

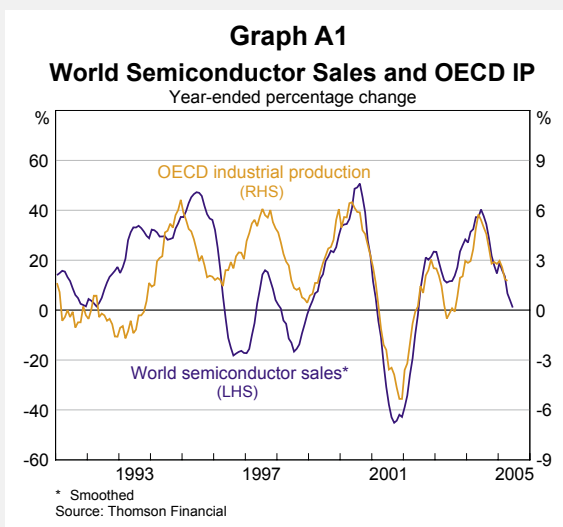
Box A: Developments in the ITC Sector

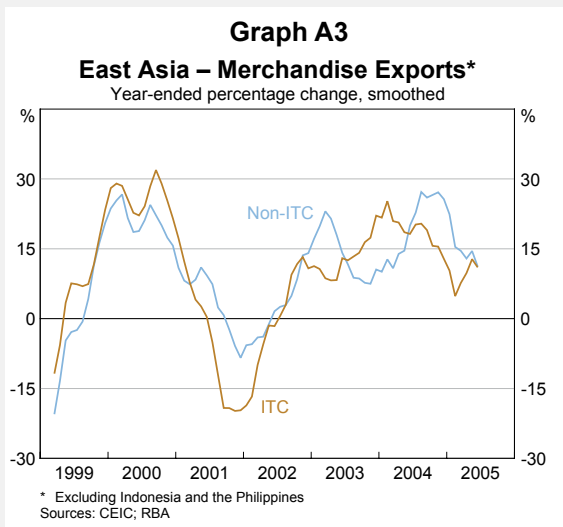
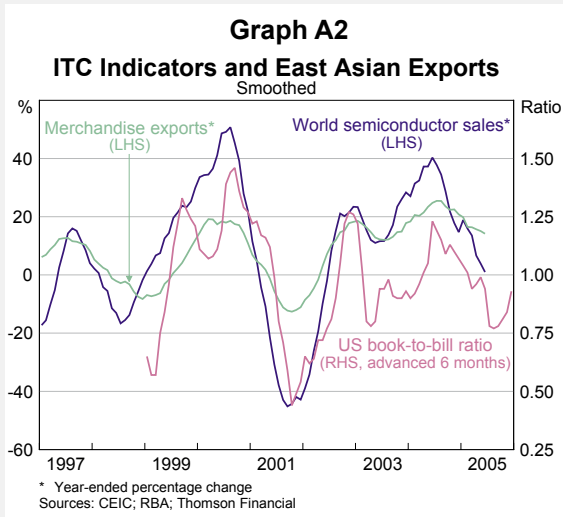
Developments in the global information, technology & communication (ITC) goods sector are an important driver of activity, particularly in east Asia, which has become the global manufacturing base for ITC products. Demand for ITC goods surged during 2003 and early 2004, but has eased noticeably since then. The outlook for the sector has nonetheless improved in the past few months, and activity is expected to rebound sometime in the second half of this year.

The latest cyclical upturn in the ITC sector reached its peak around mid 2004, when growth in world semiconductor sales, a commonly used indicator of the current state of the ITC cycle, reached its highest rate since late 2000. The upswing was consistent with the pick-up in world economic activity, which has become increasingly correlated with the ITC cycle since the late 1990s (Graph A1). This increased correlation highlights the growing importance of ITC goods to both the business and household sectors.

Semiconductor sales have been flat since mid 2004, such that the year-ended growth rate slowed from about 40 per cent to 1 per cent in June 2005. Most industry analysts expect that the slowdown will be short-lived, and milder than the 2001 downturn, with a recovery expected sometime in the second half of this year. This expectation partly reflects that inventories have not been built up to the extent seen in 2000–2001, and also that demand has been more balanced between households and businesses. More than half the semiconductors sold in 2004 were for consumer goods.

The positive outlook is also based on expectations that continued strong world growth will underpin demand, especially demand from the US where investment in ITC goods has been rising rapidly. In line with this, the Federal Reserve Bank of New York's Tech Pulse Index, which is a broad measure of the health of the US ITC industry, is growing at a fast pace. The US semiconductor equipment book-to-bill ratio, a closely watched indicator of future semiconductor production, has also risen sharply in recent months, although it is still below 1, implying that orders are falling short of current shipments (Graph A2). Investors also seem to have become more optimistic about the prospects for the ITC industry, with the Philadelphia Semiconductor





Index of share prices and the broader NASDAQ Composite Index both at their highest levels in over a year.

Economic growth in east Asia is particularly sensitive to developments in the global ITC sector, because of the high share of ITC goods in its exports. ITC goods account for one-third of total merchandise exports from the region as a whole, and more than half of the exports from Malaysia and the Philippines. The ITC shares of China's and Korea's exports have risen significantly over the past five years to be more than 35 per cent in 2004; China is now the largest ITC exporter in the region. The softening in ITC demand has accordingly contributed noticeably to slower economic growth in the region since mid 2004, and production of ITC goods has remained subdued in recent months. While considerable progress has been made in reducing inventories, the adjustment may still have further to run. However, growth is expected to pick up as companies work off excess inventories, and there are already signs of recovery in the rebound in growth of ITC exports since late 2004 (Graph A3).