ACM Funds



# Global Economic Outlook

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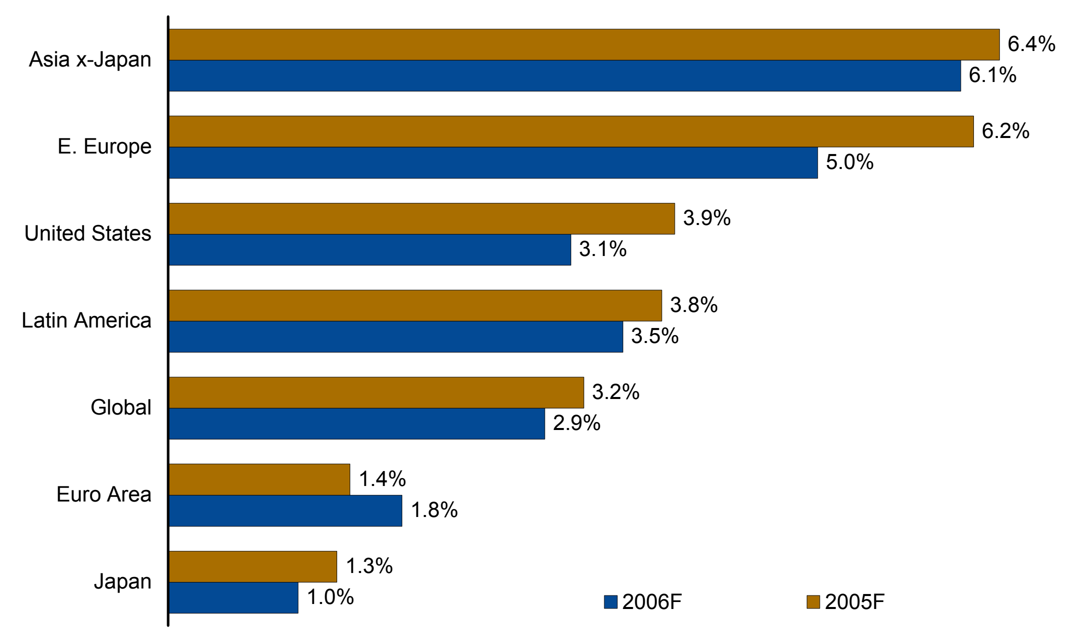
### World Economic Growth




*Source: Alliance Capital Fixed Income*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## Global Outlook

*Global economic growth prospects improved in July*

Global economic growth estimates have moved up a bit during the past month. Most of the upward revisions stem from the projection of stronger growth in the US, but expectations of a better second half are also building in Canada and Europe, if not Japan as well. In the US we now see both third- and fourth-quarter real GDP growth running over 4%. And, while at this writing growth estimates for other countries have not yet been lifted, analysts undoubtedly are becoming more convinced of a better second half, which we believe will soon lead to higher forecasts.

*Lack of inventory overhang implies faster production in coming months*

One of the catalysts for a global expansion in coming months is the lack of any inventory overhang. At the end of 2004 and in the early months of 2005, inventory positions looked to be building across the globe. Yet at this writing, other than some inventory accumulation in Canada no single economy appears burdened with too much stuff. In fact, inventory positions look greatly improved, if not thin in some cases. In the US, for example, inventories were liquidated in the second quarter—a rare occurrence for a business cycle—setting the stage for faster production growth in the second half of the year. In Japan, inventory investment looks to be flat over the past six months, with declines seen in metals, precision machinery and textiles. In China, the rate of inventory investment has slowed, from about 25% at year-end 2004 to a bit below 20% at mid-year 2005. Most of the deceleration has been in light industry and machinery and equipment. In Europe, hard data on inventory positions is difficult to find but the purchasing manager surveys do suggest some inventory correction occurred during the first half of 2005.

*Official rate trends are mixed*

Yet while global growth prospects have improved, official rate trends paint a mixed picture. Indeed, analysts anticipate official rate hikes in nine countries over the next six months, while eight countries are expected to cut rates and another nine to keep rates steady (see table below). Within this, only two G7 countries—the US and Canada—are expected to raise rates while central banks in the UK, Europe and Japan are expected to keep rates steady.

The six-month outlook for major currencies is unchanged. The US dollar is expected to trade in a narrow range versus the euro (1.20 to 1.25) and Japanese yen (108 to 112), as rising US official and market rates are expected to offset a list of negatives, which include the large trade deficit and ever-rising oil prices.

### Alliance Economists' Central Bank Official Rate Outlook

Expected Change in Official Rates During the Next Six Months

| Increase | Steady | Decrease |
|---|---|---|
| Canada | Australia | Brazil |
| Hong Kong | China | Hungary |
| Indonesia | European Central Bank | Kazakhstan |
| Norway | Japan | Mexico |
| Philippines | New Zealand | Poland |
| Singapore | Russia | South Africa |
| Taiwan | South Korea | Turkey |
| Thailand | Sweden | Ukraine |
| United States | United Kingdom | |

*Source: Alliance Capital Fixed Income*

## Oil Review and Outlook

*Our forecasts of oil prices in 2005 and 2006 have been revised up*

We have raised our forecast of average West Texas Intermediate crude oil spot prices for 2005 and 2006: the 2005 average spot price has been revised to $56 per barrel from $50 and our estimate for 2006 is now $65 per barrel, up from $55.

During the past few months, oil prices have risen sharply as world supply exceeded demand and inventories expanded. To be sure, total US oil inventories increased 5% during the past three months, mirroring increases elsewhere, and world oil prices increased $12 per barrel.

*Inventories are expanding faster than supply …*

The appetite for inventories appears to be expanding more rapidly than excess supply, causing the risk premium in the oil price to rise considerably. Indeed, there is a strong incentive to hold inventories with the market in contango (where future prices are higher than the spot price) instead of normal backwardation.

*…and use of spare capacity may not be sustainable*

The risk premium increase is probably due to very low spare capacity. The official estimate of OPEC spare capacity is 1.5 million barrels per day (mbd) compared to world production of about 85 mbd. What is more, this additional production generates heavy sour crude, which is more difficult to refine, and may not be sustainable for long. Consequently, world oil markets are vulnerable. Any supply disruption, either due to political or natural events, could put the oil balance into shortage. The only buffer is increased inventories.

*With autumn and winter just ahead, we see no possibility of a price reduction this year*

We are now in summer, a season of heavy oil use in the US. In autumn, some inventory stocking usually occurs, in anticipation of heavy winter use. As a result, prices should remain elevated and we see no visible impetus for a reduction in the remainder of 2005.

Over the longer term, we believe oil demand will increase with global GDP. The way we see it, oil reserves will continue to be depleted, and higher prices will provide incentive for oil conservation, increased production, and development of alternative energy sources. The relative strength of the opposing forces will determine where oil prices end up. At any rate, high price volatility is likely.

## US Outlook

*A recovery that just won't quit*

The US economy continues to produce one of its most impressive and consistent performances in decades. Despite worries about a jobless recovery, corporate hesitancy to invest, high energy prices and huge trade imbalances, it just keeps on going.

Over the past two years, real GDP has grown by 3.3% to 4.3% in every quarter, with the exception of the third quarter of 2003, when it grew by 7.3%. Recent data paints a bright outlook and suggests that economic growth in the second half of 2005, and possibly beyond, will continue at this pace.

No recovery is ever problem free, as this one demonstrates. What really matters for the life of a cycle, however, is how accommodative financial conditions are. As long as domestic and global liquidity conditions remain accommodative—supported by persistently low official interest rates—we believe the strength and length of this cycle could surprise everyone.

### Businesses Were Surprised

Second-quarter real GDP rose 3.4%, a tad below the first-quarter gain of 3.8% but nonetheless extremely impressive. Real final sales rose an annualized 5.8%, the fastest gain since the third quarter of 2003; in a fundamental sense, it was actually far more impressive because the latter reflected a temporary boost from tax rebates. Final sales growth was surprisingly strong and broad-based last quarter, with exports rising 12.5%, business investment on equipment and software advancing 11%, and housing up 9.8%. Consumption lagged at 3.3%.

*Businesses were blindsided by sales strength in second quarter…*

Despite the strength in final demand, inventory positions were liquidated during the period—one of the main reasons why second-quarter real GDP growth was not stronger. This is unusual during expansions and is usually the result of unexpected strength in final sales. In hindsight, it appears that many businesses were expecting a more moderate pace in final demand and were blindsided by the strength in sales.

*…which is even more apparent when orders and backlog data are considered*

This was evident in the strong rebound in new-order bookings and the rise in backlogs. Durable-goods orders rose 2% in June, following revised gains of 6.4% in May and 1.5% in April. The cumulative three-month gain of 10.1% is the second-strongest quarterly gain of the past 15 years. More importantly, there was a huge gain in unfilled orders. Backlogs are the lifeblood of durable manufacturers, given the time involved in the design, tooling and assembly of big-ticket items. In the three months ending in June, these grew an unprecedented $26 billion to record levels. Put another way, at the end of June, durable-goods companies had $4 in backlogs for every $1 of shipments, the highest unfilled order/shipment ratio in about two years.

We can probably expect incremental gains in new orders, based on the Institute of Supply Management's (ISM) July report and last month's near-record sales of new motor vehicles. The ISM's new-order index surged 4.4 points to 60.6, the highest reading of the year.

This view is supported by the July orders report from Parker Hannifin, a diversified US manufacturer, which showed its North American industrial orders growing 10% over year-ago levels—twice the 5% gain in June and even higher than the 2% gain in May. This reflects broader trends within the manufacturing sector; Parker Hannifin is present in 25 different markets and produces more than 40,000 products. They also suggest that the rebound in the ISM's new-orders index reflects some incremental gains at the start of the third quarter. This is consistent with our view that economic growth will expand at a 4.2% annualized rate in the third quarter, nearly one point over the initial reading for the second quarter.

July's motor-vehicle sales hit 20.8 million units annualized**,** the second-strongest monthly selling pace on record. Domestic car companies increased third-quarter production after the July sales surge, expecting a big payback in coming months. But domestic car inventories should be unusually light by quarter-end and last year's stock especially thin. This should encourage dealers to increase their stock orders for 2006 models, obliging manufacturers to raise production schedules for the fourth quarter and possibly the first quarter of 2006. In light of these expectations, we have lifted our fourth-quarter real GDP forecast from 3.5% to 4%, and first-quarter 2006 from 3.5% to 3.75%.

*Improved foreign demand expected to continue to fuel the current economic cycle*

Improved foreign demand should also continue to fuel the current economic cycle. Real second-quarter export growth was the fastest in eight years, thanks to very strong gains in capital goods, especially commercial aircraft. And there is much more to come, judging by the growth in commercial-aircraft orders and ISM's export-orders index.

Export gains should also benefit from faster, more balanced global growth. Japan's and Europe's growth prospects appear to be improving, while growth still looks solid in China, Australia, Canada and Latin America. Importantly, domestic demand has been stronger than export growth in all of these countries—a big positive for US multinational companies.

## Implications for Monetary Policy

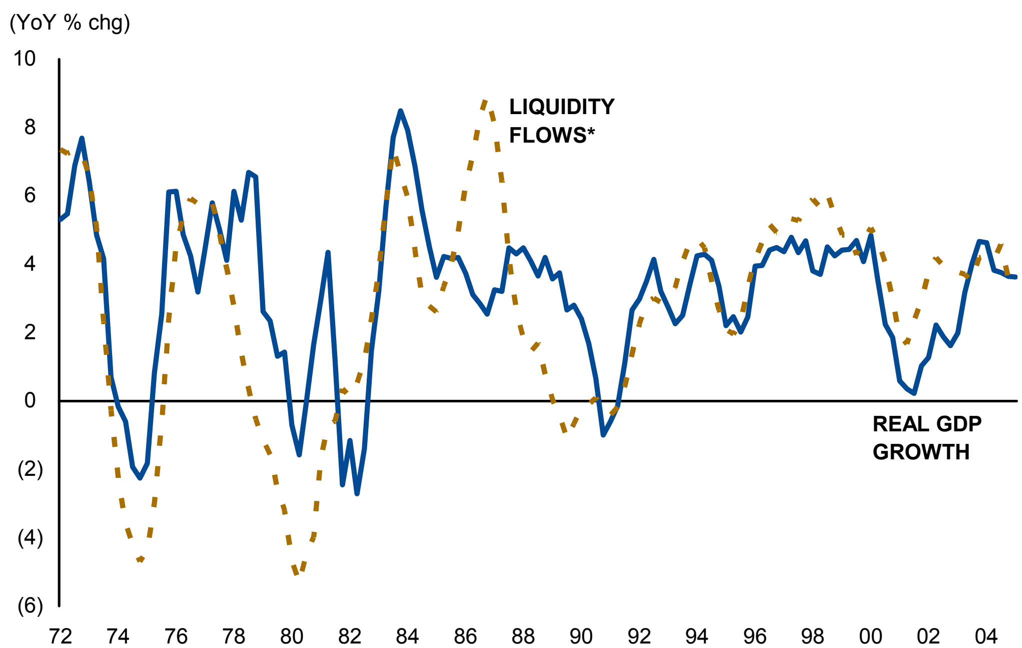
From all sides, the US economy looks to be stronger, with a lot of positive forward momentum and less slack in labor and product markets. Moreover, recent GDP revisions revealed a less favorable mix between growth and price. Nominal GDP growth was revised from 6.6% to 7% for 2004, the fastest nominal growth since 1989. But the incremental growth came entirely from faster price increases. Real GDP was revised down slightly in 2004.

*US federal funds rate below fair value*

Accordingly, the fed funds rate, which was already below fair value before the GDP revisions, appears even more so. As a consequence, policymakers will, in our view, be forced to raise official rates to a higher level than we originally thought. We now look for the fed funds rate to go to 4.5% before the fed pauses, bypassing the 4% target that many, including ourselves, have forecast by year-end. The Fed may offer additional guidance at the August 9 meeting of the Federal Open Market Committee, which is expected to increase the target rate another 25 basis points to 3.5%. Policymakers will likely hint that more rate hikes are in the pipeline, suggesting that accommodative monetary policy must be removed to maintain general price stability going forward.

**Liquidity Drives Economic Cycles**

Liquidity Flows* and Real GDP Growth




**Liquidity is a measure of real money growth, growth in business and consumer credit, growth in short-term liquid assets, foreign purchases of US securities, net cash flow into bond and stock funds*

*Source: Bureau of Economic Analysis, Haver Analytics and Alliance Capital Fixed Income*

## Europe Outlook

*Second-quarter growth is likely to be weak…*

The hard data for the second quarter continue to point to sluggish euro-area growth. This was particularly true for retail sales which fell by 0.2% during the quarter, the first negative since the third quarter of 2003. Nonetheless, there were some encouraging signs. Car sales were up by 1.9% on the quarter and average industrial production in April and May was up 0.3% on the first quarter (which saw flat growth). In addition, there was a strong rebound in exports, with the average for April and May 2.9% higher than in the first quarter. This was driven by strong demand from other industrial countries and oil-exporting nations, for many of whom the euro area is the biggest trading partner.

*…but the latest data*

We continue to expect euro-area GDP to rise by 0.2% in the second quarter after a 0.5% gain in the first. However, signs that world trade growth is strengthening and a weaker euro *point to a better third quarter*

should help support a modest recovery in demand in the second half of the year. This view is supported by recent data, with business surveys starting to surprise on the upside. The manufacturing purchasing managers index (PMI) rose to 50.8 in July from a low of 48.7 in May, with the more forward-looking orders component recovering to 52.3 from 48.5. Data from individual countries show that stronger export orders have played an important role in this.

*Growth unlikely to reach trend until early 2006*

While growth should accelerate somewhat in the second half of the year, there are still reasons for caution and we do not expect growth to reach trend until the first quarter of 2006. Even after their improvement, the PMIs and other indicators are still consistent with slightly sub-trend growth. Moreover, there are few signs of an improvement in the labor market. The employment component of the composite PMI (manufacturing and services combined) has been stuck at 49.4 for the last three months, the lowest readings since April 2004. Finally, the oil price continues to represent a downside risk to the outlook.

*Rates on hold this year before rising modestly in 2006*

For the ECB, recent data are likely to strengthen its reluctance to cut interest rates. It is also important to note that while a lower euro and higher oil prices act in opposite directions on growth, they both act to boost headline inflation which is still above target at 2.2% in July. With money supply and credit growth continuing to accelerate, the chances of a rate cut have diminished and the next move is still likely to be up, albeit not until 2006.

*The Bank of England has lowered interest rates…*

The Bank of England's decision to cut interest rates by 25 basis points to 4.50% is unlikely to represent the first in a series of rate cuts. Indeed, the growth outlook is improving. As we have argued before, much of the weakness of consumer spending can be attributed to the impact of last year's rate hikes and a rising savings rate. The good news is that the negative impact from higher rates is over and the savings rate is unlikely to rise as strongly as in the first quarter. This should allow consumer spending growth to move more in line with labor-income growth which, though slowing somewhat, remains resilient.

*…but this is unlikely to be the start of an aggressive easing cycle*

As the Bank of England noted after its rate cut, many of the forward-looking indicators for the economy have become more supportive. Since the bank's May inflation report, sterling's trade-weighted exchange rate has fallen by 3.5% (almost the equivalent of 1% off interest rates), equities have risen by 9% and long-term yields have fallen 25 basis points. Moreover, the outlook for the global economy has improved. All of these factors argue against a succession of rate cuts.

## Japan Outlook

*Our basic growth scenario is unchanged*

Notwithstanding the decline in industrial production growth in the second quarter, the outlook for the third and fourth quarters is somewhat brighter thanks to a weaker yen, bottoming export volumes and rising retail sales. Furthermore, although we still find the probable negative impact from a significant increase in the individual tax burden in 2006 to be somewhat worrisome, our basic scenario that Japan's economic recovery will stay alive for the rest of this year remains unchanged. Thus, our forecast for real GDP growth in 2005 is still 1.3%.

*Industrial production growth declined in the second quarter after a sharp rise in the first …*

Industrial production rose 1.5% in June, up for the first time in two months. This was very close to the Ministry of Economy, Trade and Industry (METI) outlook of 1.7%, and pretty much in line with market expectations. But it wasn't high enough to make up for a lackluster quarter. Indeed, production declined 0.4% in the second quarter overall, a sharp deterioration from first-quarter growth of 1.7%. This suggests that the first quarter's spike was just a short-term rebound, and implies that the second quarter GDP (due out on August 12) may show near-zero growth. We estimate that real GDP grew 0.2% in the quarter

(0.7% annualized), after having risen sharply by 1.2% (4.9% annualized) in the first quarter.

*...but the outlook for the third and fourth quarters is somewhat brighter*

The outlook for industrial production in the third and fourth quarters is somewhat brighter, however, thanks to bottoming export volumes and rising retail sales. Indeed, June export volumes rose 0.4% year-over-year, a marked improvement after negative growth in the prior two months. Retail sales grew 3.2% year-over-year in the second quarter, the highest rise in more than eight years. Meanwhile, the METI outlook for July production has been significantly revised up from –1.2% month-over-month to –0.2%, and expects August production to rise a solid 1.9%. If this occurs, production growth may turn positive again in the third quarter. In year-over-year growth terms, the METI July projection points to –1.4%, the largest drop since June 2002, which is expected to be followed by a sharp rebound of 3.2% growth in August.

*But buyer beware – bonds and equities may become highly volatile while politics are unsettled*

In politics, Prime Minister Koizumi dissolved the Diet on Monday, calling for a general election to be held on September 11 after parliament's upper house voted down bills for privatizing the postal service. We see odds of less than 50% that the coalition between the Liberal Democratic Party (LDP) and Komeito wins. Indeed, the general mood does not appear favorable to LDP, as internal conflicts within the party are surely giving a bad impression to voters, not to mention that a split within the LDP during the election would cause it to weaken further. Instead, we think there is a good chance that the opposition Democratic Party wins the majority in the lower house, gaining political leadership. In our view, the breakup of the LDP and advance of the Democratic Party may be necessary to accelerate economic reform, desirable for the long term. In the near term, however, equities and bonds may become highly volatile in response to the political turmoil, although at the moment, we maintain our six-month target of the 10-year JGB yield at 1.35% for fundamental reasons.

## Australia Outlook

*We still expect a "muddle-through" growth scenario…*

Our thinking on Australia's economic outlook has changed little in recent months. The dynamics of the housing downturn and the terms-of-trade boom remain critical in determining outcomes for the economy over the next year. We continue to expect these influences to be broadly offsetting, leaving overall growth running at or slightly below trend.

*…but risks are now skewed to the upside*

Recent data, however, indicate that the risks are skewed to the upside. Retail spending has been somewhat stronger over the past couple of months. Leading indicators of housing construction—i.e., finance and building approvals—have stabilized, and are now showing signs of a tentative uptrend. Business confidence is still holding up very well. And, employment growth continues to surprise on the high side.

While for now, we're inclined to stick with our "muddle through" scenario, it's clear the risk that the domestic economy has moved to a more solid footing has increased. That said, monetary policy looks to be on hold for at least the next six months. The central bank gave a very relaxed assessment of the outlook on Monday, effectively signaling a removal of its long-held tightening bias.

## Canada Outlook

*Two rate hikes seem quite likely, given stronger domestic demand in the second*

The Bank of Canada has explicitly stated that rates will be hiked in the near term. And, despite some modestly soft data over the past two weeks, we believe that means successive 25 basis-point hikes at the bank's September and October meetings.

*quarter*

To be sure, domestic demand still seems to be robust. Moreover, though the manufacturing sector recovery has been uneven, and surveys of future intentions are not particularly strong (not to mention that the trajectory of exports is also suspect) in our view, stronger US growth will mitigate concerns going forward, as well as provide cover for BoC rate hikes.

***Inflation remains well behaved, helped by the currency which is still relatively strong***

And, although economic growth is slightly below the 3% thought necessary to close the output gap, inflation remains generally very well-behaved, with core numbers remaining in a narrow range below the 2% inflation target. The currency continues to trade in a narrow band, making overall monetary conditions still relatively tight and—in contrast to the US—not likely to provide the fuel for any worrisome price increases. The risk for the central bank is that rate hikes cause another spike in the Canadian dollar, but the growing belief that the US Federal Reserve has more to do may mollify those fears.

## Emerging Markets Outlook

**Emerging Markets Summary:** Forecast: EMBI global spreads at 260 to 275 basis points over Treasuries. *This forecast is derived from a composite of individual country spread forecasts compiled in our relative value package.*

***Growth has picked up somewhat and market conditions remain robust***

There has been some improvement in the growth prospects of major Latin American countries. We believe interest rates will be generally lower in most markets during the coming months. The main driver for bond returns, however, has been the liquidity resulting from soaring dollar reserves, which are now being used for liability management operations. This is boosting already favorable technicals.

***Monetary policy easing is now generally on the agenda and growth remains in good shape***

**Latin America:** The second quarter has seen a modest growth reacceleration in most countries. External accounts remain well-behaved, with the primary challenge being currency appreciation, as capital inflows continue to be quite strong.

In **Brazil**, growth remains more problematic than in the rest of the region, as the country's earlier and stronger monetary tightening has yet to be unwound. External accounts are quite robust, but longer term, we are watching the effects of the stronger currency on soybean plantings, the negative effects of which could begin to be felt in the first quarter of next year. In our view, the central bank will likely begin cutting rates in September, cutting by about 175 basis points until year-end.

In **Argentina**, growth continues to defy skeptics. Strong capital inflows are reducing concerns about a future IMF deal, possibly rendering it moot. Inflation, however, remains a key weakness and may slightly exceed double digits.

For **Mexico**, a growth trajectory of about 3.5% seems likely. We expect the central bank to begin lowering rates in September very gradually, but headline inflation looks set to end the year under the 4% ceiling for the target, while core inflation will approach its 3% target.

In **Venezuela**, the nationalization of the economy continues day by day, and fiscal numbers become more suspect as government subsidies abound—yet high oil prices are allowing both spending and financing for other governments.

***Normal Andean political noise is being overshadowed by high commodity prices***

Economic growth in **Colombia** is solid, but an impending court decision on presidential reelection could somewhat derail markets.

In **Ecuador**, after cannibalizing the pension system and failing to gain some expected multilateral money, a debt issue prompted by Venezuela should fund the country through this year and perhaps next, though political uncertainty remains high.

*China's nominal GDP growth slowing despite stable and robust real growth rates*

**Asia ex-Japan:** Registering strong real GDP growth of 9.5% year-over-year in the first half of 2005, **China** shows hardly any slowdown from annual growth of 9.5% in 2004. Not only is the incredibly stable and robust growth profile inconsistent with sharp cyclical swings witnessed in most monthly economic indicators over the past six quarters, but also, nominal growth has eased noticeably to 13.6% year-over-year in the second quarter from a peak of 17.4% in the third quarter of last year. Certainly, surging net exports—largely the result of local producers off-loading excess capacity onto overseas markets—has provided a significant boost to GDP growth. The trade surplus accounted for a staggering 4.4% and 5.3% of quarterly nominal GDP in the first and second quarters, respectively, in contrast to last year, when it contributed –2.6% in the first quarter and a marginal surplus of 0.4% in the second.

Our main concern is that, even with the substantial boost from net exports, nominal growth has still fallen over the past four quarters because of a decline in the growth of the GDP deflator, from a peak of 7.6% year-over-year in the third quarter of last year to 3.6% in the second quarter. Indeed, excluding net exports, nominal growth has collapsed from a peak of 18% in the second quarter of 2004 to a mere 7% in the first quarter of 2005 and 8% in the second. Thus, the underlying growth of the economy has hardly been expanding as robustly as the production-based headline real GDP growth rates suggest. Accordingly, we maintain our forecast of real GDP slowing to around 8.7% year-over-year in the second half, which will leave full-year growth at 9.0%. Our projection for 2006 is still 8.0%. In nominal terms, we expect GDP growth will decelerate to 13.0% in 2005 and further to 10.0% in 2006, down from growth of 16.5% last year.

*Room for monetary relaxation increases in 2H*

Given the slowdown in underlying growth and inflation, we see room to relax monetary policy somewhat during the latter half of the year. Real interest rates have been on the rise, bank lending is too tight—particularly on short-term working capital for firms—and the velocity of money in the economy has been declining. It is no wonder to us why the central bank now favors a more neutral policy stance. The recent pickup of M2 growth to 15.7% year-over-year in June, which exceeded the central bank's annual growth target of 15%, was merely due to a rebound of quasi-money (deposits). Short-term liquidity, represented by M1 growth, remained benign at 11.3% year-on-year in June. We expect the central bank will begin to consider interest rate reduction again in early 2006.

*Rate cuts in Poland and Hungary*

**Emerging Europe:** The National Bank of **Poland** cut its base lending rate by another 25 basis points, citing lower inflation and an improved fiscal position, with positive local debt performance. The upside is limited by political uncertainty over general elections to be held next month. So far, opinion polls predict the triumph of a pro-EU and moderate government, but Polish elections are notorious for producing very complicated and unpredictable results.

**Hungary's** central bank also has approved rate cuts, but the country's fiscal position continues to worsen, increasing risks of currency and interest-rate volatility in early 2006, part of which should be election-related.

The new round of upgrades to **Russia** began with a Fitch upgrade to BBB, based on the country's improved debt ratio. We expect an upgrade from Moody's within the next three

*Upgrade in the works for Russia…*

months, with S&P following after a significant delay. The Fitch upgrade should not significantly impact flows into sovereign debt, but raising the sovereign ceiling undoubtedly will bring more corporate issuers into the investment-grade mold.

*… and Ukraine*

**Ukraine** is another country which deserves an upgrade based strictly on fundamentals, though political considerations cloud its prospects.

*South Africa: Looser monetary policy and a weaker rand*

**Emerging Economies:** In **South Africa**, inflation is slowing to between 3% and 4%, growth is remaining at around 4%, and the currency has strengthened somewhat. The government has announced its intentions to move on to the next stage of reform. In eleven years, the ruling ANC has succeeded in achieving financial stability through controlling the budget deficit, lowering inflation, raising central bank reserves, and lessening exchange-rate volatility. The government is less satisfied with its progress on bringing poverty down, decreasing unemployment, and lowering the crime rate (and perhaps dealing with the AIDS pandemic, although it hasn't admitted this). The administration views faster economic growth as the only way to cure these problems. Therefore, it advocates labor deregulation, lower central bank interest rates, and a weaker rand in the future. Accordingly, we expect aggressive rate reductions.

*Turkey: Strong macroeconomics, destabilizing politics*

**Turkey's** macroeconomic performance remains on an excellent path. The budget is doing much better than expected and will easily reach the 2005 target of a 6.5% primary surplus and a reduction in the overall deficit. Inflation at 7.5% is below the end-2005 target and recently has fallen. Growth has slowed to around 5%. Yet the current account deficit is increasing and could reach –6% of GDP in 2005. Financing is not a problem as the government is privatizing state-owned enterprises at a rapid pace and this is attracting increased foreign direct investment. On the political front, Turkey is running into road blocks from the EU. In our view, membership talks plainly are in trouble. In the latest round, some EU members have indicated that full recognition of Cyprus and opening of Turkish ports to Greek Cypriot vessels should be required before accession talks can begin. This is insensitive to Turkey's delicate peace negotiations with Cyprus and clearly is adding new conditions. Overall, economics probably will dominate politics in this case.

| | Real Growth[1] | | | Inflation[1] | | | Official Rates[2] | | | Long Rates[2] | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2004 | 2005F | 2006F | 2004 | 200F | 2006F | 2004 | 2005F | 2006F | 2004 | 2005F | 2006F |
| **Global** | 3.9% | 3.2% | 2.9% | 2.5% | 2.6% | 2.6% | 3.00% | 3.67% | 3.90% | 4.29% | 4.33% | 4.59% |
| **United States** | 4.4% | 3.9% | 3.1% | 2.7% | 3.1% | 3.4% | 2.25% | 4.25% | 4.75% | 4.24% | 4.75% | 5.25% |
| **Euro Area** | 1.8% | 1.4% | 1.8% | 2.2% | 2.1% | 1.7% | 2.00% | 2.00% | 2.50% | 3.68% | 3.50% | 3.75% |
| **Japan** | 2.7% | 1.3% | 1.0% | 0.0% | -0.2% | 0.0% | 0.00% | 0.00% | 0.00% | 1.40% | 1.35% | 1.40% |
| **Canada** | 2.8% | 2.7% | 2.8% | 2.1% | 2.3% | 2.0% | 2.50% | 3.00% | 3.00% | 4.80% | 4.40% | 4.80% |
| **United Kingdom** | 3.1% | 2.0% | 2.5% | 1.3% | 2.0% | 2.0% | 4.75% | 4.50% | 4.50% | 4.54% | 4.50% | 4.60% |
| **Sweden** | 3.0% | 2.6% | 2.8% | 0.8% | 0.9% | 1.3% | 2.00% | 1.50% | 2.50% | 3.97% | 3.35% | 3.75% |
| **Norway** | 2.9% | 3.4% | 3.8% | 0.3% | 1.3% | 1.7% | 1.75% | 2.25% | 2.75% | 4.07% | 3.85% | 4.00% |
| **Latin America** | 5.5% | 3.8% | 3.5% | 7.5% | 6.0% | 6.0% | -- | -- | -- | -- | -- | -- |
| **Argentina** | 9.1% | 6.8% | 5.0% | 6.5% | 10.5% | 8.0% | -- | -- | -- | 32.24% | 9.30% | 9.50% |
| **Brazil** | 5.2% | 2.8% | 3.0% | 7.5% | 6.1% | 5.5% | 18.50% | 18.00% | 16.00% | 9.04% | 9.50% | 9.60% |
| **Mexico** | 4.3% | 3.6% | 3.0% | 5.2% | 3.8% | 3.5% | 8.80% | 9.00% | 8.00% | 5.99% | 6.60% | 6.75% |
| **Asia x-Japan** | 7.5% | 6.4% | 6.1% | 3.5% | 3.0% | 3.0% | -- | -- | -- | -- | -- | -- |
| **Australia** | 3.2% | 2.6% | 2.8% | 2.3% | 2.6% | 2.5% | 5.25% | 5.50% | 5.50% | 5.33% | 5.65% | 5.70% |
| **China[3]** | 9.5% | 9.0% | 8.0% | 3.9% | 1.8% | 1.5% | 5.58% | 5.58% | 5.33% | 5.76% | 6.12% | 5.87% |
| **Hong Kong[4]** | 7.8% | 5.0% | 4.5% | -0.4% | 1.5% | 2.0% | 3.75% | 5.25% | 5.50% | 3.61% | 4.50% | 4.25% |
| **India[5]** | 8.0% | 7.0% | 7.0% | 3.7% | 5.0% | 5.5% | 6.00% | 6.25% | 6.25% | 6.70% | 7.50% | 7.25% |
| **Indonesia[6]** | 5.1% | 4.5% | 5.0% | 6.1% | 8.0% | 7.5% | 7.00% | 7.50% | 7.75% | 10.10% | 12.75% | 12.00% |
| **Korea[7]** | 4.6% | 3.5% | 4.0% | 3.6% | 2.8% | 3.0% | 3.25% | 3.25% | 3.50% | 3.40% | 4.50% | 5.00% |
| **Thailand[7]** | 6.3% | 5.0% | 5.5% | 2.8% | 3.0% | 2.8% | 1.83% | 2.50% | 2.75% | 3.76% | 4.70% | 5.00% |
| **Poland** | 5.9% | 5.0% | 4.5% | 4.3% | 2.0% | 2.3% | 6.75% | 4.25% | 3.50% | 7.00% | 5.00% | 4.50% |
| **Russia** | 7.1% | 5.5% | 4.6% | 11.5% | 14.0% | 11.0% | 12.00% | 11.00% | 11.00% | 7.50% | 6.00% | 5.30% |
| **South Africa** | 3.7% | 4.1% | 3.6% | 4.3% | 4.5% | 5.0% | 7.50% | 7.00% | 7.00% | 8.10% | 7.95% | 8.25% |
| **Turkey[8]** | 9.1% | 5.1% | 4.8% | 8.6% | 7.5% | 6.5% | 19.70% | 14.00% | 12.00% | 21.40% | 15.00% | 13.00% |

*NOTES:*

*1) Growth and inflation forecasts are reported on a calendar year/calendar year basis. For Norway and Sweden, inflation is underlying.*

*2) Official and long rates are end-of-year forecasts. Long rates are 10-year yields unless otherwise indicated.*

*3) China: Official rates are 1-year benchmark lending rates and long rates are 10-year lending rates*

*4) Hong Kong: Base rate and 10-year exchange funds yield*

*5) India: Bank rate and 10-year government bond yield*

*6) Indonesia: Intervention rate and 5-year government bond yield*

*7) Korea & Thailand: Overnight call rate and 5-year government bond yield*

*8) Turkey: Long term rates are 3-year rates*

*Source: Alliance Capital Fixed Income*