25 YEARS

FRIEDBERG'S

COMMODITY & CURRENCY COMMENTS

Friedberg Commodity Management Inc. | Volume 18, No. 1 | January 26, 1997

The jury is out

For quite some time, we have fitfully avoided taking sides in the world's main exchange parities. Mindful that exchange rates are exercises in relative rather than absolute judgment, we found nonetheless little interest in participating in a beauty contest where the jurors were asked to choose the least ugly participant. To beauty, one is understandably attracted, but what attraction could the least ugly have? As well, how is one to decide which is the least repugnant feature?

The US economy, in its sixth year of economic expansion, enjoying full employment, a shrinking fiscal deficit, and dramatic gains in corporate profitability appeared to be the natural winner. And yet, as we pointed out as recently as two months ago, on a trade-weighted basis the US dollar remained stuck in a narrow range — almost exactly where it had been four years earlier. Were it not for rising interest differentials, as we demonstrated then, the US dollar would have almost certainly fallen to post-war lows. We advanced the view that the problem lay with the worldwide surfeit of dollars, aggravated by an easy money policy, which manifested itself most vividly in rampant securities speculation and reckless consumer credit. There is indeed something rotten in the State of the Union, and that is money and credit.

The other two contestants were even more miserable. Germany, saddled with enormous labor rigidities, a suffocating welfare state, and confiscatory labor and income taxes, is trapped in a vicious circle of low or nonexistent growth, falling government revenues, rising unemployment outlays — these two items alone accounted for a deterioration of DM34 billion in the fiscal accounts compared with the 1996 budget forecasts — and further efforts to cut the deficit below the Maastricht limit of 3%. In the meantime, unemployment continues to climb to post-war record highs (see Chart 1).

For all intents and purposes, the Bundesbank has lost all its credibility: It religiously sets M3 targets and later misses them, making a mockery of its avowed monetarism. Its latest example: M3 grew at an annualized rate of 7.9% in December compared with its 1995 Q4 base, putting the Q4/Q4 growth rate above the 1996 money supply growth target *ceiling* of 7%. Why set any targets if all the Bundesbank does is set interest rates, and as any school-child knows, central banks can control only one variable — either the cost of money or the quantity of money — but not both!

On the credit side of the ledger is the government's belated attempt at tax reform. Billed as "the most sweeping tax reform for 50 years," the finance minister proposed to cut the top and bottom range rates of income tax from 53% and 25.9% at present to 39% and 15% in January 1999. While commendable, the proposal does nothing about cutting back the overall ratio of public spending to GDP, which remains close to 50%. Nor does it address the fact that social security contributions are almost two-thirds as large as tax revenues, imposing an almost intolerable burden on employment costs. Finally, while the proposals have been approved by the parties of the Bonn coalition, the government will have to overcome the opposition majority in the second chamber of the Parliament, which has consistently blocked plans to deregulate the German economy.

And then there is Japan. Unwilling to swallow the hard medicine in the aftermath of the collapse of the great bubble of the '80s, the government tried again and again to bring back to life the crippled economy, but to no avail. In the process, national dignity and self-esteem fell to new lows, gross government debt skyrocketed, and austerity measures inevitably were introduced.

In this issue

Contributions by Albert D. Friedberg and Sholom Sanik.

The government's draft budget for fiscal 1997, which starts April 1, increases consumption tax to 5% from the current 3% and fails to renew reductions in the income and residence taxes in place since January 1995. Corporate tax reform, once thought to be a pillar of fiscal 1997 revisions, was tabled; the Hashimoto government fell prey to unabashed pork barrel politics by legislators tied to special interests. Hence, even though spending was due to increase only 3% on the current year, it contained new public works programs and a whole network of new money-losing bullet-train routes, while restoring allocations for rice subsidies.

The budget, highly inimical to economic growth, is certain to aggravate the present situation. At its root lies a comatose banking system carrying an unspecified but huge load of bad loans. Continued deflationary pressures on asset values, primarily real estate, have eroded the value of the loan collaterals faster than the banks have been able to write off the loans. Because the losses have not as yet been realized, the economy cannot move ahead. Attempts to pump prime domestic demand when large sectors of the economy are paralyzed by government-sponsored blockages of market clearing prices can end only in failure.

The other significant impediment to recovery has been the shrinkage in the trade and current accounts, the result of an overvalued yen. This overvaluation, which saw the currency appreciate by over 65% in the short span of three years, was a case of market failure, a speculative blow-off remarkably similar to the earlier stock and real estate blow-offs of the late '80s. Instead of being an engine of recovery, as is typical during economic contractions, the external sector became a drag on domestic economic activity; as a percentage of GDP, the current account surplus has fallen steadily, to 1.2% in 1996 from 3.1% in 1993.

In absolute terms the trade surplus shrank to $8.2 billion in 1996 from $15.5 billion in 1993, pleasing the politicians in Washington but imposing an absolutely unnatural burden on an already prostrated economy. Fortunately for Japan, the trade surplus has stopped shrinking over the past six months (Chart 5) and, with the aid of a cheaper yen, is likely to expand in the months and years ahead. Japan needs to tackle the banking problem head on: It must liquidate the deadbeats and recapitalize the balance, socializing, hopefully, the smallest amount of losses. Inviting foreign banks to participate in the consolidation of the Japanese banking system may be a partial solution to what probably will involve a staggering amount of official resources. If Japanese officials continue to bury their heads in the sand, a full scale banking crisis will erupt and "solve" the problem at a much greater cost.

Of the three contestants, Japan looks the weakest, but this, we suggest, is only apparently so. The banking losses are already there, they need only to be *realized*.

The yen is returning to earth, and the external sector is improving. The labor situation is unparalleled anywhere in the Western world; despite years of economic stagnation, unemployment stands at a mere 3.3%. The nation's frugality and productivity are legendary and don't seem to have been affected by the crisis. It is quite clear to us that the yen will once again attain the status of a hard currency *once the banking problem has been fully resolved.*

Germany, on the other hand (along with the rest of Europe and the future EMU, if it ever gets off the ground), is affected by a greater number of fundamental, and almost intractable, problems. This is probably why the deutschemark/yen cross has stopped appreciating despite a positive albeit shrinking carry (see Chart 2). Until we get a better handle as to how the Japanese government intends to deal with its banks, we cannot place our bet on this cross rate with sufficient confidence. But what is clear is that Japan is no longer the undisputed ugliest duckling in the contest.

Our reservations with regards to proclaiming the US dollar the winner in this contest can be outlined as follows: a) The economic boom has been built on credit and its first derivative, speculative excesses; b) economic booms built on credit are not sustainable, and they are in constant need of new stimulus; c) the Federal Reserve will want to keep the boom alive or, perhaps, will be just too afraid to prick the bubble and will continue to make money and credit easily available; d) as a result, interest rate differentials will narrow, and the prop will be removed from under the dollar. This is the argument we put forth last November, although we wisely refrained from endorsing a short dollar position. Since then, the US dollar has posted substantial gains against its main trading counterparts, making 36-month and 24-month highs, respectively, against the yen and DM. It appears that the market has a greater degree of confidence than we have in the Fed's resolve to avoid inflationary pressures *even at the cost of collapsing the bubble.*

We had hoped that the Fed's resolve would have been put to the test in early 1997 in the context of a weakening economy. We were led to believe that this was the case as we studiously pored over economic statistics covering the first half of the last quarter of 1996. More recent numbers, however, show little or no signs of economic deceleration. It is now almost certain that the fourth quarter 1996 will show a 3%- plus (and as high as possibly 4%) real rate of growth for GDP. Clearly we will need to wait *for some weakness* before we can put to test the Fed's mettle. In the meantime the market's perception — the dragon slayer image — will persist. It may indeed happen that the Fed will risk raising rates by one quarter of a percentage point should the fourth-quarter 1996 Employment Cost Index (to be released this coming Tuesday) show a rise of more than the expected 0.8%. If so, the market's perception will grow.

In sum, a continued expansion, and the perception that the Fed has its finger on the trigger should wage costs accelerate (as per Greenspan's remarks last week), should keep the US dollar ahead of its competitors. The jury is out: While there may be no beauties in this pageant, the US dollar is for now the least ugly of them all.

STRATEGY: *Remain long British pounds and New Zealand dollars against sales of yen. In addition, new outright short positions in yen can be established, risking New York closes below $/yen 114.50.*

Chart 1

ISI GROUP

Chart 2 – DM/¥

Reuter Graphics

Chart 3 – US/DM

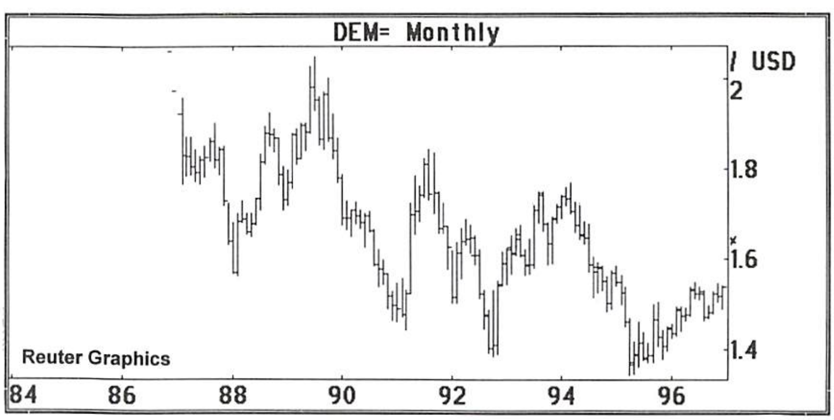


Chart 4 — US Trade-Weighted Index

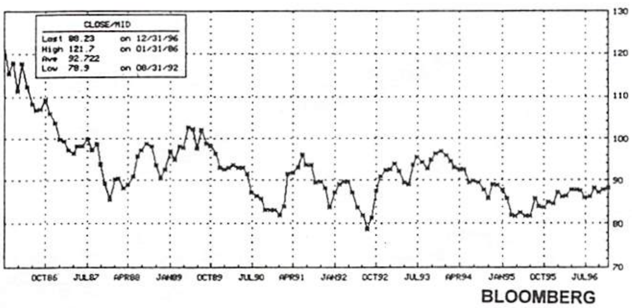
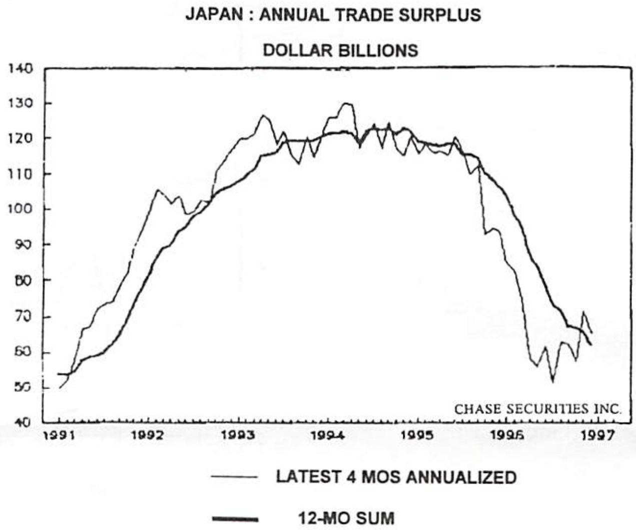


Chart 5



STOCK INDEXES

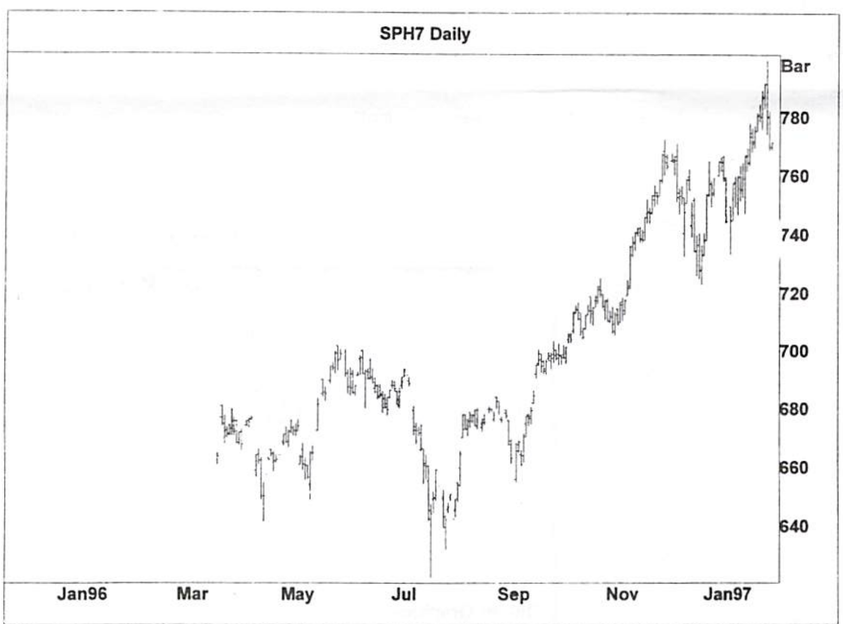
Highly vulnerable

The market's recent acceleration bears all the marks of a classic blowoff. Of course, bull markets have long tails, and it is only by chance that one can pinpoint the absolute top. It is a great deal safer to say that we are close to the top in terms of time than in terms of points.

Last month we thought that weak economic numbers would prompt the Fed to ease further. Alas, the weak numbers turned into stronger ones, and now chances are that the next move in rates will be up rather than down. *At these lofty levels the market is highly vulnerable to even a one quarter percentage point hike in Fed funds.*

STRATEGY: *Raise stops on long positions to 760 basis March '97, good anytime.*

Chart 6 — S&P Index



CANADIAN DOLLAR

Keeping your powder dry

The conditions for a more sustained advance are slowly coming into place. GDP for October was up 2.4% year-over-year, while employment growth for December was 1.4% up from a year ago, indicating that the recovery was proceeding, albeit at a very sluggish pace. More importantly for our purposes, inflation has begun to accelerate — enough to stay the hand of the Central Bank, hell-bent heretofore on easing monetary conditions.

Indeed, the CPI for December was up 2.2% (1.8% ex-food and energy) from a year earlier, compared with a 2% (1.4%) increase in November and a 1.8% (1.3%) gain in October. The crucial housing price index was up 0.3% in November from a month ago, narrowing the year-over-year decline to a mere 1%.

Interest rate differentials vis à vis the US (see Chart 7) have begun to stabilize, and the Bank of Canada has allowed the MCI to tighten sharply from recent all-time lows. The low in interest rates is almost certainly behind us. Paradoxically, this has led to heavy non-resident liquidation of debt securities, in turn pressuring the Canadian dollar, when, in fact, the opposite effect was to be expected.

Given present interest rate differentials, the carrying cost of a long Canadian dollar position is too steep to warrant putting on a speculative line. In due time this handicap will disappear, and a much more comfortable position will be established. For now, however, nothing more than nimble range-trading, with an upside bias.

STRATEGY: *Medium-term traders are advised to remain sidelined and keep their powder dry.*

Chart 7

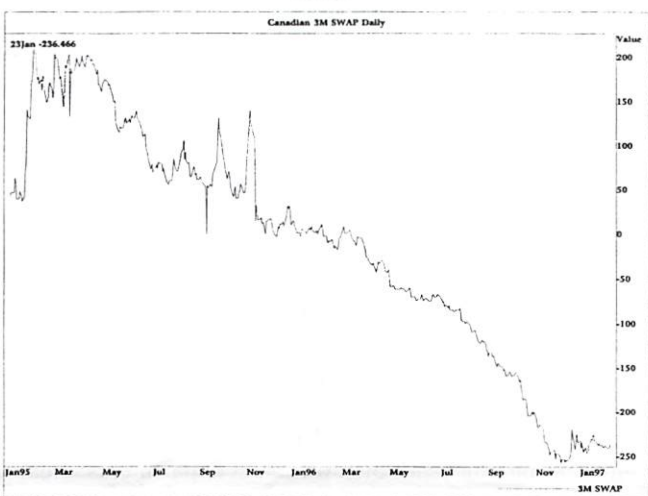


Chart 8

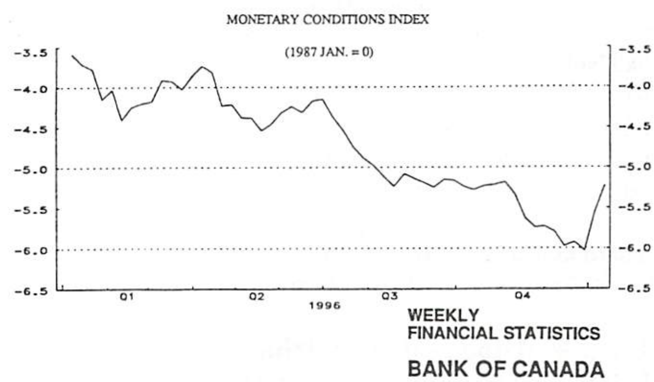
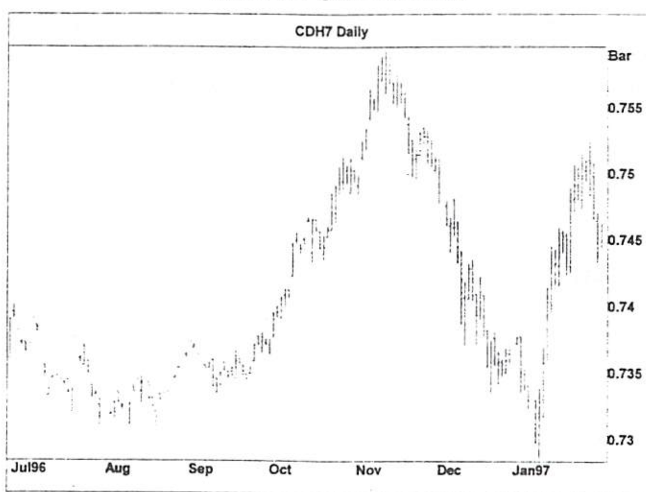


Chart 9 — Canadian Dollar



NEW ZEALAND

Accountability, transparency key to New Zealand reforms

With sweeping and sustained reforms, New Zealand has recently retooled its economy. A centerpiece of this process has been a bold restructuring of the public sector. How was momentum built and popular support retained? Marco Cangiano, in an IMF Working Paper, *Accountability and Transparency in the Public Sector: The New Zealand Experience*, reviews these reforms and concludes that commitment to transparency and accountability helped win, and retain, public acceptance. It also enabled policymakers, over time, to shift the focus of fiscal policy from short-term stabilization to a framework that encouraged pursuit of efficiency in expenditure and taxation and responsible longer-term policies.

Background

In the early 1980s, New Zealand's fiscal woes resembled those of many industrial countries. Government expenditures as a percent of GDP had risen sharply, and the deficit had ballooned. Moreover, compared to other industrial countries, New Zealand's public enterprise sector played an unusually large role in the economy, accounting for nearly one-third of total employment and managing a substantial range of trading activities. In 1985, when slow growth and chronic and rising deficits prompted the government to take a hard look at the economy, the scope and role of the public sector was a principal focus of concern.

Corporatizing and privatizing

In 1986, New Zealand took the first step in its reform process. It reorganized its state trading activities around five broad principles:

- Shed activities more efficiently performed by the private sector.
- Run state trading organizations like private companies (and shift non-commercial functions elsewhere).
- Require managers to run their organizations like successful enterprises and hold them fully accountable to performance objectives set by ministers.
- Operate the enterprises without artificial competitive advantage.
- Set up enterprises with specific commercial purposes, with new boards of directors from the private sector.

By the end of 1993, New Zealand had created 31 corporatized state-trading organizations and a number of new agencies to assume regulatory functions. In general, corporatization dramatically reduced unit costs, prices, and tariffs, and improved service and profitability. Much of the increased efficiency derived from managers pursuing clearly defined objectives. Competition offered an important incentive. Between 1986 and 1988, remitted profits and dividends doubled. By 1989, New Zealand had ended subsidies to virtually all state-owned enterprises.

But corporatization also had its shortcomings. The effectiveness of incentives and monitoring devices was limited by the absence of tradable shares and the threat of takeover or bankruptcy. Likewise, the perception of an implicit government guarantee for debt remained, as did the presumption of political interference. Penalties for failing to meet agreed-upon targets were not clearly spelled out. And some state-owned enterprises found themselves at a commercial disadvantage because their social responsibilities affected their bottom line.

To address these shortcomings and to meet budgetary needs, the government complemented its corporatization effort with a strong privatization push. Between 1988 and 1994, it sold $NZ 13 billion of government assets (including 21 state-owned enterprises) — equivalent to an annual average of 4 percent of GDP. In pursuing privatization, New Zealand opted to accept foreign ownership, even in strategic sectors, in recognition of the small size of its domestic financial market. It also made certain there was competition before a public sector monopoly was put up for sale.

Responsive, efficient government

Next, the authorities turned their attention to the second phase: ensuring that government provided its core services efficiently. In 1987, the New Zealand Treasury recommended that greater attention be paid to the relationship between ministers and the heads of government departments; greater autonomy be granted to department heads; a clear distinction be drawn between the output of services and the desired outcome of a social program; and provision be made for financial accountability.

Legislation in 1988 and 1989 laid the basis for new management relationships and created new methods for ensuring accountability. Department heads became "chief executives" on five-year contracts, accountable for their performance. Government agencies and departments were restructured to rationalize responsibilities and separate policy from operational functions, and funding from the purchase and provision of services. Private providers now competed with public providers.

These operational and organizational changes made the existing appropriation process obsolete. To ensure accountability and managerial efficiency, the new legislation distinguished between outcomes (policy goals) and outputs (the goods and services, including policy advice, needed to achieve these goals). The legislation held chief executives accountable for achieving agreed-upon outputs, while ministers retained responsibility for outcomes.

The quest for improved financial information to support the new asset management led to the adoption of private sector accounting practices in the public sector, including the preparation of annual financial statements on an accrual rather than cash basis. The government also shifted the appropriation system from inputs to outputs and substantially revised its financial procedures to devolve responsibility for managing financial and human resources to the chief executives.

The next step was compiling a balance sheet for the government. This took approximately three years and several phases of legislation, because, notes Cangiano, "no other government had undertaken such an exercise before." Since 1994, the government has been publishing a full set of financial statements similar to those of a publicly listed company.

Ensuring fiscal responsibility

In June 1994, New Zealand moved into the third phase — innovative institutional reform that balanced principles of responsible fiscal management with a degree of policy flexibility. The reform embodied in the Fiscal Responsibility Act, was deliberately designed to provide a strong medium- and long-term orientation to fiscal policy. The reform rejected quantified fiscal targets and instead adopted five principles that serve as legislative benchmarks:

- reduce government debt to prudent levels by requiring fiscal operating surpluses until this is achieved;
- once debt is at a prudent level, ensure that operating expenses do not exceed operating revenues;
- achieve and maintain a sufficient level of net worth as a cushion against future adverse developments;
- manage fiscal risks prudently; and
- pursue a reasonable degree of predictability in the level and stability of future tax rates.

Governments may temporarily deviate from these principles with justification and with assurances that they will, within an explicit time frame, return to them. To ensure transparency and accountability, the law also established disclosure requirements for fiscal policy intentions and objectives. To date, fiscal developments have been signaled well in advance, and key ministers have shown awareness of the five crucial fiscal variables: revenues, expenses, accrual operating balance, total debt, and net worth. Transparency and predictability have come to characterize fiscal policymaking, and market analysts and the media have reacted favorably.

Dividends of reform

New Zealand's reform efforts have improved its fiscal position dramatically. Surpluses have been recorded since 1994, following two decades of deficits. In 1995/96 the operating surplus was 3.7 percent of GDP; net worth turned positive, reaching 3.7 percent of GDP; and net public debt declined to 31 percent of GDP. State-owned enterprises, and the government itself, abide by the same set of rules and regulations (including taxation), disclosure requirements, and accounting practices that apply to the private sector. And the results, in terms of efficiency gains and the dramatic turnaround in the country's fiscal position, are impressive.

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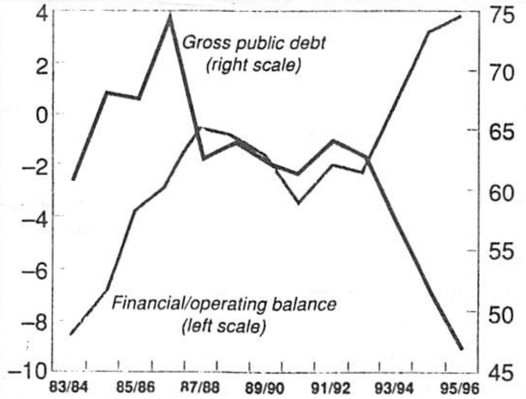
New Zealand Fiscal Developments[1]

(In percent of GDP)



[1] Data relate to years ending in June. Starting in 1991/92, financial statements are on an accrual basis and not strictly comparable to the previous cash-based statements. From 1992/93 onward, the reporting entity includes all state-owned enterprises and Crown entities as well as the Reserve Bank of New Zealand.

Data: New Zealand Treasury and Statistics New Zealand

NEW ZEALAND DOLLAR

Still (apprehensively) bullish

Political pressure for a lower exchange rate notwithstanding, there is little that the government can do to afford relief to the tradables sector. As pointed out by the monetary authorities, interest rates have already fallen 260 basis points at the short end of the curve, and yet the trade-weighted index continues its relentless climb, having recently traded at close to 69.

In the opinion of the Reserve Bank of New Zealand's Governor Don Brash, the interest rate-exchange rate mix is outside of the monetary authorities' influence. With the Reserve Bank intent on keeping a tight rein on inflation (shooting for the middle of the new 0%-3% range), however, real appreciation can come only via an increase in the nominal rate of exchange. And real appreciation is a result of confidence in New Zealand, built on its high reputation in fiscal and monetary policy.

In this regard one notes that the operating budget *surplus* for the first 5 months to November 30, at NZ$1.78 billion, exceeded the forecast surplus of NZ$1.51 billion, continuing the long string of better-than-expected fiscal results. As a result, New Zealand's net public debt as a percentage of GDP fell to 29.3%, breaking below 30% for the first time since the year ending March 1983. Net public debt had peaked at 51% in 1991-92.

We have reason to believe that the exchange rate appreciation will continue for quite some time yet. In the first place, as the Reserve Bank itself has noted, the resident measure of broad money, M3R, grew by a very strong 3.3%, seasonally adjusted, in the month of October, bringing the annual percentage change to 15.4%, while the resident measure of private sector credit, PSCR, increased by a seasonally adjusted 1.1% for the month, the strongest monthly increase since May. Disquietingly, these increases came before the huge reductions in interest rates and were accompanied by anecdotal evidence that prices are again on the rise in the housing market.

More worrisomely, dollar prices of imports for the September quarter fell by 0.9%, a markedly smaller fall than the 3.9% that the Reserve Bank had assumed on the basis of historical relationships when preparing the projection in the Monetary Policy Statement. This may mean that the Reserve Bank may have to allow for firmer monetary conditions in the period ahead. Firmer monetary conditions spell a higher trade-weighted dollar — so long as the Coalition government does not do anything foolish and unexpected in the upcoming budget.

STRATEGY: *We remain apprehensively (because of the politics) bullish on the currency and New Zealand's equity market.*

GOLD

Downtrend still with us

The recently released *Gold 1996 Update II* from Goldfields Mineral Services Limited contains a number of interesting observations. Most noteworthy is their discussion of producer selling.

It appears that initially, mining companies viewed gold as if locked in a tight $380-$415 range and accordingly sold the upper part of the range (once they became convinced that the market had peaked) and liquidated positions, i.e., covered forward sales at the lower end of the range. When during the fourth quarter the range was pierced on the downside, hedge selling picked up steam, significantly in North America and Australia, and marginally in South Africa. As noted in the report, in Australia "there were some [producer sales], which appeared to represent real panic selling." There you are: Producers are as human as you and I.

While the report indicated that it had information that official sector sales were made in the October to early December period "amounting to around 150 tonnes," more recently the Dutch central bank confirmed that it had sold twice that amount. The Dutch sale reawakened fears that the drive towards a European Monetary Union would see much higher official sector disposals in the future. This, of course, is a red herring. In the first place countries cannot meet their deficit reductions via sales of gold, and secondly, even if they could, their gold reserves are far too small to help them achieve this objective.

This EMU theme, which has been repeated ad nauseam, ignores the true reasons behind the recent collapse: persistent official sector sales since well before any talks about the European Monetary Union and primarily in response to recognition of the demonetization of gold; producer forward sales (a financing and hedging technique); and more recently, disinvestment in favor of more exciting financial assets.

On the other hand while it is true that central banks hold a hoard of gold in excess of 34,000 tonnes, this amount, as imposing as it may seem, *is only ten years' worth of present consumption.* Moreover, the US, France, Germany, Switzerland, and Italy — by far the largest holders — remain strongly committed to the precious metal (but see our comments last month re Switzerland). As a result, in practical terms official sector sales represent a maximum overhang of *three years' worth of consumption.*

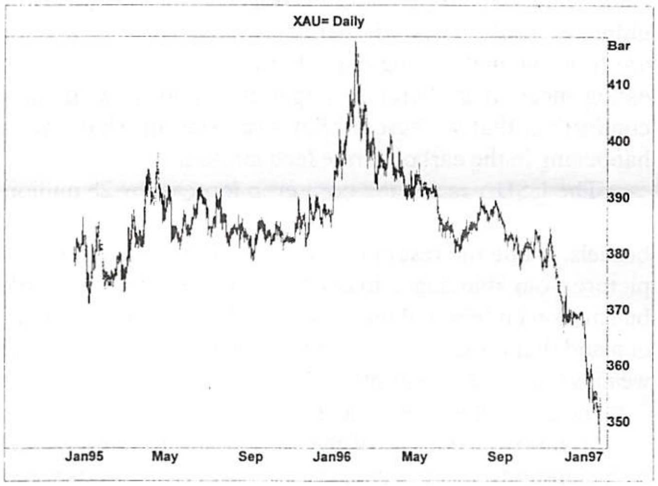
As to producer sales, it is significant that 1996 was the first year in which total outstanding positions did not increase. Simply replacing or rolling over existing positions has no impact on the bullion market. If "outstandings" stop increasing, the bullion market will have succeeded in shaking off one of its most bearish influences.

Finally, disinvestments. More than anything else, disinvestments are products of speculative activity. Most of it is represented by large, highly leveraged, speculators, individuals, or funds using trend-following systems. The present downtrend bears the earmarks of large speculator selling, although significantly, the selling has been rather orderly and lacking conviction; small rallies have brought forth large scale short-covering. This tells us that the current downtrend has as yet not been exhausted.

In sum, the fundamentals remain highly constructive, as total fabrication exceeded mine production during 1996 by 950 tonnes, with more of the same in prospect for years to come. Official sector sales will, in all likelihood, continue to supply bullion to the market, but it will have little or nothing to do with the EMU. The net bearish impact of producer sales may be coming to an end as "outstandings" fail to rise. Finally, speculators will press the downtrend but will be nimble to cover positions on the first sign of a bottom. They have been the main force behind the current decline.

STRATEGY: *Remain short, lowering stops to 364.70, basis April '97, close only.*

Chart 10 — Gold



SOFT COMMODITIES

Soy complex

After taking a well-deserved break for the holiday season, the export market rang in the new year with renewed vigor. For a couple of weeks, export commitments for soybeans fell off to next to nothing. Some doubt was thus created as to whether the torrid pace of exports on which the USDA based its forecast for 1996-97 exports of 900 million bushels on would be sustained.

Talk had been circulating that the Chinese Government was going to impose quotas on soybean imports to protect Chinese farmers. In fact it does seem that the Chinese are going to engage in some state-sponsored protectionism. However, an examination of the actual numbers involved will reveal that it shouldn't make much of a dent in our case. Total imports of soybeans into China for 1996 will be about 1 million tonnes, approximately three-and-a-half times more than in 1995.

Traders in the know say that any quota will probably be for about 1 million tonnes. So even if they were to slap on the quota, imports, at the very least, don't have to drop. If on the other hand the Chinese were to stay on track with the move to free market-oriented economics or if trade barriers prove to be politically inconvenient, there may be no quota at all.

Regardless, export commitments have now resumed last year's trend. The first two reporting periods of the year registered an average weekly commitment of only 160,000 tonnes. This is contrasted with an average weekly commitment for the month of December of 650,000 tonnes. In the past two weeks, the average shot up to 580,000 tonnes. In fact this past week's figure was 50,000 tonnes above the highest trade guesstimate and enough to spark a rally in the beans that brought prices back to the top of the range.

This month's crop report brought an interesting spin in the bean market that resulted in a forecast for a further dwindling of ending stocks. While all the bullish excitement to date has come from the demand sector, in the January 10 report the USDA lowered its US production figure by 21 million bushels to 2.382 billion bushels. Exports were left unchanged, but ending stocks will now be 155 million bushels. Even with the downward revision in the crop size, it is still a very large crop. The market was taken aback and awarded holders of long positions with a limit-up session.

In the past decade South American exporters of soymeal equivalents (soymeal plus whole beans) have competed with the US for the position of the world's largest exporter. This highlights the importance of participating in the Brazilian and Argentinean crop watch, which will be harvested in our springtime. The USDA left the size of both crops unchanged from last month at 26 and 13 million tonnes respectively.

When the US has a 155 million bushel, or 6.4% of consumption carryover, you can bet that our Latin counterparts have no room to produce anything but a bumper crop. There has been a problem with insufficient precipitation in Brazil, although the situation is not terrible, as there is still some time for the moisture to come, but not too much time.

We've argued in past issues that this market is strong enough to break its traditional ties to the general direction of corn and wheat. This thinking is, admittedly, in response to a latent fear that the high prices in corn that killed demand will ultimately spill over into the demand for soy. After all, if there are fewer animals eating corn, there will be fewer animals eating meal. It is therefore imperative, and as we'll find, comforting, that we have a brief discussion of what's been happening in the carbohydrate feed market.

The USDA raised the corn crop forecast by 28 million bushels but also raised domestic consumption by 225 million bushels. While the resulting lower carryover alters the corn picture from abundance to adequacy, it doesn't really spark bull market embers. It does, however, tell us that the feedgrain demand that brought us the 1996 bull markets is still alive. If we may continue to veer off topic a bit more, we see the feed demand outlook cuts even deeper.

Grain sorghum, one of the solutions to last year's tight corn situations, had a bumper crop and was to alleviate some pressure from corn demand. In fact it had a huge crop: 803 million bushels vs. 460 million bushels in the previous year. The only catch is that demand grew by 240 million bushels, leaving almost nothing in ending stocks.

We see the carbohydrate market is nicely supplied, and we wouldn't try to make an argument for substantially higher prices. But feedlot operators are restocking, and those broilers and hogs for which the buying is being done are going to need their protein.

Most of our discussions have focused on protein feed. Indeed the huge demand has clearly been for protein feed rather than vegetable oils. It was thought that the outsize amount of beans that was crushed for meal would create a glut of soybean oil. Dispelling any notion that the oilseed market is amply supplied, *Oil World*, the respected authority on oilseeds, reports that consumption of the 10 main oilseeds will outstrip production by 4.8 million tonnes to leave a carryover of 26.5 million tonnes, or 10% of consumption. Last year's carryout: 12% of consumption.

Anywhere you look, the demand for soybeans and its products is healthy and growing. The 140 million bushels of carryout that we've spoken of is now in sight.

STRATEGY: *Remain long March '97 soymeal, raising stops to 219.50, good anytime.*

Wheat

The January 10 USDA supply/demand situation report held little in the way of drama. A small addition to the supply side and a nip and tuck on the demand side saw ending stocks rise from 435 million bushels to 469 million bushels. The new figure represents a 21% stocks-to-consumption ratio, up from 19% in last month's report.

The global scene was much the same. Forecasts for all the major producers stayed the same for the most part, confirming the plentiful availability of wheat from Australia, Argentina, Canada, and the European Union. A small downward revision in consumption will bring ending stocks up to 19.7% of consumption up from last month's report of 19.5% of consumption.

An interesting historical perspective will show us just how tight the wheat market may really be. Typically, and logically, in an environment of low stockpiles, higher prices will show up sooner or later as tightness emerges. The higher prices entice excessive plantings that will fill the empty silos soon enough.

In the US, since the dust bowl years of the 1930s, there was only one era when stocks sank to dangerous levels and stayed that way for a few years. That was in the post-World War II years. Supplies were tapped on heavily for civilian relief feeding and military food use. Even as supplies were replenished with better crops, prices did not recede until the late 1950s.

The point for our purposes is that we may well have established $3.00-$3.50 a bushel as a *floor* for wheat prices rather than as the breakout point that's been shown on the charts for the past decade.

Crop size may indeed follow demand to some extent. But the rate of growth of consumption in the type of geopolitically shifting climates we find ourselves living in today has the potential of revolutionizing the wheat market. Enormous chunks of populations that were consuming little or nothing suddenly create fresh demand, just as they did in the years after World War II. Similarly, the countries emerging from the dark clouds of communism will continue to provide markets for crops that are continuously being enhanced by advancing Western technologies.

From 1980 through 1990 the average ending stocks for US wheat was 54.1% of consumption. The average since the beginning of this decade was 22.18. Thus, with a 21% of consumption carryout, a pattern emerges in which we cannot seem to rebuild our stocks.

In conclusion, although the latest series of numbers seems to indicate an improving availability situation, the bigger picture still remains a fertile ground for the continuation of the bull market, albeit at a later stage when demand heats up and the headline numbers start to show the tightness.

STRATEGY: *Stopped out at 3.75 as per previous suggestion.*

— Sholom Sanik

Chart 13 — FOREIGN CURRENCY BONDS

DATE: January 24, 1997 *We offer the following Bonds subject to change without prior notice: Minimum US $5000 (CDN $7000)*

ISSUER / COUPON / MATURITY DATE	PAR VALUE	BID	OFFER	YTM	CURR. COUPON	NEXT INTEREST PAYMENT DATE
DEUTSCHE MARK DENOMINATED BONDS						
World Bank 5 7/8% 4/02/97 RRSP eligible		99.40	-	-		Feb-04
World Bank 7 1/4% 13/10/99 RRSP eligible		107.90	108.75	3.78		Oct-13
World Bank 9% 13/11/00 RRSP eligible		115.90	-	-		Nov-13
Kingdom of Denmark 6 1/8% 15/04/98		102.70	-	-		Apr-15
Argentina 8% 5/10/98		103.65	-	-		Oct-05
Kgdm. of Spain (6 Mo. LIBOR-1/16) 29/6/02 (semi)		99.90	100.20	-	3.1875	Jun-30
CZECH REPUBLIC KORUNA BONDS						
General Electric Cap. Corp. 10.5% 23/10/98		99.10	-	-		Oct-23
Nordic Inves. Bk 10.625% 10/11/00		99.15	-	-		Nov-10
Intl. Fin. Corp 10% 30/4/98		98.20	-	-		Apr-30
SWISS FRANC DENOMINATED BONDS						
General Electric Cap. Corp. 4 3/4% 2/7/98		102.90	-	-		Jul-02
General Electric Cap. Corp. 4 1/2% 17/12/99		105.75	-	-		Dec-17
DANISH KRONE DENOMINATED BONDS						
Kgdm. of Denmark 9% 15/11/98		108.45	109.30	3.55		Nov-15
ECU DENOMINATED BONDS						
United Kingdom 9 1/8% 21/02/01		115.30	116.15	4.67		Feb-21
BRITISH POUND DENOMINATED BONDS						
European Invt. Bk. 7% 22/12/98		100.40	101.25	6.27		Dec-22
Kgdm. of Denmark FRN 28/8/98 3mo LIBOR-12.5b.p.(qtly)		100.16	100.46	-	6.29688	Feb-28
JAPANESE YEN DENOMINATED BONDS						
World Bank 4 1/2% 22/12/97 RRSP		103.50	104.35	-0.34		Dec-22
CANADIAN DOLLAR DENOMINATED BONDS						
Eksportfinans 7 3/4% 5/11/97		102.15	-	-		Nov-05
Ontario Province 10 5/8% 15/7/98 RRSP eligible		108.40	109.65	3.69		Jul-15
SOUTH AFRICAN RAND DENOMINATED BONDS						
ESCOM 11% 1/6/08 (semi)		75.55	76.40	15.47		Jun-01
AUSTRALIAN DOLLAR DENOMINATED BONDS						
Toronto Dominion Bk. Aust. 7.25% 26/2/99 RRSP eligible		101.40	102.25	6.06		Feb-26
NEW ZEALAND DOLLAR DENOMINATED BONDS						
World Bank 12.5% 25/7/97 (semi) RRSP eligible		101.70	-	-		Jan-25
World Bank 8.25% 30/4/99 RRSP eligible		102.35	103.20	6.65		Apr-30
New Zealand Gov't 10% 15/7/97 (semi)		100.65	-	-		Jul-15
New Zealand Gov't 8% 15/7/98 (semi)		101.25	102.10	6.47		Jul-15
Fletcher Challenge 10.75% 15/12/97 (semi)		100.90	-	-		Jun-15
Fletcher Challenge 10.15% 30/11/98 (semi)		101.80	-	-		May-30
Tranz Rail Ltd. 10% 15/10/99 (semi)		102.65	103.50	8.52		Apr-15
Trans Tasman 9% 27/6/99 (semi)		96.25	97.10	10.65		Jun-27
St. Luke 8.7% 1/4/99 (semi) CV @ 1.00 p/sh		144.05	-	-		Apr-01
Kiwi Income Prop. Trust 9% 30/9/03 (semi)		123.00	127.00	N.A.		-
ARGENTINEAN PESO DENOMINATED BONDS	PAR VALUE			IRR		
Bocon Pre 1: 1/4/2001	137.325	119.50	121.25	10.12		May-01-97
U.S. DOLLAR DENOMINATED FIXED CONV. BONDS						
Atari Corp. 5 1/4% 29/4/02 CV@16.31 p/sh		64.75	-	-		Apr-29
Coeur D'Alene 6% 10/6/02 CV@ 26.00 p/sh		89.25	-	-		Jun-10
Sports & Recreation 4 1/4% (semi) 1/11/00 CV @ 25.5 p/sh		73.75	75.25	12.74		May-01
The Learning Co. 5 1/2% 1/11/00 CV @ $53.00 p/sh		84.75	86.25	9.97		Nov-01
U.S. DOLLAR DENOMINATED FIXED RATE BONDS						
Queensland Tres. (Gold Bull) 2% 4/3/98		92.70	94.20	-		Mar-04
World Bank 7 1/8% 27/9/99 (semi) RRSP eligible		102.15	103.00	5.89		Sep-27
T.W.A. 12% 3/11/98 (semi)		96.40	97.25	-		N/A
U.S. DOLLAR DENOMINATED FLOATING RATE NOTES						
Kgdm. of Denmark 25/3/97 (Gold call, JY put),(semi)		89.375	90.875	-	9.50631	Mar-25
Canada Gov't 10/2/99 3 mo. LIBOR - 1/4 (qtly), callable @ 100 RRSP eligible		99.69	99.99	-	5.25	Feb-13
Bocon 1/4/01 (30 day LIBOR) starts paying May 1,'97	PAR: 131.0102	124.50	-	-		May-01-97
Argentina: Series L:FRB 31/3/05, 6 mo. LIBOR+13/16 (semi	PAR: 98	88.00	89.50	9.29	6.625	Mar-27
Venezuela: DCB: 18/12/07, 6 mo. LIBOR+7/8 (semi)		90.55	91.40	8.74	6.50	Jun-20

GOLD (in ounces, at market prices, can also be held in your bond account) client eligibility determined at point of sale.

Chart 14
Recommended current portfolio allocations

1. Canada FRN (US$)	55%	4. Trans-Tasman 9% (NZ$)	15%
2. The Learning Company 5.5% cv (US$)	5%	5. New Zealand Government 8% (NZ$)	10%
3. Sports & Recreation 4.25% cv (US$)	5%	6. Kingdom of Denmark FRN (£)	10%

HOTLINE UPDATE

Flash Update: Monday, December 23, 1996:
Good afternoon for Monday, December 23, 2:40 pm. This is a flash update. Buy February crude oil at the market, presently trading at 25.03, placing initial stops at 23.50, close only. Please note that this recommendation was already made in our latest newsletter, which is being mailed tomorrow.

Tuesday, December 24, 1996:
Good afternoon for Tuesday, December 24. There are no changes or new recommendations.

Friday, December 27, 1996:
Good afternoon for Friday, December 27. There are no changes or new recommendations. The following is a recap of this week's recommendations.

- On Monday, December 23, via flash update, we advised to buy February crude oil at the market, then trading at 25.03, placing initial stops at 23.50, close only.

Tuesday, December 31, 1996:
Good afternoon for Tuesday, December 31. There are no changes or new recommendations. Happy New Year.

Friday, January 3, 1997:
Good afternoon for Friday, January 3. Those of you holding long sterling/short Swiss franc positions should cover the short Swiss franc position and replace it with an equal dollar amount of short Japanese yen.

Tuesday, January 7, 1997:
Good afternoon for Tuesday, January 7. There are no changes or new recommendations.

Flash Update: Friday, January 10, 1997:
Good morning for Friday, January 10, 8:45 am. This is a flash update. Raise stops on March S&P to 732.00, good anytime, from 722.00, good anytime, as previously recommended.

Tuesday, January 14, 1997:
Good afternoon for Tuesday, January 14. There are no changes or new recommendations.

Flash Update: Wednesday, January 15, 1997:
Good morning for Wednesday, January 15, 11:15 am. This is a flash update. Liquidate long February crude oil at the market, presently trading at 25.00, cancelling the 23.50 stop, close only.

Friday, January 17, 1997:
Good afternoon for Friday, January 17. There are no changes or new recommendations.

Tuesday, January 21, 1997:
Good afternoon for Tuesday, January 21. There are no changes or new recommendations.

Friday, January 24, 1997:
Good afternoon for Friday, January 24. There are no changes or new recommendations. This is a complete summary since our last market letter dated December 22, of all liquidations of open positions and new recommendations that remain outstanding.

- On Friday, January 3, we recommended to those holding long sterling/short Swiss franc positions to cover the short Swiss franc position and replace it with an equal dollar amount of short Japanese yen.

- On Friday, January 10, via flash update, we advised to raise stops on March S&P to 732.00, good anytime, from 722.00, good anytime.

Friedberg's Commodity & Currency Comments (ISSN 0229-4559) is published by Friedberg Commodity Management Inc., P.O. Box 866, Suite 250, BCE Place, 181 Bay Street, Toronto, Ontario, M5J 2T3.

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