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The Coming Great Tax Depression

by Martin A. Armstrong

There are many in Washington who would like to see the issue of tax reform fade away into the sunset. Many indeed hold the opinion that tax reform is just too difficult. Just when the momentum for tax reform was reaching a level of national significance, the Republicans bit off there own foot to win the primary. In order to get rid of Steve Forbes, they had to kill the Flat Tax.

While the Flat Tax is far from a good idea, it did serve its purpose to highlight the coming Great Tax Depression that now appears unavoidable. The last Great Depression was in part expanded by the tariff wars as countries fought over protecting jobs. This time around, the landscape has changed. Government has expanded so vastly since the 1930s that it now is in serious trouble. With deficits mounting, the demand for revenue is increasing. Along with this demand for revenue comes more aggressive enforcement of tax codes as well as tax increases.

Internationally, governments are all becoming far more aggressive. In Germany, they have raided institutions looking for records of clients who have placed funds off-shore. In the UK, Glaxco Welcome is in a heated battle trying to desperately limit government's legal ability to audit international income to 10 years. In Japan, the government is widely rumored to be preparing personal tax IDs for all its citizens.

These trends are not restricted to outside markets. We find the same thing developing here in the United States. California has opened tax collection offices in New York seeking out business that might be conducted in their state even by telephone. States are trying to capture revenue from nonresidents on a national scale. This is even taking place at the city level. For example, Philadelphia demands a wage (income) tax from anyone visiting the city. Sports teams, conventions, entertainers and more are all being taxed in the city even if they do not benefit or use the city services.

This is a dangerous international/domestic trend. We are embarking on the era of greed from the government perspective. As each level of government seeks to increase its tax revenues, a free-for-all is slowly emerging. Since these tax authorities do not care how much tax you may have already paid to another tax authority, the combined tax rate can rise sharply, as was the case in

Britain when the COMBINED tax rate hit 102%.

The next Great Depression will be caused once again by the mismanagement of government. However, the driving force of this future event will be the unsound finance of government desperately in search of increased revenue.

Our timing models show that the threat of such a depression is likely to emerge in 1998. The length of this debacle appears to extend into 2003. Therefore, we have been talking about government debt and the deficit for years. But it appears to be the 1998-2003 time period where this crisis comes to a head.

The greed and mismanagement of government is simply the driving force behind the marketplace. It is why the majority have been confused by the bond and stock markets. This very issue is the heart and soul of our future. Because of this problem, government has been constantly revising the CPI (Consumer Price Index) in a desperate attempt to portray that inflation does not exist.

As government attempts to manipulate its inflation indices, the net effect is to slow the growth of government entitlements and wages. All of these things are automatically indexed to inflation (CPI). If we can cut the inflation index in half, we will slow the growth of expenditures. At the same time, if we can increase the tax rates or reduce the deductions from taxes, we increase revenues. This is the two-front war that has been waged and will continue to expand into the year ahead until the bubble bursts.

While President Clinton ran in 1992 promising to make the rich pay their fair share, he did nothing for the rest of America. People didn't vote for Clinton because they wanted to see the rich hurt more, they wanted relief. By raising taxes on the rich, some thought that this would benefit them by lowering their taxes. It did not! Nothing was

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accomplished other than lower economic growth for all and greater job insecurity.

The very issue of taxation sets the tone of a nation by determining its very fabric. We are facing a period ahead where we will wake up to the shock that our worst nightmares have not faded with the coming of a new dawn. Taxation is the means through which government communicates to the masses. It has always, and without exception, been the deciding factor for the future. Taxation has set the course upon which the future sails and this moment is no different from any of those in the past. With the best of intentions, all governments ultimately commit suicide. The question that remains - Are we any wiser than our fathers who also fought and died under the slogan **"no taxation without representation?"**

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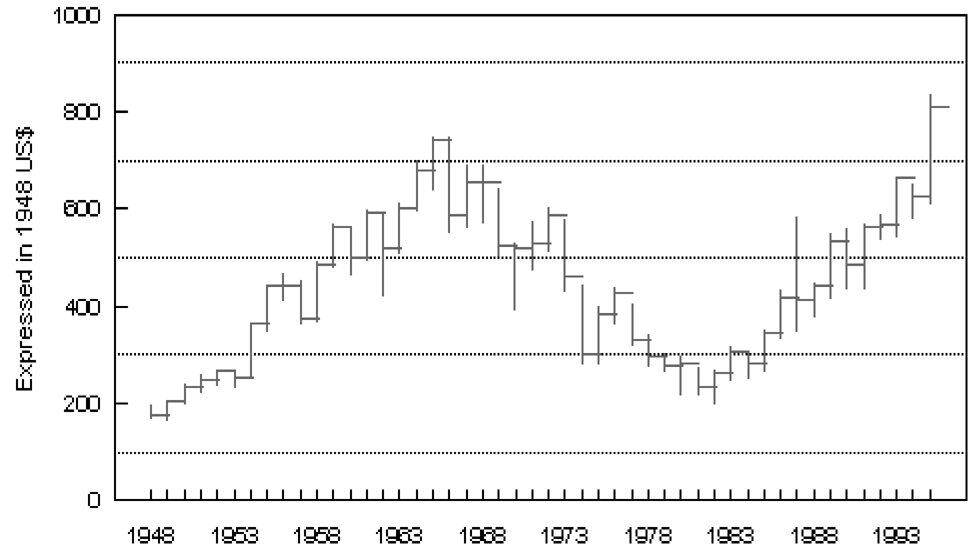
The Crash '96 or Bull Market of '96

The US share market has been rising nicely since the April low of 1994. The advance has been at times relentless - enough to surprise just about every analyst ever born. But there is something missing from the typical analysis that dominates the press nationwide as well as internationally. This is the question of value. Is the market overvalued or undervalued? To answer this question, we must at least frame the US share market in a familiar term.

While we tend to look at most economic oriented things in terms of adjusted for inflation, there are a two notable exceptions - commodities and investments. Most aspects of the economy are automatically indexed to inflation including not merely government programs like Social Security, but even short-term income taxes and, of course, wages. Yet when it comes down to commodities and investments, we do NOT take the effects of long-term inflation into consideration either in analysis or in taxation. Therefore, it is completely acceptable for wages to be up several hundred percent but not our investments. As soon as the stock market rallies in a big way, everyone screams that it is over priced. Nobody seems to argue that



point about wages, government spending or worse still, taxation (capital gains).

While inflation can have a positive impact on investments in nominal current dollars, at the same time inflation has a very negative impact upon savings. To some extent, Clinton argued this point in the 1992 elections claiming that the "rich got richer" while the poor and middle class didn't participate. This political statement, like so many, is not merely an outright lie, it has nothing to do with the actions of the rich. This is the net impact of rising inflation over the long-term. Tangible investments in nominal terms rise with inflation including the stock market. Savings, particularly cash invested in bonds, always decline or lag behind both stocks and real estate in purchasing power thanks to long-term inflation.

For example, $100,000 invested in a 30 year bond in 1965 was a SUBSTANTIAL amount of money. A home in New Jersey that currently sells between $250,000 and $300,000 cost only $14,000 30 years ago. A Cadillac sold for less than $4,000. Therefore, $100,000 in 1965 would have been enough to buy a home for cash and two cars while still leaving nearly

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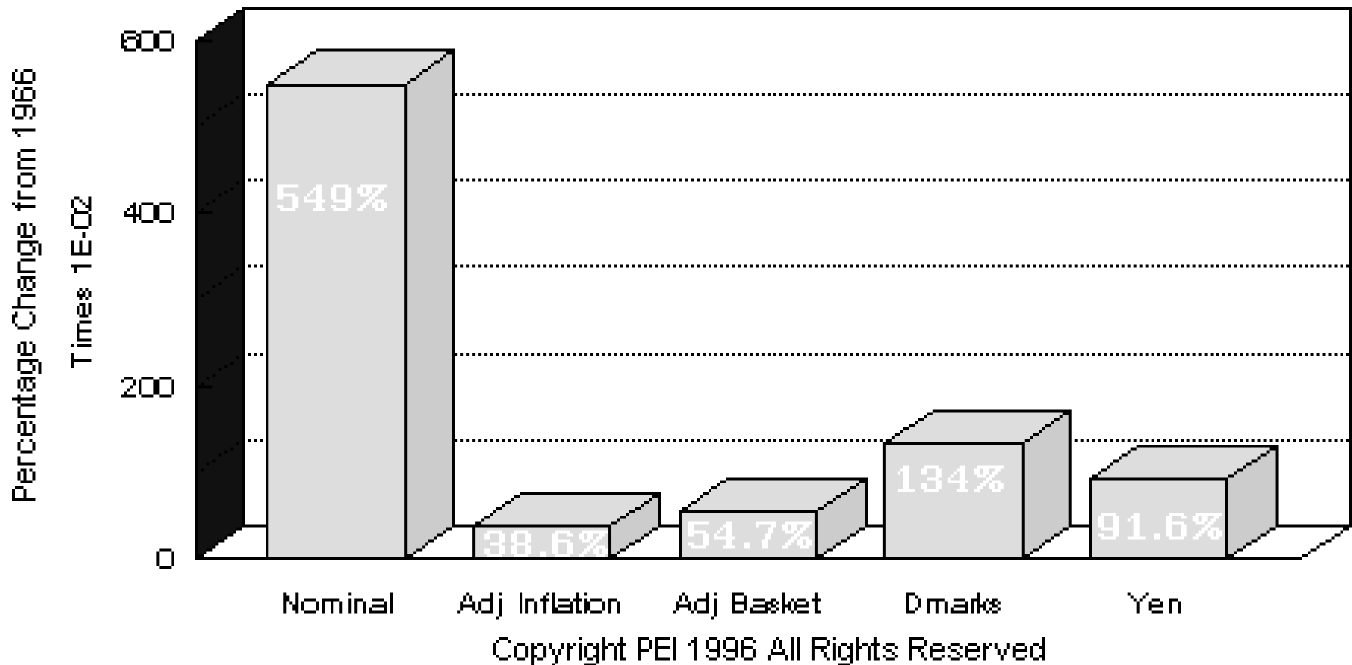

$75,000 in the bank. Take that 30 year bond and try to buy the same tangible assets and you find that there is no way you can even buy the same home for cash with the principal. Even if we include the accumulative interest compounded minus taxes at 30%, the nominal dollars earned for 30 years was $152,658 at 4.61%. Therefore, tangible assets do respond by rising in current dollar terms, albeit in an oscillating manner of boom and bust. Still, real estate prices have kept pace with inflation while savings (in the form of bonds) has not.

If we consider the fact that the Dow Jones Industrials first tested the 1,000 level back in 1966, at 5,000 the Dow has risen by 500%. Therefore, it would appear that the Dow might not be overvalued when compared to everything else within the economy as a whole but in fact might be finally catching up to the realities of long-term inflation.

Figure #1 illustrates the impact of the Dow Jones Industrials through the eyes of the government's inflation index (CPI). Here we can see that adjusted for inflation, the US share market was grossly undervalued as it reached a major bottom in 1982. Going into 1995, the Dow has finally exceeded the 1966 high only after 13 years. This suggests that instead of the US share market being way overpriced, the end result is that after 30 years, it has reached the same value it once held at the peak in 1966.

Figure #2 illustrates something very interesting. Here we have also expressed the Dow in a variety of perspectives compared to the nominal index itself. This chart illustrates that while the Dow may appear to have advanced 549% between the close of 1996 and the close of 1995, we do NOT see the same advance from any other perspective. Adjusted for inflation, the Dow is up only 38.6% since 1966. In terms of a basket of curren-

cies it has risen 54.7%. In terms of DMarks, the Dow is up 134% while in yen only 91.6%. The conclusion from this perspective is that the Dow appears overbought only in nominal terms while it still lags seriously behind in real terms.

In summary, the US stock market is merely trying to catch up to reality in terms of everything else in the world. While we do see a potential for a 20% decline in nominal terms, this is largely possible should the market continue to rally into the week of May 20th reaching between 5800-6200 on the Down Jones Industrials. Otherwise, a decline into a May low which is in the area of about 10%-12% is most likely going to continue its bull market going into 1998. At that time, the nominal high might very well be in the 7000+ zone. Given a very strong dollar, overseas investment could cause the Dow to reach closer to the 10,000 zone. Nevertheless, a 1998 high clearly warns of a sharp decline into 2003 where we could see a drop of some 40%. As far as we see right now, the risk of a major collapse does not seem to be ready at this stage in the game.

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UNITED STATES

ECONOMIC GROWTH: The government said that the economy grew by 0.9% in the final quarter, just one fourth of the rate in the preceding period. Last year's growth rate was the weakest performance since 1991, when the economy shrank 1%. The National Association of Business Economists forecast that GDP, the broadest measure of the economy, would grow 1.9% this year and 2.2% in 1997. Despite the slowdown in economic activity, the chance of recession was seen as only "one in four in 1996" the group said. The survey included 36 of the group's economists. The risk that the near 5-year expansion would slip into recession rose to one in three in 1997. The group warned that the failure of the Clinto administration and the Republican-led Congress to reach a long-term deficit reduction agreement could hurt economic growth and push up interest rates.

TRADE DEFICIT: The US trade deficit dropped to $7.1 billion in November, signaling a sharp improvement in the US external position and raising hopes of a sustained strength in the US dollar. The Commerce Department said the shortfall was the smallest since March 1994. The decline marked the fifth consecutive monthly improvement in the deficit, which hit a peak of $11.4 billion last June. The improvement reflected a 1% increase in exports to $67.4 billion - impressive given sluggish demand in many of US export markets. Exports in November were running 9.2% higher than in the equivalent period of 1994. Imports fell 0.7% to $74.4 billion, reflecting slower growth of consumer and business demand in the US. Imports were up in the year to November, but by only 4.6% - half the rate of growth of exports.

US bilateral deficits with most regions declined substantially. The deficits with Japan and China fell to $4.1 billion and $2.8 billion, against $4.8 billion and $3.6 billion respectively in October. The deficit with western Europe declined to $0.9 billion, against $1.1 billion in October. But the deficit with Mexico rose to $1.7 billion from $1.4 billion, reflecting continuing strains in Mexico after last year's financial crisis. The weakness of the US trade account in 1994, and in the first half of last year, was widely regarded as a main factor depressing the dollar on foreign exchange markets. The sharp improvement now apparently underway is expected to help the US dollar.

The US trade deficit in December was smaller than expected but figures for 1995 as a whole were the worst in seven years, the Commerce Department said. The trade deficit was $6.8 billion in December, marginally higher than a revised deficit of $6.7 billion in November, but confirming a trend toward lower monthly deficits evident last summer. The monthly deficit peaked at $11.4 billion last June. The December figures were better than expected as most analysts had expected a shortfall of about $7.2 billion.

The deficit for the year as a whole was $111 billion, up from $106.2 billion in 1994. The US ran record deficits with Mexico and China of $15.4 billion and $33.8 billion respectively. The overall deficit reflected a $174.5 billion shortfall on trade in goods only partly offset by a surplus on services of $63.4 billion. Mr. Ron Brown, Commerce Secretary, said 1995 "will be the year we turned the corner on trade". Exports of goods rose 14% from 1994, the fastest growth since 1988. Imports of goods rose 12%.

CONSUMER PRICE INDEX: The consumer price index rose 0.4% in January and 2.7% in the year to January. Economists had expected a gain of 0.3%. The rise partly reflected a 1.9% rise in energy costs. Excluding energy and food, the core index was up 0.3%, more than expected.

CONSUMER CONFIDENCE: The Conference Board, a New York business analysis group, said its index of consumer confidence rebounded sharply in February, suggesting economic data in January may have been artificially depressed. Its confidence index rose 97 against

88.4 in January, almost regaining the 99.2% level registered in December. Confidence readings close to 100 typically signal solid economic growth.

RETAIL SALES: The Commerce Department said retail sales fell 0.3% in January, largely reflecting weakness in car sales. However, given the harsh winter storms, financial markets had expected a decline of about 0.5%. Sales data for December showed an increase of 0.6%, rather than 0.3% as previously reported.

PRODUCER PRICES: The Labor Department said that producer prices for finished goods rose 0.3% in January and by 2.3% in the year to January. The increase followed substantial price gains in November and December. However, as the price gains were concentrated in the energy sector, it was not seen as signaling a rise in underlying inflation pressures.

Excluding food and energy, "core" producer prices fell 0.1% in January.

GREENSPAN NOMINATION: President Clinton nominated Mr. Alan Greenspan to a third term as Federal Reserve chairman, and Ms. Alice Rivlin, the US administration's budget director, to the Fed vice-chairmanship vacated by Mr. Alan Blinder, the Princeton University economist.

Mr. Laurence Meyer, an economics professor at Washington University in St. Louis, was also nominated to a second board vacancy, created by the resignation last year of Mr. John La Ware, a Boston banker.

UNITED KINGDOM

UNEMPLOYMENT: Official figures showed that un employment dropped to its lowest level for almost five years in January. The number of people out of work in the UK and claiming benefit fell by a seasonally adjusted 29,300 to 2,205,800 in January according to the Central Statistical Office.

This was the 29th consecutive monthly decline and the largest drop for 13 months. Unemployment is now at its lowest level April 1991 and represents 7.9% of the workforce - the first time the unemployment rate has been below 8% since May 1991. Long-term unemployment also dropped - the eighth consecutive monthly decline. The number of people unemployed for more than one year fell by 9,700 between October and January, and was 11,000 less than January last year.

BANK OF ENGLAND HINTS AT RATE CUT: In its quarterly Inflation Report, the Bank of England said that the government was back on course to hit its inflation target, reinforcing expectations of another cut in interest rates.

The Bank cut sharply its forecasts for price increases over most of the next two years. The report said that economic growth had been weaker last year than initial estimates suggested, improving the outlook for inflation. The Bank predicted that it was now " a little more likely than not that inflation will be somewhat below 2.5% or less from the spring of 1997. The report put the chances of hitting this target in two years at about 55%.

The report predicted that any further slowdown in the economy was likely to be temporary as companies cleared shelves of unsold goods. Stronger consumer spending would lend the economy momentum later in the year. However, the Bank cautioned that growth might turn out to be depressed for a more protracted period in 1996 if spending remained in UK export markets, especially France and Germany.

TRADE GAP: Britain's trade gap with the rest of the world was reduced by two-thirds in November, easing fears that the recent slowdown in mainland European markets might seriously damage British exporters. Overall, the gap in traded goods was a seasonally adjusted BP567 billion compared with BP1.6 billion in October.

The figures showed that UK sales were rising in most mainland European countries in spite of the weaker

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pattern of growth in those countries. The trade deficit with European Union countries shrank to BP131 billion in November, its lowest level for more than two years. The level of imports into the UK economy fell 2.5% in November, according to the CSO. The volume of imports was 0.4% lower in the three months to November compared with the previous three months.

MANUFACTURERS PRICES: Inflationary prices in industry eased in January as raw materials costs fell and manufacturers kept the price of goods at the factory gate unchanged for the first time in almost two years. The better than expected figures underlined the slowdown in manufacturing since the middle of last year, with weak demand making it difficult for producers to pass on price increases to customers. Factory output prices - excluding volatile food, drink tobacco and petroleum prices - were unchanged between December and January. This was the first time prices were unchanged since April 1994.

MANUFACTURING OUTLOOK: A survey of purchasing managers from the Chartered Institute of Purchase and Supply showed that, though new orders rose in January, production levels were flat and jobs were cut for the first time in two years.

FALLING OUTPUT: British factories cut production in December. The decline in output left the longer-term trend for manufacturing growth at its weakest level since 1992. Overall, manufacturing output was a seasonally adjusted 0.6% lower in December than in November. On a three month basis - a more reliable guide to trend - output was 0.2% lower in the last quarter of 1995 than the third quarter, but 0.4% higher than the same period a year before. The weakness of manufacturing fueled fears in the City that factory output could fall further, as companies respond to their excess levels of stocks by reducing orders.

The Treasury said it had not changed its forecast of 2.5% manufacturing growth this year. The fall in output was spread across most of industry, but it was largest in the food and textile sectors.

CAR REGISTRATIONS: New car registrations in January were just 0.3% above year ago levels, leaving a "very disappointed" motor industry hoping that tax cuts due in April could coax back buyers. The 191,761 new cars registered in January alarmed the volume manufacturers, who may find it increasingly difficult to carry out their pledges to restrict supplies to the short-term rental market - now suspected of undermining the entire new car market.

The statistics also showed a continuing rise in the market share taken by imports. They accounted for 60.9% of registrations in January, compared with 58.9% in the same month last year.

The UK short-term rental market in the past has absorbed nearly 500,000 vehicles a year. However, they are bought at deeply discounted prices, and are returned to the market as "nearly new" cars after just a few months in such volumes that new car ales have suffered.

DEBT FIGURES EXCEED EUROPEAN UNION CRITERIA: Britain still fails to meet some of the criteria for European monetary union according to the latest update on government debt figures. The UK's general government financial deficit in the financial year 1994-95 was 6.5% of GDP, revised up from 6.1%, the CSO said. In the calendar year 1994 the general government deficit was 6.9% of GDP, compared to 7.8% in 1993. Both measures exceed the guidelines set out in the Maastricht criteria which require a deficit of 3% of GDP or less. But the UK does meet the criteria for general debt levels of 60% of GDP or less although the situation has worsened, the CSO's figures showed.

PUBLIC SECTOR JOBS: The number of public sector employees fell by only 1.2% (66,000) last year in spite of the government's hopes of reducing the size of the public sector labor force, according to figures released by the CSO. There was a rise of 0.1% (2,000) in local author-

ity employment last year, the first annual increase since 1990. The numbers working for national health service trusts rose 8.5% or 85,000 people and there was a small net growth in social service jobs.

GERMANY

RATE EASING: The Bundesbank cut the repo rate, considered to be the third leading interest rate in Germany, in another sign of monetary easing that partly reflects the current weakness in the German economy.

At its council meeting in early February, the German central bank left its two key interest rates unchanged, but decided to switch to a variable tender in its money market operations. The move brings the repo rate within 30 basis points of the discount rate - currently at 3% - a threshold below which the likelihood of another discount rate cut increases.

UNEMPLOYMENT: Severe weather effecting the building industry was the main cause of a 368,300 increase in non-seasonally adjusted unemployment in January that left a record 4.16 million people - 10.8% of the labor workforce - without work at the end of January, against 9.9% the month before.

The Federal Labor Office also reported a substantial 59,0000 increase in the underlying, seasonally adjusted unemployment to 3.85 million in January. On this measure, the German unemployment rate rose to 10% from 9.9% in December.

Mr. Bernhard Jagoda, head of the labor office, warned Germany's jobless total could increase further in February and that an improvement was not expected until March. January's headline unemployment figure was higher than forecast and 308,942 above the January 1995 level. But it was compatible with January's Bonn government projections that average unemployment would rise by 280,000 to just under 3.9 million this year, Mr. Jagoda said.

In reaction to the sharp rise in unemployment, Mr. Helmut Kohl, the German chancellor , called for wage restraint by unions and urged the opposition to back government plans to boost growth and jobs.

OPPOSITION TO CUT "SOLIDARITY TAX": In a rare show of unity, Christian Democrat (CDU) and Social Democrat (SPD) premiers from Germany's 16 states unanimously condemned plans by the center-right coalition to cut the "solidarity" tax by 2 percentage points to 5.5% from July next year.

The tax - a surcharge on taxed income which contributes to the reconstruction in eastern Germany - is one of the most unpopular taxes ever levied in Germany. The strong opposition from the states is based largely on the way the Bonn government proposed to finance the tax cut, which it is estimated will lead to a DM4 billion ($2.7 billion) revenue shortfall in the second part of 1997. Under the coalition's plan, the states would fund three quarters of the costs through reductions in their share of value-added receipts.

The premiers' united opposition does not suggest that they will necessarily veto the proposal. Relations between central and state government have traditionally been complex, with trade-offs and counter-deals being common practice.

MANUFACTURING ORDERS: Germany's economic slowdown was underlined by seasonally adjusted figures for manufacturing orders showing a volume fall of 0.4% in December against November and a 6.4% drop against December 1994. The month-on-month decline reflected a 15% fall in eastern Germany following an exceptional bunching in November. Orders for western German industry increased 0.8% in December. Industry as a whole saw domestic orders fall by 2.4% in the month, while those from abroad rose by 3.1%. Mr. Theo Waigel, finance minister, announced plans to cut 7,000 more federal civil service jobs over the next 5-10 years.

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TAX RAID ON COMMERZBANK: German officials raided the Frankfurt headquarters of Commerzbank, Germany's third largest bank, and three other branches seeking evidence of tax evasion through the transfer of funds to Luxembourg and other investment centers.

Some 200 officials searched the bank premises to see if bank employees had given positive assistance German residents shifting funds abroad to escape Germany's high taxes. Other banks which have been targeted for this reason by German authorities include Dresdner Bank, Hypo Capital Management (HCM), which is part of Bayerische Hypotheken und Wechselbank, Merrill Lynch of the US and Norddeutsche Landesbank. It is not illegal for Germans to hold funds abroad, but earnings must be declared for taxation purposes.

ENGINEERING ORDERS: German engineering orders declined 4% in January over the same the same month a year earlier, according to the German Engineering Association. Domestic orders were down 7% and foreign orders fell 1%.

JAPAN

LONG-TERM CREDIT RATES: Two long-term credit banks increased their prime long-term lending rate, for loans of more than a year's maturity to the best quality corporate customers, by 0.2 of a percentage point to 3%. This followed a lead set by Industrial Bank of Japan, the Leading long-term lender.

Mr. Yasuo Matushita, governor of the central bank, sought to dampen market expectations that the Bank of Japan would allow rate to rise further. He repeated his view that the economy is recovering, but plans to maintain an easy monetary policy to reinforce the upturn.

The BOJ's official discount rate, at which it lends to the banking system, has been held at 0.5% since last September, the lowest seen in an industrialized country in postwar years.

The increase in the long-term prime, brings it back to the level of last September, when the long-term rate dropped in two-stages to 2.6% from which it started to rise again in January. Long-term rates have been inching up on the market's belief that the Bank of Japan will eventually tighten monetary policy once the recovery gathers force.

DEPARTMENT STORE SALES: The Japan Department Stores Association announced sales of Tokyo department sales rose in January, by 3.6%, from the same month last year, for the first time in 47 months.

HOUSEHOLD SPENDING: Japanese household spending fell 1.1% in 195, a record third year of decline. The fall in spending completed a record seven consecutive months' decline and marked an acceleration compared with the 0.9% decline in consumer spending in 1994, according to the government's management and coordination agency.

Household spending, which accounts for just under 2/3rds of gross domestic product, was hit last year by a record low wage increase, lower bonuses and overtime, and the psychological shock of the Kobe earthquake and the gas attack on the Tokyo subway.

Household income rose 0.9% to Y570 818 ($5,385) a month explaining last year's estimated 1 percentage point rise in the savings rate to 16.3%, the highest of any industrialized company.

Agency officials argued the decline in personal spending as a lagging economic indicator, did not challenge the government's recent declaration that the recession was over.

INDUSTRY OUTPUT: The ministry of international trade and industry announced a 3.3% rise in output for December and for 1995 as a whole - the best for five years. But a disappointing new-years sales by the Japanese car industry contributed to an unexpected slowdown in the pace of industrial growth in January. Overall production growth slowed slightly to

0.5% between December and January, from 0.8% the month before, causing MITI to downgrade its output forecast for the three months to the end of March.

The January increase was far below the 1.1% companies told MITI to expect in the monthly output survey in December. MITI now thinks production will rise by 0.8% from the fourth quarter of last calendar year to the first quarter of 1996. Year-on-year, the first quarter increase in output would be 0.4%.

TRADE SURPLUS: Japan's trade surplus fell 83% to a six year low of $467 million in January, easing the country's politically sensitive surplus with the US and providing further evidence of a long-term rise in its appetite for imports.

The year-on-year decline, for the seventh month in a row came after a 6.7% rise in exports, to $28.95 billion and a 16.9% rise in imports, to $28.48 billion. The trade surplus with the US declined 51.2% to $1.5 billion.

Imports continued strong in the sectors that used to be dominated by Japanese domestic producers. Japan bought 71.5% more office equipment, including computers, in January than in the same month last year; car imports rose 38.4% and electronics 69.8%.

PENSION FUND REFORMS: The Japanese government announced sweeping reforms to investment rules governing pension funds, giving more access to foreign fund managers and opening the way for more Japanese investment abroad. It also announced a further relaxation of controls on foreign exchange trading, including an easing of restrictions on the foreign currency deposits held abroad by Japanese residents.

The main changes, which will take effect within the next few months, are a liberalization of rules restricting investment companies' access to Japanese corporate pension fund management, and a relaxation of investment restrictions on fund managers. The reforms also give Japanese pension funds more freedom to invest in domestic equities. In the past few years, foreign fund managers have secured far higher returns than the leading Japanese investors, and the change is likely to encourage pension funds to entrust more money to foreigners.

Trust banks, the largest domestic operators of pension funds, will no loge have to invest at least half their funds in government bonds or other safe assets. They have been restricted to holding at least 59% of funds in safe investments - a maximum of 30% in equities and foreign-currency denominated assets and 20% in property.

The reforms have been prompted by the desire for a weaker yen to assist exporters, and the need to improve the condition of the country's pension funds. Japan's aging population will be a growing burden on pension funds into the next century.

MONEY SUPPLY: The Bank of Japan announced its benchmark measure of money supply, M2 plus certificates of deposits, grew 3.1% in January, a slight slackening on the 3.2% achieved in December.

END TO ECONOMIC STAGNATION? Japan's official economic forecaster announced that Japan's five years of economic stagnation have ended. The government's Economic Planning Agency said in its monthly report that "the economy is starting to show a move toward recovery again, albeit a moderate one." It is the first time in six months the agency has used the word recovery in its assessment, which economists view as a sign of the government's economic confidence and as a guide to the likely course of monetary policy.

The agency cited as encouraging signs of a rise in corporate capital spending and housing starts, a three month run of increased industrial production to December and the beginning of the end of the decline in exports. But the agency said household spending and retail sales continued to decline

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and unemployment was stagnating at a record level of 3.4%.

The announcement was met with widespread skepticism. One reason is that the EPA has on two previous occasions, falsely identified an end to what has become the worst downturn since the 1930's.

The agency claimed the economy had hit bottom in June 1993 and pointed to signs of moderate recovery in September the following year. Last July it moderated that statement to say that the recovery was at a standstill, then last September changed that to "prolonged standstill".

To add to the uncertainty, the agency uses no fixed definition of recovery. On one criterion widely used by US economists - two consecutive quarterly rises in GDP - Japan is not quite out of a recession.

GDP grew, year on year, in the first two quarters of the calendar year but fell back in the third. The government's preliminary estimate of growth of growth will not b available until mid-March. On a popular definition of a recovery - a decline in unemployment - Japan is still in a recession.

CURRENT ACCOUNT: Japan's current account surplus, measuring trade in goods and services, fell 14.5% to $110.44 billion in 1995, the second consecutive year of decline. The fall, in line with market expectations, came after a 15.5% year-on-year decline in the December surplus to $10.7 billion, according to the finance ministry.

Japan's politically sensitive trade surplus, the largest slice of the current account, fell 7.6% to $134.8 billion for the whole of 1995, the first fall in five years, after a 9.5% fall in December.

Exports rose by 11.2% last tear, but this was easily outstripped by the 22.8% growth in imports. Japan's traditional deficit on services grew 61% to $14.98 billion. Most of the increase came from a rise in the number of Japanese taking holidays abroad, causing the deficit on tourism to rise 23% to a record $33.51 billion.

That was partially offset by an increase in foreign investment income. The balance on the investment return account rose nearly 10% to $45.08 billion, a consequence of the rise in interest payments on increased holdings of foreign bonds - higher yielding then Japanese ones. The deficit in the long-term capital account grew to $84.5 billion from $82.04 billion.

RECORD FOREIGN EXCHANGE RESERVES: Japan's foreign exchange reserves hit a world record of $182.84 billion at the end of January, but the increase was small, suggesting a decline in central bank intervention. The total rose by just $18 million from the month before - the previous record - a small increase compared with the $1.57 billion jump from November to December.

The dollar has risen to Y107 from Y95 last August when the Bank of Japan and other leading central banks started to intervene to support the US currency, partly to avert fears of the damage to the Japanese economy risked by a strong yen. That anxiety has now eased, at least temporarily. However, the government is still making contingency plans against another rise in the yen, according to a Finance Ministry official.

An advisory panel to the ministry is considering a scheme to allow Japanese companies to make direct foreign exchange dealings with foreign banks abroad, to be able to take advantage of lower transaction costs, which would be designed to encourage Japanese institutions to sell yen.

DISCONTENT WITH SOCIETY: Most Japanese adults are discontented with Japanese society but are optimistic about their own lives. according to a survey by the Economic Planning Agency. The questionnaire found 79% of respondents see an increase in the number of "irresponsible people", amid concern about the safety and order of Japanese society. Some 79% said people were

selfish, 75% said ethics and social justice were being eroded. But over half the respondents said they were optimistic about their own future.

Some 59% were satisfied or somewhat satisfied with their lives as a whole. The percentage ratio of those satisfied with their lives is higher for women than men; workers in bigger companies were more satisfied than employees of smaller companies in the same income bracket.

FRANCE

1996 GROWTH FORECAST: According to Mr. Alain Lamassoure, the budget minister, this year's growth in the French economy will be probably nearer 1.5% than 2%. This is the most precise forecast the government has given of its reestimate of 1996 growth in the wake of last December's strikes and economic slowdown. The budget minister played down the impact of slower growth on tax revenue. He pointed out that in drafting its 1996 budget, to which it attached a 2.8% growth estimate for the economy, the government had assumed tax receipts would only rise by 1.8%

RATE CUT: The Bank of France lowered one of its key interest rates after the cuts by the monetary authorities in the US and Germany. The bank cut the floor intervention rate by 0.15 points to 4.05%, the eighth reduction in rates since the crisis in the French franc in November last year.

Separately, a number of banks announced cuts in their rates for consumer loans, which are subject to new tax deductions. This move followed cuts in the rates offered on a key government tax-free savings product.

The latest interest rate cut followed positive comments recently from Mr. Jean-Claude Trichet, governor of the central bank, about the direction French reform policy was taking.

RURAL TAX BREAKS: The French government is to match its recent tax break initiative for deprived city zones with a new series of fiscal exemptions to try to stem depopulation in rural areas. It will give rural employers and individuals temporary relief from social security charges, increase investment allowances and reduce property taxes.

The largest farmers' union, the FNSEA, welcomed the government measures, but said more would need to be done to stop "desertification" of rural areas, which had left 20% of the country's population living on 80% of its land

UNEMPLOYMENT: Unemployment in France broke through the politically sensitive 3 million barrier in December, a further embarrassment for Mr. Alain Juppe, the prime minister, whose top priority is tackling unemployment. The increase was despite government measures last year to boost employment. The seasonally adjusted figure rose by 29,000 in December to 3,019,400, a reflection of the faltering economy , which expanded only 2.6% last year.

Unemployment, which started rising in August, is expected to continue deteriorating during the first half of the year. Recent estimates suggest economic growth this year may only be 1.6%, against the 2.8% level needed to compensate for jobs lost through corporate productivity gains. This latest figure will further undermine consumer confidence, which the government has tried to bolster recently with a cut in base rates and a 25% tax deduction on loans for consumer goods for two years after purchase.

TAX EVASION: The French government stepped up its efforts to stop tax evasion by multinational companies by strengthening proposals for a new law on the reporting of company accounts.

The new bill, which was finalized by the French finance ministry, will be presented to parliament this spring. It also aims to give the government more powers to collect information on the internal operations of multinational corporations working in France. The initiative comes amid

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growing suspicion that corporate tax evasion may have been one reason behind the lower than expected budget revenues last year.

In particular, there are concerns that multinational corporations are using "transfer pricing" - the rate at which different subsidiaries charge for services and goods provided to each other - to move profits out of France.

The new law would allow the French authorities to demand more information about the transfer of goods and profits in multinational groups and give it powers to impose additional taxes using this information. ‘The French employers, the Patronat, has expressed concern that any excessively draconian regime could deter foreign investment.

INDUSTRIAL PRODUCTION: French industrial production dropped 0.5% between the second and third quarters of last year, according to official figures. Manufacturing fell 1%.

FINAL 1995 BUDGET DEFICIT: The French government announced a finalized 1995 budget deficit of FFr323 billion ($64 billion), only FFr1.4 billion more than its target, despite the strikes in November and December, which cost it FFr13 billion in lost tax revenue. Mr. Jean Arthius, the finance minister, said it was too early to judge whether the target of keeping total public deficits to within 5% of GDP had been met, because final figures for the social security deficit were not yet available.

The government is aiming at progressive deficit reductions from 5% of GDP last year, 4% this year and 3% in 1997, the year in which France hopes to qualify for monetary union.

Last year’s tax receipt shortfall was offset by the cancellation and postponement of the same amount of spending credits for ministries. Mr. Alain Lamassoure, the budget minister, praised the fact that budget spending rose only 2% last year, the lowest increase for 5 years.

INFLATION/SPENDING: The Insee statistics agency reported a 0.2% consumer price rise in January over December’s level, leaving the annual inflation unchanged at 2%. The agency also announced that spending on consumer durables in January bounced back with a 5.1% increase, after December’s 0.8% decline.

GROSS DOMESTIC PRODUCT: The slide in the French economy last autumn was confirmed by Insee, the national statistics agency, which reported that GDP fell 0.3% ‘in the final quarter against the previous three months, which in turn had seen a 0.2% decline. The fourth quarter saw industrial output falling 0.9% but industrial investment rising 4%. For the year, the French economy expanded 2.4%, compared with 2.9% growth recorded in 1994 and once hoped for in 1995. The late autumn decline would have the effect of shaving 0.1% off the GDP figure for this year’s first quarter, Insee said.

AUSTRALIA

UNEMPLOYMENT: Australia’s unemployment rate jumped 8.6% in January (seasonally adjusted) against 8.1% the previous month. The January unemployment was significantly higher than most forecasters had expected.

The estimate of people in employment fell 24,100 following an increase of 4,900 the previous month. This means that over the past half-year, employment has been increasing by only some 7,000 jobs a month, against a rise of about 30,000 jobs a month in the previous half-year.

TRADE DEFICIT: Australia’s current account deficit eased in December following a surge in rural exports. The December deficit wad A$1.63 billion, down almost 20% on the November figure of A$1.86 billion. Analysts had been predicting a deficit above A$2 billion following a 5% increase in imports, disclosed in mid-January. But this was more than offset by a 10% rise in total exports to a record monthly level of A$6.36 billion.