

## WORLD'S TWO MAIN ECONOMIES GOING DIFFERENT WAYS

### *The U.S. Economy: Still Firing Strong*

Recent U.S. economic data continues to be upbeat and indicates no evidence of cooling. Even the usually laggard manufacturing sector is showing new vigor. The Fed's industrial production index spurted by 0.9% in March, the largest gain in a year, and the prior two months of data were revised upward. This strength is beginning to place some pressure on the rate of capacity utilization, which was 84.1% in March, the highest in two years. Consumer spending continues to move ahead also. The latest University of Michigan survey showed consumer confidence at record-high levels, not surprising given the exuberant conditions in the job market.

For a long time, those who argued that there was no need for the Fed to tighten the money supply pointed to the lack of any smoking gun on inflation. That is partly true. The CPI rose by 0.1% in March on a monthly basis after rising by 0.3% in February. The figure shows that the overall level of consumer prices is still very much in check around 3% annually.

However, in the context of rising wages and the Fed's famous pre-emptive policy stance, another tightening move at the May 20 meeting of the FOMC seems quite likely. Average hourly earnings rose 0.4% in March, bringing the 12-month change to 4.0%. This is the fastest rate of wage increases in the economy since 1989. Some components of CPI are already exhibiting an upward drift, especially for the labor-intensive services sector. It should also be noted that some of the factors such as low health care costs and the strong dollar which

have helped to hold overall CPI in check cannot be expected to continue.

### *Japan: Entering Economic Slowdown Again*

Japan is entering a difficult phase for its economy as the consumption tax was bumped on April 1 from 3% to 5%. It is too early to assess the precise impact, but the still-limping economy will clearly be hobbled in the second quarter. It is hard to imagine a scenario of strong consumer demand in the near future, even though consumption for durable goods, such as automobiles, surged from January through March. The still weak labor market and the high corporate bankruptcy rate will drain demand. The number of jobless jumped in February to 2.7% above last year's level and the number of bankruptcies rose 9.5% in March from the month before. Corporate capital spending is moderating as well. Domestic machinery orders in February dropped 1.6% from the previous month and the prospect for future orders is also not bright. The Bank of Japan's Tankan survey indicates that growth in corporate investment by large firms will slow to 2.7% in fiscal 1997 from 4.7% last year. The reduction in public spending is also retarding economic growth.

The expected economic backdrop calls for a continuation of Japan's easy monetary policy to achieve domestic-demand-led growth in 1997. Indeed, Japanese government officials have repeatedly emphasized that the central bank's policy priority is on economic recovery. **VIP**

*(Jae-Chil Kim)*

*"Another tightening move at the May 20 meeting of the FOMC seems quite likely."*