Economics@ANZ

ANZ Economics Monthly

Asia's soft landing coming in 2006-07

31 May 2006

Inside:

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Our Vision:

For Economics@ANZ to be the most respected, sought-after and commercially valued source of economics research and information on Australia, New Zealand, the Pacific and Asia.

This month we undertook a significant shift in our global macroeconomic forecasts, which now call for higher inflation, higher interest rates and a slower global growth profile over the next 12-18 months. The shift in view follows stronger-than-expected first quarter GDP data, higher commodity prices and signs of greater commodity price pass through to consumer prices. As a result, we have shifted our forecast for the peak Fed funds rate to 5.5% (5.0% previously); the peak Reserve Bank of Australia rate to 6% (from 5.75%); and the end-2006 Bank of Japan target rate to 0.5% (from 0.25%).

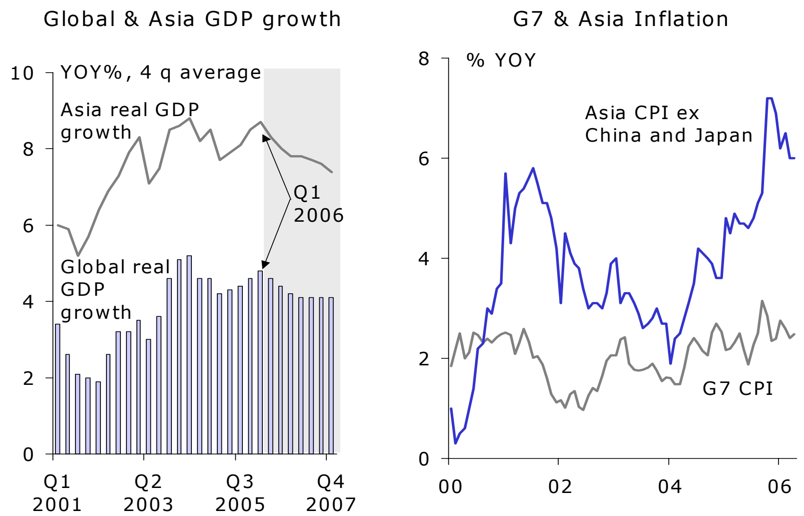
It appears that the constraints to growth from finite natural resources are emerging, and in conjunction with higher interest rates will end this period of exceedingly strong global growth and low inflation. Nonetheless, we anticipate a soft landing, with global GDP growth forecast to decline from 4.7% this year to a near-trend rate of 4.1% next year. The respectable growth rate reflects weakness in the US economy (to 2.5%) being offset by trend-level growth in Euroland, Japan and China. Growth in emerging Asia, however, should fall to below-trend at around 4.5% as domestic consumption trends downward.

Since the catalyst for this slowdown is a more restrictive monetary policy stance, concerns have surfaced as to whether the downturn will be accompanied by a financial market disruption. Financial market volatility has clearly increased and we believe it will remain high in the next month as speculation about whether the US Fed will raise rates again gathers fever pace. However, we believe the Asian region will be able to weather higher rates and tighter liquidity relatively well, as the underlying economies have substantial cushions to soften the blow of capital outflows. Our new risk tool – the Early Warning Indicator, released just this month – supports this view. The EWI had not flashed signs of increased risk perceptions across Asia as at end-April.

Global rate forecasts raised as inflation tracks higher

As has been written here previously, this business cycle has been characterised by above-trend global growth, below trend inflation, accommodative monetary policy and very low financial market volatility. Our previous forecasts assumed that high commodity prices and a return to a neutral policy stance would be sufficient to contain inflation pressures and slow global growth to trend levels.

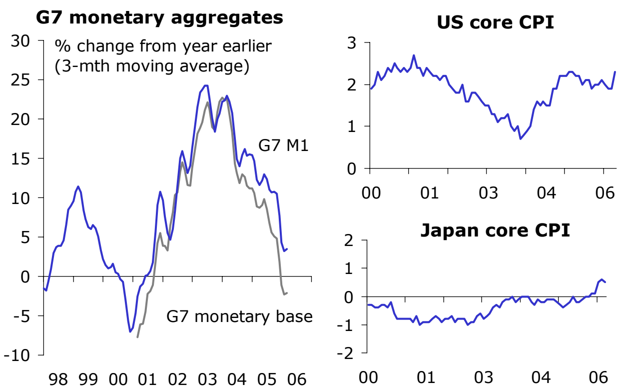
Global growth should slow as inflation tracks higher



Source: Datastream

However, it now seems that years of base money growth in excess of 10% across the G7 is coming home to roost. That liquidity has mostly brought global asset price inflation, but an upward trend in all CPI measures indicates that there is now greater pass through to consumer prices as well. We believe that at least some central banks, including the US Fed, will need to move into restrictive territory to prevent another uptick in inflation expectations.

M1 growth is only now approaching zero



Note: The monetary base is comprised of currency in circulation plus required and excess reserves held at the central bank; M1 is monetary base + demand deposits.
Sources: US Federal Reserve; Bank of Japan; European Central Bank;Bank of England; Bank of Canada; converted to US$ by Economics@ANZ

Our forecasts call for global growth of 4.7% this year and 4.1% in 2007 (from 4.3% previously), while inflation is expected to rise to nearly 3.5% in 2006 before falling back to 3.3% in 2007. Below is a regional review of our forecast changes.

Summary of global forecast changes

	GDP growth (annual average)		Inflation (annual average)		Policy rates (eop)	
	06	07	06	07	06	07
US	3.3	2.5	3.2	1.5	5.5	4.25
Japan	2.4	2.0	0.2	0.9	0.5	1.0
Eurozone	2.0	2.0	2.3	2.1	3.25	3.50
UK	2.2	2.5	2.2	2.0	4.75	4.75
Australia	2.9	3.1	2.9	2.7	6.0	6.0
New Zealand	1.4	2.3	3.2	2.4	7.0	5.5
China	9.8	8.9	1.8	4.3	6.12	5.85
East Asia ex Japan & China	5.1	4.5	6.0	4.5		
World	**4.7**	**4.1**	**3.5**	**3.3**		

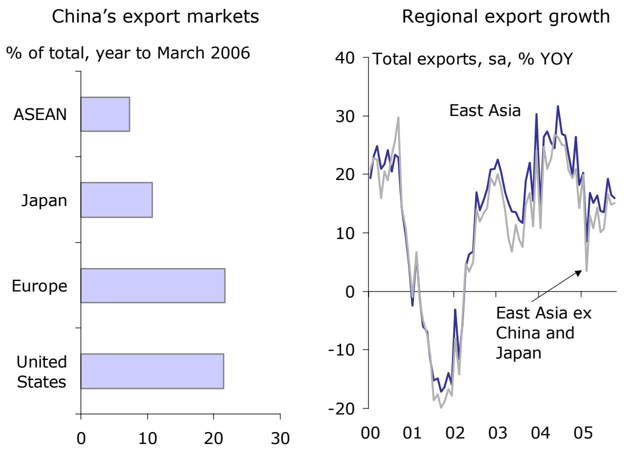
Source: Economics@ANZ

A soft-ish landing for Asia

The above scenario represents a relatively soft landing for Asia as a region, but with some important intra-regional variations. Generally speaking, a downturn in the US economy rings warning bells for the Asian region given the historic reliance upon US demand for export growth.

However, given that our forecast slowdown in US growth is focused on household consumption rather than business investment, we believe that slower US growth does not in and of itself spell doom for Asia if corporates can ride through the downturn. Moreover, we are forecasting European growth to remain around 2%. This is more important for Asia than most observers commonly recognise, as the EU and the US both absorb 21% of all Chinese exports. If Chinese exports can expand at a rate of 35% YOY when the EU is growing at a rate of less than 1% - as was the case in 2003 – then US growth of around 2% does not necessarily pose a major threat to China's external demand, particularly if business investment remains solid.

EU as important as US for China's exports



Source: Datastream, Economics@ANZ

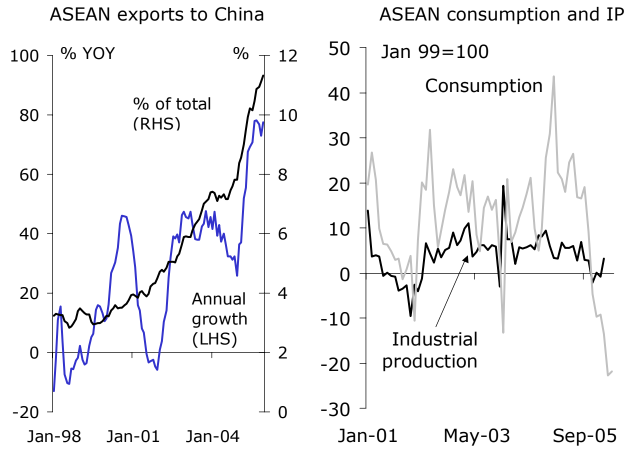
As can be seen in the chart above, the rest of East Asia's exports are heavily reliant on the outlook for China and Japan, as these two economies now represent the major trade partners for the region. Thus, if China can coast through a soft patch in US household consumption, the rest of East Asia's exports can hold up reasonably well too.

Oil subsidies making a difference

In addition to decent external demand conditions, China's domestic economy is steaming ahead. Fixed asset investment remains a major growth driver, and is up more than 25% YOY so far in 2006. Moreover, Chinese consumers are not facing the implicit tax of high energy prices, as stringent price caps on retail fuels remain in place. The government has said that caps will be raised gradually and have recently announced another price hike, but retail fuel prices have risen only 15% in the past year as against a 32% YOY rise in the cost of crude, and remain well below market levels overall.

In contrast, high oil prices have really taken the steam out of growth in much of SE Asia. As can be seen in the chart below, exports remain strong thanks to rapidly increasing trade between SE Asia and China. Given growing reliance on China for external demand, the export outlook for SE Asia is decent. However, domestic demand is suffering in the wake of the sudden reduction in fuel subsidies that took place late last year in Indonesia, Malaysia and Thailand, as well as a rapid rise in inflation and interest rates that followed.

SE Asia consumption in dramatic decline



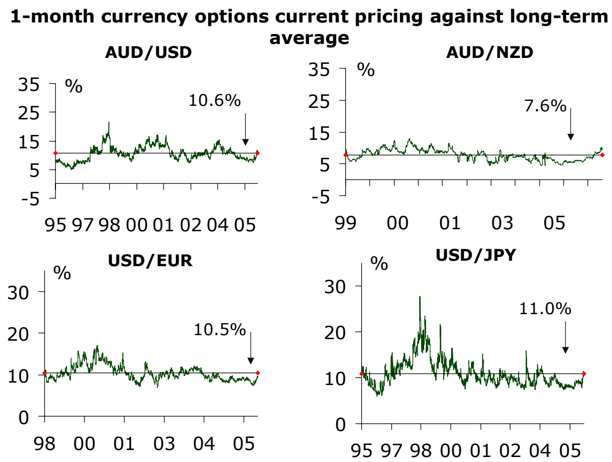
Sources: Datastream, China Statistical Yearbook, Economics@ANZ

The chart illustrates falling consumption as against a recent upturn in industrial production in the ASEAN-five economies. The consumption data is viewed with caution as it is comprised largely of motor vehicle sales, given the absence of retail sales data in much of the region. Thus the index may overstate the case; nonetheless, weak household consumption is likely to shave a couple of percentage points off of SE Asian growth in the coming 12 months.

Financial market volatility is up….

Another factor with the potential to affect the medium term economic outlook for Asia is volatility in the financial markets given the higher interest rate environment. Volatility has already increased; for example, the chart below shows how prices on one-month currency options – which fell to below long-term averages for major currency pairs in 2004 and 2005 – have returned to trend level and in the case of the AUD/NZD are now above trend.

Market volatility has increased



Sources: Bloomberg; Economics@ANZ

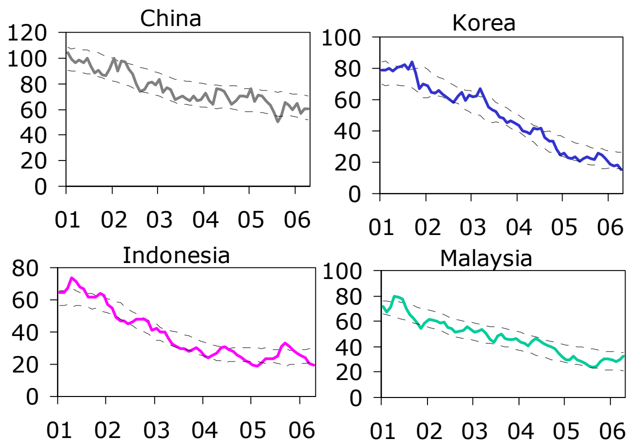
The reason why some commentators fret about market volatility is that increased volatility often leads to risk aversion, which can cause a sell-off for the assets of countries that are outside the G7. Such concerns can then lead to speculation about whether a sell-off in Asian equity, bond or currency markets could spark a crisis similar to that experienced by the region in 1997-1998.

…But risk perceptions remain stable

In order to estimate perceptions of risk across Asia in a disciplined way, Economics@ANZ constructed a new tool called the Early Warning Indicator. The EWI is based upon literature from the post-Asia crisis period that identified specific data that might sound warning bells before the onset of a major financial crisis.

A background paper explaining the methodology behind and construction of the EWI is being sent along with this report, and will be available on our web site. Suffice to say here that the EWI aggregates financial market data that can act as a gauge of risk perception into one indicator. The indicator is watched over time for statistically significant movements, which when they occur are noted as flashing a signal of an increase (or decrease) in market perceptions of risk.

EWI contained in emerging Asia (end-April)

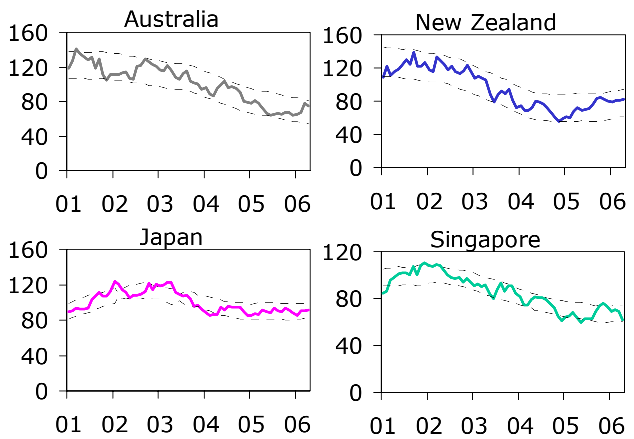


Note: In all cases, the base year for the index is 1999; Source: Economics@ANZ

The above charts show the results for individual countries as at end-April. In emerging Asia, risk overall is trending downward, except for Indonesia where it is now traveling sideways. Within indices, only Malaysia's EWI has shown significant movement. Indonesia's EWI flashed a signal last year after the rupiah depreciated sharply, but has since returned to within normal levels, albeit with higher volatility.

It is perhaps more interesting to note the EWI movements for highly rated economies. There, risk perceptions were trending downward from 2002 through 2005 pictured below, but risk perceptions now are traveling sideways or rising. Australia's EWI has had a statistically significant move up due to rising domestic credit and bond yields, while New Zealand's EWI is at a high level due to real exchange rate depreciation. Singapore has recently sent a warning flash on its EWI, due to bond yield movements. The possible interpretation is that there is a greater risk perception for the developed economies of the region as we enter this period of higher financial market volatility. With major movement in the financial markets this month, the EWI for May could throw up interesting results.

EWI in AAA-rated Asia (end-April)

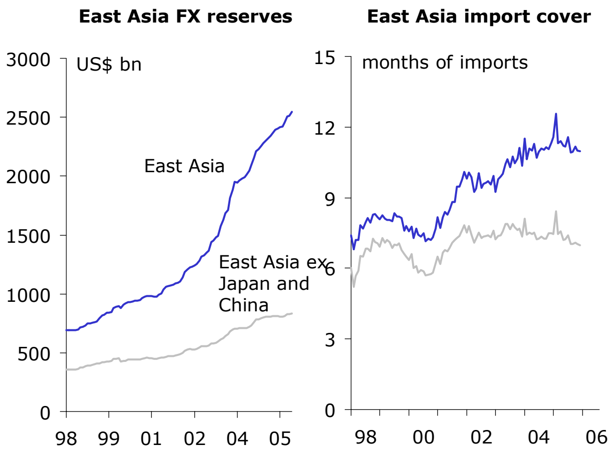


Note: In all cases, the base year for the index is 1999; Source: Economics@ANZ

Asia can withstand capital outflows

Even in the event of a market sell off and increased risk perceptions across Asia, we believe the Asian region generally should be able to withstand some pretty substantial capital outflows. Most obviously, in contrast to the 1997-1998 period, Asian economies have effectively built up a savings chest in the form of foreign exchange reserves held at central banks, which now total US$2.6 tr. This level of reserves provides central bank with plenty of ammunition to smooth foreign exchange volatility in the event of a regional sell-off.

High levels of foreign exchange reserves



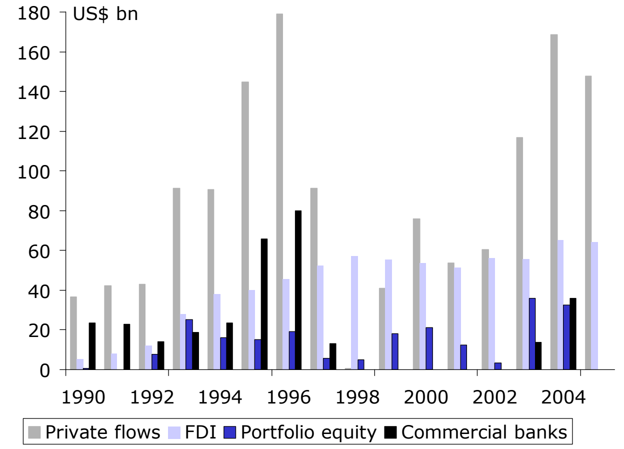
Source: Bloomberg, Datastream, Economics@ANZ

Perhaps more importantly, however, economic reform and structural changes have put Asia on a more stable footing vis-à-vis the capital markets. First, there is the overall balance of payments position. At end-2005, Asia had a current account surplus in excess of 2% of GDP, as opposed to a deficit of 1.7% of GDP in 1996. The surplus is US$170 bn of Asian savings that have been exported, and can be brought home.

Second, although capital flows to Asia have risen in the past few years, they have actually diminished relative to the size of local economies and capital markets when compared to the pre-crisis period. In 2004 and 2005, total net private capital inflows to Asia were US$169 bn and US$147.7 bn respectively, implying that net flows fell last year. However, both figures are below the US$179 bn in net private capital inflows recorded in 1996.

Third, the structure of capital inflows has improved. Of total net private capital inflows into Asia, about 50% in 2005 came in the form of foreign direct investment, as against only 25% in 1996. Thus, while Asia has been the recipient of significant capital inflows over the past several years, the bulk of those inflows are for real investment that tends to be illiquid and can only be reversed with a lag.

Capital inflows now far more stable



Source: Institute for International Finance, Economics@ANZ

Fourth, commercial bank liabilities denominated in foreign currency have been static. This reflects the restructuring of local banking sectors and development up of foreign exchange markets that allow more domestic funding to be sourced onshore. Exposure to mismatched foreign currency liabilities in the banking sector was the real undoing of Asia in 1997, and is unlikely to be repeated in the current environment.

Thus, while a drying up of global liquidity and some outflows from Asia has the potential to cause equity, property and bond markets to sell off, we believe the economic impact would be limited. A bear market in Asia would likely hurt consumer sentiment, dampen demand and possibly send a few companies into bankruptcy, but should not cause anything approaching a systemic crisis.

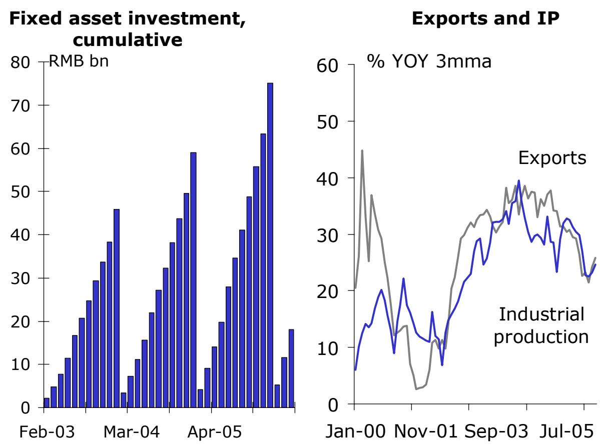
Of course, there are some regional variations with specific economies whose capital inflows have been more weighted toward the equity markets and commercial bank debt. FDI inflows to Korea and Malaysia have been less than 20% of net foreign capital inflows, with the remaining 80% directed to the equity, bond and commercial bank markets. More than half of all foreign capital inflows to India have ended up in the equity market. These three economies would therefore seem most prone to a region-wide shift in capital flows. At the same time, it must be noted that Korea's total net private capital inflows in 2005 were only US$13 bn as against US$44 bn in 1996.

China's soft landing is still the main risk

While a downturn in the US and regional capital outflows pose some risk to the outlook for Asia, in our view the as-yet-undetermined ability of China to reach a soft landing is the major risk for the region, and indeed for the global economy. With China currently producing 15.4% of global GDP as against 20% for the United States (PPP weighted basis), it is actually difficult for the global economy to fall to below-trend growth as long as GDP growth in China remains above 8%. If growth in China slows to below 8%, it will be difficult for Asia and possibly the global economy to avoid a recession.

The Chinese economy is steaming ahead, and the authorities are concerned about overheating. In the past month, the government has raised interest rates, reinforced lending guidelines on sectors that it considers overheated, and announced a number of measures aimed at cooling speculation in the property market.

Chinese demand up across the board



Source: Datastream, Economics@ANZ

However, there is little doubt that it is the continued growth of the monetary base due to extraordinary capital inflows that are fueling domestic liquidity, excessive investment and asset inflation. Although the PBOC continues to sterilize inflows, M2 growth of 17.5% YOY in April remains well above the 15% growth target; M2 growth has now been above target for nearly a year.

Observers point to China's exchange rate as being at fault for the buildup in foreign exchange reserves. Our argument is that the real cause is the closed capital account that prevents Chinese residents from investing their funds offshore, and arguably artificially inflates the value of the RMB as the real demand for the currency in the economy is hidden.

China's next policy steps

The coming 12 months are important in China with the scheduled opening of the banking sector to foreign competition, as well as the ongoing evolution of the local foreign exchange market and the opening of the capital account. In the past month, the government has announced:

- Plans to open a futures exchange to allow greater access to hedging instruments for domestic firms;
- The launch of an automatic collateralised financing system for commercial and policy banks in China;
- The opening of the local swap market, as anticipated as it has been 6 months since the opening of the forward market in 2005.

The authorities remain focused on building a financial markets architecture that will help to move US$2.6 tr in domestic savings – mostly held by households – from the banking sector (which now holds 72% of the economy's total financial stock, as estimated by McKinsey's), to the equity and debt markets. The migration will support a more efficient allocation of capital and, for the first time, offer residents a decent rate of return on their savings.

Part of this process is the freeing of the exchange rate and opening of the capital account. However, history has shown that sequencing is important, and that a premature opening of the capital account can often lead to capital outflows and undue pressure on an underdeveloped banking sector. Thus, the authorities are moving slowly and cautiously, as would seem prudent.

China's risks

The difficulty the Chinese government faces is in walking the tightrope between gradual reform, and the day-to-day management of monetary policy. Efforts to manage liquidity and avoid overheating, considering the very blunt policy instruments at hand, will arguably only be effective at the margin as long as the current policy mix remains in place.

In the absence of market-based levers such as liberalised interest rates to manage the economy, risks remains that the government can easily over- or undershoot the mark in balancing demand and price stability. Undershooting the mark would, over time, cause more excess capacity and exchange rate appreciation, and set the stage for a deflationary bust in the long term. Overshooting the mark would cause a rapid slowdown that would slow the global economy and raise social tensions at home.

For now, we expect to see continued efforts to tighten demand, for example by raising reserve requirements. We also have a second interest rate rise penciled in for later this year. Our baseline forecast is for GDP growth to cool slightly and then remain in a 8.5-9.5% range, in which case global growth remains at trend levels. Continued growth in excess of 10%, however, increases the risks around the above scenarios.

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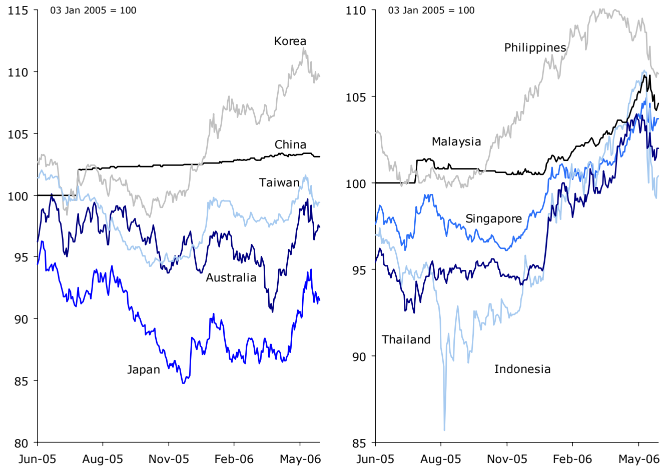
Financial Markets Update

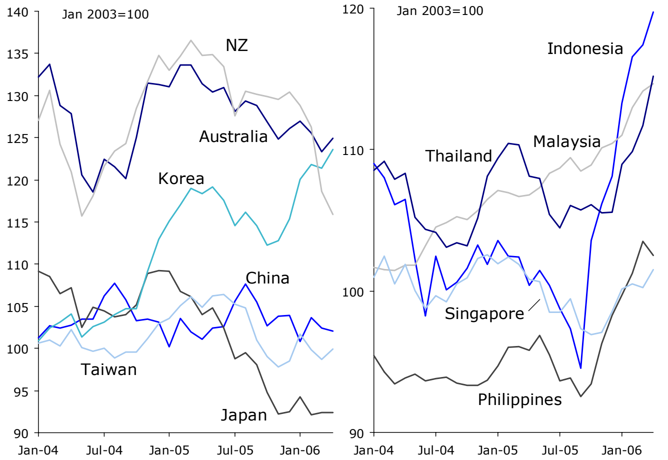
Exchange rates, US$ per local currency unit, indexed



Exchange rates

- After a sustained period of currency appreciation across Asia, currencies took a tumble in May as the US dollar strengthened on expectations of further US rate hikes and rising risk aversion.
- China breached the psychologically-important USD/CNY8.0 level on 15 May but has since retreated. However, we believe that the CNY is on track to resume its appreciation and end the year at USD/CNY7.79. The Indonesian rupiah recorded the sharpest fall of 4.9% in May.
- Further FX volatility is expected over coming months as markets examine every single US data release for clues as to whether the Fed will again raise rates at its 29 June meeting.

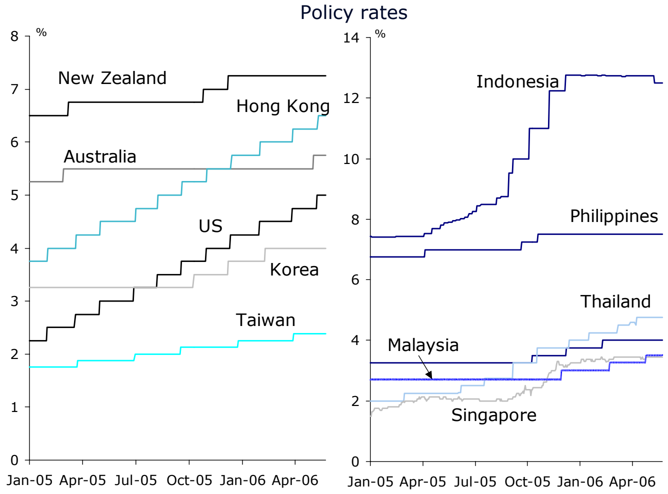
Real exchange rates, US$ per local currency unit, indexed



Real Exchange rates

- The latest data in this chart, which is April, still shows ASEAN real exchange rates, except the Philippines, continuing to appreciate. This is largely underpinned by the steady rise in the nominal value of these currencies through the month. However, we expect some retracement in May reflecting the sharp correction in nominal exchange rates.
- The New Zealand real exchange rate continues to be weighed down by the sharp decline in the nominal exchange rate.
- Expectations of higher inflation in Japan coupled with our forecast of a stronger yen should see the real exchange rate reverse its current downward trend in coming months.

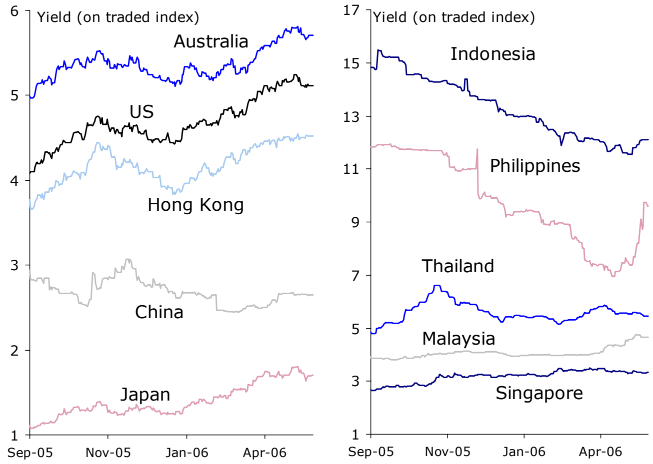
Policy rates



Policy rates

- Inflation concerns in the US have prompted us to lift our Fed Funds forecast to peak at 5.5% in 2006 from the current 5%.
- Another 25 bps rate hike is expected for Australia later in 2006 as core inflation edges closer to the top of the target band while we expect a rate cut in New Zealand in December as inflation pressures subside.
- With the exception of Indonesia, we expect central banks across ASEAN to lift policy rates in the second half to counter inflation fears and limit the impact of an erosion in interest rate differentials with the US.
- Inflation in Indonesia is expected to ease in coming months as the impact of the fuel subsidy cuts in March and October 2005 diminishes. This will widen the scope for Bank Indonesia to reduce the BI rate.

Government Bond Index



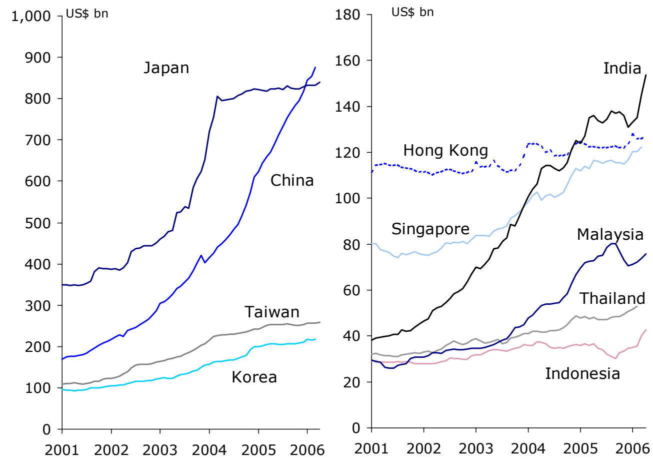
Source: JPMorgan

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

Bond markets

- Rising inflation expectations have lifted bond yields through the course of 2006. This is particularly evident in the case of the US, Australia, Hong Kong Japan and Malaysia.
- Philippine peso-denominated government bond yields hit their highest level since early January 2006 as a weaker peso, emerging-market risk-aversion as well as inflation pressures prompted a sell-off.
- Moderating inflation expectations have brought Indonesian bond yields down from its peak of 15.5% in September 2005.
- Japanese yields continue to rise with the expectation of the end of the zero interest rate policy and higher inflation.

Foreign exchange reserves

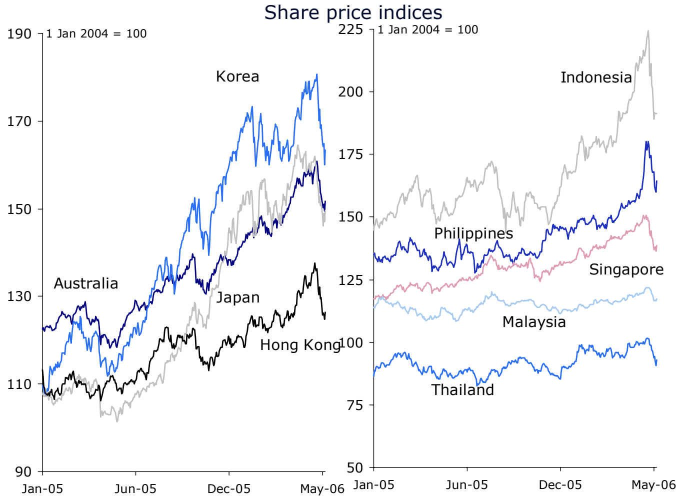


Source: Bloomberg

International reserves

- There has been ongoing speculation around reserve diversification in Asia including to alternative currencies and to gold.
- Reserve accumulation in China is continuing at a rapid pace, averaging US$17.6 bn per month in the six months to March.
- With foreign reserves in Indonesia exceeding US$40 bn currently and expectations of an acceleration in FDI flows, the government is set to pre-pay debt owing to the IMF within the next two years. This is expected to send a positive signal to investors.
- India's foreign reserves have resumed their climb after the repayment of India Millennium Deposits at the end of 2005.

Share price indices



Source: Datastream

Equity markets

- Stockmarkets across Asia suffered steep corrections in May as investors moved out of emerging market assets, took profit and/or reacted to concerns over inflation expectations in the US.
- Across North Asia, the decline averaged 4-6.5% between 12-24 May, while the falls were much steeper in ASEAN markets. The Jakarta stockmarket recorded the sharpest decline, falling by 13.3%. India's BSE Index, which recorded sharp gains through 2006, fell by 14% for the same period.
- After a sustained rise since late last year, equity markets are likely to be volatile in the next few months as further monetary tightening and consequent economic impact prompts investors to reassess investment strategies.

Foreign Exchange and Policy Rate Forecasts

	Apr 06	May 06	Jun 06	Sep 06	Dec 06	Mar 07	Jun 07
China							
USD/CNY, eop	8.01	8.01	7.99	7.91	7.79	7.73	7.67
AUD/CNY, eop	6.05	5.99	5.91	5.69	5.45	5.33	5.21
One year base lending rate	5.58	5.85	5.85	6.12	6.12	6.12	6.12
Hong Kong							
USD/HKD, eop	7.75	7.78	7.79	7.78	7.78	7.77	7.76
AUD/HKD, eop	5.86	5.82	5.76	5.60	5.45	5.36	5.28
HKMA discount rate	6.25	6.50	6.50	6.50	6.50	6.25	5.50
India							
USD/INR, eop	45.0	44.6	44.2	43.8	43.3	42.8	42.3
AUD/INR, eop	34.0	33.4	32.7	31.5	30.3	29.5	28.8
Reverse Repo rate	5.50	5.50	5.50	6.00	6.00	6.00	5.75
Indonesia							
USD/IDR, eop	8,806	8,783	8,760	8,750	8,700	8,675	8,650
AUD/IDR, eop	6,652	6,567	6,482	6,300	6,090	5,986	5,882
BI rate	12.73	12.50	12.50	11.50	10.25	9.50	8.50
Korea							
USD/KRW, eop	943	957	970	960	950	960	970
AUD/KRW, eop	712	715	718	691	665	662	660
Overnight call rate	4.00	4.00	4.00	4.00	4.25	4.00	4.00
Malaysia							
USD/MYR, eop	3.63	3.61	3.59	3.57	3.55	3.54	3.53
AUD/MYR, eop	2.74	2.70	2.66	2.57	2.49	2.44	2.40
Overnight policy rate	3.50	3.50	3.50	3.75	3.75	3.50	3.25
Philippines							
USD/PHP, eop	51.8	51.5	51.3	51.0	50.8	50.5	50.3
AUD/PHP, eop	39.1	38.5	37.9	36.7	35.5	34.8	34.2
Overnight Reverse Repo rate	7.50	7.50	7.75	7.75	7.75	7.50	7.25
Singapore							
USD/SGD, eop	1.58	1.59	1.59	1.58	1.57	1.56	1.56
AUD/SGD, eop	1.20	1.19	1.18	1.14	1.10	1.08	1.06
3-month interbank rate	3.44	3.50	3.50	3.50	3.50	3.25	3.00
Taiwan							
USD/TWD, eop	31.9	31.7	31.4	30.5	30.0	29.8	29.5
AUD/TWD, eop	24.1	23.7	23.2	22.0	21.0	20.5	20.1
Discount rate	2.38	2.50	2.75	2.75	2.50	2.50	2.40
Thailand							
USD/THB, eop	37.5	37.7	37.5	37.3	37.1	37.0	36.8
AUD/THB, eop	28.4	28.2	27.8	26.9	26.0	25.5	25.0
14-day repo rate	4.59	4.75	4.75	4.75	4.75	4.50	4.25
Vietnam							
USD/VND, eop	15,933	15,946	15,959	15,998	16,037	16,076	16,108
AUD/VND, eop	12,036	11,923	11,810	11,519	11,226	11,093	10,954
Japan							
USD/JPY, eop	114.2	111.1	108.0	105.0	102.0	100.0	98.0
AUD/JPY, eop	86.2	83.1	79.9	75.6	71.4	69.0	66.6
Overnight call rate	0.00	0.00	0.00	0.00	0.25	0.25	0.50
Australia							
AUD/USD, eop	0.76	0.75	0.74	0.72	0.70	0.69	0.68
Cash rate	5.50	5.75	5.75	5.75	6.00	6.00	6.00
New Zealand							
NZD/USD, eop	0.63	0.63	0.62	0.60	0.58	0.55	0.53
AUD/NZD, eop	1.19	1.19	1.19	1.20	1.21	1.25	1.28
Overnight call rate	7.25	7.25	7.25	7.25	7.00	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	7.9	7.6
China	10.1	9.9	9.8	8.9
Hong Kong	8.6	7.3	4.8	3.5
India+	7.5	8.4	7.5	7.2
Indonesia	5.0	5.6	4.8	6.4
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	2.2	1.4	2.3
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	4.5	4.3
Vietnam	7.7	8.4	7.8	7.4

Nominal GDP (US$ bn)

	2004	2005	2006f	2007f
Australia	637.4	705.4	725	715.9
Cambodia	4.9	5.2	5.4	5.6
China	1931.0	2175.6	2437.4	2680.8
Hong Kong	165.7	173.6	185.7	196.8
India+	670	753	845	935
Indonesia	257.6	300	345	390
Japan	4674.7	4672.3	4765.7	4813.4
Korea	681.5	799.7	847.7	890.1
Malaysia	117.7	125	136	146
New Zealand	97.9	108.6	99.2	91.1
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	195	208
Vietnam	45.3	53.1	61.3	69.6

Inflation (%)

	2004	2005	2006f	2007f
Australia	2.3	2.7	2.9	2.7
Cambodia	3.8	5.8	5.3	5.0
China	3.9	1.8	2.5	3.0
Hong Kong	0.0	0.8	1.8	1.5
India+	3.8	4.1	4.5	3.5
Indonesia	6.1	10.4	12.7	7.7
Japan	0.0	-0.2	0.2	0.9
Korea	3.6	2.8	3.1	3.8
Malaysia	1.4	3.1	4.0	3.0
New Zealand	2.3	3.0	3.2	2.4
Philippines	5.9	7.7	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	4.5	4.8	3.0
Vietnam	7.8	8.2	6.0	4.5

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	-1.3	-0.5
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	4.2	3.6
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	-2.3	-2.9

Current Account (% of GDP)

	2004	2005	2006f	2007f
Australia	-6.3	-6.0	-5.4	-6.0
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	1.2	0.5	1.2	1.6
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	-9.2	-9.3
Philippines	2.6	2.0	2.0	1.8
Singapore	26.1	28.5	24.0	22.0
Taiwan	5.8	3.4	3.1	2.5
Thailand	4.1	-1.4	-1.1	-1.0
Vietnam	-2.1	-2.7	-3.6	-4.0

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	6.4	9.2	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

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
Aa1	Belgium	**AA+**	Belgium **New Zealand**
Aa2	Italy	**AA**	
Aa3	Cayman Islands **Taiwan**	**AA-**	**Hong Kong** Italy **Japan** **Taiwan**
A1	Czech Republic **Hong Kong** Hungary Macau Qatar UAE	**A+**	Qatar Kuwait
A2	**China** Cyprus Israel Kuwait Poland	**A**	Chile Cyprus **Korea** Saudi Arabia
A3	**Korea** **Malaysia** Saudi Arabia	**A-**	**China** Czech Republic Hungary Israel **Malaysia**
Baa1	Chile Mexico South Africa **Thailand** Oman	**BBB+**	Oman Poland **Thailand** South Africa
Baa2	Mauritius Tunisia Russia	**BBB**	Mexico Tunisia Bulgaria Russia
Baa3	El Salvador **India** Jordan Bulgaria	**BBB-**	Romania

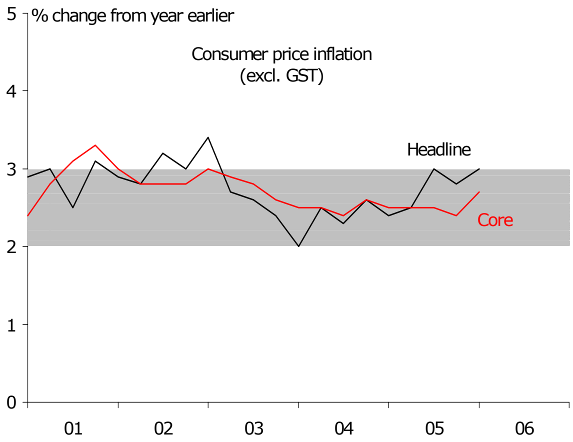
Sub-Investment Grade

Moody's		S&P	
Ba1	Costa Rica Egypt Morocco Panama Romania	**BB+**	Egypt El Salvador **India** Morocco
Ba2	Colombia Fiji Guatemala	**BB**	Colombia Costa Rica Jordon Panama Peru Brazil
Ba3	Peru **Vietnam** Brazil Turkey	**BB-**	Cook Islands Guatemala **Philippines** Serbia Turkey Venezuela Ukraine **Vietnam**
B1	Papua New Guinea **Philippines** Suriname Ukraine	**B+**	Ghana **Indonesia** Pakistan
B2	Honduras **Indonesia** Pakistan Venezuela	**B**	Papua New Guinea Uruguay Argentina
B3	Argentina Bolivia Lebanon Uruguay	**B-**	Bolivia Lebanon Paraguay Suriname
Caa1 and below	Cuba Ecuador Nicaragua Paraguay Belize	**CCC and below**	Belize Ecuador

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.

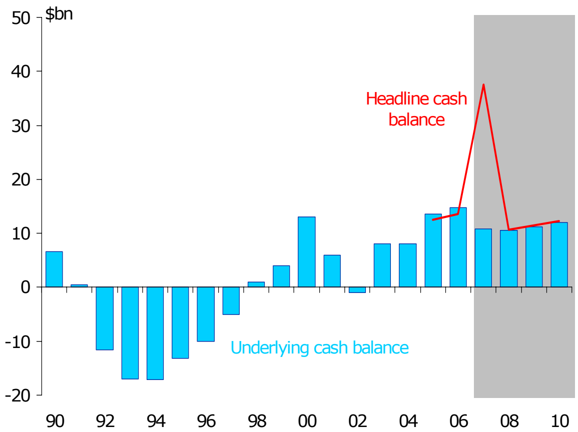
Country Update: Australia

Core inflation has risen



Source: Australian Bureau of Statistics

The Budget is in surplus



Source: Budget Papers

- The RBA raised the cash rate by 25bps to 5.75% on 3 May. The move was precipitated by indications of a pick up in domestic demand in the early part of 2006 and an earlier-than-expected lift in the RBA's measure of underlying inflation to 2¾%.
- Retail sales grew by a surprisingly strong 1.4% in April. This outcome is significantly stronger than the trend of recent months and possibly overstates the underlying strength of consumer demand, given difficulties associated with seasonally adjusting for the fewer trading days in April. In any case, this result predates the latest rate rise, which, combined with higher petrol prices, is likely to take its toll on consumers' hip pockets in coming months.
- Employment fell by 3,200 in April and the unemployment rate increased back to 5.1%. The ANZ Job Advertisements Series – a key leading indicator of the labour market - points to continued soft employment outcomes in the near term. We expect the unemployment rate to rise to around 5½% over the next few months.
- The Commonwealth Budget showed a larger surplus of $14.8bn (1.5% of GDP) in 2005-06, with surpluses for 2006-07 and beyond little changed from previous forecasts at around 1% of GDP. The centerpiece of the Budget was personal income tax cuts costing $37bn over four years.
- Beyond the next few months, economic growth is expected to gather momentum. Consumer demand will be underpinned by stronger growth in disposable incomes, while the much-anticipated recovery in exports is expected to materialise as new capacity comes on stream. With core inflation now in the upper half of the target band, and the A$ expected to depreciate over the course of this year, it now seems likely that the RBA will be forced to raise rates 25bp once more by year's end.

Mark Rodrigues

Economic data – Australia

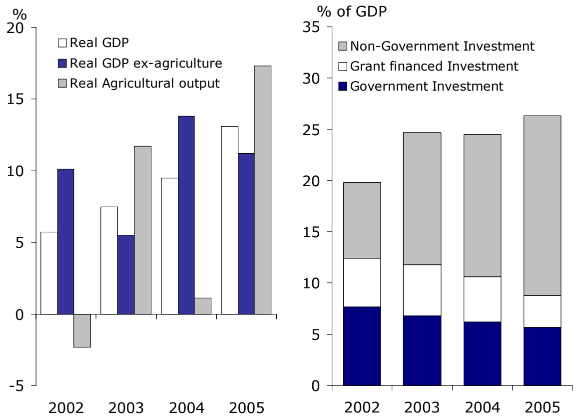
Monthly data	Sep 05	Oct 05	Nov 05	Dec 05	Jan 06	Feb 06	Mar 06	Apr 06
Building Approvals, 000's	12.4	12.3	12.7	12.3	12.0	12.2	12.5	12.1
Retail Sales, % YOY	2.3	3.1	3.1	4.0	4.6	4.6	4.8	7.4
Exports, % YOY	11.0	14.3	15.8	24.1	13.4	24.4	19.3	14.6
Imports, % YOY	5.4	5.6	11.6	11.2	13.0	10.1	9.9	13.1
Trade Balance, AUD bn	-1.61	-1.33	-2.40	-0.98	-2.4	-0.43	-1.51	-1.09
Foreign Exchange Reserves, US$ bn	35.9	41.2	42.9	43.3	43.7	41.4	44.3	48.5
Quarterly data	**Jun 04**	**Sep 04**	**Dec 04**	**Mar 05**	**Jun 05**	**Sep 05**	**Dec 05**	**Mar 06**
Real GDP, % YOY	4.7	3.4	2.0	1.9	2.6	2.5	2.7	n/a
- Private consumption	6.4	5.7	4.4	3.6	3.3	2.8	2.9	n/a
- Government consumption	3.3	4.0	3.7	2.9	3.6	2.3	4.2	n/a
- Gross fixed capital expenditure	10.8	6.9	5.2	2.6	7.6	9.2	7.8	n/a
Consumer Price Index, % YOY (nsa)	2.5	2.3	2.6	2.4	2.5	3.0	2.8	3.0
Current Account, AUD bn	-12.1	-14.1	-16.2	-15.1	-12.1	-13.7	-14.4	n/a
Capital Account, AUD bn (nsa)	11.3	15.6	15.7	14.8	11.0	15.9	14.1	n/a

Sources: Australian Bureau of Statistics, RBA.

Note: data seasonally adjusted unless otherwise stated

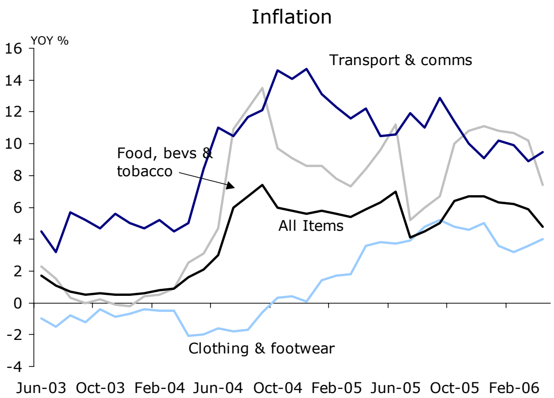
Country Update: Cambodia

GDP reliant on agriculture, driven by investment



Source: IMF

Inflation down on lower food prices



Source: National Institute of Statistics (NIS) of Cambodia

- It has been reported by the IMF that the Cambodian economy is estimated to have grown by 13.1% in 2005. Favourable weather and improved productivity have driven a revival of growth in the agricultural sector, which contributed significantly to the result (agriculture accounts for around 30% of the economy). Construction, tourism and the garments trade all added to stronger growth. The IMF expects growth to moderate in 2006 to around 5% as agricultural growth normalises.

- Total domestic investment has continued to perform strongly, rising to over 25% of GDP, targeted primarily at developing industry and infrastructure. Government investment has fallen slightly, as a percentage of GDP, as the Cambodian government shows fiscal restraint in an effort to improve the current budget deficit. However, this restricted expenditure growth did not extend to social spending as the government continues its commitment to reduce poverty. The most significant area of investment, in terms of size and growth, is non-government investment, the majority of which has been sourced from overseas. The bulk of these funds are directed into principal industries, predominantly the garment and tourism sectors. Foreign direct investment quadrupled in 2005 to US$1.1 bn, up from US$230mn in 2004. Grant-financed investment (from overseas donors) is also important for the development of Cambodia. However, this too is decreasing as a proportion of GDP.

- The better-than-expected agricultural performance in 2005 has begun to flow through to food prices in the first few months of 2006. The fall in the price of food has occurred primarily in prices of rice and other crops, whereas meat prices have remained relatively stable. However, due to the presence of bird flu both chicken prices and the prices of alternate meats such as fish remain elevated. Transport remains a significant source of inflationary pressure due to the relatively high and volatile world oil price.

Alex Joiner

Economic data – Cambodia

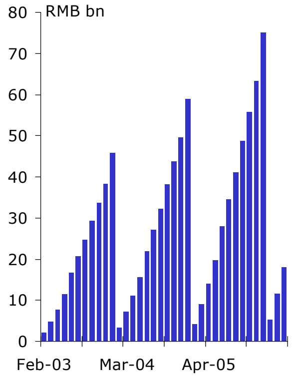
Monthly data	Sep 05	Oct 05	Nov 05	Dec 05	Jan 06	Feb 06	Mar 06	Apr 06
Consumer Price Index, % YOY	5.0	6.4	6.7	6.7	6.3	6.2	5.9	4.8
-Transport & Communication	12.9	11.4	10.0	9.1	10.2	9.9	8.9	9.5
-Food & Beverages	6.7	10.0	10.8	11.1	10.8	10.7	10.2	7.4
Exports, % YOY	22.9	17.8	13.0	15.7	n/a	n/a	n/a	n/a
Imports, % YOY	4.7	11.0	13.8	29.4	n/a	n/a	n/a	n/a
Trade Balance, US$ mn	-65.6	-91.9	-89.3	-86.7	n/a	n/a	n/a	n/a
Foreign Exchange Reserves, US$ mn	930.6	942.2	929.2	952.7	959.1	981.9	n/a	n/a
Tourist Arrivals, % YOY	37.8	41.9	26.8	34.5	17.5	21.1	14.3	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

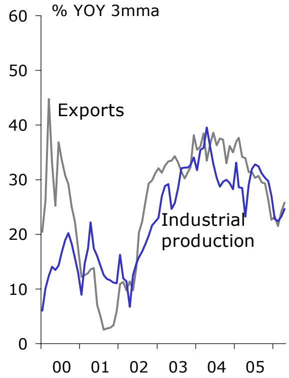
Country Update: China

Fixed asset investment is still growing strongly

Fixed asset investment, cumulative



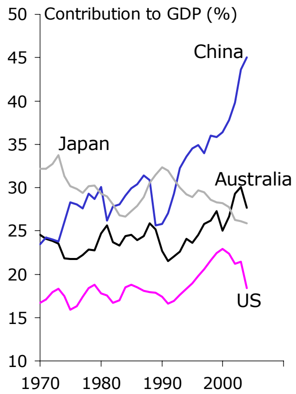
Exports and IP



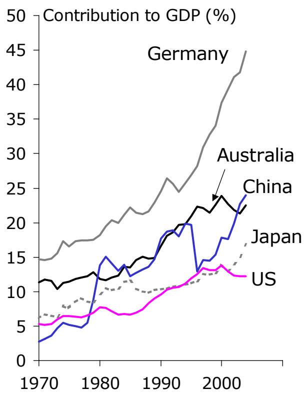
Source: Datastream, Economics@ANZ

And is a main growth driver

Gross fixed capital formation



Exports



Sources: UN Statistics Database, Economics@ANZ

- Real GDP growth for the first quarter was revised up to 10.3% YOY from 10.2% previously, confirming once again that the economy is steaming along. The authorities remain rightly concerned about excessive investment, with fixed asset investment up 28.4% YOY in April (cumulative measure) and industrial production up 24.6% YOY (unadjusted).
- The authorities responded to the strong first quarter result and April data by announcing a new round of tightening measures. The lending rate was raised by 27 bps to 5.85%, with deposit rates left unchanged. New taxes and charges have been levied on property transactions in order to cool what the authorities consider to be the main recipient of investment inflows; the CBRC guidelines for lending to overheated sectors were reinforced.
- Consumption indicators in April were mixed, with retail sales still at 13% YOY while import growth fell to below 20% for the first time in a year. Imports tend to be the most reliable indicator of domestic demand. Certainly, a continued trend of strong investment and weak consumption is not what the authorities are after, but they still have little choice but to try to slow investment. Continued weak consumption data could see more efforts to boost demand through fiscal stimulus.
- We had forecast a rate rise as of August and have retained it, so now anticipate a 6.12% lending rate by year-end. There is also ongoing speculation about an increase in reserve requirements to help tighten liquidity. Our forecast calls for growth to slow to 9.3% YOY by Q4 2006, with inflation rising from 1.2% in April to above 3% in the next few months.
- After appreciating consistently at a rate of 0.2% per month since the beginning of the year, the RMB took a breather and actually depreciated against the US dollar in the last half of May, ending the month at USD/RMB8.025 as against USD/RMB8.014 at the end of April. We expect appreciation to resume and for the exchange rate to settle below USD/RMB8.0 this month.

Amy Auster

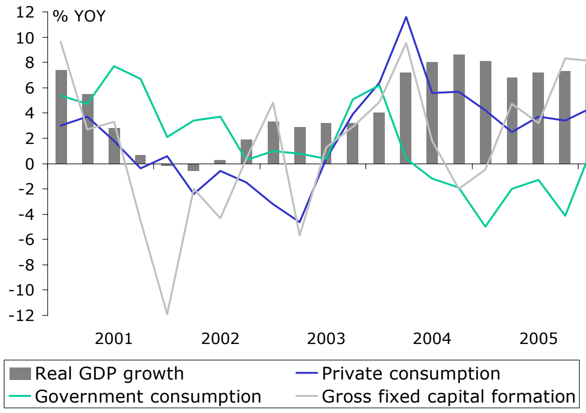
Economic data – China

Monthly data	Sep 05	Oct 05	Nov 05	Dec 05	Jan 06	Feb 06	Mar 06	Apr 06
Retail Sales, % YOY	12.7	12.8	12.4	12.5	15.5	9.4	13.5	13.6
Consumer Price Index, % YOY	2.0	1.2	1.3	1.6	1.9	0.9	0.8	1.2
Exports, % YOY	25.8	29.6	18.6	18.2	28.4	22.2	28.3	23.9
Imports, % YOY	23.3	23.4	21.0	22.2	25.3	29.5	21.1	15.3
Trade Balance, US$ bn	7.6	12.0	10.5	11.0	9.7	2.44	11.19	10.46
Foreign Exchange Reserves, US$ bn	769.0	784.9	794.2	818.9	845.18	853.67	875.07	n/a
Quarterly data	**Jun 04**	**Sep 04**	**Dec 04**	**Mar 05**	**Jun 05**	**Sep 05**	**Dec 05**	**Mar 06**
Real GDP, % YOY	9.6	9.1	9.5	9.9	10.1	9.8	9.9	10.3
- Primary sector	4.9	5.5	6.3	4.6	5.0	5.0	5.2	4.5
- Secondary sector	11.5	11.1	11.1	10.9	11.0	10.9	11.4	12.5
- Tertiary sector	8.1	8.1	10.0	9.7	9.8	10.0	9.6	8.9
Nominal GDP, US$ bn	455.1	473.8	567.8	565.1	580.2	608.5	470.1	n/a
Current Account, US$ bn	51.6	76.1	100.8	125.7	137.8	154.1	174.0	184.2
FDI (actual), US$ bn*	19.1	14.8	15.3	13.4	15.2	14.7	17.7	14.3

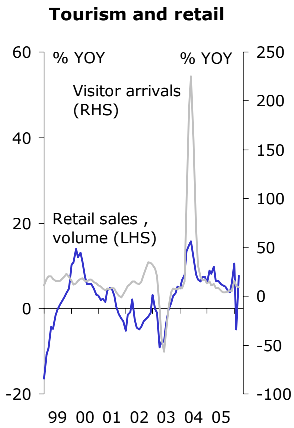
Sources: Datastream, Bloomberg * - Quarterly sum

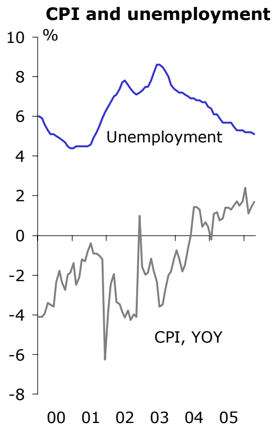
Country Update: Hong Kong

First quarter GDP saw rising investment and private consumption



Conditions still seem supportive of demand





Source: Datastream, Economics@ANZ

- Real GDP growth rose 1.2% QOQ and 8.0% YOY in the first quarter, a marginal deceleration from quarterly growth of 1.8% in the fourth quarter of 2005. Private consumption softened to 1.1% QOQ (4.4% YOY) growth from 1.7% QOQ in the fourth quarter of last year, but still appears robust in the face of higher energy prices and interest rates. Government consumption turned positive again, up 3.2% QOQ and 1.2% YOY after four consecutive quarters of flat to negative growth, while gross fixed capital formation recorded its second consecutive quarter of above 8% growth. Exports remained strong, and net exports made a positive contribution to growth in the quarter.
- With our Fed funds forecast having moved to 5.5% as of August, we have now pencilled in more rate hikes for the HKMA, to a base rate of 7% as of August. Although the prime rate may lag a base rate rise now forecast for June, it seems unlikely that the prime rate can remain at 8% through two more rate rises; a peak rate of at least 8.25% seems more likely. Headline CPI has risen by 0.3% MOM for two months in a row, bringing annual inflation to 1.7%, while unemployment actually declined from 5.2% to 5.1% in April.
- Hong Kong's externally-oriented data confirms growing ties to the mainland and China's continued strength. Exports were up 10% YOY in April, as were visitor arrivals. Visitor arrivals from China are up on average 13.7% YOY for the first four months of the year as against a rise of only 3.7% on average for all of 2005.
- Retail sales remain quite robust, up 8.3% YOY in the first quarter. The unexpected drop in unemployment attests to the strength of the economy. Nonetheless, demand should soften with a lagged response to higher rates and energy prices.
- The ongoing movement of the RMB toward the Hong Kong dollar's US exchange rate of USD/HKD7.78 has raised speculation about a unified exchange rate. We do not anticipate such a move in the next few years.

Amy Auster

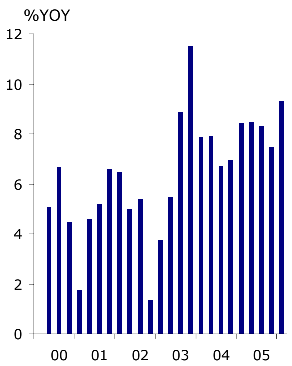
Economic data – Hong Kong

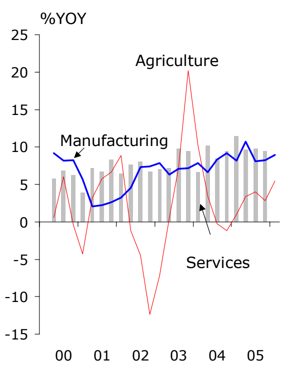
Monthly data	Sep 05	Oct 05	Nov 05	Dec 05	Jan 06	Feb 06	Mar 06	Apr 06
Visitor Arrivals, %YOY	5.9	6.2	5.6	5.5	15.6	10.6	14.8	9.5
Retail Sales, % YOY	4.9	4.8	4.1	6.8	11.6	-3.2	8.98	n/a
Consumer Price Index, % YOY	1.3	1.2	1.1	1.3	1.5	1.1	1.4	1.7
Exports, % YOY	17.5	12.1	11.8	7.0	4.7	21.1	15.3	n/a
Imports, % YOY	15.7	10.1	13.9	11.0	1.2	28.9	16.6	n/a
Trade Balance, US$ bn	-0.5	0.4	-0.5	-2.2	0.6	-3.0	2.4	n/a
Foreign Exchange Reserves, US$ bn	122.8	121.9	122.4	124.3	127.8	125.7	125.9	127
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	42.7	44.3	44.9	45.8	n/a
Current Account, US$ bn	0.6	6.5	7.5	4.2	4.1	5.6	6.4	n/a
Capital Account, US$ bn	0.0	-0.2	-0.1	-0.3	-0.2	-0.1	n/a	n/a

Source: Datastream

Country Update: India

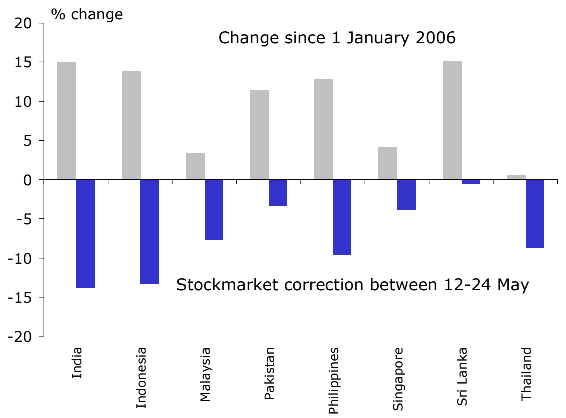
Economy powers ahead





Source: Datastream

Stockmarket suffers sharp correction in May but still up from the start of the year



- The economy grew by a strong 8.4% in FY2005/06 (April 2005-March 2006), underpinned by a strong agriculture sector, assisted by normal monsoon rains, and robust growth in services and manufacturing. The final quarter (ie. Q1 2006) saw above-expected growth of 9.3%, buoyed by bumper harvests. The outlook is for a slower, albeit healthy, pace of growth of around 7.5% in FY2006/07 reflecting the impact of higher interest rates and inflation on domestic demand as well as a high base effect.

- The level of foreign direct investment is improving but from a low base. It is currently tracking at around US$7.5 bn pa compared with an average US$3-4 bn pa over the past several years. FDI flows, however, are dwarfed by portfolio investment flows. Net portfolio equity investment in India was recorded at US$10.5 bn in 2005. There are, however, concerns over the sustainability of these capital flows.

- The recent sharp correction in global equity markets, particularly in India where the Bombay stock index (BSE) experienced the sharpest fall across Asian markets of 14% between 12-24 May 2006, underscores India's exposure to swings in portfolio capital flows. Nevertheless, the BSE Index has risen by 15% since the start of the year.

- On the political front, election results in four key states of Assam, Kerala, West Bengal and Pondicherry in April/May 2006 saw the Left Front parties emerge as clear winners, signalling the expectation that the group would exert more influence at the national level. The Indian National Congress retained power in Assam and Pondicherry. The opposition Bharatiya Janata Party suffered setbacks in the recent round of elections exacerbated by internal divisions. The pressures of coalition politics in India means that progress on economic reform is only likely to take place at a gradual pace. However, the direction of reform is clearly irreversible.

Jasmine Robinson

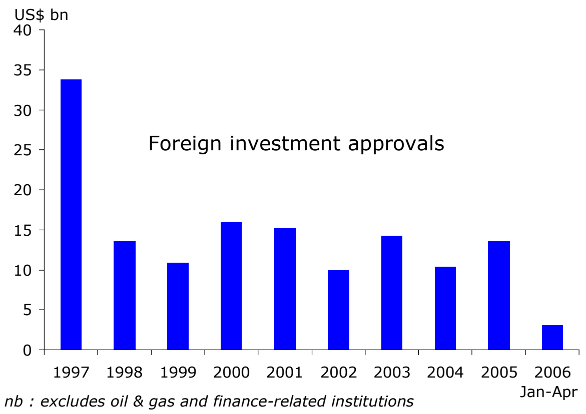
Economic data – India

Monthly data	Sep 05	Oct 05	Nov 05	Dec 05	Jan 06	Feb 06	Mar 06	Apr 06
Industrial Production, %YOY	6.8	9.6	6	5.9	8.4	8.9	8.3	n/a
Passenger car sales, % YOY	11.1	2.3	0.0	1.3	8.5	7.7	19.1	21.0
Consumer Price Index, % YOY	3.6	4.2	5.38	5.59	4.36	4.62	4.62	n/a
Exports, % YOY	17.7	35.9	0.99	21.1	25.8	17.04	28.1	27.0
Imports, % YOY	22.1	37.3	9.4	16.6	18.6	18.5	37	20.5
Trade Balance, US$ bn	-3.2	-3.3	-3.7	-2.8	-2.9	-3.2	-2.9	-4.2
Foreign Exchange Reserves, US$ bn	137.0	137.0	137	131	134	136	145	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	8.1	8.0	7.6	n/a
- Agriculture	6.6	8.0	8.1	6.8	9.9	6.7	7.1	n/a
- Industry	3.5	-0.2	-1.9	1.7	1.4	2.4	4.2	n/a
- Services	10.1	8.4	9.4	11.4	9.6	9.7	9.4	n/a
Nominal GDP, US$ bn	144.2	142.0	172.1	175.9	167.9	167.9	191.4	n/a
Current Account, US$ bn	3.4	-3.5	-5.5	0.2	-4.6	-5.1	-3.9	n/a
Capital Account, US$ bn	4.5	3.1	11.7	12.4	5.4	9.9	-0.6	n/a

Source: Datastream, Bloomberg

Country Update: Indonesia

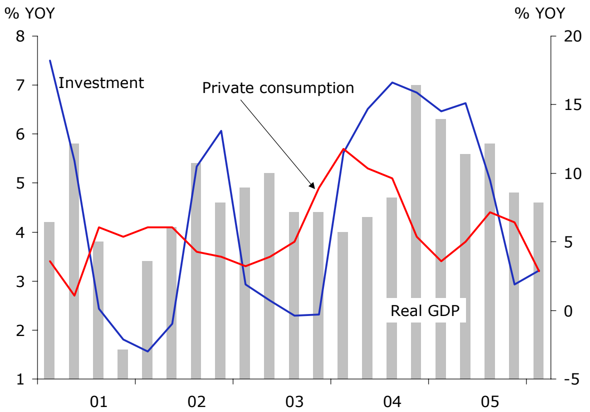
Foreign investment trends



nb : excludes oil & gas and finance-related institutions

Source : Investment Coordinating Board (BKPM)

Economic growth slows in the first quarter



Source : Datastream

- Just as Indonesia has been making strides in the reconstruction of tsunami-hit Aceh and recovering from the terror attack in Bali, the country has been hit again, this time by an earthquake, which struck the central Java region leaving hundreds of thousands homeless and a death toll of near 5,000. It is too early to assess the economic and fiscal impact but rebuilding activity would be positive for the economy.
- On a more positive note, Moody's upgraded Indonesia's debt rating in May, reflecting improved government finances and fiscal management. The government remains committed to fiscal discipline although the fiscal deficit is forecast to exceed 1% of GDP, due largely to high fuel prices and an expected acceleration in government spending. Government debt has dropped from 84% of GDP in 2000 to 49% of GDP in 2005. With foreign exchange reserves exceeding US$40 bn currently, and expectations that FDI inflows will help support further increases, the government is expected to prepay IMF debt of US$7.8 bn within two years. Payment was due to be completed in 2010.
- The government has made headway in improving the investment climate, completing a review of close to 90% of policy actions that it had set out to address in the first two months since the launch of its investment package in February, tackling the issue of corruption and addressing high-profile investment cases. Investment, however, is still at low levels. Actual FDI for the first four months of the year was US$2.9 bn, up 21% from the same period in 2005. FDI approvals, however, fell by 36% to US$3.1 bn during the same period.
- Indonesia posted its slowest rate of growth since Q2 2004, expanding by just 4.59% YOY in Q1 2006 after growth of 4.9% YOY in Q4 2005. High interest rates and inflation took its toll on consumer spending which slowed to 3.2% YOY from 4.2% YOY in Q4 2005.

Jasmine Robinson

Economic data – Indonesia

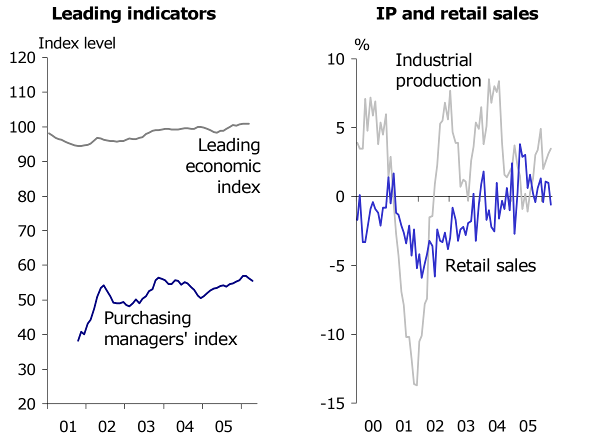
Monthly data	Sep 05	Oct 05	Nov 05	Dec 05	Jan 06	Feb 06	Mar 06	Apr 06
Industrial Production, %YOY	-1.1	-5.4	0.2	-4.7	-3.3	0.07	0.17	n/a
Motor cycle sales, % YOY	21.5	28.5	35.4	-3.0	-31.1	-9.0	-31.0	-33.5
Consumer Price Index, % YOY	9.1	17.9	18.4	17.1	17.0	17.9	15.7	15.4
Exports, % YOY	1.9	4.8	11.5	22.1	22.5	15.18	1.14	n/a
Imports, % YOY	15.3	15.3	3.7	-3.7	3.6	5.3	-12.9	n/a
Trade Balance, US$ bn	2.5	3.0	2.8	3.3	3.3	2.84	3.11	n/a
Foreign Exchange Reserves, US$ bn	28.7	31.0	31.6	33.0	33.2	33.66	38.17	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

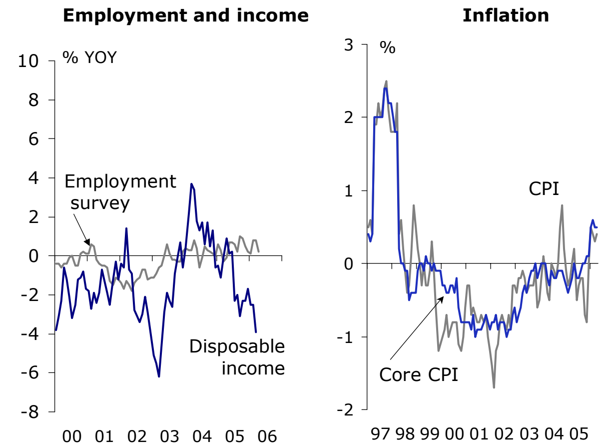
Country Update: Japan

Production is strong, consumption still slow



Source: Datastream, Economics@ANZ

But improving job growth should help



Source: Datastream, Economics@ANZ

- Real GDP growth rose 0.5% on a quarterly basis and 1.9% on an annualised basis in the first quarter, which was in line with our expectations and above market consensus. Despite higher frequency data pointing to a weaker retail sales in the first quarter, household consumption rose 2.2% YOY in the first quarter, on par with the fourth quarter of last year. Housing was surprisingly strong, up 2.9% YOY, while business investment rose 1.4% QOQ and 4.5% YOY.
- April data showed a continued trend in which business activity and corporate profits look to be strong, but with apparent lack of pass through to wages and personal consumption. Industrial production was up 3.5% YOY, with the rate of producers' shipments up 4.5% YOY and inventory accumulation rates falling to 3.0% from 3.3% the previous month. However, department store sales were down 1.6% YOY in April, and disposable income remained in decline for the first quarter.
- Stronger GDP growth and the BOJ's rapid removal of excess liquidity following the end of the quantitative easing policy in March led to market speculation of an imminent rise in the BOJ's call target rate as early as June. We still expect the move in August, after second quarter GDP data. The puzzle remains in the GDP deflator, which was a negative 0.4% QOQ and negative 1.4% YOY in the first quarter, suggesting there are still deflation pressures in the broad economy despite six consecutive months of extremely mild core consumer price inflation.
- There is interesting market activity as the BOJ sits between the end of QE and the arrival of positive interest rates. Toward the end of May, the BOJ began pumping significant liquidity into the system in order to discourage short term market rates from rising too high. The move supports our view that BOJ is not overly rushed in returning to a positive rate environment.

Amy Auster

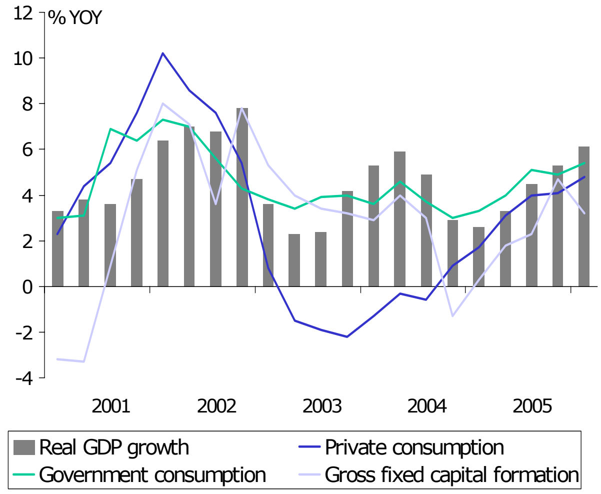
Economic data – Japan

Monthly data	Sep 05	Oct 05	Nov 05	Dec 05	Jan 06	Feb 06	Mar 06	Apr 06
Industrial Production, %YOY	0.9	2.5	3.4	4.9	2.8	2.5	3.1	3.8
Retail Sales, % YOY	0.2	-0.5	0.6	1.3	-0.4	1.1	1.1	-0.6
Consumer Price Index, % YOY	-0.3	-0.7	-0.8	-0.1	0.5	0.4	0.3	0.4
Exports, % YOY	7.8	2.3	1.4	2.9	1.4	7.5	5.9	1.9
Imports, % YOY	16.5	11.7	3.1	11.6	13.4	16.0	12.5	10.1
Trade Balance, US$ bn	8.5	7.1	5.0	7.7	-3.1	8.0	8.3	5.5
Foreign Exchange Reserves, US$ bn	824.9	823.2	824.3	828.8	832.9	831.6	832.7	839.2
Quarterly data	**Jun 04**	**Sep 04**	**Dec 04**	**Mar 05**	**Jun 05**	**Sep 05**	**Dec 05**	**Mar 06**
Real GDP, % YOY	2.7	2.3	0.5	1.1	2.7	2.7	4.0	3.0
- Private consumption	2.5	2.4	0.6	1.1	1.9	2.0	3.3	2.3
- Government consumption	2.2	1.6	1.4	1.9	1.4	2.1	1.6	0.8
- Gross fixed capital formation	0.9	1.4	-1.2	1.2	3.4	5.0	3.8	2.2
Nominal GDP, US$ bn	4643.7	4525.6	4515.0	4676.0	4766.3	4821.9	4771.2	4766.1
Current Account, US$ bn	179.1	171.4	170.2	170.9	167.9	165.5	167.4	200.4
Capital Account, US$ bn	2.7	2.3	0.5	1.1	2.7	2.7	4.0	3.0

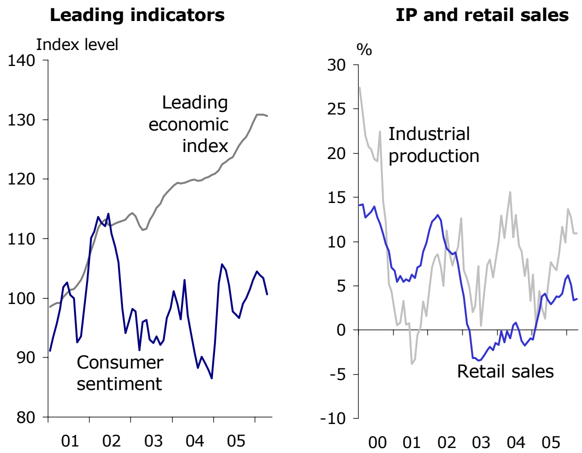
Source: Datastream

Country Update: Korea

Growth was above expectations again in Q1



Higher interest rates are softening demand



Source: Datastream, Economics@ANZ

- Real GDP rose 1.3% on a quarterly basis and 6.1% on an annual basis in the first quarter, ahead of our expectations that were in turn more bullish than the consensus. The reason for the above-expected outturn was slightly stronger private consumption (up 1.2% QOQ after a 1.1% QOQ rise in the previous quarter) as well as a 1.9% QOQ surge in government consumption. Net exports were slightly positive for the quarter.
- Activity appears to have remained strong going into the second quarter, with industrial production up 11% YOY in April, capacity utilisation at record high levels and the unemployment rate declining to 3.5% from a recent high of 4.1% in February.
- Nonetheless, there are signs that elevated energy prices and higher interest rate hikes are beginning to have effect. The leading and coincident composite indicators declined in April from March levels, while consumer sentiment declined on a monthly and annual basis for the second month in a row. Retail sales were up slightly, to 4.4% YOY after a gain of 3.6% YOY in March.
- Although the Bank of Korea seems to have signalled that it does not consider interest rates to yet be in strictly "neutral" territory, the absence of apparent inflation pressures and a strong won may allow the BOK to remain on hold. Headline and core inflation were only 0.1% MOM in April, leaving core inflation at a low 1.6% on an annual basis. Meanwhile, the won remains under USD/KRW950 despite the sell-off in Asian currencies in late May.
- The political fortunes of the government continue to wane, with local elections at the end of May expected to deliver a sharp rejection of the Uri party. The chairwoman of the opposition Grand National Party, Park Geun-Hye, was injured at an attack at an election rally in the run-up to this vote, an event that is expected to add greater support to the GNP from disenchanted voters.

Amy Auster

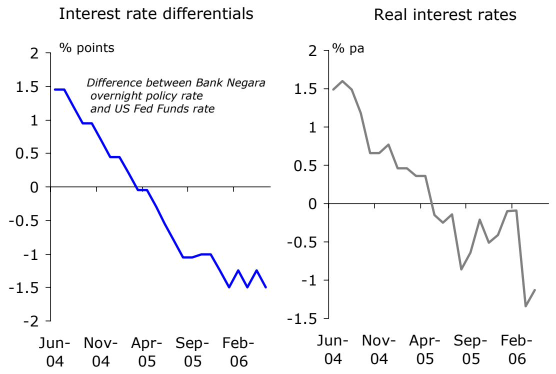
Economic data – Korea

Monthly data	Sep 05	Oct 05	Nov 05	Dec 05	Jan 06	Feb 06	Mar 06	Apr 06
Industrial Production, %YOY	7.6	8.0	11.8	11.3	6.9	20.6	10	9.5
Retail Sales, % YOY	4.2	4.7	6.7	10.7	12.3	-2.8	3.8	5.4
Consumer Price Index, % YOY	2.7	2.5	2.4	2.6	2.8	2.3	2.0	2.0
Exports, % YOY	17.7	11.9	11.9	10.5	3.5	16.6	12.2	12
Imports, % YOY	24.9	11.0	17.4	15.3	18.0	27.1	12.9	13.7
Trade Balance, US$ bn	1.8	2.7	2.0	1.4	0.3	0.4	1.1	1.5
Foreign Exchange Reserves, US$ bn	206.0	206.6	207.6	210.0	216.5	215.5	216.9	222.5
Quarterly data	**Jun 04**	**Sep 04**	**Dec 04**	**Mar 05**	**Jun 05**	**Sep 05**	**Dec 05**	**Mar 06**
Real GDP, % YOY	5.9	4.9	2.9	2.6	3.3	4.5	5.3	6.1
- Private consumption	-0.3	-0.6	0.9	1.7	3.1	4.0	4.1	4.8
- Government consumption	4.8	3.7	2.8	3.2	4.2	5.1	4.8	5.4
- Gross fixed capital expenditure	4.7	2.9	-1.1	0.4	2.0	1.9	4.2	3.4
Nominal GDP, US$ bn	166.8	170.1	181.1	192.4	197.6	197.7	199.6	n/a
Current Account, US$ bn	6.9	7.6	7.3	5.9	2.6	2.6	5.4	-1.1
Capital Account, US$ bn	-0.5	-0.4	-0.5	-0.5	-0.7	-0.6	-0.5	-0.7

Source: Datastream

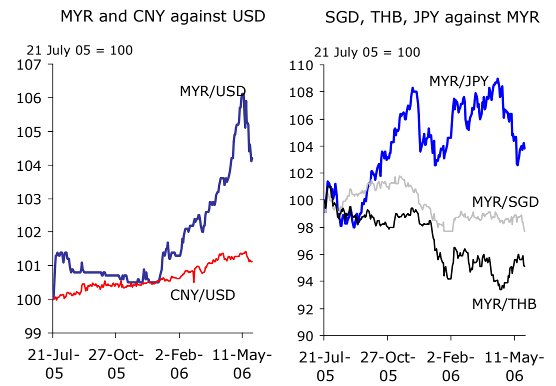
Country Update: Malaysia

Inflation expected to accelerate



Sources: Bloomberg, Datastream

Ringgit's movement against major trading partner currencies



Source: Datastream

- First quarter growth was a healthy 5.3% YOY after a 5.2% YOY gain in Q4 2005. Growth was underpinned by the manufacturing sector, which expanded by 8%.
- Bank Negara left its policy rate unchanged at 3.5% at its recent meeting. However, the central bank is expected to continue with monetary policy normalisation, hiking rates in the second half of the year. Although inflation eased to 4.6% YOY in April from 4.8% YOY in March, it still remains at near 7-year highs. Higher electricity bills with Tenaga Nasional lifting rates by an average of 12% from 1 June will keep inflation elevated.
- Real interest rates have been negative since May 2005. The outlook, nonetheless, is for an improvement in the second half when we expect inflation to ease as the effects of one-off fuel price hikes wear off. Malaysian interest rates are now below the US and the spread has widened in favour of the US.
- While real interest rates and interest rate differentials do not support currency strength, expectations of higher interest rates amidst a stronger inflation profile and relatively healthy economic growth are expected to underpin gains in the ringgit. Since the new exchange rate regime was adopted on 21 July 2005, the ringgit has strengthened by 3.7% against the US dollar – a faster pace of appreciation than the Chinese yuan of 1.1%. It breached the USD/MYR3.60 level briefly, moving to USD/MYR3.59 on 8 May but has since been trading at around USD/MYR3.65 amidst a US dollar rally.
- To some extent, the accelerated pace of ringgit appreciation reflects weakness in the US dollar. Against other major trading partner currencies, the ringgit's performance has been mixed. It weakened by about 1.3% against the Yen between March and May 2006.
- Trade trends so far this year have also underpinned currency strength and are likely to continue to do so, with exports recording healthy growth. The trade surplus for January-March 2006 was 3.3% higher than the same period in 2005.

Jasmine Robinson

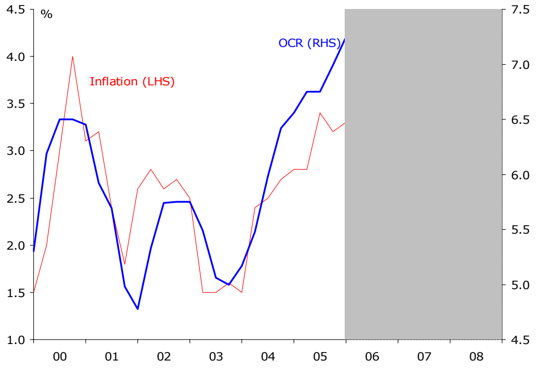
Economic data – Malaysia

Monthly data	Sep 05	Oct 05	Nov 05	Dec 05	Jan 06	Feb 06	Mar 06	Apr 06
Industrial Production, %YOY	6.3	6.3	8.5	2.2	4.7	5.8	3.6	n/a
Motor Vehicle sales, % YOY	14.7	29.1	7.7	4.9	2.9	-8.7	-9.4	-5.4
Consumer Price Index, % YOY	3.5	3.1	3.3	3.2	3.2	3.2	4.8	4.6
Exports, % YOY	8.4	13.8	12.5	13.8	11.6	17.1	12.6	n/a
Imports, % YOY	9.0	9.5	6.6	8.7	10.3	20.1	17.2	n/a
Trade Balance, US$ bn	2.0	2.8	2.3	2.5	2.3	2.0	2.6	n/a
Foreign Exchange Reserves, US$ bn	80.4	77.2	72.9	70.5	71.6	73.0	73.5	n/a
Quarterly data	**Jun 04**	**Sep 04**	**Dec 04**	**Mar 05**	**Jun 05**	**Sep 05**	**Dec 05**	**Mar 06**
Real GDP, % YOY	8.4	6.7	5.8	6.0	4.4	5.4	5.2	5.3
- Private consumption	11.9	11.2	10.2	10.1	7.4	10.4	9.0	7.5
- Government consumption	9.5	1.1	4.2	1.5	0.9	5.9	12.8	-0.5
- Gross fixed capital expenditure	3.5	3.2	2.3	2.0	6.7	9.6	0.4	11.4
Nominal GDP, US$ bn	29.3	30.1	30.7	31.1	32.0	33.5	34.0	35.2
Current Account, US$ bn	3.3	4.4	3.4	5.5	4.7	5.0	4.7	n/a
Capital & Financial Account, US$ bn	0.0	-0.9	2.7	0.9	0.1	1.6	-12.4	n/a

Sources: Datastream, Bloomberg

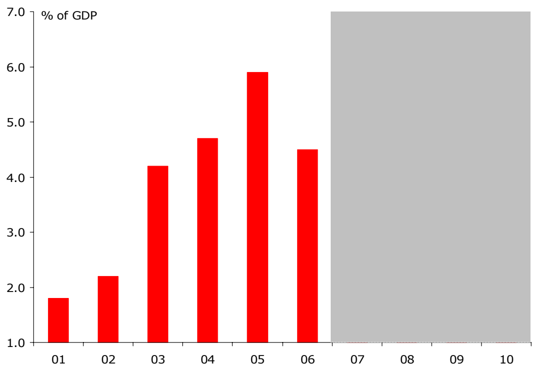
Country Update: New Zealand

OCR and Inflation



Sources: Statistics NZ; Reuters; ANZ National Bank

Fiscal operating balance



Sources: NZ Treasury; ANZ National Bank

- To regular readers, what follows will resemble the mouse on the exercise wheel…this looks familiar, this looks familiar. Inflation remains the key theme shaping the business cycle and necessitating a period of sombre growth. Monetary policy will remain in a restrictive policy setting – with the Official Cash Rate currently at 7.25% – until inflation pressure percolating within the economy subsides.
- The economy has recovered from a temporary lull in late 2005 and early 2006. Solid employment growth and retail activity underpinned activity in the first quarter of the year. However, the underlying pace of momentum remains subdued. Leading economic gauges, including business and consumer confidence, suggest growth will remain sluggish over 2006 as capacity constraints, tight financial conditions, and imbalances curtail the pace of activity.
- We continue to believe economic momentum will remain respectable at the nadir in the economic cycle, with growth troughing at around 1.5%. Corporate balance sheets and cash-flow remains strong. A lower currency will provide a strong fillip to the export sector and help restore some balance to growth.
- Modest growth will gradually remove excess demand pressure within the economy from late 2006 and allow monetary policy to begin the long journey back to a neutral policy setting. Combined with further corrective moves lower in the New Zealand dollar, easier financial conditions will lay the platform for the next upswing from late 2007.
- The 2006 Budget elicited a yawn from commentators. New Zealand's fiscal position is strong with surpluses projected out to 2009. While there were welcome spending initiatives in the form of additional funding to roading, the policy platform remains distributive as opposed to welfare enhancing. Considerable political pressure is being applied for New Zealand to follow the lead of Australia and offer lower taxes. We expect progress in this area to emerge closer to the 2008 election.

Cameron Bagrie

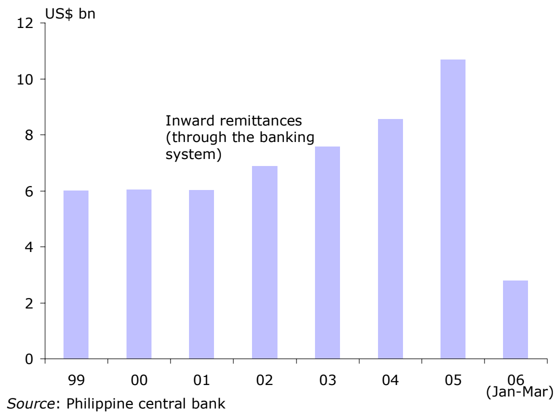
Economic data – New Zealand

Monthly data	Sep 05	Oct 05	Nov 05	Dec 05	Jan 06	Feb 06	Mar 06	Apr 06
Retail Sales, % YOY	6.9	7.0	6.7	6.4	6.4	6.3	6.1	n/a
Residential building consents (%	-15.0	-17.5	-17.8	-17.2	-15.1	-13.7	-16.1	n/a
Exports, % YOY	2.4	1.6	0.8	0.3	-0.6	-1.2	0.0	0.4
Imports, % YOY	7.1	8.0	7.9	6.8	8.5	7.8	7.7	7.7
Annual Trade Balance, US$ bn	-4.1	-4.3	-4.7	-4.6	-5.0	-5.1	-4.9	-4.7
Quarterly data	**Jun 04**	**Sep 04**	**Dec 04**	**Mar 05**	**Jun 05**	**Sep 05**	**Dec 05**	**Mar 06**
Real GDP, % YOY	4.1	4.3	4.3	3.7	3.1	2.6	2.2	n/a
- Private consumption	6.5	6.7	6.5	5.8	5.7	5.1	4.6	n/a
- Government consumption	4.9	5.4	5.7	5.2	4.9	5.6	5.3	n/a
- Gross fixed capital expenditure	15.6	15.4	13.2	7.8	4.9	4.1	4.3	n/a
Nominal GDP, US$ bn	89.4	93.6	97.9	100.5	105.1	107.8	108.6	n/a
Annual Current Account, US$ bn	-4.5	-5.6	-6.5	-7.5	-8.4	-9.2	-9.6	n/a
Consumer Price Index, annual %	2.4	2.5	2.7	2.8	2.8	3.4	3.2	3.3

Sources: Statistics NZ, ANZ National Bank

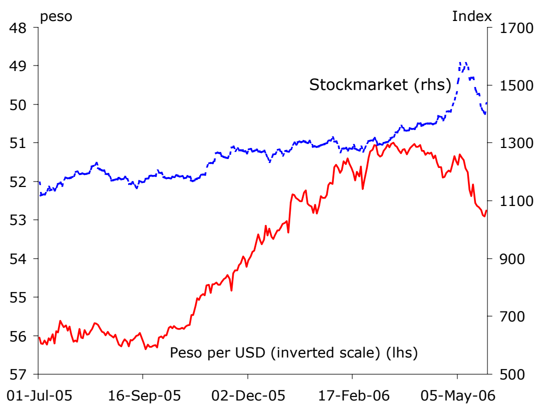
Country Update: Philippines

Remittance inflows support private consumption



Source: Philippine central bank

Financial market trends



- First quarter GDP was a lower-than-expected 5.5% YOY, as higher VAT rates and oil prices weighed on domestic demand. Private consumption rose by 1.2% YOY in Q1 2006 compared with a 1.3% YOY gain in Q4 2005. Nevertheless, consumer spending has been supported by strong remittance inflows. According to the central bank, inward remittances reached US$10.7 bn in 2005 and for the first three months of this year, inflows were US$2.8 bn, up around 15% from the same period in 2005. The amount is likely to be larger given that not all funds go through the banking system.
- The fiscal surplus for April was Ps17.6 bn, the highest monthly surplus in nine years. This was achieved largely as a result of below-target spending. Tax revenue rose by 13% compared with April 2005 to Ps71.4 bn but was under the target of Ps78.6 bn. For the first four months of this year, the fiscal deficit was Ps50 bn, an improvement of 17% from the same period last year. At this rate, the fiscal deficit for 2006 will be far below the government's target of Ps125 bn. Improving the fiscal position and reducing the public sector debt have been key to securing credit rating upgrades.
- Inflation has been below 8% since June 2005 with the average for the first four months of this year at 7.3% YOY. The government has temporarily reduced the duty levied on imports of crude oil and petroleum products in order to limit the impact of high oil prices but underlying price pressures are likely to become more evident reflecting still-high energy prices and the impact of the higher VAT rate.
- The peso, which strengthened by 8.4% against the US dollar between October 2005 and February 2006 also helped contain imported inflation. However, the currency has weakened by around 2.6% between March and May 2006. The erosion of interest rate differentials and US dollar strength across most currencies has weighed on the currency.

Jasmine Robinson

Economic data – Philippines

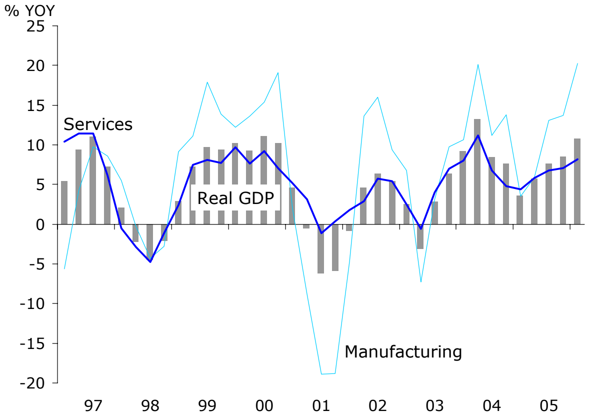
Monthly data	Sep 05	Oct 05	Nov 05	Dec 05	Jan 06	Feb 06	Mar 06	Apr 06
Manufacturing Production, %YOY	-4.5	7.3	10.8	0.4	-9.4	-12.1	-6.6	n/a
Motor Vehicle sales, % YOY	10.2	12.8	-4.0	11.2	19.9	-12.7	-3.8	-12.3
Consumer Price Index, % YOY	7.0	7.0	7.1	6.7	6.7	7.6	7.6	7.1
Exports, % YOY	1.0	-3.2	-1.5	16.8	1.2	14.9	26.3	n/a
Imports, % YOY	17.7	-3.1	1.4	28.9	5.0	4.6	8.0	n/a
Trade Balance, US$ mn	-440.0	-248.0	-79.0	-382.0	-354.0	89.0	-12.0	n/a
Foreign Exchange Reserves, US$ bn	15.9	15.5	15.4	15.8	17.7	17.9	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	4.0	3.6	4.3	-8.1	-3.9	-2.1	-1.4	-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

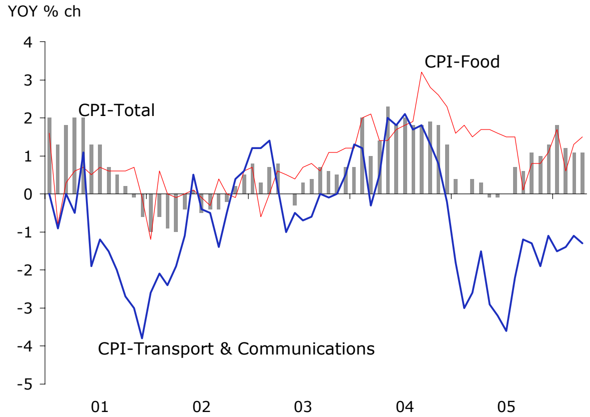
Country Update: Singapore

Economic growth strengthens further in Q1 2006



Source : Datastream

Inflation trends



Source: Datastream

- The ruling People's Action Party (PAP) maintained its overwhelming parliamentary majority in the 6 May elections, securing 82 of the 84 seats. It, however, lost some ground in terms of its share of total votes, garnering only 67% of the votes, down from 75% in the 2001 elections. While the PAP's strong mandate ensures continued political stability and prudent economic management, the reduced electoral support and increased majorities secured by the two opposition wards suggest that the party has its work cut out for it in its bid to address growing public disenchantment.
- Growth in the first quarter eclipsed China's, with real GDP expanding by 10.6%, the strongest pace since Q2 2004. On the production side, the manufacturing sector posted robust growth of 20% YOY, stronger that the 14.2% YOY for previous quarter. Wholesale and retail trade also recorded double-digit growth of 14.8% YOY. The robust outcome prompted an upward revision to the official growth forecast to 5-7% from 4-6% for 2006. We have lifted our forecast to 7%. The healthy global outlook and strong electronics demand are expected to underpin growth in the manufacturing sector in coming quarters. The services sector is also expected to receive a boost from major events such as the IMF/World Bank meetings in September and Singapore recently being ranked as the world's second "Top Convention City" for the second successive year.
- The strong GDP result lends further support to the Singapore dollar, which has risen by 5.4% against the US dollar since the start of the year. The appreciating currency has helped to contain imported inflation with latest data suggesting that consumer prices are under control. Annual inflation was 1.1% YOY in April, bringing the average for the first four months to 1.3% YOY. However, high petrol prices, low unemployment (2.6% as of March 2006) and a pick-up in wage growth will continue to underpin upside risks to inflation.

Jasmine Robinson

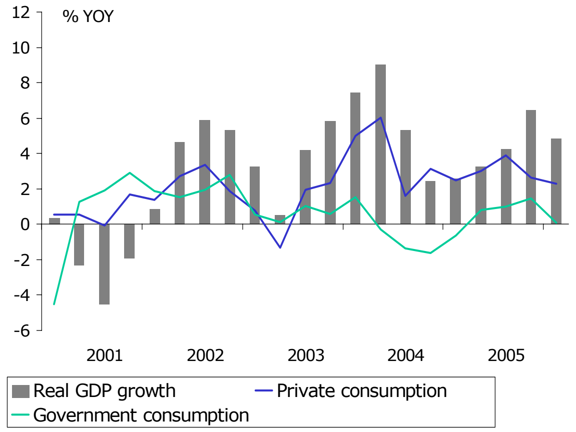
Economic data – Singapore

Monthly data	Sep 05	Oct 05	Nov 05	Dec 05	Jan 06	Feb 06	Mar 06	Apr 06
Industrial Production, %YOY	22.3	18.9	21.1	5.4	1.8	37.2	26.1	3.0
Retail Sales, % YOY	8.8	6.3	6.4	7.4	-0.5	10.6	12.1	n/a
Consumer Price Index, % YOY	0.6	1.1	1.0	1.3	1.8	1.2	1.1	1.1
Exports, % YOY	11.0	16.9	18.1	20.2	18.6	30.7	20.8	16.0
Imports, % YOY	15.6	20.3	13.1	19.0	10.4	40.3	12.5	13.5
Trade Balance, US$ bn	2.8	2.2	3.2	3.8	3.1	1.9	3.8	2.7
Foreign Exchange Reserves, US$ bn	115.6	115.7	114.6	115.8	119	119.0	121.4	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

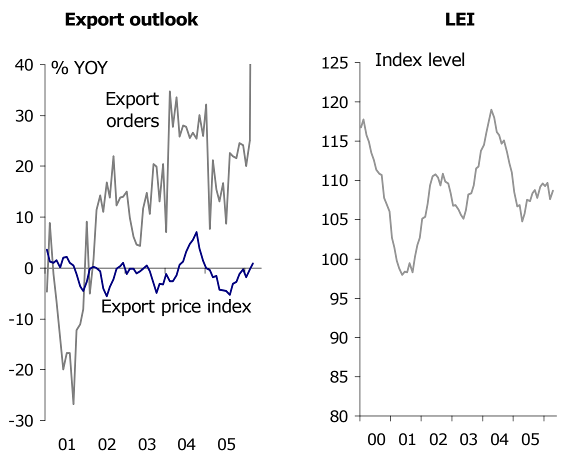
Sources: Bloomberg, Datastream, Economic Survey of Singapore

Country Update: Taiwan

Downturn in government consumption hit GDP results for first quarter



Conditions still positive for manufacturing sector



Source: Datastream, Economics@ANZ

- First quarter GDP growth was -0.07% QOQ and 4.8% YOY, considerably below our forecast. While private consumption was above our expectations at 2.3% YOY growth, investment fell 4% on an annual basis and there was a sharp, unexpected drop in government consumption of 20% on a quarterly basis. Assuming the pattern of government consumption normalises in the following quarters, we still expect GDP growth to reach 5% this year. The government has revised up its growth projection from 4.2% to 4.3% this year.
- Export orders fell 0.8% on a monthly basis but were up 19% YOY, pointing toward continued strength in exports and production in the months ahead. Moreover, the export price index remained in positive territory in annual terms for the second month in a row, after falling consistently through 2005. Taiwan's industrial production volume index was up 5.5% YOY in April and 7.8% on average for January-April.
- Consistent with the upturn in industrial activity, unemployment has fallen to a 5-year low of 3.78%. Unit labour costs remain in decline, however, with average wages across industry and construction essentially flat for the year thus far.
- Low wage rises are keeping the lid on consumption and inflation, with retail sales also seemingly flat for the year and CPI ex energy and food contained below 1% YOY. Headline inflation has drifted down to only 0.3% YOY in April after a peak of 2.6% YOY in January. The central bank's slight rate increase to 2.375% in March seems to have had effect, and money market rates continue to drift higher to reach 1.7% in April versus 1.65% in March.
- The initial image of the Democratic Progressive Party as free from corruption and nepotism is being tarnished by an unrelenting series of scandals. This month, President Chen's son-in-law and four family members were questioned in relations to allegations of insider trading.

Amy Auster

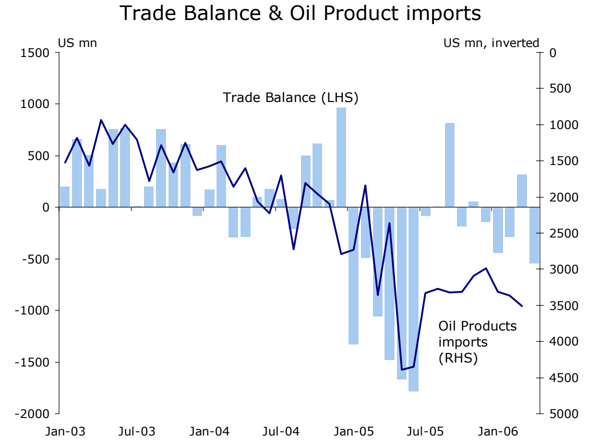
Economic data – Taiwan

Monthly data	Sep 05	Oct 05	Nov 05	Dec 05	Jan 06	Feb 06	Mar 06	Apr 06
Industrial Production, %YOY	7.7	8.5	9.5	9.3	4.1	14.1	7.7	5.5
Retail Sales, % YOY	7.6	3.5	4.0	7.1	6.2	-1.7	n/a	n/a
Consumer Price Index, % YOY	3.2	2.7	2.5	2.2	2.7	1.0	0.4	1.2
Exports, % YOY	7.2	15.6	9.6	15.6	5.0	24.9	7.2	15.4
Imports, % YOY	7.6	8.1	4.5	-10.6	-6.6	45.3	-0.5	5.3
Trade Balance, US$ bn	1.4	2.2	2.1	3.6	2.3	-0.6	1.5	2.3
Foreign Exchange Reserves, US$ bn	253.8	252.0	251.8	253.3	257.3	257.0	257.1	259.0
Quarterly data	**Jun 04**	**Sep 04**	**Dec 04**	**Mar 05**	**Jun 05**	**Sep 05**	**Dec 05**	**Mar 06**
Real GDP, % YOY	7.8	8.9	5.3	2.5	2.3	3.2	4.3	6.5
- Private consumption	5.1	5.9	1.6	3.1	2.5	3.1	3.8	2.7
- Government consumption	1.4	-0.2	-1.4	-2.0	-0.6	0.9	1.0	1.5
- Gross fixed capital expenditure	15.2	24.1	15.5	15.7	8.8	7.9	0.2	-13.8
Nominal GDP, US$ bn	79.4	80.6	80.0	82.1	86.3	86.9	86.7	86.0
Current Account, US$ bn	5.9	5.5	5.3	1.7	4.4	1.8	1.0	9.2
Capital Account, US$ bn	-5.7	-5.0	-4.8	-4.4	-4.6	-3.4	-2.9	-7.6

Sources: Bloomberg, Datastream, National Statistics

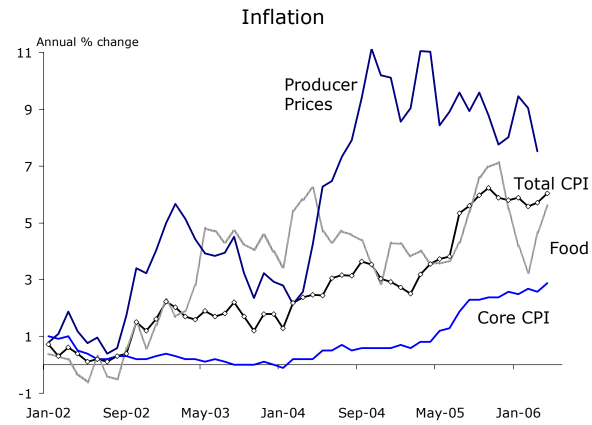
Country Update: Thailand

Trade Balance suffers under weight of oil imports



Source: Datastream

Inflationary pressure remains



Source: Datastream

- Thailand recorded a half billion-dollar trade deficit in April as high oil prices continue to weigh heavily on imports. With the Tapis oil price averaging over US$74.70/bbl in May (after US$74.20/bbl in April), it is expected that the deficit will persist into the second quarter. This is despite a strong export growth performance. For the first 4 months of this year, export growth averaged 16%YOY, compared with imports averaging 5.9%YOY. However, Thailand's oil products bill has doubled since 2004, blunting any positive impact of export growth on GDP. Combined with slowing visitor arrivals, it is expected that the current account will return to deficit in April for the first time in 10 months. The decline in the current account, higher interest rates dampening consumption and ongoing political uncertainty has led Bank of Thailand to suggest that GDP growth may slow to 4.25% in 2006.
- Inflation continues to edge up reaching 6%YOY in April with food prices contributing significantly to the result. With producer price inflation remaining high and pass-through to core prices evident, upward pressures on prices remains despite recent interest rate rises.
- The political situation in Thailand remains in limbo. Incumbent Prime Minister Thaksin has resumed his post after a 49-day absence that resulted in charges of dereliction of duty being brought against him. With the 2nd April election annulled, new elections are due later this year. However, there is increasing concern that the uncertainty is damaging the Thai economy with loss in confidence impeding private and foreign investment. The lack of governance has already delayed the US$44bn public infrastructure spending project with foreign investors unlikely to make any further commitment to the projects until the election of a new government. Also delayed are the free trade agreements Thailand was pursuing with its two major trading partners, the US and Japan.

Alex Joiner

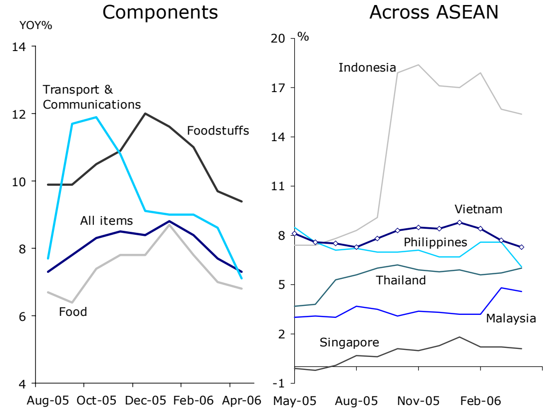
Economic data – Thailand

Monthly data	Sep 05	Oct 05	Nov 05	Dec 05	Jan 06	Feb 06	Mar 06	Apr 06
Manufacturing Production, %YOY	11.1	8.0	7.8	5.8	5.8	12.8	8.4	n/a
Car Sales, % YOY	7.9	3.7	8.3	6.4	-2.8	13.3	-2.2	n/a
Consumer Price Index, % YOY	6.0	6.2	5.9	5.8	5.9	5.6	5.7	6.0
Exports, % YOY	23.2	8.4	14.5	11.6	13.6	22.8	15.9	11.7
Imports, % YOY	20.6	18.8	14.8	27.9	2.0	19.0	1.3	0.3
Trade Balance, US$ bn	0.8	-0.2	0.1	-0.1	-0.4	-0.3	0.3	-0.6
Foreign Exchange Reserves, US$ bn	48.5	48.5	49.4	50.7	51.7	52.9	53.7	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	5.5	3.3	4.5	5.4	4.7	n/a
- Private consumption	6.2	5.9	5.2	4.4	4.8	4.4	4.1	n/a
- Government consumption	5.9	1.6	3.7	16.9	8.6	16.5	7.1	n/a
- Gross fixed capital expenditure	13.2	10.5	15.8	14.9	14.7	8.6	7.6	n/a
Nominal GDP, US$ bn	40.1	39.8	41.8	43.8	43.3	44.1	45.2	n/a
Current Account, US$ bn	0.6	1.3	2.9	-1.4	-4.5	1.2	0.9	n/a
Capital & Financial Account, US$ bn	0.3	0.2	0.5	0.1	4.3	1.4	0.8	n/a

Sources: Bloomberg, Datastream, ANZ Bank

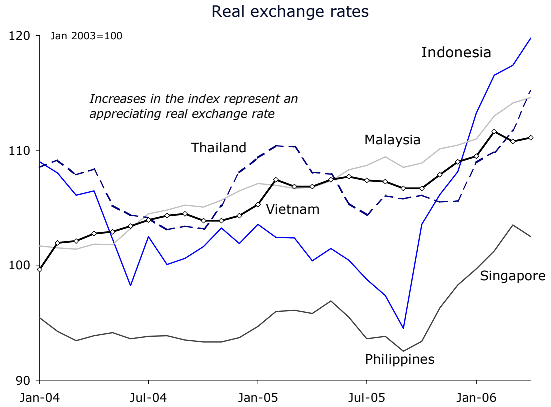
Country Update: Vietnam

Inflation continues to moderate but remains above ASEAN average



Source: General Statistics Office of Vietnam

Inflation may be eroding trade competitiveness



Source: Economics@ANZ, Datastream,

- Vietnam's inflation rate has fallen to 7.3%YOY in April from a peak rate of 8.8% in January 2006, driven by lower food prices and transportation costs. However, Vietnam's inflation remains high compared to its ASEAN neighbours. This could see an erosion of trade competitiveness despite the government's policy of a gradual 1-2% per annum depreciation of the nominal currency. The policy of both the State Bank of Vietnam and the government to gear towards the inflation rate target of 7% for 2006. To that end, the State Bank of Vietnam lifted interest rates by around 50bps bringing the base lending rate to 8.25% and the refinancing and discount rates to 6.5% in late 2005. However, data released thus far suggest that there has been little reduction in credit and M2 growth, which the government is looking to rein in, in order to dampen inflationary pressure. Although, it is reported that a significant contributor to this growth has been due to increases in foreign currency inflows.

- Vietnam's reliance on imported fuel products continues to create inflationary and budgetary pressures. Due to fiscal constraints the government is unlikely to raise fuel subsidies (costing around US$628mn in 2005) leaving the retail market under pressure from oil price fluctuations. In late April, the government was forced to raise premium petrol prices by VND1,500/litre to around VND11,000/litre, after initially indicating no increase would take place. The price rise was to alleviate the pressure on the many state-owned petroleum importers who are making combined losses of around US$5mn per day selling their product at state-sanctioned price levels. The government had initially sought to reduce this burden by removing the fuel import duty to avoid the inflationary impact of a price hike.

- The changing pattern of consumption in Vietnam has prompted a re-weighting of the basket of goods used to calculate the CPI. Around 100 items will be added to the basket, bringing the overall number to 500. Significantly, this move reduces the weight of food from 47.9% to 42.8% and is expected to slightly diminish the influence of seasonal impacts on inflation.

Alex Joiner

Economic data – Vietnam

Monthly data	Sep 05	Oct 05	Nov 05	Dec 05	Jan 06	Feb 06	Mar 06	Apr 06
Industrial Production+, %YOY	16.0	18.1	16.5	16.7	15.7	15.8	12.8	15.6
Retail Sales+, % YOY	19.0	19.1	19.7	20.0	24.8	19.2	19.3	19.4
Consumer Price Index, % YOY	7.5	7.3	7.8	8.3	8.8	8.4	7.7	7.3
Exports+, % YOY	18.1	18.7	21.1	21.9	16.0	28.3	20.3	25.1
Imports+, % YOY	20.5	20.0	19.2	18.3	10.8	4.2	1.9	6.9
Trade Balance*, US$ bn	-3.5	-3.8	-3.9	-4.1	0.35*	0.2	0.05	0.2
Tourist Arrivals+, %YOY	23.8	22.7	20.6	20.3	15.9	15.1	16.3	15.9
China, number of visitors*	478,195	527,138	559,790	621,786	69,569*	96,277	142,664	210,348
Quarterly data	Growth Q1-Q4 2005			Contributions to Growth				
Real GDP+, % YOY		7.2						
Agriculture, forestry, fishery, %		2.1			1.0			
Industry & construction, % YOY		8.7			3.1			
Services, % YOY		7.4			3.1			

+: January-to date vs same period in previous year *: January to date ^: US$ bn
Source: General Statistics Office of Vietnam

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