FRIEDBERG'S
COMMODITY & CURRENCY COMMENTS
Friedberg Commodity Management Inc. Volume 6, No. 9 September 23, 1985

The Saudis Capitulate

It couldn't be otherwise. At the production and export rates prevailing for the third quarter of 1985, the Saudis were suffering a monthly budgetary shortfall of close to $1.5 billion *in addition to the planned drawdown of $10 billion for the entire fiscal year*. A $28 billion annual dip in reserves (which could be a great deal bigger if government expenditures rise and receipts fall more than planned, an excellent probability) is good cause for beating a strategic retreat. It will, however, not be that simple.

Before we analyze the difficulties the Saudis are likely to encounter in coming weeks and months, it is imperative that we understand the nature of the strategic switch. Market observers believe that Saudi Oil Minister Sheikh Yamani is interested on forcing "discipline" on other Opec members and that the recent netback arrangement, in which the Saudis in effect discount their oil, is intended to show the brotherhood that Saudi Arabia can also play the same game.

But, are conventional observers correct in their perceptions? We submit that they are not. In fact, Opec has been producing substantially less than the agreed-upon quota of 16 million barrels per day (mb/d). Furthermore, and this is significant, *Opec ex Saudi Arabia* has been producing between 11.5 and 12 mb/d, *exactly on target*. Whatever cheating takes place, it is offset by voluntary and/or involuntary cutbacks on the part of the Opec members. The Saudis, therefore, have no valid argument: Opec has been behaving remarkably well.

The problem then, is not one of hidden discounts and cheating but, far more ominously, the demand for oil at the margin (and Opec is the world's self-appointed marginal producer) is shrinking rather alarmingly. A scissor-type effect is in operation. On the one hand, total demand has been falling at 3.5% per year in the industrialized countries (and probably slightly more in the developing and less-developed countries), cutting as much as 1.8 mb/d, on an annual basis, from the swing suppliers, i.e., Opec. On the other hand, non-Opec supplies continue to increase: Developed countries, such as the US, Canada, UK, and Norway have increased their production as much as 2 mb/d since 1980, while the LDCs (including Mexico, Egypt, China, etc.) have upped theirs by 2.5 mb/d. The combined total indicates that non-Opec supplies are growing each year at a rate close to 1 mb/d, again at the expense of the marginal supplier, i.e. Opec.

Opec is being squeezed out of business. If it wants to remain effective, it must cut its overall quota by at least 2.8 mb/d each and every year, starting with 1985. Since, however, the Saudis are unable, and now clearly unwilling, to reduce their total output below 3.5 mb/d, the balance of the adjustment must fall on the rest of the Opec cartel: Produce a maximum of 9.7 mb/d, down from the already catastrophic 11.5-12 mb/d prevailing in mid-1985. And as long as demand continues to falter (a good possibility given the long lags involved in energy conservation and the imminent world recession), the 1986 overall quota would have a maximum ceiling of 10.4 mb/d. Carving such a low level of output would present insurmountable difficulties.

It should be clear, by now, that total genuine demand for Opec oil is running, at best, at 14 mb/d and probably closer to 13.5 mb/d if we consider the probably involuntary stock additions that occurred in the second and third quarters of this year. Furthermore, there are a number of immediate and extraordinary developments that are slated to weaken this de-

In this issue

The great stock market bull has come to an end, and we buy S&P 500 puts. Short-term shakeouts in gold shouldn't worry you: Gold will rise. And we remain comfortably bearish on the US dollar. Contributions by Albert D. Friedberg and Daniel A. Gordon. And in this issue we introduce Steve H. Hanke, Chief Economist for Friedberg Commodity Management Inc., and Director of FCMI World Advisory Services.

mand scenario. Iraq is due to begin pumping 500,000 b/d from its southern oilfields to the Saudi-East-West pipeline by October 1; with UK summer maintenance work completed, North Sea output has been recovering and will reach a level 500,000 b/d higher in October than in June; finally, Nigeria, desperate for foreign exchange and facing the collapse of three countertrade deals that would have represented $2 billion in oil sales is rapidly increasing output from the August low of 900,000 b/d to about 1.45 mb/d by mid-October. The new Nigerian military government has already taken steps to bring about this increase by lowering posted crude prices to the same level as its official selling price, thus guaranteeing oil producing companies a $2/barrel margin. If we assume that any potential increase in seasonal offtake for the fourth quarter can be satisfied by the planned increases on the part of Iraq, the UK, and Nigeria, we are left with our original assumption: Final demand for Opec crude for the final quarter of 1985 will not exceed 14 mb/d.

We know that Opec ex Saudi Arabia produces between 11.5 and 12 mb/d. We have good grounds to believe that the demand for Opec crude will not exceed 14 mb/d. How can Saudi Arabia, then, increase output to 3.5 mb/d? Obviously, the answer lies in the fact that by discounting, the Saudis are hoping to displace 1-1.5 mb/d of other producers' output. But, we ask, who will want to be displaced? Will the rest of Opec, as a group, be willing to cut its output to 10.5 mb/d? It is far more likely that the Saudis will find other Opec members selling below their newly-discounted price in a desperate effort not to lose market share. At which point, if the Saudis are serious about their budgetary problems, they will have to adopt an aggressive selling policy. A price war will have begun.

There is one other problem with Saudi Arabia's new netback arrangement: the Aramco companies are being given the discount, provided they continue to lift the same amount of crude they've been lifting for the past few months (1.2 mb/d?) at the official selling price. The netback concession, therefore, is not that significant: Aramco's overall price may well be just an average of $28 and $25.50, or $26.75/barrel. Viewed in this light, Aramco's edge is not overwhelming and may not lead after all to a rapid build-up in liftings. It should be noted that Far East buyers were excluded from the netback deal because their liftings had fallen to extremely low levels. In effect, the Saudis are rewarding long-standing customers of officially-priced crude with cheap crude — and probably tying them to it as well.

The netback arrangement is merely an ad hoc response to a worsening budgetary crisis. There is not, as yet, any glimmer of a serious medium- to long-term policy switch. *Perhaps* the Saudis are looking for a fight to give them an excuse to drop oil prices to substantially lower levels. Politically, it may be the only viable method of producing such an outcome: they could blame falling prices on the greediness and intransigence of other Opec producers.

If that is the avowed Saudi intention, the world is in for a rude awakening: Oil prices will fall to below long-term equilibrium levels and reach totally unsuspected levels ($10? $5? $2?/barrel). If, however, the Saudis do not care to carry out a medium- to long-term policy of substantially lower prices and just feel that their recent netback deal can be fine-tuned to give them a net increase in output to 3.5 mb/d, *they* are in for a rude awakening. The output is unlikely to rise, and in fact, it is likely to continue falling until the day that Saudi Arabia will no longer be a crude operator. And the vast fortunes of the Royal Family will have melted away in the scorching heat of the desert.

Why, then, has the market reacted so coolly to the Saudi announcement? And to add insult to injury, why has the market recovered in recent days?

It is all quite simple: So long as the Saudis maintain their reduced output, supply and demand remain in fair equilibrium: At present average spot prices, world demand for and supply of Opec crude meet at 13.5-14 mb/d. Fears of supply interruptions, as for example the recent damaging blows to the Kharg Island terminal, cause sharp upward spurts in crude oil futures. This situation *will not change* until either the Saudis increase supplies to the market or demand for Opec crude falls to an even lower plateau. At this time, the only effect of a total destruction of the Iranian loading facility will be to accommodate increased Saudi output without causing a market glut. In the medium term, however deprived of their export earnings, the Iranians will be persuaded to come to the negotiating table, which, in turn, may mean an additional 4-5 mb/d of Opec output and a certain price collapse.

Deep forward discounts, which embody expectations of lower prices, continue to punish the bears, as every month, they rise to cash prices. While the October '85 crude on the NYMEX expired 50¢/barrel cheaper than the October 1984 crude, it has risen more than $3/barrel during the life of the contract, a punishing blow to any short-seller. Chart 1, a picture of gently falling prices, portrays the same commodity as Chart 2. Cash prices *have been weakening*, but futures prices *have been rising*: In effect, cash prices have not fallen as much as the built-in discount (which in the near months approaches 50¢/barrel per month, or $6/barrel per year!). The bears can be rewarded only if a price spiral develops that will force prices lower and at a faster pace than the present discount.

STRATEGY: *Since deferred contract months show a gentler discount, or backwardation, we advise maintaining short positions in those forward positions. Be sure to continue to roll them forward to be, at the minimum, six months away from the spot month.*

Short positions in the Kuwaiti dinar and more particularly, in the Saudi riyal, present a complementary sure-fire speculation on the oil situation: Sharply lower oil prices may mean higher oil revenues for these producers and a diminished necessity to devalue their currencies. Conversely, present oil prices mean continually falling revenues and an absolute necessity to devalue in order to increase fiscal revenues. Bear speculators in oil and *Petrocurrencies must come out big winners.*

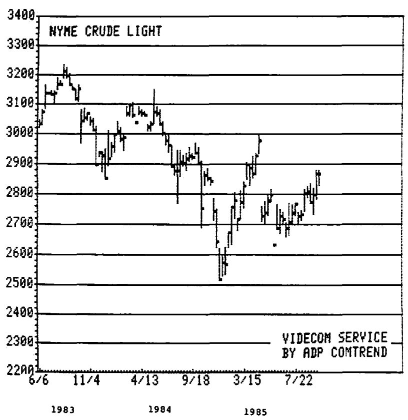

Chart 1

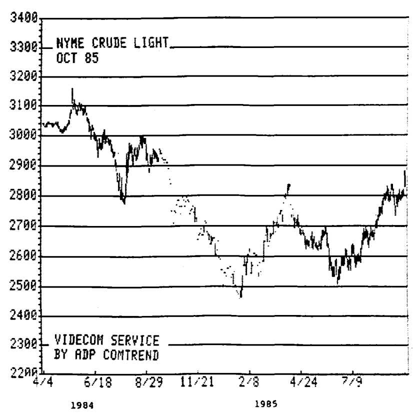

Chart 2

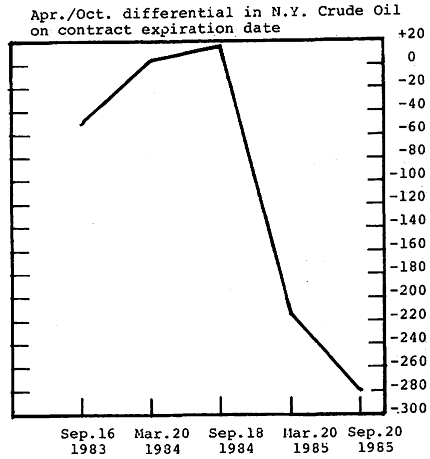

Chart 3

Stock Market Indices

The Bear Market

Barring an unforeseen and massive reflation, one must conclude that the great bull market that began in the late, despairing days of 1974 came to an end in July 1985. The last three years have seen its crowning success: the leveraging of America. In the words of William Lilley III, a CBS senior vice-president (quoted by *The Wall Street Journal*, September 10), "prudence is putting debt on your balance sheet." Debt was the key economic concept of the '80s: The US, as a nation, spent a great deal more than it earned, going into debt; the US, as a government, ran the highest string of budget deficits in recorded history; and, of course, US industry, not to be left behind, recorded the largest shrinkage of equity capital in memory (see Chart 4).

Debt has become so important that only through increased doses can we lift our mystical GNP: car sales skyrocket, not due to bargain-priced cars, but to bargain-priced debt; the household savings rate dips to 2.8%, the lowest since figures have been compiled; and installment debt as a percentage of disposable personal income climbs to its highest level in history. Only massive increases in debt are able to sustain the economy, and at that, it is barely afloat.

It is an era when deflation is out and debt restructuring is in: Liquidation is unthinkable, especially when bad debts can be carried on the books indefinitely. The FSLIC (Federal Savings and Loan Insurance Corporation) says it would like to close financial institutions which show losses in excess of $20 billion but it is unable to do so because its own insurance kitty has, at best, only $5 billion at this time. It's far better, in the meantime, to allow these corpses to continue to operate until the required bail-out funds can be obtained.

The Federal Home Loan Banks are devising a unique plan that, guess what?, envisages *borrowing* $20 billion (not US government-guaranteed yet) to help the FSLIC get on with its mandate. Slowly, enormous quantities of office buildings, condominiums, farms, and oil lands are coming into the hands of receivers. The debt-restructurists do not yet grasp the tragic truth: Death by attrition is one thousand times more painful than a nuclear holocaust.

We are wallowing in debt and the moment of truth has arrived: It cannot be serviced. First, the farmers, the shipowners, and the oil patch operators; next, the real estate developers, the junk-bond issuers, and the raiders (who will bail out Adelman, Icahn, Pickens, Murdock et al?); and finally, the much-maligned Latin American less-developed countries, Philippines, Nigeria, South Korea, and Poland.

More than one-half century ago, following a similar debt orgy, debt was extinguished in a rather inelegant fashion: default. While Monetarists like to blame the Great Depression on the fact that money supply was allowed to shrink one-third from 1929 to 1933, *the fact remains that real banking assets shrunk one-third because of losses.* You cannot paper over real losses any more than you can paper over wealth and production losses caused by an earthquake. The losses must be recognized; real liquidity must be cut by the amount of the true losses. Papering over them, through increases in money supply and inflation, only *transfers* the losses of debtors to creditors. Therefore, it is no different than partial or total default.

In the next two or three years, will default occur through bankruptcy or through inflation? Barring a fiat to de-index floating-rate debt, inflation may not even be able to accomplish a spreading of the pain. In the alternative, a very slow process of debt liquidation will take place with enormous downward pressures on profit margins and wages (or employment) and upward pressures on real interest rates.

This scenario is hardly conducive to a rising stock market. In fact, we believe that stock prices have begun, in earnest, a very dramatic bear market signalled by the first downside penetration of the July 1984-January 1985-August 1985 uptrend, the virtual collapse in the number of new highs (with new lows exceeding new highs in the last few sessions), and the disturbing breakdown in the stock performance of the nation's largest banks.

A significant and confirming technical milestone is within reach: a break below 1270 on the Dow Jones Industrial, 175 on the S&P 500 (see Chart 6), and 102 on the N.Y. Composite Index would violate the entire 1982-1985 uptrend, setting the stage for the first round of panic liquidation.

The bear market has begun. We are setting our sights on DJIA 875, and 120-130 on the S&P 500.

STRATEGY: *Continue to accumulate S&P 500 put options, as already suggested last month and through numerous Hotline recordings. For larger and more aggressive traders, outright selling of December '85 S&P futures is in order, placing initial stops at 192.00, close only.*

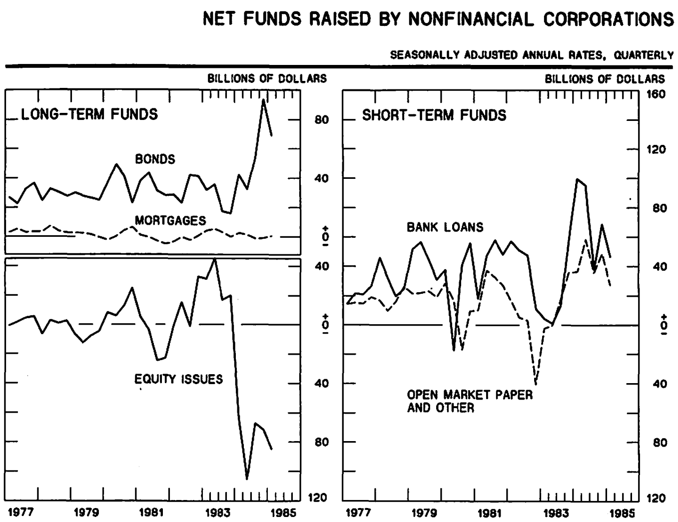

Chart 4

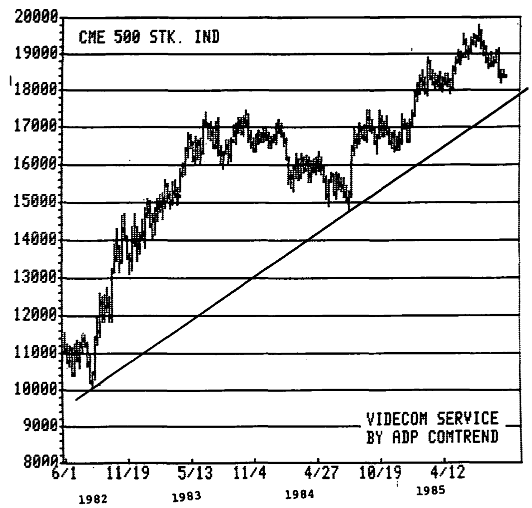

Chart 6

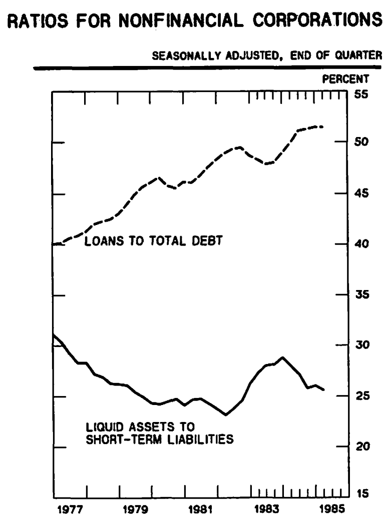

Chart 5

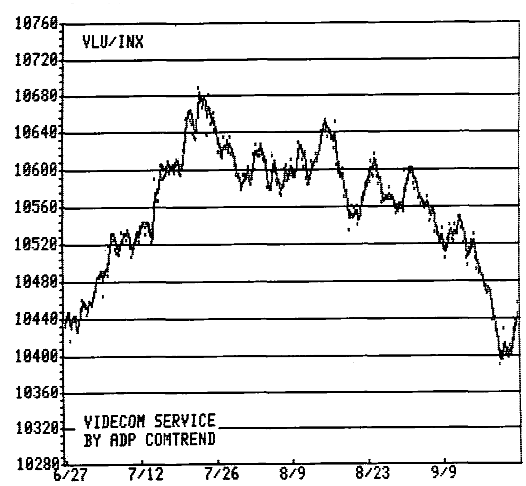

Chart 7

Gold

Large speculative long positions established in anticipation of labor unrest and widespread strikes in South African Gold mining areas clouded gold's true bullish fundamentals. With expectations of serious production cutbacks fizzling, stale liquidation overtook the market and pushed prices down to the low end of the last six months' range. But, in fact, the reasons for expecting higher gold prices improve day by day: a weakening dollar, with the potential for a serious crisis in the near future; a snowballing banking collapse caused by ever-increasing difficulties in servicing debt; and, to boot, a very reasonable price (relative to the explosion of debt: see *Commodity & Currency Comments* July 21 and August 18 for a fuller discussion of this particular item).

We remain very bullish.

STRATEGY: *Long-term investors should not be disturbed by short-term shakeouts.*

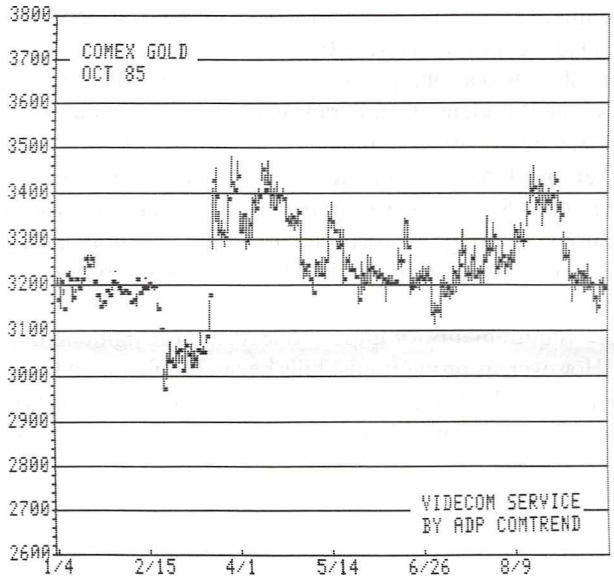

Chart 8

The US Dollar

Back to Basics

By Steve H. Hanke

The US Congress is now and then overcome by hysteria. For the origin of its present disorientation, we must look no further than the rhetoric about America's trade and current account deficits. With few exceptions, the members of Congress believe that salvation will come from protectionism. It is not surprising, then, that Congress has drafted over 400 protectionist trade bills in recent months. These range from rather modest, narrowly focussed measures, to sweeping pieces of legislation.

For currency traders, the outcome of the Congressional stampede to protectionism merits close attention.

With protectionist measures, America's imports will be reduced. Consequently, the number of dollars foreigners earn from exports to the US will be reduced from what they would have been. This means that fewer dollars will be available on foreign exchange markets. However, the number of dollars that foreigners will want to purchase — either to invest in the US or to buy American goods and services — will initially remain essentially unchanged. Faced with these conditions — a stable demand for dollars and a reduced supply of dollars — the price of dollars must rise in relation to what it was without protectionist measures. (It should be emphasized that these analyses of the initial effect of protectionism on currency markets that only indicates that protectionism, *the price of the dollar will initially be higher than it would have been without protectionism.*)

The issue is not whether protectionist measures would have an initial effect on the value of the dollar or, for that matter, on the direction that this change would take; rather, the issue is whether Congress will pass, and whether President Reagan will sign, protectionist legislation.

Early in President Reagan's first term, he issued a "Statement on US Trade Policy" and committed his administration to international trade liberalization. However, this policy was quickly cast to the winds of pragmatic politics. The Reagan administration's backsliding began in 1981: The Multifiber Agreement, a compact that restricts textile imports, was extended; sugar quotas were tightened; and a quota, euphemistically called a voluntary restraint, was placed on Japanese autos. The President's liberal trade image was further tarnished in 1982, when he obtained an agreement from the Common Market and Japan to limit their exports of certain types of steel to the US. In 1983, we witnessed a significant increase in the duties on foreign motorcycles and the imposition of quotas on specialty steel products. Domestic textile producers were afforded further protection in 1984 when the "rules of origin" requirements for imported textiles were tightened.

However, as protectionist bills began to pile up on Capitol Hill, President Reagan was forced to alter his tactics on trade policy. He could no longer afford to accept any protectionist measures because the adoption of one would invite the Congressional passage of many others. It would also make the President's rejection of new protectionist legislation, on principle, more difficult. Consequently, this year President Reagan did not extend the so-called voluntary restraint on Japanese autos and rejected a measure to limit shoe imports to the US.

Although Congress will pass protectionist trade legislation, the President will hang tough with his new-found position, and will veto it. Congress, for its part, will not be able to muster the votes to override these Presidential vetoes. Even though there is broad support for protectionist legislation on Capitol Hill, it is thin: Many Members of Congress have promised one vote, not two, for the pending protectionist bills before them.

As things stand currently in Washington, DC, protectionism has no chance. However, President Reagan's steadfastness has been challenged before and his positions changed. That's what currency traders should monitor closely in the next few months. *They should be prepared for some strengthening of the dollar in the eventuality of a modification of the President's position.*

Steve H. Hanke joins Friedberg's

With this issue we are pleased to introduce Steve H. Hanke, Professor of Applied Economics at The John Hopkins University in Baltimore. In addition to his professorship, Dr. Hanke has assumed the newly-created position of Chief Economist at FCMI, and will also be Director of a new FCMI Division, World Advisory Services, which specializes in providing foreign exchange hedging advice to private firms and public entities.

Prof. Hanke has extensive research and academic experience (he has been a faculty member at the Colorado School of Mines, the University of California at Berkeley, and a scholar at Research Institutes in Austria, France, Sweden, and the US). In addition, Prof. Hanke has been active in economic policy formulation in the US, where he served at the White House as a Senior Economist on the President's Council of Economic Advisers and is currently a Senior Advisor to the Joint Economic Committee of Congress. Prof. Hanke has also been a consultant to numerous private firms and governments in Australia, Europe, and the United States. Prof. Hanke has published over 125 technical articles, is currently an associate editor of four scholarly journals, and serves on the boards of several economic research institutes.

Bearish fundamentals

By Albert D. Friedberg

The combination of better economic statistics (especially the unemployment figures) and the gathering storm of protectionist legislation derailed the US dollar decline in recent weeks. Finding support at the technically important DM2.75/$ level, the dollar rallied to an intraday high of DM2.9750/$ before falling back to DM2.8850/$. Late last week, poor economic statistics began once again to reassert themselves: The second quarter GNP was revised downward to an annual growth rate of 1.9% and the third quarter "flash" estimate at the 2.8% annual rate of growth, indicated that the economy, at best, continued to display a great deal less vigor than originally anticipated. Naturally, most of the increase in GNP was of extremely poor quality: new non-residential construction, to add to an already glutted market; an increase in personal consumption expenditures financed by drawing down savings to the lowest levels in history; and so on. The foreign exchange markets perceived this weakness and moved to sell dollars at once, pushing the DM to a three-week high of 2.84.

The bearish dollar fundamentals are reasserting themselves, and it is only a matter of time before we move to a new DM2.25-2.50 plateau. The speed of the decline will depend on the severity of the protectionist measures that Congress will attempt to pass (as discussed in Steve Hanke's article) and on the position of the Fed as it faces the delicate task of retaining foreign savings to finance the country's nagging current account deficit. Alternatively, the Fed may try to produce an economic adjustment of some magnitude, lowering consumption/raising savings to *eliminate* the current account deficit.

In either case, the Fed would be faced with the unpleasant task of tightening monetary policy, even while the economy gives every sign of being extremely frail, if not outright weak.

Running through the various possible combinations regarding protectionism and Fed policy, and the likely impact on the dollar, we find the following:

*It would appear that President Reagan will be able to contain, at least for the time being, the flood of protection. This should allow the dollar to find lower levels in quick order.

*Furthermore, in an effort to *thwart* protectionist legislation, the Fed may try to ease further and allow the dollar to weaken some more.

*Finally, it is probable that even if Congress is able to erect new tariffs and quotas, the Fed will be able and willing to offset the upward dollar pressure.

Although day-to-day trading remains a treacherous affair, we remain, in the medium-term, comfortably bearish on our dollar views.

STRATEGY: *Long December '85 Swiss franc and Deutschemark. Leave protective stops at 4195 and 3445 respectively, close only.*

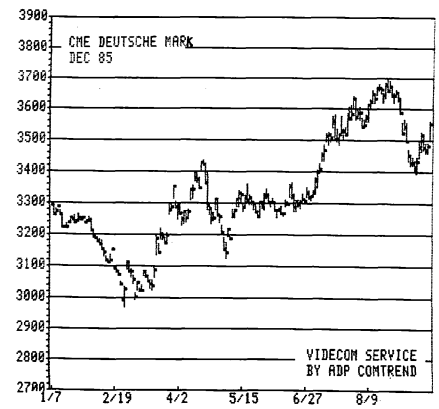

Chart 9

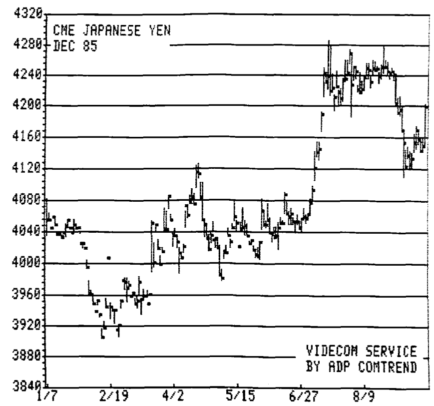

Chart 10

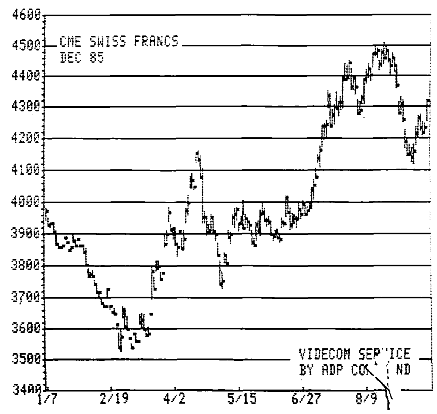

Chart 11

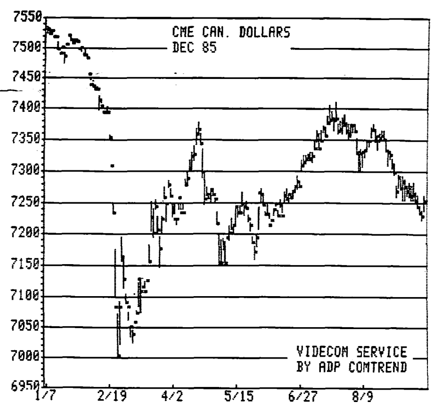

Chart 12

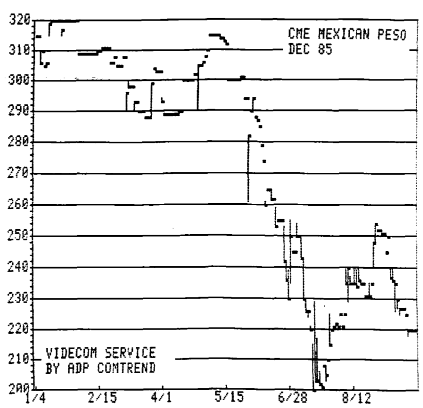

Chart 13

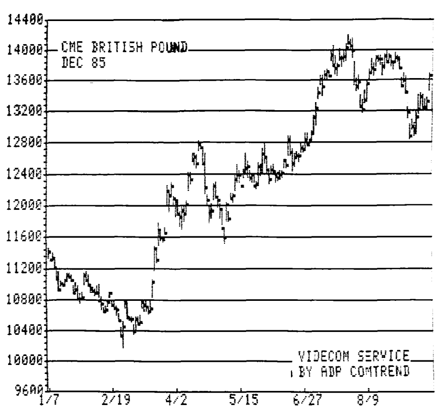

Chart 14

Financial Futures

We review the three spreads first recommended in our July 7 issue.

a) **Long T-bonds/short S&P 500 futures**: Chart 15 shows the spread continuing to gain and reaching new highs. Maintain positions.

b) **Long T-bonds/short 2.6 Eurodollars**: The spread continues to recover (see Chart 16) from the low point registered in late July, principally the result of an improvement in the risk component (Eurodollar rates vs. government rates). Maintain positions.

c) **Short Toronto Oil & Gas Index/long TSE 300**: After the sharp deterioration suffered in late July and early August, a result of the elimination of the worst features of the National Energy program, the spread has stabilized at between 550 and 580 points (see Chart 17). Maintain position, as we expect oil shares to come under severe downward pressure and consequently perform relatively worse than the overall industrial index.

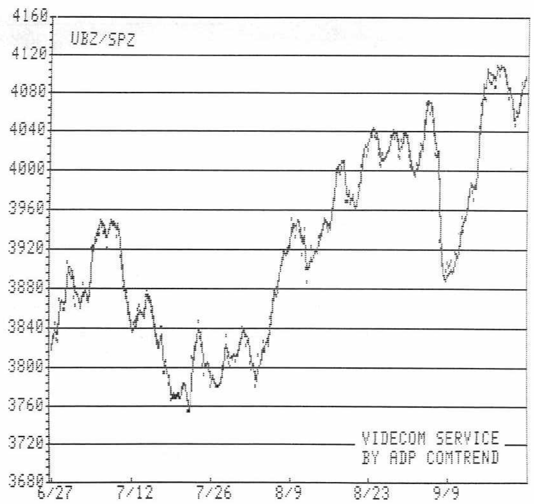

Chart 15

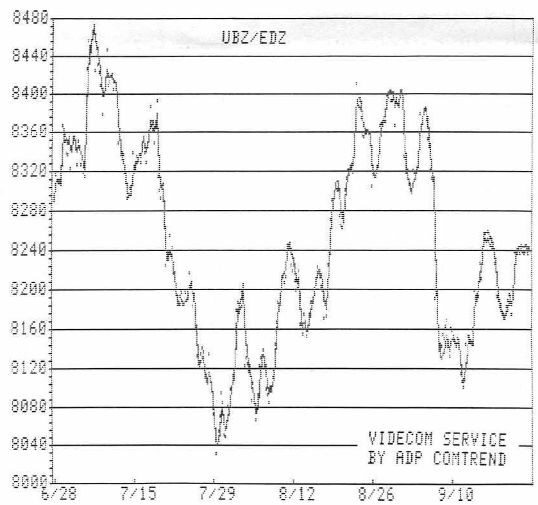

Chart 16

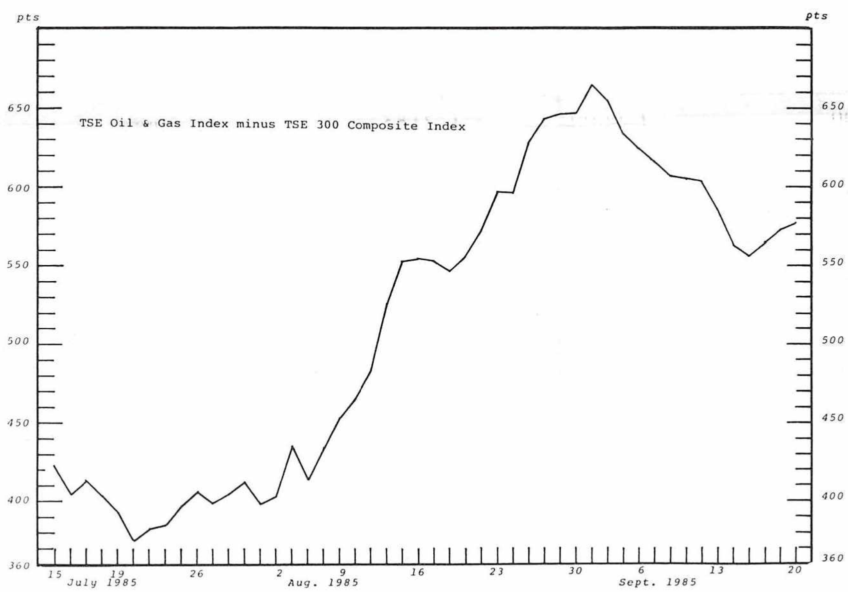

Chart 17

The Exotics

Portugal escudo

Portugal continues to make significant improvements in its external sector. While the 1983 IMF standby agreement called for a $1.2 billion current account deficit for 1984, in fact, Portugal recorded a significant lower deficit now put at $514 million. During the course of 1985, Portuguese imports fell 13.2%, while exports increased by almost 1% and trade deficit narrowed by 37.8%, a savings equal to approximately $600 million. Thus, a current account equilibrium for 1985 is in sight, and the long increase in the country's foreign debt may have come to an end.

On a more negative note, the fiscal accounts continue to disappoint, as the budget deficit looks to end substantially higher than last year's 8.5% of GDP, and a wide mark off the originally-planned 6.1% of GDP. Inflation continues at a high rate and is expected to be around 20% for 1985, although it must be pointed out that the inflation rate will fall from the original government target of 22% and compares favorably with the 29.3% rate recorded in 1984.

With the recent improvement in inflation, interest rates have eased but remain positive in real terms. Forward rates on the offering side offer full protection against the expected rate of inflation and a possible depreciation of the exchange rate, which might be necessary to keep it competitive.

STRATEGY: *Aggressive accounts should consider long positions in Portuguese escudos, either vis à vis the US dollar or against a weak European currency such as the Greek drachma and Spanish peseta.*

BASKET: U.S. 20%, SPAIN 10%, Germany 20%, NETHERLANDS 8%, FRANCE 17%, ITALY 8%, U.K. 17%

YEAR	PORTUGESE ESCUDOS PER U.S. DOLLAR (PERIOD END)	U.S. 1972 =1.00	U.S. 1979 =1.00	BASKET 1972=1.00	BASKET 1979=1.00
1967	28.8600	1.3019	1.5861	1.2261	1.1469
1968	28.7700	1.2728	1.5506	1.1921	1.1151
1969	28.6500	1.2245	1.4918	1.1521	1.0777
1970	28.7500	1.2271	1.4950	1.1527	1.0783
1971	27.5600	1.0962	1.3355	1.1077	1.0362
1972	27.0000	1.0000	1.2183	1.0000	0.9354
1973	25.8450	0.9010	1.0976	0.9440	0.8830
1974	24.5960	0.7610	0.9271	0.8341	0.7802
1975	27.4720	0.7694	0.9373	0.8195	0.7666
1976	31.5490	0.7858	0.9573	0.8258	0.7725
1977	39.8550	0.8327	1.0145	0.9722	0.9094
1978	46.0100	0.8434	1.0275	1.0470	0.9794
1979	49.7810	0.8208	1.0000	1.0690	1.0000
1980	53.0400	0.8507	1.0364	1.1183	1.0461
1981	65.2490	0.9628	1.1730	1.0928	1.0222
1982	89.0640	1.1357	1.3836	1.1860	1.1094
1983	131.4500	1.3831	1.6850	1.3421	1.2554
1984	169.2800	1.4410	1.7556	1.2342	1.1545
1985 (1Q)	171.3200	1.2921	1.5741	1.1501	1.0759
1985 (2Q)	174.5400	1.2889	1.5702	1.1804	1.1042

Above 1.00 = undervalued
Below 1.00 = overvalued

Chart 18

Year	Foreign Assets (Mln US$)	CURRENT ACCOUNT As % of GNP %	CUMULATIVE 12 QTR. Current Account (Mln US$)
1970	1,730	-	-
1971	2,119	-	-
1972	2,540	4.13	-
1973	2,937	2.96	-
1974	2,520	-6.17	-135
1975	1,412	-5.13	-1,244
1976	285	-8.36	-2,867
1977	-1,426	-5.93	-2,994
1978	-1,177	-2.65	-2,702
1979	- 854	-0.27	-1,474
1980	3,065	4.43	-1,581
1981	1,772	-11.35	-3,723
1982	1,657	-14.73	-6,919
1983	1,411	- 5.13	-6,860
1984	1,717	- 2.65	-4,769

Chart 19

RATES	SPOT	1 MONTH	3 MONTH	6 MONTH	12 MONTH
	172-173	173-177	176-185	183-198	192-215

Chart 21

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

Reserves * + Previous 12-months current Account *** = 6,327

(Reserves + 12-months C/A)/ M1 ** = 6,327/4,490 = 141%

(Reserves + 12-months C/A)/ Broad Money **= 6327/14,437 = 44%

*As at June 1985 ** January 1985 *** 1985 (1) - 1985(4) E

Figures in millions of U.S. Dollars

	M1 (Converted to U.S. Dollars)	Broad Money (Converted to U.S. Dollars)
1974	6420	13,916
1985 (Jan)	4490	14,437
%Increase (decrease)	(39.5)	3.7
Corresponding % increase in the United States	100	152 %

(a) 1984 Imports as percentage of GNP 37.32%
(b) 1975-1984 Imports as percentage of GNP 33.69%
1984/(1975-198 average) = (a)/(b) = 110.77%

Source: IFS

Chart 20

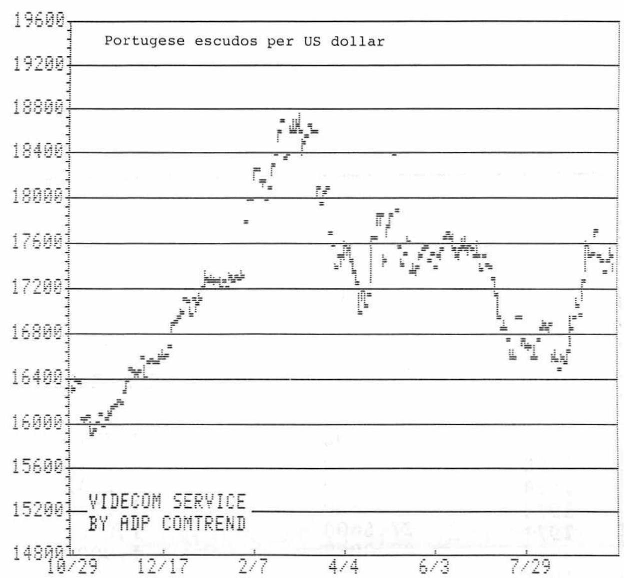

Chart 22

Norwegian krone

As concern about an imminent oil price collapse rises, one would expect to find oil exporting countries vulnerable to drastic belt tightening measures which would include relatively large devaluations. This is clearly not the case with Norway. In our *Comments* of February 17, we indicated that the country's finances are in excellent shape: Current account surplus equal to 6% of GNP; total reserves and gold equal to $13.7 billion; and oil exports equal to only about 36% of total exports (a halving of oil prices will cut the export *surplus* by 65%). The state budget, after oil tax revenues, remains in surplus. On a slightly more negative note inflation is running close to 6%, a bit higher than US dollar inflation, and wages may be running at almost twice that pace — a very early warning signal that competitiveness will be affected.

STRATEGY: *We expect the NKR to perform in line with the strong European currencies. We are therefore inclined to go long NKR against the US$ and neutral against the DM.*

				BASKET: U.S. 10%, NETHERLANDS 8%, Germany 22%, U.K. 35%, SWEDEN 18%, DENMARK 7%	
YEAR	NORWEGIAN KRONER PER U.S. DOLLAR (PERIOD END)	U.S. 1970 =1.00	U.S. 1979 =1.00	1970=1.00	1979=1.00
1967	7.1500	1.0156	1.5898	1.0134	1.0685
1968	7.1500	1.0205	1.5975	1.0115	1.0665
1969	7.1500	1.0468	1.6387	1.0480	1.1050
1970	7.1400	1.0000	1.5654	1.0000	1.0544
1971	6.7100	0.9200	1.4402	1.0143	1.0695
1972	6.6400	0.8809	1.3789	0.9492	1.0009
1973	5.7273	0.7488	1.1722	0.8422	0.8880
1974	5.2050	0.6907	1.0812	0.8218	0.8665
1975	5.5850	0.7246	1.1343	0.8333	0.8786
1976	5.1850	0.6524	1.0212	0.7316	0.7714
1977	5.1395	0.6309	0.9875	0.8129	0.8572
1978	5.0225	0.6141	0.9613	0.8500	0.8962
1979	4.9260	0.6388	1.0000	0.9484	1.0000
1980	5.1800	0.6885	1.0778	1.0693	1.1275
1981	5.8075	0.7495	1.1733	0.9622	1.0145
1982	7.0540	0.8673	1.3576	0.9930	1.0470
1983	7.7425	0.9062	1.4186	0.9508	1.0025
1984	9.0870	1.0439	1.6342	0.9201	0.9701
1985 (1Q)	8.8875	1.0061	1.5749	0.9401	0.9913
1985 (2Q)	8.7990	0.9920	1.5529	0.9692	1.0219

Above 1.00 = undervalued
Below 1.00 = overvalued

Chart 23

Year	Foreign Assets (Mln US$)	CURRENT ACCOUNT As % of GNP %	CUMULATIVE 12 QTR. Current Account (Mln US$)
1970	893	-2.1	-106
1971	1061	-4.1	-640
1972	1248	-0.4	-827
1973	1514	-1.9	-950
1974	1769	-4.8	-1542
1975	2150	-8.8	-3961
1976	2042	-12.2	-7342
1977	1928	-14.3	- 11258
1978	2785	-5.3	-10883
1979	3560	- 2.3	-8181
1980	3909	1.9	- 2049
1981	4725	3.9	2231
1982	5232	1.2	3937
1983	4762	3.8	4875
1984	6827	6.0	5926
1985(1)	6837		6346

Chart 24

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

Reserves * + Previous 12-months current Account *** = 16,836

(Reserves + 12-months C/A)/ M1 ** = 16,836/9,253 183%

(Reserves + 12-months C/A)/ Broad Money **= 16,836/29,727 57%

*As at July 85 ** April 1985 *** 1984 (2) - 1985 (1)

Figures in millions of U.S. Dollars

	M1 (Converted to U.S. Dollars)	Broad Money (Converted to U.S. Dollars)
1974	5533	14426
1985(April)	9253	29727
%Increase (decrease)	67%	106%
Corresponding % increase in the United States	113	159

(a) 198 Imports as percentage of GNP 26.37%
(b) 1975-1984 Imports as percentage of GNP 30.10%
1984/(1975-198 average) = (a)/(b) = 87.61%

Source: IFS

Chart 25

RATES	SPOT	1 MONTH	3 MONTH	6 MONTH	12 MONTH
	8.37-8.38	8.40-8.41	8.46-8.48	8.54-8.55	8.65-8.68

Chart 26

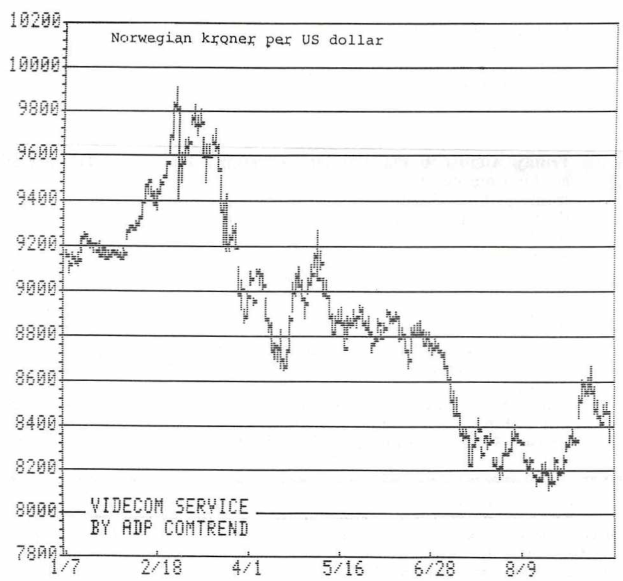

Chart 27

Forex Rates & Update

Currency	*Spot*	*3-month*	*12-month*	*Comments vis-à-vis US$*	*Comments vis-à-vis DM spot DM 2.8400*
Australian dollar	.6870-.6880	.6735-.6750	.6450-.6475	sell at .750, stop at .6400, Basis spot	Liquidate as per stop
Belgian franc	57.65-57.75	57.72-57.89	58.00-58.30	Remain long	Remain long
Danish krone	10.35-10.36	10.35-10.37	10.34-10.37	Neutral	Neutral
Dutch guilder	3.2090-3.2140	3.1884-3.1945	3.1150-3.1230	Remain long	Neutral
Greek drachma	138.40-138.60	147.10-152.60	154.40-163.60	Short; long Swiss	Remain short
Italian lira	1918-1923	1937-1946	1999-2011	Neutral	Neutral
Indonesian rupiah	1120-1130	Discontinuing due to lack of forward markets		Remain short	Remain short
Kuwaiti dinar	.30570-.30590	.30425-.30512	.30166-.30433	Short; long Swiss	Remain short
Malaysian ringgit	2.4890-2.4920	2.4890-2.4935	2.4890-2.4950	Sell	Remain short
Mexican peso	395-405	N/A	N/A	Remain short	Remain short
New Zealand dollar	.5345-.5355	.5095-.5120	.4595-.4680	Remain long	Neutral
Saudi Arabian riyal	3.6520-3.6530	3.6670-3.6710	3.6790-3.6850	Remain short	Remain short
Singapore dollar	2.2040-2.2070	2.1940-2.2070	2.1640-2.2070	Sell	Remain short
South African rand	.3750-.3850	.3800-.3950	.3750-.4050	Liquidated	Neutral
Spanish peseta	170.35-170.75	172.10-173.25	176.85-179.25	Neutral	Neutral
Swedish krona	8.42-8.43	8.57-8.59	8.81-8.43	Neutral	Neutral
Venezuelan bolivar	14.60-14.70	14.63-14.78	15.10-16.10	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 liquidate 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

The market letter is in the mail tomorrow.
Maintain stops of 4240 and 3495, basis Sept. SF and DM, respectively, close only.

Friday, August 23: The market letter was mailed mid-week. There are no changes this week. Maintain stops of 4240 and 3495, basis Sept. SF and DM respectively, close only.

Tuesday, August 27:
1. Raise stops on Sept. SF and Sept. DM to 4355 and 3580, respectively, close only.
2. Liquidate South African rand positions. Next regular update August 30.

Friday, August 30, Flash update. 1:55 p.m.: The SF and DM are selling at this time below our recommended sell stops. However, due to extremely thin conditions as a result of Labor Day weekend, we think these levels are artificial and prefer to ignore sell stops. New instructions will be given at approximately 9:00 a.m. Tuesday Sept. 3.

Tuesday, September 3, 9:00 a.m.: As told to you on Friday's flash update, we are revising our SF and DM stops to the following level: 4260 and 3510, respectively, basis September, close only. We emphasize close only, as these represent the important psychological levels of 235 and 285 in the European quote system. Naturally, if you stopped yourself out as per earlier suggestion, we advise reentering the market with the new revised stops. If no further developments, this tape will replace the regular Tuesday update.

Friday, September 6: A review of this week's activities. We were stopped out of long Sept. SF and DM positions at Tuesday's close as per our revised stops announced on Tuesday's flash-update at approximately 4243 and 3495, respectively. Stand aside. Next regular update Tuesday Sept. 10.

Tuesday, September 9, Flash update. 1:14 p.m.: We are once again reinstating our buy recommendations in Dec. SF and DM for speculative and hedge accounts. Place stops at 4139 and 3415 respectively, good anytime. Repeat, good anytime.

Tuesday, September 10: You are now, once again, long the Dec. SF and DM for speculative and hedge accounts. Place stops of 4139 and 3415 respectively, good anytime. Next regular update Friday Sept. 13.

Wednesday, Sept. 11: This is a special update for Wednesday, September 11. This is a reminder that the S&P 500 has finally broken the one-year uptrend as discussed in our market letter of August 18. We now advise aggressive purchase of S&P put options.

Friday, September 13: A review of this week's activity. You were stopped out of long Dec. SF and DM positions on Wed. at approximately 4139 and 3415, respectively. On the close of Wednesday, you were reminded that the S&P 500 broke the long-term uptrend and that as a result, aggressive purchase of S&P put options were in order. The next regular update is Wednesday September 18 at 9:00 a.m.

Wednesday, September 18, 9:00 a.m.: There are no changes recommended at this time. Next regular update: Friday September 20.

Friday, September 20, Flash-update. 8:45 a.m.: Buy Dec. SF and Dec. DM at the market. Stops will be provided on the regular market update today.

Friday, September 20: A review of the week's activities:
1. Speculative and hedge accounts are now once again long Dec. SF and DM at approximately 4282 and 3530, respectively. Please sell stops at 4195 and 3445, respectively, close only.

Friedberg's Commodity & Currency Comments (ISSN 0229-4559) is published monthly by Friedberg Commodity Management Inc., 347 Bay Street, Toronto, Ontario, M5H 2R7.

Subscription Enquiries
Friedberg's Commodity & Currency Comments
347 Bay Street
2nd Floor
Toronto, Ontario, Canada
M5H 2R7
(416) 364-1171

Trading Accounts
All enquiries concerning trading accounts should be directed to
Friedberg Mercantile Group
347 Bay Street
Toronto, Ontario M5H 2R7
(416) 364-2700