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COMMODITY & CURRENCY COMMENTS

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.

The above prophetic words, uttered more than a half-century ago, portray rather well the Fed's dilemma today, a dilemma that was clearly revealed in the July 18 meeting of the Open Market Committee. In discussing monetary target ranges, a minority held that M1 be allowed to grow at rates in excess of 6 1/2% annually so as to accomodate real growth of 3% given that inflation would run somewhere around 7-8% per annum. The majority view, which of course carried the day, continued to pay lip service to the 4-6 1/2% range but generously allayed the minority view's fears by conceding that target breaches heretofore allowed would continue to stimulate economic growth in the months ahead. With majorities like that, who needs minorities...

Recent statistics point to a continuation of the expansive pace of monetary creation. Bank credit, in the first seven months of this year grew at about 12% led by the unusually strong business loans sector which expanded by 18% on an annual basis. Commercial banks continued to find little difficulty in accomodating this demand eschewing the traditional phase of liquidation of securities for the comfortable fund-raising method of issuing certificates of deposit, which, at last count, had reached a record $ 88 billion for just the 'large weekly reporting commercial banks' category. The much lower reserves required against certificates of deposits has enabled the banking system to pyramid its reserve base thus ballooning broad measures of monetary aggregates. One such favorite yardstick, deposits subject to reserve requirements, has grown at an annul 9.7% rate of growth (July 78 over July 77) well ahead of rates of 7.6% and 8.2% shown for M1 & M2.

And now the Fed - in a desperate, but vain, attempt to raise Eurodollar ıtes without also raising domestic rates and thus provide support for the .nking dollar - has introduced a new wrinkle. To wit, Eurodollar borrowing ' domestic banks from foreign banks and branches will no longer be subject › reserve requirements. Since CD's and Eurodollar deposits are nearly lentical products, one would expect the 'arbitrage' to raise the Eurodollar/ ı spread in favor of the former by a minimal amount so as to allow for their ›re favorable treatment. At 10% interest rates, Eurodollars would yield : best .004% more, hardly conducive to stiffen up the positive U.S. interest ıte differential. To the extent, however, that it causes a substitution : CD's for Eurodollar deposits, it accomplishes a further reduction in 'erall reserve requirements thus allowing a greater monetary expansion on a .ven level of bank reserves.

The present monetary expansion will soon require considerably more ›sages of money if the boom is to sustain itself. This is so as credit :mands - Federal, business & speculative - accelerate. Already a minority : the FOMC admits this point & is willing to be accomodative. Political :essure emanating from Washington may persuade a few more members of the :d to go along with this easier monetary policy. If so the damage to the ›llar will become irreversible.

There has been no credit crunch and in keeping with the above comments, ıere may not be one for many months to come but it will inevitably come :cause credit demands (as well as lack of confidence) tend to accelerate :ometrically. The longer the Fed waits, the more agonizing will be the ıngover.

From a trading point of view, it is still a correct strategy to be ıeavily) short GNMA's, U.S. Treasury Bills & Bonds looking for eventual .elds of 14-18% per annum. Also long positions in foreign currencies, ırticularly the DM, and Gold remain extremely attractive.

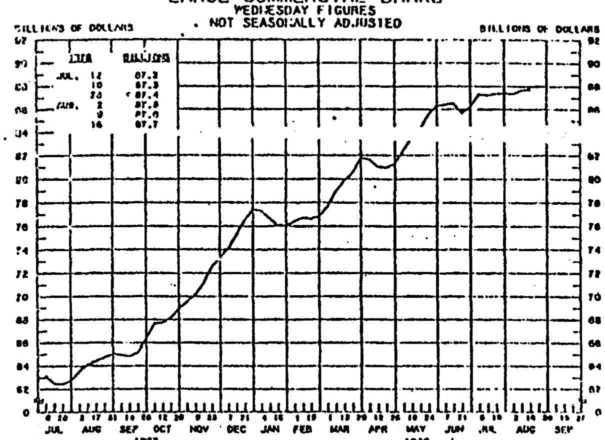
ER BANK DEPOSITS - SUBJECT TO RESERVE REQUIREMENTS

DATE	3 MO. *	6 MO. *	12 MO.**
AN. 78	12.90	10.69	8.11
EB. 78	9.84	10.16	8.28
AR. 78	9.45	10.80	8.50
PR. 78	7.82	10.13	8.74
AY 78	10.27	10.05	9.8
UN. 78	9.6	9.53	9.61
UL. 78	9.83	8.76	9.7

ALL PERCENTAGE CHANGES ARE AT SEASONALLY ADJUSTED COMPOUNDED ANNUAL RATES.

ALL PERCENTAGE CHANGES ARE AT NOT SEASONALLY ADJUSTED ANNUAL RATES.

CERTIFICATES OF DEPOSIT
LARGE COMMERCIAL BANKS
WEDNESDAY FIGURES
NOT SEASONALLY ADJUSTED



RESERVES AGGREGATES *

	TOTAL RESERVES **			NON-BORROWED RESERVES **		
	13 WKS	26 WKS	52 WKS	13 WKS	26 WKS	52 WKS
JUN.7/78	5.5	7.8	7.4	- 0 2	6.8	5.5
14	8.7	8.2	8.0	2 1	7.7	6.2
21	11.4	9.0	8.3	4.0	7.3	6.2
28	11.4	8.9	9.3	3.1	6.2	6.0
JUL.6/78	16.11	10.7	9.1	6.1	7.2	6.4
12	12.8	9.3	8.2	2.3	5.5	5.4
19	14.7	9.8	8.7	3.1	5.2	5.8
26	15.4	9.4	8.9	5.7	5.1	5.6
AUG.2/78						
9	11.8	-7.5	8.0	9.5	3.0	5.6
16	8.3	5.8	6.9	9.4	1.9	5.3
23	7.1	5.2	6.7	7.4	0.9	6.0

* ALL PERCENTAGE CHANGES ARE AT SEASONALLY ADJUSTED ANNUAL RATES, NOT COMPOUNDED.
** AVERAGE OF 4 WEEKS ENDED FROM # WEEKS AVERAGE...

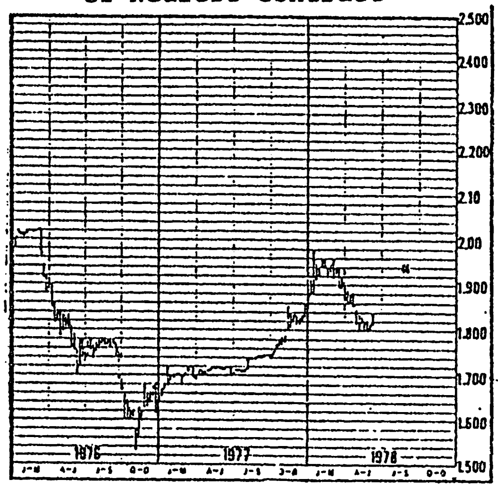
British Pound

Spot: 194.30 Sept.'78: 194.20 Dec.'78: 193.00
Mar. '79: 191.75

	MAY. 78	JUN. 78	JUL. 78	JUL. 77
ALANCE OF TRADE (MLN STG)				
AN-JUL.'77: -1,890				
AN-JUL.'78: - 860	-218	-106	-150	-256
ALANCE OF PAYMENTS(MLN STG)				
AN-JUL.'77: - 894				
AN-JUL.'78: - 111	- 98	+ 14	- 30	- 36
ESERVES (BLN U.S.$)	16.66	16.54	16.73	13.42
ETAIL PRICE INDEX **	7.65	7.41	7.78	17.59
ETAIL SALES INDEX **	3.83	5.01	3.27	-0.74
.P.I. **	9.55	9.07	8.62	20.93
NEMPLOYMENT RATE	5.7	5.7	5.8	6.8

British Pound Futures

Weekly Hi Lo & Close of Nearest Contract



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URO DEPOSIT %	1978 AUG. 4	AUG.11	AUG.18	AUG.25	1977 AUG.30
1 MO.	10 1/4	11 1/2	11 1/4	10 7/8	7 1/2
3 MO.	10 5/8	11	11 3/8	11 1/8	7 3/4
6 MO.	10 7/8	11 1/4	11 3/8	11 1/2	8 1/4
12 MO.	11 1/4	11 1/2	11 1/2	11 11/16	9 1/8

PEN INTEREST (AUG. 30/78): 3,000 VOLUME (AUG. 30/78) :643
ONTRACT SIZE : BP 25,000.00 (APPROX. U.S. $ 48,500.00)
INIMUM FLUCTUATION : .00050 ($12.50)
AILY LIMIT (NORMAL) : .05000 ($1,250.00)
ARGIN REQUIRED : US $2,500.00 COMMISSIONS : $60.00
RADING HOURS : 8:45 AM - 1:10 PM (CHICAGO TIME)
ELIVERY MONTHS : MARCH, JUNE, SEPTEMBER, DECEMBER

* YEAR-OVER-YEAR % CHANGE

	Output Consumer goods	Invst. goods	Current Balance (£m)	Oil Balance (£m)	M1 % *	M3% *
1977						
2nd Qtr.	113.4	98.1	-365	-745	24.8	14.9
3rd Qtr.	115.5	98.6	+537	-602	28.0	10.4
4th Qtr.	117.0	98.0	+486	-657	23.2	12.6
1978						
1st Qtr.	116.1	99.6	-305	-646	24.7	24.0
2nd Qtr.	116.8	99.0	+221	-420	8.7	15.9
Feb.	117.0	99.0	+132	-203	26.8	25.5
Mar.	117.0	100.0	-189	-209	24.7	24.0
Apr.	117.0	100.0	+307	-149	19.1	24.7
May	115.0	98.0	- 98	-155	13.2	17.4
Jun.	118.0	99.0	+ 12	-116	8.7	15.9
Jul.			- 30	-229	9.3	9.5

* Three months' growth at annual rate.

After having moved up from 3.75 DM to 3.95 DM in the latter half of June and through July, the BP has eased off slightly in front of renewed trade unrest.

In the weeks & months ahead, the BP is likely to follow the course of the DM bloc of currencies particularly in view of the fact that its trade balance is continuing to improve - albeit rather disappointingly - and its retail price index has stabilized in the 7 ½ - 8 %/year over year rate. Short term money and long term Gilts continue to show positive returns and are likely to renew hot money inflows with the consequent headaches for the British Monetary Authorities.

Hedgers are advised to remain covered for commitments extending up to three months, taking advantage of the forward discounts.

Canadian Dollar

Spot : 86.84 Sep. 78: 86.81 Dec. 78: 86.71 Mar. 79: 86.61

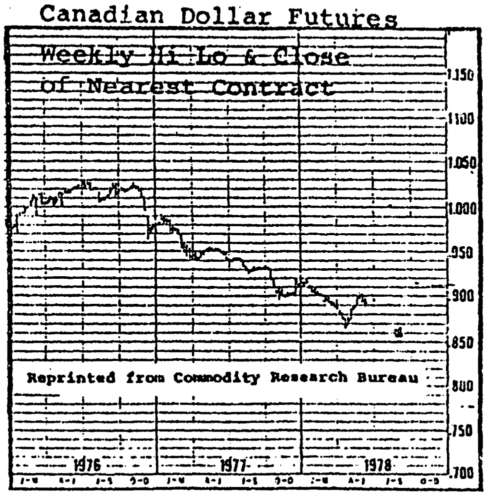
	MAY. 78	JUN. 78	JUL. 78	JUL. 77
ANCE OF TRADE (MLN $)				
-JUL.'77: +1,376				
-JUL.'78: +1,711	315 R	+38 R	- 98	+328
ERAL BANK LOANS**	11.32	11.06 R	11.41	15.10
EY SUPPLY **				
M1	10.24 R	8.51 R	10.29	8.34
M1B	9.48	7.87 R	9.08	7.51
M2	9.95	9.41 R	10.06	14.02
M3	11.88	12.43	12.92	14.93
RENCY PLUS ALL				
OSIT LIABILITIES**	12.05	12.37	N/A	15.32
L RESERVES(BLN U.S.)	4.7	4.7	4.58	5.0
I.(ALL ITEMS)**	9.04	9.23	9.83	8.37
PRICE INDEX**	16.87	17.92	20.12	9.00
PLOYMENT RATE S.A.	8.6	8.6	8.4	7.9
N.S.A.	8.4	8.0	8.0	8.2

DEPOSIT %	1978				1977
	AUG. 4	AUG.11	AUG.18	AUG.25	AUG.30
1 MO.	8 5/8	8 3/4	8 15/16	8 3/4	7 3/8
3 MO.	8 3/4	8 7/8	9 3/16	9 1/8	7 3/8
6 MO.	9 1/8	9 3/8	9 5/16	9 3/8	7 11/16
2 MO.	9 3/8	9 7/16	9 9/16	9 9/16	7 15/16

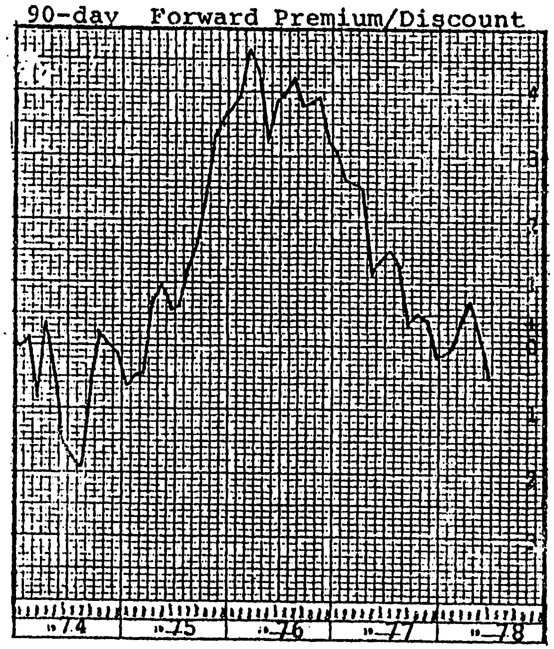
INTEREST (AUG. 30/78): 2,584 VOLUME (AUG. 30/78) :473
RACT SIZE : CD 100,000.00 (APPROX. U.S.$ 86,000.00)
MUM FLUCTUATION : .00010 ($10.00)
LIMIT (NORMAL) : .00750 ($750.00)
IN REQUIRED : US $2,500.00 COMMISSIONS : $60.00
ING HOURS : 8:45 AM - 1:10 PM (CHICAGO TIME)
VERY MONTHS : MARCH, JUNE, SEPTEMBER, DECEMBER

AR-OVER-YEAR % CHANGE

Canadian Dollar Futures



90-day Forward Premium/Discount



The year over year advance in the Consumer's Price Index stood in July at a new high of 9.83%, clearly the result of the ongoing devaluation & the excessive monetary creation. As we repeatedly pointed out in the past, Canada is likely to move into high double digit inflation by early 1979.

It is unlikely that the Central Bank will tighten up considerably in the coming weeks with the unemployment situation remaining at well over 8% and economic activity advancing at just a crawl. Evidence of the subdued pace of the private sector lies in the minimal 1 ½% real increase in General Bank Loans experienced in the twelve months to date.

Slightly more than one third of the government's net financing requirements is being financed by the liquidation of international reserves, to boot, mostly borrowed. It should be noted that this form of financing is preferable to Bank of Canada monetization, as it is not inflationary. The drawback is that : a) Canada's debt capacity has a limit in world markets & steps must be taken now to cut the forthcoming deficits & obviate further borrowings & b) interest & amortization payments are skyrocketing & placing a further burden on the balance of payments.

Remain short; it looks like a long way down. Place stops at 87.5 basis nearby.

Deutsche Mark

Spot : 50.52 Sep.'78: 50.59 Dec.'78: 51.34
Mar. 79: 52.07 Jun.'79: 52.65 Sep.'79: 52.65

	MAY 78	JUN. 78	JUL. 78	JUL. 77
BALANCE OF TRADE (MLN MARKS)				
JAN-JUL.'77: +20,120				
JAN-JUL.'78: +21,250	3,040	3,960	2,300	1,760
BALANCE OF PAYMENTS (MLN MARKS)				
CURRENT ACCT.				
JAN-JUL.'77: +3,370				
JAN-JUL.'78: +6,156	800	2,200	-1,700	-2,000
OVERALL ACCT.				
JAN-JUL.'77: -1,157				
JAN-JUL.'78: -5,818	-3,080	+ 614	+5,400	+1,970
MONEY SUPPLY ** , M3	10.25	10.60	N/A	9.90
W.P.I.**	-0.7	-1.1	UNCH.	-0.3
COST OF LIVING INDEX**	2.66	2.45	2.59	4.33
UNEMPLOYMENT RATE	4.0	3.9	4.1	4.3

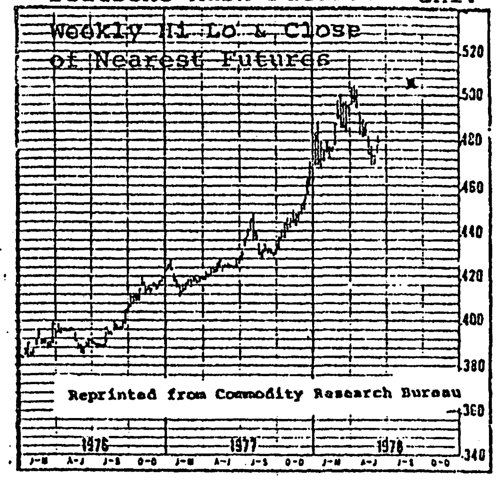
EURO DEPOSIT %	1978				1977
	AUG. 4	AUG.11	AUG.18	AUG.25	AUG.30
1 MO.	3 7/16	3 1/4	3 3/16	3 3/8	4.
3 MO.	3 9/16	3 5/16	3 7/16	3 9/16	4.
6 MO.	3 15/16	3 5/8	3 3/4	3 3/4	4.
12 MO.	4 1/4	3 15/16	4.	4.	4 1/16

WEEKLY RESERVES
NET MONETARY
(MLN MARKS) 88,400 90,300(15/8) 92,300(22/8) 86,500

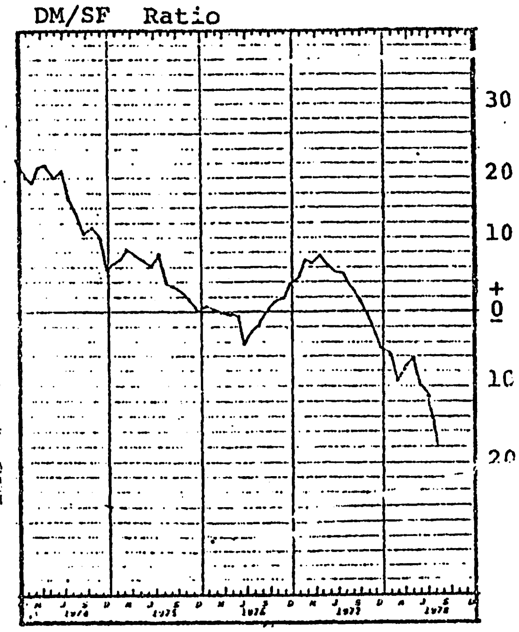
OPEN INTEREST (AUG. 30/78): 6,666 VOLUME (AUG. 30/78) :2,383
CONTRACT SIZE : DM 125,000.00 (APPROX. U.S.$63,000.00)
MINIMUM FLUCTUATION : .00010 ($12.50)
DAILY LIMIT (NORMAL) : .00600 ($750.00)
MARGIN REQUIRED : US $4,000.00 COMMISSIONS : $60.00
TRADING HOURS : 8:45 AM - 1:10 PM (CHICAGO TIME)
DELIVERY MONTHS : MARCH, JUNE, SEPTEMBER, DECEMBER

FEDERAL BALANCE (BLN MARKS)	JAN-JUN 1978	JAN-JUN 1977
FEDERAL FINANCING BALANCE	-18.6	-14.0
SPENDING	92.6	81.6
INCOME	74.0	67.6
YEAR-OVER-YEAR % CHANGE		

Deutsche Mark Futures - Chi.



DM/SF Ratio



Swiss Franc

Spot: 61.69
Sept. 78: 62.35
Dec. 78 : 63.68

Mar. 79: 65.25

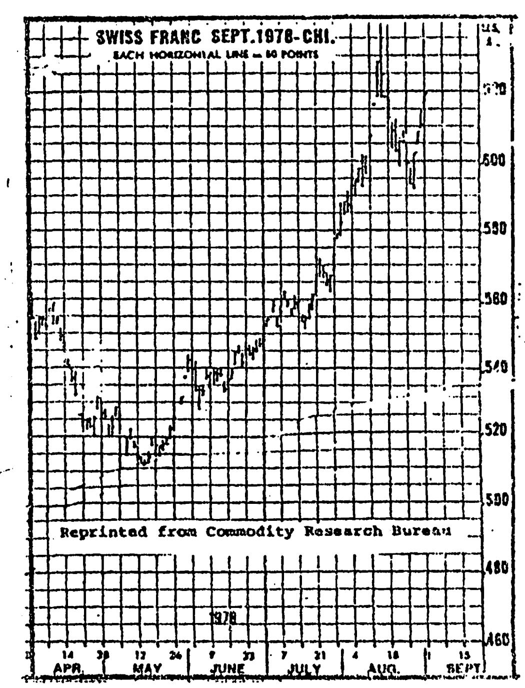
	MAY 78	JUN. 78	JUL. 78	JUL. 77
BALANCE OF TRADE (MLN SFR)				
JAN-JUL.'77: - 901..				
JAN-JUL.'78: -854..	- 101	- 110	- 38	+5.4
MONEY SUPPLY **	17.57	.....	.....	...
W.P.I.**	-3.68	-3.56	-3.64	0
UNEMPLOYMENT RATE	0.3	0.4	0.3	0.3

EURO DEPOSIT %	1978				1977
	AUG. 4	AUG.11	AUG.18	AUG.25	AUG.30
1 MO.	N/A	3/8	3/8	7/16	2 3/16
3 MO.	..	3/4	5/8	7/8	2 5/16
6 MO.	..	1 1/8	1.	1 1/4	2 15/16
12 MO.	..	1 1/4	1 1/16	1 3/8	3 3/16

WEEKLY RESERVES
(MLN SFR) 18,500 20,590 20,300 20,930 12,940

OPEN INTEREST (AUG. 30/78): 4,022 VOLUME (AUG. 30/78) :1,529
CONTRACT SIZE : SF 125,000.00 (APPROX. U.S.$78,000.00)
MINIMUM FLUCTUATION : .00010 ($12.50)
DAILY LIMIT (NORMAL) : .00600 ($750.00)
MARGIN REQUIRED : US $4,000.00 COMMISSIONS : $60.00
TRADING HOURS : 8:45 AM - 1:10 PM (CHICAGO TIME)
DELIVERY MONTHS : MARCH, JUNE, SEPTEMBER, ~~DECEMBER~~

** YEAR-OVER-YEAR % CHANGE



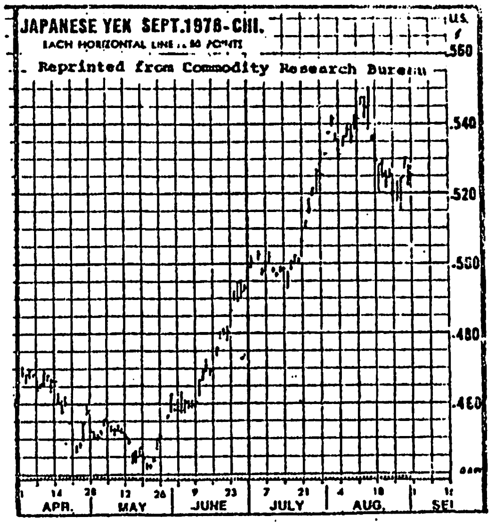
Japanese Yen

Spot: 52.65 Sep.'78: 52.84 Dec. '78: 53.73

	MAY 78	JUN. 78	JUL. 78	JUL. 77
BALANCE OF TRADE (MLN U.S.$) JAN-JUL.'77: +6,693. JAN-JUL.'78: +15,080	1,370	2,950	2,700	2,050
BALANCE OF PAYMENTS (MLN U.S.$) JAN-JUL.'77: +2,927 JAN-JUL.'78: +6,495	-113	+576	+853	+937
MONEY SUPPLY ** M1	+11.4	+11.3	N/A	6.2
RESERVES (MLN U.S.$)	27,710	27,331	29,370	17,439
C.P.I. **	3.5	3.5	4.15	7.35
W.P.I. **	-2.09	-2.23	-2.65	1.08
UNEMPLOYMENT RATE	2.3	2.4	2.34	2.13

OPEN INTEREST (AUG. 30): 3,995 VOLUME (AUG. 30): 2,135
CONTRACT SIZE : YEN 12,500,000.00 (APPROX.US$66,000.00)
MINIMUM FLUCTUATION : .0000010($12.50)
DAILY LIMIT (NORMAL) : .000060($750.00)
MARGIN REQUIRED : US $4,000.00 COMMISSIONS : $60.00
TRADING HOURS : 8:45 AM - 1:10 PM (CHICAGO TIME)
DELIVERY MONTHS : MARCH, JUNE, SEPTEMBER, DECEMBER

** YEAR-OVER-YEAR % CHANGE



JY/DM/SF : Very bullish

The accompanying figures of U.S. imports & exports paint a near hopeless picture. In all categories, except for Crude Inedible Materials Except Fuels, the U.S. has suffered either a massive deterioration or reversal. Aside from the well-publicized erosion in the Mineral Fuels & Lubricants sector of $15.4 billion, almost similar deterioration is noted in Manufactured Goods and Machinery & Transport Equipment.

	Food, live animals	Beverages, tobacco	Crude inedible materials, except fuels	Mineral fuels lubricants	Oils, fats (animal, vegetable)	Chemicals and related prod.	Mfg. goods classified by material	Machinery, transport equip.	Misc. mfg. articles	Not classified elsewhere	Total
Imports 1/											
1975	8.5	1.4	5.6	26.5	0.6	3.7	14.7	23.5	9.2	2.5	96.1
1976	10.3	1.6	7.0	34.0	0.5	4.8	17.6	29.8	12.6	2.5	120.7
1977	12.5	1.7	7.9	44.3	0.5	5.4	21.4	35.5	14.9	2.7	146.8
1978	13.5	2.2	8.9	40.6	0.5	6.3	27.4	45.5	18.1	4.0	165.5
Exports 2/											
1975	15.5	1.3	9.8	4.5	0.9	8.7	10.9	45.7	5.7	3.2	107.1
1976	15.7	1.5	10.9	4.2	1.0	10.0	11.2	49.5	6.6	2.7	114.8
1977	14.1	1.8	12.8	4.2	1.3	10.8	11.3	51.0	7.3	3.2	120.1
1978	17.9	2.0	14.6	3.2	1.4	11.4	11.6	54.4	9.5	4.5	132.7
Trade Balance											
1975	7.0	-0.1	4.2	-22.0	0.4	5.0	-3.8	22.2	-3.6	0.6	11.0
1976	5.4	-0.1	3.9	-29.8	0.5	5.2	-6.4	19.7	-6.0	0.2	-5.9
1977	1.6	0.2	4.9	-40.1	0.8	5.4	-10.2	15.5	-7.5	0.5	-26.7
1978	4.4	-0.1	5.7	-37.5	0.9	5.1	-15.9	8.9	-8.7	0.5	-32.7
Change in Trade Balance											
1975-1978	-2.6	—	1.4	-15.4	0.5	-0.1	-12.1	-13.3	-5.1	-0.1	-43.8
1977-1978	2.8	-0.3	0.8	2.7	0.1	-0.3	- 5.7	- 6.6	-1.1	0.0	- 6.0

Source: Bureau of the Census

1/ Imports are Census basis, f.a.s., Schedule A categories.
2/ Exports are Census basis, f.a.s., Schedule B categories for 1975-1977 and Schedule E categories for 1978.

Clearly, the U.S. has suffered an enormous deterioration in its int'l competitiveness. It will require momentous exchange adjustments accompanied by extremely tight money policies to reverse this trend. The former option is slow, particularly in view of the well-known J curve effect & the offsetting domestic inflation. The latter option will

a) cause private capital to flow back to the U.S. & thus balance the negative trade effect,
b) block the devaluation from flowing right into the domestic price structure & thus lose the competitive advantages gained to date &
c) move the U.S. into a slower expansion vis a vis Europe (or even a recession), thus alleviating the excessive rate of imports.

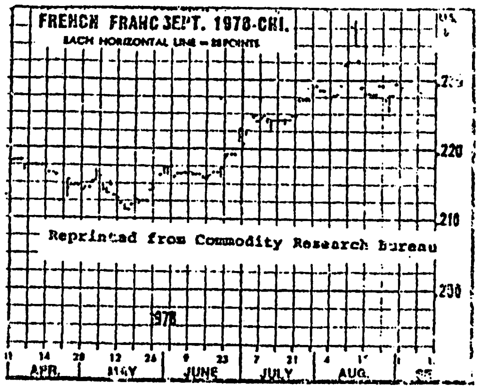
The key to the ongoing devaluation is tight monetary policy. Without it, it will become almost impossible for the U.S. to reverse the damage.

Present statistics indicate that the Bank of Japan, the Bundesbank & the Swiss National Bank have stopped intervening, at least in a massive way. A fairly clean float with just occasional burst of 'scare speeches' would imply higher levels for the strong currencies.

French Franc

Spot : 23.00 SEP.'78: 23.00 DEC.'78: 23.30

	MAY 78	JUN. 78	JUL. 78	JUL. 77
BALANCE OF TRADE (MLN FFR)				
JAN-JUL. '77: -9,081				
JAN-JULY '78: +1,615	+155	+459	+905	-797
INT'L RESERVES(MLN US)	11.215	11.583	N/A	9.948
NET CHANGE OF FOREIGN EXCHANGE ASSETS **	19.34	12.62	17.89	18.8
RETAIL PRICE INDEX**	9.0	8.99	9.34	10.1



Reprinted from Commodity Research Bureau

EURO DEPOSIT %	1978				1977
	AUG. 4	AUG.11	AUG.18	AUG.25	AUG.25
1 MO.	8 7/8	8 1/2	8 7/8	8 1/8	9 1/2
3 MO.	9 1/2	8 7/8	8 1/2	8 7/8	10 1/4
6 MO.	10 3/4	9 5/8	10 3/4	9 3/8	11.
12 MO.	10 3/8	10 3/16	10 1/2	10.	12 1/8

WEEKLY RESERVES GOLD & CONV. CURRENCY (MLN FFR)	115,060	115,183	115,203	115,192	94,024

OPEN INTEREST (AUG. 30/78): 131 VOLUME (AUG. 30/78) :NIL
CONTRACT SIZE : FR 250,000.00 (APPROX. U.S.$57,500.00)
MINIMUM FLUCTUATION : .00005 ($12.50)
DAILY LIMIT (NORMAL) : .0050 ($1,250.00)
MARGIN REQUIRED : US $5,000.00 COMMISSIONS : $60.00
TRADING HOURS : 8:45 AM - 1:10 PM (CHICAGO TIME)
DELIVERY MONTHS : MARCH, JUNE, SEPTEMBER, DECEMBER

** YEAR-OVER-YEAR % CHANGE

The figures showing France's turnaround in its int'l trade are nothing short of sensational. No doubt they are heavily resp... for the Franc's scintillating performance in the forei... exchange markets.

Remain long.

Mexican Peso

Spot: 43.75 Sep.'78: 43.65 Dec.'78: 42.69
Mar.'79: 41.45 Jun.'79: 40.45 Sep.'79: 39.39
Dec.'79: 38.75

	APR. 78	MAY 78	MAY 77
BALANCE OF TRADE (MLN $)	-120.4	-91.78	-75.50
JAN-MAY 1977: -169.4			
JAN-MAY 1978: -397.20			

Forward Discount -
Compounded Annual Rates

	Dec. 78	Mar. 79	Jun. 79	Sep. 79	Dec. 79
Spot	10.31	11.41	11.02	9.52	10.20
Dec. 78		12.51	11.38	11.32	10.17
Mar. 79			10.26	10.73	9.4
Jun. 79				11.21	8.97
Sep. 79					6.77

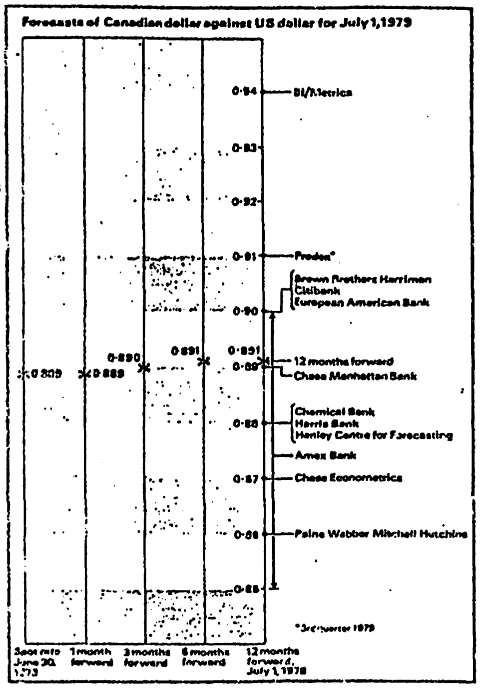
In a 3½-hour annual report to the nation, President Lopez Portillo announced that: a) Mexico's proven oil & gas reserves currently stand at 20 billion barrels, an increase of 4 billion barrels from last March, while probable and possible reserves stood at 37 and 200 billion barrels respectively; b) Mexico's primary foreign exchange reserves totaled the equivalent of $2.71 billion, an increase of $837 million from the end of 1977 & c) his current concern is to cope with Mexico's most important & serious problem : the social problem.

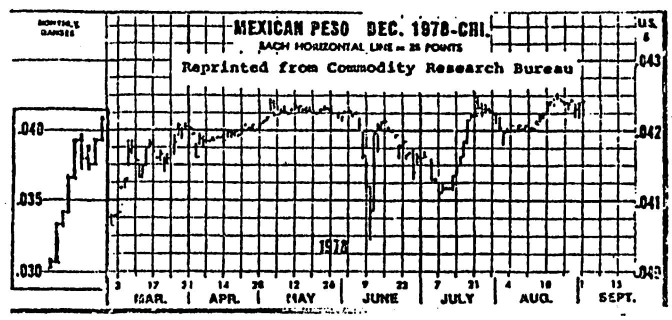
Mexico's high rate of inflation is slowly undermining its international competitiveness with the resultant detrimental effect on its trade balance (see figures). Most observers figure that the Peso is already overvalued by between 5-10%. High oil & gas reserves are not a totally useful asset in the hands of the highly inefficient state-owned petrochemical company PEMEX. At any rate, at present prices for oil (in real terms), PEMEX will be hard put just to cover ...

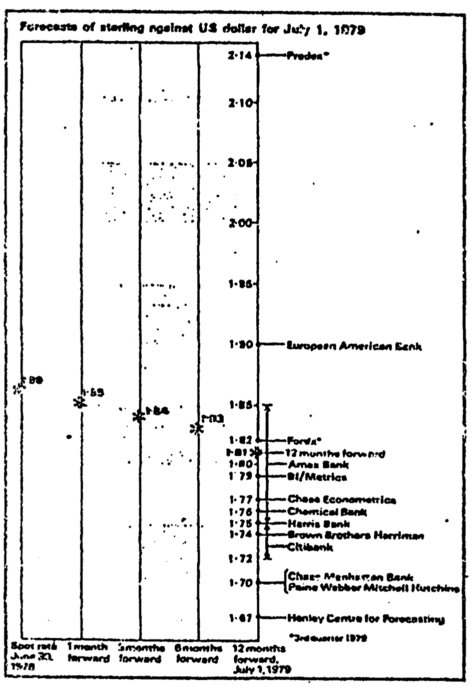
MP...

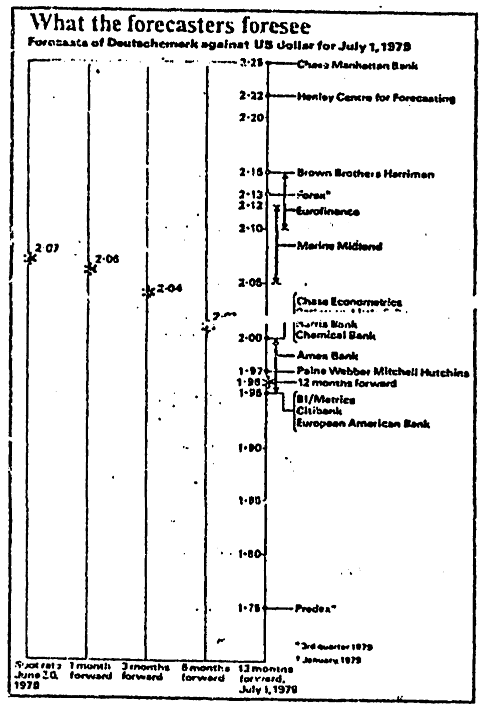
Finally, the large jump in int'l reserves must be viewed in the light of the 7.3 % increase in the public sector's public debt, to 24.5 billion - from 22.83 billion, or roughly $1.67 billion. The $837 mln increase in reserves translates into a an increase in borrowed reserves and implies a loss of $840 million. It should be noted that Mexico's public debt is mostly composed of roll-over Euro-credits with floating rates above LIBOR and that in this days of rising interest rates, each percentage point increase represents an additional $250 million drain of external assets.

Remain heavily short, particularly the deferred months.









Source: Euromoney August 1978

Will the Majority consensus be wrong again ?

INTEREST RATE FUTURES

	Sep.'78	Dec.'78	Mar.'79	Jun.'79	Sep.'79	Dec.'79	Mar.'80
GNMA's	92.28	92.13	91.31	91.21	91.14	91.09	91.03
U.S. TB	92.45	92.34	92.19	92.09	92.03	91.92	91.78
U.S. T. Bonds	95.30	95.23	95.15	95.05	95.0	94.28	94.21

Very bearish

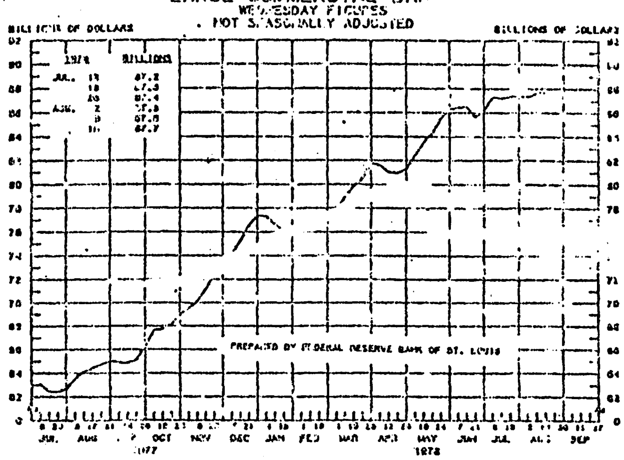
The structure of the yield curve indicates that we are approaching the more dynamic phase of the bear market.

Continue to add to present short positions and be patient. We expect Sept. '79 GNMA's to trade down to the 78-80 area for a potential profit of $11,000 - $13,000 per contract. Stops should be placed at 92.04, on close only. By the same token, we expect Sept.'79 TB to trade down to 88-87.50 for a potential gain of $10,000 - $11,000 per contract. Sotps should be placed at 92.12,on close only.

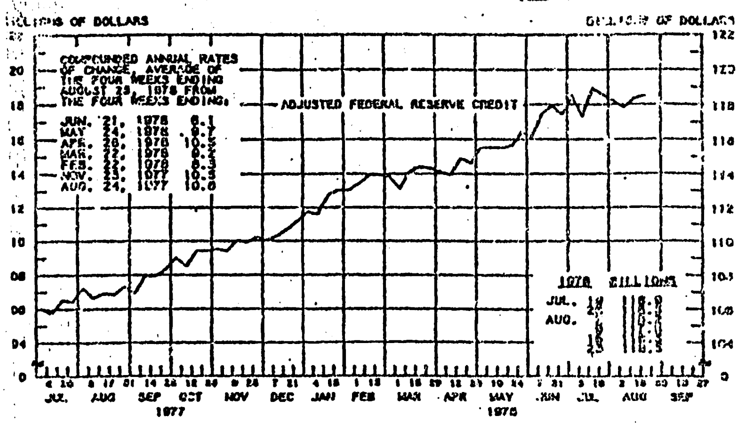
AS OF AUG. 31ST,1978

DELIVERY MONTH	TB	YIELD	GNMA	YIELD
SEP. 78	92.58	7.42	92 25/32	8.987
DEC. 78	92.34	7.66	92 07/32	9.072
MAR. 79	92.12	7.88	91 25/32	9.139
JUN. 79	91.93	8.07	91 14/32	9.191
SEP. 79	91.76	8.24	91 06/32	9.230
DEC. 79	91.56	8.44	91 02/32	9.249
MAR. 80	91.36	8.64	90 26/32	9.288
JUN. 80	91.19	8.81	90 21/32	9.312
SEP. 80			90 16/32	9.336
DEC. 80			90 11/32	9.360
MAR. 81			90 10/32	9.365

CERTIFICATES OF DEPOSIT
LARGE COMMERCIAL BANKS
WEDNESDAY FIGURES
NOT SEASONALLY ADJUSTED



MULTIPLIER
ADJUSTED FEDERAL RESERVE CREDIT
AVERAGES OF DAILY FIGURES
SEASONALLY ADJUSTED

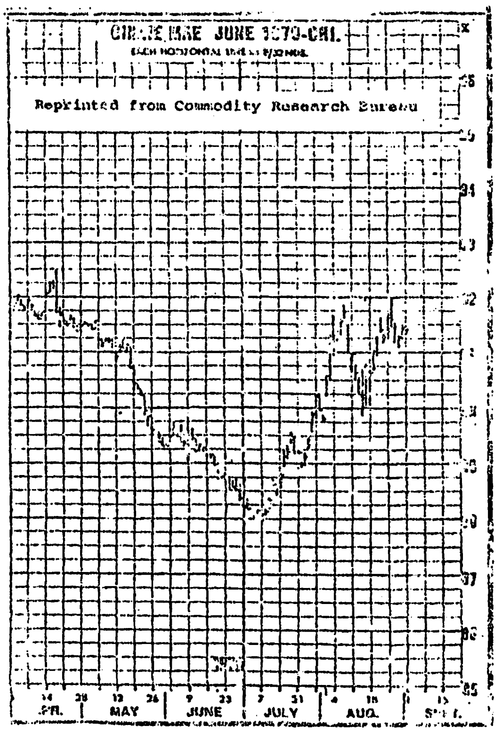


RECENT CHANGES IN SELECTED INTEREST RATES

Type of Security	Average Rate for August 14-18, 1978	Average Rate for August 21-23, 1978	Difference in Percentage Points
90 Day CD's	7.99 %	8.20 %	0.21
Prime Commercial Paper 4-6 Month	7.86	7.95	0.09
Federal funds	7.96	8.29	0.33
3-Month Treasury Bill	7.12	7.25	0.13
1-Year Treasury Bill	7.78	7.81	0.03
3-5 Year Treasury Securities	8.34	8.34	0.00
Long-Term Treasury Securities	8.44	8.37	-0.07
Corporate Aaa Bonds	8.70	8.72*	0.02

* Based upon rates for August 21-22.

PREPARED BY FEDERAL RESERVE BANK OF ST. LOUIS



GOLD : $250/oz by Dec. 1978, $300/oz by April 1979 ?

Increased bullion offerings by the U.S. Treasury will just add more fuel to the bullish fire. As we once commented, bull markets thrive and prosper on increased supplies. At the present rate, the U.S. will be out of gold in just 30 years. As this supply is exhausted (around the year 2008), watch out, the bottom may fall ...

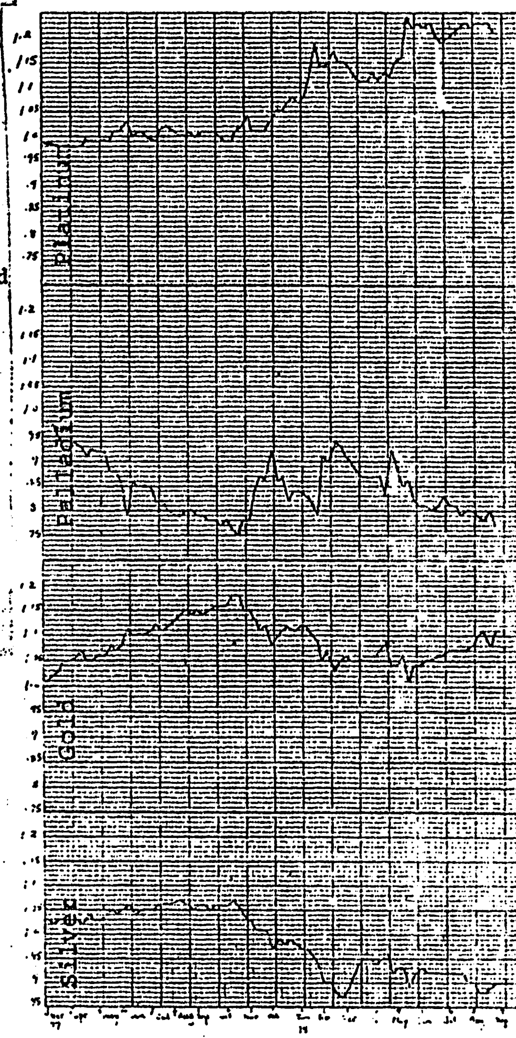
Below is a Citibank projection which, while useful, may be a bit too conservative, particularly in view of its elasticity function - in foreign currencies there has been no real rise in price.

For every 3% increase in price, the demand for gold generally shrinks by 1%, according to econometric estimates. This suggests that the average gold price may rise about 21% above the $148 level, in order to equate supply and demand for all 1978—and about 38% to do so in 1979. Now, we add on an expected dollar inflation averaging at least 7.5% for the two years. Result: The average price of gold for all 1978 is projected at $190-195, and for 1979 at $230-240. Since the London price averaged $180 through last July, our projection implies an average of $205-215 for the rest of 1978.

	1977 actual	1978 projected	1979 projected
	(all figures in metric tons)		
Free-world production	965	965	975
Soviet sales	401	345	350
Central-bank sales (including IMF)	241	320	315
TOTAL SUPPLY	1607	1630	1640
Industrial usage	1201	1280	1365
Private usage	406	470	510
TOTAL DEMAND	1607	1750	1875
AVERAGE GOLD PRICE	$148	$190-195	$230-240

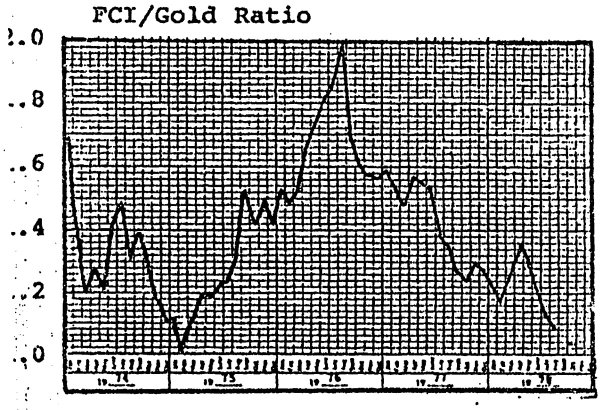
Aug. 28/78 • CITIBANK •

Relative Strength - Precious Metals



Remain firmly long.

FCI/Gold Ratio



The Commodity Price Index in terms of good money viz. Gold, is it indicating a potential deflation ?

F.C.I.	Aug. 78	Jul. 78	Aug. 77
Unch. from Month ago	226	226	199

+13.57 from year ago

*** *** *** *** *** *** *** *** *** *** *** *** *** *** *** *** *** *** ***

Albert D. Friedberg