Economics@ANZ

ANZ International Economics Monthly

2008: The great slowdown

February 2008

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.

The following note details our global economic, commodity and financial market forecasts for 2008. We expect the first half of the year to be characterised by a slowdown in the US economy, and for the second half to witness the much-anticipated slowing of the Chinese economy. Though the bottom of the US business cycle will be much deeper than the trough in China, we anticipate that it will be China's deceleration that will more acutely affect the fortunes of the Asia and Pacific region.

- We expect global GDP growth to slow from a peak of 5.5% per annum in the third quarter of 2007 to a rate of 4.4% per annum in the final quarter of 2008. Although the US is expected to trough at 1.4% per annum growth in the third quarter, we do not expect global growth to trough until the first quarter of 2009 due to China's impact on global growth.[1]
- Our forecast is for real GDP in China to slow from 11.3% annual growth in Q4 2007 to 9.5% in Q4 2008. Reduced demand from China and the United States represents a negative external shock to the Asian region (excluding Japan), which we expect to slow from growth of 9.8% per annum in Q3 2007 to 9.0% in Q4 2008 and 8.5% in Q1 2009.
- The slowdown in China is expected to weigh on commodity prices in the second half of this year. We are forecasting WTI crude oil to ease to US$80/bbl, copper to fall to US$6614/tonne and agricultural prices to similarly decline. Falling commodity prices should bring relief to concerns about rising headline inflation starting around August.
- In the financial markets, we expect equity markets to remain skittish and the US dollar weak through the first half of the year. High risk aversion is negative for the A$, NZ$ and floating Asian currencies, but the appreciation of the CNY, VND, MYR and SGD against the US dollar may accelerate in the first half before unwinding in the second half.

Chart 1: Global growth forecasts

	2007	2008f	2009f
US	2.3	1.9	2.9
Japan	1.8	0.7	1.8
G7	2.3	1.7	2.4
Eurozone	2.7	2.0	2.1
China	11.4	10.2	9.1
East Asia ex Japan & China	5.9	5.4	5.2
India	8.8	8.5	8.5
Eastern Europe	6.7	5.9	5.2
Latin America	5.2	4.4	4.2
Australia	3.9	3.6	3.3
New Zealand	3.0	1.5	2.4
World	**5.2**	**4.7**	**4.7**

Source: Economics@ANZ

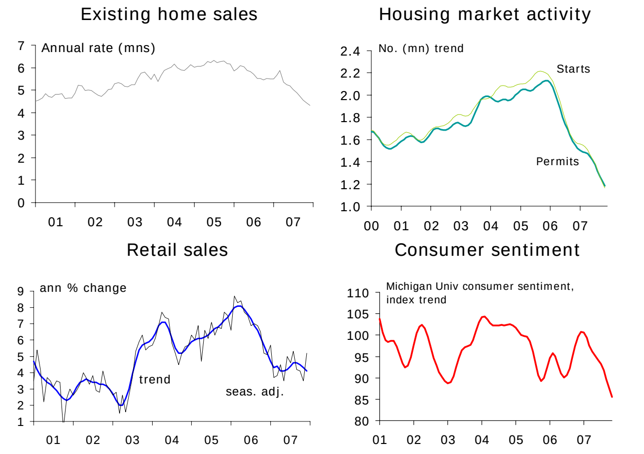
Our global growth calculations are based upon purchasing power parity (PPP) weights calculated by the World Bank and IMF. These weights will be altered some time in the coming weeks.

Uncle Sam looking very pale

All eyes are on the US economy, with labour market and retail sales data confirming that the slowdown has arrived. Ironically, the paralysis of the US money markets that heralded the "subprime crisis" in mid-August is starting to improve. But it is all coming too late now to save the US, where bank write-offs have now topped US$100 bn.

Speculation as to whether the US may enter recession is rife. Regardless of whether the US experiences two consecutive quarters of negative growth, it is clear that domestic demand will be extremely soft and that the unemployment rate will most likely climb to above 5.5%. We are forecasting real GDP growth of 1.9% per annum for 2008 as a whole, but with final domestic sales rising by less than 1% on an annualised basis for two consecutive quarters. This represents an acute slowdown, and for the US consumer, will feel like a hard landing.

US indicators looking sick



Sources: Datastream and Economics@ANZ

Appreciable downside risks to the economy and the sharp sell-offs in equity markets prompted an unscheduled rate cut in the Fed funds rate on 22 January of 75 bps – the largest single cut since 1984 – to 3.5%. With Fed rhetoric clearly shifted towards shoring up the economy, we expect further reductions in the Fed funds rate in the months ahead, to trough at 2% by August.

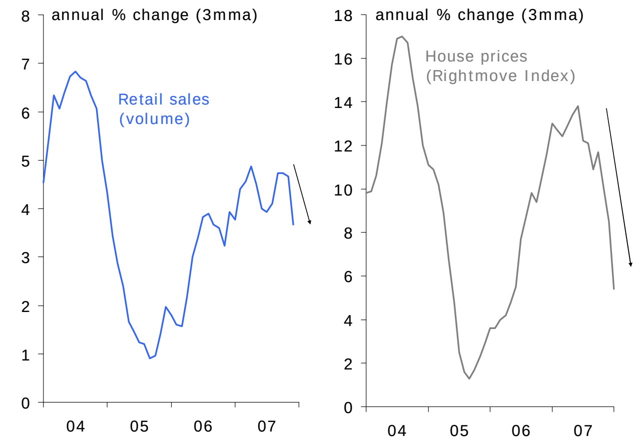
EU holding on….for now

In contrast to the US, which is the epicentre of the global liquidity crisis, data releases in the Euro zone are providing some comfort that the economic fallout of the subprime crisis may be limited. Domestic consumption has never contributed as much to growth in Europe as it has in the US; the improvement in Euro area real GDP growth from sub-1% per annum in 2003 to above 3% in recent quarters has been largely due to net exports and business investment. Net exports appear to be holding up well enough for now, and the German economy in particular is benefiting from recent reforms that have improved corporate profits.

There is a concern in Europe, however, and that is that interest rates will remain at present levels for some period of time, even if the growth outlook deteriorates. The European Central Bank is staring down the barrel of 3.1% annual headline inflation and is unlikely to cut its benchmark interest rate to support growth until it is sure that inflation is moderating. Should net exports decline on falling external demand, there does not appear to be any immediate prospects for domestic demand to be supported by a falling interest rate environment.

The situation in the UK is somewhat more dire, with house prices falling over the past three consecutive months. House price growth is now running at just 3.4% in annual terms, the lowest rate of growth since December 2005. This is already having a considerable impact on consumer sentiment, and is beginning to filter into the real economy via sluggish retail sales. Real GDP growth is expected to fall to below 2% per annum in the first half of this year. Like the ECB, the Bank of England is looking at an uncomfortable rate of inflation and will likely not be able to cut rates sufficiently to restore domestic demand to previous levels.

UK indicators have topped out



Sources: Bloomberg, Economics@ANZ

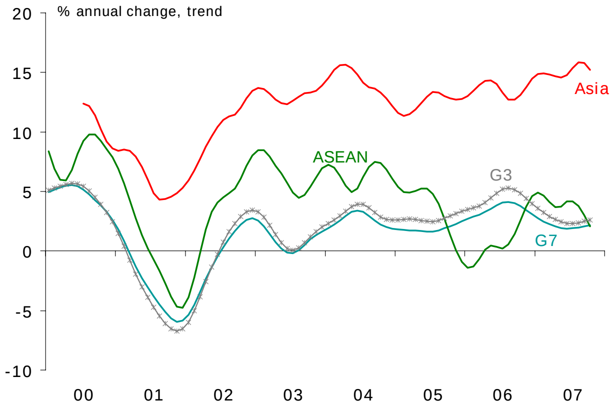
External demand enough for Asia

The Asian economies have yet to be seriously impacted by the deepening slowdown in the US economy. Decoupling is working so far, at least in the real economy sense. The US only represents 14% of global imports, and North America and the East Asian region have a similar share of global imports at 17.5% each. In contrast, the European Union claims 28% of global imports. Unsurprisingly, exports to the EU is fast expanding and so is at least as important as the US, if not more so, for export growth for the Asian region overall.

It is then perhaps not surprising that Asian export growth remains strong, rising by 20% on an annual basis in October 2007 – the latest available data point – for all of East Asia excluding Japan. For the ASEAN economies, export growth rose to 11% per annum in October from 8.4% in September.

Asia IP continues to accelerate

North Asia strong IP led by Taiwan and Korea, whereas China is flattening



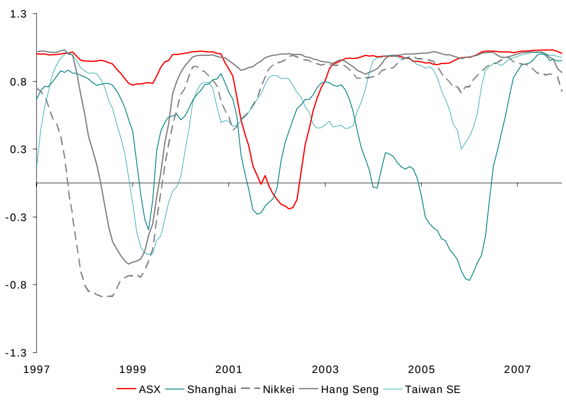
Sources: Bloomberg and Economics@ANZ

Two other potential channels of transmission exist from the US slowdown to Asia. One is through the debt markets, with the freeze in US dollar liquidity. This has affected the Australian market, where funding costs have risen considerably. It has not affected East Asia, however, given abundant local liquidity and little need for US dollar funding.

The second channel of transmission is through the equity markets. This channel is still unfolding, but seems likely to take a toll on household wealth in Asia in the coming months and may therefore slow consumption in the more advanced East Asian economies of Hong Kong, Taiwan and Korea. The below chart highlights correlations between the US Russell 3000 equity index and some key regional indices. The data show that equity markets are highly correlated during bull markets, but that correlations declined when markets were weak through the Asian crisis and the US tech wreck.

Can Asia equity markets break from US?

2 year rolling correlations between the US Russell 3000 index and key Asia Pacific equity markets



Sources: Bloomberg and Economics@ANZ

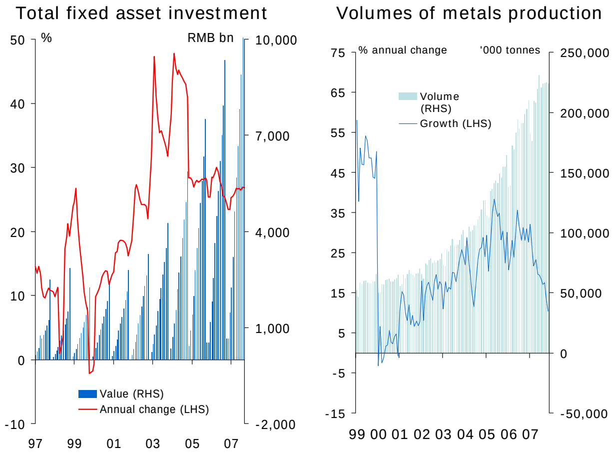
Notably, the Australian equity market has been highly correlated with the US since 2001, whereas the Shanghai exchange has had a volatile relationship.

But then there is China

The key block to another stellar year for economic growth and asset prices in Asia is the slowdown that is already in progress in China. Our forecast is for real GDP growth in China to slow from a peak of 11.9% annual growth in Q2 2007 to 10.8% in Q1 2008, and to 9.5% in Q4 2008. Many observers have speculated that the Chinese economy would slow after the August 2008 Beijing Olympics. We agree with the timing, but not the cause.

The key driver for our China growth forecast is an expectation that **the pace of fixed asset investment (FAI) will slow.** Fixed asset investment is 40% of GDP, and China's key growth driver. In China, there are two main contributors to FAI: real estate, and manufacturing. Together they account for 50% of FAI and contributed nearly 20 percentage points of growth last year. Both will be negatively affected by government policies adopted in the past year aimed at cooling investment. For real estate investment – driven by residential development - tighter liquidity conditions, following the appreciation of the currency and seven interest rates hikes since 2006, will have an effect. The government is taking administrative measures to cool the property market in key urban locations, and we believe there is also less urgency to proceed with housing development in some more remote locations now that the 17th Communist Party National Congress has passed.

Fixed asset investment slows

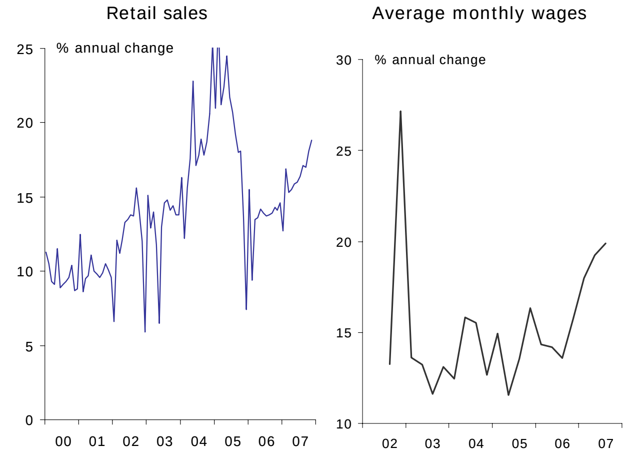


Sources: CEIC, Bloomberg and Economics@ANZ

Manufacturing investment is expected to slow amid signs of rising inventories and excess capacity, brought about in part because of the government efforts to reduce the trade surplus. Export tariffs have been introduced in key areas, such as steel, while imports are being encouraged. Ironically, the government's regulations may end up being overkill in light of the likely fall in G3 demand. As can be seen in the chart above, FAI has flattened in recent months while the volume of metals production has fallen from 20%+ per annum growth since 2004 to less than 10% per annum as of November.

Unfortunately, net exports and domestic consumption are unlikely to fully offset the slowing in FAI. Net exports represented 7.5% of GDP as of end-2006, as against 40.8% for gross fixed investment, and contributed about 3.5 percentage points of growth. Net exports are likely to make a lower contribution to growth this year given falling external demand and the government's regulations to reduce the trade surplus.

Rising wages and consumption

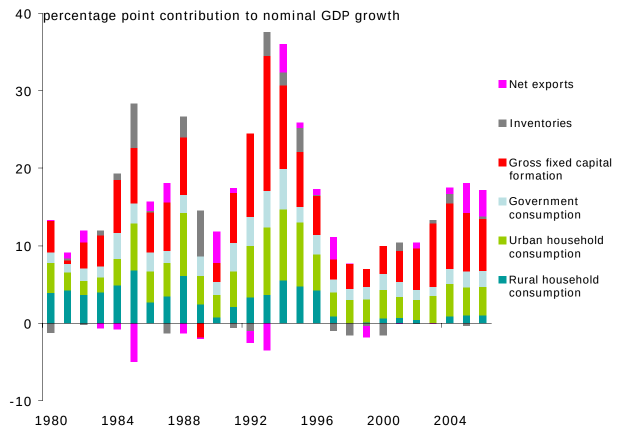


Sources: CEIC, Bloomberg and Economics@ANZ

That leaves domestic consumption as China's saviour. The government has had a policy intention to lift income levels, particularly in rural areas where there have been social tensions over rising income disparities. The measures seem to have worked, as wage data shows a marked acceleration and retail sales surged past 18% per annum growth in recent months – a level not seen for several years.

However, both urban (26% of GDP) and rural consumption (13.7% of GDP) would have to accelerate markedly to make up for lost ground on investment. The chart below shows the contribution to nominal GDP growth on the expenditure side over the past several years. Note how declining net exports in the past have been absorbed through an expansion of inventories. A key risk in this business cycle is that listed government-held companies, with greater transparency and more efficient balance sheets, will be unable to hold excess capacity and will instead reduce production and jobs growth.

Will China's listed companies be able to sit on inventories to support growth in 2008-2009



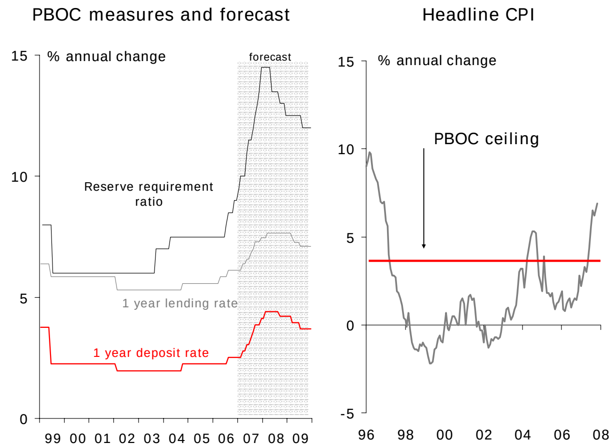
Sources: Datastream, CEIC and Economics@ANZ

This seems unlikely to happen, in part because the boost to consumption, brought about by higher wages, is also spurring an outbreak of inflation. Although some commentators have dismissed persistently high inflation as due to short-term fluctuations in food prices, in fact underlying trends look grim. Our estimate for core inflation shows a shift from deflation in 2006 to core inflation above 1% in recent months, with rises across household goods, health care, social services and housing. Food comprises more than 30% of the basket of goods in headline inflation, and so tends to dominate the trends; however, it is also true that it is a significant part of expenditure for an average Chinese household. High prices that persist for months and are spread across many food groups including meat, eggs, edible oils and grains cannot be dismissed as "temporary".

In addition to wage inflation already mentioned, base money growth has been well above the central bank's target for most of the past year. M2 growth has accelerated from 15.8% per annum in January to 18.5% per annum as of November, well above the central bank's target limit of 16%. There is evidence that the velocity of money is also increasing, with rising cash in circulation and a shift away from term deposits as more retail investors participate in the stock market.

Inflation pressures are expected to persist until July or August this year. We expect the PBOC to raise interest rates once more, after Chinese New Year in early February. More importantly, we are forecasting a more rapid pace of currency appreciation – particularly against the weak US dollar – in the first half of this year to USD/CNY6.7 or an appreciation of 7½% from the current spot rate.

Evident inflation pressures



Sources: CEIC, Bloomberg and Economics@ANZ

The rest of Asia follows China

The moderation in growth across the rest of Asia is likely to become more evident towards the second half the year as China's slowdown becomes more pronounced. Nevertheless, Asia is in a much stronger macroeconomic position than it was a decade ago to weather the headwinds of the current global slowdown and financial market turmoil with a healthier balance of payments profile and rising income levels lifting domestic demand. Fiscal management has also improved through the years, leaving scope for governments to adopt expansionary fiscal policies to pump-prime the economy if required. East Asia excluding Japan and China is projected to expand by 5.5% in 2008 from 5.9% in 2007. Indonesia and Thailand are the exceptions, with growth in the two countries expected to accelerate this year.

Northeast Asia's exposure to China will see external demand slowing more significantly later this year. China is the top export market for Korea and Taiwan, accounting for about a quarter of total exports, while China absorbs close to half of Hong Kong's exports. In the case of Korea, consumer sentiment appears to be weakening in the face of high energy prices, higher interest rates and a new bout of concern around consumer finance in the domestic banking system.

The recent victory by the Kuomintang party (KMT) in Taiwan's legislative elections held in January could foreshadow an improvement in ties with China. A possible easing in cross-Straits tensions and increased opportunities for trade and investment would bode well for Taiwan's medium-term growth prospects.

Within Southeast Asia, Singapore, Malaysia and the Philippines are expected to be more vulnerable to a sharp slowing in US consumption as an anticipated downturn in electronics demand, which makes up a sizeable share of their exports, persists at least in the first half of this year. Nevertheless, domestic demand is likely to help cushion the drag from exports with Malaysia and the Philippines forecast to continue to post an above-trend rate of expansion. Singapore's real GDP growth is projected to ease to 5.5% but this comes after two successive years of 7.5-8% growth.

For Indonesia and Thailand, an expected pick-up in domestic demand should help to offset the adverse impact of a slowdown in external demand. With Q3 2007 GDP growth exceeding expectations, the Indonesian economy is headed for its strongest year in a decade. Real GDP is forecast to expand by 6.2% in 2007 and is projected to pick up in 2008 to 6.5%. Growth will be lifted by investment and private consumption against a lower interest rate environment. The government also plans to step up investment, spending an estimated IDR100 tn (US$10.6 bn) on infrastructure projects in 2008.

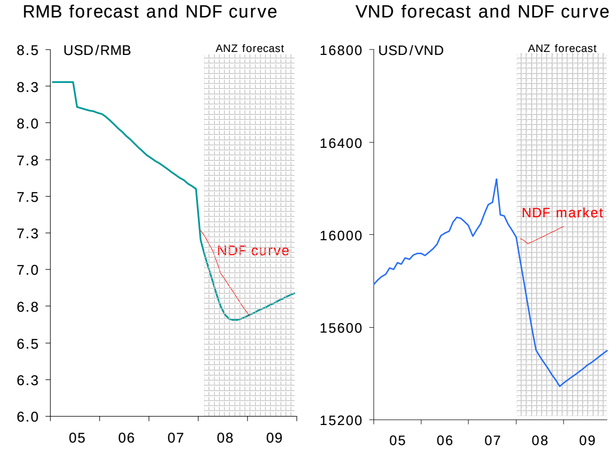
Momentum in the Thai economy is expected to accelerate as consumer and business sentiment improves with a return to democratic rule. Domestic consumption and investment are expected to rise after a sluggish performance in 2007, clouded by political uncertainty. Real GDP is forecast to expand by 5¼%. The risk to the outlook is if policy implementation is delayed through lack of consensus.

While exposure to the US, and to a lesser extent, China, will adversely impact both the exports of goods and services from India, domestic consumption and investment is likely to remain resilient. The US is India's single largest export market, absorbing about 15% of total exports. China accounts for around 8% of the total. Our forecast is for the economy is expand by 8.5% in the coming fiscal year.

Inflation to ease in second half

A marked slowing of China's economy in the second half of the year would reverse the trends that are expected for the first half of the year. Inflation would begin to decline, with a lag, and central banks will be in a position to ease monetary policy in order to support growth.

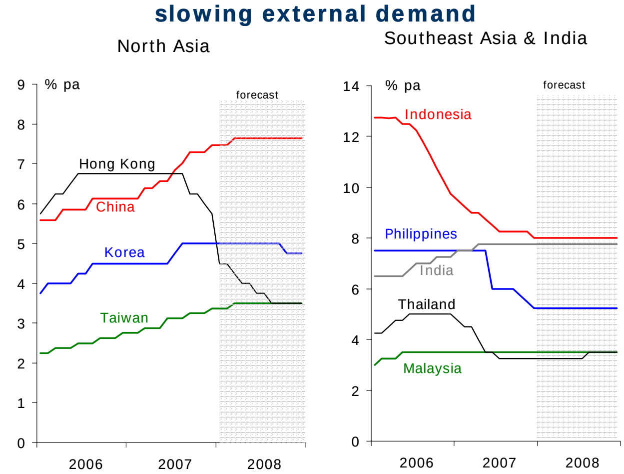
Managed currencies may accelerate in first half



Sources: Bloomberg and Economics@ANZ

For countries with managed exchange rates – CNY, MYR, SGD and VND – this spells the end of aggressive currency appreciation, and perhaps even some reversals. The moves will be most notable against the US dollar, as the US dollar should recover in the second half of the year as the US economy stabilises and the Fed stops cutting interest rates. Particularly with the CNY, we are forecasting a strong rate of appreciation in the first half of the year to USD/CNY6.73 as of June – ahead of present NDF pricing – followed by a nearly flat line to bring the end of the year exchange rate to USD/CNY6.66. In Vietnam, we are expecting the dong to appreciate to USD/VND15,345 against the US dollar by end-2008, with most of that movement again happening in the first part of the year.

Inflation limits central banks' scope to respond to slowing external demand



Sources: Datastream, Economics@ANZ

For countries that use interest rates to manage inflation, this economic scenario points to flat or declining rates either in late 2008 or early 2009. We expect the Bank of Korea to be in a position to cut interest rates by the end of the third quarter, while the central banks in Taiwan, Indonesia, the Philippines and Thailand are expected to be on hold.

In this environment, we expect to see some depreciation against the US dollar in the second half of the year as the US dollar strengthens. A significant movement of the US dollar against the euro, from a forecast EUR/USD1.50 as of June 2008 to EUR/USD1.42 by December, would cause the majority of Asian currencies to strengthen against the euro in the second half of 2008. In contrast, we forecast an ongoing slight appreciation of the yen against the US dollar through the course of 2008.

Aside from general trends around appreciation or depreciation, the key factor to monitor in the currency markets in 2008 is volatility. The floating currencies will remain volatile, as they have been in late 2007. Any prolonged sell off in the US and/or Asian currency markets would cause volatility to rise even further for this group of currencies.

However, even managed currencies are likely to experience increased volatility in the second half of 2008. This is particularly true for the CNY and the MYR, both of which were freed from their US dollar peg in July 2005. Since that time, the authorities have been active in developing their domestic foreign exchange markets, including instruments with which to hedge currency exposure. The Chinese authorities in particular have explicitly stated their intention to increase exchange rate volatility and to avoid making the CNY a “one-way bet.” As the Chinese economy slows and the imperative to tighten monetary policy eases, we expect not only the pace of CNY appreciation to slow but also for more volatility to be introduced into the intra-day market and the inter-day exchange rate fixing. Similarly, in late December the Vietnamese authorities widened the band within which the dong trades, clearly signalling more room for the currency to move. Investment and hedging strategies in the currency markets will need to take account for greater uncertainty and more volatility in the year ahead.

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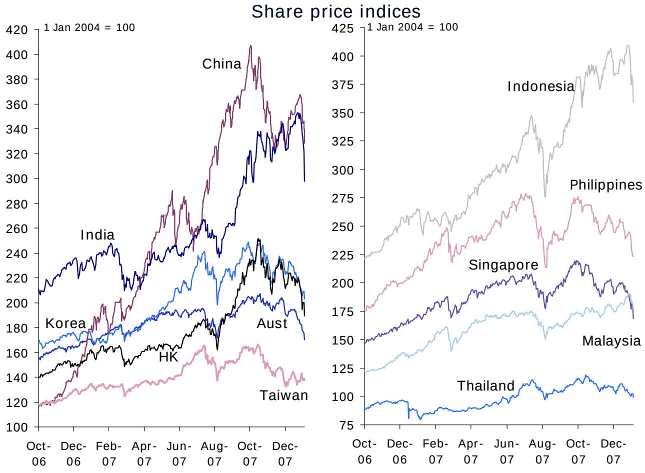
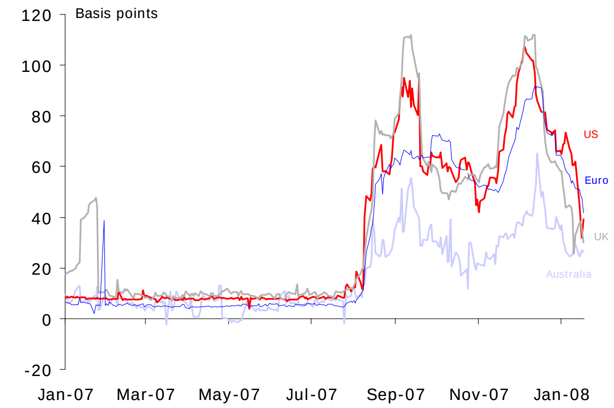
Financial Markets Update

Share price indices



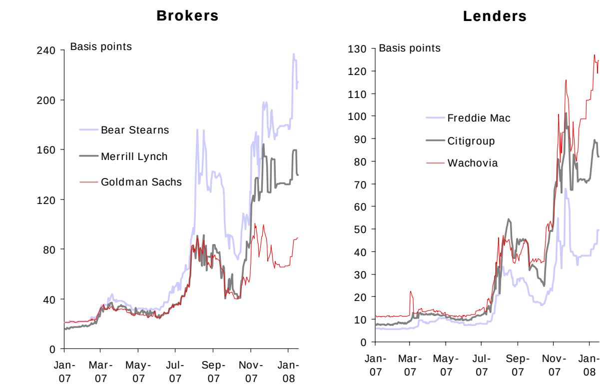
Source: Bloomberg and Economics@ANZ

Spread between 3-month interbank and 3-month OIS[1] rates



[1] Overnight indexed swap rate, a measure of market expectations of official policy rates
Sources: Bloomberg and Economics@ANZ

Credit default swap spreads for the US financial sector remained elevated



Source: Bloomberg and Economics@ANZ

Equity markets

- Global equity markets fell sharply over January. The trigger for the sharp fall was increased pessimism over the US economic outlook with investors unconvinced that the rest of the world can weather a US recession.
- Hardest hit were the equity markets of Europe and the emerging world. German equities are now 20% down from recent peaks, UK equities are down 17% and US stocks are down 13%.
- In Asia, all equity markets are down by double-digit levels. Shares in Hong Kong and Taiwan have suffered the biggest losses, down 25% from last year's peak, closely followed by Japan and Singapore, both down 24%. In Australia, the ASX 200 is now trading at 22% below last year's peak, the worst fall since the early 1990s recession.
- The Fed's surprise 75 bp interest rate cut has calmed equity markets for now, but uncertainty and thus volatility looks set to remain high.

Money markets

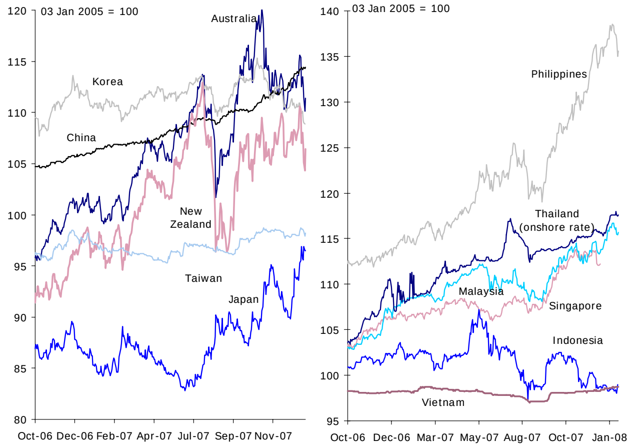
- The rout in global equity markets has caused a deterioration in broader global financial conditions.
- However, in some welcome news, the stress in money markets that had been caused by liquidity shortfalls have eased notably since the start of the year. The spread between cash and interbank rates has eased considerably from recent highs across the US, Europe and Australia.
- Partly, this reflects the passing of heightened end of year funding pressures. However, it also reflects the success of the Fed's new Term Auction Facility (TAF). The TAF was introduced in December as an adjunct to normal open market operations. It is designed to allow banks and institutions to access a wider range of collateral on a broader term rate. The TAF also allows for auctions of these term facilities for US$ in different countries, including Canada and parts of Europe, representing a new degree of global central bank co-operation.

Credit markets

- Credit spreads have widened sharply across the world in the last few months and are now much wider than when the 'liquidity crisis' began in August last year.
- The catalyst for the most recent widening of corporate credit spreads has been the Q4 reporting season in the US. In the last month US financial institutions have announced bigger than expected sub-prime related losses and sharper than expected declines in profits, in some cases of up to 90%.
- There is still clearly more bad news to come. Sub-prime related losses so far revealed amount to US$150 bn and are expected to total "in the multiples of billions of dollars" according to Fed Chairman Bernanke.
- Unsurprisingly, the sharp widening in credit spreads has led to a sharp fall in new bond issuance. In Australia, corporate bond issuance dropped by 40% YOY in the December quarter.

Exchange rates

Exchange rates, US$ per local currency unit, indexed

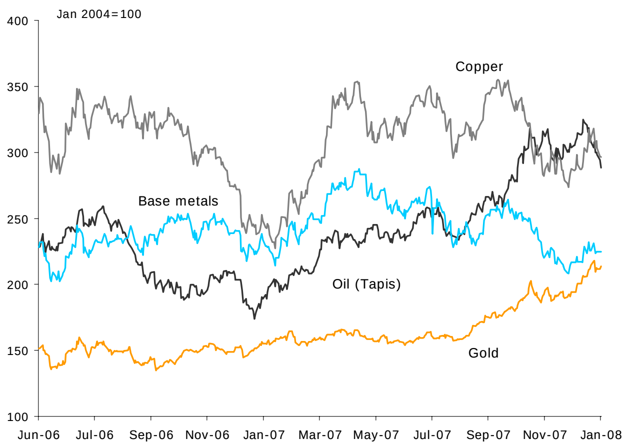


Source: Bloomberg and Economics@ANZ

- Interestingly, volatility in currency markets has not matched the wild swings in equity markets in the last month. This partly reflects the recent relative stability of the USD, which has lost little ground despite the deterioration in US prospects and aggressive rate cuts.
- The JPY has been the major beneficiary of the equity market turmoil, appreciating to a three-year high against the USD as carry-trades were unwound.
- Across Asia, the Korean won has been the worst performer, falling 1.4% against the USD since the end of last year. In contrast, most other Asian currencies have actually made small gains over January.
- Perhaps in an attempt to address elevated local inflation, authorities have allowed a faster appreciation of the CNY in the last month. And in Vietnam, authorities appear to have stepped away from their policy of currency depreciation to instead allow the VND to appreciate.

Commodities

Commodity Prices

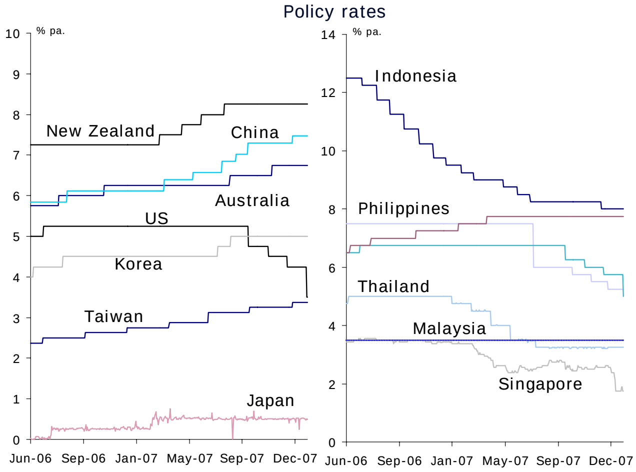


Source: Datastream, Bloomberg

- The most recent global financial market turmoil has delivered both winner and losers in commodity markets.
- The big winner has been gold, which hit a record high above US$900/oz in January. In this uncertain environment, gold remains an attractive alternative source of value as well as an inflation hedge and looks well placed to test the US$900 level again.
- Base metals, unsurprisingly, have been amongst the biggest losers. Base metal prices are most closely linked to the fate of global growth and so have experienced sharp falls on growing concerns of a US recession. Of base metals, copper has remained the best supported, as recent mine strikes highlight ongoing supply concerns in this market.
- Having started the year strongly, oil prices have retreated sharply in recent weeks. The oil market is finally waking up to the fact that the world's biggest oil consumer, the US is facing slower demand.

Policy rates

Policy rates



Source: Datastream and Economics@ANZ

- The rout in global equity markets in mid-January prompted the FOMC to deliver a 75 bps cut in the Federal Funds rate on January 21, prior to its scheduled January 30 meeting. This was the biggest cut in the Fed funds rate for 25 years. The FOMC is scheduled to meet again at the end of January with markets expecting at least another 25bp cut to be delivered.
- Unsurprisingly, the Bank of Japan decided to keep interest rates unchanged at 0.5% this month. Across the rest of Asia, interest rates have remained on hold for the first month of this year.
- In Australia, the pressure remains for higher interest rates. The latest data revealed that inflation remains uncomfortably high while, to date, the local economy is showing little signs of a slowdown. The RBA is thus expected to lift interest rates by 25 bps to 7.0% at its first meeting of the year in early February.

Foreign Exchange and Policy Rate Forecasts

	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09
China							
USD/CNY, eop	7.30	6.99	6.73	6.65	6.66	6.68	6.69
AUD/CNY, eop	6.39	6.36	6.06	5.85	5.73	5.70	5.67
One year base lending rate	7.29	7.65	7.65	7.65	7.65	7.47	7.28
Hong Kong							
USD/HKD, eop	7.80	7.80	7.80	7.79	7.80	7.80	7.80
AUD/HKD, eop	6.83	7.10	7.02	6.86	6.71	6.65	6.60
HKMA discount rate	6.00	4.25	3.75	3.50	3.50	4.00	4.75
India							
USD/INR, eop	39.4	39.0	38.8	38.9	39.0	39.0	39.1
AUD/INR, eop	34.5	35.5	34.9	34.2	33.5	33.3	33.1
Repo rate	7.75	7.75	7.75	7.75	7.75	7.75	7.75
Indonesia							
USD/IDR, eop	9,400	9,500	9,400	9,450	9,500	9,517	9,533
AUD/IDR, eop	8,227	8,645	8,460	8,316	8,170	8,121	8,072
BI rate	8.25	8.00	8.00	8.00	8.00	8.00	8.00
Korea							
USD/KRW, eop	936	940	920	925	930	932	933
AUD/KRW, eop	819	855	828	814	800	795	790
Overnight call rate	5.00	5.00	5.00	5.00	4.75	4.75	4.75
Malaysia							
USD/MYR, eop	3.31	3.27	3.25	3.30	3.32	3.33	3.34
AUD/MYR, eop	2.89	2.98	2.93	2.90	2.86	2.84	2.83
Overnight policy rate	3.50	3.50	3.50	3.50	3.50	3.50	3.50
Philippines							
USD/PHP, eop	41.2	40.5	40.3	40.8	41.5	41.7	41.8
AUD/PHP, eop	36.1	36.9	36.3	35.9	35.7	35.6	35.4
Overnight Reverse Repo rate	5.50	5.25	5.25	5.25	5.25	5.50	5.50
Singapore							
USD/SGD, eop	1.44	1.42	1.40	1.39	1.38	1.38	1.39
AUD/SGD, eop	1.26	1.29	1.26	1.22	1.19	1.18	1.17
3-month interbank rate	2.56	1.65	1.85	2.10	2.30	2.50	2.50
Taiwan							
USD/TWD, eop	32.4	32.5	32.8	33.0	33.0	33.1	33.1
AUD/TWD, eop	28.4	29.6	29.5	29.0	28.4	28.2	28.0
Discount rate	3.25	3.50	3.50	3.50	3.50	3.50	3.50
Thailand							
USD/THB, eop	33.7	32.9	32.8	33.1	33.4	33.5	33.5
AUD/THB, eop	29.5	29.9	29.5	29.1	28.7	28.6	28.4
1-day repo rate	3.25	3.25	3.25	3.50	3.50	3.75	3.75
Vietnam							
USD/VND, eop	16,017	15,794	15,500	15,423	15,345	15,358	15,371
AUD/VND, eop	14,018	14,373	13,950	13,572	13,197	13,105	13,014
Japan							
USD/JPY, eop	111.7	110.0	108.0	106.0	104.0	104.3	104.7
AUD/JPY, eop	97.8	100.1	97.2	93.3	89.4	89.0	88.6
Overnight call rate	0.50	0.50	0.50	0.75	1.00	1.00	1.25
Australia							
AUD/USD, eop	0.88	0.91	0.90	0.88	0.86	0.85	0.85
Cash rate	6.75	7.00	7.25	7.25	7.25	7.25	7.25
New Zealand							
NZD/USD, eop	0.77	0.76	0.74	0.71	0.68	0.67	0.67
AUD/NZD, eop	1.14	1.20	1.22	1.24	1.26	1.27	1.27
Overnight call rate	8.25	8.25	8.25	8.00	7.50	7.00	6.75
United States							
Fed Funds Rate, eop	4.50	2.75	2.25	2.00	2.00	2.50	3.25

Macro Economic Forecasts

Real GDP Growth (%)

	2006	2007f	2008f	2009f
Australia	2.8	3.9	3.6	3.3
Cambodia	10.7	9.5	8.5	8.0
China	10.7	11.3	10.3	9.0
Hong Kong	6.8	6.3	5.7	4.2
India+	9.4	8.8	8.5	8.5
Indonesia	5.6	6.2	6.5	6.0
Japan	2.2	1.4	1.2	2.1
Korea	5.0	4.7	4.1	4.3
Malaysia	5.9	6.1	5.8	6.3
New Zealand	1.6	3.0	1.5	2.4
Philippines	5.4	6.9	5.3	4.9
Singapore	7.9	7.5	5.5	6.3
Taiwan	4.6	5.9	4.8	4.1
Thailand	5.0	4.4	5.2	5.5
United States	2.9	2.3	1.9	2.9
Vietnam	8.2	8.5	8.0	7.0

Nominal GDP (US$ bn)

	2006	2007f	2008f	2009f
Australia	761.0	914.2	1034.3	1017.3
Cambodia	7.2	8.4	9.5	10.6
China	2529.6	2888.9	3234.3	3659
Hong Kong	223.3	236.5	249.8	264
India+	886.9	1027	1186	1364
Indonesia	364.2	411	465	521
Japan	4882.2	4970	5095	5280
Korea	847.2	911	974	1040
Malaysia	150.9	163	177	192
New Zealand	105.3	127.6	132.3	121.0
Philippines	118.0	130	142	154
Singapore	132.2	145	159	172
Taiwan	379.6	392.3	410	428
Thailand	206.3	220	237	256
United States	13,195	13,851	14,419	15,107
Vietnam	61.0	70.1	79.0	89.0

Inflation (%)

	2006	2007f	2008f	2009f
Australia	3.5	2.3	3.3	2.8
Cambodia	4.7	7.0	5.0	5.0
China	1.5	4.6	3.4	3.8
Hong Kong	2.0	2.0	3.6	1.5
India+	6.2	6.7	6.5	6.0
Indonesia	13.3	6.4	6.1	5.6
Japan	0.2	0.4	1.3	1.5
Korea	2.5	2.6	2.6	2.5
Malaysia	3.6	2.0	2.7	2.0
New Zealand	2.6	3.2	3.0	2.7
Philippines	6.3	2.8	4.2	3.4
Singapore	1.0	1.6	3.9	2.4
Taiwan	0.6	1.5	3.1	2.4
Thailand	4.7	2.3	3.3	2.4
United States	3.2	2.8	2.3	1.4
Vietnam	7.5	8.3	7.5	6.5

Fiscal Balance (% of GDP)*

	2006	2007f	2008f	2009f
Australia	1.7	1.6	1.4	1.3
Cambodia	-2.0	-3.0	-3.5	-3.5
China	-2.0	-1.9	-2.1	-2.5
Hong Kong	-0.2	-0.5	-0.5	-0.5
India+	-3.8	-3.3	-3.0	-3.0
Indonesia	-1.0	-1.6	-1.8	-1.6
Japan	-6.0	-5.8	-5.5	-5.5
Korea	1.8	1.9	2.4	2.2
Malaysia	-3.5	-3.2	-3.1	-3.0
New Zealand	7.3	4.8	4.0	3.1
Philippines	-1.0	-0.7	-0.5	-0.3
Singapore	-0.8	-0.3	0.1	0.1
Taiwan	-2.0	-2.6	-2.0	-2.0
Thailand	-0.8	-2.0	-1.8	-1.5
United States	-1.6	-1.3	-2.5	-2.2
Vietnam	-1.8	-1.9	-1.8	-1.8

Current Account (% of GDP)

	2006	2007f	2008f	2009f
Australia	-5.5	-5.8	-5.7	-5.5
Cambodia	-7.2	-7.0	-8.0	-7.0
China	9.5	9.8	9.6	9.5
Hong Kong	9.0	10.0	8.5	8.0
India+	-1.1	-1.0	-1.1	-1.1
Indonesia	2.6	2.3	2.0	2.0
Japan	3.7	3.5	2.5	2.5
Korea	1.7	1.2	1.1	0.9
Malaysia	16.3	14.4	12.0	12.8
New Zealand	-8.6	-8.0	-7.6	-7.4
Philippines	4.3	3.7	2.5	2.0
Singapore	27.5	25.0	24.0	22.0
Taiwan	5.8	5.5	6.0	5.5
Thailand	1.6	5.0	4.0	3.0
United States	-6.2	-5.7	-5.2	-4.5
Vietnam	1.5	-1.2	-1.8	-1.5

Foreign Exchange Reserves (US$ bn)

	2006	2007f	2008f	2009f
Australia	55.1	26.9	n/a	n/a
Cambodia	1.09	1.4	1.6	1.8
China	1066	1500	1750	2000
Hong Kong	154	150	160	170
India	170.2	262	300	315
Indonesia	40.7	53	60	66
Japan	875	950	1045	1150
Korea	238	263	289	315
Malaysia	81.7	102	114	125
New Zealand	13.8	n/a	n/a	n/a
Philippines	22.3	30	35	38
Singapore	136.3	155	165	180
Taiwan	266	271	276	282
Thailand	65.1	83	95	103
United States	41.5	n/a	n/a	n/a
Vietnam	13.0	22.0	31.0	35.0

+: 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

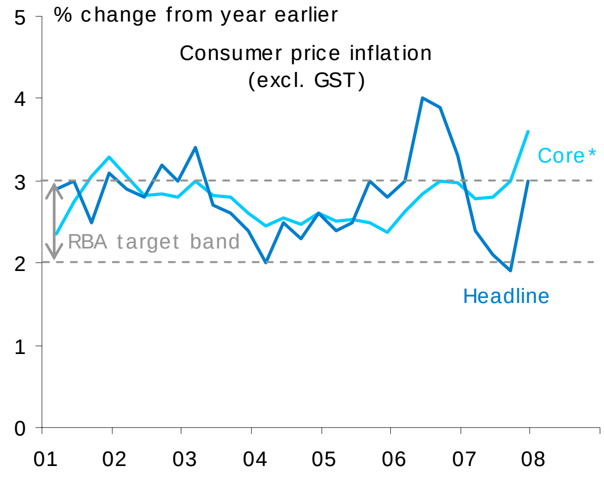
Moody's	S&P
Aaa	**AAA**
Australia Canada France Germany **Japan** **New Zealand** **Singapore** United Kingdom United States	**Australia** Canada France Germany **Singapore** United Kingdom United States
Aa1	**AA+**
Belgium	Belgium **New Zealand**
Aa2	**AA**
Hong Kong Italy Qatar Kuwait UAE	**Hong Kong** **Japan**
Aa3	**AA-**
Cayman Islands Macau Oman **Taiwan**	Kuwait Qatar **Taiwan** Saudi Arabia
A1	**A+**
China Cyprus Czech Republic Saudi Arabia	Chile Italy
A2	**A**
Chile Hungary Israel **Korea** Poland	**China** Cyprus Czech Republic Israel **Korea** Oman
A3	**A-**
Malaysia	**Malaysia** Poland
Baa1	**BBB+**
Mexico South Africa **Thailand**	Hungary Mexico Russia South Africa **Thailand**
Baa2	**BBB**
Mauritius Tunisia Russia	Tunisia
Baa3	**BBB-**
Bulgaria **India** Romania	Romania **India** Colombia Morocco

Sub-Investment Grade

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

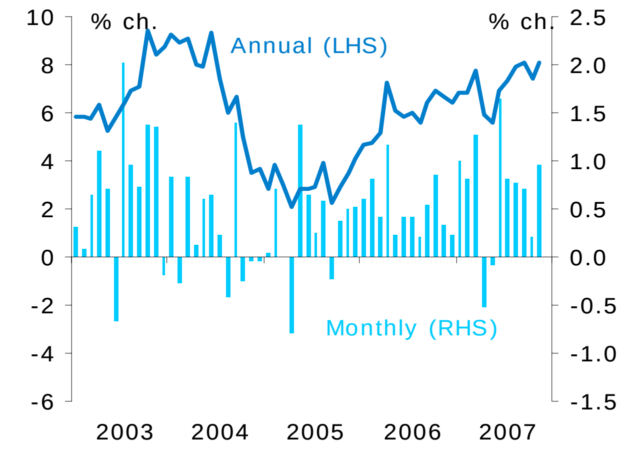
Country Update: Australia

Inflationary pressures intensify



Source: Australian Bureau of Statistics

Retail sales growing at fastest pace since 2004



Source: Australian Bureau of Statistics

- Inflationary pressures remain the primary concern in Australia. The RBA's statistical measures of underlying inflation averaged 1.05% in the December quarter and 3.6% over the year. This was the highest year-ended pace of underlying inflation since the early 1990s, before the inception of inflation targeting. The headline CPI rose by 0.9% in the quarter and 3.0% over the year, with particularly large contributions coming from petrol prices, food prices (excluding fruit and vegetables) and housing costs (including rents).
- The medium-term outlook for inflation also remains of concern. In addition to general upward pressure on inflation stemming from strong domestic demand and capacity constraints, there is specific upward pressure on food prices, rents, utility prices and petrol prices (although crude oil prices have eased a little in recent weeks).
- Most activity indicators over the past month have printed on the strong side, particularly relating to households. In particular, nominal retail sales rose by 0.8% in November, despite monetary policy and higher petrol prices in the month. This took the YOY rate to 8.1%, the fastest pace since 2004. Household spending is being supported by strong growth in household incomes in turn due to a favourable combination of solid growth in employment and wages and tax cuts.
- The Reserve Bank will take into consideration the recent deterioration in global growth prospects and renewed volatility in financial markets when putting together their growth and inflation forecasts. However, the global environment will need to deteriorate substantially from here for the inflationary outlook to weaken enough to deter further rate increases. We continue to expect the RBA to raise the cash rate by 25bp in February.
- In addition to monetary policy tightening, the new federal government is under pressure to deliver tighter fiscal policy. There is now greater recognition of the role that expansionary fiscal policy has had in neutralising the impact of cash rate increases. So while much of the expansionary fiscal policy (such as the 2008 tax cuts that were promised during the election campaign) are likely to go ahead, the new federal government is looking to tighten the belt elsewhere.

Riki Polygenis

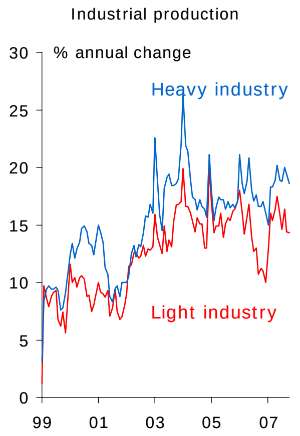
Economic data – Australia

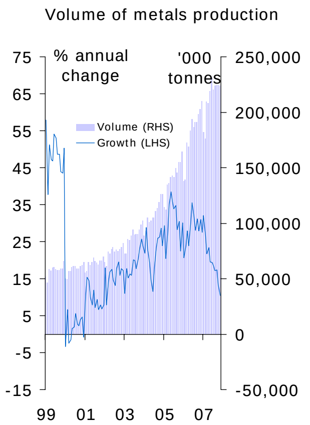
Monthly data	May 07	Jun 07	Jul 07	Aug 07	Sep 07	Oct 07	Nov 07	Dec 07
Building Approvals, 000's	12.2	12.9	13.1	12.9	13.9	13.4	14.6	n/a
Retail Sales, % YOY	5.6	6.9	7.3	7.9	8.1	7.5	8.1	n/a
Exports, % YOY	9.1	-3.5	2.6	3.6	0.4	-3.8	3.4	n/a
Imports, % YOY	2.2	4.6	5.3	10.3	7.3	4.6	11.3	n/a
Trade Balance, AUD bn	-1.13	-1.92	-1.10	-1.75	-2.06	-2.86	-2.25	n/a
Foreign Exchange Reserves, US$ bn	69.8	67.6	68.9	57.8	46.5	33.2	29.0	26.9
Quarterly data	**Mar 06**	**Jun 06**	**Sep 06**	**Dec 06**	**Mar 07**	**Jun 07**	**Sep 07**	**Dec 07**
Real GDP, % YOY	3.3	2.5	2.6	2.8	3.6	3.7	4.3	n/a
- Private consumption	2.5	2.7	2.7	3.4	4.0	3.7	4.5	n/a
- Government consumption	1.7	3.6	6.4	3.6	4.5	2.6	1.3	n/a
- Gross fixed capital expenditure	10.4	5.3	2.2	2.7	5.2	9.4	10.6	n/a
Consumer Price Index, % YOY (nsa)	3.0	4.0	3.9	3.3	2.4	2.1	1.9	3.0
Current Account, AUD bn	-13.3	-13.7	-12.9	-15.2	-15.3	-15.6	-15.6	n/a
Capital Account, AUD bn (nsa)	13.5	12.6	14.1	15.1	15.3	14.4	18.0	n/a

Sources: Australian Bureau of Statistics, Reserve Bank of Australia   Note: data seasonally adjusted unless otherwise stated

Country Update: China

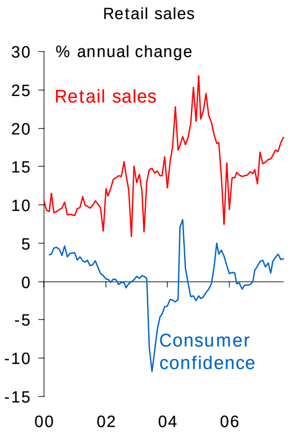
Production growth is easing

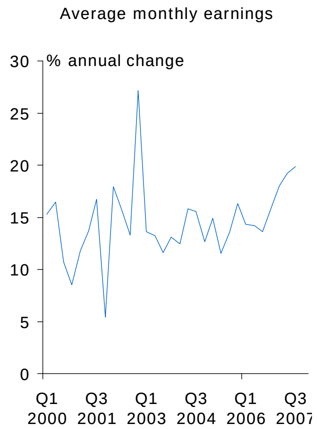




Sources: CEIC, Economics@ANZ

But strong consumption fuelling inflation





- High frequency data show that the economy is slowing, albeit very gradually. Fixed asset investment growth has flattened at 26% annual growth and appears set to slow. Industrial production growth has declined from a peak of 19.4% per annum in June to 17.3% in November. Metals production looks to have slowed sharply, with production volumes rising only 10.4% on an annual basis in November from a rise of 19.3% in June. The fall in metals production was led by steel, with output of steel and iron alloy products growing at below 10% per annum in November on a volume basis. We expect this slowdown to continue and deepen as 2008 unfolds.
- The fall in steel production growth is likely related to the introduction of export tariffs in June and ongoing consolidation in the steel sector. The government has clearly stated an intention to reduce the trade surplus, and its measures are working. Export growth slowed to 21.7% on an annual basis in December and 22.3% for the fourth quarter as a whole, the weakest growth rate since the blip of Q4 2005. Meanwhile, import growth surged to 25.7% in December and 25.5% for the fourth quarter, the strongest rate of growth since the end of 2004. The December trade surplus was still high at US$22 bn, however, and even if import growth exceeds export growth by 5-10 percentage points over the coming year, the trade surplus will remain above US$20 bn most months over the course of 2008.
- Although production is softening, domestic demand is heating up with retail sales rising at more than 18% per annum in Q4 2007. This is the strongest growth since mid-2005 and is consistent with data showing faster rises in wages growth. Stronger consumption is translating into higher inflation, and although inflation may start to moderate in the coming months it is likely to exceed the PBOC ceiling of 3% for the entire first half. We expect the PBOC to lift interest rates in March after Chinese New Year, and to continue with the more rapid pace of currency appreciation in a bid to tame inflation. Our target is for the exchange rate to reach USD/CNY6.7 by June, due to stronger appreciation and a weak US dollar.

Amy Auster

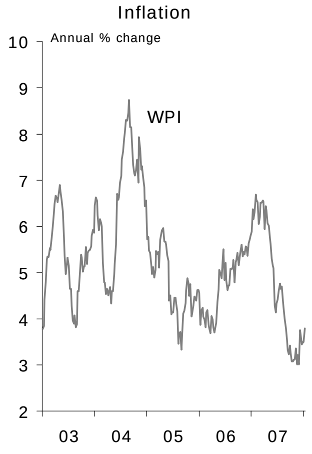
Economic data – China

Monthly data	May 07	Jun 07	Jul 07	Aug 07	Sep 07	Oct 07	Nov 07	Dec 07
Industrial Production, % YOY	18.1	19.4	18.0	17.5	18.9	17.9	17.3	n/a
Retail Sales, % YOY	15.9	16.0	16.4	17.1	17.0	18.1	18.8	n/a
Consumer Price Index, % YOY	3.4	4.4	5.6	6.5	6.2	6.5	6.9	n/a
Exports, % YOY	28.7	27.1	34.1	22.7	22.7	22.3	22.8	21.7
Imports, % YOY	19.1	14.3	26.9	20.1	16.1	25.5	25.3	25.7
Trade Balance, US$ bn	22.4	26.8	24.3	25.0	23.8	27.1	26.3	22.7
Foreign Exchange Reserves, US$	1292.7	1332.6	1385.2	1408.6	1433.6	1454.9	1496.9	1528.3
Quarterly data	**Dec 05**	**Mar 06**	**Jun 06**	**Sep 06**	**Dec 06**	**Mar 07**	**Jun 07**	**Sep 07**
Real GDP, % YOY	9.9	10.4	11.5	10.6	10.4	11.1	11.9	11.5
- Primary sector	5.2	4.5	5.1	4.9	5.0	4.4	4.0	4.3
- Secondary sector	11.7	12.7	13.3	13.3	12.5	13.2	13.6	13.5
- Tertiary sector	10.5	8.9	9.3	9.5	10.3	9.9	10.6	11.0
Nominal GDP, US$ bn	615.4	604.5	630.3	658.7	733.8	710.4	761.6	810.0
Current Account, US$ bn	177.2	243.7	247.0	249.7	259.0	302.1	341.6	380.5
FDI (actual), US$ bn* YTD	60.3	14.2	28.4	42.6	65.8	15.9	31.9	47.2

Sources: Datastream, Bloomberg   * - Quarterly sum

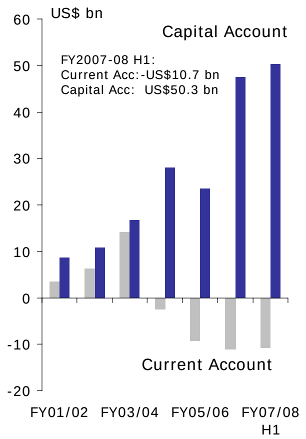
Country Update: India

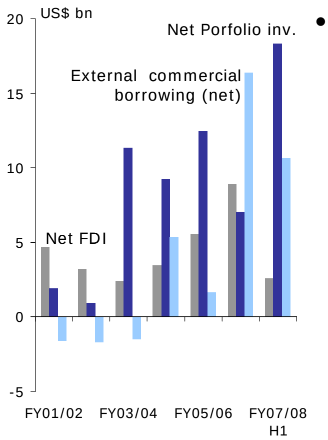
Inflation stays below target



Sources: Bloomberg, Datastream

Capital account surplus more than offsets current account deficit





Source: Bloomberg

- Annual inflation, as measured by the wholesale price index, appears to be contained. At the end of 2007, WPI was 3.5% YOY, down from over 6% in January 2007. The first reading for 2008 was up slightly to 3.79% YOY for the week ended 5 January but inflation has stayed below the Reserve Bank of India's target of 5% since mid-June 2007. The decline in India's 10-year bond yield and lower US interest rates has lifted expectations that the central bank is likely to cut rates soon. The key repurchase rate has been held at 7.75% since March 2007. We, however, expect the RBI to keep its policy rate unchanged over the next few months as the risk of upside price pressures persist in the short term, particularly with food costs staying elevated. The potential for a rise in fuel prices will also lift inflation expectations. The pump price of diesel and gasoline were last raised in June 2006 and cooking gas has been capped since April 2005. Money supply (M3) is still expanding at a relatively healthy pace of 22.3% YOY as at December 2007. The central bank sold US$1 bn of notes due July 2010 on 17 January in an effort to soak up liquidity. Nevertheless, we should see some moderation in commodity prices as the global economy decelerates, leaving scope for lower interest rates in the second half of this year.
- India's current account deficit continues to worsen. The shortfall in Q3 2007 was a wider-than-expected US$5.5 bn, due to a further deterioration in the merchandise trade account. This brought the current account deficit for the first half of FY2007/08 (fiscal year beginning 1 April) to US$10.7 bn. A high oil import bill, growing domestic demand and an appreciating currency, which makes exports less competitive and imports cheaper, are expected to keep the trade deficit large this year and contribute to a wider current account shortfall. The latter, however, is expected to be more than offset by strong surpluses in the capital account. The surplus on the capital account was US$50.3 bn for the first half, exceeding the full year balance of US$47.5 bn for FY2006/07. These inflows comprise largely of portfolio investments and external commercial borrowings by corporates. Foreign direct investment has been picking up from a low base.

Jasmine Robinson

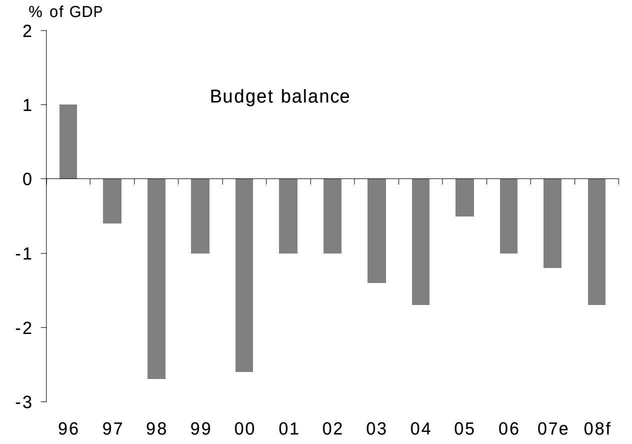
Economic data – India

Monthly data	May 07	Jun 07	Jul 07	Aug 07	Sep 07	Oct 07	Nov 07	Dec 07
Industrial Production, %YOY	9.8	8.7	8.0	10.5	6.7	11.7	5.2	n/a
Passenger car sales, % YOY	6.5	12.1	14.5	15.7	8.7	13.9	16.0	6.6
Consumer Price Index, % YOY	6.6	5.7	6.5	7.3	6.4	5.5	5.5	n/a
Exports, % YOY	26.8	19.1	22.8	22.2	24.2	38.3	28.4	n/a
Imports, % YOY	37.0	39.5	23.8	41.1	10.1	31.3	24.9	n/a
Trade Balance, US$ bn	-6.2	-7.3	-5.0	-6.9	-4.4	-7.5	-7.4	n/a
Foreign Exchange Reserves, US$ bn	201.0	206.0	220.0	222.0	240.0	256.0	265.0	n/a
Quarterly data	**Dec 05**	**Mar 06**	**Jun 06**	**Sep 06**	**Dec 06**	**Mar 07**	**Jun 07**	**Sep 07**
Real GDP, % YOY (at factor cost)	9.3	10.0	9.6	10.2	8.7	9.1	9.3	8.9
- Industry	7.2	8.6	10.6	11.3	10.8	11.2	10.6	8.3
- Agriculture	8.7	6.2	2.8	2.9	1.6	3.8	3.8	3.6
- Services	10.0	12.1	12.0	11.1	11.3	9.9	10.6	n/a
Nominal GDP, US$ bn	193.4	200.2	187.1	184.8	223.6	233.2	237.4	239.8
Current Account, US$ bn	-4.8	2.8	-4.6	-4.8	-2.8	2.6	-4.7	-5.5
Capital Account, US$ bn	0.1	10.5	10.6	6.8	10.3	17.9	15.3	33.9

Source: Datastream, Bloomberg

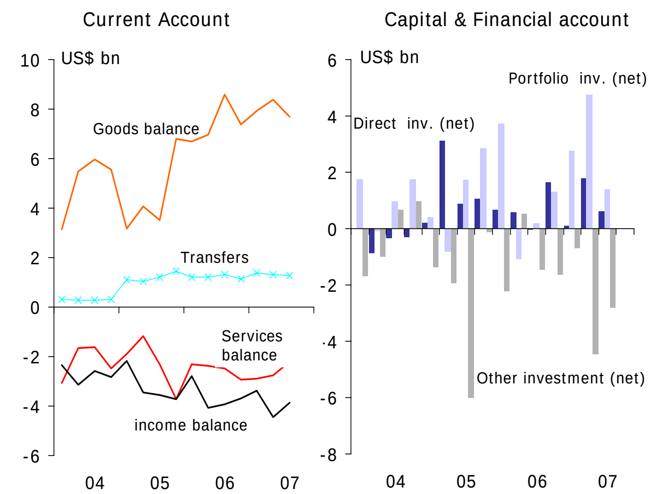
Country Update: Indonesia

Prudent fiscal management



Source: Datastream

Current account surplus expected to narrow



Sources: CEIC, Bank Indonesia

- Indonesia's budget deficit for 2007 is likely to have been smaller due largely to lower spending. The fiscal deficit is estimated at 1.2% of GDP against the target of 1.5%. However, the deficit is budgeted to widen to 1.7% of GDP on the back of a surge in public works spending. To help finance this shortfall, the government sold US$2 bn of bonds in January which mature in 10 and 30 years, making this the country's largest foreign currency debt sale since March 2006. Recent years of prudent fiscal and debt management has helped Indonesia to receive credit rating upgrades and has raised scope for the government to adopt expansionary policies ahead of the elections in 2009.
- The government has projected real GDP growth of 6.8% for 2008 – the strongest pace of expansion since 1996. Our forecast is for the economy to expand by 6.5%. The rupiah, however, has not been responding to improved prospects for investment and growth with the currency slipping 1.9% against the US dollar since the central bank unexpectedly cut its benchmark rate in early December. Lower real interest rates have eroded support for the currency and indications that central bank policy is tilted towards growth, and therefore the potential for a further easing in interest rates, are likely to weigh on the currency. However, we expect that upside risks to inflation will keep policy rates on hold in the first half of this year.
- Rising domestic demand is likely to see the trade surplus narrow in 2008 despite commodity exports staying strong. The services and income account is also expected to weaken due in part to higher interest payments and repatriation of profits and dividends, resulting in a smaller current account surplus of 2% of GDP for 2008 compared with an estimated 2.3% in 2007. Portfolio inflows dominate the capital account making Indonesia more vulnerable to changes in sentiment especially in the current climate of increased global financial market volatility.

Jasmine Robinson

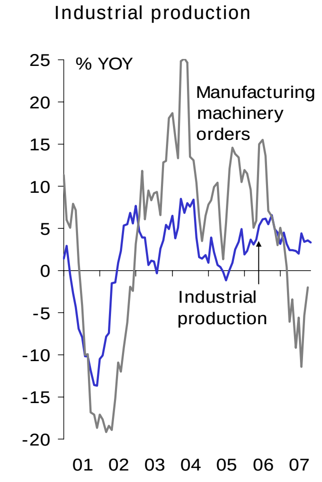
Economic data – Indonesia

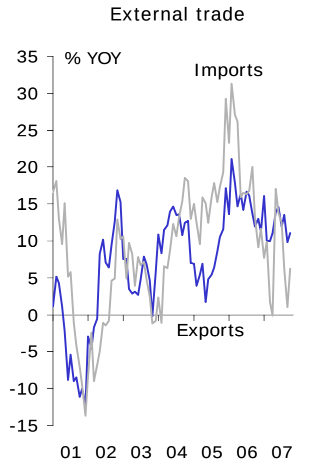
Monthly data	May 07	Jun 07	Jul 07	Aug 07	Sep 07	Oct 07	Nov 07	Dec 07
Industrial Production, %YOY	6.6	5.1	4.7	4.8	1.8	8.2	2.0	n/a
Motor cycle sales, % YOY	16.6	7.8	-1.6	-3.0	-3.4	22.6	-7.1	-11.2
Consumer Price Index, % YOY	6.0	5.8	6.1	6.5	7.0	6.9	6.7	6.6
Exports, % YOY	17.2	13.1	13.1	7.8	7.6	17.6	10.0	n/a
Imports, % YOY	26.7	5.1	17.3	20.1	19.6	36.5	29.7	n/a
Trade Balance, US$ bn	3.4	3.5	3.7	2.8	2.8	4.0	2.3	n/a
Foreign Exchange Reserves, US$ bn	48.6	49.4	50.3	49.9	51.2	52.32	n/a	n/a
Quarterly data	**Dec 05**	**Mar 06**	**Jun 06**	**Sep 06**	**Dec 06**	**Mar 07**	**Jun 07**	**Sep 07**
Real GDP, % YOY	4.8	5.1	5.0	5.9	5.9	6.0	6.4	6.7
- Private consumption	4.1	3.0	3.0	2.9	3.8	4.8	4.7	5.3
- Government consumption	26.8	11.4	27.9	2.3	0.4	5.8	3.5	6.2
- Gross fixed capital expenditure	2.7	1.5	1.1	0.5	8.7	8.0	6.9	9.0
Nominal GDP, US$ bn	76.7	84.6	89.5	94.1	96.2	101.1	103.4	109.7
Current Account, US$ bn	0.8	2.8	1.7	3.5	1.9	3.0	2.5	2.9
Capital & Financial Account, US$ bn	4.0	2.3	0.0	-1.2	1.5	2.2	2.2	-0.7

Sources: Bloomberg, Datastream, Bank Indonesia

Country Update: Japan

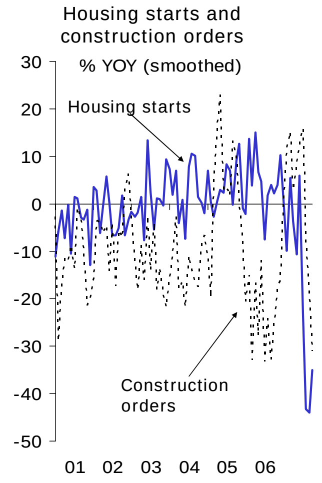
Exports losing steam

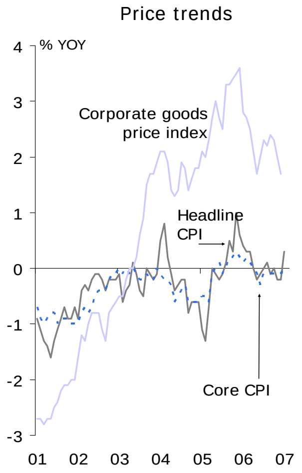




Sources: Datastream, Economics@ANZ

Slide in domestic demand throw doubt over reflation prospects





Sources: Datastream, Economics@ANZ

- The Japanese economy is looking decidedly downbeat as a confluence of external and domestic factors combine to worsen the outlook for 2008. On the external front, falling G3 demand and a stronger yen are likely to cause exports to slow; export growth declined from 13.5% per annum in August to 9.1% in November, and appear likely to have risen only marginally from the third to the fourth quarter. As a result, net exports may not have contributed at all to real GDP growth in the fourth quarter of 2007, in sharp contrast to the previous five quarters, and this situation is likely to perpetuate through 2008.
- On the domestic front, demand has slumped with a collapse in residential construction following the introduction of stricter building regulations in June and a resulting slowdown in the approvals process. Housing declined by 7.9% on a quarterly basis and 11.1% on an annual basis in the national accounts in the third quarter of 2007, and the final quarter of the year. Although the contraction in the annual rate of housing starts and total construction works improved in November, the levels are still very low. On the basis of recent data, the trough in the Japanese housing market could rival that of the United States, although we expect it to be followed by a much sharper recovery in the second or third quarter of 2008.
- While the housing market represents a short-term problem, the combined effects of falling investment and weak exports threatens any possible improvement in wages and disposable income. After growth in disposable income deteriorated in the third quarter, household expenditure has followed suit and measures such as the volume of retail sales is tepid. The much-hoped for improvement in consumption has yet to come through, and now appears unlikely as business sentiment has deteriorated with the external outlook.
- Ironically, consumer price inflation has begun to accelerate at long last. Annual headline inflation rose to 0.6% per annum and core to 0.4% in November, but the BOJ will be on hold until the two present shocks to the economy dissipate.

Amy Auster

Economic data – Japan

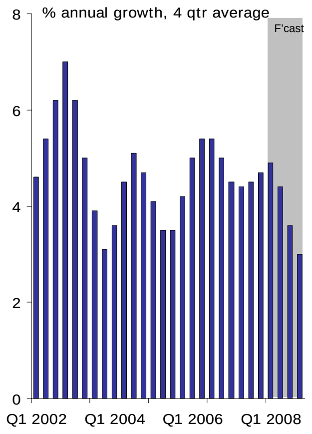
Monthly data	May 07	Jun 07	Jul 07	Aug 07	Sep 07	Oct 07	Nov 07	Dec 07
Industrial Production, %YOY	2.4	2.3	2.0	4.4	3.4	3.6	1.6	n/a
Retail Sales, % YOY	0.1	-0.4	-2.3	0.5	0.5	0.8	1.6	n/a
Consumer Price Index, % YOY	0.0	-0.2	0.0	-0.2	-0.2	0.3	0.6	n/a
Exports, % YOY	6.6	8.6	6.5	13.7	8.4	16.4	16.0	n/a
Imports, % YOY	7.0	3.6	11.6	5.1	-1.4	11.2	19.7	n/a
Trade Balance, US$ bn	3.2	10.0	5.4	6.3	14.2	8.6	7.1	n/a
Foreign Exchange Reserves, US$ bn	890.1	892.8	902.5	910.9	922.5	930.3	946.1	948.0
Quarterly data	**Dec 05**	**Mar 06**	**Jun 06**	**Sep 06**	**Dec 06**	**Mar 07**	**Jun 07**	**Sep 07**
Real GDP, % YOY	2.9	2.7	2.4	1.9	2.5	2.8	1.6	2.1
- Private consumption	2.5	2.7	2.6	1.1	1.6	1.7	1.1	2.4
- Government consumption	0.5	-1.1	-0.1	-0.6	0.1	0.7	0.6	0.3
- Gross fixed capital formation	3.1	1.0	1.3	0.0	2.7	3.2	-0.7	-1.0
Nominal GDP, US$ bn	4741.6	4708.3	4686.4	4638.4	4654.3	4636.4	4573.9	4541.0
Current Account, US$ bn	194.0	182.8	168.1	174.2	206.9	201.9	232.0	218.2
Capital Account, US$ bn	-11.9	-11.0	-5.2	-1.3	-3.0	-9.0	-0.8	-2.5

Source: Datastream

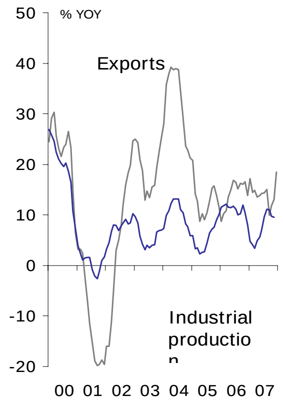
Country Update: Korea

Economy expected to slow

Growth and inflation projection



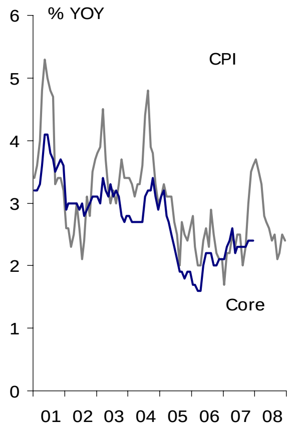
Production



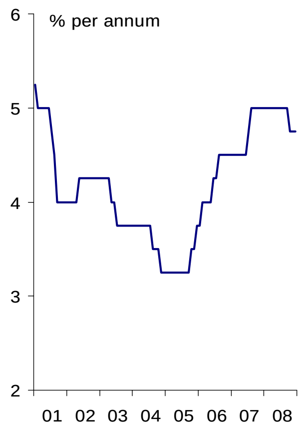
Sources: Datastream, Economics@ANZ

BOK on hold, easing at end-2008

Inflation forecast



Interest rate forecast



Source: Datastream, Economics@ANZ

- The economy is showing some signs of slowing down from an annualised rate of growth in excess of 5% in the most of 2007. Slowing retail sales imply a softer rate of consumption growth in the fourth quarter, whereas rising consumption had been an important contributor to growth in the previous few quarters. In addition, the trade surplus narrowed from US$4.5 bn in the third quarter to US$3.0 bn in the fourth, implying a falling contribution from net exports to GDP growth. We expect fourth quarter GDP to rise by 0.9% from the third quarter, bringing annual growth to 5.0% and full year 2007 real GDP growth to 4.7%
- We expect growth to continue to soften in 2008 due to slowing external and domestic demand. Falling external demand may not be felt until later this year, as the Chinese economy begins to slow. For the time being, export growth is still in excess of 15%, but we expect this to slow toward 10% or below in the coming months. On the domestic front, consumer sentiment appears to be weakening in the face of high energy prices, higher interest rates and a new bout of concern around consumer finance in the domestic banking system. Slowing domestic demand should allow inflation to ease over the course of 2008, setting the stage for declining inflation and interest rate cuts by the Bank of Korea toward the end of this year.
- The wild card in the outlook for 2008 is politics, following the election of Lee Myun-bak. MB Lee pledged to lift real GDP growth to 7% per annum and more than double the rate of per capita income. Mr Lee's vast experience with running major Korean conglomerates evidently convinced voters that he could make good on his promises; now the proof will be in the pudding, but tax cuts seem to be on the cards going forward. On the other hand, a criminal inquiry has been launched against Lee in relation to a share manipulation scandal in 2001, ahead of his inauguration in February. Lee may be cleared of the charges ahead of the 25 February deadline and subsequently given presidential immunity for the standard five-year period, but any damaging information could hurt his GOP party in the upcoming May election and hamper Lee's efforts to pass key legislation.

Amy Auster

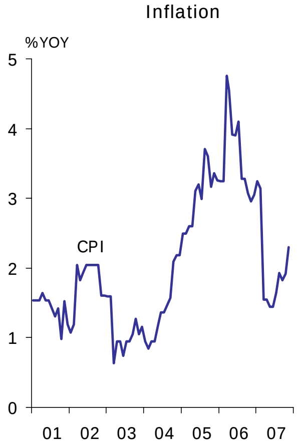
Economic data – Korea

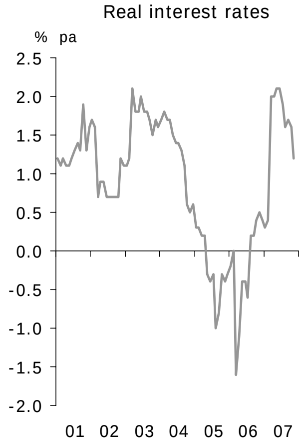
Monthly data	May 07	Jun 07	Jul 07	Aug 07	Sep 07	Oct 07	Nov 07	Dec 07
Industrial Production, %YOY	6.7	7.7	14.4	11.2	7.5	10.6	10.5	n/a
Retail Sales, % YOY	3.8	3.8	4.3	4.4	10.4	4.1	5.4	n/a
Consumer Price Index, % YOY	2.3	2.5	2.5	2.0	2.3	3.0	3.5	3.6
Exports (US$), % YOY	11.1	14.5	17.2	13.6	-1.1	22.9	17.1	14.9
Imports (US$), % YOY	13.8	9.5	14.4	9.9	-1.6	27.8	26.6	23.2
Trade Balance, US$ bn	1.2	3.5	1.0	1.3	2.1	1.7	1.9	-0.8
Foreign Exchange Reserves, US$ bn	250.3	250.2	254.4	254.9	256.8	259.7	261.5	261.8
Quarterly data	**Dec 05**	**Mar 06**	**Jun 06**	**Sep 06**	**Dec 06**	**Mar 07**	**Jun 07**	**Sep 07**
Real GDP, % YOY	5.7	6.1	5.2	4.8	4.0	3.9	5.0	5.1
- Private consumption	4.7	5.4	4.0	3.9	3.6	3.9	4.2	4.6
- Government consumption	5.4	5.4	5.2	5.8	6.8	5.6	5.9	3.9
- Gross fixed capital expenditure	4.3	3.5	0.1	4.6	4.5	7.0	6.7	1.4
Nominal GDP, US$ bn	200.9	213.2	221.5	223.4	229.7	232.9	241.0	245.5
Current Account, US$ bn	5.2	-2.0	0.2	1.0	6.1	-1.7	0.0	4.4
Capital Account, US$ bn	-0.5	-0.7	-0.8	-0.7	-0.9	-0.8	-0.7	-0.6

Source: Datastream

Country Update: Malaysia

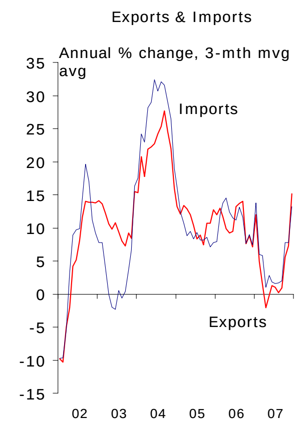
Inflation edges up

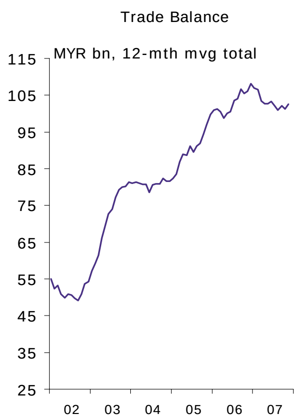




Sources: Bloomberg, Datastream

Trade surplus expected to narrow





Source: Datastream

- Despite the aggressive cuts in US interest rates, Bank Negara is likely to keep interest rates unchanged at 3.5% in the first half of the year until upside risks to inflation abate. Over the second half of last year, inflation accelerated, reflecting a rise in crude oil, palm oil and food prices. Annual inflation reached a nine-month high of 2.3% in November. Flooding across several areas in December is also likely to push up food prices in the short term. Nevertheless, a softer commodity price outlook in response to a slowdown in global growth should help to alleviate price pressures. We are likely to see inflation moderate towards the second half of this year. The government is also expected to continue to subsidise retail fuel prices and the strong currency is likely to keep a lid on imported inflation. Our forecast is for inflation to average 2.7% in 2008 from 2.0% in 2007.
- Malaysia's trade performance so far this year has been better than expected given the slowdown in external demand. The trade balance for the first eleven months of 2007 was MYR90.9 bn, down 5.8%, in ringgit terms, from the same period in 2006. Export growth is expected to slow, due largely to softer demand from the US and other Southeast Asian economies although shipments to China are likely to hold up. Electrical and electronics goods are Malaysia's top export item, accounting for close to half of total exports. Import growth could also moderate, largely reflecting reduced demand for intermediate inputs but goods for domestic consumption are likely to remain relatively healthy. Consequently, we expect the trade surplus to narrow over 2008. As a share of GDP, the current account surplus is forecast to decline to around 12% in 2008 from 14.4% estimated for 2007.
- On the political front, while the next general elections need not be held until April 2009, there is growing speculation that PM Abdullah Badawi may hold an election as early as March 2008. Political rallies calling for electoral reforms are likely to escalate in the run-up to the election.

Jasmine Robinson

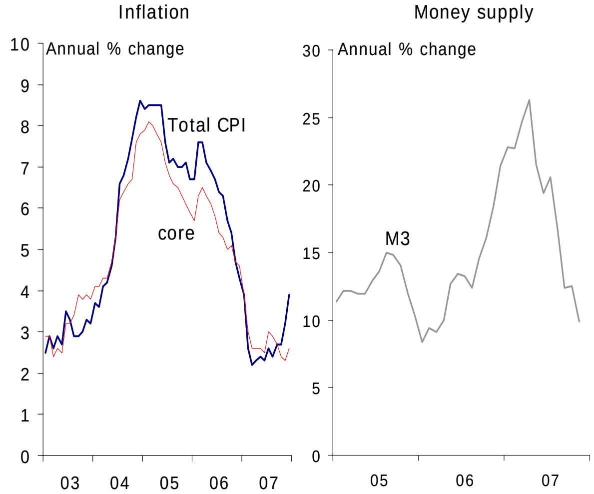
Economic data – Malaysia

Monthly data	May 07	Jun 07	Jul 07	Aug 07	Sep 07	Oct 07	Nov 07	Dec 07
Industrial Production, %YOY	3.8	1.6	2.1	1.1	3.1	4.7	2.7	n/a
Motor Vehicle sales, % YOY	-11.9	8.2	2.3	0.8	4.9	20.7	21.3	n/a
Consumer Price Index, % YOY	1.4	1.4	1.6	1.9	1.8	1.9	2.3	n/a
Exports, % YOY	9.3	6.2	6.6	6.2	7.7	24.4	14.7	n/a
Imports, % YOY	10.0	4.8	9.3	9.6	5.1	30.5	12.8	n/a
Trade Balance, US$ bn	2.3	2.5	2.3	2.5	3.3	2.5	3.1	n/a
Foreign Exchange Reserves, US$ bn	99.7	98.6	98.8	95.8	96.5	100.8	102.8	n/a
Quarterly data	**Dec 05**	**Mar 06**	**Jun 06**	**Sep 06**	**Dec 06**	**Mar 07**	**Jun 07**	**Sep 07**
Real GDP, % YOY	5.6	5.7	6.0	6.1	5.9	5.4	5.8	6.8
- Private consumption	8.8	6.6	7.7	7.0	7.0	8.6	13.1	14.0
- Government consumption	13.4	1.2	4.5	9.9	4.1	7.1	10.2	5.3
- Gross fixed capital expenditure	0.5	11.4	7.6	3.5	9.8	9.9	6.6	13.5
Nominal GDP, US$ bn	35.8	37.3	38.8	39.5	40.5	42.6	45.3	46.5
Current Account, US$ bn	4.5	5.5	5.0	7.4	7.7	5.7	6.9	8.3
Capital & Financial Account, US$ bn	-12.4	-1.4	-0.1	-4.9	-5.5	0.8	2.2	-8.9

Sources: Datastream, Bloomberg

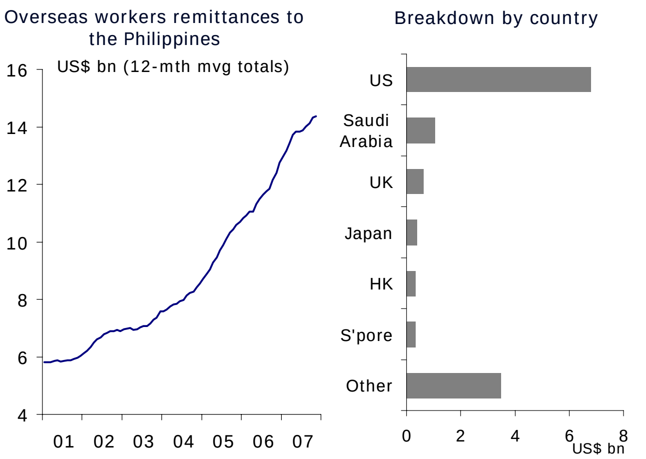
Country Update: Philippines

Strong peso helps contain inflation



Sources: Bloomberg, Datastream

Remittances – an important source of foreign exchange



Source: Bloomberg

- Inflation accelerated to 3.9% over the year to December but was still within the central bank's 4-5% target, bringing average inflation for 2007 to 2.8%. The target for 2008 is 3-5%. The spike in December was a reflection of higher oil and food prices and utility costs. In response, the government cut the import duty on crude oil in January. Our forecast is for annual inflation to average 4.2% in 2008. Money supply (M3) growth seems to be well-contained, expanding at less than 10% over the year to November, and an appreciating peso will help to rein in imported inflation.
- While assisting to control inflation, the rising peso has eroded the Philippines' export competitiveness. Recently released export data for November, which was US$3.95 bn was 2% lower than a year earlier as shipments of electronics goods fell 4.5% over the year to November and garment exports fell 20.6%. Against the climate of moderating external demand, the strong currency is likely to adversely impact overseas sales in coming months especially as the US and Japan collectively absorb around 25% of total exports. The Philippines' main exports are consumer-based electronics and semiconductors, accounting for around two-thirds of total exports, and which are likely to be adversely affected by weaker consumer demand.
- The US is also still an important destination of Filipinos working overseas, accounting for around half of total remittances. Thus the slowdown in the US, particularly in the first half of 2008, is likely to have both direct and indirect effects on the domestic economy. Real GDP growth is forecast to moderate to 5¼% in 2008 from an estimated 6.9% in 2007.
- Remittances and investment (portfolio) flows are the main sources of foreign exchange. To help curb the pace of peso appreciation, the government has plans to sell bonds to Filipinos working abroad. It is also working towards offering them a fixed exchange rate to the US dollar to stem increased remittances to compensate for the rising peso.

Jasmine Robinson

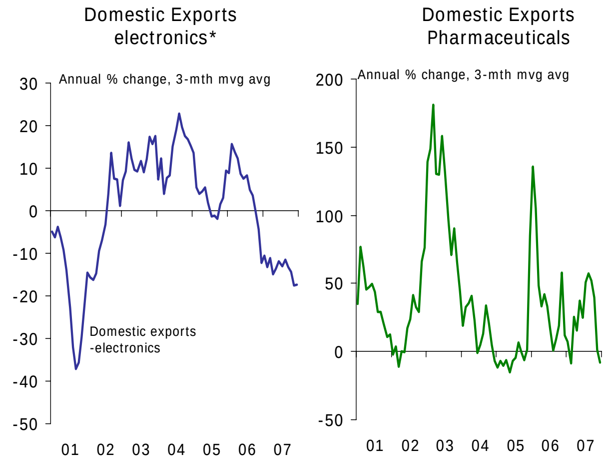
Economic data – Philippines

Monthly data	May 07	Jun 07	Jul 07	Aug 07	Sep 07	Oct 07	Nov 07	Dec 07
Manufacturing Production, %YOY	-7.7	-4.5	0.9	-5.8	-2.7	-1.7	n/a	n/a
Motor Vehicle sales, % YOY	14.0	15.6	15.5	7.5	23.2	35.2	16.5	20.1
Consumer Price Index, % YOY	2.4	2.3	2.6	2.4	2.7	2.7	3.2	3.9
Exports, % YOY	6.1	1.6	5.9	-3.8	4.8	10.7	-1.7	n/a
Imports, % YOY	-3.4	3.8	14.5	2.1	9.7	9.8	n/a	n/a
Trade Balance, US$ mn	-174.0	-588.0	-853.0	-882.0	-371.0	-489.0	n/a	n/a
Foreign Exchange Reserves, US$ bn	22.5	23.3	24.9	27.2	27.7	29.0	n/a	n/a
Quarterly data	**Dec 05**	**Mar 06**	**Jun 06**	**Sep 06**	**Dec 06**	**Mar 07**	**Jun 07**	**Sep 07**
Real GDP, % YOY	5.4	5.7	5.5	5.1	5.5	7.1	7.6	6.6
- Private consumption	5.0	5.3	5.4	5.2	5.8	5.9	6.0	5.7
- Government consumption	-1.5	7.6	3.3	4.5	9.9	9.9	12.4	8.4
- Gross fixed capital expenditure	-6.0	2.4	-1.0	2.1	2.2	8.5	10.1	9.0
Nominal GDP, US$ bn	26.2	28.0	28.4	29.7	31.6	32.8	34.7	36.0
Current Account, US$ bn	1.1	1.2	1.5	1.2	1.7	2.0	1.8	0.6
Capital & Financial Account, US$ bn	-3.1	1.4	-1.7	-0.5	-0.8	0.2	0.1	2.9

Sources: Datastream, Bloomberg

Country Update: Singapore

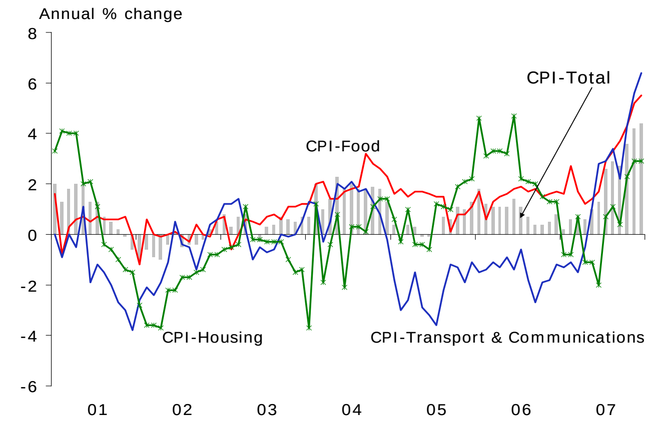
Exports under the pump



*: *Electronics exports : disk drives, integrated circuits, PCs, parts of PCs & telecom. eqpt*

Source: Datastream

Inflation reaches new highs



Source: Datastream

- Real GDP is forecast to have risen by 7.5% in 2007 after advance estimates showed a marked slowing in the economy in the final quarter. The manufacturing sector rose by just 0.5% over the year to Q4 2007, the lowest rate of expansion since Q2 2003 as pharmaceuticals output fell and electronics production lagged. Production from the pharmaceuticals sector is subject to wide swings as plants shut down for maintenance periodically. However, in the electronics sector, which accounts for about 29% of total manufacturing output, a build-up of inventory and expected moderation in external demand for semiconductors could delay the turnaround in this industry.
- Exports in December were decidedly weak with non-oil domestic exports falling by 4.5% from a year earlier, in Singapore dollar terms - the second successive decline. Domestic exports of electronics and telecommunications equipment fell by 15.9% YOY while pharmaceuticals shipments dropped 11.1% YOY after sliding by 21.5% YOY in November.
- Nevertheless, growth in the construction sector stayed robust and the services sector performed well, expanding by an annual rate of 24.4% and 8.3% respectively. While growth in the construction sector is expected to moderate from the robust pace last year, activity is likely to remain healthy. A strong events calendar will drive growth in the services sector.
- Inflation remains a concern with consumer prices accelerating to 4.4% over the year to December. Further upside risks are expected over the coming months as high oil and food costs and increases in utilities add to price pressures. Average annual inflation is forecast to edge up to 4.5% in the first half of this year before moderating to 3.4% in the second half. With the exchange rate used largely to manage inflation expectations, a more rapid pace of appreciation is forecast in coming months alongside weakness in the US dollar but the second half should see a milder appreciation track as the US dollar recovers. Our forecast is for the USD/SGD exchange rate to end the year at 1.38.

Jasmine Robinson

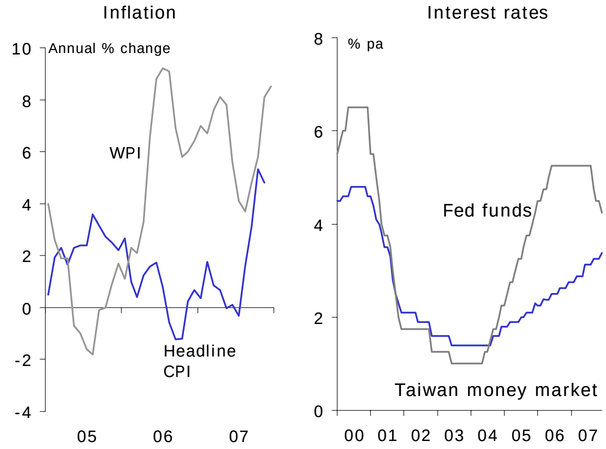
Economic data – Singapore

Monthly data	May 07	Jun 07	Jul 07	Aug 07	Sep 07	Oct 07	Nov 07	Dec 07
Industrial Production, %YOY	17.6	-7.7	21.9	13.1	-2.8	2.2	-1.5	n/a
Retail Sales, % YOY	2.1	14.9	-1.9	6.4	6.5	4.0	-0.3	n/a
Consumer Price Index, % YOY	1.0	1.3	2.6	2.9	2.7	3.6	4.2	4.4
Exports, % YOY	4.0	4.1	14.0	6.2	5.7	19.9	11.8	12.7
Imports, % YOY	2.2	4.3	7.6	2.0	4.7	29.4	21.6	12.1
Trade Balance, US$ bn	2.6	2.6	3.4	3.5	4.1	2.6	1.9	2.0
Foreign Exchange Reserves, US$ bn	140.9	144.1	147.0	147.6	152.4	158.2	n/a	n/a
Quarterly data	**Dec 05**	**Mar 06**	**Jun 06**	**Sep 06**	**Dec 06**	**Mar 07**	**Jun 07**	**Sep 07**
Real GDP, % YOY	8.2	10.3	8.1	6.9	6.5	6.6	8.8	8.9
- Private consumption	3.3	2.8	1.9	2.5	2.7	2.6	5.2	5.8
- Government consumption	11.0	11.5	11.8	19.7	3.6	0.4	0.9	-1.8
- Gross fixed capital expenditure	18.0	10.5	8.3	10.1	17.0	18.8	26.7	14.7
Nominal GDP, US$ bn	30.4	31.3	32.3	33.4	35.2	36.4	38.3	39.8
Current Account, US$ bn	7.4	8.1	9.3	9.0	9.8	10.8	12.0	13.7
Capital & Financial Account, US$ bn	-4.0	-3.6	-6.2	-5.7	-5.5	-8.8	-5.1	-8.0

Sources: Bloomberg, Datastream, Economic Survey of Singapore

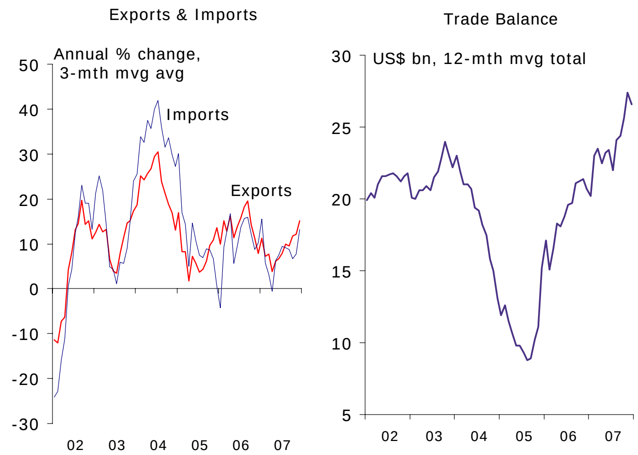
Country Update: Taiwan

Inflation pressures lift interest rates



Source: Bloomberg, Datastream

Trade surplus narrows



Source: Datastream

- Financial markets have reacted positively to the Kuomintang party's (KMT) landslide victory in parliamentary elections held on 12 January. The benchmark Taiex index rose 1.8% on 14 January while the Taiwan dollar climbed 0.4% against the US dollar.
- KMT will have 81 of 113 seats when the new parliament convenes on 1 February. This triumph has also boosted Ma Yin-jeou, the KMT's presidential candidate's chances of a victory in presidential elections to be held on 22 March. He will face Frank Hsieh who replaced President Chen as chairman of the Democratic Progressive Party. A KMT-led government is likely to ease cross-Straits tensions and open up investment opportunities in the mainland. Taiwan could also ease restrictions on direct shipping, postal and air links with China. Mr Ma's proposed initiatives include allowing Taiwanese firms to investment more than 40% of their assets in China and to permit direct travel. An improvement in bilateral ties will bode well for Taiwan's long-term economic growth prospects. KMT's failure to win the presidency, however, could lead to policy delays and constrain growth as it is the president who appoints the prime minister and cabinet.
- On the economic front, inflation remains a concern, raising the risk of further interest rate hikes in coming months. The central bank has raised its policy rate eight times since January 2006 and the rate is currently at 3.375%. Although consumer prices rose by a slower 3.3% over the year to December compared with the 4.8% increase in November, wholesale prices have edged up signalling potential upside risks to CPI in coming months. WPI rose 8.51% YOY, the fastest increase since August 2006.
- Taiwan's trade surplus declined sharply in December to US$2.22 bn compared with US$4.25 bn in November despite exports reaching a record high. Exports grew by 19.3%, in US dollar terms over the year to December but imports rose a sharper 27%, inflated by high oil prices.

Jasmine Robinson

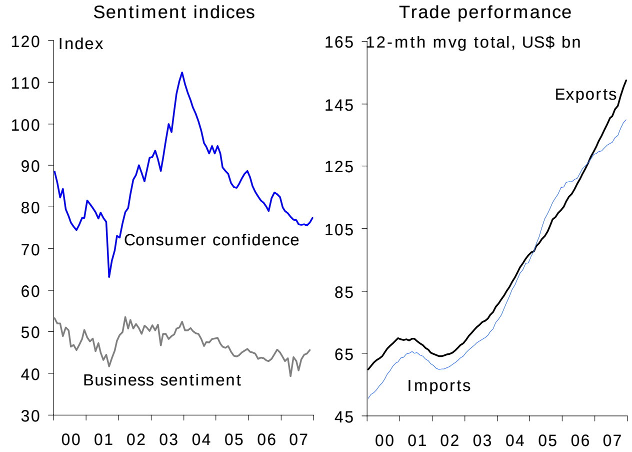
Economic data – Taiwan

Monthly data	May 07	Jun 07	Jul 07	Aug 07	Sep 07	Oct 07	Nov 07	Dec 07
Industrial Production, %YOY	6.6	7.2	13.3	10.3	9.2	16.0	11.13	n/a
Retail Sales, % YOY	2.3	1.8	4.1	6.8	3.8	5.1	n/a	n/a
Consumer Price Index, % YOY	0.0	0.1	-0.3	1.6	3.1	5.3	4.8	3.3
Exports, % YOY	3.4	12.2	8.1	9.8	10.5	15.2	11.0	19.3
Imports, % YOY	-0.2	11.9	16.6	-0.9	10.4	10.6	2.1	27.0
Trade Balance, US$ bn	1.3	1.4	0.4	3.2	3.1	3.4	4.2	2.1
Foreign Exchange Reserves, US$ bn	265.7	266.1	266.3	261.4	262.9	265.9	270.1	270.3
Quarterly data	**Dec 05**	**Mar 06**	**Jun 06**	**Sep 06**	**Dec 06**	**Mar 07**	**Jun 07**	**Sep 07**
Real GDP, % YOY	6.8	5.2	4.6	5.4	4.3	4.5	5.09	6.96
- Private consumption	2.4	2.3	0.9	1.3	2.5	2.2	2.4	3.6
- Government consumption	2.9	-1.0	-0.7	0.1	-0.1	0.2	0.0	1.8
- Gross fixed capital expenditure	-12.8	-3.0	-4.8	3.7	7.4	1.1	6.2	5.2
Nominal GDP, US$ bn	88.6	89.3	89.9	92.5	93.7	91.8	92.1	98.6
Current Account, US$ bn	9.1	5.5	4.5	6.2	8.5	8.7	5.3	6.0
Capital Account, US$ bn	-7.5	-5.8	-6.3	-5.2	-8.5	-10.7	-5.8	-6.1

Sources: Bloomberg, Datastream, National Statistics

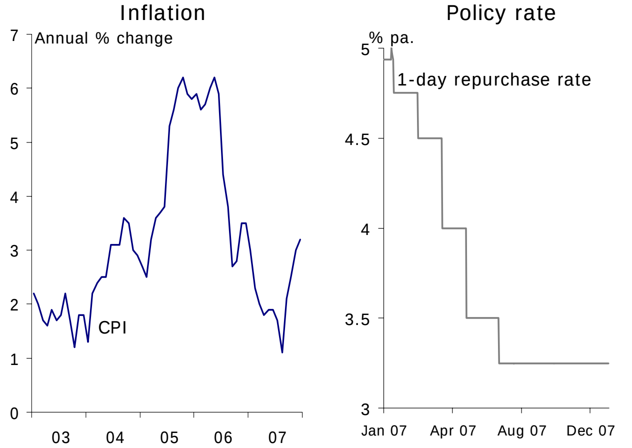
Country Update: Thailand

Pick-up in domestic demand to help offset slowdown in exports



Sources: Bloomberg, Datastream

Policy rate on hold given upside inflation risks



Source: Datastream

- December elections saw the People Power Party (PPP) secure 232 seats in the 480-seat parliament. The PPP has formed a coalition with five other parties to claim a majority in parliament, and has been cleared of charges of acting as a proxy for ousted PM Thaksin Shinawatra, paving the way for the PPP to form a new government. However, the election outcome has been clouded by concerns that the military might step in again if Thaksin's likely return sparked more political turmoil.
- Meanwhile, sentiment ahead of the December elections improved in anticipation of a return to democratic rule. This has been reflected in a strengthening in consumer and business confidence. Private consumption over the past year has been weak and business investment has been weighed down by political uncertainty. Exports have been the main driver of growth but the expected moderation in external demand and high oil prices will mean that net exports is likely to contribute less to GDP growth over 2008. Our forecast is for the economy to expand at a stronger pace of 5.2% as domestic demand gains momentum but this will largely depend on the political backdrop.
- Upside risks to inflation coming from high fuel and food costs are likely to prompt the central bank to keep interest rates unchanged at 3.25% in coming months after adopting an easing bias over the past year. Inflation accelerated to a 12-month high of 3.2% YOY in December. Average inflation for 2007 was 2.3%, below the government's target of 2.5%. This year's target is 3-3.5%. An anticipated pick-up in domestic demand is also likely to drive price growth. The Thai baht continues to strengthen, with the onshore rate reaching a near 10-year high following the central bank's decision to keep interest rates unchanged. A further appreciation is expected in coming months to help limit imported inflation but its pace is likely to be more modest given efforts to help slow the baht's gain.

Jasmine Robinson

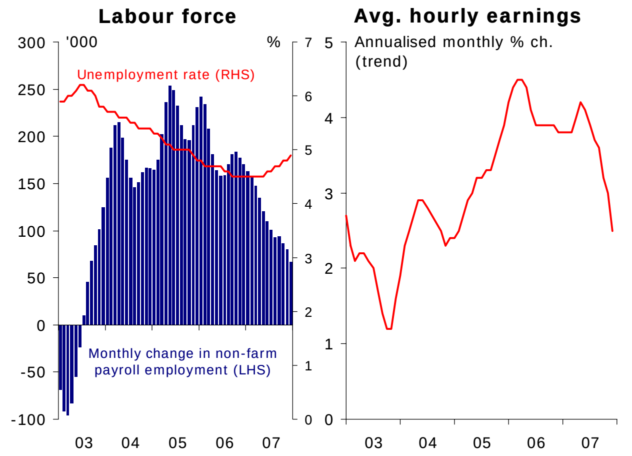
Economic data – Thailand

Monthly data	May 07	Jun 07	Jul 07	Aug 07	Sep 07	Oct 07	Nov 07	Dec 07
Manufacturing Production, %YOY	6.3	3.9	7.8	9.9	8.8	12.7	10.8	n/a
Car Sales, % YOY	-7.8	-4.2	1.0	0.9	8.3	12.6	-0.1	n/a
Consumer Price Index, % YOY	1.9	1.9	1.7	1.1	2.1	2.5	3.0	3.2
Exports, % YOY	18.0	17.7	6.3	17.9	10.4	26.7	24.4	19.0
Imports, % YOY	6.7	5.1	2.4	14.0	7.4	20.3	17.4	8.8
Trade Balance, US$ bn	0.5	0.9	0.2	0.8	2.0	1.5	1.9	1.2
Foreign Exchange Reserves, US$ bn	69.3	71.3	72.2	72.6	78.7	80.3	82.5	n/a
Quarterly data	**Dec 05**	**Mar 06**	**Jun 06**	**Sep 06**	**Dec 06**	**Mar 07**	**Jun 07**	**Sep 07**
Real GDP, % YOY	4.3	6.4	5.4	4.4	4.4	4.2	4.3	4.9
- Private consumption	3.8	4.1	3.1	2.8	2.7	1.3	0.8	1.8
- Government consumption	5.6	3.4	5.7	3.0	-2.8	9.2	9.3	11.5
- Gross fixed capital expenditure	6.1	6.1	3.6	3.9	1.5	-1.5	0.1	2.5
Nominal GDP, US$ bn	45.3	48.7	50.9	52.3	54.8	60.4	63.7	66.8
Current Account, US$ bn	0.0	0.7	-2.3	1.2	2.6	4.7	1.1	2.9
Capital & Financial Account, US$ bn	2.0	2.3	2.4	1.7	-0.7	-2.9	1.8	0.7

Sources: Bloomberg, Datastream,

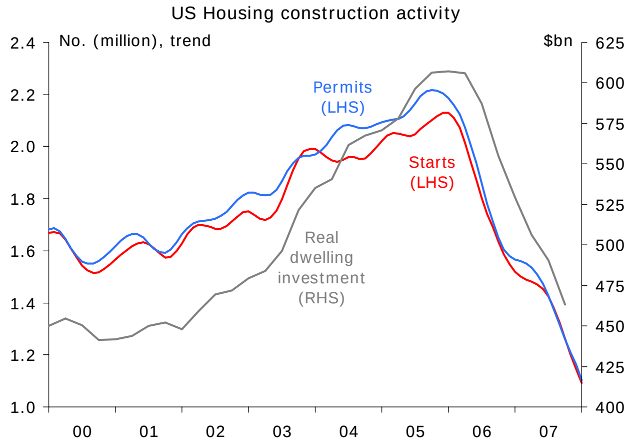
Country Update: United States

The deteriorating labour market will see household income growth slow



Source: Thomson Financial Datastream

The downturn in the residential construction market looks set to deepen



Source: Thomson Financial Datastream

- Economic conditions in the US have deteriorated further, with mounting evidence that the malaise in the housing market is spreading through the rest of the economy. Unease about prospects for the economy has seen financial conditions tighten further over the past month, with equity markets down almost 15% from the peak in September.
- The single most worrying piece of economic news in the past month came from the labour market. Non-farm payroll employment increased by a paltry 18,000 jobs in December slowing annual growth to 1%. The unemployment rate increased to 5% from 4.7% previously, well above the recent cyclical low of 4.4% earlier in 2007. The deterioration in the labour market is significant as, up until now, strong growth in personal disposable incomes has been the primary support for consumer spending.
- We are beginning to see the first signs of financial consolidation in the household sector. Core retail sales (excluding gas and autos) fell for the third time in five months in December, and in trend terms is now growing at an annualised pace of just 2.6%, below the current rate of inflation.
- The downturn in the housing sector shows few signs of abating, and if anything, appears to have intensified. Starts fell a further 14.2% in December while permits fell 8.1%. Both indicators are now around their lowest levels since the early 1990s.
- Against the backdrop of a weakening economic outlook and increasing downside risks to growth, the Federal Reserve surprised markets with a 75bp cut in the Fed funds rate to 3.5% on 22 January, outside its regular meeting schedule. It noted that even after this action, “Appreciable downside risks to growth remain.” The Fed appears to have put its concerns about inflation on the backburner to insure against downside risks to growth, placing the central bank on a significantly more aggressive easing posture. We now expect the Fed funds rate to be lowered to 2% by the middle of 2008.

Mark Rodrigues

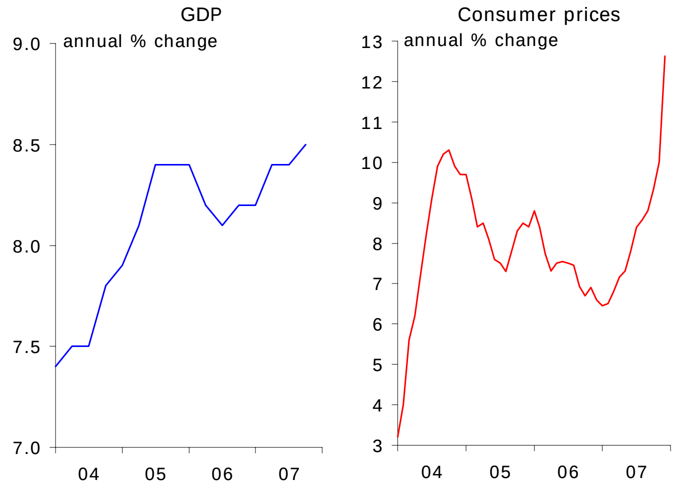
Economic data – United States

Monthly data	May 07	Jun 07	Jul 07	Aug 07	Sep 07	Oct 07	Nov 07	Dec 07
Building permits, 000’s	1520	1413	1389	1322	1261	1170	1162	1068
Retail Sales, % YOY	5.0	3.7	3.3	3.4	5.0	4.7	6.0	4.3
Consumer Price Index, % YOY	2.7	2.7	2.4	1.9	2.8	3.5	4.3	4.1
Core Consumer Price Index, % YOY	2.3	2.2	2.2	2.1	2.1	2.1	2.3	2.4
Exports, % YOY	11.7	11.0	15.1	13.6	13.8	13.7	13.0	n/a
Imports, % YOY	4.4	4.6	5.2	3.2	5.4	9.1	11.4	n/a
Trade Balance, USD bn	-59.9	-59.6	-59.1	-57.0	-57.1	-57.8	-63.1	n/a
Quarterly data	**Dec 05**	**Mar 06**	**Jun 06**	**Sep 06**	**Dec 06**	**Mar 07**	**Jun 07**	**Sep 07**
Real GDP, % YOY	2.9	3.3	3.2	2.4	2.6	1.5	1.9	2.8
- Private consumption	2.8	3.3	3	2.7	3.4	3.2	2.9	3.0
- Government consumption	0.9	1.8	1.8	1.2	2.5	1.2	1.9	2.7
- Gross fixed capital expenditure	5.1	7.5	7.3	6.4	5.2	2.5	4.1	5.1
Unit labour costs (non-farm), %YOY	1.6	2.8	2.2	2.6	4.1	4.3	4.2	3
Current Account, US$ bn	-215.8	-200.6	-205.6	-217.3	-187.9	-197.1	-188.9	-178.5
Capital & Financial Account, US$ bn	291.2	192.4	142.2	239.5	226.4	166.6	153.2	92.8

Sources: Datastream Note: data seasonally adjusted unless otherwise stated

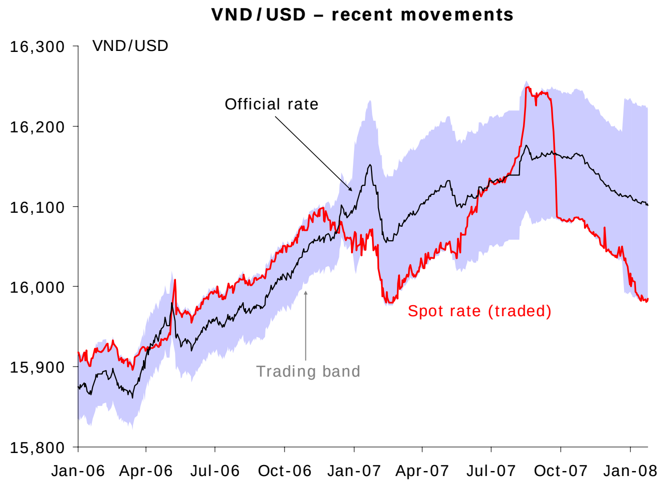
Country Update: Vietnam

GDP growth has strengthened, but inflation has risen at an even faster rate



Source: CEIC

The dong continues to appreciate against the USD



Sources: Bloomberg, Reuters and Economics@ANZ

- The Vietnamese economy clocked up real GDP growth of 8.5% in 2007 according to preliminary estimates from the General Statistics Office, meeting the set plan annual growth target of 8-8.5%. Services grew at an annual rate of 8.7%, exceeding the set plan, while growth in the agriculture, forestry and fishery sector came in at 3.4%, and annual growth of 10.6% was achieved in the industry and construction sector.
- Consumer prices continued to accelerate, climbing to an annual rate of 12.6% in December, the fastest rate of increase since 1995. Food prices persist in being the main driver of headline inflation, rocketing up 18% in the year to December. Prices for construction materials have also surged 17.1% over the year to December as Vietnam imports increasing amounts of building materials needed for a real-estate boom. However, massive inflows of foreign exchange which are increasing the money supply are also to blame.
- The State Bank of Vietnam (SBV) has implemented a number of initiatives in an attempt to slow prices growth. Firstly, there appears to be a growing acceptance by the SBV of increased exchange rate flexibility: in a surprise announcement on 24 December, the SBV allowed daily dollar-dong movements to fluctuate in a wider range of plus or minus 0.75% from a rate set each morning by the Bank, versus 0.50% previously. We expect the dong to appreciate around 3% by mid 2008, and another 1% in the second half of the year as China and the global economy slow, before modestly depreciating by approximately 1% in 2009 as the USD rebounds.
- Further, in an announcement in late January, the SBV stated that it is raising the reserve requirement for credit institutions, effective as of February. For dong and foreign currency deposits up to one year (including demand deposits), the compulsory reserve rate will be raised to 11% from 10%, with the reserve rate on deposits of more than 12 months raised to 5% from 4%.
- The SBV has also announced that it will remove limits on the amount of dong that overseas investors may convert into foreign currency. The increased flexibility in capital flows is hoped to encourage trade and investment in the country.

Amber Rabinov

Economic data – Vietnam

Monthly data	May 07	Jun 07	Jul 07	Aug 07	Sep 07	Oct 07	Nov 07	Dec 07
Industrial Production, %YOY+	17.1	19.5	18.7	18.9	18.1	16.7	17.4	20.7
Retail Sales, % YOY	27.7	27.3	25.1	26.0	24.4	24.2	25.1	25.0
Consumer Price Index, % YOY	7.3	7.8	8.4	8.6	8.8	9.3	10.0	12.6
CPI-Food & Foodstuffs, %YOY	9.2	9.9	11.1	11.9	13.3	13.9	14.9	18.9
Exports, % YOY+	19.7	19.7	19.6	19.3	18.3	19.3	21.0	21.5
Imports, % YOY+	32.8	31.3	31.3	30.9	30.2	31.9	34.9	35.5
Trade Balance, US$ bn +	-3.8	-4.7	-5.6	-6.6	-7.9	-9.2	-10.8	-12.4
Tourist Arrivals, %YOY+	11.7	14.7	16.2	16.9	18.5	17.8	17.7	18.0
Quarterly data	Growth Q4-2007							
Real GDP+, % YOY		8.5						
Agriculture, forestry, fishery, % YOY		3.4						
Industry & construction, % YOY		10.6						
Services, % YOY		8.7						

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

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