ASIA MONTHLY

December 2006

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

http://www.jri.co.jp/english/asia/index.html

Topics *Asian economic growth for 2007 expected slightly lower than previous year*

Overall economic growth in East Asia for 2007 is expected to be slightly lower than that of 2006. However, although China has implemented investment curbs in an effort to sustain stable economic growth, a stellar 10% growth rate is forecast.

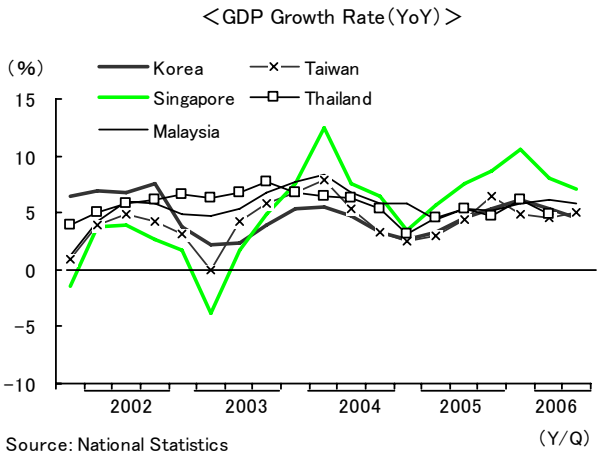
1. Asia's economies in 2006

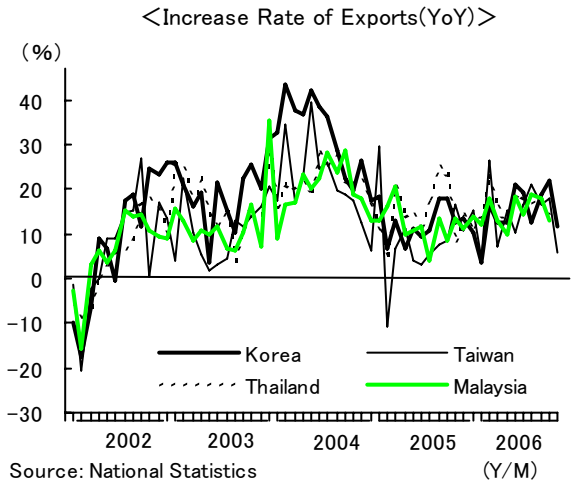
Against a backdrop of economic deceleration, NIEs and ASEAN economies grew at around 5%. Meanwhile, China sustained stellar growth at over 10%, with Vietnam and India at around 8%.

■ Economic deceleration amongst NIEs

Asia's economies, excluding China, encouraged by global economic expansion and China's economic acceleration, recovered in 2005, but then began to slow, generally, after that.

Korea's real GDP growth rate (compared to the same period in the previous year) was 6.3% in Q1, 2006, 5.3% in Q2 and 4.8% in Q3, falling for three consecutive quarters. The growth rate in Q1 appeared high due to the poor growth rate of the same period in the previous year, but the economy was already slowing in early 2006, as seen in the gradual decline from 1.6% in Q4, 2005, through 1.2% in Q1, 2006, to 0.8% in Q2. July to September was 1.1%. While increased exports and the accompanying expansion in plant and equipment investment functioned as economic growth drivers, private consumption for April to June slowed from 0.9% growth in the previous quarter down to 0.5% growth. Growth failure in real incomes, interest rate rises and a cooling consumption sentiment were among the causes.





In 2005, a renewed upward movement in real estate prices, coupled with the high price of crude oil, strengthened the upward pressure on inflation so that, in October of that year, the government's policy interest rate was raised for the first time in three years and five months, by 0.25 points. In 2006, the rate was raised again in February, May and August. Further, due to the effects of the comprehensive real estate measures introduced in response to soaring real estate prices, construction investment has languished. Economic growth for 2006 is expected to be 4.7%.

Taiwan's real GDP growth rate for the period July to September (compared to the same period in the previous year) was 5.0%, a slight improvement on 4.6% for April to June. Exports maintained solid growth at 13.1%, similarly, and private sector fixed asset formation grew 5.6% in the same period, the first positive growth in four quarters. Private consumption, meanwhile, began to slow noticeably, posting 2.0% growth in Q1, compared to the same period in the previous year, dropping to 1.4% in Q2 and 0.4% in Q3. Factors dampening consumption include 1) the failure of real wages to grow, 2) tougher card loan restrictions, 3) rising interest rates, and 4) political instability. The credit card debt

issue has worsened in recent years, prompting the introduction of measures to reduce the framework of credit to private consumers.

Export orders have been able to maintain comparatively high levels, so exports will continue to drive the economy in the meantime and economic growth for the year is forecast at 4.3%.

■ ASEAN4 continue medium level economic growth

Malaysia, Indonesia and the Philippines have been able to sustain comparatively robust economic growth, expected to be on the order of 5% for 2006, but Thailand's economy has begun to decelerate.

In the wake of the currency crisis, fixed capital formation rates in the ASEAN countries fell dramatically. As the region overall struggled to recover, Thailand was able to recover quite noticeably over recent years. This was due to the large scale infrastructure development projects (including railroad development in Bangkok, such as an expanded underground service and an elevated railroad, and the construction of a new international airport) promoted under the Thaksin administration (2001 to 2006). While the expansion of total fixed capital formation helped drive economic growth, it also led to a poorer trade balance and higher commodity prices, and, from mid 2005 onwards, the central thrust of government policy was to improve the balance of trade and curb inflation. Along with raising the policy interest rate, the government conducted a review of the large scale infrastructure development projects, promoted energy conservation, and introduced tougher monitoring of imports of crude oil and iron and steel. The deceleration of private consumption and total fixed capital formation caused real GDP in Q2, 2006, to grow by 4.9% (compared to the same period in the previous year), down from 6.1% in Q1. In a quarter to quarter comparison, growth was slightly better than January to March, but was still low at only 1.0%.

There were fears about the impact on the economy of the coup d'état on September 19, but the provisional administration managed to have the large framework of the budget for fiscal 2007 (October, 2006, to September, 2007) approved by the cabinet at the end of October (to be implemented from January, 2007). The package contains economic countermeasures and significantly increased expenditure, and the economy is expected to be able to avoid a slump.

Malaysia's real GDP growth rate for July to September (compared to the same period in the previous year) was slightly down from Q2's 6.2%, but was stable enough at 5.8%. In addition to healthy external demand, expanded private consumption and fixed asset formation boosted economic growth.

Indonesia's real GDP grew by 5.5% in Q3, up from Q2's 5.2%. While exports continued to perform solidly, private consumption could only manage 3.0% growth and fixed capital formation posted negative growth at -0.3%.

Indonesia has long used subsidies to keep the prices of petroleum products, such as paraffin and gasoline, low, and this caused the fiscal deficit to increase as crude oil prices skyrocketed. This, in turn, brought about a significant drop in the exchange rate. The government decided to cut subsidies and, in October, 2005, raised the prices of petroleum products by hefty margins. This had the effect of rapidly pushing up commodity prices and interest rates, but foreign confidence in the country was restored and the exchange rate began to stabilize. As inflation has been brought under control, the policy interest rate was lowered from mid 2006 and consumption has begun to recover slowly but steadily.

The Philippines continues to enjoy economic growth of around 5%, thanks to a recovery in agricultural production, solid private consumption and increased exports of electronics related goods. In 2005, the consumer price increase rate was 7.6%, due to the rising price of crude oil, but by September, 2006, this had fallen back to 5.7%. Also, along with a significant contraction of the fiscal deficit, the economic environment has begun to improve, with fewer national bonds issued and market interest rates coming down.

■ China continues high growth and India takes the stage

In China, growth in fixed asset investment and in exports resulted in continued high levels of economic growth, at 10% and over, from 2004. On the other hand, however, faced with problems such as a huge international trade surplus and trade friction with foreign countries, overheated domestic investments, soaring real estate prices, electrical power shortages, and growing regional income disparity, the government has sought to achieve stable growth levels.

In 2006, the reserve requirement ratio and interest rates were increased several times and measures restricting new investments were employed in response to investment overheating and production glut industries. The government has also sought to curb real estate investments by strengthening land control,

introducing restrictions on foreign capital investment in real estate, personal income tax on real estate resale, and tougher conditions on real estate related financing. These measures have gradually begun to take effect and the real GDP growth rate (compared to the same period in the previous year) cooled from 11.3% in Q2 to 10.4% in Q3, while urban fixed asset investment in October grew by 16.8%, compared to the same month in the previous year, 6.8% points down from September's growth. Meanwhile, the money supply has begun to pick up the pace again and at the end of October was 17.1% up on the same period in the previous year. Additionally, bank loans continue to grow and were up 15.2%, similarly, leading to expectations that tight money policies will be strengthened in the near future.

With regard to the trade imbalance, the renminbi has been revalued upwards by a slight margin and efforts are being made to increase imports and consumption. The renminbi's rate against the dollar was raised by 2.1% in July, 2005 and has continued to rise very modestly since then. However, the trade surplus for January to October, 2006, was in the $130 billion range and is expected to be on the order of $170 billion for the whole year, indicating that there has been little progress in correcting it.

In order to correct a pattern of economic growth that has tended to overemphasize investments and exports and to develop private consumption as an engine of growth, it will be essential to raise the income levels of the agricultural communities. The government is attempting full scale regional development, including raising the purchase prices of agricultural produce, abolishing agricultural taxes and raising minimum wage levels, but the results have been limited. The correction of domestic-foreign imbalances is likely to have to be carried over to 2007.

When speaking of Asia, mention must be made of the emergence of India. After suffering many years of poor economic growth, India implemented economic reform in 1991, built around central strategies such as 1) a smaller public works sector, 2) abolishing the industrial approval system, 3) liberalizing trade and exchange, and 4) attracting foreign investment, and the results are now beginning to show. Real GDP growth in fiscal 2005 (April, 2005, to March, 2006) was 8.4%, second only to China (Vietnam's real GDP growth rate was also 8.4%). Foreign investment has been vigorous, attracted by growing local markets. In terms of the activities of Japanese companies, encouraged by the business investments of automobile manufacturers, engineering equipment manufacturers are beginning to invest in the Indian market, while iron and steel manufacturers have plans to do the same.

In comparison with China, India's manufacturing industry is not developed enough to be an export industry, but India can boast growth in IT related services such as data processing and system development, for industrialized countries and in its pharmaceutical industry (including generic medicines). India and China have rapidly developed close economic links, as evidenced by the rapid growth in exports of iron ore and iron and steel to China in recent years. India's biggest export partner in fiscal 2005 was the US (16.7%), followed by the UAE (9.0%), China (5.8%), Singapore (4.8%) and the UK (4.5%). In terms of imports, China (6.3%) has overtaken the US (5.9%) to become India's biggest import partner.

2. Asia's economies in 2007

■ Economic growth rates slightly lower than in 2006

Given that the US economic deceleration is very likely to be comparatively slight (economic growth forecast in the mid 2% range for the whole year), and that exports to China will continue to expand as China sustains high levels of economic growth, Asia's economies in 2007 (excluding China) are expected to post stable levels of growth, albeit slightly lower than 2006 levels.

However, the following points need to be borne in mind. As indicated by rapidly increasing exports to China, China's high levels of growth in recent years have fuelled economic growth in the countries of east Asia. As Korean and Taiwanese companies shift production to China, their exports of production materials, such as raw materials, parts and components, and machinery, have increased, and as China becomes the world's production site, exports of electrical and electronic parts and components, mineral fuels, chemical products and other raw materials to China from the ASEAN countries are expanding. However, that impetus does seem to be waning of late and as US economic deceleration makes production adjustment in China likely, albeit temporary, it is thought that growth in east Asian exports to China may cool.

In terms of NIEs, Korea's private consumption continues to fail to grow and the won's appreciation has blunted export growth so that economic growth is expected to stall at around 4.1%, below that of

2006. Taiwan's domestic and foreign demand will continue to loose impetus till the middle of the of year but, from the latter half onward, IT related demand will increase and plant and equipment investments are believed likely to recover, bringing economic growth to 4.0%.

With the exception of Thailand, the ASEAN countries are expected to achieve economic growth of 5% or over. Although domestic demand in Thailand will continue to go through a phase of adjustment throughout the first half of the year, exports of mainly automobiles and computers and their parts and components will likely perform strongly and the forecast is for 4.3% economic growth for the year. In Malaysia, private consumption is believed likely to continue strongly and fixed capital formation growth, following the Ninth Five Year Plan, will bring economic growth to 5.7%. For Indonesia, lower commodity prices and interest rates will probably reinforce the recovery in private consumption and an economic growth rate of 5.8% is forecast, improving on 2006 figures.

A series of consumption stimulus measures implemented by the Chinese government have begun to take effect and individual consumption is expected to increase, but fixed asset investment growth is beginning to cool slightly and, along with the contraction of the trade surplus, economic growth is expected to be 10.0%.

Given the likely expansion in large scale public works investments in the runup to the Beijing Olympics in 2008 and the Shanghai Expo in 2010, and the strong corporate appetite for new plant and equipment investment as high levels of economic growth continue, and the fact that regional governments are continuing to promote investment, fixed asset investment growth will probably continue strongly, but will probably be kept to within a certain level as 2007 sees further raises in interest rates, and statutory reserve requirement ratios, investment curbing measures, such as stricter limits on bank lending, are likely to be introduced.

In terms of external demand, against the backdrop of US economic deceleration and China's review of export and import related taxation and production and process items, Chinese export growth is expected to fall to around 20%. In contrast, boosted by domestic demand promotion measures and efforts to encourage imports in order to correct the trade imbalance, imports are expected to recover to the upper 20% range, with the trade deficit for the year contracting to about $100 billion. Also, the renminbi is thought likely to continue its slight increase, with its price rising by about 5% throughout the year.

India's economic growth is expected to be about 8.0%, supported by growth in mining and manufacturing and in services. Vietnam, thanks to expanded domestic and foreign demand, is also expected to do well, at around 8.3%. Thanks to Vietnam's WTO (World Trade Organisation) accession, foreign direct investment is expected to infiltrate as far as the service sector.

■ All eyes on China

As China begins to pull more weight in the global economy and economic relations with Asian nations, including Japan, deepen, it is important to have some prospect of which course China will take in the future. In this regard, there are two specific points to be made.

The first is that the 17th Communist Party Congress is to be held in the autumn of 2007. It is expected that the Congress will reveal a strengthening of measures aimed at the realization of the Hu Jintao administration's goal of an 'harmonious, socialist society' on the economic front, and reinforcement of Hu Jintao's power base on the political front.

The 11th Five Year Plan (2006 – 2010) calls for a change in the previous policies of prioritizing economic growth, adopting instead the new target of 'sustainable, stable growth', based on the concept of 'scientific (balanced) economic growth'. In addition to the resolving of the Three Agrarian Issues (agricultural communities, agricultural workers and the agricultural industry) as a priority in order to reduce poverty and to correct income disparities, the Plan also calls for energy consumption per GDP1, to be cut by 20% from 2005 levels. At the Sixth Plenum of the CPC's Central Committee in October, 2006, the need to put the concept of 'an harmonious, socialist society' into practice was emphasized and the commitment to the advancement of measures to correct inter-regional income disparity and the introduction of a rational income distribution system, the securing of employment, a social security system and new rural construction (infrastructure provision, including education, medical treatment and hygiene and roads) was confirmed.

In order to pursue this line, the government's political base needs to be strengthened. The reasons behind the dismissal of Chen Liangyu, secretary of the Shanghai Municipal Committee of the Communist Party of China in September, 2006, include his resistance to central government's investment curbing

measures and his dismissal from the Jiang Zemin group appears to be part of an attempt to bolster the political base of the Hu Jintao line. It is expected that in the future the Party Congress will see the appointment of new, young cadres who will support the Hu Jintao line.

The second point to be made is that the Chinese economy is currently in a period of transition and may be expected to undergo significant changes in the future. As countries like Japan, Korea and Taiwan went through the process of economic development, their exchange rates were raised and wage levels rose, causing manufacturers to shift their production to less developed countries and, at the same time, to develop domestic industries to advanced levels. Viewed over the mid-term, it is virtually certain that the renminbi will appreciate over a significant margin against the dollar and other major currencies, and that wages will rise in the coastal regions.

Given the above, it may be expected that China's labor-intensive industries will be relocated away from the coastal regions to the interior regions. This trend will be accelerated if the 'Great Development of the West' brings infrastructure provision. Further, it is likely that there will be an increase in production shift to Vietnam, Cambodia and other Asian countries. There are hopes that new industries can be formed in these countries, and steps taken towards the eradication of poverty.

In terms of external relations, there is a high possibility that China's overseas investments will expand. In fact, China's foreign direct investment worth shot up from $1.8 billion in 2004 to $11.3 billion in 2005 (UNCTAD World Investment Report 2006). Against the backdrop of an appreciating renminbi and trade friction, in addition to more local production in Europe and the US, it is expected that there will be a greater tendency for Chinese firms to buy out foreign firms, with the aim of securing energy resources and acquiring advanced technology.

In the light of the foregoing, it would seem logical to suggest that the circumstances surrounding China are undergoing great changes and that Japanese companies need to pay careful attention to developing trends.

(Hidehiko Mukoyama)

Economic Prospects for 2007

(year-on-year, %)

1. Economic Growth

	2003	2004	2005	2006 (forecast)	2007 (forecast)
Korea	3.1	4.6	4.0	4.7	4.1
Taiwan	3.4	6.1	4.0	4.3	4.0
Hongkong	3.2	8.6	7.3	6.4	5.7
Thailand	7.0	6.2	4.5	4.7	4.3
Malaysia	5.4	7.3	5.2	5.9	5.7
Indonesia	4.9	5.1	5.6	5.6	5.8
Philippines	4.9	6.2	5.0	5.4	5.4
Vietnam	7.3	7.8	8.4	8.0	8.3
India	8.5	7.5	8.4	8.4	8.0
China	10.0	10.1	10.2	10.6	10.0

2. Consumer Prices

	2003	2004	2005	2006 (forecast)	2007 (forecast)
Korea	3.6	3.6	2.7	2.4	2.3
Taiwan	−0.3	1.6	2.3	0.4	0.5
Hongkong	−2.6	−0.4	1.0	2.2	2.5
Thailand	1.8	2.8	4.5	4.5	3.0
Malaysia	1.1	1.4	3.0	3.5	2.5
Indonesia	6.7	6.1	17.2	14.0	8.0
Philippines	3.2	5.9	7.6	6.6	5.5
Vietnam	3.0	9.5	8.4	8.3	7.5
India	3.9	3.8	4.4	5.8	5.0
China	1.2	3.9	1.8	1.5	1.7

3. Exports

	2003	2004	2005	2006 (forecast)	2007 (forecast)
Korea	19.3	31.0	12.0	13.4	9.8
Taiwan	11.3	21.1	8.8	12.2	12.8
Hongkong	11.8	15.8	11.6	10.3	12.9
Thailand	17.4	20.6	14.9	16.5	14.0
Malaysia	11.6	20.5	11.4	15.0	12.0
Indonesia	6.8	17.2	19.5	10.5	10.8
Philippines	2.9	9.5	4.0	14.0	10.0
Vietnam	20.6	31.4	22.4	25.0	25.0
India	21.7	31.3	23.6	18.0	22.0
China	34.6	35.4	28.4	27.3	18.0

4. Imports

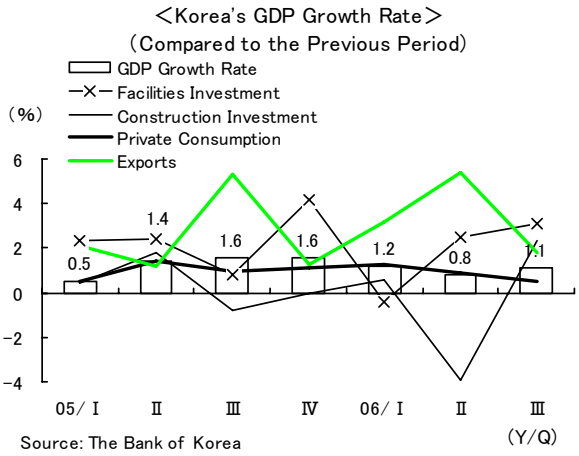
	2003	2004	2005	2006 (forecast)	2007 (forecast)
Korea	17.6	25.5	16.4	18.7	12.4
Taiwan	13.0	31.8	8.2	11.2	12.3
Hongkong	11.8	16.7	10.5	11.8	13.1
Thailand	16.8	26.6	25.7	9.0	13.0
Malaysia	4.8	25.9	8.5	16.5	13.0
Indonesia	4.0	42.9	24.0	7.3	10.0
Philippines	3.1	8.8	7.7	7.0	7.0
Vietnam	27.9	26.6	15.7	20.0	20.0
India	29.2	40.7	29.9	22.0	27.0
China	39.8	36.0	17.6	20.6	28.0

Notes: The figures in 2006, 2007 are forecasts by JRI.
Source: National Statistics

Korea 2007 growth below previous year at 4.1 %

■ Economic deceleration to continue

Korea's economy is slowing modestly. The real GDP growth rate for Q3 was 4.8%, compared to the same period in the previous year, down from 6.1% in Q1 and 5.3% in Q2, and could only manage 1.1% on the previous period (compared to 0.8% in Q2). Exports and plant and equipment investment were the drivers of the economy, while private consumption was only 0.5% up on the previous period, down from 0.9% in Q2. Among the causes for this slump were the failure of incomes to grow, and poor consumption sentiment. According to the National Statistical Office's report on the household income and expenditure, average monthly incomes for households (excluding single person households) throughout the country grew by 1.1% in Q3, the lowest growth rate since Q3, 2005 (-0.2%), while those in the low income bracket (lowest 20%) suffered negative growth.



In terms of recent trends, exports (customs cleared basis) are maintaining solid growth. Export growth in October slowed to 11.5% compared to the same period in the previous year, but the loss of impetus is largely ascribed to the reduced number of working days due to the Harvest Moon festival. Global economic expansion and the emergence of BRICs and other new economies are supporting export growth. Country by country, exports to China, Korea's largest export partner, dipped to 11.9%, as a result of China's recent high levels of economic growth, which is lower than the overall 14.7% (cumulative export worth January to September, compared to the same period in the previous year), but exports to Brazil (36.1%), Russia (32.2%) and India (27.9%) were all up. Particularly outstanding were the growth in exports to Poland (143.3%), Mexico (71.7%) and Greece (83.8%). In terms of items, IT related products, such as information communications equipment and semiconductors, could only manage pedestrian growth, but non-IT products, such as shipbuilding, iron and steel and machinery, all posted high growth.

Economic deceleration will likely mean that economic growth for 2006 will be 4.7%. Economic growth for 2007 is expected to be below that of 2006 at 4.1%, due to low levels of growth in domestic and foreign demand.

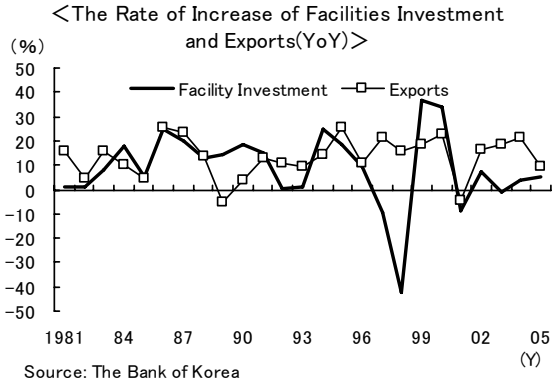
Hitherto robust export growth is highly likely to lose some of its momentum in the near future, due to the effects of the high won and global economic deceleration. The won – dollar exchange rate rose from $1 = 1,183 won in January, 2004, to $1 = 937 won in October, 2006. Attention needs to be paid to the fact that, from 2005 on, the won has gained strength against the yen (rising from 1 yen = 10.0 won in January, 2005, to 1 yen = 8.0 won in October, 2006). Korean products compete with Japanese products in the shipbuilding, automobile, iron and steel and electronic equipment fields. From past data, it can be seen that won appreciation against the yen has a negative impact on exports. In fact, in US markets, the prices of Korean and Japanese products are reversed, and due to this and other factors impacting profitability, some small and medium sized enterprises have begun to abandon the idea of exporting to Japan.

However, Korea's dependence on exports to the US is still decreasing and exports to newly emerging economies are likely to be affected only slightly by a high won, as many Korean companies produce raw materials, parts and components, and machinery locally. Also, as trends suggest that there is a high possibility that IT related demand will grow significantly in 2007, it seems fairly certain that export growth will be close to double digits.

■ Modest growth expected in private consumption and plant and equipment investment

The consumer expectation index, indicating economic and living standard trends six months hence, turned upwards in September, 2006, for the first time in eight months, but nervousness over North Korea's nuclear experiments and other events sent it trending downwards again in October. Since real wages still fail to show signs of any real growth, private consumption growth is expected to be very limited.

Private consumption expanded rapidly due to tax reductions and increased amounts of credit to consumers between 2001 and 2002. However, the introduction of consumer credit restrictions in the wake of increased numbers of credit delinquents (people defaulting on loan repayments of 300,000 won or over for three months or longer) caused consumption appetite to cool rapidly. The majority of credit delinquents were those in low to middle income brackets, using loans to augment their falling incomes. While consumption has been on the road to recovery since 2005, the recovery among the low and middle income brackets has been slow and lacking in vigor. Among the reasons for this are poor growth in incomes and increased non-consumption expenditure on things like social security and pensions, etc., which significantly impacts consumption spending. The failure of incomes to grow is related in part to the effects (increased unemployment and contingent work, lower wages) of the corporate restructuring that took place in the wake of the currency crisis and the expanding of state pension eligibility to include the self-employed and small business employees in urban areas and part-time and day laborers.



From around 2004 onwards there has been a gradual slowing in the increase of part-time and day laborers and an increase in the numbers of ordinary laborers. However, the (seasonally adjusted) unemployment rate as of October, 2006, is 3.5%, which is worse than January's 3.4%, and the employment situation is still not improving much, with unemployment among the young still serious. Along with attempts to provide the young with employment support and to create employment in the public works sector, the government is trying to draft laws related to contingent workers, in order to improve their treatment.

While these attempts are to be lauded, in the creation of employment, greater private sector investment is essential to improving the quality of such employment. The problem is that, in fixed capital formation also, plant and equipment investment has grown at a very slow pace in recent years, and this has contributed to decreasing employment creation. Though materials exports have grown comparatively strongly, among the reasons for the failure of plant and equipment investments to grow are said to be 1) the progress of international division of labor in IT industries and poor domestic production inducement effect due to increased final demand, 2) the prioritizing of overseas investment, and 3) the continuing stagnation of domestic consumption.

Fixed capital formation needs to be expanded if incomes and employment are to be improved but in the light of 1) a loss of momentum in export growth, 2) the accumulation of surplus inventory, and 3) shrinking corporate profits due to the high won, 2007's growth is likely to be lower than that of 2006. However, there is a high possibility that construction industry investments, which have been struggling so far, will do better than in the previous year, albeit slightly.

Based on the foregoing, due to failing growth in domestic and foreign demand, 2007's real GDP growth rate is forecast to be 4.1%, lower than that of 2006. Among the factors likely to inhibit economic growth are the instability in the North Korean situation and the domestic political situation. The country has begun to anticipate the next presidential elections, scheduled for December, 2007, and 'lame-duck' allegations are already being leveled at Roh Moo-hyun's presidency. If the Korean government strains its relations with the US and Japan in an attempt to continue to appease the North, this will likely have a negative impact on the economy.

(Hidehiko Mukoyama)

Taiwan 2007 economic growth similar to previous year at 4.0%

■ Sluggish domestic demand provides 4.3% growth in 2006

Taiwan's economy exhibited signs of deceleration in 2006. The real GDP growth rate (compared to the same period in the previous year) was 4.9% in Q1, down 1.5% points from 6.4% in Q4 in 2005. The rate was 4.6% in Q2, falling below the government's May forecast. Solid export growth pushed the growth rate back up to 5.0% in Q3 but, in spite of this slight improvement, other demand items still leave much to be desired.

The main factor behind the economic deceleration is the struggling domestic demand. Private sector consumption has been affected by a contraction in real average salaries and tighter restrictions on card loans, and could only manage 1.4% growth in Q2, compared to the same period in the previous year, and a feeble 0.4% increase in Q3, similarly. This is the lowest level of consumption growth since the SARS outbreak resulted in negative consumption spending in April to June, 2003. The loss of purchase appetites can be seen particularly clearly in the huge drop in automobile sales.

Total fixed capital formation, also, fell below the previous year's figures for three consecutive quarters until it finally managed positive growth (3.5%) in Q3, 2006. This is believed due to 1) a rebound from the healthy growth in plant and equipment investment from the end of 2003 and 2) the loss of temporary demand for products such as aircraft and high speed railway cars.

Against this backdrop, external demand is contributing to economic growth in a significant way. Exports (customs cleared basis) of electronics related products (semiconductors, liquid crystals) and optical equipment were growth drivers and, after bottoming out in June, 2005, have continued to grow overall in excess of 10%, compared to the same month in the previous year. The increase in the growth of exports to Taiwan's biggest export partner, China, is also one factor behind the economy's steady expansion. On the other hand, due to escalating prices, the import values of crude oil and other raw materials have skyrocketed, but imports of capital goods and consumption goods are struggling, due to the loss of appetite for plant and equipment investment and purchasing. As a result, import growth has fallen below export growth.

Observation of recent trends suggests that there are more than a few causes for concern. October exports (customs cleared basis) grew 5.6%, the first time in seven months that the growth rate has been in single digits. Export orders, mainly for electronics related products, are still strong and the possibility of negative growth there is very slight. However, deceleration in the US economy and other factors mean that export growth is likely to run out of steam towards the end of the year. The continued decline in automobile sales figures and the decision by some major companies to cut back on plant and equipment investment means that there is little prospect of a recovery in private consumption and investment, and real GDP growth for 2006 is expected to be on the order of 4.3%.

■ Full recovery delayed. 2007 growth 4.0%

Economic growth in 2007 is expected to be driven by exports and plant and equipment investment. However, growth for the whole year is expected to be similar to the previous year, at 4.0%.

With regard to private sector consumption, the development of efforts to resolve card loan issues is seen as a positive factor. The credit card arrears ratio peaked in April, 2006, at 3.38%, and has begun to improve, falling to 2.47% in September. Sustained economic growth has helped to reduce unemployment to its lowest level (3.9%) recently (October, 2006), since the spring of 2001. Further, real average salaries have begun to improve gradually, from the latter half of 2006. Given these factors, private sector consumption growth is expected to exceed 2006 levels, at 2.3%.

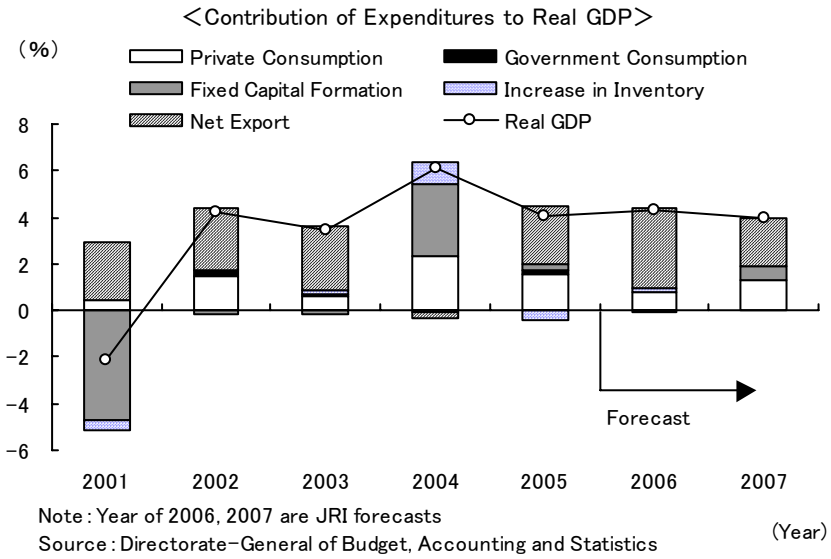
On the investment front, there are expectations of a recovering increase in machinery and plant and equipment investment. The two main reasons for this are 1) the effects of sales of Microsoft's new OS 'Windows Vista' and 2) aggressive investment plans on the part of influential corporations. With respect to the former, many believe that replacement purchases of Vista will increase gradually after launch in January, 2007. In addition, Vista will require much more memory than for the previous OS and it is expected that the production equipment for related materials will need to be increased and improved. As regards the latter, some influential corporations are beginning to announce plans to

increase expenditure for the implementation of the most advanced plant and equipment, in excess of 2006 levels. Taking corporate competition into consideration, it is not unreasonable to expect an increase in investment totals. However, given that some corporations expect to continue inventory adjustments of semiconductors, etc., through Q4, 2006, and the polarization of business showings, growth will likely be restrained. Government and public corporation investments have stayed below the previous year's levels, due in part to delayed implementation because of ruling and opposition party conflict and the fact that some projects have run their course. Taking all of this into consideration, total fixed capital formation for the year will likely increase by a modest 3.0%.

Looking at foreign demand, along with economic deceleration in ultimate demand destination USA, exports will lose momentum in the first half of the year. However, as a result of the effects of factors such as the Vista replacement purchases mentioned above, global electronics demand is expected to grow steadily and Taiwanese exports, which give extra weight to these kinds of products and their parts and components, are expected to make a recovery in the short term. Total exports, including services, are expected to perform at about the same level as in the previous year, at around 11%. Also, the implementation of capital goods is expected to become more vigorous and import growth is expected to recover to around 10%.

One factor restraining the economy is surely the political future. The opposition has seized upon the current financial scandals involving the family and close aides of President Chen Shuibian and their opposition is likely to be protracted. Although the pressure is on to clear up the issue as quickly as possible, there can be no calls for presidential impeachment unless there is a large scale revolt within the ruling party. Both sides are involved in internal struggles as to how to deal with the issue, and the political situation is stalemated. The situation is expected to last until the elections for the Legislative Yuan at the end of 2007 and the economic impact is expected to be slight.

Nevertheless, there are fears that, if President Chen attempts to break the current deadlock by implementing strongly independence-oriented measures, relations with China will be aggravated and popular opinion division within Taiwan will become more intense. In that case, there will likely be a significant drop in foreign direct investment and economic deceleration will be unavoidable. In order to obviate social confusion and economic cooling, the Chen administration will need to do some serious work on securing economic and societal security. Looking forward to Taiwan's economic prospects in 2007, careful attention will need to be paid to the political situation.



Note : Year of 2006, 2007 are JRI forecasts
Source : Directorate-General of Budget, Accounting and Statistics

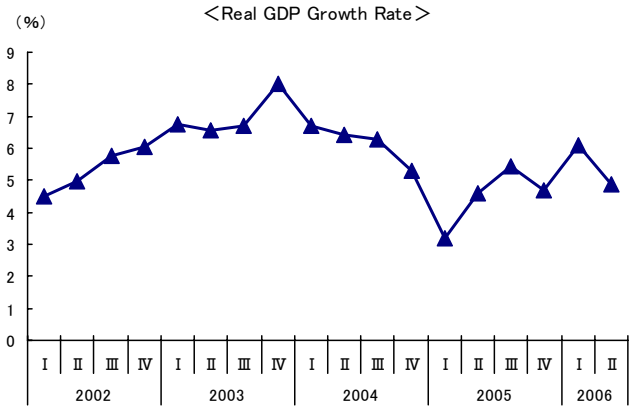
(Junya Sano)

Thailand *2007 economic growth rate expected to be in low 4% range*

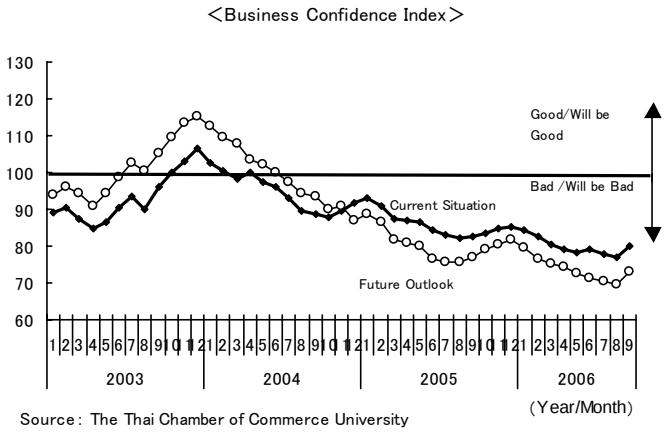
■ 2006 growth held at 4.7% due to stagnating domestic demand

Thailand's real GDP growth rate, impacted by skyrocketing crude oil prices, political instability, etc., slowed from 6.1% in Q1, 2006, to 4.9% in Q2. As the trend continued throughout the latter half of the year also, year on year growth is expected to be held at 4.7%.

The main factor behind the sluggish economic growth is poor growth in domestic demand. Private consumption growth slowed noticeably from 4.1% in Q1 to 3.7% in Q2. With interest rate hikes following commodity price increases, sales figures for consumer durables like automobiles and motorbikes in the period January to September were 488,000 (minus 3.3%, compared to the same period in the previous year) and 1.491 million (minus 0.3%, similarly), respectively, below the previous year's levels. Since the start of 2006, the business confidence index compiled by the Thai Chamber of Commerce University is falling significantly, both in terms of the current situation and future outlook.



Source: NESDB



Source: The Thai Chamber of Commerce University

The addition, fixed capital formation posted 13.8% year on year growth in 2004 and 11.4% in 2005, sustaining double digit growth in both years, but lost a great deal of momentum in 2006, slumping to 6.6% in Q1, compared to the same period in the previous year, and 3.9% in Q2. A main factor behind this has been the decision by many corporations to postpone investment expansion while political instability continues. In Addition, BOI's (Board of Investment) cumulative figures for foreign investment approvals (January to September) show a drop in the number of applications from 562 in the same period in the previous year to 553, and a reduction in investment worth from Bt238 billion to Bt198 billion.

Exports were the drivers of economic growth against this backdrop. Exports for January to September grew 16.4%, compared to the same period in the previous year, worth $95.6 billion. Of these, computer related exports grew by 29.8%, similarly, worth $7.7 billion, and automobiles and other transport equipment exports grew by 23.2%, worth $7.2 billion. In both cases, the impressive growth was due to the expansion of production by multinational corporations, which was the result of foreign investment attraction measures implemented under the Thaksin administration.

Imports, meanwhile, could only manage 7.8% growth in the same period, worth $96 billion, resulting in a balance of trade deficit of $400 million. Original forecasts spoke of a trade deficit in the $4 billion range, but it seems likely that the deficit will be held to around $1 billion for the year. The current account balance is expected to be in the black for the year, thanks to increased revenues from tourism.

The Thaksin administration was overthrown in the coup d'état of September 19 but the subsequent speedy inauguration of a provisional government meant that social unrest was avoided. In fact, due to the handover of power, the sense of political opacity was judged to have been cleared and the baht exchange rate went to $1 = 36 baht in November, for the first time in seven years, and the SET (Thai Stock Exchange) price index returned to its pre-coup levels.

■ Economic growth expected to grow by 4.3% in 2007, under the provisional government

Though the first half of 2007 is thought likely to see a continuation of the adjustment phase in domestic demand, exports of mainly automobiles and computers and their parts and components are expected to perform solidly through the year, resulting in an economic growth forecast of 4.3%.

On the political front, after the military coup, based on the provisional constitution promulgated on October 1, procedures are underway to enact a new constitution and to found a new government. A Legislative Assembly was convened on October 20, in place of parliament, and plans call for the inauguration of the people's assembly in order to have the new constitution enacted within the year, and for a constitutional draft assembly and conference draft committee to be formed in the new year. However, since the work of drawing up a draft constitution is likely to take around six months, a national referendum will not be held until around August, with the general election carried out sometime between October and the year end.

During that interval, the Surayud interim administration will be charged with the political and economic management of the country.

Prime Minister Surayud is prioritizing tackling economic stagnation, building a team of economic experts around him, with the Bank of Thailand governor, Pridiyathorn, as Finance Minister and the Executive Chairman of Bangkok Bank, Kosit Panpiemras, as Industry Minister. Also, he has given instructions that the delayed budget for fiscal 2007 (October, 2006 to September, 2007) be drafted as quickly as possible, and a budget is due to be drafted within the year, including Bt100 billion of economic stimulus measures. The Prime Minister delivered his policy address on November 3, declaring that the interim government would prioritize policies in line with His Majesty the King's philosophy (sufficiency economy: setthakij phopiang) and would rethink policies hitherto overly biased towards growth. Such prompt action is gradually winning more and more support from the people. Some 80% of the people responded that they 'support' the military coup in a questionnaire survey, and, if political stability continues, there is now a possibility that private sector investment will make an early recovery.

However, an important point will be whether the new government can separate the policies of the previous government from the personality of former Prime Minister Thaksin and make the correct choices. For example, the interim government has taken the stance of deciding the implementation priorities and reducing the scale of the so-called Mega-projects, large scale infrastructure development projects, involving the extension of the mass transportation system, including a new underground railway system, and communications facilities, with investments totaling Bt1.8 trillion (approx. 5 trillion yen) over four years. With regard to the FTA that the previous government had pursued aggressively in recent years, the interim government has now attached the conditions that there be full disclosure of information to the people and that sufficient parliamentary debate be held on the matter. In line with these moves, the Japan Thailand Economic Partnership Agreement (JTEPA), agreed in September, 2005, will now need to have parliamentary approval, so that official signing of the agreement will likely be put back till the latter half of 2007. It is possible that such policy changes will cause delays in public works investments and will hinder attempts to attract foreign investment. While the Thaksin regime exercised a somewhat dictatorial style of political and economic management, it was able to respond swiftly and successfully to an ever changing international environment. For example, it initiated FTAs with ASEAN, China, Australia and New Zealand, and, by providing a suitable investment environment, succeeded in attracting foreign capital. As a result, Thailand is now a world production center for pickup trucks. On the other hand, the change of government by military coup is regarded by the rest of the world as somewhat outmoded, leaving other countries skeptical about the new administration. The Surayud administration will need to focus on recovery from economic stagnation and dispassionately choose the best of the previous administration's policies and restore the confidence of foreign corporations.

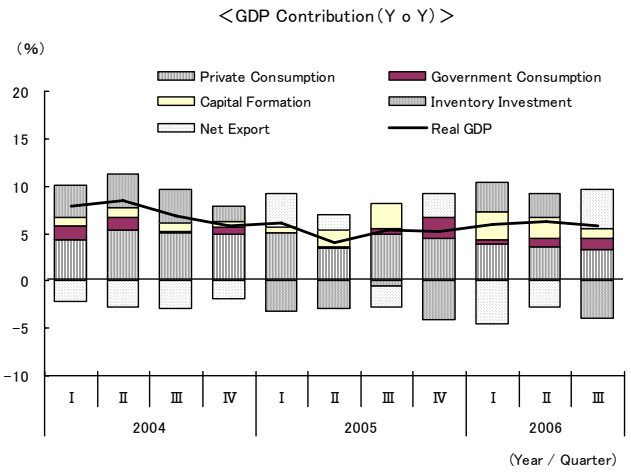
(Keiichiro Oizumi)

Malaysia 5.7% economic growth forecast for 2007

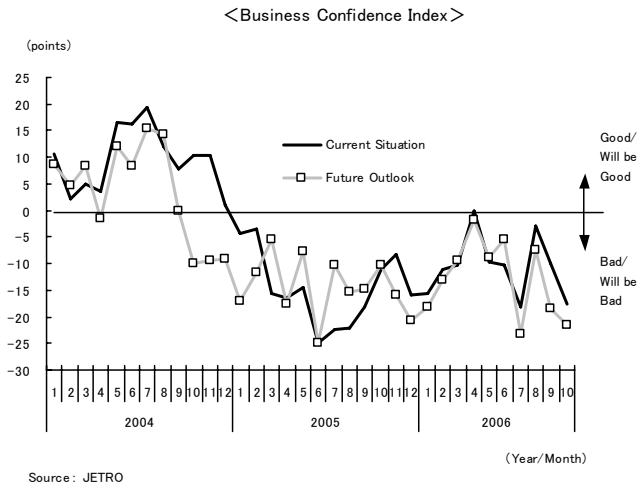
■ 2006 economic growth to reach 5.9%, powered by high crude oil prices

Malaysia, though caught between high interest rates on one hand and fierce competition from China and India on the other, nevertheless managed to sustain healthy economic growth, with a real GDP growth rate of 5.9%, compared to the same period in the previous year, in Q1, 2006, 6.2% in Q2 and 5.8% in Q3.

In terms of domestic demand, private sector consumption growth was high, at 7.5%, compared to the same period in the previous year, in Q1, 7.3% in Q2 and 6.8% in Q3. In spite of some signs of slowing in the cities, private consumption was boosted by increased consumption in rural communities, thanks to increased disposable income following higher natural rubber and palm oil prices. Also, credit card lending totals grew by over 15%, year on year, helping to maintain consumption growth. According to the government, this growth in private consumption is explained by the fact that per capita GDP is now over $5,000 and that the nation's consumption structure is changing from that of a developing nation to that of an industrialized one.



Source：Central Bank of Malaysia



Source：JETRO

In addition, fixed capital formation, which has been struggling till now, has achieved a solid recovery, posting 11.4% growth, compared to the same period in the previous year, in Q1, 7.6% growth in Q2 and 3.5% growth in Q3. The total value of investment projects approved by Malaysia's Ministry of Trade and Industry (MITI) between January and August was up 58.8% on the same period in the previous year at 28.9 billion ringgit. New investments, in particular, grew 107%, year on year, to 19 billion ringgit. Further, the start of the Ninth Five Year Plan (2006 to 2010) has boosted investments by state run enterprises.

As for external demand, exports grew 15.3%, compared to the same period in the previous year, in the period January to August, worth $104.5 billion. Exports of electrical and electronic goods grew solidly at 7.8%, similarly, worth $53.6 billion, and, boosted by the high price of crude oil, exports of petroleum products, petrochemicals and crude oil grew 11.1%, similarly, worth $12.6 billion. In addition, though imports grew by 16.5%, worth $86 billion, over the same period, thanks to increased imports of parts and components and equipment for export products and cheap household electrical parts and products from China, the balance of trade was still $21.1 billion in the black. Further, the number of foreign tourists for the year is expected to grow 6.7%, year on year, reaching 17.5 million visitors, which is expected to generate some $5.4 billion in tourism revenue.

Against this backdrop of healthy external demand, the foreign currency reserve as of the end of September was at its highest ever level of $79.5 billion, worth 8.1 months of import value. Given this robust domestic and external demand, economic growth for 2006 is expected to be 5.9%.

■ 5.7% growth expected for 2007 as Ninth Five Year Plan gets underway

In 2007, also, it is expected that private consumption will be able to maintain 6% growth, year on year, due to a more favorable employment situation and increased disposable incomes following sustained economic growth. As public works investments get fully underway, in line with the Ninth Five Year Plan, it is expected that the private sector will follow suit and increase investments, so that fixed capital formation is forecast to grow by 9.6%, similarly. Also, exports of principally electronic goods and crude oil and petroleum products are expected to continue to increase, bringing the balance of trade to around $20 billion in the black. This structure of robust domestic and external demand driving economic growth will continue into 2007, and the economy is expected to grow by 5.7%.

＜The Ninth Five Year Plan（2006-2010）＞

（%）

	Growth Rate（Target）
Real GDP	6.0
Private Consumption	6.9
Capital Formation	7.9
Private	11.2
Government	5.0
Government Consumption	5.3
Net Export	
Export	7.1
Import	7.9

Source：The Ninth Five Year Plan

The Ninth Five Year Plan will get fully underway in 2007. The Plan calls for an annual average 6% growth (see table at right), which is higher than the annual average 4.5% growth of the last five years (2001 to 2005). Specific measures are detailed in the Third Industrial Master Plan (2006 to 2020), announced in August. While the Master Plan calls for continued industrial development centered on the electrical and electrical industries, it also focuses on the development of national resources, such as crude oil and palm oil, as well as the varied natural resources of the tropical zone, and the development of ICT (information communications technology) enhanced bio-informatics. Further, the Plan has set its sights on introducing a greater element of service into the industrial structure, with the establishment of funds in order to provide support for service industries like finance, real estate and tourism, and the inauguration of the Service Industry Development Committee and other measures.

The budget for fiscal 2007 (October, 2006, to September, 2007) appears to be founded on positive fiscal policy, with expenditure up by 11.6% on the previous year at 157.5 billion ringgit, of which 44.5 billion ringgit is a 24.3% year on year increase in investment expenditure. Revenues will be 11.8% up on the previous year at 134.8 billion ringgit, leaving a fiscal deficit of 12.7 billion ringgit (3.4% to GDP). In consideration of the fact that the Abdullah administration has prioritized the development of sound government finance since its inauguration, it may be said that the administration has used the occasion of the Five Year Plan to make a bold change of strategy towards development through expanded government finance.

However, as Malaysia is an oil producing nation, its economy does risk being adversely impacted by the movement of the price of crude oil, and this fact cannot be treated lightly. For example, a detailed examination of the budget for fiscal 2007 shows that, while there are plans to implement tax reductions for corporations, some 40% of revenue depends on crude oil related tax revenues and income transfers by petroleum related state-run enterprises. As such, the income structure is a brittle one and vulnerable to the vagaries of the price of crude oil. And, on the export front, the outstanding growth of crude oil and petroleum related products in recent years has helped to offset the loss of competitiveness of Malaysia's electronic and electrical products. In particular, exports of household electrical goods have lost out to fierce competition from Chinese products, and export levels have fallen below those of the previous year for four consecutive quarters, since July to September, 2005.

Japanese owned enterprises are particularly critical of an economy that is sustained in this way, by relying heavily on the still high price of crude oil. According to the Diffusion Index (DI) by JETRO (Japan External Trade Organization), while the business confidence index has been improving since the start of 2006, the mainstream view is a pessimistic one (see diagram on left page). Also, on an international balance of payments basis, cumulative direct investment from Japan to Malaysia (January to June) was $113 million, which is low compared to the direct investments made by Thailand ($799 million), Indonesia ($531 million) and the Philippines ($231 million).

Over the mid to long term, attention will be focused on how well the Abdullah administration can leverage the benefits of the current high price of crude oil to usher in the development of the country's industrial structure and, to that end, what kinds of measures it can devise to attract foreign capital.

(Keiichiro Oizumi)

Philippines *2007 economic growth expected to be similar to previous year at around 5.4%*

■ Real GDP growth rate 5.4% in 2006

Real GDP grew strongly by 5.6% in January to June, 2006, compared to the same period in the previous year (Q1: 5.7%, Q2: 5.5%). Among the reasons for this were a recovery in agricultural production, recovery in exports, increased money sent home by Filipinos working abroad and a major improvement in the fiscal deficit.

The economy is also expected to have performed solidly throughout July to December also, despite a slight loss of pace. The main reason behind the recovery in agricultural production has been the plentiful rainfall, and it appears that climatic factors are unlikely to worsen by much in the future, leading to expectations that good levels of production can continue to be expected. Though exports have been affected somewhat by the deceleration of the world economy and the peso's appreciation, expectations are that performance will be good in the future. In addition, money remitted home from Filipinos working abroad increased by 15.4% in January to June, compared to the same period in the previous year, worth approximately $6 billion, and this high growth is expected to continue and to support personal consumption. Further, the fiscal deficit for January to July was 34.2 billion pesos (compared to 80.8 billion pesos in the same period in the previous year) so that the target of 125 billion pesos for the whole year seems certain to be achieved. This dramatic improvement in the deficit will enable 1) a reduction in the issue of government bonds, leading to lower long and short term interest rates, 2) an increase in important expenditure on economic development, such as infrastructure provision and measures to combat poverty, and 3) a restoration of confidence in the Philippines on the part of foreign investors, leading to increased capital inflow and an improved sovereign rating.

Real GDP growth for 2006 is forecast to be of the order of 5.4%. Personal consumption growth for January to June was a healthy 5.4%, despite worrisome factors such as high rates of CPI increase, caused by rising crude oil prices and VAT (value added tax) rate hikes, and political instability. This healthy growth is believed due to the recovery in agricultural production and the increase in money remitted home by Filipinos working abroad. Personal consumption is expected to continue to perform strongly in the future.

Fixed capital formation was -2.7% for January to June. Since 2005, poor export growth, political instability, rising interest rates and restrictions on public works investments, have all contributed to a continuing slump in durable equipment investment and construction. As export related investments and public works are expected to grow in the near future, fixed capital formation will likely rally, albeit modestly.

Exports grew by 16.8% in January to June, compared to the same period in the previous year, boosted by the global recovery in demand for electronics products (all references to exports and imports are on a customs cleared basis). As regards electronics related exports, semiconductor exports grew by 17.2%, but this figure was exceeded by the growth in exports of clothing (18.6%) and mineral products (89.5%). The growth in mineral products is due to the increased supply following a rise in international commodity prices. Though exports may be expected to decelerate slightly, they will nevertheless continue to perform fairly solidly. Imports, by contrast, could only manage 8.4% in January to June. Crude oil related imports grew by 34.4%, but raw materials and intermediate goods (2.3%) and consumption goods (2.2%) languished.

The consumer price increase rate was 6.8% in January to September, compared to the same period in the previous year. However, on a monthly basis, the rate fell from 7.6% in February and March to 5.7% in September. This has been due to falling food and drink prices as a result of increased production of rice, corn and other agricultural products, in spite of the continued inflationary pressure brought about by spiraling

＜Real GDP by Expenditure Shares＞

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

	2005-Q1	2005-Q2	2005-Q3	2005-Q4	2006-Q1	2006-Q2
Real GNP	4.9	5.8	4.8	6.9	6.5	6.6
Real GDP	4.2	5.4	4.8	5.3	5.7	5.5
Personal Consumption	5.0	4.8	4.9	5.0	5.6	5.2
Government Consumption	2.2	12.4	−0.2	1.1	8.1	0.4
Fixed Capital Formation	−8.1	−2.5	0.0	−4.6	0.3	−5.4
Exports	1.4	1.6	6.7	6.3	12.5	22.3
Imports	−2.2	2.6	7.5	1.4	0.7	4.0

Source: National Statistical Coordination Board

crude oil prices. The CPI increase is expected to trend downwards slightly in the future. After raising interest rates in October, 2005, the Central Bank has kept the policy interest rate unchanged, and in the light of the economic impact will probably maintain its current stance for the foreseeable future.

■ 5.4% real GDP growth forecast for 2007

2007's real GDP growth rate is expected to be around 5.4%. A gradual slowing of the world economy is forecast compared with the previous year, but the Philippines' economy is doing well and is expected to grow at a similar pace to that in 2006. Nevertheless, the future movement of crude oil prices, expected to remain high, is still a possible risk factor.

＜Main Economic Indicators＞

(YoY、%)

	2004	2005	2006	2007
Real GDP	6.2	5.0	5.4	5.4
Agriculture	4.9	2.0	4.0	3.6
Industry	5.2	4.2	5.1	5.0
Services	7.1	6.4	6.2	6.4
Personal Consumption	5.8	4.9	5.2	5.2
Government Consumption	1.4	4.0	3.5	3.7
Fixed Capital Formation	1.3	−3.9	−2.6	1.5
Exports (in US Dollars)	9.5	4.0	14.0	10.0
Imports (in US Dollars)	8.8	7.7	7.0	7.0

Notice: forecasts for 2006 and 2007

Source: NSCB and others

In terms of demand items, personal consumption will probably continue at much the same pace as in the previous year. Given that money remitted home by Filipinos working abroad will likely continue to grow at a respectable pace, it is unlikely that there will be any change in the current structure where personal consumption is the driver of the economy. There is a possibility that agricultural production growth will not be as high as the previous year, but the consumer price increase rate is continuing to trend downwards, and this will reinforce consumer sentiment. The faster pace in improving the fiscal deficit also will most likely give rise to greater optimism towards the future among individuals and corporations.

As regards fixed capital formation, it is expected that there will be an expansion in public works such as infrastructure provision, so a fairly high level of growth is expected in construction. Durable equipment investment has posted negative growth for six consecutive quarters, since Q1, 2005. Continued tight monetary policies and poor growth in direct investment mean that there is unlikely to be any dramatic growth, but against a backdrop of sturdy export growth, a slow but steady recovery is expected among communication equipment, electrical machinery, automobiles, etc.

In the future, in order to boost real GDP growth, it will be necessary to promote capital accumulation. It will be essential to raise the investment rate (15.7% in 2005), which is low in comparison with other Asian countries, and the government will have to take serious steps to improve the investment environment, through infrastructure provision, for example, taking advantage of the improved fiscal deficit.

As regards exports, though the global trade value is decreasing slightly, demand for electronics products is expected to be sustained, so the exports will grow at roughly 10.0% year on year. Based on the premise that imports will continue to be influenced by the movement of crude oil prices and that imports of raw and intermediate materials and capital goods are expected to increase as exports increase, import growth of around 7.0% is expected.

The risk factors facing economic growth are, firstly, external factors such as US interest rates, crude oil prices and the Chinese economy. Over 95% of the Philippines' petrol demand depends on imports, so any increases in the price of crude oil will cause the consumer price increase rate to go up again, adversely impacting economic growth.

Secondly, there is the unstable political situation. Since the declaration of a state of emergency in February, 2006, the activities of the anti-Arroyo camp have quieted somewhat and the second impeachment motion was defeated in the Lower House in August. The President has no powerful opponents and her erstwhile languishing support rate is beginning to improve. However, there are many in the lower ranks of the military who are dissatisfied with the government and, after the mid-term elections scheduled for May, 2007, it is possible that the power structure within parliament may change. The President is attempting to maintain her political authority by revising the constitution so that she can introduce a parliamentary cabinet system, but it remains uncertain as to whether she will be able to achieve this. Though it is difficult to envisage a change of political power in the near future, the situation may be said to be still fluid. Political tension will likely increase just before and after the mid-term elections, and this is likely to have an adverse impact on the economic situation.

(Satoshi Shimizu)

Indonesia *Consumption recovery and 5.8% growth expected in 2007*

■ 2006 economic growth expected to be around 5.6%

Indonesia's real GDP grew by 5.0% in January to June, 2006, compared to the same period in the previous year. Encouraged by a recovery in consumption over the latter half of the year, growth might be expected to grow further, but fuel price increases in October, 2005, and subsequent interest hikes seriously impacted private sector consumption in the first half of the year, so that real GDP growth in 2006 is expected to be on the order of 5.6%.

According to Bank Indonesia's market perception survey, many economists are expecting real GDP growth in 2006 to be between 5.1 and 6.0%, inflation over 8.0% (annual average 10.23%), the dollar exchange rate 9,501 to 10,000 rupiah and current account balance to GDP between 0.1 to 1.5%. Commodity prices and the exchange rate are stable and the economy appears poised for a recovery, but a commonly held opinion is that there is a lack of vigor.

In terms of the GDP demand items for January to June, domestic demand has failed to grow significantly, as private sector demand grew by only 3.0%, compared to the same period in the previous year, and fixed capital formation decreased by 0.1%. Economic growth was supported by external demand. In particular, exports of natural gas posted high growth. On the supply side, only agriculture, mining and manufacturing, construction and services were able to top the previous year's performances.

Private sector consumption finally showed signs of recovery in the latter half of 2006. Bike sales were brisk, with 490,000 motorbikes in September and 500,000 in August, a new record for monthly sales. In response to stable commodity prices, Bank Indonesia decided to lower the policy interest rate (BI rate) intermittently from September, 2005, which has encouraged private sector consumption.

Though domestic private sector investments (approved basis) for January to September did grow 182.1%, compared to the same period in the previous year, worth 108 trillion rupiah, half of this investment worth was accounted for by large scale investment projects in the paper and printing industries and it is uncertain as to whether this trend will continue. Meanwhile, foreign direct investments (approved basis) for January to September grew 1.3%, compared to the same period in the previous year, worth 10.5 billion rupiah. The vitalization of investments through improvements in the investment environment is an important topic recently, but outstanding results have yet to be seen.

The fragility of the macro-economic situation has begun to ease, with a reduction in external debt totals, compression of the fiscal deficit, and an increase in the foreign currency reserve. The IMF (International Monetary Fund) expects the external debt total to be 39.0% (to GDP) in 2006, and the fiscal deficit to be 1.2%, similarly. However, economic growth of under 6% is believed to be incapable of absorbing fully the new entrants into the labor market. While boosting economic growth with a combination of consumption plus investment, efforts also need to be made to heighten the sustainability of such growth.

<Economic Forcast for 2006>

(%)

	2004	2005	2006		
			2005/Ⅳ	2006/Ⅰ	2006/Ⅱ
GDP Growth Rate	5.13	5.6	5.1-6.0	5.1-6.0	5.1-6.0
Inflation Rate	6.4	17.11	>8.0	>8.0	>8.0
Exchange Rate	8,940	9,713	9,501-10,000	9,001-9,500	9,001-9,500
Current Account(% of GDP)	1.03	0.03	0.1-1.5	<1.0	0.1-1.5
Export Growth	11.28	21.84	7.6-15.0	15.1-22.5	15.1-22.5
Import Growth	21.51	26.16	22.5-30.0	22.5-30.0	22.5-30.0
Budget Deficit(% of GDP)	1.3	0.91	<1.0	2.1-2.5	2.1-2.5
Unemployment Rate	9.8	10.26	10.1-11.0	10.1-11.0	10.1-11.0

Source: Bank Indonesia, *Market Perception Survey Ⅱ 2006*

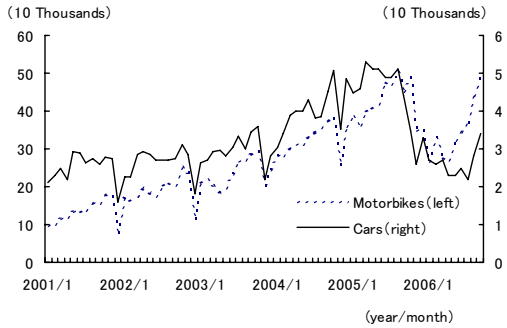
<Economic Growth>

(Trillion Rupiahs,%)

	2004	2005	Growth Rate	2006 Jan-Jun	Growth Rate
Private Consumption Expenditure	1,004.1	1,043.8	4.0	529.7	3.0
General Gov. Consumption Expenditure	126.2	136.4	8.1	68.2	22.7
Gross Domestic Fixed Capital Formation	354.6	389.8	9.9	191.7	-0.1
Change in Stock	23.5	4.3	-81.7	8.9	71.2
Statistics Discrepancy	12.9	48.5	276.0	33.0	-22.7
Export of goods and services	680.5	739.0	8.6	393.2	11.1
Import of goods and services	545.0	612.3	12.3	319.1	6.0
GDP	1,656.8	1,749.5	5.6	905.6	5.0
Agriculture, Livestock, Forestry & Fishery	248.2	254.4	2.5	134.7	4.5
Mining and Quarrying	160.1	162.6	1.6	82.4	4.5
Manufacturing Industry	470.0	491.7	4.6	250.6	3.1
Electricity, Gas and Water Supply	10.9	11.6	6.4	6.1	5.7
Construction	96.3	103.4	7.4	54.3	7.7
Trade, Hotel and Restaurant	271.1	294.4	8.6	151.2	4.7
Transport and Communication	96.9	109.4	12.9	59.4	12.2
Financial, Ownership & Business Services	151.2	162.0	7.1	83.7	5.2
Services	152.1	160.0	5.2	83.1	5.6
GDP WITHOUT GAS	1,506.6	1,604.2	6.5	833.8	5.5

Note: Constant price year 2000
Source: BPS

<Domestic Sale of Motorbikes and Cars>



Source: Astra International

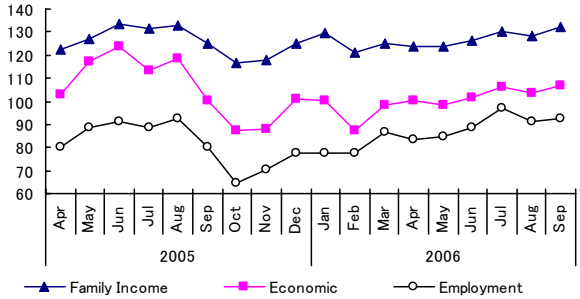
■ 5.8% economic growth forecast for 2007

Economic growth in 2007 is expected to do slightly better than in the previous year, at 5.8%. Private sector consumption will be the growth engine. Bank Indonesia's survey of consumers shows that the indices for household income, the economy and employment, which were all down in October, 2005, have all been rising in 2006. If commodity prices and the exchange rate can stabilize, a reduction in interest rates will probably vitalize private consumption.

The government is forecasting 6.3% growth for 2007, but this will not be easy to achieve. In a survey of economists run by Bank Indonesia, many responded with forecasts ranging between 5.1 to 6.0%. The key lies with investments. The government announced a package of measures for the infrastructure and investment environment fields in February, 2006, and for the financial sector in July, indicating their intent to speed up reform. These packages represent a completely new type of endeavour by the government, specifying as they do the reforms the government is attempting to achieve as well as the time limits for implementation.

However, many hold the opinion that improvements to the investment environment will take some time, and believe that investors will stay cautious. In its 'Doing Business' report issued by the World Bank in September, Indonesia was ranked in 135th place out of 175 countries, dropping from 131st place the year before. And, in the business survey run by Bank Indonesia, the business forecast for the next six months (the percentage of respondents who responded 'getting better' minus those who responded 'getting worse') was 35.8 points for the second quarter of 2006, an improvement on the lowest figure of 24.4 points in the third quarter of 2005, but down from 36.7 points in the first quarter of 2006, albeit slightly.

<Consumer Survey (Expectation for Six Months Hence)>



Note: Indexes are calculated by balance score method (% up − % down)+100
Source: Bank Indonesia, *Consumer Survey Sep 2006*

<Main Economic Indicator for 2007>

(%)

	Survey Period		
	2005/Ⅰ	2006/Ⅱ	2006/Ⅲ
GDP Growth Rate	>6.0	>6.0	5.1～6.0
Inflation Rate	7.1−8.0	7.1−8.0	7.1−8.0
Exchange Rate	9,501−10,000	9,001～9,500	9,001～9,500
Unemployment Rate	10.0−11.0	10.1～11.0	10.1～11.0

Source: Bank Indonesia, *Market Perception Survey*

<Foreign Trage>

(Million US$)

		Total	Oil and Gas				Non-Oil nad Gas
			Sub Total	Crude Oil	Petroleum Products	Gas	
Jan-Jun 2005	Export	47,903	10,456	4,466	1,043	4,947	37,447
	Import	33,449	9,473	4,321	5,148	4	23,976
	Balance	14,454	983	145	−4,105	4,943	13,471
Jan-Jun 2006	Export	55,769	12,461	4,942	1,471	6,048	43,308
	Import	34,257	10,814	4,591	6,209	14	23,443
	Balance	21,512	1,647	351	−4,738	6,034	19,865

Source: BPS

As for external demand, though crude oil production volume continues to languish, production and exports of natural gas are expected to perform strongly and to support economic growth. However, increased imports of petroleum products mean that it is only a matter of time before Indonesia becomes an importer of natural resources, and the level of contribution to external demand will surely decrease year by year. Non-petroleum and gas exports are doing fairly well, but rising energy and utility costs, wages and transportation costs lead many to voice concern that Indonesia's labor intensive industries will lose their competitiveness.

Indonesia's lack of vigor where investments and exports are concerned, compared to surrounding countries, is a problem, and it will need sure and steady reform to resolve it. In 2007, President Yudhoyono's leadership will be put to the test again. In order to break the solidarity of those with vested interests, the government must have the confidence of the people, in particular, the support of the poor. However, the number of poor in 2006 rose by 11% compared to the previous year, to 39 million people, and it is clear that the government's measures to tackle poverty have not been sufficiently successful. Though energy prices were raised, ostensibly in an effort to redistribute the subsidies used for the gasoline consumed by the rich to aid the poor, the poor themselves have yet to benefit from this. The success or failure of measures to combat poverty will affect the President's centripetal force and, indeed, the speed of reform. The government has earmarked some 51 trillion rupiah of the budget for fiscal 2007 to be used to tackle poverty, and has set itself the target of reducing the numbers of poor to 8.2% of the total population by 2009. Attention will be on the government to see how well they are able to increase the effectiveness of anti-poverty measures through community participation and information disclosure.

(Yuji Miura)

Vietnam *Investments will power 8.3% growth in 2007*

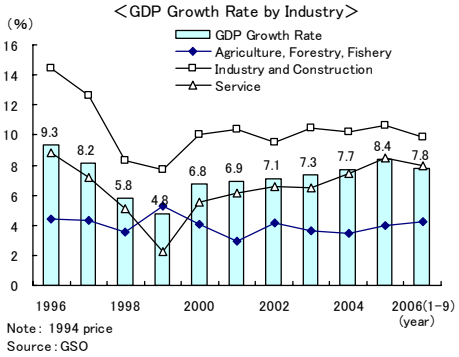
■ 8.0% growth in 2006

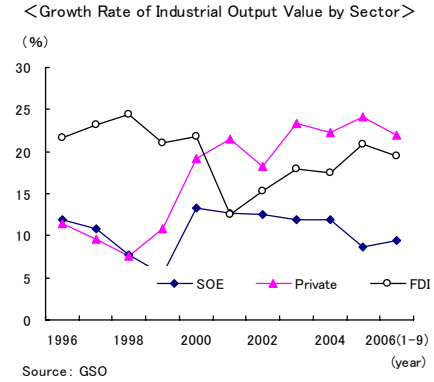
Vietnam's real GDP grew by 7.8% in January to September, 2006, compared to the same period in the previous year. The growth rate has increased every quarter, and it is reckoned that the real GDP growth rate will reach 8.0% for 2006. Vietnam's long pending WTO (World Trade Organisation) accession was formally approved in November and the APEC (Asia-Pacific Economic Cooperation) conference hosted by Vietnam that same month was an excellent opportunity to show off the new 'open Vietnam'.

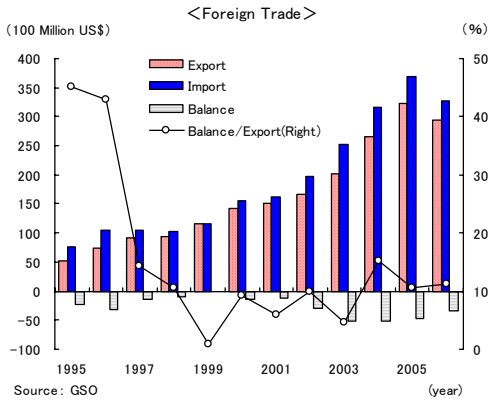
Viewing GDP from January to September in terms of supply items, agriculture, forestry and fisheries posted 3.3% growth over the same period, industry 9.9%, and services 8.0%, solid growth in all cases. Agriculture, forestry and fisheries were driven by fisheries (8.4% growth), industry by manufacturing (12.1%) and services by hotels and restaurants (11.1%).

Industrial producers' statistics by sector trends show that private and foreign-backed enterprises grew by 22.7% and 19.5%, respectively, over the same period, well ahead of the 9.4% growth reported by state-run enterprises. Foreign-backed enterprises grew by 24.9% when the crude oil sector (4.0% down over the same period) is excluded, and the private and foreign sector together fuelled industrial growth. In the state-run sector, meanwhile, firms under the jurisdiction of the central government posted solid 12.2% growth, whereas firms under local government jurisdiction could only manage a feeble 1.8%, exposing a considerable difference between the two.

There were over 20,000 newly registered domestic private sector investments in January to June, 2006, and the total for the whole year is expected to exceed the previous year's 38,144. As regards foreign direct investments (approved basis, as of September, 20, 2006), there were 580 applications, worth $3.85 billion. The number of applications was 1.8% up compared to the same period in the previous year, while the investment worth represented an increase of 47.7%, similarly. Hong Kong ($640 million) and Korea ($600 million) continue to invest positively in Vietnam, while Japan ($47 million) and the US ($480 million) are gradually increasing their profiles. As the risk of over-concentration in China increases, Vietnam's cheap labor force and political stability are again being regarded as attractive.





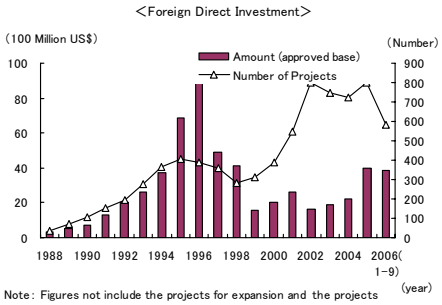


Exports for January to September grew 24.2% compared to the same period in the previous year, at $29.4 billion, while imports grew 19.3% over the same period, worth $32.8 billion, leaving a trade balance deficit of $3.4 billion. As crude oil exports narrow, imports of petroleum products are increasing. Further, as exports of textiles and electronic parts and components increase, so do imports of parts and materials, and this kind of structural relationship is gradually taking root. Nevertheless, exports of primary exports such as marine produce, coffee and rubber, and timber products, are performing strongly, so the trade deficit is thought likely to be no more than around 10% of exports.

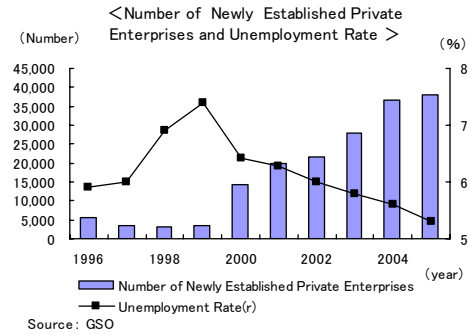
The consumer price index for January to September was 6.9%, continuing to rise at a high level. The prices of rice and construction materials are expected to have risen by over 8% for the whole year. The current account deficit is contracting, thanks to tourism revenues and an increase in money remitted from abroad.

■ 8.3% economic growth forecast for 2007

Real GDP growth for 2007 is expected to grow at 8.3%, a slightly higher pace than the previous year. Before the Assembly in late October, Prime Minister Nguyen Tan Dung set the economic growth for 2007 at between 8.2 and 8.5%. In order to achieve this, four policy targets were set, namely: 1) the vitalization of domestic and foreign investment, 2) the development of rural communities, 3) enhanced investments in human resources, and 4) further administrative reform. 2007 will be the year in which the new Prime Minister's ability to leverage WTO accession to improve the sustainability of economic growth will be put to the test.



Note: Figures not include the projects for expansion and the projects approved by provinces.
Source: GSO



Source: GSO

When it comes to investments, many are optimistic about the future. Foreign direct investments are expected to continue do well, encouraged by Vietnam's WTO accession. Investments are expected to accelerate not only in Vietnam's labor intensive industries, such as textiles and footwear, but also in fields such as finance, distribution, communications, mining and energy, etc., where participation restrictions are due to be relaxed. With the exception of crude oil, half of Vietnam's exports involve foreign capital, and increased foreign direct investment will undoubtedly contribute to market diversification and the refining of export items. In 2007, talks aimed at the concluding of an economic partnership agreement with Japan will begin.

Domestic private sector investment is also thought likely to perform fairly solidly as well. Though there are movements to restrict investments in some regions and government departments, there is growing hope that administrative reform will push ahead under Prime Minister Nguyen's leadership and that the likelihood of the investment appetite being dampened will be very slight. The scale of private sector investment is very small and tends to concentrate on the service industries, but its employment creation effect is considerable. If investment in the manufacturing sector can be energized, the employment creation effect will be magnified and will contribute to the expansion of development and consumption in rural communities.

The government has drafted a socio-economic development plan till 2010 and is targeting real GDP growth of between 7.5 and 8.0% over the next five years. While investments contribute to employment creation and expanded consumption and a stable increase in exports seems probable, many international financial institutions and aid organizations have been led to deem the plan 'achievable'. From now on, attention will be on to what extent the issue of the state-run enterprises, which has until now been put on the back burner as a 'political issue', and the reform of the financial sector that has supported inefficient state-run enterprises, can be resolved. Reform of the state-run enterprises is so far following the Chinese example in converting companies to stock companies and holding companies, in order to make a clear distinction between ownership and management, but it is still unclear as to whether this will improve levels of management autonomy and efficiency, and the results need to be watched carefully.

Also, it will be important to deal with the problems of corruption and income disparities, which have become more noticeable with economic development. These problems give rise to a loss of confidence in the government and in the communist party and are very likely to contribute to social disorder. The ratio of the poor living in areas inhabited by ethnic minorities is still high and there is a growing danger that poverty problems will escalate into ethnic problems. The widening income disparities in the cities are becoming ever more serious and the ranks of the poor, left behind by economic development, are beginning to swell. Severe disparity restricts access by the poor to medical and educational services and hinders the growth of the human resources that are so vital to economic growth. Attention will be paid from now on as to how well access to medical and educational services can be improved for the poor, and how well 'equal opportunities' can be provided, and to whether decentralization can improve the government's transparency and efficiency.

(Yuji Miura)

India Economic growth to continue at around 8% in 2007

■ Real GDP growth in 2006 expected to be 8.4%

India's real GDP growth rate for fiscal 2005 (April, 2005, to March, 2006) was 8.4%, exceeding 2004's 7.5%, and was encouraged by the agricultural sector's growth from 0.7% in the previous year to 3.9%. Growth in April to June, 2006, was 8.9%, compared to the same period in the previous year, the second highest quarterly growth rate in the past six years. Agriculture maintained comparatively high growth of 3.4%, while the industry sector grew 9.7%, mainly in manufacturing, and the service sector grew 10.6%, mainly in trading, hotels, transportation and communications.

The real GDP growth rate for 2006 is forecast to be on the order of 8.4%. With regard to the agricultural sector, rainfall between June and September was close to that of average years and water storage conditions have improved compared to the previous year, but rainfall levels differ widely from region to region and the central and western regions have suffered crop damage due to flooding. As a result, agricultural production is expected to decelerate slightly, with growth for the whole year forecast at around 2% compared to the previous year.

In the industry sector, the industrial production index for April to July was up 10.6%, compared to the same period in the previous year. In manufacturing, metals, transportation equipment and machinery performed especially well. Viewed in terms of use, capital goods grew by a strong 19.9%, reflecting strong investment demand, and durable consumer goods also did well at 15.7%. Corporate views of the economy are very optimistic and plant operating ratios are high, leading to a rapid growth in new investment. Corporate investment and production are expected to continue strongly for the time being. Also, reflecting a real estate boom, it is thought likely that the construction industry will also continue strongly.

In the service sector, trading, hotels, transportation and communications were the drivers. With the energizing of economic activity, hotels and transportation have performed solidly, and the number of aircraft passengers between April and August was up by 36.6%, compared to the same period in the previous year. In the communications industry, the number of mobile phone subscribers at the end of August was 86.62 million, up 77.1%, compared to the same period in the previous year. Finance, insurance, real estate and business services also turned in strong performances, encouraged by such factors as growing IT related services and increased bank lending. These trends are believed likely to continue in the future, and the service sector will likely maintain its robust performance.

As regards external sectors in fiscal 2006, both exports and imports are expected to post double digit growth. Exports for April to August were up 20.7%, compared to the same period in the previous year, and imports up 17.7%, similarly. Export growth was powered mainly by strong performances in manufacturing, and machinery, chemical products (pharmaceuticals, etc.) and clothing, which were the principal export items. Exports of IT related services, which grew 32.2% in fiscal 2005, compared to the same period in the previous year, are also maintaining solid growth. For imports, meanwhile, crude oil and petroleum products account for about 30% of all imports, and the rising price of crude oil is one of the main factors behind the rise in import worth.

Price trends give some cause for concern. Measures have been in place so far to restrict the passing on of rising crude oil prices to domestic consumers, but there is a possibility that future price trends will

＜Real GDP Growth Rate＞

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

	2004-Q1	2004-Q2	2004-Q3	2004-Q4	2005-Q1	2005-Q2	2005-Q3	2005-Q4	2006-Q1
Real GDP Growth	7.9	6.7	7.0	8.6	8.5	8.4	7.5	9.3	8.9
Agriculture,etc.	3.5	-0.2	-1.2	1.5	3.4	4.0	2.9	5.5	3.4
Industry	7.1	7.7	11.1	8.4	10.2	7.8	8.1	8.9	9.7
Mining and Quarrying	8.2	6.0	5.7	3.7	3.1	-2.6	0.0	3.0	3.4
Manufacturing	6.6	8.3	9.2	8.1	10.7	8.1	8.3	8.9	11.3
Elec., Gas & Water Supply	4.9	7.9	3.1	1.4	7.4	2.6	5.0	6.1	5.4
Construction	8.9	6.8	20.8	13.5	12.4	12.3	11.5	12.0	9.5
Services	10.1	8.4	9.4	11.4	9.8	10.0	9.4	10.9	10.6
Trade, Hotel, Trans., Commun.	10.6	11.2	9.7	11.0	11.7	11.0	10.2	12.9	13.2
Finance, Insurance, Real Estate, etc.	8.8	7.5	9.7	10.7	8.8	10.5	8.9	10.5	8.9
Social, Personal Services, etc.	10.7	4.8	8.5	12.7	7.3	8.0	8.4	7.6	7.4

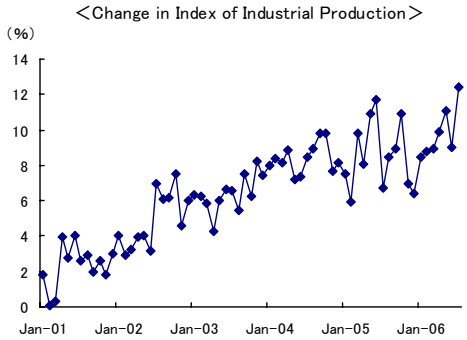
Notice: Q1:Apr.－Jun., Q2:Jul.－Sep., Q3:Oct.－Dec., Q4:Jan.－Mar.

Source: CMIE

be reflected in the prices of domestic petroleum products. Also, inflationary pressure is mounting, with house prices rising to reflect healthy economic growth, and the consumer price index for April to August rose by 6.4%, compared to the same period in the previous year. Since April, 2005, the policy interest rate has been raised five times, by a total of 1.25%. If further interest rate hikes are implemented, there is a possibility that the economy will be adversely affected.

■ Real GDP growth for fiscal 2007 forecast at around 8.0%

Real GDP is expected to grow by around 8.0% in fiscal 2007. The agricultural sector is significantly dependent upon rainfall and predictions are difficult to make, but the possibility is high that the industry and services sectors will be able to sustain high growth levels. India's economic activity has shifted its concentration from agriculture to services, so GDP growth has become high and stable. Therefore, if there is no major fall in agricultural sector growth, there is every reason to expect that economic growth will continue as expected.



Source: CMIE

In October, the Planning Commission announced the draft details of the Eleventh Five Year Plan (fiscal 2007 to 2011). The Plan calls for an ambitious target of an average 9.0% economic growth over the five years. Therefore, attempts are being made to raise the growth rate of the agricultural sector to 4.0%, well above its current level (the annual average for 1995 to 2005 was 2.6%). While the problem of poverty in India does appear to be improving, it is still serious and a recovery in the growth rate of the agricultural sector, which has been falling for a long time, is a vitally important issue as a part of attempts to raise income levels in rural areas. The policies prioritized within the framework of the Five Year Plan are the strengthening of agricultural research, the diversification of crops, the granting of subsidies and insurance to farmers, the development of rural road networks and the provision of secure employment, and so on. These will need to be implemented at a steady pace.

The major risk factor in the foreseeable future is the price of crude oil. India's petroleum consumption has shot up, and around 75% of that is import-dependent. Rising crude oil prices will definitely translate into domestic inflation over the long term. Therefore, if crude oil prices begin to spiral upwards again, strict monetary policies will likely be implemented over an extended period of time. In that scenario, corporate funding costs will rise and there is a possibility that corporate profits will dip and plant and equipment investment plans will be put off. Also, it is conceivable that real estate prices and stock prices, which have been moving upwards so far, will fall, curbing individual consumption, and this will likely be a factor in bringing the real GDP growth rate down. According to a trial calculation carried out by the Asia Development Bank in 2005, a $17 rise in the price of crude oil will translate into a 1.1 point drop in the economic growth rate. While this is smaller than the expected impact on Thailand and the Philippines, it is still too big to be ignored.

The government has, hitherto, prevented crude oil price rises from being passed on to domestic consumers by reducing customs and commodity taxes on crude oil and petroleum products, and by forcing government-backed petrol companies to keep their retail prices steady. Because of this, rises in the price of crude oil are one factor that hurts the fiscal balance. The government is currently marking time in its efforts to reduce the fiscal deficit. The fiscal deficit target for fiscal 2006 is 3.8% to GDP (actual figure for fiscal 2005 was 4.1%), but the deficit for April to June was 777 billion rupees, already equivalent to 52% of the annual estimated target value. Against that backdrop, political resistance is preventing any progress in efforts to reduce current expenditure, privatize state-run enterprises or relax regulations. In the future, in order to maintain the current high levels of growth, it is indispensable that Special Economic Zones be developed in order to promote direct investment, government social spending on diverse areas such as education, health and measures to correct income disparity be expanded, and the infrastructure be developed further. Reduction of the fiscal deficit is an important prerequisite to achieving the implementation of these measures.

(Satoshi Shimizu)

China Growth to continue high at 10% in 2007

■ 2006 real GDP growth expected to be 10.6%, compared to previous year

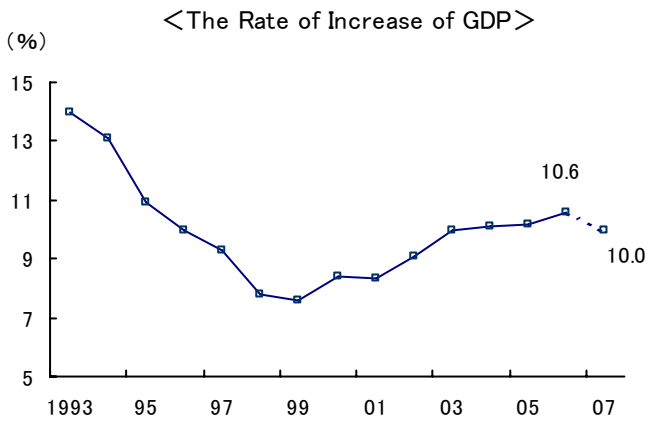
China's real GDP growth rate for January to September, 2006, was 10.7%, compared to the same period in the previous year. Investment curbing measures were reinforced from the middle of the year, causing GDP growth to lose some momentum, reaching 10.4% in Q3, slightly down on Q2 (11.3%). Expansion in investments and external demand continue to support economic growth, and real GDP growth for the whole year is forecast to be 10.6%.

First, with regard to investments, total social fixed asset investments are believed likely to grow by 26.5% on the previous year, slightly up on 2005 (25.7%). From the beginning of 2006, new investments have been restricted in industries with over-production, interest rates raised twice and banks' statutory deposit reserve rates raised three times. In addition, Prime Minister Wen Jiabao has repeatedly ordered tighter investment curbs at meetings of the State Council's Standing Committee (where decisions are made regarding major macro-economic policies). In spite of the implementation of a series of investment curbing measures, total social fixed asset investment growth for January to September was still high, at 27.3% compared to the same period in the previous year. In investment overheated industries such as iron and steel (-1.4% over the same period) and cement (-4.5%), growth rates have decelerated, but growth rates in the mining industry overall, textiles, apparel, chemical products, railway construction, and others, are in double digits.

The reasons for this include 1) reinforced efforts to foster energy related industries, following the start of the 11th Five Year Plan, including new investments, 2) more positive lending by the banks, and 3) major increases in new plant and equipment investments caused by the rapid growth of private industry.

Also, real estate development investments, which got fully underway from 2005 (up 24.3% in January to September) have begun to pick up momentum. Following a series of measures designed to restrict real estate investment, implemented from April, 2006, extra measures were introduced in July, restricting the investment in and purchase of real estate by foreign capital (corporate and individual) and, from August, land management and the collection of personal income tax on real estate transfers have been tightened. Nevertheless, with the exception of Shanghai (6.6%) and Zhejiang province (5.9%) real estate development investments in more than 80% of regions have posted stellar growth of 20% or more. Real estate prices also, though falling in Shanghai, are continuing to rise in Beijing and Shenzhen.

Second regarding individual consumption, the annual retail sales worth is expected to grow by 13.7% on the previous year, 0.8% points up on 2005. The retail sales worth for January to September was 13.5% up compared to the same period in the previous year, a steady expansion. Per capita disposable income (real basis, 10.0% up over the same period) in the cities has gained slightly on 2005's figures for the same period (9.8%), and has contributed to the expansion in retail sales (14% growth over the same period). From the start of 2006, the government has raised the personal income tax collection reference (from RMB800 to RMB1,600) and the minimum wage, and has conducted revisions of the salary system for retirees, public officials and the employees of state-run corporations. As a result, the incomes of some 120 million people stand to be increased. On the other hand, in the agricultural sector, though a variety of tax reduction measures and increased subsidies for food production have been implemented in an attempt to improve the income levels of farmers, the per capita cash income of farmers in the period January to September grew by 11.4%, practically



Source: National Bureau of Statistics of China

the same level as for 2005, so the government's measures appear to have had only limited effect.

In terms of external demand, exports for January to October grew by 26.8%, compared to the same period in the previous year, at $779.3 billion, and imports 20.9%, similarly, at $645.7 billion, causing the trade surplus to increase dramatically to $133.6 billion. For the whole year, exports are thought likely to grow by close to 30% and imports by around 20%, which will leave a trade surplus of $170 billion (the highest ever). The reasons for this include increased exports to Europe and the US, export promotion in over-producing industries, increases in exports brought forward, following the government's review of export value-added tax, tariffs, and process trade items, as well as reduced import growth due to investment curbs.

■ Real GDP growth rate in 2007 expected to continue high at around 10%

While individual consumption is expected to grow in 2007, curbs on fixed asset investments will continue and the trade surplus is thought likely to contract. Real GDP growth for the whole year will probably be on the order of 10%.

With regard to individual consumption, new measures aimed at stimulating consumption are expected to be introduced, and the retail sales figures will likely grow by around 14%, compared to the previous year. The review of wage systems that were started in some cities in the latter half of 2006 will be expanded to include the whole country, from 2007, and domestic demand stimulus measures are thought likely to be introduced, in an effort to resolve domestic over-production and trade imbalance. As living standards improve, the demand for travel, leisure and luxury items will increase, driving expanded consumption in the cities. In rural communities, in addition to exhaustive tax reduction measures for farmers, government expenditure is expected to be increased, in order to ease the burden of education and medical treatment on rural household accounts.

With regard to investments, curbing measures will continue to be applied, so the expectation is that fixed asset investment growth will fall to the low 20% range, compared to the previous year. In addition to increased investments in large scale public works projects in the runup to the Beijing Olympics in 2008 and the Shanghai Expo in 2010, sustained high levels of economic growth are keeping corporate appetites for new plant and equipment investment keen. Local government investment promotion activities are believed likely to continue, so fixed asset investment growth will likely stay high, but the raising of interest rates in 2007, along with expected increases in the statutory deposit reserve rates, stricter limits on bank lending, stricter land management and tighter conditions for new entry into certain industry sectors will probably mean that fixed asset investment growth will be kept to within a certain limit.

As for external demand, as the result of deceleration in the US economy and the revision of export and import related taxation and production process items, export growth will probably slow to around 20%. In contrast, domestic demand stimulus measures and investment promotion geared towards correcting the trade imbalance are expected to push import growth to the high 20% range, so that the trade surplus for the year will contract to around $100 billion.

The US economic deceleration will affect the EU and Japanese economies to a certain extent, so growth of Chinese exports to the EU, US and Japan, which account for more than half of the total, will likely lose some momentum. Other factors likely to inhibit export growth include moves by the Chinese government, after revising the export value-added tax rebate rate in September, to review the export and import tariff rates on some products from November, and to prohibit process trade on some items (see list of prohibited process trade items, Ministry of Commerce site), in order to curb exports of items that have low value-added tax and high consumption of energy and natural resources.

Looking forward to the economic situation in 2007, the following trends should be noted.

First, there is the issue of excess liquidity. In spite of a variety of measures to curb investment growth, such as raising interest rates and statutory deposit reserve rates and tightening administrative measures, fixed asset investment, the money supply (M2) and bank lending totals are still growing at high levels.

The People's Bank of China, in its report on currency policies from 2006 onwards, has pointed out that rapid increases in bank lending totals and still high levels of fixed asset investment, among others, are problems, and has voiced concern over their possible negative impact on the macro-economy. In the background to this situation lies a trade imbalance and the influx of large amounts of foreign currency, due to upward pressure on the renminbi, and other factors, so Central Bank has used market intervention to discharge renminbi into the market. As a result, financial institutions' lending appetites became

sharper and it became easier for local governments to procure funds for investment promotion.

Second, central government's macro-control is becoming ever more difficult. Of the funds procured for fixed asset investment, some 60% of the total is accounted for by corporations' own fund raising efforts, local government external budgetary funds and foreign capital, so that the effect of tighter administrative procedures and tight fiscal policies is actually limited to within a fairly narrow range. Also, as central and local governments have conflicting interests, there are many local governments who consider themselves 'not applicable' to macro-control. Real estate is a 'pillar' industry of local economies and, unless it can be fostered, local governments run the risk of insufficient revenue and of failing to meet their leaders' performance targets, so there is an increasing trend to ignore the macro-control targets (investment growth, higher real estate prices) of central government.

Third is the movement of the renminbi's exchange rate. It is over a year since the renminbi was revalued upwards in July, 2005. The daily fluctuation range of the exchange rate has increased since the spring of 2006 and at the end of October the rate was $1 = RMB7.879, a 2.8% gain on the rate at July 21, 2005.

Given the dramatic increase in the trade deficit and the foreign currency reserve, the Chinese government appears poised to tolerate a limited increase in the renminbi's exchange rate. From 2007 onwards, given the policy of accelerating the liberalization of capital transactions and the development of the foreign exchange market (the enhancement of measures to hedge against exchange risk), the renminbi exchange rate is expected to increase in elasticity and is expected to appreciate by around 5% in the year. However, in consideration of the increased inflow of capital that followed the complete opening up of the financial markets to foreign capital, and the fragility of the financial system, it is likely that the government will be very careful about reforming the exchange system.

(Fang Meng)

Hong Kong 2007 growth on the order of 5%

■ Pedestrian export growth, real GDP growth 6.4% in 2006

Hong Kong's economy is slowing, with a real GDP growth rate of 5.2% in Q2, compared to the same period in the previous year, down from 8.0% in Q1. The main cause has been unimpressive export growth. Capital export growth was 6.4% in Q2, the first time in five quarters that growth has stayed in single digits. In the latter half of the year, also, the deceleration of the US economy had its effect and export momentum was lost. Domestic demand has been the growth engine. Private sector consumption in Q2 grew by 5.1%, compared to the same period in the previous year, gaining on the 4.5% posted in Q1. Improvements in the unemployment rate and a recovery in the stock market accelerated consumption. Total fixed capital formation managed to maintain positive growth compared to the same period in the previous year, particularly with regard to machinery and plant and equipment.

Towards the end of the year, a gradually slowing US economy and continued investment curbs in Hong Kong's biggest export partner, China, mean that there is little hope of a sudden increase in exports. Import growth will slightly exceed that of exports, fueled by lively consumption in the region. Meanwhile, domestic consumption is expected to perform solidly. The unemployment rate has fallen to the 4% range and stock prices (Hang Seng index) have reached a record high, and these factors are expected to boost consumption over the latter half of the year. Against the backdrop of improved corporate earnings, plant and equipment investments, for example, will probably be higher than 2005's levels. Everything taken into consideration, real GDP growth in 2006 is expected to be 6.4%.

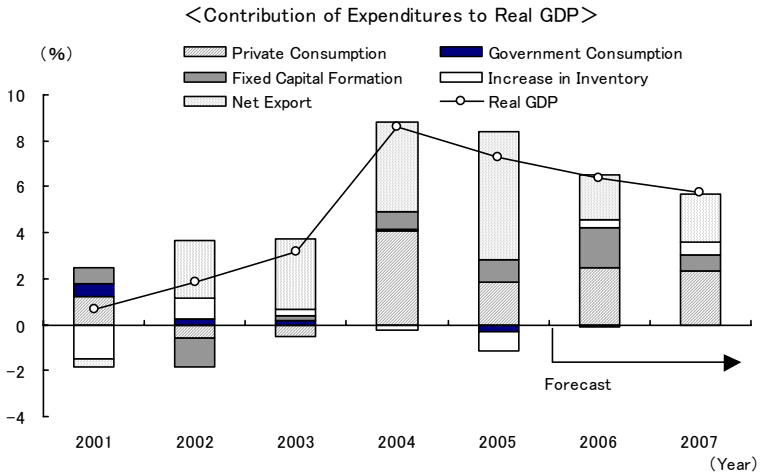
■ 5.7% growth in 2007 as driving forces grow weaker

In 2007, though the external environment is likely to take a turn for the better, the factors fueling domestic demand will begin to lose some of their potency, so that economic growth of 5.7% is forecast for the year, below the performance of the previous year.

With regard to private sector consumption, there are many reasons to be optimistic about continued expansion, such as the Hong Kong People Management Association's survey, which suggests that the salary increase rate in 2007 will be higher than that of 2006. Also, the unemployment rate is now at its lowest level (4.5% in August to October, 2006) since 2000, when Hong Kong posted record economic growth of over 10%. On the other hand, since consumption has continued to grow at a fast pace since 2004, it is likely that some of the driving forces will gradually begin to weaken. Everything taken into account, private consumption growth will likely be around 4.4%, compared to the same period in the previous year, slightly down on the previous year's performance.

As far as external demand is concerned, given that the deceleration of the US economy is likely to come to an end and that China will continue to maintain high economic growth of around 10%, exports of goods and services may be expected to exceed the previous year's performance at around 13% growth. However, as Hong Kong's customs tariffs on exports to China have, to all intents and purposes, been abolished, the expansion of local exports is believed to have run its course for the time being.

Through the reinforcement of economic cooperation with China, the Hong Kong economy has been able to realize high economic growth in recent years. In contrast, increased China-dependency in trade and tourism means that there is a



Note : Year of 2006, 2007 are JRI forecasts
Source : Census and Statistics Department

greater risk that Hong Kong's economy may lose impetus as a result of changes in the Chinese government's economic policies, and China's economic trends. The development of ports and airports in neighboring provinces, such as Guangdong, and advancing reforms of China's domestic finance systems, threaten to reduce Hong Kong's position as an international distribution and finance center.

Early 2007 will see elections for the Hong Kong government's top position of Governor. Currently, Donald Tsang Yam-Kuen is thought most likely to be re-elected Governor, as he is highly thought of in economic circles and by the Chinese government, and, among influential politicians and officials, enjoys a high level of popular support. Therefore, it seems reasonable to expect that Donald Tsang Yam-Kuen's mid-term activities will be with a view to re-election, and will focus on the development of policy coordination with China and the enhancement of distribution infrastructure, among other measures.

(Junya Sano)