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The new year has brought with it a number of questions from around the world mostly concerning the sharp increase in volatility that has afflicted nearly every market in the world. Attendance at our worldwide seminars has grown sharply over the past two years, virtually doubling, particularly in Japan and Canada. The undeniable cause for the dramatic increase is that everyone knows something is wrong. You may not reach a worldwide concensus as to the source of the international instability nor will the world agree upon the possible future outcome. Still, there is an unprecedented level of concern about the rise in confusion and volatility around the globe. Above all, no field has demonstrated this confusion as much as fund management which has turned in the worst performance this past year since the crash of 1987.

The primary cause for the staggering losses in fund management is a result of incorrect forecasts in worldwide interest rates and foreign exchange - particularly the Japanese yen. Even the Orange County default was brought about by poor management and forecasts concerning interest rates.

As the volatility and disappointment in share market investment spread around the globe, the sales teams went out among the masses talking a good game in support for the emerging markets. Institutional and private investors around the world bought the sales pitch hook-line-and-sinker. As the sales teams reeled in their prey, volatility struck in the last quarter of 1994. From the bright shining star to the depths of despair, the emerging markets have proven to be less of a diversification maneuver and more of just the same speculative fever that has afflicted so many markets since 1987.

The future for 1995 shows capital trends shifting yet again. The best performing investment sectors will be commodities and the US share market. The source of capital investment for these two areas will be rather wide spread. In part, concern of the likelihood of a Canadian government suspension of interest payments on its debt and a continued decline the Canadian dollar will result in an increasing outflow of capital heading toward the United States. Rising inflation and declining corporate profits combined with a heightened pressure on interest rates throughout Europe will also add to the net capital inflows for the US marketplace. Joining the party will be a shift in net capital outflows building in Japan as the yen stagnates and eventually declines against the dollar. Most investors in Japan do not expect a repeat of last year's 30% rise in the yen so foreign exchange risks appear to be favoring US investment. This trend is further enhanced by a large interest rate differential.

Combining these trends with domestic US investment trends points to a significant rally for the US share market. It is entirely possible that new record highs will be established during early 1995, then an eventual rally into early 1996 could result in a 30-40% advance in the Dow Jones Industrials.

The commodity sector, including crude oil, appears to be quite strong as we move into 1996. Gold will be a key indicator to watch. We do see a potential for near-term weakness in gold with a decline down to the $361-350 level. This should then be followed by a rally into 1998 where the $1,000 level will be visited. Silver could also still see a near-term drop to the $4.39-$3.90 level during the first quarter of 1995 with a reversal in trend toward the upside going into 1996 if not 1998.

The Japanese yen will be a key currency to watch. If the dollar closes above the 102.74 level on a weekly basis in cash, then this could signal a change in trend for the US dollar as a whole - with the exception of the A$.

The issue that will dictate the primary trend in global markets will br the escalating debt crisis. We suspect the next country to move into a financial crisis will be Canada. If we do see Canada move into a temporary default position due to a sharp rise in its interest expenditures, the impact will be globally. Capital will become focused upon the rising interest expenditure problem in all nations. Given the fact that 40% of the total outstanding debt of Canada will come due between now and 1996, the rising interest expenditures will result in over 50% of all expenditure going for interest. This at the very least will force dramatic policial and social change in Canada as we approach 1996. This in turn will shake the confidence in capital with respect to all public debt causing stock markets to rise as capital flees government bonds in search of safety. Consequently, our strongest recommendation remains for borrowers to lock-in their loans and lenders to stay as short-term as possible.

Interest expenditures as a percent of total government expenditure should rise rather sharply going into 1996 in most nations due to the extreme short-term maturity of most national debts. This will become an issue throughout Europe, the United States and Japan.

1995 may prove to be a rather interesting year not just in the marketplace but geopolitically as well. In Russia, Yeltsin has clearly lost a lot of support and the internal strife combined with a continued eroding economic situation does not look good for Russia as a whole. Another great concern will be the fate of China following the death of Deng Xiaoping and the possibility of the Israel-Palestinian peace process completely falling apart. All three of these issues are likely to reach a conclusion between 1995 and 1996 as we move into the next turning point on the business cycle as defined by our Economic- Confidence Model.

The following is a list of specific questions that were presented to us by one of the largest funds management operations in Tokyo.

1. Emerging Markets

Q.As the long-term growth potential of the Japanese economy declines, Japanese investors are increasingly turning to emerging markets to secure long-term gains. In Asia, Thailand and Malaysia appear to have peaked, but what are the prospects for other emerging markets such as Asia, India, Turkey and Latin America?

Prospects for all emerging markets remains very volatile for the short-term. As financial pressures continue to increase within the major G7 economies, the stability of the emerging markets will suffer. Within the emerging market area, the strongest and most stable economies for the short-term will remain in India and Chile, but even these will be subjected to rising financial pressures and volatility. Australia, although not an emerging market, will tend to benefit from the instability and volatility within Southeast Asia. We see the western portion of Australia tending to benefit as a stepping stone for South East Asia as a whole. Long-term growth in these emerging areas may prove to be far more promising after the 2003 period.

With respect to China, caution must be exercised for the immediate near-term. Some skepticism on our models remains in place with respect to the short-term outlook. We suggest waiting for the death of Deng Xiaoping to see how the political process truly unfolds in the immediate period that follows. Recent comments that China still regards Taiwan as a province and refuses to rule out military force to gain reunification must be taken seriously. These comments seem to characterize the China-Taiwan issue in the same light as recent events in Russia. China warned that foreign intervention in this matter would be viewed as an intervention in the internal affairs of China. Such comments at this time have not been taken seriously when they should be viewed with caution as to the political changes that remain possible following the death of Deng Xiaoping. Concerning fair trade with China, again extreme caution is necessary. Trade sanctions by the United States are inevitable particularly when one realizes that many of the privatizations within China are owned in part or influenced by the military. Therefore, the prominent theft of foreign products is not solely due to enterprising individuals but the military also. China will not back down on the exploitation and counterfeiting of foreign goods due to the behind the scenes involvement of the military.

2. Interest Rates

Q.Will rising interest rates slow the US economy in the near future?

The US economy is very strong and the interest rates are not currently high enough to slow down the economy. Interest rates will continue to rise going into 1996. We would expect at least another 3 more rate hikes by the Fed during 1995. We must also keep in mind that the last high in the discount rate was 7% back in 1989 when the peak in our Economic Confidence Model took place. Therefore, with the Fed discount rate closing 1994 at 4.75%, there is little resistance until we see this rate rise to 5.25%. Eventually, the primary resistance will stand at the 6.5% area. Exceeding this level will warn that a worldwide debt crisis is beginning to pick up significant momentum. For now, the economy in the United States will still expand moving into 1996 as employment stabilizes. This suggests that while unemployment may begin to rise slightly, wage pressures for skilled jobs will still rise sharply along with corporate profits. Furthermore, if the Republicans are successful in bringing meaningful tax reductions, we could see a flurry of economic activity going into 1996.

3. Global Investment

Q.What is the most attractive investment available? For example, what stock, bond, real estate, commodity, currency, etc. and in what country?

The most promising country for investment will be the United States. The most attractive areas by performance will be (1) commodities, such as gold, base metals and agriculturals, (2) stocks, (3) currency (4) real estate and (5) bonds. This will hold true for not merely the Japanese perspective, but also from the European and Canadian views.

4. Investment Strategy

Q.In the world of investing, what do we need to know in order to succeed? How do we work towards these objectives?

The most important thing to know in order to invest successfully is to understand that you must consider the currency first. It is also very important to understand and remember that capital moves internationally. You must look outside the domestic economy and domestic fundamentals to understand capital flows and economic outlooks.

It is also very important to understand timing models and the concept of cycles, such as Princeton's Economic-Confidence Model. If you know how long markets move in either direction, you can use this knowledge to anticipate turns in the markets as a whole. For example, the US bond market peaked in August of 1993. If you understand cycles, you would know that the period of greatest risk always lies within the first two years following a major high (1994-1995). Understanding this vital aspect about how markets move would have prevented any serious loss last year following the very first uptick in interest rates.

5. Capital Flows

Q.In your recent monthly report, you said we have to pay attention to the movement of international capital transfers. Could you give us your concrete idea about this?

Net capital movement statistics are obtainable from the OECD, in addition to individual statistical agencies on a nation by nation basis. Net capital movement is first evidenced by the changes in direction of the currency.

CANADA

Continued business investment growth and solid gains in exports contributed to GDP growth of 3% in the first half of 1994 - equivalent to an annualized rate of 6.4% - the strongest performance among the G7 countries.

Private demand expanded during the 2nd quarter as employment recovered. Investment in residential construction rose by nearly 5% in the 2nd quarter. However, interest rate increases are gradually taking their toll on big ticket items such as cars which saw decreased monthly sales of 5.5% in the summer. Retail sales also fell by 1.8%, although total sales excluding automotives posted a small increase of 0.4%.

The underlying rate of inflation is just over 1.5%, and inflationary pressures will remain subdued over the short term. The weakness of the CD, although raising the price of imported commodities, is expected to only have a moderate impact on headline inflation, because the current slack in the domestic economy should prevent retailers from passing on the full increase to consumers.

Although the Bank of Canada's base rate dropped to 5.4% in early October, down from 7.09% at the end of the first six months of 1994, the country's low inflation rate still means that Canada's real interest rates remain the highest in the developed countries.

The long takeover battle for the Canadian gold-mining company Lake Minerals Ltd, which at one stage involved at least four contenders, was finally won by American Barrick Resources Corporation. The acquisition makes Barrick the world's 12th largest gold producer.

Canada's merchandise exports reached record levels in the first seven months of the year, totalling more than C$18.5bn on a balance-of-payment basis. This was nearly 25% higher than the same period of 1993. Boosted by the rise in commodity prices and growing international demand for metals and minerals, exports of industrial goods rose by 30.2% between July '93 and July '94.

Canada posted a record trade surplus in 1994 of C$2.3bn, the result of a substantial surplus with the USA (C2.7bn) and to a much lesser extent, Japan(C$389m). Canada and the USA are the world's largest commercial partners with bilateral trade of some US$210 billion. In the first 10 months of 1994, the trade surplus climbed 34% to $15.5 billion. Exports to the USA now account for 81% of total foreign shipments, a proportion that has grown from 76% at the start of the decade.

Despite a healthy trade surplus, the burgeoning size of the country's public debt and the related increase in interest payments made to foreign holders of Canadian securities has resulted in a chronic current account deficit. In the 2nd quarter of 1994 it reached C7.5bn, up C$100m on the previous quarter.

CURRENCY: As of Jan 10, the CD fell to near 9-year lows, triggering higher interest rates and the prospects of increased prime lending rates. In response, the Bank of Canada increased the range for the rate on overnight loans from 5.75% to 6.25%, which was linked to a 12-basis-point increase in the bank rate to 7.24%. Analysts attribute the reluctance of the Bank of Canada to raise rates as a major contribution to the fall in the CD. Investors are hesitant to buy or hold Canadian dollars until the government details its deficit reduction plans next month. The dollar's weakness has spilled into the money and bond markets, pushing bond yields to their highest levels in more than two years. The yield on Canada's 3-month bill was 7.35%.

The weak Canadian dollar has been beneficial for Canadian stocks.

A weaker currency makes Canadian goods more inexpensive abroad, boosting sales and profits of exporters. Industrial product stocks, which account for 16.7% of the TSE 300, have played the biggest role in leading the TSE higher.

However, while a weaker Canadian dollar makes assets cheaper for foreigners to buy now, it also reduces the value of assets currently held by non-Canadians. Higher rates crimp corporate profits by slowing the economy and increasing borrowing costs.

HOUSING STARTS: Canada's national housing starts fell 10.6% in December from November according to Canada Mortgage and Housing Corp. National starts fell to 130,000 units in Dec. from Novembers 145,400 units (seasonally adjusted at an annual rate). The December decline stemmed from a 24.2% drop in the construction of urban apartment and condominium buildings and a 12.7% drop in the construction of single family homes.

MOTOR VEHICLE SALES: New motor-vehicle sales fell 4.3% to a seasonally adjusted 104,314 units in November from October. The decline reflected a 5.2% drop in truck sales to 43,743 units and a decrease of 3.6% in car sales to 62,845.

Sales of cars and trucks improved steadily over the first 11 months of the year, climbing 6% from the year earlier period.

BUDGET DEFICIT: Canada's budget deficit widened to C$2.77 billion in November from 2.1 billion in November 1993. Much of the increase was attributed to the timing of federal government employee pay periods. Canada's 93-94 budget deficit of $42 billion amounted to about 6% of GDP.

GERMANY

The Bundesbank has set a tight monetary target for this year and warned industry, trade unions and state governments against following policies that could push up inflation. Although the "steady-hand" policy has been endorsed by many policy makers, some economists said that the money supply-goal for 1995 could only be achieved if interest rates rose. It was said that monetary tightening would be appropriate because of expected higher wage rises, rising import prices and price levels at the producer level.

The bank set its target range for M3, the broad monetary aggregate, at between 4 and 6%. This is unchanged from 1994, but because of the way the rate is calculated - on an annualised basis from fourth quarter to fourth quarter - it implies a much lower average growth rate of 3.5% after the '94 rate of 9%.

However, two economic releases in January suggested that inflation was under tight wraps. Therefore, an expected acceleration in growth and weakening inflation dangers should make rate increases unnecessary for the time being.

Most council members of the Bundesbank have mixed views on inflation. While labor costs are tame and private consumption is too weak to permit retailers to raise prices, an expected 14% increase in dollar-based commodity prices will keep pushing up German import prices, which have been rising since the summer of 1994.

Hans-Juergen Krupp is alone among the 16 members of the Bundesbank policy-making council in publicly urging additional reductions in interest rates to help economic recovery. Krupp has said that the economy is growing too slowly and that January's annual inflation rate is likely to fall from 2.7% in December. (This view on inflation was strengthened by Bundesbank president Hans Tietmeyer, who said that the Western German inflation rate should fall below 2.5% in January, even as commodity prices rise.) Krupp has said that the Bundesbank can bring down long- term rates by cutting its short-term rates, which it has held steady since last July.

Lower interest rates, according to Krupp, would help long-term German and European rates decouple from levels that have been dictated by the U.S. bond market.

Bundesbank president Tietmeyer said that the Western German economy grew nearly 3% in 1994, declaring that the recession was over. He put growth in the five ex-communist states of Eastern Germany at more than 8%, bringing the growth rate for all of Germany to around 3%. He said that the government must use the economic rebound to get its fiscal house in order and to scale back spending that will eat up 45% of German economic output in 1995. Excessive public spending, according to Tietmeyer, poses a threat to the health of the economy and called on the government to cut its deficits to 1%-1.5% of Germany's GDP.

Germany's recovery from a recession remains uneven as evidenced by a drop in West German manufacturing orders in November. The main reason for the lower order level was a 1% drop in demand from abroad. Domestic orders were unchanged.

BUDGET CUTS: Chancellor Helmut Kohl's government plans to cut 3 billion DM ($2billion) off the estimated 58.6 billion mark budget deficit for 1995. Budget planners are confident they will find enough extra savings to keep the deficit below the 56 billion shortfall of 1994. Budget planners aim to cut government payrolls by more than the official 1% target.

UNEMPLOYMENT: The number of unemployed in Western Germany rose by 1,000 to 2.534 million in December from November. The increase, which adjusted for seasonal influences was expected.

According to a German survey, more jobs will be lost in 1995 in Germany's construction, chemicals and retail industries. Only in computer and machinery industries is net job creation expected.

In Eastern Germany, the jobless count advanced to 1.015 million from 980,448. The regions unemployment rate climbed to 13.5% from 13%.

CONSTRUCTION: Falling prices and increasing competition will continue to squeeze profits at German construction companies in 1995, according to the German Construction Association. Difficult competition is expected to result in too-low prices, weak earnings and further increase in insolvencies, particularly among medium-sized companies.

The overall recovery in the German economy hasn't reached the construction industry.

FRANCE

INFLATION: France's inflation ended 1994 at its lowest level in nearly 40 years, with consumer prices in December rising between 1.6% and 1.7% from a year earlier. That's down from an annual rate of 2.1% in December 1993. While economists say France is not likely to repeat 1994's performance this year, inflation looks set to remain under control.

Low inflation, according to the ministry, helped economic recovery by boosting household's consumption as well as exports, as French goods remained competitive. Ten years of shadowing Germany's strict interest rate policy (known as the franc-fort policy) has allowed France to effectively import its neighbor's low inflation rate.

The franc-fort has been given the credit on braking the endless cycle of wage rises, inflation and devaluation. Employers, aware that there would be no devaluation to bail them out, have been forced to keep their costs down and keep the wraps on wages. The flip-side has been a rise in the unemployment rate to record levels. Some 12.6% of France's workforce is now out of a job, compared with just above 10% at the end of 1984.

CONSUMER CONFIDENCE: French consumer confidence improved in December, with households more optimistic about job prospects and their personal finances, according to a monthly survey by the National Statistics Institute, Insee. An increasing number of those surveyed also forecast stable or lower consumer prices, while households were less pessimistic over the general outlook for living standards.

Doubts, however, have been raised over the strength of France's economic recovery. According to the Centre de Provision de l'Expansion, one of France's most influential forecasting institutes, the French economy, as measured by gross national product, will grow by a mere 2.5% this year, just as in 1994. That compares with a 3.1% forecast by the government and a concensus among private economists of 3%.

The prior build up in inventories, which fueled economic growth in '94 must now be followed by an increase in domestic demand for economic growth to continue. However, a pick up in domestic demand is in serious jeopardy because of higher taxes that will hit consumers and financial market upheavals that will hit companies.

Almost every French economist is forecasting a steep rise in taxes once the presidential election, due in April and May, is out of the way. The government must fund a social security deficit that is forecast to remain above 50 billion francs (9.3 million) this year for the third year running. Probabilities favor an increase in the "contribution sociale generalisse," a 2.5% flat-rate tax on nearly all sources of income.

An additional factor that will put a brake on consumer spending is a weak rise in disposable income. High unemployment is helping companies put a squeeze on wages. And many wage earners, sensing their job is under threat, will be in no mood for free spending. Consumer spending typically accounts for 2/3 of GDP.

ERM: French Budget Minister Nicolas Sarkozy ruled out the possibility of taking the franc out of the European Exchange rate mechanism as a way to spur economic growth. The minister cited Spain as an example of a country that widened its band of fluctuation of the Spanish pesata but still faces continued economic problems, including high unemployment.

CURRENT ACCOUNT: France's current account surplus in October narrowed to 3.1 billion francs ($600 million) from 7.7 billion francs in September, according to the Economy Ministry. In unadjusted terms, the current account, which includes transactions in goods and services to international organizations, showed a 5.1 billion-franc surplus after September's 11 billion francs.

Long-term capital outflows slowed, to 14.3 billion francs from September's 27.7 billion. But, foreign investors continued to sell French securities, of which they sold a net 12.2 billion francs, compared with 3.5 billion francs in September.

UNITED KINGDOM

A surprise rise in U.K. consumer prices in December, boosting the annual inflation rate to 2.9%, point to an interest rate rise in February. In addition, the total number of British workers without jobs and claiming benefit fell by a larger-than- expected 54,000 in December, the largest decline in nearly 6 years, fueling concern the economy is growing too strongly.

U.K. Chancellor of the Exchequer Kenneth Clark sought to play down the surprise increase by saying the government had taken steps to control inflation. (Interest rates were raised in September and December of last year.) Nonetheless, the inflation rate is now in the upper half of its 1% to 4% target range, and the government has said that monetary policy is aimed at getting the rate below 2.5% by April 1997. The Bank of England remains firmly committed to keeping inflation under control. The central bank's key objective remains to achieve price stability and that by acting early, before inflation gets out of control, the level to which interest rates may have to rise will be lower.

An all-party parliamentary committee of U.K. legislators broadly endorsed Chancellor of the Exchequer Kenneth Clark's budget strategy, although there were several concerns voiced on public spending, inflation and the housing market. There was also some concern about the effect on British business of increased tax on alcoholic drink.

In general, the legislators say that although Chancellor Clarke is confident of economic recovery, for the consumer, they believe, this may seem only a partial recovery. The negligible growth in real disposable income and hence very limited improvement in living standards, and the continued weak housing market are striking features of this recovery.

Legislators cited inflation and net exports as the 'principle motor' of the recovery, and the governments ability to deliver above trend growth depends more on these two factors continuing than the government has allowed for.

RETAIL SALES: Sale's in Britain's shops stores and supermarkets picked up in December with growth in most retail sectors, according to the Confederation of British Industry's latest distributive trades survey. Some 49% of retailers said sales climbed in December from a year earlier, giving a positive balance of 19 percentage points, compared with 6 points in November. The largest increases were reported by footwear, leather and clothing shops, followed by hardware, china and DIY retailers.

JAPAN

The Bank of Japan released its quarterly economic report (known as the josei mandan) which states that Japan's economy has been gaining self-sustaining momentum, although the pace of the recovery is slower than in past upswings. The report did not reflect the impact of the earthquake, although Kunihiko Takeshima, director of the central bank's research and statistics department said that the quake's impact is unlikely to dramatically change the outlook.

Compared to October's report, some changes are clear, according to Takeshima. The central bank has seen a growing possibility that a leading force for the recovery is shifting to consumer spending from investment in public projects and housing constructions. Takeshima said this view may change if earthquake damage induces massive spending on housing and social infrastructure.

Increasing overtime and employment are contributing to higher household incomes and consumer spending, but the pace of recovery will remain weak because corporate spending in new factories and production facilities has yet to increase. In the recessions that ended 1975, 1983, and 1986, capital investment started rising or stopped deteriorating one year after the economy bottomed out, the report said. In the case of the latest recession, which the government said ended in the fourth quarter of '93, capital investment is still falling. Takeshima said the central bank expects capital investment will stop falling in the half year to March or the half year through September.

The report said that Japanese wholesale and consumer prices will remain stable and the trade and current surpluses will continue to fall. The central bank expects about 3% growth in the money supply this quarter.

Perceptions of an inefficient government response to the Kobe earthquake may cause a shake-up within the ruling coalition in Tokyo and even undermine faith in Japan's social contract. Immediately, however, the quake may save Prime Minister's Tomiichi Murayama's cabinet from any challenges because it's caused a truce among his socialist party, and postponed politics.

Damages from the Kobe quake are likely to lower Japan's GDP by 0.1% for the fiscal year ending March 31 according to an estimate by Cosmo Securities Research Institute. However, for the year to March 1996, orders for restoration of the stricken areas will help raise Japan's GDP by .6% to 1.0%

The perception that the earthquake damage will hobble Japan's nascent recovery has sent a shock wave through Asian stock markets as investors calculate that the earthquake in Japan and higher interest rates in the U.S. make more traditional investments a better bet.

The Bank of Japan will try to supply sufficient funds to the banking system to insure that the Kobe Region has enough funds to rebuild following the devastating earthquake. Since the earthquake hit the Kobe and Osaka region in western Japan Jan. 17, the bank of Japan has added extra money to the banking system, apparently trying to meet a sudden surge in cash demand. Commercial and regional banks have rushed for this interbank money, anticipating large withdrawals from and individuals who are starting to repair their damage.

TRADE SURPLUS: Japan's merchandise trade balance, which measures the flow of goods in and out of the country, came to a surplus of $121.167 billion in 1994, the Ministry of Finance said, up from $120.241 billion in 1993. Japan's surplus with the U.S. rose 9.6% to $54.962 billion for the year -- the fourth annual increase and an all-time high.

On a more positive note - after ballooning at an alarming rate for years, the surplus rose a mere 0.8% last year. A rising tide of imports is making a significant dent in Japan's surplus, and many economists predict that the trade gap will contract next year.

Overall, the slight growth in the annual surplus wasn't surprising, economists said, given the yen's 10.9% appreciation against the dollar during the year. The higher yen pushes up the value of Japanese exports and reduces the value of imports, thus bloating the surplus when calculated in dollars. In yen terms, Japan's annual surplus shrank 7.1% to 12.425 trillion yen, the ministry said.

It was an impressive year for imports, which rose 14% in spite of the yen's strength. Leading contributors to import growth were computer chips, televisions, stereos, fish, meat and office equipment. Exports also did well over the year, helped by demand from the growing economies of the U.S. and Southeast Asia. Automobiles, motors, computer chips and plastic products led all exports, which rose 9.6% in 1994. Automobiles and auto parts together made up 55% of Japan's global trade surplus in 1994. Vehicles and parts accounted for $31.427 billion of Japan's trade surplus with the U.S., or 57.2% of the bilateral trade gap.

December's trade surplus rose 0.3% from a year ago to a surplus of $12.986 billion. Japan's trade surplus with the U.S. rose 2.8% to $5.528 billion in December, the ministry said.

VEHICLE PRODUCTION: Japan's vehicle rose 9.4% in December from a year before to 863,393 units, the Japan Automobile Manufacturers Association said, and represents the third consecutive monthly rise. In 1994, Japan's vehicle production fell 6.0% to 10.554 million units.

In December, passenger car production rose 5.9% to 638,471. Truck production rose 20.5% to 225,193, and bus production rose 34.1% to 3729. In November, production rose 2.5% year-on-year. Production rose 0.4% in October, the first rise in 26 months.

LEADING DIFFUSION INDEX: Japan's leading diffusion index (DI) of economic indicators stood at 70.0 in November, up from 45.5 in October, the Economic Planning Agency said. The coincident diffusion index was at 60.0, down from 70.0 in October. A diffusion index below 50.0 is considered to indicate a weak economy, the agency says, while a figure above 50.0 shows the economy is healthy.

The leading index is based on 13 economic indicators which suggest economic conditions three to six months in the future. the leading diffusion index consists of indicators such as the industrial production inventory-to-shipment ratio, new job offers, machinery orders, floor space of newly-built houses, and money supply.

INDUSTRIAL OUTPUT: Japan's industrial production for November was revised to a 3.0% month-on-month increase from a preliminary 2.7% rise, the Ministry of International Trade and Industry (MITI) said. Compared to a year earlier, industrial output in October was revised to a 6.3% increase from a 5.9% rise in the preliminary report. The production index stood at 95.1 against a base of 100 for 1990.

The report said the manufacturer's shipments index for October was revised to a 3.1% rise from an earlier 2.8% rise. The inventory index was revised to a decline of .2% unchanged from the preliminary 0.2% drop, MITI said. The capacity utilization index, which measures how much manufacturers are using their facilities, rose 7.0% on the year to 87.5. Compared to October, the utilization rate rose 2.9%.

MONEY SUPPLY: Japan's most watched measure of money supply, M2 plus certificates of deposit, grew 2.9% in November over the same month last year to 532.0 trillion yen, the bank of Japan said. M2 plus CDs measure coins and cash in circulation as well as money funds and various types of deposits. However, the measure does not include money held on account at Japan's huge postal savings system.

AUSTRALIA

Australian employment surged 43,900 to 8.07 million, the government said, with an increase in part-time employment masking a drop in full-time jobs. The rise follows a 30,400 surge in jobs in November. The Bureau of Statistics said unemployment fell to 8.9% from 9.3% in November. That's the lowest level since February 1991. The jobless rate has declined from an 11.1% peak in October 1993.

INFLATION: The prices Australians paid for goods and services in the three months to December 31 rose 0.8%, delivering an annual inflation rate of 2.5%, the government reported. That compares with a 0.6% rise in the July-September quarter and an annual rate of 1.9%. While this is the strongest since September 1991, it is at the bottom of the Reserve Bank's target rate, which should ease upward pressure on interest rates.

Underlying, or core, inflation -- which is measured by the Treasury -- rose 0.5% in the quarter, for an annual rate of 2% in the previous quarter. The underlying rate excludes volatile prices, such as fresh fruit and vegetables, and mortgage interest charges. It's also the rate the Reserve Bank watches when determining monetary policy.

Australia's central bank has lifted its benchmark short-term rate 2.75 percentage points to 7.5% since August. A fourth rate increase was expected as soon as February, following the central bank's monthly board meeting on February 7. The Bureau of Statistics said the main contributors to higher consumer inflation in the September quarter were housing, tobacco, alcohol and recreation costs

Australian Treasurer Ralph Willis said one of the worst droughts ever to affect eastern Australia is having "minimal" impact on consumer prices. He said that the government report on lower than expected inflation reflected last year's three rises in official interest rates, because Australian banks increased charges for fixed and variable rate loans to consumers following the rate rises. Mortgage interest charges, which rose 6.1%

Because the inflation report showed lower-than expected inflation, expectations that the central bank would raise rates next month were reduced, which helped to put some pressure on the A-Dollar.

Forex traders are now focusing on the upcoming current account report in February. Its deficit widened 28% to $2 billion in November. The deficit means that there are more goods, services and interest payments flowing out of Australia instead of in. Countries with large current account deficits often see their currencies suffer if investors stop buying financial assets to offset the deficit.

Earlier in January, the government reported a 6% record surge in merchandise imports , fueling expectations that interest rates will need to be raised to cool the economy. Imports rose to A$ 6.43 billion ($489.7 billion), from A$6.04 billion in November.

Evidence of robust consumer demand also adds weight to calls for the government to cut spending or raise taxes quickly to slash the budget. Such a move would temper the nation's widening current account deficit, which is expected to expand beyond A$2 billion in coming months. The import figures are further reinforcement of that argument.

CAPACITY UTILIZATION: Factory capacity utilization increased "markedly" in the Oct-Dec quarter, pointing to a higher inflation rate and higher interest rates, National Australia Bank said. Capacity utilization rose 1.7% points to 82.4%, almost as high as levels reached in the boom times in the late 1980s. During those years, consumer prices averaged about 8% a year, the bank said.

HOUSING APPROVALS: Housing approvals in Australia fell 8.2% to the lowest level in two years, confirming that three interest rate increases are starting to bite into housing demand. Wilhelm Harnisch, national director of economics with Master Builders of Australia, said the latest housing figures showed the shock the jump in interest rates has given the industry. According to Harnisch, "the greatest danger for the housing industry lies in housing activity prospects for 1995-96, which could see the industry take a nose-dive."

On the year, housing finance approvals fell 17.3% -- in line with analysts predictions. Housing minister Brian Howe said the figures showed the industry is on the decline after three years of strong growth. When the string of rate rises began last year, the central bank singled out a roaring housing market as one of the biggest threats to low inflation. Housing industry leaders called on the government to refrain from further rises in interest rates.

UNITED STATES

American's incomes rose at a faster pace than their spending last year, the first time that has happened since 1991. The 6.1% growth in incomes, the strongest annual performance in four years; outpaced a 5.7% increase in spending, the Commerce Department said today. The spending increase was the smallest in three years, the department said.

In December, personal income increased a larger-than expected 0.8%, while spending was up a modest 0.3%, suggesting that concerns about higher borrowing costs may have caused Americans to shop conservatively during the Christmas season -- which may be the first signs of a consumer pullback. One exception was the consumer electronics industry, which saw video sales rise 9% in December and 7% during the year, according to the Electronic Industries Association's Consumer Electronics group.

Last year's overall rise in incomes was aided by the addition of 3.5 million new jobs, the most in a decade, while December's 0.8% income gain was bolstered by higher subsidy payments to farmers, auto industry bonuses, and retroactive Social Security payments. Disposable income, or the money left over after taxes, increased 0.8% in December and 5.8% for the year, while the savings rate rose 4.8% during the month.

Consumer spending, the engine that drives the economy, had been rising at a 5.9% annual growth rate through the first 11 months of 1994. Even with the December slowdown, consumer spending was a major reason the U.S. economy expanded at a robust 4.5% pace in the fourth quarter and 4% for all of 1994 -- the strongest annual performance in a decade.

However, according to White House economist Laura D'Andrea Tyson, head of the Council of Economic Advisors, because wages on average have just about kept pace with inflation, and many wage categories showing no gain or some decline, Americans don't feel they have been part of the boom. Moreover, though total income has been on the rise, many people laid off in recent years have been forced to take lesser paying, often temporary, jobs.

Furthermore, family balance sheets may be overburdened with debt. Consumer installment credit -- led by larger credit card balances owed -- rose a larger-than-expected $12.884 billion in November for the 24th consecutive monthly increase. That may mean that American consumers will have to pull back further from spending this year -- especially now that borrowing costs are now higher. After showing little change in the early 1980s, consumer borrowing began surging more than a year before the Federal Reserve started raising interest rates last Feb. 4 to cool the economy and contain inflation.

MEXICO

President Clinton bypassed a congressional stalemate Jan. 31, authorizing a $20 billion U.S. contribution toward a freshly crafted $50.8 billion international rescue plan for Mexico. The announcement, viewed by investors as reducing uncertainty surrounding the Mexican rescue, sparked a powerful rally in Mexico and other Latin American financial markets.

Clinton moved after Treasury secretary Robert E. Rubin and other top aids warned him in the Oval Office that time had run out, and that a default by Mexico -- which seemed only days away -- could set off a panic in large emerging markets around the world.

The U.S. package is expected to include short-term swaps, with a maturity of three to five years, and security guarantees with a maturity of 5-10 years. The swaps are an arrangement that will enable Mexico to draw dollars partly on the Federal Reserve but mostly from the Exchange Stabilization Fund, a Treasury account used for U.S. foreign exchange intervention and containing around $25 billion, with the ability to draw on another $25 billion.

In addition to the U.S. commitment, the rescue plan includes a commitment by the International Monetary Fund to lend Mexico $17.5 billion - its biggest loan ever to country in financial distress - and a loosely defined agreement by central banks around the globe to contribute an additional $10 billion. Canada and Latin American nations agreed to contribute an additional $2 billion.

LABOR COST: Business' wage, salary and benefit costs rose a modest 3.0% in 1994, the smallest gain on record, the Labor Department said (Jan 31), though there were signs that labor costs would be edging higher. For the fourth quarter, the employment cost index climbed 0.7% after rising a revised 0.8% in the third quarter. Previously, the government had pegged the increase in labor costs at 0.7% for the third quarter.

Fed Alan Greenspan and other officials pay close attention to the employment cost index, because higher wage costs can translate to increased producer and consumer costs. Some economists point out that inflation is not likely to accelerate as long as wage and benefit increases remain as moderate as they have been in the last 5 years.

Other reports from private organizations hint that rising interest rates already may be cooling off the economy. According to the Conference Board in its monthly report on consumer confidence, consumers are planning to buy fewer appliances and cars. The National Association of Realtors said houses were less affordable last year than in 1993, reflecting higher mortgage costs. And the Purchasing Management Association of Chicago's monthly index of prices paid by business declined in January from its December level.