

# FRIEDBERG'S

## COMMODITY & CURRENCY COMMENTS

347 Bay Street, Suite 207, Toronto, Ontario M5H 2R7 Telephone: (416) 364-2700 Cable: Friedco Toronto Telex: 06-23446

JULY 2, 1980

### WHY THIS COMPLACENCY ... ?

"... It appears that the United States economy is more vulnerable, in many respects, to the damage wrought by inflation than are other economies. The tax system has not been adapted to inflation, except in the main for periodic personal tax cuts that have helped to offset the drift of taxpayers into higher brackets. Savings institutions have found it very difficult to cope with inflation, which has let to severe damage to the housing industry. Usury ceilings, only in part recently overruled by the Congress, have interfered with the flow of credit at high interest rates. Business profits are grossly overstated by an accounting system that ignores inflation. The development of an underground economy, which has helped some economies defend themselves against inflation in some degree, has been largely forestalled in the United States by the effective administration of a tax and legal system that, all pressure notwithstanding, continues to perform effectively. It is not surprising, therefore, that among countries with high rates of inflation the United States probably has had the worst productivity experience."

Speech: by Henry C. Wallich,  
Member, Board of Governors of the Federal Reserve  
System. to the Swiss-American Society Basel, Switzerland.  
June 10, 1980.

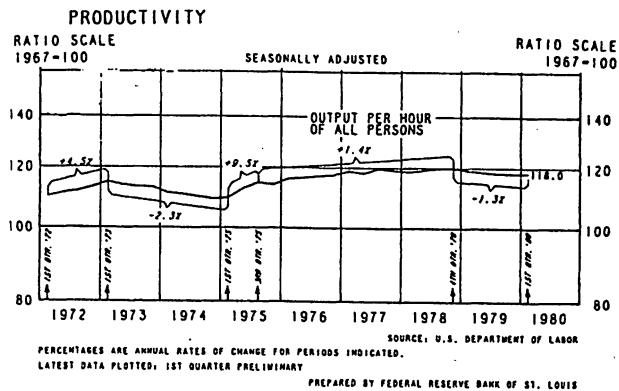
\*\*\*

Economic observers are frantically searching for the 'inflection point' of this ever deepening recession. Once again, they are missing the point. There is little doubt that the steepness of the recent decline is unsustainable. Car sales are already 'groping' for a bottom in the 5½ million per year rate while housing starts may begin to stabilize or even perk up from the 850,000 - 900,000 yearly rate along with a slightly better availability of mortgage funds. More reassuringly, commodity prices have bounced well off their extreme April-June lows indicating a respite from heavy liquidation. The real question is, what kind of recovery will the US, and for that matter, the rest of the industrialized world enjoy ?

The above quote from H. Wallich, a distinguished member of the Board of Governors of the Federal Reserve, is brutally frank. The U.S. economy, crippled by the deleterious effects of a non-indexed (i.e. inflation neutral) system of taxation has lost its vitality and is about to enter a decade of stagnation, at levels well below those attained in the early 70's.

FRIEDBERG  
MERCANTILE  
GROUP

Let us review the argument. An economy can grow in real terms in a inflationary environment if the corrosive effects of inflation are neutralized, particularly in the areas of savings and taxation. The Brazilian economic miracle of the late 60's and early 70's, the Colombian experience of the 50's and 60's and more recently, the Chilean recovery of the late 70's bear vivid testimony to this effect. Industrialized countries, however, with high rates of personal and corporate taxes and substantial tax bases struggle along an even more difficult path. The postwar economic growth of Sweden is in no small measure a result of generous tax relief at the corporate level, allowing a good rate of capital formation despite inflation's negative impact on savings. The alternative would mean 'going underground', essentially the Italian response and one that met a great deal of success. In the words of Mr. Wallich, 'development of an underground economy.... has been largely forestalled in the United States by the effective administration of a tax and legal system that, all pressures notwithstanding, continues to perform effectively.' The result can be gleaned from the accompanying chart. The effects of inflation on productivity



are appalling: the only substantial increase takes place in the first half of 1975, a normal cyclical occurrence resulting from a slight upturn in industrial production accompanied by rising unemployment and/or lagging employment.

It becomes apparent that given inflation rates in excess of 5% (?), a high and non-indexed rate of taxation and an effective tax enforcement scheme, productivity and therefore, per capita economic growth suffers and threatens to become negative. The reason the U.S. economy managed to grow, at all, during the late 70's was simply the result of a credit expansion engineered by a relatively permissive Federal Reserve. As the expansion gathered momentum and inflation accelerated, economic agents operated under false boom conditions. Capital/labor ratios fell because of a dearth of capital formation (the effect of inflation on savings) and the relative cheapness of labor (where compensation per hour steadily lagged behind the totally un-anticipated rate of inflation). The Carter administration hailed the creation of 12 million new jobs without realizing (?) that they were the ephemeral creation of a transitory and highly unstable credit boom. As inevitably as the chicks come home to roost, unemployment begins to rise to painful levels. Before the year is out, a 10% rate of unemployment will mark the littered debris of a floundering economic policy.

But, one may ask, can the Fed not engineer another successful bout of credit expansion, one that will pull the country out of its misery? The question should be restated: can the Fed inflate beyond the present wildest imagination of economic agents? Because inflationary expectations are already high, it is unlikely that labor, for example, will be caught short in its wage negotiations. Furthermore, and unrelated to the above, because after tax returns on savings remain negative, it is likely that capital investments will continue to shrink. The combined result is less employment and less capital formation. A state of stagnation at low levels of economic activity.

The shift to reserves management and away from interest rates targets is credible enough insofar as it precludes the Fed from inflating beyond normal rates of money supply growth, i.e. 6-10% per annum. That being the case, one could argue that present monetary policy is restrictive in the context of creating an unanticipated boom. We may have come full circle in the management of Fiat money: Central Banks (including the Bank of Canada, the Bank of England, the Bundesbank, etc.) become respectable citizens, fearful of their creation and only willing to permit monetary growth rates that have been sanctioned in the past as being moderate. Inflation persists, in the industrialized world, but at 'subdued' rates of 5-10% per annum and surely not sufficient to get the economy moving to pre-recession levels.

The above discussion leaves one hope. Tax relief in the form of sharp tax-cuts, exemptions on interest income and accelerated depreciation rules. While we may not know where we stand on the Laffer Curve and therefore, we may not be able to determine precisely optimum tax rates (as argued recently by the Federal Reserve of Minneapolis), we do know that present tax rates and present inflation rates are incompatible if we are to enjoy continued economic growth.

The choice is amazingly simple: either we bring inflation rates below 5 % per annum or we neutralize its effects. If the Fed sticks to its guns, the first is remotely possible. If Reagan is elected and he receives a modicum of Congressional support, the second alternative is also remotely possible. Regardless of the above, if world trade is further hampered by rising protectionist sentiment (and the test will come in the next few months), a worldwide depression may not be avoidable. Major world traders, particularly LDC's, will have to face a stagnating industrialized world whose doors are being shut in the fallacious hope of rescuing their own faltering employment market. Being unable to service out of cash flow their rising debt, they will resort to reschedulings and moratoriums.

#### INTEREST RATES FUTURES

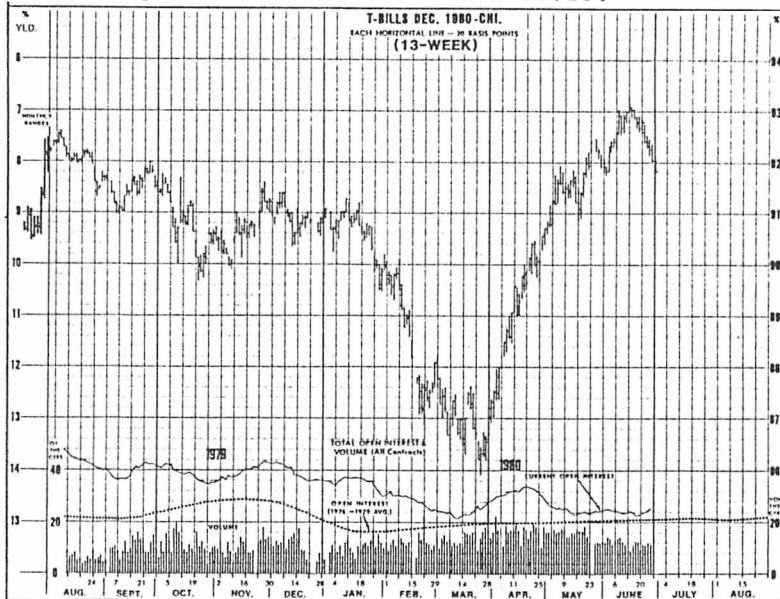
Despite strenuous efforts on the part of the Federal Reserve to increase bank reserves and, thus, influence monetary aggregates such as  $M_1a$  and  $M_1b$ , results have been disappointing. Federal Reserve holdings of securities have increased a spectacular \$6.5 billion since the week ended March 19/80 and total Federal Reserve Bank credit has increased a no less dramatic \$4.2 billion since the same date. Member bank reserves, on the other hand, have declined approximately \$200 million. This phenomenon took place not for lack of wanting but because of a technicality involving public portfolio preferences. To wit, currency in circulation absorbed approximately 83% of Bank Credit. Any slight downward shift in this puzzling preference for currency will swell member bank reserves. Lagging monetary aggregates will resume their desired course.

The Fed has no doubt sensed this transitory (?) occurrence and has decided to absorb reserves from the system in the past few weeks at the 8-8½% Fed funds level. It should be noted that during the depression of the 30's, currency preference became ever stronger concurrent with/and as a result of bank failures and the Fed failed to offset this leakage either by way of coming to the rescue of defaulting banks or by trying to inject larger dosage of funds into the system. Given the psychological protection of deposit insurance, it does not seem likely that such is the situation today, and a currency reflow may be soon in the offing. At any rate, the Fed has pushed credit as much as it would like for the present time and funds may settle in the 8½-9½% range until results become visible at the  $M_1a$  and  $M_1b$  level.

Short term rates represented by the three-month Treasury Bills broke their downtrend around the third week in June. It is unlikely, however, that they surpass the 9% level and, therefore, Dec.'80 bills may be bought around 91 for a new test of the contract highs. Fed funds management rather than rising inflationary expectations are responsible for this interest rate correction and therefore, long term bond yields may not rally much above 11% basis the long term U.S. Treasury Bond.

Last month's suggestion to enter into a spread long 7 Sept.'80 Treasury Bills VS. short 2 Sept.'80 Treasury Bond at the then prevailing level rewarded us with a quick \$8,500 -\$10,000 profit as the yield curve steepened about 100 basis points. Profits were taken, as suggested, by taking the cue from the penetration of the uptrend in Treasury Bills, along the April-May line.

Once again the yield differential is down to 2.2 percentage points and a new spreading opportunity is available. Buy 7 Sept'80 Treasury Bills and sell 2 Sept'80 Treasury Bonds at market. Take profits at the 3 percentage point level (almost \$10,000 profit) and place stops if and when Sept.'80 bills trade below 90.25.



TREASURY BONDS

	Settle	Yield
Sep.	80-10	10.350
Dec.	80-07	10.363
Mar'81	80-02	10.385
Jun	79-29	10.408
Sep.	79-24	10.430
Dec.	79-20	10.448
Mar'82	79-16	10.466
June	79-13	10.480
Sept.	79-11	10.489
Dec.	79-10	10.493
Mar.	79-10	10.493

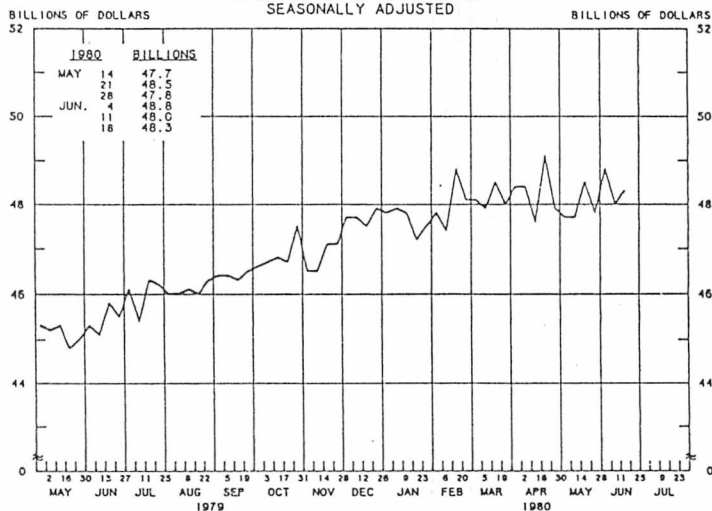


TREASURY BILLS

Sep.	92.07	7.93
Dec.	91.81	8.19
Mar.81	91.60	8.40
Jun	91.40	8.60
Sep.	91.16	8.84
Dec.	90.93	9.07
Mar'82	90.71	9.29
Jun	90.48	9.52

Commodity Research Bureau, Inc.

ADJUSTED BANK RESERVES  
AVERAGES OF DAILY FIGURES  
SEASONALLY ADJUSTED



PREPARED BY FEDERAL RESERVE BANK OF ST. LOUIS

CURRENCIES:

THE US DOLLAR - a widening trade gap, put last month at \$3.96 billion, dashed the Administrate's hopes for a 1980 current account surplus. One suspects that this disappointing performance is due as much from a continued rise in the oil bill as from a severe drop in economic activity of other OECD members. Witness the unusual drop in exports.

Short term capital flows are continuing to move out of the dollar as evidenced by the large degree of intervention on the part of the EEC countries and Japan. International reserves of W. Germany, Switzerland and Japan increased by at least \$5 billion in the April - early June period.

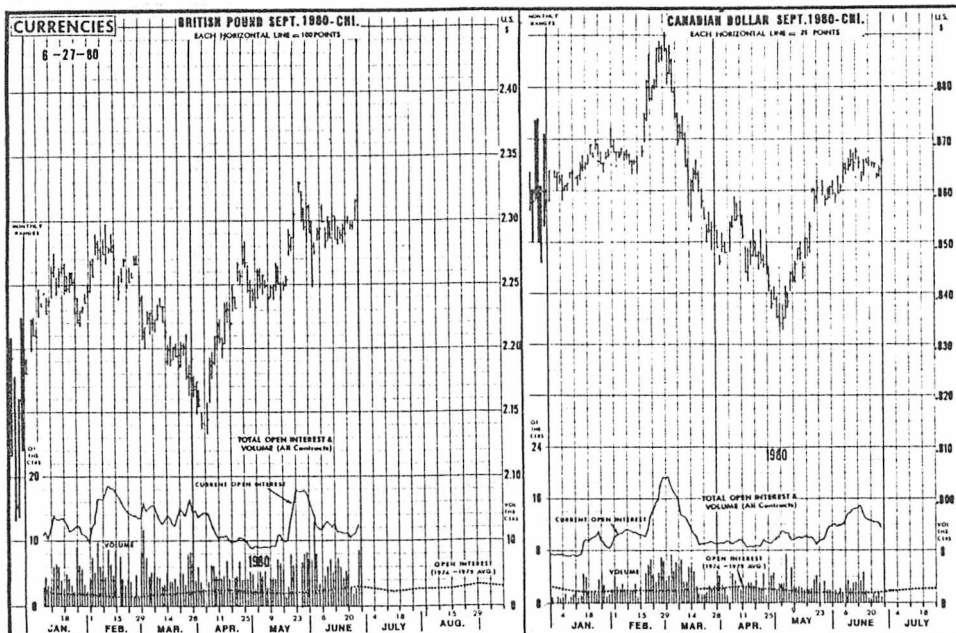
We are friendly to the DM and advise purchases of the Sept'80 contract at present levels with stops @ 56.25, close only.

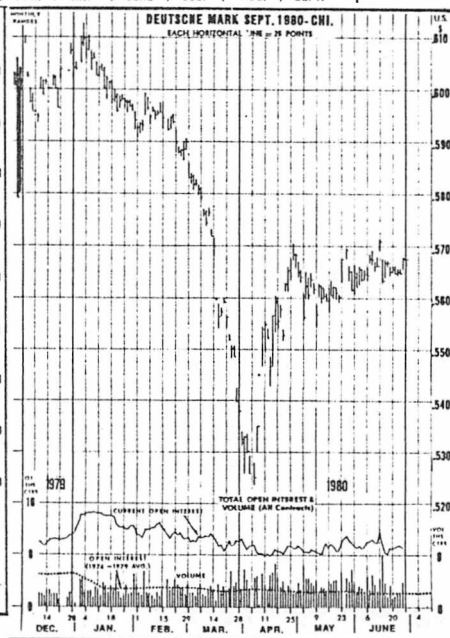
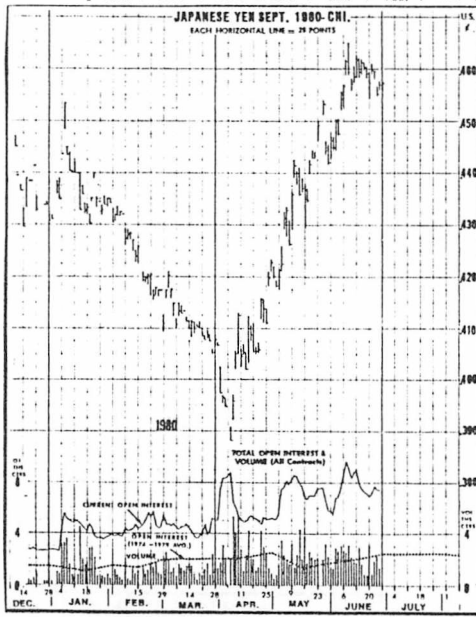
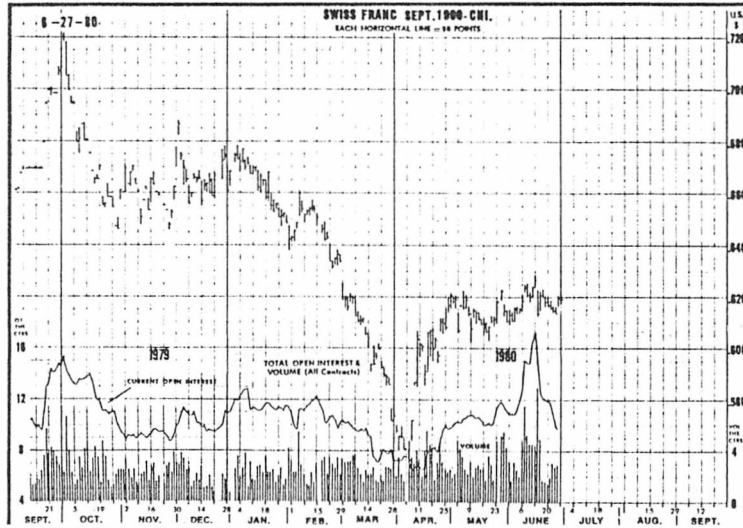
STERLING - The gathering recession will soon reflect in a vastly improved trade balance while rising unemployment (now at a post-war high) should put a substantial dent in upcoming wage demands. In our view the UK's rate of inflation will begin to taper off to international levels no later than the third quarter. Unexpectedly low readings (better than the US or Canada) could appear in the fourth quarter, a delayed effect of rising Sterling.

We favour continued accumulation of Sept'80, Dec'80 and March '81 BP contracts at present levels. International reserves figures released today indicate an underlying increase of a mere \$3 million emphasizing the UK's Government's determination to allow a relatively clean float.

CANADIAN DOLLAR - A powerful bull market in the CD\$ may be seen to have begun in early May and now threatens the 1979 high of 87.50. Given the Treasury's exceptionally low holdings of cash, we would expect little resistance at these levels. Furthermore, the Bank of Canada's avowed intention to maintain the interest rate differential in its favor vis a vis the U.S. market augurs well for short term capital inflows.

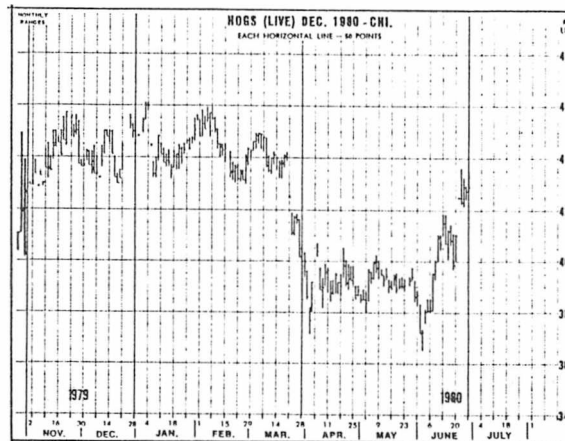
Continue to purchase deferred positions of CD\$ at market. Place stops at 86.40 basis Sept'80.





Commodity Research Bureau, Inc.

POTPOURRI - The long awaited bull market in the Livestock Complex has begun; bargain-conscious investors must be long deferred contracts, particularly Hogs... Cocoa groping for a bottom; remain short, nonetheless, with stops at 111.00 basis Sept'80.



Commodity Research Bureau, Inc.

PRECIOUS METALS

Last month we concluded the end of the bear market phase in Gold would be made by two consecutive closes above 570.00 basis (expired) June. To keep subscribers abreast of what was done for managed accounts : we covered all short positions, went long and took profits at an average price of 657.50 basis August. We thus find ourselves presently without a position and, at the same time of course, tempted.

Our considerations are as follows : first of all, as discussed at greater length in our introductory comments, we view the economy moving along a long recessionary path. Contrary to the concensus of forecasts we read we cannot subscribe to the "sharp but short" scenario. The fiscal ledger points to the slowdown in the automotive and housing sectors spreading to secondary markets. In addition the consumer's reluctance to borrow and spend as he strives to improve cash balances removes the single biggest prop of the previous boom. On the monetary front, and this is of greater concern to precious metals speculators who have come to take the contrary for granted, there is nothing thus far to suggest that the Fed (or Central banks in Germany, Canada, or England) is reflatting beyond normal limits. Chairman Volker stated plainly last March 14th that bank reserves, the fuel of monetary growth, would be closely monitored and so far he has abided by that statement. We thus foresee reduced industrial fabrication of gold, silver, and platinum in coming months. At the same time, we expect to see a flattening in the rate of consumer price increases thus reducing demand from inflation hedgers.

Turning now to supplies : last month we made mention of the reduction in availability resulting from the curtailment of GSA and IMF auctions and from reduced selling by South Africa. Our view of this was mixed inasmuch as, while of course reduced supplies portend higher prices, a significant drop in offerings would reduce liquidity thus militating against extremely well heeled investors (viz. oil producers) stepping into the market forcefully. Our views of the supply side of the equation are now more bullish. Reliable estimates put total gold supplies to the non-communist private sector at 1,100 tonnes versus 1,765 tonnes in 1979. At the same time market sources indicate that much of the current buying has originated in the Middle East. Still, one notes that prices have, in recent days, tended to move in the same spurts as in December/January. The economic background today cannot possibly be perceived the same as six months ago. Can it be that the relatively thin offerings are, for the first time, showing their effects and, if so, will this become a factor in future decisions from the Middle East? Silver supplies remain more than adequate; combined U.S. and LME stocks stand at approximately 155,692m ozs versus 146,249m ozs Jan. 1st.

One final point that deserves mentioning before we leave the subject of supplies: South African and Canadian gold stocks are currently trading at new highs while bullion remains some \$220/oz lower than its highs of January. Why? Presumably the persistently high prices have encouraged companies whose assets were the low grade ore to press ahead with full scale excavations. We don't know when these companies will be ready to offer their refined product to market but we do mention it to remind complacent traders that eventually classical economics does work, high prices do discourage demand while at the same time encouraging supplies. In the case of gold the possibility of fresh sources of selling is now a very real background factor.

Technically the market appears very strong. Our reservations are the extremely high consensus of bullish opinion - there is already talk of \$2,000/oz gold by year-end - and the fact that today's market sits precisely at 50% between its highs of \$865.00 and (volume) low \$480.00; this mornings fix being \$670.00. Charles Dow, the originator of chart analysis, opined that a market could correct itself by as much as 50% and sometimes even 67%, against its prevailing trend and still remain within that trend. If this is truly a major bull move the market must crack the 670 mark and then the 735 level to prove itself conclusively. A move above the former would definitely imply a testing of the latter.

In summary : barring a major bank failure which at this point seems unlikely, or a thrust into the persian Gulf by the goviets (an event which may already have been hedged against by the oil-rich shieks ), or some other catastrophe, it is hard to imagine gold making new highs in the foreseeable future. Still, we would be prepared to trade from the long side according to the numbers above placing stops at the uptrend. (note chart)

DBR

CREDIT SUISSE SEES 1980 PLATINUM SURPLUS

ZURICH, JUNE 17 - CREDIT SUISSE SAID IT ESTIMATED WORLD PLATINUM PRODUCTION TO SHOW A SURPLUS OF BETWEEN 70,000 AND 345,000 OUNCES THIS YEAR, COMPARED WITH A DEFICIT OF 240,000 OZ IN 1979.

NEW AND OLD PLATINUM ON OFFER TO THE MARKET SHOULD TOTAL 2.45 MLN OZ THIS YEAR COMPARED WITH 2.3 MLN IN 1979, THE BANK SAID IN ITS MONTHLY BULLETIN.

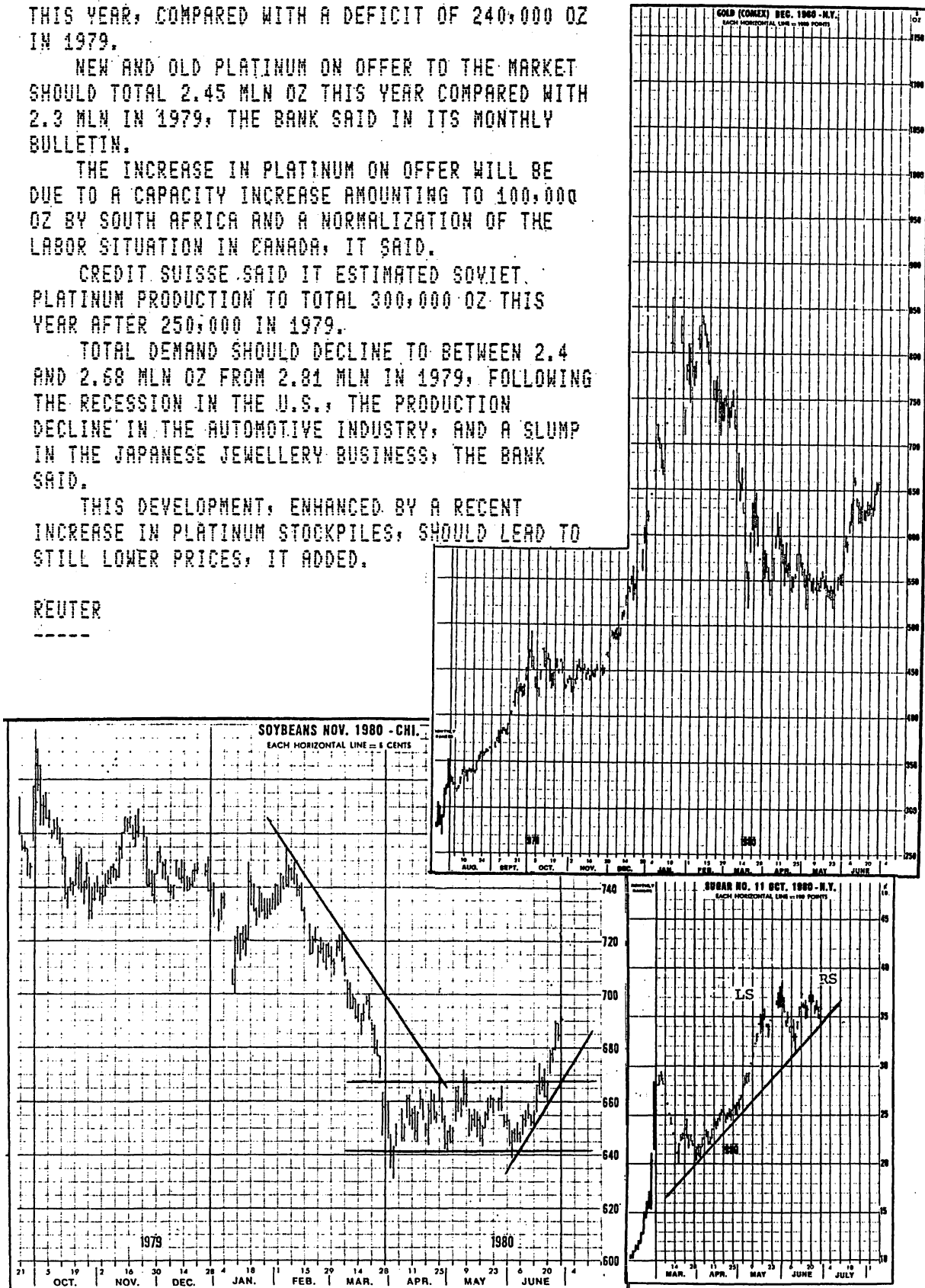
THE INCREASE IN PLATINUM ON OFFER WILL BE DUE TO A CAPACITY INCREASE AMOUNTING TO 100,000 OZ BY SOUTH AFRICA AND A NORMALIZATION OF THE LABOR SITUATION IN CANADA, IT SAID.

CREDIT SUISSE SAID IT ESTIMATED SOVIET PLATINUM PRODUCTION TO TOTAL 300,000 OZ THIS YEAR AFTER 250,000 IN 1979.

TOTAL DEMAND SHOULD DECLINE TO BETWEEN 2.4 AND 2.68 MLN OZ FROM 2.81 MLN IN 1979, FOLLOWING THE RECESSION IN THE U.S., THE PRODUCTION DECLINE IN THE AUTOMOTIVE INDUSTRY, AND A SLUMP IN THE JAPANESE JEWELLERY BUSINESS, THE BANK SAID.

THIS DEVELOPMENT, ENHANCED BY A RECENT INCREASE IN PLATINUM STOCKPILES, SHOULD LEAD TO STILL LOWER PRICES, IT ADDED.

REUTER



Soybean Complex

Long-time readers of these COMMENTS may be somewhat surprised to see us discussing this market. We have not remarked upon oilseeds or grains, either for several years. The reason is that (we admit) we don't know very much about them. Now, finding ourselves with beans and oil as two of our biggest positions, we feel it behooves us to justify ourselves and, at the same time, offer our thus-far profitable sentiments to our friends.

Look at the accompanying chart of November beans ! A commodity trader rarely sees a more beautiful picture. The market broke its long term down-trend, formed a two and a half month base beginning April 1st and then erupted on good volume to its current 735 mark. And the last upside move has come about despite the absence of any real bullish news; in fact, on the contrary, many of the Chicago-based trade firms have been slightly bearish. And not without reason; the numbers we have to work with are definitely not as bearish as the chart. The USDA's most recent estimate of 1980/81 world oilseed production is between 162 and 178 mln tonnes which or may not be much of a reduction over last years 177.8 mln tonnes crop. World stocks at the beginning of this year were 13.0 mln tonnes, versus 6.7 mln tonnes last year and 6.3 mln tonnes averaged 1975 through 1979.

In addition the current advance is contra seasonal. However, poor weather has hurt crops in Argentina and Brazil and according to the much-anticipated USDA report of last Friday, domestic (US) acreage is expected to be reduced this coming season. Last season's planted acreage was 71.6 mln. We expect, admittedly without any degree of expertise, that U.S. production will be reduced by more than 2%. For one thing, the heat wave which has reportedly affected yields in the South, now threatens to move into the prime bean producing states of the Mid West. But we think even more of a factor falls under the auspices of standard economics. According to a conversation with a USDA economist it costs, (taking into account such items of accounting as "variable costs, machinery ownership, land, overhead, labour and management") \$6.97 to grow a bushel of beans. This assumes a yield of 28.3 to 31.7 bushels/acre. Beans are planted in May. At that time cash beans were trading in the \$6.00 range. Farmers planted beans beneath the cost of production. They had little choice as to substitute crops because, with the exception of cotton, most competing crops are also beneath production costs. What would you do ? Answer : stint on fertilizer, stint on irrigation, in sum, reduce your costs. And at the same time reduce your yields. Last year's yields were 32.2 bushels per acre. If yields are reduced by 2%, thus, taking into account abandonment, production could fall to as low as 1,950 mln bushels, leaving total supply at 2,350 mln bushels. Assuming that demand increases by 10%, a not unreasonable amount considering the effect low prices presumably have had and the fact that usage is presently running by that amount greater than last year, a production deficit is definitely within the realm of possibility.

While much of the foregoing are, again admittedly, the calculations of an acolyte, we do believe that, as the crop year progresses, the fundamental statistics will bear out the bullish chart pattern. In sum, we believe we are in the midst of a bull market that will last throughout the rest of the 1980/81 season. Our initial target is 775 basis November beans. Secondary target is 840. Present stops are at 680. Those not long are advised to enter on dips to the 720 mark.

DBR

Sugar

First estimates for the 1980/81 crop year put production at 89.8 mln tonnes. This is significantly higher than was generally anticipated and results from improved growing conditions in the past six weeks. Current year production is 84.6 mln tonnes.

Next year's production deficit is now tentatively put at no greater than 4.0 mln tonnes. In addition demand resistance may manifest itself in the wake of persistently high prices. These fresh perceptions have not been lost on trade firms and have thus proven sufficient to break the bull market; whether permanently or temporarily remains to be seen. The market finally broke its uptrend, (note chart) via a complex head shoulders replete with hefty volume on the left side and extremely light trade on the right. The persistent optimism of the bulls that the market would resume its advance after the expiration of July seems due to be punished now; there problem has always been that the expected shortage has always resulted in widening forward permiums, and never strong a cash market.

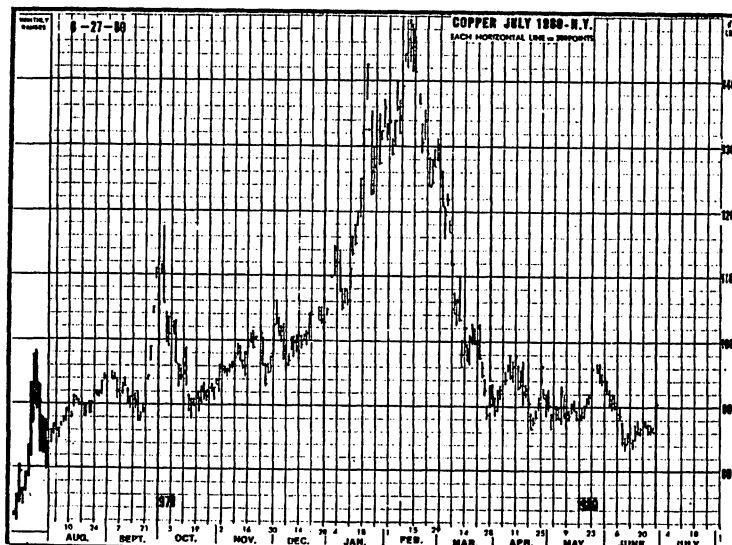
The current dip should take the market down to 29.50 basis October. A violation of that market will drag the sweetener to 25.50. We are short with stops at 36.50.

DBR

Copper

Combined stocks in approved warehouses in N.Y. and London increased from 226,291 tonnes to 279,057 or 23% from the first of the year to June 15th. During the first three months of this year, the latest period for which data is available, refining in the U.S. was up slightly and imports were up substantially; imports rose 41% March 80 over March 79. The data suggests a stockpiling in anticipating of the strike which began yesterday. Given the ongoing fall in industrial usage due to the recession, the issue is how long will this strike last. Normally a person's inclination is to seek work during periods of rising unemployment, however the effects of last year's inflation may make the unions more intransigent. Still the cards seem to be in the hands of management and, ironically, the bears at present. As such we are inclined to trade the red metal from the short side with stops at 96.00 basis nearest future on close.

DBR



Commodity Research Bureau, Inc.

Albert D. Friedberg  
David B. Rothberg

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