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The State of the World Economy: Structural Divergence

1. American Growth, European Retreat, Japanese Disaster

After several years of uncertainty, the international financial community is generally in agreement that, world-wide, there are few if any identifiable inflationary dangers. However, it would be rash and overly simplistic to conclude that the world economy is therefore in a highly convergent phase. Economic developments in the United States, Europe, and Japan differ at critical points and in decisive ways. The objective of this investment commentary is to detail and explain these differences.

To start with, consider the following macro-economic data. The average economic growth in the key industrial nations of Europe will reach between 1,5 and 3 % this year. The inflation rates are hovering at historically low levels. Excluding several of the Southern countries, the rates are at little more than 3 %. In view of this rather positive situation, interest rates remain relatively unfavorable. This is especially true of the long-term interest rates, those most relevant to economic investment practices. The 6 or 7 % for DM obligations and the 8 or 12 % for long-term obligations in other European currencies, yield a real interest rate of well above 4 %. The consumption climate is very restrained; apparently, the average European is anticipating earning less, rather than more, in the next few years. The result is that domestic economic stimuli are lacking. At the same time, exports have taken a beating from developments in the currency markets.

It is different across the Atlantic. The fear that the American economy could drift into an actual recession have largely dissipated. Apparently the slow-down in economic growth was only temporary, a response to a discharge of inventory holdings and to last year's rise in interest rates. Meanwhile, the gross domestic product is again approaching a growth rate of 3 %. This stable growth is occurring at a time of declining inflation, which currently stands at less than 2.5 %. Developments in the interest rate curve also point to stability; short- and long-term interest rates are approximately the same, holding steady at 5 to 6%. In other words, the long-term rates do not indicate any inflationary expectations. Export numbers are improving steadily; the domestic economy continues to be supported by the enthusiasm for investment in the "producer durable goods" sector.