

FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

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The Saudis' last hurrah...

Saudi Arabia has defended the price of oil for so long and at such cost to themselves — yet rarely has a monopolist acted so irrationally. With an installed production capacity of nearly 12 million barrels per day (mb/d) and reserves equal to perhaps the lifetime of an ordinary mortal, the Saudis dictated a high-price, low-output policy that encouraged conservation, substitution, and new high-cost production. The cost: a steady and now alarming drop in total oil revenues. The figures speak for themselves. As recently as 1981, the Saudis produced 9.8 mb/d (including Neutral Zone share) at an average of \$32.50/barrel, for a total gross revenue of \$116 billion. In the 1985-86 budget, the government forecast that its revenue-earning oil exports would amount to 3.1 mb/d at an average price of \$25/barrel (after paying Aramco's operational expenses), for a total revenue of \$28.4 billion, a whopping 75% decline in income.

The government projections, however, are highly optimistic and quite improbable. Plentiful supplies of competing Middle East sour crudes from Dubai, Iran, and Oman have driven Saudi crudes substantially below their official prices, forcing the Kingdom to reduce liftings to an average of 2.7 mb/d. If this output is maintained (allowing for domestic consumption of 800,000 b/d and 200,000 produced on behalf of Iraq), Saudi Arabia's total oil revenues would shrink further, to a relatively paltry \$15.5 billion.

The impact of these numbers on Saudi Arabia's fiscal position is devastating. The anticipated 1985-86 budget is perfectly balanced with revenues and expenditures projected at SR200 billion (approximately \$55.4 billion), which includes the aforementioned oil revenue of \$28.4 billion and a shortfall of \$10.4 billion to be met by drawing down reserves. *Short of substantial preventive measures*, the Kingdom may need to draw reserves down by an additional \$13 billion, a prospect that it hardly relishes. Furthermore, as a result of the worsening domestic recession, government expenditures for 1984-85 have unofficially been put at \$67 billion, a full \$7 billion higher than targeted. It would thus be doubtful that the 1985-86 estimate of a modest \$55.4 billion in expenditures could be realized. Any further shortfall, of course, would have to be met by drawing on reserves.

The Kingdom faces three unpleasant choices if it wants to avoid losing a good part of its (private) reserves.

1. It could slash expenditures by anywhere between \$10 and \$20 billion, enormous magnitudes when we realize that every \$1 billion equals approximately 1% of GNP.

2. It could devalue by anywhere up to 50%. The impact of this devaluation on revenues could, however, have a negative and offsetting impact on expenditures, especially those linked to the purchase of imported goods and services. On balance, it would appear that this second option is feasible, although not without some disturbing economic and social effects.

3. Its third and most practical, as well as most daring and most logical, choice involves a unilateral drop of oil prices *to somewhere between \$8 and \$15/barrel*.

A sudden and dramatic drop in prices would halt the insidious and corrosive (to Opec) process of destocking and might even induce some restocking by users and oil speculators convinced that the bottom has been seen. It would also reduce the output of producers whose *operating costs* lie above these levels. In all, it would allow the Kingdom to hoist crude liftings to 8.5-10.0 mb/d.

Using the lowest and highest figures of the price and output ranges, we estimate that Saudi oil revenues could increase to anywhere between \$20 billion and \$55 billion. Our best guess lies around \$30 billion, which is slightly above the *projected* but unattainable 1985-86 target. In the long run, the Saudis would gain from a reversal in conservation, substitution, and rising production from the likes of Colombia, China, Mexico, Tunisia, and so on.

Of course, the Saudis could choose any combination of the above options. A small(er) devaluation and a small(er)

In this issue

On the Canadian deficit — and what it needs. We stand aside in the Continental currencies. Higher prices to come in precious metals — so we stay long. Something new in the exotics — the Greek drachma. Contributions by Albert D. Friedberg and Daniel A. Gordon.

cutback in expenditures could help restore balance to the Kingdom's finances, but at a substantial social cost. At the same time a *partial* drop in oil prices would be only counter-productive as it would induce an accelerated process of destocking at the expense of Saudi output. An eclectic approach, therefore, would not produce optimal results.

As an aside, it is worthwhile to note how Opec power has been nothing more than Saudi power. In 1981, Opec produced 22.5 mb/d, out of which the Saudis produced 9.8 mb/d. By early 1985, Opec had reduced output to approximately 15.3 mb/d, a 7 mb/d cutback after lengthy and acrimonious meetings carried on with shameless pomp. Strangely enough, Saudi Arabia in the same period has lowered production by exactly 7 mb/d! Opec power, or Saudi power? As a group, Opec ex Saudi Arabia has not been able to cut output since 1981 by even 5%! So much for the cartel.

Budgetary and solvency considerations do no longer allow the Kingdom to bear the brunt of holding up prices. In fact, Sheikh Yamani's strategy has boomeranged: The Kingdom of Saudi Arabia has taken the largest absolute losses. It is time for this price searcher to find a more optimum price/output combination.

In the US, West Texas Intermediate (WTI) prices for June delivery have again recovered to flirt with the \$28/barrel level, almost \$2/barrel higher than the North Sea Brent. This is due to its high gasoline yielding qualities, a commodity that has been in relatively short supply. API statistics show

that gasoline stocks are 36 million barrels lower than last year; *nonetheless, they are not much lower than levels seen in 1982-83.* A continued high level of gasoline imports and a slight dropoff in demand (for the first time this year, demand for motor gasoline is lower in the past four weeks than the corresponding period last year) should help bring inventories to adequate levels. It is clear, then, that NYMEX short positions, based on the WTI should be moved to the deferred contracts, *past the critical July period*, to avoid being squeezed. It is worthwhile noting that during the heating season, *WTI can sell at a discount to Brent*, making fall and winter attractive short vehicles.

At the risk of sounding monotonous, we insist that oil prices are headed a great deal lower, perhaps even into single digit numbers, but certainly \$10-\$12/barrel. At the same time, some petrocurrencies offer extraordinary short-selling opportunities. We continue to advise retaining short Saudi riyal positions, first initiated at 3.5620 on October 14, 1984.

STRATEGY: *The particular idiosyncracies of the NYMEX and crude oil contract (see above) allow for some nimble trading. On May 9 (see Hotline Update) we advised covering positions in the hope of reestablishing them 50-100 points higher. In the interim, only the spot June contract has advanced in anticipation of a tight delivery condition. Reestablish short positions in the crude oil via the August and forward contract months, at market.*

Chart 1

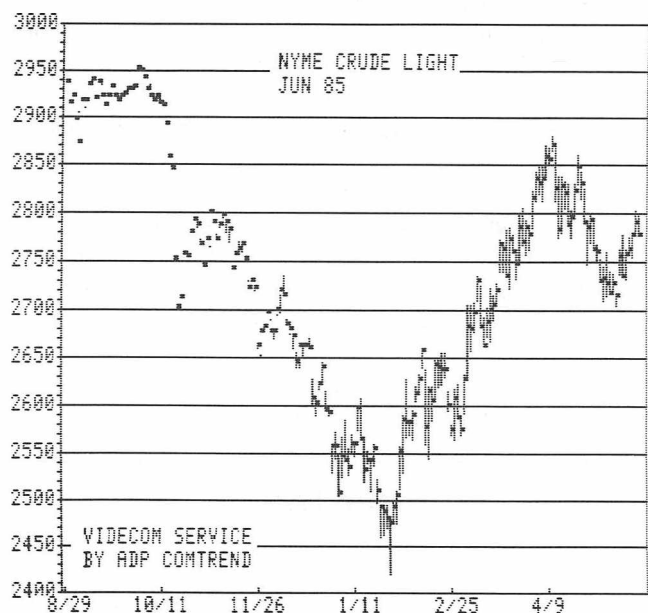


Chart 2

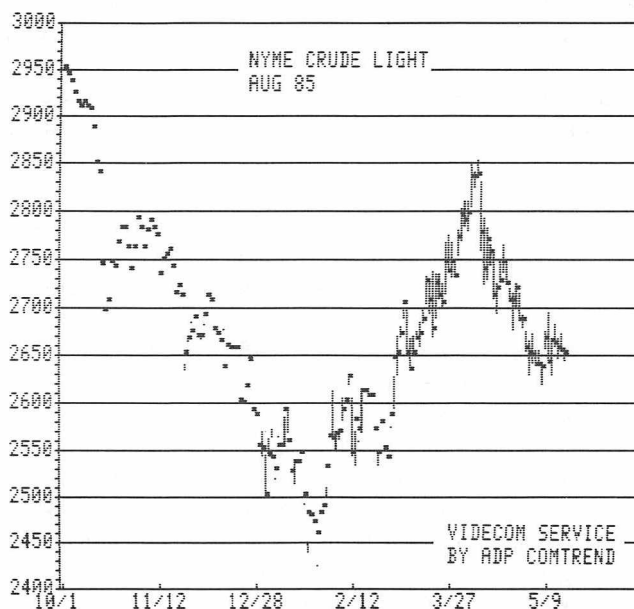


Chart 3

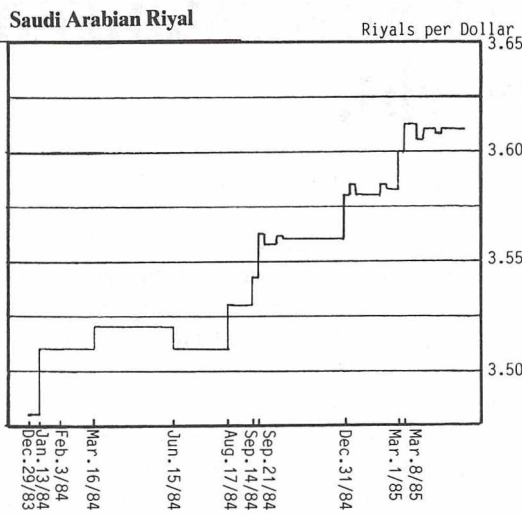


Chart 4

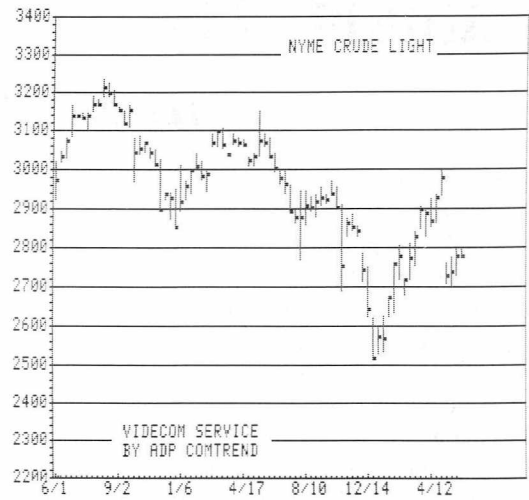


Chart 5

YEAR	Saudi Arabian Riyals Per: U.S. DOLLAR (PERIOD END)	U.S.		BASKET	
		1970=1.00	1980=1.00	1970=1.00	1980=1.00
1967	4.5000	0.9057	1.8271	0.9081	1.4599
1968	4.5000	0.9283	1.8726	0.9272	1.4905
1969	4.5000	0.9448	1.9059	0.9455	1.5200
1970	4.5000	1.0000	2.0172	1.0000	1.6076
1971	4.1500	0.9206	1.8571	0.9650	1.5514
1972	4.1500	0.9111	1.8378	0.9485	1.5248
1973	3.5500	0.7097	1.4315	0.7623	1.2255
1974	3.5500	0.6486	1.3083	0.7175	1.1534
1975	3.5300	0.5239	1.0568	0.5684	0.9138
1976	3.5300	0.4209	0.8491	0.4511	0.7253
1977	3.5050	0.3998	0.8065	0.4608	0.7408
1978	3.3150	0.4133	0.8338	0.4974	0.7996
1979	3.3650	0.4585	0.9249	0.5709	0.9178
1980	3.3250	0.4957	1.0000	0.6220	1.0000
1981	3.4150	0.5473	1.1041	0.6162	0.9906
1982	3.4350	0.5777	1.1655	0.6175	0.9928
1983	3.4950	0.6011	1.2126	0.6126	0.9848
1984 (1Q)	3.5150	0.6284	1.2676	0.6435	1.0345
1984 (2Q)	3.5050	0.6312	1.2733	0.6299	1.0127
1984 (3Q)	3.5550	0.6480	1.3071	0.6248	1.0044
1984 (4Q)	3.5750	0.6633	1.3380	0.6253	1.0053

Above 1.00 = undervalued
Under 1.00 = overvalued.

Chart 6

Year	Foreign Assets (Min US\$)	CURRENT ACCOUNT		CUMULATIVE 12 QTR.	
		As % of GNP	As % of GNP	Current Account (Min US\$)	Current Account (Min US\$)
1970	957	2.30		- 107	
1971	1,759	25.30		957	
1972	3,154	42.00		3,129	
1973	5,081	31.00		5,581	
1974	22,236	78.80		27,634	
1975	39,198	40.40		39,930	
1976	52,254	30.60		51,770	
1977	61,400	20.30		40,736	
1978	61,668	-3.30		24,139	
1979	64,838	14.60		20,946	
1980	94,384	34.90		49,996	
1981	141,770	24.30		90,558	
1982	156,986	-0.07		78,291	
1983	148,517	-16.60		18,817	
1984				-32,733	

Chart 8

RATES	SPOT	1 MONTH	3 MONTH	6 MONTH	12 MONTH
	3.6100	3.6050	3.6050	3.6050	3.6050
	3.6110	3.6110	3.6110	3.6110	3.6160

Chart 7

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

Reserves * + Previous 12-months current Account *** = 12037
(Reserves + 12-months C/A)/ M1 ** = 12037/24460 = 49.2%
(Reserves + 12-months C/A)/ Broad Money ** = 12037/37490 = 32.1%
*As at March 1985 ** Dec. 1983 *** 1984 (1) - 1984(4)

Figures in millions of U.S. Dollars

	M1 (Converted to U.S. Dollars)	Broad Money (Converted to U.S. Dollars)
1973	1,490	1,918
1984 (4)	24,460	37,490
% Increase (decrease)	1541%	1854%
Corresponding % increase in the United States	98%	142%

(a) 1983 Imports as percentage of GNP = 30.19%
(b) 1974-1983 Imports as percentage of GNP = 24.54%
1983/(1974-1983 average) = (a)/(b) = 123.02%

Source: IFS

Canada: The heavy burden of Keynesianism in a monetarist world.

In the spring of 1982, in a paper entitled "Inflation in Canada," we criticized the Bank of Canada's brand of monetarism — one that it had been practicing for well over six years — for using M1 as its policy target. At the time, we said that "while the Bank, in its Annual Report, concedes that the 'use that can be made of M1 has been complicated by velocity considerations, it nevertheless expects that it will be possible to identify and take sufficient account of shifts to preserve the usefulness of M1 as a longer-run policy target.' Our analysis indicates that this has not been the case; that is, the Bank has not been able to properly 'identify and take sufficient account of shifts' due to banking innovation and rising interest rates."

We praised the Bank of Canada for showing "a commendable restraint against the background of Ottawa's chaotic and extravagant fiscal posture . . . the Bank can be faulted for not refusing to finance any government obligations, i.e., by applying shock therapy. Nevertheless, the results do indicate a tightened and disciplined approach to a delicate political problem."

Finally, we recommended that the "Bank must first find that rate of growth of the *monetary base* that is compatible with a domestic credit expansion not in excess of 4% of nominal GNP . . . the Bank would probably have to lower the growth in the *adjusted monetary base* to half of the present pace."

We are happy to report that the Bank of Canada did just that, without, of course, talking about it. Chart 9 shows a sharp and discontinuous drop in the rate of growth of the adjusted monetary base after 1981 and the results: A steady and almost spectacular drop in the rate of inflation. Chart 10 shows how little M1 and M1A rates of growth correlate with movements in the CPI and how even M2 correlates poorly with this measure of inflation.

The central bank can, even while the government behaves irresponsibly, control the *rate of inflation*. In the process however, it forces the federal government to service a frightening and snowballing mountain of debt. In the 1984-85 fiscal exercise, 20.7 cents of every dollar of expenditure went to service the public debt. *What is worse, 32.8 cents of every dollar of revenue went to service the public debt*, an incredible sum that threatens, in the near future, to paralyze the working of a normal government.

On May 23, the new Conservative government in Ottawa will present its first budget proposal for the 1985-86 year. We thought it would be interesting to project what share of government revenues and expenditures will go towards servicing the debt in five years under two different sets of assumptions.

Scenario A (Chart 11) extrapolates the past six years and derives government revenues and expenditures. It cumulates the deficits and obtains the total unmatured debt outstanding in 1989-1990. It applies the same service costs that prevailed in the 1984-85 period. The result: Public debt ser-

vices will absorb 30.5% of public expenditures and 55.4% of public revenues.

Under scenario B (Chart 12), we have assumed that normal GNP will grow by a mere 5%, revenues by 5%, expenditures by 4%, and that interest rates will average 10½%. The result is a slightly more modest but still wildly unacceptable absorption of 32% and 48.3% respectively.

A great many citizens have become flippant and even complacent about government deficits and the mountain of public debt. They argue that the debt is really owed to ourselves (which is true) and therefore it makes little difference how much it owes. There are, however, two fallacies in this argument. In the first place, gigantic borrowing needs raise interest rates, crowding out private investment and, in fact, socialize the economy. Secondly, the federal government's social scope of action is slowly being strangled as debt service charges take an ever larger share of the budget. In the absurd case, the government must dismiss its entire civil service and eliminate all transfer payments and investments to concentrate on just one activity: servicing the debt. The above ratios come quite close to this condition — and they are just five years away!

In the past, Latin America democracies, when faced with deficits, resorted to the printing press. This method had the advantage of leaving the slate clean (wipes out the public debt) and allowed a new government to begin with few obligations and responsibilities. As well, it allowed a new government to put in place a Keynesian or anti-cyclical fiscal policy.

Not so Canada's case. Ottawa will be forced to take painful measures in the 1985-1990 period to reduce the burden of debt. It will be facing two formidable obstacles: First, a drop in the government net fiscal impulse threatens to lurch the economy into reverse gear, wiping out, perhaps, all the growth achieved in the '60s and '70s (with the help of a positive fiscal impulse) and, in the process, initiating a vicious circle of falling government revenues. It will be the economic equivalent of running on a treadmill. Second, higher taxation (if that is chosen as a method of closing the gaps) will push the economy further underground, once again eroding any potential gains in revenues. Here again, the government will run just to keep even.

What to do? Our preference is to bite the bullet and slash expenditures by \$15 billion in 1985-86 and \$5 billion in 1986-87, risking a severe but short recession. We admit, however, that we have no political finesse.

Pity the Conservatives, who have inherited a grandiose mess, not of their own making, and who nonetheless will be blamed for the evils to come.

STRATEGY: *You were stopped out, profitably, of the long Canadian dollar position. Stand aside.*

Chart 9

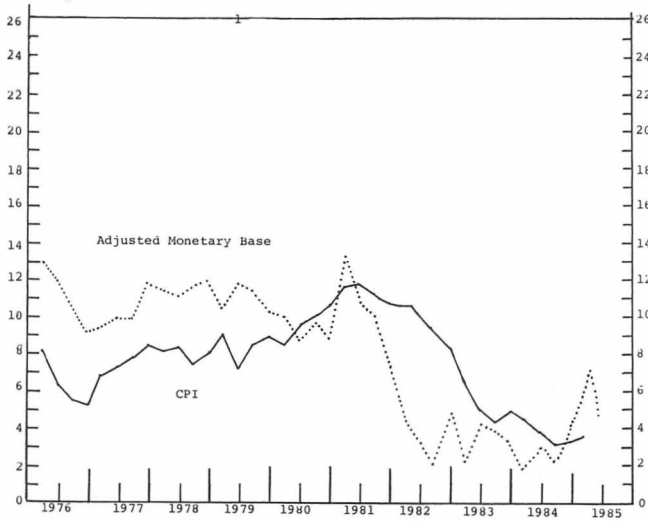


Chart 10

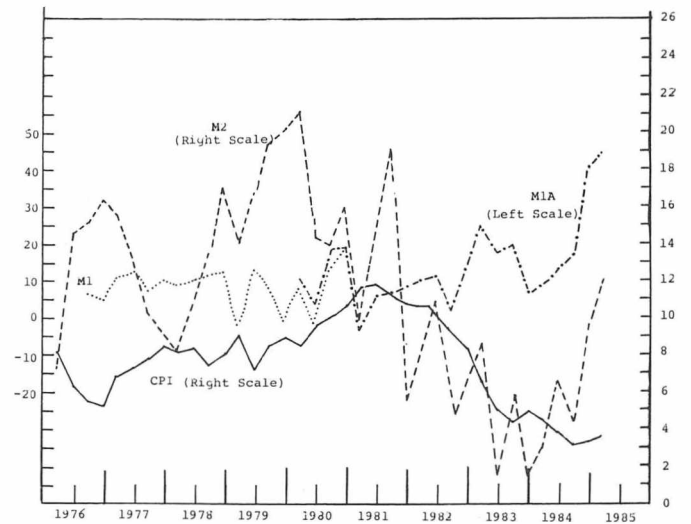


Chart 11

Scenario A

GOVERNMENT OF CANADA

	Total Revenue	Total Expenditure	Total Deficit	Public Debt Service	Unmatured Debt	Public Debt Service as % of Total Revenue	Public Debt Service as % of Total Expenditure
	(in millions of Canadian Dollars)						
1978/79	34,313	46,020	11,707	7,058	58,610	20.57%	15.34
1979/80	38,936	51,236	12,300	8,524	71,440	21.89	16.64
1980/81	45,398	57,704	12,306	10,687	82,098	23.54	18.52
1981/82	54,068	67,440	13,372	15,168	92,059	28.05	22.49
1982/83	55,126	79,467	24,341	16,970	117,916	30.78	21.35
1983/84	56,261	88,614	32,353	18,147	142,267	32.26	20.48
1984/85	62,840	99,330	36,490	20,658	174,418	32.87	20.78
1985/86 e	69,507	112,918	43,411	25,790	217,829	37.10	22.84
1986/87 e	76,882	128,365	51,483	31,886	269,312	41.47	24.84
1987/88 e	85,039	145,925	60,886	39,095	330,198	45.97	26.79
1988/89 e	94,061	165,889	71,828	47,600	402,028	50.60	28.69
1989/90 e	104,041	188,582	84,541	57,609	486,567	55.37	30.55

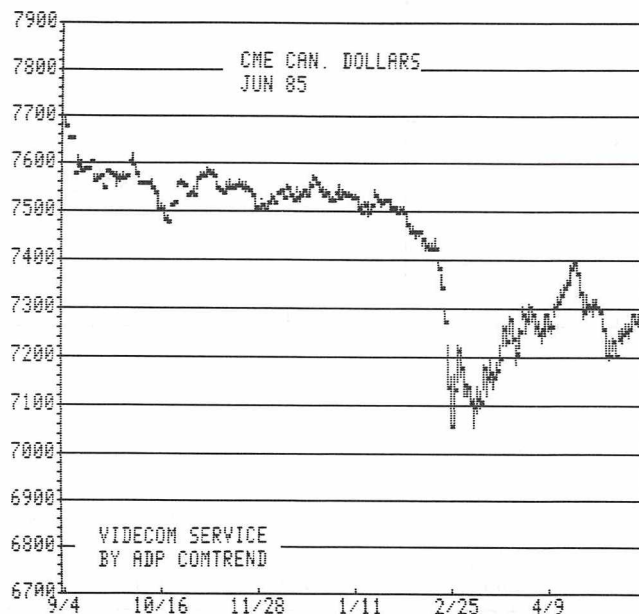
Chart 12

Scenario B

GOVERNMENT OF CANADA

	Total Revenue	Total Expenditure	Total Deficit	Public Debt Service	Unmatured Debt	Public Debt Service as % of Total Revenue	Public Debt Service as % of Total Expenditure
	(in millions of Canadian Dollars)						
1978/79	34,313	46,020	11,707	7,058	58,610	20.57%	15.34
1979/80	38,936	51,236	12,300	8,524	71,440	21.89	16.64
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1983/84	56,261	88,614	32,353	18,147	142,267	32.26	20.48
1984/85	62,840	99,330	36,490	20,658	174,418	32.87	20.78
1985/86 e	65,982	103,303	37,321	22,232	211,739	33.69	21.52
1986/87 e	69,281	107,435	38,154	26,238	249,893	37.87	24.42
1987/88 e	72,745	111,732	38,987	30,332	288,880	41.70	27.14
1988/89 e	76,382	116,202	39,820	34,514	328,700	45.19	29.70
1989/90 e	80,201	120,850	40,649	38,781	369,349	48.35	32.09

Chart 13



Currencies

The forex markets have become inordinately erratic. In the words of a superb trader and good friend of ours (the man at Bankers Trust), we should be looking for direction.

Indeed, an all-too-logical US dollar decline was abruptly reversed in April, taking the crucial \$/DM parity above 3.20, a key level. No sooner had we proclaimed that the dollar decline was over, when the market, once again, reversed course and headed to the 3DM level.

Reviewing the fundamentals: US interest rates are falling, although not in real terms, monetary policy is accommodative, although the Fed has shown some restraint in the past few weeks, and the US economy has entered a recession (bad for capital flows). The US trade deficit has settled in at around \$11 billion/month, and the current account deficit is growing, if ever so slightly, as a result of its newly acquired net debtor status. Still, the current account deficit has still to reach 4% of GNP, a relatively tolerable level.

Pressure by debt-ridden countries to service debt (net resources transfers to the US banking system, in the banking

parlance) underpin strongly and critically the foreign exchange value of the US dollar.

It is here that we must focus our attention. Default or repudiation, of course, would relieve upward dollar pressure. At the same time, dollar funding requirements on the part of banking intermediaries would diminish, also helping to relieve upward dollar pressure. In between stages, no default but little or no servicing à la Argentina and/or Peru, carry a slightly bearish dollar connotation.

STRATEGY: *At this time, we prefer to stand aside regarding Japan and Continental currencies (or as we commonly call them "currencies") and advise concentrating on the special situation.*

See the summary of our forex special situation recommendations. We particularly like short positions in Saudi riyals, Kuwaiti dinars, Mexican pesos, Greek drachmas, and long positions in the South African rand. Stand aside Japanese yen, UK sterling, and Continental currencies.

Chart 14

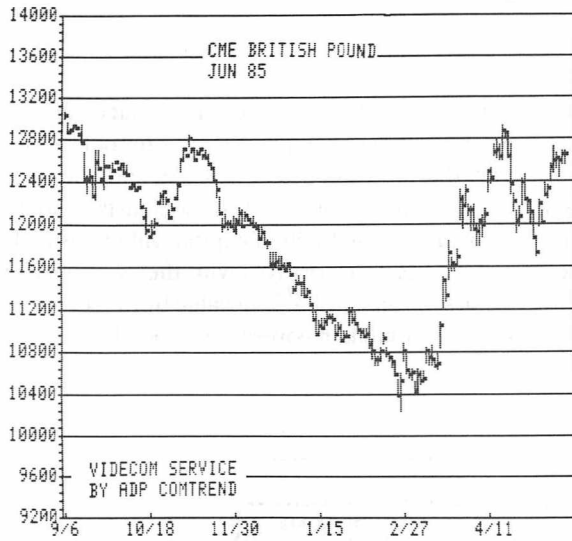


Chart 15

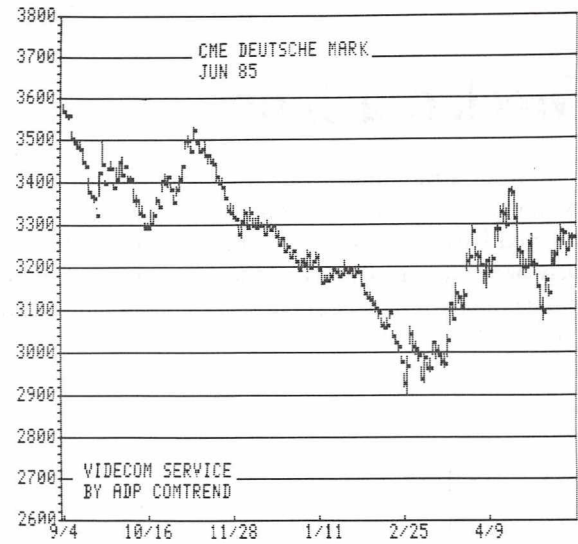


Chart 16

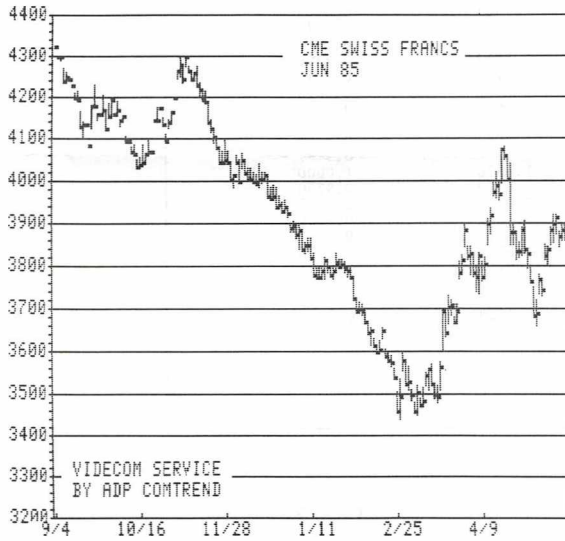


Chart 17

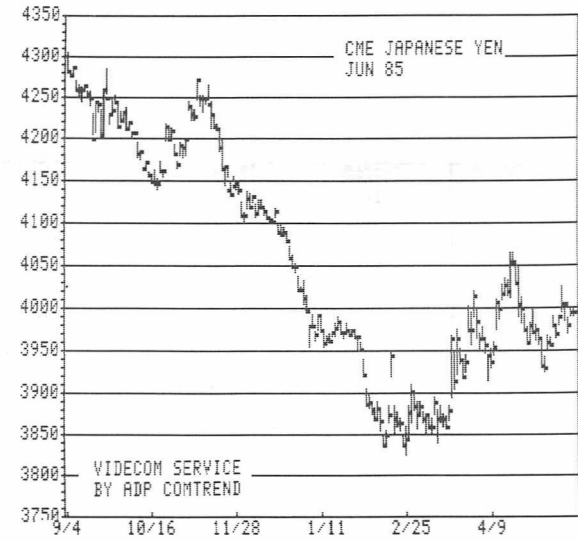


Chart 18

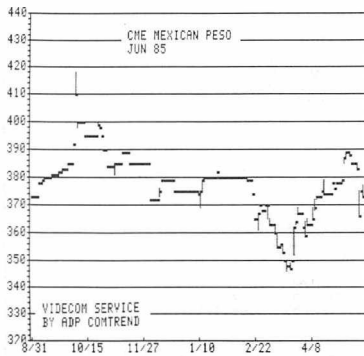
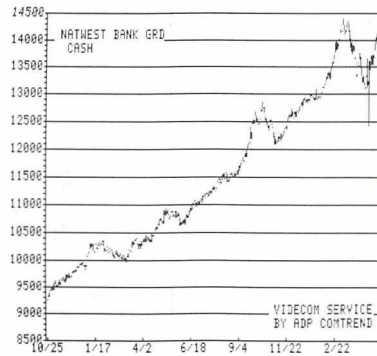


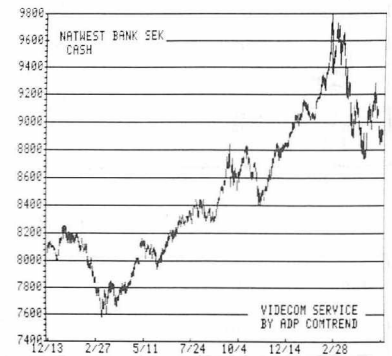
Chart 19



Greek drachma

Chart 20

Swedish krona



The Exotics

Greek drachma

The Greek drachma presents an interesting selling opportunity: An overvalued currency (at least on a trade-weighted basis); a widening current account deficit; a relatively heavy foreign debt (and therefore growing inability to finance the current account deficit), and an inflation rate of at least 20%.

Two items of *great* interest: In the first place, the forward discounts approximately equal the differential rates of inflation, and are therefore not prohibitive; second, the country is facing an election on June 2. If the socialists, who are now in power, win again, the flight of capital will intensify. If, on the other hand, the conservatives win, they will need to begin with a clean slate and probably devalue by 15-20%, coupled with substantial cutback in government spending.

Chart 21

YEAR	GREEK DRACHMAS PER: U.S. DOLLAR (PERIOD END)	U.S.		BASKET	
		1973=1.00	1978=1.00	1973=1.00	1978=1.00
1967	30.00	0.9967	1.1516	0.7321	0.6350
1968	30.00	1.0344	1.1951	0.7451	0.6462
1969	30.00	1.0652	1.2307	0.7810	0.6774
1970	30.00	1.0975	1.2680	0.7944	0.6890
1971	30.00	1.1103	1.2828	0.8982	0.7790
1972	30.00	1.1000	1.2709	0.9270	0.8040
1973	29.70	1.0000	1.1554	1.0000	0.8673
1974	30.00	0.8830	1.0202	0.9601	0.8327
1975	35.65	1.0096	1.1665	1.0342	0.8969
1976	37.03	0.9807	1.1330	1.1063	0.9595
1977	35.50	0.8926	1.0313	1.0916	0.9467
1978	36.00	0.8655	1.0000	1.1530	1.0000
1979	38.28	0.8601	0.9937	1.1219	0.9730
1980	46.53	0.9506	1.0983	1.0437	0.9052
1981	57.63	1.0439	1.2061	0.9361	0.8119
1982	70.57	1.1209	1.2950	0.9710	0.8422
1983	98.67	1.3426	1.5512	1.0228	0.8871
1984 (1Q)	103.35	1.3021	1.5045	1.0254	0.8893
1984 (2Q)	110.25	1.3307	1.5374	0.9797	0.8497
1984 (3Q)	124.70	1.4958	1.7282	1.0145	0.8799
1984 (4Q)	128.48	1.4704	1.6989	0.9628	0.8551

----- BASKET -----
 Japan 10% Saudi Arabia 11%
 France 13% Italy 21%
 Netherlands 10% Germany 35%

Above 1.00 = undervalued
 Under 1.00 = overvalued.

Chart 22

Year	Foreign Assets (Mln US\$)	CURRENT ACCOUNT As % of GNP	CUMULATIVE 12 QTR. Current Account (Mln US\$)
1970	356	-4.15	-1048
1971	396	-3.05	-1127
1972	853	-3.09	-1166
1973	771	-7.08	-1933
1974	543	-5.89	-2732
1975	165	-4.06	-3209
1976	-418	-3.99	-2949
1977	-822	-3.98	-2881
1978	-1347	-2.93	-2959
1979	-1615	-4.74	-3916
1980	-1319	-5.32	-5050
1981	-1768	-6.36	-6503
1982	-2386	-4.87	-6509
1983	-2486	-5.38	-6178
1984			-5770

Chart 24

RATES	SPOT	1 MONTH	3 MONTH	6 MONTH	12 MONTH
	135.80 -	137.60 -	141.20 -	146.00 -	N/A
	136.00	138.25	142.00	148.00	

Chart 23

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

Reserves * + Previous 12-months current Account *** = 86
 (Reserves + 12-months C/A)/ M1 ** = 86/4517 = 2%

(Reserves + 12-months C/A)/ Broad Money *** = 86/21316 = Nil

*As at Feb. 1985 ** March 1984 *** 1984 (1) - 1984 (4)

Figures in millions of U.S. Dollars

	M1 (Converted to U.S. Dollars)	Broad Money (Converted to U.S. Dollars)
1973	3154	9077
1984 (1)	4517	21316
% Increase (decrease)	43%	134.8
Corresponding % increase in the United States	94.7	146.2

(a) 1983 Imports as percentage of GNP 24.09%
 (b) 1974-1983 Imports as percentage of GNP 22.63%
 1983/(1974-1983 average) = (a)/(b) = 106.45%

Source: IFS

Swedish krona

As the Swedish recovery comes into old age, it is beginning to show signs of deterioration. A consumer boom has reversed the country's modestly favorable current account balance; for the first four months of the year, exports rose only 4%, while imports soared 19%, plunging the nation's first quarter current account into a deficit of SKR 6.1 billion. Traumatized by the brutal and unexpected 16% devaluation carried out in 1982, capital has taken to the gates; the outflow of capital, which began last November, has turned into a flood as over SKR 10 billion has left the country, a quarter of it in the first week of May alone.

A nasty civil servants' strike is paralyzing the country, and is a reflection of the difficult labor conditions prevailing in Sweden. Sweden's notorious wage drift helped drive up the average industrial worker's wages by 10.9% last year, way out

of line with its competitors' costs. In addition, a relatively high domestic monetary expansion coupled with the delayed effects of the 16% devaluation of 1982 have given Sweden a higher rate of inflation than its trading partners.

Recent moves to defend the krona include a sharp increase in the bank lending rates and a substantial cutback in lending authorization of the country's commercial banks. The government seems to be acutely aware of the dangers of devaluing in this overheated environment and seems to be intent on maintaining the present trade-weighted parity, in spite of the political costs that these policies may incur (the country is four months away from an election.)

Even though this government is burdened with a low degree of credibility, we still would chance remaining long the krona *vis à vis* the Deutschmark, particularly in view of the deep discounts.

Chart 25

YEAR	SWEDISH KRONOR per U.S.\$ (Period End)	U.S. 1970 =1.00	U.S. 1978 =1.00	B A S K E T			
				U.S. 1970 = 1.00	Germany 15%	U.K. 22%	Denmark 13%
1967	5.1650	0.9612	1.3627	0.9571		0.9995	
1968	5.1800	0.9858	1.3976	0.9776		1.0209	
1969	5.1700	1.0107	1.4329	1.0115		1.0563	
1970	5.1700	1.0000	1.4177	1.0000		1.0444	
1971	4.8650	0.9126	1.2938	0.9906		1.0345	
1972	4.7430	0.8697	1.2330	0.9304		0.9717	
1973	4.5875	0.8358	1.1849	0.9426		0.9845	
1974	4.0805	0.7502	1.0636	0.8918		0.9314	
1975	4.3855	0.8021	1.1372	0.9207		0.9615	
1976	4.1265	0.7246	1.0273	0.8240		0.8605	
1977	4.6695	0.7832	1.1104	1.0001		1.0445	
1978	4.2955	0.7054	1.0000	0.9575		1.0000	
1979	4.1465	0.7066	1.0017	1.0117		1.0566	
1980	4.3728	0.7434	1.0540	1.0885		1.1367	
1981	5.5710	0.9328	1.3224	1.1576		1.2090	
1982	7.2945	1.1933	1.6918	1.3479		1.4077	
1983	8.0010	1.2403	1.7583	1.2985		1.3561	
1984	8.2718	1.2384	1.7557	1.2324		1.2870	
1985 (1Q)	9.2649	1.3424	1.9031	1.1909		1.2437	

Above 1.00 = undervalued
Under 1.00 = overvalued.

Chart 26

Year	Foreign Assets (Mln US\$)	CURRENT ACCOUNT As % of GNP	CUMULATIVE 12 QTR. Current Account (Mln US\$)
1970	916	-0.8	-578
1971	1286	0.9	-110
1972	1950	1.3	654
1973	3267	2.7	2348
1974	3261	-0.9	1444
1975	4072	-0.4	535
1976	3443	-2.1	-2542
1977	3553	-2.6	-4171
1978	3263	-0.2	-4080
1979	369	-2.2	-4846
1980	-1221	-5.5	-7069
1981	-3119	-2.5	-9665
1982	-3748	-3.5	-10645
1983	-3717	-1.0	-7157
1984	-4705		-4210

Chart 27

HARD CURRENCY COVER (In millions of U.S. Dollars)		
Reserves * + Previous 12-months current Account *** = 5758		
(Reserves + 12-months C/A)/ M1 ** = 5758/7327 = 78.1%		
(Reserves + 12-months C/A)/ Broad Money ** = 5758/42644 = 13.5%		
*As at March 1985 ** Feb. 1985 *** 1984(1) - 1984 (4)		

Figures in millions of U.S. Dollars		
M1 (Converted to U.S. Dollars)	Broad Money (Converted to U.S. Dollars)	
-----	-----	
1974	9332	37617
1985 Feb.	7372	42644
%Increase (decrease)	-21.0%	+13.3%
Corresponding % increase in the United States	96.6%	152.6%

(a) 1983 Imports as percentage of GNP 28.57%		
(b) 1974-1983 Imports as percentage of GNP 25.16%		
1983/(1974-1983 average) = (a)/(b) = 113.55%		
Source: IFS		

Chart 28

Swedish krona

<u>RATES</u>	<u>SPOT</u>	<u>1 MONTH</u>	<u>3 MONTH</u>	<u>6 MONTH</u>	<u>12 MONTH</u>
	8.91 -	8.97 -	9.08 -	9.22 -	9.42 -
	8.92	8.99	9.10	9.24	9.45

Forex Rates & Update

<u>Currency</u>	<u>Spot</u>	<u>3-month</u>	<u>12-month</u>	<u>Comments vis-à-vis US\$</u>	<u>Comments vis-à-vis DM</u>
Australian dollar	.6845-.6855	.6718-.6733	.6151-.6535	Remain Long: Keep stops at 64.00	Remain Long: Keep stops at 1.9980
Belgian franc	61.90-62.00	62.02-62.16	62.15-62.40	Liquidated	Remain Long
Danish krone	11.05-11.06	11.08-11.10	11.10-11.14	Neutral	Remain Short
Dutch guilder	3.4730-3.4750	3.4618-3.4655	3.4010-3.4070	Liquidated	Neutral
Italian lira	1962-1966	1966-1971	1970-1976	Liquidated	Remain Long
Indonesian rupiah	1114-1119	1135-1180	N/A	Remain Short	Remain Short
Kuwaiti dinar	.30270-.30290	.30220-.30290	.30075-.30290	Remain Short	Remain Short
Malaysian ringgit	2.4690-2.4720	2.4810-2.4860	2.4970-2.5080	Neutral	Remain Short
Mexican peso	255-257	290-307	385-400	Remain Short	Remain Short
New Zealand dollar	.4485-.4495	.4280-.4320	.3835-.4035	Neutral	Neutral
Norwegian krone	8.87-8.89	8.96-8.99	9.16-9.20	Neutral	Neutral
Portugese escudo	175-177	180-189	200-225	Liquidated	Remain Long
Singapore dollar	2.2120-2.2150	2.1950-2.1990	2.1550-2.1650	Neutral	Remain Short
South African rand	.5020-.5030	.4880-.4900	.4660-.4690	Remain Long	Remain Long
Spanish peseta	173.70-174.00	175.70-176.50	182.00-184.00	Neutral	Neutral
Venezuelan bolivar	12.70-12.80	12.72-12.92	13.20-14.30	Neutral	Neutral

Explanatory Notes

Currency expected to firm against both currencies.

Currency expected to strengthen against US \$ and weaken against DM.

Currency expected to weaken against both major currencies.

Currency expected to weaken against US \$, but strengthen against DM.

Term used to liquidate short position but does not imply a new buy recommendation.

Term used to indicate sale advice of previous long position, but does not imply a new short sale recommendation.

Buy

Buy

Sell

Sell

Buy

Sell

Sell

Buy

Cover

Liquidate

Stock Index Futures

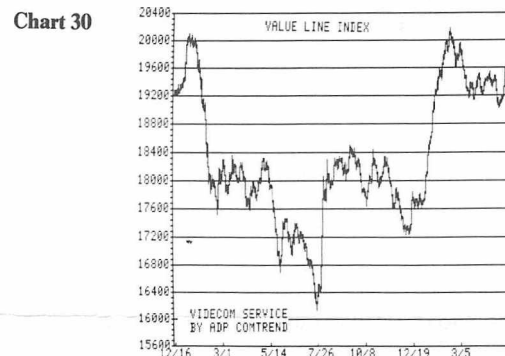
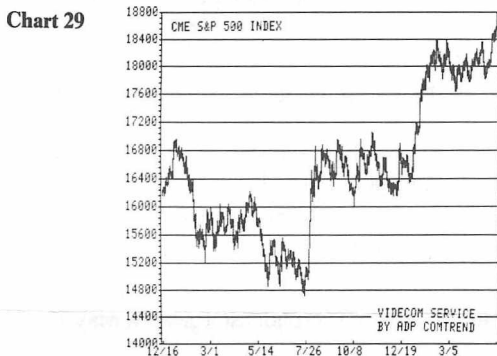
The incomprehensible happened: Despite falling corporate earnings, the unexpected arrival on the scene of a recession that promises to be long and nasty, and the inordinately large and growing burden of debt (at all levels), the stock market surged ahead. Late last week, new highs were recorded by the S&P 500, the NY Stock Exchange Composite Index and the Dow Jones Utility. Failing to conform, as yet, the new highs were the Dow Jones Industrials, Dow Jones Transportation, and the Value Line Index. Given the extraordinary momentum of the advance, it seemed only a matter of days before the laggards reached over the top.

What could possibly be fuelling the advance? We don't have an answer nor do we believe does anyone else.

But, *their* view is consistent with *their* beliefs that the US

economy will grow this year by around 3.1% and slow down near year to 2.2% (US business leaders meeting in Hot Springs, Virginia on May 10, as reported by Reuters). They felt that the US economy would slow down mainly because of the country's problems in competing with foreign industries. "But they see little chance of a recession." Can anything more ridiculous be said in May of 1985, at least five months *into a recession*? Will the stock market be so obliging to these gentlemen and begin the descent when everyone finally concedes the downturn has come? Only time will tell.

STRATEGY: *Stopped out of June '85 S&P short position at approximately 186.00, as per previous advice. Retain June S&P 180 puts, just in case . . .*



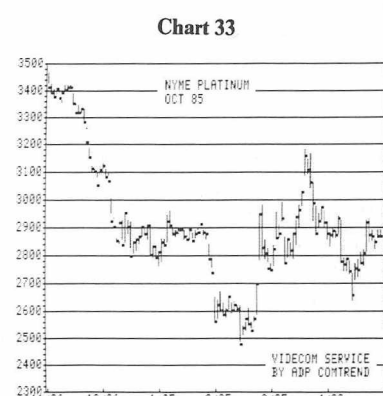
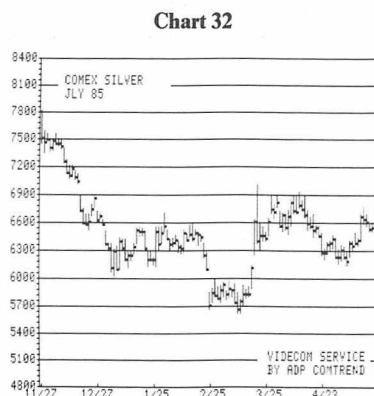
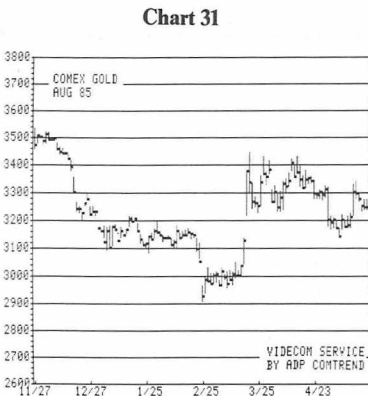
Gold/Silver/Platinum

Quiet base-building action interrupted by occasional and sharp sell-offs characterize the precious metals markets. Technically, the action is impressive and speaks of much higher prices.

Can precious metals swim against the tide of deflation? We think that *gold* can, although we have some reservations about silver and platinum. It is worthwhile pointing out that our gold valuation model (*Commodity & Currency Comments*, March 24, 1985) continues to point to higher bullion prices. Depending on the source (Federal Reserve, IFS) and consid-

ering that the data are a number of months behind, we obtain a range of \$334-\$383/oz. The uptrend is in full force.

STRATEGY: *Tight stops in these volatile markets are a prescription for losses. Ultimately it is preferable to buy less so that one can afford larger adverse swings. Investors must be long gold; Traders maintain long positions, risking 313, 610, and 259.00, basis August Comex gold, July Comex silver and July platinum, close only.*



Hotline Update

Tuesday, April 30: The market letter is in the mail today.

1. If you were stopped out of June gold on the close, buy back on a higher opening; otherwise, retain a stop of 316.00, basis June, close only.
2. Retain stops on Canadian dollar of 72.80, basis June, close only.
3. Retain stops on crude oil of 28.05, basis July, close only. Next update Friday, May 3, unless there is a flash update.

Friday, May 3: A brief review of present positions.

1. You are stopped out of all currencies: the Canadian dollar as per 72.80 stop, close basis June; the rest of the currencies today as the dollar/mark rate crossed and closed above 320.
2. You are stopped out of the gold as per the 316.00 stop, close basis June. Retain stops on silver of 610.00, close only, basis July. Also retain stops on platinum of 265.00, close only, basis July. Lower stops on July oil and forward months to 27.65, close only.

Tuesday, May 7: No new developments.

Thursday, May 9: We advise taking a profitable trade. Cover immediately all crude oil positions and look to reinstate at higher levels. Stay posted.

Friday, May 10: A review of changes and recommendations made in the past week.

1. You have covered all short crude oil positions as of yesterday, May 9, a.m. We look to reinstate at higher levels. Stay posted.
2. Having been stopped out of long platinum and gold positions early this week, we now advise reinstating long positions. Buy July platinum at market and place stops at 259.00, close only. Buy August Comex gold at market and place stops at 313.00, close only. You were not stopped out of the long July silver positions. Maintain stops at 610.00, basis July, close only.

Tuesday, May 14: There are no changes. Next regular update Friday, May 17, after market close.

Friday, May 17: There are no changes. Stay posted, especially concerning reentry of crude oil market, which is nearing. In deference to the Canadian holiday, this recording will continue til Tuesday a.m. Next regular broadcast Tuesday, May 21, after market close.

The First Mercantile Currency Fund, Inc.

A preliminary prospectus has been filed with the regulatory authorities in most provinces of Canada for The First Mercantile Currency Fund, Inc. If the prospectus becomes final, the Fund will provide investors with access to world currency markets under the investment supervision of Friedberg Commodity Management Inc.

The Fund will give investors the opportunity to participate in a managed portfolio of European and Asian currencies, as well as the more exotic foreign currencies that are described in *Friedberg's Commodity & Currency Comments*.

The offering is made by prospectus and is available in all provinces except Quebec through the offices of Walwyn Stodgell Cochran Murray Limited, Investment Dealers, and such other stockbrokers and investment dealers eligible to sell the securities. A call to your broker or to Walwyn will provide you with full information.

This advertisement shall not constitute an offer to sell.

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