

Asian FX Strategist – KRW Focus

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Summary of Key Views

Asian Economics and FX Fundamentals: Exports have been the main engine of growth over the past five quarters for South Korea. However, an expected slowdown in external demand, particularly from China and the US - Korea's top two export markets - and more subdued electronics demand, means that the Korean won is likely to face some downward pressure against the US dollar in 2005.

Asian FX Technicals: AUDKRW appears set to break out to the topside, with the move through 820 likely confirming the start of a 2 week run towards 840 then 860 in the more medium term. Short term traders should stay long the cross, or enter on dips.

Asian FX Derivatives: Last publication we suggested buying outright KRW vol, particularly a spread trade going long KRW 1y vs short JPY 1y at 2 vols under. We reaffirm this recommendation this edition, with the market straddling the 2% level currently.

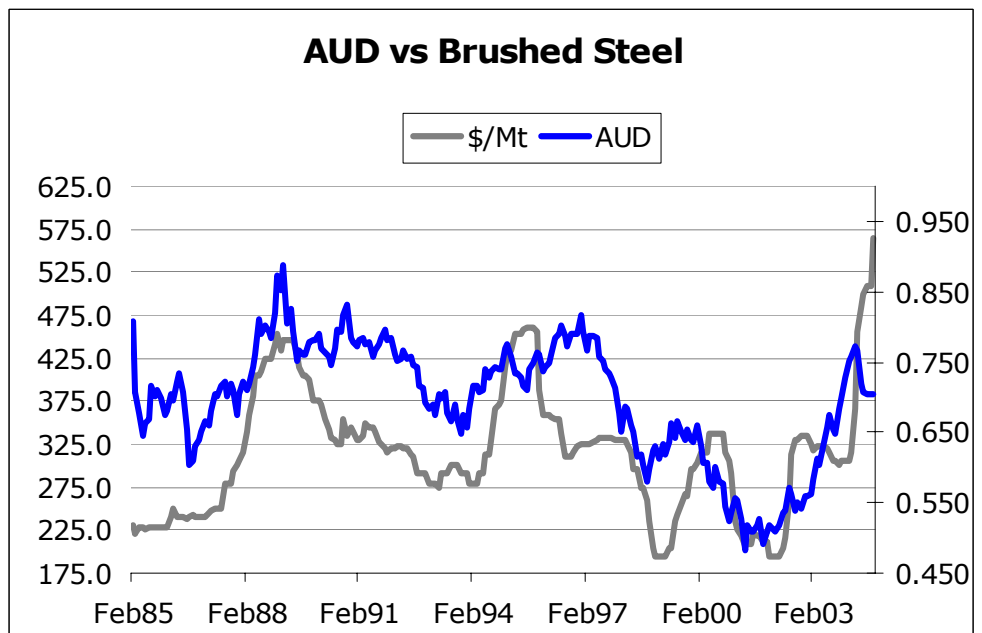
Regional Trading Desk Views: The JPY remains vulnerable to rising oil prices, with WTI testing Monday night's highs around \$49.96 a barrel in Asian trade. Exporters remain key \$JPY sellers around 112. AUDJPY issuance related demand evident from Japanese securities houses between 17/9 and 4/10, although 80 in AUDJPY should be tough to break. Indonesian markets remain positive following the recent peaceful election process, though the IDR and other Asian currencies are weakening with the JPY.

Strategies:

FX Spot- Retain AUDJPY long from 77, risk 74 target 85 (6 month trade duration). Long \$SGD positions from 1.7150 were stopped at 1.69. Buy AUDKRW at 821 (50%) and 815 (50% risking 805 targeting 840).

FX Volatility – No change. Buy KRW vol or put on a long KRW short JPY vol spread in order to capture a rise in the global risk premium. For hedgers we maintain our view to buy knock-ins and sell knock-outs.

Global steel prices – AUD\$, but also AUDKRW and AUDJPY, the beneficiaries



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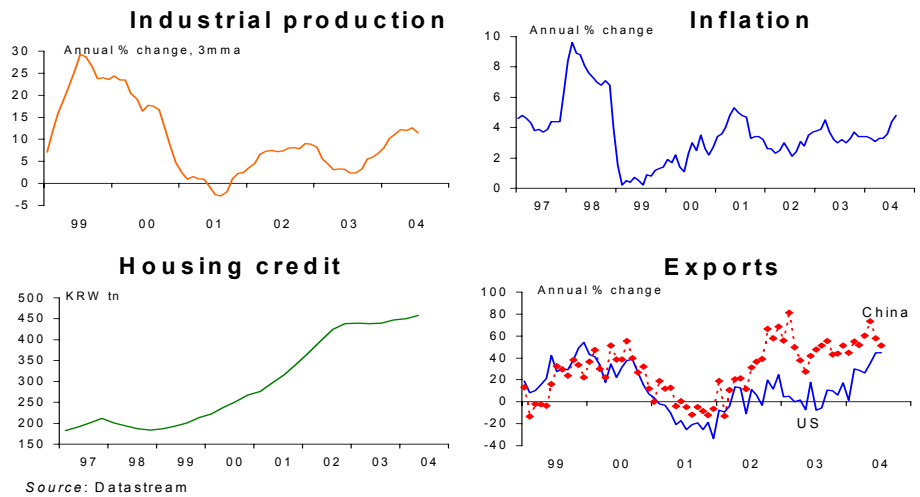
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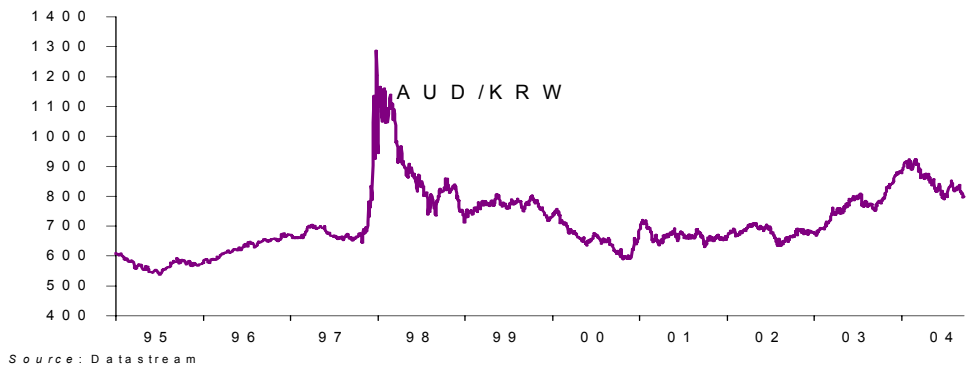
Asian Economics - "Economic challenges likely to place some pressures on KRW"

The South Korean economy grew by a slower-than-expected rate of 5.8% over the year to Q2 2004, dragged down by sluggish domestic demand and softer export growth. Exports have been the main engine of growth over the past five quarters. However, an expected slowdown in external demand, particularly from China and the US which are Korea's top two export markets, and more subdued electronics demand have raised the urgency to revive domestic demand. Accommodative fiscal and monetary policies have been adopted with the overnight call rate at a record low of 3.5% and the government introducing income tax cuts and abolishing some special consumption taxes. However, the rapid acceleration in household credit in recent years has left households with large debt service payments. In addition, annual inflation has edged up to 4.8% in August, the highest rate since July 2001 and unemployment was 3.6% in August compared with 3.3% in January.

South Korean exports closely compete with Japanese goods, particularly in industries such as automobiles, telecommunications equipment, petrochemicals and shipbuilding and competitive pressures are likely to stay strong. Coupled with sluggish domestic demand, the Korean won is likely to face some downward pressure against the US dollar in 2005.



The AUD climbed steadily against the Korean won in 2003, mainly reflecting strong AUD fundamentals. It has since eased but a firmer AUD/USD profile towards the end of 2004 into Q2 2005 should see some strengthening of the AUD/KRW before it retraces on the back of a much weaker AUD outlook late in 2005.

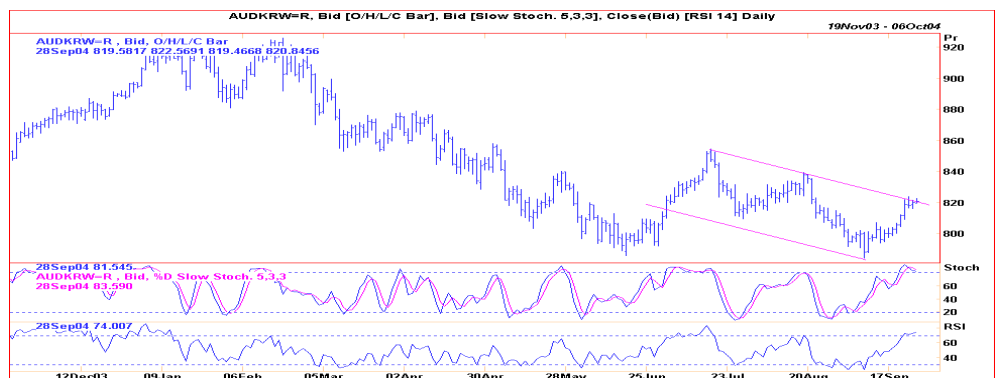


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Asian FX Technicals – “AUDKRW set to extend gains towards 840/860”

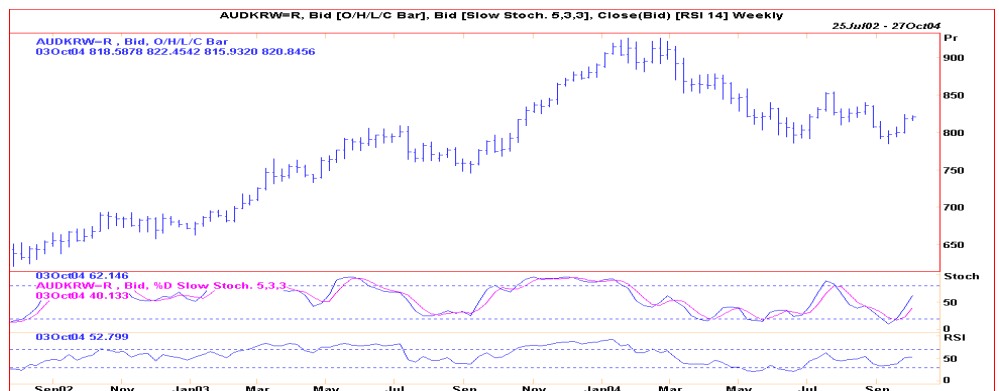
The strength in global base metals and energy prices continues to highlight one of our favourite trades of the next six months, namely long commodity currencies and short Asian currencies. We continue to suggest traders retain long AUDJPY positions initiated around 77.00, given that new highs in WTI oil prices appear inevitable, and there exists no evidence that the current upmove is set to stall. Yes it may pause temporarily for 1-2 week periods, but WTI oil prices once through \$50 have little resistance above them. Japan being an energy importer of note, and Australia a net energy exporter (gas and coal outweighing imports of Oil), the implications are pretty clear for the AUDJPY. However on page 1 we also outline what has happened to global steel prices in recent months – as the AUD\$ has declined from over .80 cents back towards .68 cents, Brushed and Hot Rolled Coil Steel prices have made substantial new highs, suggesting that Asian demand for commodities, in particular Chinese demand, shows few signs of pausing. Obviously AUDJPY is a major beneficiary here, but so is AUDKRW, given the sensitivity of the Korean manufacturing sector to rising commodity (especially iron ore) and hence steel prices. Clearly the AUD crosses have risen in the last few weeks on the back of strengthening base metals prices, however we feel they have a substantial catch up game to play still. As a result, we suggest traders buy AUDKRW at both 821 and 815, targeting above 840.

Daily AUDKRW - On the verge of a breakout



Note in the weekly chart below, the cross remains within an extremely wide 3 year uptrend that would only be breached on a move through 5800.

Weekly AUDIDR – Momentum oversold and bullish



Trade Strategy – Retain AUDJPY long from 77, risk 74 target 85 (6 month trade). Long position in \$SGD from 1.7150 stopped at 1.69. Now buy AUDKRW at 821 and 815 risking 805 target above 840.

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Asian FX Derivatives - "KRW Volatility Approaches Value"

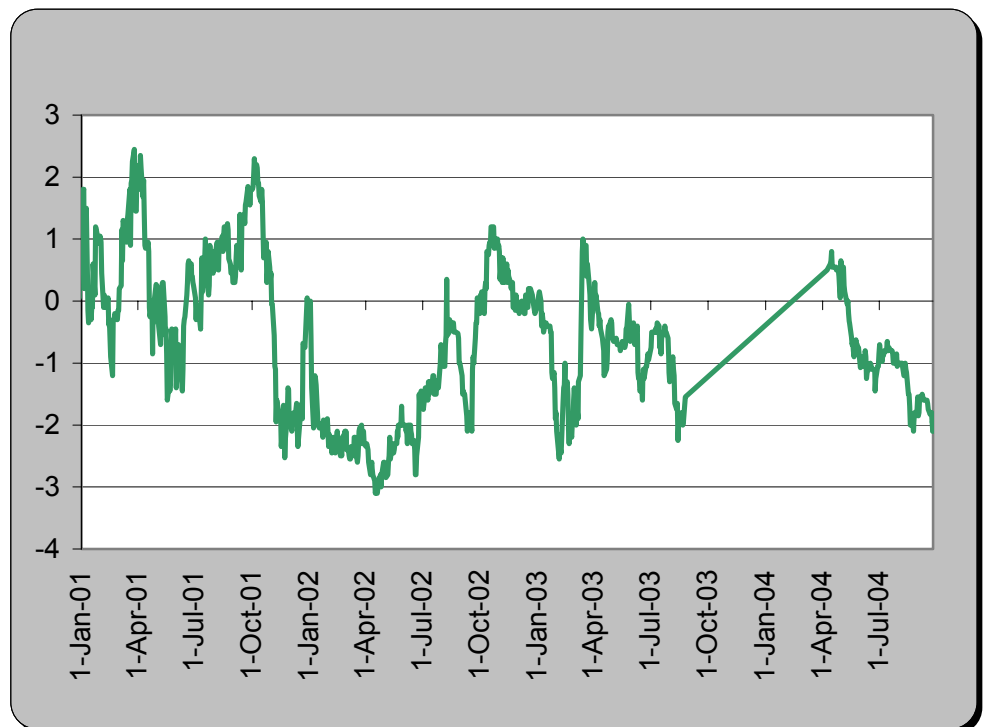
Fortnightly Roundup

A very quiet two weeks in the Asian derivatives market. JPY vols have lead the slide down towards 5 year lows and other regional markets remain anchored toward the lower quartile of their 5 year range. The CNY market again presented a more interesting proposition as the 1y NDF moved right with funds unwinding their short positions ahead of Friday's G7, and 1y CNY vols softened back to 5.3%.

Trading Opportunities

Last publication we suggested buying outright KRW vol, particularly a spread trade going long KRW 1y vs short JPY 1y at 2 vols under. We reaffirm this recommendation this edition, with the market straddling the 2% level currently.

JPY 1y vs KRW 1y – 2001-2004



Corporate Hedging Opportunities

No change. Corporates continue to be the main beneficiaries of the continued slide into the US elections. The market is building for a breakout, but it is difficult to justify significant risk taking leading into an election with two candidates both representing quite different policies on the economy. So for corporates optionality remains cheap relative to outright cover in particular strategies which knock-in cover or knock-out obligations if volatility increases.

OPTION STRATEGY – No change. Buy KRW vol or put on a long KRW short JPY vol spread in order to capture a rise in the global risk premium. For hedgers we maintain our view to buy knock-ins and sell knock-outs.

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Regional Currency News and Views

Japan

News – Prime Minister Koizumi will announce a reshuffling of his cabinet and the nomination of new ministers this week, targeting privatization of Japan Post, cutting public spending, a restructure of social security, and a further reduction of Non-Performing Loans by major Japanese banks especially UFJ. Building construction in centre of Tokyo and Osaka has now broadened into cities other than Tokyo and Osaka, with the government announcing last week that real estate prices in urban districts have started to rise after 13 years of decline with extension likely into residential areas.

FX markets – Higher oil prices and geopolitical risks from North Korea hostility towards Japan have seen \$JPY breach 111 early this week. Exporters target 112 to sell. A break of the 107-112 range unlikely unless next G7 meeting in provides a surprise on the Chinese peg. Otherwise selling JPY against high yielders will be favoured trading. Daiwa Securities conducting AUD Uridashi for American Investment Bank from 17/9 to 4th Oct, amount undisclosed. Profit takers expected around AUDJPY 80.

Data – Last week's data showed Retail Sales at large department stores in Aug –2.7% and Tertiary Industry Index last Friday at –0.8%, evidence of further cooling in the Japanese economy. The Nikkei press last week reported that the stock of Ito Yokado, one of largest super market shop, has fallen in recent weeks, suggesting consumer spending in Japan is not recovering as much as expected.

- **Other markets** – 10 years JGB future hit 138 four weeks high, with cash yields below 1.45% on back of weakening Nikkei and slowing economy due to fears of a higher oil price. Normalisation of BOJ monetary policy still unlikely until 2005-2006 fiscal year.

Hong Kong

News

Hong Kong LEGCO election finished peacefully on Sept 12. The Pro-Democracy parties only managed to get 25 seats out of the 60 seats even though they garnered 60% of vote - the DAB will be the largest party in the LEGCO. The political atmosphere between Beijing and Hong Kong is expected to become calmer now the election is out of the way. Hong Kong financial markets remained calm after Jiang Zemin's resignation as the Chairman of China's Central Military Commission at the annual Central Committee meeting. Only Mainland-related H shares rallies, as investors believe that President Hu Jintao will have a free hand to make better economic policy decisions. ADB raises 2004 Hong Kong GDP growth estimate to 7.5% from 6.0% forecast in April due to strong tourism. Hong Kong's major banks followed the FED on Sept 22 and increased base lending rates by 12.5 bp for the first time in four years, less than analysts expected.

Data - The Jun – Aug unemployment rate fell to 6.8%, the lowest level in the past 30 months. Aug CPI rises 0.8% y/y; lower than market consensus of +1.0% y/y.

FX - Spot USD/HKD is expected to remain in range of 7.7970/7.8000. The interest rate differentials between the USD and HKD in the long-date widened, as 1 year HKD forwards broke –500 support as speculators bet on CNY revaluation.

Taiwan

News- The Taiwan Stock Exchange will double the number of companies it normally audits to 10 percent to tighten monitoring after a string of accounting scandals spooked investors.

FX - USD/TWD continues its upward bias tracking gains in the USD against Asian currencies. Interbank players should keep the U.S. dollar around or above 34.00 and we don't see the central bank supporting the TWD for now.

Data - 05/10 CPI (P) 2.53%, 05/10 Foreign Reserves USD 231.6 bn

Other markets – The Taiwan key stock index jumped to end higher at 5970, but investors were cautious about chasing stocks higher with the psychologically critical 6000 point level

ahead. The over night interbank rate was higher from 1.040% to 1.095% as the central bank has been selling short-term paper aggressively in the past few weeks. Taiwan government bonds were largely down, with 10-year yields at 2.62% - though the Fed rate hike was in line with expectations, investors are cautious of more hikes this year and Taiwan's central bank following suit at its next policy meeting on Sep. 30.

Indonesia

News- Indonesian 's biggest telephone firm, PT Telekomunikasi Indonesia Tbk said on Thursday it planned to issue one trillion rupiah (\$109 million) of bonds by the end of year for debt refinancing. The 20 September direct presidential elections confirmed former security minister Susilo Bambang Yudhoyono the winner, although counting is ongoing and a final result is not due to be announced until October 5. Diplomats, pundits, and former colleagues are divided over the kind of leader the US-educated Yudhoyono would make, but most agree the majority of Indonesians want change after three years of aloof rule under President Megawati. Meanwhile, in her annual speech to the People's Consultative Assembly, Megawati apologized for the shortcomings of the three-year tenure, and urges Indonesians to accept the results of the country's first direct election of a leader. PT Astra International has mandated ABN AMRO Bank, BNP Paribas, Citigroup, HSBC, Standard Chartered Bank and Sumitomo Mitsui to arrange US\$ 186.4 million in revolving credit.

-FX The market opened at 9220-9250 on 13 Sep, after failing to sustain dollar buying after the bomb explosion the weeks before and the IDR closed the week around 9035. The market gapped down a low of 8935 on 21 Sep (a day after the election), but subsequently, profit taking and huge local corporate demand to pay USD debt took the USD/IDR back to as high as 9240 (23Sep), before settling down at 9130 last week. Expect a drift higher in accord with a stronger \$JPY.

Other markets – Debt – Bank Indonesia indicates that they would monitor the impact of the US interest rate hike on domestic rates. The market expects the 1mo-SBI rate to be around 7.5% (compared to 7.32% currently).

Stock market – The Jakarta shares opened higher on Tuesday (21Sep) on post-election euphoria, jumping 1.83% to a record high of 829.57 by last week's end.

Phillipines

News- Philippine National Treasurer Mina Figueroa submitted her resignation effective end of September. Unidentified sources say that Figueroa resigned due to her desire to go back to the private sector, while other sources suggest it was due to disagreements over policy.

Data - The Philippine budget deficit for August was Php11.7 billion (\$208.9 million), narrower than July Php19.29 billion and a year earlier (Aug 2003 = Php18 billion) as the government cut costs after acknowledging it is facing a fiscal crisis. The Philippine trade deficit ballooned by 37 percent in July from a year earlier raising concerns about the impact of high oil prices and waning global electronics demand. Imports were \$3.416 billion in July from the \$3.236 billion in the same month last year, while \$3.455 billion in June 2004. Exports in July at \$3.106 billion with the trade deficit now to \$310 million in July from \$226 million a year earlier. Philippine government debt is up by 19% to Php3.537 trillion (US\$63.20 billion) in the year to June, 52% of which is from domestic sources and 48% from offshore sources. The borrowing mix however is expected to change slightly to 78-22% in 2005 with interest rates still relatively flat despite continued US interest rate hikes and inflationary pressures. The Philippine unemployment rate fell in July as jobs growth outpaced expansion of the workforce. Unemployment fell to 11.7 percent from 12.6 percent a year earlier. The number of people looking for work fell to 4.21 million people from 4.4 million, the first drop since April last year. The government said the falling unemployment rate reflected increased investor confidence in the administration and hopes it will boost consumer spending and aid achievement of government growth targets.

FX- Recent USD/PHP gains above 56.30 were attributed to anticipation of another 25bps hike by the US Fed and a negative trade data amidst rising oil prices (above US\$47 per barrel). However peso gains last week were attributed to the country's bullish stock market,

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which continues to draw investor interest – currently the rate is flirting with major resistance at 56.45.

Other markets- 91-day benchmark T-bill is up by 28bps on the last auction. Traders say that the rise was expected due to concerns about rising inflation but the country's Bureau of Treasury said it would limit any rise above 8%. The 91-day bill was awarded at 7.718%. However, the Philippine central bank issued a statement after the US Fed hike that it will probably leave interest rates stable, stating that rising remittances from overseas workers will help support the peso and help damp inflation. Philippine stocks rose last week as the central bank signalled it wanted to fuel economic growth by not matching a hike in U.S. interest rates. Investors continued to favor blue chips like second-ranked mobile phone firm Globe Telecom Inc., top property firm Ayala Land Inc. and leading mall developer SM Prime Holdings Inc.. Telecom stocks have been favoured due to expectations the sector will continue to benefit from huge demand for mobile phones, while the property sector is now coming out of a prolonged slump. The main stock index rose 0.42 percent or 7.2 points to 1,727.88 points, even as losers beat gainers 43 to 37. The index is up 19.8 percent this year, making it one of the top performers in Asia. Turnover rose to 975.3 million pesos (\$17.4 million) from Tuesday's 880 million pesos.

FX FORECASTS

Majors	Current 28-Sep-04	1 mth	3 mth	6 mth	9 mth	12 mth
USD / SGD	1.6940	1.7070	1.6900	1.6950	1.7000	1.7050
USD / THB	41.56	41.30	41.00	40.80	40.50	40.30
USD / KRW	1150	1160	1157	1160	1164	1167
USD / TWD	33.90	33.80	33.00	33.30	33.50	33.80
USD / IDR	9225	9200	9000	8900	8700	8200
USD / JPY	111.20	112.00	108.00	105.00	107.00	108.00
AUD / USD	0.7140	0.6900	0.7500	0.8100	0.7800	0.7400
NZD / USD	0.6680	0.6500	0.6800	0.6900	0.6500	0.6200
AUD / JPY	79.3968	77.2800	81.0000	85.0500	83.4600	79.9200
NZD/JPY	74.2816	72.8000	73.4400	72.4500	69.5500	66.9600

Cross Rates	Current 28/09/2004	1 mth	3 mth	6 mth	9 mth	12 mth
AUD / KRW	821.10	800.40	867.75	939.60	907.92	863.58
NZD / KRW	768.20	754.00	786.76	800.40	756.60	723.54
AUD / THB	29.67	28.50	30.75	33.05	31.59	29.82
NZD / THB	27.76	26.85	27.88	28.15	26.33	24.99
AUD / TWD	24.20	23.32	24.75	26.97	26.13	25.01
NZD / TWD	22.65	21.97	22.44	22.98	21.78	20.96
AUD / IDR	6587	6348	6750	7209	6786	6068
NZD / IDR	6162	5980	6120	6141	5655	5084
AUD / SGD	1.21	1.18	1.27	1.37	1.33	1.26
NZD / SGD	1.13	1.11	1.15	1.17	1.11	1.06

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