Emerging Asia Economics Monthly – May 2009

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Global Markets – Asia Team :

EconsAndResearchAsia@anz.com

Paul Gruenwald
Chief Economist, Asia
+65 6216 1814
Paul.Gruenwald@anz.com

Tamara Henderson
Director, FX and Rates Strategy
+65 6216 1845
Tamara.Henderson@anz.com

Yeo Han Sia
Associate Director,
FX and Rates Strategy
+65 6419 7930
HanSia.Yeo@anz.com

Franklin Poon
Economist, North East Asia
+852 3929 5340
Franklin.Poon@anz.com

Chang Wei Liang
Analyst, Economic Research
+65 6216 1838
Weiliang.Chang@anz.com

Research Interns:

Chong Jun Jie

Zhou Hao

Naresh Navaratnarajah

Our Vision:

For Economics & Markets Research to be the most respected, sought-after and commercially valued source of economics and markets research and information on Australia, New Zealand, the Pacific and Asia.

Highlights

- The worst is likely behind emerging Asia, but the pace of activity continues to decline across most of the region, albeit at a slower rate than in late 2008.
- A notable (upside) exception is China, where a broad range of indicators show that the stimulus plan continues to gain traction; however, growth momentum remains below the 8% rate desired by the authorities. Positive spillovers to the rest of Asia will be modest.
- External sector developments remain extremely weak with exports and imports still in sharp decline in most economies. Domestic demand will have to drive activity this year and we expect to see growing evidence of public sector spending supporting growth.
- Setbacks on the road to recovery should quell enthusiasm for risk, while "green shoots" will boost sentiment—subjecting USD-AXJ to two-way risk. Landmark agreements between China and Taiwan will make the TWD hard to beat in 2009.
- Asian rates will remain vulnerable to swings in risk appetite. Scope for more rate cuts, worries about supply, and signs of improvement in global demand should altogether maintain the bias for steeper curves generally.

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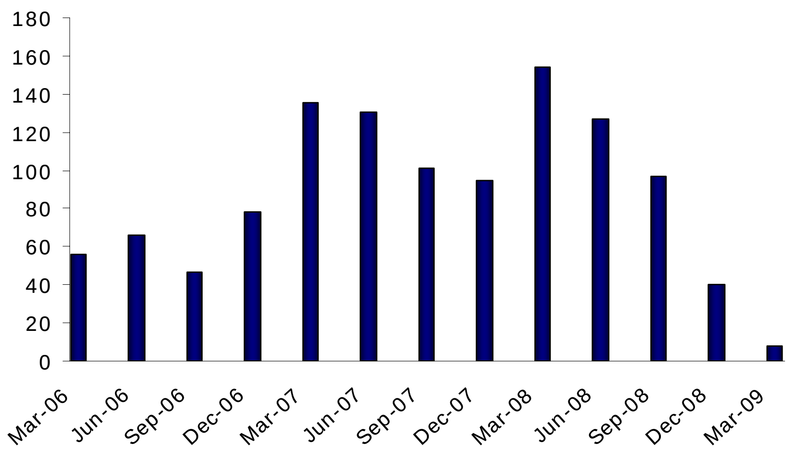
Feature Article: Chinese Hot Money Flows, An Update

In this article we update our February 2009 analysis of unidentified or "hot money" capital outflows from China. We conclude that the large hot money outflows that emerged during the final months of 2008 continued into early 2009, but abated somewhat in terms of size. Putting together recent balance of payments developments with the observed stability of USD-CNY, we conclude that the Chinese authorities have at times resorted to selling down their foreign currency reserves in order to attain their stated objective of USD-CNY stability. We expect hot money outflows to ease further as growth momentum in China builds, and retain our call for a stable USD-CNY until a global recovery takes hold.

Chinese reserve growth slowed sharply in the first quarter of 2009. According to data released by the authorities last month, the rise in official reserves from end-December 2008 to end-March 2009 totalled only $7.7 billion. This modest rise followed average quarterly reserve growth of $87 billion over 2006-08. Reserves actually fell by $32 billion in January and declined fractionally in February. In terms of the stock, reserves were $1.95 trillion at the end of the quarter.

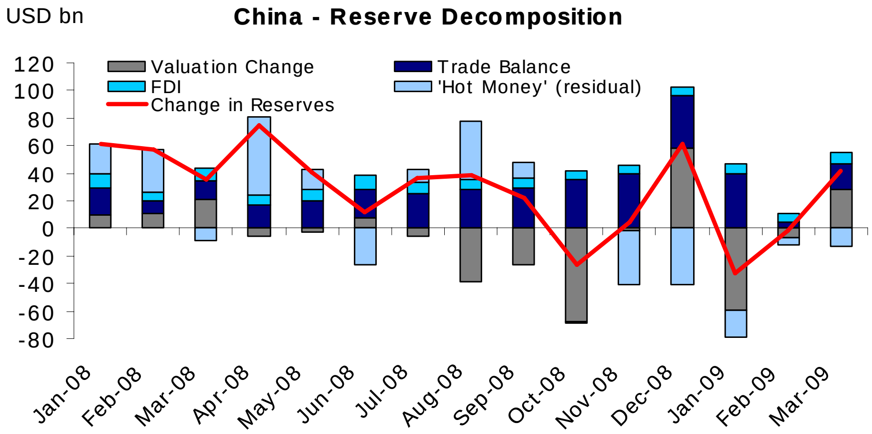
China - FX Reserves, Quarterly Increase (USD bn)



Valuation changes accounted for most of the volatility in reserve growth in Q1; the overall balance of payments remained in surplus. The currency composition of China's reserves is not publicly available so valuation effects on reserves resulting from exchange rate movements have to be estimated. For simplicity, we assume a two-currency reserve portfolio comprising two-thirds USD and one-third EUR. (Our analysis is robust with respect to changes in these shares as noted in our February 2009 article.) Under this assumption, valuation changes are driven solely by changes in EUR-USD and were -$59 billion in January, -$7 billion in February and +$28 billion in March. Given that changes in total reserves can be decomposed into valuation effects and balance of payments flows, these valuation estimates imply that the balance of payments registered a surplus in every month of Q1.

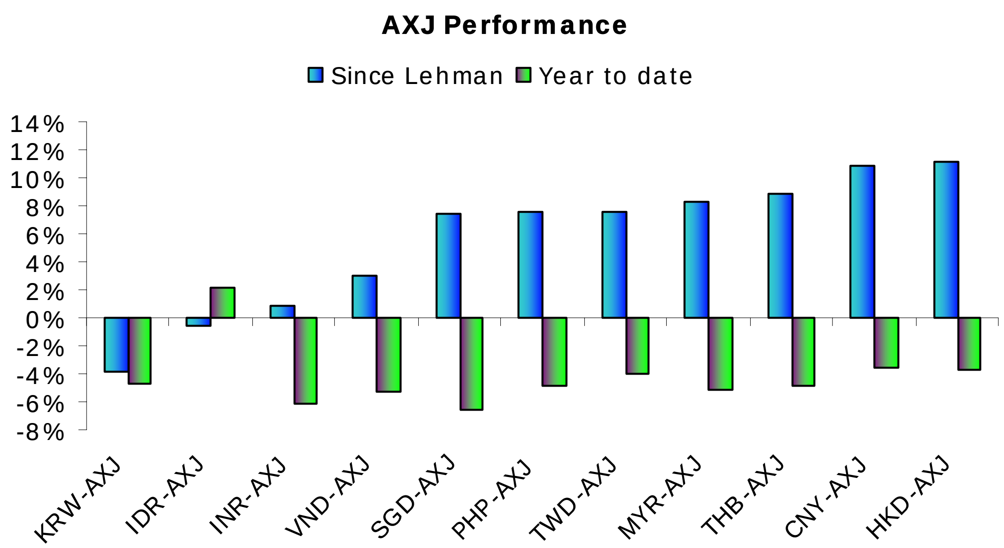
The trade surplus, the most important driver of the balance of payments, declined by almost one-half from 2008 Q4. For the first quarter of 2009, the trade balance registered a surplus of $62.5 billion, down from a surplus of $114 billion in the final quarter of 2008. In February, the surplus fell to just $4.8 billion, the lowest level in three years. However, the 2009 Q1 outturn was close to the quarterly average since 2006, and was 50% higher than the same period in 2008. The continued trade surplus should not be interpreted as a sign of export strength. Exports fell 17% (y/y) in the first quarter of 2009, reflecting the deepening recession in the advanced economies. However, reflecting a pattern we have seen across the region, imports fell by an even greater 25%.

We calculate that hot money outflows continued into Q1, but that the pace slowed from late 2008. This result stems from the residual approach where the balance of payments flows are decomposed into the known trade balance, known FDI flows, and unidentified capital flows. The last of these is interpreted as "hot money." (Other variables in the balance of payments are assumed to remain unchanged.) Our calculations show that hot money flows were $38 billion for the quarter, and positive in every month. Therefore, we have now seen unidentified capital outflows from China for five consecutive months beginning in November 2008.



We suspect that the slowing of hot money outflows is related to the initial success of the authorities' stimulus programme. The swing into negative territory of the unidentified capital flows in late 2008 corresponded to the sharp slowing of the Chinese economy as the global financial crisis intensified. (We estimate that quarter-on-quarter GDP growth in 2008 Q4 was close to zero.) Related to this were fears that the authorities might engineer a devaluation of the Yuan in order to boost export competitiveness and thereby growth. However, the most recent national accounts data suggest growth has bottomed and there is broad-based evidence that the fiscal stimulus plan is enjoying some success. As a result, the probability of a devaluation is now much smaller than in late 2008. Indeed, the 12-month non-deliverable forward level of USD-CNY has fallen from an implied devaluation of 7½% in early December of last year to a level consistent with a small appreciation of the Yuan at present.

Turning to exchange rate policy, the Chinese authorities have reportedly been intervening in both directions in order to keep USD-CNY stable. While the balance of payments has remained in surplus on a monthly basis, this does not preclude transitory deficits given the inherent "lumpiness" of trade and other balance of payments flows. Indeed, there has been anecdotal evidence that the authorities have at times *sold down* their reserves in order to keep the Yuan from *depreciating*. (We analysed this issue earlier, see: "Is China Now Selling Down Its Reserves? – March 2009.) This revealed preference of exchange rate stability is in contrast to the view that the Chinese authorities prefer a weak Yuan in order to boost competitiveness, exports and growth. In fact, the Yuan has been one of the strongest currencies in the region during the current crisis.



Given the above, we expect hot money outflows to ease further as the stimulus plan gains more traction, and retain our call for a stable USD-CNY in the near term. We would note that at the current juncture Chinese exchange rate policy is very similar to what we witnessed during the Asian financial crisis last decade. The Yuan has been kept stable despite sizeable deprecations against the USD of other currencies in the region and despite ongoing hot money outflows, which run the potential of putting downward pressure on the currency. We would also note that, given the size of official reserves, hot money flows of the size we have seen in recent months pose little risk to China's formidable external stability. Moreover, we would expect these flows to diminish further, assuming the stimulus plan continues to gain traction and growth continues to rise toward the authorities' target level of 8%. Once the global recovery gains momentum—and we would underscore that this may take some time—we would expect USD-CNY to be allowed to gradually strengthen along the lines seen in the run-up to the crisis.

Paul Gruenwald and Jun Jie Chong

FX and Rates Strategy Overview: Two-Way Risk is Back in Play

Market Outlook

Risk appetite will remain in the driver's seat for USD-AXJ into the summer months. Given the number of hurdles that need to be cleared before a normalisation in global demand can be achieved, setbacks are likely. Such set-backs will quell enthusiasm for risk trades. At the same time, it will be hard for markets to ignore the "green shoots" from aggressive stimulus programs across the globe. No doubt these "green shoots" will fuel hopes that a recovery will come sooner, rather than later. As such, two-way risk is back in play. Over the next several months, such two-way risk is likely to trap USD-AXJ in a range.

FX Strategy

The ebb and flow of risk appetite during this financial crisis has seen USD-KRW lead the way in both directions, with the pair representing the more liquid vehicle for expressing general fear (and most recently, hope) within emerging Asia. Nevertheless, a re-test of 1,600 or even 1,500 seems less and less likely, especially since Korean economic data suggest signs of a bottom. Ultimately, we expect the Korean won to be an out-performer within AXJ in 2009; however, the ride will be bumpy. Also, there is now stiff competition from the Taiwan dollar.

Landmark agreements between China and Taiwan will make the TWD hard to beat in 2009, with Chinese investors now having access to the Taiwan market. The policy shift likely spells the end of the uptrend in USD-TWD during this cycle. Having easily broken key support (the 61.8% Fibonacci retracement and the 200-day moving average), the next key level for USD-TWD is the 38.2% retracement at 32.11.

Turning to India, we expect USD-INR to be trapped in the 50.0 to 52.0 range for the remainder of the year. Improvements in global financial markets and India's external balance should cap further upside. At the same time, we anticipate a further deterioration in India's fiscal accounts, along with a more than even chance of a ratings downgrade to "junk" in India's domestic currency sovereign debt rating.

- ***Corporates***: Remove hedges for TWD export exposure and balance sheet risk.
- ***Real money funds with AXJ allocations***: Over-weight TWD.
- ***Leveraged funds:*** Take advantage of rallies to sell USD-TWD and USD-KRW forward outright. Always be mindful of episodes of opposing momentum if your time horizon is short.

Rates Strategy

Range-bound activity in equity markets would suggest similar conditions in emerging Asian rates markets, many of which are significantly affected by risk appetite. Asian rates already face cross-winds from the possibility of further rate cuts by AXJ central banks combined with concerns about digesting extra supply from fiscal stimulus programmes. However, such conditions are mutually supportive of curve steepening—especially for Indian OIS.

- ***Real money funds*** with emerging Asia in their benchmark should reduce duration toward neutral.
- ***Leveraged funds*** can side-step the problem of negative carry in steepeners by taking on basis risk. For example, a front-end receiver position in Indian OIS could be paired with a long-end payer position in Hong Kong IRS.

Tamara Henderson

Foreign Exchange and Policy Rate Forecasts

		Current	Jun 09	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10
China	USD/CNY, eop	6.822	6.83	6.83	6.83	6.82	6.82	6.80
	AUD/CNY, eop	4.867	4.50	4.30	4.00	3.80	3.90	3.90
	PBoC base lending rate	5.31	5.04	5.04	5.04	5.04	5.04	5.04
Hong Kong	USD/HKD, eop	7.750	7.750	7.750	7.755	7.760	7.770	7.790
	AUD/HKD, eop	5.529	5.1	4.9	4.6	4.3	4.4	4.5
	HKMA discount rate	0.50	0.25	0.25	0.25	0.25	0.25	0.50
India	USD/INR, eop	49.90	52.0	51.0	51.0	50.0	50.0	49.0
	AUD/INR, eop	36.22	34.3	32.1	30.1	28.0	28.5	28.4
	RBI repo rate	4.75	4.75	4.50	4.50	4.50	4.75	4.75
Indonesia	USD/IDR, eop	10,846	11,500	11,900	11,500	11,500	11,000	10,500
	AUD/IDR, eop	7,754	7,600	7,500	6,800	6,400	6,300	6,100
	BI rate	7.50	7.00	7.00	7.00	7.00	7.00	7.25
Malaysia	USD/MYR, eop	3.56	3.70	3.75	3.75	3.70	3.65	3.60
	AUD/MYR, eop	2.61	2.44	2.36	2.21	2.07	2.08	2.09
	BNM overnight rate	2.00	2.00	2.00	2.00	2.00	2.00	2.00
Philippines	USD/PHP, eop	48.38	49.5	50.0	49.5	48.8	48.5	48.0
	AUD/PHP, eop	35.07	32.7	31.5	29.2	27.3	27.6	27.8
	BSP reverse repo rate	4.50	4.25	4.25	4.25	4.25	4.25	4.25
Singapore	USD/SGD, eop	1.48	1.58	1.60	1.62	1.63	1.61	1.60
	AUD/SGD, eop	1.08	1.04	1.01	0.96	0.91	0.92	0.93
	3M SGD SIBOR	0.68	0.65	0.65	0.65	0.85	1.05	1.30
S Korea	USD/KRW, eop	1,341	1,400	1,450	1,400	1,325	1,300	1,250
	AUD/KRW, eop	957	920	910	830	740	740	730
	BoK overnight call rate	2.00	1.75	1.75	1.75	1.75	1.75	2.00
Taiwan	USD/TWD, eop	32.92	32.7	32.0	32.0	31.0	30.0	30.0
	AUD/TWD, eop	24.05	21.6	20.2	18.9	17.4	17.1	17.4
	CBC discount rate	1.25	1.00	1.00	1.00	1.00	1.00	1.00
Thailand	USD/THB, eop	35.30	36.5	37.5	37.0	36.5	36.0	36.0
	AUD/THB, eop	25.67	24.1	23.6	21.8	20.4	20.5	20.9
	BoT repo rate	1.25	1.00	1.00	1.00	1.00	1.25	1.25
Vietnam	USD/VND, eop	17,783	18,300	18,800	18,800	19,300	19,300	19,900
	AUD/VND, eop	12,759	12,100	11,800	11,100	10,800	11,000	11,500
	SBV base lending rate	7.00	6.00	6.00	6.00	6.00	6.00	7.00

Foreign Exchange Cross-Rate Forecasts

	Current Spot	ANZ Forecast					Current 12M Fwd or NDF	Implied 12M % Change	
		Jun-09	Sep-09	Dec-09	Mar-10	Jun-10		ANZ	Forwards
CNY-HKD	1.14	1.13	1.13	1.14	1.14	1.14	1.14	0%	1%
CNY-INR	7.31	7.61	7.47	7.47	7.33	7.33	7.86	0%	7%
CNY-IDR	1,590	1,680	1,740	1,680	1,690	1,610	1,760	1%	11%
CNY-MYR	0.521	0.542	0.549	0.549	0.543	0.535	0.528	3%	1%
CNY-PHP	7.09	7.25	7.32	7.25	7.16	7.11	7.38	0%	4%
CNY-SGD	0.217	0.231	0.234	0.237	0.239	0.236	0.219	9%	1%
CNY-KRW	197	205	212	205	194	191	195	-3%	-1%
CNY-TWD	4.83	4.79	4.69	4.69	4.55	4.40	4.70	-9%	-3%
CNY-THB	5.17	5.34	5.49	5.42	5.35	5.28	5.23	2%	1%
HKD-INR	6.44	6.71	6.58	6.58	6.44	6.44	6.88	0%	7%
HKD-IDR	1,400	1,480	1,540	1,480	1,480	1,420	1,540	1%	10%
HKD-MYR	0.459	0.477	0.484	0.484	0.477	0.470	0.462	2%	1%
HKD-PHP	6.24	6.39	6.45	6.38	6.29	6.24	6.46	0%	4%
HKD-SGD	0.191	0.204	0.206	0.209	0.210	0.207	0.192	8%	0%
HKD-KRW	173	181	187	181	171	167	171	-3%	-1%
HKD-TWD	4.25	4.22	4.13	4.13	3.99	3.86	4.11	-9%	-3%
HKD-THB	4.55	4.71	4.84	4.77	4.70	4.63	4.57	2%	0%
INR-IDR	217	221	233	225	230	220	224	1%	3%
INR-MYR	0.071	0.071	0.074	0.074	0.074	0.073	0.067	2%	-6%
INR-PHP	0.97	0.95	0.98	0.97	0.98	0.97	0.94	0%	-3%
INR-SGD	0.030	0.030	0.031	0.032	0.033	0.032	0.028	9%	-6%
INR-KRW	26.9	26.9	28.4	27.5	26.5	26.0	24.8	-3%	-8%
INR-TWD	0.660	0.629	0.627	0.627	0.620	0.600	0.598	-9%	-9%
INR-THB	0.707	0.702	0.735	0.725	0.730	0.720	0.665	2%	-6%
IDR-MYR	0.00033	0.00032	0.00032	0.00033	0.00032	0.00033	0.00030	1%	-8%
IDR-PHP	0.00446	0.00430	0.00420	0.00430	0.00424	0.00441	0.00420	-1%	-6%
IDR-SGD	0.00014	0.00014	0.00013	0.00014	0.00014	0.00015	0.00012	7%	-9%
IDR-KRW	0.124	0.122	0.122	0.122	0.115	0.118	0.111	-4%	-10%
IDR-TWD	0.00304	0.00284	0.00269	0.00278	0.00270	0.00273	0.00267	-10%	-12%
IDR-THB	0.00325	0.00317	0.00315	0.00322	0.00317	0.00327	0.00297	1%	-9%
MYR-PHP	13.6	13.4	13.3	13.2	13.2	13.3	14.0	-2%	3%
MYR-SGD	0.416	0.427	0.427	0.432	0.441	0.441	0.416	6%	0%
MYR-KRW	377	378	387	373	358	356	369	-6%	-2%
MYR-TWD	9.26	8.84	8.53	8.53	8.38	8.22	8.91	-11%	-4%
MYR-THB	9.93	9.86	10.00	9.87	9.86	9.86	9.91	-1%	0%
PHP-SGD	0.031	0.032	0.032	0.033	0.033	0.033	0.030	8%	-3%
PHP-KRW	27.7	28.3	29.0	28.3	27.2	26.8	26.4	-3%	-5%
PHP-TWD	0.680	0.661	0.640	0.646	0.635	0.619	0.637	-9%	-6%
PHP-THB	0.730	0.737	0.750	0.747	0.748	0.742	0.708	2%	-3%
SGD-KRW	905	886	906	864	813	807	889	-11%	-2%
SGD-TWD	22.2	20.7	20.0	19.8	19.0	18.6	21.4	-16%	-4%
SGD-THB	23.8	23.1	23.4	22.8	22.4	22.4	23.8	-6%	0%
KRW-TWD	0.025	0.023	0.022	0.023	0.023	0.023	0.024	-6%	-2%
KRW-THB	0.026	0.026	0.026	0.026	0.028	0.028	0.027	5%	2%
TWD-THB	1.07	1.12	1.17	1.16	1.18	1.20	1.11	12%	4%

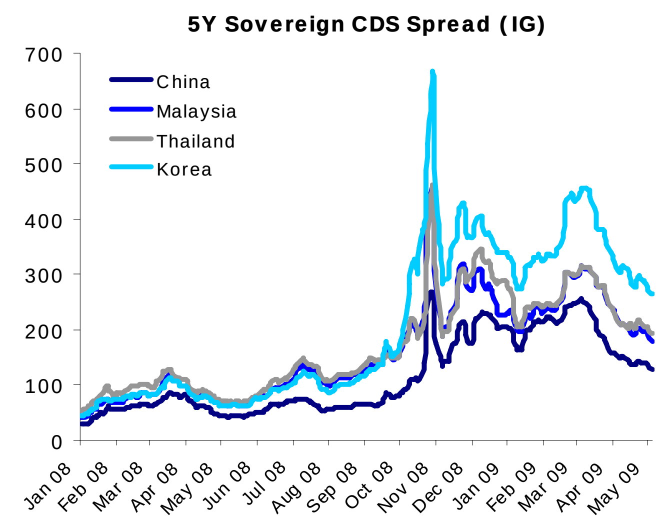
Long-Term Foreign Currency Government Bond Ratings

	Moody's	S&P	Fitch
Investment Grade			
China	A1	A+	A+
Hong Kong	Aa2	AA+	AA
India	Baa2	BBB-	BBB-
Korea	A2	A	A+
Malaysia	A3	A-	A-
Singapore	Aaa	AAA	AAA
Taiwan	Aa3	AA-	A+
Thailand	Baa1	BBB+	BBB#
Sub-Investment Grade			
Cambodia	B1	B+	NR
Indonesia	Ba3	BB-	BB
Philippines	B1	BB-	BB
Vietnam	Ba3	BB	BB-

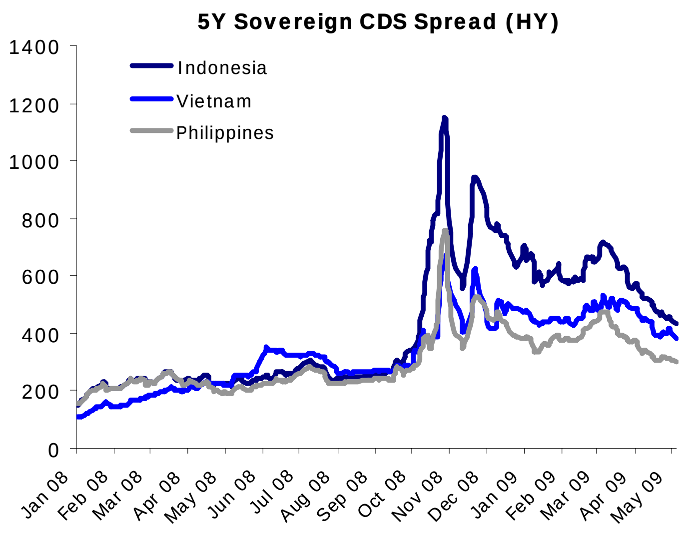
** denotes an upgrade; # denotes a downgrade over previous month*

Source: Bloomberg

Sovereign CDS Spreads



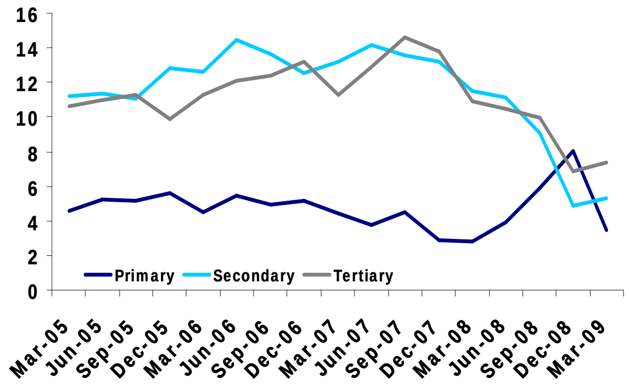
Source: Bloomberg



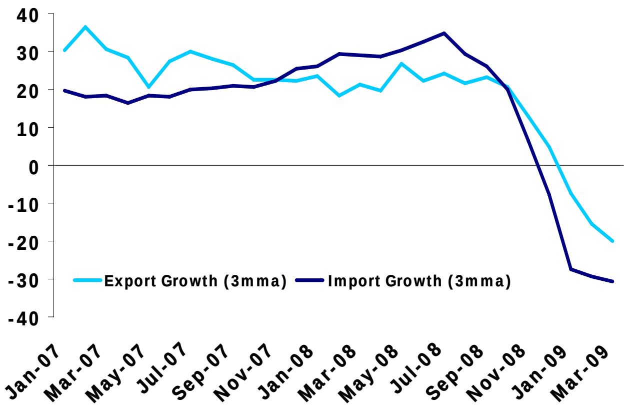
Source: Bloomberg

Country Update: China

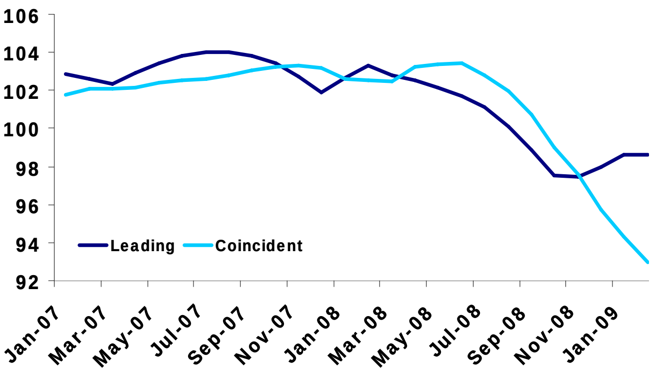
China - GDP Growth, Production Based



China - Trade Developments



China - Macro Indicators



The stimulus plan continues to gain traction. Activity appears to be expanding, albeit moderately, as measured by a broad range of indicators. However, trade continues to contract and price pressures are still declining. We expect GDP growth to reach the authorities' 8% comfort level by end-year, although the annual average will fall short of this mark.

- GDP rose by 6.1% (y/y) in Q1, down from 6.8% in the final quarter of 2008. That said, momentum appears to have turned up in both secondary and tertiary activities. Real retail sales continued to expand at a double digit pace through Mar while industrial value added growth appears to have bottomed.
- The official purchasing managers' index (PMI) registered an expansionary reading in Mar for the first time in six months. Most sub-indices rose; new orders did particularly well. However, a separate PMI released by CLSA declined modestly.
- Monetary aggregates continue to expand briskly. Credit growth reached 27.1% (y/y) in Mar while M2 growth rose to 25.5%. The China Banking Regulatory Commission has warned banks to increase risk management as the amount of new loans tripled in Q1 from a year earlier.
- Trade continued to contract in Mar. Exports fell by 17.1% (-25.7% in Feb) while imports fell by 24.9% (-23.8% in Feb). Shipments of garments and furniture reportedly rose year-on-year. The monthly trade surplus climbed to $18.6bn. Foreign reserves were broadly unchanged in Q1 at just under $2 trillion.
- Deflation pressures continued into Mar. The CPI fell by 1.2% (y/y) while producer prices were down 6.0%. Property prices fell by 1.3%, but recorded the first monthly rise since mid-2008.
- The Chinese economy looks to have bottomed. However, the pace of activity remains well below the authorities' comfort level. We expect growth momentum to continue to build and for the economy to grow at an 8% (y/y) pace by the end of 2009.

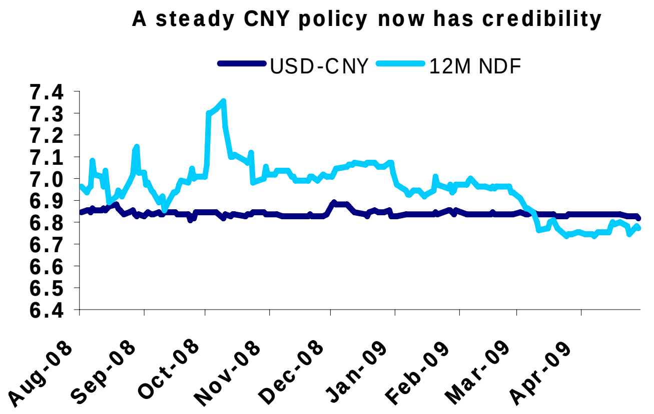
Paul Gruenwald

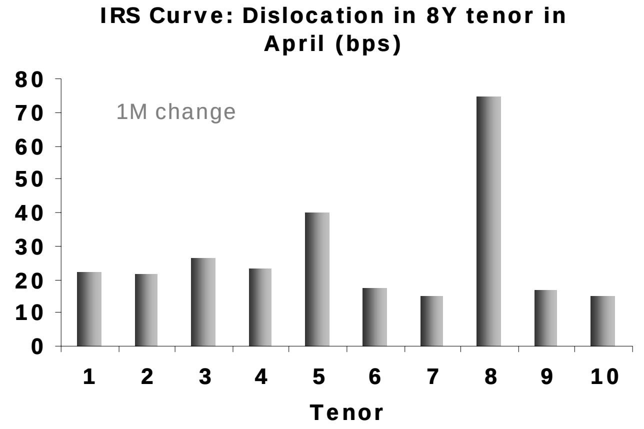
Economic Data – China

Monthly data	**Aug 08**	**Sep 08**	**Oct 08**	**Nov 08**	**Dec 08**	**Jan 09**	**Feb 09**	**Mar 09**
Industrial Production, % y/y	12.8	11.4	8.2	5.4	5.7	N/A	11.0	8.3
Retail Sales, % y/y	23.2	23.2	22.0	20.8	19.0	18.5	11.6	14.7
Consumer Price Index, % y/y	4.9	4.6	4.0	2.4	1.2	1.0	-1.6	-1.2
Exports, % y/y	21.1	21.3	19.1	-2.2	-2.8	-17.5	-25.7	-17.1
Imports, % y/y	22.9	20.9	15.4	-18.0	-21.3	-43.1	-23.8	-24.9
Trade Balance, US$ bn	28.7	29.4	35.2	40.1	39.0	39.1	4.8	18.6
Quarterly data	**Jun 07**	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**
Real GDP, % y/y	14.0	13.0	12.0	10.6	10.1	9.0	6.8	6.1
-Primary Sector ytd	4.0	4.3	3.7	2.8	3.5	4.5	5.5	3.5
-Secondary sector ytd	15.0	14.8	14.7	11.5	11.3	10.6	9.3	5.3
-Tertiary sector ytd	13.5	14.0	13.8	10.9	10.7	10.5	9.5	7.4
Nominal GDP, RMB tn	11.2	17.4	25.7	6.3	13.5	20.8	30.1	6.6
Foreign Exchange Reserves, US$ bn	1,332.6	1,433.6	1,528.2	1,682.2	1,808.8	1,905.6	1,946.0	1,953.7
Current Account, US$ bn (semi-annual)	162.9	N/A	371.8	N/A	191.7	N/A	426.1	N/A
Capital Account, US$ bn (semi-annual)	1.5	N/A	3.1	N/A	1.7	N/A	3.1	N/A

Sources: CEIC

China: FX and Rates Strategy





USD-CNY continues to hold steady, which is likely to be the state of affairs throughout 2009. Although economic growth in China is gaining traction, the authorities probably prefer to see a normalisation in global trade and GDP back at 8% before allowing the renminbi to continue on its appreciation path versus the USD. Meanwhile, real interest rates have risen in tandem with the drop in inflation—suggesting another rate cut by the PBoC in order to keep monetary conditions loose and allow "green shoots" to prosper.

FX

USD-CNY remains rock solid, holding within the 6.81 to 6.89 range, maintained since July 2008. Meanwhile, the daily CNY fixing has started to inch successively lower amid signs of increased traction in China's economy. NDFs have taken this as a signal that the authorities will allow the renminbi to resume its appreciation path, sooner rather than later.

Although there are indications that economic growth in China bottomed at 6.1% (y/y) in Q1, at this juncture the risk that the authorities will set the CNY fixing outside of the range established since July is low. Indeed, the risk will remain low until: 1/ growth is back near the 8% target, and 2/ there is a distinct improvement, if not normalisation, in global trade.

We maintain our view that USD-CNY will remain in a holding pattern until the authorities are confident that sufficient growth momentum has been restored. At such time (unlikely in 2009), a resumption in gradual CNY appreciation against the USD is anticipated. Adding to the case for a lower USD-CNY over the longer-term, the authorities have indicated in a number of contexts concern about the value of what would seem to be a large US asset exposure.

Rates

Real interest rates have risen in tandem with the drop in inflation, tightening monetary conditions at the margin. In order to ensure that the "green shoots" of traction in the economy are able to prosper, we expect another rate cut from the PBoC—mitigating the impact of higher real interest rates. This should help bring a bout of bull-steepening back to the CNY rates market.

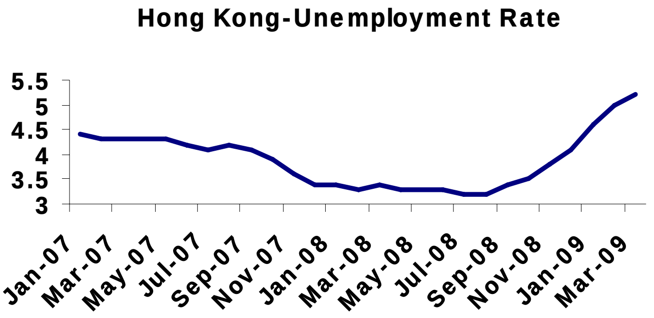
Tamara Henderson

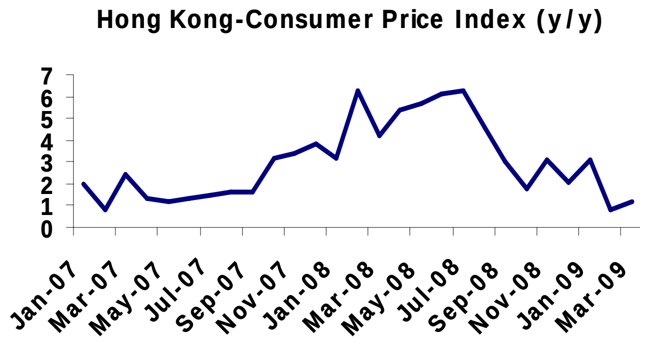
Market Forecasts – China

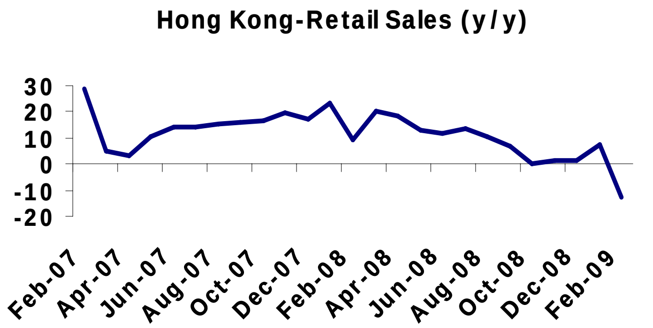
FX	Current	Ytd (%)	Jun 09	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10
USD-CNY	6.822	-0.1%	6.83	6.83	6.83	6.82	6.82	6.80
AUD-CNY	4.867	1.5%	4.50	4.30	4.00	3.80	3.90	3.90
NZD-CNY	3.860	-2.3%	3.70	3.50	3.30	3.20	3.20	3.30
JPY-CNY	0.070	-6.3%	0.065	0.063	0.062	0.059	0.059	0.058
EUR-CNY	8.999	-5.6%	8.74	8.47	8.06	7.64	7.64	7.75
Rates	**Current**	**Ytd**	**Jun 09**	**Sep 09**	**Dec 09**	**Mar 10**	**Jun 10**	**Sep 10**
PBOC's 1-year base lending rate	5.31	0	5.04	5.04	5.04	5.04	5.04	5.04
3-month SHIBOR	1.21	-56	1.0	1.1	1.2	1.3	1.4	1.5
2-year IRS (onshore vs 7-day repo fix)	1.63	56	1.4	1.5	1.6	1.7	1.8	1.9
10-year IRS	3.15	136	3.0	3.2	3.4	3.6	3.9	4.2

Sources: Bloomberg, ANZ

Country Update: Hong Kong







While prices of residential properties and equities kept rising for most of the past month, many real economy indicators suggest continued weakness. External trade statistics remained on a downward trend, and retail sales and the jobless rate continued to reflect weak domestic demand. Hong Kong is expected to be among the first non-mainland Chinese cities to implement a CNY foreign trade settlement system, and Mainland units of Hong Kong banks will be allowed to issue CNY bonds in Hong Kong.

- The rebound in both prices and transacted volumes for residential properties continued in April, as banks have reportedly started lending again to home buyers. The equity market was also on the rise for most of the month despite some recent weakness.
- Nevertheless, the real economy continued weakening. Retail sales fell by 2% (y/y) in Jan-Feb after 1.1% growth in Dec. In terms of volume, retail sales dropped by 3.6% in Jan-Feb, compared with a 0.5% contraction in Dec. Seasonally adjusted, retail sales volume also decreased by 1% (q/q) in the three months ending Feb.
- The labour market deteriorated further in Mar. The seasonally adjusted unemployment rate continued rising, climbing 0.2% to 5.2%. Construction remained the worst hit sector, followed by manufacturing. In addition to layoffs, companies have resorted to unpaid leave and pay-cuts to save costs. We suspect the impact of those actions on the labour market have not been fully reflected by the headline jobless statistics.
- Disinflation continued in March. Consumer prices rose 1.2% (y/y), less than the 2.0% increase in Jan-Feb. Netting out the effects of the government's one-off relief measures, inflation was 2.6%, smaller than the 3.3% level of the previous two months.
- On structural developments, Hong Kong is expected to be among the first non-mainland Chinese cities to implement a CNY settlement system for China's foreign trade, and mainland units of Hong Kong banks are allowed to issue CNY bonds in Hong Kong. Hong Kong's status as a financial centre should benefit accordingly.

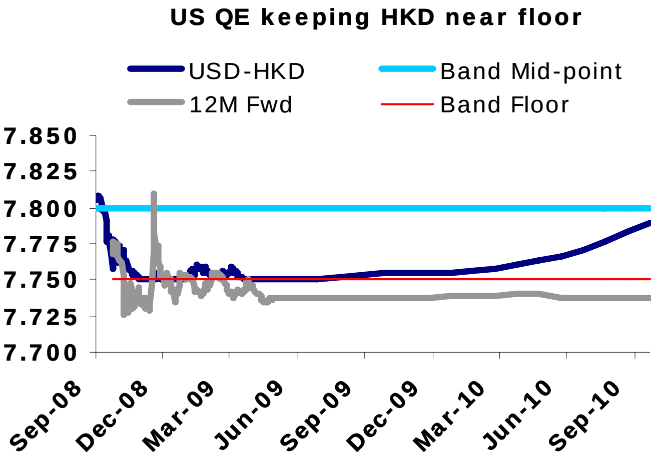
Franklin Poon

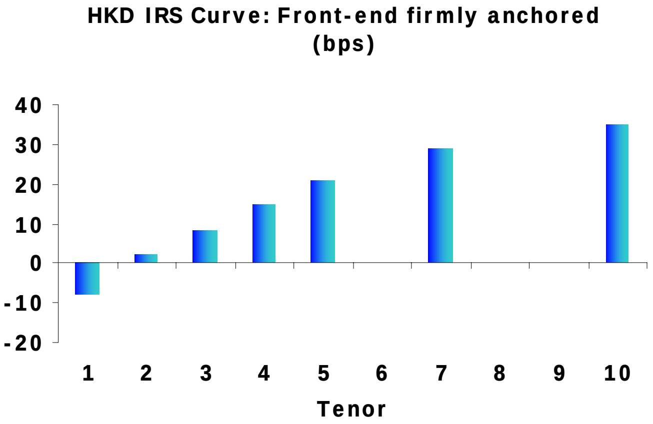
Economic Data – Hong Kong

Monthly data	Aug 08	Sep 08	Oct 08	Nov 08	Dec 08	Jan 09	Feb 09	Mar 09
Retail Sales, % y/y	10.4	7.2	0.4	1.3	1.1	7.3	-12.6	N/A
Composite Consumer Price Index sa, % y/y	4.5	3.1	1.7	3.1	2.1	2.7	1.1	1.0
Exports, % y/y	1.9	3.6	9.4	-5.3	-11.4	-21.8	-23.0	N/A
Imports, % y/y	1.5	3.9	11.3	-7.9	-16.2	-27.1	-17.5	N/A
Trade Balance, US$ bn	-1.6	-2.1	-1.8	-1.1	-1.5	0.9	-3.0	N/A
Foreign Exchange Reserves, US$ bn	153.2	153.7	149.3	160.5	178.1	174.4	171.7	N/A
Quarterly data	**Jun 07**	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**
Industrial Production, % y/y	-2.3	-2.0	-0.3	-4.4	-4.2	-6.7	-10.4	N/A
Real GDP, % y/y	6.1	6.7	6.9	7.3	4.3	1.7	-2.5	N/A
-Private consumption	7.6	11.3	9.7	7.6	3.5	0.0	-3.2	N/A
-Government consumption	3.8	2.4	3.3	0.6	3.2	2.0	2.6	N/A
-Gross fixed capital formation	6.5	-1.1	8.0	10.1	4.9	3.2	-17.3	N/A
Nominal GDP, HKD bn	378.1	415.4	447.9	410.6	401.6	429.9	436.4	N/A
Current Account, US$ bn	3.2	7.8	6.1	6.6	4.0	9.7	10.4	N/A
Capital & Financial Account, US$ bn	-5.1	-9.6	-8.3	-4.3	-2.6	-11.9	-8.9	N/A

Sources: CEIC

Hong Kong: FX and Rates Strategy





The HKMA is still having to flood the money market with liquidity in order to keep USD-HKD within its trading limit. Although the global economy is showing signs of stabilization, a tepid recovery in global demand is not expected until next year, with risks still considered to be skewed to the downside. As such, we still expect the HKMA to narrow further the gap with the Fed funds target, bringing the policy rate to 0.25% around the middle of this year.

FX

USD-HKD remains pinned to the floor of the 7.75-7.85 trading range with the HKMA having to intervene frequently, buying USD in order to keep the pair within the convertibility zone. In the wake of the Lehman Brothers bankruptcy last September, USD-HKD was pinned down by a mass unwinding of carry trades. Risk appetite has improved significantly, but the US move to quantitative easing (QE) has been an additional source of downward pressure on USD-HKD.

Meanwhile, forwards continue to trade below the floor, anticipating a shift in the trading band. In the current environment, however, the risk of a revaluation of the HKD is close to zero. Hong Kong is highly exposed to the global economy, both in terms of trade and financial links, and the normalisation in global demand and risk appetite will take time, probably longer than the market anticipates. As such, USD-HKD should remain near the lower threshold of the convertibility zone throughout 2009—weighed by bouts of USD weakness and continued unwillingness to take on meaningful risk.

Rates

In order to maintain the viability of the USD-HKD currency peg, HKMA monetary policy must mirror that of the Fed. The Fed has resorted to QE, but the HKMA still has room to cut its base rate. Thus far, the authorities have been content to maintain the existing gap, but the requisite injections of liquidity to keep the HKD from strengthening beyond its limit have become more and more frequent. Meanwhile, a normalisation in global demand is a long way away. As such, a further narrowing in the gap with the Fed Funds target seems just a matter of time.

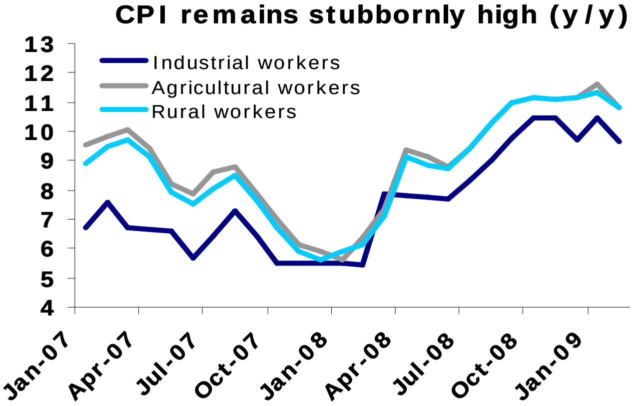
Tamara Henderson

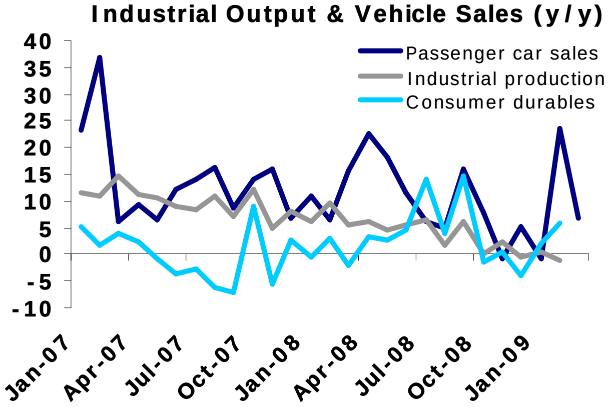
Market Forecasts – Hong Kong

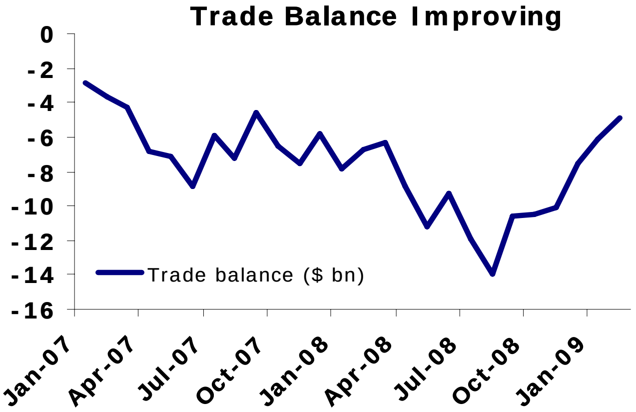
FX	Current	Ytd (%)	Jun 09	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10
USD-HKD	7.750	0.0%	7.750	7.750	7.755	7.760	7.770	7.790
AUD-HKD	5.529	1.5%	5.1	4.9	4.6	4.3	4.4	4.5
NZD-HKD	4.393	-2.2%	4.2	4.0	3.7	3.6	3.7	3.7
JPY-HKD	0.080	-6.2%	0.074	0.072	0.071	0.067	0.067	0.066
EUR-HKD	10.231	-5.5%	9.9	9.6	9.2	8.7	8.7	8.9
Rates	**Current**	**Ytd**	**Jun 09**	**Sep 09**	**Dec 09**	**Mar 10**	**Jun 10**	**Sep 10**
HKMA's discount rate	0.50	0	0.25	0.25	0.25	0.25	0.25	0.50
3-month HIBOR	0.79	-16	0.6	0.7	0.8	0.9	1.0	1.3
2-year IRS (onshore versus 3M	1.36	-13	1.2	1.3	1.4	1.5	1.6	1.9
10-year IRS	2.84	91	2.6	2.8	3.0	3.2	3.5	3.8

Sources: ANZ, Bloomberg

Country Update: India







The PMI index edged closer to the neutral mark in Mar, signalling further moderation in the decline in industrial activity. External demand worsened, but a sharp drop in imports led to a significant improvement in the trade balance. The focus will likely turn to the composition of the new coalition government and the challenging fiscal position.

- Wholesale price index (WPI) inflation surprised on the upside, rising 0.26% (y/y) during the week of 18 April, but the broad direction is still a decline towards negative territory. However, measures of CPI inflation remain stubbornly high, indicating a very slow forward transmission in prices.
- Industrial output contracted 1.2% y/y in Feb, the weakest in more than 14 years. However, consumer durables production rose for the second consecutive month, to 5.7%, from 1.9% in Jan.
- Manufacturing PMI improved further in Mar but remained below the neutral level. The Mar reading came in at 49.5, up from 47.0 in Feb. Ongoing improvement suggests the pace of decline in industrial output will likely moderate further in the coming months.
- Exports posted their largest monthly contraction on record at 21.7% (y/y) in Feb. Imports also fell in tandem to a record decline of 23.3%. The trade deficit narrowed to $4.9bn, reducing the net drag on growth from the external sector.
- The RBI lowered its benchmark policy rates by 25bps on 21 April, less than the market consensus of a 50bps cut. The RBI set the FY09/10 GDP forecast at 6%, broadly in line with market consensus. While WPI inflation is projected to dip briefly below zero in the early months of FY09/10, the RBI downplayed the risk of deflation.
- Developments on the fiscal front will likely gain more attention when there is more clarity on the government's spending plans post-election (results are due on 16 May). We see a significant risk of greater fiscal profligacy. Market perception on the stability of the coalition rather than party leadership would arguably matter more for investor confidence.

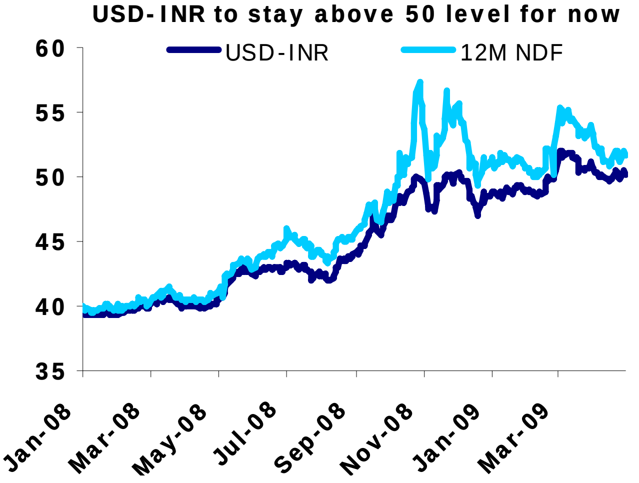
Yeo Han Sia

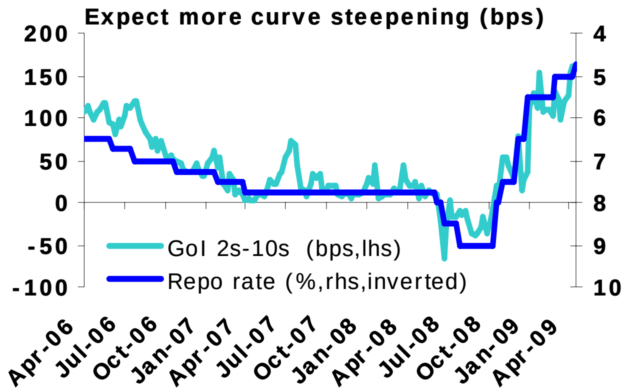
Economic Data – India

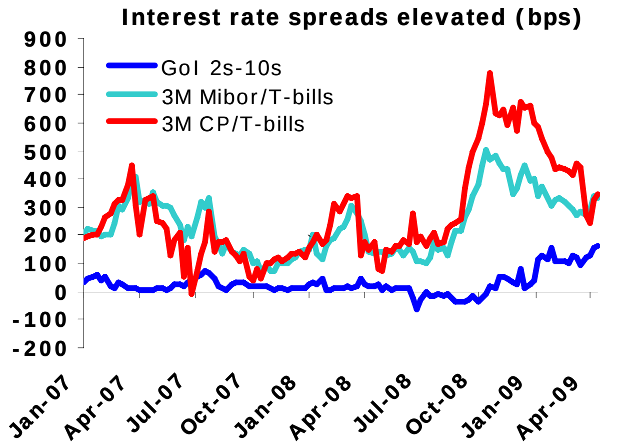
Monthly data	Aug 08	Sep 08	Oct 08	Nov 08	Dec 08	Jan 09	Feb 09	Mar 09
Industrial Production, % y/y	1.7	6.0	0.1	2.5	-0.6	0.4	-1.2	N/A
Automobile Sales, % y/y	11.7	15.2	-9.3	-10.4	-11.8	-6.0	10.0	0.5
Wholesale Price Index, % y/y	12.9	12.1	10.7	8.2	5.9	4.5	3.1	0.3
Exports, % y/y	26.1	13.5	-13.1	-20.1	-5.3	-15.9	-21.7	N/A
Imports, % y/y	46.6	55.3	7.6	-1.4	-1.0	-18.2	-23.3	N/A
Trade Balance, US$ bn	-13.1	-12.3	-10.0	-9.8	-6.3	-6.1	-4.9	N/A
Foreign Exchange Reserves, US$ bn	286.1	277.3	244.0	239.0	246.6	238.9	238.7	N/A
Quarterly data	**Jun 07**	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**
Real GDP, % y/y	9.1	9.1	8.9	8.9	7.9	7.6	5.3	N/A
-Agriculture	4.4	4.4	6.9	3.1	3.0	2.7	-2.2	N/A
-Industry	9.9	10.0	8.7	7.0	7.5	6.5	2.0	N/A
-Services	10.8	10.3	10.2	11.9	10.0	9.6	9.9	N/A
Nominal GDP, INR tn	9.9	9.9	11.4	12.0	11.6	11.7	13.0	N/A
Current Account, US$ bn	-6.7	-4.3	-4.5	-1.5	-9.0	-12.8	-14.6	N/A
Capital Account, US$ bn	17.8	33.2	31.0	26.0	11.1	7.9	-3.7	N/A

Sources: CEIC

India: FX and Rates Strategy







We expect a resurgence in risk aversion and USD strength to propel USD-INR back toward historical highs near the 52.0 level before reverting to current levels towards year end. The modest 25bps policy rate adjustment in April will likely reinforce the view that future RBI easing will be more measured.

FX

The INR is expected to trade in the 50.0 to 52.0 range, buffeted by cross-winds from relatively attractive growth prospects on the one hand and vulnerability from large twin deficits on the other hand. Near term risk factors include the rupee's vulnerability to swings in global risk appetite, uncertainty surrounding the election outcome and further deterioration in the fiscal accounts. We expect a resurgence in risk aversion and USD strength to propel USD-INR back toward the 52.0 level before mid-year. Improvements in global financial markets and India's external balances should cap upside beyond the historical high of 52.18. Our twelve-month view, however, is for USD-INR to revert back toward current levels, near 50.0, as broad USD strength starts to abate.

Rates

The RBI eased monetary policy during its 21 April quarterly review. Repo and reverse repo rates were lowered by 25bps to 4.75% and 3.25%, respectively. Market consensus was narrowly in favour of a 50bps repo rate reduction. There was little in the policy statement to suggest the easing cycle is over; the modest rate adjustment in April should reinforce the view that any future policy easing will be more measured following large liquidity injections in the past months.

The monetary transmission mechanism appears to be on the mend, although rate spreads remain elevated. Prime lending rates have fallen by less than 200bps in the last 7 months, far less than the RBI's effective rate cuts of 575bps over the same period. While there is still some scope for easing, we believe the RBI will likely pause after a final 25bps rate cut in July. Meanwhile, we continue to expect a steepening of the curve on the near-term policy outlook and uncertainty over fiscal spending post-election.

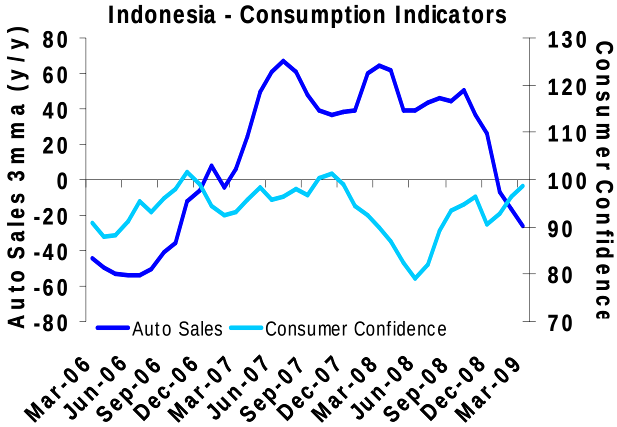
Yeo Han Sia

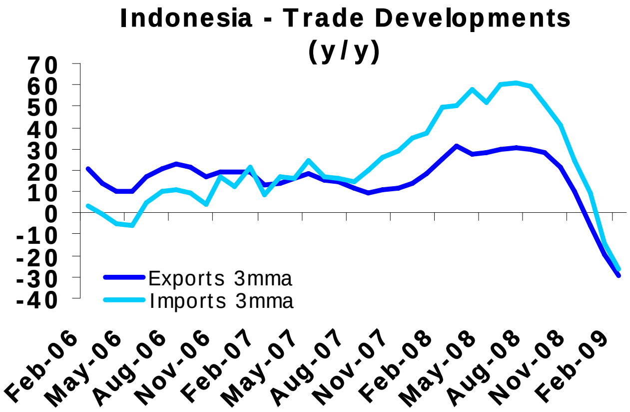
Market Forecasts – India

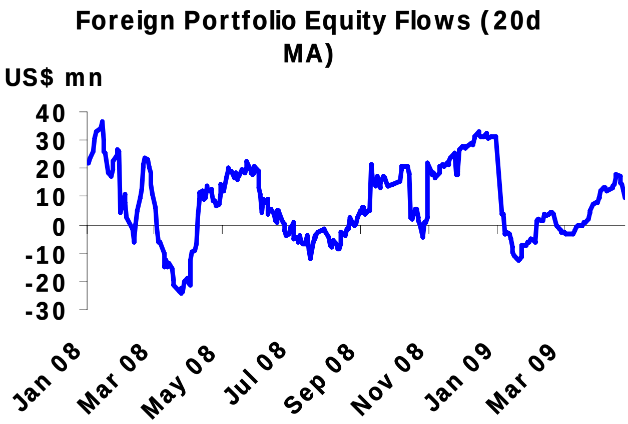
FX	Current	Ytd(%)	Jun 09	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10
USD-INR	49.90	2.2%	52.0	51.0	51.0	50.0	50.0	49.0
AUD-INR	36.22	5.9%	34.3	32.1	30.1	28.0	28.5	28.4
NZD-INR	28.24	0.2%	28.1	26.0	24.5	23.3	23.5	23.5
JPY-INR	0.51	-4.0%	0.495	0.472	0.464	0.431	0.431	0.415
EUR-INR	66.42	-2.4%	66.6	63.2	60.2	56.0	56.0	55.9
Rates	**Current**	**Ytd(bps)**	**Jun 09**	**Sep 09**	**Dec 09**	**Mar 10**	**Jun 10**	**Sep 10**
RBI's repo rate	4.75	-175	4.75	4.50	4.50	4.50	4.75	4.75
3-month MIBOR	5.64	-325	5.6	5.4	5.4	5.4	5.6	5.6
2-year IRS (versus NSE MIBOR)	4.25	-20	4.2	4.0	4.0	4.0	4.2	4.2
10-year IRS	5.95	113	6.0	6.0	6.0	6.0	6.1	6.1

Sources: Bloomberg, ANZ

Country Update: Indonesia







Consumption should remain a pillar of growth for Indonesia, although indicators are mixed. Investment and exports continue to be adversely affected by the global financial crisis. Inflation pressures continue to wane and the BI has more room to ease if necessary. The smooth election lowered political risk and bodes well for an uptick of investment flows going forward.

- Domestic consumption indicators remain mixed. Auto sales show no sign of recovery, declining 26.9% (y/y) in Mar compared with -27.4% in Feb. However, consumer confidence continues to rally, improving to 98.6 in Mar (its best reading since Dec 2007) from 96.4 in Feb.
- Local cement consumption plummeted 10.9% (y/y) in Mar, down from -2.4% in Feb, reflecting a large decline in investment and construction. Indonesian companies had been highly dependent on foreign financing prior to the crisis, and the ongoing global deleveraging process has resulted in many local investment plans being scrapped as foreign financing was withdrawn.
- Exports appear to be entering a phase of slower declines, falling 32.9% (y/y) in Feb from -35.0% registered in Jan. Imports also continue to fall sharply, declining by 42.0% in Feb from -27.9% previously as a result of the falling price of oil. The trade surplus increased to $2.5bn in Feb from $1.7bn in Jan.
- Inflation eased to a one-year low of 7.9% in Mar from 8.6% in Feb. Our short-term 3m/3m 'momentum' measure remains negative in Mar, indicating that inflation pressures remain subdued.
- The BI cut is benchmark policy rate for a fifth time this cycle, reducing the rate by 25bps to 7.5% on 3 Apr. There remains scope for the central bank to reduce rates further in order to support growth.
- The election campaigning was largely uneventful, with exit polls showing incumbent President Yudhoyono leading with the support of more than half of all respondents. We view political stability as a positive development for Indonesia that should be supportive of inward investment going forward.

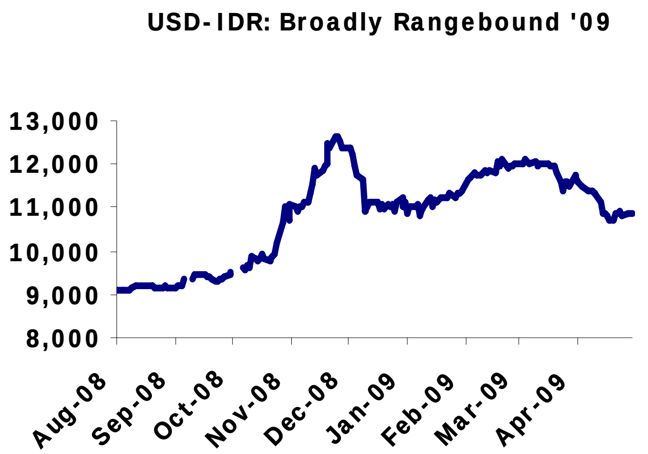
Chang Wei Liang

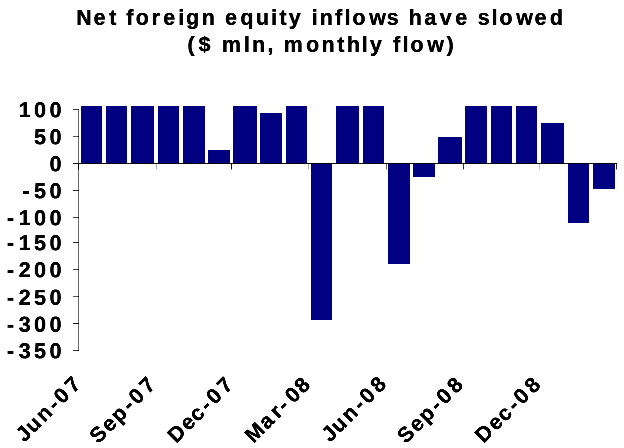
Economic Data – Indonesia

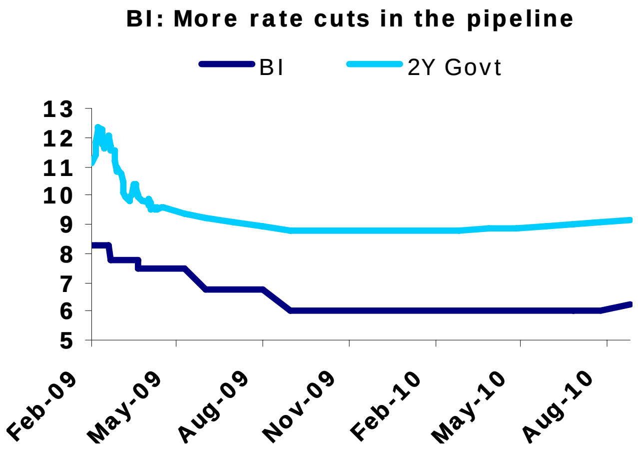
Monthly data	Aug 08	Sep 08	Oct 08	Nov 08	Dec 08	Jan 09	Feb 09	Mar 09
Industrial Production, % y/y	2.9	-0.8	6.1	0.6	-3.2	-4.7	-2.4	N/A
Retail Sales Index, % y/y	13.7	3.2	-15.5	-26.3	-5.0	2.9	-12.4	N/A
Consumer Price Index, % y/y	11.8	11.9	11.6	11.5	11.1	8.2	8.6	7.9
Exports, % y/y	29.9	29.0	4.7	-1.8	-18.7	-35.0	-32.9	N/A
Imports, % y/y	45.4	38.5	40.3	-5.6	-8.0	-27.9	-42.0	N/A
Trade Balance, US$ bn	2.4	2.9	2.0	2.5	2.6	1.9	2.5	N/A
Foreign Exchange Reserves, US$ bn	55.9	54.6	48.4	47.8	49.2	48.3	47.9	N/A
Quarterly data	**Jun 07**	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**
Real GDP, % y/y	6.6	6.6	5.8	6.2	6.4	6.4	5.2	N/A
-Private consumption	4.7	5.1	5.5	5.7	5.5	5.3	4.8	N/A
-Government consumption	3.8	6.5	2.0	3.6	5.3	14.1	16.4	N/A
-Gross fixed capital expenditure	7.6	9.7	12.4	13.7	12.0	12.2	9.1	N/A
Nominal GDP, IDR tn	964.8	1,030.8	1,034.9	1,117.6	1,229.6	1,332.5	1,274.3	N/A
Current Account, US$ bn	2.3	2.2	3.4	2.8	-1.0	-0.9	-0.2	N/A
Capital & Financial Account, US$ bn	2.0	-0.9	0.7	-1.4	2.5	0.9	-3.8	N/A

Sources: CEIC

Indonesia: FX and Rates Strategy







The IDR has strengthened in line with the general improvement in risk appetite. Also supportive of the rupiah, Indonesia's fundamentals are attractive on a relative basis and the smooth progression of elections is reducing political uncertainty. Going forward, global sentiment should remain in the driver's seat for much of this year. The road to normalisation in global demand will be longer than the market would prefer, so setbacks in risk appetite are likely—along with retreats in USD-IDR.

FX

Improved sentiment in global financial markets has pushed USD-IDR below its 200-day moving average near 10,780. Year-to-date, the rupiah has rallied nearly 4% against the USD, by far the best performance within AXJ. The conclusion of first round parliamentary elections, giving President Yudhoyono's party a larger share of government, was also a source of support for the rupiah mid-month.

Indonesia's growth prospects remain among the more promising in Asia as the economy is more insulated from external shocks. Indonesia is a net exporter of natural resources, so the bottoming in commodity prices should help push the current account back toward surplus. Net foreign equity inflows have picked up recently, although the net flow is still down 95% (ytd y/y).

Going forward, attractive fundamentals should support the IDR within AXJ. Relative to the USD, however, global sentiment is expected to remain in the driver's seat until a recovery in global demand is at hand. Global growth prospects for 2010 remain tepid and fraught with downside risks. As such, setbacks in risk appetite are likely along this long road to normalisation.

Rates

We remain bullish on IDR rates in 2009. Notwithstanding BI's recent 25bps rate cut to 7.5%, another 50bps of cuts are believed to be in the pipeline. Also, the government is in a better financing position than its counterparts, having raised excess of funds in the preceding year. Government issuance in 2009 has been well-diversified, including over-subscribed USD and sukuk deals. Also, IDR bonds offer attractive yields and good value, having sold-off sharply last year.

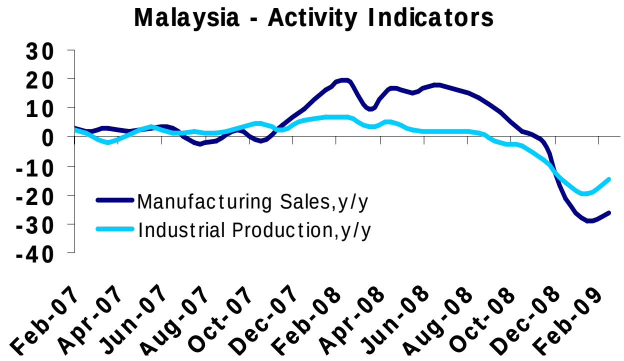
Tamara Henderson

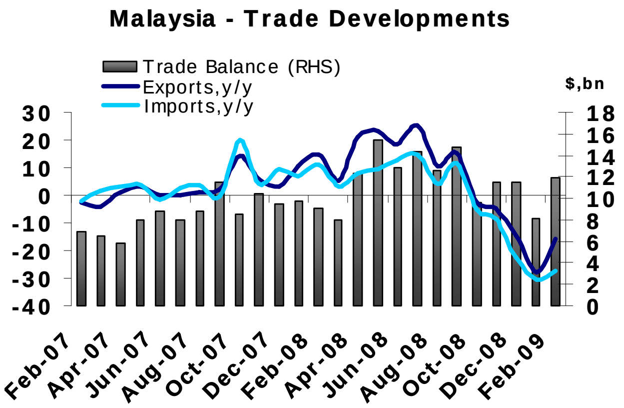
Market Forecasts – Indonesia

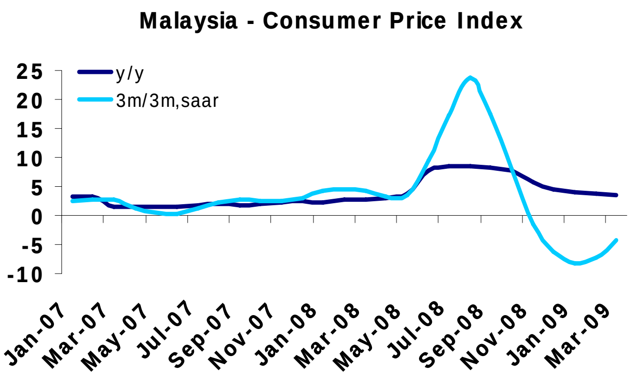
FX	Current	Ytd(%)	Jun 09	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10
USD-IDR	10,846	-2.5%	11,500	11,900	11,500	11,500	11,000	10,500
AUD-IDR	7,754	-2.6%	7,600	7,500	6,800	6,400	6,300	6,100
NZD-IDR	6,148	-6.3%	6,200	6,100	5,500	5,300	5,200	5,000
JPY-IDR	112	-10.0%	110	110	100	100	90	90
EUR-IDR	14,309	-9.6%	14,700	14,800	13,600	12,900	12,300	12,000
Rates	**Current**	**Ytd(bps)**	**Jun 09**	**Sep 09**	**Dec 09**	**Mar 10**	**Jun 10**	**Sep 10**
BI's bank rate	7.50	-175	7.00	7.00	7.00	7.00	7.00	7.25
3-month JIBOR	8.78	-336	8.3	8.4	8.5	8.6	8.7	9.0
2-year IRS (versus IDR fix)	11.25	-275	10.8	10.9	11.0	11.1	11.2	11.5
10-year IRS	11.25	175	10.9	11.1	11.3	11.5	11.8	12.1

Sources: Bloomberg, ANZ

Country Update: Malaysia







Trade data and activity indicators point to a moderation in the pace of decline in economic activity. Despite building optimism, the speed of the recovery is uncertain, exacerbated by swift reforms in policies by the new administration.

- Manufacturing sales fell 26.1% (y/y) in Feb after falling 29.1% in Jan. Industrial production dropped for a sixth straight month, contracting by 14.7% (y/y) in Feb as compared with -19.8% in Jan.
- Domestic consumption remains weak. Although the government provided subsidies for the replacement of older model cars, auto sales slid 4.8% (y/y) in Mar and fell by 9% (y/y) in Q1.
- Trade continued to shrink, with exports falling 15.9% (y/y) in Feb, and imports down 27.3%. Both exports and imports witnessed a slower pace of deterioration in contrast with -27.9% and -30.4%, respectively, in Jan. Overall, the trade balance improved to $12.0bn in Feb from $8.1bn in Jan.
- Inflation eased to 3.5% in Mar from 3.7% in Feb; monthly inflation fell to 0.2%. Declining global commodity prices and slowing demand have damped price pressures, allowing policy makers room to cut borrowing. However, the BNM refrained from cutting the benchmark rate in Apr, which remains at 2.00%.
- Prime Minister Najib, who took office in April, moved swiftly to implement structural changes to the financial sector in order to attract more foreign investment and improve competitiveness. Foreigners will now be able to own a majority stake in all financial institutions (70% ownership limit, up from 49% previously) except in commercial banks where the limit remains at 30%. We expect that this will be one of the many policy reforms that the new administration will undertake aimed at reducing Malaysia's dependence on external demand.
- Looking ahead, exports are unlikely to be source of growth anytime soon and domestic demand growth should remain tepid. The economy is expected to shrink in H1 and expand by only 2% in 2009.

Zhou Hao & Naresh Navaratnarajah

Economic Data – Malaysia

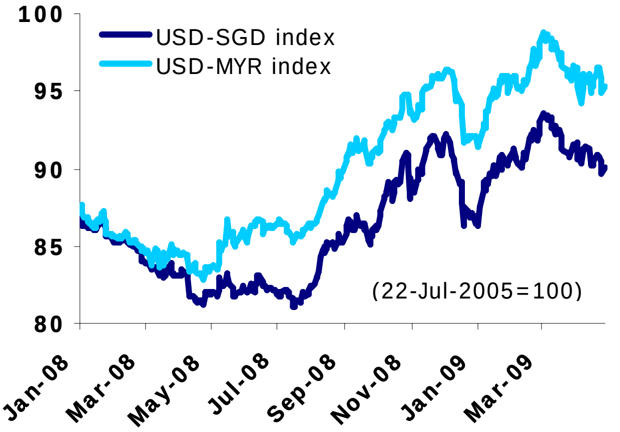
Monthly data	Aug 08	Sep 08	Oct 08	Nov 08	Dec 08	Jan 09	Feb 09	Mar 09
Industrial Production, % y/y	1.2	-1.7	-2.8	-8.2	-15.5	-19.8	-14.7	N/A
Manufacturing Sales, % y/y	13.4	8.6	2.1	-1.9	-20.8	-29.1	-26.1	N/A
Consumer Price Index, % y/y	8.5	8.2	7.6	5.7	4.4	3.9	3.7	3.5
Exports, % y/y	10.7	15.0	-2.6	-4.9	-14.9	-27.9	-15.9	N/A
Imports, % y/y	4.4	11.4	-5.3	-8.6	-22.8	-30.4	-27.3	N/A
Trade Balance, USD bn	3.7	4.3	2.7	3.2	3.3	2.2	3.2	N/A
Foreign Exchange Reserves, US$ bn	116.9	104.5	94.9	92.1	85.7	85.9	85.3	82.3
Quarterly data	**Jun 07**	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**
Retail Sales, % y/y	33.0	39.7	35.7	19.8	23.8	25.4	16.5	N/A
Real GDP, % y/y	5.7	6.7	7.3	7.4	6.7	4.7	0.1	N/A
-Private consumption	12.3	13.0	10.2	11.7	9.0	8.1	5.3	N/A
-Government consumption	10.4	6.0	4.2	14.7	10.9	6.9	13.8	N/A
-Gross fixed capital formation	6.0	12.8	10.2	6.0	5.6	3.1	-10.2	N/A
Nominal GDP, MYR bn	154.3	166.3	176.7	175.4	189.4	198.7	177.3	N/A
Current Account, US$ bn	7.3	8.6	8.0	7.5	11.3	11.2	8.8	N/A

Sources: CEIC

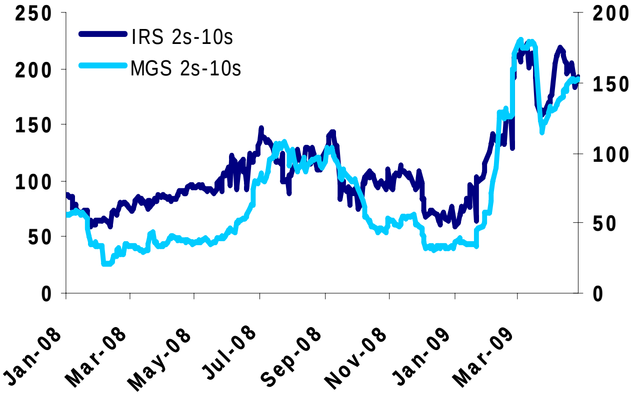
Malaysia: FX and Rates Strategy

We continue to expect USD-MYR to rise towards the former peg level of 3.80 on weak growth prospects. Negative swap spreads narrowed in the past month, but the market anomaly could persist in view of supply concerns in the MGS market.

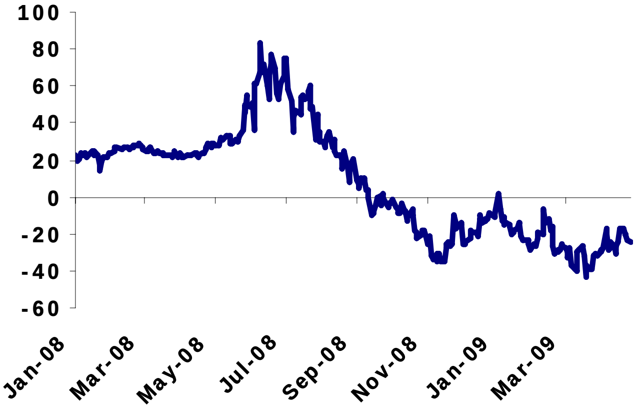
MYR closely tracking the SGD



2s-10s spreads eased from March highs (bps)



Negative 2Y swap spread narrowed (bps)



FX

The pace of contraction in monthly trade numbers eased in Feb, in part due to calendar effects, but data continue to point to ongoing deterioration in external demand. The steeper decline in imports should however cushion the impact on trade balances and MYR in the coming months. The partial liberalization in financial services announced on 27 April should at the margin increase capital account inflows, but any beneficial effects may only be felt in 2010 and beyond, when global financial markets recover. With the BNM projecting a 25% decline in exports and zero growth in 2009, the central bank will likely continue to tolerate MYR weakness to support economic growth and to maintain competitiveness within the region. The MYR continues to track the SGD closely, but we see scope for SGD-MYR to ease from the upper end of the 2.20–2.40 trading range in the post-peg period on relatively stronger growth prospects. We expect USD-MYR to rise towards the former peg level of 3.80 in coming months.

Rates

The unexpected revision to the 2009 issuance calendar on 20 March has flattened the 2s-10s MGS curve by around 30bps on a cutback in supply of long dated government bonds. Although liquidity conditions remain supportive of the MGS market, the potential for further gains may be limited with BNM signalling an end to its easing cycle in April and downside risks to the government's fiscal position. Negative swap spreads (IRS-MGS) have narrowed in the past month, but the market anomaly could persist for several more months in view of supply concerns in the MGS market.

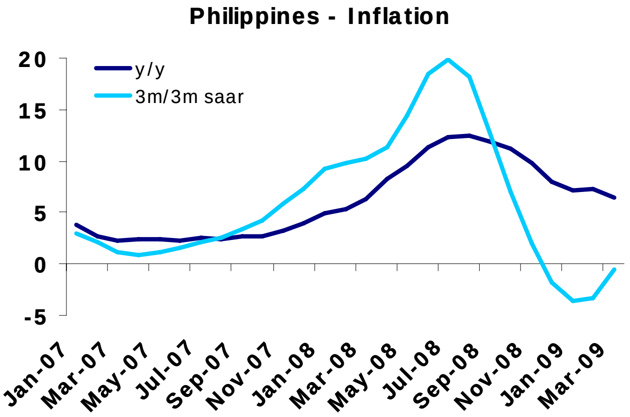
Yeo Han Sia

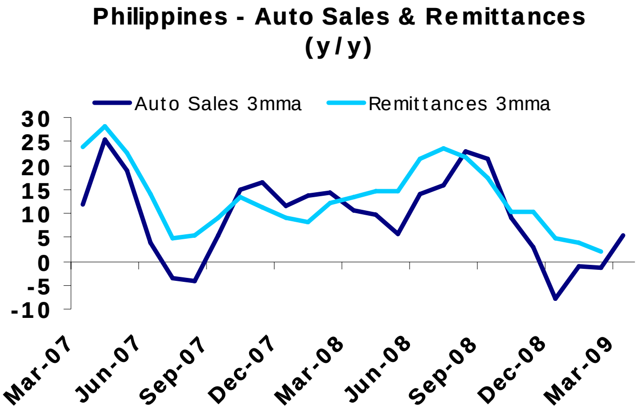
Market Forecasts - Malaysia

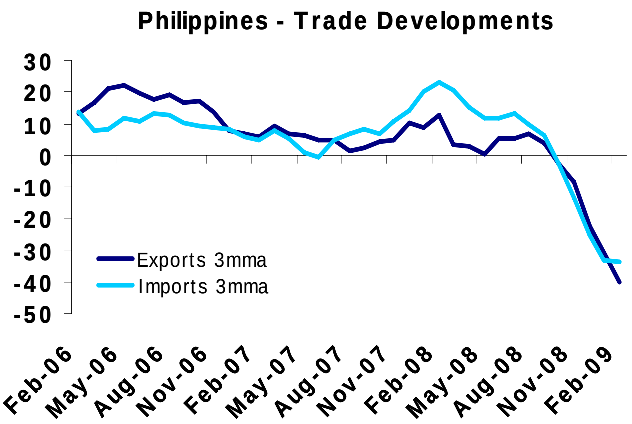
FX	Current	Ytd(%)	Jun 09	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10
USD-MYR	3.56	2.5%	3.70	3.75	3.75	3.70	3.65	3.60
AUD-MYR	2.61	7.7%	2.44	2.36	2.21	2.07	2.08	2.09
NZD-MYR	2.04	1.9%	2.00	1.91	1.80	1.72	1.72	1.73
JPY-MYR	3.65	-12.9%	3.52	3.47	3.41	3.19	3.15	3.05
EUR-MYR	4.76	-1.4%	4.74	4.65	4.43	4.14	4.09	4.10
Rates	**Current**	**Ytd(bps)**	**Jun 09**	**Sep 09**	**Dec 09**	**Mar 10**	**Jun 10**	**Sep 10**
BNM's overnight policy rate	2.00	-125	2.00	2.00	2.00	2.00	2.00	2.00
3-month KLIBOR	2.11	-126	2.1	2.1	2.1	2.1	2.1	2.1
2-year IRS (versus 3M KLIBOR)	2.34	-47	2.3	2.3	2.3	2.3	2.3	2.3
10-year IRS	4.30	80	4.0	3.9	3.9	3.9	3.9	3.9

Sources: Bloomberg, ANZ

Country Update: Philippines







The Philippines will see slowing growth as consumption moderates in line with remittances. Exports continue to languish with the fall in global trade while manufacturing remains weak. Inflation continues to fall and the BSP has ample ammunition if needed.

- Consumption, which has been the sole pillar of growth recently, appears to be easing. Auto sales growth slipped to 0.6% (y/y) in Mar from 1.3% in Feb, although the trend has picked up.
- Remittances, which have supported consumption in previous downturns, have slowed sharply as top source countries have been the worst affected by the crisis. Remittances growth fell to 4.9% (y/y) in Feb compared with an average 14.2% growth for 2008.
- Exports have yet to show signs of a turnaround, falling 39.0% (y/y) in Feb compared with -40.6% in Jan. Electronics shipments, which account for around half of all exports, are down by 45% in Mar compared with -48% in Feb. Imports declined by 31.9% in Feb as fewer raw materials and capital goods were imported. The trade deficit shrank to $552mn in Feb ($759mn in Jan).
- Manufacturing production value-add fell 18.9% (y/y) in Feb compared to -21.2% in Jan. Capital goods imports fell by a record 43.3% (y/y) in Mar, far below the nadir of the 1998 Asian Crisis.
- Inflation fell to 6.4% (y/y) in Mar from 7.3% in Feb as both food/fuel and core prices stabilised. Our short-term 'momentum' indicator indicates that inflationary pressures are still subdued.
- Foreign portfolio flows recovered strongly in Q1 as risk appetite returned. The Philippines registered net inflows of $54.8mn compared to net outflows of $895.3mn in Q4 last year.
- The BSP lowered its policy rate by 25bps to 4.75% in Mar, indicating they are mindful of lingering inflation pressures. There is still ample room for the central bank to continue easing should downside risks to growth and inflation materialise.

Chang Wei Liang

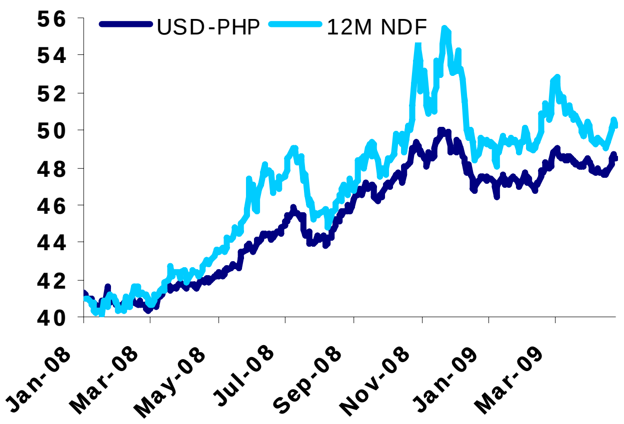
Economic Data – Philippines

Monthly data	Aug 08	Sep 08	Oct 08	Nov 08	Dec 08	Jan 09	Feb 09	Mar 09
Manufacturing Production Value-add, % y/y	6.3	14.5	10.7	2.3	-8.0	-21.2	-18.9	N/A
Passenger Car Sales, % y/y	20.6	12.3	-5.9	2.0	-19.5	14.2	1.2	0.6
Consumer Price Index, % y/y	12.4	11.8	11.2	9.9	8.0	7.1	7.3	6.4
Exports, % y/y	6.6	1.3	-14.4	-11.4	-40.3	-40.6	-39.0	N/A
Imports, % y/y	1.2	3.1	-11.1	-31.5	-34.0	-34.5	-31.9	N/A
Trade Balance, US$ bn	-0.6	-0.4	-0.6	0.0	-0.6	-0.8	-0.6	N/A
Foreign Exchange Reserves, US$ bn	32.5	32.3	31.8	32.4	32.6	34.1	33.6	N/A
Quarterly data	**Jun 07**	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**
Real GDP, % y/y	8.3	7.1	6.4	4.7	4.4	5.0	4.5	N/A
-Private consumption	5.6	5.7	6.2	5.2	4.1	4.4	4.5	N/A
-Government consumption	11.9	6.4	4.6	1.9	-1.5	13.4	4.7	N/A
-Gross fixed capital formation	20.9	8.8	6.7	2.9	3.0	7.0	1.9	N/A
Nominal GDP, peso bn	1,618.6	1,613.8	1,891.8	1,668.0	1,837.9	1,864.9	2,126.8	N/A
Current Account, US$ bn	1.9	1.3	2.0	1.3	0.9	-0.3	2.3	N/A
Capital & Financial Account, US$ bn	-0.4	3.1	-0.1	0.5	0.4	0.4	-3.3	N/A

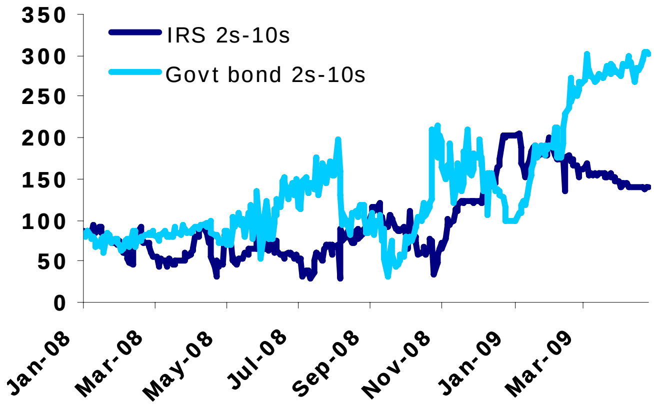
Sources: CEIC

Philippines: FX and Rates Strategy

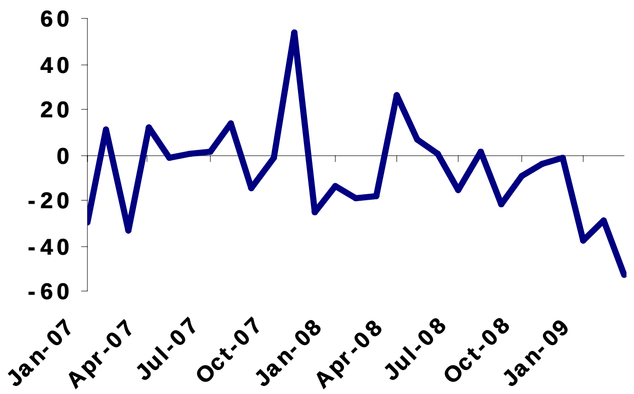
PHP resilience likely to fade



Upside risk to 2s-10s IRS spread (bps)



Budget deficit hits record high (PHP bn)



PHP underperformed within AXJ in April on negative developments on the fiscal front. We continue to expect USD-PHP to retest the 50.0 level. The balance of risk remains skewed towards a further widening of the fiscal deficit.

FX

The deterioration in the fiscal position appears to have taken its toll on the peso in April. USD-PHP bucked the regional trend to rise 0.2% despite March remittance inflows rising to 4.9% (y/y) from 0.1% in February. The March fiscal deficit surged to a record high of PHP52.6bn, pushing the 1Q09 deficit almost 10% above the official target of PHP110bn. The 1Q09 shortfall is around two-thirds of the revised full year forecast of PHP199.2bn pesos (2.5% of GDP). The adjustment in the government's external-domestic borrowing mix to 72%-28% from 75%-25% should at the margin increase foreign currency inflows. Foreign borrowings are projected to rise to PHP175bn (PHP147bn previously). The proceeds from external borrowing and privatization to fund the deficit should support the BoP in 2009, though fiscal sustainability remains a medium-term issue.

Remittance flows play a large part in Philippines' growth resilience, and the evolution of flows will likely remain topical in the coming months. In this regard, we continue to see scope for the peso to retest the 50.0 level. Presidential elections due in May 2010 will be a significant risk factor to watch out for towards end-year.

Rates

The BSP lowered its overnight rate by 25bps to 4.5% on 16 April as was widely expected. Comments by Governor Tetangco continue to suggest room for more rate cuts in the coming months, though the characterization of monetary policy as "appropriately stimulative" indicates the easing cycle may be ending soon. We expect the policy rate to bottom at 4.25% by mid-2009.

While the fallout from the unexpectedly large March deficit was limited by a timely announcement of a cutback in domestic debt issuance to 439bn from 442bn, the balance of risk remains skewed towards a further widening in the fiscal gap. The government has already revised its deficit forecast twice since the beginning of the year, and the official GDP forecast remains more optimistic than current market consensus.

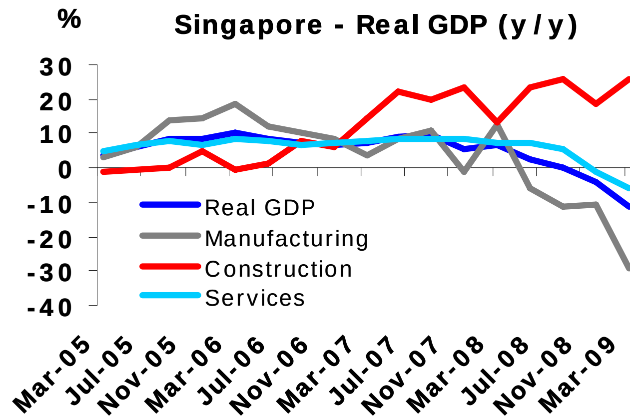
Yeo Han Sia

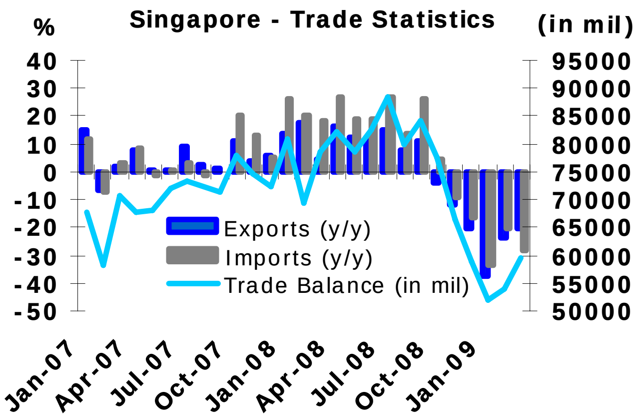
Market Forecasts - Philippines

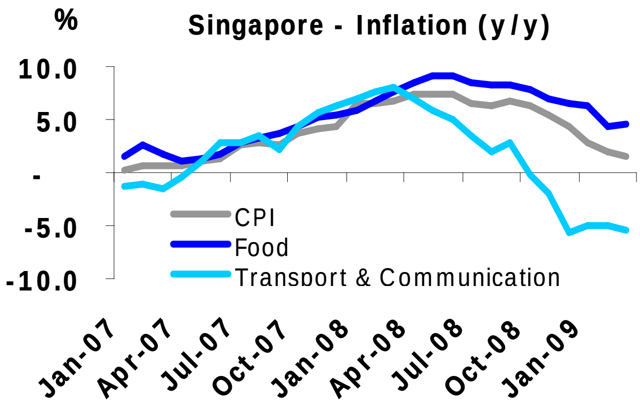
FX	Current	Ytd(%)	Jun 09	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10
USD-PHP	48.38	1.8%	49.5	50.0	49.5	48.8	48.5	48.0
AUD-PHP	35.07	5.3%	32.7	31.5	29.2	27.3	27.6	27.8
NZD-PHP	27.33	-0.5%	26.7	25.5	23.8	22.7	22.8	23.0
JPY-PHP	0.50	-4.8%	0.471	0.463	0.450	0.421	0.418	0.407
EUR-PHP	64.23	-3.0%	63.4	62.0	58.4	54.7	54.3	54.7
Rates	**Current**	**Ytd(bps)**	**Jun 09**	**Sep 09**	**Dec 09**	**Mar 10**	**Jun 10**	**Sep 10**
BSP's overnight reverse repo rate	4.50	-100	4.25	4.25	4.25	4.25	4.25	4.25
3-month PHIBOR	4.00	-125	3.8	3.8	3.8	3.8	3.8	3.9
2-year IRS (versus 3M IB ref rate)	4.16	9	3.9	3.9	3.9	3.9	3.9	4.1
10-year IRS	5.58	-52	5.5	5.7	5.9	5.9	5.7	5.5

Sources: Bloomberg, ANZ

Country Update: Singapore







The continuing global economic slump has driven down non-oil domestic exports and manufacturing outputs, prompting the government to again revise its 2009 growth forecast downwards. Declining retail sales and falling visitor numbers add to the overall weak sentiment.

- GDP declined by 19.7% (q/q, saar) in the first quarter of 2009, after shrinking by 16.4% in the last quarter of 2008. Non-oil domestic exports and manufacturing fell by 17% (y/y) and 33.9%, respectively, in Mar.
- Inflation continued to fall, with the consumer price index slowing to 1.6% (y/y) in Mar from 1.9% in Feb. The weakening economy eroded demand and transportation and communication costs eased.
- The retail sales index dropped by 5.7% (y/y) in Feb after declining by 11.8% in Jan. Although sales of food & beverages and apparel & footwear dropped by 25.8% and 22.9%, respectively, vehicle sales rose by 6.2%, boosted by lower COE prices. Falling visitor arrivals, which dipped by 13.2% (y/y) in Mar, will also hurt retail sales.
- Boosted by gains in US equity markets arising from Treasury Secretary Geithner's comments that stress tests will show that most of the largest US banks have sufficient capital, equity prices rose and the STI index closed higher by around 9% from early-Apr.
- The government revised its 2009 growth forecast for the third time. The official forecast is now for the economy to contract in range of -6% to -9% this year, from a estimated contraction as low as -5% previously.
- Reflecting weak growth and falling inflation, the MAS re-centred the exchange-rate band to the prevailing level at a twice-yearly monetary policy review held on 14 Apr. The central bank explained that the current level of the Singapore dollar's nominal effective exchange rate is appropriate for maintaining domestic price stability over the medium term as the Singapore economy, although in recession, remains sound.

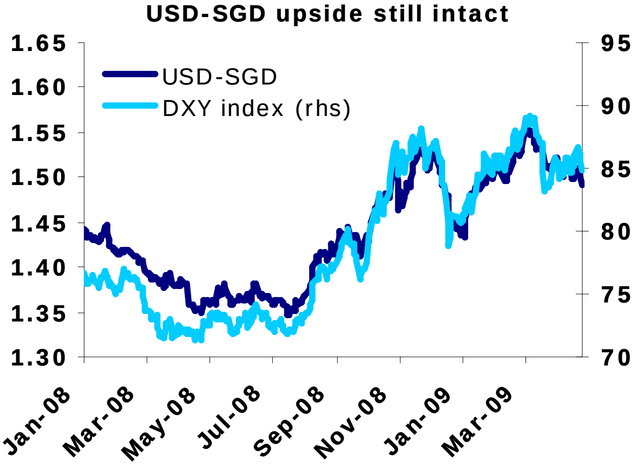
Ivy Tan

Economic Data – Singapore

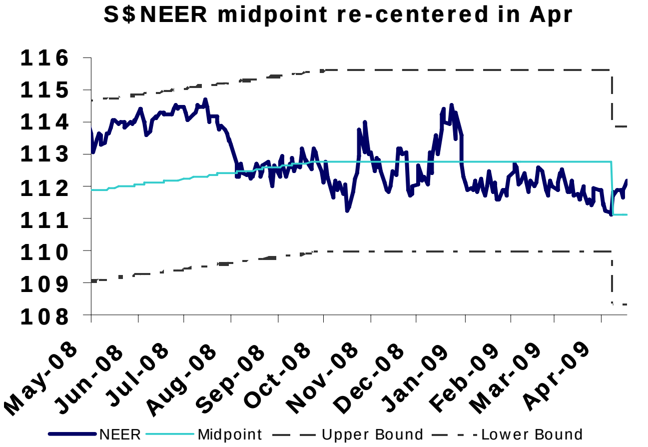
Monthly data	Aug 08	Sep 08	Oct 08	Nov 08	Dec 08	Jan 09	Feb 09	Mar 09
Industrial Production, % y/y	-12.0	3.3	-12.2	-6.7	-13.4	-27.6	-15.1	-33.9
Retail Sales, % y/y	3.9	7.2	-3.5	-2.9	-0.9	-11.8	-5.7	N/A
Consumer Price Index, % y/y	6.4	6.7	6.4	5.5	4.3	2.9	1.9	1.6
Domestic Exports (Non-oil), % y/y	-13.9	-5.7	-15.5	-17.5	-20.8	-34.9	-23.8	-17.0
Imports (Non-oil), % y/y	0.1	12.6	-2.2	-12.4	-14.0	-29.1	-17.3	-25.4
Trade Balance, US$ bn	2.6	1.5	0.4	1.0	0.7	0.5	0.8	2.7
Foreign Exchange Reserves, US$ bn	171.5	169.1	162.5	165.8	168.9	169.2	166.0	164.7
Quarterly data	**Jun 07**	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**
Real GDP, % y/y	8.6	9.5	5.5	6.7	2.5	0.0	-4.2	N/A
-Private consumption	5.8	6.3	5.8	4.1	4.4	2.7	-1.2	N/A
-Government consumption	3.4	-0.6	9.5	10.4	9.0	9.9	2.7	N/A
-Gross fixed capital formation	25.7	15.4	17.0	30.5	25.0	14.9	-9.9	N/A
Nominal GDP sa, SGD bn	61.8	64.2	66.5	66.0	64.3	64.5	62.8	N/A
Current Account, US$ bn	9.8	11.5	6.3	8.1	6.7	7.7	4.5	N/A
Capital & Financial Account, US$ bn	-3.1	-8.0	0.7	2.0	-3.8	-8.6	-1.1	N/A

Sources: CEIC

Singapore: FX and Rates Strategy



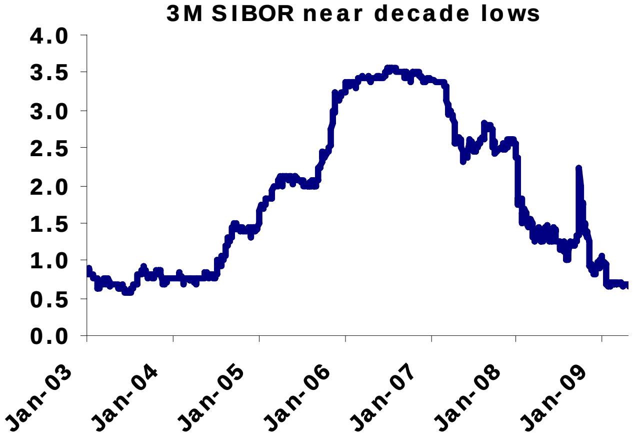
The MAS loosened monetary policy on 14 Apr in line with our expectations. The unwinding of long USD positions has nudged S$NEER to the strong side of the band, but we expect a resurgence in risk aversion and USD strength to propel USD-SGD above the 1.60 level.



FX

The MAS re-centred its S$NEER band to the prevailing level on 14 Apr, while keeping the neutral bias (i.e. zero slope) and band width unchanged. This was in line with our call, and translates to approximately a 1.5% shift in the band—less aggressive than the 2%-3% shifts in the past. The April statement suggests that the MAS sees little need for much looser monetary policy, barring a further sharp deterioration in the economic outlook from its revised forecast of a 6% to 9% contraction.

Going forward, a recovery in external demand will be a necessary condition for the MAS to revert back to a gradual appreciation bias. Meanwhile, mounting job losses in 2009 will weigh on domestic demand, notwithstanding the sizeable transfer programs implemented in recent months. With the economy likely to perform well below growth potential through 2009-10, we expect current policy to be maintained into 2010. In the wake of the MAS policy announcement, an unwinding of long USD positions amid a more conducive risk environment nudged the S$NEER to the strong side of the policy band. However, we expect the S$NEER to drift back to the weaker side of the band and look for USD-SGD to break above the 1.60 level on a resurgence in risk aversion and USD strength.



Rates

We revised the 3-month SIBOR forecast higher. Despite comfortable liquidity conditions, interbank rates appear to have found strong support in recent ranges. Ample fiscal reserves should limit the impact on 2s-10s (GOV and IRS) even if a supplementary budget is proposed in the coming months.

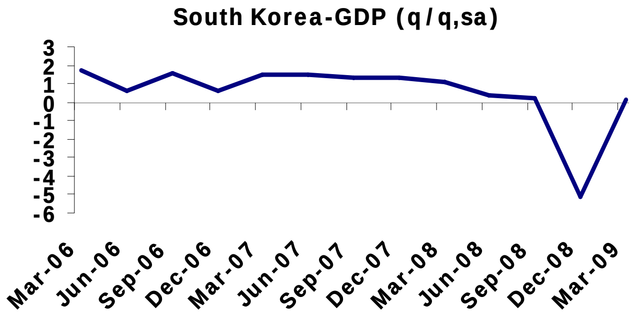
Yeo Han Sia

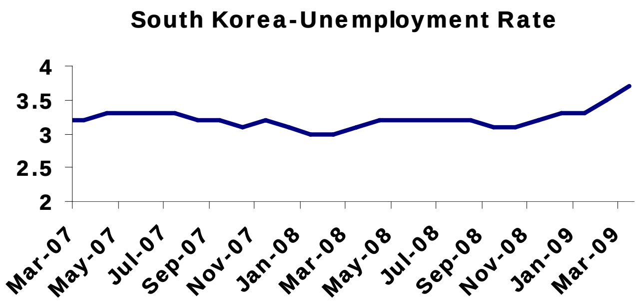
Market Forecasts – Singapore

FX	Current	Ytd(%)	Jun 09	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10
USD-SGD	1.481	3.5%	1.58	1.60	1.62	1.63	1.61	1.60
AUD-SGD	1.077	7.1%	1.04	1.01	0.96	0.91	0.92	0.93
NZD-SGD	0.839	1.2%	0.85	0.82	0.78	0.76	0.76	0.77
JPY-SGD	1.518	-3.7%	1.50	1.48	1.47	1.41	1.39	1.36
EUR-SGD	1.972	-1.3%	2.02	1.98	1.91	1.83	1.80	1.82
Rates	**Current**	**Ytd(bps)**	**Jun 09**	**Sep 09**	**Dec 09**	**Mar 10**	**Jun 10**	**Sep 10**
3-month SIBOR	0.68	-28	0.65	0.65	0.65	0.85	1.05	1.30
2-year IRS (onshore versus 6M SOR)	1.58	1	1.6	1.5	1.5	1.6	1.8	2.1
10-year IRS	2.66	40	2.3	2.1	2.0	2.2	2.6	2.9

Sources: Bloomberg, ANZ

Country Update: South Korea





The Korean economy surprisingly stabilised in Q1 following a 5.1% contraction in Q4 2008. Improvements were across-the-board, with numbers either dropping less or staging a modest rebound. Nevertheless, it is too early to call a recovery, and we expect the economy to register sluggish growth for the coming quarters. A recovery is not expected until 2010.

- The economy expanded by 0.1% in Q1, much stronger than the 5.1% drop in Q408 and well above consensus (and ANZ's forecast). Growth was in part driven by the government's stimulus plan, as seen from the strong rebound in construction growth to 5.3% (q/q sa) from the previous quarter's 3% contraction.
- More generally, government expenditure rose by 3.6% (q/q sa), faster than Q4's 1% pace. On the other hand, private consumption rose 0.4% (q/q sa) in Q109, after a 4.6% decline in Q4, and facilities investment improved, dropping by 9.6% (q/q sa) compared with 14.2% in Q409. The contribution to growth from the external sector was strong, with imports falling much faster than exports (-8.7% q/q sa vs -4.2%).
- Consumer price inflation rose 3.9% (y/y) in Mar, the same as the average for Jan-Feb. Excluding agricultural and oil products, the core rate dropped to 4.5% in Mar from 5.2% in the previous two months
- Seasonally adjusted jobless rate rose to 3.7% in Mar from 3.5% in Feb. By comparison, the unemployment rate reached a high of 4.7% in Feb 2001.
- The economic outlook remains weak but improving. The Leading Composite Index rose by 0.5% in Feb, the first increase after eight consecutive monthly declines. At the same time, the forecast business survey index rose to 62 in Apr from Mar's 56, still below the 100 neutral line but the third consecutive monthly rise from the bottom reading of 50 recorded in Jan. The country's expansionary fiscal policy and easy monetary policy should continue cushioning any downside to growth.
- Nevertheless, it's too early to call for a recovery, given the economy's heavy dependence on external demand. We forecast the economy to register sluggish growth at best for the coming quarters. A more robust recovery is expected for 2010.

Franklin Poon

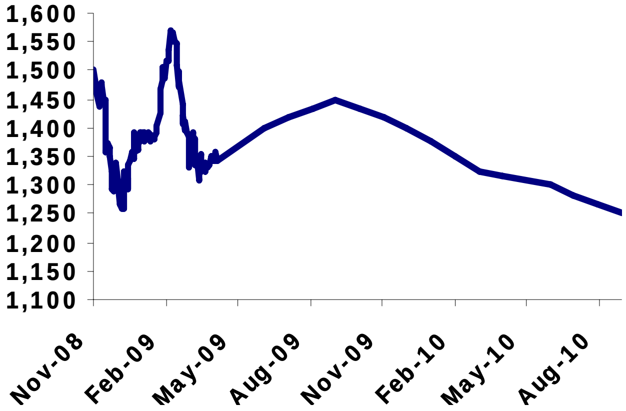
Economic Data – South Korea

Monthly data	Aug 08	Sep 08	Oct 08	Nov 08	Dec 08	Jan 09	Feb 09	Mar 09
Industrial Production, % y/y	1.8	6.3	-1.9	-13.8	-18.7	-25.5	-10.3	N/A
Retail Sales, % y/y	11.1	4.9	1.9	-0.5	-1.2	-1.2	-4.0	N/A
Consumer Price Index, % y/y	5.6	5.1	4.8	4.5	4.1	3.7	4.1	3.9
Exports, % y/y	18.1	27.6	7.8	-19.5	-17.9	-34.2	-18.5	-22.0
Imports, % y/y	36.4	45.4	10.3	-15.0	-21.6	-31.5	-31.0	-35.9
Trade Balance, USD bn	-3.8	-2.1	1.0	0.0	0.5	-3.6	2.9	4.3
Foreign Exchange Reserves, US$ bn	243.4	240.4	212.8	201.0	201.0	201.6	201.8	206.4
Quarterly data	**Jun 07**	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**
Real GDP, % y/y	5.3	4.9	5.7	5.5	4.3	3.1	-3.4	-4.3
-Private consumption	5.2	5.4	4.7	4.0	2.3	1.4	-3.7	-4.4
-Government consumption	6.3	4.8	4.7	3.6	4.0	4.5	4.7	7.2
-Gross fixed capital formation	5.7	1.5	3.1	-0.5	0.6	1.8	-7.3	-7.5
Nominal GDP, KRW tn	241.0	246.7	263.1	240.8	260.7	261.5	260.9	N/A
Current Account, US$ bn	1.1	2.0	-0.8	-0.1	1.8	-1.3	0.9	6.6
Capital & Financial Account, US$ bn	-0.3	-3.9	0.3	0.4	-3.6	-4.4	-4.8	-2.2

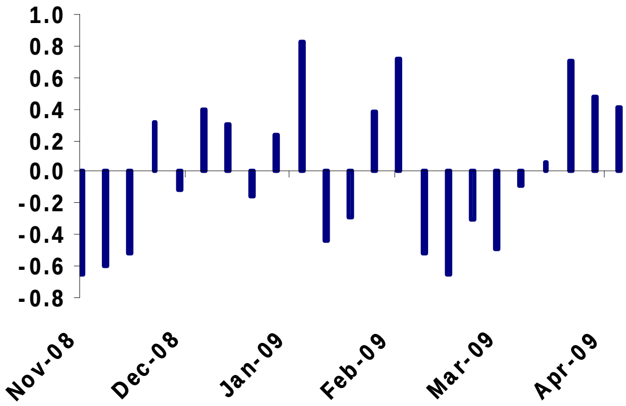
Sources: CEIC

South Korea: FX and Rates Strategy

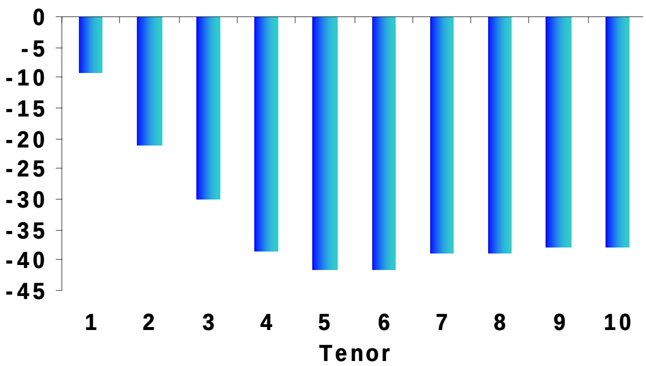
The ride lower in USD-KRW will be bumpy



Net foreign equity flows have improved ($ bn)



KRW IRS Curve: Shifted lower in April (bps)



The won gained 7% against the USD in April, benefiting from a sustained improvement in risk appetite as well as signs that the Korean economy has bottomed.

FX

The improvement in global risk appetite was sustained in April, pushing USD-KRW below its 200-day moving average around 1309. The won was among the out-performers within AXJ, gaining 7% against the USD in April, bested only by the Indonesian rupiah which rallied 9%.

Along with further gains in global equity markets, Korea's fundamentals are showing signs of stabilisation. Q1 GDP rose 0.1% (q/q) following a contraction of 5.1% in Q4. The current account surplus widened significantly, posting a record high of $6.6bn in March. Korea's FX reserves (the sixth-largest in the world) rose by nearly $5bn in March to $206bn. Korea's external debt continued to fall in March, and net foreign equity inflows have accelerated, up 113% (ytd y/y) to $2.7bn as of end-April.

Meanwhile, the BoK extended its won-yen swap arrangement with the BoJ to $20bn from $3bn. This is on top of an existing $10bn won-USD swap arrangement with the BoJ. The Korean government also announced plans to sell up to $3bn in USD-denominated bonds, the first such sale since 2006. Altogether, pressure on the KRW has eased significantly.

Just as the KRW heavily under-performed in the wake of the Lehman bankruptcy, we expect the KRW to lead USD-AXJ lower as the global economy recuperates. However, the road to recovery will likely face set-backs and, although the pace of deterioration in the global economy is slowing, the fact remains that global demand continues to contract. Moreover, the normalisation in global demand will likely take longer than the market hopes. As such, expect the ride lower in USD-KRW to be bumpy.

Rates

We still see scope for further easing by the BoK. At the same time, alternating worries about supply related to fiscal stimulus measures or improved growth prospects should weigh on the long-end of the curve. As such, we continue to favour curve steepeners—above 100bps in 2s-10s IRS.

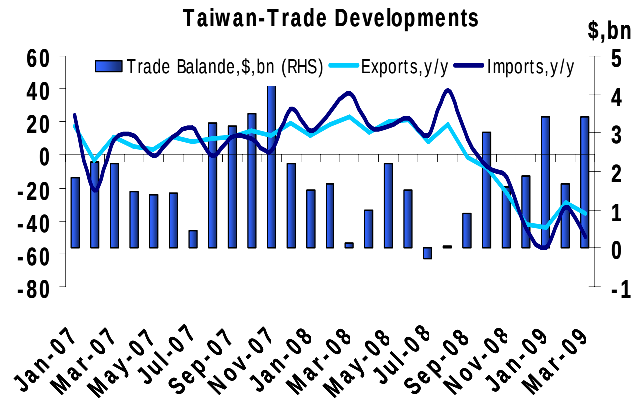
Tamara Henderson

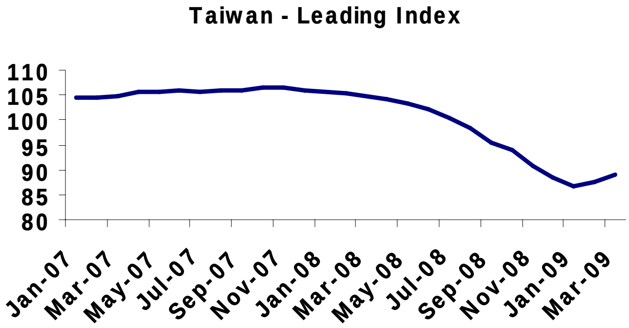
Market Forecasts – South Korea

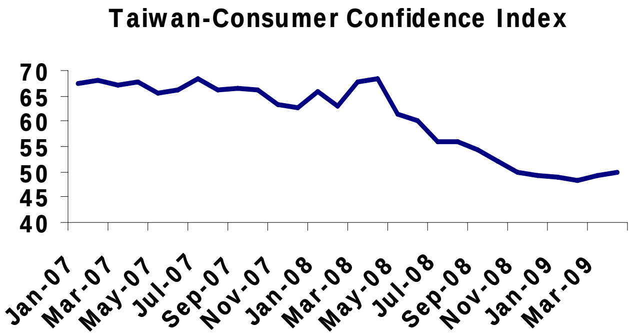
FX	Current	Ytd(%)	Jun 09	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10
USD-KRW	1341	6.4%	1400	1450	1400	1325	1300	1250
AUD-KRW	957	8.2%	920	910	830	740	740	730
NZD-KRW	761	4.3%	760	740	670	620	610	600
JPY-KRW	13.85	-0.3%	13.3	13.4	12.7	11.4	11.2	10.6
EUR-KRW	1768	0.5%	1790	1800	1650	1480	1460	1430
Rates	**Current**	**Ytd(bps)**	**Jun 09**	**Sep 09**	**Dec 09**	**Mar 10**	**Jun 10**	**Sep 10**
BOK's overnight call rate	2.00	-100	1.75	1.75	1.75	1.75	1.75	2.00
3-month KORIBOR	2.41	-154	2.2	2.3	2.4	2.5	2.6	2.9
2-year IRS (versus 91D KRW CD)	3.09	-20	2.8	2.9	3.0	3.1	3.2	3.5
10-year IRS	3.60	3	3.4	3.6	3.8	4.0	4.3	4.6

Sources: Bloomberg, ANZ

Country Update: Taiwan







Various indicators continue to suggest that weak activity and deflation pressures persist. Exports dropped by more than a third in March and imports decreased by one-half. Although some data have started falling less, we believe the economy will remain weak until external demand recovers.

- Industrial production dropped by 26% (y/y) in Mar, better than the 34% contraction in Jan-Feb. On a seasonally adjusted basis, IP rose 8.9% in Feb, on the back of the Mainland's stimulus plan.
- Mar exports dropped by 35.7% (y/y) following a 37.2% decline in Jan-Feb, while imports fell 49.5% after declining 45.6% in Jan-Feb. A trade surplus of USD3.4bn was recorded in Mar. Export orders fell by 24.3% (y/y) in Mar, less than the 32.7% decline in Jan-Feb.
- The Leading Composite Index has yet to show any improvement. Its annualised 6-month (sa) drop in Feb was 22.5%, compared with a 24.3% decline in Jan. Commerce sales dropped by 12.2% (y/y) in Mar, only slightly less than the average 14.1% decline in Jan-Feb. Wholesale sales decreased more than retail sales (-15% in Mar vs -4.7%), reflecting the impact of the external trade slump as well as inventory adjustment.
- The consumer confidence index rose marginally in Mar to 49.1 from 48.4 in Feb. As the index remains well below the neutral line of 100, the Mar reading should not be interpreted as an improvement in sentiment. At the same time, the jobless rate rose to 5.7% (sa) from 5.6% in Feb, the highest on record since the series was first published in Apr 1993.
- The CPI dropped by 0.15% (y/y) in Mar, the second consecutive decline. The decline in oil import prices was the major contributor. Excluding volatile food and energy prices, the core inflation rate continued to register a positive number, 0.8%, albeit much weaker than last year's average.
- China and Taiwan are going to sign an agreement on financial services, giving Taiwanese banks access to China's banking sector. This is positive for Taiwan's growth over the medium term as it should help diversify the economy and increase exposure to the Mainland.

Franklin Poon

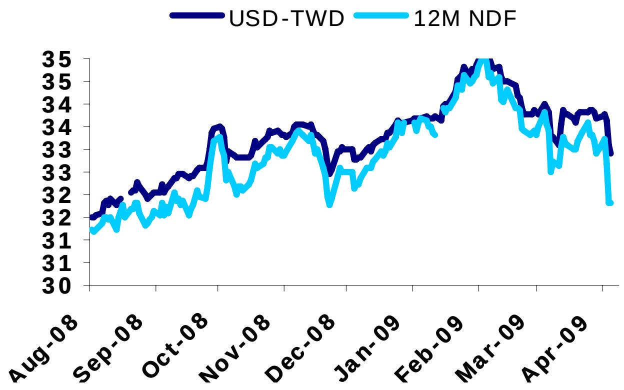
Economic Data – Taiwan

Monthly data	**Aug 08**	**Sep 08**	**Oct 08**	**Nov 08**	**Dec 08**	**Jan 09**	**Feb 09**	**Mar 09**
Industrial Production, % y/y	0.7	-1.2	-12.5	-28.3	-32.0	-43.3	-27.2	-26.0
Retail Trade Index, % y/y	-7.3	-7.8	-6.1	-9.0	-11.3	-1.8	-8.3	N/A
Consumer Price Index, % y/y	4.7	3.1	2.4	1.9	1.3	1.5	-1.3	-0.1
Exports, % y/y	18.2	-1.6	-8.3	-23.3	-41.9	-44.1	-28.6	-35.7
Imports, % y/y	39.3	9.9	-7.4	-13.7	-44.6	-56.5	-31.6	-49.5
Trade Balance, US$ bn	0.0	0.8	2.9	1.5	1.8	3.3	1.6	3.4
Foreign Exchange Reserves, US$ bn	282.1	281.1	278.2	280.7	291.7	292.7	294.2	300.1
Quarterly data	**Jun 07**	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**
Real GDP, % y/y	5.5	7.0	6.4	6.2	4.6	-1.0	-8.4	N/A
-Private consumption	2.2	3.1	1.6	2.1	0.5	-2.1	-1.7	N/A
-Government consumption	0.7	1.7	1.1	1.3	-0.2	1.2	2.2	N/A
-Gross fixed capital formation	4.7	3.8	-0.8	3.7	-8.0	-11.8	-23.2	N/A
Real GNP, % y/y	6.2	6.4	6.1	6.8	3.1	-0.5	-8.4	N/A
Nominal GDP, TWD tn	2.5	2.8	2.9	2.7	2.6	2.7	2.6	N/A
Current Account, US$ mn	5,905.0	6,477.0	11,183.	8,494.0	6,744.0	1,867.0	7,919.0	N/A
Capital Account, US$ mn	-19.0	-33.0	-18.0	-271.0	-20.0	-32.0	-11.0	N/A

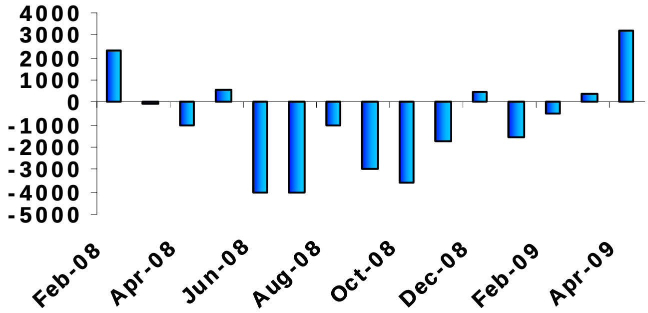
Sources: CEIC

Taiwan: FX and Rates Strategy

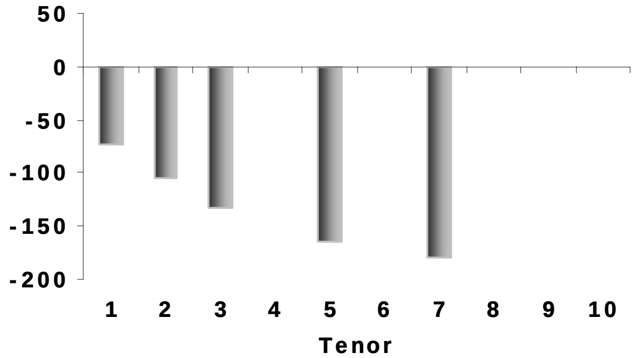
USD-TWD Headed Lower



Net Foreign Equity Inflows Have Accelerated (m/m)



TWD IRS curve shifted lower in April (bps)



Landmark agreements between Taiwan and China, giving Chinese institutional investors access to the Taiwan market is a game changer for USD-TWD, spelling the end of the uptrend in USD-TWD during this cycle. Having easily broken the 61.8% Fibonacci retracement as well as the 200-day moving average, the next key level for USD-TWD is the 38.2% retracement at 32.11.

FX

In April, the TWD rose 2.5% against the USD—about average performance within AXJ. A sustained improvement in global risk appetite helped push USD-TWD lower during most of the month, defying signals that growth in Taiwan has yet to trough. Still, Taiwan's trade surplus continues to rise (as the drop in imports outpaces that of exports) and FX reserves have increased by 4.6% (y/y) to $300bn, amid reported intervention by the CBC to weaken the TWD in support of exports. As such, Taiwan's external position has remained quite healthy despite fierce headwinds from the global economy.

Meanwhile, toward the end of the month, China and Taiwan signed landmark agreements, allowing Chinese institutional investors to invest in Taiwan's money and convertible bond markets and allowing Chinese companies to invest in Taiwanese companies. Once a memorandum of understanding is signed, China's qualified domestic institutional investors (QDII) will be allowed to purchase Taiwanese stocks as well.

Net foreign equity inflows have accelerated—already up 600% (ytd y/y) to $1.6bn as of 29 April, and Taipei's stock index recorded the largest single day gain in 18 years (6.74%) on 30 April. Although the CBC has favoured a weak TWD to support exports during the global downturn, it will be hard for the central bank to do more than slow the flow. As such, we expect USD-TWD to remain in a downtrend, with 32.1 (the 38.2% Fibonacci retracement) as the next target.

Rates

Deflation has pushed real interest rates sharply higher, which is likely to prompt the CBC to cut further the nominal policy rate in order to sustain accommodative monetary conditions. Inflows from Chinese investors would also put a bid into the market, although yields in Taiwan are relatively low and hence unappealing at current levels.

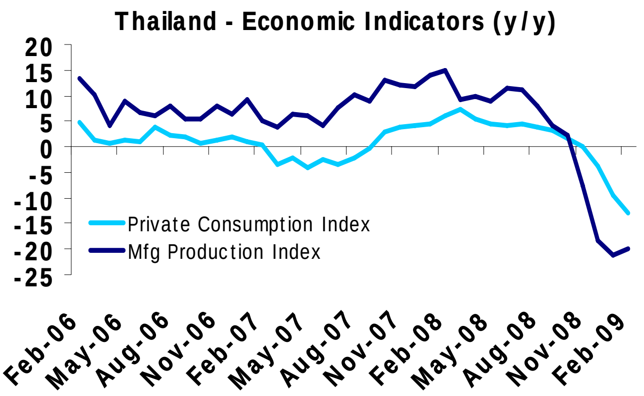
Tamara Henderson

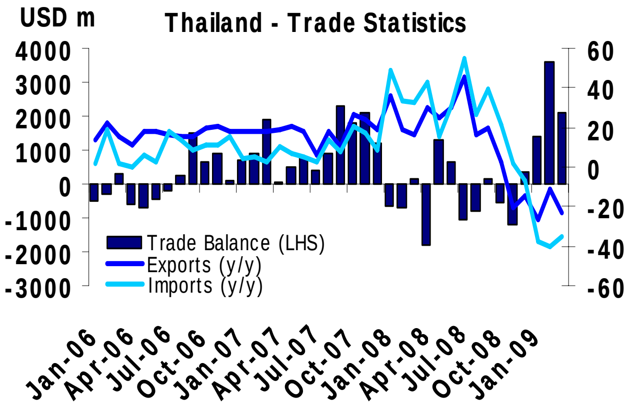
Market Forecasts - Taiwan

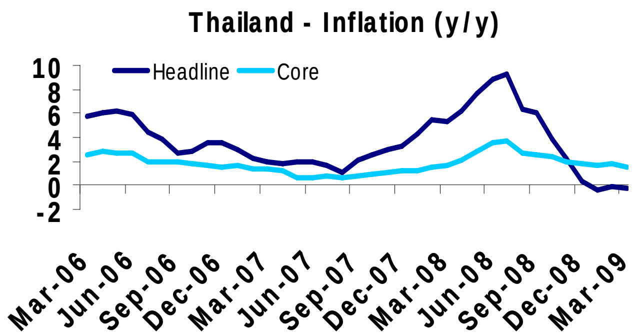
FX	Current	Ytd(%)	Jun 09	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10
USD-TWD	32.92	0.4%	32.7	32.0	32.0	31.0	30.0	30.0
AUD-TWD	24.05	4.3%	21.6	20.2	18.9	17.4	17.1	17.4
NZD-TWD	18.76	-1.3%	17.7	16.3	15.4	14.4	14.1	14.4
JPY-TWD	0.332	-8.2%	0.311	0.296	0.291	0.267	0.259	0.254
EUR-TWD	43.68	-4.7%	41.9	39.7	37.8	34.7	33.6	34.2
Rates	**Current**	**Ytd(bps)**	**Jun 09**	**Sep 09**	**Dec 09**	**Mar 10**	**Jun 10**	**Sep 10**
CBC's discount rate	1.25	-75	1.00	1.00	1.00	1.00	1.00	1.00
3-month CP	0.52	-57	0.4	0.5	0.6	0.7	0.8	0.9
2-year IRS (versus 3M CP)	0.93	-13	0.7	0.8	0.9	1.0	1.1	1.2
10-year IRS	1.78	34	1.6	1.8	2.0	2.2	2.5	2.8

Sources: Bloomberg, ANZ

Country Update: Thailand







Activity indicators continue to deteriorate with production, consumption and export figures all in decline. The inflation outlook remains benign and the BOT reduced its benchmark interest rate in a bid to stimulate the economy. The political situation remains a large downside risk to the economy.

- Domestic demand continues to falter as the economic downturn deepens. The private consumption index fell 12.9% (y/y) in Feb following a 9.6% contraction in Jan. Likewise, the consumer confidence index dipped 1.2ppts to 72.8 in Mar.
- The manufacturing production index shrank for a fourth consecutive month, albeit at a slower rate, declining 19.8% (y/y) in Feb compared with a drop of 21.2% in Jan. The private investment index also decreased by 3.2% to 12.9% over the same period.
- Net exports remained positive with a $2.2bn trade surplus recorded in Mar. Exports plummeted 22.7% (y/y) against an 11.1% contraction in Feb while imports declined 35.1% compared with a drop of 43.5% in the previous month.
- Inflation recorded its third consecutive negative month in Mar, declining by 0.2% (y/y) after falling by 0.1% a month earlier. Core inflation also receded by 0.3ppts to 1.5% and remained within the BoT's inflation target band of 0% to 3.5%. Similarly, producer prices fell 4.0% in Mar, the same rate as in Feb.
- The BoT reduced its policy rate by 25bps to 1.25% in Apr as downside risks to growth remain amid an improved inflation outlook.
- Thailand saw anti-government protests in the past month which cast uncertainties around the young government. We are maintaining our outlook for the economy to shrink by 2% this year, slightly higher than the official forecast of 2.5% to 3%. Risks remain clearly on the downside owing to political developments.

Chong, Jun-Jie

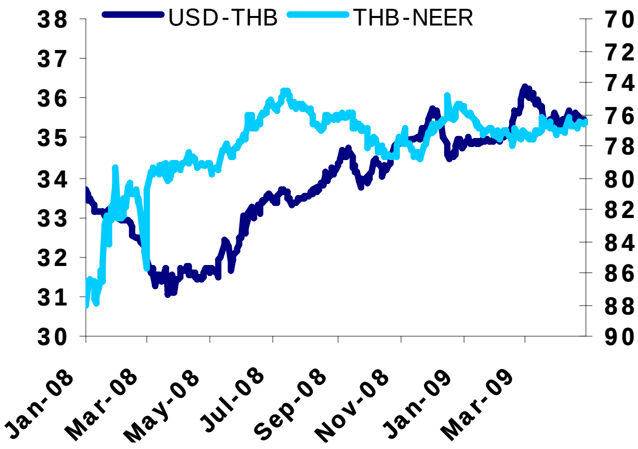
Economic Data – Thailand

Monthly data	Aug 08	Sep 08	Oct 08	Nov 08	Dec 08	Jan 09	Feb 09	Mar 09
Industrial Production, % y/y	7.7	4.3	2.4	-7.7	-18.6	-21.1	-20.3	N/A
Retail Sales, % y/y	4.7	-0.5	-3.1	-13.4	-2.8	-11.2	-9.5	N/A
Consumer Price Index, % y/y	6.5	6.1	3.9	2.2	0.4	-0.4	-0.1	-0.2
Exports, % y/y	17.5	22.8	4.7	-17.7	-15.7	-25.3	-11.1	-22.7
Imports, % y/y	26.9	38.6	23.5	0.2	-8.8	-36.5	-43.5	-35.1
Trade Balance, US$ bn	-0.4	0.6	-1.0	-0.9	0.5	1.7	3.9	2.2
Foreign Exchange Reserves, USD bn	98.9	99.9	101.0	103.8	108.3	107.9	110.4	113.4
Quarterly data	**Jun 07**	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**
Real GDP, % y/y	4.4	5.1	5.7	6.0	5.3	3.9	-4.3	N/A
-Private consumption	1.2	1.9	1.9	2.7	2.5	2.7	2.2	N/A
-Government consumption	10.5	8.9	9.0	-0.4	-3.7	-2.9	10.4	N/A
-Gross fixed capital formation	0.1	2.5	3.8	5.4	1.9	0.6	-3.3	N/A
Nominal GDP, THB bn	2,047.3	2,093.7	2,255.7	2,297.1	2,283.1	2,321.4	2,201.1	N/A
Current Account, US$ bn	1.1	1.7	2.2	1.0	0.7	-0.3	0.1	N/A
Capital & Financial Account, US$ bn	0.6	2.3	1.0	6.6	-4.0	2.6	-1.0	N/A

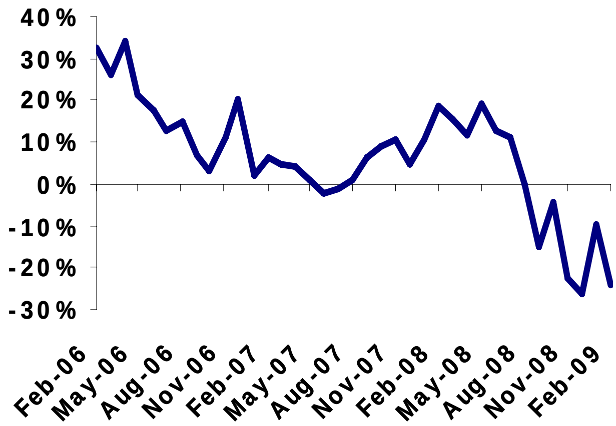
Sources: CEIC

Thailand: FX and Rates Strategy

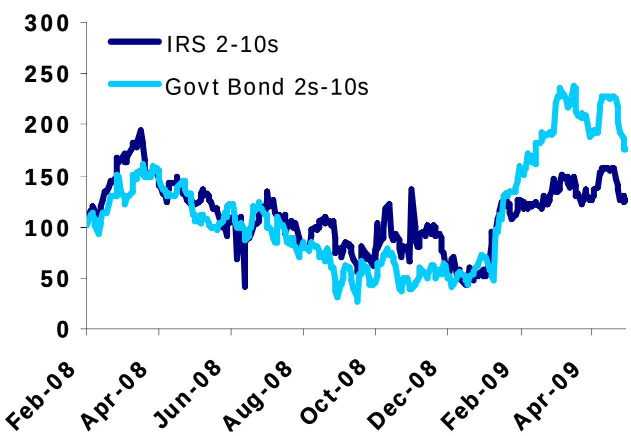
NEER trading in range



Tourist arrivals on a decline



2s-10s spreads eased slightly (bps)



A swift end to the social unrest limited the fallout in local markets but will have negative implications on the external balance. We continue to expect USD-THB to reach towards the 37.0 level. The modest 25bps rate cut in April suggests that the BoT's monetary easing cycle may end soon.

FX

Political risk intensified in April following the disruption of the ASEAN summit in Pattaya and the declaration of a state of emergency in Bangkok, prompting S&P and Fitch to downgrade Thailand's sovereign ratings in mid-April. The swift end to the unrest limited the fallout in local financial markets, but the resurgence of political unrest will have negative implications for the balance of payments. Inbound tourism, an important source of current account support, will likely slip further from the 24% (y/y) drop in Feb. While the authorities have achieved some degree of credibility from the swift resolution of this recent bout of unrest, investment flows will be under threat if the government fails to demonstrate its ability to end the protracted political turmoil. Meanwhile, the BoT's revised forecast of an export contraction between 24.5% and 27.5%—a 19ppt mark down from its January forecast—adds to the gloomy outlook on the baht. Overall, the balance of risks remains skewed toward a higher USD-THB over the next 2-3 quarters.

Rates

The BoT slashed its growth forecast by 3.5ppts on 22 April. The Thai economy is now projected to contract between 1.5% and 3.5% this year, its worst performance since the Asian crisis. Notwithstanding the weaker growth outlook, the BoT's modest rate cut in April suggests the monetary easing cycle may be nearing an end after a cumulative 250bps repo rate cut. We have revised our terminal repo rate to 1% from 0.5%, with a final 25bps rate cut expected on 20 May.

While the 17 April announcement of a THB 94bn increase in government borrowing to 619bn stoked supply concerns, upward pressure on yields was mitigated by the cabinet's smaller deficit spending plan for FY09/10. The revised draft budget on 21 April projected a shortfall of THB 350bn (4% of GDP), down from 390bn in the previous draft. While fiscal spending may surprise on the upside in view of the weak economic outlook in 2009-10, the scope for further steepening of the curve appears limited given comfortable liquidity conditions and the near-term policy rate outlook.

Yeo Han Sia

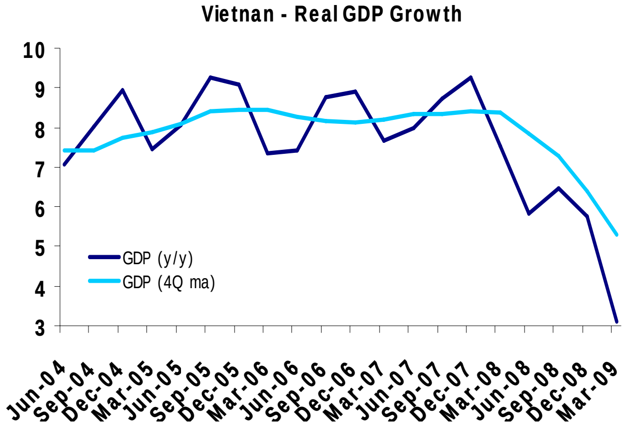
Market Forecasts – Thailand

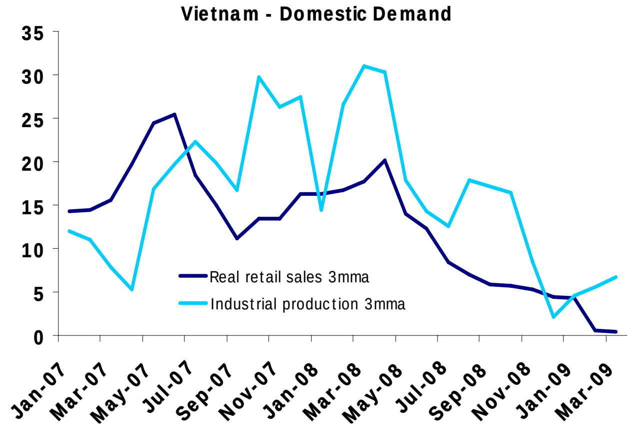
FX	Current	Ytd(%)	Jun 09	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10
USD-THB	35.30	1.6%	36.5	37.5	37.0	36.5	36.0	36.0
AUD-THB	25.67	5.2%	24.1	23.6	21.8	20.4	20.5	20.9
NZD-THB	19.98	-0.7%	19.7	19.1	17.8	17.0	16.9	17.3
JPY-THB	20.25	0.0%	0.348	0.347	0.336	0.315	0.310	0.305
EUR-THB	19.79	0.6%	46.7	46.5	43.7	40.9	40.3	41.0
Rates	**Current**	**Ytd(bps)**	**Jun 09**	**Sep 09**	**Dec 09**	**Mar 10**	**Jun 10**	**Sep 10**
BOT's 1-day repo rate	1.25	-150	1.00	1.00	1.00	1.00	1.25	1.25
3-month BIBOR	1.50	-145	1.2	1.2	1.2	1.2	1.5	1.5
2-year IRS (versus 6M THB fix)	2.14	29	1.9	2.0	2.0	2.0	2.3	2.3
10-year IRS	3.45	108	3.2	3.3	3.3	3.3	3.5	3.5

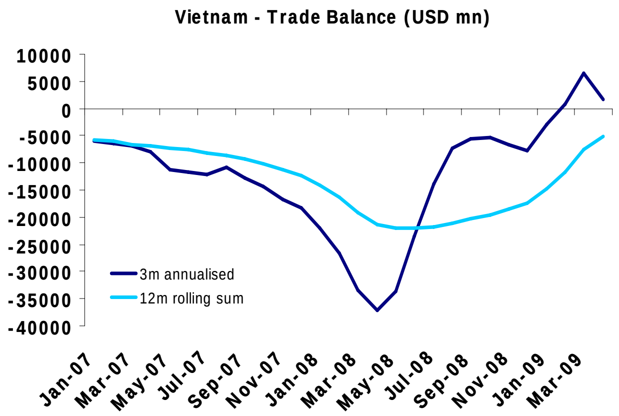
Sources: Bloomberg, ANZ

Country Update: Vietnam

Growth hit a record low in Q1. Industrial production rebounded, led by the government's stimulus plan, while consumption remains weak. The trade balance is in surplus and balance of payments pressures appear muted. It appears as if the worst is now behind Vietnam, although the recovery will be protracted.







- GDP growth continued to decline, posting a 3.1% (y/y) expansion in Q1. On a production basis, industry output growth declined sharply to 1.5% while construction growth rebounded. Services growth moderated.
- Domestic demand developments are mixed. Retail sales ytd are up 23.7% (y/y) in Mar but real consumption growth remains flat. However, industrial production seems to have bottomed reflecting the authorities' stimulus plan.
- The trade account remains surprisingly strong. Exports expanded modestly in April, at 1.4% (y/y), bucking the regional trend. The outturn was led by precious stones and metals. Imports are still declining sharply, falling 27.7% in Apr; petroleum and steel imports remain weak. The trade balance posted a $846mn deficit in April, although the trend value remains in surplus.
- Inflation pressures remain subdued. Prices rose 9.2% (y/y) in Apr, the first single-digit print since Oct 2007. Food price inflation came in at 15.9%. For the month, consumer prices rose 0.3%.
- In a bid to boost demand, the government cut the VAT on clothing, textile and garments while producers of similar products will see a 30% corporate tax cut. Car registration fees will be halved as well. The State Bank of Vietnam left its policy rate unchanged at 7% in Apr.
- Equity markets were volatile. After rising by almost one quarter in the first half of the month, more than half of that gain has been subsequently erased. Foreigners were net buyers in three of the last four weeks.
- The worst is probably behind the Vietnamese economy as the government's stimulus plan should bolster investment going forward. We retain our call for 4% to 5% growth this year, with the risks on the downside.

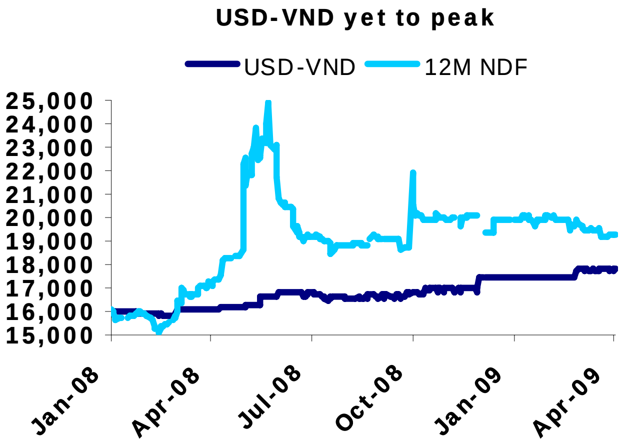
Paul Gruenwald

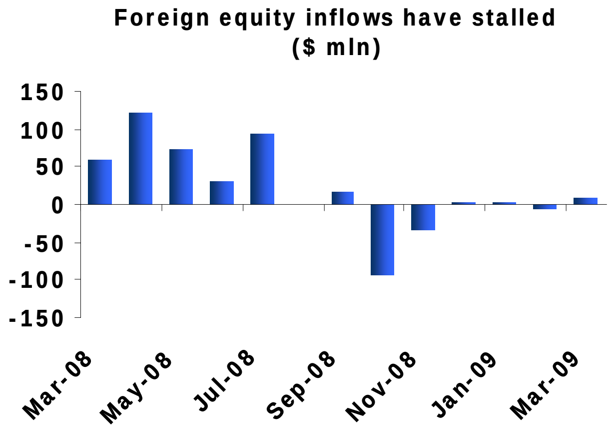
Economic Data – Vietnam

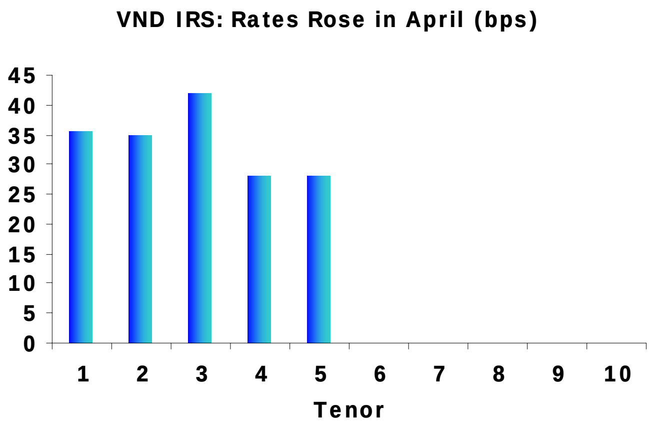
Monthly data	**Sep 08**	**Oct 08**	**Nov 08**	**Dec 08**	**Jan 09**	**Feb 09**	**Mar 09**	**Apr 09**
Industrial Production, % y/y	9.1	9.2	-0.3	0.5	-4.2	5.8	-13.1	N/A
Retail Sales ytd, % y/y	33.4	34.0	33.2	33.3	29.7	17.7	23.7	N/A
Consumer Price Index, % y/y	27.9	26.7	24.2	19.9	17.5	14.8	11.2	9.2
Exports ytd, % y/y	39.6	37.3	32.8	29.5	-24.3	5.4	2.4	N/A
Imports ytd, % y/y	50.4	45.0	37.6	32.7	-53.8	-43.8	-45.0	N/A
Trade Balance, USD bn	-0.3	-0.8	-0.6	-1.0	0.4	0.9	0.4	N/A
Quarterly data	**Jun 07**	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**
Real GDP, % y/y	7.8	8.2	8.5	7.5	6.5	6.5	6.2	3.1
-Agricultural, forestry, fishery	2.8	3.1	3.7	3.2	3.3	3.8	3.8	0.6
-Industry and construction	9.7	10.1	10.6	8.0	7.0	7.0	6.3	1.4
-Services	8.5	8.6	8.7	8.3	7.6	7.2	7.2	5.6
Nominal GDP, VND tn	282.6	293.8	356.8	254.1	371.7	390.8	462.2	N/A
Foreign Exchange Reserves, USD bn	20.8	22.6	23.5	26.4	22.3	23.8	0.0	N/A

Sources: CEIC

Vietnam: FX and Rates Strategy







In the coming weeks, the authorities are likely to sanction further weakening in the dong as a means of addressing an onshore USD supply/demand imbalance. Although a (rare) quarterly trade surplus was recorded in Q1, the authorities are likely to prefer to preserve their FX reserve holdings.

FX

New FDI pledges dropped 87% (y/y) to $342 million in April, and net foreign equity flows have turned negative, down more than 100% (ytd y/y). Meanwhile, onshore demand for USD has recently spiked in Vietnam's unofficial markets, pushing the USD-VND rate above 18,250 (compared with the official rate of roughly 17,780). The increased demand is from importers (taking advantage of low prices) and gold traders. Importers have turned to the black market because banks do not have sufficient USD available to sell, as exporters prefer to maintain their bank deposits in USD.

Exacerbating the problem, sellers of USD in the official interbank market have started to hold back because of the large (and building) differential between the official and unofficial markets—waiting to see whether the SBV will intervene (provide more USD to the system) or allow the VND to depreciate further. Thus far, the SBV has denied that there is a shortage of USD. Something has to give, and we expect it to come in the form of a dong devaluation—sooner, rather than later.

Rates

The SBV cut its refinancing, discount, and 14-day loan rates by 100bps (to 7%, 5% and 6.5%, respectively) in April. Nevertheless, upward pressure on bond yields is building. The State Treasury auction came up short again in April, with bidders requiring a yield premium of nearly 200bps above the 7.6% that the government would accept for its 2-year issue.

The government's interest rate subsidy program (introduced in February and expanded in April) is also putting pressure on rates, with local banks having to raise dong deposit rates in order to raise more dong funds to meet increased loan demand. As of 10 April, banks had lent VND 218trln ($12.4bn) compared with a government target of VND 420trln for 2009 as a whole.

Tamara Henderson

Market Forecasts - Vietnam

FX	Current	Ytd(%)	Jun 09	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10
USD-VND	17,783	1.7%	18,300	18,800	18,800	19,300	19,300	19,900
AUD-VND	12,759	3.9%	12,100	11,800	11,100	10,800	11,000	11,500
NZD-VND	10,136	0.1%	9,900	9,600	9,000	9,000	9,100	9,600
JPY-VND	183	-5.0%	174	174	171	166	166	169
EUR-VND	23,539	-3.7%	23,400	23,300	22,200	21,600	21,600	22,700
Rates	**Current**	**Ytd(bps)**	**Jun 09**	**Sep 09**	**Dec 09**	**Mar 10**	**Jun 10**	**Sep 10**
SBV's base lending rate	7.00	-150	6.00	6.00	6.00	6.00	6.00	7.00
Overnight VNIBOR	5.99	41	5.2	5.3	5.4	5.5	5.6	6.6
2-year IRS (versus 3M VNIBOR)	8.75	-173	8.0	8.1	8.2	8.3	8.4	9.4
10-year IRS	9.15	-56	8.9	9.1	9.3	9.5	9.8	10.8

Sources: Bloomberg, ANZ

Contacts

ANZ Economics & Markets Research

Saul Eslake	Chief Economist	+61 3 9273 6251	Saul.Eslake@anz.com
Fiona Allen	Business Manager	+61 3 9273 6224	Fiona.Allen@anz.com

Industry and Strategic Research

Julie Toth	Senior Economist	+61 3 9273 6252	Julie.Toth@anz.com
Paul Deane	Rural and Regional Economist	+61 3 9273 6295	Paul.Deane@anz.com

Australian Economics and Interest Rates Research

Warren Hogan	Head of Australian Economics and Interest Rates Research	+61 2 9227 1562	Warren.Hogan@anz.com
Katie Dean	Senior Economist	+61 3 9273 1381	Katie.Dean@anz.com
Riki Polygenis	Economist	+61 3 9273 4060	Riki.Polygenis@anz.com
Dr. Alex Joiner	Economist	+61 3 9273 6123	Alex.Joiner@anz.com
Patricia Gacis	Strategist	+61 2 9227 1272	Patricia.Gacis@anz.com

Global Markets Credit Research

Jason Hill	Global Markets Credit Analyst	0434 312 356	Jason.Hill@anz.com

Commodities Research

Mark Pervan	Head of Commodities Research	+61 3 9273 3716	Mark.Pervan@anz.com
Amber Rabinov	Economist	+61 3 9273 4853	Amber.Rabinov@anz.com
Doug Whitehead	Soft Commodity Strategist	+61 3 9273 6684	Doug.Whitehead@anz.com
Natalie Robertson	Graduate Analyst	+61 3 9273 3415	Natalie.Robertson@anz.com

Property and Financial System Research

Paul Braddick	Head of Property and Financial System Research	+61 3 9273 5987	Paul.Braddick@anz.com
Ange Montalti	Senior Economist	+61 3 9273 6288	Ange.Montalti@anz.com
Dr. Alex Joiner	Economist	+61 3 9273 6123	Alex.Joiner@anz.com
Stephanie Wayne	Research Analyst	+61 3 9273 4075	Stephanie.Wayne@anz.com

Foreign Exchange and International Economics Research

Amy Auster	Head of Foreign Exchange and International Economics Research	+61 3 9273 5417	Amy.Auster@anz.com
Tony Morriss	Senior Currency Strategist	+61 2 9226 6757	Tony.Morriss@anz.com
Amber Rabinov	Economist	+61 3 9273 4853	Amber.Rabinov@anz.com

Foreign Exchange and Interest Rates Research (London)

Tim Riddell	Currency and Interest Rate Strategist		Tim.Riddell@anz.com

Asian Economics Research (Singapore)

Paul Gruenwald	Chief Economist. Asia	+65 6419 7902	Paul.Gruenwald@anz.com
Tamara Henderson	Director, Currency & Rates Strategy	+65 6216 1845	Tamara.Henderson@anz.com
Franklin Poon	Economist, North East Asia	+852 3929 5340	Franklin.Poon@anz.com
Yeo Han Sia	Associate Director, Currency & Rates Strategy	+65 6419 7930	HanSia.Yeo@anz.com
Chang Wei Liang	Analyst, Economic Research	+65 6216 1838	WeiLiang.Chang@anz.com

New Zealand Economics Research (Wellington)

Cameron Bagrie	Chief Economist, New Zealand	+64 4 802 2212	Cameron.Bagrie@anz.com
Khoon Goh	Senior Economist	+64 4 802 2357	Khoon.Goh@anz.com
Philip Borkin	Economist	+64 4 802 2199	Philip.Borkin@anz.com
Steve Edwards	Economist	+64 4 802 2217	Steve.Edwards@anz.com
Kevin Wilson	Rural Economist	+64 4 802 2361	wilsonk1@anz.com
David Croy	Interest Rate Strategist	+64 4 802 2286	David.Croy@anz.com

Research and Information Services

Marilla Rough	Senior Information Officer	+61 3 9273 6263	Marilla.Rough@anz.com
Manesha Jayasuriya	Publications Coordinator	+61 3 9273 4121	Manesha.Jayasuriya@anz.com

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Australia and New Zealand Banking Group Limited is represented in:

AUSTRALIA by:

Australia and New Zealand Banking Group Limited ABN 11 005 357 522

14th Floor 100 Queen Street, Melbourne, Victoria, 3000, Australia

Telephone +61 3 9273 6224   Fax +61 3 9273 5711

UNITED KINGDOM by:

Australia and New Zealand Banking Group Limited

ABN 11 005 357 522

40 Bank Street, Canary Wharf, London, E14 5EJ, United Kingdom

Telephone +44 20 3229 2121   Fax +44 20 7378 2378

UNITED STATES OF AMERICA by:

ANZ Securities, Inc. (Member of FINRA and SIPC)

6th Floor 1177 Avenue of the Americas

New York, NY 10036, United States of America

Telephone +1 212 801 9160   Fax +1 212 801 9163

NEW ZEALAND by:

ANZ National Bank Limited

Level 7, 1-9 Victoria Street, Wellington, New Zealand

Telephone +64 4 802 2000

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