

Princeton Economic's The World Capital Market Review

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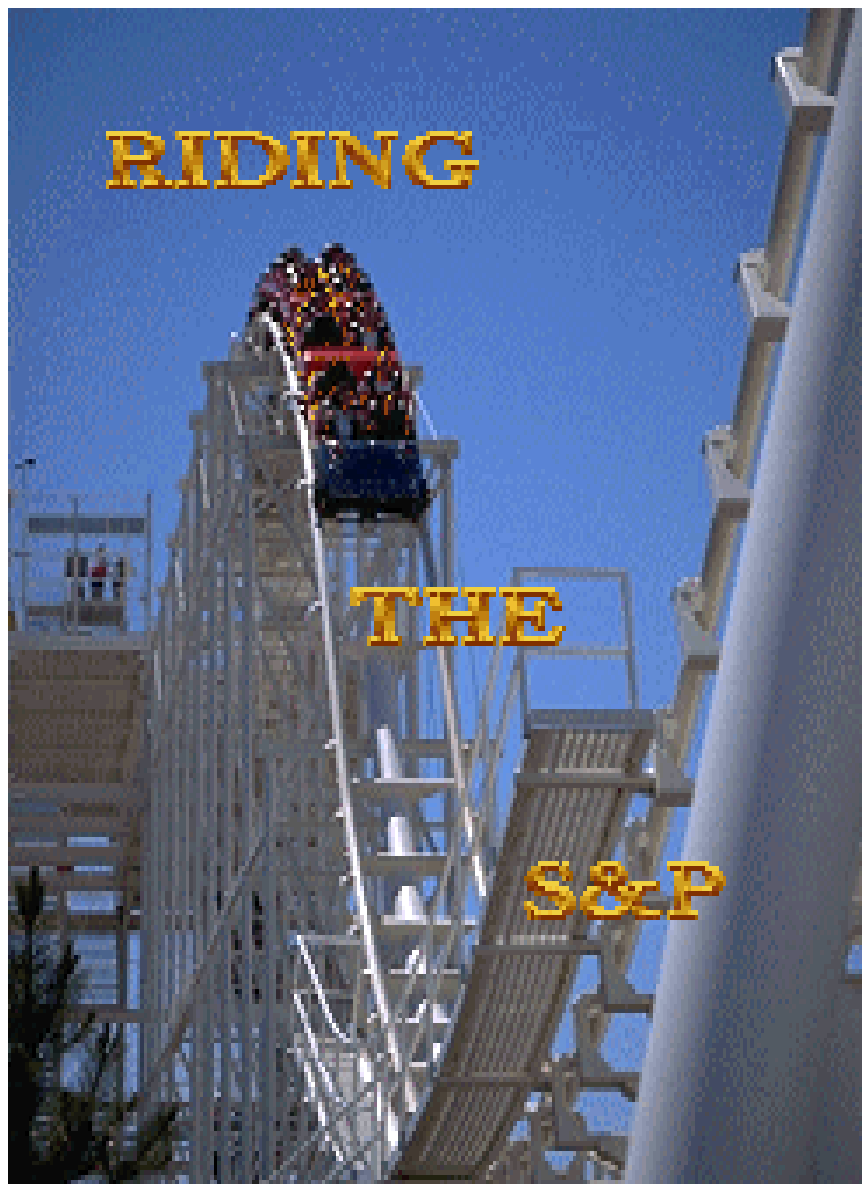
Riding the S&P 500

by Martin A. Armstrong

The US share market has been a rising star among investment opportunities creating a sensational ride to just where nobody seems to know. Every time the market makes the slightest dip, buyers pour into the market from every which direction. There is little doubt that this market is starting to foam at the mouth and the risks that lie ahead certainly warrant our undivided attention.

The core behind this raging bull market is none other than the recent strength in the dollar particularly so against the Japanese yen. International capital has lost all confidence in government and the Japanese were perhaps the last society to come to this conclusion. With interest rates at a mere 0.25% in Japan, there is little wonder why Japanese capital has adopted the attitude of investing anywhere but home. The spread between the bid and the ask on interest rates is at an all time record gap. So while interest rates appear to be very low, the economy just doesn't seem to be moving. While traditional economics would argue that low interest rates spark economic growth, the flaw in the assumption begins with the fact that banks will pass on those savings to clients.

In Japan, outstanding mortgages are still being charged at 4-6% while deposit rates remain next to nothing at 0.25%. Corporations are



getting into trouble because they are earning nothing on their cash deposits while still paying rates of 4%+ on outstanding loans. Pension funds in Japan are on the brink of insolvency. Here, the low deposit rates simply create a nightmare. Future liabilities require income of about 4% annually. Anything below that brings the house of cards down even on private pension funds in Japan.

All this adds up to one simple fact. Japanese investment has been pouring out of the country faster than at anytime in western history. This becomes shockingly evident when one looks at the Japanese holdings of US government short-term debt (10 years or less). From a peak of about 25% going into 1987, Japanese holdings of US debt fell to about 7% going into 1995. The plunge in the dollar insured that little if any US government debt was salable in Japan. Since the turn in the dollar during April of 1995, that trend has also reversed. Today, in less than 18 months, Japanese holdings of US government debt have risen to nearly 33%! That means that the Japanese have helped Clinton get reelected by purchasing virtually 100% of the last year's equivalent deficit. This has helped interest rates remain steady in the US yielding the appearance of success on the economic front.

Japanese purchases of foreign debt have also helped interest rates plummet in Canada and to a lesser degree in Australia. In Britain, Japanese investment has been targeting that country to the near exclusion of most other European nations. The result is pushing the pound out in a bull market against the Dmark that makes the S&P rally look small.

The most interesting change in Japanese investment trends is in the realm of equities. During the 1980s, Japanese purchased foreign debt but little if any foreign equities. The biggest and strongest companies at that time were in Japan. Seven of 10 of the world largest banks were in Japan. All that changed with the real estate bubble burst and the crash in the Nikkei. This round of foreign investment pouring out of Japan is for the first time interested in non-Japanese equities.

One trick that is very helpful in distinguishing institutional investment vs domestic retail investment is to watch the Dow vs the S&P500. As long as the Dow leads the way higher with the S&P 500 trailing along, you know that institutional investors are setting the pace. This is particularly true among foreign institutional investors. They above all others, prefer big name stocks that can absorb a lot of capital. Japanese purchases of the Dow stocks has hit an ALL time record high during the past 18 months.

All this gives us pause when looking at the current rally. This means that a fair portion of the buyers are getting involved based upon the currency rather than the domestic economic considerations. This also means that if there is a pause in trend for the dollar, we are running the risk of setting off a round a major foreign profit taking.

There is another unsettling risk appearing on the horizon. That has a lot to do with what takes place in Washington. Clinton hinted during the election that he was suddenly in favor of a targeted relief on capital gains. That means we could see some sort of a compromise in 1997 on the tax policies. There is a reasonable chance that a cut in the capital gain tax or at least an indexing of capital gains to inflation may come our way. This means that domestic profit taking could also be sparked as the first knee-jerk reaction. A cut in the capital gains tax to 15% or an indexing to inflation would add at least 15-20% to the Dow in after tax dollars. That means you don't have to wait for 7,000-8,000 on the Dow - its there right now!

There is no doubt that a capital gains reform would be extremely bullish for the economy and eventually the stock market long-term. Indeed, perhaps this is what our computer is picking up in the years ahead. We still see that the Dow will eventually gravitate toward the 10,000 mark. The only question is will it do it by 1998 or do we see a correction into 1998 with another leg up into 2003?

If the Window Is Open - JUMP

There are certain timing elements that come into play with any bull or bear market. You can only hold your arm straight up in the air for so long. Sooner or later you are compelled to lower it. Markets function in the same manner. Nothing can continue to go straight up forever. We heard those stories in Japan about how the Nikkei was different. It wasn't and it fell like every other market in history. Some of the same stories are starting to come out about the current rally. Strangely enough, there is also a lot of bearishness out there as well, forewarning about pending doom and gloom.

It is safe to say that our computer models are somewhere in between. There is no way we see the end of the world and the Dow falling to 500 or 600. Such prognostications are just plain nonsense. On the other hand, upward trends that surge like the present cannot be sustained. There is always the inevitable correction. The market's objective is to get the greatest amount of people out before a bull market rally and to sucker in the greatest amount of players near the top. Understanding that game is the first step in becoming a more sophisticated investor.

There are two windows in time where our computer models show a POSSIBLE TEMPORARY top could form. The first is during the weeks of 11/25-12/02 with ideal days being 11/27, 11/29 and 12/03. The price resistance for the S&P 500 nearest futures appears to be around the 772 and 784 zones. Support seems to be forming at the 737 area followed by 689. This suggests that if we see the 770+ level going into these target weeks, then there will be a possibility of a temporary top forming. If this pattern unfolds, then a 2-3 month correction would be likely with the potential for an overall consolidation phase of up to 6 months.

The other window of opportunity appears to be forming in mid to late January starting the week of 01/13. Here target resistance will be a bit higher in the 794 area with a maximum target of 827. Certainly, the later target objective would

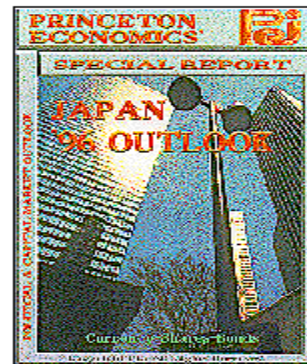
warn of a real blow-off top that could stand for up to 2 years before being exceeded in the future. A 1997 high does run the risk of creating a more pronounced correction that could extend into a low in 1998. That would imply a 2003 rally thereafter.

In other words, a high in late 1996 is more likely to produce a low in early 1997 followed by a rally into 1998 as long as the 624 level holds on a monthly closing basis. A strong excessive high in January will raise the risk that we have established a possible blow-off top from which a decline back to even 4600 on the Dow will be possible going into 1998.

There are certainly a lot of reasons why a correction may be in the making near-term. We must be concerned about the dollar as well as possible tax induced profit taking. We also have to be concerned about the immediate trend of booming housing sales going into November - a period where sales usually decline. It seems that a lot of people are borrowing on margin against their stocks and running out to buy new homes using the interest paid as completely deductible. This is creating a trend of increased leverage within the market while at the same time running the risk of capturing the attention of the Federal Reserve. Rising stock

markets are an economic sign of one thing - asset inflation. Even though stocks are not part of the CPI and real estate was drastically reduced as an input to the CPI, it doesn't mean that the Fed ignores this type of asset inflation. In England, the rates were just raised slightly by a quarter percent. It showed that when politics was not involved, the trend could be toward higher interest rates out of fear that asset inflation will spill over into wage inflation.

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European Union - A Good European

by Bruce Allen

I recently enjoyed lunching with an acquaintance whom I can describe as a good European. After an exchange of views on world markets we settled on debating European Union issues as so often happens in London today. His premise was straight forward - in Ireland (he is Irish) a large proportion of commercial activity is imports and exports. The banks effecting exchange profit hugely to the detriment of industry. A single currency would solve this problem. Ireland has played their cards well and benefitted by using European grants to invest in infrastructure for the future. Closer political integration which embraces unification of law, taxation and social legislation will complete the free trade area in Europe bringing benefits to everyone. Years of attempts to introduce free, unrestricted trade in every sense have been slow to produce results because of individual country's domestic political concerns. The United Kingdom is the extreme example. Ireland he maintained, does not share Britain's concerns of domination by Brussels.

I had to agree with his premise based on Ireland's current position. (A plebiscite today in Ireland would undoubtedly return a yes vote for Europe.) To play devil's advocate I said that the monetary and political union was an experiment never put to an uncommon monetary and cultural area previously and therefore without the benefit of history to guide the decision. Contemporary large scale monetary union areas such as the United States and Canada were providing plenty of reasons for being wary of such structures. But, I suggested, we should not stop at Europe. Surely the prize is so great we should look wider. This will one day be a global objective.

"Pax Romanis" was the reply. This was not Europe's first such attempt at political and economic integration. It has been achieved in the past. Undeterred I recalled that Caesar, Pompey and Cicero vied with each other in intrigue introducing city states into Roman citizenship for political advantage much

like might happen today at Inter-Governmental Conferences (the impending one under Irish chairmanship). In the end economic decay marked by profligate government borrowing and a debasing of currency spelt the end of the political and economic integration. Ironically, as the state decayed and the Roman Catholic church took over the international stage, it was the Celts in Wales and Ireland who kept the Pax Romanis and civilisation alive according to some historians. That is until the invading barbarians (Anglo-Saxons) finally destroyed the last vestige of Roman influence at the Celtic capital known as the "White City", and gave rise to the legend of King Arthur! Well, after months of inter-European conflict on such important issues, we need a little romance - and it was an excellent lunch, prime Scottish beef.

Britain - Elections, Interest Rates and Inflation

In the run up to the next general elections to be held at latest by May next year, the ruling Conservative party continues to hang on with a majority of one and the sometime support of Ulster Unionists. Despite trailing in opinion polls by a considerable amount, John Major's government continues to benefit from an increasing "feel-good" factor and the pressure eased off their own performance by allegations of a secret account funding the Labour party's leader Tony Blair and questionably acceptable fund raising by the "whiter than white" Liberal party. In their desperation to maintain/achieve/influence power, the three main parties have adopted very similar policies attracting the broad middle ground of public opinion. An example of this is that all three parties have now proposed they will hold a referendum on Britain's relationship with Europe (after the elections). The diverse spread of opinions on Europe within all the major parties now is more obvious and the danger of Sir James Goldsmith's Referendum party is being taken seriously by party strategists.

Meanwhile, inflation statistics have not been very kind to the chancellor Kenneth Clarke. The Office of National Statistics announced the largest increase in underlying inflation (excludes mortgage interest rates) since 1993 to 3.3% from last month's 2.9% and above the government's target of 2.5%. This figure, unexpected by most economists, will probably lead to the Bank of England insisting on an increase in interest rates on the basis that this will reduce money supply and dampen down inflation as it would under a fixed exchange rate regime. Capital flows into the UK, particularly from Germany will see higher interest rates as positive news, supporting inward capital flows and pushing the pound higher while increasing the money supply and the cost of government borrowing and increasing inflation particularly in the unrecorded government sector. Perhaps it is too much to ask the Bank of England to review what happened during the Lawson years in the eighties.

The UK is just about the only country where the market is expecting interest rates to rise and ten year gilts are already higher than Italian and Spanish rates thanks to speculation that the lire and peseta will be locked into the EMU in 1999. The UK budget due this month, continued disputes with the European electioneering in process have caused a divergence in trends between the UK and US markets. However, the strength in the pound will continue and we should see more rational markets by early 1997.

Middle East - Palestine Powder Keg

The Middle East and North Africa economic conference held this month in Cairo focussed on the integration of Arab economies rather than the expansion of trade with Israel as planned in happier times. Both corporate Israel and the Palestinians want expansion of commercial activity between the two states. Living conditions particularly in the Ghaza Strip, have greatly worsened since the in-

crease in tension and security clamp-down. Palestinians crossing into Israel each day from Ghaza to work have been restricted to 20% of previous numbers. Economic development in Ghaza has been brought to a standstill by Israel's economic blockade. Malnutrition in children and despair in adults is rising.

The Israeli prime minister, Benjamin Netanyahu, seems determined to stall the completion of phase 1 of the Oslo peace accord creating increased frustration in Arab leaders and raising the prospect of a Palestinian flashpoint igniting another Middle East war. Netanyahu's actions seem more aggressive than needed to satisfy his domestic extremists. Why? The

answer may lie in considering the question - "What happens after phase 1?" The Oslo agreement was achieved by pushing the impossible resolutions into phase 2. Delay the start of phase 2 and you delay the inevitable stalemate and probable major conflict. Better the occasional car bomb than all out war.

How long completion of phase 1 can be delayed is another question. Arab leaders including those in the oil rich Gulf states are under pressure from their own hard line fundamentalist "constituencies". They will be forced to show some solidarity and meaningful action to stay in power. Watch out for any declaration of intent to put pressure on western governments to lean on

Israel. The obvious action is to reduce oil supplies to the west. In a period when the majority are forecasting lower oil prices ahead, stocks are very low and futures prices are in backwardation. For example in June this year the OECD forecast an average price of \$17.60 for 1996 and \$16.80 for 1997. Assuming we achieve a closing year price above \$22.85 this year, our models are looking at a minimum target for the oil price to hit \$32 and possibly \$45.



The View From Germany

by Harry Groenert

How to collect taxes...

One of the biggest raids within the German history has happened some weeks ago. About 600 (six hundred) "Tax-Policemen" searched the Westdeutsche Landesbank in Düsseldorf in the beginning of September. They were especially looking to find people who had taken their money to Luxembourg trying to avoid paying taxes. The tax officials and especially the "Steuerfahndung" (a department of the German IRS with the only purpose to find people who break the tax laws and do not declare all their income) started to become more efficient and more vigorous in the last three years. Since 1994 they have searched about 60 Banks and also big foreign institutions like Merrill Lynch.

A total of 17,000 preliminary inquiries have been launched since 1994 according to an estimate of the "Steuerwerkschaft" (Tax-Union). But this will not be the end - so far the tax authorities have concentrated mainly on Luxembourg and have other countries like Austria, Switzerland and Liechtenstein still on the waiting list.

The first victim had been the Dresdner Bank in January 1995. They complained about the procedure of the Tax agents at the Supreme Court and lost. This became the *carte blanche* for the German IRS. Nothing could stop them anymore. The Supreme Court substantiated: "Those who want to hide that they do have an account in Luxembourg do so, because their tax declarations do not include the income

derived from foreign accounts." Suspicion is sufficient to search a bank, however, not only for one particular citizen but for the whole bank and all their related client files.

Those who are convicted of false tax declarations face severe penalty of up to ten years in prison and severe fines. If one would indict himself before the tax authorities have started an investigation he would not be prosecuted but he would have to pay the "saved" taxes plus interest. Despite this there is probably more black money leaving Germany than in any other civilized country. Why? Because taxes and solidarity surcharges are simply too high. It is obvious, that the pain of paying taxes is greater than trying to avoid paying, even when facing severe consequences.

How could the start of the Emu generate tax bills ?

With the introduction and change to a single currency most of the companies need to evaluate their long term foreign assets and liabilities. This is currently scheduled for 1999. This could lead to significant Exchange "gains" and potentially affect the tax liability for 1998. This is particularly bad news

for Germany because companies are allowed to make provisions against exchange rate losses but they are not allowed to realize any gains until the loan or asset has matured. Changing to the new Euro means exactly that: Realizing currency gains - Mr. Waigel will like that although he might not be in his job anymore at that time.

There had been several attempts in the past to bring European accounting standards in line with global ones, however, so far EU countries remained quite reluctant to do so. Interestingly enough, when Daimler Benz started to list their shares on the NYSE their profit according to German accounting rules was not only less but even a loss under US rules. Mr. John Heggarty, secretary general of the federation of European accountants, said: "This is a serious issue which many companies have barely considered yet - but it is only two years away".

How do the European countries see the gold reserves?

We know Germany's standpoint. The Bundesbank and the Finance Minister agreed on the issue not to

Gold Reserves	Gold as % of Total Reserves	Value of Gold reserves (\$bn)	Amount needed to reduce debt 10% or to 60% which ever is less
France	53.97	31.50	0
Italy	33.93	25.70	120.00
Holland	31.20	13.40	39.00
Germany	30.38	36.60	35.00
Portugal	28.51	6.20	11.00
Belgium	24.59	5.90	26.00
Austria	16.60	4.40	23.00
Spain	10.45	6.00	46.00
Finland	8.60	7.20	3.00
Sweden	8.00	1.90	25.00
Denmark	5.20	14.80	17.00
Ireland	1.80	7.70	6.50

Source: IFS and SBC Warburg

sell any of the gold reserves in order to meet Maastricht criteria. The market obviously behaves as knowing and feeling Damocles' sword of massive gold sales through the governments which are in trouble to either reduce their debt by 10% or to bring it under 60% of GDP.

This is as far as the amounts are concerned quite understandable. If all the countries who own gold would sell their total reserves to qualify for Emu, it would add up to approximately 2,300 tons - which is more than all the gold mined last year. Belgium for example sold between the end of 1991 and October this year 14.9m ounces of gold. During 1996 alone it has sold 5.2m ounces. It is getting tighter.

The official arguments for the sale had been twofold. First, Belgium had a high percentage of gold as total reserves - so they just readjusted. Secondly, the use of the proceeds of the sale were for a worthy cause, the reduction of debt. Anyhow, in most of the cases the size of gold sales necessary to reduce the budget deficit is much too high and exceeds the amount of gold these countries have. As in many cases in the past it seems to be obvious that gold could not increase in price. But what could happen if some governments default on their debt. What would capital regard as an alternative and as a safe haven investment? If that would happen then just fasten your seat belt.



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Long on Russia but Short on Oil?

by Dana Schneider

Russia has a vast amount of energy resources and with that comes the ability to influence the world energy markets. Many investors in the energy markets have discounted Russian market participation in this sector as a net supplier based on the traditional pattern of exporting energy to acquire hard currencies. Certain fundamentals back up this conclusion and even support expectations that this pattern will continue: the Russian State Geological Committee reported that Russia has 13% of the world's proven oil reserves, 12% of the coal, and 35% of the natural gas resources. Even though it is estimated that only 10% of these resources are under development and/or production, the rush of virtually every major energy company into Russian oil development projects has psychologically embedded the expectation that Russia will continue to be an exporter and will only increase its supply to the world energy markets. So we see many investors and analysts long on Russia but short on world oil markets.

Although the Russian oil sector has produced major interests from the world's largest energy companies, clinching the final deal and implementing plans have proven tedious and slow. Oil industry experts believe that an initial \$60 bn investment would be needed with additional huge yearly payments just to regain the levels of 1988 production by the year 2000. Fruits of these investments will not be realized for several years down the road so expect pressure on the world energy sector to build as investors wake up to the fact that Russian oil and resources are not going to flood the market any time soon.

Russia's ability to supply global oil markets has been steadily decreasing. Russian oil production for 1995 was down 46% from that of 1988. Estimates for 1996 state that oil production had dropped to less than 6 mn bl/day in comparison with the 11 mn bl/day for 1988 production which would be a 54% decrease - 8% over the 1995 data.

The Russian Economics Ministry has forecast that oil output is expected to decline by another 1.6% for 1997 from 1996 levels. Estimates peg Russian oil export at 2 mn bl/day as compared to OPEC exports of 17 mn bl/day. A chief economist from the Centre for Global Energy Studies noted that global oil usage was up 500,000 bl/day more than estimated while oil coming out of OPEC was 600,000 bl/day less than expected. Part of the expectation that oil prices will stay level and even fall is in part due to belief that sanctions against Iraq will be lifted. Even if Iraqi oil sanctions were lifted, world consumption is on the rise and supply can not be expected to get a major boost from Russia in the near-term.

Russia has been lobbying to end the sanctions on promises that Iraq will then pay off a \$7 bn debt. In this event, pressure to sell oil for hard currency will lessen making allocation of energy resources for domestic consumption more plausible. Even if the sanctions are not lifted, Russian oil exports will most likely continue to decline as new sources for hard currency are being cultivated. The first international debt offering since 1917 in five-year notes raked in \$1 bn and far exceeded expectations. The Central Bank opened the treasury bill market to foreign investment and has sold nearly \$3.5 bn since August while payments due at maturity totals \$2 bn. As Russia is able to secure loans or hard currency through debt offerings, it is likely that domestic energy demand will limit exports which are already on a decline.

Russia's waning ability to satisfy current domestic energy demands is influencing the amount of oil allocated to sales abroad. Legislation may be introduced to curtail fuel oil exports during the winter months of November to the beginning of March as cold weather approaches and many regions already site insufficient supplies for the winter. Close to 45% of Russia's total 1996 exports were in the energy sector. Interfax reported that the Ministry of Fuel and Energy is considering placing a levy of \$14.70 (80,000 rubles) per

ton of fuel oil that will essentially negate the profit on sales abroad. As colder weather approaches, workers' strikes are on the rise, customer supplies have been dramatically curtailed or stopped, production is continuing to decline, and companies are short on inventories to carry them through the winter. A greater portion of Russian energy exports may be allocated to domestic needs and neighboring countries within the CIS decreasing supplies to the global market place.

Outrageous for a country with such a vast amount of resources? Stranger things have happened. On a short term basis, we may see Russia becoming a net importer of fossil fuels until we see economic stabilization - particularly growth and market reform in the energy and fuel sectors.

Five years after reforms began, gas, coal, and oil industries have been left standing as huge inefficient monopolies relying on price controls and subsidies granted through non-collection of taxes. Not surprisingly, over two-thirds of delinquent taxes owed to the government are found in the energy sectors (over \$9 bn) as well as the lion's share of company wage arrears. The IMF has withheld the \$380 mn October installment of a three-year \$10 bn loan in an effort to prod Moscow to increase tax collection. This has resulted in bankruptcy proceedings against several large energy companies, particularly oil, tightening the screws on the payment crisis and sparking off political fights with heads of regional governments.

The vicious cycle of debt and nonpayment from consumer to worker to supplier has taken its biggest toll on the energy sector where little if any market reforms have been initiated. As privatization and market reforms in some sectors of the economy eventually spur growth and consumer demand, the energy and fuel sectors that have not undergone reform and restructuring are unable to produce adequate supply. Deepening the problem is a deteriorating system of production as well as an

inefficient and hazardous system of distribution and storage. The immense cost and complexity of addressing the problems of Russia's energy resources - on top of the domestic and international politics and legalities - makes a quick resolution unlikely. Investors may recall that China was once the fifth largest exporter of oil and has now become a net importer. Some analysts have predicted cheaper oil prices from Iraqi oil and Russia's

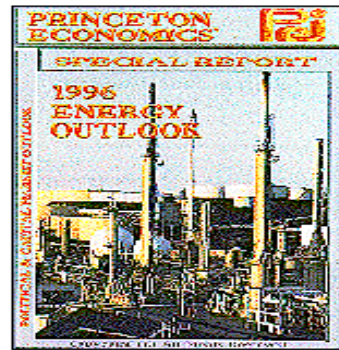
vast energy potential as an underlying factor of world supply. However, this may be several years down the road.

Chernobyl. Of the four reactors, one was shut down after the 1986 meltdown and another in 1992. The third is scheduled to be shut down at the end of November while the fourth has continued to run as a vital energy source for the country.

Note:

Due to expected energy shortages, the Ukrainian government has reportedly stated its interest in restarting one of the reactors at

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Asia Update

by Craig Stephens

Tung triumphant

After the inaugural round of the selection process for Hong Kong's first post colonial leader, Mr Tung Chee-hwa looks to have an unstoppable lead, casting 206 of the 400 votes. Sir Ti Liang Yang, the former chief justice managed 82 votes and businessman Mr Peter Woo had 54 votes. All three now proceed to the final run-off on December 11 which is looking increasingly like a mere formality for Mr Tung. Since January Mr Tung has worn the tag of pre-ordained candidate after Mr Jiang Zemin, the Chinese president made a rather conspicuous point of shaking his hand during a gathering of Hong Kong business and political leaders in Beijing. "Not so," retorted Quian Quichen, China's foreign minister, who hailed the ballot as a democratic break-through for Hong Kong. Hong Kong's 100 odd democracy protesters clearly thought otherwise, although their demonstrations were easily contained by a police presence that left them outnumbered three to one.

Business interests will be satisfied by the choice of the conservative former shipping tycoon. Mr Tung has also indicated that he would retain the popular Anson Chan as the head of the civil service as his deputy. Such continuity should be welcomed and help facilitate a smooth handover. Beijing has already signaled its political will to ensure a prosperous transition. So far signs are either that capital is happy with the way the handover is progressing or is happy to ignore the political maneuvering as testified by the buoyant state of the stock and property markets. In China the easing of austerity has allowed more liquidity to trickle into Hong Kong. An estimated 25% of value of all property transactions this year have been accounted for by mainland money. With the market still only modestly above 1994's highs, valuations do not look excessive against a backdrop of benign US interest rates.

Developers ready to spend

As the Hang Seng Index follows Wall Street to record highs, the territory's major property developers are playing their parmentum going. Last week property magnates Li Ka-shing of Cheung Kong Holdings and Lee Shau-kee of Henderson Land both pledged their companies would be investing \$10bn a piece in the territory's property market in the coming year. Not to be outdone, at the weekend Sun Hung Kai Properties, said it will spend at least \$14bn on property development in the year to June 1997. This show of confidence amongst the developers is underpinned by an estimated 30% appreciation of residential capital values over the past 12 months. According to the government, prices are now only about 10 percent below their peak reached in April 1994. That time around the government intervened to cool the market. However we do not expect a repeat of such actions which would risk jeopardizing a smooth handover next year. Particularly when a bumper year of land sale revenues is expected - official estimates have just been upped to \$40bn for land sale revenue, 10% higher than December's forecast. All the flurry of speculation has been prompted by last week's government land auction which has all the major developers bidding for a relatively unexciting piece of land out in the sticks. The price fetched of \$375mn was 20% higher than market expectations. The next major land sale is not until December 11th.

However after this year's sharp rebound in prices, in the next two years price increases are expected to slow to around 10% a year. Supply in 1996 and 1997 is still forecast to be down on previous years which will support prices. Meanwhile demand is being oiled

by a continued mortgage war amongst the territory's banks. While this may hurt margins, it looks as if good times will continue to roll for the property developers.

Regulators fight back

After decades of effortless profit growth, Hong Kongs' cosseted utilities are facing a wake-up call from regulators under pressure from consumers and increasing global competitive forces. First it was Hong Kong Telecom, now China Light and Power (CLP), the larger of the territory monopolies is finding itself under attack. Last years 9% rise in electricity prices combined with a 50% excess generating capacity underlined the failings of a scheme of control which links profits to capital investment. This had resulted in electricity demand being consistently overestimated over the last 10 years, particularly as the lucrative China market failed to materialize. It now looks likely CLP will have to postpone the second phase of its Black Point power station, undermining earnings growth.

Hong Kong Telecom has had a hard time since competition was introduced this year. Its recent interim results showed that it had lost 15% of the International direct dial (IDD) market to newcomers and current estimates may be up to 30%. Now Hong Kong Telecom is under pressure from US regulators to reduce the accounting rate for Hong Kong calls (the amount it receives for calls coming into Hong Kong). The US accounting rate is increasingly important because of the growing number of call back services. There are seven times more calls coming into Hong Kong as going out. Taken together with calls to bring forward the ending of its international monopoly licence, regulator is undoubtedly an ugly word inside Hong Kong Telecom.



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Forecasting the World

Australia & New Zealand Update

by Nigel Kirwan

The World

Despite an air of confidence stemming from the prominent role Australia has taken in world affairs over recent years there were a lot of red faces at the Australian UN mission recently when we were denied another term as a member of the UN Security Council. Despite being "hot" favourites Australia was roundly beaten by Sweden and Portugal in two rounds of voting. It is widely accepted that France worked hard against Australia and for Portugal particularly with African countries as a pay-back for our opposition to French nuclear tests in the Pacific. There is also some resentment toward Australia in third world countries stemming from our acceptance of Indonesia's rule in East Timor which contravenes UN resolutions on the former Portuguese colony.

Most interestingly though is talk of perceptions (particularly by China & ASEAN) that Australia under the coalition, is too keen to take the US position on world issues. When John Howard became Prime Minister he and Defence Minister Ian McLachlin pledged "to reinvigorate the US alliance" - it was a curious commitment given the almost adulation Clinton held for Paul Keating. Even more curious is the question as to why successive Australian conservative governments tend to want to appear closer to the US when they (the Americans) have Democratic administrations - Harold Holt pledging "Australia is all the way with LBJ" in committing us to further involvement in Vietnam and to a lesser extent the Fraser governments rhetoric during Jimmy Carter's presidency. That the Democrats have a soul connection with the Labor Party was amply demonstrated by Bill and Hillary on their recent Australian visit with conflicts over guest lists at functions and speeches on the multicultural debate and the environment implying some criticisms of Howard's stance on these issues. Many hope that a more independent and mature voice such as that which

lead to the establishment of the Cairns Group in the Uruguay round of GATT, initiatives such as APEC and the UN intervention in Cambodia, and sponsoring of the UN Global Nuclear Test Ban Treaty and the Canberra Convention on Nuclear Disarmament, can resurface.

The Asian Region

Evidence is emerging that the ongoing race and immigration debate within Australia is hurting our tourism from and trade with the region. Already several group bookings from Hong Kong have been cancelled and the debate has taken some prominence in Asian media and political discussions. Stirred up by a populist disendorsed Liberal MP Pauline Hanson, who is aiming mainly at the welfare programmes targeted at Aborigines and the level of asian immigration to Australia the controversy just won't go away. While the facts are that out of a population of 18 million only 870,000 Australians are of asian descent there is a perception amongst a minority of the population that we are being swamped by asian immigrants. Support for these views is possibly as high as 30% while the belief that immigration levels are generally too high is held by as much as 60% of the population.

While the present government has rebalanced immigration levels away from refugees and family reunions and toward skills that are in demand it is statistically accepted that each family arriving in Australia over time generates on average four new jobs. The Prime Minister has been criticised by many for not taking a strong stance against Hanson. Many on his own side of politics are worried about the doubts about Australian commitment to integration with the economies of asia even though 60% of Australia's trade is with asia and we remain the driving force behind the Asia Pacific Economic Cooperation Forum (APEC) which was an Australian initiative (now being claimed by Clinton). Even though all major political parties voted unanimously to reaffirm Australia's non-discriminatory im-

migration policy and a commitment to multiculturalism Howard has not personally debated the issues and some believe he sees more votes in not doing so because many of those who support Hanson's views are Labor voters.

Similar issues are alive in New Zealand but those most vocally objecting to asian immigration are associated with the maori dominated New Zealand First Party.

Another item of interest in the region is the press coverage of the mirth expressed by orthodox economists toward the views of Indonesia's Finance Minister. Tired of conventional economic "wisdom" he engaged a group of aerodynamic engineers to examine the effects of monetary policy on inflation, their conclusion: government pressure on rates fuels inflation. Martin Armstrong published his article drawing the same conclusion around eight years ago!

Political Roundup

New Zealand still does not have a declared winner from the recent national elections but it now appears that the caretaker Government of National Party Prime Minister Jim Bolger may yet survive. This will be the case if the populist New Zealand First Party of ex-National former minister Winston Peters is as rumoured, about to agree to support a coalition with the Nationals and the economic rationalist ACT NZ.

The Federal Liberal Party won a stunning victory in a bi-election for what was before the March federal election a safe Labor seat. With a further swing of 6% Prime Minister John Howard claimed a sweeping mandate for reform and warned Democrats leader Cheryl Kernot to "get out of his way". The Democrats continue to participate in blocking key legislation in the Senate. Industrial Relations Minister Peter Reith reached a deal with the Democrats to pass an Industrial Relations (IR) reform bill which will overturn Labor's disastrous unfair dismissal laws and also lead to a breaking of the domination of big industrial unions in enterprise

bargaining agreements.

Western Australia goes to the polls on December 14 with Premier Richard Court's Liberal/National coalition Government ahead in two party preferred opinion polls. However, the Labor Party under new leader Jeff Gallop appears revitalised and because of the concentration of Liberal voters in safe seats the election may hinge on the Liberals retaining some marginal electorates.

The South Australian Premier Dean Brown narrowly survived a challenge to his leadership being mounted by backbenchers supporting former Liberal leader John Olsen. The backbench rebellion stems from complaints about the pace of economic reform. To be fair to Brown much of his problem stems from an uncooperative upper house controlled by Labor and the Democrats which is disallowing the types of reforms seen in Victoria under its Liberal Premier Jeff Kennett being implemented in South Australia.

Following passage of the federal IR bill Victoria's Premier Jeff Kennett handed over all of his state's industrial relations powers to the Commonwealth. This is seen as a unilateral first round move in efforts to rationalise Commonwealth/State administrative responsibilities and financial relations. While all state leaders do not agree with Kennett's decision there was expected to be a generally united front from State Premiers at last week's Council of Australian Governments meeting which had to be postponed until after the WA poll. Kennett has elected to lead the charge on these issues by leading further calls for rationalisation of the Tax system and introduction of a GST.

Many believe that the Commonwealth should retain income tax powers and revenues and hand to the states consumption tax powers and revenues with responsibilities divided between national economic considerations maintained at the federal level and more community based considerations at the state level. Many of these proposals actually cut across constitutionally defined roles and as such are not necessarily as easy to implement as logic would dictate.

The National Party dominated Queensland coalition government of Premier Rob Borbidge continues to go down a discredited path from the past. Borbidge recently appointed a barrister acting for Police Minister Russel Cooper in a corruption inquiry to undertake an inquiry into Queensland's Criminal Justice Commission (CJC) which among other things was conducting the above corruption inquiry. The corruption inquiry is into allegations of electoral bribery against Borbidge, Cooper and the State Police Union and was tipped to bring down an adverse finding against both Ministers which may have resulted in criminal charges being laid and most certainly could bring down the Government which has only a majority of one. This style of blatant political interference in the justice system and a past unhealthy, scandal ridden, alliance between the National Party and the Queensland Police was what brought Labor to power in Queensland for six years and led to the establishment of the CJC.

Many conservatives in Queensland would not be too sorry to see Borbidge's government off as it also shows unrepentant tendencies to want to involve government in details best left to the private sector. Already the Queensland Government is embroiled in an expensive project to use taxpayers funds to merge three state based entities into a medium sized bancassurance group. In order to keep private investors in the listed vehicle for this scheme the government has now agreed to forgo approximately \$100 in dividend payments due to it so that the profit to be distributed to other shareholders can be enhanced. Now Borbidge is proposing that state owned Queensland Railways should bid for the federal Government's share of the National Rail Freight Corp and the federally owned Australian National Railways both of which lose vast amounts of money. Queensland Railways only claim to fame is that it is mandated to carry all mined ores to port charging the miners exorbitant rates and being owned by a government which bans competition!

The Economy

On November 6 the Reserve Bank of Australia cut .5% off official rates for the second time in less than four months. The Bank cited low and falling inflationary pressures as the reason for the cut following a fall in the September quarter inflation rate to an underlying 2.4% from December's 5% and the CPI at 2.1% from just over 3% in December. The market greeted the news soberly after a frenzy of anticipation in the long bonds over previous weeks. Bonds have again rallied as traders again anticipate a further rate cut early in the new year.

Princeton Fund to launch Prospectus on the Internet

The Princeton Precious Metals and Capital Markets Fund is to launch its next prospectus on the Internet sometime in December. The Fund can trade up to 30% of capital on margin in world futures markets and another 40% of capital can be placed in equities if the need or opportunities arise. Untraded capital is held in Australian currency at commercial bank bill rates. Proceeds of the Fund are treated as income tax free for non-Australian residents but withholding tax is charged on the interest portion of non-resident unit holders profits. The Fund is not open to U.S. residents or citizens (resident or non-resident). Information about the Fund can be obtained at [Http\www.afsd.com.au](http://www.afsd.com.au) click on <Commodities> then click on <Princeton Precious Metals Fund>

Stop Press: A handful of Junior Gold Exploration Companies listed on the ASX are booming following promising discoveries of gold, copper and uranium in the Gawler Craton region of South Australia. It is in this same region where WMC operates the huge Olympic Dam mine and the consistent geology of the area lends it to becoming another major gold province. More net month.

Canada Update

by Chris Quigley

Large Debt Still a Big Problem

Despite the recent successes in reducing spending, Canada is still a high risk. This is according to the OECD's newly released annual report on Canada. The OECD study says that the debt-to-GDP ratio in Canada is still much too high and will not begin to fall until at least 1997. And it will be longer still before the ratio approaches the OECD average. While the OECD advised Ottawa to keep on track with cuts in government spending, the organization also feels that these cuts could have a short-term adverse effect on the economy.

Meanwhile, Alberta may not become debt-free as quickly as the ruling Conservatives claim it will. The Conservatives are claiming that the province will be debt-free by the year 2005. However, agencies that assign Alberta's credit rating say the provinces debt is three times higher by their definition. The difference comes because the agencies take a broader definition of debt.

The government counts everything it owns as assets. By that definition, Alberta's debt is only C\$6.5 billion. However, the bond agencies only count readily marketable assets - such as rainy day trust funds. By the agencies definition, Alberta is C\$18.5 billion in the red. However, the province has made great strides in reducing its debt and has seen growing budget surpluses in each of the last three years.

Bank Profits Surge, Backlash Grows

Canadian banks will see record profits this year with profits among the big six topping the C\$6 billion mark. This year's profit will beat last year's C\$5.2 billion by more than 20%. This year's record profit comes thanks to a soaring stock market, high mutual fund fees and lower provisions for loan losses. The soaring stock market caused an increase in brokerage income

and a strong flow of money into mutual funds. Low interest rates and a healthy economy have allowed for a more diversified lending portfolio and a decrease in loan losses. While this may be a cause for celebration in the banking industry, bank executives are getting ready to go on the defensive in justifying the high bank profits.

Anticipating backlash from consumers over the huge profits, bank executives have been preparing. Royal Bank of Canada has prepared a 16-page defense of industry wealth called "Bank Profits in Perspective." It points out the large share of taxes the banks pay and that a lot of bank profits are returned to Canadians through pension and mutual funds that invest in bank stocks. Toronto Dominion Bank's incoming chief executive told an audience in Ottawa that "a strong and healthy country requires strong and healthy banks."

Trade Issues

Free Trade Deal With Chile Signed

Canada and Chile signed a free trade deal that is designed to ease Chile's entry into NAFTA. The agreement eliminates tariffs on 80% of Canadian exports to Chile.

Trade between the two countries totaled about C\$600 million last year, with Canada enjoying a large surplus. Canada's C\$7 billion of direct investment, mostly in mining, makes Canada the second largest investor in Chile. A mandatory 30% reserve deposit on foreign investment was a major sticking point in the negotiations. In the final deal, direct investments are free from the requirement, but reserves may still be required for credit financing.

Chretien to Asia

The Prime Minister will make a swing through Asia, visiting the Phillipines, China and Japan all in an effort to drum up trade opportunities for Canada. The Phillipines visit will be at the annual summit of the Asia-Pacific

Economic Cooperation forum (APEC) where it has already been agreed to phase in free trade for industrialized countries by 2010 and 2020 for less developed nations. In China, Chretien will meet with Premier Li Peng and witness the signing of a C\$4 billion deal to build two Candu nuclear reactors in China. The deal should provide jobs to 27,000 Canadians over eight years, according to government officials. The third stop is with Canada's biggest trading partner next to the United States - Japan. Trade between Canada and Japan totaled C\$ 24 billion last year. Chretien will spend three days in Japan meeting with Japanese Prime minister Tyutaro Hashimoto and business leaders.

US Sticking to Lumber Deal

It appears that the United States will not seek to renegotiate a seven-month-old trade deal with Canada that restricts the amount of Canadian softwood lumber to be imported into the US duty-free. This is despite pressure from the National Association of Home Builders and others. The US lumber lobby, of course, is in favor of the deal. It claims that the agreement doesn't restrict the import of Canadian wood into the US but only gives the US lumber industry a chance to compete. The price of lumber in the US is soaring. The cost of 1000 board feet of soft wood has risen from US\$350 to US\$480 in the past seven months. This rise alone could raise the price of a new home in the US by as much as US\$3000. The agreement lasts for five years.

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World Capital Market Review

GOLD

Gold remains in trouble on a fundamental basis. Here we see selling ahead of the 1999 target unification date coming from European central banks. In addition, selling from the IMF still appears likely over the next two years despite denials intended to keep prices steady for obvious selling strategy purposes. Yet as all the sales are coming arriving in big lots, the buying is there but more in thousands of small pieces. A lot of the buying is coming out of Asia including Japan where retail gold purchases have been rising for the first time in history.

Nevertheless, important support in gold remains at the 371 area. A penetration of that level warns that we should see a decline down to the 360-361 area. Major long-term support comes into play aroundnd ONLY a penetration of that level would warn of a further decline to 303. This we do not expect to develop. In fact, it may be very difficult to move gold much below the 360 area.

Resistance is starting to form in the 398.60 zone for next year. This means that a breakout to the upside will ONLY be possible by a weekly and monthly closing ABOVE 398.60. Until gold can accomplish that type of movement, it is wise not to get too bullish near-term. Long-term we still see that the major high for gold is perhaps more likely to form going into 2003 than 1998. It is still possible that a decline into the first quarter of 1997 might be followed by a rally into 1998, correction into 1999 and a new rally into 2003 thereafter. However, a rally for gold into early 1997 which bounces OFF of the 398.60 area will be a warning that we might be faced with a May/June low in 1998 before the next bull market is unleashed.

SILVER

Silver is literally fighting for its life. The critical support is still resting under the market at the 450 zone. We also see some minor support at 429. However, a penetration of the 429 level warns that silver may be headed sharply lower to the point

that it penetrates not merely \$4, but also \$3 encountering support somewhere around \$2.83. A year-end closing for 1996 in silver BELOW 4.86 is a warning that we may yet see lower prices just ahead.

S&P 500

We see resistance standing at the 772 and 784 levels going into the end of November to the first week of December. A temporary top is possible during that time period. If correct, expect up to a 6 month correction/consolidation phase. However, should the US share market rally into January, then we could be setting the stage for a more serious decline that could cause a 1998 low to form.

US BONDS

We still see that the 30 year bonds are capable of rising to the 132 level. That is about 10 full points above the double top at the 122 area. Long-term bonds remain strong as long as they hold the 10100 level on a weekly and monthly closing basis. Given that prospect, bonds could rise on a flight to quality in early 1997 should a major temporary top form in the stock market. We also see that an inverted yield cure is p o s s i b l e and that the demand by pension funds to extend the maturity of their portfolio as one important factor in supply underlying support for the near-term.

INTEREST RATES

We still see short-term rates remaining fairly firm at this time in the United States despite the fact that they have DOUBLED in the past 3 years. Our models also continue to show a strong case for an inverted yield curve developing. One factor to watch is now that the elections are over, the truth about medicare will be out. In 1997, the combined revenue received in medicare and social security will move into deficit. That means that something has to give here. Clinton is proposing to shift medicare onto the general budget. That means the

elimination of a trust fund status and giving up on trying to fix it. All short-falls will simply be made up by income tax and other general revenue. This would be a VERY negative turn of events. Another solution will be to raise the payroll tax by 15%-25%. Of course then there is the prospect of raising the minimum age to 67 and cutting payments to doctors while raising premiums. Somehow, some way this problem will explode by 1998 if not properly dealt with in 1997. Any shift of this burden to the general budget will no doubt cause short-term rates to rise even further, creating the inverted yield curve single-handedly.

CANADIAN DOLLAR

Despite the rise in the dollar and the pouring of foreign investment into Canada, the C\$ has yet to break out above major resistance. ONLY a monthly and year-end closing above 7576 will signal a reversal in trend for the C\$. A failure to close above 7576 at year-end will only leave this currency in a questionable position. As far as provincial debt is concerned, the NDP in British Columbia has proven our warnings to be correct. This is perhaps one of the most corrupt political organizations in the world clearly willing to outright lie to win office. One could argue that Clinton merely exaggerated the medicare position of the Republicans. He didn't go as far as to make up a story that didn't exist. In the case of the NDP, they stand as the primary example of Marxists out of touch with reality. They talk the balanced budget game and falsify the numbers. We are no longer the only advisors raising the red flag. BC is being black listed by institutional investors worldwide.

DOLLAR vs EUROPE

The dollar is still in a neutral position against most continental currencies. Against the Dmark, the major support basis the futures remains at the 6350 level. Until we can accomplish a monthly closing BELOW 6350 for the Dmark, then there is a great risk of one more rally against the dollar in 1997. The Swiss franc has been dropping like

a stone against the dollar more so for rising concerns of the banks opening up their books for audits in the wake of the Nazi gold deals. Many depositors are starting to worry that the banks could cave in under international pressure to capturing taxation coming out of the US, Germany and France. Add to this the fact that the banks will depart from the gold standard and you suddenly have a situation where Switzerland might not be everything it was once cracked up to be. Against the pound, the dollar

has dropped like a stone. Here, the trends are doing exactly as we have been forecasting for the past two years - the pound will become the strongest currency within Europe. Even if Labour wins at the elections in 1997, it will be too late for Britain to join the first round of currency mergers. That, means that the pound will in fact continue to become the safe currency of choice in Europe among those who fear that a single currency will lead to a currency that is worth less than the final official exchange rate.

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World Economic Review

UNITED STATES

CHIP SALES: The Semiconductor Industry Association's book-to-bill ratio, a leading indicator of market trends, rose to 0.99 in September, up from a revised figure of 0.93 in August. The ratio, which measures the value of orders booked by chipmakers in the Americas against the value of shipments, is now at its highest level this year.

Orders by US manufacturers increased 9 percent over the previous month to \$3.19bn for September. Shipments rose 2.1 percent to \$3.22bn, the US industry trade group said.

Data for worldwide sales, which trail American figures by a month, also show a rising trend. The global book-to-bill ratio rose to 0.97 in August, up from 0.95 in July. The September figure is expected to rise by about 1.0, analysts said.

Chip sales in the Americas remain well down on last year. September shipments were, for example, more than 20 percent below those of the same period last year.

INDEX OF LEADING INDICATORS: The US index of leading indicators rose 0.2 percent in August to 103.3, its highest ever level. The Conference Board reported that the index rose 1.7 percent in the six months to August, indicating the economy was likely to expand steadily well into next year. The index is designed to give six to nine months' warning of turning points in economic activity. The group said seven of the 11 components of the leading index rose in August.

PURCHASING MANAGERS INDEX: The national association of purchasing managers said its index of manufacturing activity declined modestly to 51.7 percent in August, from 52.6 percent in July. Readings above 50 percent indicate expansion of the manufacturing sector. The drop in the index reflected declines in indices measuring the growth of production and employment. However, an index of new orders rose for the second consecutive month to 56.3 percent

against 55.6 percent.

EMPLOYMENT: According to the labor department, non-farm employment fell by 40,000 last month after gains of more than 200,000 in preceding month projected an increase of about 160,000. The jobless rate edged up from 5.1 percent to 5.2 percent, but remained below its average of recent months.

The drop in employment was the first since January but may partly have reflected poor seasonal adjustments. Government employment fell 81,000, mainly because the expected seasonal gain in teaching jobs failed to appear. Officials said more teachers were now employed during the summer months, reducing the usual jump in September.

However, growth of private-sector employment was also weak. Manufacturing employment fell 57,000 last month, with the largest declines in industrial machinery and transport equipment. Service-sector hiring was sluggish, especially in retailing and business services. Other aspects of the jobs report pointed to steady economic growth. Average earnings rose 0.5 percent last month.

NEW HOME SALES: Sales of new homes in the US rose 4.7 percent between July and August, to their highest level in a decade. The Commerce Department said new home sales rose to a seasonally adjusted annual rate of 832,000, the highest level since April 1986. Figures for June and July were also revised up. The jump in sales surprised Wall Street economists who had predicted a decline to an annual rate of about 744,000. The strength of home sales has surprised economists because long-term interest rates have risen this year. Rates on a 30-year mortgage averaged 8 percent in August, against 7 percent at the beginning of the year.

CONSUMER SPENDING: Real consumer spending rose 0.5 percent in August following a zero increase in July. The gain reflected strong demand for durable goods such as cars, sensitive to interest rate levels. Disposable personal

incomes also rose 0.5 percent in August following a 0.1 percent drop in July.

CONSUMER PRICES: US consumer prices rose 0.3 percent in September signaling a slight increase in inflationary pressure, official figures showed. The largest price gains were for food, clothing and transport, each of which rose 0.5 percent from August. Energy costs were flat after falling in previous months.

The Labor Department said the annual rate of inflation edged up to 3 percent against 2.9 percent in August. In the first nine months of this year, consumer prices rose at an annualized rate of 3.2 percent, up from 2.5 percent for 1995 as a whole. The figures, however, sparked little reaction in bond markets in part because they followed a modest price gain of 0.1 percent in August. In recent months prices have risen at an annualized rate of 2.6 percent.

The "core" consumer price index, which excludes the volatile components of food and energy, rose 0.3 percent last month and by 2.7 percent in the year to September.

EMPLOYMENT COST INDEX: The Labor Department said the employment cost index rose 0.6 percent in the three months ending September, compared with increases of 0.8 percent in two preceding quarters. Annual growth of employment costs fell to 2.8 percent against 2.9 in the year to June.

The wage costs figures surprised many Wall Street analysts who feared the strong economy would lead to an acceleration. In previous business cycles, the current jobless rate of 5.2 percent was associated with stronger upward pressure on inflation. The employment cost index, including fringe benefits and wages, is seen as the most reliable guide to labor market trends.

Figures showed a decline in both components of the employment cost index. Wages and salaries rose by 0.6 percent, compared with 0.9 in the second quarter; costs of benefits rose the same amount,

compared with 0.7 percent.

CONFERENCE BOARD INDEX: Figures showed a modest decline in the Conference Board's index of consumer confidence to 106.2 against 111.8 in September, but it remained 10 points higher than a year ago. The board, a US business analysis group, said the decline was no cause for alarm, with confidence in nearly all regions "running at relatively strong levels, suggesting a strong holiday spending season ahead."

DURABLE GOODS: The Commerce Department said orders rose 4.6 percent between August and September, the largest monthly gain in four years. Economists expected an increase of 2 percent or less following a 3.5 percent fall in August.

The orders figures are highly volatile on a monthly basis, much of last month's increase reflected a big jump in aircraft orders. But excluding transport and defense, the two most erratic components, orders were up 1.7 percent, indicating that business investment is likely to remain robust in the coming months.

UNIVERSITY OF MICHIGAN CONSUMER CONFIDENCE: Reports showed a rise in the University of Michigan's index of consumer confidence to 96.5 in mid-October from 94.7 in September.

EXISTING HOME SALES: Sales of existing homes were reported down 2.9 percent in September, the fourth successive monthly decline. New home sales also fell last month.

RETAIL SALES: A surge in US car sales led to higher than expected retail sales last month, official figures indicated. The commerce department said retail sales rose 0.7 percent, well above projections in financial markets of about 0.2 percent. The increase mainly reflected a 1.7 percent increase in sales of new cars. Excluding cars, sales were up 0.4 percent. August sales were reported down 0.2 percent, rather than up 0.2 percent. As a result, consumer spending grew sluggishly in the third qe.

PRODUCER PRICE INDEX: The producer price index for finished goods rose 0.2 percent in Septem-

ber and by 2.9 percent in the year to September. The "core" index, excluding food and energy, however, rose 0.3 percent, the largest gain since May.

INDUSTRIAL PRODUCTION: The Federal Reserve said industrial production grew 0.2 percent in real terms in September compared with 0.4 percent in August. The slow down reflected a drop in output of cars and light trucks.

The Fed said real growth of industrial output slowed from an annualized rate of 6.7 percent in the second quarter to 4.4 percent in the last three months, a still robust rate of expansion. The rate of industrial capacity utilization, often seen as a measure of upward pressure on industrial prices, fell slightly to 83.3 percent last month, against 83.4 percent in July and August.

HOUSING STARTS: The Commerce Department reported a 6 percent fall in housing starts last month to a seasonally adjusted annual rate of 1.44m, the lowest this year. Analysts said the fall in housing starts was sharper than expected and could indicate a decline in housing demand following increases in mortgage rates this year.

END TO INFLATION DIP?: A six-year trend of lower US inflation may be coming to an end, though only modest threats of faster price growth appear on the horizon, Mr. Mark Rogers, Atlanta Federal Reserve Band economist, said.

Creeping wage pressure and higher energy prices should ultimately filter through the US economy, stalling further inflation reduction, said Mr. Rogers. "By saying the best news is behind us, I think prices will no longer be as soft, but . . . we won't see the inflation picking up either," he said.

GERMANY

GDP: Germany maintained its economic recovery in the third quarter, the Bonn economics ministry reported. It predicted that gross domestic product would show stronger year-on-year growth than in the second quarter when GDP was a real 1.2 percent higher than in the second three months of 1995.

However, the ministry said growth was insufficient to have a significant impact on Germany's high unemployment of 3.85m and singled out sluggish business investment as a problem. The ministry said it was vital that the government's program of deregulation, spending cuts and tax reform be implemented rapidly and in full.

WHOLESALE PRICES: German wholesale prices fell 0.1 percent in September from August, and were down 0.7 percent from the year-earlier level, the Federal Statistics Office said. In August, wholesale prices had declined 0.6 percent from July and 0.5 percent from August 1995.

M3 MONEY SUPPLY: Growth in German M3 money supply fell from an annualized 8.7 percent in August to 8.4 percent in September against the fourth quarter to 1995, according to Bundesbank data. On a month-on-month basis M3 went up by 0.4 percent in September, following .8 percent in August.

JOBLESS TARGET QUESTIONABLE: German chancellor Helmut Kohl acknowledged he was unlikely to realize his ambition of halving unemployment by the year 2000. In a keynote address to the annual congress of his Christian Democratic Union, the chancellor said he would be happy if unemployment fell to two-thirds of present levels. Germany has 3.85m jobless, just over 10 percent of the labor force.

RETAIL SALES: German retail sales presented a mixed picture in July, rising strongly compared with the same month of last year but declining from the level of June. The federal statistics office reported sales were up by 2.5 percent in real terms compared with July 1995 but down by a real 1.9 percent from June 1996 after adjustment for seasonal and calendar changes. Compared with July last year, volume sales increased in all retail sectors except specialty food stores. The month's turnover was further boosted by a real 19.2 percent year-on-year increase in mail order sales as households reacted positively to the new catalogs issued during the month.

UNEMPLOYMENT: A higher than expected rise in German unem-

ployment last month has cast doubt on the strength of economic recovery. The seasonally adjusted rise of 39,000 compared with economists' estimates of around 10,000 and an increase of 21,000 in August. The total jobless figure was just below 4m, making a seasonally adjusted rate of 10.4 percent against 10.3 percent in August. In west Germany, the rate was 9.3 percent and in east Germany 15.3 percent. Normally, September shows a seasonal upswing in the labor market after the summer holiday period. But this time, the autumn trend was "very weak".

TRADE SURPLUS: The country's trade surplus rose sharply in July to DM10.9bn (\$7.3bn) from DM7bn in June and DM6bn in July, 1995. Exports were 16.5 percent higher, with imports up by 8.9 percent.

CONSUMER PRICES: German consumer prices fell 0.1 percent in September from August and were up 1.4 percent year-on-year, unchanged from t

INDUSTRIAL OUTPUT: German industrial production expanded further in August, continuing a recovery that began in March, the economics ministry reported.

Overall industrial output rose a seasonally adjusted 0.8 percent in August from July and was up 0.7 percent from a year earlier. Output in the west of the country rose by 0.3 percent in August from July, and by 0.9 percent on the year. In the east there was a 5.1 percent rise on the month, but a 1.4 percent fall year-on-year.

The economics ministry revised the figure for July month-on-month industrial output to an increase of 1.1 percent, from the earlier figure of 0.2 percent. The July year-on-year figure was revised to an increase of 1.1, from 0.5. In August, pan-German manufacturing industry output rose 1.7 percent from July and 2.4 percent from a year earlier.

ENVIRONMENT JOBS: Nearly 1m people in Germany make a living from environmental protection, making it almost as many as in vehicle manufacturing, IFO, the German economic research institute said. Environmental protection directly

employs 508,000 people while 448,000 are employed in manufacturing goods and services aimed at environmental protection.

UNITED KINGDOM

MANUFACTURERS' COSTS: Higher oil prices hit British industry in September, pushing up manufacturers' fuel and raw material costs and causing the first rise in factory output price inflation for 14 months. But the underlying annual rate of manufacturers' output price inflation, which excludes petrol, food, drink and tobacco, was the lowest for 29 years, easing fears that strengthening consumer demand was tempting manufacturers to make large price rises.

RETAIL SALES: The official figures come as Britain's biggest retailers report that sales grew strongly during September but at a slower rate than in August. The latest survey by the BritishRetail Consortium suggests that the buoyant pick-up in retail sales is not getting out of hand even though inflationary pressures remain subdued.

M4 MONEY SUPPLY: The Bank shed figures showing that its broad money supply measure M4, cash plus bank and building society accounts, edged further above the ceiling of the Treasury's "monitoring range" in September. M4 rose by a seasonally adjusted 0.8 percent, taking the annual rate of increase from 9.4 percent in August to 9.8 percent in September.

VEHICLE PRODUCTION: Vehicle production showed a sharp increase for cars and a small decline in commercial vehicles. Car production in the third quarter jumped by almost 21 percent compared with the same period last year, while commercial vehicle output fell by 6 percent on the corresponding period in 1995.

MACHINE TOOL EXPORTS: Machine tool exports rose 8.5 percent in the three months to August, compared with the previous three months, underlining the industry's growth during 1996, according to figures from the Office for National Statistics. Total turnover, on a seasonally adjusted basis and including domestic sales, increased 2.7 percent in the last three month

period compared with the previous one, and showed a 5.1 percent rise year-on-year.

CONSUMER BORROWING: Consumers borrowed a seasonally adjusted BP1.1bn (\$1.7bn) in September, the third successive month that borrowing has exceeded BP1bn, the Bank of England, the UK central bank, said. Consumer credit increased by 16.2 percent compared with the same month last year, the fastest year-on-year growth rate since comparable monthly records began three and a half years ago, the Bank said.

ECONOMIC GROWTH: The amount of goods and services produced in the economy rose by 0.8 percent between the second and third quarters of the year, as the service sector continued to grow strongly and manufacturing pulled out of the technical recession in which it has been mired since the end of last year.

The Office for national Statistics reported that output in the service sector expanded by 0.9 percent in the third quarter. Finance and business services continue to perform best. The modest pace of growth in industrial productave picked up in the third quarter, with factory output rebounding after three successive quarterly declines.

Activity in the construction sector picked up significantly in the third quarter while agricultural output grew strongly. Excluding oil and gas extraction, the economy grew by 0.8 percent in the third quarter, the same figure as for the whole economy. This is slightly above the rate that has proved sustainable in the past without putting upward pressure on inflation.

INFLATION DATA: The government's target measure of inflation rose unexpectedly in September, fueling concern that the consumer recovery is producing price pressures. Official figures showed the biggest monthly increase in clothes and footwear prices since records began almost 50 years ago.

The annual rate of headline inflation was 2.1 percent last month, unchanged from August, the Office for national Statistics

said. But underlying inflation, which excludes mortgage interest payments, rose to 2.9 percent in September, compared with 2.8 percent in August. Clothing and footwear prices rose 5.2 percent in September.

CONSUMER BORROWING: Consumer borrowing grew strongly again in August and the amount of notes and coins circulating in the economy continued to expand rapidly in September.

The Bank of England, the UK central bank, said that notes and coins circulating in the economy grew a seasonally adjusted 0.5 percent last month, slightly less than the 0.6 percent growth rate in August. This took the annual rate to 7.4 percent from 7.5 percent.

M0, the narrow measure of the money supply which includes notes and coins and banks' operational deposits, grew at an annual rate of 7 percent last month compared with 7.4 percent in August. However, the brighter longer-term prospect for spending was underlined by separate figures from the Bank of England which showed that consumer credit grew by a seasonally adjusted \$1.54bn in August. This was slightly less than the BP1.1bn consumers borrowed in July, but it was above the rwas more than City economists expected.

BUSINESS FAILURES: Fewer than 10,000 businesses failed in the third quarter of this year, down 6.6% from the same period last year, according to figures published by Dun & Bradstreet, the business information service. The biggest drop in failures, by nearly a fifth, was in London.

More than 1,900 businesses failed in the third quarter of 1995 compared with 1,548 this year in the same period. Mr. Philip Mellor, for Dun & Bradstreet, said the figures for the UK, excluding Northern Ireland, showed the second "significant" quarterly drop in the business failure rate in succession.

HOUSE PRICES: House prices are rising faster than at any stage since 1989 as mortgage lending has surged over the summer according to figures published by the Bank of England, the UK central bank, and nationwide building

society, one of the country's largest mutually owned savings and loan institutions. Nationwide says average prices have risen by 6.7 percent in the past 12 months, the biggest annual increase for seven years.

JAPAN

BANKRUPTCIES: Corporate bankruptcies in Japan fell 6.3 percent in the first six months of the financial year, the first year-on-year decline since 1994, Teikoku Databank, a private research agency said. But the number of bankruptcies, at 7,075, in the six months to September, marked the fourth half-year in succession that the figure has been above 7,000, suggesting companies still face substantial financial difficulties in a fragile economic recovery.

Most were attributable directly to weak demand, reflected in falling sales revenues, Teikoku said. But the number resulting from competitive price-cutting rose for the fourth consecutive half-year, by 40.6 percent from a year earlier. Total liabilities in the six-month period came to Y2,880bn (\$25.7bn), down 38.5 percent from the same period in 1995, the agency said.

DIFFUSION INDEX: Japan's diffusion index of leading indicators, a wide gauge of economic activity, fell to 33.3 percent in August, the first dip in five months below the 50 percent line between growth and decline. Compared with the previous three months, five indices worsened: inventories/shipments ratios of finished goods and raw materials; new job offers; real private machinery orders; the Nikkei commodity price index; and new car registrations. The coincident index of economic indicators fell further to 30 percent, the first time below 50 percent in three months, and the lowest since September last year.

Five of the indices changed to negative in August: industrial production; raw materials consumption; plant-operating ratio; large-lot use of electricity; and sales at small and medium-sized companies. Three stayed on the plus side, while two remained negative.

FUND COSTS FALL: The cost of long-term funds for Japanese

industry is to fall significantly, the country's top corporate lender, the Industrial Bank of Japan announced. The bank said it would reduce its long-term prime lending rate, as charged to top corporate customers, from 3 to 2.7 percent, the lowest since Dee comes as a consequence of a fall in interest rates on bank debentures, a big element in the cost of funds, since the end of August. Then, the Bank of Japan's latest quarterly report on the business outlook said the economic recovery was cooling. The reduction will also help to improve credit banks' competitiveness, enabling them to offer cheap long-term funding more closely linked to the BOJ's record low official discount rate of 0.5 percent.

RETAIL SALES: Sales at Japan's large retailers recovered from their recent dips to remain unchanged for September from a year earlier at Y1,672bn (\$15bn), following two consecutive months of year-on-year decline, the ministry of international trade and industry announced. The overall figure reinforced a patchy recovery in personal consumption from the summer, with recent improvements in company profits and the labor market pointing to continued growth in consumer spending. In July, at the height of the food poisoning scare, total sales at large retailers fell 4.1 percent. At department stores, mainstay clothing sales were particularly strong, growing 3.3 percent on the strong performance of women's autumn apparel.

UNEMPLOYMENT: The weakness of Japan's economic recovery was underlined by government figures which showed that the unemployment rate, which improved this summer, remained unchanged in September. The unemployment rate remained at a relatively high 3.3 percent, after falling for two months from a recent peak of 3.5 percent in May and June, according to the labor ministry. While the overall number of people with jobs has been on the rise, this has been countered by job losses from restructuring.

INDUSTRIAL OUTPUT: The ministry of international trade and industry said Japan's industrial output rose 1 percent last month, rather than the forecast 0.1 percent, following a fall in August.

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Miti expects output to increase 4 percent in October before falling 1.9 percent in November.

TRADE SURPLUS: The trade gap fell by 30.3 percent in September to ¥779.5bn (\$6.9bn), at the lower end of market expectations. That, however, still left the surplus for the six months to September, the first half of Japan's fiscal year, down 41.6 percent to ¥2,900bn, the biggest six-monthly drop in 16 years. The slight slowdown in the decline of surplus at the end of the first half is a consequence of lower import growth stemming from the depreciation of the yen.

CAR OUTPUT: Japan's car industry output inched ahead by 0.3 percent in the half-year to September, the first six-monthly rise in six years. According to the Japan Automobile Manufacturers' Association, the country produced 4.9m vehicles during the period. Output was helped by a last-minute spurt, 7.3 percent up in September alone, attributed to the launch of a range of sports utility cars and sedans in that month.

FOOD SALES: Sales at supermarkets rose 0.9 percent in September, the first increase in three months, according to industry figures. Food sales had been hit by a poisoning epidemic during the summer. Department stores, less reliant on food, did better, with a 2.3 percent rise in sales in September against the same month last year.

MACHINE ORDERS: Japan's private-sector machinery orders for August slipped 11.1 percent month-on-month, reflecting weakness in the semiconductor market, following a 13.6 percent jump a month earlier, according to the Economic Planning Agency. The fall in memory-chip prices that has hurt the semiconductor industry also led to a 48 percent year-on-year decline in receipts for semiconductor manufacturing equipment such as steppers.

The agency indicated that machinery orders excluding ships and power equipment were believed to be on a modest upwards trend in spite of the August downturn. On a year-on-year basis, orders in August were 11.4 percent higher than the same month last year, the agency said. The seasonally

adjusted machinery orders for August are still higher than those for June, according to the agency. August saw a significant decline on-manufacturing companies, government agencies and overseas customers. Orders from the public sector, in particular, which have been supporting Japan's fragile economic recovery, dropped 28.7 percent, underlining the slowdown in public works.

INDUSTRIAL PRODUCTION: Japan's industrial production declined in August but the longer-term trend remains upward, the country's ministry of international trade and industry reported. Factory output fell by 1.9 percent from a month earlier, the first decline for two months, largely because of weak production of cars, personal computers and microchips.

But output is estimated to have been higher in September, maintaining the pace of gradual recovery this year. Production in the July-September quarter is forecast to have risen by 1.5 percent on the previous three months. Shipments fell by 1.8 percent in August while inventories edged up by 0.6 percent. The rise in stocks was largely because of sluggish sales in the second quarter, Miti said. But there was also evidence some companies were increasing inventories in anticipation of higher consumer demand.

HOUSING STARTS: The construction ministry reported the sixth consecutive monthly rise four housing starts in August. Low rates on housing loans helped to maintain demand for new homes, and total starts in the month were 14.3 percent higher than a year earlier.

UNEMPLOYMENT: Japanese unemployment eased slightly in August, but the labor market remained weak, suggesting joblessness will continue to be a drag on economic growth for the foreseeable future. The unemployment rate fell to 3.3 percent, or 2.2m people out of work, from 3.2 percent in July, the second consecutive month of decline from the record 3.5 percent achieved in June, the government's management and coordination agency said.

That is low by western standards

because of unusually loose criteria used by the agency to define people in work. Using comparable statistics, private sector economists believe that Japan's underlying unemployment to the US, just under 5.5 percent. That does not include Japan's many more surplus workers who are employed in unproductive jobs, because of companies' reluctance to sack people. Unemployment is especially acute among the young, where the August rate was 6 percent for 15-24 year olds.

FOREIGN CURRENCY RESERVES: Japan's foreign exchange reserves at the end of September increased \$1bn from the previous month to \$215.03bn, rising for the 35th straight month and marking a new record for the 31st consecutive month, the finance ministry reported.

MERGER & ACQUISITIONS: The number of mergers and acquisitions involving Japanese companies in the January-September period rose 16.1 percent from the same period last year to 454, the highest number since 1990, Daiwa Securities reported. Outside Japan, Japanese companies were involved in 188 mergers and acquisitions, an increase of 31.4 percent.

FRANCE

TRADE SURPLUS: France's impressive trade surplus hit a new record of FF13.88bn (\$2.7bn) in August, spurred by a strong increase in exports, notably to the US. The seasonally adjusted figures took the surplus for the first eight months of the year to FF77.53bn, against FF65.38bn in 1995.

HOUSEHOLD SPENDING: French household spending on manufactured goods fell 1.5 percent in September, in spite of a second consecutive strong monthly increase in purchases of new cars, according to figures published by Insee, the national statistics institute.

The decline did not prevent household consumption for the third quarter as a whole from registering a reasonably strong 2.6 percent increase. But it augured

badly for the final quarter, when car sales are expected to be significantly lower, following the expiry on September 30 of a government incentive scheme for new car buyers. household consumption in September was still more than 4 percent up on September 1995.

By sector, consumption of textiles and leather was down 10.5 percent from August (and 9.9 percent from September 1995), while spending on household goods such as televisions and hi-fi equipment fell 6.3 percent (3.5 percent). Purchases of cars rose 18.8 percent, after a similar 18.4 percent increase in August.

CURRENT ACCOUNT: France's current account showed a seasonally adjusted surplus of FF98m (\$19m) in July, down from an unrevised FF8.18bn in June.

ECONOMIC GROWTH: The French economy will grow more strongly in the second half of this year, touching an annual rate of expansion of "a bit more than 2 percent" by the end of 1996, according to Insee, the official statistics agency. But in its published forecast, Insee sees the possibility that the increase in the number of jobless may "slacken its progression" but "without any significant improvement" in the level of unemployment which

touched a record 12.6 percent in August.

Insee predicts that the economy will expand 1.2 percent this year, compared with the government's own growth forecast of 1.3 percent for 1996. The increase will be led by a year-on-year rise in household consumption of 2.5 percent. But, partly because companies are still getting rid of old inventories, the annual increase in industrial output and in new investments will only be 0.2 and 0.4 percent. Overall growth is forecast to be 1 percent in the third quarter of this year and 0.4 percent in the final three months.

UNEMPLOYMENT: France's sea-

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