World Economic Prospects
Monthly Review

September 2004
### GROSS DOMESTIC/NATIONAL PRODUCT

| Region      | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|-------------|------|------|------|------|------|------|
| North America |      |      |      |      |      |      |
| United States | 3.0  | 4.3  | 3.7  | 3.1  | 3.0  | 3.2  |
| Canada       | 2.0  | 3.0  | 3.0  | 2.4  | 2.7  | 2.7  |
| Mexico       | 1.1  | 3.8  | 4.0  | 3.9  | 3.6  | 3.5  |
| Europe       |      |      |      |      |      |      |
| EuroZone     | 0.5  | 1.8  | 2.2  | 2.4  | 2.3  | 2.1  |
| Germany      | -0.1 | 1.4  | 1.9  | 2.0  | 1.8  | 1.4  |
| France       | 0.5  | 2.5  | 2.4  | 2.6  | 2.3  | 2.3  |
| Italy        | 0.4  | 1.0  | 1.9  | 2.4  | 2.1  | 2.1  |
| Spain        | 2.5  | 2.5  | 2.9  | 3.0  | 2.9  | 2.8  |
| Netherlands  | -0.9 | 1.1  | 2.1  | 2.7  | 2.6  | 2.6  |
| Belgium      | 1.1  | 2.5  | 2.1  | 2.1  | 2.1  | 2.0  |
| Austria      | 0.7  | 1.5  | 2.5  | 2.7  | 2.4  | 2.2  |
| EU15         | 0.8  | 2.1  | 2.4  | 2.4  | 2.3  | 2.2  |
| UK           | 2.2  | 3.4  | 2.8  | 2.3  | 2.8  | 2.6  |
| Sweden       | 1.7  | 3.1  | 2.6  | 2.5  | 2.5  | 2.5  |
| Switzerland  | -0.5 | 1.3  | 1.8  | 1.9  | 1.9  | 2.0  |
| Far East     |      |      |      |      |      |      |
| Japan        | 2.5  | 4.3  | 2.4  | 1.9  | 1.5  | 1.5  |
| Australia    | 3.0  | 3.5  | 3.4  | 3.7  | 4.0  | 3.8  |
| South Korea  | 3.1  | 4.8  | 5.4  | 5.5  | 5.3  | 5.0  |
| Taiwan       | 3.3  | 6.0  | 4.7  | 4.6  | 4.4  | 4.2  |
| G7           | 2.2  | 3.4  | 2.8  | 2.5  | 2.3  | 2.3  |
| OECD         | 2.0  | 3.5  | 3.0  | 2.7  | 2.6  | 2.6  |
| World        | 2.8  | 4.2  | 3.6  | 3.3  | 3.3  | 3.3  |
| World 2000 PPPs | 3.8  | 5.1  | 4.5  | 4.2  | 4.3  | 4.4  |

### CONSUMER PRICES

| Region      | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|-------------|------|------|------|------|------|------|
| North America |      |      |      |      |      |      |
| United States | 2.3  | 2.7  | 2.2  | 2.1  | 2.6  | 2.7  |
| Canada       | 2.8  | 1.9  | 2.5  | 2.6  | 2.7  | 2.6  |
| Mexico       | 4.5  | 4.3  | 3.4  | 3.4  | 3.2  | 3.2  |
| Europe       |      |      |      |      |      |      |
| EuroZone     | 2.1  | 2.1  | 1.8  | 1.8  | 2.0  | 2.0  |
| Germany      | 1.1  | 1.6  | 0.8  | 1.1  | 1.7  | 1.7  |
| France       | 2.1  | 2.2  | 1.6  | 1.7  | 1.8  | 1.8  |
| Italy        | 2.6  | 2.2  | 2.0  | 1.9  | 1.8  | 1.8  |
| Spain        | 3.0  | 3.1  | 2.4  | 2.2  | 2.2  | 2.1  |
| Netherlands  | 2.1  | 1.3  | 1.6  | 1.7  | 1.8  | 1.8  |
| Belgium      | 1.6  | 1.9  | 1.7  | 1.6  | 1.6  | 1.7  |
| Austria      | 1.4  | 1.8  | 1.4  | 1.6  | 1.6  | 1.7  |
| EU15         | 2.2  | 2.2  | 1.8  | 1.8  | 2.0  | 2.0  |
| UK**         | 2.8  | 2.2  | 2.2  | 2.2  | 2.3  | 2.5  |
| Sweden       | 1.9  | 0.7  | 2.3  | 2.0  | 2.0  | 2.0  |
| Switzerland  | 0.6  | 0.6  | 1.3  | 1.5  | 1.7  | 1.7  |
| Far East     |      |      |      |      |      |      |
| Japan        | -0.3 | -0.2 | -0.2 | 0.0  | 0.1  | 0.1  |
| Australia    | 2.8  | 2.4  | 2.5  | 2.5  | 2.5  | 2.5  |
| South Korea  | 3.5  | 3.9  | 3.5  | 2.9  | 3.0  | 3.1  |
| Taiwan       | -0.3 | 2.0  | 1.7  | 1.6  | 2.0  | 2.0  |
| G7           | 1.9  | 2.1  | 1.7  | 1.6  | 2.0  | 2.1  |
| OECD***      | 2.0  | 2.1  | 1.8  | 1.7  | 2.0  | 2.1  |

** UK Underlying Rate  
*** OECD Total excludes Turkey
OVERVIEW

A brief pause…

- The summer months have seen plenty of speculation that the global economy is running out of steam. US growth dipped to a below trend 2.8% at an annualised rate in 2004Q2, while Japan also slowed sharply. And the authorities in China - a vital engine of Asian growth in the last three years - are attempting to bring their own economy down gently. Add in the dampening effect of high oil prices, which remain over $40 pb, and it is easy to see why pessimism has grown.

…but the global economy is on track…

- But at the moment we see no reason to change our view; the world economy is still in good shape and we expect global GDP growth (in PPP terms) of around 4½% in 2005 after 5% this year. Given the strength of growth over the last year, we shouldn't be surprised to see some softer patches in activity at this stage in the economic cycle. The dismal US jobs data in July certainly fell into this category, but August saw an improvement. And with new incentives in the car market in the last couple of months, we expect US consumer spending, and GDP growth, to now pick up back above 3%. Meanwhile, Japan has merely moved onto a more realistic growth path after a heady couple of quarters. Business investment and profitability remain strong, so growth should stay above 2% heading into 2005.

- The fact we expect Japan and the rest of Asia to slow slightly in part reflects our belief the Chinese authorities will successfully engineer a soft landing. There are already signs this is happening: tight restrictions on credit mean slower investment growth and car sales, while the expansion of industrial production and exports, while still rapid, has cooled off a bit. This is welcome - some discomfort now seems a small price to pay to avoid more drastic action sometime next year.

…despite the threat from oil prices

- Another sign the Chinese medicine is working is in inflation, which has probably peaked around 5%. In fact given the rise in oil prices over recent months the pressure on core inflation has been pretty modest in most countries. While the possibility of higher oil prices is still a risk to the forecast, the effect of this should not be overstated. Indeed the major central banks appear happy to accommodate the direct impact of higher oil prices - although they will be eager to prevent any second-round effects from spilling over through higher wage demands. As a result, the stance of monetary policy will continue to support healthy growth heading in the coming quarters.
UNITED STATES

Past the weak patch

- There have been some positive developments recently that suggest that the period of weakness encountered in the late spring and early summer is over. These include rebounds in consumer spending and industrial production in July and the more rapid growth in payrolls in August, along with the upward revisions to payrolls in June and July.

- A closer look at these developments, however, suggests that it is too soon for celebration. The 0.4% July gain in industrial production was not sufficient to make up for the previous month's decline, resulting in a third quarter gain that is the slowest in five quarters. The June fall and July rebound in consumer spending was caused to a great extent by sharp swings in motor vehicle sales. These were weak again in August.

- Payrolls expanded by 144,000 in August, well above the upwardly revised gains in June and July but at the lower end of expectations and below the monthly rate of 150,000 or so required to absorb population growth. The unemployment rate did edge down by a tenth to 5.4%, but that was due to a 122,000 drop in the labor force, as would-be workers gave up the search.

- Although these indicators are at best lukewarm, there are other factors that support growth going forward. New orders and order backlogs have been posting robust, double-digit growth when measured on a year-ago basis, suggesting stronger growth in industrial production in coming months. And the ISM indexes for both the manufacturing and nonmanufacturing indexes remain well above the 50 mark, signalling expansion. In August, consumer confidence fell by 7.5 points, but at 98.2 it is still consistent with moderate growth in consumer spending.

- Oil prices have fallen by about 10% from their mid-August peaks, and gasoline prices have stabilized at levels well below the highs of last May. This should support both real discretionary income and consumer confidence, allowing for stronger growth in consumer spending in the second half of the year.

- Our forecast is for a moderate strengthening of the economy after a weak Q2, but growth will fall well short of the second half of last year and first quarter of this year. Real GDP should expand at an annual rate of about 3.7% during the second half of this year, posting a similar increase for the year as a whole.
The Fed will continue on course

- Although, as mentioned, oil prices have retreated, the inflation measures have climbed. This is certainly true of the overall indexes, which includes energy, but is also apparent, to a lesser extent, in the core indexes, which exclude both energy and food. But food and energy are excluded in the core indexes because of their month-to-month volatility. Over a longer period of time, these volatile prices must be considered.

- The Federal Reserve has moved its target for the federal funds rate higher twice this year. The two quarter-point hikes have boosted the rate to 1.5% and we had been expecting two more hikes this year, in November and December. That assumed no change at the FOMC meeting in September. We had always felt this to be a close call, but given the proximity to the election and the weakness of a lot of the statistics earlier this summer, gave a slightly greater probability to no change in September.

- We still think it is a close call, but with inflation near the upper limit of the Fed’s presumed tolerance and prospects for growth a bit above trend in the near term quite good, we now assign a slightly higher probability to the near term hike.

- Our forecast now assumes three more quarter-point hikes this year, boosting the federal funds target to 2.25% at year end. We expect the Fed to continue tightening through 2005, bringing the target to 4.0% by the end of that year. At that point, the real federal funds rate would still be below its historical average.

---

**Key Indicators: United States**

*Percentage changes from previous month unless otherwise stated*

| Year | Month | Industrial production | Capacity Utilization | Unemployment | CPI | Core CPI | Consumer Confidence | Nominal Net Trade | Retail sales |
|------|-------|-----------------------|---------------------|--------------|-----|----------|---------------------|------------------|-------------|
| 2003 | Sep   | 0.6                   | 74.9                | 6.1          | 0.3 | 0.1      | 77.0                | -41.3            | -0.5        |
|      | Oct   | 0.3                   | 75.0                | 6.0          | -0.1| 0.2      | 81.7                | -41.5            | 0.2         |
|      | Nov   | 1.0                   | 75.7                | 5.9          | -0.2| 0.0      | 92.5                | -40.0            | 1.2         |
|      | Dec   | 0.2                   | 75.8                | 5.7          | 0.2 | 0.1      | 94.8                | -44.0            | 0.2         |
| 2004 | Jan   | 0.6                   | 76.2                | 5.6          | 0.5 | 0.2      | 97.7                | -45.2            | 0.5         |
|      | Feb   | 0.8                   | 76.7                | 5.6          | 0.3 | 0.2      | 88.5                | -45.2            | 1.0         |
|      | Mar   | -0.1                  | 76.6                | 5.7          | 0.5 | 0.4      | 88.5                | -46.6            | 2.1         |
|      | Apr   | 0.5                   | 76.8                | 5.6          | 0.2 | 0.3      | 93.0                | -48.1            | -0.8        |
|      | May   | 0.9                   | 77.4                | 5.6          | 0.6 | 0.2      | 93.1                | -46.9            | 1.4         |
|      | June  | -0.5                  | 76.9                | 5.6          | 0.3 | 0.1      | 102.8               | -55.8            | -0.5        |
|      | July  | 0.4                   | 77.1                | 5.5          | -0.1| 0.1      | 105.7               | -                | 0.7         |
|      | Aug   | -                     | -                   | 5.4          | -   | -        | 98.2                | -                | -           |
JAPAN

Solid outlook despite Q2 GDP

- Last month the announcement of weaker than expected Q2 GDP growth prompted some to fear that the Japanese recovery was coming to an end. This argument was given further ammunition when the July unemployment rate jumped and exports fell in the same month. However, this looks an overly pessimistic analysis. Other indicators such as business confidence and the job offers to applicants ratio remain at high levels, while export growth – though slowing now after a year-long surge – should remain respectable as long as the US economy doesn’t falter. Domestically, the economy is in much better shape than a few years ago – banks’ bad loans have decreased significantly, corporate profits have increased and confidence in the Bank of Japan’s handling of monetary policy is much higher. GDP growth should exceed 4% in 2004 before slowing to about 2 to 2.5% in 2005 and 2006.

Weaker domestic demand in Q2

- Real GDP in 2004Q2 increased by 0.4% quarter-on-quarter, compared to expectations of a 1% rise, implying year-on-year growth of 4.4%. This was the lowest quarterly gain since 2003Q1; however, it did follow particularly rapid growth in both 2003Q4 and 2004Q1, when GDP climbed by 1.8% and 1.6% respectively. The apparent slowdown was driven by the main domestic demand components, with real consumer spending up 0.6% on the quarter after 1% rises in previous quarters, business investment flat, as was stockbuilding, and government investment sharply down. Exports rose 3.5% on the quarter. Meanwhile the GDP deflator continued to report price deflation of 2.6% year-on-year, implying that in actual money terms the economy was only 1.8% larger than a year ago.

…but profits growing rapidly

- However, Japanese GDP data need to be analysed cautiously and in conjunction with the monthly statistics. Moreover they are prone to significant revision. And one subsequent piece of information from the corporate sector suggests that business investment in Q2 may be revised higher; certainly profits continued to climb rapidly in Q2, up 33.2% on a year ago, and this feature should support investment over the next couple of years. However, consumer spending may be more problematic over the same period. Though the labour market has stabilised, despite the rise in the unemployment rate to 4.9% in July, wages continue to fall faster than prices, down 1.2% on a year ago in the May – July period. Consequently with real incomes growing only very modestly, a falling saving ratio...
is largely behind the higher growth in consumer spending. And although this may partly reflect structural demographic factors, the current trend may not be sustainable for much longer.

**Mixed monthly indicators**

- The outlook for exports remains the other key component of the forecast. Export growth over the last year has greatly benefited from the boom in China and the surge in the global IT/electronics sectors. Looking forward, these favourable influences are expected to moderate, but as long as overall world trade remains robust Japanese export growth should continue to be a positive factor in the overall economy (if nowhere near as positive as over the last two years). Producers also appear to be slightly more cautious about the export outlook, with firms not wanting to be left with unwanted inventories. In July industrial output was unchanged on the month after June’s fall of 1.3%. However, firms expect output to increase in both August and September. Moreover business confidence remains at high levels. The Shokochukin index of business conditions was 49.9 in August, against 50.8 in July and levels around 49 at the start of the year.

**Bad loans down sharply**

- And while the strength of the cyclical recovery may be waning somewhat, some of the structural problems hindering the economy appear to be gradually easing. According to the Financial Services Agency the stock of banks’ bad loans was over Yen 8 trillion lower at the end of March 2004 than a year earlier. They now stand at Yen 26.2 trn compared to Yen 42 trn just two years ago.
EUROZONE

Healthy growth again in Q2…

- The Eurozone revival continues. After growing by 0.6% on the quarter in 2004Q1, the economy grew another 0.5% in Q2. Hardly racy, but after three years of disappointment, most welcome. Now the bad news: the recovery is still fragile at a time that in the world as a whole, the speculation is whether or not global growth has peaked. And it’s still true to say that the limited upturn so far is too dependent on events in the rest of the world. Despite heroic efforts from consumers in France, spending in the region as a whole only contributed 0.1% points to growth in Q2, while net trade was responsible for 0.4% points.

…but a slightly softer patch may lie ahead

- With concern mounting about the pace of expansion in the US, the Japanese boom seemingly over and China clearly slowing, the Eurozone economy must find its own momentum. However, there is no sense in recent data that this is about to happen. The latest batch of readings from Purchasing Managers suggest that activity in both manufacturing and services was still growing in August, but not as quickly as in the first half of the year.

- Meanwhile, the corresponding survey of retailers suggested spending fell in August, with stores also pessimistic about prospects in September. It seems domestic demand is clearly not yet ready to come to the rescue, so a slight pause in the recovery looks likely. With a slightly weaker 2004H2, we expect GDP growth of 1.9% this year and 2.2% in 2005. This is very disappointing - after three dismal years, we should expect some lost ground to be recaptured by above trend growth. Yet despite low interest rates, there is little sense of any pent-up demand ready to be unleashed.

Does reform offer some hope?

- So far, firms have used the subdued recovery to rebuild productivity and profitability. Employment is essentially flat. Indeed, seasonally adjusted unemployment rose again in Germany in August. The Hartz IV reforms, which have just been refined by the German parliament, could start to help from the beginning of next year. The duration of unemployment benefit in Germany will be limited to one year and then those still unemployed will have to rely on less generous means tested benefits. Of course this by itself won’t immediately create new jobs, but it will encourage job seeking. At the same time the move towards a longer working week across the Eurozone should help partially offset the very high cost of taking on workers.
A less rigid stability pact…

- A more flexible approach to fiscal policy is also on the way. A watering down of the stability pact was announced earlier this month. This excuses countries breaching the 3% government deficit floor if they are faced by a period of sluggish growth - before a severe recession was the only get-out. And more time will be allowed for corrective action, so situations where fiscal policy is tightened while domestic demand is mired are less likely. But the most sensible decision is to look at debt positions when policing fiscal conduct. It’s possible a stricter view might be taken of miscreants with large debt stocks, like Italy - not before time in our view.

…and a less conservative EU?

- And the composition of the new EU Commission also offers some longer-term encouragement. José Manuel Barroso, the next president of the EC has dished out the four most important economic posts to market minded politicians, some from smaller countries like the Netherlands and Ireland. The power of France and Germany, too often used in the past to defend their own positions has been diluted. French finance minister Nicolas Sarkozy recently suggested EU structural funds should be withheld from new EU entrants with rock bottom corporation tax rates – Germany was sympathetic to the idea. But the dilution of power makes damaging proposals like harmonisation of tax rates even less likely and should reinforce the encouraging signs of liberalisation already emerging.

---

### Key Indicators: Eurozone

*Percentage changes on a year earlier unless otherwise stated*

| Year | Month | Industrial production | Unemployment | CPI | Business confidence | Consumer confidence | Exports | Imports | Trade balance (€ bn) |
|------|-------|-----------------------|--------------|-----|---------------------|---------------------|---------|---------|---------------------|
| 2003 | Sep   | -0.9                  | 8.9          | 2.2 | -9                  | -17                 | 1.5     | 2.1     | 8.8                 |
|      | Oct   | 1.1                   | 8.9          | 2.0 | -8                  | -17                 | -1.5    | -1.2    | 9.2                 |
|      | Nov   | 0.8                   | 8.9          | 2.2 | -6                  | -15                 | -5.2    | -1.8    | 5.7                 |
|      | Dec   | 2.1                   | 8.9          | 2.0 | -8                  | -16                 | 4.8     | 5.7     | 6.5                 |
| 2004 | Jan   | 0.6                   | 8.9          | 1.9 | -6                  | -15                 | -2.6    | -6.3    | 1.7                 |
|      | Feb   | 0.9                   | 8.9          | 1.6 | -7                  | -14                 | 3.1     | 1.1     | 6.8                 |
|      | Mar   | 1.7                   | 8.9          | 1.7 | -7                  | -14                 | 13.2    | 5.1     | 10.7                |
|      | Apr   | 1.5                   | 9.0          | 2.0 | -4                  | -14                 | 10.1    | 5.4     | 7.0                 |
|      | May   | 3.6                   | 9.0          | 2.5 | -5                  | -16                 | 8.5     | 4.9     | 7.8                 |
|      | June  | 2.8                   | 9.0          | 2.4 | -4                  | -14                 | 15.4    | 14.8    | 8.7                 |
|      | July  | -                     | 9.0          | 2.3 | -4                  | -14                 | -       | -       | -                   |
|      | Aug   | -                     | -            | 2.3 | -                  | -                    | -       | -       | -                   |

Source: Eurostat
GERMANY

Output increased by 0.5% in Q2...

- German GDP increased by 0.5% in 2004 Q2, a fraction weaker than our forecast of 0.6%. As expected net trade provided the sole impetus to growth, with exports rising by 3.2% on the quarter and imports by 2.2%. Domestic demand actually fell slightly, as a small rise in consumption was offset by a fall in investment. The weakness in investment was mainly down to construction, but machinery and equipment only managed a 0.1% increase - hardly inspiring when industrial production and exports are showing solid growth.

...self-sustaining recovery still not assured

- The theory goes that the boost to net trade should at some point spark a recovery in internal demand, with a pick-up in investment and consumption. But Q2’s figures underline that it is by no means assured that domestic demand will revive before the boost from trade wanes. That point was further highlighted by a fall in the IFO index in August - with the business climate worsening in manufacturing, wholesaling and retailing - and by a fall in consumer confidence. We expect growth to remain fairly subdued for the rest of the year, with output increasing by 1.4% in 2004 as a whole, before a modest improvement to 1.9% in 2005.

| Month | Industrial production | Unemployment | CPI | IFO Index 1991=100 | Consumer confidence % balance | Exports | Imports | Trade balance (€ bn) |
|-------|-----------------------|--------------|-----|-------------------|-----------------------------|--------|--------|---------------------|
| Aug   | -2.7                  | 10.6         | 1.1 | 92.8              | -18                         | -0.2   | -2.2   | 12.7                |
| Sep   | -2.3                  | 10.5         | 1.1 | 93.0              | -19                         | 2.8    | -1.3   | 14.0                |
| Oct   | 1.1                   | 10.5         | 1.2 | 95.3              | -17                         | -0.7   | 0.3    | 10.3                |
| Nov   | 0.6                   | 10.5         | 1.3 | 96.2              | -14                         | 0.8    | 3.8    | 10.3                |
| Dec   | 2.7                   | 10.5         | 1.1 | 97.0              | -15                         | 4.8    | 0.8    | 13.0                |
| 2004 Jan | 1.5                  | 10.2         | 1.2 | 97.5              | -16                         | 6.7    | 0.2    | 36.7                |
| Feb   | 1.6                   | 10.3         | 0.9 | 96.4              | -13                         | 6.0    | 4.1    | 14.2                |
| Mar   | 0.1                   | 10.4         | 1.1 | 95.4              | -16                         | 8.6    | -0.8   | 57.1                |
| Apr   | 1.9                   | 10.5         | 1.6 | 96.3              | -17                         | 14.7   | 6.6    | 51.5                |
| May   | 3.6                   | 10.5         | 2.0 | 96.1              | -18                         | 14.8   | 8.9    | 38.5                |
| Jun   | 2.6                   | 10.5         | 1.7 | 94.6              | -15                         | 9.9    | 5.1    | 29.6                |
| Jul   | 2.2                   | 10.6         | 1.8 | 95.6              | -17                         | -      | -      | -                   |
| Aug   | -                    | 10.6         | 2.0 | 95.3              | -                           | -      | -      | -                   |
FRANCE

Robust growth again in Q2

• We highlighted the possibility of an upward revision to our French growth forecast last month, and with the consumer powering the economy forward, we now expect a 2.5% increase in GDP this year, up 0.2% points on our August forecast. The economy expanded 0.8% on the quarter in Q2, the same pace as in Q1. And it wasn’t just consumer spending that helped out; business investment surged over 2% higher.

• Can this pace be maintained? There is some cause for optimism. Real interest rates remain at very low levels and the unemployment rate dipped from 9.9% to 9.8% in July - the economy is now growing fast enough to actually create jobs, although the headline numbers still make for depressing reading. However, we actually believe growth is likely to moderate slightly in the second half of this year. Consumers have been running down their savings to fund the current spree and this can’t continue indefinitely, particularly when the rising price of fuel has eroded purchasing power.

• And at the same time there is concern that the support from the external sector is starting to ease as doubts grow over pace of expansion in the US and China. A surge in imports already exerted a sizeable drag on growth in 2004Q2 and latest survey evidence from purchasing managers suggests that new orders aren’t rising at the speed seen a couple of months ago. Even so, France is easily set to outperform Germany and Italy again next year, with growth remaining around 2½%.

Key Indicators: France

| Year | Month | Industrial production | Consum’n manufact. | CPI | Unemployment | Confidence: industry | Confidence: consumer | Trade balance | Vehicle Reg’ns |
|------|-------|-----------------------|-------------------|-----|--------------|---------------------|---------------------|--------------|---------------|
| 2003 | Sep   | 0.1                   | 3.2               | 2.1 | 9.9          | -26                 | -                   | 459          | 1.5           |
|      | Oct   | 1.6                   | 3.3               | 2.2 | 9.9          | -15                 | -                   | 157          | -1.9          |
|      | Nov   | 0.4                   | 0.9               | 2.3 | 9.9          | -2                  | -23                 | 123          | -9.4          |
|      | Dec   | 0.9                   | 0.2               | 2.2 | 9.9          | 7                   | -25                 | 823          | 0.6           |
| 2004 | Jan   | -0.3                  | 2.9               | 2.0 | 9.9          | 12                  | -22                 | 787          | -11.9         |
|      | Feb   | 0.7                   | 3.3               | 1.8 | 9.8          | 11                  | -23                 | 319          | -2.8          |
|      | Mar   | 1.2                   | 1.4               | 1.7 | 9.8          | 5                   | -22                 | 871          | 5.6           |
|      | Apr   | 0.8                   | 3.8               | 2.1 | 9.8          | -9                  | -20                 | -229         | -4.0          |
|      | May   | 3.5                   | 4.6               | 2.6 | 9.8          | -5                  | -23                 | -336         | 4.8           |
|      | Jun   | 2.7                   | 8.6               | 2.4 | 9.9          | -3                  | -23                 | -304         | 6.3           |
|      | Jul    | -                    | -                  | 2.3 | 9.8         | 3                   | -23                 | -           | -10.1         |
|      | Aug    | -                    | -                  | -   | -           | -                   | -                   | -           | 2.8           |
ITALY

Recovery losing steam

- Italy’s economy expanded 0.3% on the quarter in Q2 - a touch weaker than we expected. Recovery so far has relied on the stimulus from foreign demand, but that is expected to slow. Moreover, sluggish retail sales suggest consumers have little desire to revive spending. Industrial production fell on the month in June and the Purchasing Managers’ Surveys dipped in August, although they still indicate growth. August’s ISAE business confidence index bucked the trend - it was the strongest for over three years on the back of de-stocking. That’s often a positive sign for future output, but with activity slowing, the worry is that it reflects softer demand. As a result, we have shaved our GDP growth forecast to 1.0% for 2004 and 2.3% in 2005.

- Meanwhile Economy Minister Siniscalco has won cabinet approval for across-the-board caps on spending that limit growth to 2% a year. Sweeping spending cuts are needed in the 2005 budget to pave the way for tax cuts promised by Berlusconi. Little wonder public sector unions are getting nervous. That said, investment, pensions and certain social services are exempt. In addition, as the EU waters down the Stability & Growth Pact, the government is planning to adopt a ‘Golden Rule’ approach to fiscal planning - new borrowing will only be used to finance investment. Not before time in our view.

### Key Indicators: Italy

*Percentage changes on a year earlier unless otherwise stated*

| Year | Industrial production | Nominal retail sales | CPI | Industrial producer prices | Contracted hourly earnings | Household confidence (1982=100) | Business confidence (balance) | Trade balance € bn |
|------|-----------------------|----------------------|-----|-----------------------------|---------------------------|--------------------------------|-----------------------------|------------------|
| 2003 |                       |                      |     |                            |                           |                                 |                             |                  |
| Sep  | -0.7                  | 3.3                  | 2.7 | 1.0                        | 2.7                       | 106.8                          | -1                          | -0.4             |
| Oct  | 0.0                   | 1.6                  | 2.5 | 0.7                        | 2.6                       | 104.7                          | -2                          | 2.7              |
| Nov  | 0.0                   | -0.9                 | 2.4 | 1.2                        | 2.5                       | 101.8                          | -2                          | 0.2              |
| Dec  | 0.4                   | 1.8                  | 2.4 | 0.8                        | 2.7                       | 103.0                          | -5                          | -0.6             |
| 2004 |                       |                      |     |                            |                           |                                 |                             |                  |
| Jan  | 0.1                   | 3.6                  | 2.2 | 0.4                        | 2.1                       | 99.4                           | -4                          | -2.3             |
| Feb  | 0.0                   | 0.1                  | 2.3 | 0.1                        | 2.8                       | 98.2                           | -3                          | -0.8             |
| Mar  | 0.0                   | 0.2                  | 2.1 | 0.7                        | 2.8                       | 100.9                          | -4                          | 0.7              |
| Apr  | 0.7                   | 0.8                  | 2.1 | 1.7                        | 2.8                       | 101.7                          | 0                           | -0.1             |
| May  | 1.7                   | -3.2                 | 2.2 | 2.9                        | 3.3                       | 98.6                           | -3                          | 0.2              |
| Jun  | 0.0                   | 2.0                  | 2.3 | 3.2                        | 3.3                       | 101.9                          | -3                          | -1.1             |
| Jul  | -                     | -                    | 2.2 | 3.3                        | 3.2                       | 102.9                          | 0                           | -                |
| Aug  | -                     | -                    | 2.3 | -                          | -                         | 103.4                          | -                           | -                |
SPAIN

Consumers cool spending in Q2

- GDP growth slowed to 0.5% on the quarter in 2004Q2 with consumer spending making a much more modest contribution. Nevertheless domestic demand looks robust. It’s rising at close to 4% year-on-year, and remains the key driver for the economy. Net trade continues to drag, the deterioration in competitiveness does not help, but the trade gap largely reflects strong Spanish domestic growth relative to that elsewhere in the Eurozone. We expect that to continue. After rising 2.6% in 2004 we expect GDP growth to climb to 2.9% in 2005.

- Consumer spending was up by 0.6% quarter-on-quarter in Q2, well off the pace in the previous two periods, though still pretty healthy. More recently, new car registrations have slowed following double-digit growth in May and June. But retail sales figures suggest consumer demand is holding up. Even with some deceleration in 2004H2, we expect consumption growth of 3.1% in 2004, followed by 2.8% in 2005.

- Industrial production surged 5.7% in the year to June and August’s Purchasing Managers’ Survey for manufacturing indicates output is still growing, and new orders, mostly foreign, are rising. But weak capital spending, particularly equipment purchases, risks leaving the capital stock hollowed out over time. On top of that, the construction boom could leave the economy more exposed to a shift in monetary policy over the next year.

Key Indicators: Spain

Percentage changes on a year earlier unless otherwise stated

| Month | Industrial production | New car reg. | CPI | Unemployment | Business confidence | Consumer confidence | Trade balance | Retail sales |
|-------|-----------------------|--------------|-----|--------------|---------------------|---------------------|--------------|-------------|
|       | % nsa                 | % nsa        |     | % nsa        | balance             | balance             | € bn         |             |
| 2003  |                       |              |     |              |                     |                     |              |             |
| Sep   | 2.5                   | 17.3         | 2.9 | 8.5          | -2                  | -11                 | -4.9         | 6.7         |
| Oct   | 0.8                   | 11.5         | 2.6 | 8.8          | -2                  | -12                 | -4.1         | 7.2         |
| Nov   | 1.4                   | 15.8         | 2.8 | 9.0          | -1                  | -12                 | -4.6         | 3.5         |
| Dec   | 4.2                   | 13.7         | 2.6 | 9.0          | -4                  | -11                 | -4.3         | 7.3         |
| 2004  |                       |              |     |              |                     |                     |              |             |
| Jan   | -2.8                  | 10.6         | 2.3 | 9.3          | -4                  | -12                 | -3.5         | 6.2         |
| Feb   | 2.0                   | 23.5         | 2.1 | 9.2          | -2                  | -12                 | -3.7         | 6.7         |
| Mar   | 8.0                   | 28.6         | 2.1 | 9.2          | -3                  | -11                 | -4.4         | 7.1         |
| Apr   | 0.9                   | 5.8          | 2.7 | -            | -1                  | -8                  | -4.9         | 6.4         |
| May   | 2.9                   | 10.9         | 3.4 | -            | -1                  | -9                  | -4.7         | 3.0         |
| Jun   | 5.7                   | 16.2         | 3.5 | -            | -4                  | -11                 | -5.5         | 7.3         |
| Jul   | 0.4                   | 5.6          | 3.4 | -            | -3                  | -11                 | -           | 6.3         |
| Aug   | -                     | 9.1          | -   | -            | -                   | -                   | -            | -           |
UNITED KINGDOM

Interest rate expectations ease…

• There is increasing expectation that UK interest rates are now at or at least very close to their peak in this cycle. Sterling futures now show three-month rates rising to 5.09% by December and 5.19% by the middle of next year, having earlier in the summer implied that would rise to close to 5.5% over the next year. This shift in expectations follows more sanguine indications from the Monetary Policy Committee, whose August Inflation Report shows CPI inflation stabilising at its 2% target rate in two years’ time. And it has been reinforced by recent data on the housing market, which provides the clearest evidence yet that the boom of recent years has at last come to an end.

…as house price inflation comes down to earth…

• Both the Nationwide and Halifax indices show a marked deceleration in house price inflation in recent months, with the Halifax reporting that prices actually fell in August for the first time since late 2002. This follows reports from Rightmove suggesting that asking prices for properties in England and Wales had fallen by an average of over £1,200 during the second half of August, and similar reports from the Royal Institution of Chartered Surveyors.

• At the same time, latest figures from the Bank of England point to a downturn in activity in the housing market. For example, the number of applications for loans for house purchase fell over 13% in July, having already fallen over 10% in June. Mortgage applications are now down to levels last seen at the time of the Iraq War. Similarly, net mortgage lending fell in July to £8.6 billion from £9.3 billion in June and average monthly borrowing of £9.2 billion over the previous year.

…and retail and manufacturing falter

• In addition, there are signs that consumer spending has been subdued over the summer, with retail sales falling 0.4% in July; the BRC survey reporting sales growth in August at its lowest since last December; and consumer confidence also at its lowest since December. Moreover, the LFS survey shows a 53,000 fall in employment in Q2. And the manufacturing recovery seems to have stalled after just six months, with output falling 0.2% in July, on top of June’s 0.6% drop.

But underlying economy still strong…

• But these recent data do need to be seen in perspective. While it is increasingly clear that higher
interest rates are now reining back the housing market, data for July and August need to be interpreted cautiously given the potential impact of the holidays and difficulties with seasonal adjustment during the summer. Moreover, even after the August fall, the Halifax data still show house price inflation running at an annualised rate of 7.2% over the last three months, while on the Nationwide index it is still nearly 13%. Similarly, even after its July fall, mortgage lending remains higher than at any time prior to the last year. And anecdotal evidence suggests that much of the recent weakness of retail sales has been caused by the recent poor weather.

- In addition, while manufacturing output has fallen in the last two months, data for the first half of the year have been revised up substantially – sufficient to mean that GDP growth in Q2 is likely to be revised up from the current estimate of 0.9% to 1.0%. And other indicators – the purchasing managers’ survey, CBI manufacturing output expectations, the EEF survey, exports – all point to continued robust growth.

...and a hard landing still unlikely
- We would therefore caution against reading too much into the recent batch of apparently weak data, and our forecast continues to assume that there will probably be two more 25bp interest rate rises. Yes, the housing market is slowing sharply, but that was only to be hoped and is already reflected in our forecasts. However, we continue to doubt that prices are about to crash given the underlying strength of the economy and increasing expectations that interest rates are now very close to their peak. Even at 5.25%, there are not the cashflow problems for the vast majority of borrowers that triggered the recession of the early 1990s. A soft landing still looks the most likely scenario.

### Key Indicators: United Kingdom

| Year | Month | Manuf. output | Retail sales | Unemployment claimant% | CBI total orders %bal. | Headline RPI | CPI | Average earnings headline | Trade balance £bn |
|------|-------|---------------|--------------|------------------------|------------------------|--------------|-----|--------------------------|------------------|
| 2003 | Sep   | 0.4           | 3.6          | 3.0                    | -33                    | 2.8          | 1.4 | 3.6                      | -4.7             |
|      | Oct   | 2.5           | 3.2          | 3.0                    | -40                    | 2.6          | 1.4 | 3.6                      | -4.4             |
|      | Nov   | 1.2           | 3.1          | 2.9                    | -24                    | 2.5          | 1.3 | 3.6                      | -4.6             |
|      | Dec   | 1.4           | 3.1          | 2.9                    | -19                    | 2.8          | 1.3 | 3.4                      | -4.1             |
| 2004 | Jan   | 1.9           | 6.6          | 2.9                    | -18                    | 2.6          | 1.4 | 4.7                      | -5.6             |
|      | Feb   | 0.8           | 6.0          | 2.9                    | -15                    | 2.5          | 1.3 | 4.9                      | -4.2             |
|      | Mar   | 1.0           | 6.5          | 2.8                    | -8                     | 2.6          | 1.1 | 5.2                      | -4.2             |
|      | Apr   | 2.0           | 6.0          | 2.8                    | -14                    | 2.5          | 1.2 | 4.3                      | -4.8             |
|      | May   | 2.6           | 7.3          | 2.8                    | -1                     | 2.8          | 1.5 | 4.4                      | -4.8             |
|      | Jun   | 1.9           | 6.9          | 2.7                    | -6                     | 3.0          | 1.6 | 4.4                      | -5.0             |
|      | Jul   | 0.8           | 6.6          | 2.7                    | -7                     | 3.0          | 1.4 | -                        | -5.2             |
|      | Aug   | -             | -            | -                      | 2                      | -            | -   | -                        | -                |
EMERGING MARKETS

China remains the focus in Asia

- Developments in China remain the centre of attention in emerging Asia. At the moment the monthly data are still compatible with the government’s aim of a controlled slowdown, with most of the adjustment being felt by the previously overheating sectors and largely sparing consumer spending and exports. The year-on-year growth of industrial value added has steadily fallen from 19.4% in March to 15.5% in July, while retail sales growth in real terms has held up much better, only declining from 9.4% to 8.8% over the same period. Export growth has actually accelerated. However, there have been other apparently contradictory indicators. For example cumulative investment growth in the January – July period was put at 31.1% compared to 31% in 2004H1 – suggesting that investment remained vigorous despite the efforts to curb it. But against that, bank lending has stopped increasing in recent months, its year-on-year growth rate falling sharply from 21.2% in March to 12.3% in July – suggesting that new investment will be much more difficult to finance. These differences highlight the risk that a controlled slowdown in China cannot be taken for granted, even if it remains the most likely outcome.

Disparities in Q2 performance

- Though what happens to China will be very important for the other emerging Asian economies, domestic differences will also play a key role in determining overall growth rates. Indeed this was already shown in the Q2 GDP figures released over the last month when some, Malaysia and Singapore, outperformed expectations, while others, Thailand and Korea, underperformed, even though the exporting environment was favourable for all countries. A large part of the disparity was down to the varying fortunes of consumer spending in the respective countries. For example in both Malaysia and Singapore year-on-year consumer spending growth topped 10% (although helped by comparison with SARS-hit 2003Q2) but in Thailand it slowed from 6.1% in Q1 to 5.5% in Q2, affected by the impact of bird flu on the rural sector, and in Korea it actually continued to fall on a year ago, reflecting the household sector’s persistent concern over excessive debt.

Greater dependence on consumer spending

- Looking forward over the next year or so, the moderation in both the China boom and the global IT/electronics sector is likely to result in significantly slower export growth for most Asian economies. This will inevitably place a greater importance on what happens to consumer spending;
otherwise the drop off in growth between 2004 and 2005 may be quite sharp. Fearing exactly this, the Bank of Korea cut interest rates in mid August to bolster business and consumer confidence, despite the rising trend in inflation. As it happens Korea may be one of the few countries to post higher growth in 2005 than in 2004. However, this view is very dependent on the belief that consumer spending must at some point bounce back sharply after two years of decline, during which time real incomes have been steadily increasing.

**Growth accelerating outside Asia**
- Whereas growth across Asia may have already peaked, outside of that region many other emerging economies are still experiencing accelerating growth. Indeed each of the three major emerging regions should report very buoyant growth in 2004. However, with a shorter track record of containing inflation several economies are already seeing a significant tightening in monetary policy (Poland) or a halt to interest rate cuts (Brazil), as stronger demand conditions combine with rising oil prices to heighten inflation pressures. But this tendency is not universal; despite a strong pick up in domestic demand, the effects of a persistently strong currency on inflation allowed the South African Reserve Bank to make a surprise rate cut recently.

**Sharp pick up in Brazil**
- One notable development this year has been the substantial pick up in the Brazilian economy, given the country’s size, massive external debt and dismal economic performance for much of the last six years. On a seasonally adjusted basis GDP increased by 1.5% quarter-on-quarter in Q2 after a 1.7% gain in Q1, and is well on course to achieve growth of close to 4% for 2004 as a whole. In H1 both rising domestic demand (a marked contrast on last year) and surging exports were responsible for generating the growth. However, inflation has been more troublesome than expected, rising from 5.2% in May to 6.8% in July, and the financial markets have become much more cautious about their expectations of interest rate cuts. Indeed the central bank may have to nudge rates higher briefly to dampen inflation expectations; but this would be much less damaging to growth than risking losing investor confidence – given the country’s indebtedness. If the latter can be avoided then the country could grow between 3.5 to 4% per annum for the next few years.

**Turkey’s boom at risk from deficit**
- Whereas Brazil’s move into macro stability over the last two years has been associated with a huge improvement in its current account position, Turkey’s has not. Although high growth has been achieved throughout 2002-04 and inflation cut to around 10%, the current account deficit has steadily increased and could exceed 4% of GDP this year. Consequently the country has to attract a large amount of short-term capital inflows and this could prove problematic if the Turkish lira starts to slide from its currently overvalued level.

---

**GDP forecast for Emerging Markets**

(Amount percentage changes unless otherwise specified)

| Region          | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|-----------------|------|------|------|------|------|------|------|
| **Asia**        |      |      |      |      |      |      |      |
| China           | 8.0  | 9.4  | 9.1  | 7.9  | 7.2  | 8.0  | 8.4  |
| India           | 4.8  | 7.1  | 6.7  | 6.5  | 7.8  | 7.3  | 7.2  |
| Indonesia       | 3.7  | 4.2  | 4.4  | 4.8  | 5.6  | 5.8  | 5.6  |
| Korea           | 7.0  | 3.1  | 4.8  | 5.4  | 5.5  | 5.3  | 5.0  |
| Malaysia        | 4.1  | 5.3  | 6.9  | 6.1  | 6.1  | 5.9  | 5.7  |
| Philippines     | 4.3  | 4.7  | 5.7  | 4.6  | 4.2  | 4.2  | 4.2  |
| Thailand        | 5.4  | 6.8  | 6.3  | 6.3  | 5.6  | 5.2  | 5.5  |
| **Latin America** |      |      |      |      |      |      |      |
| Argentina       | -10.9| 8.8  | 7.0  | 3.8  | 3.7  | 3.5  | 3.4  |
| Brazil          | 1.9  | -0.2 | 3.7  | 3.9  | 3.7  | 3.6  | 3.6  |
| Chile           | 2.2  | 3.3  | 4.9  | 4.7  | 4.5  | 4.4  | 4.3  |
| Mexico          | 1.0  | 1.1  | 3.8  | 4.0  | 3.9  | 3.6  | 3.5  |
| **South Africa** | 3.6  | 1.9  | 2.7  | 3.3  | 3.3  | 4.1  | 3.6  |
| **Eastern Europe** |      |      |      |      |      |      |      |
| Czech Rep       | 1.5  | 3.1  | 3.2  | 3.8  | 4.3  | 4.3  | 4.5  |
| Hungary         | 3.5  | 2.9  | 3.9  | 4.4  | 5.0  | 5.0  | 4.9  |
| Poland          | 1.4  | 3.7  | 5.7  | 4.9  | 4.2  | 4.2  | 4.5  |
| Russia          | 4.7  | 7.3  | 6.9  | 5.4  | 4.8  | 4.6  | 4.4  |
| Turkey          | 7.9  | 5.8  | 6.6  | 4.2  | 4.8  | 4.6  | 4.5  |
### TABLE 1: SUMMARY ITEMS

| YEARS BEGINNING | Q1 | Q2 | Q3 | Q4 |
|-----------------|----|----|----|----|
| U.S.A.          |    |    |    |    |
| **CONSUMERS**   |    |    |    |    |
| EXPENDITURE     |    |    |    |    |
| **REAL PERSONS**|    |    |    |    |
| DISPOSABLE INCOME |    |    |    |    |
| **SAVINGS**     |    |    |    |    |
| RATIO (%)       |    |    |    |    |
| **REAL GDP**    |    |    |    |    |
| INDUSTRIAL PRODUCTION |    |    |    |    |
| **EMPLOYMENT**  |    |    |    |    |
| RATE (%)        |    |    |    |    |
| **AVG EARNINGS**|    |    |    |    |
| **WHOLE ECONOMY** |    |    |    |    |
| PRODUCTIVITY   |    |    |    |    |
| **COMPETITIVENESS** |    |    |    |    |
| (2000=100)      |    |    |    |    |
| **PROD PRICES** |    |    |    |    |
| **CONSUMER PRICES |    |    |    |    |
| **TOTAL PROFITS** |    |    |    |    |

| YEARS BEGINNING | Q1 | Q2 | Q3 | Q4 |
|-----------------|----|----|----|----|
| U.S.A.          |    |    |    |    |
| **BALANCE**     |    |    |    |    |
| ACCOUNT ACCOUNT |    |    |    |    |
| ACCOUNT UNIFIED |    |    |    |    |
| INTEREST RATIO |    |    |    |    |
| **FEDERAL**     |    |    |    |    |
| UNIFIED BALANCE |    |    |    |    |
| (IN $)         |    |    |    |    |
| **FEDERAL**     |    |    |    |    |
| SHORT-TERM INTEREST RATE |    |    |    |    |
| **LONG-TERM INTEREST RATE |    |    |    |    |
| **TOTAL HOUSING STARTS (MILLIONS) |    |    |    |    |
| **LIGHT VEHICLE SALES (MILLIONS) |    |    |    |    |
| **YEN**         |    |    |    |    |
| PER DOLLAR      |    |    |    |    |
| **DOLLAR**      |    |    |    |    |
| EFFECTIVE RATE  |    |    |    |    |

### TABLE 2: SUMMARY ITEMS

| YEARS BEGINNING | Q1 | Q2 | Q3 | Q4 |
|-----------------|----|----|----|----|
| U.S.A.          |    |    |    |    |
| **TRADE**       |    |    |    |    |
| BALANCE ($BN)   |    |    |    |    |
| CURRENT ACCOUNT |    |    |    |    |
| CURRENT ACCOUNT |    |    |    |    |
| CURRENT ACCOUNT |    |    |    |    |
| CURRENT ACCOUNT |    |    |    |    |
| **FEDERAL**     |    |    |    |    |
| UNIFIED BALANCE |    |    |    |    |
| (IN $)         |    |    |    |    |
| **FEDERAL**     |    |    |    |    |
| SHORT-TERM INTEREST RATE |    |    |    |    |
| **LONG-TERM INTEREST RATE |    |    |    |    |
| **TOTAL HOUSING STARTS (MILLIONS) |    |    |    |    |
| **LIGHT VEHICLE SALES (MILLIONS) |    |    |    |    |
| **YEN**         |    |    |    |    |
| PER DOLLAR      |    |    |    |    |
| **DOLLAR**      |    |    |    |    |
| EFFECTIVE RATE  |    |    |    |    |
### TABLE 1  SUMMARY ITEMS

| YEARS BEGINNING | CONSUMERS EXPENDITURE | REAL PERSON DISPOSABLE INCOME | SAVINGS RATE (%) | REAL GDP | INDUSTRIAL PRODUCTION | UNEMPLOYMENT RATE (%) | AVERAGE EARNINGS | WHOLE ECONOMY PRODUCTIVITY | COMPETITIVENESS (2000=100) | PRODUCER PRICES | CONSUMER PRICES |
|-----------------|------------------------|-------------------------------|------------------|---------|------------------------|-----------------------|----------------|----------------------------|-----------------------------|----------------|----------------|}
| 2003            | 0.8                    | 1.6                           | 4.0              | 2.5     | 3.3                    | 5.3                   | -0.4           | 2.7                        | 80.3                        | -0.8           | -0.3           |
| 2004            | 0.7                    | 1.8                           | 2.8              | 4.3     | 6.0                    | 4.7                   | -0.3           | 3.9                        | 79.2                        | 1.0            | -0.2           |
| 2005            | 1.9                    | 1.8                           | 2.7              | 2.4     | 2.7                    | 4.6                   | 0.3            | 2.2                        | 75.1                        | 0.4            | -0.2           |
| 2006            | 1.5                    | 1.3                           | 2.5              | 1.9     | 1.4                    | 4.6                   | 0.4            | 2.1                        | 73.3                        | 0.1            | 0.0            |
| 2007            | 1.4                    | 1.3                           | 2.5              | 1.5     | 0.9                    | 4.5                   | 0.3            | 1.7                        | 72.3                        | 0.5            | 0.1            |
| 2008            | 1.3                    | 1.3                           | 2.5              | 1.5     | 1.2                    | 4.2                   | 0.4            | 1.6                        | 72.4                        | 0.5            | 0.1            |

### TABLE 2  SUMMARY ITEMS

| YEARS BEGINNING | TRADE BALANCE (YEN BN) | CURRENT ACCOUNT (YEN BN) | CURRENT ACCOUNT (% OF GDP) | GOVERNMENT FINANCIAL BALANCE (YEN BN) | GOVERNMENT FINANCIAL BALANCE (% OF GDP) | SHORT-TERM INTEREST RATE | LONG-TERM INTEREST RATE | REAL SHORT-TERM INTEREST RATE | REAL LONG-TERM INTEREST RATE | YEN PER DOLLAR | EFFECTIVE RATE (1990=100) |
|-----------------|------------------------|--------------------------|-----------------------------|----------------------------------------|------------------------------------------|--------------------------|--------------------------|-------------------------------|-------------------------------|----------------|--------------------------|
| 2003            | 12384                  | 15957                    | 3.2                         | -38541                                  | -7.7                                     | 0.09                     | 0.99                     | 0.34                          | 158.94                        | 129.44        | 131.36                   |
| 2004            | 14572                  | 18051                    | 3.6                         | -39198                                  | -7.7                                     | 0.4                      | 0.99                     | 0.34                          | 158.94                        | 129.44        | 131.36                   |
| 2005            | 12397                  | 15349                    | 3.0                         | -39285                                  | -7.7                                     | 0.16                     | 0.99                     | 0.34                          | 158.94                        | 129.44        | 131.36                   |
| 2006            | 11781                  | 14921                    | 2.9                         | -38827                                  | -7.5                                     | 0.16                     | 0.88                     | 0.32                          | 158.94                        | 129.44        | 131.36                   |
| 2007            | 11754                  | 14634                    | 2.8                         | -37884                                  | -7.2                                     | 0.16                     | 0.79                     | 0.30                          | 158.94                        | 129.44        | 131.36                   |
| 2008            | 11739                  | 14347                    | 2.7                         | -36292                                  | -6.8                                     | 0.25                     | 0.70                     | 0.30                          | 158.94                        | 129.44        | 131.36                   |

19
## GERMANY

### TABLE 1: SUMMARY ITEMS

| YEARS BEGINNING Q1 | CONSUMERS EXPENDITURE | REAL-PERS. DISPOSABLE INCOME | SAVINGS RATIO (%) | REAL GDP | INDUSTRIAL PRODUCTION | UNEMPLOYMENT RATE (%) | AVERAGE EARNINGS | WHOLE ECONOMY PRODUCTIVITY | COMPETITIVENESS (2000-100) | PRODUCER PRICES | CONSUMER PRICES |
|---------------------|------------------------|------------------------------|-------------------|----------|-----------------------|----------------------|------------------|-----------------------------|-----------------------------|----------------|----------------|
| 2003                | 0.0                    | 0.2                          | 10.7              | -0.1     | 0.1                   | 10.5                 | 1.2              | 0.9                         | 1028.8                      | 1.8            | 1.1            |
| 2004                | -0.4                   | 0.9                          | 11.8              | 1.4      | 2.3                   | 10.4                 | 1.5              | 1.8                         | 1056.2                      | 1.2            | 1.8            |
| 2005                | 1.4                    | 1.9                          | 12.3              | 1.9      | 3.1                   | 103.5                | 2.5              | 2.0                         | 1042.4                      | 1.4            | 0.8            |
| 2006                | 1.9                    | 1.7                          | 12.1              | 2.0      | 1.7                   | 100.0                | 2.7              | 1.8                         | 1032.3                      | 1.4            | 1.1            |
| 2007                | 1.6                    | 1.9                          | 12.4              | 1.8      | 1.2                   | 9.6                  | 2.8              | 1.5                         | 1031.6                      | 1.6            | 1.6            |
| 2008                | 1.1                    | 1.8                          | 13.0              | 1.4      | 1.3                   | 9.2                  | 2.8              | 1.0                         | 1030.0                      | 1.6            | 1.7            |

### TABLE 2: SUMMARY ITEMS

| YEARS BEGINNING Q1 | TRADE BALANCE (EUROS BN) | CURRENT ACCOUNT (EUROS BN) | CURRENT ACCOUNT (% OF GDP) | GOV.FIN. BALANCE (MASS DEF) (EUROS BN) | GOV.FIN. BALANCE (% OF GDP) | SHORT-TERM INTEREST RATE | LONG-TERM INTEREST RATE | REAL SHORT-TERM INTEREST RATE | REAL LONG-TERM INTEREST RATE | D-MARK PER DOLLAR | D-MARK PER EURO |
|---------------------|--------------------------|----------------------------|-----------------------------|----------------------------------------|-----------------------------|-------------------------|--------------------------|-------------------------------|-------------------------------|---------------------|-----------------|
| 2003                | 132.2                    | 48.1                       | 2.3                         | -83.1                                  | -3.9                        | 2.34                    | 4.09                     | 1.27                          | 3.02                          | 1.73               | 1.96            |
| 2004                | 164.2                    | 87.5                       | 4.0                         | -83.1                                  | -3.8                        | 2.08                    | 4.33                     | 0.50                          | 2.75                          | 1.61               | 1.96            |
| 2005                | 168.4                    | 82.0                       | 3.6                         | -79.8                                  | -3.5                        | 2.50                    | 4.85                     | 1.70                          | 4.03                          | 1.70               | 1.96            |
| 2006                | 187.4                    | 92.3                       | 4.0                         | -74.2                                  | -3.2                        | 3.88                    | 4.97                     | 2.77                          | 3.86                          | 1.75               | 1.96            |
| 2007                | 206.8                    | 101.9                      | 4.2                         | -68.5                                  | -2.9                        | 4.50                    | 5.00                     | 2.77                          | 3.27                          | 1.74               | 1.96            |
| 2008                | 218.4                    | 106.4                      | 4.3                         | -65.3                                  | -2.7                        | 4.70                    | 5.00                     | 2.76                          | 3.26                          | 1.77               | 1.96            |

WORLD ECONOMIC PROSPECTS MONTHLY REVIEW: SEPTEMBER 2004
### FRANCE

**TABLE 1 SUMMARY ITEMS**

Annual Percentage Changes, Unless Otherwise Specified

| YEARS BEGINNING Q1 | CONSUMERS EXPENDITURE | REAL. PERS. INCOME | SAVINGS RATIO (%) | REAL. GDP | INDESTRUCTIBLE PRODUCTION | UNEMPLOYMENT RATE (%) | AVERAGE EARNINGS | WHOLE ECONOMY PRODUCTIVITY | COMPETITIVENESS (2000=100) | PRODUCER PRICES | CONSUMER PRICES |
|---------------------|------------------------|-------------------|------------------|----------|--------------------------|----------------------|-----------------|--------------------------|--------------------------|-----------------|-----------------|
| 2003                | 1.7                    | 0.5               | 15.8             | 0.5      | -0.4                     | 9.8                  | 2.2             | 0.7                      | 102.5                    | 0.9             | 2.1             |
| 2004                | 2.5                    | 1.4               | 14.9             | 2.5      | -1.9                     | 9.8                  | 2.8             | 2.7                      | 104.2                    | 1.6             | 2.2             |
| 2005                | 2.9                    | 3.2               | 15.2             | 2.4      | -2.9                     | 9.4                  | 3.1             | 1.6                      | 104.2                    | 1.2             | 1.6             |
| 2006                | 3.0                    | 2.5               | 14.6             | 2.6      | 1.9                      | 8.6                  | 3.4             | 1.4                      | 105.0                    | 1.9             | 1.7             |
| 2007                | 2.8                    | 2.5               | 14.6             | 2.3      | 1.4                      | 8.0                  | 3.5             | 1.2                      | 106.8                    | 2.6             | 1.8             |
| 2008                | 2.7                    | 2.7               | 14.6             | 2.3      | 1.8                      | 7.1                  | 3.5             | 0.9                      | 107.9                    | 2.4             | 1.8             |

| YEARS BEGINNING Q1 | I | II | III | IV |
|---------------------|---|----|-----|----|
| 2003                | 2.2 | 1.4 | 1.6 | 1.6 |
| 2004                | 1.8 | 1.3 | 1.2 | 1.3 |
| 2005                | 2.7 | 2.1 | 2.3 | 2.3 |
| 2006                | 3.0 | 3.5 | 3.5 | 3.5 |
| 2007                | 2.7 | 2.9 | 2.9 | 2.6 |
| 2008                | 2.8 | 2.8 | 2.8 | 2.6 |

| YEARS BEGINNING Q1 | I | II | III | IV |
|---------------------|---|----|-----|----|
| 2003                | 2.2 | 1.4 | 1.6 | 1.6 |
| 2004                | 1.8 | 1.3 | 1.2 | 1.3 |
| 2005                | 2.7 | 2.1 | 2.3 | 2.3 |
| 2006                | 3.0 | 3.5 | 3.5 | 3.5 |
| 2007                | 2.7 | 2.9 | 2.9 | 2.6 |
| 2008                | 2.8 | 2.8 | 2.8 | 2.6 |

### FRANCE

**TABLE 2 SUMMARY ITEMS**

| YEARS BEGINNING Q1 | TRADE BALANCE (EUROS BN) | CURRENT ACCOUNT (EUROS BN) | CURRENT ACCOUNT (% OF GDP) | PURSUECT BALANCE (MAAS-MDEF) (EUROS BN) | PURSUECT BALANCE (% OF GDP) | SHORT-TERM INTEREST RATE | LONG-TERM INTEREST RATE | REAL SHORT-TERM INTEREST RATE | REAL LONG-TERM INTEREST RATE | FF PER DOLLAR | FF PER EURO |
|---------------------|---------------------------|-----------------------------|----------------------------|----------------------------------------|-----------------------------|--------------------------|--------------------------|-------------------------------|-----------------------------|----------------|-------------|
| 2003                | 2.0                       | 6.4                         | 0.4                        | -63.9                                   | -4.1                         | 2.41                      | 4.07                      | 0.31                          | 1.96                        | 5.80           | 6.56        |
| 2004                | 0.4                       | 3.4                         | 0.2                        | -64.3                                   | -3.9                         | 2.06                      | 4.33                      | -0.09                         | 2.18                        | 5.40           | 6.56        |
| 2005                | -1.7                      | 6.0                         | 0.5                        | -58.2                                   | -3.4                         | 2.50                      | 4.87                      | 0.04                         | 3.24                        | 5.71           | 6.56        |
| 2006                | -0.1                      | 12.4                        | 0.7                        | -45.4                                   | -2.6                         | 3.88                      | 4.97                      | 2.15                          | 3.24                        | 5.85           | 6.56        |
| 2007                | 2.0                       | 14.9                        | 0.8                        | -32.8                                   | -1.8                         | 4.50                      | 5.00                      | 2.66                          | 3.16                        | 5.82           | 6.56        |
| 2008                | 3.2                       | 16.7                        | 0.9                        | -25.8                                   | -1.4                         | 4.50                      | 5.00                      | 2.68                          | 3.18                        | 5.92           | 6.56        |

| YEARS BEGINNING Q1 | I | II | III | IV |
|---------------------|---|----|-----|----|
| 2003                | -0.1 | 2.6 | 0.7 | 1.59 |
| 2004                | -0.2 | 2.4 | 0.6 | 1.58 |
| 2005                | -1.1 | 1.8 | 0.5 | 1.60 |
| 2006                | -1.1 | -0.4 | -0.1 | -1.62 |
| 2007                | 2.0 | 0.3 | 0.1 | -16.7 |
| 2008                | -0.9 | -1.0 | -0.3 | -16.3 |

| YEARS BEGINNING Q1 | I | II | III | IV |
|---------------------|---|----|-----|----|
| 2003                | 0.3 | 4.6 | 1.0 | -9.3 |
| 2004                | 0.4 | 2.3 | 0.5 | -8.4 |
| 2005                | 0.5 | 4.7 | 1.0 | -7.7 |
| 2006                | 0.7 | 3.4 | 0.7 | -7.4 |
| 2007                | 0.7 | 5.1 | 1.1 | -7.0 |
| 2008                | 0.8 | 2.7 | 0.6 | -6.6 |

**THE SEPTEMBER FORECAST**

21
### TABLE 1 SUMMARY ITEMS

|                | 2003        | 2004        | 2005        | 2006        | 2007        | 2008        |
|----------------|-------------|-------------|-------------|-------------|-------------|-------------|
| **YEARS BEGINNING Q1** |             |             |             |             |             |             |
| 2003  | 2.3         | 2.3         | 2.6         | 2.6         | 2.7         | 2.5         |
| 2004  | 2.3         | 2.7         | 3.0         | 3.0         | 2.7         | 2.6         |
| 2005  | 2.9         | 2.5         | 3.0         | 3.0         | 2.8         | 2.6         |
| 2006  | 2.7         | 2.7         | 2.6         | 2.7         | 2.6         | 2.5         |
| 2007  | 2.6         | 2.7         | 2.6         | 2.7         | 2.6         | 2.5         |
| 2008  | 2.5         | 2.6         | 2.5         | 2.5         | 2.5         | 2.5         |

### UK

#### TABLE 2 SUMMARY ITEMS

|                | 2003        | 2004        | 2005        | 2006        | 2007        | 2008        |
|----------------|-------------|-------------|-------------|-------------|-------------|-------------|
| **YEARS BEGINNING Q1** |             |             |             |             |             |             |
| 2003  | -16.4       | -16.6       | -16.5       | -16.3       | -16.4       | -16.4       |
| 2004  | -11.1       | -11.2       | -11.1       | -11.0       | -11.0       | -11.0       |
| 2005  | -14.4       | -14.7       | -15.0       | -15.3       | -15.3       | -15.3       |
| 2006  | -15.0       | -15.1       | -15.2       | -15.4       | -15.5       | -15.5       |
| 2007  | -15.6       | -15.7       | -15.8       | -15.9       | -15.9       | -15.9       |
| 2008  | -16.0       | -16.1       | -16.2       | -16.3       | -16.4       | -16.5       |

---

**UK**
### Table 1: Summary Items

| Years Beginning Q1 | Consumers Expenditure | Real Pers. Disposable Income | Savings Ratio (%) | Real GDP | Industrial Production | Unemployment Rate (%) | Average Earnings | Whole Economy Productivity | Competitiveness (2000–100) | Producer Prices | Consumer Prices |
|--------------------|-----------------------|-----------------------------|------------------|---------|----------------------|----------------------|-------------------|--------------------------|-----------------------------|----------------|----------------|
| 2003               |                       |                             |                  |         |                      |                      |                   |                          |                             |                |                |
| I                  | 1.7                   | 0.6                         | 15.5             | 0.7     | 0.0                  | 8.9                  | 3.0               | -0.3                     | 114.0                        | 2.7             |                |
| II                 | 1.5                   | 1.5                         | 15.9             | 0.2     | -1.6                 | 8.7                  | 3.8               | -1.1                     | 116.1                        | 1.7             |                |
| III                | 1.4                   | 0.7                         | 15.1             | 0.4     | -0.2                 | 8.6                  | 5.1               | -0.6                     | 115.3                        | 2.4             |                |
| IV                 | 0.6                   | 0.9                         | 15.5             | 0.1     | 0.1                  | 8.7                  | 3.2               | -0.5                     | 116.5                        | 0.9             |                |
| 2004               |                       |                             |                  |         |                      |                      |                   |                          |                             |                |                |
| I                  | 1.6                   | 1.0                         | 15.0             | 0.7     | 0.0                  | 8.7                  | 3.1               | 0.2                      | 115.4                        | 0.4             |                |
| II                 | 1.5                   | 0.5                         | 15.1             | 1.1     | 0.8                  | 8.7                  | 2.7               | 1.0                      | 116.6                        | 2.6             |                |
| III                | 1.2                   | 0.8                         | 14.8             | 1.0     | 0.7                  | 8.6                  | 1.4               | 0.9                      | 116.3                        | 3.0             |                |
| IV                 | 1.8                   | 0.9                         | 14.8             | 1.4     | 1.4                  | 8.6                  | 3.1               | 1.1                      | 114.4                        | 3.4             |                |
| 2005               |                       |                             |                  |         |                      |                      |                   |                          |                             |                |                |
| I                  | 1.5                   | 1.2                         | 14.8             | 1.4     | 2.4                  | 8.5                  | 3.2               | 1.3                      | 114.6                        | 3.0             |                |
| II                 | 1.8                   | 1.2                         | 14.6             | 1.7     | 3.1                  | 8.3                  | 3.0               | 1.4                      | 114.3                        | 1.6             |                |
| III                | 2.0                   | 1.4                         | 14.3             | 2.1     | 2.4                  | 8.2                  | 3.0               | 1.6                      | 114.0                        | 1.3             |                |
| IV                 | 2.1                   | 1.5                         | 14.4             | 2.3     | 2.4                  | 8.0                  | 3.0               | 1.8                      | 113.8                        | 1.2             |                |
| 2006               |                       |                             |                  |         |                      |                      |                   |                          |                             |                |                |
| I                  | 2.0                   | 1.8                         | 14.5             | 2.5     | 2.3                  | 7.7                  | 3.0               | 1.7                      | 113.8                        | 1.2             |                |
| II                 | 2.0                   | 2.2                         | 14.7             | 2.4     | 2.3                  | 7.5                  | 2.9               | 1.6                      | 113.8                        | 1.2             |                |
| III                | 2.0                   | 2.9                         | 15.0             | 2.3     | 2.0                  | 7.4                  | 2.9               | 1.6                      | 113.8                        | 1.2             |                |
| IV                 | 2.0                   | 2.9                         | 15.1             | 2.2     | 1.7                  | 7.3                  | 2.9               | 1.5                      | 113.8                        | 1.2             |                |
| 2007               |                       |                             |                  |         |                      |                      |                   |                          |                             |                |                |
| I                  | 2.0                   | 2.8                         | 15.1             | 2.2     | 1.4                  | 7.2                  | 2.9               | 1.8                      | 113.6                        | 1.2             |                |
| II                 | 2.0                   | 2.5                         | 15.2             | 2.2     | 1.2                  | 7.2                  | 2.9               | 1.9                      | 113.3                        | 1.2             |                |
| III                | 2.0                   | 2.3                         | 15.2             | 2.1     | 1.2                  | 7.2                  | 2.9               | 2.1                      | 113.1                        | 1.2             |                |
| IV                 | 2.1                   | 2.2                         | 15.2             | 2.1     | 1.2                  | 7.2                  | 2.9               | 2.1                      | 112.7                        | 1.2             |                |
| 2008               |                       |                             |                  |         |                      |                      |                   |                          |                             |                |                |
| I                  | 2.1                   | 2.0                         | 15.1             | 2.1     | 1.3                  | 7.2                  | 2.8               | 2.2                      | 112.1                        | 1.2             |                |
| II                 | 2.1                   | 2.0                         | 15.0             | 2.1     | 1.4                  | 7.1                  | 2.8               | 2.1                      | 111.7                        | 1.2             |                |
| III                | 2.1                   | 1.9                         | 15.0             | 2.1     | 1.4                  | 7.1                  | 2.8               | 2.1                      | 111.4                        | 1.2             |                |
| IV                 | 2.1                   | 1.8                         | 14.8             | 2.1     | 1.5                  | 7.1                  | 2.8               | 2.1                      | 111.1                        | 1.2             |                |
### EURO ZONE

#### TABLE 1 SUMMARY ITEMS

| YEARS BEGINNING Q1 | CONSUMERS EXPENDITURE | GROSS FIXED INVESTMENT | DOMESTIC DEMAND | REAL GDP | UNEMPLOYMENT RATE (%) | AVERAGE EARNINGS | WHOLE ECONOMY PRODUCTIVITY | MONEY SUPPLY M3 | PRODUCER PRICES | CONSUMER PRICES |
|---------------------|------------------------|------------------------|-----------------|---------|----------------------|-----------------|--------------------------|----------------|----------------|----------------|
| 2003                | 1.0                    | -0.6                   | 1.2             | 0.5      | 0.4                  | 8.9             | 2.6                      | 0.3            | 7.2             | 1.4            | 2.1 |
| 2004                | 1.2                    | 1.3                    | 1.5             | 1.8      | 2.3                  | 9.0             | 2.3                      | 1.7            | 9.0             | 1.8            | 2.1 |
| 2005                | 2.0                    | 3.3                    | 2.2             | 2.2      | 3.1                  | 8.8             | 2.9                      | 1.9            | 4.4             | 1.5            | 1.8 |
| 2006                | 2.4                    | 2.7                    | 2.3             | 2.4      | 2.1                  | 8.3             | 3.1                      | 1.7            | 3.3             | 1.5            | 1.8 |
| 2007                | 2.3                    | 2.6                    | 2.2             | 2.3      | 1.5                  | 7.9             | 3.1                      | 1.7            | 3.4             | 1.6            | 2.0 |
| 2008                | 2.1                    | 2.5                    | 2.0             | 2.1      | 1.7                  | 7.6             | 3.1                      | 1.5            | 3.8             | 1.7            | 2.0 |

#### TABLE 2 SUMMARY ITEMS

| YEARS BEGINNING Q1 | TRADE BALANCE (EURO BN) | CURRENT ACCOUNT (EURO BN) | CURRENT ACCOUNT (% OF GDP) | GOVERNMENT FINANCIAL BALANCE (EURO BN) | GOVERNMENT FINANCIAL BALANCE (% OF GDP) | SHORT-TERM INTEREST RATE | LONG-TERM INTEREST RATE | REAL SHORT-TERM INTEREST RATE | REAL LONG-TERM INTEREST RATE | US DOLLAR EFFECTIVE RATE (1995=100) |
|---------------------|--------------------------|---------------------------|--------------------------|----------------------------------------|----------------------------------------|--------------------------|----------------------------|-------------------------------|-------------------------------|----------------------------------|
| 2003                | 72.1                     | 24.8                      | 0.3                      | -196.0                                  | -2.7                                   | 2.34                     | 4.16                       | 0.26                          | 2.08                          | 1.13                             | 114.8 |
| 2004                | 75.8                     | 42.2                      | 0.6                      | -231.1                                  | -3.1                                   | 2.08                     | 4.40                       | 0.07                          | 2.26                          | 1.22                             | 117.9 |
| 2005                | 77.6                     | 48.8                      | 0.6                      | -216.3                                  | -3.3                                   | 2.08                     | 4.40                       | 0.07                          | 2.26                          | 1.22                             | 117.9 |
| 2006                | 100.5                    | 67.9                      | 0.8                      | -186.9                                  | -2.3                                   | 2.08                     | 4.40                       | 0.07                          | 2.26                          | 1.22                             | 117.9 |
| 2007                | 121.0                    | 78.7                      | 0.9                      | -154.6                                  | -2.8                                   | 2.08                     | 4.40                       | 0.07                          | 2.26                          | 1.22                             | 117.9 |
| 2008                | 133.6                    | 83.8                      | 1.0                      | -130.5                                  | -2.8                                   | 2.08                     | 4.40                       | 0.07                          | 2.26                          | 1.22                             | 117.9 |

### WORLD ECONOMIC PROSPECTS MONTHLY REVIEW: SEPTEMBER 2004