the excesses it creates. Furthermore, should the U.S. economy slow down to little or no real growth, it can count on a powerful boom in store for W. Germany & the U.K. and modest plusses in Japan, Netherlands, Canada, Mexico and South Africa - the latter recovering from a prolonged slump - to shore up world trade.

There is a chance for de-synchronizing economic cycles in the Western World, a development that, in the long run, should be more beneficial than harmful. If the Fed tightens now rapidly (over 8-12 weeks) short-term capital inflows will stabilize the Dollar, inflationary expectations will subside, and the trade deficit will narrow sharply, thus restoring badly needed confidence. If it demurs, the Dollar will fall to pieces, domestic inflation will accelerate seriously, interest rates will skyrocket and the inevitable depression will ensue.

August 31st - September 5th,1978

Courting Disaster

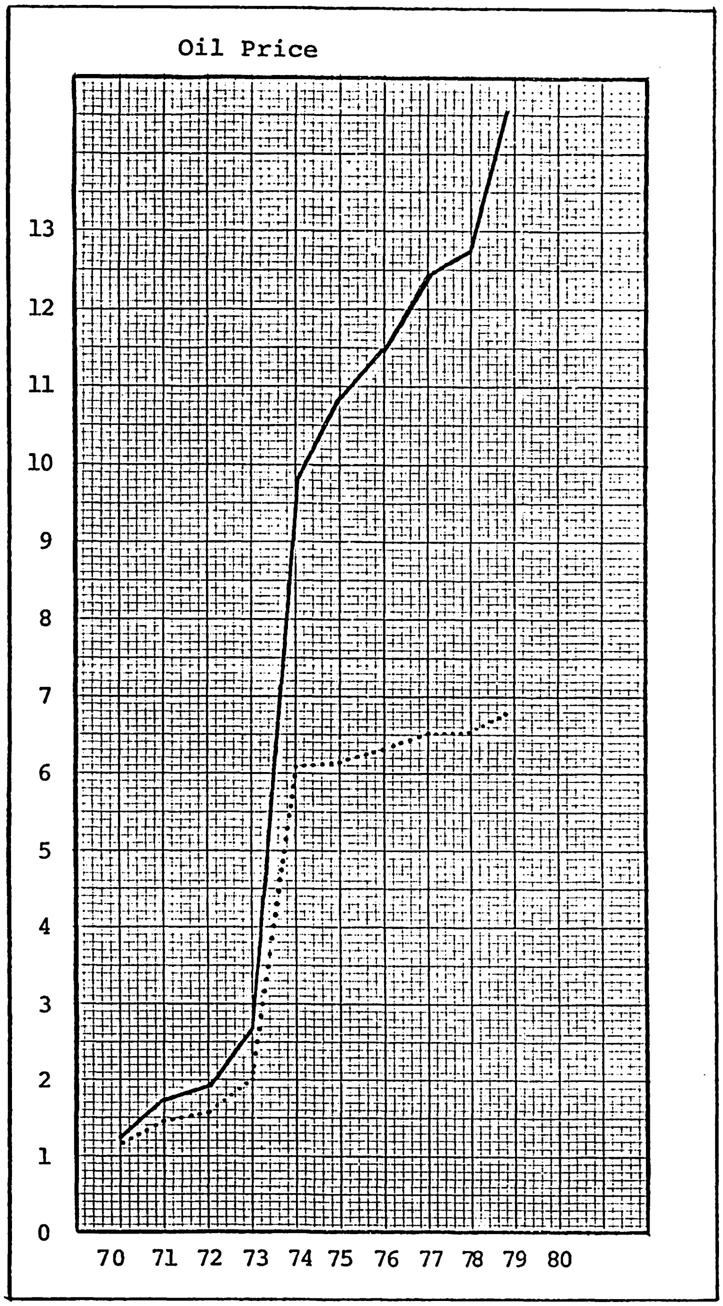
" The appearance of periodically recurring economic crises is the necessary consequence of repeatedly renewed attempts to reduce the 'natural' rates of interest on the market by means of banking policy. The crises will never disappear so long as men have not learned to aviod such pump-priming, because an artificially stimulated boom must inevitably lead to crisis and depression." *

" The managers of the banks of issue have carried out their policy without reflecting very much on its basis. If the expansion of circulation credit began to alarm them, they proceeded, not always very skillfully, to raise the discount rate. Thus, they exposed themselves to public censure for having initiated the crisis by their behavior. It is clear that the crisis must come sooner or later. It is also clear that the crisis must always be caused, primarily and directly, by the change in the conduct of the banks. If we speak of error on the part of the banks, however, we must point to the wrong they do in encouraging the upswing. The fault lies, not with policy of raising the interest rate, but only with the fact that it was raised too late. " **

Ludwig Von Mises

* from Die Ursachen Der Weltwirtschaftskrise : Ein Vortrag, Feb. 28,1931.

** from Geldwertstabilisierung und Konjunkturpolitik, 1928.



— Average Petroleum Price (U.S./Barrel);
... Average Petroleum Price (Constant 1977 U.S.$/ Barrel)

Friedberg & Co. Ltd.
347 Bay Street
Toronto, Ontario, Canada M5H 2R7
(416) 864-1195
Cable: Friedco Toronto
Telex: 06-23446

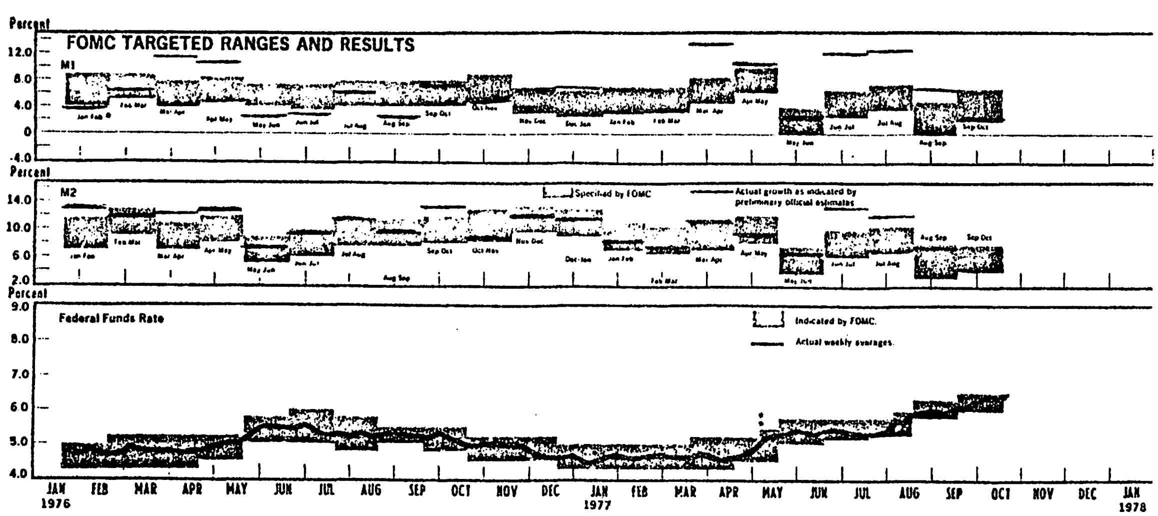
Currency Comments

The Battle for the Dollar

Jan.25th,1978

On January 6th, the Board of Governors of the Federal Reserve Board, in a split and most difficult decision, approved a 1/2% hike in the Discount Rate, to 6 1/2%. Two days earlier, the Treasury and the Federal Reserve had announced the activation of a swap agreement with the West German Bundesbank, so that the U.S. would be able to intervene in the foreign exchange market by selling DM against the purchase of Dollars. Similar arrangements were being activated with other Central Banks. Although the decision to intervene is useless in and of itself, it relieved foreign Central Banks, presumably our allies, from mounting pressure in that it transferred part of the foreign exchange risk back to the U.S. - where it belongs almost entirely. It also signalled, psychologically, the fact that the battle for the Dollar had begun. Now the U.S. had staked its reputation on the line and it would be committed to maintaining fair and equitable exchange levels and activity.

The battle will be very painful. It has been obvious for the past year that the U.S. has been following a monetary policy that is contrary to its stated objectives. Its M1 upper target of 6 1/2% and then 6 % per annum growth was breached in 1977, which saw a 7.3 % growth. Worse yet, as pointed out repeatedly here for the past few months, Federal Reserve Credit, the fully discretionary variable that the Fed controls, grew at no less than 10.5% during 1977 while the Monetary Base grew by 9.2%, rates totally incompatible with moderate M1 & M2 targets. A better indication of total money supply (in our opinion) is a figure published by the Fed (release H.3) entitled 'Deposits subject to Reserve Requirements' (DSRR). While this figure covers only member banks, it is a more comprehensive measure of money 'leakages', i.e. moneys moving between one type of deposit and another and thus avoiding sometimes the M1 and M2 classification, and therefore may be used as a good nationwide proxy. Over the past 12 months, DSRR grew by approx. 8.3% while over the past 6 months it accelerated to a 9.14% rate of growth as money was being shifted out of traditional deposits and into CD's & Euro-Dollars. As pointed out last month, CD's issued by large commercial banks grew by an astonishing $18 billion since early May, an amount equal to 5.5% of M1 !



* Actual growth reflected in the chart refers to annualized rate of change during the two-month period in question. Mechanically, it is the change from the preceding month to the terminal month.

** These and subsequent inter-meeting adjustments to the upper and lower boundaries of the indicated ranges for the funds rate were agreed upon in "telephone" meetings.

Prepared by the Economist's Department of Morgan Guaranty Trust Company of New York.

Motivated by political fear, the Fed dared not raise its Fed Funds rate rapidly enough in early to mid-1977 and thus monetized a great deal of the Treasury deficit. The Federal Funds rate seems now to have stabilized at the 6 3/4% level but, as Federal Reserve Credit figures show, even at this 3-year high, credit expansion is proceeding much too fast.

Under the present rules of the 'intervention game' , be it by the U.S. Central Bank or by its foreign counterparts, the U.S. money supply remains unchanged, for the mopped up Dollars get recycled via marketable securities while foreign money supply increases. Recent U.K. and West German money supply figures show explosive growth rates while Switzerland and Japan have been far more successful in sterilizing inflows.

The Fed has been agonizing over further tightening moves, fearful that the domestic economic recovery is still too fragile and that, perhaps, a domestic slump could spread and cause a worldwide depression. It need not worry. The recovery in the U.S. is robust and well balanced and its only enemy is inflation and the excesses it creates. Furthermore, should the U.S. economy slow down to little or no real growth, it can count on a powerful boom in store for W. Germany & the U.K. and modest plusses in Japan, Netherlands, Canada, Mexico and South Africa - the latter recovering from a prolonged slump - to shore up world trade.

There is a chance for de-synchronizing economic cycles in the Western World. a development that, in the long run, should be more beneficial than harmful. If the Fed tightens now rapidly (over 8-12 weeks), short-term capital inflows will stabilize the Dollar, inflationary expectations will subside, and the trade deficit will narrow sharply, thus restoring badly needed confidence. If it demurs, the Dollar will fall to pieces, domestic inflation will accelerate seriously, interest rates will skyrocket and the inevitable depression will ensue.

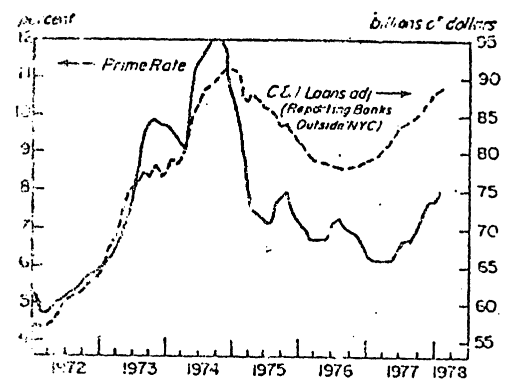
In keeping with the above remarks, the following positions are still recommended (although some have already produced large gains) :

	LAST	OBJECTIVE	STOP
Short June '78 GNMA's	93.30	90 - 92	95.10
Short June '78 TB	92.80	92 - 92.40	93.15
Long Mar. '78 Swiss Francs	51.47	54 - 57	50.00
Long Apr. '78 Platinum	223.00	250 - 300	200.00
Long Mar. '78 Palladium	59.60	75	51.00

Long Gold positions may be retained although we continue to show preference to Platinum, a 'thinner',less emotional, more undervalued & more easily 'controllable',precious metal.

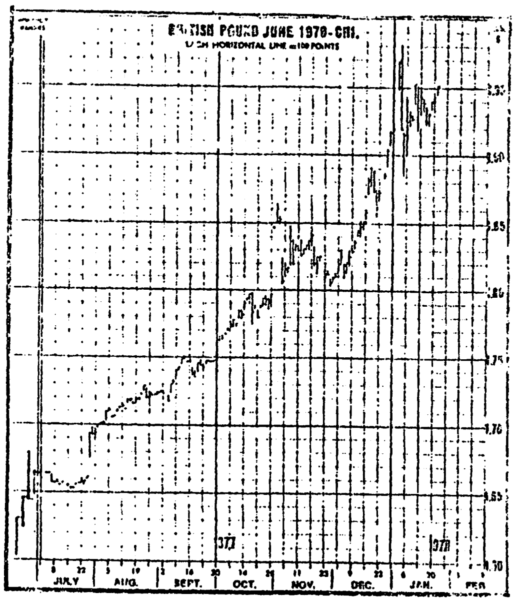
Short positions in British pounds were advised closed at 1.90 basis Spot, as per our last Currency Comments while a suggestion to establish a DM short position @ 46.75 on stop was never activated as the reaction on the DM stopped short of that particular level.

Rise in C&I Loans Signals Further Rate Pressure



The cyclical uptrend in business loans argues for a significant increase in money market rates this year, according to the Chase Manhattan Bank. In recent years, it notes, both the prime rate and short-term rates have tracked closely the volume of commercial and industrial loans at large banks outside New York City where loan demand typically emerges earlier. With the financing gap between business capital investment and cash flow expected to widen substantially this year, it adds, business borrowing at large commercial banks is not only likely to continue to expand through 1978, after the typical January dip, but to accelerate. Moreover, the recent increase in bank borrowing by the largest manufacturing corporations may be an advance signal of an increase in borrowing sometime ahead at New York banks as well.

THE MONEY MANAGER



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British Pound

Spot : 195.32 Mar. '78: 195.60 June '78 : 195.95
Sep. '78: 196.15 Dec. '78: 196.20 Mar. '79 : 195.65
June '79: 197.00

	Aug	Sep	Oct	Nov	Dec	JAN
Balance of Trade (Mln Stg) JAN 1976 ~~Total 1976: -3,677~~ - 532 ~~Total 1977: -1,547~~	+ 141	+ 80	+ 31	+73	-71 ~~-80~~	-324
Reserves (Mln U.S.$)	14,850	17,170	20,210	20,390	20,560	
Retail Sales Index **	-1.56	-2,11	-1.21	-2.93	+1.11	
Retail Price Index **	16.52	15.63	14.07	13.03	12.14	
W.P.I. **	19.8	19.0	17.89	16.05	15.22	
Unemployment Rate	6.90	6.10	6.10	6.1	6.0	

Euro Deposit %	Dec.23	Dec. 30	Jan 6	Jan 13	Jan 20
1 Mo.	7 1/8	6 3/4	6 1/2	6 7/8	6 1/8
3 Mo.	7 1/4	7.	6 3/4	6 15/16	6 3/8
6 Mo.	7 3/4	7 1/2	7 1/4	7 1/8	6 7/8
12 Mo.	7 3/4	7 5/8	7 1/2	7 3/16	7 1/4

Open Interest (Jan 23): 5,215 Volume (Jan 23): 974
Contract Size : BP 25,000.00 (Approx U.S. $48,500.00)
Minimum Fluctuation : .00050 ($12.50) Daily Limit (Normal) : .05($1,250.00)
Margin Required : US$ 2,500.00 Round Turn Commission : US$ 60.00
Trading Hours : 8:45 - 1:10 (Chicago Time) Delivery Months: Mar.,June,Sept.,Dec.

** - % change year-over-year.

Deutsche Mark

Spot : 47.62 Mar. '78 : 47.92 June '78 : 48.50
Sept.'78: 49.10 Dec. '78 : 49.64 Mar. '79 : 49.80

	Aug	Sep	Oct	Nov	Dec.
Balance of Trade (mln Marks) Total 1976: 34,380 Total 1977: 38,350	2,520	3,600	4,810	3,080	4,220
Balance of Payment (mln Marks) Total 1976: 8,820 Total 1977: 10,890	-1,430	-1,200	+3,400	+1,400	2,600
W.P.I. **	1.9	1.7	1.5	1.7	2.4
Cost of Living **	3.89	3.96	3.8	3.7	3.5
Unemployment Rate	4.3	4.0	4.2	4.4	4.8

	Dec.23	Dec.30	Jan 6	Jan 13	Jan 20
Net Monetary Reserves (mln Marks)		88,300	88,700	91,200	
Euro Deposit %					
1 Mo.	2 3/4	2 5/16	2 7/8	2 13/1	
3 Mo.	3.	2 9/16	2 15/16	2 7/8	
6 Mo.	3 3/8	2 7/8	2 15/16	3.	3 1/4
12 Mo.	3 7/8	3 1/8	3 3/16	3 3/16	3 3/8

Open Interest (Jan 23) : 2,832 Volume (Jan 23): 318
Contract Size : DM 125,000.00 (Approx. U.S.$ 60,000.)
Minimum Fluctuation : .0001 ($12.50) Daily Limit (Normal) : .0060 ($750.00)
Margin Required : US$ 4,000.00 Round Turn Commission: US$ 60.00
Trading Hours : 8:45 - 1:10 (Chicago Time) Delivery Months: Mar.,June,Sept.,Dec.

	1977 1st Half	1977 2nd Half	1977 Total Year	1976 1st Half	1976 2nd Half	1976 Total Year
[illegible] G.N.P.	+ 2.9%	+ 2.0%	+2.4%	+ 6.1%	+ 5.3%	+ 5.7%

Germany's G.N.P. grew a nominal 6.1% in 1977 to 1,193 bln marks at current prices compared with the 9.1% growth in 1976. Total productivity of the economy grew around [illegible]%, measured against the development of the G.D.P. at constant prices. Private consumption at current prices grew 6.9%, government consumption at 5.8% and plant investment at 6.5%. The external component of G.N.P. fell to 25.7 bln marks in 1977 from 28.1 bln in 1976, imports in nominal terms + 7.7% and exports at 6.2%. Gross investment grew 5.9% (16.6% in 1976), equipment investment grew 3.0% (+11.1 % in 1976), and that from entrepreneurial activities and investment by 2.5%. The rise in income from non-independent work at 7.1% was around the same as in 1976, but the 2.5% rise in income from entrepreneurial activities and investment was down on the 1976 figure of 15.4%... IMM Bulletin.

Japanese Yen

Spot : 41.48 Mar.'78 : 41.76
June'78: 42.26 Sep.'78 : 42.50

		Aug	Sep	Oct	Nov	Dec
Balance of Trade (mln US$)						
Total 1976: 10,003						
Total 1977: 17,827		1,150	1,690	1,860	1,610	2,680
Balance of PaymentS(mln U.S.$)						
Total 1976: 2,603						
Total 1977: 7,754		300	511	324	1,830	1,880
Money Supply **	M1	6.10	6.30	5.4	6.2	...
	M2	10.90	11.30	10.6	10.8	...
Reserves (mln US$)		17,770	17,870	19,580	22,150	22,850
CPI **		8.55	7.61	7.47	6.23	...
WPI **		0.78	0.50	0.05	-0.01	-.015
Unemployment Rate		1.90	2.05	2.02	2.	...

Open Interest (Jan 23) : 2,197 Volume (Jan 23) : 232
Contract Size : Yen 12,500,000.00 (Approx. U.S. $52,000.00)
Minimum Fluctuation : .0000010 ($12.50) Daily Limit (Normal) : .00060 ($750.00)
Margin Required : US$ 4,000.00 Round Turn Commission : US$ 60.00
Trading Hours : 8:45 - 1:10 (Chicago Time) Delivery Months : March,June,Sept., Dec.

<u>Japanese approval of fiscal 1978 growth</u> - The Japanese gov't formally approved an economic outlook for fiscal 1978 projecting a rise in real G.N.P. growth to 7% from an estimated 5.3% in fiscal 1977, and a fall in the current account Balance of Payments surplus to 6 bln dlrs from 10 bln, a cabinet spokesman said. The outlook projects a rise in nominal G.N.P. to 12% from an estimated 11.1% in fiscal 1977, the wholesale price index +2.7% (+0.6%), C.P.I. +6.8% (+7.6%), nominal consumer spending +11.9%(+11.4%), private residential construction +13.6% (+7.5%), private capital outlays + 9.9% (+ 3%), private inventory investment +24.6% (+3%), industrial production index + 6.8% (+2.6%), visible trade surplus 13.5 billion Dollars (16.5 bln), FOB exports + 7% to 85 bln dlrs and FOB imports + 13% to 71.5 bln dlrs. .. IMM Bulletin.

<u>Japanese current account equilibrium aim</u> - Japan's current account surplus will be "considerably reduced" in fiscal 1978, and Japan will make "all reasonable efforts" to cut the surplus further in fiscal 1979 and after, aiming at equilibrium with a deficit accepted if this should occur, a joint U.S./Japan communique said. Among measures to be taken by Japan to cut the surplus, the communique listed a sweeping review of Japan's foreign exchange control system and the planning of a new system based on the principle that all transactions should be free unless specifically prohibited. Other measures listed were advance tariff reductions by Japan on 2 bln dlrs worth of imports, effective April 1 and removal of quota controls on 12 products ; mutual efforts by the U.S. and Japan to exploit demand for beef in Japan to achieve beginning in fiscal 1978 a 10,000 ton increase in imports within the hotel use and general beef quotas; Japan will allow an increase in annual orange imports to 45,000 tons (15,000) and a rise in the citrus juice quota to 4,000 (1,000) tons. Japan intends to take all appropriate steps to increase imports of manufactured goods. .. IMM Bulletin .

Spot : 51.00 Mar.'78: 51.47 June '78: 52.39 Sep. '78: 53.12
Dec. 78: 53.85 Mar. '79: 54.35

		Aug	Sep	Oct	Nov	Dec	JAN
Balance of Trade (Mln SFr)							
Total 1976: + 253							
Total 1977: - 925		-615	-30	+7.5	+152	+491	-210
C.P.I. **		1.28	1.56	1.62	1.15	1.08	
Unemployment Rate		0.3	0.3	0.3	0.4	0.4	
Money Supply **		+.03	+.04	+.06	...	...	

		Dec.23	Dec.30	~~Jan 6~~ feb 8	~~Jan 13~~ feb 15	Jan 20
Weekly Reserves (mln SFr)		19,360	20,510	~~18,730~~ 18,560	~~18,890~~ 18,950	...
Euro Deposit %	1 Mo	2 1/16	1 3/16	1 1/16	9/16	11/16
	3 Mo	1 15/16	1 5/16	1 5/16	15/16	1 1/8
	6 Mo	2 5/16	1 13/16	1 3/4	1 7/16	1 9/16
	12 Mo	2 9/16	2 1/16	2 1/8	2.	2 3/16

Open Interest (Jan 23) : 3,200 Volume (Jan 23): 700
Contract Size : SFr 125,000.00 (Approx. U.S. $ 64,000.00)
Minimum Fluctuation : .0001($12.50) Daily Limit (Normal): .0060 ($750.00)
Margin Required : US$ 4,000.00 Round Turn Commission: US$ 60.00
Trading Hours : 8:45 -1:10 (Chicago Time) Delivery Months : Mrach,June,Sept.,Dec.

Canadian Dollar

Spot : 90.26 Mar.'78 : 90.30 June '78: 90.35
Sep.78: 90.45 Dec.'78 : 90.45

		Aug	Sep	Oct	Nov	Dec	
Balance of Trade							
Total 1976: 1,186		+298	+ 50	+524	+243	...	
Total 1977: ...							
General Bank Loans ** (% Growth)		17.16	15.89	15.66	14.48	12.79	
Money Supply **	M1	8.73	8.34	9.49	10.27	11.91	
	M1B	7.82	7.37	8.35	9.40	10.57	
	M2	13.91	13.00	12.86	12.05	11.67	
	M3	14.93	15.42	14.94	14.50	13.19	
Total Currency ** & Deposit		13.67	14.77	14.32	14.13	14.27	
CPI **		8.33	8.40	8.77	9.13	9.50	9 %
Food Price Index **		10.18	11.16	12.73	13.90	15.36	
Unemployment Rate		8.2	8.3	8.3	7.9	8.3	

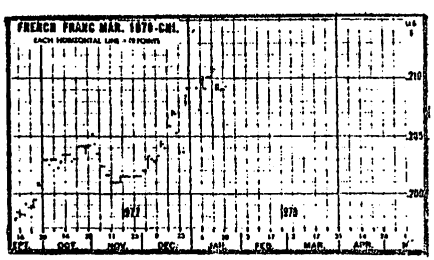
Euro Deposit %		Dec.23	Dec.30	Jan 6	Jan 13	Jan 20
	1 Mo	6 5/16	6 11/16	6 15/16	6 13/16	7.
	3 Mo	6 15/16	6 15/16	6 15/16	6 15/16	6 3/8
	6 Mo	7 3/16	7 5/16	7 5/16	7 3/8	6 7/8
	12 Mo	7 7/16	7 7/16	7 7/16	7 1/2	7 1/4

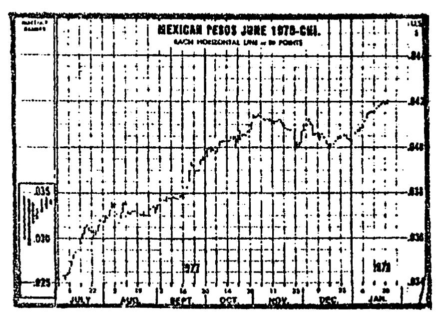
Open Interest (Jan 23) : 1,450 Volume (Jan 23) : 378
Contract Size : CD$ 100,000.00 (Approx. U.S. $90,000.00)
Minimum Fluctuation : .0001 ($10.00) Daily Limit (Normal): .00750($750.00)
Margin Required : $ 2,500.00 Round Turn Commission: US$ 60.00
Trading Hours : 8:45 -1:10 (Chicago Time) Delivery Months: March,June,Sept.,Dec.

A sharp deceleration in growth of General Bank Loans (see table) has provided the banking system with some relief and badly needed liquidity. As a result, money market rates have tumbled to cluster about the low end of 7 %. Long term rates, however, stiffened as a result of increased inflationary expectations and a clogging up of the bond calendar. With a demoralized bond market and an extremely sluggish economy, the Bank of Canada may have to live with higher-than-desired growth rates in M1, now showing a year over year gain of 11.91% (see accompanying table).

This spells further trouble for the CD$. Last month we said : " another CD$ drop of significance is almost a certainty ... advise reinstating short positions at market. "

Remain short, placing stops at 90.90 basis March '78.





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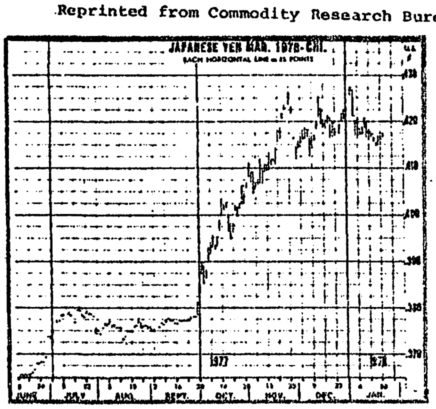
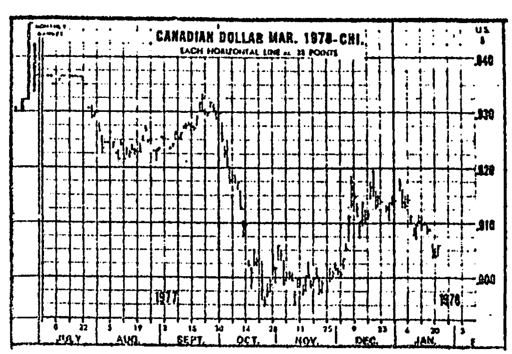




French Franc

Spot : 21.26   Mar. '78 : 21.03   June '78: 20.76   Sep. '78: 20.25

		Aug	Sep	Oct	Nov	Dec
Balance of Trade(mln FFr)						
Total 1976: -21,670						
Total 1977: -11,390		-1,850	+ 421	+127	-2,670	1,310 ~~+1,660~~
Money Supply	M1	6.42	10.24	8.59	...	...
	M2	11.82	12.89	12.31	...	...
	M3	13.51		12.61	...	...
Net Change of Foreign Exchange Assets**		19.59	19.52	18.02	17.51	16.91
Retail Price Index**		9.91	9.69	9.55	9.06	...
Unemployment Rate		5.5	5.3	5.0	4.8	...

		Dec.23	Feb 2 ~~Dec.30~~	Feb 9 ~~Jan 6~~	~~Jan 13~~	Jan20
Weekly Reserves(mln FFr)			~~94,674~~ 99.461	~~99,307~~ 98.344	99,436	...
Euro Deposit %	1 Mo.	13 1/4	12 1/2	11 3/16	11 1/8	11 1.8
	3 Mo.	14	13 1/2	12 11/16	12 7/8	12 7/8
	6 Mo.	14 7/16	14 5/16	13 1/2	13 1/8	13 3/8
	12 Mo.	13 7/16	13 1/2	13 5/16	13.	13 5/8

Open Interest (Jan.23) : 141   VOlume (Jan.23) : 10
Contract Size : FFr 250,000.00 (Approx. U.S. $ 52,000)
Minimum Fluctuation : .0005 ($12.50)   Daily Limit (Normal): .005($1,250.00)
Margin Required : US$ 4,000.00   Round Turn Commission: US$ 60.00
Trading Hours : 8:45 - 1:10 (Chicago Time)   Delivery Months : Mar.,June,Sept.,Dec.

Extremely high interest rates and an exceedingly weak U.S. dollar have temporarily succeeded in offsetting the gloomy political picture. Recent polls continue to indicate that, despite the well publicized rift, the parties of the Left may yet obtain a parliamentary victory.

Remain short.

Mexican Peso

Spot : 44.00   Mar. 78: 43.53   June'78: 42.25   Sep.'78: 40.77   Dec. '78: 39.14   Mar. 79: 37.90   June'79: 36.78

Forward Disc. Annual Basis		Mar 78	Jun 78	Sep 78	Dec 78	Mar 79	Jun 79
	Spot	8.55	9.55	11.25	12.05	11.88	11.58
	Mar 78		11.76	13.00	13.45	12.93	12.41
	Jun 78			14.67	14.72	13.73	12.95
	Sep 78				15.33	13.76	12.84
	Dec 78					12.67	12.05
	Mar 79						11.82

Exports (Mln Pesos)	1976 1st Q	2nd Q	3rd Q	4th Q	1977 1st Q	2nd Q	3rd Q	4th Q
Petroleum	1,374	1,928	2,170	3,216	3,745	5,176	5,468	...
Cotton	396	557	774	2,638	810	759	901	...
Coffee	1,201	1,321	719	1,967	4,305	2,891	1,586	...
Shrimp	323	263	267	1,686	982	868	479	...
W.P.I. 1970=100	184.0	189.9	200.5	242.6	268.1	285.9	297.8	...
C.P.I. 1970=100	193.7	198.9	203.4	225.2	243.5	253.1	264.4	...
Industrial Prod. 1970=100	144.0	145.8	243.8	137.6	138.7	149.5	...	...

Mexican public sector external debt - Mexico's public sector external debt rose 996 mln dlrs in the 3rd qtr., or 4.8% compared with 7.9% in the same qtr last year, to 21.9 bln dlrs, a Finance Minstry report to Congress said. At Sept. 30, 16.6% of the total comprised short-term loans of less than one year. The federal government's internal debt increased by 4.9% in the 3rd qtr, to 263.8 bln pesos at Sept. 30. .. IMM Bulletin.

Deferred discounts have once again narrowed sharply as a result of speculative buying hoping to cash in on the next major oil exporter. High domestic inflation coupled with an immensely heavy external debt burden and an extremely inefficient & corrupt Pemex administration stack up against the likelihood of Mexico ever achieving a payment surplus.

Remain short. Add by selling Mar & June '79 @ 37.90 & 36.78 respectively.

Commodity Comments

This month only Interest Rate Futures and Precious Metals are discussed in the introduction to currency comments.

The following is an explanation of our ranking system:

****** Very Bullish
***** Bullish
**** Bullish Neutral
*** Neutral Bearish
** Bearish
* Very Bearish

Cocoa

**** March '78: 136.00
***** September '78: 120.00

Persistent Origin selling over the past two weeks has driven Cocoa prices down to the lowest levels in nearly one year. Since most of the selling has come from Ghana, Cameroon & Ivory Coast, the London premium over N.Y. terminal has shrunk from over 10 ¢/lb (basis March '78) to the more traditional 3 ¢/lb, that covers the London/N.Y. arbitrage. In recent days, smaller and medium sized manufacturers in the U.S. have bought actuals for both nearby and 1979 shipment thus accentuating the relative tightnesses in N.Y.

The Ghana Cocoa Marketing Board said that cumulative purchases to date for the 1977/78 main crop are 151,133 tonnes which compares with 279,675 tonnes for the sixteenth week ended January 20, 1977. Last season, Main crop purchases began on September 30 while this season they began on October 14. While there is little doubt that the crop is late, the final otturn is still in question, with bears looking for 300-320,000 tonnes and bulls hoping for just 250-275,000 tonnes. The size of the Ghana crop may be decisive in determining the direction of the next major move. A figure of 250-275,000 tonnes coupled with increased Eastern European & USSR offtake & steady Western consumption could be extremely bullish.

Technically, the market seems to have found good support at the 1.34 basis March '78 despite extremely gloomy advices from manufacturers and Commission Houses.

We lean to the bulls. Buy September '78 Cocoa at present levels, placing stops 250 pts lower, on close only.

Coffee

**** March '78: 194.50
**** May '78: 178.00

Getting the cards and playing them perfectly, Brazil continues to be the big winner in this high stakes game. With consumption in the U.S. having improved and, in Europe showing signs of declining resistance, roasters must be buyers, albeit reluctant ones. Stocks in the U.S. are estimated at below 1.5 million bags, the lowest ever in memory.

As stated in these Comments since March, Brazil's strategy has been to ration out supplies in order to squeeze the market. Even the most biased participant must admit they've managed it well. Their latest move occured yesterday when IBC prez. Calazans announced a 10¢ cut in the export price. The May option fell the limit on the news before traders realized that, as a result of the drop, the ICO indicator price also declined and roasters would therefore be able to secure less of the country's 20¢ price guarantee, which is determined by the difference between the minimum export price and the ICO indicator price, than before.

Brazil had apparently lowered prices but had actually raised them.

As long as inventories remain at depressed levels and consumption is not reduced at the consumer level, it seems likely The Brazilians will be able to continue to finesse the market. Its doubtful roasters will find any relief from rival producing nations until the major harvests of the spring. Between now and then we expect a thin market to trade, as we did last month, between 185.00 and 213.00 basis May. As of this writing we recommend purchase of May risking 5¢. Stay in close contact.

Copper

**** March '78: 57.6
**** September '78: 60.6

Confirming our analysis of last month which concluded that, despite tempting looking charts, purchases were still unwarranted, the market retreated and Kennecott lowered its producer price for cathodes to 61.50 cents.

Once again examining the relative changes in stock levels and open interest we find the situation improving but still not to the degree whereby we can conclude the market will do other than trade within a narrow range.

On a three month basis combined LME and Comex stocks still are increasing though at a lower rate. On an annual basis they are decreasing. Comex stocks alone, still reflecting the stronger consumption in the U.S. than in Europe, are declining on both a three month and on an annual basis. Comex open interest is decreasing on a three month basis but increasing year over year.

Stay in close contact. Our bias is to the upside, but we still await confirmation.

Cotton

**** March '78: 56.33
**** October '78: 58.90

The USDA's January estimate of production for the current year at 14.5 million bales was the fourth consecutive month the department revised upward its forecast of the domestic crop. November's modest improvement in consumption was negated by December's poor performance; December's daily usage rate fell to a provisional 22,398 bales from 25,235 bales in November and 23,298 bales last December. Despite the reduced price, mill demand currently trails last year's pace by roughly 3.5%. Exports of raw cotton picked up considerably during November to 347.5 thousand bales versus an average of 183.4 thousand bales during the first three months of the crop year. While this is encouraging it is doubtful the USDA's estimate of total exports for 1977/78 of 4.5 million bales will be exceeded in view of the burdensome supplies and poor demand in foreign countries.

Looking ahead to next year, the USDA's much anticipated prospective plantings report was disappointing in that the projected reduction of acreage was only 7% whereas the trade was hoping for as high as a 20% reduction. Also, the report was less than conclusive, first because not all cotton producing states were surveyed and secondly because many growers, disappointed with low prices, were suspected of lying. For a more accurate account we'll have to wait until the next report due in April.

Technically the market looks healthy. Having broken above our 56¢ trading ceiling basis the March option we note only a gap at 56.80 as the only inhibition to 60¢. However with loan entries standing at more than 2.5 million bales versus 200,000 bales last year, we are still loathe to recommend aggressive long positions, despite our comments made last month, in view of the tremendous potential supply overhang.

Maintain a trading posture. Long positions should be maintained. Raise stops to 54.00 basis March. We would be scale up sellers between 60.00 and 65.00.

Orange Juice

*** March '78: 110.85
*** November '78: 108.95

January's cold storage report, listing stocks at 404.5 million pounds, the lowest level for the month since 1973, is evidence that supplies remain tight. Such tightness was slightly exacerbated by the mini-frost of two weeks ago which sent futures soaring. The final results are still out yet opinion of damage done ranges between 3% and 10%.

Movement, while continuing to average around 3.5 million gallons over the past several months - 3.9 million last week - is, since the beginning of the season, trailing last year's pace by roughly 10%. And consumer purchases, operating in response to record high prices at both the wholesale and retail level, trail last year by roughly 25%. Since wholesale prices have not come down with cash quotations for concentrate it is arguable that demand will pick up once they do. It is equally arguable, however, that processors will maintain high wholesale prices for some time, until inventories are restored to more normal levels.

Finding ourselves capable of making both a bullish and bearish case and allowing for the vagaries of the weather over Florida we conclude this market is for crap shooters only. Having been stopped out as per our last month's Comments, stay sidelined.

Sugar

** March '78: 9.40
*** September '78: 10.09
*** October '78: 10.18

The Chinese have featured prominently among world buyers of Raws in recent weeks with rumours indicating that they may have bought as much as 300-400,000 tonnes. The impact on terminal values has been negligible reflecting the enormous worldwide glut.

The market is trendless and uninspiring - in short, boring.

Advise remaining on the sidelines.

Wood Complex

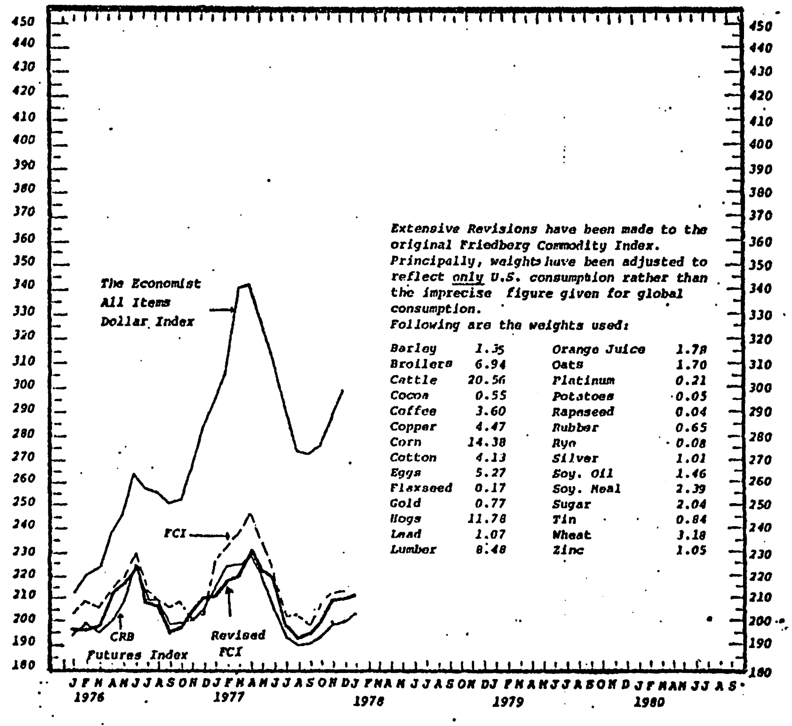
***** March Lumber: 209.7
**** July Lumber: 205.7
***** March Plywood: 209.5

Net inflows into U.S. savings and loans institutions during December totalled $5.5 billion, of which $4.5 billion is attributed to year end accruals of interest. This means S and L institutions actually attracted only $1 billion of fresh funds during the month. For 1977 as a whole, net inflows totalled $51.1 billion. On an annualized basis then, it becomes clear how poor was December's performance. Despite early indications that January's data will show some improvement, we remain convinced of higher mortgage rates. Nevertheless December's excellent housing start rate of 2.3 million units on a seasonally adjusted basis did not surprise us as we feel there will be a lag time between the cause and effects of credit tightness. Builders, conscious of decreasing availability of mortgage financing in the future, are rushing to build homes and will continue to do so, at least through February. The demand for wood products exists in the present tense as evidenced by the current state of backwardation in the markets, and contrary to the seasonal tendency of spreads to widen at this time of year. The prospect of a slowdown in the housing boom guarantees a final blowoff to the wood futures markets.

Buy March lumber at present levels. Place stops at 200.00. Our target is 225.00. A safe spread position may be assumed by buying May and selling July.

	Jan. '78	Dec. '77	Jan. '77
REVISED FCI	213	209	211

+0.2% from month ago
+0.1% from year ago



Albert D. Friedberg
David B. Rothberg