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ANZ

A repeat of 1994?

Despite recent market volatility, possible slow growth and low inflation suggest that it is not yet time for investors to abandon their fixed income assets.

The last few weeks have seen an increase in volatility within financial markets, in particular the bond markets. Notably, the US 10-year Treasury yield rose to 2.75%, its highest level in almost two years. Asian bond markets were not spared, with yields rising sharply across the region.

The primary catalyst for these moves was comments made by the US Federal Reserve Chairman Ben Bernanke. The Fed Chairman noted in late May that if the economy evolves as they expect then the Fed would start to 'taper' (that is reduce) the size of new asset purchases under their open ended QE programme later this year, with a view to ending new purchases by the middle of 2014.

The rise in bond yields has sharply renewed fears of a significant further rise in global interest rates, which would herald a period of negative returns for fixed interest assets similar to that seen in 1994. So is now the time for investors to be significantly reducing their allocations to this defensive asset class?

In short we believe the answer is no. Whilst from a long run perspective, current bond valuations remain expensive, we believe now is not the right time for investors to abandon bonds. Over the coming year, at least, we believe that the upside in bond yields is limited with the bulk of the adjustment towards an end to QE already factored in. This is premised on inflation remaining low globally and inflation expectations staying depressed.

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At the same time, rising rates would threaten the US recovery. With the US 30-year mortgage rate rising abruptly to a two year high in recent weeks, any further increase from here would not only undo all the Fed's hard work of the past few years, but would put at grave risk the recovery in house prices and activity so vital in helping to sustain the recovery. (See chart). This is not to mention China's slowing growth trajectory, which could put a dampener on the global economy.

US 30-yr mortgage rate (% p.a.)

Source: Thomson Reuters Datastream & ANZ Wealth. July 2013.

More fundamentally it is important to note that the Federal Reserve's announcement does not mean that they are planning to tighten policy anytime soon. To the contrary, the Federal Reserve continues to note that they do not see the first increase in interest rates occurring until the second half of 2015.

Given the likelihood that rates will be kept close to zero for some time, current yields (after the recent rise) appear close to their short term fair value levels in the US. At the same time, while Asian bond yields will continue to be heavily influenced by developments in the US, selected sectors within Asia offer relatively attractive yields and still-strong fundamentals.

That said, we do not see a reason to be overweight the bond asset class either. With the major downside tail risks to global growth significantly reduced, a return to the ultralow bond yields seen in many safe haven countries in 2011 is unlikely. Moreover, financial markets will likely increasingly fret about the implications of an end to the Fed's QE purchases as the end of 2013 approaches. For the emerging markets, the potential withdrawal of excess liquidity both in the US and China will potentially also weigh further on fixed income markets in the short term.

Investment Summary

We continue to favour a slightly overweight exposure to equity markets, with this weighting increased slightly from last month. While the strongest gains in equities are behind us and the higher yielding parts of the market look vulnerable, our expectations for a moderate acceleration in global economic growth, continued stimulus by central banks (with interest rate rises still some years away) and improving sentiment should help equities post positive returns.

The United States remains our preferred market as the US economy continues to slowly return to health. At the same time, we have turned slightly more optimistic on Europe given its relatively cheap valuations versus other developed markets and the increasingly global exposure of European company earnings.

We remain neutral on fixed income. Bond yields are set to rise over the longer-term, though in the medium-term we consider them to be around fair value levels given the recent rise in yields. We prefer investment grade global credits to sovereigns, but AUD holders can consider Australian sovereigns given relatively high real yields and the continued prospect for lower official rates.

As for currencies, a combination of diminishing tail risks and low inflationary pressures is prompting a reallocation back to the US market. US monetary policy is also expected to be tighter than the other G4 economies. Both these factors point to a continuing outperformance of the USD.

Finally, the current negative sentiment towards commodities is likely to continue in the coming quarter. While a number of commodities appear "oversold", ongoing low inflation expectations, a strong USD, and softer Chinese demand should keep commodity markets capped.

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Equities

Europe and the US are now favoured markets on the back of improving economic momentum and reasonable valuations. These markets are also likely to benefit from the ongoing capital shift towards the developed markets.

US - We continue to favour the US market, although we have pared back our optimism marginally. As we approach the upcoming earnings reporting season, we are concerned that market expectations may have run ahead of themselves. A strong USD plus weaker emerging market economies may dampen the revenues of large US exporters. On the other hand, we continue to like smaller capitalisation companies that have a domestic focus.

Additionally, given the market's outperformance to date, valuations are closer to "fair" value. At the point of writing, the S&P500 is up 14% year to date, outperforming the MSCI Emerging Market by 24%.

Barring a temporary slowdown in economic activity on the back of sequester-related spending cuts, we continue to believe that a broadening of US growth drivers is setting the scene for a sustained recovery. Notably, easing political uncertainty augurs well for increased business capital spending, while a housing recovery could boost confidence of the small and medium sized businesses.

Europe - We have turned more positive towards European equities. On the macro front, June eurozone PMIs were further evidence of a bottoming in Peripheral Europe's manufacturing sector. While Germany's PMI dipped to 48.6, Spain's manufacturing index improved to a two-year high of 50, alongside Italy's improved reading of 49.1. In addition, for the vast majority of the euro area economies, the planned spending cuts over the next three years are likely to be much lower than that seen over the past three years. Together, these factors should lend some support to the economy and corporate earnings. Our economists see the eurozone emerging from recession in 2H13, although the recovery is expected to be relatively shallow.

Italian Manufacturing PMI (Purchasing Managers' Index) improves

Source: Bloomberg. ANZ Wealth. July 2013.

Meanwhile, having underperformed major markets since the euro crisis erupted in 2010, valuations of European equities remain attractive relative to their peers, as well as against their historical valuation levels. We also expect European assets to benefit from the reallocation of investor flows from the emerging markets to the developed markets. The ECB's strong forward guidance that monetary policy will remain accommodative for some time is expected to be market friendly.

However, investors will require a longer time horizon as political uncertainty is likely to remain an enduring feature of European markets. While such episodes may heighten market volatility in specific markets, in our view, the measures put in place by the ECB and EU over the last 12 to18 months are likely to be sufficient to quell any contagion within the region.

Japan - We have pared back our underweight position in Japanese equities and now espouse a neutral outlook on the market. Japan's economic data has surprised on the upside, as the weak yen has boosted industrial production. Prime Minister Abe's aggressive monetary policy also appears to have lifted consumer and business sentiment. May's industrial production rose 2% mom, up from 0.9% mom in the previous month. Likewise, retail sales gained 1.5% mom. Meanwhile, surveys show that, for the second quarter running, Japanese consumers expect inflation to reach 3% within the next 12 months.

While the sizeable lift in consumer and business sentiment suggests that Japan's economy can maintain reasonable momentum in the short term, we think it is still too early to turn aggressive on Japanese equities. The ability to lift growth over the long term will depend on the reform effort, which Abe will need to flesh out after he wins the upper house election, as widely expected.

Tighter liquidity conditions, currency weakness and China's deteriorating growth outlook are headwinds for the emerging markets. That said, cheap valuations and investors' already bearish sentiment towards the region lead us to maintain our neutral stance on the market.

China – Although valuations (2013F PER of 8x) look cheap, the outlook for growth and corporate profits is highly uncertain. We believe that the downside risks to China's growth are rising amid tightening liquidity conditions. A higher cost of funding, and a more cautious lending environment could cause corporate cash flows to deteriorate further, leading to potential defaults and bank failures. A collection of better-than-expected macro data is needed before investor sentiment in China can be expected to turn around.

India – We had expected the Indian market to outperform its peers, a corollary of the country's easing cycle designed to boost much-needed growth. However, the 10% plunge in the rupee in June stamped out almost all hope of rate cuts in the near term. Unlike its regional peers, India does not rely enough on manufacturing exports to benefit significantly from a weakened currency. Instead, currency depreciation inflicts the pain of higher inflation and greater fiscal slippage via higher food and energy subsidies.

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India's high reliance on foreign capital further exposes its vulnerability to the current capital outflow trend. While India's current account deficit problems are not new, long term capital is unlikely to be attracted to the country amid the depressed economic backdrop and in the absence of significant structural reforms.

While valuations are currently trading below their historical averages, it would require a redress of India's structural issues for the market to re-rate. Finally, politics continue to be a source of added volatility with India heading into elections in April 2014.

Korea – The 2Q earnings season is likely to be a mixed affair, with the technology, telecoms and transportation sectors showing better earnings momentum relative to the banks, autos and industrials. In the near term, the domestic focused companies are likely to fare better than the exporters, as the supplementary budget, housing deregulatory measures and the rate cut in May help to revive domestic demand in 2H13. The exporters, on the other hand, continue to be held hostage to still-subdued global growth dynamics and yen weakness. That said, valuations are inexpensive, and year to date, Korea has suffered the largest net foreign selling in Asia. The market is likely to trade sideways until global growth momentum strengthens. However, longer term investors may want to find opportunities to start gaining some exposure.

Taiwan – We remain slightly positive on the Taiwan market on the back of improving tech demand. Electronics exports rose 10.9% yoy in June, in particular to China. Going forward, the pick up in manufacturing activity could be positive for the Taiwanese electronics supply chain so long as the downside risks to China's growth in 2H13 is contained. Unlike its regional peers, credit growth has been relatively contained post QE3, affording the country better protection in the event of tighter liquidity conditions. The relative resilience of the TWD versus other Asian currencies is another plus for the market.

Singapore – The central bank tightened property markets again, demanding tighter screening policies for mortgage financing loans. Going forward, we see residential property prices weakening on the back of excess supply and demand moderation, which does not bode well for property developers. As for the banks, we expect earnings to disappoint in the second half of the year. To date, net interest margins have been boosted by capital market activities and wealth management product sales. These factors are likely to be less supportive going forward in the face of elevated market volatility, but this could be offset by cheap valuations and attractive dividends. Finally, the sentiment for the REITs is likely to be weighed down by rising bond yields.

ASEAN – Cheap liquidity is being reined in with negative implications for the region's credit-fueled consumption. Bank Negara Malaysia's latest salvo is a set of measures aimed at curbing excessive household debt and reinforcing responsible credit and lending practices. Elsewhere in the region, central banks are likely to keep rates on hold in the face of currency weakness and foreign capital outflows. In fact, Indonesia, with its twin deficit and policy induced inflation pressures, is likely to have to keep monetary policy tight. Meanwhile, the macro picture appears mixed with the recoveries in Japan and the US welcomed for their potentially positive impact on the region's manufacturing supply chains but it is still early days. We would like to see upward earnings revisions and better macro newsflow before turning more positive. Therefore, although valuations are looking less stretched following last month's market correction, we would still advocate patience. The re-allocation of capital flows from emerging markets to developed markets may have further to run.

Within ASEAN, the Malaysian market could prove the most resilient, now that the overhang of political uncertainty has been lifted following the general elections. Meanwhile, the market continues to enjoy captive inflows from the country's EPF Pension Fund, which could help to offset foreign investor outflows. On the macro front, an expected strong pipeline of Economic Transformation Programs (ETPs) is set to revitalise private investments.

Brazil – Business confidence has fallen while manufacturing PMI continued to grind lower for the fifth consecutive month. Meanwhile, June's inflation is already hovering at the upper bound (6.7%) of the Central bank's target, while the weak real could send prices higher. More rate hikes can therefore be expected.

Meanwhile, job creation is likely to slow due to the lagged impact of prior quarters' slow growth, which could impact consumption. An environment of slowing growth, weak commodity prices and rising interest rates does not offer an encouraging backdrop for earnings. As such, we remain cautious on the market even though valuations are not stretched.

Russia – Valuations (2013 PER of 4.2x) look compelling but Russia's growth outlook needs to improve to trigger a re-rating of the market. A lift in Russia's industrial production, and more importantly, an improvement in investment growth in 2H13 ahead of the Winter Olympics in February 2014, will help give us greater confidence in the market. On a separate note, the government's tougher stance on requiring state-owned companies to pay out more dividends could boost the attractiveness of Russian companies, if implemented successfully. Higher dividends from state-owned companies, coupled with the sale of state assets could boost the government's revenues and help stabilise the fiscal deficit, as well as the rouble.

Market	6-12 month view
China	Neutral
Hong Kong	Neutral
India	Neutral
Indonesia	Neutral
Korea	Neutral
Singapore	Neutral
Taiwan	Slightly positive
Asean	Neutral

Source: ANZ. July 2013.

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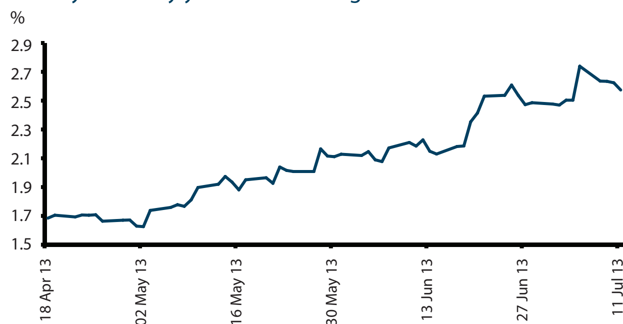
Fixed Income

We continue to favour developed market investment grade corporate bonds, based on the expectation that narrowing credit spreads will help offset the gradual rise in bond yields.

A global bond rout continued in June as Fed Chairman Bernanke laid out a conditional timetable for QE tapering, ending by mid 2014, assuming the US labour market continues to show further improvement (See chart). While yields may well drift lower in the months ahead amid possibly disappointing US economic data, the US 10-year Treasury yield is unlikely to fall back below 2% unless a major economic disappointment ensues.

Over the medium term, yields are expected to trend higher, although there is uncertainty over the timing of such moves. As such, we expect the fixed income market to remain volatile going into 3Q13, driven by market speculation over the pace of Fed tapering.

US 10-yr Treasury yield rises to a high of 2.75%



Source: Bloomberg. ANZ Wealth. July 2013.

Against this backdrop, we continue to favour developed market investment grade corporate bonds within fixed income as they are likely to benefit from the ongoing reallocation of capital from the emerging markets back to the developed markets. At the same time, a gradually improving economic backdrop is likely to compress credit spreads, and help offset the rise in bond yields.

Nevertheless, we prefer to keep duration short, around three to seven years. Rather than extending duration, investors looking for additional yield pick up can consider moving down the credit curve towards lower-rated issues within the investment grade space.

Over in the US, financial bonds offer some appeal over the short to medium term. For the rest of the year, the credit fundamentals of the US financials should continue to benefit from a benign environment. The expectation of a rise in borrowing rates is also positive for financial sector earnings. There is therefore room for spreads to tighten within US financials over the next few months, although the extent of spread compression is likely to be less than in 2012. Our preference is for the large US lending banks rather than investment banks.

Investors who are able to tolerate higher volatility may want to start gaining some exposure to European investment grade credits. With spreads still significantly above their pre-2008 levels, and the potential of increased investor inflow, there is room for moderate compression during the year. While we are also seeing signs of stabilisation in the eurozone economy, our more sanguine view on European credits does not extend as yet to European financials. In our view, the current spreads offered by the European financials do not sufficiently compensate investors for the bail-in risk associated with the sector.

Over in Australia, while the weak AUD is doing much of the heavy lifting for the slowing economy, it may be premature to call the end of the easing cycle. Unemployment is heading higher while mining sector earnings have continued to deteriorate despite cost cutting measures. Meanwhile, activity in the non-mining sectors of the economy remains sluggish. Nevertheless, for AUD holders who are willing to bear the currency risk, Australian bonds look more attractive than cash, with valuations particularly at the shorter end of the Australian yield curve looking more reasonable after the recent correction.

Finally for Asia, the reallocation of capital away from the emerging markets is likely to be negative for Asian fixed income. While we expect some of the capital flows to return, investors are likely to be more discerning going forward. Within Asian fixed income, we find Asian Financials attractive in the short term given their attractive yields and relatively shorter duration. Singapore banks in particular have strong fundamentals and offer a good risk reward trade off, in our view.

On the other hand, the tighter credit conditions in China pose potential headwinds for small and mid-sized banks in China and Hong Kong. In fact, a greater than expected slowdown in China's growth could be destabilising for the region, and weigh on investor sentiment, especially for Asian high yields.

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Commodities

The current negative sentiment towards commodities is likely to continue in the coming quarter. While a number of commodities appear "oversold", ongoing low inflation expectations, a strong USD, and softer Chinese demand should keep commodity markets capped.

The price of gold broke through the USD1,200/oz level and traded as low as USD1,180/oz in June, before bouncing slightly in recent weeks, although it remains 26% lower than the start of the year. Silver was not spared; down 12% for the month, while declines were also seen in platinum (-8%) and palladium (-10%).

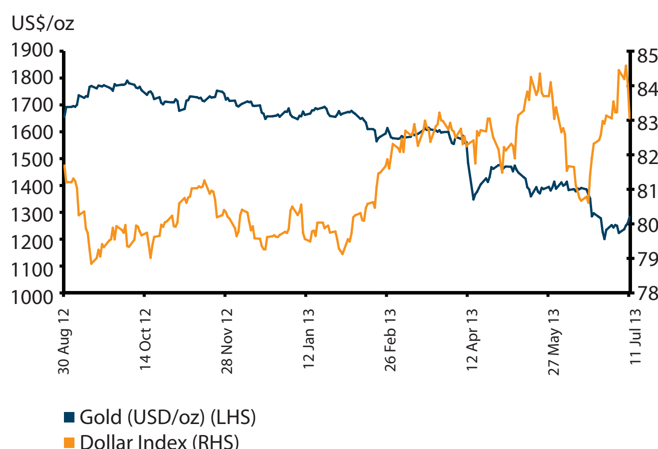
Going forward, we think investor sentiment towards the precious metals will remain negative. The ongoing capital flows into developed markets is boosting the USD and US bond yields, both of which reduce the investment appeal of precious metals.

Interestingly, physical gold demand in China remains strong and imports for the first 5 months of 2013 are almost double from a year-ago levels. However, India should continue to see weak import volumes amid higher import duties and restrictions on gold consignments. Indian gold imports reportedly fell to 31.5mt in June from 162mt in May. However, while we expect this to persist for some months, we should see a pick up in volumes as we approach the wedding season starting in November.

Gold and silver are highly vulnerable to short-covering, though we expect the style of these moves to be short, sharp and unsustained as the near-term fundamental picture remains negative. Technically, the market is still trying to establish a base. We are biased lower in the near-term and are targeting prices sub-USD1,150/oz, but look for a recovery in coming quarters. We expect gold to recover mildly from these levels towards the end of the year and stabilise around USD1,300/oz. However, selling by gold-backed exchange traded funds (ETFs) needs to subside before the market can stage any real recovery.

Meanwhile, the platinum and palladium markets are supported by supply issues in South Africa, as workers undertook industrial action related to pay disputes. Immediate concerns may have been alleviated as Amplats announced the return of workers, though wage negotiations are set to continue over the next few weeks and could be a source of near-term volatility.

A strong USD weighs on gold



Source: Bloomberg. ANZ Wealth. July 2013.

Rising geopolitical risk in the Middle East is supportive of energy prices relative to other commodities. Meanwhile, divergent demand trends in the US versus China are likely to boost WTI prices over the Brent benchmark.

An improving US economy/manufacturing sector is likely to buoy US oil consumption and hence WTI prices. The return of the Tulsa East refinery, coupled with the start or ramp up of several new pipelines suggest that crude oil inventories at Cushing could start being drawn upon in the coming months.

On the other hand, demand for Brent could disappoint given China's uncertain growth outlook. Risks to China's growth would be to the downside if tight market liquidity conditions persist. At the same time, North Sea supplies are expected to return to normal levels following a maintenance period, thereby boosting Brent supplies. Saudi Arabia is also likely to continue to raise production to maintain market share.

Base metal prices are likely to remain volatile going forward as the market focuses on China's demand. Although encouraging Chinese data could trigger relief rallies or speculative short covering, any upside is likely to be short-lived, given China's lacklustre growth picture.

The bellwether copper market stumbled in June, with copper prices down 8% for the month. Supply side disruptions have been growing in the last two months, but the impact on prices should be short-lived. A two or three-month production outage at Indonesia's Grasberg copper mine has garnered significant attention although recent reports suggest that the open-pit mine is now running at full capacity. Meanwhile, the company is continuing to negotiate with the Indonesian government on possible increases in royalties and other regulations.

These issues aside, the copper market is likely to end the year with excess supply, with the long-awaited start up of production and exports from Rio Tinto's Oyu Tolgoi mine in Mongolia expected to create a fresh headwind to prices.

Bulk markets should remain under pressure in the coming quarter due to slower seasonal demand.

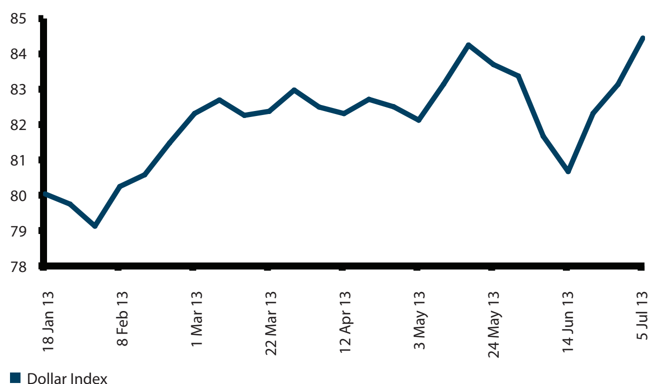
While iron ore has further downside risk if Chinese steel producers pull back output, government support for 70% of total Chinese steel capacity will make it harder to expect this outcome in the short-term. Reports of rising seaborne supply, particularly from Australia, has and will continue to weigh on prices. On the other hand, the restocking of tight Chinese port and steel mill yard inventories is expected to offset the higher output, although this could be a fourth quarter phenomenon when seasonal demand improves.

Currencies

A combination of diminishing tail risks and low inflationary pressures is prompting a reallocation back to the US market. US monetary policy is also expected to be tighter than the other G3 economies. Both these factors point to a continuing outperformance of the USD.

USD –Investors had previously gravitated towards commodity and emerging market currencies on fears of elevated tail risks and heightened inflation in the developed markets. The abatement of such fears is encouraging a re-allocation back to the core markets. Until Chinese growth expectations stabilise, we believe that the USD will continue to be one of the key beneficiaries of this reversing trend.

USD to continue outperforming



Source: Bloomberg. ANZ Wealth. July 2013.

GBP – Over the short term, currency markets are likely to be heavily influenced by Central bank statements and so–called "forward guidance". For example, the new BOE Governor Mark Carney has stated his preference for loose monetary conditions to continue for some time. He further deemed market expectations of a rate hike by 2015 to be unwarranted, citing local fundamentals. Such a stance is likely to keep the GBP weak in the coming months.

We are also negative on the sterling over the longer term. In particular, the EU referendum in 2017 poses major uncertainty to the UK's economic future with more than half of those recently surveyed apparently against staying in the EU. In fact, London is becoming increasingly marginalised as a result of the government's hesitant stance towards Europe. Notably, the oversight of the LIBOR benchmark has been moved to New York following the LIBOR scandal, a potential blow to London's global prestige.

We would also question the sustainability of what appears to be green shoots emerging in the UK economy. Notably, the main contributor to the first quarter's GDP growth was an increase in inventories and although employment is growing, real wage growth is negative. Lending contracted in 1Q13 and the UK is running a structural current account deficit. That said, a more pro-active policy leadership from the new BoE governor, Mark Carney, could support confidence in an eventual revival of economic activity but that remains to be seen. For now, we maintain our bearish outlook on the pound.

EUR –The ECB has similarly signalled its reluctance to raise interest rates at the current stage of the European business cycle. This "forward guidance" is presumably aimed at distancing the ECB's policy settings from the anticipated tightening and "tapering" in the US. In fact, ECB President Mario Draghi has introduced a neutral to downward bias for interest rates and extended the horizon over which rates can be expected to stay unconventionally low.

With the market taking this new communication from the ECB as a green light to sell the EUR, a period of further correction on some key EUR crosses cannot be ruled out. In particular, we see the EUR reversing some of its recent outperformance against the NZD.

Nevertheless, in the longer term, the progress towards deepening economic union within the euro zone, the emergence of a more broad-based economic recovery and the move to a balance of payments surplus is euro positive.

JPY – Recent expectations of Fed tapering has driven up US bond yields. While higher US bond yields have historically led to JPY weakening, the USDJPY's rally on the hopes of a Japanese economic revival has been stronger than the JPY's relationship with US bond yields would suggest. We continue to forecast further weakness in the yen, but expect the pace of the currency's decline to moderate going forward.

AUD – Shifts in the outlook for US monetary policy have caused leveraged and low conviction investors to unwind their AUD exposures. As a result, capital has flowed out of the Australian markets and the exchange rate depreciation has been the quickest in recent memory. Our fair value estimate for the AUD is around 0.90. This, however, does not rule out a dip below these levels, especially in the event of a shock.

Looking ahead into 2014 and beyond, we anticipate further depreciation of the currency, partly due to our measure of the exchange rate's purchasing power parity. At the same time, the medium term fundamentals for Australia, namely a slowing China and softer commodity prices, are looking less attractive.

NZD – We would be sellers of NZD in a rally. While the New Zealand economy is expanding, global forces hold sway. The reversal of diversification flows, spectre of QE tapering and re-rating of the US economy is likely to continue to remove the "premium" from the NZ dollar's valuation. That said, the recent price action suggests a period of consolidation, as a strong USD view is rapidly becoming very consensus.

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Meanwhile, we expect the NZD to outperform the AUD through to the end of 2014. The rotation of China's growth from investment to consumption-led will see demand for hard commodities such as iron ore and coal decline, while the demand for soft commodities such as milk and proteins is set to increase. These relative changes favour New Zealand's basket of exports relative to Australia's exports.

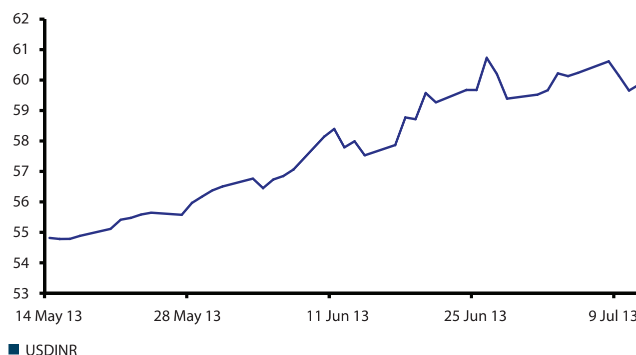
At the same time, the NZ economy appears on track for 3% growth in the coming 12 months, triggering market speculation of rate hikes and potentially putting a floor on the NZD. In contrast, more rate cuts are on the cards for the AUD as the Australian economy deteriorates.

The capital outflow from Asia may have yet to fully run its course. We need the market to overcome its fear of Fed tapering and slower Chinese growth before turning more constructive on Asia currencies. In the near term, the TWD and MYR are expected to be relatively more resilient.

CNY – We expect slight CNY weakness in the next 12 months, against our earlier expectations of modest appreciation. Data has disappointed in the real economy and our Chinese leading indicators are grinding lower. Speculative inflows underpinned the CNY earlier in the year, but capital outflows are exacerbated by the government's crackdown on over-invoicing of exports and have contributed to tight onshore liquidity. We caution that a prolonged period of liquidity tightness could have a negative impact on the real economy. Meanwhile, the strong currency has weighed on China's exports. Amid slowing growth and tepid inflation, we see room for the CNY to ease modestly from its current levels.

INR – USDINR broke above the 60 mark in June and in response to the currency's sharp decline, the Indian authorities have tightened derivative trading rules and cut position limits of banks in order to stabilise the currency. At the same time, the RBI is continuing its discussion with the oil companies to curtail the impact of oil-related USD demand. These measures could provide a reprieve, albeit temporary, to the INR. Going forward, we continue to see the INR under severe pressure, as the US Fed QE tapering could continue to trigger capital outflows from India. The government's recent move to enact the Food Security Bill and provide USD21bn a year of cheap food to the country's poor, ahead of a general election in 2014, could worsen the country's fiscal deficit. This may put India's credit rating at risk, which could weigh on the asset markets and currencies.

Indian rupee to remain under severe pressure



Source: Bloomberg. ANZ Wealth. July 2013.

IDR – Within Emerging Asia, Indonesia appears highly vulnerable to foreign capital outflows, in our view. Despite recent rupiah weakness, its real effective exchange rate still appears overvalued relative to its long term average. Indonesia's large private external debt load is particularly worrying as its FX reserves do not fully cover its external debt obligations. In addition, with foreigners holding on to more than one third of Indonesian government bonds, foreign outflows from its bond market could prove disruptive. Finally, strong credit growth and high loan to deposit ratios point to possible pressure on asset prices in a tighter liquidity environment.

SGD –At the point of writing, the USDSGD has hit a 3-week low of 1.2580 following Ben Bernanke's comments that the Fed would maintain a highly accommodative policy stance. A better than expected Singapore 2QGDP reading further boosted the SGD. However, we do not expect this move to be sustainable and see the SGD underperforming the USD for the rest of the year. This is premised on our expectations that Fed QE tapering would begin in September. At the same time, we do not expect Singapore's GDP growth in the second half of the year to be as strong. 2Q growth was boosted by volatile sectors and external demand has yet to show signs of a rebound.

TWD – We believe Taiwan to be the least vulnerable to foreign capital outflows within emerging Asia. The country has a strong current account surplus and balance of payments position, as well as an undervalued exchange rate. At 85% of GDP, Taiwan's ample FX reserves also have the potential to enhance the currency's resilience.

Returns

Country Equity Markets	YTD	1-Yr	3-Yr
ASX 200	3.3%	18.7%	9.5%
FTSE 100	5.4%	13.2%	22.6%
Hang Seng	-8.2%	9.3%	0.4%
India Sensex	-0.2%	14.2%	9.1%
Jakarta Comp	11.6%	24.0%	63.0%
Korea KOSPI	-6.7%	2.4%	7.6%
Malaysia KLCI	5.0%	11.2%	33.8%
Nikkei 225	31.6%	54.1%	41.1%
S&P 500	12.6%	20.9%	49.5%
Shanghai-A	-12.8%	-9.9%	-21.9%
Singapore ST	-0.5%	10.7%	9.8%
Taiwan Weighted	4.7%	12.4%	7.5%

Regional Equity Markets	YTD	1-Yr	3-Yr
MSCI World	4.7%	17.5%	27.6%
MSCI Europe	0.0%	20.8%	18.1%
MSCI BRIC	-14.4%	0.7%	-18.5%
MSCI Emerging Market	-10.9%	3.7%	-1.2%
MSC AP ex Japan	-7.3%	9.1%	9.6%

Fixed Income	Yield	1-mth chg	YTD chg
Aust Govt (10Y)	3.76	40	49
Bunds (10Y)	1.73	22	41
Gilts (10Y)	2.44	44	62
JGB (10Y)	0.85	0	6
NZ Govt (10Y)	4.13	55	62
SG Govt (10Y)	2.35	54	105
US Trsy (2Y)	0.36	6	11
US Trsy (10Y)	2.49	36	73

Currencies	Level	1-mth chg	YTD chg
USD-JPY	99.14	1.3%	-14.3%
EUR-USD	1.30	0.1%	-1.4%
AUD-USD	0.91	-4.5%	-12.1%
USD-SGD	1.27	-0.3%	-3.8%
NZD-USD	0.77	-2.6%	-6.6%
GBP-USD	1.52	0.1%	-6.4%
USD-CAD	1.05	-1.4%	-6.0%
USD-TWD	29.98	-0.1%	-3.3%
USD-IDR	10004.00	-1.3%	-2.2%
USD-INR	59.39	-5.1%	-8.0%
USD-KRW	1142.06	-1.1%	-7.3%

Source: Bloomberg. As of 28 June 2013. .

Commodities	Level	1-mth chg	YTD chg
Aluminium	1773	-7.0%	-14.5%
Copper	6750	-7.6%	-14.9%
Gold	1224	-12.1%	-27.0%
Lead	2051	-6.8%	-12.0%
Nickel	13710	-7.5%	-19.6%
WTI Oil	97	5.0%	5.2%
Zinc	1853	-3.8%	-10.9%

Forecasts

Base Metals (US$/lb)	Sep-13	Dec-13	Mar-14
Aluminium	0.82	0.85	0.88
Copper	3.25	3.40	3.60
Nickel	6.60	6.90	7.40
Zinc	0.85	0.88	0.92
Lead	0.95	0.97	1.00
Tin	10.10	10.10	10.20

Precious Metals (US$/oz)	Sep-13	Dec-13	Mar-14
Gold	1150	1300	1330
Platinum	1390	1450	1490
Palladium	690	735	770
Silver	18.5	21.6	22.3

Energy (US$/bbl)	Sep-13	Dec-13	Mar-14
WTI Nymex	100	105	107

Currencies	Sep-13	Dec-13	Mar-14
USD-JPY	105	105	105
EUR-USD	1.34	1.37	1.4
GBP-USD	1.56	1.53	1.50
AUD-USD	0.93	0.92	0.91
NZD-USD	0.80	0.79	0.78
USD-SGD	1.28	1.29	1.3
USD-TWD	30.2	30.3	30.4
USD-IDR	10200	10350	10500
USD-INR	59	59.5	60

Cross Rates	Sep-13	Dec-13	Mar-14
AUDNZD	1.16	1.16	1.17
AUDSGD	1.19	1.19	1.18
NZDSGD	1.02	1.02	1.01
EURSGD	1.72	1.77	1.82
SGDJPY	82.03	81.40	80.77
GBPSGD	2.00	1.97	1.95
AUDIDR	9486	9522	9555
NZDIDR	8160	8177	8190
EURIDR	13668	14180	14700
JPYIDR	97	99	100
GBPIDR	15912	15836	15750

Source: ANZ Economics & Markets Research. As of 30 July 2013. Forecasts are quarterly averages.

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