U.S. & JAPAN: MODERATING GROWTH AND FURTHER DETERIORATION

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United States: Growth To Be Moderate

Corporate earnings will be a major concern in the coming quarters, adding to the stock market's worries, along with the further sinking yen. However, even as the downturns in Japan and the rest of Asia deepen, U.S. domestic demand remains strong. May retail sales jumped by 0.9%. That implies that real consumer spending is rising at a rate of about 4.5% in the second quarter, after a 6.1% gain in the first quarter. Despite the current strength, the U.S. economy will not remain immune to Asia's troubles forever, and growth is about to slow sharply under pressure from the trade sector and inventory investment.

Net exports cut 2.5 percentage points from GDP growth in the first quarter, and trade will likely continue to be a substantial negative for the rest of the year. The foreign trade sector will knock about 1.0 percentage points off current-quarter GDP growth.

The latest inventory data point to a slowdown that should trim about 1.5 percentage points from second-quarter GDP growth. Along with trade, inventories will likely remain a drag on growth for the rest of the year.

Overall, GDP growth rate is expected to average around 2% for the rest of 1998, even though domestic demand remains robust. Meanwhile, inflation remains nowhere to be seen. Some institutes and investment banks are boosting their growth estimates to over 3.5%, but it seems likely that as the production side of the economy slows, demand should eventually moderate. Consequently, in July, the downward pressure on economic activities will probably be more evident.

Japan: Bad Situation Expected to Deteriorate Further

Japan now meets the conventional definition of recession with two consecutive quarterly declines in GDP. Final demand remains weak and production continues to decline in Japan. With respect to final demand, public-sector investment seems to have bottomed out. Growth in net exports, however, has virtually peaked out as exports to other Asian countries declined. Business fixed investment continues to be on the decline. Private consumption shows little sign of recovery, although the deterioration has slowed. Housing investment has decreased further. Against the background of weak final demand, inventories have accumulated further and industrial production continues to decrease. As a result, corporate profits have worsened, and employment and income conditions have deteriorated evidently, as recently seen in the rapid rise of the unemployment rate.

The implementation of the supplementary budget for fiscal 1998 is assumed to boost demand through additional public works and special income tax-reduction, and cease the negative interactions of production, income, and expenditure. However, such positive effects of the fiscal policy may be weakened if the ongoing rapid deterioration in employment and income conditions further dampens overall economic activities.

Anyway, it is very critical that Japan now act decisively to resolve the difficulties in its banking system and to make clear its readiness to carry out any further fiscal stimulus needed to achieve its goal of domestic demand-led growth. VIP

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