

MAJOR WORLD ECONOMIES ON A DECENT PACE

The Time to Raise Interest Rates in Both U.S. and Japan

Recently released statistics were almost all positive for the U.S. economy. One of the most important statistics was the larger than expected 239,000 gain in nonfarm payroll employment in June. During the first half of 1996, job gains jumped to an average of 233,000 per month, up from 185,000 per month during the 12 months of 1995. Some economists have said that the second quarter real GDP growth will be at a 4.0% annual rate or so as businesses have begun to rebuild their inventories and final sales continue to expand.

Currently, the Fed seems to be waiting until August for more information to determine its monetary action because the economy is operating at or close to its potential. However, the strong economic pace in the second quarter and the continuous growth anticipated in the second half of 1996 raise the prospect of the Fed tightening its monetary policy to cool inflationary pressure.

Therefore, we expect that the Fed will raise the target Federal funds rates later this year, possibly at its August meeting. However the raise in rates will be slight, from the current 5.25% to 5.5%. Moreover, the Fed will most likely continue to seriously watch the future movement of Japanese interest rates because the continuous appreciation of the dollar against the yen will not be helpful to the U.S. export sector.

Japan's real gross domestic product surged at a 12.7% annual rate in the first quarter, the highest rate in 23 years. Since the effects of the weak yen have not carried over into exports yet, the contribution of the external sector to the first quarter growth was minimal. However, all other sectors suggest a solid recovery of the Japanese economy.

Despite the unexpected advance in real GDP, the Bank of Japan did not raise interest rates because of high unemployment and stable prices.

However, the Tankan results suggest that business spending will remain on an uptrend and the weaker yen will help to boost exports later this year. Furthermore, the Bank of Japan should consider investors' complaints about the prolonged low interest rates. Therefore, it is expected that the Bank of Japan will raise the discount rate, which is currently at 0.5%, this summer or later this year.

Rays of Light for the German Economy

Despite a stagnant economy in the two preceding quarters, there are signs of recovery for the German economy. There has been growth in foreign orders for German manufactured goods and domestic orders have also grown in recent months. Furthermore, the business climate in West German retail trade has also improved.

Even though the depreciation of the German mark against the U.S. dollar has stopped recently, the weaker mark since early this year will boost German exports later this year. Additionally, there are no signs of inflation, so the Bundesbank will not raise its key interest rates soon.

However, the labor market is still the dark side of the German economy. It is estimated that 3.82 million people were registered as unemployed at the end of May. Since no upturn in labor demand before next spring is expected, personal consumption will not be on a good pace in the near future. Therefore the anticipated recovery of the German economy in the second half of this year will not be strong, being induced by business investment and exports. **VIP**

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