

# FRIEDBERG'S

## COMMODITY & CURRENCY COMMENTS

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ACHILLES' HEEL

MARCH 26TH 1980

Red lights are once again flashing onto the world's economic scene. On the one hand, liquidity is evaporating. On the other, protectionism is on the rise threatening world trade and, consequently, living standards. The unfolding boom-bust drama is purely man made as it is the result of an uncontrolled process of credit creation.

Let us start with liquidity. Commercial banks in the U.S. are 'loaned up' to the tune of 86.5%, the highest ratio in history and a full 7 percentage points higher than the 1974 peak (see chart). Worse yet, the presumed liquidity cushion, bills, notes and bonds which amount to approximately \$290 billion, is for all practical purposes frozen. The reason is simply horrendous capital losses. A look at the accompanying table tells a frightening story:

Loan/Deposit Ratio

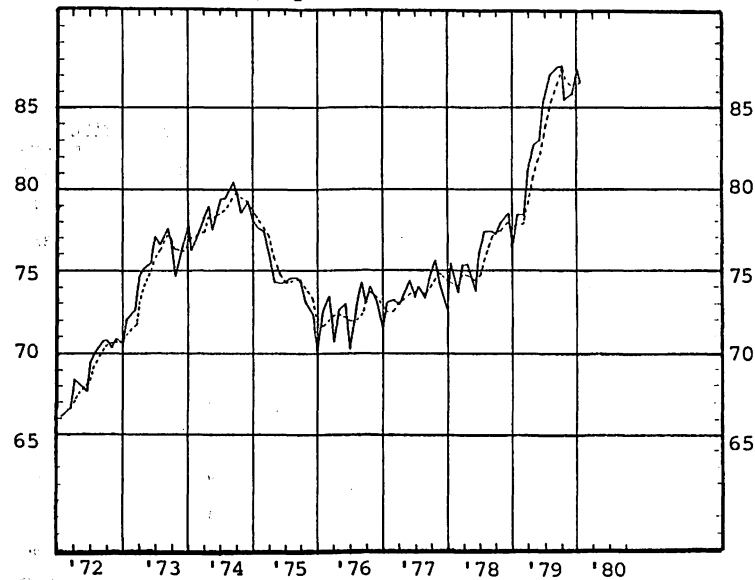


Table I

	Shareholders' Equity	Investment Securities Carry Value	Securities Market Value	Est. Market Value* (End of Mar)	Losses as a % of Shareholders' Equity	Present Market Capitalization	Discount from Book Value
CitiCorp.	3,597,988	4,815,811	4,668,700	4,201,830	17.06%	2,152,000	40.19%
Chase Corp.	2,026,533	4,058,000	3,685,000	3,316,500	36.59%	1,156,000	42.96%
Morgan	1,949,253	3,405,218	3,212,975	2,891,677	26.35%	1,544,000	20.79%
Manuf.	1,554,952	2,552,763	2,458,458	2,212,612	21.88%	908,000	41.61%
Bankers Tr.	778,600	1,804,636	1,667,029	1,500,326	39.08%	413,000	46.96%

\* Assuming 10% overall drop in prices since Dec. 31, 1979.

We have assumed that the banks' securities portfolio dropped in price by approximately 10% since the end of last year. This assumption may be realistic in view of the drop in long Treasuries of about 20%, the relative stability of bills and short term notes and our lack of information regarding the portfolio mix. It is noteworthy that the market, in all cases, has been able to adjust for these hidden losses by capitalizing bank stocks at a substantial discount from book value.

But the horror show does not stop there. Banks' loan portfolios are brimming with claims on countries that can hardly be called solvent Table II depicts the growing banking involvement in doubtful loans for the mere sake of earning an average of less than 1% (see Table III).

Table II

Total Bank Claims on Non-Oil Developing Countries and Eastern Europe  
(billions of dollars)

	December 1974 <sup>e</sup>	December 1975	December 1976	December 1977 <sup>1/</sup>	December 1978 <sup>2/</sup>	September 1979
<u>Claims on Non-Oil Developing Countries</u>						
U.S. Banks	23.8	33.4	41.7	47.7	49.4	55.4
Non-U.S. Banks	20.0	29.6	39.2	51.1	72.3	91.8
Subtotal	43.8	63.0	80.9	98.8	121.7	147.2
<u>Claims on E. European Countries</u>						
U.S. Banks	3.0	3.7	5.2	6.5	6.9	7.3
Non-U.S. Banks	11.9	19.7	25.8	35.6	46.2	52.3
Subtotal	14.9	23.4	31.0	42.1	53.1	59.6
<u>Total Claims</u>						
U.S. Banks	26.8	37.1	46.9	54.2	56.3	62.7
Non-U.S. Banks	31.9	49.3	65.0	86.7	118.5	144.1
Total	58.7	86.4	111.9	140.9	174.8	206.8

Sources: BIS Quarterly data on banks claims and Federal Reserve and Treasury Banking data.

1/ Beginning December 1977, banks in Austria, Denmark, and Ireland began reporting to BIS.

2/ Beginning December 1978, excludes customers claims of domestic offices of U.S. banks.

e Partly estimated.

Table III

Spreads and Maturities on Syndicated Bank Loans to Non-Oil Developing Countries and Eastern Europe

Date	Average Spread <sup>1/</sup>		Average Maturity <sup>2/</sup>	
	Non-oil Developing	Eastern Europe	Non-oil Developing	Eastern Europe
1973: Q <sub>4</sub>	1.17	.59	10.8	8.8
1974: Q <sub>4</sub>	1.46	3/	7.5	3/
1975: Q <sub>4</sub>	1.82	1.49	5.4	5.5
1976: Q <sub>4</sub>	1.90	1.33	5.1	5.5
1977: Q <sub>4</sub>	1.76	1.16	7.3	6.0
1978: Q <sub>4</sub>	1.04	.75	9.8	6.7
1979: Q <sub>1</sub>	.94	.89	9.9	7.3
Q <sub>2</sub>	.79	.78	9.0	6.8
Q <sub>3</sub>	.80	.78	10.1	7.2
Q <sub>4</sub> P	.91	.63	8.4	8.8

1/ Unweighted data on spreads in basis points on syndicated bank loans to nine developing and four Eastern European Countries.

2/ Average maturity from date of credit agreement to date of final repayment.

3/ No credits granted.

Source: International Bank for Reconstruction and Development.

It is noteworthy that this mad game is being played more aggressively by non-U.S. than by U.S. banks. Perhaps US banks, in absolute terms, started out with a larger commitment (at least on an individual basis). Perhaps US banks were busier with domestic business, where C & I loans grew at an astonishing 19% last year. Perhaps they were just a bit wiser ....

But the folly of these staid and conservative members of the financial community can only be appreciated in perspective. Table IV shows th U.S. banks' loan exposure to selected developing nations relative to capital.

Table IV

Country	Exposure Relative to Capital for Groups of U.S. Banks <sup>1/</sup> (Per Cent)			
	Dec. 1977		Jun. 1979	
	All U.S. <sup>2/</sup> Banks	Nine Largest Banks	All U.S. <sup>2/</sup> Banks	Nine Largest Banks
	(1)	(2)	(3)	(4)
<u>Non-oil Developing</u>	<u>115</u>	<u>156</u>	<u>112</u>	<u>161</u>
Brazil	30	40	28	39
Mexico	28	32	21	27
Philippines	5	7	6	10
<u>Eastern Europe</u>	<u>18</u>	<u>25</u>	<u>15</u>	<u>21</u>
<u>Combined Total</u>	<u>133</u>	<u>181</u>	<u>117</u>	<u>182</u>

1/ Exposure after reallocating claims from country of obligor to country of guarantor.

Capital defined as equity subordinated debt, and loan-loss reserves.

2/ All 128 U.S. banks completing the Country Exposure Report.

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Since we have shown that the figure for capital, defined as equity, subordinated debt and loan-loss reserves, is overvalued, it follows that loan exposure relative to capital has increased rather than decreased, a particular ominous development in front of a looming liquidity crisis.

But, one may ask, isn't Mexico a good credit risk? Have they not raised their estimates of proven petroleum reserves 69% from the 6.4 billion barrels reported by Pemex in November 1976, to a formidable 50 billion barrels? Let us examine the facts.

Mexico's crude oil, products and gas exports have increased approximately tenfold over the past 5 years. Nonetheless, the current account has reverted to a (growing) deficit and Mexico's international indebtedness has grown by leaps and bounds. Table V tells the story.

Table V

## Mexico : a financial profile

(In bln of US\$)	1975	1976	1977	1978	1979	1980 (e)	% increase 1980/1975
Total Oil and Gas Exports	.460	.544	1.02	1.8	4.1	10.	2,170 %
Merchandise Imports	5.1	5.0	4.5	6.2	8.6e	10.5	205 %
Current Account	-4.18	-3.66	-2.02	-3.07	-3.8		
Gov't & Gov't Ent. Foreign Financing	.658	.90	2.88	1.472			
Money Supply	13.1	12.2	13.3	16.5			
Foreign Financing/ Money Supply	5.0%	7.4%	21.8%	8.9%			
Debt Service*	1.0 e	1.5 e	2.0 e	5.0 e	6.0 e	7.5 e	750 %
Gov't Expenditure	32.0	34.4	32.7	35.5	57.4	74.0	231 %
Inflation - Mexico. Yr. over yr	15.74	15.1	29.0	17.5	19.7	30	
U.S. increase	9.17	5.8	6.5	7.54	11.3	18	
Relative Overvaluation	-	8.7	32.2	43.9	54.9	70.5	

e Estimated

\* of External funded debt of public sector.

Mexico is rapidly approaching its own borrowing limit, despite a dramatic increase in oil and gas earnings. There are a few further negatives to consider: 1) it is unlikely that the US banking system, in the present retrenchment mood, will increase its own exposure relative to capital; 2) Mexico's capacity to extract oil and gas may have been reached as evidenced by heavy order backlogs, port congestions and refining bottlenecks; 3) Mexico's own domestic consumption has grown spectacularly and is likely to affect the exportable surplus - all a result of unrealistic domestic pricing and nationalistic feelings; 4) Mexico's well-known inefficiency (witness the Campeche blow-out and the loss of three million barrels) and corruption make it unlikely that further substantial gains will be achieved; finally 5) the incipient worldwide oil glut may make it difficult for Mexico to increase export penetration without substantial price concessions. As an example of reverse leverage, @ \$1.30/barrel discount represents a massive \$1 billion loss in earnings.

The self-labelled conservative and business oriented stewardship of Lopez Portillo has increased Government expenditures by over 230% in four years, reneged on a production ceiling of 2.25 million barrels per day (the recent reappraisal does not owe little to balance of payments considerations) and has withdrawn from signing the General Agreement on Tariffs and Trade, a move that will eventually boomerang against its weak and inefficient industry.

Should the upcoming world contraction pick up momentum and develop into a full fledged recession à la 1974/1975, Mexico may be forced to 'reschedule' its debt. Furthermore, a massive flight of capital may precede and follow the inevitable devaluation (see Table V, relative overvaluation), bring into the open latent social tensions and, perhaps, follow the revolutionary path of its Central American neighbors: Nicaragua, El Salvador and Cuba. In that case any debt rescheduling will turn into a write-off.

The Brazilian case was foretold in the Commodity & Currency Comments as far back as August 1977. At the time we stated: "The bankruptcy of a substantial client may be all we need to close the 'liquidity trap' at which time we will have reached the point of 'no return'. Could Brazil be the one? Consider the following: the current account deficit for 1974 amounted to \$4.5 billion. It was reduced to \$2.0 billion by end of 1976 and began to show a surplus, albeit a small one (\$200 million) by mid-1977, thanks mostly to Coffee, Cocoa and Soybeans. Since June, however, Brazil has not sold any Coffee even though it reportedly still has nearly 4 million bags available for export. That represents \$1 billion (at current prices) less than it had originally anticipated when it forecast a \$1 billion trade surplus for 1977. It may even represent \$1.2 billion less by the time the unwanted merchandise is dumped. Furthermore, a ridiculous 12% surtax on soybean exports and natural greed militated to book just 700,00 tons of soybean out of an available 1.8 million tons of exportable surplus in spite of the fact that nearly all the surplus is normally registered by the middle of July. At current prices, the loss from forecast values exceeds \$200 million, without counting soybean products that remain to be sold. The same may be said for Sugar and, perhaps, Cocoa. In all. Brazil, the jewel of non-oil exporting LDC's, may suffer another current account deficit of perhaps as much as \$500-800 million. This comes atop a need to repay interest and amortization of nearly \$6 billion this year on the staggering foreign debt of \$25 billion. Another point is that a large part of the debt will become due over the next 2 years, putting heavy pressure on the country's meager \$6.5 billion reserves. Will Citicorp et al refinance their loans? What will it do to the commercial banking system's liquidity preference?"

Since late 1977, Brazil has managed to keep afloat by borrowing a staggering amount of money as can be seen from Table VI. In an environment of easy money, Brazil did not deem it necessary to restrict its appetite to a digestible level and used the oil deficit as its excuse for not taking remedial action. Like Mexico, Brazil's economy typifies the failures of a Statist Economy - market oriented at the micro-economic level but rigidly controlled by huge and corrupt State-owned enterprises. Subsidies, foreign trade and capital controls and grandiose projects blurred the vision of millions of its aggressive entrepreneurs. Massive increases in money supply supported an illusory wealth condition.

A grim speculation puts the cost of recent interest rate increases of Brazil foreign debt (more than half is floating) at no less than \$1.5 billion. Moreover, its term of trade have deteriorated considerably: agricultural prices have softened of late (particularly Soybean, Cocoa and Coffee) while prices for oil and other industrial imports have risen. Given the soaring debt servicing ratio, we should expect some debt re-scheduling not later than the end of this year.

Table VI

## Brazil : A financial profile.

	1975	1976	1977	1978	1979*	1980(e)
Exports (Bln of \$)	8.5	10.0	11.9	12.5	13.6	14.5
Imports	12.0	12.3	12.0	13.6	15.0	18.0
Current Account	-7.0	-6.6	-5.1	-7.1	-8.9	-10
Foreign Debt	21	26	31	42	50	62
Foreign Debt (net of Reserves)	17.0	19.5	23.8	30.1	40.8	53
Debt Service Ratio	41%	48%	51%	62%	70%	
Money Supply Increase	40%	37%	44%	50%	33%	
Inflation	29%	42%	44%	39%	53%	80
Depreciation of Cruzeiro	18%	27%	23%	23%	51%	
Total Gov't Spending (Bln US\$)	10.5	13.4	15.1	16.5	11.9	

\* Annualized.  
e Estimated

Sources : International Financial Statistics  
Bank of Brazil

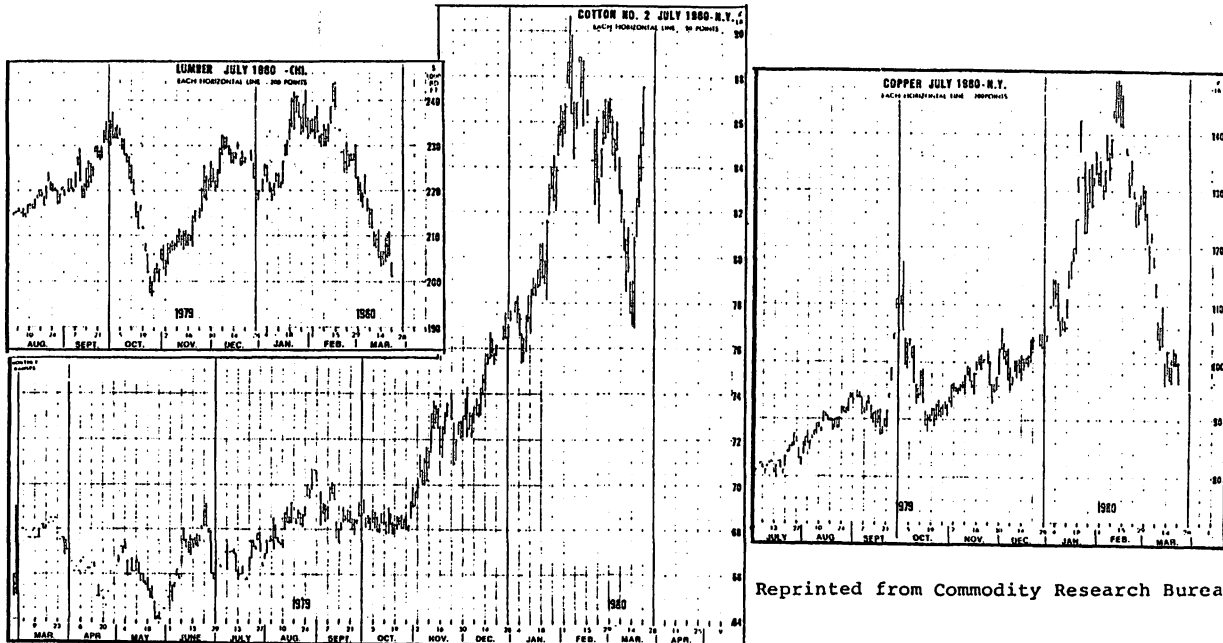
The list could be expanded. Poland's debt servicing requirements for 1979 have exceeded \$5.5 billion, as much as 74% of its export target of \$7.8 billion. Debt rescheduling has already begun. And so on.

The ugly face of protectionism is surfacing again. Steel, automobiles, petroleum based chemicals, among the industrialized nations; meat, wool, fruits, textiles against the less developed ones; grains instead of force are being used as hostages against enemies but the whole process is being circumvented by an aggrieved ally. If Mexico is any indication, withdrawals from the fragile GATT may be the prelude for a generalized beggar-thy-neighbor malaise that will, undoubtedly, have catastrophic repercussions on world trade and living standards.

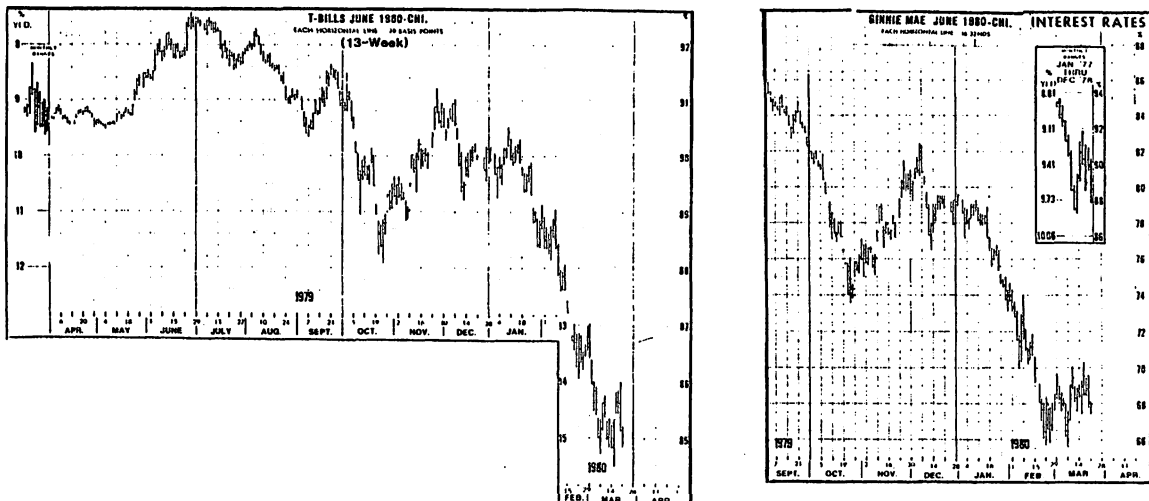
**SCENARIO** - The liquidity crunch underway grows progressively more serious until one or more events such as a major corporate bankruptcy or country default causes it to snap. Central Banks, in their function of Lenders of Last Resort, come to the rescue and pump enormous doses of funds to stave off a generalized panic. Calm returns but a recessionary tendency makes itself felt. Hopefully, protectionism does not get a firm enough foothold and the recovery can begin sometime in 1983.

**STRATEGY** - Interest rates are still headed higher. Short Treasury Bonds and Treasury Bills positions should be covered, however, on news of a major default or an explicit Fed Reserve statement signalling a change to ease or a wage/price freeze.

Almost all commodities are headed lower; remain short copper and lumber as suggested last months but cover short positions in cotton, the exception to the rule. For precious metals see next section.



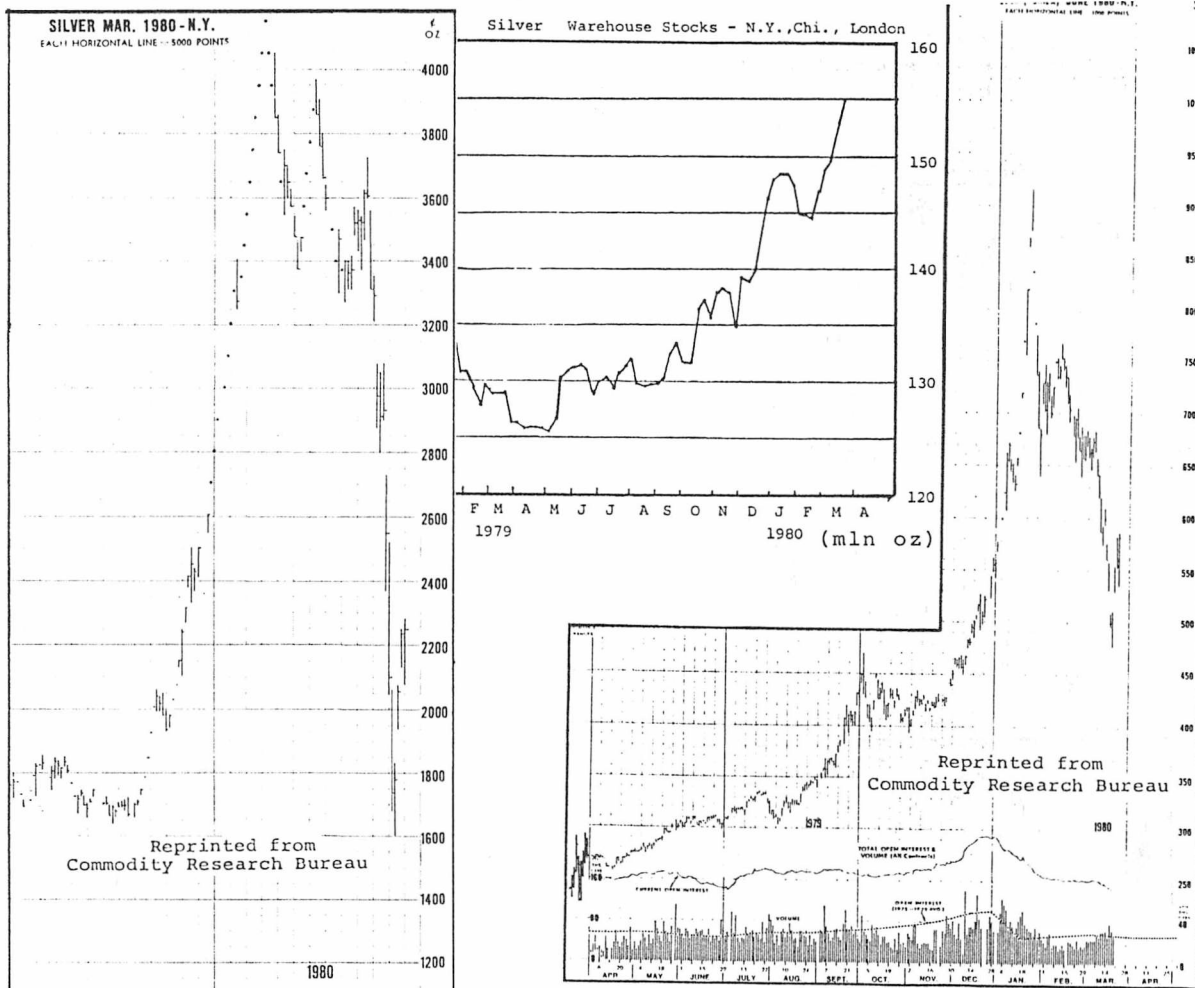
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PRECIOUS METALS

We are proud to have made the Fitch book of records: Platinum was recommended at the all-time high price level of \$1000-1085 /oz. No matter; the \$150/oz stop and the caveats of 'thinness' and extremely 'poor liquidity' should have kept our readers' losses to manageable proportions. On the other hand, our oft repeated advice on Silver short positions was a real winner. From a weekly downside reversal recorded in late January at \$34/oz, Silver slumped to today's six months' low of \$15.80/oz, a stunning drop of \$36/oz or 70% from the all-time high: In January we stated: " Irrespective of the buying power propelling silver prices into the stratosphere, there is simply not enough money in the world to sustain prices at anywhere near present levels for many more months. The numbers are staggering: a decrease in demand and/or increase in supplies of 200 million ounces yearly requires no less than \$7 billion of investment demand, atop \$7 billion in minimum, irreplaceable consumption... We can confidently predict that the world will not run out of silver, furthermore, Silver prices, in real terms, will begin to drop very soon and as such, will provide a painfully negative return to those who persist in ' buying at any price'. " We then proceeded to outline a short selling strategy.

On Feb. 4th, we recommended that : " Well financed speculators would be well advised to establish short positions at these levels, risking the 41.00 mark basis spot."



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TREASURY BILLS

June	84.69	15.31
Sep	85.54	14.46
Dec	86.29	13.71
Mar'81	86.72	13.28
Jun	87.16	12.84
Sep	87.30	12.70
Dec.	87.31	12.69
Mar'82	87.40	12.60

TREASURY BONDS

GNMA	Settle	Yield			
Jun	67-03	13.816	Jun	66-09	12.674
Sep	67-10	13.764	Sep	67-12	12.464
Dec	68-08	13.545	Dec	68-13	12.272
Mar'81	69-03	13.350	Mar'81	69-09	12.112
Jun	69-23	13.209	Jun	69-29	12.000
Sep	70-06	13.104	Sep	70-11	11.917
Dec	70-13	13.055	Dec	70-24	11.852
Mar'82	70-18	13.021	Mar'82	71-01	11.803
Jun	70-21	13.000	Jun	71-08	11.765
Sep	70-23	12.986	Sep	71-12	11.744
			Dec'82	71-15	11.728

That stop was never executed as the market barely edged up to \$39.20/oz basis spot. We also offered an alternative: " Well financed spreaders (require about \$460,000 per spread) may sell 5 contracts of June Chicago Silver at 3500 and buy 13 March Chicago Gold at 670. The present gold/silver ratio of 20-1 should widen to at least 30-1 with each point representing approximately \$45,000 profit." That ratio reached today 31.4.

Where is Silver headed now ? The rapidity of the decline undoubtedly reflects the market's perception that some of the 'big boys' holdings are overhanging the market and are effectively trapped by the grotesque size of their position. Have Hunt , Waltuch et al liquidated? Only their carrying broker ( and banks) will know for sure but it is likely that a substantial amount of their holdings remains outstanding. On top of the unforgiving ferociousness of the Bear one should note the significant increase in Warehouse stocks now taking place on both sides of the Atlantic ( as predicted as far back as last October); see chart. Our next downside target is 9.50/oz basis Spot, where we would suggest covering 50% of short positions.

### GOLD

Following a fairly predictable path, bullion penetrated two important levels \$620/oz basis April and \$560/oz basis Spot (see Commodity & Currency Comments Feb. 4 and March 4) and then plunged to meet quick support at the 450-460 level, reversing back to the 560-570 area. It is worthwhile noting that \$450/oz represents the October '79 peak of the high level consolidation that launched gold to its all-time high of \$875/oz. Our downside target remains fixed at the \$367/oz level which is significant on two counts: a) represents a 'maximum' retracement allowable (66%) of the 1976-1980 advance if we are to believe that gold is still in a long term Bull Market and b) represents the lower extremity of the October-November high level consolidation.

In keeping with the arguments advanced in our Feb. 4th issue, "The Price of Gold and its Economic Consequences" ( copies available on request), we believe that \$367/oz gold is a fair value. We would therefore advise covering short positions on a scale down from \$400/oz. Long term investors may begin a serious buying program at the \$360-400/oz level providing they understand the high carrying charges that are being incurred.

Although most Bear Markets do not last just two months nor do they turn on a dime, a case can be made that gold will rapidly reverse its downward trend ( once it has achieved the lower target, of course). In the first place, a politically - mandated reflation will follow the first serious default ( see opening comments), cheapening carrying charges (i.e. lowering the opportunity costs) and unnerved inflation watchers. Secondly, the mere episode of major default will shift nervous money out of financial instruments and bank deposits and into a tangible store of value.

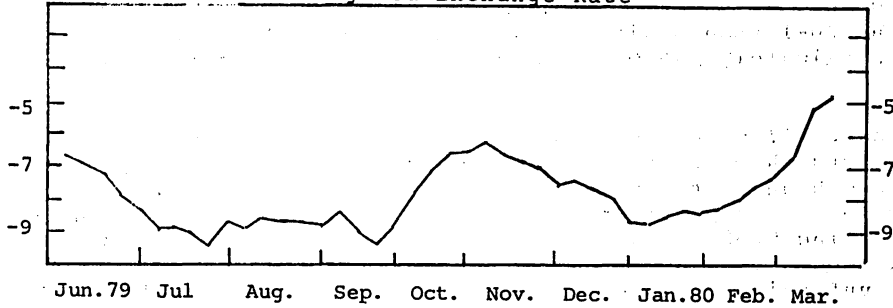
We'd like to add an intriguing possibility. It has been reliably reported that Ronald Reagan, the Republican candidate, has been seeking and receiving the advice of Arthur Laffer and Robert Mundell ( two brilliant and unorthodox economists) on various financial matters. It is believed that they are urging Reagan , if elected President of the United States, to announce a return back to the Gold Standard. We have previously shown ( Commodity & Currency Comments, Oct, 3, 1979, Substitution, Diversification and Convertibility) that a return to an international Gold Standard would make eminent sense and we proposed setting a price of somewhere between \$450 and \$500/oz so as to allow full convertibility of U.S. liabilities and then some. Messrs. Laffer & Mundell, in the good libertarian tradition, have a novel approach: announce a return to GOLD based on the free market price of gold six months hence. It is their considerate opinion that gold would settle somewhere between \$ 200 and \$300/Oz. We disagree. Nevertheless, the idea is ingenious enough to merit consideration, especially if Reagan wins the election.

Could Gold bottom on the first inkling of a Reagan victory ?

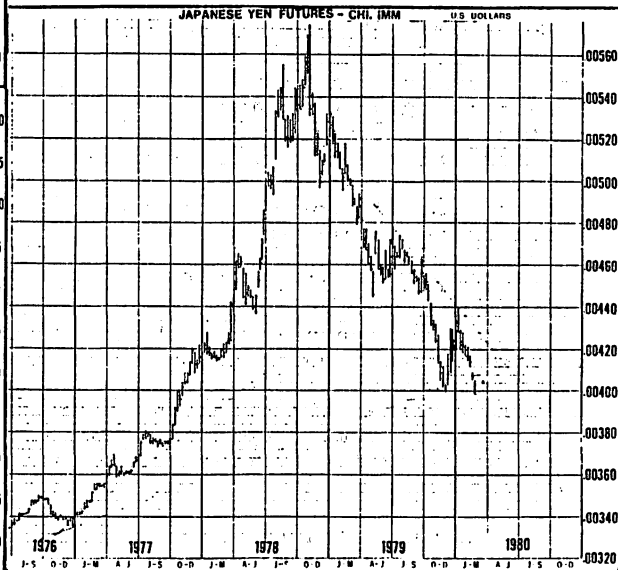
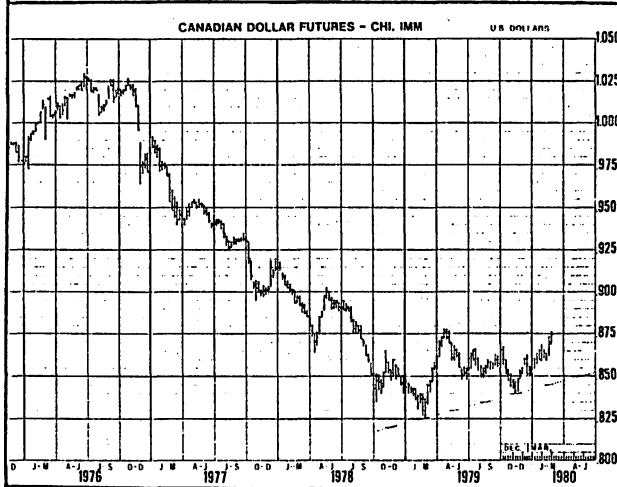
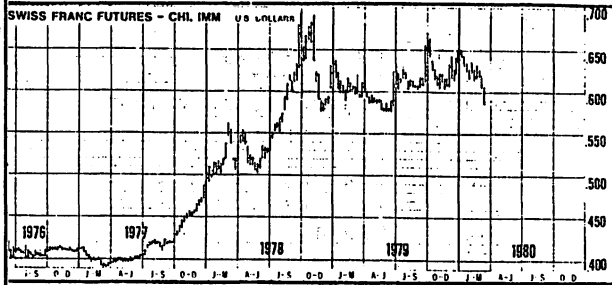
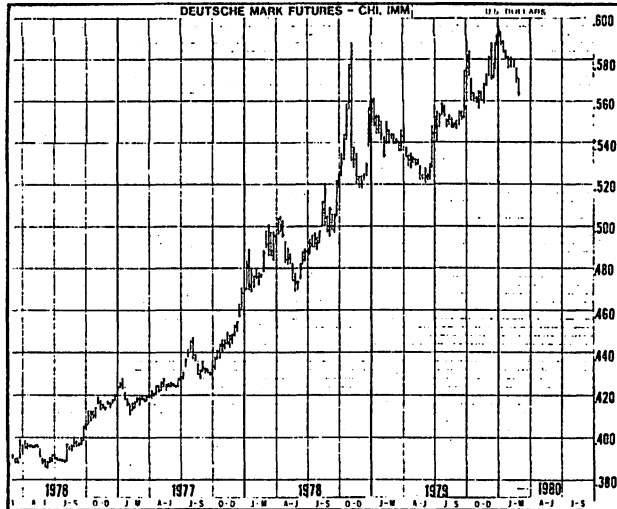
CURRENCIES

THE MIGHTY U.S. DOLLAR

U.S. Trade Weighted Exchange Rate



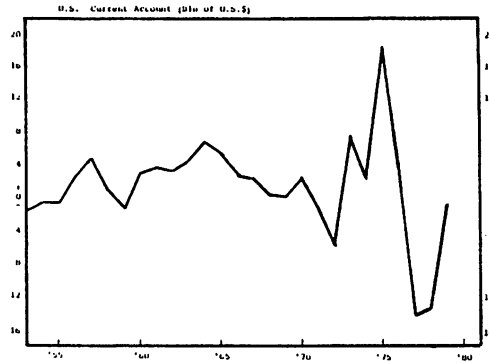
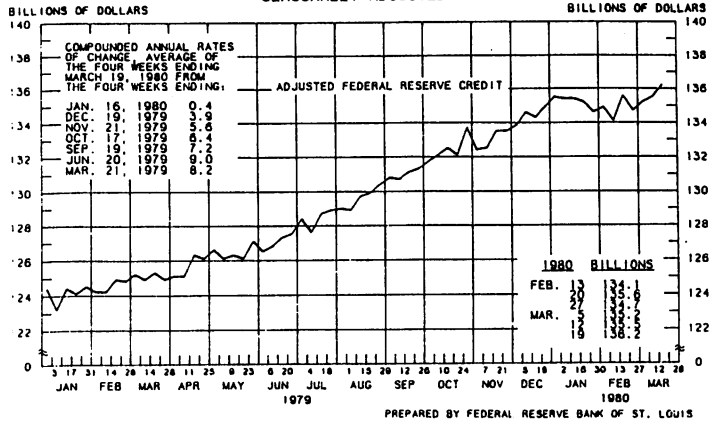
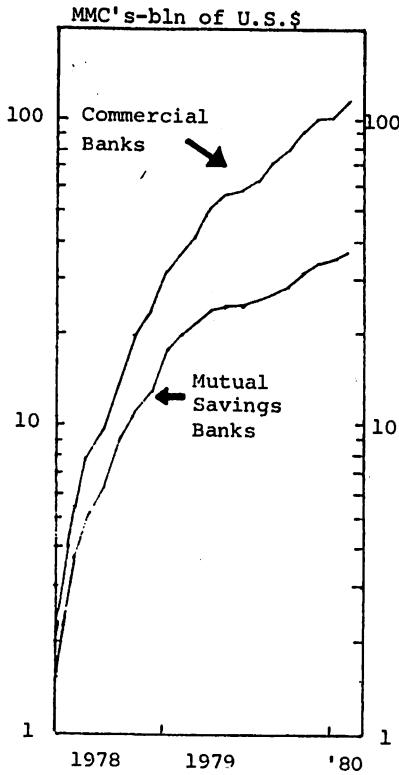
Data from:  
Morgan Guaranty  
Trust Co.



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A picture speaks more than one thousand words.  
The U.S. dollar steam roller is being fuelled by two complementary forces: a) excess money supply growth being absorbed by the rapid rise in prices rather than by a negative current account; (in fact, the U.S. current account position was in balance for 1979 and is probably in surplus during the first quarter of 1980, in spite of the rising oil import bill) and b) a tightening grip on Federal Reserve credit ( see chart ) , the stuff of which money supply grows.

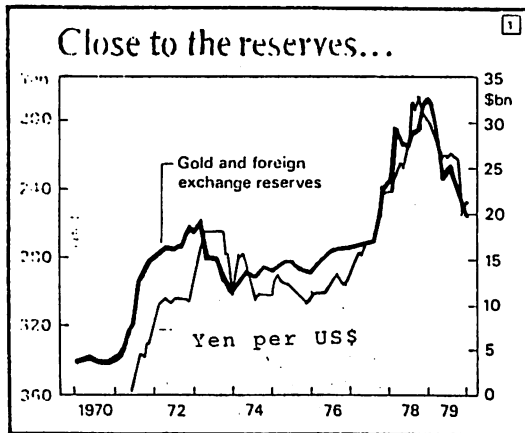
ADJUSTED FEDERAL RESERVE CREDIT  
AVERAGES OF DAILY FIGURES  
SEASONALLY ADJUSTED



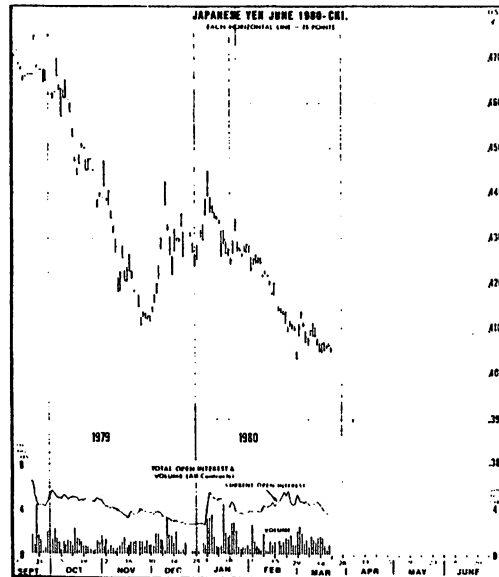
The efforts by the Bundesbank and the Swiss National Bank to shore up their currency by way of persuading foreign official institutions to diversify their reserves are contemptible and hypocritical. In the not-too-distant past, controls on capital inflows were slapped with the pretext that it was not 'convenient' for these two countries to become reserve currencies. How many times can you play this game? The next time around, if there is one, let the market decide.

Japanese intervention has been mostly of the non-market variety. Whatever useful measures were taken, such as raising the Bank Rate to 9% from 7.25%, has been too little and too late. Furthermore, heavy support operations involving enormous sales of U.S. dollars, have lost their effectiveness as the Bank of Japan insists on buying Government bonds at a fixed interest rate. In effect, the money market desk of the Bank of Japan offset the action of the foreign exchange desk.

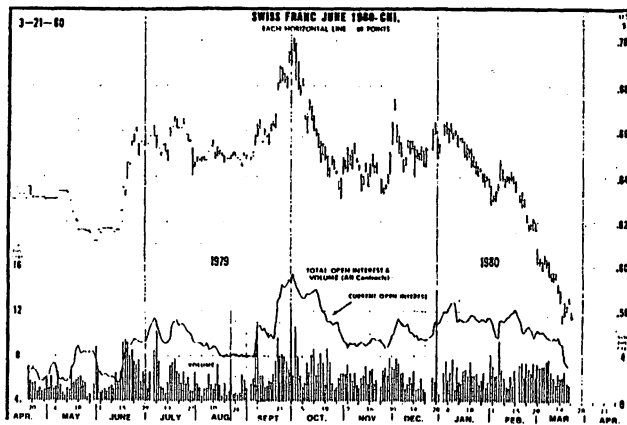
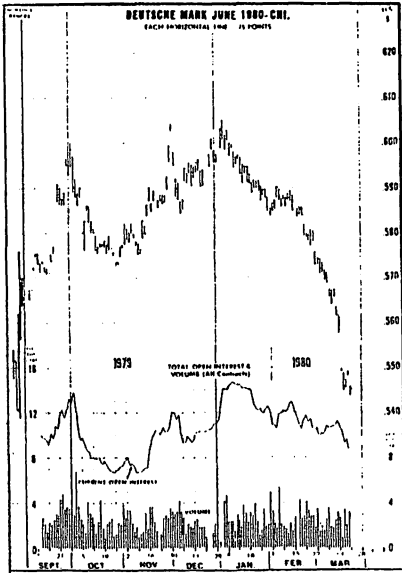
Monetary expansion is still excessive and the Bank of Japan is risking the total exhaustion of its already depleted international resources.



YEN OBJECTIVE : 36.30  
Stop : 41.40



Remain Short June DM, June SF and June Yen.



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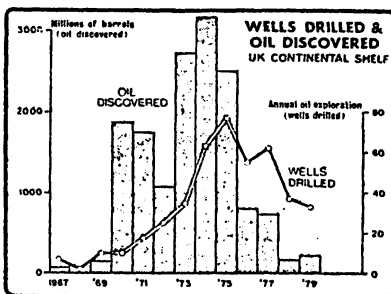
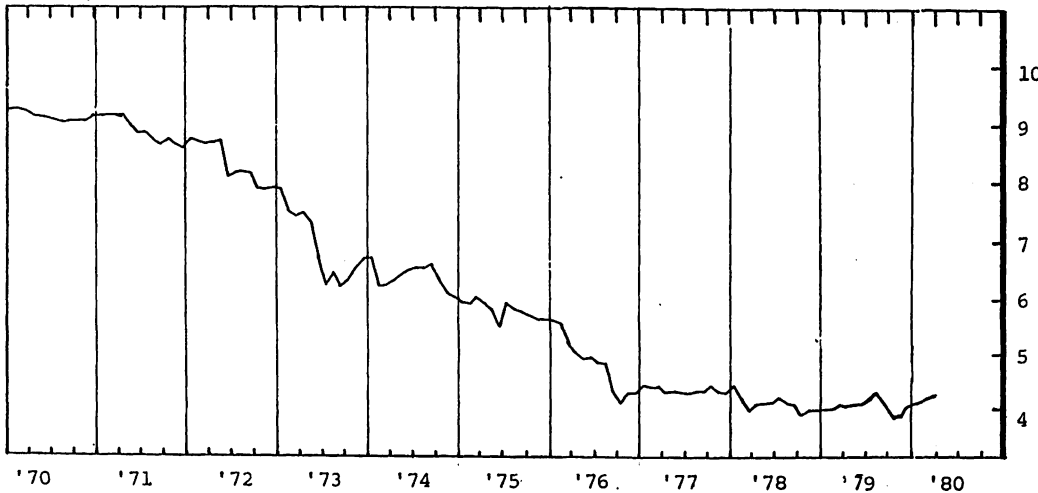
DM    OBJECTIVE : 50.00  
          Stop        : 57.50

SF    OBJECTIVE : 51.00  
          STOP        : 61.25

BRITISH POUND

The much - awaited U.K. budget contained little in the way of surprises. The ridiculous 'banking corset' was being eliminated with a slight bearish implication for Sterling as commercial banks begin to unwind their offshore borrowings and substitute them for domestic deposits. On a very negative note, the North Sea Oil royalty tax is being raised to 70% from 60% , thus yielding to 'windfall profit' wing of the cabinet and endangering the U.K.'s plan for energy sufficiency. The accompanying chart speaks loudly enough.

BP/DM Ratio



Financial Times

The failure to raise the MLR to a competitive world level was a disappointment to the bulls in Sterling. We would therefore abandon the long side, at least temporarily, looking to re-enter on a stop above 221 basis Spot.

CANADA

We are keeping our Canadian comments purposely brief in view of the forthcoming issue entitled ' Inflation in Canada Spring Review 1980'.

The combination of negative interest rates differentials and the upcoming Quebec referendum are too much to bear and this was so stated last month when we advised liquidating long positions, then at 87.00 basis Spot.

Here are some inspiring words from Rodrigue Biron, former Union National leader : " In my land of Lotbiniere, each spring, we live in extraordinary gathering. Yes, regardless of the temperature, the rigor of winter, the depth of the snow... those magnificent birds, the geese, gather in the land of Lotbiniere. They are at the rendezvous in their thousands, their tens of thousands, and they sing, they cry their joy to be back in the land of Quebec. It is to a similar rendezvous, that of solidarity, of pride and of dignity, that the Quebecois and Quebecoises are invited in this spring of 1980. They will be at the rendezvous in the tens of thousands, in the hundreds of thousands. The Quebecois and Quebecoises will cry out and sing their joy to be in the land of Quebec. Together , the Quebecois will perform an act of faith in the future. They will perform an act of individual pride, but also of collective and national solidarity." Why, then, the personal income tax cut?

We doubt the CD\$ will hold 83.20, the previous low, and set our target at 80.00. Sell any rally.

Yen						DM							
		Balance of payments				1979 ---		Balance of Trade	Balance of Payments	Unemployment Rate			
		Overall Account	Current Account	Reserves	W.P.I.	Unemployment	( Mln Marks )						
1979 ---	Trade	Account	Account				Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.
	- 669	- 387	-1,530	25,170	10.94	2.23	976	1,900	1,800	1,510	800	342	
Aug.	+ 147	-2,330	- 792	25,330	12.61	2.03							
Sept.	- 350	-3,470	-1,120	23,270	14.54	2.15							
Oct.	-1,220	-1,560	-2,220	20,170	16.07	2.17							
Nov.	+ 731	- 512	-2,470	20,330	17.52	2.07							
Dec.	-2,380	-2,220	-3,370	21,010	20.39	1.87							
Jan.	- 180	- 840	-1,240	20,770	21.37								
Feb.													
Contract Size : Yen 12,500,000.00 ( Approx US\$ 51,000 )								Open Interest (Mar.25/80) : 9538					
Minimum Fluctuation : .0000010 (\$12.50) Margin Req'd :US\$ 3,500.00								Daily Volume (Mar.25/80) : 5498					
Daily Limit (Normal): .0001 (\$1,250.00) Commission :US\$ 55.00								Contract Size : DM 125,000.00					
Trading Hours : 8:25 am - 1:25 pm Chicago Time								(Approx. US\$ 67,000 )					
Delivery Months : March, June, September, December.								Minimum Fluctuation : .00010(\$12.50)					
Open Interest (Mar.25) : 3,921 Daily Volume (Mar.25) : 1,611								Daily Limit (Normal): .010 (\$1,250.00)					
								Margin Required : US\$3,500.00					
								Commission : US\$55.00					
								Trading Hours :8.19am - 1:19 pm					
								( Chicago Time )					
								Delivery Months:Mar.,Jun.,Sep.,Dec.					
Quotes ... Jun. '80 : 40.42 Sep. '80 : 40.75 Dec. '80 : 41.30								Jun. '80: 53.80 Sep. '80: 54.85 Dec. '80:55.56 ***					

SF		Balance of Trade		W.P.I.*		Unemployment		Open Interest (Mar.25/80) : 7,822	
1979 ---	Trade	W.P.I.*	Unemployment					Daily Volume (Mar.25/80) : 2,742	
	(Mln SF)	%						Contract Size : SF 125,000.00(Approx.US\$72,500)	
Aug.	- 667	4.9	0.3					Minimum Fluctuation: .00010(\$12.50)	
Sept.	- 445	6.9	0.3					Daily Limit (Normal):.0150 (\$1,875.00)	
Oct.	- 593	6.75	0.3					Margin Required :US\$ 3,500.00	
Nov.	- 386	6.83	0.3					Commission : US\$ 55.00	
Dec.	- 417	6.90	0.3					Trading Hours: 8:15 am - 1.15 pm	
Jan.	-920.2	6.99	0.4					Delivery Months: Mar.,June.,Sept.,Dec.	
Feb.	-1.10	5.86	0.3					Reserves : Feb.29: 22.08 Mar.10:19.27	
								Mar.20: 19.29	
Quotes ... Jun. '80 :57.16 Sep. '80 :58.59 Dec. '80 :59.80 Mar. '81: 61.60									



Albert D. Friedberg-

\*\*\* All statements made herein, while not guaranteed, are based on information considered reliable and are believed by us to be accurate. \*\*\*

**U.S. OFFICIAL FOREIGN EXCHANGE MARKET INTERVENTION** undertaken jointly by the Federal Reserve and the Treasury amounted to \$1.3 billion in the three months ended January 31. The total consisted of sales of \$1,246.9 million equivalent of German marks and \$22.8 million equivalent of Swiss francs. Sales were financed partly from existing holdings of foreign currencies by the Federal Reserve and the U.S. Treasury, and partly by drawing on the Federal Reserve's "swap lines" with foreign central banks.

The intervention by U.S. authorities in support of the dollar's exchange rate during this period was considerably less than the \$4.2 billion intervention in the preceding three months ended October 31, 1979. (See *International Letter*, No. 410.) This, despite worrisome political and economic developments during the quarter, such as the freezing of Iranian assets following seizure of the U.S. embassy in Tehran, increases in the rate of domestic inflation, leap-frogging oil price increases charged by OPEC members, and a surge in prices for precious metals. Rising U.S. interest rates, which attracted foreign investors into dollar assets, and the foreign exchange market's favorable response to the Federal Reserve's October 6, 1979, policy actions aimed at dampening inflation by slowing the expansion of money and credit (see *International Letter*, No. 407) were major factors accounting for the dollar's relative strength.

Gross market intervention by major central banks during the three months ended January 31 (including the intervention in support of exchange rates of currencies participating in the European monetary system) amounted to \$24 billion, compared with \$31 billion in the previous three months and a record \$38 billion in the February-April 1979 quarter.

**RESTRICTIVE MONETARY POLICY MEASURES** were adopted recently in several countries in their efforts to fight incipient inflation and moderate the impact of rising U.S. interest rates on the value of their currencies.

Last week, **Germany's Bundesbank** increased the discount rate (the rate of interest it charges commercial banks on their borrowing within a predetermined discount quota) from 6 percent to 7 percent and the rate on loans against securities (the Lombard rate) from 7 percent to 8.5 percent. The boost in rates was apparently prompted by growing concern in Germany about rising inflation and a deteriorating balance-of-payments position. Inflation in Germany has been accelerating, from a 2.7 percent rise in consumer prices in 1978 to a 5.4 percent rise in the 12 months ended December 1979. In January, wholesale prices were up at an annual rate of almost 23 percent, a rise that is expected to be reflected in further pressures on consumer prices in the months to come. Higher interest rates and tighter credit conditions stemming from the increase in the discount rate are expected to moderate the price pressures. At the same time, the higher interest rates are expected to aid the country's balance-of-payments position. Germany's current account balance swung into a deficit of \$1.4 billion in 1979, following a surplus of \$8.8 billion in 1978. In addition, rising interest rates in the United States and the Eurodollar market have provided incentives in recent months for capital outflows from Germany. German authorities estimate that some \$1.4 billion in long-term capital left Germany in January alone. The combined effect of these developments has been a downward pressure on the exchange rate of the German mark. So far this year, the mark has declined 4.5 percent relative to the U.S. dollar despite heavy intervention in the foreign exchange markets by the German monetary authorities in support of the mark rate. The decline in the external value of the mark has been putting upward pressure on Germany's import prices (which rose 18 percent in 1979) and thus on domestic inflation. Higher interest rates are expected to help arrest the mark's decline and reverse these trends. Some observers, however, expressed concern about the impact of these measures on the already slow economic growth in Germany.

Rising interest rates in major world money centers apparently prompted discount rate action in several other European countries. The **Belgian Central Bank** raised its discount rate by 1.5 percentage points to 12 percent in a new effort to bolster the sagging Belgian franc, which since January has lost 4.2 percent in its value relative to the U.S. dollar, and has been at the bottom of the permissible range within the European Monetary System (EMS).<sup>2</sup> The **Danish Central Bank** raised its official rate by 2 percentage points to a record 13 percent to combat rising domestic inflation and support the Danish krone in the EMS. Earlier, the **Bank of Sweden** had raised the discount rate from 10 percent to 11 percent to bring domestic rates in line with other international rates. The central bank expects the measure to encourage foreign borrowing, which should help finance the deficit on current account that Sweden expects in 1980.

The **Swiss National Bank** raised its discount rate from 2 percent to 3 percent and the Lombard rate from 3 percent to 4 percent. The increase in the discount rate closely follows the decision of the Swiss authorities to lift the ban on the payment of interest on nonresident Swiss franc term deposits (see *International Letter*, No. 416). Both measures are apparently designed to strengthen the value of the franc by inducing capital inflows into Switzerland. The value of the Swiss franc dropped by some 8.5 percent relative to the dollar and 4.3 percent relative to the German mark so far this year. Along with rising prices of imported energy, the decline in the value of the Swiss franc has been fueling the rate of "imported" inflation in Switzerland: in the 12 months ended December, consumer prices in Switzerland rose 5.1 percent, up sharply from the 1.1 percent increase in 1978. The **Bank of France** last week instructed French banks to reduce the amount of credits they grant outside official norms to 50 percent from 60 percent currently effective April 1. The move is in line with the government's stated intention of stepping up efforts to keep a lid on inflation, which surged to over 20 percent annual rate in January—the biggest monthly increase in over 20 years. The move is also expected to aid the French franc, which has declined by 4.5 percent relative to the dollar so far this year.

Credit-restraining action was also taken last week by the **Bank of Japan** when it raised the reserve ratio on domestic time and other deposits by 0.125 percentage point and 0.75 percentage point, respectively, to 1.75 percent and 3.25 percent, respectively, in an apparent effort to absorb excess liquidity from commercial banks. The measure, which closely follows the decision to raise the discount rate to 7.25 percent (see *International Letter*, No. 416), is aimed at controlling the weakness in the value of the Japanese yen, which over the past 12 months has declined by some 20 percent relative to the U.S. dollar. Other recently adopted yen-support measures included a relaxation of interest ceilings on foreign deposits, the easing of restrictions on foreign-currency loans to Japanese enterprises through foreign exchange banks, and the easing of restrictions on the negotiable certificates of deposit and Euro-yen bonds Japanese banks are allowed to issue overseas. To further aid the Japanese currency the central banks of Switzerland, Germany and the United States pledged their active participation in foreign market intervention on behalf of the yen last week.

<sup>1</sup>Swap lines are mutual short-term lines of credit under which the U.S. authorities and participating foreign central banks "swap" their currencies for foreign currencies needed for market intervention. Currently, 14 participating foreign central banks and the Bank for International Settlements are linked with the Federal Reserve through mutual swap lines. See *International Letter*, No. 382, for a more detailed discussion of the swap network.

<sup>2</sup>For details on the functioning of the EMS, see *International Letter*, No. 391.