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THE GOOD, THE BAD, AND THE UGLY

July 30th, 1979

Starring Jimmy Carter

Below we reproduce the best analysis yet made on Carter's energy program.

The Real Jimmy Carter

THE WALL STREET
JOURNAL

Out of all the sermonic and confusing rhetoric President Carter has showered on the American public these last two days, at least one thing is clear. The President has weighed the merits of either getting the government out of the energy business or getting it more deeply in. He has chosen to get it further in, on a massive, almost unbelievable scale. The real Jimmy Carter has finally stood up, on the far left of the Democratic Party.

There'll be a new government "Energy Security Corp." to siphon \$140 billion in "windfall profits" from the oil companies over the next 10 years. That would pretty much eliminate oil profits of any kind. While the oil companies quietly pass out of business, the ESC would squander this money on expensive and technologically risky forms of energy.

There'll be an Energy Mobilization Board to ride roughshod over normal legal processes, except maybe those that are mainly responsible for retarding energy development, the environmental laws, for example.

There'll be a new army of government inspectors scouring the country, levying \$10,000 fines on any hapless building operator whose thermostats are showing something less than 78 degrees. Electric utilities will be "made" to switch out of oil—as if they themselves, and not the government, are to blame for their not doing that.

There'll be a federal "Solar Bank" finally to capture the elusive riches of solar power. The President will set conservation goals for states, import quotas for the nation, etc.

In short, Mr. Carter has reacted to the public's low opinion of his administration by "getting tough" and proposing a further suspension of private freedoms. He justifies this on grounds that it is the American people, not his administration and the Congress, who deserve the blame for our economic problems. He summons up the memory of Franklin Roosevelt as he casts himself in the role of a President leading the country out of awful crisis; except where FDR confronted Depression and poverty, Mr. Carter seems to find his crisis in excessive affluence:

"Too many of us now tend to worship self-indulgence and consumption . . . we have learned that piling up material goods cannot fill the emptiness of lives which have no confidence or purpose . . . the symptoms of this

crisis of the American spirit are all around us: two-thirds of our people do not even vote, the productivity of American workers is actually dropping and the willingness of Americans to save for the future has fallen below that of all other people in the Western world . . . there is a growing disrespect for government: and for churches and for schools, the news media and other institutions. . . ."

Quite an indictment. It is the kind of indictment clergymen use to lash their congregations with on Sunday mornings and it is appropriate in that setting of spiritual redemption. But it is highly inappropriate coming from the man who is supposed to be managing the affairs of the United States government. The two key problems that provoked this rhetorical outburst — inflation and gasoline lines — are clearly and directly attributable to the policies of the Carter administration.

The gasoline lines are caused by the government's refusal to remove price controls, and hence supply allocations. Given the enormous economic inefficiencies that have resulted from this refusal, it now seems clear that prices of gasoline would fall, not rise further, after decontrol. Other forms of government intervention—energy use regulation and draconian environmental rules, in particular — have added to the dislocations and inefficiencies. It doesn't take a \$140 billion government program to solve the energy problem; the problem would evaporate if the government would simply get out of energy.

As to those other problems of the American "spirit," low savings and productivity and low confidence in institutions—the main cause is inflation. Why should anyone have confidence in a government that can't balance its budget or run a stable monetary policy? Or why should they save the money it prints?

Now, it seems, it will be necessary to print still more money, and generate still more inflation, to finance the latest grandiose schemes dreamed up by the statists who hold the President in their grip. They are in the saddle and they are exultant about the President's vigorous showmanship Sunday night and Monday. The only trouble is that the policies he has proposed will only get the country into a deeper tangle. And next year, the voters will have a chance to decide which side they're on—or at least so we hope.

A few further comments are in order. In the first place, import quotas, if they are to bite, must be followed up by either domestic rationing or price decontrol. The present 8.2 MBD ceiling should satisfy (rising) domestic demand well into late 1980, & thus, relieve the present Administration from having to make an unpleasant political choice before the upcoming presidential election. It is then obvious that the only potential GOOD to come out of Mr. Carter's speech will remain unrealized for at least 18-24 months.

And now the UGLY. The 50-60 or 70% windfall profits tax on 'decontrolled' oil prices to be exacted on prices above \$16/barrel, will not generate the necessary wherewithal (\$140 billion greenbacks, to be exact) to finance Mr. Carter's grand scheme. In fact, the higher world oil prices go, the smaller will be the U.S. Treasury's revenue on oil profits; oil companies will not find it worthwhile to sell an appreciating commodity at a widening discount from world prices. As an example, assuming a profits tax of 60% and an oil price of \$20/barrel, \$30/barrel and \$40/barrel (the current equivalent of synfuels, & most probably, the floor price for marginal oil in the years ahead), oil companies will realize \$17.6, \$21.6 and \$25.6 per barrel respectively. We will enter a vicious circle, rising oil prices will elicit declining production which, in turn, will cause prices to rise further.

If the present Administration remained in power long enough to reap the whirlwind, an inevitable confrontation would ensue in which the U.S. would be 'forced' to nationalize the oil companies. Against this eventuality, and to protect their stockholders' interest, these multinational companies may be well advised to form non-U.S. based holding companies to carry on their non-U.S. based activities and thus expose only their least profitable operations.

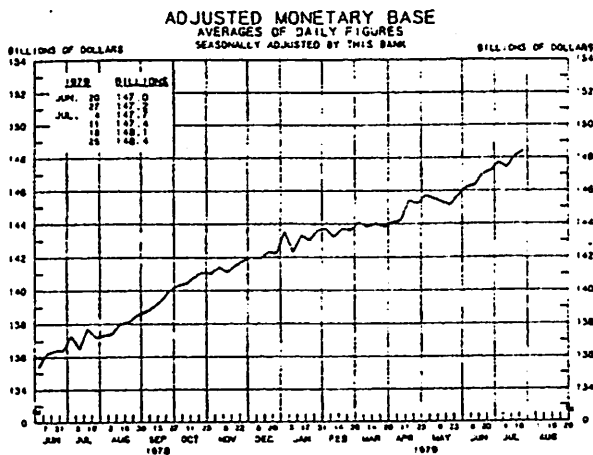
The above mentioned revenue shortfall coupled with the likelihood of a politically-timed tax cut will ensure a string of U.S. budget deficits of absolutely monstrous proportions starting with fiscal year 1979 and well into the mid-80's.

The outlook for the U.S. dollar and interest rates.

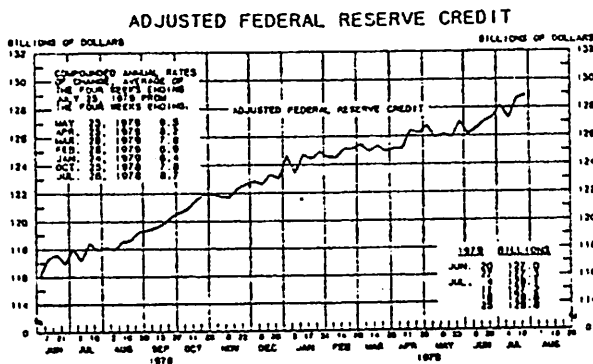
- Q. (Senator Dole, Rep. Kansas) : "Are we in a recession?"
 A. (Treasury-Secretary-to-be W. Miller) : "Yes, we are."

We admire former Fed's Chairman candor, straightforwardness and perspicuity. Whether he is right or not, what matters is that such a perception exists at the highly rarified levels of the U.S. Administration.

Banking statistics are clearly pointing to a re-acceleration of reserve and deposit growth caused by the unrealistically low Fed Fund target prevailing over the past few months. (see charts)



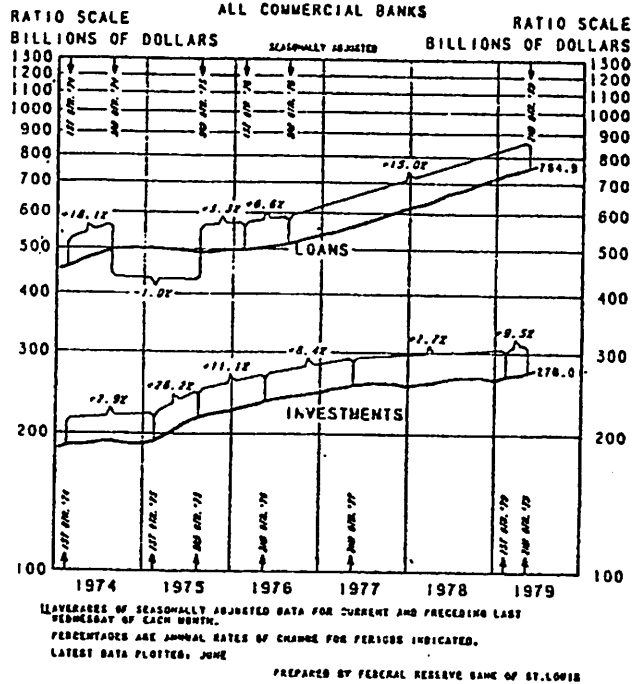
Member Bank Deposits - Subject to Reserve Requirements			
Date	3-month*	6-Month*	12-month**
Jun. 78	9.6	9.53	9.61
Jul.	10.05	8.73	9.68
Aug.	6.22	8.23	9.28
Sep.	7.45	8.52	9.74
Oct.	5.3	7.65	8.99
Nov.	11.2	8.73	9.43
Dec.	6.55	7.14	8.47
Jan. 79	8.26	6.98	7.88
Feb.	1.83	5.72	7.30
Mar.	-0.20	3.12	6.02
Apr.	-1.60	3.21	5.52
May	-3.69	-0.97	3.84
Jun.	-2.12	-1.16	2.21



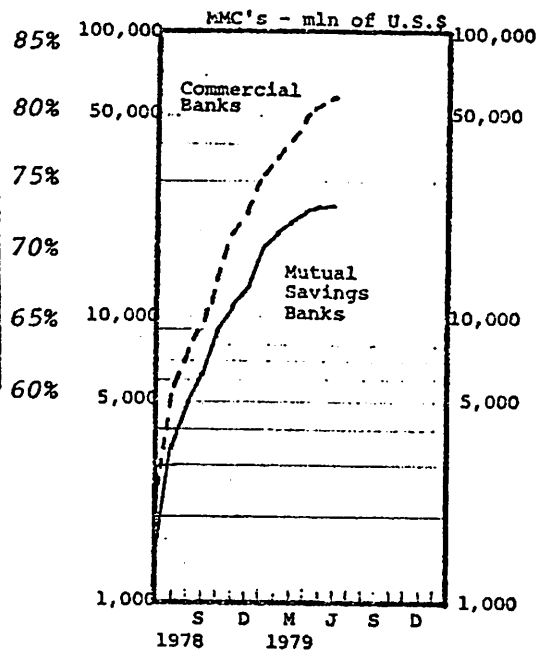
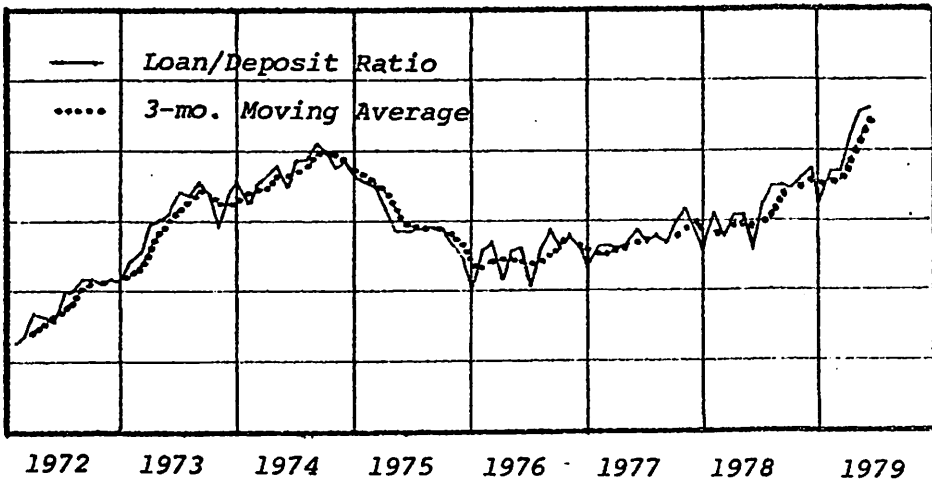
* All percentage changes are at seasonally adjusted compounded annual rates.

**All percentage changes are at not seasonally adjusted annual rates.

BANK LOANS AND INVESTMENTS 4



The positive and relatively high rate of growth of the banking system's investment portfolio (see chart) indicates a relatively comfortable balance sheet position despite the historically high Loan/Deposit ratio (see Chart).



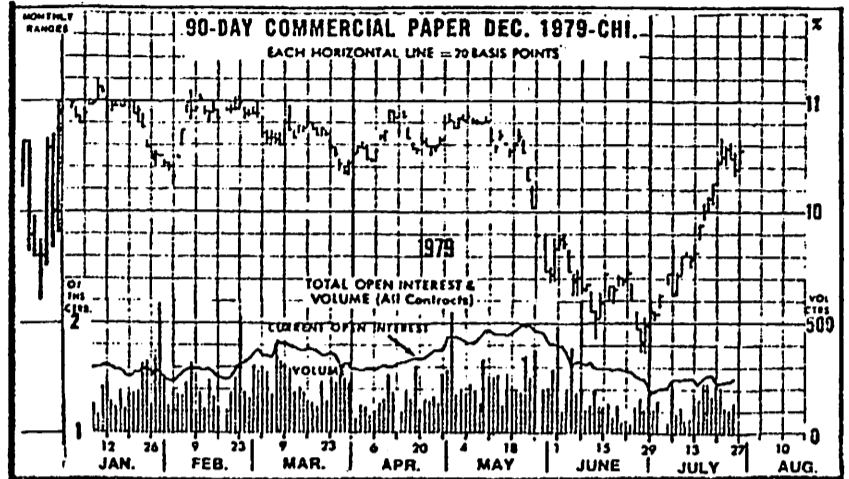
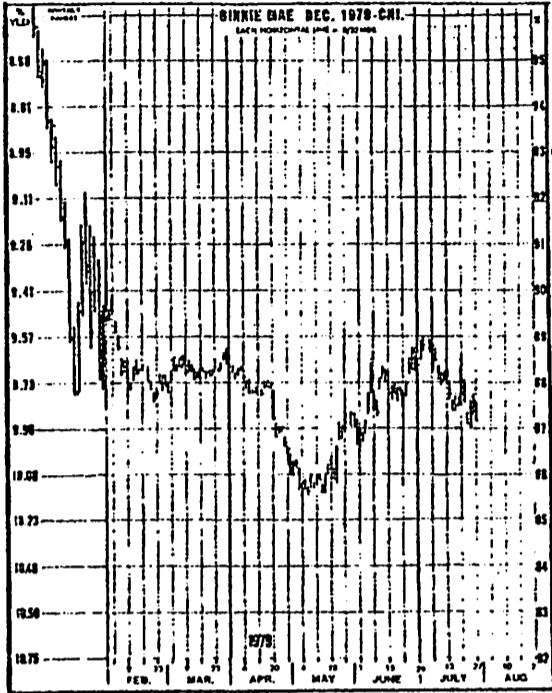
It is also noteworthy that the rate of growth of Money Market Certificates outstanding has begun to taper off much sooner than anticipated (see chart) while CD's outstanding continue their six-months long decline.

Our interpretation follows: faced by accelerating loan demand, (a result of negative interest rates), the banking system, as a whole, may either demand more reserve (and get it from an accommodating Central Bank) or leverage existing reserve. Clearly, the latter occurred between IVQ 1978 and IQ 1979 forcing commercial banks to bid for deposits not subject to (or subject to low) reserve requirements such as Fed Funds, Eurodollars and Money Market Certificates. In IIQ 1979, the Federal Reserve relaxed its grip on reserves by the simple expedient of maintaining a Fed Funds target of 10 1/4% and, thus, injecting an increasing amount of reserves at the upper intervention point. No longer did the banking system need to leverage reserves, a normally expensive operation.

The expansion of bank credit will continue unhindered provided nominal interest rates remain below actual and expected inflation rates. While no doubt there is a limit to how high the Loan/Deposit ratio will accommodate such behaviour, the past few years have witnessed a spectacular increase in the non-deposit sector of the banking system's liabilities. To compare, at the start of the present economic recovery non-deposit liabilities represented 12.7% of the combined deposit and non-deposit totals, and now they represent 18.6%. We may easily be many months away before a real lending constraint develops.

Our scenario still calls for slowly rising interest rates over the foreseeable future with a 'spiked' run-up to occur at the point where balance sheet constraints appear in earnest.

Remain firmly short GNMA's and Treasury Bonds. Ninety-days Commercial Paper, first recommended at 9.46 basis Dec.79, are now showing a solid gain; we still feel they will trade well above 11% by year-end.



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GNMA	Settle	Yield	TREASURY BONDS U.S.	
Sep	87-07	9.860	Sep	90-13 9.046
Dec	87-09	9.850	Dec	90-12 9.050
Mar80	87-10	9.845	Mar80	90-14 9.042
Jun	87-06	9.865	Jun	90-12 9.050
Sep	87-01	9.891	Sep	90-10 9.057
Dec	86-26	9.927	Dec	90-07 9.068
Mar81	86-20	9.958	Mar81	90-07 9.079
Jun	86-14	9.989	Jun	90-01 9.090
Sep	86-09	10.015	Sep	89-30 9.102
Dec	86-04	10.041	Dec	89-28 9.109
Mar82	86-00	10.062	Mar82	89-26 9.116

The outlook for the U.S. dollar in the foreign exchange markets remains crucially dependent on monetary policy and traders' perceptions of the movement in the trade figures. On the first count,, the verdict must continue to be bearish, especially in view of the relatively tighter monetary posture in the strong currency countries. On the second count, and on present trends, the trade balance will remain negative for all of 1979 to the tune of \$23-25 billion, a figure only slightly lower than last year's \$28.5 billion deficit. A substantial \$10 billion(annualized) improvement has already taken place vis a vis last year's first half. This betterment took place during the first 2 quarters of 1979, as U.S. economic activity slumped and was accompanied by a rallying dollar. No further improvement is evident from the May and June data and, therefore, no perceptual benefit is to be expected.

Remain long the BP, DM, SF and Japanese Yen.

EURO DEPOSITS %

	1979				1978
	July 6	July 13	July 20	July 27	July 28
BP					
1 Mo.	14 1/4	14 1/16	13 3/4	14 1/4	10 3/4
3 Mo.	13 1/2	14 1/16	13 3/4	14 1/8	11 1/2
6 Mo.	12 7/8	13 9/16	13 1/4	13 7/8	12 1/4
12 Mo.	12 1/2	12 11/16	12 3/4	12 3/4	12 1/4
CAN. \$					
1 Mo.	11.	11	11.	11 1/2	8 5/8
3 Mo.	11.	11	11.	11 1/2	8 3/4
6 Mo.	10 15/16	11 1/16	11 1/16	11 7/8	9 1/4
12 Mo.	10 9/16	10 11/16	10 13/16	11.	9 3/8
DM					
1 Mo.	6.	6 1/8	6 1/8	6 1/4	3 1/2
3 Mo.	6 11/16	6 5/8	6 1/2	6 9/16	3 5/8
6 Mo.	7 3/16	7 1/8	7.	6 7/8	3 15/16
12 Mo.	7 3/8	7 1/4	7.	6 7/8	4 3/16
SFX					
1 Mo.	5/8	1 1/4	13/16	1 1/2	1 11/16
3 Mo.	1.	1 5/16	1 3/16	1 9/16	1 15/16
6 Mo.	1 7/8	2 5/16	2 1/16	2 1/2	2 1/8
12 Mo.	2 5/16	2 5/8	2 1/2	2 11/16	2 3/8

QUOTES ...

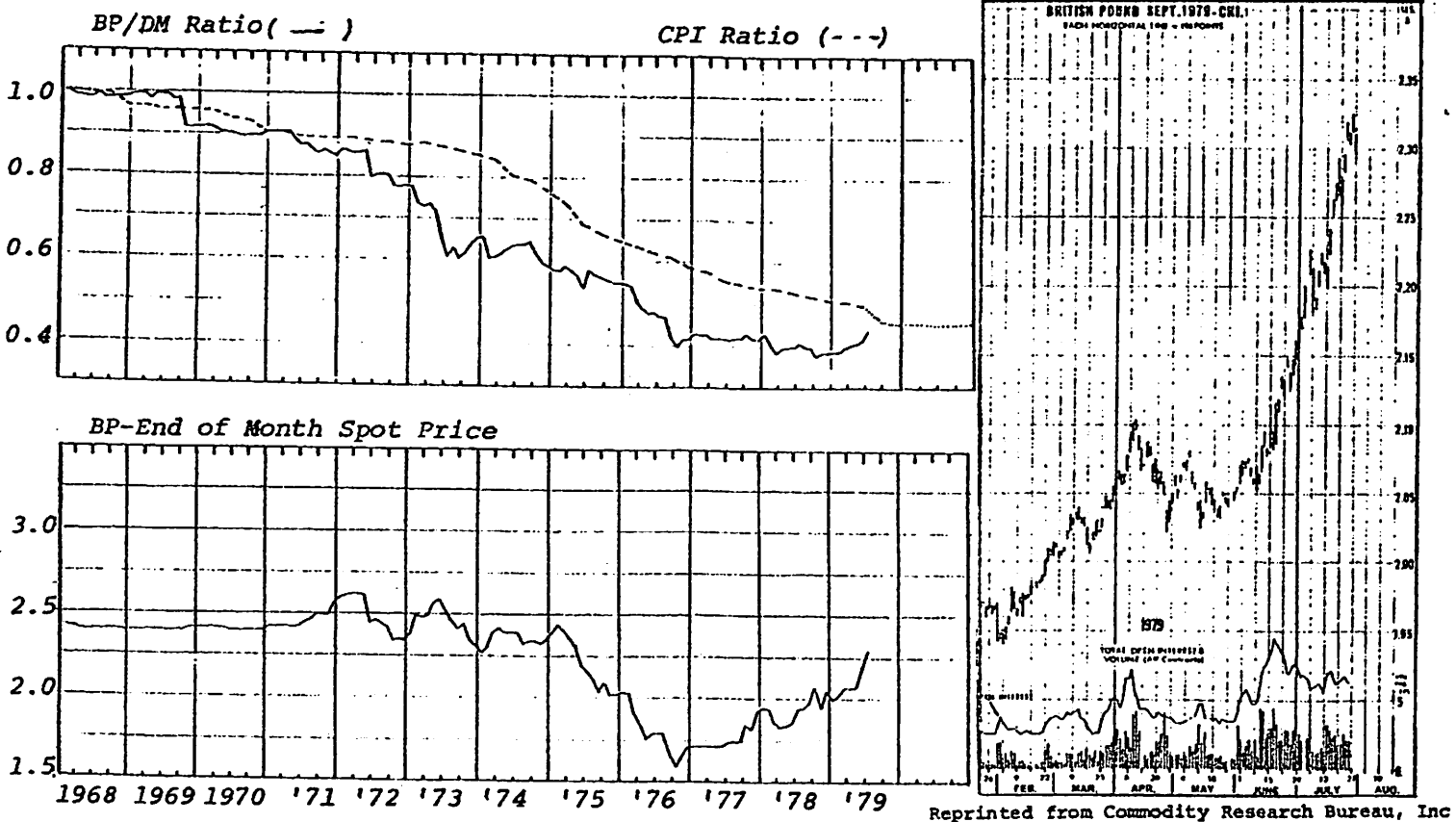
	Sep'79	Dec'79	Mar'80	Jun'80	Sep'80
BP	2.2795	2.2550	2.2550	2.2500	....
CD\$	.8563	.8559	.8565	.8560	.8585
JY	.4616	.4662	.4698	.....	.....
SFr	.6059	.6184	.6328	.6435	.....
DM	.5475	.5529	.5568	.5663	.....

BRITISH POUND

The spectacular rise of the BP has easily dominated global foreign exchange activity of the past month. The Tory Government of Mrs. Margaret Thatcher has, thus far, stood firmly in favor of a freely floating currency pledging prior commitment to domestic monetary considerations.

Recent banking figures indicate that monetary targets are still elusive and a further increase in the MLR may be required to bring about the desired effect. Mrs. Thatcher's Cabinet, no doubt, has deliberately set itself out on a recessionary course so as to influence indirectly the outcome of upcoming union negotiations. The tactic of engineering in the short run a substantial slack in the labor market should successfully restrain union pay demands, all based on transitory VAT effects. Furthermore, the unexpected postponement of a decision to enter the European Monetary System can only mean that the Conservatives are hoping that the market revalue Stg to a level more compatible with Purchasing Power Parity equilibrium levels.

Taking 1968 as our departing point (a year in which the UK's basic balance of payments was roughly even) we charted the course of the Stg/DM ratio vis a vis the quotient of their CPI figures (See Chart)



For a particularly long period of time (1972 - 1978) Stg remained widely undervalued on a purchasing power parity concept. Admittedly long term parities are not particularly good trading parameters. Furthermore, CPI figures may under or overstate true inflation rates as every country utilizes different weights and quality adjustments. Nonetheless, the long term parallelism is remarkable and may be a useful predictive tool. On the present basis, Stg may have to rise to 5 DM to close the gap, a 19% appreciation vis a vis the DM. We have also projected CPI figures for the UK and Germany into IVQ 1980 and conclude that a rise to 4.5 DM would not be unreasonable. Moreover, just as Stg was undervalued for a considerable period of time, Stg may become overvalued if only due to the present glamorous combination of a truly conservative Government and oil self sufficiency.

Remain firmly long, raising stops to 2.20 basis Sept. 79; our longer term target remains in the 2.55-2.75 area.

	Visible Balance (EM)	Current Balance (EM)	Oil Balance (EM)	M1*	M3*	DCE (EM)	Reserves US\$bln	MLR %	Food Index	FT Comdty
1978										
1st Qtr.	- 590	-369	-620	24.3	23.8	+1,811	20.63	6 1/2	197.3	238.61
2nd Qtr.	- 173	+208	-414	10.1	15.0	+2,800	16.75	10	203.8	242.27
3rd Qtr.	- 367	+154	-501	17.2	8.3	+ 591	16.55	10	206.2	253.74
4th Qtr.	- 39	+450	-480	15.1	13.0	+1,875	15.77	12 1/2	208.0	257.69
1979										
1st Qtr.	-1,181	-787	-237	7.2	10.1	+1,672	16.78	13	218.8	268.83
Jan.	- 126	+ 6	- 62	14.6	18.9	+ 801	16.26	12 1/2	217.5	260.63
Feb.	- 766	-635	- 78	17.6	20.6	+1,089	16.62	14	218.7	267.36
Mar.	- 289	-158	- 97	7.2	10.1	- 263	17.45	13	220.2	268.83
Apr.	- 327	-217	-114	16.8	7.4	+ 846	#21.47	12	221.6	277.11
May	- 185	- 75	- 54	12.8	8.4	+ 932	21.53	12	224.0	279.20
Jun*	- 49	+ 61	- 42	9.7	16.7	+ 816	22.07	14	230.0	293.55

Reserves: now revalued annually, new estimates.

* Three months' growth at annual rate.

Source: Financial Times

Real Annualized Rates of Return on 3 months Currency Deposits

Based on expected rates of inflation *

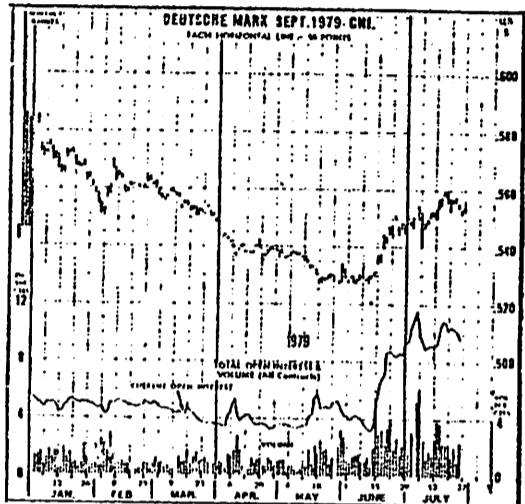
	Apr'79	May'79	Jun'79	Jul'79	Average
British Pound	1.37	1.295	2.68	1.20	1.636
Canadian \$	1.26	0.95	1.61	3.595	1.834
Deutsche Marks	1.62	1.37	2.025	2.0	1.754
Swiss Francs	-2.938	-1.588	-1.083	-4.7295	-2.585
US\$	-0.525	-0.354R	-0.62R	-0.30	-0.450
Japanese Yen***	3.61	2.39	N/A	N/A	2.999

* Linear regression used on past 3 month's year over year rates of inflation to project next 3 months.
 ** Projection is compared to prevailing rates in 3rd week of the first month of the subsequent period.
 *** For Japanese Yen we apply call money rate of the first month of subsequent period, others are 3 month Eurodeposit rates.
 R - Revised information received.

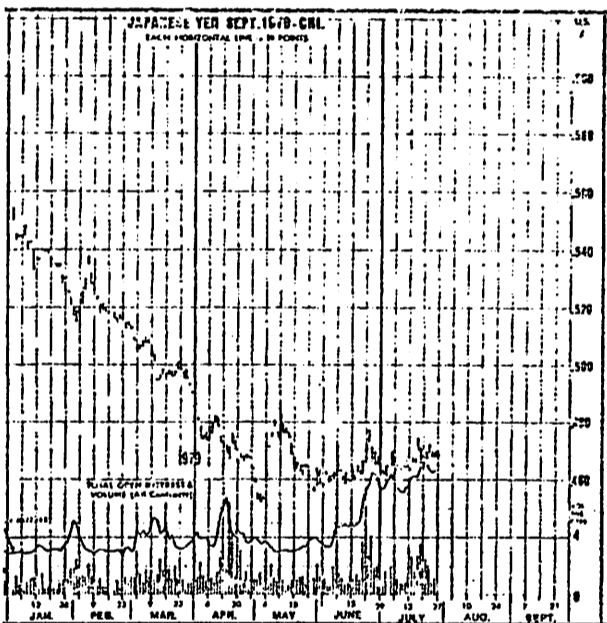
DM ...

	Balance of Trade (Mln Marks)	Balance of paym't	Money Supply**	W.P.I.**	Cost of Living**	Unem-ploym't Rate
Jan.79	2,050	200	9.91	1.18	2.83	5.1
Feb.79	2,400	800	10.92	3.07	2.95	5.0
Mar.79	3,400	1,900	11.21	4.83	3.27	4.2
Apr.79	3,330	1,350	10.89	5.79	3.53	3.8
May.79	2,000	-300		6.18	3.65	3.4
Jun.79	1,730	-2,800		n/a	3.91	3.3
Jun.78	3,960	2,200	10.80	-1.1	2.45	3.9

** Year-over-year % change.



YEN...



	Balance of Trade (Mln US\$)	Balance of Overall Account (Mln US\$)	Balance of Current Account (Mln US\$)	Money Supply**	Reserves (Mln US\$)	W.P.I.**	Unem-Ploym't
Jan.79	- 827	- 974	-1,420		33,110	-1.61	2.06
Feb.79	+1,000	- 760	+ 300	11.01	32,690	-0.85	1.88
Mar.79	+1,540	-1,570	+ 596	13.27	28,820	0.09	2.08
Apr.79	+ 510r	-2,970	- 258r	18.18	26,110	2.18	2.19
May 79	+ 53r	- 754r	- 828r	18.22	24,190	3.50	2.01
Jun.79	+1,110	- 380	+ 120		24,980	5.23	2.01
Jun.78	2,950	+ 576	+2,340	11.3	27,331	-2.23	2.4

** Year-over-year % change.

Balance of Trade (Mln SF) WPI** unem-employment

Jan.79	-186	-1.17	0.4
Feb.79	-355	0.5	0.6
Mar.79	-321	1.11	0.5
Apr.79	-300	2.09	0.4
May 79	-219	3.13	0.4
Jun.79	- 76	3.83	0.3
Jun.78	-110	-3.56	0.4

Weekly Reserves (Bln SFr)
 25.9(29/6) 24.71(6/7) 22.6(13/7)
 22.18(20/7)

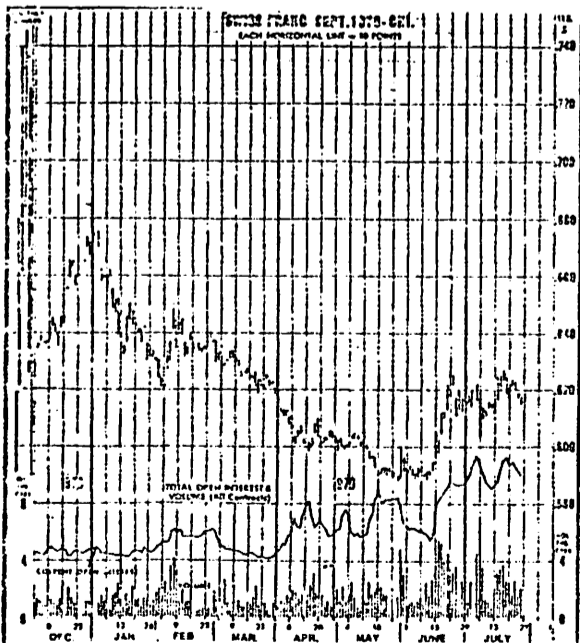
** Year-over-year % change.

Current Account - Payments Balance

1978 1977

(Bln SFr) +7.87 +8.27

SFR ...



CANADIAN DOLLAR

Despite the recent 1/2 point hike in the Bank Rate, Ottawa found difficulty today placing its 3-part \$1 billion offering. Furthermore, as much as \$350 mln is being taken up by the Bank of Canada, reflecting Ottawa's continuous policy of offering debt at sub-optimal interest rates. A huge refunding operation coming in early FALL along with a potentially highly destabilizing run-off in CSB will force the Bank of Canada to keep interest rates high, regardless of foreign exchange considerations.

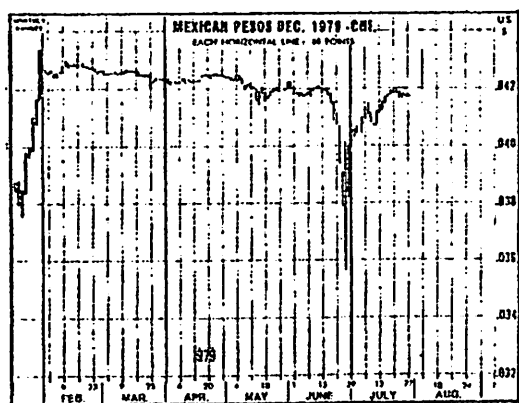
On a more positive note, Finance Minister Crosbie revised downwards the Government's net financing requirements for 1979/80, which, excluding foreign exchange, should total \$10 billion as against a widely touted \$13 billion during the election campaign. Should Ottawa avail itself of almost \$7.0 bln of foreign exchange financing (\$4.1 billion have already been used to date), by way of more active currency intervention, financing requirements should not strain unduly the domestic money and bond markets. As a result, we would have to lower somewhat our monetization and money supply growth estimates made earlier this year.

It remains to be seen whether the Tories can forget election promises of a stimulative budget deficit and, instead, concentrate on narrowing further the presently outsized shortfall. Should they succeed, we may see the CD\$ begin a long term relative improvement vis a vis the U.S.

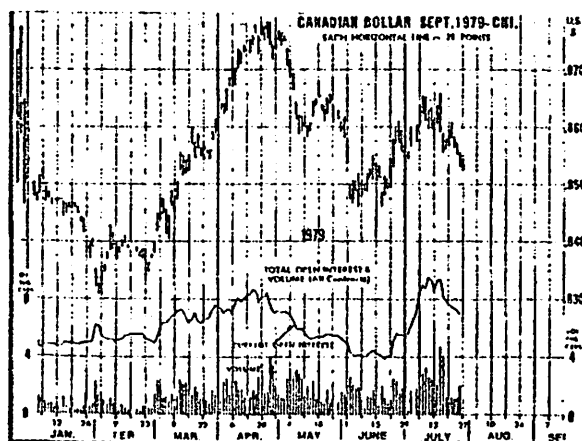
Maintain short CD\$ positions with an eye on upcoming budget developments. Lower stops to 86.00 basis Sept.79, close only (previous 86.5 stop was never triggered on closing basis).

	Balance of Trade (mln \$)	General** Bank Loans	Money Supply**				Total Liabilities**	Int'l Reserves (bln US\$)	C.P.I.**	Food Index**	Unemployment	
			M1	M1b	M2	M3					S.A.	N.S.A.
Jan.79	+ 386	14.14	7.48	6.16	13.46	19.57	15.9	4.4	8.9	14.09	8.1	9.1
Feb.79	146	14.34	8.85	5.83	13.95	20.14	17.6	4.11	9.18	16.11	7.9	8.8
Mar.79	150	15.60	7.03	4.04	13.57	18.36	17.3	5.42	9.2	17.4	7.9	8.9
Apr.79	115	16.55	7.96	5.31	14.38	17.58	16.4	5.14	9.75	16.52	7.9	8.6
May 79	216	18.32	8.51r	6.26r	15.22r	20.03r	16.98	4.08	9.27	13.38	7.7	7.5
Jun.79		20.34	9.32	6.35	15.75	20.22	n/a	4.18	8.85	11.70	7.5	7.0
Jun.78	38	11.06	8.51	7.87	19.41	12.43	12.37	4.7	9.23	17.92	8.6	8.0

** Year-over-year % change.



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MEXICAN PESO

Forward Discounts Comp. Annual Rates

	Sep'79	Dec'79	Mar'80	Jun'80	Sept'80	Dec'80
Spot	18.24	15.06	13.90	13.75	12.74	12.91
Sep'79		13.50	12.84	13.02	12.07	12.39
Dec'79			12.18	12.78	11.60	12.11
Mar'80				13.37	11.30	12.09
Jun'80					9.27	11.45
Sep'80						13.68

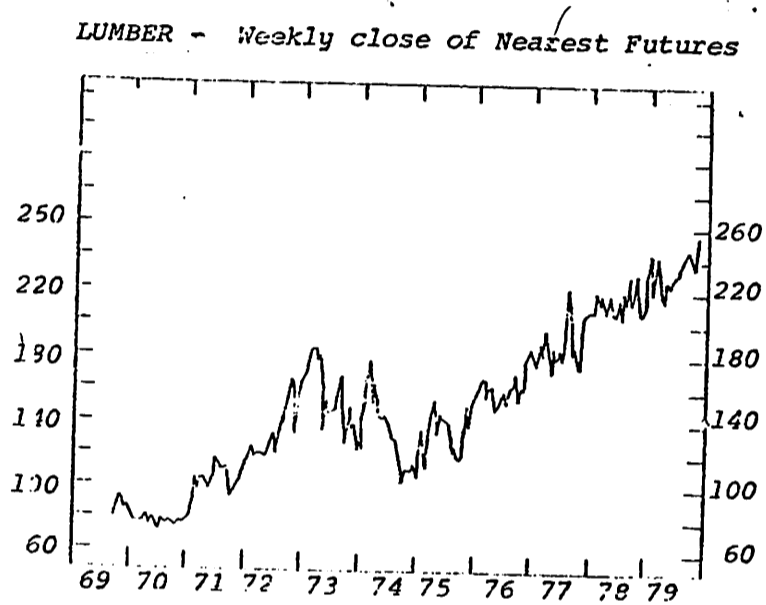
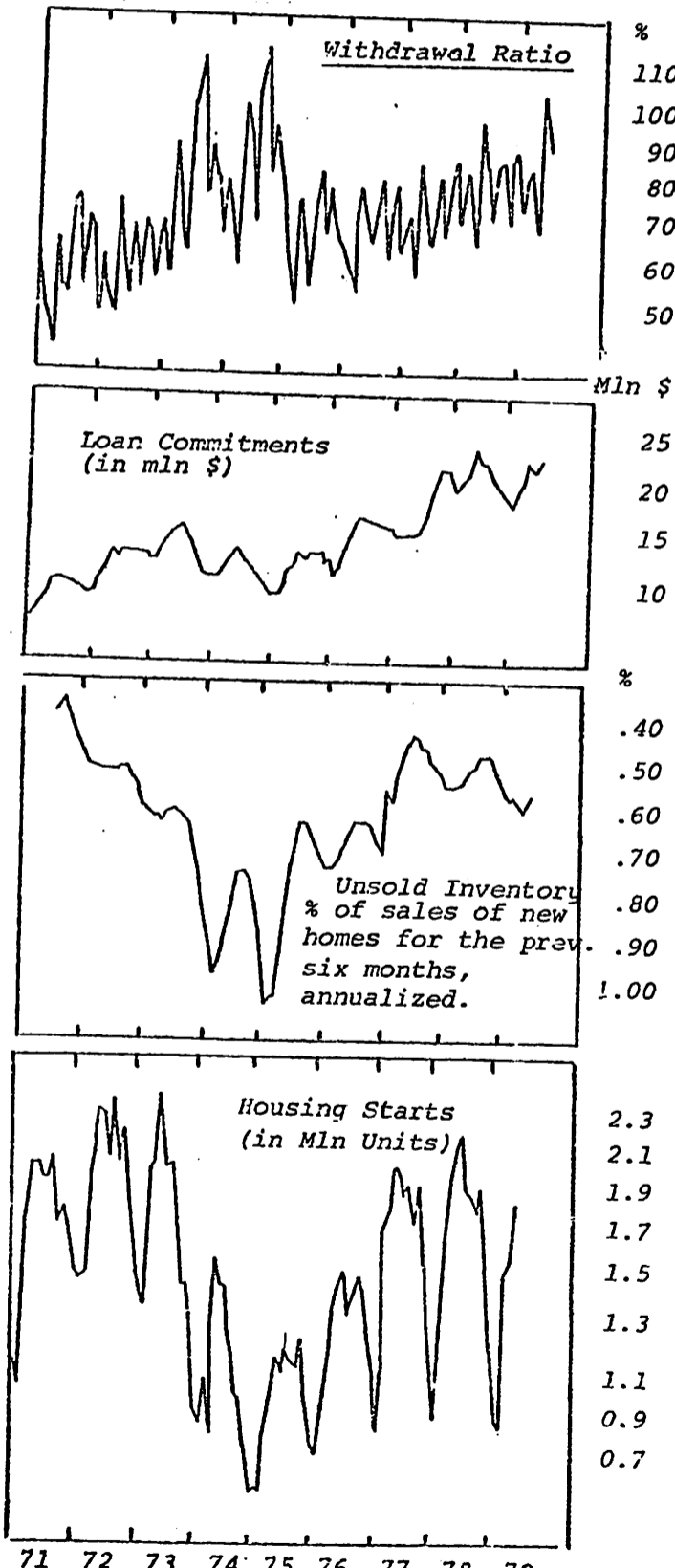
Mexican Oil Export Price - The Mexican State oil firm PEMEX said Mexico has increased the price of its crude oil exports by 32.2% to 22.60 U.S. dlrs a barrel from 17.10 dlrs a barrel, effective from July 1 to Sept. 30.

Having taken a profit on June MP, remain sidelined.

POTPOURI

Short OJ position should be closed at 103.50 basis November, close only liquidate long Cocoa positions at market - reinstate them on move above 140 basis September '79 Raise stops on long Dec '79 Comex Gold to 304, close only After promising start, hog spreads reverted to bearish configuration cancelling our (well) thought-out rationale - stand aside until a clear-cut contango re-appears....

The set of charts reproduced below has been prepared by our staff from readily available data. It purports to show the 1973 turning point in housing starts and the conditions under which it developed. Upon close examination, a still-bullish case can be made for housing starts and lumber. In the first place, the backlog of unsold homes as a percentage of recent sales has not been increasing as rapidly as in 1972-1973 - nor has it crossed the apparent danger point represented by the 60% mark. Secondly, mortgage loan commitments have rebounded strongly in recent months, most probably a result of the very gradual tightening of S & L's balance sheets. Here again, the in-and out flow of savings at S & L's compare favourably with the 1973/74 experience, when desintermediation was a brutal fact of life. The recent proposal by the FHLB Board to let S & L Association seek Eurodollar deposits in minimum quantities of \$100.00 will, no doubt, further strengthen their lending facilities.



In sum we do not, as yet, foresee a significant drop in housing starts. We are, therefore bullish on lumber and believe the market will ultimately reach above \$300 per 1000 board feet.

FCI	July 30/79	June 29/79	July 31/78
	251.88	266.42	226.00
	-5.46% from prev. month		
	+11.45% from prev. year.		

Albert D. Friedberg

All statements made herein, while not guaranteed, are based on information considered reliable and are believed by us to be accurate.

Sources: Nat'l Forest Assoc., FHLB, U.S. Gov't Const. Starts Branch