

# FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

Hume Publishing

May 31st, 1981

## Western Europe: The Declining Phase

The recent downtick in U.S. interest rates has revealed a surprising divergence: European currencies remain prostrated at their lowest levels in four years. Are currencies no longer sensitive to interest rates? Or are they responding to a much deeper malaise? We think the latter.

In at least one major country, social democracy has given way to socialism. In the early measures adopted by French socialist Mitterrand's team, one senses that all vestiges of enlightened economic liberalism have been irretrievably lost. Admittedly, Mitterrand's ascension does not signify a revolutionary change in economic and social policies: The previous government had already instituted a national minimum wage, retained rent controls, used currency controls, adopted strongly protectionist policies, and so on. The evolution towards a mercantalistic and government-directed economy, a process lasting over fifteen years, has now ripened into a mature state. Furthermore, communist participation in the new government practically guarantees that a reversal from present trends will be so difficult as to require a violent revolution once discontent inevitably sets in.

The European landscape is desolate. After running a trade deficit of \$4 billion in the first quarter of 1981, up from \$3 billion in 1980, and a payments deficit of almost \$3 billion for the first four months of 1981, and having a host of unsolvable political problems, Italy introduced a 30 per cent import deposit scheme, which has done very little, so far, to stem the spectacular fall of the lira. Monstrous government deficits, amounting to as much as 6.5 per cent of GNP, are at the heart of political instability in Sweden, Netherlands and Belgium. The crowding-out effect of government borrowing has already shattered the industrial base of these countries, causing unemployment rates to soar to levels not seen since the Great Depression. Spain, a soon-to-be-admitted member of the European Community, can only contribute more trouble with the following problems: stagnant production; the need to erect even taller tariff walls to protect its agriculture; an official 12 per cent rate of unemployment (up from less than 2 per cent in 1970); and a 31 per cent rate of unemployment among workers under the age of 25.

### In this issue

- U.S. Dollar: Higher, but not necessarily because of interest rates
- Interest Rates: The rally came and went, and now? Lower of course...
- Precious Metals: Dull, listless, but still slightly bearish...
- Mexican Peso: Enormously overvalued, so keep selling...

Friedberg's Commodity & Currency Comments is published monthly by Hume Publishing. Make subscription checks payable to Hume Publishing.

All editorial and subscription enquiries should be directed to:

U.S. subscribers — 120 Interstate N. Parkway E., Box 723188, Atlanta, Georgia 30339 Tel. (404) 952-5740

Canada and all other countries except the U.S. — 716 Gordon Baker Road, Willowdale, Ontario M2H 3M8 Tel. (416) 493-5380

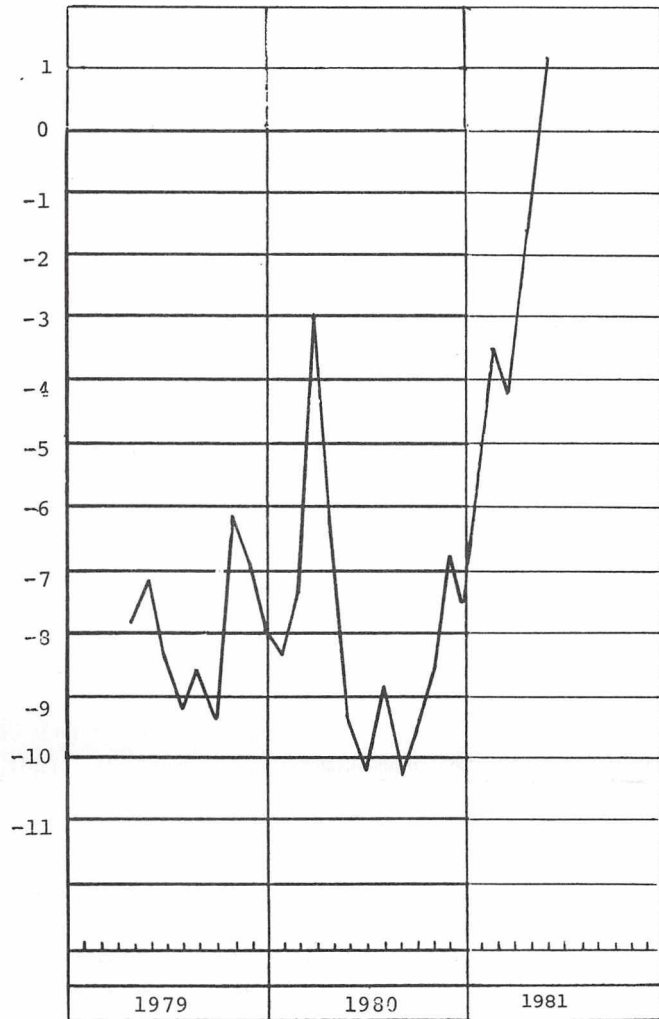
Content for Friedberg's Commodity & Currency Comments is supplied by Friedberg Commodity Management Inc.

All enquires concerning trading accounts should be directed to the Friedberg Mercantile Group,

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

Figure 1

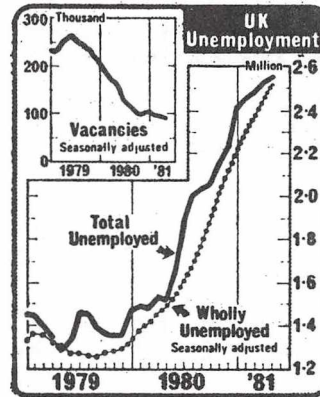
U.S. Trade Weighted Exchange Rate  
(Smithsonian Central Rates Dec. 1971)



Source: Morgan Guaranty Trust Company

The Thatcherite failure in the U.K. is a source of further encouragement to the left-of-center forces gaining control of Europe. The current 12 months rate of inflation in the "tax and price index" of 15.7 per cent, gained at the expense of 2.6 million workers laid off, leaves the U.K. with but few meaningful choices, the single most important of these being a drastic cutback in government spending. But how? The easy budgetary cuts have already been made since 1973. Capital expenditures (future projects and jobs) have fallen from over 20 per cent in the mid-seventies to less than 12 per cent of the budget. Spending on housing in 1981-1982 has dropped by half over the past 5 years, while spending on education has fallen by ten per cent in real terms over the same span of time. The decisions to cut military spending and entitlement programs such as social security will be a most difficult one and hardly likely to be adopted in full view of the next parliamentary election. After all the austerity prayers have been recited, public expenditures in the U.K. remain at approximately 44 per cent of GDP, well above the 38 per cent share taken in 1969-1970.

Figure 2



Financial Times

West Germany, the former bastion of conservatism in Western Europe, has thrown austerity out the window by announcing that the Central government's budget deficit will rise DM6.5 billion above the January forecast. The Bundesbank has suggested that the overall public deficit will rise DM10 billion to DM69 billion, a level not seen since the 1975 recession. With some luck, actual results will not exceed forecasts by more than 10 per cent. The Bundesbank further notes the close connection between last year's current account deficit of DM29 billion and the disorderly conditions of state finances.

Figure 3

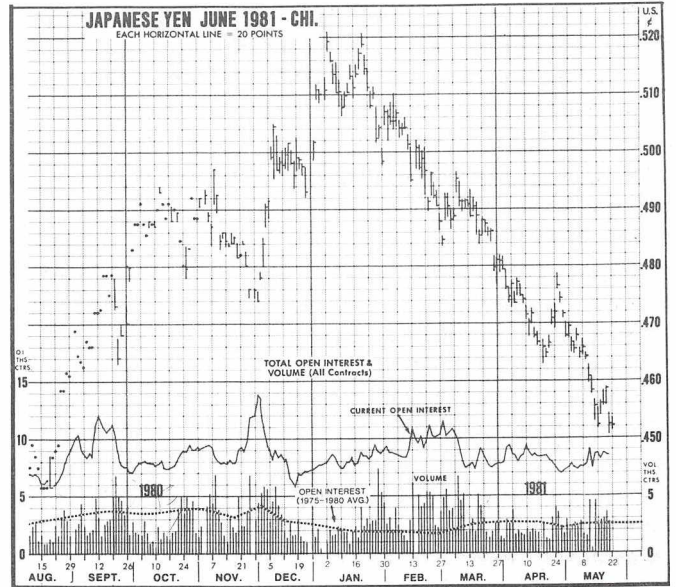
	Apr. 81	Mar. 81	Feb. 81	Jan. 81	Dec. 80
<b>Balance of Trade</b>					
U.K. (bln Stg)			+ .314	+ .742	+ .246
C.D. (bln CD\$)		+ .512	+ .461r	+ .793	+ .670
D.M. (bln Marks)		- .134r	+ .864	- .923	1.01
J.Y. (bln US\$)	1.51	+2.15	1.38	-1.47	2.39
SFr. (bln Francs)	- .708	- .798r	- .784	- .388	- .880
<b>Current Account</b>					
U.K. (bln Stg)			+ .614	+1.04	+ .346
D.M. (bln Marks)		-2.8	-1.6	-5.1	- .7
J.Y. (bln US\$)	.490	+ .763r	- .207	-2.83	1.18
<b>Overall Account</b>					
D.M. (bln Marks)		+8.14	-6.09	+ .085	- .675
J.Y. (bln US\$)	+2.35	+1.82r	+ .656	- .048	+ .4
<b>Reserves</b>					
U.K. (bln US\$)	28.07	28.21	28.43	28.39	27.43
C.D. (bln US\$)	3.165	3.715	3.341	3.436	4.03
D.M. (bln Marks)	72.8	69.1	61.0	67.1	67.04
J.Y. (bln US\$)	27.34	27.02	26.68	26.5	25.23
SFr. (bln Francs)	20.37	23.38	20.96	21.72	27.36
<b>Cost of Living/C.P.I.</b>					
U.K. (1974 base)	292.2	284.0	279.8	277.3	275.6
C.D. (1971 base)	231.1	229.40	226.4	224.1	221.3
D.M. (1976 base)	122.8	122.0	121.3	120.5	119.3
J.Y. (1975 base)	143.3	142.2	141.4	141.3	139.6
SFr. (1977 base)	113.5	113.8	113.1	112.0	110.9
<b>W.P.I.</b>					
U.K. (1975 base)	217.8	214.5	211.8	209.6	206.6
C.D. (1971 base)		264.6	262.6	261.1	257.5
D.M. (1976 base)	124.8	124.0	121.9	120.3	119.2
J.Y. (1975 base)	132.7	132.1	132.1	132.3	133.0
SFr. (1963 base)	163.6	163.1	161.8	160.6	158.9
<b>Unemployment Rate</b>					
U.K.	10.1	9.9	9.6	9.3	9.3
C.D.	7.0	7.4	7.2	7.3	7.4
D.M.	4.9	5.2	5.6	5.6	4.0
J.Y.		2.5	2.2	2.2	2.1
SFr.	0.2	0.2	0.2	0.3	0.2

Figure 4



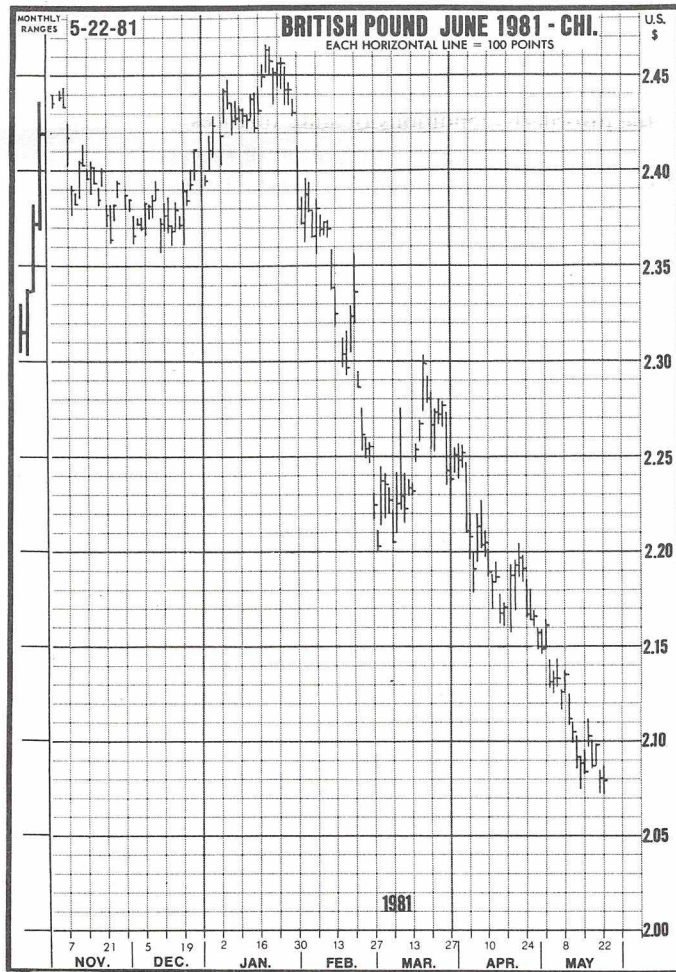
Reprinted from Commodity Research Bureau, Inc.

Figure 6



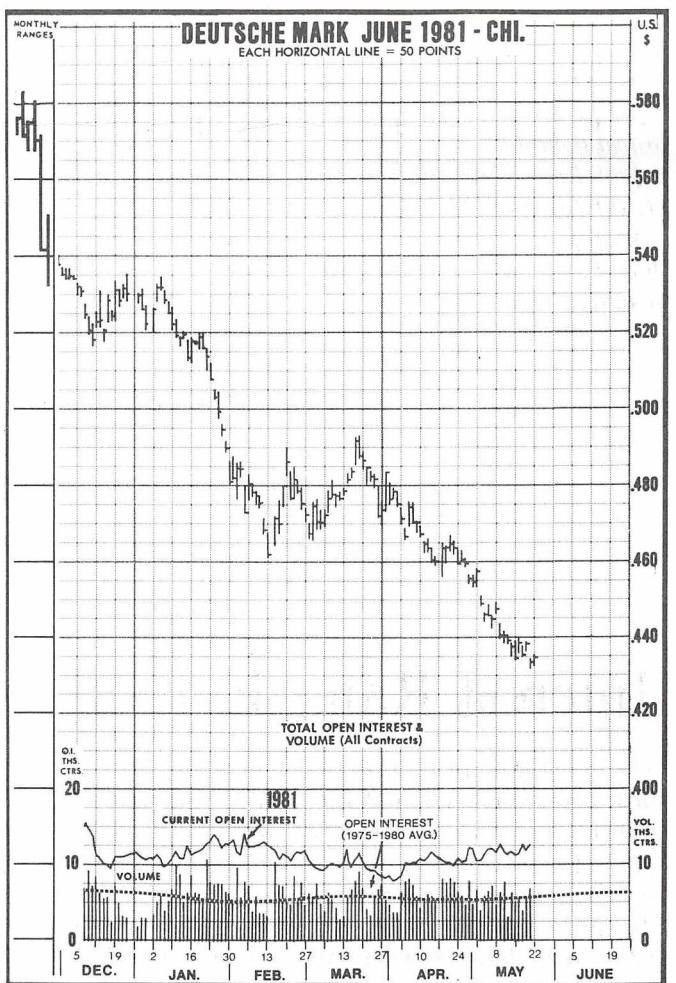
Reprinted from Commodity Research Bureau, Inc.

Figure 5



Reprinted from Commodity Research Bureau, Inc.

Figure 7



Reprinted from Commodity Research Bureau, Inc.

Capping Western Europe's trouble is the cost of running the EEC's Common Agricultural Policy (CAP) which now takes up as much as 72 per cent of the EEC's total budget and threatens to exhaust available resources. This policy has not only cost Western European consumers billions of dollars in extra food costs and piled up an embarrassing surplus of agricultural goods, but also now threatens the very basic unity of the Common Market. Moreover, the EEC's ever increasing battery of trade barriers erected against third parties has become a powerfully distorting force in world trade, causing misallocation of resources as far away as the far east and the southern hemisphere.

Finally, by floating together under the European Monetary System (EMS), Western Europe has been able to transmit the weaker partners' ills on to the stronger ones, achieving a cumulatively downward ratchet effect on industrial production and exchange rates and a cumulatively upward ratchet effect on unemployment, trade barriers and discontent.

Any wonder, then, that the U.S. dollar reigns supreme despite falling interest rates?

---

**STRATEGY:** *Remain short European currencies, particularly the West German DM, the Swiss franc and the British pound.*

*Lower protective stops to 46.50 basis June '81 DM, 51.50 basis June '81 SF and 2.16 basis June '81 BP.*

*With protectionism on the rise, the Japanese yen should continue to work its way down; lower stops to 46.50 basis June '81.*

---

Velocity is defined as the turnover ratio of spendable money balances. An incomes measure of velocity is arrived at by dividing nominal GNP over monetary balances, say  $M_1B$ . This straightforward calculation, however, misses two points: a) spending not associated with GNP activity, i.e., payments to babysitters, purchases of financial assets, purchases of collectibles, etc.; and b) spending that goes unreported to tax and census authorities, i.e., illegal drug trade, smuggling, gambling, etc. These two forms of spending, however, create activity and income despite their lesser status and doubtless understate the true impact of velocity on economic activity and inflation.

A more faithful proxy of velocity, in our view, is the ratio of debits to demand deposits divided by demand deposits. While it may also miss some of the impact of unreported transactions (normally done with currency), it is able to account fully for the category of spending that includes purchases of financial assets, collectibles and so on. Figure 8 charts debits to demand deposits, the turnover ratio and the percentage increase in this turnover ratio from 1960 to 1981.

Although velocity doubled from 1960 to 1970, in the decade of the 70s (and particularly in the past 2 years) velocity rose at an exponential rate. In the 12 months to Feb. 1981, the turnover ratio increased by no less than 32.15 per cent, indicating that the demand for money was falling almost five times as fast as the supply of money was increasing. The economization of spendable money balances has made superfluous the Fed's desire to increase spendable money balances at a rate "consistent with balanced growth." This phenomenon, already discussed in previous issues, is a distinctive characteristic of a fiat money standard and, ultimately, leads to destruction of the fiat money standard as confidence in paper money wanes to the point that idle money balances only last a few hours or minutes.

## Interest Rates Futures

The recent upward revision to real GNP growth for the first quarter, now put at 8.4 per cent, was greeted with disbelief by monetarists who have argued that moderate rates of money-growth result in moderate increases in real and nominal economic activity. Aside from the fact that broader measures of money supply, such as  $M_2$  and bank credit, have grown at rates well in excess of  $M_1B$ , velocity has picked up considerably, introducing a new uncertain element in the monetarist world.

Figure 8

	Debits to Demand Deposits (billions of US\$)	Annual Change %	Demand Deposit Turnover	Annual Change %
1960	2,839		35.5	
1961	3,111	9.58	38.2	7.61
1962	3,346	10.45	41.5	8.64
1963	3,755	9.28	44.3	6.75
1964*	4,141	10.28	47.7	7.67
1964**	4,631		44.8	
1965	5,162	11.47	48.1	7.37
1966	5,923	14.74	52.8	9.77
1967	6,662	12.48	56.7	7.39
1968	8,010	20.23	62.0	9.35
1969	9,223	15.14	68.0	9.68
1970	10,904	18.22	77.0	13.24
1971	12,383	13.57	83.7	8.70
1972	16,438	32.75	76.7	-8.36
1973	20,904	27.16	91.3	19.04
1974	22,938	9.73	99.0	8.43
1975	25,028	9.12	105.3	6.36
1976	29,180	16.59	116.8	10.92
1977	34,322	17.62	129.2	10.62
1978	40,298	17.41	139.4	7.89
1979	49,775	23.52	163.5	17.29
1980	62,925	26.42	201.6	23.30
1981 Feb.	73,175	22.1***	253.6	32.15***

\* Comparable with earlier years

\*\* Comparable with later years.

\*\*\* Feb. 81 over Feb. 80

Sources: Federal Reserve Bulletin  
Historical Statistics of the United States.

Despite the much publicized 1980 recession and/or 1980-1981 slowdown, bank liquidity has shown remarkably little improvement.

Figure 9

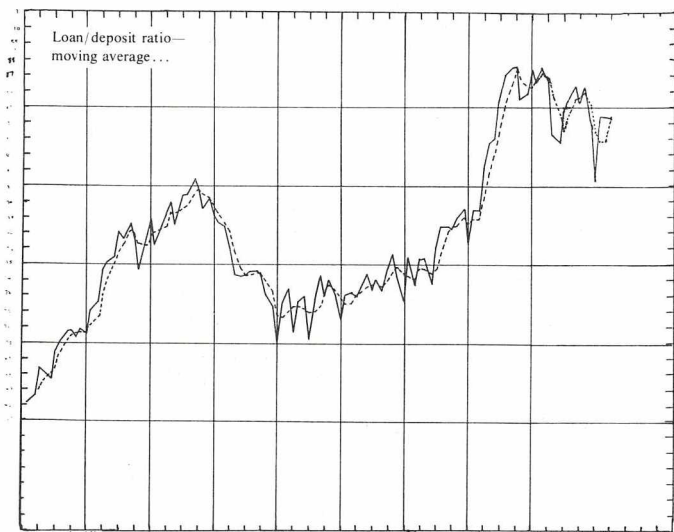


Figure 9 shows that the 1980 "correction" brought the loan/deposit ratio down to 80.3 per cent, barely the top of the 1971-1974 credit cycle and has now turned upwards and stands within 3 percentage points of its all-time high. This serves to confirm our view that the long credit cycle begun in 1975 is still intact.

The implications of this long credit cycle are ominous. Previous credit cycles such as those of 1966, 1970 and 1974 were interrupted by artificial, government-engineered crunches (relying on interest rates ceilings), allowing the economy time to correct pervasive illiquidity and cheap, credit-induced, mal investments. Not so this time around. Relatively free money markets, fed by cheap central bank credit, are likely to push available resources to the point of no return. Sooner rather than later, the Fed will be forced to monetize illiquid financial institutions or, in the alternative, accept a depression, as banks attempt to regain liquidity by liquidating loans and investments.

Last month we suggested accepting partial profits on short T-Bonds positions at the 61 level basis December '81 in view of the possibility that the 14 per cent level would provide good technical support. The market did find support at the 14 per cent level and now stands almost exactly 100 basis points lower (trading at the equivalent of 13 per cent).

**STRATEGY:** We expect little improvement from these levels despite the mirage of a more restrained growth in "shift-adjusted  $M_1B$ ." Broader aggregates such as  $M_2$  are growing well in excess of Fed targets, and very soon the Fed will have to allow Funds to trade up into new high territory.

With the yield curve having flattened from 300 basis points to just under 200 points, we prefer selling September '81 T-Bills in this rally rather than T-Bonds. Our new objectives are: 81.50 for Sept. '81 T-Bills (a \$14,000 potential profit per contract) and 55 for Dec. '81 T-Bonds (a \$12,000 potential profit per contract) with, of course, T-Bills requiring less margin per contract.

Figure 10

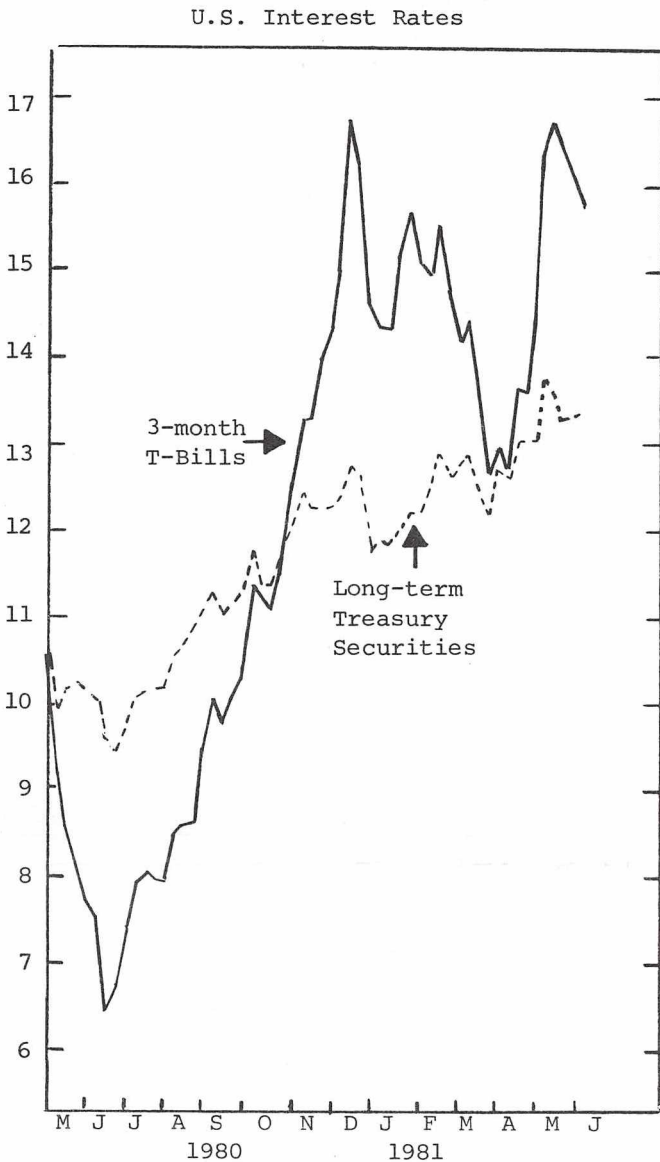
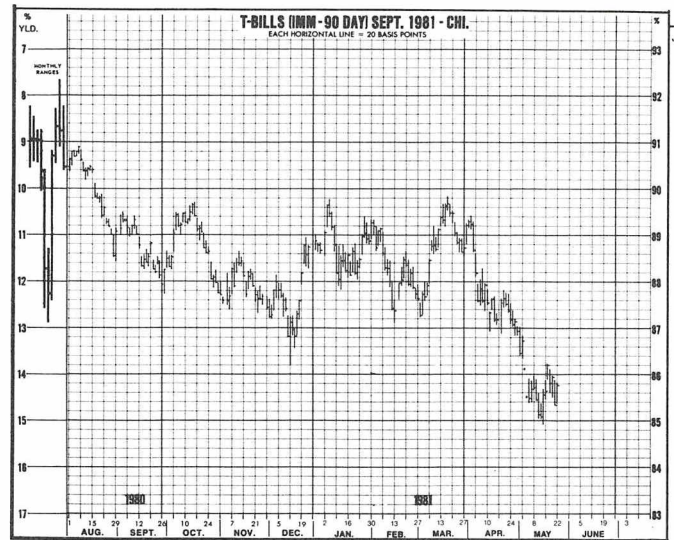


Figure 12



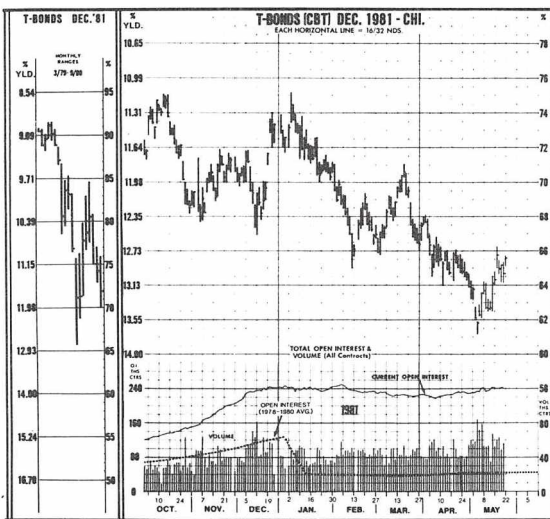
Reprinted from Commodity Research Bureau, Inc.

Figure 13

TREASURY BONDS (CBT) - \$100,000; pts. 32nds of 100%										
June	64-18	64-30	64-10	64-24	+	2	12.977	-	.013	15,783
Sept	65-28	66-00	65-14	65-26	-	1	12.765	+	.006	44,092
Dec	66-21	66-26	66-09	66-20	-	2	12.607	+	.012	24,410
Mar82	67-04	67-10	66-25	67-04	-	2	12.511	+	.011	22,264
June	67-15	67-19	67-07	67-15	-	2	12.446	+	.011	23,590
Sept	67-20	67-26	67-15	67-24	-	2	12.394	+	.012	26,677
Dec	67-28	68-02	67-24	68-00	-	2	12.347	+	.012	22,294
Mar83	68-03	68-09	68-00	68-07	-	2	12.306	+	.011	18,830
June	68-10	68-16	68-07	68-14	-	2	12.266	+	.012	14,474
Sept	68-15	68-23	68-13	68-20	-	3	12.231	+	.017	16,722
Dec	68-21	68-29	68-18	68-26	-	3	12.197	+	.017	9,230
Mar84	68-27	69-03	68-24	69-00	-	3	12.163	+	.017	4,111
June	69-02	69-09	68-30	69-06	-	3	12.129	+	.017	518
Sept	69-06	69-15	69-03	69-12	-	3	12.095	+	.017	30
Est vol 50,130; vol Thu 77,382; open Int 244,473, +3,000.										

TREASURY BILLS (1MM) - \$1 mil.; pts. of 100%										
	Open	High	Low	Settle	Chg	Settle	Chg	Discount	Open	
June	85.11	85.40	84.95	85.39	+	.35	14.61	-	.35	10,078
Sept	87.06	87.09	86.77	87.06	+	.09	12.94	-	.09	12,015
Dec	87.60	87.65	87.38	87.64	+	.06	12.36	-	.06	6,455
Mar82	87.76	87.79	87.55	87.70	+	.01	12.30	-	.01	3,286
June	87.62	87.79	87.58	87.72	+	.03	12.28	-	.03	1,634
Sept	87.67	87.80	87.61	87.74	+	.05	12.26	-	.05	1,074
Dec	87.65	87.80	87.61	87.74	+	.05	12.26	-	.05	394
Mar83	87.73	87.80	87.64	87.74	+	.05	12.26	-	.05	112
Est vol 27,005; vol Thu 26,292; open Int 35,778, +1,838.										

Figure 11



Reprinted from Commodity Research Bureau, Inc.

## Precious Metals

Trading in precious metals remains dull and uninspiring. The most notable feature of recent weeks is the continued deterioration of silver and platinum vis à vis gold, a development fully anticipated by us in view of the latter's "moneyness."

Bearish factors, such as the following, continue to predominate: private dishoarding; a probable increase in net sales by the Communist Bloc, which had reduced overall sales from 410 tonnes in 1978 to 199 tonnes in 1979 and 90 tonnes in 1980; weak commodity prices, with the CRB index breaking a 5-year uptrend; high carrying costs; and so on.

With the spectre of the Hunt block overhanging the market, rallies in silver are not likely to exceed 10 to 15 per cent from any lows, while merchant platinum prices are likely to narrow their present premium above the producer mark.

**STRATEGY:** Aggressive positions are not warranted although we advise remaining short; risk closes above 550 basis December '81 Comex Gold, closes above 12 basis July '81 Silver, and closes above 500 basis July '81 Platinum.

Figure 14

WORLD GOLD SUPPLY AND DEMAND			
	(tonnes)		
	1980	1979	1978
Non-communist production	+943	+961	+979
of which:			
South Africa	675	703	706
Canada	49	51	54
Brazil	35	25	22
U.S.	28	30	30
Philippines	22	19	20
Australia	17	19	20
Colombia	17	10	9
Net sales by Communist bloc (incl. China)	+90	+199	+410
Net official sales/purchases by non-communist agencies	-230	+544	+362
Increase in gold holdings of non-communist private sector	-803	-1,704	-1,751

+ Denotes supplies, - denotes offtake. Source: Consolidated Gold Fields.

Figure 15

GOLD OFFTAKE BY NON-COMMUNIST PRIVATE SECTOR (tonnes)		
	1980	1979
Increase in holdings of fabricated gold	521	1,315
of which:		
Carat jewellery	120	737
Official coins	179	290
Electronics	81	94
Dentistry	62	86
Increase in holdings of gold bullion	282	389
Total increase in gold holdings	803	1,704

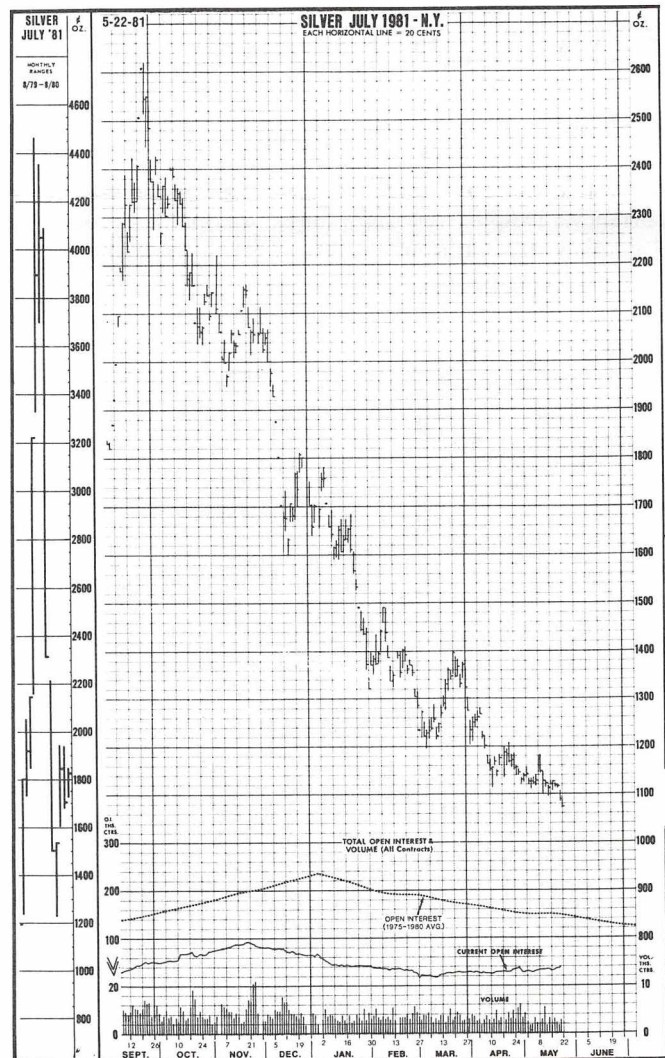
Source: Consolidated Gold Fields

Figure 16



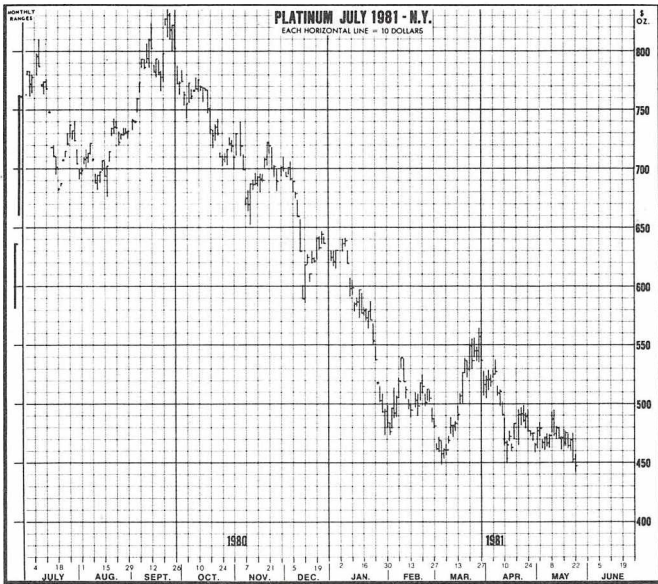
Reprinted from Commodity Research Bureau, Inc.

Figure 17



Reprinted from Commodity Research Bureau, Inc.

Figure 18



Reprinted from Commodity Research Bureau, Inc.

# Canadian Dollar

In our 1981 Spring Review of Inflation in Canada, we conclude that domestic credit expansion in Canada is still too expansive, resulting in continued losses of foreign currency. Despite relatively fixed exchange rates, Canadian inflation is accelerating and is now running 2 or 3 percentage points above the U.S. rate. We expect inflation differentials to widen considerably over the coming months, forcing the Bank of Canada into a politically unpalatable high interest-rate policy.

The pressures facing the Bank of Canada are considerable. The attempt to maintain the CD\$ around 83¢ has resulted in a widening interest rates gap vis à vis the U.S.: 325 basis points basis 3 months T-Bills and 220 points basis long-term Treasuries. This development was anticipated in our previous issues and resulted in our advice to short June '81 Canadian Treasury Bills, then trading at 96.385. Last week, June '81 traded at a yield equivalent of 19 per cent for a profit of \$8,850.

Figure 19

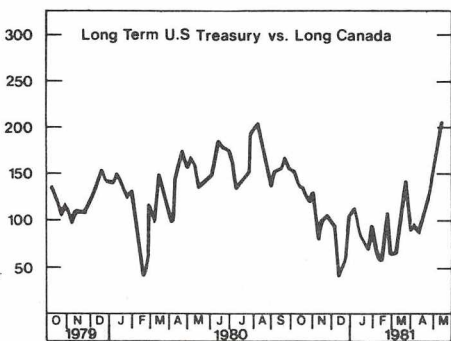
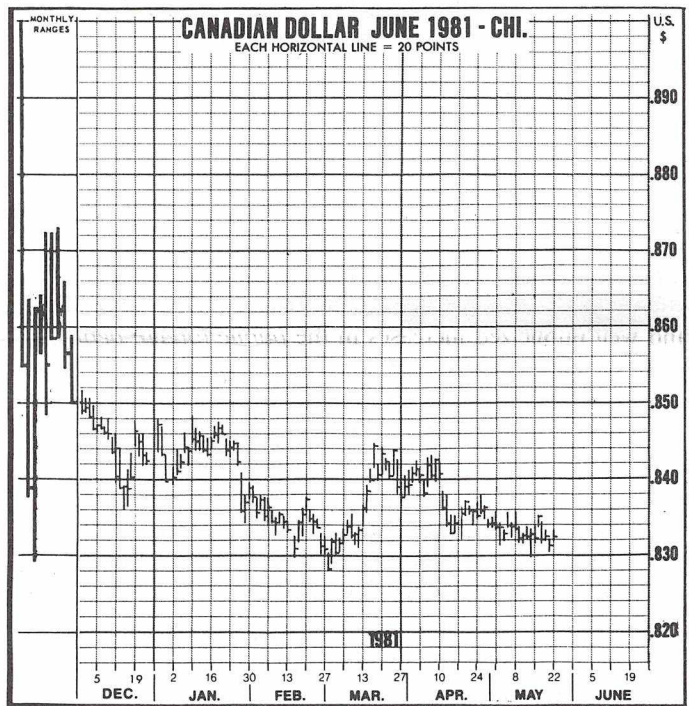


Figure 20

91-DAY TREASURY BILLS (Combined Toronto-Montreal trading) \$1 million; multiples of 50,000					GOV'T. OF CANADA BONDS (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	Ch'ge	Open	High	Low	Settle	Ch'ge	Open				
95.720	95.480	95.595	-	10	74.15	57.12	Jun 81	63.07	62.14	63.07	+21	60	
96.675	95.625	95.910	95.910	-.025	24	71.02	58.20	Sep 81	64.00	63.06	64.00	+24	299
96.725	95.850	95.950	-	5	61.72	61.22	Dec 81	-	-	64.08	+20	5	
95.890	95.890	95.970	-	2	Sales: Friday 0; Thursday 0 Total Open Interest: Thursday 0 N.C. Normal Daily Price Limits: 64.32 above or below prior settlement price.								
91-day Canada treasury bills \$200,000; points of 100 per cent					MID-TERM GOVERNMENT OF CANADA BONDS (Combined Toronto-Montreal trading) 5 Year 9% \$50,000 princ.; Price is % of Par Value (Fractions are 32nds of 1%)								
High	Low	Settle	Ch'ge	Open	High	Low	Settle	Ch'ge	Open				
86.20	81.15	81.75	-10	-	79.20	63.20	Jun 81	-	-	68.25	+20	12	
86.20	81.90	82.70	+15	11	79.20	64.30	Sep 81	-	-	68.31	-06	-	
87.78	82.35	82.85	+15	-	79.15	64.02	Dec 81	-	-	69.20	-	-	
87.75	82.75	83.05	-	-	79.30	67.02	Mar 82	-	-	70.09	-	-	
Total Sales: Thursday 0. Normal Daily Price Limits: \$0.150 above or below prior settlement price.					Total Sales: Thursday 0. Normal Daily Price Limits: 64.32 above or below prior settlement price.								

Figure 21



**STRATEGY:** Remain short Canadian T-Bills and T-Bonds. Last month we suggested a new (lower) plateau for the CD\$ (81.50 — 84.50) and advised trading accordingly. We now doubt that rallying attempts will carry beyond 83.75.

# Mexican Peso

For the first time since Mexico adopted a downward float, spot MP dropped a full 1 per cent for the month of May. Deferred positions have returned to the levels reached in early 1981, thus vindicating our no-lose strategy.

In the background, Mexican oil and gas sales were running last month \$4-\$5 billion lower, on an annual basis, than anticipated by government officials at the beginning of the year. Moreover, in recent weeks, major oil companies have announced that supply contracts for Mexican oil will have to be renegotiated; one purchaser has stated that given the market conditions for refined products, Mexican crude may have to drop to \$26/barrel from the present \$32/barrel. Clearly, either Mexican sales dry up or price concessions are made. In the latter case, Mexico stands to "lose" as much as \$4 billion from this year's exports.

While price inflation in Mexico is running at least 20 percentage points higher than in the U.S., monetary inflation in Mexico is running out of control. Figure 22 shows the increase in domestic credit (adjusted to U.S. dollars) from 1976 to the third quarter of 1980, the last date for which statistics are available. The staggering 346.5 per cent increase exceeds U.S. monetary inflation by a factor of 8. The attempt to maintain a relatively fixed rate of exchange has thus resulted in a steady loss of foreign currency. International reserves held by the monetary authorities are being offset by the growing drain of foreign currency experienced by the private sector. The resultant overall net liability position of the consolidated banking system amounts to U.S. \$500 million. This "leakage" has taken place despite enormous and well publicized increases in the *public foreign debt*, now amounting to \$34 billion (increases in the private foreign debt are not given).

There is little doubt that the Mexican peso is overvalued. Official and banking sources use price indexes as their reference point and hint that the peso may have to be devalued somewhere between 10 and 18 per cent during 1981 to regain competitiveness. In our opinion, the peso is probably overvalued by between 100 and 200 per cent, making it worth between .0013 and .0020.

**STRATEGY:** Continue to add to deferred short positions, particularly March '82, June '82 and Sept. '82. The potential reward is immense; risks are seen to be almost nil.

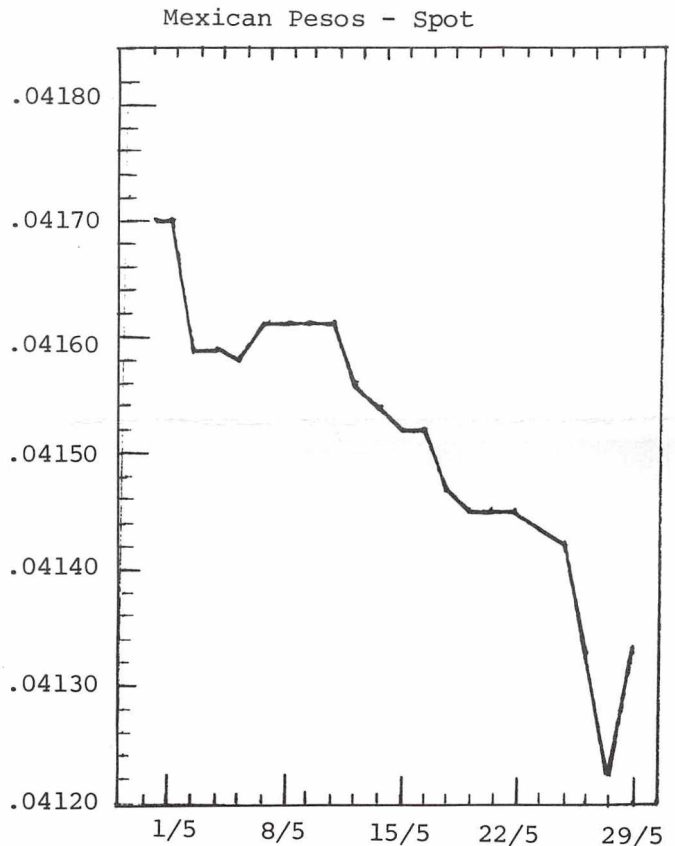
Figure 22

MP	Monetary Statistics			
	Domestic Credit (billions of US\$)	Annual Change %	Int'l Reserves ( billion of US\$ )	Net Foreign Assets
1976	11.995	-23.9	1.412	1.106
1977	25.33	111.2	2.044	0.191
1978	33.25	31.3	2.393	0.116
1979	43.70	31.4	3.178	0.001
1980 III Qtr.	53.56	34.3*	3.807	-.529
1976-1980 III Qtr.		346.5		

\* III Qtr 1980 over III Qtr 1979.

Source: International Financial Statistics

Figure 23



## Coffee

The recent collapse of prices is thought to have originated in Brazil. Producer hedge selling presumably failed to meet anticipated frost-fear speculative buying; instead, existing longs liquidated, exacerbating the retreat.

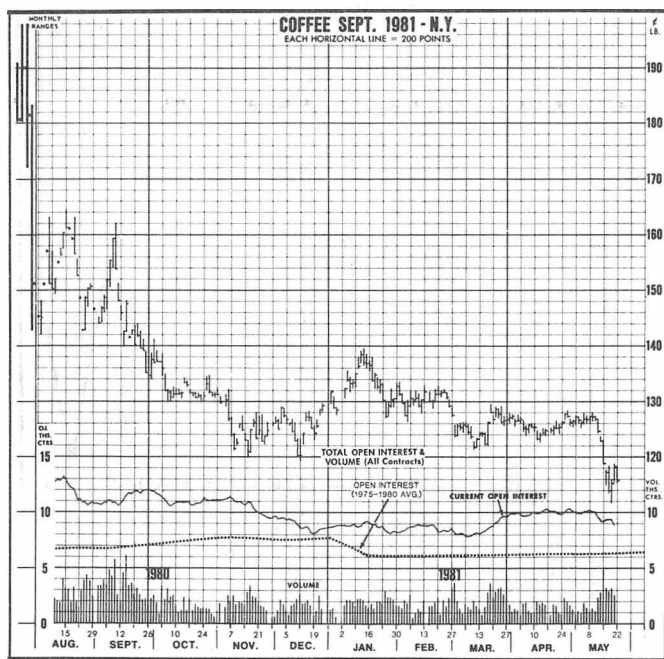
The current and long-term demand situation remains favorable to bulls. Roasters have apparently allowed inventories to dwindle to less-than-lean levels in reaction to prevailing high borrowing costs and in anticipation of the availability of the huge 32.0 mln. bag Brazilian 1981-1982 crop. Inventories at the end of the first quarter in the U.S. stood 2.2 per cent below the comparable period in 1980, at 2.85 mln. bags, and have apparently fallen

considerably since. In addition, the trend towards an upturn in consumption, which was projected in our April *Comments*, is evidently developing. First quarter data shows usage of 4.74 mln. bags, up a substantial 10.2 per cent over 1980.

Nevertheless, it now appears that the bullish demand data be overshadowed by availability. In April we projected that the upcoming 1981-1982 crop, though bolstered by Brazil's record outturn, would still register a small deficit. Last month we revised that projection and cautioned that a small surplus was likely. Now, as a result of recently-made-available statistics which show improvement in Central American production, a fairly substantial surplus of 3.0 mln. bags is indicated.

For those of us holding somewhat tarnished call options in London, the only consolation we have is the forecast by a trusted meteorological savant who claims there is a 60 per cent chance of a freeze in early July. If there's no freeze, we'd be forced to conclude that taking into account the totally deteriorated chart picture, the trend is down.

Figure 24



Reprinted from Commodity Research Bureau, Inc.

**STRATEGY:** To those stopped out of long positions at 122.2 as per last month's *Comments*, we apologize for the typographical error which read "182.20 — advise remaining sidelined." To those holding call options: Hope for a freeze.

## Copper

Our long-range forecast has been outlined in detail in the March and May issues of our *Comments*. To review very briefly: In our March issue we demonstrated that current and projected supplies over the coming three years would be inadequate. The cost of bringing new mining and refining capacity on stream was based on prices having to rise to in excess of \$1.85 per pound. Serious shortfalls and bottlenecks coupled with zealous speculation could drive prices as high as \$2.50 per pound by 1983. Such a scenario was initially predicated upon demand maintaining its 5 per cent cyclical rate of growth. However, last month we pointed out that such a growth-rate could no longer be taken for granted; that so much depended upon business conditions in the U.S.; and that the outlook for business will be determined by the monumental decisions now facing Congress. (See May 3rd *Comments*.) We concluded that unless the "right" combination of policies were enacted, our price projection would have to be modified to a target of "only" an average of \$1.25 per pound by 1983.

At present, given the array of monetary and fiscal options open to the legislature, we are unable to fix a long-range goal for copper prices. Normally a long-range target is crucial inasmuch as it allows for the trend-following speculator to maintain positions in the face of the often vicious swings that accompany a major bull (or bear) market. However, in the present case of copper, such long-range thinking has thus far been rather pathetically academic. Copper prices, as readers know all too well, have fallen, albeit softly, almost without interruption since our March issue. The present question is therefore not Where will we take a profit? but When will we stop losing money? or even, Would it be better to sacrifice the position until the downtrend is broken?

The reasons for copper's slide are as follows:

- 1) High *nominal* borrowing costs have frightened dealers into paring inventories to lean levels;
- 2) The auto and housing sectors do not show good, strong signs of an about-face yet;
- 3) Technically-oriented speculators have sold short in keeping with the prevailing downtrend in copper and the bear sentiment that hangs over commodity prices generally.

We have pointed out that in the longer run, prevailing rates will prove to be less than draconian (see Interest Rates Futures). We thus believe that dealers who are shy of stock are vulnerable. Secondly, the panoply of economic statistics — unemployment, index of leading economic indicators, productivity — does not show that the economy is being choked. The odds of good underlying industrial demand for copper surfacing in coming months are good. Warehouse stocks in N.Y. and London, at 175,727 tonnes and 118,575 tonnes respectively, have dipped slightly beneath their twelve-week

moving averages during the past four weeks.

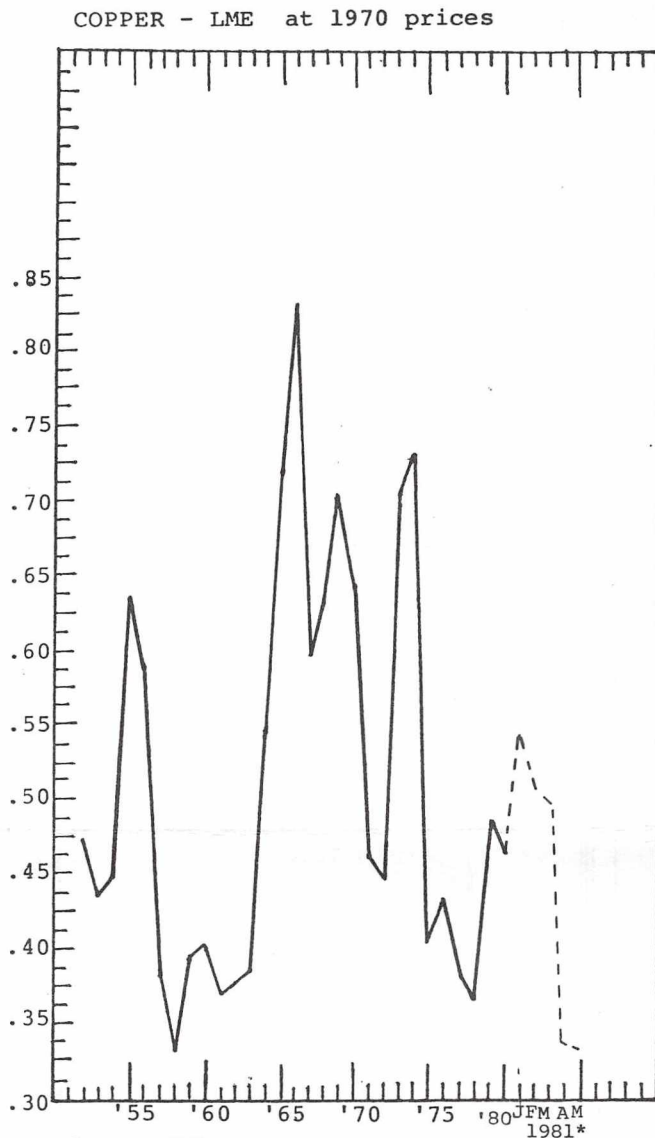
Copper's technical picture offers mixed signals. Charts show that the market did puncture a major area of support when it violated the 88.0 level basis December '81. One could reasonably argue that there is no safety net to hold prices and that a fall to 70¢ or even lower basis cash is possible. However, referring to the price of copper charted in real terms, one notes not only that copper is as cheap as it has ever been but also that the lows have thus far held. In addition, it is noteworthy that this week (ended May 29th), the market managed a weekly reversal, which in the past has been a fairly good indicator of an overall trend-reversal. Finally, the speculative selling mentioned earlier is part of an environment that is "too bearish for its own good." The consensus of bullish opinion of hard and soft commodities in the past two weeks has averaged less than 35 per cent. Opinions of newsletter writers and commission houses has been 75 per cent bearish on the red metal. We doubt that so high a degree of public pessimism will go unpunished.

Figure 25



Reprinted from Commodity Research Bureau, Inc.

Figure 26



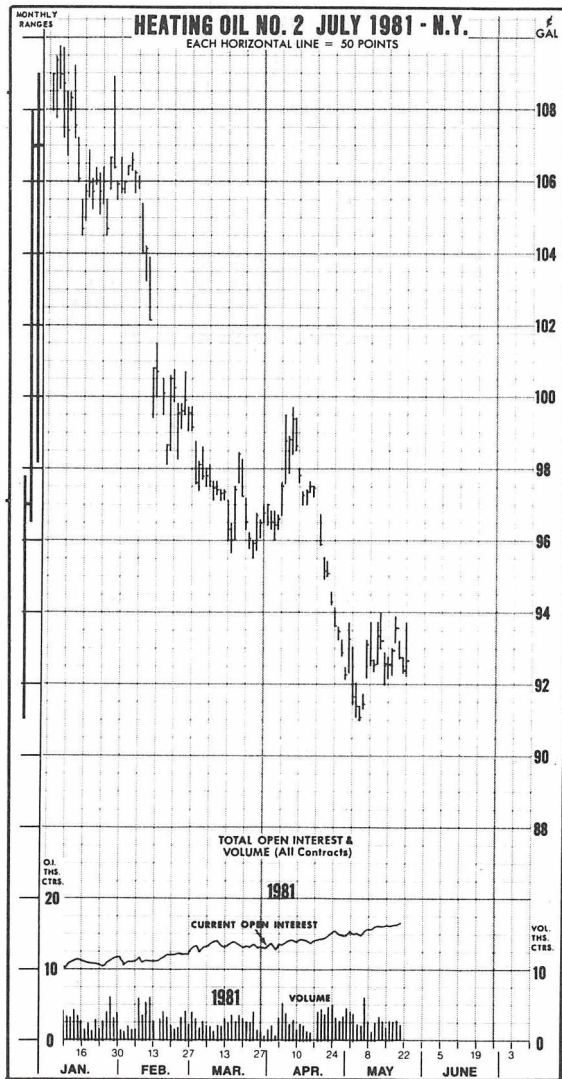
Source: IFS  
\* 1981 data are by months.

**CONCLUSION AND STRATEGY:** *The current fundamental and technical picture tells us we are close to lows if we've not seen them already. We are forced to advise maintaining long positions without stops. Our faith will yield more than just its own reward.*

# Potpourri

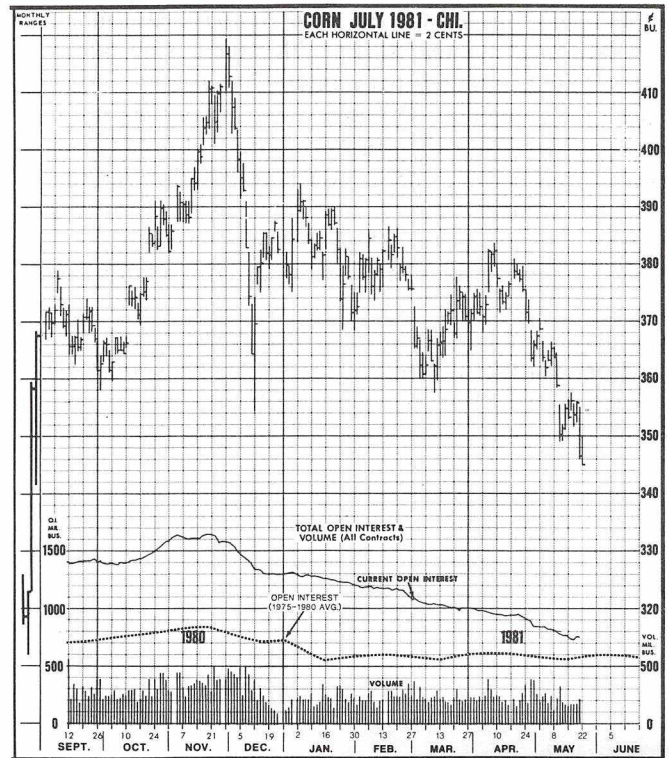
**STRATEGY:** With heavy rains having changed fears of another drought to forecasts of better than average yields and the U.S. having almost certainly damaged its position in the world marketplace as a result of last year's embargo, we are inclined to probe corn from the short side. In keeping with our oft-stated bearish views on oil, (note Comments of Nov. 26th), we find ourselves short the heating variety with stops at 102.10 on close basis December '81.

Figure 27



Reprinted from Commodity Research Bureau, Inc.

Figure 28



Reprinted from 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.