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Will a Clinton Victory and Pending Hillary Indictment Kill The Bull Market?

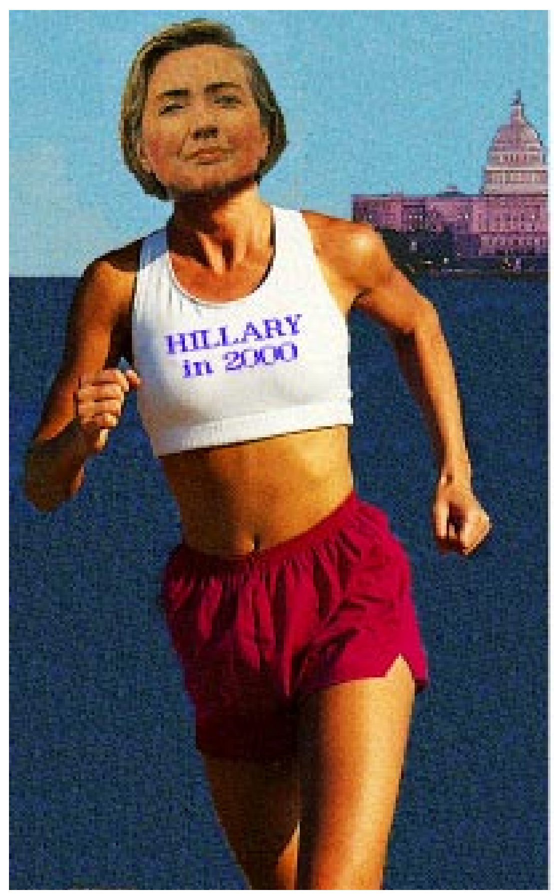
by Martin A. Armstrong

Market myths are rarely logical and often contradictory and when you throw in politics, the end result is sheer pandemonium. For some strange reason, it is widely observed that Democratic presidents produce bull markets in stocks and Republican presidents usually usher in bear markets. However, this is true of **ONLY** the postwar era and has little to do with politics or market trends. The fact is that the business cycle has simply been closely correlated with that of politics over the past 50 years. That doesn't mean that politics is driving the business cycle. Upon closer analysis, one quickly finds that spending increases and inflation rises along with the national debt more so under Democrats than Republicans. Now if we try to correlate this fact with the market myth that stocks do bad during inflationary periods of rising interest rates what you end up with is total confusion. Obviously, when you examine stock trends and interest rates you realize that there is only about a 35% correlation and that rising interest rates rarely ever affect stock prices until interest rates rise near expectations of future stock appreciation. Clearly, if you are very bullish and expect stock prices to rise by 20%, you are willing to pay 5% interest. But when interest rates reach 15%, a sure bet becomes too attractive causing capital to shift from stocks into fixed income.

The political questions that are dominating the press these days **OUTSIDE** the United States often makes one question the assumption that free press exists within the United States. Both European and Asian press coverage of Bill and Hillary is overwhelmingly negative compared to domestic press coverage. In a recent poll of journalists in Washington, over 90% voted for Clinton in 1992. There is clearly a trend in the US media to not discuss anything controversial and this is beginning to appear very biased to the rest of the world.

On our fall Asian tour this year, the number one question asked by our clients was: Why are Americans voting for Clinton? Don't the scandals mean anything anymore?

Outside the United States one hears only about the Asian drug money being channeled into the Clinton campaign via Ron Brown's old connections. You hear about Bill Clinton being a hard drug user being the reason behind his refusal to release his medical records. You hear about the mounting evidence



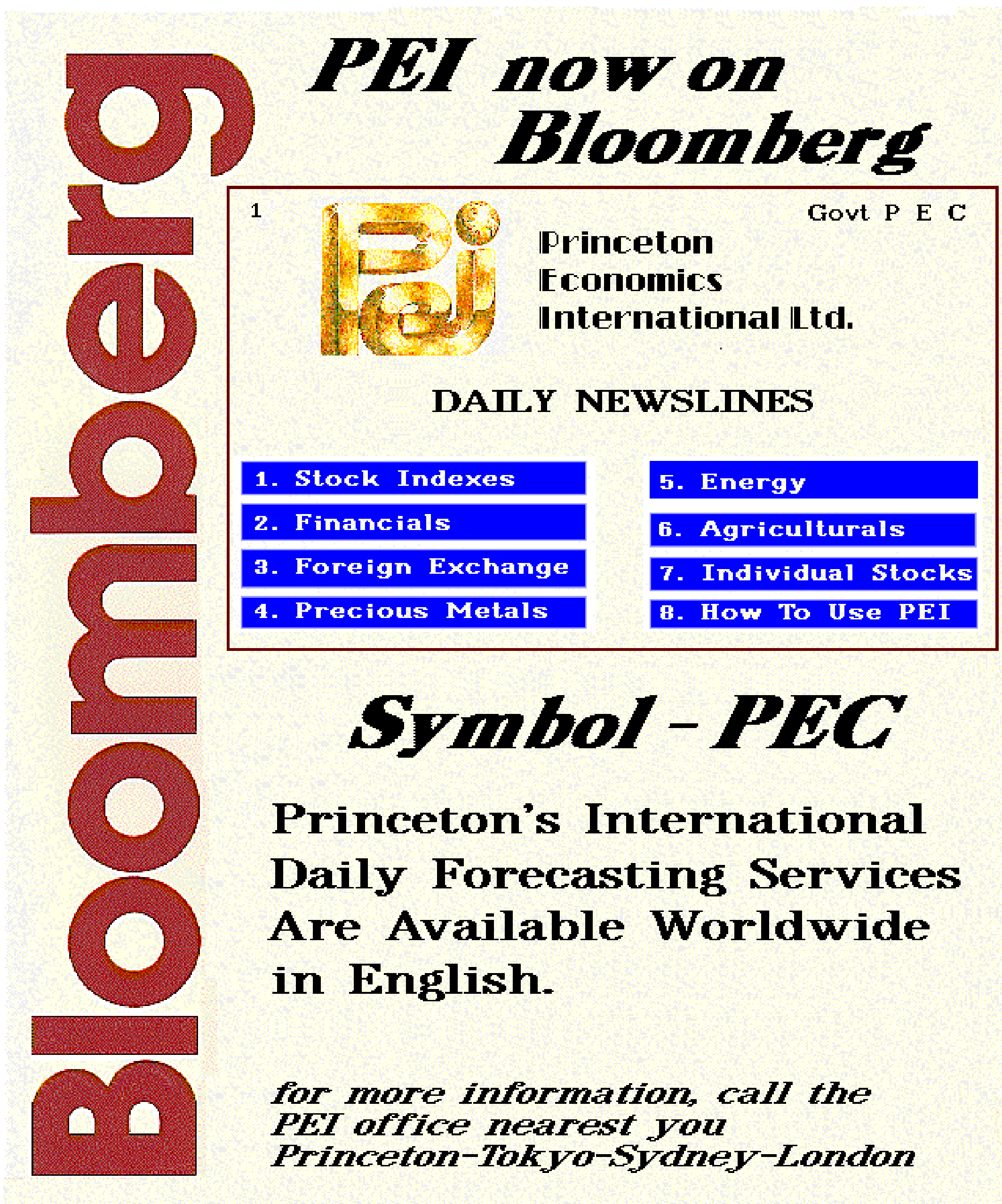
likely going to be indicted after the elections. You hear about Medicare plan A going bankrupt in 1997 and the possibility of Social Security going into deficit. You hear about how short-term interest rates have doubled in the United States under Bill Clinton causing nearly 100% of this year's deficit being purchased by Japanese. You hear about how over 30% of the entire US national debt is now held by foreign investors - the largest percentage in history. You hear about the collapse of the Western coalition and how Clinton's foreign policy has been a disaster.

Indeed, when you step outside of the United States you cannot help but notice that there are two completely different worlds as far as the media is concerned. The New York Times runs a story telling that Bill Clinton has severe allergies which forces him to use nasal spray 4 or 5 times a day. Outside the US that story is told that Clinton was at least in the past a cocaine user who burnt out is nasal passages and now requires nasal spray applications throughout the day.

On October 21st, the Wall Street Journal published an article "Hale Predicts Hillary Indictment." The story goes on to say "As a cooperating witness, inmate Hale spent hundreds of hours with federal investigators, and knows more about their evidence than anyone not bound to silence." If you do dig deep in the American press you will find the same stories. But they are far from the front pages and certainly never discussed by ABC, NBC, CBS or CNN. This is perhaps one of the reason's behind the latest battle for the air waves between Murdoch's Fox News and CNN. Murdoch has been launching Fox News Channel - commenting on the need to offset the filtered liberal news Americans get to hear.

When we look at the stock market we do see that while the correlation between it and interest rates is almost non-existent, the one relationships that is higher than 90% is the Dow Jones Industrials and the dollar. While the US national debt has reached record highs in foreign ownership, so have US equities! The trouble that politics now presents to the future of the bull market is not an issue of political bias, but one of foreign confidence which if lost, spells disaster!

It is clear that Clinton will most likely win. This is something our computer models have been predicting for several years. We have also warned that Clinton could be the last Democratic president ever to be elected.



The EMU Bubble, When will it Burst?

by Bruce Allen

The Euro (the European single currency) and who is in and who is out has been shaping up as the single biggest issue to confront Europe for many years and is certainly the most divisive. At stake is the future economic structure of Europe and the degree to how far political integration can be pushed before cultural & ethnic differences inevitably re-assert themselves. At stake as well, is the reputations and egos of many European leaders. A significant political campaign is being waged to convince the world that the first phase of the single currency will be in place from January 1999. From this point, the Euro will exist on the balance sheets of the central banks. National currencies will remain in circulation at an exchange rate "irrevocably locked" to the Euro until replaced by Euro notes and coins in 2002. In a recent survey 80% of the economists interviewed agreed that the European Monetary Union will start on time. No-one imagined it would not happen. Germany, France, Belgium, Holland, Luxembourg, Austria and Ireland are the leading contenders to qualify at the outset although currently only Luxembourg has met the criteria set out in the Maastricht treaty. Italy, Spain, Portugal and Finland have set their sights on qualifying in the first wave as a matter of national pride. Sweden has adopted a wait-and-see policy while Britain and Denmark have an opt-out. Greece is unlikely to approach qualification during this period.

The Maastricht treaty

Maastricht represents a milestone in the history of the European Union which started as a free trade zone in 1957. It set the criteria a state must reach to take part in monetary union - government debt must be below 60% of Gross Domestic Product, the budget deficit must be below 3% of GDP, interest rates and inflation rates must converge to be within a small band of the strongest states and the foreign exchange rate must be stable for a period before joining. No matter in which official language of the EU you choose to study the thousands of words of the treaty, it lends itself to interpretation and nearly all European countries will need imaginative accounting to qualify on time. As we mentioned in an earlier issue, it does not consider unfunded social security liabilities which, if included would blow all the core countries out of the water! This is a politically driven scheme. It is not an evolutionary scheme coming together under market forces for mutual benefit. As such it has many economic dangers for some countries not apparent in others. It also has economic and social benefits but again these are not of an even nature in all states. Luxembourg is the nearest thing to Cinderella with a variety of - we should not say ugly - sisters squeezing their feet into the glass slipper.

Germany

Chancellor Kohl is the champion of monetary union. He clearly wishes to be remembered as the founding father of a united Europe to match any other super power of the future. A single currency bloc and by implication, a boosted economy is seen as helping the re-unification of Germany. Capital flows from the West to the East of Germany have been on a scale far larger than foreseen and will need to continue for some time. Kohl has also implied he sees a Europe tied together economically as the best defense against the possibility of war between European states. Some might argue forcing states together in this way would lead to increasing tension at least during a period of adjustment, but such voices are seen as being against the tide of sentiment. The Bundesbank backs Kohl up in that it has always maintained monetary union without political union is doomed to fail. However, Kohl also knows that the electorate will accept a Northern European (Deutschemark) bloc plus France in political and monetary union. The "Club Med" countries are not really acceptable.

This year Germany is likely to come in with a budget deficit nearer 4% of GDP rather than 3%. Government forecasts show the target being met in time due to tax restructuring, paring back government expenditure and assuming an increase in the economy's growth. Private forecasts are not so optimistic. Ironically, Germans are perhaps the most "socialist" in Europe in their attitude to government. It will not be easy to cut back expenditure and most attention is on re-structuring of the complicated tax system. We believe this is only likely to encourage further capital flows out of Germany.

In Germany itself, monetary union is not such an emotional debate as in Britain for example. Most people regard it merely as a re-naming of the Deutschemark. Nothing is being given up. Perhaps an example of this almost lack of interest was the criticism of the Association of German ConsumerGroups' on the government's advertising campaign to promote the Euro. The brochures were described as "long-winded, amounting to little more than a mountain of barely intelligible theory".

France

The "Franc Fort" policy of France has more than once this century led France into economic difficulties. Today is no exception. Finance Minister Jean Arthuis is publicly confident he is on course to steer the country into monetary union. The goal is to maintain the national strength of the currency and by locking other competing nations within Europe into fixed exchange rates, to protect French industry from depreciating imports. France has a history of instigating tariff protection from outside products and this philosophy no doubt will be proposed within an "Euro Fort". The French view from the deal struck between Kohl and Mitterand over five years ago supports the idea of a united Europe based on Germany and France, with Germans looking after economic policy and the French running the foreign policy.

The need to qualify for monetary union is the excuse to propose savage cuts to government spending on social security. In turn this is being fiercely resisted by the industrial and more particularly public service unions. A package of tax cuts announced in September top stimulate spending is seen by many as too complicated to have much effect on consumer confidence and offset by other increases. Arthuis refuses to discuss the possibility that France might not achieve the criteria. Amongst the tricks he has up his sleeve is the FFr 37.5 billion transfer in pension fund assets from France Telecom to reduce the deficit.

Despite the best “neutral” estimates that France will not be in a position to achieve the Maastricht criteria, we can assume that the books will be fudged to ensure they are met. A comment worth reporting from Arthuis - “ We were late in realising that high public spending risked stifling the economy and destroying the potential for creating jobs”. Whether the French will give up their right for their children to have skiing lessons paid for by the state is yet to be seen!

Belgium

Without the EEC Brussels would be a ghost town is the cynical view of many expatriates living in the Belgium capital. There is no doubt the European Union is a major article of faith particularly in view of the traditional split between the Wallonian South and Flemish North sections. Being part of a larger European nation provides some relief from the cultural dichotomy. Belgium has the highest debt in Europe at 133.8% of GDP but is pursuing a first wave seat in monetary union. Remember the target is 60%. How can this be achieved.? For many years the Belgium government had a nice line in borrowing Marks and Swiss Francs at a preferential low rate and buying higher yielding Swedish Kronor, British Pound and French Franc debt. Since 1992 this profit has turned into a paper loss of $1.1 billion following the devaluations. Undeterred they have resorted to selling gold. Some 300 tons last year realising a profit of $7.6 billion in windfall profit on a market to book basis. Even so the public budget deficit was 4.5% of GDP last year.

[Note that Germany remains firmly against bullion sales believing that gold should be retained in reserves to support the Euro in future.]

The Prime Minister Jean-Luc Dehaene has taken special powers to draw up the 1997 budget without parliamentary consent. Unpopular social cuts are proposed as well tax increases to reduce the deficit to 3%. A forecast reduction in the overall debt of 10% of GDP is sufficient decline, in Belgium’s view, to warrant inclusion on the basis that it is going in the right direction. Other analysis suggests that it might be sometime towards the end of the 21st century before Belgium achieves the 60% target. Again, like France, social unrest is evident and will increase as the cuts in state funding is put in place. As one Belgium economist said “ We have to do what we can within the limits of our own culture”. How true.

Luxembourg

The Grand Duchy easily qualifies with a public debt of only 6.2% of GDP (a tenth of the maximum level allowed) and a budget surplus of 0.7% of GDP. Inflation is around the 2% . Monetary union (with Belgium) is already 75 years old., the majority of exports and imports are within the EU. For Luxembourg, the Euro is almost a non-issue.

Netherlands

The Dutch have traditionally applied a skeptical view to the European Union but as natural traders they are embracing the project and enjoying a positive relationship with Germany. Debt as a percentage of GDP was 79% last year and falling. The budget deficit was 3.5 % of GDP . Like Belgium the view is that the trend is sufficient to justify their inclusion in the first wave. Holland has already put in place structural reforms in industry and social security which is giving their economy a realistic chance of meeting government targets. Like Belgium they have been replacing bullion with interest bearing securities.

Italy

Official growth projections in Italy have been proved unrealistic as the economy verges on recession. Never-the-less, the Prime Minister, Romano Prodi, stung by French comments denigrating Italy’s qualification for monetary union in 1999 and by Spain’s Jose Maria Aznar’s aggressive program to be in the first wave, has dropped previous plans for a later entry. The government will implement an austerity package to cut the budget deficit to 3% by the end of 1997 instead of the previous 4.5% target. Whether his centre left Olive Tree alliance will hold sufficiently for parliament to pass such a budget is yet to be seen. Mario Monti, EU commissioner for financial affairs, commented “a short recession is an acceptable price for Italy to pay for monetary union”.

Spain

Monetary union has become the major policy objective of Aznar’s minority centre-right government. While many remain skeptical that Maastricht criteria can be met in time, Spain feels that on the basis of a roughly equal economic performance with France, it should not be excluded. The benefits are seen as providing a boost to the economy, lower inflation and interest rates and higher employment within “a zone of stability”. There is also the issue of political status. Irrespective of successfully joining in the first wave, it has provided Aznar with the justification to apply tough economic policies and proceed rapidly with a program of privatisation if state assets.

Portugal

Recent polling reveals that more than 80% of the population want monetary union. Prime Minister Guterres’ socialist government is committed to this objective and on their own projections will achieve Maastricht criteria without raising taxes or cutting social spending in their latest budget. The benefits are seen as allowing Portugal to offer the best return on investment in terms of labour costs and government incentives within a stable currency regime.

Ireland

The economy has been boosted by net payments from the EU for several years transforming the infrastructure and creating a very positive attitude to Europe. The German chancellor has stated that he would be very pleased to see Ireland in the first wave. There should be no problems in meeting the Maastricht criteria and studies published by the government sponsored Economic and Social Research Institute have indicated a small positive result for Ireland joining the single currency. The falling off of US investment in Ireland, once the overwhelmingly favoured location, is a further inducement. Ireland's tie to the UK economy, its largest trading partner, is the only cause for concern. Based on the UK staying outside monetary union, some studies have shown a "catastrophic" effect on small businesses.

Sweden

Although Swedish Prime Minister, Goran Persson, is a supporter of EMU, there is significant public opposition to joining a single currency group. Inflation is the lowest in Europe and tough debt reduction measures should allow a deficit of 3% of GDP by next year. However, the total government debt is above 80% of GDP. It is unlikely Sweden will attempt to be in the first wave.

Denmark

Although qualifying for membership already, Denmark along with the UK, is tied by its opt-out of a single currency. Government policy is to track the Euro within a very tight currency band.

Finland

Finland joined the EU along with Sweden in 1995 and is the most committed in Scandinavia to monetary union. A closer economic relationship with Europe in preference to Russia is the main incentive. The coalition government led Paavo Lipponen has reduced spending and cut indebtedness with the Maastricht criteria in mind. It has recently joined the ERM and should qualify on all points in time.

(**Norway** rejected EU membership in 1994 against projections that staying outside would lead to higher interest rates, higher unemployment and an exodus of industry to other countries. The opposite occurred and Norway enjoys the strongest economic growth in the region.)

Austria

Austria is expected to be in the first wave of single currency members. The economic experience since joining the EU 19 months ago has been positive and the majority of businesses polled in a recent survey indicated acceptance of a single currency.

United Kingdom

The Maastricht opt-out will prevent the UK from joining in 1999. Even if, as is likely, the Labour party takes power next year, it is highly unlikely they will wish to bring on a constitutional crisis by pushing forward with membership as a high priority. Opinion polls show the majority of people against a single currency.

When will the bubble burst?

The current euphoria following the positive noises from Brussels and other European capitals recently has led to a remarkable reduction in credit spreads of EU members compared with Germany. As one pension fund manager said recently - never mind the capital performance, where do I go now to lock in double digit earnings? The critical point is the first quarter of 1998 when countries will be assessed to see who qualifies. At this time we can expect that the Deutschemark bloc and France will ensure that the "club Med" countries are found wanting. This will be despite the fact that economic growth in the main European countries will not perform to government expectations and a number of fudges will be needed to have more than one core member. Disillusion will set in before then as the pressure on social service cuts bites into economies. It is unlikely that credit spreads will stay at their current low levels. Continued recession in Europe will put pressure on currencies such as the lire and the French Franc by mid 1997 causing claims and counter claims of competitive devaluation. Perhaps we will see some form of Euro in the books of the central banks by 1999 but if notes and coins are issued they will look suspiciously like Deutschemarks.

Investment in Europe

The Japan External Trade Organisation (Jetro) survey of Japanese corporations reveals an increasing interest in Eastern Europe for investment but the UK remains the top destination, favoured by 41.9% followed by the Czech Republic and Spain at 23.6% and 16.9% respectively.

Meanwhile the value of overdue payments from customers in Europe is rising at the fastest rate for three years. Overdue payments to UK companies exporting to European Union countries rose 9% in the third quarter over the same period last year. Public spending cuts or intended cuts to meet Maastricht criteria for EMU are blamed for slowing economies and making the EU a risky export market for UK exporters.

Brussels Sprouts Out

The European Commission has announced an Ecu 51 ($us64) million information campaign over two years to "sell" the single currency to the general public after polls revealed 70% of people felt they were poorly informed on monetary union. A group of 130 civil servants, bankers and academics willtake part in the exercise throughout the continent, which will include campaigns in German and French schools. The UK government has declined support from Brussels and will not take part in the exercise.

Brussels has also presented a report criticising EU countries for not doing enough to improve conditions for industry, citing high costs of labour, energy, telecommunications and transport. Efforts made by governments to restructure their economies in the face of increasing competition have not gone far enough to be effective. The EU's share of exports to OECD countries has been falling since 1987. Mr Martin Bangemann, industry commissioner, suggested economic and monetary union in 1999 would do much to improve competitiveness. How this would come about was not detailed.

Meanwhile, Cenelec, the European body that sets electrical standards, has abandoned its proposals to produce a standard European electrical plug after five years work. The 18 countries involved could not agree on a common design after objections on commercial, safety and technical grounds from various countries. Perhaps in the future you will not have to change your currency as you move through Europe but don't forget that multi-adaptor for your laptop power supply and mobile phone.

Oiling Inflation

As we warned in June this year, oil prices have moved up strongly pushing up UK manufacturers' fuel and raw material costs causing the first increase in factory output price inflation in 14 months. Prices of petroleum products rose 3.9% between August and September. Crude oil was up 32% on the same month last year. But all is well according to most commentators. Underlying inflation (which excludes such luxuries as oil, petroleum products, food and drink) rose only 0.9% year on year, the lowest annual rise since 1967.

Political Gaps

The last annual conferences of the major political parties before the next UK general election have been held without any dramatic change in the opinion polls. Labour maintains a very significant lead with the increasing optimism on the economy, which should improve the ruling Conservatives chances, balanced by the latest attack on the government's handling of inquiries into political "sleaze", particularly the "cash for questions" affair. If anything the gap between various polls has widened. The Referendum Party, campaigning on a single platform to let the people decide on European integration and the single currency, will hold their conference later this month. They planned for an attendance of 2,000 people but have had to increase capacity to satisfy a much higher then expected response.

German Update

by Harry Groenert

Much ado about nothing?

Pension payments are not taxed as ordinary income in Germany. It is the current law - virtually no tax payments on the pension but only on a portion of about 30% which is seen as capital income (Interest portion of the pension). The first 12,000 of any income is free for everybody as the “living minimum”, though pensioners could theoretically earn a tax free pension of around DM63.000 for singles and DM110.000 for couples. Theoretically, because there are no pensions of this magnitude, however, some of the pensioners get other income and pay a lower tax rate than normal working people, because the major portion of the pension is tax-free. This is good for the pensioners but not so for the finance minister, Mr Theo Waigel, whose wallet looks quite small these days while he is trying to buy tickets for the great Euro-Performance, scheduled for 1998 in Maastricht.

The construction of the pension formula is in favor of the pensioner. It is the law since 1992 that any increase in public duties will be compensated by higher pension payments which subsequently will increase the budget. Mr Bluem, the minister for labor and social affairs could not afford this other than by either increasing the installments or by changing the pension formula. - Both would certainly start a public discussion and not be a help for the election at all.

Mr Waigel on the other hand is known for being creative whenever he sees a chance for increasing the tax revenue. The “Waigel-Commission” came up with the request to check the ability to raise taxes on the pensions. The thought is twofold: Either tax deductible pension contributions or a tax-free pension. The commission is examining the current status and Waigel knows the result already. About 70% of the contributions are deducted from the taxable income - he will say, why not tax 70% of the pension then?

The public is quite sensible as far as pensions are concerned. Not any politician likes to generate a public hysteria but the seed is spread. At the end of the day the government will decide and the only thing they need is income. The more the budget deficit is surging, the more likely it will become a fact of life finally. Just another small nail in the coffin.

Othello - put money in thy purse.

The German tax reform shall combine several objectives. One is to reduce the budget deficit, while another is to gain votes at the next election. Within a democracy the ruling party needs the agreement of the opposition. The SPD controls the Bundesrat, the parliament’s second chamber. This is the reason why Mr Waigel postponed some tax and benefit proposals which had been in the press for some time. He abandoned the plan to delay an increase in children’s allowances and he also stopped the go ahead of the modification of Germany’s wealth tax because it was obvious that the SPD would vote against it.

The present wealth tax had been declared unconstitutional in a court ruling last year and will not be charged in 1997. The increase in the children’s allowance is estimated at DM3.5bn a year and the wealth tax will cost about DM3.9bn a year in lost revenue. Mr Waigel is still confident and believes he can solve the problem with the deficit. He admitted that Germany will this year exceed the 3 per cent limit for deficit as a proportion of gross domestic product and he said: “Even with no further progress on the above mentioned tax points, Germany would achieve its goal of bringing the deficit down to 2.5 per cent of GDP.”

How is he going to solve the problem? He indicated that the revenue loss could be partly offset by a reform of the inheritance tax. Just another field with a good chance to get money. There are about DM500bn of assets inherited each year. The major part of this is real estate, which is taxed on the “Einheitswert”, which is less than 10 per cent of the real value.

Germany has one of the most complicated tax systems with an immense variety of different taxes. To reform each of these would be of great help for the sluggish economy but the further Mr Waigel goes the more it becomes clear that tax reform is a new word for shifting tax obligations. Well, lets go then and play musical chairs.

Alexander Lebed's "Heads Up"

Widespread corruption is destabilizing the military

by Dana Schneider

When the popular General Alexander Lebed (ret.) and head of the Security Council was fired, he revealed several very troubling aspects of Russia's transition to democracy and a market based economy. Lebed has only verbalized what most Russians have known for quite awhile: that corruption is spread through out the government and reaches the highest levels starving the economy, intensifying domestic tensions, and destabilizing the military.

Lebed's three months in the Kremlin sent a strong message: Crime and corruption are sapping the budget and economy placing an enormous strain on the population and the military. Moreover, the lawlessness of the emerging market is a major interest driving the Kremlin's power struggles and political instability. In short, the issue is not a relentless drive to the market but the critical need to pause, clean up some of the mess, and make what already has been done work. A rational place to start is law, domestic strife, and 1.5 million soldiers with guns.

Lebed's commentary has made no friends in the Kremlin where big banking, natural resource monopolies, and various brands of criminality dine together. Alas, the former general of the Afghan war was accused of no less than treason, power-grabbing, and mutiny. The variables just do not add up since **even the most optimistic can not believe that the Kremlin has just one rotten apple.** Assessing this situation with a healthy dose of political reality reveals a theme very familiar to the established **democracies**: The whole bushel is full of rotten apples and the relatively edible one got tossed to preserve the quality of the others. Two weeks later, Yeltsin is still issuing public statements that the presidential campaigning in the Kremlin must end.

Lebed has questioned the costs of reform...

Market reforms and privatization has knocked over the military industrial complex and left the military without funding, future employment, and wages. Output from this sector has fallen 75-80% while funding for conversion has dropped from 67% of set-aside funds in 1993, 13% in 1994, and a big zero for 1996. At the same time, market forces have left the majority of citizens priced out of the market without a safety net and owed four months to a year of back wages. After five years of economic reform, what has emerged to replace the previous system is not sustainable: funding for the military and social spending is slated for deep cuts. This is a glutton for social strife that many hope that the government has the good sense to avoid.

Which move one step forward and two steps backward...

Lebed made sure to point out that one of the most successful outgrowths of Russia's economic reforms has been financial crime and institutional corruption. Apparently, the IMF may have grown tired of the government's corruption. After all, many of the folks in and around the government have become millionaires in a desperate economy being subsidized and funded by the IMF, sovereign governments, and multinational investors. The shortfall in the budget from failure to collect taxes is not really a matter of inefficiency but more a result of campaign promises and deal making between federal and regional politicians in coordination with financial and industrial market makers. For the second time since July, the IMF will hold back on $380 million loan installment in an effort to force the Kremlin to start legislating and enforcing some very basic elements of law.

With crime and corruption taking big strides....

Estimates have cited tax payments at less than 40-60% than budgeted. The government's recent attempt to collect by publishing a list of offenders left off some of the biggest culprits with the most obvious links to the government. 20% of Russia's banks are believed to be controlled by organized crime while a number of very large financial/industrial conglomerates are also believed to offer cooperation to various degrees. For the third time, bond thefts of $57 mn have been reported. And a recent report from the central bank estimates $60-$80 bn worth of capital has been taken out of the country since reforms began in 1992. An amazing amount of money has been placed in foreign bank accounts. Why should foreign investors put their money in Russia when the Russians are exporting the money faster than you can say embezzle, defraud, bribe, threaten, and launder?

Sapping social spending and stirring tensions...

Recent reports show a profit of 1.7 trillion rubles from privatization for the period of January to August 1996 while 2.7 trillion rubles were stolen ("misappropriated") within the government agencies during the same time. This is more than a net loss that over 147 million citizens must absorb. Consequently, cuts in social spending are proposed as well as in the military where 15% of the staff is slated for cuts (this may slow down theft of military funds). The result of corruption in government and in market reforms has caused drastic cuts in the military which by the way is still a nuclear superpower.

Splintering territories...

The military and domestic unrest takes on a huge dimension when autonomous republics or regional governments begin making noise. Several regional governments have demanded to have a say in the Kremlin's budget - writing that it will have serious consequences for the individual territories and lead to "...further curtailment of investments, a catastrophic industrial decline, social tensions and, ultimately, the termination of democratic reform." The recommendation was to refocus the budget to allow more "economic development of all constituent territories and to their greater independence and responsibility." (Interfax)

More and more regional governments are reaching to control their own territorial concerns: tax collection, crime enforcement, control and funding of the military and natural resources as well as economic policies. The Tatarstan Republic government has told Moscow tax collectors that it is "bewildered" at accusations that a key industry has not paid sufficient taxes and has rejected the claim. Other Republic governments have taken the side of the industry within their territory to reject Moscow's tax demands and seek "negotiations" on the matter.

The current gubernatorial campaigns play a part in the money game. Elections on regional levels have turned up some opponents to Yeltsin, polling postponements, and invalid results. Valid, however, is Alexander Rutskoi winning the governor's seat for the Kursk Region. Rutskoi, recall, was the Vice President of Russia in 1993 when parliament voted to impeach Yeltsin - making Rutskoi President. The White House was then seized but the coup was unsuccessful. With this in mind, one must wonder if the threat of a military "coup" would be incubated within the Kremlin or in the far off regions.

Leaving the military in disarray...

The Russian military has over 1.5 million servicemen who live in deplorable conditions, receive seldom and minuscule wages, and have no where to go for housing and employment even if they were discharged. Army crimes have also caused over 5,000 deaths. Desertion and suicide rates continue to climb further deepening low morale.

But providing insufficient and dangerous solutions....

In the beginning of October, Yltsin called for more funds to be immediately sent to the angry servicemen since salaries have not been delivered for months. By the end of the month, nothing had been resolved. The Defense Minister, Igor Rodionov, stated that "Chronic lack of funds is taking the armed forces to the brink of undesirable, and even uncontrollable developments."

The Defense Ministry has proposed placing 10-12,000 soldiers in a special military police force to crack down on crime within the army. Apparently, this new force will augment an already integrated military police force that patrols traffic and maintains order within and without the civilian and military population. It probably won't be long before they are sent out to enforce tax laws and collections. Yeltsin's chief of staff and now proxy, Anatoly Chubais, is set to meet with regional officials to discuss the enforcement of the federal constitution and legislation.

Lebed traveled to a military base outside of Moscow where he pointed out that the commander responsible for access to 60% of the nuclear missile capabilities had not been paid wages for several months. A director of nuclear arms research recently committed suicide in Chelyabinsk. These men have no money, no jobs, nowhere to relocate and little money expected from the Kremlin.

Lebed has shown the most difficult reform is in the military.

Lebed has shown that a weak, underfunded, and leaderless military is the primary threat to Russia. Lebed was accused of raising a force of 50,000 soldiers for a coup. Half right. Lebed did suggest raising a force of 50,000 but to counteract crime, domestic turmoil and/or breakaway regions that seems to be brewing across the time zones.

Lebed also pointed out that the corruption in the military was providing arms to forces that the leadership is currently trying to suppress, like Chechnya, and places that they plan to or would like to continue to control later. Certainly, holding the Russian Federation together is an objective as well as exercising influence over the Southern Republics. But this task becomes ever more difficult when certain members in the military command are enriching and promoting themselves through a conflict that they are unequipped to win. At the same time, engaging in a losing war only demonstrates weakness and invites other would-be independent states to take the risk.

Lebed also sent another message home to some of the most unreceptive ears when he negotiated a peace accord with Chechnya. He revealed the prolonged and failing activities in Chechnya were a means to create an environment where criminal activities can have a big payoff. Indeed, as already documented by missing 1995 funds set aside for Chechnyan war reparations, the war is a means to appropriate funds and weapons directly into ones own pocket.

History has shown that a nation in economic turmoil, saddled with an a large and overbearing military, must restructure its forces or meander down the road to conflict and warfare. Lebed did take a giant step toward making Russia a constitutionally bound democratic nation: He saw how unpopular the Chechnyan war was with the citizens and acted to abide by their voice and to end the violence; and he has insisted that the rule of law must be established and enforced if a free market and democracy are to survive - particularly in the ranks of the military. In this regard, Alexander Lebed had begun to restructure and rebuild the old Soviet military into a new Russian Army. It is unfortunate that his work was cut short.

Australasia

by Nigel Kirwan

Will New Zealand snatch defeat from the jaws of victory?

After 13 hard and often harsh years of economic reform the people of New Zealand could be about to turn their backs on the long awaited fruits of their sacrifice. From a country which in 1983 was the most debt ridden and over protected economic basket case in the western world it is today the world's most unprotected trading environment with liberal foreign investment rules, zero foreign currency denominated government debt, low inflation, low taxes, relatively low and falling unemployment, and soaring business investment. However, gone are the principal architects of these dramatic changes and in their place stand a mixed bag of populist nationalists, protectionists and racists in the Maori dominated NZ First Party, a resurgent Labour Party of "old school" big spending interventionists, and outright marxists in the far left Labour breakaway Alliance Party. Together these loonies now command 67 seats in a 120 seat parliament after the October 12 NZ national election.

The voices of reason in the minority governing National Party and the right wing Labour breakaway Act NZ still maybe have a chance to govern if the often contradictory and bitter rhetoric of the left-wing parties prevents them from forming a workable coalition. Nevertheless the impetus for further reform is largely spent as no minority government would stand a chance in implementing any further liberalisation or privatisation. It will be sad not only for the people of New Zealand but also from a global perspective if this one shining example of economic resuscitation is not allowed to continue to bloom and express its full potential.

The Liberal's honeymoon comes to an embarrassing end

Some are beginning to wonder whether the Liberal Party have lost their collective senses following a week where two ministers have resigned and two other Cabinet members are just hanging on to their political lives. At issue are Minister's declarations of shareholdings and conflicts of interest between shares continuing to be held and the ability some Ministers may have in affecting the fortunes of various companies they hold shares in. This comes only a fortnight after Treasurer Peter Costello broke a diplomatic convention by briefing the press on the substance of his discussions with Alan Greenspan, then denied what he'd said only to be confronted with a tape of him doing just that. The electorate's verdict on these events will be delivered in a forth coming bi-election. Some commentators believe, however, that the Prime Minister will soon have an excuse to sack some embarrassing non-performers and revitalise his team with some exciting back-bench talent.

Employment grinds to half in the Senate

Unemployment has taken a turn for the worse in Australia with the main cause being a drop in the growth of new jobs and a downturn in business and consumer confidence. It is predictable that the Labor Party and far-left Democrats and "Greens" (Reds!) should blame the abolition of A$2billion worth of "training schemes" which in fact achieved nothing other than to disguise the real level of unemployment. The real culprit for the above malaise on all fronts is the continued existence of Labor's "unfair dismissal" laws covering all federal industrial awards. Administered and adjudicated upon by Labor appointed industrial relations commissioners the repeal of these laws is being held up in the left controlled Senate.

Recently I had first hand evidence of the damage these laws have done to employers and intended employees alike. The law actually prevents an employer from dismissing an employee without working through a 3 periods of "counselling" over 3 months. Example: My optometrist hires an optical technician who makes repeated errors in filling prescriptions costing the firm several thousand dollars. Only after discovering that the employee is working under a false name and forged qualification certificate does the employer confront him and is promptly told to "get stuffed". The employment is terminated with 2 weeks full pay plus accrued holiday pay with a 17.5% loading. The former employee sues for "unfair dismissal", wins and the employer emerges A$17,000 poorer! Stories like this abound and in a country where small business is the largest employer is it any wonder that nobody is hiring and confidence is hitting rock bottom?

Hong Kong

by Craig H. Stephen

Hong Kong's new CEO

In Hong Kong only two months remain before the appointment of the first chief executive of the new post 1997 Special Administrative Region and so far we have around five contenders. There is little of the baby kissing and electioneering known in the West, as the verdict will be delivered by a 400 strong Selection Committee rather than the Hong Kong population. The Selection Committee is to be chosen by the Beijing appointed Preparatory Committee next month. Sixty of the 400 selection committee seats have been set aside for the China's hand-picked deputies to the National People's Congress leaving more than 5,000 Hong Kong citizens volunteering themselves for the remaining 360 places. You do not have to be unduly cynical to believe that the choice of the Preparatory Committee - headed by Chinese Vice-premier Qian Quichen - ultimately lies with Beijing. Nonetheless Beijing realizes that the chosen candidate will be seen by outsiders as a leading indicator of whether Hong Kong is going to have its promised "one country two systems" post 1997.

Understandably for Hong Kong, most candidates have a high profile business backing. The most recent declared candidate is Peter Woo, former chairman and major shareholder of Wharf Holdings. He is probably seen as the most liberal of the candidates and this together with his earlier support of Governor Patten's democratic reforms is likely to rule him out. The current chief Secretary of the Hong Kong civil service, Anson Chan would be the popular choice, polling a support level of more than 50%. However she is seen as too close to the present British administration. Indeed she may not have done her Chinese credentials much good recently by referring to the disputed Diaoyu Islands as the Senkakus, their Japanese name. A second best and more likely scenario might be her appointment as a Deputy Chief Executive while staying on as the head of the civil service. Shipping magnate Tung Chee-hwa, chairman of Container Lines is widely expected to be the most likely choice. While he has single digit local popular support, this does include Cheung Kong chairman Mr. Li ka-shing. More important is his close links with Beijing. He is a vice-chairman of the Preparatory Committee, while in Hong Kong he was until recently a member of the Government's policy making executive council. He also has close links with Taiwan which could be helpful in bridging the gap with Taipei. Two other outsiders are Chief Justice Sir Ti Liang Yang and Lo Tak-shing who is backed by Henderson Land's Lee Shau kee, recently ranked the territory's richest man. Lo is the only contender to have publicly renounced his British passport although Sir Ti has apparently asked the British government to take back his knighthood. However despite these commendable sacrifices both remain outside choices.

Senkakus or Diaoyu Islands?

The ongoing feud over the disputed Diaoyu Islands between East Asia's two giants, China and Japan has thus far been limited to a flotilla of Chinese protesters from Taiwan and Hong Kong planting symbolic flags on the rocky outcrop and the loss of one foolhardy Hong Kong legco candidate. The issue sparked by right wing Japanese activists repairing an unmanned lighthouse in July, has been fanned by protesting Taiwanese and Hong Kong democrats, demonstrating their Chinese patriotism. Ironically it does not seem so many months ago that attention was focusing on the military stand- off between China and Taiwan over the Taiwanese straits. Both governments have been fairly restrained in their rhetoric, despite the temptation to play the nationalist card. However with a general election this month, Japan's Liberal Democratic Party has put the claim to the Senkakus in its campaign manifesto. While the issue may be sidelined short-term, it does once again highlight to investors the underlying fragility of Asian peaceful coexistence.

In China inflation fell to a four year low last month, increasing the likelihood that we might see the third consecutive cut in interest rates this year. In September the retail price index - China's official inflation measure fell to 5 per cent, the lowest level since austerity was introduced in 1993. With returns falling in savings accounts, local investors are moving into the country's stock markets in a big way. October 13th saw turnover soar to a total of HK$21bn on the Shanghai and Shenzhen A share (local) exchanges, representing three times the turnover of Hong Kong. Hong Kong too is rediscovering its heady days of 1994 as daily average turnover has doubled to HK$8bn and new highs are repeatedly reached.

China - poor enough for WTO

A recent report on China by the World Bank has substantially downgraded the estimated size of the Chinese economy. The new figures reduce previous estimates of the size of the Chinese economy by over 25%. Also the number of the Chinese population living in poverty is closer to a third than the less than ten percent previously estimated. While the growth rate of the Chinese economy remains amongst the highest in the world, it might still be further behind than many thought. For Beijing, these figures are a double edged sword, while some off the gloss might come off the Chinese economic miracle, China's case for gaining entry to the WTO on the less demanding terms of developing nation status is given a boost.

South Korea's OECD bid

South Korea is likely to assume a higher profile in Asian investment circles with its membership of the OECD club expected to be made official by the year end. South Korea will accelerate the opening of its financial markets. The lifting of restrictions on foreign ownership of the stock market will be of particular interest and from 1998, foreigners will be able to establish their own banks and brokerage houses.

Canada Update

by Chris Quigley

GM Strike Settled

The Canadian Auto Workers union and General Motors Corp. reached an agreement to end a strike that had lasted about three weeks. GM's 26,000 Canadian workers began walking off the job on October 2nd and idled assembly lines across North America. The main sticking point between the automaker and the union was over outsourcing - GM's practice of hiring outside firms to produce parts with cheaper labor. On that point, GM agreed to limit outsourcing but won the concession to sell two parts plants in Windsor and Oshawa - affecting 3,500 workers. But those workers were guaranteed wages and benefits for at least three years under any new ownership. The CAW workers will also get a 2% wage increase for the next three years in addition to cost of living increases. GM also accepted voluntary overtime for its Oshawa plants - supervisors used to be able to demand a worker stay after his shift.

The work stoppage in Canada forced GM to stop production at some of its US and Mexican plants because those plant are dependant on parts produced in Canada. About 20,000 workers in the US and Mexico were laid off during the Canadian strike and were expected to have to wait at least a week for the Canadian plants to get back up to speed.

The strike will affect fourth quarter and yearly GDP figures for Canada. The only real source of growth for the Canadian economy this past year has been exports. With auto exports making up the largest part of total exports, any slow down will have an effect on growth. Canadian Conference Board analyst Paul Darby felt a month long strike would take a tenth of a point off Canada's growth this year.

Interest Rates moving lower

Interest rates in Canada continue to move lower. The bank rate has been cut 19 times in the last 19 months declining from 8.25% to 3.5% as of October 28th. Banks have responded in kind by reducing the prime lending rate to 5% - a 40 year low. Lower interest rates mean good news for reducing deficits. Finance Minister Paul Martin's current budget estimates that every 100 basis point reduction in interest rates translates into C$1.3 billion less in interest charges from financing the public debt. Lower interest rates should help Ottawa to easily reach its deficit targets set last year.

All the good news about deficit reduction has put the pressure on Ottawa to cut taxes. However, Canada's debt this year will grow to C$602.7 billion, up C$24 billion from last year - three quarters of Canada's yearly output. This reason alone will squelch any hopes of a tax cut in the near future. Both Prime Minister Jean Chretien and Paul Martin have stressed that the focus needs to remain on deficit reduction and balancing the budget. Only then can the question of tax cuts be addressed.

Quebec Could Go It Alone

The Conference Board of Canada announced that it felt that Quebec would have the economic resilience to go it alone. Quebec is close to the same size economically as Austria, Sweden and Denmark. Quebec also has a highly developed and diverse economy that compares directly to countries that have a double-A rating by debt rating agencies. Analysts feel that if the separation was done properly, the effect on the C$ would be minimal.

In Washington, professor Earl Fry of Brigham Young University predicted that a Quebec separation would cost the US billions. He told a Congressional committee that Canadian interest rates would skyrocket, there would be a massive flight of domestic and foreitgn capital and huge drops in revenues for US border towns. He said the Canadian government would run out of money trying to prop up the C$. This in turn would spark a bailout by the US that would be much more expensive than the Mexican bailout of 1995. Fry urged the US government to adopt a position on Quebec separation before it is too late. However, the US probably will not respond because it does not want to appear to be meddling in Canadian internal affairs.

Special Report on Canada & its Future

One of the most concerning areas of investment remains the outlook for Canada. In this Special detailed report we have covered it all.

Stocks - Bonds - Currency - Debt

In this report we have answered some of the most pressing issues from both a domestic as well as an international perspective.
Above all, we have dealt with a very serious question. We the TSE reach a major high in May of 1996?

Available now for immediate delivery US$95.00

World Capital Market Review

US STOCK MARKET

The US share market has been driven by capital flows to a large extent originating out of Asia. Recently published data on foreign holdings of US government securities has reached all time record highs. Since the dollar reached its low against the yen in 1995, the directional change, combined with excessively low interest rates in Japan, have sent Japanese purchases to almost 100% of the current deficit. This foreign investemnt pouring into the dollar is also affecting the US share market.

Whenever the Dow leads the broad market, this is a clear sign of foreign investment entering US equities. This is precisely the case at this time for both bonds and shares. Therefore, one of the key factors that will determine both the short-term as well as long-term outlooks will be the fate of the dollar. At some point, the broader market will take the lead from the Dow. When this develops in the future on a consistent basis, then a major high is not far behind.

The May 23rd high, which took place exactly in line with the Economic Confidence Model, was indeed almost identical in pattern formation with that of 1987 - 8.6 years prior. In both cases, the correction took place lasting only 2 months. Our difficulty with the 1996 version stems from the fact that we are not dealing with a free market as was the case in 1987. The day of the low in July was “locked limit” at 610 on the S&P 500 futures. While the target support based upon our Reversal System stood at 598 and 605, it became impossible to reach those objectives.

The question remains is this: What is more important time or price? Historically, price has been the most important factor in determining a major turning point as long as timing is reasonably correct. In this case, the timing was perfect but the price was obstructed by limitations imposed by government. It is still not certain whether or not the market is satisfied with the July low. There does appear to be a risk that a high might form in early 1997 followed by a correction thereafter. That correction could still reach 598-605 on the S&P 500 without reversing the broader uptrend in motion.

Timing models clearly warn that we are approaching yet another vulnerable period where a temporary high might form. November and Jan/Feb are two targets where a turning point of some importance is likely. The resistance basis the Dow stands at 6300. A November high may be possible in the dollar/yen closes below 11345 at the end of October. A closing above 11345 warns that the dollar could strengthen even further pressing upwards to the 11800-12000 area by January. This could cause a Jan/Feb high in the US equities as well.

The worst possible pattern for the US market would call for a rally into the 1st quarter of 1997. This would then signal a major correction becomes possible including an extended decline into as late as 1998 around May/June. This type of pattern would then set this market up for a truly explosive move to the upside where the Dow Jones Industrials could come very close to reaching the 10,000 market by 2003.

We also see that a November high may cause a brief decline into early 1997 holding at worst the July low area of 610-598. Thereafter, a rally during the second half of 1997 may still produce a 10,000 target on the Dow by June of 1998.

Weekly timing models place key targets for turning points 10/28-11/04 going into the elections and possibly Yeltsin’s heart operation. The next target week appears to be 11/25. Key target weeks in early 1997 appear to be 01/13 and 01/27.

PRECIOUS METALS:

Gold and silver remain bearish short-term and as we move closer to year-end, both of these markets are trading around very critical numbers that will determine the outcome next year going into 1998. In silver, the primary numbers to watch are 480, 462, 452 and 439. While short-term models suggest that a decline to 462-452 is likely before any sustainable rally is possible, the key factor will be any rally after such a low. If silver manages to close above 480 at year-end then a rally into 1998 is still possible. However, a closing below 480 will warn that silver should press lower at least into early 1997. A closing below 439 would warn that we could still penetrate 350 before any turn in this market develops.

Gold, despite recent weakness, remains rather strong from a long-term perspective. The key number remains 371 and a closing below this area would warn that a drop to 341 next year as being possible. A closing above 371 signals that getting gold to decline even $20 may be extremely difficult. This will also warn that a sharp rally could begin early next year moving into an initial high in 1998. Resistance is building at the 398.60 area for 1997. Our models are showing that a weekly and monthly closing back ABOVE this level could signal the start of the next big rally. Of course the final confirmation will remain a penetration ABOVE the 428.30 area. Nonetheless, 398.60 will be a signal that should not be ignored.

US DOLLAR

The US dollar is being pulled at from all directions. The strength in the dollar against the yen is approaching legendary status. Here we still see that a monthly closing ABOVE 11345 will signal a move most likely up to the 11800 zone. Pressing much beyond that area will set the stage for a delightful move up to the 12500 zone. Long-term, the dollar appears to be headed on its way to test the 14500 level by 1998.

The European view of the dollar remains distinctly different. Here a whole host of conflicting trends are combining with serious geopolitical conflicts not to mention the infamous rush to meet EMU criteria.

The three strongest European currencies against the DM within

Europe are the pound, Swiss franc and Italian lira. It is no coincidence that these are the three main currencies outside of the ERM at this time. The DM appears to be headed for a serious decline with a distinct risk of being unable to qualify for EMU in 1997. Add to this the nervous problems building with Russia and the right-wing position in Russia being totally opposed to an expansion of NATO. Rumbling from Moscow have been reaching our sources in the West. If the fast track expansion of NATO takes place, Russia may cancel not merely its arms agreements unilaterally with the West, but it may begin to default or temporarily suspend any repayment of loans and interest. The biggest loser in this game is also Germany from which almost 70% of the outstanding Russian loans originated. Taking these risks into consideration, we can see why capital flows are pouring out of Germany headed to a variety of currencies other than ERM. This is helping to drive the pound higher as our computer long-range models have been predicting for the past two years. The pound will emerge as the strongest currency against the dollar within Europe.

At this time, there is a small risk that the dollar could make a near-term correction going into early 1997. This risk will gain in importance should the dollar FAIL to close above 11345 at the end of October. As far as the DM is concerned, only a monthly closing for the dollar above 15840 would suggest that the dollar low is in place and that a change in long-term trend has begun. A monthly closing below 13985 for the dollar vs Dmark would suggest that the dollar will decline first before rising long-term.

US 30 YEAR BONDS

The change in the dollar against the yen has drastically shifted the capital flows from Japan. Over the past year, foreign holding of US government securities has risen to all time record highs in excess of 30%. However, this capital influx to the US is also creating a lack of demand pressure on interest rates as foreign capital takes up the slack from domestic capital. As a result, inflationary pressures in the US are building keeping the Fed awake at night with each rising tick the dollar. The danger here is that the majority of that money going into US government securities is headed into the short-end of the market. Over the past year, Japanese money has accounted for nearly 100% of the entire current fiscal deficit. Most of this money is being invested short-term 5 years or less with a staggering amount being targeted in the 1 year or less category. This is “HOT” money due to the low 0.25% deposit rates in Japan for short- term cash. At this time, this “hot” cash is merely parking on a day basis due to a positive trend for dollar investments. If the dollar fails to close above 11345 on a monthly basis, then any correction could seriously affect US domestic markets.

Resistance is now starting to form at the 11302 level on a weekly closing basis while major resistance stands at the 11728 area going into the end of 1997. Support is starting to become very critical at 10814 as year-end approaches. Despite the intense capital influx from Japan, this has done little to help reestablish a breakout to the upside on the long-end of the yield curve. It has helped to keep increased supply on the short-end of the curve from moving into an immediate inverted yield curve. Thus the trading range remains 10800-11300. Only a weekly closing above the 11300 level will warn that the bond market is still capable of testing the old highs. A monthly closing above 11216 will indeed shift the market back to a slightly bullish posture but a breakout to the upside appears to require a monthly closing back above 11606.

We do have to keep in mind that a sharp correction in the share market, political disintegration in Russia, breakout in oil and/or political destabilization in the Middle East, a war unfolding in Korea or a tougher posture in Hong Kong on the part of China after July could spark very intensive capital inflows for US assets. Any one or a combination of such events could still create new highs in the bond market despite a Clinton victory in November.

NIKKEI

The Japanese share market has major resistance standing at the 23000 zone as we go into early 1997. Support is becoming critical at 19879 on a monthly closing basis. Should the Nikkei close beneath this area on a monthly basis, then a temporary top is most likely in place. This could still warn of a retest of the mid 17000 zone and a penetration beneath this area may warn that new lows are still posible early in 1997. Indeed, a monthly closing below 18896 would warn that a retest of long-term support is possible taking this market back to the 15292 level an a penetration of that area would point to a drop possibly to 11500 in 1997. We also see that a mere closing for 1996 BELOW 20813 will at least warn that this market is getting a bit weak short- term and that recent gains may not be sustainable. Yearly support for 1997 begins at 17242. This will be vital support that MUST hold next year. Penetrating this area could spark a massive sell-off.

CANADA TSE

The Canadian share market basis the TSE continues to follow the overall pattern of the US share market. The widespread belief that the proposed $50 billion bailout fund discussed by the G7 is in fact ear marked for Canada, implies that a debt default is not likely and that at worst we are looking at a repeat of Mexico. This external talk combines with domestic trends where capital continues to shift out of public sector assets into private sector is also helping the TSE domestically. Now if we consider the capital flows from Europe interested in a possible rising commodity play, and the end result is a strong TSE.

Support in the TSE is starting to begin at 51146. Here we see that a monthly closing below this area will signal a correction ahead. Like the US market, major support will now become the July low.

LONDON FT

The British share market basis the FT100 remains very strong breaking above the 40000 mark for the first time in history. Here we see

40335 as critical year-end resistance that must be watched. A closing above this area warns that the FT could press higher into early 1997 where resistance will stand at the 42111 level. Indeed, a closing for 1996 above 36906 will signal that a rally into 1997 is still possible. However, 1997 remains a key target for a top. A high in early 1997 will signal a possible sharp decline of importance which could cause a 1998 low to develop. Additional targets for an important top will be 43340 during the first quarter of 1997. Monthly models show a maximum target objective around the 45000-46000 area. Timing models seem to coincide with those for the US share market.

GERMAN DAX

The German share market basis the cash DAX continues to remain very strong despite future earnings. Here we see resistance stands at the 26000-27061 area. Penetrating ABOVE this level on a sustained basis could leading to a final rally up to the 34000 zone. Here too, timing seems to be very close to the US targets. A new high early in 1997 could prove to be a MAJOR high. In the case of Germany, the major low remains that of 1966. Therefore, the bull market in Germany is MORE vulnerable to a major high than the US or the UK. Here we are dealing with a 30 year trend compared to 22 year trends in the US and UK.

Capital Market Review

UNITED STATES

UNEMPLOYMENT: The US unemployment rate dropped from 5.4 percent in July to 5.1 percent in August.

PURCHASING MANAGEMENT INDEX: The National Association of Purchasing Management index rose to 52.6 percent in August, the third consecutive increase. The figures showed no sign that inflationary pressures are growing. For the third month in a row, the NAPM's index of prices paid by manufacturers remained under 50, a sign that inflation is under control.

LEADING INDICATORS: The Conference Board's Index of Leading Economic Indicators rose 0.2 percent in July to hit a record high of 103.1. But the increase, for the sixth consecutive month, was seen as indicating the kind of moderate growth economists have been expecting in the second half.

RETAIL SALES: US retail sales grew by 0.2 percent during August, much lower than the 0.7 percent rise predicted.

CONSUMER PRICES: Consumer prices rose by only 0.1 percent, below July's 0.2 percent rate, and weaker than the forecast 0.3 percent.

HOUSING STARTS: US housing starts in August showed a rise of 4.5 percent over July to the highest level for more than two years. The strength of the rise surprised Wall Street analysts who had projected a decline of about 1 percent.

The Commerce Department said housing starts rose to a seasonally adjusted annual rate of 1.53m. The biggest gains were for single-family home starts, up 8.3 percent last month.

BEIGE BOOK: Upward pressure on wages is becoming more widespread in the US, but there is no clear evidence yet of a strengthening price inflation, according to the Federal Reserve in its latest round-up of regional economic conditions.

The summary of the Beige Book, which contains anecdotal evidence of business conditions from the 12 Fed districts, said the economy continued to expand moderately in August. It suggests the economy has maintained much of the momentum it enjoyed in the second quarter of the year.

Only the San Francisco Fed reported that inflationary pressures in its district were intensifying, but none said that pressure on prices showed signs of easing. Few, if any, districts reported big price increases since the last comparable survey at the end of July.

DURABLE GOODS: New orders for US durable goods dropped sharply in August, the Commerce Department said. New orders fell a seasonally adjusted 3.1 percent between July and August, more than wiping out a 1.4 percent gain in the previous month. Wall Street economists had expected a decline of 0.1 percent.

Orders so far in the third quarter are running above their second-quarter average, pointing to continued economic growth. The figures were depressed last month by an erratic 38 percent decline in aircraft orders. Excluding transport, orders were down only 1.6 percent last month following a 2.4 percent gain in July.

UNITED KINGDOM

FACTORY OUTPUT: The latest monthly survey by the Chartered Institute of Purchasing and Supply showed that consumer demand was now driving a steady recovery in manufacturing after weak orders and a build-up of stocks pushed industry into recession late last year.

The institute said its purchasing managers' index was a seasonally adjusted 51.8 last month. A reading above 50 denotes an increase in activity. This was the third successive monthly increase. The picture of buoyant consumer-led growth was reinforced by separate figures yesterday which showed that the amount of notes and coins circulating in the economy grew last month at the fastest rate since December 1988. This suggests that the pick-up in retail sales continues to gather momentum.

CONSUMER CONFIDENCE: The latest survey for the European Commission by Gfk, the polling organization, shows that growing optimism about the economy is driving the upturn in confidence, while consumers are also more confident about their household finances.

The news follows figures this week which showed retail sales growing at their fastest rate since 1988, raising fears that present rates of growth may be unsustainable and may be stoking inflationary pressures.

INDUSTRY INFLATION: Inflationary pressures in industry fell to their lowest level for almost 29 years in August, official figures showed

The Office for National Statistics said factory gate prices rose 2.0 percent in the year to August, compared with 2.2 percent in July, continuing the downward trend in inflationary pressures in manufacturing since last summer's peak. The underlying annual inflation rate, which excludes food, drinks, tobacco and petroleum, fell to 1.2 percent — the lowest since October 1967.

The low inflationary pressures in industry reflect recessionary conditions in manufacturing since last winter. Companies were forced to cut prices to clear stocks of unsold goods as demand dried up, especially in markets outside Britain.

They also reflect sharp falls in manufacturers' input costs, which the ONS said fell 0.3 percent last month, the fourth successive monthly decline. The drop meant input prices were 2.1 percent lower than in the same month last year. A rise in the price of crude oil was more than offset by falls in commodities such as rubber and paper and seasonal foods. Adjusting for seasonal factors, however, underlying input costs rose 0.1 percent last month, the first monthly increase for 13 months.

RETAILERS' REPORT: Business conditions in shopping centers are more upbeat than at any point since the consumer boom of 1988, retailers have reported. The business survey from the Confederation of British Industry, the country's main employers' lobby, showed that retailers themselves were now reporting an acceleration in price increases.

In the CBI report, two-thirds of retailers said their sales were higher than in August 1995. Only one in seven said they were lower. Retailers have also stepped up their orders — and expect to increase them further. This trend may be fueled by the fact that the stock of goods held by shops is now lower than at any point for four years.

However, the trend also left retailers confident that they did not need to discount their goods as much as last year to attract business: more than half said prices were now higher than a year before.

MANUFACTURING PRODUCTION: The Office for National Statistics said manufacturing production rose by a seasonally adjusted 0.5 percent. This left the level of output in the three months to July identical to the previous three months. Although the upturn was small, it provided a hint that manufacturing output was no longer in recession.

Government statisticians also believe there are signs that the recent stock swings in manufacturing are easing. They expect little change in stock patterns in the third quarter. This should mean that any pick up in demand should boost output.

CONSUMER DEMAND: Manufacturing appears to be emerging from recession thanks to a strong pick-up in consumer demand fueled by lower taxes, interest rate cuts and higher personal incomes. The British Retail Consortium measure of the value of "like-for-like" high street sales was 6.9 percent higher last month than a year ago. The BRC said the latest rise confirmed the steady acceleration in sales since last autumn.

FAMILY EXPENDITURE SURVEY: Families spent on average BP289.90 ($452.24) each week during the last financial year (1995-96) and received an average weekly income of BP380.90, according to the latest family expenditure survey published by the Office for National Statistics. This compares with households' average weekly expenditure a year earlier of BP283.60 and average gross weekly income of BP369.30.

TRADE: Better exports to the US and South America helped cut Britain's trade gap with countries outside the European Union to its smallest level for 15 months in August but the deficit with EU countries more than doubled in July.

The Office for National Statistics said the UK's overall trade gap with the rest of the world was a seasonally adjusted BP1.2bn in July, higher than June's BP1.1bn deficit and worse than the City of London expected.

The deficit with EU countries rose to BP0.5bn from BP0.2bn in June. Exports fell by 1 percent in the month but imports from the EU rose 2.5 percent. More encouraging was the trade gap with countries outside the EU, which fell to BP0.5bn from BP0.7bn in July. This was helped by a fall in imports from Switzerland and Norway and stronger exports to the US, Brazil and Saudi Arabia.

However, the trade performance was flattered by oil and erratic items. Stripping out these influences, the underlying picture was more disappointing, showing import volumes rose 2.5 percent between June and July to record levels while exports fell 0.5 percent.

CURRENT ACCOUNT: The UK has recorded the biggest current account surplus for nine years and the first since late 1995, thanks to record incomes from investment and services. The Office for National Statistics said the UK recorded a current account surplus of BP0.5bn ($0.78bn) adjusted for seasonal factors, in the second quarter of this year, compared with a deficit of BP0.8bn in the first quarter.

The surpluses on income from trade in services rose from BP1.2bn to BP1.9bn and investment income registered a surplus of BP3.7 bn, up from BP3bn. Both figures were the highest since records began in 1946. Services income was boosted by a surge in visitors to the UK, which may be linked to the summer Euro 96 football championships.

The ONS said gross domestic product grew a seasonally adjusted 0.5 percent between the first and second quarters to reach a level 2.2 percent higher than in the same quarter a year ago. This was significantly faster growth than earlier estimates suggested. The ONS said consumers' expenditure, investment and net exports were now growing faster than first estimated.

UNEMPLOYMENT AND WAGE INFLATION: Unemployment in the UK fell in August to the lowest level for five and a half years, but wage inflation in some areas of the jobs market was the weakest for almost three decades.

The Office for National Statistics said the number of people out of work and claiming benefit fell by 15,600 in August to 2,110,400, the lowest level since march 1991. The unemployment rate fell to 7.5 percent from 7.6 percent. The drop, the sixth consecutive monthly decline, confirmed that unemployment has now resumed its downward trend after rises last winter when manufacturing went into recession.

Official survey-based measures of joblessness showed unemployment was still rising earlier this year. However, the ONS said the number of people employed rose 90,000 in the second quarter, the biggest rise for almost two years. Almost all the rise was due to new jobs in the services sector. However, the latest monthly figures showed manufacturing may have begun to recover in the third quarter with employment in July growing at the fastest rate since last October.

JAPAN

GROSS DOMESTIC PRODUCT: Japan's economy shrank slightly in the three months to June. Gross domestic product fell at an annualized rate of 2.9 percent in the second quarter, in reaction to a revised 12.2 percent increase in the first quarter, Japan's economic planning agency (EPA) announced.

Growth in the first three months had been artificially pumped up by one-off statistical factors and a surge in public works spending, which has since subsided to more normal levels.

The economy actually grew by 3.4 percent in the second quarter when measured by comparison with the same period last year, a significant slowdown from the 5.6 percent year-on-year growth of the first three months of 1996. This brings growth for the first six months of the calendar year to 4.5 percent, from the first half of 1995.

Growth in the second quarter was led by the two factors most sensitive to low interest rates—corporate investment and housing. Corporate investment rose 1.6 percent from the previous three months, the sixth quarterly rise in a row, contributing 0.2 of a percentage point to growth. Housing rose 3.7 percent, the third consecutive quarterly rise, adding 0.3 points to growth.

The main drags on second quarter economic growth were private consumption, the biggest single sector of the economy, and public investment. Private spending shrank 1.3 percent from the first to the second quarters, after having risen by 2.4 percent in the first. That removed 0.8 of a point from growth.

Public investment rose by a mere 0.6 percent, after a startling 8.7 percent rise in the first quarter, making a 0.1 point contribution to GDP growth.

For the first time in two years, the GDP deflator, a measure of prices, swung positive, another sign of recovery in demand. It rose by 0.3 percent from the same quarter of the previous year, suggesting that deflation, a contributor to Japan's economic stagnation of the past four years, might at last be easing.

RATE WILL REMAIN LOW: Mr. Yasuo Matsushita, governor of the Bank of Japan, indicated that Japanese interest rates would be kept low. The central bank would continue to "put priority on solidifying the recovery base", he said.

Earlier, the government's Economic Planning Agency — in its monthly report — described the pace of recovery as "mild". This was unchanged from its assessment last month, though it fell short of registering a decline in confidence, as shown in the Bank of Japan's August survey of business conditions.

The EPA report said the labor market remained weak, with unemployment at 3.4 percent, just below a record high of 3.5 percent in June. Corporate capital investment was improving, but there was "a long way to go before we have sustained recovery", led by private sector demand.

The EPA cited a decline in semiconductor companies' investment plans as a concern, while retail sales declined in the summer because of an epidemic of food poisoning. Supermarket sales fell by 2.5 percent in July and department store sales were down by 2.9 percent. There was a modest rise in industrial production, but the EPA did not see any further improvement in the pace of output growth.

DEBT: The damage wrought by years of slow growth and repeated fiscal stimuli on Japan's public finances was revealed when the country's finance ministry revealed that the gross level of outstanding debt owed by the central government stood at Y334,131bn ($3,037bn) at the end of June.

The figure indicates a rapid deterioration in the fiscal position in the last five years, and is likely to renew calls from the ministry and some politicians for an early move towards consolidation of the national budget.

But the broader picture of public sector debt suggests that while there has clearly been a decline in the nation's fiscal health the underlying position remains comfortable.

During the last decade Japan has moved from being the most fiscally conservative of the leading economies to one of the most lax. Long-term central government debt — at Y302,146bn — is now just under 60 percent of gross domestic product. Next year, according to the country's finance ministry, the figure is expected to rise to over Y320,000bn, or 64 percent of GDP.

TRADE SURPLUS: Rising oil prices contributed to a 31 percent decline in Japan's trade surplus to Y369.47bn ($3.35bn) in August compared with the same month last year, the 21st consecutive monthly fall, the finance ministry said.

The politically sensitive bilateral surplus with the US decreased by nearly 17 percent to Y222.3bn, much faster than the 6.5 percent fall in July and the 18th consecutive month of decline. Japan's surplus with the European Union was down by 17 percent last month and the surplus with the rest of Asia by 11.4 percent compared with the same month last year.

Within the total surplus, exports rose by 8.7 percent to Y3,472bn, easily outrun by the growth in imports, up 16.6 percent to Y3,102bn. The ratio of finished products to total imports rose a fraction to 59.4 percent, a reflection of Japan's continuing shift fro a nation of processors of raw materials for re-export, to consumers. Import growth, however, was unusually swollen by a 54 percent rise in Japan's monthly oil bill and by the purchase of three large aircraft from the US.

Exports were helped by the weakness of the yen, allowing the Japanese car industry to increase overseas sales by 18 percent. Exports of personal computers and other office equipment rose by 20 percent.

MONEY SUPPLY: Japanese demand remains modest on evidence released by the Bank of Japan yesterday of a 3.7 percent growth in the main measure of money supply — M2 plus demand and time deposits — in the year to August, a growth rate unchanged from the previous month. But on another measure, broad liquidity, money growth is slowing, a consequence of lower bank lending growth and a fall in public works spending in August. Broad liquidity grew by 3.7 percent in August, down from 4 percent in July and the weakest rise since April.

DEPARTMENT STORE SALES: Sales in Tokyo department stores in August rose by 2.5 percent from the same month last year, after falling by 2.7 percent in July, the first drop in seven months.

INDEX OF COINCIDENT ECONOMIC INDICATORS AND DIFFUSION INDEX: The economic planning agency said its index of coincident economic indicators remained in positive territory for the second month running in July. The diffusion index, which nets out current positive and negative data in a range of economic statistics, stood at 80 percent, well above the 50 percent level that marks the break-even between growth and contraction.

INDEX OF LEADING INDICATORS: The index of leading indicators was above 50 percent for the fourth consecutive month at 77.8 percent, suggesting the immediate economic outlook also remains moderately healthy.

MACHINE ORDERS: Private sector machinery orders in Japan rose in July a seasonally adjusted 13.6 percent from the previous month after two months of consecutive decline, the Economic Planning Agency said. The key orders — private-sector orders minus volatile orders for ships and machinery used by the electric power industry — amounted to Y1,185bn ($10.8bn). The July orders were 22 percent up on their level the year before.

The agency traced the orders upsurge to the “trend of mild recovery” in Japan’s economic activity as well as a Y50bn order placed by one corporation during the month. If that order is excluded, the month-on-month growth figure would be in the 8 percent range.

SURPLUS: Japan’s current account surplus declined by 27.3 percent in July compared with the year before, the result of strong import growth and a rise in the number of Japanese taking foreign holidays, the finance ministry announced.

The decline to Y568.2bn ($5.2bn), slightly sharper than the 25.5 percent drop recorded in June, represents the 11th month in a row in which the surplus, a source of continuing trade tension, has shrunk.

Within the total, the surplus on goods and services fell by 79.3 percent to Y110.8bn. The services account fell Y619bn into the red, a 35 percent increase on the services deficit in July last year, a reflection of the rise in tourism. It was the biggest monthly services deficit for 11 years. The surplus on merchandise trade fell by 26.4 percent to Y730.1bn over the same period. It is the smallest July trade surplus for 11 years.

Exports rose by 16 percent, greatly outstripped by a 35 percent rise in imports, reflecting a modest recovery in domestic demand from the unusually low level of mid-1995. imports rose across the sectors, with a 49 percent rise in the purchase of crude oil, reflecting the usual summer increase in the use of air conditioners, a 53 percent rise in imports of office equipment and a 46 percent increase in purchases of clothes.

On the export account, foreign car sales rose by 35 percent, a rebound from unusually depressed sales in the same period last year, when sales to the US were held up by a trade dispute and US threats of sanctions. Exports of personal computers and office equipment rose by 28 percent.

WHOLESALE PRICES: The Bank of Japan said wholesale prices declined by 0.7 percent compared with a year earlier, confirmation Japan suffers from continued excess domestic capacity, as a result of which inflation is non-existent.

PRIME RATE CUT: The Industrial Bank of Japan announced a cut of 0.3 percentage points in its long-term prime rate, a benchmark lending rate for first-tier customers, in response to a lingering weakness in business confidence. It was the first prime rate cut for three months by the IBJ, Japan’s largest long-term credit bank.

Two other long-term credit banks are expected to follow suit and the move, which will ease funding costs for companies, could help increase capital investments at a time when corporations are looking to raise spending.

The bank attributed the cut to declines in market rates following the release of the tankan, the quarterly survey of business sentiment, last month. While expectations of a rise in the official discount rate had earlier in the year pushed up market interest rates, the survey revealed that overall confidence among leading manufacturers had weakened, leading to a fall in bond yields and money market rates.

GERMANY

DECLINE IN PHONE COSTS: The cost of telephone calls in Germany will fall by about 6 percent on January 1, 2000, the latest of several tariff changes designed to force down prices, the post and telecoms ministry said. Several tariffs were reduced earlier this year and are due to fall by a further 4.5 percent in real terms on January 1, 1998, when most of the European Union’s telecoms markets will open to full competition.

The reductions planned for 2000 (whose real effect will depend on inflation at the time) will take the form of a price cap which means that all tariffs across the board must be reduced. Tariffs will still have to be agreed by the new regulatory authority.

FINANCIAL SUPPORT FOR EAST GERMANY: The German cabinet agreed that federal financial support for businesses in eastern Germany should be kept “at a high level” from 1999, when current plans expire.

After reviewing a progress report on the eastern German economy, Mr.

Gunter Rexrodt, the economics minister, said details of the aid would be fixed next year when the government had a better idea of the impact of tax changes due in 1997 and the large scale tax reform that it is planning for 1999. He indicated that aid would be focused on manufacturing industry, and especially the small to medium-sized Mittelstand companies.

The minister said eastern Germany continued to suffer from too narrow an industrial base and provided only 2 percent of Germany's exports. Unit labor costs were too high: they averaged 131 percent of western German levels last year and were higher than the year before. Eastern German companies also had insufficient capital resources and suffered liquidity shortages.

However, the minister forecast that growth in the new Lander would be higher than in the west, although the period of exceptionally fast expansion was over. The economics ministry expects that western support for eastern German companies will amount to about DM25bn ($16.6bn) this year out of net transfers totaling DM144bn.

MONEY SUPPLY: The Bundesbank said that August M3 money supply went up by an annualized 8.7 percent against the fourth quarter average of 1995. The M3 growth rate, which was slightly ahead of expectations, compares with rates of 9.6 percent in June and 8.6 percent in July. The rise in M3 has once again triggered market comment that the Bundesbank may have reached the end of the cycle of interest rate cuts.

INDUSTRIAL PRODUCTION: German industrial production was 0.2 percent higher in July than in June. The seasonally adjusted month-on-month figures were driven by a 4.2 percent surge in building output, but the economics ministry warned the increase reflected efforts to catch up on work lost rather than new growth. Losers on a month-on-month basis were non-durable consumer goods, down 3.9 percent, and mining, down 3 percent. On a calendar-adjusted year-on-year basis, July industrial production was 0.5 percent above July 1995, with strongest growth in consumer durables (7.9 percent) and investment goods (3.3 percent).

SOCIAL SECURITY SPENDING: Germany's spending on social security rose 4.7 percent to a record DM52.1bn ($35.4bn) last year, reflecting the growing number of elderly and unemployed. Spending of the old and handicapped was DM33.3bn, while other income support totaled DM18.8bn. Germany also spent DM5.5bn funding asylum-seekers, a fall of 1.7 percent on 1994. Mr. Horst Seehofer, health minister, said the figures underlined the need to reform the national health service.

NEW ORDERS FOR MANUFACTURING: New orders for German manufacturing industry rose 0.6 percent in July, bolstering hopes that second quarter growth will carry over into the third quarter. But analysts warned that growth would be slower than in the second quarter, when manufacturing orders rose 3.8 percent over the previous quarter. Domestic demand was weaker in July, falling 2.9 percent compared with a 5.2 percent increase in June.

GDP: The German government upgraded its forecast of economic growth for this year after a higher-than-expected jump in output in the second quarter.

Mr. Theo Waigel, the finance minister, said 1 percent real growth was now likely in 1996. Before news of a 1.5 percent seasonally adjusted rise in gross domestic product between the first and second quarters, the government had been predicting growth of 0.75 percent. He said Bonn was sticking to its goals of a DM56.5bn ($38.1bn) federal borrowing requirement and a 2.5 percent cut in spending to DM440bn next year, despite risks posed by high unemployment.

Looking ahead to the income tax reform planned for 1999, Mr. Waigel said this would include abolition of the solidarity surcharge, which helps finance eastern Germany. The government wanted to cut the top tax rate to below 40 percent from 53 percent and set an initial tax rate of about 20 percent against 25.9 percent.

INFLATION: The statistics office said pan-German inflation fell to a year-on-year 1.4 percent in August from 1.6 percent in July after a sharp drop in east German inflation to 1.8 percent from 3 percent.

TRADE SURPLUS: Germany's visible trade surplus fell to DM7bn in June from DM9.5bn in May.

GDP: Germany returned to growth in the second quarter, but rising unemployment last month and a sober report on the economy from the Organization for Economic Cooperation and Development gave little hope of the country's unemployment crisis easing.

On a seasonally adjusted basis, gross domestic product jumped 1.5 percent from the first quarter, when the economy declined 0.5 percent, the federal statistics office said. GDP was 1.2 percent higher than in the second quarter of last year after year-on-year growth of just 0.2 percent in the first three months of 1996.

Germany's return to growth between the first an second quarters owed much to an unprecedented 11.5 percent jump in construction activity, which made up for the 9.5 percent drop during the first quarter. The statistics office pointed to a 2.5 percent increase in export demand and a 3.6 percent jump in public-sector consumption as important factors behind the year-on-year growth of 1.2 percent.

UNEMPLOYMENT: On an unadjusted basis, Germany's August jobless total of 3.9m was 9,950 below that of July but 323,500 higher than in August last year. The nation's unemployment rate held steady at 10.2 percent of the working population last month, with a continuing sharp divergence between the 15 percent jobless rate in former Communist eastern Germany and 9 percent in the west.

NEW ORDERS FOR ENGINEERING INDUSTRY: New orders for the German engineering industry fell 18 percent in August compared with a year earlier, the VDMA engineering industry association said after its survey of 1,200 larger engineering companies. A 16 percent fall in foreign orders was explained by an unusually high set of orders in August 1995, the VDMA said, but it could not offer an explanation for 20 percent drop in domestic orders. More reliable three-month figures showed new orders 6 percent lower than in the June-August period last year.

INDEX OF BUSINESS CONFIDENCE: Indications of a modest upturn in the economy were corroborated by the monthly IFO confidence indices. The western German index edged up from 94.0 in July to 94.4 in August, which is the combined effect of more pessimism about current business conditions and more optimism about the future. The east German business confidence index rose from 102.9 to 103.9. Monetary capital formation continued to weaken in August because of slack demand for longer-dated instruments.

FRANCE

NEW CAR SALES: New car sales in France surged by around 90 percent in the first half of September of year-earlier levels. The surge in demand has been propelled by the impending expiry of a state rebate scheme, an industry official said.

UNEMPLOYMENT: Unemployment in France fell a seasonally adjusted 0.7 percent in July to 3.05m, confounding fears that the jobless total could hit a new record. The unemployment rate, based on International Labor Organization criteria, was unchanged at 12.5 percent.

TRADE SURPLUS: Mr. Yves Galland, trade minister, suggested that this year's trade surplus could set another record, higher than last year's FFr104.5bn ($20.5bn). The latest statistics showed a marginal improvement in the country's first-half trade performance, with the surplus rising to FFr53.28bn from FFr52.9bn in the first half of 1995. The surplus for the month of June was down substantially from levels a month earlier, however, at FFr9.75bn against FFr11.24bn. Both imports and exports fell.

GDP: The French economy contracted more sharply than expected in the second quarter this year. Figures released showed a 0.4 percent decline in second-quarter gross domestic product, against an anticipated fall of 0.2 to 0.3 percent.

TAX CUT PLAN: Mr. Alain Juppe, French prime minister, rushed out a sweeping package of tax cuts. FFr75bn ($14.8bn) would be wiped off income tax over the next five year, with taxpayers receiving a third of the reduction next year.

The net reduction in taxes in 1997 would be FFr18bn, with income tax cuts offset by FFr7bn increase from levying social security charges for the first time on investment income as well as salaries. He promised that all taxpayers would pay less income tax and indicated that the top rate, currently 56.8 percent for those earning from FFr288,100, would be brought down to 54 percent next year and to 47 percent over the next five years. But he said those on modest incomes would get the biggest cuts.

He also pledged a reduction in state medical insurance payments, with an initial cut next year of 1.3 percentage points from 6.8 percent of gross income to 5.5 percent. From next year, the government also plans to abolish or reduce many tax privileges for specific groups of employees.

Employees are to be offered the opportunity to save independently for retirement. It is planned to set up funds run by independent managers to complement the existing system of universal pensions. They will be company-based and voluntary.

UNEMPLOYMENT: France's jobless rate rose to a record 12.6 percent in August, underlining slackness in the economy and fueling union anger over unemployment and government budget cuts.

The unemployment rate, reported by the labor ministry, was 0.1 percentage points above last month's figure and a full point higher than a year ago. The number of job-seekers rose by 39,500 in August, bringing the total to 3.085m and reversing a decline in July.

CAR PLAN DISCONTINUED: France has decided not to extend a government incentive program for new car buyers ending on September 30.

The decision, disclosed by the industry ministry, represents a victory for Mr. Jean Arthuis, the finance minister, who had argued strongly against an extension in cabinet. But it is likely to disappoint some car industry leaders, particularly Mr. Jacques Calvet, the outspoken head of the Peugeot Citroen car making group.

Under the scheme, new car buyers have been offered a bonus of FFr5,000 to FFr7,000 ($1,300) for trading in a vehicle at least eight years old. The scheme has been instrumental in triggering a sharp upsurge in French car registrations. September registrations are expected to be nearly double September 1995 levels.

BASE RATE CUT/BUDGET: The Bank of France lowered its intervention base rate to 3.25 percent. The prime minister, Mr. Alain Juppe, put the stress on his planned tax cuts next year. Bar from being "a budget of rigor", the 1997 plan would inject a total of FFr55bn ($10.84bn) into the economy through a FFr25bn income tax cut, an early FFr15bn off-budget payment of savings premiums to poorer families outside the income tax net, and the carry-over of some consumption-boosting measures introduced earlier this year. He omitted to mention a FFr13bn rise in tobacco, alcohol and petrol taxes.

The government is counting on growth rising from 1.3 percent this year to 2.3 percent next year to help realize its calculation. France can bring its overall public deficit down to 3 percent in 1997, the level needed to qualify for monetary union. The rate cut may renew pressure on commercial banks but, faced with their own financial problems, they have left their "bank base rate" unchanged since April at 6.75 percent.

DROP IN SAVINGS: The French look set to save a significantly lower proportion of their disposable income in 1996. Economists are projecting an average savings ratio of between 12.5 percent and 12.7 percent in 1996, a sizable reduction from the 14.3 percent level of 1995.

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