

# Valance Company, Inc.



Weekly

August 17, 2005

III

## Highlights

**US** – Core CPI remains contained, but PPI shows potential inflation brewing (page 2)

**Euroland** – German and French Q2 growth both disappoint (page 10)

**Japan** – GDP bolstered by domestic demand (page 17)

**UK** – MPC minutes reveal a surprising 5-4 vote (page 24)

**China** – Trade Surplus widened, Consumer Prices edged up (page 40)

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## August 11 - August 17 Short Term Interest Rates

| Country | Change in BPs |              | (3Mth. Futures Contracts Yields) |        |        |        |
|---------|---------------|--------------|----------------------------------|--------|--------|--------|
|         | Official Rate | 3 Mth. LIBOR | Sep-05                           | Dec-05 | Mar-06 | Jun-06 |
| US      | 0.00          | 0.03         | -0.75                            | -3.00  | -5.50  | -9.00  |
|         | 3.50          | 3.81         | 3.99                             | 4.30   | 4.41   | 4.45   |
| EU      | 0.00          | 0.00         | -0.50                            | -5.00  | -11.00 | -14.50 |
|         | 2.00          | 2.13         | 2.14                             | 2.17   | 2.19   | 2.26   |
| JN      | 0.00          | 0.00         | 0.00                             | -1.50  | -0.50  | 0.00   |
|         | 0.00          | 0.06         | 0.09                             | 0.11   | 0.17   | 0.23   |
| UK      | 0.00          | 0.00         | 2.00                             | 0.00   | -4.00  | -7.00  |
|         | 4.50          | 4.59         | 4.58                             | 4.48   | 4.42   | 4.42   |
| CA      | 0.00          | 0.04         | 1.00                             | 0.00   | 0.00   | -3.00  |
|         | 2.50          | 2.80         | 2.93                             | 3.16   | 3.34   | 3.43   |
| AU      | 0.00          | 0.00         | -1.00                            | -1.00  | -5.00  | -8.00  |
|         | 5.50          | 5.57         | 5.62                             | 5.58   | 5.50   | 5.45   |
| NZ      | 0.00          | -0.02        | 1.00                             | 0.00   | 2.00   | 4.00   |
|         | 6.75          | 6.96         | 7.03                             | 6.97   | 6.83   | 6.63   |
| SZ      | 0.00          | 0.00         | 0.00                             | -2.00  | -4.00  | -7.00  |
|         | 0.75          | 0.76         | 0.79                             | 0.90   | 1.02   | 1.16   |

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## Valance Economic Report: United States

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August 17, 2005

This week's economic data had a weaker tone with Core Retail Sales, Industrial Production and the Trade Balance coming in soft. Also, Core CPI showed a tame inflationary environment, but the PPI data showed some inflationary pressures building that will likely keep the Fed moving.

### Weekly Highlights

**Core CPI-** up 0.149% M/M in July. (page 2)

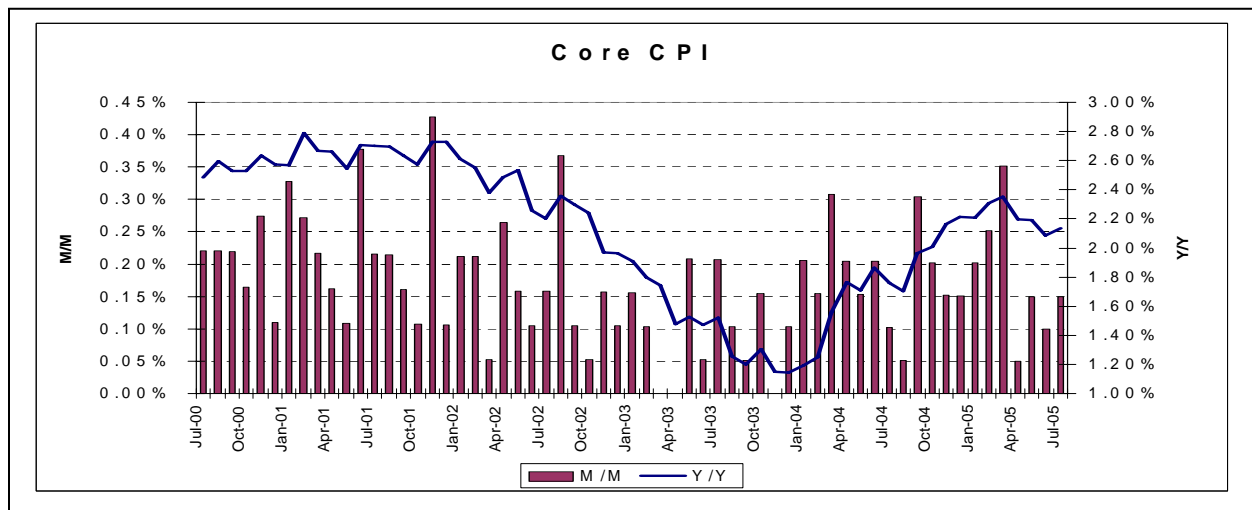
**Core PPI-** increased 0.4% M/M in July. (page 4)

**Retail Sales ex. autos-** increased 0.3% M/M in July. (page 4)

**Capacity Utilization-** dropped to 79.7% in July. (page 6)

### Weekly Releases

#### Chart of the Week: *Core CPI*



Core CPI increased 0.1% M/M and 2.1% Y/Y in July. The M/M increase actually rounded down from 0.149%- again. Core CPI appears stable and pricing dynamics in the apparel and motor vehicle sectors should still exert deflationary pressures. However, the inflationary pressures seen in the PPI today will likely keep the Fed moving despite a moderation in core retail inflation measures.

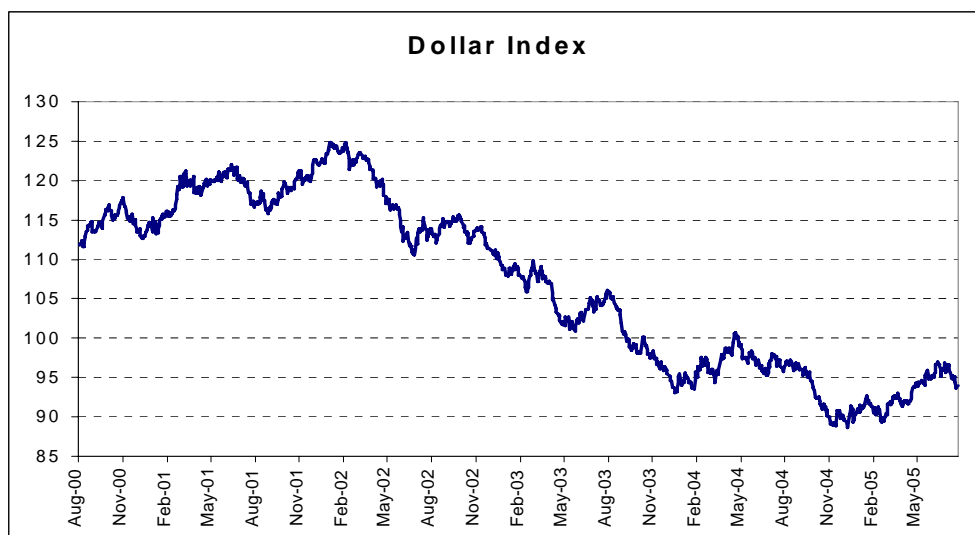
# U.S. Financial Balances & Trade Weighted Dollar

## Financial Balances

|                         | <i>Latest period (\$bns)</i> | <i>Last 12mo. as a % of GDP</i> |
|-------------------------|------------------------------|---------------------------------|
| Budget Balance          | -57.8 (July)                 | -2.6%                           |
| Trade Balance           | -58.8 (June)                 | -5.4%                           |
| Current Account Balance | -195.1 (Q1)                  | -5.8%                           |
| Private Balance         |                              | -3.2%                           |

The budget deficit is currently at \$319 billion on a trailing twelve month basis and the CBO is estimating that the deficit will end fiscal year 2005 at \$331 billion, down \$81 billion from 2004. The CBO is also forecasting that the deficit will remain above \$300 billion until 2011 when the 2001 tax cuts are scheduled to expire-largely due to elevated defense spending. The trade balance in June also widened as the growth in exports was not large enough to reduce the large gap between the levels of imports and exports. The budget deficit remains too small to support a robust and sustained expansion. As mortgage equity extraction slows and debt service levels increase- fragility in the economy should become more evident.

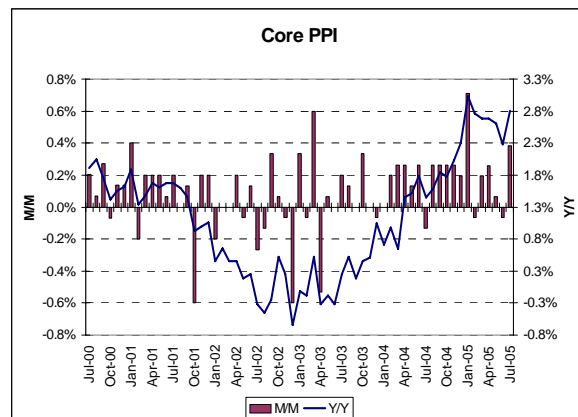
## Trade Weighted Dollar



# PPI, Import Prices & Retail Sales

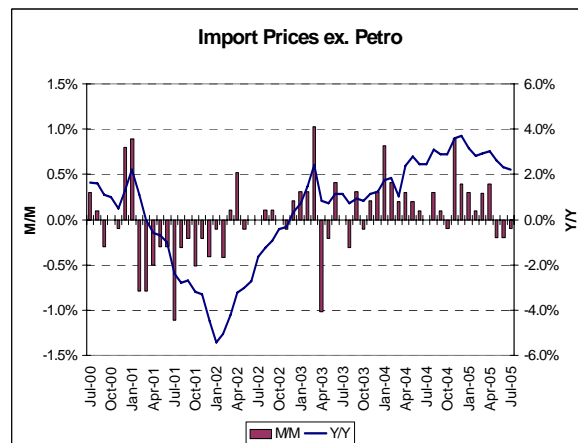
## Core PPI

Core PPI increased 0.4% M/M and 2.8% Y/Y in July. Crude and core intermediate goods' prices increased 1.0% M/M and 6.7% M/M, respectively. The price pressures in early stages of production validate the Fed's concern about inflationary pressures remaining "elevated".



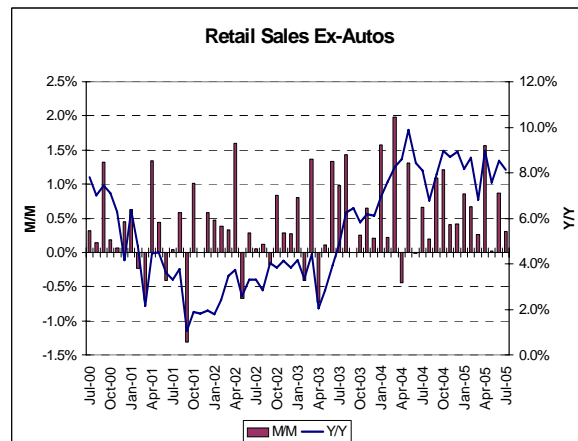
## Import Prices

Import Prices, excluding petroleum, decreased 0.1% M/M and increased 2.2% Y/Y in July. As discussed previously, the strengthening of the dollar is exerting deflationary pressures via import prices.



## Retail Sales ex Autos

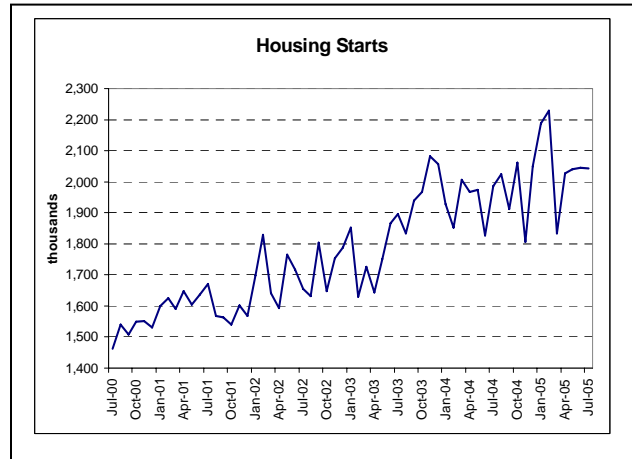
Retail Sales, excluding autos, increased 0.3% M/M and 8.1% Y/Y in July. The headline number increased 0.9% M/M due to strong auto sales. However, retail sales, excluding autos and gas, were flat for the month- a sign that high energy prices may have started to weaken the consumer a bit.



# Housing

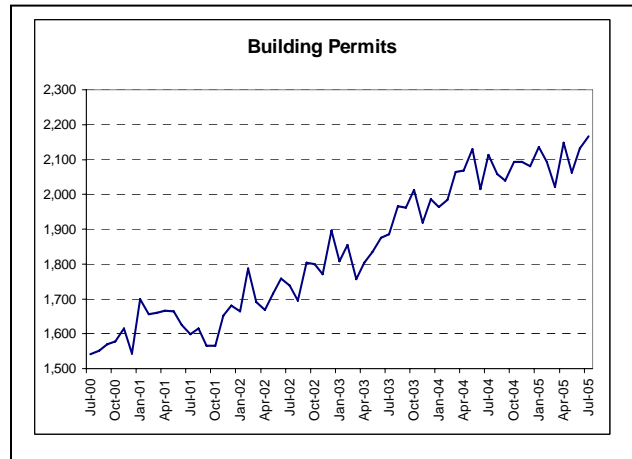
## Housing Starts

*Housing Starts were flat at 2,042k in June. Housing starts continue to remain strong, but over the past year have not shown any significant growth.*



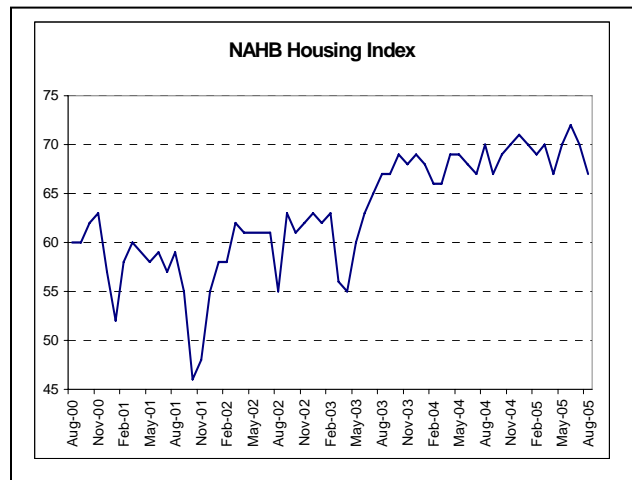
## Building Permits

*Building Permits grew from 2,132k to 2,167k in July. This series continues to remain robust and is starting to show some growth in the housing backlog over the last two months.*



## NAHB Housing Market Index

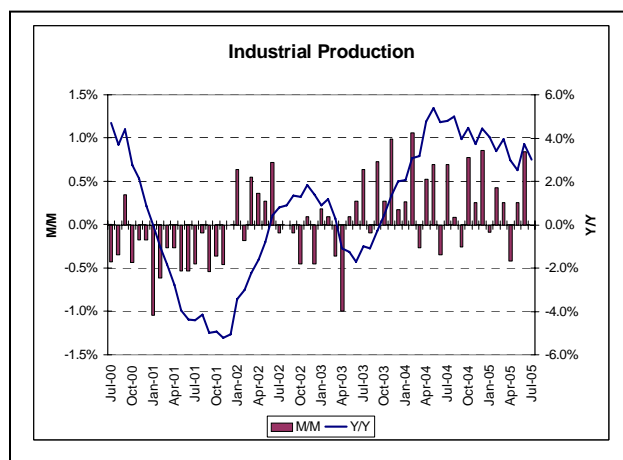
*The NAHB Housing Market Index dropped from 70 to 67 in August. The present sales index declined from 76 to 72, but future sales remained at 77. This series has been relatively flat over the past two years.*



# Industrial Production, Capacity Utilization & Empire Index

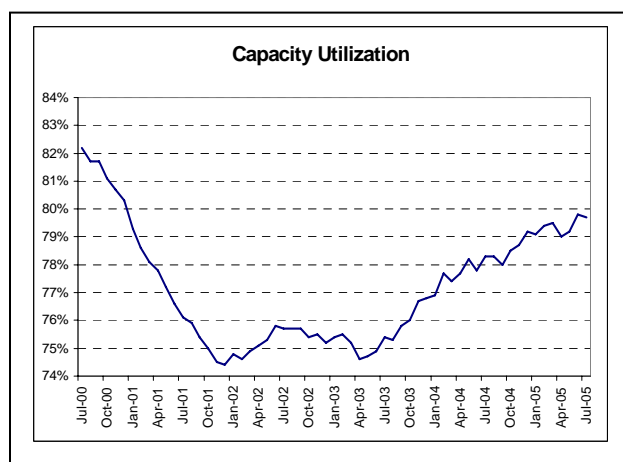
## Industrial Production

Industrial Production increased 0.1% M/M and 3.0% Y/Y in July. The weakness was most likely caused by the auto sector cutting production to reduce inventory levels, a factor unlikely to be repeated in the following months. Motor vehicle sector production declined 2.3% M/M.



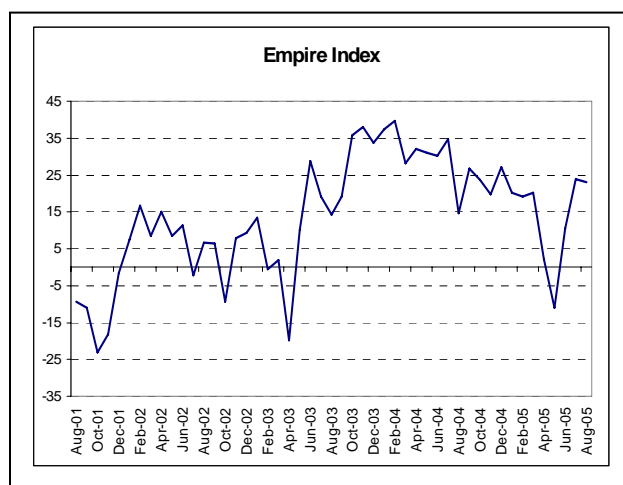
## Capacity Utilization

Capacity Utilization dropped from 79.8 to 79.7 in July. The decline in capacity utilization was mostly attributed to the weakness in the auto sector discussed above.



## Empire Manufacturing Index

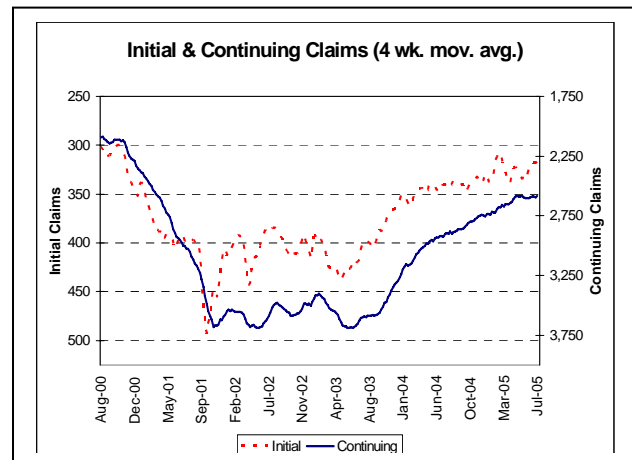
The Empire Manufacturing Index declined slightly from 23.91 to 23.04 in August. The employment component increased from 1.42 to 10.17. The prices paid component increased from 21.57 to 29 and the prices received component declined from 1 to -1.



# Unemployment Claims, Trade Balance & Budget Balance

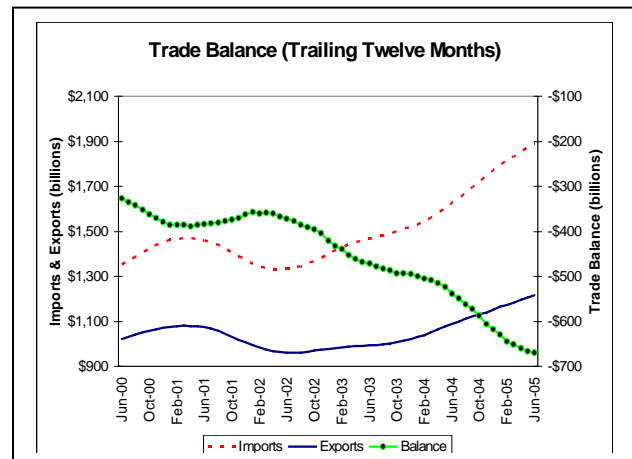
## Initial & Continuing Claims

The four-week moving average of initial and continuing claims declined to 309k and 2,582k, respectively. The level of continuing unemployment claims is again signaling for an above trend payroll number.



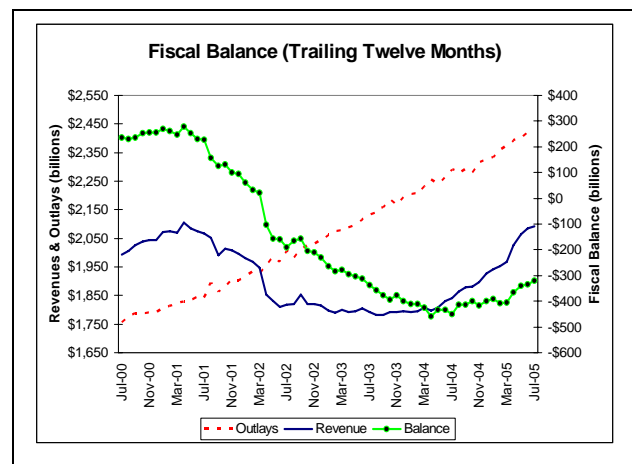
## Trade Balance

The trade balance widened to \$58.8 billion in June and on a trailing twelve month basis, expanded to -\$669.6 billion (5.4% of GDP). Imports grew 2.1% M/M and 11.1% Y/Y, and exports grew 0.0% M/M and 13.4% Y/Y, but the absolute deficit continued to widen and should put downward pressure on Q2 GDP revisions.



## Budget Statement

The budget balance in July was a deficit of \$57.8 billion versus in July 2004. On a trailing twelve month basis, the deficit has dropped to \$319 billion. Higher than expected tax collections have been the key driver in lowering the deficit. The narrowing budget deficit combined with the relatively stable trade balance will be a headwind on the economy that can only be temporarily overpowered by credit expansion.

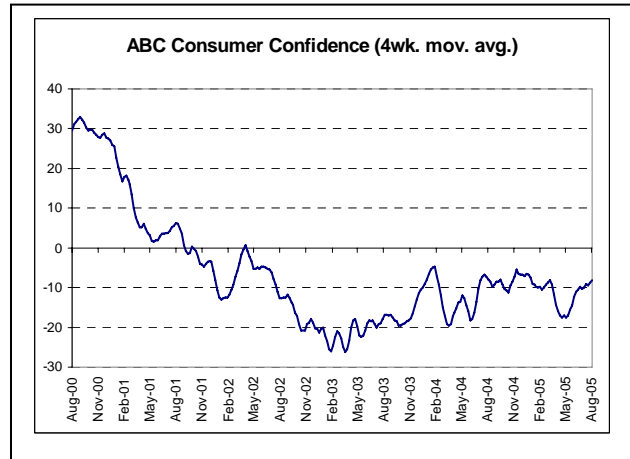




# Confidence & Mortgage Applications

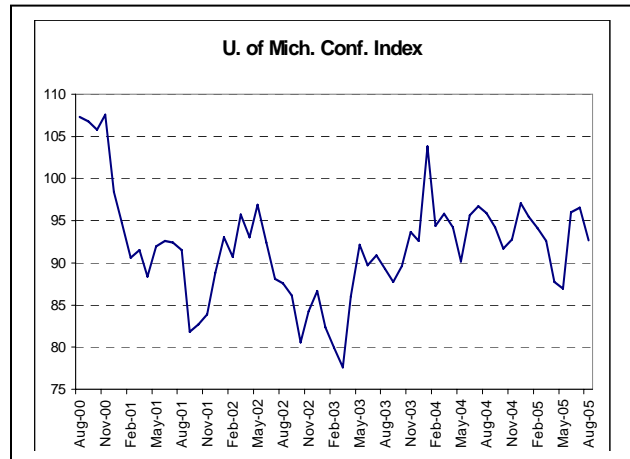
## ABC Consumer Confidence

*The ABC Consumer Confidence Index improved from -8 to -7. The buying climate component surged from -30 to -24, but the finance component remained flat at 22 and the economic component weakened from -16 to -18.*



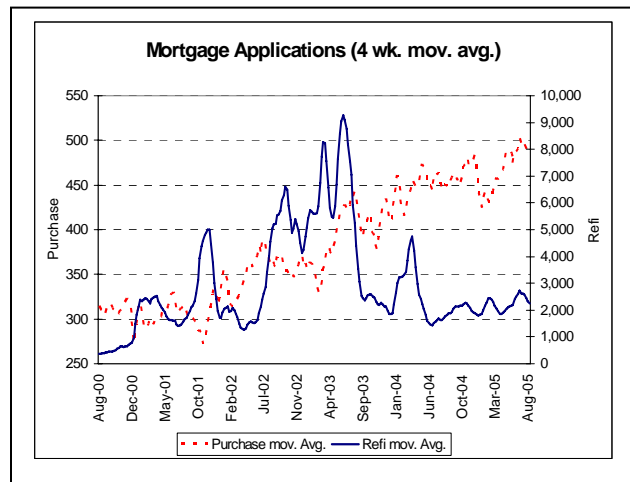
## U. of Michigan Confidence

*The preliminary reading of the University of Michigan Confidence Index in August decreased from 96.5 to 92.7. The current and expectation components both declined more than three points to 110.4 and 81.3, respectively.*



## MBA Mortgage Applications

*Purchase and refinancing mortgage applications increased 0.1% and 5.0%, respectively this week. The decline in mortgage rates led to a pick-up in mortgage applications in response. Absolute levels for purchase applications still show a healthy housing market.*





## *Key Dates This Week*

| <i>Date</i> | <i>Indicator</i>                   | <i>Expectation</i> | <i>Previous</i> |
|-------------|------------------------------------|--------------------|-----------------|
| 08/18       | Initial Jobless Claims (AUG 13)    | 310K               | 308K            |
| 08/18       | Continuing Claims (AUG 6)          | 2572K              | 2573K           |
| 08/18       | Leading Indicators (JUL)           | 0.2%               | 0.9%            |
| 08/18       | Philadelphia Fed. (AUG)            | 14.0               | 9.6             |
| 08/23       | Existing Home Sales (JUL)          | 7.26M              | 7.33M           |
| 08/23       | ABC Consumer Confidence (AUG 21)   | NA                 | -7              |
| 08/24       | MBA Mortgage Applications (AUG 19) | NA                 | 2.2%            |
| 08/24       | Durable Goods Orders (JUL)         | -0.8%              | 2.0%            |
| 08/24       | Durables Ex. Transportation (JUL)  | -0.5%              | 3.2%            |
| 08/24       | New Home Sales (JUL)               | 1325K              | 1374K           |

## Valance Economic Report: Euro Zone

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August 17, 2005

Growth was relatively weak in the Euro Zone once again in Q2 with the only true surprise being Italy's 0.7% Q/Q expansion. German and French growth both disappointed while growth in Spain remained buoyant. For the Eurozone as a whole, GDP grew 0.3% Q/Q. Inflationary forces remain generally contained, with a slight pickup in Spain and a slight deceleration in France.

### Weekly Highlights

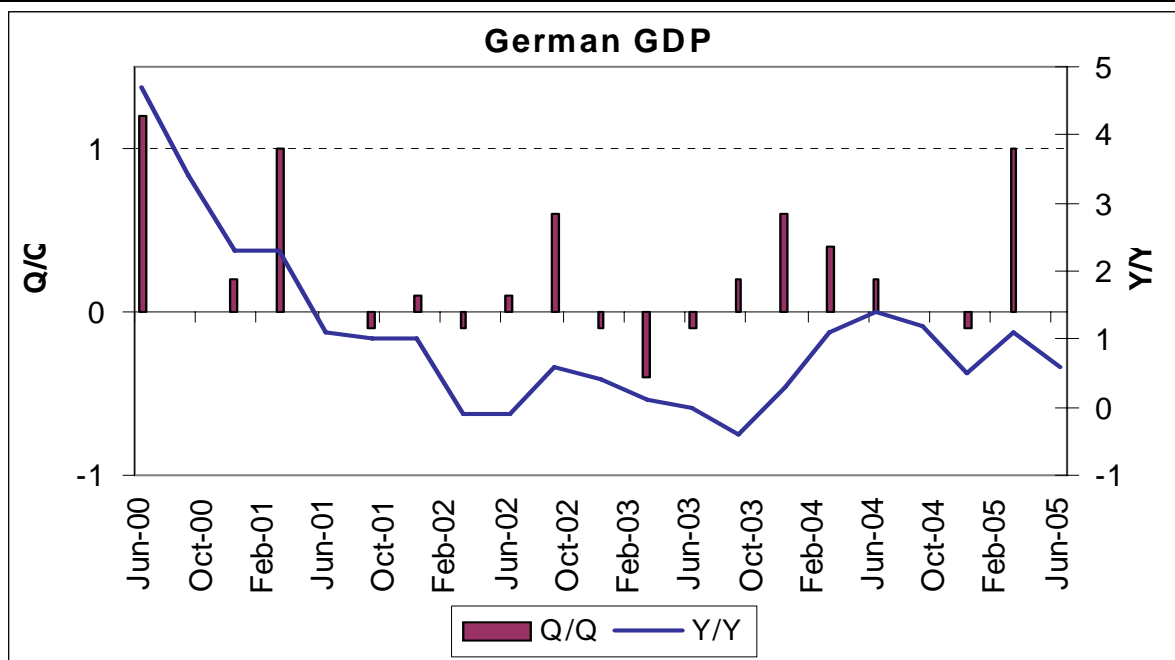
**German GDP**— Q2 growth stagnated, remaining unchanged Q/Q. (page 10)

**French GDP**—economy expanded 0.1% Q/Q, slightly disappointing expectations. (page 12)

**Spanish GDP**— as expected, Q2 growth was strong, expanding 0.9% Q/Q. (page 12)

### Weekly Releases & News

#### Chart of the Week: *German GDP*



Economic growth in Germany stalled in Q2, disappointing market expectations. GDP was unchanged Q/Q and rose just 0.6% Y/Y. Q1 GDP was revised downward as well, from 1.0% Q/Q to 0.8%. Consumer demand and investments reportedly improved in Q2, while import growth exceeded that of exports for the quarter.

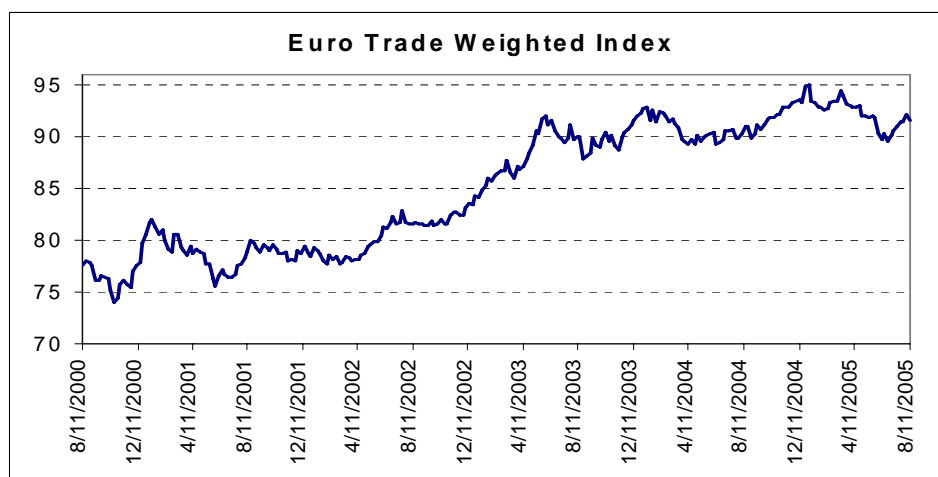
## ***Euro Zone Financial Balances & Trade Weighted Euro***

### ***Financial Balances***

| <i>Germany</i>          | <i>Last period (\$bns euros)</i> | <i>Last 12 mo. as a % of GDP</i> |
|-------------------------|----------------------------------|----------------------------------|
| Budget Balance          | -80.3 (12/04)                    | -3.6%                            |
| Trade Balance           | 12.1 (May)                       | 7.1%                             |
| Current Account Balance | 5.2 (May)                        | 3.6%                             |
| Private Savings Balance |                                  | 7.2%                             |
| <i>France</i>           |                                  |                                  |
| Budget Balance          | -5.15 (May)                      | -3.4%                            |
| Trade Balance           | -1.25 (May)                      | -1.3%                            |
| Current Account Balance | -2.87 (May)                      | -1.0%                            |
| Private Savings Balance |                                  | 2.4%                             |
| <i>Italy</i>            |                                  |                                  |
| Budget Balance          | -3.4 (July)                      | -3.5%                            |
| Trade Balance           | -0.36 (May)                      | 0.4%                             |
| Current Account Balance | -3.2 (May)                       | 1.2%                             |
| Private Savings Balance |                                  | 4.7%                             |

Euro area public deficits will most likely overshoot their official targets once again in 2005 as growth this year has proven much weaker than forecasted. Initial 2006 budget drafts also suggest overly optimistic growth forecasts. Citigroup forecasts an average euro area deficit of 3.2% in 2005 and 3.4% in 2006, above the EU's 3% limit.

### ***Trade Weighted Euro***

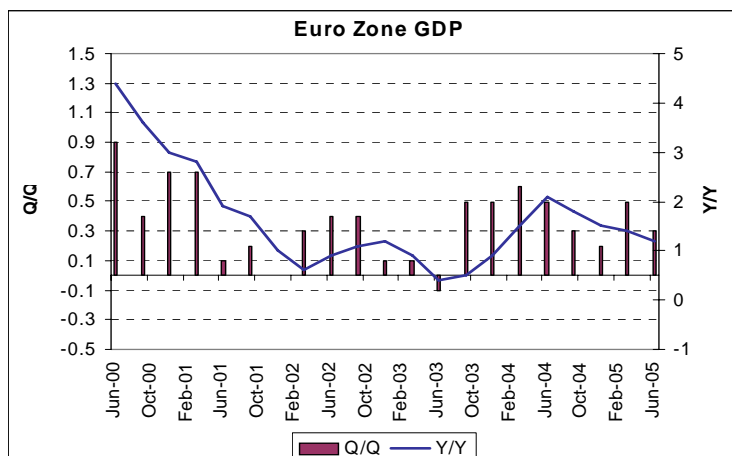


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# Euro Zone GDP, French GDP & Spanish GDP

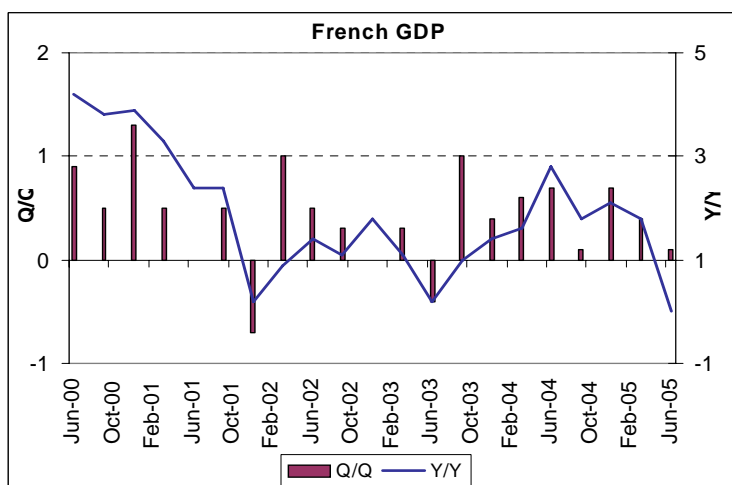
## Euro Zone GDP

The Euro Zone's Q2 growth decelerated to 0.3% Q/Q and 1.2% Y/Y, down from 0.5% Q/Q and 1.4% Y/Y in Q1. The EC is forecasting an acceleration of growth to 0.4% Q/Q in Q3 and 0.6% in Q4.



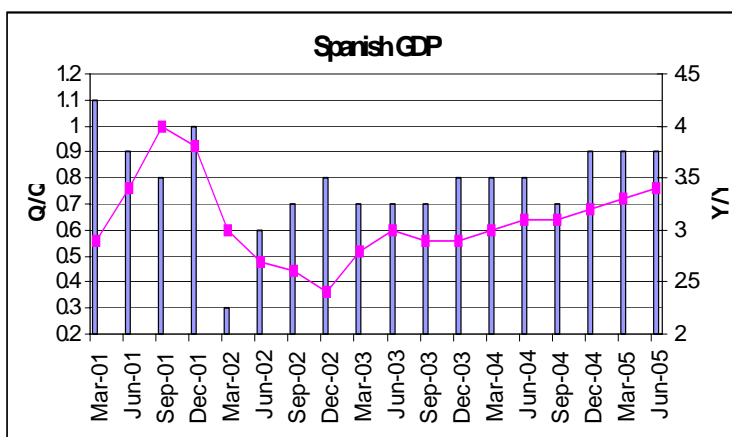
## French GDP

French growth slowed in Q2, expanding 0.1% Q/Q. The economy had expanded 0.3% Q/Q in Q1.



## Spanish GDP

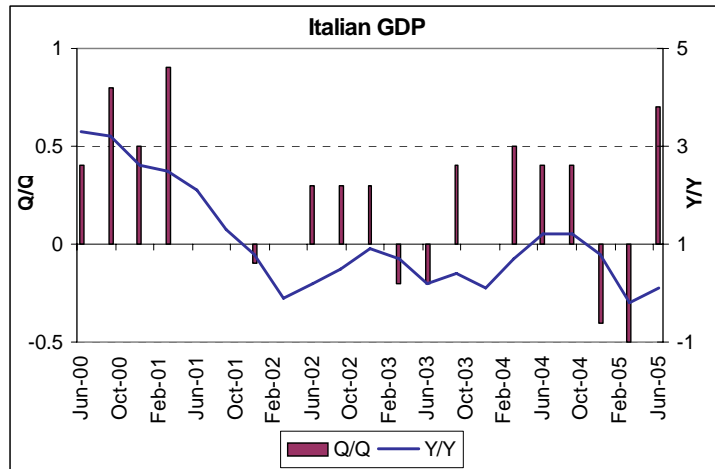
Spain's Q2 GDP expanded 0.9% Q/Q and 3.4% Y/Y, in line with expectations. Strong consumer spending played a large role in the expansion.



# Italian GDP, French Payrolls & Wages

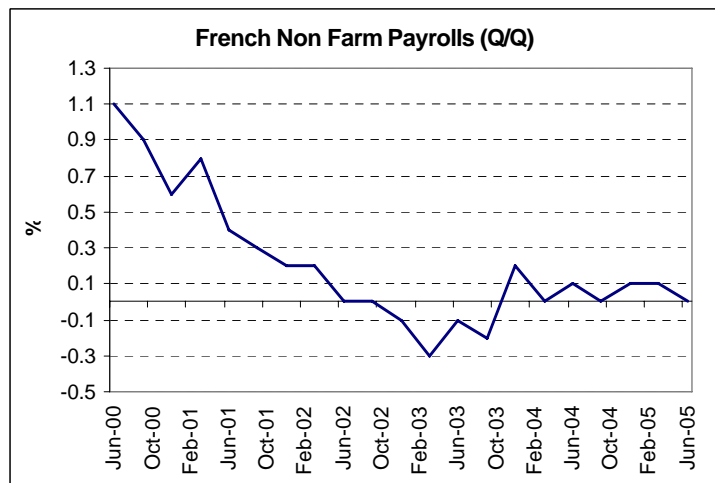
## Italian GDP

Italy's Q2 GDP was significantly stronger than expected, expanding 0.7% Q/Q and 0.1% Y/Y. It's still too early to say whether this was just a rebound from two abysmal quarters preceding it, or the start of a genuine recovery—we think it's most likely the former.



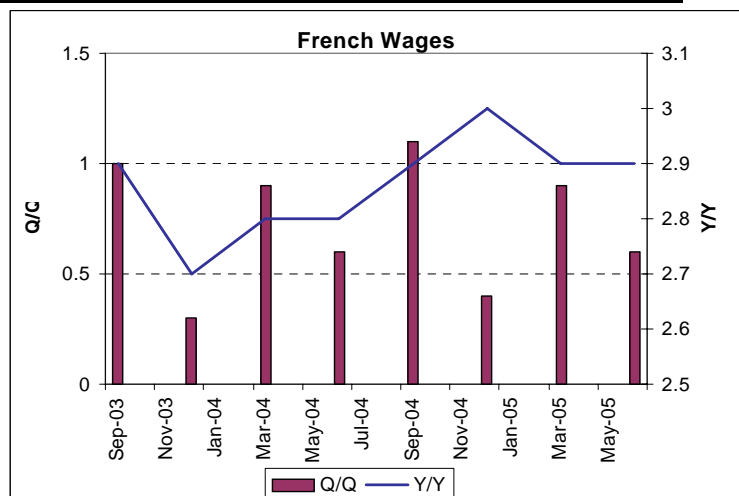
## French Non Farm Payrolls

France's Q2 Non Farm Payroll growth remained unchanged Q/Q after expanding 0.1% Q/Q in Q1.



## French Wages

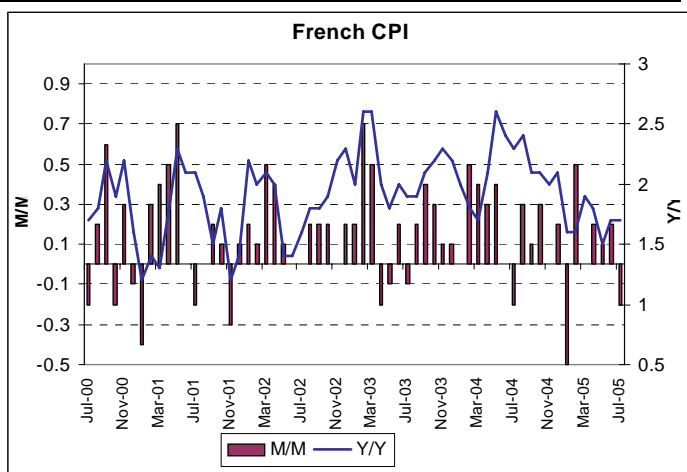
France's Q2 hourly wages decelerated from 0.9% Q/Q in Q1 to 0.6%. Y/Y wage growth was unchanged at 2.9%.



# French CPI, Spanish CPI & French Trade

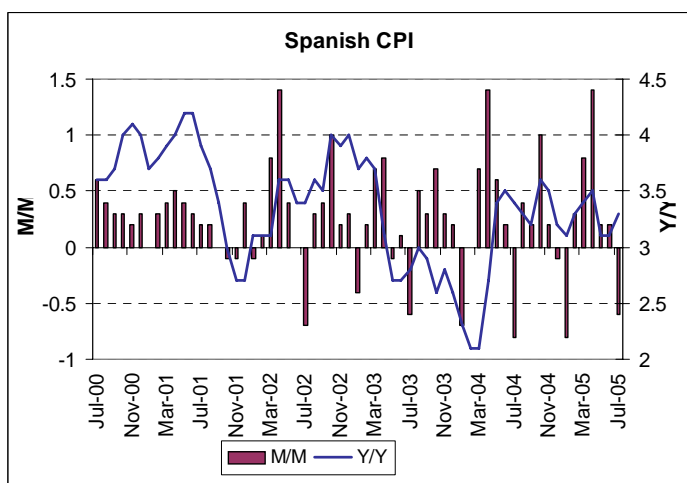
## French CPI

France's July CPI fell 0.2% M/M while growing 1.7% Y/Y due to a fall in food prices. Expectations were for unchanged M/M growth.



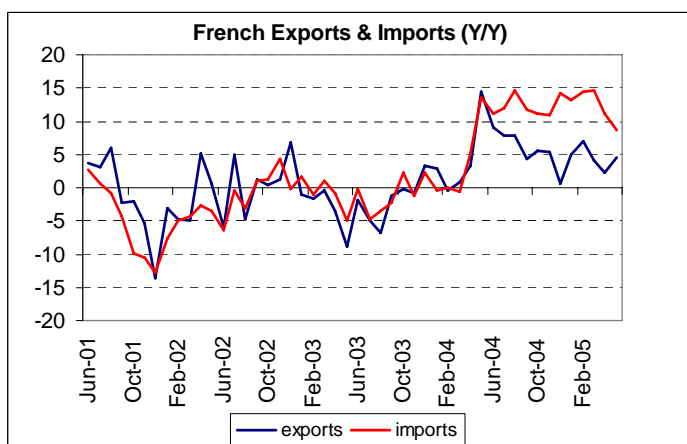
## Spanish CPI

Spain's July CPI accelerated from 3.1% Y/Y to 3.3% Y/Y while falling 0.6% M/M. Ex food and energy, inflation remained unchanged at 2.5% Y/Y.



## French Trade

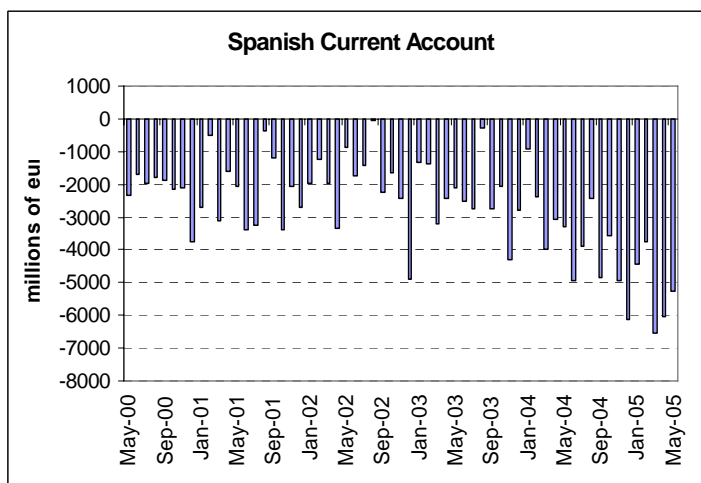
France's June Trade deficit widened slightly to 1.19 billion euros from 1.14 billion euros in May. Imports climbed 8.6% Y/Y and exports grew 4.5% Y/Y.



## Spanish, Italian Current Account & Euro Zone New Car Reg.

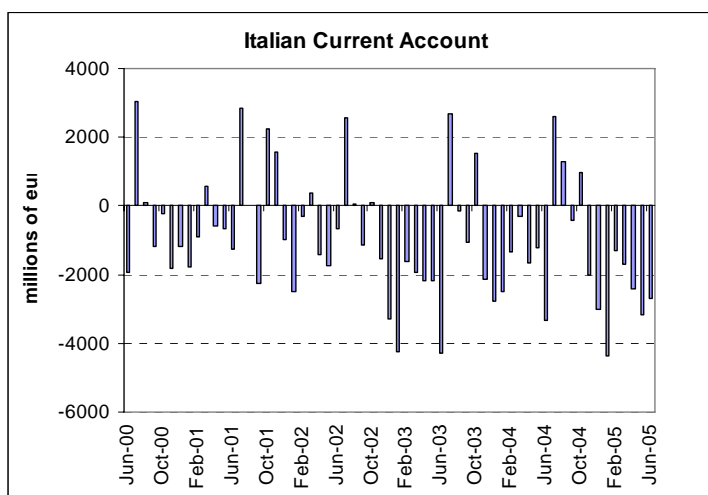
### Spanish Current Account

*Spain's May Current Account deficit narrowed from 6.0 billion euros in April to 5.3 billion euros.*



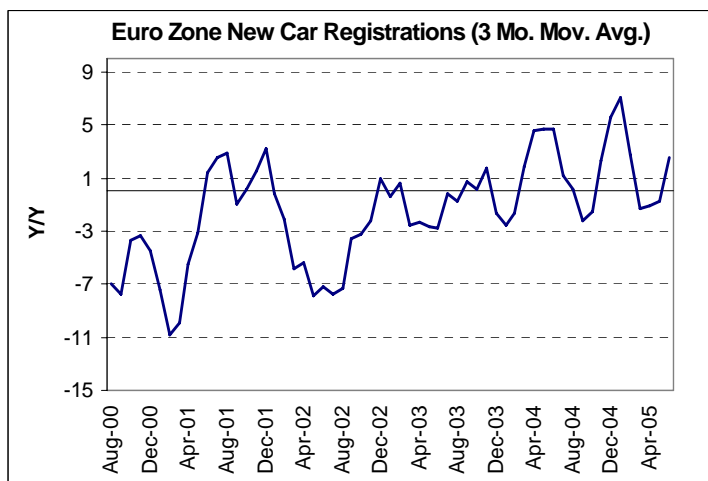
### Italian Current Account

*Italy's June Current Account deficit narrowed, decreasing from 3.2 billion in May to 2.7 billion.*



### Euro Zone New Car Registrations

*The Euro Zone's June New Car Registrations increased 4.5% Y/Y. For the year, registrations are down 0.3% as compared to this point last year.*





## News & Upcoming Dates

**Aug 16<sup>th</sup> – Germany may be governed by a coalition of the CDU and Social Democrats** come this September, though businesses are not necessarily happy. Both parties may fail to garner enough votes to win outright, resulting in the forming of a coalition. Cries regarding whether or not a coalition can come together and make positive changes for the economy have been voiced by business owners as a result. The two parties share very little common ground, causing concern that very little will be accomplished during their possible term.

**Aug 15<sup>th</sup> – The German Bundesbank** stated that Germany is no where near its balanced budget goal and that the goal, as stated in the S+G Pact, is currently “way out of sight.” The Bundesbank noted that due to high spending on unemployment, oil prices denting growth, and meager tax gains, there is a high risk that Germany won’t comply with the rules through 2007.

**Aug 11<sup>th</sup> – ECB member, Axel Weber,** stated that the inflation outlook doesn’t justify making any changes to euro zone interest rates. “There are no signs of any build up in domestic inflation pressure that would suggest a need to end our steady state policy,” Weber stated. He also noted the need for vigilance pertaining to accelerating money supply growth.

**Aug 11<sup>th</sup> – The ECB** stated in its monthly report that interest rates in the euro zone are “appropriate” and noted expectations for the economy to continue expanding at a sustained, but gradual level. The monthly report noted that monetary conditions were “making a significant contribution towards a recovery in economic growth.” Finally, the ECB also commented that economic data in the euro zone has “shown some improvement.”

**Aug 11<sup>th</sup> – German Economy and Labor Minister, Wolfgang Clement,** made another call for the ECB to cut rates, stating that rates should be lowered to boost economic growth. Clement stated, “I expect that, when price stability is achieved, the ECB focuses on growth by cutting interest rates...The ECB is remarkably more hesitant than most other banks (in cutting rates).”

## Key Dates This Week

| <i>Date</i> | <i>Indicator</i>                | <i>Expectation</i> | <i>Previous</i> |
|-------------|---------------------------------|--------------------|-----------------|
| 08/18       | Euro Zone CPI (JUL)             | 0.0% M/M           | 0.1% M/M        |
| 08/18       | Euro Zone Ind. Production (JUN) | 0.4% M/M           | -0.3% M/M       |
| 08/18       | French Current Account (JUN)    | --                 | -2870M          |
| 08/19       | Spanish Factory Orders (JUN)    | --                 | 5.9% Y/Y        |
| 08/19       | Euro Zone Trade Balance (JUN)   | --                 | 3.2B s.a.       |
| 08/23       | German Private Consumption (Q2) | --                 | -0.2% Q/Q       |

## Valance Economic Report: Japan

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August 17, 2005

Despite a softer than expected headline June GDP result, domestic demand continued strong as growth was bolstered by steady consumer spending and capital investment. Net external demand also posted the first quarterly increase in a year, adding to mounting evidence that a recovery in the Japanese economy is well underway. Looking forward, we expect domestic demand and exports to fuel a twin-engined recovery .

### Weekly Highlights

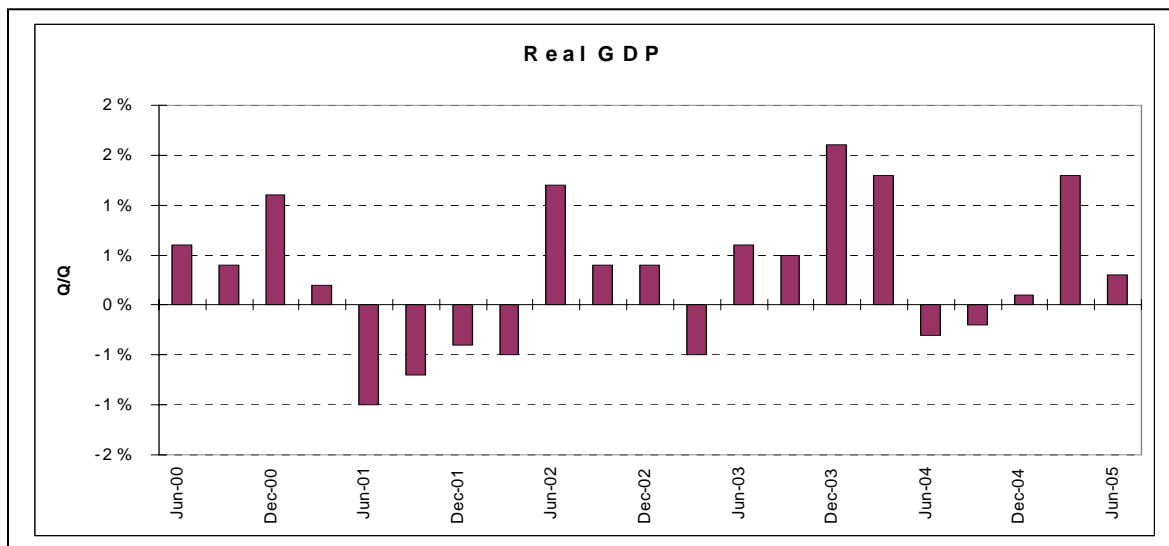
**Real GDP** – increased 0.3% Q/Q in Q2 2005. (page 17)

**Current Account Balance** – increased from ¥1.44 tln to ¥1.50 tln in June. (page 19)

**Industrial Production** – increased 1.6% M/M and 0.2% Y/Y in June. (page 19)

### Weekly Releases & News

#### Chart of the Week: *Gross Domestic Product*

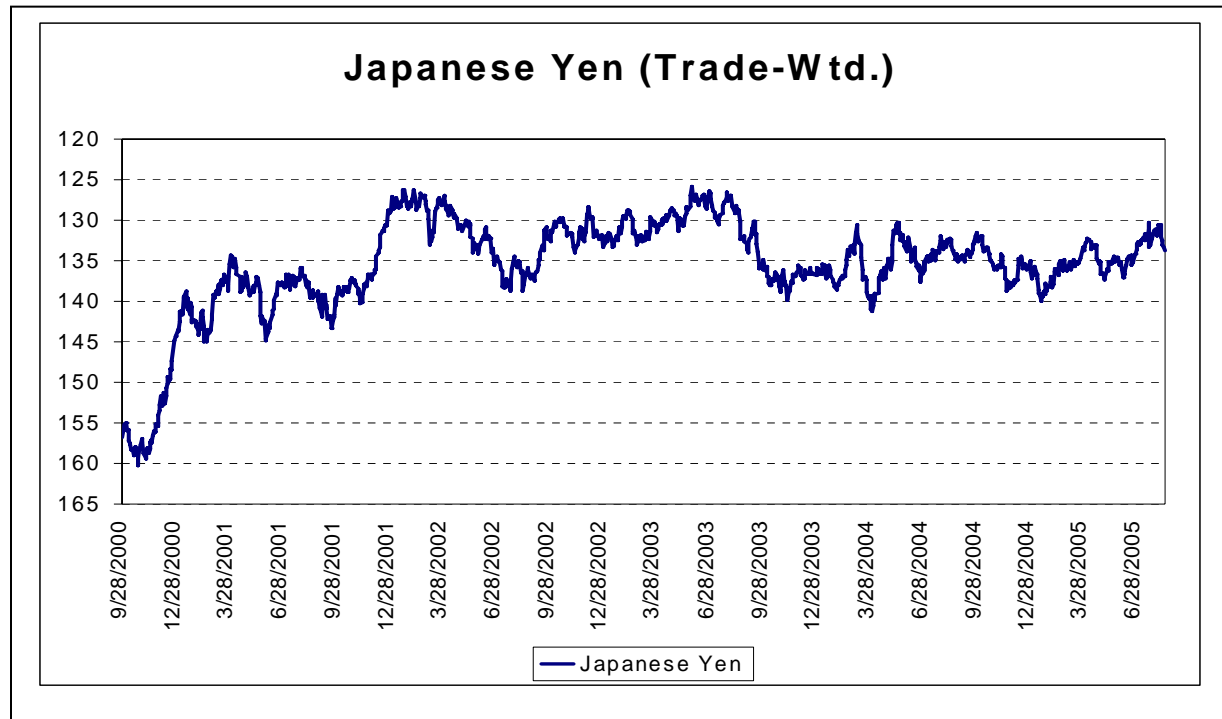


The Japanese economy expanded 0.3% Q/Q in Q2 in real terms. Private consumption increased 0.7% Q/Q, and household spending increased 0.8% Q/Q. This data suggests that the economy is continuing to recover and, although the rate of growth declined from the previous quarter's 1.3% Q/Q increase, domestic demand has remained resilient. As a result, the general picture of the economy continues to become increasingly stronger as inventories have been worked off (subtracted 0.5% from Q2 real GDP growth) and machine orders have been improving better than expected.

# Japan Financial Balances

## Financial Balances

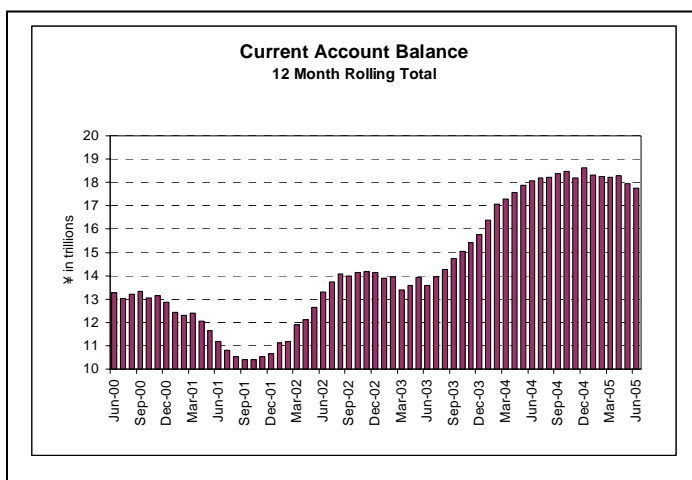
| <i>Japan</i>            | <i>Last period (¥trln)</i> | <i>Last 12mo. as a % of GDP</i> |
|-------------------------|----------------------------|---------------------------------|
| Budget Balance          | -3.03 (May)                | -6.9%                           |
| Trade Balance           | 0.69 (June)                | 2.2%                            |
| Current Account Balance | 1.50 (June)                | 5.2%                            |
| Private Balance         |                            | 12.1%                           |



# Current Account, Industrial Production, Capacity Utilization

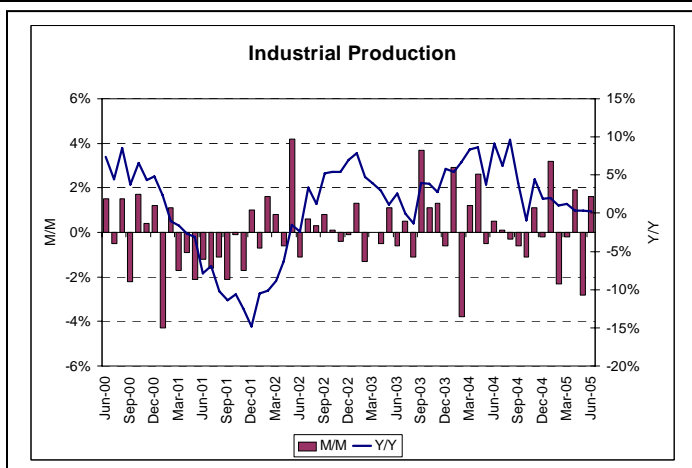
## Current Account Balance

*On an adjusted basis, the Current Account Balance increased from ¥1.44 tln to ¥1.50 tln in June. Exports increased 3.9% M/M, the largest increase in over a year, and imports increased 1.9% M/M.*



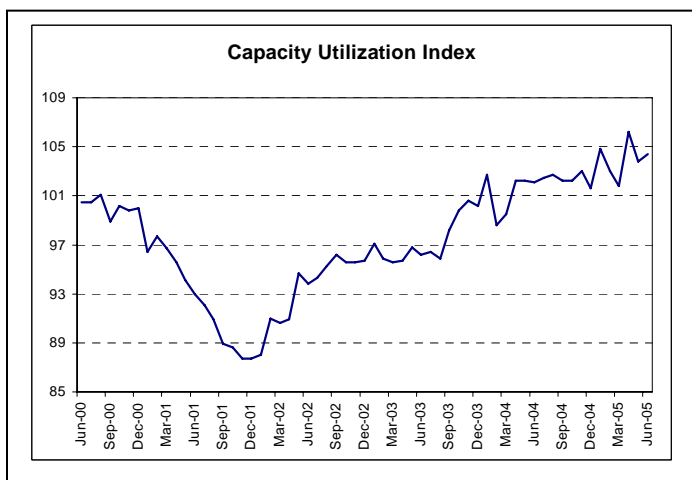
## Industrial Production

*Industrial Production increased 1.6% M/M and 0.2% Y/Y in June. The METI did not change its assessment that the trend for production is flat for the he next 2 months.*



## Capacity Utilization

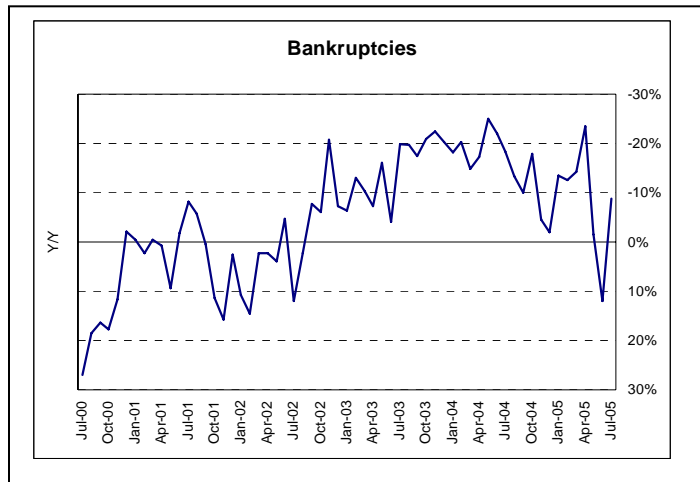
*Capacity Utilization increased from 103.8 to 104.4 in June.*



# Bankruptcies, Tokyo Condominium Sales & Tokyo Dept. Store Sales

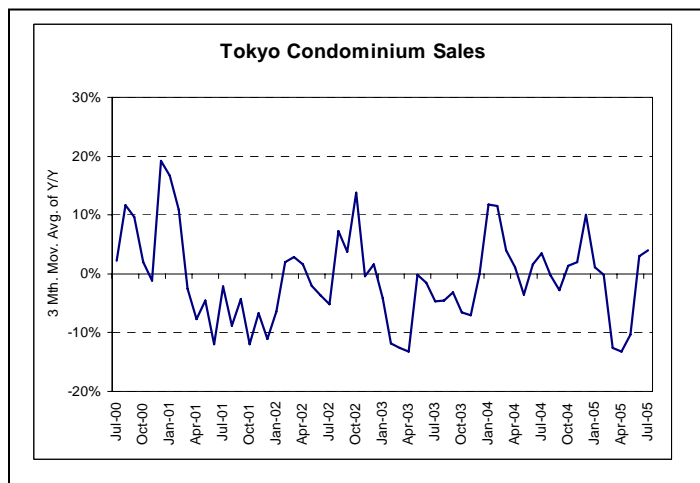
## Bankruptcies

*Bankruptcies declined 0.8% Y/Y in July.*



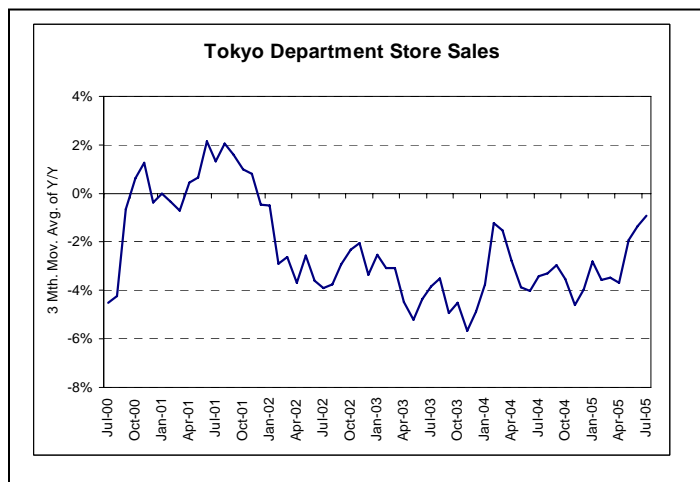
## Tokyo Condominium Sales

*Tokyo Condominium Sales declined 4.4% Y/Y in July but remain on an upward general trend.*



## Tokyo Dept. Store Sales

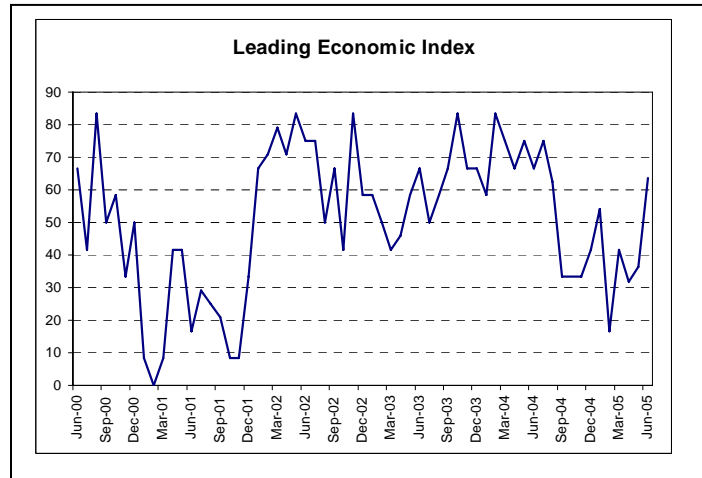
*Tokyo Department Store Sales increased 1.2% Y/Y in July. The increase was supported by both clearance promotions and an extra weekend shopping day and was the largest Y/Y increase since November 2001.*



# Leading Economic Index & Coincident Index

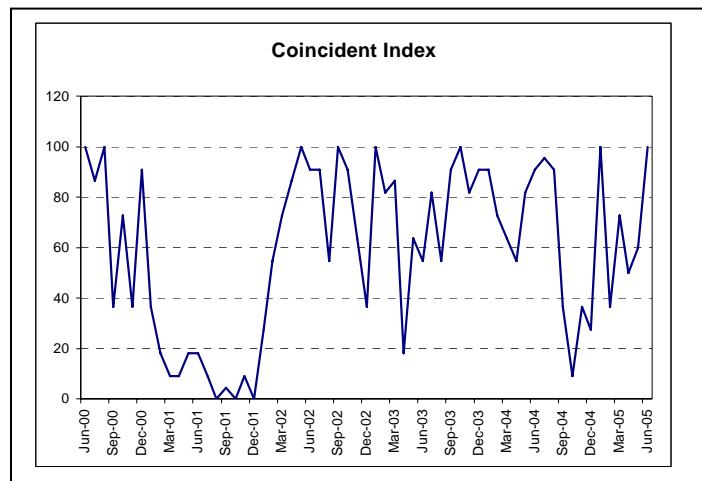
## Leading Economic Index

*Japan's Leading Economic Index increased from 36.4 in May to 63.6pts in June, the highest level since July 2004.*



## Coincident Index

*The Coincident Index increased from 60.0 to 100.0 in June.*



### ***Political Update***

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Japanese LDP Lawmakers that opposed the postal privatization bill formed a new political party to contest national elections against the LDP next month. The name of the party, “Kokumin Shinto,” translates to mean “Peoples’ New Party” and is intended to help dissenting lawmakers rally opposition against Koizumi.

Looking towards the elections, Koizumi’s job-approval level has risen from 46% on August 9<sup>th</sup> to 51% on August 16<sup>th</sup> according to the latest Asahi Survey,. The result, in addition to other polls, suggest that Koizumi has the people’s support on the postal privatization bill and may remain in power following the September 11<sup>th</sup> lower house elections.

Meanwhile, DPJ leaders stated that they intend on cutting government spending and bond sales in three years without raising taxes, should they win the national elections in September.

### ***Banks Raise GDP Expectations***

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Most major banks increased their expectations for growth for Japan this year as domestic demand has increased ahead of expectations. According to the median forecast of 14 economists compiled by Bloomberg News, real GDP will probably expand 2% in the year ending March 31, 2006. This estimate is above the 1.5% predicted in the July survey.

### ***BoJ Minutes: Policy Makers Proposed Cutting Reserve Target***

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According to the minutes released from the BoJ meetings on July 12-13, policy makers Toshikatsu Fukuma and Atsushi Mizuno repeated proposed reducing the reserve target. The action was not taken as other members felt that current conditions should have been maintained. Another member expressed concerns that the act would be seen as a “tightening of monetary policy.”

Also in the minutes, members commented that core consumer prices may begin to rise either at the end of this year or early in 2006 as the impact from utility rate cuts fades.



## *Key Dates This Week*

| <i>Date</i> | <i>Indicator</i>                     | <i>Expectation</i> | <i>Previous</i> |
|-------------|--------------------------------------|--------------------|-----------------|
| 08/18-31    | Consumer Confidence (Jul)            | 48.2               | 46.8            |
| 08/18-31    | Consumer Confidence Households (Jul) | 48.5               | 46.6            |
| 08/22       | Machine Tool Orders (Jul)            | N/A                | 7.9%            |
| 08/22       | Convenience Store Sales (Jul)        | N/A                | -1.3%           |
| 08/22       | Tertiary Industry Index (Jun)        | 1.0%               | -1.5%           |
| 08/22       | All Industry Activity Index (Jun)    | 0.8%               | -1.4%           |
| 08/23       | Corp Service Price (Jul)             | N/A                | -0.4%           |

## Valance Economic Report: United Kingdom

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August 17, 2005

The MPC's Minutes were released today which surprisingly showed that members voted 5-4 to cut rates at its last meeting, a much closer outcome than the markets expected. For the members who voted to cut, there was "no presumption for the future direction of rates", signaling a possibility that the next rate move may be up.

### Weekly Highlights

**CPI-** rose 0.1% M/M and 2.3% Y/Y in July, jumping above the Bank of England's year-end CPI forecast. (page 24)

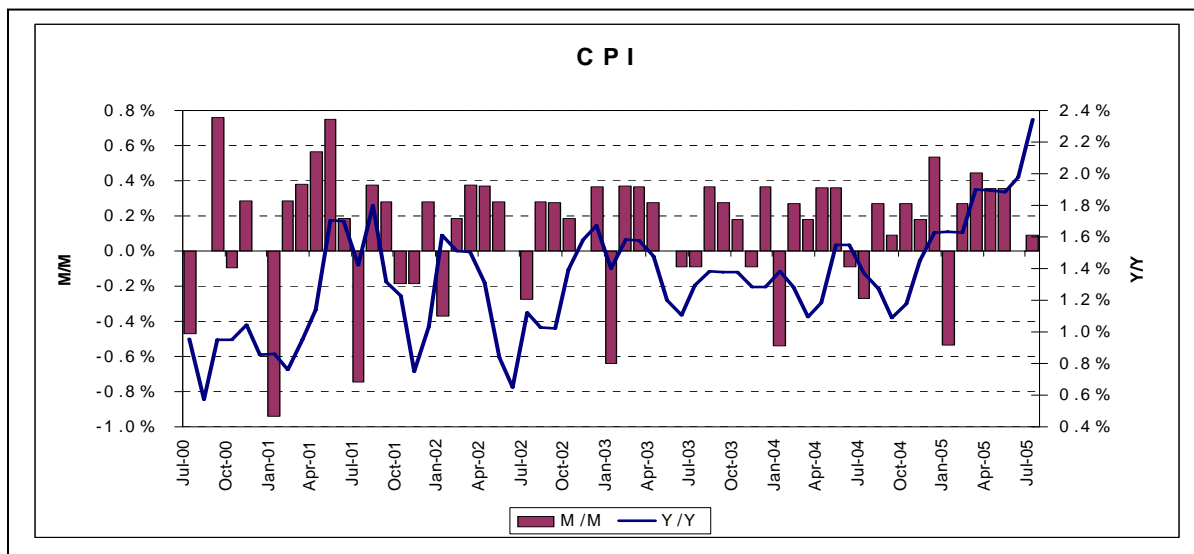
**MPC's Minutes-** members surprisingly voted 5-4 to cut rates at its last meeting. (page 26)

**RICS Reported House Prices-** increased from -41 to -36 in July. (page 27)

**Average Earnings-** increased 4.0% 3M/3M and 4.0% Y/Y in June.(page 28)

### Weekly Releases & News

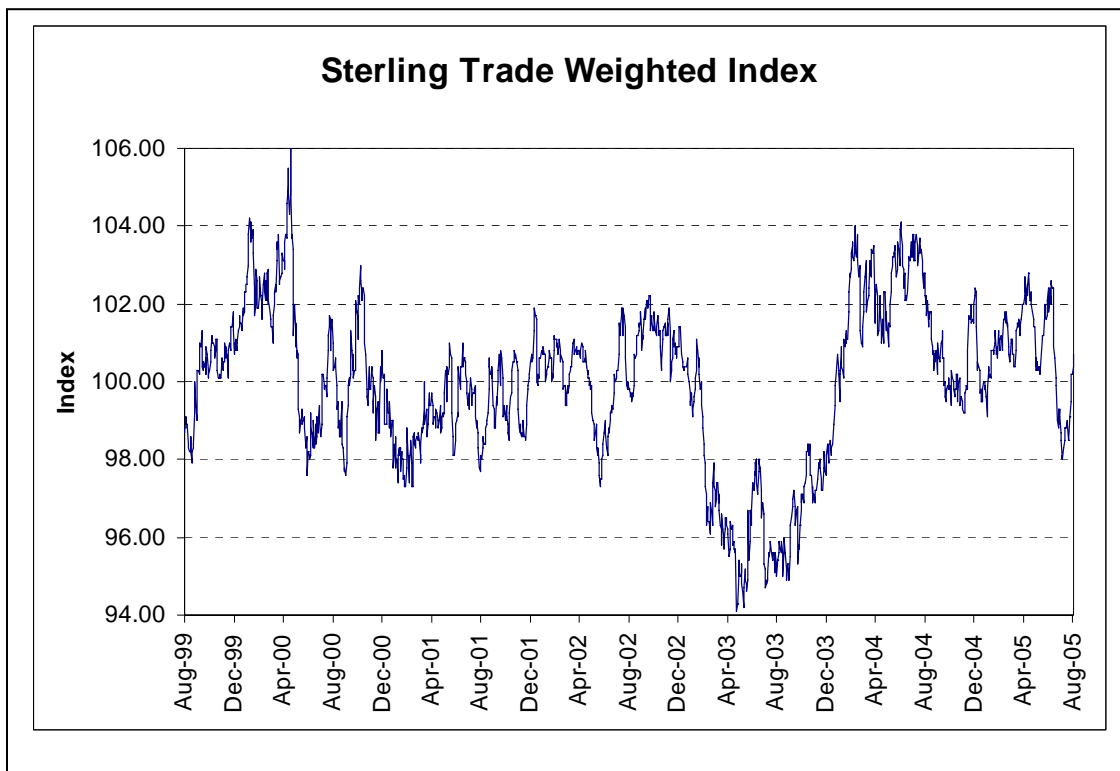
#### Chart of the Week: CPI



CPI rose 0.1% M/M and 2.3% Y/Y in July, jumping above the Bank of England's year-end CPI forecast of 2.2% Y/Y. The recent increase in the price of oil has only now trickled through to consumer prices. The largest upward effect came from transport which increased 2.5% M/M and 4.6% Y/Y, mainly due to fuels and lubricants and air services. Air services increased in part due to oil and also because it has a higher weight in this year's index versus last year.

## ***Financial Balances***

|                                    | <i>Last Period (billions)</i> | <i>Last 12m % of GDP</i> |
|------------------------------------|-------------------------------|--------------------------|
| Budget Balance<br>(monthly)        | -£5.9 (June)                  | -2.0%                    |
| Trade Balance<br>(monthly)         | -£3.4 (May)                   | -1.2%                    |
| Curr. Acct. Balance<br>(quarterly) | -£5.8 (March)                 | -2.0%                    |
| Private Balance                    |                               | -0.04%                   |



## ***MPC Minutes***

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### ***MPC Minutes***

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The MPC released their minutes from the August 3-4 meeting and surprisingly showed that members voted 5-4 for a rate cut. Expectations had been for either an 8-1 or 7-2 vote. This split vote shows the division among members as to how to respond to a combination of slowing growth and accelerating inflation due in large part to oil prices increasing to over \$60 a barrel. In a repeat of last months Minutes, the four members that had previously been full time economists again voted for a rate cut (Barker, Bean, Nickell, and Walton). The swing vote came from Lambert who had previously been a Financial Times editor.

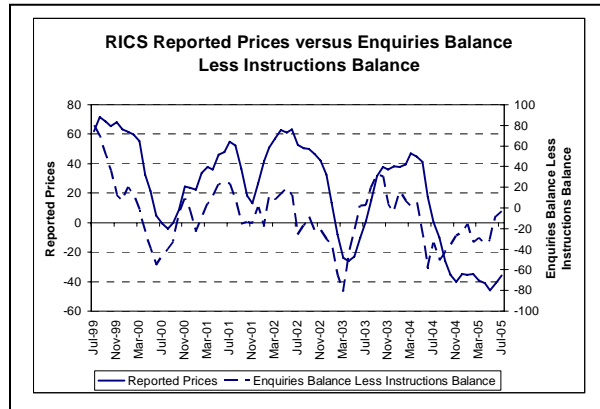
Those members who voted for a rate cut felt that although there had been signs of a pickup in consumer spending in Q2, downside risks remained in the near term, given the loosening in the labor market and uncertainty about the underlying strength of consumer spending in the first half of the year. In addition, higher oil prices might raise inflation further in the short term, but the slackening in the pressure of demand on supply capacity in the first half of the year should lead to some moderation in inflation going forward. Lastly, these members felt they needed to “validate” the expectations of a rate cut built into the market.

The other members who voted to leave rates on hold, including Governor King, felt that while growth in aggregate output had slowed, and the labor market had eased a little, the economy was still operating close to full capacity. Looking ahead, the members think activity is likely to be supported by fiscal policy and the continuing strength of the world economy. The members also thought that the housing market appeared to be stable and activity levels even showed an increase. Members felt future oil prices were likely to remain strong and with unit labor costs accelerating since the beginning of the year, it is too early to say that inflationary pressures had abated. Thus, a rate cut would risk adding inflationary pressures to the economy while costs were still working their way through the supply chain.

# RICS House Price Survey

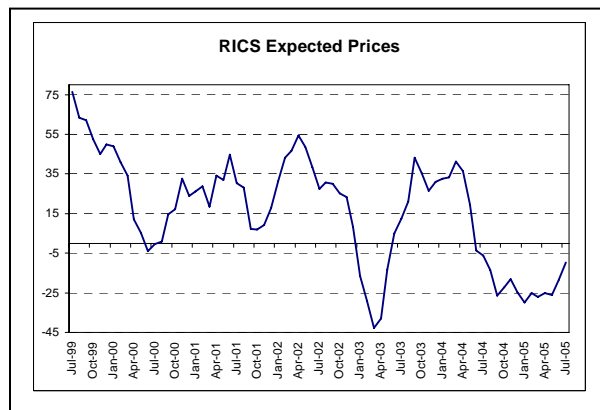
## RICS Reported Prices

*RICS Reported House Prices increased from -41 to -36 in July, continuing the fall of the last twelve months, though the pace of decline eased back for a second consecutive month. The recent interest rate cut may motivate buyers and provide some stimulus to the sluggish housing market. House prices decreased in all regions except the North West where prices increased for the first time in almost a year.*



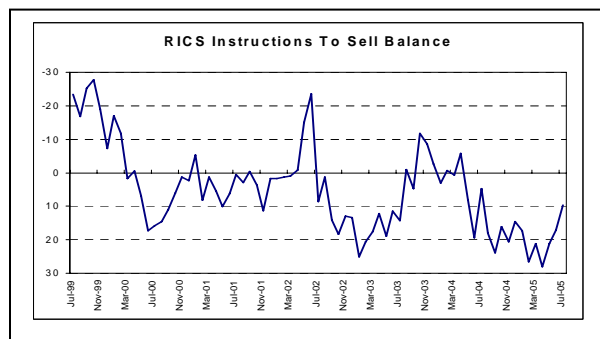
## RICS Expected Prices

*RICS Expected Prices jumped from -18 to -10 in July as agents were the least pessimistic in over a year for home prices. Agents feel that the relatively high level of properties on the market will continue to make it harder for sellers to increase their prices. Agents expect house prices to rise slightly in London and the North West, while all other regions are expected to remain in moderate decline or see stabilization.*



## RICS Instructions to Sell

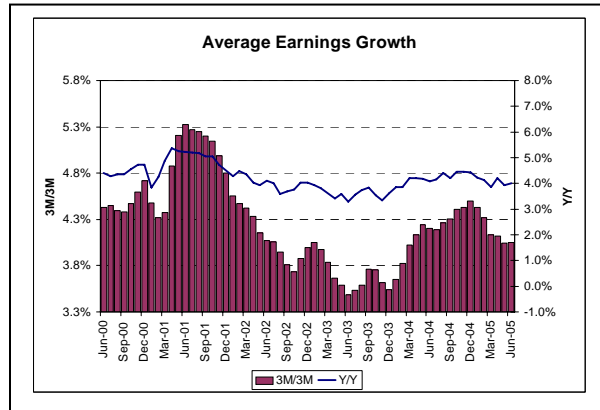
*RICS Instructions to Sell decreased from +17 to +10 in July, the slowest pace in over a year. There was a significant decrease in new instructions in London, though all other regions have had an increase in new instructions, but at a lower rate than in June.*



# Labor Growth

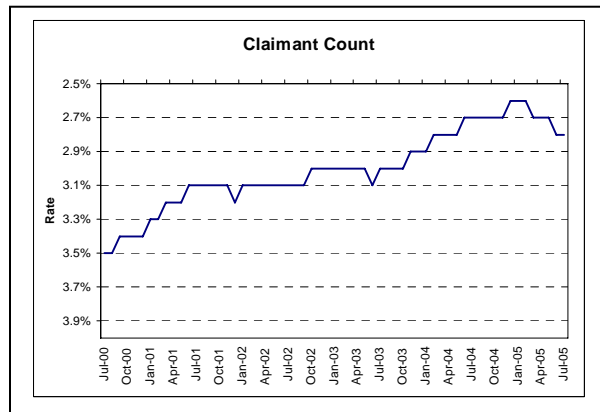
## Average Earnings

*Average Earnings (ex bonus) growth was little changed from 4.0% 3M/3M and 3.9% Y/Y in May to 4.0% 3M/3M and 4.0% Y/Y in June. Private sector wages increased 3.8% 3M/3M and 3.8% Y/Y while the public sector increased 4.8% 3M/3M and 4.5% Y/Y.*



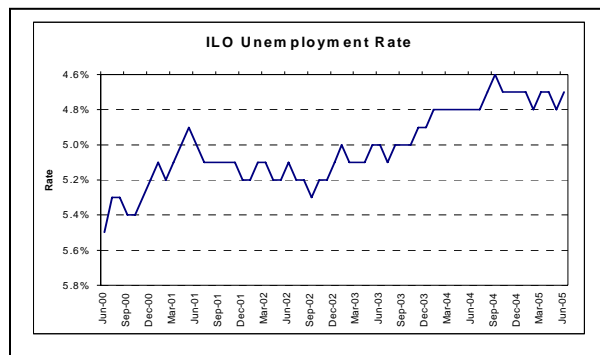
## Claimant Count Unemployment

*The Claimant Count Unemployment Rate remained at 2.8% for a second consecutive month in July, with the number of unemployed increasing by 2,800 people. Businesses have started to lay-off workers as surging oil prices have reduced companies' profits. The number of unemployed people in Q2 grew by 27,000.*



## ILO Unemployment

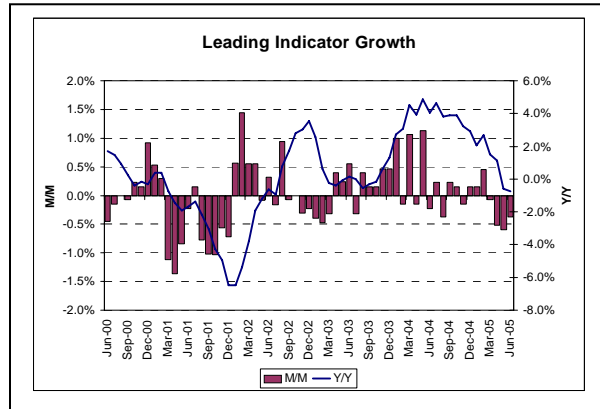
*The ILO Unemployment Rate decreased from 4.8% to 4.7% in June.*



# Leading & Coincident Indicator

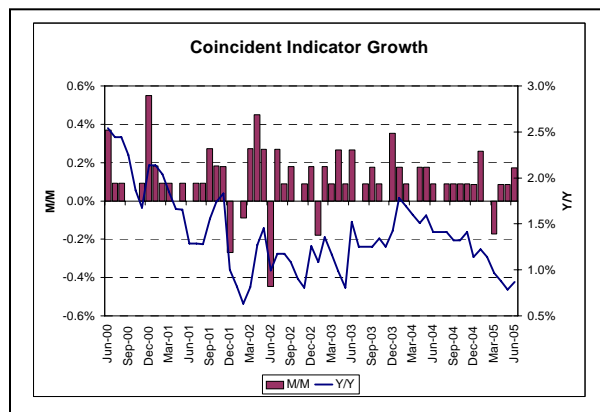
## Leading Indicator

The Leading Indicator decreased 0.4% M/M and 0.7% Y/Y in June.



## Coincident Indicator

The Coincident Indicator increased 0.2% M/M and 0.9% Y/Y in June.





## *Data, Comments & Key Dates*

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### *Data*

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#### **FT House Prices**

The Financial Times House Price survey increased 0.3% M/M and 5.0% Y/Y in July.

#### **Rightmove House Prices**

Rightmove House Prices decreased 1.0% M/M and increased 0.2% Y/Y in August. Rightmove reports that sellers continue to reduce prices to undercut competition as the stock of unsold homes continues to increase. Rightmove feels that the market will not collapse but that properties will remain on the market for a longer period.

### *Key Dates This Week*

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| <i>Date</i> | <i>Indicator</i>             | <i>Expectation</i>    | <i>Previous</i>      |
|-------------|------------------------------|-----------------------|----------------------|
| 08/18       | Retail Sales                 | -0.6% M/M<br>2.0% Y/Y | 1.3% M/M<br>1.6% Y/Y |
| 08/18       | Public Sector Net Borrowing  | -1.5B                 | 5.9B                 |
| 08/24       | CBI Industrial Trends Survey | --                    | --                   |

# Valance Economic Report: Canada

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August 17, 2005

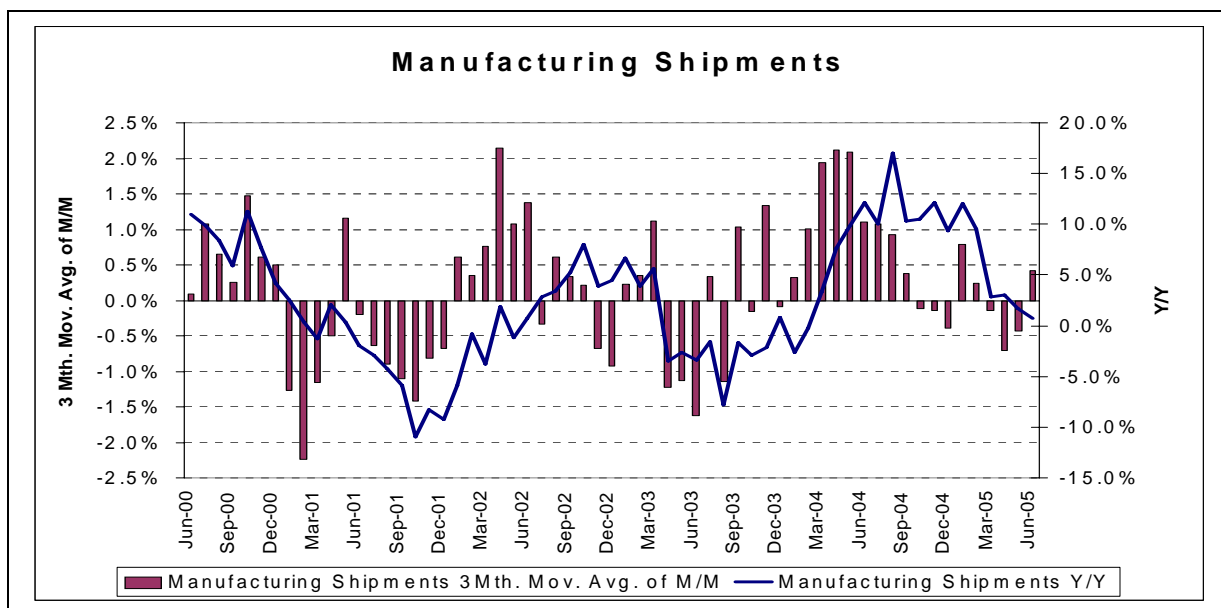
Economic data from Canada has remained firm as Manufacturing Shipments picked up, the Trade Balance widened and Motor Vehicle Sales posted an upside surprise. The economic environment continues to support room for interest rate hikes in the “near term” which could start as early as September 7<sup>th</sup>.

## Weekly Highlights

**Manufacturing activity** - picked up in June as shipments increased 0.5% M/M. (page 31)  
**Canada's Trade Surplus** -widened from \$4.4 billion in May to \$5.0 billion in June. (page 32)  
**New Motor Vehicle sales** - posted an upside surprise in June, increasing 7.4% M/M. (page 33)

## Weekly Releases & News

### Chart of the Week: *Manufacturing Shipments*

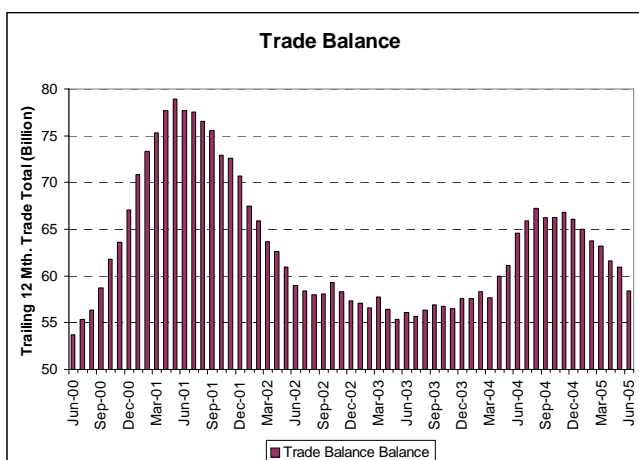


Manufacturing activity picked up in June as shipments increased 0.5% M/M following a decrease of 0.1% M/M in May. Shipments also increased 0.7% Y/Y in June. Excluding vehicles and parts, shipments were up 0.7% M/M. In addition, unfilled orders rose 0.7% M/M, inventories increased 0.3% M/M and new orders increased 0.4% M/M. Overall, this data is in line with the BoC's view that the manufacturing sector is continuing to adjust to prior C\$ strength.

# Trade Balance, Exports & Imports

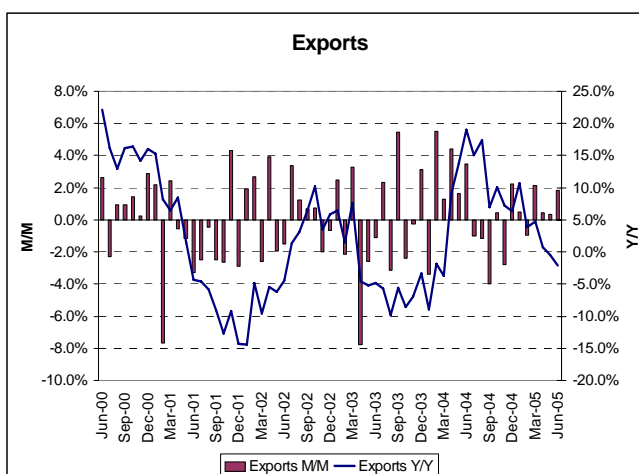
## Trade Balance

Canada's Trade Surplus widened from \$4.4 billion in May to \$5.0 billion in June as exports to all trading partners, excluding the U.S., reached an all time high.



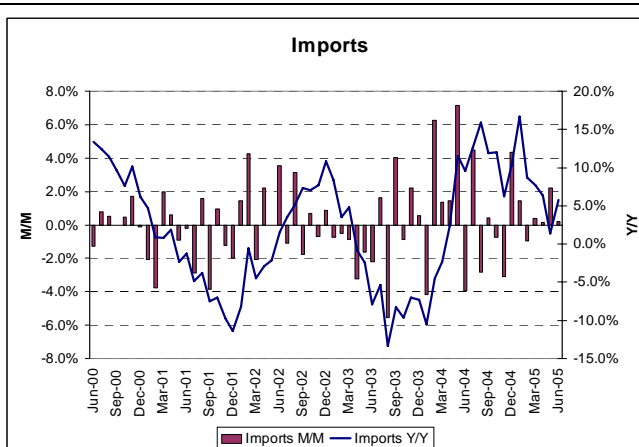
## Exports

Exports increased from 0.4% M/M to 1.8% M/M in June. Increased coal exports to several European Union countries, other OECD countries and Japan were a key contributor to total exports. Exports increased in all major categories except "other consumer goods".



## Imports

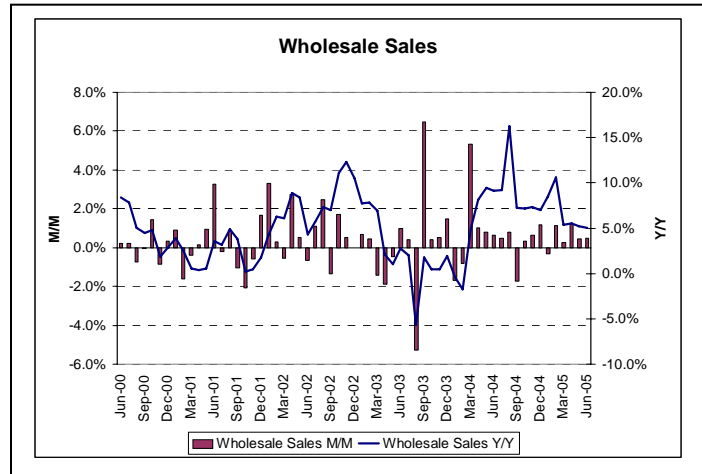
Imports increased 0.2% M/M in June following an increase of 2.2% M/M in May. On a Y/Y basis imports increased from 1.4% in May to 5.8% in June. June's increase was mainly attributed to increased imports of aircraft engines and parts, and automotive products.



# Wholesale Sales and New Motor Vehicle Sales

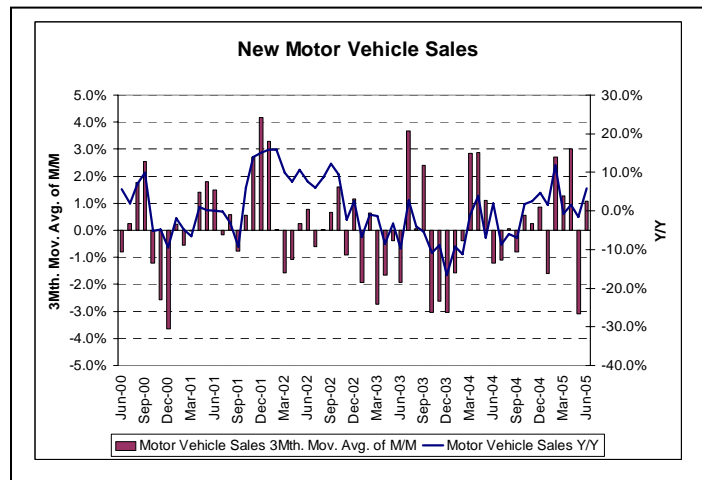
## Wholesale Sales

Wholesale Sales increased 0.5% M/M and 5.0% Y/Y in June, posting its fifth consecutive M/M increase. Five out of the seven wholesale sectors posted positive results. Growth was mainly attributed to the increase in demand for machinery and electronic equipment (+3.4%) and for personal and household goods (+2.8%).



## New Motor Vehicle Sales

New Motor Vehicle Sales posted an upside surprise in June, increasing 7.4% M/M versus expectations for a decrease of 6.9%. June's improvement in sales is partly attributed to additional financial incentives offered by certain car makers.



## *Key Dates This Week*

| <i>Date</i> | <i>Indicator</i>                    | <i>Expectation</i> | <i>Previous</i> |
|-------------|-------------------------------------|--------------------|-----------------|
| 08/18       | Int'l Securities Transactions (JUN) | C\$2.1             | C\$1.7          |
| 08/22       | Retail Sales (M/M) (JUN)            | 1.0%               | -1.3%           |
| 08/22       | Retail Sales Less Autos (M/M) (JUN) | 0.4%               | -0.4%           |
| 08/23       | Leading Indicators (M/M) (JUL)      | 0.3%               | 0.3%            |

## Valance Economic Report: Australia

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August 17, 2005

This week's employment data was surprising as Australian employers unexpectedly added 12,700 workers in July. The RBA stated this week that economic growth has slowed and inflation pressures have eased, signaling that another rate hike is unlikely this year. The Wage Cost Index rose sharply again in Q2, matching the Q1 increase.

### Weekly Highlights

**Employment** – 12.7k jobs added; unemployment rate remained at 5% in July. (Page 35)

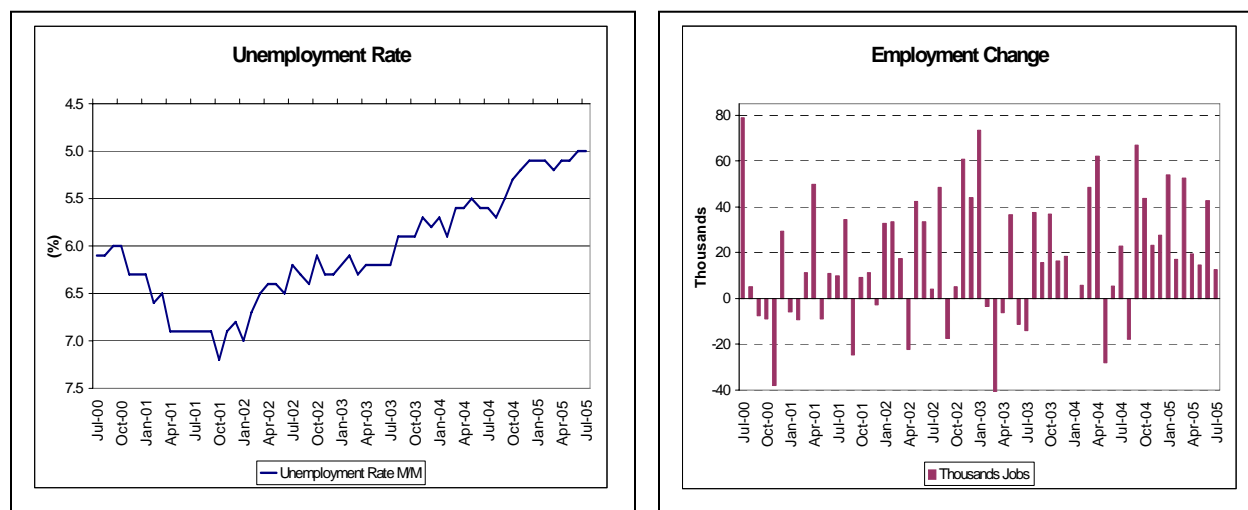
**RBA's Semi-Annual Testimony** – the Central Bank has shifted to a neutral bias. (Page 36)

**Wage Price Index** – increased 1.1% Q/Q and 4% Y/Y in Q2. (Page 36)

**Westpac Leading Economic Index** – rose 1.1% M/M and 2.9% Y/Y in June. (Page 36)

### Weekly Releases & News

#### Charts of the Week: *Employment*



Employment rose 12,700 last month as full-time jobs fell 14,500 in July and part-time jobs gained 27,200. The jobless rate remained at a 29-year-low of 5%. July's employment increase marks the 11th consecutive month of gains. An additional 374,100 jobs have been created since September 2004.

## ***RBA's Semi-Annual Testimony, Wage Price Index & Westpac's June Leading Economic Index***

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### ***RBA's Macfarlane Semi-Annual Testimony to Parliament***

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Australia's Central Bank Governor, Ian Macfarlane commented that he does not expect to change interest rates soon because consumer spending and borrowing have cooled and inflation is in check. Macfarlane's comments underpin expectations that the RBA will keep the overnight cash rate at 5.5% for the rest of the year. He also mentioned that current developments do not mean that further rises could not happen. It only means that in RBA's present estimation there is no longer a more than 50% possibility of it happening. This is a pretty comfortable position in which to be, he said.

Providing that the RBA keeps inflation low, between 2% and 3% (at the moment is well within that band), the RBA can continue to keep interest rates low, but the trick is to keep inflation low, according to Macfarlane.

### ***Wage Price Index***

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The Wage Price Index, which measures hourly rates of pay, excluding bonuses, rose 1.1% in Q2, which matched the Q1 increase. With unemployment at a 29-year low, there are skill shortages in the economy and companies are increasing pay rates to secure workers. Rising wages should spur consumer spending and the economy.

### ***Westpac's June Leading Economic Index***

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The Leading Index, a gauge of growth for the next six to nine months, rose 1.1% in June from May. The Y/Y growth rate of the index was 2.9%, less than its long-term trend of 3.8%.



## *Key Dates This Week*

| <i>Date</i> | <i>Indicator</i>          | <i>Expectation</i> | <i>Previous</i> |
|-------------|---------------------------|--------------------|-----------------|
| 8/17        | Average weekly wages (2Q) | --                 | --              |
| 8/21        | New Auto Sales (JUL)      | --                 | --              |

## Valance Economic Report: New Zealand

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August 17, 2005

This week's strong data suggests that the RBNZ may not cut rates any time soon as some have speculated. On the contrary, falling unemployment, rising wages and strong retail sales turned the odds towards another rate hike.

### Weekly Highlights

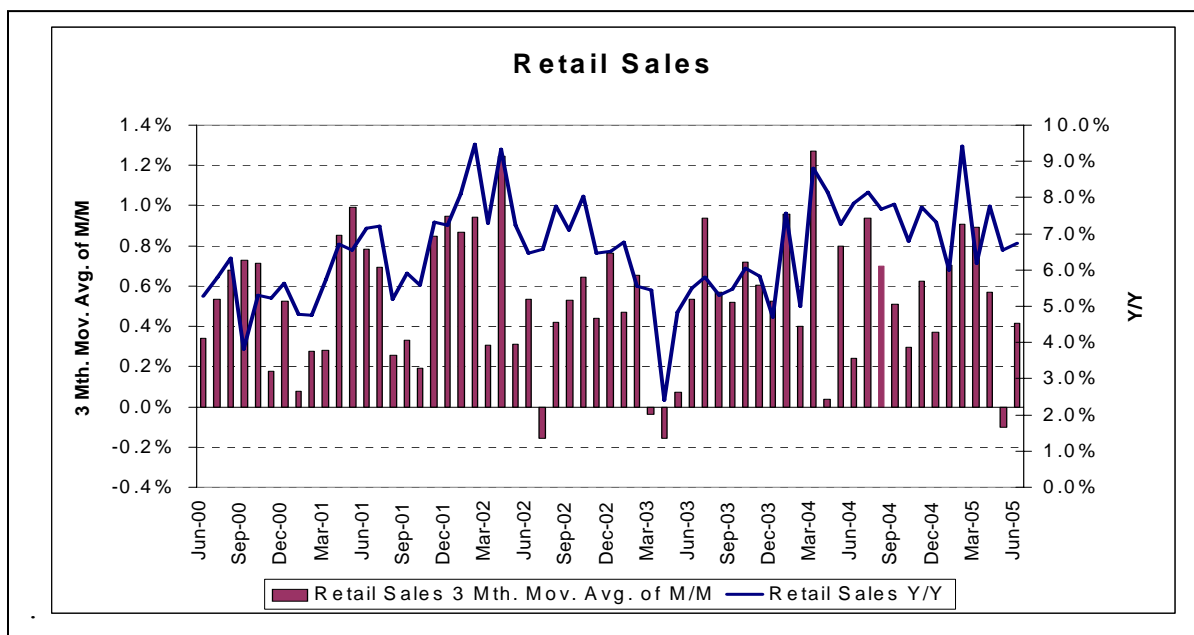
**Retail Sales** – rose, seasonally adjusted, 1.2% M/M and 6.7% Y/Y in June. (Page 38)

**Employment** – 11k jobs were added; the unemployment rate fell to 3.7% in 2Q. (Page 39)

**Manufacturing Index** – contracted to 48.2 in July from 52.2 in June. (Page 39)

### Weekly Releases & News

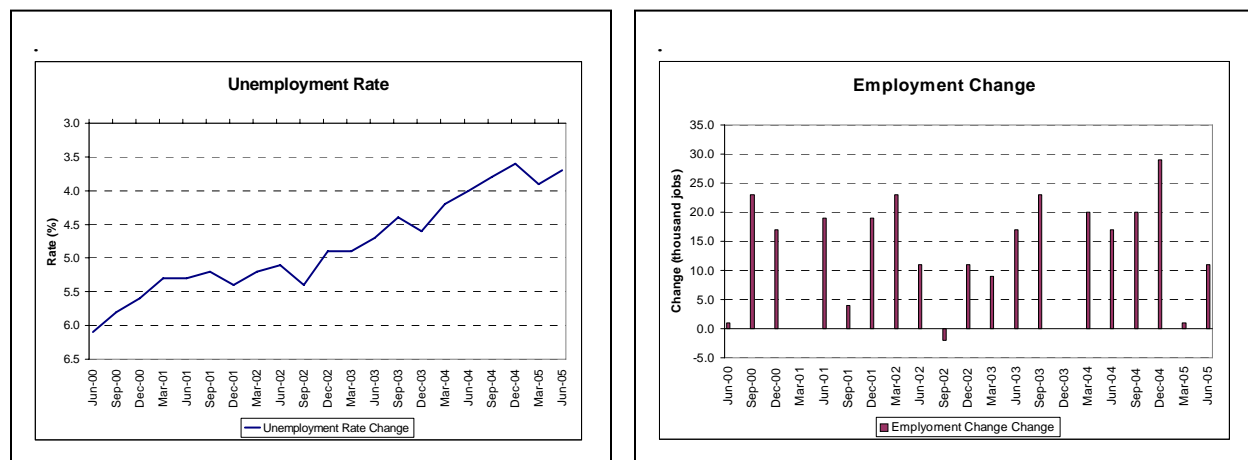
#### Chart of the Week: *Retail Sales*



New Zealand Retail Sales rose 1.2% for the second month in three in June, buoyed by a surge of overseas visitors supporting the touring British & Irish Lions' rugby team. This Retail Sales boost, coupled with rising wages and falling unemployment, have added to the possibility of another interest rates hike in the near future.

# Employment, Manufacturing Index & Upcoming Dates

## Employment



Businesses added 11,000 jobs in 2Q and the unemployment rate fell to 3.7% from 3.9% in Q1. New Zealand's jobless rate is the second-lowest on record after the 3.6% rate in the Q4 of last year and is the lowest of 27 economies in the Organization for Economic Cooperation and Development. This has been the 4<sup>th</sup> consecutive quarter with unemployment below 4%, which strongly suggests that the Central Bank may not cut rates any time soon.

## Manufacturing Index

New Zealand's manufacturing contracted for the third month in four in July. The index fell to 48.2 from 52.2 in June. A reading below 50 indicates a contraction. The declines are attributed to a typical seasonal slowdown in manufacturing.

## Key Dates This Week

| Date  | Indicator                             | Expectation | Previous       |
|-------|---------------------------------------|-------------|----------------|
| 08/18 | Visitor Arrivals (July)               | --          | 14.4%          |
| 08/22 | Producer Prices – Inputs/Outputs (2Q) | --          | 0.3%/0.5%      |
| 08/24 | Trade Balance (July)                  | --          | -522.0 million |

## Weekly Economic Report: *China*

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August 17, 2005

**Economic releases in China displayed solid growth in July. The Trade Surplus widened and Consumer Price growth unexpectedly edged up. Moreover, M2 money supply exceeded the PBoC's 15% target for this year for the second consecutive month.**

### Weekly Highlights

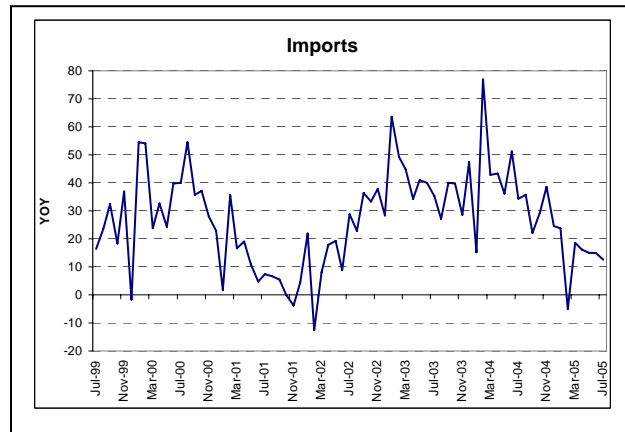
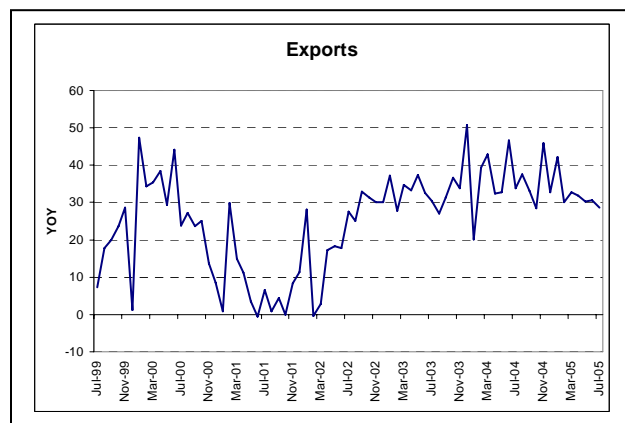
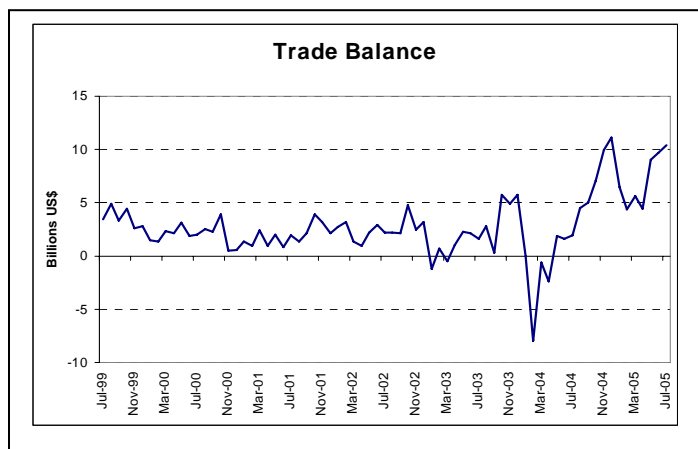
**China's Trade Surplus** – widened above expectations in July. (page 40)

**Consumer Price growth** - edged up from 1.6% Y/Y in June to 1.8% Y/Y in July. (page 41)

**M2 money supply** - exceeded the PBoC's 15% target for the second consecutive month in July.(page 42)

### Weekly Releases & News

#### Chart of the Week: *Trade Surplus, Total Exports & Imports*

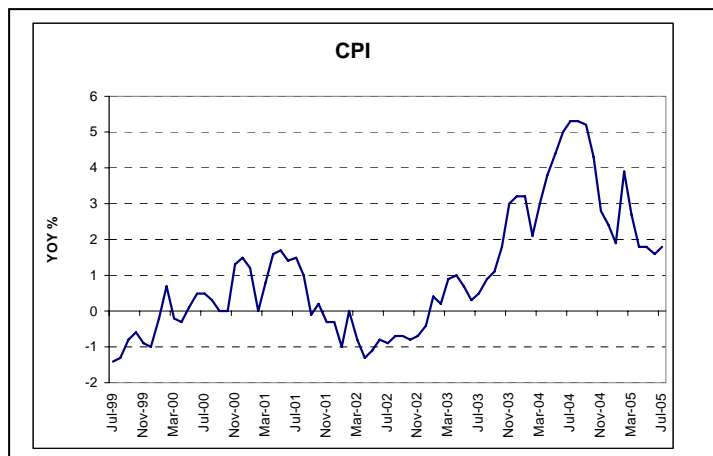


*China's Trade Surplus widened from US\$9.7 bln in June to US\$10.4 bln in July, above expectations. Total Export growth slowed slightly from 30.6% Y/Y in June to 28.7% Y/Y in July. Import growth also slowed, moving from 15.1% Y/Y in June to 12.7% Y/Y in July. Persistent increases in the Trade Surplus indicate that the two percent increase in the value of the Yuan versus the US\$ is likely insufficient to make any significant impact on China's trade balance.*

# CPI, Retail Sales & Wholesale Price Index

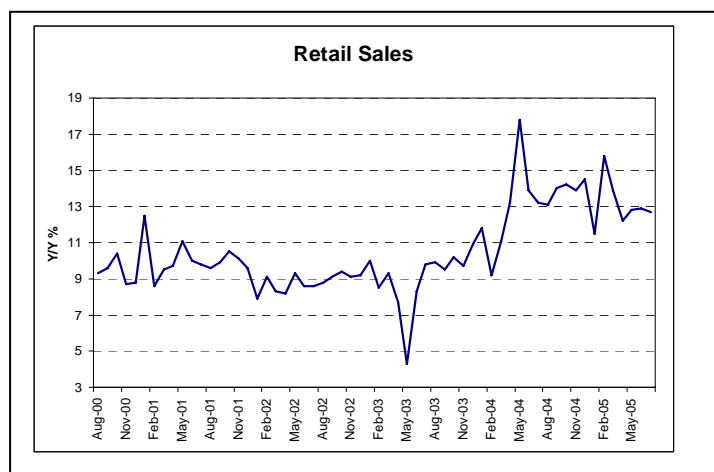
## CPI

Consumer Price growth edged up from 1.6% Y/Y in June to 1.8% Y/Y in July, above market expectations of 1.5% Y/Y. Food inflation ticked up from 2.1% in June to 2.3% in July. Y/Y basis results include: clothing - 1.8%, household appliances unchanged and service costs +3.6%. Meanwhile, the fuel price hikes granted to refiners in July by the government has not yet caused any significant impact on prices.



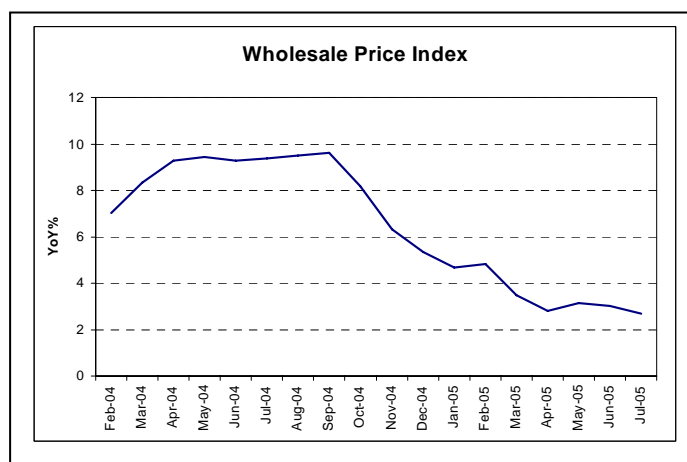
## Retail Sales

Retail Sales growth slowed slightly from 12.9% Y/Y in June to 12.7% Y/Y in July, below market expectations of 13.0% Y/Y.



## Wholesale Price Index

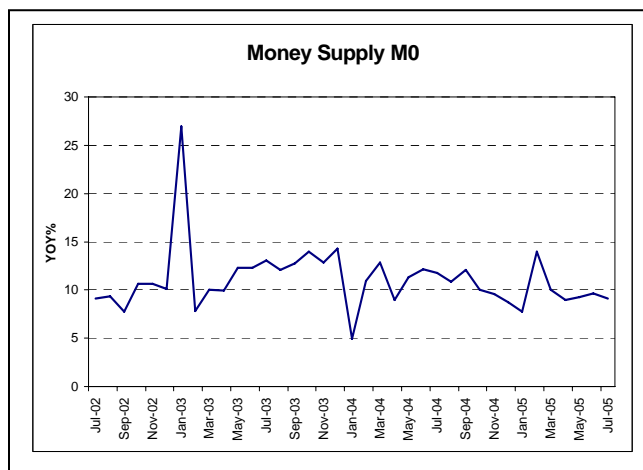
Wholesale price growth slowed from 3.0% Y/Y in June to 2.7% Y/Y in July. Oil and Vegetable prices posted the highest price increases on a M/M basis.



# Money Supply

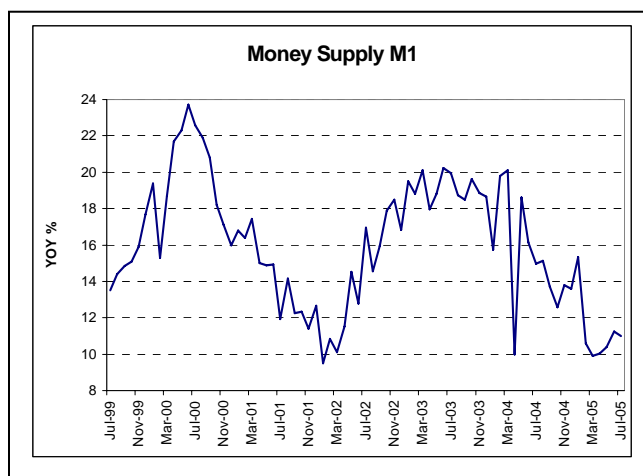
## Money Supply – M0

*Money Supply M0 growth slowed from 9.6% Y/Y in June to 9.1% Y/Y in July.*



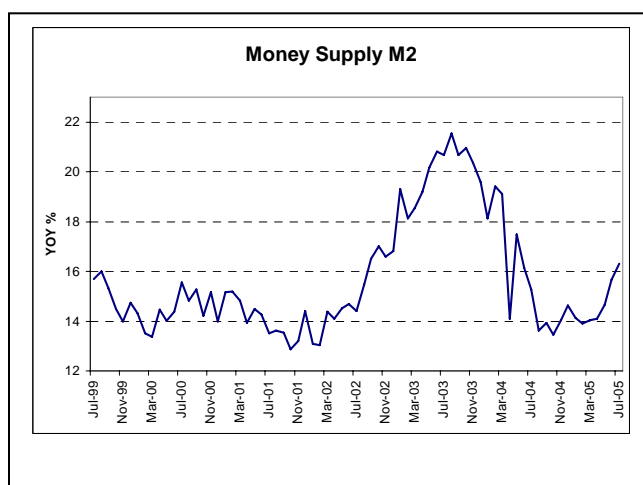
## Money Supply – M1

*Money Supply M1 growth, which includes cash, slowed from 11.3% Y/Y in June to 11.0% Y/Y in July.*



## Money Supply – M2

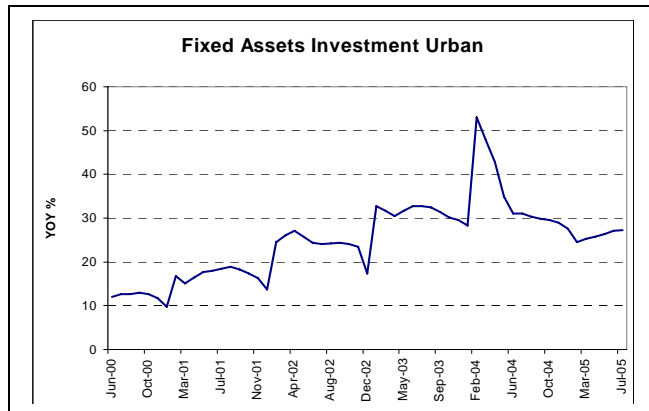
*Money Supply M2, which includes cash and all deposits, increased from 15.7% Y/Y in June to 16.3% Y/Y in July, above market expectations of 16.0% Y/Y. M2 money supply exceeded the PBoC's 15% target for the second consecutive month.*



# Fixed Assets Investment & Foreign Capital

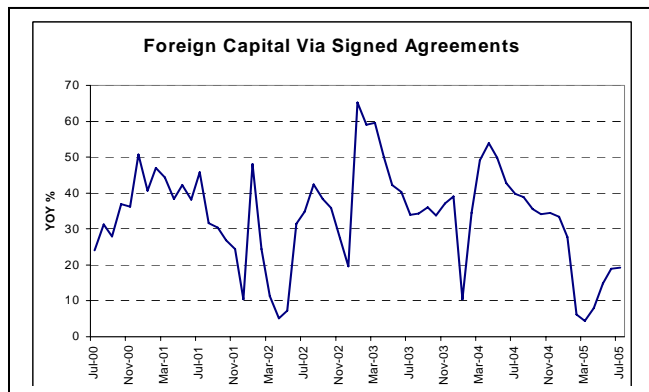
## Fixed Assets Investment

*Fixed Assets Investment increased from 27.1% Y/Y in June to 27.2% Y/Y in July.*



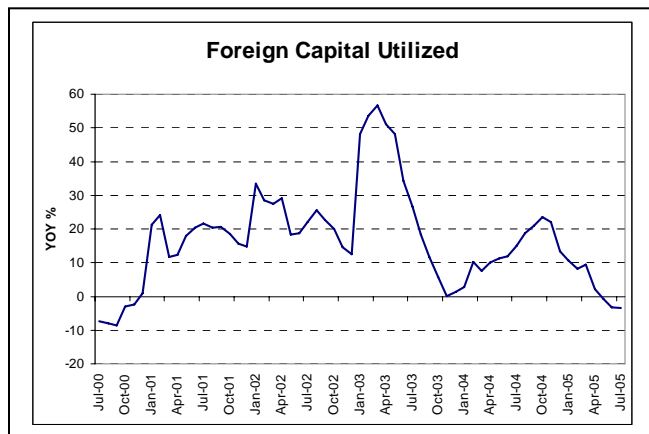
## Foreign Capital Via Signed Agreements

*Foreign Capital Via Signed Agreements growth increased from 19% Y/Y in June to 19.2% Y/Y in July as foreign companies plan to build more factories.*



## Foreign Capital Utilized

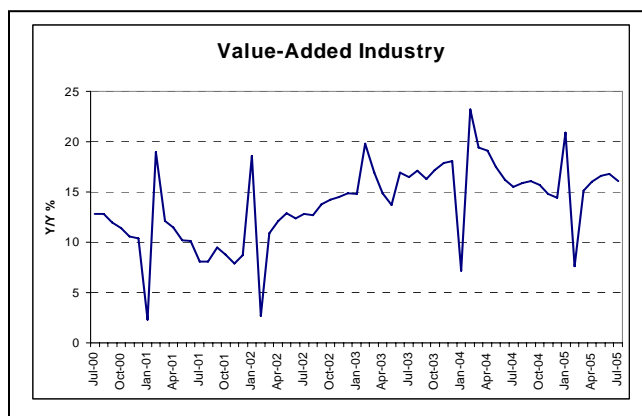
*Foreign Capital Utilized continued its downward trend, decreasing from -3.2% Y/Y in June to -3.4% Y/Y in July.*



# Value-Added Industry & News Releases

## Value Added Industry

Value Added Industry growth slowed from 16.8% Y/Y in June to 16.1% Y/Y in July, below expectations of 16.8% Y/Y.



## News Releases

**August 16<sup>th</sup> – U.S. Still Seeking Limits** – The Associated Press reported that the U.S. is still seeking limits on certain Chinese textile exports. These limits will result in an increase in prices of items such as pants, shirts and dresses. A now-expired textile quota has attributed to the substantial influx of Chinese textile imports to the U.S. resulting in a loss of jobs and textile plant closures.

**August 16<sup>th</sup> – Potential Property Bubble** – The Central Bank announced that increased real estate prices could cause a possible property bubble, which if it bursts, can result in considerable losses for banks and a “contraction” of the real estate market. Average real estate prices in China increased 14.4% Y/Y in 2004 and by 12.5% Y/Y in Q1 of 2005.

**August 16<sup>th</sup> – Economic Growth in China** - The World Bank announced that it expects China’s economy to grow 9.0% this year and 8.0% in 2006. The Bank based its predictions on a slowdown of global economic activity and trade.

**August 15<sup>th</sup> – Keep Yuan Moves Within a 2.0% range** - The National Development and Reform Commission stated that China should keep the yuan’s movement to within a 2.0% range to reduce revaluation pressure. Currently, the yuan stands at 8.0971 against the dollar. The Commission added that China should increase interest rates along with the U.S. to prevent manufacturing costs from rising and to curb inflation.

**August 12<sup>th</sup> – Central Bank Yu Comments on Capital Controls** – China’s Central Bank Monetary Policy Committee Member, Yu Yongding, vehemently rejected comments by a U.S. trade official who stated that the feud between China and the U.S. could be quelled if China loosens its capital controls. Yu added that “This position is totally wrong,” citing the weak state of the financial system and further adding that “preconditions” must be met prior to relaxing the capital account.



## *News (cont'd.) & Upcoming Dates*

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### *News Releases (cont'd.)*

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**August 12<sup>th</sup> – Shanghai's Real Estate Prices Fall in July** – The National Development and Reform Commission reported that Shanghai's real estate prices decreased 2.7% in July from June. The Commission added that China's real estate prices, on the other hand, rose 0.4% M.M and 6.4% in July.

### *Key Dates This Week*

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| <i>Date</i> | <i>Indicator</i>          | <i>Expectation</i> | <i>Previous</i> |
|-------------|---------------------------|--------------------|-----------------|
| 08/21-30    | Household Savings – Jul   | --                 | 13.00T          |
| 08/21-30    | Foreign Exchange Reserves | --                 | 711.00B         |

# Valance Economic Report: Sweden

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August 17, 2005

**Softening inflation and stronger than expected Industrial Production were the highlights of this week's report. CPI growth fell from 0.0% M/M and 0.6% Y/Y in June to -0.4% M/M and 0.3% Y/Y in July, while Industrial Production advanced from 0.9% M/M in May to 1.6% in June. M/M growth in Industrial Orders and the Activity Index Level also improved in June. Additionally, the NIER expects Sweden's economic growth to expand above 3.0% in 2006 and 2007.**

## Weekly Highlights

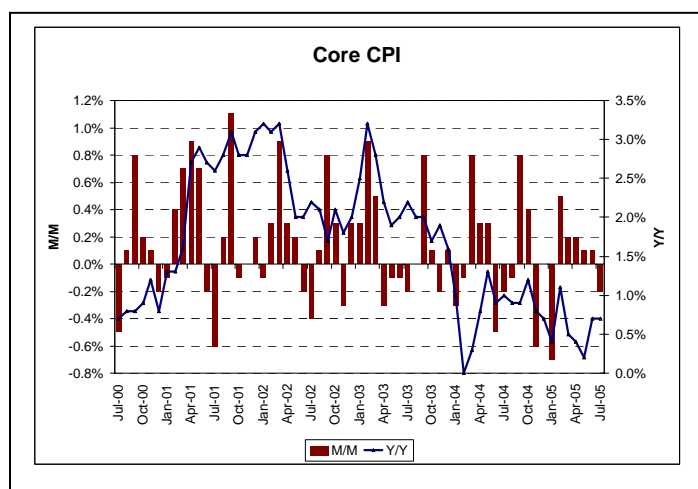
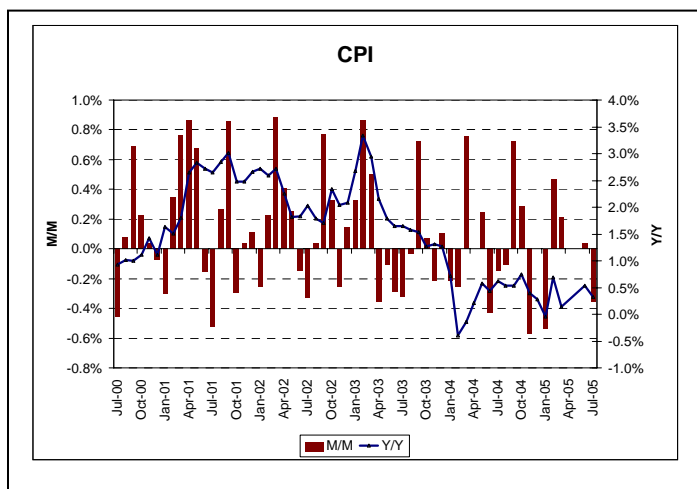
**CPI** – fell from 0.0% M/M and 0.6% Y/Y in June to -0.4% M/M and 0.3% Y/Y in July. (page 46)

**Core CPI** – fell from 0.1% M/M in June to -0.2% M/M in July, while the Y/Y growth remained unchanged at 0.7% from June to July. (page 46)

**Industrial Production** - rose 1.6% M/M and 2.6% Y/Y in June. (page 47)

## Weekly Releases & News

### Charts of the Week: *CPI*

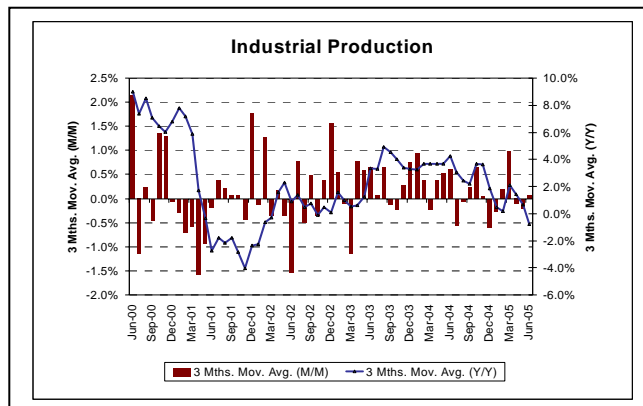


Swedish Consumer Prices eased from 0.0% M/M in June to -0.4% M/M in July. The Y/Y growth also decreased from 0.6% in June to 0.3% in July. The M/M slowdown was partially attributed to falling food and clothing costs. At the same time, underlying inflation fell from 0.1% M/M in June to -0.2% in July, while the Y/Y growth remained unchanged at 0.7%, staying below the Bank's 2.0% target rate since September of 2003.

# Industrial Production, Orders & Activity Index Level

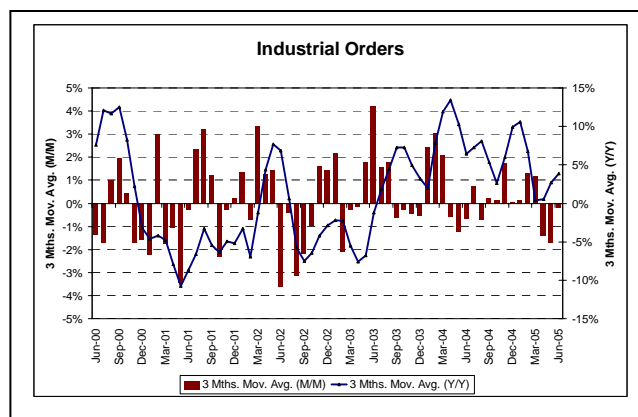
## Industrial Production

Industrial Production rose 1.6% M/M and 2.6% Y/Y in June above expectations of a 0.3% M/M gain and -0.5% Y/Y fall. The M/M rise was led by an increase in non-durable consumer goods.



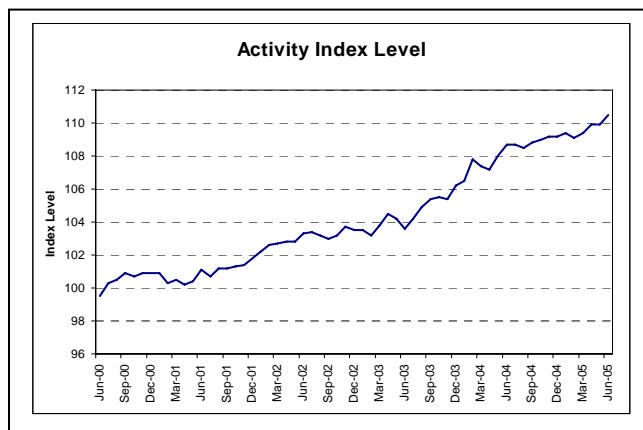
## Industrial Orders

Industrial Orders rose 3.0% M/M and fell 1.8% Y/Y in June. The monthly gain was reflective of a 0.8% increase in domestic market orders and a 4.6% decrease in export market orders. In addition, new orders in the capital goods industry decreased by 0.7% while new orders in the intermediate goods industry increased by 7.3% in the same period.



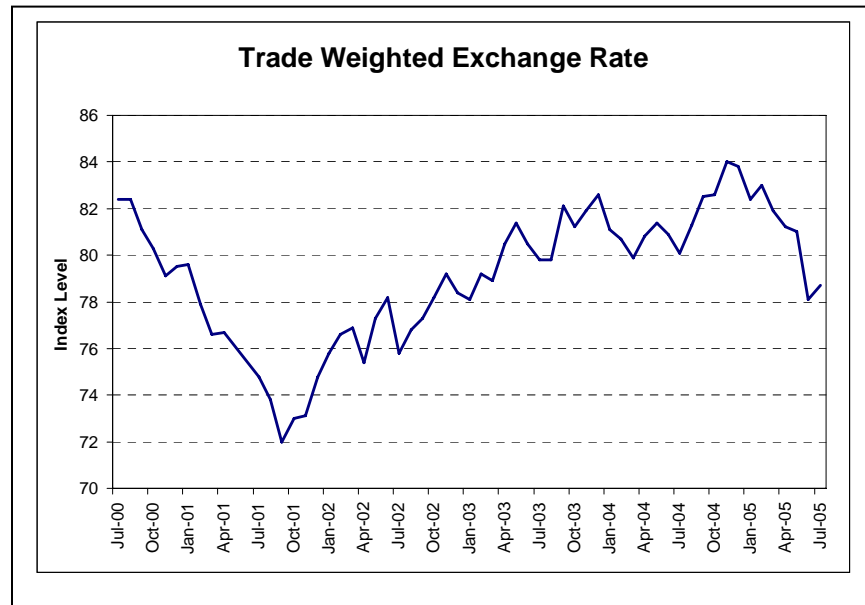
## Activity Index Level

The Activity Index Level increased from a revised 110.2 (up from 109.9) in May to 110.5 in June.



# Trade Weighted Exchange Rate, News & Upcoming Dates

## Trade Weighted Exchange Rate



## News Releases

**August 17<sup>th</sup> – Above 3.0% Economic Growth** – Ingemar Hansson, Head of Sweden's National Institute of Economic Research (NIER), stated at a labor union seminar, that Sweden's economic growth should exceed 3.0% in 2006 and 2007.

## Key Dates This Week

| Date  | Indicator              | Expectation | Previous |
|-------|------------------------|-------------|----------|
| 08/24 | Riksbank Interest Rate | --          | 1.50%    |

## Valance Economic Report: Switzerland

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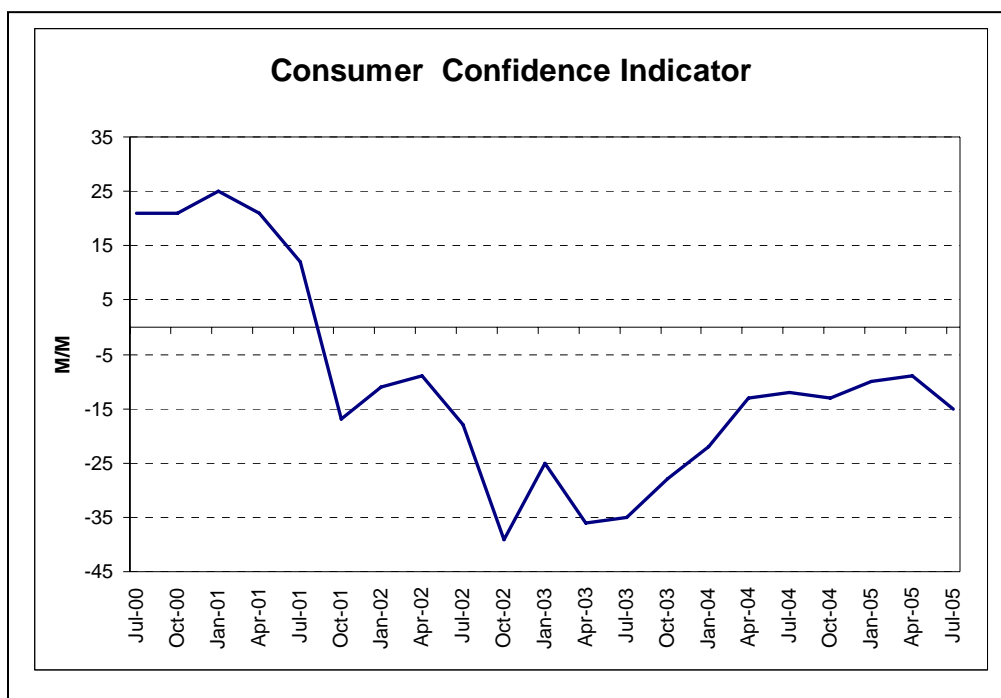
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August 17, 2005

This week's light economic data was highlighted by the Swiss Consumer Confidence Indicator which unexpectedly fell to -15, the lowest in 18 months, as oil prices have increased to record levels. Interestingly, SNB vice-chairman Blattner, made some very hawkish comments on rates.

### Weekly Releases & News

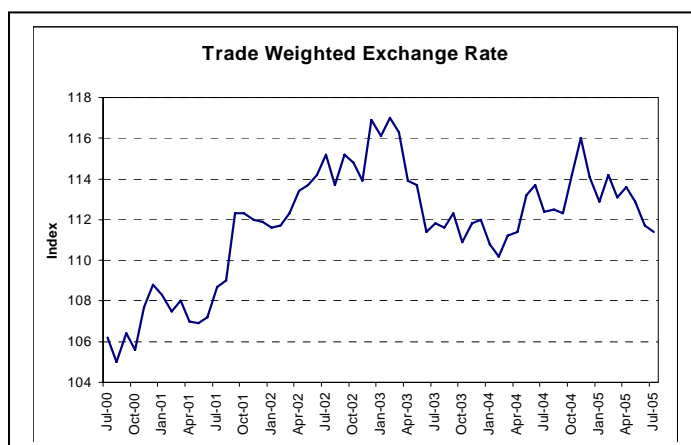
#### Chart of the Week: *SECO Consumer Climate*



Switzerland's Consumer Confidence Index fell from -9 in April to -15 in July, the lowest in 18 consecutive months. The decrease was attributed to record high oil prices. Expectations were for an increase to -8.

# Trade Weighted Exchange Rate, Blattner's Comments & Upcoming Dates

## Trade Weighted Exchange Rate



## Blattner's Comments

Deputy SNB President, Niklaus Blattner, in an interview with Handels Zeitung, stated that the Central Bank sees economic conditions strengthening going forward and hopes that once recovery is established it can return to its interest rate normalization process. Blattner promised that growth forecasts will not be cut any further this year and further indicated growth, this year and next, could be above expectations -- suggesting raising interest rates.

## Key Dates This Week

| <i>Date</i> | <i>Indicator</i>                           | <i>Expectation</i> | <i>Previous</i> |
|-------------|--|--------------------|-----------------|
| 08/18       | Adjusted Retail Sales (Y/Y) - Jun          | --                 | -0.4%           |
| 08/19       | Producer & Import Prices - M/M / Y/Y - Jul | --                 | -0.3% / 0.5%    |
| 08/23       | Trade Balance - Jul                        | --                 | 1.71B           |
| 08/23       | UBS Consumption Indicator - Jul            | --                 | -0.037          |