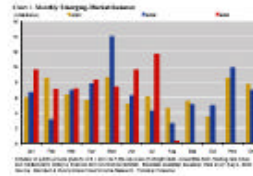




Emerging
Markets
Weekly



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Japan Rising from the East...

The Japanese economy is now in its fourth year of expansion and there are positive signs that the decade-long deflationary period seems to have abated. Yet, uncertainty still exists over the Bank of Japan's (BOJ) monetary policy. The current recovery of the world's second largest economy has been supported by healthy consumer spending, solid business investment and robust export demand. Growth was running at an estimated 1.9% in the first three months of 2006, the fifth consecutive quarter of positive growth. Improved conditions have flowed through to households via the labour market where the unemployment rate fell to 4.1%, a seven year low.

Japan also appears to be emerging from deflation. CPI inflation was recently released at 0.5%, an average performance for the first four months of 2006 while asset prices have also been rising. The Topix equity index has increased by more than 50% over the past year; property prices in Tokyo are now rising after a 15 year hiatus.

Given these signs, the BOJ in March 2006 began the transition to more normal policy settings, after a prolonged period of highly unorthodox quantitative easing, which flooded the financial markets with excess liquidity to promote lending, while simultaneously keeping overnight interest rates at zero. Until March, quantitative easing saw liquidity at around ¥ 30,000 billion, levels necessary to keep overnight rates effectively at zero percent. Since then, the BOJ has rapidly drained liquidity from the financial system and the markets have speculated that the BOJ would raise its interest rate target to 0.25% much earlier than anticipated. As liquidity fell towards the ¥ 12,000 billion marker, however, the BOJ made a ¥ 500 billion injection into the money market to help curb a sharp rise in overnight rates. This action highlighted the inherent uncertainty in the transition to a more normal monetary regime.

Quantitative easing contained an explicit commitment to stay put until inflation stabilized above zero. Now, the BOJ has no specific commitments except to set its policy interest rate in line with price stability, somewhere between zero and 2 percent. This has led to speculation amongst market participants about a possible link between reaching certain liquidity levels and raising interest rates. But they are not sure where to look for guidance as to the intentions of the BOJ. Should it come from the Governor's speeches, the forecasts in the

outlook report, or even the language in the monthly report?

Clearly rising interest rates would be of great concern in an economy that has been surviving on a zero interest rate policy since March 2001. Take public debt servicing for instance. At the end of March 2006, the public sector debt registered ¥827 trillion. A 0.25% increase in interest rates would result in higher interest payments of ¥2.1 trillion, adding further pressure to the government's fiscal deficit. Reformation of the public sector finances is imperative since Japan's government debt to GDP stands at 163.5%, much higher than many other industrialized countries. Another factor is the yen, whose appreciation to an 11-month high against the US dollar would slow export growth. A third consideration relates to prices. The methodology on which the headline CPI is calculated will change in August, taking 0.3 points of the annual inflation rate.

With these and many other implications of the impact of rising interest rates, Bank of Japan governor, Toshihiko Fukui, has stated that there must be full confidence in the resilience of the Japanese economy before any hikes in borrowing and lending rates are made. The specific timing of an interest move is very crucial. August would mark the sixth anniversary of a similar action by the BOJ that proved premature. September will be fraught with uncertainty surrounding the election of a successor to the Prime Minister.

The road to a firm economic expansion is by no means an easy task, as overcoming deflation stands as a feat on its own. Subsequently, running the risk of overheating the expansionary growth would thus be a reality since real interest rates would fall in the face of increasing inflationary pressures coupled with the zero interest rate policy. Hence, in our view, the BOJ could make its move as early as next month.

FINANCIAL & ECONOMIC INDICATORS

As at 25 May 2006

Exchange Rate/US\$	Closing Value	Previous Week
Yen	111.78	110.82
Euro	1.28	1.28
Jamaica	64.50	65.68
Guyana	200.70	200.70

Commodity Prices	Closing Value	Previous Week
Crude oil (US\$/bbl)	71.32	69.45
Natural Gas (US\$/mmbtu)	5.85	5.79
Gold (US\$/Troy Ounce)	650.90	682.30

Eurobond Indices (Returns, % YTD as of 18-May-06)

Lehman Brothers Global Aggregate Index	-0.69
JP Morgan EMBI+	-10.46
CMMB Eurobond Index	-0.32

Policy Interest Rates (%)	Closing Value	Previous Month
United States	5.00	5.00
Euro Zone	2.50	2.50
Japan	0.07	0.00
Brazil	15.66	15.75
Trinidad	7.00	6.75
Jamaica	12.45	12.45
Barbados	4.75	4.75

Market Interest Rates (%)	Closing Value	Previous Week
US 90-day T-Bill	4.70	4.83
US 10-Yr Treasury	5.07	5.06
3-month UK Libor	4.71	4.71
Japan 90-day T-Bill	0.18	0.18
Brazil 90-day T-Bill	15.35	15.14
TT 90-day T-Bill	5.64	5.64
Jamaica 90-day T-Bill	12.28	12.39
Barbados 90-day T-Bill	6.04	6.04

Sources: Bloomberg, CMMB Research Centre, Central Bank of Trinidad and Tobago, Bank of Jamaica, Central Bank of Barbados, Bank of Guyana

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