FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

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The Saudis get tough – but oil prices *still* going down

It finally dawned on the Saudi monarch that his deep pockets were being systematically and shamelessly picked by the rest of the Brotherhood. King Fahd is no longer willing to play the game: Production, down to 2.5 million barrels per day (mb/d), was woefully inadequate to cover planned expenditures at a time when international reserves were dipping and his country was well into its worst recession in history. As we demonstrated rather conclusively last month, the Saudis were left on the horns of a dilemma, with little room to maneuver: devalue or lower oil prices enough to increase total revenues — or a combination of both.

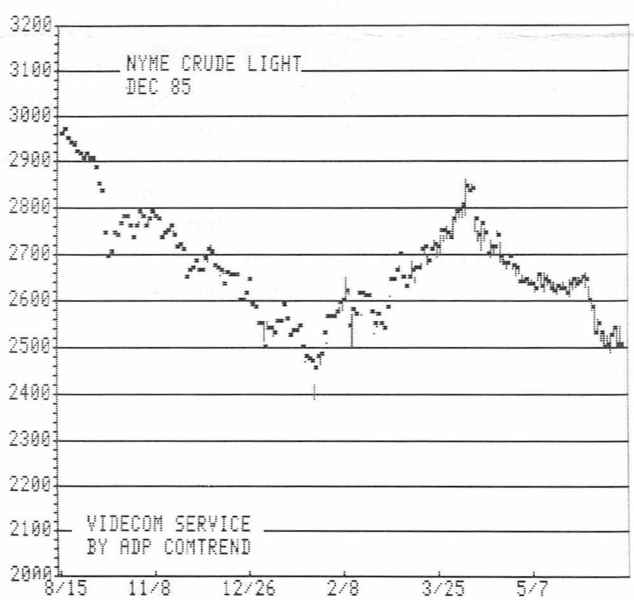
At Taif, on June 5, the monarch delivered a blunt message to the Brotherhood: Play by the rules (i.e., stop cheating) or the Saudis will feel free to raise production and exports, and disregard the downward impact on prices. One week later, still haunted by grim budgetary prospects, the Saudis adjusted the rate at which they were willing to sell dollars to commercial banks in Saudi Arabia to 3.65 riyals to the dollar from 3.61.

The devaluation, the third in 1985, was the largest one-time shift in the riyal in at least four years. Although it came as a complete surprise to Saudi dealers (deposit rates had not risen in the previous days), the move was, of course, well anticipated by *Commodity & Currency Comments*, which, since October 14, 1984 has been advocating outright short sales of the riyal as a very rewarding speculative play.

The full Opec meetings, called for July 5, will consider both King Fahd's ultimatum to fall back into line and Sheikh Yamani's (his oil minister) suggestion that heavy crude oils should be reduced in price. The Saudis, well aware of most Opec members' inevitable propensity to cheat, are hoping that the latest threat will, *for a time*, introduce some restraint. Time enough to weather the slack summer months. And time enough to weather what, in their view, appears to be a temporary lull in economic activity in the US, Japan, and Germany. With weak seasonal and economic considerations out of the way by September, the Saudis will once again be able to bring production up to 4.3-5.0 mb/d and hope to achieve some relief from their budgetary problem.

Sadly for them, though, things are not likely to turn out that way. According to the International Energy Agency, consumption in the second quarter by the 24 members of the

Chart 1



In this issue

Again, the Mexican peso — this time a maxi-devaluation on the way. Guest writer Neil Reynolds on the recent Canadian budget — and why it's likely to make things worse. Currencies: What to do in a dull and trendless market. And we review the exotic currencies. Contributions by Albert D. Friedberg and Daniel A. Gordon.

OECD will fall by about 2% from the same period last year, a forecast that comes as a major surprise to the market but that is exactly in line with some of our earlier estimates. A drop of this magnitude, on an annual basis, represents approximately 1 mb/d. Since non-Opec sources continue to expand production, this drop in demand *must be absorbed fully by Opec.* Furthermore, Iraq's new pipeline, permitting 500,000 b/d to flow through Saudi Arabia by fall, the full impact of the settlement of the UK miners' strike (another 400,000 b/d), and a number of new major refineries coming on stream later this year will force Opec to take cuts of well in excess of 2 mb/d if they insist on stabilizing the market.

US statistics present an even more bearish picture of demand. Whereas total products supplied (i.e., US oil demand) for the first 157 days of the year equalled 15,397,000 b/d — 3.1% less than the corresponding period last year — the drop in consumption became even more pronounced in the past four weeks when the year-over-year decline rose to 4.6%. Significantly, for the first time this year, gasoline consumption is down from the year before over the critical Memorial day weekend.

These EIA figures are corroborated by a well-known industry newsletter, *Petroleum Intelligence Weekly*. According to PIW, "international figures for April indicated a drop of 4% in the six main markets (US, Japan, West Germany, France, Italy and Britain), quadruple the rate of decline expected by most major oil companies for the second quarter as a whole." The loss of consumption equal to approximately 1 mb/d is occurring because coal, natural gas, and nuclear power are "still furiously (pushing out) oil from power generation and heavy industry."

Can Opec survive a marginal demand of 13-14 mb/d, which it is likely to face in coming months? Positively not. At that point, or perhaps much before then, Yamani's strategy will have collapsed simply because the Kingdom will find the loss of revenues unbearable.

The Saudi monarch will find that the *next* best threat will be a unilateral $5/barrel cut in prices, which may scare the Brotherhood into holding the line for a few weeks or months. In due course, a cut in prices will elicit a perverse reaction from Opec — increased production in a desperate attempt to increase revenues. This will be followed by another sabre rattling session, and another price cut, and so on. Each price cutting operation will elicit more production increases and lower spot market quotes. We still believe that from King Fahd's perspective, the best strategy is a sudden and dramatic cut to $8-$12/barrel coupled with a boost in production to near-capacity levels.

An important observation about the New York crude oil futures market. In previous issues we have discussed the inversion, or backwardation, prevailing in particular in the first two contract months. It occurred to us that the market was becoming more efficient and was, in fact, making it quite difficult for bears to profit from a drop in prices. If the present inversion remains for the rest of 1985 (see Chart 2), the crude oil market would have to drop by $5/barrel for the bears to merely break even; the cost of rolling over nearest contracts for one year would amount to almost $12/barrel, thus taking all the fun (and profit) out of being right.

The alternative is to seek out immediately the most deferred position (as we have been emphasizing for a good many months) and accept perhaps a $1.50-$2.00/barrel discount for six months. Moreover, the deferred position should be rolled over forward perhaps as frequently as every month in an attempt to beat the market's tendency to "stretch out" just prior to delivery. Since for all practical purposes, spot prices will not rise, the cost of the six-month discount can be equated to the cost of a put option.

It should be noted that a widening backwardation will act to depress present consumption, thus putting further pressure on oil producers. This is, in effect, another way of saying that bearish expectations cause middlemen to maintain low inventories, thus putting downward pressure on spot prices. A steep backwardation is the financial equivalent of a game of "chicken": It tests the resolve of users and producers. In the end, the winner will be the party with the most financial resources.

In the oil game, bearish expectations are having a devastating financial impact on producers who seem to be no longer able to resist the attrition of stocks.

STRATEGY: *The days leading to the July 5 Opec meeting may see some short covering in the expectation of a new and successful realignment of prices and perhaps quotas. Nevertheless, the inversion in the futures markets continues to steepen and its weight is slowly becoming unbearable (see Chart 3).*

Traders *are advised to purchase some (half of their short positions) nearby contracts to take advantage of a one- to two-week upward spurt.* ***Long-term investors*** *should ignore any near-term strength and concentrate on building ever-larger short positions in the Dec. '85-Jan. '86 contracts.*

We continue to believe that much lower prices are inevitable, and we set our sights on the $8-$10/per barrel level.

Chart 2

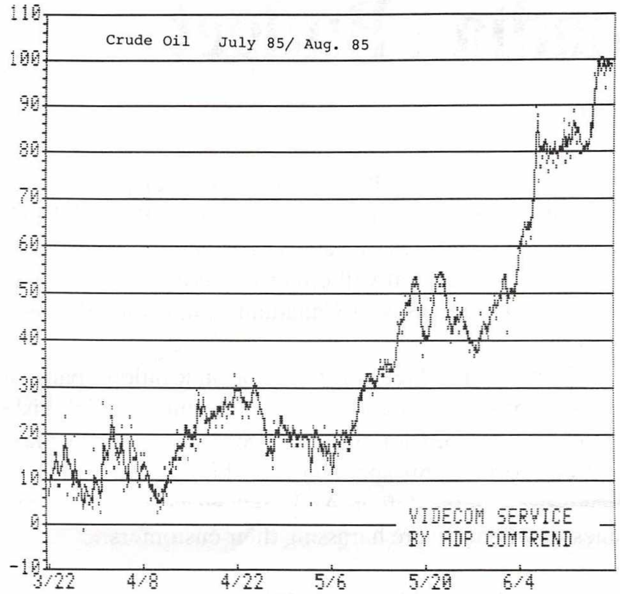
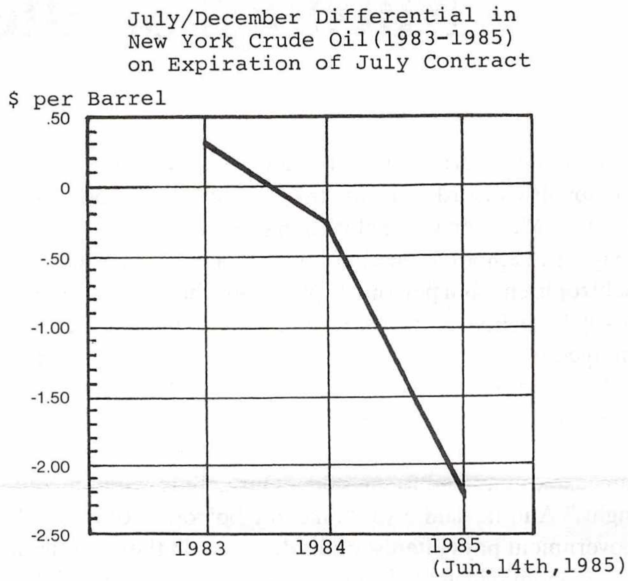


Chart 3



Mexico

A maxi is around the corner

Once the July 7 Mexican congressional elections are out of the way, the Mexican authorities will have to decide on the size of the upcoming devaluation.

On two previous occasions, November 11 and February 17, we pointed to Mexico's growing overvaluation problem and its nefarious efforts on non-oil trade and capital flight. The evidence is there for everyone to see: For the first four months of 1985, Mexico's trade surplus totalled $2.41 billion, 40.3% down on the year-ago period. Exports in the period were $5.69 billion, down 11.1%, imports $3.28 billion, up 38.9%, and non-oil exports $1.78 billion, down 16.3%. The huge 60% year-over-year increase in M_1 has boosted real liquid holdings substantially in view of the relatively smaller 37% devaluation *vis à vis* the US dollar. This factor, no doubt, has influenced the surge in imports, the reduced surplus on tourism, and the persistent capital outflow.

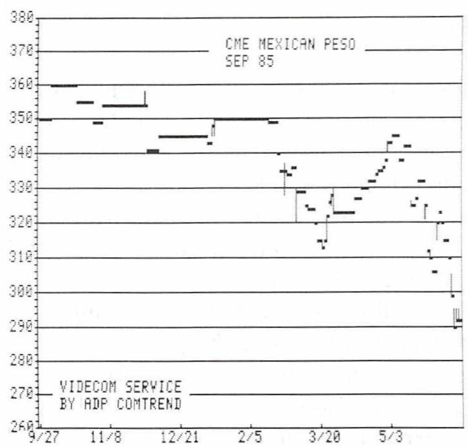
An even greater problem is shaping up in the oil export sector: Mexican crudes are trading in Europe as much as $3-$5/barrel below official quotes, causing Pemex (the Mexican oil agency) to lose exports of as much as 200,000 barrels per day in recent weeks. If continued, this loss would translate into a $1.8 billion reduction in *exports and government revenues*. Alternatively, a decision to cut prices $3/barrel and bring them somewhat in line with spot quotes would cost the country a similar amount. 'Tis a case of damned if you do, damned if you don't.

It is interesting to note that a $2 billion reduction in the expected 1985 trade surplus will not be nearly as serious as a reduction of that magnitude on government fiscal receipts. The drop in revenues will seriously jeopardize monetary targets and/or interest rate policy. Of course, if our forecast of oil prices is correct (an eventual drop to $8-$10/barrel), the damage to Mexico's finances will be irreparable.

Our guess is that the Mexican authorities will maxi-devalue the peso by at least 30% in the next few weeks, and then accelerate the daily devaluation to 30 centavos from the present 21 centavos.

STRATEGY: *Since our first short sale recommendation (November, 1984), the "free" peso has depreciated 38%. Maintain positions.*

Chart 4



Musings on the Canadian Budget

By Neil Reynolds

In psychiatric terms, the Mulroney government has a serious personality disorder. In his first budget speech on May 23, Finance Minister Michael Wilson showed himself and his colleagues in apparent need of formal diagnosis. The catatonic schizophrenic is a person of split mind who seeks advice endlessly but who never acts, his need to do the right thing submerged by paralytic fears that, in choosing and in acting, he will offend someone. For the moment, at least, this government is looking like a classic case.

Wilson knew what he needed to do. In his budget speech (in case you missed it), he said: "Our debt is spiralling out of sight." And he said also: "Like any borrower, the Canadian government pays interest on its debt." With these fundamental economic insights firmly in his grasp, what then did Wilson proceed to do? He proceeded to sanctify enough government spending to double the nation's debt in this decade.

Wilson says that a public debt of $180 billion in 1985 is unacceptable. A public-debt target of $360 billion by 1990, however, demonstrates courageous leadership. How we will pay for it? Wilson says that he will finesse a solution in the fullness of time.

In the meantime, he will raise taxes substantially. This from a man who asserts, as "central to our philosophy," that individual Canadians — not politicians, not civil servants — must determine "where they will put their money."

Self-contradictory budget

Wilson's best intentions aside, his budget — in its most important aspects — is as self-contradictory as the collective mind that produced it. The psychology of taxation is very simple. If you want individual citizens to determine where more of their money will go, you reduce taxes. If you want the government to determine where more of this money will go, you raise taxes. It's that simple.

Beyond the principle, there are equally simple practical consequences. If government leaves people with more money, they will buy more things. If government leaves people with more money, they will buy more things. If government takes more money from them, they will window-shop. With the multi-billion-dollar tax increases already set in place by the government, one can expect a sharp increase in consumer browsing in this country in 1986 and 1987.

It is ironic that individual Canadians were just beginning to have more money in their own personal control, for the first time in three years, when Wilson decided to take it away. Personal disposable income, adjusted for inflation to measure real new wealth, was rising sharply, and consumer spending was sustaining the country's precarious economy.

Real personal disposable incomes rose by 2.5% in 1984 — or $130 per person. Economists had estimated real increases slightly lower in 1985 (perhaps $75 per person) and lower still in 1987 (perhaps $25 per person). With Wilson's new broadly-based taxes (which will cost more than $100 per person), the government will effectively confiscate the real-wealth income increases of Canadian families for the next two years.

Wilson did introduce commendable innovations, particularly in stimulating small business and encouraging risk-investment. This does not excuse the government's abject failure to cut government spending — which is the right and proper way to cut the deficit. And it will be hard to help small businesses when you are harassing their customers.

Bureaucratic budget control

The Tory budget was audacious primarily to the extent that it confirmed federal bureaucratic control over Tory budget-makers. This is the most important consequence of all: The Conservative government has decided to befriend, not fight, the bureaucracy. The Mulroney government will maintain this country's very expensive federal establishment in the manner to which it has grown comfortably accustomed.

Wilson's worst assumption? That his tax increases will raise money for the government over the next three or four years. This is a crucial question right now, with the United States getting set to cut marginal tax rates again in Ronald Reagan's tax-reform "revolution." In a blunt and disappointing dismissal of any "massive tax reform," Wilson said that Canada could not afford to risk "uncertainty and instability."

Wilson seems confused between "stability" and downright entrenchment. Where, in the Canadian fortress, can we find certainty now? Not in the proposition that higher taxes produce commensurately higher revenues. We have had significant "shortfalls" in tax-increase revenues for the last 10 years. Our tax increases during this period have become an important cause of higher-than-forecast annual deficits.

Can Canada avoid tax reform that somehow parallels the prospective American reform? In my judgment, no one can speak more persuasively on this subject that an economist named Robert Mundell.

Although Canadian-born, Mundell remains largely unknown in his own land. Given his influence elsewhere, this is strange. He is a teacher of international economics at Columbia University. He goes to breakfast meetings with Donald Regan, chief-of-staff in Ronald Reagan's White House, and describes Paul Volcker, chairman of the Federal Reserve Board, as a close friend for 20 years. From his high-ceiling apartment in New York (designed by Atnello, a famous turn-of-the-century Italian architect) and his renaissance villa in Italy, Mundell travels the world, advising governments on four continents to reform their tax systems. The highest-priority components in what is now called the Mundell mix are these: (1) reduce marginal tax rates; (2) broaden the tax base; (3) protect the personal disposal income of taxpayers.

Mundell first advanced this policy combination in March 1962, when — as a young economist with a brilliant academic record — he helped to shape the Kennedy administration's 1963 tax reforms. "An across-the-board reduction," as Kennedy announced it, "in personal and corporate tax rates." (The Kennedy tax cuts reduced the top marginal rate from 91% to 77% in 1964 and to 70% in 1965.)

Mundell became a consultant for the Republican administrations of Richard Nixon and Gerald Ford. Neither president, he says, listened to him. When Nixon took the United States off the gold standard in 1972, and imposed a surcharge on income tax rates, Mundell predicted the global increases in commodity prices (and, in particular, the dramatic increases in oil prices) that followed.

In 1981, Ronald Reagan won lower marginal tax rates, with an across-the-board, 25% reduction. Now, in 1985, he seeks a further reduction in both personal tax rates and in personal taxes. It is the Mundell mix.

Personal disposable income in the United States rose by 4%, in real-money terms, in 1984. Reagan's reforms would direct still more disposable income into the hands of individuals in the years ahead.

The Reagan reforms would increase corporate taxes, but in relative terms, American companies would be in a much better position than Canadian companies: The top corporate rate in the US will be 33%; the effective corporate rate in Canada, by 1986, will exceed 42%.

In a series of conversations with *The Whig-Standard*, Mundell discussed the implications for Canada in Reagan's tax reforms.

"Canada will have to go along," Mundell said, "and do it very quickly. Canada will have to remain competitive. Canada will simply have to follow."

Canada risks disaster

Unless Canada does so, he said, the country will risk economic disaster. Unless Canada matches the US reforms, these consequences will follow:

☐ Upper-income people — "a lot of upper-income people" — will leave Canada for the United States.

☐ Upper-income people who do not leave Canada will instead move their money to the United States. "The Canadian taxpayer," Mundell said, "is sophisticated enough to avoid undue tax burdens."

☐ As a result, Canada will lose "several billion dollars a year" in income tax revenue.

☐ The federal deficits will rise.

☐ American exporters will gain a significant cost advantage over Canadian exporters, and Canadian exporters will be "greatly hurt."

☐ The Canadian dollar will experience "a new depreciation" against the US dollar.

Mundell said that Canada's loss of tax revenue would be merely a first effect, a "preliminary problem."

Companies that have found it profitable to operate branches and subsidiaries in Canada because of lower wage costs could very well roll up their operations in this country. With greater after-tax earnings left in their pockets as a result of tax reform in the US, American workers will push less hard for raises. The advantage of using labor in one country rather than the other will pass to the US, and Canada's unemployment problems will worsen.

Even Canada's auto plants, now booming, could be forced to close, Mundell said. "Canada has always had a wage advantage in its auto plants. But taxes are a cost of doing business. If tax rates go down in the US, and stay high in Canada, auto plants may be closed."

At this point, Mundell said, Canada is making a serious mistake in raising taxes. "Raising tax rates will weaken Gross National Product," he said. "As a result, tax revenues will actually fall off."

In looking at the deficit, Mundell said, the Canadian government should be asking itself: What is the best way to keep tax revenues fairly high? "By lowering your tax rates, you get a more efficient economy," he said, "and you prevent a very substantial erosion of revenue."

Mundell points to the "(Margaret Thatcher) monetary model" in Britain, where tax rates remain high and where unemployment exceeds 13%. By contrast, "the Reagan government, since 1982, has brought unemployment down to 7% from 12%.

Maxi-recession a danger

The Canadian government's biggest immediate concern, he said, should be the avoidance of a "mini-recession" as a result of the momentarily flat economy in the United States. By raising its tax burden, Canada may well push itself into a maxi-recession — which, in turn, will make our deficit problems much worse.

Consumers who are paying more in taxes, Mundell said, will have less money to spend on goods and services. "Any substantial decrease in GNP will result in very substantial loss in tax revenues for the government — because of its progressive tax rates."

Mundell said that people get confused by this analysis, since it seems to suggest that governments should cut taxes and let deficits run. The problem, he said, is a failure to distinguish between tax rates and tax revenues.

"Revenues equal your tax base times your tax rate," he said. "When you erode your tax base (as in a recession), the last thing you should do is increase your rates — since the higher rates erode your base further. A reduction in rates, on the other hand, protects the base, and may enlarge it."

The international consequences of American tax reform, Mundell said, will be enormous. "This (reform) represents a whole new approach to capitalism. We will have a high return on ventures. It could put the US five years ahead of Europe in this respect."

Reagan has been accused of hyperbole in calling the reforms "a revolution." Mundell said that they are historic because they represent a disavowal of progressive tax rates and a major step toward restoration of the proportional tax rates favored in classical economics. The reforms do not go all the way, but they establish a clear sense of direction for the future. If the Reagan reforms are enacted, pressures will develop to reduce them more in the future. Any income-tax rate higher than 25% is probably counter-productive.

Progressive income tax penalizes

"You know," Mundell said, "the progressive income tax has been a great penalty that prevents upward social mobility, a great barrier.

"It penalizes the people who invest in human capital, in themselves, in education and personal skills. With a very high marginal tax bracket, people are doing the sort of work that will keep them away from those high rates. They move to untaxed area of activity when they should be working in the market, where their greatest efficiency and skills are."

Mundell said that Canadians have been excessively taxed, in relation to services, for a long time. "Canada has an expensive bureaucracy," he said, "and the level of taxes should not be determined by the level of the bureaucracy."

Within the narrow limits apparently set for him by Brian Mulroney's frustrating quest for universal consensus, Wilson probably did move as best he could to send a message of encouragement to entrepreneurial enterprise. Under all of the circumstances, unfortunately, a message isn't enough. In relative terms, Canada's public-debt and tax-policy problems are more acute than in the United States, and the trend lines suggest things are going to get much worse before they get better. If Robert Mundell is right, we'll know for sure very soon.

Neil Reynolds is Editor-in-Chief of The (Kingston) Whig-Standard *and a big supporter of personal disposable income. Any reader who wants a free copy of a comprehensive* Whig-Standard *report on tax reform should write to him at 306 King Street, Kingston, Ontario, K7L 4Z7.*

Stock Index Futures

Powered by falling interest rates and merger mania, the stock market has continued to ignore poor corporate earnings. In a sense, blue chip stocks, the only participants in last year's bull market, have been a proxy for bonds although, of late, they have clearly underperformed bonds (see Chart 5).

STRATEGY: *If this rationale for rising stock prices is correct, and if we continue to believe (which we do) that the US (and perhaps Germany and Japan) have already entered a recession, then a correct strategy would involve an equal dollar purchase of T-bonds versus a sale of stock index futures. Moreover, given that the S&P 500 has far outperformed the broader Value Line index (see Chart 6) and given that in recent weeks the latter has begun to show better relative strength, we would favor selling the S&P 500 as our stock proxy.*

Closes below 176.00, basis the S&P 500 spot index, should signal the onset of a bear move of significant proportions. If and when it occurs, sell Sept. '85 S&P at market.

Chart 5

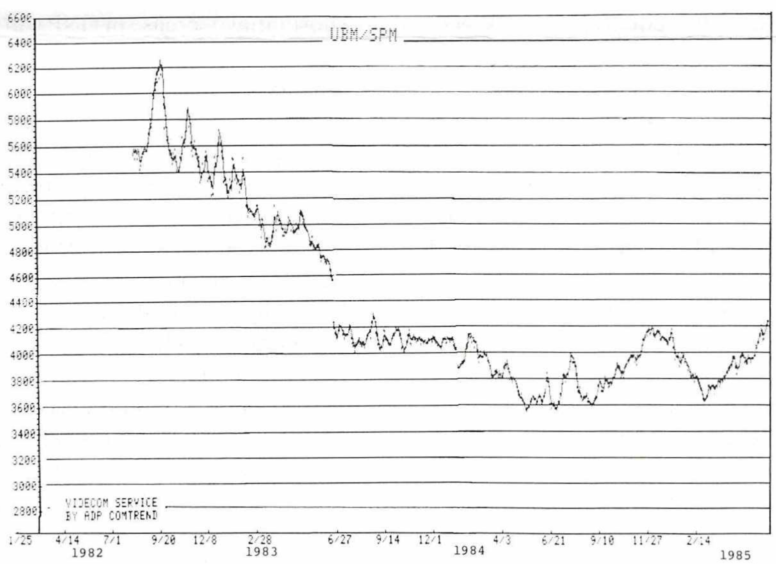


Chart 6

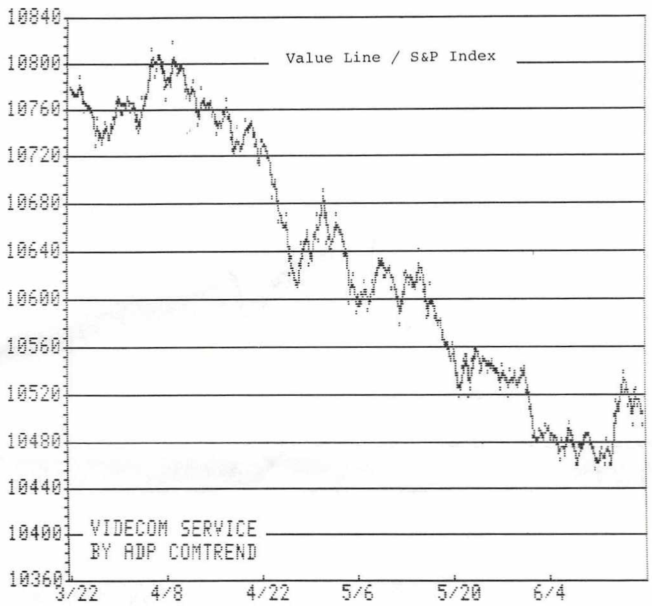
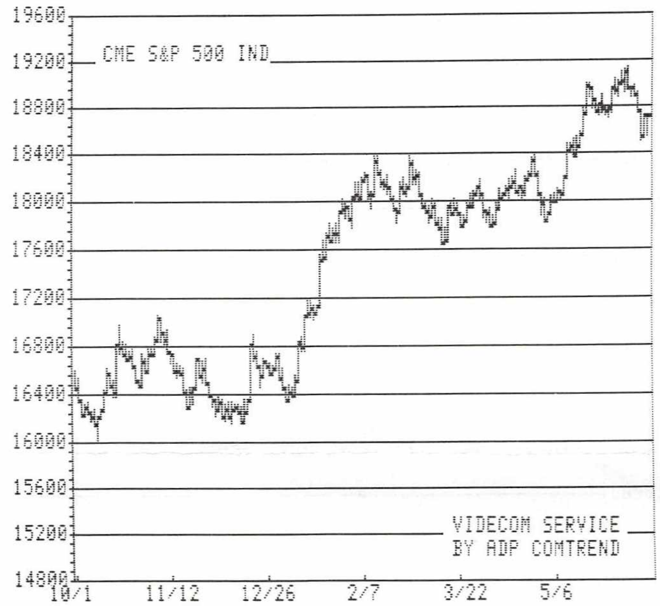


Chart 7



Precious Metals

Basing action continues. As the two spread charts show (Charts 9 and 10), gold has performed better relative to both silver and platinum. This situation is likely to persist in the near future as the markets move further away from an industrial-usage rationale.

STRATEGY: *Stopped out of July '85 silver at 6.0250; still long July '85 platinum and August Comex gold. Retain stops at 259 and 313, close only.*

Chart 8

Chart 9

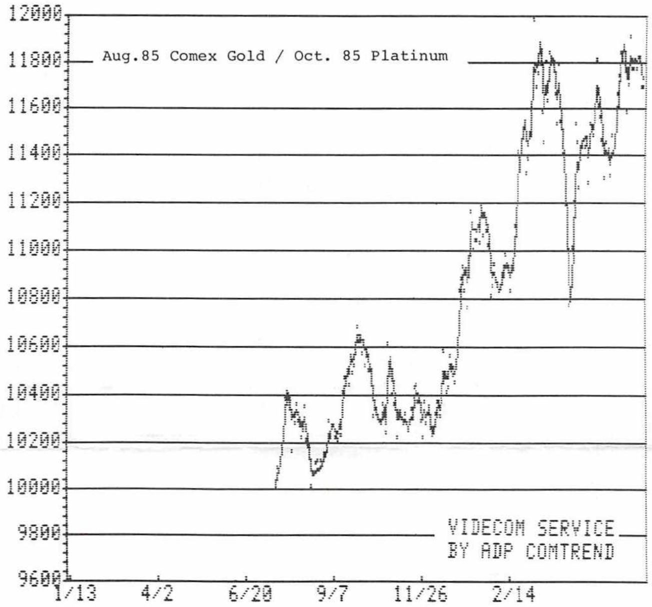
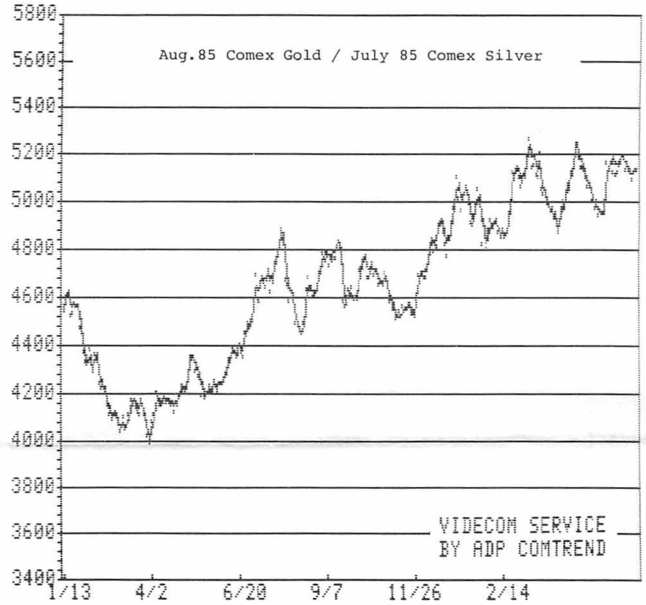


Chart 10



Currencies

"Dull" and "trendless" are the two most apt words describing activity in the key Continental currencies. Sentiment continues to be divided between those who argue that the US dollar has entered a soft-landing phase and those who argue that it is merely taking a refreshing pause. We belong to the second camp although it would not surprise us to see the \$/DM move as low as 2.85 before a dollar improvement sets in.

STRATEGY: *At this time, we prefer to stand aside.*

Chart 11

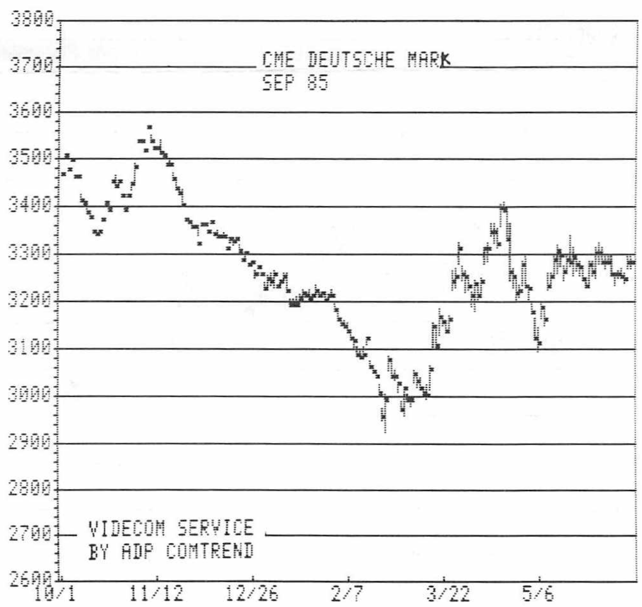


Chart 12

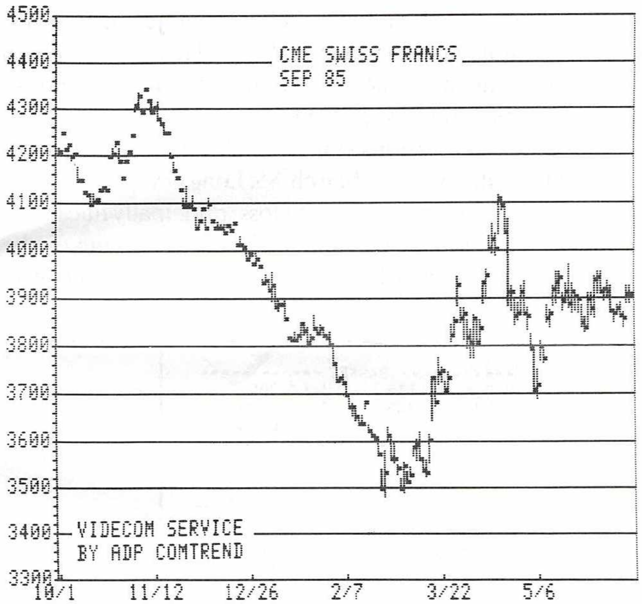


Chart 13

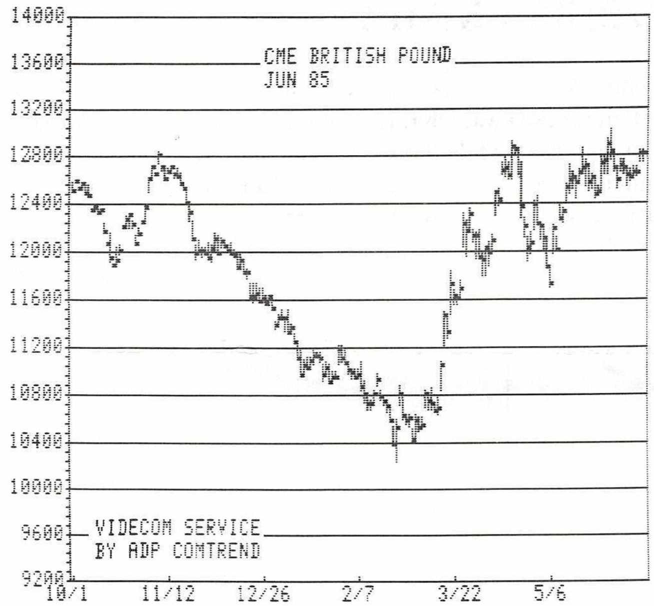


Chart 14

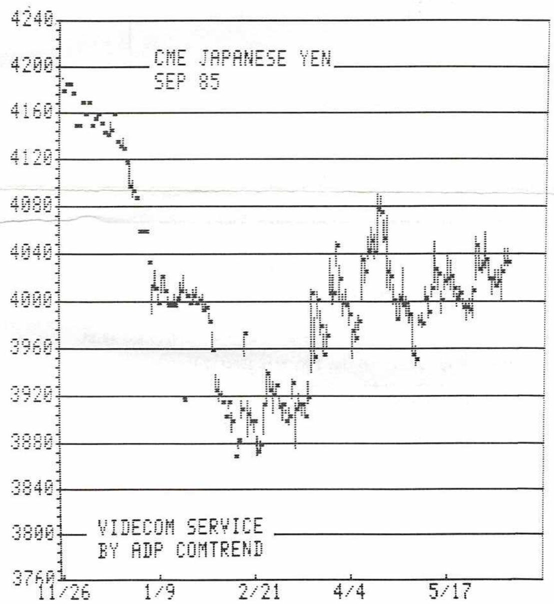
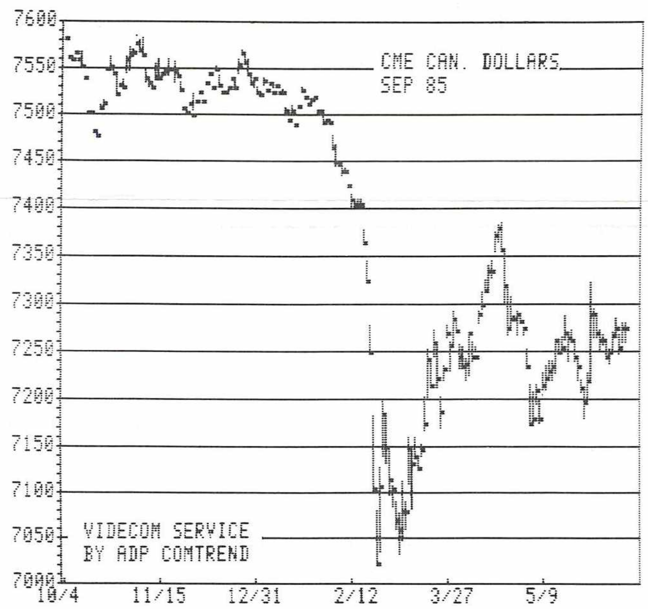


Chart 15



The Exotics

Danish krone

Denmark's current account continues to deteriorate. Total deficit for 1984 was DKr. 17.2 billion compared with DKr.11.1 billion in 1983, while the 1985 payment deficit could equal as much as DKr. 20 billion despite earlier OECD forecasts for an improvement to DKr. 15.5 billion. A significant part of the deficit of the current account in 1984-85 is due to a sharp increase in interest payments on the soaring external debt.

Denmark is facing a painful long-run adjustment if it is to slow down its growing indebtedness. This may mean an 8%-10% realignment in the EMS, although it's clearly not as imminent as previously supposed.

Long dollar positions (taken in November 1984) were closed out profitably in late March '85. Long DM positions, on the other hand, have shown a slight loss, principally due to the forward premiums in the DM and the forward discounts on the DKr. Liquidate the long DM/short DKr. cross-trade stand aside.

Chart 16

BASKET: U.S. 11%, U.K. 20%, SWEDEN 20%, NORWAY 9%, Germany 32%, FRANCE 8%

YEAR	DANISH KRONER PER: U.S. DOLLAR (PERIOD END)	U.S. =1.00	U.S. =1.00	=1.00	=1.00
1967	7.4620	1.1682	1.7349	1.0794	1.1868
1968	7.5015	1.1306	1.6791	1.0351	1.1382
1969	7.4920	1.1518	1.7106	1.0642	1.1701
1970	7.4890	1.1438	1.6987	1.0563	1.1614
1971	7.0620	1.0619	1.5771	1.0726	1.1794
1972	6.8470	1.0000	1.4851	1.0000	1.0996
1973	6.2900	0.8900	1.3217	0.9436	1.0375
1974	5.6500	0.7705	1.1442	0.8635	0.9495
1975	6.1775	0.8398	1.2472	0.9023	0.9922
1976	5.7875	0.7636	1.1341	0.8165	0.8978
1977	5.7775	0.7305	1.0849	0.8740	0.9610
1978	5.0900	0.6295	0.9348	0.8069	0.8873
1979	5.3650	0.6733	1.0000	0.9095	1.0000
1980	6.0150	0.7626	1.1326	1.0391	1.1426
1981	7.3250	0.9179	1.3632	1.0439	1.1478
1982	8.3840	1.0120	1.5030	1.0433	1.1472
1983	9.8750	1.1511	1.7076	1.0725	1.2013
1984	10.3566	1.1844	1.7590	1.0648	1.1708
1985 (1Q)	11.6435	1.3230	1.9648	1.0574	1.1627

Above 1.00 = undervalued
Below 1.00 = overvalued

Chart 17

Year	Foreign Assets (Mln US$)	CURRENT ACCOUNT As % of GNP %	CUMULATIVE 12 QTR. Current Account (Mln US$)
1970	446	-3.44	-1170
1971	618	-2.40	-1379
1972	1.180	-0.03	-1032
1973	1,229	-1.67	- 964
1974	1,258	-3.10	-1519
1975	994	-1.31	-1946
1976	1,135	-4.64	-3384
1977	2,274	-3.74	-4126
1978	3,428	-2.70	-5138
1979	3,631	-4.58	-6189
1980	3,857	-3.81	-6933
1981	3,159	-3.38	-7306
1982	2,842	-4.18	-6600
1983	3,578	-2.16	-5310
1984	3,398	-3.29	-5169

Chart 18

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

Reserves * + Previous 12-months current Account *** = 2224

(Reserves + 12-months C/A)/ M1 ** = 2224/12506 = 17.8%

(Reserves + 12-months C/A)/ Broad Money **= 2224/25.953 =8.5%

*As at April 1985 ** Jan 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	6966	14874
1985 (Jan)	12506	25953
%Increase (decrease)	79%	74%
Corresponding % increase in the United States	100%	152%

(a) 1984 Imports as percentage of GNP	30.8%
(b) 1975-1984 Imports as percentage of GNP	28.7
1984/(1975-1984 average) = (a)/(b) =	107.3%

Source: IFS

Chart 19

RATES	SPOT	1 MONTH	3 MONTH	6 MONTH	12 MONTH
	10.99-11.00	11.01-11.03	11.02-11.04	11.03-11.05	11.08-11.11

Malaysian ringgit

A slight improvement in the current account deficit has done little more than slow the alarming trend of rising external debt, which now stands at almost M$40 billion. In a short period of three years, foreign debt jumped from M$15.4 billion to M$40 billion and is now becoming a major contributor to the high invisible deficit on the balance of payments.

Sales of forward contracts in mid-October '84 were covered late March '85 and produced a good return. Nevertheless, we continue to believe that the ringgit will depreciate further. We advise retaining a short position *vis à vis* DM to avoid the unnecessary risk of a US dollar drop.

Chart 20

BASKET: U.S. 21%, JAPAN 39%, GERMANY 7%, SINGAPORE 33%

YEAR	MALAYSIAN RINGGITS PER U.S. DOLLAR (PERIOD END)	U.S. 1970=1.00	U.S. 1978=1.00	BASKET 1970=1.00	BASKET 1978=1.00
1967	3.0563	0.8647	1.1511	0.9105	1.0146
1968	3.0650	0.9052	1.2050	0.9380	1.0453
1969	3.0750	0.9611	1.2794	0.9784	1.0903
1970	3.0775	1.0000	1.3312	1.0000	1.1143
1971	2.8860	0.9622	1.2810	0.9828	1.0951
1972	2.8170	0.9406	1.2521	0.9698	1.0806
1973	2.4520	0.7863	1.0468	0.9015	1.0045
1974	2.3128	0.7007	0.9328	0.8688	0.9681
1975	2.5883	0.8200	1.0916	0.9510	1.0597
1976	2.5350	0.8282	1.1025	0.9444	1.0524
1977	2.3655	0.7859	1.0462	0.9104	1.0145
1978	2.2060	0.7512	1.0000	0.8974	1.0000
1979	2.1890	0.8008	1.0661	0.9300	1.0364
1980	2.2224	0.8647	1.1512	0.9802	1.0923
1981	2.2423	0.8780	1.1689	0.9781	1.0899
1982	2.3213	0.9110	1.2128	0.9935	1.1070
1983	2.3383	0.9136	1.2162	0.9765	1.0881
1984 (1Q)	2.2935	0.8846	1.1776	0.9551	1.0643
1984 (2Q)	2.3195	0.9076	1.2082	0.9622	1.0722
1984 (3Q)	2.3710	0.9328	1.2418	0.9755	1.0870
1984 (4Q)	2.4250	0.9647	1.2843	0.9946	1.1083

Above 1.00 = undervalued
Below 1.00 - overvalued

Chart 21

Year	Foreign Assets (Mln US$)	CURRENT ACCOUNT As % of GNP %	CUMULATIVE 12 QTR. Current Account (Mln US$)
1970	682	+0.02	279
1971	795	-2.61	139
1972	979	-5.05	-348
1973	1255	+1.42	-251
1974	1496	-5.97	-686
1975	1446	-5.49	-932
1976	2257	+5.46	-447
1977	2659	+3.45	522
1978	3027	+0.07	1,124
1979	4163	+4.71	1,473
1980	4210	-1.24	762
1981	3434	-10.56	-1,842
1982	3296	-14.43	-6,414
1983	3048	-12.10	-9,479
1984	2262	- 8.18	-9,493

Chart 22

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

Reserves * + Previous 12-months current Account *** = 1617

(Reserves + 12-months C/A)/ M1 ** = 1401/5590 = 25.0%

(Reserves + 12-months C/A)/ Broad Money **= 1401/18993 =7.3%

*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	1753	3767
1985 Feb.	5567	18116
%Increase (decrease)	217%	381%
Corresponding % increase in the United States	105%	152%

(a) 1983 Imports as percentage of GNP 47.77%
(b) 1974-1983 Imports as percentage of GNP 44.01%
1983/(1974-1983 average) = (a)/(b) = 44.01/47.77% = 92.12%

Source: IFS

Chart 23

RATES	SPOT	1 MONTH	3 MONTH	6 MONTH	12 MONTH
	2.4630-2.4640	2.4680-2.4705	2.4790-2.4830	2.4940-2.5000	2.5050-2.5215

Forex Rates & Update

Currency	*Spot*	*3-month*	*12-month*	*Comments vis-à-vis US$*	*Comments vis-à-vis DM spot DM 3.0600*
Australian dollar	.6655-.6670	.6530-.6550	.6285-.6315	Remain Long: stops at 64.00	Remain Long: keep stops at 1.9980
Belgian franc	61.60-61.70	61.73-61.87	62.05-62.30	Neutral	Remain Long
Dutch guilder	3.4500-3.4550	3.4406-3.4460	3.3960-3.4040	Neutral	Neutral
Greek drachma	136.40-136.60	141.65-144.35	154.40-164.60	Remain Short	Remain Short
Italian lira	1948-1948	1951-1956	1958-1963	Neutral	Remain Long
Indonesian rupiah	1120-1125	1150-1200	N/A	Remain Short	Remain Short
Kuwaiti dinar	.30350-.30370	.30250-.30370	.30150-.30300	Remain Short	Remain Short
Mexican peso	290-294	327-340	435-475	Remain Short	Remain Short
New Zealand dollar	.4515-.4530	.4330-.4370	.3950-.4000	Neutral	Neutral
Norwegian krone	8.80-8.82	8.90-8.93	9.14-9.18	Neutral	Neutral
Portugese escudo	174-176	180-189	200-225	Neutral	Remain Long
Saudi Arabian riyal	3.6495-3.6505	3.6475-3.6515	3.6440-3.6530	Remain Short	Remain Short
Singapore dollar	2.2120-2.2150	2.1950-2.1990	2.1550-2.1650	Neutral	Remain Short
South African rand	5070-5080	4935-4955	4725-4755	Remain Long	Remain Long
Spanish peseta	174.70-175.00	178.00-178.60	187.00-189.00	Neutral	Neutral
Swedish krona	8.86-8.87	9.05-9.07	9.37-9.40	Neutral	Remain Long
Venezuelan bolivar	13.10-13.30	13.12-13.35	13.70-14.70	Neutral	Neutral

Explanatory Notes

Currency expected to firm against both currencies.	Buy	Buy
Currency expected to strengthen against US $ and weaken against DM.	Buy	Sell
Currency expected to weaken against both major currencies.	Sell	Sell
Currency expected to weaken against US $, but strengthen against DM.	Sell	Buy
Term used to liquidation short position but does not imply a new buy recommendation.	Cover	
Term used to indicate sale advice of previous long position, but does not imply a new short sale recommendation.	Liquidate	

Hotline Update

Tuesday, May 21: The market letter will be mailed tomorrow. It contains the following recommendations. Reinstate short crude oil positions at the market, using August and deferred months.

Friday, May 24: There are no changes. Next regular update: Tuesday, May 28, after market close.

Tuesday, May 28: Same.

Friday, May 31: Same.

Tuesday, June 4: Same.

Friday, June 7: Same.

Tuesday, June 11: Same.

Friday, June 14: The oil market looks poised for another short-term 50-100 point rally, particularly the nearby two months. Retain short deferred positions (we like the December '85 and January '86 contracts) and buy half as many August contracts to take advantage of this trading opportunity. Stay posted. No other changes.

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