



## Friedberg & Co. Ltd.

347 Bay Street  
Toronto, Ontario, Canada M5H 2R7  
(416) 864-1195  
Cable: Friedco Toronto  
Telex: 06-23446

# Currency Comments

Musings on Money Supply Forecasting

March 28th, 1978

The U.S. dollar continues weak and the U.S. economy fairly robust yet interest rates remain parsimoniously perched at the same levels prevailing almost six months ago. Monetarists puzzle at the slow rate of growth evidenced by the widely followed monetary aggregates in spite of unusual bulges in the Monetary Base and Adjusted Federal Reserve Credit. Fed watchers receive a lethal blow when the Fed admits to having understated M1 and M2 growth for 1977 and January 1978. The Fed's revised numbers, after taking into consideration deposits of smaller banks that do not normally report on a weekly basis and new seasonal adjustments, showed M1 growing by 7.8% last year from 7.4% originally reported and M2 at 9.8% instead of 9.6%. More significantly, M1 grew by 9.6% annualized in January '78 up from an originally reported 7.2% while M2 was revised to 8.9% from 8.2%.

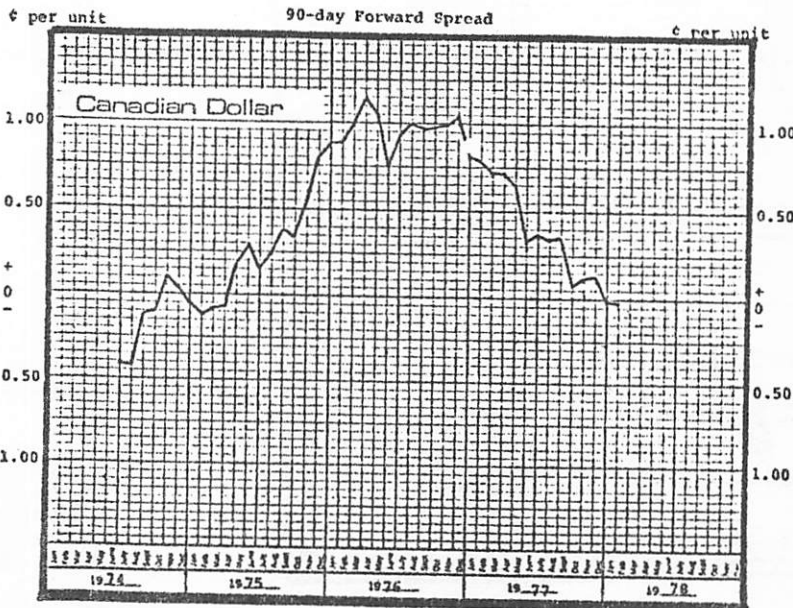
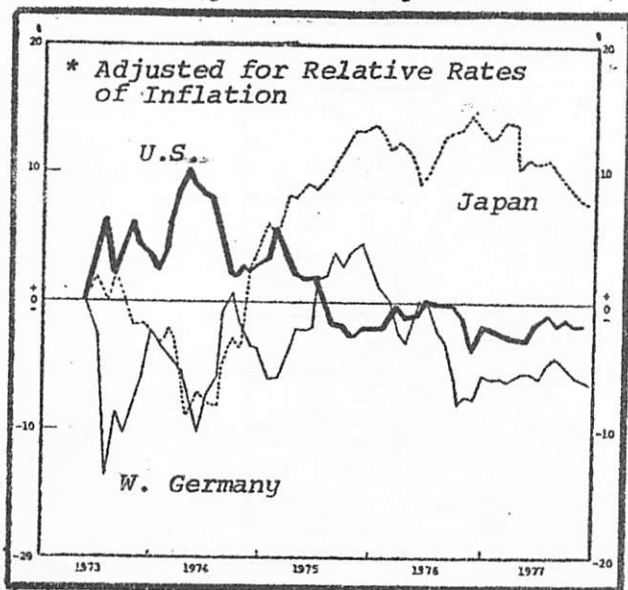
The above revisions come as no surprise to us. For a variety of reasons, discussed in earlier issues, we prefer Deposits Subject to Reserve Requirements (DSRR) to either M1 or M2 as a proxy for monetary expansion. For 1977, DSRR grew by a relatively moderate 7.61%. On close inspection, however, we notice that in October 1977, DSRR grew over 6 months earlier by 7.8% annualized, in November '77 by 10.04%, in December '77, 9.36%, and in January '78 by 10.22%! Yes Virginia, money is being printed at a fast clip.

What of the future? Growth of Federal Reserve Bank Credit (unadjusted) and Total Member Bank Reserves have slowed down significantly in recent weeks from the torrid pace of early January. The commercial banking system still remains well supplied with funds as evidenced by the shift towards an increase in the holdings of securities at an annualized rate of 9.9% registered in January 1978, the first such accumulation in 5 months. Despite official pronouncements to the contrary, the Fed is not about to step on the brakes.

The popularly watched monetary aggregates will reflect in due time the pick-up in monetary expansion already evidenced by the DSRR. The Fed will continue to confound 'Fed Watchers' as to its real intentions: an easy money policy.

Remain sidelined in GNMA's & TB's.

Trade-Weighted Exchange Rates \*



# British Pound

Spot : 188.40      June '78 : 188.25  
 Sept. '78 : 188.15      Dec. '78 : 187.90  
 Mar. '79 : 187.70      June '79 : 186.80

	Sep.77	Oct.77	Nov.77	Dec.77	Jan.78	Feb.78
Balance of Trade(mln Stg)						
Jan-Feb. 1977 : -721						
Jan-Feb. 1978 : -244	+80	+31	+73	-71	-324	+80
Balance of Payments(mln Stg)						
Jan-Feb. 1977 : -301						
Jan-Feb. 1978 : + 5	+255	+206		+74	-179	+184
Money Supply						
M1	36.7	35.6	41.5	21.3	24.4	21.8
Sterling M3	14.9	17.0	19.5	14.1	16.5	18.5
MLR %	6	5	7	7	6 1/2	6 1/2
Reserves (mln U.S.\$)	17,170	20,210	20,390	20,560	20,870	20,700
Retail Sales Index **	-2.11	-1.21	-2.93	+1.11	-1.12	+0.76
Retail Price Index **	15.63	14.07	13.03	12.14	9.92	9.47
W.P.I. **	19.0	17.89	16.03	15.22	13.0	12.74
Unemployment Rate	6.1	6.1	6.1	6.0	6.0	5.9
Trade Weighted Value of Stg(Dec 1971=100)	62.4	62.5	63.6	63.8	66.0	65.2

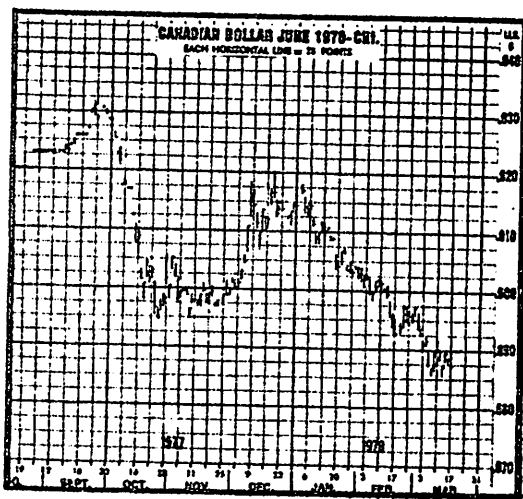
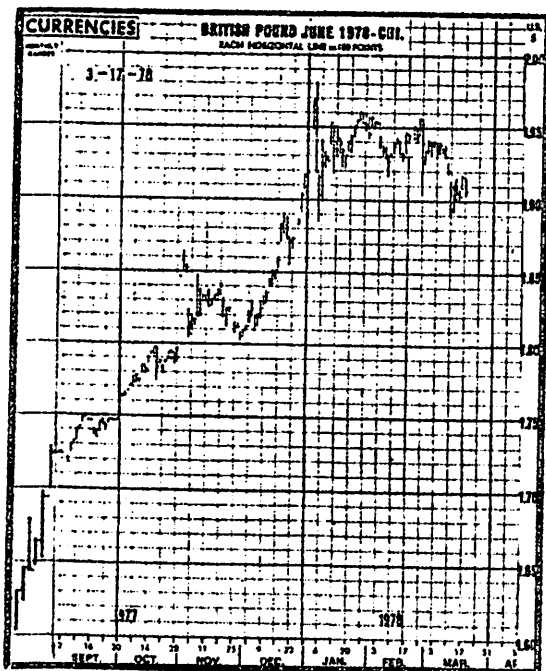
	Feb. 27	Mar. 3	Mar.13	Mar.21	Mar.28
Euro Deposit					
1 Mo.	6 3/4	7 5/8	7 1/2	7 1/2	6 7/8
3 Mo.	7 1/2	8 1/16	8 1/8	7 7/8	7 3/8
6 Mo.	7 3/4	8 5/8	8 1/2	8 3/8	7 7/8
12 Mo.	8 7/16	8 1/2	8 1/2	7 5/8	8 1/8

Open Interest (Mar.27) : 5,332      Volume (Mar.27) : 944  
 Contract Size : BP 25,000.00 (approx. U.S. \$47,000.00)  
 Minimum Fluctuation: .00050(\$12.50)      Daily Limit (Normal): .0500(\$1,250.00)  
 Margin Required : US\$2,500.00      Commissions : US\$ 60.00  
 Trading Hours : 8:45 am - 1:10 pm      Delivery Months : Mar.,June,Sept.,Dec.

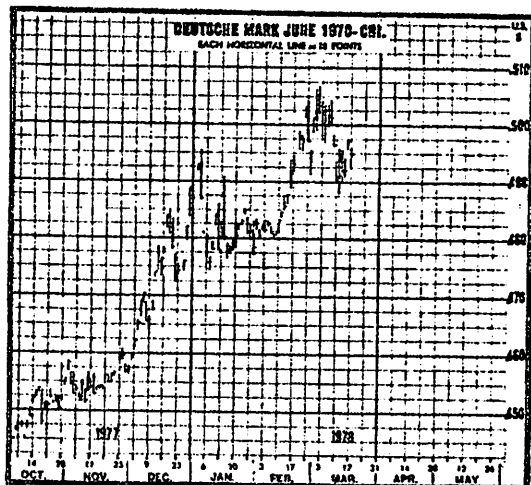
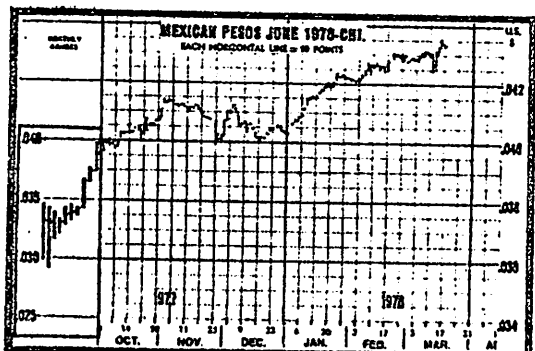
We are growing increasingly bearish on the BP. The North Sea Oil and Gas is proving to be too little to bail out the U.K. from its horrendous lack of competitiveness in the manufacturing sector. Should a significant surplus in current account become suspect ( as we believe will happen over the next few weeks ) capital flows will reverse and a new run on Sterling will have begun.

Last month we suggested selling Dec. '78 BP ( then at 193.25 ) against buying Dec. '78 DM ( then at 50.55 ) so as to neutralize the potential weakness of the U.S. dollar, ( the most correct ratio should be 5 BP versus 4 DM so as to equalize contract values ). At this writing, both positions are showing a profit, particularly the BP short.

Add to straddle at present levels and lift long DM should Dec. '78 close below 49.75.



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# Canadian Dollar

Spot : 88.14 June '78 : 87.98 Sept '78: 87.86  
Dec. '78 : 87.70 Mar. '79: 88.87

Balance of Trade (mln Dlr\$)	Sep. 77	Oct. 77	Nov. 77	Dec. 77	Jan. 78	Feb. 78
Jan-Feb. 1977: +239						
Jan-Feb. 1978: ...	+ 50	+524	+180	+420	+306	...
General Bank Loans (% Growth)	15.89	15.66	14.48	12.79	12.33	11.47
Money Supply**						
M1	8.34	9.49	10.27	11.91	11.42	11.48
M1B	7.37	8.35	9.40	10.57	10.34	10.53
M2	13.00	12.86	12.05	11.67	10.91	10.77
M3	15.42	14.94	14.50	13.19	13.01	12.74
C.P.I. **	8.40	8.77	9.13	9.50	9.0	8.69
Food Price Index **	11.16	12.73	13.90	15.36	14.88	13.36
Unemployment Rate	8.3	8.3	7.9	8.3	8.3	8.3
Reserves (Bln-U.S.) (% Growth)		4.17	4.2	4.6	4.4	3.7
		-28.59%	-17.32%	-21.23%	-35.10%	-29.79
		1976			1977	

Balance of Payments	1st Q.	2nd Q.	3rd Q.	4th Q.	1st Q.	2nd Q.	3rd Q.	4th Q.
Current Account	-1,906	-1,077	-104	-1,100	-1,583	-1,370	-575	
Capital Account								
Long-term	2,778	1,991	1,791	1,314	866	1,352	1,624	
Short-term	-369	-742	-1,860	-194	-49	5	-1,401	

Euro Deposit	Feb. 27	Mar. 3	Mar. 13	Mar. 21	Mar. 28
1 Mo.	7 3/8	7 1/4	7 3/8	7 3/8	7 1/2
3 Mo.	7 3/8	7 3/8	7 5/8	7 5/8	7 3/4
6 Mo.	7 7/8	7 7/8	8	8	8 1/8
12 Mo.	8 1/8	8 1/8	8 1/8	8 1/8	8 1/4

Open Interest (Mar.27) : 2,148      Volume (Mar.27) : 726  
 Contract Size : CD\$ 100,000.00 (approx. U.S.\$ 88,000.00)  
 Minimum Fluctuation: .0001 (\$10.00)      Daily Limit (Normal): .0075 (\$750.00)  
 Margin Required : US\$ 2,500.00      Commissions : US\$ 60.00  
 Trading Hours : 8:45 am - 1:10 pm      Delivery Months : Mar., June, Sept., Dec.

Our special study " Inflation in Canada; a monetarist interpretation and forecast " ( available upon request ) spells out in detail the sad story of the ongoing troubles.

Short of another increase in the administered Bank of Canada Discount Rate, the CD\$ will continue to slide.

Remain short, lowering stops to 88.5 basis Spot.

# Deutsche Mark

Spot : 49.17 June '78 : 49.67 Sep. '78: 50.26  
Dec. 78 : 50.90 Mar. '79 : 51.35 June '79: 51.75

Balance of Trade (mln Marks)	Sep. 77	Oct. 77	Nov. 77	Dec. 77	Jan. 78	Feb. 78
Jan-Feb. 1977 : +4,710						
Jan-Feb. 1978 : +3,960	3,600	4,810	3,080	4,220	1,900	2,060
Balance of Payments (mln Marks)						
Current Account						
Jan-Feb.1977: -479						
Jan-Feb.1978: -1,500	-1,200	3,400	1,400	2,600	-2,000	500
Overall Payments						
Jan-Feb.1977: -123						
Jan-Feb.1978: ...	-1,550	2,530	2,380	6,420	+1,770	...
Money Supply      M3	9.4%	8.8%	10.2%	11.1%	10.87%	...
W.P.I. **	1.7	1.5	1.7	2.4	-0.1	-0.1
Cost of Living **	3.96	3.8	3.7	3.5	3.2	3.1
Unemployment Rate	4.0	4.2	4.4	4.8	5.4	5.4

Euro Deposit	Feb. 27	Mar. 3	Mar. 13	Mar. 21	Mar. 28
1 Mo.	3 1/4	3 1/4	3 5/16	3 1/2	3 1/2
3 Mo.	3 1/4	3 1/4	3 1/4	3 7/16	3 1/2
6 Mo.	3 1/4	3 1/4	3 1/4	3 7/16	3 7/16
12 Mo.	3 5/16	3 1/4	3 1/4	3 3/8	3 7/16

Open Interest (Mar.27) : 2,738      Volume (Mar.27) : 1,009  
 Contract Size : DM 125,000.00 ( approx. U.S.\$ 62,000.00)  
 Minimum Fluctuation: .0001 (\$12.50)      Daily Limit (Normal): .0060 (\$750.00)  
 Margin Required : US\$ 4,000.00      Commissions : US\$ 60.00  
 Trading Hours : 8:45 am - 1:10 pm      Delivery Months : Mar., June, Sept., Dec.

DM ...

Since our last writing, additional measures of support for the U.S. dollar have been taken by the U.S. and German Governments. According to the announcement made March 13th:

- a) Existing swap arrangements between the Federal Reserve and the Bundesbank were increased to \$4 billion from \$2 billion.
- b) The U.S. Treasury arranged to sell SDR 600 million to obtain DM.
- c) The U.S. pledged to use its IMF reserve position as needed to acquire foreign currencies.

Foreign exchange intervention increases U.S. indebtedness and tends to increase, when not offset, the money supply of the foreign country involved in the swap, in this case, W. Germany. Accompanying figures bear testimony to the last point and augur for a re-acceleration of inflation in Germany. In all, however, prices are likely to rise faster in the U.S. than in Germany.

Remain long the June '78 DM raising stops to 48.75, close only.

### French: Franc

Spot : 21.55 June '78: 21.55 Sep. '78: 21.25  
Dec. 78 : 21.05 Mar. '79: 21.13

Balance of Trade (mln FFr)	Sep.77	Oct.77	Nov.77	Dec.77	Jan.78	Feb.78
Jan-Feb.1977: -3,900						
Jan-Feb.1978: -1,786	-1,890	+420	+127	+1,310	-1,850	+64
Net Change of Foreign Exchange Assets **	19.59	19.52	18.02	17.51	16.91	14.04
Retail Price Index **	9.91	9.69	9.55	9.06	9.18	...
Unemployment Rate	5.5	5.3	5.0	4.8	...	...
Money Supply M1 **	10.24	8.6	8.0	11.4	...	...

Balance of Payments	4th Qtr 77	3rd Qtr 77	4th Qtr 76	Total 1977	Total 1976
Current Acct. (Bln FFr)	-1.25	-4.10	-10.1	-15.7	-29.1

Euro Deposit	Feb. 27	Mar. 3	Mar. 13	Mar. 21	Mar. 28
1 Mo.	13 1/8	15 1/4	10 1/2	9 1/4	9 5/8
3 Mo.	13 1/2	14/	11 1/2	9 3/4	10
6 Mo.	12 7/8	13/	11 5/8	10 1/8	10 7/8
12 Mo.	12 3/4	12 5/8	11 7/8	10 1/2	11

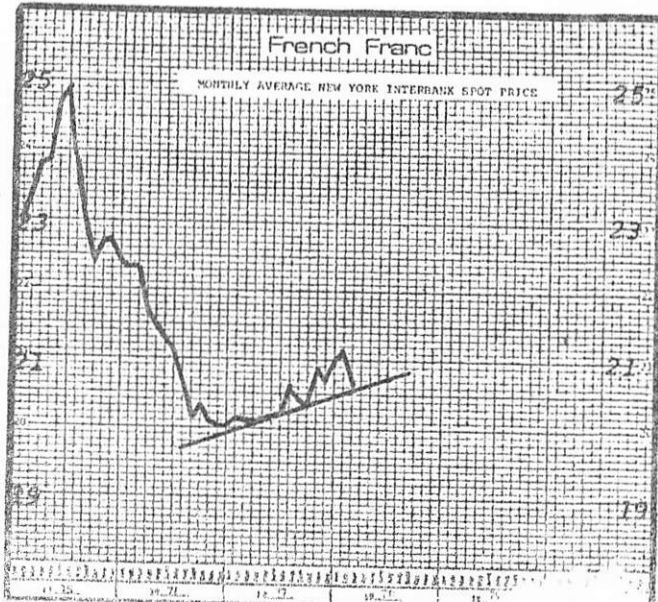
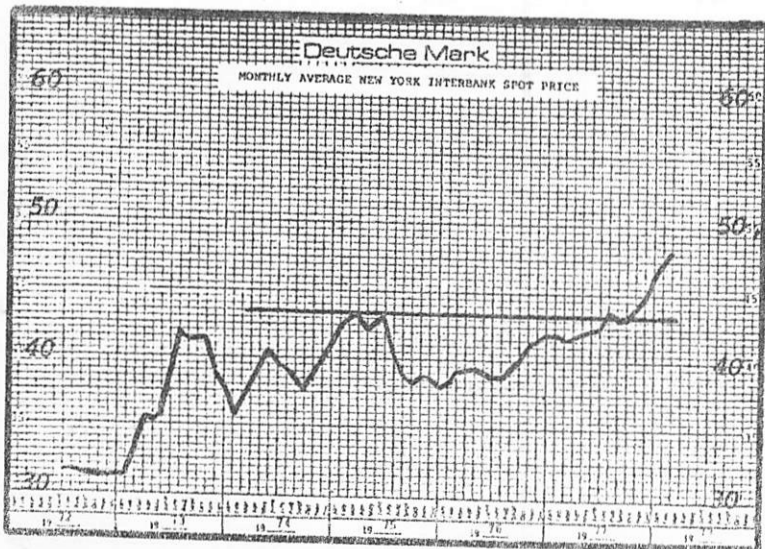
  

Weekly Reserves (Mln FFr)	98,299	98,326	98,338	98,443	....

Open Interest (Mar.27) : 469      Volume (Mar.27) : 3  
 Contract Size : FFr 250,000.00 (approx. U.S.\$ 54,000.00)  
 Minimum Fluctuation: .00005 (\$12.50)      Daily Limit (Normal): .0050 (\$1,250.00)  
 Margin Required : US\$ 5,000.00      Commissions : US\$ 60.00  
 Trading Hours : 8:45 am - 1:10 pm      Delivery Months : Mar., June, Sept., Dec.

Last month's advice to cover all short positions at market was well-timed. Already prior to Sunday's decisive run-off, smart money had bid up the Franc to 21.70¢ basis Spot. Subsequent to the Centrist victory and contrary to popular opinion, we believe that sophisticated holders of French Francs' assets (stocks, bonds and currencies) have been liquidating, already anticipating economic trouble.

Sell June '78 French Francs at market.



Spot : 44.43 June '78: 45.22 Sep. '78: 45.75  
 Dec. '78 : 45.95 Mar. '79: 42.64

Balance of Trade (mln U.S.)	Sep.77	Oct.77	Nov.77	Dec.77	Jan.78	Feb.78
Jan-Feb.1977: +1,173						
Jan-Feb.1978: +2,680	+1,690	+1,860	+1,610	+2,675	+ 350	+2,330
Balance of Payments (Overall Payments Balance)						
Jan-Feb.1977: - 392						
Jan-Feb.1978: +1,810	+ 511	+ 324	+1,820	+1,860	- 200	+2,010
Money Supply**						
M1	6.3	5.4	6.2	7.1	6.8	...
M2	11.3	10.6	10.8	10.7	10.6	...
Reserves (Mln U.S.)	17,870	19,580	22,150	22,850	23,370	24,190
C.P.I.**	7.61	7.47	6.23	4.80	4.27	...
W.P.I.**	0.5	0.05	-0.01	-0.02	-1.5	-1.8
Unemployment Rate	2.05	2.02	2	2.08	2.05	...

Open Interest (Mar.27) : 6,727 Volume (Mar.27) : 227  
 Contract Size : Yen 12,500,000.00 ( approx. U.S.\$ 57,000.00)  
 Minimum Fluctuation : .000001(\$12.50) Daily Limit (Normal) : .000060(\$750.00)  
 Margin Required : US\$ 4,000.00 Commissions : US\$ 60.00  
 Trading Hours : 8:45 am - 1:10 pm Delivery Months : Mar., June, Sept., Dec.

The Japanese Central Bank has done a superb job in neutralizing dollar inflows with the consequent result that M1 figures have remained relatively static while M2 figures have trended downwards.

The run on the Yen has become frenetic. Having nearly attained our 45.50 target for the June '78 position, we prefer to nail down profits at these levels. Sell long positions and stand aside.

Mexican Peso

Spot: 43.90 Jun.78: 43.69 Sept.78: 42.80  
 Dec. 78 : 42.07 Mar.79: 41.25 June 79: 40.67  
 Sep. 79 : 40.00

Forward Disc. Annual Basis	Jun. 78	Sep. 78	Dec. 78	Mar. 79	Jun.79	Sep.79
Spot	1.91	5.01	5.56	6.04	5.89	5.92
Jun. 78		8.15	7.42	7.45	6.91	6.76
Sep. 78			6.82	7.24	6.64	6.54
Dec. 78				7.80	6.66	6.56
Mar. 79					5.62	6.06
June 79						6.59

	1975				1976				1977			
	1st Q.	2nd Q.	3rd Q.	4th Q.	1st Q.	2nd Q.	3rd Q.	4th Q.	1st Q.	2nd Q.	3rd Q.	4th Q.
Reserve Money**	41.27	40.30	37.10	33.73	25.77	16.23	12.32	-7.02	-10.25	12.26	20.51	...
Currency Outside Banks **	24.87	25.76	24.30	22.40	17.64	19.79	38.49	52.79	49.02	53.45	40.95	...
Money Supply**	22.26	22.12	20.46	21.43	17.45	16.70	25.83	29.10	30.40	27.84	23.36	...
Money Supply** (Seasonally Adjusted)	22.26	21.99	20.45	21.32	17.46	16.59	25.84	29.10	30.40	27.71	...	...
Gov't Finance (Mln Pesos)	-8.5	-6.9	-9.6	-16.8	-10.3	-6.8	-13.0	-27	-5.3	-9.1	-10.7	...
	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.
W.P.I. **	45.04	45.68	46.30	49.81	50.74	50.94	48.27	52.85	44.67	33.20	23.07	...
C.P.I. **	25.21	27.64	26.09	26.66	26.81	28.29	29.13	30.59	30.29	26.34	21.74	...

Open Interest (Mar. 27) : 2,338 Volume ( Mar. 27 ) : 126 Daily Limit (Normal) : .00150(\$1,500.00)  
 Contract Size : MP 1,000,000.00 ( approx. US\$ 42,000.00) Minimum Fluctuation : .00001(\$10.00)  
 Margin Required : US\$ 6,000.00 Commissions : US\$ 60.00 Delivery Months : Mar., June, Sept., Dec.  
 Trading Hours : 8:45 am - 1:10 pm

Forward discounts have contracted to absurd levels. As an example, June '79 is selling at a discount of just 5.89% annualized, which can barely be said to cover the inflation differential of at least 18% vis a vis the U.S. yield. Conscious investors may profit from the covered arbitrage by using the IMM as a hedge for Peso deposits.

Add to previously established short positions; patience will be handsomely rewarded.

# Swiss Franc

Spot : 52.90    June '78 : 53.90    Sep. '78 : 54.89  
 Dec. 78 : 55.70    Mar. '79 : 56.60

Balance of Trade (mln SFr)	Sep.77	Oct.77	Nov.77	Dec.77	Jan.78	Feb.78
Jan-Feb.1977: -117						
Jan-Feb.1978: -162	-30	+7.5	+152	+491	-210	+48
Money Supply**		+6.0%		+3.4%		
W.P.I. **	-1%		-1.02	-1.62	-2.43	-2.83
Unemployment Rate	0.3	0.3	0.4	0.4	0.5	0.5
	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>
Balance of Payments						
Current Account (mln U.S. Dlr)	+220	+280	+171	+6,500	+8,000	...
	<u>Feb. 27</u>	<u>Mar. 3</u>	<u>Mar.13</u>	<u>Mar. 21</u>	<u>Mar. 28</u>	
Euro Deposit						
1 Mo.	1/8	3/8	5/8	7/16	1/2	
3 Mo.	3/8	1/2	7/8	5/8	11/16	
6 Mo.	5/8	11/16	1 1/16	15/16	15/16	
12 Mo.	1 1/8	1 1/16	1 1/2	1 5/16	1 3/8	
Weekly Reserves (mln SFr)	19,820	19,950	20,200	20,150		

Open Interest (Mar.27) : 3,067    Volume (Mar.,27) : 129  
 Contract Size : SFr 125,000.00 (approx. U.S. \$ 68,000.00)  
 Minimum Fluctuation : .0001 (\$12.50)    Daily Limit (Normal) : .0060 (\$750.00)  
 Margin Required : US\$ 5,000.00    Commissions : US\$ 60.00  
 Trading Hours : 8:45 am - 1:10 pm    Delivery Months : Mar., June, Sept., Dec.

Swiss Negative Interest - Swiss National Bank President Fritz Leutwiler said the bank is writing to Swiss banks with a new ruling that Franc balances of foreign central banks are subject to the same negative interest rules as other non-resident deposits. In addition, effective Mar. 1st, exceptions, whereby interest was paid on a portion of these balances are no longer applicable, he said. Last Friday (Feb. 24), the bank said that 20% of Franc non-resident deposits, previously free of negative interest because they were placed before Oct. 31, 1974, would be subject to the charge from Apr. 1st. Leutwiler said this has now been extended to balances of foreign central banks which were previously exempt. Commenting on the latest fall of the dollar he said there is no question whatsoever of introducing a two tier market in Switzerland. The bank has studied this and it would not work, he said. A two tier market is also opposed by the Swiss Government and by the Swiss Chamber of Commerce and Industry.

Stiff foreign exchange controls imposed by the Swiss National Bank had a sobering impact on the SFr which reacted nearly 10% off its February highs.

The sudden move triggered our sell stop at 53.00 basis June '78 thus closing out long positions first taken at 42.50 - 43.00 in Sep. '77. Remain sidelined.

