# FRIEDBERG'S
COMMODITY & CURRENCY COMMENTS

Friedberg Commodity Management Inc. Volume 10, No. 3 March 19, 1989

# Inflation jitters: real or imagined?

It is in the nature of economic matters that 1) significant events take place unexpectedly, catching most participants by surprise and 2) the overwhelming majority of observers — having been wedded to the status quo — will fight the meaning of this unexpected change and try to minimize its implications.

A good example is the recent acceleration of inflation. Granted that most commodity indexes have been relatively flat (except, perhaps, for the CRB spot index — see Chart 1), labor market strains, tight capacity utilization, and the inevitable inflationary effects of a massive dollar devaluation had to make themselves felt, sooner or later.

The complacency of the past three years was broken in January when the PPI (Producer Price Index) rose 1%. It was the largest monthly advance since April 1981 and *two and a half times* the expected rise. The "shock" was resisted by the street, which expected a February figure of 0.5%. Instead, the PPI for February advanced again 1% (a 12.7% annual rate of inflation), twice the expected rise.

Of course, the status quo believers (who hope the Fed won't take notice) blamed fresh vegetables (up 35.3%), led by an amazing 158% surge in the price of tomatoes. But even excluding the notoriously volatile food and energy components, prices rose a hefty 0.6%, indicating an annual inflation of more than 7%. Ominously, consumer goods led by prescription drugs, footwear, periodicals, sporting goods, and books, rose an astounding 1.2%.

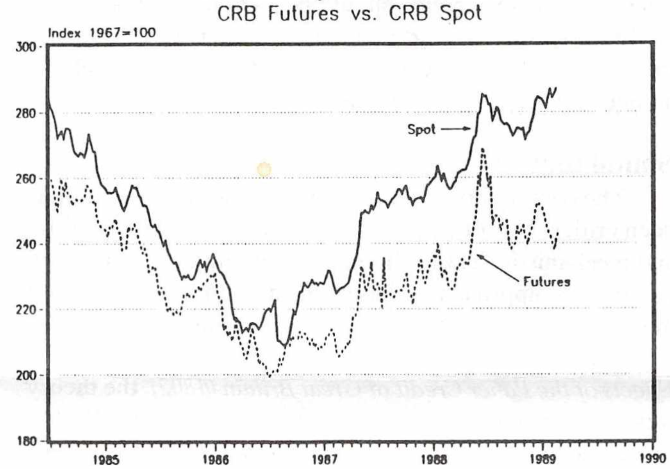
This "unexpected" surge of inflation is, of course, the result of a boom in domestic demand. Until very recently, this boom was reflected in a widening current account deficit, a point that we've made repeatedly over the past number of years. The US dollar devaluation, which began in 1985, had the effect of halting the deterioration in the balance of trade, *shifting the inflationary adjustment to the domestic sector via higher inflation.*

That was the inevitable choice: a strong dollar and a widening current account deficit or a weak dollar, a containment of the trade hemorrhage (and, even, an improvement relative to GNP) but accelerating inflation rate. Either form of adjustment to excessive domestic demand (brought about by years of easy money and credit) leads to less consumption and more savings, including the strong possibility of an eventual recession. (For a more detailed discussion of the adjustment process, see for example *FC&CC* Sept. 87, "Can the dollar do the job alone?")

Rising inflation pressures will force the Fed's hand (see next article). Annualizing the PPI increase of the last three months yields a 10.4% inflation rate, turning long-term and short-term US interest rates *negative in real terms.* Clearly, negative interest rates are no way to cool off an overheated domestic economy.

**Chart 1**

**Commodity Price Indexes**
CRB Futures vs. CRB Spot




SOURCE: Commodity Research Bureau.

## In this issue

Old wine in a new bottle: commodity prices and monetary policy. Potentially profitable S&P puts. We can't justify a forex position. Silver shines brighter than gold. We're long platinum and wheat is trying our patience. Also in this issue: A special pull-out feature — LDC DEBT COMMENTS. Contributions by Albert D. Friedberg, Dr. Steve H. Hanke, Daniel A. Gordon, Michael D. Hart, and Lorenzo DiIorio.

***THE ECONOMY***

# Old wine in a new bottle

During the past three years, interest in using commodity prices as a guide for monetary policy has been growing. This stems, in large part, from the fact that advocates of this approach include heavyweights at the Federal Reserve Board, namely Vice Chairman Johnson, Governor Angell, and Governor Heller. In consequence, it is important for us to understand the underlying analytics of this approach to monetary policy, so that we can interpret Fed policy and the future course of the economy.

The naive rationale for stabilizing commodity prices has recently been expressed in three propositions. First, inflation is a monetary phenomenon. Second, commodity prices respond quickly to changes in monetary policy (or changes in expectations about policy), because these prices are determined in auction markets. Third, changes in commodity prices are good predictors of changes in the future aggregate price level.

If we accept these three propositions and if we wish to eliminate inflation, then commodity prices should serve as a good target for monetary policy. In this case, the operating rules for monetary policy should be as follows: When commodity prices are rising, monetary policy is too loose and should be tightened; when commodity prices are falling, monetary policy is too tight and should be loosened.

## Sound theory

The commodity-based approach to monetary policy has been criticized for being, among other things, too simplistic and mechanistic. These charges are unfounded because the commodity approach is based on a sound, sophisticated monetary theory. Although it was largely anticipated by Mr. Henry Thornton in his classic *An Inquiry into the Nature and Effects of the Paper Credit of Great Britain (1802)*, the theory was fully developed by the great Swedish economist, Professor Knut Wicksell, in his *Interest and Prices: A Study of the Causes Regulating the Value of Money*, which was first published in German in 1898.

That contemporary critics of the commodity-based monetary policy exist shouldn't be too surprising because many are unaware that it is an old vintage wine in a new bottle. If this weren't enough, others — who are aware of the policy's strong analytical underpinnings — simply don't understand them. On this last point, we should mention that this is nothing new.

For example, in 1915, when Europe was on the threshold of an inflationary era, Professor Wicksell toured the Continent's capitals and proposed raising bank discount rates. However, no one took him seriously, and he complained bitterly that in the entire world, only the "Raven of Zurich" (Dr. Felix Somary) and Professor Ladislaus von Bortkiewicz of Berlin understood his theory.

## A tale of two rates

The central element in Wicksell's analysis, which has also been employed by members of the Austrian School of Economics, is the sharp distinction between two interest rates: (1) the money or market rate; and (2) the natural or equilibrium rate. The former is the rate charged on loans in the money market. The latter is the internal rate of return on newly created capital, or stated differently, it is the rate that equates aggregate demand for real output with available supply.

According to Wicksell, as long as the market rate is equal to the natural rate, aggregate demand will equal supply and there will be price stability. If the market and natural rates diverge, there will either be inflation or disinflation. For example, if the market rate is less than the natural rate, aggregate demand will exceed supply, and inflation will occur. Conversely, if the market rate exceeds the natural rate, aggregate demand will fall short of supply, and prices will fall.

To stabilize prices, it follows that a central bank should pursue a monetary policy that attempts to keep the money rate equal to the natural rate. There is, however, one problem with this Wicksellian policy rule: It requires knowledge of the natural rate of interest. This creates a practical problem precisely because the natural rate is a non-observable variable that is incapable of objective measurement.

This practical problem didn't deter Wicksell, however. Using the logic of his theory, Wicksell noted that even though we can't observe the natural rate, we can observe commodity prices, make a determination about the relationship between the market and natural rate, and adjust monetary policy so as to stabilize prices. For example, when commodity prices are rising, the market rate is less than the natural rate, and the central bank should increase the market rate. Conversely, when commodity prices are falling, the market rate exceeds the natural rate, and the central bank should reduce the market rate.

## Modern reformulation

While adopting Professor Wicksell's theory, the modern Wicksellians at the Federal Reserve have slightly reformulated the Professor's operating rules. Specifically, the moderns argue, like Wicksell, that commodity prices, which are determined in auction markets, contain inflation expectations. They can be used to determine whether the money rate is equal to or diverges from the natural interest rate. Hence, commodity prices can be used as a guide to monetary policy.

In addition, the moderns argue that two additional prices should be used as policy guides: those determined in the financial and foreign exchange markets. These prices, too, are determined in auction markets and contain valuable information about inflation expectations. In consequence, they, along with commodity prices, can be used to determine the relationship between the money rate and natural rate.

The modern Wicksellian formulation runs along the following lines. The money rate is below the natural rate and monetary policy is loose, when commodity prices are rising, yields on long bonds are rising, and the dollar's value is falling. Conversely, the money rate is above the natural rate and monetary policy is tight, when commodity prices are falling, yields on long bond are falling, and the dollar's value is rising.

We should mention that the interpretation of the dollar's value is somewhat more complicated than the other prices because the monetary policies of other nations must be included in the analysis. For example, if the Federal Reserve were loose, but the other central banks were even looser, it is possible to observe rising commodity prices, increasing long-bond yields and an appreciating dollar (rather than a depreciating dollar).

### Implications

**1.** During 1987, commodity prices increased by 35% (measured by *The Economist's* dollar index for all items), long-bond yields began to move up, and the dollar's value continued to fall. Hence, the money rate was less than the natural rate.

**2.** It shouldn't be too surprising that the modern Wicksellians at the Federal Reserve begin to tighten policy by increasing the money rate (federal funds) in 1988.

**3.** This squeeze has had an impact. Since June 1988, commodity prices have fallen by 6% (gold has fallen by about 15%). (However, there is some evidence to suggest that this trend might not continue and that commodity prices might have bottomed out.) Until last Friday, long-bond yields had been very stable. Also, since June 1988, the dollar has drifted upward.

**4.** As we pointed out last month, this squeeze is the stuff that soft landings (economic slow downs) are made from. We continue to hold to this position.

**5.** We also see the possibility for a hard landing. This could develop if the soft landing is a bit too soft and the dollar comes under pressure. In this case, the Federal Reserve might be forced to defend the dollar with higher short rates. This defense would be most likely if, at the time the dollar comes under pressure, it is determined that other central banks aren't operating with excessively tight monetary policies.

Also, if commodity prices and/or long-bond yields should begin to rise, we would anticipate a further application of a Wicksellian squeeze and the increased likelihood of a hard landing.

**– Dr. Steve H. Hanke**

***STRATEGY:*** *Higher interest rates are inevitable. If our assessment of the adjustment is correct, we may require* much *higher interest rates.*

## EURODOLLAR FUTURES

# Add to profitable puts

***STRATEGY:*** *We are setting our initial target at around 13% for LIBOR. Last month we recommended purchasing June and/or September '89 puts, 89.75 striking. Maintain position (which is already showing hefty gains) and add by purchasing September puts, 88.75 striking.*

## S&P FUTURES

# Up against the 300 barrier

As the stock market once again approached the February highs (and the two-thirds retracement level; see last month's issue), the PPI bombshell exploded, and prices were set back, rather violently (see Chart 2).

Increasingly, the 300 level on the S&P 500 is becoming a critical barrier. For one thing, it does represent exactly a two-thirds retracement of the August-October 1987 decline. For another, it is a "round" number, and these barriers tend to attract widespread attention.

Finally, we must admit that the market has climbed a wall of worry (usually associated with bull markets). If the present interest rate scenario — rising rates and an inverted yield curve — does not spook this market and it persists in breaking through this all-important barrier, then an important upswing is in the cards. A very big "IF," indeed.

***STRATEGY:*** *Remain short, with stops at 306.50, good anytime. Also, remain long June S&P 500 puts, with a 295 strike, as recommended last month.*

## CURRENCIES

# Trading the range

Interest-rate differentials are once again becoming the predominant influence in currency movements. This is the logical outcome of a semi-fixed exchange regime (as, for instance, the EMS). The market is perceived to be moving in a band; high (and/or rising) inflation rates force it to the top of the band, and low (and/or falling) interest rates force it to the bottom.

A good example has been the DM/US$ rate of the past three weeks. In early March, three-month Euro-DM rates peaked at 7%, while three-month Eurodollar rates traded at 10 5/16%. The failure of the Bundesbank to confirm the rise in rates sent Euro-DM rates down to 6 3/8%. At the same time, Eurodollar interest rates dipped to 10 1/8% and later rose to 10 9/16%, widening the spread to 4 3/16% from 3 5/16%.

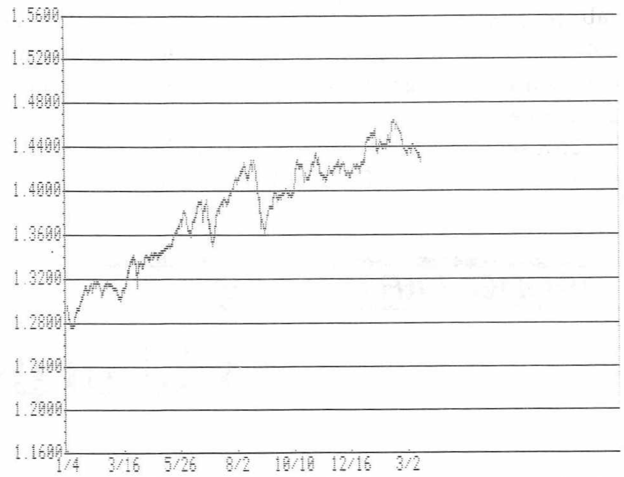
The rise in the differential, moved the DM/US$ rate from 1.81 to 1.8750 in exactly the same period. If true to form, the Bundesbank is likely to nudge interest rates higher and narrow the gap once more, so as to put an effective lid at 1.90 DM.

The even-lower Japanese interest rates are beginning to exert a bearish influence on the forex value of the yen, which in recent weeks has fallen rather significantly against the US dollar (see Chart 4) and against the DM (see Chart 5).

***STRATEGY:*** *For the moment, the trading focus (and, of course, volatility) has shifted to the interest rate market. While medium to long term we remain basically bullish on the dollar, we do not believe that there will be sizable enough* trading turns *to justify a forex position.*

**Chart 4 – YEN**


**Chart 5 – DM/YEN**




## GOLD/SILVER

# Silver shines brighter than gold

Rising inflationary expectations have benefitted gold and silver, more than compensating for rising interest rates. This phenomenon supports our view that the present high level of nominal interest rates is perceived to be negative.

Still, the downside pressure on gold prices — a result of growing supplies — continues. The "super pit" project, to link and consolidate a number of Western Australia's major gold mines on Kalgoorlie's Golden Mile, is on target to boost production from an annual rate of 450,000 ounces to 650,000 ounces by June of this year. More importantly, costs of production are being reduced to A$300/oz. (equivalent to US $240/oz.) from A$400/oz. The second stage will boost output to an annual 850,000 ounces by the end of 1990, making the super pit by far the biggest gold producer in Australia.

A study prepared by M. Murenbeeld and Associates, publishers of the well-known *The Gold Monitor* (Ste. 607, 5468 Dundas Street West, Toronto, Ontario, Canada M9B 6E3), concludes that *ceteris paribus*, a 10% increase in supply lowers gold prices 5%, and this result is significant at the 0.1% probability level. Were gold supplies to rise from an annual level of 2,000 tonnes to 2,500 tonnes (not improbable at all — *our comment*), or by 25%, the model would project a decline in the gold price in the order of $50, to $350 from $400, in today's prices.

Insofar as silver is concerned, while real progress is being made in electronic photography, silverless photography is not likely to affect demand for the foreseeable future. Furthermore, pure silver mining (as opposed to by-product mining) is not profitable — at least in the US — below $5.75/oz. Therefore, supplies will begin drying up below these levels.

Technically, warehouse silver may be moving into stronger hands, as 17,000 contracts (85 million ounces) were delivered against the expiring March contract, with none of the metal coming back to the market. In short, silver's fundamentals continues to shine brighter than gold's.

continues to shine brighter than gold's.

***STRATEGY:*** *Retain long 5 December '89 silver/short 4 December '89 gold spread (see Chart 6). The most recent decline has made this position profitable. Also, retain the highly profitable long 2 CRB/short 7 gold spread (see Chart 7).*

**Chart 6 – GOLD/SILVER**

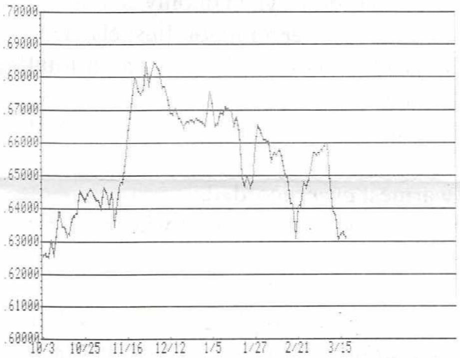



**Chart 7 – CRB/GOLD**

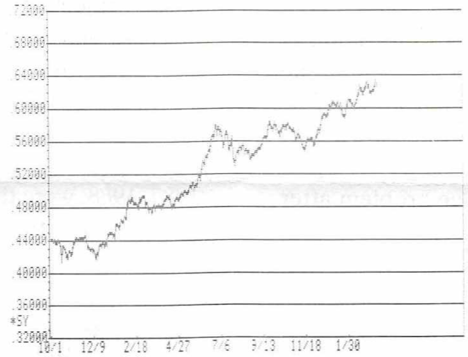
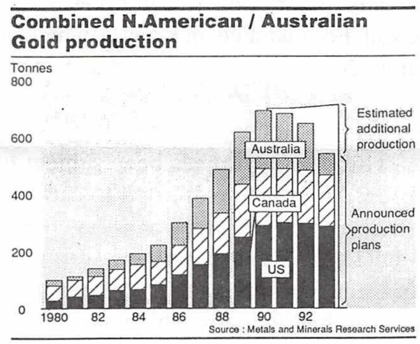



**Chart 8**




FINANCIAL TIMES

## *PLATINUM*

# Waiting for a motivator

During the past month, the platinum market has remained calm. The price now is virtually the same as it was at our last writing. Gold has gained a bit on platinum, and the small backwardation in platinum has almost disappeared.

We anticipate that this calm will be broken, and suggest that one or more of the following factors will provide the needed motivation for this market:

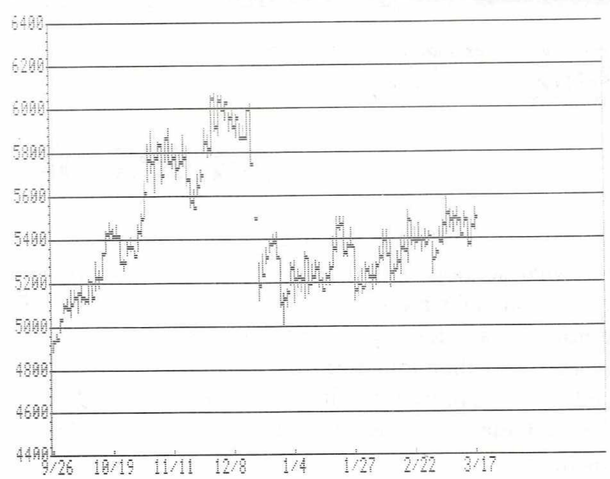
**1.** If inflation expectations continue to flare up, there will be some speculative building of platinum inventories. As we have pointed out over the past few years, changes in desired inventory levels can lead to rather sharp price moves, because supply cannot adjust rapidly to accommodate changes in desired inventory levels.

**2.** If environmental issues and concerns continue to move to the top of the European Community's political agenda, there could be a more rapid adoption of US-style auto emission standards. This would further stimulate platinum demand in Europe.

**3.** If the yen, which has been weak during the past month, strengthens, the yen-price of platinum will weaken, and this will stimulate Japanese buying once again.

***STRATEGY:*** *Remain long, basis April '89, stops at 520.00, close only.*

**Chart 9 – NYME PLATINUM APR '89**



## *WHEAT*

# Trying our patience

The wild card for future price direction is the condition of the winter wheat crop, and the situation does not look promising. The number of cattle on placements for February increased 15% from year-ago levels — a record placement number. The explanation is that the winter wheat crop is so bad that it is no longer suitable for grazing.

The major concern right now is the lack of moisture in the soil. For instance, in Kansas, which accounts for approximately 20% of the US winter wheat, topsoil moisture is 73% short, 19% adequate, 8% surplus. Subsurface moisture is 86% short, 14% adequate.

This year's crop has been subject to one problem after another, from severe drought to extreme cold to 70 mile an hour gales, and the situation isn't going to get any better. The 30-day forecast calls for above-average temperatures, below-average precipitation, and continuing strong winds.

Another concern, which has received little media attention, is the condition of the secondary root system. Most of the wheat plants examined so far showed signs of a poor secondary root system. Once a system is damaged, it is irreparable, and even adequate rain may not salvage the plant.

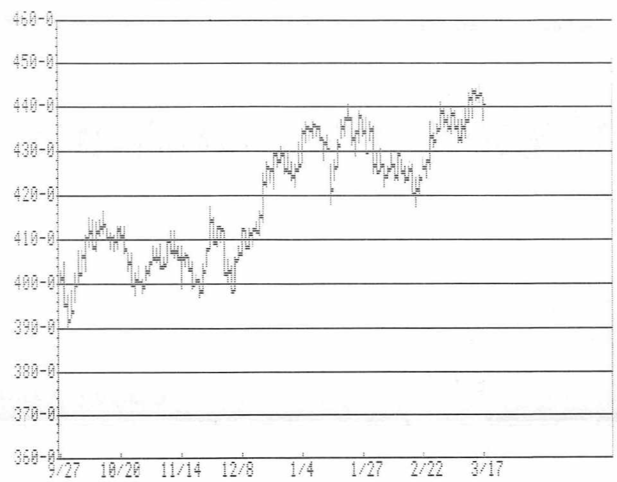
The condition in Kansas has been compared with the dust bowls of the 1930s and 1950s. Even then the most optimistic projections call for an average yield of only 30 bushels per acre and a total state crop of 285 million bushels. This compares with a 1988 yield of 34 bushels/acre and a total state crop of 323 million bushels.

Weather-related trivia: Since 1978, we have had seven of the warmest years in recorded history — 1980, 1981, 1983, 1987, 1988, were the warmest *ever* recorded.

It is said that good things come to those who wait. Be patient and you will be duly rewarded.

***STRATEGY:*** *Raise stop on May '89 long position to 4.31, close only. Add to long positions by purchasing July '89 wheat at present levels, placing initial stops at 4.01, close only.*

**Chart 10 – CBT WHEAT MAY '89**




## *FRIEDBERG CAPITAL MARKETS*

# Notes on the inversion

The yield curve in the US has inverted between the two-year and 30-year section, and the Federal Reserve has publicly affirmed that tight monetary policy will continue in 1989. The normal case for a yield curve exists when short-term rates are lower than long-term rates. However, a negatively sloped yield curve carries with it some recessionary signals and should relay a message to investors to take a more defensive stance.

The inverse relationship between price and interest rate makes an investment in fixed-coupon bonds highly unattractive in an environment of rising interest rates. Investors should consider the following key points when making their investment decisions:

1. Floating rate notes offer investors capital protection when interest rates look like they are going higher.

2. High nominal rates have a negative effect on economic activity in general and specifically on the ability of highly-leveraged entities to service their debt. Therefore, it is

highly advisable to choose high-quality paper.

3. Investors should look for a peak in long-rates in order to purchase zero coupon bonds. Zeros perform best in an environment where interest rates are falling. Since, however, there is usually a lag between the time that the curve inverts until the zenith in interest rates, investors should remain sidelined on purchasing zeros.

For further insight into the inverting yield curve, see *Friedberg Commodity & Currency Comments* Oct. 1988 issue.

We offer the following floating rate notes denominated in US dollars:

United Kingdom
24/9/96 3-month LIBID -1/8
Current coupon 9.125%
priced at 100.42

Republic of Italy
30/4/93 3-month LIMEAN
Current coupon 9.375%
priced at 99.50

Republic of Portugal
8/12/93 6-month LIBOR +5 B.P.
Current coupon 9.425%
priced at 99.80

Stay tuned to this station!

## Recommended bond portfolio allocation:

| | |
|---|---|
| **New Zealand dollar bonds:** | 15% |
| **US dollar floating-rate notes:** | 85% |

## Chart 11
## FOREIGN CURRENCY BONDS

Date: March 16, 1989

We offer the following Bonds subject to change without prior notice: Minimum amount US$5,000 (Cdn.$7,000)

| ISSUER/MTY.DATE/COUPON | BID | OFFER | CURRENT ANN. YIELD TO MTY | LAST PAY NEXT PAY DATE |
|---|---|---|---|---|
| **NEW ZEALAND DOLLAR DENOMINATED BONDS** | | | | |
| TORONTO DOMINION BANK 02/04/90 18% RRSP eligible | 102 1/4 - | 103 | 14.61 | 02/04/88-02/04/89 |
| SALLIE MAE (semi annual) 04/08/90 17% | 103 3/4 - | 104 1/2 | 13.68 | 04/02/89-04/08/89 |
| MCDONALD'S (semi annual) 15/08/90 16 3/4% | 102 7/8 - | 103 5/8 | 14.24 | 15/02/89-15/08/89 |
| TOURIST HOTEL (N.Z.) 04/06/93 zero coupon | 55 1/2 - | 57 1/4 | 14.21 | matures 04/06/93 |
| **AUSTRALIAN DOLLAR DENOMINATED BONDS** | | | | |
| COMMONWEALTH BANK OF AUSTRALIA 01/07/94 14% | 96 1/4 - | 97 | 14.80 | 01/07/88-01/07/89 |
| WORLD BANK 15/03/93 12 3/4% RRSP eligible | 94 1/2 - | 95 1/2 | 14.30 | 15/03/88-15/03/89 |
| CAN.IMP.BANK OF COMMERCE 13/03/91 13% RRSP eligible | 92 3/4 - | - | - | 13/03/88-13/03/89 |
| **DANISH KRONE DENOMINATED BONDS** | | | | |
| WORLD BANK 20/11/92 9 3/4% RRSP eligible | 99 7/8 | - | - | 20/11/88-20/11/89 |
| STOCKHOLM 10/11/91 10 5/8% | 102 5/8 - | 103 3/8 | 9.08 | 10/11/88-10/11/89 |
| **BRITISH POUND DENOMINATED BONDS** | | | | |
| KGDM of SWEDEN 14/4/93 9 3/8% | 94 5/8 - | 95 3/8 | 10.84 | 14/04/88-14-04/89 |
| **DEUTSCHE MARK DENOMINATED BONDS** | | | | |
| QUEBEC HYDRO 1/5/96 5 1/2 RRSP eligible | 92 1/4 - | 93 | 6.77 | 01/05/88-01/05/89 |
| **SWISS FRANC DENOMINATED BONDS** | | | | |
| GOVT.OF AUSTRALIA 30/10/98 5% | 97 1/4 - | 98 1/4 | 5.23 | 30/11/88-30/10/89 |
| **JAPANESE YEN DENOMINATED BONDS** | | | | |
| GOVT.OF CANADA 23/7/93 5 5/8% RRSP eligible | 101 3/4 - | 102 1/2 | 4.96 | 23/07/88-23/07/89 |
| **U.S.DOLLAR DENOMINATED FIXED CONVERTIBLE BONDS** | | | | |
| PACIFIC SCIENTIFIC 7 3/4% (semi ann.) 15/06/03 CV Sh's per $1000 bond 26.32 @$38 p/sh. | 67 1/4 - | 68 1/4 | 13.00 | 15/12/88-15/06/89 |
| **U.S.DOLLAR DENOMINATED FIXED RATE BONDS** | | | | |
| ALBERTA 9/12/91 7 3/8% RRSP eligible | 93 1/2 - | 94 1/4 | 9.86 | 9/12/88-9/12/89 |
| **U.S.DOLLAR DENOMINATED FLOATING RATE NOTES** | | | | |
| ISSUER MAT.DATE COUPON | BID | OFFER | CUR.COUP. | |
| UNITED KINGDOM 24/9/96 3 mo.LIBID-1/8 (quarterly) | 100.12 - | 100.42 | 9 1/8% | 28/12/88-28/03/89 |
| REPUBLIC OF ITALY 30/4/93 3 mo Limean (quarterly) | 99.10 - | 99.50 | 9 3/8% | 31/01/89-28/04/89 |
| REPUBLIC OF PORTUGAL 8/12/93 (semi annual) 6 mo LIBOR +5 B.P. | 99.50 - | 99.80 | 9.425% | 08/12/88-08/06/89 |
| **L.D.C. PAPER DENOMINATED IN U.S.DOLLARS** | | | | |
| ISSUER MAT.DATE/COUPON | BID | OFFER | CUR.COUP. | |
| BANCO CENTRAL De CHILE (restructured) 12mo.LIBOR +1 1/8 (annually) | 56 - | 59½ | 10 11/16 *17.96% | 20/01/89-20/01/90 |
| ARGENTINA 15/2/92 BONEX ser.82 LIBOR (sem.ann.) | .7175- | .7305 | 9 5/8% **25.4% | 15/02/89-15/08/90 ammortized:12½% of principal paid yearly |

For further information and current prices please call:
FRIEDBERG CAPITAL MARKETS (416) 364-2700 F/MICHCM

## Chart 12
### Breakeven exchange rates for US$ – based investor

This analysis shows a "snapshot" of the relationship between interest rate differentials and rates of exchange. The breakeven rate measures how far the foreign currency has to devalue (for NZ$, A$, DKr) or revalue (for DM, SF, JY) before the interest rate advantage/disadvantage is overcome by currency depreciation/appreciation. **BOND YIELDS AND RATES OF EXCHANGE AS OF MARCH 16/89.**

| | U.S. $ | NEW ZEALAND $ | AUSTRALIAN $ | DEUTSCHEMARK | SWISS FRANC | JAPANESE YEN | DANISH KRONE |
|---|---|---|---|---|---|---|---|
| 1 year | 9.51% | Tor Dom 18% 2/4/90 Yields 14.61% (.588 NZ/US) | | | | | |
| 2 year | 9.62% | | | | | | Stockholm 10⅝% 10/11/91 yields 9.08% (7.21 Dkr/US) |
| 4 year | 9.52% | Tourist Hotel 0% 4/6/93 Yields 14.21% (.520 NZ/US) | World Bank 12¾% 15/3/93 Yields 14.30% (.689 A$/US) | | | Canada 5⅝% 23/7/93 Yields 4.96% (1.10 US/JY) | |
| 5 year | 9.44% | | | | | | |
| 6 year | 9.40% | | | | | | |
| 7 year | 9.37% | | | Quebec Hydro 5½% 1/5/96 yields 6.77% (1.58 US/DM) | | | |
| 10 year | 9.31% | | | | Australia 5% 30/10/98 yields 5.23% (1.10 US/SF) | | |
| Spot Exchange Rate | N/A | .615 | .8168 | 1.8688 | 1.6067 | 130.69 | 7.2833 |

**For example, in parentheses, since a US$ based investor would receive 469 basis points (1421-952) by holding the Tourist Zero bond, NZ$ can depreciate to .520 NZ/US from the present spot exchange rate of .615 NZ/US over the next 4 years for the NZ$ investment to break even with current US$ rates of interest. Assumes that bonds are held to maturity, and coupons are reinvested.

## FOREX RATES & UPDATE

| *Currency* | *Spot* | *3-Month* | *12-Month* | *Comments vis à vis US$* | *Comments vis à vis DM (Spot DM: 1.8750)* |
|---|---|---|---|---|---|
| Australian dollar | .8178-.8188 | .8040-.8050 | .7720-.7740 | Neutral | Neutral |
| *Belgian franc | 39.29-39.34 | 39.08-39.15 | 38.30-38.53 | Liquidated** | Neutral |
| *Danish krone | 7.3190-7.3230 | 7.2825-7.2905 | 7.1870-7.2040 | Liquidated** | Neutral |
| *Dutch guilder | 2.1155-2.1165 | 2.0977-2.0991 | 2.0459-2.0477 | Liquidated** | Neutral |
| Greek drachma | 157.50-157.70 | 160.40-162.60 | 166.00-174.20 | Remain short | Remain short |
| Hong Kong dollar | 7.7965-7.7985 | 7.8045-7.8095 | 7.8040-7.8200 | Neutral | Neutral |
| *Irish punt | 1.4240-1.4270 | 1.4330-1.4360 | 1.4550-1.4610 | Liquidated** | Neutral |
| *Italian lira | 1376-1377 | 1383-1385 | 1402-1406 | Liquidated** | Neutral |
| Kuwaiti dinar | .28970-.29020 | .28830-.28890 | .28280-.28550 | Remain short | Neutral |
| Malaysian ringgit | 2.7535-2.7545 | 2.7280-2.7320 | 2.6785-2.6895 | Neutral | Neutral |
| New Zealand dollar | .6130-.6150 | .6080-.6100 | .5960-.6030 | Neutral | Neutral |
| Norwegian krone | 6.82-6.83 | 6.84-6.85 | 6.85-6.87 | Neutral | Neutral |
| *Portugese escudo | 154.15-154.55 | 154.75-156.00 | 156.65-160.10 | Neutral | Liquidate |
| Saudi Arabian riyal | 3.7500-3.7505 | 3.7485-3.7510 | 3.7485-3.7520 | Remain short | Remain short |
| *Singapore dollar | 1.9395-1.9405 | 1.9175-1.9195 | 1.8555-1.8665 | Remain long | Buy |
| Spanish peseta | 116.55-116.65 | 117.00-117.20 | 119.40-119.70 | Neutral | Neutral |
| Swedish krona | 6.41-6.42 | 6.43-6.44 | 6.44-6.46 | Neutral | Neutral |

**Explanatory Notes**

*Indicates change in recommendation from last issue.
**As per Hotline Update of Feb. 17, based upon DM stop.

| | US$ | DM |
|---|---|---|
| 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, February 21:**
There are no changes or new recommendations.

**Friday, February 24:**
The market letter was mailed Wednesday. There are no changes or new recommendations.

**Flash update, Monday, February 27, 11:45 a.m.**
Sell May sugar at market, accepting profits.

**Tuesday, February 28:**
One change this week: As of yesterday's flash update, we have liquidated long sugar positions, accepting profits.

**Friday, March 3:**
We have liquidated long sugar positions as of Monday morning's flash update.

**Tuesday, March 7:**
No changes or new recommendations.

**Friday, March 10:**
No changes or new recommendations.

**Tuesday, March 14:**
No changes or new recommendations.

**Friday, March 17:**
No changes or new recommendations.

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

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