

Global Watch

August 2004

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This is an abstract of our monthly reports on the Japanese, U.S., European, and Asian economies, translated and edited by Mariko Noda (ndmariko@ufji.co.jp), with the assistance of Chisa Hiro. The information and the views contained herein are subject to change without notice.



Economic Research Department

JAPANESE ECONOMY: Signs of adjustments behind the current recovery

By Akihiko Suzuki, Senior Economist

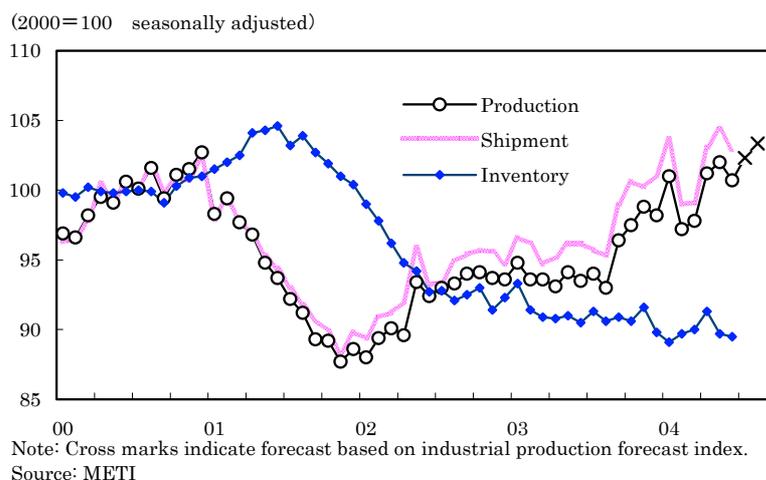
There are growing expectations for a recovery. In upgrading its assessment of the economy, the Japanese government stated in its July Monthly Economic Report that “the economy is recovering at a solid pace as improvements in the corporate sector are extending into the household sector.” The Bank of Japan has also raised its growth forecast, and business surveys, such as the Bank of Japan’s Tankan survey, indicate that more people have recognized the recovery.

Exports are expanding, as the global economy has recovered, and business investment is increasing, as production has risen and corporate earnings have improved. In addition, private consumption is recovering, as both the employment environment and consumer confidence have improved. The recovery continues with increasing strength and breadth. At this time, there appear to be no worrisome factors for the prospects of the economy, but there are some signs of adjustment.

First, let’s examine external demand. The U.S. economy continues to recover, but the Dow industrial average peaked in February and has been falling since then. The NASDAQ index, covering mainly high-tech related stocks, has also followed a declining trend since January. Corporate earnings remain robust in the U.S., but the growth rate in earnings has been disappointing to some extent, compared with forecasts. In addition, the monetary authority has begun to raise interest rates, albeit slightly, and the effects of large tax cuts will fade during the latter half of this year. The stimulating effects of historically low interest rates and large tax cuts will disappear soon. A slowdown in the U.S. and other countries will affect Japan’s exports, which remain robust at the moment.

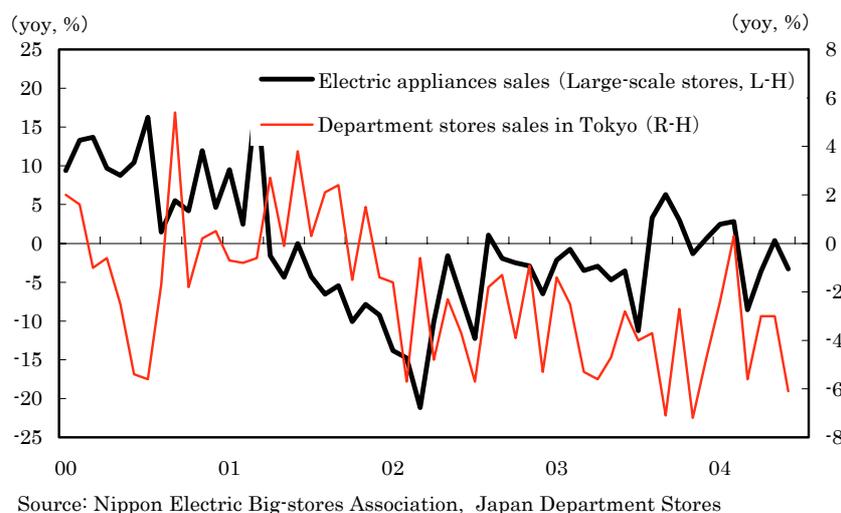
Second, take a look at production. June industrial production, mainly transportation equipment and electric machinery, declined by 1.3% on a month-on-month basis (mom); the decline was larger than expected. Production will likely remain healthy, as it grew by 2.6% on a quarter-on-quarter basis (qoq) in the second quarter, and month-on-month growth is expected for both July and August. Nevertheless, actual figures continue to undercut forecast numbers, indicating that growth in production has slowed. Moreover, inventory has accumulated rapidly in industries such as electronics parts and devices, including semiconductors. The increase in inventory may be intentional, based on expectations of a future increase in demand, but the inventory ratio has risen. An unintentional accumulation in inventory may develop in some sectors, as demand for digital-related products has not grown as expected.

Japan: Industrial production



Finally, consider private consumption. According to sales statistics by the Nippon Electric Big-stores Association, sales of DVD recorders and flat panel TVs remained robust in June, in anticipation of the Athens Olympic Games. In addition, sales of air conditioners have grown strongly, due to a heat wave. In contrast, sales of PCs and digital cameras have stagnated, and sales of cars, mainly small cars, have been sluggish. According to the Family Income and Expenditure Survey by the Ministry of Public Management, Home Affairs, Posts and Telecommunications (PMHPT), real living expenditures for workers' households declined by 3.5% mom in June, representing the second consecutive month of a decrease. On a quarter-on-quarter base, they grew in the second quarter, but the growth rates varied by items. It is likely that the recovery in private consumption will lose momentum. (2004.8.2)

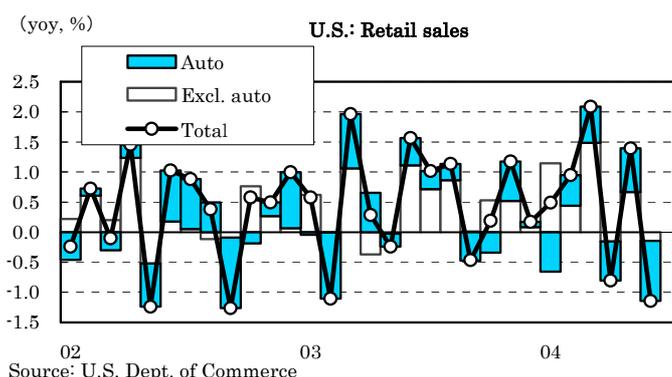
Japan: Retail sales



US ECONOMY: Private consumption will slow, but not plunge.

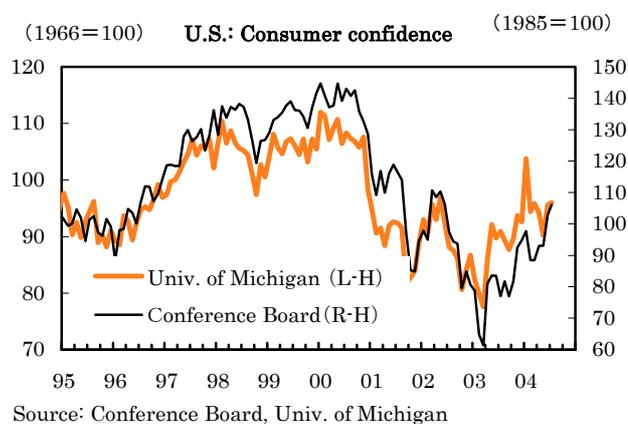
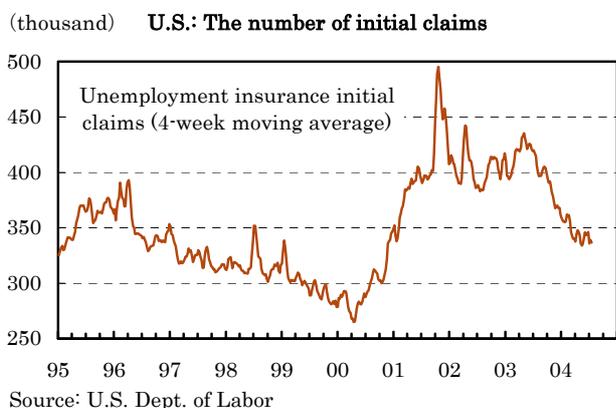
By Shin Takayama, Economist

The U.S. economy continues to expand, but there are some signs of a slowdown, especially in private consumption. Retail sales declined by a large 1.1% mom, and auto sales fell by 13.4% mom to an annualized 15.41 million units in June. Private consumption has remained robust so far, due to an increase in income from tax cuts, but tax refunds ended in May, and the effects of tax cuts will dissipate. As a result, it is highly likely that private consumption will slow.



Nevertheless, there were some temporary factors behind the decline in retail sales in June. The decrease in sales of food and drinking places as well as clothing and clothing accessories was mainly due to bad weather. In addition, the fall in auto sales was partly due to a reduction in sales incentives offered by auto manufacturers.

In the latter half of this year, however, an increase in employment may bolster private consumption. Labor market conditions recovered strongly during the first half of this year, and the number of initial claims fell to approximately 340,000. With an upturn in the employment environment, consumer confidence has been improving. Although the effects of tax cuts will disappear during the latter half of this year, income and consumer confidence will improve with the rise in employment. It appears unlikely that private consumption will plunge. (2004.7.22)



EUROPEAN ECONOMY

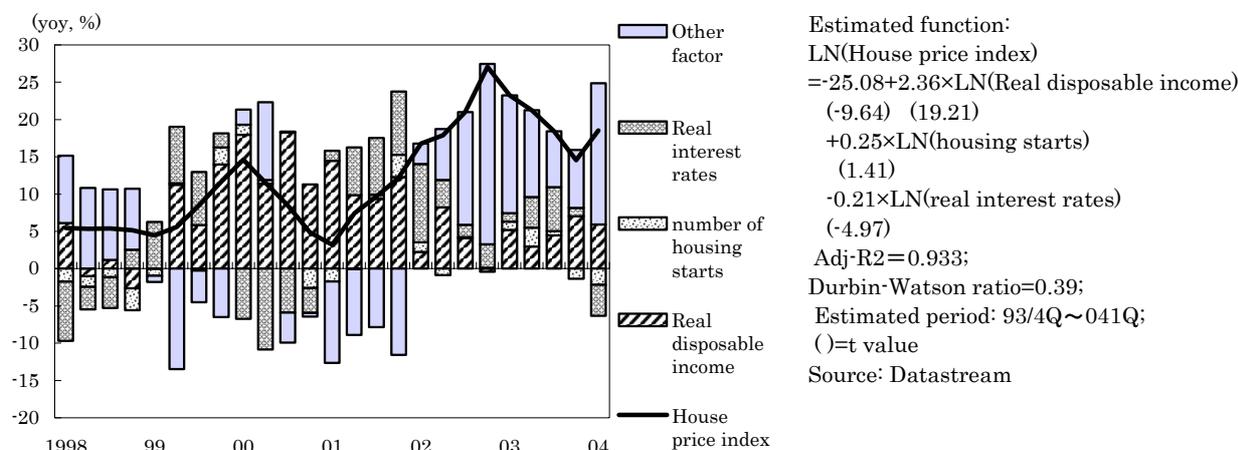
By Yoshiyuki Honda, Economist

§ U.K.: How far will the Bank of England raise interest rates?

The Bank of England has raised its key interest rate by 1.25% points since last November. CPI inflation has remained below the target of 2.0%, but the wealth effects due to a continued increase in housing prices have fueled fears of overheating in private consumption and future inflation. In fact, according to a survey by the Confederation of British Industry, as the economy expands robustly, the number of business managers who expect an increase in prices has risen.

How far will the Bank of England raise interest rates to maintain price stability? We must, first, estimate the extent to which housing prices are raised with factors not explained by the real economy, and then, calculate the level of interest rates that can offset the effects of these bubble-like factors. The above calculation indicates that the Bank of England may raise interest rates up to 5.5%. But if one takes the secondary effects of rising interest rates into account, it is more likely that the Bank of England will continue to raise interest rates towards the range between 5.0% and 5.25%. (2004.7.22)

U.K.: Factors behind rise in housing prices



ASIAN ECONOMY

§ China: Slowing signs

by Takamoto Suzuki, Economist

Second quarter real GDP growth rate was at 9.6% on a year-on-year base (yoy), and it was below market expectations. Exports led the economy, but investment has slowed, partly due to the government's tightening measures. Private consumption has also lost momentum, partly because real estate speculation has peaked. (2004.7.23)

§ China: Effects of stimulating measures towards the agricultural sector

The Chinese government decided to cut the issuance volume of construction bonds, but stated that it would increase expenditures related to agricultural developments. According to the official Chinese news agency Xinhua, Chinese Minister of Finance Jin Renqing announced that the Ministry of Finance would collect fewer taxes and fees from farmers and cancels agricultural tax in five years, as well as increase investment in rural projects, in order to solve the "three rural issues" --- *san nong* in Chinese ---, meaning agriculture, peasants, and rural areas.

As a result of these government incentives, farmers' income will increase by 200 billion yuan in total in 2004. Since the propensity to consume is high among farmers, all additional income will likely be spent, and it may raise the real GDP growth rate by 1.5% points. (2004.7.23)

China: Penetration rates of durable goods in rural areas

(%)

	2000	2001	2002	2003
TV	101.7	105.2	108.6	110.6
Refrigerator	12.3	13.6	14.8	15.9
Washing machine	28.6	29.9	31.8	34.3
Motorcycle	21.9	24.7	28.1	31.8
Fixed phone	26.4	34.1	40.8	49.1
Mobile phone	4.3	8.1	13.7	23.7
Audio set	7.8	8.7	9.7	10.5
Personal computer	0.5	0.7	1.1	1.4
Air conditioner	1.3	1.7	2.3	3.5

Source: China Statistical Abstract

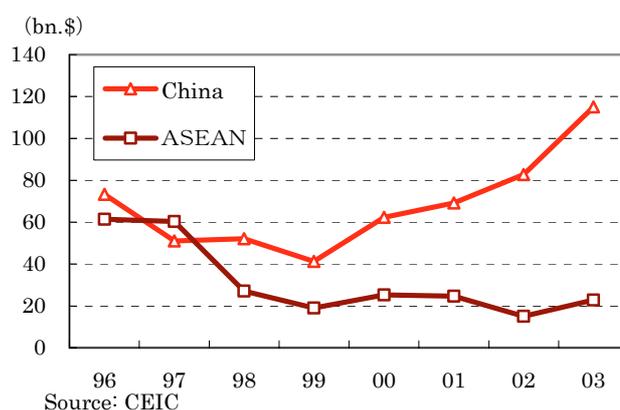
§ ASEAN: FDI flows remain stagnant.

by Masato Horie, Economist

Foreign direct investment (FDI) flows to China have surged since 2002, but those to ASEAN4, namely Thailand, Malaysia, Indonesia, and the Philippines, have remained stagnant since the Asian currency crisis. Upon entry into the WTO in 2001, China's deregulation in relation to foreign companies' investment has progressed. As a result, FDI flows in China have increased, and this trend will likely continue in coming years.

Among ASEAN4, FDI flows to Thailand and Malaysia are recovering to some extent, as these economies have expanded robustly, but FDI inflows to Indonesia and the Philippines are still sluggish, except for some resource development projects. In Indonesia and the Philippines, major elections took place this year. One of the issues of highest priority for newly elected governments should be to increase FDI inflows by restoring international confidence and pursuing political stability. (2004.7.23)

ASEAN: FDI inflows to China and ASEAN4



ASEAN: FDI inflows to each ASEAN4 country

