Global Economic Research

International Views

Spring 2006

Global growth remains robust alongside persistent trade imbalances. North America, Europe and Japan are adopting a monetary tightening bias. International leaders are increasingly focused on energy security and avian flu risks. Iran crisis heightens security tensions in the Middle East. Developing economies are well positioned to absorb the shock posed by higher interest rates.

Robust, though decelerating, economic activity will materialize in the United States in the context of large trade and fiscal deficits. Oil price strength and currency appreciation are shaping Canadian and Mexican outlooks. Intensive debt refinancing improves Latin American prospects amidst a sensitive electoral cycle.

Renewed sense of economic optimism, coupled with oil market sensitivity, leads to pre-emptive monetary tightening in Europe. Leadership transition intensifies in core European nations. Market rigidities limit growth potential and delay fiscal consolidation. Russia becomes a stabilizing force in global energy markets.

Asia remains the world's fastest growing region, led by China and India. Japan's economic revival signals the end of the zero-interest rate policy while Koizumi's departure looms on the horizon. China continues to dictate the speed of changes to its currency regime, instilling an appreciating bias to Asian currencies.

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Foreign Currency Long Term Sovereign Credit Ratings

INVESTMENT GRADE

Moody's

RATING	AMERICAS	EUROPE	ASIA & OCEANIA	MIDDLE EAST & AFRICA
Aaa	Canada United States	Austria Denmark Finland France Germany Ireland Luxembourg Netherlands Norway Spain Sweden Switzerland UK	Australia Japan New Zealand Singapore	
Aa1	Bermuda	Belgium		
Aa2		Italy Portugal		
Aa3	Cayman Islands	Slovenia	Taiwan	
A1		Czech Rep. Greece Hungary (-)	Hong Kong Macao	Qatar UAE
A2		Cyprus Poland Slovakia (+)	China	Israel Kuwait (+)
A3	Bahamas	Malta	Malaysia South Korea	Saudi Arabia
Baa1	Chile (+) Mexico		Thailand	Bahrain Oman South Africa
Baa2	Barbados Trinidad and Tobago	Russia		Tunisia
Baa3	El Salvador	Croatia	India Kazakhstan (+)	

Standard & Poor's

RATING	AMERICAS	EUROPE	ASIA & OCEANIA	MIDDLE EAST & AFRICA
AAA	Canada United States	Austria Denmark Finland France Germany Ireland Luxembourg Netherlands Norway Spain Sweden Switzerland UK	Australia Singapore	
AA+		Belgium	New Zealand	
AA	Bermuda			
AA-		Italy (-) Portugal Slovenia	Hong Kong Japan Taiwan (-)	
A+				Kuwait Qatar
A	Chile	Cyprus Greece Malta	South Korea	Saudi Arabia (+)
A-	Bahamas Trinidad and Tobago	Czech Rep. (+) Hungary (-) Slovakia (+)	China (+) Malaysia	Bahrain (+) Israel
BBB+	Barbados (-)	Poland (+)	Thailand	Oman South Africa
BBB	Mexico	Croatia Russia		Tunisia
BBB-		Romania	Kazakhstan	

Fitch

RATING	AMERICAS	EUROPE	ASIA & OCEANIA	MIDDLE EAST & AFRICA
AAA	Canada United States	Austria Denmark Finland France Germany Ireland Luxembourg Netherlands Norway Spain Sweden Switzerland UK	Singapore	
AA+			Australia New Zealand	
AA	Bermuda	Belgium Italy (-) Portugal (-)	Japan	
AA-		Slovenia (+)	Hong Kong	Kuwait
A+		Cyprus (+)	South Korea Taiwan	
A	Chile	Czech Rep. Greece Malta (+) Slovakia	China	Saudi Arabia
A-			Malaysia	Bahrain Israel
BBB+		Hungary Poland (+)	Thailand	South Africa
BBB	Aruba (-) Mexico	Russia	Kazakhstan	Tunisia
BBB-		Croatia Romania		

SPECULATIVE GRADE

Moody's

RATING	AMERICAS	EUROPE	ASIA & OCEANIA	MIDDLE EAST & AFRICA
Ba1	Costa Rica (-) Panama	Romania (+)		Egypt Morocco
Ba2	Colombia Guatemala			Jordan (-)
Ba3	Brazil (+) Peru	Turkey	Vietnam	
B1	Jamaica		Mongolia Papua New Guinea Philippines (-)	
B2	Venezuela		Indonesia (+) Pakistan (+)	
B3	Argentina Dominican Rep. Uruguay (+)			Lebanon
Caa1	Cuba Ecuador (+) Nicaragua			
Caa2				
Caa3	Belize			
-				
-				
Ca				

Standard & Poor's

RATING	AMERICAS	EUROPE	ASIA & OCEANIA	MIDDLE EAST & AFRICA
BB+	El Salvador		India	Egypt Morocco
BB	Colombia(+) Costa Rica Panama Peru (+) Brazil			Jordan
BB-	Guatemala Venezuela	Turkey (+)	Philippines Vietnam (+)	
B+			Indonesia (+) Pakistan (+) Sri Lanka	
B	Dominican Rep. Jamaica Uruguay (+)		Mongolia (+) Papua New Guinea	
B-	Argentina Grenada			Lebanon
CCC+	Ecuador			
CCC				
CCC-	Belize (-)			
CC				
C				
SD				

Fitch

RATING	AMERICAS	EUROPE	ASIA & OCEANIA	MIDDLE EAST & AFRICA
BB+	Panama El Salvador Guatemala		India	Egypt
BB	Colombia Costa Rica (-) Peru (+)		Philippines	
BB-	Brazil (+) Venezuela	Turkey (+)	Indonesia Sri Lanka Vietnam	Iran (-)
B+	Uruguay		Mongolia	
B			Papua New Guinea	
B-	Dominican Rep. Ecuador (-)			Lebanon (+)
CCC+				
CCC				
CCC-				
CC				
C				
DDD	Argentina			

Note : (+) "Positive Outlook"; (-) "Negative Outlook"; (rwn/p) Rating Watch Negative/Positive

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International Views

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Global economic growth will continue to be driven by resilient US domestic demand and robust, broad-based gains in China and other key developing countries. A gradual deceleration in activity in the NAFTA zone, with output increasing by about 3¼% in 2006, will be partially offset by a modest revival in the Euro zone. Japan's expansion will become more heavily dependent on domestic spending. With the exception of the Bank of England, central banks in advanced economies will lean towards nudging interest rates higher. The degree of reduction in policy accommodation will be tempered by generally low rates of inflation, exchange rate uncertainties, commodity volatility and concern about the consequences of liquidity reduction on asset markets.

Energy and industrial commodity prices will be underpinned by burgeoning demand from China and other emerging industrial leaders and by sustained demand from the United States, Europe and Japan. Security tensions in the Middle East and Nigeria also point to the persistence of high and volatile crude oil prices. The US accounts for a quarter of world oil usage and imports nearly 60% of its needs – up from about one-third of its requirements in the mid-1980s. China – the world's second largest oil consuming nations – accounts for only 8% of global usage. However, over the past 3 years, its economy has grown at an average rate of 10%. Apparent oil demand will expand by 6% in 2006. China is also the world's biggest consumer of copper, zinc, aluminum, coal and iron ore.

Adjusting for the impact of hurricanes and other weather-related distortions, US growth is expected to fall below 3% by year-end; it experienced a moderating trend over the past year. Business investment in productivity-enhancing initiatives will not fully offset the softening in big-ticket consumer purchases as job creation moderates and the new Fed Chairman, Ben Bernanke, follows his predecessor in nudging borrowing costs higher. Chronic fiscal and trade deficits, which are unlikely to show any meaningful improvement in 2006-07, remain a constraint on overall economic performance.

Despite booming conditions in the energy-rich west, Canadian growth is likely to lag the US performance this year, particularly if the Canadian dollar continues to appreciate. Intensifying offshore competition and reduced US momentum will add to the pressure on domestic manufacturing and other trade-dependent industries to cut costs and boost productivity. Mexican growth will also hinge on energy markets, although overall gains should slightly outpace the US trend. Prospects for most of the developing Americas are promising, despite uncertainties linked to presidential elections in Peru (April), Colombia (May), Mexico (July), Brazil (October) and Venezuela (December). The strengthening of domestic financial sectors and securities markets, coupled with improvements in public external debt burdens through prepayments and buybacks, are key factors supporting this favourable outlook. While Brazil has become a symbol of growth and stability, social and political tensions have persisted in Venezuela and Argentina.

There is growing evidence of a revival in European domestic demand, though gains will be limited by the slow advance of structural reforms to labour and product markets. The external sector will be constrained by renewed currency strength. Monetary policy remains very cautious, with the European Central Bank now gradually pushing interest rates higher despite low rates of inflation and an uneven and generally lackluster economic performance across the Euro zone.

Russia – the world's largest producer of crude oil and natural gas – has emerged as a major force influencing energy markets amidst heightened security tensions in the Middle East. In particular, Russia will be a key player in Western Europe's quest for adequate longer-term supplies of oil and gas. Economic prospects also are positive for Turkey as it advances structural reforms and privatization.

Japan is finally showing signs of more sustained economic revival, with real GDP set to expand by about 2.5% in 2006. The nation remains the world's largest foreign holder of US Treasury bonds. China is poised to grow by about 9% annually, followed by India, which is cruising along a 7% trend. Gains in market share, rapid growth of the Asian market and the prospect of very robust growth in domestic demand should keep these economies in the fast lane well beyond 2006.

China remains the world leader in attracting foreign direct investment, with inflows totalling about US$60 billion in 2006 for the third year in a row. Improvements in the regulatory and supervisory framework point to an acceleration in structural reforms in the domestic financial sector. While the rest of developing Asia will benefit from robust growth in the largest economies, many countries are vulnerable to persistently high crude oil prices and overheating in its securities markets.

Despite growing friction between the US and China in connection with the government-administered exchange rate regime, appreciation of the yuan will be moderate. The sizable accumulation of foreign exchange reserves will allow the Chinese authorities to comfortably manage exchange rate liberalization. Global liquidity is becoming increasingly concentrated in Asian central banks: combined foreign exchange reserves in Japan, China, Hong Kong and Taiwan reached US$2 trillion at the end of 2005.

AMERICAS

The US economy is expected to grow 3.2% this year following a 3.5% expansion in 2005. The modest slowdown is largely a reflection of the smaller contribution to growth that we anticipate later this year from the household sector, whose purchases of durable goods and investment in real estate have helped the US grow at an above-trend pace over the past two years.

There have been few signs that a slowdown in the housing sector has begun to affect consumer spending – mortgage refinancing cash-outs were very strong in Q4, which, alongside warm weather and late-season holiday shopping, helped lift retail sales by 2.3% m/m in January. Retail sales softened in February, but consumers are still carrying considerable momentum early in the year. Nevertheless, rising short-term interest rates are making it more expensive for households to continue spending in excess of their personal disposable incomes, blunting demand for consumer credit and revolving home-equity loans. A torrid pace of new home construction and deteriorating home affordability have resulted in a significant increase in the supply of properties available for sale. This should weigh on consumer spending via a reduced rate of home equity extraction as price appreciation begins to slow. Real estate- and construction-related jobs have made a major contribution to overall employment growth in recent years, so a lower level of new residential construction will also weigh on spending via its effect on income growth.

As consumer spending slows, business investment should continue at its recent elevated pace, sustaining the economic expansion. Corporate cash flow has been strong, and with balance sheets in good shape, businesses have the wherewithal to continue investing briskly, even though corporate profits are expected to slow. The primary risk is a loss of confidence in the sustainability of the economic expansion, perhaps due to a resurgence in energy prices or a disorderly correction in housing markets. According to the Conference Board, CEO sentiment rebounded in Q4; however, it remains well below the levels seen two years ago. The pace of business investment early in 2006 will be telling, because in addition to strong cash flow, businesses have enjoyed a tax holiday on repatriated foreign earnings over the past year. A failure to put some of this cash to work expanding capacity – which has tightened considerably in the past two years – would be an unwelcome sign of reticence in executive suites.

The trade deficit is expected to set another record in 2006 despite our expectation of a slowdown in consumer spending later this year, posing a further modest drag on overall growth. A pickup in domestic spending in Europe, the ongoing recovery in Japan and a renewed weakening in the US dollar should contribute to a faster pace of export growth; however, the expansion in those countries is forecast to fall well short of what we expect from the US this year, limiting the scope for a significant improvement in the US external accounts. Combined with a shrinking positive balance on investment income, the current account deficit is expected to widen to a record 6.6% of nominal GDP this year.

The pressure on headline inflation from energy prices is expected to abate this year, slowing annual CPI growth from its 5-year high of 3.4% in 2005 to about 2.7%. However, recent geopolitical developments underscore the uncertainty of the outlook for energy prices. Core inflation has remained within the Fed's comfort zone despite tightening labour and product markets. Strong competition, ongoing productivity gains and a lack of pressure on wages have helped keep a lid on inflation. However, while consumer goods inflation is expected to remain under wraps in the year ahead, we foresee more pressure on core inflation from the services sector and housing in particular.

The Federal Reserve is widely seen to be nearing the end of its more than 1½ year long rate hike campaign. Policymakers explicitly stated in the minutes to the January 31st FOMC meeting that near-term policy would depend on incoming economic data, which have been difficult to interpret given the noise introduced by Hurricane Katrina. However, real GDP growth could exceed 5% (annualized) in Q1, while the trend in underlying inflation has been a bit stronger since last summer, suggesting the hawks on the committee will lobby for a further increase in Fed funds in Q2. We expect two more rate hikes from the Federal Reserve before mid-year, bringing the Fed funds rate to 5%.

US - KEY ECONOMIC INDICATORS					
GDP: US$12.5 trillion (2006f)	**Population: 294 million (2005e)**				
Long-term Foreign Currency Rating: Moody's: Aaa S&P: AAA					
	2003	**2004**	**2005e**	**2006f**	**2007f**
Real GDP (% change)	2.7	4.2	3.5	3.2	2.7
Industrial Production (%)	0.6	4.1	3.2	3.8	3.0
Fiscal Balance (% GDP)	-3.4	-3.5	-2.6	-2.9	-2.7
Inflation (eop % change)	1.9	3.4	3.7	2.0	1.9
US$/Euro (year end)	1.26	1.36	1.18	1.28	1.33
Yen/US$ (year end)	107.2	102.5	117.0	105.0	98.0
Fed Funds (% year end)	1.00	2.25	4.25	5.00	4.25
Trade Balance (US$ bn)	-547	-665	-782	-860	-865
Total Exports (US$ bn)	713	808	892	960	1045
Total Imports (US$ bn)	1261	1473	1674	1820	1910
Current Account (US$ bn)	-520	-668	-805	-870	-860
% of GDP	-4.7	-5.7	-6.4	-6.6	-6.6
Public debt (% of GDP)	36	37	37	38	39
Public debt service (% GDP)	1.4	1.4	1.5	1.7	1.8

Canadian output growth moderated slightly over the final months of 2005, though the economy continues to expand at a reasonably good clip. We expect real GDP growth to average slightly below 3% this year and next, essentially in line with the 2004-05 pace. On a regional basis, momentum will continue to favour the resource-rich provinces of western Canada and Newfoundland & Labrador over the manufacturing heartland of central Canada. High commodity prices remain a major factor supporting exports and earnings. Continuing momentum in the US is also helping to underpin manufacturing activity; however, the subdued pace of shipments and new orders suggest that overall market conditions remain challenging. This is perhaps most evident in the large motor vehicle and parts sector, which has recently announced major multi-year restructuring initiatives and payroll cuts.

Strong commodity prices and demand are bolstering export receipts and the trade surplus. Nevertheless, many of Canada's traditional manufacturers continue to struggle in the face of an appreciating currency and lower-cost overseas production. The trade surplus in energy products has surpassed C$50 billion, more than double the level recorded in the late 1990s. Over the same period, however, the trade surplus in motor vehicles and parts has dropped by more than half, falling to C$10 billion in 2005 for the first time since 1997.

A diet of healthy job and income gains, low borrowing costs and aggressive pricing have kept consumers in a buying mood. Retail sales volumes rose almost 5% in 2005 while household credit demand jumped 10%. The housing market remains red-hot, with starts running only modestly below the peak levels reached in 2004, and home sales as well as prices continuing at a record pace. Combined, consumers and homebuilders contributed 2½ percentage points to Canada's 2.9% real GDP advance for 2005.

Looking ahead, however, we expect consumer spending and the housing sector to provide less support to overall economic growth, particularly if the pace of job creation begins to slow. Tax relief and rebates are providing some offset to high energy costs, but with virtually no savings cushion to draw on, many households may opt to trim their discretionary outlays. Reduced affordability and modestly higher interest rates are also expected to temper homebuying activity, particularly among first-time buyers who have fuelled the housing boom in recent years.

In this environment, businesses and governments are expected to do most of the heavy lifting. The stronger Canadian dollar, healthy corporate balance sheets and competitive pressures are making efficiency-enhancing machinery and equipment investments, which are now growing at a double-digit annual rate, increasingly attractive. High commodity prices are spurring major capital investments in the energy, mining and other resource sectors. Non-residential construction is also getting a lift from renewed office market activity and expanded distribution facilities, most notably in the Western provinces.

At the same time, governments at all levels are ramping up infrastructure spending on much-needed transportation and utility upgrades, as well as on new or expanded health care and educational facilities. Combined, business investment and government expenditures should contribute about 2 percentage points to Canada's projected 2.8% economy-wide advance this year – slightly more than the contribution from the much larger consumer and housing component.

Underlying inflation trends are still subdued, suppressed by an appreciating domestic currency and intense competitive pressures. Nevertheless, wage pressures have begun to build and, with the unemployment rate holding near its lowest level in three decades and anecdotal reports of skilled labour shortages in key industries, the Bank of Canada is expected to continue nudging rates higher through the first half of 2006. At the same time, fiscal policy is likely to remain stimulative, with the newly elected minority federal Conservative government expected to proceed with several tax and spending initiatives.

On the policy front, trade-related issues will likely remain high on the agenda, with the record US trade deficit threatening to intensify protectionist sentiments south of the border. Developing new export markets and reducing Canada's reliance on the US – destination for 85% of its foreign shipments – is taking on added importance. Given an increasingly competitive global environment, improving Canada's rather dismal labour productivity performance is also a priority, though there have been some encouraging signs that accelerated capital spending is beginning to pay dividends.

CANADA - KEY ECONOMIC INDICATORS					
GDP: US$1291 billion (2006f)	Population: 32.3 million (2005e)				
Long-term Foreign Currency Rating: Moody's: Aaa S&P: AAA					
	2003	2004	2005e	2006f	2007f
Real GDP (% change)	2.0	2.9	2.9	2.8	2.7
Industrial Production (%)	0.7	3.8	2.1	3.1	2.3
Fiscal Balance (% GDP)	0.7	0.1	0.2	0.2	0.3
Inflation (eop % change)	2.0	2.1	2.2	1.5	2.0
CAD$/US$ (year end)	1.29	1.21	1.16	1.10	1.08
Overnight rate (% year end)	2.75	2.50	3.25	4.00	3.50
Trade Balance (US$ bn)	41	51	55	58	48
Total Exports (US$ bn)	286	330	374	429	457
Total Imports (US$ bn)	245	279	319	371	409
Current Account (US$ bn)	13	22	25	23	10
% of GDP	1.5	2.2	2.2	1.8	0.7
Public debt (% of GDP)	41	39	37	35	33
Public debt service (% GDP)	2.9	2.6	2.5	2.4	2.3

Sustained economic expansion in Latin America, yet not impressive by emerging market standards

The core countries in the developing Americas remain in expansion mode. A favourable commodity market cycle, excess global liquidity and low, yet increasing, interest rates support a positive, broad-based, growth outlook; however the region as a whole is not expanding as quickly as developing regions in Asia and Europe. The absence of substantial structural reforms in Mexico, the persistence of high interest rates in Brazil, the fight against narco-terrorism in Colombia, slow progress in enhancing the business environment and the quality of institutions in Venezuela and Argentina, and a heavy electoral calendar in the months ahead act as persistent growth impediments.

Monetary regimes in consolidation mode; government intervention remains an option

Floating currency regimes, inflation-targeting, improving fiscal consolidation and foreign exchange reserve accumulation are the policy recipes in vogue in the developing Americas. Mexico, Chile and Peru have already converged to US-style inflation standards, whereas Brazil and Colombia are heading in that direction. Argentina and Venezuela still retain double-digit inflation rates, although there is some improvement in sight. Official intervention in exchange rate markets remains the norm in Brazil, Venezuela, Argentina and Colombia, while the better rated countries do not see it as a policy option. Strict capital controls and government interference in the formation of prices will persist in Argentina and Venezuela longer than planned, undermining the conduct of monetary policy.

Ongoing strengthening of domestic financial sectors & local capital markets; dollarization widely rejected

All countries in the developing Americas are strengthening their domestic banking sectors. While Chile is at the top of the charts in overall strength, progress in Mexico is remarkable. Also, Peru and Colombia enjoy relatively sound financial sectors, whereas systemic risk in both Argentina and Venezuela remains high. Countries with more robust financial sectors are accelerating the development of local securities markets; in particular, Mexico is rapidly deepening its government fixed-income securities market. The dollarization ratio in banking sector assets and liabilities as well as in public debt instruments is also receding, thereby improving the creditworthiness in most countries in the region. Brazil has virtually eliminated US dollar-linked debt obligations, Argentina reduced the foreign currency debt after its sizable debt restructuring in 2005 and Peruvian savings are shifting towards local currency instruments. Mexico, Chile and Brazil are seeking to deepen the international use of their local currencies in financial transactions.

Adequate preparedness to weather external shocks, yet overheating risk in securities markets is high

The constant search for higher yield by global portfolio investors remains alive. As a result of massive capital inflows, debt and equity securities in the developing Americas are showing signs of overheating and overvaluation. In addition, the potential for disorderly currency adjustments linked to the massive US trade and fiscal deficits, coupled with persistent supply-side and demand-side pressures on global energy markets, increases the likelihood of disruptive exogenous shocks undermining the Americas. In preparation for such a scenario, sovereign borrowers have been conducting an aggressive programme of asset liability management composed of prepayments, buybacks and debt exchanges. Also, Latin America has over US$200 billion in foreign exchange reserves to help manage the increase in currency and security market volatility that may ensue throughout the year.

Energy-driven regional integration initiatives cohabit with ideology-intensive official rhetoric

The proliferation of bilateral investment and trade agreements between the United States and individual or small groups of countries in the Americas points to the weakening, if not outright failure, of the Free Trade Area of the Americas (FTAA) initiative. The heated debate on the CAFTA-DR agreement in the US congress also hints at persistent protectionist pressures in the north, with negative consequences for the integration with Brazil-led South American countries. The US plan to build a 1,300 km-long wall at the border with Mexico also sends a conflicting message to leaders in the Americas who are embracing regional integration as a priority. Energy security and immigration control, not trade liberalization, remain US priorities. Meanwhile, the adverse social effects of more open economic borders may continue to fuel anti-globalization ideologies in many countries in the region.

Leadership transition in major countries to fuel temporary policy uncertainties and investment delays

Latin America will be subject to very important presidential elections this year. Following the smooth transition in Chile, attention is now focused on Peru (April), Colombia (May), Mexico (July), Brazil (October) and Venezuela (December). In this context of multiple electoral-related uncertainties, Brazil has emerged as an axis of stability, growth and conflict resolution in Latin America. Its significant role in G7 ministerial meetings, its key contribution to Haiti's institutional reconstruction, its leadership in multilateral trade liberalization talks and its potential role in alleviating ideologically inspired tensions in Argentina, Bolivia and Venezuela are welcome developments.

The dynamics of an election year will dominate the Brazilian business climate over the coming months. However, for the first time in decades, there is evidence of economic disengagement from election-related politics; policy continuity will prevail after the October 1st presidential vote. All international credit rating agencies maintain a "positive" outlook for Brazil's sovereign credit rating.

Convergence towards US-style price stabilization is progressing remarkably well. There is widespread consensus – amongst domestic analysts – that consumer price inflation, measured by the IPCA index, will continue on a declining phase and trend towards 4.6% by the end of 2006. The monetary authorities deserve recognition for their inflation-containment successes. The combined effect of extremely high interest rates (the highest within the G20 group) and an appreciating exchange rate (the second best performing currency versus the US dollar last year) contributed to the marked reduction of price pressures. High energy costs have not undermined progress on the inflation front; however, further shocks to the global oil market on the back of heightened security concerns in the Middle East may adversely affect Brazilian economic prospects.

High government-administered short-term interest rates are taking their toll in terms of economic activity; a sharp deceleration during the second half of 2005 limited real GDP growth for the year as a whole to about 3%, down from 5.1% in 2004. Looking ahead, local interest rates will likely decline to 15% by the end of this year. Even so, domestic demand will be negatively influenced by the maintenance of a growth-damaging interest rate environment, limiting the economic expansion to 3.5% in 2006/07.

Progress on the external front is impressive; as a top-tier developing economy, Brazil continues to deepen its influence in global trade. The execution of an export-led development strategy is showing evidence of success. The country's foreign trade surplus, the second largest in the Americas, achieved an unprecedented level of US$45 billion in 2005. It is worth noting that international trade dynamics have improved both in quantitative and qualitative terms. In terms of products and markets of destination, Brazilian exports show a well-diversified and balanced mix. The country's export sector should benefit from another year of still-solid global economic activity.

A steady improvement in public sector finances is at the root of the positive outlook for further credit rating upgrades. In a surprising, yet favourably received move, the Lula da Silva administration opted to prepay the entirety of the debt obligations owed to the International Monetary Fund last December. Global investors welcomed the initiative, as it was interpreted as a decision made from a position of strength. Owing to its sizable trade surplus and steady accumulation of foreign exchange reserves, the Brazilian government was in a strong position to surprise the global financial community. With US$57 billion in liquid international reserves combined with still very high interest rates, Brazil is well-placed to weather any financial shock which may be caused by a depreciating US dollar or higher US interest rates. On a positive fiscal note, Brazil has virtually eliminated currency-indexed government debt securities, further contributing to de-dollarization efforts. However, the fiscal adjustment may face adverse headwinds in the period leading to the October 2006 presidential election; the consolidated public sector deficit will average 2.6% of GDP over the next two years.

Brazil has emerged as a truly influential force in global affairs, particularly regarding those regional issues affecting the developing world. In fact, the US views the country as a key ideological ally to counteract the development of left-leaning anti-US sentiment in the southern countries of the hemisphere. Brazil's peace-keeping leadership in Haiti, its forceful presence in the Doha round of trade liberalization talks, its role in moderating the potential confrontation between the US and Venezuela and the repeated participation (as a special guest) in G7 ministerial gatherings highlight the regional leadership role that Brazil has adopted over the past two administrations. A second term for President Luiz Inácio Lula da Silva is far from being secured; indeed, it remains uncertain whether the president will seek re-election. Moreover, persistent high unemployment will have a negative effect on the current administration's political outlook. However, we do not expect any material deviation from current policies when a new government takes office in January 2007.

BRAZIL - KEY ECONOMIC INDICATORS

GDP: US$918 billion (2006f) — Population: 185 million (2005e)

Long-Term Foreign Currency Rating: Moody's: Ba3(+) S&P: BB

	2003	2004	2005e	2006f	2007f
Real GDP (% change)	0.1	5.1	2.3	3.5	3.5
Industrial Production (% change)	0.5	7.7	3.2	4.0	4.3
Harmonized Fiscal Balance (% GDP)	-5.1	-2.6	-3.3	-2.8	-2.4
Consumer Prices (eop % change)	9.3	7.6	5.7	4.8	4.5
Exchange Rate (% change)	21.8	9.4	13.0	4.4	-8.2
Exchange Rate (year-end)	2.91	2.66	2.35	2.25	2.45
Trade Balance (US$bn)	24.8	33.7	44.8	40.0	35.0
Exports (US$bn)	73	96	118	130	145
Imports (US$bn)	48	63	74	90	110
Current Account (US$bn)	4.2	11.7	14.0	8.0	5.0
% GDP	0.8	1.9	1.8	0.9	0.5
FDI (% of current account deficit)	n/a	n/a	0	n/a	n/a
External Debt (US$bn)	215	201	185	180	175
% of GDP	43	33	23	20	18
% of Exports of G&S	275	198	149	138	121
Public Sector (% of total)	63	66	66	67	66
S-T Debt / Reserves (%)	41	38	31	25	20
Foreign Reserves (US$bn)	49	49	54	60	70
Months of Imports	12	9	9	8	8

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Mexico

The July presidential and congressional elections will dominate the political scene and investment climate during the first half of the year, keeping market participants in a cautious mood. Moreover, the lengthy transition to a new six-year administration may trigger delays in foreign investment and legislative approval of long-overdue structural reforms. The quest for private sector competitiveness, not public sector debt sustainability, will shape the policy agenda of the new government. Building a national front to tackle structural deficiencies will be a key challenge for Mexican leaders. Without material advances in the implementation of structural reforms, Mexico's sovereign credit rating will not be upgraded.

The economy remains on a moderate, sustainable, growth trajectory; real GDP growth will average about 3½% over the next two years, slightly above the rate of expansion recorded in 2005. The country's non-oil trade sector remains impaired by a lack of productivity improvement needed to face the overwhelming challenges posed by China's emergence as a global manufacturing powerhouse; as a result, Mexican exports are losing market share in the US market. A prolonged period of real exchange rate appreciation has also contributed to the erosion in Mexico's competitiveness. On a positive note, the systemic strengthening of the banking sector has translated into a steady expansion of local credit (up 30% in 2005 y/y) with positive consequences for domestic consumption; consumer credit increased by 45% in 2005 (y/y).

The monetary and inflation fronts continue to improve, as both consumer prices and interest rates are declining. Progress on inflation containment and reduction has been both impressive and unexpected; the headline consumer price index increased by 3.3% in 2005 and only a slightly higher rate is expected for the 2006-07 period. Banco de Mexico has not formally adopted an inflation-targeting scheme; however, it seems increasingly comfortable with the prospect of moving towards an interest rate-reference mechanism *à la Fed* to guide monetary policy. In an election year, price stabilization is not assured; therefore, we expect the monetary authorities to remain vigilant to external shocks (e.g., US dollar adjustment, higher than expected US interest rates, correction in emerging markets) while maintaining a policy of gradual easing.

The fiscal front remains Mexico's weakest link despite improvements in the structure and profile of public sector debt. Overdependence on oil-related revenue (37% of total fiscal income in 2005) places the country in a vulnerable position should crude oil prices weaken, although given the strength of global demand and increasing supply-side pressures in energy markets (Iran, Iraq, Russia), oil prices are poised to remain high in 2006. The government is implementing a programme of external debt substitution with domestic debt, and has pre-financed external debt assets maturing in 2006. International reserves accumulation will provide a liquidity shield against exogenous shocks; they totaled almost US$69 billion at end-2005.

Political challenges will most likely re-emerge by the end of the year as the new government works with a highly fragmented congress. Although adverse political developments can always arise, we expect business-friendly policies to remain in place, but a radical acceleration in the approval of structural reforms is unlikely. The new administration will also face a more challenging external economic environment. The steady erosion in the US fiscal and current account deficits may push the US monetary authorities to be more aggressive in tightening policy, with direct consequences for Mexico. A slower rate of US growth and a further tightening of monetary conditions by the Fed will be felt in the Mexican economy and its securities markets, given the deepening convergence with US economic structures. In addition, the US drive to implement immigration reform to "protect its borders" may negatively affect US-Mexico relations in the years ahead. The proposal to erect a 700-mile wall along the border with Mexico, already approved by the US House of Representatives, will fuel tension between the governments, with a potentially adverse impact on bilateral trade.

Oil prices, carry-trade investment inflows, steady gains in equity securities, sizable non-resident remittances, and a benign political context have created a supportive environment for the Mexican peso (MXN) and peso-denominated securities. Looking ahead, some of these factors may disappear, weakening the foundations of MXN strength. Negative structural-related issues, such as the lack of progress in advancing the process of tax and energy reforms, may weigh more heavily on Mexican markets over the next two years.

MEXICO - KEY ECONOMIC INDICATORS

GDP: US$794 billion (2006f) — Population: 107 million (2005e)

Long-Term Foreign Currency Rating: Moody's: Baa1 S&P: BBB

	2003	2004	2005e	2006f	2007f
Real GDP (% change)	1.3	4.4	3.0	3.4	3.8
Industrial Production (% change)	-0.8	3.8	1.6	3.3	3.8
Fiscal Balance PSBR (% GDP)	-3.3	-2.5	-1.4	-1.2	-1.0
Consumer Prices (eop % change)	4.0	5.2	3.3	3.8	3.8
Exchange Rate (% change)	-7.7	-0.2	5.9	-6.5	-7.9
Exchange Rate (year-end)	11.24	11.26	10.63	11.38	12.36
Trade Balance (US$billion)	-5.8	-8.8	-8.4	-12.7	-23.0
Exports (US$bn)	165	188	211	223	234
Imports (US$bn)	171	197	219	236	257
Current Account (US$billion)	-8.6	-7.3	-6.8	-13.4	-18.0
% GDP	-1.3	-1.1	-0.9	-1.7	-2.3
FDI (% of current account deficit)	143	246	225	108	100
External Debt (US$billion)	141	139	151	157	162
% of GDP	22	21	20	20	20
% of Exports of Goods & Services	86	81	84	87	90
Public Sector (% of total)	58	57	52	50	49
S-T Debt / Reserves (%)	40	36	32	31	29
Foreign Reserves (US$billion)	57.4	61.5	68.7	70.0	75.0
Months of Imports	4.0	3.7	3.8	3.6	3.5

Argentina

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Argentina is still undergoing economic and institutional reconstruction. The emergence of a serious inflationary threat in the context of a still fragile financial sector and negative real interest rates undermines the sustainability of high rates of economic expansion. Given a manageable external debt maturity calendar and the absence of elections in the near term, there is a unique opportunity to advance the structural and institutional reform agenda in the months ahead, end a sustained period of isolationism and reduce the heavy intervention of the state in the economy.

Decoupling from International Monetary Fund (IMF) surveillance has injected a new challenge to the country's economic and debt outlook. The existence of an IMF facility usually provides a comfort level to global investors exposed to countries that have emerged from a severe financial crisis, like the one suffered by Argentina in the early years of the decade. The lack of appropriate monetary response to inflationary pressures, combined with the negative market reaction to the Argentine authorities' decision to prepay the entirety of debt obligations owed to the IMF are key factors behind global investors' bearish view on Argentina. However, the existence of twin surpluses (fiscal and current account) places the country in a good position to secure a sustainable growth path.

The Argentine economy will decelerate in 2006-07, in line with international economic trends and higher interest rates. The level of Brazilian economic activity will have a direct effect on Argentine exports; authorities will continue to artificially weaken the peso versus the Brazilian real to maintain export competitiveness. The construction boom, which developed after three years of severe economic contraction, will moderate in the months ahead, thereby reducing the contribution of investment to economic growth. Domestic consumption will also soften, as the central bank raises local interest rates in order to contain the so far resilient inflationary pressures. Real GDP growth exceeded 8.5% for a third consecutive year in 2005, while the trade surplus totaled more than US$11 billion, pushing the current account surplus to 4½% of GDP.

The escalation of price pressures is the most negative recent economic development; consumer price inflation closed at 12.3% last year and a double-digit rate is also expected for 2006 as a whole. Aggressive monetary policy (not executive) action is required. Empirical evidence demonstrates that government-administered controls of retail prices further distorts market signals, with adverse effects on long-term investment and business confidence. Serious efforts should also be adopted to develop a more transparent exchange rate mechanism, for which the adequate recapitalization of domestic banks is necessary. Financial sector intermediation is a sine qua non (as Mexico demonstrates) to boost domestic consumption and support broad-based economic growth.

The effective reconstruction of monetary and financial sector institutions remains imperative. The central bank continues to be under scrutiny by global investors due to its lack of independence (from the executive branch) and its slow progress in containing the inflationary pressures. Prompt and effective monetary action is increasingly required to avoid an economic hard landing. Moreover, the development of adequate monetary instruments and regulations is also a necessity to inject investor credibility into monetary policy. The constant intervention of the central bank in the foreign exchange market, clearly dictated by executive order, also undermines the creation of a solid institutional framework. As a result, we expect the peso to depreciate modestly in 2006/07.

Debt sustainability will remain an issue of concern through the remainder of the decade; however, this year's debt service is manageable. Market pressures on external debt maturity calendar will gradually worsen in the years ahead given that the Republic of Argentina has not regained access to private sources of credit yet. The decision by the Kirchner administration to prepay the entire debt obligations owed to the IMF (widely thought to be inspired by ideological motives rather than by skillful liability management) was cautiously received by the global creditor community. The administration's confrontational diplomatic approach with the global creditor community and with trading partners (including Brazil, Chile and Uruguay) leads only to a dead-end; the third largest Latin American economy cannot sustain high growth rates over the longer term without adequate access to global private sources of financing.

ARGENTINA - KEY ECONOMIC INDICATORS

GDP: US$210 billion (2006f)	Population: 38.7 million (2005e)				
Long-Term Foreign Currency Rating:	Moody's: B3		S&P: B-		
	2003	2004	2005e	2006f	2007f
Real GDP (% change)	8.8	9.0	9.1	6.5	5.0
Industrial Production (% change)	16.2	10.7	6.8	6.5	5.8
Fiscal Balance NFPS (% GDP)	1.1	4.5	3.2	2.0	1.0
Consumer Prices (eop % change)	3.7	6.1	12.3	12.0	8.0
Exchange Rate (% change)	14.4	-1.1	-1.8	-5.4	-5.9
Exchange Rate (year-end)	2.94	2.97	3.03	3.20	3.40
Trade Balance (US$bn)	**16.4**	**12.1**	**11.3**	**10.0**	**9.0**
Exports (US$bn)	29.6	34.6	40.0	43.5	46.0
Imports FOB (US$bn)	13.1	22.4	28.7	33.5	37.0
Current Account (US$bn)	**8.0**	**3.3**	**4.5**	**4.0**	**2.5**
% GDP	6.3	2.2	2.4	1.9	1.1
Gross External Debt (US$bn)	**165**	**171**	**120**	**125**	**120**
% of GDP	129	112	64	60	53
% of Exports of G&S	468	415	252	241	219
Public Sector (% of total)	64	68	53	53	55
S-T Debt / Reserves (%)	194	149	111	140	117
Foreign Reserves (US$bn)	**14.1**	**19.6**	**28.0**	**25.0**	**30.0**
Months of Imports	13	10	12	9	10

Venezuela

Venezuela is preparing, once again, for a presidential election in the context of a strong economic performance and an improving external debt profile. President Hugo Chávez' confrontational stance with the US, recently exacerbated by his decision to support Iran's nuclear development and energy policy, will lead to further deterioration in bilateral relations. This may have negative consequences for Latin America as a whole.

Venezuela's oil-rich economy continues to post a remarkable recovery, following a deep contraction in 2002-03. We expect average growth of 6% for 2006-07, an impressive result, though well below the double-digit average of 2004-05. An aggressive government spending programme and a stimulative monetary environment gave a substantial boost to the non-oil sector last year, while the run-up in energy prices pushed the trade surplus to a record-high US$28 billion.

President Chávez enters the electoral cycle in a strong position. The presidential election is scheduled to take place on December 3rd, and he is expected to win, once again, with a clear majority. Following the opposition parties' boycott of the December 2005 congressional elections, the ruling government secured the totality of the 167-member unicameral Assembly. Only 25% of the registered voters exercised their right to cast a ballot last year.

Venezuela's fiscal position will likely deteriorate sharply during this election year, as the administration will use price controls and other income policies to stimulate domestic consumption and boost employment. Early in 2006, the authorities announced a 15% increase in the minimum wage and the elimination of the 0.5% tax on financial transactions; both vote-seeking measures will worsen the government's budgetary position in the year ahead.

The external financial front remains resilient despite the lack of confidence in the Chávez administration. In fact, the economic team has been taking full advantage of the favourable global financial conditions created by excess liquidity and high oil prices, and has refinanced external debt obligations at more favourable terms. Credit rating agencies are of the opinion that Venezuela is about to receive net external creditor status, so they have been relatively indifferent to the intensifying diplomatic friction with the US and to the economically disruptive exchange rate and price controls. On February 3rd, Standard & Poor's upgraded the Bolivarian Republic of Venezuela's long-term foreign-currency rating by one notch to "BB-" with a "stable" outlook. It is worth noting that the agency's decision was adopted at the same time that President Chávez expelled a US military officer from Caracas on espionage allegations; this triggered immediate retaliation by the US Department of State, which declared a Venezuelan diplomat 'persona non grata'. As for the outlook for the country's foreign debt situation, policy measures adopted by the Venezuelan authorities indicate that they do not have any intention of imposing a unilateral moratorium on debt repayments; the central bank welcomed the new year with US$30 billion in liquid international reserves.

Ideology-inspired policies will continue to dominate and contaminate the country's business climate. Venezuelan leaders are fully aware that foreign direct investment is needed to exploit the vast hydrocarbon resources of their territory. According to the latest industry statistics, Venezuela accounts for 6.2% of the world's crude oil reserves (2nd largest in the Americas after Canada) and 2.5% of the world's natural gas reserves (2nd in the Americas after the US).

President Chávez continues to threaten the Bush administration with a disruption of the 1.5 million barrels of oil per day that the country exports to the US. Venezuela-led initiatives to counteract US foreign policy influence in the developing Americas include the creation of regional oil pacts (PetroCaribe, PetroSur), the launching of a South American television channel (TeleSur) and, more troublesome, extending its support to Iran's nuclear research and development programme. The eventual imposition of US-driven economic sanctions against Tehran's regime may, if mismanaged, open a new, more aggressive chapter of US-Venezuela international relations. Domestic political and legal institutions remain fragile despite favourable international liquidity conditions and strong social support for the current administration. President Chávez will continue with his goal of strengthening his regional power base through energy-sector agreements with developing countries. Meanwhile, any unexpected non-democratic move to terminate the Chávez' regime may lead to violent social unrest and political turmoil in Latin America.

VENEZUELA - KEY ECONOMIC INDICATORS

GDP: US$143 billion (2006f)	Population: 26.7 million (2005e)				
Long-Term Foreign Currency Rating:	Moody's: B2	S&P: BB-			
	2003	2004	2005e	2006f	2007f
Real GDP (% change)	-7.7	17.9	9.4	6.5	4.5
Industrial Production (%)	-8.0	20.0	21.4	10.0	8.0
Central Government Balance (% GDP)	-4.4	-2.0	0.5	-3.0	-2.0
Consumer Prices (eop % change)	27.1	19.2	14.4	14.0	12.0
Exchange Rate (% change)	-13.1	-16.7	-10.8	-8.5	-13.0
Exchange Rate (year-end)	1,598	1,918	2,150	2,350	2,700
Trade Balance (US$bn)	16.5	21.4	28.0	25.0	20.0
Exports (US$bn)	27.2	38.7	51.0	65.0	70.0
Imports (US$bn)	10.7	17.3	23.0	40.0	50.0
Current Account (US$bn)	11.4	13.8	22.1	20.0	15.0
% GDP	13.7	12.7	17.7	14.0	10.0
External Debt (US$bn)	39.7	44.5	47.1	50.0	52.0
% of GDP	48	41	38	35	35
% of Exports	146	115	92	77	74
Foreign Reserves (US$bn)	20.6	24.0	30.4	33.0	35.0
Months of Imports	23	17	16	10	8

Colombia

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Colombia's economy will maintain its solid growth trajectory supported by declining inflation, though it will remain vulnerable to higher US interest rates. Key issues to monitor that may cloud the country's economic outlook through the forecast period include delayed fiscal and structural reforms, and the internal war against narco-terrorism.

We expect the economy to expand by about 4% in 2006-2007, although some moderate deceleration will be evident. Growth will be driven by higher public expenditures and by consumer spending. Preliminary data show that growth reached 5% in 2005, led by construction activity. Investment climbed and private consumption remained solid. While export volume growth was moderate, foreign exchange receipts were buoyed by high commodity prices. Labour-market strength is giving a boost to consumer confidence and spending. By end-2005, the jobless rate had fallen to a record-low 10.2%.

We expect inflation to remain stable through the forecast period. Banco de la República has set a target range of 4-5% for 2006 and 3-4.5% for 2007. In spite of massive intervention in the foreign exchange markets, the central bank managed to achieve its year-end inflation goal for 2005 – the official target range was 4.5-5.5%. The build-up in foreign exchange reserves over the past two years reflects an effort by the monetary authorities to achieve currency stability. Should the Colombian peso depreciate more rapidly than expected, the central bank is prepared to reverse the easing stance in place since November. Net international reserves totalled US$14.9 billion in December, as the central bank had previously sold around US$3.5 billion in reserves to the government to prepay costly external debts.

Public sector finances will come under pressure in 2006 as the election campaign intensifies; however, we do not expect the government's impressive fiscal performance to be derailed. Under the 18-month International Monetary Fund Stand-By agreement, the administration had agreed to a public-sector deficit of 2.5% for 2005. Due to an increase in tax revenues, favourable international conditions and government firmness in reducing its expenditures, the deficit is estimated to have been only 1.2% of GDP. The government and the Fund will soon review and set new policy objectives for 2006. We expect the deficit to be 2-2½% of GDP in 2006, as fiscal and pension reforms initiatives will be on hold until at least after the May presidential election.

The current account shortfall will widen slightly over the forecast period, as the trade account swings into deficit alongside more subdued export growth, and as the burden of interest payments intensifies. Even so, the current account deficit will remain below 1.5% of GDP through 2007.

The political front has been dominated by the Constitutional Court's October 2005 decision to allow President Alvaro Uribe to run for re-election in May; under the constitution, a president may not run for a second term in office. Uribe is very likely to win again, unless there is a significant change in economic performance or a sharp deterioration in internal security conditions. The president has managed to maintain approval ratings of around 70% throughout his term.

In late February, Colombia and the United States signed the US-Andean Free Trade Agreement, which also includes Ecuador and Peru; negotiations began in May 2004. Peru also signed the agreement in December. The accord will need to ratified by both the Colombian and US legislatures - which will probably take place in mid-2007; the current agreement granting duty-free access to US markets (in place since the early 1990s) expires by the end of this year. Once in place, the country will benefit from additional foreign direct investment and from a pickup in exports.

The US$300 million natural gas pipeline agreement with Venezuela signed in November 2005 will be advantageous for Colombia; construction is expected to get under way this year and will take approximately two year to complete. Operations will begin in 2008. The cost will be incurred by Venezuela, which will own and operate the system. The pipeline will transport natural gas from Colombia to Venezuela, and when the flow is reversed, will export fuel from Venezuela.

Early in 2006, Standard & Poor's and Moody's revised Colombia's outlook to "positive" from "stable" and "stable" from "negative", respectively, on the back of better economic prospects coupled with continued improvement in the country's external indicators.

COLOMBIA - KEY ECONOMIC INDICATORS

GDP: US$132 billion (2006f) — Population: 45.6 million (2005e)

Long-Term Foreign Currency Rating: Moody's: Ba2 S&P: BB(+)

	2003	2004	2005e	2006f	2007f
Real GDP (% change)	4.0	4.0	5.0	4.2	4.0
Industrial Production (% change)	3.7	4.8	4.2	4.1	3.8
Public Sector Fiscal Balance (% GDP)	-2.8	-1.2	-1.2	-2.0	-2.5
Consumer Prices (eop % change)	6.5	5.5	4.9	4.7	4.3
Exchange Rate (% change)	3.1	18.1	2.8	0.7	-7.1
Exchange Rate (year-end)	2,780	2,355	2,290	2,275	2,450
Trade Balance (US$bn)	0.4	0.3	0.1	-0.1	-0.1
Exports (US$bn)	13.7	17.0	20.9	22.1	24.9
Imports (US$bn)	13.3	16.7	20.8	22.2	25.0
Current Account (US$bn)	-1.3	-1.1	-1.2	-1.6	-1.9
% GDP	-1.7	-1.1	-1.0	-1.2	-1.4
FDI (% of current account deficit)	134	285	292	188	165
External Debt (US$bn)	38	38	37	39	39
% of GDP	48	40	31	29	28
% of Exports of G&S	245	200	164	177	157
Public Sector (% of total)	63	66	70	68	69
S-T Debt / Reserves (%)	31	24	22	22	21
Foreign Reserves (US$bn)	10.8	13.4	14.9	15.5	16.1
Months of Imports	9.7	9.6	8.6	8.4	7.7

The Chilean economy remains on a sound footing, strongly influenced by a vibrant global economy and persistent demand for commodities from the US and developing Asia. External debt indicators will continue to improve, prompting international rating agencies to upgrade the country's sovereign credit ratings.

Chile continues to lead the growth charts in the Americas. The economy expanded by 6.3% in 2005, exceeding the annual average growth rate of 4.7% recorded over the preceding decade. Sales, production and trade indicators point towards a mild deceleration of economic activity over the next two years. Foreign trade remains strong, although export and import growth rates softened in the latter half of 2005. The country's trade surplus reached US$9.2 billion in 2005. Sustained import strength, supported by further gains in consumer spending and business investment, coupled with a decline in copper prices, may push the current account into modest deficit in 2006-07.

Monetary policy will remain influenced by the US Federal Reserve tightening cycle and by energy-related price pressures. The central bank's reference rate has been in strict alignment with the Fed since mid-2004. The monetary authorities will continue to restrict domestic liquidity with the aim of guiding the rate of consumer price inflation towards the center of its pre-established 2-4% band. The upward trend in labour costs, coupled with persistently high crude oil and natural gas prices, point to a prolonged phase of monetary tightening. The central bank's benchmark interest rate is trending towards 5.5% by the end of this year.

The boom in domestic lending is showing signs of consolidation, if not a mild slowdown. The rate of expansion of domestic credit, which peaked at 20% in mid-2005 (on a year over year basis), has been decelerating over the past few months. The central bank has warned that increasing household indebtedness may pose risks to the financial sector's asset quality. According to the regulatory authorities, overall bank lending will increase by 13-15% in 2006. Total loans reached a level of 70% of GDP, in line with advanced-economy standards. Moreover, the value of institutional assets under management by the country's private pension funds increased by 18% last year to US$71 billion (or 63% of GDP). Well-capitalized banks and liquid pension funds represent Chile's best shield against external shocks which may originate over the next two years.

A steady improvement in the country's terms of trade has fuelled a period of sustained currency strength and foreign exchange reserve accumulation. The Chilean currency has appreciated by 23% against the US dollar since October 2004, while copper prices have increased by almost 300% over the past four years. Looking ahead, the expected decline in copper prices together with persistent supply and demand-side pressures in energy markets will weigh on the Chilean peso and cause a modest depreciation.

Fiscal performance remains strong. The economic team estimates that fiscal accounts will close this year with a surplus equivalent to 3.5% of GDP, slightly down from the 4.8% recorded in2005. The new government will continue with the deepening of domestic capital markets through the issuance of longer-duration government securities aimed at global investment portfolios. Further capital market reform will have a positive impact on the country's creditworthiness.

Chile entered a new political phase in March, when President-elect Michelle Bachelet assumed the presidency for a four-year term, and with full control of Congress. Global investors widely discount continuity of macroeconomic policies as the ruling coalition passed the baton to the first female president in Chilean history. However, it is on the social front where most changes may take effect. There is widespread belief that the economic successes of the past decades have not fully been translated into social benefits for the low-income-segment of the population. Andrés Velasco has been appointed as the new Finance Minister.

On the diplomatic front, the new government will likely adopt a more integrationist approach towards Brazil, while managing the adverse ideological headwinds present in Chile's three neighbouring countries. Regional diplomatic friction with bordering countries will continue in connection with Chile's acquisition of military equipment (combat jets, submarines, frigates and tanks) from US and European suppliers. Meanwhile, Chile signed a 15-year copper supply agreement with China's Minmetals valued at US$2 billion in an effort to deepen Asian integration efforts.

CHILE - KEY ECONOMIC INDICATORS

GDP: US$130 billion (2006f)	Population: 16.3 million (2005e)				
Long-Term Foreign Currency Rating:	Moody's: Baa1(+) S&P: A				
	2003	2004	2005e	2006f	2007f
Real GDP (% change)	3.3	6.1	6.3	5.6	5.5
Industrial Production (% change)	1.5	9.4	5.5	5.0	4.8
Fiscal Balance Central Govt (% GDP)	-0.5	2.2	4.8	3.5	2.0
Consumer Prices (eop % change)	1.1	2.4	4.0	3.2	3.0
Exchange Rate (% change)	21.5	6.7	8.5	-6.1	-3.5
Exchange Rate (year-end)	593	556	512	545	565
Trade Balance (US$bn)	3.5	9.0	9.2	10.1	6.3
Exports (US$bn)	21.5	32.0	39.5	49.4	56.8
Imports (US$bn)	18.0	23.0	30.3	39.3	50.5
Current Account (US$bn)	-0.6	1.4	0.1	-0.5	-1.0
% GDP	-0.8	1.5	0.1	-0.4	-0.7
External Debt (US$bn)	43.1	43.3	44.8	45.0	45.5
% of GDP	59	46	40	35	34
% of Exports of G&S	163	114	97	78	69
Public Sector (% of total)	11	11	9	8	8
S-T Debt / Reserves (%)	45	48	43	39	36
Foreign Reserves (US$bn)	15.9	16.0	16.8	18.0	19.0
Months of Imports	11	8	7	5	5

Peru

Robust economic growth, presidential elections, improving fiscal and current account balances, monetary alignment with the US cycle, and a highly dollarized, yet well capitalized, banking sector will shape the country's economic outlook through the forecast period.

The economy is well positioned to sustain 5% growth rates through the rest of the decade. Peru's pace of expansion will decelerate slightly in 2006-07 attaining real GDP growth of around 5.5% after having reached an estimated 6.3% in 2005 (the highest level since 1997) – led by domestic consumption and construction activity. We estimate that GDP grew 7.5% in the fourth quarter of 2005; with that, Peru registered 18 consecutive quarters of economic expansion. Foreign trade will remain a key engine of growth; export receipts jumped more than 20% last year. Favourable commodity markets and steady energy-related exports led to a trade surplus of 6.6% of GDP (US$5.2 billion) in 2005, bringing the current account close to equilibrium.

The government's commitment to fiscal responsibility also translated into positive gains in public sector finances; we expect the consolidated deficit to be less than 1% of GDP through the forecast period. The steady accumulation of foreign exchange reserves has also improved the country's external financial position; net international reserves totalled US$14.1 billion at the end of 2005.

The progress in containing inflation is remarkable; Peru enjoys the lowest inflation rate in the developing Americas. The year-over-year rise in the consumer price index was just 1.5% at end-2005, at the low end of the official target of 1.5-3.5%. Over the next 18 months, the pace of inflation is expected to remain within the central bank's target range.

The political front will be dominated by the presidential election scheduled to take place on April 9th 2006. The president is not allowed to run for re-election. A second round of voting will probably be needed as we expect that none of the candidates will attain the 50% or more of the votes required to win. Although it seems it will be a close result between two of the candidates, Lourdes Flores-Nano (Unidad Nacional), and Ollanta Humala (nationalist movement), so far, Ms. Flores maintains the lead in the surveys of voting intentions (30% if Fujimori is not included). The new government will take office at the end of July.

Former President Alberto Fujimori is banned from running for office, in spite of the fact that he still retains a relatively high degree of popular support. He has been under arrest in Santiago (Chile) since November 7th at the request of Peruvian authorities, who are seeking his extradition to stand for trial on charges involving corruption and mismanagement of public funds. If inadequately managed by Chile, the "Fujimori Affair" may somewhat affect the natural gas integration plan.

The International Monetary Fund (IMF) continues to support Peru. Since the year 2000, the government has been adopting a policy of signing Stand-By agreements without drawing from IMF credit facilities. The current 26-month US$416 million Stand-By credit line expiring in August 2006 has never been used. In its most recent review, the Fund notes the country's positive growth performance, low inflation, ongoing fiscal consolidation and sustained reserve accumulation.

Relations with the US will remain strong. A US-Andean Free Trade Agreement, including Colombia and Ecuador, has not been finalized. However, Peru, on its part, concluded negotiations with the US and signed the accord in early December. Colombia and Ecuador have not yet signed, as disagreements with the US on items regarding agriculture and intellectual property continue. The ultimate ratification may be delayed until the second half of 2006, once the other two countries settle their differences with the US. The steady development of the energy (natural gas and crude oil) industry, together with common objectives in the fight against illegal narcotics, has deepened the engagement of the United States in Peruvian affairs.

International credit rating agencies will continue to upgrade the country's sovereign ratings in the coming months. Both Standard & Poor's and Fitch maintain a "positive" outlook for the country's long-term foreign-currency credit ratings. When and if these agencies opt to take action, Peru will be rated one notch below investment-grade status. Moody's is lagging behind its peer-group competitors.

PERU - KEY ECONOMIC INDICATORS

GDP: US$76 billion (2006f) — Population: 27.9 million (2005e)

Long-Term Foreign Currency Rating: Moody's: Ba3 S&P: BB(+)

	2003	2004	2005e	2006f	2007f
Real GDP (% change)	4.0	4.8	6.3	5.5	5.5
Industrial Production (% change)	3.4	7.0	6.0	5.5	4.6
Fiscal Balance NFPS (% GDP)	-1.7	-1.1	-1.0	-0.8	-0.5
Consumer Prices (eop % change)	2.5	3.5	1.5	2.0	2.5
Exchange Rate (% change)	2.5	4.3	-2.4	1.5	-2.9
Exchange Rate (year-end)	3.46	3.32	3.40	3.35	3.45
Trade Balance (US$bn)	0.8	2.8	5.2	4.4	4.2
Exports (US$bn)	9.1	12.6	15.4	17.0	19.2
Imports (US$bn)	8.3	9.8	10.2	12.6	15.0
Current Account (US$bn)	-0.9	-0.1	-0.1	-0.5	-0.2
% GDP	-1.5	-0.1	-0.1	-0.7	-0.3
FDI (% of current account deficit)	143	3632	4600	347	934
External Debt (US$bn)	29.7	29.8	30.0	32.0	32.5
% of GDP	49	43	41	42	41
% of Exports of G&S	291	278	267	271	262
Public Sector (% of total)	77	77	73	75	74
S-T Debt / Reserves (%)	25	22	21	19	17
Foreign Reserves (US$bn)	10.2	12.6	14.1	16.2	18.0
Months of Imports	15	15	17	15	14

EUROPE

European growth prospects limited by slow progress in pursuing market reform and financial integration

Western European economic growth will remain below potential through 2007, constrained by weak public sector finances, labour market rigidities and the failure to fully achieve a single market for goods, services and capital. The euro zone economy will expand by about 1¾% in 2006, but may slow slightly in 2007, should the Angela Merkel-led German government proceed with its current plan to raise the value added tax by three percentage points. Such a move would help strengthen the government's problematic finances, but would also have a significant adverse impact on German consumer spending, and hence on export prospects for Germany's major trading partners. The United Kingdom's positive growth differential vis-à-vis the euro zone may disappear completely in 2006; in recent years, the gap has been as wide as 1.7 percentage points. Housing prices will no longer provide the big stimulus to spending and, with the number of jobless slowly creeping higher, household income growth will likely abate alongside some softening in consumer confidence.

Monetary policy views: tightening in euro zone, Switzerland & Sweden contrasts with status quo in the UK

Interest rates on the continent are on the rise. In the euro zone, the rate of increase in the harmonized index of consumer prices is still lingering above the European Central Bank's (ECB) target of 'near but less than 2%', though cost pressures are still heavily concentrated on energy-related components. The authorities also remain concerned about the longer-term inflationary consequences of excessive money supply growth. In addition, demands from major German trade unions for wage increases of as much as 5% have raised concerns in the ECB. In both Switzerland and Sweden, inflation is running at about 1%; however, with signs of a gradual recovery in both countries, we expect the central banks to continue their cautious, preemptive monetary policy tightening.

The Bank of England (BoE) feels no sense of urgency to provide additional interest rate relief, although some slight easing of monetary conditions is likely in the second half of the year. The BoE's modest 25 basis point rate reduction in August 2005 appears to have provided renewed energy to the housing market: prices are once again trending higher and mortgage issuance has increased sharply. Moreover, while domestic demand growth has slowed, monetary authorities consider the current pace as "close to potential".

Demographic challenges add to urgency of fiscal consolidation

Large fiscal deficits continue to be a chronic problem among the largest countries of the European Union. Agreed commitments to limit the shortfalls to a maximum of 3% of GDP have been ignored with impunity. Admittedly, savage deficit cutting during a period of particularly weak domestic growth would have been ill-advised. However, the failure to address structural weaknesses on both the revenue and expenditure side raises the risk of more tumultuous and painful adjustments in the future. Rapidly aging populations pose major challenges to widening the taxation base and meeting spending requirements. Italy is at the vanguard of this challenging demographic problem. In the United Kingdom, Chancellor Gordon Brown's leadership ambitions may intrude on the British government's willingness to speed up the pace of deficit reduction.

Large divergence in balance of payments pattern: Russia generates massive current account surplus

The pattern of the balance of payments across Europe will remain largely unchanged in 2006. Russia will record another massive surplus as will Switzerland and Sweden. A slight shortfall will be evident in the euro zone, while Turkey and the major central European economies will register deficits equivalent to as much as 8% of GDP. A slowdown in domestic spending growth in the United Kingdom may help to prevent a further widening in its current account deficit; we expect it to continue to linger near US$50 billion. Only moderate shifts within the region will be evident in 2007 if, as we project, oil prices begin to gradually decline.

Leadership transition in major western European countries adds to political uncertainties

The election calendar in western Europe is rather empty. Of the largest countries in the region, only Italy will go to the polls this year. Even so, political change is afoot. In both the United Kingdom and France, the jockeying for position is under way in preparation for changes in leadership. Chancellor Gordon Brown is anxious to secure the Labour Party leadership when Prime Minister Tony Blair retires. In France, where a presidential election will be held in 2007, two members of the current government – Prime Minister Dominique de Villepin and Interior Minister Nicolas Sarkozy are currently the leading candidates to succeed President Jacques Chirac. In Germany, which had elections in September 2005, the 'grand coalition' under Chancellor Angel Merkel, is still feeling its way; 'uneasy' rather than 'grand' is a more apt description of the current arrangement.

Russia and Turkey achieving more stable developing status despite still fragile public governance

Favourable near-term economic prospects in the two most populous developing European economies – Russia and Turkey – may overshadow troublesome political issues that could dim the longer-term outlook. In Russia, though benefiting from massive oil and gas reserves, governance problems coupled with tensions with bordering countries, raise questions about its reliability as an energy supplier. Turkey's bid to become a member of the European Union continue to be undermined by its reluctance to embrace western-defined democratic principles and practices.

The German economy will continue to be characterized by sub-par growth, high unemployment and only limited progress in reducing the fiscal deficit over the next two years. Initial policy announcements suggest that the coalition government, which was finally confirmed two months after the September 18th general election will be inclined to proceed very cautiously along the path of economic reform.

The recovery in German economic activity may prove relatively subdued. Although some acceleration will be evident this year, the acceleration will likely be brought to an abrupt halt in early-2007, assuming the new administration proceeds with announced plans to raise the value added tax (VAT). Taken together, we expect growth to average just over 1½% in 2006-07 following a 1.1% gain last year. While Germany will retain its preeminence as a trading nation, export volume growth may ease somewhat by 2007 in response to an easing in global investment and renewed euro appreciation. Nevertheless, trade will remain a net contributor to growth, as imports will slow alongside the tax-related softening in consumer spending. In addition, a jobless rate of more than 9% (EU definition) will continue to weigh on consumer confidence, while cutbacks in unemployment benefits may result in a rise in precautionary savings.

Industrial activity will sustain its encouraging recovery through 2006, though some deceleration may be evident the following year. While manufacturing orders have been volatile, the overall trend is positive, and business confidence is on the mend; the closely followed Ifo index of business sentiment reached its highest level in more than five years at the outset of 2006. As a leading producer of capital goods, Germany is obtaining significant benefits from the global upturn in outlays on machinery and equipment. In addition, a recovery in profitability coupled with competitive pressures will induce an upgrade in domestic production facilities. The outlook for the construction industry is still poor; orders have been below year-earlier levels through much of the past year, highlighting the acute depression in this industry.

The new coalition government may meet the European Union's fiscal deficit target ceiling of 3% of GDP by 2007, provided it follows through on proposed reductions in subsidies and fresh revenue generation measures. Most notably, the authorities have extended the freeze on pension payments for another two years and plan to raise the VAT by three percentage points in 2007.

The European Central Bank will likely continue to nudge interest rates higher this year, following a 25 basis point hike in December 2005. Concerns regarding above target increases in both money supply and headline inflation will not be assuaged with just one rate move. The bias towards a more restrictive monetary policy stance has been reinforced by the failure of elected officials among the major euro zone economies to adhere to budget deficit reduction commitments under the Stability and Growth Pact.

German consumer inflation is poised to ease in 2006 after spiking above 2% in the autumn of 2005. A sharp rise in energy prices, government-mandated increases in personal health care costs and higher indirect taxes prevented any improvement in 2005. Price pressures will gradually abate this year alongside more stable oil prices and renewed euro appreciation. However, yet another reversal in trend may be evident in 2007 should the VAT be raised by the full three percentage points as planned. While organized labour is calling for wage increases of 5%, high levels of unemployment should help to ensure that wage settlements are widely matched by productivity gains. The administration is unlikely to implement any major measures designed to enhance labour market flexibility.

Germany will record the world's largest trade surplus for a seventh consecutive year in 2007, with the gap poised to exceed US$250 billion. As a result, the current account will also continue to register substantial surpluses, notwithstanding deficits in the services and net transfers accounts.

Chancellor Angela Merkel is utilizing international platforms to strengthen her domestic standing. After playing a key role in brokering an agreement on the European Union budget, she has had meetings with Presidents George Bush and Vladimir Putin. At home, the economic policy focus is on deficit reduction, though improvement will likely be slow. The 'grand' but uneasy coalition between the Christian Democratic/Social Union and the Social Democrats does not allow for anything beyond very modest steps towards market liberalization. With German reforms slowed, there is little pressure to implement substantial policy changes in other major euro zone economies.

GERMANY - KEY ECONOMIC INDICATORS

GDP: US$2.9 trillion (2006f)	Population: 82.7 million (2005e)				
Long-Term Foreign Currency Rating:	Moody's: Aaa		S&P: AAA		
	2003	2004	2005e	2006f	2007f
Real GDP (% change)	-0.2	1.1	1.1	1.8	1.5
Industrial Production (% change)	2.8	1.1	3.4	5.0	3.5
Fiscal Balance NFPS (% GDP)	-4.0	-3.7	-3.3	-3.2	-2.8
Government Debt (% of GDP)	63	65	67	69	70
Consumer Prices (eop % change)	1.1	2.2	2.2	1.6	2.0
Central Bank Rate (%)	2.00	2.00	2.25	2.75	2.75
Exchange Rate (% change)	20.0	8.7	-13.9	8.5	5.5
Exchange Rate (year-end)	1.26	1.37	1.18	1.28	1.35
Trade Balance (US$bn)	148	190	205	220	265
Exports (US$bn)	752	910	960	1035	1125
Imports (US$bn)	605	720	755	815	860
Current Account (US$bn)	51	104	130	130	160
% GDP	2.1	3.8	4.6	4.5	5.0
Foreign Reserves (US$bn)	50.7	48.8	46.0	48.0	50.0
Months of Imports	1.0	0.8	0.7	0.7	0.7

The UK economy will maintain moderate growth over the next two years, with the pace of expansion averaging less than 2%. The manufacturing sector will register only a modest pickup in activity despite a weakening of the pound vis-à-vis the euro. A gradual shift to a more accommodative monetary policy stance through the forecast period should help to prevent further economic deceleration. Government spending, which has been consistently outpacing private consumption, will likely begin to be reined in, though Chancellor of the Exchequer Gordon Brown's prime ministerial ambitions may prompt him to limit the extent of fiscal retrenchment.

The household sector poses the largest risk to the economy. Its record-high debt burden – closely linked to an earlier rapid rise in housing prices – is equivalent to about 140% of disposable income. The adverse impact on debt servicing capacity of sluggish growth in household incomes over the next two years should be partially offset by interest rate reductions. However, recent signs of renewed strengthening in housing prices will tend do limit the extent of monetary easing; they also point to the risk of increased price volatility in this sector over the next two years. Consumer confidence is beginning to weaken, despite still-favourable labour market conditions; the jobless rate (claims basis) is less than 3%, not much above earlier cyclical lows. Nevertheless, employment growth will likely abate as the labour-intensive services sector undergoes a slowdown.

Fiscal deficits will hover around 3% of GDP through 2007. Selective increases in government fees will likely be announced in the upcoming budget for fiscal 2006-07 (beginning April 1st). The administration has consistently exceeded budget deficit projections, largely as a result of a failure to meet revenue forecasts – despite the fact that economic growth has been in line with official expectations. The ratio of government debt to GDP is equivalent to less than 50%, substantially lower than that of other major European Union members, but has been growing rapidly. Even so, it is still readily manageable. However, the reluctance to achieve significant deficit reductions during periods of reasonable economic growth gives the authorities less leeway to react vigorously to any economic downturn without damaging the government's balance sheet.

There is scope for further monetary policy easing, although a slight economic pickup in the final quarter of 2005 and signs of an upturn in the housing market have dampened hopes of an early interest rate reduction by the Bank of England (BoE). We expect the BoE to lower its benchmark repo rate by a total of 50 bps through the course of 2006-07. At present, the monetary authorities believe that the economy is still running very close to full capacity, a situation that does not invite aggressive policy easing. Moreover, with wages still rising at an annual rate of close to 4%, the central bank is aware that there is still considerable risk that consumer spending growth may prove more resilient than is currently assumed. The 25 bps of easing implemented in August 2005 may not be replicated until about mid-year, despite the fact that consumer inflation has fallen back to just below the official target of 2.0% from a recent peak of 2.5%.

The UK will continue to register massive merchandise trade deficits – second largest in the world after the US. The shortfall should, however, begin to stabilize as domestic spending growth abates and demand in continental Europe gradually strengthens. As yet, gains in foreign sales continue to be matched by a consumer-led rise in imports and by the adverse impact of the rapid run-up in commodity prices. Moreover, the UK has become an intermittent net oil importer. As a result, high oil prices are beginning to work against the UK's balance of payments. Although net services and investment income flows offer a partial offset to the trade shortfall, the current account deficit will likely hover in the range of 2-2½% of GDP in 2006 and 2007.

Prime Minister Tony Blair's authority is beginning to erode. Although the Labour government was returned to office in the May 2005 general election, it suffered a significant reduction in the share of the popular vote and in the size of its parliamentary majority. The November 2005 defeat of the government's security bill in the legislature highlighted the gulf that has opened between the Blair-led administration and Labour parliamentarians. The prime minister has announced that this will be his final term in office and Chancellor Brown is waiting impatiently as the leading candidate to succeed him. A fresh push for European Monetary Union membership is unlikely in the foreseeable future, as a substantial majority of the British public remains firmly opposed to closer ties with Europe.

UK - KEY ECONOMIC INDICATORS

GDP: US$2.2 trillion (2006f)	Population: 59.7 million (2005e)				
Long-Term Foreign Currency Rating:	Moody's: Aaa	S&P: AAA			
	2003	2004	2005e	2006f	2007f
Real GDP (% change)	2.5	3.2	1.8	1.8	1.9
Industrial Production (% change)	0.3	0.6	-2.6	2.0	2.5
Fiscal Balance NFPS (% GDP)	-3.3	-3.2	-3.1	-3.0	-3.0
Government Debt (% of GDP)	40	42	44	46	47
Consumer Prices (HICP, % change)	1.3	1.6	2.0	2.0	1.8
Central Bank Rate (%)	3.75	4.75	4.50	4.25	4.00
Exchange Rate (% change)	10.4	8.6	-10.4	5.8	2.7
USD/GBP (year-end)	1.78	1.93	1.73	1.83	1.88
Trade Balance (US$bn)	-78	-107	-118	-125	-135
Exports (US$bn)	308	350	373	395	420
Imports (US$bn)	387	457	491	520	555
Current Account (US$bn)	-28	-42	-49	-50	-60
% GDP	-1.5	-2.0	-2.2	-2.2	-2.5
Foreign Reserves (US$bn)	41.9	45.3	43.0	41.0	40.0
Months of Imports	1.3	1.2	1.0	0.9	0.9

France will remain on a moderate growth trajectory through 2007, led by a pickup in consumer spending and business investment. The degree of official commitment to deficit reduction targets, the policy implications of the intense rivalry between the prime minister and the security minister in pursuit of the presidency, and the pace and sequence of structural reforms will be key issues to monitor.

The French economy is in gradual expansion mode. We expect GDP to rise by an average of close to 1¾% over the next two years, constrained somewhat by a likely reversal of last year's big inventory build-up. Supported by modest increases in employment and household incomes, consumer spending will continue to underpin activity, although with a persistently high jobless rate – it will likely remain near 9% (standardized definition) through the forecast period – a spending boom is not imminent. The housing sector has been responding robustly to the relatively low interest rate environment, but gains may begin to abate in the wake of the European Central Bank's (ECB) decision to begin to raise interest rates. Manufacturing activity is rising at a subdued pace. Even so, business confidence is still relatively intact and investment outlays will likely register sustained, though moderate increases. The gap between import and export growth over the next two years will remain small, as the lingering impact of euro depreciation in 2005 should help to ensure some degree of export growth even as the pickup in domestic demand stimulates imports.

The government's failure to boost employment continues to weigh heavily on its popularity; job creation ground to a halt in the final quarter of 2004 and has since staged only a marginal revival. Elections need not be held until mid-2007. President Jacques Chirac suffered a severe blow to his prestige after the administration's confused response to the November 2005 riots. Last year's ignominious defeat of the European Union (EU) constitution, which Chirac had championed, also tended to weaken his position. Tensions between President Chirac and Nicolas Sarkozy, the interior minister and aspirant to the presidential office, and between Sarkozy and Prime Minister Dominique de Villepin – who also may seek the presidency – could prove a disruptive force to policy initiation and implementation over the next year and a half.

The government is unlikely to accelerate the pace of deficit reduction in the run-up to the 2007 elections; as a result, the shortfall will continue to hover near the EU target ceiling of 3% of GDP over the next two years. The narrowing in 2005 was a result of one-off payments by state enterprises in exchange for the state assuming their pension liabilities. With a government revenue/GDP ratio more than five percentage points above the euro zone norm of 46%, there is little scope for achieving deficit reduction through higher taxes. Public sector finances will, however, be supported by the partial divestment of a number of major state-owned utilities.

Popular resentment in the wake of the administration's program of cautious structural reform may have contributed to the negative vote on the EU constitution in May 2005. An easing of restrictions on hours worked and on worker dismissals will, over the longer term, improve the overall efficiency of the French labour market and enhance employment prospects by ensuring greater flexibility in the work force. However, reductions in employer contributions to social security - which account for 30% of total employment costs in France, the highest in the European Union - may also be necessary to spark a more robust recovery in hiring. The apparent rejection of a reform agenda by German voters in September 2005 may reinforce the Chirac administration's reluctance to implement further policy changes in the particularly contentious area of pension reform in the run-up to the 2007 presidential election.

The gradual shift to a less accommodative monetary policy stance will not prove unduly restrictive from a French economic perspective. Slightly higher interest rates may tend to dampen the rate of increase in housing prices – they have been rising at a double-digit pace – and construction, but consumer spending overall will remain on track to grow by more than 2% in 2006-07. European Central Bank officials have consistently stressed that real interest rates are exceptionally low, highlighting their underlying bias towards further policy tightening. We anticipate that the ECB's benchmark rate will reach 2.75% by end-2006.

The current account will register moderate deficits through 2007 as the euro resumes its appreciating trend. The large services surplus will fail to fully offset the trade shortfall, as tourism receipts may be limited by the impact of US dollar weakening.

FRANCE - KEY ECONOMIC INDICATORS

GDP: US$2.2 trillion (2006f) | Population: 60.5 million (2005e)

Long-Term Foreign Currency Rating: Moody's: Aaa S&P: AAA

	2003	2004	2005e	2006f	2007f
Real GDP (% change)	0.9	2.1	1.5	1.5	1.8
Industrial Production (% change)	1.1	2.3	-0.4	2.5	2.3
Fiscal Balance NFPS (% GDP)	-4.2	-3.6	-3.0	-3.0	-2.8
Government Debt (% of GDP)	63	65	66	67	68
Consumer Prices (eop % change)	2.4	2.3	1.8	1.6	1.5
Central Bank Rate (%)	2.00	2.00	2.25	2.75	2.75
Exchange Rate (% change)	20.0	8.7	-13.9	8.5	5.5
USD/EUR (year-end)	1.26	1.37	1.18	1.28	1.35
Trade Balance (US$bn)	4	-8	-30	-33	-30
Exports (US$bn)	362	421	445	467	505
Imports (US$bn)	358	429	475	500	535
Current Account (US$bn)	12	-8	-35	-33	-28
% GDP	0.7	-0.4	-1.7	-1.5	-1.2
Foreign Reserves (US$bn)	30.2	35.3	30.0	32.0	35.0
Months of Imports	1.0	1.0	0.8	0.8	0.8

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The pace of economic and fiscal reform, excessive public debt levels and the administration's efforts to boost popularity in the run-up to the April general election will be key factors influencing Italy's near-term outlook. Improving the nation's longer-term growth potential depends on reforms geared towards enhancing productivity and boosting labour participation rates, while reducing rigidities in labour markets. These will be particularly challenging given political and public opposition.

Italian economic growth will continue to lag the performance of its major euro zone partners over the next two years, with the pace of expansion averaging just over 1% in 2006-07. However, after virtually no growth in 2005, even these modest advances represent an improvement. Consumers remain reluctant to purchase 'big-ticket' items – auto sales languished below year-earlier levels through much of 2005 (though a pickup was finally evident in early-2006) – while business sentiment has been undermined by a thinning of order books and a build-up in inventories of final goods. In any event, private sector spending will likely register modest gains in 2006, but a marked pickup in either household spending or investment is unlikely. Personal income tax cuts have given only a moderate near-term boost to household outlays, as overall earnings prospects will remain constrained by minimal increases in real wages and a very limited rise in full-time employment.

The failure to undertake a vigorous and sustained program of fiscal reform and debt reduction is a key constraint on Italy's longer-term outlook. The ratio of government debt to GDP is approaching 110%, with adverse consequences for debt servicing costs as interest rates move higher. In view of the upcoming election and limited domestic economic growth prospects, significant deficit reduction through 2007 appears unlikely. Authorities continue to be overly dependent on such one-off revenue raising measures as tax amnesties and asset sales to preserve their fiscal footing. Reliance on such initiatives undermines the government's revenue base in the longer term.

Social security reform will become an increasingly pressing issue over the next decade alongside a rapidly aging population. Government plans to delegate additional responsibilities to regional and local authorities also threaten to add to public costs. The administration's proposals to tighten pension requirements – including a gradual increase in the retirement age and in contribution years – have been modified in the wake of heavy union resistance. Even this diluted plan is not to be implemented until 2008.

Inflation is gradually abating. Slack domestic demand, excess production capacity, direct government pressure on retailers, and renewed currency appreciation will help to offset the impact of high energy costs, although intermittent increases in indirect taxes will limit the scope for a sustained easing of inflationary pressures. The recent convergence of Italian inflation with the euro zone norm will help stem the deterioration in competitiveness vis-à-vis other euro zone economies, but will be insufficient to reverse the gradual erosion that has been evident in recent years. As a result, prospects for a robust rebound in manufacturing remain poor.

Both exports and imports will register only moderate gains through 2007, leaving the current account in deficit for an eighth consecutive year despite a return to surplus in the balance of trade. The retreat in the value of the euro through 2005 will prove insufficient to trigger a strong rebound in foreign sales in 2006, particularly in view of the relatively constrained prospects for Germany, Italy's most important market. The country does have relatively strong trade ties with the Middle East, and manufacturers should benefit when the oil-rich countries of the region embark on a fresh spending spree. Import growth will be limited by the modest size of the pickup in domestic activity and by some easing in energy costs in 2007.

Political issues remain contentious. Divisions within the coalition government have been a recurring problem, as reflected in the September 2005 resignation of the finance minister. He was succeeded by Giulio Tremonti, who had been replaced by the exiting minister fourteen months earlier. The protracted refusal of Italy's former central bank governor to resign amid an ongoing controversy surrounding his role in the takeover of a domestic bank added to public scepticism regarding the quality of governance. The next national election will be held in April 2006. Although the opposition is not free of scandal, polls indicate that it has moved into the lead alongside ongoing concerns regarding the prime minister's tendency to use his office to support his extensive business empire. Nor, should one conclude that even if elected, a new coalition government under the leadership of former European Commission President Romano Prodi will push the pace of economic reform.

ITALY - KEY ECONOMIC INDICATORS

GDP: US$1.8 trillion (2006f)	Population: 58 million (2005e)				
Long-Term Foreign Currency Rating:	Moody's:	Aa2	S&P:	AA-(-)	
	2003	2004	2005e	2006f	2007f
Real GDP (% change)	0.4	1.0	0.1	1.3	1.1
Industrial Production (% change)	-0.2	-3.1	1.0	2.0	2.5
Fiscal Balance NFPS (% GDP)	-3.2	-3.2	-4.3	-4.2	-4.0
Government Debt (% of GDP)	107	107	108	109	110
Consumer Prices (eop % change)	2.6	2.3	2.0	1.9	2.0
Central Bank Rate (%)	2.00	2.00	2.25	2.75	2.75
Exchange Rate (% change)	20.0	8.7	-13.9	8.5	5.5
USD/EUR (year-end)	1.26	1.37	1.18	1.28	1.35
Trade Balance (US$bn)	12	11	-17	-8	5
Exports (US$bn)	298	352	365	385	415
Imports (US$bn)	287	341	382	393	410
Current Account (US$bn)	-19	-15	-25	-30	-20
% GDP	-1.3	-0.9	-1.5	-1.7	-1.0
Foreign Reserves (US$bn)	30.4	27.9	26.0	25.0	25.0
Months of Imports	1.3	1.0	0.8	0.8	0.7

The emergence of political uncertainties linked to regional aspirations within the country combined with high energy costs, a housing market boom and a widening current account deficit cloud the outlook for the AAA-rated Spanish economy.

Political and institutional risk factors in Spain are on the rise. The Basque and Catalonia regions have intensified their demands for a higher degree of autonomy, if not outright separation. Intensifying friction between the administration of José-Luis Rodríguez-Zapatero on the one hand and leaders of the opposition and the Armed Forces on the other in connection with Catalonia's drive for greater autonomy may jeopardize the continuity of a friendly business environment. Moreover, escalating tensions with the United States linked to planned sales of Spanish-made military equipment to Venezuela add political risk factors that may further undermine international business confidence in Spain. US-Spain bilateral relations have been deteriorating following Rodríguez-Zapatero's decision to withdraw troops deployed in Iraq, a move that has already been mimicked by Italy. To some political experts, the continuity of the ruling minority government is at risk, perhaps prompting a call for early elections.

Spain remains among the top-performing economies within the European Monetary Union. Following a 3.3% economic expansion in 2005, real GDP growth will modestly decelerate and average about 3% over the next two years. The European monetary policy environment has contributed to the rapid pace of local credit expansion and to consumption activity. Domestic demand will remain the key engine of growth in 2006-07, despite the tightening of monetary conditions by the European Central Bank (ECB). The International Monetary Fund (IMF) has repeatedly stressed the risks associated with an overheating real estate market. Employment indicators, together with a robust construction sector and sustained gains in equity securities investments, also reinforce a positive outlook for domestic consumption in the year ahead.

The external sector remains the weak link of Spain's fundamental picture, and it will continue to show signs of both cyclical and structural strain. Robust import growth linked to high energy prices and strong domestic consumption has triggered a marked widening of the country's trade deficit which, in turn, led to a sharp increase in the current account deficit last year; the US$65 billion shortfall was equivalent to 6.1% of GDP. A 13% depreciation of the single European currency against the US dollar in 2005 was not enough to boost export growth. Additionally, competitiveness has been eroded by a relatively high inflation rate within Europe, the incorporation of new low-cost-producers into the EU, and a surge of Asian manufactured products. Looking ahead, the current account deficit/GDP ratio, although declining by 2007, will remain at high levels on the back of persistent pressures in energy markets.

Spanish inflation will continue to outpace the euro zone norm by more than a full percentage point. Even so, a modest deceleration is anticipated through 2007 provided energy prices do not move sharply higher. The escalation of tensions in the Middle East in connection with Iran's decision to resume uranium-enrichment activities as an integral part of its nuclear research and development programme, has put global energy markets on alert. Spain would be negatively affected should crude oil prices move sharply upwards. On the other hand, an appreciation of the euro versus the US dollar – which we expect – would help moderate a potentially negative inflationary effect stemming from high prices for oil or other key industrial commodities.

Spain continues to be a remarkable success story in the process of European Union enlargement. Its corporate sector is actively participating in the process of globalization. Through heavy-weight private firms in the energy, utilities, telecommunications, defence and financial sectors, Spain is increasing its involvement in Europe and the Americas. The extensive presence of these multinational corporations in the developing Americas represents both a source of risk and unique opportunities, at a time when there is a new political ideology emerging in the region. The ongoing process of political transition in countries such as Argentina, Chile, Bolivia, Mexico and Brazil will influence Spanish interests in the Americas, prompting the administration of Prime Minister Rodríguez-Zapatero to engage in supportive corporate diplomacy.

SPAIN - KEY ECONOMIC INDICATORS					
GDP: US$1,113 billion (2006f)	Population: 43 million (2005e)				
Long-Term Foreign Currency Rating:	Moody's: Aaa		S&P: AAA		
	2003	2004	2005e	2006f	2007f
Real GDP (% change)	3.0	3.1	3.3	3.1	2.8
Industrial Production (% change)	1.6	1.8	0.4	1.3	1.7
Fiscal Balance NFPS (% GDP)	0.0	-0.1	0.2	0.0	-0.1
Government Debt (% of GDP)	49	47	45	42	40
Consumer Prices (eop % change)	2.7	3.3	3.7	3.2	2.8
Central Bank Rate (%)	2.00	2.00	2.25	2.75	2.75
Exchange Rate (% change)	20.0	8.7	-13.5	8.0	3.9
Exchange Rate (year-end)	1.26	1.37	1.18	1.28	1.33
Trade Balance (US$bn)	-49	-68	-85	-85	-70
Exports (US$bn)	177	198	220	240	270
Imports (US$bn)	227	266	305	325	340
Current Account (US$bn)	-32	-55	-65	-72	-75
% GDP	-3.7	-5.6	-6.1	-6.5	-6.0
Foreign Reserves (US$bn)	19.8	13.5	14.0	14.0	14.5
Months of Imports	1.0	0.6	0.5	0.5	0.5

The Russian Federation is immersed in a deep structural transformation with positive implications for Europe, developing economies and global energy markets. Robust, yet decelerating, economic growth, massive fiscal and current account surpluses, sizable international reserves, the gradual elimination of exchange controls, a decisive drive to de-dollarize the economy and further steps to strengthen the financial sector augur an excellent year ahead.

Russia will be a key participant in determining the global response to the shock associated with Iran's determination to resume its uranium-enrichment activities. As a permanent member of the United Nations' Security Council, it will be crucial in supporting (or rejecting) the imposition of global sanctions on Iran some time during the spring. Foreign policy experts put in doubt Russia's ability to contain Iran from resuming nuclear research and development; the so-called 'Russian proposal' to enrich uranium in Russia to be later sent to Iran does not seem to have the support of US and European leaders. Meanwhile, its defense officials have stressed that plans to step up arms exports to countries such as China, India, Iran and Syria will proceed, fuelling the potential for further diplomatic confrontation with US and European leaders.

Strong energy markets are allowing the administration of President Vladimir Putin to place the Russian Federation at the table for debates and decisions on the most critical global affairs. In mid-July 2006, Russia will host the Group of Eight (G8) meeting in St. Petersburg. Energy security will be a key topic of discussion, as European leaders are increasingly concerned about the ability of Russia to disrupt natural gas supplies. Russia is, at present, the world's single largest producer of natural gas and crude oil. Oil production may soon exceed 10 million barrels-per-day. At the same time, President Putin's drive to join the World Trade Organization is a top priority; to achieve this end, he still needs the support of both the US and Japan.

The Russian economy continues to enjoy robust growth on the back of highly supportive energy markets. Real GDP gains will average close to 6% in 2006-07. Persistent price pressures linked to strong domestic demand, improving employment and an accommodative monetary policy will delay the attainment of single-digit inflation until 2007; Bank of Russia's inflation target for 2006 is 7-8.5%. The year 2005 was marked by major economic successes: the fiscal account recorded a surplus equivalent to 7.5% of GDP and the trade surplus totalled US$120 billion, the world's second largest surplus after Germany. A massive inflow of energy-related capital led to a 40% increase in foreign exchange reserves to US$174 billion, which in turn, reinforced the strengthening enjoyed by the ruble.

The restructuring of the domestic financial sector and the gradual liberalization of the country's capital account are core objectives of the Putin administration for 2006 and 2007. Finance Minister Aleksei Kudrin has stated that full convertibility of the Russian ruble might be put in place well ahead of the scheduled date of January 1st, 2007. The surprise announcement was made prior to the gathering of G8 Finance Ministers in early February, as a means of receiving support from the global financial community. The Russian ruble, which appreciated by 10% in real terms last year, is poised to maintain stability in nominal terms, but will continue to appreciate in inflation-adjusted terms against both the US dollar and the euro. The massive inflow of oil-related capital continues to exert upward pressure on the exchange rate, prompting the monetary authorities to actively intervene in foreign exchange markets. The Russian central bank will keep its dual-currency reserve management approach intact, whereby the US dollar has a 65% weight and the euro 35%.

Russia's ongoing commitment to prepaying external debt obligations is causing a structural shift in the emerging market asset class, as a large share of issuing emerging-market countries have already attained investment grade status. The Russian finance team announced that it will prepay up to US$12 billion in debt obligations owed to the Paris Club of (government) creditors; this move follows the US$15 billion prepayment executed last year. We anticipate that foreign investment inflows will continue to increase in the years to come. The combined effect of a massive accumulation of foreign exchange reserves, projected to reach US$220 billion by the end of 2006, coupled with a sharp reduction in foreign indebtedness, will most likely trigger multiple sovereign credit rating upgrade revisions throughout the year.

RUSSIA - KEY ECONOMIC INDICATORS

GDP: US$785 billion (2006f)	Population: 143 million (2005e)				
Long-Term Foreign Currency Rating:		Moody's: Baa2		S&P: BBB	
	2003	2004	2005e	2006f	2007f
Real GDP (% change)	7.3	7.2	6.4	6.0	5.5
Industrial Production (% change)	7.0	6.1	5.5	5.3	5.0
Fiscal Balance (% GDP)	1.5	4.4	7.5	6.0	5.0
Consumer Prices (eop % change)	12.0	11.7	10.9	10.0	8.0
Exchange Rate (% change)	9.3	1.9	2.2	-0.8	-0.4
Exchange Rate (year-end)	29.2	28.7	28.1	28.3	28.4
Trade Balance (US$bn)	60	86	120	110	105
Exports (US$bn)	136	183	245	290	310
Imports (US$bn)	76	97	125	180	205
Current Account (US$bn)	35.4	60.1	86.6	90.0	85.0
% GDP	8.2	11.3	13.0	11.5	9.5
FDI (US$bn)	6.3	4.7	5.0	7.0	10.0
External Debt (US$bn)	186	214	228	240	250
% of GDP	43	40	34	31	28
% of Exports of G&S	122	105	85	76	75
Public Sector (% of total)	53	46	32	29	28
S-T Debt / Reserves (%)	46	29	23	17	15
Foreign Reserves (US$bn)	78	125	174	220	240
Months of Imports	12	15	17	15	14

Switzerland

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Switzerland will remain solidly entrenched on a growth trajectory that is likely very close to its maximum longer-term potential. The combination of a sound financial sector, massive current account surpluses and small fiscal deficits will ensure that it remains a 'safe haven' for offshore capital. The slow process of regulatory harmonization with the European Union will continue, but membership remains unlikely over the medium term.

The Swiss economy is poised to register economic growth of about 2% through 2007. The expansion will remain well balanced and sustainable, and will become increasingly driven by the private sector. The manufacturing sector is in good shape – the purchasing managers' index has remained well above the 50.0 'expansion/contraction' threshold in recent months – and the closely followed KOF index of leading economic indicators has reached a 5½-year high. Consumer spending will likely offer continuing support to economic growth into 2007, underpinned by modest increases in real disposable incomes and by low (albeit slowly rising) interest rates. With the unemployment rate slowly declining over the past year to its lowest level in 2½ years, consumer confidence has been on the mend.

The general government deficit will likely narrow over the next two years to about ½% of GDP, alongside the cyclical economic recovery and a determined effort to strengthen public sector finances. The sudden, temporary swing into substantial surplus in 2005 was a result of gold sales by the Swiss National Bank and the subsequent transfer of the proceeds to the government's accounts.

The central bank is once again embarked on a course of gradual monetary policy tightening. After implementing two 25 bps interest rate increases in the second half of 2004, the Swiss National Bank (SNB) held its target 3-month Libor rate steady at 0.75% until December 2005, when it nudged its benchmark rate up another 25 basis points. Price pressures in Switzerland remain well-contained, with little apparent risk of an upsurge in the foreseeable future. The headline consumer inflation rate is running at an annual rate of about 1% (with the core rate very close to zero) and a similar pace is evident further up the distribution chain. Such modest increases will not dissuade the SNB from further monetary policy tightening this year; however, they do allow the central bank to proceed at a measured pace, alongside the gradual pickup in domestic economic activity. The SNB describes the current monetary policy stance as "expansionary". At the same time, monetary officials have offered reassurance to the financial markets that they will remain cautious in their shift to a more neutral position, and will continue to offer substantial support to the nation's economic recovery. In particular, the central bank will want to avoid taking any action that might trigger an excessive appreciation of the Swiss franc, though the strength of the external accounts will set the stage for moderate gains against the euro (to 1.46) and more substantial appreciation vis-à-vis the US dollar (to 1.08) by the end of 2007. Despite the likelihood of modest increases in administered rates over the next year, the country's large savings surpluses will ensure that market rates remain low by international standards.

The current account of the balance of payments will stay in massive surplus through the forecast period, averaging 14-15% of GDP in 2006 and 2007. Substantial surpluses in both services and merchandise trade will complement huge net inflows of investment income. The modest depreciation of the Swiss franc vis-à-vis the euro (in real terms) over the past two years and a gradual upturn in spending within Europe should help to offer some additional stimulus to exports in 2006-07. Renewed currency appreciation is unlikely to have a significant impact on either export or import volumes through the end of the forecast period, though a pickup in US dollar terms will be evident in 2007.

Swiss authorities are moving ahead carefully with a deepening of ties with the European Union, though membership is not in the works. Progress has been evident in such areas as cooperation in addressing tax evasion and fraud problems while preserving bank secrecy, as well as an easing of impediments to trade in processed agricultural goods. A mid-2005 referendum gave support to closer judicial/security cooperation and common border controls. However, a firm deadline for the implementation of some of these measures has not yet been agreed to, and an unfavourable referendum could still put a temporary halt to further integration. A constitutional dependence on referenda and a rise in nationalist sentiment in Switzerland will slow domestic reform and the push towards further regulatory harmonization.

SWITZERLAND - KEY ECONOMIC INDICATORS					
GDP: US$378 billion (2006f)	Population: 7.3 million (2005e)				
Long-Term Foreign Currency Rating:	Moody's: Aaa S&P: AAA				
	2003	2004	2005e	2006f	2007f
Real GDP (% change)	-0.3	2.1	1.9	2.0	1.8
Industrial Production (% change)	2.2	2.7	2.5	3.0	2.5
Fiscal Balance NFPS (% GDP)	-1.3	-1.4	3.6	-1.0	-0.5
Government Debt (% of GDP)	55	56	56	57	57
Consumer Prices (eop % change)	0.6	1.3	1.1	1.2	1.0
Central Bank Rate (%)	0.25	0.75	1.00	1.50	1.75
Exchange Rate (% change)	-7.0	1.3	-1.3	4.0	2.7
EUR/CHF (year-end)	1.56	1.54	1.56	1.50	1.46
Trade Balance (US$bn)	6.9	15.7	14.0	16.0	17.0
Exports (US$bn)	115	138	145	154	170
Imports (US$bn)	108	123	131	138	153
Current Account (US$bn)	45	60	55	57	60
% GDP	13.9	16.8	14.8	15.0	13.9
Foreign Reserves (US$bn)	48	56	37	40	45
Months of Imports	5.3	5.4	3.4	3.5	3.5

Turkey's economic growth prospects will be supported by foreign capital inflows linked to its privatization programme, attractive interest rate differentials, the launch of accession negotiations with the European Union (EU), massive financial support from the United States and the International Monetary Fund (IMF) and favourable financial market conditions for emerging market economies. However, rising crude oil prices, the escalation of tensions connected with Iran's nuclear development programme and the outbreak of bird flu may weigh on the country's economic and financial market outlook.

The economy remains in solid growth mode, although current indicators point towards a slowdown following a 6% expansion in 2005. The monetary front may experience some volatility in coming months. The fight against inflation will remain a top priority while the authorities pave the way for the adoption of an inflation-targeting scheme. Exchange rate fluctuations may intensify through the remainder of the year on the grounds of heightening global risk aversion, increasing interest rates in the US and persistently high energy prices.

The steady deterioration of the country's current account deficit and the potentially negative economic impact of the outbreak of bird flu are issues of concern. While it is still premature to assess the success or failure of Turkish authorities in containing the spread of the disease caused by the H5N1 virus, the possible adverse implications for the economy (in particular, for tourism and agriculture), should not be underestimated. Although export growth slowed in 2005, the steady widening of the current account deficit to a level equivalent to more than 6% of GDP was mainly a result of an increase in energy prices; the value of oil imports grew by almost 30% in 2005 from a year earlier. The energy-linked deterioration in the current account deficit is a negative factor weighing on the outlook for the local currency; however, it will be partly offset by a surge in foreign direct (and portfolio) investment inflows.

The potential imposition of economic sanctions on Iran may also exacerbate volatility in crude oil markets and increase the risk of temporary supply disruptions, with adverse implications for Turkey. On a positive note, economic activity remains strong and consumer price pressures continue to recede. The central bank formally adopted an inflation targeting scheme at the beginning of 2006, setting the targets at 5% +/-2% for 2006 as a whole, and 4% for 2007. The steady decline in consumer price inflation, intermittent pressures towards currency appreciation (versus the US dollar), and the substantial accumulation of foreign exchange reserves have prompted the monetary authorities to adopt a gradual, yet cautious, process of interest rate reduction. The central bank's reference rate has been reduced to 13.5% from 18% a year ago. Looking ahead, provided that the inflation rate continues its path towards the 5% inflation target, real interest rates will remain sufficiently high to encourage foreign capital inflows and support exchange rate stability. We estimate that the currency will depreciate in nominal terms, roughly in line with the inflation rate, in 2006.

Turkey has substantially advanced on its structural reform agenda, and it has been rewarded by market participants and credit rating agencies. In the latter part of 2005, Moody's upgraded the country's long-term foreign currency rating to "Ba3" (stable outlook), the IMF approved the first and second review under the US$9.5 billion Stand-By credit facility (authorizing a disbursement of US$1.6 billion), and the authorities completed the sale of a mobile telephone company valued at US$4.6 billion to the British-based Vodafone group. The government has privatized over US$30 billion in assets, and more proceeds are in store for 2006. All these factors, together with a benign global economic and financial environment, made Turkey a success story in 2005. On the negative side, domestic political issues connected with the "Pamuk Affair", that is, the arrest and trial of novelist Orhan Pamuk, who according to media reports "insulted the identity of Turkishness", have emerged. The media also highlighted that these actions undermine the standards of freedom of expression enjoyed in Europe.

Notwithstanding all the challenges faced by Turkish leaders, we strongly believe that Turkey will remain on a steady path of structural transformation, prompting multiple credit rating upgrades in the near term.

TURKEY - KEY ECONOMIC INDICATORS

GDP: US$368 billion (2006f) — Population: 73 million (2005e)

Long-Term Foreign Currency Rating: Moody's: Ba3 S&P: BB-(+)

	2003	2004e	2005e	2006f	2007f
Real GDP (% change)	5.9	9.9	6.0	5.5	5.0
Industrial Production (% change)	8.2	10.0	5.5	5.4	5.2
Public Sector Balance (% GDP)	-9.8	-7.1	-2.0	-1.8	-1.5
Consumer Prices (eop % change)	18.4	9.3	7.7	6.0	4.5
Exchange Rate (% change)	17.7	4.7	-0.6	-3.5	-3.4
Exchange Rate (year-end)	1.41	1.34	1.35	1.40	1.45
Trade Balance (US$bn)	-14	-34	-45	-45	-40
Exports (US$bn)	51	64	73	80	90
Imports (US$bn)	65	98	118	125	130
Current Account (US$bn)	-7.9	-15.6	-22.0	-24.0	-22.0
% GDP	-3.3	-5.2	-6.0	-5.9	-5.1
Net Equity Flows (US$bn)	1.3	2.9	2.6	2.6	3.6
External Debt (US$bn)	152	173	175	185	200
% of GDP	64	57	48	46	46
% of Exports of G&S	217	199	174	168	167
Public Sector (% of total)	65	61	63	65	60
S-T Debt / Reserves (%)	68	78	60	58	55
Foreign Reserves (US$bn)	33.6	35.9	50.0	52.0	55.0
Months of Imports	6.2	4.4	5.1	5.0	5.1

Sweden's economic prospects remain encouraging, combining solid growth and a sound fiscal position with low inflation and a strong balance of payments.

We expect economic growth in 2006-07 to average just over 3%, surpassing the euro zone by more than one percentage point. Investment will continue to set the pace, as it has since 2004. Dwindling excess production capacity, low interest rates and a pickup in foreign sales have been providing the necessary stimulus for increases in capital expenditures.

Swedish industry is beginning to report advances in both new orders and output, although gains have been subject to intermittent reversals; encouragingly, purchasing managers' indices continue to suggest that the sector is solidly positioned for expansion. In addition, record-low domestic interest rates through the second half of 2005 and last year's depreciation of the Swedish krona vis-à-vis the euro of more than 5% (in inflation adjusted terms) gave a boost to confidence. Some deceleration in capital outlays will be evident in the latter part of the forecast period alongside a maturing of the investment cycle and a gradual shift to a less accommodative monetary policy stance. As exports of goods and services account for more than 40% of Sweden's GDP, growth will continue to be influenced by economic developments abroad and by fluctuations in the value of the krona.

Consumer spending will be supported by a gradual improvement in labour market conditions over the course of the next two years, reinforced by tax cuts. Following an extended period of corporate retrenchment that led to a substantial rise in job losses, moderate increases in private sector employment opportunities will set the stage for a slow decline in the unemployment rate – currently hovering around 5½% (relatively high by Swedish standards) – through the forecast period. Rising domestic interest rates will, however, tend to dampen the pace of increase in home prices, a trend that has been supporting the expansion in household expenditures.

Public sector finances are expected to remain in modest surplus through 2007, though the gap will continue to fall short of the medium-term target surplus of 2% of GDP. The revenues derived from privatizations will be small. The minority government's budget for 2006 focused on job creation measures that should help to provide a temporary boost to household incomes. Last year, income and wealth tax rates were reduced and inheritance taxes eliminated. These measures provided a moderate boost to consumer spending, despite the adverse impact of higher energy taxes.

The Riksbank is beginning to shift away from its accommodative monetary policy. The central bank raised its benchmark repo rate 50 bps to 2.0% in the first two months of 2006 after holding it at a record low 1.5% since June 2005. The central bank continues to flash warnings of further increases in interest rates later in the year. Price pressures remain muted; the core consumer inflation rate is a modest 1%, comfortably below the Riksbank's 2% target. Nevertheless, the central bank expects core inflation to reach target over the next two years, even with further gradual monetary policy tightening; further up the distribution chain, a pickup in costs is already evident, in part a reflection of the krona's substantial depreciation in 2005.

Sweden's current account of the balance of payments will continue to register large surpluses over the next two years. Currency depreciation through 2005 – the krona weakened by about 17% against the US dollar as well as losing ground against the euro – has given Swedish exporters a significant competitive edge that can be preserved for some time should they decide to hedge their foreign exchange positions. The current account surplus, relatively bright economic prospects and the likelihood of further global asset diversification are all factors supporting renewed krona strengthening. Export strength will be sustained by the recovery in euro zone spending, as the region absorbs approximately 40% of foreign sales. With consumer spending and business investment remaining reasonably robust in Sweden through 2007, so too will imports despite the potential dampening impact of a recent krona weakness.

Sweden will likely remain outside the European Monetary Union, at least through the balance of the decade. With the defeat of the European Union constitution by voters in both France and the Netherlands early in the summer of 2005, the minority Social Democratic government has been spared pushing ahead with this contentious issue in the run-up to the general election, scheduled for September 2006.

SWEDEN - KEY ECONOMIC INDICATORS					
GDP: US$364 billion (2006f)	Population: 9.1 million (2005e)				
Long-Term Foreign Currency Rating:	Moody's: Aaa		S&P: AAA		
	2003	2004	2005e	2006f	2007f
Real GDP (% change)	1.7	3.7	2.7	3.3	3.0
Industrial Production (% change)	0.2	-2.2	2.7	4.0	3.5
Government Balance (% GDP)	-0.1	1.4	1.3	1.0	1.0
Government Debt (% of GDP)	52	51	51	50	49
Consumer Prices (eop % change)	1.3	0.3	0.9	1.5	2.0
Central Bank Rate (%)	2.75	2.00	1.50	2.00	2.50
Exchange Rate (% change)	20.0	9.7	-16.9	11.8	6.4
SEK/USD (year-end)	7.2	6.6	7.9	7.1	6.7
Trade Balance (US$bn)	19.0	23.4	20.0	21.0	22.0
Exports (US$bn)	102	125	135	146	160
Imports (US$bn)	83	102	115	125	138
Current Account (US$bn)	22.8	27.5	25.0	26.0	26.0
% GDP	7.6	7.9	7.1	7.1	6.2
Foreign Reserves (US$bn)	21.0	22.1	22.0	27.0	30.0
Months of Imports	3.0	2.6	2.3	2.6	2.6

Poland

The outlook for Poland will be characterized by a pickup in the rate of economic expansion, low interest rates, mild though quickening inflation, a moderate current account deficit and a challenging political environment.

Poland appears to be on an upward growth trajectory. We estimate that the economy expanded by around 3¼% in 2005, lower than initially expected, following sluggish growth during the first half of the year. According to the National Bank of Poland (NBP), this was partially attributable to below-potential private sector spending. Going forward, we anticipate that growth will accelerate to 4% by 2007. Construction and manufacturing activity are picking up and wages are slowly rising. The unemployment rate, however, is hovering around 17.5% (the highest in the European Union) and is unlikely to fall significantly until substantial labour market reforms are implemented.

Political uncertainty persists in Poland, despite some recent encouraging developments. Parliamentary and presidential elections have been held, and a minority government led by Kazimierz Marcinkiewicz's Law and Justice Party (PiS) has successfully negotiated an agreement that should provide for some political stability, at least over the next year, thereby avoiding the risk of a legislative deadlock. Nevertheless, with local government elections taking place in the second half of 2006, the possibility of renewed political turbulence should not be entirely dismissed. We have already seen a change in a key post – Zyta Gilowska replaced Teresa Lubinska as finance minister in early January.

Improving the condition of government finances will be a key focus over the forecast period as Poland prepares for euro zone membership. The country must reduce its fiscal deficit to a maximum of 3% of GDP in order to enter the next phase of euro adoption. We estimate that the deficit narrowed slightly in 2005 to 3.5% of GDP. Going forward, much will depend on the willingness and ability of the administration to enact fiscal reforms. The International Monetary Fund (IMF) has highlighted the need to control public sector debt by reducing expenditure, while improving the efficiency of government spending. In addition, the IMF believes that revenue projections for the 2006 budget are somewhat unrealistic. This, combined with the uncertain political environment, has led us to forecast a slightly wider fiscal shortfall in 2006 than the 3.1% contained in the draft 2006 budget.

Inflation will likely average just over 2% through 2007. Consumer price pressures declined dramatically in 2005 and inflation has been near or below the low end of the 2.5% +/- 1% target band since mid-2005. This has occurred due to high base year inflation, owing to one-off costs associated with EU accession in 2004. Furthermore, wage pressures remain subdued, given the persistence of high unemployment, and the zloty continues to retain its strength. Stronger economic growth and the continuation of elevated oil and gas prices will contribute to slightly higher rates of inflation than are currently being registered. Given the decline in price pressures in 2005, the Monetary Policy Council has been able to cut interest rates by 2¼ percentage points over the past year. The reference rate now sits at 4.25%. With interest rates elsewhere in Europe biased higher, we do not anticipate any further easing in monetary policy.

The current account deficit will inch back out towards 2% of GDP over the forecast period, following a substantial narrowing in 2005. Last year's reduction was largely achieved through a contraction in the trade deficit, but we anticipate a reversal of this trend through 2007. The investment income account remains in sizeable deficit, as foreign companies continue to repatriate profits; however, this is largely offset by the services and transfers surpluses.

Poland's sovereign credit ratings remain firmly entrenched in the investment grade category, and poised for further upgrades. Both Fitch and Standard & Poor's raised their outlooks for Poland to "positive" from "stable" on their "BBB+" ratings in 2005. Moody's continues to rate Poland two notches higher at "A2" with a "stable" outlook. The agency notes the good economic outlook, strong foreign exchange reserves, moderate current account deficit and solid debt management, but remains concerned about the state of government finances, the need for restructuring in some sectors of the economy and the high unemployment rate.

POLAND - KEY ECONOMIC INDICATORS

GDP: US$270 billion (2006f)	Population: 39 million (2005e)				
Long-Term Foreign Currency Rating:	Moody's:	A2	S&P:	BBB+(+)	
	2003	2004	2005e	2006f	2007f
Real GDP (% change)	3.8	5.4	3.2	3.8	4.0
Fiscal Balance of NFPS (% GDP)	-4.8	-3.9	-3.5	-3.2	-3.0
Consumer Prices (eop % change)	1.7	4.4	0.7	2.0	2.2
Exchange Rate (% change)	-14.8	15.6	6.1	2.8	1.1
PLN / EUR (year-end)	4.7	4.1	3.8	3.7	3.7
Trade Balance (US$bn)	-5.7	-5.6	-2.4	-2.7	-3.2
Exports (US$bn)	61	82	96	111	128
Imports (US$bn)	67	87	99	114	131
Current Account (US$bn)	-4.6	-10.4	-4.3	-4.8	-5.6
% GDP	-2.2	-4.3	-1.7	-1.8	-2.0
FDI (% of current account deficit)	100	122	186	167	143
External Debt (US$bn)	107	128	128	130	138
% of GDP	51	53	50	48	48
% of Exports	175	157	133	117	108
S-T Debt / Reserves (%)	44	57	58	55	53
Total Public Sector Debt (% GDP)	45	44	44	44	44
Foreign Reserves (US$bn)	31.7	34.5	41.5	44.0	48.0
Months of Imports	5.7	4.7	5.0	4.6	4.4

Czech Republic

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The Czech Republic will enjoy solid, sustainable economic growth and low inflation over the forecast period; however, with parliamentary elections due in June 2006, key fiscal reforms continue to be delayed. This in turn is lengthening the time frame for euro adoption, as the fiscal deficit once again exceeds the 3% of GDP ceiling. The Czech Republic may benefit from a long-term foreign currency credit rating upgrade from Standard & Poor's following an outlook revision to "positive" in November 2005.

The Czech economy is positioned to expand by at least 4% through 2007. Investment will be the driving force, growing by more than 5%. Underpinned by lower personal income tax rates, private consumption will also play a key supportive role, with the potential to rise by an annual average of about 4% over the next two years. A low interest rate environment - the repo rate currently sits at 2% - will prove supportive to both capital expenditures and consumer spending. The central bank believes that the strength of the exchange rate poses the biggest risk to the competitiveness of the economy over the forecast period. The koruna has appreciated by more than 15% against the euro in its latest strengthening phase, which began roughly two years ago.

We anticipate that inflation will be in the 2-2½% range through 2007. The strong growth environment will likely lead to a gradual reduction in joblessness. The latest Convergence Report suggests that the unemployment rate will dip below 7% in 2008; however, this is still high enough to limit the risk of any significant wage-based price pressures. In addition, the strength of the currency will help to dampen any imported inflation, including pressures from oil and gas prices.

Fiscal deficit targets could prove challenging to meet over the forecast period. After achieving a budget deficit of just 3% of GDP in 2004 (though this was largely attributable to changes in budget accounting procedures), down from 12.5% in 2003, we estimate that a rebound to almost 5% occurred in 2005. Going forward, a more gradual and sustainable downward trend will likely be established, though not until after the parliamentary elections. Key areas requiring reform include pensions, healthcare, and social spending, particularly given the Czech Republic's adverse demographics.

A parliamentary election is nearing. Since joining the European Union in May 2004, the Czech Republic has had three different prime ministers. Fortunately, the latest, Jiri Paroubek, has managed to stabilize the political environment by strengthening ties with his coalition partners, as well as improving relations within his own party; however, this was achieved at the expense of delays to some of the aforementioned reforms. Ideally, the June 2006 election will yield a stable administration that will be able to resume the reform process, thereby ensuring that the Czech Republic is on track for euro adoption.

European Monetary Union membership is on the horizon, but the lack of fiscal consolidation is leading to delays. In the latest assessment of compliance with Maastricht criteria, compiled by the ministries of finance and industry & trade and the Czech National Bank, the final recommendation was that the Czech Republic should aim to enter the next stage of euro adoption (ERM II) in mid-2007. The country complies with the inflation and debt requirements; however, the budget deficit must be brought below 3% of GDP. Two key areas that must be addressed in order for this to occur are pensions and healthcare, as these are not only posing challenges on the fiscal front, but are also acting as key constraints on any substantial improvement in the country's sovereign credit ratings.

The current account deficit will likely stabilize around US$4 billion over the forecast period; as a share of GDP, the shortfall will shrink to about 3% of GDP by 2007. The trade surplus will widen. Exports have now exceeded imports on a twelve-month cumulative basis since March 2005. Net services and transfers will also remain in positive territory. Counteracting these surpluses will be the sizeable investment income gap (the ministry of finance estimates that the shortfall will be in the range of US$7-8 billion per year over the next two years) resulting from the substantial outflow of profits generated by foreign firms operating in the Czech Republic. Foreign direct investment should cover the entirety of the current account shortfall going forward. International reserves are positioned to pass the US$30 billion mark in 2006.

CZECH REP. - KEY ECONOMIC INDICATORS

GDP: US$123 billion (2006f)	Population: 10.2 million (2005e)				
Long-Term Foreign Currency Rating:	Moody's:	A1	S&P:	A-(+)	
	2003	2004	2005e	2006f	2007f
Real GDP (% change)	3.2	4.4	4.8	4.4	4.2
Fiscal Balance of NFPS (% GDP)	-12.5	-3.0	-4.8	-3.8	-3.3
Consumer Prices (eop % change)	1.0	2.8	2.2	2.5	2.3
Exchange Rate (% change)	-3.0	6.9	4.6	0.8	0.0
CZK / EUR (year-end)	32.5	30.4	29.1	28.9	28.9
Trade Balance (US$bn)	-2.5	-0.9	1.9	3.1	4.3
Exports (US$bn)	49	67	78	87	100
Imports (US$bn)	51	68	76	84	96
Current Account (US$bn)	-5.8	-5.6	-4.5	-4.0	-4.0
% GDP	-6.4	-5.2	-3.9	-3.5	-3.0
FDI (% of current account deficit)	33	70	204	125	250
External Debt (US$bn)	35	45	45	44	44
% of GDP	39	42	39	36	33
% of Exports	72	68	58	51	44
Total Public Sector Debt (% GDP)	38	37	37	37	38
Foreign Reserves (US$bn)	26.3	27.8	29.1	31.0	33.0
Months of Imports	6.2	4.9	4.6	4.4	4.1

Persistent macroeconomic imbalances are likely to impair Hungary's goal of adopting the euro by 2010. Convergence criteria must be met by 2008; however, the large fiscal deficit puts this goal in jeopardy. Hungary also has a wide current account shortfall, and is preparing for parliamentary elections in April and municipal elections in the second half.

The economy is currently positioned to expand by at least 4% over the forecast period. Growth will be supported by an accommodative interest rate environment and lower income taxes. Household consumption is expected to expand by more than 3½% in 2006, and investment by 7½%. Real GDP growth figures for 2003 and 2004 have been upwardly revised owing to the inclusion of a new category of financial sector services in the calculation.

The fiscal deficit will likely remain well above the limit required for adoption of the euro for at least the next two years. Though the government is anticipating some moderate improvement, the budget gap will continue to exceed the European Union's ceiling of 3% of GDP by a wide margin unless significant reforms are enacted to tackle the structural fiscal shortfall (which is highly unlikely given the upcoming elections). A Eurostat decision in 2005 requiring the cost of a highway construction project to be recorded as a government expenditure is a key factor behind the widening of the 2005 fiscal gap. According to the Organization for Economic Cooperation and Development (OECD), Hungary's deficit reduction strategy needs to focus on cutting government spending, as high tax rates are undermining competitiveness while causing labour market distortions. The OECD remains concerned that progress in narrowing the fiscal shortfall has largely been due to accounting measures, rather than reform in areas such as healthcare, taxation, welfare, labour markets and education. Public sector debt will remain close to 60% of GDP through 2007.

Subdued inflation will persist, though a gradual rise will be evident over the forecast period. The value added tax rate was reduced by five percentage points at the beginning of this year to 20%. This resulted in a one-time decline in prices, which will lower inflation in 2006. A slight acceleration towards 3% (the medium-term target) in 2007 is anticipated once the impact of the tax change wears off. The Monetary Council of the Central Bank of Hungary has reduced its benchmark interest rate from 9.5% at the end of 2004 to the current 6%.

The current account deficit will likely remain in excess of 7% of GDP through 2007, as the trade deficit moves back above US$1 billion and the income deficit remains wide (more than US$7 billion), on account of profits repatriation by foreign firms and investors. Foreign direct investment inflows will only cover a portion of the current account shortfall. This will exert pressure on the external debt indicators.

Currency pressures will persist over the forecast period. The forint fluctuates within a band of +/- 15% around a 282.36 central parity against the euro. While the currency has been reasonably strong, the current account deficit, sizeable debt and narrower interest rate spreads will likely lead to further depreciation.

The current political environment is likely to delay any meaningful attempts to address the current economic imbalances. With a parliamentary election due this spring, and municipal elections in the fall, it is unlikely that we will see a significant curbing of public sector expenditures, or for that matter, any real attempt at reform until 2007, which casts some doubt on the current fiscal deficit targets – as shown in the table below – in Hungary's Updated Convergence Programme. Parties in contention include the leader of the current coalition government, the Hungarian Socialist Party under Prime Minister Ferenc Gyurcsany and the primary opposition party, the Fidesz-Hungarian Civic Union; recent polls point to a small lead by Fidesz, but it is generally acknowledged that the final outcome will be narrowly balanced.

Hungary's long-term foreign currency sovereign credit ratings are in the investment grade category; however, rating agencies are quick to note the substantial risks associated with the large fiscal and current account deficits. These factors led to long-term local currency rating downgrades in 2005 by Standard & Poor's and Fitch, and a long-term foreign currency rating downgrade by the latter agency to "BBB+" from "A-" in December. Moody's recently lowered the outlook on its "A1" rating to "negative". The International Monetary Fund has stressed the need for Hungary to aggressively tackle its structural fiscal deficit, while establishing monetary and fiscal policy predictability.

HUNGARY - KEY ECONOMIC INDICATORS

GDP: US$115 billion (2006f) — Population: 10 million (2005e)

Long-Term Foreign Currency Rating: Moody's: A1(-) S&P: A-(-)

	2003	2004	2005e	2006f	2007f
Real GDP (% change)	3.4	4.6	4.2	4.3	4.1
Fiscal Balance of NFPS (% GDP)	-6.5	-5.4	-6.1	-6.0	-5.0
Consumer Prices (eop % change)	5.7	5.5	3.3	2.0	3.0
HUF/EUR (% change)	-10.5	7.2	-3.0	-2.7	-2.0
HUF/EUR (year-end)	263	245	253	260	265
Trade Balance (US$bn)	-3.4	-2.3	-0.6	-1.8	-1.3
Exports (US$bn)	43	50	55	60	65
Imports (US$bn)	47	52	55	62	67
Current Account (US$bn)	-7.3	-8.6	-8.8	-9.0	-8.8
% GDP	-8.8	-8.8	-8.2	-7.9	-7.2
FDI (% of current account deficit)	29	34	46	46	49
External Debt (US$bn)	58	74	74	89	99
% of GDP	70	76	70	77	81
% of Exports	135	150	136	148	152
Total Public Sector Debt (% GDP)	57	57	58	58	58
Foreign Reserves (US$bn)	12.7	15.9	18.5	20.0	22.0
Months of Imports	3.3	3.7	4.0	3.9	4.0

A S I A / O C E A N I A

Regional economic strength to persist despite high energy prices and monetary policy tightening

Asia remains the world's most economically dynamic region. Neither high oil prices nor broadly based monetary policy tightening will derail the expansion. Japan is entrenched on a sustainable private sector-led expansion. However, longer-term growth potential is constrained by the impact of a declining population and by the need for further restraint on budget expenditures and an increase in government revenues. The Japanese public is prepared for an increase in the national sales tax sometime in 2008. Elsewhere, we anticipate that Australia will shift from consumer-led to export/investment-led growth. The major developing Asian economies will set the pace globally. China and India will experience moderate economic decline over the next two years, though growth will still average 9% and 7%, respectively. As the world's third biggest trading nation generating the second largest trade surplus, China will continue to have a profound impact on global markets for commodities and manufactured goods. Among the other key nations within the region, Korea, Taiwan and Indonesia will experience domestically-led growth.

Gradual strengthening of regional financial sectors

Japanese financial sector reform is well-advanced and improvement in China is also evident. Japan's banking system has been recapitalized and problem loans have been sharply reduced. In the aftermath of extensive consolidation, a Japanese bank once again ranks first in global size charts. Lending is finally reviving, after a near-decade long contraction, setting the stage for more sustainable earnings growth. In China, the government's new five-year development plan is clearly committed to financial sector reform. The authorities have demonstrated an openness to foreign banking expertise. The major state-owned domestic will be increasingly subject to market discipline, with one bank already listed on the Hong Kong stock exchange and two other listings under way.

Massive buildup in foreign exchange reserves reinforces Asian financial strength

The power of Asian central banks continues to build alongside the rise in foreign reserves, which now approach US$3 trillion. Asian governments are still reluctant to exploit the US financial dependence on Asian capital to elicit trade concessions; the depth and breadth of US capital markets remains a powerful magnet for official funds. However, liquidity is a two-edged sword, as it also may increase the risk of heightened market volatility in the event of a sudden change in sentiment. As a result, rumours of even moderate asset diversification by Asian central banks have led to substantial swings in the US dollar. In reality, it is highly unlikely that these central banks will be major sellers of US dollar assets in the foreseeable future, as they will wish to avoid major shocks to domestic manufacturing sectors. Indeed, Asian central banks may feel obliged to resume their role as US dollar 'buyers of last resort' in 2006.

China's exchange rate regime to play key role in influencing Asian currency appreciation versus US dollar

Asian currencies will be influenced by the pace of China's currency regime reform. Its rapidly widening trade surplus has led to persistent calls on Beijing for a more ambitious reform. In addition, intermittent bouts of protectionism directed at Chinese products also add to the arguments favouring a currency adjustment. With China on track to record a US$150 billion trade surplus this year and net direct investment inflows likely to be approximately US$60 billion, the yuan will retain a strengthening bias. Should the authorities concede a more rapid appreciation, central banks within the region may allow their currencies to gain ground. In so doing, relative competitiveness among the major Asian economies would not be significantly altered, while currency appreciation vis-à-vis the US dollar would help to contain any inflationary pressures stemming from high oil – and other commodity – import costs.

Asian central banks biased to less accommodative monetary policies; important shift in Japan

Further, modest interest rates hikes will be widespread, although inflation will remain moderate throughout most of the region. The Bank of Japan is ending the quantitative easing policy that had been in place for five years; in March it began to reduce its reserves target from ¥30-35 trillion to ¥6 trillion, to be phased in over several months. Even so, massive liquidity pools will ensure that short-term interest rates remain very close to zero for some time. Elsewhere, relations between central banks and political institutions appear less contentious; as yet, interest rate hikes have tended to be accepted stoically by both government and the private sector. In China, the authorities have been inclined to rely more on administrative fiat than on interest rates in efforts to curb excessive lending.

Tensions linked to nuclear plans in India, Iran & North Korea & to China-Taiwan relations will be manageable

The leadership roles of China (as a permanent member of the UN Security Council) and of India, which recently reached a pact with the US on nuclear development, will be tested in the months ahead as efforts intensify to curb Iran's nuclear programme. Major powers have yet to reach an agreement on how to deal with North Korea's nuclear plan, though that nation's recent missile tests near China's border may lead Beijing to adopt a higher profile role in managing that issue. We expect that recent efforts by Taipei to bring Taiwan's status vis-à-vis the mainland back to the forefront will not lead to a major confrontation, although Beijing will maintain its strong criticism of President Chen Shui-bian's efforts to widen the political gulf.

Encouraging – albeit decelerating – growth, large current account surpluses, a bias towards yen appreciation, dormant inflation and gradual progress in reducing the government deficit will be key characteristics of the Japanese economy in 2006-07. In light of Prime Minister Junichiro Koizumi's resounding success in the September 2005 lower house election, it is likely – but not certain – that his gradualist reformist stance will be sustained by his successor; Koizumi is scheduled to leave office in September 2006 when his term as leader of the ruling Liberal Democratic Party expires.

Internationally, Koizumi's re-election raises the likelihood of continuing political strains with China, as both countries become more assertive regarding their regional (and global) leadership aspirations. Economically, the new Koizumi administration will remain focused on maintaining growth while pursuing a policy of gradual fiscal deficit reduction. As such, the government will likely hold fast to its decision to allow temporary personal income tax cuts to lapse and will continue to prepare the public for an eventual increase in the national sales tax, though this will not occur until 2007 – at the earliest. Expenditure policies may focus on means of consolidating the party's support among urban voters.

We expect the pace of economic expansion to fall back to about 1½% in 2007 following three successive years of 2%-plus growth. Demographics are weighing on the economy's overall potential. The number of retirees is increasing rapidly and the population has begun to decline. Business investment will remain robust for several more quarters, but the ongoing process of corporate restructuring linked to relentless pressures on businesses to increase productivity will have a constraining impact on employment and on household incomes. While corporate profits have been rising, recent surveys point to the possibility of a slowdown in business investment growth in 2006. In addition, consumer spending will be limited by higher income tax rates and user fees in 2006-07 and by an eventual stabilizing of household savings rates following a protracted period of decline. Moreover, price-sensitive Japanese consumers are increasingly turning to lower cost foreign goods. As a result, gains in domestic demand will be partially offset by imports.

The Bank of Japan (BoJ) is beginning to shift away from its 5-year policy of quantitative easing. However, the cautious reduction in excessive liquidity that is now under way will not have any immediate impact on the nation's interest rate structure, and subsequent increases in short-term rates through the latter part of 2006 will likely be minimal. Price pressures remain largely absent despite the run-up in oil prices. With the yen biased towards renewed strengthening, domestic demand prospects uncertain, and bank lending growth still weak (though successful commercial bank restructuring now positions them to effectively respond to any pickup in credit demand) monetary authorities are understandably reluctant to push interest rates higher and thereby add to currency pressures or put bank earnings at risk. Nor is such a move urgently needed, as inflation risk remains low. At the same time, the Ministry of Finance remains willing to direct the BoJ to intervene heavily to stem any large yen appreciation.

Substantial and protracted fiscal retrenchment is long overdue, as government deficits will probably be equivalent to at least 5½% of GDP through 2007. Public sector debt, already equivalent to about 160% of GDP, will continue to rise. Large fiscal shortfalls will eventually push government funding costs higher, a development that will weigh on public sector debt servicing. Further cutbacks in public works expenditures have been included in the draft 2006 budget. In addition, increases to pension contributions and benefit reductions are slowly being phased in. Nevertheless, these initiatives fall far short of what is necessary to rectify the imbalances. Increases in taxes and other government charges, divestments and additional expenditure cutbacks will be required to reverse the financial deterioration. Many of these measures will have an adverse medium-term impact on both household income and corporate profitability.

Japan will continue to generate massive trade and current account surpluses. Net investment income has become an important source of foreign exchange earnings, averaging more than ¥1 trillion (US$9 billion) per month. This trend will continue over the longer term, providing a valuable counterbalance to the gradual 'hollowing out' of Japan's manufacturing sector and an eventual narrowing of the trade surplus. Domestically-based firms remain competitive across a broad range of goods, as the yen has remained relatively stable in real effective terms over the past year – and has depreciated by about 25% since the turn of the decade.

JAPAN - KEY ECONOMIC INDICATORS					
GDP: US$4.8 trillion (2006f)	Population: 128 million (2005e)				
Long-Term Foreign Currency Rating:	Moody's: Aaa		S&P: AA-		
	2003	2004	2005e	2006f	2007f
Real GDP (% change)	1.8	2.3	2.7	2.5	1.5
Industrial Production (% change)	4.9	1.4	3.3	3.0	2.5
Fiscal Balance NFPS (% GDP)	-7.5	-6.9	-6.7	-6.0	-5.5
Government Debt/GDP (%)	155	158	161	164	167
Consumer Prices (eop % change)	-0.3	0.2	0.1	0.3	0.2
Exchange Rate (% change)	11.3	4.8	-13.6	12.4	10.5
Exchange Rate (year-end)	107	102	118	105	95
Trade Balance (US$bn)	88	110	87	90	100
Exports (US$bn)	472	564	582	607	675
Imports (US$bn)	384	453	496	517	575
Current Account (US$bn)	137	172	159	173	185
% GDP	3.2	3.7	3.3	3.6	3.5
Foreign Reserves (US$bn)	674	845	847	975	1100
Months of Imports	21.1	22.4	20.5	22.6	23.0

Maintaining social stability and a rapid pace of economic expansion, cooling investment in overheated sectors, and implementing exchange rate regime reforms will be among the major challenges to China's economic planners over the forecast period. Possible challenges to the hegemony of the Communist Party of China, and bilateral relations with Taiwan, the United States and Japan will be key issues to monitor.

The country's economy will continue to be one of the world's fastest growing through 2007, with the pace of expansion averaging more than 9%. The recent revision of China's GDP figures, which added about 17% to the size of the economy, indicates that some of the perceived economic imbalances are not as severe as had been assumed. With GDP substantially higher than previously estimated, the current account/GDP ratio has been reduced; as a result, the analytical underpinnings of arguments supporting a substantial revaluation of the yuan have been weakened (though foreign pressures for such a move will not abate). Similarly, at the macroeconomic level, concerns about over-investment may be slightly relieved, though at the sectoral level it is clear that problems persist. Indeed, the administration has announced new measures aimed at curbing capital expenditures in mining and mineral processing in an effort to limit over-capacity and dampen the expansion of energy-intensive industries. Declining profits in several key manufacturing sectors – including transportation equipment, synthetic fibres and construction materials – and limited earnings gains in such sectors as steel and chemicals highlight the strains associated with excessive expansion.

The draft of the official 5-year economic development plan calls for more balanced and more evenly distributed growth. The object is to quell potential social unrest by increased transfers to the poorest segments of the population, and to diversify the sources of growth away from a reliance on exports and foreign investment in favour of consumer demand.

Exchange rate regime reform will proceed cautiously. We expect the yuan to appreciate by about 5% annually through 2007. The abandonment of the currency peg to the US dollar, the 2.1% revaluation versus the US dollar and a shift to a system based on a basket of currencies in July 2005 were important steps forward. The authorities remain determined to avoid any destabilizing initiatives, preferring to proceed at a measured pace, simultaneously easing restrictions on the capital account while opening the door to increased currency trading among approved dealers within the context of the ±0.3% daily trading range. Nevertheless, Beijing will continue to be subject to recurring criticism from some of its major trading partners regarding the slow pace of currency appreciation.

Substantial financial sector reform is also under way, including a more open policy towards foreign participation in the banking sector – more than US$10 billion was invested by foreign interests in 2005 – and a strong push toward strengthening bank balance sheets. The ratio of non-performing loans in the country's large banks has been steadily falling as a result of injections of cash from the government and improvement in credit allocation. Listing of state-owned banks on the Hong Kong stock exchange is now under way. The goal is to prepare the country's financial institutions for competition with foreign banks when the sector is opened in 2007, in keeping with Beijing's World Trade Organization commitments.

The profound differences between Beijing and Taipei regarding the nature of Taiwanese autonomy will remain a potentially dangerous issue; however, massive Taiwanese investment in mainland China may help to moderate tensions. In the near-term, China's relations with the US will be heavily influenced by the November 2006 mid-term elections. Calls by US legislators for greater protection against Chinese imports as a means of preserving US jobs will likely intensify, overlaid by US concerns regarding China's efforts at obtaining secure supplies of key industrial minerals. A territorial dispute and a jockeying for Asian leadership will be among the factors influencing China's relations with Japan.

The trade and current account surpluses will remain massive through 2007, notwithstanding high commodity prices and recurring trade tensions with the US and the European Union. In view of the ongoing additions to manufacturing capacity and the still-dominant role of foreign-owned plants, we expect China to continue to increase its share of global exports, though some easing in the rate of growth will be evident.

CHINA - KEY ECONOMIC INDICATORS					
GDP: US$2.5 trillion (2006f)	Population: 1.3 billion (2005e)				
Long-Term Foreign Currency Rating:	Moody's: A2			S&P: A-(+)	
	2003	2004	2005e	2006f	2007f
Real GDP (% change)	10.0	10.1	9.9	9.3	8.8
Industrial Production (% change)	18.1	11.5	16.5	15.0	15.0
Government Balance (% GDP)	-2.3	-1.4	-1.7	-1.5	-1.5
Consumer Prices (eop % change)	3.2	2.4	1.6	2.0	2.0
Exchange Rate (% change)	0.0	0.0	2.5	4.9	5.5
Exchange Rate (year-end)	8.28	8.28	8.08	7.70	7.30
Trade Balance (US$bn)	44	59	131	150	135
Exports (US$bn)	438	593	762	920	1080
Imports (US$bn)	394	534	631	770	945
Current Account (US$bn)	46	69	145	160	140
% GDP	2.6	3.6	6.6	6.3	4.7
Foreign direct investment (US$bn)	54	61	60	60	60
External Debt (US$bn)	209	249	285	300	325
% of GDP	12	13	13	12	11
% of Exports of G&S	42	37	33	28	26
S-T Debt / Reserves (%)	20	17	16	15	15
Foreign Reserves (US$bn)	403	610	819	1000	1200
Months of Imports	12.3	13.7	15.6	15.6	15.2

The pace of recovery in consumer spending, the impact of gradual global economic deceleration and won appreciation on Korea's trade performance, housing price trends and relations with North Korea will be key issues to monitor.

South Korea's economic growth will be in the 4½-5% range in 2006-07. Household spending and business investment will become the driving force of the expansion, while the contribution from trade will diminish. The domestic upturn that is now taking shape is being supported by low (albeit rising) interest rates, increases in household incomes and housing market strength. Business confidence is reviving, despite the burden of higher oil prices. Korean industry is energy intensive and the run-up in oil costs has had a dampening effect on profit margins.

A strengthening in household spending will become increasingly evident in 2006. The more vigorous, sustainable pace of economic growth will be based on that recovery. The gradual shift to a less accommodative monetary policy stance may temper, but will not reverse, this pickup. Consumer confidence is on the mend alongside an improved household assessment of living standards and spending plans. Employment is slowly, but steadily increasing; the attendant rise in household incomes is helping to spark an acceleration in consumer outlays. Expenditure growth may, however, be constrained by the public's desire to strengthen personal finances. Household debt is equivalent to more than 100% of disposable income, highlighting the need for further improvement in household balance sheets.

Monetary and fiscal policy will increasingly focus on preempting any resurgence of inflationary pressures. Although the authorities are concerned about overheating in the housing market, they prefer to address this problem primarily through administrative measures and higher property taxes. Core inflation has remained relatively stable and is currently below the central bank's medium term target range of 2½-3½%; even so, the central bank has been signaling the likelihood of further interest rate hikes. Since monetary tightening got under way in October 2005, the benchmark overnight call rate has been raised 75 bps from a record low of 3.25%. Won appreciation against the yen – it has gained more than 15% over the past year – and modest gains against the US dollar have helped to ensure that price pressures remain well contained. The government will likely move to a neutral fiscal stance following moderate income tax cuts and a solid increase in expenditures in 2005. A strong financial position – official debt is equivalent to approximately 25% of GDP – gives the administration scope to adopt fresh expansionary measures should growth falter.

President Roh Moo-hyun will likely see a steady erosion of influence in 2006-07, as prospective presidential candidates attempt to mobilize party support; he is now more than halfway through his single five-year term. Roh has not wielded a firm grasp on power, in part because his party, which failed to obtain a majority in the legislature, has faced a series of by-election losses. Maintaining stable peninsular relations will remain a high priority of the administration, as it is in South Korea's economic interest to prop up the current North Korean regime. This reality is straining relations with the United States, which is concerned about the risks of nuclear blackmail and proliferation following the resumption of North Korea's uranium enrichment program. Iran's recent decision to revive its enrichment program will further intensify more general global concerns regarding nuclear proliferation.

The current account surplus will likely narrow through 2007. Export earnings will continue to grow at a double-digit pace, though some deceleration will be evident. Won appreciation is beginning to erode the comfortable position of local manufacturers between their high-cost, high-productivity competitors in Japan and low-cost but (on average) lower value-added competitors in China. The 2% revaluation of the Chinese yuan in July 2005 and its subsequent small gains will provide very limited relief from a global competitiveness perspective, but should be helpful in ensuring further substantial increases in Korean shipments to China. Imports will also continue to rise at a double-digit pace, driven by high energy costs, purchases of raw materials to feed the nation's industries, and by the pickup in both consumer spending and business investment.

Korea's external balance sheet is strong. Key external debt ratios will continue to improve over the next two years. Gross liabilities are fully offset by foreign exchange reserves, which now exceed US$210 billion.

SOUTH KOREA - KEY ECONOMIC INDICATORS					
GDP: US$917 billion (2006f)	Population: 47.8 million (2005e)				
Long-Term Foreign Currency Rating:	Moody's: A3		S&P: A		
	2003	2004	2005e	2006f	2007f
Real GDP (% change)	3.1	4.5	4.0	5.0	4.5
Industrial Production (% change)	10.7	4.6	11.3	8.0	7.5
Fiscal Balance (% GDP)	0.5	-1.1	-1.5	-1.5	-1.0
Consumer Prices (eop % change)	3.4	3.0	2.6	2.5	2.4
Exchange Rate (% change)	-0.9	15.7	2.8	6.0	0.0
Exchange Rate (year-end)	1,197	1,035	1,007	950	950
Trade Balance (US$bn)	22	38	27	25	20
Exports (US$bn)	197	258	289	315	345
Imports (US$bn)	175	220	262	290	325
Current Account (US$bn)	12	28	17	15	10
% GDP	2.0	4.1	2.0	1.6	1.0
Foreign Direct Investment (US$bn)	4	8	5	3	3
External Debt (US$bn)	161	178	185	195	205
% of GDP	26	26	23	21	20
% of Exports of G&S	70	60	55	53	50
S-T Debt / Reserves (%)	35	30	31	32	32
Foreign Reserves (US$bn)	155	199	210	225	240
Months of Imports	10.6	10.9	9.6	9.3	8.9

India's near-term economic prospects are promising, combining solid growth with moderate inflation. Nevertheless, high levels of government indebtedness, a widening current account deficit and a reluctance to push vigorously ahead with structural reforms pose major risks to the longer-term outlook. The ballooning trade shortfall may set the stage for some quickening in the pace of rupee depreciation through 2006.

A solid cyclical expansion is under way. We expect that growth through 2007 will average about 7%. The anticipated deceleration is largely attributable to the risk that the agricultural sector, which accounts for about one-fifth of GDP, will not offer as substantial a contribution to growth as in 2005. The spillover effects of the rapid expansion in the labour-intensive software and business services sectors are providing key support to household incomes. Relatively low interest rates are also providing a solid base for gains in consumer spending and business investment. Recent export strength is providing an additional boost to industrial activity and capital expenditures, reinforcing robust domestic demand and broadening the basis for economic growth.

Weak public sector finances are a major impediment to the nation's longer-term development ambitions. The federal deficit continues to hover above 4% of GDP; when combined with other levels of government, the overall shortfall will be almost double that size. As a result, public sector debt, currently equivalent to more than 80% of GDP, may ratchet higher. A high household savings rate has helped to counterbalance weak fiscal results, but a pickup in private sector credit demand is beginning to put a strain on the national savings pool. While some improvement in fiscal stance has been evident, the failure to pursue a more aggressive deficit reduction program during a period of robust economic activity leaves the public sector's financial position highly vulnerable to any cyclical downturn. On the positive side, the federal government is making progress in creating a more competitive economy by lowering corporate taxes and reducing import tariffs. The introduction of a value added tax across a majority of the states in 2005 was a useful step forward in simplifying government revenue bases.

A cautious shift to a less accommodative monetary policy stance is under way. The Reserve Bank of India raised the benchmark reverse repo rate a further 25 bps to 5.5% in January 2006, the fourth such increase in less than a year and a half. While the pace of economic expansion remains strong, price pressures are relatively subdued; the wholesale inflation rate will likely hover in the 4-5% range, in line with the level that the Reserve Bank considers to be growth optimizing (about 5%). Even so, central bank officials continue to warn of the risk of an intensification of price pressures. In addition, they are concerned about the rapid pace of credit growth – bank lending is increasing at an annual rate of 30%. Such measures as stricter loan provisioning requirements and increased risk weightings, aimed at ensuring that commercial banks adopt more rigorous credit assessment procedures and avoid excessive exposure to the volatile property or capital markets have not yet proven effective in stemming the surge in lending activity.

India's current account deficit will likely escalate to US$30 billion by 2007. The gap, equivalent to about 3¼% of GDP, will be readily funded though foreign portfolio and direct investment and by increased offshore borrowing. The value of merchandise exports is also growing by close to 20% y/y; however, imports continue to expand even more quickly, in part as a reflection of the run-up in petroleum costs. Consumer spending and investment, and reductions in customs and excise taxes, are also stimulating import demand. As a result, the trade shortfall will continue to widen, but this trend will be at least partially offset by the rapid rise in earnings linked to the country's role as a major global supplier of services in technology-related industries. In addition, tourism receipts, which last year approached US$6 billion, are increasing at a 20% annual rate, though the outlook depends heavily on the avoidance of fresh bouts of sectarian violence.

The minority coalition government (made up of almost 20 parties), which took office in 2004, is proving resilient. While some progress has been evident, the likelihood of a major push for the resumption of market opening measures is dimmed by the lack of a clear electoral mandate and by the constraining influence of Communist parliamentarians, upon whom the government must rely for support. Efforts to normalize relations with Pakistan are continuing. Progress will likely be limited despite the fact that improvement could yield substantial economic dividends. Pakistan accounts for less than 0.5% of India's exports.

INDIA - KEY ECONOMIC INDICATORS

GDP: US$868 billion (2006f) — Population: 1.1 billion (2005e)

Long-Term Foreign Currency Rating: Moody's: Baa3 — S&P: BB+

	2003	2004	2005e	2006f	2007f
Real GDP (% change)	8.5	7.5	7.9	7.3	6.8
Industrial Production (% change)	7.4	8.9	5.0	8.5	8.0
Fiscal Balance NFPS (% GDP)	-9.8	-8.1	-7.8	-7.0	-7.0
Wholesale Prices (eop % change)	4.5	6.0	4.4	4.5	4.5
Exchange Rate (% change)	4.3	5.7	-3.5	-6.0	-4.0
Exchange Rate (year-end)	46.0	43.5	45.1	48.0	50.0
Trade Balance (US$bn)	-8	-26	-42	-56	-65
Exports (US$bn)	65	81	95	110	125
Imports (US$bn)	72	107	137	166	190
Current Account (US$bn)	6.7	1.1	-16.0	-25.0	-30.0
% GDP	1.1	0.2	-2.0	-2.9	-3.2
Foreign Direct Investment (US$ bn)	4	5	5	5	6
External Debt (US$bn)	127	138	142	155	170
% of GDP	21	20	18	18	18
% of Exports of G&S	136	101	81	74	71
S-T Debt / Reserves (%)	10	11	11	11	12
Foreign Reserves (US$bn)	99	127	137	140	143
Months of Imports	16.4	14.2	12.0	10.1	9.0

Australia

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Australia's economic and financial outlook depends heavily on the pace and pattern of correction to the large current account deficit. Although the requisite adjustment is proving slow to take hold, we continue to expect that the process will be smooth. However, the gap will remain substantial, as imports will be supported by a pickup in business investment. Global growth will remain sufficiently robust to avoid any marked decline in commodity prices or a contraction in demand for Australian manufactured goods.

The economy is beginning to shift toward a more stable, better balanced expansion. The momentum will likely be sustained through 2007 with growth expected to move back above the 3% threshold. The impetus for activity is now shifting to investment. Consumer spending has moderated to a more sustainable rate of growth alongside an easing in housing price pressures. A modest upward nudge in interest rates in March 2005 appears to have been effective in taking some of the speculative fever out of the housing market. However, consumption will continue to provide a vital basis for the expansion. Favourable household earnings prospects (the unemployment rate continues to hover near a 3-decade low of 5%), tax relief and wealth gains, linked to higher equity prices, will likely help to ensure that consumer spending continues to grow by about 2-3% y/y through 2007. Business sentiment remains positive and profits are on the rebound; as a result, business investment jumped almost 10% q/q in the final quarter of 2005 and a further substantial rise in capital expenditures is likely in 2006.

The balance of payments, which has been the weak link in Australia's economic outlook, is beginning to stabilize. Even so, the current account deficit is expected to hover around US$40 billion this year and next, although as a share of GDP, the shortfall likely peaked in 2004 at 6.6%. Roughly half the gap is now attributable to net investment income outflows, pointing to the need for substantial improvement on the trade account in order to slow the rapid build-up in offshore liabilities. While some slight narrowing in the trade shortfall has been evident recently, the pickup in Australian demand for capital goods coupled with further growth in consumer spending will tend to limit the speed with which the trade imbalance can be corrected. The strength of commodity prices in general is providing a partial offset to these negative factors. In the near term, wide interest rate differentials will continue to whet demand among yield-hungry investors in high-grade debt, who will provide the requisite capital to fund the current account shortfalls, though at the cost of an ongoing build-up in foreign liabilities. Recurring deficits pushed net foreign debt up to roughly A$475 billion by end-2005, equivalent to more than 50% of GDP and roughly 275% of export receipts (goods and services).

The Reserve Bank of Australia is becoming somewhat less concerned about domestic inflationary pressures alongside some deceleration in household credit growth and a cooling in the housing market. As a result, the benchmark official cash rate will likely hold steady at 5.5% at least into the second half of 2006. Even so, the monetary authorities still maintain that the risks to the outlook are on the upside, and they will be keeping a particularly watchful eye on labour costs. Despite a recent, slight moderation in earnings growth, the official wages index is still increasing at an annual rate of more than 4.0%. This approaches the central bank's tolerance level of about 4½%. While consumer demand has moderated, some further currency depreciation – the Australian dollar has declined by 7½% against the US dollar over the past two years – may set the stage for a pickup in import costs, with adverse spillover effects on domestic prices. We expect Australian dollar weakness to extend through 2007, reaching US$0.70 by the end of the forecast period.

Australian government finances are sound. Steady gains in domestic economic activity, high energy prices and strong corporate tax receipts will help to ensure that the public accounts remain in surplus though the forecast period. Gross Australian public debt is equivalent to less than 20% of GDP, while net debt is approaching zero. The steady improvement in the national government's balance sheet strengthens the administration's capacity to absorb any unanticipated economic blows without doing serious damage to its debt servicing capacity. With the economy on an even keel and the governing Liberal-National coalition enjoying a comfortable majority, substantial changes in macroeconomic policies over the next two years are unlikely. John Howard is now serving his fourth term as prime minister and, while still popular, may find himself under increasing pressure to name a successor.

AUSTRALIA - KEY ECONOMIC INDICATORS

GDP: US$679 billion (2006f)	Population: 20.2 million (2005e)				
Long-Term Foreign Currency Rating:	Moody's: Aaa		S&P: AAA		
	2003	2004	2005e	2006f	2007f
Real GDP (% change)	3.1	3.5	2.5	2.9	3.2
Industrial Production (% change)	0.4	-0.6	2.0	3.0	3.5
Fiscal Balance (% GDP)	0.8	1.1	1.0	1.0	1.0
Consumer Prices (eop % change)	2.4	2.6	2.8	2.5	2.6
Exchange Rate (% change)	33.9	5.3	-6.3	-2.7	-2.8
Exchange Rate (year-end)	0.75	0.79	0.74	0.72	0.70
Trade Balance (US$bn)	-15.4	-18.1	-20.6	-18.0	-16.0
Exports (US$bn)	71	87	101	112	122
Imports (US$bn)	86	105	122	130	138
Current Account (US$bn)	-29.6	-40.2	-42.1	-40.5	-39.0
% GDP	-5.8	-6.6	-6.3	-6.0	-5.6
Foreign direct investment (US$bn)	9.8	42.5	-35.0	10.0	10.0
Net External Debt (US$bn)	270	315	350	370	390
% of GDP	53	51	53	55	56
% of Exports G&S	295	280	273	261	252
Foreign Reserves (US$bn)	31.0	35.8	42.3	43.5	45.0
Months of Imports	4.3	4.1	4.2	4.0	3.9

Taiwan

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Solid, low-inflation economic growth will be accompanied by lingering political uncertainties regarding Taiwan's relations with the People's Republic of China (PRC). In addition, recurring policy clashes between the independence-minded administration and the pro-status quo legislature will slow the pace of structural reform.

The Taiwanese economy is poised to grow by about 4½% in 2006-07 following a 4.1% rise in output in 2005. Orders from overseas are at record highs, suggesting that the recovery in export momentum that was evident in the second half of 2005 can be sustained. The pickup in foreign sales is sparking a strong revival in manufacturing activity. This should in turn lead to a quickening in business investment, more than offsetting any negative impulse from the gradual rise in domestic interest rates. Improving labour market conditions – the jobless rate has fallen back to a 4-year low of 4% – and rising credit demand will help to sustain consumer spending.

Relations with the PRC will continue to have a profound impact on Taiwan's economic outlook. The recent decision of President Chen Shui-bian to bring the operations of the National Unification Council to a close had little practical importance – the Council was virtually dormant; nevertheless, the action is widely interpreted as another move to widening the political gap between Taipei and Beijing. The Taiwanese administration's efforts to manage links with the mainland have been complicated by the direct ties that have been established between the PRC government and the opposition Kuomintang, which supports the status quo. Further compounding President Chen's problems is the fact that his party does not control the legislature; virtual policy gridlock has ensued. Highlighting the unsettled domestic political situation is the appointment of a new cabinet in early-2006 and the departure of Premier Frank Hsieh after serving for less than a year; Hsieh was succeeded by Su Tseng-chang, the fifth prime minister to serve under President Chen since he took office in 2000. Su had resigned as head of the president's Democratic Progressive Party in the immediate aftermath of the losses incurred in the December 2005 local elections.

Commercial relations between Taipei and Beijing will likely continue to deepen despite the political tensions, permitting more direct access to the PRC for Taiwan-based exporters. Nevertheless, some slowing in the pace of investment may be evident alongside rising official concerns in Taipei regarding Taiwan's ever-increasing economic dependence on the PRC. Taiwanese investment on the mainland is thought to total a cumulative US$100 billion, led by the steady migration of more labour-intensive manufacturing firms. The PRC (including Hong Kong) is now Taiwan's largest export market, accounting for more than one-third of foreign sales. The surge in exports to China has been driven in part by the sale of production equipment and of component parts to subsidiaries.

The central bank of Taiwan's policy of cautious tightening remains intact. The monetary authorities nudged their benchmark interest rate up 12.5 bps for the sixth consecutive quarter in December, raising the 10-day discount rate to 2.25%. While core consumer inflation remains virtually dormant, with an annual rate of less than 1%, and the headline inflation rate has fallen back to 2% y/y, the central bank has seen no clear justification for abandoning its bias towards a less accommodative monetary policy stance. Domestic spending is recovering – even with higher interest rates – and the external sector remains sound. Moreover, the New Taiwan dollar was in gradual depreciation mode through much of the second half of 2005, raising concerns that a failure to nudge interest rates higher might eventually trigger a more substantial currency weakening, with attendant adverse implications for inflation.

Tensions between the Chen administration and the legislature may impede further budget deficit reduction. With a public debt to GDP ratio of less than 50%, the shortfalls are readily manageable. However, a failure to curb expenditure growth might force the authorities to push taxes higher, thereby adding to the pressure on firms to shift production facilities to the mainland.

Taiwan's current account surplus will likely stabilize near US$10 billion through 2007. Import growth is projected to exceed that of exports this year, alongside a quickening in domestic spending, with a modest reversal in 2007. Commodity prices in general are likely to remain high; in particular, average oil prices in 2006 are expected to hover around US$60/barrel. Export orders have been increasing at an annual rate of 20%. Renewed strength in global electronics markets coupled with the rapid expansion of the PRC economy should set the stage for solid gains in foreign sales.

TAIWAN - KEY ECONOMIC INDICATORS

GDP: US$361 billion (2006f) — Population: 23 million (2005e)

Long-Term Foreign Currency Rating: Moody's: Aa3 S&P: AA-(-)

	2003	2004	2005e	2006f	2007f
Real GDP (% change)	3.2	6.1	4.1	4.5	4.5
Industrial Production (% change)	17.1	-0.7	9.5	7.5	7.0
Fiscal Balance (% GDP)	-2.8	-2.5	-2.5	-2.5	-2.5
Consumer Prices (eop % change)	-0.1	1.6	2.2	2.0	1.5
Exchange Rate (% change)	1.8	7.3	-3.4	5.8	3.3
Exchange Rate (year-end)	34.0	31.7	32.8	31.0	30.0
Trade Balance (US$bn)	16	6	8	2	4
Exports (US$bn)	143	174	189	207	222
Imports (US$bn)	127	168	182	205	218
Current Account (US$bn)	29	19	16	10	12
% GDP	10.2	6.2	4.8	2.8	3.0
Foreign Reserves (US$bn)	207	242	253	260	265
Months of Imports	20	17	17	15	15

Indonesia

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Indonesia's government will maintain its focus on improving the investment climate, reforming the banking sector and keeping on course towards more prudent fiscal and monetary policies. Of immediate concern will be managing the impact of a volatile currency and possible political disaffection following the curtailing of fuel subsidies in September 2005.

Economic growth will average 5¼% in 2006-07. The slight slowing this year will be the result of higher energy prices and the lagged impact of monetary policy tightening in 2005. The government will focus on reviving the country's economy using a variety of strategies. In particular, it is attempting to create a better business environment for both local and foreign interests by attacking corruption and streamlining regulation. Although scepticism greeted the plans to fight corruption, the government has shown its willingness to remove a number of high-ranking officials in its ongoing campaign. The banking sector, which has seen improvements in recent years, will continue to be the focus for the clean-up campaign. The challenge remains to increase economic growth to a pace such that job creation will absorb new entrants in the labour force - the Asian Development Bank estimates that growth of around 6.5% is necessary.

The fiscal deficit will remain modest through 2007 as fuel subsidies continue to be reduced. The goal is to have market-driven energy pricing by end-2007. In 2005, fuel prices were raised twice: by an average 30% in early March and by over 100% in September. In order to lessen the impact of these higher costs on poorer families, the government has committed to distributing grants where needed. Despite the additional costs of this income support measure, the government will still succeed in making further structural progress towards limiting the fiscal gap.

The rupiah will remain volatile, though biased towards gradual weakening, and will be highly sensitive to the domestic political environment. After touching a 4-year low against the US dollar in August 2005, the exchange rate subsequently staged a strong rally alongside rising domestic interest rates, higher oil prices and direct intervention by the central bank. With non-oil exports flagging, the authorities may be more willing to countenance renewed rupiah depreciation in 2006 as domestic inflationary pressures abate. In the longer term, a credible record of economic reform is an essential prerequisite for renewed confidence in rupiah-denominated assets.

Inflation will remain a concern over the next couple of years, although improvement will be evident. The impact of higher fuel prices pushed the rate of increase in the consumer price index close to 20% in the latter part of 2005 before abating somewhat to 17.1% at year-end. The aftershocks from higher wages and transportation costs will not prevent an encouraging reduction in consumer inflation in 2006.

Indonesian interest rates may be near their cyclical peak. Bank Indonesia's benchmark rate is currently 12.75%, the highest among major Asian economies, and we expect that the central bank will soon begin to relax its policy stance. While the monetary authorities recognize that it is still too early to declare victory over inflation, signs that pressures are beginning to abate have already elicited hints from the central bank that monetary policy easing might occur as early as the second quarter of 2006.

Rating agencies differ on Indonesian prospects. Moody's recently placed Indonesia's ratings on review for a possible upgrade. This followed S&P's decision to raise the outlook on its "B+" long-term foreign currency rating to "positive" from "stable". In contrast, Fitch Ratings recently lowered its outlook on Indonesia's "BB-" long-term foreign currency rating to "stable" from "positive", citing the need to address risks to the external balance sheet in a speedy and effective manner.

The president will continue to tread carefully as he navigates the country through a series of subsidy reductions. Mass protests over fuel price increases were not destabilising to the government, as had been the case for previous regimes. Other issues remain contentious, such as the country's vulnerability to terrorist attacks. These have targeted foreign interests, intending to dissuade tourists and international investors from choosing Indonesia. The latest, in October 2005, were again attacks on the tourist destination of Bali. This is a setback in a country where leaders have been working to improve the political climate. Among positive steps taken – in part as a consequence of the post-tsunami spirit of reconciliation – is movement towards resolving the decades old conflict in Aceh province, where thousands have died as the result of civil strife. Government and rebel leaders agreed to a peace accord in August, 2005.

INDONESIA - KEY ECONOMIC INDICATORS					
GDP: US$277 billion (2006f)	Population: 223 million (2005e)				
Long-Term Foreign Currency Rating:	Moody's: B2(+)		S&P: B+(+)		
	2003	2004	2005e	2006f	2007f
Real GDP (% change)	4.1	5.1	5.6	5.0	5.5
Fiscal Balance NFPS (% GDP)	-2.1	-1.5	-0.5	-1.0	-1.0
Consumer Prices (eop % change)	5.9	6.1	17.1	10.0	7.0
Exchange Rate (% change)	6.3	-9.5	-5.4	-4.6	-6.4
Exchange Rate (year-end)	8,420	9,300	9,830	10,300	11,000
Trade Balance (US$bn)	24	22	26	26	24
Exports (US$bn)	63	72	84	90	95
Imports (US$bn)	39	51	58	64	71
Current Account (US$bn)	7.4	1.5	5.0	4.5	3.0
% GDP	3.6	0.7	2.1	1.6	1.0
Foreign Direct Investment	-0.6	1.0	1.5	2.0	2.0
External Debt (US$bn)	135	132	127	126	125
% of GDP	65	59	54	46	41
% of Exports of G&S	195	145	121	113	105
S-T Debt / Reserves (%)	44	49	54	58	63
Foreign Reserves (US$bn)	35.0	34.9	34.7	36.0	38.0
Months of Imports	10.8	8.3	7.2	6.8	6.4

Solid, sustainable, low-inflation, domestically-led growth will characterize the Thai economy over the next two years. The risks to the forecast rest largely on non-economic factors, most notably the impact of social unrest in southern Thailand and the possibility of a resurgence of avian flu.

We expect the economy to expand by about 5% in 2006-07. A post-tsunami slump in the labour intensive tourism sector and an accompanying slowdown in domestic spending brought 2005 growth down from the previous year. We anticipate that this pattern will be reversed over the forecast period, although the impact will be partially offset by related strength in imports alongside a gradual slowing in export growth.

The government will be focusing on large-scale infrastructure projects as both an economic stimulus and for political insurance. It is pursuing a massive 5-year infrastructure upgrade program that is projected to cost more than US$40 billion. Undertakings include extensions to Bangkok's transit system, railway improvements, oil and gas pipeline upgrades, and increasing the country's electricity generating capacity.

Fiscal deficits will return after a brief period of relief. Although the government has ended fuel subsidies, it has committed to other costly undertakings, such as a debt relief program for poorer families, that will entail higher spending. As further stimulus, tax cuts are being implemented for low-income earners and small businesses. We foresee a modest shortfall of ½% of GDP in 2006, rising to 1% the following year on infrastructure spending. Government debt remains relatively high (about 50% of GDP) and there are lingering uncertainties regarding the underlying strength of bank balance sheets. There is much debate about the affordability of the administration's infrastructure plan, which will be partially funded by private sector monies, but still places an enormous financial burden on the government.

The current account will likely remain in moderate deficit through 2007. This follows a series of seven consecutive years of surplus beginning in 1998. An erosion of Thailand's share of the global textile trade following the expiration of the international quota system at the beginning of 2005 will contribute to slightly slower growth in exports receipts as will some loss of market share as an electronics exporter. Continuing strength in investment and solid gains in consumer spending will buoy imports, also preventing any recovery in the trade account. While tourism earnings will pick up, assuming no heightened concerns regarding health or security issues, this will be offset by increased income and services outflows.

Inflation will decline over the forecast period in line with a more subdued rise in domestic energy prices. However, the imposition of a variety of price controls is distorting the markets and has led to highly-publicized shortages of sugar. While we believe that this policy will not last, the phasing out of price curbs could have a temporary adverse effect on consumer inflation. The central bank has been steadily raising interest rates since August 2004. The benchmark 14-day repo rate was increased to a 5-year high of 4.25% following the January 2006 policy meeting. This still implies a negative real interest rate. We expect the bank to continue lifting rates in small increments. The stated goal is to exceed inflation and move into positive real interest rates by mid-2006, a development that should help to ensure that national savings and credit demand are roughly in balance.

Political uncertainties in Thailand are on the rise. Intensifying demonstrations against Prime Minister Thaksin Shinawatra prompted him to call a snap election to be held on April 2, barely a year after his coalition government was returned to office with a massive majority. The recent tax-free sale of the country's largest telecommunications firm (previously owned by Thaksin before he transferred his interests to other family members) for US$ 1.9 billion, was the catalyst for the protests. The prime minister's autocratic and seemingly self-serving style of governing has also created strains within his own administration; nevertheless, outside of Bangkok he appears to retain significant support – with the important exception of the predominantly Muslim south where recurring violence remains a challenge for the government. Last year, emergency measures granting broad powers to detain and interrogate suspects were reintroduced in that region in an effort to control the violence; however, this has tended to aggravate discontent. The conflict has been simmering for over a decade, but the death toll has increased sharply (to over 1000) since a renewal of hostilities in 2004.

THAILAND - KEY ECONOMIC INDICATORS					
GDP: US$196 billion (2006f)	Population: 64.2 million (2005e)				
Long-Term Foreign Currency Rating:	Moody's: Baa1		S&P: BBB+		
	2003	2004	2005e	2006f	2007f
Real GDP (% change)	6.9	6.1	4.5	5.0	5.0
Industrial Production (% change)	21.5	6.7	6.1	6.5	7.0
Government Balance (% GDP)	1.8	0.7	0.0	-0.5	-1.0
Consumer Prices (eop % change)	1.8	2.9	5.8	4.0	3.0
Exchange Rate (% change)	8.6	2.1	-5.1	2.5	-2.4
Exchange Rate (year-end)	39.7	38.9	41.0	40.0	41.0
Trade Balance (US$bn)	11.2	10.6	3.0	3.0	1.0
Exports (US$bn)	78	95	109	125	135
Imports (US$bn)	67	84	106	122	134
Current Account (US$bn)	7.9	6.6	-3.7	-2.5	-4.0
% GDP	5.5	4.0	-2.1	-1.3	-1.9
Foreign Direct Investment (US$bn)	1.9	1.4	2.5	2.0	2.0
External Debt (US$bn)	53	51	52	54	57
% of GDP	37	31	29	28	27
% of Exports of G&S	55	44	40	37	36
Public Sector (% of total)	32	28	22	20	19
S-T Debt / Reserves (%)	27	26	26	27	29
Foreign Reserves (US$bn)	41.0	48.7	52.1	55.0	55.0
Months of Imports	7.4	6.9	5.9	5.4	4.9

Hong Kong

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The flexible, well-developed financial markets and potential for further growth in the services sector remain Hong Kong's greatest strengths. Economic prospects depend heavily on two factors: broadening the government's revenue base, and the ability to continue to capitalise on China's expansion through the ongoing development of the tourist sector along with a wide range of financial and trade-related services. The revaluation of the yuan is expected to have little net impact on Hong Kong's economy in the medium term, and the local currency's fixed rate regime will likely remain intact at least through 2007. However, higher domestic interest rates (the Hong Kong Monetary Authority follows the lead of the US Federal Reserve) will likely weigh somewhat on growth over the next two years. The risk of an outbreak of avian influenza remains a threat over the medium term. The government has reacted effectively to previous health crises, but is aware that Hong Kong's function as a hub for people and goods makes it particularly vulnerable.

The authorities are looking for ways to harness the economic power of the mainland. China is both a land of opportunity for Hong Kong businesses and workers, and a powerful competitive force that threatens even industries in which Hong Kong has traditionally excelled. In the tourism sector, for example, mainlanders are visiting Hong Kong in record numbers, but Chinese attractions are increasingly in competition with Hong Kong sites. The growth in tourism has been driving retail activity. The number of visitors from mainland China is soaring, as Beijing now permits more individual (rather than only group) visits, and has increased spending limits. A major theme park, which opened at the end of 2005, is also expected to boost numbers. To strengthen cross-border sectoral development, a government working group is looking at possible cooperation with the mainland in four areas: automotive parts and accessory systems, radio frequency identification technologies, Chinese medicine, and integrated circuit design.

Consumer inflation is expected to average 1½% over the forecast period. (This follows a protracted period of deflation from 1997 to mid-2004.) The cost of imports will be key in determining Hong Kong's inflation rate, though the pace of revival in the property market will also be a factor.

The robust rebound in economic activity has enabled the authorities to achieve budget surpluses well in advance of their 2008 target. To sustain the recovery, Finance Secretary Henry Tang has announced reductions in personal income tax rates and has extended mortgage interest deductibility by three years to ten years. The next major fiscal policy challenge is to widen the revenue base. The excessive dependence on earnings derived from property sales creates major problems during any economic downturn. In order to wean itself of this reliance – property sales represent about 15% of total government receipts – the administration is slowly moving towards introducing a sales tax. The government has announced that public consultations will begin in mid-year and should conclude in early-2007.

Hong Kong will continue to register sizable current account surpluses despite a trade deficit. Large surpluses in services and investment income will be maintained. Growth in merchandise exports (which consist mostly of re-exports) will dip below 10% as higher interest rates and oil prices weigh on global demand, other Chinese ports expand their capacity, and Hong Kong manufacturers continue to shift production facilities to the mainland.

The Hong Kong Monetary Authority is unlikely to drop the local currency's peg to the US dollar despite changes in China's currency regime. Authorities reaffirmed their commitment to the current arrangement when announcing a series of modifications in May 2005. They added a ceiling to limit appreciation of the currency, in part to offset flows of speculative funds that are using the Hong Kong dollar as a proxy for the yuan. Officials view the fixed exchange rate, which has been in place since 1983, as an important stabilizing force for the local economy.

Chief Executive Donald Tsang has proven an agile administrator. He has managed not to antagonise the central government in Beijing while making overtures towards pro-democracy advocates – a delicate balancing act; as yet his reform proposals have proven insufficient to meet local democrats' demands. He will likely continue to focus on devising a reform package that establishes a more open electoral process, though universal suffrage has been ruled out until after 2012. Mr. Tsang is completing the term of his predecessor, who resigned (under pressure from Beijing) in March 2005. The term expires in 2007; assuming Tsang makes no egregious policy errors, he will likely be reappointed for another five years.

HONG KONG - KEY ECONOMIC INDICATORS

GDP: US$188 billion (2006f) — Population: 6.8 million (2005e)

Long-Term Foreign Currency Rating: Moody's: A1 — S&P: AA-

	2003	2004	2005e	2006f	2007f
Real GDP (% change)	3.2	8.2	7.3	5.0	4.0
Industrial Production (% change)	-6.1	5.0	4.0	3.0	2.5
Fiscal Balance NFPS (% GDP)	-3.8	1.7	0.3	0.4	0.7
Consumer Prices (eop % change)	-1.9	0.2	1.8	1.5	1.5
Exchange Rate (% change)	0.0	0.0	0.0	0.0	0.0
Exchange Rate (year-end)	7.80	7.80	7.80	7.80	7.80
Trade Balance (US$bn)	-5.7	-9.3	-8.5	-10.0	-10.0
Total Exports (US$bn)	225	260	292	310	335
Total Imports (US$bn)	230	270	300	320	345
Current Account (US$bn)	17	16	23	22	23
% GDP	10.7	10.1	13.0	11.7	11.6
Foreign Reserves (US$bn)	118	124	124	130	135
Months of Imports	6.2	5.5	5.0	4.9	4.7

Adjusting to the much anticipated end to the currency peg and its consequences for the economy will remain a major focus for this investment grade-rated country in the near term. The government will also aim to strengthen its own finances while continuing its effort to diversify away from electronic and oil exports as the prime engine for growth in favour of building stronger domestic markets.

We expect the economy to expand by more than 5% in 2006-2007. Revived interest in the country's assets, a strong external sector and targeted government investment are helping to sustain the economy. International and local investor confidence has been strengthened by the leadership of Prime Minister Abdullah Ahmed Badawi, who has pledged to fight corruption by, among other things, more vigorous oversight and by increased transparency in the government contract bidding process.

The prime minister will continue to strengthen Malaysia's economic foundations by promoting sectoral diversification and reducing the fiscal gap. Foreign investment has recovered to pre-Asian crisis levels: it now represents 4% to 5% of GDP by government estimates. However, flows may be impeded if the authorities prove reluctant to adopt a more open attitude towards foreign investment in state-owned enterprises.

On the fiscal front, progress in narrowing the deficit will remain steady, but slow. Improved tax collection, lower fuel subsidies and especially the addition of a goods and services tax in 2007, will contribute to deficit reduction efforts. In the past, rating agencies have criticised the country's propensity to run deficits in order to finance large scale developments, but have also recognised recent efforts to rein in spending while expanding the revenue base. Prime Minister Abdullah is committed to a broadly-based national development program, but under his leadership, government expenditures have tended to focus on smaller projects (such as rural roads, bridges, schools and hospitals) rather than the large showpieces favoured by his predecessor.

Malaysia will continue to register large trade and current account surpluses through 2007. A revival in global demand for the country's main export, electronics (semiconductors, hard disks and other electronic parts represent about half of export earnings) will persist, although some moderation is expected with a slower pace of expansion in major markets such as the US. This will be partly offset by continued strong demand for other important exports: oil, natural gas, timber and rubber. (The country remains vulnerable to higher world oil prices, however, as it must import refined products.)

Malaysia's external balance sheet will continue to strengthen through the forecast period. Foreign exchange reserves comfortably exceed Malaysia's total external debt. Most key debt ratios will likely decline through 2007 (interest payments on the overall external debt are estimated to be equivalent to less than 1½% of foreign exchange earnings).

Inflation will remain well-contained. It has been on the rise as the result of higher fuel prices (though subsidies remain large) and selective increases in indirect taxes. It will also be boosted in 2007 when a new more comprehensive goods and services tax is introduced to replace the existing sales tax. With economic growth well-supported, the monetary authorities are moving to a less accommodative policy stance. Over the past three months, they have pushed the benchmark overnight policy rate up 55 basis points to 3.25% after holding it at 2.7% since April 2004. Further cautious interest rate increases are likely through the forecast period.

We expect a mild appreciation of the ringgit vis-à-vis the US dollar over the forecast period, alongside recurring bouts of direct central bank intervention. Following the change in the exchange rate regime (the seven-year-old peg of the ringgit to the US dollar came to an end on July 21st, 2005), the currency has registered only modest gains; it is now being traded in a managed float system against a currency basket. China's move to end its own peg to the US dollar served as the catalyst for terminating a policy originally instituted to ensure stability after the Asian financial crisis.

Prime Minister Abdullah maintains a strong hold on power. Although there are divisions within his party as well as in the ruling coalition, there are no potential political turning points on the horizon (such as an election or party congress) that might trigger large-scale change. The country's external relations will need some of the prime minister's attention, though, as the expulsion in 2005 of illegal workers and some territorial disputes have strained regional ties.

MALAYSIA - KEY ECONOMIC INDICATORS

GDP: US$142 billion (2006f)	Population: 25.3 million (2005e)				
Long-Term Foreign Currency Rating:	Moody's:	A3		S&P:	A-
	2003	2004	2005e	2006f	2007f
Real GDP (% change)	5.3	7.1	5.3	5.5	5.2
Industrial Production (% change)	14.7	6.4	4.2	7.5	7.0
Government Balance (% GDP)	-6.9	-4.3	-3.5	-3.0	-2.8
Consumer Prices (eop % change)	1.2	2.1	3.5	2.5	2.8
Exchange Rate (% change)	0.0	0.0	0.5	3.6	4.3
Exchange Rate (year-end)	3.80	3.80	3.78	3.65	3.50
Trade Balance (US$bn)	26	28	34	33	35
Exports (US$bn)	105	127	142	155	170
Imports (US$bn)	79	99	108	122	135
Current Account (US$bn)	13.4	14.9	16.0	15.0	15.0
% GDP	12.9	12.7	12.5	10.5	9.5
Foreign Direct Investment (US$bn)	2.5	3.0	5.0	4.0	4.0
External Debt (US$bn)	55	66	62	60	58
% of GDP	53	56	48	42	37
% of Exports of G&S	47	46	39	34	30
S-T Debt / Reserves (%)	26	27	18	15	14
Foreign Reserves (US$bn)	44.5	66.4	70.5	85.0	97.0
Months of Imports	6.8	8.0	7.8	8.4	8.6

Singapore

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Prudent economic management, large current account and trade surpluses, solid growth and supportive fiscal policies will continue to underpin Singapore's status as the top-rated economy in Asia. Over the medium term, Singapore's leadership will be focused on developing policies aimed at ensuring more balanced growth: a heavy reliance on exports leaves the country vulnerable to changes in global demand.

The Singapore economy is on a firm growth path. The nation's successful effort at economic diversification should help to ensure growth of about 5¼% in 2006-07 following an overall expansion of almost 6½% in 2005. GDP rose 8.7% y/y in the fourth quarter of 2005, according to preliminary official data. The expansion was led by a double-digit rise in manufacturing activity, reinforced by a 7% increase in services. The construction sector remains the laggard, with output up just 1% y/y. While some of the recent momentum may be lost through 2006, we believe that renewed strength in the global electronics industry, coupled with further rapid expansion in other manufacturing sub-sectors will prove supportive. In addition, increased household incomes alongside rising employment should give a boost to domestic spending, providing further assurance that the economy will meet or exceed the official growth target of 5%.

Singapore is in the midst of a transformation from manufacturing centre to services hub. The process involves attracting foreign businesses wishing to take advantage of Singapore's financial acumen and location, as well as efforts to develop the country into a centre of excellence for sectors such as biotechnology. The 2006 budget is giving a high priority to research and development activity as well as offering some (pre-election) taxpayer rebates. At present, export-oriented manufacturing still remains a major driver of the economy, accounting for about a quarter of GDP. A gradual decline in the jobless rate will be evident over the next two years as the role of more labour-intensive services industries continues to strengthen.

Singapore is hoping to attract substantial investment from China and India (even as these countries act as competitors in a variety of fields). In an effort to elicit further foreign direct investment, the city-state has cast itself as a prime location for multinational companies to establish regional headquarters, or for regional corporations to launch global expansion efforts.

Tourism will increase in importance in the years ahead. Though this sector represents only 3% of GDP, the government has ambitious longer-term expansion goals, aiming to double visitor numbers within a decade. Public money will be invested in upgrading existing attractions and developing new ones. Visitors from China and India are heading to Singapore in record numbers. This is expected to continue alongside the rapid emergence in both countries of households with significant surplus income. Ironically, as Singapore's prime minister has noted, although China is the source for much of the expansion in the tourism sector, Chinese tourist destinations also have the potential to attract visitors away from the island.

Inflation will remain well contained, with consumer prices rising at an average rate of 1% through the forecast period. As a very open economy – gross imports are equivalent to more than 160% of GDP – Singapore is highly vulnerable to imported inflation. Consequently, the Monetary Authority of Singapore is committed to its policy of maintaining a strong exchange rate (versus a basket of currencies), an approach that was adopted in April 2004 and reaffirmed at a policy review in October 2005. The primary sources of inflation (including the price of oil, service charges and increased wages) are showing no signs of relenting and thus authorities see no reason to deviate from their currency-supportive stance. They are liable to intervene only in order to smooth volatility.

Singapore will register large current account surpluses through 2007, though some easing in global demand and still strong domestic spending will result in a narrowing of the imbalance. Massive foreign exchange reserves – totalling US$120 billion – and a long string of current account surpluses place Singapore in one of the strongest financial positions in the world. As such, its role as a regional financial centre will likely continue to grow.

The People's Action Party continues to dominate the political landscape and the continuity of the governing party is all but assured. An election must be held by early-2007, but Prime Minister Lee Hsien Loong is expected to go to the polls relatively soon. Little change in the overall standings is likely. Social stability remains a key government priority, even at the expense of curtailing some freedom of expression. This approach seems generally accepted by the population, although the rigidity of the system is such that the breadth and depth of dissent are difficult to assess.

SINGAPORE - KEY ECONOMIC INDICATORS

GDP: US$127 billion (2006f)	Population: 4.3 million (2005e)				
Long-Term Foreign Currency Rating:	Moody's: Aaa		S&P: AAA		
	2003	2004	2005e	2006f	2007f
Real GDP (% change)	2.2	8.8	6.4	5.5	5.0
Industrial Production (% change)	0.7	32.3	5.1	7.5	6.0
Fiscal Balance NFPS (% GDP)	-1.6	-1.0	0.5	-0.5	0.5
Consumer Prices (eop % change)	0.7	1.3	1.3	1.0	1.1
Exchange Rate (% change)	2.4	4.3	-1.8	3.7	1.9
Exchange Rate (year-end)	1.70	1.63	1.66	1.60	1.57
Trade Balance (US$bn)	28	31	30	30	25
Exports (US$bn)	158	197	220	230	240
Imports (US$bn)	130	166	190	200	215
Current Account (US$bn)	27.0	27.9	28.0	26.0	21.0
% GDP	29	26	24	20	15
Foreign Reserves (US$bn)	96	113	117	125	130
Months of Imports	8.9	8.2	7.4	7.5	7.3

The Philippines

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Fiscal reforms, debt containment and reducing unemployment will be key priorities for the Philippines' government over the forecast period. Ongoing political unrest continues to weigh on the currency while remaining a major constraint on the country's sovereign credit rating.

The economy is set to grow by about 5% in 2006-07. This is in line with the pace of expansion in 2005, when solid gains in both industrial production and services were partially offset by a lacklustre performance in agricultural output. The government maintains ambitions to push growth higher, in the hope of making some inroads on joblessness. Officially, the unemployment rate hovers around 10%, one of the highest in Asia. In reality, the rate may be as high as 20%. President Gloria Macapagal Arroyo, who was returned to office with a slim majority in May 2004, promised the creation of one million jobs a year, essentially the minimum necessary to absorb new entrants in the workforce. To achieve this goal will require economic growth of at least 6%.

The government will continue to work towards implementing a variety of revenue generating measures needed in order for the country to achieve a balanced budget by the target date of 2008. The added revenue would also allow for targeting investment in infrastructure, an area where the country is sorely under serviced. Although the government has been making progress in lowering the deficit, significantly exceeding its deficit reduction goals in 2005, the improvement has not yet led to any easing of the debt-servicing burden: interest payments account for 40% of government expenditures. The general government debt to GDP ratio is approximately 80%.

Arroyo continues to face challenges to the legitimacy of her mandate. The president declared a state of emergency in late-February, claiming that she had crushed a coup attempt but that threats of further destabilizing efforts still lingered. Moves to impeach her failed in 2005, but the accusations and power struggles will continue to dog her through to the end of her mandate in 2010. Civil unrest is another challenge. Talks with Communist insurgents have been suspended since August 2004, and no settlement has been reached with rebel leaders in the province of Mindanao.

The pace of moderation in inflation will be slowed by higher transport and electricity fees and by increases in the value-added tax. After easing considerably through the second half of 2005, we anticipate only modest further reductions in the inflation rate over the next two years. The value added tax was expanded to include a wider variety of products in 2005, and was increased by two percentage points on February 1st, 2006. The central bank will continue to raise interest rates at a modest pace in order to control inflation. However, the risks of potential social unrest linked to high levels of joblessness will limit the extent of monetary policy tightening. After three increases in 2005, the benchmark overnight deposit rate stands at 7.5%.

The peso will remain sensitive to the domestic political situation. Instability puts into question the government's will and ability to implement reforms. As a result, the currency will continue to be biased towards depreciation throughout the forecast period, as there appears to be no expiry date on the political wrangling.

The export sector, which accounts for two-fifths of GDP, will grow by an average of about 5% (in value terms) over the next two years. Philippines-based firms may continue to lose market share in the global electronics industry; this sector accounts for about two-thirds of merchandise exports. The current account will remain in surplus as trade shortfalls will be amply covered by surpluses in services and transfers: the Philippines benefits substantially from money sent home by overseas workers (remittances increased by about 25% in 2005, totalling over US$10 billion for the year).

The narrowing of the budget deficit is beginning to pay dividends. Standard & Poor's and Fitch both recently upgraded the outlook for their long-term foreign currency ratings to "stable" from "negative". Moody's, however, has indicated that it was maintaining the "negative" outlook on its "B1" rating (one notch below that accorded by S&P). Even so, ample global liquidity and investor pursuit of higher yield are enabling the authorities to obtain reasonably favourable terms when tapping the international capital markets. The Philippines government raised US$2.1 billion at the outset of 2006, including a 25-year US$1.5 billion issue priced to yield 7.875% and a 10-year EUR500 million issue. Nevertheless, the failure to reduce external indebtedness during a period of large current account surpluses points to a chronic problem of capital flight that has undermined the nation's pace of development.

PHILIPPINES - KEY ECONOMIC INDICATORS

GDP: US$112 billion (2006f)	Population: 83 million (2005e)				
Long-Term Foreign Currency Rating:	Moody's:	B1(-)	S&P:	BB-	
	2003	2004	2005e	2006f	2007f
Real GDP (% change)	4.7	6.1	5.1	5.0	5.0
Industrial Production (% change)	3.0	5.0	5.6	5.9	5.5
Fiscal Balance NFPS (% GDP)	-4.6	-3.8	-3.0	-2.0	-1.0
Consumer Prices (eop % change)	3.9	8.6	6.6	6.5	6.0
Exchange Rate (% change)	-3.6	-1.1	5.6	-5.2	-6.7
Exchange Rate (year-end)	55.5	56.1	53.1	56.0	60.0
Trade Balance (US$bn)	-5.5	-5.8	-6.8	-8.2	-7.0
Exports (US$bn)	35.3	38.7	40.1	41.6	44.0
Imports (US$bn)	40.8	44.5	46.9	49.8	51.0
Current Account (US$bn)	3.4	2.2	3.5	4.0	5.0
% GDP	4.3	2.6	3.5	3.6	4.3
Foreign Direct Investment	0.3	0.5	1.0	1.5	2.0
External Debt (US$bn)	61	61	63	64	65
% of GDP	77	71	62	58	56
% of Exports G&S	146	132	129	126	120
S-T Debt / Reserves (%)	60	58	51	49	47
Foreign Reserves (US$bn)	13.7	13.1	16.0	17.5	19.0
Months of Imports	4.0	3.5	4.1	4.2	4.5

GLOBAL ECONOMIC INDICATORS

Global Economic Growth Outlook (real GDP, % change)

Region	Sub-region	Country	94-03	2004	2005e	2006f	2007f	2005-2009f
Global Growth			2.5	3.9	3.4	3.2	2.9	3.1
Americas	North America	United States	3.2	4.2	3.5	3.2	2.7	3.0
		Canada	3.5	2.9	2.9	2.8	2.7	2.8
		Mexico	2.7	4.4	3.0	3.4	3.8	3.5
	South America	Brazil	2.5	5.1	2.3	3.5	3.5	3.2
		Argentina	1.1	9.0	9.1	6.5	5.0	4.5
		Venezuela	-0.9	17.9	9.4	6.5	4.5	5.8
		Colombia	2.3	4.0	5.0	4.2	4.0	3.5
		Chile	4.6	6.1	6.3	5.6	5.5	5.0
		Peru	4.4	4.8	6.3	5.5	5.5	4.5
Europe	EMU	Euro Zone	2.1	1.8	1.4	1.8	1.7	1.7
		Germany	1.4	1.1	1.1	1.8	1.5	1.5
		France	2.0	2.1	1.5	1.5	1.8	1.7
		Italy	1.7	1.0	0.1	1.3	1.1	1.3
		Spain	3.1	3.1	3.3	3.1	2.8	2.9
	Non-EMU	United Kingdom	2.8	3.2	1.8	1.8	1.9	2.2
		Switzerland	1.1	2.1	1.9	2.0	1.8	1.6
		Sweden	2.5	3.7	2.7	3.3	3.0	2.8
	Developing Europe	Russia	0.9	7.2	6.4	6.0	5.5	6.2
		Poland	4.4	5.4	3.2	3.8	4.0	4.0
		Turkey	2.7	9.9	6.0	5.5	5.0	4.5
		Czech Republic	2.2	4.4	4.8	4.4	4.2	3.9
		Hungary	3.6	4.6	4.2	4.3	4.1	3.5
Asia-Oceania	Industrialized	Japan	0.8	2.3	2.8	2.5	1.5	1.9
		Australia	4.0	3.5	2.5	2.9	3.2	3.0
	Newly-Industrialized	Republic of Korea	5.5	4.5	4.0	5.0	4.5	4.5
		Taiwan	4.7	6.1	4.1	4.5	4.5	4.1
		Hong Kong	3.3	8.2	7.3	5.0	4.0	5.2
		Singapore	5.5	8.8	6.4	5.5	5.0	5.0
	Developing Asia	China	9.1	10.1	9.9	9.3	8.8	8.2
		India	6.5	7.5	7.9	7.3	6.8	6.3
		Indonesia	3.2	5.1	5.6	5.0	5.5	5.2
		Thailand	3.4	6.1	4.5	5.0	5.0	6.5
		Malaysia	5.3	7.1	5.3	5.5	5.2	5.4
		The Philippines	3.9	6.1	5.1	5.0	5.0	4.8

Global Fiscal Outlook (% of GDP)

Region	Group	Country	94-03	2004	2005e	2006f	2007f
Americas	North America	United States	-0.9	-3.5	-2.6	-2.9	-2.7
		Canada	-0.4	0.1	0.2	0.2	0.3
		Mexico	-2.1	-2.5	-1.4	-1.2	-1.0
	South America	Brazil	-6.0	-2.6	-3.3	-2.8	-2.4
		Argentina	-2.6	4.5	3.2	2.0	1.0
		Venezuela	-3.3	-2.0	0.5	-3.0	-2.0
		Colombia	-2.8	-1.2	-1.2	-2.0	-2.5
		Chile	-1.2	2.2	4.8	3.5	2.0
		Peru	-2.0	-1.1	-1.0	-0.8	-0.5
Europe	EMU	Euro Zone	-4.3	-2.7	-2.9	-2.7	-2.5
		Germany	-2.5	-3.7	-3.3	-3.2	-2.8
		France	-3.5	-3.6	-3.0	-3.0	-2.8
		Italy	-4.6	-3.2	-4.3	-4.2	-4.0
		Spain	-3.0	-0.1	0.2	0.0	-0.1
	Non-EMU	United Kingdom	-2.3	-3.2	-3.1	-3.0	-3.0
		Switzerland	-0.9	-1.4	3.6	-1.0	-0.5
		Sweden	-2.3	1.4	1.3	1.0	1.0
	Developing Europe	Russia*	-0.7	4.4	7.5	6.0	5.0
		Poland	-3.1	-3.9	-3.5	-3.2	-3.0
		Turkey	-11.7	-7.1	-2.0	-1.8	-1.5
		Czech Republic	-3.8	-3.0	-4.8	-3.8	-3.3
		Hungary	-6.7	-5.4	-6.1	-6.0	-5.0
Asia-Oceania	Industri-alized	Japan	-5.7	-6.9	-6.7	-6.0	-5.5
		Australia	-0.8	1.1	1.0	1.0	1.0
	Newly-Industrialzed	Republic of Korea	0.7	-1.1	-1.5	-1.5	-1.0
		Taiwan	-2.5	-2.5	-2.5	-2.5	-2.5
		Hong Kong	-1.2	1.7	0.3	0.4	0.7
		Singapore	5.2	-1.0	0.5	-0.5	0.5
	Developing Asia	China	-2.2	-1.4	-1.7	-1.5	-1.5
		India	-8.3	-8.1	-7.8	-7.0	-7.0
		Indonesia	-1.1	-1.5	-0.5	-1.0	-1.0
		Thailand	-1.5	0.7	0.0	-0.5	-1.0
		Malaysia	0.4	-4.3	-3.5	-3.0	-2.8
		The Philippines	-3.0	-3.8	-3.0	-2.0	-1.0

*The average for this country is from 97-03, not 94-03.

Global Inflation Outlook (end of period, annual change)

Region	Group	Country	94-03	2004	2005e	2006f	2007f
Americas	North America	United States	2.4	3.4	3.7	2.0	1.9
		Canada	1.8	2.1	2.2	1.5	2.0
		Mexico	14.8	5.2	3.3	3.8	3.8
	South America	Brazil	218.1	7.6	5.7	4.8	4.5
		Argentina	5.0	6.1	12.3	12.0	8.0
		Venezuela	42.4	19.2	14.4	14.0	12.0
		Colombia	14.8	5.5	4.9	4.7	4.3
		Chile	5.1	2.4	4.0	3.2	3.0
		Peru	7.3	3.5	1.5	2.0	2.5
Europe	EMU	Euro Zone	1.9	2.1	2.2	1.9	1.7
		Germany	1.5	2.2	2.2	1.6	2.0
		France	1.6	2.3	1.8	1.6	1.5
		Italy	3.0	2.3	2.0	1.9	2.0
		Spain	3.2	3.3	3.7	3.2	2.8
	Non-EMU	United Kingdom	2.4	1.6	2.0	2.0	1.8
		Switzerland	0.8	1.3	1.1	1.2	1.0
		Sweden	1.3	0.3	0.9	1.5	2.0
	Developing Europe	Russia	56.5	11.7	10.9	10.0	8.0
		Poland	13.2	4.4	0.7	2.0	2.2
		Turkey	47.1	9.3	7.7	6.0	4.5
		Czech Republic	5.6	2.8	2.2	2.5	2.3
		Hungary	14.3	5.5	3.3	2.0	3.0
Asia-Oceania	Industrialized	Japan	0.0	0.2	0.1	0.3	0.2
		Australia	2.3	2.6	2.8	2.5	2.6
	Newly-Industrialzed	Republic of Korea	4.1	3.0	2.6	2.5	2.4
		Taiwan	1.6	1.6	2.2	2.0	1.5
		Hong Kong	1.8	0.2	1.8	1.5	1.5
		Singapore	0.9	1.3	1.3	1.0	1.1
	Developing Asia	China	5.3	2.4	1.6	2.0	2.0
		India	6.8	6.0	4.4	4.5	4.5
		Indonesia	14.3	6.1	17.1	10.0	7.0
		Thailand	3.7	2.9	5.8	4.0	3.0
		Malaysia	2.7	2.1	3.5	2.5	2.8
		The Philippines	3.7	8.6	6.6	6.5	6.0

Global Currency Outlook (annual % change*)

			94-03	2004	2005e	2006f	2007f
Americas	North America	Canadian Dollar	-1.3	2.5	3.3	4.0	3.5
		Mexican Peso	-10.7	-0.2	5.9	-6.5	-7.9
	South America	Brazilian Real	-18.9	9.4	13.0	4.4	-8.2
		Argentinian Peso	-5.6	-1.1	-1.8	-5.4	-5.9
		Venezuelan Bolivar	-22.1	-16.7	-10.8	-8.5	-13.0
		Colombian Peso	-9.9	18.1	2.8	0.7	-7.1
		Chilean Peso	-2.8	6.7	8.5	-6.1	-3.5
		Peruvian Sol	-4.4	4.3	-2.4	1.5	-2.9
Europe	EMU	Euro (ECU pre-1998)	1.9	8.7	-13.9	8.5	5.5
	Non-EMU	Pound Sterling	2.1	8.6	-10.4	5.8	2.7
		Swiss Franc	-0.7	1.3	-1.3	4.0	2.7
		Swedish Krona	2.2	9.7	-16.9	11.8	6.4
	Developing Europe	Russian Rouble	-21.3	1.9	2.2	-0.8	-0.4
		Polish Zloty**	-1.7	15.6	6.1	2.8	1.1
		Turkish Lira	-34.3	4.7	-0.6	-3.5	-3.4
		Czech Koruna**	2.1	6.9	4.6	0.8	0.0
		Hungarian Forint**	0.0	7.2	-3.0	-2.7	-2.0
Asia-Oceania	Industri-alized	Japanese Yen	1.1	4.8	-13.6	12.4	10.5
		Australian Dollar	2.1	5.3	-6.3	-2.7	-2.8
	Newly-Industrialzed	South Korean Won	-1.6	15.7	2.8	6.0	0.0
		New Taiwan Dollar	-2.3	7.3	-3.4	5.8	3.3
		Hong Kong Dollar	-0.1	0.0	0.0	0.0	0.0
		Singapore Dollar	-0.3	4.3	-1.8	3.7	1.9
	Developing Asia	Chinese Renminbi	-2.9	0.0	2.5	4.9	5.5
		Indian Rupee	-3.6	5.7	-3.5	-6.0	-4.0
		Indonesian Rupiah	-9.8	-9.5	-5.4	-4.6	-6.4
		Thai Baht	-2.4	2.1	-5.1	2.5	-2.4
		Malaysian Ringgit	-2.6	0.0	0.5	3.6	4.3
		Philippine Peso	-5.9	-1.1	5.6	-5.2	-6.7

* Annual percent change is against the USD except for Poland, Hungary and the Czech Republic, w hich are against the EUR.
**The average for this country is from 99-03, not 94-03.

Global Current Account Balance Outlook (% of GDP)

			94-03	2004	2005e	2006f	2007f
Americas	North America	United States	-2.9	-5.7	-6.4	-6.6	-6.6
		Canada	0.4	2.2	2.1	1.8	0.7
		Mexico	-2.6	-1.1	-0.9	-1.7	-2.3
	South America	Brazil	-2.9	1.9	1.8	0.9	0.5
		Argentina	-1.2	2.2	2.4	1.9	1.1
		Venezuela	5.5	12.7	17.7	14.0	10.0
		Colombia	-2.9	-1.1	-1.0	-1.2	-1.4
		Chile	-2.6	1.5	0.1	-0.4	-0.7
		Peru	-4.2	-0.1	-0.1	-0.7	-0.3
Europe	EMU	Euro Zone	0.6	0.6	-0.4	-0.5	-0.2
		Germany	0.0	3.8	4.6	4.5	5.0
		France	1.5	-0.4	-1.7	-1.5	-1.2
		Italy	0.9	-0.9	-1.5	-1.7	-1.0
		Spain	-1.7	-5.6	-6.1	-6.5	-6.0
	Non-EMU	United Kingdom	-1.3	-2.0	-2.2	-2.2	-2.5
		Switzerland	9.7	16.8	14.8	15.0	13.9
		Sweden	3.7	7.9	7.1	7.1	6.2
	Developing Europe	Russia	6.7	11.3	13.0	11.5	9.5
		Poland	-3.1	-4.3	-1.7	-1.8	-2.0
		Turkey	-0.8	-5.2	-6.0	-5.9	-5.1
		Czech Republic	-4.6	-5.2	-3.9	-3.5	-3.0
		Hungary	-5.5	-8.8	-8.2	-7.9	-7.2
Asia-Oceania	Industrialized	Japan	2.4	3.7	3.3	3.6	3.4
		Australia	-6.7	-6.6	-6.3	-6.0	-5.6
	Newly-Industrialzed	Republic of Korea	1.7	4.1	2.0	1.6	1.0
		Taiwan	4.9	6.2	4.8	2.8	3.0
		Hong Kong	3.1	10.1	13.0	11.7	11.6
		Singapore	20.1	26.1	23.9	20.4	15.1
	Developing Asia	China	2.1	3.6	6.6	6.3	4.7
		India	-0.4	0.2	-2.0	-2.9	-3.2
		Indonesia	1.5	0.7	2.1	1.6	1.0
		Thailand	2.2	4.0	-2.1	-1.3	-1.9
		Malaysia	4.1	12.7	12.5	10.5	9.5
		The Philippines	1.5	2.6	3.5	3.6	4.3

Global Foreign Reserves Outlook (US$, billions)

			94-03	2004	2005e	2006f	2007f
Americas	North America	United States	64.9	75.9	54.0	n/a	n/a
		Canada	23.5	34.4	32.9	n/a	n/a
		Mexico	31.5	61.5	68.7	70.0	75.0
	South America	Brazil	42.9	49.3	54.0	60.0	70.0
		Argentina	18.9	19.6	28.0	25.0	30.0
		Venezuela	12.5	24.0	30.4	33.0	35.0
		Colombia	9.3	13.4	14.9	15.5	16.1
		Chile	14.6	16.0	16.8	18.0	19.0
		Peru	9.2	12.6	14.1	16.2	18.0
Europe	EMU	Euro Zone*	241	211	205	220	0
		Germany	66.9	48.8	46.0	48.0	50.0
		France	32.2	35.3	30.0	32.0	35.0
		Italy	33.0	27.9	26.0	25.0	25.0
		Spain	40.6	13.5	14.0	14.0	14.5
	Non-EMU	United Kingdom	38.6	45.3	43.0	41.0	40.0
		Switzerland	37.8	55.5	37.0	40.0	45.0
		Sweden	17.3	22.1	22.0	27.0	30.0
	Developing Europe	Russia	24	125	174	220	240
		Poland	22.3	34.5	41.5	44.0	48.0
		Turkey	19.9	35.9	50.0	52.0	55.0
		Czech Republic	14.5	27.8	29.1	31.0	33.0
		Hungary	10.2	15.9	18.5	20.0	22.0
Asia-Oceania	Industr-ialized	Japan	313	845	847	975	1100
		Australia	17.8	35.8	42.3	43.5	45.0
	Newly-Industrialzed	Republic of Korea	71	199	210	225	240
		Taiwan	115	242	253	260	265
		Hong Kong	90	124	124	130	135
		Singapore	76	113	117	125	130
	Developing Asia	China	175	610	819	1000	1200
		India	40	127	137	140	143
		Indonesia	22.6	34.9	34.7	36.0	38.0
		Thailand	33.6	48.7	52.1	55.0	55.0
		Malaysia	29.2	66.4	70.5	85.0	97.0
		The Philippines	10.5	13.1	16.0	17.5	19.0

*The average is from 99-03, not 94-03.

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