

The upward march of global interest rates

July 2006

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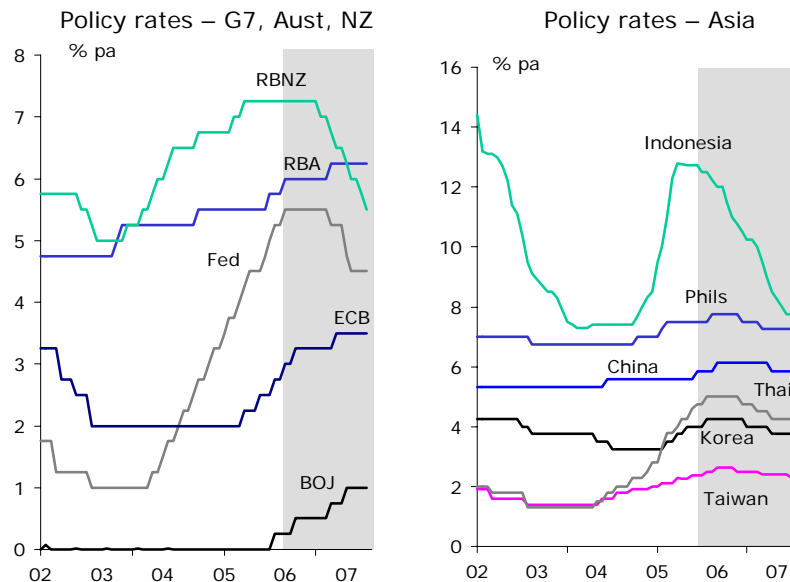
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August will be a busy month for central banks, with policy interest rates rising across the G20. Asian central banks will continue to follow suit, in the face of flush liquidity and booming regional demand caused by a hyperactive China. Since market interest rates in many Asian economies have lagged central bank action in the region – with some central banks themselves still behind the march to higher rates set by the G7 – interest rates in several Asian economies appear to be at risk of a rather sudden, upward adjustment over the next few months.

In this note, we review

- The busy month ahead, with rate hikes expected in Australia on 2 August, in Europe on 3 August and in the US on 8 August;
- The outlook for rates in Asia, with our analysis showing that Hong Kong, Malaysia, Singapore and Taiwan are at risk of a sudden interest rate and/or currency adjustment in the coming weeks;
- The outlook for monetary policy in China, where some combination of higher interest rates and faster real currency appreciation is required; and
- The downgrading of growth expectations for SE Asia, where tighter monetary conditions and high oil prices are putting the squeeze on consumption.

Interest rates rising everywhere except NZ and Indonesia



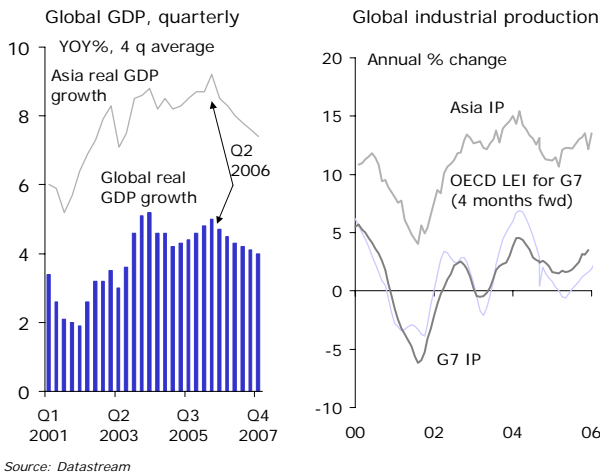
Source: Datastream, Bloomberg, Economics@ANZ

G7 sets the pace on higher interest rates

August should see a swift upward move in interest rates across the G7, with rate hikes expected in Europe on 3 August and in the United States on 8 August, despite some softer US data in late July. Japan’s return to positive interest rates last month raised expectations of another imminent rate hike, but we believe the Bank of Japan will now pause until November before raising rates again. Nonetheless, the direction is clear, with the balance of risks still tilted toward even more rate hikes across the G7 through the end of this year.

There are several reasons why, in our view, inflation pressures are continuing to build. The first is that global demand remains strong. Growth in the EU is accelerating, and Japan's expansion continues. In the US, the housing market appears to be cooling more rapidly, but wages are still rising and labour markets are tight, allowing for greater transmission of energy price inflation. Perhaps most importantly, however, China's growth continues to accelerate, reaching 11.3% YOY in the second quarter, with the main growth driver being the high rate of domestic investment. As China is now responsible for about 15% of global GDP (PPP basis), the impact of such high growth rates is felt directly in the global economy. By our reckoning, global economic activity may have accelerated to 5.0% YOY in the second quarter, nearly matching the previous high of 5.2% recorded in the first half of 2004.

Global boom continues



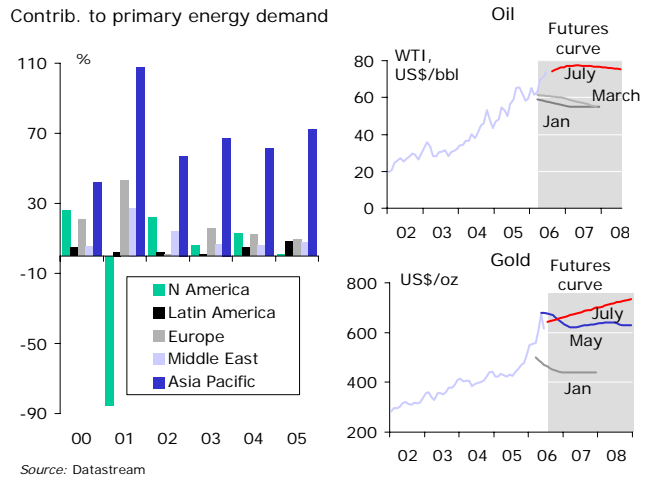
As can be seen above, our global growth forecasts continue to foresee a soft landing in 2007, albeit to still above-trend growth. This very much depends, however, on the as-yet-undetermined ability of the Chinese authorities to engineer a soft landing for the world's most rapidly growing economy.

Commodity prices still rising

The major threat posed to price stability by the unfettered expansion of China is China's impact on commodity prices. Commodity price expectations have risen consistently over the past two years, in line with China's accelerating growth rate. More recently, however, an important shift emerged, as the shape of the futures curve for oil and gold became upward sloping, a clear sign that high energy prices are now directly related to higher inflation expectations.

The fact that the major cause of higher commodity price expectations is Asia cannot be doubted; latest data show that Asia was responsible for 72% of the increase in global consumption of primary energy in 2005. Of course, the major source of that demand is China.

Commodity prices expected to rise in future



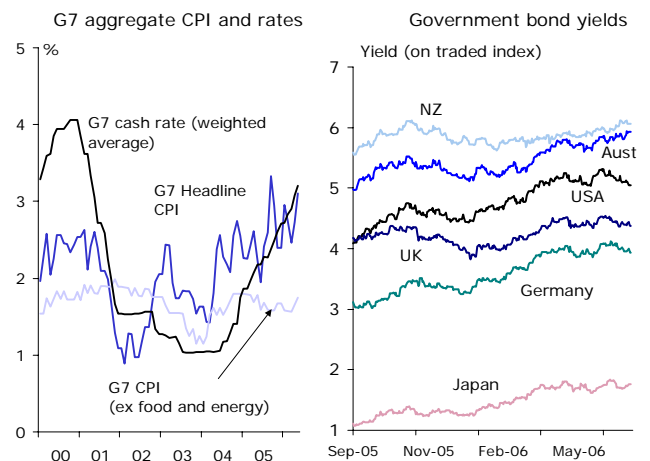
G7 tightening continues

Strong global demand, high commodity prices and tight labour markets are all contributing to the upward drift in G7 inflation, where the headline rate accelerated to 3.1% YOY in May. Market participants ignored the headline rate in the early phases of the oil price rally, but have had a rude wake-up call.

In July, Stanford economist John Taylor, author of the Taylor rule, wrote that the Fed must react to measures of inflation that include food and energy to achieve its goal of raising the Fed funds rate by more than any incipient increase in inflation. A few days later, RBA Deputy Governor Glenn Stevens remarked in an address that central banks cannot rely solely upon measures of consumer prices that account for the deflationary impact of China (on consumer goods) while ignoring the inflationary impact of China (on raw materials prices).

The implication is that central banks are on watch for pass through of energy prices to CPI, and we expect G7 rates to rise further in the fourth quarter. The key risk to all our financial market forecasts is that the Fed will have to move beyond our forecast 5.5% Fed funds peak, raising rates even in the face of slowing sectors in the US – such as the housing sector – which appear to be substantial.

Bond markets now responding to central banks

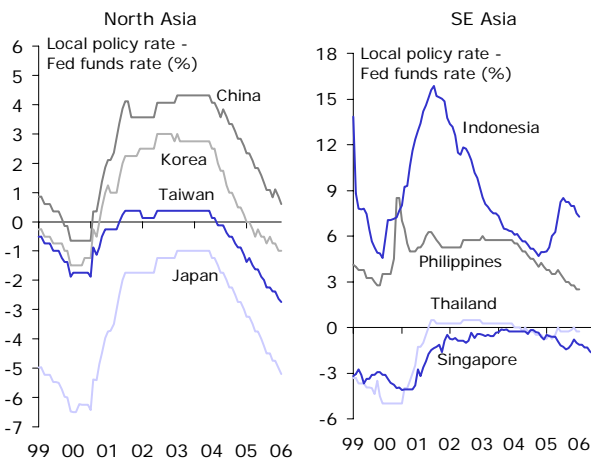


But parts of Asia are behind

Across Asia, an interesting feature of this phase of the business cycle has been the lagged response of central banks in the region toward higher interest rates in the G7, and particularly in the United States. Prior to the 1997 crisis, when the majority of Asian economies managed their currencies in a fixed or semi-pegged exchange rate regime against the US\$, there was little autonomous monetary policy and interest rates generally moved with those of the United States.

However, with the region still generally enjoying low inflation thanks in part to one-off deflationary events such as SARS (Hong Kong, Singapore), home-grown credit busts (Korea, Taiwan) and beneficial base effects of drought-induced food price spikes (China), central banks around Asia have been happy to allow their interest rate differentials with the US rise over the past year. The charts below illustrate how the interest rate premiums offered by Asian economies have turned to discounts since 2005, particularly across North Asia. Across the entire region however, excepting Indonesia, Asian interest differentials are moving downward.

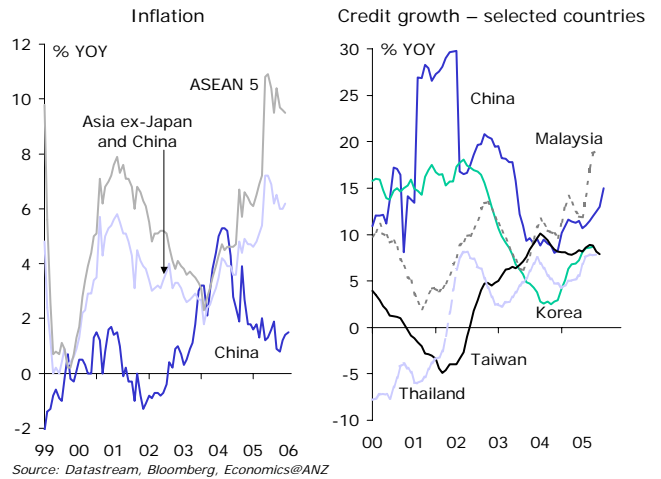
Policy interest rate differentials – Asia v US



Looking at CPI trends of late, it is increasingly difficult to believe that inflation will remain benign in Asia. Consumer price inflation is still contained, but there is no question that it has accelerated. When China is taken out of the picture, CPI across the region has risen from 2.5% YOY in mid-2004 to 6.2% YOY in June. Inflation is markedly higher in SE Asia due to the reduction or elimination of fuel price subsidies late last year in Thailand, Malaysia and Indonesia, as well as the subsequent increase in oil prices. A local drought in Indonesia that has affected the rice crop has exacerbated the situation.

In contrast, inflation is arguably artificially low in China for two reasons. First, fuel and electricity prices are capped, so that higher energy costs are absorbed by oil refiners and electricity producers. Second, food prices comprise a very high weighting in the basket, and have been held down in 2005 due to the base effect following a drought-related surge in 2004.

Inflation and credit growth



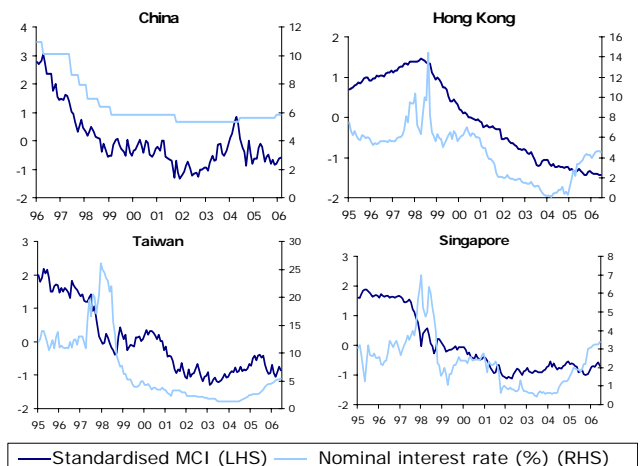
Further evidence of inflation risk comes from credit data, as growth remains strong (chart above). The countries of North Asia that have the greatest lags with rate rises against the US Fed – China, Malaysia, Taiwan and Korea – are experiencing credit growth at an annual rate of 10% or above.

Exchange rates and monetary policy

Traditionally, Asian central banks have relied on a combination of interest rates and exchange rates to manage inflation expectation, reflecting the small, open nature of their economies. As such, interest rates are not a wholly accurate measure of monetary conditions in Asia. To examine conditions taking both interest rates and exchange rates into account, we have constructed a set of Monetary Condition Indices (MCIs) for selected East Asian economies.¹

The MCIs show that there has been little if any tightening of monetary conditions in China, Japan, Hong Kong, Malaysia, Taiwan and Singapore. Charts below plots these countries' MCIs against 90-day money market rates. As might be expected, countries with loose monetary conditions also tend to be exhibiting strong credit growth, shown above.

Monetary conditions index – loose stance



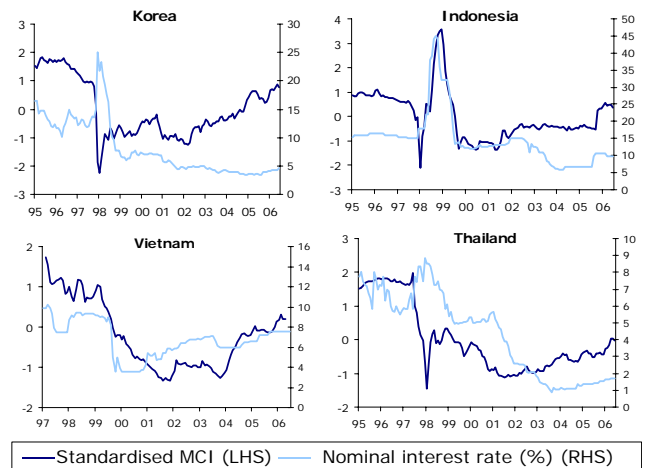
¹ For more on the construction and interpretation of MCIs, see accompanying note, "Monetary Conditions Indices – Asia," 28 July 2006 by Alex Joiner.

The reasons for loose monetary conditions vary:

- **China's** interest rates have been virtually unchanged for two years – the May rate rise has had little effect thus far. The real exchange rate has weakened with the base-effect fall in headline CPI. Higher inflation may help force faster real exchange rate appreciation, but a faster rate of nominal appreciation is likely required to make a real difference to domestic monetary conditions.
- **Taiwan's** central bank has raised interest rates only slowly, and market-based interest rates have lagged central bank action. The real exchange rate began appreciating in March as inflation rose, but is only now back to Jan 2006 levels. There is a risk that interest rates will need a sharper upward adjustment, perhaps accompanied by a faster currency appreciation.
- The slow pace of **Singapore's** currency appreciation means monetary conditions have not tightened significantly, despite slightly higher domestic money market rates. Given the gradualist approach to FX management, further domestic rate rises seem likely.
- The existence of a currency board in **Hong Kong** means that the HKMA has no independent monetary policy, with conditions in HK meant to mirror those of the US. That is clearly not the case now as conditions continue to loosen. The reason is that Hong Kong's lower inflation rate is causing the currency to depreciate on a real exchange rate basis against the US dollar. The real depreciation against the RMB – Hong Kong's major trade partner – is also providing an economic boost. The rise in local nominal interest rates – eg, the prime rate – has lagged HKMA action, contributing to easy conditions.
- Although not pictured, **Japan** and **Malaysia** are both experiencing loose conditions. Japan has just exited its zero interest rate policy, and low rates have been further aided by the recent weakening of the yen on a real exchange rate basis. Continued rate rises plus higher inflation and nominal yen appreciation should all combine to tighten conditions in the coming months. Malaysia is more of a concern, as the central bank transitions from a fixed exchange rate regime. It seems clear that interest rates will have to rise faster in Malaysia in the near term.

In contrast, a second set of countries in Asia have experienced a significant tightening of monetary conditions in recent months. To determine whether conditions have reached a "tight" level, we have compared the current level of the MCI as against the level in late 2000, which is when US interest rates were last at their peak. Countries where the MCI exceeds the level that it reached in 2000 include Korea, Indonesia, Thailand and Vietnam. In India and the Philippines, which are not included in the charts, monetary conditions are currently at about par to where they were in 2000.

Monetary conditions index – tight stance



For these economies, we can see in the charts above how monetary conditions have tightened beyond the increases in nominal interest rates, particularly in **Korea** and **Thailand**. The cause is the relative importance of the exchange rate in determining monetary conditions, combined with significant real currency appreciation in Korea and Thailand over the past 6 to 12 months. While **Indonesia's** currency has also appreciated significantly, this has been accompanied by a significant increase in interest rates, led by aggressive central bank action.

In contrast, while interest rates have risen in **Vietnam**, the fixed exchange rate regime means that inflation expectations remain much more closely tied with the exchange rate. The real exchange rate has appreciated rapidly in Vietnam, despite slight nominal depreciation, as inflation has risen.

In the **Philippines** and **India**, not shown in the charts, monetary conditions have tightened but the MCI for these countries is still slightly below the level it reached in 2000. The tightening has been orderly, and appears likely to remain on track.

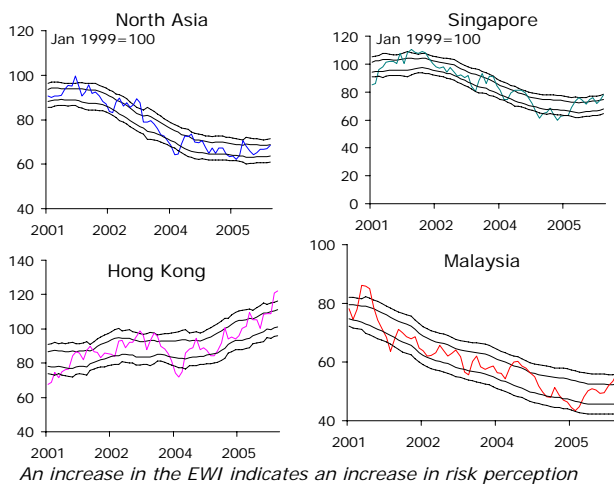
The conclusion we draw from the above exercise is that there are a number of Asian countries where interest rate cycle may be drawing to a close – including most of SE Asia (Malaysia excepted) and Korea. However, there is significant risk of an upward adjustment of interest rates in Northern Asia, particularly in China, Hong Kong and Taiwan. In SE Asia, Singapore and Malaysia seem poised to experience a rate adjustment. For China and Hong Kong, this may be accompanied by real exchange rate appreciation as inflation rises.

Early Warning Index underlines risks

Interestingly, our Early Warning Indicator for June supports the conclusions of our MCI study, with the EWI flashing warning signals for most of the countries that are still exhibiting loose monetary conditions. The major exception is China, where rapid increases in foreign exchange reserves held by the central bank are driving down the M2:Reserves ratio, while the thinness of the traded markets

onshore implies some economic information may be lacking on financial market expectations. The steady risk perceptions in China have left the EWI for North Asia well within its normal range.

EWI – flashing in Singapore, HK and Malaysia

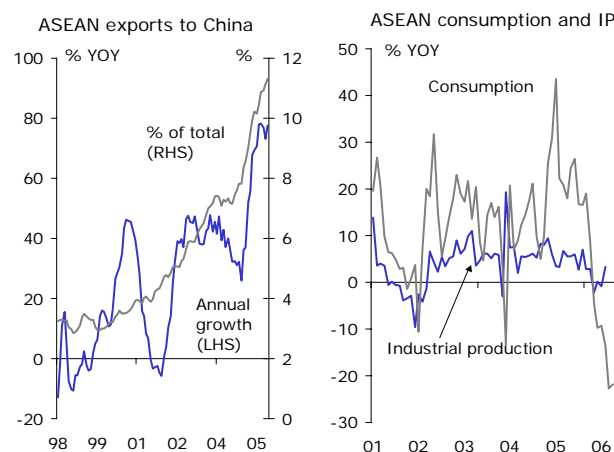


However, the EWI flashed a warning signal for Hong Kong and Malaysia in June – implying a statistically significant increase in risk perceptions. The EWI has nearly broken through its second confidence interval for Singapore. The main cause of the upward moves were rising bond yields and higher M2:reserves ratios as M2 growth outpaced that of reserves. These are the main economic and financial market indicators linked to inflation expectations. We thus find further evidence in the EWI that monetary conditions will need to tighten further in these economies.

Tight conditions slow SE Asia growth

Tighter monetary conditions in SE Asia have led to a weaker growth outlook for SE Asia this year. While external demand remains strong, domestic consumption has declined rapidly in the face of higher interest rates and energy prices. Our index of ASEAN 5 consumption – comprised of retail sales and motor vehicle sales - is contracting at an annual pace of more than 20%.

Consumption slowing rapidly in SE Asia



Source: Datastream, Economics@ANZ

Overall, we expect the ASEAN 5 economies to slow to below a 5% annual rate starting in the third quarter, whereas the region had been growing at above 5% since 2003. Our forecasts do not envisage a return to significantly stronger growth until late 2007 when central banks should be able to ease monetary policy again.

A variety of factors aside from higher interest rates are contributing to the domestic slowdown in the largest SE Asian economies. In Thailand, protracted political uncertainty is reducing investment as well as dampening consumer sentiment. While upcoming October elections may improve the situation, there is concern about the direction of the new government, particularly if it is a coalition government. As a result, we have downgraded our 2006 growth forecasts for Thailand from 4.9% to 4.2% for this year, and have slightly increased our 2007 growth forecast from 4.1% to 4.3%.

In Indonesia, the economy has been impacted by a series of natural disasters, including a devastating earthquake in Yogyakarta and a second, significant tsunami in southern Java. A localised drought has also affected the rice crop, which has pushed up the price of a staple food and prevented consumer price inflation from declining in the wake of last year's fuel price rises. Moreover, these disasters and more tepid consumer confidence have slowed the pace of domestic and foreign investment.

On the positive side, the government has made some progress on its reform agenda, with three new policy packages in recent months. S&P upgraded its long-term foreign currency rating in July, from B- to BB+. Nonetheless, we have downgraded our GDP forecasts for Indonesia, from 4.8% to 4.6% for this year, and from 6.1% to 5.5% for 2007. Our inflation forecast for 2006 (average) has risen from 12.7% to 14.7%, and we forecast average CPI of 8.9% in 2007. As a result, we believe that BI will not be able to cut rates as aggressively as we had envisaged; we now think the BI rate will reach 10.75% at year-end (vs 10.25% previously), with a further 300 bps reductions in 2007 to 7.75%. The need to maintain higher interest rates will prevent the acceleration of growth to the 6% or more that we believe is the potential growth rate for Indonesia.

GDP Forecast Revisions

| | 2006 | | 2007 | |
|-------------|--------|--------|--------|--------|
| | Jan 06 | Jul 06 | Jan 06 | Jul 06 |
| Indonesia | 4.8 | 4.6 | 6.1 | 5.5 |
| Malaysia | 5.0 | 5.4 | 5.0 | 5.0 |
| Philippines | 4.8 | 4.5 | 4.3 | 4.3 |
| Singapore | 5.6 | 7.0 | 4.8 | 5.0 |
| Thailand | 4.9 | 4.2 | 4.1 | 4.3 |
| Vietnam | 7.8 | 7.8 | 7.4 | 7.4 |

Source: Economics@ANZ

Amy Auster

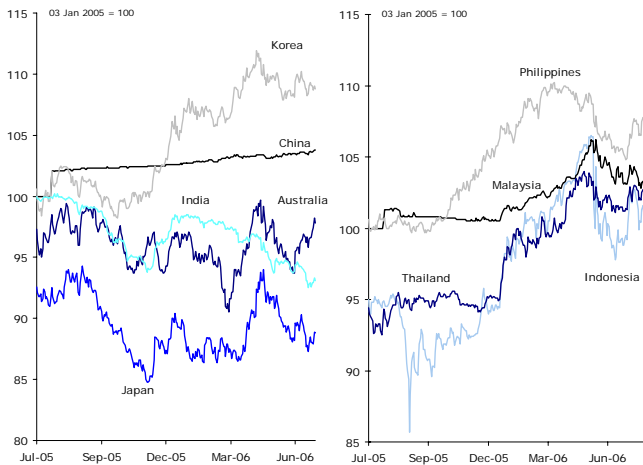
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Financial Markets Update

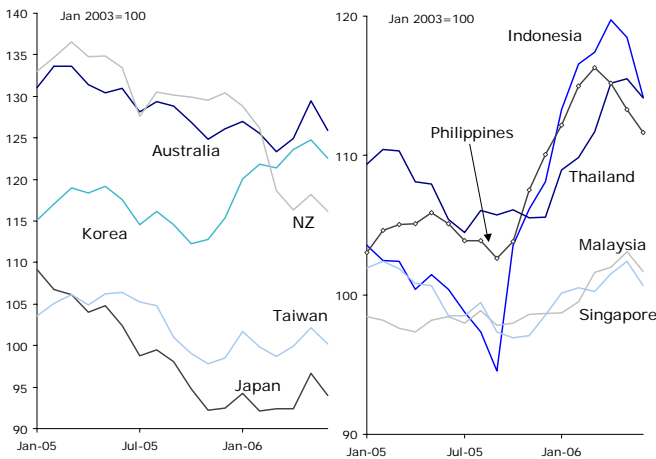
Exchange rates, US\$ per local currency unit, indexed



Exchange rates

- It has been a year since the Chinese yuan and Malaysian ringgit moved to more flexible exchange rate arrangements. However, since the 2.1% revaluation of the RMB in July 2005, the currency has only appreciated by 1.7%. The ringgit has strengthened at a faster pace of 2.3%.
- Exchange rates across East Asia have recovered somewhat from their May sell-off, but have not yet returned to their pre-May highs.
- The slower pace of capital inflows coupled with a large current account deficit has put downward pressure on the Indian Rupee. Since the start of the year, the Rupee has depreciated by around 3.8% against the US dollar.

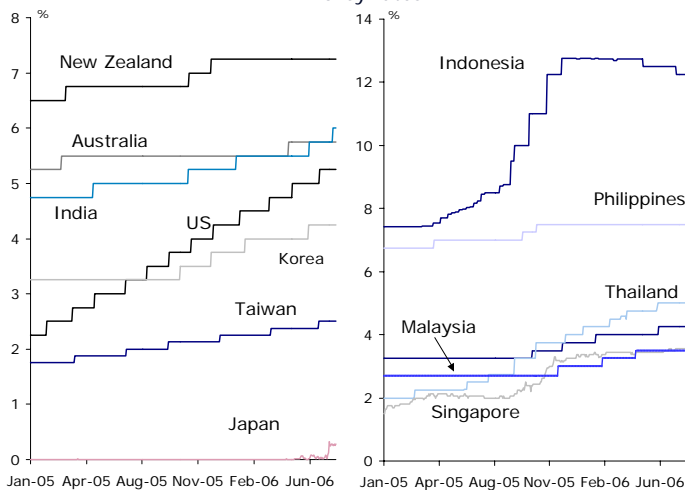
Real exchange rates, US\$ per local currency unit, indexed



Real Exchange rates

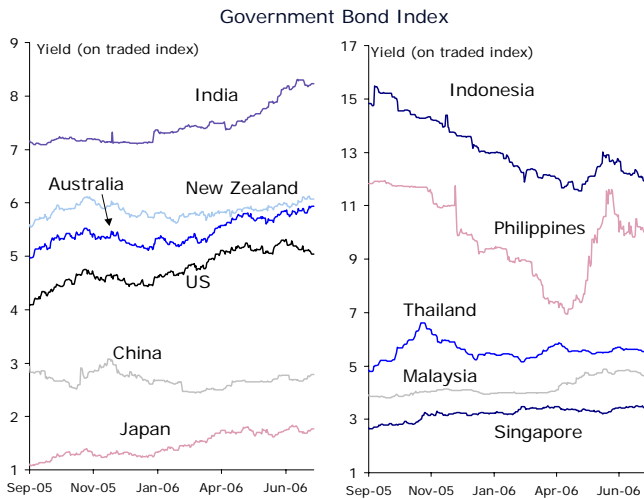
- Real exchange rates in East Asia have become more competitive over the past few months due to rapid nominal currency depreciation.
- Despite higher-than-expected inflation in Australia in the second quarter, the real exchange rate has dipped in July due nominal exchange rate weakness. New Zealand's real exchange rate resumed its decline in June, due to a weaker nominal exchange rate.
- Inflation expectations in Japan have been raised on the back of accelerating June inflation figures. Coupled with our forecast of a stronger yen, this should see the real exchange rate trend upwards in coming months.

Policy rates



Policy rates

- The Bank of Japan raised its benchmark uncollateralized overnight call rate to 0.25% at its 13-14 July meeting, ending its longstanding zero interest rate policy.
- Rising inflation expectations reflecting greater pass-through of fuel costs and solid domestic demand, led the Reserve Bank of India to raise its reverse repo rate on 25 July to a 4-year high of 6%.
- Higher-than-expected headline inflation for Q2 2006 coupled with relatively healthy partial indicators in Australia has all but guaranteed a rate hike in August.
- Indonesia was the only Asian economy to cut rates this month, reflecting some moderation in inflation. Bank Indonesia is expected to continue to unwind its tight monetary stance as price pressures abate, particularly when the impact of the October 2005 fuel subsidy cut wears off.

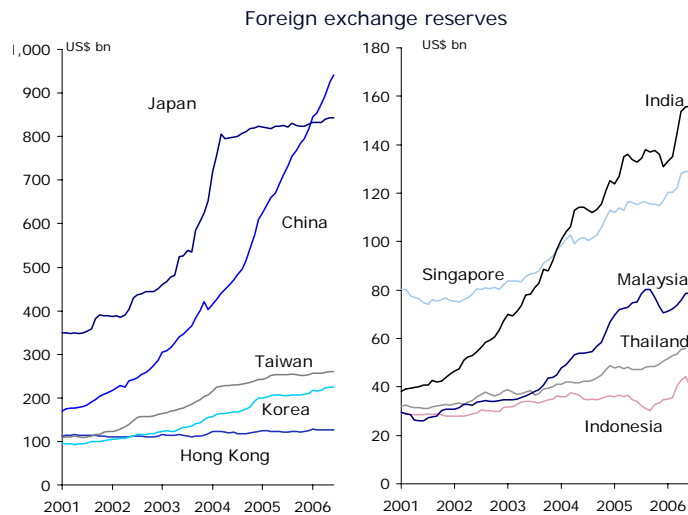


Source: JPMorgan

Philippines' index is the 10-year bond yield as there is no GBI index.

Bond markets

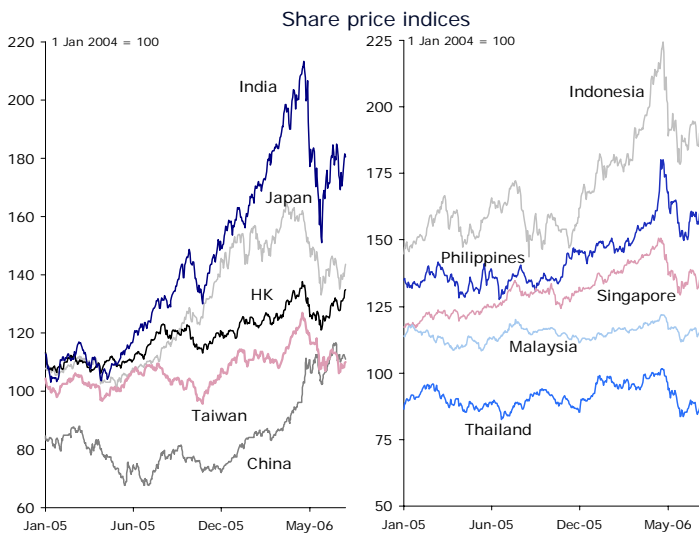
- Australian bond yields continue to rise on the back of increased inflation expectations following the surprisingly strong acceleration of CPI inflation in the June quarter. Conversely, US inflation expectations are moderating which is reflected in a downward trend in bond yields. This gives rise to a divergence of yields between Australia and the US, which is uncharacteristic of the historical relationship of the yield curves.
- Bond yields in India have been rising since the beginning of 2006. This upward trend has accelerated in recent months with inflation expectations rising due to fuel costs and strong domestic demand.
- Yields in Indonesia and the Philippines are beginning to moderate after the rapid increases of May and June.



Source: Bloomberg

International reserves

- Foreign exchange reserves in Taiwan, Korea and Hong Kong have been relatively steady this year while China's continue to accelerate.
- Reserves in Japan have begun to accelerate marginally, increasing by around US\$12bn in the 4 months to June; almost double the accumulation for 2005 as a whole. A resurgence in economic growth and strong trade performance has been largely responsible for the increase.
- Except for Indonesia, reserves in South East Asia and India trended upwards. The decline in Indonesian reserves largely reflects the partial pre-payment of debt owed to the IMF.



Source: Datastream

Equity markets

- Asian equity markets have been clawing back ground lost in the sell-off of May. The majority of Asian markets have only made up around half of the losses since the correction. High oil prices and tensions in the Middle East and North Korea have weighed heavily on regional markets.
- Thailand's financial markets have remained relatively depressed due to the current uncertain political situation that has cast doubt on significant investment projects.
- China's stock market has been one to buck the recent trend, climbing significantly since the beginning of 2006 reflecting strong growth and ample liquidity.

Foreign Exchange and Policy Rate Forecasts

| | Jun-06 | Jul-06 | Sep-06 | Dec-06 | Mar-07 | Jun-07 | Sep-07 |
|-----------------------------|--------|--------|--------|--------|--------|--------|--------|
| China | | | | | | | |
| USD/CNY, eop | 7.99 | 7.97 | 7.91 | 7.79 | 7.73 | 7.67 | 7.61 |
| AUD/CNY, eop | 5.93 | 5.91 | 5.85 | 5.61 | 5.49 | 5.37 | 5.25 |
| One year base lending rate | 5.85 | 5.85 | 6.12 | 6.12 | 6.12 | 6.12 | 5.85 |
| Hong Kong | | | | | | | |
| USD/HKD, eop | 7.77 | 7.78 | 7.78 | 7.78 | 7.77 | 7.76 | 7.75 |
| AUD/HKD, eop | 5.76 | 5.77 | 5.76 | 5.60 | 5.52 | 5.43 | 5.35 |
| HKMA discount rate | 6.50 | 6.75 | 7.00 | 7.00 | 7.00 | 6.50 | 6.00 |
| India | | | | | | | |
| USD/INR, eop | 46.0 | 45.7 | 45.0 | 44.5 | 44.3 | 44.0 | 43.5 |
| AUD/INR, eop | 34.2 | 33.9 | 33.3 | 32.0 | 31.4 | 30.8 | 30.0 |
| Reverse Repo rate | 5.50 | 6.00 | 6.00 | 6.00 | 6.00 | 5.75 | 5.50 |
| Indonesia | | | | | | | |
| USD/IDR, eop | 9,263 | 9,142 | 8,900 | 8,750 | 8,700 | 8,650 | 8,600 |
| AUD/IDR, eop | 6,876 | 6,779 | 6,586 | 6,300 | 6,177 | 6,055 | 5,934 |
| BI rate | 12.50 | 12.25 | 12.00 | 10.75 | 10.25 | 9.00 | 8.00 |
| Korea | | | | | | | |
| USD/KRW, eop | 949 | 952 | 960 | 950 | 960 | 970 | 980 |
| AUD/KRW, eop | 704 | 706 | 710 | 684 | 682 | 679 | 676 |
| Overnight call rate | 4.00 | 4.25 | 4.25 | 4.25 | 4.00 | 4.00 | 3.75 |
| Malaysia | | | | | | | |
| USD/MYR, eop | 3.67 | 3.65 | 3.59 | 3.57 | 3.55 | 3.54 | 3.52 |
| AUD/MYR, eop | 2.73 | 2.70 | 2.66 | 2.57 | 2.52 | 2.47 | 2.43 |
| Overnight policy rate | 3.50 | 3.50 | 3.75 | 3.75 | 3.50 | 3.25 | 3.25 |
| Philippines | | | | | | | |
| USD/PHP, eop | 53.1 | 52.6 | 51.5 | 50.8 | 50.5 | 50.3 | 50.0 |
| AUD/PHP, eop | 39.4 | 39.0 | 38.1 | 36.5 | 35.9 | 35.2 | 34.5 |
| Overnight Reverse Repo rate | 7.50 | 7.50 | 7.75 | 7.75 | 7.50 | 7.25 | 7.25 |
| Singapore | | | | | | | |
| USD/SGD, eop | 1.58 | 1.58 | 1.56 | 1.55 | 1.55 | 1.54 | 1.54 |
| AUD/SGD, eop | 1.17 | 1.17 | 1.15 | 1.12 | 1.10 | 1.08 | 1.06 |
| 3-month interbank rate | 3.44 | 3.55 | 3.60 | 3.60 | 3.60 | 3.50 | 3.40 |
| Taiwan | | | | | | | |
| USD/TWD, eop | 32.4 | 32.1 | 30.5 | 30.0 | 29.8 | 29.5 | 29.3 |
| AUD/TWD, eop | 24.0 | 23.8 | 22.6 | 21.6 | 21.1 | 20.7 | 20.2 |
| Discount rate | 2.38 | 2.50 | 2.63 | 2.50 | 2.50 | 2.40 | 2.40 |
| Thailand | | | | | | | |
| USD/THB, eop | 38.1 | 38.2 | 38.5 | 37.8 | 37.0 | 36.8 | 36.5 |
| AUD/THB, eop | 28.3 | 28.4 | 28.5 | 27.2 | 26.3 | 25.8 | 25.2 |
| 14-day repo rate | 4.75 | 5.00 | 5.00 | 5.00 | 4.75 | 4.50 | 4.25 |
| Vietnam | | | | | | | |
| USD/VND, eop | 15,996 | 16,026 | 16,047 | 16,079 | 16,122 | 16,154 | 16,186 |
| AUD/VND, eop | 11,874 | 11,884 | 11,875 | 11,577 | 11,447 | 11,308 | 11,168 |
| Japan | | | | | | | |
| USD/JPY, eop | 114.4 | 112.9 | 110.0 | 105.0 | 102.0 | 100.0 | 98.0 |
| AUD/JPY, eop | 84.9 | 83.8 | 81.4 | 75.6 | 72.4 | 70.0 | 67.6 |
| Overnight call rate | 0.01 | 0.25 | 0.25 | 0.50 | 0.50 | 0.75 | 1.00 |
| Australia | | | | | | | |
| AUD/USD, eop | 0.74 | 0.74 | 0.74 | 0.72 | 0.71 | 0.70 | 0.69 |
| Cash rate | 5.75 | 5.75 | 6.00 | 6.00 | 6.00 | 6.25 | 6.25 |
| New Zealand | | | | | | | |
| NZD/USD, eop | 0.61 | 0.61 | 0.60 | 0.58 | 0.55 | 0.53 | 0.53 |
| AUD/NZD, eop | 1.22 | 1.22 | 1.23 | 1.24 | 1.29 | 1.32 | 1.30 |
| Overnight call rate | 7.25 | 7.25 | 7.25 | 7.00 | 6.50 | 6.50 | 6.00 |

Macro Economic Forecasts

Real GDP Growth (%)

| | 2004 | 2005 | 2006f | 2007f |
|--------------------|------|------|-------|-------|
| Australia | 3.6 | 2.5 | 2.9 | 3.1 |
| Cambodia | 7.7 | 9.6 | 7.8 | 7.6 |
| China | 10.1 | 9.9 | 10.5 | 9.6 |
| Hong Kong | 8.6 | 7.3 | 4.8 | 3.5 |
| India ⁺ | 7.5 | 8.4 | 7.5 | 7.2 |
| Indonesia | 5.0 | 5.6 | 4.6 | 5.5 |
| Japan | 2.3 | 2.6 | 2.4 | 2.0 |
| Korea | 4.7 | 4.0 | 5.0 | 3.2 |
| Malaysia | 7.1 | 5.3 | 5.4 | 5.0 |
| New Zealand | 4.3 | 2.3 | 1.5 | 1.4 |
| Philippines | 6.0 | 5.1 | 4.5 | 4.3 |
| Singapore | 8.7 | 6.3 | 7.0 | 5.0 |
| Taiwan | 6.1 | 4.1 | 5.1 | 3.0 |
| Thailand | 6.2 | 4.6 | 4.2 | 4.3 |
| Vietnam | 7.7 | 8.4 | 7.8 | 7.4 |

Nominal GDP (US\$ bn)

| | 2004 | 2005 | 2006f | 2007f |
|--------------------|--------|--------|--------|--------|
| Australia | 637.4 | 705.4 | 726.4 | 724.0 |
| Cambodia | 4.9 | 5.2 | 5.4 | 5.6 |
| China | 1931.0 | 2175.6 | 2452.1 | 2813.8 |
| Hong Kong | 165.7 | 173.6 | 185.7 | 196.8 |
| India ⁺ | 670 | 753 | 847 | 952 |
| Indonesia | 257.6 | 300 | 360 | 414 |
| Japan | 4674.7 | 4672.3 | 4765.7 | 4813.4 |
| Korea | 681.5 | 799.7 | 862 | 922 |
| Malaysia | 117.7 | 125 | 136 | 146 |
| New Zealand | 97.9 | 108.6 | 99.0 | 89.9 |
| Philippines | 86.1 | 98 | 110 | 122 |
| Singapore | 106.8 | 114 | 123 | 130 |
| Taiwan | 305.4 | 330.7 | 350.6 | 368.1 |
| Thailand | 161.7 | 177 | 194 | 210 |
| Vietnam | 45.3 | 53.1 | 61.3 | 69.6 |

Inflation (%)

| | 2004 | 2005 | 2006f | 2007f |
|--------------------|------|------|-------|-------|
| Australia | 2.3 | 2.7 | 3.4 | 2.4 |
| Cambodia | 3.8 | 5.8 | 4.9 | 5.1 |
| China | 3.9 | 1.9 | 2.0 | 4.7 |
| Hong Kong | 0.0 | 0.8 | 1.8 | 1.5 |
| India ⁺ | 3.8 | 4.2 | 4.6 | 4.8 |
| Indonesia | 6.1 | 10.4 | 14.7 | 8.9 |
| Japan | 0.0 | -0.2 | 0.2 | 0.9 |
| Korea | 3.6 | 2.8 | 2.7 | 3.6 |
| Malaysia | 1.4 | 2.9 | 4.0 | 3.0 |
| New Zealand | 2.7 | 3.2 | 3.7 | 2.7 |
| Philippines | 5.9 | 7.8 | 7.5 | 6.0 |
| Singapore | 1.7 | 0.5 | 1.5 | 0.9 |
| Taiwan | 1.6 | 2.3 | 3.0 | 2.5 |
| Thailand | 2.8 | 4.6 | 5.1 | 3.7 |
| Vietnam | 7.8 | 8.2 | 6.8 | 6.2 |

Fiscal Balance (% of GDP)*

| | 2004 | 2005 | 2006f | 2007f |
|--------------------|------|------|-------|-------|
| Australia | 1.2 | 1.7 | 1.0 | 1.0 |
| Cambodia | -5.4 | -5.6 | -5.8 | -6.0 |
| China | -2.1 | -1.1 | -2.0 | -1.9 |
| Hong Kong | -0.4 | -0.4 | -0.4 | -0.7 |
| India ⁺ | -4.5 | -4.2 | -3.8 | -3.6 |
| Indonesia | -1.6 | -0.5 | -1.4 | -0.8 |
| Japan | -6.5 | -6.2 | -6.0 | -5.8 |
| Korea | 0.7 | -0.3 | -0.8 | -0.2 |
| Malaysia | -4.3 | -3.3 | -3.0 | -2.3 |
| New Zealand | 5.2 | 4.1 | 5.8 | 3.3 |
| Philippines | -3.9 | -2.8 | -2.1 | -1.5 |
| Singapore | -0.1 | 0.2 | -1.3 | 0.1 |
| Taiwan | -2.5 | -2.5 | -2.2 | -2.4 |
| Thailand | 0.1 | -1.2 | -1.7 | -1.4 |
| Vietnam | -1.7 | -2.1 | -2.0 | -1.9 |

Current Account (% of GDP)

| | 2004 | 2005 | 2006f | 2007f |
|--------------------|-------|-------|-------|-------|
| Australia | -6.3 | -6.0 | -6.3 | -6.8 |
| Cambodia | -10.1 | -10.9 | -10.6 | -10.3 |
| China | 4.0 | 6.7 | 4.4 | 4.0 |
| Hong Kong | 9.5 | 9.3 | 5.6 | 2.1 |
| India ⁺ | -0.1 | -2.1 | -2.5 | -2.5 |
| Indonesia | 1.3 | 0.9 | 1.4 | 0.7 |
| Japan | 3.8 | 3.9 | 4.0 | 3.5 |
| Korea | 4.1 | 2.4 | 1.7 | 1.2 |
| Malaysia | 12.5 | 11.7 | 8.9 | 6.6 |
| New Zealand | -6.7 | -8.9 | -10.2 | -8.3 |
| Philippines | 2.6 | 2.4 | 2.3 | 2.0 |
| Singapore | 26.1 | 28.5 | 24.0 | 22.0 |
| Taiwan | 5.8 | 3.4 | 3.1 | 2.5 |
| Thailand | 4.1 | -2.1 | -1.0 | -0.5 |
| Vietnam | -2.1 | -0.3 | 0.5 | 0.7 |

Foreign Exchange Reserves (US\$ bn)

| | 2004 | 2005 | 2006f | 2007f |
|-------------|-------|------|-------|-------|
| Australia | 33.9 | 43.3 | n.a. | n.a. |
| Cambodia | 0.94 | 0.95 | 0.94 | 0.96 |
| China | 609 | 818 | 925 | 850 |
| Hong Kong | 123 | 123 | 125 | 127 |
| India | 126.5 | 138 | 150 | 155 |
| Indonesia | 34.9 | 33 | 35 | 40 |
| Japan | 833 | 828 | 815 | 800 |
| Korea | 198 | 215 | 230 | 220 |
| Malaysia | 66.6 | 70.5 | 75 | 80 |
| New Zealand | 6.9 | 9.1 | n.a. | n.a. |
| Philippines | 13.1 | 16 | 17.5 | 18.5 |
| Singapore | 112.2 | 117 | 122 | 125 |
| Taiwan | 241 | 253 | 265 | 270 |
| Thailand | 48.7 | 50.7 | 52 | 54 |
| Vietnam | 7.0 | 8.9 | 9.6 | 10.2 |

+ : Fiscal year beginning April; * : Fiscal balance for Australia, New Zealand, Malaysia and Singapore corresponds to fiscal year

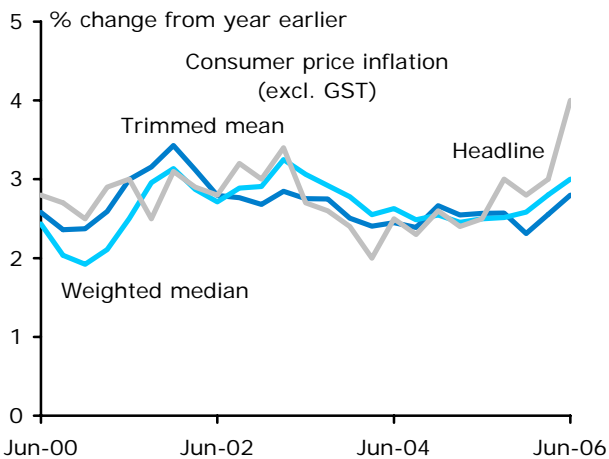
Long Term Foreign Currency Government Bond Ratings

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

At the end of May, Moody's changed its ratings methodology and established new country ceilings that are 1 or 2 notches above the sovereign credit rating for many countries rated A and below. Bloomberg's CSDR page now shows the new country ceilings rather than the old sovereign bond ratings. We are evaluating the change and how we will interpret the new ratings.

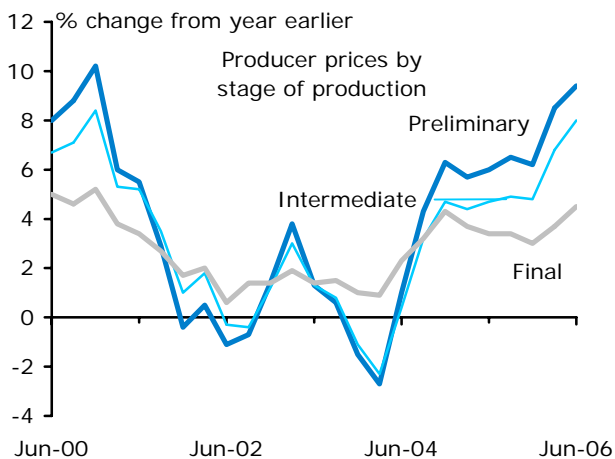
Country Update: Australia

Inflation accelerates



Source: Australian Bureau of Statistics

Upstream price pressures are building



Source: Australian Bureau of Statistics

- Inflation was a whopping 1.6% in the June quarter, lifting the annual rate from 3.0% to 4.0%. Excluding the effect of the GST, this is the highest annual rate since the December quarter 1995, and places inflation well above the RBA's 2-3% target band. Inflation was boosted by a 250% increase in banana prices, reflecting the effect of Cyclone Larry on supply, and an 11.2% rise in petrol prices. Together, these two categories, which account for just 5% of the total CPI, contributed 1ppt to the 1.6% quarterly increase.
- Core inflation also crept up in the quarter. The statistical measures favoured by the RBA – the weighted median and trimmed mean – recorded annual increases of 3.0% and 2.8% respectively, up 0.2ppts from March and ½ of a ppt over the last two quarters.
- Price pressures are building, suggesting the risks to inflation remain skewed to the upside. The labour market continues to test historical frontiers with employment up another 52,000 jobs in June, the participation rate up 0.3ppts to a record 64.8%, and the unemployment rate stable around 30-year lows of 4.9%. Cost pressures are also being generated by high commodity prices. The final commodities producer price index increased by 1.6% in the June quarter and 4.5% over the year. Intermediate and preliminary producer price inflation also increased substantially.
- A 25bp rate rise at the RBA's next meeting in August is now a near certainty, and the risk of a further hike is increasing. This in large part will depend on whether inflation expectations remain anchored through a period when headline inflation is well above 3%. Having raised rates in May and almost certainly again in August, we expect the RBA will pause to assess the effect of its actions. Regardless, with headline inflation now well above the target band, the labour market at historically tight levels, and upstream price pressures accelerating, commentary from the central bank will be decidedly hawkish.

Mark Rodrigues

Economic data – Australia

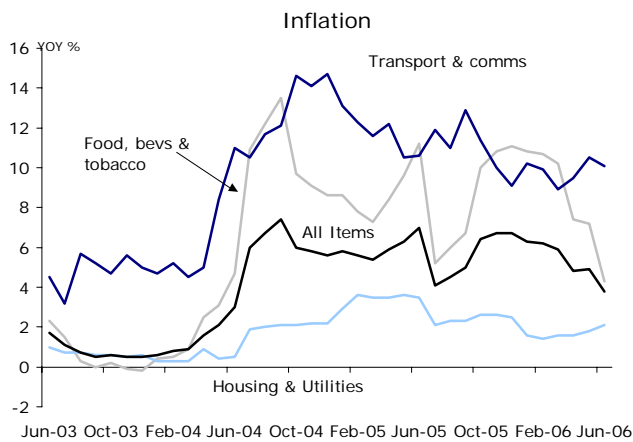
| Monthly data | Nov 05 | Dec 05 | Jan 06 | Feb 06 | Mar 06 | Apr 06 | May 06 | Jun 06 |
|------------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|
| Building Approvals, 000's | 12.7 | 12.3 | 12.1 | 12.2 | 12.7 | 12.3 | 12.7 | n/a |
| Retail Sales, % YOY | 3.1 | 3.9 | 4.6 | 4.6 | 5.0 | 7.3 | 5.2 | n/a |
| Exports, % YOY | 16.0 | 24.6 | 13.4 | 24.3 | 19.4 | 15.4 | 9.2 | n/a |
| Imports, % YOY | 11.7 | 11.1 | 12.7 | 9.8 | 9.5 | 13.8 | 15.5 | n/a |
| Trade Balance, AUD bn | -2.36 | -0.91 | -2.39 | -0.40 | -1.40 | -1.12 | -2.27 | n/a |
| Foreign Exchange Reserves, US\$ bn | 42.9 | 43.3 | 43.7 | 41.4 | 44.3 | 48.5 | 51.3 | 47.4 |
| Quarterly data | Sep 04 | Dec 04 | Mar 05 | Jun 05 | Sep 05 | Dec 05 | Mar 06 | Jun 06 |
| Real GDP, % YOY | 3.3 | 2.0 | 2.0 | 2.7 | 2.6 | 2.9 | 3.1 | n/a |
| - Private consumption | 5.7 | 4.5 | 3.6 | 3.3 | 2.8 | 2.7 | 2.9 | n/a |
| - Government consumption | 4.0 | 3.9 | 3.1 | 3.8 | 1.8 | 2.6 | 1.9 | n/a |
| - Gross fixed capital expenditure | 6.9 | 5.2 | 3.0 | 7.9 | 9.1 | 9.7 | 12.0 | n/a |
| Consumer Price Index, % YOY (nsa) | 2.3 | 2.6 | 2.4 | 2.5 | 3.0 | 2.8 | 3.0 | 4.0 |
| Current Account, AUD bn | -14.1 | -16.0 | -15.3 | -12.1 | -13.5 | -14.3 | -14.0 | n/a |
| Capital Account, AUD bn (nsa) | 15.5 | 15.4 | 14.6 | 10.8 | 15.7 | 13.3 | 13.7 | n/a |

Sources: Australian Bureau of Statistics, RBA

Note: data seasonally adjusted unless otherwise stated

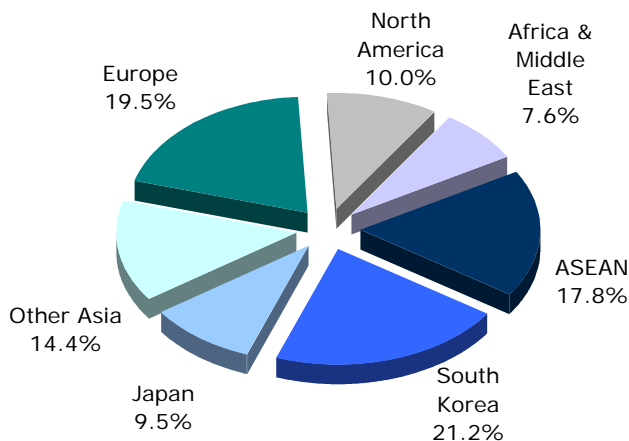
Country Update: Cambodia

Inflation slumps on lower food prices



Source: IMF Direction of Trade Statistics

Cambodia's major tourist-generating markets



Source: Cambodia Ministry of Tourism

- Food prices continue to be the main driver of inflation movements in Cambodia, accounting for around 80% of the basket of goods included in the headline measure. Pre-2004, low food prices had kept headline CPI contained. However, due to a combination of bird flu outbreaks and persistently high oil prices, food prices have remained high for the last 2½ years. Due to seasonal weather factors, especially drought, food prices are also extremely volatile, experiencing over 11%YOY inflation three times since late-2004.
- Much improved weather conditions were responsible for a very strong agricultural performance in 2005. Rice production alone increased by a record 43.6% in the year. These favourable conditions have put continued downward pressure on inflation for 2006 thus far. Food price inflation has fallen from 11.1%YOY in December 2005 to 4.3%YOY in June 2006. This decrease has driven the headline measure down from 6.7%YOY to 3.8%YOY over the same period, the lowest inflation since June 2004. The other key driver of inflation over this period has been in the transport and communications sub-index, kept high by elevated world oil prices. For the remainder of 2006, it is expected that with the normalisation of agricultural production growth, and barring extreme weather conditions, food prices are likely to pick up again towards the end of the year. With oil prices not expected to fall significantly, headline inflation is expected to average around 5% for 2006.
- Tourism continues to be a key driver of growth in Cambodia. During January-April 2006, tourist arrivals were up 18.9% (around 95,000 arrivals) compared with the same period last year. Much of the growth in tourist arrivals is coming from the Asian region, especially from Korea, Malaysia and China. However, tourists from destinations further away have dropped. Arrivals from Europe have fallen by around 10%YOY in the 4 months to April and no increase in numbers from North America has been experienced in 2006 thus far. This is most likely due to higher airfares (due to oil prices), and lingering fears of bird flu discouraging travellers from these regions.

Alex Joiner

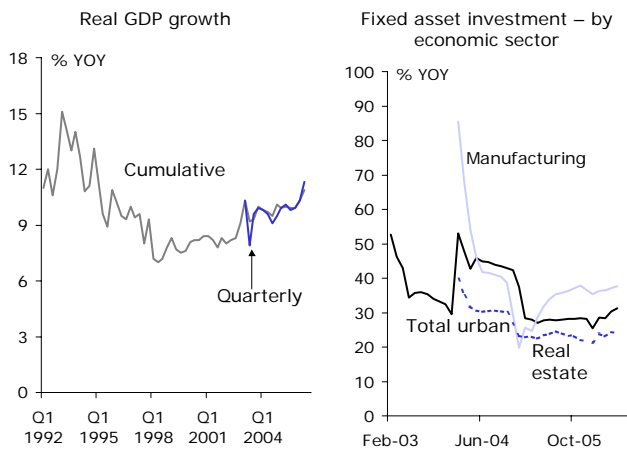
Economic data – Cambodia

| Monthly data | Nov 05 | Dec 05 | Jan 06 | Feb 06 | Mar 06 | Apr 06 | May | Jun 06 |
|------------------------------------|-------------|-------------------------|--------|----------------|---------|----------------|----------|--------|
| Consumer Price Index, % YOY | 6.7 | 6.7 | 6.3 | 6.2 | 5.9 | 4.8 | 4.9 | 3.8 |
| -Transport & Communication | 10.0 | 9.1 | 10.2 | 9.9 | 8.9 | 9.5 | 10.5 | 10.1 |
| -Food & Beverages | 10.8 | 11.1 | 10.8 | 10.7 | 10.2 | 7.4 | 7.2 | 4.3 |
| Exports, % YOY | 13.9 | 23.2 | 31.2 | 23.6 | n/a | n/a | n/a | n/a |
| Imports, % YOY | 11.1 | 21.3 | 24.4 | 32.3 | n/a | n/a | n/a | n/a |
| Trade Balance, US\$ mn | -83.6 | -118. | -42.79 | -68.6 | n/a | n/a | n/a | n/a |
| Foreign Exchange Reserves, US\$ mn | 929.2 | 952.7 | 959.1 | 981.9 | 1,002.7 | n/a | n/a | n/a |
| Tourist Arrivals, % YOY | 26.8 | 34.5 | 17.5 | 21.1 | 14.3 | 23.1 | n/a | n/a |
| GDP Composition | 2004 | Trading Partners | | Exports | | Imports | | |
| Real GDP, % YOY | 7.7 | 2004 % share | | US | 55.9 | | Viet'm | 10.9 |
| - Agriculture, % YOY | -2.0 | | | Germany | 11.7 | | Thail'nd | 22.5 |
| - Industry, % YOY | 16.1 | | | UK | 6.9 | | Sing | 10.8 |
| - Services, % YOY | 9.2 | | | Vietnam | 4.4 | | China | 13.6 |
| Nominal GDP, US\$ bn | 4.89 | | | Japan | 3.5 | | HK | 14.1 |

Sources: Datastream, National Institute of Statistics of Cambodia

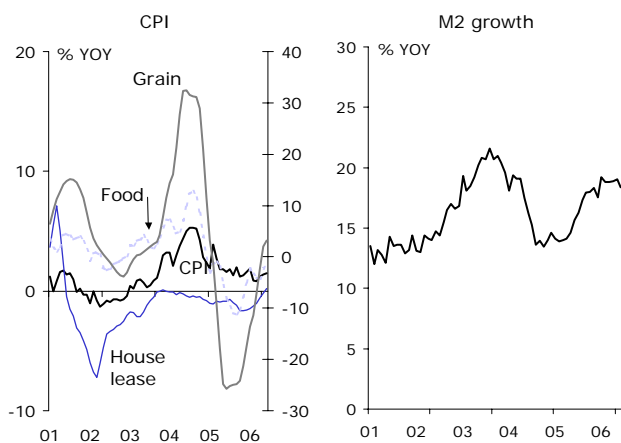
Country Update: China

Growth accelerated sharply in Q2 – no soft landing apparent yet



Sources: Datastream

Inflation forces gathering steam



Sources: Bloomberg, Datastream

- Real GDP rose 11.3% YOY in the second quarter, far exceeding expectations and higher than the growth rate recorded in any quarter since 1994. Growth was led by high domestic investment, as fixed asset investment rose 30% YOY in the quarter, up from 28% in the second quarter. The increase in FAI was led by the manufacturing sector, as the growth rate accelerated to nearly 40% in June. Consumption also appears to have increased, as retail sales rose nearly 14% YOY in the quarter as against 12.8% in the first quarter. Finally, net exports appear to have made a further contribution, with the trade surplus reaching US\$38 bn for the quarter as against US\$23 bn in the first quarter. Exports were up 24% YOY while imports softened to growth of 18% YOY.
- The very high growth rate, supported by rising credit growth and a more rapid expansion of the monetary base, has further fuelled the government's concerns about a potentially overheating economy. While inflation has been relative tame – reaching 1.5% YOY in June – the falling away of the base effect from the drought of 2004 is pushing the annual increase in grain prices ever higher. We expect inflation to accelerate and believe annual inflation is on track to rise above 3% before year-end in the absence of a rapid slowdown in demand.
- The very large trade surplus has once again ratcheted up rhetoric out of the United States on the need for more rapid currency appreciation, accompanied by renewed threats of trade sanctions. We do not believe the Schumer bill to impose trade tariffs on Chinese products will be passed in the near term, not least since Congress is now in recess. However, there is greater speculation as to the possibility of a widening the RMB trading band, in part to help cool the economy.
- Further announcements aimed at cooling sectors the government has decided are overheated should continue. High-end property markets were targeted in July, but any reduction in foreign investment in the real estate market will have marginal affect as the main source of demand is domestic.

Amy Auster

Economic data – China

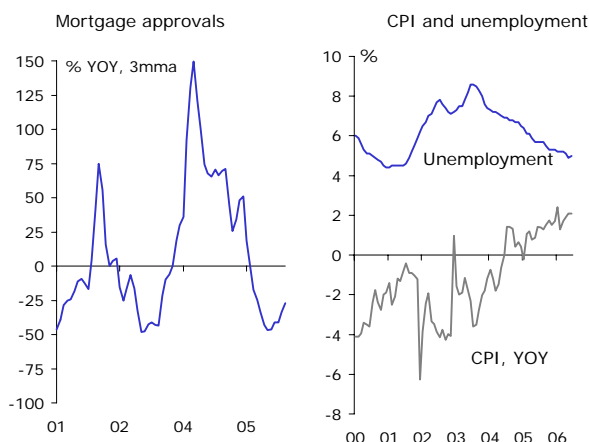
| Monthly data | Nov 05 | Dec 05 | Jan 06 | Feb 06 | Mar 06 | Apr 06 | May 06 | Jun 06 |
|------------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|
| Industrial Production, % YOY | 16.6 | 16.5 | 0.0 | 20.1 | 17.8 | 16.6 | 17.9 | n/a |
| Retail Sales, % YOY | 12.4 | 12.5 | 15.5 | 9.4 | 13.5 | 13.6 | 14.2 | 13.9 |
| Consumer Price Index, % YOY | 1.3 | 1.6 | 1.9 | 0.9 | 0.8 | 1.2 | 1.4 | 1.5 |
| Exports, % YOY | 18.6 | 18.2 | 28.4 | 22.2 | 28.2 | 23.9 | 25.1 | 23.3 |
| Imports, % YOY | 21.0 | 22.2 | 25.3 | 29.4 | 21.1 | 15.3 | 21.7 | 18.9 |
| Trade Balance, US\$ bn | 10.5 | 11.0 | 9.7 | 2.5 | 11.2 | 10.5 | 13.0 | 14.5 |
| Foreign Exchange Reserves, US\$ bn | 794.2 | 818.9 | 845.2 | 853.7 | 875.1 | 895.0 | 925.0 | 941.1 |
| Quarterly data | Sep 04 | Dec 04 | Mar 05 | Jun 05 | Sep 05 | Dec 05 | Mar 06 | Jun 06 |
| Real GDP, % YOY | 9.1 | 9.5 | 9.9 | 10.1 | 9.8 | 9.9 | 10.3 | 11.3 |
| - Primary sector | 5.5 | 6.3 | 4.6 | 5.0 | 5.0 | 5.2 | 4.5 | 5.1 |
| - Secondary sector | 11.1 | 11.1 | 10.9 | 11.0 | 10.9 | 11.4 | 12.5 | 13.2 |
| - Tertiary sector | 8.1 | 10.0 | 9.7 | 9.8 | 10.0 | 9.6 | 8.9 | 9.4 |
| Nominal GDP, US\$ bn | 466.3 | 590.4 | 557.9 | 573.1 | 601.2 | 492.0 | 645.3 | n/a |
| Current Account, US\$ bn | 76.1 | 100.8 | 130.9 | 143.4 | 156.7 | 129.8 | 142.9 | 146.3 |
| FDI (actual), US\$ bn* | 44.2 | 60.6 | 13.4 | 28.6 | 43.3 | 72.4 | 14.3 | 28.4 |

Sources: Datastream, Bloomberg

* - Quarterly sum

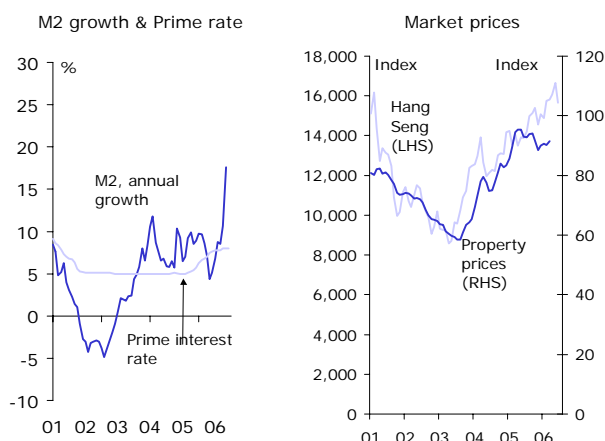
Country Update: Hong Kong

Housing market is turning a corner; labour markets still tight



Source: Datastream, Economics@ANZ

Hang Seng rally contributing to local high liquidity



Source: Datastream, Economics@ANZ

- The residential market appears to be turning a corner, with mortgage approvals on the upturn after a steep slide in 2005. Despite the fall in new housing activity, property market prices have held in well, particularly with commercial real estate as increased business ties with the mainland expand. An uplift in the real estate market combined with continued low unemployment and strong consumption data suggests that our second quarter GDP growth forecast of 5.2% (0.8% QOQ) may be exceeded. Hong Kong continues to benefit from China's incredible growth through the widening of the Closer Economic Partnership Agreement.
- The opening of new direct routes between Hong Kong and many major cities in China should provide a further boost to the tourism market, as well as commercial ties between Hong Kong and the mainland. Hong Kong's exports are not performing particularly well, and were up only about 5% on an annual basis in the second quarter while the trade balance remained well in the red. However, the importance of net exports relative to domestic consumption is likely to decline over time.
- The government appears ready to launch its public consultation on the levying of a goods and services tax (GST) to help modernise the tax structure and broaden the tax base. Only 40% of residents currently pay income tax, which makes the government's budget overly reliant upon government income – primarily derived from government businesses and land taxes – and therefore vulnerable to the business cycle. Having worked to achieve a significant fiscal surplus over the past few years, the government is now in a position to support the transition to a GST-based tax regime.
- July 1 was the ninth anniversary of Hong Kong's return to Chinese rule, and was marked by a democracy march that attracted more than 30,000 participants. Former Chief Secretary Anson Chan made an appearance, sparking speculation that she intends to run for chief executive against Donald Tsang in March 2007.

Amy Auster

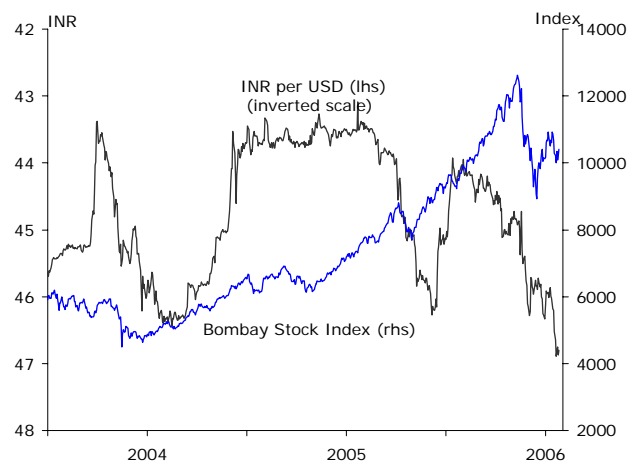
Economic data – Hong Kong

| Monthly data | Nov 05 | Dec 05 | Jan 06 | Feb 06 | Mar 06 | Apr 06 | May 06 | Jun 06 |
|------------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|
| Visitor Arrivals, %YOY | 5.6 | 5.5 | 15.6 | 10.6 | 14.8 | 9.5 | 7.3 | n/a |
| Retail Sales, % YOY | 4.1 | 6.8 | 11.6 | -3.2 | 9.1 | 9.5 | 5.3 | n/a |
| Consumer Price Index, % YOY | 1.2 | 1.4 | 1.8 | 1.3 | 1.7 | 1.9 | 2.1 | 2.1 |
| Exports, % YOY | 11.8 | 7.0 | 4.7 | 21.1 | 15.3 | 10.0 | 0.4 | n/a |
| Imports, % YOY | 13.9 | 11.0 | 1.2 | 28.9 | 16.6 | 11.8 | 3.0 | n/a |
| Trade Balance, US\$ bn | -0.5 | -2.2 | 0.6 | -3.0 | -2.4 | -1.9 | -1.9 | n/a |
| Foreign Exchange Reserves, US\$ bn | 122.4 | 124.3 | 127.8 | 125.7 | 125.9 | 127.0 | 126.5 | 126.6 |
| Quarterly data | Jun 04 | Sep 04 | Dec 04 | Mar 05 | Jun 05 | Sep 05 | Dec 05 | Mar 06 |
| Real GDP, % YOY | 12.3 | 7.0 | 7.5 | 5.5 | 7.3 | 8.4 | 7.8 | 8.0 |
| - Private consumption | 11.2 | 5.7 | 6.0 | 4.1 | 2.4 | 3.6 | 3.4 | 4.5 |
| - Government consumption | 0.0 | -1.3 | -1.7 | -4.6 | -2.3 | -1.6 | -3.8 | 1.3 |
| - Gross fixed capital expenditure | 10.3 | 0.8 | -2.4 | 0.4 | 4.9 | 2.8 | 8.4 | 8.5 |
| Nominal GDP, US\$ bn | 41.5 | 41.1 | 42.1 | 42.6 | 44.3 | 44.9 | 45.8 | 46.2 |
| Current Account, US\$ bn | 0.6 | 6.5 | 7.5 | 4.2 | 4.1 | 5.6 | 6.4 | 4.6 |
| Capital Account, US\$ bn | 0.0 | -0.2 | -0.1 | -0.3 | -0.2 | -0.1 | -0.1 | n/a |

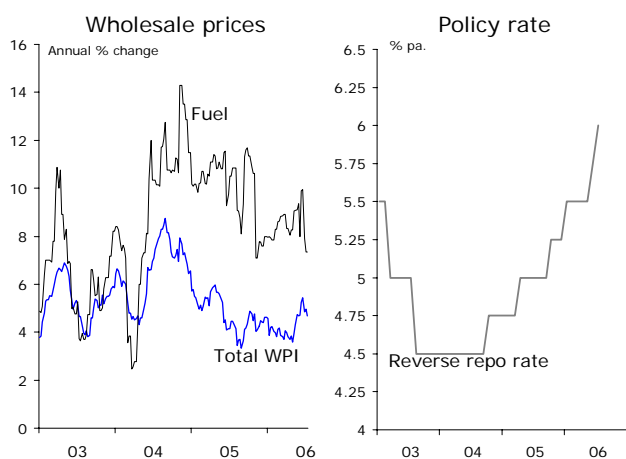
Source: Datastream

Country Update: India

Financial market trends



Inflation expectations rise



- The bomb attacks on Mumbai's rail network on 11 July failed to disrupt business activity. Financial markets were resilient with the Bombay stock index rising by 3% on the day after the event and the Rupee dipped by just 0.2% against the US dollar.
- However, markets have been increasingly volatile since May. Higher oil prices and uncertainty over when the G7 will reach the peak of its rate hikes have slowed purchases of Indian equity. The slower pace of capital inflows coupled with a large current account deficit has also put downward pressure on the Rupee. Since the start of the year, the Rupee has depreciated by around 3.8% against the US dollar and is at levels last reached in mid-2003. The Bombay stock index has dropped by 12% since 15 May but risen by 10.8% since January 2006.
- Rising inflation expectations reflecting greater pass-through of fuel costs and solid domestic demand, led the RBI to raise its reverse repo rate on 25 July to a 4-year high of 6%. The central bank, which has lifted the benchmark rate five times since October 2004, is expected to maintain a tightening bias in the months ahead. Wholesale prices remain high although they have come off a recent peak since the government cut import duties on farm products. The WPI rose by 4.68% in the week ended 8 July, down from 5.44% in mid-June. Money supply and credit growth indicators have also stayed high. The global rate tightening cycle will also underpin a firm domestic monetary policy stance. Bond yields have climbed in response to accelerating inflation expectations.
- The reform momentum has suffered a setback this month as the government decided to hold off on its privatization programme amidst pressure from a coalition partner. The Indian National Congress-led coalition government has three years left in its term, which ends in 2009. It will have an increasingly difficult task in pushing forward with reform as the elections approach.

Jasmine Robinson

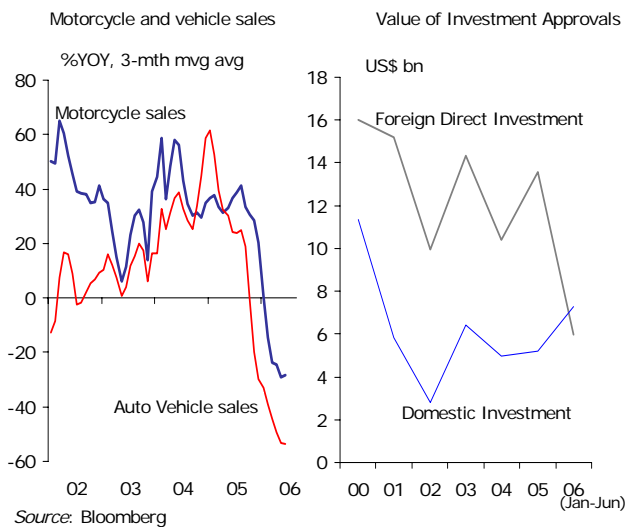
Economic data – India

| Monthly data | Nov 05 | Dec 05 | Jan 06 | Feb 06 | Mar 06 | Apr 06 | May 06 | Jun 06 |
|------------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|
| Industrial Production, %YOY | 6.0 | 5.9 | 9.0 | 8.9 | 8.9 | 9.3 | 9.9 | n/a |
| Passenger car sales, % YOY | 0.0 | 1.3 | 8.5 | 7.7 | 19.1 | 21.0 | 27.7 | 24.3 |
| Consumer Price Index, % YOY | 5.4 | 5.6 | 4.4 | 4.6 | 4.6 | 4.6 | 5.9 | n/a |
| Exports, % YOY | 22.7 | 26.9 | 25.7 | 12.3 | 20.6 | 27.1 | 21.6 | 40.2 |
| Imports, % YOY | 20.5 | 16.0 | 14.1 | 21.4 | 18.7 | 20.5 | 8.0 | 24.0 |
| Trade Balance, US\$ bn | -2.5 | -2.7 | -2.9 | -3.2 | -2.9 | -4.2 | -3.8 | -3.8 |
| Foreign Exchange Reserves, US\$ bn | 137.0 | 131.0 | 134.0 | 136.0 | 145.0 | 154.0 | n/a | n/a |
| Quarterly data | Jun 04 | Sep 04 | Dec 04 | Mar 05 | Jun 05 | Sep 05 | Dec 05 | Mar 06 |
| Real GDP, % YOY (at factor cost) | 7.9 | 6.7 | 7.0 | 8.4 | 8.5 | 8.3 | 7.5 | 9.3 |
| - Agriculture | 6.6 | 8.0 | 8.1 | 6.8 | 9.5 | 6.3 | 7.0 | 7.9 |
| - Industry | 3.5 | -0.2 | -1.2 | 1.0 | 3.4 | 4.0 | 2.9 | 5.5 |
| - Services | 10.1 | 8.4 | 9.4 | 11.4 | 9.6 | 9.7 | 8.2 | 10.8 |
| Nominal GDP, US\$ bn | 144.2 | 142.0 | 171.9 | 175.9 | 168.4 | 168.3 | 191.1 | 196.4 |
| Current Account, US\$ bn | 3.4 | -3.5 | -5.5 | 0.2 | -3.6 | -5.0 | -3.8 | 1.8 |
| Capital Account, US\$ bn | 4.5 | 3.1 | 11.7 | 12.4 | 4.4 | 10.0 | -0.6 | 10.9 |

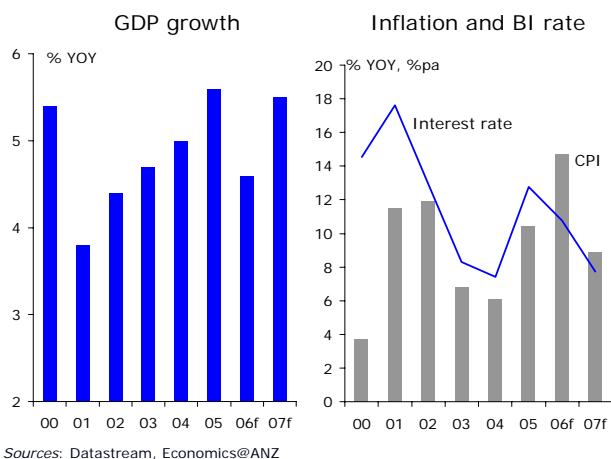
Source: Datastream, Bloomberg

Country Update: Indonesia

Domestic demand remains weak



Revisions to GDP growth and inflation forecasts



- Although the economic impact of the tsunami, which hit southern Java this month is expected to be limited, the series of natural disasters over the past 18 months has raised pressure on the government to improve communications infrastructure, education systems and step-up reconstruction measures.
- High fuel prices, inflation and interest rates are affecting consumer sentiment, which continues to slide. Retail sales, as measured by motorcycle and car sales, remain weak. Optimism over the fast-tracking of investment reform, which began well at the start of 2006, is starting to fade.
- Inflation has eased but at a much slower pace than we had initially anticipated. It was 15.5% YOY in June and the average for the first half of this year was 16.2% YOY. Apart from the impact of the fuel subsidy cut in October 2005, drought-induced hikes in food prices have kept inflation elevated. This has prompted us to raise our projection for average inflation in 2006 to 14.7% from 12.7% earlier. Consequently, our forecast for a more aggressive cut in interest rates has been pared back. We now expect the BI rate to end the year at 10.75% from 10.25% previously.
- Expectations of a stronger growth track in 2007 have been held back against a higher-than-expected inflation and interest rate environment and slower pace of reform. The spike in oil prices is likely to add to fiscal pressures along with the increased burden of power subsidies. Indonesia imports about a third of its fuel demand and fuel subsidies have not been fully unwound. The electricity subsidy bill for 2006 is likely to be around Rp31 tr compared with some Rp17 tr initially estimated. Overall, a much more moderate upturn in real GDP growth of 5.5% is now forecast for 2007 from 4.6% in 2006.
- S&P's lifted its long-term foreign currency rating for Indonesia to BB- from B+, reflecting improvements in the government's debt profile and commitment to manage its fiscal position.

Jasmine Robinson

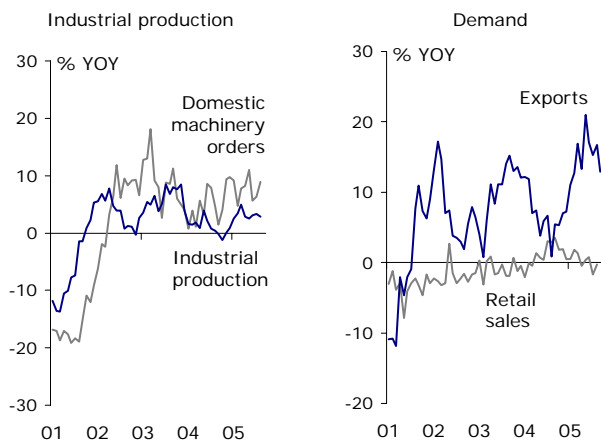
Economic data – Indonesia

| Monthly data | Nov 05 | Dec 05 | Jan 06 | Feb 06 | Mar 06 | Apr 06 | May 06 | Jun 06 |
|--------------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|
| Industrial Production, %YOY | 0.2 | -7.6 | -6.5 | -2.6 | -1.2 | 4.1 | -1.6 | n/a |
| Motor cycle sales, % YOY | 35.4 | -3.0 | -31.1 | -9.0 | -31.0 | -33.5 | -23.1 | -28.0 |
| Consumer Price Index, % YOY | 18.4 | 17.1 | 17.0 | 17.9 | 15.7 | 15.4 | 15.6 | 15.5 |
| Exports, % YOY | 11.5 | 22.1 | 22.5 | 15.2 | 1.1 | 11.9 | 16.1 | n/a |
| Imports, % YOY | 3.7 | -3.7 | 3.6 | 5.3 | -12.9 | -5.4 | 1.9 | n/a |
| Trade Balance, US\$ bn | 2.8 | 3.3 | 3.3 | 2.8 | 3.1 | 2.9 | 3.3 | n/a |
| Foreign Exchange Reserves, US\$ bn | 31.6 | 33.0 | 33.2 | 33.7 | 38.2 | 40.7 | 42.1 | n/a |
| Quarterly data | Jun 04 | Sep 04 | Dec 04 | Mar 05 | Jun 05 | Sep 05 | Dec 05 | Mar 06 |
| Real GDP, % YOY | 4.4 | 4.7 | 7.0 | 6.3 | 5.6 | 5.8 | 4.8 | 4.6 |
| - Private consumption | 5.3 | 5.1 | 3.9 | 3.4 | 3.8 | 4.4 | 4.2 | 3.2 |
| - Government consumption | 7.1 | -1.6 | -0.9 | -8.1 | -6.3 | 14.4 | 33.2 | 13.8 |
| - Gross fixed capital expenditure | 14.3 | 17.0 | 16.2 | 14.3 | 15.0 | 9.4 | 1.8 | 2.5 |
| Nominal GDP, US\$ bn | 62.1 | 63.3 | 66.1 | 67.8 | 69.1 | 69.5 | 74.8 | 82.8 |
| Current Account, US\$ bn | 2.2 | 2.8 | 0.3 | 1.0 | 0.9 | -0.1 | 1.3 | n/a |
| Capital & Financial Account, US\$ bn | -0.7 | 0.9 | 1.1 | 0.1 | -0.2 | 1.7 | 4.7 | n/a |

Sources: Bloomberg, Datastream, Bank Indonesia

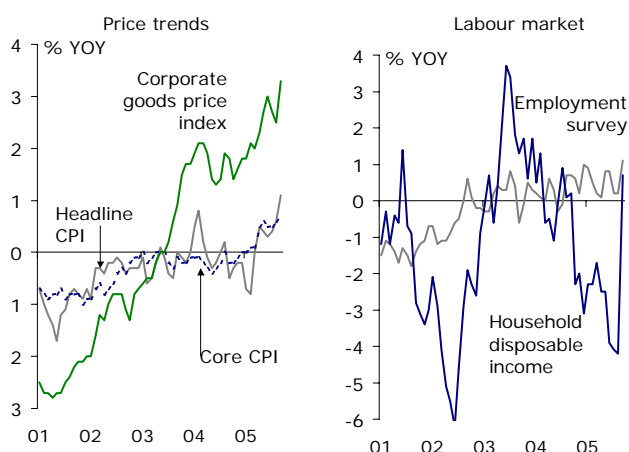
Country Update: Japan

Domestic and external demand still strong



Source: Datastream, Economics@ANZ

Household indicators catching up



Source: Datastream, Economics@ANZ

- The Bank of Japan raised its benchmark uncollateralized overnight call rate to 0.25% at its 13-14 July meeting, ending its longstanding zero interest rate policy. However, the BOJ only raised its discount rate (equivalent to the Lombard rate) to 0.4%, which was slightly below market expectations and consistent with our view that BOJ remains very cautious in removing policy stimulus from the economy. Our expectation remains that the next interest rate hike will not occur until November.
- Second quarter GDP results due out in the first half of August should confirm the BOJ's assessment that the economy's expansion is continuing. Data for the quarter showed producers' shipments continued to grow at an above-4% annual pace, while the rate of inventory accumulation declined and manufacturing production capacity expanded only slightly. Machinery orders were up more than 10% annually in the first two months of the second quarter. Our forecast is for real GDP to have risen 0.7% QOQ and 2.9% at an annualised rate in the second quarter.
- Inflation indicators are also ticking upward slowly, with headline CPI for Tokyo rising 0.5% YOY in June. The domestic corporate goods price index (CGP-I) was up 3.3% on an annual basis in both May and June. We expect high oil prices to continue to lift headline inflation in the coming months, while core inflation should continue to rise albeit at a slower pace.
- Domestically, the coming month will be focused on the September retirement of PM Koizumi. While the odds-on favourite to succeed Koizumi as head of the LDP is still Cabinet Chief Shinzo Abe, other front-runners will be grabbing headlines in August; other top LDP officials will be positioning for cabinet positions in the new government. Most important will be statements on how the new government plans to rein in the fiscal deficit, with persistent risks that the introduction of new taxes will hamper the ongoing recovery in domestic consumption.

Amy Auster

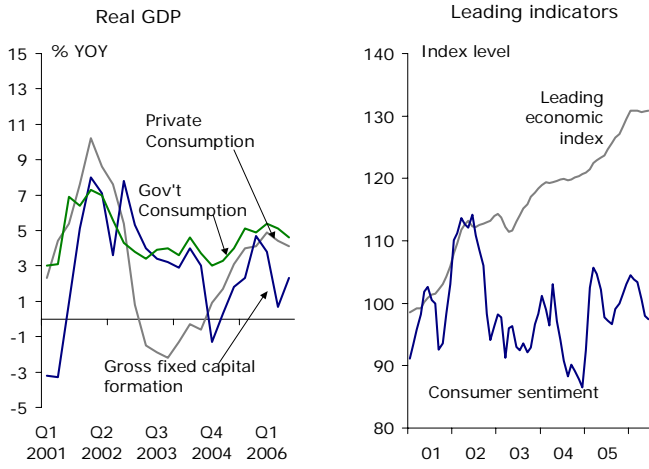
Economic data – Japan

| Monthly data | Nov 05 | Dec 05 | Jan 06 | Feb 06 | Mar 06 | Apr 06 | May 06 | Jun 06 |
|------------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|
| Industrial Production, %YOY | 3.4 | 4.9 | 2.8 | 2.5 | 3.1 | 3.3 | 2.8 | n/a |
| Retail Sales, % YOY | 0.6 | 1.3 | -0.4 | 1.1 | 1.1 | -0.8 | 0.1 | 0.4 |
| Consumer Price Index, % YOY | -0.8 | -0.1 | 0.5 | 0.4 | 0.3 | 0.4 | 0.6 | 1.0 |
| Exports, % YOY | 1.4 | 2.9 | 1.4 | 7.5 | 5.9 | 2.0 | 13.5 | 8.5 |
| Imports, % YOY | 3.1 | 11.6 | 13.4 | 16.0 | 12.5 | 10.2 | 12.6 | 12.1 |
| Trade Balance, US\$ bn | 5.0 | 7.7 | -3.1 | 8.0 | 8.2 | 5.6 | 3.4 | 7.0 |
| Foreign Exchange Reserves, US\$ bn | 824.3 | 828.8 | 832.9 | 831.6 | 832.7 | 839.2 | 842.8 | 844.0 |
| Quarterly data | Jun 04 | Sep 04 | Dec 04 | Mar 05 | Jun 05 | Sep 05 | Dec 05 | Mar 06 |
| Real GDP, % YOY | 2.6 | 2.3 | 0.5 | 1.1 | 2.7 | 2.7 | 4.0 | 3.5 |
| - Private consumption | 2.5 | 2.4 | 0.6 | 1.1 | 1.8 | 2.0 | 3.3 | 2.4 |
| - Government consumption | 2.2 | 1.6 | 1.4 | 1.9 | 1.4 | 2.1 | 1.6 | 0.8 |
| - Gross fixed capital formation | 0.9 | 1.5 | -1.1 | 1.0 | 3.4 | 5.1 | 3.9 | 4.8 |
| Nominal GDP, US\$ bn | 4523.8 | 4513.5 | 4676.7 | 4770.5 | 4819.6 | 4766.3 | 4752.4 | 4710.5 |
| Current Account, US\$ bn | 171.4 | 170.2 | 170.9 | 167.9 | 165.5 | 167.4 | 200.4 | 181.2 |
| Capital Account, US\$ bn | -1.1 | -2.5 | -7.0 | -4.7 | -2.7 | -1.4 | -11.9 | -10.7 |

Source: Datastream

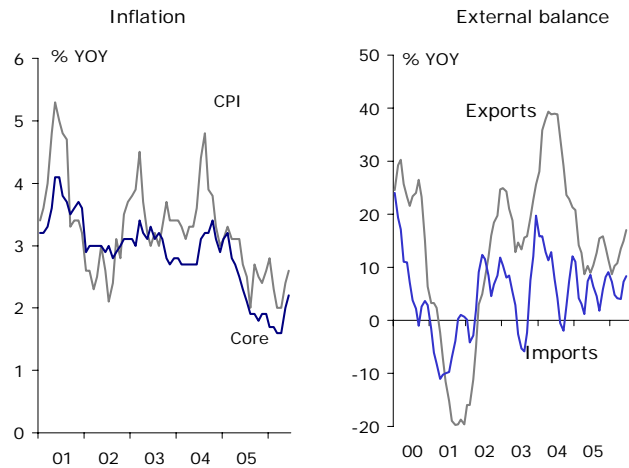
Country Update: Korea

Economic growth clearly moderating



Source: Datastream, Economics@ANZ

BOK should be able to remain on hold



Source: Datastream, Economics@ANZ

- Real GDP rose 5.3% on an annual basis in the second quarter, slightly below market expectations but in line with our forecasts. Private consumption was healthy with 0.9% quarterly growth, despite higher interest rates in the quarter. Gross fixed capital formation declined by 1.2% on a quarterly basis – whereas we had expected a small increase – but government consumption made up the difference with 1.6% growth over the quarter. Net exports made a small positive contribution to growth in the second quarter as the trade surplus rose to US\$5.2bn, after presenting a small drag in the first quarter.
- We expect growth to continue to moderate in the second half of this year, with the economy on track to reach the 5% growth this year that the government has targeted. The leading composite indicator has been tracking sideways for six months, and consumer expectations fell again in June after falling below 100 in May for the first time since late 2005. External demand was strong in the second quarter, and should continue to support the economy even as domestic demand weakens.
- Capacity utilisation rose just slightly to 81.9 in June from 80.6 in May, but unemployment rose from 3.2% to 3.4% over that period as more people re-entered the work force. The index for manufacturing production capacity has held static, but the July results for the manufacturers' survey showed decidedly weaker sentiment.
- Headline inflation declined 0.2% MOM in June, allowing the annual rate to remain contained at 2.6% YOY. Core inflation rose 0.2% MOM, which is broadly consistent with trends over the past several months, bringing the annual rate to 2.2%. When the Bank of Korea raised rates in June, it indicated its intention to continue normalising monetary policy. Our own index of monetary conditions in Korea shows significant tightening, thanks also to a stronger won. Taking this into account, weakening economic activity and contained inflation pressures may allow BOK to remain on hold for the next few months.

Amy Auster

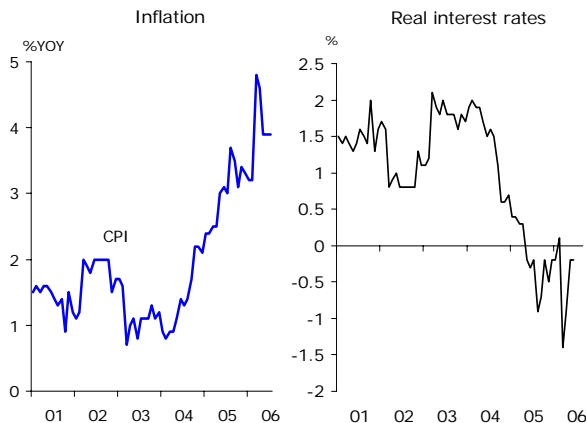
Economic data – Korea

| Monthly data | Nov 05 | Dec 05 | Jan 06 | Feb 06 | Mar 06 | Apr 06 | May 06 | Jun 06 |
|------------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|
| Industrial Production, %YOY | 11.8 | 11.3 | 6.9 | 20.6 | 10 | 9.9 | 12.1 | 10.9 |
| Retail Sales, % YOY | 6.7 | 10.7 | 12.3 | -2.8 | 3.8 | 5.1 | 5.7 | 6.2 |
| Consumer Price Index, % YOY | 2.4 | 2.6 | 2.8 | 2.3 | 2 | 2 | 2.4 | 2.6 |
| Exports, % YOY | 11.9 | 10.5 | 3.6 | 16.6 | 12.1 | 11.7 | 20.8 | 18.6 |
| Imports, % YOY | 17.4 | 15.4 | 18.1 | 27.3 | 13.1 | 14.4 | 23.1 | 21.9 |
| Trade Balance, US\$ bn | 2.0 | 1.4 | 0.3 | 0.4 | 1.1 | 1.2 | 1.9 | 2.2 |
| Foreign Exchange Reserves, US\$ bn | 207.6 | 210.0 | 216.5 | 215.5 | 216.9 | 222.5 | 224.3 | 224.0 |
| Quarterly data | Sep 04 | Dec 04 | Mar 05 | Jun 05 | Sep 05 | Dec 05 | Mar 06 | Jun 06 |
| Real GDP, % YOY | 4.9 | 2.9 | 2.6 | 3.3 | 4.5 | 5.3 | 6.0 | 5.4 |
| - Private consumption | -0.6 | 0.9 | 1.7 | 3.1 | 4.0 | 4.1 | 4.9 | n/a |
| - Government consumption | 3.7 | 2.8 | 3.2 | 4.2 | 5.1 | 4.8 | 5.3 | 5.2 |
| - Gross fixed capital expenditure | 2.9 | -1.1 | 0.4 | 2.0 | 1.9 | 4.2 | 3.9 | 0.7 |
| Nominal GDP, US\$ bn | 170.1 | 181.1 | 192.4 | 197.6 | 197.7 | 199.6 | 211.7 | n/a |
| Current Account, US\$ bn | 7.6 | 7.3 | 5.9 | 2.6 | 2.6 | 5.4 | -1.1 | 0.9 |
| Capital Account, US\$ bn | -0.4 | -0.5 | -0.5 | -0.7 | -0.6 | -0.5 | -0.7 | -0.8 |

Source: Datastream

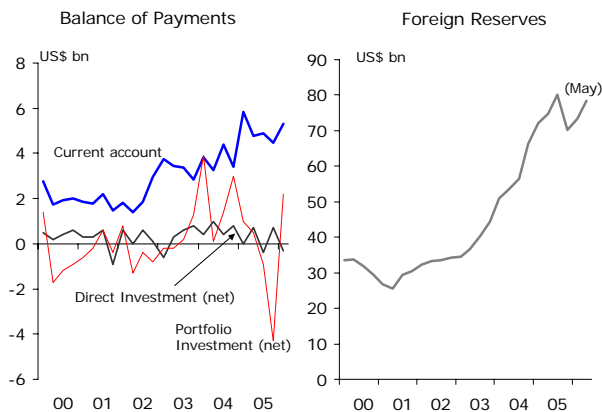
Country Update: Malaysia

Inflation pressures expected to persist



Sources: Bloomberg, Datastream

External balances remain healthy



Source: Datastream

- The central bank left its key policy rate unchanged at 3.5% this month as inflation stayed weaker in June. CPI rose by 3.9% YOY in June, the same rate as in May, after staying above 4.5% YOY in March and April. We, however, expect another 25 bps rate hike before the end of the year reflecting persistent price pressures underpinned by relatively healthy domestic demand and high oil prices. The risk of a further rate hike has also increased in the climate of global monetary tightening.
- It has been a year since the Ringgit's fixed exchange rate regime of USD/MYR3.80, which was adopted in 1998, was replaced with a managed float system. The movement of the Ringgit against the US dollar since July 2005 has been less than 3%. This, however, represents a faster pace of appreciation than the Chinese Yuan.
- The current account recorded a healthy surplus in Q1 2006 of US\$5.3 bn (MYR19.8 bn). This was 18% higher than the previous quarter but 8.7% lower than in Q1 2005. On the capital account, portfolio investment recorded a net inflow of US\$2.2 bn after a large outflow in Q4 2005 but direct investment stayed weak with a net outflow of US\$0.3 bn in the first quarter. Overall, the balance of payments remains in surplus with a steady accumulation of reserves thus far this year. Foreign reserves stood at US\$78.4bn as at May 2006, up 11.7% from December last year.
- On the political front, strained ties between Prime Minister Abdullah Badawi and former PM Mahathir Mohammad have threatened to divide the ruling UMNO party and is likely to adversely affect the effectiveness of the current government in policy implementation.

Jasmine Robinson

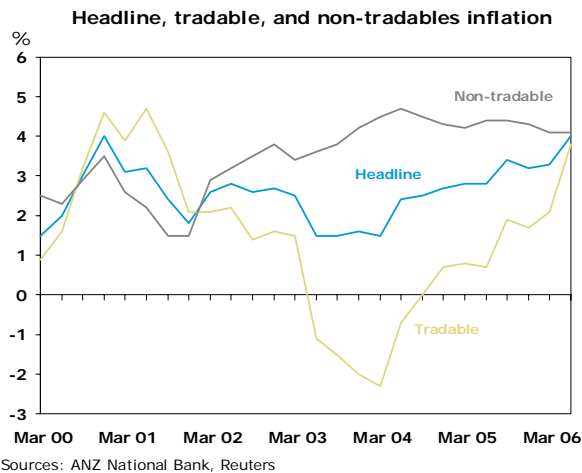
Economic data – Malaysia

| Monthly data | Nov 05 | Dec 05 | Jan 06 | Feb 06 | Mar 06 | Apr 06 | May 06 | Jun 06 |
|--------------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|
| Industrial Production, %YOY | 8.5 | 2.2 | 4.7 | 7.9 | 4.8 | 4.7 | 5.5 | n/a |
| Motor Vehicle sales, % YOY | 7.7 | 4.9 | 2.9 | -1.9 | -8.4 | -5.4 | -0.5 | -14.3 |
| Consumer Price Index, % YOY | 3.3 | 3.2 | 3.2 | 3.2 | 4.8 | 4.6 | 3.9 | 3.9 |
| Exports, % YOY | 12.5 | 13.8 | 11.6 | 17.1 | 12.6 | 10.3 | 19.0 | n/a |
| Imports, % YOY | 6.6 | 8.7 | 10.3 | 20.1 | 17.2 | 15.6 | 17.5 | n/a |
| Trade Balance, US\$ bn | 2.3 | 2.5 | 2.3 | 2.0 | 2.6 | 2.0 | 2.2 | n/a |
| Foreign Exchange Reserves, US\$ bn | 72.6 | 70.2 | 71.3 | 72.7 | 73.2 | 75.9 | 80.1 | 78.9 |
| Quarterly data | Jun 04 | Sep 04 | Dec 04 | Mar 05 | Jun 05 | Sep 05 | Dec 05 | Mar 06 |
| Real GDP, % YOY | 8.4 | 6.8 | 5.9 | 5.9 | 4.1 | 5.4 | 5.2 | 5.2 |
| - Private consumption | 11.9 | 11.2 | 10.2 | 10.1 | 7.4 | 10.4 | 9.0 | 7.5 |
| - Government consumption | 9.5 | 1.3 | 4.4 | 1.0 | 0.6 | 4.7 | 12.6 | 0.1 |
| - Gross fixed capital expenditure | 3.5 | 3.2 | 2.3 | 2.0 | 6.7 | 9.6 | 0.4 | 11.4 |
| Nominal GDP, US\$ bn | 29.4 | 30.1 | 30.7 | 31.2 | 32.0 | 33.6 | 34.0 | 35.2 |
| Current Account, US\$ bn | 3.3 | 4.4 | 3.4 | 5.8 | 4.8 | 4.9 | 4.5 | 5.3 |
| Capital & Financial Account, US\$ bn | 0.2 | -0.9 | 2.9 | 0.9 | 0.1 | 1.5 | -12.4 | -1.4 |

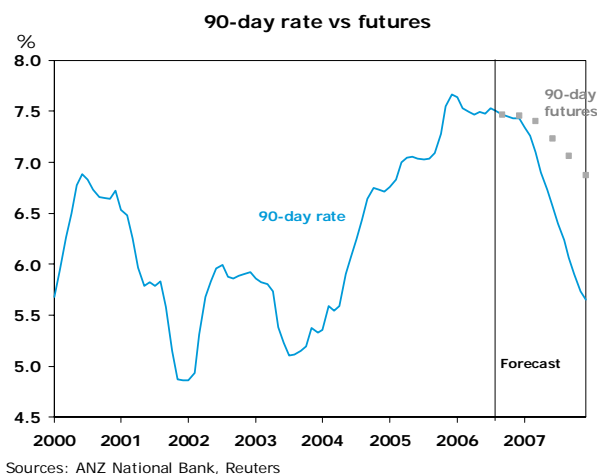
Sources: Datastream, Bloomberg

Country Update: New Zealand

Inflation



Interest rate expectations



- Despite economic activity rebounding in the first quarter of 2006, the prognosis remains one of sombre growth. Indeed, we expect the tenor of economic data to turn weak through August, starting with labour market data due early in the month, and carrying through to some weak retail and housing activity data relating to Q4. Financial conditions remain tight. The “spending” and domestic oriented sectors of the economy are coming under increasing stress as higher petrol prices and rising interest rates on fixed rate mortgage loans progressively place a squeeze on incomes.
- Yet, despite the subdued outlook, inflation continues to be the dominant concern. Headline inflation hit 4% in the June quarter, with a disconcerting acceleration within the housing group. Near term inflation remains sticky, and higher petrol prices along with a persistent inflation theme will underpin a chunky September quarter inflation result, ensuring that inflation remains elevated for some time. We do not expect to see the annual inflation rate back below 3% until late 2007.
- This near term inflation outlook, and its possible effect on inflation expectations, continues to give the Reserve Bank discomfort. The Bank signaled at their July OCR Review that, while they did not intend to raise interest rates further, they did not expect to be easing policy “for some time”. This suggests that they plan to leave the OCR at current levels for longer.
- Nevertheless, the Reserve Bank will take some comfort from the increased traction that it is getting through higher fixed lending rates. Furthermore, weakness in the domestic economy will ultimately give the Reserve Bank comfort that inflationary pressures will subside, and enable them to make a pre-emptive move (lowering the OCR) as early as March 2007 – prior to the inflation rate receding.
- The NZ dollar is expected to remain under pressure, but with the bottom of recent ranges to provide a floor until the market firms up its expectations for lower interest rates in New Zealand.

Sean Comber

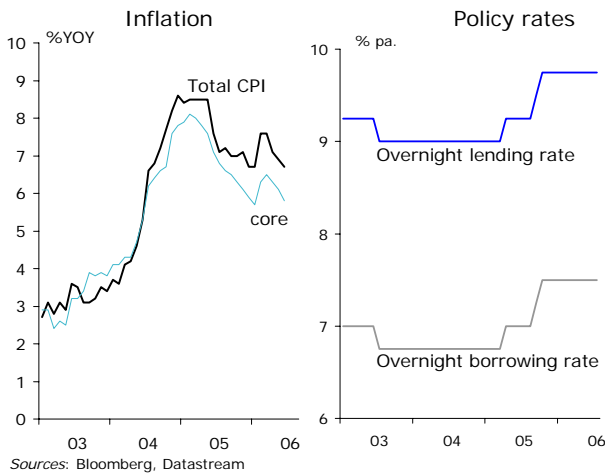
Economic data – New Zealand

| Monthly data | Nov 05 | Dec 05 | Jan 06 | Feb 06 | Mar 06 | Apr 06 | May 06 | Jun 06 |
|-----------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|
| Retail Sales, % YOY | 6.7 | 6.4 | 6.4 | 6.3 | 6.1 | 5.7 | 5.7 | n/a |
| Residential building consents (%) | -17.8 | -17.2 | -15.1 | -13.6 | -16.0 | -13.6 | -10.7 | -7.3 |
| Exports, % YOY | 0.8 | 0.3 | -0.5 | -1.2 | 0.0 | 0.4 | 4.1 | 6.0 |
| Imports, % YOY | 7.9 | 6.8 | 8.5 | 8.1 | 7.7 | 7.6 | 8.7 | 9.2 |
| Annual Trade Balance, US\$ bn | -4.7 | -4.6 | -5.0 | -5.1 | -4.9 | -4.7 | -4.7 | -4.4 |
| Quarterly data | Sep 04 | Dec 04 | Mar 05 | Jun 05 | Sep 05 | Dec 05 | Mar 06 | Jun 06 |
| Real GDP, % YOY | 4.3 | 4.3 | 3.7 | 3.1 | 2.7 | 2.3 | 2.2 | n/a |
| - Private consumption | 6.7 | 6.5 | 5.8 | 5.7 | 5.1 | 4.7 | 4.1 | n/a |
| - Government consumption | 5.3 | 5.6 | 5.2 | 5 | 5.9 | 5.7 | 5.6 | n/a |
| - Gross fixed capital expenditure | 15.4 | 13.2 | 7.8 | 4.9 | 4 | 4.3 | 5.6 | n/a |
| Nominal GDP, US\$ bn | 93.5 | 97.8 | 100.4 | 105.0 | 107.8 | 108.6 | 107.7 | n/a |
| Annual Current Account, US\$ bn | -5.6 | -6.5 | -7.5 | -8.4 | -9.2 | -9.7 | -10.1 | n/a |
| Consumer Price Index, annual % | 2.5 | 2.7 | 2.8 | 2.8 | 3.4 | 3.2 | 3.3 | 4.0 |

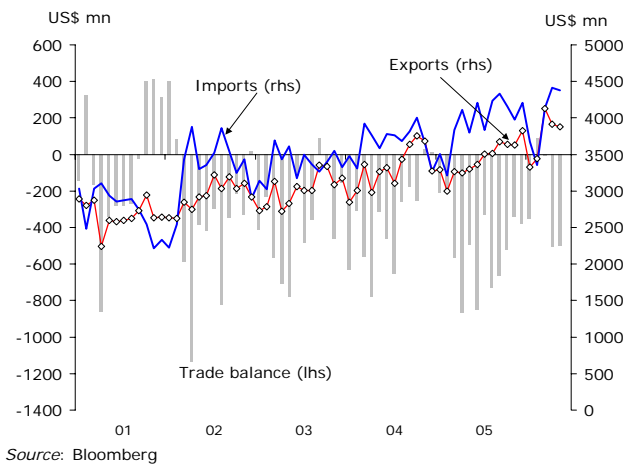
Sources: Statistics NZ, ANZ National Bank

Country Update: Philippines

Inflation moderates keeping interest rates unchanged



Trade deficit narrows



- The Philippines will offer 10 and 25-year bonds worth US\$750 mn to meet borrowing requirements for 2006. This follows an issue of US\$2.1 bn worth of USD and Euro-denominated bonds in January. This latest bond offer is the first emerging market debt issue after heightened volatility in financial markets since May. The response, however, is expected to be positive given the country's efforts to implement fiscal reform and rating agencies' improved ratings outlook. The fiscal deficit for the first half of the year is lower than expected but this not only reflects increased revenues but also spending restraint.
- President Arroyo unveiled a bold medium-term plan to expand and upgrade infrastructure. Funding this plan, which is likely to cost more than US\$5 bn, will be an issue. While expected improvements in tax revenue and collection methods will assist in meeting this cost, public sector debt remains high (approx. 70% of GDP) which will limit the scope for increased foreign borrowing. Private sector domestic and foreign investment will have to play a bigger role.
- Inflation has stayed between 6.7-7.1%YOY over the past three months compared with the average of 7.7% for 2005. High oil prices and the expansion of the EVAT do not appear to be adversely affecting inflation. The central bank has kept its benchmark rate on hold since October 2005. However, we expect greater price pass-through from oil prices and the VAT in coming months. Together with global rate tightening which would negatively impact interest rate differentials and could, in turn, affect the stability of the peso, an interest rate hike in the second half of this year cannot be ruled out.
- Despite an escalating oil import bill, Philippines' trade deficit has narrowed to US\$1.3 bn for the first five months of 2006 compared with US\$2.3 bn for the same period in 2005. Exports have been underpinned by strong global electronics demand while imports of consumer goods have dropped.

Jasmine Robinson

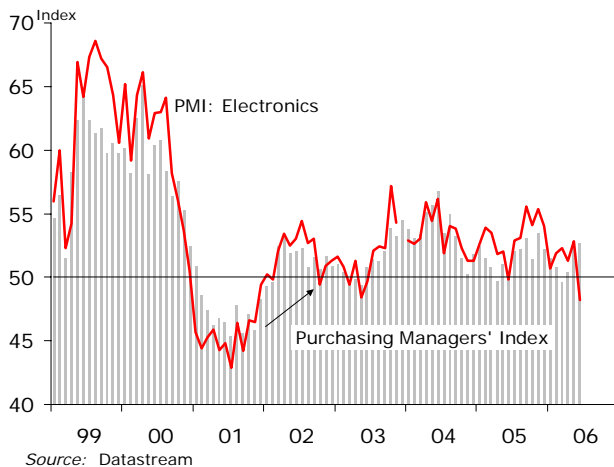
Economic data – Philippines

| Monthly data | Nov 05 | Dec 05 | Jan 06 | Feb 06 | Mar 06 | Apr 06 | May 06 | Jun 06 |
|------------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|
| Manufacturing Production, %YOY | 10.8 | 0.4 | -9.4 | -11.4 | -5.1 | -13.2 | -5.4 | n/a |
| Motor Vehicle sales, % YOY | -4.0 | 11.2 | 19.9 | -12.7 | -3.8 | -12.3 | 5.2 | -9.8 |
| Consumer Price Index, % YOY | 7.1 | 6.7 | 6.7 | 7.6 | 7.6 | 7.1 | 6.9 | 6.7 |
| Exports, % YOY | -1.5 | 16.8 | 1.2 | 14.9 | 26.3 | 20.5 | 17.3 | n/a |
| Imports, % YOY | 1.4 | 28.9 | 5.0 | 4.6 | 8.0 | 7.4 | 15.2 | n/a |
| Trade Balance, US\$ mn | -79.0 | -382.0 | -354.0 | 90.0 | -10.0 | -505.0 | -498.0 | n/a |
| Foreign Exchange Reserves, US\$ bn | 15.4 | 15.8 | 17.6 | 17.7 | 17.7 | 17.7 | n/a | n/a |
| Quarterly data | Jun 04 | Sep 04 | Dec 04 | Mar 05 | Jun 05 | Sep 05 | Dec 05 | Mar 06 |
| Real GDP, % YOY | 6.9 | 6.0 | 5.5 | 4.2 | 5.4 | 4.8 | 5.3 | 5.5 |
| - Private consumption | 6.3 | 5.5 | 5.7 | 5.0 | 4.8 | 5.0 | 5.0 | 5.1 |
| - Government consumption | 0.8 | -1.9 | 1.6 | 2.2 | 12.4 | -0.3 | 1.1 | 9.4 |
| - Gross fixed capital expenditure | 3.3 | -3.4 | 0.8 | -8.1 | -2.5 | -0.1 | -4.6 | -3.4 |
| Nominal GDP, US\$ bn | 21.3 | 22.0 | 22.6 | 23.3 | 24.5 | 24.4 | 26.3 | 27.6 |
| Current Account, US\$ bn | 0.3 | 0.5 | 1.5 | 0.7 | 0.4 | 0.2 | 1.1 | n/a |
| Capital Account, US\$ mn | 0.8 | -0.7 | -1.5 | 1.1 | 0.5 | 0.5 | -3.1 | n/a |

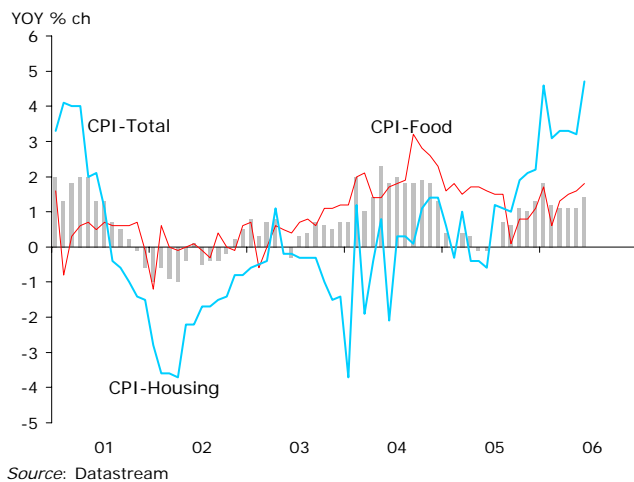
Sources: Datastream, Bloomberg

Country Update: Singapore

The electronics sector heads down



Price pressures persist



- Advance estimates for the second quarter show that the economy remained resilient. Growth moderated to 7.5% YOY after a robust expansion of 10.7% YOY in Q1 2006. Manufacturing, which accounts for around a quarter of GDP, expanded by 10.2% YOY due largely to lower pharmaceuticals output.
- Nevertheless, the better-than-expected exports data for June suggest that the estimate for manufacturing output in Q2 2006 could be revised upwards. Exports grew by 28% YOY (in US dollar terms) and, in particular, non-oil domestic exports climbed by 23% YOY. The services sector is estimated to have grown by 6.8% YOY in the second quarter. This was higher than the 2005 average of 6% but lower than the 8.2% YOY recorded in Q1 06.
- Our full-year forecast of 7% remains well on track. We expect growth in the manufacturing sector to ease in the second half reflecting a moderation in the global electronics cycle. The PMI for June suggest continued expansion in manufacturing activity but the electronics PMI reverted to below 50, signalling a decline in activity in the months ahead. The services sector, however, is likely to remain well supported by a strong events calendar, which includes the IMF/World Bank meetings in September.
- Inflation edged up to 1.4% YOY in June, due largely to higher food prices and housing costs which together make up 44% of the index. Lower car prices have, however, kept transport & communication costs well contained. For the first half of this year, inflation was 1.3% YOY and we expect the full-year rate to edge closer to 1.5% as oil-related price pressures persist. This is significantly higher than the 0.5% recorded in 2005 but within the central bank's forecast range of 1-2%.

Jasmine Robinson

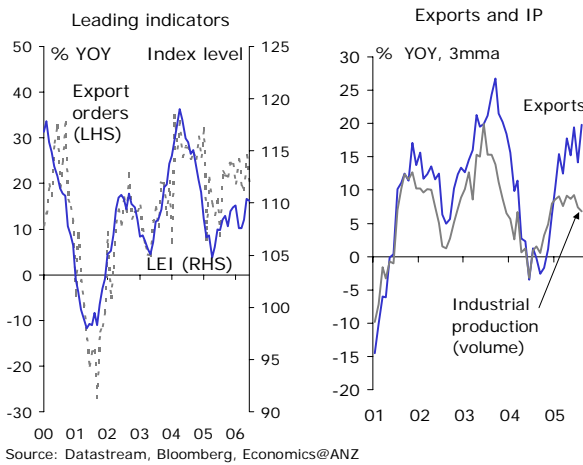
Economic data – Singapore

| Monthly data | Nov 05 | Dec 05 | Jan 06 | Feb 06 | Mar 06 | Apr 06 | May 06 | Jun 06 |
|--------------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|
| Industrial Production, %YOY | 21.1 | 5.4 | 2.4 | 37.6 | 26.2 | 3.1 | 10.6 | 22.5 |
| Retail Sales, % YOY | 6.4 | 7.4 | -0.5 | 10.7 | 12.2 | 6.9 | 12.9 | n/a |
| Consumer Price Index, % YOY | 1.0 | 1.3 | 1.8 | 1.2 | 1.1 | 1.1 | 1.1 | 1.4 |
| Exports, % YOY | 18.1 | 20.2 | 18.6 | 30.7 | 20.7 | 16.0 | 23.3 | 27.9 |
| Imports, % YOY | 13.1 | 19.0 | 10.4 | 40.3 | 12.5 | 13.5 | 30.2 | 27.0 |
| Trade Balance, US\$ bn | 3.2 | 3.8 | 3.1 | 1.9 | 3.8 | 2.7 | 2.1 | 2.6 |
| Foreign Exchange Reserves, US\$ bn | 114.6 | 115.8 | 119 | 119.0 | 121.4 | 126.5 | 127.7 | n/a |
| Quarterly data | Jun 04 | Sep 04 | Dec 04 | Mar 05 | Jun 05 | Sep 05 | Dec 05 | Mar 06 |
| Real GDP, % YOY | 13.2 | 8.4 | 7.6 | 3.6 | 5.7 | 7.6 | 8.5 | 10.8 |
| - Private consumption | 10.1 | 5.1 | 2.9 | 2.9 | 2.0 | 1.3 | 3.9 | 1.9 |
| - Government consumption | -6.9 | -5.9 | 0.5 | 7.6 | -1.8 | 7.1 | 9.9 | 10.0 |
| - Gross fixed capital expenditure | 12.3 | 13.6 | 0.7 | -8.8 | -6.4 | -6.6 | 15.0 | 11.4 |
| Nominal GDP, US\$ bn | 26.1 | 26.5 | 28.6 | 28.3 | 28.7 | 29.3 | 30.4 | 30.9 |
| Current Account, US\$ bn | 5.9 | 7.4 | 7.5 | 6.5 | 7.8 | 9.4 | 9.5 | 9.4 |
| Capital & Financial Account, US\$ bn | -4.9 | -6.8 | -3.1 | -4.0 | -1.0 | -9.4 | -5.8 | -4.8 |

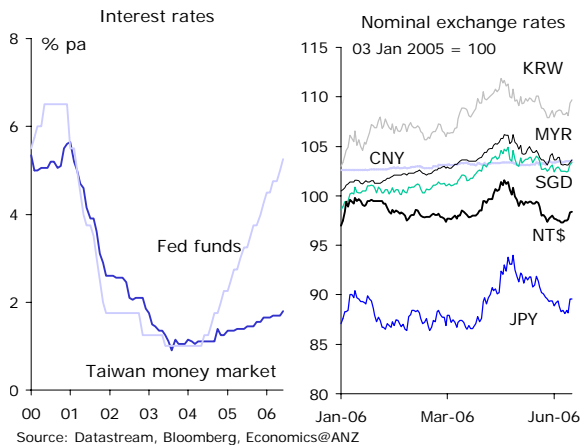
Sources: Bloomberg, Datastream, Economic Survey of Singapore

Country Update: Taiwan

External demand still looking strong for Taiwan exports



Monetary conditions look pretty easy



- Taiwan remains our top pick for more interest rate rises, as economic activity remains sufficiently strong to generate greater inflation expectations while interest rates have clearly lagged the region and monetary conditions are easy. Second quarter GDP results are not yet available, but we expect real GDP to have expanded by 2.5% QOQ and 5.8% YOY on the back of a strong export sector and improved consumer sentiment.
- Exports rose nearly 20% YOY in June (NT\$ terms, and were up 16% YOY for the second quarter after rising 15% in the first quarter. Export orders remained strong, rising 21.8% in the second quarter following growth of 21.5% in the first quarter. Moreover, the export price index has recorded its first consistent rise since 2004, with prices up more than 5% YOY in June. The composite leading indicator rose to above 110 in May for the first time since late 2004, and stayed at that level in June.
- Domestic activity has lagged the dynamism of the export economy, but nonetheless appears sufficiently strong. Industrial production was up 6.8% YOY in the second quarter after rising just over 8% in the first quarter, and the unemployment rate is below 4%.
- Inflation has remained contained, but has recorded relatively strong gains of more than 0.5% MOM over the past three months, allowing the annual rate to accelerate to 1.7% YOY in June from a low of 0.4% in March. Core CPI is running at about 0.5% YOY, but appears poised to follow the headline rate higher. Although the CBC has raised rates by 12.5 bps in each of the last several quarters, interest rates are lagging rises elsewhere and monetary conditions are easy, as indicated by our MCI index for Taiwan.
- President Chen Shui-bian's son-in-law was indicted on charges of insider trading in early July, deepening the crisis surrounding this government in the wake of a string of corruption scandals.

Amy Auster

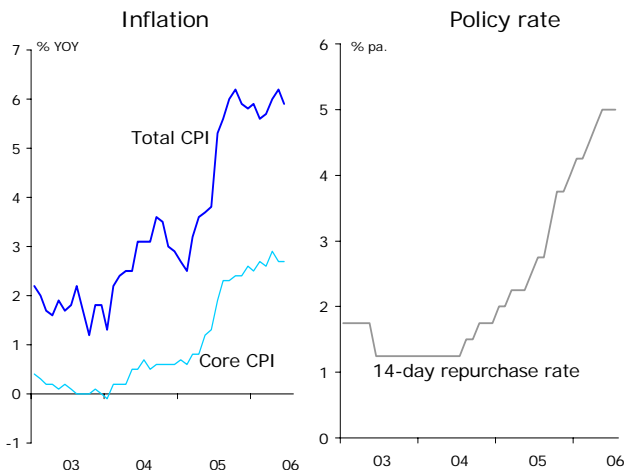
Economic data – Taiwan

| Monthly data | Nov 05 | Dec 05 | Jan 06 | Feb 06 | Mar 06 | Apr 06 | May 06 | Jun 06 |
|------------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|
| Industrial Production, %YOY | 9.5 | 9.3 | 4.1 | 14.1 | 7.7 | 6.1 | 8.9 | 5.5 |
| Retail Sales, % YOY | 4.0 | 7.1 | 6.2 | -1.7 | 1.1 | 1.3 | n/a | n/a |
| Consumer Price Index, % YOY | 2.5 | 2.2 | 2.7 | 1.0 | 0.4 | 1.2 | 1.6 | 1.7 |
| Exports, % YOY | 9.6 | 15.6 | 5.0 | 24.9 | 7.2 | 15.4 | 10.5 | 15.6 |
| Imports, % YOY | 4.5 | -10.6 | -6.6 | 45.3 | -0.5 | 5.3 | 12.3 | 11.1 |
| Trade Balance, US\$ bn | 2.1 | 3.6 | 2.3 | -0.6 | 1.5 | 2.3 | 0.7 | 1.2 |
| Foreign Exchange Reserves, US\$ bn | 251.8 | 253.3 | 257.3 | 257.0 | 257.1 | 259.0 | 260.9 | 260.4 |
| Quarterly data | Jun 04 | Sep 04 | Dec 04 | Mar 05 | Jun 05 | Sep 05 | Dec 05 | Mar 06 |
| Real GDP, % YOY | 8.9 | 5.4 | 2.5 | 2.4 | 3.3 | 4.2 | 6.5 | 5.0 |
| - Private consumption | 5.9 | 1.6 | 3.1 | 2.5 | 3.0 | 3.9 | 2.6 | 2.3 |
| - Government consumption | -0.2 | -1.4 | -2.0 | -0.6 | 0.9 | 1.0 | 1.5 | 0.1 |
| - Gross fixed capital expenditure | 24.0 | 15.8 | 15.6 | 8.6 | 7.7 | 0.7 | -13.9 | -3.6 |
| Nominal GDP, US\$ bn | 80.6 | 80.0 | 82.1 | 86.2 | 86.8 | 87.0 | 85.9 | 87.1 |
| Current Account, US\$ bn | 5.5 | 5.3 | 1.7 | 4.4 | 1.7 | 0.9 | 9.1 | 6.4 |
| Capital Account, US\$ bn | -5.0 | -4.8 | -4.4 | -4.6 | -3.4 | -2.9 | -7.6 | -7.7 |

Sources: Bloomberg, Datastream, National Statistics

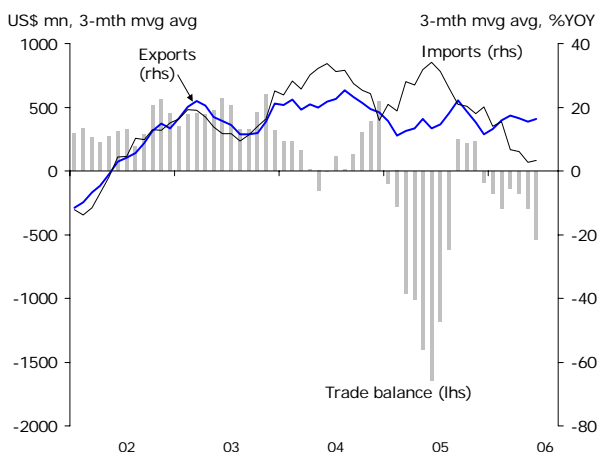
Country Update: Thailand

Interest rates on hold as inflation moderates



Source: Bloomberg, Datastream

Trade deficit narrows



Source: Datastream

- The mood is lifting in Thailand as steps are taken to ease political pressures. A new election commission to oversee the polls, which are likely to occur in October, will be appointed now that the previous team have been found guilty of mismanaging the election process in April. The imprisonment of three commissioners has sent a positive signal that Thailand is serious about putting its political house in order.

- Nevertheless, prolonged political uncertainty is expected to dampen economic activity in the second half of the year as new public sector investment projects await government approval and this can only take place once a functioning parliament is established. Consumer sentiment continues to slide and business investment has weakened. Investment, in terms of net applications submitted by domestic and foreign firms, in the first half of the year was down 53% to Bt183 bn from Bt392 bn for the same period last year. In addition, negotiations over free trade agreements, such as with the US, have been put on hold and the signing ceremony of the Closer Economic Partnership agreement reached with Japan has been postponed.

- Moderating inflation and concerns over sluggish domestic demand prompted the central bank to keep its policy rate unchanged at its meeting this month. Unlike many of the other Asian economies, we believe that interest rates will remain on hold for the rest of the year. Inflation is likely to remain contained as the impact on prices of the removal of fuel subsidies wears off but high oil prices will underpin price pressures.

- On a customs-cleared basis, the merchandise trade deficit has narrowed to US\$2 bn in the first half of this year compared with US\$7.8 bn in the same period in 2005. Despite the high oil import bill, sluggish domestic activity has dampened demand for both consumer and capital goods. Exports, on the other hand, continue to benefit from healthy global demand, particularly for electronics, expanding by 16.8% YOY in the first six months of 2006.

Jasmine Robinson

Economic data – Thailand

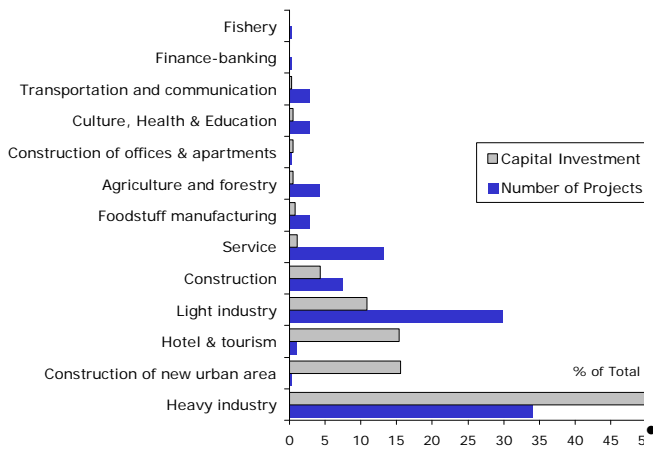
| Monthly data | Nov 05 | Dec 05 | Jan 06 | Feb 06 | Mar 06 | Apr 06 | May 06 | Jun 06 |
|--------------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|
| Manufacturing Production, %YOY | 7.8 | 5.7 | 5.8 | 13.1 | 10.2 | 4.5 | 9.2 | n/a |
| Car Sales, % YOY | 8.3 | 6.4 | -2.8 | 13.3 | -2.2 | -4.3 | -7.3 | n/a |
| Consumer Price Index, % YOY | 5.9 | 5.8 | 5.9 | 5.6 | 5.7 | 6.0 | 6.2 | 5.9 |
| Exports, % YOY | 14.5 | 11.6 | 13.6 | 22.8 | 15.9 | 11.7 | 18.8 | 18.2 |
| Imports, % YOY | 14.8 | 27.9 | 2.0 | 19.0 | 1.3 | 0.3 | 6.4 | 3 |
| Trade Balance, US\$ bn | 0.1 | -0.1 | -0.4 | -0.3 | 0.3 | -0.6 | -0.7 | -0.43 |
| Foreign Exchange Reserves, US\$ bn | 49.4 | 50.7 | 51.7 | 52.9 | 53.7 | 55.5 | 56.0 | n/a |
| Quarterly data | Jun 04 | Sep 04 | Dec 04 | Mar 05 | Jun 05 | Sep 05 | Dec 05 | Mar 06 |
| Real GDP, % YOY | 6.4 | 6.1 | 5.4 | 3.3 | 4.5 | 5.4 | 4.7 | 6.1 |
| - Private consumption | 6.2 | 5.9 | 5.2 | 4.3 | 4.8 | 4.5 | 4.1 | 4.1 |
| - Government consumption | 5.8 | 1.6 | 3.7 | 16.9 | 8.6 | 16.6 | 7.1 | -0.9 |
| - Gross fixed capital expenditure | 13.2 | 10.4 | 15.9 | 14.7 | 14.5 | 9.2 | 7.6 | 6.9 |
| Nominal GDP, US\$ bn | 40.2 | 39.7 | 41.8 | 43.9 | 43.3 | 44.0 | 45.3 | 48.5 |
| Current Account, US\$ bn | 0.6 | 1.3 | 2.9 | -1.4 | -4.5 | 1.2 | 0.9 | 1.7 |
| Capital & Financial Account, US\$ bn | 0.3 | 0.2 | 0.5 | 0.1 | 4.3 | 2.9 | 0.2 | 0.9 |

Sources: Bloomberg, Datastream, ANZ Bank

Country Update: Vietnam

FDI targeted at Industry

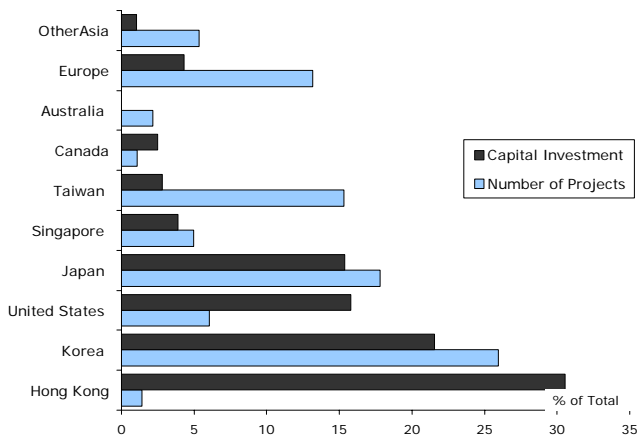
Foreign Direct Investment by Sector



Source: Vietnam General Statistics Office, Economics@ANZ

Investment strong from Asia

Foreign Direct Investment by Country



Source: Vietnam General Statistics Office, Economics@ANZ

- The conclusion of the 9th session of the 11th National Assembly in late June saw the appointment of a new President, Prime Minister and Party chairman as well as the confirmation of nine new cabinet ministers. Phan Van Khai (Prime Minister) and Tran Duc Luong (President) were appointed to the top jobs and both are expected to continue Vietnam's agenda of administrative and economic reforms. The Communist Party Central Committee also met recently, identifying several socio-economic weaknesses that need to be addressed by the incoming political appointees. Despite the 8.4% GDP growth in 2005, economic performance has been viewed as "not commensurate with available potential". With investment at around 40% of GDP, there have been calls for the government to improve investment quality to ensure continued economic growth.

The Vietnamese economy grew by 7.4%YOY in the year to Q2, slowing marginally compared to 7.6%YOY growth over the same period in 2005. This slowdown was mainly due to a fall in agricultural production. The sector suffered due to a breakout of foot and mouth disease, the effects of a mass slaughter of poultry to contain bird flu and a typhoon that impacted on fisheries. Other sectors maintained strong growth. The industry and construction sector expanded 9.3%YOY in the second quarter compared with 9.5%YOY for the same period in 2005 and services expanded 7.7%YOY in Q2 as compared with 7.6%YOY in Q2 2005.

- Foreign direct investment continues to pour into Vietnam. According to the Ministry of Planning and Investment (MPI), around 350 projects have been licensed in the first half of 2006. Total registered capital has increased to US\$2.4 bn, up around 20%YOY from 2005. Average capital invested per project was US\$6.7 mn. Larger projects included a US\$605 mn micro-chip manufacturing plant, a US\$314 mn urban development project in Hanoi, and a US\$300 mn project to develop a 1,200 room hotel and a casino. Despite FDI to June reaching only 40% of the government's US\$6.5 bn target for 2006, several very large capital projects are being considered by the MPI, including billion-dollar investments in the steel industry.

Alex Joiner

Economic data – Vietnam

| Monthly data | Nov 05 | Dec 05 | Jan 06 | Feb 06 | Mar 06 | Apr 06 | May 06 | Jun 06 |
|-----------------------------------|-------------------|---------|---------|--------|---------|---------|---------|--------|
| Industrial Production+, %YOY | 16.5 | 16.7 | 15.7 | 15.8 | 12.8 | 15.6 | 15.9 | 16.1 |
| Retail Sales+, % YOY | 19.7 | 20.0 | 24.8 | 19.2 | 19.3 | 19.4 | 19.6 | 19.7 |
| Consumer Price Index, % YOY | 7.8 | 8.3 | 8.8 | 8.4 | 7.7 | 7.3 | 7.5 | 7.6 |
| Exports+, % YOY | 21.1 | 21.9 | 16.0 | 28.3 | 20.3 | 25.1 | 24.2 | 25.7 |
| Imports+, % YOY | 19.2 | 18.3 | 10.8 | 4.2 | 1.9 | 6.9 | 7.3 | 14.1 |
| Trade Balance*, US\$ bn | -0.35 | -0.33 | 0.466 | -0.31 | -0.1 | -0.3 | -0.4 | n/a |
| Tourist Arrivals+, %YOY | 20.6 | 20.3 | 15.9 | 15.1 | 16.3 | 15.9 | 12.0 | n/a |
| China, number of visitors* | 559,790 | 621,786 | 69,569* | 96,277 | 142,664 | 210,348 | 264,870 | n/a |
| Quarterly data | Growth Q1-Q2 2006 | | | | | | | |
| Real GDP+, % YOY | | 7.4 | | | | | | |
| Agriculture, forestry, fishery, % | | 3.0 | | | | | | |
| Industry & construction, % YOY | | 9.3 | | | | | | |
| Services, % YOY | | 7.7 | | | | | | |

+: January-to date vs same period in previous year * : January to date ^ : US\$ bn

Source: General Statistics Office of Vietnam

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