| Standard Chartered Global Focus |
Monthly analysis of economic and financial market developments - 14 August 2008

The world is split

- One year on, the credit crisis still has some way to run
- There is no evidence yet of a bottom in the US housing market, which is key to the current crisis
- In fact, the crisis is spreading from the US to the globe
- But the world is split between the haves and have-nots
- Those with sound fundamentals will benefit, those without will have tougher times ahead
- We expect the West to see more bank failures, slower or no growth, lower inflation and interest rates
- For the emerging markets, especially Asia, this may be the pause that refreshes as economic activities move from breakneck to solid
- Analysis inside on Brazil, Indonesia, Jordan, Kenya and Thailand
- Plus focuses on FX and Commodities

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Synopsis

Monthly analysis of economic and financial market developments - 14 August 2008

Credit crisis continues

Overview: The credit crisis - one year on pp.3-6

The credit crisis started a year ago has still got some way to run. There is not likely to be any let up in the near term and we have, as yet, not seen the full impact of deteriorating credit card and other consumer debt. In fact, the crisis is spreading from US financial sector to the whole global economy. For next year, we expect more Western financial institutions to fail, Asia moving from breakneck to solid growth while the West from slow to no growth. Also, we expect inflation fears to subside and interest rates to fall.

FX: The paradox of thrift pp.7-8

Current US optimism is overdone, but USD will gain from pro-active policies and valuation. Asian currencies have further to fall into H1-09 as inflation concerns give way to growth. Further out, USD will suffer from rebounding liquidity and competition for capital inflows.

Commodities: Commodity confidence crunch pp.9-11

Crude oil prices fall 18% m/m, erasing June's gains and leading the commodity complex lower. Cyclical demand concerns outweighing supply risks for now. Broadly, we expect commodity prices to consolidate at a lower level as the cyclical downturn progresses and the direction of the USD is less clear, but they will still be at historically high levels.

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Overview

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- One year on, the ‘credit crisis’ has still got some way to run
- The crisis is spreading from US financial sector to whole global economy
- Inflation fears will subside and interest rates should fall

The credit crisis - one year on

Last week marked the one year anniversary of the 'rant' by CNBC's Jim Cramer (the host of a US financial programme) at the serious state of the markets and the US authorities' lack of action to deal with the housing market problem. (It is well worth watching for anyone who has not already seen it.) He called for the Federal Reserve to 'open the discount window' and to 'cut rates'. Within two weeks the sub-prime losses in the US froze the world's money markets when several European financial institutions acknowledged losses in their asset-backed securities portfolios. The severity of the losses, and their unexpected location, broke an already fragile market. Funding for securities portfolios dried up and the cost of inter-bank borrowing soared as banks lost faith in each other.

The Fed did respond, cutting rates heavily, opening the discount window to a wider range of institutions and accepting a wider range of collateral. Other western central banks also extended their repo facilities, though worries about inflation allowed them less room to cut rates aggressively. However, the situation is far from being resolved. Back in March we estimated the total losses of the US financial system to be well in excess of USD 500bn and now, if anything, we expect it to be worse. Already US financial firms have declared losses of USD 250bn out of global losses of over USD 500bn, as outlined in Table 1. Losses so far in Asia-Pacific have been small but many of the problems that we have seen in the US housing market are also present in the Australian housing market, where the slowdown has been delayed by booming commodity markets. The losses have spread from sub-prime to higher credit-quality mortgages. The losses and market seizure have caused the demise of the fifth biggest US broker-dealer, Bear Stearns, as well as the first bank-run in over 100 years in the UK. Northern Rock was then forcibly nationalised. Many financial institutions have been taken over, gone under or had to restructure radically.

Table 1: Losses reported and capital raised by financial firms
USD bn

Region	Total		Q3 08		Q2 08		Q1 08		Q4 07		Q3 07	
	Loss	Cap.	Loss	Cap.	Loss	Cap.	Loss	Cap.	Loss	Cap.	Loss	Cap.
Worldwide	493	357	6	38	90	170	176	91	173	46	44	11
- Americas	252	177	6	16	69	70	70	60	30	28	28	1
- Europe	229	159	0	17	19	86	98	27	86	17	16	11
- Asia	22	21	0	3	0	13	10	3	11	0	0	0

Source: Bloomberg WDCI (6/8/08)

During 2005-06 there were no closures or assistance for any bank by the Federal Deposit Insurance Corporation (FDIC). But since the start of 2008, eight FDIC-guaranteed banks have failed, which we show in Table 2. This is out of a universe on over 8,500 FDIC guaranteed banks in the US.

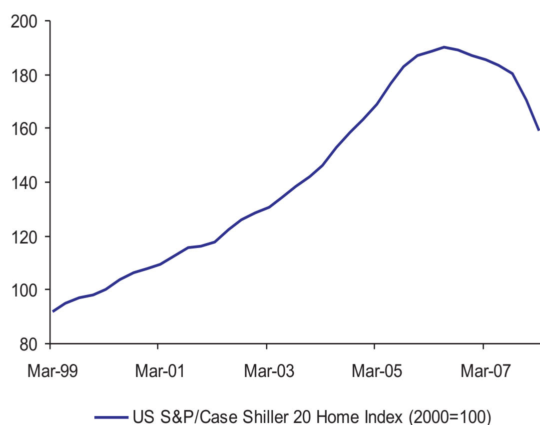
Table 2: US bank failures in 2008 (as of 1 August)

Name	Assets/deposits (USD bn)	Comments
Indymac Bank, CA	32.1/ 19.1	11 July 2008. Transferred to FDIC as IndyMac Federal Bank. Buyer being sought. Losses on mortgages and depositors withdrawing cash as they lost confidence.
First National Bank of NV/ First Heritage, CA	3.6/ 3.2	25 July 2008. Acquired by Mutual of Omaha, NB for USD 120MM. Mortgage defaults across US, lending predominantly to developers and home builders. FDIC retained USD 860 MM of assets.
First Priority Bank, FL	0.26/0.23	1 August 2008. Deposits acquired by Suntrust Inc. Failure due to excessive mortgage related losses.
First Integrity Bank, MN	0.054/ 0.050	30 May 2008. Acquired by First International Bank of Watford City, ND. FDIC retains about 1/3 of all assets. Delinquent loans doubled in 12 months.
ANB Financial, AR	2.1/ 1.8	9 May 2008. Part of the assets and deposits acquired by Pulaski Bank & Trust, AR. Delinquencies had risen 58% in 3 months and 10-fold in 12 months – loan book skewed towards real estate development – 94%.
Hume Bank, MO	0.018/ 0.013	7 March 2008. Acquired by Security Bank, MO. Past due loans not reported.
Douglass National, MO	0.058/ 0.053	25 January 2008. Assets acquired by Liberty Bank & Trust, LA at a discount to face value of 12%. Mounting losses and growing delinquencies – 20% NPL.

Source: SCB Global Research

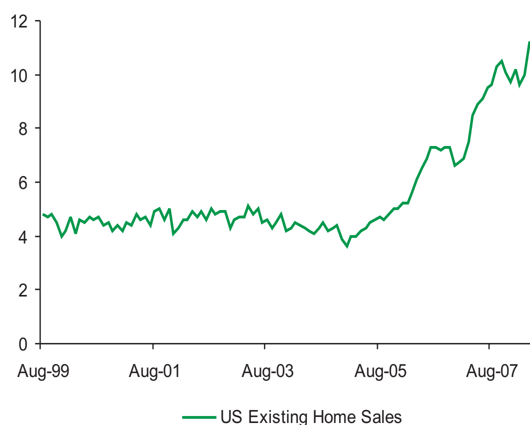
The main reason for these failures is the housing market. Even though the last month has seen some evidence that the US housing market is no longer accelerating to the downside, there is no evidence yet of a bottom in prices, and the overhang of unsold homes is still enormous. Chart 1 shows the Case-Shiller house price index, 18.4% off its peak. Chart 2 shows there are 11 months of unsold inventory out there, a number that is still climbing.

Chart 1: US House prices keep falling



Source: Case-Shiller

Chart 2: Lots of US houses still to sell (months of supply)



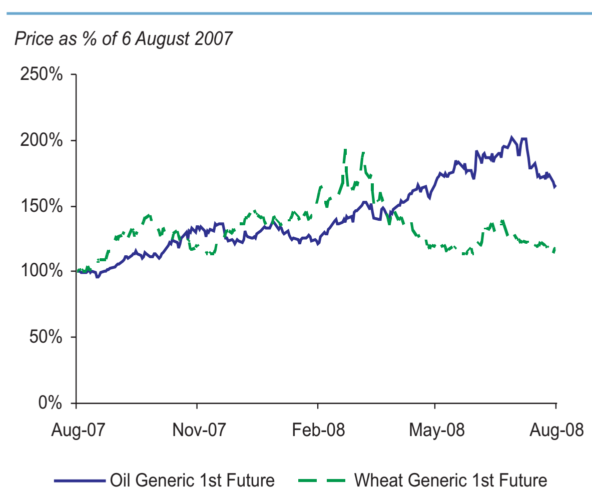
Source: Nat. Assoc. of Realtors

There is not likely to be any let up in the near term and we have, as yet, not seen the full impact of deteriorating credit card and other consumer debt. Recent card company results fell short of estimates with significantly increased provisions for losses. US retail sales have been helped by the Q2 tax rebates so there is more pain to come. The pain is also spreading, with retail sales falling in the UK and Europe and the corporate sector in the West, which entered the crisis in sound financial condition, is finding that the increased costs of borrowing, the unavailability of credit and the drop in retail sales are starting to take their toll. Banks are putting aside increasing amounts of provisions for future client defaults. There will clearly be more financial institutions that fail both in the US and elsewhere.

Another aspect of the credit crisis has been the flight to emerging markets and commodities following the Fed's unscheduled decision to cut rates on 17 August 2007 (just ten days after keeping rates unchanged at the scheduled meeting). Though we never subscribed to it, there was a view that Asia (and EM in general) was 'decoupled' from the turmoil in the US. With the US consumer responsible for 30% of world consumption we always felt that the EM would be 'insulated' rather than 'decoupled'. Increased domestic consumption and the ever-increasing importance of new inter- and intra-regional trade corridors were always going to be important supports, but were clearly not of the scale required to replace the US. Growth in EM has weakened, partially in response to the weakness in the G3, but also partly because of the tightening of monetary conditions in response to inflationary pressures. EM does face a cyclical slowdown, but from very high levels of growth. The longer-term outlook is still very positive, though. The secular shift of economic power from West to East will continue and the eventual end of the credit crisis will almost certainly leave Asia and much of the rest of EM in a much stronger relative position.

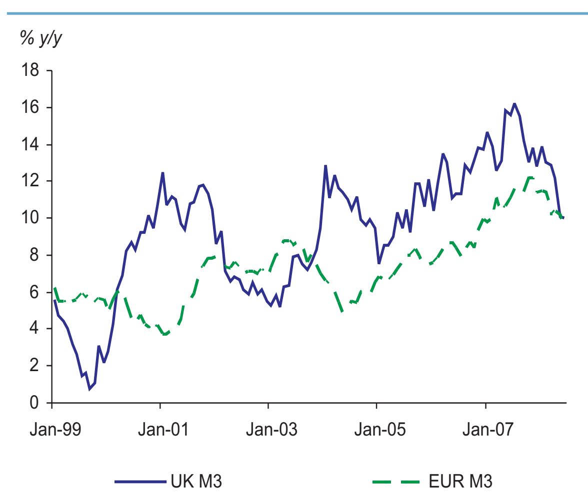
The prospects of continued growth in EM and weakness in the USD led to big moves in commodity markets, especially for oil and food, in the last 12 months. Oil has rallied from below USD 70 per barrel in August 2007 to reach a peak of over USD 145 per barrel last month. Though some of this move was geo-political, little was 'speculation' as the buying of oil futures does not affect the amount of oil available for consumption. Most of the rise came from increased demand and the inability to deliver enough 'cheap' oil - a result of higher drilling and exploration costs and the lack of investment over many years. The recent fall in oil prices is a welcome relief for the world but the move is unlikely to last long given demand growth from Asia and other EM. Similarly, demand and supply remain the key factors in food prices and we should not expect much, if any, reduction in prices. Chart 3 shows oil and wheat prices.

Chart 3: Commodity inflation set to fall



Sources: NYMEX, CBOT

Chart 4: UK and Eurozone money growth falling



Sources: BoE, ECB

Inflation remains the predominant issue for EM, mostly because of commodity prices. Inflation has hit much of EM hard as its exposure to commodities, given their investment-intensive growth, is high and oil/energy-use efficiency is often low. Moreover, food-importing EM has suffered with its higher Engel co-efficients. The response across EM to inflation has varied. China, for instance, tightened the availability of credit sharply starting in October 2007, with apparently positive results. Producer (factory gate) prices are still accelerating but the CPI seems to have peaked. Other parts of EM are initially benefitting from the commodity boom, but there are clear risks that the seeds of bust are sown in the boom. In the Gulf, in particular, where there are few instruments to tackle inflation because of the currency pegs, inflation could become embedded. At some point in the future the GCC countries must address their monetary and currency regimes. Hopefully sooner rather than later.

We remain relatively sanguine on inflation. The deflationary effects of the credit crunch and the increase in the prices of oil and food, which reduces other discretionary spending, undermines inflationary pressures in many, though not all, economies. Money supply, which is notoriously difficult to measure, globally was running at elevated

levels for a number of years prior to August 2007. Thanks to easy monetary conditions in the US, fast liquidity growth in China and the Gulf, combined with the creation of liquidity through financial engineering and the world was awash with cash. As ever, this money found its way into unproductive 'investments' and over-consumption, especially in the US and UK (but also elsewhere).

Are we now at a tipping point for the global economy? The data seems to show that in several key markets money growth is slowing. In the UK, for example, the amount of money available to companies and individuals is collapsing, as Chart 4 shows. In China, money supply seems to be moderating, though the authorities are already looking to protect growth, partly relaxing the loan quota and easing up on the appreciation of the CNY. With property and equities under pressure throughout Asia and households being squeezed by high commodities maybe inflation will take care of itself.

The nature of the credit crisis has gradually evolved over the past year from a pure liquidity logjam, into a broader deleveraging trend, as solvency doubts rose, and then, finally, into a broad real economy crisis, not just in the US but across the global economy. Confidence indicators and cyclical leading indicators have plunged in many developed economies (with the UK looking particularly vulnerable). In our footprint, there is more tangible evidence of an abrupt slowing in the pace of trade growth. For the moment, the straws in the wind are not encouraging. Singapore GDP rose 2.1% y/y in Q2 and we have flagged the risk of a technical recession in 2008. China's export growth has been slowing steadily from the 25% annual growth of 2005-06 and will be just close to 0% in real terms by year-end.

However, there is a fine line to tread for the US and other policy makers worried about whether the credit crisis could finally spill over into a broader global economic crisis. For the EM economies at least, this may be the pause that refreshes. Heading into the market melt-down, they had been on a tear; real growth averaged 7 .5% over the years 2004-2008 - real output in EM conomies climbed by a third in just four years. But financial market distortions powered over-investment in (arguably unproductive) residential housing stock in the developed economies, while vital infrastructure investment failed to match the requirements of super-charged output growth across EM. A redistribution of savings as well as a retooling of financial markets are required - but underlying investment demand is still healthy across EM.

And for the next year? First, expect more Western financial institutions to fail or be restructured. Second, expect the lack of credit to lead to slower economic activity, with Asia moving from breakneck to solid growth, and the West from slow to no growth. Third, expect inflation to ease as growth slows and deflation returns as a key risk for the West. A geographic rotation of the policy response to the crisis will be required. Whilst the US Federal Reserve may have hesitated back in early-August 2007, since then much has been done in terms of both monetary and fiscal stimulus. Additional US monetary policy easing carries risks - it could drive dollar commodity prices even higher, and undermine confidence in fiat currencies. At root, it may simply postpone some erosion in US living standards and have adverse distributional consequences (potentially harming those on fixed incomes). Going forward, the policy response may be more vigorous outside the US with central bankers globally, ranging from the European Central Bank to the BSP in the Philippines turning their attention from fighting inflation to supporting the pace of economic expansion. This sea-change is already evident in China (our 01 August OTG was headed China: Loosening Begins). Against this backdrop, it would not be surprising if the US dollar develops a firmer footing in coming quarters.

The Fed and much of the world went into the credit crisis one year ago worried about inflation and believing that the crisis would be short-lived. It was not. The process of unwinding the excesses of the last few years will take time, and will probably involve three broad steps. First, liquidity will be reduced, second insolvencies will increase and finally, economic activity will fall. We are somewhere between steps one and two. Economic activity still has some way to fall. As deflation and slowing growth causes inflation fears to subside, rates should fall as well. This started as a US centred crisis but the effects will be felt globally. Overall the world will be split between the haves and have-nots. For countries and especially companies with good liquidity, solvency and sound business models there will be great opportunities to buy assets and build businesses. For those without there will be even tougher times ahead.

FX

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- USD should strengthen gradually on cyclical forces into H1-09…
- …but see renewed multi-year weakness thereafter on secular forces
- Asian currencies to fall further into H1-09 as inflation concerns give way to growth

The paradox of thrift

Markets continue to focus on cyclical economic risks. It is important to differentiate between the current cyclical forces, which may eventually lead to a powerful USD rally, and the secular forces, which will see renewed, multi-year weakness. To summarise our views here, we think that the current cyclical downturn is a positive event for the USD. We have been warning since the start of the year that H2 would be more positive for the greenback. Near term, we do not expect the current wave of USD strength against the majors to be sustained as cautious optimism over US economic prospects seems overdone. However, the USD does seem to be reversing higher gradually and we look for a sustained rally heading into H1-09 as the US authorities are effectively rewarded by investors for pro-growth policies, while policymakers elsewhere are duly punished. The secular outlook is a very different matter. With China going through its own Industrial Revolution, the USD faces similar secular headwinds as GBP did in the 20th Century. Going forward, the US will face increasing competition for capital inflows - if it is not already doing so - with potentially major implications for the US economy and US asset markets.

Long cyclical vs. short secular

After five years of blistering economic growth, the global economy is turning down. Yet, for the first time in several decades, it is doing so at a time of rising inflation. Economic lessons are by their nature retrospective. From this, we see that global monetary policy was overly loose. Policy interest rates were too low relative to non-accelerating inflation rate of unemployment (NAIRU) "fair value" levels. More importantly, global central banks - notably those in Asia and the Middle East - injected truly massive amounts of liquidity into the global system as a result of intervening to keep their currencies cheap. The so-called Bretton Woods II arrangement reflected a cyclical framework of flows that kept US rates low, asset markets supported and Asian currencies cheap. Booming FX reserve and money supply growth led to an extraordinary world of parallel gains in US interest rate and commodity markets. Amid refrains of "this time is different," market participants sought to explain this new paradigm. Those who witnessed the last major boom time of commodity markets in the 1970s and 1980s saw instead a very familiar - and old - picture. The late Milton Friedman explained it succinctly when he said, "Inflation is always and everywhere a monetary phenomenon." Excessive money supply growth created the asset market - housing and credit - bubbles. Central banks defended the indefensible by saying it was not their job to tackle asset market inflation, yet it was precisely their policies that created the asset market inflation and thus by implication allowed for pass through to the consumer price inflation that we are seeing now. From an FX perspective, excess global liquidity is de facto excess USD liquidity since the USD remains both the world's reserve and borrowing currency. Soaring supply relative to demand debased the USD, boosting other currencies and leading to a multi-year boom in commodities. That was then, this is now. First G10, then Emerging Market (EM) monetary policy was tightened - but not swiftly enough. Cost-push price pressures have emerged from soaring oil and food prices, but these are merely in addition to demand-push pressures from strong domestic demand, particularly in the EM regions of Asia, Middle East and Latin America.

Global economic activity is finally moderating, but at a time when price pressures remain elevated. The result is massive cross-market volatility as investors vacillate between inflation and growth concerns. Such volatility typically marks the end of a cyclical trend and that is what we suspect is happening with regard to the USD. Global

FX reserve and money supply growth is starting to decelerate. For instance, Asian central banks are now intervening to sell USD and buy their own currency to limit local currency weakness. On the face of it, this may seem USD-negative, but on a global scale the reverse is true for two reasons. Firstly, excess USD liquidity is being withdrawn, reducing supply relative to demand. Investors and corporates who have borrowed in USD for the last few years are increasingly faced with a USD shortage and will react accordingly, exacerbating it in the process. Secondly, the age of reserve diversification is over for the time being, at least in the majors. Less FX reserves means less willingness - or ability - to diversify. In effect, reserve diversification was itself a function of profligate liquidity.

From profligacy to thrift

The most obvious symptom of global excess liquidity was the US current account deficit. In 2007, this was around -5.4% of GDP. We expect it to narrow gradually to around -4.0% of GDP in 2010 and the risk to that is for a narrower deficit. On a quarterly basis, the US current account deficit peaked in Q3-06 and has been trending down thereafter. If we exclude oil, the trend is even clearer. In effect, we know from the accounting identity (S - I = X - M = Y - E) that a narrower US external deficit means the US will be saving more and investing less. John Maynard Keynes' concept of "The Paradox of Thrift" teaches us that not everyone can save at the same time and if they try what occurs is a fall in aggregate demand. Thus, the US government is doing exactly the right thing in dis-saving or spending to offset the economic impact of the sharp slowdown to come in US domestic demand. The problem for the rest of the world is that a narrower US current account deficit of necessity means a narrower global surplus with the US - and most of that surplus is in Asia, followed by the Middle East. Just as the US economy will be saving more, so Asia will be saving less. Asian current account surpluses are starting to narrow and will narrow further in the next six- to 12 months. Finally, once inflation is defeated in Asia, so the bias will change back to growth. When that happens, Asian central banks are likely to revert to past practice, actively weakening their currencies to support external demand. Eventually, this renewed injection of global liquidity will set off the next round of buying of riskier assets, including commodities, funded out of USD weakness.

Valuation is an important consideration in all this. Most long-term fair value models put USD fair value well above current levels against the G10 - though lower against Asia ex-Japan. This is why we hear IMF pronouncements saying that the USD is roughly "fair value." Overall, that may be true, but it is certainly not true against the G10 where it looks significantly undervalued according to standard Purchasing Power Parity (PPP) and Real Effective Exchange Rate (REER) methodology against the likes of the Euro (EUR), sterling (GBP), Swiss franc (CHF), Australian dollar (AUD), New Zealand dollar (NZD) and Canadian dollar (CAD). For instance, as of the end of 2007, the OECD puts PPP-based fair value for GBP-USD, USD-CHF, AUD-USD, NZD-USD and USD-CAD at 1.52, 1.67, 0.70, 0.65 and 1.22 respectively. We do not suggest that these exchange rates will reach those levels or anything like it - but we are suggesting that direction over the next six- to nine months. An age of relative thrift will once more be USD-positive.

Secular bears

This does not mean to say that the age of USD weakness is over - far from it. If we look at the secular rather than the cyclical trends, we arrive at three main conclusions: global economic imbalances will be reduced, but at a significant cost, EM will continue to lead global growth and inflation will continue to trend higher. The first of these may be seen as a short-term cyclical event, but it should be remembered that Asian current account surpluses following the Asian crisis of 1997-98 were also thought of that way. Consumer and bank balance sheets will undergo significant restructuring. Elsewhere, the secular picture looks brighter in EM. Growth will moderate, but from very elevated levels and should remain well above the Developed Market (DM) pace on a trend basis, supported by more pro-growth policies, greater inter-regional trade and focus on domestic demand. The global economy has evolved into a multi-polar growth world. Finally, global inflation will continue to trend higher until global interest rates temper demand-pull price growth in EM and cost-push in DM. From a market perspective, this suggests three main investment conclusions. EM will eventually become oversold and offer significant value to DM outside of the US, Asian consumption should be favoured over exports and the USD will see renewed weakness - as it did in the 1970s - when the global economy stabilises. The US economy will still be running an external deficit, albeit a smaller one, which will still have to be financed. However, it will continue to face increasing competition for global capital flows from EM, notably Asia. Moreover, Asian and Middle Eastern-based capital will be increasingly focused on higher potential returns domestically. This means that US yields will have to rise and the USD will have to fall to attract sufficient capital inflows to restore balance of payments' equilibrium.

Commodities

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- Crude oil prices fall 18% m/m, erasing Junes's gains
- ...leading the commodity complex lower
- Cyclical demand concerns outweighing supply risks for now

Commodity confidence crunch

Commodity indices plunge

The key commodity indices have plunged this month - the Reuters/Jeffries CRB index is down 15.7% m/m, the Dow Jones AIG is down 17.8%, and the S&P Goldman Sachs index, which is most weighted towards energy, is down 18.4%, as Chart 1 shows. Declines have been across all the sectors, but have been most dramatic in the energy sector led by a significant drop in crude oil prices, show in Chart 2.

Talk of an end to the boom is premature

The important thing to note is that all the indices are still up significantly (6-19%) ytd. Oil prices in particular are still up 24% since the beginning of the year, and 65% y/y. Talk of an end to the commodity boom is premature - the fundamentals of these markets largely remain very tight. A cyclical downturn in demand will ease the situation but long-term secular demand growth from industrialisation and rising incomes in Asia, and particularly China and India, are still dominant trends. However, the USD will be providing less momentum as the outlook is choppy over the year, with our FX strategists anticipating a decisive strengthening in H1 2009 as market attention shifts to weakness in Europe and Asia. Broadly we expect commodity prices to consolidate at a lower level as the cyclical downturn progresses and the direction of the USD is less clear, but they will still be at historically high levels.

Energy prices should consolidate at high levels

The WTI crude oil price has fallen significantly over the last month, more than offsetting the sharp rise in June. Fundamentally, little has changed, but deteriorating sentiment over the demand outlook in the US has taken precedence over concerns over supply risks. There has been some rhetoric from Iran and Israel, but on the whole there is a more conciliatory tone from the US on the Iran situation, and the US hurricane season has so far proved largely uneventful. Thermal coal prices have also slipped further (Chart 4). A number of factors were behind the squeeze in the first half - severe flooding in Australia, a sharp fall in exports from China, and, in the Atlantic Basin, supply disruptions in South Africa. While some of the shorter term factors have now been resolved, longer term concerns over expanding supplies sufficiently to meet growing demand against a background of declining exportable surpluses from some key market players, will keep prices well supported. For more details, see the feature on “Thermal coal: finding a firmer footing”, SCB Commodity Focus, 6 August 2008. Overall, we expect both oil and coal prices to consolidate at high levels.

Diesel is key driver of global oil demand growth… and will remain so

Downstream, higher crude oil prices have contributed to higher oil products prices in the first half of 2008, with tightness in diesel supply being the overriding theme. Global refining production is skewed towards gasoline production as its margin was the highest historically. Diesel and other middle distillate products, such as jet fuel and gasoil, overtook gasoline's position in 2008. This is because diesel demand rose due to power shortages, a colder winter and a growing consumer preference for diesel vehicles. For the rest of 2008, we expect the global economy to slow, and oil products demand growth to follow. Higher prices have slowed demand growth for jet fuel and fuel oil. We believe this is likely to continue as air travel is tightly linked with the economy, and fuel oil

consumption is tied with world trade. The US accounts for around 35% of global gasoline consumption and a weaker economy had led to a fall in gasoline demand. Naphtha is also primarily used for producing gasoline. In the OECD, we believe the pattern of switching from gasoline to diesel vehicles will persist into the next decade. In conclusion, diesel should remain the key driver in global demand growth.

An estimated 1 million barrels per day (mbd) of refining capacity is projected to come on-stream by the end of 2008. We expect supply tightness to dissipate as diesel should make up a third of new production. Regional supply-demand imbalances should ease as around three quarters of new capacity is based in Asia and the Middle East, where nearly all demand growth is centred. Nevertheless, crude oil is the primary refining input cost and its strength will continue to support prices of oil products.

Base metals expected to continue to fall

We have been bearish on base metals for some time in anticipation of the global growth slowdown. Nickel, zinc and lead have moved significantly lower so far this year (19-33%) as improving supplies have met with weakening demand growth. End use demand in the stainless steel and galvanising sectors is particularly soft. Prior to the recent correction, aluminium had gained on rising energy costs and announced production cuts in China, but high and rising inventories support our view of a substantial market surplus this year and we expect prices to deteriorate further.

Copper and tin are the only base metals markets expected to be in deficit this year. Supply problems and low inventories will likely provide some support for copper in H2, but here too an emerging surplus in 2009 will drive prices lower. While our outlook for base metals seems bearish, our forecasts for 2009, show prices 85-317% higher than 2002 levels.

Agriculture - prices weakening on better harvests - but still high historically

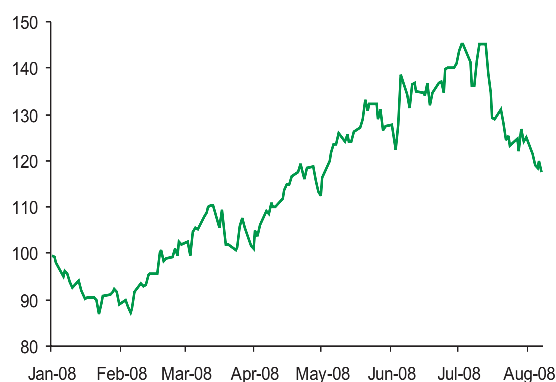
Grains prices have come under pressure not only from deterioration in sentiment towards commodities generally, but also from improving harvest forecasts. The US Department of Agriculture's (USDA) next monthly world demand and supply report (WASDE) is due out on 12 August. The dominant view is that this will show a sharp adjustment higher in yields forecast and consequently higher world production for grains, due to the steady improvement in crop conditions in the month of July. The weather is key to the outlook and it is worthwhile watching if expected rains in Australia's eastern growing region materialise as this could add to overall improvement in crop conditions over the past 2-3 weeks and further pressure wheat lower. Longer term however, pressure on acreage and yields to meet growing demand as population and incomes rise remains. We expect wheat and rice prices to average lower in 2009, but they will be up 173% and 320% respectively on 2002 levels.

Chart 1: Dow Jones commodity index

Source: Dow Jones

Chart 2: Crude oil price

WTI near future, USD/barrel

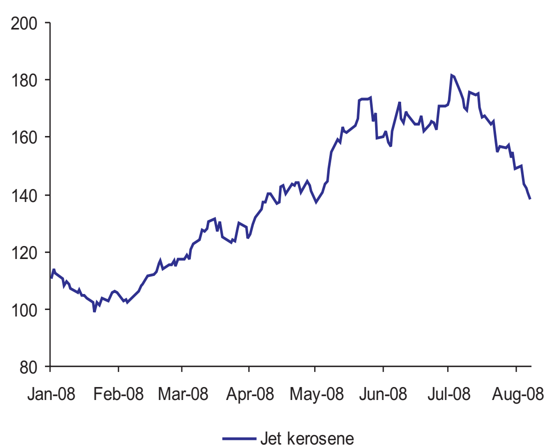


Source: Bloomberg

Finally … precious metals

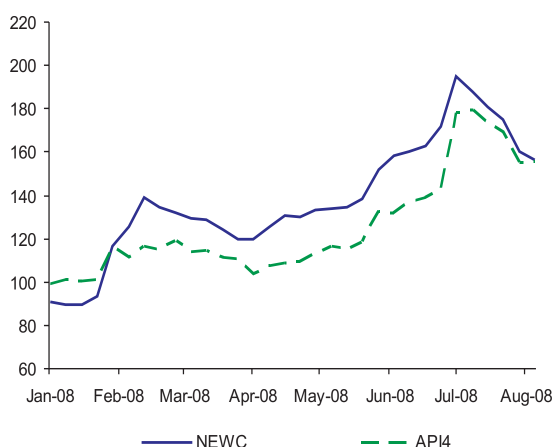
We are cautiously retaining our bullish medium tem view on gold. Global conditions are likely to deteriorate further in the months ahead, inflation risks remain and the USD is likely to remain weak this year. Our FX strategists expect a rebound in the USD in H1 2009, however, before declining thereafter. This suggests little momentum for gold in H1 2009, and we have pushed back our forecasts for USD 1,000+/oz gold until H2 2009. However, bullish sentiment towards platinum has faded as the outlook for the auto industry has deteriorated particularly in the US, and supply fears have become less intense. On 29 July, we therefore revised down our forecast for Q4 to USD 1,750/oz and for 2009 to USD 1,675/oz. This suggests a recovery near term from current levels as the market regains confidence in precious metals. Heading into next year, we expect prices to remain high but power problems should ease as energy saving measures in South Africa take effect and high platinum prices encourage thrift. See the SCB Commodity Outlook, "Platinum - Auto sector weighs on market", 29 July 2008, for more details.

Chart 3: Jet kerosene
Singapore, USD/barrel



Source: Platts

Chart 4: Benchmark coal prices
USD/tonne



Sources: Bloomberg, globalCOAL

Brazil

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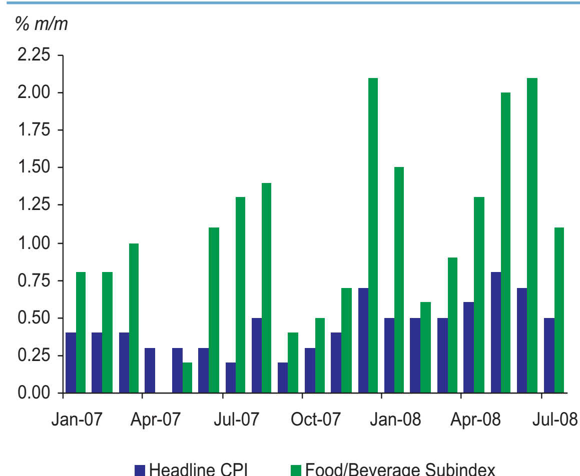
- Slower food price inflation has tempered recent headline CPI prints
- That is welcome but not enough to stop the central bank from hiking further
- We expect more rate hikes to bring inflation and inflation expectations to the 4.5% inflation target in 2009

Monetary tightening to continue

The most recent inflation data have probably prompted celebrations in some parts of Brazil's government. The benchmark IPCA consumer price index, which is the key CPI in the central bank's inflation targeting system and covers the major cities of the country, rose a lower-than-expected 0.53% m/m in July from 0.74% in June. The key driver of the lower headline inflation was the slower rise in the food and beverages subcomponent - up 1.05% m/m in July vs. 2.11% in June and 1.95% in May. With a weight of 30% of the headline index, the rise in the food and beverages component has been responsible for roughly half of the recent m/m increases in the overall index. Not surprisingly, the local rates market has rallied on the back of the lower inflation readings.

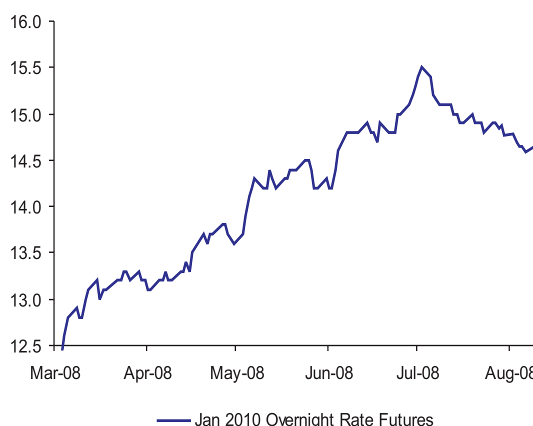
An even more dramatic turnaround, thanks to lower food prices, is seen in the broader IGP-M index, which is similar to the GDP deflator. The IGP-M index printed -0.01% m/m in the first preview for August from +1.55% in July. Looking at the breakdown, the wholesale price sub-index showed a 0.24% m/m decline, thanks to a 2.79% m/m fall in raw materials prices, of which the narrower agricultural price index was down 2.79%.

Chart 1: Decline in food price index has helped headline CPI decline



Sources: Bloomberg, SCB Global Research

Chart 2: Local rates have rallied on the back of lower inflation



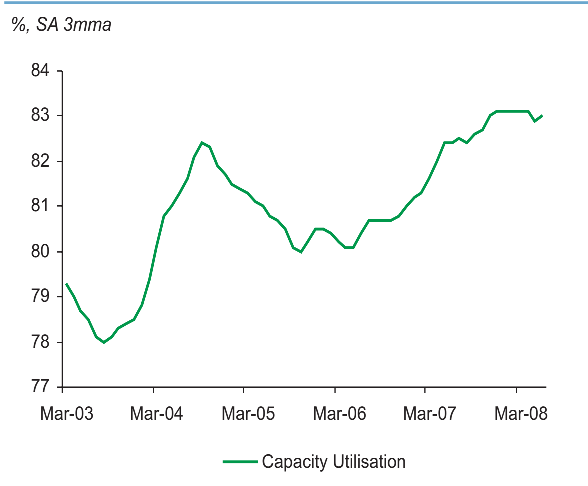
Sources: Bloomberg, SCB Global Research

Don't order a second bottle just yet

But alas it is too early to open the second bottle of champagne. The improved inflation numbers are of course welcome, but just as the international prices of food contributed to the rise in inflation, the fall in agricultural prices in recent weeks is helping on the downside. Meanwhile, the closely-watched central bank's weekly survey of market expectations released each Monday tells a less sanguine story. According to the most recent survey results, the outlook for 2008 inflation has improved, and now shows expected inflation for 2008 at 6.45% from

6.54% the prior week and the second consecutive weekly decline. The current expectation is within the central bank's inflation targeting range of 4.5% +/-2ppt. The latest reading on inflation for July was 6.37% y/y vs. 6.06% y/y in June.

Chart 3: Capacity utilisation just off the all-time highs



Sources: Bloomberg, SCB Global Research

As 2009 inflation targets are still distant

While the market's lower expectations for 2008 inflation are welcome, the outlook for 2009 is much more relevant at this point as the central bank has little control over the outcome for 2008. In an inflation targeting system, inflation expectations for 12 to 18 months ahead are more relevant than the current level of inflation. Here the expected inflation rate for 2009 is 5.0% -- unchanged in recent weeks and down from 5.1% a month ago in contrast to the faster decline in inflation expectations for 2008.

Again, the expectations for 2009 are well within the central bank's range, though hawkish comments from central bank officials recently stated that they want to push actual inflation to 4.5% in 2009 (from 6.4% y/y as of July). Also, Central Bank Governor Meirelles voiced worries that rising inflation and inflation expectations could pressure corporates to re-adopt indexation in their wage and price-mark up decisions. Indexation was disastrous for most countries in Latin America in the past. Meirelles was correct to warn that indexation would only make the central bank's job harder and thus makes the reduction in inflation and inflation expectations all the more painful.

Interestingly, the weekly market survey is also showing a rise in expectations for central bank tightening despite the falling inflation expectations for 2008 and stability for 2009. For end-2008, the overnight rate is expected to be 14.75% vs. 13.0% now, and for 2009, the market is looking for 14.00% or only 75bps in cuts.

Inflation is also driven by domestic demand

Why does the market survey seem to be unimpressed with the lower inflation prints and still expects 5.0% inflation in 2009 and further tightening? The answer is the ongoing significant expansion in demand, something we have written about quite a bit. Across the board, indicators of domestic economic activity show that domestic demand continues at a strong pace, whether that is capacity utilisation which is just off its highs, strong car sales, expanding consumer credit, or a tightening labour market.

So while lower food prices have pushed consumer prices and broader prices lower recently (and may continue to do so in the near term), robust domestic activity looks set to continue. That will put a floor on how long inflation can get. For 2008, we see the headline CPI index finishing the year at 6.6% y/y or 5.6% for the year's average relative to 2007. We maintain our growth forecast of 4.9% for 2008. We also maintain our view that rates will peak at 14.25% by end-year, so there is still 125bps in hikes yet to come with 75bps at the 10 September meeting and 50bps at the 29 October meeting. If there is a risk to that view, it is to more tightening, not less as the higher rates to date have not filtered through to domestic activity yet.

Indonesia

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- Biggest political party Golkar losing provincial elections
- President Yudhoyono losing his lead in opinion polls
- Leadership changes unlikely to affect fundamental policy direction

The comeback of PDI-P

With a general election scheduled for 2009 (once every five years), Indonesian politics is becoming interesting again. As in 2004, the election will be divided into two phases: parliamentary (at the national and regional levels) and presidential. The parliamentary elections will be held in April. The parties elected to the national parliament will then propose their presidential candidates for the first-round presidential election in July. If no single candidate wins a simple majority (more than 50% of the votes), the two top contenders will contest in a second-round election in September. The president will be sworn in October.

What the local elections and opinion polls say

Almost four years after President Bambang Yudhoyono was elected, Indonesia's political landscape is changing again. The world's third largest democracy (after India and the US) has seen its largest political party Golkar (the political base of Vice President Jusuf Kalla) losing a string of provincial elections. In 2008 alone Golkar lost seven provincial elections, four to opposition party PDI-P (of former president Megawati Sukarnoputri), three to a coalition of Islamist parties often led by the Prosperous Justice party (PKS). However, this does not mean Golkar's dominance will collapse. Based on the most recent survey by the Centre for Strategic and International Studies (CSIS), a think tank, 70% of voters have already made up their mind on which parties to vote in 2009. While more than 20% of eligible voters are likely to vote for PDI-P (secular nationalist party), Golkar (secular centrist) came second with 18% - a ranking order like in the 1999 general election. The two are then followed by PKS (conservative Islamist), PKB (moderate Islamist) and Demokrat (Yudhoyono's secular centrist). Surveys by two other pollsters (Reform Institute and Indo Barometer) also put Golkar in second place after PDI-P.

Since Yudhoyono became president, Indonesia's GDP growth has risen from 4.9% in 2004 to 6.3% in 2007, but many voters believe that not everyone has benefited. While the global commodity inflation has benefited Indonesia as a large net-producer of commodities, industrial and agricultural workers in Java, where 60% of the country's population live, are mainly fixed wage earners. As a result, accelerating inflation erodes their purchasing power, exacerbating the economic inequality between industrial Java and the commodity-based islands of Sumatra, Kalimantan, Sulawesi and Papua. The 200% rise in the Jakarta stock exchange index since President Yudhoyono's election benefits mainly the affluent. Meanwhile the government's decision to hike domestic fuel prices in 2005 and 2008, while needed for fiscal prudence, was politically unpopular. Though the burden to the poor was limited by the government's policy of cash transfers to poor households, poverty rate (defined by the percentage of the population earning less than USD 1 a day) still rose from 16% in 2005 to 16.6% in 2007. As a result, Yudhoyono's lead in public opinion since his election has, for the first time, been taken over by his former boss Megawati (Yudhoyono was her coordinating minister for political and security affairs), as shown by the results of the three polls next page. The CSIS poll indicates that, if a first-round presidential election were held, Megawati would take 23.2% of the votes, followed by Yudhoyono (with 14.7%) and the Sultan of Yogyakarta (8.8%). Generally, the polls suggest that Megawati and PDI-P, as the only opposition party, are gaining popularity at the expense of the incumbent mainly because of worsening income inequalities among the population, which is aggravated by the rise in global energy and food prices.

Table 1: Poll results on potential presidential candidates

	CSIS (Jul)	Reform Institute (Jun-Jul)	Indo Barometer (Jun)
Presidential candidate			
Megawati Sukarnoputri (former president)	23.20%	19.40%	30.40%
Bambang Yudhoyono (current president)	14.70%	19.10%	20.70%
Sultan of Yogyakarta	8.80%	7.10%	8.80%
Hidayat Nur Wahid (chairman of parliament)	7.90%	N/A	N/A
General Wiranto (former military commander)	7.60%	N/A	9.30%
Abdurrahman Wahid (former president)	N/A	N/A	6.00%

Sources: Jakarta Post, CSIS, Reform Institute, Indo Barometer

What difference does it make?

While a political comeback of Megawati and PDI-P is possible, it may not make a fundamental difference for government policies. First, both Yudhoyono and Megawati are politically secular (she did, after all, choose him as senior minister) in contrast to Islamist leaders like Hidayat Nur Wahid of PKS, who are often seen as promoters of Islamic Sharia. Second, while PDI-P is in opposition to Yudhoyono's Golkar and Demokrat-led government, the three parties are also politically secular and have in the past shared similar policy platforms. During Megawati's presidency (2001-04), for example, her economic team was led by coordinating economic minister Dorodjatun Kuntjoro Jakti and finance minister Boediono, both of whom are US-trained economists. Boediono then became Yudhoyono's coordinating economic minister in 2005, before becoming BI governor in 2008. On the political front, in 2004 PDI-P and Golkar almost formed a political coalition, which remains possible towards the 2009 presidential election. Whether Megawati gets elected or Yudhoyono re-elected, it is likely that the privatisation of state enterprises will revive (as soon as market condition improves), infrastructure development will accelerate (particularly power generators and toll roads), while tax and customs reforms will continue. PDI-P may beg to differ by proposing a medium-term economic platform that also promotes the redistribution of state-owned lands to poor farmers and easy credits to small-medium size enterprises, as well as to the urban poor - to replicate the success of the Gremin bank in Bangladesh. However, pro-poor policy platforms are commonly shared by many political parties, both secular and Islamist.

In principle, as long as Indonesia continues to be led by secular leaders and parliament dominated by secular parties that do not pose a threat to Indonesia's ethnic minorities (especially the powerful Chinese business establishment), the investor community is unlikely to be concerned. At the moment, almost 70% of the national parliament is dominated by secular/moderate parties (Golkar, PDI-P, Demokrat, PKB and others). If the 2009 parliamentary election confirms their dominance further (which is likely), fundamental change would be unlikely in Indonesian politics, at least until 2014. Interestingly, most Islamist parties have abandoned their attempts to introduce strict Islamic Sharia - as indicated, for example, by their decision not to press hard for the passage of the anti-pornography bill through parliament.

The general election is likely to be peaceful

Because the general election process is likely to take six months to complete, there are concerns over political stability in 2009. However, given relatively peaceful national and regional elections in recent years, we do not expect the 2009 elections will be destabilising. Investors may postpone investment plans until after the election, but this alone is unlikely to hit GDP growth significantly. In the election year of 2004 GDP growth was 4.9%, the same as in 2003. Growth in consumer spending in fact rose to 5.0% from 3.9%, as money politics stimulated voters' consumption. We expect GDP growth to rise to 6.2% in 2009 from 6.0% in 2008 on the back of government spending on infrastructure and election-related consumption. We also expect inflation to fall to 7% y/y by YE-09 from 12% at YE-08, as the government is unlikely to hike domestic fuel prices in an election year, while global oil

prices are expected to fall further. Indeed, as in 2004, after the 2009 general election (and given expected continuation of fiscal prudence and strong external payments balance), Indonesia's risk rating could be upgraded further - currently, Standard and Poor's put Indonesia's sovereign rating at BB- (three notches below investment grade) and Fitch Ratings at BB (two notches), both with stable outlook.

Table 2: Poll results on party affiliations among voters

	CSIS (Jul)	Reform Institute (Jun-Jul)	Indo Barometer (Jun)
Political party			
PDI-P (secular nationalist)	20.30%	22.60%	23.80%
Golkar (secular centrist)	18.10%	16.20%	12.00%
PKS (conservative Islamist)	11.80%	9.80%	7.40%
Demokrat (secular centrist)	5.20%	10.00%	9.60%
PKB (moderate Islamist)	6.80%	N/A	7.40%
PAN (moderate Islamist)	N/A	5.60%	N/A

Sources: Jakarta Post, CSIS, Reform Institute, Indo Barometer

Jordan

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- Jordan is struggling with the commodity price shock
- But its economic management should be hailed
- Investors interested in the Levant should consider Jordan as a great option

Riding the storm

Rising international commodity prices have exposed Jordan to high inflation and rising macroeconomic imbalances, similar to other non-oil producing Middle East/North Africa (MENA) countries. However, the economy has remained resilient on account of sound economic policies and the continued confidence of foreign investors. This augurs well for the short to medium term outlook while the long term growth prospects for Jordan should be bright with the country now positioning itself to become a net exporter of oil.

Vulnerabilities come to the forefront

The significant deterioration in the global economy has hit Jordan hard, as the country is heavily dependent on imports to meet its demand for oil and food, and hence is extremely vulnerable to commodity price shocks. The worst fears were realized this year with prices of all commodities registering record growth. It led to a 35% y/y increase in the import bill. The current account deficit for 2008 is estimated to rise sharply to 26% of GDP from 17.4% of GDP in 2007 and 11.2% of GDP in 2006. On the other hand, export growth slowed down to 14% y/y due to weak external demand from the US, which accounts for 26% of all exports.

The increases in food and oil prices have also translated into a rising fiscal deficit on account of the large subsidy bill. The government has traditionally subsidised staple food items and oil prices through the budget. However the size of the price shock has been so large that the fiscal deficit has jumped up from 3.8% of GDP in 2006 to 6.2% of GDP in 2007. We estimate that the 2008 fiscal deficit will widen further to 9.3% of GDP. In order to address the rising deficit and bring the public debt down from 73% of GDP in 2007, Amman has decided to replace the fuel subsidy system with a fuel price adjustment mechanism. This is a very unpopular move as it has exposed the domestic consumers almost overnight to the skyrocketing international oil prices and led to a sharp rise in inflation.

Record high food and oil prices have also contributed to a sharp increase in inflation with headline inflation registering 15% y/y in April 2008 compared to the average annual CPI of 4.8% over the past 5 years. We estimate that annual CPI inflation in 2008 will register 11%, compared to 5.4% in 2007 (Chart 1).

…which renders Jordan's relative resilience all the more noticeable

Despite the external shocks that the country has had to absorb the economy has remained resilient. Jordan's recent growth has been very strong at a real 6% y/y in 2007, although slightly below the 7% average real GDP growth seen in the last 4 years. Although the short term prospects will see a slowdown on the back of the external shock, the country has been taking the right structural measures to prepare its economic future.

The strong growth seen over the past five years has been supported by high levels of investment, domestic and foreign. Total investment as a percent of GDP has been close to 32% of GDP over the last five years and this trend is expected to continue. Infrastructure and real estate have been the prime recipient sectors as the government has been able to bridge the rising investment-saving gap through higher investment from expatriates as well as higher Gulf Arab States investments.

Jordan has recovered its position as a favourite tourist destination in the region. This has been helping offset the large trade deficit by boosting the non-merchandise surplus especially through tourism receipts. This is likely to continue, granted the geopolitical situation does not deteriorate. Tourism as measured by the number of package tours sold grew by an impressive 50% y/y in Q1-08 according to the Jordan Ministry of Tourism. Jordan has always tried to market itself as a tolerant, open and peaceful country. It paid dearly the price for terrorism attacks a few years ago but has since regained the lost ground.

Monetary policy is mostly defined by the peg between the Jordanian Dinar and the USD. Yet the Central Bank of Jordan has allowed itself to let the spread widen between the two countries' interest rates and has not followed suit with the repeated US Fed Funds Rate cuts. Despite a 325 bps cuts since September 2007, the Central Bank of Jordan only followed by a 75 bps cut. This decision has avoided so far an excessively accommodating monetary environment which would have compounded the imported inflationary pressures. So far there are no indications that the widening interest differential has attracted significant speculative capital and there are no signs of patent currency misalignment.

Amman also decided to buyback USD 2bn non-concessional Paris Club debt in early 2008 which helped cutting the external debt stock to 35% of the GDP forecasted for 2008 compared to 51% in 2007 and 71% in 2004 (Chart 2) . Its international reserves have decreased from an average of 7.6 months of imports in the past 3 years to a projected 5.3 months for 2008, but this is still at a comfortable level, especially considering the high level of commodity prices.

Long term prospects for investors in the kingdom look promising

Even though many recent economic decisions undertaken by the government have been met with resentment by the population, they bode well for the country's long term prospects. Jordan remains a favourite destination for the excess liquidity of the Gulf Arab States and should benefit from the improvement of the situation in Iraq. The historic friendly relationship with Iraq is warming up again after mutual suspicion that followed the Shia-led Iraqi administration coming to power. An agreement signed in 2006 provided that Iraq would meet 10-30% of Jordan's oil needs (provision for gas was also planned) at a discount price. The insecurity surrounding the transport of the precious commodity to Jordan made the agreement pragmatically unenforceable in the years after. It looks like the agreement will be revived soon which could substantially improve the country's trade balance.

This oil dependency could actually be completely reversed and change Jordan from a fossil energy importer to a substantial energy producer:

First, fossil energy could come domestically. Indeed massive shallow oil shale deposits have been discovered in the country decades ago and the amount suspected is massive: 40 billions tonnes. Our in-house oil specialist explains that the technology for oil shale deposit is ready and the current price of crude oil makes the drilling of this fossil more than profitable. According to the Jordan Natural Resources Authority, with the current reserves, the kingdom could hope to yield about 4bn tonnes of oil, equivalent to 30bn barrels or ¾ of Libya's reserves. Final feasibility studies are under way which should lead to opening of International Request for Proposals (RFP) exploration and development concessions for a production start in a range of a dozen years at least. All these projections do not even take into account the deeper layers of oil shale. This should draw attention from the industry concerned but also from a general investor point of view on the country's prospects.

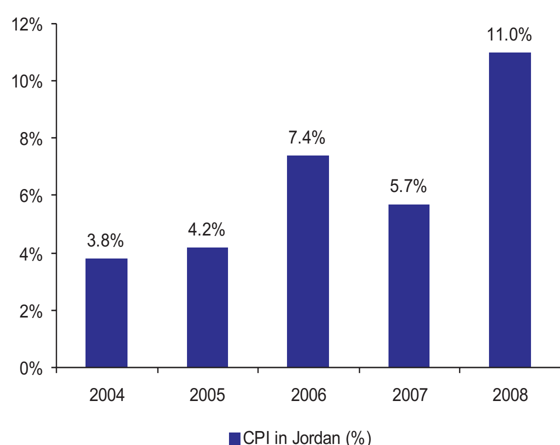
Second, Jordan has embarked in a very determined path toward production of nuclear energy. With a USD 10bn nuclear investment programme, the country has already signed various agreements with foreign operators. Jordan is very well placed to be a future nuclear energy producer: not only is it home to substantial uranium reserves (estimated at around 70,000 tonnes) but it is also labelled as the peacemaker, western ally, in excellent terms with the IAEA, and a stable country in a turbulent region: it could be viewed as the excellent candidate for peaceful civil nuclear energy development.

Finally investors could also join the already numerous FDI participants that have strongly contributed to the past years' country growth, which should be the case in the short to medium term as well. These foreign investments have principally been in real estate and construction. A good example is the redevelopment of downtown Amman

which will transform the city's skyline. There is also the Aqaba Special Economic Zone which encompasses various sub projects of massive scale. It is run by a government-owned entity called the Aqaba Development Corporation (ADC). Aqaba is an ancient city, the only maritime exit for Jordan, through the Red sea channel. ADC owns Jordan's ports, the city's international airport and strategic parcels of land as well as the development rights for these assets and infrastructures. One of ADC's project is Saraya Aqaba, a major mixed use development that combines shopping, dining, entertainment, accommodations and cultural activities. Ayla Oasis is another one, a Tourism project, the largest foreign direct tourism investment in the history of Jordan when announced. It is a USD 750mn/12-year tourism project including hotels, residential and recreational facilities that will completely revamp the whole southern shore of Jordan. This development is to be unfolded in successive phases.

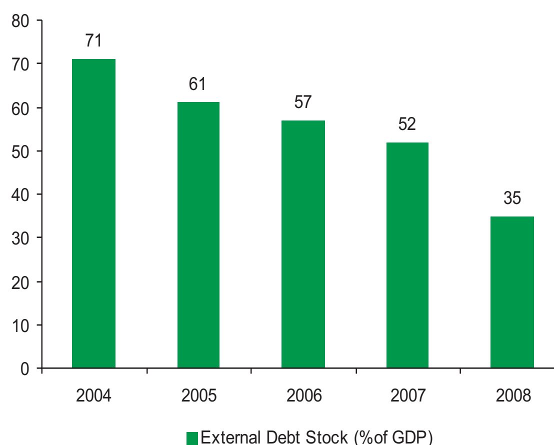
The USD750 million 12-year tourism project includes hotels, residential and recreational facilities including a signature championship golf course. The first of three phases commenced in 2005 (4 year duration); it involves building and developing the Marina Lagoon, one of the Leisure Lagoons, the water canal, waterfront outlets within the Marina Village, Arabian Venice and the Fort Hotel, plus some waterfront residences. The second phase will feature the construction of the golf course in addition to two hotels and a variety of residential and commercial units. The third phase will bring the development of the resort to completion, as all remaining hotels, residences, necessary infrastructure and other proposed developments are made ready for use. The Ayla project is expected to create 4,000 job opportunities over the 12 years of its development.

Chart 1: Jordan's CPI: a steep acceleration in 2008
CPI, %



Sources: IMF, SCB Global Research

Chart 2: External Debt Stock cut by half in 5 years
Debt Stock in proportion of GDP



Sources: IMF, SCB Global Research

Kenya

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- Three factors have driven the improvement in Kenyan trend growth
- Strong regional growth, domestic reform, and rising investor confidence
- Post-crisis, we examine how much has really changed

Forecasting post-crisis growth in Kenya

An atypical market response to political crisis in Africa

Kenya's post-election political crisis earlier this year surprised in two ways. First, the extent of fallout in a country traditionally noted for its relative stability. The second surprise was Kenya's susceptibility to the crisis, given a backdrop of accelerating growth and gains in poverty alleviation. Between 2000 and 2006, the incidence of poverty fell sharply from 57% to 46%, amidst a vast improvement in annual real GDP growth, from negative to 7% just prior to the crisis. Neither the country's longstanding reputation for stability, nor its economic success would have provided much indication of the fallout that was to ensue, post-election. Much of the analysis of the potential economic impact of the crisis focused on the disruption to tourism - an approach we believe to be flawed, given that hotels and restaurants account for barely 2% of GDP, despite important linkages with the rest of the economy. Nonetheless, in Q1, the Kenyan economy did contract by 1.3% y/y. Despite predictions of a long-drawn out slowdown, or even more severe economic contraction, both anecdotal evidence and more recent data point to some recovery in the months since the unity government was formed. Nowhere was this more dramatic than in the case of a high-profile telecoms sector IPO, which was more than five times oversubscribed, drawing interest from both domestic and foreign investors and boosting fiscal revenue. This took place only a few months after the worst of the post-election fallout. It was certainly an atypical market response to an African political crisis.

The relationship between growth and political stability - necessary, but not sufficient

What should be read into this? There are at least two key questions. Are investor expectations of longer term Kenyan growth overdone, or is there a realistic basis to this optimism about the future? How should a meaningful forecast of Kenyan growth be formulated post-crisis? Second - and equally important - if political volatility could be ignited even against the backdrop of a booming economy, what guarantee is there of political stability in the future? An adequate response to this question might demand an entire research piece in its own right. For now, suffice it to say that Kenya's experience appears to suggest that it is not only the level of growth, but the quality of that growth that matters for longer term political stability. In particular, perceptions of unequal opportunities, growing income disparity, and a limited number of beneficiaries from growth may in some instances contribute to political risk. This holds true in Kenya as it does in other emerging markets. While growth would appear to be a necessary pre-condition for political stability, on its own it may not be sufficient to guarantee political stability. It is still important however, and this piece will focus on how to assess the economy's near and medium term prospects. We do this by examining the factors that led to Kenya's improvement in trend growth in the first place, and ask, 'what has changed as a result of the crisis?' Alongside this, we also explore the other indicators already available to us, and use these to forecast growth more conventionally.

The economy declined -1.3% y/y in Q1-08. This was the good news

In many respects the absence of a deeper contraction in growth in Q1 represents good news. With the post-crisis dislocation felt most keenly in the immediate aftermath of the elections, Q1 growth is likely to have represented the greatest extent of economic weakness, the worst of the fallout. From here on it should only get better as the availability of data from April 08 now suggests. The unfavourable base should also be noted. Growth of 6% y/y was

recorded in Q1-07. Even assuming a calmer post-election scenario, sustaining that rate of growth given the high base might have been difficult.

Table 1 sets out the sectoral contribution to GDP in Kenya. Agriculture, the dominant sector, was affected most profoundly, given the rise in internally displaced people as a result of the post-election unrest, as well as the disruption to transport routes. Although Kenya did see a steep decline in visitor arrivals in Q1, data on the sectoral contribution to GDP suggests that this would have had a negligible impact on overall growth. (For example, the sharp contraction in the sector in 2003, following terrorism warnings and the cancellation of scheduled flights to Kenya, was insufficient to tip the entire economy into recession). Whilst the cancellation of some flights earlier this year did help to drive freight costs higher, posing a threat to horticulture exports by adding to the pressures associated with already-high oil prices; with horticulture exports up 23%y/y over the Jan-April 08 period, there is evidence that the sector is taking these pressures in its stride. For other commodities, price moves have provided an important mitigant to output declines. Between Jan and April for example, tea output in Kenya dropped 30% y/y, but prices rose by 33.6%. Encouragingly, there is now evidence of more normalisation in the agricultural sector.

Table 1: Sectoral contribution to Kenyan GDP, and recent growth rate by sector

	Share of Real GDP	2003	2004	2005	2006	2007
Agriculture	25.88	2.5	1.7	6.8	5.5	7.6
Manufacturing	9.93	6.0	4.5	4.7	6.9	8.3
W/sale & retail trade	9.44	1.2	9.5	10.5	11.5	7.0
Hotels & restaurants	1.44	-20.3	15.1	16.1	17.1	12.6
Financial Services	3.72	1.5	1.4	2.8	5.5	7.9
Building & Construction	3.03	1.0	4.4	7.6	6.3	10.3
Transport & Communication	10.89	3.5	7.0	8.9	10.8	8.5
Government	11.84	2.6	1.8	2.8	3.8	--
Others	11.37	4.3	2.6	3.6	4.6	--
Real GDP	**--**	**2.9**	**5.1**	**5.7**	**6.1**	**6.9**

Sources: Central Bank of Kenya (CBK), Kenya National Bureau of Statistics

The evidence from manufacturing is also interesting. Strong growth in Kenyan manufacturing in recent years (Table 1, again) may have reflected the growing importance of trade with the East African subregion. For these countries, Kenya has been an important source of manufactured goods. Data available for the first four months of this year does indicate some growth (cement production was up 8.3%, soda ash output up 23%, cigarettes up 9.8%), perhaps reflecting the ongoing impetus to growth from firm regional demand, although there are also notable pockets of weakness. However, electricity generation fell 5%. Of this, thermal generation of electricity fell most sharply between Jan-April, down 20% y/y. Nonetheless, electricity consumption, one of our preferred proxies for growth in Africa (it's available more quickly than official GDP statistics, and the data is generally trusted), rose 5% over the Jan-April period. The implications are worth thinking about. Outside of the political crisis, more expensive oil imports may also have been a factor in economic performance. Not all the threats to Kenyan growth are necessarily homegrown, and while the oil intensity of the economy does appear to be shifting (despite a doubling of oil prices, oil accounted for 24% of total imports more recently compared with 21% a year earlier), economic performance will also be influenced by international developments. From this perspective, the recent decline in the price of imported oil is positive.

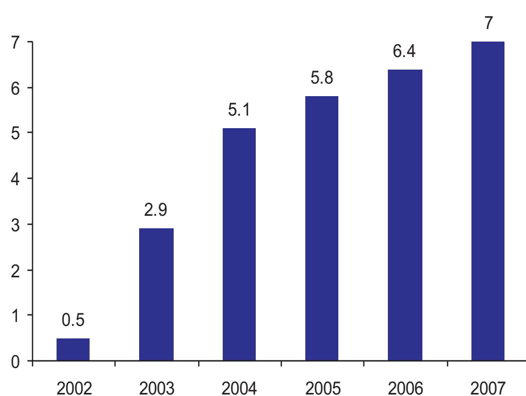
Turning to the demand side of the economy and available consumption indicators, new vehicle registrations contracted 7.7% between Jan and April. Confidence had obviously taken a hit. People may have been delaying big purchases. Even so, excise revenue on mobile phone airtime received by the Kenya Revenue Authority rose 16.6%. (Some caution must be exercised in reading too much into this data. It may well be that the nature of the political crisis, and the tragic consequences of the crisis leading to rising numbers of displaced people, created temporary demand for greater communication. Only time will tell whether the rise in tax revenue from mobile phone

airtime will be sustained). For now, however, there is at least some evidence that the economy is recovering from the worst of the post-crisis dislocation.

Looking to the drivers of growth - how much did the crisis change?

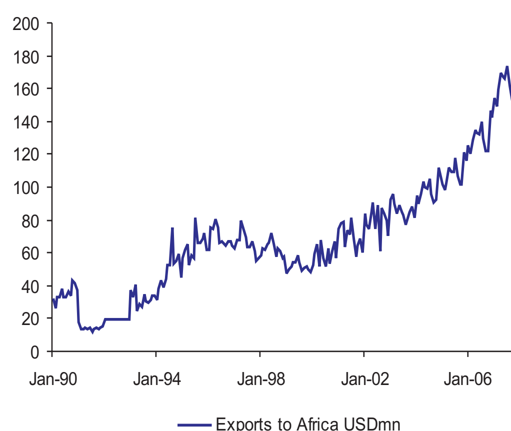
But what about the more long term drivers of Kenyan growth - the reasons behind the improvement in trend GDP? (See Chart 1, above). Do these remain in place? How much has the crisis changed? Broadly, we identify three factors that have driven the structural shift in Kenyan growth, and examine each one in turn below. Higher regional growth, domestic reform and rising investor confidence.

Chart 1: Recent years had seen a sustained uptrend
Kenya real GDP growth %



Source: CBK

Chart 2: Regional growth was and should remain a strong growth driver
Exports to Africa USD mn



Source: IMF Direction of Trade Statistics

Regional growth

Chart 2 shows the gains made in terms of Kenya's exports to Africa. Although Kenya's trade with other countries has been rising, it is trade with other African countries that has been rising fastest. From a negligible share of total exports only a few years ago, trade with Africa now accounts for between 44-47% of Kenya's total trade in goods. While the formation of the East African Customs Union and gradual liberalisation of trade with neighbouring countries has been one driver of this improved performance, the post-conflict resurgence in the resource-rich economies of southern Sudan and the eastern regions of the DRC have established even greater demand for Kenyan manufactured goods. As the most industrialised economy in the East African region, Kenya benefits greatly. Interestingly, even Chinese forays into these resource-rich regions have yielded benefits to Kenya, with the establishment of infrastructure allowing for the transport of commodities to the coast expected to yield further trade gains for Kenyan companies. With post-conflict growth in the wider region more structural than cyclical, and strong growth rates forecast even in Kenya's more traditional trading partners such as Uganda and Tanzania, the outlook is favourable. Growth should continue to benefit.

Domestic reform

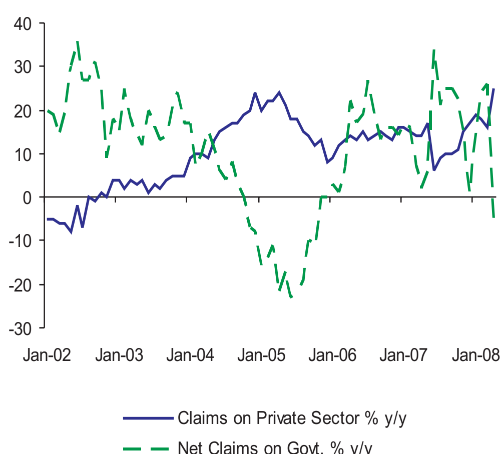
Despite the relative absence of large amounts of donor financing even after the 2002 elections, micro-level efficiency reforms at the Kenya Revenue Authority yielded real results. The improved tax take allowed for a decline in government borrowing, freeing up resources for lending to the private sector (see Chart 3). Together with the lengthening of the maturity of Kenyan domestic debt, T-bill yields were driven dramatically lower (Chart 7) and Kenya's private sector benefited from the resulting credit boom. Even when borrowing by the government picked up again, credit growth remained strong, helping to support economic growth. (A reduction in the cash reserve ratio from 10% to 6% early on in Kenya's reform program also helped things along nicely).

Simultaneously, a subtle rebalancing of government spending was underway, with an increasing proportion of fiscal expenditure devoted to development spending (especially spending on infrastructure), rather than just recurrent spending.

From past experience therefore, the sustainability of low interest rates, and evidence of continued private sector loan growth are important to the growth outlook. Initial signs, based on the FY 08/09 Budget, are that the realignment of government spending in favour of greater levels of development spending should continue. KES 65bn has been allocated to finance new construction, rehabilitation and routine maintenance of road infrastructure. Free primary as well as secondary education have been promised. With the support of the Government of Japan, over KES 20bn will be spent over the medium term, modernising the port of Mombasa, allowing bigger ships to dock. Other improvements to the rail system are planned. A further KES 6.8bn has been pledged for rural electrification. In all, in FY 08/09, roughly 25.8% of total expenditure will be on development. Recurrent expenditure, although dominant, will nonetheless get a smaller share of the spending pie, accounting for 74.2% of total spending - a major improvement from historic trends in Kenya.

Chart 3: In the past, credit growth fuelled the economy

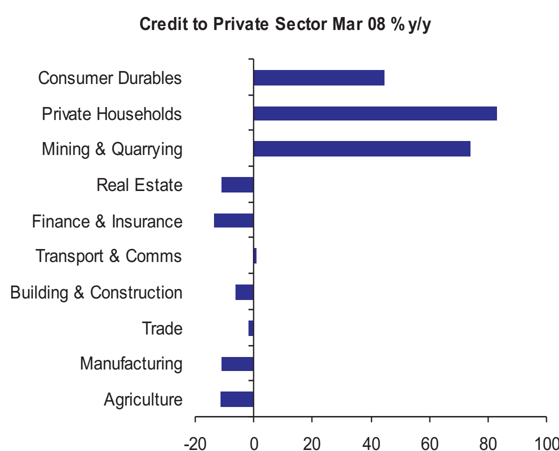
The governmant cut back borrowing, freeing up resources for the private sector



Sources: SCB Global Research, IFS

Chart 4: Credit provides a useful lead indicator

Negative trends in many sectors are a concern



Source: CBK

While this is all growth-supportive, the question of financing remains important. As set out in Table 2, this year Kenya will see a mix of financing options, including aid, privatisation, reliance on both long term domestic borrowing and external financing. Significantly, Kenya is set to issue its first Eurobond, to finance its infrastructure spending plans. While a net domestic borrowing requirement of KES 36bn is not exceptionally large by the standards of recent years (and allowing for some nominal growth over the course of time), there is evidence that the post-crisis spike in Kenyan inflation, which peaked at 31%, has fed a reluctance on the part of both domestic and offshore investors to invest in longer dated government paper. The recent undersubscription of Kenya's inaugural 20 year bond issue was a key example, with fears of potential capital losses deterring investors. Now, with increasing evidence that inflation may have peaked (measures to deal with food inflation introduced in the June Budget are also having an impact), things may change. In any case, with the government still flush with funds from the recent Safaricom IPO, there is little evidence of stress on short term borrowing at the moment. The problem is that a deficit of -5.3% of GDP is still quite sizeable. Compared with recent years, it is probable - although not guaranteed - that interest rates will remain at a stable-to-low level. But the risks also need to be recognised - there is more uncertainty now than there was in the past. Post-crisis, the stakes are higher.

Investor confidence

The third element in Kenya's economic recovery was the rising level of investor confidence that accompanied the NARC election victory in 2002. Change was promised, and the private sector was caught up in the euphoria. Although the government of national unity has returned the same parties to power, post-crisis, conditions are of course markedly different. It is important to try to measure just how meaningful the impact on private sector confidence has been, and what the effect on growth is likely to be.

The latest credit growth figures (Chart 4) are a source of concern. While it is plausible that a tightening of lending standards post-crisis has driven credit growth weaker, poor demand by borrowers may also have had a role to play. Credit trends usually provide an important lead indicator of Kenyan growth, but y/y data for March 08 demonstrates that loan growth to agriculture, manufacturing and many other important sectors of the economy was negative. Only lending to households outperformed, and this was largely believed to have been on the basis of the 'Safaricom' effect, with investors borrowing to participate in the IPO. Otherwise, there is scant evidence of the sort of investment that might drive future growth. Investor confidence may be pivotal to a turnaround in this trend.

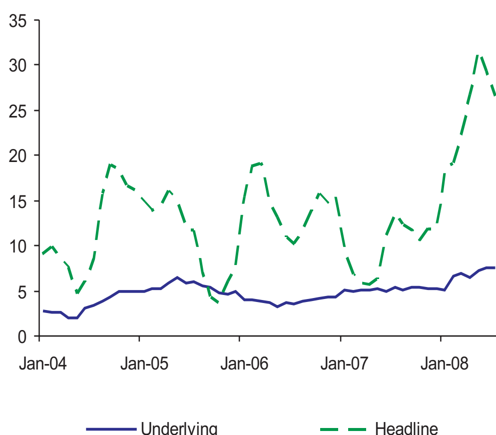
Table 2: Budget 08/09 poses little immediate threat to the level of interest rates, but inflation could be the spoiler

	In KES bn	% of GDP
Fiscal deficit excluding grants	-127	-5.3%
Of which, Net external financing	-25.2	-1.1%
Domestic financing	-101.8	-4.2%
Breakdown:		
Privatisation	8	0.3%
Infrastructure spending financed by sovereign Eurobond	33.6	1.4%
Infrastructure spending financed through domestic long term bonds	18.5	0.8%
Net domestic borrowing	36	1.5%

Sources: Budget Speech FY 08/09, Kenya Treasury, SCB Global Research

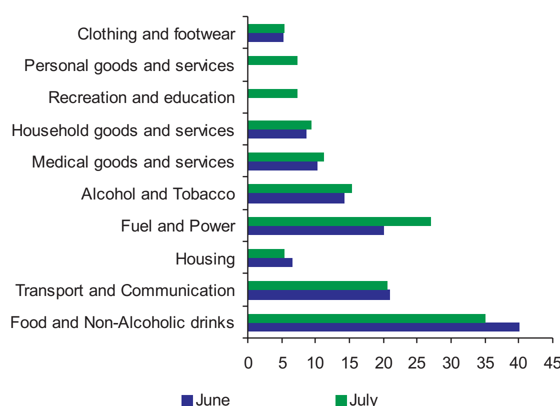
The rising level of inflation (Chart 5) is an additional source of concern, as it cuts into disposable incomes and poses downside risks to consumption growth. Although there is evidence of inflation having peaked (Chart 6), partly due to measures introduced in the recent Budget, it may be a while before inflation is restored to levels where it ceases to be a significant macro threat. The difficulty likely to be faced by the authorities is that monetary policy options are constrained by the need to ensure cheap financing of the fiscal deficit. There are no easy near term fixes.

Chart 5: Oil and food provide considerable headwinds to growth
CPI % y/y



Source: CBK

Chart 6: Some improvement in CPI underway
Breakdown of inflation by category, % y/y

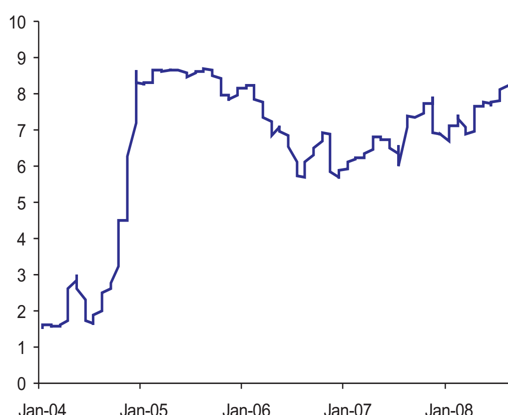


Source: CBK

Given the liquidity of Kenyan FX markets, another means of gauging investor confidence in Kenya is to look at the performance of the currency. For the most part, it has held up well, despite the disappointment over the actual level of inflows related to the Safaricom IPO. (While the IPO was massively oversubscribed, much of the FX generated is thought to have remained outside Kenya. Participating banks are thought to have borrowed KES, then filled obligations at higher levels of USD-KES, benefiting from the subsequent depreciation in the currency.) However,

data on the FX balances held by residents and banks in Kenya reveals a potential threat to the current level of USD-KES - evidence perhaps that a rebound in confidence has been more elusive than initially thought.

Chart 7: Interest rates seen stable for now
91 day Tbill yield %



Source: SCB Financial Markets Kenya

Chart 8: KES may weaken at a faster rate
USD-KES

Source: Reuters

Although the level of Foreign Currency Accounts (or FCAs) dropped in the immediate aftermath of the crisis (this may also have reflected some moves of foreign currency balances offshore), the amounts involved, both for private residents and financial institutions have built up steadily since then. While this may reflect expectations of further KES weakness post-Safaricom, there is still a possibility that it reflects - at least in the short term - some element of uncertainty over Kenyan economic prospects (see Table 3).

In conclusion then, the overall picture is mixed. Forecasting growth meaningfully, post-crisis, was never going to be a simple task. Anecdotally, the situation on the ground is normalising. Output figures are starting to recover. We know that regional growth, a strong support to the Kenyan economy pre-crisis, should continue to provide a decent impetus to growth even post-crisis. On the sustainability of stable interest rates, there is greater uncertainty, but no pressing grounds for concern. It is only on the final driver of growth, investor confidence, that the concerns are particularly nagging. A lot more is likely to be needed to restore confidence to pre-crisis levels, but a concerted effort by the authorities, as well an ongoing emphasis on the things that made a difference to past growth - reform, infrastructure spending and the settling of fears over further political volatility - may just do the trick. The Kenyan economy has demonstrated remarkable resilience to shocks over the years - both domestic and external. While growth may dip to half the levels seen last year (our official forecast is 3.2% against the government's 4-5% projection), we remain believers in Kenya's longer term potential.

Table 3: Foreign currency accounts - an important indicator of confidence

	Residents' Foreign Currency Deposits USD mn	FX Holdings of Commercial Banks USD mn
Dec 06	1428	916
Apr 07	1467	1033
Dec 07	1764	1202
Jan 08	1684	1055
Feb 08	1706	1092
Mar 08	1813	1321
Apr 08	1923	1587

Source: CBK

Thailand

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- The economy is increasingly dependent on external demand
- Global slowdown will pose a challenge to growth
- Slowing private spending calls for more fiscal stimulus

In search of a growth engine

Thailand's exports continue to surprise on the upside, reporting a buoyant expansion of 23.9% y/y in H1-08. That was thanks to a well-diversified export structure and high rice prices. We estimate that the Thai economy should have grown by 5.9% in H1-08. That said, this economy is reliant upon external demand. Domestic demand was being hit by the higher cost of living and weak local sentiment induced by domestic political uncertainty. The increasing reliance on external demand will make it tougher for Thailand to maintain growth if global demand eases at a faster face in H2-08 and in 2009 as we have expected.

Weak domestic demand

The contribution to growth from domestic demand, both private consumption and investment, has continuously decreased since 2004. As shown in Chart 1, the contribution to GDP growth from private consumption has dropped from 3.4 percentage points (ppts) in 2004 to 2.5ppts, 1.7ppts, and 0.8ppts in 2005, 2006, and 2007, respectively. The same pattern can be seen in private investment as well. In 2007, private investment contributed only 0.3ppts to real GDP growth, down from 2.7ppts in 2004. Sustained high oil prices combined with prolonged political instability have weighed on domestic demand.

It will be hard for Thailand to maintain its current growth momentum as global growth slows. Even though export growth in H1-08 was at a healthy 23.9%, it was partly attributed to a strong surge in rice and rubber prices in H1-08. However, we have already seen a correction in these prices given higher output from the second harvest. While manufacturing exports continued to expand well, it is worth noting that some categories, including integrated circuit (IC) and auto, have shown clear signs of deceleration. Among manufacturing exports, IC contributes the largest share of export income to the country (10.3% of total exports), while auto (8.4% of total exports) is one of the top three exports. As shown in Chart 2, exports of auto and parts have cooled down continuously in H1-08, while exports of IC are already in contraction on a year-on-year basis.

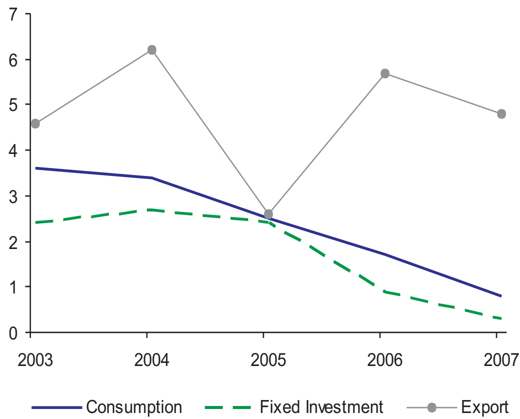
Political instability could hold back tourism growth

In 2008, Thailand aimed to attract 16mn foreign visitors to generate THB 800bn in income. If achieved, this will represent a 6% increase in tourist arrivals from 2007, when 14.5mn foreigners visited the country. Tourism contributes as much as 13% of GDP if related business such as hospitality and restaurants are included. Thus far, Thailand has attracted about 7.9mn foreign visitors during H1-08. Looking into H2-08, however, concerns over political instability and the higher costs of travel could constrain tourism growth. We note that visitors from East Asia are particularly sensitive to political events and they account for 60% of total visitor arrivals. In 2005, one year after the devastating Tsunami, the number of visitors from East Asia into Thailand dropped by 5.1% from 2004, while total tourism income decreasede by 4.4%. So a second military coup, while a low probability threat in our view, will be a stumbling block to the country's 2008 growth target.

Betting on fiscal stimuli

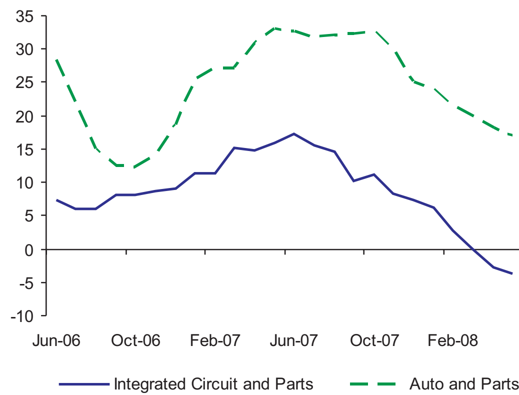
On the local front, political tension will continue to keep sentiment on the back foot. Despite the recent cabinet reshuffle and former PM Thaksin's self-imposed exile, the government coalition is still under the shadow of various litigation cases. The High Court's imminent ruling on the issue of party dissolution is a major threat to the coalition parties, and could put the stability of the coalition at risk. Moreover, concerns about rising inflation and political risk have caused the consumer and business sentiment indices to weaken in recent months. There is little reason to expect any revival in private consumption and investment in H2-08. Hence, the Thai economy will have to rely on fiscal stimulus in the second half of this year. The government, despite the various political troubles, is likely to push ahead with further fiscal stimulating measures to boost growth, such as a possible tax cut for corporates. This may improve sentiment at the margin, but will not convince investors to jump back into Thailand.

Chart 1: Domestic contribution to GDP falls



Source: NESDB

Chart 2: Slower auto and IC export growth



Source: Bank of Thailand

Forecasts

Commodity (in USD, EUR, JPY and CNY)

		USD			EUR			JPY (thousand)			CNY		
	Latest 12-Aug	2007 a	2008 f	2009 f	2007 a	2008 f	2009 f	2007 a	2008 f	2009 f	2007 a	2008 f	2009 f
Crude oil (near future)													
NYMEX WTI (/barrel)	113.6	72	118	120	52	76	83	8.48	12.51	13.18	548	809	795
% y/y		*+9%*	*+63%*	*2%*	*-0%*	*+45%*	*9%*	*+10%*	*+48%*	*5%*	*+4%*	*+48%*	*-2%*
ICE Brent (/barrel)	111.7	73	117	119	53	75	82	8.53	12.39	13.07	551	801	788
% y/y		*+10%*	*+61%*	*2%*	*+0%*	*+43%*	*9%*	*+11%*	*+45%*	*5%*	*+5%*	*+45%*	*-2%*
Dubai spot (/ barrel)	110.3	68	111	114	50	72	78	8.02	11.82	12.47	519	764	752
% y/y		*+11%*	*+62%*	*3%*	*+2%*	*+44%*	*9%*	*+12%*	*+47%*	*5%*	*+6%*	*+47%*	*-2%*
Industrial metals (3m LME)													
Aluminium (/tonne)	2,833	2,664	2,867	2,503	1,949	1,848	1,731	314	304	275	20,285	19,724	16,581
% y/y		*+3%*	*+8%*	*-13%*	*-6%*	*-5%*	*-6%*	*+4%*	*-3%*	*-10%*	*-2%*	*-3%*	*-16%*
Copper (/tonne)	7,330	7,104	7,913	6,500	5,180	5,101	4,490	837	839	714	53,997	54,440	43,070
% y/y		*+6%*	*+11%*	*-18%*	*-2%*	*-2%*	*-12%*	*+7%*	*+0%*	*-15%*	*+1%*	*+1%*	*-21%*
Lead (/tonne)	1,925	2,560	2,305	1,800	1,854	1,488	1,243	300	244	198	19,382	15,915	11,929
% y/y		*+100%*	*-10%*	*-22%*	*+82%*	*-20%*	*-16%*	*+101%*	*-19%*	*-19%*	*+90%*	*-18%*	*-25%*
Nickel (/tonne)	18,000	36,124	24,208	22,250	26,527	15,626	15,386	4,274	2,563	2,444	275,639	167,110	147,441
% y/y		*+56%*	*-33%*	*-8%*	*+45%*	*-41%*	*-2%*	*+58%*	*-40%*	*-5%*	*+49%*	*-39%*	*-12%*
Tin (/tonne)	18,750	14,509	21,216	14,625	10,557	13,666	10,104	1,705	2,250	1,606	110,150	145,630	96,913
% y/y		*+66%*	*+46%*	*-31%*	*+52%*	*+29%*	*-26%*	*+68%*	*+32%*	*-29%*	*+59%*	*+32%*	*-33%*
Zinc (/tonne)	1,690	3,249	2,101	1,763	2,384	1,356	1,218	384	223	194	24,775	14,489	11,680
% y/y		*-0%*	*-35%*	*-16%*	*-7%*	*-43%*	*-10%*	*+2%*	*-42%*	*-13%*	*-4%*	*-42%*	*-19%*
Precious metals (spot)													
Gold (/oz)	815	697	930	994	508	600	688	82	99	109	5,294	6,395	6,583
% y/y		*+15%*	*+33%*	*7%*	*+6%*	*+18%*	*15%*	*+17%*	*+20%*	*11%*	*+10%*	*+21%*	*3%*
Palladium (/oz)	312	356	415	344	260	268	237	41.9	44.0	37.8	2,705	2,861	2,278
% y/y		*+11%*	*+17%*	*-17%*	*+2%*	*+3%*	*-11%*	*+12%*	*+5%*	*-14%*	*+6%*	*+6%*	*-20%*
Platinum (/oz)	1488	1,306	1,887	1,675	951	1,217	1,158	154	200	184	9,921	12,989	11,098
% y/y		*+14%*	*+44%*	*-11%*	*+5%*	*+28%*	*-5%*	*+16%*	*+30%*	*-8%*	*+9%*	*+31%*	*-15%*
Silver (/oz)	14.69	13.39	17.30	18.00	9.77	11.16	12.46	1.58	1.84	1.98	102	119	119
% y/y		*+16%*	*+29%*	*4%*	*+6%*	*+14%*	*12%*	*+17%*	*+16%*	*8%*	*+10%*	*+17%*	*0%*
Softs and fibres (near future; NYBOT, LIFFE)													
Cocoa (/tonne)	2,704	1,882	2,719	2,800	1,372	1,752	1,939	222	288	308	14,305	18,672	18,551
% y/y		*+25%*	*+44%*	*3%*	*+15%*	*+28%*	*11%*	*+27%*	*+30%*	*7%*	*+19%*	*+31%*	*-1%*
Coffee - robusta (/tonne)	2,319	1,784	2,314	2,425	1,298	1,492	1,679	210	246	266	13,543	15,909	16,065
% y/y		*+33%*	*+30%*	*5%*	*+23%*	*+15%*	*12%*	*+36%*	*+17%*	*9%*	*+28%*	*+17%*	*1%*
Coffee - arabica (c*/lb)	136	117	141	160	86	91	111	13.8	15.0	17.6	892	972	1060
% y/y		*+9%*	*+20%*	*13%*	*+0%*	*+6%*	*22%*	*+10%*	*+9%*	*17%*	*+4%*	*+9%*	*9%*
Cotton (Cotlook A, c/lb)	77.4	63	80	86	46.1	51.6	59.4	7.44	8.50	9.42	481	550	568
% y/y		*+9%*	*+26%*	*7%*	*-0%*	*+12%*	*15%*	*+10%*	*+14%*	*11%*	*+4%*	*+14%*	*3%*
Sugar (c/lb)	13.56	9.92	12.80	16.20	7.25	8.26	11.20	1.17	1.36	1.78	75.5	87.9	107.2
% y/y		*-32%*	*+29%*	*27%*	*-38%*	*+14%*	*36%*	*-31%*	*+16%*	*31%*	*-35%*	*+16%*	*22%*
Grains, oilseeds and edible oils (near future; CBOT,MDV)													
Corn (c/bushel)	497	374	605	693	273	390	480	44.0	64.2	76.1	2,843	4,152	4,588
% y/y		*+43%*	*+62%*	*15%*	*+33%*	*+43%*	*23%*	*+46%*	*+46%*	*19%*	*+38%*	*+46%*	*10%*
Rice (c/cwt)	16.25	10.92	17.01	16.30	8.0	11.0	11.3	1.28	1.80	1.79	83	117	108
% y/y		*+21%*	*+56%*	*-4%*	*+11%*	*+38%*	*3%*	*+23%*	*+40%*	*-1%*	*+16%*	*+41%*	*-8%*
Soyabeans (c/bushel)	1215	863	1,408	1556	627	908	1076	101	149	171	6,543	9,671	10,309
% y/y		*+46%*	*+63%*	*11%*	*+33%*	*+45%*	*19%*	*+47%*	*+48%*	*14%*	*+39%*	*+48%*	*7%*
Wheat (c/bushel)	794	637	895	884	461	578	612	74	95	97	4,818	6,168	5,855
% y/y		*+58%*	*+41%*	*-1%*	*+44%*	*+25%*	*6%*	*+59%*	*+27%*	*2%*	*+51%*	*+28%*	*-5%*
Palm oil (/tonne)	797	704	1,080	1,265	511	696	876	83	115	139	5,340	7,427	8,378
% y/y		*+70%*	*+53%*	*17%*	*+55%*	*+36%*	*26%*	*+71%*	*+39%*	*21%*	*+62%*	*+39%*	*13%*
Soyoil (c/lb)	50	37	63	74	27	40	51	4.35	6.66	8.11	281	431	489
% y/y		*+48%*	*+70%*	*+17%*	*+36%*	*+50%*	*26%*	*+50%*	*+53%*	*22%*	*+41%*	*+53%*	*13%*
FX rate/USD end period	..	..	..	..	1.47	1.56	1.45	111	107	108	7.30	6.60	6.50
FX rate/USD average	..	..	..	..	1.37	1.55	1.43	118	108	110	7.61	6.65	6.55

** c=currency unit/100*

Source: Bloomberg, SCB Global Research

Forecasts

Economy

Forecasts in BLUE (RED) indicate upward (downward) revision

Country	Real GDP growth (%)				Inflation (yearly average %)				Current account (% to GDP)			
	2007	2008	2009	2010	2007	2008	2009	2010	2007	2008	2009	2010
Majors												
US^	2.2	**1.5**	**0.8**	**2.7**	2.2	**2.1**	1.8	**1.6**	-5.4	-4.8	-4.4	-4.0
Eurozone	2.6	**1.6**	**1.2**	2.2	2.1	**3.7**	**2.7**	**2.0**	0.2	0.0	0.1	0.0
Japan	2.1	1.2	1.5	2.2	0.1	**1.6**	**1.6**	**1.4**	4.8	4.7	3.2	3.5
UK	3.0	**0.8**	**-1.6**	2.2	2.3	**3.8**	**2.6**	**1.8**	-4.2	**-3.5**	-2.8	-3.0
Canada	2.7	0.8	1.5	3.2	2.1	**2.8**	**2.4**	1.5	0.9	0.0	-1.5	-1.0
Australia	4.3	**1.7**	**2.7**	3.4	2.4	**4.6**	**4.6**	**3.8**	-6.2	**-5.6**	**-3.6**	**-3.2**
New Zealand	**3.1**	**1.5**	**2.7**	**2.3**	**2.4**	**3.7**	**3.8**	**3.1**	**-8.0**	-7.5	-7.7	-8.2
Asia												
Bangladesh*	6.5	6.0	6.0	6.5	7.2	9.5	6.0	4.5	1.4	-0.6	-1.0	-1.0
China	11.9	**9.9**	**8.6**	8.0	4.7	6.5	**5.0**	3.0	11.3	**9.1**	**7.1**	6.0
Hong Kong^^	**6.4**	4.6	5.0	5.9	2.0	**5.8**	4.4	4.0	13.2	10.8	11.4	12.5
India*	9.0	7.4	8.5	9.0	4.6	**10.9**	**3.6**	4.5	-1.3	-1.9	-2.6	-1.9
Indonesia	6.3	6.0	6.2	6.5	6.4	**9.9**	**8.4**	**8.1**	2.5	1.7	0.9	0.8
Malaysia	6.3	4.8	4.0	5.0	2.0	**5.0**	**4.3**	3.0	15.4	14.0	13.5	13.5
Pakistan*	7.0	5.8	**5.5**	6.0	7.8	**19.2**	**9.7**	**9.0**	-4.9	-7.9	-6.8	-5.7
Philippines	**7.2**	**3.5**	**4.1**	**5.3**	**2.8**	**9.3**	**3.2**	**4.5**	**4.4**	**1.0**	**0.8**	**1.5**
Singapore	7.7	**3.5**	**4.0**	5.5	2.1	6.2	4.0	3.0	24.3	21.0	22.0	22.0
South Korea	5.0	4.5	5.0	6.3	2.5	**4.7**	**3.2**	3.4	0.6	**-1.0**	**0.1**	0.6
Sri Lanka	6.7	6.3	6.0	6.1	14.0	21.0	9.5	6.0	-4.5	-3.5	-3.0	-3.0
Taiwan	5.7	3.5	4.8	6.0	1.8	2.9	2.5	1.8	8.6	3.9	4.4	5.0
Thailand	4.8	4.7	**4.5**	5.3	2.2	**6.4**	3.8	4.0	6.1	-0.4	-1.0	-1.2
Vietnam	8.5	6.7	6.0	7.5	8.3	**25.5**	**15.0**	5.5	-2.0	-15.0	-7.0	-5.0
Africa												
Botswana	5.8	4.9	6.3	7.0	7.1	**14.0**	**9.7**	7.5	20.6	12.0	15.0	14.0
Cameroon	4.5	4.2	4.7	4.5	2.0	5.0	4.5	4.2	-1.9	-3.1	-2.9	-4.0
Côte d'Ivoire	1.5	3.8	4.7	5.3	2.6	4.7	3.8	3.6	2.6	1.3	1.8	1.4
The Gambia	7.0	5.2	6.0	5.7	6.0	**4.0**	8.1	7.8	-21.8	-18.6	-12.0	-9.8
Ghana	6.3	6.9	6.5	7.2	10.7	18.2	**16.0**	9.8	-12.8	**-11.0**	**-8.9**	-7.6
Kenya	7.0	3.2	5.5	7.1	9.6	**22.0**	**9.0**	7.5	-3.5	-5.4	-5.8	-4.0
Nigeria	6.5	9.5	10.0	11.2	5.4	12.5	9.4	9.6	12.0	9.0	7.5	9.1
Sierra Leone	7.5	7.0	6.8	6.5	12.5	14.0	12.2	11.0	-6.7	-10.0	-9.4	-6.0
South Africa **	5.1	3.6	4.6	5.2	6.5	**11.6**	**9.0**	**5.8**	-7.3	**-8.6**	**-8.4**	-7.5
Tanzania	7.3	7.7	8.0	8.5	7.0	12.0	7.0	6.9	-10.6	-10.8	-9.0	-7.0
Uganda	6.5	9.0	7.3	6.5	6.0	**13.2**	**7.2**	5.4	-2.4	-7.7	-9.3	-8.1
Zambia	6.0	6.5	6.2	6.3	10.1	**13.0**	**11.4**	10.5	-0.5	**-1.2**	**0.4**	-4.3
Middle East and North Africa												
Algeria	4.6	**5.0**	**4.7**	4.5	**3.5**	**4.8**	3.8	3.0	23.5	**25.0**	18.0	20.0
Bahrain	6.8	6.2	4.7	5.0	3.4	5.2	3.5	3.0	24.0	25.0	18.0	16.0
Egypt*	7.1	6.2	6.0	5.8	8.8	**16.0**	**10.0**	**8.0**	1.5	0.7	0.5	0.4
Iran*	4.5	3.8	3.8	4.0	18.2	20.0	16.5	15.0	9.2	8.5	8.0	7.6
Jordan	5.8	5.3	4.8	5.0	5.8	**10.8**	**7.5**	6.0	-17.4	**-26.0**	**-20.0**	**-15.0**
Kuwait	5.3	5.5	3.7	4.0	5.0	**7.2**	5.0	4.5	47.4	45.0	43.0	41.0
Lebanon	4.0	2.5	3.0	3.5	4.1	**8.5**	**5.4**	3.5	-11.0	-10.0	-11.5	-9.5
Libya	6.8	8.0	7.8	8.2	6.8	**11.5**	**7.8**	6.8	35.0	39.0	38.0	36.0
Morocco	**2.7**	5.0	5.4	5.8	**2.1**	**2.9**	2.8	2.5	0.2	0.5	0.5	0.5
Oman	6.4	6.3	4.0	4.5	5.5	**9.8**	6.0	5.0	10.0	11.0	7.0	6.5
Qatar	11.0	9.0	6.5	7.5	13.8	14.0	9.0	7.5	33.0	39.0	32.0	33.0
Saudi Arabia	3.9	3.4	2.9	3.5	4.2	9.7	7.0	5.0	28.0	30.0	25.0	24.5
Tunisia	6.3	**5.6**	5.7	5.7	3.1	**4.8**	3.0	3.0	-2.1	-1.7	-1.7	-1.7
Turkey	4.5	3.8	6.0	6.5	8.8	9.9	7.8	6.8	**-5.7**	**-6.4**	-5.6	-5.7
UAE	7.4	6.5	6.0	6.4	**11.1**	12.0	8.0	7.0	22.0	24.0	17.0	16.0
Latin America												
Brazil	**5.4**	**4.9**	**3.4**	3.4	3.6	**5.9**	**5.3**	3.8	0.1	**-1.0**	**-1.2**	-1.0
Chile	5.1	4.1	4.3	3.8	4.4	8.5	5.1	4.4	4.4	2.0	2.6	2.8
Mexico	**3.2**	**2.7**	3.1	3.5	4.0	**4.9**	**4.2**	3.7	**-0.5**	-1.6	-1.2	1.6

* fiscal year data: fiscal years starts in Apr in India, Mar in Iran, and ends in Jun in Bangladesh, Pakistan and Egypt
** inflation: CPIX used for South Africa ^For US inflation, Core PCE deflator is used ^^For HK inflation, underlying CPI is used

Forecasts

Market

Forecasts in BLUE (RED) indicate upward (downward) revision

Country	Exchange rate vs USD					Short term interest rates				
	Present	Q3-08	Q4-08	Q1-09	Q2-09	Present	Q3-08	Q4-08	Q1-09	Q2-09
Majors										
US	N.A.	N.A.	N.A.	N.A.	N.A.	2.00 (FFTR)	2.00	2.00	1.50	1.00
Eurozone	1.58	1.54	1.56	1.48	1.40	4.25 (Refi rate)	4.25	4.25	4.00	3.50
Japan	106	109	107	109	112	0.50 (O/N call rate)	0.50	0.50	0.50	0.75
UK	1.99	1.94	1.96	1.88	1.80	5.00 (Base rate)	5.00	4.50	4.00	3.50
Canada	1.02	1.04	1.06	1.08	1.11	3.00 (O/N lending rate)	3.00	2.50	2.00	2.00
Australia	0.96	0.94	0.92	0.87	0.83	7.25 (OCR)	7.00	6.50	6.25	6.00
New Zealand	0.76	0.73	0.71	0.68	0.65	8.00 (OCR)	7.75	7.25	7.25	7.00
Asia										
Bangladesh	68.52	71.00	71.20	71.25	71.30	6.50 (RRP)	6.50	6.50	6.50	6.50
China	6.85	6.70	6.60	6.65	6.70	7.47 (1-yr base lending)	7.47	7.47	7.47	7.47
Hong Kong	7.80	7.83	7.81	7.82	7.79	2.25 (3M HIBOR)	1.95	1.75	1.05	1.00
India	43.06	42.80	43.00	43.80	44.50	9.00 (RP)	9.00	9.50	9.50	9.50
Indonesia	9,226	9,050	9,000	9,100	9,000	9.00 (BI rate)	9.25	9.50	9.00	8.50
Malaysia	3.27	3.26	3.30	3.35	3.40	3.50 (OPR)	3.50	3.50	3.50	3.50
Pakistan	68.40	75.00	74.50	73.20	72.82	14.07 (6M KIBOR)	14.00	14.80	14.80	14.80
Philippines	44.81	44.75	45.00	45.50	46.00	5.75 (RRP)	6.00	6.25	6.25	6.25
Singapore	1.36	1.37	1.38	1.40	1.43	1.00 (3M SGD SIBOR)	1.10	1.10	0.95	0.95
South Korea	1047	1030	990	1,020	1,010	5.25 (Target rate)	5.25	5.25	4.75	4.75
Sri Lanka	107.70	108.0	109.00	110.00	116.00	12.00 (RRP)	12.00	12.00	12.00	12.00
Taiwan	30.36	30.70	31.20	31.50	32.00	3.625 (Discount rate)	3.75	3.75	3.75	3.75
Thailand	32.47	34.00	34.50	35.00	35.50	3.50 (1-day repo)	3.75	3.75	3.75	3.75
Vietnam	16,842	17,000	17,500	17,300	17,100	14.00 (Base Rate)	14.00	18.00	16.00	14.00
Africa										
Botswana	6.54	6.41	6.55	6.58	6.47	12.49(91-day T-bill)	12.75	13.29	13.05	12.09
Cameroon	416	426	420	443	469	5.50 (TIAO)	5.50	5.50	6.00	6.00
Côte d'Ivoire	416	426	420	443	469	4.75 (Discount rate)	4.75	4.75	5.00	5.25
The Gambia	20.98	21.50	22.00	22.60	23.00	8.69 (91-day T-bill)	8.40	8.20	8.80	9.20
Ghana	1.10	1.15	1.18	1.24	1.30	22.00(91-day T-bill)	23.00	26.00	24.00	22.00
Kenya	65.28	67.50	69.50	72.00	71.00	8.10 (91-day T-bill)	7.60	6.80	6.50	7.20
Nigeria	118	117.0	117	114	112	9.2 (91-day T-bill)	9.30	9.60	9.40	9.10
Sierra Leone	2,970	3,060	3,050	3,060	3,070	13.91 (91-day T-bill)	15.20	15.60	15.90	16.40
South Africa	7.82	7.50	8.00	8.10	7.90	12.00 (Repo rate)	12.50	12.50	12.50	12.00
Tanzania	1,170	1,160	1,210	1,240	1,205	8.28 (91-day T-bill)	8.40	8.00	7.60	8.20
Uganda	1,616	1,590	1,620	1,660	1,640	9.04 (91-day T-bill)	8.80	8.50	7.70	9.20
Zambia	3,195	2,975	3,120	3,300	3,500	12.49 (91-day T-bill)	12.70	12.96	13.50	14.00
Middle East and North Africa										
Algeria	62.83	65.00	62.00	67.50	68.00	3.28 (interbank rate)	3.28	3.28	3.28	3.28
Bahrain	0.38	0.35	0.35	0.35	0.35	2.00 (1 week deposit rate)	2.00	2.00	1.50	1.00
Egypt	5.34	5.30	5.30	5.25	5.20	10.50 (O/N depo rate)	10.50	10.75	10.75	10.75
Iran	9,193	9,423	9,423	9,423	9,423	…	…	…	…	…
Jordan	0.71	0.71	0.71	0.71	0.71	6.50 (repo rate)	6.50	6.50	6.50	6.50
Kuwait	0.27	0.27	0.27	0.27	0.27	5.75 (discount rate)	5.75	5.75	5.75	5.75
Lebanon	1,508	1,510	1,510	1,510	1,510	…	…	…	…	…
Libya	1.19	1.19	1.18	1.20	1.21	…	…	…	…	….
Morocco	7.29	7.30	7.25	7.40	7.50	5.00 (1M depo rate)	5.00	5.00	5.00	5.00
Oman	0.38	0.35	0.35	0.35	0.35	3.44 (repo rate)	3.44	3.44	3.00	2.50
Qatar	3.64	3.35	3.35	3.35	3.35	2.00 (O/N deposit rate)	2.00	2.00	1.50	1.00
Saudi Arabia	3.75	3.45	3.45	3.45	3.45	2.00 (reverse repo rate)	2.00	2.00	1.50	1.00
Tunisia	1.16	1.18	1.16	1.20	1.22	5.25 (money market rate)	5.25	5.25	5.25	5.25
Turkey	1.22	1.16	1.17	1.19	1.17	16.75 (base rate)	17.00	17.00	16.25	15.00
UAE	3.67	3.38	3.38	3.38	3.38	2.00 (repo rate)	2.00	2.00	1.50	1.00
Latin America										
Brazil	1.60	1.55	1.51	1.57	1.64	13.00 (Selic)	13.75	14.25	14.25	14.25
Chile		500	490	525	565	7.25 (Overnight rate)	7.75	7.75	7.00	6.50
Mexico	10.31	9.80	10.20	10.55	10.80	8.00 (TdF)	8.25	8.25	8.00	7.50

Forecasts are for end of period

Sovereign risk watch: Africa

Country	Rating Positives:	Rating Negatives:	What to watch:	Sovereign ratings - Long-term foreign currency		
				S&P	Fitch	Moody's
		Source: SCB Global Research		Source: External ratings agencies		
Benin	Recent economic reforms and improvements in public indebtedness.	Overdependence on re-export trade with Nigeria. High poverty levels, low HDI performance.	Ability to cope with rising prices for commodity imports.	B *stable*	B *stable*	Not rated
Botswana	Long history of sound growth & good economic management. Strong savings Low external debt, favourable import cover	Narrow economic base, limited options for diversification Impact of HIV/AIDS	Growth rate of fiscal revenue. Progress in diversification. Ability to weather a US economic slowdown, deal with near term inflation threat	A *stable*	Not rated	A2 *positive*
Burkina Faso	Positive impact on growth from new mining activity, switch from cotton to food crops	Public finances under strain despite donor support	Rising import bill with oil, gas, wheat and rice pressured. Benefits from decline in commodity prices will be limited.	B ***stable***	Not rated	Not rated
Cameroon	HIPC and MDRI debt relief have improved external debt ratios Improvement in economic management	Significant improvement in governance still needed	Ability to translate debt relief into higher economic growth Increased FDI expected in services and extractive industries	B *stable*	B *stable*	Not rated
Côte d'Ivoire	Fresh hopes for lasting peace after a four-year political deadlock	Significant fiscal challenges persist	Presidential elections in 2008. Rising oil exports.	Not rated	Not rated	Not rated
Gabon	Middle Income Status. High level of economic development relative to many Sub Saharan peers	Uncertainty over political succession. Declining oil reserves	Ability to increase domestic revenue collection, prevent decline in oil reserves	BB- *stable*	Not rated	Not rated
Gambia	Role of currency appreciation in keeping inflation expectations anchored	Capacity constraints especially with regards to energy Vulnerability to oil price strength	Groundnut marketing season and impact on FX reserves and consumer confidence	Not rated	CCC rating affirmed & withdrawn July 2007	Not rated
Ghana	Recent established track record for reform, political stability Impact of HIPC & MDRI debt forgiveness on external liquidity	Vulnerability to imported oil. Further fiscal deterioration (see report in July *Global Focus*) Ongoing dependence on ODA. Widening current account deficit	Impact of higher oil imports on current account Fiscal sustainability given rising T-bill yields. Rising inflation near term. Further GHS weakness.	B+ *stable*	B+ *stable*	Not rated
Kenya	Well established private sector, relatively diversified economic base. Revenue collection above Sub Sahran average As a regional centre for manufactured exports, Kenya benefits from strong growth in region.	Deterioration in politics & security situation. Impact on long term investor confidence, tourism & agriculture. Governance concerns, ability to sustain IFI support, infrastructure constraints	Resolution of post-electoral political crisis. Implementation of power sharing agreement Impact of displaced population on agriculture and food security. Ability to recover from post-Safaricom tightening of interbank liquidity	B ***positive***	B+ *negative*	Not rated
Lesotho	Improved medium term growth prospects Low external debt, strength in public finances	Liberalisation of international trade in textiles, impact on FDI	Ability to weather withdrawal of textiles-related FDI	Not rated	BB- *stable*	Not rated
Malawi	Economic management is improving, recently awarded HIPC debt relief.	Weak growth, although improving. Narrow economic base	Fiscal management, diversification of exports	Not rated	B- *stable*	Not rated
Mali	Increased agricultural production will support growth Relative domestic political stability	Vulnerable to poor weather and natural disasters Narrow economic base	Unbudgeted government expenditure on social programmes	B	B- *stable*	Not rated
Mauritius	History of stable economic growth, good performance on Human Development Index	Textiles liberalisation, end of EU sugar preferences, chronic budget deficits	Ability to develop new engines of growth in absence of trade preferences	Not rated	Not rated	Baa2 *negative*

Sovereign risk watch: Africa

Country	Rating Positives:	Rating Negatives:	What to watch:	Sovereign ratings - Long-term foreign currency		
				S&P	Fitch	Moody's
		Source: SCB Global Research			Source: External ratings agencies	
Mozambique	Sound history of economic reform, strong economic growth, diversification of export base Beneficiary of HIPC & MDRI debt relief	Vulnerability to floods and drought Per capita incomes remains low	Ability of robust economic growth to reduce poverty levels	B+ *stable*	B *stable*	Not rated
Namibia	Stable growth, low indebtedness, growth of mining exports	Weak international liquidity relative to peer group	Diversification of exports, impact of global growth on mining output prices	Not rated	BBB- *stable*	Not rated
Nigeria	Strong oil related revenue, healthy external liquidity, sizeable current account surplus Negligible external debt following Paris Club deal & London Club buy-back	Impact on oil output of Niger Delta unrest. Vast social challenges. Low per capita income Weak institutions, weak capacity at state & local levels, short history of economic reform	Continuation of economic reform, strengthening of institutions under Yar'Adua Plans to reduce rate of oil windfall savings, transparency within the 3 tiers of government.	BB- *stable*	BB- *stable*	Not rated
Senegal	Traditional low inflation helped by CFA franc peg to the euro Relative political stability	Extra budgetary spending has hit record levels in recent years. Widening deficit despite favourable revenue performance	Impact of imported oil on state subsidies, inflation and the fiscal position Ability to overcome recent weak GDP growth	B+ *negative*	Not rated	Not rated
South Africa	Sound economic management with budget surplus & inflation targeting framework Improving external liquidity	Sizeable current account deficit. Dependence on s/t portfolio flows for financing of deficit. Political transition within the ANC. The power crisis. Rising inflation.	Ability to weather any future EM-related risk aversion, given current account deficit Political developments with moves to prosecute ANC President, Jacob Zuma. Operation of the 'dual centres' of power	BBB+ *stable*	BBB+ *positive*	Baa1 *positive*
Tanzania	Strong trend growth across a number of sectors, economic reform, beneficiary of HIPC and MDRI	Low rate of domestic revenue collection, dependence on donors	Vulnerability of FX reserves to higher oil import requirement. Governance reforms following recent resignation of cabinet	Not rated	Not rated	Not rated
Uganda	Economic reform, beneficiary of HIPC & MDRI. Increased energy sector projects	Low rate of domestic revenue collection, ability to reduce dependence on donors as set out in Budget 08/09	Improvements in governance & revenue collection, relations with donors Energy Security.	Not rated	B *stable*	Not rated
Zambia	Strong export growth particularly in copper mining, beneficiary of HIPC & MDRI. Moves to increase domestic revenue.	Donor dependence, low import cover Vulnerability to portfolio outflows. Ability of energy sector issues to constrain mining output	Public sector wage bill. Pressures for a rise in spending Resilience of FX reserves to potential outflows	Not rated	Not rated	Not rated

African policy watch

Africa policy rates

	Benchmark rate	Current (%)	Last meeting (Date)	Action taken at last meeting	Next meeting (Date)	SCB forecast for the next meeting	Background	The risks
South Africa	Repo Rate	12.00	12 Jun 08	Raised 50 bps	14 Aug 08	Raise 50bps	With consumption growth showing clear signs of deceleration - y/y retail sales have been negative for some time - we are likely to be at the end of the tightening cycle. Reinforcing this are plans to switch to a new CPI index with new weights from Jan 09, which will reduce the share of food in the CPI basket and boost the share of transport. Market expectation is that this will reduce overall inflation - perhaps by as much as 2 percentage points.	The dilemma faced by the SARB is that long term inflation expectations will be framed on the basis of current inflation experience. The switch to a new CPI basket may not count for much if high inflation expectations remain entrenched, as reflected by wage settlements at least twice the upper level of the inflation target. Nonetheless, the resumption of an easing cycle, from Q2 2009 is probable, even with CPIX expected to accelerate until the end of this year.
Kenya	Central Bank Rate	9.00	5 Jun 08	Raised 25bps	Aug 08	No change	Reprieve from the immediate post-crisis dislocation, along with budgetary measures aimed at providing some respite from higher food prices, suggest that headline inflation has peaked. Even more significant is the assertion that Kenya's inflation rate would be at half its current level, if Kenya adopted the same CPI calculation methodology as neighbouring countries. Watch this space!	Despite the 25bps rate hike seen earlier this year, we now believe policy interest rates are likely to remain on hold. Interbank liquidity is only just returning to more normal levels following the Safaricom IPO and refund delays. With doubts over the accuracy of the CPI data, sustaining credit and economic growth, as well as keeping the cost of debt service low, are likely to be prime considerations.
Nigeria	Monetary Policy Rate	10.25	5-Aug-08	Raised 25 bps	Oct 08	No change	Although inflation has spiked to double digits, reaching 12% y/y in June, market expectations for a further tightening of policy at the Aug MPC meeting of the CBN were disappointed. Policymakers predict more favourable harvests and the return to single digit inflation by the year end. We have our doubts.	Greater reliance on OMOs to mop up liquidity is now promised, although it is not clear that there has been an additional budgetary allocation for this purpose. Increasingly, the authorities will have to rely on a stronger naira, to contain inflation risks. But a steep decline in oil prices might temper fiscal appetite for NGN appreciation. The waiver of the financial year end reporting requirement for banks should also trigger some easing of market liquidity.
Ghana	Prime Rate	17.00	21-Jul-08	Raised 100bps	Sep-08	Raise 50 bps	The Bank of Ghana disappointed markets by raising the Prime Rate only 100 bps at its last meeting, despite the surge in inflation to 18.4%. While Ghana will benefit from slightly softer oil prices (although not by much - we believe that fuel subsidies were reimposed at USD 122/bbl), near term inflation risks remain weighted to the upside. A weaker currency will not help.	Despite a disappointing rate hike in Jul, T-bill yields have continued to rise, reflecting the domestic financing difficulties faced by the authorities (see Jul Global Focus). Further aggressive tightening is therefore unlikely, and we may see only a moderate hike in Oct, if that.
Botswana	Bank Rate	15.50	20 June 08	Raised 50 bps	Aug/Sept 08	Raise 50 bps	Markets were taken by surprise by the two consecutive 50 bps rate hikes, with barely a month between the 26 May and the 20 June tightening. Greater reliance is now placed on BoBC auctions as an indication of the authorities' tightening intentions. Prior to both official policy hikes, the 91 day BoBC yield was allowed to rise 50 bps above the previous yield, although interest rates have stabilised in recent auctions. A further rise in yields would be a necessary precursor to any rate hike.	Doubts about the transmission mechanism of monetary policy persist. With much of the pressure stemming from imported inflation, we argue that allowing the BWP to strengthen against components of its currency basket would make more sense. However, this is a decision of the Finance Ministry, rather than the Central Bank. Near term, the threat of steep levies on alcoholic beverages will put further pressure on inflation, more than compensating for any decline in imported fuel. Inflation risks are still weighted to the upside.

Africa: monthly economic data

	Latest CPI (% y/y)	Month	Latest FX Reserves (USD mn)	Month	Estimated Import Cover in months
Southern Africa					
Botswana	14.5	Jun-08	10,346	Apr-08	36.0
South Africa (CPIX)	11.6	Jun-08	34,171	Jul-08	5.4
Zambia	12.6	Jul-08	1,338	Jun-08	5.6
East Africa					
Kenya	26.5	Jul-08	3,390	Apr-08	3.8
Tanzania	9.3	Jun-08	2,761	Dec-07	5.0
Uganda	13.7	Jul-08	2,613	Feb-08	6.6
West Africa					
The Gambia	1.6	Jul-08	143.0	Mar-08	2.4
Ghana	18.4	Jun-08	2,300	Jun-08	2.4
Nigeria	12.0	Jun-08	60,740	Jun-08	31.9
Sierra Leone	15.28	May-08	196.1	Dec-07	3.6
Francophone Africa					
Cameroon	3.0	Jul-08	2,800	Feb-08	4.0
Côte d'Ivoire	4.4	Jul-08	2,888	Jan-08	4.5

Source: SCB Global Research

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Data available as of 14 August 2008 GMT 0830.
This document is released on 14 August 2008 GMT 0830.