

Princeton Economic's The World Capital Market Review

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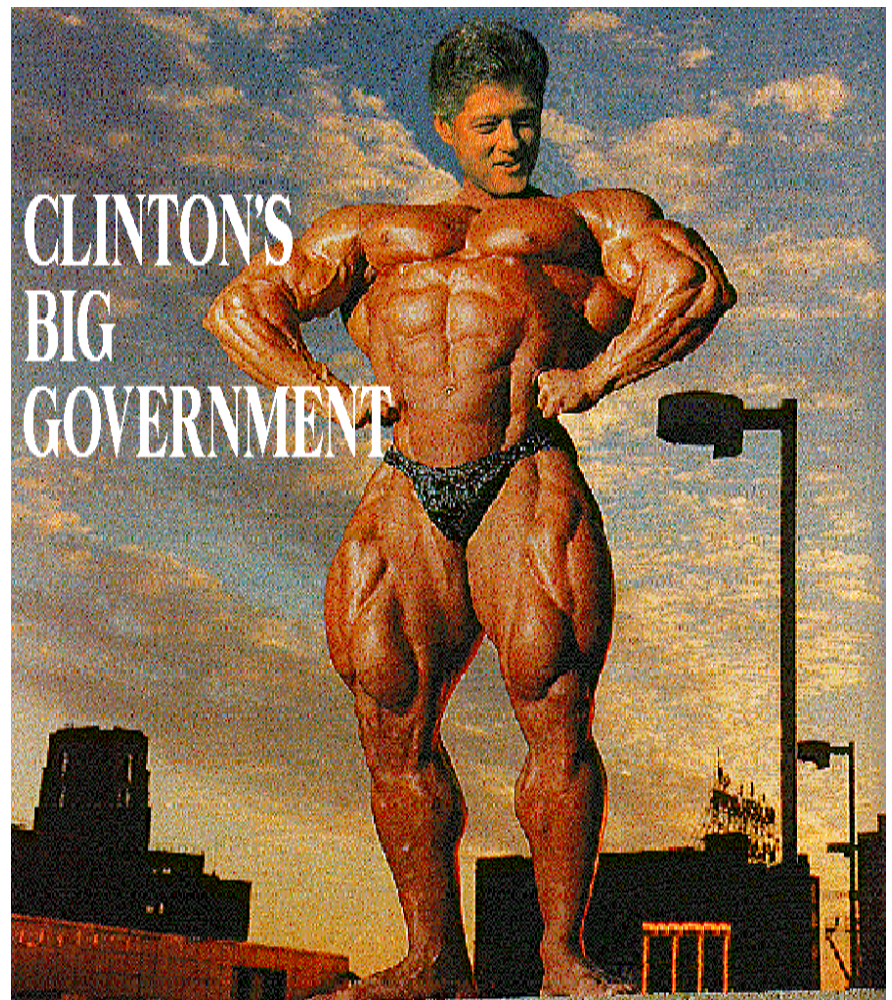
CLINTONOMICS

Just Another Arkansas Financing Scheme

by Martin Armstrong

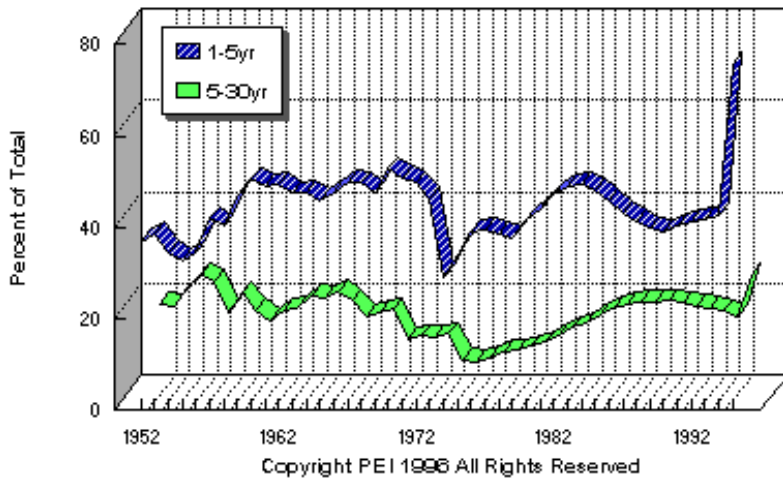
Bill Clinton loves to brag about how he has cut the budget deficit by \$500 billion. The amazing side-effect of the Clinton Budget Deficit Reduction Plan is that nobody got hurt except business and the rich. Still even more incredible is the fact that nobody in the media has dared to look closely at what Clintonomics is all about. Why is it that if Republicans try to cut spending, suddenly everyone will die from pollution or tainted meat while children starve to death in the streets when spending cuts of barely 50% of Clinton's savings are proposed?

To start with, Clintonomics involved two aspects. First, the obvious approach was taken by passing the largest tax increase in the history of our nation - \$250 billion. The second part of Clintonomics was to bring Arkansas financing schemes to Washington in an effort to save on interest expenditures. This Arkansas financing scheme



US Marketable Debt

Maturity Perspective



When Bill Clinton cut the deficit by \$500 billion+, he did so by placing the nation at risk. He shifted the funding of our debt to more than 70% 5 years or less. The result of his style of deficit reduction

is now creating an inverted yield curve where short-term interest rates are higher than long term. This false manipulation of our debt is now causing the economy to slow. No other president has ever manipulated the debt for political gain.

would "hopefully" generate another \$250 billion in spending cuts without ever having to reduce actual program spending.

Some will argue that Clinton is just a genius since he is the first President who has ever manipulated the national debt. After all, many people have refinanced their mortgages in an effort to save on interest costs. So why shouldn't Clinton do the same for the nation if his scheme saves money? To begin with, Clintonomics has actually reversed more than 40 years of a concerted effort by all previous administrations to extend the national debt as long as possible. Long-term fixed debt eliminates short-term risks where interest rates can rise sharply due to a host of issues including geopolitical. Instead of simply refinancing a mortgage, Clinton got rid of the mortgage and decided to allow our debt to float on the whim of short-term interest rates. Ask any homeowner if that makes sense. As soon as interest rates rise even slightly, your mortgage payments rise immediately. You never know what

your monthly payment will be from one year to the next no less 10 or 20 years from now. Over the past 15 years alone, mortgage rates have been everywhere from 25% down to 5.5%. Not exactly a steady environment to bet your future on these days.

So is there a problem? You bet! Within a few years, almost 20% of every dollar the federal government spends will go to make interest payments. What happens if short-term rates go up by only 2%? The answer is total chaos. Instead of progressively moving toward a balanced budget, suddenly the interest expenditures explode wiping out any hope of ever achieving a balanced budget. Spending cuts of \$150 billion will have to be made and forget about tax cuts. Most likely, a second term of Clintonomics will bring with it another round of tax increases. Its either that, or cut medicare and social security.

Then there are those who will argue that short-term interest rates would never go up again so there is

nothing to worry about. However, short-term rates rose 7 times since Clintonomics began. The interest expenditures for even 1994 were 11.4% higher than 1993 while total expenditure rose only 4.7% for the same period. At times, even overnight interest rates have risen above 10 year treasury rates. This is what is commonly referred to as an "inverted" yield curve when short-term rates are higher than long-term.

Another casualty of Clintonomics is none other than the Federal Reserve. The way the Fed fights inflation is by raising short-term rates. At the peak in interest rates back in 1981, short-term rates were nearly 5% points higher than 30 year bond rates. What is interesting here, is that Clintonomics has jeopardized the entire Keynesian economic models. If the Fed tries to raise interest rates to fight inflation, the excessive borrowing demand is now emerging from government -not the consumer. Any rise in interest rates will now cause the deficit to explode immediately. By stacking all the government bor-

rowing demand on the short-term (5 years or less), the treasury has usurped the Fed's most important tool and in effect is causing short-term rates to rise faster than long-term - exactly the policy taken back in 1981 to slow the economy. Indeed, while the economy has been recovering, it is in fact the weakest postwar recovery in terms of the number of jobs created - less than half of the Reagan period.

Clintonomics has indeed changed not merely the political landscape, but also the economic stability of our economy. By simply measuring the rate of change in bond prices, volatility has more than doubled in a few short years. By increasing volatility, we run the risk that the expected crisis years for medicare and social security are no longer 2020 but can emerge as soon as 2003. What is really scary is that 70% of our entire national debt is now funded 5 years or less and 33% is funded 1 year or less. This is simply nuts! It is as if the nation is financing everything on a Visa Card.

Interest expenditures are a dynamic and major force that are reshaping politics itself while distorting our perception of the future.

For example, if we honestly review the 8 years of the Reagan administration, we find that the budget was actually balanced between spending and revenue. The national debt doubled by \$1 trillion dollars, which was exactly the amount of interest costs for the 8 year term. Of course the Marxists in this country would like us to believe that the debt doubled because of "trickle down" or "voodoo" economics. Well, the national debt has since moved from \$2 trillion to \$5 trillion and counting during a period of low inflation and rising taxation. We better stop trying to rewrite history in the eyes of political bias and realize that at 8%, you double your money in less than 10 years in the bank. Our national debt will continue to grow on a compound basis despite which party holds the office. However, with Clintonomics, our national debt will now grow exponentially even if

spending and revenue are balanced.

The economic truth about our debt is just never discussed openly. Back in Reagan's era, the national debt was financed between 60-70% long-term. Like any 30 year mortgage, change in short-term interest rates have no effect when you are locked in on a long-term basis. Still, with 60-70% of our debt funded long-term, the lag period between a rise in interest rates and a rise in interest expenditures for the government was about 4 years. The doubling of the national debt under Reagan was actually set in motion under Carter and so on. Every President reaped the benefit or suffered the pain due to the previous administration when it came to interest expenditures. With Clintonomics, that time lag has disappeared and we have less than 2 years between a rise in interest rates resulting in higher federal deficits due to interest expenditure.

Clintonomics has not merely created the false illusion that the

deficit has been reduced due to painless spending cuts, it has also escalated the odds against any hope of restoring sound finance to save our future. By shortening the time lag between changes in interest rates and a rise in government spending, the entire long-term picture begins to change. What would have taken 20 years can now be accomplished in less than 10 years using simple compound interest analysis.

From the start, those of us under 55 would have had a greater chance of being abducted by aliens than ever collecting our first social security check under the same terms and conditions of today. Now, Clintonomics just may have guaranteed that you will never see that first check under any terms and conditions. If the polls hold true, one more political swing toward economic absurdity may be our penance before a true conservative revolution takes hold in the media - where it seems to count while the rest of us are still waiting to exhale.

Bloomberg - Internet

PRINCETON ECONOMICS

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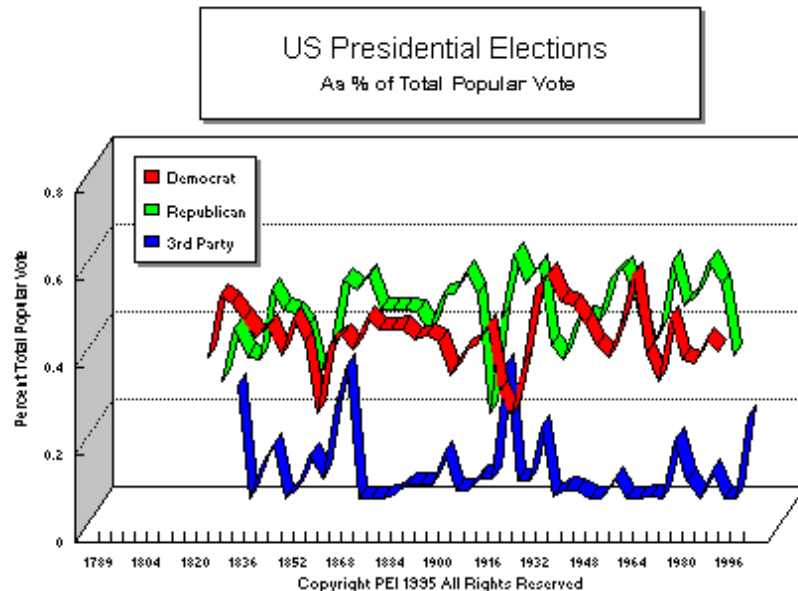
Why Republicans Are Doomed

by Martin Armstrong

Republicans often appear as though they are stupid and incompetent to the point that they couldn't sell a life-preserver on the deck of a sinking ship. The Republican Party itself has always been an uneasy coalition of not always compatible conservative views. What it boils down to is the sad fact that there are two types of conservatives - **FISCAL** Conservatives and **SOCIAL** Conservatives.

The elite within Republican circles in Washington are predominantly Social Conservatives. These are people who rant and rave over issues like gay marriages, abortions and school uniforms. **These are irrelevant issues because they are by no means the cause of social decay but rather merely a symptom.** All social decay throughout history begins by the slow and steady economic decay that ultimately causes the family unit to break down and crime to rise. Social Conservatives have always failed to grasp these points and prefer to rule the nation on issues of flag burning and moral decay without ever bothering to listen to economic issues of importance.

Fiscal Conservatives are far fewer in number but seem to have a better understanding of what is killing the patient. Here we find that the prevailing view is that the "**Evil Empire**" does not reside in Moscow, but in Washington. Social Conservatives reject these notions because they feel that this is also directed at them. Instead of reviewing the issues, it is far easier to demonize people like Ross Perot than admit that 20% of voters are fed up with Washington regardless



of party affiliation. Perot did not begin this voter dissent, he just happened to be at the right place at the right time. **To vilify Perot, allows the Social Conservatives to justify their own political agenda in Washington, which is merely the opposite of the Social Liberal policies that currently dominate the Democrats.**

These two primary groups of conservatives are never happy with each other. Each group feels strongly that their cause should be at the head table of discussion. When you try to talk to a Social Conservative about anything substantive dealing with economics, taxes or government waste, their eyes glaze over and out comes the silver cross, which is then held up in your face in hopes of scaring you off. Such issues are viewed as too complicated to deal with. Gays, flag burning and abortion are simply easier to understand than the more pressing issue of property rights, taxation, declining standard of living and contradictory over-regulation.

Let's face the facts. If abortion were illegal, all children adorned uniforms, flag burners were in prison and gays were prohibited from marriage, the basic standard of living for the middle class would not be changed in the slightest. It would still take two incomes to support a family and it would still require someone to earn 40% more than welfare just to break-even in the workplace. Unfortunately, the basic core economic issues are simply never discussed by the Social Conservatives because they just don't get it or feel that you cannot portray it in 60 seconds or less. This attitude merely condemns us to a fate worse than hell - inability to discuss serious issues that will determine the course of our economic destiny.

The Republican Party itself has never been a real unified party to say the least. This battle between Social and Fiscal Conservatives has been waged throughout this entire century and remains the reason why the Republicans, whenever possible, fail!

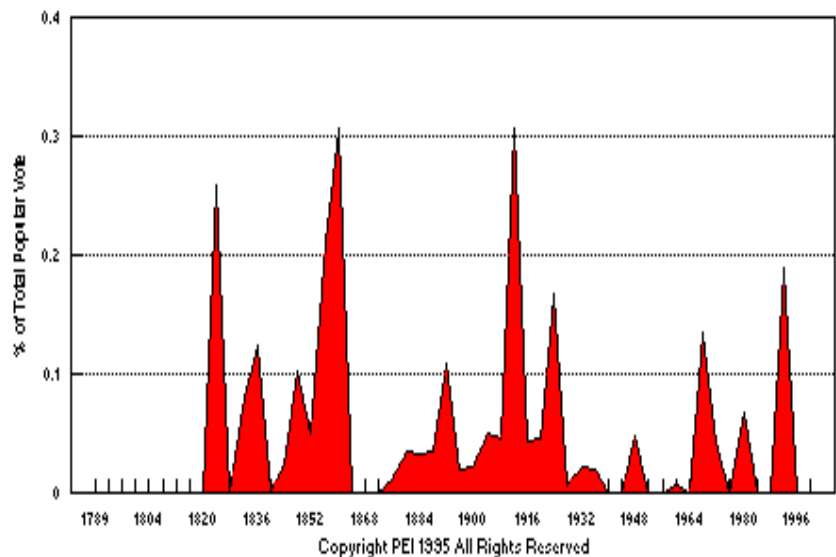
An interesting footnote to history is that the conservatives have **ALWAYS**, and without exception, split into two parties. The Republicans were actually born as a third party movement against the Whigs and Democrats during the mid-19th century. **Table #1** illustrates how the Republicans have spilt numerous times usually giving the victory to the Democrats 70% of the time during strong 3rd party showings.

The only three elections that the Democrats lost despite a strong 3rd Party vote were 1860, 1924 and 1968. All of these elections are of important interest for they show just how politics can split parties in two based exclusively on the opposing conservative views.

The election of 1860 saw massive division along the lines of slavery. The Democratic Party split between North and South and actually offered two separate candidates for President - Stephen Douglas in the North and Breckinridge in the South. A 3rd Party was also formed called the Constitutional Party, which nominated John Bell as its Candidate taking the middle of the road approach thereby earning the label "**Do Nothing**" or "**Old Gentlemen's**" party. Lincoln, the Republican Candidate, won the election with less than 40% of the popular vote despite the fact that he was not even on the ballot in the South. Therefore, the Republican victory came

US 3rd Party as % Popular Vote

Presidential Elections



at the hands of the Democratic Party conservative split in 1860.

The election of 1924 brought a split over the issue of prohibition. The Democrats were deadlocked and only on the 103rd ballot did a candidate emerge. Progressives formed a 3rd party that drew from both Republicans and Democrats with the purpose to "**break the power of the private monopolistic system over the economic and political life of the American people.**" So here again, it was the conservative element within the Democratic Party that split and caused the Republican victory.

Nixon following the massive riots and demonstrations by anti-war activists. It would be George Wallace, the 3rd Party Candidate from the South at the head of the American Independence Party, who posed the more formidable threat to both Nixon and Humphrey. While the issues seemed to break down to "**peace**" vs "**law and order,**" the conservative votes split from the Democratic Party and seemed to filter over to both Wallace and Nixon. **Humphrey was left gathering support from Liberals, which in the final analysis would mark a major shift in philosophy for the Democratic Party itself.**

In all cases, it has been this division on the conservative side of both parties that has swung the election process back and forth. While perhaps it has been the social issues that provided the most explosive debates (**slavery, prohibition and war**), the central key issue of small government and low taxation has been a dominant theme that stood silently behind the majority of all elections. In fact, it has always been the unsound finance policies of government that has produced the most chaotic periods in our political history. The unsound finance policies during the 1790s forced the collapse of the

Table #1

US Presidential Elections

Election Year	Democrat	Republican	3rd Party
1824	42.16%.....	31.89%	25.94%
1836	50.93%.....	36.62%	12.43%
1856	45.63%.....	33.27%	21.08%
1860	29.39%.....	39.79%	30.81% *
1892	46.11%.....	43.08%	10.79%
1912	44.61%.....	24.67%	30.70%
1924	28.98%.....	54.32%	16.69% *
1948	49.95%.....	45.33%	4.81%
1968	42.86%.....	43.56%	13.57% *
1992	43.28%.....	37.68%	19.02%

The election of 1968 was fought over the Vietnam War as its central issue. Nixon faced Humphrey following the shocking March 31st telecast by LBJ where he announced "**I shall not seek and I will not accept the nomination of my party for another term.**" The Democratic Party convention in Chicago all but handed the election to

Continental Dollar and the birth of the US dollar in 1792. It was the age of high inflation and unsound finance under the Silver Democrats of the 1880-1890s that led to the near bankruptcy of the US government, which in turn ushered in the conservative Republican era between 1896 to 1908. Once again, we find ourselves dealing with what may appear to be a 90's thing of unsound finance and uncontrollable budget deficits as the most significant issue of all.

The election of 1896 was waged solely on the fiscal conservative issues versus liberalism spendthrifts. The London Daily Mail reported that the election of 1896 was fought over two fiscal views that were as different as *"night and day."* The report went on to say *"in every newspaper, in every cafe, in every street car, it is the dollar and the dollar alone, whose fate is discussed."* Others called it the *"Battle of Standards"* with the Republicans backing the gold standard and the Democrats backing an inflation policy with the silver standard. It was at this convention where the impassioned speech of William Jennings Bryan was delivered. *"You shall not press down upon the brow of labor this crown of thorns, you shall not crucify mankind upon a cross of gold."* The votes were cast. The nation swung back to conservative fiscal policy ending one of our darkest economic periods in American history.

It would appear that the only hope for the Republican Party in 1996 would be again to highlight the sound vs unsound economic policies that are still as different in 1996 as they were in 1896. All the polls show that the vast majority of Americans do not believe that they will **EVER** see their first social security check. In a Time Magazine poll, only 3% of respondents were satisfied with the current tax system. These are core elements of voter dissatisfaction. If the Republicans do not adopt the fiscal conservative issues and highlight the dangers of social liberalism to the economic stability of the nation,

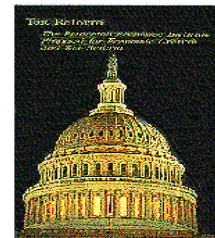
then indeed the battle will be lost. **In the final analysis, it is the economic decay that dictates the ultimate fate of any nation. Just look at Russia if you disagree with that statement.**

Social Conservatives fail to realize that the majority of people do not want government to dictate moral values. They do not want liberals or conservatives to impose their extreme views on the nation. If the Social Conservatives within the Republican Party do not give way to the Fiscal Conservative elements, our computer model warns that indeed a 3rd party movement will emerge as it has before on the back of fiscal conservative issues. **The Democrats will become the party of gay rights, the Republicans the party of religious rights and morals, and the 3rd Party movement will emerge as the fiscal conservatives who try to ease the economic burdens for the middle class.**

If history is any guide, the future looks very bleak indeed. The political fabric of the United States is slowly coming apart and Washington is still trying to hold on to symbols of power while ignoring the rising tide of fiscal conservatism. **In the end, the massive unfunded liabilities that have been accumulated over the years will be our undoing. The longer the social debate grabs top billing, the worse the fall from grace at the hand of unsound finance.**

There is little doubt that promises of Washington cannot be kept. The only question that remains: If we cannot trust Washington to solve our problems, then can we trust their forecast for a debt crisis being held off until 2020? Our computer dares to differ with that optimistic vision of spend now and worry about it 30 years from tomorrow. For if you look closely at the fine print in Washington, tomorrow just never seems to come.

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Sir James Goldsmith, the Ross Perot of Britain?

by Bruce Allen
Executive Director
PEI UK & Middle East

Established democracies appear to be entering a period of increasing volatility in the previously cozy structure of their party systems; be it a convicted murderess in India heading India's first lower caste political party, the former "King of the Russian Gulag" dissident Natan Sharansky's new immigrants party in Israel or the Anglo-French financier Sir James Goldsmith's new Referendum Party in Britain. Is RPS (Ross Perot Syndrome) sweeping the world?

While the first two examples can perhaps be explained as significant groups previously unrepresented by any established parties now finding a leader to voice their needs, the case of Sir James draws immediate comparison with Ross Perot. Both are wealthy political "prophets" from beyond the established political system, bringing with them the charisma of extraordinary financial success. Both have made and continue to make a national impact on domestic politics while drawing substantial support from parties showing advanced stages of sclerosis. Both have essentially one issue around which they spin a broader vision for the nation's economic and political future. In the case of Perot it is taxation and the attendant mismanagement of the government's spending. In the case of Goldsmith, it is Britain's economic and political relationship with Europe.

As in times past, when people see that the Ship of State is heading for the rocks, they become worried. But when it becomes obvious that no one on the bridge can read a chart and insist that the lighthouse is the glow at the end of the tunnel, someone will start winching out a life boat and say "follow me." In a metaphorical sense we have this parallel between Goldsmith and Perot. However, Perot wants to be the new captain; he stood for the Presidency. Goldsmith just wants to avoid the rocks; he is not a candidate in his own party.

The Referendum Party has made it clear they will dissolve if John Major's government allows a referendum before the next general election on the political future of Britain within Europe and the EMU (European Monetary Union). Indeed, prospective Referendum Party candidates have said that should the referendum **not** proceed now and they contest and are elected to parliament, they will cross the floor and join the Conservative Party after the referendum finally takes place. Several Conservative Members of Parliament, largely those known to be "Euro-sceptics" have met with Goldsmith, ostensibly to point out to him that his actions will make it more likely the Pro-Europe Labour opposition will win the elections. Another view reveals that those very same Conservatives were there to promise their support for a referendum on Europe and therefore would not like to see a Referendum candidate contesting their constituency!

It is clear the self-styled "New" Labour Party headed by Tony Blair will most likely win the next British elections although their opinion poll lead is narrowing. Despite a change of captain, the Ship of State

will continue to head for the rocks in the view of those gathering around the life raft. In parallel with the political situation in the United States the mainly two party system of the past 75 years will begin to fracture. And oh yes, Ross Perot Syndrome will be part of the transition to a new order.

Interest Rates **Economics and Politicians**

The Governor of the Bank of England, Eddie George, and the UK Chancellor, Kenneth Clark, meet monthly to decide amongst other things whether or not to adjust the current bank base rates. This is the economic picture they see at the moment.

Official statistics released show Britain's February trade gap at £1.5bn seasonally adjusted with the relatively strong domestic economy pulling in imports and exporters struggling to achieve sales in depressed Continental Europe. The deficit was eased by the highest oil trade surplus since 1986. Adjusting for oil and erratic items, the February deficit was £2.0bn, the highest in six years. Export volumes declined within the European Union but grew by 6% in other markets. House building figures show a revival in the market over the past month. These are generally regarded as more forward looking than the house loans statistics which seasonally adjusted remained fairly static. Retail sales volume also rose on the latest figures for March, 2.2% higher than in March 1995. However, industrial output has slowed with orders in the engineering industry down 5.5% on a year earlier. Investment from Europe, particularly from Germany continues to grow. The attraction is lower costs, greater so-

cial flexibility and the view that low productivity and poor industrial relations are things of the past.

Whether Clark, who has the final decision, decrees a change depends on the traditional view of the risk of lower rates pushing up inflation balanced against lower rates helping industry. Clark of course is also a politician and member of the government. George is a banker and civil servant but, is finding himself more and more pulled into the political arena. He recently announced that the British economy has a good chance of achieving low inflation and stable interest rates even if it does not join the single European currency - an anathema to the staunch pro-Europeans with whom Clark counts himself.

Soap, Gold, Poverty and the IMF

What does Russia and Mexico have in common apart from the popularity of Latin American soap operas? A recent forecast projects that together they will account for half of the International Monetary Fund's outstanding credits by the end of 1997. At the last committee meeting one national director pointed out the six largest debtors would represent 70% of credits by the end of next year, the largest two being Russia and Mexico at 49%.

In the same meeting, the UK chancellor backed a proposal by the Belgium finance minister to specify an amount of the Fund's gold to be sold to pay for the soft-loan facilities offered to the world's poorest countries. The scheme is an attempt to reduce the resistance to gold sales, particularly from Germany, who worries that IMF sales might prompt calls back home to sell some of the Bundesbank's reserves. The IMF managing director, Michel Camdessus, thought 5% of the Fund's gold should be sold and the proceeds invested (in government bonds?) to provide half of the \$3bn subsidy needed to finance the soft-loans over the next five years. The rest should come from government donations. Finance ministers however, said the

Fund should use its own resources rather than calling on governments for more money.

The German finance minister then criticised the IMF's world economic outlook for being too lenient on countries such as Britain, Sweden and Italy who had devalued against hard currencies such as the Deutschmark. Soap indeed.

The Welfare State and European Monetary Union

The IMF and some politicians have stated that the only way to cut government deficits is to cut public spending. Many others suspect growing government deficits spell eventual economic disaster. Others appear entirely oblivious. Unfortunately, it is becoming difficult to avoid the fact that spending on the welfare state is increasing throughout Europe at an alarming rate and has to be a target of cuts. The 19th century free trader Frederic Bastiat's definition of the state as "the great fictitious entity by which everyone seeks to live at the expense of everyone else" is approaching achievement.

Despite the "will" now shown by politicians in speeches, where is the "way"? Here lies the sceptic's true rationalisation for European monetary union. Not for the result in itself. There is little evidence that it will achieve the politicians pledge of a land of milk and flowing honey, and structural problems will at least defer complete union, but after selling the dream of European unity, the pain of spending cuts may then be blamed on the need to achieve that dream.

Spain's new coalition government, led by Jose Maria Aznar's Populist Party with support from regional parties, cites as over-ridingly important the need to qualify for the European single currency and announced a 250bn Peseta cut in spending. In Belgium, Jean-Luc Dehaene's government faces a long running strike and dispute with teachers over government cut backs. The government still needs to push through an additional 30bn

Belgium Francs of cuts to be on target. Chirac in France, a committed unionist, must make savings of over 60bn French Francs in the next year by cutting the civil service and trimming the cradle to grave social security system. Portugal's central bank announced it was on target for the 1999 convergence criteria needed to join the single currency. The bank forecasts lower economic growth this year than the projections of the ruling socialist party but being closer to the criteria than any other southern European country is a source of national pride. In Italy, Prodi of the winning Olive Tree Alliance, does not take over from the caretaker government till the end of May but has confirmed his pledge to take the Lire back into the European ERM (exchange rate mechanism). In Germany, the cause of union is fairly planted as the reason for the economic pain.

Whether governments in Europe will succeed with this opportunity to break expectations for welfare remains to be seen. It is all too easy to bow to populist pressure of demonstrations on the street and to reduce spending cuts - then tax a bit more and borrow a bit more.

Fate of Europe

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Russia Discovers Polls Yeltsin as the "Come-Back Kid?"

by Dana Schneider
director Russian
Studies

On June 16th, Russia will make a giant historical step by holding its second freely contested presidential election. For a country that has barely developed political parties and legislation to govern such an historic occasion, the quantity of polls that are being conducted is noteworthy. Russian and international pollsters alike have gotten into the game. Indeed, the opportunity to conduct polls, number crunch and analyze the 1991 Russian Presidential elections was not possible. However, 1996 now presents the first opportunity in which the Russian political psyche may be poked, prodded, cajoled, and manipulated in the all too familiar poll.

Yeltsin

The staple of American political life - the poll - has not been much use in predicting the outcome of Russian politics. Less than four weeks away from the elections and the only clear opinion to emerge from all these numbers is that anything is possible. In light of the uncertain outcome, several prominent western leaders gathered in Moscow to give Yeltsin a political boost. President Clinton was among the leaders affording Yeltsin photo opportunities, hand shakes, and invariably tips on how to tilt the polls. On one such occasion, BBN describes President Clinton's April 21 encounter with an 83 year old woman. Her concern was that her son is an alcoholic but she can not afford treatment for him. President Clinton empathized and told the woman, *"In my family, I have many people with the same problem."* He continued by telling journalists that the cost of treatment was driven up because of the lack of treatment centers. On April 22, a poll by CNN/Moscow Times reported Yeltsin ahead of Zyuganov at 20.7% to 19.8%.

Polls are by no means a tell-all forecasting tool, but they can serve as an interesting tool for politicians. Over the past several weeks, Yeltsin has rapidly ascended in the polls so that the contest is neck and neck between Communist Party candidate Gennady Zyuganov and President Boris Yeltsin. If no candidate receives the majority of the votes then the top two candidates will contest a run-off scheduled for July 7th. A run-off is expected since Zyuganov and President Yeltsin stand to receive an equal share of around 25-30% support. The other contenders - reformer

Zyuganov

and Yabloko Party leader Yavlinsky - garners about 10% support and former General Alexander Lebed - popularly liked for his opposition to the Chechnyan War - also receives 10%. Candidates Zhirnovsky, Fyodorov, and Gorbachev have gathered negligible support.

Although Zyuganov has maintained the lead until recently and the Communist victory in December presented a shift in direction, the electorate provided an ironic response in a Ramir poll. A large percentage of Russians - 40% - believe Yeltsin will win regardless of Zyuganov's lead and the public's distaste for the President. Meanwhile, Zyuganov was expected to win by only 26% of those questioned. It is not clear if this poll highlights the disbelief in the ability of the political system to reflect the voters concern; an underlying and reluctant support for Yeltsin; or just an example of conducting a western-styled analysis of the Russian political process at too early a stage.

Support for the top two candidates falls around 26%. While Zyuganov has increased his ratings by only several percentage points, Yeltsin has more than tripled his since late Dec/early January. Zyuganov has not publicly changed his platform to any great degree. His intentions and political positions have been divulged with little visible impact on the electorate's support for the Communist Party or their candidate. These numbers could suggest that Zyuganov has reached a threshold of popular support as his numbers have neither dramatically increased or decreased. This would also indicate that Zyuganov's base of support is quite strong and his numbers stand to increase as he reaches out for a broader coalition to those uncommitted and apathetic voters.

On the other hand, revelations regarding Zyuganov's position may be prompting voters to throw their support behind Yeltsin and thus his growing popularity. However, this seems unlikely as the voters' comfort and security with the old communist system far exceeds that of the economic reforms of the past five years. By the same token, the electorate does not appear to be reacting to what Zyuganov says but responding to Yeltsin's campaigning. Yeltsin has had to perform extensive political maneuvering and coalition building just to reach a competitive polling number. In this regard, it is more likely that Yeltsin has reached his support threshold than Zyuganov.

A recent admission by one of Yeltsin's campaign advisors, Anatoly Chubais, seemed to underline this possibility by saying that the polls reflect the need for Yeltsin's campaign to be more aggressive. However, there are few places remaining for Yeltsin to find support. Billions of dollars have been promised to constituent groups, a call for the cessation of violence in Chechnya has been issued, and numerous western leaders have paid homage to Yeltsin in the past couple of weeks. These actions were

further aided by loans and credits from world banking and lending institutions. The Russian press also has not been slow to report on the achievements of Yeltsin. These maneuvers have been sufficient to bring Yeltsin back into the race but by no means do they secure his victory. This realization may be what prompted a close associate of Yeltsin to publicly state that postponement of the elections might possibly be needed in order to avoid bloodshed. Accordingly, Yeltsin refuted that statement and made assurance that the polling would proceed as planned. Nevertheless, Yeltsin's campaign is under pressure.

A recent poll found that over half of the participants thought that Yeltsin should resign while 20% voiced approval of his bid for reelection. The poll also found that a large majority of the participants laid fault for the economic crisis on the current government while 36% identified the former Communist government. Clearly, Yeltsin has large obstacles to overcome. But this poll is interesting in that the Communist victory in December and the cabinet changes did not shift blame from Yeltsin let alone his government. In fact, ideology or party affiliation does not yet appear to play a major role in the public's opinion but rather the tendency to personalize. Even Gorbachev, who barely gets polled with 1% support, continues to suffer from the public's blame and political exile. Oddly enough, this inclination to personalize may be the reason behind Yeltsin's growing popularity as he campaigns not on party affiliations, free-markets and democratic reform but rather on political pork and the President's personal accountability to each constituent group. Yeltsin is feeling their pain and it is paying off.

Yeltsin has recently attempted to pull in endorsements from prominent politicians. At a recent May Day celebration, popular Moscow Mayor Luzhkov addressed the crowd with words of support for Yeltsin. Although Yeltsin has gained the support of the well-liked

Chernomyrdin, he still faces criticism and challenges from other popular political figures. Gregory Yavlinsky, reformer and leader of the second largest bloc in the Duma, receives around 10% support in presidential polls. Retired General Alexander Lebed, a well-liked military professional and an opponent of the Chechnyan war, also receives numbers around 10%. Both men have so far refused to back Yeltsin or Zyuganov. The endorsement from these two candidates would broaden Yeltsin's support and secure his victory.

Headlines report Yavlinsky and Lebed toying with the option to unite and form a coalition party to contest the elections. In this scenario, Yeltsin stands to lose in the general election as moderate and reform votes would be split while Zyuganov's base would remain untouched. However, if the run-off were to contest Zyuganov and Yavlinsky, popular opinion holds that Yavlinsky would win. This would suggest that the public is not so adverse to continued reform as it is to Yeltsin. However, the course of Eastern European nations, former Soviet nations, and the Baltic countries alike suggests that reformed Communists are preferred to reformers.

The Debt Crisis Tax Crisis and Political Crisis



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The View From Germany

By Harry Groenert
Executive Director,
PEI Continental
Europe

German Luxury Cars

Within the German car industry the mood is changing. They get a bit upset about the German Tax modifications. Car costs are not any more just deductible as business expenses, but an employee has to pay personal tax for his private use of the company car. This has an affect especially at the top management level.

Luxury car sales for the first quarter 1996 confirm this. The Mercedes flagship, the "S" class sales plummeted by 31 percent, while BMW's 7 model sales decreased by 27 percent and the Audi A8 sales dropped by almost 14 percent.

Michael Jackson vs German Taxation

The 1996 German tax law illustrates an important point - that Germany is desperate for revenue. Recently Michael Jackson decided to cancel his German leg of his European concert tour because under the new tax law, the taxes owed to the German government would be more than 100% of his total revenue!

German tax law does not allow foreign entertainers to deduct expenses from locate taxation. Following Michael Jackson's decision to write-off Germany as a place to do business, strong criticism has sprung forth forcing perhaps a policy change at the very top.

Theo Waigel, the German finance minister, has written a letter to the entertainer begging him to reconsider his decision to cancel the concert tour.

"Dear Michael Jackson:

...You should reconsider your decision to cancel concerts in Germany. At least you have no reason to, from a tax point of view. If the costs of your concerts are higher than 50 per cent of your income, you will be able to file a normal tax declaration instead of paying a lump-sum tax. This is precisely my proposal for a change in the tax law."

It appears as though the offer made to Michael Jackson is that he can become a resident of Germany for tax purposes. Therefore, he will be able to deduct part of his costs from income but he will also have to share the same burden of the average German taxpayer. This means that Jackson can contribute to the "solidarity" surcharge tax to help rebuild eastern Germany on top of one of the highest income tax rates in Europe.

The Euro (Part 1)

Why are the markets and politicians so sure that a single currency will happen in Europe, even though the Maastricht targets are clearly out of reach? And why are they equally confident that a near bankrupt country like Belgium will become a founder-member, while Italy (and Britain) will not?

The answer lies, as usual, in the German politics. The defeat of the anti-EMU campaign in Baden-Württemberg did not merely show that the Germans were relatively immune to populist campaigns about preserving the "strong mark." It also showed something more subtle - German public opinion no

longer sees EMU as a black and white issue.

First, the Germans have seen the dark side of the old Bundesbank slogan "**a strong mark is a good mark.**" The Germans now want the mark to weaken, not only against the dollar and the yen, but also against the lira, the pound and the Swedish crown. The second point: the German public has grasped the distinction between a monetary union embracing the whole Europe and a German dominated hard core. Polls have shown that a monetary union involving only Germany, France, Austria and the Benelux countries enjoys 70 percent public support. But if Italy or Spain is included in such an arrangement support immediately drops to 40 percent or less.

Anyhow, the man on the street is still trying to figure out what positive effect the Euro might bring to him. At least it would reduce his hassle to change currencies when leaving for the holiday. Politicians - Helmut Kohl seated in the first row - sold him successfully on the premise that a single European currency would secure his job, however, nobody has yet explained at which level of pay he would need to accept.

One reason the Germans (not the man on the street) are becoming more relaxed about EMU is that these politicians, bankers and businessmen are quietly reassuring them that improvident Mediterranean countries will not be allowed to join. The Maastricht criteria have plenty of scope to achieve this result. But the problem is that a single currency without the "**Club Med**" would be almost pointless. One of the main functions of EMU from the German and French standpoint is to stop their neighbours from improving their competitiveness by devaluing. This is the problem addressed by the new-style ERM demanded by France (with the usual

German support). If Italy and other peripheral countries can be forced to tie their currencies to the euro and to cede control of domestic policies to the European Central Bank, then the threat of "competitive devaluation" after 1999 can be averted without allowing them to become founder-members of EMU, and thereby forfeiting German public support.

The new Italian Government is talking of rejoining the ERM within weeks - and if Italy does so, then Sweden and Finland, the two other holdouts, may soon follow. Britain will then be the only EU country determined to stay outside both EMU and ERM. As usual, Britain will be in a minority of one.

The Euro (Part 2)

The Siemens board member Karl-Hermann Badman is full of excitement when talking about the EMU. He emphasises the importance of a single currency for Europe whenever he speaks publicly. **"Siemens' turnover amounts to about 63 billion (\$ 42 billion) marks. If we will be able to bill in a single currency we would abolish currency risk for hundreds of millions"**. Siemens plans to be able to have a Euro-balance sheet in 1999.

Siemens is well ahead of the crowd. Only 12 percent of all companies have started to prepare themselves for the Euro. That could be a mistake. The change will not happen overnight but gradually over the next several years and it will be expensive.

The change will cost, according to a poll for all German banks, approximately four billion marks, not having taken into account the revenue loss of fees and commissions for the currency transactions. Deutsche Bank is estimating the cost at about 350 million marks, while Bayerische Vereinsbank is calculating only 120 million marks. Non-banking companies think more in double

digit millions, however, that will not be enough.

Roland Berger & Partner, a management consulting firm believes that a single currency will undoubtedly change the competition. They recommend that corporations should start now to examine the impact of a single currency. The firm suggests that an internal task force should be created to conduct analyses, come up with a report, and a cost plan as well as a time schedule for the operational changes. In the spring of 1998, when the politicians have finally decided upon the members of the EMU and when Germany alone will have established a minimum of 4,000 procedures and regulations, the operational changes will have to take place.

The whole administration requires not only a double bookkeeping system but also technical adaptation in various fields. Karstadt, a department store in Germany, is for instance forced to change more than 10,000 cash registers in about 165 shops. The German Telecom has to decide to change their 70,000 telephone kiosks into card phones or modify their phones totally. BMW estimates the cost for changing their computer hard- and software will be more than 10 million marks. Their task force also examined the affect on the marketing and sales. **"The Euro will lead to equal prices throughout Europe, but due to the fact of different tax-systems and purchasing power differentials we can not afford to have the same price for a car all over Europe."**

The schedule for the Euro is on first sight quite easy to accept but time is running out fast. The members shall not be decided until 1998. The currency parities have to be deter-

mined and the Euro shall be introduced in 1999. By 2002, all of the old notes and coins shall be abolished. The middle and small corporations still have a lot of doubts about the Euro.

"What do middle-sized organizations think about the Euro?"

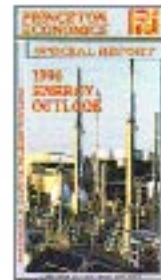
1) I expect comprehensive help from my bank.... 92%

2) I am not informed about the Euro..... 65%

3) I believe competition will increase..... 87%

4) I have not yet analysed the affect of a single currency... 89%

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HONG KONG UPDATE

by Craig H Stephen
Chief Analyst
Hong Kong Branch

Count Down to '97

The return of Hong Kong to Chinese sovereignty in 1997 is now just over 400 days away. This issue has and will dominate events and sentiment until then. The world is watching to see whether Beijing can manage the handover of Hong Kong intelligently and resist tampering with its free institutions. Some developments so far have proved worrying. Beijing seems steadfast in its intent to dismantle Hong Kong's legislature and implant its own provisional legislature. Continuity and neutrality of the Civil Service emerged as a controversial issue which encouragingly Beijing appeared to guarantee to Chief Secretary Anson Chan after a recent visit to Beijing. While British influence and certainly Governor Patten's influence on Beijing is waning, the Preparatory Committee - a Beijing appointed body set up to aid a smooth transition - does have a close ear to China. Comprised largely of key Hong Kong business figures it is hoped that their self interest will ensure they will educate Beijing that the one country two systems must remain for Hong Kong's success to continue. Pragmatism appears to be the name of the day. Public opinion is generally ambivalent about the political maneuvering. More important is that the prosperity Hong Kong people are used to continues.

US/China relations

US/China relations have been reaching new lows mired in mutual suspicion and hostility. With last month's military stand-off in the Taiwan Straits behind us, trade disputes are back to the fore. The annual MFN (most favored nations) tussle is again reaching its climax, but has been upstaged by a US ultimatum to China to crack down on intellectual copyright piracy by May 15th or it will take stiff sanctions. True to form China has retaliated by threatening its own tit for tat actions. The US appears to be losing patience with China that after signing last year's international property rights (IPR) agreement, the problem is still growing. For instance China's CD piracy has in fact increased to nearly 90 per cent of China's estimated output. There have even been reports that China has managed to produce a copy car - an exact replica of an Audio 100. A last minute agreement is still on the cards although the US has left itself little room for maneuvering. President Clinton may find it difficult to climb down in an election year.

MFN(most favored nations) is expected to be renewed. Republican presidential nominee Bob Dole has added his support to that of President Clinton's. Congress's support is still required and Congress has 60 days after July 3 to disapprove the President's recommendation - disapproval based on a majority on both houses. If MFN were not renewed the Hong Kong government estimates the effect would be to slash 2.1-3.0 percentage points off of Hong Kong's GDP.

China cuts interest rates

The main economic event in China this month was the long awaited cut in interest rates after three years of austerity. Interest rates were cut by one per cent in a move designed to help China's ailing state enterprise sector, still plagued by debt levels averaging 75 per cent. The cuts were slightly bigger for savings deposits than for loans in a move to ease the crisis facing banks which had been triggered by a savings glut. China's inflation fell to 7.7 per cent in the first quarter producing positive real interest rates which had attracted savings of 3.3 trillion yuan (about HK\$3.05 trillion) by the end of March. These cuts and a removal of the inflation index subsidy for medium-term deposits will lift a huge burden for China's banks. The move should give a boost to China's fledgling stock markets as investors seek better returns for their savings. The outlook for Hong Kong's economy will also improve with the easing of monetary policy in China in the 2H96. Hong Kong listed H-shares which generally reported terrible results should also benefit from the cut in interest rates.

World Capital Market Review

US STOCK MARKET

The US share market is starting to shift gears as we head into the May the broader market is clearly in first place taking the lead from the Dow Jones Industrials. This is often the final sign that signals that a temporary top is starting to form. **If the Dow should also break to new highs reaching the 5800 zone during the last two weeks of May, then look out, we could see a correction begin from about mid June on into as late as Jan/Feb 1997.** The US share market needs to hold on to its current momentum beyond June in order to avoid such a correction period. One key area to watch will be the 647 level on the S&P 500. A weekly closing beneath this area at any time beyond May will confirm that a sharp correction could be under way.

PRECIOUS METALS IMF GOLD SALES

Here the luster is starting to dwindle. Financial trouble at the IMF is starting to build. With 70% of IMF outstanding loans currently extended to Russia and Mexico, the dark clouds of uncertainty are gathering on the horizon. **The IMF is strapped for cash and in a political year like this, nobody wants to pour more money into the IMF treasury.** Russia is simply not making payments and fear is starting to rise the closer we come to the June/July Russian elections process. The fear is that Yeltsin might lose and if so, it is widely expected that Russia will permanently default on its loans - some \$85 billion dollars.

While at first glance one might think this news to be bullish for gold. However, the pressure on the IMF is translating into potential gold sales out of desperation. This

means that we could see the metals move down first, then react positively later.

There remains only two windows in times left for a final low in the metals - May/June 1996 and Jan/Feb 1997. We need to see gold decline at least under \$387 basis spot **NOW** in order to raise any hope of bringing this bear market to a conclusion. Silver must drop at least below \$5.12 before June 15th in order to qualify this period as a major reaction low. To be better, silver should break below \$5 to yield a better signal for a possible low. Thereafter, silver must close above \$5.80 before year-end or else we could see silver drop to \$2.90 for the first quarter of 1997.

US BONDS

The bond market is simply confused. Clinton's shifting of the national debt is distorting the view of this market in a very big way. Here the bonds have fallen from 122 back to 106 while the Fed has done **NOTHING!** Talk about volatility and confusion.

MORE TRICKS FROM THE TREASURY

Rubin is expected to be flirting with the idea of issuing US treasury bonds **INDEXED** to inflation. **WARNING!** These issues may be seriously hazardous to your financial survival. Although the scheme sounds good on the surface, don't forget it is another Wall Street brain storm that has landed such firms as Prudential nearly in jail. Rubin, an old Wall Street banking schemer, is about to give the nation a real shaft. These bonds, if indexed to inflation, will be tied to the CPI. The CPI is already the most politically manipulated statistic ever invented. Besides 14 major revisions, there is

talk of cutting the CPI in half. Don't forget, that while the CPI shows 2.5% inflation, the PPI shows 7.5%. The difference between the two is purely political manipulation. The PPI is not used for anything with respect to inflation. The CPI is used for automatically increasing entitlements. Therein lies the motive.

The CPI does not include taxation other than a retail sales tax. Taxation is up more than 200% in less than 10 years and in some states it is up 700%. In 1983, the government took real estate out of the CPI which used to be 40% of the statistic. It is now based on rents while the real estate component is based upon FHA data, which limits the value of a property considered to \$100,000.

These "**Rubin Indexed Junk Bonds**" that you will be hearing about in the press soon are the worse investment you could possibly make. The real risk is in interest rate exposure and as we can see, the price of bonds has fallen from 122 to 106 over the last 3 months on anticipation of what the Fed might or might not do in the near future. This index would still not shield you from that exposure and would undoubtedly provide an underestimation of inflation in any event. **RECOMMENDATION: Stay very, very far away!**

DOLLAR

The US dollar is pressing higher going into May and could reach a possible temporary top. The DMark is a key currency to watch here. The dollar must move above 158.40 to signal that the rally will continue. **If we cannot accomplish a monthly closing ABOVE 158.40 on the DMark by the end of July, then the dollar could fall back to one more new low going into the first quarter of 1997 against many continental Europeans.**

C\$ DOLLAR

The C\$ remain in a very weak position with a definite risk of dropping into the first quarter of 1997 where a test of the **66 cent** level is likely. There is also a risk the we could see a decline at worse down to the **52 cent** level against the US dollar. While major economic reform is starting to take place at the provincial level, the federal government of Canada is by no means dealing with the issue of serious debt reform. **Given this prospect, we see that a debt crisis in Canada is still likely and there is a major risk of at least a temporary default developing going into the first quarter of 1997.** Best advise to Canadians - diversify out of \$C as much as possible. You might also want to look at gold since you can buy it exempt from the GST.

ECONOMIC UPS & DOWNS

The economy in the US is certainly reaching a position where a minor downtrend is possible starting in the 3rd quarter moving into the 1st quarter of 1997. We do see the possibility that the Fed could raise rates one more time during May, June or July. This is the last window in time that we see for a temporary high in rates that are directly in control of the Federal Reserve. Thereafter, the economy will remain relatively strong and we see NO risk of a serious recession until 1998 to 2003 time period.



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World Economic Review

by **Harold Ludwig**
Director PEI US

UNITED STATES

PURCHASING INDEX: The US purchasing manager's index edged up in March, but continued to indicate depressed conditions in the manufacturing industry. The index rose to 46.9% against 45.2% in February, but remained below 50% - the threshold for expansion in manufacturing - for the eighth month running. Mr. Ralph Kaufmann, a spokesman for purchasing managers, said indices for production and new orders, although slightly stronger than in February, still pointed to a contraction in manufacturing. If the overall index maintained March's level for the rest of the year, the economy was likely to grow by only 0.9% in real terms this year, he said.

The purchasing index used to be regarded as an accurate guide to the direction, if not magnitude, of economic changes. But confidence has been reduced recently because it has been sending more pessimistic signals than other indicators.

SEMICONDUCTOR CHIP SALES: The US semiconductor industry's "book to bill ratio", a closely watched indicator of market trends, dropped to a record low in March, signaling an industry-wide slowdown.

Chip sales during March in North and South America were \$4.16 billion, down from 3% from February sales of \$4.29 billion, according to data released by the Semiconductor Industry Association. New orders booked during March dropped sharply to \$3.33 billion, down 12.5% from February.

The book to bill ratio, a measure of the value of chips sold against

new orders - fell to 0.80 from a revised February figure of 0.89. A ratio below 1.00 normally means demand for semiconductors is slowing. Overall, the semiconductor market growth for the year is now expected to moderate to about 15-20%, down from close to 40% last year, but in line with the industry's long-term growth rate.

WHOLESALE PRICES: According to the US Labor Department, US wholesale prices rose by 0.5% in March. The figures were difficult to interpret because of an unusually large rise in the food and energy component of the index, which was blamed on the cold weather during March.

Energy costs in March jumped 2.4%. Fuel oil prices rose 10.5%, the largest rise in more than two years. Food prices rose 0.6%. Beyond food and energy prices, the "core" index rose 0.1%, half of what market analysts had expected.

Wholesale prices have been fluctuating sharply, but the March increase means the annual rate of increase in the first quarter is 2.8%. March's rise follows a 0.2% decline in February and a 0.3% rise in January.

CONSUMER SPENDING: US consumer spending and personal incomes grew vigorously in February, confirming other evidence of an economic rebound, according to official figures. Consumer spending rose 0.9% in February in real terms, after a fall of 0.7% in January.

TRADE GAP NARROWS: The US trade deficit in goods and services in February shrank by 17.1% from that of the previous month. Although the deficit dropped from \$9.9 billion in January to \$8.2 billion in February, it was running at an annual rate of \$108.4 billion for the first two months of the year, only marginally better than the \$111.5

billion in the equivalent period last year.

Aircraft, a big component in the improvement but a volatile sector, accounted for most of a \$700 million rise in exports. Exports were also boosted by sales of US tobacco products and pharmaceuticals. Crude oil imports fell, mostly as a result of reduced volumes rather than lower prices. The improvement was also powered by a surge in trade in services, particularly foreign trade to the US.

The politically sensitive trade deficit with Japan rose by 2.7% to \$3.89 billion. The US bought more computers, electrical machinery and power generating machinery from Japan in February. Japan bought more fish, aircraft and computers from the US.

HOUSING STARTS: US housing starts fell modestly in March but remained at levels that historically have signaled solid economic growth, according to official figures. The Commerce Department said starts dropped 3.9% to a seasonally adjusted annual rate of 1.447 million, roughly in line with analysts' projections. Revised data showed starts rose to 1.505 million in February, the highest level in more than a year. During the first quarter starts were 12% higher than in the same period of last year, providing further evidence of economic recovery after sluggish growth late last year.

Building permits - a guide to future construction activity - were flat last month but 14% higher than in March last year. Regionally, the biggest improvement in housing markets was in the north-east where starts rose 10% following a large gain in February.

INDUSTRIAL PRODUCTION OUTLOOK: The outlook for US industrial production is improving, despite the impact of a strike at GM,

which artificially depressed output in March. The Federal Reserve said that production had fallen by 0.5% last month, following a revised gain of 1.3% in February.

During the first quarter as a whole, US production grew at an annualized rate of 2.7% - up from 0.6% in the final quarters of last year.

However the Fed said the underlying picture for US manufacturers was brighter than these figures were suggesting. Production would have risen by 0.3% last month but for the 18-day strike at General Motors which led to an erratic 15% decline in the output of motor vehicles and parts.

The outlook for industrial production has been obscured by a series of distortions. The strike at General Motors was preceded by severe winter storms, which depressed output in January, and by a strike at Boeing, the aircraft maker, which cut production in the final period of last year.

March's fall in production left overall output 1.3% higher than in March 1995. Excluding cars, output is up by 2.5%. Industrial capacity utilization dropped by 0.7% in March to 82.5%.

HOME SALES: Sales of US existing homes shot up in March to the briskest rate in more than two years as buyers rushed to take advantage of relatively low interest rates, according to the National Association of Realtors. Sales jumped 6.9% from February to a seasonally adjusted annual rate of 4.21 million units - the highest rate since 4.35 million in December 1993, according to the real estate group.

March sales were 16% higher than the rate a year earlier, when used homes were selling at a rate of 3.63 million a year. The March figure was well above Wall Street expectations of a 3.94 million rate. Every region in the US reported higher sales.

JAPAN

INDUSTRIAL PRODUCTION:

There was further evidence of the strengthening Japanese recovery with the publication of figures showing a rise in industrial production and an easing of disinflationary pressures in the first three months of the year. Special statistical factors were responsible for an unusually large decline in industrial output in March, according to the ministry of international trade and industry. The index fell 4.3% between February and March, the first month-on-month decline for six months, but the underlying trend remained positive. The more reliable three-month moving average of output growth showed a rise of 1.3% in the first quarter of the year compared with the previous three months. The index stands at 7% above its trough in late 1993, although it is still 6% below its level before the recession began in 1991.

A ministry official said the sharp decline in March was the result of quirks in the calendar - February's output had been especially strong because of the extra day in leap year, while March had two fewer days than normal. The ministry said the overall outlook for factory output this year remained good. It expects increases of more than 4% this month and 2% in May.

CURRENT ACCOUNT SURPLUS: Japan's current account surplus fell 38.8% in February, compared with a year earlier. The decline in the surplus to Y745.9 billion (\$6.88 billion), announced by the finance ministry, means Japan is now likely to report a smaller current account gap in the fiscal year to March for the third year running.

It brings the surplus for the first 11 months of the fiscal year to Y8,202 billion, down a quarter on the same period of the previous year. On the financial account,

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there was Y1,349 billion net capital inflow to Japan in February, the second month running in which money flowed in, as foreigners rushed to buy Japanese equities.

Japan's surplus in goods and services, excluding financial transfers, fell 55.7% to Y390 billion in February, the 15th monthly decline and smallest trade gap in five years. Exports rose 16.6%, while imports were up 46%, completing a 19-month run of rises. Within this, Japan's services account deficit rose 22.4%, chiefly due to growth in foreign travel.

HOUSEHOLD SPENDING:

Further evidence of a modest recovery in Japanese consumer confidence emerged with a 3.2% year-on-year rise in household spending in February, the second monthly increase in row. The improvement, announced by the government's management and coordination agency, marks only a gradual recovery, because it comes from an unusually low base, said officials. Spending early last year declined after the Kobe earthquake in January.

The latest result marks a 2.4% decline compared with January 1994, the year before the earthquake, when consumer confidence was more comparable. However, officials see this as evidence of a sustainable turnaround from the seven-month run of declines to the end of last December.

WHOLESALE PRICES: Japan's overall wholesale prices fell 0.1% month-on-month in March, after being unchanged in February, according to the Bank of Japan. Compared with a year earlier, the overall wholesale price index was down 0.6% in March, after falling 0.1% in February.

The import price index was down 0.4% after rising 0.4% in February, while the export price index was unchanged after declining 0.1% in February. The central bank said prices of oil related products rose, reflecting international price movements. Electric equipment and mi-

crochip prices fell due to the yen's decline. The BOJ said the decline in March domestic wholesale prices was due mainly to a fall in computer prices, stemming from the downturn in semiconductor demand in the US.

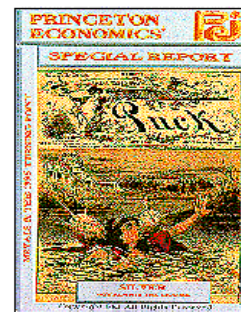
VEHICLE EXPORTS: Japan's vehicle exports last fiscal year shrank to their lowest level in 20 years, as the strong yen forced Japanese makers to move More output overseas. Japan's vehicle exports in fiscal year ending March 1996 fell 16.7% from the previous year to 3.62 million, the fourth straight year of decline, the Japan

Automobile Manufacturers Association said.

The 1995/96 export figure was just under the 3.82 million vehicles exported in 1976/77, but above the 2.99 million in 1975/76.

CAR OUTPUT: The Japan Automobile Manufacturers Association said that last year vehicle production in Japan dropped 5% to 10.1% units. This is the first time in the industry's history that production has fallen five years in a row. Production in March was down 11% month-on-month to 963,245 units, the association noted.

Special Report on Gold & Silver



If you think that silver always trades along with gold this is one special report you should take a look at! While the outlook for gold may be very bullish, a lot has changed on the commercial side of demand when it comes to silver.

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GERMANY

INTEREST RATE CUT: The Bundesbank cut German short-term interest rates by a further half percentage point, in a move that came sooner than expected. The reductions in the discount and Lombard rates to 2.5% and 4.5% respectively came a day after the IMF urged the German central bank to cut rates.

The reductions brought the discount and Lombard rates - the floor and ceiling for money market rates - back to record lows last reached more than eight years ago. Many economists expect them to stay at these levels until 1997 in spite of fresh indications of very high money supply growth.

Reaffirming the Bundesbank's commitment to the M3 money supply indicator as its monetary yardstick, Mr. Hans Tietmeyer, president of the Bundesbank, said recent overshooting of the 1996 target did not invalidate this. M3 was expected to grow more slowly in coming months.

M3 MONEY SUPPLY: M3 grew at an annualized rate of 12.2% in March after 12.8% in February, based on the level in the fourth quarter of 1995. This compares with a 1996 target range of 4-7%. However, based on the 1994 fourth quarter level, the M3 rise was 4.6% against February's 4.2%.

INFLATION: Inflation in Germany moved up a tick in March as the year-on-year increase in the cost of living index advanced to 1.7% from 1.6% in February. Prices were 0.1% higher in March than in February and the annual rate of inflation was also stable at 1.4%.

In eastern Germany, the cost of living index rose 0.1% between February and March while the annual rate of price increases rose to 2.7% from 2.6%. Eastern Germany's inflation is nearly double the western rate as a result of sharp rent increases

Preliminary inflation figures for April, based on results from the four biggest west German states, showed the annualized inflation rate in April had dropped to 1.3% from the 1.4% a month earlier.

INDUSTRIAL PRODUCTION: Industrial production in February dropped by 2.8% compared with a month earlier. This was a much sharper drop than the 1.65 reported when the preliminary figures were released. While the downward revision was largely driven by poor results in the construction industry - where production fell 11.6% - there was also a 2.1% fall in industrial production.

New orders for February were also revised downwards in the final, seasonally adjusted February figures released by the Bundesbank.

SLOWDOWN SEEN BY BONN: The German government forecast a sharp slowdown in economic growth to 0.75% this year, from 1.9% in 1995, but insisted there would be no recession.

Chancellor Helmut Kohl said the economy would not grow by 1.5% as forecast by the government three months ago. Although he told parliament that most German and international experts expected activity to pick up in the second half, the recovery would only have a positive impact on statistics next year.

Mr. Kohl said the planned spending cuts, welfare reductions, tax reforms and deregulation created scope for Germany to adapt to changes in the world economy

UNEMPLOYMENT: German unemployment continued to hover around record levels in March, prompting the main opposition Social Democrats to urge the government to abandon budget consolidation and borrow more to boost the economy.

The federal labor office reported a "disappointing" drop in March. Although the unadjusted figure fell by 129,000 to 4.14 million, from Feb-

ruary's record 4.27 million, seasonally adjusted unemployment rose for the eighth month in a row - by 26,000 to a new high of just under 4 million.

The latest "headline" total was the highest for March in the history of the federal republic and was 467,000 up on a year earlier. According to the unadjusted figures, 10.8% of the labor force were without work last month compared with 11.1% in February and 9.6% in March last year.

The figures showed that 2.87 million or 9.3% of the labor force were unemployed in western Germany in March compared with 1.27 million or 17% in the former Communist eastern Lander (states).

BUILDING INDUSTRY RECESSION AND JOB LOSS: Germany's building industry is in its first recession since unification and facing the loss of 80,000-100,000 jobs this year, according to the Munich-based Ifo economic research institute. Investment in construction is expected to fall nationwide by 2-3% in 1996 after a sharp deceleration in growth last year to only 1.2% from 7.8% in 1994.

Ifo expects a moderate 4% expansion in construction output in eastern Germany this year after growth of roughly 10% last year and 21% in 1994. However, eastern Germany growth will not be sufficient to offset the anticipated 5% fall in Western output.

The institute forecast that the building industry recession would reach eastern Germany next year, with output in the new Lander declining more sharply than in the west so that overall investment in construction would fall by another 2-3% in 1997. Ifo said that the completion of new homes would fall to 595,000 in the whole of Germany this year from an estimated 615,000 in 1995, with demand in the western Lander bottoming out in the course of the year.

The outlook for commercial property development in the west was bleak because of oversupply of offices and hotels and the growing tendency of manufacturing industry to invest abroad.

MINIMUM WAGE ACCORD: German construction workers and employers agreed on a minimum wage for the building industry, a move aimed at pricing foreign construction workers out of the market. The two sides agreed to introduce a minimum wage of DM15.3 (\$10.20) an hour in western Germany, rising to DM18.60 in December. In eastern Germany, the minimum wage will start at DM14.08, rising to DM17.11 by next April.

The new minimum wages compare with going rates of between DM10 and DM15 currently paid by many construction companies to workers from other EU countries. The minimum wage is designed to reduce their competitive advantage over German workers who have been bound to a "de facto" minimum wage of more than DM20.

The number of foreign workers on German building sites is estimated at around 200,000. Unemployment among German construction workers runs at 20%.

CORPORATE INSOLVENCIES: The number of corporate insolvencies in Germany in January rose 13.3% from a year earlier. Germany's federal statistics office reported that insolvencies rose to a total of 1,868, following December's 10% year-on-year rise in corporate insolvencies to 2,174.

CAPACITY UTILIZATION: Ifo said in its March economic survey that capacity utilization fell to 81.9% in the first quarter from 84% at the end of December. But Ifo said there was an increase in the number of companies which regard the level of outstanding orders too low.

Companies were more pessimistic about the general outlook for the next six months and less confident about export prospects. Companies in some sectors remain just

as skeptical about business prospects as February, the research institute said

UNITED KINGDOM

HOUSE PRICES: A sharp increase in UK house prices has pushed the number of households in negative equity below 1 million for the first time since 1992 and raised hopes of a sustained housing market recovery. House prices increased by a seasonally adjusted 1.2% in March following a 1% advance in February, according to Halifax Building Society, the UK's largest mortgage lender. House prices increased in 9 out of 12 UK regions.

MONEY SUPPLY: The Bank of England, the UK central bank, said that M4, the broad measure of the money supply, grew a seasonally adjusted 10.1% in the year to March, the fifth successive month that growth has exceeded the government's monitoring range of between 3 and 9%. Between February and March, it grew 1.2%, more than double February's growth rate.

Lending by banks and building societies grew a seasonally adjusted BP5.9 billion in March, slightly below City expectations. The 12-month growth rate fell to 9.3% from 9.8% in February

March's M4 figures represents a slight slowdown from the revised annual growth rate of 10.2% in February and the peak of 10.6% in January. But economists said it would still add to the authorities' worries that pressures may be building that could lead to resurgence in inflation and higher interest rates.

RETAIL SALES: The Office for National Statistics said retail sales volumes grew by a seasonally adjusted 0.2% between February and March and were 2.2% higher than the same month a year earlier.

Sales in the three months to March - considered a better measure of the trend - were 2.1% higher than the same period a year earlier, the biggest rise since February 1995.

The figures disappointed the city after recent consumer surveys suggested activity in town centers were buoyant last month. But the ONS revised upwards its February sales figure which meant the growth between February and March appeared smaller, while the ONS Iso adjusted for the Easter period.

Unadjusted data showed sales values in March were 7.1% higher than the same month a year earlier, the biggest rise for five years and in line with survey evidence. Non-food retailers enjoyed the most robust growth in March, with sales of clothing, footwear and household goods rising strongly.

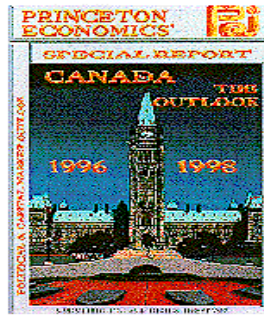
FRANCE

TRADE SURPLUS: France's trade surplus continued to grow in February in spite of a decline in the value of the country's exports. Customs office figures released showed a seasonally adjusted surplus for the month of FFr10.21 billion (\$1.9 billion), up from FFr8.26 billion in January. This gave a surplus of FFr18.47 billion for the first two months of 1996 - a 15% increase over the FFr16.05 billion recorded in the 1995 corresponding period. Exports and imports both fell in February to FFr117.6 billion and FFr107.4 billion respectively.

WHOLESALE ORDERS: French wholesalers do not expect to have to reduce their orders further, according to a survey by the Insee national statistics bureau.. However, orders in the construction and semi-finished goods will probably weaken, the study indicated.

Overall, inventories during January and February continued to shrink, particularly for consumer goods. They are now viewed as

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being at normal levels. Wholesalers also said their sales during that 2-month period improved slightly after having fallen in the previous six months. Sales improved in the consumer goods and food sectors, but continued to fall in the equipment and semi-finished agricultural goods sectors.

GDP: France's gross domestic product in 1995 grew 2.2%, revised

down from a preliminary estimate of 2.4%, according to Insee. The country's fourth quarter GDP shrank 0.4%, a steeper decline than the 0.3% estimated earlier. Insee also revised second- and third-quarter 1995 growth to 0.1% for each quarter, from 0.2%. First quarter growth was left unchanged at 0.7%. Mr. Alain Lamassoure, budget minister, blamed the down-

ward revisions on the national strikes late last year.

NEW CAR SALES: New car sales in France rose 3.3% in March to 192,000 from 186,000 a year earlier, according to the French carmakers association. During the first three months of the year, sales of new cars rose 12.2% compared with the same period a year earlier to 553,000. The quarterly figure was boosted in part by very strong January sales, which included cars that couldn't be delivered in December because of nationwide strikes.

French carmakers took 57.8% of the domestic market in March and had 57.2% for the three-month period.

RATE CUT: The Bank of France took advantage of a strong French franc to cut another 0.1% of a percentage point off its base intervention rate, bringing it down to 3.70% in the 11th rate reduction since November.

The government recently cut its official estimate of growth this year from 2.8% to 1.3%, and has pinned hopes of an upswing later this year largely on the effect of lower interest rates feeding through to industrialists and consumers.

INFLATION: France experienced its biggest rise in monthly inflation for five years in March, but consumer spending on manufactured goods dipped for the second month running. The national statistics bureau reported the monthly increase in consumer prices reached 0.6% in March, taking annual inflation to 2.3%.

It said three factors were principally responsible: a 5.9% increase in the price of fresh products; higher energy prices; and an increase in the cost of summer clothing after last year's rise in sales tax.

Consumer spending dropped 1.2% in March. The surge in consumer spending in January, as the country emerged from a wave of strikes, meant that French con-

sumption of manufactured goods rose by 4.9% in the first quarter.

AUSTRALIA

JOBLESS RATE: The March jobless rate of 8.5% was only marginally higher than the 8.4% recorded in February, but was noticeably worse than most private-sector economists had forecast (about 8.3%).

During the month, the number of jobs fell by 55,300, with both the full-time and the part-time sectors registering a decline. Again, forecasters had expected a brighter picture with most predicting a 10,000 gain in jobs.

PRIVATE-SECTOR ECONOMISTS OUTLOOK: Private sector economists have raised their expectations for Australian growth after the country's recent election, according to Consensus Economics', which monitors forecasts from leading banks and other financial institutions.

The mean expectation for 1996 growth has risen to 2.9% from 2.7% in March. Expectations have been bolstered by the publication of official statistics showing strong private-sector consumption in the final quarter of 1995. Consumer sentiment was lifted with the removal of uncertainty following the election, Consensus said.

Private consumption is still expected to moderate in coming months, but last year's strong private consumption figures have encouraged economists to raise their forecasts for the economy as a whole.

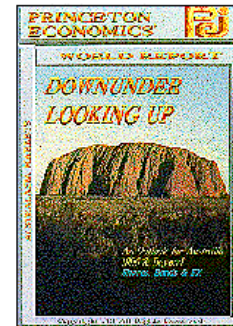
The mean forecast for 1997 has also been raised to 3.4% from 3.3% in March.

INFLATION RATE: Australia's annual inflation rate slowed to 3.7% during the March quarter, the lowest level for more than a year and a sharp reduction from the previous quarter's 5.1%. The con-

sumer price index rose 0.4% in the March quarter, compared with market forecasts of 0.6-0.7%. The rate of "**underlying**" inflation, which attempts to exclude one-off influences, also rose 0.4%, to give an annual rise of 3.3% in the quarter. In the December quarter, underlying inflation rose 0.7%.

The latest figures are seen as particularly significant because they come when wage pressures are threatening to push the Australian economy off course.

Special Report on Australia 1996-1998



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