Business Planning Forecasts

10 November 2006

FORECASTS: DECEMBER QUARTER 2006

Introduction

This bulletin is designed to help plan your business. It brings together forecasts of important indicators to help you prepare budgets and business plans.

The forecasts are drawn from two main sources. The New Zealand information is based on a survey of the five main trading banks (ANZ, ASB, BNZ, National, and Westpac). The Australian information is based on consensus forecasts put together by the UK based magazine “The Economist”. Sources of other information are as shown.

We stress that the information in this publication is by its nature uncertain. Your firm is unique, and you will need to make your own decisions. However, we believe the better informed you are about the way various business people see the future, the better decisions you can make.

Where appropriate we have not only included the average value across all forecasters, but also the highest and the lowest forecast. This gives some idea of the spread of forecasts, and therefore an idea of the uncertainty involved.

Business New Zealand
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BusinessNZ
The voice of business

Executive Summary – The Brakes are Slowly Being Applied

As we mentioned in our last planning forecast, the economy continues to be caught in a holding pattern. Various economic indicators show that in certain respects, the economy is holding up, while in others numbers are heading downwards or coming off their peaks. The notion of a hard landing for the New Zealand economy is becoming more of a whisper than a reality, although this doesn't mean some will not be feeling the negative effects of a general slowdown.

Part 1: The New Zealand Economy

1.1. Economic Growth (GDP) – Shifting Down a Gear

Most recent outcome: 1.9% for the year-ended June 2006.

Gross Domestic Product (GDP) is a measure of total economic activity for a country over a given period. Over the past six years GDP growth has averaged 3.6% per annum, which indicates a strongly performing economy and higher growth rates than many other countries New Zealand compares itself with. However, over the last year annual growth has averaged out at around 2.4%, with the June 2006 year result below 2% for the first time since the June 2001 year.

Results by quarter show economic activity increasing 0.5% in the June 2006 quarter, following an increase of 0.8% for the March quarter and no growth during the December 2005 quarter. Growth for the quarter continues to be driven by the services sector (+0.5%). Both business investment (-5.6%) and household consumption expenditure (-0.5%) took a dive during the June quarter.

While the quarterly results for June and March show stronger levels of growth compared with September and December, the results are still not those that would provide enough impetus for New Zealand to head towards the top half of the OECD. Furthermore, expectations are for New Zealand's growth rate to bottom out at 1.6% by the end of 2007, before picking up again towards the end of 2008.

Forecasts: Real GDP % Growth

	Years Ending		
	Dec 06	*Dec 07*	*Dec 08*
Highest	1.9	2.1	3.3
Average	1.8	1.6	2.8
Lowest	1.7	1.2	2.6

Source: ANZ, ASB, BNZ, National, and Westpac

Business New Zealand believes key factors to influence GDP over the next two years will include:

Interest rates – I'm King of the World! (for now)

New Zealand's Official Cash Rate (OCR) continues to be king of the world, although other countries are slowly but surely vying for the crown, including both Australia and the United States.

Since the last planning forecast the Reserve Bank has continued with its no change policy as the OCR remains at 7.25%. However, it was a close run thing with commentators split about what the Reserve Bank would do during the OCR announcement on 26 October. The OCR has now remained at 7.25% for seven announcements, with the last change occurring in December 2005.

The Reserve Bank has stated that here has been a significant improvement to the near term inflation outlook, mainly as a result of the recent decline in oil prices. However, they still believe monetary policy pressure will need to be maintained for some time yet, as indicators of medium-term inflation pressures remain significant.

On balance, we would be surprised if the next change in the OCR is an upwards movement at this stage, as it would appear the inflation mountain has reached its peak, and the gradual descent has begun. However, it is important to bear in mind that with many New Zealanders holding memories of interest rates well into double digits, interest rates of 8-9% may not be significant enough to deter many from continuing to spend (especially with job security at an all time high). Any notion of a decrease in the OCR is well away yet, and probably not expected until the second half of 2007 at the earliest.

The New Zealand Dollar – Just when you thought it was safe to predict its direction….

One might as well throw some arrows on a dartboard when trying to predict the short-term direction of the NZ dollar.

The first half of 2006 had seen a continuing drop in the value of the New Zealand dollar, which had been long overdue as general consensus was that it was too high for too long. As the steam started to go out of the New Zealand economy, so would demand for the dollar, and increasing interest rates offshore would mean some investors would look elsewhere for returns. From August onwards, that view changed. The dollar has been on an upwards path against all major currencies, eclipsing much of the falls experienced during the first half of the year.

As we mentioned last quarter, a few factors have caused investors to take a wait and see approach rather than ditching the NZ dollar.

Firstly, the continued inflationary pressures in the NZ economy have significantly delayed any expectations that the Reserve Bank might drop interest rates in a hurry; hence investors are still willing to sink money into the New Zealand economy given the relative high real interest rate returns being achieved. Having said this, some investors appear oblivious to the fact that the NZ dollar could well fall thus seriously undermining real returns for investors. In this respect there would appear to be some naivety amongst some investors in the sense that they focus unduly on interest rates rather than ultimately expected returns taking into account wider issues such as the likely future direction of the NZ dollar.

Also, reduced inflationary concerns have also put a damper on future interest rate rises in the United States with softer output growth than previously anticipated. After 17 consecutive 25 basis point increases, the Federal Reserve has left the Funds rate at 5.25% since late June.

One would expect the NZ dollar to head southwards over the coming year. However, determining the timeframe and level is difficult at best. From the Reserve Bank's perspective, they would hope any fall is gradual, rather than a sudden short-term adjustment that may cause a boost in tradeables inflation.

Net migration flows – further signs of improvement

Over the past two to three years, large migration inflows have boosted domestic consumer spending, car sales and house building. Migration has also, to an extent, helped mitigate some of the pressures that have built up in the labour market.

The annual net migration gain peaked at +42,500 for the year ended June 2003 but fell as low as a +6,000 gain for the year ended October 2005. However, since that time it has improved to stand at +13,200 for the year ended September 2006. While arrivals of New Zealanders and non-New Zealanders have remained relatively stable over recent years, what has mainly halted the decline has been a drop in the number of departures from New Zealand, which had previously been steadily rising since the later half of 2003. Arrivals into New Zealand have remained relatively stable at around 80,000 per annum (now almost back up to 2004 levels), with total departures at around 70,000. New Zealanders continue to view living offshore as a tempting proposition, as the departure of New Zealanders offshore continues to remain close to the 50,000 mark per year, meaning a net loss of 23,500 for the year ended September 2006.

Continuing positive net migration figures will help hold up the property market, as people arriving in the country obviously need somewhere to live. Although one could argue that the property boom of 2000-2003 is over where capital gains in some areas were nothing short of spectacular, latest figures show the trend is still positive, although at a much more leisurely pace. Some commentators have already expressed the view that the property boom is well and truly over, and a settlement period will exist for some time to come. However, one would be brave to expect any general fall in house prices, although short-term corrections in some regions are likely. The median sale price for houses across New Zealand show that the level of increase over recent months has flattened out, switching between $310k and $313k for the previous four months. The number of days to sell a house is still over 30 days, compared with less than a month a year ago.

Issues surrounding homeownership and rental returns should give would-be investors some consideration to rethink before investing too much into an already overheated market.

Indications are that home ownership is declining further as first home buyers find it increasingly difficult to get on the first rung of the housing ladder. Rents, in general, currently do not reflect reasonable economic returns on capital invested suggesting either that investors are continuing to expect capital gains on housing will continue or that rents will move up to more “acceptable” levels.

Commodity prices – World and NZ Dollar Commodity Price Indexes heading in opposite Directions

The ANZ Commodity Price Index in world price terms has shown a gradual improvement over the last five months, and has recovered two-thirds of the fall recorded between the peak of May 2005 and the recent low in March 2006. In New Zealand dollar terms the index again slipped slightly in October (-0.9%), which was the third consecutive fall, reflecting the recent firming in the value of the New Zealand dollar. However, New Zealand dollar priced exports are close to 10% higher than they were a year ago – reflecting the significant drop in the NZ dollar over the first quarter of this year.

Overall, while stronger international commodity prices are providing support to the export sector, the firmer New Zealand dollar is starting to bite into prospective returns.

	World Price Index	Monthly % Change	Annual % Change	NZ$ Index	Monthly % Change	Annual % Change
Oct 2001	123.1	-2.3	4.1	151.5	-0.2	0.4
Oct 2002	116.2	2.8	-5.6	124.8	0.5	-17.6
Oct 2003	127.7	3.2	9.9	112.9	1.5	-9.5
Oct 2004	151.8	0.5	18.9	119.1	-2.8	5.5
Oct 2005	151.5	-0.6	-0.2	115.3	-0.9	-3.2
Oct 2006	154.7	0.3	2.1	126.1	-0.9	9.4

Source: ANZ Commodity Price Index NZ – 3 November 2006

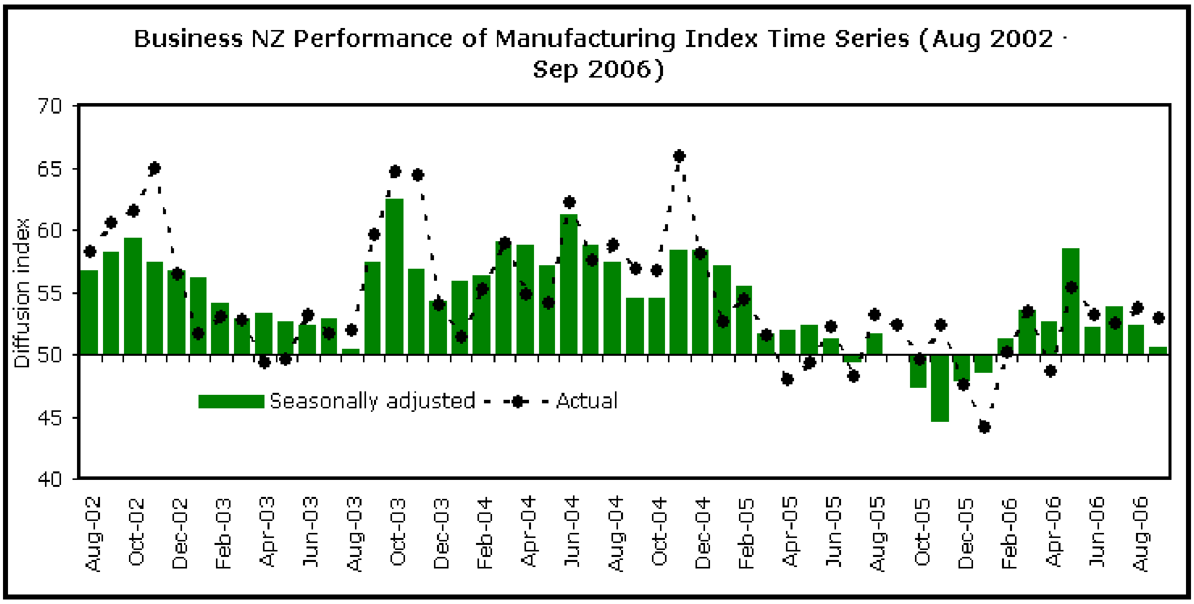
Business confidence – Less pessimistic

Business confidence influences the propensity for businesses to invest in capital and employ staff, so it is an important determinant of future economic growth. Businesses were somewhat pessimistic late last year and this pessimism has continued over the first two quarters of this year.

The September 2006 NZIER Quarterly Survey of Business Opinion (QSBO) reported that although businesses are still more negative than positive (a net 26% of firms expect deterioration compared to 40% in June 2006), expectations about the general business situation have improved sharply. In fact, this was the most positive result since March 2005, and the increase in confidence was reflected across all regions and business sectors.

In terms of their own activity, the number of firms reporting an increase in their own activities during the last quarter was the same as the number reporting a decrease.

Results for manufacturers show they are more positive than negative, with only 5% of manufacturing firms reporting a decline in output in the previous three months. Capacity utilisation for manufacturers increased for the first time since December 2004, and close to the all time high level of 92.6%. These results are similar to those recorded by the Business NZ Performance of Manufacturing index, which provides a monthly record of activity levels for manufacturers. While manufacturers have improved from consistent declines in activity during the later half of 2005, results have been positive and steady during 2006. Whether this remains the position for the rest of the year is debatable when the value of the New Zealand dollar continues to climb, putting pressure on exporting manufacturers.



One last notable piece of information to come out of the QSBO that is a worrying factor for both business and the Reserve Bank was the continued concern from businesses over cost increases with a net 32% of firms intending to increase prices over the next 3-months - up significantly on the net 28% recorded in the June 2006 survey.

Like the QSBO, the National Bank Business Confidence Index shows that businesses remain relatively negative about future business conditions, but the index continues to show continual improvement in confidence levels over recent months. During October a net 22% of respondents expected business conditions to deteriorate over the coming year – a significant improvement from the previous result that showed a figure of 34% for the month of August. The October result represents an 18-month high.

A similar improvement is evident in firms' own activity expectations, which is a key indicator of future economic growth. During October, this stood at +18%, which on historical values tends to suggest economic growth of around 2-2.5% - stable, but not spectacular.

It is interesting to compare the movement downwards of petrol prices (now only 2 cents a litre above levels at this stage last year), and the cost to growth due to the higher value of the New Zealand dollar. At this stage, the cuts to petrol prices are winning, while the effect on exporters regarding the high dollar is not as prevalent. While lower petrol prices relieve pressure on business margins, they also provide a tangible way in which consumers can also feel better off, and not feel squeezed in terms of their discretionary income, thus providing the capability to spend more, and relieving pressure on business margins. However, petrol remains at historically high prices, and further increases in the New Zealand dollar (particularly anywhere near the US70c mark) may tip the balance away from petrol prices providing some relief.

Consumer confidence – Improving but a way to go

Although the Westpac McDermott Miller Consumer Confidence Index continues to show low confidence amongst consumers, the result for September (111.7) was at its highest level since September 2005 (120.2), but still remains below its long run average of 112.1.

There have been various reasons for improved consumer confidence. As mentioned above, petrol prices have fallen; in addition to the implementation of the Working for Families package. Also, strong housing and labour markets have been a plus to consumers. However, escalating costs elsewhere, such as debt servicing costs, higher electricity prices and increased local government rates have caused reason for concern.

Looking ahead, the direction of consumer spending looks odds on to go down rather than up, when the housing market looks to have stalled (giving house owners no additional impetus to 'feel' more wealthy), slowing employment causing wage inflation to settle, and debt servicing costs to increase.

1.2 Inflation – odds on to show a descent

Most recent outcome: +3.5% year-ended September 2006

The rate of inflation, as measured by the Consumer Price Index (CPI), provides an indication of the extent to which price levels have increased and is indirectly a benchmark for wage demands. It is also the key reference point for monetary policy.

Inflation rose 0.7% in the September quarter (down from the surprisingly large 1.5% increase during the June quarter), with the impact of housing and housing utilities (up 2%) and food prices (up 1.9%) leading the way. In contrast, transport prices decreased 1.2%, as second hand cars eased in price. Overall, the inflation rate stood at 3.5% for the September year, which is again well outside the 1-3% inflation target by the Reserve Bank, although down from the 4% mark for the June quarter.

The Reserve Bank is continuing to watch these figures with extreme scrutiny. One would expect that inflation has reached its peak from the 4% annual rate for the previous quarter, although the descent will be slow. Annual inflation is not expected to be within the 1-3% band until sometime in 2008.

The dynamic between tradable and non-tradeable inflation in the short-medium future will be a key element in determining New Zealand's inflation path. If the gap continues to widen between the two, further movements by the Reserve Bank to curb domestic inflation will at the same time provide an adverse result on exporters as the dollar appreciates due to higher interest rates. A softening in domestic inflation is a key step in relieving inflation pressure overall.

Forecasts: % Change in Inflation (CPI)

	Years Ending		
	Dec 06	*Dec 07*	*Dec 08*
Highest	3.3	3.6	2.5
Average	3.1	3.0	2.0
Lowest	2.8	2.5	1.7

Source: ANZ, ASB, BNZ, National, and Westpac

1.3 Labour Costs – Wage pressures persist

Most recent outcome: +3.2% year-ended September 2006

Statistics NZ produces an index that measures movements in the total cost of employing labour, the Labour Cost Index (LCI). The LCI has fixed industry and occupation weights and measures changes in wages and salaries for a fixed quantity and quality of labour input. As such, the LCI is preferred by the Reserve Bank as a measure of labour costs.

Stronger demand for labour over recent years has caused skills shortages in a number of industries and regions, so pushing up average labour costs. Growth in the LCI has increased steadily since 1999 that reflects stronger employment growth and lower levels of unemployment. The latest wage inflation results continue to show the ongoing stretch in the labour market, with wage inflation at historic highs. Private sector salary and ordinary time wage rates increased 0.9% for the September 2006 quarter, taking the annual rate up to 3.0%. This is now the fastest quarterly increase since the series began in 1992.

Notwithstanding rises in the private sector, it is the public sector that is continuing to lead the way with wage and salary rises. The public sector recorded an average rise of 1.3% for the September quarter 2006 and 3.9% for the year to September 2006. This latest increase was driven by rises in the central government sector.

Forecasts show wage inflation pressure to gradually ease over the next few years, much like general inflation levels. However, a key element will be how much pressure is released from the labour market, which despite a small increase in unemployment is still very tight, with many firms struggling to find and retain staff.

Forecasts: Labour Cost Index % Change

	Years Ending		
	Dec 06	*Dec 07*	*Dec 08*
Highest	3.0	3.0	2.5
Average	2.8	2.6	2.2
Lowest	2.5	2.1	1.9

Source: ANZ, ASB, BNZ, National, and Westpac

An alternative measure of labour costs is the Quarterly Employment Survey (QES). The QES tends to be much more volatile than the LCI, mainly because it reflects compositional changes in the labour force. The most recent QES release shows that average total hourly earnings for all sectors grew by 5.1% for the year-ended September 2006.

1.4 Employment – strong but slowdown starting

Most recent outcome: +1.5% year-ended June 2006

Employment growth has been increasing on an annual basis since 1999. According to the Household Labour Force Survey, the number employed has grown by 33,000 in the year to September 2006, which represents an annual increase of 1.5%. Although this is still a significant increase, the annual increase for the June year was double that figure, while in late 2004 employment growth reached almost 4.5%. The level of growth in employment is definitely slowing, although the ever-decreasing pool of potential workers with which to increase numbers employed has meant a pull back in employment growth was due sooner rather than later. Quarterly employment growth actually fell 0.4%, which was mainly due to both a 0.3% fall in full-time employment and 1% fall in part-time employment. Annually, full-time employment grew by 1.9% while part-time employment almost stood still (+0.1%).

The latest QSBO showed lower employment hiring intentions, while the Business NZ PMI has shown a negative result for employment for some months. All factors point to a gradual weakening of employment, although when put in context the labour market is still extremely tight.

The unemployment rate now stands at 3.8%, up from 3.6% for the June quarter. Given the long-term average unemployment for New Zealand is 6.3%, one would expect significant space for the unemployment rate to increase before businesses are able to alleviate general labour shortages, and workers become more alert to their job situation given the ease of finding work at the present time.

Statistics New Zealand's Quarterly Employment Survey (QES) also showed a drop in quarterly growth. Employment, as measured by full-time equivalent employees decreased 0.3% for the September 2006 quarter. Over the year, it increased 2%, driven by construction, finance & insurance, and cultural & recreational services industries.

The ANZ Job Vacancy series show that the level of job advertising in New Zealand hit a new record high in the June 2006 quarter. Underpinning the rise has been a continued surge in internet based advertising, which rose 9% in June. The impact of internet advertising can be seen from the fact that when the ANZ began collating internet job advertising in March 2000, there were just over 10,000 advertisements posted on the main NZ websites at the time. This figure is now only marginally behind the 79,900 adverts that were placed on the seven major daily newspapers over the June quarter.

The ANZ Job Vacancy Rate (which measures job advertising as a proportion of employment) moved up slowly to 9.4% in June 2006. In would suggest that business are still advertising strongly, to keep pace with what has been a very resilient labour market to date.

Forecasts: Unemployment % (HLFS)

	Years Ending		
	Dec 06	*Dec 07*	*Dec 08*
Highest	3.9	4.9	5.0
Average	3.8	4.5	4.5
Lowest	3.7	4.2	4.2

Source: ANZ, ASB, BNZ, National, and Westpac

1.5 Interest Rates (90-day bill rate) – stability is the name of the game

Most recent outcome: 7.57% as at 10 November 2006

In general, overdraft and mortgage interest rates move in line with the 90-day bill rate, which is in turn heavily influenced by the Reserve Bank's OCR (although they may be in variance if the markets price in future increases or decreases in the OCR). As the market was divided whether the Reserve Bank would increase the OCR in late October, the 90-day bill rate got as high as 7.78% before falling significantly when the Reserve Bank announced no change for the current round.

However, the Reserve Bank remains concerned that medium-term inflation pressures remain significant. Therefore, monetary policy pressure will need to be maintained for some time to bring inflation back sustainably within the 1-3% target band.

Predictions for the 90-day bill rate have largely been revised down for the medium-long term, with the short-term level largely unchanged. Although further increases in the OCR cannot be totally ruled out over the short-medium term, we reiterate that it would be somewhat surprising if they were raised given the general slowing of the economy now evident.

Forecasts: Interest Rates (90 day bills)

	As at End of		
	Dec 06	*Dec 07*	*Dec 08*
Highest	7.6	7.0	6.1
Average	7.5	6.8	5.8
Lowest	7.5	6.7	5.6

Source: ANZ, ASB, BNZ, National, and Westpac

1.6 Exchange Rates – To fall, but when?

Most recent outcome: NZD = US$0.6661 as at 10 November 2006
NZD = AU$0.8647 as at 10 November 2006
TWI = 66.60 as at 10 November 2006

The NZ dollar continues to rise after spending the first half of 2006 tracking downwards. The TWI is now back at levels experienced in early April, while the NZ$:US$ shows a similar trend. The fact that the Federal Reserve has put a halt on rate rises has played a part in the continuing strength of the New Zealand dollar, although continued movements in the Cash Rate in Australia means the rate differential between New Zealand and Australia continues to narrow.

Despite the recent rise in the NZ dollar compared to our major trading partners, forecasters have continued to forecast significant declines in the NZ dollar over the medium term.

AUD (cents)			
	Dec 06	*Dec 07*	*Dec 08*
Highest	0.880	0.816	0.819
Average	0.864	0.774	0.792
Lowest	0.846	0.750	0.780

USD (cents)			
	Dec 06	*Dec 07*	*Dec 08*
Highest	0.668	0.620	0.590
Average	0.652	0.568	0.573
Lowest	0.630	0.540	0.560

TWI			
	Dec 06	*Dec 07*	*Dec 08*
Highest	66.4	63.4	59.1
Average	65.3	56.5	57.1
Lowest	62.9	53.5	54.2

Source: ANZ, ASB, BNZ, National, and Westpac

Part 2: The Australian Economy

Monitoring the performance of the Australian economy is critical in that firstly, it provides a measure of how well New Zealand exporters are likely to fare (a stronger Australian economy will generally 'suck in' imports) and secondly, it provides an indication of the likely strength of competition from Australian sourced products on the domestic market.

2.1 Economic Growth (GDP)

Most recent outcome: +2.3% for the year-ended June 2006.

Forecast 2007: +3.3%
Source: The Economist

Australia's annual GDP fell to 2.3% for the June year. However, forecasts point to increases in growth, with a growth rate over 3% by mid 2007. Weaker than expected GDP for Australia in the June quarter of 2006 (GDP rose just 0.3% which was well below market forecasts of 0.7%) can be seen as a temporary blip.

Despite the latest blip in GDP, growth prospects for Australia remain good on the back of continued strong commodity prices. A favourable business climate, strong profitability and high levels of capacity usage are contributing to rapid growth in investment spending. Consumers are also reasonably confident which is being reflected in consumption expenditure.

Some key recent economic statistics:

- Real retail sales up 6.0% in September 2006 compared with September 2005.
- New motor vehicle sales down 1.8% for September 2006 compared with September 2005.
- Manufacturers' sales down 1.4% for the June quarter 2006 compared to June 2005.
- Dwelling unit approvals up 6.0% for September 2006 compared to September 2005.
- Employment up 2.6% for September 2006 compared to September 2005.
- Unemployment rate of 4.8% as at September 2006 – down from 5.1% in September 2005.
- Company profits before tax up 10% for the June quarter 2006 compared to June 2005.

The latest Australian PMI results (October 2006) show that Australian manufacturing faces a similar situation to New Zealand. The PMI is currently at 51.9 (seasonally-adjusted). Manufacturing activity has slowed, reflecting weaker exports, patchy domestic demand and import competition.

2.2 Headline Inflation

Most recent outcome: +3.9% for the year-ended September 2006

Forecasts:

- Mid 2007: 2.8%

Source: The Economist

Inflation in Australia has increased of late and reached a peak of 4% for the year to June 2006, which included the impact of increasing fuel prices and a sharp rise in the price of bananas in the wake of recent cyclones. Since then, it has dropped slightly to 3.9% for the September year.

After holding interest rates at 5.25% for a long period of time, the Reserve Bank of Australia (RBA) lifted the cash rate to 5.5% in March 2005 and has subsequently moved it up three further times, including the most recent increase on November 8. This has meant the Cash Rate currently stands at 6.25%.

In announcing the latest increase, the RBA said the decision was taken against a background of continued expansion in the global economy and further evidence that inflationary pressures had increased.

Much of the inflationary pressures have been similar to New Zealand. Domestic demand has been expanding at a relatively strong pace against a background of limited spare capacity. Labour conditions have remained tight and business has been reporting high levels of capacity usage. Therefore, a somewhat more restrictive stance on monetary policy was required in order to moderate inflation over time, and thereby secure sustainable growth.

Part 3: Rest of the World

The economic picture in the rest of the world is very important for New Zealand. Over recent quarters, growth in the world economy has picked up, which will lift demand for New Zealand products and commodities.

United States

America's Federal Reserve held its benchmark interest rate at 5.25%, extending its pause for a third month after two years of step-by-step tightening. The Fed said that the economy seems likely to expand at a moderate pace, but added that some inflation risks remain.

America's housing market cooled further, with median house prices falling 2.2%. This was the second monthly fall in a row. Demand for loans to buy homes had eased, but bounced back a bit after a decline in the cost of borrowing.

The USA's growth rate continues to be one of the better performing, with GDP growth well over 3%. Continued expansion in growth is expected, fuelled by lower energy prices.

Europe

In the Euro area, the immediate industrial outlook remains good, with new orders rising 3.7% in August, leaving it 14.3% higher than the same time last year. This has primarily been due to higher demand for transport equipment and metal products.

GDP growth in the Euro area remains steady at 2.7%, although it is expected to taper off to 1.8% by 2007.

In Britain, annual growth was a little stronger at 2.8%, after growing 0.7% in the third quarter. This has raised expectations that interest rates may be increased soon.

Japan

After being in the economic doldrums for some years with deflationary pressures evident, the economic recovery in Japan over recent months is expected to continue and deepen with GDP growth of 2-3% likely over the next 2-3 years. While consumer prices are expected to rise slightly, inflationary pressures, by international standards, will remain modest. This is reflected in the Bank of Japan (BOJ) raising its target for the overnight call rate to only 0.25% in July. It should be noted that this was the first such increase since August 2000. Some further "tightening" in interest rates is expected, although four subsequent decisions have kept the call rate at 0.25%.

Deflationary pressures continue to fade. In August 2006 consumer prices increased by 0.9% year on year, well ahead of expectations by commentators. However, inflation is expected to increase at a much slower pace, only increasing by 0.5% by 2007.

A weaker yen has bolstered Japan's exports, widening the country's trade surplus to $8.5 billion in September, and 6.9% more than a year ago. Exports to the USA went up by 20.4%, and those to China increased 19.8%, thanks to rising demand for cars and electronics.

China

Economic activity in China is showing no signs of slowing. Latest results show GDP growth at 10.4% over the year, with industrial production increasing 16.1%. At the same time, inflation is in check, increasing only 1.5% over the year.

At the political level, the Government's main priority is on trying to achieve more balanced economic growth, by orientating policy measures towards the poorer western and central provinces and the less well-off sections of the population. The government is also trying to make the economy less dependent on exports and investment while introducing measures to boost consumption.

Forecasts: World GDP Growth (Selected Trading Partners)

Country	*Latest*	*2007*
Australia	2.3%	3.2%
Canada	2.9%	2.6%
Japan	2.5%	2.1%
United Kingdom	2.8%	2.4%
United States	3.8%	2.4%
Euro Area	2.7%	1.8%

Source: Economist

Forecasts: World Consumer Price Inflation (Selected Trading Partners)

Country	*Latest*	*2007*
Australia	3.9%	2.8%
Canada	2.4%	2.2%
Japan	0.9%	0.5%
United Kingdom	2.4%	2.2%
United States	2.1%	2.4%
Euro Area	1.7%	2.2%

Source: Economist