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The Real Battle of Tax Reform

by Martin A. Armstrong

During the last week in July, I was fortunate enough to spend some time in Washington to listen and participate in the movement that is building concerning tax reform. There appears to be little doubt that tax reform of some type will be upon us. However, this issue appears to be slated as a Presidential issue for the 1996 campaign rather than coming to a vote in the next session if the current forces have their way.

The Republican camp appears to be headed toward a Flat Tax proposal. Congressmen Armey is currently enjoying the front- runner status in this debate and it is widely expected that the Kemp Commission will return a favorable verdict for the Flat Tax.

The Retail Sales Tax, which is currently being championed by Congressman Archer and Lugar, is clearly in last place within Washington circles. Despite this fact, it is this proposal that we still believe holds the greatest promise for America, both from a quality of life perspective as well as economically sound policy.

We must realize that the tax code has been tampered with over 30 times in 3 decades. Each of those adjustments have left the American people and business with more rules and regulations and arguably worse off. Countless industries have migrated elsewhere and other industries, such as boating and small planes, were simply decimated by Congress's luxury tax.

There is little doubt that any tax reform other than a retail sales tax will end up undergoing further tax increases. The prospects of honestly lowering the tax burden is not very good beyond the initial stage. Any promise by the Armey plan to start high and gradually decline is simply a dream for idle minds. Washington just doesn't work that way and in the end, the political winds will change once again. When they do, you can bet on one thing - taxes will be higher, not lower.

While the US has preferred to characterize itself as the champion of democracy in both rhetoric and the sacrifice of its sons on the altar of freedom, there is an undeniable echo of laughter that still resounds in the hallowed halls of Capitol Hill. Perhaps you might recall the words of Khrushchev who once boasted that the Marxist theories upon which the Russian Revolution was based would one day conquer the United States from within and bury the capitalists in the end.

It is sad to say that the internal battle that was forewarned by Khrushchev is far too visible in Washington. Not a single element remains unscathed by the class warfare that has eaten away at the very foundation of what once symbolized economic freedom to so many from around the world. Those solemn streets and corridors, where so many a noble spirit once prevailed, have been corrupted and tainted with the internal partisan conflict through which the soul of our once great democracy appears to have fled.

Like Athens in the days that filled history beyond the death of Perikles, we too are in grave danger of collapse through unsound finance and void of true statesmanship. We have turned our back, not only upon our legacy, but upon the dreams of those who sought to create a new land of freedom. And like Athens, who turned upon its own and sentenced to death the great Socrates who dared to question the logic of the state, those who speak out today are ignored, ridiculed and portrayed as evil exploiters of the working class.

Indeed, America has lost its way. For in Washington, we no longer see the noble accomplishments of our most ingenious, but rather only their material gain as a spoil to be seized by the state in the name of the people. Washington remains blinded by the millions earned by people like Henry Ford and portray such wealth and accomplishment as if it were a mortal sin. Nowhere in the equation does Washington see the trillions of dollars that have been contributed by Ford's invention of mass production. It is always the wealth that Washington sees - not the accomplishments of men.

One can only be moved by the shallowness of Washington. For through the pains of time and circumstance, we have indeed transgressed far from our dreams. If Jefferson, Washington, Franklin, Madison or Adams were to gaze upon this morally corrupt capitol, would they not be moved to tears? Where once self-sacrifice and noble ideals reigned supreme, there remains only the clamor of self-interest, misguided ideology and petty greed.

Where once a torch of economic freedom burned bright, we seek to build economic walls to penalize those who wish to leave. We favor short-term income and penalize those who would invest long-term by ignoring the economic benefits to society while remaining focused only upon the profit that might be derived there from. We say to our rich, go ahead, invest what you will long-term, but we will tax you upon your gains without credit for your loss. And to those who have toiled a lifetime and paid their fair share of taxes, we stand perched on a nearby tree waiting for the moment of their death to seize yet even more from their family in the dark hours of their grief.

It is upon this landscape that the battle of tax reform is to be waged. The lines have been drawn, not by economic principles, but upon the ideology that was given birth by Karl Marx. And like Marx, the fervor is intertwined with a deeply rooted resentment based solely upon materialism. A trip to Washington quickly brings back memories of grade school and that one unruly child who would destroy someone else's toy simply because he didn't have one too. Such unprincipled logic permeates throughout Washington as any attempt at reform is immediately characterized by either starving, endangering or killing children.

In this venomous atmosphere, the glory and majesty seem to slip away slowly like life itself. With each passing moment, a little more is lost for posterity - never again to be regained or even missed. The thought of a non-partisan approach based upon proven economic facts rather than idealistic rantings, doesn't even enter into the mind of Washington no less surface within the debate. Most on Capitol Hill have not the slightest clue about market or economic behavior. The vast majority are lawyers who know only self-centered ideology and nothing about the dynamics of the world economy. It is this atmosphere in which someone must try to bring some basic common sense into a battle to turn the tide of the cancer that has afflicted our once noble state.

From the practical side, there are two central problems in dealing with Washington.

FIRST:

First is the Congressional use of "static" models. This simply means that you cannot correctly forecast a change in behaviour so therefore, you should not try. Consequently, any proposal must be scored using the current situation without any assumption of change. This means that if interest rates stand at 6%, there cannot be any assumption of change for the better or worse due to a change in tax policy. It was the use of this model that resulted in the destruction of so many jobs in the boating industry. A static model assumes that if government were to raise Federal taxation to 90%, all citizens would simply comply. There is no room whatsoever to consider the possibility that some would leave the US, others would avoid reporting income, or even the possibility of civil unrest. The only acceptable assumption is that everything will remain unchanged except government will receive more revenue. Given this background to any proposal, the one thing we can guarantee is that it will not deliver what the politicians promise.

The single greatest critic against any use of a dynamic model remains the Democrats themselves. This misguided group views that a dynamic model is somehow entwined with trickle-down economics because it is based upon reality rather than fiction. The notion that lower taxes creates greater disposable income and higher economic growth is simply repulsive to the Democratic party because they are worried only about the rich having more and ignore the impact upon the middle class. Because of this fact, the Democrats will argue against any forecast that employs a dynamic model because they claim that it benefits the rich. This clearly strange and uneducated viewpoint is a huge obstacle to overcome in Washington. They insist upon intruding into economic issues without any understanding of free market behaviour and always twist whatever it is into a class warfare mentality. To make matters worse, the Peter Jennings of the world love to focus in on such points to support their own personal socialistic philosophy while distorting the facts as much as possible in an effort to yield the steadfast image of unbiased reporting. This lethal combination of socialists in the media in line with the Democrats insure that our government will NEVER be able to use a realistic model to forecast the future economy and as such, there may be no honest way out.

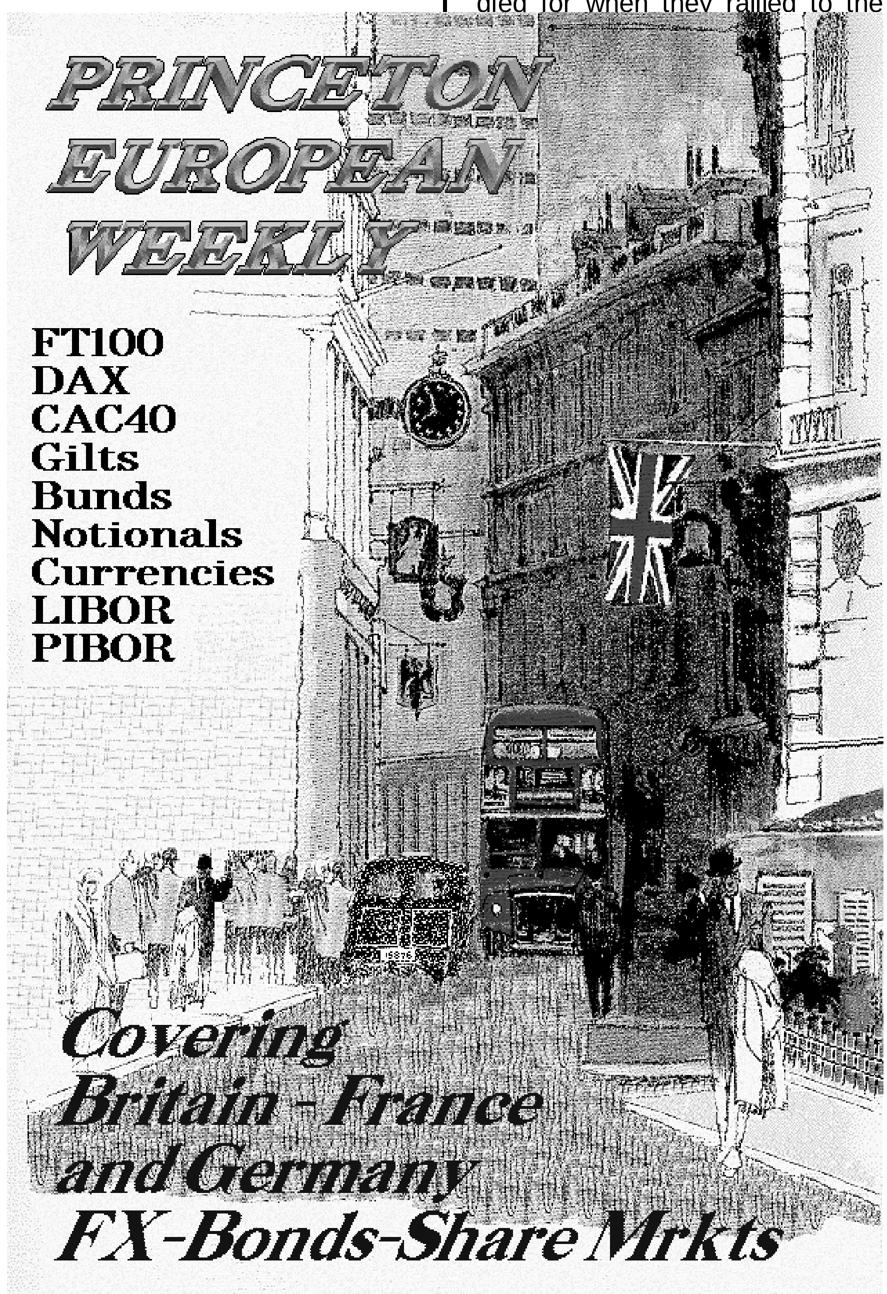
SECOND:

The second serious problem stems from the lack of willpower in Washington itself among both parties. The Retail Sales Tax proposal is currently flawed by this lack of willpower. For example, the current proposal as its stands will place a sales tax on everything including the basic necessities. In turn, there will be a rebate of a few thousand dollars to every person with a social security number. It would appear that a far more simple approach would be to eliminate the sales tax from food, housing rent and medicine. Unfortunately, this is where the willpower comes into play. It is feared that by allowing even one sector to escape the taxman, will lead to untold lobbying that would argue for the elimination of sales tax from all sorts of pet sectors. Therefore, because our elected representatives lack the willpower to stand unified for the benefit of the nation, it is viewed that a rebate scheme is necessary with no exceptions to the tax.

This is the atmosphere within which all proposals must be made. I can tell you that this is extremely frustrating. Any study you do that shows that lower taxation produces lower interest rates is immediately challenged on the basis that this will benefit the rich. There is no honest consideration how this will benefit the middle class or reduce government spending to carry the national debt. It is like a brain surgeon trying to debate the proper way of driving a car in the Indy 500 with Roger Penske. There is simply NO expertise whatsoever that would allow for a basic intelligent debate no less a mere successful conversation.

Of course there are those who are raising substantial sums of money to lobby against any tax reform. The National Realtors Association is rumored to have raised $20 million. They are afraid that if a flat or retail sales tax goes through, then the mortgage deduction will be lost and people will never again buy a home. Then there are the charities. Some will be taking your tax deductible contributions to make sure that you will still have to pay taxes. They fear that unless everyone is taxed and given a deduction for their donations, then nobody will ever donate to their organizations again. They fail to realize that Rockefeller made so many contributions to charity before there was even an income tax in this country. These are but only two groups that have drawn their lines in the sand to insure that you pay taxes and they remain exempt. They see no good in mankind and only evil or stupidity that must be tempered and controlled by the state.

For in the final hours of this battle there lies something far more important than mere taxation methods and levels. This is not a battle over money - it is a battle for the heart and soul of our personal liberty and freedom. The high courts may rule that discrimination is only related to race, gender or sexual preference and not applicable to class based upon mere material measurement. Still, such rulings are mere clever tricks that allow government to squander the fruits of labour gained by the working class while always pretending to be the defender of the people. Tax reform is not about making the so called rich richer - it is about recapturing the economic freedom for which our ancestors fought and died for when they rallied to the



cause of "no taxation without representation." This is the true battle for liberty that begins first with economic freedom.

UNITED STATES

LEADING INDICATORS: The official index of US leading indicators turned up in June for the first time this year, providing further evidence that an economic reboud is getting underway after a flat second quarter. The index of leading indicators rose 0.2% following declines of 0.2% in May and 0.6% in April. The index is designed to give advanced warning of cyclical changes in economic activity.

The index of coincident indicators - designed to track the current state of the economy - also rose in June followng declines in the month of April and May.

Eight of eleven indicators contributed positively to the leading index in June, the most significant being an increase in the money supply and higher levels of share prices and consumer confidence.

NEW HOME SALES: The Commerce Department reported a 6.1% incease in new home sales between May ad June to an annual rate of 728,000, another sign that the decline in bond yields thisyear is stimulating interest-sensitive sectors. New home sales are now running at their highest level since December of 1993.

The increase in new home sales in June followed a revised 12.5% increase in May. Sales rose in all regions of the country.

GDP GROWTH: The US economy registered its slowest growth in nearly four years during the three months to June, but appeared poised to rebound in the second half of the year. The Commerce Department said growth slowed to an annualized rate of 0.5% against growth of 2.7% in the first three months and 5.1% at the end oflast year. But the data also showed that nuch of the slowdown was due to cuts in business inventories - with consumer sales remaining strong.

PERSONAL INCOME: Helped by higher wages, the incomes of Americans grew modestly in June, rebounding from a decline in the previous month, accordig the Commerce Department. Income increased 4/10ths of 1% in June, after having fallen 2/10ths of 1% in May - the first decline since January 1994. Private wages and salaries increased in all major parts of the economy. Private wages and salaries, the most closely watched component of income, increased at a $19.6 billion annual rate in June, in contrast to a $23 billion decline in May. Personal income also includes income from such sources as dividends, interest and businesses.

CONSUMER SPENDING: Consumer spendig increased 2/10ths of 1% in June, slowing from May's increase of 9/10ths of 1%, the biggest gain in 9 months. May's increase was revised upward from the gain of 7/10ths of 1% reported earlier. Consumer spending represents about 2/3rds of the nation's economic activity. Spending on costly durable gods, an indicator of consumer confidence, was relatively strong.

CONSUMER CONFIDENCE: Consumer confidence rose to 99.9% in July, against 94.6% in June, according to the index compiled by the Conference Board, a New York-based analysis group, providing further tentative evidence that the pace opf US economic growth will accelerate in the second half of the year. The jump in confidence has brought the index back at a level historically associated with robust growth.

DURABLE GOODS: New orders for durable goods registered their fourth decline in five months in June, indicating that manufacturers are still adjusting to slower growth of consumer demand. The Commerce Department said new orders fel 0.1% last month, reflecting weakness in the elecrical machinery andtransport sectors. Between the first and second quarters, orders fell 3.3%, a sharp adjustment after robust growth during the preceding three years.

MANUFACTURING DATA: The US purchasing managers' index in June fell to its lowest level in four years, indicating near recessionary conditions in the manufacturing sector.

The purchasing managers' index - a reliable guide to cyclical trends in the economy - fell from 46.1% to 45.7% in June, its lowest since May 1991 when the economy was emerging from the 1990-91 recession. The index fell 6 points between April and May, after a peak of 57.9% in January. It is well below the 50% level that marks the threshohold for expansion in the manufacturing sector, and only slightlly aboce the 44.5% that signals contraction for the economy.

JOBLESS RATE: The labor department said non-farm employment had risen by 215,000 in June, about twice the gain expected in financial markets. It also substantially revised up the figures for April and May. The June jobless rate dropped from 5.7% to 5.6%, its lowest level since March.

The solid gain in employment indicates the risk of a recession is less than many economists had feared and raised questions of the timing of the Fed's cut in short-term rates by a quarter point to 5.75% - its first easing of monetary policy in 3 years.

The rise in US employment was concentrated in services and construction. Manuacturing employment fell 40,000, bringing the decline in the past 3 months to 104,000.

RETAIL SALES: The Commerce Department said retail sales rose 0.7% in June - more than most economists expected. Officials also revised data for May to show a robust increase of 0.9%.

s The Federal Reserve said industrial production edged up 0.1% in June, mainly reflecting a switch from contraction to expansion at the big US car companies. It was the first increase in overall production since February, when many industries reduced output to bring inventories into line with sales. Production fell at an annual rate of 3.2% in the 2nd quarter.

CONSUMER PRICE INDEX: Price data indicated inflationary pressures remained subdued. The consumer price index rose 0.1% in June and by 3% in the year to June. In the year to date, core consumer prices have risen at an annualized rate of 3.6% against 2.6% last year.

PRODUCER PRICES: US producer prices fel 0.1% between May and June, indicating that inflationary pressures remain subdued at the wholesale level. The annual rate of producer price inflation fell 2.1% last month, against 2.2% in May. The drop in prices was the first since last October and followed a zero increase in May. The decline reflected falls in fod and energy prices, which tend to be volatile. Ecluding these components, "core" producer prices rose 0.2% last month, in line with economist's projections.

UNITED KINGDOM

M0 MONEY SUPPLY: Figures released by the Bank of England reflected slower growth in high street spendig oer recent months, by showing stable expansion in the narrow measure of UK money supply. The money supply measure MO - cash plus bank's balances at the Bank - rose 0.7% in July, keeping the rate of increase over the previous year stable at 5.7%. The anual growth rate of notes and coins in circulation picked up a little to 6.1% in the year to July, but this was still weaker than 6.3% recorded in the year to May.

EXPORTS TO THE US: The UK Central Statistical Office said exports to the US dropped by a seasonally adjusted 8.7% in the three months to June compared with the previous three months, and were 0.3% lower than the same period last year. The drop, wich follws several quarters of strong export growth, is likely to fuel fears that the US slowdown could affect UK growth.

Nonetheless, the data showed that UK sales to other regions such as the Far East and European countries outside the European Union have grown in recent months. Measured overall, the CSO said the value of exports to non-EU countries - which account for half of all UK trade - grew 0.5% in the three months to June, compared to the previous three months. Exports were 9.2% higher than the year before, with overseas sales rising from 5.1 billion to 5.2 billion pounds between May and June.

The volume of imorts grew at a faster rate of 7% between the first and second quarters, rising from 5.8 billion pounds to 6 billion between May and June. This discrepency in growth rates helped to push the overall trade deficit up to 765 billion i June. However, the deficit was exaggerated by North Sea maintenence work. Exports of crude, for example, fell back by one third between the first and second quarters as some rigs were taken off stream.

A further factor which adversley affected the import picture was exchange rates. The strenthening of the yen and currencies such as the Swiss franc pushed import prices, excluding oil and erratics, up by 3% between May and June.

MANUFACTURING DATA: The UK purchasing managers index - a measure of overall manufacturing activity - fell in June to its lowest level for 18 months. The index provides further evidence that the UK economy is not slowing. The index has been operating for only four years, so its data still has less influence in the City of London than other surveys, but economists pointed out that the figures have been increasingly accuraate in forecasting trnds in recent months.

The index, composed of data on stocks, output and demand, prices and delivery times, recorded a seasonally adjused level of 51.9% in June, alittle lower than in May. Although this still showed slight growth - any figure above 50% indicates a monthly increase - it was the lowest level since December 1993.

FACTORY OUTPUT: Manufacturing output declined by 0.1% in May, confounding economists' expectations that the drop in theprevious month would be reversed. The Central Statistics Office believes factory is now rising by only 1% a year, the lowest growth rate since late 1993 and down from 5.5% last autumn. The fall in May was dominated by retrenchment in the metal and textile industries. Manufacturing output has, in effect, been flat since autumn of last year, although it was o.3% stronger between March and May than in the preceding three months. Weak output growth may suggest that rising factory prices are meeting ccustomer resistance.

HEAVY TRUCKS SALES/REGISRATIONS: Registrations of heavy trucks in the first half of the year were almost 50% higher than in the first half of 1994. Registrations of trucks weighing more than 15 tons in June were 56% higher than in June of 1994. The increase means that the market for such vehicles has increased by 47.9% in the first half of this year compared with the same period of 1994. The increase has helped to raise the maret for all truks to nearly 27,000 in the first half of the year.

Total new commercial registrations, including vans, buses and coaches and utility four-wheel drive vehicles, reached 18,939 in June, an increase of 3.6% on June. This was the smallest monthly increase for the current year, but the relatie weakness was focused on light vans.

GERMANY

UNEMPLOYMENT: German unemployment fell slightly in June against the previous month, but the seasonally adjusted number for the western half of the country showed an increase. The total out of work in in east and west Germany edged down by4,200 to 3.457 million, leaving the rate unchanged on the month at 9% and 0.3 of a percentage point lower than in June of last year.

However, the seasonally adjusted figure for west Germany rose by 11,000 to 2.56 million. But the west German jopbless rate, based on seasonally unadjusted data, eased to 7.9% from 8% in May. Unemployment in east Germany moved back over the million level on an unadjusted basis, a rate of 13.4% against 13.3% in May.

MONEY SUPPLY: Germany's money supply finally started to grow again in June. The Bundesbank said M3 rose in June at a seasonally adjusted annualized rate of 0.3% over the fourth quarter of 1994 after declining by 0.8% in May and 1.5% in April. The reasons for the pickup were stronger growth in bank lending to the private sector - up by 7.1% in June (on a 6-monthly annualised basis) after 6.4% in May - and weaker monetary capital formation in which funds are shifted outside M3 to long-term bonds and deposits. The Bundesbank has already said it does not expect its M3 growth target of 4-6% to be met this year. It has left interest rates unchanged, saying the effect of the March cut still needs to be observed.

INDUSTRIAL ORDERS: West German industrial orders fell 0.7% in March on the month before, while east German orders rose by 14%, leaving the pan-German figures unchanged.

CURRENT ACCOUNT: The current account deficit was DM1.6 billion in April, up from DM0.2 billion in March and DM0.5 billion in April 1994.

INTEREST RATES: The central bank decided to leave the discount and Lombard rates at 4% and 6% respectively, having cut the discount rate by 1/2 a point at the end of March. The Bundesbank held out the hope of a further cut in its interest rates, saying it needed time to see if German inflation was rising too quickly.

Mr. Hans Tietmeyer, Bundesbank president said that not enough progress had been made in keeping prices down and the consumer price index had grown faster in June - at an annual rate of 2.4% against 2.2% in May.

Mr. Tietmeyer said the March cut in interest rates should help speed the money supply and bring it closer to the target range. The Bundesbank also announced further cuts in minimum resreve requirements - the proportion of banks' deposits held interest- free with the bundesbank - to help the competiveness of German financial markets. It lowered the rate for sight deposits to 2% from 5% and savings deposits to 1.5% from 2%. Mr. Teitmeyer hoped the European central bank would follow Germany's minimum reserve system after monetary union.

CONSUMER PRICES: West Germany's conumer price index for June has been revised up by 0.1 percentage points to an annual rate of 2.4%. The final June figure, 0.2 points above the previous month, falls within the range of economists forecasts. Inflation, excluding the volatile oil and heating oil components, came in at a rate 2.6%, an increase of 0.4% over May, according to the federal statistics office.

WHOLESALE PRICES: West German wholesale prices fell by 0.3% in June compared with the previous month but rose by 2.0% from June 1994, according to the Federal Statistis Office. The increase over the 12 months is considered satisfactory, considering that prices had risen 0.1% in May compared with April andclimbed 3.2% on a year-on-year basis. The prices of fresh eggs, imported fruit and steel products rose, but the price of fresh egetables, sea fish and domestic oil fell.

RETAIL SALES: The Statistics Office also repoted that west German retail sales were unchanged in May in real terms from April, but were up a real 1% from a year earlier.

BUSINESS CONFIDENCE: Business confidence among German companies fell sharply in June, pointing to a possible slowdown in the economy, according to Ifo, one of Germany's six leading economic institutes. The Ifo confience index fell by 2.6 points to 98 loast month, but was still higher than than the June index of 1994. The monthly survey, among 2,500 west German companies is the latest in a series of signals pointing towards a mild slowing of the economy, Ifo said manufacturers were more pessimistic about current and future business prospects. Traditionally, confidence indices in Germany have a tendency to trail actual economc developments.

JAPAN

BUILDING ORDERS: Orders received by Japan big consruction companies rose 11.3% in June from a year earlier, the fourth successive monthly rise. Domestic orders from the public sector were 134.3% higher, a likely reflection of previous government spending packages.

Private sector domestic orders were a more modest 7.4% higher, with much of the increase attributed to project commitments by the telecoms and transport sectors.

UNEMPLOYMENT: Japanese unemployment returned to a record high of 3.2% in June. Thye rise in unemployment, largely the result of the loss of 300,000 manufacturing jobs over the past year, is among a series of grim economic data showing that deflation isecoming more pronounced and that industrial output continues to slow.

The number of job offers per 100 applicants declined from 63 in May to 61 in June, the lowest since January 1987. The ratio, a test of labor market weakness, is an advance indicator of the jobless rate, and has led economists to believe that unemployment will go on rising.

The unemployment rate last touched 3.2% in April, dipping to 3.1% in May. While comparatively low wit other leading economies, the underlying figure is thought to be considerably higher than the very narrow definition of joblessness used by the Japanese government.

HOUSING STARTS: June housing starts fell 15.7%, the fourth monthly decline in a row. Virtuall the only growth came from the Kobe area where homes are being replaced following the January earthquake.

FOREIGN EXCHANGE RESERVES: The finance ministry said that Japan's foreign exchange reserves hit another world recors at the end of June. The figure of $157.03 billion, up from $2.76 billion from a month earlier was the 20th consecutive monthly rise since November 1993. The sharper increase than expected was attributed to settlements in June of massive purchases of dollars by the Bank of Japan at the end of May to curb the yen's appreciation. The intervention has been considered somewhat sucessful, as the yen has traded throughout June in a limited range between the mid-Y83 and Y86 levels against the US dollar - a narrower band than in previous months.

Japan's reserves have risen by 82% in the last two years as the central bank has fought an increasingly futile battle to stem the yen's rise. Domestic inflationary conseqences have been largely nullified by "sterilization" of intevention, sale of government securities to soak up the extra liquidity in the financial system. In the process, Japan has become the world's largest holder of foreign currency reseves.

CURRENT ACCOUNT SURPLUS: Japan's current account surplus, the source of continued political friction, grew by a higher-than- expected 7.2% in May from the same month last year, to $8.9 billion. This is the first rise in six months - a mark of how the yen's rise against the dollar, by 20% in the year to May, has caused the US currency value of the surplus temporarily to increase.

However, finance ministry officials and private sector economists agreed that this one-month rise does not change the long-term decline in the surplus, as the high yen starts to price some Japenese goods out of the export markets. last year's May current account surpluswas unusually small because of the timing of the annual spring holiday forced comp

BANKRUPTCIES: Further evidence of the weakness of Japan's economy was provided with figures showing the highest nmber of bankruptcies in the first half for nearly a decade. According to Teikoku Databank, business failures among companies with debts of over Y10 million ($119,000 reached 7,303 in the period, up 5.5% on a year earlier and the highest figure since 1986. Total liabilities of all bankrupt companies were Y3,860 - a 54% increase. Nearly 2/3rds of the bankruptcies werfe attributed directly to the weak econony. The strong yen accounted for 61 companies, more than 50% more than a year ago. There was a slight improvement in ne, however, when the numer of bankruptcies fell by 2% from a month earlier.

TRADE GAP: Japan's trade gap widened by a smaller than expected 2.1% in June, leaving the surplus for the first 6 months of the year down by 3.9% at $57.42 billion. This is the second 6-monthly decline period of decrease in dollar terms.

In yen terms, the June surplus fell by 16.6%, bringing the decline in the first 6 months to 17.8%, the fourth 6-monthly period in which the yen measured surplus has fallen. The sharp difference between the yen and dollar figures is a result of the fall in the US currency's value against the yen.

Within the June trade surplus of $11.57 billion, imports to Japan rose by 27.2%, passing a 18.7% growth in exports. However, exports were smaler than usual because of Japanese carmakers' self-imposed curbs on sales to the US, awaiting the outcome of the car trade dispute, on whichan agreementwasc reached in June. Carmaershae since resumed normal export sales to the US.

FACTORY OUTPUT: The Ministry of Trade and Industry, in another report, said factory output in May fell by a seasonally adjusted 0.5% from April, revising its earlier estimate of a 0.3% fall.

CAR OUTPUT: Japan's domestic car production declined in June, largely the result of falling output of luxery cars bound for the US due to the recent car imports dispute between the US and Japan. The Japan Automobile Association said output fell 5.8% from a year earlier to 901,334 units, its first decline in five months. The association also attributed the fall to production adjustments by carmakers ahead of the launch of improved versions of mainstream models.

Production of passenger cars including minicars fell 6.1% to 662,141 units, the first decline in five months, while output of trucks fell 4.9% to 234,855, the first fall in 13 months. In the first six months of the year, domestic production rose 1.4% to 5.3 million units, the first rise in five years. Passenger cars production rose 1% to 4 million while trucks output rose 2.4% to 1.3 million. Bus output fell 2.5% to 23,435. Domestic sales rose 6.6% to 3.5 million, with passenger cars sales rising 5.5% to 2.3 million and trucks up 8.7% to 1.2 million. Exports fell by an estimated 8%.

RETAIL SALES: Sales at large-scale Japenese retailers declined year-on-year for the successive month in June, despite improving slightly compared with May. June sales were 1.5% down from a year earlier, against a 2.1% year-on-year decline in May, according to an international trade and industry preliminary report. June is traditionally the month for buying "chugen" summer gifts for friends and business contacts. Deartment store sales fell 1.7% year-on-year; suermarket sales slipped 1.6%.

Food and beverage sales at supermarkets rose 1% from a year earlier, but the rise was offset by declines in other categories. Retail sales in Kobe are gradually recovering from the impact of January's earthquake. Department store sales reached 68% of the previous year's levels in June; supermarket sales amounted to 92.3% of the June total.

FRANCE

INTEREST RATES: Mr. Jean-Claude Trichet, governor of the Bank of France said that the new French budget was stringent enough for the central bank to allow interest rates to "return progressively to a normal level".

Both the prime minister Juppe and Mr. Alain Madelin, the finance minister, have made it clear that it is now up to the central bank to respond to their pledge to hold this years budget deficit to FFr322 billion and to reduce it further by FFr100 billion in 1996-97. French 3-month rates are still 2 1/2 percentage points above those in Germany. The government claims that closing the gap would save the state FFr30 billion a year and French companies FFr50 billion a year in interest rate charges.

Following this announcement, t he Bank of France reduced the rate on its 5-10 day "repurchase" rate from 7.50 to 7.25.

INDUSTRIAL OUTPUT: French industrial output bouned back in May, showing a 2.2% increase following the 1.8% decline in April, according to the Insee official statistics agency. The year-on- year rise was 3.8%. The economy ministry claimed that the May rebound showed the "rising trend" in industrial activity, even though that month's increase has only returned output in most sectors to the level of March. The improvement was broadly based, led by a 2.1% rise in intermediate goods and including a 1.4% increase in consumer durables. Strong demand for trucks resulted in 1.5% increase for the vehicle sector as a whole, but goernment and private analysts expect car out put figures to tail off in the second half of the year.

WELFARE FUNDING WARNING: France's social security accounts comissionforecast a rise in the country's welfare funding deficit from FFr 56 billion last year to FFr62 billion this year, a trend, which left uncorrected, risks barring France from European union in 1998-99. The French welfare system is still mainly financed uotside the government's budget by payroll contributions from employers and employees. But the Maastricht treaty counts deficits on welfare spending as part of the overall deficit which must be kept within 3% of the national output for a country to qualify for Emu.

French governments are increasingly beig forced to assume the welfare systems chronic deficits. At the end of 1993, the state took over the FFr10 billion accumulated deficit, and now the government is considering a "solidarity fund" to deal with FFr118 billion deficit for 1995-96. The 1995 deficit in the social security "general regime" is now expected to be nearly FFr12 billion higher than originally estimated, because of a FFr6.5 billion rise in the health insurance deficit and a further FFr4.8 billion shortfall in the famly allowance system

TRADE GAP: France's trade surplus shrank in May, but trade flows with its partners reached a record as both exports and imports rose from the previous month. The French customs office said May's seasonally adjusted trade surplus contrtacted to FFr 8.82 billion from a revised FFrr 12.11 billion in April, which was boosted by the sale of a satellite and a luxery cruise liner. Imports rose to a record FFr111.42 billion from FFr106.57 billion in April, but exports also edged higher, to FFr120.23 billion. May's figures included the lowest ever trade deficit with Japan of FFr670 million and a FFr230 million surplus with Germany, the strongest performance for more than a year. But France's trade gap with the US widened to FFR2.15 billion from April's FFr1.84 billion, highlighting exporter's concerns about the sliding value of the US dollar. It was also confirmed that gross domestic product grew by 0.7% during the first quarter of 1995 following a 0.8% rise in the preceding quarter.

VALUE ADDED TAX: French value added tax on most consumer products and services will rise by 2 percentage points amid concerns about the impact on consumption and the inflation rate. The rise is expected to raise FFr19 billion ($4 billion) by the end of the year and is part of the new conservative government's straegy of reining back the public sector to FFr322 billion this year.

It takes the normal VAT rate, which applies to most goods and services with the exception of non-luxery food products, frfom 18.6% to 20.6%. This is above the European Union average and compares with a standard rate of 17.5% in the UK, 15% in Luxembourg and Germany and 25% in Sweden and Denmark

The timing of the increase raises concerns that fragile consumer spending might be further weakened. Government officials play down the impact on consumption, arguing that much of the increase will be absorbed by reduced profit margins and that falling unemployment and salary increases will support household spending.

AUSTRALIA:

CURRENT ACCOUNT DEFICIT: Australia's current account deficit stood at A$2.39 billion, seasonally adjusted in June. This reflected some improvement from the record A$2.85 billion deficit sen in the previous month, but was still the largest monthly deficit registered.

The June result brought the nation's current account deficit for the 1994-95 financial year to A$26.06 billion, a 55% increase on the 1993-94 outcome. June exports (on an adjusted basis) were almost unchanged, though rural exports rose some 5% - a futher indication that the effects of the recent drought are receding.

Import figures were released earlier in the month, and showed a 1% decline, with consumption goods falling by 5% while capital goods increased by 6%.

EMPLOYMENT: Employment data showed a 51,700 surge in the number of new jobs, seasonally adjusted in June. Australia's jobless rate fell back to 8.35 from 8.5% in the previous month. The growth in jobs was much larger than expected.

INFLATION EXPECTATIONS: Accordig to the Westpac-Melbourne Institute for Business Cycle Analysis, Australian expectations for annual inflation fell to 4.9% in July. The decline follows a 5.0% measure in June. Since April, the median has varied between 4.9% and 5.1%. The index has, however, been rising since March, when inflation expectations were 4.6%. The measure is a median rate of price rises exdpected by consumers in the next 12 months.

"Headline" or consumer price inflation was running at 3.9% in the year to March 31. Core inflation, which is the focus for the central bank, was just an anual 1.9%.

INFLATION INDEX: Australia recorded its highest quarterly inflation since late 1991, raising fears that official interest rates may have to be increased later in the year. Reflecting sharp increases in prices for housing, transport and tobacco ad alcohol, the consumer price index rose 1.3% in the June quarter, bringing the rate for the latest year to 4.5%.

Mr. Ralph Willis, federal treasurer, indicated the CPI increase for the September quarter could be still higher. He said increased sales taxes, announced in the federal budget in May, would add a further .25 points to the September figure. But beyond that, the rate of increase should fall because the effects of previous interest rate rises would drop out of the statistics.

HOUSING APPROVALS: Approvals for housing financing in May fell 2.1%, accordingto the Australian Bureau of Statistics. That followed a 5.9% slump in April. The bureau said housing approvals in May fell 34.7% on the year, seasonally adjusted. The decrease in May was in line with expectations.

In the month, 31,510 home loans were approved compared with 32,172 approvals in April. The bureau said housingfinancig was valued A$3.07 billion (US$2.25 bilion), down from A$3.13 billion. Thebureau'strend estimate on housing financing fell 3.0% in May, and was down 33.4% on the year. Trend figures smoth anomalies in the seasonaly adjusted data.

CONSUMER CONFIDENCE: The widely watched Westpac Consumer Confidence index slipped only 0.7% in July, keeping the index close to year highs. The decline in the Westpac-Melbourne Institute index of consumer sentiment came after a 3.9% surge in June. Economic reports released recently have given mixed signals on the pace of the economy. Retail sales and employment remain strong, while the heat has come out of the housing market.

In July, consumers were more optimistic that good economic times would prevail in the next five years. They were slightly less optimistic about economic prospects in the coming year.

MANUFACTURING PRICES: Prices charged by Australian manufactures in May for gods they produced posted their biggest annual gain in more than four years, sugesting that inflation has not been tamed yet. The government said manufacturing output prices rose 0.4% in May from April, up 4.0% on the year - the biggest annual increase since February 1991. The figures compare with a month-on-month gain of 0.4% and an annual rise of 3.8% in April.

The index of manufacturing output is the closest measure Australia produces to a wholesale, or producer price index. Within the index of eight components of manufacturig output prices, seven rose ad onedeclied. The biggest decline was in the price of exported beef, reflecting lower demand from Japanese and US markets.

MONEY SUPPLY: Australia's most widely watched measure of money supply, the credit aggregate, rose 0.9% in May, matching April's increase, according to the Reserve Bank of Australia. Credit rose by 9.3% in the year to May. The component of the credit aggregate that mainly measures loans to business rose 0.8%, up 4.6% on the year.

The Australian gvernment is closely watching business investment, predicting a 14.5% rise in the fiscal year starting July 1. The component that measures credit for housing was up 1% in May and up 16.9% on the year. The bank's broad money indicator - which measures currency, bank deposits, plus net borrowings by non-bank financial institutions - rose 0.7% in May, up 7.9% on the year.

The bank's measure of M3 in the month rose 0.4%, up 7.6% on the year. M3 measures the total of cash, plus all private deposits and certain financial assets, including bank certificates. M3 isn't a reliable measure of money supply in Australia because the measure has been skewed by the introduction of new banks.

CANADA:

RAW MATERIAL PRICE INDEX: Canada's raw material price index fell 0.2% in June from May because of a plunge in crude oil prices. June's index stood at 132.4, up 6.9% from the year-earlier month, Statistics Canada said. The index stood at 100 in 1986. Statscan said a 5.8% decline in crude oil prices from May was responsible for the monthly decline. Compared with June 1994, crude oil prices were down more than 2%.

INDUSTRIAL PRICES: Canada's industrial price index rose 0.7% in June from May because of higher pulp prices, higher than economist's predictions. The index stood at 128.9 in June, showing prices were up 8.3% from the year-earlier month. The index stood at 100 in 1986.

A 3.3% increase in paper and paper products, mostly because of higher pulp prices, drove up the monthly index, according to Statscan. Excluding petroleum and coal products, the producer price index rose 0.8% in June to 130.9, and was up 8.4% from the year-earlier month. Fifteen of the 21 commodity groups reported higher industrial prices, three groups had lower prices and three groups, including clothng and tobacco products were unchanged.

CONSUMER PRICE INDEX: Canada's consumer price index was unchanged in June from May as lower gasoline and durable goods prices reversed their recent upward trend. The June index stood at 133.7, the same as in May and 2.7% higher than a year ago. The base is 100, set in 1986. The figures are not seasonally adjusted.

JOBLESS CLAIMS: The number of people receiving unemoployment insurance in Canada fel 1.2% in April from May, according to Statscan. Some 712,000 Canadians received benefits in May, down from 721,000 in April. The number of beneficiaries has plunged 41% since peaking at 1.2 million people in July 1992. In May, the number who filed new claims rose 2.7% to 260,000. All figures are seasonally adjusted.

HOUSING STARTS: Canada's national housing starts fell 15% in the second quarter to 108,300 units, according to the Canada Mortgage and Housing Corp. The fall was attributed to weak job creation, a high inventory of unsold new housing and an earlier surge in mortgage costs.

Second-quarter single-detatched housing starts increased slightly to 63,700 units from 62,500 units, while multiple unit construction fell 31% to 44,600 units from 64,900 units the previous quarter, CMHC said.

Analysts are optimistic construction will rebound, especially following the recent round of rate cuts. On July 10, Canad'smajor banks reduced the popular fixed five-year mortgage rate by 12.5 basis points to 8.5% - their sixth cut this year. That, however, is still 125 basis points higher than January 1994, when it stood at a 30-year low of 7.25%.

BANKRUPTCIES: The number of personal and business bankruptcies in Canada rose 24% in May to 7,009 from 5,671 a year earlier. Personal failures accounted for 5,865 of May's total. The number of businesses folding added to 1,144. In the first five months of the year, bankruptcies rose 10% from a year ago to 31,283.

M1 MONEY SUPPLY: Canada's M1 money supply rose C$897 million (US$660.4 million), or 1.54%, in June to $59.168 billion from $58.271 billion in May, according to the Bank of Canada. M1 includes currency in circulation and demand deposits.

M2 money supply, which includes all the components of M1 as well as savings deposits, rose $3.895 billion in June to $374.333 billion from $370.438 billion in May.

Canada's M3 money supply in June totalled $451.767 billion, up $1.959 billion from May's $449.808 billion, the bank said. M3 consists of M2 along with non-personal fixed-term deposits and foriegn-currency deposits of Canadian residents deposited in Canada.

WHOLESALE TRADE: Canadian wholesale merchants' sales surged 1.8% to 1.8% to C$20.691 billion (US$15.3 billion) in May because of increased machinery sales, according to StatsCan. May's sales marked the biggest increase since December and bettered economists expectations of an unchanged report. April's sales were revised upward to C$20.319 billion from the originally reported C$20.257 billion. All figures are seasonally adjusted.

Wholesalers reported higher sales in 9 of the 11 trade groups, which accounted for 90% of all sales. May's sales climbed 9.1% from the year earlier month. In dollar terms, a 3.6% jump in sales of industrial machinery, equipment and supplies contributed most to May's rebound.

RETAIL SALES: Increased auto sales helped bost Canada's May retail sales 0.6% from April, the second cosecutive monthly gain. May's sales totalled C$17.628 billion (US$12.92 billion), up from April's C$17.525 billion.

In dollar terms, a 1.3% gain in automotive sales led spending. Automotive sales account for about 30% oftotal retail spending. Clothing sales also jumped, rising 3.3% from April, StasCan said. It was the second consecutive monthly retail gain after a first quarter of weakening sales. April's sales were earlier reported up 0.3% from March.

Offsetting the gains was a 3.7% drop in furniture sales as Canadians shy away from big-ticket items because of job worries and higher interest rates compared with year-earlier levels.

TRADE SURPLUS: Exports of cars and industrial goods fell for a fourth consecutive month in May, narrowing the country's trade surplus, according to StatsCan. The monthly trade surplus narrowed to C$894 million (US$652 million) from a revised C$1.8 billion in April. April's surplus was first reported as C$1.78 billion.

StatsCan said exports fell 1.2% to C$20.17 billion and imports rose 3.5% to C$19.28 billion. Most of the decrease in exports reflected slow vehicle sales in the US. Car and truck exports to the US fell 9.5% and 6.5% respectively.

StatsCan said Canada's trade surplus with the US narrowed by 3.7% to C$2.59 billion in May from $2.69 billio in April. Canadian exports to the US fell 2% to C$16.22 billion and imports from the US fell 1.6% to C$13.63 billion.

COMPOSITE LEADING INDICATOR: Canada's composite leading indicator fell 0.3% in June from May amid extended weakness in the housing market. The indicator fell to 172.7 from May's 173.3, according to StatsCan. The index was at 100 in the base year of 1981. Canadian economists were of the opinion that the recent decline in inerest rates and an increase in economic activity in the US should help boost Canada's leading indicator in the next several months.

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