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Global Markets – Asia Team:
EconsAndResearchAsia@anz.com

Paul Gruenwald

Chief Economist, Asia
+65 6216 1814
Paul.Gruenwald@anz.com

Tamara Henderson

Director, FX and Rates Strategy
+65 6216 1845
Tamara.Henderson@anz.com

Liu Li-Gang

Head of China Economics, Asia
+852 3929 5376
LiGang.Liu@anz.com

Yeo Han Sia

Associate Director,
FX and Rates Strategy
+65 6216 1968
HanSia.Yeo@anz.com

Franklin Poon

Economist, North East Asia
+852 3929 5340
Franklin.Poon@anz.com

Ivy Tan

Associate Director, Credit Research
+65 6216 3643
Ivy.Tan@anz.com

Chang Wei Liang

Analyst, Economic Research
+65 6216 1918
Weiliang.Chang@anz.com

Research Interns:

Zhou Hao
Ray Lam
Jaimin Shah
Eesh Mengi
Yansen Poaler

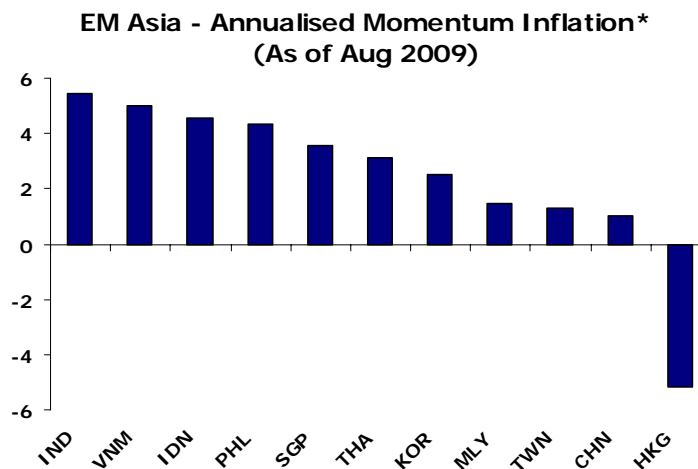
Our Vision:

For Economics & Markets Research to be the most respected, sought-after and commercially valued source of economics and markets research and information on Australia, New Zealand, the Pacific and Asia.

Highlights

- Growth momentum continues across most of emerging Asia, although some indicators (IP and PMIs) have begun to soften. The level of external demand facing the region remains depressed.
- Inflation has turned positive almost everywhere on most measures, although large output gaps imply price pressures will be moderate.
- As noted last month, we remain wary of calling the ongoing rebound a “recovery” given weak discretionary consumption out of the US and EU. We have seen no new evidence to change this view.
- The downtrend in USD-AXJ (Asia excluding Japan) should remain intact into 2010, with risk appetite sustained by favourable base effects on growth as well as more apparent stimulus effects in the developed economies. Near-term, Q3 earnings are key for pace.
- As 2010 draws closer, the bias for market interest rates shifts from neutral to higher. Although it will not be clear whether a durable recovery has been secured until mid-2010, markets know it is only a matter of time before central banks initiate the tightening cycle.

Chart of the Month:



*Note: Annualised 3-month average of m/m inflation
Sources: ANZ Economics, CEIC

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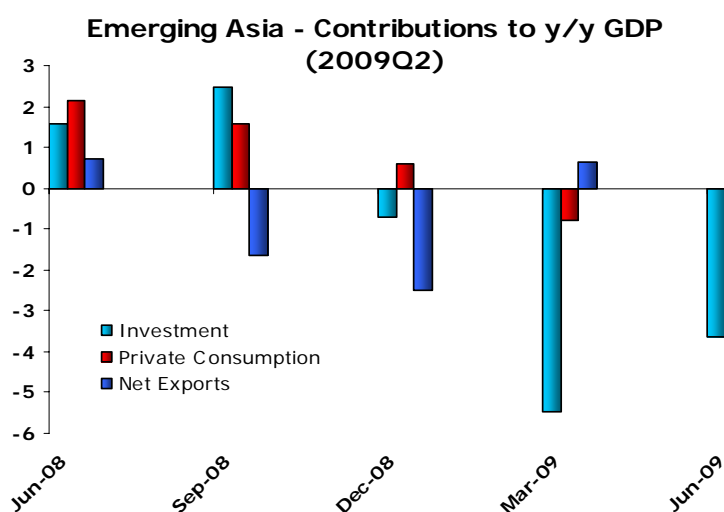
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Feature Article: IP, Inventories and Asia's Recovery

The crisis that began in the United States first struck Asia through lower exports and then moved “on shore” via the interplay between the inventory-shipments ratio and industrial production (IP). In this note we summarise our recent work in this area—the full analysis appears as a forthcoming separate research offering. We found that shipments are the main long-term driver of IP and that IP tends to undershoot during downturns and overshoot during recoveries. Given the normalisation of inventory-shipment ratios and the ongoing weakness in foreign demand for Asia's products, we see the recent boost to IP and its impact on growth as temporary. Absent any compensating factors ahead, we see downside pressure on IP, investment and GDP growth going forward.

The initial shock to Asian growth from the financial crisis in the United States and much of Europe was sharply lower exports. Through mid-2008, Asian economies remained largely unaffected by the financial crisis and the resulting recession in the United States. However, this changed dramatically with the intensification of the crisis following the collapse of Lehman Brothers in September 2008. As financial markets seized up and activity in the advanced markets began to contract sharply, demand for Asian exports fell rapidly. Indeed within a matter of months the year-on-year growth rate for exports across emerging Asia went from double-digit positive rates to double-digit negative rates. As we have noted elsewhere (see *The Anatomy of Emerging Asia's Export Slowdown*, December 2008), compared with the tech bust earlier this decade, the export downturn in the current crisis was quicker, deeper, and more broad-based. Northeast Asia's more export dependent economies (plus Singapore) were hit harder than those in Southeast Asia.

However, the effects of the crisis subsequently broadened and investment has been the major contributor to Asian GDP growth in recent quarters. It was originally thought that Asian economies would be able to at least partially decouple from the advanced countries. The reasoning was that domestic demand in this region was considered to have become more resilient owing to structural reforms, rising incomes and stronger exchange rates. However, this view was, with the wisdom of hindsight, too optimistic. Following the sharp decline in exports was a sizeable decline in investment (see chart), which has dominated growth in recent quarters.¹ The effects of the crisis had therefore come “on shore.”

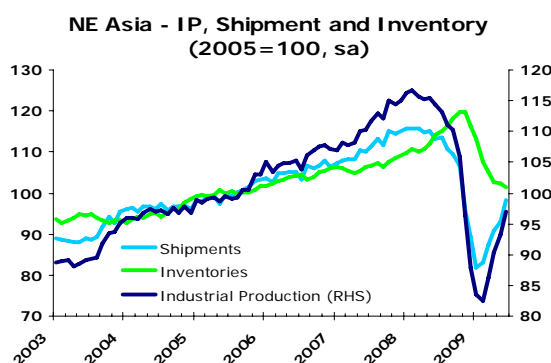
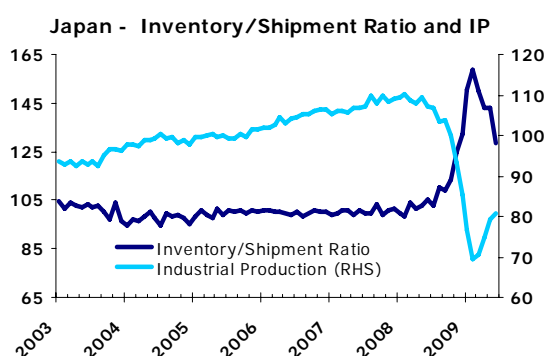
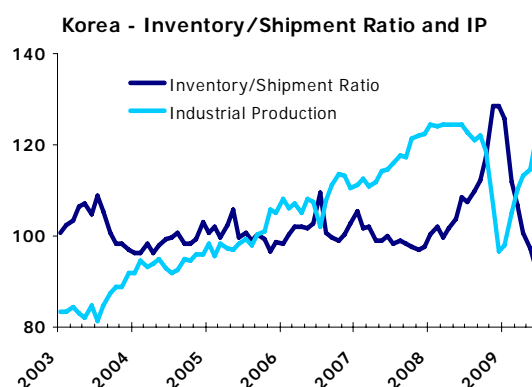
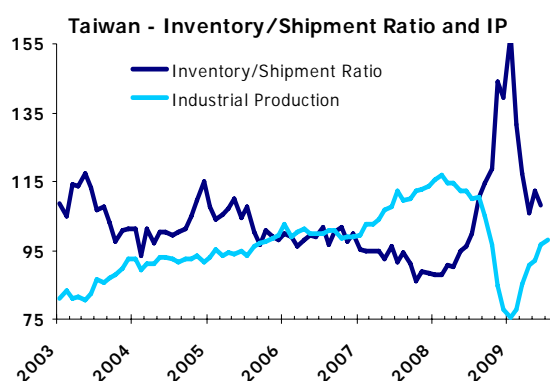


Sources: CEIC, ANZ Economics

¹ These data exclude China, India and Vietnam, where the national accounts are not published on an expenditure basis. China and Vietnam use a production basis; India uses a factor cost basis.

A key driver of Asian investment has been the interplay between the inventory-shipment ratio and industrial production. As demand for their products dried up in late 2008, Asian firms found themselves with too much inventory relative to shipments. Since holding inventory and producing goods are both costly, firms responded to the demand shock by slashing industrial production in order to rein in the surging inventory-shipment ratio. As a result, the levels for both of these indicators breached multi-year bands. Unfortunately, data to measure this process are not widely available across economies, so our sample size is limited to Japan, Korea and Taiwan. Despite the small sample size, the inventory-shipment management process is well established in these economies, which will allow us to measure and model the cycle.

Inventory-shipment ratios across our sample have now largely reverted to pre-crisis levels, and industrial production growth rebounded beginning earlier this year. The data show that inventory-shipment ratios rose for several months following the onset of the crisis in Northeast Asia as shipments collapsed from both foreign and domestic sources.² However, the level shipments then bottomed and began rise off of a lower base at the same time that inventories were being run down. As a result, the inventory-shipment ratio began to decline. Industrial production then began to rise sharply in order to enable the return to an “equilibrium” inventory-shipment ratio. At the current juncture, this normalisation process appears largely complete in Korea and Taiwan, but is less advanced in Japan—see charts.



Sources: CEIC, ANZ Economics

In order to better understand this process, we developed an empirical model linking shipments, inventories and industrial production. The dataset for each economy in our sample includes monthly numbers for the indicators listed above, measured in levels. The data span the period from the previous peak of the inventory-shipment ratio (reached earlier this decade) to the most recent peak in the latter part of 2008. The analytical structure is an “error correction model”

² A breakdown between foreign and domestic shipments is only available in Korea, where the shares are roughly equal. We did not analyse this split in the current research project.

that looks at the long-run relationship between the variables in question as well as the short-run dynamics when the system is away from its equilibrium (long-run) values.³ Industrial production was the dependent variable (that is, the variable to be forecast) while inventories and shipments were the independent variables.

Our long-run result is that changes in shipments, not inventories, are the main driver of IP.

Our regressions showed that the coefficient on the level of shipments is close to unity. This implies that, over the long run, any changes in shipments will drive a roughly equal change in inventories. In contrast, the relation between the level of inventories and industrial production is much weaker. We found that for any given reduction (increase) in inventories, the long-run increase (decrease) in industrial production is only around 10% to 15% of this amount. This result is intuitive since inventory levels are much smaller than shipments, and the ratio has declined owing to ongoing improvements in inventory management.

	Korea	Taiwan	Japan
Long Run Elasticity			
Shipments	1.17	0.98	0.97
Inventory	-0.10	-0.14	-0.12

Sources: CEIC, ANZ Economics

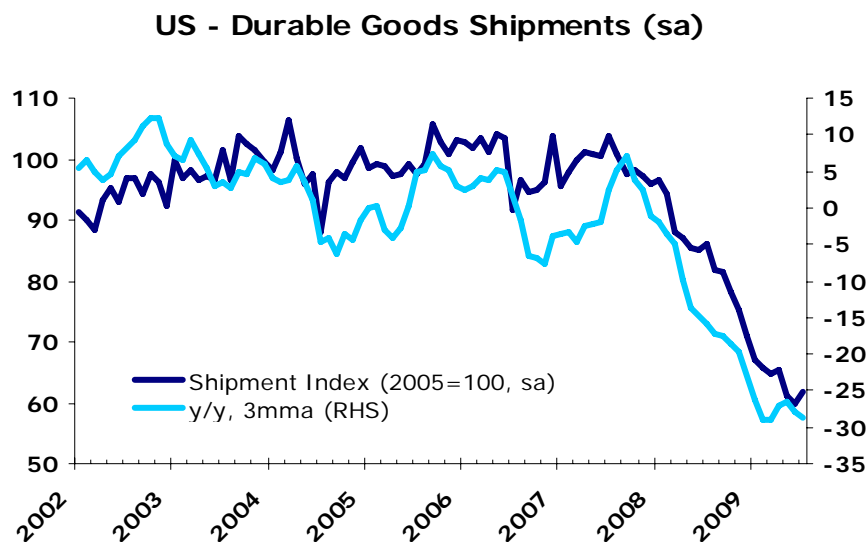
Our short-run result is that industrial production overcorrects to temporary shocks by a factor as large as two. In the present framework, a shock implies that shipments have been forecast incorrectly and that IP must overcompensate for this “forecast error.” For example, given the unexpectedly sharp drop in shipments over several months in late 2008 as the crisis deepened, IP was successively cut in order to (eventually) bring about the restoration of the inventory-shipments ratio to its equilibrium value. Our coefficients on industrial production’s short-run response to changes in shipments range from ½ to 1. When added to the fundamental or long-run coefficients, this implies that IP responds quite aggressively to out-of-equilibrium movements in shipments. As far as investment and growth are concerned, the implication is that the over-adjustment on the downside in IP in late 2008 and (in some cases) early 2009 exacerbated the slowdown in GDP, while the opposite has occurred in since. That is, the temporary over-adjustment of IP in recent quarters has contributed to the sharp recovery in GDP in many economies in the region.

At present, with the short-run adjustment process (nearly) complete, industrial production and GDP growth should slow, all else constant. As noted above, recent data suggest that the inventory-shipment ratio has returned to normal or equilibrium levels, meaning that the short-term adjustment process outlined above is largely complete. Absent other sources of new growth, this implies that the recent boost to activity from industrial production associated with the inventory-shipment management process will fade and that investment and GDP growth will fade as well. In our sample, this adjustment process seems complete in Taiwan and Korea (where there may have been some overshoot), although the adjustment in Japan still has some ways to go. Indeed, sequential IP growth in Korea and Taiwan has softened of late. While other expenditure components such as consumption and domestic-led investment may pick up the slack, indicators to substantiate this remain mixed. Moreover, government spending plans with their heavy infrastructure components may underpin the slowdown in industrial production to the extent that these begin to roll off.

Going forward, a rise in IP growth will require a rise in shipments, which is not strongly supported by the most recent indicators. In terms of our model, the near-completion of the inventory-shipment adjustment means we are back in a long-run world. Therefore, industrial production, and hence investment and its contribution to GDP growth, will be driven largely by (expected) shipments. A key component to shipments—foreign demand—remains soft across much of

³ For a full explanation and derivation of the model, see our forthcoming research offering.

Asia with both contemporaneous exports as well as export orders still weak. A good indicator of foreign demand facing Asia is durable consumption goods shipments in the United States. This indicator captures demand for the types of “discretionary” consumption goods that much of Asia produces and exports. The most recent data for US durable consumption goods shipments shows ongoing weakness into the second half of the year (see chart).⁴ Durable goods consumption data found in the national accounts for Q2 (not shown) underscore this trend, albeit with a longer lag.⁵



Sources: CEIC, ANZ Economics

Overall, we continue to be wary of a V-shaped recovery in Asia. Recent growth has surprised on the upside, with a strong contribution from domestic demand, including industrial production and investment. Demand from outside the region has been weak and we expect it to remain so given the need for extensive household, bank and government balance sheet repair in the advanced countries. Our analysis has shown that part of the recent bounce in Asian economies relates to a short-term “over-adjustment” in industrial production related to managing the inventory-shipment ratio. Indeed, IP in the short-run may move by as much as twice the rate of the underlying movement in shipments. However, this adjustment process now appears largely complete, meaning that part of the recent impetus to growth from robust IP will fade going forward. Absent any offsetting new sources of growth in emerging Asia, IP, investment and GDP growth will be under downward pressure in the near term.

Paul Gruenwald
Yeo Han Sia
Zhou Hao

⁴ As to durable goods demand from domestic sources, the most recent consumer sentiment data for Korea show weak spending intentions for durable goods and tourism although overall consumer sentiment is relatively positive.

⁵ Unfortunately for our analysis, the European Union does not produce comparable data on durable goods shipments and consumption. Our conjecture is that the story for consumption would be similar to what we see in the United States.

FX and Rates Strategy Overview: Let the Race Resume

Market Outlook

Resurgent risk appetite after the conclusion of August holidays in the Northern hemisphere benefited emerging Asia (AXJ) in September. Going forward, highly favourable base effects for year-on-year exports and growth should maintain the bid in AXJ markets into year-end. The upcoming October earnings season is seen as being more important for the pace as opposed to the direction of market moves. Once global demand starts to recover in a meaningful way next year, those AXJ economies with the largest exposure to trade stand to benefit the most.

FX Strategy

Gains in the Korean won (KRW) have started to outpace the Indonesian rupiah (IDR), supported by a tidal wave of foreign equity inflows. Looking ahead, we continue to favour the KRW in 2010, expecting the currency to be a primary beneficiary of improved global discretionary demand. The IDR should continue to benefit on an outright basis from sustained risk appetite and attractive yields during 2010, but in relative terms the rupiah will likely face headwinds from inflation expectations more quickly.

A predominate focus for AXJ currency markets has become the timing of the resumption of renminbi (CNY) appreciation. The PBoC's daily USD-CNY fixing inched lower during the course of September, giving some the impression that a move has already begun. We continue to believe that USD-CNY will remain stable until the middle of next year as: 1/ the PBoC's fixing remains within 100 pips of the 6.830 level—as it has since mid-December 2008; 2/ on a trade-weighted basis the CNY has only recently recovered from the sharp appreciation experienced during the post-Lehman meltdown in global financial markets; and 3/ a meaningful recovery in external demand will not take place until next year.

At the other extreme, pressure for greater flexibility in the Vietnamese dong (VND) appears to be mounting, supporting our view that the VND will be devalued before year-end. Reserve cover has fallen to just over three months of imports, making the country vulnerable to modest shocks, and September trade data suggest an annualised deficit equivalent to about one-quarter of GDP. At the same time, the authorities continue to support domestic demand, FDI pledges are down sharply, and net foreign equity flows have become negative in recent weeks (in sharp contrast with the tidal wave of portfolio inflows into the rest of the region). On a strategic basis we suggest:

- **AXJ corporates with USD payables:** Reduce KRW and TWD hedge ratios.
- **Real money funds with dedicated AXJ allocations:** Over-weight KRW and TWD.
- **Leveraged funds:** Sell USD-KRW and USD-TWD forward outright.

Rates Strategy

With favourable base effects for year-on-year inflation set to unwind at the same time that highly favourable base effects for growth emerge, local interest rate markets are expected to price in more imminent policy responses by the region's central banks. Indeed, policy makers will be keen to withdraw the portion of monetary stimulus deemed as post-Lehman "emergency" measures in order to avert asset bubbles. However, the overriding concern will be to avoid derailing the recovery.

As such, we expect only gradual tightening to commence from Q2 (for China, India, Indonesia, the Philippines and South Korea) and from Q3 (for the rest of the region). Rate hikes in Q1 are deemed unlikely assuming that: 1/ AXJ currencies continue to strengthen; 2/ stimulus effects from the developed economies start to wane; and 3/ negative output gaps persist until the latter part of 2010. During the wait for rate hikes, we continue to favour curve flatteners (which earn positive carry) and suggest shortening duration where both growth momentum is stronger and inflation fighting records are weaker (i.e. India, Indonesia and Vietnam).

- **Real money funds with dedicated AXJ allocations:** Underweight INR and VND government bonds. Maintain neutral IDR bond allocations.
- **Leveraged funds:** Opt for payers on the INR, IDR and VND interest rate swap curves.

Tamara Henderson

Foreign Exchange and Policy Rate Forecasts

		Current	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10	Mar 11
China	USD/CNY, eop	6.828	6.83	6.83	6.83	6.74	6.66	6.58
	AUD/CNY, eop	5.897	5.90	6.10	6.30	6.10	5.90	5.70
	PBoC base lending rate	5.31	5.31	5.31	5.58	5.85	6.12	6.39
Hong Kong	USD/HKD, eop	7.750	7.750	7.750	7.760	7.770	7.765	7.760
	AUD/HKD, eop	6.727	6.9	7.1	7.1	6.9	6.8	6.6
	HKMA discount rate	0.50	0.50	0.50	0.50	0.50	0.75	1.00
India	USD/INR, eop	48.00	47.0	46.5	46.0	46.0	45.0	44.5
	AUD/INR, eop	41.32	41.8	42.8	41.9	40.9	39.2	37.8
	RBI repo rate	4.75	4.75	4.75	5.25	5.75	6.00	6.25
Indonesia	USD/IDR, eop	9,725	9,500	9,500	9,625	9,500	9,250	9,000
	AUD/IDR, eop	8,364	8,500	8,700	8,800	8,500	8,000	7,700
	BI rate	6.50	6.50	6.50	6.75	7.00	7.25	7.50
Malaysia	USD/MYR, eop	3.48	3.41	3.34	3.37	3.40	3.40	3.35
	AUD/MYR, eop	2.99	3.03	3.07	3.07	3.03	2.96	2.85
	BNM overnight rate	2.00	2.00	2.00	2.00	2.25	2.25	2.50
Philippines	USD/PHP, eop	47.32	47.0	46.0	46.5	46.0	45.0	45.0
	AUD/PHP, eop	40.86	41.8	42.3	42.3	40.9	39.2	38.3
	BSP reverse repo rate	4.00	4.00	4.00	4.25	4.50	4.75	5.25
Singapore	USD/SGD, eop	1.417	1.40	1.39	1.40	1.41	1.41	1.40
	AUD/SGD, eop	1.223	1.25	1.28	1.27	1.25	1.23	1.19
	3M SGD SIBOR	0.68	0.69	0.85	1.00	1.30	1.50	1.70
S Korea	USD/KRW, eop	1,194	1,125	1,100	1,150	1,175	1,050	1,000
	AUD/KRW, eop	1,030	1,000	1,010	1,050	1,050	910	850
	BoK overnight call rate	2.00	2.00	2.00	2.25	2.50	3.00	3.50
Taiwan	USD/TWD, eop	32.46	31.5	31.0	31.3	31.5	30.3	30.0
	AUD/TWD, eop	28.01	28.0	28.5	28.4	28.0	26.4	25.5
	CBC discount rate	1.25	1.25	1.25	1.25	1.50	1.75	2.25
Thailand	USD/THB, eop	33.61	33.0	33.0	33.0	32.5	32.5	32.5
	AUD/THB, eop	28.92	29.4	30.4	30.0	28.9	28.3	27.6
	BoT repo rate	1.25	1.25	1.25	1.25	1.50	1.50	1.75
Vietnam	USD/VND, eop	17,837	18,500	18,500	18,500	18,500	19,300	19,300
	AUD/VND, eop	15,343	16,500	17,000	16,800	16,500	16,800	16,400
	SBV base lending rate	7.00	7.00	7.00	7.00	7.50	8.00	8.50

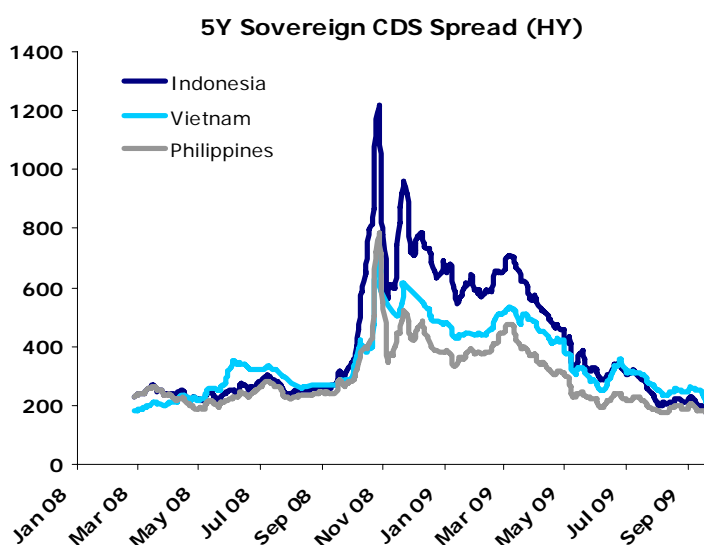
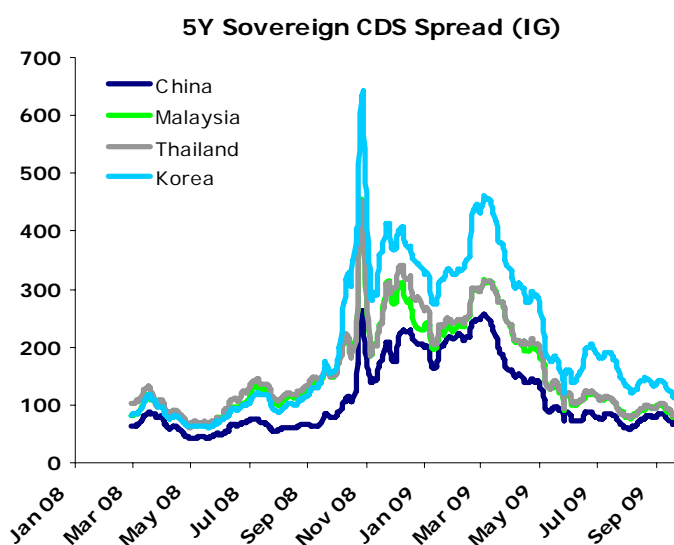
Foreign Exchange Cross-Rate Forecasts

	Current Spot	ANZ Forecast					Implied Spot from 12M Fwd or NDF	Implied 12M % Change	
		Dec-09	Mar-10	Jun-10	Sep-10	Dec-10		ANZ	Forwards
CNY-HKD	1.14	1.13	1.13	1.14	1.15	1.17	1.12	3%	-1%
CNY-INR	7.03	6.88	6.81	6.73	6.82	6.76	6.85	-4%	-3%
CNY-IDR	1,420	1,390	1,390	1,410	1,410	1,390	1,380	-2%	-3%
CNY-MYR	0.509	0.499	0.489	0.493	0.504	0.511	0.494	0%	-3%
CNY-PHP	6.93	6.88	6.73	6.81	6.82	6.76	6.75	-2%	-3%
CNY-SGD	0.207	0.205	0.204	0.205	0.209	0.212	0.203	2%	-2%
CNY-KRW	175	165	161	168	174	158	169	-10%	-3%
CNY-TWD	4.75	4.61	4.54	4.58	4.67	4.55	4.58	-4%	-4%
CNY-THB	4.92	4.83	4.83	4.83	4.82	4.88	4.80	-1%	-2%
HKD-INR	6.19	6.06	6.00	5.93	5.92	5.80	6.13	-6%	-1%
HKD-IDR	1,250	1,230	1,230	1,240	1,220	1,190	1,230	-5%	-2%
HKD-MYR	0.449	0.440	0.431	0.434	0.438	0.438	0.442	-2%	-1%
HKD-PHP	6.11	6.06	5.94	5.99	5.92	5.80	6.03	-5%	-1%
HKD-SGD	0.183	0.181	0.179	0.180	0.181	0.182	0.182	-1%	-1%
HKD-KRW	154	145	142	148	151	135	151	-12%	-2%
HKD-TWD	4.19	4.06	4.00	4.03	4.05	3.90	4.10	-7%	-2%
HKD-THB	4.34	4.26	4.26	4.25	4.18	4.19	4.29	-3%	-1%
INR-IDR	203	202	204	209	207	206	201	1%	-1%
INR-MYR	0.072	0.073	0.072	0.073	0.074	0.076	0.072	4%	0%
INR-PHP	0.99	1.00	0.99	1.01	1.00	1.00	0.99	1%	0%
INR-SGD	0.030	0.030	0.030	0.030	0.031	0.031	0.030	6%	1%
INR-KRW	24.9	23.9	23.7	25.0	25.5	23.3	24.7	-6%	-1%
INR-TWD	0.676	0.670	0.667	0.680	0.685	0.673	0.669	0%	-1%
INR-THB	0.700	0.702	0.710	0.717	0.707	0.722	0.701	3%	0%
IDR-MYR	0.00036	0.00036	0.00035	0.00035	0.00036	0.00037	0.00036	3%	0%
IDR-PHP	0.00487	0.00495	0.00484	0.00483	0.00484	0.00486	0.00490	0%	1%
IDR-SGD	0.00015	0.00015	0.00015	0.00015	0.00015	0.00015	0.00015	5%	1%
IDR-KRW	0.123	0.118	0.116	0.119	0.124	0.114	0.123	-8%	0%
IDR-TWD	0.00334	0.00332	0.00326	0.00325	0.00332	0.00328	0.00333	-2%	0%
IDR-THB	0.00346	0.00347	0.00347	0.00343	0.00342	0.00351	0.00349	2%	1%
MYR-PHP	13.6	13.8	13.8	13.8	13.5	13.2	13.7	-3%	0%
MYR-SGD	0.407	0.411	0.416	0.415	0.415	0.415	0.411	2%	1%
MYR-KRW	343	330	329	341	346	309	342	-10%	0%
MYR-TWD	9.34	9.24	9.28	9.29	9.26	8.91	9.28	-5%	-1%
MYR-THB	9.67	9.68	9.88	9.79	9.56	9.56	9.72	-1%	1%
PHP-SGD	0.030	0.030	0.030	0.030	0.031	0.031	0.030	5%	1%
PHP-KRW	25.2	23.9	23.9	24.7	25.5	23.3	25.1	-8%	-1%
PHP-TWD	0.686	0.670	0.674	0.673	0.685	0.673	0.680	-2%	-1%
PHP-THB	0.710	0.702	0.717	0.710	0.707	0.722	0.712	2%	0%
SGD-KRW	843	804	791	821	833	745	832	-12%	-1%
SGD-TWD	22.9	22.5	22.3	22.4	22.3	21.5	22.6	-6%	-2%
SGD-THB	23.7	23.6	23.7	23.6	23.0	23.0	23.6	-3%	0%
KRW-TWD	0.027	0.028	0.028	0.027	0.027	0.029	0.027	6%	0%
KRW-THB	0.028	0.029	0.030	0.029	0.028	0.031	0.028	10%	1%
TWD-THB	1.04	1.05	1.06	1.05	1.03	1.07	1.05	4%	1%

Long-Term Foreign Currency Government Bond Ratings

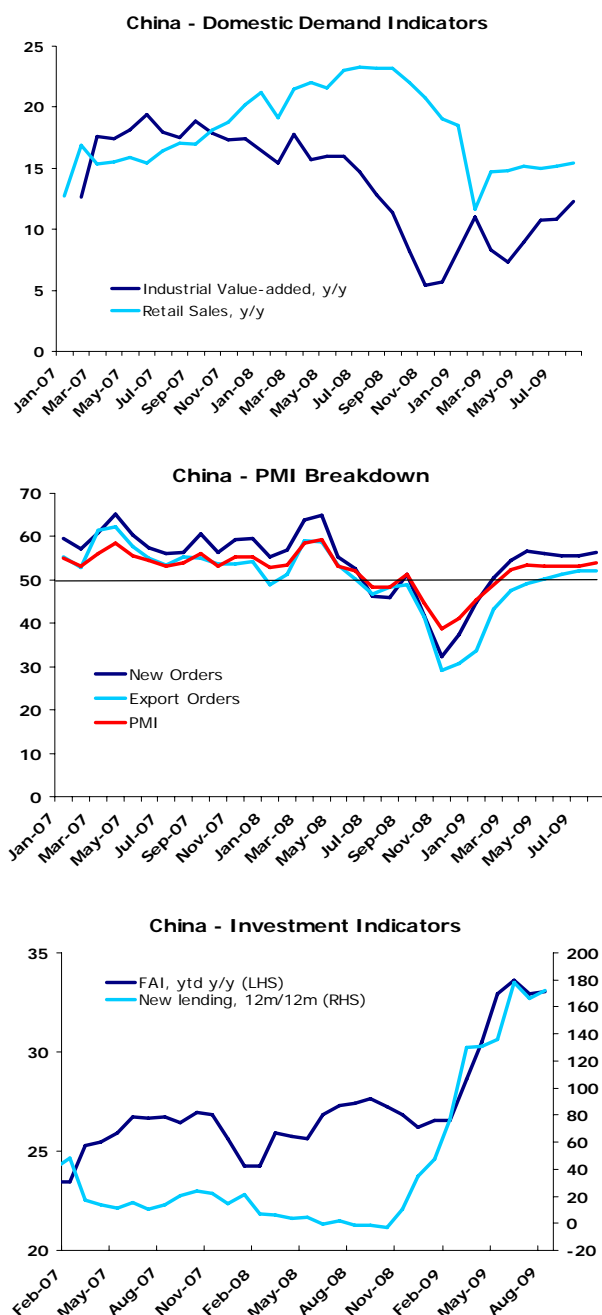
	Moody's	S&P	Fitch
Investment Grade			
China	A1	A+	A+
Hong Kong	Aa2	AA+	AA
India	Baa3	BBB-	BBB-
Korea	A2	A	A+
Malaysia	A3	A-	A-
Singapore	Aaa	AAA	AAA
Taiwan	Aa3	AA-	A+
Thailand	Baa1	BBB+	BBB
Sub-Investment Grade			
Cambodia	B1	B+	NR
Indonesia *	Ba2	BB-	BB
Philippines	Ba3	BB-	BB
Vietnam	Ba3	BB	BB-
* denotes an upgrade; # denotes a downgrade over previous month			
Source: Bloomberg			

Sovereign CDS Spreads



Source: Bloomberg

Country Update: China



The recovery of domestic activity continues to gain strength. Although trade is still declining at double-digit rates, momentum is improving. We see no major change of overall policy in the near term, but further mid-course adjustments are possible.

- Retail sales increased 15.4% (y/y) in Aug, slightly better than the 15.2% growth in Jul. Vehicle sales surged again to 37.1% from 36% largely due to a low base. Industrial production expanded faster than expected, rising 12.3% in Aug, compared with a 10.8% rise in Jul; heavy industry led the charge.
- Fixed asset investment expanded 33% (y/y) in Aug, up slightly from Jul, on very relaxed monetary conditions. Real estate investment continued to rebound strongly, although the recovery is not yet even across all sectors.
- Exports fell 23.4% (y/y) in Aug, slightly worse than the 23.0% drop in Jul. Imports declined by 17.0% in Aug from a 15.0% drop in Jul, mainly led by a fall in manufacturing products. The trade surplus rose to \$15.7bn in Aug, a \$5.1bn increase from Jul.
- The CPI declined 1.2% (y/y) in Aug, after a 1.8% drop in Jul. Rising food prices helped ease the price fall. Meanwhile, inflation momentum was positive for the second month in a row, rising 0.5% (m/m). The Producer Price Index also contracted less than a month ago, falling by 7.9% (y/y) in Aug from an 8.2% decline in Jul on rising commodity prices.
- New bank loans rose to CNY410.4bn in Aug, increasing 15.3% (m/m) from Jul. The central bank reiterated that it would maintain an appropriately accommodative monetary policy after a sharp correction in the stock market. Total new loans for Jan-Aug stood at CNY8.1tn, far exceeding the initial CNY5.0tn target set for 2009.
- China's official PMI was 54 in Aug, slightly higher than Jul, marking the sixth consecutive reading above 50, indicating an expansion. As new orders and export orders continued rising to new highs, economic activity is expected to remain strong for the rest of the year.
- We maintain our growth projection at 8.1% in 2009 with some upside risk, as the authorities have shown no intention to make a major change of the accommodative policy stance. We do, however, expect some further mid-course adjustments going forward.

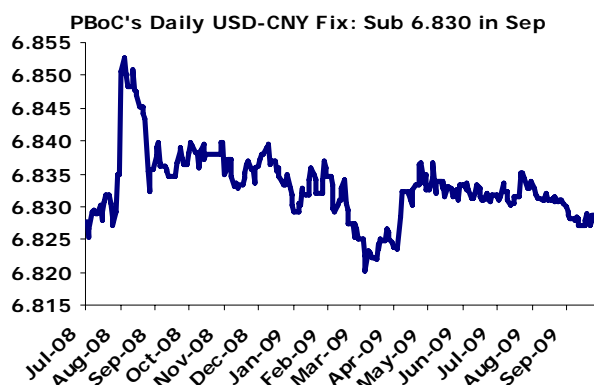
Liu Li-Gang

Economic Data – China

Monthly data	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09
Industrial Production, % y/y	0.0	11.0	N/A	7.3	8.9	10.7	10.8	12.3
Retail Sales, % y/y	18.5	11.6	14.7	14.8	15.2	15.0	15.2	15.4
Consumer Price Index, % y/y	1.0	-1.6	-1.2	-1.5	-1.4	-1.7	-1.8	-1.2
Exports, % y/y	-17.5	-25.7	-17.1	-22.6	-26.3	-21.4	-22.9	-23.1
Imports, % y/y	-43.1	-23.8	-24.9	-22.8	-24.8	-13.0	-14.9	-17.1
Trade Balance, US\$ bn	39.1	4.8	18.6	13.1	13.4	8.3	10.6	15.7
Quarterly data	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09
Real GDP, % y/y	13.0	12.0	10.6	10.1	9.0	6.8	6.1	7.9
-Primary Sector ytd	4.3	3.7	2.8	3.5	4.5	5.5	3.5	3.8
-Secondary sector ytd	14.8	14.7	11.5	11.3	10.6	9.3	5.3	6.6
-Tertiary sector ytd	14.0	13.8	10.9	10.7	10.5	9.5	7.4	8.3
Nominal GDP, RMB tn	17.4	25.7	6.3	13.5	20.8	30.1	6.6	14.0
Foreign Exchange Reserves, US\$ bn	1,433.6	1,528.2	1,682.2	1,808.8	1,905.6	1,946.0	1,953.7	2,131.6
Current Account, US\$ bn (semi-annual)	N/A	371.8	N/A	191.7	N/A	426.1	N/A	130.0
Capital Account, US\$ bn (semi-annual)	N/A	3.1	N/A	1.7	N/A	3.1	N/A	1.3

Sources: CEIC

China: FX and Rates Strategy



Growth momentum is picking up, but we still expect the authorities to keep USD-CNY stable until mid-2010, when discretionary demand improves in the US and Europe. Meanwhile, the PBoC is now expected to raise the base lending rate as soon as Q2, although the tightening trajectory will likely remain quite benign until 2011.

FX

The PBoC's daily USD-CNY fixing inched lower during the course of Sep, fuelling market expectations that a resumption of CNY appreciation may be at hand. The offshore market is priced for a move from the current peg of 6.83 to 6.81 by year-end, which appears too aggressive.

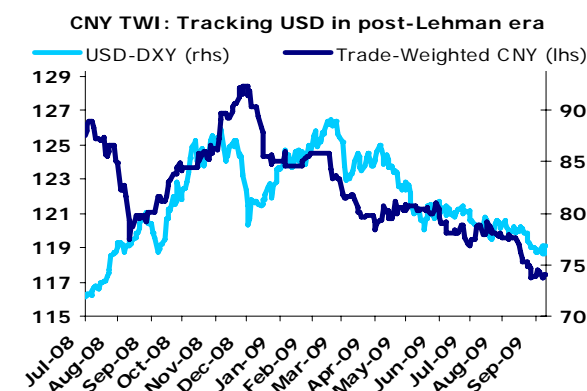
Certainly, economic momentum in China continues to rise—even without a pickup in external demand—and is likely to approach 10% in Q4. However, policymakers continue to suggest that the renminbi will be kept stable for some time to come, even highlighting the importance of the temporary renminbi peg for the region's stability. Indeed, the daily USD-CNY fixing has remained within 100 pips of the 6.830 level since mid-December 2008. Meanwhile, on a trade-weighted basis the sharp appreciation experienced during the meltdown in global financial markets at the end of last year has only recently unwound and provided some relief for Chinese exporters. With exports still down 23% (y/y), an imminent appreciation seems hard to justify.

Rates

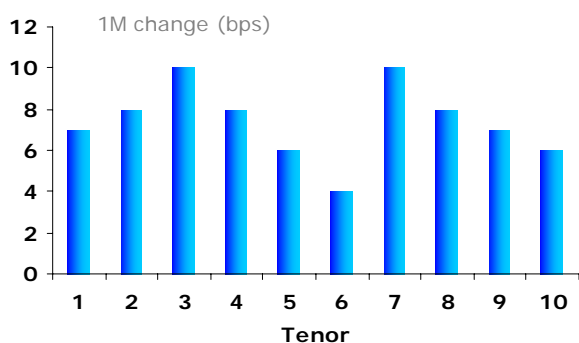
Local IRS rates were little changed in September as continued volatility in China's equity markets offset concerns about the PBoC's exit strategy. Going forward, we expect market rates to maintain a more explicit upward bias into 2010, as base effects unwind on inflation and growth.

Although we now expect the PBoC to initiate its rate hike cycle in Q2 next year (compared with Q3 previously), the upward trajectory should be benign. Increases in the reserve requirement will likely be more aggressive, however, as this is a more effective tool for absorbing liquidity in China's banking system.

Tamara Henderson



IRS Curve: Shifted Higher in Sep

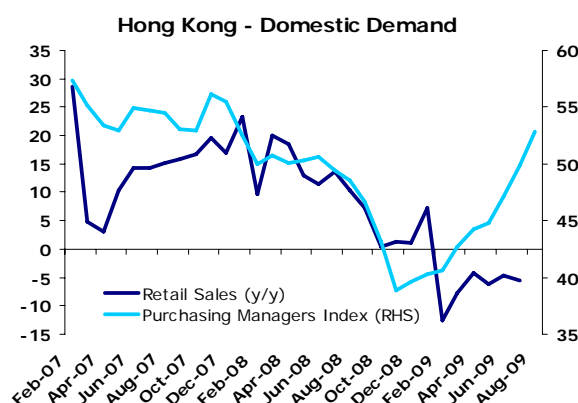
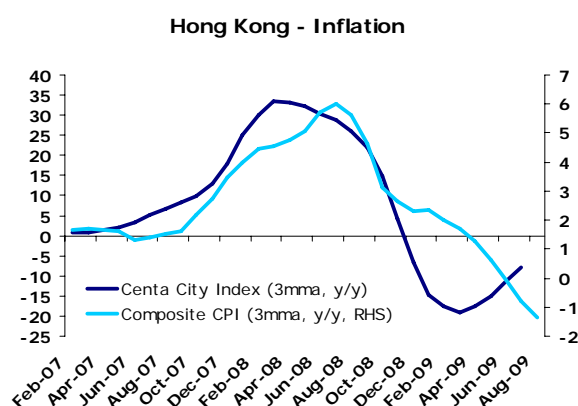
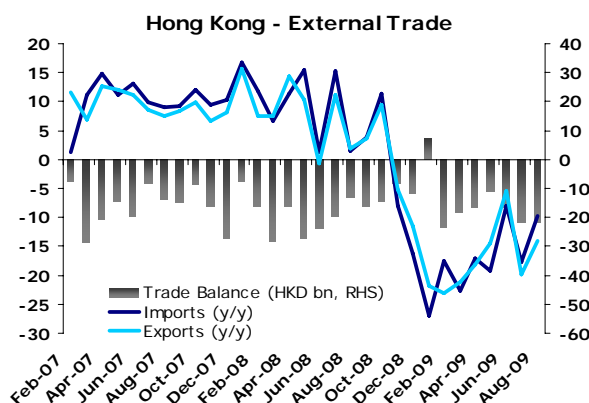


Market Forecasts – China (eop)

FX	Current	Ytd (%)	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
USD-CNY	6.828	0.0%	6.83	6.83	6.83	6.74	6.66	6.58
AUD-CNY	5.897	23.0%	5.90	6.10	6.30	6.10	5.90	5.70
NZD-CNY	4.880	23.5%	4.90	4.80	4.90	4.80	4.60	4.50
JPY-CNY	0.076	1.4%	0.076	0.078	0.079	0.077	0.074	0.072
EUR-CNY	9.970	4.6%	0.00	10.11	10.38	10.11	9.86	9.67
Rates	Current	Ytd	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
PBOC's 1-year base lending rate	5.31	0	5.31	5.31	5.58	5.85	6.12	6.39
3-month SHIBOR	1.76	-1	2.0	2.3	2.8	3.3	3.8	4.3
2-year IRS (onshore versus 7-day repo)	2.42	135	2.7	2.9	3.4	3.9	4.4	4.9
10-year IRS	4.04	225	4.2	4.3	4.5	4.8	5.0	5.3

Sources: Bloomberg, ANZ

Country Update: Hong Kong



Further positive growth momentum, together with abundant liquidity on the back of continued strong capital inflows, is contributing to the territory's rising property prices. The HKMA has warned banks of the potential risks associated with the recent mortgage rate reductions. Our 2010 growth forecast is unchanged at 3.3% given upside interest rate risk and the uncertain export outlook.

- Retail sales dropped 5.5% (y/y) in Jul from Jun's revised -4.7%. Volume growth also declined to -5.4% from -4.1%. Seasonally adjusted, however, volumes increased by 1.6% in the three months ending Jul.
- Exports declined by 13.9% (y/y) in Aug, compared with Jul's -19.9%. Weakness remained across-the-board, with shipments to Asia falling by 10.7%, compared with -14.6% to the US. Imports dropped by 9.8%, from Jul's -17.8%. A trade deficit of HK\$21.8bn was recorded, compared with Jul's HK\$21.7bn.
- The composite CPI dropped by 1.6% (y/y) in Aug, the third consecutive negative number and compared with the 1.5% decline in Jul. Netting out the effects of the government's one-off measures, consumer prices declined by 0.3% in Aug, the same as in Jul.
- Property prices continued to rise in Sep. This reflects that mortgage rates remain lower than rental yields, and that capital inflows have remained strong.
- The jobless rate was unchanged at 5.4% for the third consecutive month in Aug, suggesting that the bottom of the labour market has been reached.
- The PMI increased for the ninth straight month to reach 52.8 in Aug, up from 49.9 in Jul. This now exceeds the neutral level of 50, confirming that the territory's manufacturing sector is expanding.
- The HKMA has warned banks over recent mortgage rate reductions. The central bank/regulator said that banks cut mortgage rates to such an extent that they might not have given due regard to reputation, interest rate and liquidity risks associated with their pricing.
- We have kept our 2010 forecast unchanged at 3.3%, taking into account the upward interest rate risks and the uncertain export outlook.

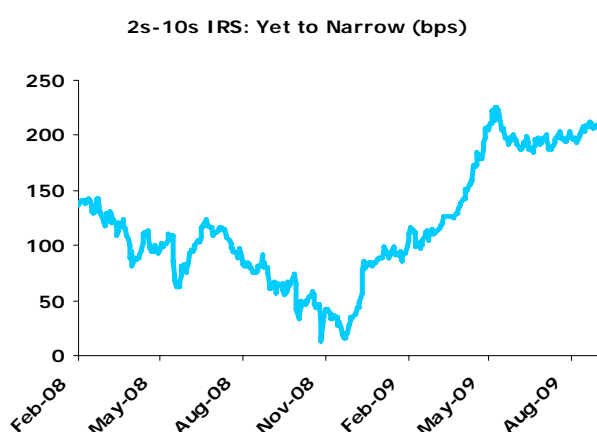
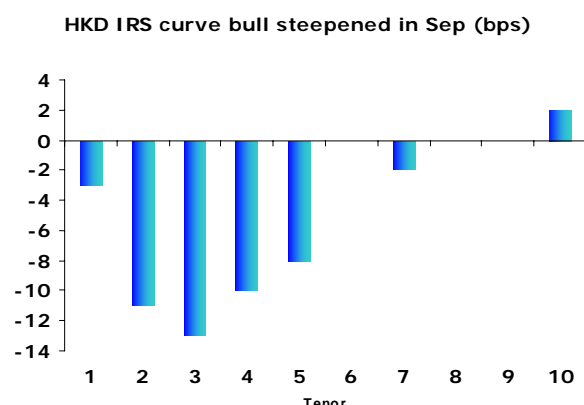
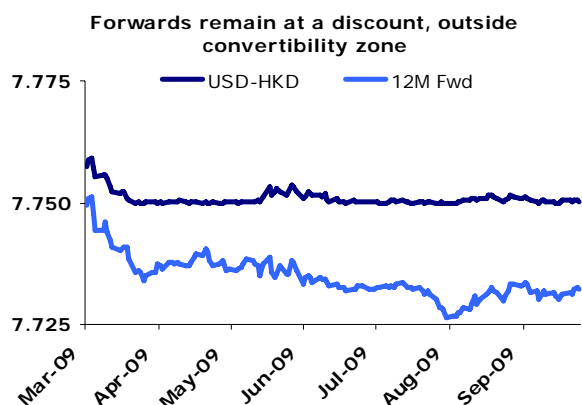
Franklin Poon

Economic Data – Hong Kong

Monthly data	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09
Retail Sales, % y/y	7.3	-12.7	-7.8	-4.3	-6.2	-4.8	-5.5	N/A
Composite Consumer Price Index sa, % y/y	2.7	1.1	1.2	0.6	0.1	-0.8	-1.5	-1.6
Exports, % y/y	-21.8	-23.0	-21.1	-18.2	-14.5	-5.4	-19.9	-13.9
Imports, % y/y	-27.1	-17.5	-22.7	-17.0	-19.2	-7.9	-17.8	-9.8
Trade Balance, US\$ bn	0.9	-3.0	-2.3	-2.1	-1.4	-2.1	-2.8	-2.8
Foreign Exchange Reserves, US\$ bn	174.4	171.7	181.7	185.9	196.2	205.7	209.5	N/A
Quarterly data	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09
Industrial Production, % y/y	-2.1	-0.3	-4.5	-4.2	-7.0	-10.6	-10.1	N/A
Real GDP, % y/y	6.8	6.9	7.3	4.1	1.5	-2.6	-7.8	-3.8
-Private consumption	11.4	9.7	8.0	3.0	-0.2	-4.1	-6.0	-1.0
-Government consumption	2.4	3.3	0.6	3.1	1.6	1.8	1.4	1.6
-Gross fixed capital formation	-1.1	8.0	9.9	5.1	2.9	-17.8	-13.7	-14.0
Nominal GDP, HKD bn	415.5	448.0	410.0	401.4	430.2	435.3	379.6	392.7
Current Account, US\$ bn	7.8	6.1	6.5	4.1	9.6	10.4	5.5	N/A
Capital & Financial Account, US\$ bn	-9.6	-8.3	-4.3	-2.6	-11.9	-8.9	-3.9	N/A

Sources: CEIC

Hong Kong: FX and Rates Strategy



Efforts by Mainland China to increase the use of the renminbi in Hong Kong will likely keep USD-HKD on the strong side of the convertibility zone for the foreseeable future.

FX

In the run-up to the change in HKMA leadership on 1 Oct USD-HKD (spot) continued to trade on the strong side of the convertibility zone (supported by fund inflows) and forwards continued to trade at a discount despite the positive interest rate differential (amid building expectations that there will be an adjustment in the USD-HKD peg). Chief Executive Joseph Yam's successor, Norman Chan, has said that the HKD-USD peg will be maintained, while the use of the renminbi (CNY) would be expanded in Hong Kong. HKMA icon Joseph Yam, Asia's longest serving central bank governor, has said that the CNY could someday become the most widely circulated currency in Hong Kong.

Indeed, Mainland China has taken a number of steps recently to increase the use of the CNY in Hong Kong. Amidst the global financial crisis, swap arrangements were established between the PBoC and HKMA, and a CNY trade settlement program was established on a trial basis. On 28 Sep, the first overseas offering of CNY-denominated government bonds was launched to retail and institutional investors in Hong Kong. The sale is likely to be an overwhelming success given: 1/ the small issuance size, 2/ the attractive yields that have been offered, and 3/ the prospective currency gains in the CNY. Prospective gains in the CNY alone will enhance the appeal of transacting in renminbi, not just for local investors and companies in Hong Kong, but also for overseas agents. As an access point for foreigners to Mainland investment opportunities, USD-HKD is likely to continue to trade on the strong side of the convertibility zone for the foreseeable future. Eventual rate hikes by the FOMC will probably only slow the flow, not redirect it.

Rates

HKD rates remain range-bound as the latest FOMC statement on 23 Sept supported the status quo of an "exceptionally low" federal funds rate for an "extended period." We continue to favour the positive carry of HKD flatteners during the waiting period.

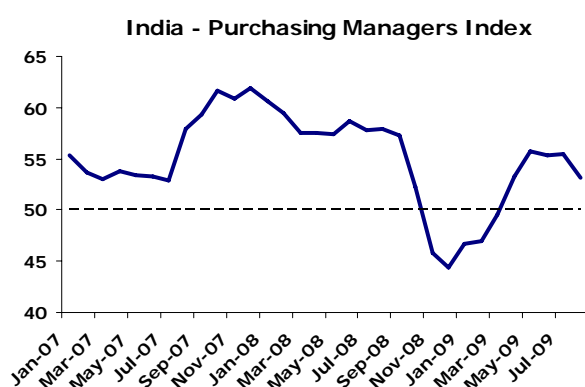
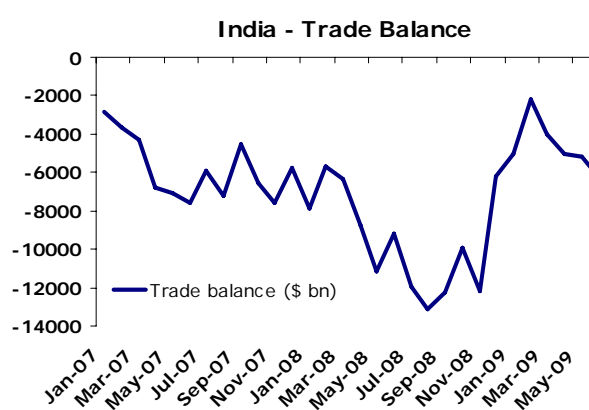
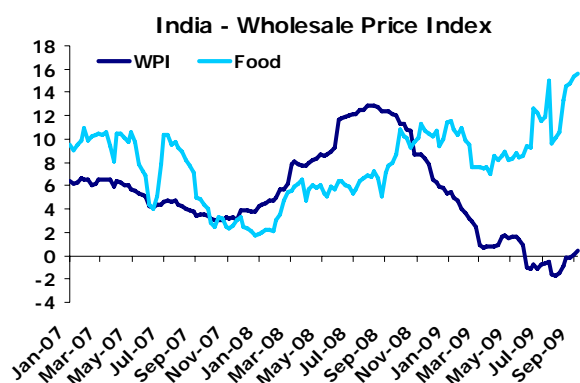
Tamara Henderson

Market Forecasts – Hong Kong (eop)

FX	Current	Ytd (%)	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
USD-HKD	7.750	0.0%	7.750	7.750	7.760	7.770	7.765	7.760
AUD-HKD	6.727	23.5%	6.9	7.1	7.1	6.9	6.8	6.6
NZD-HKD	5.574	24.2%	5.5	5.6	5.5	5.4	5.3	5.2
JPY-HKD	0.087	1.3%	0.088	0.090	0.088	0.086	0.084	0.083
EUR-HKD	11.386	5.1%	11.5	11.8	11.6	11.5	11.4	11.3
Rates	Current	Ytd (bps)	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
HKMA's discount rate	0.50	0	0.50	0.50	0.50	0.75	1.00	1.50
3-month HIBOR	0.22	-74	0.3	0.5	0.7	1.0	1.5	2.0
2-year IRS (onshore versus 3M)	1.15	-34	1.3	1.5	1.7	2.0	2.5	3.2
10-year IRS	3.22	129	3.3	3.5	3.7	4.0	4.3	4.6

Sources: ANZ, Bloomberg

Country Update: India



The pace of activity remains solid. Inflation turned positive in Sep, ending four months of decline, and the surge in food prices will exacerbate price pressures going forward. Meanwhile, the RBI has flagged the risk of above-target inflation in FY09/10.

- Domestic demand continued to improve in Aug, with car sales expanding 25.6% (y/y), the seventh consecutive monthly increase. Commercial vehicle sales also gained pace to 18.5% after ending an 11-month decline in Jul. Cement production surged 17.8% to 15.5mn tonnes. Shipments grew 17%, the fastest in almost three years.
- Industrial production slowed to 6.8% (y/y) in Jul from 8.2% in Jun. The IP reading will likely improve in Aug with infrastructure sector output (over one-quarter of IP) gaining pace to 7.1% in Aug from 2.5% in Jul. Output of consumer durables and non-durables recorded strong growth of 19.8% and 5.0% in Aug, respectively
- The contraction in external demand persisted in Jul. Exports declined by 28.4% (y/y), down from -27.7% in Jun. Imports fell 37.1% from Jun's -29.3%. The trade deficit narrowed slightly to \$6bn from \$6.1bn in the previous month.
- The WPI ended a 4-month long decline on account of higher food prices, gaining 0.1% (y/y) for the week ending 5 Sep. The rise in inflation continued with a 0.4% (y/y) outturn for the week ending 12 Sep.
- The PMI fell in Aug to a 5-month low of 53.2 from 55.4 in Jul. The new orders index dropped to 56.2 from 60.0 in Jul. Input costs are rising according to the monthly survey, but output prices are not keeping pace.
- A late surge in monsoons eased the rainfall deficit in Sep, but cumulative rainfall remains 21% below average. While the drag on GDP growth is likely to be limited, the surge in food prices will exacerbate inflation pressures going forward. Indeed, RBI Deputy Governor Chakrabarty warned that the WPI could exceed the central bank's end-FY09/10 forecast of 5% by 1ppt.
- Governor Subbarao stressed that the RBI will not unwind its accommodative stance before the economy recovers. However, he noted that the issue of exiting the current policy stance will confront India sooner than other countries.

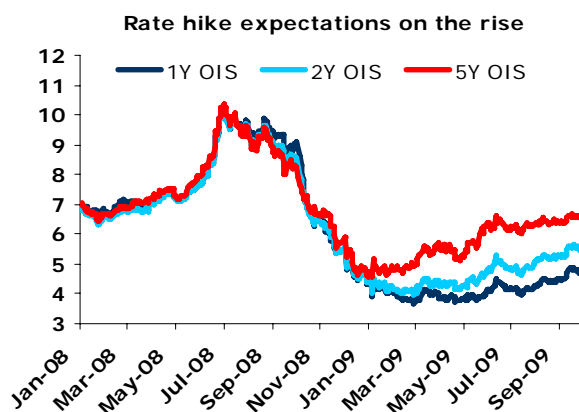
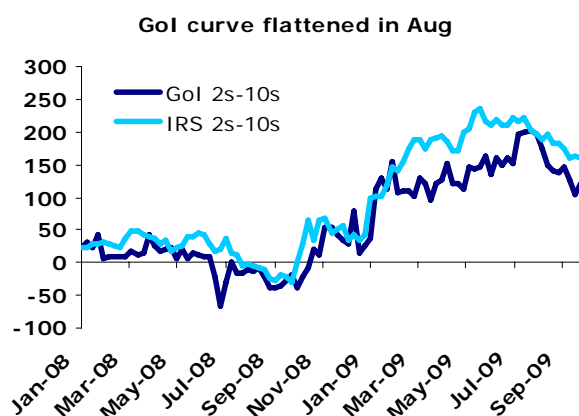
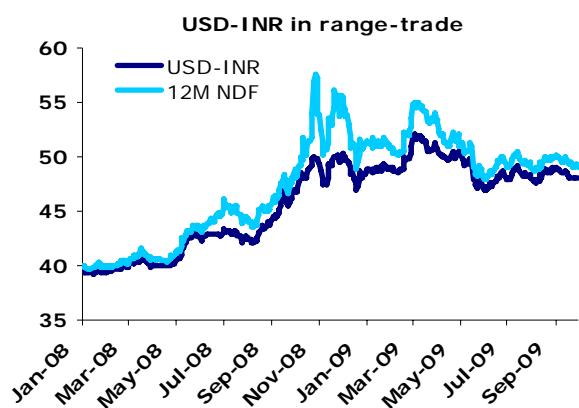
Yeo Han Sia

Economic Data – India

Monthly data	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09
Industrial Production, % y/y	1.0	0.2	0.3	1.2	2.2	7.8	6.8	N/A
Passenger Vehicle Sales, % y/y	-6.9	15.0	-1.2	4.4	-0.8	8.3	29.2	25.6
Wholesale Price Index, % y/y	4.5	3.1	0.8	1.7	0.9	-1.6	-1.6	-1.6
Exports, % y/y	-16.8	-21.7	-33.3	-33.2	-29.2	-27.7	-28.4	N/A
Imports, % y/y	-19.2	-23.3	-34.0	-36.6	-39.2	-29.3	-37.1	N/A
Trade Balance, US\$ bn	-6.1	-4.9	-4.0	-5.0	-5.2	-6.1	-6.0	N/A
Foreign Exchange Reserves, US\$ bn	238.9	238.7	241.4	241.5	251.5	254.1	260.6	251.5
Quarterly data	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09
Real GDP, % y/y	9.0	9.3	8.6	7.8	7.7	5.8	5.8	6.1
-Agriculture	3.9	8.1	2.2	3.0	2.7	-0.8	2.7	2.4
-Industry	9.8	9.0	6.5	6.4	6.5	2.0	1.2	3.4
-Services	10.3	10.3	11.8	10.2	9.8	10.2	8.6	8.1
Nominal GDP, INR tn	9.9	11.5	11.9	11.6	11.8	13.1	12.9	12.4
Current Account, US\$ bn	-4.3	-4.5	-1.5	-9.0	-12.5	-13.0	4.7	N/A
Capital Account, US\$ bn	33.2	31.0	26.0	11.1	7.6	-4.3	-5.3	N/A

Sources: CEIC

India: FX and Rates Strategy



We expect USD-INR to break lower into Q4 on broad USD weakness and sustained portfolio inflows. Rate hike expectations continue to rise, but the curve flattening in Q3 appears overdone and is vulnerable to a pullback.

FX

USD-INR remained range-bound in Sep, with the 200-day MA (48.95) capping topside and the trend line from Jun lows supporting (47.80). We expect an eventual downside break for USD-INR in Q4. Technical indicators are bearish on USD-INR, with broad USD weakness and sustained portfolio inflows supportive of rupee gains. The INR also benefits on an outright basis from attractive yields and prospects of the RBI being one of the early movers in the rate tightening cycle. Near-term, the INR faces headwinds from commodity price inflation, exacerbated by the weak monsoon rainfall. The 73% year-to-date gains in Indian equities could also be a source of vulnerability on any short-term pull back in risk appetite.

Rates

We see growing risks of a rate hike before Q2 2010. Pressure on RBI to shift away from its accommodative policy stance has intensified with the WPI turning positive in Sep. While the turnaround is widely expected due to fading base effects and a growth recovery, surging food prices also contributed to the rise in headline inflation. Indeed, the RBI has started flagging the risk of the WPI overshooting its target in FY09/10 and the prospect of the central bank exiting the current policy stance ahead of other Asian countries. Market rate hike expectations have also risen further, with the front-end of the OIS curve up another 17bps in Sep. While we expect strategic flattening trades to gain favour, the 86bps of flattening in the 2s-10s G-Sec curve in Q3 appears overdone and vulnerable to a short-term pullback. Meanwhile, expectations of the RBI raising banks' hold-to-maturity portfolio limit from 25% should underpin the G-Sec market outright. The fiscal H2 borrowing calendar on 29 Sep was in line with market expectations. Despite increased spending on drought relief, food and employment subsidies, the budgeted INR1.56tn gross borrowing plan was left unchanged, consistent with officials' comments in the past month. Instead, the government is leaning on selective expenditure cuts to trim the deficit, but the balance of risks is still tilted towards a larger financing gap.

Yeo Han Sia

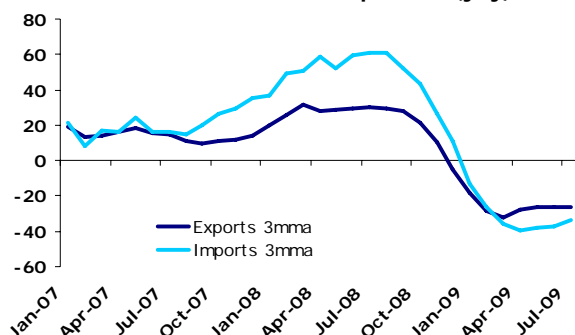
Market Forecasts – India (eop)

FX	Current	Ytd (%)	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
USD-INR	48.00	-1.7%	47.0	46.5	46.0	46.0	45.0	44.5
AUD-INR	41.32	20.8%	41.8	42.8	41.9	40.9	39.2	37.8
NZD-INR	34.32	21.7%	33.4	33.5	32.7	31.7	30.6	29.8
JPY-INR	0.54	0.4%	0.534	0.541	0.523	0.511	0.489	0.473
EUR-INR	70.04	3.0%	69.6	70.7	69.0	68.1	66.2	65.0
Rates	Current	Ytd (bps)	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
RBI's repo rate	4.75	-175	4.75	4.75	5.25	5.75	6.00	6.25
3-month MIBOR	4.63	-426	4.7	4.7	5.2	5.7	6.0	6.3
2-year IRS (versus NSE MIBOR)	5.48	104	5.5	5.5	6.0	6.5	6.8	7.0
10-year IRS	7.10	227	7.1	7.1	7.4	7.6	7.8	8.0

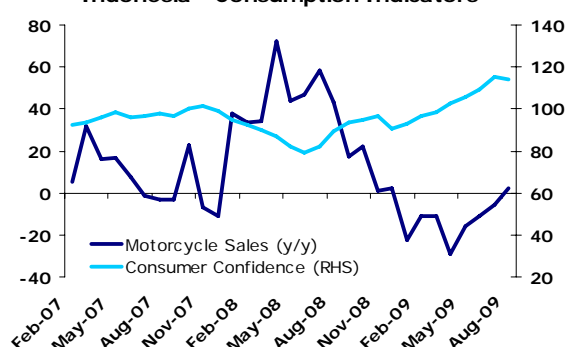
Sources: Bloomberg, ANZ

Country Update: Indonesia

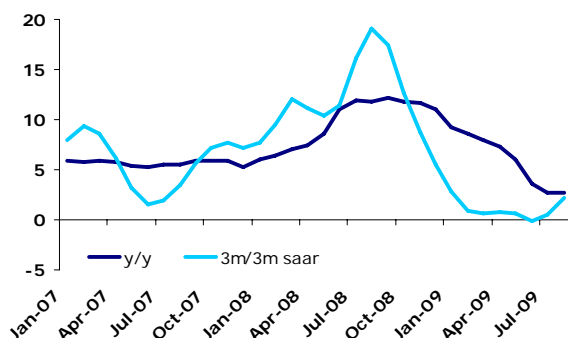
Indonesia - Trade Developments (y/y)



Indonesia - Consumption Indicators



Indonesia - Inflation



Strong growth remains supported by buoyant private domestic demand as well as government stimulus spending. Meanwhile, exports continue to show little improvement amid weak external demand. The inflation cycle has turned, with price pressures gradually picking up. We expect the positive outlook to remain intact.

- Domestic demand remains strong. Retail sales grew for the fifth straight month in Jul, rising 4.3% (y/y), largely unchanged from Jun. Increased sales of motor vehicles, spare parts, food and tobacco and clothing helped sustain momentum.
- Consumer confidence declined to 114.3 in Aug from 115.4 in Jul, affected by proposals to increase LPG prices and toll rates. On the whole, consumer optimism remains high.
- Both motorcycle and local auto sales grew by 15.0% (m/m) in Aug, indicating a recovery in consumer spending. Cement consumption increased by a modest 3.8% (m/m) to 4.0mn tonnes in Jul, helped by increased infrastructure development and construction activity.
- The improvement in trade was modest. Exports fell by 23.0% (y/y) in Jul against a 26.8% decline in Jun, while imports decreased at a slower pace of -32.5% (y/y) compared with -34.5% a month earlier. The trade surplus was \$1.0bn in Jul down from \$1.5bn in Jun.
- Tourism is performing well, with arrivals increasing by 9.3% (m/m) in Jul compared to a 5.5% increase in Jun. Room occupancy rates in Jul, however, stayed more or less flat compared with Jun.
- Inflation is picking up, with the CPI rising 2.8% (y/y) in Aug compared with 2.7% a month earlier.
- BI kept the policy rate unchanged at 6.5% as was widely expected. The central bank expects its cumulative cuts of 300bps since Nov 2008 to offer ample assistance to the recovery and remains wary of any build up of inflation pressures. The central bank targets inflation in a 3.5% to 5.5% band.
- Moody's raised the country's sovereign debt rating by one notch to Ba2 on improving economic prospects. The agency also indicated a stable outlook as it expects the overall macro policy stance to achieve its targets.

Chang Wei Lang

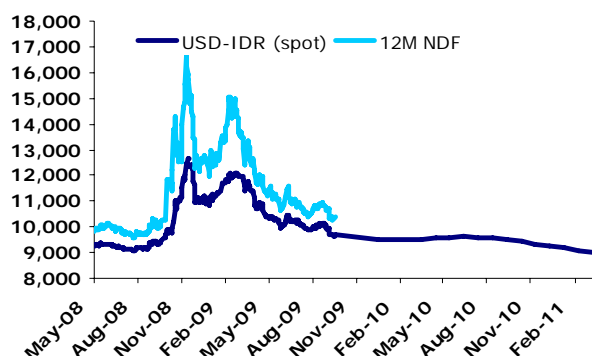
Economic Data – Indonesia

Monthly data	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09
Industrial Production, % y/y	-1.7	0.9	1.4	1.1	-0.1	0.2	-0.7	N/A
Retail Sales Index, % y/y	2.9	-8.2	5.9	4.2	4.8	3.9	4.3	N/A
Consumer Price Index, % y/y	9.2	8.6	7.9	6.0	4.6	3.7	2.7	2.8
Exports, % y/y	-35.0	-32.3	-28.3	-22.6	-28.7	-26.8	-23.0	N/A
Imports, % y/y	-27.9	-40.1	-33.7	-41.6	-34.5	-34.5	-32.5	N/A
Trade Balance, US\$ bn	1.9	2.4	3.3	3.0	3.0	1.5	1.0	N/A
Foreign Exchange Reserves, US\$ bn	48.3	47.9	52.2	54.0	55.2	54.9	54.8	55.2
Quarterly data	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09
Real GDP, % y/y	6.6	5.8	6.2	6.4	6.4	5.2	4.4	4.0
-Private consumption	5.1	5.5	5.7	5.5	5.3	4.8	6.0	4.8
-Government consumption	6.5	2.0	3.6	5.3	14.1	16.4	19.2	17.0
-Gross fixed capital expenditure	9.7	12.4	13.7	12.0	12.2	9.1	3.4	2.7
Nominal GDP, IDR tn	1,030.8	1,034.9	1,117.6	1,229.6	1,332.5	1,274.3	1,301.8	1,365.5
Current Account, US\$ bn	2.2	3.4	2.8	-1.0	-0.9	-0.7	2.9	3.1
Capital & Financial Account, US\$ bn	-0.9	0.7	-1.4	2.5	0.9	-3.3	1.8	-2.4

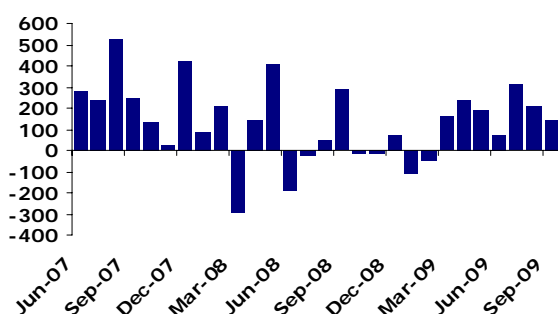
Sources: CEIC

Indonesia: FX and Rates Strategy

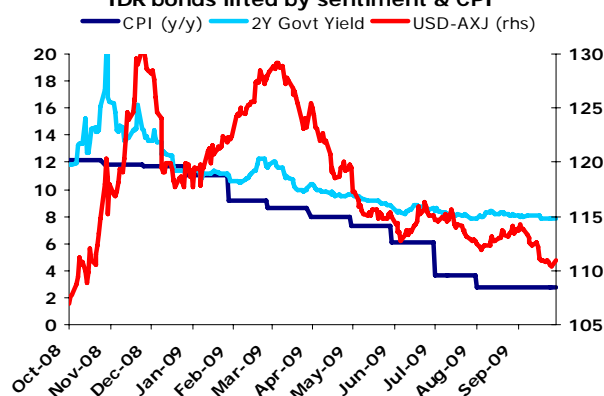
USD-IDR experiencing lower highs



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



IDR bonds lifted by sentiment & CPI



Sustained risk appetite should maintain the broad downtrend in USD-IDR into year-end, but scope for further out-performance against the Korean won appears limited.

FX

The IDR rallied another 3.5% against the USD in Sep, making a clear break below the 10,000 level. The currency was boosted by improved risk appetite after the conclusion of Aug holidays in the Northern hemisphere. Investors piled into Indonesian equities as well as bonds, which were also supported by Moody's upgrade of its foreign and local currency sovereign debt ratings, now just two notches below investment grade. Around the 9,950 level, Bank Indonesia (BI) signalled approval for further rupiah strengthening, albeit at a "slow" pace, and USD-IDR responded with a move below 9,700. Our year-end target is now 9,500.

Going forward, the IDR should continue to benefit on an outright basis from sustained risk appetite and attractive yields into 2010. In relative terms, however, the IDR will face headwinds from inflation expectations. Highly favourable base effects on y/y inflation are set to unwind in Q4, while monthly inflation momentum has reversed and is set to pickup further. Also, the currencies of the more open economies within AXJ stand to benefit more once foreign discretionary demand starts to recover.

Rates

A Moody's upgrade helped sustain the rally in Indonesian bonds into Sep, but enthusiasm is likely to fade with the simultaneous appearance of unfavourable base effects on y/y inflation and favourable base effects on y/y growth. The combination is likely to put inflation back on the radar screen in Indonesian bond markets, following BI's shift in focus back in Aug.

Still, we believe that official rate hikes are some way off (because of the remaining output gap) and Indonesia's high yields will remain appealing to investors seeking to enhance returns. Such cross-winds will make conditions choppy in IDR local rates markets. We continue to suggest a neutral allocation in IDR bonds.

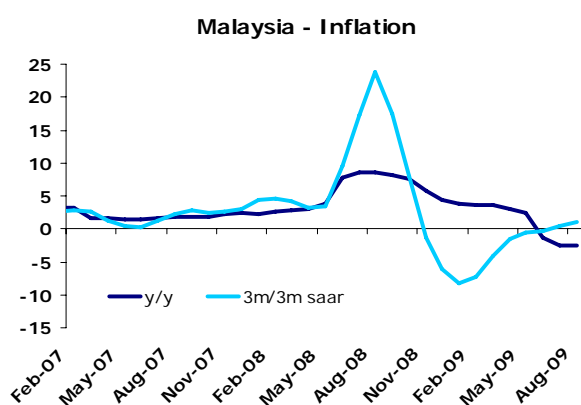
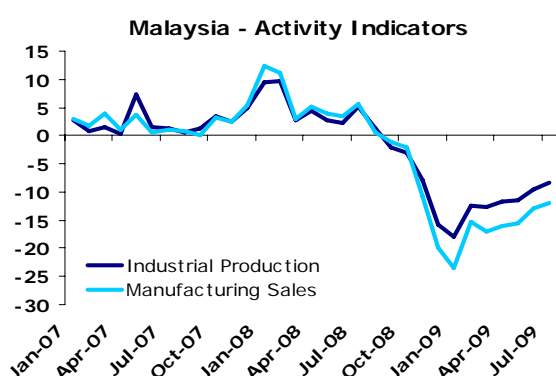
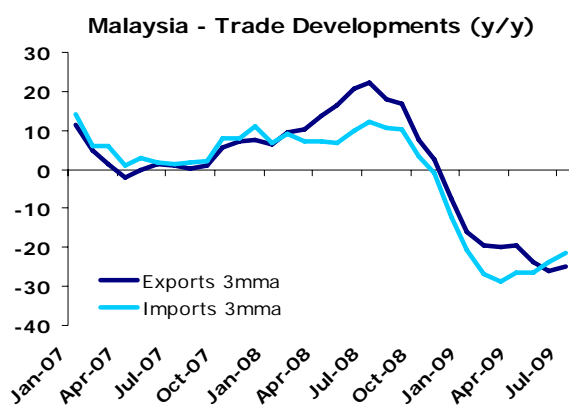
Tamara Henderson

Market Forecasts – Indonesia (eop)

FX	Current	Ytd (%)	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
USD-IDR	9,725	-12.5%	9,500	9,500	9,625	9,500	9,250	9,000
AUD-IDR	8,364	5.1%	8,500	8,700	8,800	8,500	8,000	7,700
NZD-IDR	6,935	5.7%	6,700	6,800	6,800	6,600	6,300	6,000
JPY-IDR	109	-12.8%	110	110	110	110	100	100
EUR-IDR	14,180	-10.4%	14,100	14,400	14,400	14,100	13,600	13,100
Rates	Current	Ytd (bps)	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
BI's bank rate	6.50	-275	6.50	6.50	6.75	7.00	7.25	7.50
3-month JIBOR	6.93	-520	6.9	7.0	7.2	7.3	7.5	7.6
2-year IDR bond yield	7.80	-362	7.7	7.7	8.1	8.6	9.3	10.2
10-year IDR bond yield	10.12	-177	9.9	9.9	10.5	11.1	11.9	13.1

Sources: Bloomberg, ANZ

Country Update: Malaysia



The economy appears to be rebounding from its nadir in Q1. Exports, production and manufacturing sales have all risen on a momentum basis in recent months, signalling that the worst is over. However, given Malaysia's relatively high dependence on external demand, the outlook remains relatively weak.

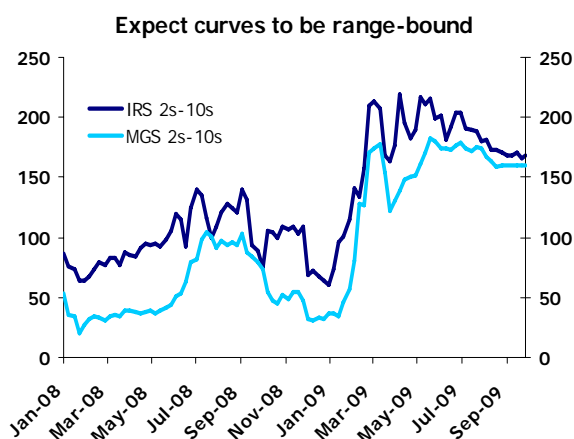
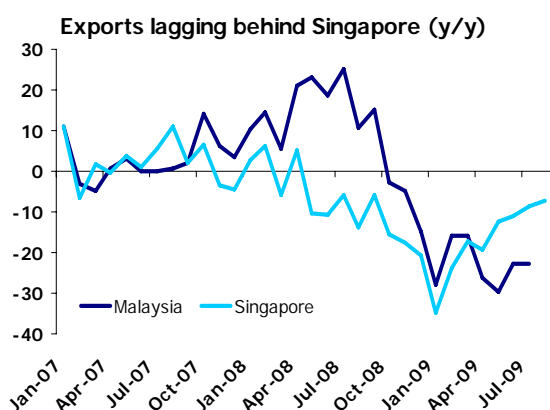
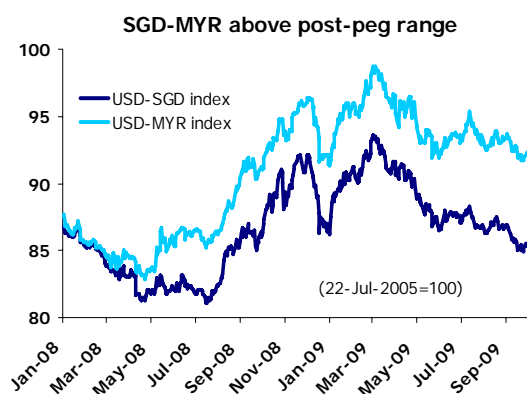
- Manufacturing sales dipped by 22.4% (y/y) in Jul compared with a revised 25.3% decline in Jun. The decline was primarily due to poor performance in the iron and steel sector (-55.8%) and the computer industry (-36.7%). However, manufacturing sales posted a strong increase of 7.0% on a month-on-month basis.
- Industrial production fell by 8.4% (y/y) in Jul compared with a revised 9.5% drop in Jun. By our estimate, this represents a 2.2% (m/m) increase from Jun on a seasonally adjusted basis.
- Export growth was flat, falling 22.8% (y/y) in Jul compared with -22.7% in Jun. However, we estimate that exports actually rose by 8.7% (m/m) on a seasonally adjusted basis. Imports fell by 16.0% (y/y) in Jul against the revised 20.9% slide in Jun, representing a 13.8% (m/m saar) increase from the previous month. The trade surplus narrowed to MYR7.8bn in Jul from MYR9.1bn in Jun.
- Malaysia witnessed deflation for third straight month in Aug as the CPI fell by 2.4% (y/y). This was mainly on account of lower petrol and diesel prices. However, the CPI rose by a 0.2% from the previous month. The sub-index for food and non-alcoholic beverages expanded by 1.4% (y/y) in Aug, whilst the non-food sub-index contracted by 4.3%.
- Bank Negara Malaysia left its policy rate unchanged at 2.00%; the move was widely expected. Governor Zeti said that domestic demand is showing clear signs of recovery aided by the fiscal stimulus and an accommodative monetary stance.
- Growth will turn positive in the coming months, boosted by the recent sequential pick-up in activity as well as late 2008 numbers dropping out of the data. However, continued soft external demand is likely to weigh heavily against a quick recovery.

Chang Wei Liang

Economic Data – Malaysia

Monthly data	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09
Industrial Production, % y/y	-17.9	-12.5	-12.6	-11.7	-11.4	-9.5	-8.4	N/A
Manufacturing Sales, % y/y	-1.9	-21.0	-25.6	-26.3	-25.9	-25.5	-22.4	N/A
Consumer Price Index, % y/y	3.9	3.7	3.5	3.0	2.4	-1.4	-2.4	-2.4
Exports, % y/y	-27.8	-16.0	-15.7	-26.3	-29.7	-22.7	-22.8	N/A
Imports, % y/y	-30.4	-27.6	-29.0	-22.4	-27.8	-20.9	-16	N/A
Trade Balance, USD bn	2.2	3.3	3.4	2.1	2.9	2.6	2.2	N/A
Foreign Exchange Reserves, US\$ bn	85.9	85.3	82.4	81.9	82.2	85.3	84.3	84.5
Quarterly data	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09
Retail Sales, % y/y	39.7	35.7	19.8	23.8	25.4	16.5	7.8	2.8
Real GDP, % y/y	6.5	7.2	7.4	6.6	4.8	0.1	-6.3	-3.9
-Private consumption	14.2	9.9	11.3	9.4	8.2	5.3	-0.7	0.5
-Government consumption	6.0	4.0	14.1	10.3	6.4	12.7	2.1	1.0
-Gross fixed capital formation	12.7	10.2	4.6	5.6	3.1	-10.2	-10.8	-9.8
Nominal GDP, MYR bn	165.4	176.2	175.5	188.5	197.6	177.0	155.3	161.3
Current Account, US\$ bn	8.6	8.0	7.2	11.7	11.2	8.6	8.6	N/A
Capital & Financial Account, US\$ bn	-9.0	-5.2	8.6	-3.4	-18.0	-20.8	-8.2	N/A

Malaysia: FX and Rates Strategy



Improving export performance should stimulate some catch-up in the MYR over the next six months. The government is likely to shift focus toward fiscal consolidation in the Oct budget, but we expect the magnitude of consolidation to be modest.

FX

USD-MYR broke below the Aug trading range of 3.48 to 3.55 on improved risk appetite and broad-based USD weakness, but MYR gains continue to lag the region and the SGD. Continued underperformance by Malaysia's export sector is seen as the primary driver behind the MYR's lacklustre showing. Over the next 6 months, however, we expect the base effect in commodity prices to boost Malaysia's export growth, which should see the MYR catching up with other regional currencies including the SGD. More stable economic conditions have reduced the need for additional government stimulus, easing investors' concerns over Malaysia's fiscal outlook. We have revised our forecast profile for USD-MYR in view of our expectation that the USD will extend its weakness into Q1 2010 on structural and cyclical factors. SGD-MYR is projected to return to the familiar post-peg trading range of 2.20 to 2.40 in the next 6 months.

Rates

Focus will shift in the coming weeks to the 2010 budget statement due 23 Oct. While details are scarce, comments by Second Finance Minister Ahmad Husni in Aug suggest the government's emphasis will shift from mitigating the impact of the downturn to consolidating the budget deficit. However, the magnitude of consolidation is likely to be modest. Prospects for the implementation of a goods and services tax in 2010 are low, while oil-related receipts will be well off the recent-year highs in the coming fiscal year. Indeed, BNM Governor Zeti pared expectations of an aggressive budget, noting in a recent interview that "any premature exit from the fiscal stimulus would affect the sustainability of the recovery" and that the government still "has the potential to continue with the stimulus in 2009 and 2010." While aggressive fiscal consolidation in 2010 could trigger a knee-jerk flattening of the MGS curve, the likelihood of a budget surprise is low. We expect the 2s-10s MGS and IRS spreads to remain largely range-bound until clearer signs of improvement in external demand emerge.

Yeo Han Sia

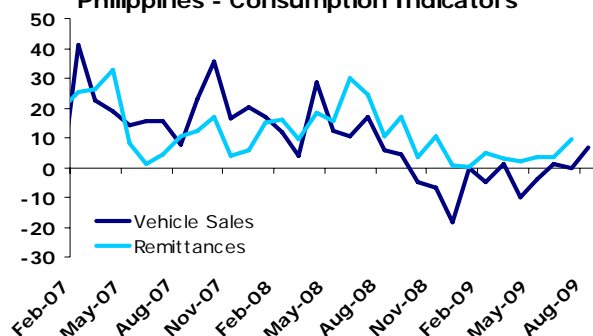
Market Forecasts – Malaysia (eop)

FX	Current	Ytd (%)	Dec-09	Mar-10	Jun-10	Sep-10	Sep-10	Mar-11
USD-MYR	3.48	0.3%	3.41	3.34	3.37	3.40	3.40	3.35
AUD-MYR	2.99	23.3%	3.03	3.07	3.07	3.03	2.96	2.85
NZD-MYR	2.48	24.1%	2.42	2.40	2.39	2.35	2.31	2.24
JPY-MYR	3.89	-7.0%	3.88	3.88	3.83	3.78	3.70	3.56
EUR-MYR	5.07	5.1%	5.05	5.08	5.06	5.03	5.00	4.89
Rates	Current	Ytd (bps)	Dec-09	Mar-10	Jun-10	Sep-10	Sep-10	Mar-11
BNM's overnight policy rate	2.00	-125	2.00	2.00	2.00	2.25	2.25	2.50
3-month KLIBOR	2.14	-123	2.1	2.1	2.1	2.3	2.3	2.6
2-year IRS (versus 3M KLIBOR)	2.73	-9	2.7	2.8	2.8	3.0	3.1	3.3
10-year IRS	4.43	93	4.5	4.6	4.6	4.7	4.8	4.9

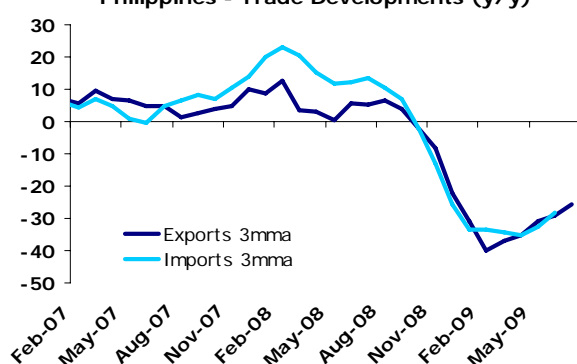
Sources: Bloomberg, ANZ

Country Update: Philippines

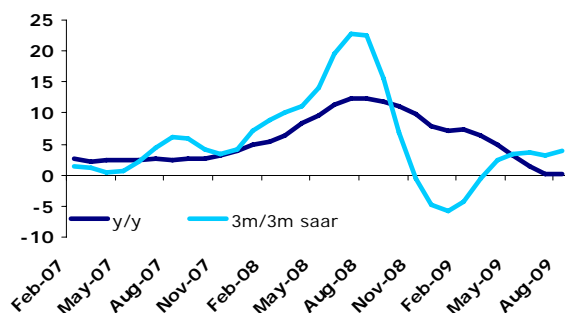
Philippines - Consumption Indicators



Philippines - Trade Developments (y/y)



Philippines - Inflation



Growth remains well-supported by healthy domestic consumption while consumer and business optimism have also improved. Exports have stabilised but are still far from recovery. Inflation remains low but momentum has turned positive. We expect the Philippines to maintain its current growth momentum for the remainder of 2009.

- Consumption indicators remain strong but momentum is unclear. The diffusion index slipped to 43.4 in Q3 from 44.4 in the previous quarter. However, vehicle sales rose at the highest pace since Jul 2008, growing 6.8% (y/y) in Aug compared to -0.3% in Jul.
- Overseas remittances soared to \$1.5bn, up 9.3% (y/y) in Jul, compared with a 3.3% increase in Jun. We expect remittances growth to remain resilient and to continue to support consumption going forward.
- The business outlook index reported a jump to 18.4 in Q3 from -2.6 in the previous quarter, ending four quarters of negative readings.
- Credit growth to the public and private sectors dropped to 23.1% (y/y) and 11.3%, respectively in Jul from 28.4% and 15.1% in Jun on account of a contraction in loans to the manufacturing sector.
- Exports continued to slump, falling 25.4% (y/y) in Jul compared with a revised 24.8% decline in Jun. Shipments also fell 2.8% on a monthly basis. Imports fell by 31.6% (y/y) in Jul, down from -22.8% previously and the trade deficit widened marginally to \$715mn.
- The Philippines reported a monthly budget deficit of PHP22bn in Aug on account of poor tax collections and increased government spending. As of end-Aug, the deficit stood at PHP210bn, only PHP40bn less than the government's deficit target of PHP250bn for all of 2009. ANZ expects the FY deficit to reach PHP320bn this year.
- Inflation eased to a 22-year low of 0.1% (y/y) for Aug, down from 0.2% in Jul. However, 3m/3m 'momentum' inflation has picked up modestly. Core inflation stood at 2.9% (y/y), down from 3.6% in Jul.
- BSP left its policy rate unchanged at 4.00% in Sep, saying that current monetary policy is properly calibrated and supportive of growth given subdued inflation pressures.
- The growth outlook has improved markedly but external demand will remain a drag on activity going forward.

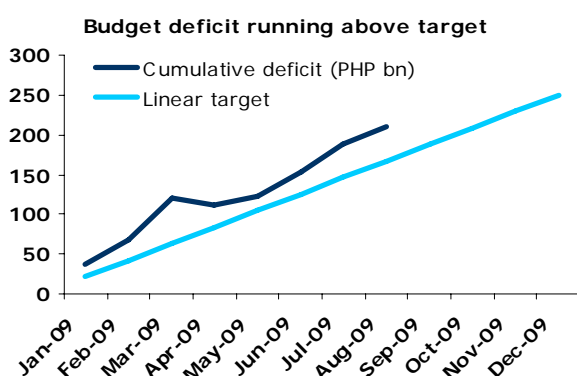
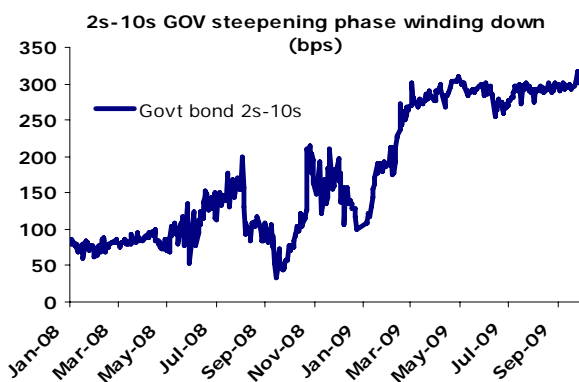
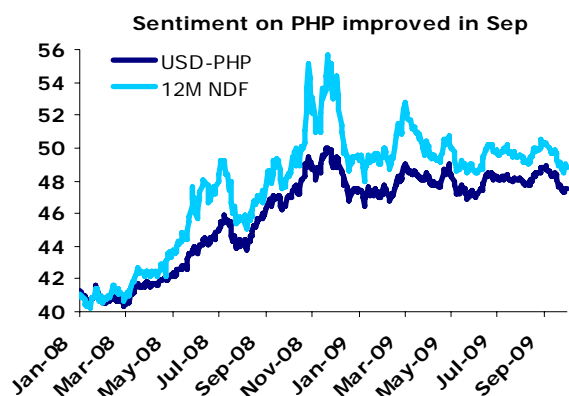
Chang Wei Liang

Economic Data – Philippines

Monthly data	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09
Manufacturing Production Value-add, % y/y	-24.5	-20.7	-11.9	-17.5	-13.0	-12.8	N/A	N/A
Motor Vehicle Sales, % y/y	-0.2	-4.7	1.1	-9.8	-4.1	1.3	-0.3	6.8
Consumer Price Index, % y/y	7.1	7.3	6.4	4.8	3.3	1.5	0.2	0.1
Exports, % y/y	-40.6	-39.0	-30.8	-35.2	-26.9	-24.8	-25.4	N/A
Imports, % y/y	-34.5	-31.9	-36.2	-37.4	-24.3	-22.8	-31.6	N/A
Trade Balance, US\$ bn	-0.8	-0.6	-0.4	-0.2	-0.5	-0.7	-0.7	N/A
Foreign Exchange Reserves, US\$ bn	34.1	33.6	33.9	34.3	34.1	34.2	39.6	N/A
Quarterly data	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09
Real GDP, % y/y	6.8	6.3	3.9	4.2	4.6	2.9	0.6	1.5
-Private consumption	5.7	6.2	5.1	4.1	4.4	5.0	1.3	2.3
-Government consumption	-2.6	8.0	-0.3	0.0	11.8	2.6	4.5	9.1
-Gross fixed capital formation	6.8	5.3	3.0	1.7	7.1	0.1	-7.2	-1.9
Nominal GDP, peso bn	1,610.7	1,895.7	1,660.3	1,833.9	1,853.4	2,075.5	1,738.8	1,869.9
Current Account, US\$ bn	1.3	2.0	1.3	0.9	-0.3	2.3	2.2	N/A
Capital & Financial Account, US\$ bn	3.1	-0.1	0.5	0.4	0.4	-3.3	-0.8	N/A

Sources: CEIC

Philippines: FX and Rates Strategy



Sentiment on the peso improved in Sep as concerns over remittance inflows dissipated. A seasonal rise in remittances and debt capital inflows should keep the balance of payments supported in Q4.

FX

Sentiment on the peso, the worst performing AXJ currency in 2009 so far, appears to have turned in Sep. The PHP gained 2.5% during the month, outperforming all regional currencies except for the IDR and KRW. Residual concerns over the resilience of remittance flows dissipated after Jul inflows surged to a 8-month high of 9.3% (y/y). Cumulative inflows are now firmly on track to exceed the BSP's forecast of flat growth in 2009. Market consensus on remittances rose to 5.5% in a Sep newswire poll, a sharp reversal from -0.5% and -5.0% expected in Jul and May, respectively. Into Q4, the seasonal rise in remittance inflows, a \$500mn sovereign global bond issue, and reportedly sizeable debt-related private sector inflows should keep the balance of payments well supported, notwithstanding the Philippines' sluggish external sector performance and risk of an above-target budget deficit in 2009.

Rates

The BSP retained its growth and inflation forecasts despite damage from Typhoon Ketsana in Sep. While reconstruction spending could generate some upward price pressures, the central bank expects inflation to remain in the 2.5% to 4.5% target zone. The economic planning agency estimated the flood damage to be moderate, lowering GDP growth by 0.1ppt to 0.7% to 1.7% in 2009.

Meanwhile, monthly budget numbers continue to disappoint. Market consensus on the full year deficit has widened to PHP285bn in the Sep newswire poll, up from PHP270bn in a similar survey in Jun. However, alternative sources of funding reduced the need for a larger borrowing plan in Q4. The government sold a record PHP114.4bn worth of retail Treasury bonds in Sep, well above its forecast of around PHP80bn. The Q4 Treasury auction calendar was cut to PHP65bn, down from PHP73.5bn in Q3. Easing funding conditions in the global market also pave the way for the government to raise another \$500mn from foreign investors in Q4, earmarked for 2010 deficit funding. We continue to favour strategic flattening trades in anticipation of higher inflation from base effects and rising inflation momentum into year-end.

Yeo Han Sia

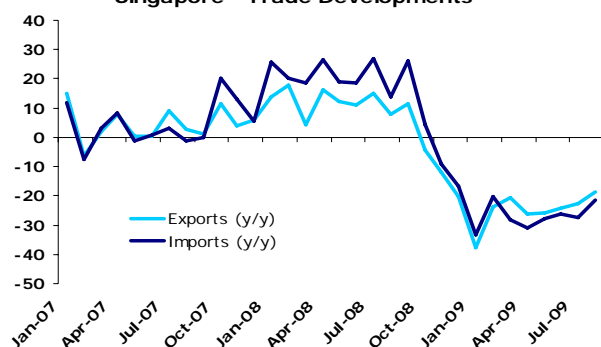
Market Forecasts – Philippines (eop)

FX	Current	Ytd (%)	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
USD-PHP	47.32	-0.4%	47.0	46.0	46.5	46.0	45.0	45.0
AUD-PHP	40.86	22.7%	41.8	42.3	42.3	40.9	39.2	38.3
NZD-PHP	33.93	23.6%	33.4	33.1	33.0	31.7	30.6	30.2
JPY-PHP	0.53	2.0%	0.534	0.535	0.528	0.511	0.489	0.479
EUR-PHP	69.38	4.8%	69.6	69.9	69.8	68.1	66.2	65.7
Rates	Current	Ytd (bps)	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
BSP's overnight reverse repo rate	4.00	-150	4.00	4.00	4.25	4.50	4.75	5.25
3-month PHIBOR	4.38	-88	4.4	4.4	4.5	4.6	4.8	5.3
2-year IRS (versus 3M IB ref rate)	4.75	68	4.8	5.0	5.3	5.5	5.7	6.0
10-year IRS	6.13	3.0	6.2	6.2	6.4	6.6	6.7	6.8

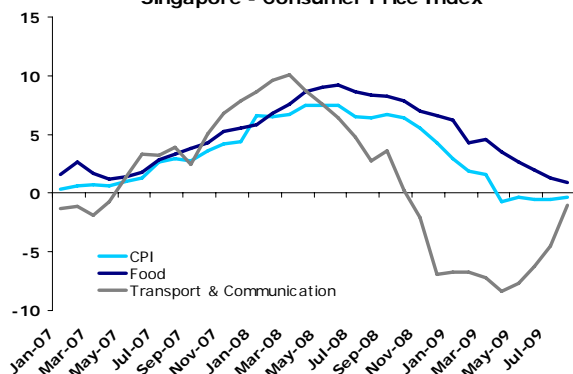
Sources: Bloomberg, ANZ

Country Update: Singapore

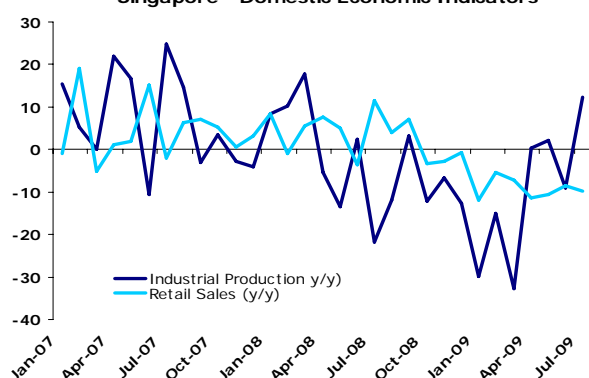
Singapore - Trade Developments



Singapore - Consumer Price Index



Singapore - Domestic Economic Indicators



Singapore's economy is slowly emerging from its worst-ever recession. Demand for domestic exports is (sequentially) improving, inflation is low, industrial production is rising, unemployment is decreasing and retail sales are improving. In Oct, the Monetary Authority of Singapore will review its neutral currency policy stance—we expect no change.

- Singapore's non-oil domestic exports dropped by 7.1% (y/y) in Aug, after contracting by a revised 8.7% in Jul. Electronic shipments dropped by 13.7% while non-electronics shipments (which include petrochemicals and pharmaceuticals) fell 2.8%.
- Inflation was -0.3% (y/y) in Aug compared to -0.5% in Jul, amid lower housing and transport costs. Food prices rose by 0.9% while transport and communication costs fell 0.4% and housing cost declined by 1.6%. For the month, price rose 0.4% in Aug.
- Industrial production climbed 12.3% (y/y) in Aug from a revised 17.0% increase in Jul as the slump in exports eased. Pharmaceutical production surged 108.1% while electronic goods production fell 6.4%. Excluding biomedical manufacturing, production contracted 6.1% in Aug. IP also fell 5.6% (sa) on a monthly basis.
- Retail sales fell 9.8% (y/y) in Jul, after sliding by a revised 8.4% in Jun, as vehicle sales fell 28% and purchases at gas stations dropped 23%. In contrast, department store sales as well as purchases of telecommunication and computer equipment grew by 2% and 6%, respectively. Sales of discretionary items continued to improve month-on-month, suggesting some improvement in consumer sentiment.
- Employers fired fewer workers and increased job openings in the last quarter. Employers cut 5,980 jobs in the 3-month period ending in June, compared with 12,760 in the first quarter. The seasonally adjusted unemployment rate held steady at 3.3%.
- The benchmark Straits Times Index rose by 2% in Sep, extending this quarter's gains to about 13%, amid signs that the global economy is emerging from recession.
- The Monetary Authority of Singapore will review its current neutral currency policy stance in Oct. We expect no change in policy as the recovery remains fragile.

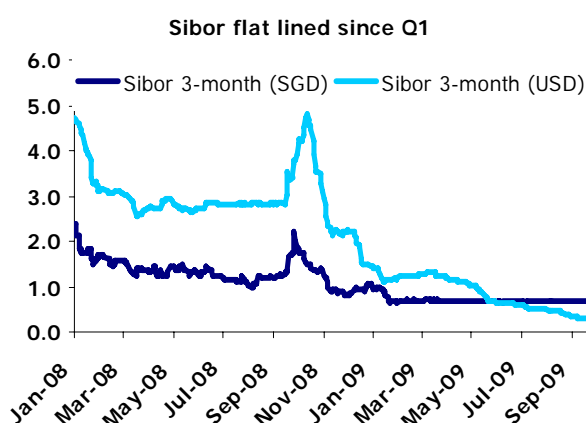
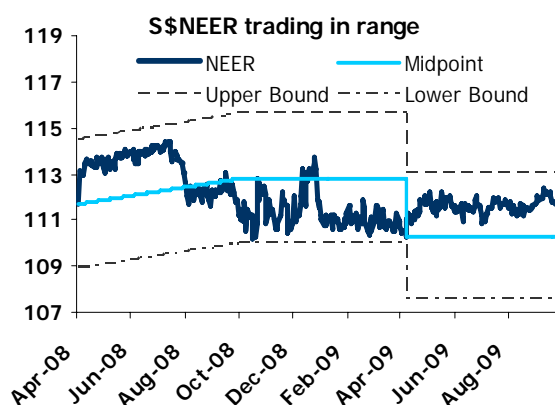
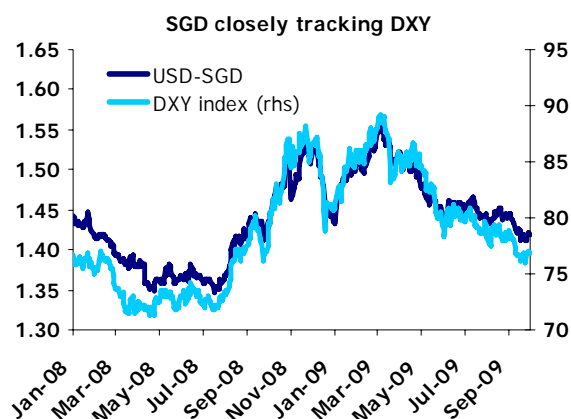
Ivy Tan

Economic Data – Singapore

Monthly data	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09
Industrial Production, % y/y	-26.2	-11.8	-32.7	0.7	2.2	-9.0	17.0	12.3
Retail Sales, % y/y	-11.8	-5.5	-7.0	-11.5	-10.4	-8.4	-9.8	N/A
Consumer Price Index, % y/y	2.9	1.9	1.6	-0.7	-0.3	-0.5	-0.5	-0.3
Domestic Exports (Non-oil), % y/y	-34.9	-23.8	-17.3	-19.2	-12.6	-11.1	-8.5	-7.1
Imports (Non-oil), % y/y	-29.1	-17.3	-25.4	-26.6	-20.0	-18.6	-18.7	-17.5
Trade Balance, US\$ bn	0.5	0.8	2.7	2.4	1.6	1.6	2.6	2.8
Foreign Exchange Reserves, US\$ bn	169.2	166.0	164.9	166.6	169.3	172.1	172.2	174.5
Quarterly data	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09
Real GDP, % y/y	9.5	5.5	6.7	2.5	0.0	-4.2	-9.5	-3.5
-Private consumption	6.3	5.8	4.1	4.4	2.7	-1.2	-4.2	-3.7
-Government consumption	-0.6	9.5	10.4	9.0	9.9	2.7	-1.7	6.3
-Gross fixed capital formation	15.4	17.0	30.5	25.0	14.9	-9.9	-15.1	-7.2
Nominal GDP sa, SGD bn	64.2	66.5	66.0	64.3	64.5	62.8	59.7	62.3
Current Account, US\$ bn	11.5	6.3	8.1	6.7	7.7	4.5	4.1	4.9
Capital & Financial Account, US\$ bn	-8.0	0.7	2.0	-3.8	-8.6	-1.1	-7.8	-4.1

Sources: CEIC

Singapore: FX and Rates Strategy



We expect the MAS to maintain its S\$NEER policy bias in Oct despite robust growth momentum. Inflation should begin to rise in Q4 on base effects, but any up-ticks in the price level are unlikely to destabilise inflation expectations in the near-term.

FX

The strong IP outturn in Aug (12.3% y/y) almost guarantees that the Singapore economy will maintain a strong pace of GDP growth in Q3. The official forecast of a 4% to 6% contraction in 2009 now appears overly pessimistic; an upgrade can be expected when the government releases Q3 GDP in mid-Oct. Notwithstanding the swift rebound in the past two quarters and policy measures to cool the property market in Sep, official commentary in recent months suggests a preference for policies to remain accommodative in view of the baseline scenario of a very gradual recovery into 2010. The S\$NEER traded in the familiar 0.5-1.5% range, with the rapid rise in FX reserves and forward USD positions indicative of the MAS's preference to keep the exchange rate stable. The IMF also gave the current neutral S\$NEER policy stance a vote of confidence in the recent annual Article IV consultation, noting that monetary policy settings are "broadly appropriate," and should stay the course until a recovery "is clearly established." All in all, we expect the MAS to reaffirm its neutral S\$NEER policy bias in Oct. USD-SGD should continue to track the DXY in the absence of an outright policy shift.

Rates

SGD rates remain largely range-bound with a neutral-to-higher bias. Downside is limited by historically low Sibor rates, despite weak loan demand and comfortable liquidity conditions. The downtrend in CPI has tapered off and should begin to rise in Q4 on base effects, but any up-ticks in inflation are unlikely to spark a rapid rise in short-end rates or destabilise inflation expectations in the coming months. However, Sibor rates could harden as the central bank begins to withdraw liquidity support, though the risk of a policy shift in Q4 is relatively low despite growing concerns over asset price inflation. With the authorities expressing concerns over the sustainability of the growth recovery, targeted measures will likely remain the preferred policy response.

Yeo Han Sia

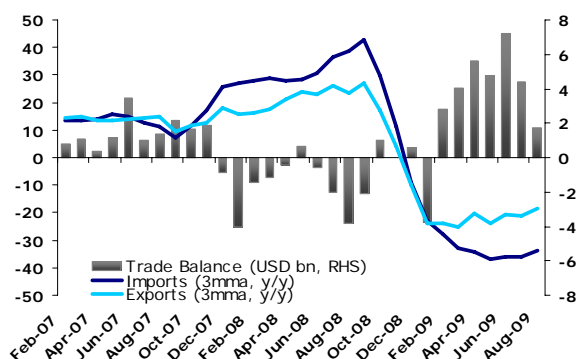
Market Forecasts – Singapore (eop)

FX	Current	Ytd (%)	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
USD-SGD	1.417	-0.9%	1.40	1.39	1.40	1.41	1.41	1.40
AUD-SGD	1.223	21.7%	1.25	1.28	1.27	1.25	1.23	1.19
NZD-SGD	1.015	22.6%	0.99	1.00	0.99	0.97	0.96	0.94
JPY-SGD	1.595	1.2%	1.59	1.62	1.59	1.57	1.53	1.49
EUR-SGD	2.076	3.9%	2.07	2.11	2.10	2.09	2.07	2.04
Rates	Current	Ytd (bps)	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
3-month SIBOR	0.68	-27	0.69	0.85	1.00	1.30	1.50	1.70
2-year IRS (onshore versus 6M SOR)	1.54	-3	1.8	1.9	2.1	2.2	2.4	2.6
10-year IRS	2.88	61	2.9	2.9	3.0	3.0	3.2	3.4

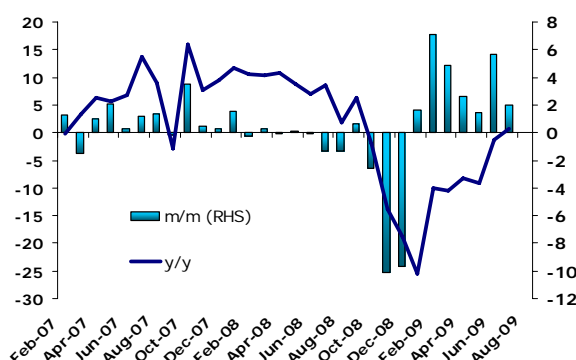
Sources: Bloomberg, ANZ

Country Update: South Korea

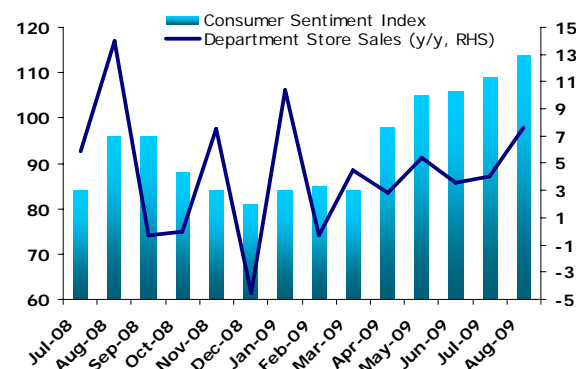
Korea - External Trade



Korea - Industrial Production



Korea - Domestic Demand



Domestic demand has maintained its recent momentum, as seen from continued improvements in department store sales and industrial production as well as strong overall consumer confidence. Exports remain relatively weak, still falling by more than 20% in Aug. We have upgraded our 2009 forecast on the back of the government's upward revision of Q2 growth, but maintain our 2010 forecast.

- Industrial production rose 0.7% (y/y) in Jul, compared with Jun's -1.2%. During the month, the index rose 2.0% (sa), following a 5.7% increase in Jun.
- Department store sales rose for the sixth straight month in Aug, by 7.6% (y/y), compared with Jul's 4.0%. The contraction in discount store sales eased to -1.5% from -6.0% in Jun.
- Exports fell by 20.6% (y/y) in Aug, the tenth consecutive decline compared with a 21.8% drop in Jul. Exports to China dropped by 13.2% in the first 20 days of the month, compared with the US's -13.1% and Japan's -20.7%. Imports dropped by 32.2% in Aug, compared with Jul's -35.7%. The trade surplus stood at \$1.7bn in Aug against \$4.4bn in Jul.
- The CPI rose by 2.2% (y/y) in Aug, faster than Jul's 1.6% rate, the first rise in inflation in six months. Core CPI inflation eased to 3.1% in Aug from 3.2% in Jul. PPI inflation improved to -3.0% in Aug, from -3.8% in Jul.
- The forecast manufacturing business survey index for Sep rose to 93 from Aug's 80, now only 7 points below the 100 neutral level.
- The consumer confidence index was unchanged at 114 in Sep, the first pause after five successive rises. Components of "prospective living standard" and "expectations of domestic economic situation" dropped slightly. Discretionary consumption components remained weak.
- The BOK kept the base rate unchanged at 2.00% for the seventh consecutive month, and will likely maintain an accommodative policy stance. The central bank remains concerned about the uncertain economic outlook and the recent large-scale expansion in mortgage lending.
- The government revised its Q2 economic growth estimate to 2.6% (q/q, sa) from 2.3%. We have thus upgraded our 2009 growth forecast to -1.0% from -1.2%, but maintain our 2010 forecast at 3.3%.

Franklin Poon

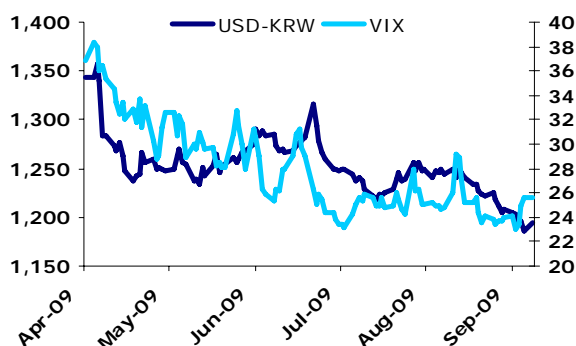
Economic Data – South Korea

Monthly data	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09
Industrial Production, % y/y	-25.5	-10.0	-10.5	-8.2	-9.0	-1.2	0.7	N/A
Retail Sales, % y/y	-1.2	-3.9	-2.3	-1.4	1.8	6.6	4.0	7.6
Consumer Price Index, % y/y	3.7	4.1	3.9	3.6	2.7	2.0	1.6	2.2
Exports, % y/y	-34.5	-18.5	-22.5	-19.9	-28.6	-12.5	-20.1	20.6
Imports, % y/y	-31.4	-30.8	-35.7	-35.4	-40.0	-32.9	-35.8	32.2
Trade Balance, USD bn	-3.8	2.8	4.0	5.6	4.9	7.3	4.4	1.7
Foreign Exchange Reserves, US\$ bn	201.6	201.8	206.4	212.5	226.5	231.2	238.8	N/A
Quarterly data	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09
Real GDP, % y/y	4.9	5.7	5.5	4.3	3.1	-3.4	-4.2	-2.5
-Private consumption	5.4	4.7	4.0	2.3	1.4	-3.7	-4.4	-1.1
-Government consumption	4.8	4.7	3.6	4.0	4.5	4.7	7.3	7.0
-Gross fixed capital formation	1.5	3.1	-0.5	0.6	1.8	-7.3	-8.1	-4.0
Nominal GDP, KRW tn	246.7	263.1	240.8	260.7	261.5	260.9	236.9	N/A
Current Account, US\$ bn	2.0	-0.8	-0.1	1.8	-1.3	0.9	6.6	5.4
Capital & Financial Account, US\$ bn	-3.9	0.3	0.4	-3.6	-4.4	-4.8	-2.7	-0.4

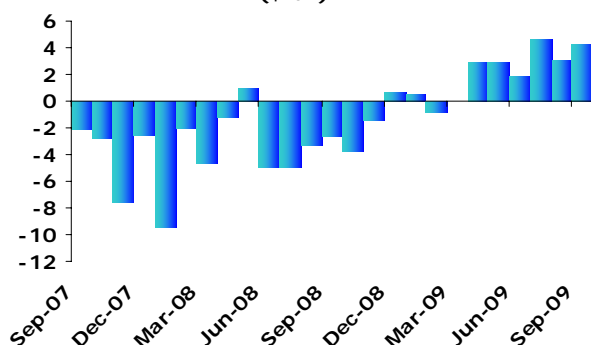
Sources: CEIC

South Korea: FX and Rates Strategy

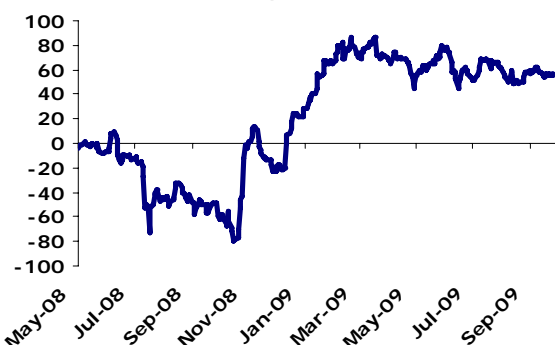
USD-KRW still tracking risk appetite



Net foreign equity inflows leading AXJ (\$ bn)



2s-10s KRW IRS: Starting to flatten (bps)



Resurgent risk appetite—supported by highly favourable base effects—should keep USD-KRW in a downtrend into 2010. October earnings season presents the risk of possible headwinds.

FX

USD-KRW has finally broken its summer range, including key support at 1,200—a level that had held since last Oct. Resurgent risk appetite after Aug holidays in the Northern hemisphere has benefited the region generally, but the KRW is starting to outperform AXJ with the help of a tidal wave of foreign portfolio inflows. Korea attracted net foreign equity inflows amounting to a staggering \$4.2bn in Sep, bringing the total net inflow to \$19.4bn year-to-date, by far the largest within AXJ. Final Q2 GDP was better than expected and Fitch upgraded its outlook on the Korean economy and its policy banks to stable from negative, back to where it was 9 months ago.

Looking ahead, we continue to favour the KRW into 2010, expecting the currency to be a primary beneficiary of improved global demand. The Korean economy is more sensitive to foreign discretionary demand and the collapse of the KRW during the meltdown in global financial markets last year has made Korean exports more competitive. Although we do not expect a meaningful improvement in foreign discretionary demand until mid-2010, highly favourable base effects for y/y exports and growth should sustain risk appetite in the interim.

Rates

Some BoK members are sounding a bit more hawkish, increasing expectations that rate hikes will come sooner than elsewhere in the region. The BoK would like to withdraw the portion of monetary stimulus deemed as post-Lehman “emergency” measures in order to avert fuelling bubbles in equity and property markets, but also must avoid derailing the recovery. As such, we expect only gradual tightening commencing from Q2 given that: 1/ the KRW is likely to continue to strengthen; 2/ stimulus effects will start to wane; and 3/ Korea’s negative output gap will persist until discretionary demand in the US and Europe recovers in the latter part of 2010. During the wait for BoK rate hikes, we favour curve flatteners which earn positive carry.

Tamara Henderson

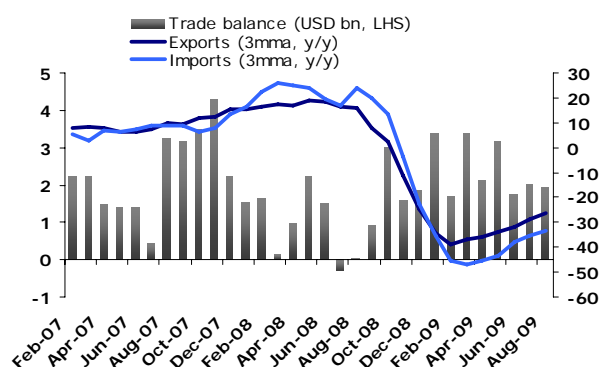
Market Forecasts – South Korea (eop)

FX	Current	Ytd (%)	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
USD-KRW	1,194	-5.2%	1,125	1,100	1,150	1,175	1,050	1,000
AUD-KRW	1,030	16.4%	1,000	1,010	1,050	1,050	910	850
NZD-KRW	853	16.9%	800	790	820	810	710	670
JPY-KRW	13.38	-3.6%	12.8	12.8	13.1	13.1	11.4	10.6
EUR-KRW	1743	-1.0%	1670	1,670	1,730	1,740	1,540	1,460
Rates	Current	Ytd (bps)	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
BOK's overnight call rate	2.00	-100	2.00	2.00	2.25	2.50	3.00	3.50
3-month KORIBOR	2.70	-125	2.8	3.1	3.3	3.6	4.1	4.6
2-year IRS (versus 91D KRW CD)	4.07	78	4.2	4.4	4.7	4.9	5.4	5.9
10-year IRS	4.63	106	4.8	5.2	5.6	5.7	5.8	6.0

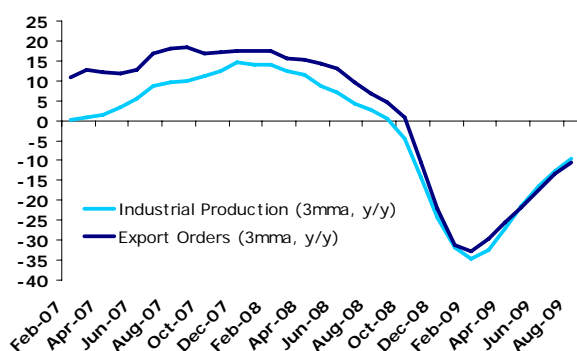
Sources: Bloomberg, ANZ

Country Update: Taiwan

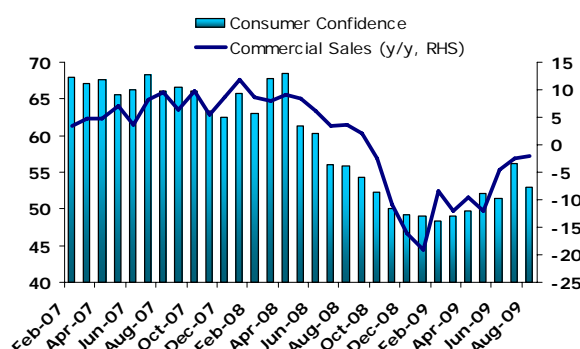
Taiwan - External Trade



Taiwan - Activity Indicators



Taiwan - Domestic Demand



While industrial production fell in Aug partly due to Typhoon Morakot, commercial sales, led by retail trade, continued to improve. Export shipments and orders both remain weak. We maintain our GDP forecasts for 2009 and 2010.

- Commercial sales declined by 2.1% (y/y) in Aug, better than Jul's revised -2.6%. Excluding price effects, sales rose by 7.0%. Wholesale trade and restaurant receipts dropped by 4.3% and 1.4%, respectively, while retail trade increased by 4.6%.
- Industrial production dropped by 9.6% (y/y) in Aug, worse than expected, compared with Jul's -8.1%. For the month, the index declined by 0.4% (sa), partly due to Typhoon Morakot. The output of electronics components increased for the seventh consecutive month.
- Exports fell by 24.6% (y/y) in Aug partly due to base effects, compared with Jul's -24.4% outturn. Shipments to China declined by 18.5%, while those to the US fell by 34.4%. Imports decreased by 32.3%, compared with Jul's -34.1%. The trade surplus stayed at \$2.0bn in Aug.
- The CPI dropped by 0.8% (y/y) in Aug, compared with Jul's -2.3% reading. Consumer prices fell less during the month as the damage from Typhoon Morakot pushed food prices higher. Excluding fresh food and energy prices, the core index declined by 0.8% in Aug, compared with Jul's -0.9%.
- Export orders declined by 12.0% (y/y) in Aug, compared with Jul's -8.8%, worse than expected. Orders from China rose by 7.3% (compared with Jul's 2.2%), while those from the US fell by 19.3% (versus -12.5% in Jul).
- The consumer confidence index dropped to 53.0 (100 is neutral) in Aug from 56.2 in Jul, likely due to political uncertainties associated with the cabinet reshuffle.
- President Ma reshuffled his cabinet after Premier Liu resigned to take responsibility for the poor handling of Typhoon Morakot. Wu Dun-yi replaced Liu as the new premier. We expect no major shift in economic policies.
- The CBC kept its benchmark discount rate unchanged at 1.25%, citing benign inflation and the need for accommodative conditions to support the recovery. Our growth forecasts are unchanged at -4.1% and 3.9% for 2009 and 2010, respectively.

Franklin Poon

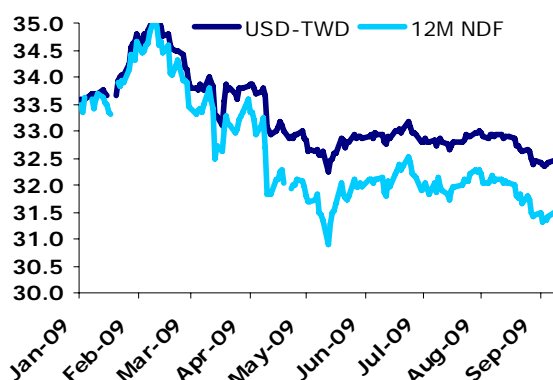
Economic Data – Taiwan

Monthly data	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09
Industrial Production, % y/y	-43.3	-27.2	-25.8	-20.0	-18.4	-11.4	-8.1	-9.6
Commercial Sales, % y/y	-19.0	-8.2	-12.2	-9.5	-11.6	-5.3	-2.6	-2.1
Consumer Price Index, % y/y	1.5	-1.3	-0.1	-0.5	-2.4	-2.0	-2.3	-0.8
Exports, % y/y	-44.1	-28.6	-35.8	-34.3	-31.5	-30.4	-24.4	-24.6
Imports, % y/y	-56.5	-31.6	-49.5	-41.1	-39.1	-33.5	-34.1	-32.3
Trade Balance, US\$ bn	3.3	1.6	3.4	2.1	3.1	1.8	2.0	2.0
Foreign Exchange Reserves, US\$ bn	292.7	294.2	300.1	304.7	312.6	317.6	321.1	325.4
Quarterly data	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09
Real GDP, % y/y	7.0	6.4	6.2	4.6	-1.0	-8.6	-10.2	-7.5
-Private consumption	3.1	1.6	2.1	0.5	-2.1	-1.7	-1.6	0.4
-Government consumption	1.7	1.1	1.3	-0.2	1.2	2.2	3.7	1.5
-Gross fixed capital formation	3.8	-0.8	3.7	-8.0	-11.8	-22.6	-33.4	-23.7
Real GNP, % y/y	6.4	6.1	6.8	3.1	-0.5	-8.7	-10.5	-6.5
Nominal GDP, TWD tn	2.8	2.9	2.7	2.6	2.7	2.6	2.5	2.5
Current Account, US\$ mn	6,477.0	11,183.	8,520.0	7,042.0	1,865.0	7,467.0	12,674.	9,915.0
Capital Account, US\$ mn	-33.0	-18.0	-271.0	-20.0	-32.0	-11.0	-24.0	-17.0

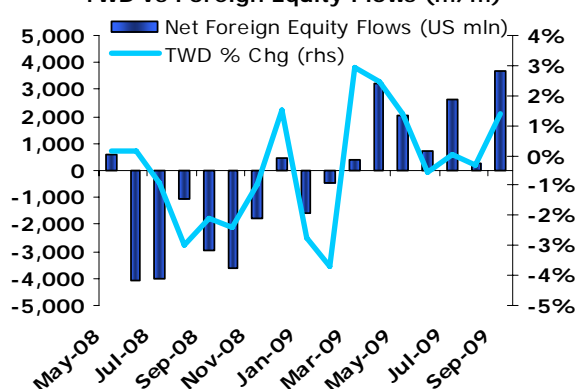
Sources: CEIC

Taiwan: FX and Rates Strategy

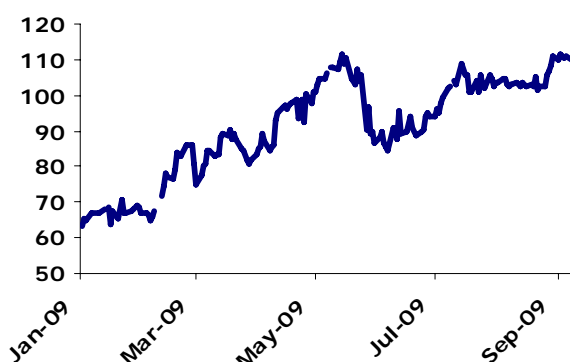
USD-TWD: Target 30.00 by 2011



TWD vs Foreign Equity Flows (m/m)



2s-10s TWD IRS to Narrow in 2010



We remain bullish on the TWD on both a structural and cyclical basis, but continue to highlight risk of a correction in local equity markets due to relatively rich valuations.

FX

USD-TWD has finally broken below the 2009 low of 32.23 (Jun 1) supported by: 1/ a rebound in risk appetite at the conclusion of Aug holidays in the Northern hemisphere, 2/ signs of further progress in the strengthening of ties with Mainland China, and 3/ a signal from the CBC that it will tolerate more TWD appreciation to offset import price pressures. During Apr-Aug, net foreign equity inflows amounted to \$8.9bn compared with inflows of \$4.6bn in Sep alone, the largest monthly inflow since Jun 2007. Although there are signs of cresting in this most recent tidal wave of inflows, Taiwan export data should soon benefit from sizeable base effects. Along with stimulus effects in the developed economies, this will likely sustain enthusiasm for risk trades into Q1. Even at Aug levels, Taiwan exports are already up 40% compared with last Dec. Nevertheless, Taiwan stocks appear relatively rich, trading at a P/E ratio of 117 compared with an (un-weighted) average of 33 for AXJ as a whole and 20 for the S&P500—making them vulnerable to a correction.

Our structural bias for the downtrend in USD-TWD to remain intact is based on the significant warming of ties between Taiwan and Mainland China over the last year. In particular, this Spring's landmark agreement allowing Mainland investment into Taiwan is seen as a game-changer. According to recent press reports there has been significant progress on the next step—the signing of the formal financial Memorandum of Understanding, spanning banking, insurance, securities and futures. In addition, negotiators may meet as soon as Oct (as opposed to Dec) to discuss a trade agreement which could be implemented as soon as May. Direct flights, shipping and postal services already commenced in Dec.

Rates

TWD local rates are expected to exhibit a neutral-to-higher bias, while the curve should remain broadly range-bound over the remainder of H2. Our calculations suggest that Taiwan's output gap is one of the largest in the region, giving the CBC ample time to reign in accommodative monetary conditions.

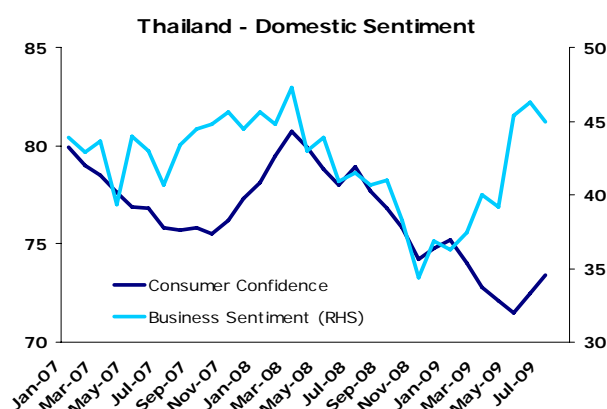
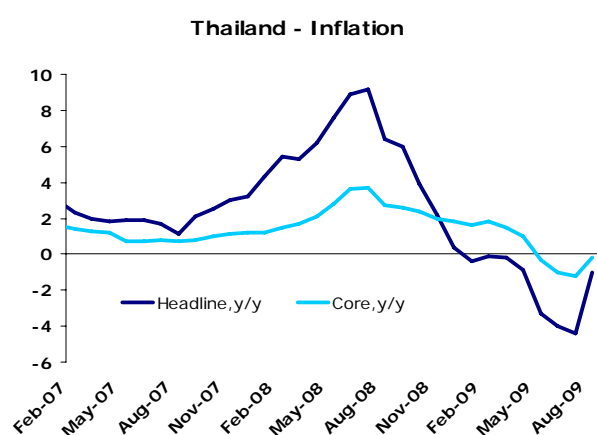
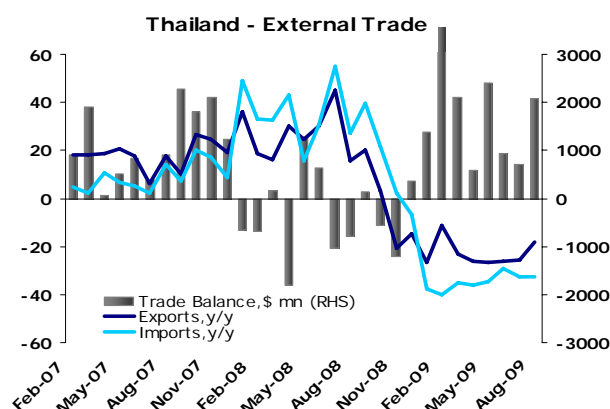
Tamara Henderson

Market Forecasts – Taiwan (eop)

FX	Current	Ytd (%)	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
USD-TWD	32.46	-1.0%	31.5	31.0	31.3	31.5	30.3	30.0
AUD-TWD	28.01	21.5%	28.0	28.5	28.4	28.0	26.4	25.5
NZD-TWD	23.20	22.0%	22.4	22.3	22.2	21.7	20.6	20.1
JPY-TWD	0.363	0.4%	0.358	0.360	0.355	0.350	0.329	0.319
EUR-TWD	47.42	3.4%	46.6	47.1	46.9	46.6	44.5	43.8
Rates	Current	Ytd (bps)	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
CBC's discount rate	1.25	-75	1.25	1.25	1.25	1.50	1.75	2.25
3-month CP	0.49	-60	0.5	0.6	0.7	0.8	0.9	1.0
2-year IRS (versus 3M CP)	0.95	-11	1.0	1.3	1.5	2.0	2.5	3.0
10-year IRS	2.05	61	2.1	2.2	2.3	2.6	2.8	3.1

Sources: Bloomberg, ANZ

Country Update: Thailand



Activity remains weak across the board, with both consumption and external demand continuing to contract. Headline inflation has picked up from a record low, but we do not expect inflation to become an issue in the near term given a large negative output gap. The outlook remains weak overall.

- Domestic demand remains soft. The private consumption index fell for a seventh straight month, dropping 1.8% (y/y) in Jul compared with a 2.7% decline in Jun. Meanwhile, retail sales slid 7.5% (y/y) in Jul after contracting 9.8% in Jun.
- Consumer confidence improved marginally, rising to 73.4 in Aug, up 1.1 points from Jul. Though the global recovery and government stimulus plans boosted sentiment, political uncertainty is still a concern.
- The manufacturing production index rose 1.9% (m/m, sa) in Aug, while on an annual basis, the index fell 8.7%, unchanged from Jul. Meanwhile, capacity utilization fell to 60.0% from 61.9% in Jul.
- The Business Sentiment Index fell in Jul, dropping to 45.0 after rising for two straight months. The pullback was due to worsening sentiment toward the manufacturing, trade and construction sectors.
- Exports fell by 18.4% (y/y) in Aug, compared with -25.7% in Jul. Imports also continue to decline sharply, falling 32.8% (y/y) in Aug versus Jul's -32.5%. As imports fell more sharply than exports, the trade surplus tripled to \$2.1bn.
- The CPI fell the least in four months, declining 1.0% (y/y) in Aug, after declining by 4.4% (y/y) in Jul. Core inflation was -0.2% in Aug, compared with -1.2% in Jul. With base effects gradually fading, headline inflation is soon expected to turn positive.
- The leading index improved marginally to 118.0 in Jul, due to a rise in exports and the stock market index. Tourist arrivals, however, continued to decline owing to growing swine flu fears, offsetting the rise in other components.
- Thailand's economic performance has lagged its ASEAN peers. As there has been limited improvement in activity, we remain cautious about the outlook, with political uncertainties remaining a downside risk.

Zhou Hao

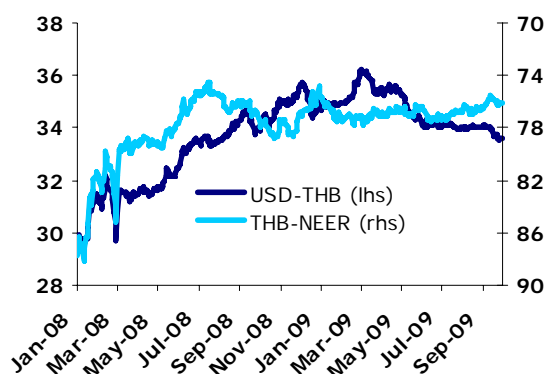
Economic Data – Thailand

Monthly data	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09
Industrial Production, % y/y	-21.2	-19.9	-14.5	-9.7	-9.8	-7.8	-7.3	N/A
Retail Sales, % y/y	-11.1	-7.7	-11.9	-8.7	-8.5	-9.8	-7.5	N/A
Consumer Price Index, % y/y	-0.4	-0.1	-0.2	-0.9	-3.3	-4.0	-4.4	-1.0
Exports, % y/y	-26.4	-11.3	-23.1	-26.1	-26.6	-25.9	-25.7	-18.4
Imports, % y/y	-37.6	-40.3	-35.1	-36.3	-34.7	-29.3	-32.5	-32.8
Trade Balance, US\$ bn	1.4	3.6	2.1	0.6	2.4	0.9	0.7	2.1
Foreign Exchange Reserves, USD bn	107.9	110.4	113.4	114.1	118.5	117.9	120.5	123.0
Quarterly data	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09
Real GDP, % y/y	5.1	5.7	6.0	5.3	3.9	-4.2	-7.1	-4.9
-Private consumption	1.9	1.9	2.7	2.5	2.7	2.1	-2.5	-2.3
-Government consumption	8.9	9.0	-0.4	-3.7	-2.9	11.0	3.6	5.9
-Gross fixed capital formation	2.5	3.8	5.4	1.9	0.6	-3.3	-15.8	-10.1
Nominal GDP, THB bn	2,093.7	2,255.7	2,297.1	2,283.1	2,321.4	2,203.3	2,178.2	2,173.6
Current Account, US\$ bn	1.7	2.2	1.0	0.7	-0.3	0.1	2.4	0.5
Capital & Financial Account, US\$ bn	2.2	1.0	6.6	-4.0	2.5	-1.0	-1.3	N/A

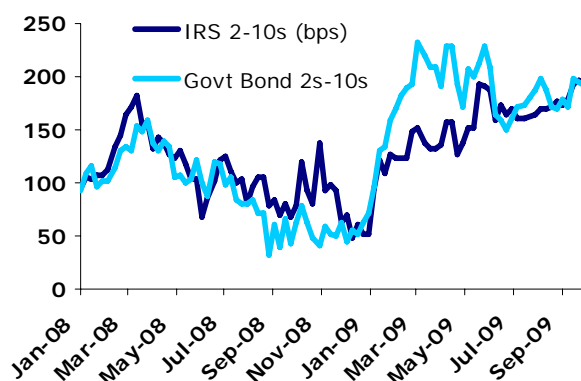
Sources: CEIC

Thailand: FX and Rates Strategy

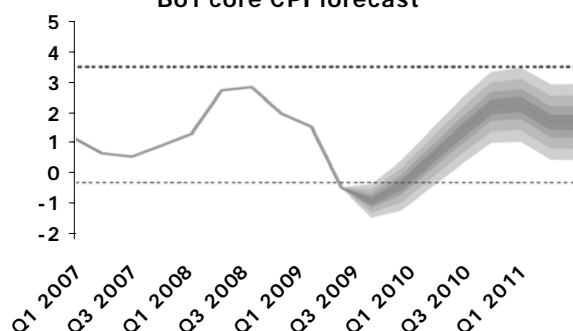
USD-THB breaks out of range in Sep



GOV curve to settle in range-trade



BoT core CPI forecast



USD-THB broke out of its recent range in Sep, and the broad USD trend remains supportive of further baht gains in Q4. The BoT revised its core inflation target, but the narrower band should have no implications on its neutral monetary stance in the coming months.

FX

USD-THB staged a convincing break out of its narrow three month trading range of 33.88 to 34.27 in Sep. Technical indicators remain bearish, with next support for USD-THB at the 33.25 level (a Jul 2008 low). While the broad USD trend points to a downward bias for USD-THB into Q1 2010, the BoT's smoothing operation should continue to slow the descent. To be sure, the central bank has stressed on several occasions that the BoT does not target a specific USD-THB level, but intervenes to smooth volatility and keep the baht in line with the regional currencies. However, on a trade-weighted basis, the baht has weakened by around 1.5% in Q3 to below the narrow ranges seen in the past two quarters. This should provide some room for the baht to appreciate without triggering the authorities' concerns over excessive currency strength.

Rates

The government approved a narrower core inflation target range of 0.5 to 3.0% in Sep. The revised target remains centred at 1.75%, but with the band reduced from 3.5ppt to 2.5ppt. We do not expect any material changes in BoT's monetary policy to follow from the target revision. Indeed, the BoT's current forecast is for core CPI to average 1.4% in 2009 and remain within target range in 2010. Our baseline scenario is for the BoT to remain on hold until Q3 2010.

We expect the GOV curve to remain range-bound despite a larger-than-expected THB801bn FY09/10 borrowing plan announced in mid-Sep. The benign inflation outlook lends credibility to BoT's stand pat stance, while excess banking liquidity should mitigate upward pressure on GOV yields. Of the THB801bn planned for FY09/10, around THB550bn will be raised through longer tenor government bond issuance. The balance will be financed by bank borrowing and promissory notes, easing concerns over an excess supply of long-term debt in 2010.

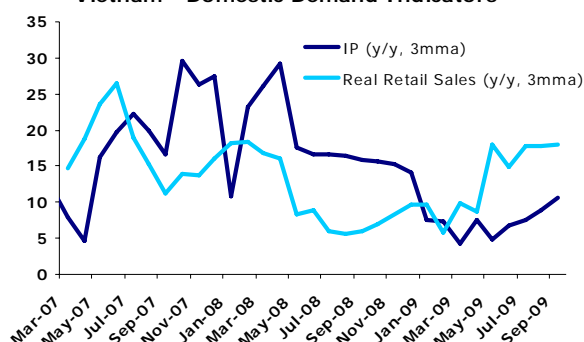
Yeo Han Sia

Market Forecasts – Thailand (eop)

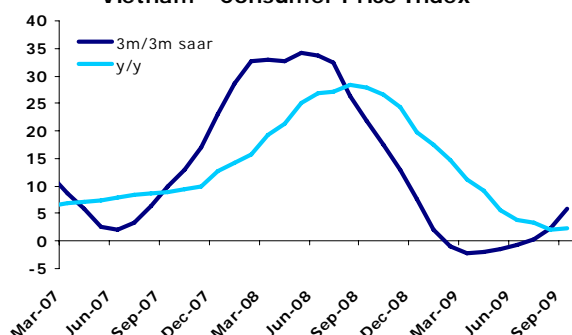
FX	Current	Ytd (%)	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
USD-THB	33.61	-3.3%	33.0	33.0	33.0	32.5	32.5	32.5
AUD-THB	28.92	18.5%	29.4	30.4	30.0	28.9	28.3	27.6
NZD-THB	24.01	19.3%	23.4	23.8	23.4	22.4	22.1	21.8
JPY-THB	0.36	0.6%	0.375	0.384	0.375	0.361	0.353	0.346
EUR-THB	47.37	3.3%	48.8	50.2	49.5	48.1	47.8	47.5
Rates	Current	Ytd (bps)	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
BOT's 1-day repo rate	1.25	-150	1.25	1.25	1.25	1.50	1.50	1.75
3-month BIBOR	1.36	-159	1.4	1.4	1.4	1.7	1.7	1.9
2-year IRS (versus 6M THB fix)	2.34	49	2.6	2.6	2.6	2.9	3.1	3.3
10-year IRS	4.28	191	4.4	4.4	4.4	4.5	4.6	4.8

Country Update: Vietnam

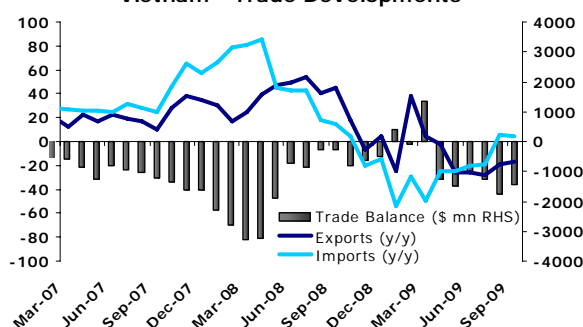
Vietnam - Domestic Demand Indicators



Vietnam - Consumer Price Index



Vietnam - Trade Developments



Growth rose sharply in Q3 and momentum remains strong. Industrial production continues to pick up and retail spending growth is steady. On the downside, the external sector remains weak with the trade balance trajectory looking unsustainable.

- Q3 GDP growth came in at 5.8% (y/y), up convincingly from 4.5% in Q2. For the third quarter alone growth was 3½% (q/q, sa), although this likely reflects that output is measured on a production basis rather than an expenditure basis.
- Industrial production growth continues in rise, reaching 13.8% (y/y) in Sep, up 3 ppt from Aug. Recent improvements have been broad-based, with the non-state and FDI sectors leading the way.
- Retail sales growth remains robust, although it softened in Sep. Sales rose 20.0% (y/y) down from 21.2% in Aug. With inflation now rising, real sales growth may be moderating at a faster rate.
- The external sector remains weak. Export growth improved to -17.0% (y/y) in Sep from -18.9% in Aug while imports grew by 4.2% in Sep (5.1% in Aug). The trade deficit for the month was \$1.4bn, roughly the average for the past six months. The annualised trade deficit of nearly \$20bn, equivalent to around one-quarter of GDP, is not sustainable.
- Moderate price pressures continue to build. Inflation measured year-on-year is rising again, with a Sep reading of 2.4% compared with 2.0 in Aug. Monthly inflation was 0.6% in Sep and has been running at 4% to 5% since Q2.
- Sentiment levels paint a mixed picture. The Domestic Investor Confidence Index rose to 117.9 in Aug from 112.3 in Jul. However, the Foreign Investor Confidence Index declined from 137.2 in Jul to 122.8 in Aug. Of note, these indices are based on investor activity rather than surveys.
- Pledged FDI and planned project increases were down 79% (ytd) through Sep, totalling \$12.5bn. Separately, the government announced that remittances could drop by 15% this year to \$6.8 billion.
- On the back of the strong Q3 outturn, we have raised our full-year 2009 growth forecast to 5% with risks to the upside (as long as official GDP is production based).

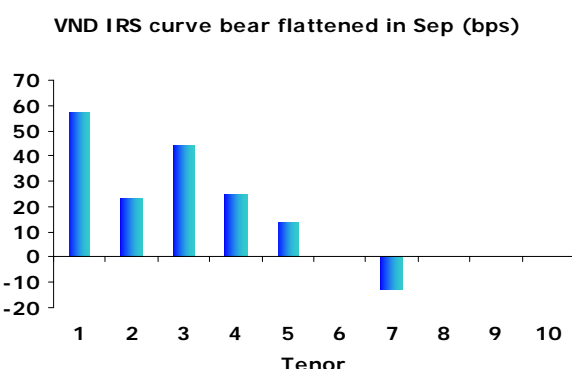
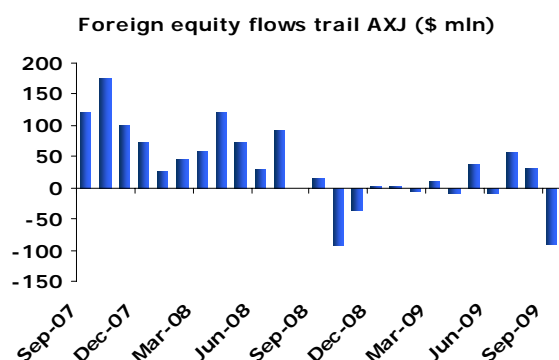
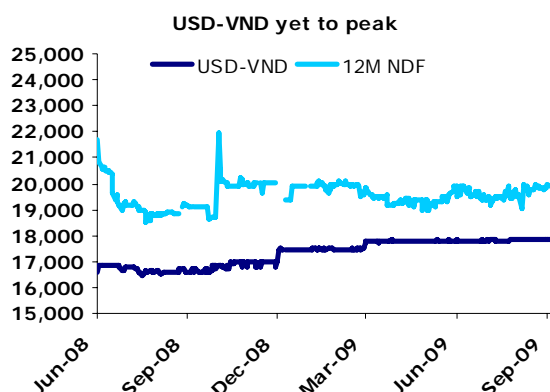
Paul Gruenwald

Economic Data – Vietnam

Monthly data	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09	Sep-09
Industrial Production, % y/y	14.9	2.4	5.4	6.8	8.2	7.6	10.6	13.8
Retail Sales, % y/y	5.8	37.7	17.7	24.5	21.4	19.9	21.1	20.0
Consumer Price Index, % y/y	14.8	11.2	9.2	5.6	3.9	3.3	2.0	2.4
Exports, % y/y	38.6	4.0	-2.2	-26.0	-26.1	-28.2	-18.9	-17.0
Imports, % y/y	-29.0	-49.5	-24.7	-24.9	-20.0	-19.3	5.1	4.2
Trade Balance, USD bn	-0.1	1.4	-1.3	-1.5	-1.0	-1.3	-1.7	-1.4
Quarterly data	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09
Real GDP, % y/y	8.4	7.5	6.5	6.5	6.2	3.1	4.5	5.8
-Agricultural, forestry, fishery	3.7	3.2	3.3	3.8	4.1	0.6	1.7	N/A
-Industry and construction	10.2	8.0	7.0	7.0	6.1	1.4	3.0	N/A
-Services	8.9	8.3	7.6	7.2	7.1	5.6	5.7	N/A
Nominal GDP, VND tn	356.5	254.1	371.7	390.8	461.2	311.1	N/A	N/A
Foreign Exchange Reserves, USD bn	23.5	26.4	22.3	23.8	23.9	N/A	N/A	N/A

Sources: CEIC

Vietnam: FX and Rates Strategy



We continue to believe that it is only a matter of time before the authorities sanction further “flexibility” in the dong in order to address the deterioration in the country’s external position. Pricing in the offshore market is broadly consistent with this view.

FX

Vietnam’s external position continues to deteriorate. The ADB reported that the country’s reserves declined from \$23bn in Dec to \$17.6bn in Jun—just over 3 months of import cover—making the country vulnerable to even “modest” shocks. The latest trade figures reveal an annualised trade deficit equivalent to one-quarter of GDP, with imports continuing to outpace exports; however, the authorities continue to support domestic consumption (and imports), even buying rice and coffee to stabilise prices.

At the same time, FDI pledges are down nearly 80% in the first nine months of the year. Net foreign equity flows have been negative (and building) for three weeks running, which is in sharp contrast with the tidal wave of portfolio inflows into the rest of the region. As such, pressures for a devaluation (or “greater flexibility”) in the dong are mounting.

Authorities were silent about the dong in Sep, while former State Bank of Vietnam (SBV) governor Le Doc Thuy said that the dong should be devalued “slightly” in order to stabilise the currency market and boost exports. This is in sharp contrast with official commentary in recent months which has signalled the intention to keep USD-VND stable. We continue to expect a 4% devaluation in the VND before year-end.

Rates

We expect VND yields to remain in an uptrend into 2010. The SBV has promised to keep policy rates unchanged until the end of the year, but financial markets generally have started to focus on exit strategies. At the same time, highly favourable base effects from last year’s slump in global commodity prices are about to unwind.

The State Treasury continues to struggle to attract bidders for dong-denominated debt, unwilling to offer the yields that investors demand. However, the ADB has now come to the rescue with a \$500mln loan to help finance the government’s stimulus measures.

Tamara Henderson

Market Forecasts – Vietnam (eop)

FX	Current	Ytd (%)	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
USD-VND	17,837	2.0%	18,500	18,500	18,500	18,500	19,300	19,300
AUD-VND	15,343	24.9%	16,500	17,000	16,800	16,500	16,800	16,400
NZD-VND	12,747	25.9%	13,100	13,300	13,100	12,800	13,100	12,900
JPY-VND	200	3.8%	210	215	210	206	210	205
EUR-VND	26,019	6.5%	27,400	28,100	27,800	27,400	28,400	28,200
Rates	Current	Ytd (bps)	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
SBV’s base lending rate	7.00	-150	7.00	7.00	7.00	7.50	8.00	8.50
Overnight VNIBOR	6.70	112	6.5	6.5	6.0	6.0	5.8	5.8
1-year IRS (versus 3M VNIBOR)	9.00	-148	9.4	9.8	10.1	10.5	10.9	11.3
5-year IRS	9.50	-117	10.0	10.5	11.0	11.5	12.0	12.5
2-year GOV	9.55	-43	9.8	10.1	10.4	10.7	11.0	11.3

Contacts

ANZ Economics & Markets Research

Warren Hogan	Acting Chief Economist	+61 2 9227 1562	Warren.Hogan@anz.com
Fiona Allen	Business Manager	+61 3 9273 6224	Fiona.Allen@anz.com

Australian Economics and Interest Rates Research

Warren Hogan	Head of Australian Economics and Interest Rates Research	+61 2 9227 1562	Warren.Hogan@anz.com
Tony Morriss	Senior Rates Strategist	+61 2 9226 6757	Tony.Morriss@anz.com
Julie Toth	Senior Economist	+61 3 9273 6252	Julie.Toth@anz.com
Riki Polygenis	Economist	+61 3 9273 4060	Riki.Polygenis@anz.com
Dr. Alex Joiner	Economist	+61 3 9273 6123	Alex.Joiner@anz.com
Daniel Bae	Analyst	+61 2 9227 1272	Daniel.Bae@anz.com

Global Markets Credit Research

Jason Hill	Global Markets Credit Analyst	0434 312 356	Jason.Hill@anz.com
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Commodity and Industry Research

Mark Pervan	Head of Commodity and Industry Research	+61 3 9273 3716	Mark.Pervan@anz.com
Paul Deane	Rural and Regional Economist	+61 3 9273 6295	Paul.Deane@anz.com
Natalie Robertson	Commodity Research Analyst	+61 3 9273 3415	Natalie.Robertson@anz.com

Property and Financial System Research

Paul Braddick	Head of Property and Financial System Research	+61 3 9273 5987	Paul.Braddick@anz.com
Ange Montalti	Senior Economist	+61 3 9273 6288	Ange.Montalti@anz.com
Dr. Alex Joiner	Economist	+61 3 9273 6123	Alex.Joiner@anz.com
Liam Getreu	Research Assistant		

Foreign Exchange and International Economics Research

Amy Auster	Head of Foreign Exchange and International Economics Research	+61 3 9273 5417	Amy.Auster@anz.com
Katie Dean	Senior Economist	+61 3 9273 1381	Katie.Dean@anz.com
Amber Rabinov	Economist	+61 3 9273 4853	Amber.Rabinov@anz.com

Foreign Exchange and Interest Rates Research (London)

Tim Riddell	Currency and Interest Rate Strategist	+44 20 3229 2082	Tim.Riddell@anz.com
Luca Jellinek	Interest Rate Strategist	+44 20 3229 2062	Luca.Jellinek@anz.com

Asian Economics Research (Singapore and Hong Kong)

Paul Gruenwald	Chief Economist, Asia	+65 6216 1814	Paul.Gruenwald@anz.com
Tamara Henderson	Director, FX & Rates Strategy	+65 6216 1845	Tamara.Henderson@anz.com
Liu Li-Gang	Head of China Economics, Asia	+852 3929 5376	LiGang.Liu@anz.com
Yeo Han Sia	Associate Director, FX and Rates Strategy	+65 6216 1968	HanSia.Yeo@anz.com
Franklin Poon	Economist, North East Asia	+852 3929 5340	Franklin.Poon@anz.com
Chang Wei Liang	Analyst, Economic Research	+65 6216 1918	WeiLiang.Chang@anz.com

New Zealand Economics Research (Wellington)

Cameron Bagrie	Chief Economist, New Zealand	+64 4 802 2212	Cameron.Bagrie@anz.com
Khoon Goh	Senior Economist	+64 4 802 2357	Khoon.Goh@anz.com
Philip Borkin	Economist	+64 4 802 2199	Philip.Borkin@anz.com
Steve Edwards	Economist	+64 4 802 2217	Steve.Edwards@anz.com
Kevin Wilson	Rural Economist	+64 4 802 2361	wilsonk1@anz.com

Research and Information Services

Karen Crothers	Head of Research and Information Services	+61 3 9273 6265	Karen.Crothers@anz.com
Marilla Rough	Senior Information Officer	+61 3 9273 6263	Marilla.Rough@anz.com
Manesha Jayasuriya	Publications Coordinator	+61 3 9273 4121	Manesha.Jayasuriya@anz.com

Important Notice

Australia and New Zealand Banking Group Limited is represented in:

AUSTRALIA by:

Australia and New Zealand Banking Group Limited ABN 11005 357 522
10th Floor 100 Queen Street, Melbourne 3000, Australia
Telephone +61 2 9226 6224 Fax +61 2 9227 5711

UNITED KINGDOM by:

Australia and New Zealand Banking Group Limited
ABN 11 005 357 522
40 Bank Street, Canary Wharf, London, E14 5EJ, United Kingdom
Telephone+ 44 20 3229 2121 Fax+44 20 7378 2378

UNITED STATES OF AMERICA by:

ANZ Securities, Inc. (Member of FINRA [www.finra.org] and SEC)
6th Floor 1177 Avenue of the Americas
New York, NY 10036, United States of America
Tel: +1 212 801 9160 Fax: +1 212 801 9163

NEW ZEALAND by:

ANZ National Bank Limited
Level 7, 1-9 Victoria Street, Wellington, New Zealand
Tel: +64 4 802 2000

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