Emerging Asia Economics Monthly – August 2009

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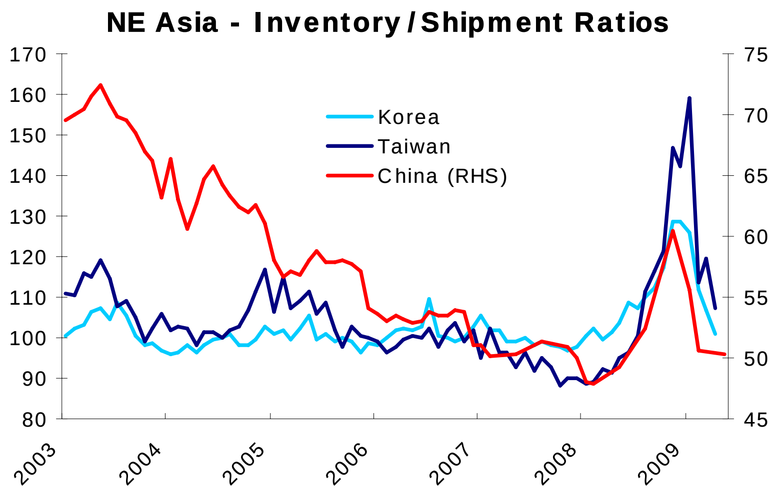
Our Vision:

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

- China registered an impressive Q2 outturn, with growth exceeding 15% (sa) on an annual basis; however, the authorities may be considering a mid-course correction to curb excessive lending.
- Elsewhere in Asia, sequential growth turned positive in Q2 with domestic demand recovering somewhat due to inventory corrections and government stimulus plans. External demand remains weak.
- We see limited scope for a region-wide recovery until discretionary consumption revives in the United States and Europe. In the meantime, look for China- and commodity-concentric growth.
- The downtrend in USD-AXJ (Asia excluding Japan) remains intact. Strong July earnings have maintained risk appetite, defying seasonal trends, while AXJ fundamentals look even stronger.
- The bias for rates is neutral-to-higher. The rate cut cycle has ended, but inflationary pressures remain benign, allowing the maintenance of accommodative monetary policy.

Chart of the Month: NE Asia Inventory Ratios are Normalising



Note: The denominator for China is industrial sales.

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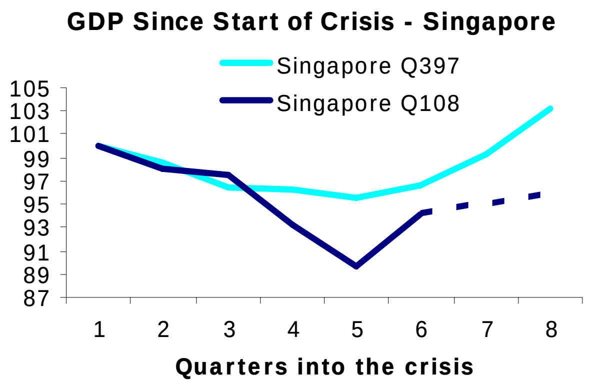
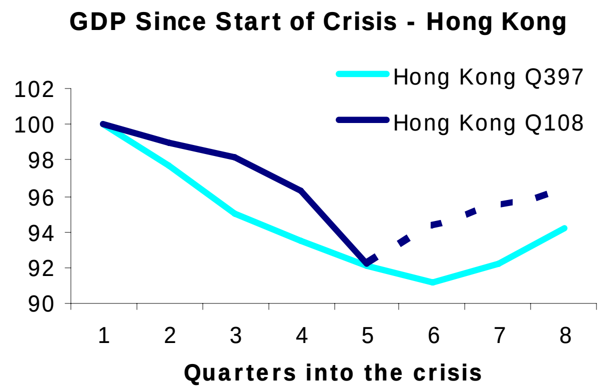
Feature Article:

The Performance of Asia's Money Centres during the Crisis

Reflecting their high degree of openness, Hong Kong and Singapore have been hit hard by the global economic crisis (although their banking sectors remain in good shape). More recently, both economies have started to register positive economic momentum, and financial and property markets have begun to revive. This is partly as a result of the normalisation of global trade activity, and partly due to the cities' own stimulus measures. Nevertheless, weak global growth and reduced trade flows remain the major impediment to the two cities' recovery. We expect growth for Hong Kong and Singapore to remain sub-par until external demand revives.

Output in Hong Kong and Singapore fell among the earliest and the sharpest in the region, due to the open nature of their economies. In addition to the slump in OECD import demand, the reduction of trade financing was also an important factor as to why the trade sectors of Hong Kong and Singapore suffered more this time than in previous crises. Hong Kong's exports of goods and services fell 14.9% (q/q, sa) in real terms in the first quarter of 2009 alone, while Singapore's fell by more than 10% in Q408 and Q109. Both of these were record declines. The record weak trade performance explains why Singapore has been hit harder this time than during the Asian Financial Crisis. The downturn in Hong Kong, on the other hand, has been comparable to that of 1997/98 (see chart).[12] Hong Kong fares slightly better than Singapore in the current global recession, owing to its somewhat lower dependence on external trade and stronger linkages to Mainland China. The weakness in trade sectors has spilled over to consumption and investment, which have also dropped substantially during the past quarters (see our June 2009 Feature Article: *Is Emerging Asia's Slowdown Really Export-Led?*).





In contrast to the real economy, the financial sectors of Asia's two money centres have held up relatively well. This reflects the fact that Asian banks in general managed to avoid sizeable exposure to the toxic assets which plagued banks in the United States and Europe. Indeed, only 3% of global toxic assets ended up on Asian bank balance sheets and about one-half of those were held by banks in Japan. Banks in Hong Kong and Singapore remain well capitalised with capital adequacy ratios of 15.0% and 15.6% in Q1 2009 and Q3 2008, respectively. In addition, the most recent data show that non-performing loan ratios remain low at 1.5% in Hong Kong in Q1 2009 and 1.4% in Singapore in Q3 2008, although these are expected to rise.

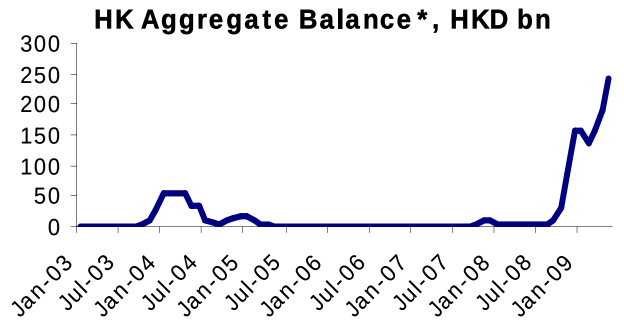
Facing the worst global recession in decades, the two centres have implemented aggressive monetary measures. These have been successful in quickly stabilising local money markets. Among other actions, the HKMA enhanced the operations of its discount window last September by expanding accepted collateral to include US Treasuries, extending maturities to up to three months, and reducing the base rate to 0.5% (broadly in line with the US Federal Reserve, consistent with Hong Kong's currency board arrangement which effectively pegs the Hong Kong dollar to the US currency). The HKMA also introduced a new term lending facility and foreign exchange swaps for licensed banks. Moreover, a blanket (unlimited) guarantee is now in place for all bank deposits.[3] In Singapore, the MAS loosened monetary policy settings in April by re-centring its

[1] Hong Kong suffered a long period of deflation during 1998-2003 due to its extremely tight monetary conditions given its relatively strong currency (currencies elsewhere in the region had depreciated sharply against the US dollar).

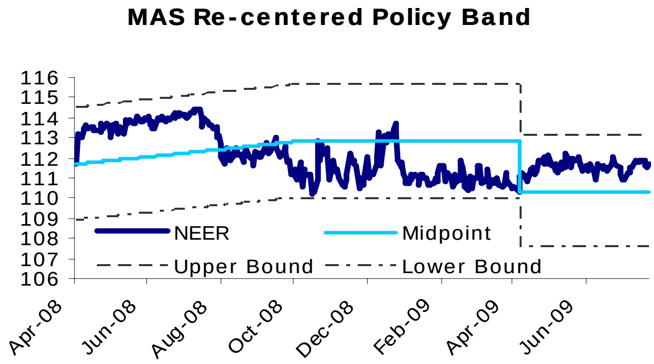
[2] The sources for all charts in this note are Bloomberg and ANZ Economics.

[3] Interestingly, Hong Kong's currency board has not been a focus recently, as was the case during the Asian Financial Crisis. A decade ago, the currencies of Hong Kong's regional trading partners depreciated massively against the US dollar. Owing to its

S$NEER band to the then-prevailing level, and established a $30bn swap line with the US Federal Reserve. The Singapore government also announced a "Special Risk-Sharing Initiative" for the provision of bank loans and insurance, and initiated a 100% deposit guarantee shortly after a similar measure was announced in Hong Kong.



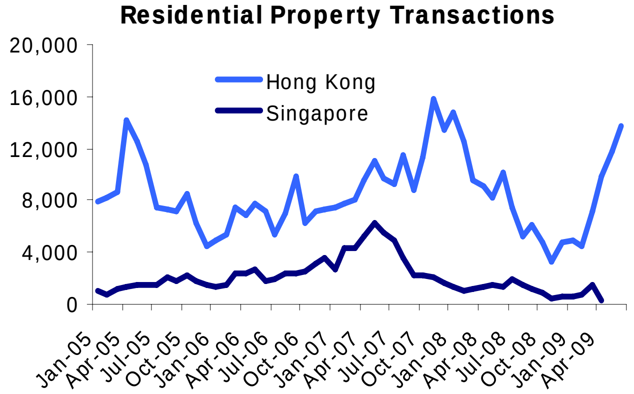
*the sum of the balances in the clearing accounts maintained by the banks with the HKMA for settling interbank payments and payments between banks and the HKMA.

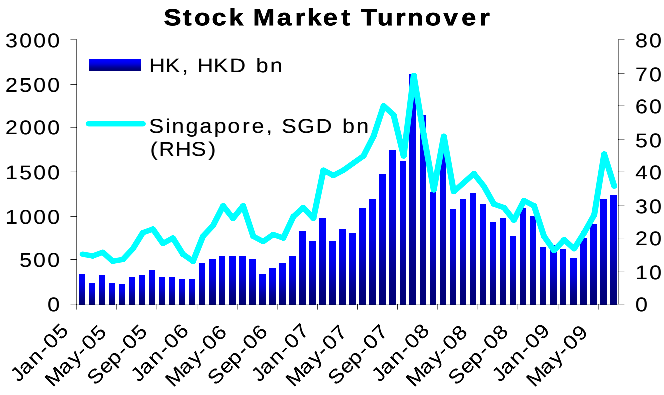


Both governments have huge fiscal reserves and have implemented sizeable fiscal stimulus packages. Hong Kong has announced a series of relief packages totalling HKD87bn, equivalent to 5.2% of GDP. Singapore has delivered a fiscal package of SGD20.5bn, equivalent to 9% of GDP. The common policy focuses of the Hong Kong and Singapore stimulus plans have been retaining jobs, supporting SMEs, and providing direct transfers to households. Owing to the two economies' high degree of openness and limited domestic economies, import leakage from the stimulus packages is likely to be high. As a result, the net impact on GDP will be smaller than suggested by their nominal sizes. (That is, the fiscal multiplier will be low relative to the rest of the region.) That said, the relief measures have been important in welfare terms.

Economic momentum has turned positive in both economies in Q2. Reflecting a combination of the normalisation of global trade financing activities and global re-stocking as well as the above-noted policy stimulus measures, output in both economies appears to have bottomed in the first quarter. Singapore has already released its advance GDP estimate for Q2, and the economy is estimated to have grown by a seasonally adjusted 20.4% (q/q, annualised), after falling by a revised 12.7% in the previous quarter. The Hong Kong government has said that the SAR's economy might expand on a q/q seasonally adjusted basis in the second quarter as well.

Activity in the financial and property markets has picked up recently. Stock market transaction volumes in both Hong Kong and Singapore have begun to recover. At the same time, IPO activities, which had remained quiet for the past six months in Hong Kong, have recently revived with Mainland companies coming to the market for equity listings; the new offers have been well received. Residential property market transactions in both cities have also risen recently from their lows in late 2008 and early 2009. Prices have risen in Hong Kong by 10% this year through May, although they fell by about 5% in Singapore in Q1. Notwithstanding the improved economic performance of both economies, specific factors have played a large part so far in the return to growth.

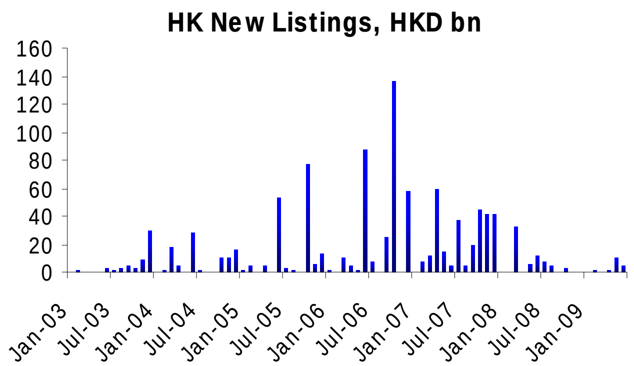


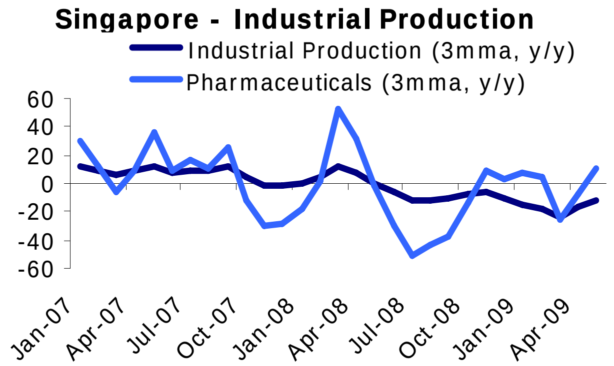


currency board arrangement, Hong Kong was forced to undergo persistent depreciation in order to generate a real effective depreciation. This time around exchange rate adjustment across the region has been relatively modest.

Hong Kong has benefited from China's stimulus package, including the aggressive loan book expansion of Chinese state banks. The RMB4tn stimulus plan, while lifting the Mainland economy, is also seen as supporting H shares and red chips in Hong Kong. This is also consistent with the increased stock market transaction volumes and IPO activities noted above. Anecdotal evidence suggests that some of the new RMB7.4tn funds lent by Chinese banks in the first six months of the year have found their way into Hong Kong's real estate market. For example, local property agents reportedly say that Mainlanders have been purchasing high-end residential units in Hong Kong with little regard to price. These factors have all improved the territory's consumer and investor sentiment in Q2.

Singapore's pharmaceutical sector has benefited from the swine flu outbreak through increased production of vaccines and drugs in Q2. Pharmaceutical production accounts for 20% of total manufacturing value-added in Singapore, second only to the 25% share for electronics. For April and May, pharmaceutical production rose by 25.9% (sa) over Q1, as a result of the increased demand for vaccines and drugs following the outbreak of the swine flu. Stripping out pharmaceuticals, industrial production growth remains negative.

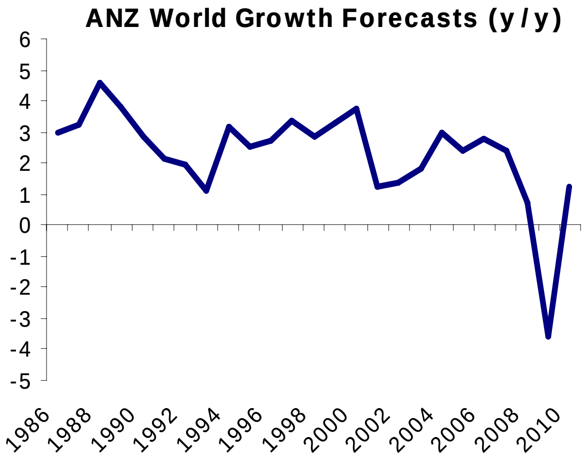


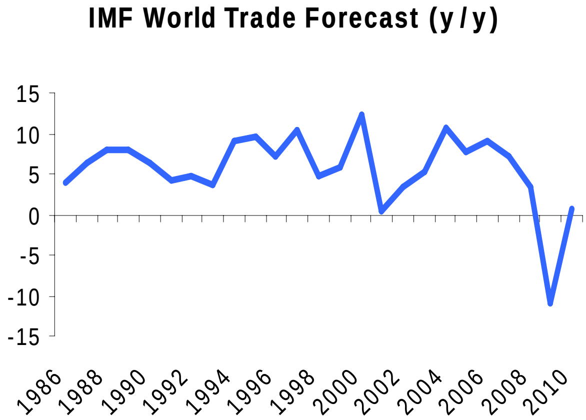


These specific factors could be transitory for both Hong Kong and Singapore. The Chinese authorities have recently expressed concern over banks' excessive loan expansion, worrying about asset price bubbles and bad debts. As a result, the PBoC has started conducting open market operations, trying to absorb excess liquidity. Although the central bank will likely maintain overall loose monetary settings, any retreat of Chinese funds from Hong Kong, or even a perceived change in China's policy tone, could negatively affect Hong Kong's nascent recovery. On the other hand, Singapore's pharmaceutical industry is characteristically volatile. The swine flu appears to be less lethal and less contagious than previously perceived. Therefore, it is highly unlikely that pharmaceutical production alone can support a sustained improvement of underlying demand and growth in Singapore.

Despite the recovery in Q2, the level of economic activity has yet to return to 2007 levels. Given the factors noted above, we interpret the recent positive momentum in both economies as more of a bounce off exceptional lows. Indeed, economic indicators are still falling in year-on-year terms. Singapore's Q2 GDP growth remained negative at 3.7% (y/y) despite the strong quarterly momentum. Hong Kong's economic indicators suggest the same. For example, retail sales volume in May remained 6% below the average recorded for 2007, and output in both economies has yet to return to pre-crisis levels in 2007.

External demand remains key to a sustained recovery. Given their heavy dependence on trade, the two cities will only enjoy a sustained recovery once external demand revives. More concretely, what is required is a return in discretionary consumption on the part of US and EU consumers. ANZ's global growth forecasts are -3.6% and +1.2% for 2009 and 2010, respectively. The IMF said in a recent report that "while the world economy is stabilising, the recession is not over and the recovery is likely to be sluggish", and "advanced economies are still projected not to show a sustained pickup in activity until the second half of 2010." There are also renewed concerns over the recovery story in the United States, and there have been calls for a second-round stimulus package. Europe and Japan will likely fare no better than the US. On the back of weak economic growth, the IMF forecasts world trade volume to remain weak for both 2009 and 2010, growing by -11.0% and +0.6% respectively, after registering average growth of 8.7% for 2004-2007. This reduced flow of goods has negative connotations for Hong Kong and Singapore given their entrepot status.





We thus expect Hong Kong and Singapore to grow below potential in the coming two years. In terms of point estimates, we forecast average quarterly growth until 2010 at 1% (q/q) and 1.3% for Hong Kong and Singapore, respectively, below the 1.7%-1.8% growth recorded for the period between 2004 and 2007. On balance, we see the risks to this forecast to be on the downside given the uncertain outlook for a recovery in discretionary consumption growth in the OECD economies.

Franklin Poon and Wei Liang Chang

FX and Rates Strategy Overview:

Earnings Trump Summer Angst

Market Outlook

Last month we warned about a possible pull-back in risk appetite in line with seasonal patterns of the past. Thanks to strong July earnings, risk appetite has in fact been sustained. Meanwhile, fundamentals in emerging Asia (AXJ) continue to improve as aggressive stimulus measures feed further through the real economy. We are only half-way through the Northern hemisphere's peak summer holiday period, but the emergence of "summer angst" is looking less and less likely. The May-July range should hold over the coming weeks, but once trading volume normalises USD-AXJ is expected to march successively lower over the course of H2.

FX Strategy

The Indonesian rupiah (IDR) has out-performed AXJ this year, rallying 10.7% against the USD thus far. In second place is the Korean won (KRW), which has gained 2.5% against the USD over the same period. Both currencies were significant under-performers during the collapse in global financial markets in Q4 last year, but the KRW was dealt a much harsher punishment owing to (unwarranted) fears of a balance of payments crisis.

IDR out-performance would seem to have three components: 1/ a correction from unfair punishment last year (when Indonesia's relatively strong fundamentals were ignored), 2/ the removal of political uncertainty with the re-election in July of a market-friendly incumbent President, and 3/ attractive yields. In H2, the IDR will continue to benefit from attractive yields. Meanwhile, the KRW will benefit more from any improvement in external demand—because the Korean economy is much more sensitive to external demand conditions and because the KRW is much more competitive. All in all, this suggests some catch-up for the KRW versus the IDR in H2.

- ***Corporates* with USD payables**: Increase IDR hedge ratios and reduce KRW hedge ratios.
- ***Real money funds with AXJ allocations:*** Under-weight IDR and over-weight KRW.
- ***Leveraged funds:*** Sell USD-KRW and buy USD-IDR forward outright.

Rates Strategy

Central banks around the world are signalling an end to the easing cycle, but at the same time are suggesting that monetary conditions will remain accommodative for some time to come in order to sow the seeds of economic recovery. Indeed, inflationary pressures remain benign (in most cases), so the monetary policy signals remain credible for now.

Just ahead, however, highly favourable base effects from the slump in global commodity prices are set to unwind. At the same time, the impact of aggressive stimulus measures will be feeding more fully through the real economy. As such, the management of inflation expectations will become more difficult for central bankers, giving yields a progressively higher bias over the remainder of the year – particularly yields in AXJ countries with the strongest growth momentum (i.e. China, India, Indonesia and Vietnam) and where central banks have the weakest inflation fighting record (i.e. India, Indonesia and Vietnam).

- ***Real money funds*** with emerging Asia in their benchmark should progressively shorten duration in India, Indonesia and Vietnam. (Unfortunately, the front-end of the IDR government bond curve has become quite rich, presenting an obstacle for trimming duration and managing interest rate risk).

- ***Leveraged funds*** should opt for payers on the INR, IDR and VND interest rate swap curves.

Tamara Henderson

Foreign Exchange and Policy Rate Forecasts

		Current	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10
China	USD/CNY, eop	6.832	6.83	6.83	6.83	6.83	6.82	6.80
	AUD/CNY, eop	5.585	5.20	5.00	5.10	5.20	5.30	5.40
	PBoC base lending rate	5.31	5.31	5.31	5.31	5.31	5.58	5.85
Hong Kong	USD/HKD, eop	7.75	7.75	7.75	7.75	7.76	7.77	7.80
	AUD/HKD, eop	6.34	5.90	5.70	5.70	5.90	6.10	6.20
	HKMA discount rate	0.50	0.50	0.50	0.50	0.50	0.75	1.00
India	USD/INR, eop	48.18	48.5	48.0	47.0	47.5	47.0	47.0
	AUD/INR, eop	40.09	36.9	35.0	34.8	36.1	36.7	37.6
	RBI repo rate	4.75	4.75	4.75	4.75	5.00	5.25	5.50
Indonesia	USD/IDR, eop	9,995	10,250	9,750	9,500	10,000	9,500	9,000
	AUD/IDR, eop	8,182	7,800	7,100	7,000	7,600	7,400	7,200
	BI rate	6.75	6.50	6.50	6.50	6.75	7.00	7.00
Malaysia	USD/MYR, eop	3.51	3.55	3.50	3.48	3.45	3.40	3.40
	AUD/MYR, eop	2.92	2.70	2.56	2.58	2.62	2.65	2.72
	BNM overnight rate	2.00	2.00	2.00	2.00	2.00	2.25	2.25
Philippines	USD/PHP, eop	48.03	49.0	48.0	48.0	47.0	47.0	46.0
	AUD/PHP, eop	39.97	37.2	35.0	35.5	35.7	36.7	36.8
	BSP reverse repo rate	4.00	4.00	4.00	4.00	4.00	4.25	4.25
Singapore	USD/SGD, eop	1.438	1.48	1.46	1.45	1.45	1.44	1.43
	AUD/SGD, eop	1.197	1.12	1.07	1.07	1.10	1.12	1.14
	3M SGD SIBOR	0.69	0.69	0.69	0.85	1.00	1.30	1.50
S Korea	USD/KRW, eop	1,241	1,225	1,125	1,175	1,225	1,100	1,050
	AUD/KRW, eop	1,014	930	820	870	930	860	840
	BoK overnight call rate	2.00	2.00	2.00	2.00	2.00	2.25	2.50
Taiwan	USD/TWD, eop	32.86	32.5	32.0	31.5	31.0	30.3	30.3
	AUD/TWD, eop	26.89	24.7	23.4	23.3	23.6	23.6	24.2
	CBC discount rate	1.25	1.25	1.25	1.25	1.25	1.50	1.75
Thailand	USD/THB, eop	33.93	35.0	34.5	34.0	34.0	33.5	33.5
	AUD/THB, eop	28.26	26.6	25.2	25.2	25.8	26.1	26.8
	BoT repo rate	1.25	1.25	1.25	1.25	1.25	1.50	1.50
Vietnam	USD/VND, eop	17,819	17,800	18,500	18,500	18,500	18,500	19,300
	AUD/VND, eop	14,556	13,500	13,500	13,700	14,100	14,400	15,400
	SBV base lending rate	7.00	7.00	7.00	7.00	7.00	7.50	8.00

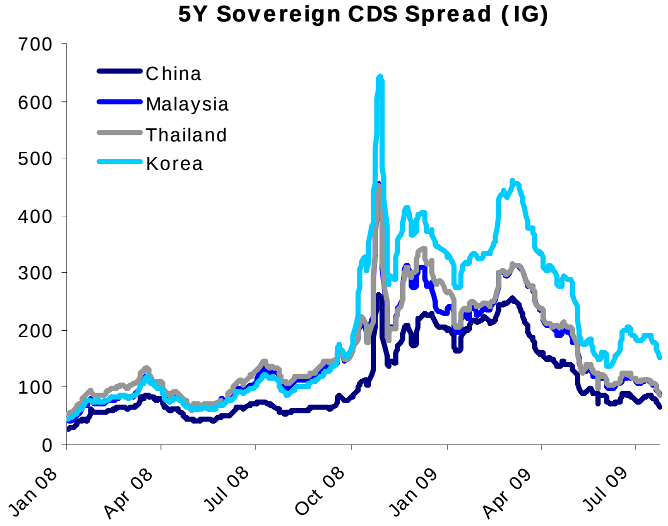
Foreign Exchange Cross-Rate Forecasts

	Current Spot	ANZ Forecast					Implied Spot from 12M Fwd or NDF	Implied 12M % Change	
		Sep-09	Dec-09	Mar-10	Jun-10	Sep-10		ANZ	Forwards
CNY-HKD	1.13	1.13	1.13	1.13	1.14	1.14	1.14	1%	1%
CNY-INR	7.05	7.10	7.03	6.88	6.95	6.90	7.09	-2%	1%
CNY-IDR	1,460	1,500	1,430	1,390	1,460	1,390	1,450	-5%	-1%
CNY-MYR	0.514	0.520	0.512	0.510	0.505	0.499	0.514	-3%	0%
CNY-PHP	7.03	7.17	7.03	7.03	6.88	6.90	7.03	-2%	0%
CNY-SGD	0.211	0.217	0.214	0.212	0.212	0.211	0.212	0%	1%
CNY-KRW	182	179	165	172	179	161	180	-11%	-1%
CNY-TWD	4.81	4.76	4.69	4.61	4.54	4.45	4.80	-8%	0%
CNY-THB	4.97	5.12	5.05	4.98	4.98	4.92	4.99	-1%	0%
HKD-INR	6.22	6.26	6.19	6.06	6.12	6.05	6.22	-3%	0%
HKD-IDR	1,290	1,320	1,260	1,230	1,290	1,220	1,270	-5%	-2%
HKD-MYR	0.453	0.458	0.452	0.449	0.445	0.438	0.451	-3%	0%
HKD-PHP	6.20	6.32	6.19	6.19	6.06	6.05	6.17	-2%	0%
HKD-SGD	0.186	0.191	0.188	0.187	0.187	0.185	0.186	0%	0%
HKD-KRW	160	158	145	152	158	142	158	-12%	-1%
HKD-TWD	4.24	4.19	4.13	4.06	3.99	3.90	4.21	-8%	-1%
HKD-THB	4.38	4.52	4.45	4.39	4.38	4.31	4.38	-2%	0%
INR-IDR	207	211	203	202	211	202	204	-3%	-1%
INR-MYR	0.073	0.073	0.073	0.074	0.073	0.072	0.072	-1%	0%
INR-PHP	1.00	1.01	1.00	1.02	0.99	1.00	0.99	0%	-1%
INR-SGD	0.030	0.031	0.030	0.031	0.031	0.031	0.030	3%	0%
INR-KRW	25.8	25.3	23.4	25.0	25.8	23.4	25.4	-9%	-2%
INR-TWD	0.682	0.670	0.667	0.670	0.653	0.645	0.676	-5%	-1%
INR-THB	0.704	0.722	0.719	0.723	0.716	0.713	0.703	1%	0%
IDR-MYR	0.00035	0.00035	0.00036	0.00037	0.00035	0.00036	0.00035	2%	1%
IDR-PHP	0.00481	0.00478	0.00492	0.00505	0.00470	0.00495	0.00485	3%	1%
IDR-SGD	0.00014	0.00014	0.00015	0.00015	0.00015	0.00015	0.00015	5%	1%
IDR-KRW	0.124	0.120	0.115	0.124	0.123	0.116	0.124	-7%	0%
IDR-TWD	0.00329	0.00317	0.00328	0.00332	0.00310	0.00319	0.00331	-3%	1%
IDR-THB	0.00339	0.00341	0.00354	0.00358	0.00340	0.00353	0.00344	4%	1%
MYR-PHP	13.7	13.8	13.7	13.8	13.6	13.8	13.7	1%	0%
MYR-SGD	0.410	0.417	0.417	0.417	0.420	0.424	0.412	3%	0%
MYR-KRW	354	345	321	338	355	324	350	-8%	-1%
MYR-TWD	9.36	9.15	9.14	9.05	8.99	8.91	9.33	-5%	0%
MYR-THB	9.67	9.86	9.86	9.77	9.86	9.85	9.70	2%	0%
PHP-SGD	0.030	0.030	0.030	0.030	0.031	0.031	0.030	2%	1%
PHP-KRW	25.8	25.0	23.4	24.5	26.1	23.4	25.6	-9%	-1%
PHP-TWD	0.684	0.663	0.667	0.656	0.660	0.645	0.682	-6%	0%
PHP-THB	0.706	0.714	0.719	0.708	0.723	0.713	0.710	1%	0%
SGD-KRW	863	828	771	810	845	764	849	-11%	-2%
SGD-TWD	22.8	22.0	21.9	21.7	21.4	21.0	22.7	-8%	-1%
SGD-THB	23.6	23.6	23.6	23.4	23.4	23.3	23.6	-1%	0%
KRW-TWD	0.026	0.027	0.028	0.027	0.025	0.028	0.027	4%	1%
KRW-THB	0.027	0.029	0.031	0.029	0.028	0.030	0.028	11%	1%
TWD-THB	1.03	1.08	1.08	1.08	1.10	1.11	1.04	7%	1%

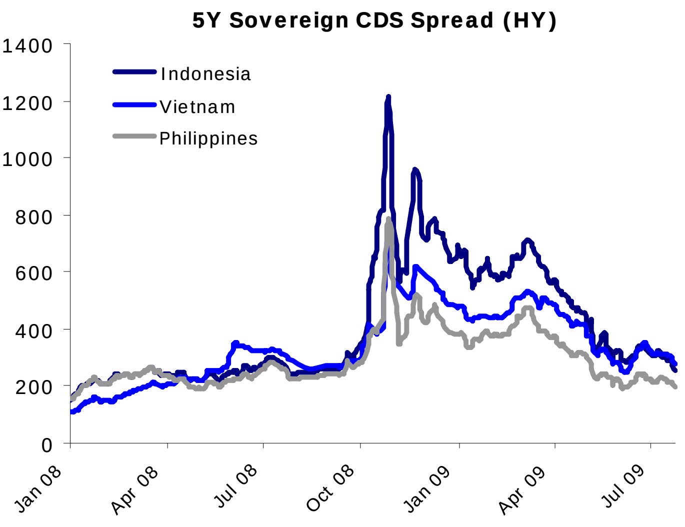
Long-Term Foreign Currency Government Bond Ratings

	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	Ba3*	BB-	BB
Vietnam	Ba3	BB	BB-
**denotes an upgrade; # denotes a downgrade over previous month*			
Source: Bloomberg			

Sovereign CDS Spreads

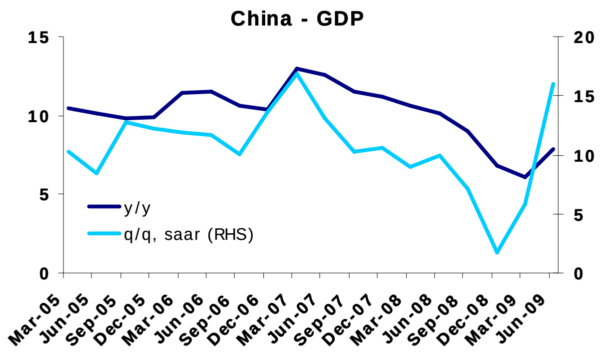


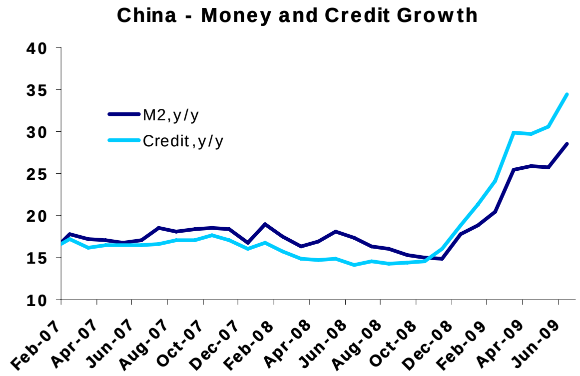
Source: Bloomberg

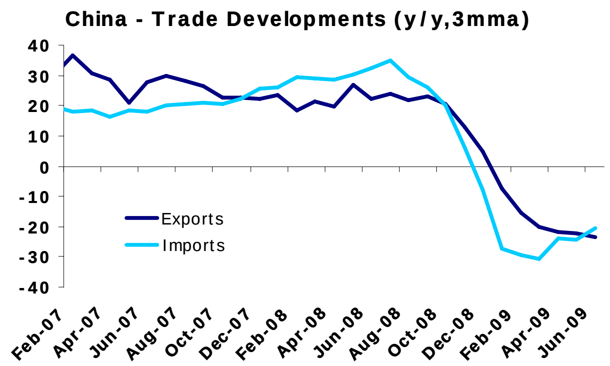


Source: Bloomberg

Country Update: China







GDP surprised on the upside in Q2 and the stimulus plan now appears to be ahead of schedule. A broad range of indicators is consistent with a solid expansion of the domestic economy while external demand remains weak. We have raised our 2009 growth forecast to 8% with upside risks.

- GDP grew by 7.9% (y/y) in Q2, well ahead of expectations, up from 6.1% in Q1. On a momentum basis, growth was over 15% (saar) in the quarter.
- Retail sales rose by 15.0% (y/y) in Jun, broadly unchanged from May. Industrial production fared better in Jun, rising 10.7% from 8.9% growth in May; this was the first double-digit increase since Sep 2008.
- Exports fell 21.4% (y/y) in Jun, better than the decline of 26.4% in May. Imports dropped by 13.2%, roughly one-half of the May decline. Increased demand for commodities underpinned import performance. The trade surplus fell to $8.3bn in Jun from $13.4bn in May.
- Inflation pressures remain weak. The CPI declined for the fifth month running, falling 1.7% (y/y) in Jun; however, the index gained 0.5% during the month. The PPI slid by 7.8% in Jun, following a 7.2% decline in May.
- The official Purchasing Managers Index rose fractionally to 53.2 in Jun, signalling a fourth straight month of expanding manufacturing activity. The CLSA PMI rose to 51.8 in Jun, the highest level in a year.
- Money and credit continue to expand rapidly. M2 grew by 28.5% (y/y) in May, while M1 and M0 increased by 24.8% and 11.5%, respectively, in Jun. New CNY-denominated loans more than doubled to CNY1.5tn in Jun from May.
- The recovery path/stimulus plan appears ahead of schedule and we have raised our 2009 growth forecast to 8%. We expect the authorities to continue with expansionary policies until the recovery is secure and foreign demand begins to recover. That said, a mid-course correction to slow credit growth cannot be ruled out. The risks to growth are on the upside.

Paul Gruenwald

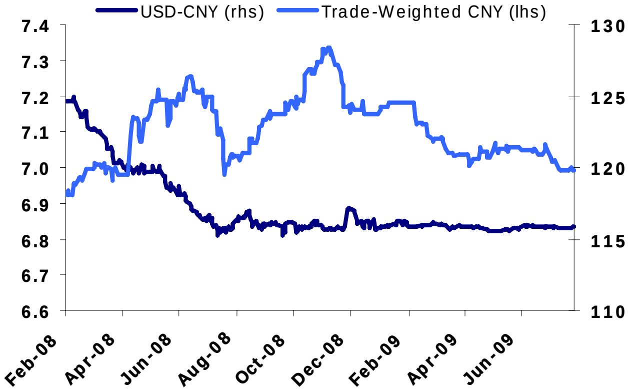
Economic Data – China

Monthly data	Nov 08	Dec 08	Jan 09	Feb 09	Mar 09	Apr 09	May 09	Jun 09
Industrial Production, % y/y	5.4	5.7	N/A	11.0	8.3	7.3	8.9	10.7
Retail Sales, % y/y	20.8	19.0	18.5	11.6	14.7	14.8	15.2	15.0
Consumer Price Index, % y/y	2.4	1.2	1.0	-1.6	-1.2	-1.5	-1.4	-1.7
Exports, % y/y	-2.2	-2.8	-17.5	-25.7	-17.1	-22.6	-26.3	-21.4
Imports, % y/y	-18.0	-21.3	-43.1	-23.8	-24.9	-22.8	-24.8	-13.2
Trade Balance, US$ bn	40.1	39.0	39.1	4.8	18.6	13.1	13.4	8.3
Quarterly data	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**	**Jun 09**
Real GDP, % y/y	13.0	12.0	10.6	10.1	9.0	6.8	6.1	7.9
-Primary Sector ytd	4.3	3.7	2.8	3.5	4.5	5.5	3.5	3.8
-Secondary sector ytd	14.8	14.7	11.5	11.3	10.6	9.3	5.3	6.6
-Tertiary sector ytd	14.0	13.8	10.9	10.7	10.5	9.5	7.4	8.3
Nominal GDP, RMB tn	17.4	25.7	6.3	13.5	20.8	30.1	6.6	14.0
Foreign Exchange Reserves, US$ bn	1,433.6	1,528.2	1,682.2	1,808.8	1,905.6	1,946.0	1,953.7	2,131.6
Current Account, US$ bn (semi-annual)	N/A	371.8	N/A	191.7	N/A	426.1	N/A	N/A
Capital Account, US$ bn (semi-annual)	N/A	3.1	N/A	1.7	N/A	3.1	N/A	N/A

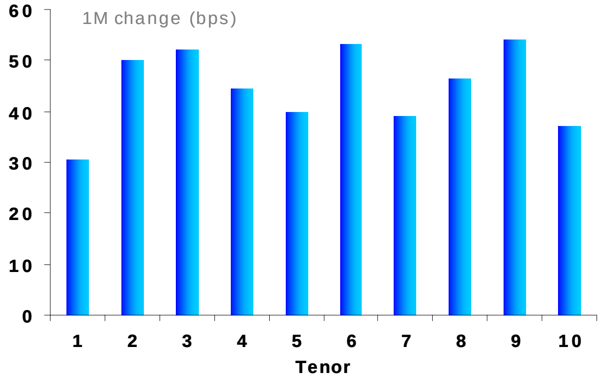
Sources: CEIC

China: FX and Rates Strategy

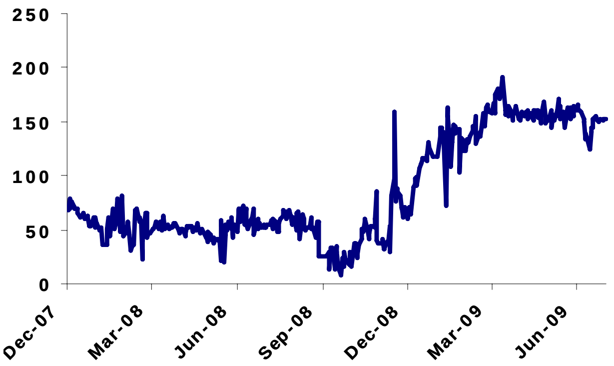
CNY TWI remains in gradual downtrend



IRS Curve Shifted Higher in July (bps)



2s-10s IRS: Flattening Just Getting Started (bps)



USD-CNY is expected to remain unchanged throughout 2009. Although economic growth is on track to meet the 8% target, the authorities most likely prefer to see a normalisation in global demand before allowing the renminbi to continue on an appreciation path. Meanwhile, the PBOC has taken steps to reign in liquidity—seen more as a means to avert an asset bubble than as the outright withdrawal of stimulus.

FX

In line with our outlook for a protracted period of sub-par growth in the developed economies, we continue to expect USD-CNY to remain in a holding pattern into 2010. Economic growth has clearly bottomed in China, but exports have yet to show any sign of a recovery, still down 21.4% (y/y) in Jun.

Meanwhile, the Chinese authorities continue to raise concerns about the USD's status as the world's reserve currency and continue to urge the US authorities to maintain prudent economic policies that will protect the value of China's large USD exposure. With the CNY effectively pegged to the USD for now, "talking down the USD" makes the CNY more competitive on a trade-weighted basis, helping Chinese exporters. As long as the CNY is held steady against the USD, China's large USD exposure is perfectly hedged. The cost of the hedge, however, is the accumulation of even larger FX reserves.

Rates

Chinese local rates continue to rise, boosted by spectacular gains in the Shanghai stock market and another batch of stronger-than-expected data, including Q2 GDP at 7.9% (y/y). Meanwhile, officials have expressed concern about credit quality and yields at PBOC T-bill auctions have been set progressively higher. As a result, markets have become jittery about the potential withdrawal of monetary stimulus. Although we expect market rates to maintain an upward bias over the course of H2, no rate hikes are expected until next year. Indeed, comments by the authorities continue to suggest that there is no intention of reigning in accommodative fiscal and monetary policies anytime soon.

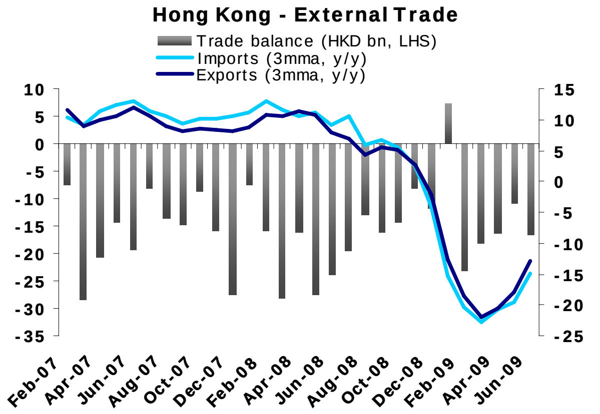
Tamara Henderson

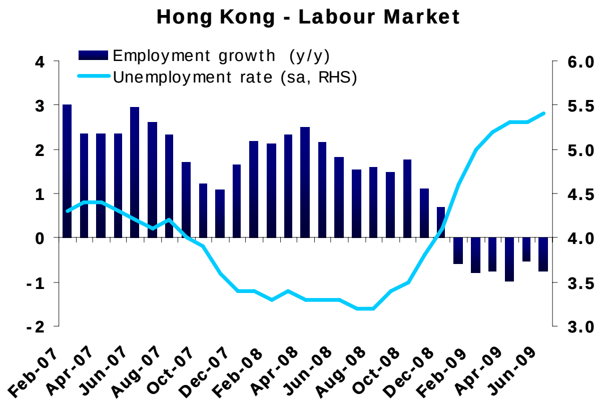
Market Forecasts – China (eop)

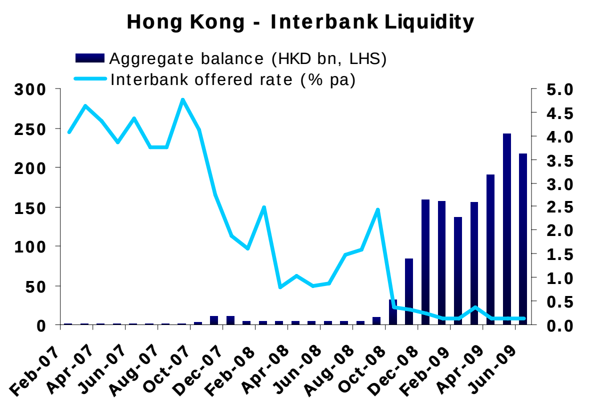
FX	Current	Ytd (%)	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10
USD-CNY	6.832	0.1%	6.83	6.83	6.83	6.83	6.82	6.80
AUD-CNY	5.585	16.5%	5.20	5.00	5.10	5.20	5.30	5.40
NZD-CNY	4.440	12.4%	4.00	3.80	3.70	3.70	3.70	3.80
JPY-CNY	0.072	-4.5%	0.070	0.068	0.065	0.063	0.062	0.061
EUR-CNY	9.602	0.7%	9.22	8.88	8.88	8.95	9.00	8.98
Rates	**Current**	**Ytd(bps)**	**Sep 09**	**Dec 09**	**Mar 10**	**Jun 10**	**Sep 10**	**Dec 10**
PBOC's 1-year base lending rate	5.31	0	5.31	5.31	5.31	5.31	5.58	5.85
3-month SHIBOR	1.65	-13	1.8	2.1	2.3	2.5	3.0	3.5
2-year IRS (onshore vs 7-day repo fix)	2.46	138	2.6	2.9	3.1	3.3	3.8	4.3
10-year IRS	3.99	220	4.1	4.2	4.3	4.4	4.7	4.9

Sources: Bloomberg, ANZ

Country Update: Hong Kong







The decline in Hong Kong's exports continues to moderate, although foreign demand remains weak. The drop in retail sales in May was due to the swine flu, which has hurt tourist arrivals. We have raised our growth forecast for 2009 to -3.9% from -6.7%.

- Growth in retail sales worsened to -6.2% (y/y) in May from a revised -4.3% in Apr. Volume growth also deteriorated to -6.4% from -5.4%. Part of the weakness was due to the swine flu, which has hurt tourist arrivals.
- Exports declined by 5.4% (y/y) in Jun, better than expected and compared with May's -14.5%. Jun is the fourth consecutive month of a narrowing export decline. Imports dropped by 7.9% (y/y), improving from -19.2% in May. A trade deficit of HKD16.5bn was recorded, compared with May's level of HKD11bn.
- Inflation remains contained. The composite CPI dropped by 0.9% (y/y) in Jun, the first negative reading since 2005. Netting out the effects of the government's one-off measures, consumer prices rose by 0.4% (y/y) in Jun, slower than the 1.3% increase in May. This was mainly due to slower increases in food prices and private housing rentals.
- Property prices continued to rise in Jul. Factors included Chinese capital inflows from the stimulus package and mortgage rates being lower than rental yields.
- The jobless rate edged higher to 5.4% in Jun.
- The PMI increased for the seventh straight month to reach 47.1 in Jun from 44.8 in May, although it remains below the neutral level of 50, suggesting an ongoing contraction in overall business activity.
- The HKMA signed a memorandum with the PBOC on RMB trade settlements on 29 June. Hong Kong banks are now authorised to develop RMB trade finance businesses. We expect CNY circulation in Hong Kong to rise, which is seen as an important step for Hong Kong to continue its development as an Asian financial hub.
- We have recently revised upward our GDP forecast to -3.9% for 2009 from -6.7%, although the risks remain on the downside.

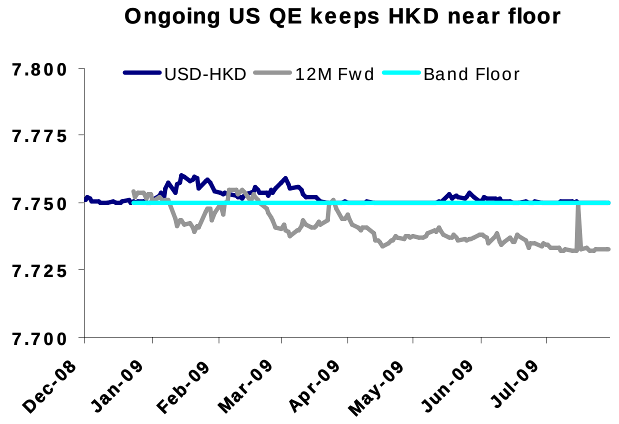
Franklin Poon

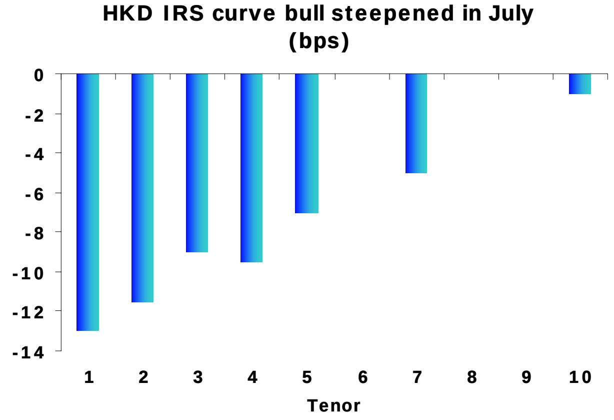
Economic Data – Hong Kong

Monthly data	Nov 08	Dec 08	Jan 09	Feb 09	Mar 09	Apr 09	May 09	Jun 09
Retail Sales, % y/y	1.3	1.1	7.3	-12.7	-7.8	-4.3	-6.2	N/A
Composite Consumer Price Index sa, % y/y	3.1	2.1	2.7	1.1	1.2	0.6	0.1	-0.9
Exports, % y/y	-5.3	-11.4	-21.8	-23.0	-21.1	-18.2	-14.5	-5.4
Imports, % y/y	-7.9	-16.2	-27.1	-17.5	-22.7	-17.0	-19.2	-7.9
Trade Balance, US$ bn	-1.1	-1.5	0.9	-3.0	-2.3	-2.1	-1.4	-2.1
Foreign Exchange Reserves, US$ bn	160.5	178.1	174.4	171.7	181.7	185.9	196.2	207.0
Quarterly data	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**	**Jun 09**
Industrial Production, % y/y	-2.1	-0.3	-4.5	-4.2	-7.0	-10.6	-10.1	N/A
Real GDP, % y/y	6.8	6.9	7.3	4.1	1.5	-2.6	-7.8	N/A
-Private consumption	11.4	9.7	8.0	3.0	-0.2	-4.1	-5.5	N/A
-Government consumption	2.4	3.3	0.6	3.1	1.6	1.8	1.5	N/A
-Gross fixed capital formation	-1.1	8.0	9.9	5.1	2.9	-17.8	-12.6	N/A
Nominal GDP, HKD bn	415.5	448.0	410.0	401.4	430.2	435.3	380.1	N/A
Current Account, US$ bn	7.8	6.1	6.5	4.1	9.6	10.4	5.3	N/A
Capital & Financial Account, US$ bn	-9.6	-8.3	-4.3	-2.6	-11.9	-8.9	-3.9	N/A

Sources: CEIC

Hong Kong: FX and Rates Strategy





We expect USD-HKD to remain on the strong side of the convertibility zone until the US signals an end to its policy of quantitative easing—more likely in 2010 than 2009. Meanwhile, market participants continue to speculate about an adjustment in the currency regime. No adjustment in the HKD peg is expected in the foreseeable future.

FX

The HKMA continues to inject liquidity into the money market (raising the Aggregate Balance) in order to prevent the HKD from strengthening against the USD beyond the limits of the convertibility zone. Injections amounted to $7.2bn in July compared with $3.1bn in June.

Meanwhile, the upcoming change in leadership at the helm of the HKMA (effective 1 October) continues to fuel speculation of an adjustment in Hong Kong's currency regime—despite a clear statement by the Hong Kong government supporting the status quo. An adjustment in the peg is unlikely as long as: 1/ global financial markets remain fragile and global growth remains sub-par, 2/ Hong Kong's trade and financial links remain dominated by the West, and 3/ the renminbi remains unconvertible for all capital account transactions.

Mainland authorities have taken further steps to increase the use of the CNY in Hong Kong (and elsewhere) and outgoing HKMA Chief Executive Joseph Yam said he would not rule out the possibility of the CNY becoming the preferred currency for daily use in Hong Kong even though the HKD remains the legal tender. No adjustment in the USD-HKD peg is expected in the foreseeable future.

Rates

HKD rates remain broadly range-bound. The latest FOMC statement on 24 Jun said that the federal funds rate would likely be kept "exceptionally low" for an "extended period," dampening concerns about an exit from QE any time soon. Although the US economy has showed some signs of stabilisation recently, recovery prospects remain fragile. This should maintain the status quo at the Fed's next meeting on 12 Aug, continuing to cap any upward pressure on yields as effects from government stimulus start to feed more fully to the real economy.

Tamara Henderson

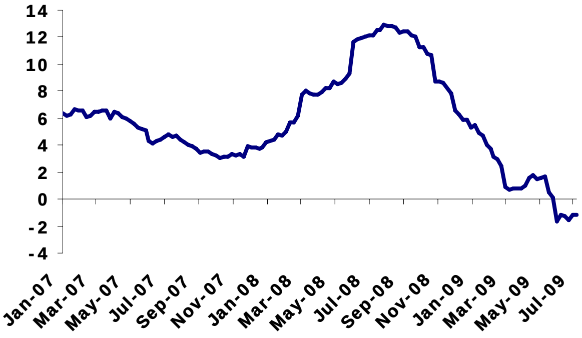
Market Forecasts – Hong Kong (eop)

FX	Current	Ytd (%)	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10
USD-HKD	7.750	0.0%	7.750	7.750	7.750	7.760	7.770	7.800
AUD-HKD	6.342	16.5%	5.9	5.7	5.7	5.9	6.1	6.2
NZD-HKD	5.040	12.3%	4.5	4.3	4.2	4.2	4.3	4.4
JPY-HKD	0.082	-4.4%	0.079	0.078	0.074	0.072	0.071	0.070
EUR-HKD	10.900	0.6%	10.5	10.1	10.1	10.2	10.3	10.3
Rates	**Current**	**Ytd (bps)**	**Sep 09**	**Dec 09**	**Mar 10**	**Jun 10**	**Sep 10**	**Dec 10**
HKMA's discount rate	0.50	0	0.50	0.50	0.50	0.50	0.75	1.00
3-month HIBOR	0.23	-72	0.4	0.6	0.7	0.8	1.3	2.1
2-year IRS (onshore versus 3M)	1.28	-22	1.4	1.6	1.7	2.0	2.5	3.2
10-year IRS	3.25	132	3.5	3.7	4.0	4.2	4.4	4.7

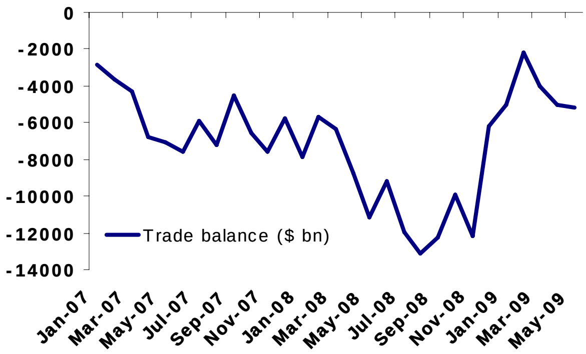
Sources: ANZ, Bloomberg

Country Update: India

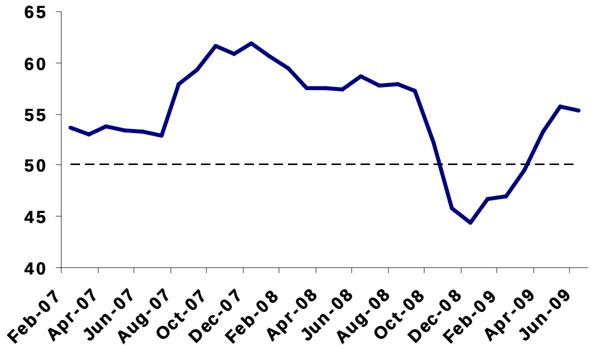
India - Wholesale Price Index



India - Trade Balance



India - Purchasing Managers Index



External trade remained depressed but industrial output continued to show signs of a turnaround on stronger domestic demand. The deficit in monsoon rainfall could impinge on growth and worsen the inflation outlook.

- Domestic demand indicators continued to improve in Jun. Domestic vehicle sales were up 14.3 (y/y), the fastest pace in almost 3 years, aided by falling borrowing costs and new model launches. Cement production also rose to a 22-month high of 13.2%.
- Industrial production strengthened to 2.7% (y/y) in May, up from a revised 1.2% gain in Apr. Output of consumer durables expanded for the fifth consecutive month at 12.4%, but non-durables growth remained lacklustre at -2.3%. The PMI remained in the expansion zone in Jun, but eased marginally to 55.3. The new orders index stood firm at 58.1.
- Exports were down 29.2% (y/y) in May against a 33.2% drop in Apr, the eighth consecutive monthly decline. The contraction in imports worsened to 39.2% (against a 36.6% drop in Apr), led by a sharp 60.6% decline in oil imports. The trade deficit widened slightly to $5.2bn.
- The fuel price hikes in Jul failed to lift the Wholesale Price Index (WPI). The WPI declined at a more moderate pace of 1.17% (y/y) for the week ending 11 Jul, compared with a fall of 1.6% during the last week of Jun. Other measures of consumer prices were substantially higher, with the May CPI for industrial workers up 8.6%.
- The FY09/10 budget promised increased spending on infrastructure and rural development and also relaxed a few tax rules to help sustain domestic consumption. However, the markets were disappointed by the absence of a clear roadmap on economic reform and fiscal consolidation. The fiscal deficit is projected to widen to 6.8% of GDP this year, with government debt issuance surprising on the upside at INR4.51tn.
- Uncertainty over the monsoon is a near-term concern. The deficiency in rainfall is reportedly as high as 50% in certain regions of the country. This poses a threat to the agricultural sector and could worsen the inflation outlook. However, we believe the economy will outperform RBI's conservative forecast of "6% with upward bias" in FY09/10.

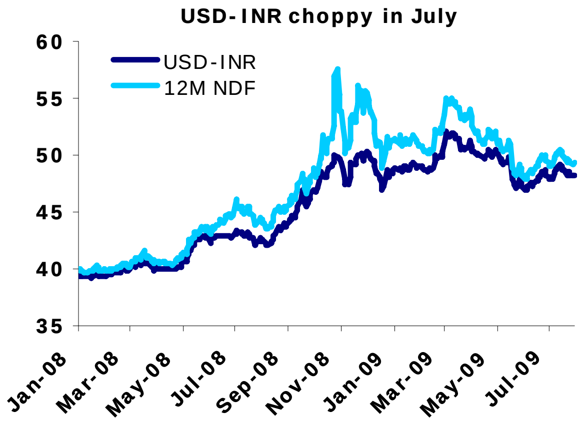
Yeo Han Sia

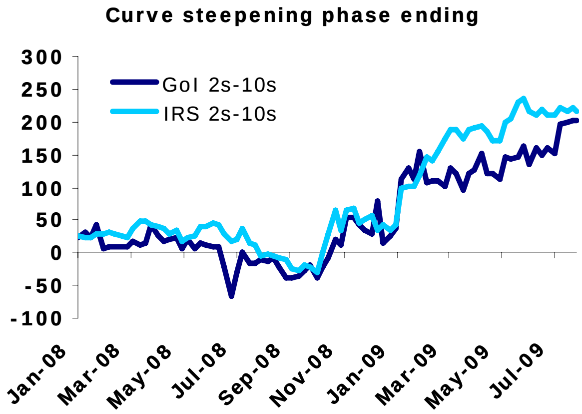
Economic Data – India

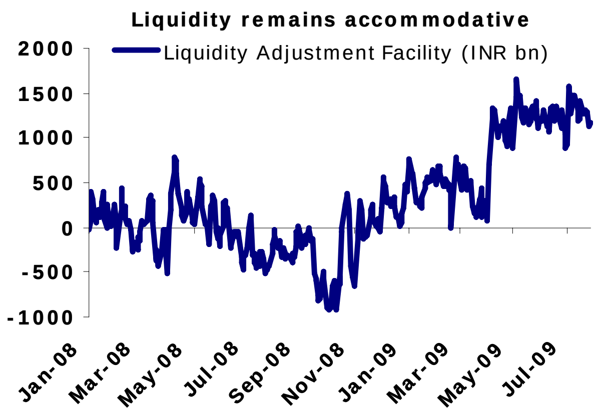
Monthly data	Nov 08	Dec 08	Jan 09	Feb 09	Mar 09	Apr 09	May 09	Jun 09
Industrial Production, % y/y	2.5	-0.2	1.0	0.2	-0.8	1.2	2.7	N/A
Automobile Sales, % y/y	-10.4	-11.8	-6.0	10.0	0.5	8.1	8.4	14.3
Wholesale Price Index, % y/y	8.2	5.9	4.5	3.1	0.8	1.7	0.1	-1.6
Exports, % y/y	-19.6	-4.6	-22.4	-27.7	-33.3	-33.2	-29.2	N/A
Imports, % y/y	10.2	-1.1	-27.1	-36.8	-34.0	-36.6	-39.2	N/A
Trade Balance, US$ bn	-12.1	-6.2	-5.0	-2.2	-4.0	-5.0	-5.2	N/A
Foreign Exchange Reserves, US$ bn	239.0	246.6	238.9	238.7	241.4	241.5	251.5	251.5
Quarterly data	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**	**Jun 09**
Real GDP, % y/y	9.0	9.3	8.6	7.8	7.7	5.8	5.8	N/A
-Agriculture	3.9	8.1	2.2	3.0	2.7	-0.8	2.7	N/A
-Industry	9.8	9.0	6.5	6.4	6.5	2.0	1.2	N/A
-Services	10.3	10.3	11.8	10.2	9.8	10.2	8.6	N/A
Nominal GDP, INR tn	9.9	11.5	11.9	11.6	11.8	13.1	12.9	N/A
Current Account, US$ bn	-4.3	-4.5	-1.5	-9.0	-12.5	-13.0	4.7	N/A
Capital Account, US$ bn	33.2	31.0	26.0	11.1	7.6	-4.3	-5.3	N/A

Sources: CEIC

India: FX and Rates Strategy







The medium-term outlook for the rupee remains bullish; any short term pull-back in USD-INR is unlikely to extend beyond tough resistance at the 200-day MA. The curve steepening phase is winding down with the RBI signalling an end to the easing cycle.

FX

USD-INR surged in early July after the FY09/10 budget failed to outline fiscal consolidation measures and step up privatisation. However, USD-INR reversed after touching 200-day MA resistance, breaking below short-term trend line support on broad USD weakness and a swift rebound in the local stock market. The island reversal pattern on 13 Jul also signalled short-term bearishness on USD-INR. Any USD-INR pull-back from seasonal risk aversion is unlikely to extend beyond the 200-day MA near the 49.10 level. The medium-term outlook for INR remains bullish, with the domestic demand driven economy showing increasing signs of a turnaround in Q2. However, the bottoming in global commodity prices presents some risks going forward, given India's high dependency on oil imports.

Rates

The RBI left policy rates unchanged on 28 Jul, as expected. The tone of the policy statement was more upbeat than in Apr, though the RBI was unequivocal in stressing that monetary conditions will remain accommodative until there are clear signs of a self-sustaining recovery. Meanwhile, inflation concerns were more elevated, limiting the scope for more policy easing in 2009. While the RBI did not outline an exit strategy, the July statement suggests liquidity support could be rapidly withdrawn if inflation expectations are destabilised. Overall, we see growing risks of a rate hike before Q2 2010. The government borrowing calendar for Apr-Sep was raised by INR580bn to 2.99tn in mid-Jul (66% of its revised 4.51tn FY09/10 borrowing target), but this was below market expectations. The steepening phase in the G-Sec curve is winding down with the RBI signalling an end to the easing cycle, and strategic flattening trades will likely gain favour as the year progresses. Meanwhile, ample liquidity and steady policy rates should keep the front-end of the curve reasonably well anchored, while back-end yields continue to face upward pressure on residual budget risks and inflation concerns.

Yeo Han Sia

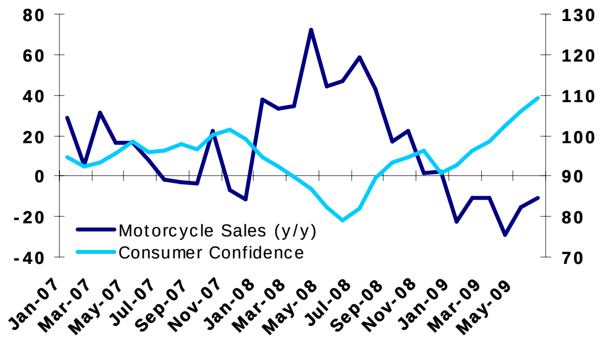
Market Forecasts – India (eop)

FX	Current	Ytd (%)	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10
USD-INR	48.18	-1.3%	48.5	48.0	47.0	47.5	47.0	47.0
AUD-INR	40.09	17.2%	36.9	35.0	34.8	36.1	36.7	37.6
NZD-INR	31.88	13.1%	28.1	26.4	25.4	25.7	25.9	26.3
JPY-INR	0.510	-5.0%	0.495	0.480	0.448	0.440	0.427	0.420
EUR-INR	68.79	1.1%	65.5	62.4	61.1	62.2	62.0	62.0
Rates	**Current**	**Ytd (%)**	**Sep 09**	**Dec 09**	**Mar 10**	**Jun 10**	**Sep 10**	**Dec 10**
RBI's repo rate	4.75	-175	4.75	4.75	4.75	5.00	5.25	5.50
3-month MIBOR	4.64	-425	4.6	4.6	4.7	5.0	5.3	5.6
2-year IRS (versus NSE MIBOR)	4.89	45	4.8	4.8	4.9	5.3	5.8	6.1
10-year IRS	7.10	228	7.0	6.9	7.0	7.1	7.4	7.6

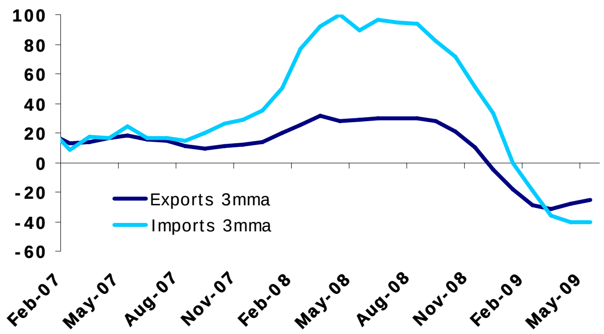
Sources: Bloomberg, ANZ

Country Update: Indonesia

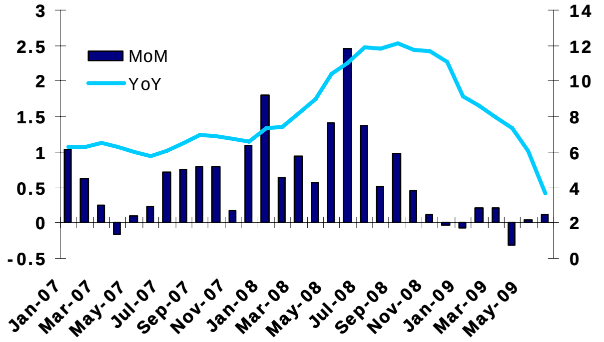
Indonesia: Consumption Indicators



Indonesia - Trade Developments (y/y)



Indonesia: Inflation



Domestic demand remains reasonably solid while external demand languishes. Inflation continues to fall and the BI continues to ease gradually, although the easing cycle is nearing an end. Indonesia will continue to be an outperformer, and we see steady but non-spectacular growth in 2009.

- Retail sales growth was steady in May, rising 4.3% (y/y) aided by spending on food, tobacco and clothing. Car sales in Jun fell by 25.7%, although sales picked up on a monthly basis to a six month high.
- Exports fell 28.3% (y/y) in May compared with a 22.6% decline in Apr on lower oil and gas shipments. Imports, on the other hand, fell by 32.7% compared with a 42.4% decline in Apr. As a result, the trade surplus narrowed by $0.3bn to $1.4bn for the month.
- Inflation fell to 3.7% (y/y) in Jun, compared with a 6.0% rise in May. The decline reflected base effects due to higher fuel prices in 2008. Core CPI, which excludes food and energy components, rose 5.6% in Jun, 1.0 ppt lower than in May.
- Bank Indonesia's Consumer Confidence Index rose to 109.1 for Jun, its highest level in over four years, up 3.2 points from May. Better macroeconomic indicators and moderating inflation levels aided the improvement in consumer confidence.
- Reflecting an outlook for modest inflation pressures, Bank Indonesia (BI) cut its benchmark interest rate by 25bps to 6.75% in June, the eighth consecutive monthly rate cut. We see one more cut in August before the easing cycle comes to an end.
- Bombings at two Jakarta hotels created concerns over investor sentiment and foreign portfolio inflows, with both the rupiah and the stock market declining immediately thereafter. However, investors seem to be interpreting these acts attacks in an international, not an Indonesia-specific, context.
- Prospects continue to look good for 2009. Indonesia should continue to outperform, at least on a y/y basis, although the rise in growth going forward will likely be more moderate than elsewhere in the region.

Paul Gruenwald

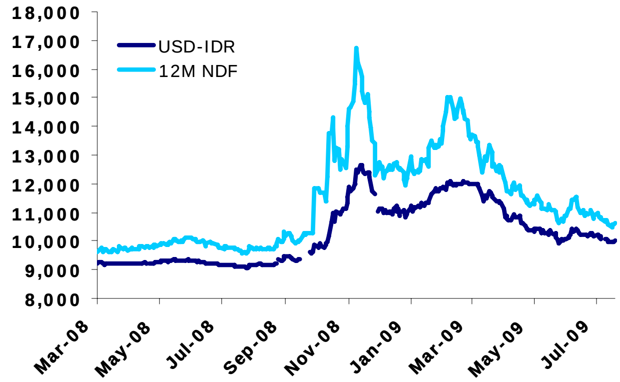
Economic Data – Indonesia

Monthly data	**Nov 08**	**Dec 08**	**Jan 09**	**Feb 09**	**Mar 09**	**Apr 09**	**May 09**	**Jun 09**
Industrial Production, % y/y	0.6	-1.9	-1.7	0.9	1.5	2.0	1.8	N/A
Retail Sales Index, % y/y	-26.3	-5.0	2.9	-8.2	5.9	4.2	4.3	N/A
Consumer Price Index, % y/y	11.5	11.1	9.2	8.6	7.9	6.0	4.6	3.7
Exports, % y/y	-1.8	-18.7	-35.0	-32.3	-28.3	-22.6	-28.3	N/A
Imports, % y/y	-5.6	-8.0	-27.9	-40.1	-33.9	-42.4	-32.7	N/A
Trade Balance, US$ bn	0.9	1.0	0.6	1.1	2.1	1.7	1.4	N/A
Foreign Exchange Reserves, US$ bn	47.8	49.2	48.3	47.9	52.2	54.0	55.2	54.9
Quarterly data	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**	**Jun 09**
Real GDP, % y/y	6.6	5.8	6.2	6.4	6.4	5.2	4.4	N/A
-Private consumption	5.1	5.5	5.7	5.5	5.3	4.8	5.8	N/A
-Government consumption	6.5	2.0	3.6	5.3	14.1	16.4	19.2	N/A
-Gross fixed capital expenditure	9.7	12.4	13.7	12.0	12.2	9.1	3.5	N/A
Nominal GDP, IDR tn	1,030.8	1,034.9	1,117.6	1,229.6	1,332.5	1,274.3	1,300.3	N/A
Current Account, US$ bn	2.2	3.4	2.8	-1.0	-0.9	-0.7	1.8	N/A
Capital & Financial Account, US$ bn	-0.9	0.7	-1.4	2.5	0.9	-4.1	2.4	N/A

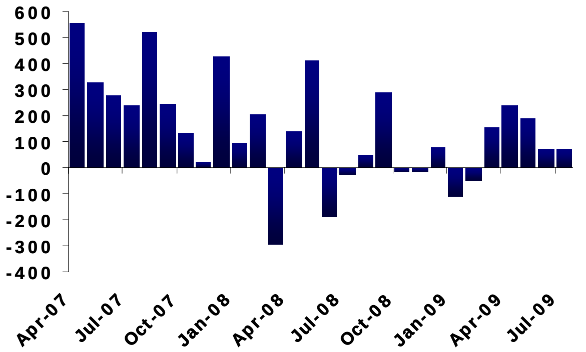
Sources: CEIC

Indonesia: FX and Rates Strategy

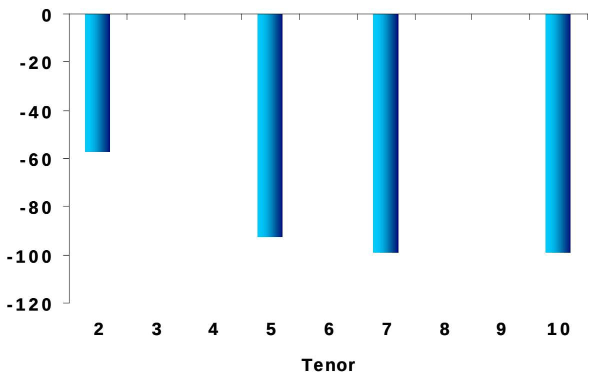
IDR has rallied 10% ytd



Net foreign equity inflows have slowed ($ mln, monthly flow)



IDR GOV yields collapsed in July (bps)



Strong July corporate earnings and the removal of political uncertainty have helped sustain risk appetite, pushing the IDR below the 9,910 level for the first time since October.

FX

The IDR has out-performed AXJ this year, rallying 10.7% against the USD thus far. IDR out-performance would seem to have three components: 1/ a correction from unfair punishment last year (when Indonesia's relatively strong fundamentals were ignored), 2/ the removal of political uncertainty with the re-election in July of a market-friendly incumbent President, and 3/ attractive yields. Going forward, the IDR should continue to benefit from attractive yields and sustained risk appetite, but note that valuations and the unwinding of highly favourable base effects on inflation may start to present obstacles toward year-end.

Presidential elections in July went as expected with the market-friendly incumbent Yudhoyono winning re-election by a wide margin—providing a strong mandate for a reform agenda which includes battling corruption. The removal of residual political uncertainty and progress on reforms should support further inflows of capital.

Underlying fundamentals remain supportive, with the economy less reliant on net exports and with consumer spending remaining relatively resilient during the global financial crisis and corresponding meltdown in global trade. As a net exporter of natural resources, the bottoming in commodity prices has also helped push Indonesia's current account back into surplus.

Rates

BI is widely expected to deliver one more rate cut of 25bps at its meeting on 5 Aug, concluding its easing cycle. Although yields will remain attractive for investors seeking to enhance returns, highly favourable base effects from the slump in global commodity prices last year are set to unwind. This will make the management of inflation expectations more difficult, especially since BI does not have the best inflation-fighting record. Unfortunately, the front-end of the IDR government bond curve has become quite expensive, presenting an impediment for trimming duration and managing interest rate risk.

Tamara Henderson

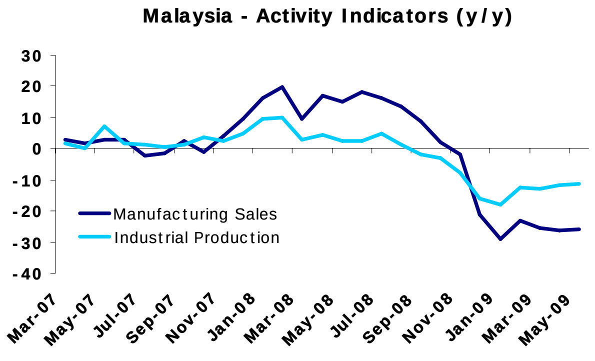
Market Forecasts – Indonesia (eop)

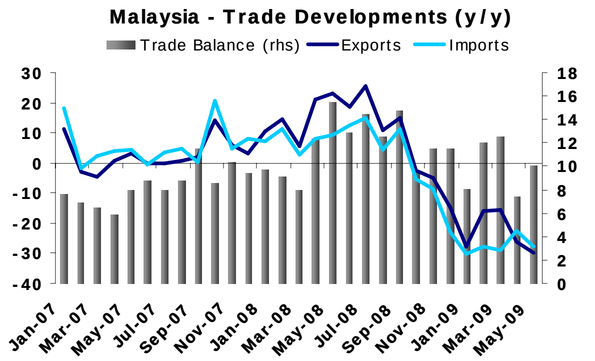
FX	Current	Ytd (%)	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10
USD-IDR	9,995	-10.1%	10,250	9,750	9,500	10,000	9,500	9,000
AUD-IDR	8,182	2.8%	7,800	7,100	7,000	7,600	7,400	7,200
NZD-IDR	6,507	-0.8%	5,900	5,400	5,100	5,400	5,200	5,000
JPY-IDR	105	-15.6%	100	100	90	90	90	80
EUR-IDR	14,072	-11.1%	13,800	12,700	12,400	13,100	12,500	11,900
Rates	**Current**	**Ytd (bps)**	**Sep 09**	**Dec 09**	**Mar 10**	**Jun 10**	**Sep 10**	**Dec 10**
BI's bank rate	6.75	-250	6.50	6.50	6.50	6.75	7.00	7.00
3-month JIBOR	7.18	-496	7.1	7.0	6.9	7.2	7.4	7.7
2-year IDR bond yield	7.83	-359	8.1	8.0	7.9	8.1	8.4	8.6
10-year IDR bond yield	10.10	-179	11.2	10.8	10.5	10.6	10.7	10.8

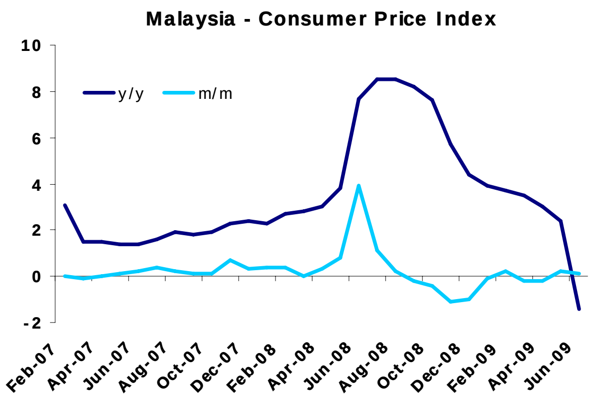
Sources: Bloomberg, ANZ

Country Update: Malaysia

External trade continues to weaken, pushing back forecasts of the bottom in growth. However, activity indicators have moved away from recent lows. Bank Negara seems content to stand pat for now. Prime Minister Najib's approval ratings are up since taking office in Apr, indicating a stable political outlook.







- Manufacturing sales remained weak, though contracting at a slower pace, with a decline of 25.9% (y/y) in May compared with a revised 26.3% fall in Apr.
- Industrial production dropped at the slowest pace in six months, falling 11.1% (y/y) in May compared with an 11.4% decline in Apr.
- External demand continued to deteriorate as exports fell 29.7% (y/y) in May, worse than Apr's -26.3%. Imports contracted by 27.8% (y/y) after a decline of 22.4% in Apr. The trade surplus widened by 36% to $2.9bn.
- The unemployment rate surged to 4.0% (q/q) in Q1 from 3.1% in Q4. We expect unemployment to climb further this year, with employees in the electrical & electronics manufacturing as well as export orientated companies bearing the brunt.
- Consumer confidence jumped in Q2 with the CSI surging 26.9 points (q/q) and 35.3 points (y/y), according to the Malaysian Institute of Economic Research.
- Inflation contracted for the first time in two decades, falling to -1.4% (y/y) in Jun from a 2.4% rise in May. Due to the high base effects from last year's fuel price hikes, we expect several months of deflation with CPI growth returning to positive territory by late 2009.
- Prime Minister Najib unveiled a slew of policies to deregulate the Foreign Investment Committee (FIC) guidelines with a view to attracting more foreign investment. Most notably, company listings on the KLSE will be required to allocate only 12.5% of their equity to ethnic Malays, down from the 30% cap previously.
- The BNM kept its overnight policy rate unchanged at 2.0%, in line with market expectations. The policy statement said the current stimulus and low interest rates are sufficient to prop up the economy.
- Going forward, we expect the implementation of the reforms to be a drawn out process and growth is expected to come from domestic stimulus rather than external demand. Risks are on the downside.

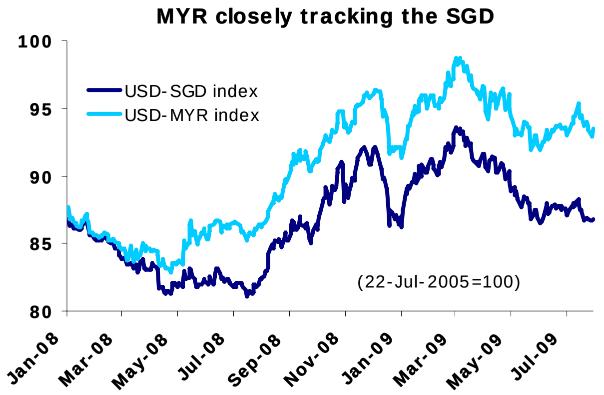
Naresh Navaratnarajah

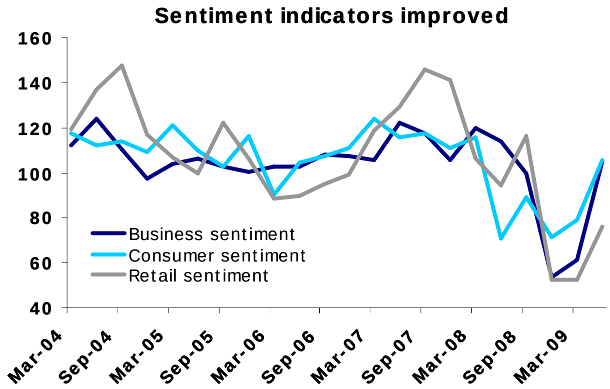
Economic Data – Malaysia

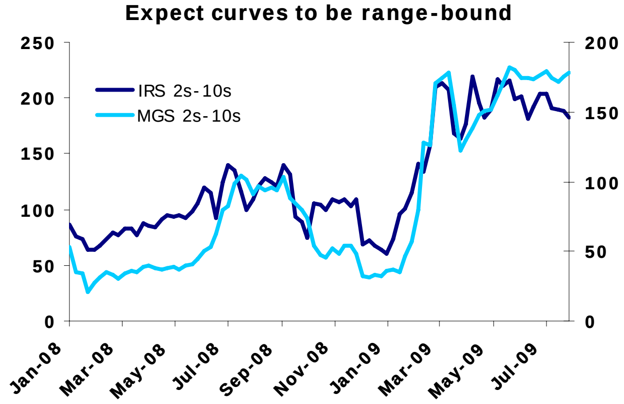
Monthly data	**Nov 08**	**Dec 08**	**Jan 09**	**Feb 09**	**Mar 09**	**Apr 09**	**May 09**	**Jun 09**
Industrial Production, % y/y	-7.9	-15.9	-17.9	-12.5	-12.6	-11.4	-11.1	N/A
Manufacturing Sales, % y/y	2.1	-1.9	-21.0	-22.9	-25.6	-26.3	-25.9	N/A
Consumer Price Index, % y/y	5.7	4.4	3.9	3.7	3.5	3.0	2.4	-1.4
Exports, % y/y	-4.9	-14.9	-27.8	-16.0	-15.7	-26.3	-29.7	N/A
Imports, % y/y	-8.6	-22.8	-30.4	-27.6	-29.0	-22.4	-27.8	N/A
Trade Balance, USD bn	3.2	3.3	2.2	3.3	3.4	2.1	2.9	N/A
Foreign Exchange Reserves, US$ bn	92.1	85.7	85.9	85.3	82.4	81.9	82.2	85.3
Quarterly data	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**	**Jun 09**
Retail Sales, % y/y	39.7	35.7	19.8	23.8	25.4	16.5	7.8	N/A
Real GDP, % y/y	6.5	7.2	7.4	6.6	4.8	0.1	-6.2	N/A
-Private consumption	14.2	9.9	11.3	9.4	8.2	5.3	-0.7	N/A
-Government consumption	6.0	4.0	14.1	10.3	6.4	12.7	2.1	N/A
-Gross fixed capital formation	12.7	10.2	4.6	5.6	3.1	-10.2	-10.8	N/A
Nominal GDP, MYR bn	165.4	176.2	175.5	188.5	197.6	177.0	155.5	N/A
Current Account, US$ bn	8.6	8.0	7.2	11.7	11.2	8.6	8.6	N/A
Capital & Financial Account, US$ bn	-9.0	-5.2	8.6	-3.4	-18.0	-20.8	-8.2	N/A

Sources: CEIC

Malaysia: FX and Rates Strategy







While relative growth underperformance continued to weigh on the MYR, we see increasing signs of a turnaround in H2. The BNM issued a more neutral policy statement in July on growing confidence over the resumption of growth.

FX

The MYR continued to track the SGD and DXY in July. The raft of economic reform measures announced in end-June to boost investment flows and enhance Malaysia's long-term growth prospects were overshadowed by the economy's weak performance. In contrast with other AXJ economies, the deep export contraction showed few signs of easing, with overseas shipments declining at a record pace of 29.7% (y/y) in May. While the coincident indicator showed the economy is bouncing along the trough of the business cycle, consumer and business sentiment turned positive in Q2. The leading index also posted gains over the past four months, indicating a likely turnaround in H2. Market expectations on Q2 GDP growth (due late-Aug) are relatively depressed at -5.5% (y/y). We see a reasonable chance for an upside surprise, which could nudge SGD-MYR back to the post-peg trading range of 2.20-2.40.

Rates

The BNM left the overnight policy rate (OPR) unchanged at 2% in July, in line with market expectations. The more neutral policy statement suggests the MPC has removed the soft easing bias implicit in the Apr and May statements. While the economic contraction persisted into Q2, the central bank took comfort from the signs of stabilisation in the global economy and improvements in labour market conditions as well as domestic sentiment indicators. The accelerated implementation of fiscal stimulus and lower financing costs are also expected to contribute to a growth recovery in H2 and beyond. Overall, we continue to see the BNM holding OPR steady well into 2010. With the BNM painting a balanced rather than upbeat view on the economy, rate hike expectations should remain anchored in the coming months and the MGS curve should remain range-bound. However, the balance of risks is still for moderately higher MGS yields and a steeper curve on residual budget risk and further signs of recovery.

Yeo Han Sia

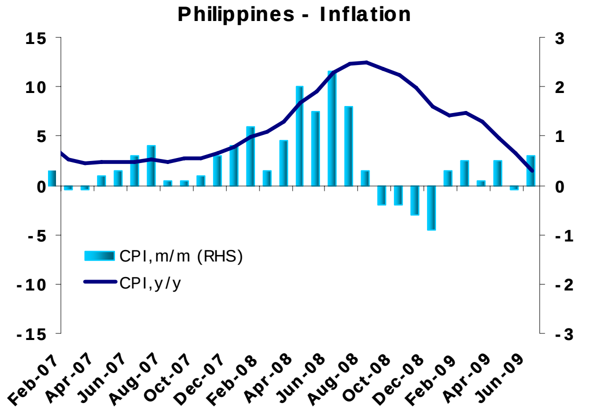
Market Forecasts – Malaysia (eop)

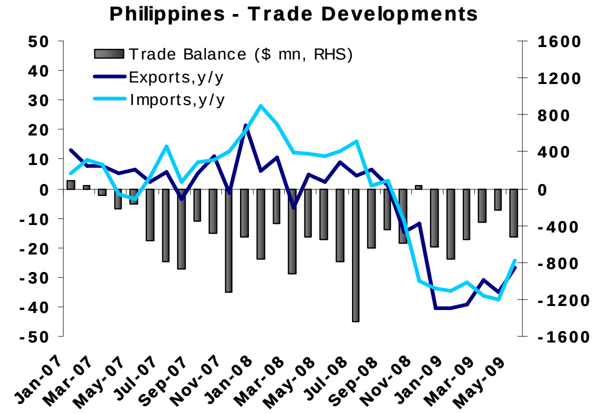
FX	Current	Ytd (%)	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10
USD-MYR	3.51	1.2%	3.55	3.50	3.48	3.45	3.40	3.40
AUD-MYR	2.92	20.5%	2.70	2.56	2.58	2.62	2.65	2.72
NZD-MYR	2.32	16.2%	2.06	1.93	1.88	1.86	1.87	1.90
JPY-MYR	3.71	-11.5%	3.62	3.50	3.31	3.19	3.09	3.04
EUR-MYR	5.01	3.9%	4.79	4.55	4.52	4.52	4.49	4.49
Rates	**Current**	**Ytd (bps)**	**Sep 09**	**Dec 09**	**Mar 10**	**Jun 10**	**Sep 10**	**Dec 10**
BNM's overnight policy rate	2.00	-125	2.00	2.00	2.00	2.00	2.25	2.25
3-month KLIBOR	2.13	-124	2.1	2.1	2.1	2.1	2.3	2.3
2-year IRS (versus 3M KLIBOR)	2.58	-23	2.6	2.7	2.7	2.7	3.0	3.1
10-year IRS	4.43	93	4.6	4.7	4.7	4.7	4.8	4.9

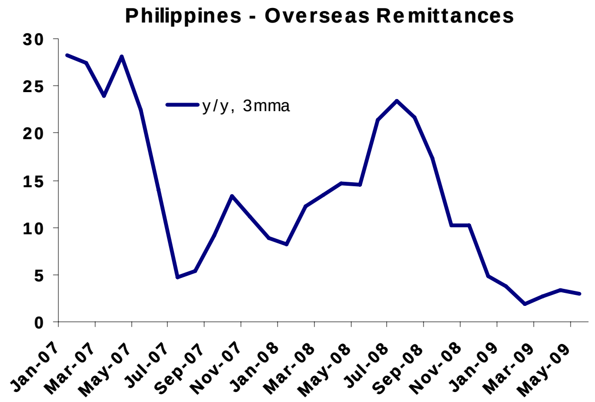
Sources: Bloomberg, ANZ

Country Update: Philippines

Domestic demand indicators are broadly positive, supported by rising consumer credit and overseas remittances. External trade data show few signs of improvement, indicating that growth will remain below trend in H2 2009. Although the sovereign rating was raised by Moody's, concerns over the fiscal deficit and public debt persist.







- Domestic demand indicators remained resilient. Auto sales in Jun recorded 4.4% (y/y) growth from 4.6% in May, bolstered by a 9.6% growth in consumption loans.
- Despite the crisis, remittances from overseas Filipinos increased by 3.7% (y/y) to a record $1.5bn in May. The cumulative inflows for the first five months stood at $7bn, an increase of 2.8% over the same period in 2008. The demand for Filipino overseas workers is expected to be sustained through agreements with various countries and employment facilitation programmes initiated by the government.
- The external sector remains weak. The decline in exports slowed to 27.0% (y/y) in May after sliding 35.2% in Apr. Imports fell by 24.3% in May, better than the fall of 37.4% a month earlier. The May trade deficit widened to $529mn, compared with $239mn (rev) in Apr.
- Headline inflation eased further in Jun to 1.5% from 3.3% in May, while core inflation eased to 3.9% from 4.4% in May.
- The BSP cut the overnight borrowing and lending rates by 25bps to 4.00% and 6.00%, respectively, the sixth cut in seven months. The rate cut cycle appears to be at an end.
- The fiscal position worsened in Jun with a deficit of PHP30.2bn, against PHP11.4bn in May, as the government pursues an aggressive stimulus plan to support the economy. However, global bond issuance will help finance the widening fiscal deficit. Meanwhile, Moody's upgraded the Philippines' sovereign debt rating by a notch to Ba3, supported by an overall BOP surplus and a record level of international reserves.
- With private consumption remaining buoyant, along with an improving external environment, we expect the Philippines to maintain positive growth in 2009, though it will be below trend.

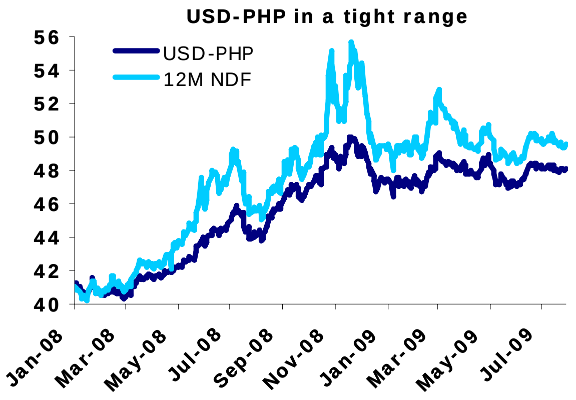
Zhou Hao & Raj Gopalakrishnan

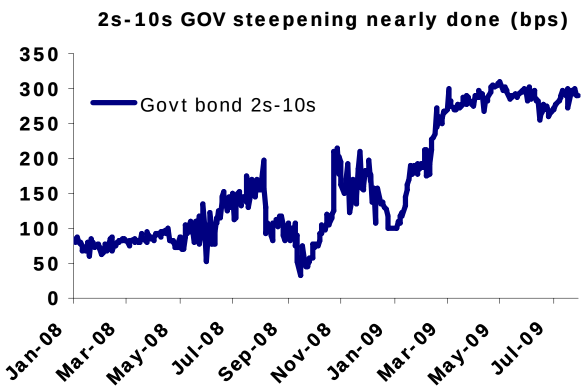
Economic Data – Philippines

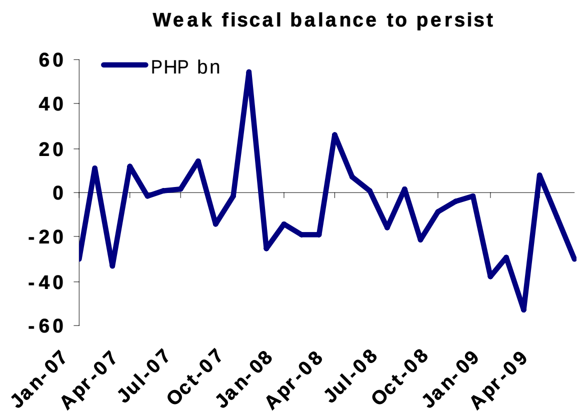
Monthly data	**Nov 08**	**Dec 08**	**Jan 09**	**Feb 09**	**Mar 09**	**Apr 09**	**May 09**	**Jun 09**
Manufacturing Production Value-add, % y/y	0.1	-9.8	-22.4	-18.7	-10.0	-14.9	N/A	N/A
Passenger Car Sales, % y/y	2.0	-19.5	14.2	1.2	0.6	-5.6	3.4	-1.4
Consumer Price Index, % y/y	9.9	8.0	7.1	7.3	6.4	4.8	3.3	1.5
Exports, % y/y	-11.4	-40.3	-40.6	-39.0	-30.8	-35.2	-26.9	N/A
Imports, % y/y	-31.5	-34.0	-34.5	-31.9	-36.2	-37.4	-24.3	N/A
Trade Balance, US$ bn	0.0	-0.6	-0.8	-0.6	-0.4	-0.2	-0.5	N/A
Foreign Exchange Reserves, US$ bn	32.4	32.6	34.1	33.6	33.9	34.3	39.6	N/A
Quarterly data	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**	**Jun 09**
Real GDP, % y/y	6.8	6.3	3.9	4.2	4.6	2.9	0.4	N/A
-Private consumption	5.7	6.2	5.1	4.1	4.4	5.0	0.8	N/A
-Government consumption	-2.6	8.0	-0.3	0.0	11.8	2.6	3.8	N/A
-Gross fixed capital formation	6.8	5.3	3.0	1.7	7.1	0.1	-5.7	N/A
Nominal GDP, peso bn	1,610.7	1,895.7	1,660.3	1,833.9	1,853.4	2,075.5	1,739.9	N/A
Current Account, US$ bn	1.3	2.0	1.3	0.9	-0.3	2.3	2.2	N/A
Capital & Financial Account, US$ bn	3.1	-0.1	0.5	0.4	0.4	-3.3	-0.8	N/A

Sources: CEIC

Philippines: FX and Rates Strategy







Short term peso-positive factors failed to nudge USD-PHP out of its range in July, but technical indicators point to a likely break out in the coming weeks. BSP comments about an 'exit strategy' pared rate cut expectations; we now expect rates to be on hold until Q3 2010.

FX

USD-PHP stood still in a narrow range of 48.00-48.50 in Jul despite sustained gains in risk trades and short-term peso-positive factors. Market reaction to Moody's one-notch upgrade to the Philippines' sovereign rating was muted, in part as the agency's previous B1 rating was the lowest among its peers. Inflows related to the $750mn global bond issue also failed to nudge USD-PHP out of familiar ranges. USD-PHP topside was firmly capped by trend line resistance, while the 50-day MA supported the downside. Technical indicators are now bullish on USD-PHP on balance. Price trends also point to the risk of heightened volatility on a break out from the triangle formation in the coming weeks. However, we expect the Mar high of 49.20 to hold into Q3 with the most severe phase of the global economic downturn now behind us.

Rates

The cumulative fiscal deficit reached PHP153.4bn in H1, or 61.3% of the government's full year target of PHP250bn. The frontloading of government spending contributed to the larger deficit, though the balance of risks is skewed towards another upward revision if revenue collection continues to disappoint. We see upside risk to the government's 3.2% deficit target, but do not envision a breach of the 4% threshold indicated by Budget Secretary Andaya. Meanwhile, the warm reception to the Philippines' global bond issue in July should ease concerns over the record high PHP250bn net borrowing this year. Improving external financing conditions could prompt the government to change its domestic-external borrowing mix from Apr's 72:28 split; this would ease pressure on the domestic bond market. While the BSP signalled the scope for more easing after its July MPC meeting, recent comments on an 'exit strategy' from the accommodative monetary policy adopted in late 2008 continue to pare rate cut expectations. Front-end Phibor yields backed up in July to almost par levels with the official policy rate; the narrowing spread between 1Y forward-start swap and 1Y IRS further suggests the market is expecting a fairly flat interest rate trajectory in 2010.

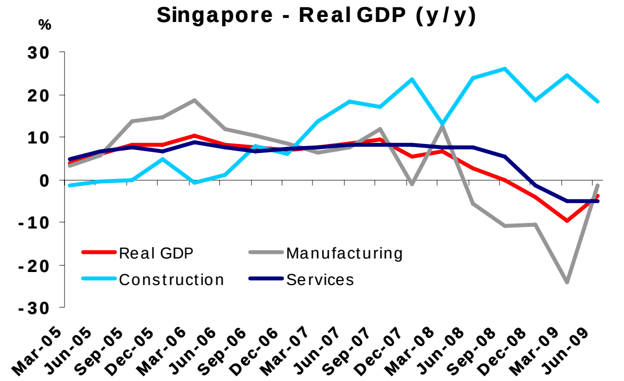
Yeo Han Sia

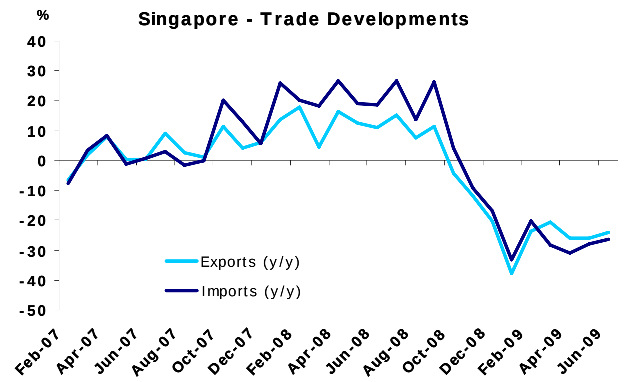
Market Forecasts – Philippines (eop)

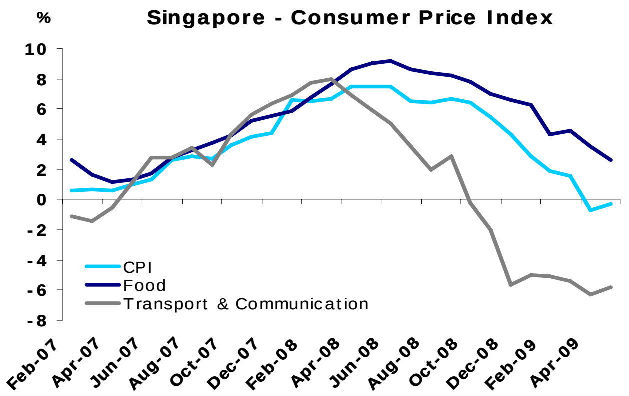
FX	Current	Ytd (%)	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10
USD-PHP	48.03	1.1%	49.0	48.0	48.0	47.0	47.0	46.0
AUD-PHP	39.97	20.0%	37.2	35.0	35.5	35.7	36.7	36.8
NZD-PHP	31.78	15.8%	28.4	26.4	25.9	25.4	25.9	25.8
JPY-PHP	0.507	-2.8%	0.500	0.480	0.457	0.435	0.427	0.411
EUR-PHP	68.56	3.5%	66.2	62.4	62.4	61.6	62.0	60.7
Rates	**Current**	**Ytd (%)**	**Sep 09**	**Dec 09**	**Mar 10**	**Jun 10**	**Sep 10**	**Dec 10**
BSP's overnight reverse repo rate	4.00	-150	4.00	4.00	4.00	4.00	4.25	4.25
3-month PHIBOR	4.25	-100	4.2	4.2	4.2	4.3	4.5	4.5
2-year IRS (versus 3M IB ref rate)	4.35	27	4.4	4.4	4.5	5.0	5.3	5.4
10-year IRS	5.83	-27	6.0	6.0	6.0	6.3	6.4	6.5

Sources: Bloomberg, ANZ

Country Update: Singapore







The government raised its 2009 forecast as Q2 growth was boosted by construction and pharmaceuticals. Supporting this rebound, non-oil domestic exports fell by the least amount in nine months but industrial production remained weak. Retail sales declined as job losses, wage cuts and declining tourist arrivals depressed spending. Inflation continued to ease on lower housing and transport costs. The MAS reported its first loss on record.

- Singapore's advance GDP estimate for 2Q09 was 20.4% (q/q, saar), boosted by gains in construction and pharmaceuticals. The government raised its official 2009 growth forecast to a range of -4% to -6% from a previous range of -6% to -9%.
- Retail sales fell 10.3% (y/y) in May as job losses, wage cuts and fewer tourist arrivals depressed spending. Tourist arrivals in the first five months of 2009 were down 11.7% (y/y). Vehicle sales fell 23.8%, followed by purchases of apparel and footwear which fell 8.6%. Gas station sales dropped 22.5% as crude oil prices declined.
- Industrial production fell 9.3% (y/y) in Jun, from a revised 2.1% gain in May. Electronics production declined 20% while pharmaceuticals rose by 14%.
- Singapore's non-oil domestic exports fell by 11% (y/y) in Jun, the least nine months, after contracting a revised 12.3% in May. Electronic shipments dropped 21.5%, which was the smallest decline since Nov 2008; non-electronics shipments fell 4.6%.
- Inflation declined for third straight month, falling to 0.5% (y/y) from -0.3% in May on lower housing and transport costs. Food prices rose 2%; transport and communication fell 4.7%; and housing costs fell 0.7%.
- The MAS reported its first loss on record of $9.2bn for its fiscal year ending 31 Mar 2009. This loss was equivalent to 3.5% of total assets and resulted from the fall in stock investments during the financial crisis.
- The STI index gained 4% in Jul as the shares of Singapore property and banking stocks rose after the government upgraded its growth forecast. With external demand weak, the risks to growth remain on the downside.

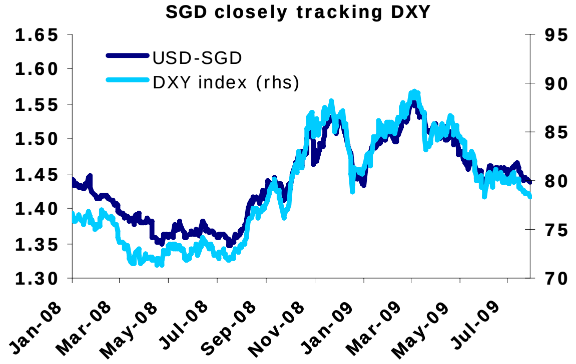
Ivy Tan

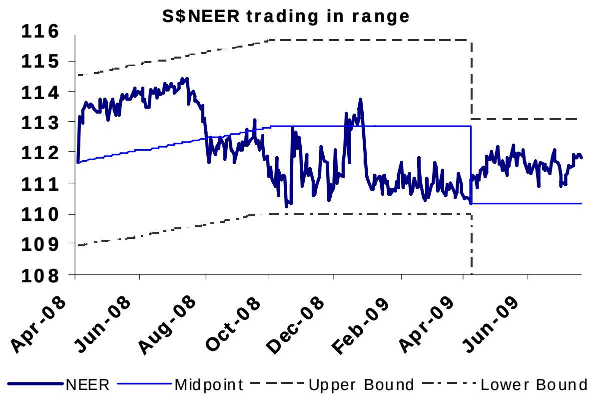
Economic Data – Singapore

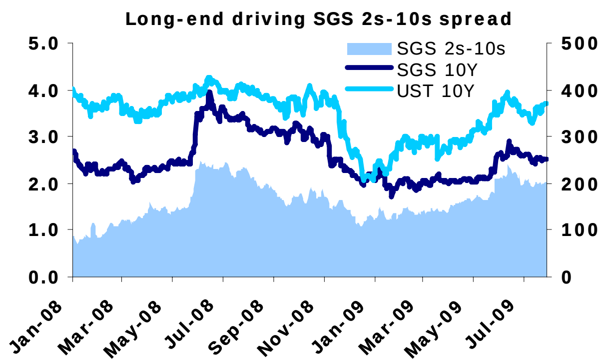
Monthly data	Nov 08	Dec 08	Jan 09	Feb 09	Mar 09	Apr 09	May 09	Jun 09
Industrial Production, % y/y	-6.7	-13.4	-26.3	-11.8	-32.6	0.8	2.1	-9.3
Retail Sales, % y/y	-2.9	-0.6	-11.8	-5.5	-7.1	-11.4	-10.3	N/A
Consumer Price Index, % y/y	5.5	4.3	2.9	1.9	1.6	-0.7	-0.3	-0.5
Domestic Exports (Non-oil), % y/y	-17.5	-20.8	-34.9	-23.8	-17.3	-19.2	-12.3	-11.0
Imports (Non-oil), % y/y	-12.4	-14.0	-29.1	-17.3	-25.4	-26.6	-20.0	-18.3
Trade Balance, US$ bn	1.0	0.7	0.5	0.8	2.7	2.4	1.6	1.6
Foreign Exchange Reserves, US$ bn	165.8	168.9	169.2	166.0	164.9	166.6	169.3	172.1
Quarterly data	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**	**Jun 09**
Real GDP, % y/y	9.5	5.5	6.7	2.5	0.0	-4.2	-10.1	N/A
-Private consumption	6.3	5.8	4.1	4.4	2.7	-1.2	-5.1	N/A
-Government consumption	-0.6	9.5	10.4	9.0	9.9	2.7	-2.2	N/A
-Gross fixed capital formation	15.4	17.0	30.5	25.0	14.9	-9.9	-14.8	N/A
Nominal GDP sa, SGD bn	64.2	66.5	66.0	64.3	64.5	62.8	59.4	N/A
Current Account, US$ bn	11.5	6.3	8.1	6.7	7.7	4.5	3.9	N/A
Capital & Financial Account, US$ bn	-8.0	0.7	2.0	-3.8	-8.6	-1.1	-7.4	N/A

Sources: CEIC

Singapore: FX and Rates Strategy







While the GDP contraction in H1 was less severe than the government's projection in Apr, it was not sufficient to alter the economic outlook materially. USD-SGD should continue to take its cue from the broad USD trend amid a stable S$NEER policy stance.

FX

The easing headwinds to growth do not appear to have altered the authorities' assessment of the near-term outlook materially. The economy rebounded strongly in Q2 on a surge in pharmaceutical output and restocking in the electronics sector, prompting the government to upgrade the official GDP forecast to a less drastic 4-6% contraction from April's 6-9%. The MAS also raised its median inflation forecast to 0% from -0.5%, citing higher global commodity prices. However, the MAS warned of "slow and uneven growth, rather than a sharp and decisive recovery", and reiterated the appropriateness of the current policy stance. We continue to expect the zero S$NEER appreciation bias to be maintained into 2010.

The sustained rise in risk appetite and broad-based USD weakness continued to drive USD-SGD lower in Jul, with the 1-month rolling correlation between DXY and USD-SGD rising to 0.94 from 0.69 at end-Jun. The S$NEER was however range-bound and traded within a familiar range of 0.5-1.5% above the midpoint of the policy band. USD-SGD should continue taking its cue from the DXY in the coming weeks, as the light local data calendar is unlikely to offer any impetus for a breakdown in the correlation.

Rates

Inter-bank rates remained pinned to the 0.65-0.70% range on comfortable liquidity conditions and slowing credit demand. The prospects of additional fiscal stimulus financed by past government savings and reserves have dimmed on diminishing downside risks to growth, limiting the scope for further liquidity expansion in 2009. Sibor rates are biased upwards, but the timing will largely depend on the Fed. In the SGS market, front-end rates are sticky with inflation expectations benign and interest rates near historically low levels; movements at the long-end of the curve will continue to drive the 2s-10s spread. External drivers such as market expectations over the shape of the global recovery and the timing of Fed policy shifts are likely to dominate domestic factors.

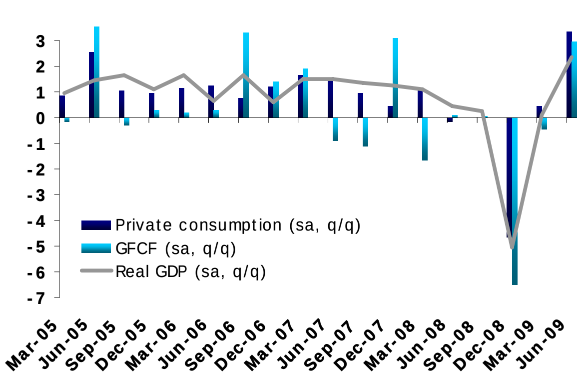
Yeo Han Sia

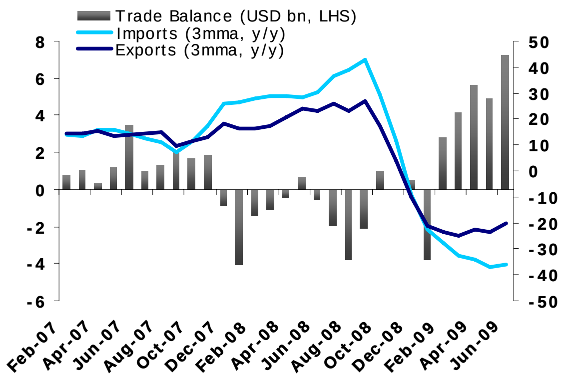
Market Forecasts – Singapore (eop)

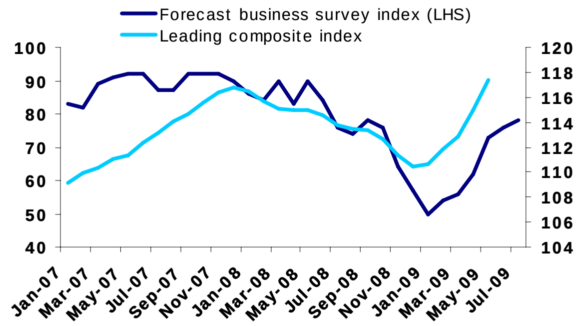
FX	Current	Ytd (%)	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10
USD-SGD	1.438	0.6%	1.48	1.46	1.45	1.45	1.44	1.43
AUD-SGD	1.197	19.1%	1.12	1.07	1.07	1.10	1.12	1.14
NZD-SGD	0.952	14.9%	0.86	0.80	0.78	0.78	0.79	0.80
JPY-SGD	1.522	-3.4%	1.51	1.46	1.38	1.34	1.31	1.28
EUR-SGD	2.054	2.8%	2.00	1.90	1.89	1.90	1.90	1.89
Rates	**Current**	**Ytd (%)**	**Sep 09**	**Dec 09**	**Mar 10**	**Jun 10**	**Sep 10**	**Dec 10**
3-month SIBOR	0.69	-27	0.69	0.69	0.85	1.00	1.30	1.50
2-year IRS (onshore versus 6M SOR)	1.64	7	1.7	1.7	1.9	2.0	2.2	2.4
10-year IRS	3.01	74	2.7	2.5	2.5	2.8	3.0	3.2

Sources: Bloomberg, ANZ

Country Update: South Korea







Korea's GDP continued to expand in Q2 2009, reflecting improved consumer sentiment and the government's stimulus measures. We believe, however, that Korea will not have a strong recovery, as external demand is forecast to remain weak. We have upgraded our growth forecast to -1.2% from -2.9% for this year, and keep our 2010 forecast unchanged at 3.3%.

- The economy grew by 2.3% (q/q, sa) in Q2, roughly in line with expectations. Year-on-year, GDP declined by 2.5% in Q2, compared with a 4.2% decline in the previous quarter.
- Department store sales rose for the fourth straight month in Jun, climbing 3.6% (y/y), compared with May's 5.4% rise. Discount store sales, however, dropped by 1.4% in Jun against May's 1.6% growth.
- The decline in exports and imports moderated in Jun. Exports fell by 11.3% (y/y), improving from the 28.5% decline in May. Imports dropped by 32.3%, compared with -40.3% in the previous month. The trade surplus improved to $7.4bn in Jun against $5.1bn in May.
- The CPI rose by 2.0% (y/y) in Jun, weaker than expected and slower than the 2.7% increase in May. Core CPI inflation also dropped to 3.5% from 3.9% in May. PPI inflation remained negative in Jun for the second month in a row at -3.1% (y/y).
- The leading composite index rose 2.1% (m/m, sa) in May, after Apr's 1.9% rise, the fifth consecutive monthly increase. The forecast manufacturing business survey index for Aug rose to 80 from Jul's 78, albeit remaining below the 100 neutral level.
- Consumer confidence rose to 109 in Jul from 106 in Jun, the third consecutive month above the neutral line of 100 and the strongest since Q3 2007.
- The BOK kept the base rate unchanged at 2% for the fifth consecutive month, and will likely maintain an accommodative policy stance as long as growth and inflation pressures remain weak. To avoid a possible property market bubble, the authorities lowered the mortgage-to-value limit to 50% from 60%.
- We have upgraded our growth forecast to -1.2% from -2.9% for this year.

Franklin Poon

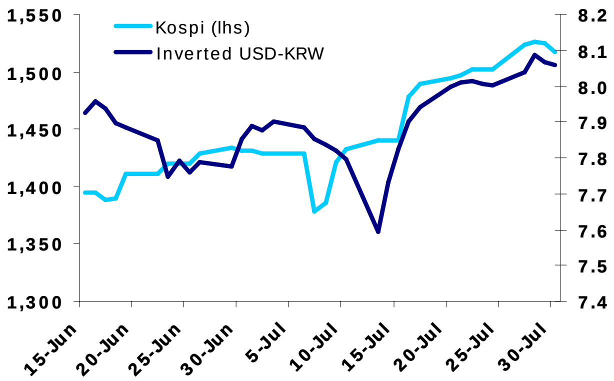
Economic Data – South Korea

Monthly data	Nov 08	Dec 08	Jan 09	Feb 09	Mar 09	Apr 09	May 09	Jun 09
Industrial Production, % y/y	-13.8	-18.7	-25.5	-10.0	-10.5	-8.2	-9.0	-10.6
Retail Sales, % y/y	-0.5	-1.2	-1.2	-3.9	-2.3	-1.4	1.9	N/A
Consumer Price Index, % y/y	4.5	4.1	3.7	4.1	3.9	3.6	2.7	2.0
Exports, % y/y	-19.5	-17.9	-34.5	-18.5	-22.1	-19.8	-28.5	-11.3
Imports, % y/y	-15.0	-21.6	-31.5	-30.9	-35.7	-35.4	-40.3	-32.3
Trade Balance, USD bn	0.0	0.5	-3.7	2.8	4.2	5.6	4.9	7.3
Foreign Exchange Reserves, US$ bn	201.0	201.0	201.6	201.8	206.4	212.5	226.5	231.2
Quarterly data	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**	**Jun 09**
Real GDP, % y/y	4.9	5.7	5.5	4.3	3.1	-3.4	-4.2	-2.5
-Private consumption	5.4	4.7	4.0	2.3	1.4	-3.7	-4.4	-1.1
-Government consumption	4.8	4.7	3.6	4.0	4.5	4.7	7.3	7.0
-Gross fixed capital formation	1.5	3.1	-0.5	0.6	1.8	-7.3	-8.1	-4.0
Nominal GDP, KRW tn	246.7	263.1	240.8	260.7	261.5	260.9	236.9	N/A
Current Account, US$ bn	2.0	-0.8	-0.1	1.8	-1.3	0.9	6.6	N/A
Capital & Financial Account, US$ bn	-3.9	0.3	0.4	-3.6	-4.4	-4.8	-2.7	N/A

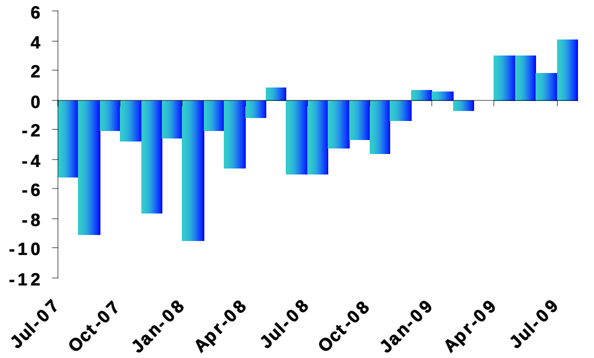
Sources: CEIC

South Korea: FX and Rates Strategy

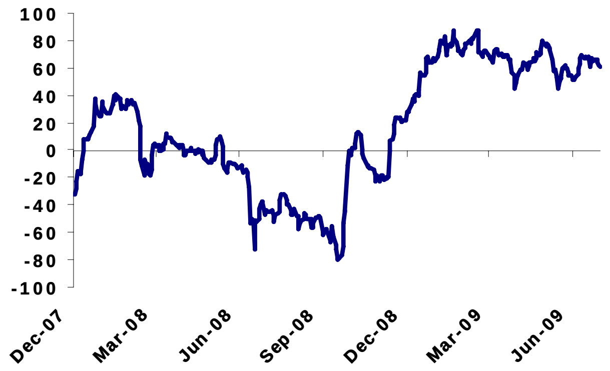
KRW and Kospi are moving in tandem



Foreign equity flows: The tide has turned ($ bn)



2s-10s IRS: Steepening has stalled (bps)



The KRW gained 3.6% against the USD in July, out-performing within AXJ and now at the strong side of the May-July range. A sustained break of the 1,200 level is only a matter of time, but is unlikely before trading volume picks up at the end of summer holidays in the Northern hemisphere.

FX

USD-KRW remains in a 13-week trading range, now at the strong side of the range near 1,225. Strong Q2 corporate earnings have trumped the seasonal pattern for summer risk aversion. Also supportive of the won, Korea continues to attract larger foreign equity inflows and FDI amid signs that economic growth gained momentum in Q2.

Net foreign equity inflows amounted to $4.7bn in Jul compared with $1.8bn in Jun, bringing the total inflow to $12.2bn year-to-date versus an outflow of nearly $37bn in 2008. Meanwhile, FDI surged by 62% in Q2 and Korea's current account surplus rose by 55% in Jun to $5.4bn—boosted primarily by gains in exports. The medium-term outlook is even brighter as Korea and the EU concluded negotiations for a landmark free trade agreement which could take effect as early as H1 2010.

Rates

Korean local rates are expected to remain in a gradual uptrend, mirroring improved economic momentum. Curve steepening has clearly stalled as the BoK maintains loose monetary conditions amid still benign inflation pressures, keeping the 2s-10s spread range-bound. Curve flattening (via rate hike expectations) is unlikely before there is a clear improvement in foreign demand.

Officials continue to indicate that it is too early to reign in economic stimulus, even though the BoK said at its Jul policy meeting that the Korean economy has emerged from the downturn and warned about possible asset inflation further down the road. BoK Governor Lee said the local economy "is still sluggish" and that the recovery in H2 would be "very weak." The Ministry of Strategy and Finance said in a report that the government would "continue its expansionary macroeconomic policy until the economy shows signs of a full-swing recovery."

Tamara Henderson

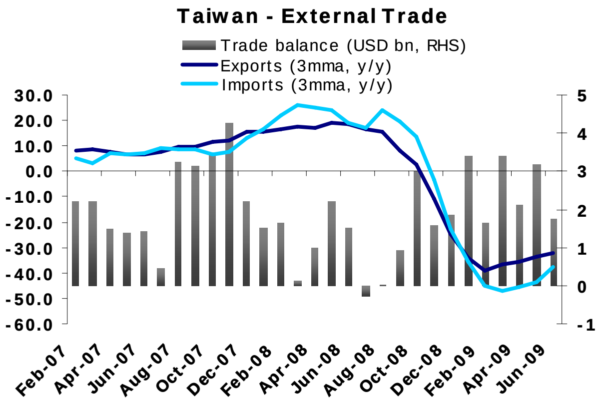
Market Forecasts – South Korea (eop)

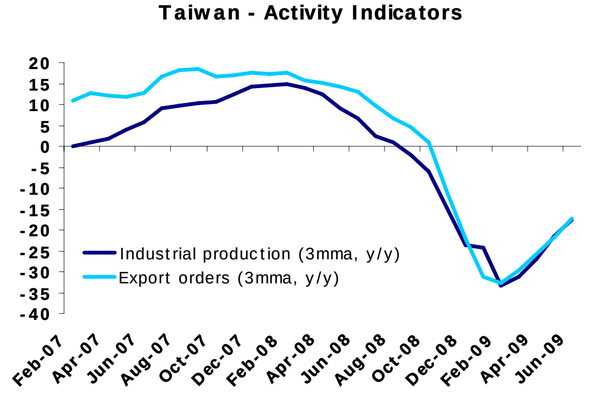
FX	Current	Ytd (%)	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10
USD-KRW	1241	-1.5%	1225	1125	1175	1225	1100	1050
AUD-KRW	1014	14.6%	930	820	870	930	860	840
NZD-KRW	806	10.5%	710	620	630	660	610	590
JPY-KRW	13.08	-5.8%	12.5	11.3	11.2	11.3	10.0	9.4
EUR-KRW	1743	-1.0%	1650	1460	1530	1600	1450	1390
Rates	**Current**	**Ytd (bps)**	**Sep 09**	**Dec 09**	**Mar 10**	**Jun 10**	**Sep 10**	**Dec 10**
BOK's overnight call rate	2.00	-100	2.00	2.00	2.00	2.00	2.25	2.50
3-month KORIBOR	2.41	-154	2.5	2.6	2.6	2.7	3.0	3.2
2-year IRS (versus 91D KRW CD)	3.58	29	3.7	3.8	3.9	4.0	4.3	4.5
10-year IRS	4.18	61	4.4	4.5	4.6	4.6	4.7	4.8

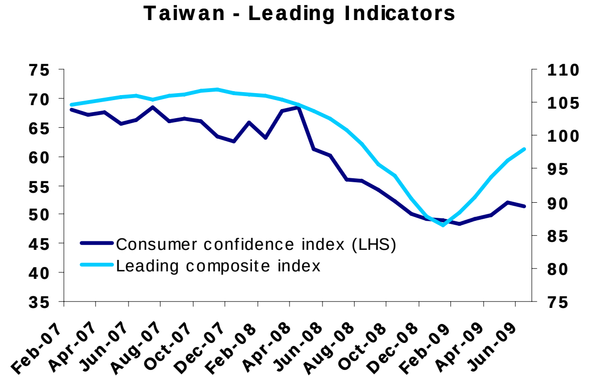
Sources: Bloomberg, ANZ

Country Update: Taiwan

Taiwan's exports remained weak in June, but export orders during the month declined at the slowest pace in eight months, suggesting a rebound may be in sight. The contraction in commercial sales and industrial production has also moderated. We have raised our 2009 growth forecast to -4.5% from -5.3%.







- Commercial sales declined by 5.3% (y/y) in Jun, improving from the 11.6% fall in May. The wholesale trade sub-index suffered the most, declining by 6.8%.
- The contraction in industrial production eased further in Jun. Output fell by 11.4% (y/y) compared with a 18.3% drop in May, with improvements in electronics parts, chemicals, and basic metals. The index rose by 5.0% on a seasonally adjusted, monthly basis.
- Exports fell by 30.4% (y/y) in Jun, against a 31.4% drop in May. Exports to China and the US fell by 30.2% and 29.0%, respectively. Jun's import growth improved to -33.5% from -39.1% in May. The trade surplus stood at $1.8bn in Jun, smaller than $3.2bn a month earlier.
- The consumer price index saw the biggest drop in nearly 40 years in Jun, posting a 2.0% (y/y) decline, compared with -0.1% in May. Excluding volatile food and energy prices, core inflation also fell into negative territory, to -0.6% (y/y) from 0.1% in May.
- The composite leading index rose 1.8% (m/m, sa) in Jun, compared with May's 3.3%, the fourth consecutive monthly rise,
- Export orders in Jun declined by the least amount in eight months. Orders dropped 10.9% (y/y) after contracting 20.1% in May, suggesting that the worst may be over. The figure was much better than the -18.7% market expectation.
- The consumer confidence index dropped slightly to 51.4 (below the neutral line of 100) in Jun from 52.1 in May, ending three months of consecutive increases.
- The government announced rules allowing Mainland Chinese capital to invest in Taiwan, covering industries such as textiles, automobiles and plastics. Chinese enterprises may also purchase offices, factories and worker dormitories in Taiwan.
- We have upgraded our 2009 growth forecast to -4.5% from -5.3%, although risks remain on the downside.

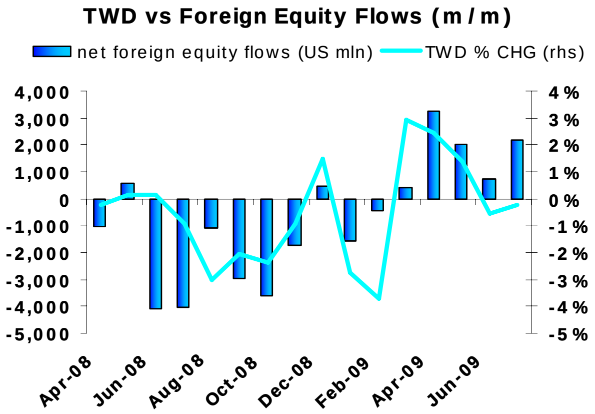
Franklin Poon

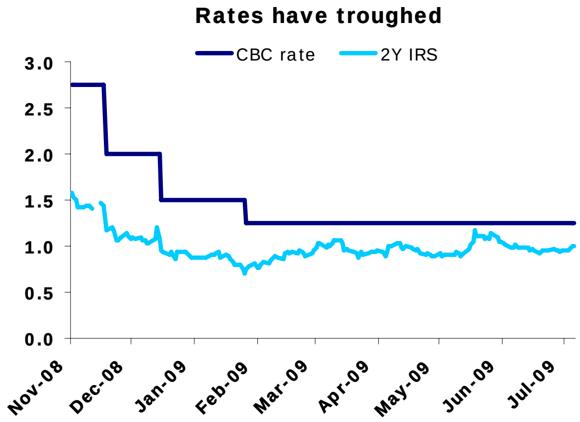
Economic Data – Taiwan

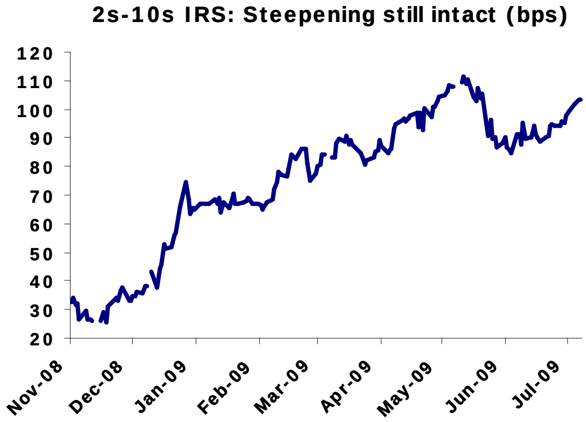
Monthly data	**Nov 08**	**Dec 08**	**Jan 09**	**Feb 09**	**Mar 09**	**Apr 09**	**May 09**	**Jun 09**
Industrial Production, % y/y	-28.3	-32.0	-43.3	-27.2	-25.8	-20.0	-18.4	-11.4
Retail Trade Index, % y/y	-8.6	-10.9	-1.0	-9.1	-2.8	-2.8	0.4	3.3
Consumer Price Index, % y/y	1.9	1.3	1.5	-1.3	-0.1	-2.8	-0.1	-2.0
Exports, % y/y	-23.3	-41.9	-44.1	-28.6	-35.8	-34.3	-31.4	-30.4
Imports, % y/y	-13.7	-44.6	-56.5	-31.6	-49.5	-41.1	-39.1	-33.5
Trade Balance, US$ bn	1.5	1.8	3.3	1.6	3.4	2.1	3.2	1.7
Foreign Exchange Reserves, US$ bn	280.7	291.7	292.7	294.2	300.1	304.7	312.6	317.6
Quarterly data	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**	**Jun 09**
Real GDP, % y/y	7.0	6.4	6.2	4.6	-1.0	-8.6	-10.2	N/A
-Private consumption	3.1	1.6	2.1	0.5	-2.1	-1.7	-1.4	N/A
-Government consumption	1.7	1.1	1.3	-0.2	1.2	2.2	3.7	N/A
-Gross fixed capital formation	3.8	-0.8	3.7	-8.0	-11.8	-22.6	-33.8	N/A
Real GNP, % y/y	6.4	6.1	6.8	3.1	-0.5	-8.7	-10.6	N/A
Nominal GDP, TWD tn	2.8	2.9	2.7	2.6	2.7	2.6	2.5	N/A
Current Account, US$ mn	6,477.0	11,183.	8,474.0	6,744.0	1,867.0	7,553.0	12,991.	N/A
Capital Account, US$ mn	-33.0	-18.0	-271.0	-20.0	-32.0	-11.0	-24.0	N/A

Sources: CEIC

Taiwan: FX and Rates Strategy







We remain bullish on the TWD on a structural basis, but note more near-term risks including: 1/ CBC activity to support exporters (until foreign demand recovers), 2/ setbacks on the warming of ties with the Mainland (e.g. further MOU delays), and 3/ rich equity valuations (the P/E ratio is approaching 80).

FX

USD-TWD is little changed from a month ago, holding around the 32.8 level. Strong Jul corporate earnings have offset the tendency for summer risk aversion as well as disappointment associated with delays on the investment MOU with Mainland China.

The tidal wave of foreign equity inflows—sparked by a landmark agreement at the end of April allowing Chinese investment in Taiwan—has crested, but inflows remain robust. Net foreign equity inflows amounted to $2.1bn in July compared with $0.7bn in June and $2.0bn in May, bringing the total inflow to $6.6bn year-to-date versus an outflow of nearly $17bn in 2008.

Over the medium-term, we remain bullish on the TWD, seeing the landmark agreement between Taiwan and Mainland China as a game-changer. Moreover, Taiwan President Ma said that the recent warming of ties with the Mainland was "just at the beginning," alluding to a fuller agreement that would cut trade restrictions.

That said, CBC activity to support exporters remains a significant risk, which importers would be advised to hedge. Also, Taiwan stocks would seem to be quite rich, trading at a P/E ratio of 76 compared with 36 for the Mainland and 17 for the S&P500.

Rates

Rates are expected to exhibit a gradual upward bias over the course of H2, but the curve should remain broadly range-bound. The prospect of CBC rate hikes remains well in the future. Taiwan's output gap is one of the largest in the region and foreign demand should remain sub-par for at least another twelve months. All of this should contain the advance in yields this year. More near-term, price action on the TWD curve should remain range-bound.

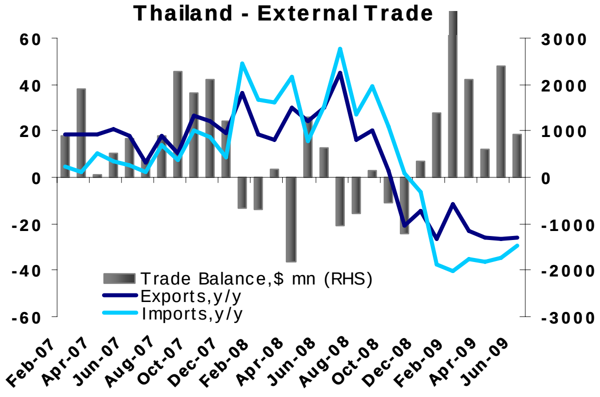
Tamara Henderson

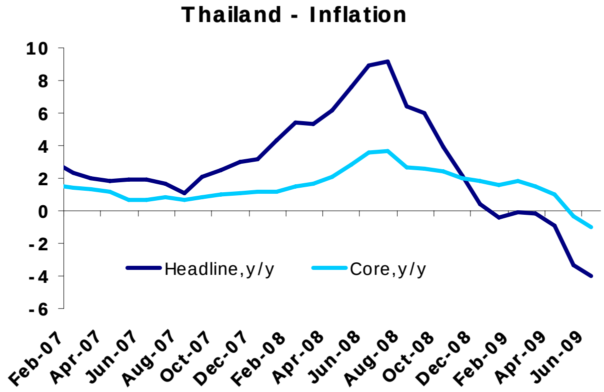
Market Forecasts – Taiwan (eop)

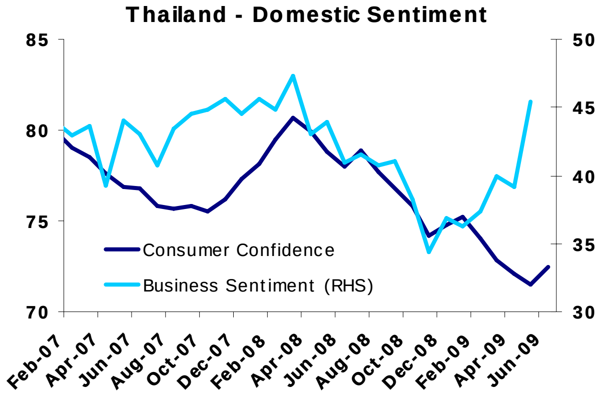
FX	Current	Ytd (%)	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10
USD-TWD	32.86	0.2%	32.5	32.0	31.5	31.0	30.3	30.3
AUD-TWD	26.89	16.6%	24.7	23.4	23.3	23.6	23.6	24.2
NZD-TWD	21.36	12.4%	18.9	17.6	17.0	16.7	16.7	17.0
JPY-TWD	0.346	-4.3%	0.332	0.320	0.300	0.287	0.275	0.271
EUR-TWD	46.19	0.7%	43.9	41.6	41.0	40.6	40.0	40.0
Rates	**Current**	**Ytd (bps)**	**Sep 09**	**Dec 09**	**Mar 10**	**Jun 10**	**Sep 10**	**Dec 10**
CBC's discount rate	1.25	-75	1.25	1.25	1.25	1.25	1.50	1.75
3-month CP	0.49	-60	0.5	0.6	0.8	1.1	1.6	2.1
2-year IRS (versus 3M CP)	1.00	-6	1.0	1.1	1.3	1.6	2.1	2.6
10-year IRS	2.03	59	2.1	2.3	2.5	2.6	2.8	3.1

Sources: Bloomberg, ANZ

Country Update: Thailand







"Hard data" haven't shown a significant improvement, yet, although sentiment and stock indices have rebounded. Absent an improvement in exports, however, negative growth this year is likely.

- The Private Consumption Index (PCI) continued to fall in May, but at a slower rate of 4.7% (y/y) compared with -5.3% in Apr. While the 23.8% decline in the car sub-index weighed on the total, the PCI stabilised due to increased household electricity (7.6%) and fuel (9.6%).
- The Consumer Confidence Index rose for the first time since Feb, to 72.5 in Jun. However, the index remained below the neutral level of 100 as political instability and the swine flu outbreak continued to dampen sentiment.
- The Index of Manufacturing Production (sa) fell at a lower rate of 9.1% (y/y) in May from a decline of 9.5% in Apr, aided by an improvement in the food and electronic equipment sectors. Industrial capacity utilisation improved from 56.7% in Apr to 60.3% in May.
- Exports fell for the eighth straight month in Jun, by 25.9% (y/y), following a 26.6% decline in May. The outturn was driven by weak demand for electronics and autos. The drop in imports continued to moderate, recording a decline of 29.3% in Jun, compared with -34.7% in May. The trade surplus stood at $0.9bn in Jun, down from $2.4bn in May.
- Consumer prices fell for the sixth month running in Jun with a 4.0% decline (y/y), the steepest fall since the authorities started computing monthly data in 1976. The decline is primarily attributed to the base effect of high oil prices in 2008. Core CPI declined 1% (y/y) in Jun, against a 0.3% fall in May.
- The Bank of Thailand retained its benchmark interest rate at 1.25% at its Jul meeting. The central bank indicated that it would retain its accommodative bias to encourage spending and revive economic growth in a subdued inflationary environment.
- Since there are few signs of improvement in the external sector, which accounts for 65% of the economy, Thailand is expected to under perform in South East Asia, with a GDP contraction of 2-3% this year.

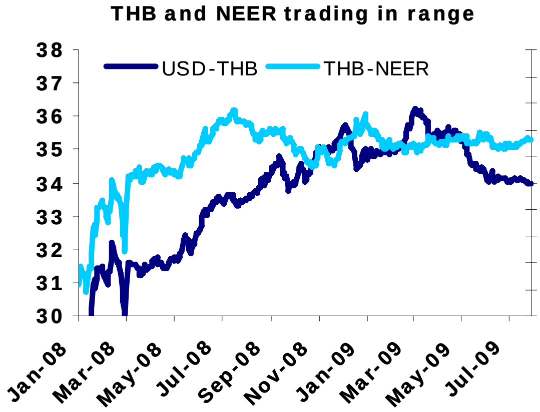
Zhou Hao & Raj Gopalakrishnan

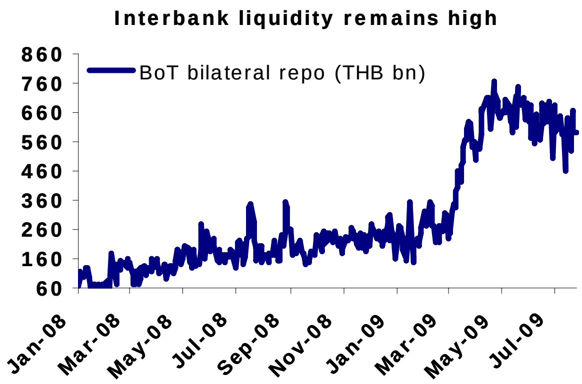
Economic Data – Thailand

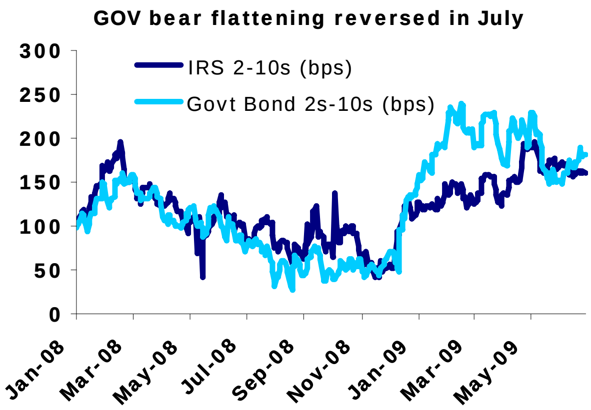
Monthly data	Nov 08	Dec 08	Jan 09	Feb 09	Mar 09	Apr 09	May 09	Jun 09
Industrial Production, % y/y	-7.7	-18.6	-21.2	-19.9	-14.6	-9.5	-9.1	N/A
Retail Sales, % y/y	-13.4	-2.7	-11.1	-7.8	-12.2	-9.2	N/A	N/A
Consumer Price Index, % y/y	2.2	0.4	-0.4	-0.1	-0.2	-0.9	-3.3	-4.0
Exports, % y/y	-20.9	-14.6	-26.4	-11.3	-23.1	-26.1	-26.6	-25.9
Imports, % y/y	2.0	-6.5	-37.6	-40.3	-35.1	-36.3	-34.7	-29.3
Trade Balance, US$ bn	-1.3	0.3	1.4	3.6	2.1	0.6	2.4	0.9
Foreign Exchange Reserves, USD bn	103.8	108.3	107.9	110.4	113.4	114.1	118.5	117.9
Quarterly data	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**	**Jun 09**
Real GDP, % y/y	5.1	5.7	6.0	5.3	3.9	-4.2	-7.1	-2.4
-Private consumption	1.9	1.9	2.7	2.5	2.7	2.1	-2.6	-4.4
-Government consumption	8.9	9.0	-0.4	-3.7	-2.9	11.0	2.8	0.9
-Gross fixed capital formation	2.5	3.8	5.4	1.9	0.6	-3.3	-15.8	-17.1
Nominal GDP, THB bn	2,093.7	2,255.7	2,297.1	2,283.1	2,321.4	2,203.3	2,179.7	N/A
Current Account, US$ bn	1.7	2.2	1.0	0.7	-0.3	0.1	2.4	N/A
Capital & Financial Account, US$ bn	2.2	1.0	6.7	-4.0	2.5	-1.0	-1.3	N/A

Sources: CEIC

Thailand: FX and Rates Strategy







We expect USD-THB downside to be limited to the 50% Fibonacci retracement level at 33.70 in the near-term, with a bias for a moderately weaker baht in H2. The BoT's revised macroeconomic projections suggest a neutral policy stance well into 2010.

FX

USD-THB was almost flat in Jul, with the pair finding firm support around the 34.0 level. Concerns over BoT smoothing operations in the FX market and the weak domestic indicators limited the baht's gains amid the rise in global risk appetite. 'Soft' indicators such as consumer and business confidence did post gains in the past month, but both indexes continue to register below-neutral readings. While the persistent BoP surpluses are THB-supportive, gains are unlikely to extend beyond the 50% Fibonacci retracement level at 33.70. The narrow interest rate differentials, sluggish economic indicators and residual political risk should confine USD-THB to a narrow trading range, with a bias for a moderately weaker baht in H2 2009.

Rates

The GOV curve partially reversed the bear flattening witnessed in Jun, with 2-year yields drifting back below the 2% mark. The warm reception to the THB80bn savings bond issued in mid-Jul and a smaller-than-expected Q3 borrowing calendar released on 2 Jul (THB119bn against expectations of THB150bn) eased concerns over the impact of the government's borrowing plan on yields. However, the balance of risks continues to tilt toward higher spending. For example, the Cabinet extended household relief measures by five months in mid-Jul, which will widen the financing gap by another THB11bn in FY08/09.

The BoT downgraded its GDP growth forecast again on 24 Jul, with the economy now expected to contract between 3-4.5% in 2009. While the range fell below the government's earlier projection of a 2.5-3.5% decline, it is in line with the market consensus of -4%. At the same time, the BoT *raised* 2010 growth expectations by 1.5ppt to 3-5%. This should reinforce market expectations that the easing cycle has concluded. A benign core inflation outlook (1.0-2.5% in 2010) further suggests that the current neutral policy stance should extend well into 2010. We expect the BoT to raise the benchmark policy rate in Q3 2010.

Yeo Han Sia

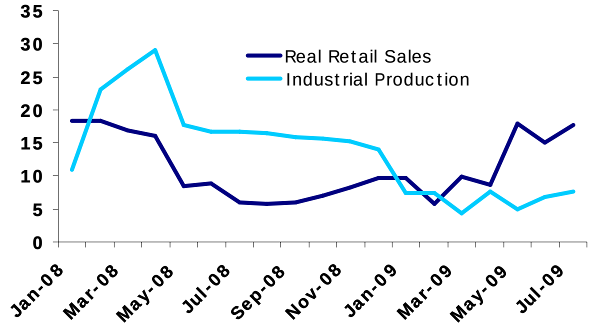
Market Forecasts – Thailand (eop)

FX	Current	Ytd (%)	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10
USD-THB	33.93	-2.3%	35.0	34.5	34.0	34.0	33.5	33.5
AUD-THB	28.26	15.8%	26.6	25.2	25.2	25.8	26.1	26.8
NZD-THB	22.46	11.6%	20.3	19.0	18.4	18.4	18.4	18.8
JPY-THB	0.346	-4.3%	0.357	0.345	0.324	0.315	0.305	0.299
EUR-THB	46.76	1.9%	47.3	44.9	44.2	44.5	44.2	44.2
Rates	**Current**	**Ytd (%)**	**Sep 09**	**Dec 09**	**Mar 10**	**Jun 10**	**Sep 10**	**Dec 10**
BOT's 1-day repo rate	1.25	-150	1.25	1.25	1.25	1.25	1.50	1.50
3-month BIBOR	1.38	-157	1.4	1.4	1.4	1.4	1.7	1.7
2-year IRS (versus 6M THB fix)	2.37	52	2.6	2.6	2.6	2.6	2.9	3.1
10-year IRS	4.01	164	4.4	4.4	4.4	4.4	4.5	4.6

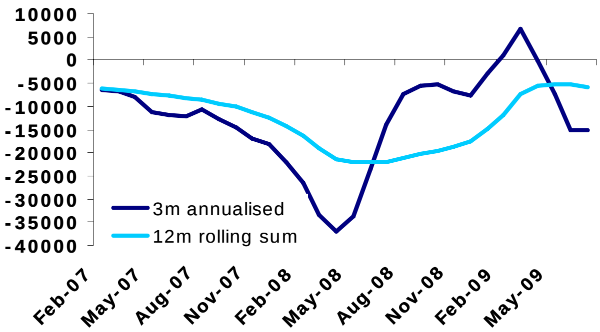
Sources: Bloomberg, ANZ

Country Update: Vietnam

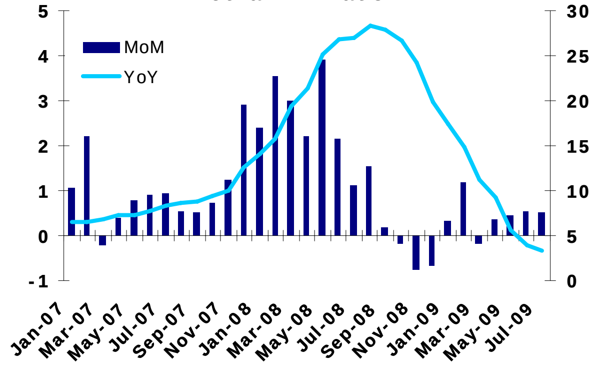
Vietnam - Domestic Demand Indicators (y/y,3mma)



Vietnam - Trade Balance (USD mn)



Vietnam: Inflation



Domestic demand continues to solidify and confidence is recovering. However, inflation momentum is rising and the trade account is weakening; the authorities have begun measures to cool credit expansion. Growth should continue to rise, but vulnerabilities are present and the authorities will need to be vigilant.

- Domestic demand remains strong. Retail sales rose 20.0% (y/y) in Jul, compared with a 21.4% increase in Jun. The decline in domestic vehicle sales eased dramatically to 0.5% in Jun (from -40% in Apr) after the government halved the value-added tax to 5%. In real terms (deflated by CPI), retail sales increased by 16.7%. Meanwhile, industrial output rose 7.6% in Jul from 8.2% in Jun.
- The trade balance deteriorated further. The deficit widened to $1.3bn in Jul from $980mn in Jun. Exports remained weak, falling 28.2% (y/y) versus Jun's -26.1%. Meanwhile, imports fell 19.2% (y/y) in Jul from Jun's -20.0%.
- Inflation fell to a five-year low of 3.3% (y/y) in Jul, reflecting declines in transportation and telecommunication costs. However, monthly inflation remained elevated at 0.5% in Jul, unchanged from Jun.
- Total bank loans rose by 17.5% through Jun compared with the same period in 2008. Loans for equity investments and property increased by 28.0% and 10.5%, respectively.
- Sentiment is improving across a range of indicators. The Domestic Investor Confidence Index rose to 111.9 in Jun from 109.2 in May (100 is neutral), while the Foreign Investor Confidence Index rose from 97.2 in May to 101.1 in Jun. In addition, the Business Confidence Index reached 130 in Q2, a 31 point increase reflecting higher expected revenues and profits.
- The State Bank of Vietnam asked banks to curb lending growth to check the rise of inflation. Key lenders have been asked to limit year-on-year credit growth to 25%.
- Vietnam's command-style structure has generated a quick turnaround, but inflation and the trade balance need to be watched, as does the quality of bank lending. We retain our call for 4½% GDP growth in 2009, with the risks marginally on the upside.

Paul Gruenwald

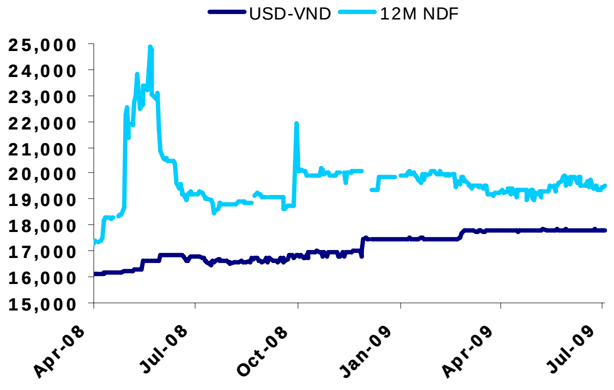
Economic Data – Vietnam

Monthly data	**Dec 08**	**Jan 09**	**Feb 09**	**Mar 09**	**Apr 09**	**May 09**	**Jun 09**	**Jul 09**
Industrial Production, % y/y	11.8	-4.4	14.9	2.4	5.4	6.8	8.2	7.6
Retail Sales ytd, % y/y	31.0	27.1	20.6	21.9	21.5	21.0	20.0	18.3
Consumer Price Index, % y/y	19.9	17.5	14.8	11.2	9.2	5.6	3.9	3.3
Exports, % y/y	4.2	-24.2	38.6	4.0	-2.1	-26.0	-26.1	-28.0
Imports, % y/y	-14.3	-53.8	-29.0	-49.5	-24.7	-24.9	-20.1	-19.2
Trade Balance, USD bn	-1.0	0.4	0.9	0.3	-1.1	-1.3	-1.5	-1.0
Quarterly data	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**	**Jun 09**
Real GDP, ytd, % y/y	8.2	8.4	7.5	6.5	6.5	6.2	3.1	3.9
-Agricultural, forestry, fishery	3.1	3.7	3.2	3.3	3.8	4.1	0.6	1.7
-Industry and construction	10.1	10.2	8.0	7.0	7.0	6.1	1.4	3.0
-Services	8.6	8.9	8.3	7.6	7.2	7.1	5.6	5.7
Nominal GDP, VND tn	293.8	356.5	254.1	371.7	390.8	461.2	311.1	N/A
Foreign Exchange Reserves, USD bn	22.6	23.5	26.4	22.3	23.8	23.9	N/A	N/A

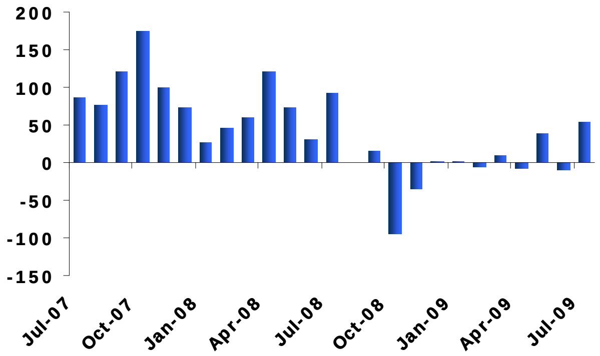
Sources: CEIC

Vietnam: FX and Rates Strategy

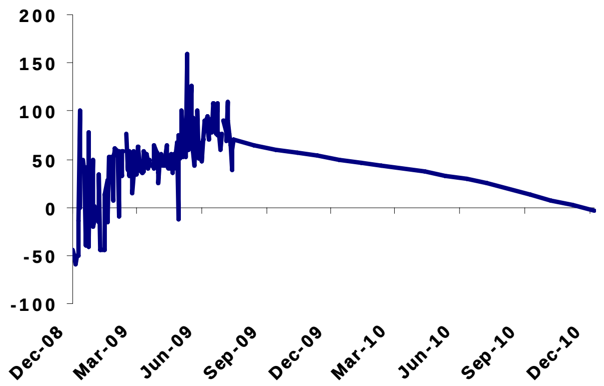
USD-VND yet to peak



Foreign equity flows picked up in July ($ mln)



1s-5s IRS set to flatten (bps)



Although reluctant thus far, we expect the authorities to sanction further weakening in the dong before year-end. Curbs on lending to contain inflationary pressures have helped support VND government bonds, but enthusiasm will likely be short-lived.

FX

Concerns about inflation have started to weigh on the dong, adding to already existing USD demand pressures. Meanwhile, FDI flows have started to dry up and Vietnam's trade deficit has widened sharply (and quickly). Equity flows have also been relatively lacklustre, although much improved in July. Net foreign equity inflows amounted to $55mln in July compared with outflows of $10mln in June, bringing the total inflow to $83mln year-to-date versus $34mln in 2008. Altogether the combination increases an already deep-seated preference for locals to maintain bank deposits in USD. We expect a 4% devaluation in the VND sometime before year-end.

Rates

VND yields should remain in an uptrend and the 1s-5s GOV spread should continue to narrow over the course of this year. Speculation that lending curbs will force banks to invest their deposits in government bonds has provided support to the market, but we expect such support to be temporary. More importantly, the management of inflation expectations will become more difficult for the SBV as economic growth gains momentum—particularly since the central bank has one of the weaker inflation-fighting records within AXJ.

The SBV has promised to keep policy rates unchanged until the end of the year. At the same time, inflation pressures are building and highly favourable base effects from last year's slump in global commodity prices are about to unwind. Meanwhile, the State Treasury continues to struggle to attract bidders for dong-denominated debt, offering a coupon of 9.2% for 3-year bonds and 8.9% for 2-year bonds (compared with bids of 10.0% and 9.3%, respectively).

Tamara Henderson

Market Forecasts – Vietnam (eop)

FX	Current	Ytd (%)	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10
USD-VND	17,819	1.9%	17,800	18,500	18,500	18,500	18,500	19,300
AUD-VND	14,556	18.5%	13,500	13,500	13,700	14,100	14,400	15,400
NZD-VND	11,558	14.1%	10,300	10,200	10,000	10,000	10,200	10,800
JPY-VND	188	-2.6%	182	185	176	171	168	172
EUR-VND	25,034	2.5%	24,000	24,100	24,100	24,200	24,400	25,500
Rates	**Current**	**Ytd (bps)**	**Sep 09**	**Dec 09**	**Mar 10**	**Jun 10**	**Sep 10**	**Dec 10**
SBV's base lending rate	7.00	-150	7.00	7.00	7.00	7.00	7.50	8.00
Overnight VNIBOR	6.44	86	6.7	7.0	7.3	7.6	8.1	8.6
1year IRS (versus 3M VNIBOR)	8.90	-158	9.2	9.5	9.8	10.1	10.6	11.1
5-year IRS	9.15	-152	9.4	9.6	9.8	10.0	10.3	10.6
1-5s IRS spread (bps)	25	33	15	5	-5	-15	-32	-48

Sources: Bloomberg, ANZ

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