

FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

Friedberg Commodity Management Inc.



Volume 7, No. 4 April 20, 1986

The battle of the dollar

How things have changed! A little more than a year ago, the dollar reigned supreme. New highs were recorded almost daily. Incredulous, bears pointed to the widening current account deficit and the unsustainability of such a condition. No one listened. The greenbacks enjoyed a self-feeding momentum, so typical of bull markets. Thirteen months later, the greenback is engaged in a mortal combat — trying to survive a confidence crisis.

The G-5 have unleashed a monster. And whereas they intervened 13 months ago merely to put an end to a speculative bubble and again seven months ago on the same side of the street (i.e., *with* the trend), now they will be forced to conduct an uphill campaign: resist a market that no longer wants to own US dollars, spooked by an incredibly accommodative central bank and rapidly diminishing business opportunities. The most difficult type of intervention. Ultimately, a futile effort.

Experts have differed widely over the cause of the US dollar's rise over the 1980-85 period. Some have attributed it to a combination of tight monetary policy and lax fiscal policy, which caused high real rates of interest; others, to the beneficial impact on returns on capital and profitability caused by Reagan's supply-side policies; yet others advanced the notion of "Fortress USA" as a haven for refugee capital. Even the international debt crisis cannot be left out as an explanatory variable. After all, debt servicing increased the demand for dollars while US lenders pulled in their horns, sharply diminishing the supply of dollars. Whatever the reason or reasons (and we are content with a somewhat eclectic ap-

proach), it seems clear that circumstances have changed, and in some cases quite dramatically.

Let us see. Monetary policy in the past 12-15 months has been extraordinarily expansive, measured by any of the growth of M1 (see Chart 2), domestic non-financial debt (13.5% in 1985 as against a proposed range of 9%-12%), adjusted monetary base (over 8% annualized), or the unusual persistence of net free reserves (Chart 3). The *thrust* of fiscal policy, on the other hand, has reversed over the past year; despite reaching new highs in the first quarter of 1986, the budget deficit, if cyclically adjusted, is clearly not expansive and borders on becoming contractionary.

Supply-side policies and more buoyant European economies have changed the relative merits of investing in the US, where a number of important corporate sectors have come under a severe squeeze. Furthermore, continuous problems in banking, agriculture, non-residential construction and en-

Chart 1

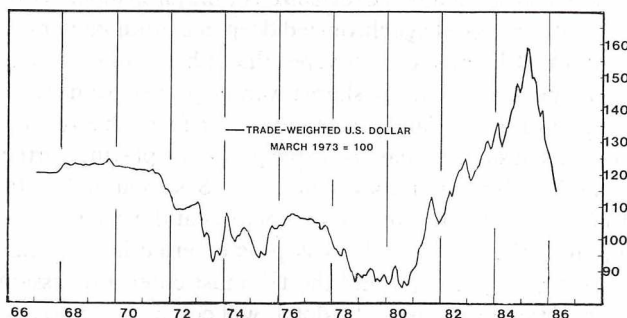
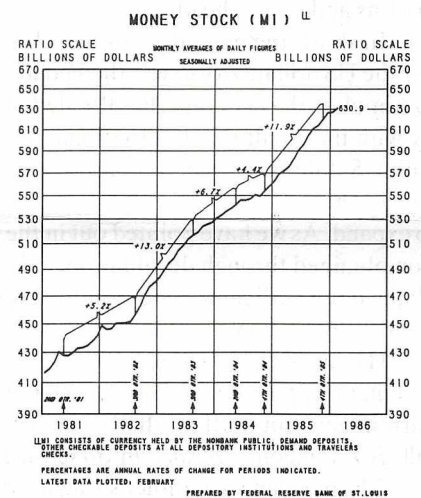


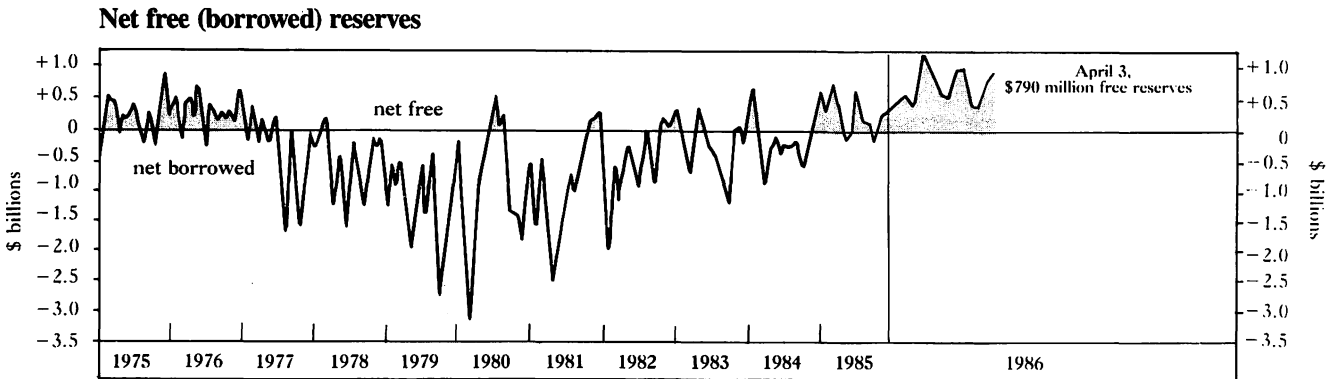
Chart 2



In this issue

We're still bearish on oil — and firmly short. The international debt quagmire: now's the time to accumulate gold and platinum. And strategies for copper, sugar, and lumber. Contributions by Albert D. Friedberg, Steve H. Hanke and Daniel A. Gordon.

Chart 3



Source: Grants

ergy, and the continuous possibility of an imminent recession (see special discussion of US the economy) have begun to shake the confidence of foreign capital, a clear negative for the US dollar.

As to the third argument: If in fact Fortress USA was responsible for large capital inflows in the early part of the decade, with Reagan's assumption, one would have to assume that the bulk of such flows has already taken place. (Marginal flows are not likely to have a major impact.)

The international debt crisis on the other hand is still exerting a relatively bullish influence on the dollar. Negative resource transfers imply a strong demand for US dollars and an extreme paucity of supply. Clearly there are offsets to this small capital inflow, such as the gigantic current account deficit. Moreover, this condition is not sustainable (as our discussion on the "international debt quagmire" points out) and therefore will come to play an ever diminishing role in the months and years ahead.

In short, the capital props have been removed from under the US dollar. Worse yet, the Fed in its (misguided) desire to stimulate the economy, has flooded the system with liquidity with the result that international portfolios are saturated with US dollars. Despite the already sizable drop in the foreign exchange value of the dollar, the trade deficit continues to expand. As we have pointed out in the past, price competition obtained through devaluation, at least in the case of the US, is not a sufficient condition to reverse the catastrophic trend in the current account.

Having lost the bonanza of autonomous capital inflows and, in the aftermath, having been left with the problem of a current account outflow, the US must force expenditures to fall *vis à vis* income. *It can only do so via a full-blown recession.*

The mechanism is rather straightforward: Domestic consumption falls and savings rise, a result of rising interest rates, which also act to attract a reluctant foreign investor. Falling interest rates serve only to perpetuate the excess of domestic expenditures over income, maintaining or even aggravating the pressures of an external outflow. Only *sharply* falling exchange rates are then able to induce nonresidents to hold dollar balances. But even this process has a limit — and this limit is called *confidence*.

In effect, the holder of dollar balances is willing to come to the rescue after and only after a substantial fall in the US dollar has made it an attractive capital gains speculation. If, however, the dollar continues to fall, with little visible effect on the trade deficit and thus never providing a profitable trading turn, the holder of dollar balances becomes disenchanted and dumps these dollars to a more hopeful soul.

This process is repeated a number of times until nearly all market participants lose hope. The conclusion is then reached that there is no hope for a turnaround. The decline turns into a rout. The impact of a fast-falling dollar on domestic inflation becomes dramatic; the market finds a solution. Whether the Fed likes it or not, interest rates skyrocket. Dollar holders receive a new incentive in the form of a potentially higher rate of return. At the same time, the domestic economy, hit by this interest rate spike, slows down and begins to contract. Presto. The adjustment is underway.

For months we have been concerned with the loss of confidence factor. We guessed that the Fed would be constrained in the execution of monetary policy by certain psychological levels in the forex value of the dollar. We thought that this level was reached at 2.60 DM/\$. Fortunately (?) the US dollar survived 2.60, 2.50 and even 2.40 DM/\$. Fed Chairman Volcker warned that we had entered the "danger zone." Incredibly, the money markets remained unperturbed by this collapse, mesmerized by the unanticipated fall in oil prices and their connection to disinflation/deflation.

Treasury Secretary Jim Baker and the pragmatists at the Treasury came up with one more trick: Force a synchronized fall in rates. The dollar would not fall, they avowed, and the economy would continue to be revitalized by the fall in money costs.

With the latest synchronized drop in central bank rates, the Bank of Japan has discovered that it has stimulated a gigantic speculative orgy in share (average price-earnings ratio in excess of 40) and land prices and that, in fact, it has reached the limits of such endeavors. Having lost one playing partner in the West German Bundesbank, the US is about to lose the other one. Furthermore, the pragmatists at the Treasury fail to realize that for the US to stop its external hemorrhage, interest rates must rise and the US must enter a recession. Short of that happening, the dollar will collapse and double-

digit inflation will come back with a vengeance.

As pressure on the US dollar mounts, the G-5 will attempt to hold the onslaught by first intervening in a massive way against the trend. The experience of the '70s is fresh enough in our memory to predict the failure of intervention. Sooner or later, intervention will be given up, US inflation will rise, US interest rates will rise, and the US will plunge into a recession.

The battle for the dollar has begun.

STRATEGY: We have become convinced that the pragmatists, who believe they can orchestrate economic policies and events, have taken full command of the US economy. We

have therefore become, at this seemingly late stage, ferocious bears on the US dollar.

Sell dollars against Swissie, Deutschemark, yen, and even Sterling, in that order of preference. Hedge (if you have not already done so) short positions in Malaysian ringgit, Singapore dollar, and Kuwaiti dinar.

Anyone long US T-bonds is courting disaster. We are unable to time the reversal, but we are confident that even if we are late, we will be able to capitalize on a bear market that will be, at the very least, as dramatic as the recent bull move, US stocks, too, will suffer from the double-whammy of rising rates and falling economic activity. Retain June '86 S&P 500 puts.

Chart 4

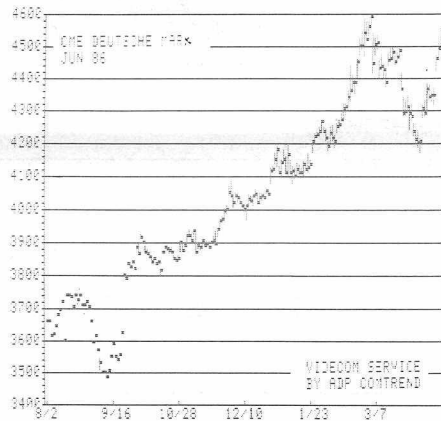


Chart 5

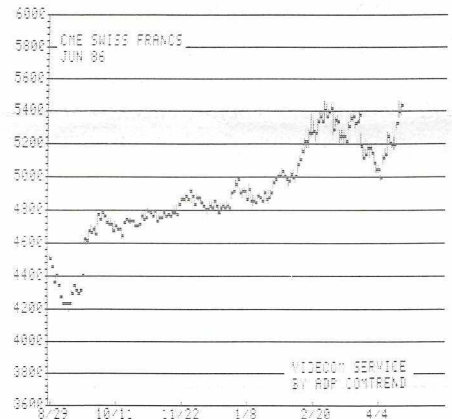


Chart 6

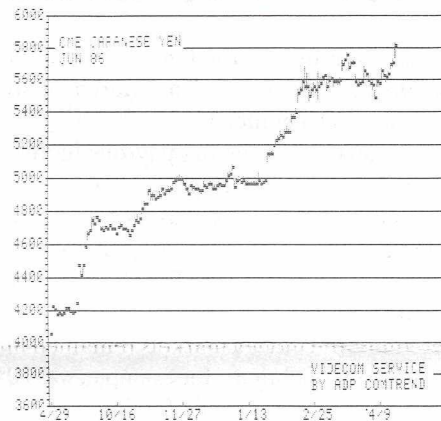


Chart 7

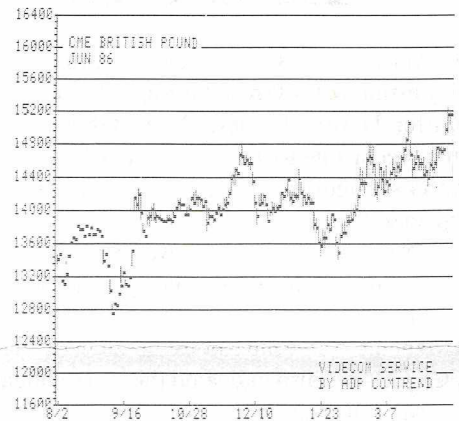


Chart 8

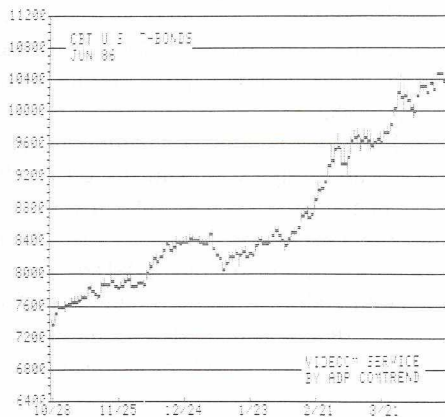
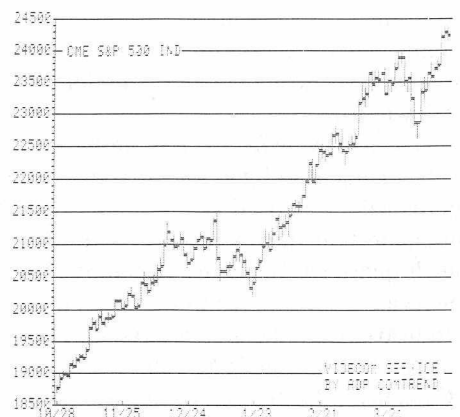


Chart 9

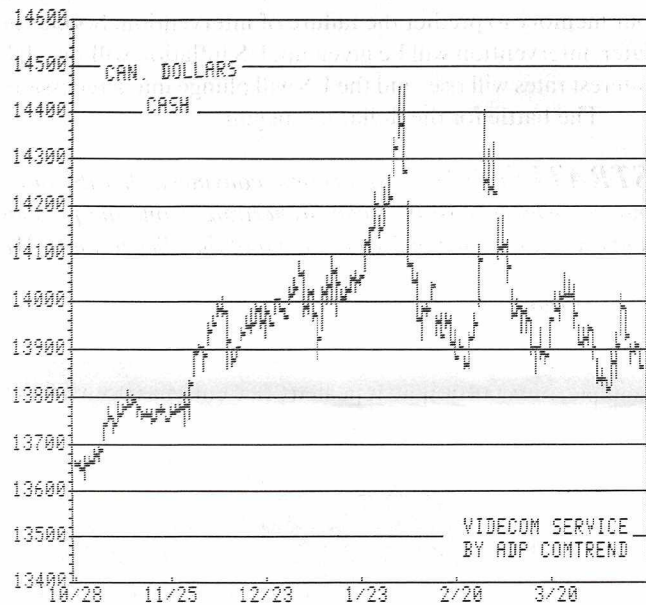


Canadian dollar

Despite the apparent strength of the Canadian dollar in March, the Bank of Canada was not able to accumulate US dollars, a sign that perhaps the Bank itself was mostly responsible for the better behavior of the Canadian unit. In the week ended April 9, the Government of Canada's cash balance declined by \$1.4 billion, an early indication perhaps that this time the Bank has indeed succeeded in purchasing a fistful of US dollars.

STRATEGY: *Rising bottoms against a relatively flat top at 72.20-72.25 (see Chart 10 where the Canadian unit is quoted in the Canadian fashion) might be signalling a temporary change in trend. We would await confirmation, such as closing on new high ground (72.00) before closing out new short positions.*

Chart 10



Economic Monitor: Green to Yellow

On April 17, the Commerce Department issued its preliminary estimate for Gross National Product (GNP) for the first quarter. During this period, real GNP grew at a 3.2% annual rate. According to *The Wall Street Journal's* initial report on the GNP figures, the "expansion was stronger than many expected."

We don't share this view. For us, the GNP figures were disappointing. Recall, we thought that the first half of 1986 would register very strong gains, with the first quarter real GNP at 4.5% and the second at 6.0%. In the January issue of "FC&CC," we also indicated the real segment of the US economy was suffering from some endemic problems that would drag the economy into a recession during the last quarter of 1986.

We now believe that the endemic problems are more severe than we had anticipated and that the credit-created boomlet will have less punch than we had originally thought. Moreover, we now feel more confident about a fourth quarter downturn.

The following factors have influenced our judgment:

- The first quarter figures are based on incomplete data. The figures will be revised as more data become available. We anticipate that they will be revised downward. Recall, the fourth quarter GNP figure began at 3.2%, and was revised downward to 2.4%, then to 1.2%, and finally to 0.7%.
- Industrial output continues to show weakness. It fell in February and then again in March.
- Capacity utilization shows persistent weakness. The capac-

ity utilization figures for January and February were 80.5% and 79.9%, respectively. The March figure of 79.4% is the lowest since December 1983.

- While service-producing payrolls increased by 271,000 in March, those in the goods-producing sector declined by 79,000. These net job increases were not enough to put much of a dent in the unemployment rate, which fell from 7.3% in February to 7.2% in March. Employment remains less than booming.
- Agriculture continues to flounder. The value of farm exports, October-February, for example, was 20% below the same period a year before, while food imports were 6% above the comparable period a year ago.
- The domestic auto industry appears to be headed for trouble. With retail sales falling below production for five of the last six months, the domestic industry's inventory-to-sales ratio stands at 3.1 months' supply, a figure that was last reached in August 1982.
- The domestic oil industry will increasingly act as a drag on the economy. Employment in the oil producing states has already begun to weaken. Capital spending will soon follow. To put this into perspective, 21% of capital spending in all manufacturing and 8.6% of capital spending by all industries was accounted for by the petroleum industry in 1984.

The economy is beginning to falter earlier than we had anticipated. In consequence, we are switching lights, from green to yellow.

Energy Futures

Despite the 12-day-old Norwegian North Sea strike, which has effectively removed 900,000 barrels per day (b/d) of oil from world supply, the market has barely been able to hold its own. It is still buoyed from time to time by the hope that Opec members will reach a new production ceiling, although the chances of that are remote. The Saudis have taken a back seat in the negotiations, seemingly content to establish their share in the overall output quota. They are distancing themselves further and further from their old swing-producer status — *the market's only hope for an effective cartel action.*

Exporters who have not tuned in to the netback arrangement have not been able to fulfill their selling targets. As an example, Mexico, despite repeated price cuts, has been unable to export more than 1.1 million b/d over the past weeks. The Soviets, on the other hand, have set up a "netback ministry," fully aware that refiners are not willing to take the 30-day price risk involved in buying unhedged crude. And so it goes. The selling window is very narrow; fortunately for the aggressive producers, not everyone has yet caught on to the netback technique.

The very large increase in NYMEX open interest, particularly in crude oil, may indicate that some at-risk refiners prefer to buy cheap and formulate their own hedge. Either way, as the game heats up, supplies will begin to mount, forcing the market down to new lows — in the low single digits. Moreover, the Norwegian strike has turned from being a bullish factor to a bearish one: Its settlement alone should drive prices down \$1-\$2/barrel.

Everyone loves to be a contrarian. It is the quintessence of astute and wise investing. But how hard is it to be a contrarian? Well, for one thing, one must be able to determine where the crowd "stands" or, in more technical jargon, what the consensus is. That is not always very easy to do. Since everyone wants to be a contrarian, everyone voices opinions based on the opposite of where he perceives the consensus lies. His opinions are, therefore, not genuine. Very often, traders are confronted with this silly paradox: the possibility that the consensus is bullish because the consensus thinks that the consensus is bearish.

To overcome this paradox, traders should consult members of the "consensus" who are not active market participants — and who, therefore, are not likely to outsmart themselves. Just such an opportunity presented itself this week with reference to oil. A *Wall Street Journal*/NBC News poll was conducted April 13 to April 15, based on telephone interviews with 2,239 adults from 400 locations across the country. Chances are that the probability-sample design used in selecting these individuals did not produce an overweighting of NYMEX futures traders. The first and most important question was: "How long do you think the current lower price of oil and gasoline will last?" A surprising 73% answered: Less than one year. A further 17% said up to five years. A very

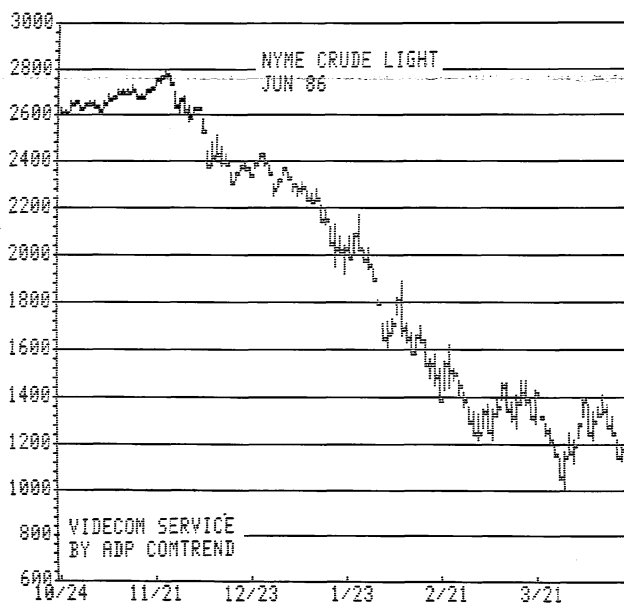
minuscule 2% answered five to 10 years; and another 2% thought it would be permanent. Just 6% of the respondents were honest enough to say "not sure."

Opec's extraordinary hold on people's imaginations can be gleaned from answers given to the second question: "How likely do you think it is that we will have another energy crisis within the next 10 years?" Fully 77% of the respondents answered *very likely and somewhat likely*. Only 15% thought that it was not very likely, and 5% said that it was not at all likely.

Conclusion: The "dumb" consensus is bullish on energy. (To be fair, the consensus may be right if the Administration caves in to the protectionists who clamor for a \$5-\$10/barrel import tax or to the revenue seekers who are prepared to levy a 50¢/gallon gasoline tax.) We are the contrarians. We are *still bearish*.

STRATEGY: *The \$10-\$14/barrel trading range is about to be broken on the downside. Remain firmly short, looking for a spike to the \$5/barrel area. Retain stops at \$14.50 basis May, close only (and do the same for June '86).*

Chart 11



The International Debt Quagmire

In the 1970s, petrodollars rolled into Western banks. This money rolled out, in large part, as loans to sovereign nations. In consequence, external debt for the 105 countries that report to the World Bank grew by 341% from 1974 through 1983.

The recycling of petrodollars proceeded rather smoothly until 1982. Since then, we have seen, with increasing frequency, loan rescheduling and threats of loan default. We now face what the majority of professionals believe to be an international debt crisis. They base their conclusion on the fact that conventional measures of external debt costs, in relation to nations' ability to pay, have increased (Chart 12).

Employing the same conventional measures, another group of professionals has concluded that the current situation should not be cause for alarm. To support their case, they argue that total debt to exports in 1913 was about 225% for India, Japan, and China, 480% for Australia, 520% for Latin America, and 860% for Canada. The comparable current percentage for all debtors is about 145% (Chart 12). In addition, they showed that in the period 1900 through 1914, the ratio of debt service to exports was 39% for Argentina, 22% for Australia, and 24% for Canada. The comparable current figure for all debtors is about 19% (Chart 12).

Even though they arrive at opposite conclusions, we disagree with both the "debt crisis" and the "pseudo debt crisis" advocates. Their views are based on the notion that developing countries' current, external, public debt is essentially the same as private domestic debt. In consequence, the conventional wisdom assumes that international public debtors will service their debt to the limit of their ability to pay.

To understand this line of thinking, consider the incentives that work with a private loan. A private debtor has a great incentive to repay a loan to the limit of his abilities. After all, his assets are exposed to creditors. If a debtor defaults on a loan, he forfeits his loan collateral and/or his assets are attached, impounded, or turned over to creditors by a bankruptcy court. In short, debt obligations are enforceable by law. That's why creditors evaluate private debtors' collateral, assets, and ability to pay before granting a loan.

The situation is quite different for the public and publicly guaranteed debt that accounts for about 85% of the total external debt of the 105 countries that report to the World Bank. For the public debt, governments do not put up collateral for the right to receive a loan, and in practice, there is no access to bankruptcy courts. This means that the loans are legally unenforceable. For the loans made to private entities, but guaranteed by governments, exchange controls can effectively make these obligations unenforceable, also. Since world opinion tends to favor debtors rather than private banks, political pressure on debtors is not an effective substitute for the lack of legal remedies designed to encourage debt repayment to the limit of debtors' ability to pay. Indeed, about the only deterrent to default is the debtors' concern about the

future availability of credit. In this context, the conventional measures of ability to repay debt are largely irrelevant.

With unenforceable claims, the important item to evaluate is "net transfers." These transfers are equal to disbursements from creditors minus debt service payments (Chart 13). Net transfers represent the burden of international debt. As long as disbursements exceed debt service charges, there are positive net transfers to creditors and their external debt is not a burden. As indicated in Chart 13, the Latin America — Caribbean region didn't face an "intolerable debt burden" until 1983, when net transfers became negative.

According to our analysis, it is the prospect of negative transfers that has triggered what is, indeed, an international debt crisis. What is central to our view is the fact that "public" debtors can't be forced to accept negative transfers. In consequence, each time negative transfers are in the offing, there will be a debt crisis, with its associated calls for debt rescheduling and outright debt default. Therefore, we shouldn't be surprised by the current debt crisis, which is centered in Latin America (Chart 13).

The explosion of public debt and unenforceable claims have dramatically altered the international debt game. Public borrowers are constrained neither by the cost of future debt service nor their ability to pay. Rather, they are constrained by the willingness of creditors to lend, so that debtors can borrow funds to service loans. Hence, with the surge in public debt, the international debt game is much less stable than it was in the past, when most external debt was private and not guaranteed by governments. The new game is bound to lead to more frequent crises, since the only way for debt crises to be avoided is for debtors to always face the prospect of positive net transfers. This can occur only if all lenders hold a stable portion of their portfolios in unenforceable claims and if they always act as net lenders. These being highly unlikely events, the prospect of periodic negative net transfers and debt crises looms large.

There are two proposed exit routes from this international debt quagmire. The first is a circular route. It has been put forward by the US Treasury Secretary James A. Baker III. The so-called Baker Plan calls for both private banks and multinational lending institutions to extend more credit. If followed, this plan would turn the net transfers from negative to positive. Hence, the debt crisis would temporarily disappear. In addition, some of the wealth of bank shareholders and taxpayers would permanently disappear.

The second exit route — which was proposed in June 1985 by Preston Martin, Vice-Chairman of the Federal Reserve Board — offers a permanent escape from the problems created by unenforceable claims. Under this proposal, outstanding external debt claims would be converted to equity claims. These debt-for-equity swaps would put a privatization process in motion and eliminate unenforceable claims. They

would also open up capital markets in the developing countries for private external capital that is attracted to projects where the real rate of return exceeds the cost of capital and where claims are enforceable.

Although policymakers have a road map marked with two clear alternatives, they appear to be having trouble choosing a course. In consequence, we continue to sink into an international debt quagmire. Until either a temporary (the Baker Plan) or a permanent (the Martin Plan) solution is chosen, the international debt game will be played in an increasingly hostile environment.

STRATEGY: Long term investors should continue to accumulate gold and platinum. (See the following comments on precious metals.)

— S.H. and A.F.

Chart 12

PRINCIPAL RATIOS FOR EXTERNAL DEBT COST AND SERVICING CAPACITY

	TOTAL		MAJOR BORROWERS	
	1974 %	1983%	1974%	1983%
Debt Outstanding and Disbursed to Exports of Goods and Services	72.2	144.6	96.8	167.0
Debt Outstanding and Disbursed to Gross National Product	13.8	29.9	13.3	29.3
Total Debt Service to Exports of Goods and Services	8.5	19.1	11.2	22.1
Total Debt Service to Gross National Product	1.6	3.9	1.5	3.9
Interest Payments to Exports of Goods and Services	2.9	10.0	3.9	12.9
Interest Payments to Gross National Product	0.6	2.1	0.5	2.3
International Reserves to Debt Outstanding and Disbursed	64.3	23.8	43.7	18.2
International Reserves to Imports of Goods and Services	39.3	26.4*	33.5	20.2**

* 1981
** 1982

Data Source: 1984-85 World Debt Tables, The World Bank, Washington, D.C., 1985.

Note: External debt is public debt plus publicly guaranteed debt.

Chart 13

PUBLIC AND PUBLICLY GUARANTEED DEBT: LATIN AMERICA AND THE CARIBBEAN (U.S. \$ Millions)

	1976	1978	1979	1980	1981	1982	1983	1984
Gross National Product	399,241	508,397	635,276	787,350	852,527	710,669	619,018	615,829
Disbursements	17,061	30,633	34,570	30,553	35,907	35,131	27,480	23,688
Interest Payments	3,367	6,107	9,079	12,825	15,304	18,589	18,520	21,857
Principal Payments	4,714	12,313	16,141	14,191	14,527	13,505	9,705	9,548
Total Debt Service	8,081	18,420	25,220	27,016	29,831	32,094	28,225	31,405
Net Transfers	8,980	12,213	9,350	3,537	6,076	3,037	- 745	- 7,717

Data Source: 1984-85 World Debt Tables, The World Bank, Washington, D.C., 1985
1985-86 World Debt Tables, The World Bank, Washington, D.C., 1986

Note: All debt is external debt.

Precious Metals

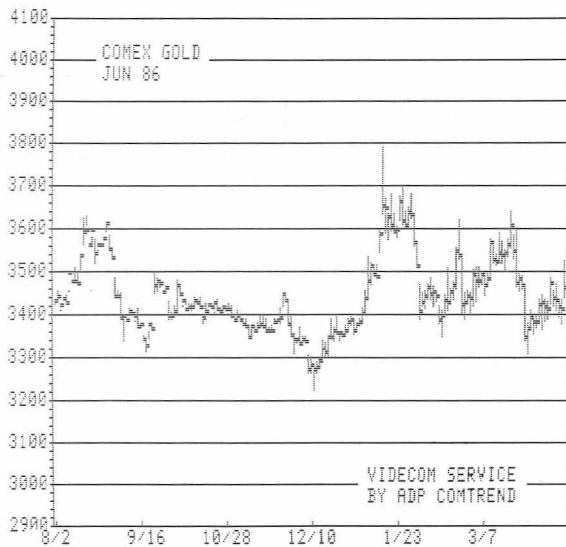
Gold

Gold is temporarily caught between the deflationary implications of falling oil prices and the inflationary consequences of a falling dollar.

In the end, there is no contest: Gold will follow the bullish consequences of the present massive credit inflation.

STRATEGY: Sharp \$15-\$20/oz. dips are outstanding buying opportunities for patient long-term investors. Short-term trades should now add on crossing 371, basis June '86.

Chart 14

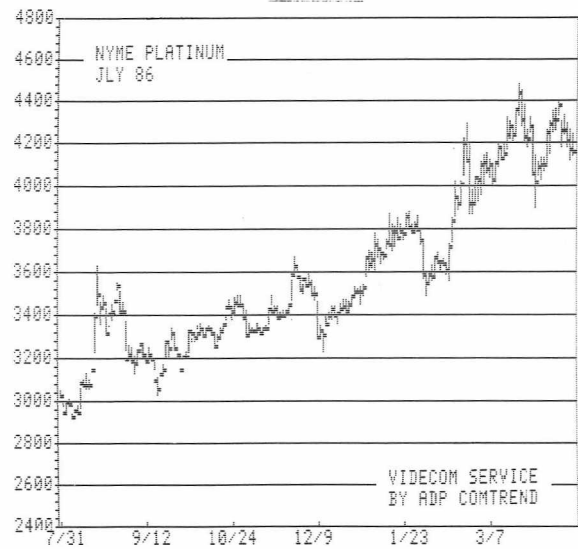


Platinum

The most recent four-week consolidation between 445 and 390, basis July '86, has strengthened the market's technical position considerably, having forced the liquidation of nearly 5,000 open contracts, presumably overanxious bulls.

STRATEGY: Remain long. Retain stops at 385, basis July '86, close only.

Chart 15

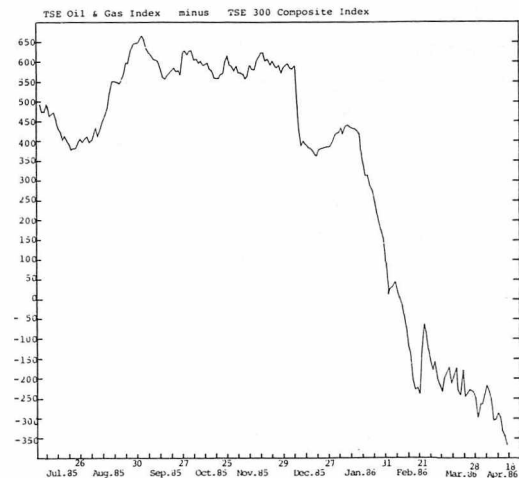


Spread Corner

Our long TSE 300 Index/short TSE Oil & Gas Index future continues to show outstanding gains. In an eight-month period, it has gained over 1,000 points, the equivalent of \$10,000 per spread.

STRATEGY: Retain balance of spread after having liquidated two thirds of position on a scale down from plus-200 points. As we said in our Feb. 23 issue, we expect the Oil & Gas Index to trade 500 points below the TSE 300 (see Chart 16).

Chart 16

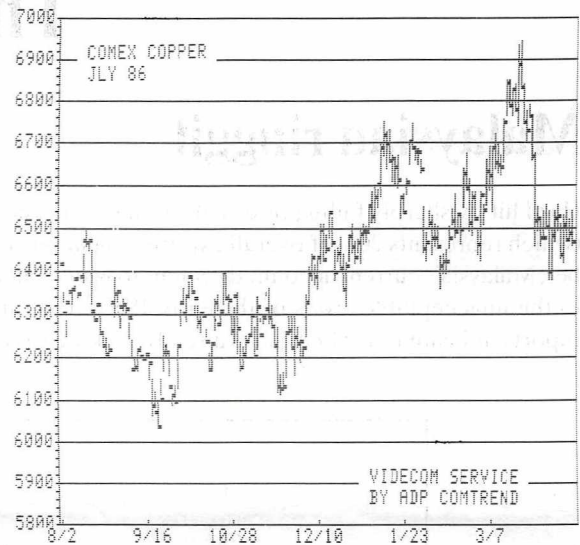


Copper

Chart 17

Fifteen consecutive combined (Comex and LME) warehouse drawdowns have left totals at new post-1982 recession lows and a full 279,000 tons lower than at mid-1984. The severe shakeout from 69.50 to 63.80, basis July '86, was justified in view of the excessive speculative open interest built up in late March and early April.

STRATEGY: At this time, the market seems poised for another attempt at the early April highs. Long positions should be reinstated (if stopped at exactly 64.00, basis close) on closes above 65.50, basis July '86.

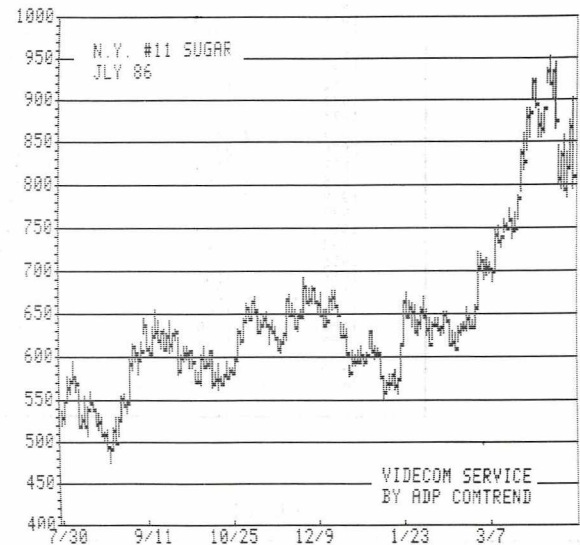


Sugar

Chart 18

Highly erratic, particularly around the closing call where large traders are fond of "gunning" stops. Here, too, the excessive build-up in open interest is being whittled down within the confines of a massive intermediate shakeout.

STRATEGY: As we said last month, large setbacks should be utilized for the purpose of building up a meaningful long position. Place stops on long positions at 7.40, basis July '86, close only.

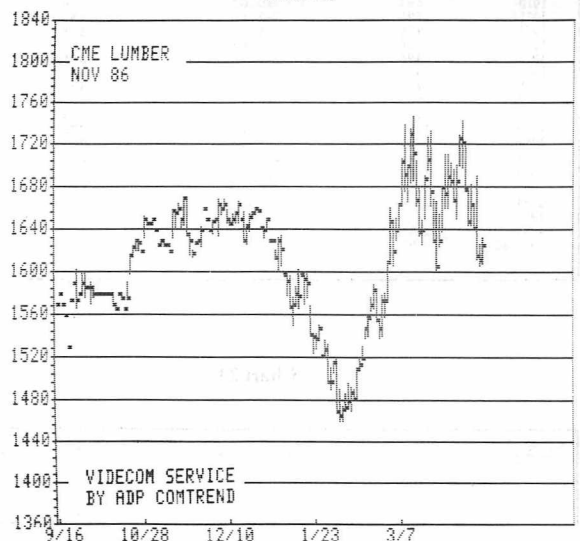


Lumber

Chart 19

Housing starts fell last month 2.4% to a seasonally adjusted rate of 1,949,000 units, still a very good pace.

STRATEGY: The May-November spread has narrowed to \$14 from \$23 last month. We still like the November '86 long position and advise retaining the 160 stop, close only.



The Exotics

Malaysian ringgit

Hard hit by sharply falling prices of its main exports, tin, oil (which represents 20% of overall exports), palm oil, and rubber, Malaysia's current account threatens to widen once again to the unacceptable levels of the early 1980s. Unconfirmed reports indicate that Malaysia is already seeking to resched-

ule its US \$15.4 billion external debt. The ringgit has been depreciating in recent weeks, hitting an all time low of 2.70. This devaluation accentuates and accelerates the process that began in 1978 and confirms a steady real depreciation.

STRATEGY: We believe that the worst is far from over. Remain short vis à vis US dollar and DM.

Chart 20

YEAR	Malaysian ringgit per U.S. DOLLAR (PERIOD END)	BASKET			
		U.S. 1970 =1.00	U.S. 1978 =1.00	U.S. 24% SINGAPORE 30% Germany 6%	JAPAN 40%
1967	3.0563	0.8647	1.1511	0.9046	1.0316
1968	3.0650	0.9052	1.2050	0.9339	1.0650
1969	3.0750	0.9611	1.2794	0.9762	1.1132
1970	3.0775	1.0000	1.3312	1.0000	1.1404
1971	2.8860	0.9622	1.2810	0.9798	1.1173
1972	2.8170	0.9406	1.2521	0.9655	1.1011
1973	2.4520	0.7863	1.0468	0.8857	1.0100
1974	2.3128	0.7007	0.9328	0.8461	0.9648
1975	2.5883	0.8200	1.0916	0.9333	1.0643
1976	2.5350	0.8282	1.1025	0.9283	1.0585
1977	2.3655	0.7859	1.0462	0.8930	1.0183
1978	2.2060	0.7512	1.0000	0.8762	1.0000
1979	2.1870	0.8008	1.0661	0.9115	1.0395
1980	2.2224	0.8647	1.1512	0.9643	1.0997
1981	2.2423	0.8780	1.1689	0.9650	1.1004
1982	2.3213	0.9110	1.2128	0.9826	1.1205
1983	2.3383	0.9136	1.2162	0.9686	1.1045
1984	2.4250	0.9511	1.2662	0.9867	1.1252
1985 (1Q)	2.5215	1.0110	1.3459	1.0396	1.1855
1985 (2Q)	2.4905	1.0078	1.3416	1.0150	1.1575
1985 (3Q)	2.4430	0.9859	1.3125	1.0278	1.1721
1985 (4Q)	2.4265	0.9953	1.3250	1.0421	1.1873

Above 1.00 = undervalued
Below 1.00 = overvalued

Chart 21

Year	Foreign Assets (Min US\$)	CURRENT ACCOUNT As % of GNP	CUMULATIVE 12 QTR. Current Account (Min 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	-10.54	-1,842
1982	3296	-14.37	-6,372
1983	3052	-12.58	-9,545
1984	2262	-5.25	-8,656
1985	-	-	-5,953
1985 (1Q)	2187	-	-
1985 (2Q)	2703	-	-
1983 (3Q)	3366	-	-

Chart 23

RATES	SPOT	1 MONTH	3 MONTH	6 MONTH	12 MONTH
	2.5370-	2.5590-	2.5820-	2.5970-	2.6320-
	2.5420	2.5710	2.5930	2.6080	2.6020

Chart 22

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

Reserves * + Previous 12-months current Account *** = 4779
(Reserves + 12-months C/A)/ M1 ** = 4779/5312 = 89.9%

(Reserves + 12-months C/A)/ Broad Money *** = 4779/19466 = 24.5%

*As at December 1985 **September 1985 *** 1985 (1) - 1985(4)

Figures in millions of U.S. Dollars

	M1 (Converted to U.S. Dollars)	Broad Money (Converted to U.S. Dollars)
1975	1680	3864
1985 (Sept)	5312	19466
Δ Increase (decrease)	216.2	403.7
Corresponding Δ increase in the United States	104.1	136.8

(a) 1984 Imports as percentage of GNP 44.23%
(b) 1975-1984 Imports as percentage of GNP 44.17%
1984/(1975-1984 average) = (a)/(b) = 100.13%

Source: IFS

Saudi Arabian riyal

The Saudi government's decision to postpone its much awaited March budget was due to a number of factors:

1. A desire on the part of the Kingdom not to disclose its oil production targets, an important strategic consideration during the upcoming Opec negotiations.
2. A genuine lack of knowledge of where oil production and prices would be in coming months.
3. A political decision to obscure the necessary budget adjustment, which by necessity has to be rather dramatic.

This act of omission does provide us with some clues to the Kingdom's future behavior. In the first place, the Saudis are determined to reemphasize their September 1985 decision to the effect that it will not give up further market share to either Opec and/or non-Opec interests. This position has become abundantly clear in the most recent Opec sessions. Secondly, the Kingdom probably will cut expenditures in a massive way to aid the necessary adjustment and announce it

five months hence as a *fait accompli*. Finally, the Kingdom may want to give itself some leeway in the formulation of foreign exchange policy as a tool to increase fiscal revenues, inhibit nonessential imports, and possibly commence a policy of export diversification.

STRATEGY: *On present trends, the Kingdom probably will suffer a shortfall of approximately US\$ 2 billion per month, which should exhaust liquid reserves in a period of less than two years. The Kingdom has already availed itself of foreign financing by way of a deferral or moratorium on at least US\$ 8 billion in payments to foreign contractors. Since most capital projects have already been completed, it is not probable that this avenue can be used again on the same scale.*

Much more austerity coupled with one or a number of mini/maxi devaluations is still in the cards. The risks to this forecast lies in the possibility of a major dollar collapse, which probably will only slow the necessary foreign exchange adjustment.

Maintain previously established short positions.

Chart 24

YEAR	SAUDI ARABIAN RYALS PER U.S. DOLLAR (PERIOD END)	U.S.		BASKET	
		1970 =1.00	1980 =1.00	1970 =1.00	1980 =1.00
1967	4.50	0.9057	1.8271	0.9183	1.5009
1968	4.50	0.9283	1.8726	0.9356	1.5291
1969	4.50	0.9448	1.9059	0.9487	1.5505
1970	4.50	1.0000	2.0172	1.0000	1.6344
1971	4.15	0.9206	1.8571	0.9595	1.5682
1972	4.15	0.9111	1.8378	0.9445	1.5457
1973	3.55	0.7097	1.4315	0.7684	1.2559
1974	3.55	0.6486	1.3085	0.7308	1.1944
1975	3.53	0.5239	1.0568	0.5745	0.9390
1976	3.53	0.4209	0.8491	0.4534	0.7411
1977	3.50	0.3998	0.8065	0.4583	0.7491
1978	3.31	0.4133	0.8338	0.4931	0.8060
1979	3.36	0.4585	0.9249	0.5606	0.9162
1980	3.32	0.4957	1.0000	0.6119	1.0000
1981	3.41	0.5473	1.1041	0.6173	1.0088
1982	3.43	0.5777	1.1655	0.6206	1.0143
1983	3.49	0.6011	1.2126	0.6197	1.0128
1984	3.57	0.6481	1.3074	0.6242	1.0201
1985(1Q)	3.60	0.6796	1.3710	0.6662	1.0889
1985(2Q)	3.64	0.7030	1.4182	0.6961	1.1377
1985(3Q)	3.64	0.7173	1.4469	0.7375	1.2054
1985(4Q)	3.64	0.7248	1.4620	0.7564	1.2362

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	957	2.30		- 107	
1971	1,759	25.30		957	
1972	3,154	42.00		3,129	
1973	5,081	31.00		5,581	
1974	22,236	78.80		27,634	
1975	39,198	40.40		39,930	
1976	52,254	30.60		51,770	
1977	61,400	20.30		40,736	
1978	61,668	-3.38		24,139	
1979	64,838	15.20		20,946	
1980	94,384	35.27		50,359	
1981	141,770	24.35		90,924	
1982	156,986	- 0.07		78,710	
1983	148,517	-14.71		-21,013	
1984	134,486	-23.63		-41,376	
1985 (1)	130,030	-		-	
1985 (2)	126,296	-		-	

Chart 27

RATES	SPOT	1 MONTH	3 MONTH	6 MONTH	12 MONTH
	3.6535-	3.6535-	3.6625-	3.6735-	3.6895
	3.6500	3.6550	3.6660	3.6790	3.7000

Chart 26

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

Reserves * + Previous 12-months current Account *** = 1816
(Reserves + 12-months C/A)/ M1 ** = 1816/22780 = 7.97%

(Reserves + 12-months C/A)/ Broad Money ** = 1816/40106 = 4.53

*As at January 1986 ** August 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)
1975	4016	5036
1985 (Aug.)	22780	40106
% Increase (decrease)	467.2%	696.3%
Corresponding % increase in the United States	101.7%	135.6%

(a) 1984 Imports as percentage of GNP 28.07%
(b) 1975-1984 Imports as percentage of GNP 24.86%
1984/(1975-1984 average) = (a)/(b) = 112.91%

Source: IFS

Forex Rates & Update

<i>Currency</i>	<i>Spot</i>	<i>3-Month</i>	<i>12-Month</i>	<i>Comments vis à vis US\$</i>	<i>Comments vis à vis DM (Spot DM 2.2100)</i>
Australian dollar	71.73-71.83	70.14-17.28	67.08-67.28	Remain long	Remain long
*Belgian franc	45.40-45.50	45.53-45.67	45.60-45.80	Buy	Remain long
*Danish krone	8.20-8.21	8.21-8.23	8.23-8.29	Buy	Neutral
*Dutch guilder	2.5040-2.5070	2.4952-2.4987	2.4690-2.4740	Buy	Remain long
Greek drachma	140.00-141.00	145.00-148.00	159.00-170.00	Remain short	Remain short
*Italian lira	1523-1526	1525-1528	1531-1535	Buy	Neutral
Kuwaiti dinar	.28760-.28790	.28790-.28890	.28860-.29134	Neutral	Remain short
*Mexican peso	503-508	Not available	Not available	Liquidate	Liquidate
*New Zealand dollar	.5530-.5550	.5345-.5380	.4900-.5020	Buy	Neutral
*Norwegian krone	7.0450-7.0550	7.1665-7.1815	7.5175-7.5400	Buy	Neutral
Portugese escudo	147.50-148.50	155.50-165.50	Not available	Neutral	Neutral
Singapore dollar	2.1730-2.1760	2.1655-2.1695	2.1330-2.1560	Remain short	Remain short
Spanish peseta	141.00-141.30	142.80-143.40	147.50-148.55	Neutral	Neutral
*Swedish krona	7.1300-7.1350	7.1950-7.2040	7.3150-7.3325	Buy	Neutral
Venezuelan bolivar	19.30-19.40	19.60-19.85	20.60-21.40	Neutral	Neutral

Explanatory Notes

*Indicates change in recommendation from last issue

Currency expected to firm against both currencies.

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

Currency expected to weaken against both major currencies.

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

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

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

Buy	Buy
Buy	Sell
Sell	Sell
Sell	Buy

Cover

Liquidate

Hotline Update

Tuesday, March 25: The *Friedberg's Commodity & Currency Comments* has been mailed. There are no new recommendations.

Thursday, March 27: Friday is a holiday. All markets are closed. There are no new recommendations.

Tuesday, April 1: No changes or new recommendations.

Friday, April 4: No changes or new recommendations.

Tuesday, April 8: No changes or new recommendations.

Friday, April 11: In recent days, the Canadian dollar strengthened to the top of the range suggested in our last issue of the market letter, namely the 7225 level. Since we suggested short covering on a spot close above 7225 and since the spot traded as high as 7240 in late trading last Tuesday and Wednesday, we assume that you were

stopped out. We do not consider that slight penetration an indication that the market has reversed itself and advise you to reinstate immediately short positions in the Canadian dollar, risking a spot close above 7245.

Tuesday, April 15: There is no change or new recommendations.

Flash Update, Wednesday, April 16, 9:30 a.m.: We advise hedging Kuwaiti dinar short positions by purchasing DM in the amount of 1/3 the dollar value of the dinar contract.

Friday, April 18: On Wednesday at 9:30 a.m. a flash update advised clients who are short the Kuwaiti dinar to hedge their positions by purchasing DM in the amount of 1/3 the dollar value of the dinar contract. Otherwise no changes or new recommendations.

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