

# FRIEDBERG'S

## COMMODITY & CURRENCY COMMENTS

Hume Publishing

May 3rd, 1981

### Forewarned Is Forearmed

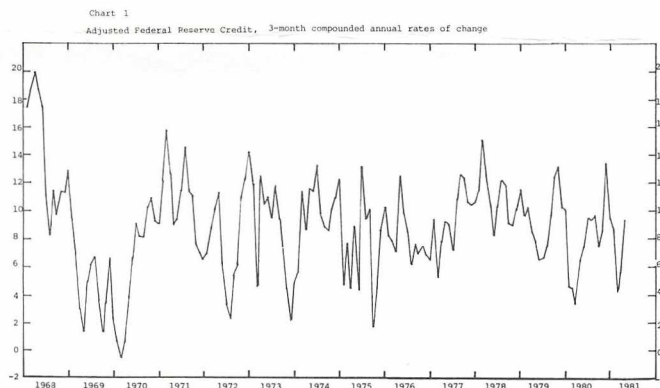
Ever since the middle of January we have been warning that interest rates were heading irregularly higher. We urged not to believe in a quick "peaking out" or "topping out" of rates *a la* Spring 1980. "Once bitten, twice shy," we concluded caustically (Varieties of Monetarist Experiments, Jan. 11th).

In reviewing our comments made over three months ago and ever since then, we noted that Federal Reserve Credit, the stuff of which reserves and money is built, was running out of control. By late 1980, Federal Reserve Credit had easily exceeded a 9% annual rate of growth and it was only a matter of time before the

popular aggregates reflected this expansion (see Chart 1). Although some tightening developed in February and March of this year, the die had already been cast.

During April, once again, Federal Reserve Credit expanded at a 9.6% annualized rate of growth. Coincidentally, at the beginning of April, M<sub>1</sub>B began to veer away from its moderate path, and by the end of April, it had shown a rise of 13.7% annualized over three months earlier. To us, this was no surprise.

The painful realities of a managed currency have still not dawned on money watchers and Central bankers. We predicted that higher interest rates would not necessarily be successful in their intent of reining in money supply because *we still did not know which money supply to control nor how to accomplish this objective, even if we did know*. Typical of this situation is a comment made on May 2 by a leading financial newspaper upon the release of a sharp \$4.2 billion jump in M<sub>1</sub>B. "... while economists agree that the recent money-supply figures are worrisome, the growth may not be as high as the M<sub>1</sub>B numbers alone suggest, some say. The reason is that the growth of NOW, or *negotiable order of withdrawal*, accounts, which are included in M<sub>1</sub>B may have a severely distorting effect. Since December 1980, these interest bearing checking accounts have grown from \$27.1 billion



#### In this issue

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Coffee: Still percolating

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to \$66.4 billion . . . the result is that  $M_1B$  overstates money growth, while  $M_1A$  understates it . . ." A lot of nonsense.

The fact is that the financial system has provided *as much credit as is demanded*, be it by way of Money Market Funds, which have grown by over \$30 billion since December/80, Money Market Certificates which, in the same span, have grown by \$25 billion, or Commercial Paper, which last week alone grew by \$2.6 billion. Admittedly, public portfolio preferences have changed — but who can blame them if they try to maximize returns? These shifts have enabled the commercial banking system to extend credit even if the Fed acts in a miserly fashion by the simple expedient of lowering their demand for reserves. In very simple terms, one dollar of time deposits requires approximately 10¢ less of reserves than one dollar of demand deposits. Credit will continue to expand until we practically exhaust non-interest-bearing demand deposits.

Late last week, as banks scrambled to square their reserve account at the Federal Reserve, Fed funds traded above 20%. Since, however, the banking system as a whole was short of reserves, no amount of inter-bank trading could accommodate the "System." Enter the Federal Reserve. It supplied the "System" with a weekly average of \$2.2 billion at the Discount Window and as much as \$8.4 billion (!) on Wednesday, settlement day, the biggest one-day total since the Franklin-National collapse on July 24, 1974. This generous accommodation masked the fact that commercial banks do not feel, *ever*, that their liquidity position is too low and that the money will ever run out. Providing support to their thesis is the give-away Discount Rate of 13%, cheap by any standard. If the Fed truly meant business, it would link the Discount Rate to money market rates, preferably two percentage points above it. It would thus become a penalty rate for those banks that became overextended.

These comments are not new. Nevertheless, they have found little success in penetrating the sanctuary of Conventional Monetarism. What makes matters worse is that even if we succeeded in measuring and controlling money supply accurately, the effort would not be entirely worthwhile. A recent article published by the Federal Reserve Bank of Dallas ("Back to Gold?") compares money-supply growth, interest rates, and inflation in the U.S. under a gold standard (1879-1914) and under a managed-money regime (1951-1980) (see Tables 1, 2, and 3).

Table 1  
LONG-RUN PRICE MOVEMENTS IN UNITED STATES  
(Annual inflation rates, in %)

	Gold-Standard Era			Recent Era			
	1879-96	1896-1914	1879-1914	1951-64	1967-71	1971-80	1951-80
GNP implicit price deflator...	-2.22 <sup>1</sup>	1.95	0.76 <sup>2</sup>	1.88	4.04	7.06	3.99
Consumer price index.....	-.66	1.04	.21	1.36	3.88	8.22	4.06
Producer price index, all commodities <sup>3</sup> .....	-1.64	2.14	.28	.30	2.67	10.00	3.80

1. 1889-96 only.  
2. 1889-1914 only.  
3. Wholesale price index before March 1978. To construct a continuous series, the wholesale price index was taken as .6854 times the Warren-Pearson index for 1879-90 and as the U.S. Bureau of Labor Statistics index for 1890-1914.

SOURCES: International Monetary Fund  
US Department of Commerce, Bureau of Economic Analysis  
US Department of Commerce, Bureau of the Census  
Federal Reserve Bank of Dallas

Table 2  
MONEY GROWTH IN UNITED STATES  
(In %)

	Gold-Standard Era			Recent Era			
	1879-96	1896-1914	1879-1914	1951-64	1964-71	1971-80	1951-80
Annual growth rate for M-2 money measure <sup>1</sup> .....	5.83	7.66	6.77	4.95	7.43	10.11	7.13
Standard deviation.....	6.46	3.87	5.27	2.05	2.36	2.14	2.98

1 For 1879-1914, currency outside U.S. Treasury and bank vaults plus demand and time deposits at commercial banks; for 1951-59, same concept as for 1879-1914 but also includes foreign demand balances at Federal Reserve banks; for 1959-80, the current definition as described in "The Redefined Monetary Aggregates," Federal Reserve Bulletin, February 1980.

SOURCES: Board of Governors, Federal Reserve System  
Citibank  
US Department of Commerce, Bureau of the Census  
Federal Reserve Bank of Dallas

Table 3  
INTEREST RATE FLUCTUATIONS IN UNITED STATES  
(in %)

	Average Yield	Standard Deviation of Yield	Average Annual absolute change
Gold-standard era, 1879-1914			
Long-term railroad bonds.....	4.46	0.52	0.13
Prime commercial paper (4 to 6 month) <sup>1</sup> ..	5.35	1.15	.91
Recent era, 1951-80			
Long-term U.S. Government bonds.....	5.36	2.32	.44
Aaa corporate bonds (Moody's).....	5.82	2.43	.46
U.S. Treasury bills (3-month).....	4.46	2.54	1.00
Federal funds <sup>2</sup> .....	5.34	3.06	1.50
Prime commercial paper (4 to 6 month) <sup>3</sup> ..	5.16	2.71	1.14

1. 1890-1914 only.  
2. 1955-80 only.  
3. From November 1979 on, 6-month notes.

SOURCES: Economic Report of the President, January 1981  
International Monetary Fund  
U.S. Department of Commerce, Bureau of the Census  
Federal Reserve Bank of Dallas

"Interestingly," the article points out, "the rate of money growth was approximately the same under the gold standard as later. Money grew at a compound rate of 6.8% compared with 7.1% in the more recent period. The rapid growth of money under the gold standard was not associated with long-run inflation because of the rapidly increasing demand for money (decreasing velocity). In the 1951-1980 period, increasing velocity aggravated the inflationary impact of rapid money-growth." (Italics ours.)

While the article concludes that "nearly unique historical conditions were favorable to the smooth operation of the gold standard, conditions that do not prevail today", it does not try to explain the enigma of decreasing velocity in the earlier period and increasing velocity in the later period.

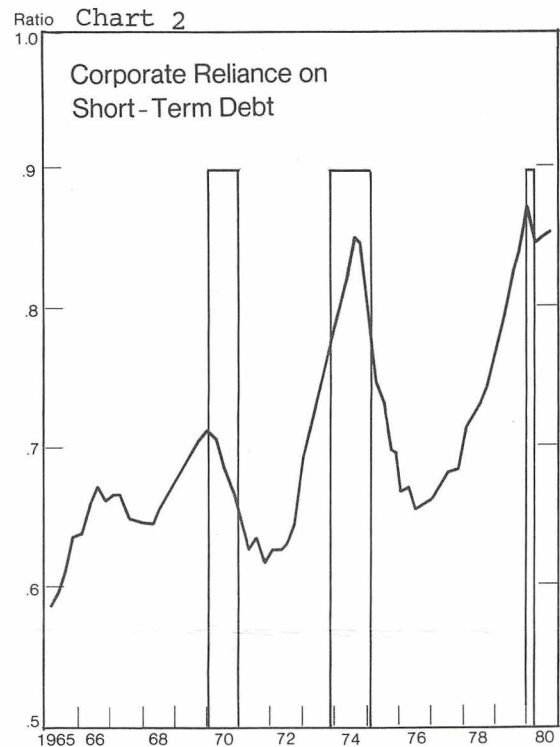
We think we can solve this puzzle. Under a convertible domestic gold standard, public holdings of money equated to holdings of gold. If the public thought that its paper-money holdings were excessive, it would simply turn them into gold, *at a fixed and pre-determined price*. Since money would not change its value (at least against gold) it became a desirable repository of purchasing power. Money possessed two ideal characteristics: a transactional purpose and, more importantly, a store of wealth. Money did not have to be disposed of and exchanged immediately for goods in fear of its changing value. As incomes rose, money holdings rose, *ergo*, a rapidly increasing demand for money, or, what is the same, decreasing velocity. But, could anyone say the same today? Can we be confident that we can exchange our paper money holdings at any time into a fixed, pre-determined amount of any commodity, let alone Gold? Wouldn't, then, money have lost its quality of being a store of value? The answer must necessarily be *yes*. Increasingly, money is viewed solely as a more or less efficient means for conducting transactions — therefore, a rapidly *decreasing* demand for money, or, what is the same, increasing velocity.

Nowadays, interest rates *could* compensate the holder of money if they were thought to be sufficiently attractive to overcome the loss of purchasing power. For this purpose, interest rates must be set high enough beyond the wildest dreams of those expecting continuous depreciation. We have seen how the U.K. learned this lesson in 1979 and 1980; the key minimum lending rate of the Bank of England was hoisted at a terrifying pace to reach beyond the "wildest expectations" of further inflation. The "shock treatment" worked well enough to lower inflation from an annual rate of 24% to the recent trough of 8% *despite the extraordinary growth of money supply (M<sub>3</sub>)*. The exceptional surge in unemployment was more the result of tinkering with market clearing-levels for wages (collective bargaining by semi-monopolistic unions, minimum wages, and transfer payments) than the rise of the demand for money.

Where does the U.S. (and Canada) stand today? Rising interest rates, led by market forces rather than by the Federal Reserve, ample credit and, as a result, continuously rising inflationary expectations. Due to the recent softening of energy, food and metal prices, price indexes such as the CPI and the PPI will, no doubt, show a reduced rate of inflation in coming weeks and months. Monetary inflation, on the other hand, will continue to be exceptionally high but may not be observed for many more months, enough time to give the market some kind

of brief respite from the present rise in interest rates.

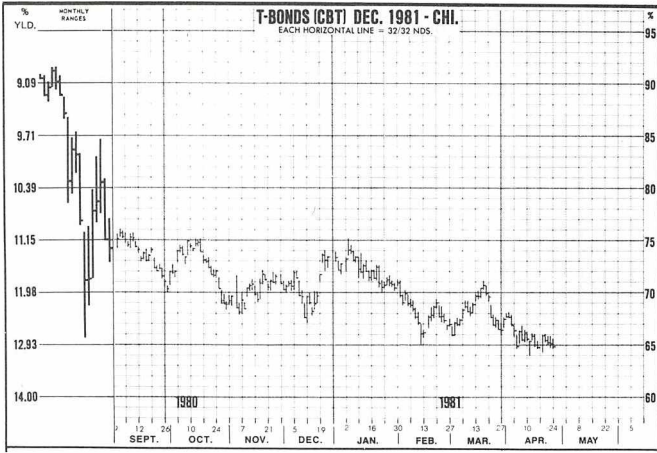
What is not commonly appreciated is the increasing illiquidity developing in the corporate area as a result of myopic thinking on the part of corporate treasurers. Chart 2 shows corporate reliance on short-term debt from 1965 to the present.



NOTE: Plottings represent the ratio of nonfinancial corporations' bank loans, commercial paper, and bankers' acceptances outstanding to their bonds outstanding. The shaded areas represent periods of recession as determined by the National Bureau of Economic Research, except for that in 1980 which was determined by The Morgan Bank. Data source: Federal Reserve Flow of Funds Accounts.

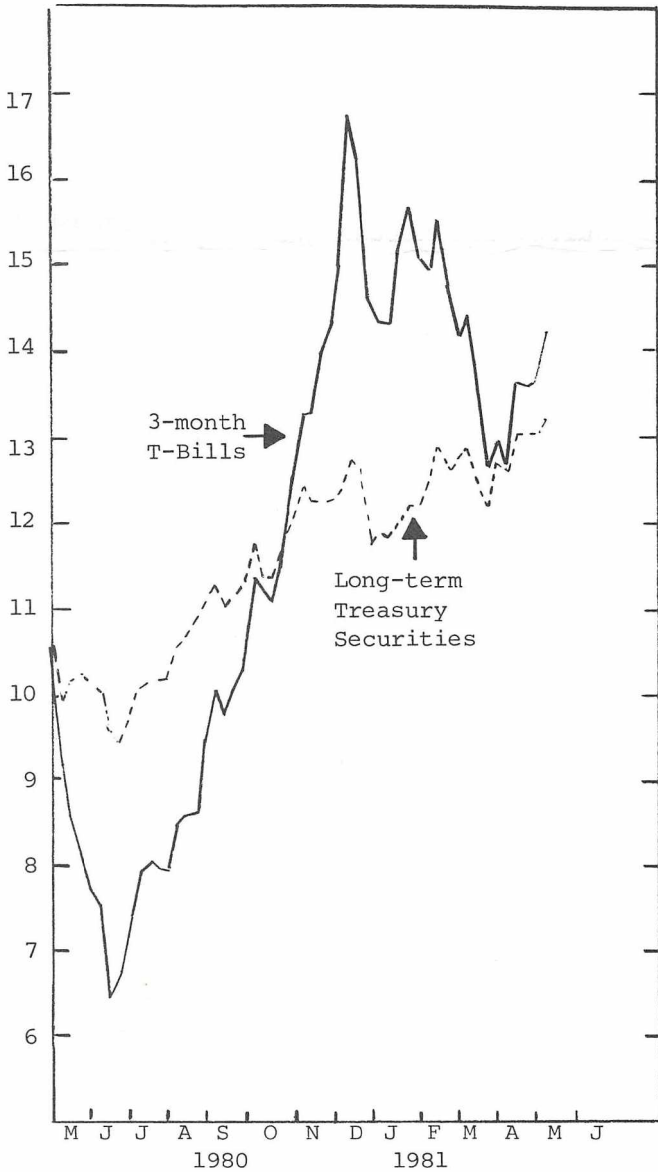
Any easing of long-term rates will be cushioned by a corporate rush to issue long-term debt. If, on the other hand, this phase does not come soon enough, a devastating spate of bankruptcies will ensue. Sowing discontent, reaping the whirlwind.

**STRATEGY:** Remain short Dec. 80 T-Bonds re-instated at 6607. A test of the 14 per cent level should take place this week; if breached, a quick 100 basis point rise will take Dec. '80 T-Bonds to 54-55, at which point total profits should be accepted. If long Treasuries hold 14 per cent, be prepared for a technical rally of as much as 100 basis points. We therefore recommend accepting partial profits at 61 basis Dec. '80, with a view towards cashing in on its ultimate target of 54-55.



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U.S. Interest Rates



CANADIAN FUTURES CONTRACTS					
<b>91-DAY TREASURY BILLS</b> (Combined Toronto-Montreal trading) \$1 million; multiples of \$0.005					
High	Low	Settle	Open		
97.290	95.875	Jun 81	--	95.830	-025 37
96.675	96.150	Sep 81	--	96.025	-075 4
96.725	96.585	Dec 81	--	96.150	-- 3
Sales: Friday 0; Thursday 7					
Total Open Interest: Thursday 44 +2					
Normal Daily Price Limits \$0.150 above or below prior settlement price.					
(Winnipeg trading)					
<b>91-day Canada treasury bills</b> \$200,000; amounts of 100 per cent					
High	Low	Settle	Open		
86.20	82.60	Jun 81	--	82.75	- 6 6
86.80	83.36	Sep 81	--	83.46	+10 8
87.78	84.00	Dec 81	--	84.00	-- --
87.75	84.20	Mar 82	--	84.20	-- --
Total Sales: Thursday 10.					
<b>MID-TERM GOVERNMENT OF CANADA BONDS</b> (Combined Toronto-Montreal trading) 5 Year 9% \$50,000 princ.; Price is % of Par Value (Fractions are 32nds of 1%)					
High	Low	Settle	Open		
79.20	76.00	Jun 81	--	76.00	- 47 12
79.20	67.10	Sep 81	--	67.10	- 42 --
79.15	69.00	Dec 81	--	69.00	- 15 --
79.30	69.20	Mar 82	--	69.20	- 10 --
76.68	77.19	Jun 81	--	76.21	- 21 1
Total Sales: Thursday 10.					
Sales: Friday 0; Thursday 1					
Total Open Interest: Thursday 1 +1					
Normal Daily Price Limits 64-32 above or below prior settlement price.					
<b>GOV'T. OF CANADA BONDS</b> (Combined Toronto-Montreal trading) — 18 Year 9 per cent \$100,000 principal; price is per cent of par value (Fractions are 32nds of 1 per cent)					
High	Low	Settle	Open		
74.15	59.28	Jun 81	--	60.15	59.28 60.12 +10 302
71.02	60.15	Sep 81	--	60.15	60.15 60.20 +08 67
Sales: Friday 57; Thursday 51					
Total Open Interest: Thursday 369 +19					
Normal Daily Price Limits 64-32 above or below prior settlement price.					
(Winnipeg trading)					
<b>Government of Canada bonds</b> 20 years 10 per cent \$20,000 face value (Fractions are 32nds of 1 per cent)					
High	Low	Settle	Open		
79.20	76.00	Jun 81	--	76.00	- 47 12
79.20	67.10	Sep 81	--	67.10	- 42 --
79.15	69.00	Dec 81	--	69.00	- 15 --
79.30	69.20	Mar 82	--	69.20	- 10 --
Total Sales: Thursday 10.					

GNMA	Settlement	
	Price	Yield

June 81	62 11	15.010
Sep.	62 18	14.952
Dec.	62 28	14.870
Mar. 82	63 06	14.788
June	63 15	14.715
Sep.	63 22	14.659
Dec.	63 28	14.611
Mar. 83	64 01	14.571
June	64 05	14.539
Sep.	64 09	14.507
Dec.	64 13	14.476
Mar. 84	64 17	14.444
June	64 21	14.413

T-Bonds

June 81	62 10	13.486
Sep.	63 05	13.306
Dec.	63 25	13.175
Mar. 82	64 11	13.059
June	64 26	12.964
Sep.	65 08	12.877
Dec.	65 19	12.808
Mar. 83	65 29	12.747
June	66 06	12.692
Sep.	66 14	12.643
Dec.	66 22	12.595
Mar. 84	66 30	12.547
June	67 06	12.500

T-Bills

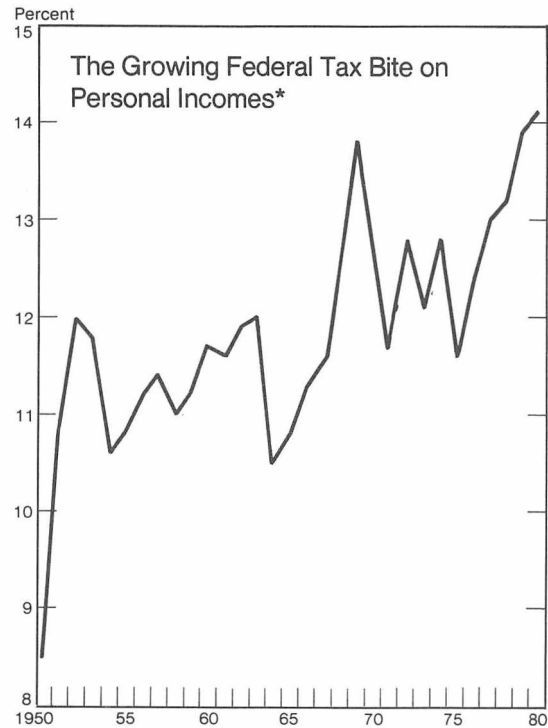
June 81	85.87	14.13
Sep.	86.72	13.28
Dec.	87.00	13.00
Mar. 82	87.12	12.88
June	87.23	12.77
Sep.	87.30	12.70
Dec.	87.39	12.61
Mar. 83	87.39	12.61

# Copper

A bullish position in copper performance equates with a bullish scenario for business activity. The unexpectedly strong 6.5 per cent spurt in first quarter GNP has not had much of an impact on professional economists' views of the robustness of the present economic recovery. For one reason or another, mostly associated with the depressed state of the housing and automobile industries, economic activity is expected to be "flat" at best for the coming one or two quarters. Adding concern is the spectacular rise in interest rates in recent weeks as well as the uncertain outcome of President Reagan's tax-cut proposals.

We strongly doubt that present levels of interest rates could derail economic activity. In the first place, rates are not prohibitively high if we consider the feature of tax deductibility. As we have oft stated in the past, the "choking point" today with an underlying inflation of 12 per cent is well in excess of 23 per cent p.a., a far cry from the present level of 18½ per cent. Secondly, even if interest rates reached these levels in coming weeks and months, these levels must be sustained in order to inflict damage and not just trade there for one or two weeks.

More crucial is the enormous burden of Federal taxation on personal income, a matter addressed by President Reagan's tax-cut proposals. Chart 7 portrays vividly the increasing share of personal income taken by the U.S. Government, mainly a result of a process known as "bracket creep." Despite *ad-hoc* tax cuts in the last 15 years, inflation has managed to push people into higher and higher tax brackets, creating serious obstacles to incentives and productivity gains. The Kemp-Roth 30 per cent multi-year tax-cut proposal may not be sufficient to reverse this trend if, as we believe, inflation, being a monetary phenomenon, is not reduced significantly below 12 per cent per annum over the next 3 years. Furthermore, Federal spending, despite proposed cuts, may grow substantially more over the coming three years than now anticipated, for the following reasons: a) a strong bipartisan commitment to re-arm — military spending overruns are as certain as death and taxes; b) a substantially higher debt-servicing cost than currently programed, resulting from rising interest rates — an argument already well-presented by the Democrats in Committee debates; c) the monstrous growth in indexed entitlement programs. Leaving aside questions of equity —



\*Based on income subject to tax—defined as personal income plus employee contributions to social insurance trust funds, minus transfer payments and fringe benefits.

Source: The Morgan Guaranty Survey

CHART 7

and we are strong believers in indexation as an alternative to confiscation — major indexed entitlement programs amounted to \$222.5 billion in fiscal 1980, close to 40 per cent of total Federal outlays. If Mr. Stockman's inflation forecasts are incorrect, and they must be, given profligate Federal Reserve policies, indexed entitlement programs will add as much as \$50 billion to Federal spending in the 1981-84 period, *over and above present forecasts*. Will Congress allow "supply-siders" an opportunity to test their hypothesis in a scenario of uncontrolled spending? In our opinion, "supply-side" experiments, as justifiable as they are, will be abrogated past the mid-term congressional elections, and both a serious reversal to crushing tax burdens and stagnation will ensue.

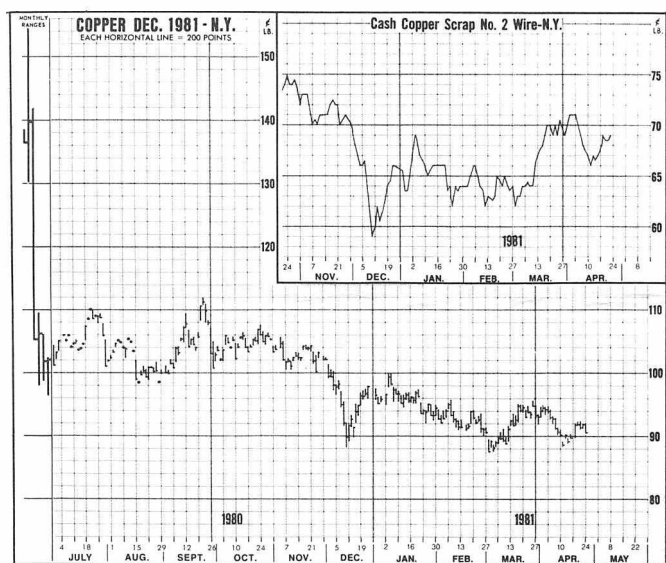
What does all this mean to Copper (and Cotton for that matter)? There is no denying that a supply shortfall is materializing. Nevertheless, unless worldwide (and particularly U.S.) economic activity breaks out to a sustained growth rate of 3 per cent p.a., serious shortfalls and bottlenecks will not develop. Rather, a fragile supply/demand situation will persist, with the danger that the delicate balance will be ruptured by occasional labor, political and military crises. In this scenario Copper will rise, if ever so slightly, above the rate of inflation, averaging perhaps only 1.25 by early 1984.

**STRATEGY:** In our March 4th Comments we projected a \$1.85-2.50/lb. target by 1983; clearly this statement should be qualified. The projection will hold only if we achieve growthflation (real growth of at least 3 per cent p.a. plus 12 per cent p.a. inflation). The alternative scenario, stagflation, calls for a modest 50 to 60 per cent rise in prices.

Either way, little is lost by maintaining long positions at the present time, giving us time to observe and adjust for progress in the enactment of appropriate tax reform and economic activity.

## Precious Metals

Once again, political factors have introduced a bullish element in the precious metals' market. While the Polish situation has been temporarily diffused (although political pundits are predicting a mid-July invasion to coincide with the Polish Communist Party election), tension in Lebanon and a possible Mitterrand victory in France have provided good support at a technically convenient level.



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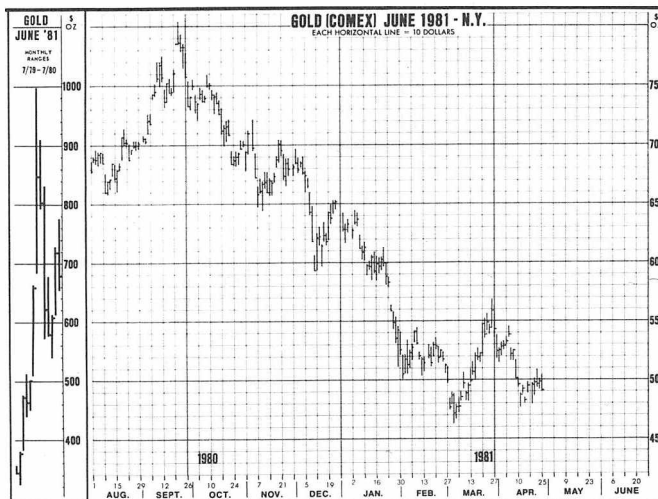
**STRATEGY:** The bear trend remains intact, but a short-term rally may develop at any time, capable of carrying gold to as high as \$530-540/oz. basis Spot. Short positions should be covered temporarily, and they may be reinstated either at \$530/oz. or on close below \$470/oz., all basis Spot.

Short positions in Platinum and Silver should be retained despite the possibilities of a rally; place trailing stops at 560 and 14.00 basis July '81 contracts respectively, close only.

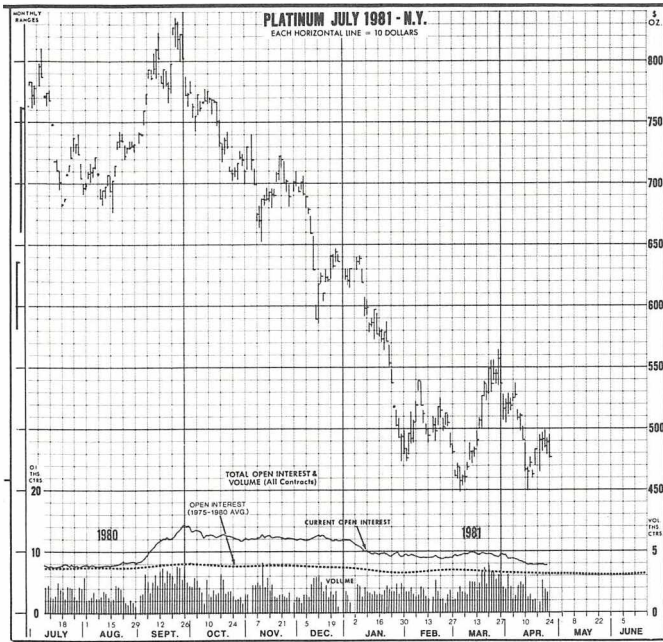
### Copper Warehouse Stocks

(Combined N.Y. & LME)

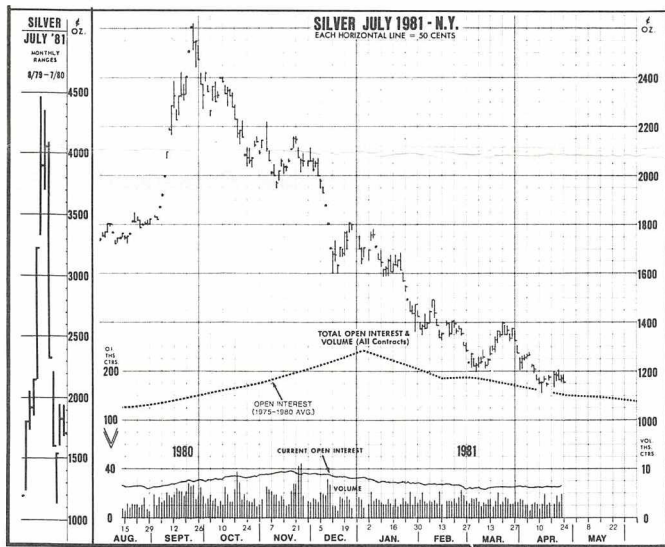
1981	Total (Metric T.)	12-weeks rate of change
Mar. 2	282,393	+1.07
9	281,867	-0.27
16	282,304	-1.36
23	277,492	-3.04
30	275,637	-3.34
Apr. 6	270,927	-4.68
13	276,165	-3.22
20	277,566	-2.83
27	283,271	-1.01



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## Currencies DM, SF, Yen

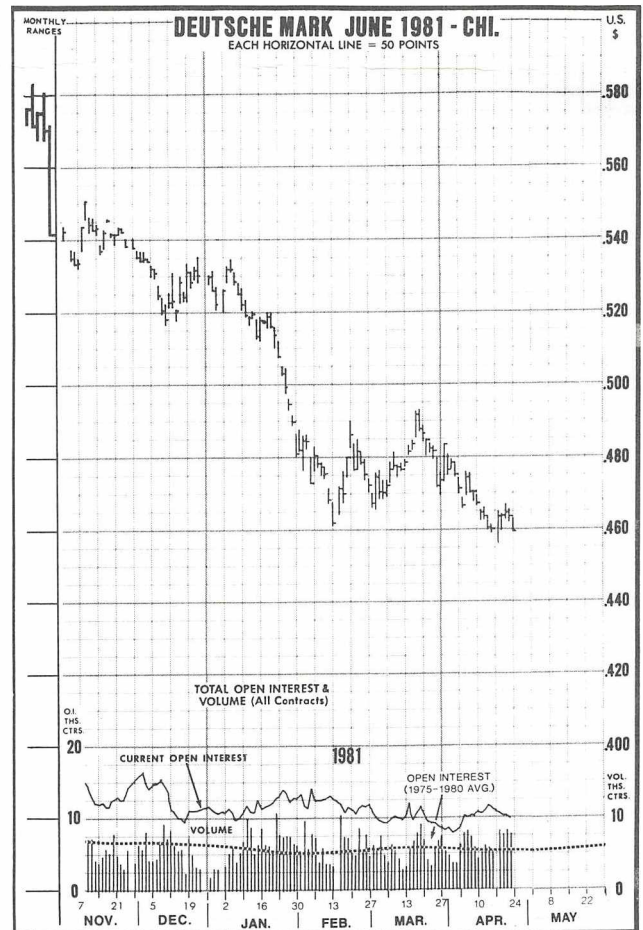
The surge in the U.S. dollar continues unabated.

West Germany reported a current account deficit of 2.8 billion DM for March, almost double the one reported for Feb. 81. For the whole first quarter, the current account deficit widened to 9.5 billion DM compared with 5.4 billion DM in the first quarter of 1980. The huge German current account deficit, which rose from 10.1 billion DM in 1979 to 28.1 billion DM last year, gives no signs of going away in spite of the evidence that oil imports are running at a lower level than a year ago and

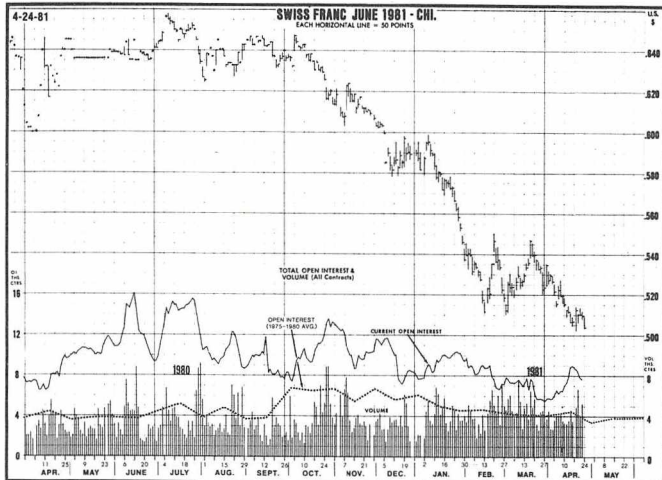
in spite of a weakening economy. Switzerland continues to pile up a trade deficit, although it is 1/3 lower than the corresponding period last year. Japan's trade balance moved to the black in the first 3 months of 1981, but its current account continued in the red, perhaps explaining the yen's grudging decline.

The most facile explanation of the U.S. dollar's strength is the *relative* tightness of domestic credit, which in turn causes an inflow of foreign currency, be it through a surplus on current account or a surplus on long and short term capital, or both. During 1980, net foreign assets of the Monetary Authorities and Commercial Banks increased from \$10.6 billion to \$53.6 billion (taking gold at \$42/oz.). This remarkable shift reverses the 1976-1979 decline, puts net foreign assets at the highest level in over 30 years in nominal terms, and equals the best levels attained in the early 50s, in real terms (see chart).

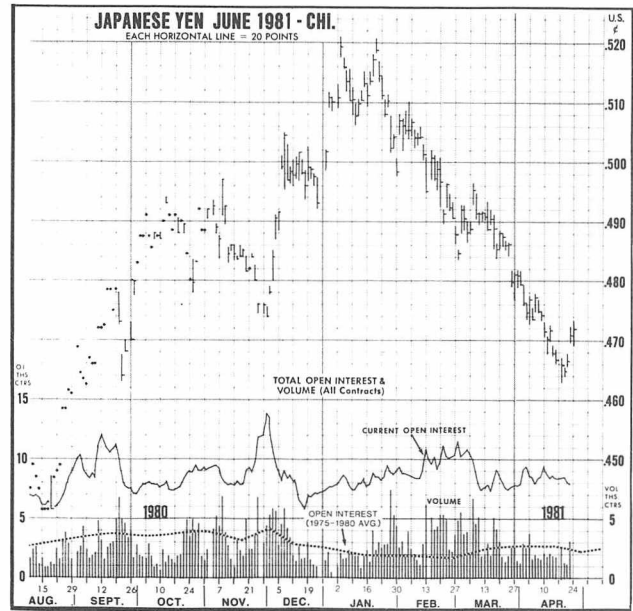
Clearly, one senses that aside from monetary factors, geopolitical factors are also at work. Refugee capital, normally unreported, has contributed mightily to this trend. As an example, net errors and omissions ran in favor of the U.S. by \$11.4 billion in 1978, \$23.6 billion in 1979, and \$34 billion for just the first 3 quarters of 1980.



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**STRATEGY:** Last month we suggested light short positions in the SF and DM, becoming more aggressive should the February lows be penetrated. They have now given way, and consequently, we are adding to these positions. Place stops at 53.00 basis June '81 SF and 47.50 basis June '81 DM, close only. Remain short Japanese Yen (recommended in March 4th issue), lowering stops to 48.00 basis June '81, close only.

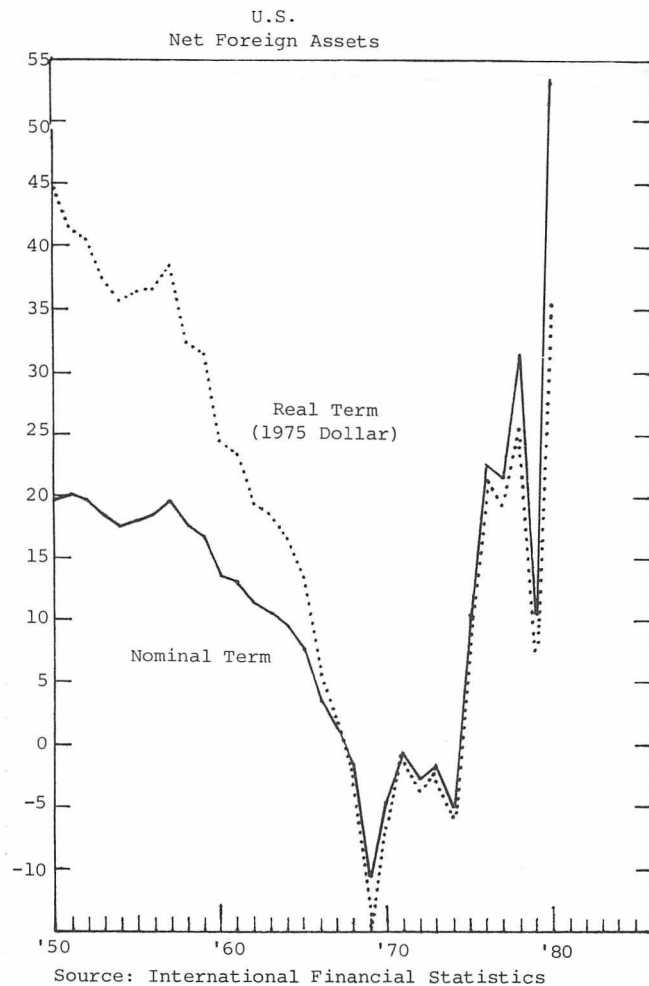
## British Pound

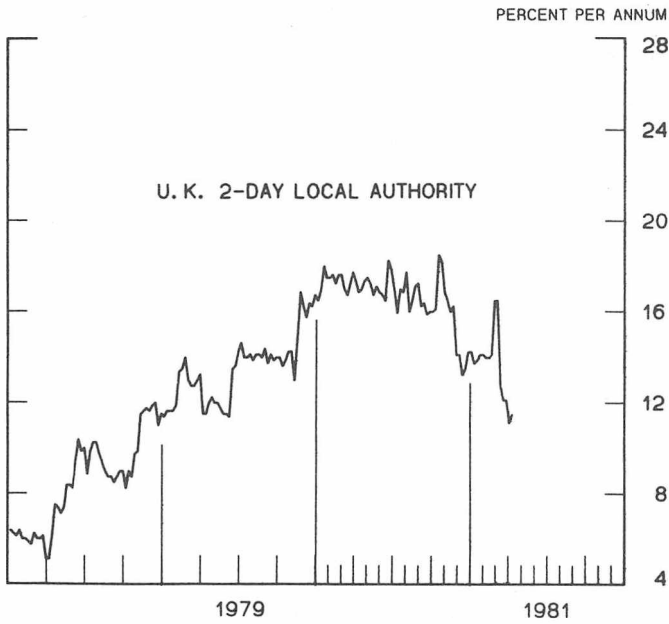
Vis à vis the DM and SF, Sterling has remained remarkably steady, reacting no doubt to the "stiffness" of the Minimum Lending Rate. London money rates, however, are perched just above 12 per cent and await government leadership before they plunge to the 10 to 11 per cent level.

The London Stock Exchange, sensing a dramatic drop in money rates ahead, has risen a spectacular 20 per cent in recent weeks and will continue to rise until money rates hit "bottom," regardless of industrial activity.

**STRATEGY:** We continue to believe that the British Government has all but given up its anti-inflation stance and has shifted to a dramatic anti-depression stance. Since tax policy is inordinately restrictive, its only weapon is low rates and lower Sterling.

Remain short; our first objective is 1.95-2.00 with an eventual target of 1.55-1.75 by early 1982. Place protective stops at 2.22 basis June '81.





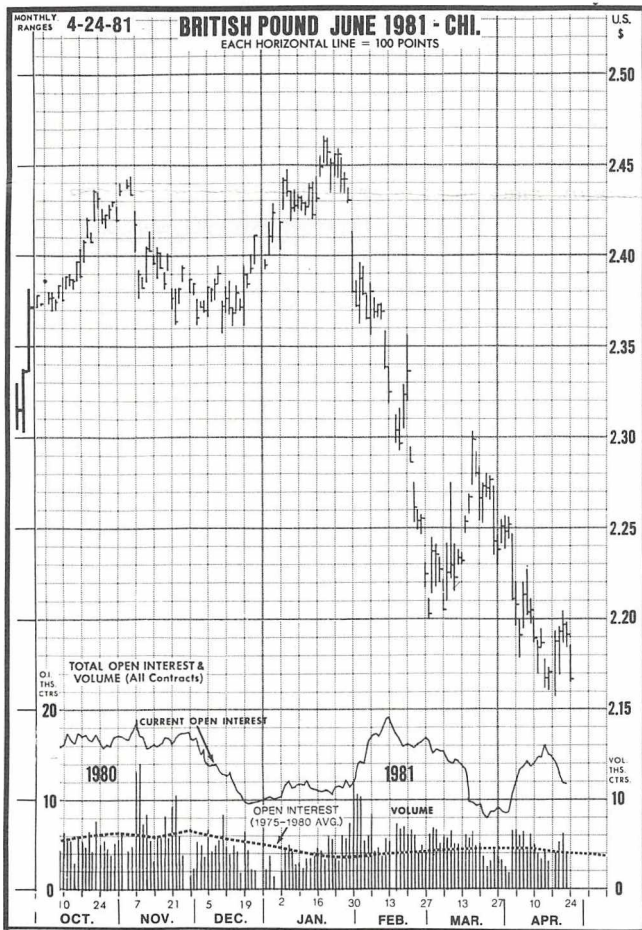
look at Canada's inflation problem is forthcoming in our annual Spring review of *Inflation in Canada*.

Inflation in internationally traded goods equals the world pace (as is to be expected under a relatively fixed exchange-rate regime), but the 20 per cent-plus 1976-1980 devaluation has begun to catch up in many sectors and threatens to push Canada to the forefront of the inflation derby of OECD countries. Furthermore, the extraordinary growth of credit experienced in the past four years has already begun to spill over non-traded goods, such as real estate.

There is little end in sight for the rise in interest rates in Canada; T-Bills now trade 300 points higher than their U.S. counterpart and long-term Treasuries have widened their premium to 150 basis points. These premiums should widen at least 50-75 basis points if the Canadian Dollar is to remain "pegged" to the U.S. around the 83c mark.

**STRATEGY:** Short positions in Canadian T-Bills are showing enormous profits; remain short.

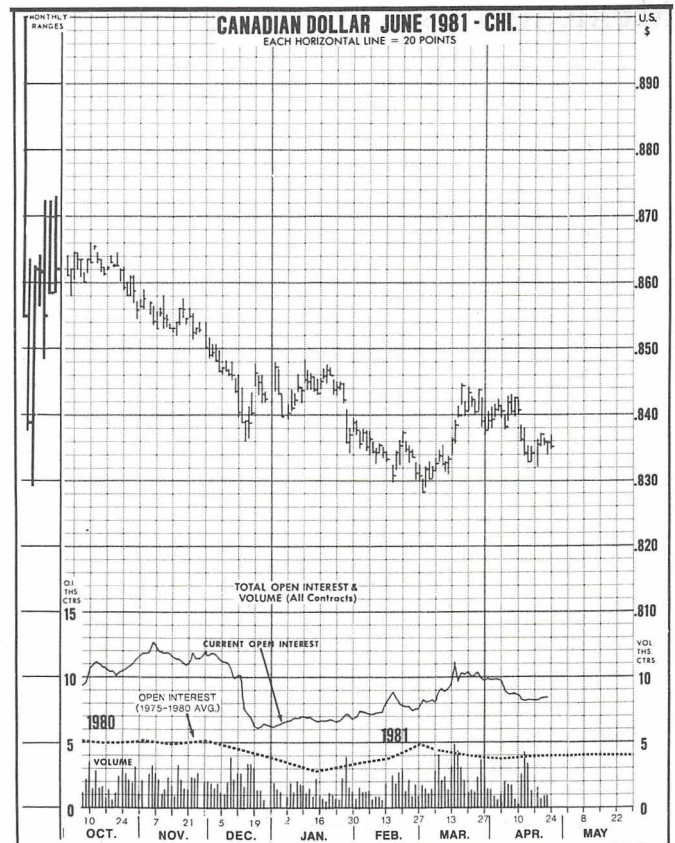
At the present time, the Canadian dollar is a trading affair, although its band should be lowered to a 81.50-84.50 range. Trade accordingly.



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## CDS

Despite repeated attempts at tightening, Canada's domestic credit expansion remains excessive (a more detailed



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Balance of Trade	Mar. 81	Feb. 81	Jan. 81	Dec. 80	Jan.-Mar. 81	Jan.-Mar. 80
U.K. (bln Stg)		+314	+742	+246		
C.D. (bln CDS)		+536	+793	+670		
D.M. (bln Marks)	+134	+864	-923	1.01	-193	+1,882
J.Y. (bln US\$)	+2.15	1.38	-1.47	2.39	+2.06	-417
SFr. (bln Francs)	-.802	-.784	-.388	-.880	-1,974	-3.09
<b>Current Account</b>						
U.K. (bln Stg)		+614	+1.04	+346		
D.M. (bln Marks)	-2.8	-1.6	-5.1	-.7	-9.5	-5.4
J.Y. (bln US\$)	+830	-207	-2.83	1.18	-2,207	-5.81
<b>Overall Account</b>						
D.M. (bln Marks)		-6.09	+0.85	-.675		
J.Y. (bln US\$)	+2.0	+656	-.048	+4	+2,608	-5.59
<b>Reserves</b>						
U.K. (bln US\$)		28.43	28.39	27.43		
C.D. (bln US\$)	3.715	3.341	3.436	4.03		
D.M. (bln Marks)	69.1	61.0	67.1	67.04		
J.Y. (bln US\$)	27.02	26.68	26.5	25.23		
SFr. (bln Francs)	23.38	20.96	21.72	27.36		
<b>Cost of Living/C.P.I.</b>						
					Mar. 81/Mar. 80	Feb. 81/Feb. 80
U.K. (1974 base)	284.0	279.8	277.3	275.6	12.61	12.46
C.D. (1971 base)	229.40	226.4	224.1	221.3	12.45	12.19
D.M. (1976 base)	122.0	121.3	120.5	119.3	5.54	5.57
J.Y. (1975 base)	142.2	141.4	141.3	139.6	6.20	6.48
SFr. (1977 base)	113.8	113.1	112.0	110.9	6.36	6.00
<b>W.P.I.</b>						
U.K. (1975 base)	214.5	211.8	209.6	206.6	10.33	10.60
C.D. (1971 base)		262.6	261.1	257.5		9.37
D.M. (1976 base)	124.0	121.9	120.3	119.2	7.08	5.81
J.Y. (1975 base)	132.1	132.1	132.3	133.0	1.77	3.85
SFr. (1963 base)	163.1	161.8	160.6	158.9	5.23	5.34
<b>Unemployment Rate</b>						
U.K. (Apr. 10.1)	9.9	9.6	9.3	9.3		
C.D.	7.4	7.2	7.3	7.4		
D.M.	5.2	5.6	5.6	4.0		
J.Y.	2.5	2.2	2.2	2.1		
SFr.	0.2	0.2	0.3	0.2		

In 1939 the daily salary of 4.11 pesos (18 cents) could buy 29 kilos of beans or 37 kilos of corn. Now, the daily salary of 163 pesos (\$7) can buy just 8 kilos of beans or barely 15 kilos of corn.

We are going to see what we see in Iran. A very bloody revolution. There is hunger and the contrast between the rich and the poor is growing.

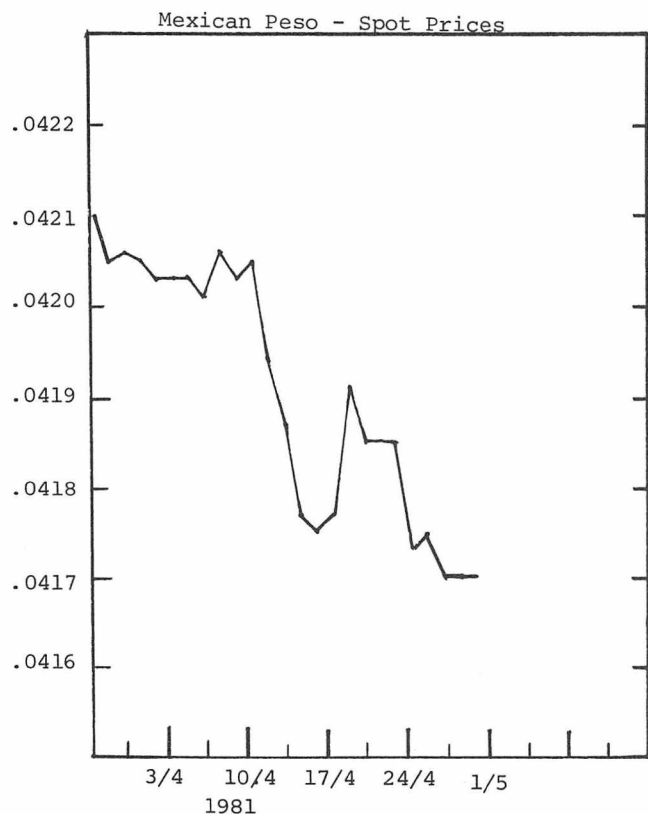
—Herberto Castillo  
President of the Mexican  
Worker's Party

We rarely would stoop down to quote a Socialist but for the fact that such perceptions are a true reflection of conditions in Mexico today and the consequent potential for chaos.

The recent strike at Telefonos de Mexico, where 25,000 workers walked out demanding a 40 per cent wage increase, is typical of the labor situation in the entire country. Since the 1976 devaluation, workers' wages have, by agreement, risen far less than the cost of living, so as to provide the government with a breathing space to stabilize the economy. As a result, real wages have dropped in excess of 25 per cent in the span of four years, a most substantial decline in the face of what has been called the Mexican "miracle" or "boom."

Lopez Portillo has built the boom on the back of oil and the decline in real wages. Both factors are about to turn against him. The recent cut in Mexico's oil price underscores the country's desperate plight for foreign currency. Having become a mono-exporter, due to the substantial deterioration in its industrial cost structure, Mexico is forced to sell oil at any price to cover a portion of its estimated \$8 billion deficit in current account. It just may not be able to make it.

## Mexican Peso



**STRATEGY:** The controlled, crawling peg continues to be evident. The Spot MP dropped just a bit more than .08 per cent during April, about in line with the previous four months.

Forward positions have not narrowed the discount, supporting our thesis that they offer an almost risk-free speculation on a possible 100 per cent devaluation. Remain short deferred positions, and be patient.

## Cotton

Since last writing, the statistical picture has tightened even further. An upward revision of 200,000 bales in export demand — due primarily to added Chinese enterprise — compensated for a downward revision in domestic usage by 100,000 bales. The net effect is to reduce projected year-end carryout to 2.5 mln. bales.

Despite such (apparently) bullish revisions, cotton prices have declined since last month, especially prices of

old crop deliveries. The reasons are: 1) an upward revision in year-end world stocks to 21.4 mln. bales from 21.3 mln. bales; 2) fears of higher interest rates and a worsening economy which induces a reduction of "the fat" from inventories; 3) excellent growing conditions for the upcoming 1981/82 crop. Planting is ahead of last year's schedule in key growing states.

**STRATEGY:** We believe the absence of mill buying is the dominating factor and will serve to inhibit rally attempts. The reluctance of domestic mills, however, should be interpreted as a somewhat speculative posture which leaves them especially vulnerable to any sudden surge in demand. Until then, however, we prefer, having been stopped out of long positions as per last month's recommendations via July, to remain sidelined. Existing longs in new crop December can be maintained only because of a somewhat more constructive technical picture and a highly favorable risk/reward ratio.



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## Coffee

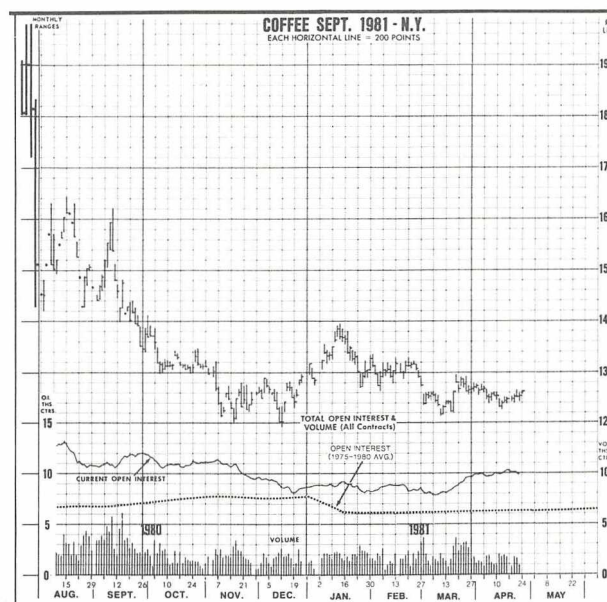
Our bullish posture which was described in detail in the March 4 Comments is, at this point, modestly rewarding: call options then at striking levels of £1,032 basis September in London have reached the £1,075 — £1,085 level.

Updating our March 4 forecast we note that latest data indicate, as opined, that consumption has picked up in the past several months. The International Coffee Organization (ICO) reports that in the U.S., household purchases during January and February were up 8 per cent over the comparable period in 1980. Most recent statistics indicate an uptick in demand in Europe and Japan as well.

Production during the current 1980/81 crop year, which ends June 30, now indicates a small surplus rather than the small deficit which was expected earlier. The size of the current year's production has, of course, already had its effect on prices; market attention is now fully focused on the upcoming 1981/82 crop. The big news remains the size of Brazil's expected harvest: a record 32.0 mln. bags as opposed to this year's 21.5 mln. bag harvest.

Trade reports indicate that roasters in the U.S. have elected to be even more cautious buyers going into the May/September period than they had been. One presumes they are sensitive both to the increasing interest rates and to the magnitude of the coming Brazilian crop. If frost should reduce the size of the Brazilian harvest, or if demand should surprise even slightly, roasters are in an extremely vulnerable position. Current inventories in the U.S. are at dangerously low levels.

**STRATEGY:** The chart picture is even more attractive than as of last writing. Light volume and small open interest leave the market in good shape for a strong runup. We continue to favor purchase of London call options on dips. More speculative accounts can take outright positions in New York, risking 182.20 basis September.



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Albert D. Friedberg  
David B. Rothberg

# Notes

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

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