WORLD ECONOMIC OUTLOOK*

Economic Growth Slowed in Many OECD Countries

Economic growth in many OECD countries slowed in recent months. Those countries include the U.S., Canada, Japan, Germany, France, the U.K., and Sweden. Output growth was especially weaker than anticipated in North America and Japan. However, there are grounds for hope for re-acceleration in the second half of the year which will prevent a hard landing in the U.S. and a fall-back to recession in Japan.

In the U.S., the second quarter was filled with bearish news. Leading economic indicators, car sales, housing starts, industrial production, and payroll employment all indicated a sharp slowdown in economic activity. Underlying economic factors, however, do not suggest that this is the start of a cyclical downturn. The U.S. economy is expected to rebound from the sharp slowdown, and the soft landing scenario is intact.

In Japan, first quarter real GDP grew by a surprisingly anemic 0.3% annualized rate from the fourth quarter of 1994. On a year-on-year basis, real GDP posted only 0.1% growth. The poor expansion during the quarter was due to weak consumer expenditures, slow public investment and strong import growth. Taken as whole, economic indicators suggest the Japanese economy is still headed for a recovery, albeit a slow one.

High Growth Sustained in Asia

While financial turmoil in the first half of 1995 left many victims in Latin America and other regions of the world, the Asian economies - except Japan - emerged stronger than ever. Asian countries face the second half of the year with more confidence, enjoying an economic stability in the near-term and a strong growth potential in the long-term.

Underpinned by strong exports and investment, and benefiting from the recent strength of the Japanese yen, first quarter real GDP growth rates increased to 9.9% in Korea and to 7.0% in Taiwan, up from 8.4% and 6.5%, respectively, in 1994. Even allowing for a possible downward revision of these growth rates, these are extraordinary performances considering that growth decelerated in many industrialized countries during the period. For other countries, the output growth fell somewhat but was still proceeded at a comfortable pace. In China, real GDP grew 11.2 percent, down from 11.8 percent in 1994. China's rate of growth is likely to weaken in the second half, reflecting tighter credit conditions. In Singapore, real GDP growth slowed to 7.2 percent, down from 10.1 percent in 1994.

Containing Inflation Is a Challenge

The challenge for the region is to contain inflation. The sustainability of recent strong growth is questionable in the face of inflationary pressures, notably in Hong Kong and in Indonesia. Years of strong growth in the Asian economies have finally created visible capacity and infrastructure bottlenecks, which are compounded by buoyant domestic demand. In some countries, like Korea and Singapore, inflationary pressures have been contained by the local currency's appreciation against the U.S. dollar. But this deflationary effect could be swamped by increased domestic demand, feeding higher consumer prices during the rest of the year. To contain inflation, tighter monetary policy is expected for most countries in the region.

There is renewed interest in Asia's emerging stock markets. Many of the Asian emerging economies are viewed as offering growth prospects equal to or better than Latin American and other emerging markets, without the same degree of currency risk. It is projected that by the end of 1995 we will see a return to significant net investment in the Asian stock markets.

* This is an abridged version of the WEFA Group's *Executive Summary* (July 10, 1995).