

THE U.S. AND JAPAN SHOULD SUPPORT WORLD ECONOMIC GROWTH

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The U.S.: Domestic Demand Should Block Off the Emerging Market Turmoil

The U.S. economy was weighed down in the second quarter by a strike at General Motors and a slowdown in exports to the East Asian region. The GDP rose at 1.6% in the second quarter, which is much lower than the first quarter's 5.5%. The recent global slowdown is almost certain to deepen in the coming months and persist into next year. The recent devaluation of the Russian ruble seems to have negative implications for currency stability and world economic growth.

What happens next will depend in large part on the spending patterns of American consumers. A slowdown in corporate earnings seems to be materializing. Second quarter after-tax earnings increased only 0.3%, and weak export demand due to the Asian crisis and the strong dollar are squeezing manufacturers' profits. Strong consumption demand and Asian economic woes are forces which are clashing interactively. Now, strong U.S. domestic demand is almost the only source of effective demand in the world economy. The U.S. government should implement a policy mix to induce demand-led sustained growth or at least a soft-landing to avoid a global depression.

Japan: Banking Crisis Is Obstacle

The comprehensive stimulus package is unlikely to have a great impact in overcoming the severe stagnation in Japan. Although

public investment seems to have bottomed out and net exports are increasing again mainly due to a decline in imports, facility investment and housing investment have weakened further. Private consumption has not yet shown a presage of recovery. Weak final demand is making substantial production cutbacks continue. With the decline in expenditure and production, corporate profits continue to decrease, and employee incomes remain below the previous year's level. In addition, the ratio of job offers has dropped to a historically low level, and the unemployment rate has risen to historic high 4.3%. As a whole, employment and income conditions have worsened.

As these gloomy prospects pervade the market, the yen and Japanese stock prices have persistently weakened. Recently, Russia's decision to enlarge the category of debt moratorium to dollar-denominated foreign debt led speculators to invest in Yen for shorter term transactions. However, the yen depreciation is still a market trend in the longer perspective. Fundamentally, the U.S. Treasury will not join in any intervention effort unless the new Japanese government reaches a bank-reform accord with opposition parties. But obstacles to bank reform remain while Japanese officials seem to adhere to the traditional gradual approach to treating the banking sector.

Unless Japan eventually takes an aggressive attitude to bank reform, one cannot avoid the depreciation of yen in the long run. As everyone is saying, to avoid the decay of Asia, Japan must restore foreign investors' confidence in the economy with certain reform prospects. **VIP**

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