

# FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

Friedberg Commodity Management Inc.



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## The US recession

It is now all but certain that the US economy has been plunged into its third recession in five years. Since August of this year, when we first suggested that probability (FC&CC, August 1984), the evidence has been mounting that the economy is rolling over. Of course, given that contractions — at least in the early stages — are not a straight line affair, and the great US economy is relatively well diversified, statistics — again in the early stages — tend to emit confusing and even conflicting signals. Utmost care must therefore be used to identify the main trend. But, even more importantly, one must be able to identify properly the contractionary influences.

Let us start first with the evidence. Leading indicators continue their downward course and, on a six-month cumulative basis, are now off 2.6%. In the past, as Chart 1 (prepared by the good people of C.J. Lawrence) indicates, a drop of this magnitude nearly always presaged at least one negative quarter in GNP. Real manufacturing inventories have been soaring, and on a nine-month cumulative percentage basis, now stand as high as they were in early 1974, in the midst of the worst recession since the '30s. Relative to sales, inventories have now been rising for 10 months (see Chart 2) and stand far enough above their low point to dismiss this mini-trend as an aberration (the high inventory/sales ratio levels attained in the '60s and '70s were primarily due to the fact that real carrying charges were either cheaper or negative).

The surprisingly strong 1.8% rise in November retail sales should be considered in the proper perspective: The overall nominal level of sales is barely above the levels reached in June of this year.

In real terms, retail sales have actually *declined* since early summer. Moreover, spotty checks of department store sales indicate that a significant reversion took place in early December, belying expectations of strong Christmas sales.

The persistent decline in orders of durable goods (Chart 3) leaves little room for equivocation: The trend is down. Even more significantly, the 7.3% third-quarter drop in after-tax profits augurs ill for corporate appropriations, which have already been scaled down, and capital spending. At this stage of the expansion, say business cycle theorists, capital spending takes over from consumer spending as the single most important propellant force in the economy. Given the recent

trend in corporate profits, this is well nigh impossible.

Finally, the relative strength in employment (a lagging indicator) is being offset by the continuous rise in state claims for unemployment (a sensitive leading indicator) as can be seen from Chart 4.

Clearly, the US economy has entered a contracting phase. The reasons are not hard to understand. The massive fiscal stimulus in the 1981-83 period that contributed to the stellar economic performance of 1983 and 1984 was almost totally dissipated by the growing trade deficit that began to widen rather alarmingly in 1983 but turned into a floodgate in 1984. Foreign trade competition not only acted as a "leakage" on the US economy but also operated as a formidable compressor of prices, corporate margins, and profits. The leveraging up of the US economy, another powerful early stimulator to economic activity, is by the same token a late contracting influence in much the same way as a hangover follows a delightful drinking episode. Charts 5 and 6 speak of extraordinary excesses and the necessity for *future retrenchment*.

The double impact of the rising trade deficits coupled with the fragile state of balance sheets are the determinants in shaping economic activity for the coming 12-24 months. Faced with a somewhat similar but necessarily less grave situation in 1981-82, the US cushioned the fall by allowing the fiscal deficit to widen to historical levels. What is more, it engineered an economic turnaround by applying strong Keynesian (disguised as clearly more acceptable supply-side tax cuts) medicine. In fact, recent IMF studies indicate that the *fiscal thrust* for the 1982-83 periods were of the order of 0.2%, 0.5% and 1.6% of GNP. This expansionary impulse, over and above the merely passive cyclical deterioration, can be contrasted with the -0.4%, -0.5%, and +0.2% of GNP fiscal thrust in six other major industrial countries.

### In this issue

We're convinced of another US recession, and that should mean lower rates. We look at the US banking system and discover that it's more than a mess. We now mortgage the house in energy futures. And we look at three more exotic currencies. Contributions by Albert D. Friedberg and Daniel A. Gordon.

For the US to engineer a similar bailout, it would have to allow its budget deficit to widen, *beyond the normal cyclical deterioration*, by at least \$60 billion. Present "mild recession" estimates for the 1985 budget deficit range from \$250-\$300 billion, thus putting a truly expansionary deficit at \$310-\$370 billion. With no further tax cuts, indexation to occur at extremely low levels of inflation, and the possibility of \$30-\$50 billion in spending cuts recently proposed by President Reagan, one fails to see the makings of a truly expansionary budget *even if cyclical factors push the shortfall to the \$300 billion area.*

As to monetary policy, it seems doubtful that *it* alone can do much to revive a flagging economy. In the first place, reason tells us that failing rates cannot stimulate loss-making operations. In fact, history tells us that rates as low as one half of 1% failed to revive the US in the early '30s. The same was true with the negative interest rates of 1974 (quite similar to our present nominal rates): The economy continued its downward course until retrenching consumers and corporations alike succeeded in restructuring their overextended balance sheets.

Chart 1

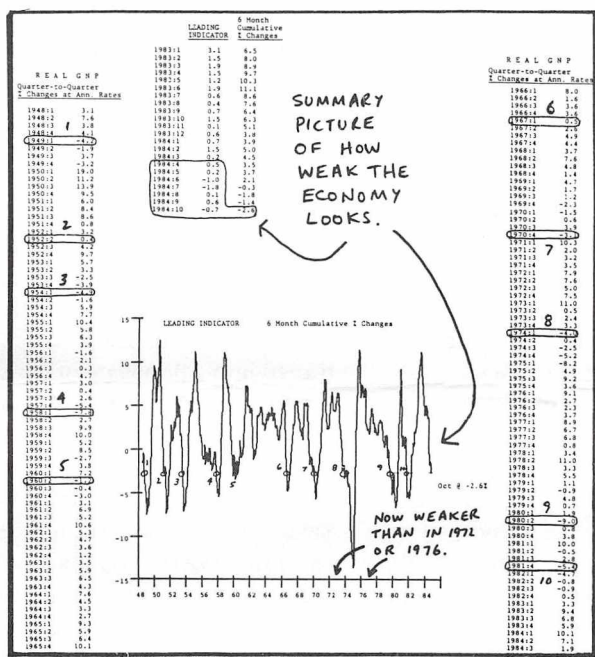


Chart 3

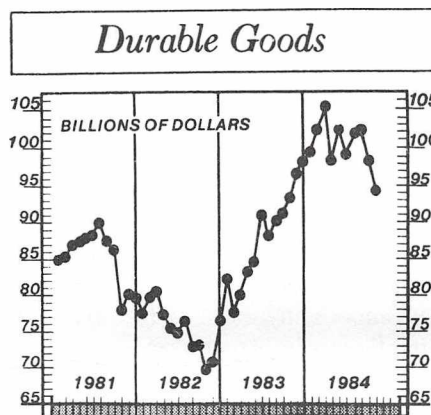


Chart 4

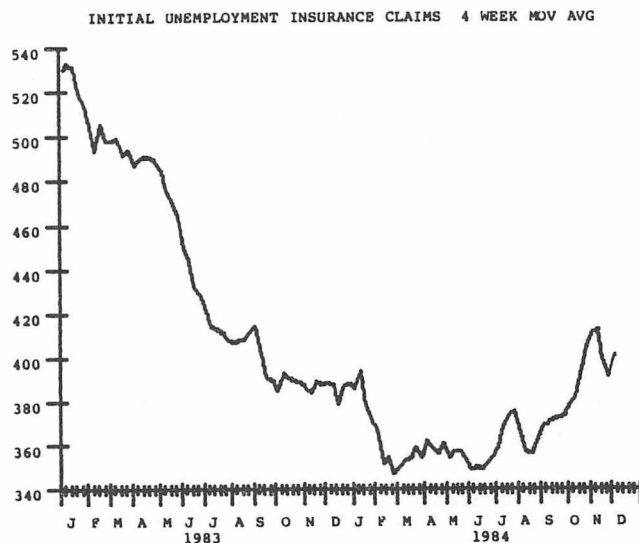
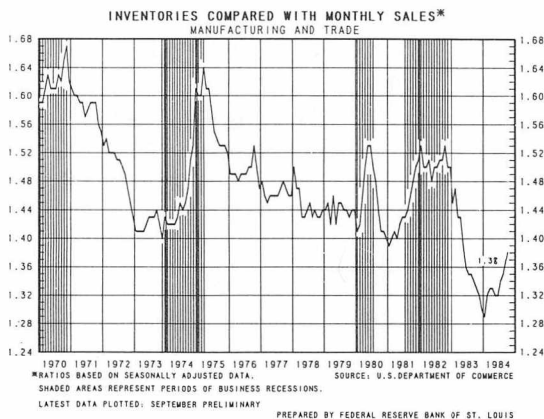
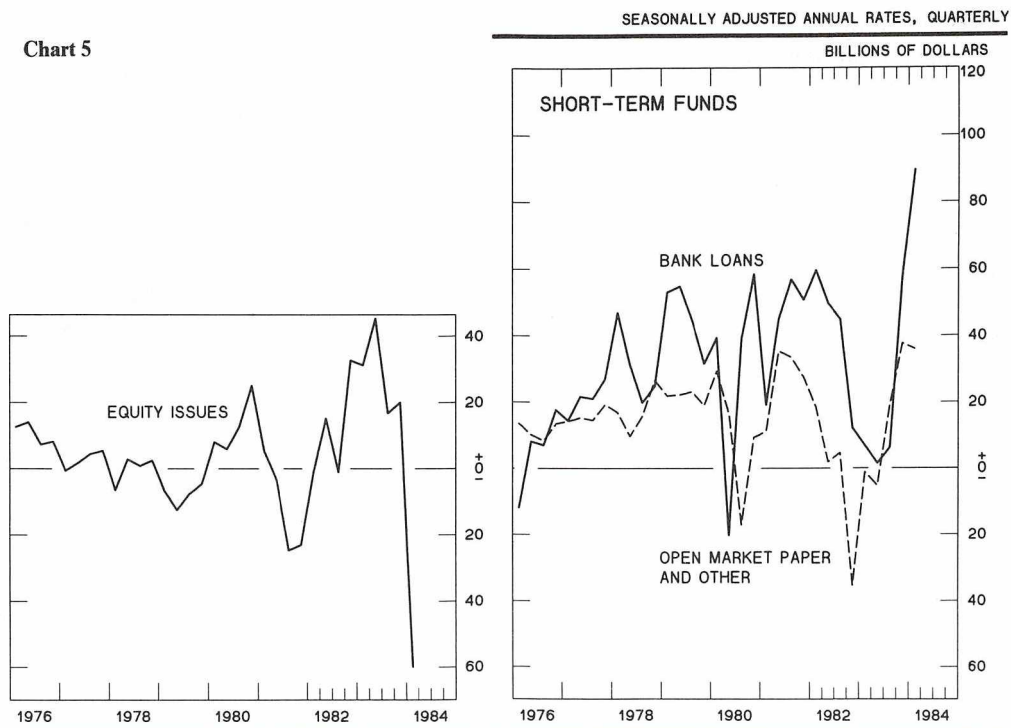


Chart 2



NET FUNDS RAISED BY NONFINANCIAL CORPORATIONS

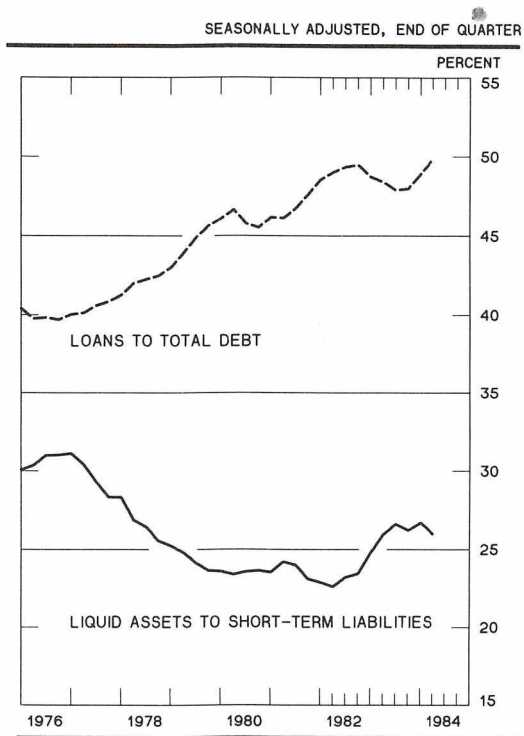
Chart 5



Source: Federal Reserve Chart Book

Chart 6

RATIOS FOR NONFINANCIAL CORPORATIONS



Source: Federal Reserve Chart Book

# Interest Rate Futures

Our recession forecast should by necessity make us bulls on interest rate futures. What is more, deflationary forces led by falling commodity prices and our expectation for sharply lower oil prices add zest to this position. Finally, a contraction that will refuse to react to early accommodating moves by the Fed may panic the US central bank into lowering Fed Funds and the Discount Rate to levels last seen in the early '70s.

It should be pointed out that the current very positive yield curve makes for a very profitable "carry" as 11.5% long bonds can be financed with 8¼% repos. Thus, the distant bond prices are selling at attractive discounts.

**STRATEGY:** We advise long positions in March '84 T-bonds, risking a close below 69.00. Switch short December Euro to March Euro, reestablishing Ted (T-bill/Eurodollar) spread, basis March '85.

Chart 7

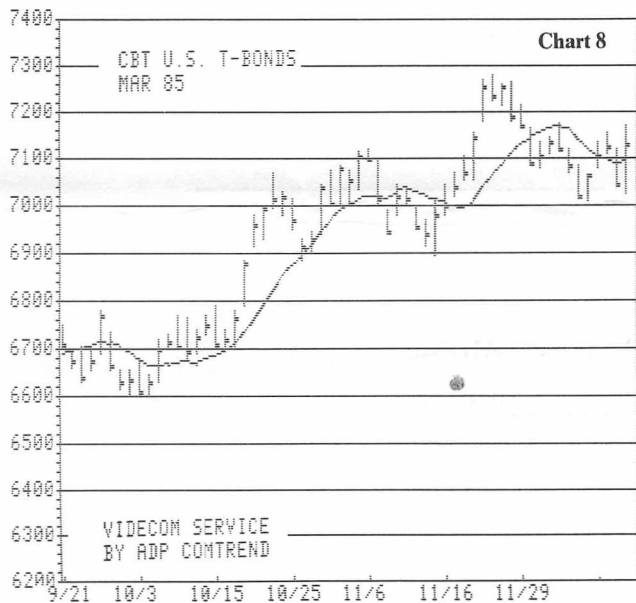
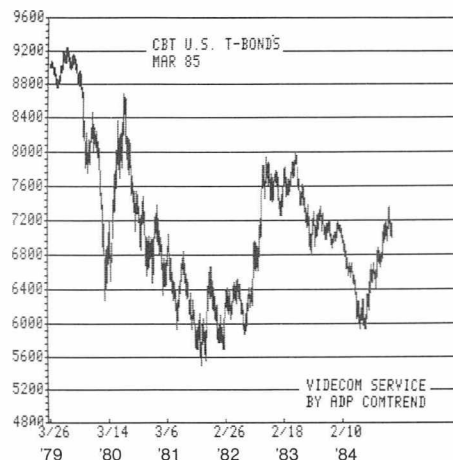


Chart 8

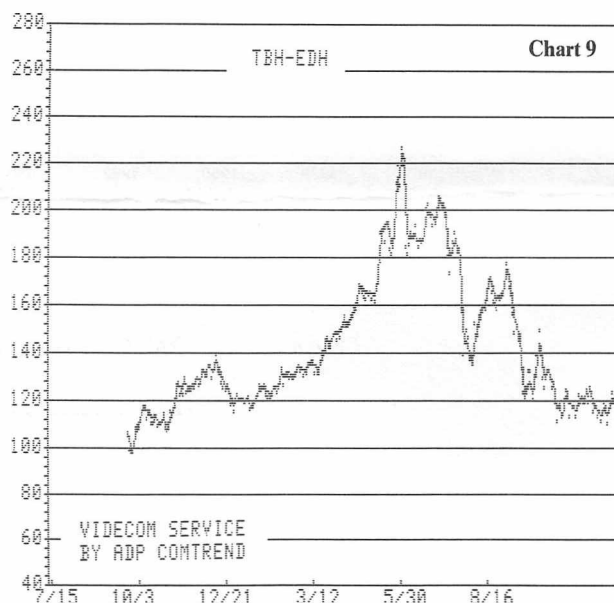


Chart 9

## The banking mess

When John Downey, chief examiner for the Comptroller of the Currency, was asked in early 1984 when the problem-bank situation will peak (having witnessed 48 bank failures in 1983) he responded that, provided the economic recovery continued, the peak would come at the end of the first quarter of 1984. Ten months later, the Federal Deposit Insurance Corporation (FDIC) continues to close banks at a worrisome pace. At the occasion of closing the 76th insured bank in Wichita, Kansas, William Isaac, chairman of the FDIC, predicted that the number of failures "should peak this year." Not since 1937, when 75 insured banks failed, has the US witnessed such a rash of bank insolvencies.

At the heart of the problem lies the process of deposit deregulation *underwritten* by the US government through the FDIC — a prescription for disaster. In recent days, the FDIC accused Merrill Lynch of placing \$2.5 billion (!) in brokered deposits at troubled banks, making it the largest source of brokered money to such banks. In all, the FDIC found that \$9.5 billion out of a total of \$22.5 billion in brokered deposits as at September 30, 1984, were deposited in banks that the FDIC had given a 3, 4, or 5 rating on its five-point scale for measuring soundness, 5 being the least sound. And, why not? These deposits are as good as US Treasury bills *and yield as much as 400 basis points more!*

Having failed to seize the occasion of the Continental failure as an example of discipline (the FDIC covered all uninsured deposits and even debenture holders of the holding company), the government has belatedly returned to a tough stand. In transferring deposits from the failed Dayton Bank and Trust Company, Tennessee, the FDIC announced that owners of uninsured deposits will share proportionately with itself "and other uninsured general creditors in the proceeds realized from the liquidation of the failed bank's assets." The FDIC offered a prompt advance, based on the estimated present value of assets to be liquidated, equal to 75% of their uninsured claims.

This tough standard, begun just months before the Continental failure, is of course applicable only to small and medium-size banks. As for the large money-center banks, the regulators have begun to force these giant bankrupts to raise their capital ratios. For the most part, this balance sheet restructuring can be accomplished if banks were to take advantage of the one and only asset that remains undervalued in their books: office towers and other bank buildings. This has been the route taken by the Bank of Boston (selling its 13-year-old headquarters for \$365 million compared with the carrying value of \$70 million), Crocker (which realized a \$185 million after-tax gain on sale), and Security Pacific (reaping a \$125 million after-tax gain on the sale of its Los Angeles headquarters). At this time, Bank of America and First Chicago are also considering similar sale and (partial) lease-back operations.

It would be difficult to believe, however, that all major banks could simultaneously put up their ivory towers and obtain such fancy prices. Ultimately, regulators have succeeded

in pushing the present banking risks into the laps of the major pension funds and insurance companies, too eager to snap up the bargain of the inflationary '70s. Market discipline, however, has *not* been reimposed, as depositors will continue to flock to banks in the TLTF (too-large-to-fail) category.

As the internal debt crisis headlines have disappeared, one is tempted to believe that the worst is over. A contrary, and fascinating glimpse of the "exposure relative to capital" problem can be obtained by juggling around certain assumptions made by the Federal Reserve Bank in its October '84 *Bulletin* ("Bank lending to developing countries"). In a table entitled (believe it or not) "Exposure relative to capital of US banks, grouped by size, to non-OPEC developing countries, assuming *no new net lending* by small banks, under alternative assumption about selected variables, 1990," the staff of the Fed estimates that the nine money-center banks will improve their exposure slightly from 209% at December 1983 to 203% at December 1990 (see Chart 10). In a recession, however, non-OPEC less developed countries will need more financing and that (referring again to Chart 10) may add 22 percentage points. Furthermore, if growth in US bank capital slows to 7% instead of the 9% baseline assumption (i.e., if real estate begins to decline in price or dividends are cut and shares cannot be sold), exposure rises by an additional 28 percentage points. The above two changes add 50 percentage points to the baseline projection of 203%. In effect, all the reschedulings, the austerity plans, lawyer fees, and endless bank committee meetings do nothing to arrest the cancer from spreading.

The patient is truly terminally ill.

Chart 10

Exposure as percent of capital

Exposure relative to capital of U.S. banks grouped by size, to non-OPEC developing countries, assuming no new net lending by small banks, under alternative assumptions about selected variables, 1990

Position, variable, or assumption	9 money center banks	15 other large banks	All other U.S. banks
Position in December 1983.....	209	145	59
<i>Estimated position in December 1990</i>			
A. Baseline projection.....	203	127	32
<i>Alternatives to baseline projection</i>			
B. Initial financing needs			
\$10 billion per year more (\$50 billion).....	225	139	32
\$10 billion per year less (\$30 billion).....	181	115	32
C. Banks' participation in financing			
10 percentage points more (60 percent).....	220	136	32
10 percentage points less (40 percent).....	185	117	32
D. U.S. banks' share in new bank credit			
10 percentage points more (50 percent).....	225	139	32
10 percentage points less (30 percent).....	181	115	32
E. Growth in U.S. bank capital			
2 percentage points slower (7 percent per year).....	231	144	37
2 percentage points faster (11 percent per year).....	178	112	28

Source: Federal Reserve Bulletin, out. 1984

# Energy Futures

## OPEC no longer matters, or how oil is gaining downside momentum

Relentlessly, free spot market prices of crude oil have continued their inexorable fall, tossing aside the bluntest-yet warning of the Prince of Oil, Saudi Oil Minister Ahmed Zaki Yamani. In fact, what is not generally recognized is that more oil trades today in the spot market than is sold at contract prices. The official producer price is slowly becoming an anachronism, very much like the aluminum and platinum producer price. The comfort of anonymity provided by the free market to all those who prefer to exchange oil for cash, and vice versa, has proved too much for even this mightiest of cartels.

BNOOC's dilemma of having to purchase oil at \$28.65/barrel to later dump it at market-related price (as much as \$1.50/barrel lower) is only a small embarrassment, equal to perhaps \$750,000 per day. What is worse is that the British have put themselves on the spot and are likely to be accused of collapsing the cartel, when in fact, for all those glorious years, they avoided the blame while reaping the benefits of full-scale production — behind the protective shield of OPEC. What a pity, being pushed into the spotlight for some silly interventionist scheme, when for so many years the UK managed to undermine OPEC without publicity!

Analysts project company stocks by the end of March at 68-70 days of consumption if drawdowns of 1.9 million barrels per day (mb/d) and 3.3 mb/d are made until the end of December and the end of March, respectively. Since 1975 (which, in everyone's Bible is Genesis), only once were stocks at those levels. That was in 1979, and we all know — at least by unspoken implication — what happened to oil prices that year; except, of course, that in 1979, OPEC was producing at nearly full capacity, almost 15 mb/d more than today; except, of course, that the Shah of Iran is already dead, and he is not likely to cause a drop in Iranian exports; except, of course, that just two governments alone today hold as much as 20-days' forward supplies, a cushion that did not exist in 1979; and except, of course, that consumption, the denominator of the equation, is itself dropping so quickly as to possibly offset the drop in stocks, the numerator.

But there is more. Conventional analysts have not taken into account the already substantial drop in prices and the effect this drop will have upon producers. *It is absolutely logical to suppose that producers will want to stabilize their already precarious revenues. In view of declining prices, output will have to rise so that a 10% drop in prices (more than*

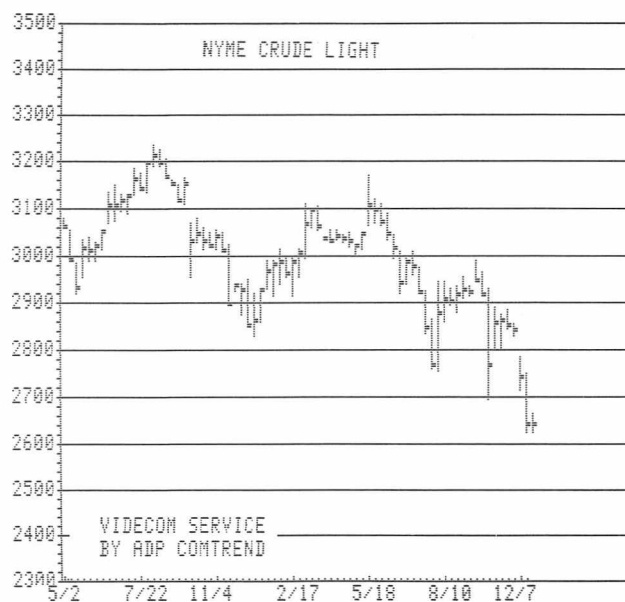
satisfied already) will bring forth a 10% increase in production. A 30% drop will result in OPEC countries' producing *at least* 21 mb/d.

Buyers are so well aware of this truism that they cannot destock fast enough, because in fact, the faster they destock, the lower prices move and the more stock becomes available. OPEC producers are trapped. The December 19 meeting is irrelevant; short of the Saudis' committing suicide in favor of the haves (UK, Soviets, UAE, Kuwait) and turning off their taps completely, the crude oil market is bent on destroying the price-fixers.

**STRATEGY:** *We combed our records and found that back in 1973, we recommended sugar futures, then at 8¢/lb., with such fervor that we uttered the unthinkable: "You might mortgage your house and add to March and May '74 long (sugar) positions." Subsequently, sugar reached all our upside targets and then some, peaking at the extraordinary price of 66¢/lb.*

*We are gripped by the same madness: Mortgage your house and sell crude oil futures (placing stops at 28.50, basis February 1985, close only) and . . .*

Chart 11



# Petrocurrency Futures

For more than a decade, the world turned around oil. Countries were classified as oil exporters/producers and non-oil exporters/producers, as if Moses' Decalogue prized moral virtue with an abundance of oil; as if it mattered not what other resources countries had; as if non-oil was the equivalent of leprosy, to be showered with "recycled" money — to be sympathized with but not counted.

No longer. The collapse of oil prices will leave in its trail a long list of victims. The sudden petro-wealth was almost entirely wasted. Such was its attraction that none escaped with all the chips.

How is it possible, one may ask, that the oil era should come and go and leave in its wake its partisans worse off than they were before the great cataclysm? Who did benefit? Or did anyone benefit?

Strangely enough, it would seem that the true beneficiaries are those countries and individuals who, not blessed with oil, adjusted themselves as naturally as possible: who allowed prices to rise, cut back consumption, did not borrow excessively to bridge the shock. Poorer for a decade, they now will emerge leaner and stronger.

What of the oil producers/exporters? The wreckage that is being left behind is likely to engulf them, for many years to come, in a most violent social and economic crisis. The (oil) price deflation will deflate incomes and expectations, making them the new pariahs of our strange world. The tables will have turned: Non-oil status will be a privilege.

Over the past few months we have discussed the UK pound, the Gulf currencies (Saudi riyal, Kuwaiti dinar), the Mexican peso, the Venezuelan bolivar, and in this issue, the Indonesian rupiah. All, in varying degrees, will be subject to severe foreign exchange depreciations.

In the Gulf area, the economic crisis has deepened considerably: hundreds and thousands of business enterprises are folding daily in a veritable house of cards effect. In a desperate but foolhardy effort to prevent a massive flight from currency, the Kuwaiti central bank has been using its vast

reserves to maintain order in the foreign exchange market: at an enormous cost of reserves but, what is worse, at a cost of contracting money supply by as much as 20% year-over-year, aggravating the local crisis.

Property and share prices have been falling so steeply throughout the entire Gulf area that banks are no longer sure of recovering even a fraction of their loans. With the very foundation of its banking system at risk, the Gulf central banks may have no choice but to devalue, or at least allow a free float, which will surely mean a dramatic depreciation.

In Mexico, the situation may be even more critical, as foreign debt continues to grow, and a multi-year rescheduling has as yet not been signed. It should be noted that Pemex revenues represent at least one third of total government fiscal revenues. A drop in oil prices, not compensated by a devaluation, will once again widen the deficit to unacceptable levels, to say nothing of the impact on the current account.

Nigeria is already a basket case, while Indonesia and Venezuela, both heavily dependent on oil, are likely to undergo some severe adjustments. While Sterling has partly corrected for the extraordinary oil-related overvaluation of 1979-81, we suspect that more is on the way.

In all cases, governments are likely to resort to devaluing their currencies as a first measure: To stimulate whatever non-oil exports they can; to inhibit imports; to help finance a growing government budget deficit; to help their banking system pay off depositors in depreciated paper while their real assets appreciate somewhat — in short, to ease the pain. Of course, capital outflow will become extremely severe and the real decision will be taken out of the hands of the central banks (with the sole exception of Saudi Arabia and Kuwait, where international reserves are more than sufficient to allow for conversion of their entire money supply).

**STRATEGY:** We are (really) bearish. Add to existing short positions in Kuwaiti dinars, Saudi riyals, Mexican pesos. Indonesian rupiahs, in that order.

## Currencies

The Fed has surely become more aggressive in recent weeks, as evidenced by the large \$2.7 billion increase in the adjusted monetary base. In view of the fact that the Fed is likely to pump even more reserves in the coming days, we prefer to protect short currency positions with close stops.

**STRATEGY:** Stopped out with an interesting profit on Sterling and the Canadian dollar (see Hotline update) and still short the Deutschmark with a stop at 32.58, basis December, close only. Move short positions to March Deutschmark and place stops at 32.88, close only.

Chart 12

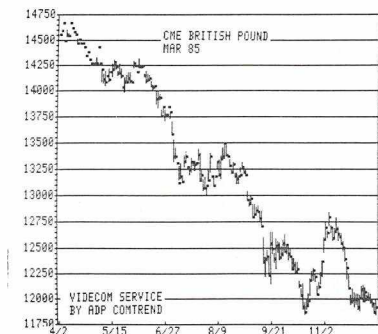


Chart 13



Chart 14

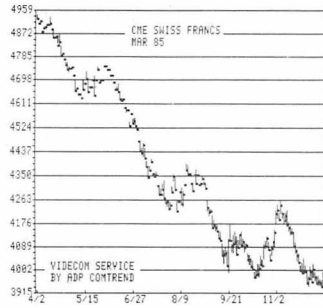


Chart 15

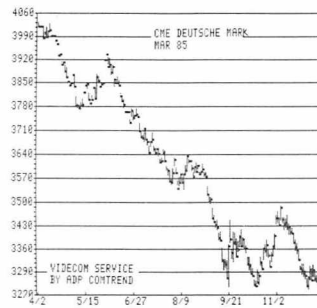
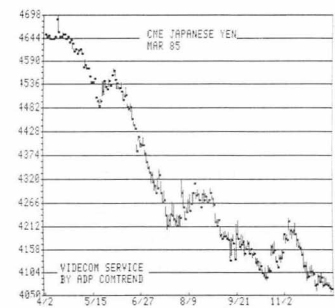


Chart 16



# Stock Index Futures

Conflicting technical signals are giving way at this time to an interest-rate-led rally, which eventually will have to recognize the realities of disastrous corporate profits.

**STRATEGY:** We do not care to follow the very probable year-end rally. Stay sidelined.

## VALUE LINE INDEX – S&P INDEX

Chart 17

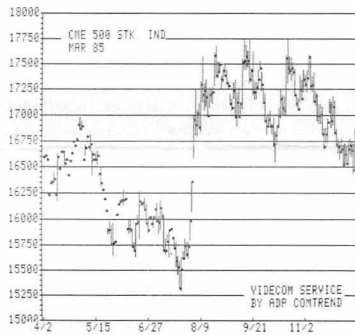
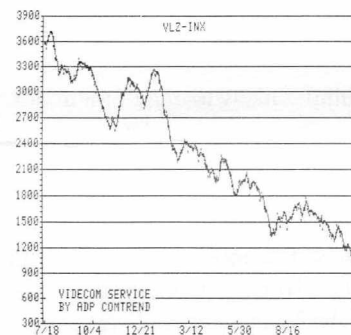


Chart 18



# Metals

**STRATEGY:** One picture is worth a thousand words.

Chart 19



Chart 20

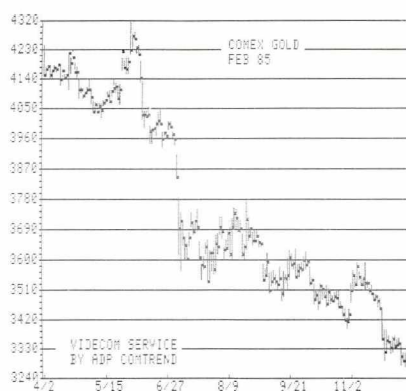
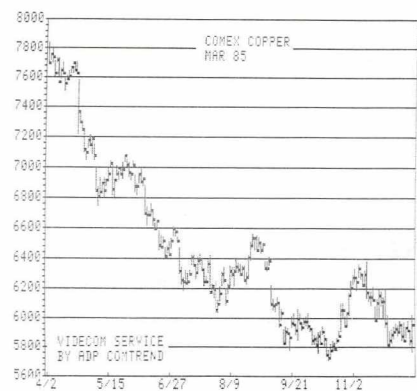


Chart 21



# Exotics

## New Zealand dollar

**HARD CURRENCY COVER** (In millions of U.S. Dollars)

RESERVES* + PREVIOUS 12-MONTH CURRENT ACCOUNT *** =	180
(RESERVES + 12-MONTH C/A) / M1 ** =	180/1,668 = 10.7 %
(RESERVES + 12-MONTH C/A) / BROAD MONEY** =	180/4,988 = 3.6%

\* AS AT Aug. 1984 \*\* July 1984 \*\*\* 1983 2Q - 1984 1Q

\*\*\*\*\*  
 Figures in millions of U.S. Dollars

	M1 (Converted to U.S. Dollars)	Broad Money (Converted to U.S. Dollars)
1973	2,206.7	3,534.4
1984 (2)	2,020	5,791.2
% increase (decrease)	(8.46%)	63 %

Corresponding % increase in The United States 81 % 146 %

Exchange Rate Adjusted By Relative CPIs

==== BASKET ====

YEAR	U.S. DOLLAR PER NEW ZEALAND DOLLAR		U.S. = 197F = 1.00		U.S. = 1978 = 1.00	
	1970 =	197F =	1970 =	1978 =	1970 =	1978 =
1967	1.1227	0.9935	1.3768	1.0148	1.1256	
1968	1.1121	1.0034	1.3005	1.0143	1.1251	
1969	1.1198	1.0001	1.3859	1.0076	1.1176	
1970	1.1161	1.0000	1.3857	1.0000	1.1091	
1971	1.1052	0.8793	1.2184	0.9395	1.0020	
1972	1.1052	0.8522	1.1810	0.9268	1.0279	
1973	1.0784	0.6990	0.9686	0.8201	0.9100	
1974	1.0155	0.7575	1.0007	0.8795	0.9755	
1975	1.0037	0.9114	1.2000	1.0510	1.1657	
1976	0.9500	0.9059	1.2554	0.9904	1.0985	
1977	1.0197	0.7851	1.0879	0.9522	1.0561	
1978	1.0666	0.7216	1.0000	0.9016	1.0000	
1979	0.9862	0.7644	1.0592	0.9724	1.0785	
1980	0.9823	0.7584	1.0510	1.0202	1.1316	
1981	0.8244	0.8077	1.1747	1.0317	1.1443	
1982	0.7325	0.8707	1.2066	0.9732	1.0794	
1983	0.6546	0.9370	1.2000	1.0000	1.1136	
1984 (1Q)	0.6658	0.9267	1.2802	1.0083	1.1183	
1984 (2Q)	0.6359	0.9603	1.3307	1.0041	1.1137	
1984 (3Q)	0.4894	1.2239	1.6961			

Above 1.00 = undervalued  
 Below 1.00 = overvalued

\*\*\*\*\*  
 Figures in Billions of Japanese Yen

	M1 (Converted to Japanese Yen)	Broad Money (Converted to Japanese Yen)
1973	7,882	12,624
1984 (2)	8,504	24,380
% increase	8 %	93 %

Corresponding % increase in The United States 99 % 172 %

Year	Foreign Assets (Mln US\$)	CURRENT ACCOUNT As % of GNP %	CUMULATIVE 12 QTR. Current Account (Mln US\$)
1970	277.01	-3.75	- 283
1971	547.88	-0.24	- 228
1972	888.39	-1.74	- 88
1973	1139.57	-0.97	+ 22
1974	568.56	-12.82	-1761
1975	55.42	-8.35	-3092
1976	- 98.89	-6.31	-3772
1977	-231.98	-5.12	-2664
1978	-234.65	-2.89	-1969
1979	425.84	-4.22	-1995
1980	317.27	-3.94	-2159
1981	729.67	-6.12	-3112
1982	797.98	-6.82	-3784
1983	850.45	-	-3970
1984 (1)	841.83	-	-3970
1984 (2)	720.28	-	-

(a) 1982 Imports as percentage of GNP = 24.42 %  
 (b) 1973 - 1982 Imports as percentage of GNP = 22.81 %  
 1982 / (1973-1982 average) = (a) / (b) = 107.05 %

\* 1983 GNP estimated

	Spot	1-Month	3-Month	6-Month	12-Month
Rates	.4835-	.4815-	.4765-	.4700-	.4550-
	.4845	.4835	.4795	.4750	.4650

**Outlook & recommendation:** Already prior to the 22% devaluation of July, New Zealand had achieved a small current account surplus, indicating that the adjustment was well underway. With the devaluation, the NZ dollar became relatively undervalued, a necessary condition for a country experiencing a deterioration in its terms of trade.

We are neutral.

# Australian dollar

Exchange Rate Adjusted By Relative CPIs

YEAR	US DOLLAR PER AUSTRALIAN DOLLAR	U.S.		***** HASKET *****					
		1967=1.00	1973=1.00	U.S.	JAPAN	GERMANY	U.K.		
1967	1.1210	1.0000	1.3246	1.0000	1.2754	31 %	49 %	8 %	12 %
1968	1.1100	1.0251	1.3783	1.0221	1.3036				
1969	1.1180	1.0432	1.4027	1.0460	1.3340				
1970	1.1150	1.0655	1.4226	1.0676	1.3617				
1971	1.1010	0.9818	1.3201	1.0299	1.3135				
1972	1.2750	0.8965	1.2054	0.9275	1.1829				
1973	1.4880	0.7437	1.0000	0.7841	1.0000				
1974	1.3270	0.8039	1.0009	0.8686	1.1079				
1975	1.2571	0.8056	1.0032	0.8573	1.0934				
1976	1.0864	0.8687	1.1681	0.9073	1.1572				
1977	1.1414	0.7888	1.0552	0.8854	1.1292				
1978	1.1505	0.7754	1.0026	0.9067	1.1564				
1979	1.1055	0.8235	1.1073	1.0040	1.2806				
1980	1.1807	0.7907	1.0685	1.0012	1.2770				
1981	1.1279	0.8372	1.1257	0.9514	1.2134				
1982	0.9806	0.9192	1.2259	0.9872	1.2591				
1983	0.8525	0.9471	1.2735	0.9760	1.2447				
1984 (10)	0.9250	0.9031	1.2143	0.9309	1.1872				
1984 (20)	0.8613	0.9900	1.3211	1.0095	1.2876				
1984 (30)	0.8230								

Above 1.00 = undervalued  
Under 1.00 = overvalued

HARD CURRENCY COVER

(In millions of U.S. Dollars)

RESERVES* + PREVIOUS 12-MONTH CURRENT ACCOUNT *** =	3704
(RESERVES + 12-MONTH C/A) / M1 ** =	3704/16532 = 22.4%
(RESERVES + 12-MONTH C/A) / BROAD MONEY** =	3704/64998 = 5.7%

\* AS AT SEPT. 1984 \*\* JULY 1984 \*\*\* JULY 1983-JUNE 1984

\*\*\*\*\*  
Figures in millions of U.S. Dollars

	M1 (Converted to U.S. Dollars)	Broad Money (Converted to U.S. Dollars)
1973	11,887	36,776
1984 (2)	16,921	66,381
% increase (decrease)	42 %	80 %
Corresponding % increase in The United States	81 %	146 %

\*\*\*\*\*  
Figures in Billions of Japanese Yen

Year	Foreign Assets (Min US\$)	CURRENT ACCOUNT		CUMULATIVE 12 QTR.	
		As % of GNP	%	Current Account (Min US\$)	
1970	1,817	- 2.23		-3019	
1971	3,350	- 1.98		-2467	
1972	6,079	+ 1.10		-1064	
1973	5,776	+ 0.80		+ 260	
1974	4,157	- 3.30		-1598	
1975	3,653	- 0.94		-2935	
1976	2,571	- 1.84		-5225	
1977	2,952	- 2.99		-5414	
1978	3,411	- 3.86		-8795	
1979	4,016	- 1.88		-9501	
1980	6,573	- 2.65		-10,129	
1981	4,474	- 4.90		-13,739	
1982	8,912	- 4.98		-19,327	
1983	11,155	- 3.34		-20,773	
1984 (1)	10,933	-		-21,566	
1984 (2)	10,225	-		-21,591	
1984 (3)	-	-		-	

	M1 (Converted to Japanese Yen )	Broad Money (Converted to Japanese Yen )
1973	42,434	131,310
1984 (2)	71,236	279,459
% increase	67 %	112 %
Corresponding % increase in The United States	99 %	172 %

\*\*\*\*\*

(a) 1983 Imports as percentage of GNP = 12.67 %

(b) 1974 - 1983 Imports as percentage of GNP = 13.38 %

1983 / 1974-1983 average = (a) / (b) = 94.69 %

	Spot	1-Month	3-Month	6-Month	12-Month
Rates	.8360-	.8340-	.8300-	.8230-	.8190-
	.8370	.8360	.8320	.8250	.8210

**Outlook & recommendation:** Persistent capital inflows, a well diversified economy, and only a modest monetary inflation (M1 converted to US dollars has only increased half as much as its US counterpart in the past decade) make the Aussie a *relatively* strong currency.

We are neutral.

# Indonesian rupiah

**HARD CURRENCY COVER**

(In millions of U.S. Dollars)

RESERVES\* + PREVIOUS 12-MONTH CURRENT ACCOUNT \*\*\* = - 518  
 (RESERVES + 12-MONTH C/A) / M1 \*\* = NEGATIVE (i.e. no coverage)  
 (RESERVES + 12-MONTH C/A) / BROAD MONEY\*\* = NEGATIVE (i.e. no coverage)

\* AS AT SEPT.1984 \*\*\* Jan. 1983-Dec. 1983

\*\*\*\*\*  
 Figures in millions of U.S. Dollars

	M1 (Converted to U.S.Dollars)	Broad Money (Converted to U.S. Dollars)
1973	1,616.8	2,438.5
1984 (2)	8,070	17,954.6
% increase (decrease)	399 %	636 %
Corresponding % increase in The United States	81 %	146 %

\*\*\*\*\*  
 Figures in Billions of Japanese Yen

	M1 (Converted to Japanese Yen)	Broad Money (Converted to Japanese Yen)
1973	577,060	870,320
1984 (2)	3,395,945	7,555,490
% increase	488 %	768 %
Corresponding % increase in The United States	99 %	172 %

\*\*\*\*\*

- (a) 1983 Imports as percentage of GNP\* = 23.66 %
- (b) 1974 - 1983 Imports as percentage of GNP\* = 19.55 %
- 1983 / (1974-1983 average) = (a)/(b) = 121.02 %

\* 1983 GNP estimated

Exchange Rate Adjusted By Relative CPIs

YEAR	INDONESIAN RUPIAHS PER U.S. DOLLAR		JAPAN		U.S.	
	1970=1.00	1970=1.00	1970=1.00	1970=1.00	1970=1.00	1970=1.00
1967	235.0000	1.5058	1.5308	2.1700	1.1950	
1968	326.0000	1.0235	1.0071	1.3920	0.7804	
1969	326.0000	0.9155	0.8909	1.2953	0.7009	
1970	374.0000	1.0000	1.0000	1.3601	0.7289	
1971	415.0000	1.1905	1.2741	1.4068	0.9016	
1972	415.0000	1.0668	1.2987	1.4510	1.0116	
1973	415.0000	0.8665	1.1981	1.1785	0.9332	
1974	415.0000	0.6814	0.9830	0.9271	0.7660	
1975	415.0000	0.6268	0.9126	0.8520	0.7108	
1976	415.0000	0.5526	0.8668	0.7515	0.6751	
1977	415.0000	0.5303	1.0208	0.7213	0.8018	
1978	425.0000	0.7908	1.0550	1.0805	1.0203	
1979	427.0000	0.7352	1.2839	1.0000	1.0000	
1980	424.7500	0.7041	1.3812	0.9576	1.0758	
1981	444.0000	0.7118	1.2209	0.9682	0.9501	
1982	492.5000	0.7412	1.1552	1.0081	0.8008	
1983	999.0000	0.9825	1.5276	1.4360	1.1808	
1984 (1)	1000.0000	0.9400	1.8929	1.2786	1.1628	
1984 (2)	1018.0000	0.9309	1.8115	1.2788	1.0990	

Above 1.00 = undervalued  
 Under 1.00 = overvalued

Year	Foreign Assets (Mln US\$)	CURRENT ACCOUNT As % of GNP %	CUMULATIVE 12 QTR.
			Current Account (Mln US\$)
1970	+61	-3.41	-871
1971	+36	-4.04	-1018
1972	+532	-3.14	-1016
1973	+710	-3.03	-1182
1974	+1592	+2.43	-212
1975	-826	-3.80	-987
1976	-120	-2.50	-1418
1977	+1204	-0.11	-2067
1978	+1697	-2.85	-2371
1979	+4693	+1.99	-484
1980	+9622	+4.13	+2431
1981	+9891	-0.68	+3278
1982	+7604	-6.22	-3128
1983	+8892	-8.23*	-12,330
1984 (1)	+9518		
1984 (2)	+10299		

\* Estimate

Rates	Spot	1-Month	3-Month	6-Month	12-Month
	1067-	1077-	1102-	1140-	1217 -
	1071	1091	1135	1190	1310

**Outlook & recommendation:** Massive current account deficits are likely to deteriorate even further on any weakness of oil (70% of export) and rising interest payments on growing external debt. There is, however, some elbow room if import reductions can be achieved and brought down to the average of the past decade. On balance, real devaluations of 25-50% are required in order to allow for a more reasonable adjustment on the international front.

Forwards, selling at a 22% p.a. discount, capture only part of the process, as inflation differentials dictate a minimum 8% annual devaluation just to maintain present real levels.

We recommend sales of rupiahs.

## Forex Rates & Update

Currency	Spot	3 month	12 month	Comments
South African Rand	.5315-.5325	.5155-.5175	.4890-.4920	Neutral
Kuwaiti Dinar	.30340-.30360	.30340-.30425	.30300-.30500	Remain Short
Saudi Arabian Riyal	3.5595-3.5605	3.5645-3.5750	3.5600-3.5800	Remain Short
Malaysian Ringgit	2.4140-2.4170	2.4215-2.4315	2.4275-2.4650	Remain Short
Portugese Escudo	166.25-166.75	172.00-183.00	186.00-216.00	Buy Foward against DM
Danish Kroner	11.10-11.11	11.17-11.19	11.22-11.29	Remain Short
Mexican Peso	217-219	237-244	302-315	Remain Short
Venezuelan Bolivar	12.60-12.80	12.85-13.20	13.85-14.95	Neutral

## Hotline Update

**November 29:** We would like to advise lowering of stops in the following commodities:

1. Dec. BP, lower stops to 125.50, close only.
2. Dec. DM, lower stops to 3355, close only.
3. Dec. C\$, lower stops to 7605, close only.

This update will repeat, unless there are any changes.

**December 6, 3:00:** This is a flash update. Cover Dec. BP, Dec. DM, and Dec. C\$ on the opening tomorrow, Dec. 7, if they open *higher* than today's close. Otherwise, from tomorrow on, lower stops to 120.05 on the BP, 32.70 on the DM, and 75.65 on the C\$, basis Dec., close only.

**December 11:** A recap of positions:

1. We were stopped out of the BP at approximately 120.35.
2. We were stopped out at the Dec. C\$ at approximately 75.78.
3. We are still short the Dec. DM and recommend lowering the stops to 32.58, close only.

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