

ANZ Economics Monthly

Impact of China's revaluation

- China's revaluation is aimed at reducing capital inflows and slowing investment, with the economic impact to depend upon the extent to which this policy aim is achieved
- There will be little near term impact on Australia or New Zealand; any effect on Australian markets from the AUD inclusion in the currency basket has already been felt
- Japan continues to outperform expectations and will help support the region as China slows
- Our baseline regional forecasts still projects a soft landing across the region, but the risks emanating from China will bear monitoring

On 21 July, the People's Bank of China announced a shift in the foreign exchange policy regime that raised the value of the yuan to USD/CNY8.11 and allowed the currency to respond more actively to market forces. Bank Negara in Malaysia announced on the same day that it would abolish the ringgit peg of USD/MYR3.8 in favour of a more flexible regime. Since the announcement, the yuan has appreciated slightly more, to USD/CNY8.1032.

Details of China's new FX regime

The key aspects of the PBOC announcement are as follows.

- The currency peg that fixed the yuan to the US dollar at a rate of USD/CNY8.277 has been abandoned and the yuan will now be managed by the PBOC against a basket of currencies. The authorities refer to this as a "managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies." The currencies that comprise the basket and its weightings are not published.

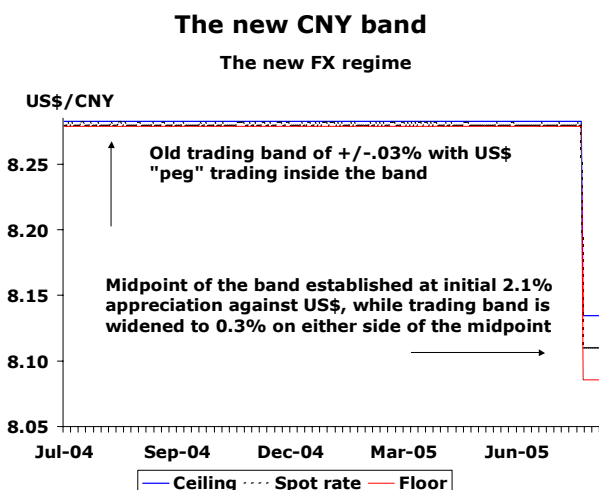
- The yuan will fluctuate in a band with a width of +/-0.3% on either side of central parity. Central parity will be the closing price of the yuan as announced by PBOC at the end of the previous trading day. Parity will be quoted against the US dollar.
- The new central parity as of 21 July was USD/CNY8.11, a 2.1% nominal appreciation from the value at the close of 20 July. The currency has closed both slightly above and below that rate in the days since the announcement.
- The band for other foreign currencies will be +/-1.5%. This is consistent with the practice under the previous regime in which the band for cross rates was wider to allow for market fluctuation.

Why change the CNY now?

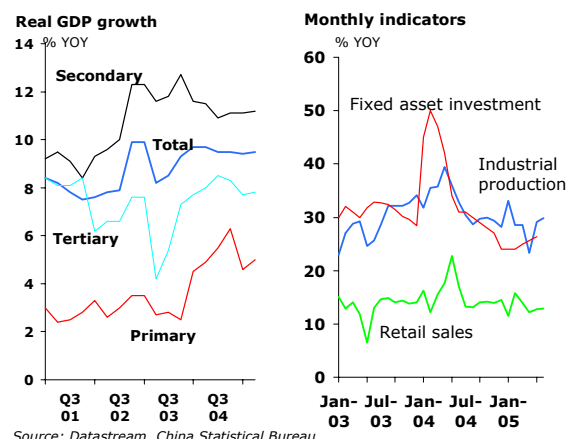
The release of a raft of Q2 data on 20 July prior to the CNY announcement provides insight into why the authorities may have taken this step now.

The data showed that attempts to engineer a soft landing were falling well short of the mark. Real GDP rose 9.5% YOY in Q2 2005, from 9.4% growth in Q1. After a soft patch early in the quarter, fixed asset investment and industrial production rose 27% and 34% YOY in June respectively, while domestic consumption was relatively flat. Industrial production was driven by both high investment (for example in the steel sector) and external demand.

No soft landing was in sight



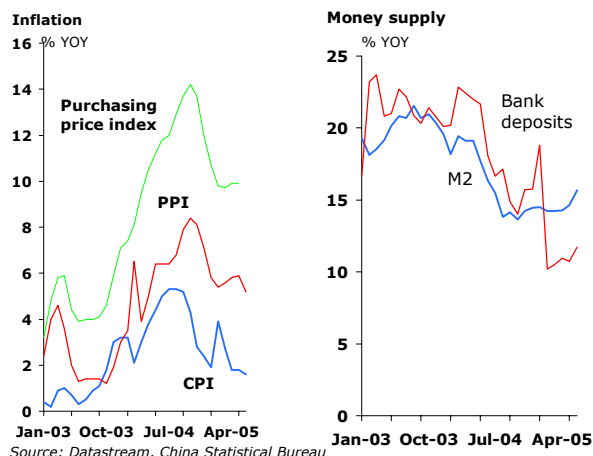
Sources: Datastream, Economics@ANZ



Against this torrid growth, CPI slowed to 1.6% YOY in June from 1.8% in May, implying deflation on a monthly basis since February. PPI fell to 5.2% YOY

in June, with purchasing prices also falling. CPI fell even though M2 and loan growth rose. Investment led booms and deflationary busts are hallmarks of China's economic history, and the authorities are keen to avoid a repeat episode.

Declining inflation and rising M2



Source: Datastream, China Statistical Bureau

Revaluation not the only policy measure

The revaluation is aimed at stemming capital inflows and reducing or reversing the accumulation of international reserves. This would in turn dampen foreign and resident demand for domestic assets, including property and productive investments. A stronger yuan would also theoretically increase the purchasing power of Chinese consumers, and therefore help the economy to rebalance toward consumption. However, a revaluation of 2.1% will not have a significant impact on the balance of supply and demand between China and the rest of the global economy. This is certainly intentional, as the authorities would want to avoid an overshooting.

Indeed, the authorities are not placing all their eggs in the revaluation basket. The authorities announced an increase on one-year deposit rates for foreign currency deposits. There has also been speculation that the central bank could also raise reserve requirements and/or reduce the rate paid on reserves at the PBOC to encourage government bonds holdings, which would drive down yields and reduce the attractiveness of yuan assets. Further, an article in the People's Daily questioned whether the current US\$711 bn of FX reserves is "too much." The article referenced US\$300 bn as representing 6 months' import cover and 100% coverage of short-term foreign currency debt. It foreshadowed a loosening of capital controls, via measures such as eliminating the required conversion of foreign currency receipts and reducing restrictions on outbound investment.

Taking a long view of history, recall that in January 1994, when the PBOC unified its exchange rate, the new FX regime was described as a "controlled floating exchange rate system based on market

demand and supply." The language in the July 2005 statement (quoted earlier) is similar, with the main change being the addition of reference to a basket of currencies. Events of that time are also reminiscent of today. In July 1994, the US Treasury report to Congress accused China of manipulating its currency to gain unfair trade advantage. From January 1994 to December 1996, the yuan appreciated by a nominal 4.6%. In late 1997, the Chinese acceded to pleas by the US and international financial institutions to keep the FX rate stable amid the Asian financial crisis. The yuan traded to USD/CNY8.28 in November 1997, and had not deviated more than 0.05% until a few weeks ago.

Expected impact on China's economy

Our view is that the PBOC intends for further revaluation to take place, but at a very slow pace consistent with their 56-year history of FX management. More recent statements by the PBOC that the markets should not anticipate imminent further revaluation support this view.

The question will be whether, or to what extent, the PBOC is able to control this process. Should the rapid accumulation of FX reserves continue, the economic impact could be more significant. Given this, we have outlined a few scenarios for the potential medium term implications of China's currency regime shift, in the table below. Our baseline forecast anticipates a total nominal revaluation of 3% by the end of this year including the 2.1% already undertaken (to USD/CNY8.03) and a further 3.0% next year. Under this scenario (Scenario 1), capital inflows decline and a soft landing sees growth slowing in H2 to reach 9.0% this year and 8.2% next year.

Scenarios for China growth and inflation

End of year 2006	Scenario 1 Base case	Scenario 2 Rapid revaluation	Scenario 3 No further reval
USD/CNY	7.78	6.89	8.11
Real GDP growth (% YOY)	8.2	7.5	6.8
Inflation (% , yr av)	2.2	1.0	-1.8

Source: ANZ Bank

Under this forecast, there is a tempered slowdown across the economy, but particularly in fixed asset investment since this has been driven by excessive capital inflows. Export growth would remain relatively strong as a 2% revaluation – even if partly passed on to consumers – is not very

significant and exporters who use imported inputs would arguably be unaffected.

There are risks to the forecast. First is the risk that our understanding of the new regime is incorrect, and that the authorities will allow a faster pace of revaluation and/or greater currency volatility than we had anticipated.

Second, there is a risk that even if we are correct in interpreting the authorities' intentions, the limited revaluation thus far provides a signalling effect that additional revaluation is bound to take place, and soon. In that case, excessive capital flows will continue to plague China's central bank and the risks posed to the economy by uneven and excessive investment in selective sectors will remain firmly in place. Under the worst case scenario, the authorities are forced into ongoing step-by-step revaluations, never satisfying the market that the currency has reached "fair value".

Both of these possibilities would lead to a more rapid strengthening of the CNY of perhaps 10-15% in the next 6-12 months (Scenario 2). In that case, the outlook would be for an accelerated cooling of economic activity. A strong revaluation and capital outflows would particularly affect exports (40% of GDP) and fixed asset investment (30% of GDP). As these two sectors have provided the main source of commodity demand, commodity imports would decline even though purchasing power would increase.

Finally, there is the risk that the authorities do not further develop the basket approach to managing the yuan. The implicit USD/CNY8.11 peg becomes another explicit USD peg and does not move from its current value for over a year (Scenario 3). In this case, unless other policies to discourage inflows become more effective, growth would remain very high in the near term, but conditions would seem ripe for a deflationary bust in 2006.

Scenario 3 outlines the possible ramifications of such a bust, with growth falling to 6.8% YOY and deflation rearing its ugly head. Although the growth rate would be viewed as high in much of the world, it is considerably below China's 35-year growth average of 9.0% as well as the 7.1% growth rate recorded during the last bout of serious deflation in 1999.

Implications for the global economy

As with China, the impact on the regional and global economy of China's new FX regime will depend upon the future path of the currency. The table below shows a range of potential global growth forecasts based upon the 3 broad scenarios outlined for China.

These scenarios assume that economic conditions remain broadly unchanged from current

expectations in Europe and the United States through the end of next year. While greater currency volatility could put pressure on domestic banks, the impact outside China would not be as significant as other periods of volatility in Asia, notably the 1997-1998 financial crisis.

Scenarios for global growth

End of year 2006	Scenario 1 Base case	Scenario 2 Rapid revaluation	Scenario 3 No further reval
USD/CNY	7.78	6.89	8.11
China real GDP growth (% YOY)	8.2	7.5	6.8
Asia ex Japan real GDP growth (% YOY)	7.0	6.2	5.7
Japan real GDP growth (% YOY)	1.7	1.4	1.0
Global GDP growth (% YOY)	4.2	4.0	3.8

Source: ANZ Bank

Under our baseline Scenario 1, China's economy achieves a soft landing and Asian ex-Japan growth remains strong at 7.0%. Growth in Japan is forecast to reach 1.7%, and our global growth forecast remains well above trend at 4.2%. Under this scenario, we would anticipate a gradual softening of commodities prices from the historic highs of recent years, particularly as fixed asset investment in China slows. Overall demand for commodities would remain fairly robust given regional Asia's growth rates, however.

Under our risk Scenario 2, China's growth slows to 7.5% in 2006 as currency appreciation accelerates. Export and capital investment growth in China would decline significantly, reducing China's commodity demand regardless of improved purchasing power. Falling demand from China would cut the forecast growth for Asia ex-Japan to 6.2%, while Japan's growth would slow to 1.4% as China is a major export market for the entire region. Global growth would slow to around 4%, which is still above trend. Demand for commodities under this scenario would fall more rapidly, and the slowdown in Asia in particular would be more keenly felt.

The risk Scenario 3 would imply the worst outcome for global growth. A further 0.5 percentage points could be shaved off Asia ex-Japan GDP growth, and Japan's growth forecast would also be cut. Under this scenario – US and Europe economic conditions taken as unchanged – global growth would revert to around its 3.75% historic trend. While this is still a comfortable level of growth for the global economy, under this scenario commodity demand in Asia would slow markedly. As Asian economies and China in particular have been the growth areas for commodities – and

energy commodities in particular because of their inefficient use of oil for example – this is also the most negative scenario for global commodity demand. Australian exporters would feel the impact strongly given that their main export markets for commodities are Japan and China.

Implications for Australia and NZ

A revaluation with a magnitude of around 3% by the end of this year, as we project, would have little impact on the balance of trade between Australia and China, or between New Zealand and China, all else being equal.

However, this revaluation is part of the authorities' efforts to cool China's growth. Declining demand from China's export sector and/or a significant slowdown in investment will reduce China's demand for imports from Australia and New Zealand. Therefore, our risk scenarios that incorporate a more rapid slowdown in China's economy would have negative implications for Australia and New Zealand exporters to China. Commodities exporters in particular could find that demand would decline, even if a stronger yuan means that Chinese purchasing power has risen.

Australian and New Zealand firms that import from China face less risk around the revaluation. Contracts that are based on US dollar or other foreign currency pricing will not be affected by the revaluation. Yuan based prices may be affected, but suppliers may choose to absorb any costs in order to remain competitive.

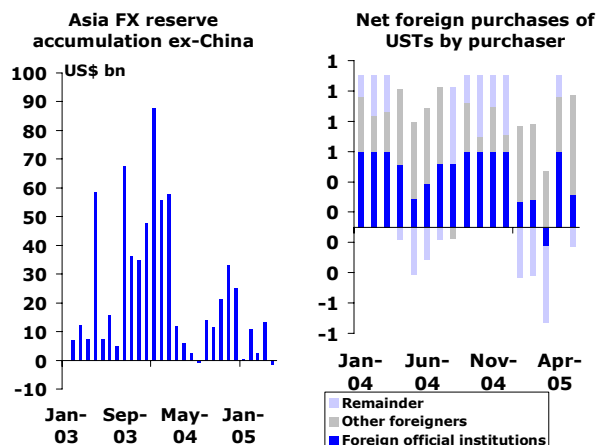
Finally, there have been numerous reports that the AUD is one of the currencies that has been included in the basket against which the yuan will be managed. The fact that the AUD is one of eight foreign currency pairs traded on the interbank market – as of May – lends credence to these reports. Presumably, inclusion in the basket means that the PBOC will hold some of its US\$700+ billion of reserves in Australian government bonds. While this may be the case, we believe the PBOC would have already adjusted their portfolio to reflect these requirements and do not anticipate much of an impact on the AUD or AUD government bond market going forward.

Elsewhere in Asia...

In the short term, China's decision to revalue the yuan and the rally of Asian currencies that followed has provided a welcome respite for Asian central banks. Across the region, central banks were struggling with how to balance the negative effect that oil prices have on growth on the one hand with the increase pressures that high oil prices place on inflation on the other. Cost-push inflation has been exacerbated by reductions in fuel subsidies in the face of rising fiscal pressures.

The result has been a downward spiral of rising cost-push inflation, weaker currencies and pass through inflation leading to currency weakness. Excluding China, Asian central banks lost foreign exchange reserves in June, an important reversal from a strong pace of accumulation earlier in the year. The chart below shows how the rate of new purchases of US Treasury bonds by Asian central banks has declined in 2005.

Asian central banks ex-China no longer accumulating massive FX reserves



Source: Datastream, US Treasury

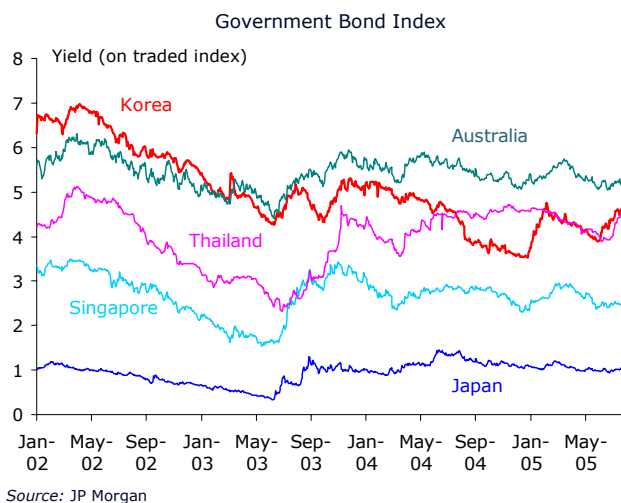
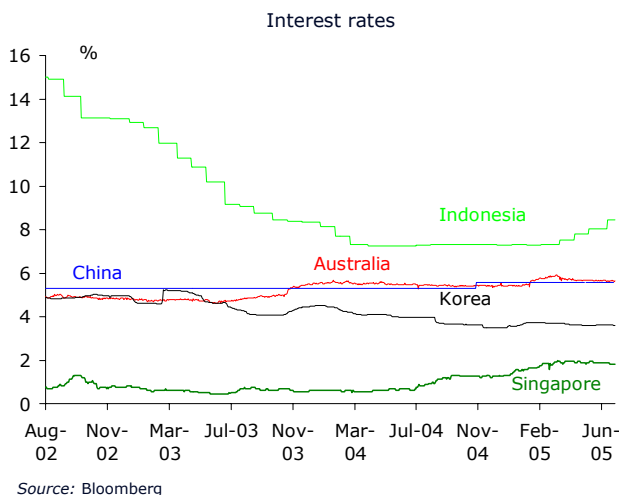
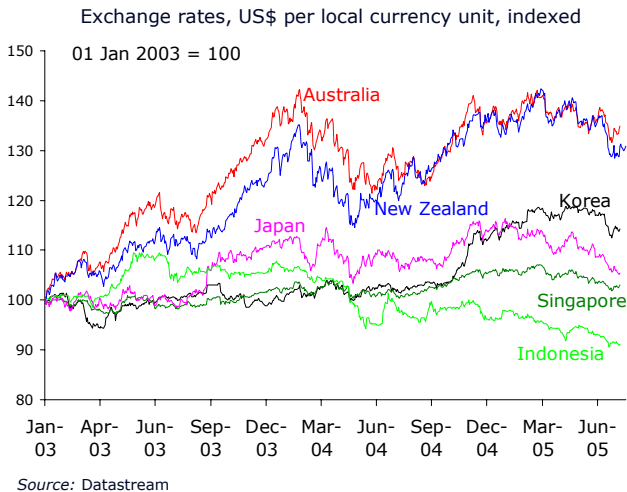
China's revaluation – followed by Malaysia's announcement that it will similarly drop its US\$ peg in favour of management against a trade-weighted basket of currencies – reversed recent currency weakness across the region. In the days since the announcement, however, the major Asian currencies have weakened once again. Our year-end currency forecasts have been adjusted for the CNY and MYR to reflect the policy change, but otherwise our projections remain based on our fundamental view that currencies will weaken over time in response to the rising US interest rate differential.

While currency weakness helps exports, rising inflation could become problematic in countries across Southeast Asia where inflation expectations have traditionally been anchored to exchange rates and central banks are still working to establish a new monetary framework.

Amy Auster

Senior Economist
 Email: auster@anz.com
 Ph: +61 3 9273 5417
 Fax: +61 3 9273 5711

Financial Markets Update



Exchange rates

- Currencies across Asia weakened from the beginning of July until the 21 July China revaluation announcement, reflecting the rising interest rate differential with the US and the inflation impact of higher oil prices.
- Although China's revaluation has stemmed currencies' slide, we expect further weakening.
- Both the Australian and New Zealand currencies have been relatively steady this year compared with the sharp movements over 2003 and 2004. Trading ranges in July remained narrow.
- The Indonesian rupiah stands out as having been under heavy selling pressure, weighed down by falling real interest rates, deterioration in the capital account and corporate US dollar-demand/supply pressures.

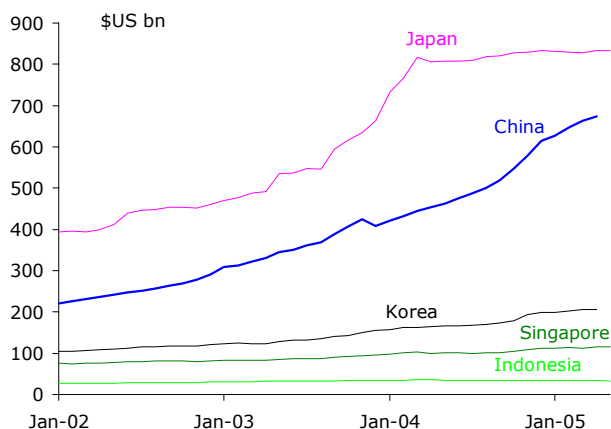
Interest rates

- The chart at left highlights policy interest rates across the region, which have been flat or risen only marginally this year. Real rates in some cases have fallen as inflation has outpaced nominal rate increases.
- Against the backdrop of a moderation in domestic demand, rates in Australia and New Zealand are expected to remain on hold.
- The Philippines, Thailand and Hong Kong have all recently raised their policy rates, with further rates rises likely going forward.
- Bank Indonesia has shifted to an interest rate targeting regime, and will likely be forced to raise rates at its next several meetings.
- Inflation remains moderate in Korea, which will allow Bank of Korea to stand pat despite higher oil prices.

Bond markets

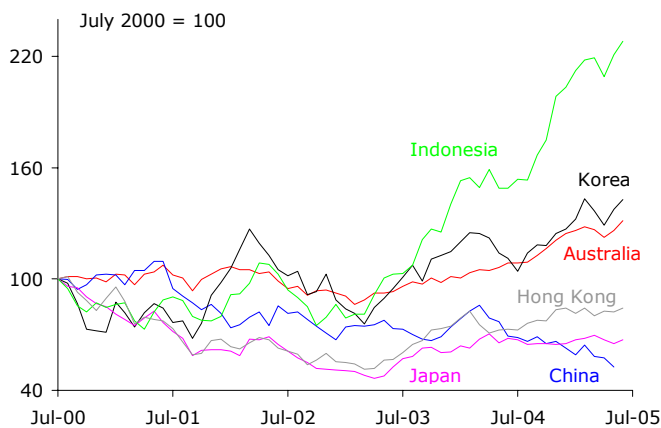
- The chart at left shows the yield on traded government bonds included in JP Morgan's Government Bond Index (GBI) of local currency bonds.
- Very low yields on Asian government bonds are indicative of the savings glut across the region, which is also helping to depress bond yields in Australia and the US. The excess of savings is arguably bringing about a mispricing of risk, with Australian government bond yields higher than those in any emerging Asian country.
- The uptick in yields in Korea and Thailand over the past few months suggests the Asia risk premium may be on the rise, reflecting slower growth, higher inflation and a steady increase in public sector debt levels.

International reserves



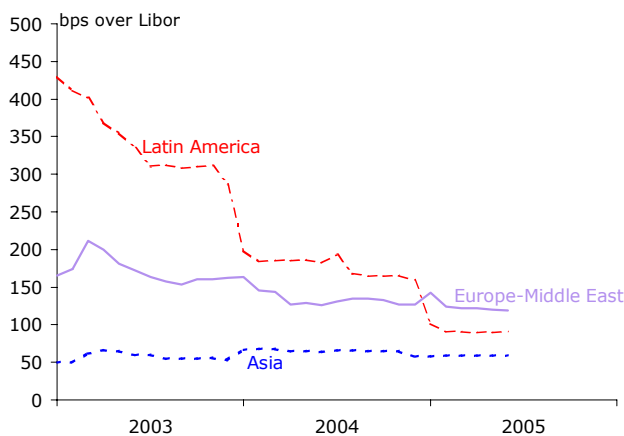
Source: Datastream

Share price indices



Source: Datastream

Trade Finance Credit Spread



Source: LTP Trade Finance Index, LTP Risk Management

International reserves

- The pace of foreign reserve accumulation across Asia has been a contributing factor to low global bond yields, as central banks have invested their holdings in primarily US Treasury debt.
- Aside from China, the pace of international reserve accumulation has slowed markedly over the past few months, on the back of lower balance of payments surpluses and weaker currencies.
- Japan remains the largest holder of foreign reserves internationally, but China's stock of reserves could overtake Japan should the pace of China's accumulation remain at recent levels.
- The revaluation of the yuan and additional measures announced are aimed at reducing capital inflows, however.

Equity markets

- Stockmarkets across Asia have trended higher this year, with the exception of China. The Shanghai Composite index has declined by 12% year to date, reflecting concerns about ongoing supply of partial IPOs by state-owned companies.
- South Korea and Indonesia have been the strongest performing markets this year, rising by 25% and 18% respectively since January, due in part to increased capital inflows from off shore.
- Improving domestic conditions and corporate profitability have been reflected in Japan's Nikkei 225 which has gained some ground over 2004 and 2005, rising by over 9% between January 04 and July 05 after the weak phase over 2000-02.

Trade finance

- The chart at left shows that the trade finance spread for Asia has been fairly steady over the past few years and at a reduced level compared with Latin America and Europe-Middle East.
- The low foreign currency risk spread largely reflects Asia's stronger macroeconomic position following the crisis of the late 1990s.
- Growing intra-Asian trade, with China being among the top exports markets for the rest of Asia, coupled with US demand have also underpinned exports and kept risk spreads low.
- The decline in the risk premium for trade finance reflects reduced risk perceptions across developing countries, which has reduced the global cost of capital.

FX and policy interest rate forecasts

	July 05	Aug 05	Sep 05	Oct 05	Nov 05	Dec 05	Jun 06	Dec 06
China								
USD/CNY, eop	8.11	8.09	8.08	8.06	8.05	8.03	7.91	7.78
AUD/CNY, eop	6.16	5.90	5.75	5.60	5.45	5.30	5.18	5.06
Short term rates*	5.6	5.6	5.6	5.6	5.6	5.6	5.3	5.0
Hong Kong								
USD/HKD, eop	7.78	7.78	7.78	7.78	7.78	7.79	7.8	7.8
AUD/HKD, eop	5.90	5.67	5.54	5.40	5.27	5.14	5.1	5.06
Short term rates**	4.50	4.50	4.75	4.75	4.75	4.75	4.5	4.0
Indonesia								
USD/IDR, eop	9,820	9,900	9,925	9,875	9,850	9,825	9,663	9,500
AUD/IDR, eop	7,456	7,216	7,063	6,858	6,671	6,485	6,329	6,175
Short term rates***	8.50	8.50	8.75	8.75	8.75	9.25	8.75	8.00
Korea								
USD/KRW, eop	1,025	1,040	1,042	1,045	1,048	1,050	1,058	1,065
AUD/KRW, eop	779	758	742	726	710	693	693	692
Short term rates****	3.25	3.25	3.25	3.25	3.25	3.25	3.00	3.00
Malaysia								
USD/MYR, eop	3.75	3.74	3.73	3.72	3.70	3.73	3.71	3.68
AUD/MYR, eop	2.8	2.7	2.7	2.58	2.51	2.5	2.4	2.4
Short term rates****	2.70	2.70	2.70	2.70	2.70	2.50	2.50	2.25
Philippines								
USD/PHP, eop	56.1	56.3	56.4	56.5	56.6	56.8	56.9	57.0
AUD/PHP, eop	42.6	41.0	40.1	39.2	38.3	37.5	37.3	37.1
Short term rates****	7.00	7.00	7.00	7.00	7.00	7.00	6.75	6.75
Singapore								
USD/SGD, eop	1.66	1.677	1.678	1.680	1.682	1.69	1.70	1.715
AUD/SGD, eop	1.26	1.22	1.19	1.17	1.14	1.12	1.12	1.11
Short term rates ⁺	1.8	1.9	2.0	2.0	2.1	2.2	2.3	2.3
Taiwan								
USD/TWD, eop	31.9	32.1	32.2	32.37	32.52	32.5	32.8	33.0
AUD/TWD, eop	24.2	23.4	22.9	22.48	22.02	21.5	21.5	21.5
Short term rates ⁺	1.5	1.6	1.7	1.8	1.9	2.0	2.1	1.7
Thailand								
USD/THB, eop	41.7	42.0	42.3	42.6	42.9	43.0	41.5	40.0
AUD/THB, eop	31.7	30.6	30.1	29.6	29.0	28.4	27.2	26.0
Short term rates ⁺	2.9	3.0	3.0	3.1	3.2	3.25	3.5	3.25
Vietnam								
USD/VND, eop	15,855	15,931	15,973	16,015	16,058	16,100	16,250	16,400
AUD/VND, eop	11,990	11,611	11,367	11,122	10,875	10,626	10,644	10,660
Japan								
USD/JPY, eop	112.2	114.3	115.0	115.3	115.7	116.0	116.7	118.0
AUD/JPY, eop	85.2	83.3	81.8	80.1	78.3	76.6	76.4	76.7
Short term rates	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Australia								
AUD/USD, eop	0.759	0.729	0.712	0.694	0.677	0.660	0.655	0.65
Short term rates [^]	5.5	5.5	5.5	5.5	5.5	5.5	5.5	5.5
New Zealand								
NZD/USD, eop	0.682	0.665	0.648	0.6300	0.613	0.595	0.573	0.55
AUD/NZD, eop	1.113	1.096	1.099	1.10	1.11	1.109	1.144	1.182
Short term rates [^]	6.75	6.75	6.75	6.75	6.75	6.75	6.5	6.0

*: One-year base lending rate; **: HKMA discount rate; ***: One-month lending rate; ****: Overnight rate

+ : 3-month rate; ^: cash rate

Real GDP Growth (%)

	2004	2005f	2006f	2007f
Australia	3.2	2.25	3.25	3.25
China	9.5	8.8	8.2	7.8
Hong Kong	8.2	4.5	3.2	3.3
Indonesia	5.1	6.0	6.5	5.7
Japan	2.6	2.0	1.8	1.3
Korea	4.6	3.8	4.6	4.2
Malaysia	7.1	4.4	4.7	6.2
New Zealand	3.8	2.0	2.3	3.2
Philippines	6.1	3.8	3.0	4.1
Singapore	8.4	3.8	5.3	4.7
Taiwan	5.7	3.8	4.5	4.2
Thailand	6.1	4.2	5.1	5.4
Vietnam	7.7	7.5	7.0	7.0

Nominal GDP (US\$ bn)

	2004	2005f	2006f	2007f
Australia	620.2	659.6	622.0	683.6
China	1,702.6	1,853.6	2,114.4	2,358.8
Hong Kong	164.6	171.8	179.1	187.0
Indonesia	257.8	281	325	350
Japan	4,772	4,692	4,546	4,861
Korea	684.6	814.0	852.6	880.7
Malaysia	118.2	125.7	135.6	145.4
New Zealand	96.8	105.1	91.6	97.3
Philippines	86.6	97.2	104.3	113.2
Singapore	106.9	111	117	125
Taiwan	306.0	336	357	385
Thailand	163.4	178	197	216
Vietnam	46	50	53	57

Inflation (%)

	2004	2005f	2006f	2007f
Australia	2.3	2.75	3.0	2.0
China	3.9	1.66	2.23	3.90
Hong Kong	-0.4	0.8	1.2	1.0
Indonesia	6.1	7.6	6.5	5.6
Japan	0.0	0.0	0.4	0.6
Korea	3.5	3.7	3.2	2.8
Malaysia	1.4	2.8	2.4	1.6
New Zealand	2.7	2.9	2.6	1.9
Philippines	4.9	7.5	6.8	6.5
Singapore	1.7	0.2	0.5	0.5
Taiwan	1.6	1.9	1.5	1.2
Thailand	2.8	3.5	2.7	2.0
Vietnam	7.8	8.0	7.0	6.0

Fiscal Balance (% of GDP)*

	2004	2005f	2006f	2007f
Australia	0.8	0.8	0.8	0.8
China	-2.3	-2.0	-1.8	-1.9
Hong Kong	1.7	0.7	-0.4	-1.4
Indonesia	-1.5	-1.2	-1.1	-0.9
Japan	-7.1	-6.9	-6.5	n.a.
Korea	-0.9	-1.5	-1.8	-1.5
Malaysia	-5.0	-4.8	-4.5	-3.5
New Zealand	5.3	3.9	4.0	2.9
Philippines	-3.9	-3.4	-3.5	-3.4
Singapore	-1.1	0.4	1.2	1.1
Taiwan	-3.1	-3.3	-4.0	-3.7
Thailand	0.1	-1.2	-1.7	-1.4
Vietnam	-3.0	-3.9	-4.2	-4.3

Current Account (% of GDP)

	2004	2005f	2006f	2007f
Australia	-6.4	-6.2	-6.2	-6.4
China	4.2	4.0	3.1	1.9
Hong Kong	9.9	9.3	5.6	2.1
Indonesia	1.1	1.6	1.0	0.7
Japan	3.7	3.3	3.0	2.5
Korea	4.0	2.2	2.2	1.7
Malaysia	12.6	9.5	5.9	4.1
New Zealand	-6.4	-6.8	-6.8	-6.4
Philippines	4.0	3.6	3.6	3.5
Singapore	26.1	24.5	24.0	23.0
Taiwan	6.9	4.9	4.4	4.0
Thailand	4.5	-0.3	-1.5	-0.8
Vietnam	-2.2	-4.7	-5.7	-5.2

Foreign Exchange Reserves (US\$ bn)

	2004	2005f	2006f	2007f
Australia	35.8	n.a.	n.a.	n.a.
China	609	735	700	660
Hong Kong	123.6	125	118	105
Indonesia	34.9	34.5	35.5	36.0
Japan	833.9	n.a.	n.a.	n.a.
Korea	199.8	215.5	236.7	230
Malaysia	66.6	78.0	75.6	70.2
New Zealand	5.3	n.a.	n.a.	n.a.
Philippines	13.5	13.8	13.6	13.4
Singapore	112.2	120	124	126
Taiwan	241.7	260	265	270
Thailand	48.7	48	49	51
Vietnam	6.8	7.0	7.2	7.5

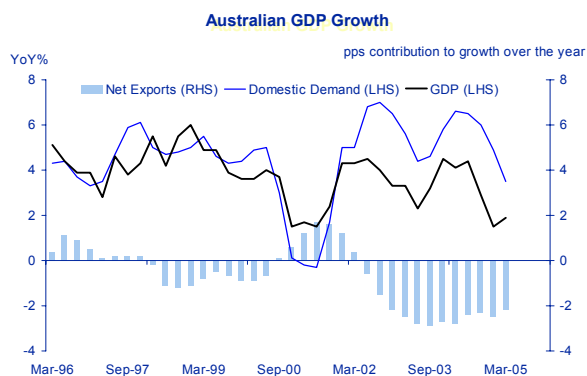
*Fiscal balance for Australia, New Zealand and Malaysia corresponds to fiscal year.

Long Term Foreign Currency Debt Ratings

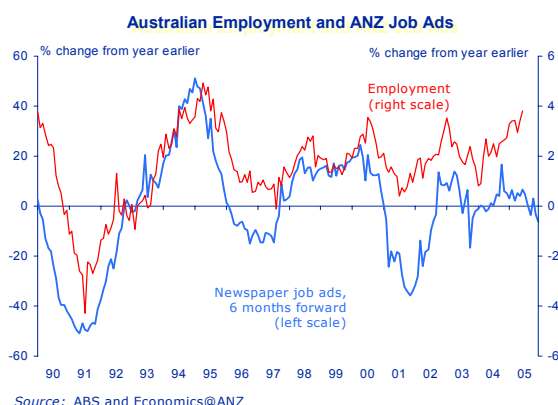
Investment Grade		Sub-Investment Grade	
Moody's	S&P	Moody's	S&P
Aaa Australia Canada France Germany Japan New Zealand Singapore United Kingdom United States	AAA Australia Canada France Germany Singapore United Kingdom United States	Ba1 Bulgaria Costa Rica Egypt Morocco Romania	BB+ Egypt El Salvador India Morocco Romania
Aa1 Belgium	AA+ Belgium New Zealand	Ba2 Colombia Fiji Guatemala Jordan	BB Colombia Costa Rica Jordan Panama
Aa2 Italy	AA	Ba3 Peru Vietnam	BB- Brazil Cook Islands Guatemala Philippines Serbia Turkey Ukraine Vietnam
Aa3 Cayman Islands Taiwan	AA- Hong Kong Italy Japan	B1 Brazil Papua New Guinea Philippines Suriname Turkey Ukraine	B+ Ghana Indonesia Pakistan
A1 Czech Republic Hong Kong Hungary Macau Qatar UAE	A+	B2 Honduras Indonesia Pakistan Venezuela	B Papua New Guinea Uruguay Venezuela
A2 China Cyprus Israel Kuwait Poland	A Chile Cyprus Korea Kuwait Saudi Arabia	B3 Argentina Belize Bolivia Lebanon Uruguay	B- Argentina Belize Bolivia Lebanon Paraguay Suriname
A3 Korea Malaysia	A- China Czech Republic Hungary Israel Malaysia Taiwan	Caa1 and below Cuba Ecuador Nicaragua Paraguay	CCC and below Belize Ecuador
Baa1 Chile Mexico South Africa Thailand	BBB+ Oman Poland Thailand		
Baa2 Saudi Arabia Mauritius Oman Tunisia	BBB Mexico South Africa Tunisia		
Baa3 El Salvador India Russia	BBB- Bulgaria Russia		

Country Update: Australia

Economic growth slows



Employment remains strong but set to cool



- The latest national accounts show that the Australian economy continued to slow going into 2005. First quarter GDP rose by 0.7%, and 1.9% over the year. While this was an improvement from growth of just 0.2% and 0.3% in Q3 and Q4 respectively, the quarterly increase was driven by a large, but unintended, build up in inventories. Excluding inventories, domestic demand fell 1.3%, the first decline in two years, while net exports continued to drag on growth.
- More timely indicators of the economy suggest a stabilisation in the rate of slowing. Business conditions, as shown by the NAB monthly business survey, rebounded in May and June, following the trend decline since October last year. Retail sales, while still weak, surprised to the upside in May, rising 0.9%, and exports have received a substantial boost from higher contract prices for several commodities beginning in April this year. Our forecast is for growth of 2¼% over 2005, down from 3¼% over 2004, and then a rebound to 3¼% over 2006.
- Despite a slowing in domestic demand since mid 2004, the labour market remains solid. Employment growth was running at 3.8% over the year to June, well above the long run average of around 2.0%, and the unemployment rate has fallen to a thirty year low of 5.0%. However with growth expected to remain below trend over 2005 and labour market indicators generally softer we expect a downward correction in employment in coming months.
- A lagged response to previously strong domestic demand and a forecast decline in the AUD, should see core inflation rise towards the upper end of the RBA's 2% to 3% target range by mid 2006. From there, a stabilisation in wages and the AUD, and a softening in global price pressures should bring core inflation back towards 2½%. This is behind our view for no change in monetary policy for the rest of this year.

Kristina Jawerth

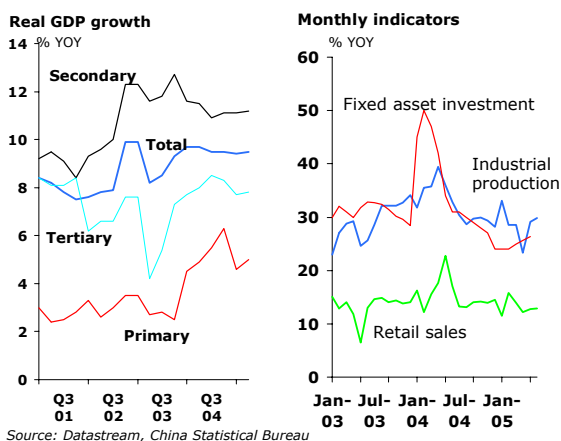
Economic data – Australia

Monthly data	Oct 04	Nov 04	Dec 04	Jan 05	Feb 05	Mar 05	Apr 05	May 05
Building Approvals, 000's	12.7	13.0	13.2	13.1	13.0	12.3	12.6	13.2
Retail Sales, % YOY	5.0	3.4	3.5	3.5	4.2	3.3	2.7	2.8
Exports, % YOY	12.4	10.8	13.6	13.1	15.3	13.5	15.5	16.3
Imports, % YOY	14.4	17.4	14.0	13.9	17.1	15.4	10.8	10.9
Trade Balance, AUD\$ bn	-2.31	-2.75	-2.44	-2.36	-2.36	-2.51	-1.56	-1.56
Foreign Exchange Reserves, US \$ bn	33.36	34.42	36.92	35.92	34.70	36.37	40.48	42.28
Quarterly data	Jun 03	Sep 03	Dec 03	Mar 04	Jun 04	Sep 04	Dec 04	Mar 05
Real GDP, % YOY	2.3	3.2	4.5	4.1	4.4	2.9	1.5	1.9
- Consumer consumption	3.7	4.4	5.6	6.4	5.9	5.6	4.2	3.4
- Government consumption	3.7	4.5	3.3	4.1	3.4	3.5	3.6	2.2
- Gross fixed capital expenditure	10.6	11.0	5.7	7.5	10.6	6.8	12.8	11.1
Consumer Price Index, % YOY	2.7	2.6	2.4	2.0	2.5	2.3	2.6	2.4
Current Account, AUD\$ bn	-12.13	-11.88	-11.87	-12.48	-11.91	-14.24	-15.41	-15.65
Capital Account, AUD\$ bn	11.90	12.55	11.95	10.69	12.07	16.00	16.74	13.53

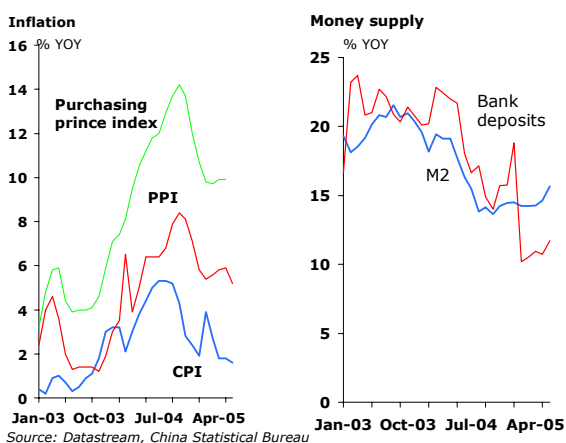
Sources: Bloomberg, RBA, ANZ Bank

Country Update: China

Domestic demand contributing more but is investment led



Inflation declines despite rising M2



- The People's Bank of China announced an immediate change to the FX regime, which abolished the decade old US\$ "peg" in favour of a currency basket and revalued the currency by 2.1% (see lead section for details and anticipated impact).
- Real GDP rose 9.5% in the second quarter and for the first half overall, a faster rate of expansion than had been anticipated. Growth was fuelled by ongoing high levels of fixed asset investment and industrial production, whereas consumption growth has been relatively flat. The national accounts showed a slight shift in the composition of growth toward agriculture, but it was the first time since the third quarter of 2003 that all three sectors published by the government experienced positive growth.
- Domestic demand absorbed a dip in external demand midway through the quarter, as industrial production rose and inventories fell even as export growth slowed – albeit to a still high rate of 30% YOY by the end of Q2. Data from the United States confirmed that the pace of import growth from China has slowed slightly from an average of more than 30% in the previous four quarters to 22% in the second quarter. The source of domestic demand is still investment, as retail sales growth has levelled out at 12%.
- CPI slowed to 1.6% YOY in June after 1.8% in May. The YOY headline figures imply that month-on-month inflation has been negative since February. Perhaps of even greater import, PPI fell from 5.9% YOY in May to 5.2% YOY in June. The manufacturer's purchasing price index also declined in a month when oil prices rose by nearly 4%.
- The aim of the revaluation is to stem foreign currency inflows that have led to excessive investment in key sectors, including the residential real estate market and some manufacturing. If successful, these sectors could see a downturn going forward.

Amy Auster

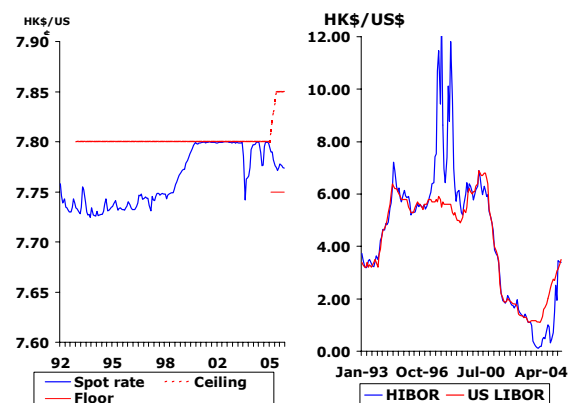
Economic data -China

Monthly data	Nov 04	Dec 04	Jan 05	Feb 05	Mar 05	Apr 05	May 05	Jun 05
Industrial Production, %YOY	28.2	26.1	44.8	14.7	25.8	29.2	32.3	34.4
Retail Sales, % YOY	13.9	14.5	11.5	15.8	13.9	12.2	12.8	12.9
Consumer Price Index, % YOY	2.8	2.4	1.9	3.9	2.7	1.8	1.8	1.6
Exports, % YOY	45.8	32.7	42.1	29.9	32.7	31.9	30.2	30.6
Imports, % YOY	38.6	24.5	23.8	-5.0	18.8	16.2	15.0	15.1
Trade Balance, US\$ bn	9.8	11.0	6.5	4.3	5.6	4.5	8.9	9.7
Foreign Exchange Reserves, US\$ bn	573.9	609.9	623.6	642.6	659.1	670.8	691.0	711.0
Quarterly data	Jun 03	Sep 03	Dec 03	Mar 04	Jun 04	Sep 04	Dec 04	Mar 05
Real GDP, % YOY	8.2	8.5	9.3	9.7	9.7	9.5	9.5	9.4
- Primary sector	2.7	2.8	2.5	4.5	4.9	5.5	6.3	4.6
- Secondary sector	11.6	11.8	12.7	11.6	11.5	10.9	11.0	11.1
- Tertiary sector	4.2	5.4	7.3	7.7	8.0	8.5	8.3	7.7
Nominal GDP, US\$ bn	354.5	446.6	329.4	383.9	416.2	524.1	378.4	436.2
Current Account, US\$ bn	13.0	12.8	10.8	14.5	12.4	16.7	12.9	20.9
FDI (capital used), US\$ bn	71.4	110.2	144.2	23.4	69.1	130.6	171.9	25.4

Sources: Datastream, China Statistical Bureau

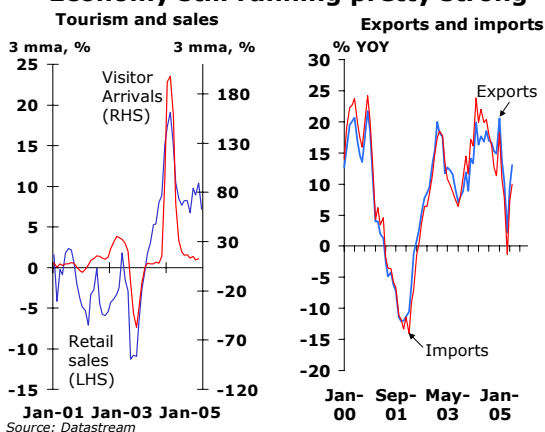
Country Update: Hong Kong

FX move helped bring interest rates back into realignment



Source: Bloomberg

Economy still running pretty strong



Source: Datastream

- In the wake of China's revaluation announcement, the Hong Kong Monetary Authority said there would be no change to its foreign exchange policy. The HKMA in May announced a shift to its convertibility regime by creating a "two-way peg" that created a floor for the currency at HK\$7.75 per USD and raised the ceiling to HK\$7.85 per USD.
- Under our forecast for a soft landing in China, Hong Kong would benefit from increased Chinese purchasing power in the tourism sector. Visitors from the mainland represent more than half of yearly tourism arrivals, and direct spending by tourists contributes about 6% of GDP according to some estimates. However, marginally higher import prices would raise inflation expectations, and any decline in demand for Chinese exports due to higher prices would be felt by the Hong Kong harbour hub as well as by Hong Kong investors in mainland enterprises.
- Data releases for May and June showed the economy continues to expand at a strong pace. Retail sales were up more than 7% in May, while exports in June rose by a higher than expected 13% YOY (US\$ terms). Export growth helped to narrow the trade deficit to its lowest level since January, despite a rise in imports of more than 10% YOY.
- CPI rose by 1.2% in June, a pace not seen since 1998. The HKMA raised its benchmark overnight rate by 25 bps to 4.5% on 4 July. Local interest rates have come now more into line with US interest rates, and a slowdown in China would have a dampening effect on the Hong Kong economy that could help cool demand. However, with inflation ticking upward, unemployment at a three-year low of 5.7% and no pause at the Fed, rates will likely continue to rise through the end of this year.
- Donald Tsang's administration will come into its own in the coming weeks with the Executive Council appointments and preparations for his first policy address in October.

Amy Auster

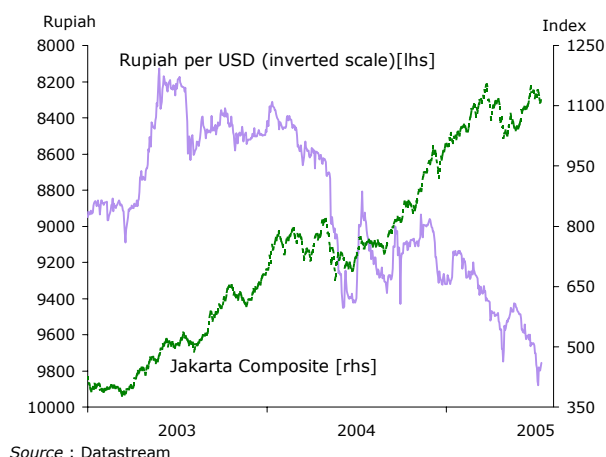
Economic data – Hong Kong

Monthly data	Nov 04	Dec 04	Jan 05	Feb 05	Mar 05	Apr 05	May 05	Jun 05
Visitor Arrivals, %YOY	15.8	16.3	8.3	20.0	5.7	11.9	7.5	na
Retail Sales, % YOY	7.4	8.7	4.1	16.3	6.2	8.6	7.2	na
Consumer Price Index, % YOY	0.2	0.2	-0.5	0.8	0.9	0.4	0.8	1.2
Exports, % YOY	16.8	12.9	34.8	-5.4	3.5	7.8	16.9	13.0
Imports, % YOY	11.2	10.5	37.2	-10.9	2.5	3.8	16.0	10.9
Trade Balance, US\$ bn	0.0	-1.3	-0.3	-1.4	-1.9	-1.4	-1.3	-1.0
Foreign Exchange Reserves, US\$ bn	122.9	122.8	122.3	122.3	121.2	121.7	121.7	121.5
Quarterly data	Jun 03	Sep 03	Dec 03	Mar 04	Jun 04	Sep 04	Dec 04	Mar 05
Real GDP, % YOY	-0.8	4.0	4.7	7.3	12.0	6.6	7.1	6.0
- Consumer consumption	-4.8	0.1	3.9	5.7	10.9	5.3	5.9	4.6
- Government consumption	0.5	0.5	5.5	5.6	0.0	-1.3	-1.7	-4.2
- Gross fixed capital expenditure	-4.7	0.8	2.7	5.1	11.5	2.1	-1.4	2.2
Nominal GDP, US\$ bn	37.5	38.9	39.5	40.4	40.8	40.4	41.4	41.9
Current Account, US\$ bn	2.0	5.5	4.2	2.1	1.0	6.7	6.5	4.3
Capital Account, US\$ bn	-0.4	-0.2	-0.3	0.0	0.0	-0.2	-0.1	na

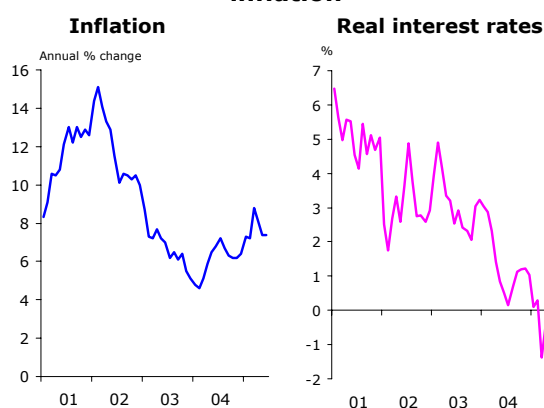
Sources: Datastream, IIF

Country Update: Indonesia

Rupiah slumps but stockmarket soars



Monetary policy fails to keep pace with inflation



- Rupiah weakness continues to take centre-stage, moving closer to the USD/IDR10,000 mark – a level last seen in March 2002. The currency weakened by around 5% between January and mid-July 2005 due to falling real interest rates, deterioration in the capital account and US dollar demand/supply pressures (eg. Pertamina's US dollar demand to purchase oil exacerbated by high oil prices). Meanwhile, the stockmarket has made solid gains, rising by 18% since the start of the year.
- Annual inflation has eased from the 2005 high of 8.8% in March to 7.8% in July. However, it is likely to remain in the 7½-8% range in the second half of the year if oil prices stay high. While there have been no changes to domestic fuel prices since March, Pertamina raised the price of diesel fuel sold to mining and large firms (ie. those consuming more than 500 kilolitres of oil per month) on 1 July. This is likely to have an adverse impact on CPI.
- The central bank introduced key changes to its monetary policy framework with the announcement of a benchmark one-month interest rate, set initially at 8.5% on 5 July. The rate will be reviewed regularly by the Monetary Policy Committee and changed according to indicators of price expectations, similar to the US model. However, BI has not widely published its inflation band and the MPC is only scheduled to meet quarterly. This may well prove insufficient to manage inflation expectations.
- We have revised our exchange rate forecast for 2005 as the factors that have put downward pressure on the rupiah – particularly low real interest rates – seem likely to persist over coming months. The rupiah is now forecast to weaken to IDR9,925 in the coming months before strengthening to IDR9,825 per USD at year end. We have projected the Rupiah to strengthen over 2006 to end the year at IDR9,500 per USD, reflecting expectations of accelerating FDI, narrowing interest rate differentials with the US and declining oil prices.

Jasmine Robinson

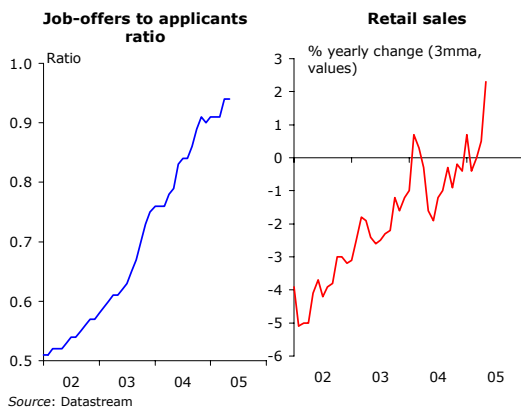
Economic data - Indonesia

Monthly data	Nov 04	Dec 04	Jan 05	Feb 05	Mar 05	Apr 05	May 05	Jun 05
Industrial Production, %YOY	7.3	5.8	7.2	4.6	10.0	na	na	na
Motor cycle sales, % YOY	26.3	46.8	37.3	29.3	33.7	30.7	35.0	44.4
Consumer Price Index, % YOY	6.2	6.4	7.3	7.2	8.8	8.1	7.4	7.4
Exports, % YOY	23.4	26.6	21.6	30.0	44.8	28.7	28.5	13.4
Imports, % YOY	32.7	66.7	19.9	17.5	43.5	41.5	44.8	24.7
Trade Balance, US\$ bn	2.4	1.8	2.1	2.4	2.4	1.8	2.2	2.0
Foreign Exchange Reserves, US\$ bn	34.5	34.9	34.8	35.1	34.6	34.9	33.2	na
Quarterly data	Jun 03	Sep 03	Dec 03	Mar 04	Jun 04	Sep 04	Dec 04	Mar 05
Real GDP, % YOY	5.0	4.2	5.2	4.3	4.4	5.1	6.5	6.4
- Consumer consumption	3.5	3.9	4.9	5.7	5.3	5.1	3.8	3.2
- Government consumption	11.3	9.7	12.2	10.6	4.7	-4.5	-1.8	-7.9
- Gross fixed capital expenditure	3.9	-2.0	-0.5	12.2	13.5	18.5	18.5	15.1
Nominal GDP, US\$ bn	59.5	61.0	61.8	63.4	63.1	64.0	67.3	na
Current Account, US\$ bn	2.09	2.14	2.39	-2.22	2.25	2.77	0.3	2.47
Capital & Financial Account, US\$ bn	-0.20	-0.63	0.83	1.64	-0.69	0.98	1.08	-0.64

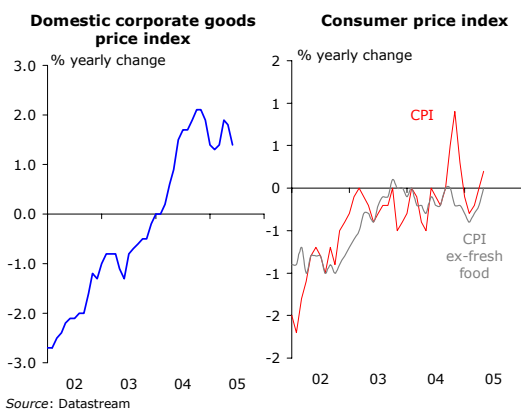
Sources: Bloomberg, Datastream, Bank Indonesia, ANZ Bank

Country Update: Japan

A stronger labour market will support the household sector



The return of inflation?



- After falling into a mild recession last year, the Japanese economy bounced back smartly in the first part of 2005 with real GDP growth rebounding by a strong 1.2% in the March quarter. Notably, the recovery in the Japanese economy occurred despite weaker exports and was instead led by a pick up in domestic spending. This is an encouraging development and bears well for the sustainability of the Japanese recovery going forward.
- Domestic conditions in the Japanese economy have continued to improve in recent months. Corporate profitability has picked up on the back of higher sales, business confidence is relatively high and the latest Tankan survey shows that firms have upgraded business investment spending plans for the year ahead. Continued employment growth meanwhile is buoying the household sector, helping to offset the impact from higher oil prices.
- In contrast, exports have continued to slow and a recent moderation in industrial production points to further downside risk in the short-term. This partly reflects a slowdown in demand for IT-related goods, which has led to a subsequent inventory overhang. The moderation also reflects a slowdown in exports to China as economic growth in that country swings away from industrial production, which is relatively import-intensive. With the global economy still buoyant and the Japanese yen becoming more competitive, the medium-term outlook for exports remains positive.
- Strong commodity prices drove a 1.4% increase in domestic corporate goods prices in the year to June while Japanese core consumer prices were flat in May compared with a year ago. Against a backdrop of improving confidence in the Japanese economy, the Bank of Japan has hinted that deflation may now end before the end of 2005, compared with previous expectations of early 2006.

Katie Dean

Economic data - Japan

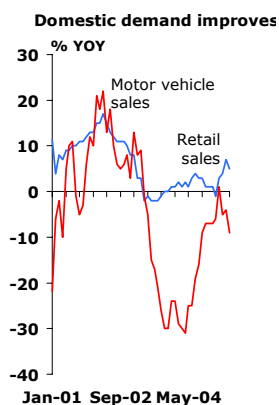
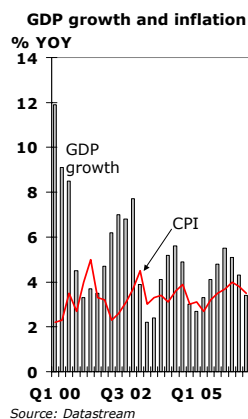
Monthly data	Nov 05	Dec 05	Jan 05	Feb 05	Mar 05	Apr 05	May 05	Jun 05
Industrial Production, %YOY	1.4	1.8	2.2	3.7	2.2	1.5	-0.9	na
Retail Sales, % YOY	0.6	-1.0	2.4	-2.7	0.3	3.8	2.9	na
Consumer Price Index, % YOY	0.9	0.3	-0.1	-0.3	-0.2	0.0	0.2	na
Exports, % YOY	13.1	6.3	7.8	4.1	5.5	6.4	1.1	na
Imports, % YOY	20.2	10.6	11.6	9.9	13.9	18.5	15.9	na
Trade Balance, US\$ bn	10.8	106	112	99	92	75	76	na
Foreign Exchange Reserves, US\$ bn	819.1	824.3	821.2	820.5	818.6	824.2	823.9	825.0

Quarterly data	Jun 03	Sep 03	Dec 03	Mar 04	Jun 04	Sep 04	Dec 04	Mar 05
Real GDP, % YOY	1.0	1.0	2.2	4.1	3.2	2.4	0.9	0.9
- Consumer consumption	0.1	-0.6	1.0	1.8	2.1	1.8	0.3	0.7
- Government consumption	7.3	6.1	11.0	8.1	7.2	7.4	0.9	6.1
- Gross fixed capital expenditure	1.2	0.8	2.9	3.0	3.2	2.9	0.5	1.9
Nominal GDP, US\$ bn	4203	4245	4615	4735	4608	4587	4772	4860
Current Account, US\$ bn	134	146	159	174	171	170	173	174
Capital Account, US\$ bn	-7.0	-1.9	-2.6	-8.5	-1.1	-2.5	-7.0	-4.7

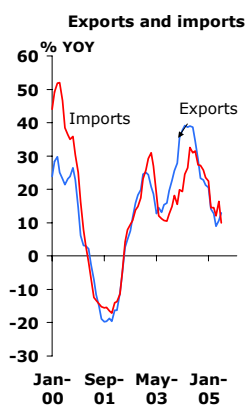
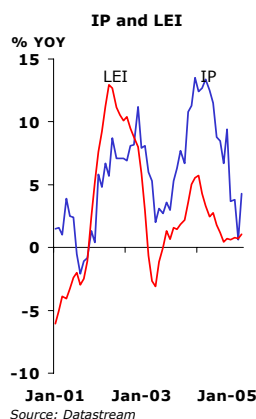
Source: Datastream

Country Update: Korea

Domestic demand improves growth performance



IP and exports turn up, slightly



- Loose fiscal and monetary policies are supporting domestic demand, with increased consumption and construction generating GDP growth of 1.2% (seasonally adjusted) in Q2, up from 0.4% growth in Q1. Manufacturing rose 2.0% QOQ on a seasonally adjusted basis, up from 0.1% in the first quarter, while retail sales and financial services and construction all posted stronger gains. The turnaround was sufficient for the government to subsequently rule out additional expenditure increases, which had been foreshadowed in the event that demand remained weak.
- The central bank has estimated that high oil prices will reduce GDP growth by 0.8 percentage points this year, and is projecting growth of 3.8% for 2005 versus 4.6% last year, which is in line with our forecast for growth this year.
- High oil prices have not had as much impact on inflation in Korea as elsewhere in Asia, with CPI falling to 2.5% in July from highs of above 4% in mid 2004. However, on a month on month basis, CPI accelerated to 0.4% in July after declining in May and June, so the window to delay rate rises may be closing. Asset price inflation is starting affecting the housing market, but the government appears more likely to adopt policies specifically aimed at cooling the property market and allow the central bank to focus on CPI. The central bank will keep its overnight call rate at 3.25% as long as inflation pressures do not increase significantly.
- High oil prices continue to hit sentiment, but industrial production has steadied as domestic demand has picked up. Exports hit a weak spot in the second quarter due to a decline in electronics demand out of the US, but appear to have bottomed out. Nonetheless, domestic demand will probably need to be the main driver for growth through this year.
- S&P upgraded raised its long-term foreign currency outlook on Korea from A- to A. Moody's upgraded selective corporates to beyond the sovereign ceiling of A3 but said a sovereign upgrade would require progress on resolving the North Korea nuclear issue.

Amy Auster

Economic data - Korea

Monthly data	Nov 04	Dec 04	Jan 05	Feb 05	Mar 05	Apr 05	May 05	Jun 05
Industrial Production, %YOY	9.9	4.6	14.3	-7.3	4.9	3.8	4.2	4.1
Retail Sales, % YOY	-0.6	1.3	-3.3	10.3	6.1	5.5	4.6	3.7
Consumer Price Index, % YOY	3.3	3.0	3.1	3.3	3.1	3.1	3.1	2.7
Exports, % YOY	26.5	17.6	18.1	6.6	13.2	6.9	11.8	9.6
Imports, % YOY	28.9	19.0	19.7	5.0	18.3	12.5	18.4	14.2
Trade Balance, US\$ bn	3.0	2.6	3.5	2.4	1.7	2.3	2.6	2.9
Foreign Exchange Reserves, US\$ bn	192.5	199.0	199.6	202.1	205.4	206.3	206.0	204.9

Quarterly data	Jun 03	Sep 03	Dec 03	Mar 04	Jun 04	Sep 04	Dec 04	Mar 05
Real GDP, % YOY	2.2	2.3	4.1	5.3	5.5	4.7	3.3	2.7
- Consumer consumption	-1.5	-2.0	-2.0	-1.3	-0.5	-0.8	0.6	1.4
- Government consumption	3.7	3.7	3.8	3.0	4.2	2.9	1.9	3.2
- Gross fixed capital expenditure	4.2	2.7	4.3	2.2	4.3	3.0	-1.2	0.1
Nominal GDP, US\$ bn	148.2	154.5	157.5	163.9	166.2	170.2	184.9	192.1
Current Account, US\$ bn	2.6	3.7	7.3	6.1	7.0	7.1	7.4	6.0
Capital Account, US\$ bn	-0.4	-0.4	-0.3	-0.4	-0.5	-0.4	-0.5	-0.5

Sources: Datastream, IIF, ANZ Bank

Country Update: Malaysia

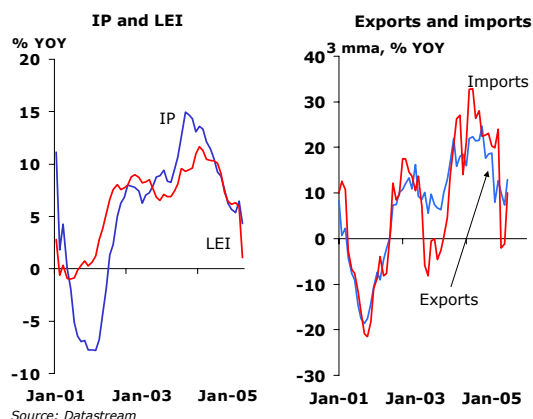
Possible currencies included in new MYR basket, by order of trade relationship

Top trading partners 2004

MYR bn	Imports	Exports	Total	% of total
US	90.1	57.8	148.0	16.8
Singapore	72.1	44.5	116.6	13.2
Japan	48.5	63.7	112.3	12.7
EU	60.4	48.0	108.4	12.3
China	32.1	39.3	71.4	8.1
Thailand	31.4	21.9	53.4	6.1
Hong Kong	28.8	10.8	39.5	4.5
Korea	16.8	19.8	36.7	4.2
Australia	15.8	6.8	22.6	2.6

Source: Bank Negara Malaysia

Industrial production and sentiment are weakening



Source: Datastream

- Malaysia has abolished the ringgit peg to the US dollar, previously at USD/MYR3.8, in favour of a managed float against an undisclosed trade-weighted basket of currencies. Malaysia's major trading partners are shown at left (excluding Indonesia and Taiwan). The basket and its weights have not been disclosed, but it would seem likely greater weight would be placed on freely floating currencies such as the US dollar, yen and euro with perhaps a smaller weighting for a combination of Asian trading partners.
- The authorities chose to shift the FX policy regime on the same day that China announced its regime shift, ensuring that little market attention was paid to Malaysia's change. In the event, the ringgit has appreciated by a nominal 1.4% to USD/MYR3.746 since 21 July, which is less than the yuan's appreciation during the same period. Malaysia's move was anticipated as the authorities have liberalised other controls that were adopted in the wake of the 1997 crisis. Although this most recent move allows for the possibility of more currency strength in the near term, Bank Negara has stated that FX stability remains a primary objective and that the new system will not result in a significant deviation from the existing exchange rate.
- The very small change in the exchange rate since the announcement is unlikely to have a major economic impact. At the margin, a stronger FX rate will help dampen inflation expectations from rising oil prices, which may be important given that CPI accelerated to a six-year high of 3.2% YOY in June. It may also hurt exporters somewhat, particularly in the electronics sector given the downturn in demand and relative levels of the MYR versus the JPY and KRW.
- Industrial production has responded to softening external demand for electronics, falling on a year on year basis in May for the first time in three years. While electronics exports have slowed, total export growth remains rather robust given high energy export prices. Thus net exports are continuing to contribute to growth, which is still expected to remain above 5% this year.

Amy Auster

Economic data - Malaysia

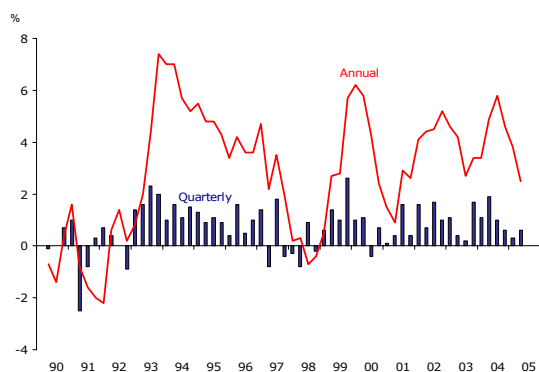
Monthly data	Nov 04	Dec 04	Jan 05	Feb 05	Mar 05	Apr 05	May 05	Jun 05
Industrial Production, %YOY	9.2	6.4	3.1	8.5	5.0	4.0	-0.4	na
Motor Vehicle sales, % YOY	13.5	49.1	23.3	20.4	21.6	6.7	17.3	na
Consumer Price Index, % YOY	2.2	2.1	2.4	2.4	2.6	2.7	3.1	3.2
Exports, % YOY	17.0	12.8	11.2	13.2	16.0	9.4	10.9	na
Imports, % YOY	22.7	12.8	9.2	11.4	8.7	4.8	14.2	na
Trade Balance, US\$ bn	2090	2429	2541	2332	3296	2722	2282	na
Foreign Exchange Reserves, US\$ bn	62.9	66.7	69.6	71.0	71.5	73.0	74.1	74.9

Quarterly data	Jun 03	Sep 03	Dec 03	Mar 04	Jun 04	Sep 04	Dec 04	Mar 05
Real GDP, % YOY	4.7	5.3	6.7	7.8	8.4	6.7	5.8	5.7
- Consumer consumption	5.0	7.0	8.6	8.9	11.9	11.2	10.2	10.1
- Government consumption	10.7	3.2	13.3	11.8	9.5	1.1	4.2	-2.3
- Gross fixed capital expenditure	0.4	3.2	3.6	3.5	3.5	3.2	2.2	2.0
Nominal GDP, US\$ bn	25.3	25.9	27.3	28.1	29.2	30.1	30.8	31.0
Current Account, US\$ bn	3.4	2.8	3.8	3.3	4.4	3.4	5.5	3.4
Capital & Financial Account, US\$ bn	0.1	-0.6	2.3	0.0	-0.9	2.7	0.9	0.1

Sources: IIF, Datastream, ANZ Bank

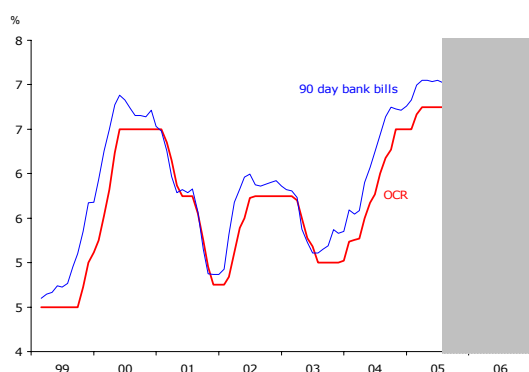
Country Update: New Zealand

Growth is slowing...



Source: Statistics NZ

But interest rates are unlikely to change soon



Sources: Reuters; ANZ National Bank

- Annual GDP growth has eased to 2.5% from a resource-sapping 4.9% in March 2004. Both demand and supply side forces are exerting a moderating influence on growth. The lagged impact of higher interest rates and a firm NZ dollar continue to exert a braking influence on the economy. From the supply side, firms continue to report widespread skill shortages. Capacity utilisation remains high. Yet at the same time both have receded from their peaks.
- We expect growth to trough at 2 percent, which is within one standard deviation of the trend rate. Housing and retail related activity continues to ease and the full impact of tighter monetary policy has yet to be felt.
- While growth is easing, inflation pressure is rising. The headline inflation rate has increased to 2.8 percent. Cost push pressures from a tight labour market and potentially lower NZD look set to push inflation temporarily through the top of the 1 to 3 percent policy band.
- Easing growth eliminates the risk of further interest rate increases in July. However, the underlying inflation pressures that continue to percolate mean that monetary policy is unlikely to ease until mid-2006.
- The NZ dollar has eased over recent months, in line with a general strengthening of the US\$ and weaker NZ economy. The NZ\$ faces further global headwinds over the coming year, including higher US interest rates, rising risk aversion, and receding commodity prices.
- A general election is due before the end of September, although as yet no polling date has been announced. Tax is shaping up as the defining issue in the election. However, there are broad similarities in other policy platforms across the two major parties. The key nucleus of policies that underpin New Zealand's medium-term growth potential (the Fiscal Responsibility Act, an independent central bank, flexibility within the labour market, and the Public Finance Act) are well enshrined.

Cameron Bagrie

Economic data – New Zealand

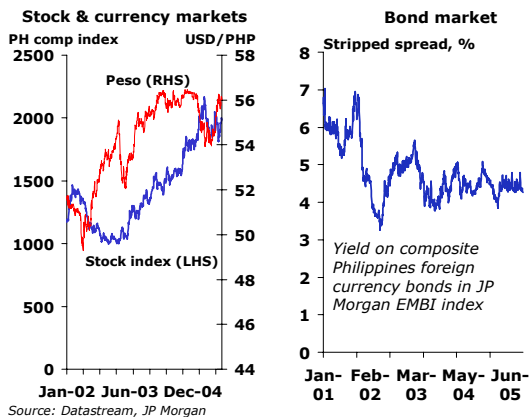
Monthly data	Oct 05	Nov 05	Dec 05	Jan 05	Feb 05	Mar 05	Apr 05	May 05
Retail Sales, % YOY	4.4	9.6	8.0	4.4	6.9	6.5	6.7	7.0
Building consents (% YOY)	4.4	-11.8	-7.5	-29.0	-15.2	-0.3	-36.4	-22.3
Exports, % YOY	8.7	9.1	10.8	10.8	5.8	0.6	4.0	-12.0
Imports, % YOY	0.5	18.5	9.3	-2.2	14.0	9.2	2.0	11.0
Trade Balance, US\$ bn	-0.37	-0.48	-0.38	-0.21	-0.08	-0.14	-0.11	-0.04

Quarterly data	Jun 03	Sep 03	Dec 03	Mar 04	Jun 04	Sep 04	Dec 04	Mar 05
Real GDP, % YOY	3.4	3.4	4.9	5.8	4.6	3.8	2.5	n.a.
- Consumer consumption	5.8	5.6	7.0	5.9	6.1	5.4	5.1	n.a.
- Government consumption	2.4	4.3	5.5	6.9	4.5	8.1	6.1	n.a.
- Gross fixed capital expenditure	12.1	11.3	18.9	15.5	10.9	8.1	3.2	n.a.
Nominal GDP, US\$ bn	21.7	23.8	22.8	24.1	26.0	26.7	21.7	23.8
Current Account, US\$ bn	-5.7	-5.6	-6.3	-6.8	-8.1	-9.3	-10.3	n.a.
Consumer Price Index, annual % change	1.5	1.6	1.5	2.4	2.5	2.7	2.8	2.8

Sources: Statistics NZ, ANZ National Bank

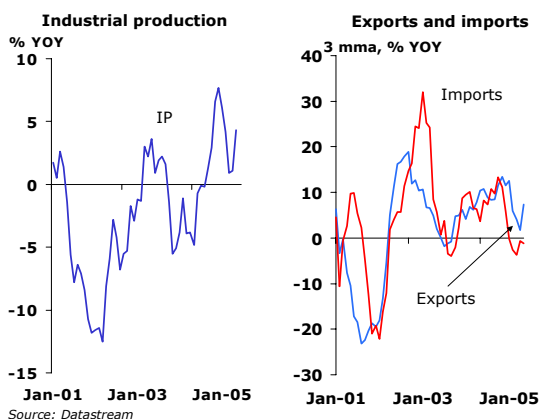
Country Update: Philippines

Political uncertainty has not affected sentiment



- The political situation remains fluid, but the likelihood of an imminent administration change has declined. President Macapagal Arroyo used her state of the nation address in late July to propose that the Philippines move from a presidential to a parliamentary system of government. Political observers believe the proposal was at the behest of former President Fidel Ramos, whose support for Arroyo has helped to solidify her backing by key segments of the political establishment. The belief was that Ramos would lend Arroyo support in exchange for her promise to leave office next year, but Ramos has since said Arroyo should be able to run for the premiership. Regardless of these machinations, it appears Arroyo will remain in office for the time being as the turnout for anti-Arroyo demonstrations has not been high, and the opposition does not have sufficient votes in Congress to send articles of impeachment to the Senate.

Export growth and IP have picked up



- The uncertainty does not seem to have impacted sentiment, which is not surprising given that the Philippines has experienced more than its share of political volatility. Indeed, the economy's performance is quite good, considering. Growth is expected to have reached 5% in the second quarter, up from 4.4% in the first quarter, helped by capital inflows from overseas worker remittances as well as increased agricultural production. Inflation has ticked downward marginally to 8.2% YOY in June, allowing the central bank to keep its overnight rate unchanged at 7%. Other measures such as reserve requirement increases have helped to control liquidity in the absence of a rate hike.
- Perhaps most surprising is the improved performance of the fiscal accounts, which have been a major point of concern as the government awaits the Supreme Court's decision on the constitutionality of the Extended Value Added Tax bill. The government said that due to lower than forecast interest rates, the overall budget deficit will be PHP20 bn less than initially forecast. Fiscal surpluses were recorded in April and June as tax revenues rose significantly.

Amy Auster

Economic data - Philippines

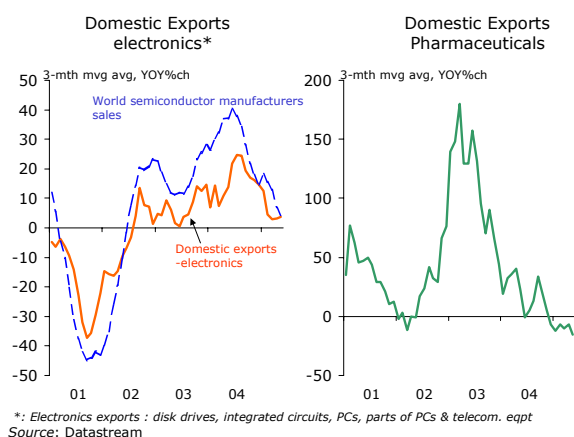
Monthly data	Nov 04	Dec 04	Jan 05	Feb 05	Mar 05	Apr 05	May 05	Jun 05
Manufacturing Production, %YOY	7.8	9.8	0.7	2.2	-0.9	3.1	5.4	7.8
Motor Vehicle sales, % YOY	4.7	2.3	-5.8	-1.3	13.5	33.9	15.6	25.2
Consumer Price Index, % YOY	8.2	8.6	8.4	8.5	8.5	8.5	8.5	8.2
Exports, % YOY	19.5	2.9	15.4	-0.6	-2.8	8.8	1.1	na
Imports, % YOY	2.6	-0.9	-2.1	-4.8	-4.0	6.5	2.7	na
Trade Balance, US\$ bn	327	222	170	132	-180	-450	-71	na
Foreign Exchange Reserves, US\$ bn	12.6	12.9	12.9	13.6	13.8	14.1	14.8	15.1

Quarterly data	Jun 03	Sep 03	Dec 03	Mar 04	Jun 04	Sep 04	Dec 04	Mar 05
Real GDP, % YOY	5.0	3.5	2.8	6.4	6.4	6.3	5.4	4.6
- Consumer consumption	5.4	5.2	5.5	5.7	6.3	5.5	5.7	5.0
- Government consumption	-3.8	4.9	5.2	4.1	-1.2	-7.2	5.6	-0.9
- Gross fixed capital expenditure	4.0	6.0	-0.5	5.0	3.9	3.6	4.3	-2.4
Nominal GDP, US\$ bn	19.7	19.3	19.8	20.1	20.8	21.5	22.1	22.9
Current Account, US\$ bn	0.6	1.1	1.5	0.7	0.8	1.4	na	na
Capital Account, US\$ mn	4.0	9.0	5.0	-4.0	-4.0	-6.0	na	na

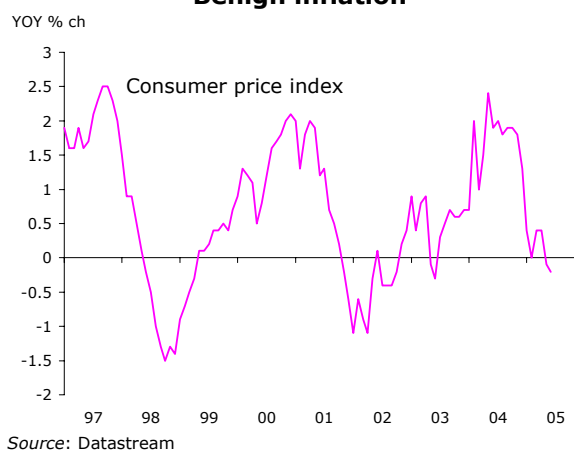
Sources: IIF, Datastream, ANZ Bank

Country Update: Singapore

Growth in exports softens



Benign inflation



- Advance estimates for real GDP growth in the second quarter were much stronger than expected. On a quarter-on-quarter seasonally adjusted annualised basis, real GDP grew by 12.3%, almost double the consensus forecast of 6.6% and the fastest pace since Q3 2003. In year-on-year terms, real GDP rose by 3.9% ahead of first quarter growth, which was revised upwards to 2.8%.
- Growth in total exports has halved, reflecting the sharp slowing in non-oil exports (85% of total exports). Non-oil domestic exports, which account for close to 40% of total exports, have slowed considerably this year, growing by just 3.8% (in Singapore dollar terms) during January-June 2005 compared with the same period in 2004 against 17% in 2004, as a whole, as global demand for electronics softened and demand for pharmaceutical products plunged.
- Nevertheless, the outlook is for faster growth in the second half of 2005, supported by stronger output from the electronics and bio-medical industries reflecting a pick-up in global demand, and a buoyant services sector. The manufacturing sector recovered slightly from its poor showing in the first quarter and the services sector grew at a much faster pace in the second quarter. Tourism has picked up, thanks to the low-cost airline boom and a busy events calendar, and is expected to continue to support growth in service industries. The latter would have been given a boost as Singapore played host to visitors who came for the announcement of the 2012 Olympic host city.
- Inflation remains subdued despite high oil prices and a generally weaker Singapore dollar, suggesting that firms are absorbing the run-up in costs of intermediate inputs amidst intense competition and lacklustre domestic demand. Annual inflation averaged 0.2% for the first half of the year.

Jasmine Robinson

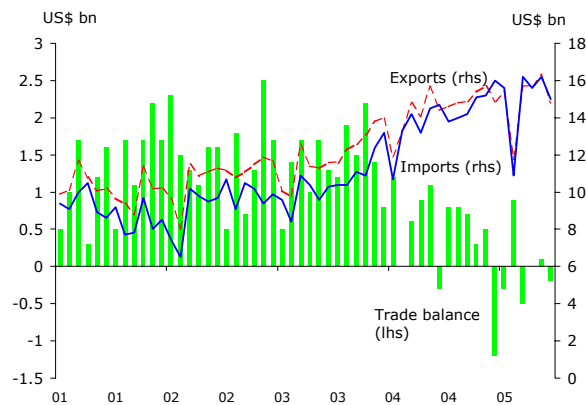
Economic data - Singapore

Monthly data	Nov 04	Dec 04	Jan 05	Feb 05	Mar 05	Apr 05	May 05	Jun 05
Industrial Production, %YOY	10.7	32.3	10.9	-10.6	9.0	4.4	2.0	11.1
Retail Sales, % YOY	10.3	3.0	11.7	-4.7	13.4	12.9	6.8	na
Consumer Price Index, % YOY	1.8	1.3	0.4	0.0	0.4	0.4	-0.1	-0.2
Exports, % YOY	25.6	20.6	19.1	8.0	16.9	12.7	15.6	12.2
Imports, % YOY	30.6	17.7	23.5	7.4	16.7	12.5	11.8	15.9
Trade Balance, US\$ bn	1.3	2.1	0.6	1.7	1.0	1.0	1.7	1.3
Foreign Exchange Reserves, US\$ bn	109.2	112.2	111.4	113.2	112.9	115.3	115.9	na
Quarterly data	Jun 03	Sep 03	Dec 03	Mar 04	Jun 04	Sep 04	Dec 04	Mar 05
Real GDP, % YOY	-3.8	2.4	5.6	7.9	12.3	7.2	6.5	2.8
- Consumer consumption	-2.7	0.4	3.4	7.9	12.8	7.2	6.6	na
- Government consumption	2.3	-9.4	3.4	5.1	-6.4	-6.4	-1.0	na
- Gross fixed capital expenditure	-10.5	0.2	1.2	11.8	12.1	9.5	0.8	na
Nominal GDP, US\$ bn	22.1	23.5	24.5	25.8	26.0	26.1	29.0	27.7
Current Account, US\$ bn	6.1	7.4	6.7	5.8	6.3	7.9	7.9	7.2
Capital & Financial Account, US\$ bn	-4.4	-3.0	-6.8	-0.1	-3.7	-7.5	-1.8	-5.0

Sources: Bloomberg, Datastream, MTI, Economic Survey of Singapore, ANZ Bank

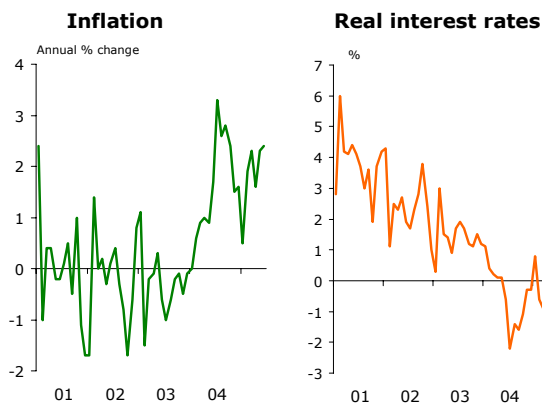
Country Update: Taiwan

Trade position deteriorates



Source: Datastream

Inflation edges up



Sources: Datastream, ANZ Bank

- The Taiwan economy grew by a disappointing 2.8% over the year to Q1 2005, the slowest rate of expansion since Q2 2003. The slowdown in global technology demand has hit manufacturing activity hard. Industrial production has been sluggish, recording a marginal decline, in year-on-year terms, in the first five months of this year. We have forecast real GDP growth of around 3¾% for 2005 due largely to the sluggish pace of exports and the adverse impact of high oil prices.
- For the first half of this year, exports grew by just 6.6% compared with an 11.2% increase in imports. A slowdown in IT exports coupled with high oil import costs have led to the deterioration in the trade balance which narrowed significantly to US\$0.2 bn during this period compared with US\$3.7 bn in the six months to June 2004.
- Although growth is slowing, consumer prices have edged up. Inflation was up 2.4% year-on-year to June from 1.6% year-on-year in December 2004. Annual inflation averaged 1.8% for the first half of the year. The central bank raised the benchmark discount rate by 12.5 basis points to a three-year high of 2% on 30 June in a bid to reign in inflation. This marked the fourth rate hike since September 2004. However, core inflation (excluding food and fuel) remains weak, suggesting a more measured pace of monetary tightening going forward. Short-term rates remain negative in real terms.
- The government plans to broaden the tax base amidst a deteriorating fiscal position. The deficit, which was 3.1% of GDP in 2004, is forecast to widen in 2005 and 2006. Measures proposed include setting a 10% minimum income tax rate for companies with annual income of at least NT2 mn and a 20% minimum income tax on individuals earning at least NT8 mn a year.

Jasmine Robinson

Economic data – Taiwan

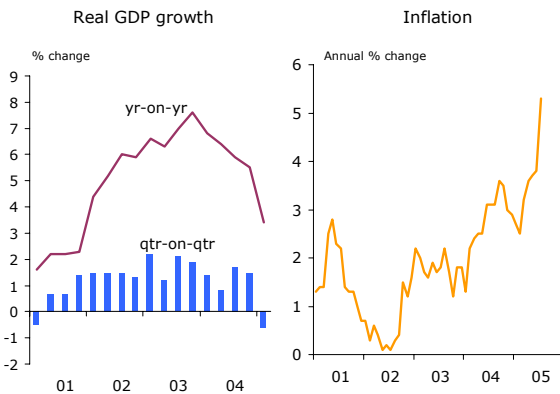
Monthly data	Nov 04	Dec 04	Jan 05	Feb 05	Mar 05	Apr 05	May 05	Jun 05
Industrial Production, %YOY	5.7	-0.7	13.3	-13.3	-0.2	0.9	-1.3	1.3
Retail Sales, % YOY	4.3	4.6	5.3	6.9	7.7	4.6	na	na
Consumer Price Index, % YOY	1.5	1.6	0.5	1.9	2.3	1.6	2.3	2.4
Exports, % YOY	13.9	6.1	29.4	-11.0	6.1	11.0	4.0	2.7
Imports, % YOY	22.3	21.3	46.5	-17.5	14.1	18.6	11.4	2.1
Trade Balance, US\$ bn	0.52	-1.17	-0.26	0.86	-0.45	0.03	0.13	-0.17
Foreign Exchange Reserves, US\$ bn	239.1	241.7	242.7	246.6	251.1	252.6	253.2	253.6

Quarterly data	Jun 03	Sep 03	Dec 03	Mar 04	Jun 04	Sep 04	Dec 04	Mar 05
Real GDP, % YOY	-0.1	4.2	5.9	6.7	7.9	5.3	3.3	2.5
- Consumer consumption	-1.9	1.8	2.5	3.7	4.3	1.4	3.3	3.0
- Government consumption	0.0	1.3	0.8	0.6	-0.9	-1.6	-0.6	-1.0
- Gross fixed capital expenditure	-10.4	-3.6	5.8	13.6	19.4	13.7	14.9	11.9
Nominal GDP, US\$ bn	69.6	72.7	74.2	76.2	76.2	75.8	77.8	82.4
Current Account, US\$ bn	6.7	6.8	8.0	5.9	5.6	5.3	1.8	4.2
Capital Account, US\$ bn	-8.5	-8.0	-6.4	-5.7	-4.9	-4.8	-4.4	-5.2

Sources: Bloomberg, Datastream, National Statistics, Republic of China, ANZ Bank

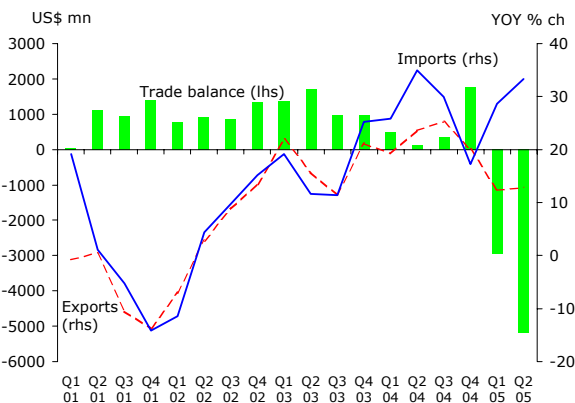
Country Update: Thailand

Growth moderates but inflation accelerates



Sources: Datastream, ANZ Bank

Trade deficit widens significantly



Source: Datastream

- PM Thaksin outlined measures to give the economy a lift in a speech at a fund-raising dinner on 12 July. Fuel subsidies will be removed while salaries and the minimum wage will rise, and villages will be given a cash injection.
- The government has also announced plans to raise salaries of civil officials by 5% from 1 October, in a bid to boost consumption after the economy slowed sharply to 3.4% in the first quarter, in year-on-year terms. About Bt20 bn will also be provided to villages to improve roads and support other infrastructure construction, which in turn, would create more jobs and lift consumer spending.
- Lax fiscal policy and high oil prices are contributing to inflation, which jumped to 5.3% in July compared with 2.7% in January. CPI has also been impacted by the decision to scrap remaining fuel subsidies and float diesel prices (gasoline prices were floated in October) from 13 July. The price of diesel, used by trucks and buses, has risen by more than 50% since the start of this year.
- Thailand's trade position has worsened, largely reflecting the impact of the rising oil import bill. Exports rose by 12% during January-June 2005 compared with the same period a year earlier but were outstripped by imports which grew by 31.4%. The current account deficit widened to US\$6.5 bn in the first six months of this year compared to a surplus of US\$2.8 bn for the same period in 2004.
- Energy-conservation measures were proposed (eg. implementing a 4-day, 10 hour a day week, switching billboard lighting off early) by the Energy Policy and Planning Office in early July. This, together with the removal of fuel subsidies, should help reduce demand for fuel and reduce import costs. However, high oil prices will continue to put pressure on external balances.

Jasmine Robinson

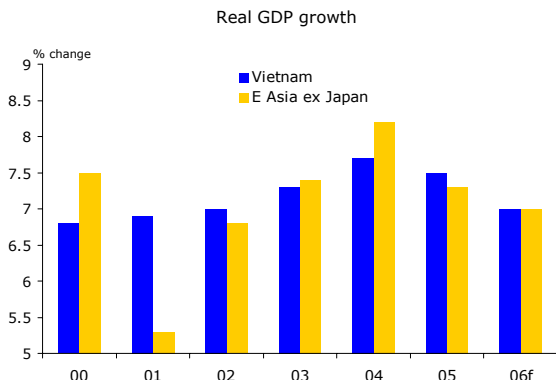
Economic data - Thailand

Monthly data	Nov 04	Dec 04	Jan 05	Feb 05	Mar 05	Apr 05	May 05	Jun 05
Manufacturing Production, %YOY	11.9	6.4	3.9	-1.1	8.4	5.7	8.5	9.1
Car Sales, % YOY	36.5	13.0	17.6	-4.1	24.1	9.0	21.9	25.6
Consumer Price Index, % YOY	3.0	2.9	2.7	2.5	3.2	3.6	3.7	3.8
Exports, % YOY	22.0	16.8	10.9	5.5	20.3	13.1	12.5	9.4
Imports, % YOY	31.0	2.9	33.6	22.0	29.8	30.0	36.4	35.4
Trade Balance, US\$ bn	0.15	0.9	-1.3	-0.5	-1.1	-1.5	-1.76	-1.88
Foreign Exchange Reserves, US\$ bn	47.1	48.7	47.8	48.5	47.5	48.1	47.1	na
Quarterly data	Jun 03	Sep 03	Dec 03	Mar 04	Jun 04	Sep 04	Dec 04	Mar 05
Real GDP, % YOY	6.1	6.7	7.9	6.7	6.3	6.0	5.5	3.4
- Consumer consumption	6.0	5.6	7.5	6.2	5.6	5.6	5.4	4.6
- Government consumption	4.1	4.5	8.4	5.9	5.1	0.8	4.9	15.9
- Gross fixed capital expenditure	9.1	11.3	19.4	16.8	12.9	12.6	15.2	15.1
Nominal GDP, US\$ bn	34.5	36.2	38.7	40.1	40.3	40.3	42.7	44.0
Current Account, US\$ bn	1.26	1.81	2.46	2.16	0.64	1.47	3.02	-1.5
Capital & Financial Account, US\$ bn	-0.3	-1.5	-2.0	-1.6	0.3	0.4	1.3	0.5

Sources: Bloomberg, Datastream, ANZ Bank

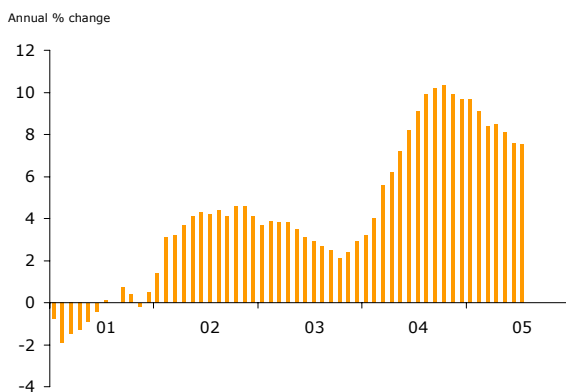
Country Update: Vietnam

The economy performs strongly...



Sources: Datastream, ANZ Bank

.... but inflation is a concern



Sources: Datastream, ANZ Bank

- Vietnam ranks as one of the fastest-growing economies in East Asia. According to official estimates, the economy grew by 7.9% in Q2 2005 compared with Q2 2004 and with real GDP expanding by 7.3% in the year to Q1 2005, this puts growth for the first half of 2005 at 7.6%, in year-on-year terms. While this represents a relatively healthy pace of growth compared with the average of 7.1% per year between 2000 and 2004, the full-year growth target for 2005 of 8.5% looks likely to be missed.
- Inflation eased to 7.5% in the year to July, bringing the average for the first seven months of the year to 8.4% but this was still higher than the 7.8% recorded for 2004. Food prices, reflecting the impact of bird flu and higher rice price, and high petrol prices have been the main contributors to the rise in the CPI. The government cut fuel subsidies on 3 July, raising the price of retail oil products by 10-33% (eg. petrol prices rose by around 10%).
- Vietnam is closer to gaining WTO membership. It has secured support from the US, EU and China for its WTO bid, lifting prospects for accession later this year or in 2006. However, the government still needs to press ahead with implementing WTO-consistent economic liberalisation measures – a pre-condition for accession.
- Moody's raised Vietnam's foreign currency country ceiling for bonds and notes by one notch to Ba3 with a stable outlook (from B1) on 7 July – the first upgrade in seven years. This places Vietnam above the Philippines and Indonesia.
- The improved credit rating will assist Vietnam as it considers launching its first sovereign bond issue in the international debt market later this year.

Jasmine Robinson

Economic data - Vietnam

Monthly data	Jan 05	Feb 05	Mar 05	Apr 05	May 05	Jun 05
Industrial Production ⁺ , %YOY	32.4	16.1	14.4	15.1	15.4	15.6
Retail Sales ⁺ , % YOY	19.1	18.5	18.5	18.7	18.8	18.9
Consumer Price Index, % YOY	9.7	9.1	8.4	8.5	8.1	7.6
Exports ⁺ , % YOY	19.6	16.2	16.2	23.2	20.4	17.4
Imports ⁺ , % YOY	18.3	24.2	18.5	22.4	21.2	22.0
Trade Balance*, US\$ bn	-0.2	-0.8	-1.1	-1.8	-2.6	-3.6
Tourist Arrivals ⁺ , %YOY	4.4	12.4	22.8	20.1	19.4	23.7
China, number of visitors*	-	-	211,930	246,066	302,439	408,817
US, number of visitors*	-	-	94,787	115,161	134,243	166,875

Quarterly data	H1 2005	H1 2005
Real GDP ⁺ , % YOY	7.6	FDI*
Agriculture, forestry, fishery, % YOY	4.2	Projects,
Industry & construction, % YOY	9.5	Value
Services, % YOY	7.6	323
		1.87 [^]

+ : January-to date vs same period in previous year

*: January to date ^: US\$ bn

Sources: General Statistics Office of Vietnam, ANZ Bank

ANZ is represented in:

AUSTRALIA by:

Australia and New Zealand Banking Group Limited ABN 11 005 357 522
10th Floor 100 Queen Street, Melbourne 3000, Australia
Telephone +61 3 9273 6224 Fax +61 3 9273 5711

UNITED KINGDOM by:

Australia and New Zealand Banking Group Limited
ABN 11 005 357 522
Minerva House, PO Box 7, Montague Close, London, SE1 9DH, United Kingdom
Telephone +44 20 7378 2121 Fax +44 20 7378 2378

UNITED STATES OF AMERICA by:

ANZ Securities, Inc. (Member of NASD and SIPC)
6th Floor 1177 Avenue of the Americas
New York, NY 10036, United States of America
Tel: +1 212 801 9160 Fax: +1 212 801 9163

NEW ZEALAND by:

ANZ National Bank Limited
Level 7, 1-9 Victoria Street, Wellington, New Zealand
Telephone +64 4 802 2000

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