ASIA MONTHLY

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株式会社 日本総合研究所
The Japan Research Institute, Limited

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Topics Asia's economic growth in 2006 projected to exceed that of 2005

Economic growth in East Asia as a whole in 2006 is expected to be higher than in 2005. As China continues to curb investment in order to maintain a stable pace of economic growth, its growth rate is expected to be around 8.8%, below that of 2005.

1. Asia's economic performance in 2005

■ NIEs stage a comeback

The economies of East Asia (excluding China) have experienced overall economic deceleration since the latter half of 2004, in the wake of global economic deceleration, the soaring price of crude oil and the fall in the China's import growth rate, following a glut in production. Against this backdrop, however, the NIEs have been staging a comeback. GDP growth rates for Q3 (July to September), 2004, were 4.4% for Korea, 4.4% for Taiwan and 7.0% for Singapore, all up on the growth rates for Q2 (April to June). In contrast, the ASEAN nations have been experiencing significant inflation and have been forced to adopt strict policy measures.

Korea's private consumption has staged a solid recovery, with exports performing strongly at double digit growth from July onwards. Private consumption had failed to grow for a long time, due to consumer credit restrictions introduced as a result of increasing household sector debt, but began to recover gradually from the latter half of 2004. The pace of recovery picked up in 2005. Among the reasons for the recovery are the gradual increase in incomes, the adjustment of household sector debt and the effects of a series of economic measures. In September, 2004, the special consumption tax on certain luxury consumer items was lowered (until the end of 2005), followed in 2005 by the lowering of the personal income tax rate by 1% point, and the withholding tax rate on both interest and dividends by 1% point each. In addition, in order to expand public works investment, the government has 1) increased investment in public housing for installment purchase and new urban housing, 2) relaxed restrictions to enable the construction of large scale theme parks and tourist sites around the capital, and 3) is promoting investment in leading edge industries and service industries.

However, due to the poor growth of facilities investment and other fixed capital formation, economic growth for 2005 is likely to fall below that for 2004, at 3.8%.

Taiwan's real GDP grew 2.5% in Q1 (January to March) and 3.0% in Q2. The worldwide inventory adjustment of IT related products resulted in a slowing of exports and caused the growth of exports to China, which had been growing at a fast pace, to fall to the 10% range. Among the causes for the recent slump in growth of exports to China are 1) the rebound from the high growth rates of recent years, 2) overproduction in China, and 3) Taiwanese industries' shift of production to China having run its course. Taiwanese investment in China, which had been trending upwards in recent years, was -12.4%, compared to the same period in the previous year (January to October, cumulative), including a 30.6% drop in the electronics sector. This has been partly due to Taiwanese companies shifting their investments to Vietnam and other ASEAN nations, because of the worsening investment climate in China.

Domestic demand is performing solidly. Against the backdrop of an improved employment climate, private consumption has maintained growth at 3% or higher. And, with the start of large scale construction projects such as chemical plants and a high-speed railway, fixed capital formation is growing quickly and is driving economic growth.

The recovery in global IT demand lent greater impetus to exports from the middle of the year onward, and growth was 4.4% in Q3. Growth for the whole year is expected to be 3.6%.

Singapore, too, has experienced a slowing in both domestic and foreign demand. Real GDP grew by 2.5% in Q1, 2005, but jumped to 7.0% in Q3, due to a very healthy performance by the manufacturing industries, bio-industries in particular.

■ Inflationary pressure rising among ASEAN countries

The ASEAN countries continue to post economic growth rates of between 4 and 5%, but inflation is on the rise and the economic climate is becoming ever more difficult. One common factor is the soaring prices of crude oil and petroleum products, but the situation in each country is a little different.

Thailand's economic growth in Q2 was 4.4%, up on 3.3% in Q1. However, the balance of trade is

worsening and inflation has risen. The soaring prices of crude oil and petroleum products and increased imports of iron and steel and machinery, resulted in a trade deficit in June that was the biggest since April, 1996. Also, steeply rising energy prices and increases in public utility charges pushed up the consumers' price rise index (compared to the same period in the previous year) from 3.8% in June to 5.3% in July. As a result, the focus of government policy from mid-year onward shifted to improving the balance of trade and curbing inflation. In addition to a series of policy interest rate hikes, the government has reviewed its plans for large scale infrastructure development, which would require massive imports of materials, and implemented energy saving promotion measures and tightened up the monitoring of imports of crude oil, iron and steel, etc.

Large scale infrastructure development plans are currently underway, involving mainly transportation, housing and energy and including a railway development plan that calls for expanding both Bangkok's elevated railway and subway. The commencement of large scale infrastructure projects caused public fixed capital formation to grow 29.2% in Q1, compared to the same period in the previous year, and 20.2% in Q2, and helped drive the economy, but was also a factor behind the worsening balance of trade.

Thanks to a series of government policies, the balance of trade edged into the black in September, albeit slightly, but consumer prices continued to rise unabated, up 6.2% in October.

In recent weeks, while exports have been performing comparatively well, growth in private sector consumption has been trending downwards. When interest rates are raised in an attempt to curb inflation, there is also the risk that consumption sentiment will cool.

Indonesia's economy has continued to grow within the 5% range since the start of 2005. The consumer price increase rate was being held at between 7 and 9%, but rises in the prices of petroleum products in October forced the rate upwards to 17.9%.

In the past, the prices of paraffin, gasoline and other petroleum products had been kept low by fuel subsidies, but the soaring price of crude oil resulted in an increase in the fiscal deficit, and saw fuel prices being raised by two to three times. Part of the background to this has been the readjustment of subsidies and continuing efforts to reduce the fiscal deficit, as part of the post-currency crisis structural reform.

In the past, Indonesia has experienced several instances of anti-government riots in response to raises in petroleum product prices. The recent price increase announcements were also preceded by a series of demonstrations, but these gradually cooled once Ramadan started. It would appear that the government has been able to win the people's understanding that 1) these price rises are temporary and that prices will once again trend downwards in the future, 2) that the price rises will lead to sounder fiscal health over the mid term, and 3) the use of coupons, etc., will help to lessen the impact on the poor. However, the rupiah continues to depreciate and it will be important to keep an eye on commodity price trends moving forward.

The Philippines' growth rate has slowed to the 4% range, while consumer prices have gone up. The inflation rate was 8.3%, compared to the same period in the previous year, in January to June, but, due to a recovery in agricultural production, fell to the 7% range from July onwards. The vulnerability of President Arroyo's political base means that, should the administration fail to curb inflation, there is every possibility that political instability will resurface.

■ China maintains strong economic growth

In 2005, China has faced the issues of curbing overheating investment at home and correcting its international trade imbalance in order to maintain stable economic growth. However, the economy has continued to grow powerfully, with real GDP for January to September growing by 9.4% and the trade surplus much bigger than in the previous year.

From 2003 onward, China began to experience slight overheating in investments and a certain amount of economic imbalance, with power shortages and skyrocketing real estate prices in the cities. Fixed capital formation also, from 2003 onwards, has tended to outperform the long term trend and has shown signs of overheating.

In order to curb investment overheating, the government trotted out a series of measures, including 1) stricter loan conditions for real estate investments, 2) higher deposit reserve rates and 3) lowering the value of construction bonds. These measures did not prove wholly effective so, in 2004, additional measures were introduced prohibiting new investments in overheating industry sectors, raising the banks' standard rates for loans and deposits and other measures

These measures have been effective in curbing investments in real estate and in some industry sectors,

such as iron and steel and cement. However, 1) fixed asset investments in city areas remain high, 2) infrastructure investments in coal and electrical power are expanding in an effort to relieve energy shortages, and 3) local government investments continue to grow strongly as local governments prioritize sustained employment and are cool towards the idea of restraining investments. As a result, total social fixed asset investments in 2005 look likely to grow at the same pace as in 2004.

In addition, as well as trying to break away from a growth pattern that is too heavily dependent on investment, the government has attempted to raise agricultural sector income levels by introducing agriculture promotion measures and tax reductions for farmers, and other steps, in order to try to ease the income gap between the cities and rural communities. Between January and September, per capita disposable income in rural communities grew at a faster pace than in the cities, and this has contributed to the expansion in consumption in those communities.

In contrast, as indicated by China's swelling trade surplus, there has been little progress in terms of correcting the trade imbalance. Export worth for the period January to October was up 31.1%, compared to the same period in the previous year, at $614.49 billion. Imports were up 16.7%, similarly, at $543.12 billion, leaving a trade surplus in excess of $80 billion (the same figure for 2004 was approx. $32 billion). While exports continued to grow at a fast pace similar to the previous year, import growth has fallen considerably. This is related to China's domestic investment restraints and overproduction.

People's Bank of China intervened in the market in order to hold down exchange rate fluctuations to within a certain range, and this had the effect of swelling the foreign currency reserves. On July 21, the exchange rate for the renminbi against the dollar was raised 2.1% and, against the backdrop of an expanding trade surplus, there is growing pressure to raise the renminbi's exchange rate even further.

2. Asian economies in 2006

■ Economic growth expected to be slightly higher than 2005

In 2006, as a result of factors such as the continuing global economic expansion and the recovery in demand for IT products, the East Asian economies, with the exception of China, are expected to grow slightly faster than in 2005.

Among the NIEs, Korea is expected to see 4.5% economic growth, supported by expanded exports and private consumption. The economies of Taiwan and Hong Kong are expected to grow by around 4.2% and 5.4% respectively, boosted in both instances by growing domestic and foreign demand. The ASEAN economies, excluding the Philippines, are expected to expand on the order of 5% or more. In addition to foreign demand, expanded infrastructure related investments are expected to be drivers of growth for Thailand and Malaysia. However, whereas private consumption in Malaysia is expected to continue to grow, supported by low interest rates, Thailand's rising interest rates are expected to cause private consumption growth to decelerate. Vietnam and India are hopeful of an influx of foreign capital and look likely to maintain economic growth of 7% or more.

In China, meanwhile, while fixed asset investments, exports and individual consumption are still growth drivers, as investment restraints begin to take effect, the economic growth rate is expected to be slightly lower than that of 2005, at 8.8%.

In October, the 5th Plenary Session of the 16th Central Committee of the Chinese Communist Party formally adopted the (draft) 11th Five Year Plan (2006 to 2010), which revised the erstwhile priority of economic growth and proclaimed the maintenance of 'lasting, stable growth', based on the perspective of 'scientific (well balanced) development' as the new target. In addition to ongoing priorities such as measures to reduce the numbers of those living in poverty and the resolution of the 'Three Agrarian Issues' in order to redress the incomes imbalance, the Tianjin Area has been designated a Special Development Area and will encourage the development of the northeast. This follows on from similar initiatives to develop the western and central regions. Further, plans call for energy consumption per unit of GDP to be reduced by 20% compared to 2005 levels over the next five years.

In terms of external relations, the redressing of the trade imbalance is an ongoing concern. The Chinese government appears to be tackling the issue pro-actively, raising the renminbi against the dollar in July, agreeing in November on restraints on textile exports to the U.S., and announcing after a meeting of heads of state that imports from the U.S., including aircraft, would be significantly increased. While there is a possibility that a more flexible exchange rate system will be introduced in 2006, the problem of unemployment in China means that it is unlikely that the renminbi will be raised much higher against the

dollar.

■ **Risk factors**

Among the risk factors likely to impact the economies of East Asia in 2006 are rising inflation and interest rates and the threat of an influenza pandemic.

The inflation is being caused by the soaring price of crude oil and, therefore, is very likely to be a temporary phenomenon. However, its movement needs to be monitored very carefully, such is its impact on the lives of those in the lowest income brackets. In some countries, prices and interest rates are likely to continue to trend upwards for the time being, inevitably cooling private consumption.

The greatest unknown factor is the possible impact of an influenza pandemic. The degree of negative impact on the economy will depend on how widely the influenza spreads and how long it lasts but, if SARS was anything to go by, there is the possibility that both consumption and tourism could be quite seriously hurt.

■ **Improving Japan-Korea/ Japan-China relations**

As economic interdependence in East Asia deepens through trade and direct investment, a recent characteristic has been the strengthening trend towards the development of systems in pursuit of economic integration. Whether these attempts at economic partnership eventually result in economic integration in the region will depend on whether Japan, China and Korea can work with each other.

However, the reality is that Japan-Korea and Japan-China relations are somewhat rocky at the moment. In December, 2003, Japan and Korea initiated negotiations aimed at concluding an economic partnership agreement. However, these negotiations were discontinued in November, 2004, after disagreement over the liberalization of marine produce. In addition, territorial disputes over the island of Takeshima (which Korea calls 'Tokto') and Prime Minister Koizumi's controversial visits to the Yasukuni Shrine have strained relations between the two countries so badly that the original target of concluding the economic partnership agreement by the end of 2005 proved impossible. Meanwhile, relationships between Japan and China are described as 'cool politically and warm economically'.

In order to realize the East Asian Economic Community being proposed by Japan, it will be necessary to ensure that the comprehensive economic partnership negotiations started with ASEAN in 2005 proceed smoothly and that relations with Korea and China are improved as quickly as possible. In particular, it is important that the economic partnership agreement with Korea be concluded successfully.

(Hidehiko Mukoyama)

Economic Prospects for 2006

(year-on-year, %)

1. Economic Growth

	2002	2003	2004	2005 (forecast)	2006 (forecast)
Korea	7.0	3.1	4.6	3.8	4.5
Taiwan	4.3	3.4	6.1	3.6	4.2
Hongkong	1.8	3.1	8.2	6.9	5.4
Thailand	5.3	6.9	6.1	4.1	5.1
Malaysia	4.4	5.4	7.1	4.6	5.5
Indonesia	4.4	4.9	5.1	5.5	5.5
Philippines	4.4	4.5	6.0	4.8	4.7
Vietnam	7.1	7.3	7.7	8.4	8.2
India	4.0	8.5	6.9	7.2	7.0
China	8.3	9.5	9.5	9.3	8.8

2. Consumer Prices

	2002	2003	2004	2005 (forecast)	2006 (forecast)
Korea	2.7	3.6	3.6	2.8	3.0
Taiwan	−0.2	−0.3	1.6	2.3	2.2
Hongkong	−3.0	−2.6	−0.4	1.1	2.3
Thailand	0.6	1.8	2.8	6.0	4.0
Malaysia	1.8	1.1	1.4	3.2	2.5
Indonesia	11.9	6.7	6.1	14.0	8.0
Philippines	3.1	3.2	6.0	7.9	7.5
Vietnam	4.0	3.0	9.5	8.0	6.5
India	3.9	3.9	3.8	4.3	4.5
China	−0.8	1.2	3.9	1.6	2.5

3. Exports

	2002	2003	2004	2005 (forecast)	2006 (forecast)
Korea	8.0	19.3	31.0	14.0	17.0
Taiwan	6.3	10.4	20.7	7.5	9.2
Hongkong	5.4	11.8	15.8	11.7	12.0
Thailand	4.5	17.4	22.1	13.1	15.0
Malaysia	7.0	11.5	20.5	10.2	15.0
Indonesia	1.5	6.8	17.2	20.0	15.0
Philippines	9.5	2.9	9.3	6.0	7.0
Vietnam	11.2	20.8	31.4	20.0	15.0
India	11.7	22.7	22.7	20.0	15.0
China	22.4	34.6	35.4	30.5	20.0

4. Imports

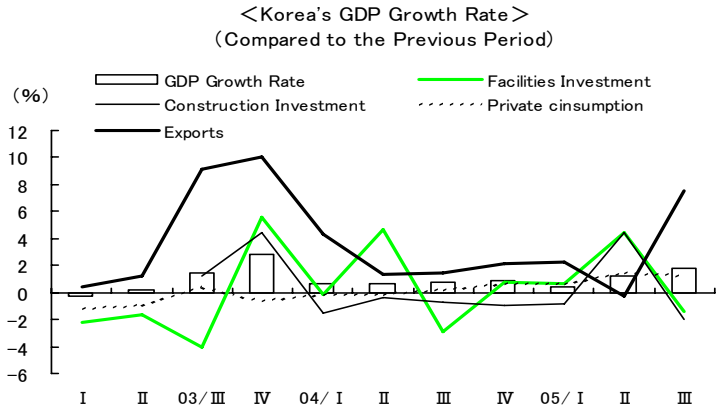
	2002	2003	2004	2005 (forecast)	2006 (forecast)
Korea	7.9	17.6	25.5	16.1	16.7
Taiwan	4.9	13.1	31.9	10.7	8.2
Hongkong	3.2	11.8	16.7	9.1	12.0
Thailand	4.0	16.8	26.6	22.5	14.0
Malaysia	8.1	4.8	25.9	7.9	12.0
Indonesia	1.1	4.0	41.9	30.0	20.0
Philippines	7.2	6.0	9.2	3.5	6.5
Vietnam	21.8	27.8	25.9	18.0	15.0
India	16.9	30.2	32.4	30.0	25.0
China	21.2	39.8	36.0	18.2	25.0

Notes: The figures in 2005, 2006 are forecasts by JRI.
Source: National Statistics

Korea *Mid 4% economic growth forecast for 2006*

■ 3.8% economic growth in 2005

Korea's real GDP grew by 4.4% in Q3, compared to the same period in the previous year, exceeding Q1's 2.7% and Q2's 3.3%. Seasonally adjusted quarterly growth is also accelerating, at 0.4%, 1.2% and 1.8%, respectively.



Source: The Bank of Korea

In October, the Bank of Korea raised the benchmark call rate for the first time in three and a half years, citing as its reasons the steady recovery of the economy, and the side effects of low interest rates, such as skyrocketing real estate prices and a widening interest differential with the U.S. Claims of an economic recovery are borne out by the comeback staged by exports and the recovery in private consumption.

Export growth had begun to slow from mid 2004, as a result of the global economic deceleration, but has continued double digit growth, compared to the same period in the previous year, since July, 2005. By product, automobile parts, petrochemical products, shipbuilding and general machinery and equipment have continued to perform strongly, while IT related items, such as semiconductors, liquid crystal panels and liquid crystal display TVs, are also beginning to show signs of recovery. By country, exports to the U.S. are beginning to recover from earlier stagnation and exports to Korea's largest export partner, China, and the other BRICs, Brazil, India and Russia, are growing at over 30%.

Due to the effects of measures introduced to restrain consumer credit after swollen household sector debt, year on year private consumption growth in 2003 and 2004 was negative but has begun to recover steadily as a result of 1) modest growth in incomes, 2) progress in debt adjustment, and 3) the effects of a series of economic measures. However, automobile sales have yet to make a full recovery.

Also, consumption among the lowest income earners has yet to recover. The consumer expectation index, which is used to evaluate economic and living trends six months hence, in the case of the lowest income earners, is still well below 100. Part of the background to this is the failure of incomes to grow, reflecting an unstable employment situation, with increased numbers of contingent workers.

Interest rates had continued at low levels for a long time and apartment prices shot up again in 2005. In late August, 2005, the government announced a series of comprehensive real estate measures aimed at lowering house prices and increasing the housing supply. The core of these measures has been to raise the transfer income tax for multiple home owners. Currently, a progressive tax rate of between 9 and 36% is levied on households that own two or more homes. From 2007, the rate will go up to 50%. In contrast, in order to ease the urban housing shortage, there are plans to expand the amount of land available for housing development.

2005's consumer price increase rate is expected to be in the 2% range. This is thought to be because, though energy prices went up due to the soaring price of crude oil, the appreciation of the won in the early part of the year kept import prices from rising by too much.

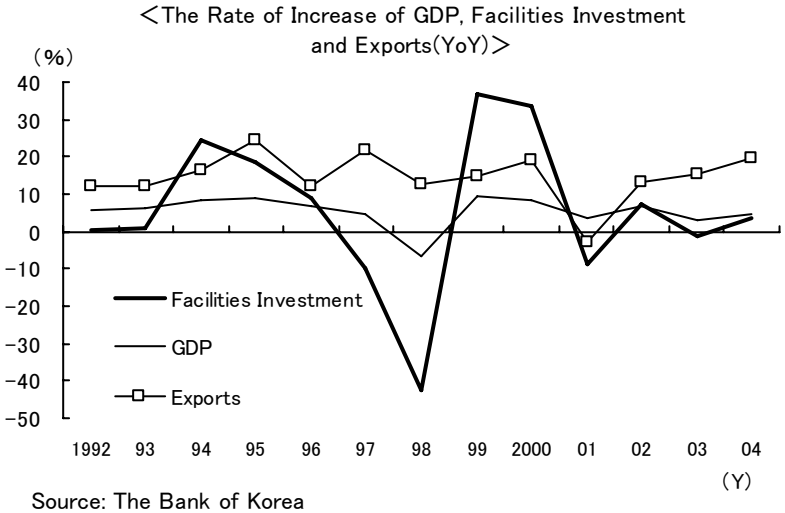
Given the above, exports and private consumption will be the growth drivers and economic growth for 2005 is estimated to be 3.8%.

■ 4.5% economic growth in 2006

It is expected that exports and private sector consumption will continue to be the growth drivers in 2006, but that poor growth in fixed capital formation will mean that economic growth for the whole year

will be only slightly better than the previous year, at 4.5%.

In addition to the U.S., it is expected that China's economy will continue to grow and that the recovery in IT demand will go from strength to strength and that exports to the BRICs will grow at a fast pace. As such, it is likely that exports (customs-cleared basis) will grow by close to 20%, compared to the previous year. Export growth is usually accompanied by an increase in facilities investment but, in recent years, this has not always been the case. This would appear to be related to the fact that the domestic production repercussion effect of the export industry has lessened somewhat of late. Among the reasons for this are the facts that 1) the demand for intermediate materials has drifted abroad, due to the global development of industrial specialization, and 2) the high dependence on imports of high quality materials and high precision equipment from Japan means that, as production expands, so do imports from Japan. Also, there is the effect of increased investments abroad, mainly by the *chaebol*.



Source: The Bank of Korea

Machinery orders received, which are an indication of future performance in facilities investment, have been trending downwards since April, 2005. Against a backdrop of inventory adjustment and the development of next generation products, facilities investment will likely increase in the future but, for the reasons given above, any such increase is likely to be fairly modest, taken over the whole year.

Construction investment, which had stalled in recent years, recovered to positive growth in Q2, 2005, for the first time in six quarters, but fell back to negative growth in Q3. In 2006, there will very probably be increased investment in public housing for installment purchase and new urban housing, for example, but since the government's real estate measures will result in restrained housing construction, which is the target of investment, investment levels overall will likely be around the same level as in 2005. For this reason, growth in fixed capital formation will probably be modest.

Elsewhere, while the recovery in private consumption is expected to pick up the pace a little, full recovery is unlikely as consumption among the lowest income earners fails to grow. According to the 'Family Income and Expenditure Survey', real earnings among the lowest income earners are not growing and the burden of debt repayment remains as heavy as ever. While incomes cannot be expected to grow by much in the near future, rising interest rates will mean that there is little room to expect any significant growth in consumption.

Also, there is cause for concern regarding consumption among higher wage earners. While the government's real estate measures are expected to bring stability to real estate prices, if that effect proves to be a limited one, there is the possibility that interest rates will be raised further. The current consumption recovery relies on higher wage earners to a significant degree so, if interest rate hikes cause real estate prices to plummet, the effect on the economy will be serious.

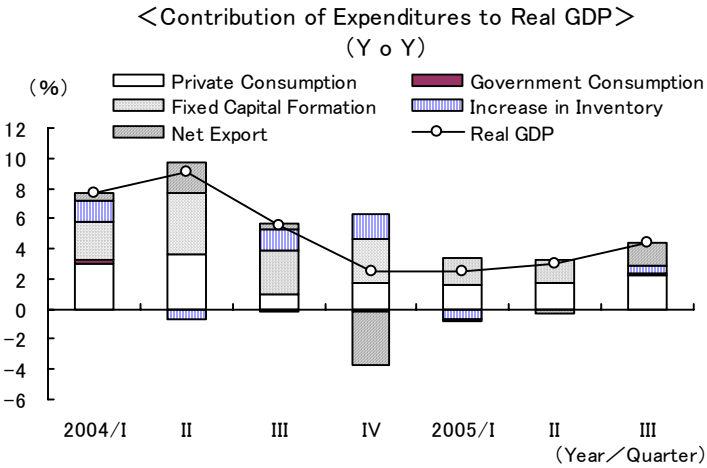
In order to bring about a full recovery in consumption, it will be necessary to raise the income levels of the lowest wage earners and that will require accelerated growth and measures to address the issue of contingent workers. Looking ahead, one of the biggest issues facing the government will be to what extent they can control real estate prices, taking the economic situation into account.

(Hidehiko Mukoyama)

Taiwan 2006 economic growth likely to recover to 4.2%

■ Export growth slows, 2005 economic growth stalled at 3.6%

Taiwan's economy has been decelerating since the latter half of 2004. Real GDP growth (compared to the same period in the previous year) peaked in Q2, 2004, at 9.0%, and slumped to 2. 5% in Q1, 2005 (figure, upper right). Though the deceleration appeared to have braked slightly, with growth recovering to 3.0% in Q2, performance was 0.6% points below the government's May forecast and the pace of economic recovery in the first half of the year was somewhat sluggish.



Source：Directorate-General of Budget, Accounting and Statistics

The biggest factor behind the economic deceleration has been the slump in foreign demand. Export growth (customs-cleared basis) has been in decline since mid 2004, and has been stuck in single digits since 2005. The major cause of the slump in foreign demand has been the significant drop in export growth to Taiwan's biggest export partner, China. Taiwanese investments in China have languished of late, due to concerns over power shortages and rising labor costs, and this has impacted exports of parts and components and capital goods. Poor export growth has, in turn, resulted in the stunting of production and plant and equipment investment. Elsewhere, the high price of crude oil has helped to push import growth above that of exports and the contribution of net exports has been negative for three consecutive quarters.

Meanwhile, domestic demand is performing comparatively solidly. Though the growth in total fixed capital formation declined, it did maintain a level of around 10% in the first half of 2005. The reasons are that the deceleration in private sector investment was less than originally expected and that investments in public works, which had been in continuous decline, began to increase as a result of the development of large scale projects (e.g., power station plant and equipment).

Private sector consumption has continued to grow at over 2.5%, compared to the same period in the previous year, since Q4 , 2004. This has been caused by 1) the improvement in the unemployment rate (from 5.2% in August, 2003, to 4.1% in September, 2005) and 2) a more positive consumer sentiment, fuelled by a recovery in stock prices.

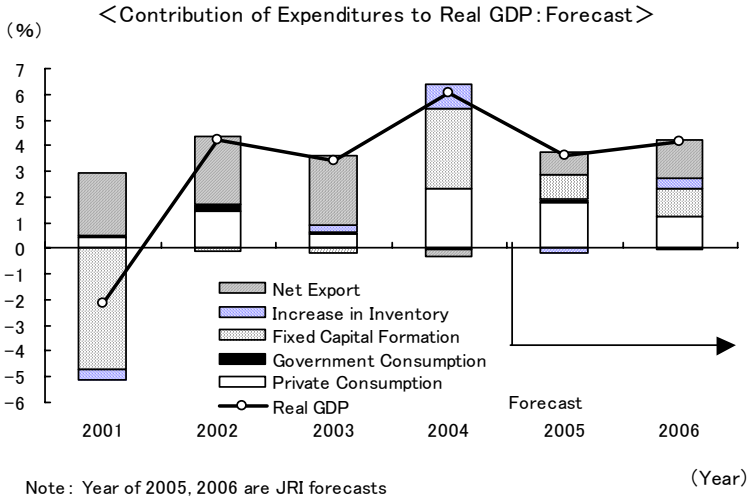
Recent economic indicators give reason for optimism. Economic trend indices have been rising monthly since June. Also, thanks to a recovery in electronic goods, and others export growth bottomed out in June and began to accelerate and the index of manufacturing production, which had consistently been negative, year on year, has begun to trend upwards. Real GDP in Q3 grew by 4.4%, exceeding the government's estimate and indicating economic recovery. However, the stagnation of the first half of the year has taken its toll and economic growth for the whole of 2005 is expected be only 3.6%, well below 2004's 6.1%.

■ Export recovery expected to contribute to 4.2% growth in 2006

The first half of 2005 is expected to see a continuation of the recovery trend of the latter half of the previous year. The prime movers will likely be 1) export recovery, centered around electronics related products, and 2) expanded investments. However, it is believed that the pace of recovery will be weak and that real GDP growth for the whole year will be a modest 4.2%.

In terms of demand items, the contribution of foreign demand is expected to become greater. The global electronics related market demand is expanding, so much so that semiconductor shipment forecasts for 2006 have been revised upwards. This is especially good news for Taiwanese exports, which rely

fairly heavily on these kinds of goods. Taking efforts to increase the numbers of tourists visiting from China into account, exports of finance and services are thought likely to grow by around 9.8%, compared to the previous year. In addition, it is expected that, if the price of crude oil does not spiral upwards any further, the factors that have boosted imports so much will begin to lose strength, so that import growth will be lower than that of exports.



Note：Year of 2005, 2006 are JRI forecasts
Source：Directorate-General of Budget, Accounting and Statistics

It is expected that domestic demand will expand at a gentle pace. Once the job-hunting season for the year's new crop of graduates finishes, the unemployment rate will likely improve from September onwards. As there are no factors thought likely to cause sudden deterioration in the employment situation, the unemployment rate will probably stay at its current level, the lowest in four years. However, factors such as the tax system reforms to be discussed later may cause consumption sentiment to cool and it is expected that private sector consumption for the whole year will increase by only 2.1%, compared to the previous year.

Both private sector and public investments are expected to grow positively compared to the previous year. In addition to the recovery in demand for electronics related goods, there are many other elements that give rise to expectations that plant and equipment investments will increase, such as substantial profits being made by two major producers of liquid crystal panels and rising capacity utilization rates among the major semiconductor producers. In contrast, starting with 70% of information communications, overseas production rates for major items are rising across the board and export orders received are losing their ability to influence plant and equipment investment directly. Considering these factors, it seems likely that private sector investment will grow at around 6.2%, compared to the previous year. In the public sector, it is expected that investment worth will be topped up, with the aims of developing infrastructure and stimulating the science and technology industry. Total fixed capital formation is thought likely to grow at around 5.5%.

Looking forward to Taiwan's economy in 2006, much attention is being focused on the review of the tax system. The Chen Shui-bian administration has changed tack and is now aiming to achieve financial reconstruction by reforming the tax system and increasing the taxation burden. As such, the implementation of a business tax rate hike and a 'minimum tax system' (the setting of a minimum tax level that can be levied even on businesses and individuals currently enjoying tax exemptions) has been proposed and is currently before the Legislative Yuan. This series of tax reforms, which could be in place as early as the start of 2006, is badly needed in Taiwan, whose finances are chronically in the red and whose fiscal burden is thought likely to increase as its society ages. However, increasing the tax burdens of corporations and individuals will inevitably dampen plant and equipment investment and private consumption, and cause the economy to slow down. The introduction of interim measures or some other consideration of the economic situation will be required.

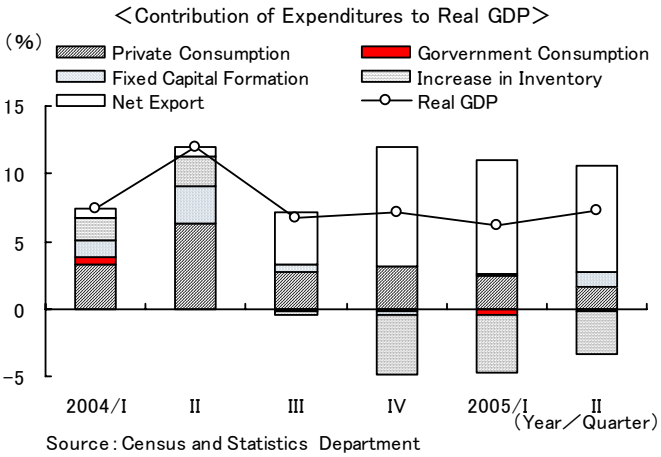
It has been pointed out that any worsening in relations with China, Taiwan's biggest export partner, could adversely affect the economic situation. However, given the fact that popular opinion in Taiwan seems to call for the maintenance of the status quo, it seems highly unlikely that there will be any sudden deterioration in Taiwan-China relations.

(Junya Sano)

Hong Kong *Economic growth expected to slow to 5.4% in 2006*

■ Exports and consumption drive economy to 6.9% growth in 2005

Hong Kong's economy has continued to expand through 2005. Real GDP growth (compared to the same period in the previous year) was 6.2% in Q1, 7.3% in Q2. Quarter on quarter growth was 1.4% in Q1 and 3.4% in Q2 and has been expanding since bottoming out at 0.6% in Q4, 2004.



One of the main growth drivers supporting economic expansion is exports. With the exception of February, when they were down 5.7% because of the Chinese New Year holiday, customs cleared exports have maintained positive growth on the previous year, with particularly large growth in August and September. Initially, there were fears that tougher investment restraints in China, Hong Kong's biggest export partner, would cause a large drop in export volume. However, in the period January to September, China maintained 9.4% economic growth, resulting in solid export performance and pushing up exports overall. Thanks to the increased numbers of visitors to Hong Kong, service exports continue to grow, while import growth is generally lower than that of exports, so it is believed that exports, powered by foreign demand, will continue to grow at a high rate.

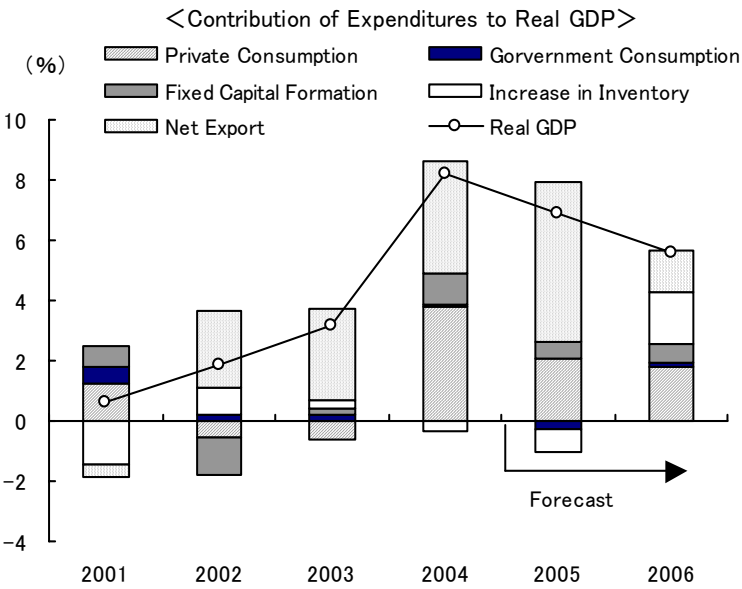
One other important driver of growth is private consumption. Total retail sales have continued to improve, compared to the same month in the previous year, since August, 2003, and other consumption related indices are still performing solidly. Part of the reason for this is the fact that the employment situation has continued to improve since the start of 2005. The unemployment rate for Q3 was 5.5%, 3.1% points lower the peak in mid 2003. Also, stock prices and the real estate market, which had been in general decline ever since the former colony was returned to Chinese rule in 1997, have recently shown signs of recovery. These factors would appear to indicate that private sector consumption may be expected to continue to expand strongly for the time being.

Meanwhile, investments have made very little contribution to economic growth. Though machinery and plant and equipment investments have increased for two consecutive quarters, construction investment has been in decline for an extended period of time, depressing total investment growth. As there are no signs of any new, large scale infrastructure development projects, the prospects of a recovery in construction investment any time soon are very slight.

There are concerns over the possible impact on exports should the price of crude oil continue to spiral upwards over the latter half of the year. Interest rates also have begun to trend upwards, leading to fears that the real estate market will cool down again. However, upward pressures are still as strong as ever and it seems unlikely that the economy will decelerate before the year is out. Given the foregoing, real GDP growth for 2005 is expected to be on the order of 6.9%.

■ 5.4% economic growth in 2006 as boosters fall away

In the first half of 2006, the factors that supported private sector consumption in the previous year may be expected to continue and will be added to the booster effect of the third phase of the Closer Economic Partnership Arrangement (CEPA) with China, which will come into effect from January 1, and economic growth is expected be around 6%. However, once into the latter half of the year, demand in Hong Kong's biggest export partner, China, is thought likely to falter, resulting in a gradual deceleration of the economy. Real GDP growth for the whole year is forecast to be on the order of 5.4%.



Note: Year of 2005, 2006 areJRI forecasts
Source: Census and Statistics Department

In terms of demand items, for private sector consumption, while 1) improvements in the unemployment rate, 2) a recovery in the real estate markets, and 3) recovery in stock prices may be expected to perform as boosters, it is likely that they will gradually fall away. Looking at Hong Kong's unemployment rate over the past five years, the rate bottomed out in the upper 4% range in the first half of 2001 and was similarly low in the autumn of 2005. Given the progress of the China shift and other factors, it is unlikely that the unemployment rate will come down much further. Also, from the beginning of 2005 to early November, the DWBR (discount window base rate) was raised seven times and the market rate of interest, which had been at a fairly low level till now, has begun to drift upwards. As these effects gradually gain strength, it is expected that the real estate market recovery will begin to slacken its pace. Along with these changes in the economic situation, expectations of rising stock prices will gradually fade, leading to a whole year forecast for private sector growth of around 3.4%, compared to the previous year.

As the second phase of construction of airport office buildings gets underway, negative growth in construction investment is expected to contract. Also, from the perspective of avoiding trade friction with China and Europe and the U.S., an increasing number of Hong Kong firms are looking at relocating textile related and other production facilities out of mainland China. Against this backdrop, a resumption of plant and equipment investment in Hong Kong may be expected. The third phase of CEPA will likely also help to encourage corporate investments. On the other hand, the manufacturing industry accounts for only 3.4% of Hong Kong's real GDP and an expansion in plant and equipment cannot be expected to be much of a booster to the area's economy. Forecasts are that gross fixed capital formation will come in slightly below the previous year's level at around 2.8%.

As far as exports are concerned, demand from Hong Kong's main trading partners, China and the U.S., is expected to grow and the beginning of the year will likely see a continuation of the fast growth from the latter half of the previous year. However, as China's investment restraints begin to take effect, not only re-exports to China but all exports are expected to suffer a deceleration. Elsewhere, local exports (accounting for just under 10% of total exports) will probably perform better than in the previous year, as a greater number of items become exempt from Chinese export duties, with the implementation of the third phase of CEPA. However, the contribution of foreign demand is expected to be smaller than in 2005. This is because, mainly in the first half of the year, imports will need to be expanded in order to meet re-export demand, as well as intra-regional demand, causing the net export surplus to contract compared to the previous year. Further, while Hong Kong Disneyland, which opened in September, 2005, has seen fewer visitors than originally anticipated, improvements in service and facilities will likely contribute to an increase in visitors from the Chinese mainland, Japan, and other countries.

Among factors that might adversely affect the economy is the fear of an avian flu pandemic. However, if the lessons learned from the SARS outbreak are put into practice and proper collaboration is conducted with neighboring countries, China in particular, then it would seem unlikely that Hong Kong will suffer the same economic impact as in early 2003.

(Junya Sano)

Thailand 2006 economic growth expected to recover to 5%

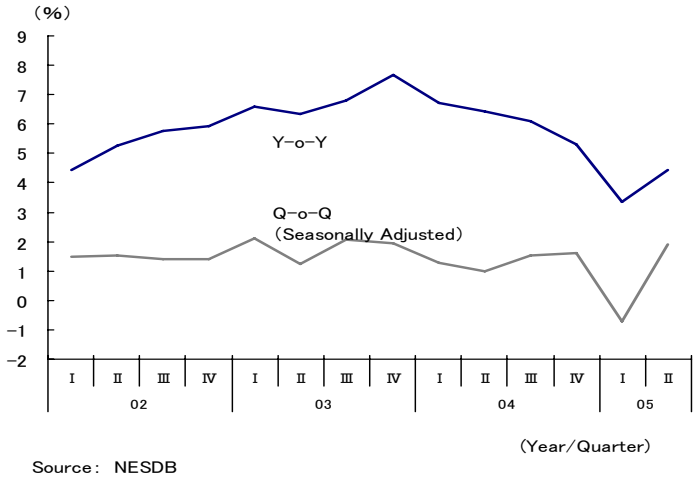
■ 4.1% economic growth in 2005

Thailand's real GDP growth demonstrated a significant slowing of pace in 2005 compared to the previous year, due to the effects of the rising price of crude oil, avian flu, drought and tsunami damage among others, posting 3.3% growth in Q1, compared to the same period in the previous year, and 4.4% in Q2. While the factors of deceleration began to ease somewhat in the latter half of the year, economic growth for the whole year is estimated to be no greater than 4.1%.

On the foreign demand front, exports for January to September were up 14.8%, compared to the same period in the previous year, at $82 billion, but the soaring price of crude oil caused imports to grow by 27.0%, at $89.4 billion, leaving a trade deficit of $7.4 billion, equivalent to 4.5% of GDP. Also, the effects of the tsunami stunted the growth of tourism revenues, resulting in a current account deficit of $5.56 billion for January to September. In August, however, the balance of trade recovered into the black, albeit slightly, and the deficit for the whole year is projected to be around $7 billion. The baht's exchange rate depreciated from 38.6 baht to the dollar on January 1, 2005, to 41.6 baht in July, but as the balance of trade recovered into the black in August, the rate stabilized at 40.7 baht in September.

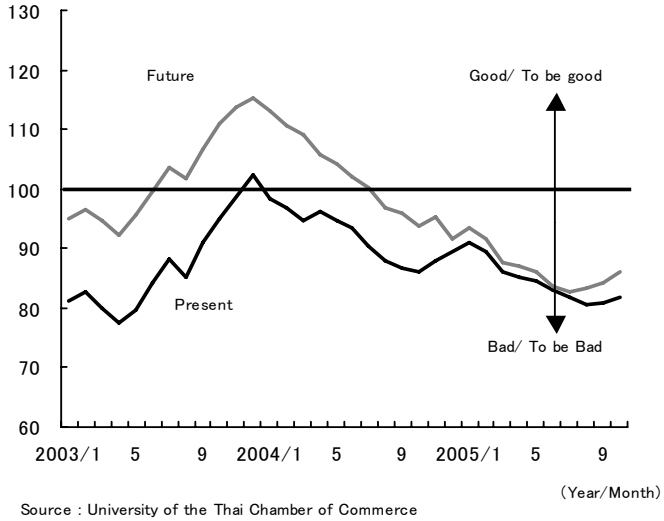
In terms of domestic demand, private sector consumption continued to support the economy, but economic deceleration, rising commodity prices and high interest rates look likely to blunt demand. The consumer confidence index produced by the University of the Thai Chamber of Commerce has been falling significantly since the latter half of 2004, in terms of both the current and future situations. Real private sector consumption growth was a healthy 4.5% in Q1 and 4.7% in Q2, but automobile sales for January to September were 103,000 vehicles (a drop of 32.6%), falling below the previous year's level for the first time since the currency crisis.

<Real GDP Growth Rate>



Source: NESDB

<Consumer Confidence Index>



Source : University of the Thai Chamber of Commerce

In response, the government has implemented a range of economic stimulus measures, such as increasing public officials' salaries by 5% in July, reviewing the minimum wage, raising pension payments, increasing funds for rural investment, and reducing taxes on low income earners, but these have had only limited impact.

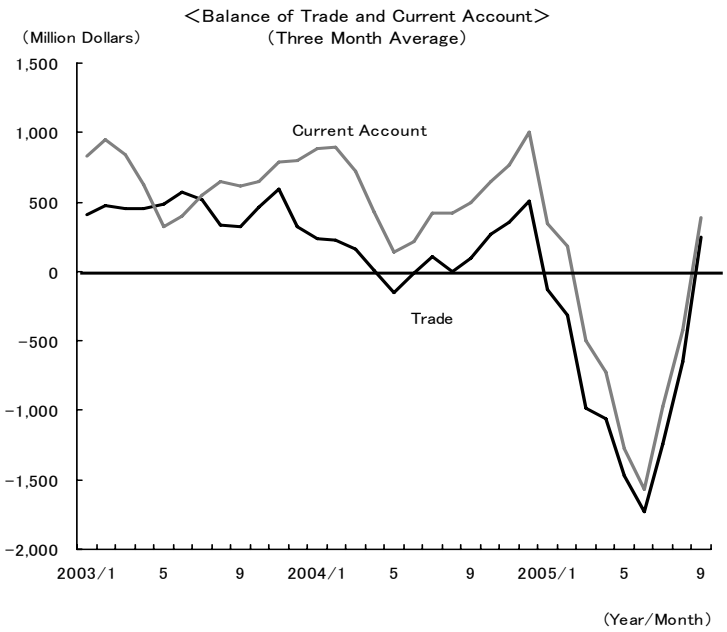
Fixed capital formation maintained double digit growth of 15.1% in Q1, compared to the same period in the previous year, and 14.2% in Q2. Manufacturers' capacity utilization ratios are over 70% and there is every reason to expect new investments. Further, foreign direct investment in January to June was worth $1.4 billion, on an international balance of payments basis, recovering to 3.9 times the value of the same period in the previous year, and for January to July, on a BOI (Board of Investment) approved basis,

was up 26.0%, compared to the same period in the previous year, at $4.8 billion. Investments from Japan accounted for a massive 63.2% of the total, with increased investments in automobile related projects.

■ Growth of almost 5% range in 2006, due to improved foreign demand and mega-project implementation

Economic growth for 2006 is expected to recover to almost 5%, thanks to a recovery in the semiconductor market and expanded investments in the mega-projects.

Though crude oil prices remain high, increased exports of electronic and electrical goods thanks to the recovery in the semiconductor market and expanded exports of agricultural produce due the progress of the FTA mean that the balance of trade is expected to improve gradually. However, increased imports of capital goods and raw materials in the wake of the implementation of the mega-projects and foreign companies coming into Thailand will probably result in a deficit of around $1 billion for the whole year.



Source: Bank of Thailand

In terms of domestic demand, private sector consumption, which has hitherto been a driver of the economy, is expected to slow to the 3% range, compared to the previous year, as a result of rising commodity prices and interest rates. September's consumer's price increase ratio was 6.0%, compared to the same period in the previous year, the highest level since the currency crisis. Bank of Thailand has responded by raising the policy interest rate in gradual steps, since mid 2004. The policy rate has gone from 1.25% in August, 2004, to 3.75% in October, 2.5% points in just over a year. Bank of Thailand appears intent on continuing a financial policy of prioritizing measures to restrain inflation but, if interest rates keep rising, there is every possibility that not only consumption but also investments will be affected.

Coming in for a lot of attention as a potential driver of economic growth in 2006 is the progress of the mega-projects, in which the government plans to invest Bt1.7 trillion (approx. 5 trillion yen) over four years. These projects involve the development of infrastructure essential to improving Thailand's competitive strength, such as the expansion of the mass transit system, including the subway and the expansion of information communication facilities, etc. In his general policy speech to Parliament in March, Prime Minister Thaksin described the last four years as a period of economic recovery and reconstruction, but the next four years as a period of transition to a stable and competitive nation, citing the mega-projects as part of the core of that transition. Some claim that pushing ahead with these mega-projects while the economy is still in an adjustment phase will lead to fiscal and trade deficit, but the government is sticking to its plan to implement the projects under the strictest monitoring. The Ministry of Finance is, in fact, hoping that the mega-projects will perform as an economic growth driver, to the tune of 0.6% growth per annum. Fixed capital formation in 2006 is expected to grow by 14%, year on year, due to increased investments by foreign companies.

Thus, the economy is expected to grow within the 5% range, due to improvement in foreign demand and the implementation of the mega-projects, but increased imports caused by the high price of crude oil and reduced exports of processed foods and tourism revenues as a result of the spread of avian flu are potential growth inhibitors and, as such, need to be paid attention to.

(Keiichiro Oizumi)

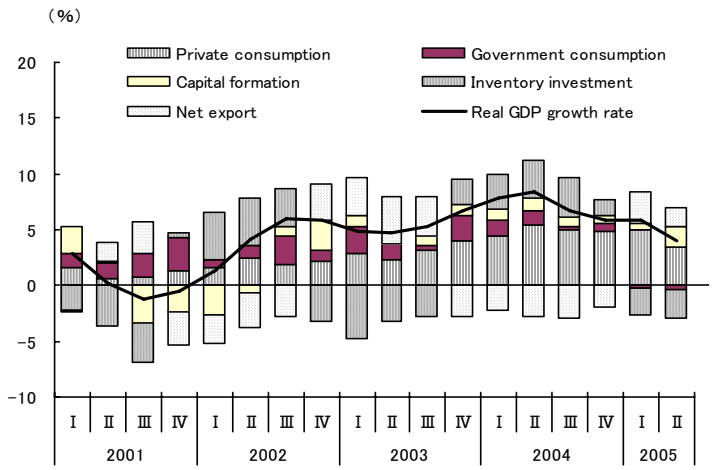
Malaysia *2006 economic growth expected to exceed previous year at 5.5%*

■ 2005 economic growth stuck at 4.6% due to sluggish semiconductor market

Malaysia's real GDP growth rate in 2004 was the highest among ASEAN at 7.1%, but in 2005 slowed to 5.8% in Q1, compared to the same period in the previous year, fell to 4.1% in Q2 and is expected to be around 4.6% for the whole year.

In terms of foreign demand, exports in January to August were up 12.0%, compared to the same period in the previous year, at $9.0 billion. Though stagnation in the semiconductor market stalled export growth of electronic and electrical goods at 8.7%, $35.3 billion, over the same period, the soaring price of crude oil meant that exports of crude oil and other products increased by 14.2%, $55.1 billion. Exports, meanwhile, affected by the slump in exports of electronic and electrical parts and components, could only manage 9.0% growth, $73.7 billion, over the same period, resulting in a trade surplus of $16.8 billion. In terms of the GDP contribution level of demand items, net exports became positive figures in 2005. In terms of export trading partners, exports to the U.S. and ASEAN are posting high growth.

<Contributions to GDP Growth Rate>



Source : Central Bank of Malaysia (Year/Quarter)

Also, tourism revenues posted a surplus of $2.5 billion, taking the current account balance for January to June to $10.2 billion in the black, and the foreign currency reserves at the end of June stood at $79.7 billion, the highest level ever.

<Export by Contries and Regions>

(Million Dollars : %)

	Japan		U.S.A		EU		ASEAN		China		Others		Total	
2000	12,834	(30.8)	20,152	(8.8)	13,426	(1.0)	25,756	(29.7)	3,028	(30.7)	23,032	(10.7)	98,229	(16.1)
2001	11,682	(−9.0)	17,794	(−11.7)	11,959	(−10.9)	21,859	(−15.1)	3,864	(27.6)	20,811	(−9.6)	87,969	(−10.4)
2002	10,449	(−10.6)	19,508	(9.6)	11,551	(−3.4)	24,015	(9.9)	5,265	(36.3)	23,272	(11.8)	94,061	(6.9)
2003	11,222	(7.4)	20,528	(5.2)	12,701	(10.0)	25,849	(7.6)	6,810	(29.3)	27,859	(19.7)	104,969	(11.6)
2004	12,777	(13.9)	23,732	(15.6)	15,891	(25.1)	31,502	(21.9)	8,460	(24.2)	34,148	(22.6)	126,511	(20.5)
2005(1−6)	6,495	(8.0)	12,784	(15.6)	7,801	(4.0)	17,458	(18.8)	4,270	(6.4)	17,851	(10.6)	66,658	(12.2)

Source : Central Bank of Malaysia

As for domestic demand, as a result of increased disposable income, lower unemployment and low interest rates, private sector consumption performed well with 10.1% growth, compared to the same period in the previous year, in Q1 and 7.4% growth, in Q2. Motorbike sales for January to July were up 12.2%, compared to the same period in the previous year, and credit card loans were up 17.5%. The retail and wholesale added value, reflecting the expansion in private sector consumption, was up 7.7% in Q1, compared to the same period in the previous year, and 7.1% in Q2. Private sector growth for the whole year is predicted to be around 7.3%.

Fixed capital formation growth increased from 2.0% in Q1 to 6.7% in Q2. The manufacturing and petroleum sectors did particularly well. Foreign direct investment, which had been in decline since 1999, began to trend gradually upwards, on a balance of payments basis, with an inflow of some $2.1 billion in

January to June. However, growth in construction investment was marginal because, though economic expansion has meant healthy growth in housing investment, public works investments have been restrained in the interests of sound financial health. Fixed capital formation growth for the whole year is forecast at 4.7%.

■ Recovery in foreign demand expected to boost 2006 growth to 5.5%

Industrial production and exports in 2006 are expected to rise, due to a recovery in the semiconductor market, and the real GDP growth rate is expected to be slightly higher than that of 2005 at 5.5%. Also, as an exporter of crude oil, Malaysia has been little affected by the soaring price of crude oil and is expected to be able to maintain its relative stability in 2006. September's consumer price increase ratio was up 3.4% on the same period in the previous year, the highest level in six years, but that level was still the lowest amongst ASEAN. The rises in commodity prices were more to do with increases in tobacco and alcohol taxes and public road tolls than with the high price of crude oil, and are expected to level off again after a while.

Private sector consumption is thought likely to grow by around 6% on the previous year, due to the sustained healthy economy and low interest rates. Meanwhile, as the government has altered its stance to one of accepting a certain degree of fiscal deficit in order to improve competitive strength, investments in public works are expected to increase in the future. Fixed capital formation will probably be around 4% up on the previous year.

As far as foreign demand is concerned, the high price of crude oil and the recovery of the semiconductor market will probably enable exports to continue to grow. Similar to 2005, the trade surplus is likely to continue to be over $20 billion. However, there is still some room for caution as regards how far the recovery in the semiconductor market can contribute to an increase in Malaysia's exports. In particular, attention needs to be paid to the fact that Japanese companies, which have become the mainstay of Malaysia's electronic and electrical equipment production, are beginning expect less and less of Malaysia. According to JETRO's business sentiment index (DI), Japanese companies judge the current economic climate to be 'bad'. In terms of both the current situation and the outlook for the future, the business climate worsened considerably from the end of 2004 and, while it appeared to bottom out mid year, the pace of recovery has been very weak. Also, according to the results of a survey on the overseas business developments of Japanese manufacturers, published by the Japan Bank for International Cooperation (JBIC) in November, 2005, Malaysia's ranking as a prospective site for mid term development fell from 5th place in fiscal 2000 to 10th in fiscal 2004 and, as a prospective site for long term development, Malaysia does not even make the top ten. Further, among electronic and electrical equipment manufacturers planning to reinforce and expand their mid term production bases, against 41.6% who answered so for Thailand, only 20.2% answered so for Malaysia. Rising labor costs and the difficulties of securing suitable staff are current issues and the cheap labor force that had earlier been so attractive to foreign investment is now undergoing a period of change.

2006 sees the start of both the 9th five year plan and Phase Two of Vision 2020 and much attention will be on what kind of development strategies can be worked out by the Abdullah administration, the successors to Dr. Mahatir. The prime minister's September speech on the budget for fiscal 2006 outlined a change from balanced fiscal policy to positive fiscal policy and stated that, in order to promote economic growth, a fiscal deficit equivalent to around 4% of GDP was acceptable. In the same speech, the prime minister laid out specific development strategies: 1) the vitalization of the economy through the promotion of infrastructure utilization, 2) improvements to the business environment, centered around preferential tax treatment and the development of the capital market, 3) development of human resources through the provision of education and training systems, and 4) improvements in the people's standard of living with respect to hygiene and the environment. The aim now is to make a switch away from the traditional electronics and electrical product manufacturing-centered industrial structure to a new structure comprising finance, IT related, biotechnology and service industries, and plans call for the fostering of related small and medium sized enterprises and the development of their human resources. The creation of a new Malaysia will be the test of Prime Minister Abdullah's mettle.

(Keiichiro Oizumi)

Indonesia *Rising fuel prices blunt individual consumption*

■ 5.5% economic growth forecast for 2005

Indonesia's real GDP grew by 5.9% in January to June, 2005 (6.2% in Q1, compared to the same period in the previous year, and 5.5% in Q2, similarly). In the latter half of the year, a major increase in fuel prices led to poor business results and a blunting of consumption, and real GDP growth rate for the whole of 2005 is expected to be on the order of 5.5%.

<ECONOMIC GROWTH>

(Trillion Rupiahs,%)

	2003	2004	Growth Rate	Jan-Jun 2005	Growth Rate	Share
Private Consumption Expenditure	956.6	1,003.8	4.9	513.2	3.3	59.4
General Gov. Consumption Exp.	121.4	123.8	2.0	55.2	-7.0	6.4
Gross Domestic Fixed Captital Formation	310.8	359.6	15.7	194.0	14.1	22.4
Change in Stock	-4.7	40.0	-948.8	24.4	-35.7	2.8
Statistics Discrepancy	16.7	11.0	-34.3	19.1	0.0	2.2
Export of goods and services	612.6	664.5	8.5	345.2	10.3	39.9
Import of goods and services	433.8	542.0	24.9	286.8	12.7	33.2
GDP	1,579.6	1,660.6	5.1	864.3	5.9	100.0
Agriculture,Livestock,Forestry & Fishery	243.1	252.9	4.0	129.9	0.3	15.0
Mining and Quarrying	168.4	160.7	-4.6	78.2	-0.9	9.0
Manufacturing Industry	441.8	469.1	6.2	245.6	6.9	28.4
Electricity, Gas and Water Supply	10.4	11.1	6.7	5.9	7.7	0.7
Construction	90.1	97.5	8.2	50.6	7.4	5.9
Trade, Hotel and Restaurant	256.3	271.2	5.8	144.0	9.7	16.7
Transport and Communication	85.0	95.8	12.7	52.1	13.5	6.0
Financial,Ownership & Business Services	140.1	150.9	7.7	80.1	8.2	9.3
Services	144.4	151.4	4.8	78.4	4.6	9.1
GDP WITHOUT GAS	1,423.9	1,511.8	6.2	793.9	7.0	91.9

Note: Constant price year 2000
Source: BRS

Viewing GDP for January to June, 2005, in terms of demand items, while fixed capital formation grew quickly at 14.1% in that period, private sector consumption, accounting for some 60% of the total, could only manage 3.3% growth. Though exports posted outstanding growth, thanks to the high price of crude oil, imports of petroleum products have also increased, reducing the contribution of foreign demand. On the supply side, the manufacturing industry, accounting for 30% of the total, grew at a healthy 6.9% over the same period, and the service industries, such as trading, hotels and food and drink, etc., were all solid. In contrast, agriculture and fisheries could only manage a very poor 0.3% and mining, where the development of new mining areas is far behind schedule, posted a lackluster 0.9%.

From October, several elements of instability became more pronounced and the almost two year old Yudhono administration is facing its toughest time yet. First were the effects of the terrorist attacks on the island of Bali in October. Though no great fluctuation was witnessed in exchange and stock prices and the impact on foreign investment attraction is expected to be limited, the service industry will inevitably suffer as the numbers of tourists decline. Second is the spread of avian flu. The government has introduced a number of measures, such as designating Jakarta an 'extraordinary case region' at the end of September. On the other hand, it has become clear that the authorities have been suppressing information and there is growing unease over the spread of the disease. Third, as energy subsidies have been slashed, fuel prices have gone up. From October, the government almost doubled the controlled prices of gasoline and other petroleum products. Originally, given the likely impact on the poor, it had been expected that the range of price hikes would be around 50%, but the eventual increase turned out to be a lot more drastic than most had imagined. Though these measures will have had a certain degree of success in protecting the rupiah, the consumer price increase ratio for 2005 is projected to reach 14% and Central Bank has begun reinforcing tight monetary policies.

The raising of fuel prices is having a deep impact upon the economy. Individual consumption, which was already in decline, will inevitably fall further as interest rates go up. While sales of automobiles and motorbikes for January to September were up 26.1% and 34.4% respectively, compared to the same period in the previous year, these figures represented a drop of about 50%, compared to the previous year's figures. In addition, corporate performance figures have declined noticeably and concerns are increasing over the worsening employment situation and the increase in non-performing loans. In the textile and other industries, weakened by competition from Chinese products, over 100,000 people are expected to be laid off. In October, Central Bank revealed that the non-performing loan ratio had increased to 9.38%, a sudden jump from 5.75% the year before.

According to private sector polls, support for President Yudhono has fallen from an initial 79% to 52%. However, foreign direct investment (approved basis) for January to September performed well, growing at 27.9%, compared to the same period in the previous year. Though the president still enjoys a good reputation abroad for his mid to long term perspective on reform, it is vitally important that the

administration achieve tangible results in addressing employment and standard of living issues at home.

■ 5.5% economic growth forecast for 2006

The government is sticking to its somewhat optimistic forecast of 6.2% economic growth. However, in October, Central Bank revised its forecast downwards from 6.1% to 5.9%. According to interviews with the bank's economists, many of them forecast growth of between 5.1 and 6.0%. Investments are strong and healthy and consumption is expected to begin to recover from the latter half of the year, leading to our forecast that economic growth in 2006 will be 5.5%, the same as the year before.

＜Forecast for 2006 ＞

(%)

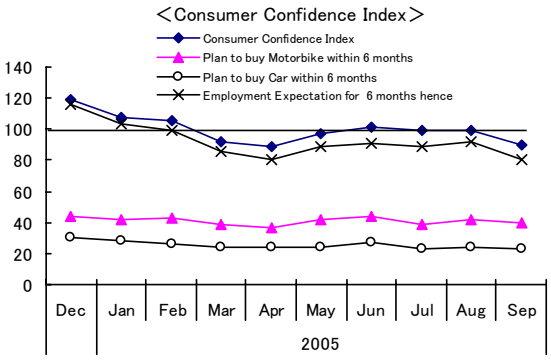
	Survey in 2005		
	1st Q	2nd Q	3rd Q
GDP Growth Rate	5.1～6.0	5.1～6.0	5.1～6.0
Inflation	6.1～7.0	6.1～7.0	7.1～8.0
Exchange Rate	8,501～9,000	9,001～9,500	9.501～10,000
Unemployment Rate	9.1～10.0	10.1～11.0	10.1～11.0

Source: Bank Indonesia,Market Perception Survey covers 94 respondents including economists,researchers and analysits.

Fuel subsidies have not been completely abolished; there are still electricity subsidies. The 2006 fiscal deficit is expected to grow to 1.1% of GDP, up from 0.9% the previous year, so there is a possibility that there will be further fuel and electricity price hikes in anticipation of the complete abolition of fuel subsidies.

However, it is expected that fuel prices will be raised to around the same levels as those of neighboring countries and that electricity charges will rise by only a small margin, so that the consumer price increase ratio will likely be no greater than 8%. If structural problems such as the swelling of the fiscal deficit and gradual depreciation of the rupiah, both caused by the high price of crude oil, were addressed, it would serve to promote stable economic growth.

Domestic demand will likely continue to be a driver of economic growth. Central Bank will continue its policy of monetary restraint throughout the first half of the year, and individual consumption is expected to decelerate. Forecasts for automobile sales in 2006 range from the conservative, which say that the figures will fall below 2005's levels, to the more optimistic who expect year on year growth of 10 to 15%. The consumer sentiment index for September, taking into account the fuel price hikes, was down to 90.1 points (where 100 points indicates equal numbers of respondents indicating 'optimistic' and 'pessimistic') 9.6 points down from the previous month. However, as figures showing intended purchases of automobiles and motorbikes over six months do not indicate any major slump, it would appear that consumption will recover as prices stabilize and expectations are that consumption for the whole year will exceed the previous year's levels.



Note: Survey of 4,350 households. The index over 100 more means "positive" answers superior than "negative" ones.
Source: Bank Indonesia, Consumer Survey

It is believed that investments will continue to perform strongly. Amidst growing calls for handling procedures, etc., to be simplified, in order to offset the increased costs that follow fuel price hikes, it is expected that improvements in the investment environment will be pushed ahead. Though credit risk will increase as interest rates and non-performing loan ratios rise, Central Bank has indicated that it is prepared to tolerate some delay in the clearing of non-performing loans, so that their impact on corporate financing will probably be limited.

Meanwhile, as the production of crude oil continues to lag behind, due to old and failing plants and equipment among other factors, the contribution of foreign demand to economic growth will likely contract even further. Exports of natural gas are doing well, but crude oil imports are expected to exceed exports and, as imports of petroleum products have increased rapidly, the outlook is that Indonesia will have converted to being a resource importing nation in 2005. Indonesia needs to update its provision for the investment environment and promote export oriented foreign direct investment, leveraging its cheap labor force and natural resources. It will be necessary for the government to reduce the burden on companies by addressing issues such as the fact that wages are rising higher than labor productivity and that it is almost impossible to dismiss employees.

(Yuji Miura)

Philippines 2006 growth expected to come in slightly under Previous year's level, at 4.7%

■ Real GDP projected to grow 4.8% in 2005

The Philippines' real GDP growth was stuck at 4.7% in January to June, 2005, compared to the same period in the previous year (4.6% Q1, 4.8% Q2). Among the main causes have been rising consumer prices caused by the soaring price of crude oil, poor export performance, and poor growth in the agricultural sector due to climactic conditions.

＜Real GDP by Expenditure Shares＞

(compared with the same quarter of last year、%)

	2004/Q1	2004/Q2	2004/Q3	2004/Q4	2005/Q1	2005/Q2
Real GNP	6.3	7.4	5.7	5.5	4.8	4.7
Real GDP	6.3	6.5	6.2	5.3	4.6	4.8
Personal Consumption	5.7	6.3	5.5	5.7	5.0	4.9
Government Consumption	4.1	−1.2	−7.2	5.6	0.6	13.2
Fixed Capital Formation	5.0	3.9	3.6	4.3	−4.4	−1.4
Exports	11.6	16.1	17.1	11.2	3.4	1.1
Imports	4.5	6.8	6.6	5.8	−3.5	1.5

Source：National Statistical Coordination Board

The economic slowdown is projected to continue throughout July to December. This is because, in spite of positive factors such as a recovery in agricultural production and a healthy increase in monies being transferred home by Filipinos working abroad, the rising price of crude oil has caused consumer prices to increase by a very large margin and this is expected to have a deep impact on personal consumption. There are also fears that rising production costs will curb the activities of the industries such as manufacturing, construction and electricity, gas and water. Central Bank raised the policy interest rate by 0.25% points in April, for the first time in 21 months. In late September, the interest rate was raised a further 0.25%, following a similar U.S. interest hike, and the overnight borrowing interest rate became 7.25% and the lending rate 9.50%. These measures were necessary in order to cope with the rising price of crude oil and the decrease of interest differential with the U.S. and, for the time being, monetary restraint is likely to continue. The government insists that 5.3% economic growth for the whole year is achievable, but the price of crude oil has risen higher than anyone expected and 5.3% will be a difficult target to achieve.

The real GDP growth rate for 2005 is expected to be around 4.8%. In the period January to June, personal consumption growth stopped at 4.9%, compared to the same period in the previous year, due to the rise in consumer prices and poor growth in agricultural produce. In the future, in addition to soaring prices, political instability and the raising of the value added tax (VAT), among other factors, will likely severely impact consumer sentiment and personal consumption growth is expected to be rather poor. Government consumption for January to June, boosted by increased current expenditure, grew 7.1%, but is likely to be restrained, looking forward, as the fiscal deficit remains as serious as ever.

Fixed capital formation growth was – 2.9% in the period January to June. Poor export performance and political instability, etc., caused investor sentiment to cool and, along with a significant slump in durable equipment investment, construction investment growth has also lost its edge. Looking ahead, a gradual recovery in exports is expected, so some slight improvement in fixed capital formation may be looked forward to.

Export growth was limited to 4.6% in January to July, compared to the same period in the previous year, due to the global decline in demand for electronics products. Electronics related exports, which account for two thirds of the total, could only manage 2.4% growth in the same period. Semiconductors grew by 10.7%, but other products contracted by about 15%. Clothing exports, too, peaked at 1.4% growth. In the future, there is expected to be a recovery in demand for electronics goods, so the export growth rate will likely improve a little. Meanwhile, as regards imports, growth was -1.7% for January to July. Imports of consumer goods, such as crude oil and foodstuffs, etc., are growing, but imports of export related capital goods and intermediate goods have slumped. If there is indeed a recovery in exports in the future, then imports will probably grow too.

The consumer price index was up 7.9% for January to September, compared to the same period in the previous year. The rising price of crude oil has brought higher prices for fuel and other petroleum related products, as well as higher electricity charges and public transport charges, and the impact is still widening. In June, 2005, Central Bank raised its forecast of the consumer price index growth rate from

the original 7.1 to 7.3% to 7.9%. In September, the growth rate fell to 7.0%, compared to the same month in the previous year, but the price of crude oil remains high and, as the effects of the value added tax hike make themselves felt, the consumer price index growth rate may well go up again.

■ Real GDP projected to grow 4.7% in 2006

The real GDP growth rate for 2006 is expected to be 4.7%. The global economy is forecast to grow at around the same rate as the previous year, but the concern is that crude oil prices will stay high. As the Philippine economy is greatly affected by the movement of crude oil prices, its growth is likely to suffer.

＜Main Economic Indicators＞

（YoY、%）

	2003	2004	2005	2006
Real GDP	4.5	6.0	4.8	4.7
Agriculture	3.2	4.9	2.0	3.0
Industry	3.6	5.2	4.2	4.7
Services	5.8	7.1	6.4	5.4
Personal Consumption	5.3	5.8	4.6	4.4
Government Consumption	2.6	0.0	3.5	3.0
Fixed Capital Formation	2.3	4.2	1.5	3.5
Exports（in US Dollars）	2.9	9.3	6.0	7.0
Imports（in US Dollars）	6.0	9.2	3.5	6.5

Notice：forecasts for 2005 and 2006
Source：NSCB and others

In terms of expenditure shares, growth in personal consumption will likely be slightly lower than that of the previous year. With the new taxation system introduced in November, the applicable range of VAT has been extended and the rate itself raised from 10% to 12%. Also, from 2006, corporate income tax will be raised from 32% to 35%, as a three year time limited measure. In addition to these increased taxes, there are fears that the consumer price index will stay high, curbing personal consumption. However, money sent home from Filipinos working abroad will likely continue to perform well and this will be one factor supporting consumption. As the reduction of the fiscal deficit continues to be a priority issue, government consumption will probably not grow by very much.

As far as fixed capital formation is concerned, since there is little hope of any expansion in public works investment, it is expected that construction investment growth will be restrained. On the other hand, durable equipment investment will likely grow at a faster pace, encouraged by a recovery in exports. However, there are many areas of concern, such as the high price of crude oil and political instability, making it difficult to hope for any substantial improvement in investment sentiment, and recovery is likely to be mild at best.

The recovery in demand for electronics goods is expected to continue, leading to forecasts that exports will grow at around 7.0% compared to the previous year. As the price of crude oil remains high, imports of consumer goods are healthy and imports of raw materials and intermediate goods are expected to grow as exports increase, import growth is projected to be around 6.5%.

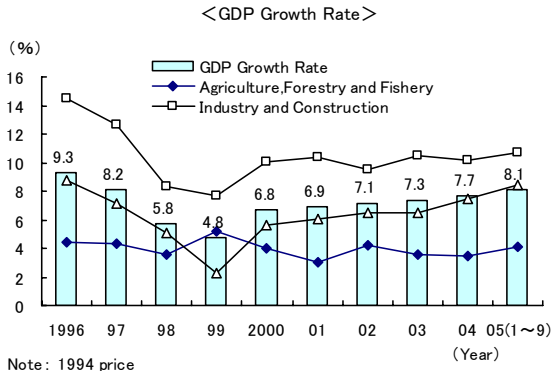
The risk factors affecting economic growth are, first, external factors such as U.S. interest rates, the price of crude oil, the Chinese economy, etc. The Philippines is dependent upon imports for 96% of its oil demand, and the value of its oil consumption as a percentage of GDP is around 2.4 times that of the industrialized nations. If the price of crude oil goes up any further, consumer prices and interest rates will also need to go up and the economic growth rate will likely fall significantly.

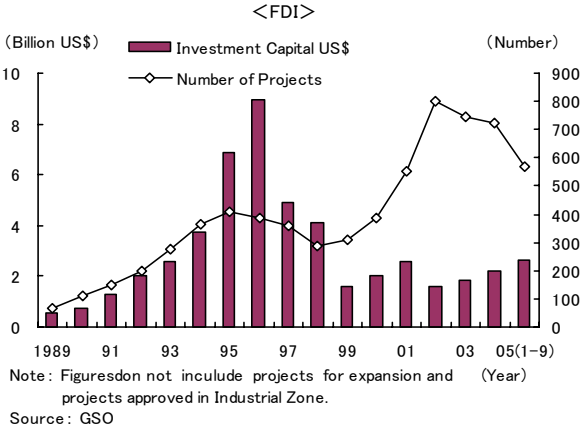
The second factor is the size of the fiscal deficit. The fiscal deficit for 2005 is expected to come in at 160 billion pesos, slightly under the target 180 billion pesos. However, much of this is accounted for by spending cuts, and tax revenue growth still lags behind. Also, government debt, including contingent liabilities, reached 112% of GDP by the end of 2004. Therefore, it has become imperative that the taxation system be reformed and that the privatization of government controlled enterprises get underway.

Third, there is political instability. As a result of suspicions of unfairness in the presidential elections of May 2004 and accusations of corruption among the president's relatives, there were growing calls for her resignation. However, a motion to impeach her was defeated in the House of Representatives in September. Subsequently, a constitutional amendment to transfer from presidential rule to a unicameral parliamentary-style republic is being debated. As to whether such a change could be realized and, if it were, when would general elections take place and what would happen to the incumbent president's term of office, among other questions, there is much that is uncertain about the political situation. It is to be expected that this will fuel social unease and have an adverse impact on the economy.

(Satoshi Shimizu)

Vietnam *High growth level sustained by expanded domestic demand*





■ 8.4% economic growth in 2005

Vietnam's real GDP grew by 8.1% in the period January to September, 2005. The growth rate in Q2 was 8.9%, exceeding Q1's 7.6%, and is expected to continue to grow, resulting in a forecast of 8.4% real GDP growth for 2005, exceeding the previous year's 7.7%.

Considering GDP growth for January to September, 2005, from the supply side, the manufacturing and service industries performed well, growing by 10.7% and 8.4%, respectively, compared to the same period in the previous year. Reflecting rising prices for main export items such as rice and coffee, etc., on the international markets, agriculture and fisheries also posted solid growth at 4.1%. Private sector businesses supported the high growth in the manufacturing industry. Manufacturing industry statistics for January to September show that the fastest growing sector was the private sector (up 24.8%, compared to the same period in the previous year), followed at some distance by the foreign sector (up 17.2%, similarly) and the state controlled sector (up 9.6%, similarly). As a result, the state controlled sector now accounts for only 35.5% of industrial production, and the foreign sector 36.1%.

As regards trade in January to September, exports were up 21.1%, compared to the same period in the previous year, at $23.5 billion, and imports up 19.2%, similarly, at $27.4 billion. Exports of natural resources such as crude oil and coal, secondary products such as rice and coffee, and also electronic parts and components have been healthy, with over 30% growth in each case, compared to the same period in the previous year. Electronic parts and components have been supported by direct investment from Japan and are expected to become a major export item. On the other hand, exports of marine products and footwear and textiles have suffered from anti-dumping legislation and tougher competition from Chinese products, and could only manage 4.4% and 13.1% growth, respectively, in the same period.

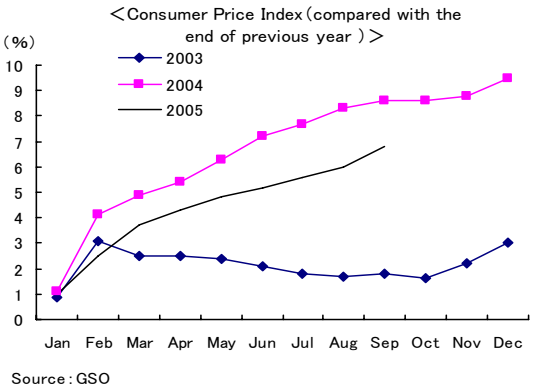
In terms of direct foreign investment (approved basis) in January to September, there were 570 applications, worth $2.64 billion, a 63.2% increase in monetary terms, compared to the same period in the previous year. Given that there are several projects with a total value of around $1.5 billion waiting approval, such as a Taiwanese stainless steel production project (investment worth: $700 million), a Korean urban development project ($300 million), a U.S. hotel construction project ($300 million) and a Hong Kong optical fiber project ($180 million), the government is expecting a gradual recovery in foreign direct investment.

Japanese investment is in fifth place at the moment, but there is growing interest in Vietnam as an investment destination, due to the growing risk of doing business with China, following the revaluation of the renminbi, electrical power shortages, rising wages and anti-Japanese demonstrations and so on. Vietnam's cheap labor force and political stability are being reassessed as several large electronics parts and components manufacturers decide to invest in the country.

The consumer price increase rate for January to September rose by 6.8%, continuing to rise at a fast pace. This was because of the increase in fuel and fertilizer costs, pushed up by the high price of crude oil, and the government forecasts that the increase rate for the whole year will top 8%. However, interest rates rose by only a small margin and the impact upon consumption and investment is expected to be limited. Turnover in the finance and services sector for January to September was up 19.8% compared to the same period in the previous year, with automobile sales up 11% similarly, at 25,000, and

motorbike production up 14.7%, similarly, at 1.32 million.

■ 8.2% economic growth forecast for 2006



Economic growth for 2006 is expected to be slightly lower than that of the previous year at 8.2%. Domestic demand will be the main growth driver. Domestic private sector companies and foreign direct investment are expected to continue strongly. Rural areas are competing to attract not only foreign direct investment but also private sector investment and there are likely to be further improvements in the business environment. Whereas investments by state controlled enterprises in large businesses under the direct control of central government are likely to continue strongly, investments in small and medium sized enterprises under the control of local government will probably continue to lag behind, suffering the effects of increased competition, stronger restrictions on new corporate investment, and the advance of privatization.

If fuel prices do not rise much further, consumption is expected to continue to grow strongly. In August, 2005, the government decided to raise the price of gasoline 1,200 dong up to 10,000 dong per liter. This was the third price hike since the start of 2005, marking a 47.1% increase within one year. However, fuel prices have reflected the movement of prices on the international market, with small increments, and given the slow pace of motorization and the gradual pace of price increases, the impact on consumption is thought likely to be limited. In fact, there is more concern over the possible impact of the stagnating real estate market on consumption. Amendments to the Land Law will restrict speculative land acquisitions and there are growing concerns that this will cause real estate prices to plummet.

In terms of foreign demand, both exports and imports are forecast to grow at roughly the same pace and are, therefore, not likely to contribute substantially to economic growth. The Minister for Trade and Industry has set an export target of 15.0% growth compared to the previous year, at $36.5 billion. Vietnam's accession to the WTO (World Trade Organization) is expected to be realized in 2006, leading to forecasts of an improvement in the export environment. The achievement of the export target will depend on how much growth there is in the exports of such items as textiles and footwear, marine produce, electronic parts and components, and wooden products. However, of these, textiles and footwear and electronic parts and components depend almost entirely on imports of raw materials, so an increase in exports will also entail an increase in imports. Also, as there are forecasts of anti-dumping legislation in the European and U.S. markets, tougher competition from Chinese products and a reduction in crude oil production, there is little room for optimism with regard to expanded foreign demand.

Electrical power shortages are likely to be a factor restricting economic growth. In particular, the power shortage is expected to worsen between March and June, when the water level at the Hoa Binh hydroelectric power plant in the North falls. During the same period in 2005, Hanoi experienced intermittent power cuts. According to government estimates, even if the current construction of power stations continues as planned, power shortages will continue until 2010.

In addition, the widening income gap is becoming more and more serious. According to a household survey carried out by the government, while the ratios of poor people as part of the population of the Red River Delta, including Hanoi, and the southeast, including Ho Chi Minh City have fallen, many households in the northeast region bordering China and the north central region are still below the poverty line, indicating that the income differences between regions and socio-economic classes are expanding rapidly. A comparison of the average household incomes of top 10% and the bottom 10% showed that the gap was around 10.6 times in 1996, 12 times in 1999, 12.5 times in 2001 and 13.5 times in 2004. In terms of regions, the income gap between the top 10% and the bottom 10% is as much as 14.4 times in the southeast. This is due to the growing numbers of poor in the cities as a result of the population drift from rural communities into the cities, and the failure of incomes to grow among ethnic minorities. The Gini coefficient, which illustrates income distribution inequality, etc., was 0.413 in 2004.

(Yuji Miura)

India 7.0% economic growth expected to continue through fiscal 2006

■ Real GDP growth 7.2% forecast for fiscal 2005

The real GDP growth rate for fiscal 2004 (April, 2004, to March, 2005) came in below fiscal 2003's 8.5% at 6.9%, held back by a slow 1.1% year on year growth in the agricultural sector. Growth in Q1, 2005, was a high 8.1%, compared to the same period in the previous year. Despite the agricultural sector's continued failure to grow more than 2.0% in that period, the manufacturing sector led industry to 9.7% growth, and services grew 9.8%, led by trade, hotels, transportation and communications. As a result, growth exceeded earlier forecasts by around 1% point. In late October, Central Bank revised its economic growth forecast for fiscal 2005 upwards from 7.0% to 7.5%.

Real GDP is expected to grow by around 7.2% in fiscal 2005. A shortage of rainfall caused wheat production to fall, resulting in continued poor growth in the agricultural sector. However, rainfall volume returned to normal between June and September and reservoir levels have improved greatly, compared to the previous fiscal year. As a result, production of rice, corn, sugar cane, etc., is expected to recover.

The index of industrial production for April to August was 8.8% up on the same period in the previous year. Reflecting strong investment demand, capital goods were up 11.8% and consumer non-durable goods such as food and drink were up 15.1%. The business confidence index is at its highest level in the past ten years, indicating that businesses are extremely optimistic about the economy. Although there are risk factors involved, such as the movement of the price of crude oil, for the time being, it is expected that corporate investments and production activities will still continue to perform strongly.

In the services sector, trade, hotels, transport and communications are growth drivers. Part of the background to this has been the increase in tourist numbers, healthy growth in air, railroad and aquatic transportation and a 53% increase in mobile telephone subscribers at the end of August, compared to the same month in the previous year, to around 49 million people. Finance, insurance, real estate and business services enjoyed the benefits of the growth in IT related services and increase of bank loans and posted high levels of growth. These trends are expected to continue for a while and the services sector overall will likely continue to perform solidly.

Exports and imports are expected to perform with double digit growth in fiscal 2005. Clothing, automobile parts and components and chemical (pharmaceutical) products are the mainstays of exports, and IT related service exports are also maintaining robust growth. Exports for April to August were up 23% compared to the same period in the previous year, and imports were up 37%, similarly. Crude oil and other petroleum products account for just under 30% of all imports and the increase in the price of crude oil is encouraging the trade deficit, which has become noticeable of late, to grow even further.

From fiscal 2004 onwards, the government has reduced tariffs and excise taxes on crude oil and petroleum products, in an effort to lessen the impact of the rising price of crude oil. Also, rises in the domestic retail prices of petroleum products have, so far, been limited, so the wholesale price increase ratio has remained low. However, in June and September, the prices of gasoline and paraffin, for example, rose by between 7 and 8%. In late October, the policy interest rate was raised 0.25% for the second time this year, and there are fears that this will hold down economic growth.

＜Real GDP Growth Rate＞

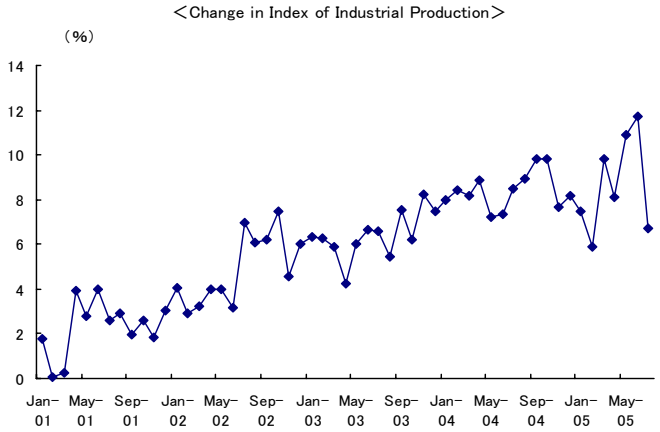
(compared with the same quarter of last year、%)

	2003/Q1	2003/Q2	2003/Q3	2003/Q4	2004/Q1	2004/Q2	2004/Q3	2004/Q4	2005/Q1
Real GDP Growth	5.5	8.8	11.0	8.4	7.6	6.7	6.4	7.0	8.1
Agriculture,etc.	0.1	7.2	18.2	10.4	3.8	0.0	−0.5	1.8	2.0
Industry	5.8	6.4	6.4	7.7	7.1	8.2	8.8	6.7	9.7
Mining and Quarrying	4.5	4.1	5.9	10.7	6.9	4.7	4.5	2.5	3.2
Manufacturing	6.1	6.9	7.0	7.6	7.9	9.6	10.5	8.6	11.3
Elec., Gas & Water Supply	3.0	1.1	3.0	7.6	6.1	9.1	4.4	2.6	7.9
Construction	6.6	8.4	6.5	6.6	5.0	4.6	7.2	4.1	7.9
Services	7.8	10.7	9.9	8.0	9.5	8.1	8.9	9.3	9.8
Trade, Hotel, Trans., Commun.	8.0	10.4	13.5	14.6	11.5	12.3	10.8	11.1	12.4
Finance, Insurance, Real Estate, etc.	6.4	7.2	7.3	7.6	7.0	5.5	8.2	7.7	8.3
Social, Personal Services, etc.	9.0	14.9	5.2	−2.9	8.2	3.0	5.6	7.2	6.1

Notice:Q1 : Apr.—Jun., Q2 : Jul.—Sep., Q3 : Oct.—Dec., Q4 : Jan.—Mar.
Source: CMIE

■ Real GDP expected to grow 7.0% in fiscal 2006

Real GDP is expected to grow by around 7.0% in fiscal 2006. The agriculture sector is affected by the rainfall, so accurate forecasts are difficult, but there are high possibilities that industry and the services will continue to perform strongly. Therefore, unless there is a serious drop in agriculture sector growth, the forecast growth rate should be achievable.



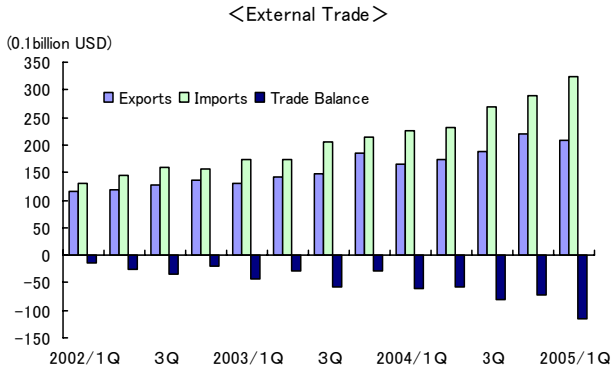
Source: CMIE

Stability in the agricultural sector is a major issue. The agricultural sector accounts for around 20% of real GDP, but around 60% of employment. For that reason, fluctuations in agricultural production greatly affect economic activity. Only 40% of arable land is properly irrigated, so the relationship between rainfall and agricultural production is extremely close. At the meeting of the State Development Committee in June of this year, Prime Minister Singh decided to make a plan to double agricultural production by increasing funding, improving production technology, diversifying crops, etc. If the plan is realized, it should contribute significantly to the stabilization of agricultural production.

The positive factors for the Indian economy in fiscal 2006 will likely be 1) the government's plans to implement large scale infrastructure development plans over four years, from fiscal 2005, 2) a robust corporate future outlook and expectations of accelerated private sector investment, and 3) expectations of progress in the easing of restrictions on economic activity. The infrastructure development plans will encourage direct investment and, therefore, from the perspective of investment climate, have an important role to play.

The IMF has stated that India now has the opportunity to realize continuous high growth. The reasons it gives include 1) high capacity utilization rates and strong capital goods demand, which indicate a strong possibility that private sector investment will accelerate another notch, 2) the deepening integration with the global economy, which is causing trade to expand rapidly, and 3) an increase of the Indian labor force of around 100 million people over the next ten years. However, preconditions to the realization of a high level of economic growth include the advancement of structural reform, such as opening markets to foreign participation and relaxing restrictions, as well as reducing the fiscal deficit.

Meanwhile, the biggest risk factor facing the Indian economy is probably the movement of the price of crude oil. The value of Indian oil consumption has more than trebled in the last 20 years, and some 75% of that depends on imports. According to calculations by the Asian Development Bank, if the price of crude oil continues at around $70 per barrel till the end of fiscal 2006, the economic growth rate will probably fall by a maximum of 1.1% points, compared to a price of $53 per barrel over the same period. Central Bank has increased its sense of vigilance towards increasing inflationary pressures resulting from the upward movement of the price of crude oil. Interest rates have been raised three times since October, 2004, and the Bank will likely continue a tight monetary stance, in the future. Also, India's energy consumption value as a percentage of GDP is over three times that of the industrialized countries and this kind of inefficiency will need to be addressed over the mid term.



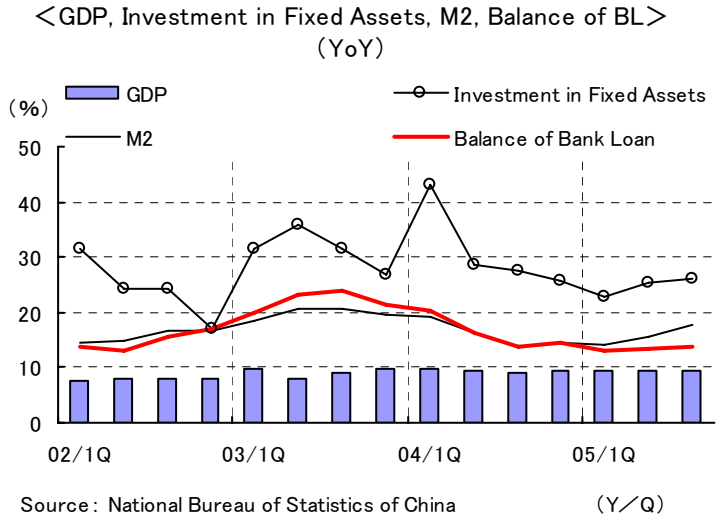
Notice: Quarters are based on fiscal year.
Source: CMIE

(Satoshi Shimizu)

China Economy likely continue to grow at close to 9% in 2006

■ 2005 real GDP grows at sky high 9.3%

China's real GDP maintained its high growth rate, up 9.4% in January to September, compared to the same period in the previous year. Investments, consumption and foreign demand are all on the increase and the government's investment restraint measures appear to have had only limited effect. Real GDP growth for the whole year is expected to be 9.3%, compared to the previous year.



First, as regards investments, total social fixed asset investments are predicted to grow by 25.6% on the previous year, continuing at the same high level as 2004. Following on from iron and steel, cement and other basic materials in 2004, the restraining of real estate investments became the priority issue for 2005 and, between March and May, the government implemented a series of measures, such as levying an added tax on real estate sales and prohibiting the rotating sales of real estate. However, total social fixed asset investments grew by 26.1%, compared to the same period in the previous year, 27.7% in the cities, and went from strength to strength from July onwards. Real investment growth was only slightly down, at a still high 22.2% for the same period. Part of the reason for this has been investment promotion activities by local governments, extra large scale infrastructure development projects for coal and electrical power, following energy shortages, and increased real estate investment in some regions.

Meanwhile, the retail turnover for January to September was up 13.0%, compared to the same period in the previous year, 14.0% in the cities and 11.0% in rural areas. The real growth rate in the rural areas was 9.4% in the same period, 4.2% points higher than the growth rate in the same period in 2004. A series of agriculture promotion policies implemented by the government, including tax reductions for agriculture workers and extra subsidies for food production, have helped the per capita disposable income in rural communities to increase by 11.5% in January to September, compared to the same period in the previous year, topping the same increase in the cities (9.8%) and contributing significantly to consumption expansion.

In terms of foreign demand, January to October exports were up 31.1%, compared to the same period in the previous year, at $614.5 billion, and imports were up 16.7%, similarly, at $534.1 billion, causing the trade surplus to soar to $80.4 billion. Exports mainly by foreign companies are continuing to perform strongly and this and the rising prices of iron and steel and petroleum products are among the main reasons for the rapid growth in exports. In January to October, exports of iron and steel, finished petroleum products and automobile parts and components grew 88.1%, 77.7% and 54.0%, respectively, compared to the same period in the previous year. In contrast, the sluggish growth in imports has been caused by companies turning to the domestic supply of raw materials, due to overproduction and the rising prices of raw materials, and the continuing growth failure of automobile sales, among other things.

■ Real GDP growth for 2006 will be close to 9%

In 2006, while individual consumption and foreign demand will continue to expand, fixed asset investment growth will decline, leading to forecasts of a slightly lower real GDP growth rate of 8.8% for the whole year.

Fixed asset investment is expected to grow by 20.0%, down from 2005. 2006 will be the first year of

the 11th Five Year Plan and will see the start of large scale construction projects (the new projects will account for 66.5% of projects underway in January to September, 2005, well above the 29.7% in the same period in 2004), so a certain level of investment growth will likely be maintained. Meanwhile, overproduction and the rising prices of raw materials have caused corporate earning rates to fall dramatically and new investment appetite has weakened considerably. In addition, investment restraint policies will be continued and the government is taking steps to tighten up the management of land use rights, bank financing controls, etc., all of which are likely to cause the value of state construction bonds to contract from $80 billion in 2005 to $60 billion in 2006, and growth in fixed asset investment to slow gradually.

The government, in an attempt to change from the traditional pattern of investment-dependent growth, is expected to throw its weight behind expanding consumption, and retail turnover is expected to grow by around 13.0% on the previous year. Specifically, in addition to increased government expenditure on the "Three Agrarian Issues" (farmers, the countryside and agriculture) and the implementation of tax reduction measures for farmers, city related measures, such as increasing the personal income tax base level (from the current RMB800 to RMB1,600), measures to reduce educational and medical burdens, improve social security provision and increase the salaries of public officials, etc., are expected to be implemented.

As far as foreign demand is concerned, though greater stability in the global economy will encourage export expansion, the growth of textile related products for Europe and the U.S. is being suppressed and export growth is expected to fall to around 20%. The government will likely introduce import promotion policies in order to alleviate pressure to revalue the renminbi upwards and to avoid trade friction with major trading partners over the trade imbalance, so imports are expected to recover to 25% up on the previous year.

As a result of expanded investments over the past few years, overproduction has become quite serious and fears are that it could sway the economic trend in the future. As iron and steel production for January to September, 2005, was up 26.5%, compared to the same period in the previous year, inventory almost tripled, compared to stock levels at the end of 2004 (see table below). Moving forward, if real estate restraints have the effect of cooling housing sales growth, real estate 'inventory' will probably increase quite significantly. Also, though the production capacity of iron and steel, cement, coal, textiles, etc., is already well in excess of domestic demand, large scale projects are being pushed ahead with. If the production plant and equipment that accompanies such investments becomes fully operative in two or three years, the problem of overproduction is going to become much more serious.

In 2006, the impact of the rising price of crude oil is expected to expand. In China, the government controls the retail prices of finished petroleum products and the big petroleum companies have a monopoly on everything from drilling to finished products, so the soaring price of crude oil has, thus far, had only a limited effect on the economy. However, from the summer onwards, gasoline shortages have spread and corporate earnings have suffered. Looking ahead, the mechanism for setting petroleum related prices will need to be reviewed, reflecting more faithfully the trends of international prices, so that increases in the price of crude oil will likely have a much more serious, negative effect.

Finally, the future of the Renminbi exchange system is of significant importance. On July 21, the Chinese government updated what had essentially been until then, a dollar pegged system, and introduced a controlled floating system, adjusted with reference to a currency basket, and the Renminbi rate was revalued upwards to $1 = RMB8.11 (an appreciation of 2.1%). At the end of October, the rate was $1= RMB 8.084, 0.3% up on July 21. The People's Bank of China plans to shift the burden of exchange risk, which, hitherto, it had shouldered alone, to market participants, by liberalizing capital transactions, developing the foreign exchange market, etc.

Also, it is expected that, from 2006, the reform of the renminbi exchange system will be speeded up, starting with broadening the exchange rate fluctuation range. However, given the fragility of the financial base and the weakness of corporations' ability to deal with exchange rate risk, the realization of an exchange rate that fully reflects the supply and demand relationships of the market will yet require some time.

(Fang Meng)