WORLD MAJOR ECONOMIES STEADY

U.S. and Japan: No Need to Raise Interest Rates So Far

The Commerce Department's initial estimate for the annual growth rate of the U.S.'s real GDP in the third quarter was reported to be 2.2%. This pace of economic growth is down from the 4.7% in the second quarter.

However, the trend is likely to reverse in the fourth quarter again. Given the continued strength in the labor market and consumer confidence, domestic demand has been picking up and inventory growth this quarter is likely to slow. Although the Fed is not likely to worry about inflation in the near future, it remains cautious because the labor market is still tight so that any reacceleration of growth can carry significant inflation risks. For instance, during the third quarter, average hourly earnings rose at a quarterly rate of 0.9% for the second consecutive quarter. Moreover, the employment cost index (ECI) for wages, considered to be a better measure of wage growth, rose 3.2% from a year ago.

In this context, the possibility of raising the Federal funds rate will not disappear until fresh evidence comes up suggesting real GDP growth has slowed to below 2% on a trend basis. However, we believe that U.S. real GDP will be about 2~2.5% in the fourth quarter and the first quarter of 1997. This expectation can be supported by the fact that consumer spending will start to rebound as the holiday season approaches. Therefore, the next move by the Fed is still likely to be a tightening, perhaps in February or March 1997.

Recently, the pace of Japanese economic recovery has been slowing. Real GDP fell by 2.9% on a quarter by quarter basis (annual rate) in the second quarter after jumping by 12.2% in the first quarter. However, the Japanese economy is not likely to be in a recession again because the first quarter gain in real GDP driven by the government spending was not expected to be sustainable. Actually, the real GDP increased by 3.9% on year over year basis in the second quarter. It is argued that components of private demand including private consumption and residential investment will be affected by the imposition of a higher rate of consumption tax in the spring of 1997. However, with an improving labor market and declining real interest rates, there is little reason for any serious impediments to the continued recovery of the household sector in general. In addition, Japanese exports have been gradually improving thanks to weakened Japanese yen. Therefore, the private sector will enter into a full-scale autonomous recovery in early 1997 and the Bank of Japan will hold its current monetary policy stance until that time.

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Germany: Still on a Positive Recovery Track

The German economy is on a positive track induced mainly by strong export expansion. The economic recovery is also being fuelled by the manufacturing sector. Industrial production jumped by a 9.6% annualized rate in the two months ending in August. However, dragging domestic investment is still a problem for job creation, and the resulting high unemployment rate has restrained personal spending. Although such negative factors still exist, we expect that the German economy will be back on a steady growth path in 1997, because there are no signals that a raising of interest rates will be necessary in the foreseeable future. VIP

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