

# FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

Friedberg Commodity Management Inc.



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## Power play

As if by magic, the crude oil market has been defying the laws of supply and demand. Since the *announcement* of the Saudis' intention to increase output, spot quotes of North Sea Brent and West Texas Intermediate have climbed \$2¼ to \$3¼ per barrel, respectively. More recently, since the *onset of stepped-up Saudi output*, followed generally by other producers, these grades of crude have risen an incredible \$1½ to \$2/barrel, completing the longest running upside move in crude oil prices in the short history of recurring bear market rallies begun in the early '80s.

Even more puzzling, the rally had all the earmarks of *panic buying* — plus days represented an astounding two thirds of all trading days since the June lows. Is it possible that the world was running out of supplies when even as recently as this past August, Opec was unable to sell 14.3 million barrels per day (mb/d)? We hardly believe it. As we showed last month, worldwide *private* stocks equalled 73 days of forward consumption, which compares with estimated minimum operating stock requirements of 45 days. And while this level of stocks cannot be considered ample, it is also true that the widening backwardation was rationalizing inventories and making spot supplies as available as necessary (see last month's *Commodity & Currency Comments*).

What gives? Can 3 mb/d extra supplies, an almost 6% rise in world output, cause prices to *skyrocket*, let alone rise? Have we repealed the first law of economics? Why has the backwardation continued to widen (now at \$4.20/barrel for six months; see Chart 1) even while physical supplies have been forthcoming at a generous pace? The questions do not end here. Why does Saudi Oil Minister Sheikh Yamani sound so concerned about a collapse of oil prices, come this spring, as expressed in at least three public statements over the past few weeks? Haven't prices risen sufficiently for him to feel relatively safe?

The astute reader will by now begin to feel some of the same suspicions we have harbored for the past few weeks. He needs one more piece of information before the picture is complete. There is an active forward market in North Sea Brent crude, primarily for delivering in 30 and 60 days — that is, the nearest two months. This informal market has a daisy chain

of as much as 40 or 50 rotations before settlement is affected.

Alongside the NYMEX, the North Sea Brent forward market has become the speculative arena for crude gladiators. It differs from NYMEX in that it has no clearing house — and consequently no cash settlements at the end of each day — no position limits, a very high degree of anonymity, and due to its geography, it can most probably be settled only by the Brent variety of crude oil produced in the North Sea. By necessity, the players are big boys, as each minimum trading unit equals one cargo, which in turn equals between 500,000 and 600,000 barrels of oil, the equivalent of 500-600 *contracts* on the NYMEX.

In normal days the market would trade 3, 4, 5 and up to 10 cargoes, which, of course, represents anywhere between 1.8 million barrels and six million barrels of Brent — in contrast to a total North Sea average output of 2.4 million barrels and a recent record of 2.65 million barrels per day. So far, so good. In recent days, *reported* transactions reached a mind-boggling total of 40 cargoes, representing as much as 24 *million barrels*. Close observers of the market have detected a great deal of short-covering, with prices between cargoes jumping as much as 50¢ per barrel.

The enormous quantity of Brent cargoes trading on a daily basis coupled with the frenzied pattern of trading and anecdotal evidence that the shorts are "throwing in the towel" point to the possibility of a gigantic short squeeze, or power play, engineered by some well-do-do speculators — more likely (and, of course, we have no evidence nor are we even accusing anyone of foul play) the Saudis, through Norbec, and some of the Seven Sisters who have recently gone to bed with the Saudis in netback arrangements.

### In this issue

Opec is unravelling, so we continue our bearish position in crude oil. The stock market has to face reality soon, and we retain puts on S&P 500. Mexico becomes a basket case, so we pack our bags and leave, taking what we can. Contributions by Albert D. Friedberg, Steve H. Hanke, and Daniel A. Gordon.

A suspicion, bordering on the paranoid, would point to the early September Saudi announcement as the time that logical minds would have bet crude prices were finally about to collapse. Aware of this danger, the manipulators(???) allowed the bears to sell forward dates, primarily October and November deliveries, while they took the opposite side of the trade. The bears had been trapped.

Not long ago, the Tin Buffer Manager on behalf the ITC initiated and completed two very similar bear traps that, were it not for the LME intervention, would have bankrupted a number of logical and sophisticated bears. Chart 2 defies the first law of economics: Tin prices rise sharply as consumption stagnates and worldwide supplies increase. At points A and C, confident bears press their shorts against a manager still armed with cash and nerve. At points B and D the bears are mercilessly squeezed to the point that the LME caps one-day tin borrowing costs at 90£/ton, a 300% per annum cost. The Buffer Manager has some fun, but the basic laws of supply and demand survive: In the end, he is forced to accept more tin than he can handle, and on October 24 — a mere two-and-a-half months later, he announces that he has run out of money.

A very powerful trader can inflict heavy punishment on

his counterpart, but he must be prepared to have a bottomless pocket. This is so because a) the absolute rise in prices cuts down consumption even further while it encourages increased output and b) the squeeze widens the backwardation, which, as we saw last week, increases the availability of spot supplies. This means that the manipulators (??) *were not able to increase their net sales*, as they have been forced to accept tenders. It is now also clear why Sheikh Yamani continues to jawbone Opec and non-Opec producers on the need for self-restraint. He has still not been able to increase net sales and requires further accommodation.

If, as is likely, Norbec had a hand in the power play, Saudi Arabia's overall financial position must have weakened further. They may have increased sales of Arab light by 2 mb/d, but they probably have been forced to buy back more than 2 mb/d of Brent and/or WTI. The speculative profit of \$2-\$4/barrel on even 100 million barrels cannot compensate them for their revenue loss of 2 mb/d for 60 days at \$28/barrel.

As Professor Hanke's article, which follows, demonstrates, the Saudis' profit-maximizing strategy lies in lower prices and full production. While this most recent bull run has bloodied many a bear, it is probably Yamani's last attempt at holding prices.

## The unravelling of Opec: crude calculations

Steve H. Hanke

Lead articles in the May, June, September, and October 1985 issues of *Commodity & Currency Comments* have addressed the fundamentals of the crude oil market. This piece is a continuation of our analyses and insights into the mysteries of the market for crude.

Excess capacity eventually becomes the Achilles' heel of any cartel. To establish a cartel price, a cartel must constrain its members' output. Once established, a cartel price induces capacity and output expansion by outsiders. In an attempt to counteract the increased production by interlopers and maintain its high price, a cartel must further cut its overall output. In consequence, excess capacity is generated within a cartel. This excess capacity, coupled with a cartel price, induces individual cartel members to violate their agreements and increase production to levels that exceed assigned quotas. To the extent that members violate their cartel agreements, they are handsomely rewarded because increased output is produced at a relatively low marginal cost and sold at a price close to, but slightly under, the official price. Eventually, cartels come unravelled because members can't resist producing with their excess capacity.

Opec, not unlike other cartels, is following the textbook script. In 1973, when the Opec cartel price began to diverge sharply from a free market price, production by non-Opec producers averaged 24.8 million barrels per day (mb/d). In-

duced by high Opec prices, non-Opec producers — led by increased production in China, Mexico, Norway, United Kingdom, and the USSR — increased output to an average of 36.6 mb/d in 1984. In an attempt to keep prices artificially high, Opec has slashed its average annual output from a peak of 31.3 mb/d in 1977 to 17.2 mb/d in 1984. In consequence, Opec's oil revenues have fallen sharply, and its excess capacity has risen to about 12 mb/d. Moreover, in an attempt to raise much needed oil revenues, Opec members have begun to increase their output and to market it at discounts from official prices. Although Opec has not yet unravelled, the day is nearing when it will. And when this inevitably occurs, the question is: How will crude oil prices respond to increased Opec production?

To shed light on this question, we offer some back-of-the-envelope calculations (see Chart 3). Our purpose is to determine the oil prices required to clear the market at alternative world oil output levels. Output levels are displayed in the first column of Chart 3. These begin at the current world output level, 55 mb/d, and increase by 1 mb/d increments until 65 mb/d is reached. The 65 mb/d level is the terminal output level for which we make calculations because we assume that when Opec unravels, its excess capacity, 12 mb/d, would be thrown onto the market and that non-Opec production would be reduced by 2 mb/d. The reduction in non-Opec produc-

tion would occur because some marginal non-Opec production would be discontinued at the lower prices that would accompany Opec's full production. Hence, it is assumed that a collapse of Opec would result in a net addition to output, over current world production, of 10 mb/d.

The market-clearing prices that would accompany alternative output levels are found in the second, third, and fourth columns of Chart 3. These prices are calculated for realistic demand elasticity alternatives. With the most inelastic alternative ( $e = 0.1$ ), demand is very unresponsive to price changes. In consequence, to clear the market, prices must decline rapidly, as output is increased. If demand is assumed to be more responsive to price changes ( $e = 0.2$  or  $e = 0.3$ ), then, to clear the market, prices do not have to decline as rapidly.

If all factors that determine market-clearing prices remain unchanged and world oil output is increased from 55 mb/d to 65 mb/d, the market-clearing prices are calculated to decline from \$28.60/b to \$5.38/b (81% decline), \$12.41/b (57% decline), or \$16.39/b (43% decline). Which of these prices is most realistic depends on which demand elasticity is assumed to best represent the real situation.

The obvious conclusion from our analysis, regardless of the demand elasticity chosen, is that the unravelling of Opec will bring with it sharply lower oil prices.

The consequences of Opec's collapse on producing countries' oil revenues are not so obvious. Non-Opec producers are already producing at capacity, and would not be able to increase production to compensate for lower prices. In fact, as was mentioned earlier, their production would actually be somewhat lower at lower prices. In consequence, non-Opec producers' oil revenues would be lower at world output of 65 mb/d than at 55 mb/d.

Turning to the members of Opec: Some would generate more and some less oil revenues if Opec collapsed and world production rose to 65 mb/d. The winners, in a narrow oil revenue sense, would be those members with the largest proportion of excess capacity: Kuwait, Libya, Qatar, Saudi Arabia, and the United Arab Emirates. Each of these producers would increase their production by more than enough to compensate for lower prices. For example, even if the most inelastic demand prevailed and prices fell to \$5.38/b (81% decline), each of these producers would increase their production by more than 81%. Hence, each would realize gains in their oil revenues. For all other members of Opec, oil revenues would decline because they would not be able to increase production by enough to compensate for the price declines, regardless of the demand elasticity assumed.

**STRATEGY:** *Our analysis strongly supports a continued bearish position on crude oil. It should be pointed out that the very deferred contracts have risen a great deal less than the spot months (see Chart 4), a result of the widening backwardation. This strategy, as well as the continued purchase of puts, should be continued.*

*We also remain bearish on the Saudi Arabian riyal. If Opec continues to unravel slowly, Saudi Arabia would at best be able to increase its oil revenues only modestly. These revenues would not be enough to rescue Saudi Arabia from a deteriorating fiscal situation. Alternatively, if Opec unravels rapidly, the Saudi Arabian oil revenues would actually increase. However, the political stability of the Persian Gulf would become more unsettled, and this would put significant downward pressure on the Saudi Arabian riyal.*

Chart 1

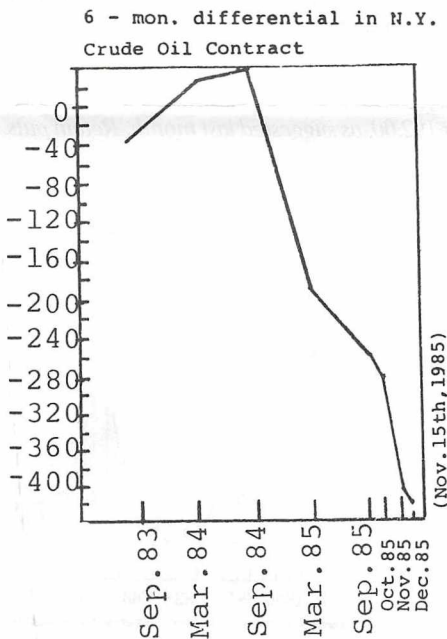


Chart 2

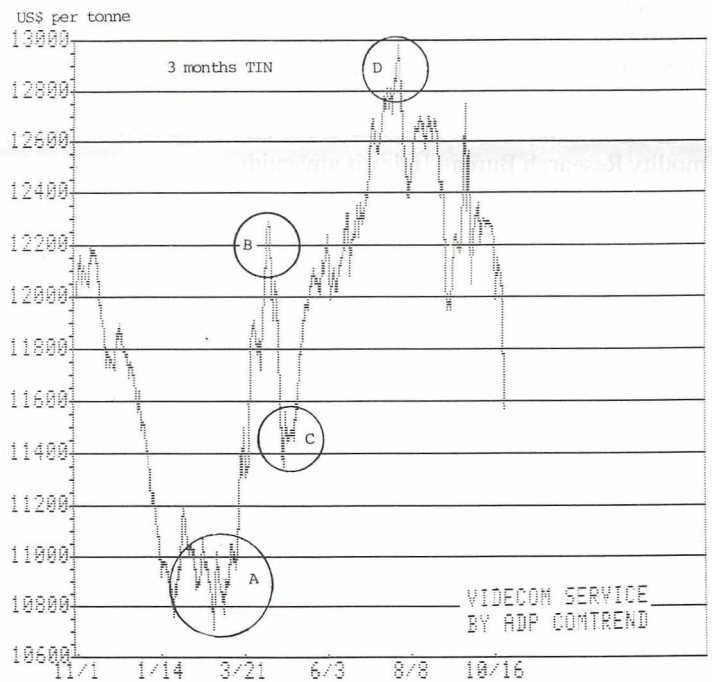
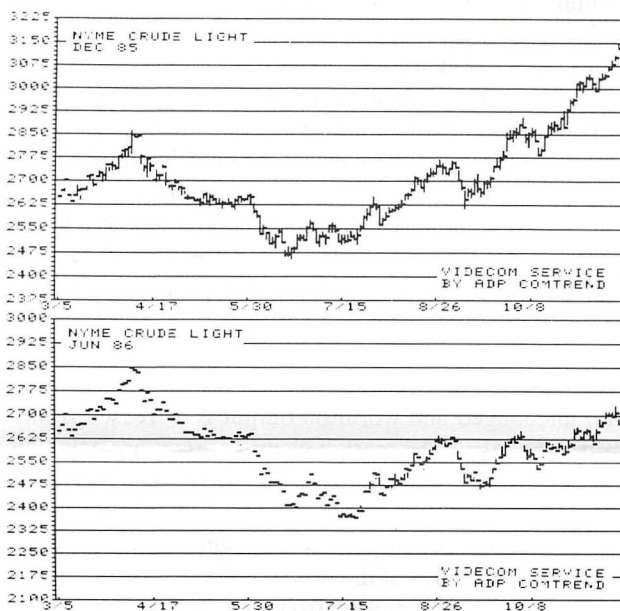


Chart 3

World Crude Production (million barrels/day)	Prices (\$/barrel)		
	Demand Elasticity (e = 0.1)	Demand Elasticity (e = 0.2)	Demand Elasticity (e = 0.3)
55*	\$28.60*	\$28.60*	\$28.60*
56	23.88	26.14	26.93
57	20.01	23.92	25.39
58	16.82	21.93	23.96
59	14.17	20.13	22.63
60	11.98	18.51	21.40
61	10.16	17.04	20.25
62	8.63	15.71	19.18
63	7.36	14.50	18.19
64	6.28	13.41	17.26
65	5.38	12.41	16.39

Notes: (1) The \* denotes either the current assumed level of world crude oil production or the current assumed crude oil price.  
 (2) The demand model employed is:  
 $Q = aP^{-e}$   
 where Q = production of crude oil in millions of barrels per day,  
 P = price of crude oil in U.S. dollars per barrel,  
 e = demand elasticity =  $\frac{dQ}{dP} \times \frac{P}{Q}$ , and  
 a = a constant =  $\frac{55}{28.60^{-e}}$   
 (3) In the table, we increase production and solve for price with alternative demand elasticity assumptions. This is accomplished by rearranging the demand model, so that:  
 $P = \left(\frac{Q}{a}\right)^{-\frac{1}{e}}$   
 (4) For information on demand elasticities, see: Paul W. MacAvoy, *Crude Oil Prices: As Determined by OPEC and Market Fundamentals*, Cambridge, MA: Ballinger Publishing Company, 1982.

Chart 4



# Stock Indices

## Market must face reality soon — stay put!

Deflationary pressures, increased debt service, and a flat economy have as yet not had a major impact on the stock market, or at least, the large capitalization segment of the stock market.

An early November *Wall Street Journal* survey shows that after-tax earnings on continuing operations of 501 major corporations dropped 7% from a year earlier. Industrial companies were particularly affected by price-cutting, a condition that seems likely to persist for quite some time if our Commodity Research Bureau Index is any guide.

It appears that easy credit and its direct effect of shrinking equity via leveraged buyouts and takeovers are a more powerful influence than the grim realities of corporate life. It can only change in one of three ways: 1) the Fed tightens, an unlikely possibility at least for now; 2) interest rates rise as a result of a weak dollar, a somewhat more plausible scenario; or 3) one or two major junk-bond issuers default, putting an end to junk-bond financed acquisitions, a very good possibility. Until then, the mania will feed on itself.

**STRATEGY:** Stopped out on outright December '85 S&P 500 short positions at 192.00, as suggested last month. Retain puts.

Chart 5

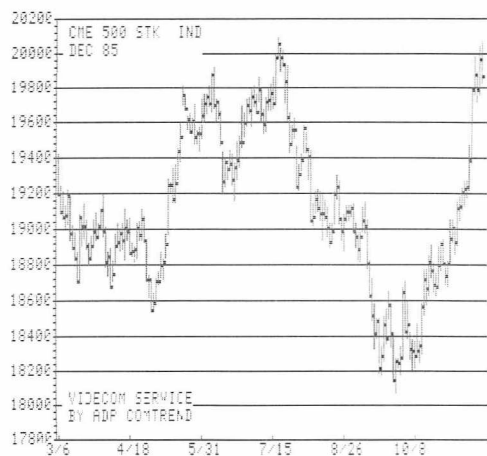


Chart 6

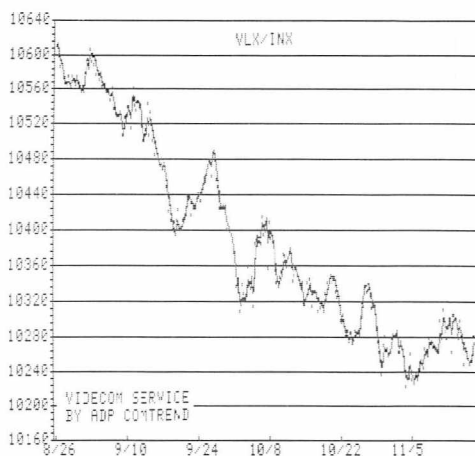
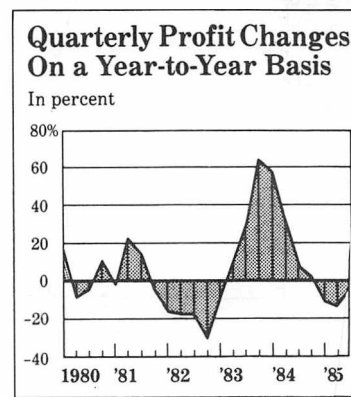


Chart 7



THE WALL STREET JOURNAL

# Financial Futures

## Three spreads reviewed

We review three spreads first recommended in our July 7 issue:  
**1. Long T-bonds/short S&P 500 futures.** Some deterioration, although it does not seem serious. Place stops at 388, basis December '85.

**2. Long T-bonds/short 2.6 Eurodollars.** The flattening of the yield curve has given us a dramatic profit. Accept profits.

**3. Short Toronto Oil & Gas Index/long TSE 300.** Spread has deteriorated again as a result of rising crude oil prices. We expect the spread to narrow rather sharply in coming weeks as we expect industrial shares to rise (a result of strong excess liquidity and good economic growth) and oil and gas shares to resume their downward trend as soon as crude reverses. Maintain positions.

Chart 8

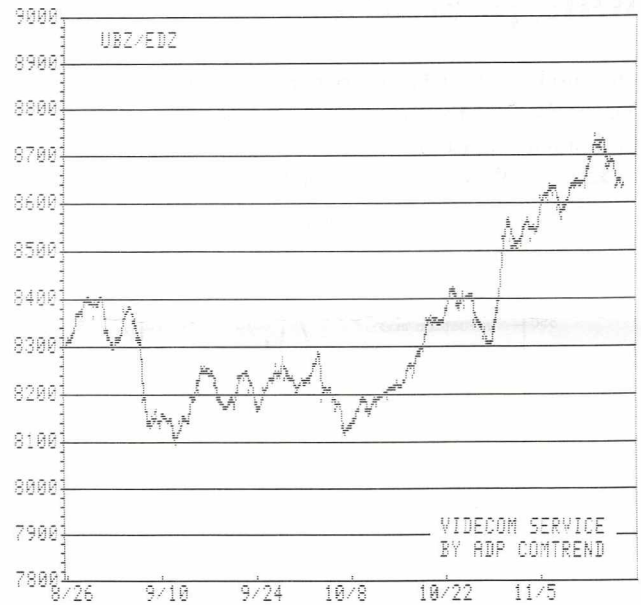


Chart 9

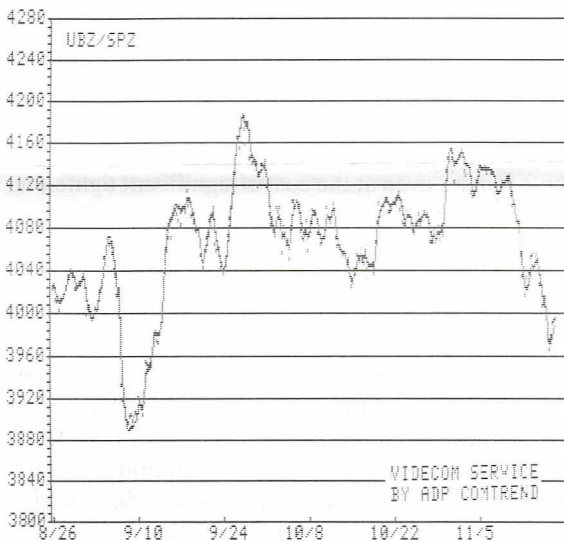
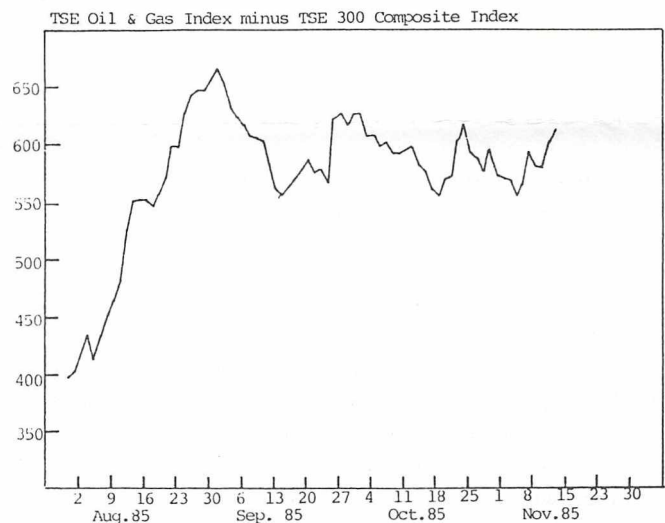


Chart 10



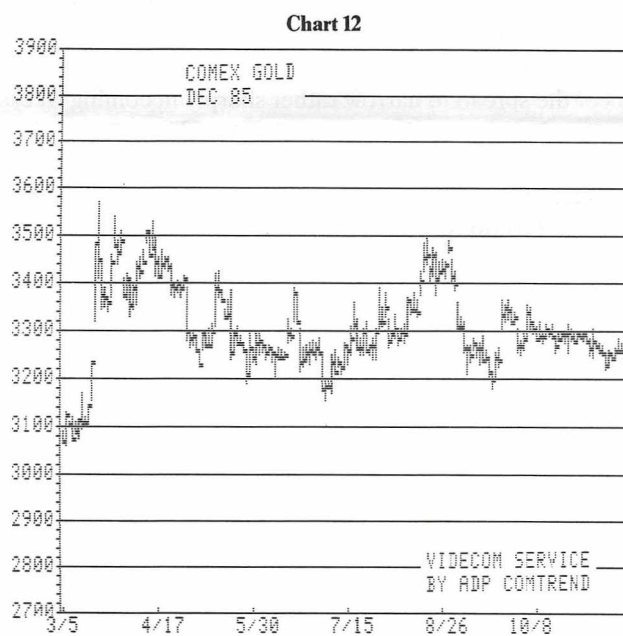
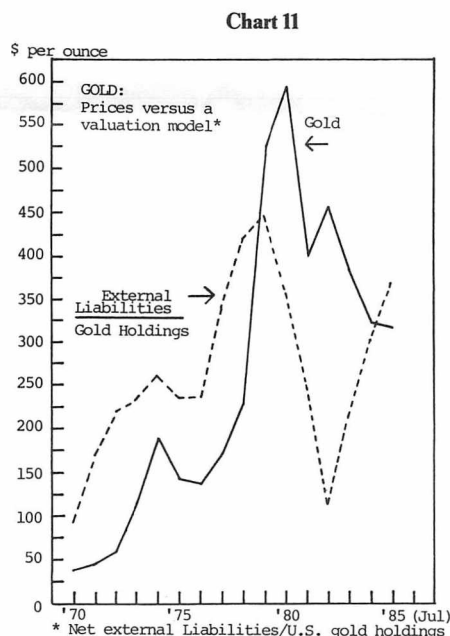
# Gold

## Bull all set, but protect long positions

Our model (Chart 11) has become more bullish (see *C&CC*, March 24, 1985 for an explanation of the model) of late, with preliminary figures for July '85 showing an equilibrium price of \$365/oz. We'd like to caution that the bullish gap between

market price and valuation can persist for quite some time (as we saw in the late '60s) before it impacts free gold prices. Nevertheless, it does indicate that the conditions have been set for the next bull market.

**STRATEGY:** *Relatively poor market action in the face of a weakening dollar may presage one further shakeout. Protect long positions with stops at 316.00, basis recent contract, good anytime.*



# Currencies

## US dollar

We stated last month that short of massive monetary inflation, the US dollar was likely to find good support at the prevailing levels and that it may even stage a significant rally in the weeks and months ahead. With the exception of the yen, the dollar maintained its level of a month ago and even improved slightly vis à vis Sterling.

Given the sharp deceleration in US monetary expansion that has already occurred as well as the slight firming of short-term US interest rates, particularly Fed Funds, we must maintain the view that the next significant \$/DM move (15-20 DM pfennigs) will see a rise of the US unit. Longer term, the US dollar is likely to lose some more ground as the present near-recession (a 1.8% rise in industrial production October '85 over October '84) turns into a full-fledged recession early in the new year.

The Japanese yen is likely to remain relatively firm in view

of the Bank of Japan's determination to maintain the ¥/\$ at around the 200 mark even at the cost of significant tightening of monetary policy. As of this past week, three-month Euroyen traded 1/8% higher than three-month Eurodollar.

Continued expectations of a Sterling entry into the EMS, as well as the ever-present threat of lower oil prices have pushed down the critical £/DM cross-rate to near the 3.70 level.

Without a defined monetary policy (Lawson recently dismissed M3), the UK would benefit from an "exchange rate anchor" to the near inflation-free West German DM. However, given its high unemployment rate, it is doubtful that the UK would choose to peg Sterling much above 3.50, thus giving it some room to reflate before the next election.

**STRATEGY:** *Our foregoing analysis suggests a profitable long yen/short British pound spread (see Chart 16) weighted, of course, by their respective dollar values (i.e., 1.73 BP vs. 1.00 Yen). Remain sidelined on the DM and SF.*

Chart 13

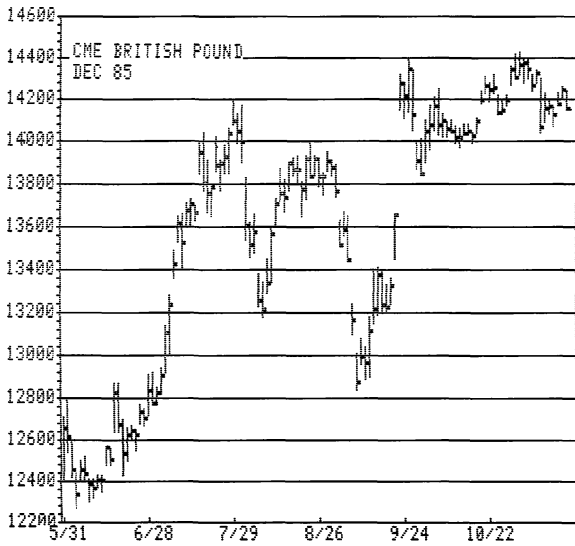


Chart 14

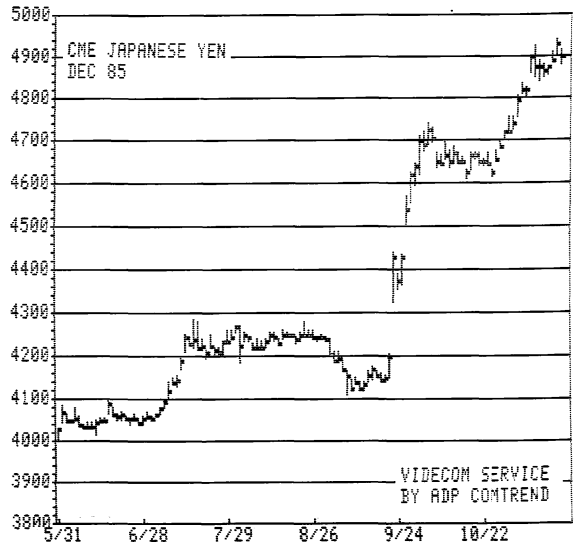


Chart 15

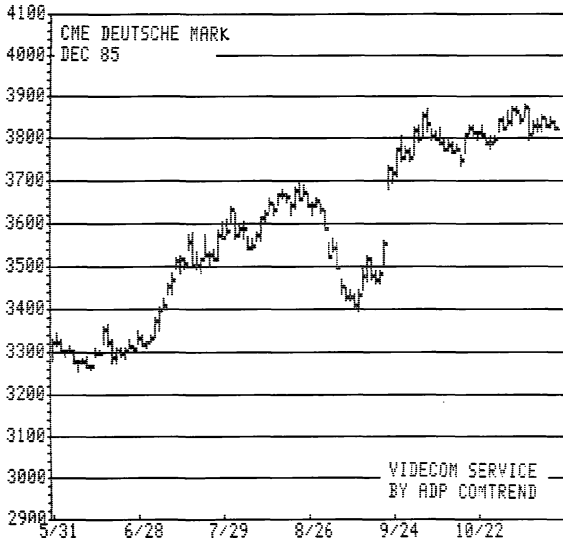


Chart 16

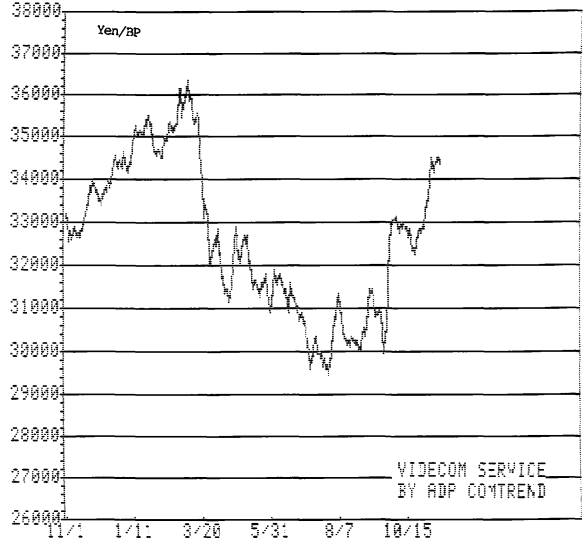


Chart 17

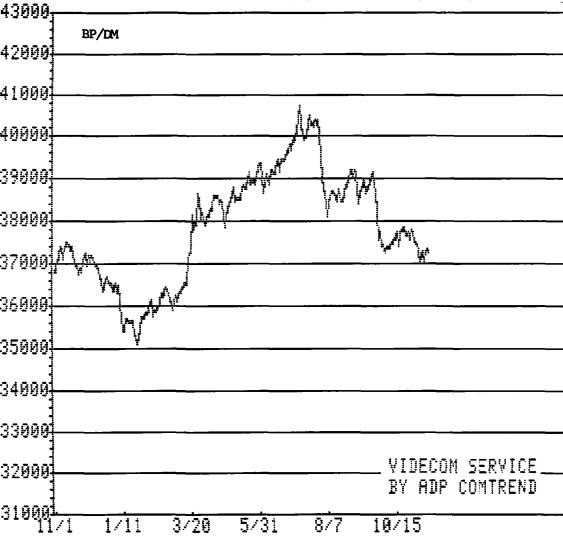
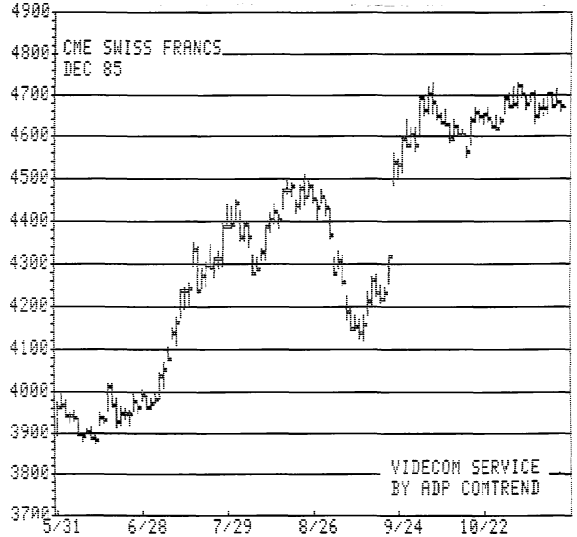


Chart 18



# Mexico: Time to pack what you can and leave

Mexico's conversion to free-market principles was a non-starter. The frantic increase in fiscal expenditures in the months leading to the mid-summer elections continued the long history of statism and corruption so typical of previous administrations. It was impossible to monitor Mexico's violations of the Letter of Intent because whatever statistics exist, they are either fabricated or are too old to be useful.

On the day before the earthquake, Mexico was told by the IMF that it would no longer be receiving financial assistance. Following the earthquake, the authorities expropriated over 5,000 acres of private property in downtown Mexico city, an area long ravaged by the effects of 50 years of rent-controls (rents in some houses are as low as \$1 per year!).

Next, the government turned its attention to the problem of servicing domestic debt: Skyrocketing fiscal deficits were increasingly being financed through the use of short-term bills yielding 80% per annum. The government's brilliant response was to lower the rate paid on the bills. Were it not for the fact that there was no lending (buyers of bills), the government could have lowered its financing costs. Alternatively, a much cheaper form of financing was obtained through

the use of the printing presses. The chosen method not surprisingly had a devastating effect on the peso: It depreciated by over 25% in one short month.

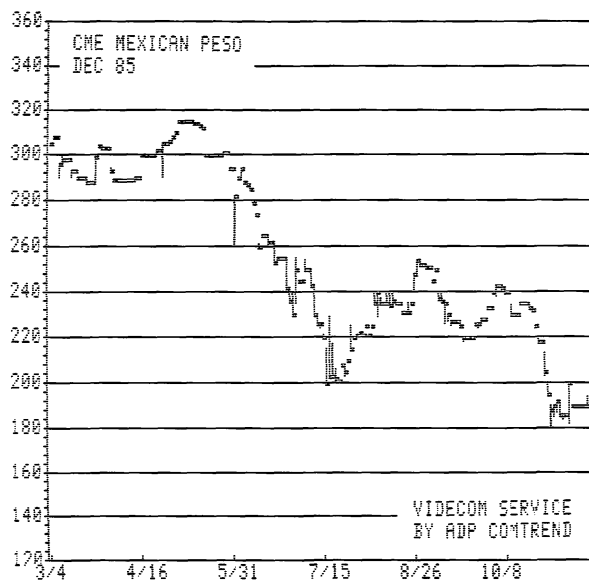
The government had to find a way to plug capital flight. It instituted exchange controls, monitored by the country's domestic banks, which, conveniently enough, are government-owned. The flourishing offshore peso market, a gift to the citizens desperately seeking to escape the clutches of economic tyranny and state confiscation, was literally sealed up with operators unable to know how settlement would be affected on previously established forward positions. Will settlement be allowed to take place through the super-free peso or only through the controlled rate? While staying tuned, you may want to speculate on what will happen to the "superfree" rate and whether it will be tarnished to the point of turning black.

And so it goes. A litany of scandals, corruption, and mismanagement that inexorably leads to debt repudiation, poverty, and social chaos.

We've said it before. We say it again. Take whatever you have left out of Mexico, at whatever price, before it is too late.

**STRATEGY:** Having covered 50% of our initial short position with spectacular profits, we now await the definition of the newly-instituted exchange controls.

Chart 19



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Chart 20

YEAR	MEXICAN PESO Per U.S. DOLLAR (PERIOD END)	U.S. 1970=1.00	U.S. 1977=1.00
1967	12.5000	0.9574	0.8889
1968	12.5000	0.9725	0.9029
1969	12.5000	0.9907	0.9198
1970	12.5000	1.0000	0.9285
1971	12.5000	0.9876	0.9169
1972	12.5000	0.9748	0.9050
1973	12.5000	0.9223	0.8563
1974	12.5000	0.8285	0.7692
1975	12.5000	0.7839	0.7279
1976	19.9500	1.1443	1.0624
1977	22.7360	1.0771	1.0000
1978	22.7240	0.9855	0.9150
1979	22.8030	0.9318	0.8651
1980	23.2560	0.8532	0.7922
1981	26.2290	0.8306	0.7712
1982	96.4800	2.0388	1.8930
1983	143.8000	1.5542	1.4430
1984	192.5600	1.3120	1.2181
1985 (1Q)	208.4800	1.0772	1.0002
1985 (2Q)	227.5900	1.3315	1.2362
1985 (aug)	291.5000	1.2509	1.1614

Above 1.00 = undervalued  
Below 1.00 = overvalued

Chart 21

Year	Foreign Assets (Mln US\$)	CURRENT ACCOUNT	CUMULATIVE 12 QTR.
		As % of GNP %	Current Account (Mln US\$)
1970	912	-3.00	-2403
1971	1,112	-2.13	-2495
1972	1,400	-2.02	-2819
1973	1,464	-2.56	-3166
1974	1,504	-3.99	-5207
1975	1,664	-4.59	-8333
1976	1,107	-3.85	-10327
1977	1,781	-2.26	- 9305
1978	2,433	-3.08	- 8434
1979	3,661	-4.05	-10484
1980	5,319	-4.38	-16792
1981	6,004	-5.80	-27520
1982	1,538	-4.07	-28857
1983	4,407	+3.33	-15943
1984	6,204	+1.87	+ 1246
1985 (May)	5,450	-	-

Chart 22

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

Reserves \* + Previous 12-months current Account \*\*\* = 6486  
 (Reserves + 12-months C/A)/MI \*\* = 6486/10390 = 62.4%  
 Reserves + 12-months C/A)/Broad Money \*\* = 6486/45292 = 14.3%  
 \* As at July 1985    \*\* May 1985    \*\*\* 1986 Estimated

Figures in millions of U.S. Dollars

	MI (Converted to U.S. Dollars)	Broad Money (Converted to U.S. Dollars)
1974	8064	11136
1985(May)	10390	45292
% Increase (decrease)	28.8%	306.7%

Corresponding % increase in the  
United States    102.7    158.2

(a) 1984 Imports as percentage of GDP 6.41%  
 (b) 1975 - 1984 Imports as percentage of GDP 8.17%  
 1984/(1975 - 1984 average) = (a)/(b) = 78.45%

Source: IFS

## Canadian dollar: remain short

Monetary policy has become noticeably more expansive in recent months. Our adjusted monetary base for October shows a year-on-year rise of 7% compared with a 1984-83 rise of 3.5%; M1A has shown a remarkable year-on-year rate of growth of 41.7%, while broader aggregates, such as M2 and M3 have accelerated from a 12-month growth rate of 10.4% and 5.2% per annum respectively to 14% and 14.2% for the latest month. Finally, excess secondary reserves, which include cash, T-bills and day loans, have moved to a new all-time high of \$10.5 billion. The system is flush with liquidity, probably a result of the Bank's concern with more potential bank failures (after

the insolvencies of the CCB and the Northland and the forced merger of the Mercantile bank). As a result, rate differentials vis à vis the US have narrowed significantly in recent weeks. As an example, 30-day commercial paper trades at around 65 basis points premium to NY as against a 225 basis-point spread in June.

A buoyant rate of growth and very accommodative monetary policy are likely to negatively affect the Canadian dollar as the surplus on current account deteriorates and short-term capital movements fail to offset this effect.

**STRATEGY:** Remain short March Canadian dollar, a position initiated on November 5 via the Hotline update. Place protective stops at 73.50, close only.

Chart 23



# The exotics

## Singapore dollar

The Singaporean economy has been in a state of virtual recession in recent months. The President has appealed for productivity-linked wage increases and has even hinted at the possibility of imposing a wage freeze for a period of two or three years, so as to cushion the impact of a slowdown on unemployment. It is doubtful that the economy will be able to recover significantly given the very large fiscal deficit and its crowding out effect on private sector borrowings. The budget deficit is

expected to equal 12% of GDP during the present fiscal year.

Short of a substantial monetary reflation or, more to the point, a devaluation, little progress will be made in reviving the economy. The monetary authorities may see it differently, and clearly have the wherewithal to defend the present trade-weighted parity. In fact, they have acted quite aggressively in this respect.

**STRATEGY:** *We remain short vis à vis both US dollar and DM.*

Chart 24

YEAR	SINGAPORE DOLLAR PER U.S. DOLLAR (PERIOD END)	U.S.		BASKET	
		1970 =1.00	1977 =1.00	1970 =1.00	1977 =1.00
1967	3.0700	0.8635	1.1509	0.9008	1.0634
1968	3.0800	0.8976	1.1964	0.9239	1.0907
1969	3.0900	0.9514	1.2681	0.9632	1.1371
1970	3.0800	1.0000	1.3328	1.0000	1.1805
1971	2.9000	0.9653	1.2866	0.9783	1.1549
1972	2.8200	0.9485	1.2642	0.9675	1.1421
1973	2.4861	0.7431	0.9905	0.8061	0.9516
1974	2.3120	0.6264	0.8349	0.7071	0.8348
1975	2.4875	0.7171	0.9558	0.7828	0.9241
1976	2.4555	0.7651	1.0171	0.8450	0.9975
1977	2.3305	0.7503	1.0000	0.8471	1.0000
1978	2.1635	0.7124	0.9495	0.8129	0.9596
1979	2.1590	0.7608	1.0140	0.8446	0.9970
1980	2.0935	0.7721	1.0290	0.8345	0.9851
1981	2.0478	0.7699	1.0261	0.8227	0.9712
1982	2.1085	0.8101	1.0797	0.8540	1.0082
1983	2.1270	0.8334	1.1107	0.8757	1.0337
1984	2.1780	0.8672	1.1558	0.8975	1.0595
1985 (1Q)	2.2083	0.8936	1.1910	0.9084	1.0724
1985 (2Q)	2.2335	0.9135	1.2175	0.9278	1.0953

----- BASKET -----  
 U.S. 32% JAPAN 27%  
 SAUDI ARABIA 12%  
 MALAYSIA 29%  
 -----

Above 1.00 = undervalued  
 Below 1.00 = overvalued

Chart 25

Year	Foreign Assets (Mln US\$)	CURRENT ACCOUNT		CUMULATIVE 12 QTR.	
		As	of GNP	Current Account	(Mln US\$)
1970	1050	-30.2		-896	
1971	1320	-32.2		-1487	
1972	1525	-17.1		-1791	
1973	1841	-12.7		-1738	
1974	2466	-20.3		-2035	
1975	2770	-10.3		-2124	
1976	2985	-9.7		-2172	
1977	3551	-4.5		-1446	
1978	3511	-5.8		-1315	
1979	5177	-7.8		-1484	
1980	5684	-14.3		-2753	
1981	6197	-10.5		-3682	
1982	6843	- 8.9		-4246	
1983	6318	-6.1		-3673	
1984	6810	-		-3292	
1984 (Feb)	6492	-		-	

Chart 27

RATES	SPOT	1 MONTH	3 MONTH	6 MONTH	12 MONTH
	2.1160-	2.1115-	2.1035-	2.0935-	2.0735-
	2.1180	2.1155	2.1095	2.1055	2.1005

Chart 26

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

Reserves \* + Previous 12-months current Account \*\*\* = 9320  
 (Reserves + 12-months C/A)/ M1 \*\* = 9320/3923 = 237%

(Reserves + 12-months C/A)/ Broad Money \*\*\* = 9320/11943 = 78%

\*As at Feb. 1985 \*\*March 1985 \*\*\* L985 Estimated

Figures in millions of U.S. Dollars

	M1 (Converted to U.S. Dollars)	Broad Money (Converted to U.S. Dollars)
1974	1236	2995
1985(March)	3923	11943
%Increase (decrease)	217.4%	298.7%

Corresponding % increase in the United States 98.7% 154.6%

(a) 1983 Imports as percentage of GNP 160.3  
 (b) 1974-1983 Imports as percentage of GNP 171.2  
 1983/(1974-1983 average) = (a)/(b) = 93.6

Source: IFS

# 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 Spot DM 2.6200</u>
*Australian dollar	.6735-.6745	.6567-.6582	.6205-.6225	Liquidated as per stop	Liquidated as per stop
Danish krone	9.46-9.47	9.49-9.50	9.51-9.54	Neutral	Neutral
Dutch guilder	2.9440-2.9460	2.9273-2.9300	2.8795-2.8845	Neutral	Remain long
Greek drachma	153.70-153.80	157.95-160.55	170.20-180.30	Remain short	Remain short
Italian lira	1766-1768	1768-1771	1774-1777	Neutral	Neutral
Kuwaiti dinar	.29200-.29210	.29079-.29155	.28865-.29113	Remain short	Remain short
Malaysian Ringgit	2.4355-2.4370	2.4390-2.4445	2.4430-2.4545	Remain short	Remain short
Mexican peso	505-515	Not available	Not available	Remain short ½ original position	Remain short ½ original position
New Zealand dollar	.5635-.5665	.5435-.5485	.4910-.5040	Neutral	Neutral
Norwegian krone	7.85-7.86	7.94-7.96	8.16-8.19	Neutral	Neutral
Portugese escudo	163-163	166-180	169-189	Neutral	Neutral
Saudi Arabian riyal	3.6505-3.6510	3.6500-3.6520	3.6540-3.6600	Neutral	Neutral
Spanish peseta	161.00-161.10	163.80-164.40	167.25-169.35	Neutral	Neutral
Swedish krona	7.85-7.86	7.94-7.96	8.15-8.17	Neutral	Neutral
Venezuelan bolivar	15.10-15.20	15.30-15.50	1.10-16.60	Neutral	Neutral

## Explanatory Notes

\*Indicates change in recommendation from last issue

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

**Tuesday, October 22:** There are no changes. Next update Friday, October 25.

**Friday, October 25:** The market letter is in the mail. There are no changes. Next regular update is Tuesday, October 29.

**Tuesday, October 29:** There are no changes. Next regular update is Friday, November 1.

**Friday, November 1:** There are no changes. Next regular update is Tuesday, November 5.

**Flash Update, Tuesday, November 5, 8:45 a.m.:** We advise selling December and March Canadian dollar at the market as we foresee a period of substantial weakness ahead for the Canadian dollar. Place initial stops at 7350, close only, basis December. If there are no changes, this will replace the regular Tuesday after-market update. Next regular update is Friday, November 8.

**Flash Update, Thursday, November 7, 4:15 p.m.:** Should the Comex gold open lower tomorrow, we would strongly advise liquidating long positions even if you consider yourself a long-term investor, as there is a substantial possibility of a severe shake out.

**Friday, November 8:** A review of the week's activities:

1) As per our Hotline recommendations of Tuesday a.m., you are short Canadian dollar with stops at 7350, close only, basis December.

2) A higher opening on the active month of December prevented a sell signal in gold today. Investors may remain long. Stay posted. Next regular update is Tuesday, November 12.

**Tuesday, November 12:** There are no changes. Next regular update is Friday, November 15.

**Friday, November 15:** No changes or new recommendations this week. Next regular update is Thursday, November 19.

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