NO NEED FOR TIGHTENING BY U.S.

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The U.S.: Unexpected Strength, but Slowdown Is Inevitable

The U.S economy has strengthened further. Economic momentum has shown little sign of a slowdown, and Fed Chairman Alan Greenspan has said that the third interest rate cut could have over-stimulated the market. As inflation is virtually absent, the Fed won't tighten monetary policy. The U.S. economy is robust, but we expect GDP growth to moderate to a rate of 3.2-to-3.5% in the first quarter from 6.1% in the fourth quarter of 1998. Data for January shipments suggest that capital-goods spending for the first quarter will run at a considerably slower rate than that for the fourth quarter. In addition, it is doubtful that the housing sector's recent strength can continue; as bond yields have risen, mortgage applications have declined sharply.

In February's semi-annual Humphrey-Hawkins testimony, Greenspan demonstrated a balanced assessment of risk, barring a major shock to the world's financial markets. Greenspan said that the U.S. economy is generally sound, but he also pointed to considerable upside and downside risks, including tight labor markets, an overvalued equity market, excessive profit expectations, and troubled conditions overseas. Indeed, more downside risks are being seen than upside potential. As many market participants estimated, the weak state of the rest of the world economy also argues against any Fed tightening. If the symptoms of slowdown emerge from the second quarter, then the Fed will not need any tightening.

Japan: Temporary Recovery

Japan's economic deterioration has moderated due to the increase in public investment. But business fixed investment has been declining significantly, and the recovery in private consumption has been weak on the whole, although a partial improvement in sales of goods has been observed. Meanwhile, net exports basically remain on a gradually increasing trend. Reflecting this development of total demand and the continued progress in inventory adjustments, industrial production, which had been on a downtrend trend, is reviving. However, Japan's total demand is insufficient by 30-40 trillion yen when compared with its total supply. Even though individual consumption has increased due to the wage increase of construction workers, the unemployment rate is still at a historically high level. As a result, it is questionable if this increasing trend can be continued. Although the recovery in industrial production means production cut-backs come to an end due to the improvement in inventory adjustments, the continued decline in business fixed investment overwhelms the recovery in production and personal consumption.

Japan needs much more fundamental measures that create an environment that encourages ordinary consumers to spend and consume without having to worry. The government should abandon its arbitrary, spur-of-the-moment policies and instead offer the Japanese people a clear medium-to-long-term vision of where Japan is headed. The true challenge facing Japan is that of taking a step back, looking at what is fundamentally wrong with its institutions, and correcting those problems as the new millennium begins. VIP

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