U.S. LOOKING GOOD; JAPAN STILL STRUGGLING

by Min-Seok Yang

The U.S.: Inflation Rate under Control

The U.S. economy keeps growing at a stable rate without causing the price level to rise. The final report on the second quarter economy, released on September 26, showed that the annual growth rate of the second quarter GDP was 3.3%. This made the Fed worry about possible inflation because the Fed unofficially regards 2-2.5% as the target rate that makes the economy grow without raising the price level. However, the economic indicators in the third quarter are weakening the possibility of raising interest rates.

One of the most important characteristics of the current U.S. economy is the rapid increase in productivity. The labor productivity of all industries except the agriculture industry has increased by 2.7% in the second quarter. The high growth rate of productivity is the fundamental factor that is making the economy grow without inflation.

The price level in August increased by 0.2%, mainly because energy prices soared by 5.4%, the highest growth rate ever since the Gulf War. The core growth rate excluding the highly volatile prices of food and energy, however, was only 0.1%.

One problem the U.S. economy faces is the increasing trade account deficit. The trade deficit in the second quarter decreased down to 26.41 from the 29.3 billion dollars from a quarter ago. But it increased by 24.7% in July compared to the deficit a month ago. To decrease the trade deficit the U.S. is pressing other countries, especially Japan, to open their markets more. However, since the trade deficit seems to have no serious effect on the current macroeconomy of the U.S., the exchange rates between the dollar and other currencies will not be affected.

The current U.S. economy implies that the Fed will keep the current fund rate of 5.25% through the next meeting of the Federal Open Market Committee November 12.

Japan: Sluggishness Continues

The Japanese economy is suffering from a recession again since the raising of the purchase tax rate from 3% to 5% on April 1 this year. The growth rate of the second quarter (the first fiscal quarter, April-June) decreased by 2.9% from the first quarter, which is the largest decrease since the first oil shock in 1974. Private consumption decreased by 5.7% partly because consumer spending increased remarkably in the first quarter before the tax increase.

A more important feature is the decrease in private investment, because Japan wants to switch its economic structure from a government-dominant one to a private sector-dominant one. The Japanese fiscal deficit has reached a very dangerous level. The raising of the purchase tax was one way of solving the fiscal problem. Thus, the recovery of the private sector including private consumption and investment is crucial for making economic growth. However, investment is not recovering although the interest rate is historically low.

The Japanese economy will recover from the current recession next year. However, the effect of the tax increase will continue throughout this year, albeit to a diminishing degree. VIP

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