Princeton Economic's The World Capital Market Review

Issue #1 January 1996
214 Carnegie Center,Princeton NJ 08540 609-987-9522 Annual Subscription US$49.95

Investor's Worst Nightmare - Washington

Beam Me Up, Scottie

by Martin A. Armstrong

After spending a day trying to sort out what direction things are headed in Washington these days, the only phrase that comes to mind is "Beam me up Scottie!" Between the budget crisis, Whitewater, Travelgate, tax reform split, egos, snow storms and playing "who done it" with Hillary's latest socialist's manifesto for raising children, as if we need advice from a non-cookie baking attorney on that matter, and it becomes brilliantly clear - the markets are just confused. Perhaps a few more months of this toxic waste of time and the drug stocks might soar to record highs on massive sales of stress relief potions around Wall Street.

BATTLE OVER ETHICS

The Whitewater hearings continue to move forward in a very dicey manner. It appears that documents that have just recently been found by Mrs. Clinton among her personal things after several years of looking, have miraculously emerged immediately after statue of limitations have expired on any possible criminal wrong doing she might have been engaged in. Of course, there isn't anybody in the financial world who believes that Hillary actually traded her cattle futures making $100,000 on $1,000. Anybody that good just doesn't stop cold turkey. But of course Washington isn't smart enough to figure out that they should subpoena Tyson Foods and the attorney accounts in futures to see if corresponding trades might have been allocated at the end of the day placing the winners in her account and the losers in theirs.

Travelgate brings to mind the old saying "what goes around, comes around." Hillary served on the team that was trying to impeach Nixon for "lying" to Congress. Sure, it is not illegal for the Clinton's to fire all the White House travel staff and replace them with their Arkansas buddies, but it is wrong to make up fraud charges in an effort to pretend that they are bringing in an Arkansas travel agency in the best interest of the nation. But to lie to Congress is nothing different than the Oliver North controversy. The real question for the Republicans, can you really charge a First Lady with criminal activity? If Hillary is charged, does Clinton have the right to grant her a presidential pardon? Talk about a constitutional crisis, well the government budget crisis, tax reform and maybe the presidential elections themselves will all take a back seat to that debate.

At least one thing is clear, this entire mess is going to stop the rumors of long-term political goals for the Clintons. The idea behind giving Hillary the point on healthcare was so that the nation would see how she was a capable politician. Her profile was higher than that of the Vice President and some say that this was a long-term political strategy that backfired. The idea was that Bill would stay in the

White House for 8 years followed by Hillary as the first woman president coming to power in 2000. At least these goals are somewhat tarnished as many question whether Hillary even wrote her own book.

TAX REFORM

Tax reform is starting to split the Republican party down the middle. We have the same old boys like Jack Kemp, who gave us the fairer 1986 tax reform movement leading the charge for the flat tax. Nobody in the Armey-Kemp camp of theoretical tax reform has any practical real world experience. The flat tax camp is too thick-headed to listen to reason and can't see how removing deductions on real estate back in 1986 led to the collapse in prices followed by the S&L Crisis. The last thing we need is a flat tax that is more of the same type of reform as 1986. They don't have a clue that countless businesses borrow to fund inventory and by removing interest deductions they will cause a durable goods crash this time around. Of course they also fail to realize that by not allowing you to deduct taxes paid to state and local governments, we just might end up with the old British system of taxation where the combined tax rates hit 102%. Maggie Thatcher was elected to end that type of tax system and Armey-Kemp are trying bring it home to America as if it were the solution to all our problems. When it comes to lobbyists, the vast majority are licking their lips in anticipation of the flat tax enactment. One actually made a comment in private that the flat tax was going to set the scale back to zero so they get to start all over again. As long as you have any form of an income tax, it allows Washington to cut deals that the American public will never know about.

The pure retail sales tax group is also totally insane with tax fever. They think that by making taxes on business zero they will create jobs. What they don't seem to get is that business income taxes account for a small fraction of total revenue. The bulk of all taxes on business are actually carried out by the tax on labor. If you shift the tax burden on to the back of labor and away from business, then labor merely demands a higher wage to survive. This is the mechanism that drives our cost of production higher and reduces jobs. To make matters worse, a zero tax on business discriminates against America. Such a system asks nothing of foreign business operations with respect to contributing to the national infrastructure costs of America while placing the entire burden upon the American citizen.

Tax reform is going to be a big issue in 1996 and the battle between theory and reality has yet to begin. Clinton will have to stick his foot in this debate and he may come down with a sales tax because any state governor knows it produces more revenue than an income tax. A sales tax is also automatically indexed to "real" inflation on the street. The liberal Democrats are only interested in punishing the rich rather than looking at the impact of taxation on the middle class. The flat tax Republicans only see getting rid of the Liberal system of progressive tax rates as their goal while ignoring the dangers of a flat tax. The pure retail sales tax camp has a goal of getting rid of the IRS while falling short of understanding how taxation on labor costs businesses more than an income tax. So somewhere in this battle lies the truth - but getting it out into the full light of day is anything but easy.

BUDGET CRISIS

The budget crisis is an illuminating issue that goes directly to the heart of why serious reform is so desperately needed. We must ask ourselves, if Congress is in charge of authorizing spending and borrowing, then how is it possible for the Treasury to be able to fund the interest on the national debt for up to 1 year without the authority of Congress? The question that arises is quite simple. Who is really running the government? Do our elected officials run the government or is it the bureaucrats in charge of all the agencies? The entire debate over the budget crisis hinges on a deal to balance the budget in 7 years. The real interesting issue here is should we care? The projections used by government are static models meaning that since we cannot forecast the future, why bother? Therefore, all the assumptions that go into this projection of a 7 year balanced budget are based upon real world outcomes that are impossible anyway. Therefore, since interest rates will certainly change between now and 7 years from now, should we care if they proclaim victory for a 7 year balanced budget deal? No matter what they agree to, it doesn't matter because that projection will never prevail for the next 7 years. Unless we are talking about a Constitutional Amendment that specifically limits government spending to a precise calculation of GDP (Gross Domestic Product), there is no hope of solving our fiscal mismanagement problems.

INVERTED YIELD CURVE & THE CLINTON DEBT CRISIS

Pension funds and institutional investors are scrambling to buy bonds while companies like Coca Cola and Disney feel their pain and try to help by issuing 100 year bonds. Bill Clinton's Arkansas style of budget management is only now starting to rise to the surface as we move into an inverted yield curve. Clinton ordered the Treasury to cut the 30 year bond auctions in half and shift the national debt short-term. While Clinton argued that this would help bring long-term rates down, the truth of the matter is that he was enticed by the fact that short-term rates were half that of long-term rates back then. He quickly broke out his pocket calculator and said "gosh, if we can issue all short-term notes and bills, it will save a lot of money in interest expenditures!" As the light bulbs went off in the smoke and mirror room at the White House, the Clinton budget reduction plan was born. He then ran out to deliver his speech about how he cut the deficit by $500 billion -the "biggest" in history, so he claimed. The curious factor is that nobody cried! We didn't hear about children starving or tainted meat. But when the Republicans try to cut spending by $150 billion, everybody dies. The difference between Arkansas style political budgets and reality is to shift the debt to save interest and throw in another tax increase while raising spending to produce a deficit reduction plan. Obviously, it takes a lot more talent to do this type of deficit reduction than to simply cut spending in order to reduce the deficit.

The inverted yield curve that is now unfolding has 10 year rates below overnight fed funds rates. Clinton's deficit reduction ended up with one-third of the national debt funded 1 year or less. What is happening is that there is a lack of long-term debt supply and an excess of short-term demand coming from government. So while mortgage rates decline, government interest expenditures are starting to rise. This brilliant scheme is no different from that used in Japan when they bought long-term real estate and funded it with short-term debt. The end result, a massive inverted yield curve that rose from 1% to 6% in less than 2 years.

THE SUCKER PUNCH

While this soap opera has occupied the attention of investment capital, the real danger to investment strategies is silently creeping along - Russia! The political shifts that are taking place in Russia are along the lines of yet another major revolution. Originally, Yeltsin promised that he would step down in 1996. Well so much for political promises. Socrates was correct more than 2000 years ago -there is a politician under every rock. American or Russian, politicians are a breed unto themselves.

The real interesting silent revolution that is taking place right before our eyes concerns the cabinet members under Yeltsin. The reformers are all gone and they are being replaced by nationalists. Yeltsin's military posture has become much more aggressive and Vladimir Zhirinovsky's plan of refocusing Russia to look north to south rather than east to west is interesting. The southern flank of Russia contains rich oil fields - a vital national asset both economically as well as militarily. Islamic nations now represent a major threat to Russia's political stability. Add to this, the fact that Yeltsen has refused to declare himself as a candidate of any party, the political strategy to stay in power is to move toward the nationalists by handing them all the power behind the scenes. The question that remains, will Yeltsin be able to pull this one off? Like Clinton who is moving more center and away from Liberals in order to stay in power, Yeltsen's strategy takes Russia in the direction of confrontation with the West and away from democratic reforms. The first run off is scheduled for June 16th. All candidates are to run at that time and the top two candidates then face each other in the final election normally held a few weeks later. But the Upper House was supposed to expire in December and nothing has been done on that issue either. Given the fact that our political models show a major turning point for Russia being May 25th, 1996, this will mark the **END** of reforms and swing back toward the good old days of conflict, oppression and intrigue. This will have a very important impact upon the capital markets and your investment strategy for 1996 going into 1998.

MARKET OUTLOOK

Precious Metals

Here we see a consolidation period for the first half of 1996 with a bull market unfolding following June. As long as the metals do not exceed the January reaction high, then a retest of support should unfold going into the May/June time period. It is unlikely that gold would fall **BELOW** the $368 area but silver could still drop to at least $4.50 before any sustainable rally develops. A weekly close above $428.30 will warn of a breakout.

Bonds

Long-term bonds on a worldwide basis are generally pressing higher going into the April/May time period. January may represent a **LOW** for US bonds followed by a rally to new highs. Basis the nearest futures, we may see the final high come in around the 12800 to 13200 level.

Dollar

The dollar has clearly bottomed against the Japanese yen. While a retest of support is possible going into the April/May time period, we see the dollar rising significantly against the yen going into 1998. Against the Europeans, the dollar could still make one last new low going into April/May. However, the dollar will rise rather sharply following June moving into a high for 1998, some consolidation for 1999, and new highs into 2003.

The dollar seems poised to make new highs against the Canadian dollar during the first half of 1996. We see the C$ dropping to at least the 67 cent level but a move under 65 cents could lead to a final low around the 58-59 cent level. The A$ may also move back down to retest support against the US dollar during the first half of 1996. However, the major low is in place and we see a rather strong bull market for this currency going into 1998. Even against the C$, we see the A$ rising to about 12190 from its current trading level of near par.

US Share Market

The US share market remains very healthy - yet volatile. As long as the Dow backs off at this time and moves into a slight correction phase to consolidation period, then all will look well into the years ahead. Run for the hills ONLY if you see the Dow rising to the 5800 to 6000 area going into May. That will warn of a major high and a big crash ahead.

For now, initial support on the Dow begins at 4946 level followed by 4770-4698. Major support begins at the 4607-4551 area. Only a monthly closing BELOW 4551 will signal the end of a bull market for right now.

Canadian Share Market

The TSE has rallied rather well in the face of problems in Canada. This undertone of bullishness has been largely due to a clear trend for capital shifts away from government debt and into the private sector. At this time the primary support lies at the 4527 area followed by 4486. Monthly closing below this zone will warn that a retest of support is likely. The major resistance stands at the 4831 level. Once we see a monthly closing **ABOVE** this area, a test of the 5000 zone will follow. However, a move above 5000 points to a final major high coming in around 6325 or perhaps 6720 by 1998. Again, we do NOT want to see a new high in May. A new high at that time warns of a major crash thereafter much like 1987.

US Economy

The US economy appears to be slowing ever so marginally going into May/June. There does **NOT** appear to be a risk of any major recession at this time. However, we do expect to see a very serious correction to begin around 1998 going into 2003.

At this time, we do see that businesses will tend to pull back as they await to see what will happen with tax reform. The capital gains issue will be a big issue caught up in the middle of the budget crisis. This issue alone caused sharp short selling against the box, all in an effort to push profits into 1996 in hopes of lower capital gains.

The flat tax has serious implications for business with regard to interest deductability. Of course, Washington is too stupid to figure out that just maybe while this debate heats up, major financing deals could be postponed. This anticipation factor caused the recession to begin in 1981 and the peak in interest rates at that time. Once Reagan won the election, everyone began to pull back in anticipation that Reagan would seriously reduce inflation. In reality, Reagan didn't do a thing, but the end result was a sharp and swift recession. If this debate over tax reform is **NOT** settled and soon, the gradual slowdown in the economy could become a bit more severe leading into a recession that builds going into 1997.

For now, expect interest rates to decline slightly going into the May/June period with a rise thereafter. Unemployment will move slightly higher at this time but again the major risk of a sharp rise will come between 1998 and 2003.

UNITED STATES

DURABLE GOODS: New orders for US durable goods dipped in October but the underlying trend remained encouraging. The Commerce Department said orders fell 1% in October but remained 8.1% higher than in the same period the previous year.

The decline mainly reflected an erratic 10.5% drop in transport orders, which are volatile on monthly basis. Excluding the transport sector, orders rose 2.3%, to register their third consecutive gain.

INDUSTRIAL PRODUCTION: The Federal Reserve revised estimates of US industrial production, which showed a drop of 0.4% in October against the 0.3% previously reported.

The rate of industrial capacity utilization was revised down to 83.2% from 83.6%, indicating reduced risk upward pressure on materials prices

PRODUCER PRICES: US producer prices rose by an unexpected 0.5% in November, but this was not seen as signaling a sustained increase in inflationary pressure. In their half-yearly economic forecast, purchasing managers predicted sluggish growth, weak capital investment and near static prices in 1996.

Economists said the producer price figures were distorted by an erratic 1.3% in car prices in November, partly caused by the timing of the release of the 1996 models. Elsewhere, price movements were largely offset: food prices rose 1.2% but energy costs fell 0.5%. The overall index rose 2% on an annual basis.

LEADING INDICATORS: The official index of leading indicators dropped sharply in October. The Commerce Department said the index - designed to predict business cycle troughs and peaks - fell 0.5%, more than expected. The fall mainly reflected an unusually large drop in materials prices, another sign of subdued inflationary pressure. The leading index has fallen in seven of the past 10 months.

"BEIGE BOOK": The Fed released its latest "beige book" of regional business conditions. This pointed to slower growth but gave no hint of a sharp contraction of activity. The economy was expanding "but at the somewhat slower pace reported in the last beige book", the Fed said. Car sales were down but their were signs of a pick up in retail spending in November after weakness in October.

Construction spending was also stronger then expected with expenditures reported up 2.6% between September and October.

RETAIL SALES: The Commerce Department said retail sales rose 0.8% in November, against projections in financial markets of an increase of 0.5%. Excluding cars, which tend to be volatile on a monthly basis, sales rose by 0.9%

The increase in sales was broadly based. Sales of clothing, building materials and furniture were up 2.8%, 2% and 1.5% respectively from October.

UNITED KINGDOM

INDUSTRIAL PRODUCTION: Official figures showed that Britain's industrial production fell a seasonally adjusted 1% in October, largely because of the unusually hot weather. Manufacturing output grew by a seasonally adjusted 0.2% in the month, roughly in line with expectations. The decline in overall production was attributed to lower gas and electricity output, as consumers cut back on fuel consumption.

Some City economists said the data was evidence of a slowdown. They warned that growth could slow even more sharply in the months ahead because official data suggest that industry is holding excess stocks. These fears about broader economic growth were strengthened by signs that the Central Statistical Office's leading indicators, which plot trends months in advance - continue to point to a downturn.

The Treasury insists that growth remains on a steady path. Officials expect some de-stocking to occur in the coming months, they believe this will be gradual. Meanwhile, some officials - and Mr. Kenneth Clarke, the chancellor of the exchequer - suspect that the CSO data on stocks and growth may be inaccurate and will be revised.

M0 MONEY SUPPLY: M0, the narrowest measure of money supply, grew by a seasonally adjusted 0.7% between October and November, and by 5.6% in the year to September. This rate was faster than the previous two months. Much of the increase was caused by a surge in the bank's operational deposits. Although these form part of the data, they are highly volatile and thus are usually discounted by economists. However, the growth also reflected a continued steady expansion in the level of notes and coins, which account for the rest of M0. These grew 0.5% between October and November, and 5.7% in the year to November.

M4 MONEY SUPPLY: The Bank of England said the annual rate of growth in M4, the broadest measure of money supply, grew by a seasonally adjusted 9.3% in the year to November up from an upwardly revised 8.9% in October.

This was the highest rate since April 1991. It also takes the annual growth rate of M4 above the top of the government's monitoring range of between 3% and 9% for the first time since the range was set up in the March 1993 budget.

In spite of the strong monetary growth, M4 lending by banks and building societies (mutually owned savings and loans institutions) was subdued. It rose by 8.2% in the year to November, down from 8.7% for the year to October

INFLATION: UK inflation fell in November for the second consecutive month to its lowest rate for almost a year. The Central Statistical Office said the headline annual rate of inflation was 3.1% in November - slightly lower than the 3.2% recorded in October.

A decline in motoring costs - in particular a fall in used car prices - contributed most to the drop. But smaller rises than last year in the prices of food and household goods and sharp reductions in alcohol prices, as shops cut prices in the run-up to Christmas, also had an impact.

RETAIL SALES MONITOR: The British Retail Sales Consortium, the shops and stores trade association, published for the first time its retail sales monitor.

The monitor, published monthly, is based on actual sales data and anecdotal evidence from a sample of 75 large retailers who account for more than half of the total UK retail sales.

It measures the growth in the value of retail sales, unadjusted for changes in prices or holiday periods, each month compared with the same month earlier.

The consortium said the survey of retailers covers the same period as that covered by the Central Statistical Office's own figures on retail sales and is therefore comparable with the official statistics.

But it said that the monitor had an advantage in that it was published a week ahead of the official figures. It said its objective was for the monitor to be the "earliest authoritative measure of monthly retail sales in the UK". The consortium also said that the monitor would provide a more useful guide to retail sales than the British Industry's distributive trades survey.

The monitor found that although the value of goods sold in Britain's high street shops grew modestly in November, consumer spending remains fragile.

It showed that the nominal value of retail sales last month was 3.2% higher than in the same month a year earlier on a like-for- like basis - which adjusts for changes in the retailers floorspace.

The consortium said the latest monthly rise was a modest pick up from the 2.4% annual growth in October but it was weaker than the 3.4% annual growth rate in September.

TRADE DEFICIT: The CSO said that Britain's trade gap with countries outside the EU more than halved in November as exports rose to a record level. The visible trade deficit was BP0.5 billion ($0.77 billion) compared with BP1.2 billion in October. Exports rose to BP5.8 billion from BP5.3 billion in the previous month while imports fell to BP6.3 billion from BP6.5 billion.

The CSO said the increase in exports was spread across all sectors, with particularly strong growth in semi-manufactured goods such as iron, steel and finished manufactured good.

Imports of food, beverages and tobacco declined, reversing the previous month's large increase. There was also a big drop in imports of basis materials and semi-manufactured goods.

The CSO's estimate of the longer-term trend now shows exports rising slightly faster than imports with the deficit remaining unchanged. In the three months to September, exports rose by 8.5% while imports rose by 6%

INSTITUTIONAL INVESTMENT: Institutional investment, which has been depressed since late 1994, recovered in the third quarter of 1995 as investment in non-UK assets rose to a record. Institutional investors such as pension funds and insurance companies made a total net investment of BP13.8 billion ($21.25 billion) in the third quarter, according to the CSO.

The CSO said this is a sharp rise from the BP8.9 billion invested in the second quarter and marked a return to the levels of investment seen until the third quarter of 1994. Spending on non-UK securities such as overseas company shares surged to BP4.8 billion from BP163 million in the second quarter.

There was also a large rise in net investment in short-term assets such as treasury bills which increased to BP3.8 billion in the latest quarter from BP1.4 billion in the previous three months. But purchases of UK government bonds, or gilts, fell to BP2.5 billion, the lowest level for almost two years. Institutions' net investment in UK company securities also remained low at BP1.5 billion.

BASE RATES: Mr. Kenneth Clarke, the chief finance officer and Mr. Eddie George, governor of the central bank cut interest rates for the first time in nearly two years. The cut was a quarter of a percentage point to a level of 6.5%.

Many mortgage lenders' basic loan rates dropped 7.5%, the lowest level since the late 1960's. Mr. George, who had requested an increase in interest rates only eight months ago, conceded for the first time that the government was on course to hit its current inflation target. He and the chancellor went out of their way to emphasize that they had both proposed a quarter point cut during their monthly monetary meeting.

Mr. Clarke said it was right to cut rates because the economy was growing at well below the its current long-term trend rate and because pressures on prices and costs was subdued.

The reduction followed three half-point increases since Mr. Clarke started tightening policy in September of 1994. Mr Clarke said he had decided to cut rates a by a quarter point rather than a half point because he expected growth to rebound in the second half of next year.

RETAIL SALES: The CSO said that retail sales volumes in November were a seasonally adjusted 0.6% higher than in October and 1.1% higher than in November of 1994. The CSO said BP3.3 billion in current prices and on a seasonally adjusted basis passed through shopkeepers' tills each week on average in November - 4.3% more than in November of 1994.

In the three months to November sales of household goods were 3.8% higher than in the previous three months. In the three months to November retail sales volumes were only 0.1% higher than in the previous three months. They were 0.4% higher than the same period in the previous year.

CAR REGISTRATIONS: Registrations of new cars rose strongly in November for the second consecutive month. Sales climbed by 12.8% to 143,055 units in November, compared with November, according to a report by the Society of Motor Manufacturers and Traders. The increase, which followed a rise of 11.5% in October on the same month of the previous year surprised the industry.

The two consecutive months of higher sales mean registrations in the first 11 months of 1995, at 1,873,826 are now almost 2% above the 1,837,696 cars sold in the same period the preceding year.

Although imports took a marginally lower 53.8% share of the market in November, compared with 55.2% in November 1994, the overall proportion of imported vehicles in the first 11 months of this year grew to 59.2% compared with 57.2% between January and November 1994.

LEVEL OF SAVINGS DROPS: The CSO said that individual's real personal disposable income fell by 0.2% between the second and third quarters, but consumers expenditure grew by 0.6%.

The shortfall was financed by savings - the savings ratio, which measures personal savings as a percentage of total personal disposable income, dropped to 8.6% from 9.3% in the second quarter.

TRADE DEFICIT: The current account - which measures trade flows and financial transactions between the UK and the rest of the world was BP1.3 billion ($1.99 billion) in the red between July and September, according to the CSO. The City expected a deficit of about BP2 billion.

The CSO also announced that the deficit in the second quarter was only half as large as it thought three months ago at BP1.2 billion and that the first quarter deficit was a third lower than previously calculated at BP0.9 billion.

This means that the total deficit for the three quarters of 1995 now stands at BP3.4 billion - less than the figure previously published for the first two quarters.

The second quarter figures were revised because it appears that Britain sold more financial services abroad than earlier surveys suggested.

GERMANY

INDUSTRIAL OUTPUT: The output of German industry declined markedly during October, according to provisional data which underlined the continued weakness of the German economy.

The fall in German production came despite a strong rise in exports, which increased by 6.5% during September. The data suggest strong export sales are alleviating some of the effects on industry of weak domestic demand.

The data showed pan-German industrial production in October 1.6% below September's level, and 3.4% below the same month last year. The consensus view among economists is that the figures were consistent with other evidence pointing towards a period of slow growth, though well short of a recession.

TRADE SURPLUS: The trade surplus rose from DM55 billion ($38 billion) in the first nine months of 1994 to DM67.6 billion in the same period this year. In September, exports were up 6.5%, compared with September 1994, while imports were up 2.2%.

ECONOMIC GROWTH: The German economy experienced zero growth during the third quarter. Pan-German gross domestic product was unchanged in the third quarter against the second quarter of 1995, and only 1.5% larger than in the third quarter last year. The year-on-year rise was the weakest for almost two years.

The weakness in the third quarter is largely a result of a 3.4% fall in investment in machinery and equipment, compared with the previous quarter.

UNEMPLOYMENT: Seasonally adjusted unemployment rose 42,000 to 3.71 million, equivalent to 9.7% of the labor force, in October. Unemployment in eastern Germany rose from 13% in November last year to 14% this past November.

GROWTH FORECAST REVISED: A leading German economic research organization revised down sharply its expectations of growth in 1996. The Munich-based Ifo economic research institute now expects growth to slow to 1.75% next year from 2% in 1995 after forecasting growth of 2.5% for 1996 and 2.25% this year as recently as October. Ifo forecast stronger growth in the second half of 1996, supported by domestic demand. Ifo believes there may be scope in the spring for a further cut in the discount rate and blamed weak investment for the lower forecasts.

INTEREST RATE CUT: The Bundesbank cut German short-term interest rates in December for the third time in 1995 in an attempt to revive a stalled economy.

The Bundesbank's half a percentage point cut in the discount and Lombard rates, to 3% and 5% respectively, brought them to their lowest levels since July 1988.

Interest rates were also cut in Switzerland, Belgium, the Netherlands, Austria, Denmark and the Irish Republic. The cuts, which came a day after the UK base interest rates were reduced, were closely coordinated. Most central banks cited currency movements and falling interest rates as the reason.

Mr. Hans Tietmayer, president of the Bundesbank said there was "no threat of recession". The reduction in interest rates should not be seen as a confirmation of pessimism about the economy and did not mean the Bundesbank was following anti-cyclical policies.

The Bundesbank, which also fixed the rate for the next three securities repurchase (repo) deals with commercial banks at 3.75% compared with the current 3.98%, linked the rate cuts with setting of a new money supply goal for 1996. The target growth range for the M3 monetary aggregate has been fixed at 4-7% for 1995, slightly higher than the 4-6% for this year.

But the M3 has expanded at well below the target range, with an annualized rate of 1.7% in October and November. Mr. Tietmayer said the cut in rates would help ensure M3 again grew at a rate consistent with potential economic growth.

M3 MONEY SUPPLY: The weak trend in German money supply continued in November as M3 grew at an annualized rate of only 2%. This leaves it well under the 1995 target range of 4-6%. The bank set an M3 target for 1996 of 4-7%. November's rise in M3 was the largest in 1995 and compares with a rate of 1.7% in October.

The Bundesbank said bank lending remained high in November, growing by 7.8% on a six monthly annualized basis against 7.2% in October. Monetary capital formation (in which funds to longer-term investments outside M3) grew more slowly at a 7% rate after October's 8.1%

ECONOMIC GROWTH TO RESUME: The Bundesbank said German economic growth was set to resume after a short period of stagnation. The central bank's monthly report on the economy was less pessimistic than some assessments of recent economic data. It acknowledged that the "actual situation and businesses outlook has been perceived increasingly badly" this year, but added: "Such periods of slowdown have been observed in previous phases of [economic] upturn."

It noted that the German council of economic experts had forecast growth for this and next year of 2%, which is in line with, or at the lower end of, most national and international expectations.

JAPAN

CURRENT ACCOUNT: Japan's current account surplus halved in October, a consequence of a plunge in the rate of growths of exports to US and Asian countries.

The surplus shrank by a far greater-than-expected 51.8% to $4.3 billion in the year to October, according to preliminary figures from the Finance Ministry, the second monthly decline in a row.

This is the biggest drop in the current account gap for five years. Finance ministry officials expected the declining surplus to continue.

Within the total surplus, the gap in trade in manufactured goods fell 32.7% to $7.6 billion, reflecting a fall in car exports to the US, while the deficit on the services, where Japan is traditionally in the red, expanded 43% to $2.49 billion, on a surge of overseas travel.

Exports overall rose 1.3% to $33.8 billion, the slowest growth rate in three years; imports raced ahead 18.5% to $26.3 billion.

The rise in Japan's foreign purchases came across a wide range: office equipment, up 82%; electronic equipment, up 75%; and cars, up 12.2%.

On the services account, the tourism deficit grew 43% to an October record of $3.08 billion, as an all-time monthly record of 1.3 million Japanese took foreign trips. The outflow of long-term capital account increased to $10.69 billion, reflecting a rise in purchases foreign bonds.

GDP: Japan's economy grew less feebly than expected in the three months to September, ahead an annualized 0.6% in real terms, avoiding a depression but still well short of a recovery. According to Mr. Makato Kobayashi, vice-minister of economic planning, the result puts Japan's GDP on track to expand 1% in the fiscal year to next March.

On a nominal basis, not adjusted for inflation, GDP fell 0.4% year on year, the third consecutive quarter of decline, the longest since the second world war.

The latest growth figure reduces political pressure on the government to add to the record fiscal and monetary stimulus it has delivered since August. A meager 0.2% growth in GDP compared with the previous three months came chiefly because of a stronger -than-expected rise in private spending.

Private consumption rose by 1.2% over the previous quarter, led by increased spending on cars and clothes, to contribute 0.7% to the overall growth rate. a decline in exports, led by a falling car sales to the US, removed 0.5% from GDP growth.

PLANS TO INCREASE SPENDING: The government's draft budget for 1996 proposed the sharpest rise in Japanese public spending for five years , to cover the rising debt costs and the controversial rescue of housing loan companies.

The draft envisages a 5.8% increase in spending to Y75,105 billion ($735 billion) in the fiscal year starting in April, funded by the largest annual issue of state bonds in the country's history.

The government plans to borrow Y21,029 billion next year, bringing the central government debt to a record Y240,000 billion, an increase that economists believe will put upward pressure on interest rates. If local government debt is included, that would bring Japan's general government deficit nearly level with its gross domestic product, well above the average for industrialized nations.

Mr Masayoshi Takemura, finance minister, expressed "deep regret" over the rise in debt and warned that drastic reform of the tax and government spending systems was unavoidable.

The budget estimates that next year's tax revenue will fall by 4.4% to Y51,345 billion because of the slowness of the economic recovery. On spending, the government expects to pay Y13,221 billion to service existing debts next year, up nearly a quarter on the previous year to stand at 28% of spending, the highest in 15 years. General spending on government programs is to rise 2.4% to Y42,141 billion. The biggest chunk goes to social security, also up 2.4% to Y13,942 billion, a result of the growing demands of an aging society.

Most of the budget was i line with expectations except for the housing loan rescue. As well as the Y685 billion to be earmarked now, the government is committed to underwriting a proportion of any other debts of the housing lenders that prove to be irrevocable. That will require at least another Y600 billion. The lenders have more than Y6,000 billion in uncollectible loans, representing half their total loan books.

COMPUTER CHIPS: Foreign companies share of the Japanese computer chip market hit a record 26.2% in the third quarter, the US government said. The previous record was 23.7% in the fourth quarter of 1994.

Foreign chip makers' market share was 22.9% in the 1995 second quarter, according to the US trade representative's office. Mickey Cantor, the US trade representative said the rise in foreign companies' share of the Japanese semiconductor market since a 1991 agreement to open up that market to US and other foreign producers showed that the renewal of the agreement was needed to maintain progress.

The Japanese chip industry has urged that the agreement be allowed to expire next summer. US industry has called for it to be renewed.

INCREASE IN BUSINESS SPENDING BUT BUSINESS FAILURES GROW: Japanese companies have started to spend more on plant and equipment, but the number of business collapses continue to rise. Corporate capital spending in the three months to September rose 5.1% against the same period last year, according to the finance ministry. That came after a 1.9% year-on-year rise in the three months to June, the first such increase in 3 1/2 years and proof that capital investment may have hit bottom, an official said.

Teikoku Data Bank, a credit research agency, said there were 1,257 corporate bankruptcies in November, up 5.2% on the same month last year and the 10th monthly increase running.

Corporate casualties' liabilities of Y971 billion ($9.6 billion) in November brings total liabilities left by collapsed companies to just over Y7,960 billion in the first 11 months of this year - a record. Cost-cutting by big companies continues to depress profits at their subcontractors, the backbone of the industrial economy.

CONSUMER PRICES: Consumer prices in Tokyo, an advance indicator for Japanese inflation, fell by 1% in the year to November, the biggest drop in 40 years, according to the government's management and coordination agency.

The decline was entirely due to a one-time 27% fall in fresh vegetable prices after an unusually sharp rise in November last year. But even adjusting for this, the underlying trend is for prices to be stable or falling slightly, a continued constraint on economic growth.

If fresh food is excluded, Tokyo consumer prices fell by 0.1%, in line with the previous trend. Official figures, however, include rising prices in such regulated sectors as transport and utilities and exclude discount retailing

Falling import prices, a consequence of the falling yen, have been one factor in deflation.

MOTOR INDUSTRY BUYS US. COMPONENTS: Japan's motor industry bought US components worth a record $10.3 billion in the six months to September 30, according to the Japan Automobile Manufacturers' Association. The purchases, an 8.3% increase in the same period in 1994, may help to ease trade frictions between the two countries, which agreed on a package of measures to encourage purchases of US made motor components last August. The April-September 1995 figure is well ahead of the previous record of $9.5 billion for the same period in 1994. But only $1.7 billion of this represents direct sales of US components to the domestic motor industry, an increase of 9.8% over the same period in 1994.

MACHINERY ORDERS: Japanese producers of computers and semiconductors went on a machinery buying binge in October, according to the government's Economic Planning Agency. Their purchases led an 11.8% rise in overall private sector machinery orders to Y1,100 billion (10.9 billion), the highest in four months. Machinery purchases are closely watched by Japan's economic policy makers, as an advance indicator of corporate capital spending.

Machinery orders rose 4.6% in the year to October. That more than made up for the 0.9% drop in the previous month, which marked a pause in 15 consecutive months of increase.

UNEMPLOYMENT: Japan's unemployment rate hit a record 3.4% in November, increasing pressure on the government to deliver economic recovery before the 1996 election.

The main reasons for the increase from 3.2% in October was a sharp rise in joblessness among young people and the continued decline of manufacturing jobs as companies shift capacity to cheaper locations overseas.

Within the total, the jobless rate for males aged 15 to 24 rose by 1.1 percentage points in the year to November to reach 6.3%, nearly double the average unemployment rate. Japan's high youth unemployment is a consequence of recruiting curbs by companies to cut costs.

AUSTRALIA

CONSUMER CONFIDENCE: According to the Newspoll conducted by the Australian newspaper, Australian consumer confidence has changed little in the past six months. The opinion poll shows 56% of consumers expect their standard of living will be little changed in next six months, against 58% in a similar poll in June. Those expecting an improvement were 20%, up from 17%, and those that expected their standard of living to deteriorate dropped to 20% from 22%. Those who were uncommitted rose to 4% from 3%.

ECONOMIC GROWTH PREDICTED: Mr Ralph Willis, Australia's federal treasurer, released the treasury's updated budget forecast showing a soft, but still growing economy for the 1995-96 financial year.

Gross domestic product growth is forecast to be 3.25% during the 12 months against an estimated 3.75% in the original forecasts in May. Headline inflation is predicted to emerge at 4.75%, a significant upward revision from the previous 4% figure.

Unemployment is now expected to be about 8.25% by the June year- end, against 8% previously.

The current account deficit has undergone a sharp downward revision: the forecast now stands at A$21 billion (US$15.5 billion) - A$27 billion last May - reflecting the recent pickup in export performance and the decline in imports. The new figure would amount to about 4.5% of GDP, from 5.5%.

The slowdown in growth stems partly from a more moderate rise in private consumption expenditure - 3.25% against an estimated 3.75% previously - and partly from a marked fall-off in business investment, expected to grow 8% (13%).

Mr. Willis said the government still expected a nominal budget surplus during the year, but the figure is now put at A$115 million, compared with A$718 million when the 1995-96 budget numbers were first unveiled in May.

STABLE RATES EXPECTED: Australian Treasurer Ralph Willis said there are no implications for interest rates in estimates for slower growth and accelerating inflation in the year ending June 30, 1996. However, he said recent cuts in interest rates in the US, the UK and in Europe are a factor for domestic rates.

NEW VEHICLE REGISTRATION: Australian new motor vehicle registrations in November fell 5.4% from October, the Bureau of Statistics. Registrations were down 5.2% on the year. The monthly decline followed a 4.0% increase in October. The Bureau said registrations for all vehicles in November fell to 49,288 from a revised 52,117 in October. Registrations of other vehicles, including commercial vans, fell 7.5% in November to 7,700. That was a drop of 16.5% on the year.

WESTPAC LEADING INDEX: A widely watched leading indicator on the Australian economy fell 0.6% in October, underscoring expectations economic growth will slow into 1996.

The Westpac-Melbourne Institute monthly index measures where the economy is likely to be in the next six months. The leading index has posted below average or negative growth rates the past 10 months. That compares with the early 1990's when the growth rate was negative for 26 months and the mid 1980's when growth was negative for nine months, according to Westpac Bank General Manager Economic Strategy Bill Evans.

MERCHANDISE IMPORTS: A larger-than-expected increase in merchandise imports in November indicated economic activity remains robust. Imports rose to A$6.30 billion (US$4.67 billion). That is the highest value imports have reached since July and compares with A$6.08 billion in October. Forecasts were for an increase of about 1.8%.

CURRENT ACCOUNT: Australia's current account deficit widened slightly in October to A$1.6 billion seasonally adjusted, largely because of the downward revision in the September figure to A$1.48

billion. The September deficit had previously been put at A$1.57 billion. In October, exports were slightly weaker at A$5.96 billion, against A$6.03 billion the previous month and A$5.52 billion a year earlier. Imports were A$6.075 billion against A$6.06 billion in September. The figures were in line with expectations, but revisions taking the August and September figures below A$1.5 billion were welcomed by government ministers.

CANADA

M1 MONEY SUPPLY: Canada's M1 money supply rose C$584 million (US$428.34 million) to C$60.375 billion in December from November, according to the Bank of Canada. M1, which includes currency in circulation and demand deposits, totaled C$59.791 billion in October.

M2 money supply, all the components of M2 as well as savings deposits, fell C$202 million to C$381.694 billion from C$381.896 billion.

Canada's M3 money supply in November totaled C$468.727 billion, up C$5.216 billion from October's C$463.511 billion, the bank said. M3 consists of M2 along with non-personal fixed-term deposits and foreign currency deposits of Canadian residents deposited in Canada.

GROSS DOMESTIC PRODUCT: Canada's GDP fell 0.3% in October from September because of reduced consumer spending, according to Statistics Canada. October's report was worse than economists had expected. All figures are seasonally adjusted.

Real gross domestic product fell to C$542.348 billion in September, the federal statistics office said. Statscan said October's report was hampered by a weakness in consumer spending. Reduced domestic demand also acted as a drag on business and personal services, and a drop in home resales restrained growth in the finance group, Statscan said.

WHOLESALE TRADE: Canadian wholesale merchants' sales fell 1.9% to C$20.092 (US$14.72 billion) in October from September because of plunging auto sales, StatsCan said. The decrease followed two monthly sales gains and countered economists' expectations of a 0.3% increase. September's sales were revised higher to C$20.449 billion. All figures are seasonally adjusted.

Among the biggest monthly sales declines was a 5.3% decrease in wholesale sales of motor vehicle and parts. Such sales account for 10% of total sales. Sales of household goods fell 6.6% and wholesale sales of computers and software dropped 3.6%, the federal statistics agency said.

StatsCan said wholesale sales have shrunk 3.2% since they peaked in February. Before then, sales had been on a two-year accelerating trend, climbing 25% from January 1993.

Inventory levels climbed for a 20th consecutive month to a record high of C$31.732 billion, up 0.9% from September's C$31.441 billion and 9% higher than the year-earlier month. September's inventories were originally reported at C$31.315 billion.

DEPARTMENT STORE SALES: Canada's department store sales rose 0.4% in November to C$1.181 billion (US$865.2 million) from October, according to StatsCan. In the first 10 months of the year, department store sales rose 4.6% compared with the year earlier period. All figures are seasonally adjusted.

Statscan said sales at discount department stores have gained at major department stores' expense such that they now account for 55% of total sales.

JOBLESS CLAIMS: The number of people receiving unemployment insurance in Canada rose 0.8% in October to 740,000 from the previous month, StatsCan said. The number of Canadians filing new claims rose 1.6% to 260,000. All figures are seasonally adjusted.

On an unadjusted basis, unemployment insurance benefits paid out in October totaled C$963.372 million (US$705.8 million), up 12% from the month earlier C$859.302 million. Such payments were down 6.5% from a year ago. StatsCan said October's average weekly jobless benefits payment edged up 0.7% from their year-earlier month the C$254.34.