Emerging Asia Economics Monthly – July 2009

1 July 2009

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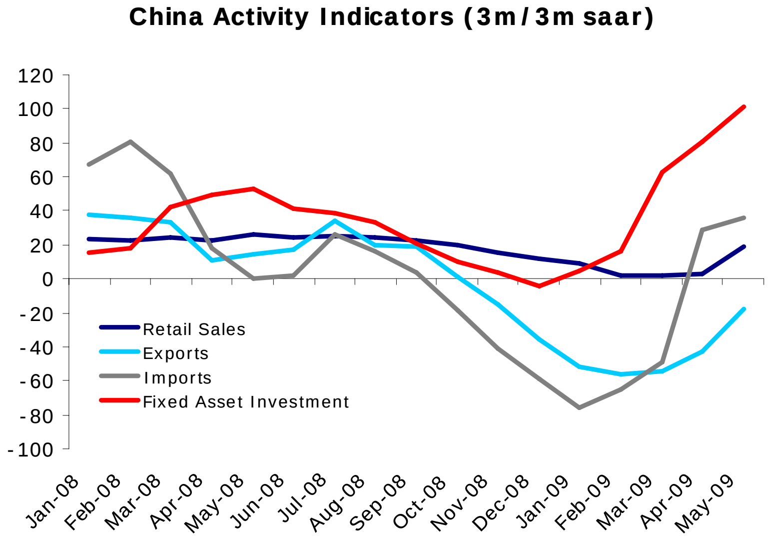
Our Vision:

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's recovery looks increasingly secure with a broad range of (domestic) indicators now signalling an expansion and Q2 growth estimated to be around 2% (q/q). Indian growth looks solid as well.
- Elsewhere in Asia we are seeing activity come off recent lows; growth momentum is positive, but levels remain depressed.
- External demand has improved at the margin, but remains extremely weak. Double-digit export growth is still the norm.
- We anticipate a pull-back in risk appetite as summer holidays in the Northern hemisphere get into full swing. Within AXJ, past experience suggests greater volatility in the TWD, KRW, INR and IDR.
- Greater risk aversion over summer months suggests a flattening bias in many, but not all, AXJ curves.

Chart of the Month: Chinese growth momentum rebounds



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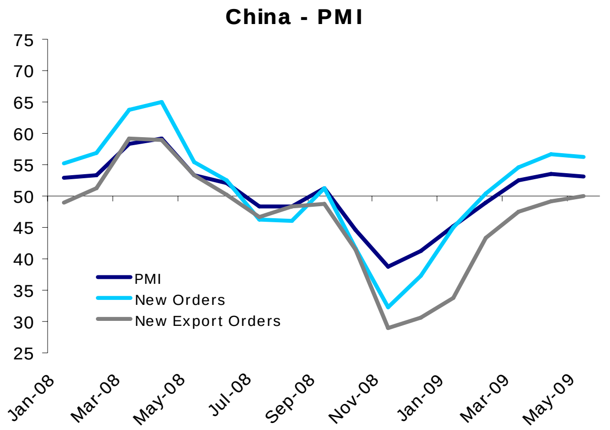
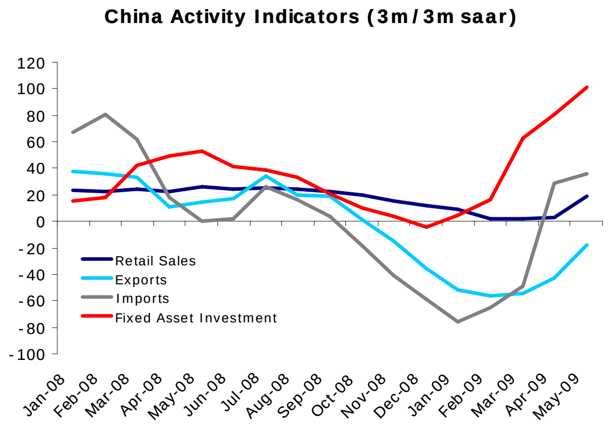
Feature Article:

It's Springtime in China as the Stimulus Plan Delivers

China is in the global spotlight as the only major economy able to engineer a strong rebound through a government stimulus plan. In this article, we examine a range of financial, survey-based, real and external indicators to gauge the recovery process. While China has been successful in generating robust domestic demand despite substantial global headwinds, 'green shoots' in support of growth elsewhere appear limited. We have raised our 2009 growth forecast for China to 7%.

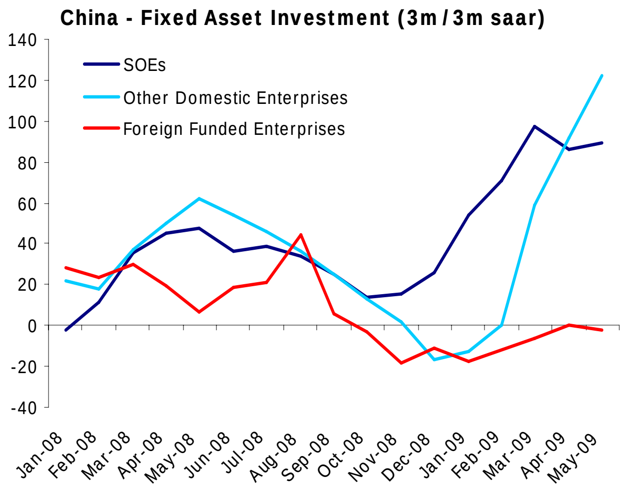
'Soft' data released in June signalled a broadening recovery. The key datum released was the official Purchasing Managers Index (PMI). The result of this survey was again above the neutral level of 50, consistent with expanding manufacturing activity. Chinese PMI numbers have indicated an improvement in production and new orders since February, as the government stimulus plan announced last November began to kick in. Even export orders, the weakest across all PMI categories, was marginally positive at 50.1 in June, suggesting that the decline in exports may be bottoming. Importantly, a separate, private sector constructed PMI (CLSA) also signalled an expansion in manufacturing activity.

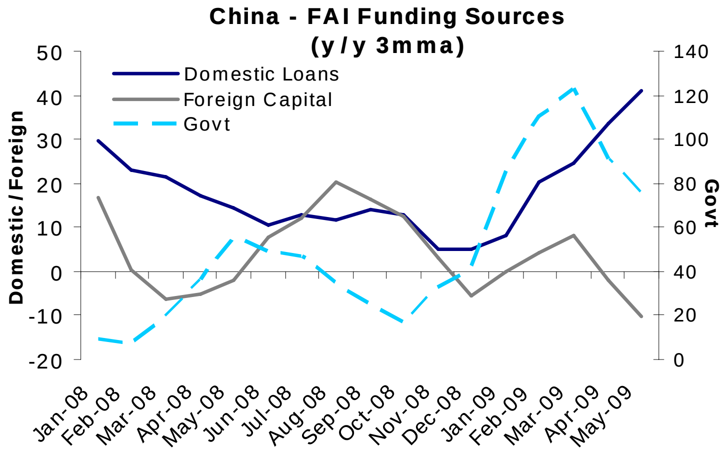




'Hard' economic indicators have rebounded sharply on a momentum basis. To get a clearer sense of how the Chinese data are trending in the short term, we eschew the more familiar year-on-year measures, which have a strong backward looking character. Instead, we use the three-month annualised growth rate of the seasonally-adjusted series to try to capture momentum. The results are striking—see chart above. For fixed asset investment and imports, growth momentum turned up sharply in early 2009. Consumption growth, which has been easing throughout the financial crisis, rose back to the pre-crisis levels in May as sentiment continued to improve. The pace of export decline slowed, suggesting that external demand may be stabilising.

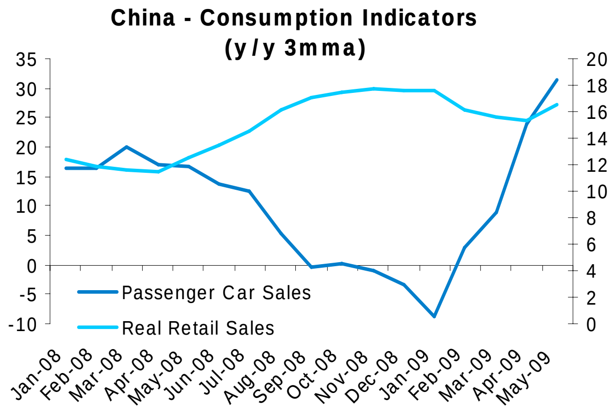
Improving FAI growth was led by the state and domestic sectors. The rebound in fixed asset investment was largely due to increased investment spending by the central government and state-owned enterprises (SOEs). Investment by the non-SOE sector also recovered strongly after the Chinese New Year, helped by a boom in lending. The sole weak spot is investment from foreign funded enterprises, which is yet to recover, a likely reflection of weak activity in the source markets.

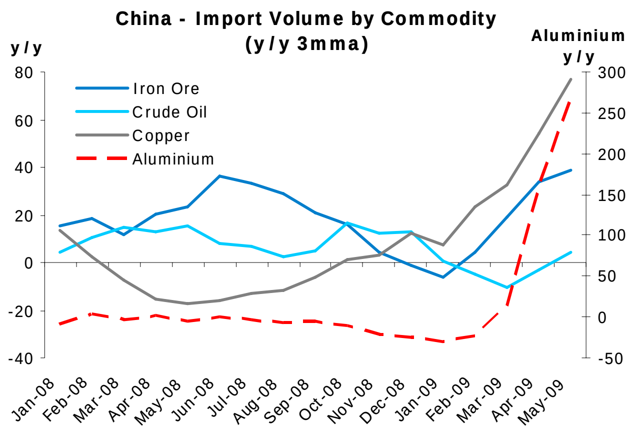




Bank lending has played an important role in stimulating investment. Along with the SOEs, the role of state-owned banks has been crucial to the quick success of the Chinese stimulus plan, as increased loan quotas at the start of this year quickly translated into new lending. The increased lending has been largely effective, with residential development activity showing signs of a strong rebound. Importantly, new mid- and long-term loans have increased noticeably since March, putting to rest earlier concerns that much of the lending is being funnelled into short-term bills rather than constructive projects. However, there do remain concerns about the quality of lending as well as whether all lending has gone towards the stimulus plan.

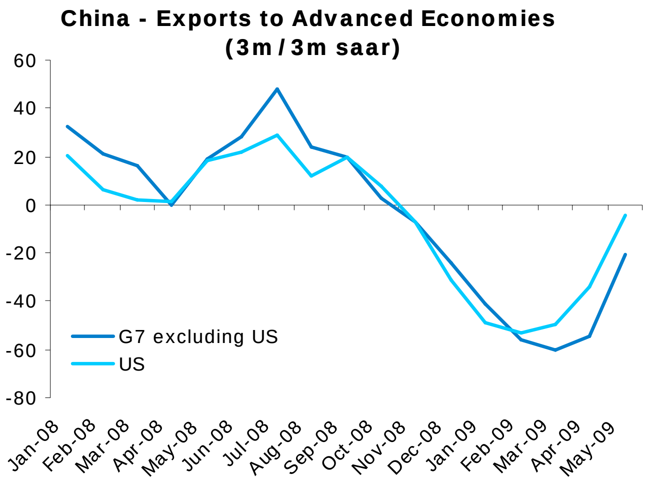
Chinese consumption has remained resilient throughout the global turmoil. Real retail sales (deflated by CPI) growth averaged 17% (y/y) throughout the crisis period, as consumption remained largely unaffected by negative sentiment in the markets. We attribute this to the generally low indebtedness of Chinese households, limited wealth effects (most savings are invested as deposits, not in equities), and a fairly high degree of confidence that the government stimulus plan will spur growth and safeguard employment. Passenger car sales also picked up sharply from a November 2008 low of -10% (y/y) to 47% growth by May. While these sales were helped by a 50% cut in vehicle retail taxes and a 10% rebate for rural residents buying small-engine vehicles, buoyant sentiment suggests consumption activity going forward will remain reasonably broad-based.





Commodity exporters to China have been the main external beneficiaries of the investment boom; the impact on the rest of Asia has been limited. Given that the stimulus plan is weighted heavily towards infrastructure and housing, it comes as no surprise that commodity imports related to these sectors have turned up first. Looking at the momentum chart above, it is worthwhile to note that the pace of import decline (that is, the second derivative of imports) bottomed out in February, coinciding with the rebound in base metals. In fact, imports of aluminium, copper and iron ore have all grown at historically unprecedented rates in the first half of this year. While there appears to have been a significant amount of stockpiling activity in recent months, we view this as noise (sometimes quite sizeable) along a rising trend of base metal usage for purposes related to the stimulus plan.

China recovered in the absence of external demand. Exports remain the worst performing sector of the economy, lagging well behind domestic components as well as imports (on a momentum basis). While external demand has likely passed its worst stage of decline, the outlook for a recovery in exports remains murky given the weak state of household balance sheets in the United States and Europe as well as the still-fragile state of financial systems there. China's export-less recovery is a significant development in our view, and calls into question the assertion by some analysts that China is an export-led economy. If that were the case, generating a turnaround of the kind we have seen in recent quarters would have been nearly impossible.



We have raised our GDP growth forecast for China based on the recovery to date. Unofficial government numbers revealed that GDP expanded by 2% in Q2 on a seasonally adjusted basis, implying that the pace of growth has already reached an annual level of 8%, which is the authorities' target.[1] This is ahead of our originally assumed trajectory for 2009 and, as a result, we have raised our forecast for the year to just over 7%. At this juncture we would see the risks to this forecast to be on the upside as we expect the authorities to continue to pursue an aggressive stimulus programme until growth in China and perhaps elsewhere is on a firmer footing.

The notion of a Chinese-led global (or even regional) recovery is far-fetched. China's 'green shoots' are too limited in terms of product and geographic impact to generate a broad-based recovery outside its own borders. As seen in the trade data, the only improvement resulting from the stimulus plan so far has been in resource (mainly base metal) imports. Moreover these imports are focussed on a small number of countries; namely, large iron ore exporters such as Australia, Brazil and India. The impact of China's stimulus on the rest of Asia will be modest since most of the increase in intra-regional trade in the past few years reflected the growing processing trade with China as the final export assembly platform. Activity in that network was driven largely by demand from the United States and Europe, which remains subdued.

The Chinese stimulus experience will be difficult to replicate elsewhere. An obvious question is whether other countries can replicate the recent Chinese success. We would argue that the answer for most countries in Asia is "no" (although Vietnam may be a possible exception). China was able to deliver a sizeable fiscal impulse in a timely and effective manner given the command-style structure of the economy, dominated by state-owned banks and enterprises. In other words, banks were essentially ordered to lend and SOEs were ordered to produce, and that outcome is not feasible in more market-based economies. The downside is that the efficiency of capital is likely to have suffered, potentially leading to non-performing loans (NPLs) down the line. But we think the cost of higher NPLs in the future is outweighed in the authorities' calculus by the need to support growth and employment in the short term in order to underpin social stability.

Wei Liang Chang and Paul Gruenwald

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[1] At the time of writing, the official forecast for Q2 was not released and the unofficial forecast was not accompanied by any details. Our suspicion is that Q2 might feature a large wedge between the production based GDP and the expenditure based GDP owing to a large accumulation of inventories.

FX and Rates Strategy Overview: Summer Angst Approaches

Market Outlook

We noted last month that we were starting to feel more bullish about emerging Asian (AXJ) currencies against the US dollar, but that set-backs were likely. One such setback seems to be quickly approaching, given the general tendency for a pull-back in risk appetite during the summer months of the Northern hemisphere—particularly the peak holiday period from mid-July to mid-August. Positioning also appears supportive of a pull-back in risk trades as there has been a re-accumulation of short USD positions, albeit not as extreme as at the end of last year, but sizeable nevertheless.

FX Strategy

Using behaviour over the past five summers as a guide, the trimming of risk has been associated with a bout of USD strength and corresponding weakness in AXJ currencies. Within AXJ, the Taiwan dollar (TWD), Korean won (KRW), Indian rupee (INR) and Indonesian rupiah (IDR) have experienced the greatest amount of volatility on average during the past five summers.

FX Market Performance – Summers (2004 – 2008)

	Total	Sep/Aug	Aug/Jul	Jul/Jun
Volatility (VIX)	5.7%	-4.9%	15.6%	0.9%
USD-DXY	0.4%	0.2%	1.4%	-1.2%
USD-Asia (Avg)	1.1%	0.6%	1.2%	-0.6%
USD-INR	1.6%	0.8%	0.7%	0.1%
USD-IDR	1.4%	0.9%	2.0%	-1.4%
USD-MYR	1.1%	0.5%	1.1%	-0.5%
USD-PHP	0.2%	0.6%	0.7%	-1.0%
USD-SGD	0.3%	0.1%	1.4%	-1.1%
USD-KRW	1.7%	0.6%	1.6%	-0.5%
USD-TWD	2.5%	1.0%	1.2%	0.2%
USD-THB	0.3%	0.1%	0.9%	-0.8%

Sources: Bloomberg, ANZ. (Performance calculated on a mid-month basis).

For investors who are *able* to ride out summer volatility, we would suggest using the expected pull-back in risk appetite to lock in better levels to ride USD-AXJ lower into 2010. For investors who are *unable* to ride out summer volatility, we would suggest:

- ***Corporates* with USD payables**: Hedge TWD, KRW, INR and IDR exposure.
- ***Real money funds with AXJ allocations:*** Under-weight TWD, KRW, INR and IDR.
- ***Leveraged funds:*** Buy USD-TWD, USD-KRW, USD-INR and USD-IDR forward outright.

Rates Strategy

A pull-back in risk appetite suggests a flattening bias in AXJ curves in the coming weeks. As the front end of the curve remains broadly anchored (and relatively rich), the best place to ride out near term volatility would seem to be in the longer tenors. Notable exceptions would be the Indian, Indonesian and Philippine curves, which should sustain a neutral, if not a steeper, bias. For one thing, all three central banks will likely continue to cut policy rates in Q3. Moreover, yields face upward pressure from budget risk in India and the Philippines.

Also, Indonesian yields tend to be positively correlated with risk aversion. Finally, the TWD government curve is the flattest in the region (excluding Vietnam), so we would not be inclined to select this curve for a tactical flattener. We would also avoid more illiquid markets, such as Vietnam, to place tactical bets. For investors interested in relatively short term tactical curve plays, we suggest curve flatteners, which offer the added benefit of (substantial) positive carry:

- ***Real money funds*** with emerging Asia in their benchmark should extend duration, (except in India, Indonesia, the Philippines, Taiwan and Vietnam).
- ***Leveraged funds*** should opt for long end receivers or short end payers on the HKD, KRW and SGD 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	6.834	6.83	6.83	6.83	6.83	6.82	6.80
	AUD/CNY, eop	5.427	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	6.18	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	48.39	48.5	48.0	47.0	47.5	47.0	47.0
	AUD/INR, eop	38.94	36.9	35.0	34.8	36.1	36.7	37.6
	RBI repo rate	4.75	4.50	4.50	4.50	4.75	5.00	5.25
Indonesia	USD/IDR, eop	10,255	10,250	9,750	9,500	10,000	9,500	9,000
	AUD/IDR, eop	8,209	7,800	7,100	7,000	7,600	7,400	7,200
	BI rate	7.00	6.50	6.50	6.50	6.75	7.00	7.00
Malaysia	USD/MYR, eop	3.53	3.60	3.55	3.50	3.50	3.45	3.45
	AUD/MYR, eop	2.85	2.74	2.59	2.59	2.66	2.69	2.76
	BNM overnight rate	2.00	2.00	2.00	2.00	2.00	2.25	2.25
Philippines	USD/PHP, eop	47.64	49.0	48.0	48.0	47.0	47.0	46.0
	AUD/PHP, eop	36.99	37.2	35.0	35.5	35.7	36.7	36.8
	BSP reverse repo rate	4.25	3.75	3.75	3.75	3.75	4.00	4.00
Singapore	USD/SGD, eop	1.454	1.52	1.51	1.50	1.50	1.49	1.48
	AUD/SGD, eop	1.172	1.16	1.10	1.11	1.14	1.16	1.18
	3M SGD SIBOR	0.69	0.65	0.65	0.85	1.05	1.30	1.50
S Korea	USD/KRW, eop	1,289	1,225	1,125	1,175	1,225	1,100	1,050
	AUD/KRW, eop	1,026	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	32.96	32.5	32.0	31.5	31.0	30.3	30.3
	AUD/TWD, eop	26.27	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	34.06	36.0	35.5	35.0	35.0	34.5	34.5
	AUD/THB, eop	27.40	27.4	25.9	25.9	26.6	26.9	27.6
	BoT repo rate	1.25	1.25	1.25	1.25	1.25	1.50	1.50
Vietnam	USD/VND, eop	17,852	18,500	18,500	18,500	18,500	18,500	19,300
	AUD/VND, eop	14,249	14,100	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%	0%
CNY-INR	7.08	7.10	7.03	6.88	6.95	6.90	7.09	-3%	0%
CNY-IDR	1,500	1,500	1,430	1,390	1,460	1,390	1,490	-7%	-1%
CNY-MYR	0.517	0.527	0.520	0.512	0.512	0.506	0.513	-2%	-1%
CNY-PHP	7.06	7.17	7.03	7.03	6.88	6.90	7.06	-2%	0%
CNY-SGD	0.213	0.223	0.221	0.220	0.220	0.219	0.213	3%	0%
CNY-KRW	189	179	165	172	179	161	186	-14%	-1%
CNY-TWD	4.82	4.76	4.69	4.61	4.54	4.45	4.80	-8%	0%
CNY-THB	4.98	5.27	5.20	5.12	5.12	5.06	4.97	2%	0%
HKD-INR	6.24	6.26	6.19	6.06	6.12	6.05	6.23	-3%	0%
HKD-IDR	1,320	1,320	1,260	1,230	1,290	1,220	1,310	-8%	-1%
HKD-MYR	0.456	0.465	0.458	0.452	0.451	0.444	0.451	-3%	-1%
HKD-PHP	6.23	6.32	6.19	6.19	6.06	6.05	6.20	-3%	0%
HKD-SGD	0.188	0.196	0.195	0.194	0.193	0.192	0.187	2%	0%
HKD-KRW	166	158	145	152	158	142	163	-15%	-2%
HKD-TWD	4.25	4.19	4.13	4.06	3.99	3.90	4.21	-8%	-1%
HKD-THB	4.39	4.65	4.58	4.52	4.51	4.44	4.37	1%	-1%
INR-IDR	212	211	203	202	211	202	210	-5%	-1%
INR-MYR	0.073	0.074	0.074	0.074	0.074	0.073	0.072	1%	-1%
INR-PHP	1.00	1.01	1.00	1.02	0.99	1.00	1.00	0%	0%
INR-SGD	0.030	0.031	0.031	0.032	0.032	0.032	0.030	5%	0%
INR-KRW	26.6	25.3	23.4	25.0	25.8	23.4	26.2	-12%	-2%
INR-TWD	0.681	0.670	0.667	0.670	0.653	0.645	0.677	-5%	-1%
INR-THB	0.704	0.742	0.740	0.745	0.737	0.734	0.701	4%	0%
IDR-MYR	0.00034	0.00035	0.00036	0.00037	0.00035	0.00036	0.00035	5%	0%
IDR-PHP	0.00471	0.00478	0.00492	0.00505	0.00470	0.00495	0.00475	5%	1%
IDR-SGD	0.00014	0.00015	0.00015	0.00016	0.00015	0.00016	0.00014	11%	1%
IDR-KRW	0.126	0.120	0.115	0.124	0.123	0.116	0.125	-8%	-1%
IDR-TWD	0.00321	0.00317	0.00328	0.00332	0.00310	0.00319	0.00323	-1%	0%
IDR-THB	0.00332	0.00351	0.00364	0.00368	0.00350	0.00363	0.00334	9%	1%
MYR-PHP	13.7	13.6	13.5	13.7	13.4	13.6	13.8	0%	1%
MYR-SGD	0.412	0.422	0.425	0.429	0.429	0.432	0.415	5%	1%
MYR-KRW	365	340	317	336	350	319	362	-13%	-1%
MYR-TWD	9.33	9.03	9.01	9.00	8.86	8.78	9.35	-6%	0%
MYR-THB	9.64	10.00	10.00	10.00	10.00	10.00	9.69	4%	0%
PHP-SGD	0.030	0.031	0.031	0.031	0.032	0.032	0.030	5%	0%
PHP-KRW	26.7	25.0	23.4	24.5	26.1	23.4	26.3	-12%	-1%
PHP-TWD	0.683	0.663	0.667	0.656	0.660	0.645	0.680	-6%	0%
PHP-THB	0.706	0.735	0.740	0.729	0.745	0.734	0.704	4%	0%
SGD-KRW	886	806	745	783	817	738	873	-17%	-1%
SGD-TWD	22.7	21.4	21.2	21.0	20.7	20.3	22.5	-10%	-1%
SGD-THB	23.4	23.7	23.5	23.3	23.3	23.2	23.4	-1%	0%
KRW-TWD	0.026	0.027	0.028	0.027	0.025	0.028	0.026	8%	1%
KRW-THB	0.026	0.029	0.032	0.030	0.029	0.031	0.027	19%	1%
TWD-THB	1.03	1.11	1.11	1.11	1.13	1.14	1.04	10%	0%

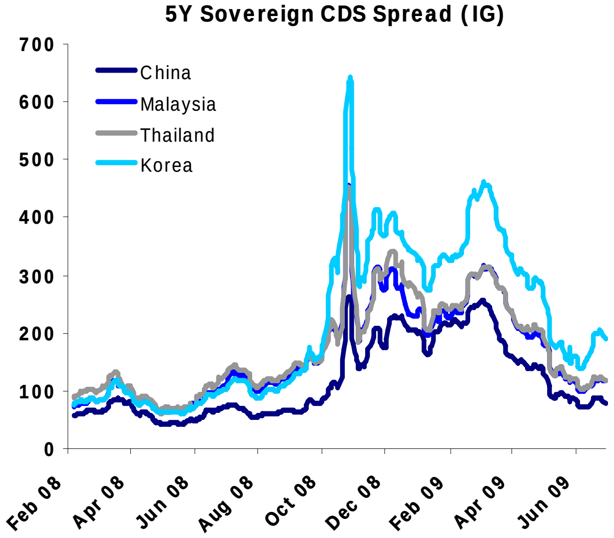
Long-Term Foreign Currency Government Bond Ratings

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

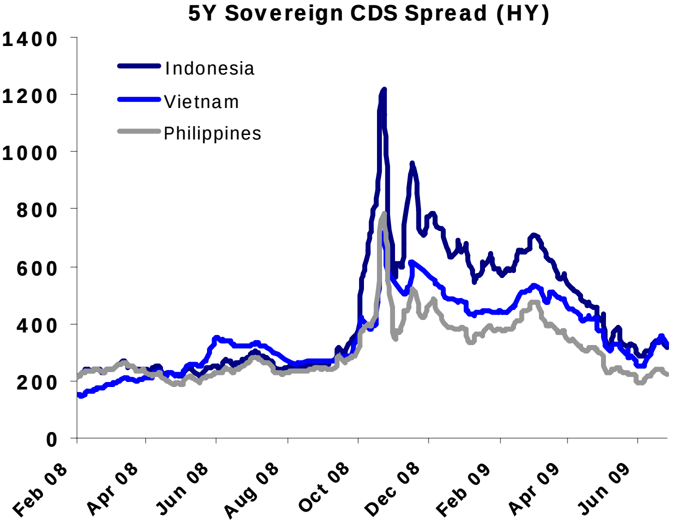
**denotes an upgrade; # denotes a downgrade over previous month*

Source: Bloomberg

Sovereign CDS Spreads



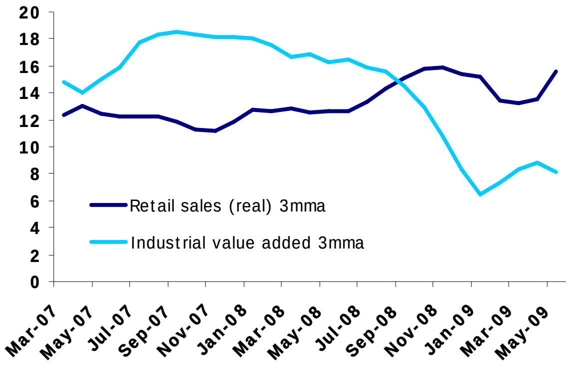
Source: Bloomberg



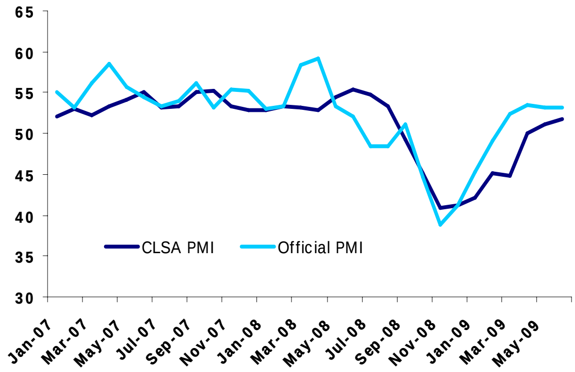
Source: Bloomberg

Country Update: China

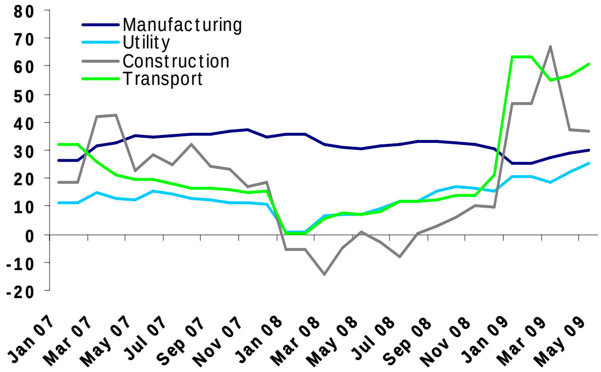
China - Domestic Demand Indicators



China - Purchasing Manager's Indices



China - Fixed Asset Investment (ytd, y/y)



The stimulus plan is on track, if not slightly ahead of expectations. Growth momentum continues to build across a range of indicators and the National Bureau of Statistics is forecasting 2% (q/q) growth for Q2. In contrast, foreign demand remains quite weak as exports languish. Confidence is improving and 2009 growth forecasts (including ours) are being raised.

- Domestic demand growth continues to improve. Nominal retail sales grew 15.2% (y/y) in May compared with 14.8% in April, and real sales growth continues to rise as inflation falls. Industrial production expanded 8.9% in May, well above April's 7.3% expansion. Fixed assets investment in urban areas was up 32.9% (ytd, y/y) in May, led by state-owned enterprises, where investment rose 40.6%.
- Exports fell 26.4% in May, worse than the 22.6% decline in April. Shipments to the US and EU weakened further. Imports in May were down 25.2%, but shipments from base metal suppliers continue to trend higher. The trade surplus was $13.4bn, down 21.8% (ytd) compared with 2008.
- The official purchasing managers index (PMI) indicated expanding activity for the third straight month, registering 53.1 in May, down from 53.5 in April. The drop reflected modest falls in new orders and output. The CLSA PMI was at a similar level.
- The CPI fell for the fourth consecutive month in May, declining by 1.4% (-1.5% in April). The slower decline supports evidence of a recovery. Producer prices dropped 7.2% (y/y), in part reflecting lower oil prices.
- Money and credit numbers remain strong. M2 grew by 25.7% (y/y) in May, broadly unchanged from April. Total outstanding RMB loans were up 30.6%.
- The economy continues to gain momentum and an 8% pace of growth looks very achievable at this point. Given the faster-than-expected recovery, we have raised our 2009 annual growth forecast to 7% with risks to the upside. We would underscore that the impact of the Chinese stimulus plan on the rest of Asia will be limited.

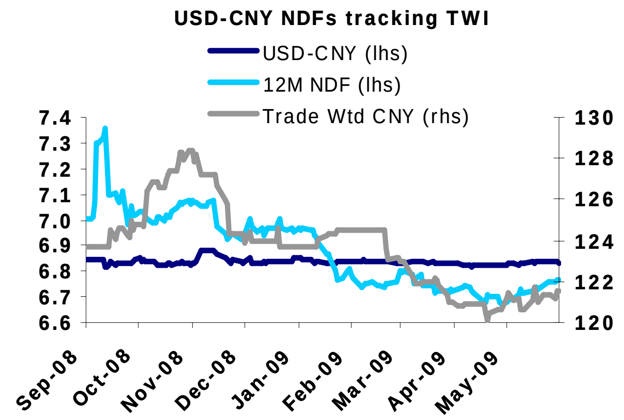
Paul Gruenwald

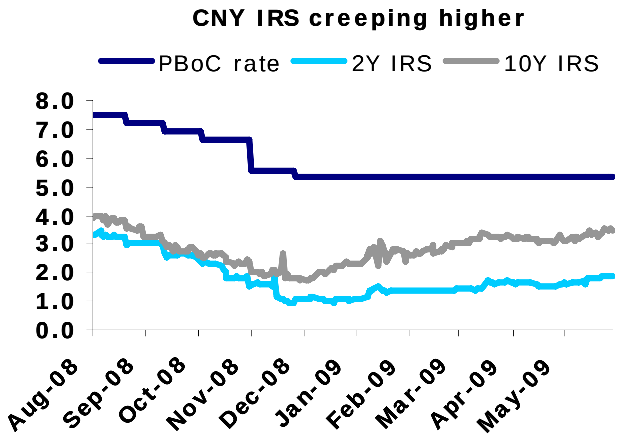
Economic Data – China

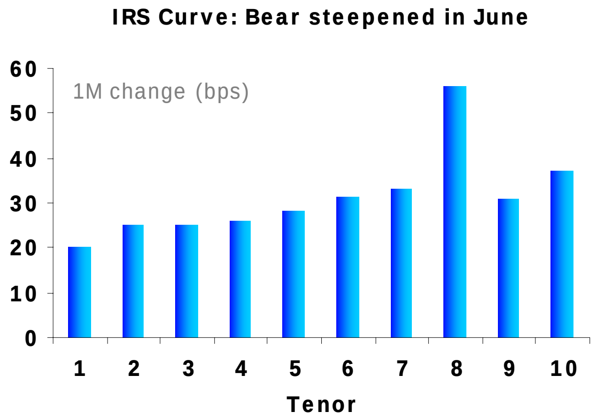
Monthly data	**Oct 08**	**Nov 08**	**Dec 08**	**Jan 09**	**Feb 09**	**Mar 09**	**Apr 09**	**May 09**
Industrial Production, % y/y	8.2	5.4	5.7	N/A	11.0	8.3	7.3	8.9
Retail Sales, % y/y	22.0	20.8	19.0	18.5	11.6	14.7	14.8	15.2
Consumer Price Index, % y/y	4.0	2.4	1.2	1.0	-1.6	-1.2	-1.5	-1.4
Exports, % y/y	19.1	-2.2	-2.8	-17.5	-25.7	-17.1	-22.6	-26.3
Imports, % y/y	15.4	-18.0	-21.3	-43.1	-23.8	-24.9	-22.8	-24.8
Trade Balance, US$ bn	35.2	40.1	39.0	39.1	4.8	18.6	13.1	13.4
Quarterly data	**Jun 07**	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**
Real GDP, % y/y	14.0	13.0	12.0	10.6	10.1	9.0	6.8	6.1
-Primary Sector ytd	4.0	4.3	3.7	2.8	3.5	4.5	5.5	3.5
-Secondary sector ytd	15.0	14.8	14.7	11.5	11.3	10.6	9.3	5.3
-Tertiary sector ytd	13.5	14.0	13.8	10.9	10.7	10.5	9.5	7.4
Nominal GDP, RMB tn	11.2	17.4	25.7	6.3	13.5	20.8	30.1	6.6
Foreign Exchange Reserves, US$ bn	1,332.6	1,433.6	1,528.2	1,682.2	1,808.8	1,905.6	1,946.0	1,953.7
Current Account, US$ bn (semi-annual)	162.9	N/A	371.8	N/A	191.7	N/A	426.1	N/A
Capital Account, US$ bn (semi-annual)	1.5	N/A	3.1	N/A	1.7	N/A	3.1	N/A

Sources: CEIC

China: FX and Rates Strategy







Economic growth in China is gaining traction, but the authorities most likely prefer to see a normalisation in global demand before allowing the renminbi to continue on an appreciation path. Like elsewhere around the world, officials are trying to manage interest rate expectations in order to allow 'green shoots' to thrive.

FX

Momentum in Chinese domestic demand continues to build. Although economic growth has clearly bottomed, a resumption in CNY appreciation against the USD will remain a low probability event until authorities believe that a growth rate of 8% can be sustained. This will require a distinct improvement, if not normalisation, in global demand. China's statistics bureau has forecast growth of 2% (q/q sa) in Q2, which meets the 8% target on an annualized basis. However, exports in May tumbled 26.4% (y/y), the worst performance in over a decade. 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.

Rates

Rising confidence, stoked by a 12% rally in the Shanghai stock market and stronger-than-expected data released during the month (industrial output, new lending, fixed asset investment, and retail sales), have fuelled optimism about China's recovery, pushing yields higher in June. The anticipated resumption of equity IPOs also put upward pressure on yields as the move is expected by markets to attract strong interest from institutional investors, diverting funds from bills and bonds. Details are still awaited as to the timing, size, and companies that will come to market, but a restart is widely expected in coming months. Meanwhile, government officials have signalled markets that they have no intention of reigning in relaxed fiscal and monetary policies anytime soon. PBOC Vice Governor Su was careful to note on June 23 that China's economic fundamentals are still not firm. As we expect economic momentum in China to continue to build in H2, yields should remain in an uptrend.

Tamara Henderson

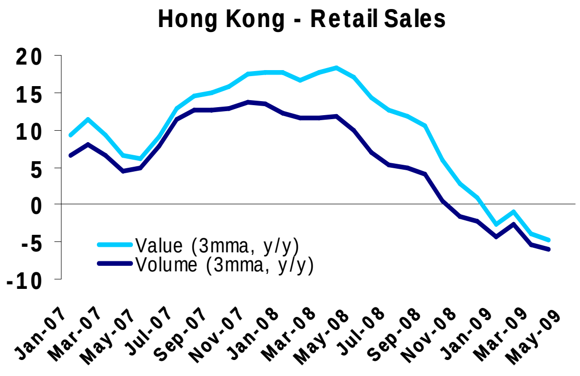
Market Forecasts – China (eop)

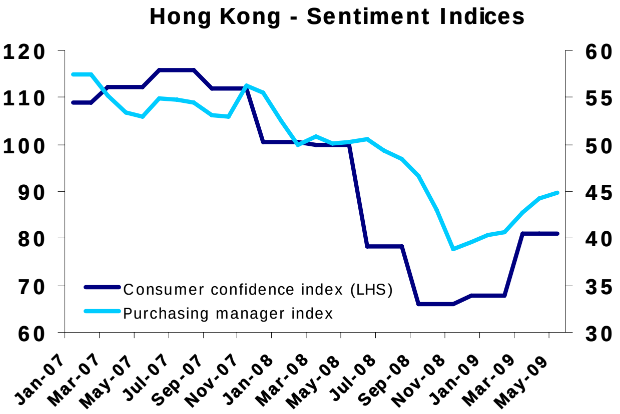
FX	Current	Ytd (%)	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10
USD-CNY	6.834	0.1%	6.83	6.83	6.83	6.83	6.82	6.80
AUD-CNY	5.427	13.2%	5.20	5.00	5.10	5.20	5.30	5.40
NZD-CNY	4.370	10.6%	4.00	3.80	3.70	3.70	3.70	3.80
JPY-CNY	0.072	-4.7%	0.065	0.068	0.065	0.063	0.062	0.061
EUR-CNY	9.624	0.9%	8.61	8.54	8.61	8.61	8.72	8.70
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	1.28	-50	1.4	1.4	1.5	1.7	2.0	2.2
2-year IRS (onshore vs 7-day repo fix)	1.86	79	1.9	2.0	2.1	2.3	2.5	2.8
10-year IRS	3.49	170	3.7	4.0	4.0	4.0	4.1	4.2

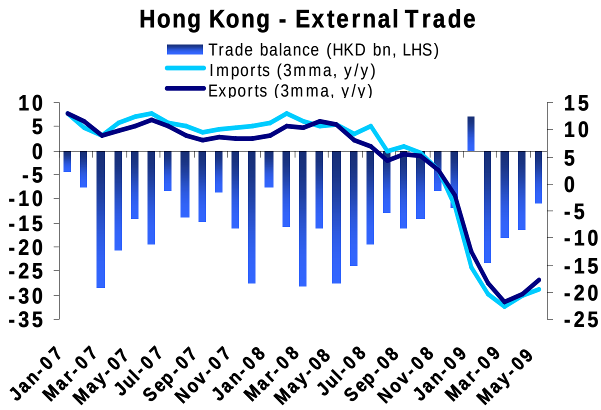
Sources: Bloomberg, ANZ

Country Update: Hong Kong

The worst has passed: the pace of decline in retail sales has eased, export growth has turned less negative, the unemployment rate has stopped climbing, and the PMI has risen for six straight months. Our 2009 GDP growth forecast of -6.7% has upside risks.







- Growth in retail sales remained negative, but improved to -4.4% (y/y) in April against -7.7% in March. Volume growth improved too, with a reading of -5.5% (y/y) against a revised number of -9.2% in March.
- Exports declined by 14.5% (y/y) in May, against -18.2% in the previous month and better than expectations. May is the third consecutive month of a narrowing export decline. Imports dropped by 19.2% (y/y), compared with -17.0% in April. A trade deficit of HK$11bn was recorded, smaller than April's HK$16.4bn.
- The composite CPI remained unchanged in May compared with the same month a year earlier. Netting out the effects of the government's one-off measures, consumer prices rose by 1.3% (y/y) in May, slower than the 1.9% increase in April, mainly due to the decline in private house rentals and charges for package tours.
- Property prices continued to rise in June. Positive factors included mortgage interest rates remaining lower than rental yields and unemployment stabilising at 5.3%.
- The PMI increased for the sixth straight month to reach 44.8 in May, although it remains below the neutral level of 50, suggesting a contraction in overall business activity.
- The task force on economic challenges has proposed a host of measures to boost the development of six areas in which Hong Kong has an edge. These are educational services, medical services, testing and certification, innovation and technology, cultural and creative industries, and environmental services.
- The outlook has improved. The Hong Kong government said that a positive q/q (sa) number will be recorded for Q2 GDP growth assuming the external sector continues to improve in May and June. Our growth forecast of -6.7%, by assuming negative sequential growth for Q2, thus has some upside risks.

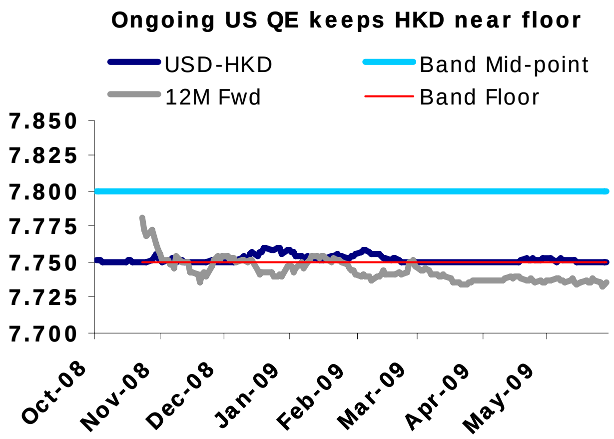
Franklin Poon

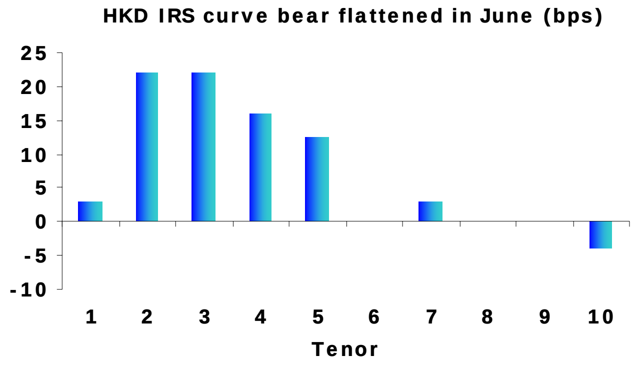
Economic Data – Hong Kong

Monthly data	Oct 08	Nov 08	Dec 08	Jan 09	Feb 09	Mar 09	Apr 09	May 09
Retail Sales, % y/y	0.4	1.3	1.1	7.3	-12.7	-7.8	-4.4	N/A
Composite Consumer Price Index sa, % y/y	1.7	3.1	2.1	2.7	1.1	1.2	0.6	0.0
Exports, % y/y	9.4	-5.3	-11.4	-21.8	-23.0	-21.1	-18.2	N/A
Imports, % y/y	11.3	-7.9	-16.2	-27.1	-17.5	-22.7	-17.0	N/A
Trade Balance, US$ bn	-1.8	-1.1	-1.5	0.9	-3.0	-2.3	-2.1	N/A
Foreign Exchange Reserves, US$ bn	149.3	160.5	178.1	174.4	171.7	181.7	185.9	N/A
Quarterly data	**Jun 07**	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**
Industrial Production, % y/y	-2.1	-2.1	-0.3	-4.5	-4.2	-7.0	-10.6	-10.1
Real GDP, % y/y	6.1	6.8	6.9	7.3	4.1	1.5	-2.6	-7.8
-Private consumption	7.6	11.4	9.7	8.0	3.0	-0.2	-4.1	-5.5
-Government consumption	3.8	2.4	3.3	0.6	3.1	1.6	1.8	1.5
-Gross fixed capital formation	6.5	-1.1	8.0	9.9	5.1	2.9	-17.8	-12.6
Nominal GDP, HKD bn	378.2	415.5	448.0	410.0	401.4	430.2	435.3	380.1
Current Account, US$ bn	3.2	7.8	6.1	6.5	4.1	9.6	10.4	5.3
Capital & Financial Account, US$ bn	-5.1	-9.6	-8.3	-4.3	-2.6	-11.9	-8.9	-3.9

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, the government has made it clear that there will be no adjustment in the currency regime.

FX

The HKMA continues to inject liquidity into the money market in order to keep USD-HKD within the convertibility zone. We expect USD-HKD to remain heavy until the US signals an exit from its policy of quantitative easing (QE), more likely in 2010 than 2009.

Meanwhile, the upcoming change in leadership at the helm of the HKMA in September has fuelled speculation of an adjustment in Hong Kong's currency regime. The government responded with a statement in early June, effectively supporting the status quo. It argued that "widening the exchange rate band or re-pegging to the US dollar at a new level will likely fail to relieve pressures on rising inflation and buoyant asset prices, as it may invite market speculations on the likelihood of further band-widening or re-pegging in the future, thereby undermining the credibility of the [currency board arrangement]… Pegging to a basket of currencies is also not a good choice because it lacks the transparency in the currency board arrangement and such a change would only erode the credibility of the monetary regime."

Rates

The June 24 FOMC statement said, "economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period." HKMA chief executive Yam commented later that problems with the US financial system remain a hindrance to economic activity and that it would take a "long time" for the US and Europe to stabilise. In other words, risk of an exit strategy from QE any time soon remains low. This should cap any upward pressure on yields as effects from the government stimulus start to come through the real economy.

Tamara Henderson

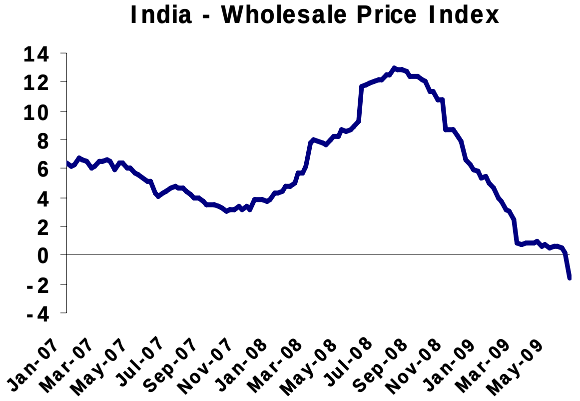
Market Forecasts – Hong Kong (eop)

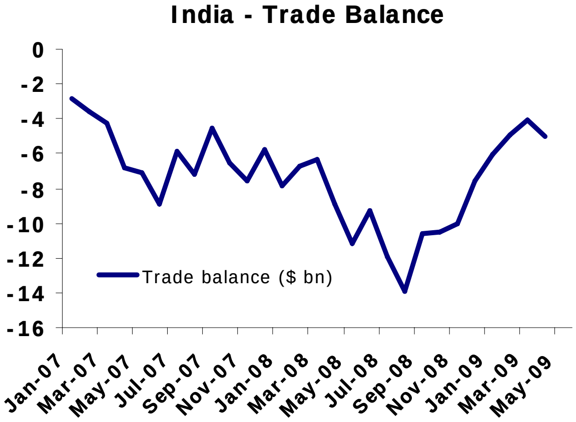
FX	Current	Ytd (%)	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10
USD-HKD	7.750	0.0%	7.750	7.750	7.750	7.760	7.770	7.800
AUD-HKD	6.177	13.4%	5.9	5.7	5.7	5.9	6.1	6.2
NZD-HKD	4.952	10.3%	4.5	4.3	4.2	4.2	4.3	4.4
JPY-HKD	0.081	-5.2%	0.074	0.078	0.074	0.072	0.071	0.070
EUR-HKD	10.808	-0.2%	9.8	9.7	9.8	9.8	9.9	10.0
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	0.35	-61	0.5	0.6	0.7	0.8	1.3	2.1
2-year IRS (onshore versus 3M)	1.45	-4	1.5	1.6	1.7	2.0	2.5	3.2
10-year IRS	3.41	148	3.7	4.0	4.2	4.2	4.4	4.7

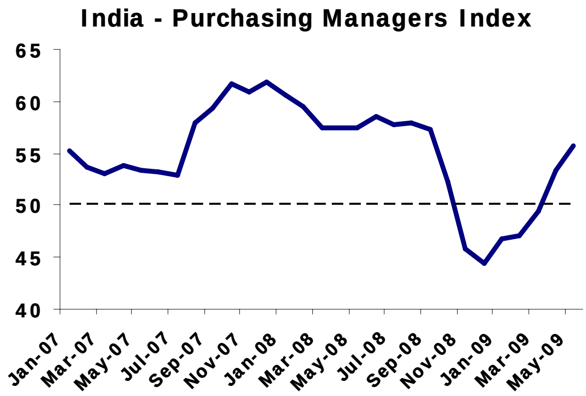
Sources: ANZ, Bloomberg

Country Update: India

India continues to outperform. The PMI reached an eight-month high in May, signalling improvements in industrial activity. Inflation fell below zero, largely due to base effects from last year's fuel price hikes. The new government's FY09/10 budget on July 6 will be watched closely.







- Industrial production grew 1.4% (y/y) in April reflecting a broad-based expansion in all subcomponents (mining, manufacturing, and electricity). Consumer durables recorded growth for the fourth consecutive month at 16.9%.
- India's PMI rose to an eight-month peak of 55.7 in May, up from 53.3 in April, on improving new orders, inventories and employment.
- Other domestic indicators also suggest resilience. Domestic auto sales grew, helped by improved two- and three-wheeler sales. Cement production grew by 11.9% (y/y) in May over a moderately lower 9.9% growth in April. Improved infrastructure and residential construction, driven by falling interest rates in the past few months, helped sustain growth as well.
- Exports contracted by 33.2% (y/y) in April, broadly unchanged from March. This is the seventh straight month of decline and the steepest in over 18 years. Imports, too, fell by a record 36.6% (y/y) against a 34% plunge a month earlier. The trade deficit widened to $5bn from $4bn in March, but was much better than the $8.7bn shortfall a year ago.
- Growth in WPI fell further to -1.1% (y/y) for the week ended June 13, turning negative for the first time since the late 1970s. The decline was largely due to base effects from administrated fuel price hikes last year.
- The Ministry of Commerce said the government is working to boost exports and bring the deficit under control by reaching closure on free trade agreements and establishing a new trade policy by August.
- The government will present its full budget on July 6. Policy priorities are likely to be centered on growth, and a further deterioration in fiscal position is widely expected. Comments on fiscal consolidation will be watched closely.

Yeo Han Sia

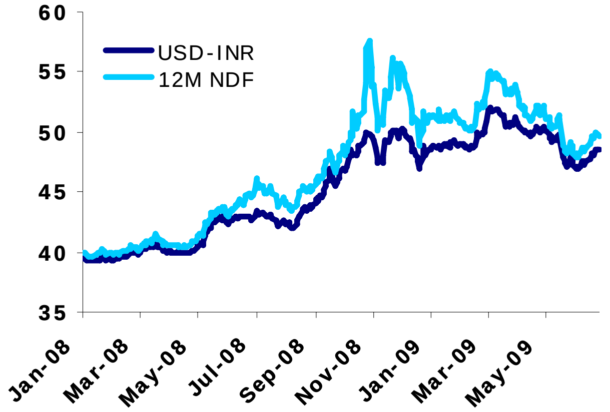
Economic Data – India

Monthly data	**Oct 08**	**Nov 08**	**Dec 08**	**Jan 09**	**Feb 09**	**Mar 09**	**Apr 09**	**May 09**
Industrial Production, % y/y	0.1	2.5	-0.2	1.0	-0.7	-0.8	1.4	N/A
Automobile Sales, % y/y	-9.3	-10.4	-11.8	-6.0	10.0	0.5	8.1	8.4
Wholesale Price Index, % y/y	10.7	8.2	5.9	4.5	3.1	0.8	0.7	0.1
Exports, % y/y	-12.2	-20.1	-5.3	-22.4	-21.7	-33.3	-33.2	N/A
Imports, % y/y	7.6	10.2	-1.0	-27.3	-23.3	-34.0	-36.6	N/A
Trade Balance, US$ bn	-9.9	-12.2	-6.3	-5.0	-4.9	-4.0	-5.0	N/A
Foreign Exchange Reserves, US$ bn	244.0	239.0	246.6	238.9	238.7	241.4	241.5	251.5
Quarterly data	**Jun 07**	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**
Real GDP, % y/y	9.2	9.0	9.3	8.6	7.8	7.7	5.8	5.8
-Agriculture	4.3	3.9	8.1	2.2	3.0	2.7	-0.8	2.7
-Industry	10.3	9.8	9.0	6.5	6.4	6.5	2.0	1.2
-Services	10.8	10.3	10.3	11.8	10.2	9.8	10.2	8.6
Nominal GDP, INR tn	9.9	9.9	11.5	11.9	11.6	11.8	13.1	12.9
Current Account, US$ bn	-6.7	-4.3	-4.5	-1.5	-9.0	-12.8	-14.6	N/A
Capital Account, US$ bn	17.8	33.2	31.0	26.0	11.1	7.9	-3.7	N/A

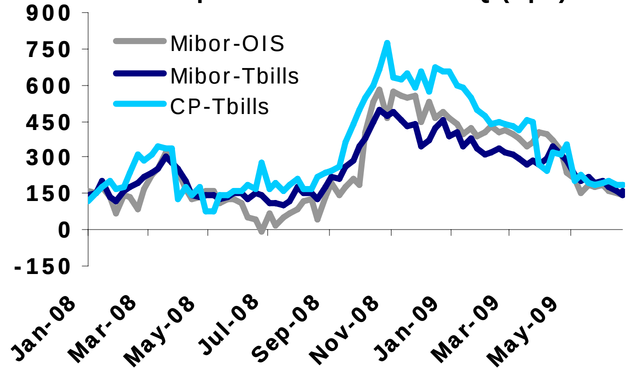
Sources: CEIC

India: FX and Rates Strategy

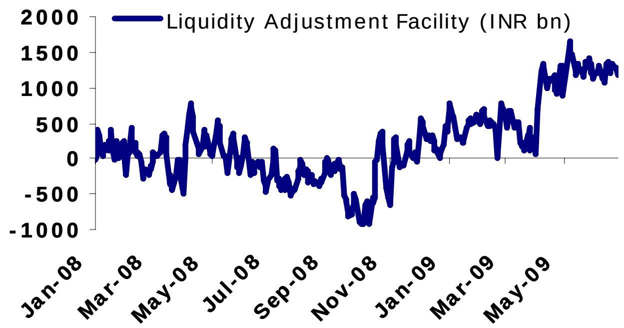
USD-INR rebounds in June



Rate spreads narrowed in 2Q (bps)



Interbank liquidity at record high



The USD-INR downtrend reversed in June on up-ticks in risk aversion, with a potential for further retracement into the summer season. The government will likely raise its deficit forecast on July 6. A larger-than-expected deficit is likely to spark a further rise in benchmark yields and steepening in the G-Sec curve.

FX

The USD-INR downtrend was broken in the second half of June on up-ticks in risk aversion. USD gains were, however, capped by trendline resistance near the 49 level. In the near term, the balance of risks is skewed towards further rupee weakness due to seasonal risk aversion during the summer period. While the May election outcome was clearly positive for the markets, the July budget could trigger a further retracement in the rupee's gains from early March. Further slippage in the fiscal outlook could jeopardise India's domestic currency sovereign rating, with negative sentiment from such a downgrade weighing on INR. Conversely, a more aggressive public sector disinvestment plan will be a positive for INR, but significant progress is unlikely in FY09/10 due to time lags in administrative approval, due diligence, and regulatory review.

Rates

Liquidity conditions continue to improve, but the rate of compression in interest rate spreads has slowed and may be flattening out. Our baseline expectation is for the RBI to keep the reverse repo rate steady at 3.25% during the July review, with a possible 25bps cut in the repo rate to signal an accommodative bias; the relevant policy rate is currently the reverse repo rate.

The government is widely expected to raise its FY09/10 deficit forecast from 5.5% of GDP on July 6. We believe a 0.5ppt rise to 6% should be seen as acceptable and fully priced in by market participants. A larger deficit, however, will likely spark a further rise in benchmark yields and a steepening of the G-Sec curve. This runs counter to RBI's effort to lower lending rates in the productive sector, and could prompt the central bank to loosen its policy stance in the near term. Against this backdrop, the scope for 2s-10s G-Sec flattening appears limited.

Yeo Han Sia

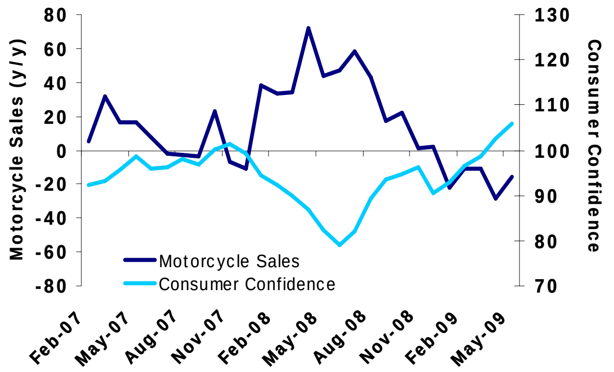
Market Forecasts – India (eop)

FX	Current	Ytd (%)	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10
USD-INR	48.39	-0.9%	48.5	48.0	47.0	47.5	47.0	47.0
AUD-INR	38.94	13.9%	36.9	35.0	34.8	36.1	36.7	37.6
NZD-INR	31.14	10.4%	28.1	26.4	25.4	25.7	25.9	26.3
JPY-INR	0.500	-5.9%	0.462	0.480	0.448	0.440	0.427	0.420
EUR-INR	67.92	-0.1%	61.1	60.0	59.2	59.9	60.2	60.2
Rates	**Current**	**Ytd (%)**	**Sep 09**	**Dec 09**	**Mar 10**	**Jun 10**	**Sep 10**	**Dec 10**
RBI's repo rate	4.75	-175	4.50	4.50	4.50	4.75	5.00	5.25
3-month MIBOR	4.69	-420	4.5	4.5	4.5	4.8	5.0	5.3
2-year IRS (versus NSE MIBOR)	4.84	40	4.6	4.6	4.6	5.1	5.5	5.7
10-year IRS	6.86	203	6.8	6.7	6.7	7.0	7.4	7.5

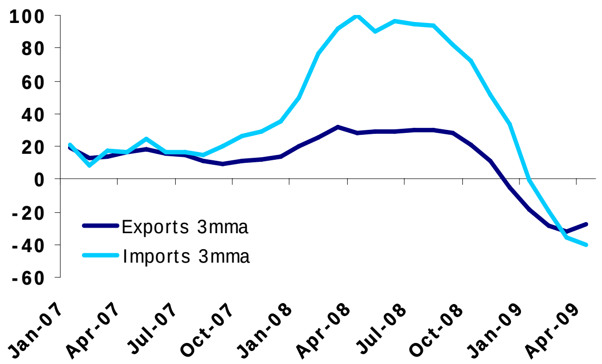
Sources: Bloomberg, ANZ

Country Update: Indonesia

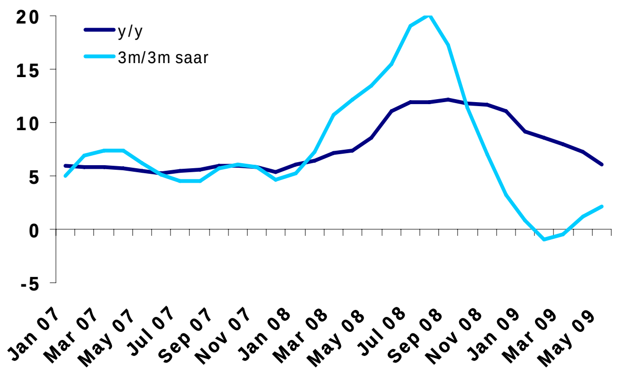
Indonesia - Consumption Indicators



Indonesia - Trade Developments (y/y)



Indonesia - Inflation



Indonesia continues to outperform its peers. Domestic consumption momentum remains strong and external demand is poised to become less of a drag on growth. Inflation is falling and the BI has ample room to maneuver if necessary.

- Consumption indicators remain strong. Retail sales continued to show signs of improvement, growing by 4% (y/y) in April. Bank Indonesia's consumer confidence index rose to a two-year high of 105.9 in May from 102.5 in April. The decline in auto sales eased, as sales fell 29.4% (y/y) in May from -33% in April.
- Industrial production rose by 1.5% (y/y) in April, beating a 1.3% rise in March. Domestic cement consumption continued to decline, falling 14.5% (y/y) in May compared to -13.3% in April, signalling continued weakness in the real estate sector. However, foreign investment in Indonesia grew by nearly 106% (y/y) in the Jan-Feb period this year, compared to average growth of 43.7% in 2008.
- Exports improved, falling 22.9% (y/y) in April against a 27.6% drop in March. However, the decline in imports remained strong with a contraction of 44.5% (y/y) in April compared with a 34.5% fall in March. The trade balance was unchanged at $2.1bn in April.
- Inflation eased to a 23-month low of 6% (y/y) in May, against 7.3% in April. The fall in prices was led by slower food and fuel price inflation. Core CPI also fell 6.6% in May from 7.1% in April, raising expectations for further interest rate cuts.
- BI cut its benchmark rate by 25bps to 7% for the sixth time this cycle, in line with market expectations. It expects GDP growth to slow to 3-4% in 2009 from 6.1% in 2008, while inflation is expected to ease to 5-7% from 9.8%. Given the lack of a clear signal on economic revival and declining inflation, BI may not yet be done with its easing cycle.
- We expect Indonesia to continue to outperform given its strong growth momentum and limited dependency on external demand and financial services for growth. GDP should expand by around 4% this year.

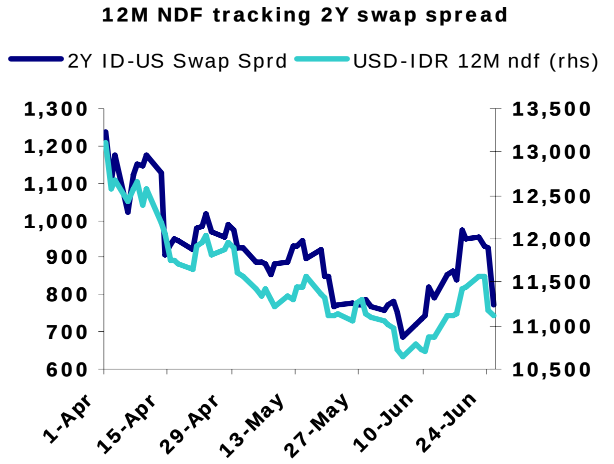
Chang Wei Liang

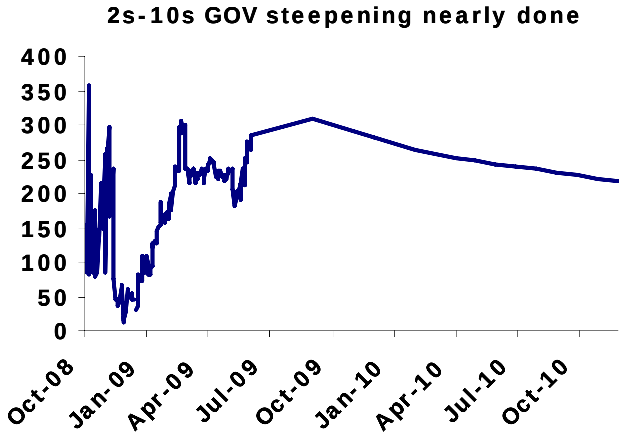
Economic Data – Indonesia

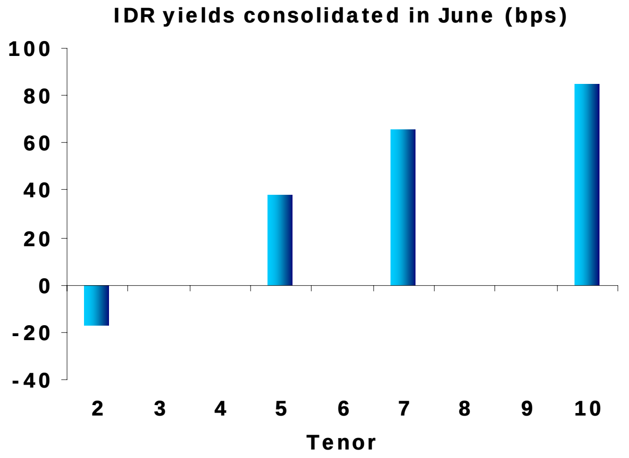
Monthly data	Oct 08	Nov 08	Dec 08	Jan 09	Feb 09	Mar 09	Apr 09	May 09
Industrial Production, % y/y	6.1	0.6	-1.9	-1.7	0.9	1.3	1.5	N/A
Retail Sales Index, % y/y	-15.5	-26.3	-5.0	2.9	-8.2	5.9	3.6	N/A
Consumer Price Index, % y/y	11.8	11.5	11.1	9.2	8.6	7.9	7.3	6.0
Exports, % y/y	4.7	-1.8	-18.7	-35.0	-32.3	-28.3	-22.6	N/A
Imports, % y/y	40.3	-5.6	-8.0	-27.9	-40.1	-33.9	-45.3	N/A
Trade Balance, US$ bn	2.0	2.5	2.6	1.9	2.4	3.3	3.3	N/A
Foreign Exchange Reserves, US$ bn	48.4	47.8	49.2	48.3	47.9	52.2	54.0	55.2
Quarterly data	**Jun 07**	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**
Real GDP, % y/y	6.6	6.6	5.8	6.2	6.4	6.4	5.2	4.4
-Private consumption	4.7	5.1	5.5	5.7	5.5	5.3	4.8	5.8
-Government consumption	3.8	6.5	2.0	3.6	5.3	14.1	16.4	19.2
-Gross fixed capital expenditure	7.6	9.7	12.4	13.7	12.0	12.2	9.1	3.5
Nominal GDP, IDR tn	964.8	1,030.8	1,034.9	1,117.6	1,229.6	1,332.5	1,274.3	1,300.3
Current Account, US$ bn	2.3	2.2	3.4	2.8	-1.0	-0.9	-0.7	1.8
Capital & Financial Account, US$ bn	2.0	-0.9	0.7	-1.4	2.5	0.9	-4.1	2.4

Sources: CEIC

Indonesia: FX and Rates Strategy







With summer risk aversion upon us, we expect the IDR to come under renewed pressure. A re-test of the eight-week high near 10,675 should be successful, but a move as far as the 200-day MA is unlikely, given our outlook for lower highs in USD-IDR.

FX

Emerging Asia's best performing currency shed some gains mid-month as investors booked profits ahead of the half year end and as corporates sought USD to make dividend and loan payments. The high yielding IDR has clearly benefited from the March rally in risk trades, but the improvement in risk appetite has now stalled. Moreover, behaviour over the past five years suggests more heightened risk aversion during the peak of summer in the Northern hemisphere starting in mid-July. As such, we expect a re-test of the eight-week high near 10,675 to be successful, but a move as far as the 200-day MA near 11,000 seems unlikely, given that we expect the recent pattern for lower highs to be maintained in the absence of fresh event risk shocks. That said, one should be wary of BI smoothing operations, particularly ahead of July 8 Presidential elections.

The conclusion of Presidential elections should be a non-event for markets as the market-friendly incumbent is widely expected to return to office. Nevertheless, the removal of residual political uncertainty should support further inflows of capital, especially once seasonal risk aversion has passed. The medium term outlook for the IDR remains bullish, 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

We remain bullish on IDR rates, anticipating another 50bps of rate cuts by BI before the end of Q3. Further improvements on the inflation front give BI more scope to support domestic demand, especially since real policy rates have risen sharply. Once summer risk aversion passes, attractive yields on IDR bonds should continue to appeal off-shore investors.

Tamara Henderson

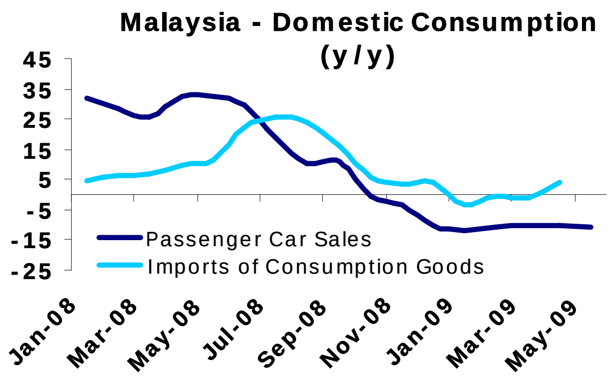
Market Forecasts – Indonesia (eop)

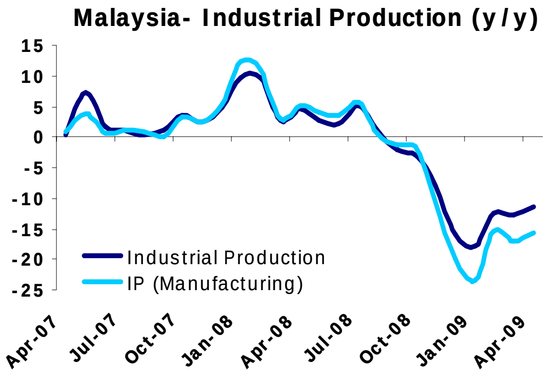
FX	Current	Ytd (%)	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10
USD-IDR	10,255	-7.8%	10,250	9,750	9,500	10,000	9,500	9,000
AUD-IDR	8,209	3.2%	7,800	7,100	7,000	7,600	7,400	7,200
NZD-IDR	6,585	0.4%	5,900	5,400	5,100	5,400	5,200	5,000
JPY-IDR	106	-14.7%	100	100	90	90	90	80
EUR-IDR	14,324	-9.5%	12,900	12,200	12,000	12,600	12,200	11,500
Rates	**Current**	**Ytd (bps)**	**Sep 09**	**Dec 09**	**Mar 10**	**Jun 10**	**Sep 10**	**Dec 10**
BI's bank rate	7.00	-225	6.50	6.50	6.50	6.75	7.00	7.00
3-month JIBOR	7.63	-450	7.1	7.0	6.9	7.2	7.4	7.7
2-year IDR bond yield	8.55	-287	8.1	8.0	7.9	8.1	8.4	8.6
10-year IDR bond yield	11.39	-50	11.2	10.8	10.5	10.6	10.7	10.8

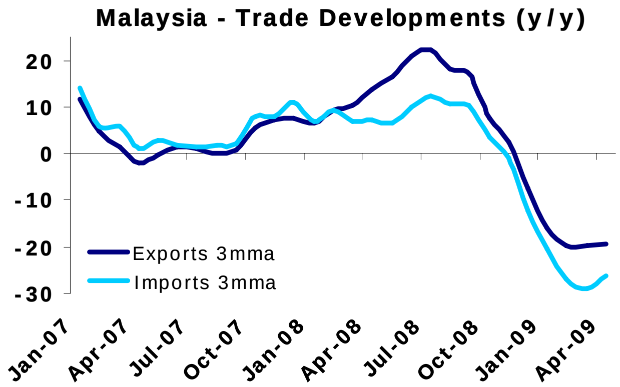
Sources: Bloomberg, ANZ

Country Update: Malaysia

Malaysia continues to face strong headwinds from external demand, with the decline in exports worsening again in April. Consumer confidence is at its lowest level since the Asian Financial Crisis and investment poses further downside risk to growth. The good news is that the external situation appears to have stabilised. The authorities have been using fiscal policy to support growth and the effects should start becoming more visible going forward.







- Consumption indicators are mixed. Passenger car sales declined by a less negative 8.1% (y/y) in May, against -18.5% in April. However, imports of consumption goods fell by 6.9% (y/y).
- Industrial production fell 11.4% (y/y) in April against -12.7% in March. This was due to a drop in all three constituent indices (manufacturing, mining, and electricity). Plunging exports continued to keep the industrial production index's growth negative.
- Manufacturing sales plunged by 26.2% (y/y) in April, against -25.6% in March. This fall was mainly due to decreasing sales of basic iron and steel products, computers and peripherals, mostly due to diminished exports and moderate domestic consumption.
- Exports slumped by 26.3% (y/y) in April, much steeper than the 15.6% drop in March. This was mainly driven by a fall in shipments of petroleum-related products. In contrast, imports declined by just 22.4% (y/y), better than the 28.7% fall in March.
- The slower pace of decline in imports is helping to rebuild inventories, given their sharp drop in Q1 and the fact that Malaysia predominantly imports goods for processing and re-exporting. The trade surplus shrank to $7.4bn, down from $12.5bn in March.
- The CPI rose by 2.4% (y/y) in May or 0.2% (m/m), marginally higher than expected. This reflected a rapid rise in food and non-alcoholic beverage prices.
- We expect BNM to hold rates at 2.00% going forward, but remain mindful of the need for further monetary easing should the outlook worsen.
- Growth is forecast at -2% this year with risks on the downside given Malaysia's high global exposure.

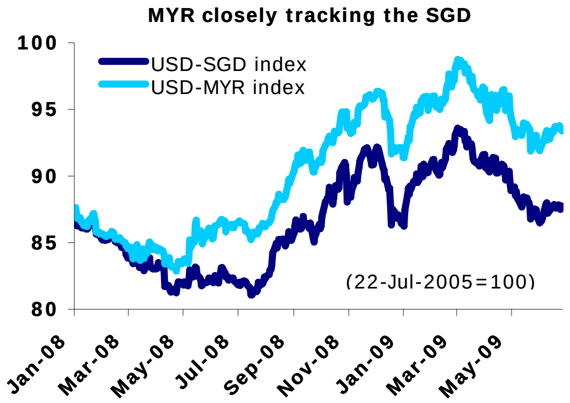
Chang Wei Liang

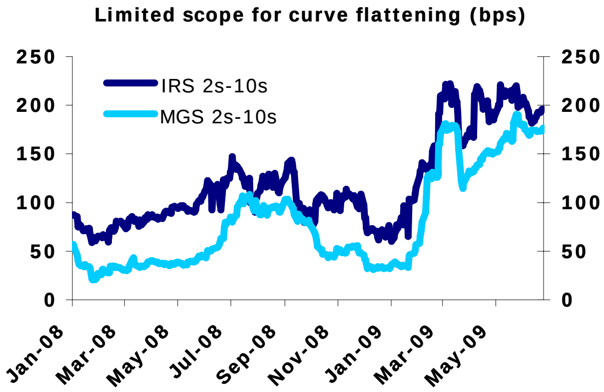
Economic Data – Malaysia

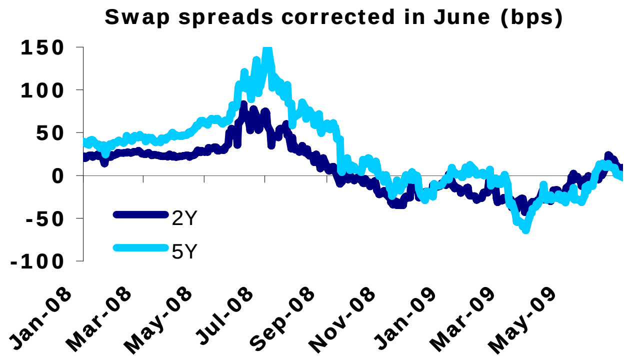
Monthly data	Oct 08	Nov 08	Dec 08	Jan 09	Feb 09	Mar 09	Apr 09	May 09
Industrial Production, % y/y	-3.1	-7.9	-15.9	-17.9	-12.5	-12.6	-11.5	N/A
Manufacturing Sales, % y/y	2.1	-1.9	-21.0	-29.2	-22.9	-25.6	-26.2	N/A
Consumer Price Index, % y/y	7.6	5.7	4.4	3.9	3.7	3.5	3.0	2.4
Exports, % y/y	-2.6	-4.9	-14.9	-27.8	-16.0	-15.7	-26.3	N/A
Imports, % y/y	-5.3	-8.6	-22.8	-30.4	-27.6	-28.7	-22.4	N/A
Trade Balance, USD bn	2.7	3.2	3.3	2.2	3.3	3.4	2.1	N/A
Foreign Exchange Reserves, US$ bn	94.9	92.1	85.7	85.9	85.3	82.4	81.9	82.2
Quarterly data	**Jun 07**	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**
Retail Sales, % y/y	33.0	39.7	35.7	19.8	23.8	25.4	16.5	7.8
Real GDP, % y/y	5.6	6.5	7.2	7.4	6.6	4.8	0.1	-6.2
-Private consumption	10.2	14.2	9.9	11.3	9.4	8.2	5.3	-0.7
-Government consumption	10.3	6.0	4.0	14.1	10.3	6.4	12.7	2.1
-Gross fixed capital formation	6.0	12.7	10.2	4.6	5.6	3.1	-10.2	-10.8
Nominal GDP, MYR bn	153.9	165.4	176.2	175.5	188.5	197.6	177.0	155.5
Current Account, US$ bn	7.3	8.6	8.0	7.5	11.3	11.2	8.8	N/A
Capital & Financial Account, US$ bn	2.2	-9.0	-5.2	8.3	-3.8	-17.8	-21.8	N/A

Sources: CEIC

Malaysia: FX and Rates Strategy







Relative growth underperformance poses a risk to the MYR, but the close correlation with SGD and DXY will likely continue. While BNM was firm on its stand pat stance, pressure to cut the policy rate will persist in the coming months.

FX

The MYR continued to track the SGD and DXY closely in June. Technical indicators are broadly neutral; the 200-day MA and 38.2% Fibonacci retracement near 3.57 are key resistance levels to watch in the coming weeks. The SGD-MYR cross, however, rose above the post-peg 2.20-2.40 trading range with Malaysia's momentum indicators lagging behind its southern neighbour. The slide in exports showed little sign of improvement, in contrast to the narrowing declines seen in other AXJ economies. That said, easing import contractions suggest a rebuilding of inventories, which should support industrial production and outbound shipments in the coming months. Meanwhile, domestic consumption indicators remain sluggish, providing little support for GDP growth or the MYR.

The CNY-MYR swap deal signed in February will be operational 'in the near term' according to BNM Governor Zeti. If the BRL-ARS swap is anything to go by, however, the utilisation rate of the CNY80bn-MYR40bn facility will likely be low. Global sentiment remains the dominant driver for the ringgit in the near term. We expect USD-MYR to break above key resistance levels into Q3, towards the 50% Fibonacci retracement at 3.60.

Rates

The BNM was unequivocal on its stand pat stance, but pressure to cut rates will persist in the coming months. While China has had early success with its stimulus program, the same cannot be said for Malaysia's 7.6% of GDP deficit spending plan. Pressure to implement a third stimulus plan could rise in the coming months, limiting the scope for MGS curve flattening. Fitch's one-notch downgrade to Malaysia's long-term local currency rating to A- should have limited impact on the government's domestic financing plan. Meanwhile, real interest rates are on the rise with inflation likely to slip into negative territory in June. Negative swap spreads (IRS-MGS) at the front end of the curve corrected in June, as hopes of further rate cuts during the cycle receded, but spreads should stay depressed on near term supply concerns in the MGS market.

Yeo Han Sia

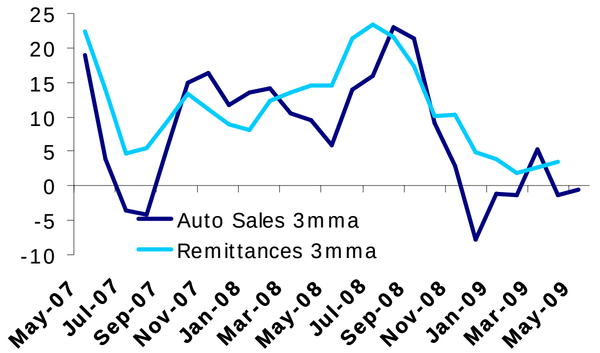
Market Forecasts – Malaysia (eop)

FX	Current	Ytd (%)	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10
USD-MYR	3.53	1.9%	3.60	3.55	3.50	3.50	3.45	3.45
AUD-MYR	2.85	17.4%	2.74	2.59	2.59	2.66	2.69	2.76
NZD-MYR	2.28	13.9%	2.09	1.95	1.89	1.89	1.90	1.93
JPY-MYR	3.69	-11.9%	3.43	3.55	3.33	3.24	3.14	3.08
EUR-MYR	4.97	3.1%	4.54	4.44	4.41	4.41	4.42	4.42
Rates	**Current**	**Ytd**	**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)	2.63	-19	2.6	2.7	2.7	2.7	3.0	3.1
10-year IRS	4.67	117	4.6	4.7	4.7	4.7	4.8	4.9

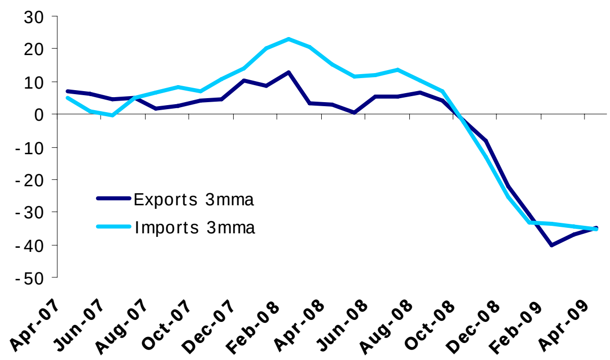
Sources: Bloomberg, ANZ

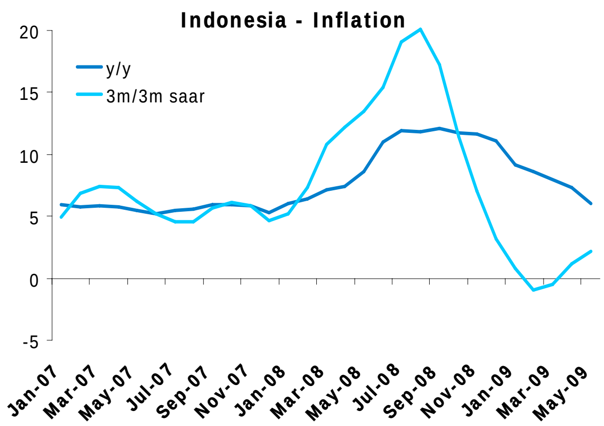
Country Update: Philippines

Philippines - Auto Sales & Remittances (y/y)



Philippines - Trade Developments (y/y)





Q1 GDP underperformed expectations, with consumption shrinking for the first time (q/q basis) in more than 10 years. However, there are signs that consumption is turning around with a corresponding improvement in the export market. Moreover, remittances growth remains positive. We forecast that GDP growth will remain positive for 2009.

- Domestic consumption indicators are positive overall. The consumer expenditure diffusion index rose to 44.4 in Q2 from 40.7 in Q1, while passenger car sales rose by 3.4% (y/y) in May against -5.6% in April.
- Remittances growth proved more resilient than expected in the face of a global recession, slowing marginally to 2.2% in April from 3.1% in March.
- Consumer loans jumped 18.7% (y/y) in April, spurred by low interest rates. Credit towards the purchase of automobiles and real estate increased by 4% and 4.2%, respectively.
- Exports remain weak, falling 35.2% (y/y) in April compared with -30.8% in March. Manufacturing exports continue to be the key drag on growth. Imports fell by 36.2% (y/y) in March, down from -31.9% in February.
- Inflation eased to an 18-month low of 3.3% in May. Core inflation was 4.4% (y/y) in May against 5% in April.
- BSP cut its policy rate to 4.25% on May 28, resulting in a cumulative easing of 175bps since December 2008. However, the rate cut pass-through has been less than 50%, prompting BSP Governor Tetangco to hint at further monetary relief.
- The government posted a deficit of $234mn in May, for a cumulative deficit of $2.4bn so far this year. The sharp rise in the deficit is due to a decline in revenues and higher infrastructure spending. Earlier this month, the government revised its deficit forecast for 2009 from PHP199bn to PHP250bn.
- Philippine growth will be constrained by base effects this year, but should remain positive provided consumption, which accounts for almost ¾ of GDP, remains buoyant.

Chang Wei Liang

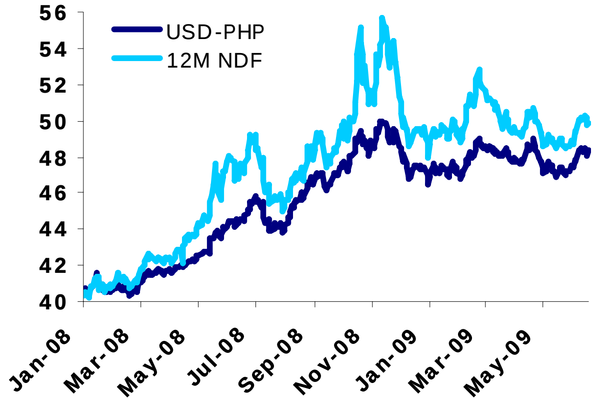
Economic Data – Philippines

Monthly data	**Oct 08**	**Nov 08**	**Dec 08**	**Jan 09**	**Feb 09**	**Mar 09**	**Apr 09**	**May 09**
Manufacturing Production Value-add, % y/y	10.7	0.1	-9.6	-22.1	-18.8	-12.0	N/A	N/A
Passenger Car Sales, % y/y	-5.9	2.0	-19.5	14.2	1.2	0.6	-5.6	3.4
Consumer Price Index, % y/y	11.2	9.9	8.0	7.1	7.3	6.4	4.8	3.3
Exports, % y/y	-14.4	-11.4	-40.3	-40.6	-39.0	-30.8	-35.2	N/A
Imports, % y/y	-11.1	-31.5	-34.0	-34.5	-31.9	-36.2	N/A	N/A
Trade Balance, US$ bn	-0.6	0.0	-0.6	-0.8	-0.6	-0.4	2.8	N/A
Foreign Exchange Reserves, US$ bn	31.8	32.4	32.6	34.1	33.6	33.9	34.3	N/A
Quarterly data	**Jun 07**	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**
Real GDP, % y/y	8.3	6.8	6.3	3.9	4.2	4.6	2.9	0.4
-Private consumption	5.6	5.7	6.2	5.1	4.1	4.4	5.0	0.8
-Government consumption	8.9	-2.6	8.0	-0.3	0.0	11.8	2.6	3.8
-Gross fixed capital formation	20.7	6.8	5.3	3.0	1.7	7.1	0.1	-5.7
Nominal GDP, peso bn	1,617.7	1,610.7	1,895.7	1,660.3	1,833.9	1,853.4	2,075.5	1,739.9
Current Account, US$ bn	1.9	1.3	2.0	1.3	0.9	-0.3	2.3	N/A
Capital & Financial Account, US$ bn	-0.4	3.1	-0.1	0.5	0.4	0.4	-3.3	N/A

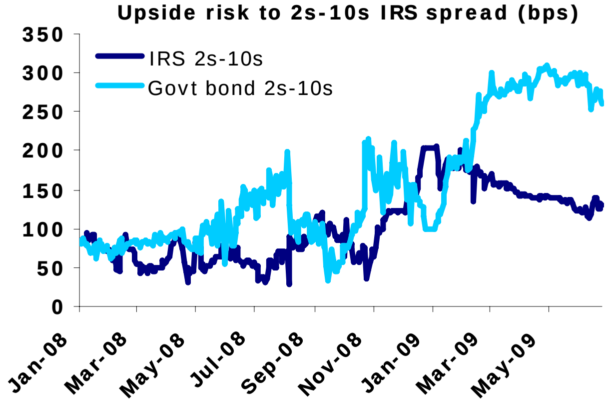
Sources: CEIC

Philippines: FX and Rates Strategy

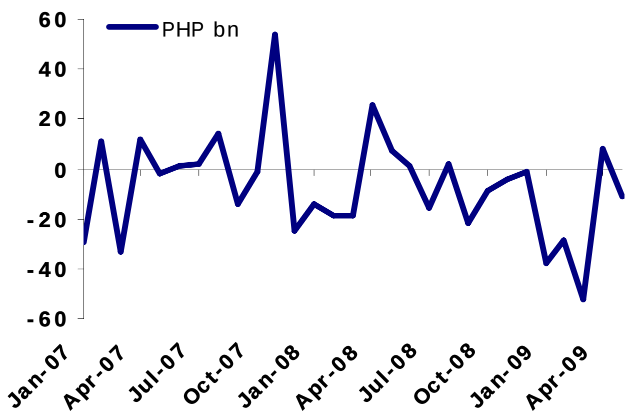
USD-PHP rebounds in June



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



Weak fiscal balance to persist



USD-PHP will likely drift higher in Q3, but a retest of the 50.0 level is unlikely in our view. The market remains unconvinced that the government can meet its revised deficit target. A change in the domestic-external funding mix, however, should ease pressure in the domestic bond market.

FX

Fading hopes of a strong rebound in global growth pushed USD-PHP higher and past 200-day MA resistance in June, but further gains were halted at trendline resistance and near the 61.8% Fibonacci retracement at 48.76. In terms of domestic fundamentals, weaker-than-expected Q1 GDP and another upward revision in the 2009 fiscal deficit forecast underpinned concerns over the growth outlook. That said, relatively resilient remittance inflows and improvements in the consumer diffusion index and household credit all suggest a bottom in consumer demand in H109. While technical signals for USD-PHP are bearish, seasonal risk aversion and growing doubts over the pace of the global recovery could see USD-PHP grinding higher in Q3. Inflows related to the USD1-1.5bn Samurai bond issue should provide a short term boost for the peso; but the timing is yet to be determined. Overall, we see USD-PHP reaching higher in Q3, but a retest of the 50.0 level is unlikely in our view.

Rates

The government downgraded its outlook for growth and fiscal balance in June. The budget shortfall is now expected to reach a five-year high of 3.2% of GDP, up 0.7ppt from the previous forecast. Government borrowing is projected at PHP250bn (+52bn), a record high. The knock-on effect on bond yields was, however, mitigated by subsequent announcements on the Samurai bond issue and the postponement of a local retail bond issue in July. As such, the government may be looking to change its domestic-external borrowing mix from April's 72:28 split; this would ease pressure on the domestic bond market.

However, persistent below-target monthly tax collection suggests the balance of risks remains skewed towards a further widening in the fiscal gap. Indeed, the current market consensus is for a full year deficit of PHP270bn. The near term monetary policy outlook also limits the scope for corrective GOV curve flattening. The BSP is widely expected to cut the overnight rate by 25bps to 4% on July 9, with no change in its easing bias.

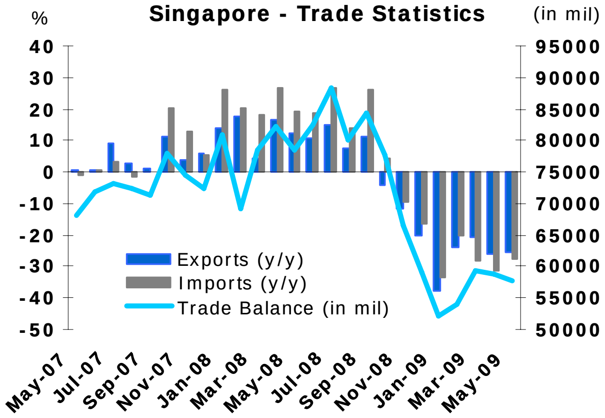
Yeo Han Sia

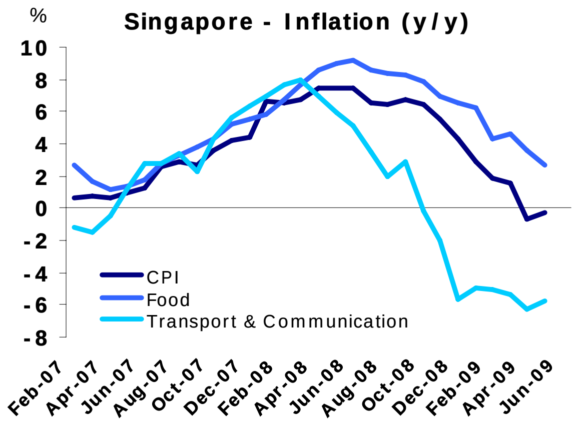
Market Forecasts – Philippines (eop)

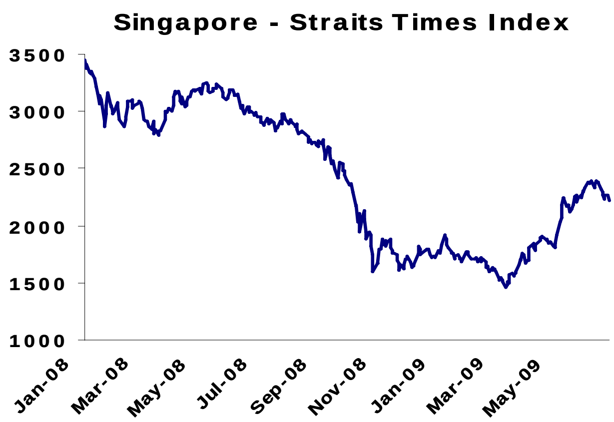
FX	Current	Ytd (%)	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10
USD-PHP	48.25	1.5%	49.0	48.0	48.0	47.0	47.0	46.0
AUD-PHP	38.84	16.6%	37.2	35.0	35.5	35.7	36.7	36.8
NZD-PHP	31.11	13.3%	28.4	26.4	25.9	25.4	25.9	25.8
JPY-PHP	0.51	-3.2%	0.467	0.480	0.457	0.435	0.427	0.411
EUR-PHP	67.95	2.6%	61.7	60.0	60.5	59.2	60.2	58.9
Rates	**Current**	**Ytd (%)**	**Sep 09**	**Dec 09**	**Mar 10**	**Jun 10**	**Sep 10**	**Dec 10**
BSP's overnight reverse repo rate	4.25	-125	3.75	3.75	3.75	3.75	4.00	4.00
3-month PHIBOR	3.94	-131	3.8	3.8	3.8	3.8	4.1	4.1
2-year IRS (versus 3M IB ref rate)	4.36	29	4.2	4.2	4.2	4.5	4.9	5.0
10-year IRS	5.65	-45	5.5	5.7	5.7	5.8	6.2	6.3

Sources: Bloomberg, ANZ

Country Update: Singapore







Singapore is still underperforming the region. Non-oil domestic exports continue to decline, as weak global demand extends the slump in overseas shipments. With the economy in recession and unemployment climbing, consumer sentiment remains weak and retail sales have contracted. Price pressures eased as inflation declined for a second straight month. GDP should fall by 7½% this year with risks on the downside.

- The retail sales index fell by 11.7% (y/y) in April, after declining by 7.2% in March. By component, vehicle sales dropped by 28.1%; purchases of apparel and footwear by 6.1%; and furniture and household equipment sales by 11.2%. The MasterCard Worldwide Index of Consumer Confidence revealed overall pessimism about the economy
- The Purchasing Manger's Index broke into expansionary territory in May, reaching 51.2. Improvements were broad-based. This was the first reading over the neutral level of 50 since August 2008.
- Non-oil exports tumbled 12% (y/y) in May 2009, following a 19% slump in April. Electronic shipments plunged by 21.8% in May, while non-electronic shipments (including petrochemicals and pharmaceuticals) declined 5.8%. The US, Japan, and Malaysia contributed most to the decline.
- Inflation was negative for the second straight month in May, with prices falling by 0.3% (y/y) following a 0.7% decline in April. Transport and communication costs declined by 5.8%. However, food and housing costs rose by 2.6% (y/y) and 0.7% (y/y), respectively.
- In June, the STI index was little changed on the month in SGD terms.
- Growth should remain weak well into 2009 as Singapore remains highly exposed to global developments. Discretionary spending will continue to suffer as consumers remain cautious, with rising unemployment and a poor economic outlook. As such, the risks to our -7½% GDP forecast on are the downside.

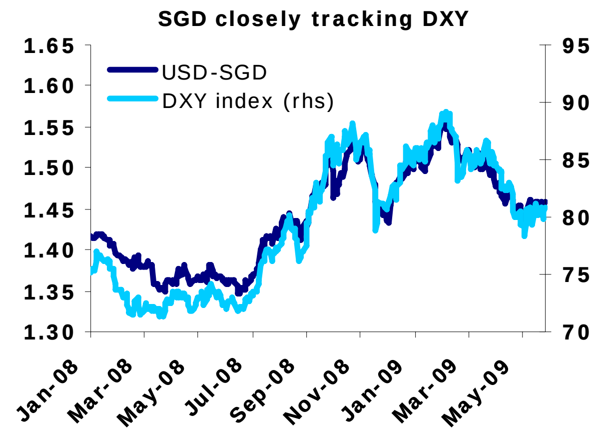
Ivy Tan

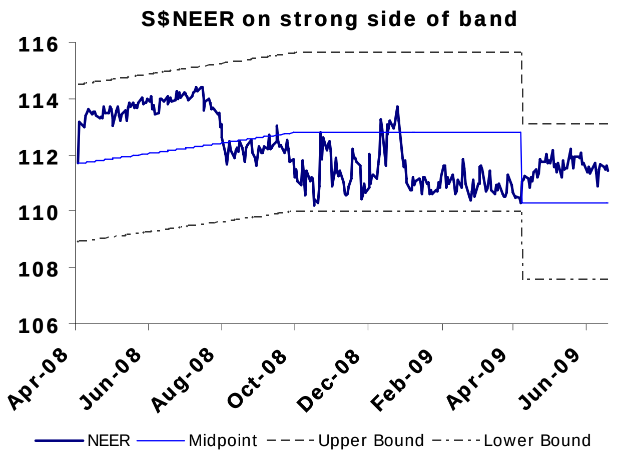
Economic Data – Singapore

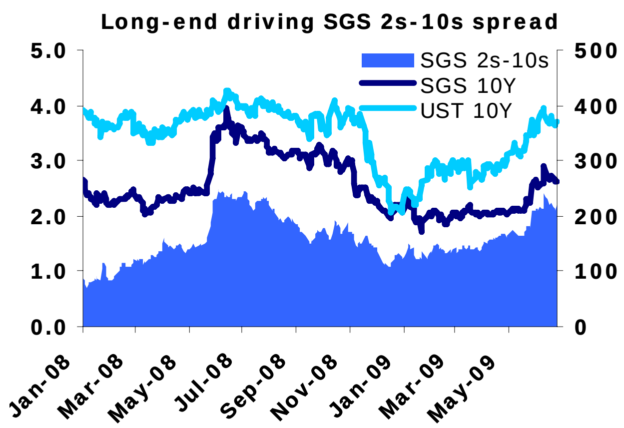
Monthly data	**Oct 08**	**Nov 08**	**Dec 08**	**Jan 09**	**Feb 09**	**Mar 09**	**Apr 09**	**May 09**
Industrial Production, % y/y	-12.2	-6.7	-13.4	-26.4	-12.5	-32.8	-0.5	N/A
Retail Sales, % y/y	-3.4	-2.9	-0.6	-11.6	-5.5	-7.2	-11.7	N/A
Consumer Price Index, % y/y	6.4	5.5	4.3	2.9	1.9	1.6	-0.7	-0.3
Domestic Exports (Non-oil), % y/y	-15.5	-17.5	-20.8	-34.9	-23.8	-17.3	-19.2	-12.1
Imports (Non-oil), % y/y	-2.2	-12.4	-14.0	-29.1	-17.3	-25.4	-26.6	-20.0
Trade Balance, US$ bn	0.4	1.0	0.7	0.5	0.8	2.7	2.4	1.7
Foreign Exchange Reserves, US$ bn	162.5	165.8	168.9	169.2	166.0	164.9	166.6	169.3
Quarterly data	**Jun 07**	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**
Real GDP, % y/y	8.6	9.5	5.5	6.7	2.5	0.0	-4.2	-10.1
-Private consumption	5.8	6.3	5.8	4.1	4.4	2.7	-1.2	-5.1
-Government consumption	3.4	-0.6	9.5	10.4	9.0	9.9	2.7	-2.2
-Gross fixed capital formation	25.7	15.4	17.0	30.5	25.0	14.9	-9.9	-14.8
Nominal GDP sa, SGD bn	61.8	64.2	66.5	66.0	64.3	64.5	62.8	59.4
Current Account, US$ bn	9.8	11.5	6.3	8.1	6.7	7.7	4.5	3.9
Capital & Financial Account, US$ bn	-3.1	-8.0	0.7	2.0	-3.8	-8.6	-1.1	-7.4

Sources: CEIC

Singapore: FX and Rates Strategy







Headwinds to growth appear to be easing, but the economy will likely perform below potential in 2009-10, providing little incentive for the MAS to change its zero S$NEER appreciation bias. The broad USD trend should continue to drive USD-SGD movements.

FX

USD-SGD tracked the DXY higher in June, but changed little on a trade-weighted basis. The S$NEER moved within a tight range of 0.5-1.5% above the midpoint, down slightly from 0.8-1.8% in May. Technical signals for USD-SGD are broadly neutral. Domestic demand indicators remain weak, with retail sales registering the steepest fall in a decade and the Q1 unemployment rate higher than the previous estimate. However, the narrowing contraction in non-oil domestic exports and a steady rise in PMI suggest the strong headwinds to growth may be easing. The reversal in employer hiring intentions for Q3 also indicates an improvement in business activity. While tail-end risks have eased, the economy will likely perform well below potential through 2009-10. We continue to expect the current zero S$NEER appreciation bias to be maintained into 2010.

Rates

Inter-bank rates have flat-lined since the beginning of 2009 on comfortable liquidity conditions and slowing credit demand. The next move is likely up, but the timing will largely depend on the Fed. In the SGS market, the two-year tenor looks rich but there is little incentive for duration extensions in the near term. With the volatility of short end yields declining on historically low rates, the long end of the curve will continue to drive the 2-10s spread. Movements in long end SGS yields should, however, reflect shifting expectations over the timing of Fed rate hikes and global risk appetite, rather than the domestic fiscal position. Additional government spending (if any) is likely to be fully funded by accumulated fiscal surpluses and investment income.

Yeo Han Sia

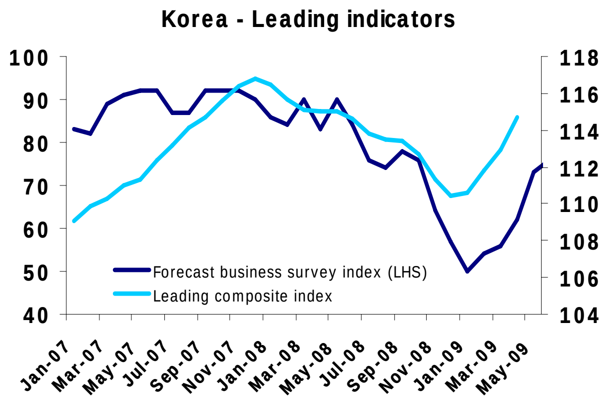
Market Forecasts – Singapore (eop)

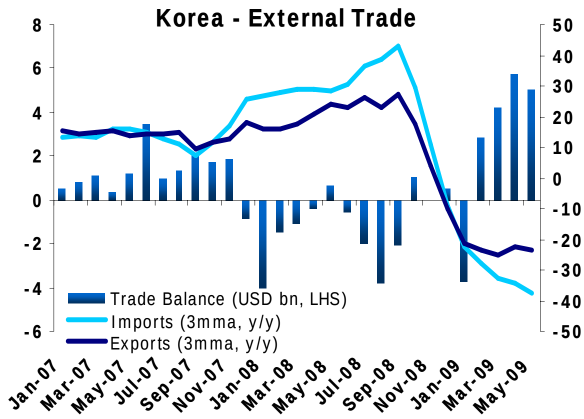
FX	Current	Ytd (%)	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10
USD-SGD	1.454	1.7%	1.52	1.51	1.50	1.50	1.49	1.48
AUD-SGD	1.172	16.6%	1.16	1.10	1.11	1.14	1.16	1.18
NZD-SGD	0.938	13.2%	0.88	0.83	0.81	0.81	0.82	0.83
JPY-SGD	1.520	-3.6%	1.45	1.51	1.43	1.39	1.35	1.32
EUR-SGD	2.048	2.5%	1.92	1.89	1.89	1.89	1.91	1.89
Rates	**Current**	**Ytd (%)**	**Sep 09**	**Dec 09**	**Mar 10**	**Jun 10**	**Sep 10**	**Dec 10**
3-month SIBOR	0.69	-27	0.65	0.65	0.85	1.05	1.30	1.50
2-year IRS (onshore versus 6M SOR)	1.79	22	1.7	1.7	1.9	2.0	2.2	2.4
10-year IRS	3.03	76	2.7	2.5	2.5	2.8	3.0	3.2

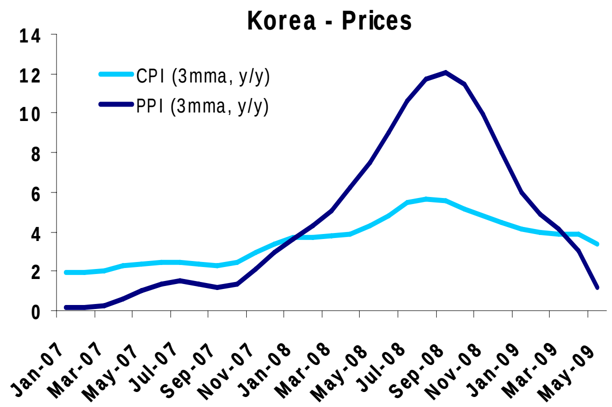
Sources: Bloomberg, ANZ

Country Update: South Korea

Expansionary macro policies appear to be producing their intended results. However, foreign demand remains weak as the export slump worsened again in May, suggesting a fragile external sector recovery in H2. Inflation remains subdued and policy rates remain at a record low; the BOK looks to be on hold for now. We maintain our 2009 GDP growth forecast at -2.9%.







- Department store sales rose for the third straight month in May, by 5.4% (y/y), compared with 2.8% growth in April. Discount store sales rose by 1.6% (y/y) in May against 0.1% growth in April.
- Exports fell at a faster pace of 28.3% in May (y/y), against a 19.6% decline in April. Exports have now declined for seven consecutive months, the longest run since 2001-02. Imports also fell strongly in May dropping by 40.4%. The trade surplus narrowed to $5.2bn from $5.8bn in April.
- The CPI rose by 2.7% (y/y) in May, a 20-month low, compared with the 3.6% increase in April. The decline in core inflation was less severe, posting a 3.9% rise compared with the 4.2% increase in April. PPI inflation turned negative in May, falling 1.3% from 1.5% in April, the first negative PPI growth since August 2002.
- The leading composite index (sa) rose 1.6% (m/m) in April, after a 1% rise in March. This was the fourth consecutive monthly increase after seven consecutive months of decline. The forecast business survey index for June stood at 76, compared with 71 recorded in May.
- Consumer confidence rose to 106 in June from 105 in May, the second consecutive month above the neutral level of 100 and the strongest reading since Q3 2007.
- The BOK kept the base rate at 2.00% for the fourth consecutive month, in line with expectations. The central bank has indicated its inclination to maintain its current stance for the time being.
- We forecast growth of -2.9% this year, with modest sequential growth from Q2 onward. Given Korea's export dependency, the risks are on the downside. Recent events out of North Korea will have little or no impact on developments in South Korea.

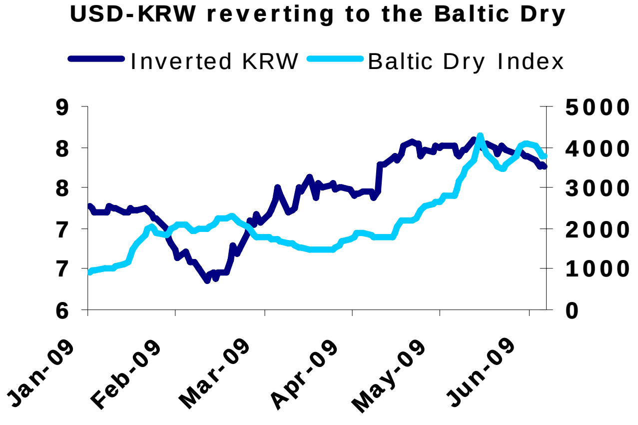
Franklin Poon

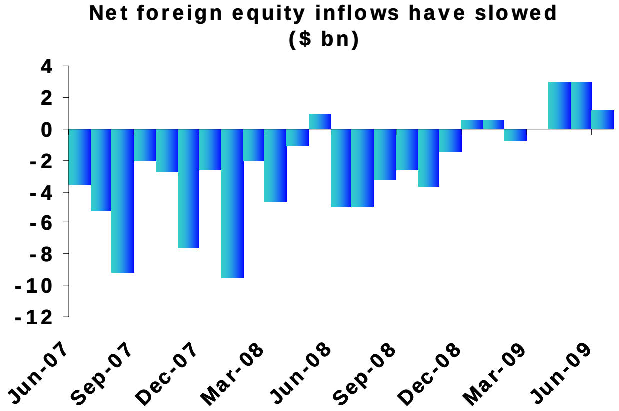
Economic Data – South Korea

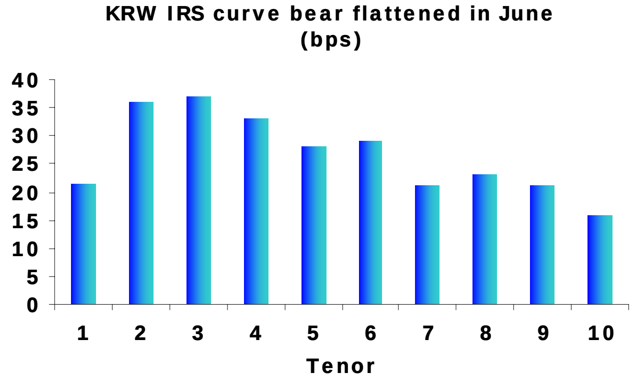
Monthly data	**Oct 08**	**Nov 08**	**Dec 08**	**Jan 09**	**Feb 09**	**Mar 09**	**Apr 09**	**May 09**
Industrial Production, % y/y	-1.9	-13.8	-18.7	-25.5	-10.0	-10.5	-8.2	-10.6
Retail Sales, % y/y	1.9	-0.5	-1.2	-1.2	-3.9	-2.3	-1.5	N/A
Consumer Price Index, % y/y	4.8	4.5	4.1	3.7	4.1	3.9	3.6	2.7
Exports, % y/y	7.8	-19.5	-17.9	-34.5	-18.5	-22.1	-19.7	-28.5
Imports, % y/y	10.3	-15.0	-21.6	-31.6	-31.0	-35.9	-35.6	-40.3
Trade Balance, USD bn	1.0	0.0	0.5	-3.7	2.9	4.2	5.8	5.1
Foreign Exchange Reserves, US$ bn	212.8	201.0	201.0	201.6	201.8	206.4	212.5	226.5
Quarterly data	**Jun 07**	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**
Real GDP, % y/y	5.3	4.9	5.7	5.5	4.3	3.1	-3.4	-4.2
-Private consumption	5.2	5.4	4.7	4.0	2.3	1.4	-3.7	-4.4
-Government consumption	6.3	4.8	4.7	3.6	4.0	4.5	4.7	7.3
-Gross fixed capital formation	5.7	1.5	3.1	-0.5	0.6	1.8	-7.3	-8.1
Nominal GDP, KRW tn	241.0	246.7	263.1	240.8	260.7	261.5	260.9	236.9
Current Account, US$ bn	1.1	2.0	-0.8	-0.1	1.8	-1.3	0.9	6.6
Capital & Financial Account, US$ bn	-0.3	-3.9	0.3	0.4	-3.6	-4.4	-4.8	-2.7

Sources: CEIC

South Korea: FX and Rates Strategy







Despite more aggressive sabre-rattling by North Korea, the won remains trapped in a range. Going forward, a seasonal pickup in risk aversion should produce a re-test of the 1,300 level in coming weeks. However, tough resistance at the 200-day MA near 1,350 should hold.

FX

The Korean won remains in an eight-week trading range, albeit currently at the weaker end of the range amid increased demand for liquidity heading into the half year-end. Supportive of the won, Korea continues to attract foreign equity inflows amid signs that economic growth continues to gain traction. The capital account recorded a surplus of $6.7bn in May compared with a surplus of $2.2bn in April, while the government raised its estimate for the current account surplus to $35bn in 2009 (from $16bn) and upgraded its growth forecast to -1.5% in 2009 (from -2%).

Capping KRW's strength, however, importers have stepped up USD purchases in order to hedge further gains in oil prices. Meanwhile, behaviour over the last five summers suggests a pickup in risk aversion at the height of Northern hemisphere summer holidays during mid-July to mid-August, suggesting a more forceful test of the 1,300 level. However, tough resistance at the 200-day moving average near 1,350 is expected to hold.

Rates

Korean officials have signalled that it is far too early to reign in economic stimulus, even though the "drastic slowdown" has probably ended. BoK Governor Lee said the central bank would maintain its easing bias as it remains unclear how much growth will rebound. Vice Finance Minister Hur said that "a change in macroeconomic policy risks choking off an economic recovery in an anaemic stage," and Finance Minister Yoon added that "uncertainties will grow in the second half, because the proportion of the fiscal spending will be smaller and oil and commodity prices are expected to rise."

However, officials also seem more wary about the effects of higher oil prices—both on economic growth and the inflation rate. We expect the front end of the curve to remain relatively well anchored, while yields at the back end of the curve face upward pressure from further signs of recovery and worries about inflation.

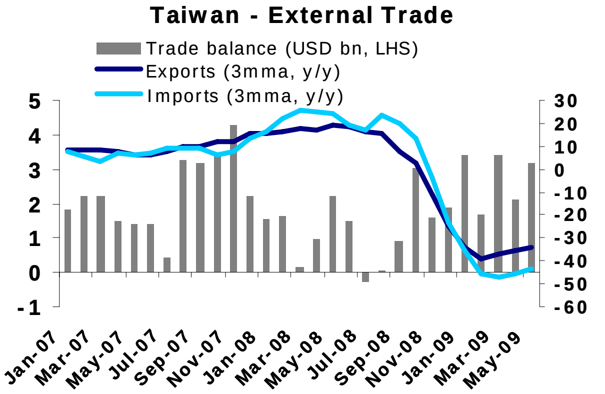
Tamara Henderson

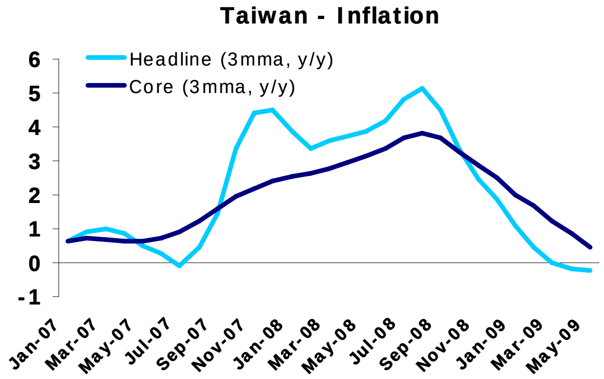
Market Forecasts – South Korea (eop)

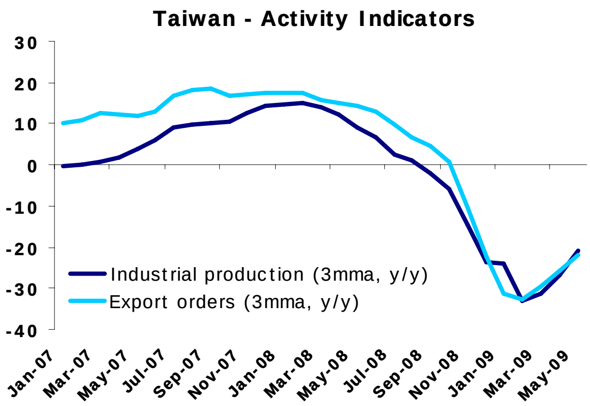
FX	Current	Ytd (%)	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10
USD-KRW	1289	2.3%	1225	1125	1175	1225	1100	1050
AUD-KRW	1026	15.9%	930	820	870	930	860	840
NZD-KRW	820	12.4%	710	620	630	660	610	590
JPY-KRW	13.37	-3.6%	11.7	11.3	11.2	11.3	10.0	9.4
EUR-KRW	1798	2.1%	1540	1410	1480	1540	1410	1340
Rates	**Current**	**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)	3.67	38	3.7	3.8	3.9	4.0	4.3	4.5
10-year IRS	4.25	68	4.4	4.5	4.6	4.6	4.7	4.8

Sources: Bloomberg, ANZ

Country Update: Taiwan







Taiwan's economy is recovering slowly as the external sector and industrial production have both improved from their lows in January. However, pockets of weakness remain. Commercial sales dropped in May, and consumer confidence remains weak. Our growth forecast is -5.3% for 2009, with upside risks owing to closer ties with Mainland China.

- Commercial sales growth worsened to -11.6% (y/y) in May, following a -9.5% outturn in April. Wholesale trade suffered the most, falling by 15.2%.
- Industrial output declined by 18.3% (y/y) in May, after dropping by a revised 20% in April. Seasonally adjusted, the index rose by 4.6% (m/m).
- Taiwan's exports fell by 31.4% (y/y) in May, less than April's 34.3% drop. The improvement came from shipments of electronic products to China. May's import growth also improved to -39.1% (y/y) from -41.2% in April. The trade surplus stood at $3.2bn.
- The CPI fell by 0.08% (y/y) in May. Excluding volatile food and energy prices, the core rate continued to register a positive number (0.12% y/y); but this was weaker than April's 0.4%.
- The composite leading index rose 3.3% (m/m, sa) in May, up from 2.6% in April, the third consecutive monthly rise. All seven index components improved.
- Export orders dropped by 20.1% (y/y) in May, following a 20.9% decline in April. This was weaker than expected.
- The consumer confidence index rose to 52 (still well below the neutral line of 100) in May from 50 in April, the third consecutive increase.
- The CBC left its rediscount rate unchanged at 1.25% after June's quarterly meeting. The central bank has become more confident that the worst has passed.
- The economy has bottomed. Our growth forecast of -5.3% assumes positive q/q growth from Q2 onwards. Risks now seem to be on the upside relating in part to the potential gains from closer ties to Mainland China.

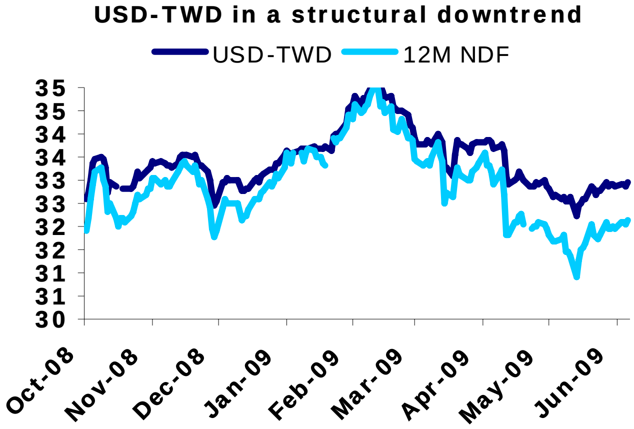
Franklin Poon

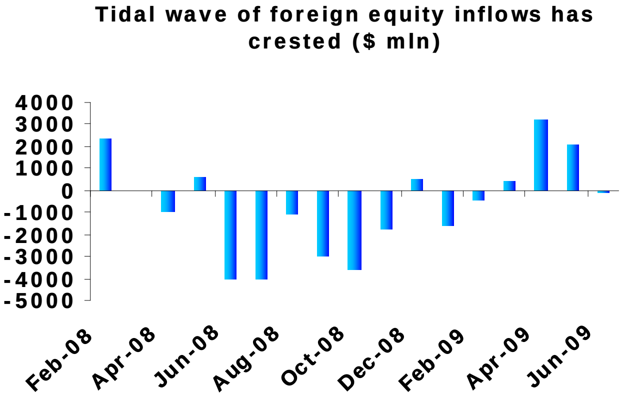
Economic Data – Taiwan

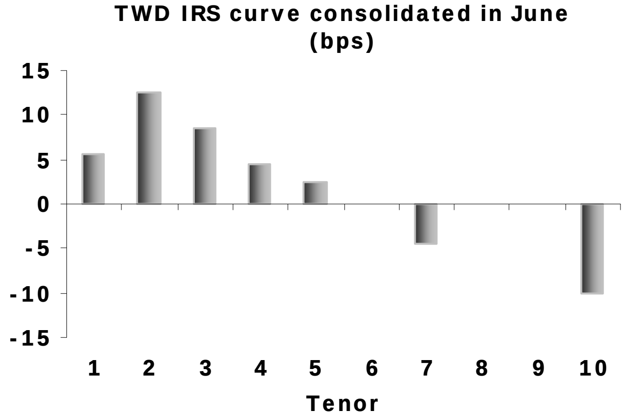
Monthly data	**Oct 08**	**Nov 08**	**Dec 08**	**Jan 09**	**Feb 09**	**Mar 09**	**Apr 09**	**May 09**
Industrial Production, % y/y	-12.5	-28.3	-32.0	-43.3	-27.2	-25.8	-20.0	-18.3
Retail Trade Index, % y/y	-6.1	-9.0	-11.3	-1.8	-8.3	-2.8	-2.8	-2.4
Consumer Price Index, % y/y	2.4	1.9	1.3	1.5	-1.3	-2.8	-0.5	-0.1
Exports, % y/y	-8.3	-23.3	-41.9	-44.1	-28.6	-35.8	-34.3	-31.4
Imports, % y/y	-7.4	-13.7	-44.6	-56.5	-31.6	-49.5	-41.2	-39.1
Trade Balance, US$ bn	2.9	1.5	1.8	3.3	1.6	3.4	2.1	3.2
Foreign Exchange Reserves, US$ bn	278.2	280.7	291.7	292.7	294.2	300.1	304.7	312.6
Quarterly data	**Jun 07**	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**
Real GDP, % y/y	5.5	7.0	6.4	6.2	4.6	-1.0	-8.6	-10.2
-Private consumption	2.2	3.1	1.6	2.1	0.5	-2.1	-1.7	-1.4
-Government consumption	0.7	1.7	1.1	1.3	-0.2	1.2	2.2	3.7
-Gross fixed capital formation	4.7	3.8	-0.8	3.7	-8.0	-11.8	-22.6	-33.8
Real GNP, % y/y	6.2	6.4	6.1	6.8	3.1	-0.5	-8.7	-10.6
Nominal GDP, TWD tn	2.5	2.8	2.9	2.7	2.6	2.7	2.6	2.5
Current Account, US$ mn	5,905.0	6,477.0	11,183.	8,474.0	6,744.0	1,867.0	7,553.0	12,991
Capital Account, US$ mn	-19.0	-33.0	-18.0	-271.0	-20.0	-32.0	-11.0	-24.0

Sources: CEIC

Taiwan: FX and Rates Strategy







If the pattern of lower highs in USD-TWD is maintained (which is our bias), then the 33.0 level should hold through the period of heightened summer risk aversion. That said, CBC activity to support exporters remains a significant risk, which importers would be advised to hedge.

FX

The tidal wave of capital inflows—sparked by landmark agreements at the end of April allowing Chinese investment in Taiwan—appears to have crested for now. Net foreign equity inflows amount to $4.4bn (ytd), but the net gain in May was a relatively small $0.7bn (compared with $2.0-$3.2 in Apr-May).

Meanwhile, more heightened risk aversion during the peak of summer in the Northern hemisphere should continue to weigh on the TWD over coming weeks. Further delays on the signing of the investment MOU with Mainland China would also be a source of weakness. That said, if the pattern of lower highs in USD-TWD is to remain intact (which is our bias), then the 33.00 level should hold. The wild card, however, is the amount of support the CBC may wish to provide exporters. As such, importers might consider a hedge to the 33.3 level, which is the 200-day MA.

Over the medium term, we remain bullish on the TWD, seeing the landmark agreements between Taiwan and Mainland China as a game-changer. Moreover, Taiwan's external position has remained quite healthy despite the sharp contraction in global trade and GDP. The current account posted the largest surplus in at least 15 years in Q1—even before the cross-strait agreement allowing investment from Mainland China—and FX reserves reached a six year high in April. As such, we view bouts of TWD weakness as opportunities to reinitiate strategic short USD-TWD positions at better levels.

Rates

Further CBC rate cuts are unlikely during this cycle, while the prospect of rate hikes remains well in the future. Meanwhile, Taiwan's output gap is one of the largest in the region and Taiwan's curve (2s-10s GOV) is one of the flattest within AXJ (as it should be). As such, we expect price action on the TWD curve to be range-bound.

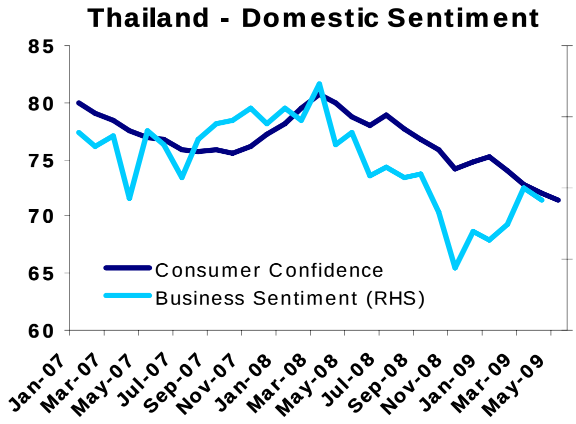
Tamara Henderson

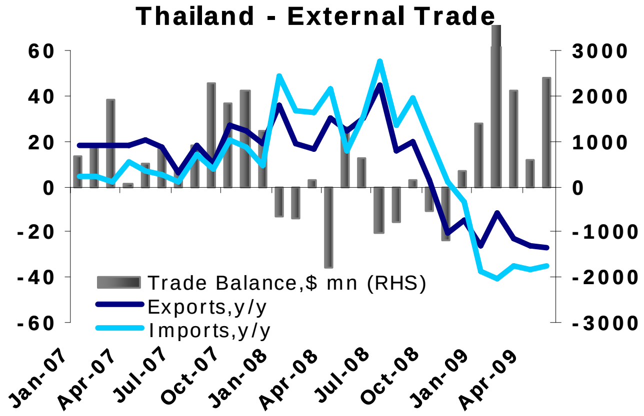
Market Forecasts – Taiwan (eop)

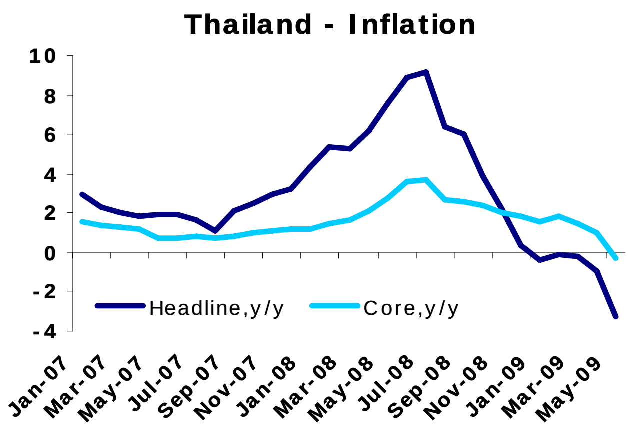
FX	Current	Ytd (%)	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10
USD-TWD	32.96	0.5%	32.5	32.0	31.5	31.0	30.3	30.3
AUD-TWD	26.27	13.9%	24.7	23.4	23.3	23.6	23.6	24.2
NZD-TWD	21.02	10.6%	18.9	17.6	17.0	16.7	16.7	17.0
JPY-TWD	0.342	-5.5%	0.310	0.320	0.300	0.287	0.275	0.271
EUR-TWD	45.95	0.2%	41.0	40.0	39.7	39.1	38.8	38.8
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	0.50	-59	0.5	0.5	0.5	0.6	0.9	1.3
2-year IRS (versus 3M CP)	1.04	-2	1.1	1.2	1.2	1.4	1.6	1.9
10-year IRS	1.89	45	2.1	2.3	2.5	2.6	2.6	2.7

Sources: Bloomberg, ANZ

Country Update: Thailand







Economic weakness was seen across the board last month, as domestic consumption, industrial production and exports all experienced sharp declines. The political situation seems to have stabilised for now. We expect the economy to contract by 3% in 2009, with growth turning positive in Q4.

- Consumption remains lacklustre, with the Bank of Thailand's private consumption index posting a decline of 5.3% (y/y) in April, following a 4.9% decline in March. This was driven by a fall in sales of motor vehicles and lower imports of consumer goods. Consumer confidence retained its downward momentum, reaching 71.5 in May, marking a seven-and-half year low.
- Industrial production continued to trend downwards, but the pace of decline slowed in April. IP growth was -10.1% (y/y), following a decline of 15.4% in March. The slump in production was led by the petroleum, commercial vehicle, and steel sectors. Capacity utilization for April stood at 56.6%, down from 66.6% a year ago, and 62.3% in March.
- Exports posted the biggest monthly decline ever in May, falling 26.2% (y/y). However, imports retreated by the smallest level in six months, falling 34.7% (y/y), raising hopes that the slump in exports will soon moderate, as manufacturers imported more components. The trade surplus improved to $2.4bn in May from $0.6bn in April.
- The CPI recorded negative growth of 3.3% (y/y), down from -0.9% in April. The fall in CPI was aided by lower oil prices and a sharp decline in the service sector. Core CPI, which excludes food and energy products, also fell in May, by 0.3% (y/y) against a rise of 1.0% in April.
- The Bank of Thailand's private investment index remained weak, registering a record low growth rate of -16.4% (y/y) in April, driven by the poor sale of machinery and commercial vehicles, as well a sharp reduction in imports of capital goods.
- The outlook remains bleak. The economy is expected to contract by 3.1% (y/y) in 2009, driven by a sharp slump in foreign demand, exacerbated by ongoing political uncertainty. The risks are on the downside.

Zhou Hao

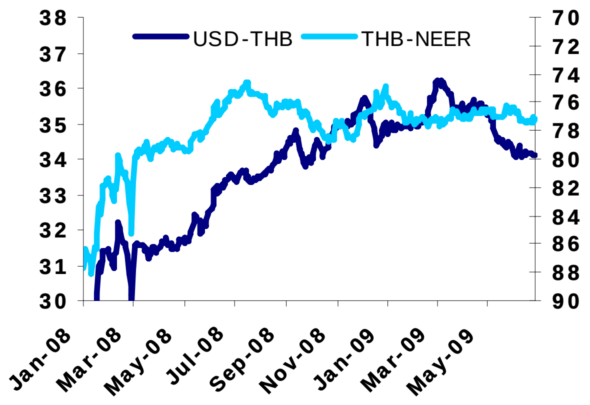
Economic Data – Thailand

Monthly data	Oct 08	Nov 08	Dec 08	Jan 09	Feb 09	Mar 09	Apr 09	May 09
Industrial Production, % y/y	2.4	-7.7	-18.6	-21.2	-19.9	-14.9	-10.1	N/A
Retail Sales, % y/y	-3.1	-13.4	-2.7	-11.2	-7.9	-13.0	N/A	N/A
Consumer Price Index, % y/y	3.9	2.2	0.4	-0.4	-0.1	-0.2	-0.9	-3.3
Exports, % y/y	3.0	-20.9	-14.6	-26.4	-11.3	-23.1	-26.1	-26.6
Imports, % y/y	21.7	2.0	-6.5	-37.6	-40.3	-35.1	-36.3	-34.7
Trade Balance, US$ bn	-0.6	-1.3	0.3	1.4	3.6	2.1	0.6	2.4
Foreign Exchange Reserves, USD bn	101.0	103.8	108.3	107.9	110.4	113.4	114.1	118.5
Quarterly data	**Jun 07**	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**
Real GDP, % y/y	4.4	5.1	5.7	6.0	5.3	3.9	-4.2	-7.1
-Private consumption	1.2	1.9	1.9	2.7	2.5	2.7	2.1	-2.6
-Government consumption	10.5	8.9	9.0	-0.4	-3.7	-2.9	11.0	2.8
-Gross fixed capital formation	0.1	2.5	3.8	5.4	1.9	0.6	-3.3	-15.8
Nominal GDP, THB bn	2,047.3	2,093.7	2,255.7	2,297.1	2,283.1	2,321.4	2,203.3	2,179.7
Current Account, US$ bn	1.1	1.7	2.2	1.0	0.7	-0.3	0.1	2.4
Capital & Financial Account, US$ bn	0.6	2.2	1.0	6.7	-4.0	2.5	-1.0	-1.4

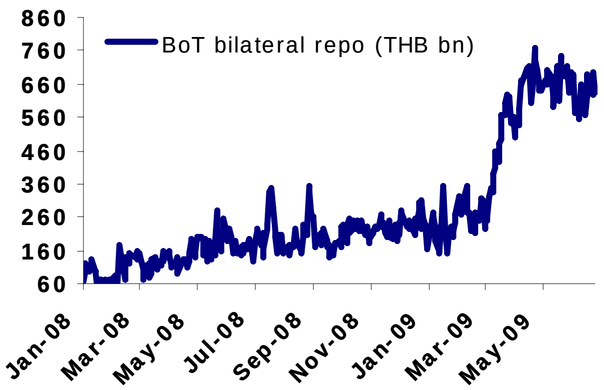
Sources: CEIC

Thailand: FX and Rates Strategy

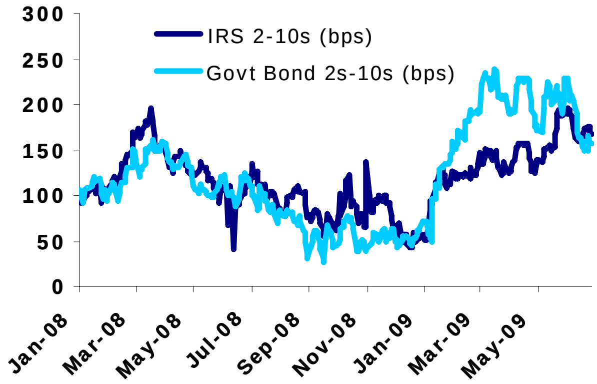
NEER trading in range



Interbank liquidity remains high



Upside risks from borrowing calendar



THB shrugged off weak economic numbers and broad USD strength in June, but gains were limited by the BoT's smoothing operations. A heavy borrowing calendar will sustain upward pressure on bond yields in the coming months.

FX

Domestic indicators remain lacklustre, with both domestic and external demand indicators showing little sign of a turnaround. However, the THB outperformed AXJ in June, shrugging off weak economic numbers and upward pressure on USD-AXJ due to healthy portfolio inflows. USD-THB was almost flat on the month, with media reports of the BoT intervening to limit the downside near the psychologically important 34.0 level. While Finance Minister Korn Chatikavanij expressed concern over recent baht strength, his view failed to resonate with the BoT. Comments from Governor Tarisa suggest no significant changes to the central bank's longstanding policy of managing FX volatility on a trade-weighted basis. The THB-NEER traded in a tight range in June, up 0.5% from May. Seasonal risk aversion should send USD-THB higher in Q3, but we expect gains to be limited.

Rates

The BoT's unexpected stand pat stance in May fuelled rate hike expectations, with two-year GOV yields breaching the 2% mark in early June. The IRS and GOV curves bear-flattened in early June, but more neutral comments from BoT Governor Tarisa pared rate hike expectations and the rise in yields.

Uncertainty over near term bond supply will weigh on the market in the coming months. In June, the government proposed a smaller THB350bn (3.8% of GDP) budget deficit for FY09/10, but a large part of the 150bn decline from FY08/09 was due to taking some THB250bn of spending off-budget to comply with the 3.5% of GDP deficit guideline. The borrowing calendar remains substantial in the next two to three years. The Senate approved THB400bn in 2009-10 borrowings to finance the three-year THB1.43tn stimulus plan in June, with another THB400bn bill for 2009-11 pending legislative approval in August. The FY09/10 budget will add another THB800bn to gross domestic borrowings in 2009-10. Overall, public sector debt is projected to rise to 60% of GDP from 42% in the next three years.

Yeo Han Sia

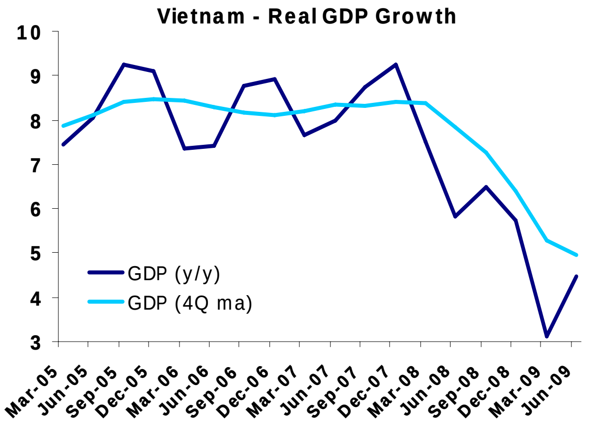
Market Forecasts – Thailand (eop)

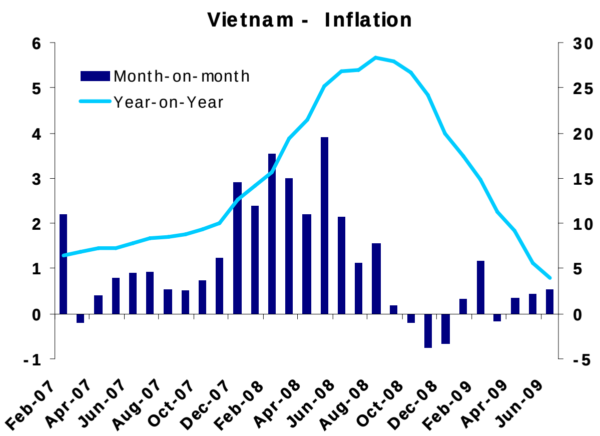
FX	Current	Ytd (%)	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10
USD-THB	34.06	-2.0%	36.0	35.5	35.0	35.0	34.5	34.5
AUD-THB	27.40	12.3%	27.4	25.9	25.9	26.6	26.9	27.6
NZD-THB	21.96	9.1%	20.9	19.5	18.9	18.9	19.0	19.3
JPY-THB	0.345	-4.6%	0.343	0.355	0.333	0.324	0.314	0.308
EUR-THB	46.36	1.1%	45.4	44.4	44.1	44.1	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	1.40	-155	1.4	1.4	1.4	1.4	1.7	1.7
2-year IRS (versus 6M THB fix)	2.55	70	2.7	2.7	2.6	2.6	2.7	2.7
10-year IRS	4.20	183	4.5	4.5	4.2	4.2	4.3	4.3

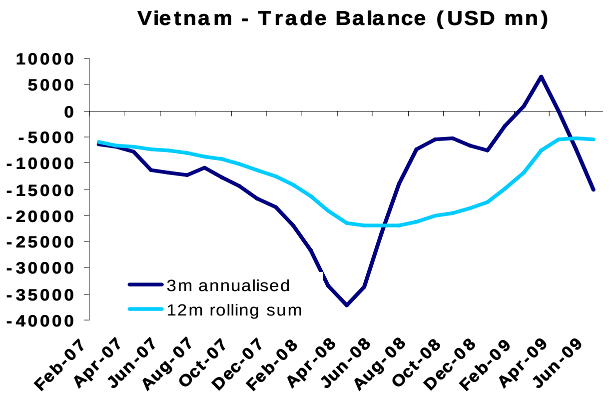
Sources: Bloomberg, ANZ

Country Update: Vietnam

GDP growth picked up to 4.5% in Q2 as the stimulus plan began to take hold. Exports remain weak and the trade balance has begun to deteriorate anew. Inflation is at a five-year low, but monthly increases have reappeared and need to be watched. We expect growth to rise throughout 2009, but remain below trend. The risks are moderately on the upside.







- GDP expanded by 3.9% in H1, implying a 4.5% (y/y) rise in Q2, well above the 3.1% print in Q1.
- Domestic demand indicators improved noticeably in Q2. Retail sales rose by 20.0% (y/y) in June. Meanwhile, industrial output rose by 5% and the 3mma measure was positive for the first time since December 2008, with the government sector leading the way.
- Exports remained weak in June, falling by 26.1% (y/y) unchanged from May. The pace of import contraction declined by 10ppts to 23.2% over the same period. As a result, the monthly trade deficit narrowed to less than $1bn
- Inflation fell to a fresh five-year low of 3.9% (y/y) in June led by declining food prices. However, monthly inflation was 0.6%, the third consecutive increase, suggesting that price momentum may no longer be trending downward.
- FDI disbursements dropped 18% (y/y) to $4bn during H1, with the bulk of flows going to the accommodation and hotel services sectors. The government expects FDI inflows of just $20bn this year against $60bn in 2008.
- Donors at a June 'Consultative Group' meeting for Vietnam expressed concerns over the budget deficit (which could reach 12% of GDP this year), credit growth, and the possible return of inflation.
- Like China, Vietnam's command-style economic structure is relatively well-suited for implementing a short term stimulus plan. The danger is a rise in non-performing loans in the banking system owing to artificially cheap credit. We retain our call for 4.5% GDP growth this year, with the risks now somewhat on the upside.

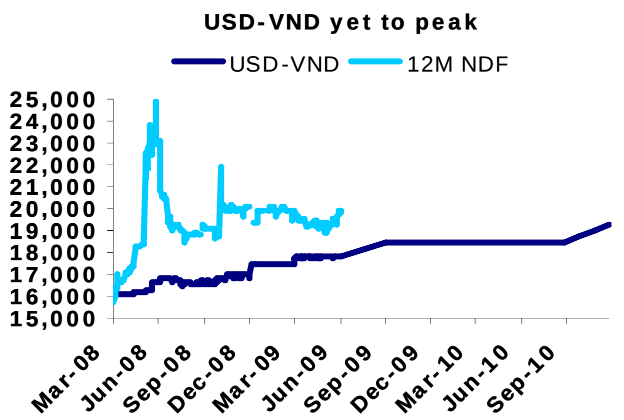
Paul Gruenwald

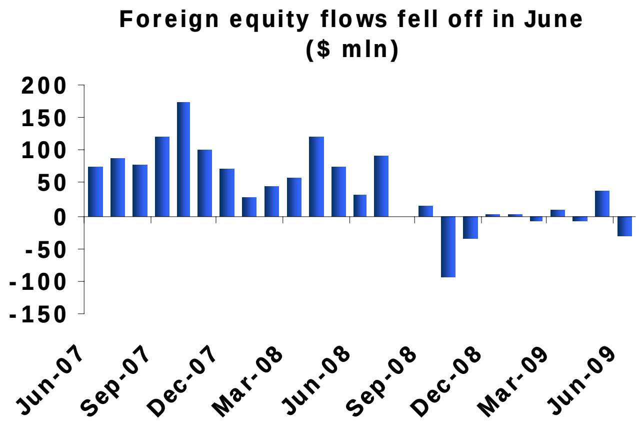
Economic Data – Vietnam

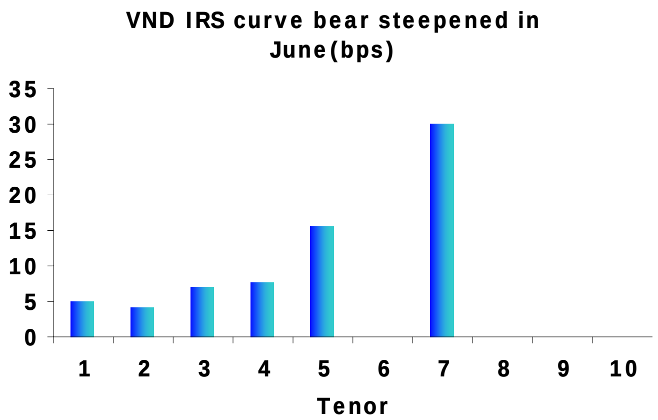
Monthly data	**Nov 08**	**Dec 08**	**Jan 09**	**Feb 09**	**Mar 09**	**Apr 09**	**May 09**	**Jun 09**
Industrial Production, % y/y	-0.3	0.5	-4.2	5.8	-12.2	1.6	3.6	4.8
Retail Sales ytd, % y/y	33.2	33.3	29.7	17.7	23.7	22.1	22.6	20.0
Consumer Price Index, % y/y	24.2	19.9	17.5	14.8	11.2	9.2	5.6	3.9
Exports ytd, % y/y	32.8	29.5	-24.3	5.4	7.4	1.1	-5.5	-10.1
Imports ytd, % y/y	37.6	32.7	-53.8	-43.8	-41.3	-39.3	-36.3	-33.7
Trade Balance, USD bn	-0.6	-1.0	0.4	0.9	0.3	-1.1	-1.5	-2.1
Quarterly data	**Jun 07**	**Sep 07**	**Dec 07**	**Mar 08**	**Jun 08**	**Sep 08**	**Dec 08**	**Mar 09**
Real GDP, % y/y	7.8	8.2	8.5	7.5	6.5	6.5	6.2	3.1
-Agricultural, forestry, fishery	2.8	3.1	3.7	3.2	3.3	3.8	3.8	0.6
-Industry and construction	9.7	10.1	10.6	8.0	7.0	7.0	6.3	1.4
-Services	8.5	8.6	8.7	8.3	7.6	7.2	7.2	5.6
Nominal GDP, VND tn	282.6	293.8	356.8	254.1	371.7	390.8	462.2	311.1
Foreign Exchange Reserves, USD bn	20.8	22.6	23.5	26.4	22.3	23.8	23.9	N/A

Sources: CEIC

Vietnam: FX and Rates Strategy







Although reluctant thus far, we expect the authorities to sanction further weakening in the dong in coming months. An expected bout of global risk aversion over the summer may present a prime opportunity.

FX

The large local banks agreed to cut interest rates on USD deposits and USD lending in an attempt to reduce onshore pressure on the dong. However, USD supply remains limited and FX fundamentals are looking more bearish for the VND. Inflation has dropped sharply on a year-on-year basis as a result of favourable base effects from lower food prices; however, monthly price momentum continues to build. At the same time, FDI flows have started to dry up, equity flows have been lacklustre, and Vietnam's trade deficit has widened sharply (and quickly)—all of which increases an already deep-seated preference of exporters to maintain bank deposits in USD.

Meanwhile, the March rally in risk trades has stalled and the typically risk averse summer holiday period is about to get into full swing. All in all, it would seem that forces are converging in favour of further weakening in the dong—possibly as soon as Q3. We expect a 4% devaluation to take place sometime before year-end.

Rates

The SBV announced that it will leave interest rates unchanged for the remainder of 2009, eliminating potential support for the bond market from hopes of further rate cuts. Meanwhile, Fitch downgraded Vietnam's long term local currency rating to BB- on concerns about the country's deteriorating fiscal position. Bond yields had already been under significant upward pressure, with the State Treasury largely unsuccessful with its attempts to auction dong-denominated government debt. Bidders have been scarce and the bids offered have demanded higher yields than what the government is willing to offer. Unless the government trims its spending plans, the SBV will be forced to offer even higher yields to investors—especially if there is decent risk of further VND depreciation.

Tamara Henderson

Market Forecasts – Vietnam (eop)

FX	Current	Ytd (%)	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10
USD-VND	17,852	2.1%	18,500	18,500	18,500	18,500	18,500	19,300
AUD-VND	14,249	16.0%	14,100	13,500	13,700	14,100	14,400	15,400
NZD-VND	11,397	12.5%	10,700	10,200	10,000	10,000	10,200	10,800
JPY-VND	185	-4.0%	176	185	176	171	168	172
EUR-VND	24,933	2.1%	23,300	23,100	23,300	23,300	23,700	24,700
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	5.44	-14	5.5	5.6	5.7	5.7	6.2	6.7
1year IRS (versus 3M VNIBOR)	8.58	-190	8.7	8.7	8.8	8.9	9.4	9.9
5-year IRS	9.08	-159	9.2	9.3	9.3	9.4	9.8	10.1
1-5s IRS spread (bps)	50	34	52	54	55	57	40	24

Sources: Bloomberg, ANZ

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