

Princeton Economic's The World Capital Market Review

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EMU Next Great European Economic Disaster

by Martin A. Armstrong

There is a huge debate fermenting over the future of Europe. In Britain, this debate is also heating up as the infamous date of 1999 moves closer to our focus. Many argue that Europe must pull together to fight off the rising tide of trade around the globe. A united Europe is seen as the answer to keeping the Marxist foundation of socialism alive. To some observers this appears as a close parallel when Rome tried desperately to fend off the invasions of barbarians that also proved fruitless in the final historical analysis.

The one sales pitch that has been used to sell this revived dream of a united Europe is none other than the currency. It has been pointed out that if one begins in London with a 100 pounds, after traveling around Europe exchanging the currency in every port, when



you return to London you will have only 60 pounds left after spending nothing.

While this argument appears to invoke much common sense about how inefficient currency transactions might be between nations, at the same time, it fails to deal with the reality behind creating a single currency. The proponents of a single currency for Europe often point to the success of the United States, albeit behind closed doors and far away from the public eye, as the justification behind a single currency. Many fund managers and multinational corporations also hail the move to a single currency as the future for Europe simply because they are finding it extremely difficult to cope with the rising volatility in foreign exchange.

Nonetheless, Europe does not quite understand the United States model of a single currency. Europe looks at the US and sees one single currency as being extremely efficient with a by-product of consistently lower unemployment as one goal. However, it is in fact a single currency policy that is actually part of the internal problems that are causing much concern within both the United States and Canada.

It is of vital importance that we understand the benefits as well as the nasty side-effects of a single currency for Europe as a whole and in that context US and Canada do serve as an excellent model to explore for answers. Prior to 1927 the central banking system in the US was established in 1913 with 12 **INDEPENDENT** branches. Each branch maintained its own separate discount rate. This is very important to understand. It was not uncommon to find rates at 7% in California and 3% in New York. This is far too often a point totally lost in history, but it is paramount in trying to define whether or not EMU will succeed or fail for Europe.

The central banking system known as the Federal Reserve emerged as a solution out of the disaster of the financial Panic of 1907. The Federal Reserve was

formed in 1913 because the evidence revealed in the investigations by Congress discovered that even though a single currency had existed in the US since 1792, the regional capital flows within the US were often to blame for numerous financial panics - 1907 being the primary Panic that drew the attention of government to this problem.

The differences on a regional basis within the US economy as a whole were the source of Panics due to cash flow problems on a nationwide scale. Even today, the differences between the local economies in Texas and New York are staggering. We call this the Texas/New York arbitrage. When Texas is booming, New York is in the depths of a recession and vice versa. The New York economy is more financial and business related today while Texas is more commodity oriented with farming and oil production. Therefore, when inflation is running high, Texas booms at the expense of New York.

This is the same regional capital flow problem is silently tearing Canada apart. When real estate was booming in 1987 in the Eastern regions of Canada, interest rates continued to rise in an attempt to stop the speculation. However, while there might have been a real estate boom in the East, the rising interest rates policies were driving farmers into bankruptcy in Alberta.

The Panic of 1907 followed on the heels of the Great San Francisco Earthquake. The claims were obviously on the West Coast but all the insurance companies were of the East Coast. As capital flowed from East to West, shortages in money supply emerged among New York banks that culminated in bank failures.

A single currency does not necessarily make things great. In fact, there is more to the issue of a stable economy than merely a single currency.

The regional cash flow problems were initially resolved between

1913 and 1927. However, a very significant development took place in 1927 that would forever alter the course of our economic destiny for the entire century.

By the mid 1920s, it was noticed that there were significant problems emerging on a cash flow basis internationally. In a power struggle within the US Federal Reserve, the New York branch managed to convince the government that the same system of regional cash flow management should be extended to the international level. The New York Fed won the battle against Chicago who warned that changing the focus would undermine the domestic policy objectives of the bank. In the end, the entire power of the Fed was shifted into a single nationwide system where one interest rates policy would be used thus abandoning the original mission of the the Federal Reserve as the guardian of domestic cash flow problems.

1927 this marked the beginning of the very first G4 effort at influencing international cash flows. The discount rate in the US was usurped into a single rate. The first action was to lower US interest rates in an attempt to divert capital back to Europe. The manipulation backfired because it gave credence to rumor that there was a problem with the escalating debt in Europe. As the cash flows into the US intensified, the Fed moved into a state of panic. Capital poured into the US driving the stock market up dramatically - doubling between 1927 and 1929 despite the Fed raising interest rates from 3% to 6%.

The post-1927 economy has remained on the international regional focus rather than on the original intent of domestic regional capital flow management. This is where our modern problems of regional disparities emerged. The one-size-fits- all approach to interest rate policy is now increasing the tensions between regions within most nations. It is this very issue that is tearing apart Canada pitting one province against another.

This theory that a single currency for Europe is **NOT** the answer. It will not solve the vast disparities between the economies of Europe but in fact will be a means of exporting deflationary policies at work in Germany to other nations such as Britain. What EMU must be about is more than a single currency. While a single currency will ease some risk problems for business associated with currency, it poses significant dangers that would breed resentment between member states.


If EMU were to adopt a single currency, it must **NOT**, under any circumstances, lead to a single monetary policy that would impose a one-size-fits-all approach. The basic sovereignty over establishing local interest rates must reside with each state. Allowing this vital power to be usurp into a single rate will undermine the entire framework of Europe much in the same manner as is taking place in Canada or even the United States.

The individual nations of Europe have distinctly different economies as is the case among the 50 US

states. When US auto manufacturers lost market share to the Japanese and European cars, the economy of Michigan was devastated. When IBM was forced to restructure, Massachusetts was devastated. When oil prices fell sharply, million dollar homes in Texas fell to \$100,000. Regional problems exist today as they did prior to 1913. If Europe follows-through with its one-size-fits-all plans for EMU, it very well may lead to the worst economic disaster in the economic history of Europe.

View From America

by **Martin A. Armstrong**

he political scene is about to go completely nuts as we approach mid to late August. At the Republican convention, rumor has it that Buchanan will not get an opportunity to speak. Amazingly, there is yet another 3rd Party movement going by the name of the US Tax Payer's Party who just so happen to be holding their convention across the street from the Republicans in San Diego. The start date will be Friday, August 16th coinciding with the end of the Republican convention. The rumor part is that Buchanan is going to stage a protest on national TV and walk across the road to assume the nomination of this new 3rd Party. The US Tax Payers Party is on the ballot in 28 States. Although Buchanan running as yet another 3rd Party candidate may not stand a chance of winning, combined with Perot, the US political scene is going to start looking like some European nations with multi-party fragmentation. This is likely going to mean that Clinton will win rather easily as our computer models had forecast.

Yet the second party of our long-term Presidential forecast for the US remains quite provocative. A Clinton victory in 1996 will mean the end of the Democratic Party. Clinton should be the last Democratic President to hold office! While this might appear to be a partisan statement, it is not! There are two factors taking shape here in the US political scene that are simply not addressed by the media or many politicians for that matter.

1)DEMOGRAPHICS: If we look at the great socialistic movement of the 20th century, we see that it actually reached a peak with the first election of Roosevelt. That first election marked the highest concentration of Democratic power in the Senate and the House. While the Democrats managed to retain

control of Capital Hill for 40 years or so, they did so with a steadily declining majority. If we analysis the generational cycle, we find that the bulk of the support for the Democrats tends to be concentrated within the elderly and low income minorities. As we look ahead, the elderly generation of the New Deal will die off as we move beyond 2000. This shift from one generation to the next will be profound. The Democrats have never bothered to build much of a coalition among the middle class who remain the bulk of the independent voters. Consequently, the most conservative groups among voters are not the elderly or low income minorities. As we move beyond 2000, the Democratic Party begins to fade in its support.

2) CORRUPTION: There is little doubt that Clinton and his wife are perhaps the most corrupt couple to have ever held the office of President. Hillary is clearly guilty of just about everything under the sun from laundering funds via cattle futures and land deals to obstruction of justice in dealing with the Congress. Since the Independent Prosecutor Ken Star is holding off on filing any charges against the Clintons until after the election, a new possibility arises. There is a reasonable chance that during the first half of 1997 Clinton may resign or at least standby and try to defend Hillary. In any event, the post-election period may become far more interesting than the pre-election speculation. This could be one factor that drives the dollar to a new low against many Europeans early next year.

ECONOMY:

The US economy appears to have reached a temporary top as of May 1996. The back-dated statistics will continue to be strong raising the serious possibility of a rate hike by the Fed come August. This may have a profound impact upon

the share market as well as bond markets in the US and elsewhere. If the US 30 year bonds close below 10801 at the end of July on a nearest futures basis, then there will be a risk that a rate rise is possible in August causing the second leg down in the stock market prior to Labor Day.

SOCIAL SECURITY:

Thanks to Clinton's clever tricks with the funding of the national debt, there is a real risk that Social Security will move into deficit next year - not 2010 as previous forecast by the government. This will help to add to the confusion of inflation and market behaviour next year promising to make 1997 a year to remember.

TAX REFORM

The Flat Tax is dead. Long live the Consumption Tax. If the Republicans do manage to hold Capital Hill (A BIG IF), then we should expect a compromise plan to emerge from Armeys- Archer. The plan will be replacing the income tax with a national sales tax while business will still be taxed on an income basis. Reforms in the business tax may also include the abolishment of worldwide income.

Congress is clearly concerned about the Internet and the emergence of a new quasi-electronic form of money. They know that tax reform is going to be necessary but at the same time they also know that money, as we know it, may also be changing. There are some on Capital Hill who do envision the day where cash will be abolished and all transactions will be taking place with some sort of a debt-card. This will answer the prayers of the tax collector and perhaps begin the 21st century on a completely new set of rules.

Princeton Economics 1996 London Seminar

by Bruce Allen
Executive Director,
United Kingdom &
Middle East

Professor, Sir Alan Walters, the former economic adviser to Margaret Thatcher was the guest speaker at our London seminar in June. He is also a member of The Referendum Party set up by Sir James Goldsmith to contest the next UK elections on the issue of British sovereignty in Europe and the right of the electorate to express a direct view by referendum. He spoke on the subject of the European Monetary Union (EMU) and the single European currency as well as broader issues. From his background at the heart of British politics in the 1980's he provided an insight into the lead up to the European position today and a thoughtful analysis of economic and political motives currently at work. Professor Walters speech, included in the video of the London Seminar, is summarized below.

Monetary Union versus Single Currency

There is a great distinction between a monetary union and a single currency, though in economic terms broadly speaking they are the same. Hong Kong and the US are an example of monetary union with the exchange rate fixed at 7.8. Interest rates in Hong Kong move based on those of the US. And the German, French and Benelux currencies are effectively in monetary union within the European Exchange Rate Mechanism (ERM) with very little movements in their parities. You get all the economic benefits of a single currency without the need to create one due to fixed rates.

Economically, it doesn't matter whether you have a single currency but politically it matters a great deal. Because once you have a single currency you have locked yourself in and thrown away the key.

The Gold Standard from 1870 through 1931 is cited by some as a case for a single currency but that was a monetary union, gold itself did not circulate to any degree. So that allowed Britain to get out of the standard at various times such as in 1913. Britain went back into the standard at \$4.85 in 1925, went into a great slump in 1926 and essentially stayed in it until coming off the gold standard in 1931. The US went off in 1933 and the French held on until 1936.

Monetary Union and Inflation

The economic argument for monetary union was that all countries would have the same inflation rate; Britain joining the ERM would borrow the Bundesbank's credibility, control the French and gang up on the Germans. There was enormous political pressure to join. However, there is no reason to believe that monetary union or even a common currency will result in common inflation rates. Hong Kong has had inflation rates spread 5% above those of the US over the same period. The central point is that you would have the same inflation but only for tradeable goods. Non-tradeable goods such as real estate can be very different. The US itself is an example with price inflation different in different areas.

Optimum Currency Area

A single currency for Europe has never been rationally argued through. To argue for this you would have to prove Europe is an optimum currency area - all economies reacting broadly in the same way to monetary policies and moving in concert. Now Europe does not react this way. Even the US

does not react this way but there is a great mobility of resources and labor in the US against minimal movement in Europe. There are strains in the US - when oil goes up its good for Texas but the East Coast cries. In Europe those strains would be two or three fold. It will be very difficult. Countries will want to break out of the straight jacket.

Conclusion

It is likely therefore that Europe will have Monetary Union but not a common currency beginning in 1999. Kohl is in a hurry; he wants this established before the 1998 German elections when he is likely to retire.

Missing Koreans

Direct investment in the UK has increased for a third year running to record levels. Although the largest number of projects still come from the US, Germany has moved to the number two position. More than 1500 German companies now have an operation in the UK, and investment from other European countries is increasing. Britain remains the favored destination for direct investment into the European Union accounting for 38% of all investment last year. The well publicized investment by Korea's LG Group of £1.5 billion creating 6,000 jobs has created euphoria in the Welsh valleys around the chosen site. A government grant of £200 million no doubt helped in attracting this Korean investment to this region along with the presence of existing successful Korean ventures. However, stable and low taxation and liberal labor regulations remain major factors in attracting inward investment.

A meeting of twenty eminent economists recently debated employment issues under the auspices of Southbank University's European Institute in London.

Could regulation and non-wage costs such as welfare and severance be responsible for Europe's high and persistent unemployment? The unanimous decision by the economists was "No"! However, it was noted that a vicious circle of the public sector providing alternative jobs or compensation triggers increased government spending, higher taxes or interest rates or both and that the extremely high severance pay rules in Spain could contribute to that country's 22% unemployment. No Korean industrialists were observed in the audience.

Bail out now - Bail out later!

The exclusion of pension liabilities from the Maastricht criteria judging qualification for the European single currency does not appear to be causing too much concern. Unfortunately, if they were included, it is unlikely any country would come close to qualification. Apart from Britain, Ireland and Holland, pensions for the expanding ranks of the elderly are funded not by past contributions but by tax from the dwindling ranks of the young employed. Unfunded liabilities as a proportion of national income run at 69% in France, 122% in Germany and 107% in Italy. Members of the currency union would be jointly liable to bail out the problems with tax payers money. Euro interest rates could go through the roof as each of the 400 million citizens of the European Union would be saddled with \$50,000 in debt. It is a compelling argument for Britain to bail out now rather than bail out Europe later.

Tax Holidays

Brussels has finally acknowledged that it would appear to be contradictory to remove currency distortions in free trade within the EU while leaving taxation distortions in place. There are very large differences in tax systems, tax rates and tax bases between

member states which significantly frustrate free trade. A "Communication on direct taxation" is due to be released by the Commission this summer with proposals for harmonisation perhaps a little bit behind the drive for harmonisation of currencies and subject to very little promotion in public. Tax, however, sits right in the door of governments whilst differences in foreign exchange can be blamed on speculators.

Reform of Value Added Taxation (VAT) is also under discussion. Three proposals put out by single

market commissioner Mario Monti were to make businesses pay for BAT on cross border transactions in the country of origin, bring all BAT rates to the same level (to avoid low tax countries having and "unfair" advantage) and to "modernize" and standardize the scope of VAT as to who would pay and who would be exempt. No doubt there will be opportunity for a little revenue raising. It has been suggested VAT should be added to the ticket price of all aircraft travel within the EU. Good news for holiday resorts in Thailand, but not in Spain!



Megalomania ?

**by Harry Groernert
Executive Director
Continental Europe**

Telekom Germany has planned to issue the first portion of 500 million shares (par value 5.00 DM) in November as part of the privatization program. The second allotment is scheduled for 1998. With a balance sheet of 160 billion DM (\$105 bln), sales of 66 billion DM (\$43 bln) and a profit of 5.8 billion (\$3.8 bln) for 1995 it appears to be an interesting investment - at least initially. The issue price is estimated between 25 and 30 DM - the sale shall fetch about 15 billion DM (\$10 bln).

Deutsche Bank, Dresdner Bank and Goldman Sachs as lead underwriters need to be successful, otherwise the second portion in 1998 wont sell. 60% of the shares shall

be placed in Germany, 20% in the US and 20% in the UK and Europe.

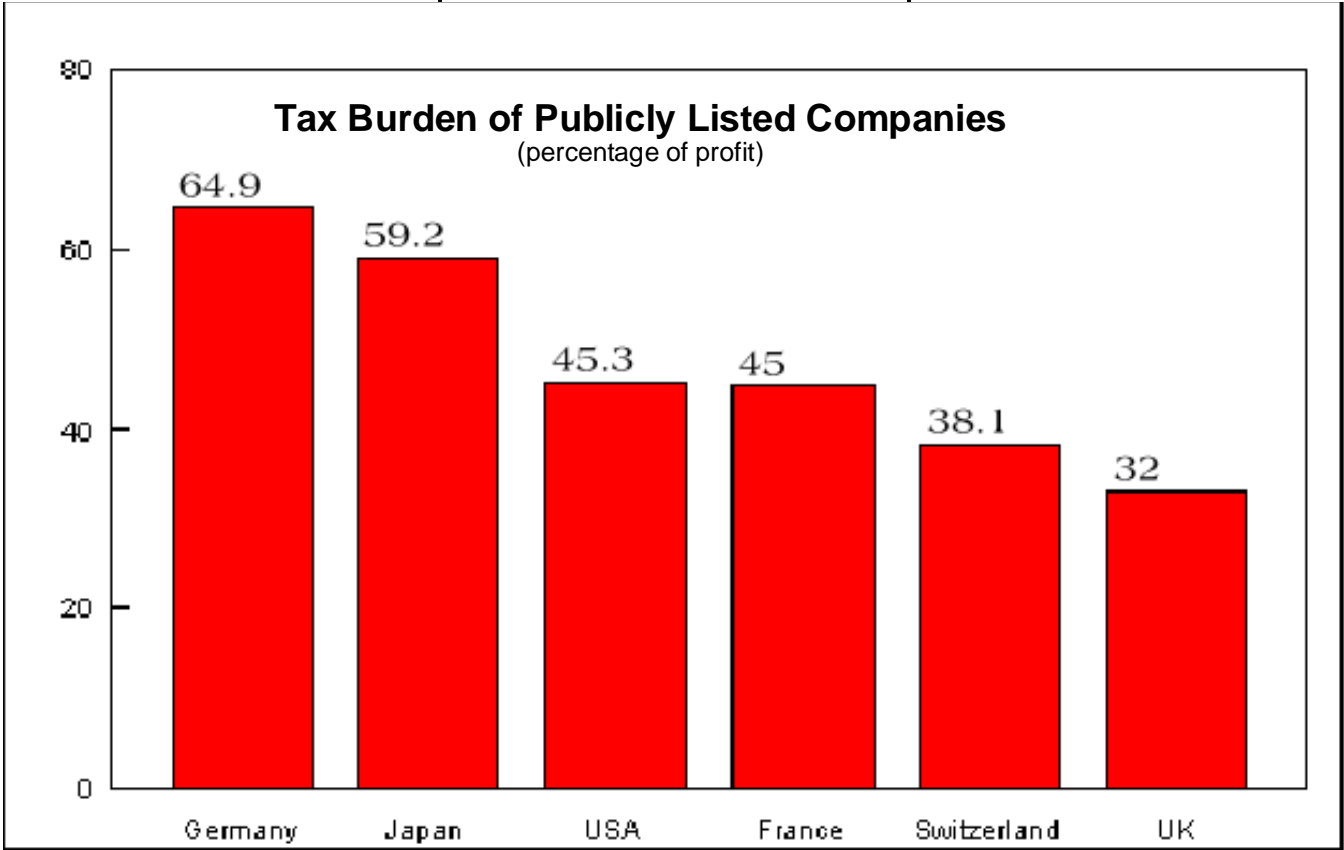
60% of the total of 15 billion for Germany means a capital requirement of 9 billion. This is a decent amount for the German Stock-Exchanges. In 1995 a total of 20 companies went public and they altogether raised just a total of 8.3 billion. In the rest of the world, irrespective of the fact that Telekom is number three on this planet, the institutions do hold a lot of telecommunications shares like AT&T, NTT and BT not mentioning the small companies. I doubt that any subscriber of the new issues of NTT or BT is happy with his investments - only AT&T has performed well. Those who place and issue shares look always with optimism into the future. They estimate the growth rate for telecommunication at 15% p.a. worldwide for the next

decade. For the domestic market the forecast hovers around 7%.

What is worth knowing about Telekom? Their debt is more than 120 billion DM (\$79 bln) and they pay more than 8 billion (\$5.2) on interest. Telekom used to be part of the government. The German civil workforce has the same reputation as other civil work forces in any other country. Telekom also has a huge obligation on old pension schemes and has not yet experienced competition in its core market. It was also exempt from revenue tax until 1996.

The tip of the iceberg

Theo Waigel, the German finance minister, recently received a letter from Mario Monti, the EU-Tax commissioner. Certainly diplomatic but down to the point: The German



corporation income tax (Körperschaftsteuer) is against some basic rules of the Maastricht treaty. It hinders and restricts free capital flow.

Tax burden of publicly listed companies, percentage of profit

That is not all. Germany now has total of 1500 companies with operations in the UK, the tax-haven of Europe. Why, because businesses are voting with their wallets and investing abroad in order to avoid taxes. It is as simple as that. As long as politicians do not learn the lessons of history they are condemned to repeat the misery. Take Munich as an example. A referendum voted with 50.6% for three new tunnels in Munich. Three days later it was obvious that this would cost some money. The city council voted and decided for an increase in trade taxes. They call it the "Tunnel-Strafsteuer" (tunnel penalty tax). What is going to happen? Any decision upon location will be influenced more by the local taxes than by economic parameters and the municipalities will get less income in the end.

The 1997 Budget

The debt increase for 1997 will be 7 billion DM more than planned because spending reductions can not offset the loss of income due to the lower and/or negative growth rate. Waigel has to deal with an additional 5 billion for social costs meanwhile missing 30 billion of tax income. How does he do that? He cuts the defense, the agriculture, the transport and the science budget. The capital investment program is also reduced by 10%. The social side, still 28% of the overall budget will only be cut by a meager 2%. His interest expenditures are now a total of 93,7 billion DM, which is 21.3% of the total budget.

This is the plan. The question is, how realistic are the assumptions this plan is based upon? The government believes in a real growth of 0,75% for 1996 and a growth rate of 2,5% for 1997. Even with this slightly optimistic figure, public debt will increase and lead to serious trouble.

In 1994 the national debt stood at 1,169 trillion - municipalities owed 938 billion. Neither the Bundesfinanzministerium, nor the Bundesbank, nor the Statistische Bundesamt yet has been able to provide us with the official numbers for 1995. Still, we can do some homework. If it would really be possible to increase the income according to above table and if it would also be possible to control spending, what would happen to the national debt?

Until 2000, the national debt would rise by 228 billion DM. Let us believe that the government has considered the effect of compounded interest and let us assume that the above numbers can be achieved - still, Germany will increase its overall debt.

But how long can they do that?

"Any government, like any family, can for a year spend a little more than it earns. But you and I know that a continuance of that habit means the poorhouse."

President Franklin Roosevelt, 1932

Germany's Plan 1996-2000

(in billions of DM)

	Target 1996	Budget 1997	Plan 1998	Plan 1999	Plan 2000
I. Spending	451.30	440.20	447.30	458.70	469.0
(%change)		-2.5	+1.6	+2.5	+2.2
II. Income					
1. Tax Income	351.2	350.3	357.3	372.8	389.2
(% change)		-.025	+1.99	+4.34	+4.4
2. Other Income	40.2	33.4	33.8	30.5	30.9
III. Net Increase in Debt	59.9	56.5	56.2	55.4	48.9

The Emerging Market of Russia

by Dana Schneider Director of Russian Studies

Investing in Russia is a risky undertaking. The political environment is by no means shatter-proof. Although the recent elections boosted stability and confidence in the fledgling democracy and emerging market, the health of President Yeltsin looms large. Speculation is in the news about who would assume control if the president were incapacitated. Alexander Lebed, who won 15% of the vote in the final presidential ballot, has been appointed as Security Chief and is presently seen as a likely candidate. The Communist Party acknowledged defeat but vowed to press their agenda through their majority in the Duma. This could hold up confirmation of Yeltsin's Prime Minister and other government officials as well as market and economic reform legislation. The most pressing issue is taxation as the IMF has held up over US\$ 300 million in a loan disbursement until Russia acts on improving collection that is down over 60% than projected for the first half of 1996. So Yeltsin's victory, although preferred, does not displace concern about political and economic stability in Russia.

Why Russian Investment

Investing in Russia is undeniably appealing. The vast amount of natural resources has investors anxious. Statistics reported from the State Geological Committee show why: Russia has 13% of the world's proven oil reserves; 12% of the coal; 35% of the gas resources; and a large chunk of the world's diamonds, timber, iron ore, gold, and rare metals. It has been estimated that only about 10% of

these resources are under development/production.

Russia ranks sixth in terms of population (148 million) and exhibits one of the most product starved of consumer markets. The Ministry of Economics reported that in 1995, foreign investors put the most capital into the trade and public service sector to total 17% or US\$ 471.9 million. Banking and finance came in with 14.3% (US\$ 386.6 million); the food sector received 10% (US\$ 282.9 million); oil and gas industry at 9.4% (US\$ 199 million); construction sector received 7% (US\$ 199 million); and the chemical and machine production both stood at 5.9% (US\$ 166 million and 165 million respectively). For the 1995 total, foreign investment is estimated at US\$ 2.5 billion (Rbl 1,032 billion) of which direct investment was US\$ 1.88 billion (Rbl 652.8 billion). However, over US\$ 890 million (Rbl 155.5 billion) was received via credits in trade, banking accounts and international financial organizations.

The Russian Equity Market

By mid-1995, over 70 exchanges had been registered. Several main exchanges have developed in Russia - St. Petersburg, Moscow, Yekaterinburg, Vladivostok, and Novosibirsk. The RFCSCM (Russian Federation Commission on Securities and the Capital Market) oversees the exchanges and investment instruments; issuance, trading, and reporting systems and enforces market rules. The RFCS is modeled after the US SEC but by no means does the Russian counterpart enjoy its seemingly broad powers as enabling legislation, mechanisms, and agencies still need to develop.

The RFCS was established by presidential decree in November of 1994 after a large portion of privatization had already begun. The late arrival of this vital agency was in part responsible for the fraud and inefficiency that affected the execution of the privatization schemes. Consequently, the role of the RFCS is complicated by correcting problems that were incurred in the past couple of years while trying to foresee and headoff problems of tomorrow.

Rossiyskiy Kredit Bank Research cited that some 40 million shareholders appeared by July of 1994 after the process to privatize over 16,000 large-scale enterprises via a voucher system started in October of 1992. More shareholders were added as the number of privatized enterprises reached over 100,000 by the end of 1994. Additionally, estimates of market capitalization for top 100 Russian companies as of April 1996 was at US\$ 13,935.48 (million).

The Rossiyskiy Kredit Bank reports that over 98% of activity in Russian stocks takes place in the over-the-counter market. Within the entire OTC market, there is the developing electronic trading system - the Russian Trading System PORTAL - RTS/PORTAL. PORTAL is the portalelectronic trading system set up in the Spring of 1995 that reports trading prices and volumes

Many professional associations have developed in each exchange location. The PAUFOR is an independent professional association of broker-dealers in Moscow. Currently, PAUFOR consists of over 90 members and is evolving toward a well recognized, self regulating and training organization. Members of PAUFOR gain access to participate in the electronic trading system through PORTAL.

This screen based system greatly improved the transparency of the market. Members of PAUFOR have committed to issuing firm bid and ask quotations to be posted daily on the PORTAL. It is the most accurate and up to date source on market activity. The RTS reports of pricing are out at 12:00, 15:00, and 18:00 Moscow time. It is expected that the RTS/PORTAL system will be expanded nationwide to incorporate other exchanges in a similar fashion to the NASDAQ.

Outside of PORTAL, the system to obtain timely and accurate market data is undeveloped. Many market players still telephone one another for bid and ask quotations. A cottage industry of independent business has sprung up to fill this void - providing not only current price information but badly needed company and sector research. Several of these businesses have established indices. The price information, method of inclusion, or weighting/calculation is not universally established and is subject to change frequently since this market is quite thin.

Currently, the Moscow Times has an index of the top 50 companies and is emerging as the widely accepted index. Other private business calculate "Blue Chip" company indices or have created other indices by sector, such as oil and non-ferrous metals. The reputation and credibility of these companies promote the index and not an industry recognized accuracy or methodology.

Although the RFCS, PAUFOR, and the electronic trading system PORTAL have helped the market system to be a more open, transparent, and regulated market - an independent and reliable registry system is not yet fully developed and organized. Manipulation, insider trading, and outright fraud, particularly outside of Moscow, is not uncommon as estimates list over 400 share registrars. Many shares are maintained by book entries written in by independent issu-

ers and registrars without oversight. Realistically, the laws on the books are not enforced nor is a body set up to clearly support regulation. Without a verifiable registry system in place, foreign investors will remain on the sidelines when it comes to the domestic equity market.

The pursuit of ADR's (American Depository Receipts) by large Russian corporations through Western financial institutions is an attempt to acquire foreign shareholders in an otherwise unsecured and high risk environment. The huge government demand for capital as well as the embattled economy has made it very difficult for Russian business to secure domestic share holders. Any capital looking for work is currently put toward buying up the government debt offering due to the high yield and short-term maturity. Sector giants such as LUKoil have used ADR's to get their shares to the international marketplace. ADR's are appealing to those investors who are impatient for Russia's system to evolve. ADR's are dollar based in their pricing and interest and dividends are paid in

dollars. Clearing and settlement is also operated by US standards so inconsistent and murky local laws/custody and shareholder rights are by-passed. However, ADRs are vulnerable to currency exchange rates as reflected in price.

Election Summary

The July 3rd Russian Presidential elections have concluded, firmly placing Yeltsin at the helm with 53.82 percent of the vote. The challenger Zyuganov received 40.31 percent. Yeltsin's margin of victory was 10 million votes, or 13.5%, over the 30.11 million votes cast for Zyuganov. Out of Russia's 108.6 million voters, 68 percent made it to the polls casting a total of 73.9 million votes as reported by the Central Electoral Commission. The turnout was 1% lower than that of the June 16th first round dispelling fears of low voter turnout that would favor the communists. The showing bolstered Yeltsin's claim to a popular mandate for continued reforms under his leadership.

Bloomberg - Internet

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Hong Kong Update

by Craig H. Stephen
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Hong Kong Branch

Ask investors why they invest in Asia and invariably the first two reasons will be strong economic growth and political stability, particularly in comparison to alternative emerging markets. While the latter has largely been achieved without the shackles of democracy, and elections are typically a one horse race, it has provided a degree of certainty where the political and economic systems are inextricably linked. However now we are seeing that this is being increasingly challenged as many of the leaders are nearing the end of their tenures whether it be the British in Hong Kong, Suharto in Indonesia, or Lee in Singapore. In China there is the perennial rumor mill on Deng Xiaoping's imminent demise - overnight an offspring of Deng on the board is no longer a guarantee to guanxi. Positions of privilege like nepotism and monopoly rights are likely to be threatened from the ex-colonial hongs in Hong Kong to the "first family" business empires of President Suharto in Indonesia. Clearly the changing economic/political landscape is one investors must prepare for.

China - soft landing likely

China's half year report card was mostly positive as further signs emerged that inflation and economic growth have been brought under control and it looks likely that there will be a further loosening in monetary policy later in this year. The only black spot was a weakening in exports. Gross domestic product rose 9.8 per cent in the six months of June to 2.97 trillion yuan (about US\$356 billion) which, after GDP growth of 10.2 percent in the first quarter, shows that growth in the second quarter slowed to around 9.4 percent. Inflationary pressures continue to ease with the

retail price index showing an average rate of 7.1 percent in the first six months. China is well on course for its 10 per cent inflation target for the whole year and single figures remain within reach.

There was a fall in exports by 8.2 per cent to \$64.06 billion in the first half which was attributed to rising wages and a strengthening currency, although it is expected that there was some reallocation of exports to the stronger domestic sector. Imports rose 11.6 per cent to \$63.8 billion and the half year trade surplus fell to just US\$880 million. A sharply lower trade surplus for the full year is forecast after a surplus of \$16.9 billion last year. However, increases in fixed asset investment and consumption should compensate for the traditionally strong export sector. China's fixed asset investment grew 19.9 per cent in the first half after a large increase in the second quarter as austerity measures were gradually relaxed. Contracted foreign investment jumped sharply in the first half of this year as investors rushed to sign contracts before the tariff exemption for imported equipment expired on April 1st. The value of contracted foreign investment grew a robust 46.3 per cent to US\$45.6 billion in the first six months. The May cut in interest rates is helping consumption to play a larger role in driving the economy - retail sales rose a robust 19.5 per cent in June year-on-year as consumers see sustained disposable income growth.

Looking ahead China is expected to see further loosening of monetary policy by the end of the year according to remarks made by China's Central Bank Governor Dai Xianglong. Despite May's cut of an average of 75 basis points, due to the continuing low levels of inflation, positive real interest rates of around 4 per cent allow scope for further cuts. It was also hinted that the People's Bank of China

(PBOC) was considering a cut in the reserve requirement's for banks from 13 per cent to 10 per cent. Although Mr. Dai said this move would be offset by a similar reduction in loans that the PBOC gave the banks, the multiplier effect would clearly make the move expansionary. The surplus credit will be directed at the cash starved state enterprises which remain a priority. Statistics showed that losses at state-owned enterprises were up 51.6 per cent to 41.6 billion yuan in the first half and about 45 per cent remain in the red. It is also expected that the cut in reserve requirements will help develop China's capital markets as banks are able to invest excess cash in treasury and enterprise bonds.

Will China devalue yuan?

China's weakening balance of payments and sluggish exports, taken with a looser monetary policy are likely to see attention focusing on the possibility of a yuan devaluation. While as expected officials have denied any such plans, speculation is increasing on the most opportune timing of such a move. Pragmatism suggests it is unlikely to happen prior to the handover of Hong Kong next July to maintain confidence. China's strong foreign currency position and relatively low inflation rate should reduce the negative impact of devaluation, while the move would likely benefit both economies. Two way trade would get a boost and as we saw during the previous yuan devaluation in 1993/94 hot mainland money will be attracted into the currency hedge offered by the Hong Kong property market. In the past few months it is estimated that more than \$5.4 billion worth of mainland backed investment has been made in the local property market. Those stocks with costs in yuan and revenues in foreign currency would benefit and vice versa.

Australian Government & Economy

by Nigel Kirwan

Budget "Black Hole" blows out to A\$10 billion

The federal government's 1995/96 underlying (net of proceeds of asset sales) budget deficit, inherited from the previous Labor government, has blown-out to approximately A\$10 billion. This has strengthened the Treasurer's justification to bring down a budget in August with expected massive cuts and rationalization of federal programs. The government now doesn't expect an underlying balanced budget for at least 3 years - the life of the current parliament. The Prime Minister however still expects to be able to deliver on the bulk of the coalition's promises during this term of office.

The deficit revelations have taken the heat off the government on several fronts. Treasurer Peter Costello faced an embarrassing back down over an attempt to impose federal sales tax on state, territory and local governments. The state premiers emerged with a one-off drop in federal allocations which were hastily passed on to the taxpayer via the raising of several state taxes. Meanwhile trouble prone Foreign Minister Alexander Downer had to first admit to misleading parliament over various Asian governments' protests at the axing of the soft loan aid scheme for importing Australian products into developing countries, then partially back down on axing the scheme due to those protests. His performance has been widely seen to have damaged Australia's standing in the Asian region and a diplomatic appointment somewhere in Africa is probably awaiting his next mishap.

World's largest zinc mine to go ahead

RTZ-CRA subsidiary Century Zinc has announced it intends to develop its north Queensland mine after resolution of disputes over the project with local aboriginal communities. The mine is also important for Pasminco which needs the relatively clean ore from the area to satisfy new government environmental standards imposed upon its smelters in the Netherlands. The project proceeding is seen as a victory for the framework set by the controversial yet popular Australian Native Title Act. This agreement acknowledges a principle that indigenous peoples whose ancestors formally occupied lands over which pastoral leases have since been granted by the Crown, have a right to negotiate compensation from but not to veto a mining project on that land. This is an issue not as yet tested by the courts and affecting huge tracts of Western Australia, the Northern Territory and Queensland where, although native title has been extinguished by the Crown granting pastoral leases, there are remnant common law rights enjoyed by the descendant aboriginal inhabitants. Any attempt by a state or territory government to extinguish these common law rights would contravene the Federal Racial Discrimination Act and suggestions of suspending the Act have provoked widespread protest.

Commonwealth Bank float raises \$4 billion

The federal government just managed to get its remaining 50% share of the Commonwealth Bank of Australia floated before the local share market gave way in sympathy with Wall Street's decline. Private investors heavily oversubscribed the float and offshore institutions bid strongly to nudge out many of the local institutions in

Australia's largest ever float and the largest worldwide this year. Unfortunately the approximate \$4 billion proceeds of the float will be put towards covering the budget deficit as were the earlier proceeds of the Qantas Airways float. The float leaves only the Queensland State Government as the owner of an insurance and financial institution. That government recently thwarted the takeover of the state's largest private bank in order to effect a reverse takeover of it by the government owned insurance and building society and development bank. It then hopes to gradually privatise the combined institution by selling down its share while at the same time preserving a major state based bank-assurance group. While politically perhaps a winner this type of political interference in the market place has been widely condemned around the country by governments and business alike.

This follows on from the National Party dominated Queensland government decision to ax a power line to connect the state to the national electricity grid which it is estimated will save the state's consumers \$700 million over the next five years. Rural based Queensland while developing exceedingly well on the back of mining and tourism has always exhibited a quirky sense of sovereignty and this issue is but the latest. Many predict a battle to free up the state's monopoly controls over the marketing of sugar - its major agricultural export - to be next.

Closer Australia & New Zealand economic ties

The Federal Government and the New Zealand Government have announced the formation of a common aviation market between the two countries following on from Air New Zealand's intention to purchase TNT's 50% of Ansett Australia.

lia. This will allow both countries' carriers to operate domestically within the other and eventually should lead to common customs and immigration controls at international ports. Ansett Australia will remain under the control of 50% shareholder News Ltd and ownership of Ansett New Zealand will be assumed 100% by News, 50% of Ansett International will be placed with Australian institutions. Although Air Zealand is 20% owned by Qantas Airways the two carriers are fierce competitors and the combined Air New Zealand/Ansett group should pose as a stronger domestic and international competitor in Australasia and the fast growing Asia Pacific market. Already the largest airline in South East Asia, Qantas is set to benefit again from the new worldwide alliance it recently helped to matchmake between 25% shareholder British Airways and Qantas' U.S. ally American Airlines. Building upon the decade old Closer Economic Relations (CER) free trade agreement between Australia and New Zealand, the Australian government recently announced the recognition of all New Zealand regulatory standards for products to be sold within Australia. In what is now the most open free trade zone in the world the extension comes only a few years after similar agreements were finally put in place between the Australian States and Territories. No political or monetary union is seriously considered between the two countries even though a place is reserved for New Zealand in the Australian Constitution. The relative ease at which international confederative agreements can be brought about as opposed to drawn-out federal/state negotiations perhaps explains why from an economic perspective (and leaving aside sport) New Zealanders are glad they never joined the Commonwealth!

Enquiry into the Financial System & Bank Mergers

The Chairman of the Committee of Inquiry into the Australian Financial System covering the regulatory compliance roles of the Reserve Bank of Australia (RBA), the Insurance and Superannuation Commission (ISC), the Australian Consumer & Competition Commission (ACCC), the Australian Financial Institutions Commission (AFIC - non-bank financial institutions), and the Foreign Investment Review Board (FIRB) has already hinted that big bank mergers are a good thing. Also the Chairman of the ACCC has hinted at a more relaxed attitude to big bank mergers. Already the bets are on National Australia Bank (NAB), which emerged from the '80s relatively unscathed and has just announced a \$2billion profit for the 2nd year in a row, having a go at one of the big bank losers of the '80s Westpac or possibly ANZ Bank. NAB has been voracious in swallowing regional banks in the Republic of Ireland, Scotland, the north of England, New Zealand, and Michigan USA. Its weakest domestic markets are in New South Wales, Queensland and Western Australia and with Westpac strongest in these states it is a logical acquisition, however ANZ Bank owns UK's Grindlays which has a strong Asian presence and which would also compliment NAB's existing market coverage. The rationalization of regional banks which has been taking place for some time could also provide some prize pickings for the big 4 to either expand through or dilute the balance sheet with in defense. This scenario could turn the Queensland government's state based institution into a prize victim for a much larger predator!

The big insurance companies can't be left out of the picture either. AMP was once aligned with Westpac and National Mutual with ANZ. Paul Keating said no to any mergers and National Mutual was taken over by the French insurer AXA. Colonial Mutual successfully bid for State Bank of NSW and AMP has now entered the home loan market. Watch this space.

Media - foreign ownership and cross-media rules could be relaxed

Ever since the former Labor government changed the rules for Australian citizenship specifically in order to deny Rupert Murdoch dual citizenship the media foreign ownership and cross-media rules have become a bigger and more complex farce as politicians sought to thwart then court Murdoch and Kerry Packer, and court then thwart the likes of Canadians Conrad Black and Tsi Asper. There are strong signs that the rules are about to be done away with and this could see some major media assets put into play. Despite the fact that they are currently suing one another Rupert Murdoch and Kerry Packer would likely emerge as the big winners controlling the majority of Australia's newspapers, television and satellite/cable assets - these two usually have the ability to put aside their differences in order to do a much bigger deal together. Though Seven Network Australia recently won control of MGM/UA using Kirk Kerkerian's money, don't be surprised if Rupert Murdoch ends up in there somehow - he already has 15% of Seven.

A look into the future for Clinton and the Democrats?

Former Commonwealth Secretary of the Treasury and National Party Senator for Queensland John Stone wrote in the Australian Financial Review that exit polls at the March 2 Australian federal election revealed:

- More **blue-collar workers** voted coalition (47%) than Labor (39%);

- Compared to the previous federal election (1993) there was a 16% drop in Labor's vote among **trade union members**;

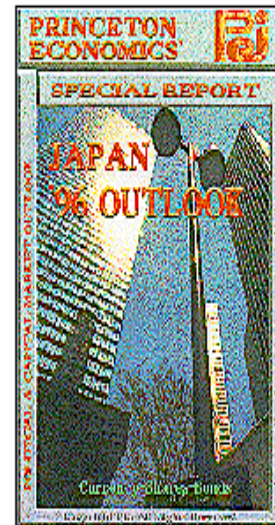
- For probably the first time ever, more **Catholic voters** (48%) opted directly for the coalition than for Labor (37%);

- **The "bush"** (rural areas), which has always been more favorable to the coalition but where Labor previously held many seats, swung violently further against Labor; on mainland Australia Labor now only holds two seats outside the major cities;

- Of the 57 House of Representatives seats in **the outlying states**, (other than New South Wales, Victoria & ACT - the Sydney, Melbourne, Canberra axis) Labor now holds only 10 (3 in Tasmania).

Since Stone's article was published several other commentators including former Labor leader and Governor-General Bill Hayden have since essentially drawn similar conclusions to Stone on the above and also the strong vote for several populist candidates openly opposed to traditional small "l" liberal causes such as so-called "gay" rights, feminism, multiculturalism, aboriginal rights, and green politics - that with the Labor Party's eternal drive to capture these minority constituencies it rightly or wrongly has been seen to be hijacked by them and this has proved a real turn-off in Labor's own heartland where youth unemployment is as high as 30%. Shades of the current state of the Democratic Party in the U.S.?

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Helms-Burton: Forcing the World to Toe the US Line

By Chris Quigley

The Cuban Liberty and Democratic Solidarity Act (LIBERTAD), better known as the Helms-Burton Act, was passed into US law this past March. The law was designed to tighten the existing US embargo against Cuba and prepare a contingency plan for the US to aid a transitional democratic government in Cuba. Two controversial sections of the legislation have caused a sharp reaction from US trading partners. Titles III and IV allow for legal action against foreign firms operating on or profiting from confiscated US property in Cuba. Specifically, Title III "Makes any person that traffics in property confiscated by the Cuban Government on or after January 1, 1959 liable for money damages to any US national who owns the claim to such property." Title IV "Directs the Secretary of State to deny a visa to, and the Attorney General to exclude from the United States, aliens (including their spouses, minor children, or agents) involved in the confiscation of property, or the trafficking in confiscated property, owned by a US national."

The bill is trying to hammer the final nail into the coffin of Cuba's centrally planned economy. Cuba lost the aid it had been receiving from the Soviet Union and Eastern Bloc nations after those communist regimes began to fall. However, Fidel Castro began to relax restrictions on foreign investment and foreign money started pouring in, taking the place of Soviet aid. Canadian companies have committed more than C\$ 250 million to investments in Cuba and two way trade between Canada and Cuba amounted to C\$ 576 million last year. European Union (EU) nations, led by Spain's \$62.4 million

in direct investment, accounted for 45% of Cuba's total trade in 1994. This new found money is, in the eyes of the US government, helping to keep Castro propped up as dictator.

The bill would never have made it out of Congress much less been signed by President Clinton had it not been for Cuba's downing of two US civilian aircraft flying near Cuban air space back in February. The Administration, the State Department and many Congressmen were initially against Helms-Burton, but this is an election year in the US and no one - not the President, not Congress - wanted to appear soft on Cuba. Therefore, in order to show the Cuban-American communities in the key election states of New Jersey and Florida that politicians were 'getting tough' with Cuba, the legislation sailed through Congress and was immediately signed by Clinton. Almost as quickly, the EU, Canada and Mexico announced plans to retaliate against Helms-Burton.

The United States recognizes an estimated \$1.8 billion in claims against Cuba. Under Helms-Burton, over 40 US companies and thousands of Cuban-Americans would be allowed to file suits against foreign firms. Already, many companies and former Cuban citizens are readying claims. However, Bill Clinton exercised his presidential option to suspend Title III for six months - stopping any claims from being filed until at least February of 1997. But, this action by Clinton did little to stem the growing controversy over a law that has been assailed by critics in the US and abroad.

International Reaction

All of the United States' trading partners have spoken up about Helms-Burton. And from the EU to Vietnam, not one has sided with the US. The EU is preparing sanctions that include publishing lists of US companies that file suits under Helms-Burton, requiring US business travelers to obtain visas for travel through the EU, imposing trade sanctions on items not covered by the World Trade Organization (WTO) such as telecommunications and aviation. The EU is also preparing a case against the US law that it will bring before the WTO.

The United Kingdom, Italy, Spain and France have all indicated that in addition to any EU sanctions they will impose sanctions of their own. These sanctions would include legislation ordering their home companies to ignore any US legal moves and allowing home companies to sue US subsidiaries in order to 'claw-back' any money awarded by US judges. Canada and Mexico have both announced retaliatory measures similar to the European Union's. The two countries also will launch an appeal to the law through Nafta.

Canada has been one of the most outspoken on the issue. Besides having a large stake in trade and investment with Cuba, the Canadians have domestic politics on their minds, too. Canadian officials don't want their electorate to perceive them as backing down to the US over Helms-Burton. Canadian special interest groups and members of the opposition have accused the ruling Liberals of not being 'aggressive enough' in countering the US law.

Canada is looking at this controversy as an opportunity to assert itself in front of the world. In an article from the Financial Times,

Bernard Simon writes “[Helms-Burton] has given Canadians a chance to satisfy two basic cravings: to stand up to the big bully across the border, and to be noticed by the rest of the world for something other than Mounties, maple syrup and ice hockey.”

Realities of Helms-Burton

Just the threat of US actions under Helms-Burton has already deterred trade with Cuba. As soon as the bill became law, some businesses either pulled out or scaled back their Cuban operations. Cemex, A Mexican cement maker is considering a complete withdrawal and ING Group NV, a Dutch bank, is pulling financing for Cuba's sugar crop. Officials at Canadian banks announced that they were scaling back their credit to businesses operating Cuba. American Express announced that it was pulling the credit of two Dutch firms operating in Cuba amid concerns over Helms-Burton. Colombian airline AeoroRepublica announced that it was pulling its twice weekly flights to Cuba over fears of US sanctions.

Title III can be either suspended or invoked every six months. That fact alone makes the decision to invest in Cuba very difficult. It would not be wise for a company to invest in Cuba with the possibility of facing a lawsuit every six months. Companies that are going ahead with investment plans are doing so cautiously. Canadian-based Wilton Hotels is planning a large investment in resorts in Cuba and owner Walter Berukoff said, “We've been very careful not to deal in expropriated US properties. We have no desire to upset the Americans.”

Right idea, wrong law

US companies and nationals have a legitimate claim on land confiscated by Castro. However, the main issue for the US's trading partners is not protection of property rights or contract sanctity.

Their concern is manly over the US method of using extraterritorial legislation to unilaterally enforce its own foreign policy objectives. With similar US legislation designed to curb international trade with Iran and Libya already being voted on in Congress, it is important not to let the US set a precedent with Helms-Burton. The European Commission has stated that “extraterritorial application of unilateral sanctions creates an unacceptable burden for the international business community.” This sentiment has been echoed by foreign trade ministers all over the world.

US business, which seemingly stands to benefit from the law, has also spoken out against the legislation. A letter to Clinton from the US Chamber of Commerce and four other trade groups said that the legislation will only hurt US businesses. Their letter said “We believe that if [Helms-Burton] were to become effective, it would drive a wedge between the United States and our democratic allies that would significantly hinder multilateral efforts to encourage democracy in Cuba.”

In practice, Helms-Burton will never work. If Title III is ever allowed to take effect, it will immediately be rendered ineffective by countermeasures from US trading partners. Any settlements awarded by US courts, if they are ever even paid, will be lost through

counter-suits in other countries. As for Title IV, harassing international business travelers by telling them where they can and cannot go does absolutely nothing to exert pressure on Castro's regime. If the US really wants to force change in Cuba it needs to be done on a multilateral level with the full cooperation of the world's largest trading blocs. Anything else will only hinder further improvements in world trade and do absolutely nothing to change the situation in Cuba.

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World Capital Market Review

US STOCK MARKET

So far our computer model forecast is running perfectly on schedule. The precise high came on May 23rd, 1996 with the Dow reaching the 5800 level. The key weekly support basis the S&P 500 Nearest Futures rested at 64760 and once that area was penetrated, the correction process was confirmed.

Overall, we expect to see the US share market decline a bit further. Primary support lies at the 59800 level followed by 57300-56100. This is about the extent that we see for the correction as a whole. While from a point perspective this appears to be major, the 1990 correction was far more significant on a percentage basis. If the 1996 correction were to match that of 1990 in percentage movement terms, then we would need to see the S&P 500 futures decline down to the 54600 zone.

Timing continues to be a big question for this correction. About 90% of the total decline should be completed by the end of August. We do see that the final low for this correction is due in August, October/November, March 1997 or May/June 1997. If we see the 57300-56100 level during mid to late August, then either the correction is over, or we will see a more significant correction if the August low is penetrated at any time beyond August. This would open the door for a decline down to the 50300 level. An August low only in the 59800 area would tend to imply that the balance of the move down to 57300-56100 might not come until early next year in a slower, more choppy style move. Our yearly models do show that if at year-end the S&P 500 futures closes below 59260, then clearly a 1997 low should be expected.

PRECIOUS METALS:

Gold and silver remain captive to what appears to be the inevitable start of IMF gold sales. While we do not see this fundamental as long-term bearish, we do expect to see it help keep a negative undertone for perhaps as much as the next 6 months. Silver remains the big problem. While many call this the poor man's gold, it is more like the poor man's opium that creates visions of unrealistic grandeur. The silver/gold ratio still appears poised to make new highs or at least in the near-term retest the 100:1 level. The primary resistance remains at the 82.84-84.80:1 zone. A monthly closing above 84.80:1 will signal that silver could completely fall apart. Vital support basis NY spot remains at the \$4.50 and \$4.29 levels. If silver declines and holds \$4.50 during mid August, then there will be some hope that the decline is over. However, if silver penetrates the \$4.29 level, then caution should be employed. Silver might yet decline under \$3.50 during early 1997 before any hope of a bull market emerges. Gold, on the other hand, has reasonable support at the \$368 area followed by \$341. We do not expect to see new lows in gold under any circumstances.

US DOLLAR

While our long-term models continue to suggest that the dollar is going to rally dramatically into 2003, we do see that the potential for one more dollar low does exist during the first half of 1997 against most major European continental currencies, with the noted exception of the pound and the Japanese yen. Only a monthly closing for the dollar above 15840 on the Dmark would suggest that this forecast is wrong and that the dollar low is in place. Otherwise, a monthly closing below 13985 for the dollar vs Dmark would suggest that this fore-

cast is correct and that an appropriate hedge position is warranted.

The dollar/yen is a different story. Here the dollar low is in place on a long-term basis and the overall decline should continue taking the dollar up to 12500 or 14500 level over the next two years. Nonetheless, resistance stands at the 11300 level and a failure to move above that level by September would also raise the possibility that a retest of support at the 10489-10315 level is likely. A monthly closing below 10315 would then raise the potential for a very sharp decline back to the 10065 area or 9755 at worst.

US 30 YEAR BONDS

Here the primary monthly closing support remains at the 10801 level. A monthly closing beneath this area will signal that a sharp decline to the 10100-10200 area is possible. If July closes below 10801, then we should expect a possible rate hike by the Fed during August.

NIKKEI

The Japanese share market has most likely reached a temporary top in June. Here we see that a monthly closing below 21170 will signal that a correction is underway once again. The bulk of support lies at the 19628 and 18896 levels. A monthly closing below 18896 would warn that a retest of long-term support is possible taking this market back to the 15292 zone.

CANADA TSE

The Canadian share market basis the TSE reached a high during May at 52490. Here we see that a correction back to the 48182 to 44867 level is likely. A monthly closing below 44867 would warn

that a much more serious decline is possible where a sharp drop to the 39307 level is likely. We do see that a year-end closing below 43300 would warn that the overall correction could extend into early 1997 before reversing to the upside for new highs going into mid 1998.

LONDON FT

The British share market reached a high in during the week of April 15th. Vital support lies at the 36552-36474 level basis the cash. A weekly closing below 36474 will signal that a sharp correction is now possible. Additional support lies at the 34334 area. A monthly closing below 34334 would then warn of a drop back to retest long-term support at the 29388-29250 zone. A year-end closing below 34808 would warn that the overall correction could extend into early 1997. We do have a panic cycle due in November so we should expect to see some sharply higher volatility at that time. Key targets for a low appear to be August and October. New lows below beyond October would then raise the possibility that a low in February or April/May of next year .

GERMAN DAX

The German share market basis the DAX futures reached a high the week of June 24th. Vital support here begins at the 24875 and 22750 levels. A weekly and monthly closing below 22750 would warn that a correction is possible where we see long-term support forming at the 21450 and 20185 levels. A September closing below 24515 would also warn that a retest of long-term support in the 20925 area would be possible over the next 6 or 10-12 months. Yearly models show that only a year-end closing below 23270 would raise the possibility of extending the correction into early 1997.

FRENCH CAC 40

The French share market basis the CAC 40 futures has underperformed most other world share markets. Here the major high took place back in February 1994. Major resistance continues to stand at the 22380 level followed by 22620-22765. Here we see that 1996 must close at least above 20252 in order to hold on to any hope that a retest of resistance is possible in the months ahead. A closing below 20252 will leave the possibility that a penetration of the 1995 low could develop in early 1997. Major year-end closing support lies at the 17968 area. Should 1996 close below this level at year-end, then a drop back to the 15750 area will be possible next year.

SWISS MARKET INDEX

The Swiss share market basis the nearest futures has been by far the strongest European market. There is a potential for a July high to form if we see a weekly closing below the 35435 area. This will immediately warn that a correction into October is possible testing at least the 31650 zone. A weekly closing below 31360 will signal that an overall correction back to the 27690 or at worst 25450-24400 area will become possible.

PEI Government Bond Watch

Government debt continues to escalate despite the fact that deficits may be declining in some nations like the US. The US situation is reaching the critical point. We see 1996 as the absolute bottom in the outright deficit numbers as reported by government. Keep in mind that the deficit would be about \$50 billion higher if it were not for the Social Security funds being used to offset the general expenditure deficit.

As reported previously, the Clinton debt crisis is the key factor that

is causing a rise in volatility for all bond markets globally. Clinton's shifting of the national debt from 40% financed short-term to 70% is not merely alarming, it is outright dangerous! In fact, 33% of the entire national debt is now funded 1 year or less. Consequently, as the deficit appears to be declining, there is a major shift in where the money is going. Revenues now amount to about \$100 billion more than is actually spent on defense and social programs combined. This excess revenue is being absorbed by interest expenditures. As a result of the Clinton Deficit Reduction Plan, interest expenditures are rising faster than ever before in history! While total expenditure for 1994 was up 4.5%, interest expenditures rose 11.5% for the same period. We are now moving into an exponential growth rate in interest expenditures in all governments around the globe.

We strongly advise that fixed income investment should be restricted to 90 days or less. Do not invest in long-term bonds of any nation at this time. This holds true in Europe as well.

LATEST ADDITION TO PEI BLACK LIST

The fiscal corruption in the NDP government of British Columbia in Canada is beyond all belief. This highly socialistic political party is about as Marxist as you can get. The budget surplus they claimed existed going into the elections has amazingly turned into a deficit following their victory. The political corruption on an ideological level within the NDP is moving counter trend to the rest of the world. With the vast majority of Provincial debt in Canada moving to reform, there is absolutely no reason to buy BC bonds. We strongly recommend that BC bonds should be sold and investment in fixed income shifted to short-term debt issues of no more than 6 months in Canada at this time. Both BC and federal debt issues of Canada are at serious risk of declining due to the rising question of direction.

World Economic Review

by Hal Ludwig
Director PEI US

UNITED STATES

CONSUMER PRICES: US consumer prices rose 0.3 percent last month and 2.9 percent in the year to May, indicating faster economic growth is putting only modest upward pressure on inflation.

In the first five months of this year, prices rose at an annual rate of 4.1 percent against 2.8 percent for 1995 as a whole. But the acceleration may not be sustained, as it largely reflected a jump in energy costs. Oil prices have since fallen from peaks reached earlier this year.

Excluding the volatile food and energy components, "core" consumer prices rose 0.2 percent last month and 2.7 percent in the year to May.

CONSUMER CONFIDENCE: US consumer confidence fell unexpectedly in June but remained higher than in June last year, figures indicated.

The Conference Board, a US business group based in New York, said its confidence index had fallen to 97.6 against 103.5 in May. This surprised Wall Street economists who had predicted little change, given recent reports of rapid employment growth and buoyant retail spending.

Some analysts said the decline was consistent with projections of slower economic growth in the second half of this year after a robust second quarter. But it may have just reflected the volatility of the index, which has fluctuated between 88 and 105 in the past six

months. Historically a reading of 90 to 100 has indicated steady economic growth.

EXISTING HOME SALES: US figures showed a 1.4 percent rise in sales of existing homes in May over April, higher than most analysts had expected.

GOVERNMENT DEVELOPMENT AID: The US slipped last year into fourth place behind Japan, France and Germany as a provider of government development aid, and the total declined to \$59bn, the Organization for Economic Cooperation and Development (OECD) reported.

Japan remained by far the largest official aid donor last year with \$14.5bn, according to the OECD's development assistance committee. Helped partly by the strength of their currencies in relation to the dollar, France and Germany overtook the US to arrive in second and third place with \$8.4bn and \$7.5bn respectively.

US official aid fell by \$2.6bn -- 28 percent in real terms -- to \$7.3bn, partly because of delays in approving its 1995-96 budget but also because of cuts in food assistance and in those peacekeeping expenditures which qualify as aid. Last year the US devoted 0.1 percent of gross national product to government aid programs, its lowest level since the second world war.

UNEMPLOYMENT: The Labor Department said non-farm payroll employment rose 348,000 last month, nearly twice the increase expected by economists. Figures for April were revised to show a gain of 163,000 rather 21,000 as reported previously.

The employment gains last month were broadly based, with large increases in many service industries. But the jobless rate, which is based on a survey of

households rather than companies, rose modestly to 5.6 percent against 5.4 percent in April, reflecting an increase in the number of people seeking work.

LEADING INDICATORS: The US index of leading indicators rose for the third consecutive month in April, suggesting the economy will grow robustly in coming months.

The leading index is designed to predict changes in economic activity six to nine months in advance. The recent string of increases was the longest since autumn 1993, when the index gave advance warning of a surge in economic growth in 1994 -- a surge that prompted the Fed to tighten monetary policy aggressively. The index rose 0.3 percent in April, following a revised 0.3 percent gain in March and a 1.3 percent leap in February.

PURCHASING MANAGERS' INDEX: Purchasing managers reported a surge in an index measuring price pressures in manufacturing industry, and the Commerce Department announced a larger than expected gain in new construction spending.

The overall purchasing managers' index fell slightly last month to 49.3 percent, against 50.1 percent in April. Most economists had expected the index to rise modestly, reflecting a mild expansion of manufacturing output.

The "prices paid" component rose to 50.8 percent from 40.1 percent in April, mainly because of increases in prices of agricultural products. This followed nine months in which price pressures, as measured by purchasing managers, had appeared to ease.

CONSTRUCTION SPENDING: The Commerce Department said construction spending rose 1 percent in April to a seasonally adjusted annual rate of \$551.7 bn. In

the first four months, construction spending averaged 5 percent higher than in the same period last year.

UNITED KINGDOM

RETAIL SALES: Retail sales fell last month for the first time since January, raising doubts about the strong recovery in consumer spending promised by the chancellor this year. The surprisingly weak figures disappointed the City of London, which had expected a strong rise in sales in line with more buoyant survey evidence. But the data appeared to provide further vindication of the chancellor of the exchequer's quarter-point interest rate cut on June 6.

Retail sales fell a seasonally adjusted 0.1 percent between April and May and were 2.0 percent higher in May than the same month last year, the Office for National Statistics said.

MANUFACTURING OUTPUT: Manufacturing activity experienced its biggest decline for more than 3 1/2 years last month as factories reined in output and cut jobs in the face of declining order books and a build-up of unsold goods. Companies making plant and machinery raised output only fractionally while producers of components cut output sharply, according to the monthly survey by the Chartered Institute of Purchasing and Supply.

But weakness in these two areas was intensified for the first time this year by a sharp slowdown in output and demand for consumer goods. Although the consumer goods sector remained the strongest area of the economy, its poor performance last month contrasts with the buoyant conditions earlier this year. It suggests that consumer demand, which the government expects to rebound strongly in 1996, may still be fragile.

CONSUMER CREDIT: Consumer credit recorded its biggest rise for 7 1/2 years last month, providing a strong signal that the re-

covery in consumer spending is gathering pace. After taking account of seasonal movements, consumers borrowed a net L1.01bn (\$1.53bn) from banks and other lenders in April, compared with L722m in March, the Bank of England said. The increase, which far exceeded City of London expectations, was the highest rise since current official records began in April 1993. The Bank said other unofficial estimates indicated it was the largest increase since autumn 1988.

IMPORTS: The level of imports sucked into the UK economy has risen sharply in recent months, suggesting that overall demand in the economy remains reasonably healthy. However, the rise in imports may also trigger concerns that the UK's trade deficit could deteriorate in the months ahead, reversing the healthy picture seen in previous years.

Although exports performed reasonably well during the spring, some economists are starting to fear that the imbalance between imports and exports could widen further in the months ahead. A hint of emerging problems in the export sector came after the Engineering Employers Federation said that export order books were now weakening. This has occurred even though the engineering sector has hitherto weathered the downturn better than many other manufacturing industries.

Measured overall, the Office for National Statistics said that the UK's overall deficit in goods with the rest of the world was a seasonally adjusted BP1.3bn (\$1.98bn) in April -- the most recent month for which data is available. This was almost double the previous month's deficit of BP765m.

OECD OUTLOOK: The Organization for Economic Cooperation and Development said in its latest Economic Outlook that the UK will be one of the fastest growing European countries over the next two years. Growth is at present below trend but activity will accelerate this

year and unemployment will fall further without triggering rising inflation, the Paris-based think-tank predicted. The OECD has become more optimistic about UK growth, revising up its forecast for GDP growth to 2.2 percent this year and 3 percent in 1997. This would make the UK the second-fastest growing economy in the Group of Seven leading industrialized nations next year. But it insisted the government would still meet its inflation target as inflation falls below 2.5 percent over the next two years.

MANUFACTURING: The Confederation of British Industry -- the UK's largest employers' lobby -- says that weak overseas demand is keeping UK manufacturing in the doldrums in spite of signs of a revival in domestic demand. The CBI's latest monthly industrial trends survey finds orders for manufactured goods were below normal for the 10th successive month, while export demand was at its lowest level for a monthly survey since February 1994.

FACTORY OUTPUT: Factory output fell sharply in April as manufacturers met demand from the storeroom shelf rather than stepping up production. But the Office for National Statistics conceded that it had been underestimating output in the past. Manufacturing output dropped by 0.3 percent in April, the biggest decline for five months. Output now stands below the average for the first three months of the year, suggesting industry may be on course for a third successive quarterly decline. Statisticians said the underlying trend in manufacturing was flat, as it was last month. Output in the three months to April was the same as in the preceding three months. The latest monthly figures were accompanied by widespread revisions to past data, extending back to the end of 1992. Manufacturing output has been revised upwards throughout 1993 and 1995 and, to a lesser extent, 1994. As a result, manufacturing growth for last year as a whole has been revised up from 1.9 to 2.2 percent.

Manufacturing activity experienced its biggest decline for more than 3 1/2 years last month as factories reined in output and cut jobs in the face of declining order books and a build-up of unsold goods. Companies making plant and machinery raised output only fractionally while producers of components cut output sharply, according to the monthly survey by the Chartered Institute of Purchasing and Supply.

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TOURISM: The UK tourism industry is heading for a record year after an 8 percent rise in overseas visitors in the first three months. A total of 4.63m visitors spend BP2.11bn (\$3.2bn) in the January to March quarter, compared with 4.27m and BP2.04bn respectively in the same period last year. The figures mean the number of visitors to the UK for the full year should exceed last year's record 23.6m.

The number of UK residents going abroad rose 11 percent to 8.09m in the first quarter, and spending climbed 16 percent to BP3.15bn.

CONSTRUCTION ORDERS: Construction orders rose by one percent in April compared with March, the second consecutive monthly increase to be announced by the Environment Department. The medium term trend in orders, however, was still downwards with the total value of orders in constant 1990 prices falling by 9 percent in the three months to the end of April compared with the previous three months. The department said that the three-monthly figures provide a better guide to performance as monthly figures could vary greatly.

INSTITUTIONAL INVESTMENT: A record surge of investment in unit trusts, thanks in part to the popularity of new corporate bond personal equity plans, or Peps, meant institutional investment remained buoyant in the first quarter of this year.

Official figures showed institutional investment in UK and overseas assets fell slightly in the first quarter of this year but was still double the level in the same period in 1995. Total net investment by institutions was BP13.5bn (\$20.65bn) in the first quarter, compared with BP14.9bn in the final quarter of last year and BP6.8bn in the first quarter of 1995, the Office for National Statistics said.

Investment in overseas securities grew strongly. Emerging market investment was BP3.8bn in the first quarter of the year. This was similar to the BP3.7bn invested in the fourth quarter of 1995, but it represents a sharp turnaround from the BP0.6bn disinvestment in emerging market assets in the first quarter of last year. Overall, there was a net disinvestment of BP0.5bn in UK company securities in the first quarter thanks mainly to a BP1.5bn disinvestment of ordinary company shares.

CAR OUTPUT: Car output for export rose 10.6 percent, year-on-year, in May to leave the industry on course for another 20-year production peak in 1996. The export performance more than compensated for weakness in the UK market, leaving total output for the month 0.5 percent higher at 141,393. That lifted total car output for the first five months of the year to 698,344, a 2 percent rise over the corresponding period of 1995. Within that total, output for export was 3.4 percent up at 363,038.

Production of commercial vehicles is also running ahead of year-ago levels, according to figures from the Office for national Statistics. May's commercial vehicle output, at 22,186 units, was 3.2 percent ahead of May last year,

with production for export 8.6 percent higher at 9,719.

However, weakness in some UK market sectors such as heavy trucks left total commercial vehicle output for the first five months only 0.1 percent higher, at 106,637. Production for export over the five-month period was 14.9 percent higher, at 52,509.

GERMANY

INDUSTRIAL ORDERS: German industrial orders rose 2.2% in volume terms in April, their strongest performance in nearly a year, according to preliminary, seasonally adjusted figures from the economics ministry. The rise was stronger than expected, prompting some economists to say the economy was recovering after the first-quarter fall in GDP. However, ministry officials said they would need another two months of favorable economic data before declaring a turnaround.

On a seasonally adjusted basis, orders were 6.4% higher than in April 1995. This was the first positive year-on-year figure for nine months. The most significant indicator of a recovery, according to economists, was a 3.5% seasonally adjusted jump in the volume of domestic orders between March and April, following a 2% rise from February to March.

COMPANY FAILURES: The number of corporate insolvencies in Germany increased 114.1% in the first quarter this year, compared with the same period in 1995. The strong rise in insolvencies reflects the continued force of the restructuring process in eastern Germany and the severe economic downturn in the whole of the country.

The Federal Statistics Office said the insolvencies had risen for the fourth year running, with 6,090 German companies either declaring bankruptcies or entering into insolvency procedures. In western Germany the number of corporate insolvencies went up by 6.6% to

4,344, while in the east they increased by 38.2% to 1,746. The east accounts for almost 30% of all German insolvencies. The total amount of money owed to creditors has been put at about DM11 billion (\$7.2 billion) for the whole of Germany, about DM3.4 billion more than was owed at the beginning of the year.

ECONOMY: While acknowledging continued weakness in the economy, the German economics ministry reported "isolated signs" that pointed to "a gradual stabilization". These follow a 0.5 percent contraction in real gross domestic product in the first quarter of this year and a stagnant economy in the two preceding quarters.

in its latest monthly report, the ministry said there had been a "marked growth" in foreign orders for German manufactured goods since late autumn. Domestic orders had grown somewhat in recent months and the business climate in the west German retail trade had "clearly improved" since the start of the year.

The ministry admitted that industrial production was sluggish, "although the decline visible up to last autumn had since ceased".

Activity in the recession-plagued construction sector had improved in recent months, although this, the ministry said, was only because businesses were trying to catch up production losses caused by the harsh winter.

The ministry said the 3.82m registered unemployed at the end of May were a continuing cause of concern. With the end of the harsh winter, it had become clear that the increase in unemployment since last autumn was largely structural rather than seasonal. Compared with the end of October last year, seasonally adjusted unemployment had risen by 230,000 -- western Germany accounting for 160,000 of the total.

ECONOMIC SLOWDOWN: The German economy contracted

as expected in the first quarter but a slight upward revision to earlier figures indicated that the country is experiencing a slowdown rather than a recession.

Real gross domestic product fell 0.5 percent in the first three months of this year compared with the previous quarter, the federal statistics office said. But revised figures pointed to economic stagnation in the fourth quarter of 1995 and not a 0.5 percent fall in GDP as was reported three months ago.

Mr. Gunter Rexrodt, the economics minister, said the pause in economic growth that began in mid-1995 had still not been overcome.

GDP figures showed activity in eastern Germany down a real 2.5 percent in the first quarter, but output unchanged in western Germany. Construction activity declined for the third successive quarter in the country as a whole. Harsh winter weather contributed to a real 7.5 percent slump in seasonally adjusted first quarter output after declines of 2.5 percent and 0.5 percent respectively in the fourth and third quarters of 1995.

The economics ministry said a strong 18 percent jump in construction activity in April triggered a 1.4 percent rise in the real, seasonally adjusted output of the production industries between March and April.

This recovery followed sharp, weather-induced declines in construction sector output in February and March which prompted a downward revision of overall industrial production growth in March to 0.9 percent from 2 percent previously reported. The ministry said it expected most of the GDP loss caused by bad weather in the first quarter would be recovered in the current three-month period.

Official figures showed that domestic demand stagnated in real and seasonally adjusted terms in the first quarter. A 0.5 percent rise in private consumption and a 1 per-

cent increase in government spending offset the building sector decline. Business investment stagnated while imports were also unchanged. Exports fell 1.5 percent compared with the final 1995 quarter, possibly indicating some weakening in the competitiveness of German industry.

First quarter GDP was 0.3 percent higher than a year earlier. Construction activity was down 11.8 percent and investment in plant equipment 0.5 percent lower. But exports of goods and services were 3 percent higher and state spending 3.4 percent up on the first quarter of last year.

PLANS TO CURB PUBLIC DEFICITS: Mr. Theo Waigel, Germany's finance minister, said the federal government and the states should take a firmer grip on their finances to ensure public deficits stay below the Maastricht treaty limit of 3 percent of gross domestic product.

Outlining controversial plans for a "national stability pact", Mr. Waigel said the federal government and states, or Lander, needed a clear set of rules to control the deficit and should be subject to penalties.

He proposed a law giving the federal government additional responsibility for any deficits run up by the state social insurance funds, which pay pensions, healthcare costs and unemployment pay.

The states should in future be responsible for the deficits of the municipalities as well as their own budget balances, he said.

He said he wanted the structure in place to control Germany's deficit by 1998, in time for the planned start of European economic and monetary union in 1999. He said the aim should be to reduce Germany's government deficit in normal economic conditions to one percent of gross domestic product.

Finance ministry forecasts prepared showed that the government

expects Germany's public deficit to fall below the Maastricht limit of 3 percent next year, dropping to 1.5 percent by 2000. The ministry also expects Germany's government debt will exceed the Maastricht limit of 60 percent of gross domestic product this year and stay above that level for the subsequent four years.

However, Mr. Waigel refused to consider accepting any weakening of the Maastricht treaty's convergence criteria and expressed the hope that a pick-up in economic growth would allow Germany to meet the debt criterion and qualify for Emu.

Mr. Waigel said the federal and state governments should take equal responsibility for the country's deficit, but he acknowledged this rule could be adapted to help those Lander such as Saarland or Bremen with heavy debts and interest payments.

EXPORT RISE: German exports are forecast to rise by 5.5 percent in value this year, but this above average expansion will not give an automatic boost to economic growth, according to the country's chambers of commerce.

Mr. Franz Schoser, chief executive of German chambers of industry and commerce (DIHT), said trade and economic growth had become uncoupled as a result of globalization. Though the export growth expected by the DIHT is far higher than the 2.1 percent growth in nominal gross domestic product forecast recently by the Organization for Economic Cooperation and Development, Mr. Schoser said there was no reason to worry any less about Germany's international competitiveness.

The DIHT's latest survey of export and import prospects, compiled with German chambers of commerce abroad says it expects the Asia and Pacific regions to be the most dynamic foreign markets this year. They have overtaken North America in this respect in the past three years.

Mr. Schoser forecast double digit growth in exports to India, South Korea, Malaysia, Vietnam, the Philippines, Taiwan and Japan. China, currently embroiled in a dispute with Germany over Tibet, is expected to increase its demand for German goods by 3 percent this year and remain an important market over the long term.

The DIHT forecast German imports will rise by about 2.8 percent in value terms this year from DM634.3bn (\$404bn) in 1995, pushing up the trade surplus to more than DM100bn from DM93.4bn last year.

Mr. Schoser said this relatively low import growth would mainly reflect increased buying of raw materials and components as German manufacturers tried to cut costs, diversify their sourcing, rationalize their production and boost exports. Germany's weak economic growth would offer little scope for exporters of finished goods elsewhere in Europe and North America. By contrast, the DIHT forecast a 6 percent increase in imports from the Asia-Pacific region and double digit growth in imports from central and eastern Europe.

BONN URGED TO CUT TAX BURDEN: The German government will fail to achieve its goal of a 50 percent cut in unemployment by the end of the decade, unless it cuts the burden of taxation on business and enacts budget cuts of between DM50bn (\$32.8bn) and DM60bn each year, according to IFO, the Munich-based economic institute.

In a wide-ranging report about the future of the German welfare state, IFO concludes that fundamental structural welfare state reform is inevitable because the next economic upturn will fail to bring down the rate of unemployment sufficiently.

Earlier this year, Chancellor Helmut Kohl promised to cut unemployment from 4m then, or roughly 10 percent of the working popula-

tion, to 2m by the end of the decade.

The institute has calculated that the level of income taxes and social security contribution consistent with 2m unemployed would be 42.5 percent of gross wages as opposed to 48 percent today.

A reduction of taxes and social security contributions to an average of 42.5 percent would imply fundamental reform of the various social insurance systems. IFO argues that the social security system needs to be freed from external financial obligations, such as the payments of pensions to former eastern German pensioners who had never contributed to the fund.

The IFO report said "the action program for investments and jobs of the federal government points in the right direction, but econometric simulations suggest however that to achieve the aim of a 50 percent reduction in unemployment by the year 2000, it is necessary to go beyond measures announced so far in terms of reduction in social levies, income taxes and corporation taxes".

VEHICLE OUTPUT: Germany's output of cars and commercial vehicles slipped to 419,700 in May, down 6 percent compared with May last year, reflecting continued weakness in the German economy. The Federation of the German Automobile Industry said yesterday car production at 397,300 was down 5 percent compared with April, while output of commercial vehicles fell 22 percent to 22,400.

The strong decline, especially in the commercial vehicle sector, amounts to another sign that the German car industry is facing a strong squeeze in its home market.

Total vehicle exports were down 8 percent compared with May 1995 at 235,000, with car exports down 8 percent and commercial vehicle exports down 1 percent.

CUT IN JOBLESS COSTS: The German cabinet agreed

sweeping changes to unemployment benefits, aimed at making savings of DM17bn (\$11bn) by 2000.

Mr. Norbert Blum, the labor minister said the measures would introduce more flexibility at the workplace, encourage people to take more part-time work and create more jobs, although he would not say how many. They would also reduce the burden paid by employers in a bid to increase competitiveness, the main thrust of the measures.

The changes to the 26-year old law, scheduled to take effect next year if passed by parliament, include increasing the minimum age for those entitled to receive Germany's generous unemployment pay for an extended period. Under the current system, those made unemployed at 42 are entitled to 18 months' full unemployment pay. If they have dependents, that pay is 67 percent of previous income, while for single people it is 60 percent.

The government wants to raise the minimum age to 45 with a sliding scale that would provide full unemployment pay for longer periods, the older a person becomes unemployed. A 57-year-old would receive 32 months' full unemployment pay while anyone aged below 45 would receive just one year's full benefit and the much less generous unemployment assistance afterwards.

RETAIL SALES: German retail sales in April were a nominal 3 percent and a real 2 percent higher than in April last year, fueling hopes that the domestic economy might be recovering from its first quarter weakness.

However, official figures slowing that turnover, adjusted for seasonal factors and the different number of days in the month, was unchanged in nominal terms and a real 1 percent higher than in March also indicated that keen pricing contributed to the sales growth.

VISIBLE TRADE SURPLUS:

The federal statistics office reported a slight increase in Germany's visible trade surplus to DM6.2bn (\$4.02bn) in March from DM5.8bn in March last year. According to preliminary estimates, the current account, which measures trade in goods, services and certain transfers, recorded a deficit of DM1.4bn in the month against a surplus of DM100m in March 1995.

INFLATION: The office reported that pan-German inflation was 1.7 percent year-on-year in May against 1.5 percent the month before. In the west, inflation rose to 1.5 percent from 1.2 percent while in the east it rose to 2.8 percent in May from 2.7 percent in April.

M3 MONEY SUPPLY: Germany's money supply continued to grow at well above the Bundesbank's 1996 target range in May, slowing down only marginally from the high rates of the previous three months. Economists said it now looked unlikely the Bundesbank would cut the securities repurchase (repo) rate, which it left at 3.30 percent when it lowered the discount and Lombard rates in April. The German central bank said M3 rose at an annualized rate of 10.5 percent in May over the level of the last quarter of 1995, after 11.2 percent in April and 12.3 percent in March. However, Mr. Helmut Schieber, a Bundesbank council member, said M3 should move towards the target range of 4-7 percent growth.

He said monetary capital formation, in which funds are moved into longer-term investments outside M3, had been relatively weak and should soon return to normal. Compared with the fourth quarter of 1994, M3's annualized increase was 4.9 percent after 4.7 percent in April.

Bank lending in Germany was up by 7.9 percent (on a six-monthly annualized basis), a slight slowdown from the April figure.

JAPAN

ECONOMIC GROWTH: Japan's economy grew at an annualized rate of 12.7 percent in the first quarter of this year, the fastest growth in 23 years, the government's economic planning agency said.

The expansion marked a decisive end to three years of economic stagnation.

Gross domestic product grew 3 percent from the final quarter of 1995 to the three months to March, or by 5.7 percent from the first quarter last year, the agency said. This brings growth for the fiscal year to March to 2.3 percent, the highest since 1991 and nearly twice the government's target of 1.2 percent.

Private consumption, which accounts for about 60 percent of GNP, rose 5.1 percent in comparison with the same quarter last year, nearly twice as fast as in the final three months of 1995.

The other important engine of economic growth was public sector investment, which rose by 27.2 percent in the first quarter from the same period last year, after 12.6 percent growth in the previous quarter.

Much of this is thought to be paid for by last September's record Y14,220bn (\$130bn) fiscal stimulation package, widely expected to run out later in the year. Public construction starts fell in April, according to separate figures.

The GDP deflator, a broad measure of prices, fell by 0.1 percent from the same quarter of last year, the seventh consecutive quarter of decline.

INDUSTRIAL OUTPUT: Japan's industrial output increased by 2 percent from April to May, according to preliminary data from the Ministry of International Trade and Industry (Miti). The rise confirms that the economic recovery is on track but not strong enough to

tempt the Bank of Japan to raise interest rates. Output rose by 3.2 percent in April.

While less than 3.4 percent increase forecast by Miti last month, the output rise in May was seen as encouraging because with it came a small decline in the ratio of unsold stocks and materials to sales.

SALES TAX INCREASE: The Japanese cabinet approved a long expected yet unpopular increase in sales tax, the first step in an attempt to rebalance the tax system and restrain a sharp rise in government debt. The increase, from the present 3 percent to 5 percent, will be included in next year's budget, to take effect from April 1, 1997.

This will raise an estimated Y4,000bn-Y5,000bn (\$36.7bn-\$45.9bn) a year for the finance ministry's coffers, and make a measurable dent in the central government budget deficit, set at Y21,000bn this year, or 4.5 percent of gross domestic product.

The tax increase is less than the finance ministry had wanted, but a step in its campaign to correct Japan's uniquely unbalanced tax structure. At present, the state derives around two-thirds of tax revenue from direct taxation and the rest from sales tax. The balance in other leading mature economies is the opposite.

DIFFUSION INDEX: The government Economic Planning Agency's leading diffusion index, a basket of 11 indicators pointing to conditions in the next six months, rose to 55.6 in April, from 36.4 in March.

It was the first time in two months that the index stood above 50, which represents equilibrium between growth and recession. Before then, the index had stood at above 50 for six months in a row, a harbinger of the recovery which emerged at the end of last year.

The figure suggests slower growth than indicated by the 12.7 percent annualized increase in

gross domestic product reported in the three months to March, the fastest in 23 years.

DEPARTMENT STORE SALES: In another sign of gentle recovery, the Japan department stores association announced sales by its 109 member companies increased 1.7 percent in May, the fifth month of increase, and unchanged from the growth rate in April.

The general measure of retail sales showed a 1.1 percent decline in April.

CHIP MARKET: The share of foreign companies in Japan's semiconductor market rose to 30.6 percent in the first quarter of this year against 22.8 percent in the first quarter of 1995, the US Trade Representative's office said.

In the last quarter of 1995 the foreign share of Japan's semiconductor market was 29.6 percent. Coinciding with the publication of the figures, the US yesterday renewed its demand for continued government involvement in helping foreign manufacturers maintain their access to the Japanese microchip market.

The US-Japan semiconductor accord, which ensures a minimum foreign share of 20 percent of the Japanese market, expires on July 31. Japan does not wish to renew the agreement because it feels the market share targets have been successfully met.

TRADE SURPLUS: Rising domestic demand for personal computers and semiconductors was a factor in a 60.5 percent decline in Japan's trade surplus in the year to May, the 18th consecutive month of decline. The trade gap reached Y231.69bn (\$2.13bn), slightly higher than the market was expecting, according to preliminary data from the finance ministry

Exports rose a vigorous 14.2 percent to Y3,405.9bn in May, but that was less than half the reported

pace of import growth, 32.6 percent to Y3,174bn.

The underlying pace of import growth is slightly slower than that, because the headline figure is distorted by the 30 percent rise in oil prices over the period. Up to 40 percent of Japanese imports -- crude and refined products -- are linked to movements in oil prices.

Even so, Japan's recovering economy showed robust demand for finished goods, nearly 60 percent of the total, last month.

Imports of office equipment -- mainly computers -- rose by almost three quarters, while imports of electronic devices increased by 48 percent.

Unusually, the surplus declined with all three of Japan's main trading regions. The trade gaps with the US and with the European Union both fell by nearly 40 percent in May. The gap with other Asian nations fell by 24.4 percent, the second month in a row to Y336.05bn. It was more than double Japan's Y167.7bn surplus with the US.

BUSINESS CONFIDENCE: The Bank of Japan announced that Japan's top companies are at their most confident for four and a half years and the business outlook continues to improve at a moderate pace. The percentage balance between large manufacturers who think conditions are getting better or worse was minus 3% in May, half what had been forecast in February when the figure was minus 12%, according to the bank's Tankan business survey.

Optimists and pessimists are forecast to even out by the next poll in September. A positive figure was reached in 1991. The survey of 9,666 businesses is the most detailed indicator of Japan's short-term economic outlook and influences the bank's monetary policy. Conditions have now improved for three quarters in a row.

The most encouraging features of the survey were that the recovery

is spreading from manufacturing to service industries and that private sector investment is starting to take up the slack from a decline in state-funded public works spending.

The balance of non-manufacturing expecting an improvement rose by 9 points to 12%. All companies nearly doubled their fixed investment plans for the current year, from a 2.7% increase to a 6% rise. Corporate investment rose 1.2% last year, the first rise for four years.

But output prices, those at which manufacturers sell goods to wholesalers, continue to fall with a balance of 17% of companies reporting a decline, down from 20% in February. Meanwhile, input prices, which are paid by companies for supplies and materials, are rising a bit, due to the yen's decline. A balance of 4%, up one point from the last survey, said input prices were going up.

Rising costs and falling prices are set to sap corporate profits growth in the coming year. Manufacturers said they expect pre-tax profit growth of 13.2% in the year to next March, after a 35.8% increase last year. This is despite an expected modest rise in sales growth to 3.4%, from 2%.

UNEMPLOYMENT: Japanese unemployment rose to 3.5 percent in May, the highest since records began in 1953 and proof that the economic recovery has not relieved the pressure on jobs.

The government's management and coordination agency attributed the rise, from 3.4 percent in April, to a sharp increase in the number of people seeking work after being encouraged by signs of an economic upturn.

The economy grew at an annualized rate of 12.7 percent in the three months to March, the fastest for 23 years.

The number of jobless rose by 320,000 people, or 15.4 percent, to 2.4m in the year to May, much more than the 0.1 percent increase in

numbers employed over the same period. "More and more people are coming on to the job market, but the economic recovery cannot absorb them all," an agency official said.

Within the rise in the number out of work were a record 50,000 young graduates. Another 160,000 people said they had left jobs in search of higher pay or started to look for work after a period at home, while 90,000 lost their jobs because their companies ceased trading or shed staff.

Worst hit were young people, kept out of work by a continued recruitment freeze among many companies, and the late middle-aged, victims of early retirement.

The jobless rate among 15 to 24 year-old men rose by 1.6 percentage points to 7 percent, while the unemployment rate among 55 to 64 year-old males rose by 0.8 points to 5.5 percent.

JOBS FOR LIFE IN DOUBT: Japan is seeing a sharp increase in the number of companies wanting to scrap jobs-for-life, according to a survey. Over half a sample of 6,000 companies surveyed by the Japanese labor ministry say they no longer stick to the traditional system, a staple of Japan's relative social stability. This is a sharp increase on the 41.5 percent making the same claim in a survey three years ago.

Larger companies are slightly less tough about "surplus labor" than smaller ones. Of businesses with 5,000 or more employees, 32 percent wanted to scrap the lifetime rule. Over half of companies with fewer than 300 workers said they wanted to be free to sack people.

OUTPUT SHIFTING OFFSHORE: Nearly 20 percent of products imported by Japanese companies are "reverse imports" of goods made overseas by Japanese-affiliated companies, according to a survey.

The survey, by the Japan External Trade Organization (Jetro), un-

derlined the extent to which Japanese companies have shifted production overseas in the so-called "hollowing out" effect, blurring the export-import picture.

Jetro said the proportion of off-shore production to total production by the companies surveyed was expected to rise to 26.8 percent by the year 2000 from 18.4 percent in the year to March 31, 1995. It said that 47.1 percent of the companies surveyed either had cut or expected to cut domestic production, while 35.5 percent expected no decline and the remainder were unclear, saying that the outcome depended on foreign exchange rate movements.

FRANCE

CUTS IN TAX IN SPENDING PLEDGED: Mr. Alain Juppe, the French prime minister, pledged to cut income tax progressively over five years--with commensurate public spending cuts--and to spread the burden of France's costly welfare system more widely.

Mr. Juppe said his government would present in mid-September, in conjunction with its 1997 budget, a five-year program setting out parallel reductions in spending and taxes.

He gave no details except that the plan would involve lowering all income tax brackets, creating a new universal health insurance charge and reforming the "professional tax", levied on companies' wage bills and investments.

Mr. Juppe stressed that the report did not commit the government, which is to hold further consultations with parliament, employers and union leaders.

Mr. Juppe said he would be guided by two principles -- that no real tax reform was possible without reducing rates, and that no tax cuts were possible without reducing public spending at the same time.

Initial tax cuts in 1997 are therefore likely to be minimal, because the government needs to reduce the budget deficit by at least another FFr40bn (\$7.78bn) in 1997 if France is to qualify in that year for European monetary union. This is expected to entail spending cuts of at least FFr60bn to counter unavoidable rise in state debt servicing and other fixed charges.

Mr. Juppe confirmed that his plan to cut income tax rates, whose current top level is 56.8 percent, would require abolishing many of France's numerous tax breaks -- only half of French families pay income tax.

Mr. Juppe said he intended to create a single health insurance charge for all, which would be levied on savings as well as salaries.

RADICAL TAX REFORM URGED: The French government should cut the top rate of income tax from 56.8 percent to 40 percent and substantially reduce the number of exemptions, according to a high level report submitted to Mr. Alain Juppe, the prime minister.

The report, by a group of five senior civil servants, contains a strong indictment of the French tax system and calls for a series of radical changes which are likely to be controversial.

It calls for the lowest-paid to be exempt from tax, for the existing sliding scale to be reduced to six bands, for higher income earners to be taxed on family allowances and for the lower income tax ceiling to be balanced by eliminating the practice of deducting 20 percent from an employee's earnings before calculating tax.

Ministers are urged to consider greater harmonization of professional tax -- levied on companies by a range of different levels of local government largely on the basis of the number of staff employed and investment undertaken.

The report says that meaningful tax reform cannot take place with-

out a reduction in public expenditure; that spending should be balanced by tax revenues; and that excessive simplification of the system could risk triggering injustices.

It criticizes proposals being discussed at the European Commission for a switch in the "destination-based" system of value added tax to one levied at the point of origin of the goods or services being sold. It says such a system would create substantial conflicts.

His proposal for a new universal health insurance charge triggered an angry response from French unions, with Fource Ouvriere calling it a precursor to the privatization of the medical system and the Communist-backed Confederation Generale du Travail.

The report says taxes and other charges now represent a record 45 percent of gross domestic product, the highest proportion in any large developed country. It warns of the sharply growing burden of social expenditure, notably in health care, and of the danger of the more rapid growth in real wages of public sector rather than private sector workers.

It says the tax system has lost its elasticity, with each rise in charges accompanied by a sharp growth in the number and value of tax deductions claimed as people adopt "survival tactics". It also calls for modification to the incentives payable on life assurance products, with renewed emphasis on encouraging the country's nascent pension system.

GROSS DOMESTIC PRODUCT: The French economy rebounded strongly in the first quarter, with gross domestic product rising by 1.2 percent after a 0.4 percent decline in the strike-affected final quarter of 1995.

According to Insee, the national statistics agency, the positive first-quarter result was due in part to the negative effect of December's strikes on fourth-quarter 1995 figures. In addition, the winter cold

snap had brought an unexpectedly high 7.8 percent increase in energy production. And the unusually high number of working days was responsible for "about half a point of growth."

Economists drew encouragement from the strong 3.1 percent quarter-on-quarter increase in industrial investment, although some expressed doubt that this would continue.

But they interpreted the steep reduction in stocks, without which first-quarter growth could have reached a highly impressive 2 percent, as a negative sign.

Car sales were particularly strong, with a quarter-on-quarter increase of 19.7 percent, after a 0.3 percent decline in the fourth quarter of 1995. First-quarter exports (up 3.3 percent) rose faster than imports (up 1.8 percent).

LUXURY SALES: A strong advance in exports helped French luxury goods makers to record a 4.1 percent increase in sales in 1995, confirming the sector's rebound from the impact of the Gulf war and the backlash to last year's French nuclear tests.

The 78 member companies of the Colbert Committee -- in fashion, perfume, champagne, cognac, jewelry and leather -- yesterday reported a combined turnover of FFr34.7bn (\$6.7bn), compared with an adjusted figure of FFr33.3bn in 1994.

Exports rose 6 percent to FFr26bn -- accounting for more than three-quarters of overall sales. Nearly half of these exports -- FFr12bn -- went to the Asia Pacific region, with Japan accounting for FFr6bn.

UNEMPLOYMENT: New figures released by Insee, the national statistics institute, put the number of people out of work in April at 3.14m -- just 11,000 less than the record of 3.156m set in March 1994. This put the unemployment rate at 12.3 percent,

among the highest in the G7 group of industrialized nations.

Mr. Juppe recently resorted to the promise of future income tax cuts in an effort to encourage consumers to spend more. But the new unemployment figures will reinforce analysts' expectations that such spending is likely to remain subdued for the foreseeable future, especially at a time when scarcely a week passes without the announcement of large-scale job losses in one sector or another.

The 12.3 percent unemployment rate compared with a previous estimate of 11.9 percent and followed an annual household survey conducted in March. The survey used international labor standard methods of calculation and, as such, differs slightly from French labor ministry data showing the number of job seekers.

HOUSEHOLD CONSUMPTION: Household consumption fell in May for the fourth consecutive month. The rate of decline, however, slowed significantly to just 0.1 percent from a downwards revised 1.5 percent in April. Insee said the marginal nature of the latest fall indicated that consumption was stabilizing.

MINIMUM WAGE: The government also confirmed that France's minimum wage -- the "smic" -- would be increased by 0.5 percent from July 1. This will carry the net monthly minimum salary over the FF5,000 (\$965) threshold from FF4,992.99 at present.

DECLINE IN TRADE SURPLUS: Official figures show that, in the first four months of the year, the surplus reached FF33.23bn (\$6.4bn) -- still a creditable performance, but down from the FF36.42bn recorded in the corresponding period of 1995.

Figures for April were affected by a comparatively weak performance from exports, which fell to FF116.7bn from FF125.7bn in March. Imports also fell -- from FF113.7bn in March to FF112.9bn in April -- but the net effect produced an April surplus of a relatively modest FF3.82bn, versus the exceptionally high figure of FF11.94bn recorded in March. This was inflated by a number of exceptional items. Mad cow disease impinged on the export figures for the first time, albeit in a modest way, in the form of a 10 percent -- or FF200m -- decline in meat exports.

External growth has acted as a powerful economic motor for France in recent years; the first half 1995 trade surplus of FF60 bn represented a 62 percent improvement over 1994 levels.

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