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MIDDLE EAST: President Sadat left for Saudi Arabia last night, beginning a tour that over the weekend will also take him to several Persian Gulf states and Syria. In Damascus, Sadat will make an effort to convince President Asad that Egypt is not seeking a unilateral settlement with Israel.

Public Egyptian comments on the disengagement agreement signed on January 18 have been designed to allay Syrian misgivings. Sadat said yesterday that the negotiations should concentrate on Syrian-Israeli disengagement prior to the resumption of the Geneva conference. By implying that the conference may not be reconvened until Syria has achieved progress to match Egypt's, Sadat probably hopes to make it clear to Syria and the other Arab states that Cairo will not act except in concert with all Arabs. Indicative of the kind of problem which Sadat may encounter from some Arabs, a fedayeen broadcast from Baghdad last night bitterly attacked Cairo's disengagement agreement with Tel Aviv as being treasonous and a capitulation to "US imperialism and the Zionist enemy."

Sadat's statement may quiet Syrian suspicions of an Egyptian sell-out. Syrian Foreign Minister Khaddam insisted earlier this week that the disengagement of forces on the Egyptian and Syrian fronts must occur simultaneously and be linked to an overall Israeli commitment to withdraw from all occupied Arab territory.

Egyptian leaders have always demanded that disengagement be linked to future Israeli withdrawals. Syria's willingness to enter into talks with Tel Aviv may hinge in large part on whether Damascus is satisfied with whatever understanding Sadat has reached on this point.

According to an Iraqi broadcast, the Syrian Government has denied an earlier press report that Damascus threatened on Thursday to sever relations with Cairo over the terms of the Egyptian-Israeli agreement. [redacted]

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CHINA - SOUTH VIETNAM: Early this morning Chinese and South Vietnamese troops clashed on an island in the Paracels believed to be Duncan Island.

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25X1 [redacted] 74 marines landed on the island and were surrounded by about two companies of Chinese troops. [redacted]

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The South Vietnamese have reported three marines killed and two wounded, and have now pulled their forces from the island. Saigon has also recalled naval and troop reinforcements that had set out from Da Nang.

[redacted]

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The South Vietnamese are unlikely to seek further combat in view of the apparent Chinese determination to use force. Each side will accuse the other of starting the fighting, but it is unlikely that either seeks a prolonged military confrontation over the islands.

Both sides have long maintained some presence in the Paracels. The current flare-up appears to have been touched off by a recent renewal of conflicting claims to islands in the South China Sea. Last fall, the South Vietnamese repeated their claim to the Spratly Islands, a group south of the Paracels, prompting a Chinese Foreign Ministry statement earlier this

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month that reaffirmed China's claim. At the same time, Peking repeated its claim to other island groupings in the South China Sea, including the Paracels, as well as "the natural resources in the sea around them."

While it is not unusual for China to spotlight its territorial claims in response to initiatives by other governments, rumors in recent years--so far unsubstantiated--of oil in the vicinity of the Spratlys, may have added a new dimension to the problem. China may have felt it necessary to reassert its interests because of recent concessions Saigon has awarded to Western companies for offshore oil exploration.

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C BELGIUM: The resignation of Prime Minister Leburton's government yesterday, following Iran's cancellation of a proposed joint Belgo-Iranian refinery project in Belgium, does not necessarily mean that new national elections will be held.

The political crisis came to a head when Iran announced withdrawal from the joint $200-million refinery project slated for an area near Lieges. The refinery would have been particularly beneficial for the economically depressed region of Wallonia, the region with which Leburton and the majority of his Socialist Party colleagues identify. The project would also have been a noteworthy success for Leburton in facing the energy crisis.

The Prime Minister appears to be gambling that public concern over the energy crisis will strengthen his bargaining position in negotiating with the Liberals and Social Christians to form a new coalition government. Should this gamble fail, Leburton can then take his case to the people, where he may also use the concern over oil supplies to try to win more seats in Parliament.

The Social Christians, under the leadership of Deputy Prime Minister Tindemans, played a key role in scuttling the agreement by raising last-minute demands in the negotiations. Tindemans, whose party is predominantly Flemish, apparently hoped to win new concessions on issues sensitive to his home region in return for going along with the refinery.

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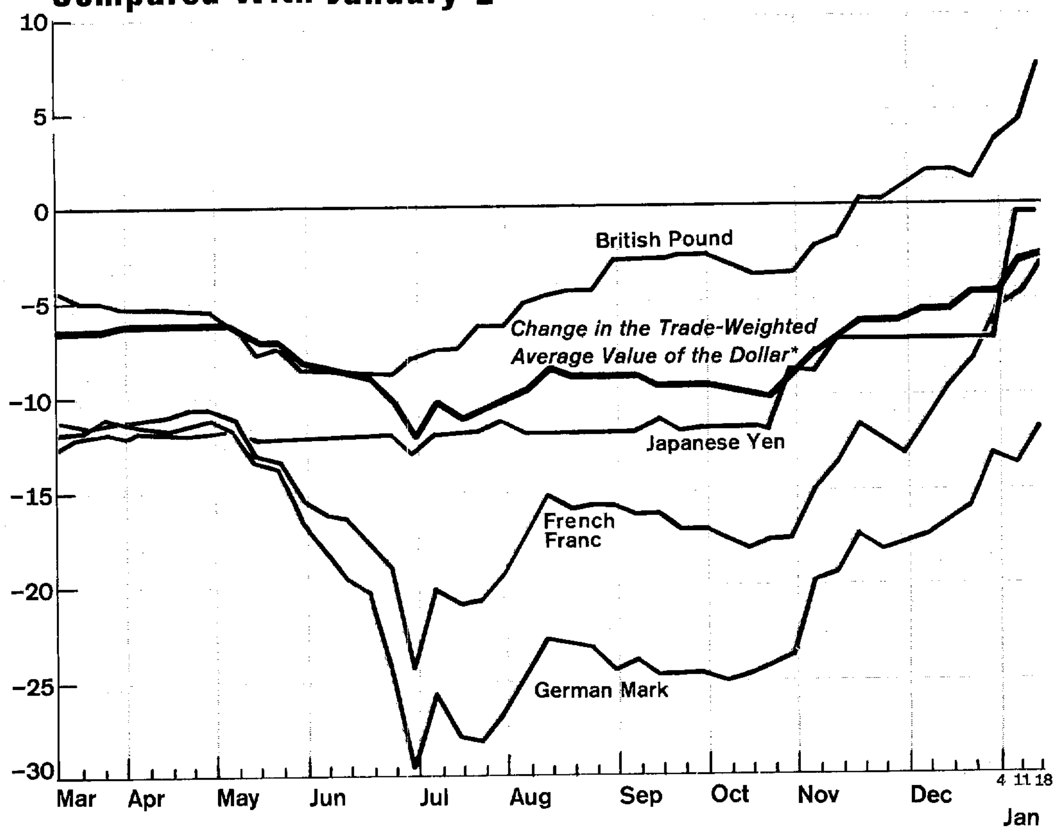
Percent Change In the Value of the US Dollar Relative to Selected Foreign Currencies Compared With January 2 1973



*Relative to 16 major currencies

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INTERNATIONAL MONETARY DEVELOPMENTS: The dollar showed another net gain in major European markets this week. The Europeans' reluctance to draw down dollar reserves to bolster their currencies contributed to the dollar's continuing strength, as did the expected uneven impact of higher oil prices.

The dollar's greatest gains were recorded against sterling and the Italian lira. Both fell to record lows by midweek, before strengthening slightly. Sterling's decline is caused by the continuing deterioration in Britain's economic outlook as well as by uncertainties surrounding the possibility of an early election. In spite of sterling's rapid drop, however, British intervention was relatively low--roughly $200 million this week. The British apparently are willing to accept the inflationary impact of a weakening pound rather than see a further decline in domestic economic activity caused by the tight money that would follow in the wake of massive dollar sales.

The Bank of France also intervened this week, selling $150 million to limit the franc's decline.

The dollar strengthened against the mark during the week, although it remains below the levels reached early last week. The Bundesbank, in an attempt to offset tight money caused by previous dollar sales, injected funds into the economy. The resulting decline in some German interest rates keyed a shift out of marks. According to press reports, Germany is unwilling to continue to reduce holdings, potentially needed for oil purchases, to maintain market stability.

In Tokyo, the Bank of Japan sold over $450 million during the week. Pressure on the yen reflected the traditional January weakness in the trade balance as well as the dollar's strength in Europe.

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<u>JAPAN</u>: Japanese industrial firms are being permitted to borrow abroad for the first time in several years. This will allow them to continue expanding international operations without draining Japan's foreign exchange reserves.

Last month Tokyo announced that industrial firms would be allowed to float bonds abroad on a case-by-case basis, and so far 120 applications have been forwarded to the Ministry of Finance. Although the Eurodollar market will be tapped first, it is likely that borrowing in the US will follow. The first bonds probably will not be issued until April.

Initially, funds raised abroad were to be used only to finance overseas operations, but power companies recently were given permission to bring such funds into Japan. This will generate some capital inflows by midyear. If large balance-of-payments deficits occur early this year, as seems likely, permission to bring in foreign funds will probably be broadened to include other industries, accelerating the inflow.

These moves, combined with new restrictions on the movement of capital abroad, probably will reduce net capital outflows from the approximately $9.5 billion registered last year. Tokyo hopes to cut the outflow to about $4 billion this year to conserve its already reduced foreign exchange holdings.

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CUBA-ECUADOR: The Cuban Government reportedly has undertaken several initiatives to gain closer ties with Quito. These include a proposal for a university exchange agreement, invitations to Ecuadorean journalists and to the navy to send delegations to Cuba, and a request for the reopening of Prensa Latina's office in Quito.

These initiatives probably result from a desire to restore the momentum of Cuba's campaign against the OAS policy of isolation. The Castro regime viewed the Chilean coup as a major setback, and also has demonstrated concern over Peron's actions against the Argentine left. In addition, Cuba probably is worried that the new Venezuelan administration will avoid further movement toward full diplomatic relations with Havana. The Cuban approach may also have been motivated by concern that Secretary Kissinger's forthcoming meeting with the Latin American foreign ministers might undermine Havana's efforts to aggravate US - Latin American differences.

It is unlikely that Ecuadorean President Rodriguez is considering re-establishing full formal relations with Cuba in the near future. Expanding contacts with Castro's regime would mollify some of the more leftist officers in the government, however, and enable Rodriguez to point to specific steps he has taken to assert Ecuador's "independent foreign policy." 25X1

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BOLIVIA: Shortages of basic consumer goods--notably wheat--could further weaken President Banzer's political position.

The wheat shortage has been caused by a variety of factors. Argentina reportedly is not meeting its supply commitments, and shipping from Peruvian ports has been slowed by strikes. It also appears that a good deal of wheat has been smuggled out of Bolivia and sold on external black markets--possibly with the connivance of some Bolivian officials. To stem this outflow, the government reportedly is planning to raise domestic prices, thus making black market sales less profitable.

According to the US Embassy, the shortage of foodstuffs, including sugar, meat, and cooking oil, has become a "principal topic of conversation," and there are long lines of shoppers at stores all over La Paz. The embassy also reports that at least one demonstration by workers protesting shortages and high prices was broken up by police.

The shortages and proposed price hikes come at a time when Banzer can ill afford a new political challenge. Many of his former supporters in the military and the two main political parties have gone into some form of opposition. The President recently exiled former president Victor Paz Estenssoro, the nation's most prestigious political figure, who was accused of actively plotting against the regime. The supply situation could arouse consumers and stimulate more active coup plotting both within the country and among exiles.

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<u>Venezuela</u>: Caracas has imposed new conservation rules that may reduce petroleum production, currently 3.4 million b/d, by 200,000 b/d, or 6 percent. [redacted] 25X1

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These items were prepared by CIA without consultation with the Departments of State and Defense.

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