KEEPING THINGS STEADY FOR NOW

Reduced Possibility of Rise in Interest Rates in the U.S. and Japan

Up until mid-July, the Fed said that the economic data to be released from mid-July to mid-August would be a crucial indicator for the current business cycle. They also suggested that if the robust data did not settle down, the monetary policy would be tightened due to worries about economic overheating.

Recent evidence shows that growth might slow in the third quarter, reducing pressure on the Fed to raise short-term interest rates, even though the U.S. economy grew at an annualized rate of 4.2% in the second quarter.

The contents of the second quarter growth were relatively nice because the expansion was broadly based on consumer spending and a rapid rise in government spending. However, the recent weakness in the manufacturing and employment sectors reduces the possibility of the Fed tightening.

Subdued job growth and declining hourly wages in July showed signs that the U.S. economy is slowing down. The U.S. economy added 193,000 jobs in July, a much smaller number than June's huge gain of 220,000 jobs. The fact that the gain is shrinking is what matters to the Fed. The average hourly earnings fell 2 cents, pushing the year-to-year increase down to 2.9% from 3.4% in June. The decline in the earnings may also be an early indicator that prices will not skyrocket in the next few months.

Since the Fed is looking for signs that growth is slowing to 2~2.5%, seen as a consistent level of growth with stable inflation, and that the current situation is exactly what the Fed wants, the Fed may keep interest rates unchanged for the time being.

After a record increase in GDP for the first quarter, the Japanese government has expressed optimism about the business outlook. They also said that they are keeping the current low interest rate policy to attain the goal of an autonomous and sustainable recovery. Because unemployment remained at a record high in June, the prospects of the Japanese central bank raising its discount rate in the near future were reduced significantly.

However, with the economy firming up, the Japanese central bank is likely to raise short-term interest rates later this year, since investors in Japan have been starting to complain about sustained low interest rates and the Japanese saving rate has been falling. Until that time, the improvement in the Japanese economy will be induced by low interest rates and the weaker yen.

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Keeping Interest Rates Low for the German Economy

The growth rate of the German economy is expected to pick up later this year and next year. The IFO Economic Institute reported recently that the growth rate will be at around 0.75% in 1996 and 2.5% in 1997. The economic slowdown in 1995 and in early 1996 was due to the sluggish activity in the construction sector as well as private consumption and business investment. The main source of the anticipated economic growth continues to be exports, propelled by the weak German mark since late 1995. Because the German mark has appreciated against the dollar recently, the Bundesbank might not raise its interest rates. Since a recovery in domestic demand is needed for the economic upturn, keeping interest rates low is the only possible choice given the high unemployment rate and restricted fiscal spending. VIP *(Jae-Chil Kim)*