Business|NZ

Business Planning Forecasts

18 August 2005

FORECASTS: SEPTEMBER QUARTER 2005

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
August 2005

Part 1: The New Zealand Economy

1.1. Economic Growth (GDP)

Most recent outcome: +4.2% for the year-ended March 2005.

Gross Domestic Product (GDP) is a measure of total economic activity for a country over a given period. GDP growth has averaged 3.8% per annum over the past five years, with only one quarter of decline out of the last 20 (June 2000).

Although GDP growth in the March quarter 2005 was up slightly on the previous quarter (rising 0.6% compared to 0.3% for the December quarter), it was still the second lowest quarterly growth since the June 2003 quarter. Growth in the March quarter was due to a lift in internal demand with buoyant household spending and strong business investment. Export volumes fell 2.6%, with marked falls in exports of wood and wood products, and other manufactured exports. In contrast import volumes rose 1% in the March quarter and were up 13.3% for the year to March 2005.

Short-term forecasts for economic growth have been significantly revised down for the second quarter running; although long-term forecasts have stayed pretty much the same. They now suggest that GDP will increase by 2.7% for the year ended September 2005, but will fall to around 2.2% for the year ending September 2006 before picking up again to around 2.8% by June 2007. These longer-term forecasts out to 2007 are more or less in line with Treasury's Economic Outlook as presented in the pre-election Fiscal and Economic Outlook (August 18 2005).

Forecasts: Real GDP % Growth

	Years Ending		
	Sep 05	*Sep 06*	*Sep 07*
Highest	2.8	2.5	3.0
Average	2.7	2.2	2.8
Lowest	2.7	1.9	2.6

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

Key factors to influence GDP over the next two years will include:

Global Economic Outlook

Global growth has slowed since early 2005 with a persistent weakness in demand in Europe. However, more recently, economic news has generally been positive in the US and Japan.

The big risk remains the future direction of world oil prices, which recently reached a new high of US$67 per barrel. The other ongoing risk is the threat of terrorism, which again has reared its ugly head. Nevertheless, recent terrorist attacks seem to have had a very short-lived impact on financial markets. In a bizarre way, New Zealand may benefit from such terrorist attacks given our relatively "safe haven" status in respect to tourism and immigration.

Interest rates

The Reserve Bank has now kept its Official Cash Rate (OCR) at 6.75% since raising it from 6.5% on the 10th of March 2005. The Reserve Bank has belatedly conceded, *"the economy has recently shown signs of softening".* However, the Reserve Bank remains concerned about additional short-term inflationary pressures which have emerged (principally surging oil prices) and uncertainty over the direction of the exchange rate which it believes could well push CPI inflation temporarily above the 3% threshold over the coming quarters. As a result, in the words of the Reserve Bank Governor, *"Certainly there remains no prospect of a policy easing in the foreseeable future*"

The Dollar

The past couple of months has since a significant drop in the NZ$ and then in recent weeks a strong rebound in the dollar with it currently hovering around the US70c mark. The NZ$ was widely considered to be over-valued by many economists with a substantial downward correction largely expected. Indicators such as New Zealand's current account deficit would suggest a reasonably substantial drop is warranted. Whether the latest rebound is a short-term blip before the dollar falls again remains to be seen but most expectations are for a further substantial drop in the value of the NZ$ over the next couple of years. The NZ$ dipped sharply in June/July against the AUS$ but since then has recovered much of the lost ground to be around the 92c mark against the AUS$. Similarly, the TWI took a tumble from around 71c in June to 68.5c in July. It has substantially recovered to be hovering around over the 70.5c mark.

Tourism and net migration flows

Over the past two to three years strong tourism numbers have helped maintain retail sales growth, and 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 in the labour market. While the prospects for tourism appear good, net migration is continuing to turn downwards at a sharp rate.

The annual net migration gain peaked at 42,500 for the year ended June 2003 but has fallen to an 8,800 gain for the year ended June 2005. While the current net gain is still above the long-run average, continued falls in migration arrivals and increases in migration departures will most likely see net gains fall further, and may lead to net losses if the current rate of fall continues.

As the slowdown in migration continues along with stable, albeit relatively high interest rates, the housing market should continue to dampen, although recent figures have shown there's still life in the property market which perhaps defies some of the fundamentals. While the median sell price for a house has dipped slightly to $280,000 in July 2005 (down from the record $284,500 in June), on a year-on-year average basis the median house price is still up 12.45% from the median a year ago of $249,000. The number of days taken to sell a house has increased slightly, up from 28 days in March/April to 31 days in July 2005. Despite the most recent statistics that are largely a mixed bag (six regions showing rises and six regions showing declines) here is no evidence of a widespread correction at this stage which somewhat defies logic with sharply reduced immigration and relatively high interest rates compared with our recent history. Maybe people are buying in the expectation that if they don't get in now they will never get a house. This mentality is certainly driving household debt levels much higher than in the early 1990s.

Short-term visitor numbers to New Zealand were up 22,700 (17%) from June 2004. Seasonally-adjusted monthly visitor arrivals were up 14% in June 2005 following a rise of 6% a month earlier. The British and Irish Lions team arrived in New Zealand at the end of May to play 11 matches between 4 June and 9 July. As a result, estimates by Statistics NZ suggest that the total number of Lions fans likely to have come to New Zealand over the period ranged from between 15,000 and 30,000. This is likely to have resulted in a one-off "blip" in short-term visitor members as suggested in closer analysis of the data. For example, in June 2005, there were 123% more visitors from the United Kingdom and 168% from Ireland in June 2005 compared to June 2004. As could be expected the number of guest nights in short-term commercial accommodation was up 7% compared with June 2004 and a 23% increase compared to June 2003.

Commodity prices and farm incomes

International commodity prices have boomed since 2003 although there is signs that the long golden period is about to come to an end. ANZ Bank's Commodity Price index shows that while in July 2005 the index remained 4.0 percent higher than in July 2004 some weakening over the last two months is evident. World prices for New Zealand export commodities recorded a second consecutive decline in July with lower world prices for apples, kiwifruit, logs, wood pulp and wool leading the charge. This was partially offset by rises in prices for beef, venison, skins and aluminium. Overall, the index dropped by 0.5% in July.

While the significant drop in the New Zealand dollar in July acted to offset a decline in commodity prices to exporters, with the very recent rebound in the NZ$, any gains from a lower dollar are likely to be short-lived. However, with growth having slowed, the current account deficit hitting 7% and the interest rate differentials between New Zealand and the rest of the world (particularly the US) diminishing, it is likely that exporters will be buffered from any further major decline in world export prices through a substantially lower dollar. The big question is not if the dollar falls substantially, but when?

Business confidence

Business confidence influences the propensity for businesses to invest in capital and employ staff, so is an important determinant for future economic growth. Businesses were somewhat pessimistic early in the year and this pessimism has continued over more recent months.

The June 2005 NZIER Quarterly Survey of Business Opinion reported that business confidence declined everywhere except in those sectors and regions already the most pessimistic. A net 34% of firms expect business conditions to deteriorate over the next six months – a level of pessimism exceeded only a few times since the early 1990s. Resources are still stretched thin as capacity utilisation is still near historic highs (92.9% compared to 92.3% in the previous survey). Labour continues to be the key constraint, although there was a sharp decrease in the number of firms having difficultly finding labour compared to the previous quarter. Nevertheless, the number of firms reporting difficulties in finding labour is still very high by historical standards. Trading activity is still reasonably robust but there are signs of a general softening, with a net 12% of firms expecting to increase their own activity in the next three months, down from a net 18% in the March quarter. On a more positive note, investment intentions remain high with a net 5% of firms intending to invest more in plant and machinery over the next twelve months.

The National Bank Business Confidence Index shows a slight rebound in business confidence from the earlier pessimism expressed in May. In July, a net 43% of businesses expect general conditions to deteriorate over the coming year compared with a net 49% in June. The improvement was most notable in the services sector but also some improvement was experienced in the manufacturing and construction sectors. Despite the slight rebound in confidence over the last two months, it is still at a very low level by historical standards. A net 15% of respondents expect an improvement in their own business activity compared with only a net 7% last month. Profit expectations are down but investment intentions are up which bodes well for further employment growth with a net 5% of firms expecting to hire more staff, up from less than 1% last month.

Meanwhile, the ANZ-Business New Zealand Performance of Manufacturing Index (PMI) stood at 48.2 for July 2005, compared to 57.5 for July 2004. 2004 was a particularly good year for manufacturing, while 2005 is so far has been patchy. All regions except the Northern region had an increase in activity during July, led by Canterbury/Westland (54.6). The Northern region (44.8) recorded its largest decline since the survey began. Despite the recent decline in the PMI compared to 2004, there is still strength in the manufacturing sector. However, the drop off in new orders (48.6) signals a likely drop in production in the near future. Overall, various surveys on the economy would suggest the economy has slowed and reinforces a “soft landing” approach for the economy rather than a rapid reduction in output growth over the next 2-3 years.

Consumer confidence

The Westpac McDermott Miller Consumer Confidence Index fell to its lowest level in two years in the June 2005 quarter (120.2) but is still at a very healthy level by historical standards. Confidence appears strongly driven by house prices, with solid increases in provincial areas holding up confidence levels. By contrast, a levelling out of house prices in most cities has taken the gloss off consumer confidence. Given close to "full-employment", rising real wages, and as just mentioned, increases in house prices, has given consumers confidence to go out and spend and damn the consequences. This is being reflected in increased levels of household debt.

The outstanding debt of households has increased strongly since 1990, quadrupling in dollar terms and more than doubling as a percentage of households' disposable income. Weighted average interest rates however have flattened from over 15% to about 8% per annum (with around 90% of household debt being housing debt). Interest servicing costs of the increased debt, as a percentage of incomes, is about 20% higher now than it was in 1990. However, the ratio of household debt to income (excluding student loans) is similar to those found in Australia, the UK and USA.

1.2 Inflation

Most recent outcome: +2.8% year-ended June 2005

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 a benchmark for wage demands. It is also the key reference point for monetary policy.

Inflation continued to increase in the June quarter (up 0.9%), with the impact of oil and infrastructure costs leading the charge. Overall, the inflation rate stood at 2.8% for the June year, which is near the limit of the 1-3% inflation target by the Reserve Bank. The booming housing market continues to be one of the main drivers of inflation (up 1.7% for the June quarter), while contributions from transportation (up 2.1% for the June quarter which mainly reflects higher prices for petrol) and increased electricity charges (up 0.5%) also made significant contributions to the rise.

The strong NZ$ over the past two years has acted as a dampener on overall inflation although significant increases in oil prices (trading at up to US$67 per barrel), and a strong likelihood of a weakening NZ$ over the next 2 years (on the back of significant current account deficits and reduced interest rate differentials between NZ and particularly the US) could see inflationary pressures continue to mount at a time when the general growth in the economy is slowing.

While the Reserve Bank has the ability to ignore "one-off" increases in prices beyond their control (e.g. oil shocks), most forecasts expect that inflation will remain towards the top-end of the Reserve Banks target range (1-3%) for the foreseeable future. Given the above, any substantial cuts to interest rates appear to be a long way off.

CPI forecasts have been revised upwards for the short-term, although the average shows the figures still below (only just) the all-important 1-3% inflation rate threshold for the medium to long-term as well. These expectations also indicate that a fall in inflation levels bringing about an accompanying fall in interest rates may be some time away.

Forecasts: % Change in Inflation (CPI)

	Years Ending		
	Sep 05	*Sep 06*	*Sep 07*
Highest	3.2	3.4	3.1
Average	3.2	2.9	2.5
Lowest	3.0	2.5	1.8

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

1.3 Labour Costs

Most recent outcome: +2.6% year-ended March 2005

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 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 which reflects stronger employment growth and lower levels of unemployment. Not surprisingly, labour costs tend to have an inverse relationship with unemployment levels. The June quarter 2005 saw an increase of 0.6% for all salary and wage rates from December 2004, and an increase of 2.6% for the year ended June 2005.

The public sector continues to attract the largest rises in labour cost (up 2.9% in the year to June 2005), compared to 2.5% for the private sector. This partially reflects the significant rise in the number of public servants over the last five years and the need to attract staff to fill new roles in the public sector.

Health and professionals' salary and wage rates rose 3.1% in the June 2005 quarter while substantial rises also occurred for labourers' (up 1.5% for the June quarter) and health and community services (up 1.7%).

Wage inflation pressures are likely to remain relatively high during the remainder of 2005. Labour market shortages still persist and with unemployment at historically low levels further wage pressures seems to be inevitable. While wage pressures do not necessarily lead to increased inflation (provided they are offset by strong productivity growth), New Zealand's overall record on productivity growth is relatively dismal compared to our major trading partners.

Labour cost forecast have remained relatively static compared the last quarter with expectations that wage and salary pressures will ease over the medium to long-term.

Forecasts: Labour Cost Index % Change

	Years Ending		
	Sep 05	*Sep 06*	*Sep 07*
Highest	2.6	3.0	2.6
Average	2.6	2.4	2.0
Lowest	2.4	2.0	1.6

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 hourly earnings grew by 3.5% for the year-ended June 2005.

1.4 Employment

Most recent outcome: +3.0% year-ended June 2005

Employment growth has been increasing on an annual basis since 1999. According to the Household Labour Force Survey, the number employed has grown by 61,000 in the year to June 2005 which represents an annual increase of 3%. While there was weak growth in the previous quarter (March 2005), employment growth recovered strongly over the June quarter increasing by 11,000 to 2,065,000. Employment is now at its highest level recorded since the HLFS began. Unemployment increased slightly in the March quarter 2005 (3.9%) after reaching a record low of 3.6% in the December 2004 quarter (the lowest unemployment rate in the OECD). However, the June quarter saw a reduction in the unemployment rate to 3.7%, again the lowest in the OECD.

While recorded employment growth is still very strong with associated reductions in unemployment, there are some leading indicators (e.g. the ANZ Job Advertisements series), which would suggest that future employment growth is likely to level off.

Perhaps the disadvantage of the HLFS compared to, say, the ANZ Job Advertisement series, is that it reflects the outcomes of past investments whereas current job ads generally reflect current or likely investments.

The ANZ Job Advertisement series shows that while internet-based job ads continue to surge which reflects a change away from traditional newspaper approaches (up 13.2% in July 2005), the number of newspaper based job advertising slipped 1.2 percent in July, the third successive decline in the series. While not too much should be read into this trend, it would suggest that while the job market is still very buoyant, employment growth prospects are likely to tamper off over coming months. This would certainly reflect the trend in a number of business surveys.

The labour force participation rate rose to 67.7% in the June 2005 quarter. This is the equal highest rate of participation since the HLFS began in 1986.

Unemployment forecasts have been revised slightly upwards for the short, medium and long-term (please note that forecasts were received before the June quarter unemployment rate of 3.7% was announced). While forecasts show an unemployment rate creeping up beyond 4% for 2006 and 2007 this still represents an extremely low rate by historical standards and would continue New Zealand's recent reputation as having one of the lowest unemployment rates within the OECD.

Forecasts: Unemployment % (HLFS)

	Years Ending		
	Sep 05	*Sep 06*	*Sep 07*
Highest	3.9	4.6	4.6
Average	3.7	4.2	4.3
Lowest	3.5	3.7	3.8

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

1.5 Interest Rates (90-day bill rate)

Most recent outcome: 7.05% as at 18 August 2005

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).

So far this year, the Reserve Bank has increased the OCR once, with it now standing at 6.75%. The Bank is still concerned that strong inflationary pressures exist, although recent economic data has pointed towards a potential slowdown. Nevertheless, pressure remains with higher oil prices as well as the potential for the strong NZ$ to weaken over the next year or so thus feeding through into imported inflation.

The recent depreciation of the exchange rate will obviously bring about concerns that tradable inflation will continue to increase. If sustained, a weaker NZ$ will generate imported inflation at a time when domestic inflation is already at uncomfortable levels. The Bank will be watching for further signs of the domestic economy slowing and easing inflationary pressures, otherwise it will be forced to make further increases in the OCR. However, as mentioned earlier, the Reserve Bank would be loath to increase interest rates further in light of a general slowing in the economy, particularly if inflationary pressure are "one-offs" (e.g. oil prices) which are outside the ability of domestic producers to control.

Most economists have keep their forecasts of 90-day interest rates for 2006 and 2007 reasonably static although short-term interest rates are likely to stay at current levels for some time. A slight easing by the Reserve Bank early next year is possible, although a lot hinges on what occurs to the NZ$ in the intervening period. A sudden decline, which is not totally unexpected, could put pressure on the Reserve Bank to keep interest rates at current levels or even increase them.

Forecasts: Interest Rates (90 day bills)

	As at End of		
	Sep 05	*Sep 06*	*Sep 07*
Highest	7.0	6.5	6.2
Average	7.0	6.3	6.0
Lowest	7.0	5.9	5.7

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

1.6 Exchange Rates

Most recent outcome: NZD = US$0.70.0 as at 18 August 2005
NZD = AU$0.92.1 as at 18 August 2005
TWI = 70.3 as at 18 August 2005

After a significant depreciation against the US$ and AUS$, in June 2005, the NZ$ has regained most of the ground lost at the time of writing. While projections of exchange rates are at best a stab in the dark, there are signs that the NZ$ should weaken against both the US$ and the AUS$. A slowing economy, current account deficits of 7% and reductions in the levels of interest rate differentials between NZ and the rest of the world would suggest a significant drop in the value of the NZ$ is likely. However, as the recent drop, then rebound in the NZ$ has taught us, accurately forecasting changes in exchange rates is fraught with difficulty. Currency forecasts must always be treated with a generous pinch of salt.

Forecasters have revised down their short and medium term expectations, but have revised up forecasts out to 2007. If the NZ$ shows strong downward trend over the coming months, medium-long term expectations will likely follow suit.

AUD (cents)			
	Sep 05	*Sep 06*	*Sep 07*
Highest	90.0	86.3	88.0
Average	89.2	84.5	85.8
Lowest	87.0	82.5	85.0

USD (cents)			
	Sep 05	*Sep 06*	*Sep 07*
Highest	70.0	63.0	59.0
Average	65.5	57.8	55.8
Lowest	60.0	55.0	52.0

TWI			
	Sep 05	*Sep 06*	*Sep 07*
Highest	69.4	63.8	61.6
Average	66.8	60.1	59.5
Lowest	62.1	57.1	56.5

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 be 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: +1.5% for the year-ended March 2005.

Forecasts (averages):
- Mid 2005: +2.4%
- Mid 2006: +3.1%

Source: The Economist

Australia's annual GDP dropped to 1.5% for the March 2005 year, which was the lowest annual GDP result since mid 2001 as consumer spending and home building cooled. However, forecasts point to a 2.4% growth rate over 2005. Looking out to 2006, GDP growth is expected to pick up to 3.1%.

Some key recent economic statistics:

- Real retail sales up 2.8% in June 2005 compared to June 2004.
- Motor vehicle sales up 4.7% for June 2005 compared to June 2004.
- Manufacturers sales down 1.9% for March 2005 compared to March 2004.
- Dwelling unit approvals down 6.5% for June 2005 compared to June 2004.
- Employment up 3.6% for June 2005 compared to June 2004.
- Unemployment rate of 5.1% as at June 2005 compared to 5.6% in June 2005.
- Company profits before tax up 13.5% for March 2005 compared to March 2004.

The latest Australian PMI results show that the underlying weaknesses seen in June 2005 has resurfaced again in July with overall activity falling significantly. The PMI fell by 6.5 points to 48.7, below the critical 50 points mark. The weaknesses were reflected in production, new orders, employment and deliveries all declining during the month, while finished stocks levels rose which signals clearly that next months release of the PMI is likely to be even lower.

2.2 Headline Inflation

Most recent outcome: +2.5% for the year-ended June 2005

Forecasts:
- Mid 2005: 2.4%
- Mid 2006: 3.1%

Source: The Economist

After breaching the higher limit of the Reserve Bank of Australia's 2-3% target in March 2003, inflation has steadily eased as the economy has generally experienced a slowdown. Because of tighter monetary conditions and slowing growth in 2005, inflation is expected to stay below 3%.

Australia's wage cost index increased by 3.9% for the year ended March 2005, while Australia's unemployment rate remains at 5.1% - considerably higher than New Zealand's current rate of 3.7%.

2.3 Interest rates (90-day bills)

Most recent outcome: 5.62% as at 18 August 2005

Late in 2003 the Reserve Bank of Australia (RBA) increased its OCR twice (from 4.75% to 5.25%) but left it untouched during the whole of 2004. In March, the RBA decided to increase the OCR by 25 basis points, due to reduced capacity, stronger inflationary pressures, stronger domestic and global demand, and increased prospects of spending growth.

Given that consumer price inflation remains relatively mild, and the increases in the rate of growth in wages have been relatively modest, it is likely that the Reserve Bank of Australia will leave the OCR at its current level for quite a while. It is evenly balanced as to whether the next move will be up or down but there is little to suggest moving it from its current level of 5.25%.

Part 3: Rest of the World

The economic picture in the rest of the world is very important for New Zealand. Generally speaking, the international climate was not particularly favourable over the period 2000-03, although economic conditions started to pick up for 2003-2004. Oil prices continue to present a risk to the global economy, pushing to new highs on the back of strong demand and refining constraints. The impact of increased terrorism is also an ever-present risk. Nevertheless, economies have taken recent terrorist attacks in their stride.

United States

US GDP growth slowed to an annual rate of 3.4% in the June quarter 2005, down from 3.8% in the March quarter, but year-on-year growth was unchanged at 3.6%.

The US Federal Reserve tightened interest rates in July 2005, for the ninth straight meeting. This helped the US dollar push to new highs for the year.

The manufacturing ISM survey (the US version of the PMI) rebounded in June after six months of continuous falls, suggesting that the US economy has bottomed out. Quite importantly, there was a jump in the number of new orders component of the survey, which is often a leading indicator of good news to come.

The labour market continues to improve and consumer confidence indicators rose further in June 2005 on the back of a reasonably buoyant housing market (median house sale prices rose 12.5% for the year to June 2005.

Japan

For over a decade the Japanese economy has been stagnating and suffering from prolonged deflation. However, there have more recently been signs of a rebound, with a raft of good economic data over the past quarter.

Households appear more positive which is being reflected in increased activity in the retail and service sectors. The driving force behind this development is a significantly improved labour market, with rises in full-time jobs while part-time jobs have declined since the start of the year.

Asia

Asian economies continue to boom with GDP in China expected to be up 9.1% for 2005 and 8.1% for 2006. While this represents a decline from the recent double–digit growth rates experienced, industrial output was up 16.6% in the year to May 2005. Hong Kong growth rates are expected to fall away from the historically high level of 8.1% in 2004 to 4.6% in 2005 and 3.6% in 2006. However, these still represent highly respectable growth rates for a developed economy.

India's growth rate for the year to March 2005 was 6.7%, with expectations of 7.2% 2005/06 before moderating to 6.7% in 2006/07. Give the minority coalition government in India, bold economic reforms, especially those requiring legislative action, are unlikely occur with lacklustre economic governance continuing to act as a drag on the economy.

Europe

Europe is facing a number of negatives at the moment. Increased oil prices (in euros) are up around 50% from the start of the year, which will reduce profits and dampen consumer demand. Businesses are also facing increased political uncertainty, which may act as a disincentive for further investment in both capital and labour. On the positive side, the depreciation of the euro exchange rate since the start of 2005 should lead to an increase in exports and profits margins for exporters.

Overall growth rates for the euro area remain dismal with expectations of 1.3% growth for 2005 rising slightly to 1.7% in 2006. These are hardly the sorts of growth rates necessary to absorb some of the significant unemployment facing a number of euro members.

Evidence of a slowdown in the United Kingdom is mounting with retail sales weakening and manufacturing declining. The impact, if any, of the London terrorist bombings, are yet to be noticed, although given that consumer confidence was in a relatively fragile state before the bombings, this event may have been enough to tip the balance. Financial markets appear to be already contemplating a further easing in monetary policy.

Forecasts: World GDP Growth (Selected Trading Partners)

Country	*2005*	*2006*
Australia	2.3%	3.1%
Canada	2.7%	3.0%
Japan	1.7%	1.7%
United Kingdom	2.1%	2.1%
United States	3.6%	3.3%
Euro Area	1.3%	1.7%

Source: Economist

Forecasts: World Consumer Price Inflation (Selected Trading Partners)

Country	*2005*	*2006*
Australia	2.7%	2.6%
Canada	2.1%	2.2%
Japan	-0.1%	0.3%
United Kingdom	1.9%	1.9%
United States	2.9%	2.6%
Euro Area	2.0%	1.6%

Source: Economist