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Our Vision:

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Highlights

- Activity indicators continue to deteriorate across emerging Asia, pointing to slower growth ahead for the region.
- Inflation has peaked in all but a few countries and is fast disappearing as an issue; a few central banks have begun to cut policy rates and others have signalled a change in bias.
- Although the direct exposure of financial entities in the region to Lehman assets was small, asset market contagion from the latest U.S. financial sector fallout was swift and substantial.
- We have updated (and downgraded) our baseline growth forecasts for the rest of 2008 and 2009, and view the risks to growth be firmly on the downside.
- Sharply deteriorating global growth prospects will keep emerging Asian currencies under pressure. Countries with current account deficits (or small surpluses) have led the way lower thus far. Countries with large export exposure and more developed financial sectors will be next.

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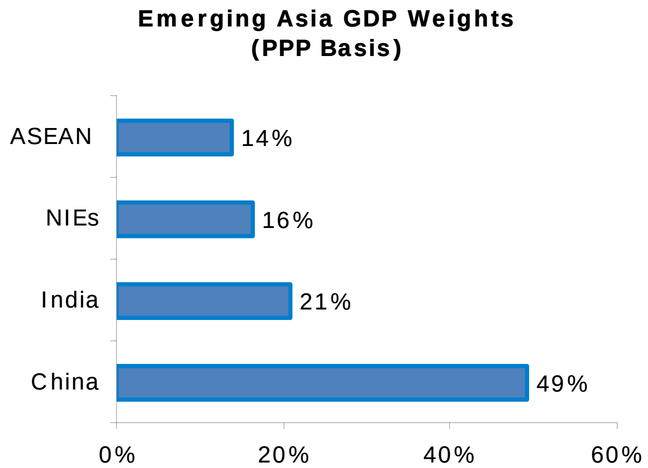
Feature Article: Updated Emerging Asia GDP Forecasts

In this issue of ANZ's *Emerging Asia Economic Monthly* we launch our feature article series. The aim is to provide readers with a short, thematic piece on an issue with region-wide ramifications. In this inaugural article we provide an overview of our recently-updated quarterly GDP growth forecasts against the background of a slowing global economy and a deepening global financial crisis. While these represent our current read on the region, given the fluid situation in financial markets we expect to revisit our forecasts on a relatively frequent basis. In an Annex to this article we present some data on Lehman-related exposures of banks in Asia.

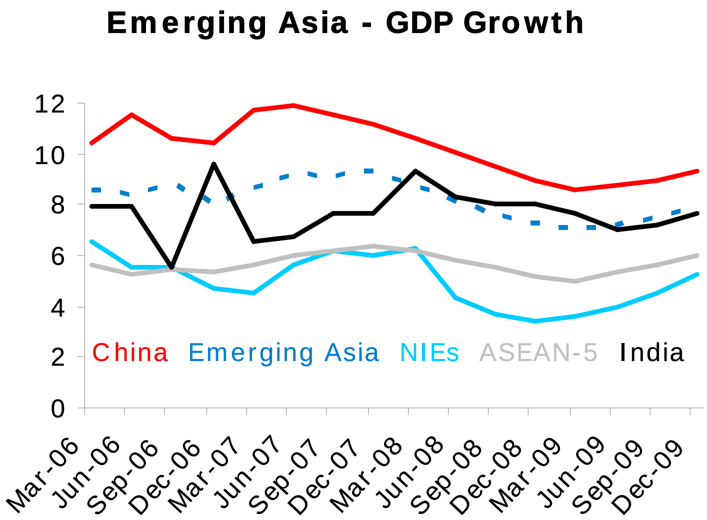
Before delving into the actual forecasting exercise, a few methodological notes are in order. First, in weighting our economies we use purchasing power parity (PPP) exchange rates as calculated by the IMF. These PPP rates ensure that all goods and services cost the same in all countries. While not a totally defensible assumption when discussing non-traded goods, it does have the benefit of analytical simplicity. Of note, on this measure China dominates the region with a weighting of almost 50%. Second, in order to help the exposition, and examine the region without the distorting effect of China, we use two well known sub-groupings for Asian economies. The Newly Industrialized Economies or NIEs includes Hong Kong, Korea, Singapore, and Taiwan. This group constitutes 16% of emerging Asia's GDP and Korea constitutes the largest share with a weight of 50%. The ASEAN group includes Indonesia, Malaysia, the Philippines, and Thailand (Vietnam is excluded owing to data availability issues). This group constitutes 14% of regional GDP and Indonesia leads the way with a 42% weight.



To date, the effects of the ongoing credit crisis on emerging Asia to have for the most part been limited to financial market channels. Although the direct exposure of the region's financial institutions to sub-prime and related credits is relatively small, equity market contagion from advanced countries to emerging Asia has been high. Bond and swap spreads have widened in line with global trends as well. That being said, the wealth channel in emerging Asia is relatively small. Not surprisingly, the real effects of the crisis have so far been most pronounced in emerging Asia's two money centres, Hong Kong and Singapore, where growth (q/q, sa) was negative in the second quarter of 2008.

Measuring the indirect effects of the credit crisis on Asia with the aim of obtaining an "all in" impact on growth is a challenging exercise. As we argued in "Emerging Asia in a Post-Lehman World" (17 September 2008), one simple approach is to focus on two key vulnerabilities—the dependency of growth on net exports and the current account deficit—in order to arrive at a ranking of regional economies in terms of their resilience to the current complex of external shocks. We concluded that the NIEs were vulnerable given their recent dependence on net exports for growth, and that India and Vietnam (and, more recently, Korea) were vulnerable as net capital importers; i.e., they are running a current account deficit.

In the context of the present exercise, the deepening of the credit crisis and its effects on financial institutions constitutes an additional source of vulnerabilities for the NIEs given their relatively advanced financial systems and the prominence of the financial sector in the macro economy. Indeed, as seen from the chart below, we are forecasting the steepest decline in growth in that group over the coming quarters.



In terms of the baseline forecast, the pace of growth for emerging Asia as a whole declines from about 8½% in the first half of 2008 to 7% in early 2009, before rising to nearly 8% by year end. The growth profiles for individual countries and groups vary according to their vulnerabilities.

- China continues to lead the region in terms of growth rates. However, quarterly growth (year-on-year) is forecast to decline from 10¼% percent in the first half of 2008 to just over 8½% in early 2009. This reflects the combination of a slowing a global economy and a rising, though still modest, contribution to growth from net exports with relatively heavy exposure to the U.S. and Europe.

- Growth in India, which accounts for one-fifth of the region's GDP, drops from over 8% in early 2008 to 7% in the first quarter of 2009. Although India is a relatively closed economy, suggesting that the trade channel will have a limited impact on growth, capital inflows needed to finance part of investment (and growth) are seen as less forthcoming in the current period of heightened global risk aversion.

- The NIEs take the biggest hit in the region, for reasons noted above, with growth falling from over 6% in early 2008 to 3½% in late 2008 and 2009. The slowdown started earlier in this group, which tends to lead the region, and growth is thus expected to turn up sooner than elsewhere.

- The ASEAN group shows the least variability in its growth profile owing to its high reliance on domestic demand, the relatively low trade exposure to countries outside the region, and the beneficial effects of high commodity prices. For this group, growth is expected to moderate from 6% in early 2008 to 5% in early 2009.

On balance, we see the risks to these baseline forecasts to be on the downside. While there is a chance that domestic demand will prove to be somewhat more resilient than expected, there is a greater probability that the knock-on effects from the global financial turbulence will be more pronounced than currently envisaged. There is also a risk that political developments in Thailand and Malaysia could pull down growth as uncertainty about developments there increases. Finally, a sharper than expected downturn in the U.S. and Europe would likely have a disproportionately large negative effect on Asia given the region's high growth beta, including dampening investment, a main factor in the recovery of domestic demand in recent years.

Paul Gruenwald

Annex: Lehman-related Exposure by Asian Banks

In its bankruptcy petition on 15 September, Lehman Brothers listed outstanding debts amounting to $613 billion. As financial companies and investors worldwide scrambled to assess their exposures to Lehman, Fitch announced its preliminary findings on 16 September, suggesting that the net exposure to Lehman for banks in the Asia Pacific region is small for most part, and that the direct impact on banks will be limited.

Based on publicly available information, the largest disclosed Lehman exposures in Asia are being held by Japanese financial institutions, with a combined amount of $2.4 billion, mostly in the form of bonds or loans. This is followed by the Taiwanese financial institutions which reportedly hold about $1.2 billion in bonds and stocks linked to Lehman. The Korean regulator announced that its financial institutions held $720 million in Lehman-linked assets (loans, securities and derivatives) and the Chinese banks are reported to have a similar amount of exposure. Several banks in the rest of Asia have also announced small exposures to Lehman-linked assets, including in the money centres of Hong Kong and Singapore.

As most of these numbers pertain only to on-balance sheet exposure, we believe that the full impact on the banks' financial performance could be greater and certainly more complex than these preliminary numbers suggest. For example, we understand that Lehman created $30.5 billion worth of structured notes for clients. For a start, the credit provisions for potential losses will be adding to the banks' existing burden of write-downs arising from turbulence in the global financial markets. As a result, banks' earnings in second-half of fiscal 2008 and probably the first-half of fiscal 2009 will be adversely affected.

Ivy Tan

Exposure to Lehman-linked Assets (US$ million)

Japanese Banks	**2,400**	**Chinese Banks**	**722**
Aozoro Bank	463	China Construction Bank	191
Mizuho Trust	382	Industrial & Commercial Bank of China	152
Shinsei Bank	231	Bank of China	129
UFJ Bank	185	China Citic Bank	76
Sumitomo Bank	177	China Merchants Bank	70
Chuo Mitsui Trust	144	Bank of Communications	70
Shinkin Central	93	Industrial Bank	34
Nippon Life Ins	46	**Hong Kong Banks (HKMA)**	**0.05% of total banking assets**
Taiwanese Banks (Taiwanese regulator)	**1,200**	Bank of China, Hong Kong	69
Mega Financial	116	**Philippine Banks (Bangko Sentral ng Pilipinas)**	**386**
Shin Kong Financial	80	Banco de Oro Unibank	134
Tai Shin Financial	56	Development Bank of Philippines	90
Cathay Financial	33	Metropolitan Bank and Trust Co.	71
Central Reinsurance	32	Rizal Commercial Bank	40
Fubon Financial	27	Bank of Commerce	15
Entie Bank	24	United Planeters Bank	10
Bank of Kaohsiung	18	**Thai Banks (Bank of Thailand)**	**124**
Hua Nan Financial	73	Bangkok Bank	102
Polaris Securities	11	**Indian Banks**	
ING Life Taiwan	9	ICICI Bank	81
Taiwan Business Bank	7	**Indonesian Banks (Bank Indonesia)**	Limited
SinoPac Financial	2	**Singapore Banks**	
First Financial	44	DBS	Insignificant
Bank of Taiwan	25	UOB	Insignificant
South Korea Banks (Financial Services Commissions)	**720**		

Source: Reuters, Bloomberg (Updated as at 29 Sep 2008)

Macro Economic Forecasts

Real GDP (%)

	2005	2006	2007	2008f	2009f
China	10.1	10.7	11.6	9.8	8.9
Hong Kong	7.1	6.8	6.5	4.4	4.8
India	8.0	7.4	7.9	8.0	7.5
Indonesia	5.7	5.5	6.3	6.2	5.8
Korea	4.1	5.2	4.9	4.7	4.5
Malaysia	5.3	5.8	6.3	6.1	5.4
Philippines	4.9	5.4	7.2	4.5	4.9
Singapore	7.3	8.2	7.7	3.8	4.5
Taiwan	4.1	4.9	5.7	4.1	3.8
Thailand	4.5	5.1	4.7	5.3	5.3
Vietnam	8.4	8.2	8.5	6.4	6.6

Inflation (%)

	Sep-08	Oct-08	Nov-08	Dec-08	2008f
China	4.7	4.6	4.0	2.9	6.2
Hong Kong	4.3	4.0	4.0	3.6	4.8
India	12.2	12.1	12.1	12.1	10.0
Indonesia	11.5	10.9	10.9	10.1	9.4
Korea	5.4	4.9	5.0	4.7	4.8
Malaysia	8.5	8.4	8.3	7.8	6.0
Philippines	11.9	11.6	11.0	10.3	9.6
Singapore	6.6	5.9	5.6	5.2	6.6
Taiwan	3.8	3.7	3.8	4.3	4.1
Thailand	6.1	5.3	4.9	4.9	6.2
Vietnam	27.8	27.2	26.0	23.1	23.5

Exports of Goods & Services (%)

	2005	2006	2007	2008f	2009f
China*	na	na	na	na	na
Hong Kong	10.5	9.6	8.1	4.9	6.9
India	5.9	3.7	6.4	11.4	10.5
Indonesia	16.9	9.5	8.0	15.2	12.3
Korea	8.5	11.9	12.0	11.1	11.0
Malaysia	8.4	7.0	4.1	7.7	8.6
Philippines	4.6	13.6	5.8	3.4	8.3
Singapore	12.1	11.4	6.6	7.1	6.9
Taiwan	7.5	10.7	8.8	7.8	7.1
Thailand	3.8	8.7	7.1	8.8	10.3
Vietnam*	21.0	23.0	22.0	17.0	15.0

Imports of Goods & Services (%)

	2005	2006	2007	2008f	2009f
China*	na	na	na	na	na
Hong Kong	7.8	9.2	8.8	4.6	6.6
India	8.3	5.0	3.7	3.1	2.5
Indonesia	18.1	8.5	8.9	15.1	10.8
Korea	7.3	11.4	11.8	9.0	11.6
Malaysia	8.9	8.7	5.3	6.9	9.5
Philippines	2.3	1.9	-4.3	4.4	7.1
Singapore	11.1	11.7	6.8	10.2	7.5
Taiwan	3.8	5.3	3.6	2.8	6.5
Thailand	8.7	2.6	3.5	7.3	7.9
Vietnam*	18.0	22.0	39.0	19.0	9.0

*Data on an expenditure basis are not available for China.

Overview: FX and Rates Strategy Asia

Our view that growth risks would trump inflation in H2 has materialized, albeit in a much more dramatic fashion and at a much more accelerated pace than what we had anticipated. The barrage of shocks now hitting the global financial system—triggered by the dizzying Lehman-Merrill-AIG weekend in mid September—has markedly downgraded global growth prospects, trumping inflation concerns in the process.

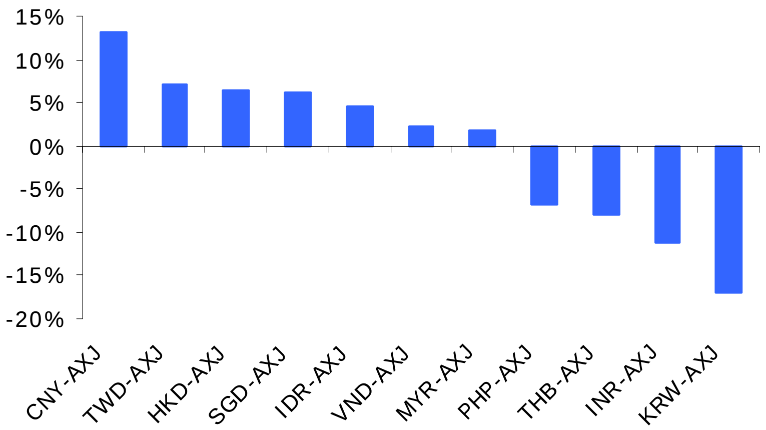
To date, FX markets have been punishing those Asian economies with current account deficits—South Korea and India. The countries with relatively small current account surpluses have also been under-performers in the region—the Philippines and Thailand. Going forward, we expect FX markets to start to target the currencies with the largest export exposures and the more developed financial sectors—notably Taiwan and Singapore.

For the first time in over 20 years Taiwan posted back-to-back trade deficits in July and August—so cracks have started to develop there. Meanwhile, swift policy U-turns by China's PBoC and Taiwan's CBC pave the way for easing by Singapore's MAS—which we expect to surprise markets in coming days with a move to a neutral FX policy. In short, the relentless downtrend in USD-CNY, USD-TWD and USD-SGD is not expected to continue.

In rates markets, the weaker trajectory for global growth should generally compress yields and steepen curves. However, where inflation remains in the double-digits—India, Indonesia, the Philippines and Vietnam—progress at the front-end of the curve will be constrained by improvement in CPI figures or, alternatively, a clear shift in central bank policy to a growth focus. There is still some risk that India's RBI and Indonesia's BI will tighten one more time this cycle, demonstrating their inflation-fighting credentials ahead of elections next year, but our baseline scenario is for both central banks to stand pat amid the global turmoil.

Tamara Henderson

Performance within AXJ (ytd % chg)



Foreign Exchange and Policy Rate Forecasts

	Current	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09
China						
USD/CNY	6.846	6.95	7.00	6.95	6.90	6.85
AUD/CNY	5.425	6.00	5.80	5.60	5.40	5.20
PBOC 1-yr-base lending rate	7.20	7.02	6.84	6.65	6.65	6.65
Hong Kong						
USD/HKD	7.765	7.80	7.83	7.81	7.80	7.80
AUD/HKD	6.153	6.70	6.50	6.20	6.10	5.90
HKMA discount rate	3.50	3.25	3.25	3.25	3.25	3.75
India						
USD/INR	46.96	48.00	49.00	48.00	47.00	46.00
AUD/INR	37.22	41.30	40.70	38.40	36.70	35.00
RBI repo rate	9.00	9.00	9.00	8.50	8.50	8.50
Indonesia						
USD/IDR	9506	9600	9800	9700	9600	9400
AUD/IDR	7532	8256	8134	7760	7488	7144
BI bank rate	9.25	9.00	9.00	9.00	9.00	9.00
Malaysia						
USD/MYR	3.44	3.50	3.60	3.60	3.50	3.50
AUD/MYR	2.72	3.00	3.00	2.90	2.80	2.60
BNM overnight policy rate	3.50	3.50	3.50	3.50	3.50	3.50
Philippines						
USD/PHP	47.05	49.00	50.00	49.80	49.50	49.00
AUD/PHP	37.28	42.10	41.50	39.80	38.60	37.20
BSP overnight reverse repo	6.00	6.00	5.75	5.50	5.50	5.00
Singapore						
USD/SGD	1.435	1.46	1.53	1.54	1.52	1.50
AUD/SGD	1.137	1.26	1.27	1.23	1.19	1.14
3-month SIBOR	1.85	1.30	0.90	1.00	1.30	1.50
South Korea						
USD/KRW	1207	1260	1300	1275	1250	1225
AUD/KRW	956	1084	1079	1020	975	931
BOK overnight call rate	5.25	5.00	4.75	4.50	4.50	4.50
Taiwan						
USD/TWD	32.21	34.00	35.00	34.50	34.00	33.50
AUD/TWD	25.52	29.20	29.10	27.60	26.50	25.50
BOC discount rate	3.50	3.38	3.25	3.13	3.13	3.13
Thailand						
USD/THB	33.86	35.50	36.00	35.80	35.30	34.80
AUD/THB	26.83	30.50	29.90	28.60	27.50	26.40
BOT 1-day repo rate	3.75	3.75	3.75	3.75	3.75	3.75
Vietnam						
USD/VND	16600	16600	16600	16500	16300	16100
AUD/VND	13154	14280	13780	13200	12710	12240
SBV base lending rate	14.00	13.50	13.00	12.50	12.50	11.00

Long Term Foreign Currency Government Bond Ratings

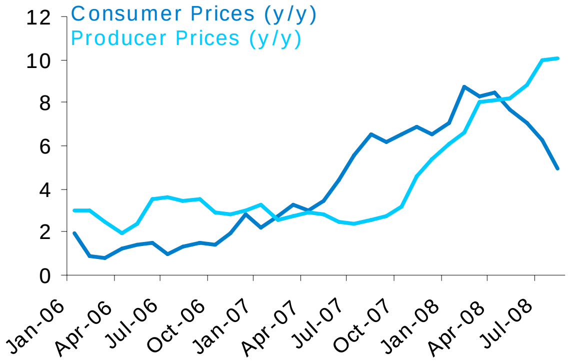
	Moody's	S&P	Fitch
Investment Grade			
China	A1	A+	A+
Hong Kong	Aa2	AA+	AA
India	Baa2	BBB-	BBB-
Korea	A2	A	A+
Malaysia	A3	A-	A-
Singapore	Aaa	AAA	AAA
Taiwan	Aa3	AA-	A+
Thailand	Baa1	BBB+	BBB+
Sub-Investment Grade			
Cambodia	B1	B+	NR
Indonesia	Ba3	BB-	BB
Philippines	B1	BB-	BB
Vietnam	Ba3	BB	BB-

** : denotes an upgrade in the current month; # : denotes a downgrade in the current month.*

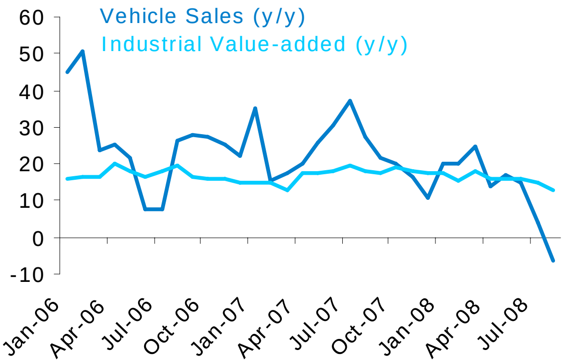
Source: Bloomberg

Country Update: China

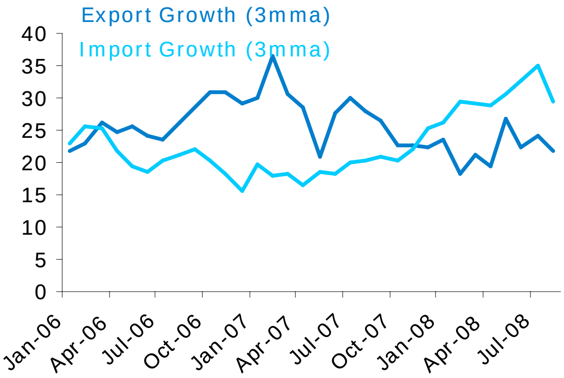
China-Inflation



China-Domestic Demand Indicators



China-Trade Development (y/y)



Consumer price inflation has clearly peaked, although producer price inflation remains at a cyclical high. The pace of activity appears to be moderating, although indicators are mixed, while exports are holding up well. Equity markets had a wild ride in September, tracking global financial and credit market concerns. The authorities have room to ease policy settings should growth slow more than expected.

- Consumer price inflation has clearly peaked, falling to 4.9% (y/y) in August after reaching 8.7% in February. This result reflects declining food prices—food inflation fell 4ppt to 10.3% while non-food inflation was steady at 2.1% However, producer price inflation remains elevated at 10.1%.
- Surprising the markets, the People's Bank of China cut its lending rate by 27 bps to 7.20%, the first central bank in Asia to lower its policy rate this year.
- Nominal retail sales growth continues to be robust, rising 23% in August on higher sales of garments, food and jewellery. However, vehicle sales growth (measured in units) dropped by 6.3% (y/y).
- Industrial production growth slowed to 12.8% in August, the lowest rate in six years. This reflected a continued moderation of the pace of activity, although sharp declines in steel, auto, and pig iron suggest that some of the decline reflects the authorities' efforts to improve air quality during the Olympics. Lower export order growth was also a factor.
- Export growth continued at a healthy 21% (y/y) rate in August. Shipments to the EU are still rising at around 20% (YTD), but those to the U.S. are increasing at half that rate. Import growth has been declining reflecting lower prices, and was 23% (y/y) in August.
- China's equity markets had a rollercoaster month. The Shanghai and Shenzhen indices declined by 15% in the first half of September, but recovered somewhat thereafter. That being said, both indices are down more than 50 percent for the year.
- We expect growth in China to continue to moderate as the external environment deteriorates and domestic demand eases. Should growth slow more than expected, the authorities have ample scope to ease policy settings. External vulnerability remains low.

Paul Gruenwald

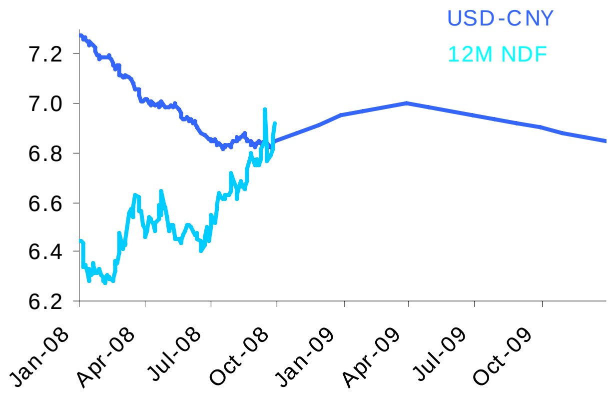
Economic Data - China

Monthly data	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Jul-08	Aug-08
Industrial Production, % y/y	N/A	15.4	17.8	15.7	16.0	16.0	14.7	12.8
Retail Sales, % y/y	21.2	19.1	21.5	22.0	21.6	23.0	23.3	23.2
Consumer Price Index, % y/y	7.1	8.7	8.3	8.5	7.7	7.1	6.3	4.9
Exports, % y/y	26.6	6.4	30.6	21.8	28.1	17.7	26.9	21.1
Imports, % y/y	27.5	35.1	24.8	26.6	40.1	31.2	33.6	22.9
Trade Balance, US$ bn	19.5	8.6	13.4	16.7	20.2	21.4	25.3	28.7
Foreign Exchange Reserves, US$ bn	1,589.8	1,647.1	1,682.2	1,756.7	1,797.0	1,808.8	N/A	N/A
Quarterly data	**Sep-06**	**Dec-06**	**Mar-07**	**Jun-07**	**Sep-07**	**Dec-07**	**Mar-08**	**Jun-08**
Real GDP, % y/y	10.6	10.4	11.7	12.6	11.5	11.3	10.6	10.1
-Primary Sector	4.9	5.0	4.4	4.0	4.3	3.7	2.8	3.5
-Secondary sector	13.3	13.0	13.2	13.7	13.5	13.4	11.5	11.3
-Tertiary sector	11.8	12.1	11.3	12.1	12.7	12.6	10.9	10.5
Nominal GDP, RMB tn	14.5	21.2	5.1	10.9	16.9	25.0	6.1	13.1
Current Account, US$ bn (semi-annual)	N/A	249.9	N/A	162.9	N/A	371.8	N/A	N/A
Capital Account, US$ bn (semi-annual)	N/A	4.0	N/A	1.5	N/A	3.1	N/A	N/A

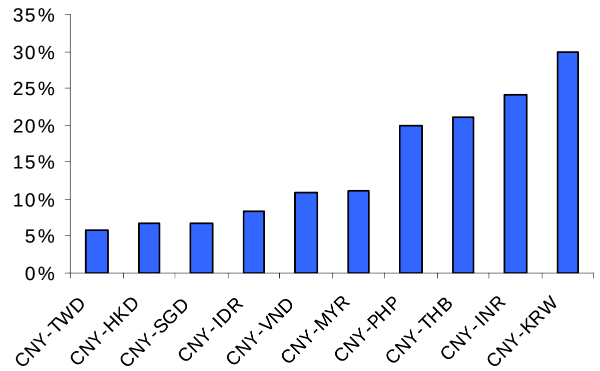
Sources: CEIC, Bloomberg

China: FX and Rates Strategy

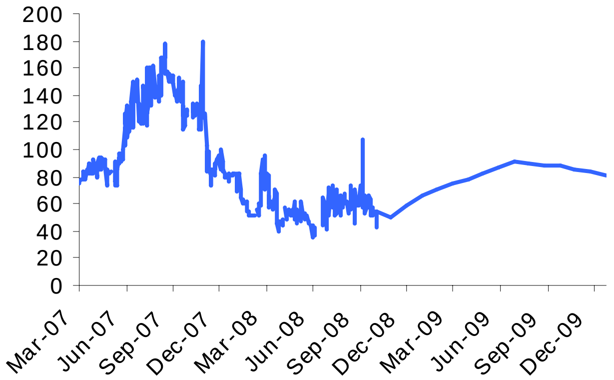
CNY appreciation is over for now



CNY gains vs AXJ (ytd % chg)



2s-10s IRS expected to steepen



The PBoC's surprise easing went beyond the move to neutral monetary policy that we had been anticipating. It also signals the end of tolerance for a stronger CNY.

FX

In the wake of Lehman's filing for bankruptcy protection, the PBoC swiftly cut the one-year lending rate by 27 bps to 7.20% and reduced the reserve requirement by one percentage point for selected banks. The move caught markets (and ourselves) by surprise—as recent commentary by authorities had previously seemed to suggest a move to more of a dual focus on inflation and growth (i.e., a shift to neutral from its previously existing bias for tighter policy).

Meanwhile, the ongoing barrage of shocks to the US/global financial system has seen a U-turn in market expectations of Fed policy, from tightening to loosening. The combination of actual PBoC easing and expected Fed easing has put USD-CNY in a holding pattern near 6.84. Meanwhile, the 12-month NDF outright is close to the 7.00 level.

The key issue for USD-CNY going forward is whether the Chinese authorities prefer a weaker as opposed to a stable CNY. Given that the renminbi has gained 12% versus AXJ year-to-date—ranging from a low of 6% versus the Taiwan dollar to a high of 27% versus the Korean won—we would expect the Chinese authorities to tolerate some retrenchment toward the 7.000 level in USD-CNY over a six month horizon. Much more retrenchment might prove difficult to achieve for political reasons, but also because of China's relatively strong fundamentals.

Rates

More rate cuts by the PBoC are anticipated, suggesting a downtrend in 2-year CNY IRS by year-end and further steepening in the 2s-10s IRS curve. The 2-year CNY IRS rate is seen at 2.6% by mid-2009 and the 2s-10s spread is seen widening to 90 bps, versus 54 bps currently.

Tamara Henderson

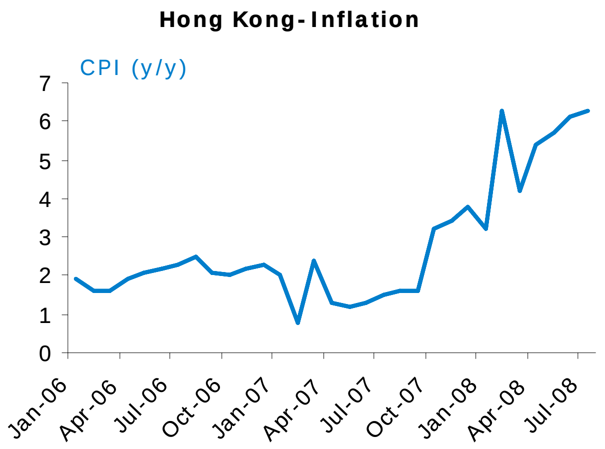
Market Forecasts - China

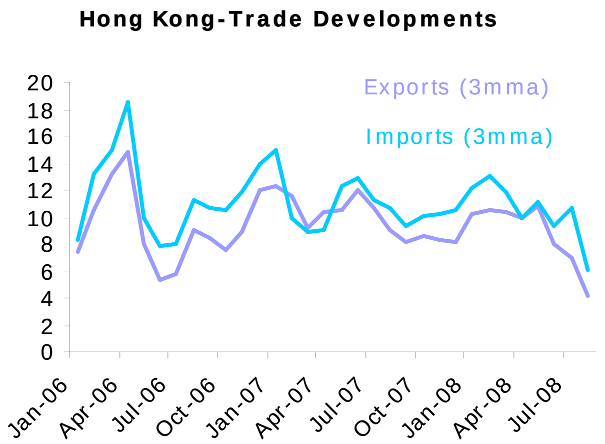
FX	Current	Ytd (%)	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09
USD-CNY	6.846	-6.3%	6.95	7.00	6.95	6.90	6.85
AUD-CNY	5.425	-15.0%	6.00	5.80	5.60	5.40	5.20
NZD-CNY	4.590	-17.9%	4.50	4.80	4.50	4.30	4.20
Rates	**Current**	**Ytd (bps)**	**Dec-08**	**Mar-09**	**Jun-09**	**Sep-09**	**Dec-09**
PBOC's 1-year base lending rate	7.20	-27	7.02	6.84	6.65	6.65	6.65
2-year IRS (versus 7-day repo fix)	3.12	-66	2.9	2.8	2.6	2.6	2.7
5-year IRS	3.25	-85	3.1	3.0	2.9	2.9	3.0
10-year IRS	3.66	-94	3.6	3.5	3.5	3.5	3.5

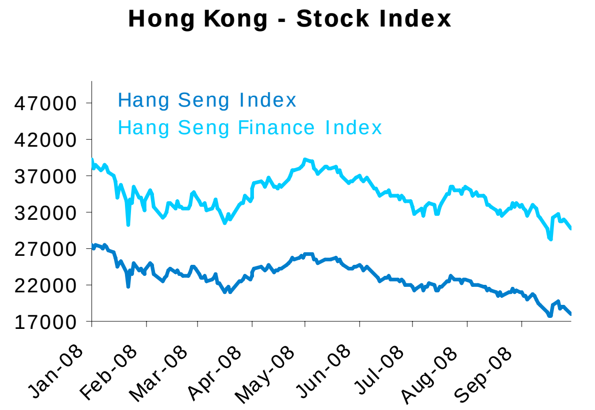
Sources: ANZ, Bloomberg

Country Update: Hong Kong

Inflation continues to decline as growth has stalled, commodity prices have fallen, and the government waived rents and introduced modest subsidies. Exports slowed as the global downturn and financial market turmoil reduced external demand. In contrast, domestic demand appears to be somewhat resilient, as retail sales firmed and unemployment remained stable. Global financial turbulence has resulted in a volatile Hang Seng Index. Going forward, Hong Kong appears relatively vulnerable on the growth front.







- Inflation slowed to 4.6% (y/y) in August from 6.3% in July owing to slower growth and declining commodity prices. This also reflected the government waiving rents to help low-income residents and introducing subsidies for food, transport, and electricity costs.
- Hong Kong's export growth fell to 1.9% (y/y) in August from 11.1% in July as the global slowdown and financial market turmoil have reduced global demand for Chinese products shipped through Hong Kong.
- Hong Kong's retail sales growth unexpectedly picked up to 13.8% (y/y) in July from 11.7% in June as visitor arrivals from China increased.
- Despite the slowdown, the seasonally adjusted unemployment rate was unexpectedly stable at 3.2% in the quarter ending in August. The ongoing financial market turbulence is expected to cost financial sector jobs going forward.
- Reacting to the news of Lehman and AIG, the Hang Seng Index plunged by 9% over the week of 15 September and only partially rebounded later in the month. Nonetheless, prices of local financial stocks continued to decline, with the Hang Seng Financial index dropping by 2% over the past two weeks.
- We expect growth to continue to decline into early 2009 as Hong Kong's open and financial services-based economy will be relatively hard hit by turbulence in global financial markets. A key risk is the extent to which growth in Mainland China slows.

Ivy Tan

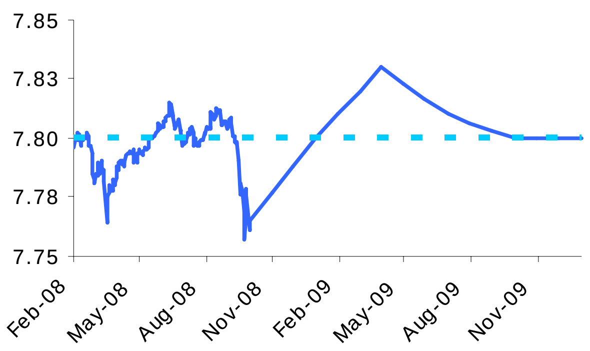
Economic Data - Hong Kong

Monthly data	**Jan-08**	**Feb-08**	**Mar-08**	**Apr-08**	**May-08**	**Jun-08**	**Jul-08**	**Aug-08**
Retail Sales, % y/y	23.3	9.6	20.1	18.6	13.1	11.7	13.7	N/A
Composite Consumer Price Index sa, % y/y	3.0	6.5	4.1	5.4	5.7	6.1	6.2	6.0
Exports, % y/y	15.8	7.6	7.6	14.5	10.3	-0.6	11.1	9.0
Imports, % y/y	16.9	11.9	6.6	11.3	15.4	1.3	15.4	10.8
Trade Balance, US$ bn	-1.0	-2.0	-3.6	-2.1	-3.5	-3.1	-2.5	-2.5
Foreign Exchange Reserves, US$ bn	155.2	156.2	157.1	155.7	154.2	152.1	153.3	N/A
Quarterly data	**Sep-06**	**Dec-06**	**Mar-07**	**Jun-07**	**Sep-07**	**Dec-07**	**Mar-08**	**Jun-08**
Industrial Production, % y/y	-0.7	-1.4	-1.6	-2.3	-2.0	-0.3	-4.4	-4.2
Real GDP, % y/y	6.4	6.6	5.5	6.2	6.8	6.9	7.3	4.2
-Private consumption	4.6	6.0	4.5	6.6	10.6	9.5	7.9	3.1
-Government consumption	-0.9	1.3	2.3	3.0	1.5	2.3	0.3	3.5
-Gross fixed capital formation	10.0	7.5	0.8	8.1	-0.5	8.2	9.9	4.3
Nominal GDP, HKD bn	375.6	400.3	373.6	380.1	413.8	448.7	410.2	404.1
Current Account, US$ bn	7.7	7.2	8.2	3.3	8.4	8.1	6.6	4.4
Capital & Financial Account, US$ bn	-10.1	-9.3	-6.9	-5.1	-10.3	-9.8	-4.3	-2.6

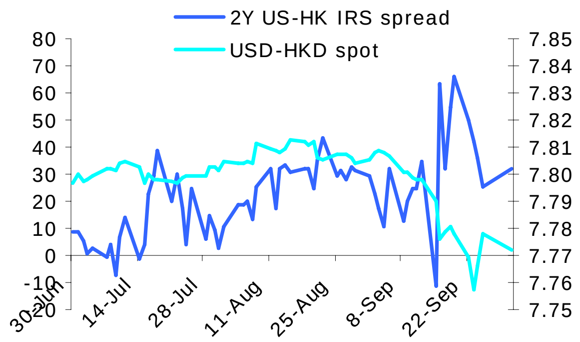
Sources: Bloomberg, CEIC

Hong Kong: FX and Rates Strategy

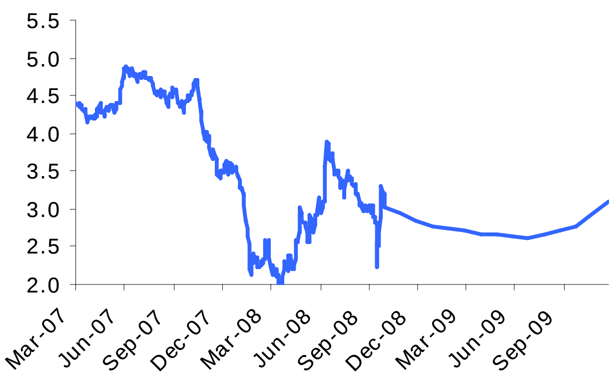
USD-HKD to move above mid-point



USD-HKD diverging from 2Y spread



IRS rates to compress



Re-coupling reinforces the viability of an already solid HK-US dollar currency peg, and should keep USD-HKD in the upper half of the trading band. US Congressional approval of a $700bn bailout should ease liquidity conditions, normalizing HKD swap rates to the benefit of receiver positions.

FX

The deteriorating global growth outlook combined with substantial stress in the global financial system present a substantial risk of a technical recession in Hong Kong, where GDP growth already contracted in Q2 (for the first time since SARS). Exports contribute close to 200% of Hong Kong's GDP. Meanwhile, Hong Kong's more developed financial market is more vulnerable to the recent barrage of shocks to the global financial system. Hong Kong's current account surplus is ample at 8.5% of GDP, but a significant narrowing is likely.

The resurgence of the re-coupling theme—i.e. the rotation of US weakness to the rest of the world—serves to reinforce the viability of the HK-US dollar currency peg. It should also put to rest the speculation heard earlier in the year of a possible revaluation of the HKD.

With growth trumping inflation concerns via two channels (the real and financial sectors), USD-HKD should find support in the upper half of the 7.75-7.85 trading range.

Rates

Because of its currency peg, movements in Hong Kong interest rates closely track US Treasuries.

Market expectations for Fed tightening have completely unwound, now pricing in substantial risk of a cut in October. At the same time, the global liquidity crunch has seen swap rates balloon amid a scramble to hold cash. The US government's bailout package should ease liquidity conditions, compressing rates across the HKD IRS curve to the benefit of receiver positions.

Tamara Henderson

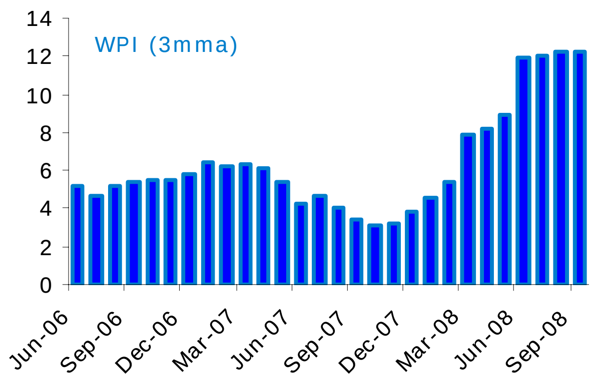
Market Forecasts - Hong Kong

FX	Current	Ytd (%)	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09
USD-HKD	7.765	-0.4%	7.80	7.83	7.81	7.80	7.80
AUD-HKD	6.153	-9.8%	6.7	6.5	6.2	6.1	5.9
NZD-HKD	5.201	-12.9%	5.1	5.3	5.1	4.9	4.8
Rates	**Current**	**Ytd (bps)**	**Dec-08**	**Mar-09**	**Jun-09**	**Sep-09**	**Dec-09**
HKMA's discount rate	3.50	-225	3.25	3.25	3.25	3.25	3.75
2-year IRS (onshore versus 3M HIBOR)	3.02	-41	2.8	2.7	2.6	2.8	3.3
5-year IRS	3.45	-34	3.3	3.2	3.2	3.3	3.6
10-year IRS	3.64	-37	3.6	3.5	3.5	3.6	3.7

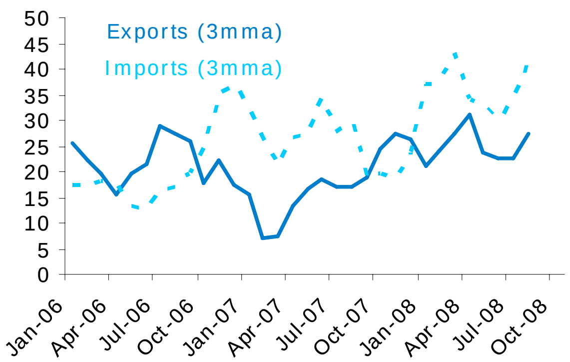
Sources: ANZ, Bloomberg

Country Update: India

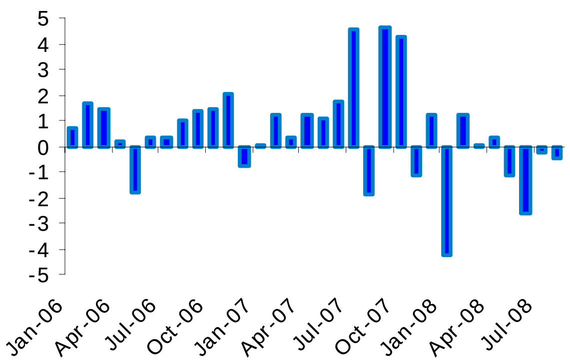
India-Inflation



India-Trade Developments



India-Net Foreign Equity Flows ($bn)



Inflation is finally moderating, while manufacturing and export growth remain robust—supported by a much more competitive rupee. The Reserve Bank of India (RBI) has a new Governor, Dr. Subbarao, who said it is essential to contain inflation, but also that he would be mindful of growth prospects.

- Inflation has started to moderate, helped by softer prices for fuel and manufactured products. The WPI fell for three consecutive weeks in August, with the most recent reading for the week ending September 6 at 12.14% (y/y) versus the peak of 12.63% in August.
- Domestic demand is weakening, weighed by higher prices and interest rates. Motor vehicle sales slowed to 9.6% (y/y) in August compared with 14.2% in July. In particular, domestic passenger car sales continued to fall, dropping 4.4% (y/y) in August following July's decline of 1.7%, the first decline in over 2½ years.
- Industrial production exceeded expectations in July, rising 7.1% (y/y) versus 5.4% in June. The primary driver was a 21.9% increase in capital goods production (versus 8.3% in June) and a surprising 11.2% (y/y) gain in consumer durables production (versus 3.7% in June and -2.7% last year).
- Export growth accelerated to 31.2% (y/y) in July, from 23.5% in June, propelled by shipments of gems, auto parts, medicines, and other manufactured products reflecting a much more competitive exchange rate. Import growth also jumped to 48.1%, bringing India's trade deficit to a record $10.8bn.
- Capital inflows continued to recede in tandem with the reduction in global risk appetite, with net foreign equity investment down $9.2bn year-to-date, compared with a gain of $17.4bn in all of 2007. The BSE Sensex equity index shed another 12% in September.
- The RBI has a new Governor, Dr. Subbarao, who said it is essential to contain inflation. Asked about further tightening this year, he said there were several unknowns, including the impact of measures already taken, and the impact of global developments. We do not expect further tightening by the RBI during this cycle.
- We cut our annual GDP forecast to 7.5% in 2009 with growth bottoming at 7% (y/y) in Q2. This is based on a more pessimistic outlook for investment, given recent events in the global financial markets.

Tamara Henderson

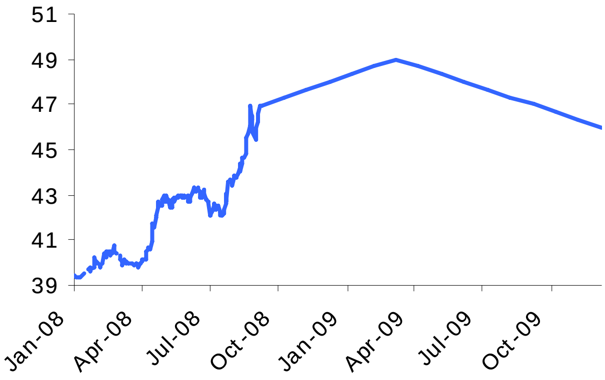
Economic Data - India

Monthly data	**Jan-08**	**Feb-08**	**Mar-08**	**Apr-08**	**May-08**	**Jun-08**	**Jul-08**	**Aug-08**
Industrial Production, % y/y	6.2	9.5	5.5	6.2	4.1	5.4	7.1	N/A
Automobile Sales, % y/y	-5.0	-4.9	4.9	12.3	9.2	8.7	15.3	11.7
Wholesale Price Index, % y/y	4.1	5.7	7.7	8.3	9.4	12.0	12.0	12.6
Exports, % y/y	35.7	40.7	18.6	31.5	12.9	23.5	31.2	N/A
Imports, % y/y	63.9	46.7	35.9	36.6	27.1	25.9	48.1	N/A
Trade Balance, US$ bn	-7.8	-5.9	-8.0	-9.9	-10.8	-9.8	-10.8	N/A
Foreign Exchange Reserves, US$ bn	283.6	291.3	299.2	304.2	304.9	302.3	295.9	N/A
Quarterly data	**Sep-06**	**Dec-06**	**Mar-07**	**Jun-07**	**Sep-07**	**Dec-07**	**Mar-08**	**Jun-08**
Real GDP, % y/y	10.1	9.3	9.7	9.2	9.3	8.8	8.8	7.9
-Agriculture	3.2	4.0	4.9	4.4	4.7	6.0	2.9	3.0
-Industry	12.1	11.1	12.6	9.9	10.0	8.8	8.0	7.4
-Services	11.5	11.1	10.3	11.0	10.5	10.4	11.2	10.0
Nominal GDP, INR tn	8.6	10.2	10.4	9.9	9.8	11.4	11.9	11.5
Current Account, US$ bn	-6.3	-3.7	4.3	-6.3	-4.9	-5.1	-1.0	N/A
Capital Account, US$ bn	8.8	11.0	15.6	17.3	34.0	31.3	25.4	N/A

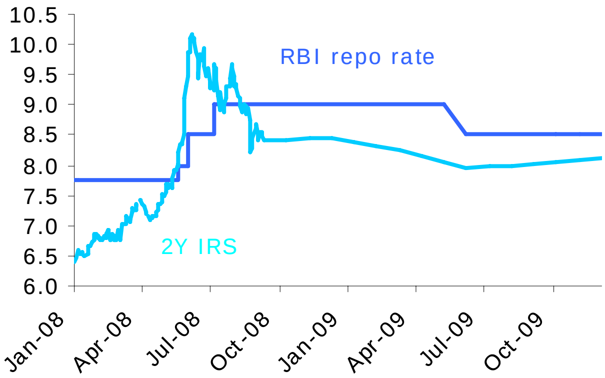
Sources: Bloomberg, CEIC

India: FX and Rates Strategy

USD-INR seen even higher



2Y IRS buffeted by cross-winds



Escalating risk aversion and continued pressure from the current account should generate further advances in USD-INR as we head into 2009. Tough talk on inflation by the RBI's new governor will not translate into rate hikes in the current global environment, but presents two-way risk for IRS.

FX

As the breadth and depth of the global slowdown has increased, risk appetite has continued to deteriorate—keeping the rupee under significant pressure. We don't expect this pressure to abate any time soon, given the continued outflow of foreign portfolio flows ($1.9bn in August alone) as well as the FX market's aversion for Asian currencies with current account deficits.

The rupee has plunged 19% year-to-date versus the US dollar, and has dropped 11% versus AXJ. Although this is giving Indian exports a boost, the trade deficit still managed to hit a new record in July. With INR under pressure from both sides of the balance of payments, USD-INR is expected to be trading near the 48.0 level by year-end (versus 46.96 currently).

Rates

The RBI has a new governor, Dr. Subbarao, who's commentary in the press suggests that the battle against inflation remains a key focus. With WPI still at 12% and elections due before May, the RBI has no choice but to maintain the hawkish rhetoric. However, we don't expect the tough talk to translate into action—particularly given the ongoing sequence of blows to the global financial system.

Although inflation has yet to make a significant retreat from double-digit rates, it is clear that Indian CPI has peaked. Also the key driver of Indian GDP growth—domestic demand—is slowing. Ultimately, this will translate into further compression in Indian IRS rates. The 2-year INR IRS rate is expected to shed 30 bps by end-March.

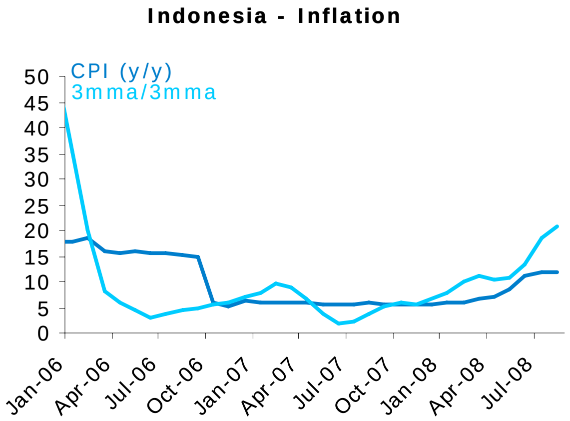
Tamara Henderson

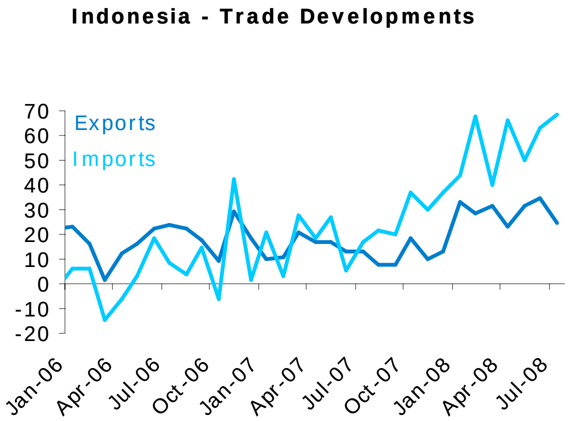
Market Forecasts - India

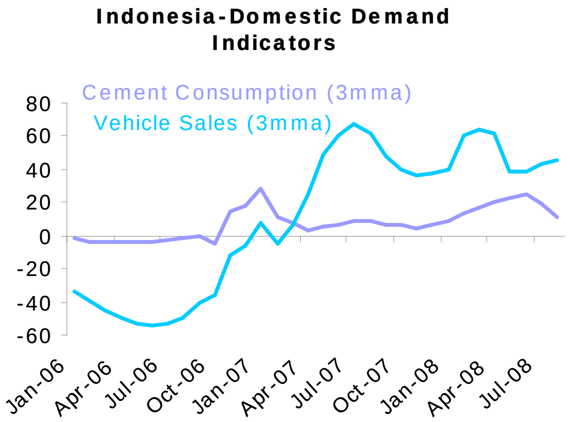
FX	Current	Ytd (%)	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09
USD-INR	46.96	19.1%	48.0	49.0	48.0	47.0	46.0
AUD-INR	37.22	7.9%	41.3	40.7	38.4	36.7	35.0
NZD-INR	31.47	4.3%	31.2	33.3	31.2	29.6	28.1
Rates	**Current**	**Ytd (bps)**	**Dec-08**	**Mar-09**	**Jun-09**	**Sep-09**	**Dec-09**
RBI's repo rate	9.00	125	9.00	9.00	8.50	8.50	8.50
2-year IRS (versus NSE MIBOR)	8.56	167	8.5	8.3	8.0	8.0	8.1
5-year IRS	8.28	125	8.2	8.1	7.9	7.9	8.0
10-year IRS	8.33	116	8.3	8.2	8.1	8.1	8.2

Sources: ANZ, Bloomberg

Country Update: Indonesia







Inflation remained near a 22-month high in August, and the Bank of Indonesia raised its benchmark rate in September for the fifth time this year. Robust vehicle and motorcycles sales and non-oil imports point to robust domestic demand and export growth continues to be strong. Indonesia was relatively unaffected by the recent financial market turmoil and growth prospects remain favourable.

- Inflation was 11.85% (y/y) in August, near a 22-month high, as food prices rose by almost 20%.
- The Bank of Indonesia raised its policy rate by 25bps to 9.25% in September, the fifth straight increase this year, as inflation hovered near its 22 month high. The central bank in raising rates stated the need to curb domestic demand within safe limits to achieve its 2009 inflation target of 6.5% - 7.5%.
- Domestic demand indicators show continued strength. Vehicles and motorcycles grew by 41% (y/y) and 43.3% (y/y) respectively in August. Also, import data in July point to strong domestic demand as non-oil imports rose 68.8% from the previous month's 63.4%.
- Industrial production for June rose 1.5% versus 3.8% the previous month. This growth was the weakest in 20 months. The biggest contractions were in the manufacture of transport equipment, refined petroleum and motor vehicles, which fell 57.1%, 36.7% and 21.6% respectively.
- Exports continued to grow robustly at 25% (y/y) in July. There was no major reduction in growth to any of Indonesia's major markets (Australia, Singapore, and the US).
- The rupiah fell by 3.2% against the US dollar in September reflecting a rise in global risk aversion following the intensification of the credit crisis.
- Foreign portfolio investments in equities continue to hold up in spite of the 32.4% fall in the equity market this year. There has been $807 million net inflows so far in 2008.

Joshua Saldanha

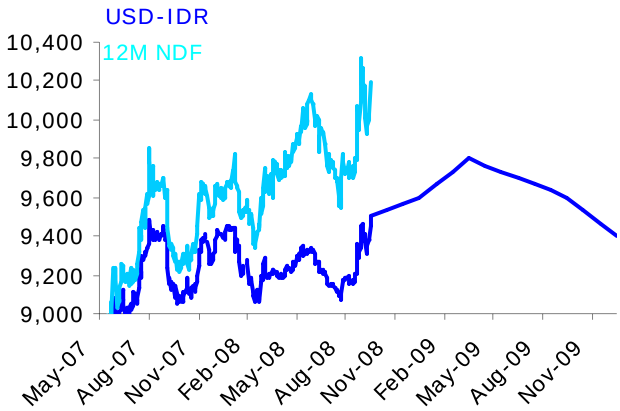
Economic Data - Indonesia

Monthly data	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Jul-08	Aug-08
Industrial Production, % y/y	5.8	9.5	2.5	2.8	3.8	1.4	1.4	N/A
Retail Sales Index, % y/y	-1.7	11.7	1.7	10.3	7.5	7.4	6.9	N/A
Consumer Price Index, % y/y	7.4	7.4	8.2	9.0	10.4	11.0	11.8	N/A
Exports, % y/y	34.5	28.7	32.5	22.5	31.6	34.9	25.0	N/A
Imports, % y/y	42.0	68.8	41.1	65.7	49.8	63.4	68.8	N/A
Trade Balance, US$ bn	3.7	2.7	4.0	1.6	3.2	3.1	1.8	N/A
Foreign Exchange Reserves, US$ bn	53.4	54.4	56.4	56.2	54.9	56.8	58.0	55.9
Quarterly data	**Sep-06**	**Dec-06**	**Mar-07**	**Jun-07**	**Sep-07**	**Dec-07**	**Mar-08**	**Jun-08**
Real GDP, % y/y	5.9	6.0	6.1	6.4	6.5	6.3	6.3	6.4
-Private consumption	3.0	3.8	4.7	4.7	5.1	5.6	5.7	5.3
-Government consumption	1.7	2.2	3.7	3.8	3.3	2.0	4.7	2.2
-Gross fixed capital expenditure	0.8	6.8	7.0	6.9	10.4	12.1	15.4	12.8
Nominal GDP, IDR tn	870.6	873.2	920.2	962.8	1,033.3	1,041.1	1,122.1	1,230.9
Current Account, US$ bn	3.8	2.2	2.6	2.3	2.1	3.4	2.3	-1.5
Capital & Financial Account, US$ bn	-1.2	1.3	1.8	2.0	-0.9	0.5	-0.3	3.7

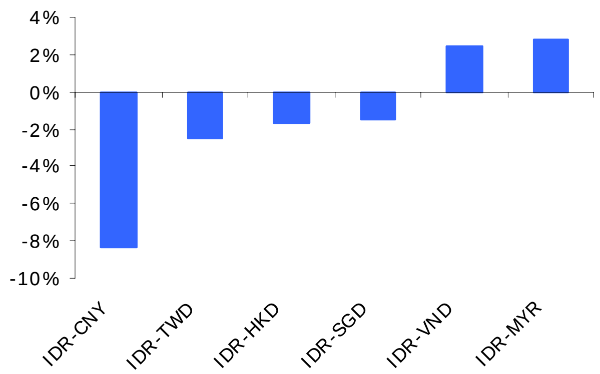
Sources: Bloomberg, CEIC

Indonesia: FX and Rates Strategy

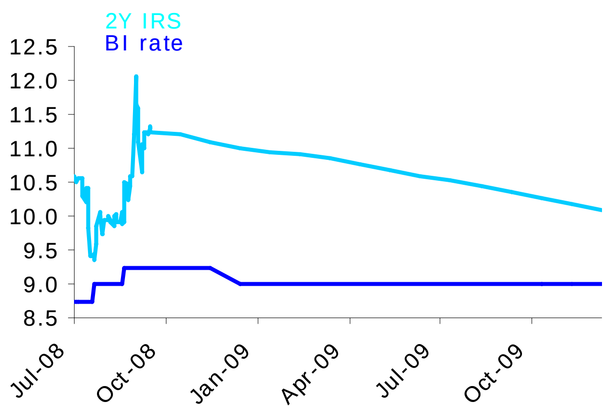
USD-IDR to break current range



IDR moves within AXJ (ytd % chg)



IRS to track CPI lower



The rupiah is among the group of out-performers in AXJ this year, benefiting from robust domestic demand and still buoyant exports. FX markets have also found Indonesia's large current account surplus appealing amid the current financial storm. We expect IDR to remain attractive versus the USD and AXJ as global conditions continue to deteriorate.

FX

Indonesia is better placed than many of its Asian counterparts to ride out the deterioration in global growth—enjoying a comfortable external position as well as smaller export exposure. Also, FDI and foreign portfolio flows have held up quite well so far this year.

Although there is still upward momentum in Indonesian inflation, the outlook has improved greatly. Global demand is slowing, food and fuel prices are in a down-trend, and 100 bps of past BI tightening should be feeding through the economy just as elections come due next year. It is a close call, but we do not expect to see any more tightening by BI over the next 12 months. Nevertheless, a BI promise to return to single digit inflation before end-2008 will require continued stability in the rupiah to deliver on this pledge.

Hence, in spite of the barrage of shocks hitting the global financial system, IDR is unlikely to wander very far from the current 9000-9500 trading range. Although IDR has been an out-performer within AXJ this year, the currency would seem to still offer good value versus TWD, SGD and HKD—economies with much greater sensitivity to financial market shocks and much larger exposure to the ongoing deterioration in global growth prospects.

Rates

An extended pause in BI tightening and heightened risk aversion point to lower IRS rates, favouring receiver positions. The market will take its cue from inflation data—seen very close to single digits by year-end (at 10.1%).

Tamara Henderson

Market Forecasts - Indonesia

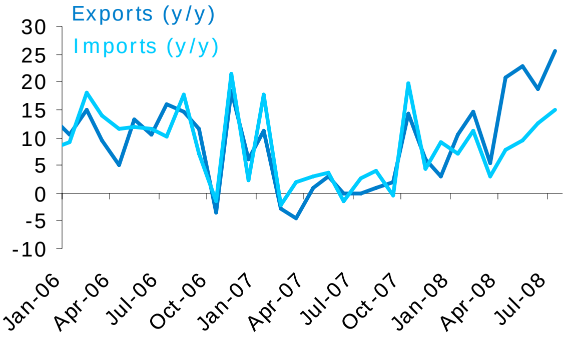
FX	Current	Ytd (%)	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09
USD-IDR	9506	1.2%	9600	9800	9700	9600	9400
AUD-IDR	7532	-8.4%	8256	8134	7760	7488	7144
NZD-IDR	6367	-11.5%	6240	6664	6305	6048	5734
Rates	**Current**	**Ytd (bps)**	**Dec-08**	**Mar-09**	**Jun-09**	**Sep-09**	**Dec-09**
BI's bank rate	9.25	125	9.00	9.00	9.00	9.00	9.00
2-year IRS (versus IDR fix)	11.25	375	11.0	10.9	10.6	10.4	10.1
5-year IRS	11.33	308	11.2	11.1	10.9	10.7	10.6
10-year IRS	11.45	255	11.4	11.3	11.2	11.2	11.1

Sources: ANZ, Bloomberg

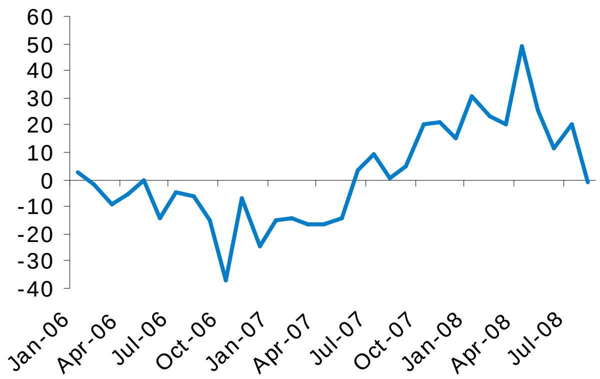
Country Update: Malaysia

In spite of the global slowdown, Malaysia's exports continue to hold up well. Inflation remained high in August, but has probably peaked and Bank Negara seems likely to stand pat on rates. Weaker industrial production and vehicle sales data point to some growth easing. On the political front, pressure heats up on the incumbent premier to step down.

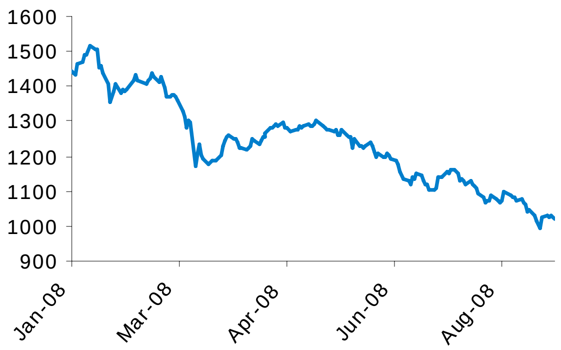
Malaysia - Trade Developments



Malaysia - Vehicle growth (y/y)



Malaysia-KLCI Index



- Inflation stayed at a 26-year high in August, rising 8.5% (y/y). Food and fuel drove the increase, rising 11.6%.
- Domestic demand growth appears to be easing. Industrial production increased by only 2.3% (3mma y/y) for July down from 3.4% in June. Meanwhile, vehicles sales contracted by 0.8% (y/y) in August after rising 20.2% (y/y) in July.
- Exports continued to hold up well despite the global slowdown, rising 25.4% (y/y) in July. Exports to the European Union and North America posted strong growth. Imports rose 14.8% (y/y) in July, up from 12.5% in June.
- With the global credit crisis intensifying, the Malaysian one month interbank LABUAN rate increased to 5.5%, up from 2.5% in August. Equity markets have fallen in line with others regionally, and are down about 30% this year.
- Political tensions have increased since the popular opposition leader Anwar Ibrahim stated he wants to oust the ruling party, putting pressure on Prime Minister Abdullah Badawi to step down earlier than the promised 2010.
- We see growth moderating in the coming quarters, but supported by firm commodity exports. For us the key short-term risk facing the country is political instability, which could hurt domestic consumption and investment.
- Inflation pressures should abate with the easing of food and fuel prices, so we don't see Bank Negara raising rates as it focuses more on combating slowing growth, which could be exacerbated by the rising political tensions.

Joshua Saldanha

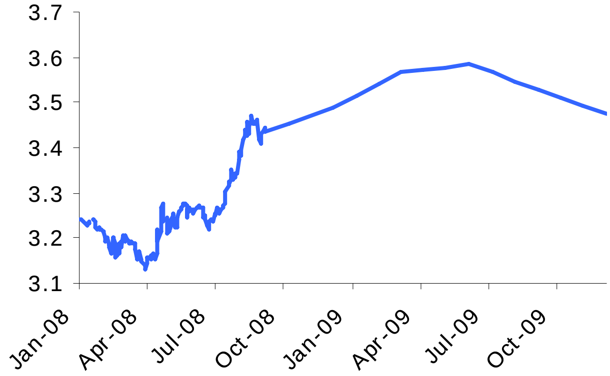
Economic Data - Malaysia

Monthly data	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Jul-08	Aug-08
Industrial Production, % y/y	7.4	6.7	3.5	5.2	2.9	2.2	1.7	N/A
Manufacturing Sales, % y/y	15.8	19.6	10.2	17.9	15.1	18.1	15.0	N/A
Consumer Price Index, % y/y	2.3	2.7	2.8	3.0	3.8	7.7	8.5	8.5
Exports, % y/y	10.4	14.5	5.5	20.9	22.9	18.6	25.4	N/A
Imports, % y/y	7.1	11.1	2.9	7.9	9.4	12.5	14.8	N/A
Trade Balance, USD bn	3.0	2.9	2.5	3.9	4.8	3.9	4.4	N/A
Foreign Exchange Reserves, US$ bn	102.9	110.6	114.2	118.0	119.4	120.0	119.3	116.9
Quarterly data	**Sep-06**	**Dec-06**	**Mar-07**	**Jun-07**	**Sep-07**	**Dec-07**	**Mar-08**	**Jun-08**
Retail Sales, % y/y	20.9	16.8	25.3	33.0	39.7	35.7	19.8	23.8
Real GDP, % y/y	5.9	5.3	5.5	5.7	6.7	7.3	7.1	6.3
-Private consumption	6.4	6.4	7.6	12.3	13.0	10.2	11.7	9.0
-Government consumption	9.2	4.4	7.3	10.4	6.0	4.2	10.5	7.1
-Gross fixed capital formation	3.5	9.8	9.5	6.0	12.8	10.2	6.0	5.6
Nominal GDP, MYR bn	149.2	147.8	144.6	154.3	166.3	176.7	174.8	188.8
Current Account, US$ bn	7.4	7.9	5.7	7.3	8.6	8.0	7.5	11.3
Capital & Financial Account, US$ bn	-4.9	-5.7	0.8	2.2	-9.0	-5.2	8.3	-3.8

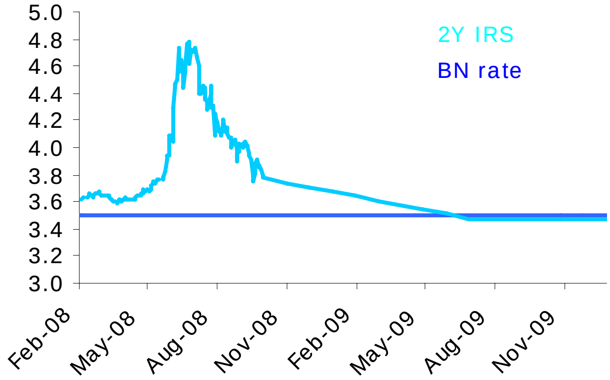
Sources: Bloomberg, CEIC

Malaysia: FX and Rates Strategy

Further upside in USD-MYR



2Y IRS in a down-trend



Malaysia's large export exposure is expected to keep MYR under pressure. Political uncertainty, a spike in inflation and lower commodity prices are additional negatives.

FX

The uptrend in USD-MYR should remain intact, with USD-MYR expected to test 3.50 by year-end, compared with 3.44 currently. Investor preference for the MYR continues to wane as Malaysia's significant export exposure becomes more of a focus amid the sharply deteriorating global outlook. Political uncertainty, lower commodity prices (i.e. lower export values), and a spike in inflation are added negatives.

Meanwhile, Malaysia has one of the best external positions in the region with a current account surplus amounting to 18% of GDP. Also, Malaysia's financial sector is less developed and therefore less exposed to the recent barrage of financial shocks reverberating out of the US and Europe. This should support the ringgit versus the Singapore dollar.

Rates

Malaysia's significant trade exposure to the weaker global outlook means the Bank Negara will be reluctant to tighten policy. Also, our model suggests that inflation is peaking—although the run-down will be relatively slow because of government fuel subsidies. The combination of a weaker growth outlook and a retreat in inflation will allow Bank Negara to leave monetary policy unchanged over the next 12 months.

IRS rates are likely to cue off of inflation data, which will be sticky on the way down. As such, the 2-year MYR IRS rate is seen only marginally lower by year-end—down to 3.7% versus 3.8% currently.

Tamara Henderson

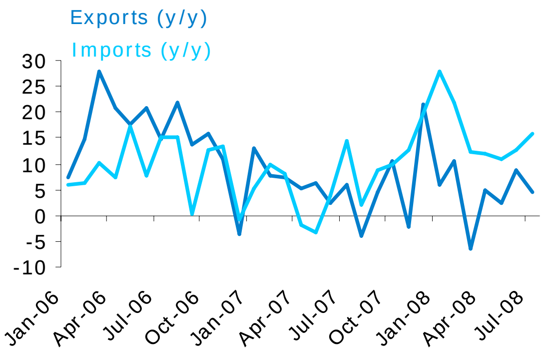
Market Forecasts - Malaysia

FX	Current	Ytd (%)	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09
USD-MYR	3.44	3.8%	3.5	3.6	3.6	3.5	3.5
AUD-MYR	2.72	-5.9%	3.0	3.0	2.9	2.8	2.6
NZD-MYR	2.30	-9.1%	2.3	2.4	2.3	2.2	2.1
Rates	**Current**	**Ytd (bps)**	**Dec-08**	**Mar-09**	**Jun-09**	**Sep-09**	**Dec-09**
BNM's overnight policy rate	3.50	0	3.50	3.50	3.50	3.50	3.50
2-year IRS (versus 3M KLIBOR)	3.78	-2	3.7	3.6	3.5	3.5	3.5
5-year IRS	4.13	-5	4.1	4.0	3.9	3.9	3.8
10-year IRS	4.68	-1	4.6	4.6	4.5	4.5	4.5

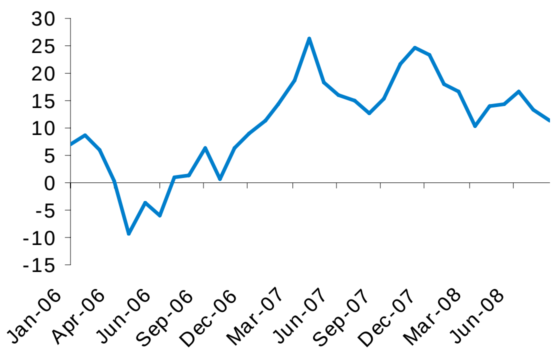
Sources: ANZ, Bloomberg

Country Update: Philippines

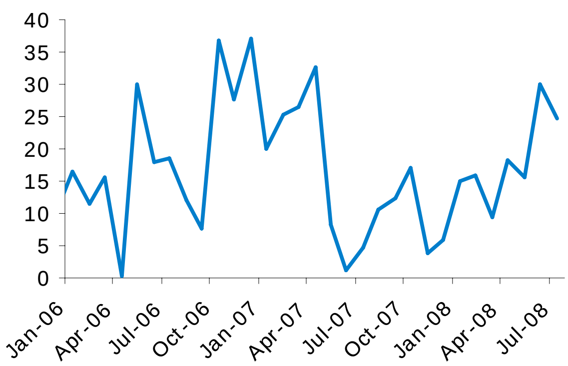
Philippines - Trade Developments



Philippines-Vehicle Sales



Philippines-Overseas Remittance



Inflation remains elevated, reaching a 16-year high in August. Vehicle sales continue to grow strongly, but industrial production data are mixed. Remittances show no sign of being affected by the global slowdown, while exports eased in July.

- Inflation remains elevated, rising 12.5% (y/y) in August, up from July's 12.3% pace. Core inflation rose to a 38 month high of 7%. The food, fuel, and services components saw the biggest increases.
- Indicators suggest that domestic demand is holding up relatively well. In August vehicles sales grew 11.3% (3mma y/y). Meanwhile industrial production (volume) was up 8.1% (y/y) in July. In the IP sub components, electrical machinery contracted 1.3% (y/y), however.
- Remittances continued their upward trend, growing 23.1% (3mma y/y) in July, the strongest rate in 15 months.
- Exports increased in July 4.4% (y/y), up from the previous month's 8.8%. Exports to China and US contracted 3.0% (y/y) and 7.9% (y/y) respectively.
- The government's budget deficit narrowed to 4.6% of GDP as a surplus of 1.7 billion pesos was posted in August. Revenue rose 1.5% (y/y) while expenditure rose 13.5% (y/y).
- Equity markets continue to fall in line with other regional indices and are down by about 30% year to date. Foreign investors have withdrawn $674 million this year. The peso has fallen 12.1% so far this year against the US dollar.
- Our momentum model shows that inflation has peaked. Combined with the global slowdown, it seems likely that the BSP will stand pat on rates.
- With export growth easing and consumption weakening, the pace of activity will slow this year and growth will be below 5% in 2009.

Joshua Saldanha

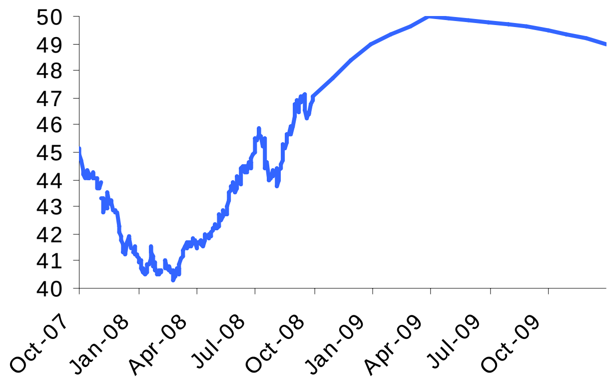
Economic Data - Philippines

Monthly data	**Jan-08**	**Feb-08**	**Mar-08**	**Apr-08**	**May-08**	**Jun-08**	**Jul-08**	**Aug-08**
Manufacturing Production Value-add, % y/y	-3.0	7.5	-4.5	7.9	10.8	9.4	14.0	N/A
Passenger Car Sales, % y/y	27.6	10.8	-7.0	25.0	-0.5	17.4	31.0	24.0
Consumer Price Index, % y/y	4.9	5.4	6.4	8.3	9.5	11.4	12.3	12.1
Exports, % y/y	6.0	10.5	-6.6	4.9	2.3	8.8	4.4	N/A
Imports, % y/y	27.9	21.7	12.2	11.8	10.9	12.7	16.0	N/A
Trade Balance, US$ bn	-0.8	-0.4	-0.9	-0.5	-0.5	-0.8	-1.4	N/A
Foreign Exchange Reserves, US$ bn	30.3	31.6	32.2	32.1	31.8	32.1	32.4	N/A
Quarterly data	**Sep-06**	**Dec-06**	**Mar-07**	**Jun-07**	**Sep-07**	**Dec-07**	**Mar-08**	**Jun-08**
Real GDP, % y/y	5.1	5.5	7.0	8.3	7.1	6.4	4.7	4.6
-Private consumption	5.3	6.2	5.9	5.6	5.7	6.2	5.2	3.4
-Government consumption	14.6	9.8	9.5	11.9	6.4	4.6	1.9	-5.1
-Gross fixed capital formation	8.0	3.7	10.3	20.9	8.8	6.7	2.9	5.6
Nominal GDP, peso bn	1,476.3	1,713.6	1,524.1	1,618.6	1,613.8	1,891.8	1,668.0	1,834.2
Current Account, US$ bn	0.9	2.2	1.9	1.7	1.0	1.7	0.9	0.8
Capital & Financial Account, US$ bn	0.4	-0.1	0.5	-0.4	3.3	-0.5	0.8	0.4

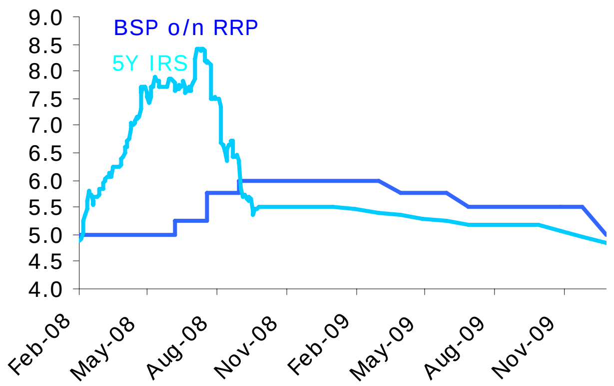
Sources: Bloomberg, CIEC

Philippines: FX and Rates Strategy

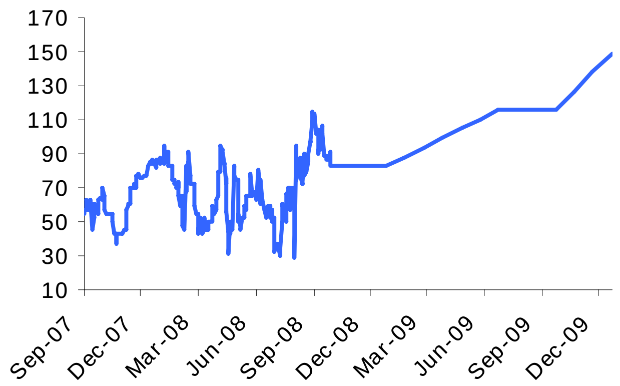
Uptrend in USD-PHP seen in tact



IRS rates headed lower



2s-10s IRS spread to widen



Although inflation remains in double digits and domestic demand is "solid," the BSP is not expected to tighten policy any further during this cycle as escalating shocks to the global financial system will adversely impact exports and capital flows. Compared to many Asian counterparts, however, the peso is better-positioned to weather the storm.

FX

The recent barrage of shocks to the global financial system has likely shifted the BSP's focus—away from double digit inflation, signs of second round effects, and still "solid" domestic demand—toward peaking inflation, worsening sentiment and a worrying global outlook. As such, the BSP is not expected to tighten policy any further during this cycle.

Fallout from the US credit crunch is accelerating, not abating. As such, there will be greater knock-on effects for the Philippines' trade deficit (exports to China have already contracted) and for capital outflows, and this will keep the peso under pressure.

The Philippines' has one of the smaller current account surplus cushions in AXJ at 2.6% of GDP, and the PHP has been punished for this. PHP is one of the region's under-performers, down nearly 14% versus USD and down 6.9% versus AXJ year-to-date.

However, FDI remains in an uptrend. Portfolio outflows are much more benign than in other parts of Asia. Remittances are slowing, but remain high. As such, the Philippines is better-positioned to handle the damage to its current account surplus.

Consequently, we should start to see PHP out-performance within AXJ, as the currencies with much larger export exposure catch-up to the realities of a much bleaker global outlook.

Rates

The combination of double-digit inflation and slowing growth should keep conditions in local rates markets choppy until the BSP makes a clear shift to a growth focus. The 2-year PHP IRS rate is seen holding near 5.2% into year-end.

Tamara Henderson

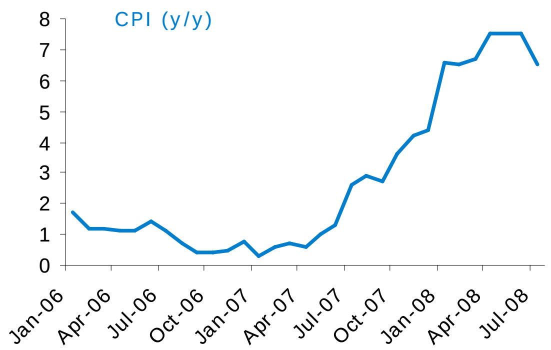
Market Forecasts - Philippines

FX	**Current**	**Ytd (%)**	**Dec-08**	**Mar-09**	**Jun-09**	**Sep-09**	**Dec-09**
USD-PHP	47.05	14.1%	49.0	50.0	49.8	49.5	49.0
AUD-PHP	37.28	3.4%	42.1	41.5	39.8	38.6	37.2
NZD-PHP	31.51	-0.2%	31.9	34.0	32.4	31.2	29.9
Rates	**Current**	**Ytd (bps)**	**Dec-08**	**Mar-09**	**Jun-09**	**Sep-09**	**Dec-09**
BSP's overnight reverse repo rate	6.00	75	6.00	5.75	5.50	5.50	5.00
2-year IRS (versus 3M IB ref rate)	5.15	-54	5.2	4.9	4.7	4.7	4.2
5-year IRS	5.53	-36	5.5	5.4	5.2	5.2	4.9
10-year IRS	5.98	-58	6.0	5.9	5.8	5.8	5.6

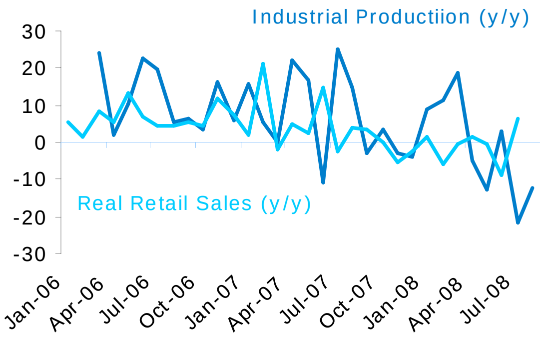
Sources: ANZ, Bloomberg

Country Update: Singapore

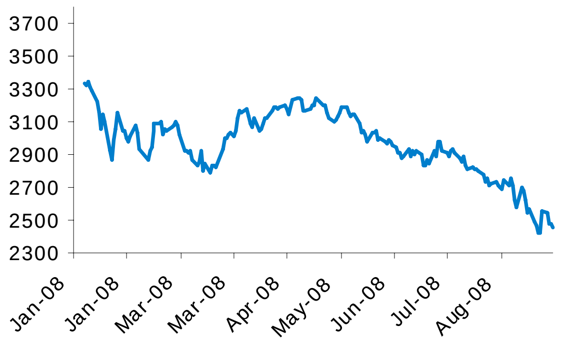
Singapore-Inflation



Singapore-Domestic Demand Indicators



STI Index



Singapore's inflation fell again as food and oil prices eased. Non-domestic exports continued to decline on weakening external demand while retail sales remained buoyant. Turbulence in the global financial markets resulted in a volatile Straits Times Index. Growth looks set to decline further as the external environment remains weak and consumption declines on lower confidence.

- Inflation slowed to 6.4% (y/y) in August from 6.5% in July as food and oil prices eased. The central bank expects consumer prices to rise between 6-7% in 2008.
- Retail sales index rose by 11.8% (y/y) in July as consumers increased purchases of vehicles and spent more at gas stations as oil prices declined. Department-store sales also gained 10.4% (y/y) in July as a result of the month-long summer sale.
- Singapore's non-oil domestic exports declined for the fourth consecutive month, falling 13.8% (y/y) in August from a decline of 5.8% in July. External demand for electronic products and drugs weakened further.
- Industrial production declined by 12.2% (y/y) in August, after falling by 22% in July, on declining electronic and pharmaceutical output. This suggests that the economy may be heading towards a technical recession (two quarters of negative growth).
- The Straits Times Index plunged by 6% over the last two weeks of September. Prices of local financial stocks remained depressed by the ongoing financial market turmoil.
- Going forward, inflation is expected to moderate but demand for Singapore's exports as well as consumption will remain weak, taking down growth. The government has indicated that growth in 2008 may be less than 4%. We agree, and expect growth to continue to decline into early 2009 as Singapore's open and export-driven economy will be adversely affected by the global slowdown and financial crisis.

Ivy Tan

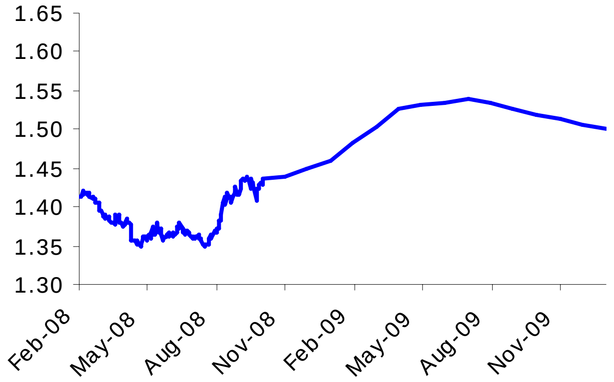
Economic Data-Singapore

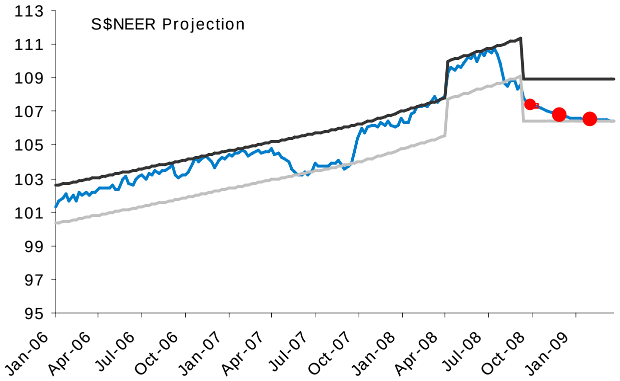
Monthly data	**Jan-08**	**Feb-08**	**Mar-08**	**Apr-08**	**May-08**	**Jun-08**	**Jul-08**	**Aug-08**
Industrial Production, % y/y	8.7	10.7	18.3	-4.9	-13.3	2.4	-21.9	22.0
Retail Sales sa, % y/y	-1.4	9.0	6.3	7.5	5.1	-3.1	12.4	NA
Connsumer Price Index, % y/y	6.6	6.5	6.7	7.5	7.5	7.5	6.5	6.4
Domestic Exports (non-oil), % y/y	2.8	6.2	-5.9	5.3	-10.5	-10.6	-5.8	-13.8
Imports (Non-oil), % y/y	12.0	8.6	7.0	18.0	3.6	3.1	4.3	0.1
Trade Balance, US$ bn	2.8	2.2	1.2	1.5	1.7	1.4	1.5	2.6
Foreign Exchange Reserves, US$ bn	165.4	169.2	176.3	174.5	174.9	175.3	175.6	171.5
Quarterly data	**Sep-06**	**Dec-06**	**Mar-07**	**Jun-07**	**Sep-07**	**Dec-07**	**Mar-08**	**Jun-08**
Real GDP sa, % y/y	7.2	7.0	7.1	9.1	9.3	5.5	7.1	2.2
-Private consumption sa	3.3	3.7	3.0	4.9	5.7	5.1	4.6	5.3
-Government consumption sa	19.7	5.1	-1.6	7.1	0.5	5.2	12.4	4.5
-Gross fixed capital formation sa	10.5	22.4	22.4	27.8	16.9	16.0	30.7	25.2
Nominal GDP sa, SGD bn	54.2	56.3	57.7	60.5	62.5	62.5	65.6	64.1
Current Account, US$ bn	7.4	8.2	9.8	9.7	12.1	7.5	7.2	6.2
Capital & Financial Account, US$ bn	-6.1	-2.2	-8.7	-2.5	-7.4	0.1	0.9	-2.8

Sources: Bloomberg, CEIC

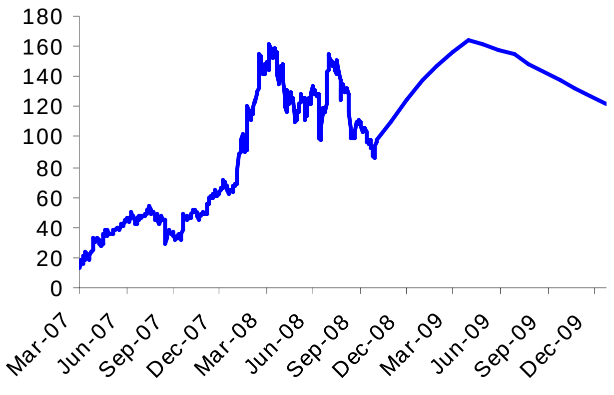
Singapore: FX and Rates Strategy

USD-SGD eying 1.50 level





2s-10s IRS to steepen



A marked deterioration in growth prospects coupled with severe stress in the global financial system pave the way for an unprecedented (and unexpected) shift to a zero percent appreciation path in the S$NEER policy band from the current tightening bias.

FX

At 6.4% y/y, inflation in Singapore remains well above the MAS's target of 1.5%. However, central bankers are inherently forward looking because of the lags in the transmission of monetary policy. Meanwhile, inflation has clearly peaked and Singapore's growth prospects have sharply deteriorated since the MAS set policy back in April.

Within emerging Asia, Singapore has one of the most open economies (exports are more than 200% of GDP) and Singapore's financial sector is much more developed. As a result, Singapore will be hit harder by the sharp deterioration in global growth prospects and the severe stress in the global financial system.

As such, we expect the MAS to adopt a zero percent appreciation path in the S$NEER policy band and to re-centre the band at the prevailing level of S$NEER at its next meeting on October 10th. This would be consistent with similar policy U-turns made by the PBoC and CBC in recent days. Nevertheless, markets are not expecting such a shift from the MAS. USD-SGD is expected to test 1.50 at the turn of the year.

Rates

A U-turn in MAS policy should relieve some of the pressure at the front end of the SGD IRS curve, and widen the 2s-10s IRS spread toward 140 bps by year-end (versus 100 bps currently).

Tamara Henderson

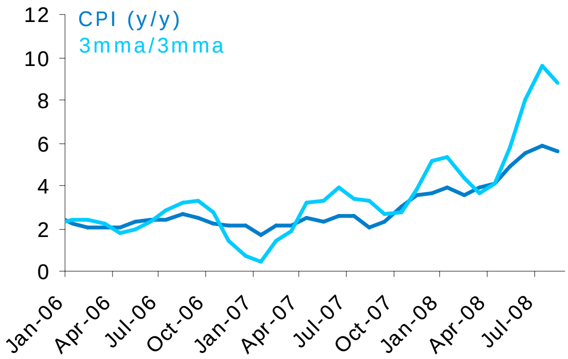
Market Forecasts - Singapore

FX	Current	Ytd (%)	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09
USD-SGD	1.435	0.8%	1.46	1.53	1.54	1.52	1.50
AUD-SGD	1.137	-9.2%	1.26	1.27	1.23	1.19	1.14
NZD-SGD	0.962	-12.1%	0.95	1.04	1.00	0.96	0.92
Rates	**Current**	**Ytd (bps)**	**Dec-08**	**Mar-09**	**Jun-09**	**Sep-09**	**Dec-09**
3-month SIBOR	1.85	35	1.3	0.9	1.0	1.3	1.5
2-year IRS (onshore versus 6M SOR)	2.24	45	1.6	1.2	1.4	1.6	1.9
5-year IRS	2.82	48	2.4	2.2	2.3	2.4	2.6
10-year IRS	3.21	25	3.0	2.9	2.9	3.0	3.1

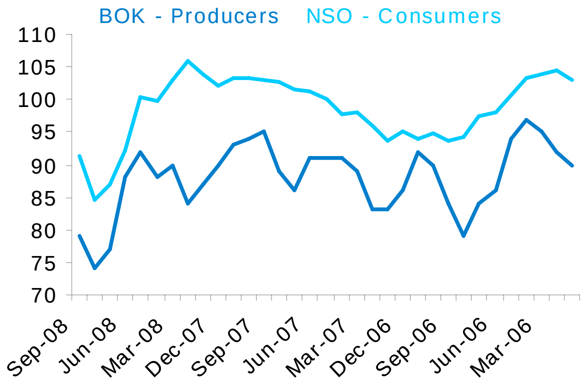
Sources: ANZ, Bloomberg

Country Update: South Korea

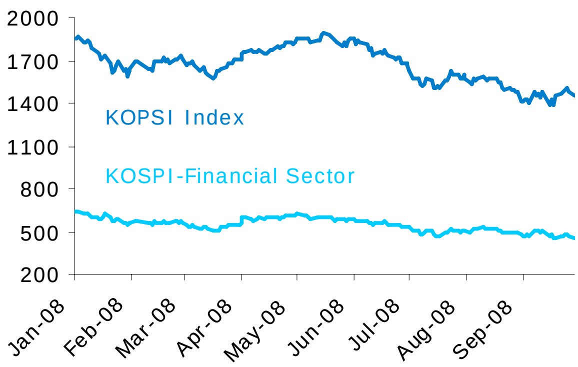
South Korea-Inflation



South Korea-Confidence Indices



South Korea-Stock Index



Domestic demand is languishing as consumers struggle with rising prices and record debts and investment growth remains flat. Inflation has peaked on our momentum measure while previously strong export growth is beginning to fade reflecting weaker external demand.

- Domestic demand and confidence remain weak. Personal consumption growth (sa) in Q2 was fractionally negative with positive overall consumption growth benefiting from a public sector boost. Consumer confidence remains near an 8-year low, but bounced back somewhat in August reflecting the decline in oil prices.
- Retail sales growth remains strong at 12 percent, but largely reflects spending on food and fuel with non-discretionary spending reportedly weak.
- Investment growth (GDP basis) was flat masking a sharp divergence between facilities (linked to the trade sector) which grew by 1 percent q/q, and construction, which declined by an equal amount. Business confidence rebounded off 3-year lows on lower commodity prices, and industrial production growth unexpectedly picked up in July on strong export orders.
- Inflation has apparently peaked, but there are still upside risks from the pass through effects of the depreciation of the won. The m/m rate declined in August on lower fuel prices resulting in a reduction in the y/y rate from 5.9% to 5.6%. That said, food and fuel prices continue to drive index growth with increases y/y of 7.3% and 11.9%, respectively. The BOK kept rates on hold at a 7-year high of 5.25% at its September meeting.
- Exports continue to propel growth, rising 18.7% y/y in August, down from 36% in July. This reflects strong shipments to China (33% growth), Latin America (87%), ASEAN (45%) and the Middle East (41%). Chemical and ship exports continue to do well, while electronics and automobile exports remain soft.
- The new government of MB Kim plans to cut taxes and increase spending to spur growth. Korea is currently running a fiscal surplus of 3-4% of GDP, which the government promises to reduce to stimulate growth.
- Slower growth remains a key risk with a weaker external environment threatening to derail the only driver of growth: exports. The good news is that Korea has a diversified export base in terms of products and destination, with most of the growth coming from emerging economies. Korea's export growth would thus compare favorably with its peers.

Chang Wei Liang

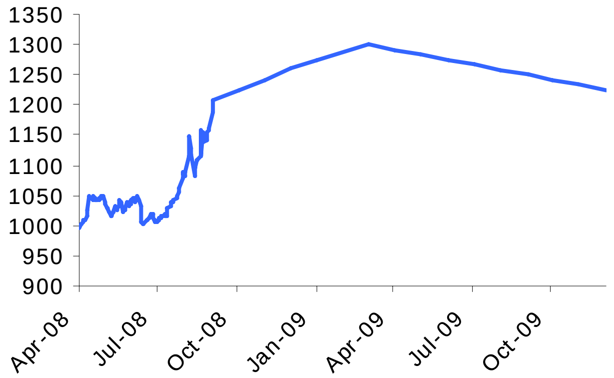
Economic Data - South Korea

Monthly data	**Jan-08**	**Feb-08**	**Mar-08**	**Apr-08**	**May-08**	**Jun-08**	**Jul-08**	**Aug-08**
Industrial Production, % y/y	11.2	10.3	10.3	10.7	8.6	6.8	9.1	N/A
Retail Sales, % y/y	9.6	7.2	8.7	10.6	10.1	6.8	12.3	N/A
Consumer Price Index, % y/y	3.9	3.6	3.9	4.1	4.9	5.5	5.9	5.6
Exports, % y/y	14.9	18.9	18.5	26.4	26.9	16.5	35.7	18.7
Imports, % y/y	31.7	28.3	26.5	29.0	29.2	32.6	47.2	37.0
Trade Balance, USD bn	-4.0	-1.4	-1.1	-0.3	0.8	-0.5	-2.0	-3.8
Foreign Exchange Reserves, US$ bn	262.3	262.6	264.3	260.9	258.7	258.5	247.9	243.4
Quarterly data	**Sep-06**	**Dec-06**	**Mar-07**	**Jun-07**	**Sep-07**	**Dec-07**	**Mar-08**	**Jun-08**
Real GDP, % y/y	5.0	4.2	4.0	4.9	5.1	5.7	5.8	4.8
-Private consumption	4.4	3.9	4.1	4.4	4.8	4.6	3.4	2.3
-Government consumption	6.2	7.2	6.3	6.9	4.5	5.6	3.9	4.0
-Gross fixed capital formation	5.1	4.9	7.2	5.5	1.3	2.9	0.5	0.1
Nominal GDP, KRW tn	213.7	231.2	204.8	221.6	226.9	247.9	218.7	241.1
Current Account, US$ bn	2.0	0.1	-1.6	1.3	2.3	-0.8	-0.1	1.8
Capital & Financial Account, US$ bn	0.6	5.5	3.6	-1.4	-3.6	1.2	0.4	-4.0

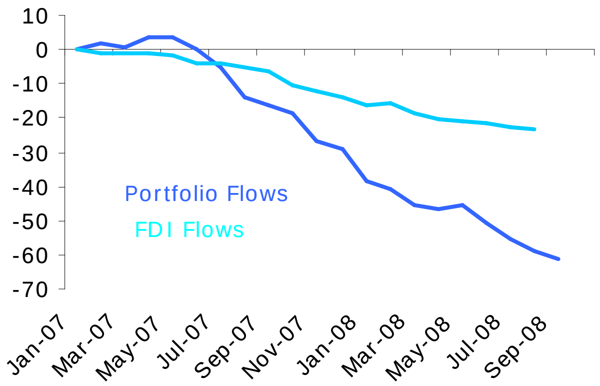
Sources: Bloomberg, CEIC

South Korea: FX and Rates Strategy

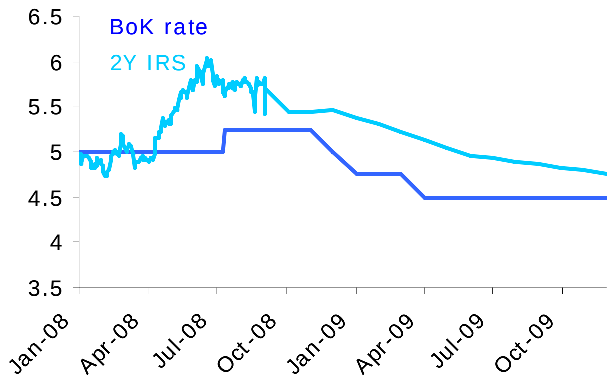
USD-KRW yet to peak



Cumulative flows from Jan 2007, $ bn



IRS headed lower



Although the won has tumbled far and fast, a meaningful turn in USD-KRW is not expected before we see improvement in Korea's current account deficit. Meanwhile, the deficit nearly doubled in August, setting a new record.

FX

Without much hesitation USD-KRW has broken through the 1200 level. Year-to-date KRW is down 27% versus the US dollar and nearly 17% versus AXJ. For one thing, FX markets have been punishing the few Asian economies which have current account deficits—namely South Korea and India. The won has also been under pressure from a systemic onshore shortage of USD—the result of restrictions on FX borrowing put in place in Q1.

Although Korea's current account deficit is relatively small, it is widening. Also, massive capital outflows raise the issue of financing the shortfall. Year-to-date portfolio outflows amount to $32.4bn versus outflows of $29.1bn for all of 2007. Somewhat encouraging, the pace of portfolio outflows successively slowed in August and September. Less encouraging, net FDI outflows have picked up sharply since the start of the credit crisis in mid-2007.

The sharp drop in the won improves Korea's export competitiveness. At the same time, lower oil prices and languishing domestic demand should curtail import growth. As such, an improvement in the goods balance should be on the horizon. The problem, however, is Korea's large services account deficit—which is in a multi-year downtrend.

Near 1200 in USD-KRW currently, the next key level is 1368, which was the 2001 peak in the wake of the bursting of the IT bubble. Having tumbled so far, so fast, the pace of KRW depreciation should moderate.

Rates

In line with our view that the BoK will commence an easing cycle in Q4, Korean swap rates are expected to continue lower and 2s-10s KRW IRS is expected to steepen.

Tamara Henderson

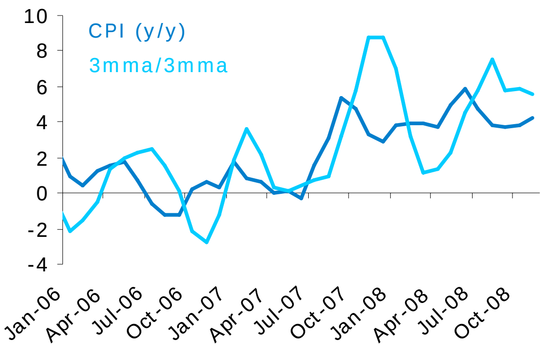
Market Forecasts - South Korea

FX	Current	Ytd (%)	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09
USD-KRW	1207	29.0%	1260	1300	1275	1250	1225
AUD-KRW	956	16.7%	1084	1079	1020	975	931
NZD-KRW	808	12.7%	819	884	829	788	747
Rates	**Current**	**Ytd (bps)**	**Dec-08**	**Mar-09**	**Jun-09**	**Sep-09**	**Dec-09**
BOK's overnight call rate	5.25	25	5.00	4.75	4.50	4.50	4.50
2-year IRS (versus 91D KRW CD)	5.72	-7	5.5	5.2	5.0	4.9	4.8
5-year IRS	5.24	-19	5.1	4.9	4.7	4.7	4.6
10-year IRS	5.10	-36	5.0	4.9	4.9	4.8	4.8

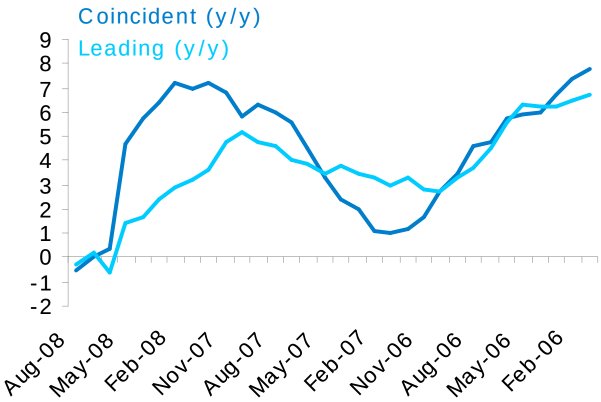
Sources: ANZ, Bloomberg

Country Update: Taiwan

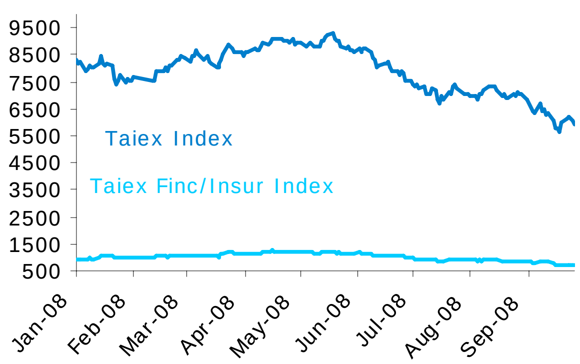
Taiwan-Inflation



Taiwan-Indicators



Taiwan-Stock Index



Domestic demand remains soft and export growth, while still relatively strong, has been negatively affected by weaker external demand. Indicators suggest a further slowdown in activity, which prompted the government to put out a package of spending and tax cuts. Inflation is declining and the CBC surprised the market by cutting rates.

- Domestic demand remains weak. Retail sales contracted 3.8% (y/y) in July, after falling 0.4% in June. Industrial production was up only 0.4% (y/y) in August, down from 1.1% in July and 6.9% in Q2.
- The consumer confidence index slid in August, reflecting poor expectations of economic conditions over the next 6 months. A survey on consumer confidence in housing prices declined sharply in Q2.
- Exports grew 18.4% (y/y) in August from 8.0% in July, reflecting a 16.4% (m/m) growth in information and technology exports. Import growth surged to 39.9% (y/y) in August from 12.3% in July, mainly due to crude oil. Taiwan registered consecutive trade deficits for August and July, respectively.
- CPI inflation in August came down to 4.8% (y/y) from 5.9% in July. Our momentum measure has peaked and is expected to decline, given that food and fuel prices are likely to trend down.
- Export orders growth fell sharply to 5.4% (y/y) in August, down from 13.2% (y/y) in Q2. In particular, orders from China and Hong Kong contracted 8.9% (y/y) in August, for the first time in more than 6 years
- The Central Bank of China unexpectedly cut its policy rate by 12.5 bps to 3.5% given markedly poorer growth prospects. Weaker external demand, with an easing of inflation, signalled a need to shift gears from controlling inflation to stimulating growth. The government had also embarked on a US$5.6bn spending and tax cuts package to bolster growth.
- The financial markets were rocked by the failure of Lehman Brothers, with the TAIEX falling more than 11% in September. In an effort to calm markets, the CBC cut its required reserved ratio on deposits by 1.25% to inject liquidity in the banking system, as well as adding US$3.6bn in the interbank market. The government is considering using a state fund to support the stock market, saying it has fallen too far.
- Declining industrial and export orders point to elevated growth risks in the months ahead. We expect Taiwan to be more vulnerable to the fallout from the US economy, given its reliance on exports for growth as well as a relatively undiversified export base.

Chang Wei Liang

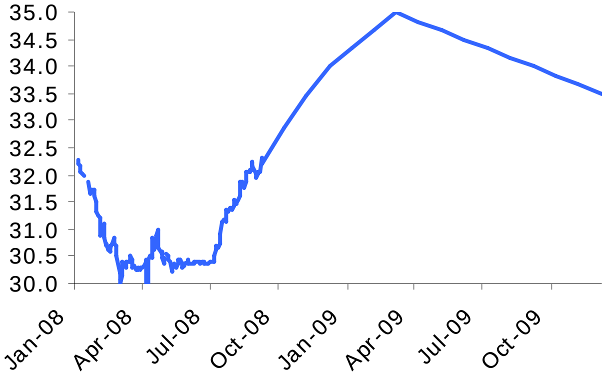
Economic Data - Taiwan

Monthly data	**Jan-08**	**Feb-08**	**Mar-08**	**Apr-08**	**May-08**	**Jun-08**	**Jul-08**	**Aug-08**
Industrial Production, % y/y	12.6	16.0	9.0	10.0	5.6	5.1	1.8	0.4
Retail Trade Index, % y/y	4.0	-0.9	-1.4	-1.0	-1.4	-5.1	-10.0	-6.3
Consumer Price Index, % y/y	2.9	3.9	3.9	3.9	3.7	5.0	5.9	4.8
Exports, % y/y	11.0	15.3	15.2	4.2	10.6	11.3	0.1	11.0
Imports, % y/y	14.0	22.8	29.2	7.7	8.0	12.3	4.1	31.1
Trade Balance, US$ bn	1.5	1.6	0.0	0.9	2.1	1.4	-0.5	-0.1
Foreign Exchange Reserves, US$ bn	272.8	277.8	286.9	289.4	290.1	291.4	290.9	282.1
Quarterly data	**Sep-06**	**Dec-06**	**Mar-07**	**Jun-07**	**Sep-07**	**Dec-07**	**Mar-08**	**Jun-08**
Real GDP, % y/y	5.3	4.1	4.2	5.2	6.9	6.5	6.3	4.3
-Private consumption	0.8	2.4	2.1	2.6	3.6	1.9	2.0	1.1
-Government consumption	0.0	0.0	-0.2	0.0	1.7	1.5	1.7	-0.8
-Gross fixed capital formation	4.0	5.2	0.8	6.0	4.5	-1.7	4.4	-7.7
Real GNP, % y/y	5.3	4.1	4.2	5.2	6.9	6.5	6.3	4.3
Nominal GDP, TWD tn	2.6	2.7	2.6	2.5	2.8	2.9	2.7	2.5
Current Account, US$ mn	6,643.0	8,815.0	9,410.0	5,909.0	6,477.0	11,183.0	8,495.0	6,493.0
Capital Account, US$ mn	-22.0	-41.0	-26.0	-19.0	-33.0	-18.0	-271.0	-20.0

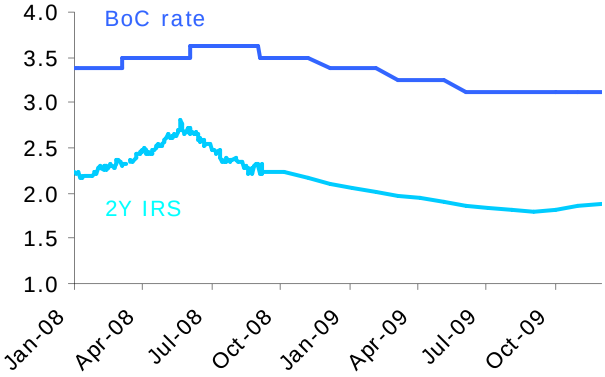
Sources: Bloomberg, CEIC

Taiwan: FX and Rates Strategy

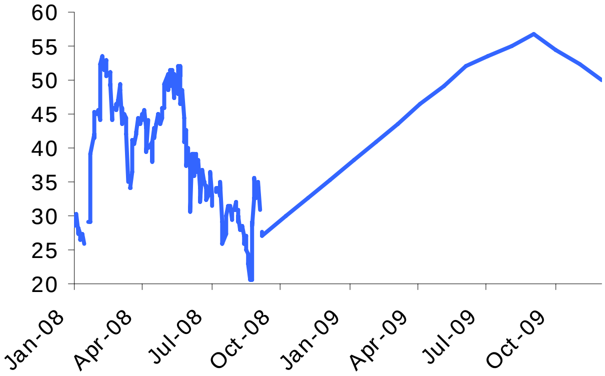
USD-TWD under pressure



2Y IRS to benefit from more CBC cuts



2s-10s IRS spread headed wider



An abrupt policy U-turn by the CBC underscores the large hurdles faced by Taiwan's economy. Thus far, the TWD has shown resilience versus its peers in the region, but we expect this to change in Q4.

FX

After raising rates for 16 consecutive quarters, the CBC caught markets by surprise with an unexpected U-turn—cutting the policy rate by 12.5 bps to 3.6% in September. Domestic demand is contracting, and the economy posted back-to-back trade deficits in July and August for the first time in over 20 years. Net foreign portfolio flows have turned massively negative, now –$11.7bn year-to-date versus a cumulative inflow of +$0.5bn at the start of June. FDI is in a downtrend, albeit normalizing from elevated levels in 2005 and 2006.

Within the region, Taiwan is one of the more exposed economies to a global slowdown. It is also more sensitive to US growth dynamics. Meanwhile, Taiwan's financial sector is among the more developed within emerging Asia, so the recent barrage of shocks to the global financial system will have a larger impact.

Nevertheless, the TWD remains among the region's top performers this year, up 1% versus the USD (the second best performance in the region after CNY's 6%) and up 7% versus AXJ. Deteriorating global growth prospects have pushed USD-TWD above the 32.00 level as we had expected, but we have yet to see a re-alignment in TWD versus AXJ. This is likely to change in Q4 as we see further deterioration in the current account surplus—already down 24% to $6.5bn in Q2 from $8.5bn in Q1.

Rates

In line with our view that the CBC will continue to ease monetary policy over the coming quarters, swap rates should continue to fall and the 2s-10s IRS curve should start to steepen.

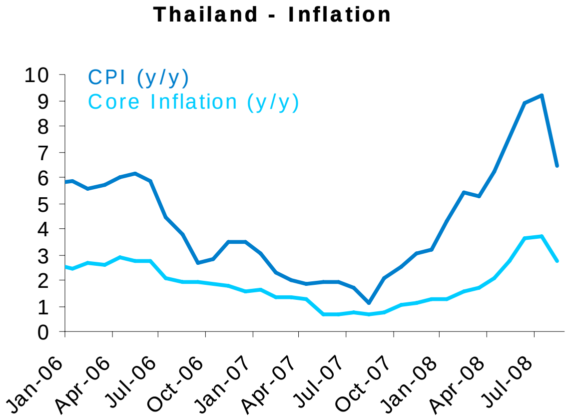
Tamara Henderson

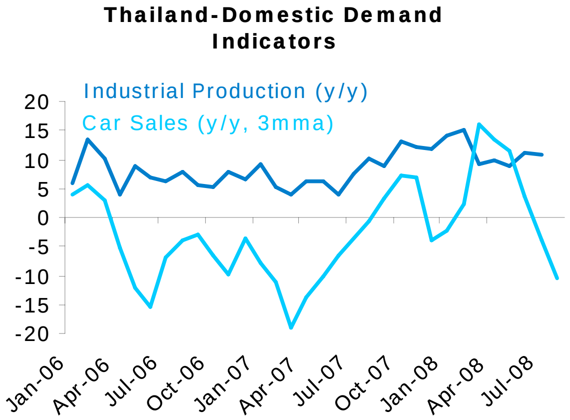
Market Forecasts - Taiwan

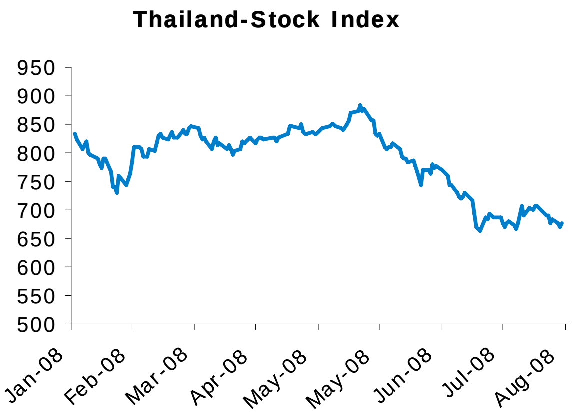
FX	Current	Ytd (%)	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09
USD-TWD	32.21	-0.7%	34.0	35.0	34.5	34.0	33.5
AUD-TWD	25.52	-10.0%	29.2	29.1	27.6	26.5	25.5
NZD-TWD	21.57	-13.1%	22.1	23.8	22.4	21.4	20.4
Rates	**Current**	**Ytd (bps)**	**Dec-08**	**Mar-09**	**Jun-09**	**Sep-09**	**Dec-09**
BOC's discount rate	3.50	13	3.38	3.25	3.13	3.13	3.13
2-year IRS (versus 3M CP)	2.23	-17	2.1	2.0	1.9	1.8	1.9
5-year IRS	2.33	-21	2.2	2.2	2.1	2.0	2.1
10-year IRS	2.50	-19	2.5	2.4	2.4	2.4	2.4

Sources: ANZ, Bloomberg

Country Update: Thailand







Political uncertainty escalated with a change of the prime minister. Inflation slowed in September from the fastest pace recorded in a decade, and looks to have peaked. The global slowdown is having a negative impact on export growth, which fell in August increasing the trade deficit. The main risks are continued political uncertainty which will depress domestic sentiment, and the effects of a weaker external environment on exports.

- Political developments saw Prime Minister Sundaravej forced out, replaced by Somchai Wongsawat (brother-in-law of the ousted Premier Thaksin Shinawatra). Protesters from the People's Alliance for Democracy continue to occupy the prime minister's office in their bid to topple the elected government.
- CPI and core inflation (y/y) declined to 6.4% and 2.7% respectively in August versus 9.2% and 3.7% in July. This result was helped by the government providing free electricity and water to low-use households and waiving some bus and train fares.
- Recent data point to slowing domestic demand. For August, vehicle sales contracted 10.4% (3mma y/y) versus the previous month's contraction of 3.8%. Manufacturing production growth eased to 10.9% (y/y) in July.
- Exports rose 14% (y/y) in August, much slower than in July. Destination data show continued increases across Thailand's key markets: ASEAN, China, and the US.
- Given the prospects of lower inflation, we see the Bank of Thailand keeping the repurchase rate unchanged at 3.75% for the rest of the year and into 2009.
- With global risk aversion increasing, and given the political situation in Thailand, the Thai stock market fell by 10% in September and almost 30% year to date. Foreigners have taken $743 million this month (year to date $3.8 billion) out of the equity markets. Moreover, the political and emerging market risk has seen the Thai Baht come under pressure, depreciating 12.4% against the US dollar this year.

Joshua Saldanha

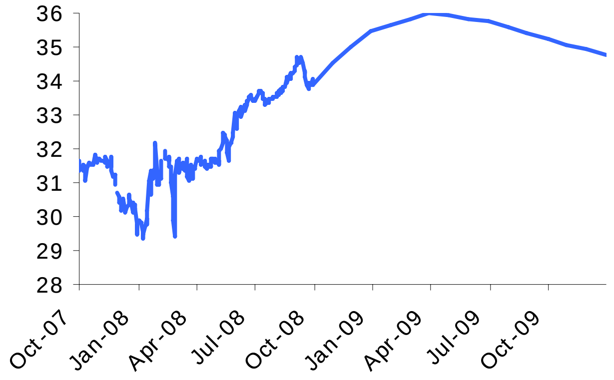
Economic Data - Thailand

Monthly data	**Jan-08**	**Feb-08**	**Mar-08**	**Apr-08**	**May-08**	**Jun-08**	**Jul-08**	**Aug-08**
Industrial Production, % y/y	14.0	15.0	9.2	10.0	9.0	11.2	10.9	N/A
Retail Sales, % y/y	11.0	11.3	9.1	7.4	9.7	9.5	N/A	N/A
Consumer Price Index, % y/y	4.3	5.4	5.3	6.2	7.6	8.9	9.2	6.4
Exports, % y/y	25.0	7.2	4.3	13.9	9.6	18.1	38.6	14.2
Imports, % y/y	39.8	22.7	20.9	29.7	4.6	21.1	49.4	26.1
Trade Balance, US$ bn	-0.8	-0.8	0.0	-1.9	1.1	0.4	-1.2	-0.9
Foreign Exchange Reserves, USD bn	90.2	97.8	107.3	107.3	106.4	103.0	102.1	98.9
Quarterly data	**Sep-06**	**Dec-06**	**Mar-07**	**Jun-07**	**Sep-07**	**Dec-07**	**Mar-08**	**Jun-08**
Real GDP, % y/y	4.5	4.3	4.2	4.3	4.8	5.7	6.1	5.3
-Private consumption	2.8	2.7	1.4	0.9	1.8	1.8	2.6	2.4
-Government consumption	3.2	-4.0	9.1	9.3	9.5	16.0	-0.1	-2.4
-Gross fixed capital formation	3.1	1.9	-1.3	0.2	2.6	4.0	5.4	1.9
Nominal GDP, THB bn	1,938.3	2,054.4	2,082.7	2,031.0	2,073.7	2,281.7	2,291.6	2,260.0
Current Account, US$ bn	0.8	0.6	1.9	1.3	1.9	2.4	0.9	0.7
Capital & Financial Account, US$ bn	1.8	1.4	0.0	1.0	2.3	1.4	6.5	-4.4

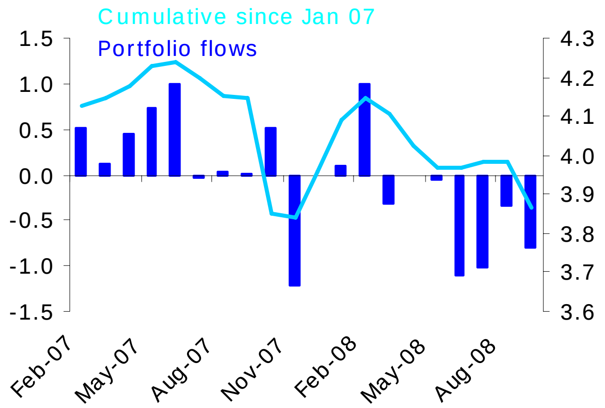
Sources: Bloomberg, CEIC

Thailand: FX and Rates Strategy

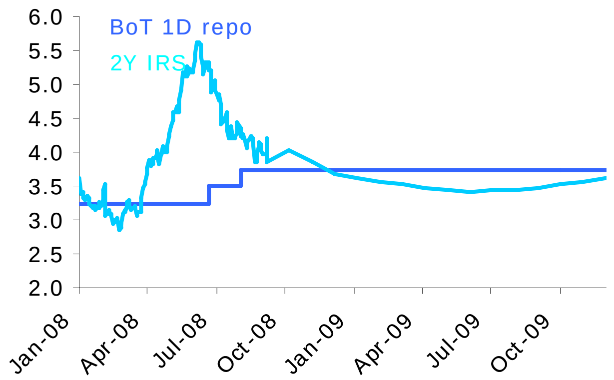
THB still under pressure



Portfolio outflows have accelerated



IRS rates headed lower



The baht is the third worst performing currency in AXJ, behind the Korean won and Indian rupee. Continued political uncertainty and a deteriorating current account will keep THB under pressure into 2009.

FX

In H1, pressure on the Thai baht was linked in part to the BoT's poor track record on inflation, which jumped to 9% (y/y) compared with 2% a year earlier while the BoT stood on the sidelines. Now in H2, the focus has shifted to the softening in domestic demand and the weaker outlook for Thailand's all-important export sector. Political uncertainty continues to be another negative.

The baht is the third worst performing currency in AXJ, behind the Korean won and the Indian rupee—both of which are in a small minority with current account deficits. Although Thailand has a current account surplus, it is the smallest among its Asian peers at 1% of GDP—and getting progressively smaller as global growth prospects deteriorate. Meanwhile, portfolio outflows have accelerated, amounting to $3.9bn so far this year, compared with a net inflow of $1.85bn for 2007 as a whole.

Thailand's key exports face stiff competition from Vietnam and the Philippines, so the drop in the baht should eventually lead to an improvement in Thailand's trade balance—but we are not there yet. As such, the uptrend in USD-THB should remain in tact and the THB is expected to continue to under-perform the more solid fundamentals elsewhere in Asia, notably Indonesia.

Rates

Inflation has peaked and growth prospects have worsened, allowing the BoT to remain on hold for the foreseeable future. This should pave the way for lower IRS rates. The 2-year THB IRS rate is expected to fall to 3.7% by year-end, versus 3.9% currently.

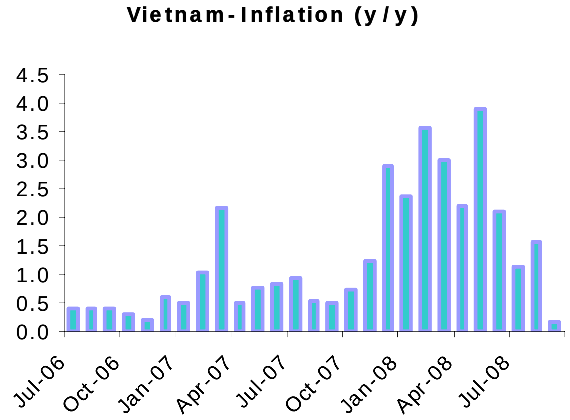
Tamara Henderson

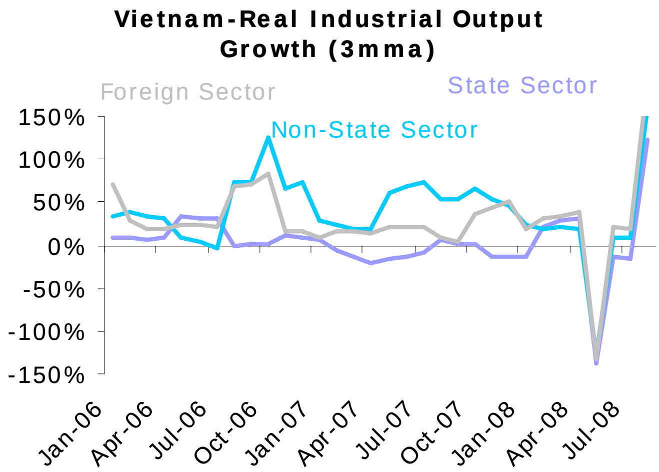
Market Forecasts - Thailand

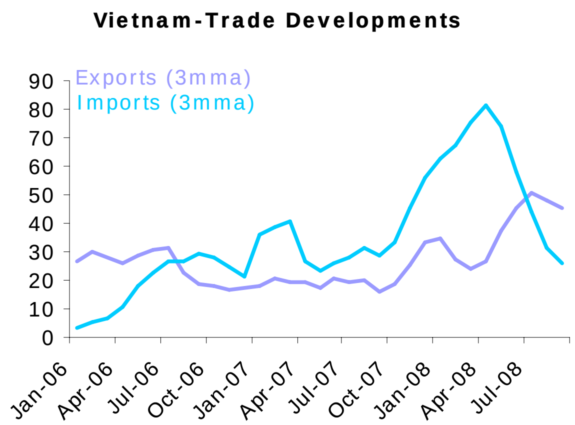
FX	Current	Ytd (%)	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09
USD-THB	33.86	13.7%	35.5	36.0	35.8	35.3	34.8
AUD-THB	26.83	2.9%	30.5	29.9	28.6	27.5	26.4
NZD-THB	22.68	-0.6%	23.1	24.5	23.2	22.2	21.2
Rates	**Current**	**Ytd (bps)**	**Dec-08**	**Mar-09**	**Jun-09**	**Sep-09**	**Dec-09**
BOT's 1-day repo rate	3.75	50	3.75	3.75	3.75	3.75	3.75
2-year IRS (versus 6M THB fix)	3.87	-47	3.7	3.5	3.4	3.5	3.6
5-year IRS	4.18	-74	4.0	3.9	3.9	3.9	4.0
10-year IRS	4.43	-91	4.4	4.3	4.3	4.3	4.3

Sources: ANZ, Bloomberg

Country Update: Vietnam







Growth is on a more sustainable track, aided by the government's stabilization measures as well as a soft global environment. Domestic demand signals are mixed and headline inflation has peaked. Exports continue to do well, import growth remains on a firm downward trend, and the trade balance resumes its gradual improvement. Equities had a bad month, but positive signs emerged in the debt markets.

- Inflation (y/y) has finally peaked, falling to 27.9% in August. This is not surprising since on a "momentum" basis the peak was back in June. Importantly, month-on-month inflation rose by only 0.2% in September, the lowest print in two years as fuel prices were cut.
- Domestic demand signals are mixed. Nominal retail sales growth in August fell to 27½% (y/y), down 6ppt from the average of the first seven months of the year; however, declining inflation complicates the read. Real industrial output growth spiked to 30% as activity in the foreign sector and domestic private sector both surged.
- Export growth remained solid in September at 46% (y/y, 3mma) as rice and crude oil continued their recent strength. Meanwhile, import growth declined to 26%, although petroleum and steel import growth remains high. The trade balance continued its gradual improvement when measured on a 12-month rolling basis.
- Recent government bond auctions have been well-bid, with coupons on 2- and 3-year notes at 15.5%. Local participation has been increasing, suggesting improved confidence.
- The Ho Chi Minh and Hanoi stock indices were down sharply in September, with volatility spiking after Lehman declared bankruptcy. Declines for the month were about 20 percent. Foreigners have been net sellers of stock four weeks running.
- The stabilization measures adopted in June appear to be successful so far, aided in part by a weaker external environment. We expect growth to remain around 6½% (the Q2 outturn) over the near term as consumption and investment growth will need to remain moderate in order to generate a sustained improvement in the trade balance.

Paul Gruenwald

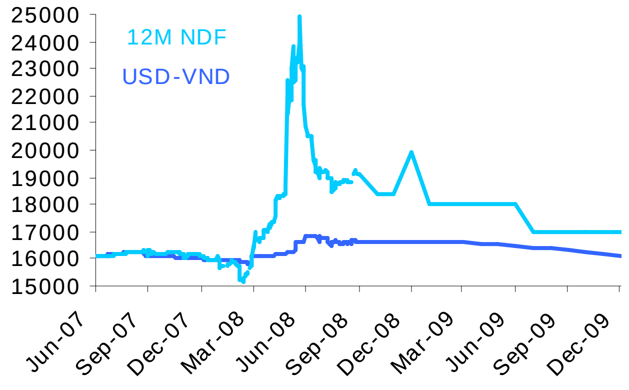
Economic Data - Vietnam

Monthly data	**Jan-08**	**Feb-08**	**Mar-08**	**Apr-08**	**May-08**	**Jun-08**	**Jul-08**	**Aug-08**
Industrial Production, % y/y	7.4	31.1	35.7	15.5	13.9	12.0	11.4	30.8
Retail Sales, % y/y	34.0	39.0	26.7	38.9	25.5	35.5	36.1	27.5
Consumer Price Index, % y/y	14.1	15.7	19.4	21.4	25.2	26.8	27.0	28.3
Exports, % y/y	30.6	16.8	24.5	39.4	43.7	53.7	46.1	49.4
Imports, % y/y	66.2	78.6	81.3	84.9	45.1	43.0	34.6	38.7
Trade Balance, USD bn	-2.3	-2.8	-3.3	-3.2	-1.9	-0.7	-0.8	-1.0
Quarterly data	**Sep-06**	**Dec-06**	**Mar-07**	**Jun-07**	**Sep-07**	**Dec-07**	**Mar-08**	**Jun-08**
Real GDP, % y/y	8.8	8.9	7.7	-37.8	8.7	9.2	7.5	5.8
-Agricultural, forestry, fishery	3.0	2.8	2.3	2.9	3.8	4.1	3.2	3.3
-Industry and construction	11.2	11.9	9.2	10.2	10.7	11.8	8.0	6.2
-Services	8.9	8.9	7.8	9.0	8.8	9.0	8.3	7.0
Nominal GDP, VND tn	248.3	299.0	210.9	282.6	293.8	356.2	254.1	371.7
Foreign Exchange Reserves, USD bn	11.9	13.4	18.3	20.8	22.6	23.6	0.0	0.0

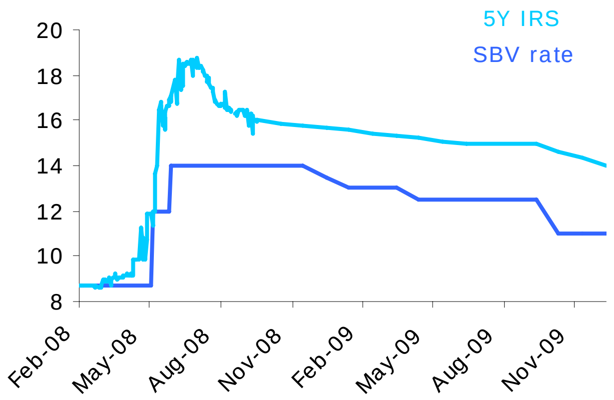
Sources: Bloomberg, CEIC, General Statistics Office of Vietnam

Vietnam: FX and Rates Strategy

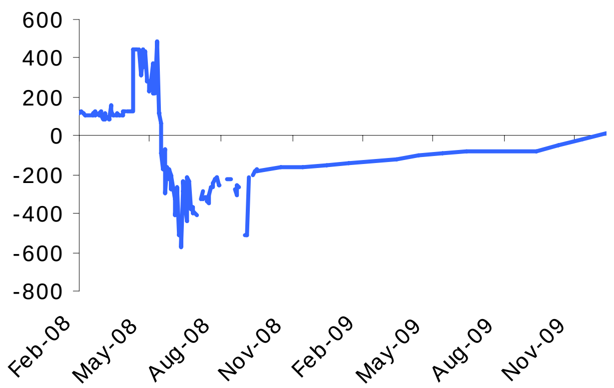
VND NDF to revert next year



Rates headed lower



2s-10s IRS to steepen



Vietnam's exports are holding up quite well despite the slowdown in global growth. Also, inflation appears to have peaked. However, the next leg of compression in the NDF premium is not expected before year-end.

FX

Inflation in Vietnam is finally showing signs of moderating, now at 27.9% (y/y) compared with a high of 28.3% the previous month. There is still a long way to go, but more importantly markets will need to see evidence of a solid down-trend. As such, further compression in the 12-month NDF premium is not expected until the turn of the year.

Although the global growth outlook has significantly worsened, Vietnam's fundamentals have been holding up. Notably, export growth remains solid at 39% (y/y) in September, despite the drop in commodity prices. That said, portfolio flows are taking a beating in Vietnam in tandem with the global drop in risk appetite. Along with an already fragile external position, this maintains pressure on the dong.

Nevertheless, much of the bad news has already been discounted by the market, and the government's stabilization measures appear to be working. This suggests more limited upside in USD-VND. Also, Vietnam's long-term fundamentals remain robust—so bargain hunters will be active.

USD-VND is expected to hold near 16,600 into year-end, while the 12-month NDF outright is not expected to sustain a break below 18,000 until next year.

Rates

Although inflation is close to 30% and real interest rates are firmly in negative territory, the downgrade in global growth prospects should benefit receiver positions given Vietnam's large external exposure. Relatively attractive valuations add to the appeal of Vietnamese rates versus counterparts in the region. The 2-year VND IRS rate is seen falling to 16.2% by year-end, versus 16.7% currently.

Tamara Henderson

FX	Current	Ytd (%)	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09
USD-VND	16600	3.6%	16600	16600	16500	16300	16100
AUD-VND	13154	-6.1%	14280	13780	13200	12710	12240
NZD-VND	11119	-9.3%	10790	11290	10730	10270	9820
Rates	**Current**	**Ytd (bps)**	**Dec-08**	**Mar-09**	**Jun-09**	**Sep-09**	**Dec-09**
SBV's base lending rate	14.00	575	13.50	13.00	12.50	12.50	11.00
2-year IRS (versus 3M VNIBOR)	16.68	861	16.2	15.7	15.2	15.2	13.7
5-year IRS	15.99	725	15.7	15.3	15.0	15.0	14.0
10-year IRS	14.85	535	14.7	14.5	14.4	14.4	13.9

Sources: ANZ, Bloomberg

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