WORLD BUSINESS CYCLES NOT IN SYNCH

The U.S. Economy: Approaching Its Growth Potential

The U.S. economy received a bit of bad news when it was announced that personal spending showed its steepest decline in more than three years, along with sluggish growth in personal income.

However, this should not be too worrisome. January's figures were skewed by the weather and the temporary shutdown of the federal government, which consequently affected the data for February. According to past experience, every economic expansion since World War II has been interrupted by one quarter of decline in GDP, and in each expansion the temporary drop in economic activity was followed by a quick resumption of growth that typically lasted for several years. The currently ongoing economic slowdown may be a similar phenomenon as well, since the slowdown can be interpreted as the delayed result of the monetary tightening early last year designed to keep inflation down as the economy peaked. The monetary policy has been eased since the second half of last year, which will have a positive effect on economic activity in the near future. The most recent employment figures were also better than expected. Even though the first quarter growth is expected to be at a sluggish rate of around 1 percent, the economy will come close to reaching its growth potential in 1996 because the financial environment is still conducive to reasonably good growth in the period ahead.

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Germany and Japan: Moving in Opposite Directions

German unemployment rose to a post-War record in February, raising the possibility that the German economy has entered into a recession. Although the government announced a program for growth and employment at the end of January, there have been serious delays in implementing the measures. The decline of the economy is due to a drop in investment in capital goods, reflecting manufacturers' pessimism, and to lower spending in the construction sector.

Since negative economic growth for two or more consecutive quarters is normally regarded as evidence of a recession, economists are not hesitating in using the word "recession" to describe the German economy. That is why we expect a further cut in interest rates within the first half of this year.

Until the end of February, Japanese interest rates were climbing fast, reflecting market participants' perceptions on an economic recovery. However, interest rates are going down again, as a series of lukewarm economic reports bolstered the government's stance on low interest rates. Unemployment remained at a record 3.4 percent in January for the third consecutive month, and the results of a survey on business sentiment, while better than the previous quarter's, were still worse than expected.

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Regardless of the sluggishness, one thing which is clear is that the Japanese economy is on a slow recovery pace. Our expectation, therefore, is that the economy will force the central bank to raise interest rates to prevent inflation. However, this will be done slowly, since pushing up interest rates and the yen could put the brakes on the economic recovery. VIP

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