ANZ RESEARCH

ASIA PACIFIC ECONOMICS
EMERGING ASIA MONTHLY

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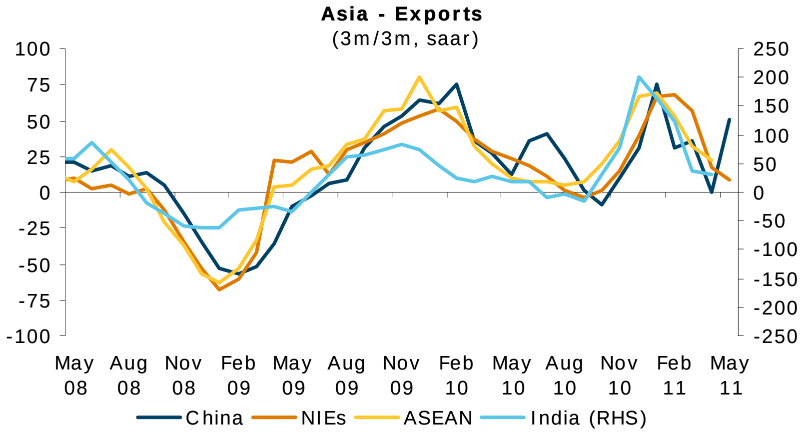
HIGHLIGHTS

- Activity remains soft throughout most of the region as consumption and investment momentum continue to decline. Trade numbers have also been weak, but intra-regional trade remains relatively healthy. We continue to see the current slowdown as a pause in growth.
- Containing inflation (rather than supporting growth) remains the main policy concern in the region as central banks in India, Korea, Taiwan and Thailand raised rates in June. In our view, the current slowdown provides an opportunity for some central banks to catch up.
- Investor sentiment ended H1 2011 on a high note, but the lift to risk appetite is likely to be short-lived. As such, USD-AXJC currencies are expected to have a higher bias in the months ahead.

CHART OF THE MONTH

EXPORT MOMENTUM APPEARS TO HAVE BOTTOMED – WILL IT FOLLOW CHINA'S REBOUND?



Sources: CEIC, ANZ Research

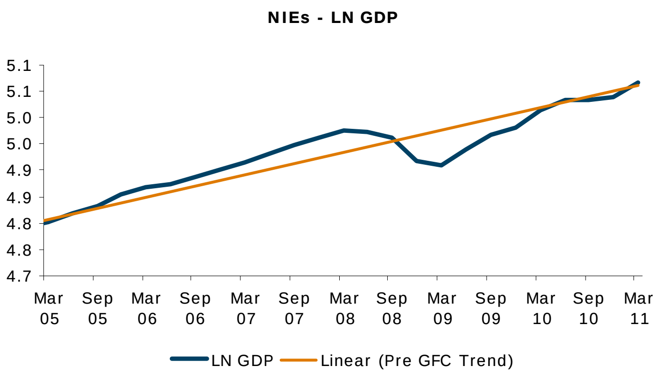
INSIDE

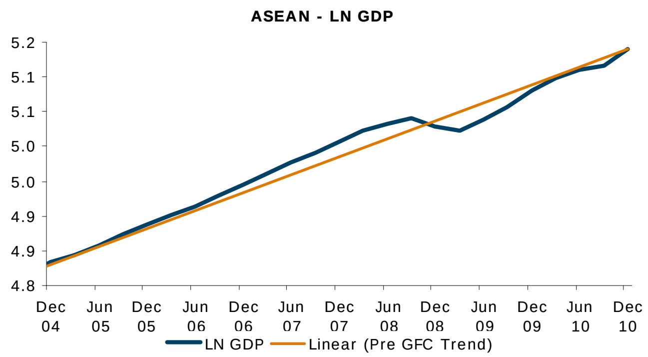
FEATURE NOTE

THE ASIAN INFLATION FIGHT AND RELATIVE ASSET PERFORMANCE

Emerging Asian economies have to a large extent de-linked from the West in the post-GFC period as domestic demand has proven relatively resilient. However, in many cases monetary policy continues to shadow that of the Fed. This is causing inflation and asset price problems and, as we argue in this paper, a divergence between fixed income and equity performance. Indeed, a relative outperformance of fixed income tells us that monetary policy is geared more toward fighting inflation (as it should be) rather than shadowing the US Fed.

As we have documented elsewhere, Emerging Asian economies have fully recovered from the GFC. This can be seen most clearly by looking at the level of GDP relative to the pre-crisis trend. As seen in the charts below for the middle and smaller sized economies in the region (China and India have closed their gaps as well), not only has growth returned to the pre-crisis rate (the slope) but the level of output has regained its pre-crisis path. Put otherwise, Emerging Asia's output gaps have closed, unlike in the US where a sizeable output gap remains.





Sources: CEIC, ANZ

Given this performance, we would conclude that Emerging Asian economies have a least partially de-linked from the US economy. In terms of the policy response, this should "de-link" as well. The implication is that central banks in the region should not be following (very stimulatory) US interest rate policy in an effort to keep their exchange rates "stable" with the hope of ensuring competitiveness. If they do, then monetary conditions would be inappropriately loose, resulting in a combination of consumer and/or asset price inflation.

MONETARY POLICY REGIMES AND MONETARY CONDITIONS IN EMERGING ASIA

First, how should we characterise monetary policy regimes in Asia? We begin by looking at the two polar cases or bookends: Hong Kong SAR and Australia (which we make a "member" of the Asian club in this article).

- The Hong Kong Monetary Authority runs a currency board with the Hong Kong dollar linked to the US dollar[1]. Both the stock and flow of the monetary base are fully backed by foreign reserves. Under this arrangement, Hong Kong effectively imports US monetary policy independent of the required monetary conditions in the SAR. Indeed, under a currency board system the necessary adjustment to external shocks takes place through wage and price adjustment, both upwards and downward. Hence the need for these to be highly flexible.

[1] The Hong Kong dollar is allowed to trade in a "convertibility zone" between 7.75 and 7.85 per US dollar.

FEATURE NOTE

- The Reserve Bank of Australia runs an inflation targeting regime which aims to keep consumer price inflation between 2% and 3% over the medium term. The RBA changes its policy rate as needed to ensure its inflation objective. The Australian dollar is allowed to float freely; the RBA does not intervene in the currency markets.

The remaining central banks in the region fall in between these two bookends. Of note, the type of monetary regime varies considerably across Emerging Asia. We have four proclaimed inflation targeters (Indonesia, the Philippines, Thailand and South Korea), a near-inflation targeter (India), two heavily managed floats (China and Vietnam), a managed floater (Malaysia), a nominal effective exchange rate targeter (Singapore), and a monetary aggregate targeter (Taiwan).

In order to have a consistent measure of central bank performance in fighting inflation, we will use a monetary conditions index (MCI) approach. This is a weighed average of the benchmark short-term market interest rate[2] and nominal effective exchange rate normalised to a base period, which for us will be the pre-crisis era (proxied by the level at end-December 2007). The relative weights between interest and exchange rates are derived from the openness of the economy. Specifically, the weight on the exchange rate will be larger if the economy has a larger share of imports as a percentage of GDP.

How do MCIs stack up in the region? The table below shows our results as of end-May 2011. As expected, Hong Kong has the loosest monetary conditions owing to its exchange rate being linked to the US dollar. A group including Korea, the Philippines and Vietnam also have monetary conditions remain substantially looser than pre-crisis levels (the first two mainly from a slow return to pre-crisis rates; the latter from a weakening exchange rate). Indonesia and India have a bit further to go in terms of tightening, while monetary authorities in most of the rest of the region have been able to return monetary conditions to pre-crisis levels.[3]

EMERGING ASIA: MONETARY CONDITONS INDICES

	CHANGE	DEC-07	MAY-11	LOW	LOW DATE
CHN	1.0	102.1	103.0	101.5	(Nov 09)
HKG	-14.4	87.4	73.0	73.0	(May 11)
IDN	-0.9	98.1	97.2	95.9	(Sep 09)
IND	-1.2	102.7	101.5	96.1	(Sep 09)
KOR	-9.1	99.0	89.9	85.0	(Mar 09)
MLY	1.4	100.0	101.4	94.4	(Sep 09)
PHL	-6.7	102.8	96.1	94.7	(Dec 10)
THA	-0.3	98.9	98.6	94.7	(Nov 09)
TWN	0.1	98.6	98.7	95.6	(Nov 09)
VNM	-9.0	97.9	88.9	92.5	(Oct 10)

Source: BIS, Bloomberg, Reuters, ANZ

As we expect that the major developed economies will remain in deleveraging process for a number of years to come with continued large output gaps, this will likely result in a sustained period of relatively low policy rates across both the US and Europe.

An implication of a sustained period of low rates across most of the developed world is that Asian economies, which as noted have recovered from the GFC, will likely require greater exchange rate and monetary policy flexibility in order to manage economies that are already around full capacity. Not doing this, and hewing closely to US policy, will only generate inflation pressures as monetary policy setting would be too loose.

[2] The market rate is intended to capture the effects of official rate rises, increases in reserve requirements, and various prudential measures.

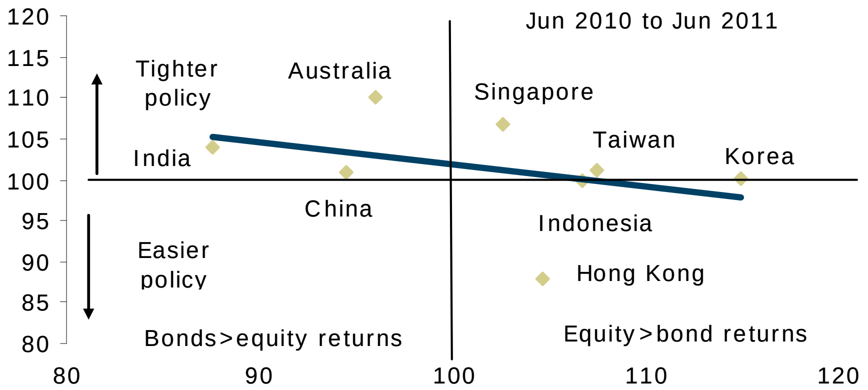
[3] We have omitted Singapore, which is an outlier on the positive side.

FEATURE NOTE

MONETARY POLICY TIGHTENING AND RELATIVE ASSET RETURNS

As noted in the previous section, the monetary policy responses across Asia have been variable in the post-GFC period and our main focus in this section is to gauge the extent that the variable policy response may have been reflected in relative asset price performance. We will measure this performance in terms of the total return to bonds as opposed to equity. In the chart below we have indexed the total returns to corporate credit (as estimated by the JP Morgan JACI indices for Asia and Merrill Lynch Bank of America for Australia) and equity (MSCI) all in local currency terms.

Equity / Bond Returns vs. MCIs



Source: Thomson Reuters, JP Morgan, MSCI, Merrill Lynch Bank of America, ANZ Economics.

In general terms we would expect those economies that have started to tighten policy to see returns shift from equities towards bonds (shift to the left quadrant), whilst those economies with relatively loose policy could be expected to see equities substantially out performing credit (right quadrant). The rationale for this prior is that the relatively high rates in markets that have tightened policy settings will allow investors to get paid, whilst in the laggards investors are more likely to prefer equities as an inflation hedge.

The chart shows that our priors have been confirmed as the line fitting our scatter plots slopes from northwest to southeast. Indeed, Australia, China and India, where the authorities have tightened relatively more, are located in the northwest quadrant as expected: here policy is tighter and bonds have outperformed. In contrast, Hong Kong and Korea, which have shown the least amount of tightening, are in the south-eastern quadrant.

In term of the numbers, India and Korea provide a stark contrast. In the case of India over the last 12 months returns to corporate bonds are up around 10% whilst returns to equities are down around 3%. In contrast, Korean equities are up around 23%, whilst returns to credit are up 7%.

BOTTOM LINE

Inflation fighting credentials show up clearly in differences in relative asset price performance. Bonds outperform in the more credible countries whilst equities outperform in the less credible ones. With interest rates in most advanced economies likely to remain low for an extended period, the challenge will be for the central banks of Emerging Asia to increasingly de-link from Fed policy to mirror the performance of their respective economies. If they are successful, not only will inflation be lower, but bonds are likely to outperform equity returns.

Paul Gruenwald

Kerry Duce

FX & RATES STRATEGY OVERVIEW

AXJ FX STRATEGY: FOCUS SHIFTS FROM GREECE TO GROWTH

Europe's sovereign debt crisis continued to dominate price action in June, initially pulling USD-AXJC higher before gains were unwound on signs that Greece will receive a second bailout package and avert default. Also notable during the month was the release of IEA reserves which triggered a correction in oil prices. As such, investor sentiment ended H1 2011 on a high note.

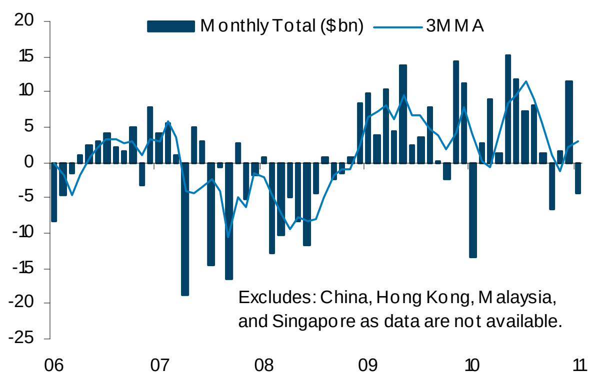
The lift to risk appetite may prove to be short-lived, however. Just released, China's June PMIs dropped sharply, now at 50.9 (official) and 50.1 (HSBC). A reading above 50 still signals expansion, but until the downtrend in PMI troughs, markets are apt to price in greater risk of a hard landing. Surely, Chinese authorities have entered a phase where policy adjustments will be more fine-tuned in order to assure a soft landing. At a minimum, markets are likely to temper expectations for CNY gains. Indeed, our China team has tweaked the USDCNY forecast, now looking for a year-end level of 6.30 versus 6.23 previously.

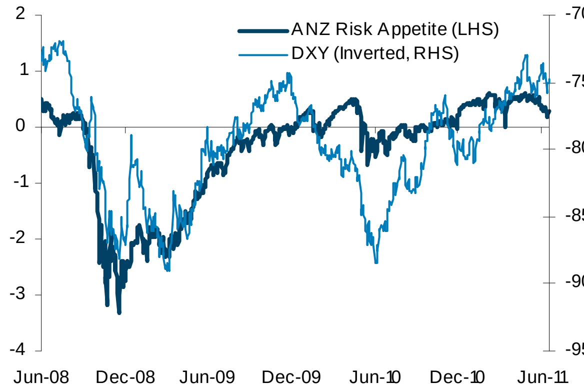
Meanwhile, we continue to flag other factors that will bias USD-AXJC currencies higher in the months ahead:

- The Fed's QE2 programme expired on 30 June, ending monthly injections of roughly $75bn into the global financial system. This will stem capital inflows and reduce appreciation pressures in AXJC currencies.
- Inflation will soon peak in the region that led the global recovery—especially in China. This will prompt markets to pare back rate hike expectations, which will reduce appreciation pressures in AXJC currencies.

A "risk off" environment would provide opportune timing for a widening in the USDCNY trading band as authorities will not want to sanction one-way bets on the CNY. Our China team expects a widening from ±0.5% currently to ±3%, which would bring the pair into alignment with the bands for CNYEUR and CNYJPY. Markets appear increasingly vulnerable to a "head-fake" especially as the USDCNY fix was set lower despite much weaker June PMIs.

The primary risk to long USD-AXJC trades during a risk-off period is seen to come from structural forces: 1/ ongoing FX reserve diversification away from US dollars by central banks, and 2/ the progressive re-weighting of portfolio benchmarks in favour of Emerging Market assets. For long term investors, pull-backs in risk appetite will be seen as opportunities to build AXJ exposure.





Sources: ANZ Research, Bloomberg

RELATIVE VALUE

Against this backdrop, past experience suggests that the Chinese yuan (CNY), Hong Kong dollar (HKD), and Singapore dollar (SGD) will be the most resilient to a pullback in risk aversion. The Chinese economy is less sensitive to external dynamics, allowing the authorities to focus on domestic inflation, economic rebalancing, and yuan internationalisation—each a source of support for the **CNY**. To side-step increasing two-way risk, however, the **SGD** is preferred.

FX & RATES STRATEGY OVERVIEW

Movements in the Indonesian rupiah (IDR) may also be more subdued than in past episodes of risk aversion. This time, the country's more imminent upgrade to investment grade (IG) status (widely expected before year-end), along with further efforts to discourage hot money, should temper outflows if risk appetite continues to sour in the months ahead. Bank Indonesia will also want to cap gains in USDIDR in order to keep inflation expectations anchored.

The AXJ currency that remains most vulnerable nearer term is the Thai baht (THB) as general elections on 3 July have potential to trigger social unrest. A victory by the current government risks sparking protests by the populist "Red Shirts," while a win by the opposition may not be accepted by the military. Much of this election risk appears to be priced in the market, but if protests were to turn exceedingly violent USDTHB has scope to move much higher.

In terms of execution, we suggest:

- **AXJ Corporates with USD Receivables**: Reduce hedge ratios into end-August.
- **Benchmarked Investors with Dedicated AXJ Allocations**: Tilt portfolios toward the SGD at the expense of the KRW; maintain IDR exposure in expectation of Indonesia's upgrade to investment grade status in H2.
- **Leveraged Investors**: Buy SGDKRW (See ANZ's Global Strategy Outlook for more details).

Tamara Henderson

FX & RATES STRATEGY OVERVIEW

SUGGESTED ALLOCATIONS FOR BENCHMARKED INVESTORS[4]

FX	VERSUS USD		VERSUS AXJ	
	1M	YEAR END	1M	YEAR END
AXJ OVERALL	Underweight	Underweight	N/A	N/A
CHINA	Neutral	Neutral	Overweight	Overweight
HONG KONG	Neutral	Neutral	Overweight	Overweight
INDIA	Underweight	Underweight	Underweight	Underweight
INDONESIA	Underweight	Underweight	Neutral	Neutral
MALAYSIA	Underweight	Underweight	Underweight	Underweight
PHILIPPINES	Underweight	Underweight	Underweight	Underweight
SINGAPORE	Underweight	Underweight	Overweight	Overweight
SOUTH KOREA	Underweight	Underweight	Underweight	Underweight
TAIWAN	Underweight	Underweight	Neutral	Neutral
THAILAND	Underweight	Underweight	Underweight	Underweight
VIETNAM	Neutral	Neutral	Underweight	Underweight

YEAR-TO-DATE P&L[5]

	SIZE (%)	TENOR	ENTRY DATE	ENTRY LEVEL	TARGET LEVEL	STOP LOSS	EXIT DATE	EXIT OR CURRENT LEVEL	'REALISED' OR CURRENT P&L (EX CARRY)	TOTAL RETURN
TOTAL (weighted by position size)										**2.9%**
LONG CNYTWD (SPOT)	25	2M	17-JUN	4.4832	4.5604	4.3612	OPEN	4.4431	-0.9%	
LONG CNYTWD (SPOT)	25	2M	9-JUN	4.4276	4.5604	4.3612	17-JUN	4.4832	1.3%	1.4%
LONG USDSGD (SPOT)	50	3M	26-MAY	1.2470	1.259	1.238	27-MAY	1.2373	-0.8%	-0.8%
LONG USDSGD (SPOT)	50	3M	12-MAY	1.2357	1.259	1.226	26-MAY	1.2470	0.9%	0.9%
LONG SGDKRW (SPOT)	100	3M	6-MAY	877	904	864	OPEN	869.31	-0.9%	-0.9%
SHORT USDSGD (SPOT)	50	3M	8-APR	1.2603	1.231	1.276	25-APR	1.2322	2.3%	2.3%
LONG AUDKRW (SPOT)	50	8M	6-APR	1,125	1,185	1,167	25-APR	1,162.9	3.4%	3.4%
SHORT JPYKRW (SPOT)	25	8M	6-APR	12.72	11.73	13.04	14-APR	13.075	-2.7%	-2.6%
LONG SGDKRW (SPOT)	25	8M	6-APR	861.4	904.4	890.9	6-MAY	869.31	0.9%	0.7%
SHORT JPYKRW (SPOT)	100	1M	17-MAR	14.300	13.598	14.586	22-MAR	13.813	3.5%	3.6%
SHORT USDSGD (SPOT)	50	3M	1-MAR	1.271	1.257	1.277	15-MAR	1.2797	-0.7%	-0.7%
LONG SGDTWD (28 MAR 2011 NDF)	25	3M	1-MAR	23.28	23.98	23.05	17-MAR	23.047	-1.0%	-1.0%
LONG SGDKRW (28 MAR 2011NDF)	25	3M	1-MAR	884.4	937.5	866.7	1-APR	865.19	-2.2%	-2.4%
SHORT USDKRW (FEB 2012 NDF)	50	12M	15-FEB	1,141.9	1,085.3	1,149.5	8-MAR	1,139.5	0.2%	0.4%
SHORT CNYKRW (FEB 2012 NDF)	50	12M	15-FEB	177.4	168.5	174.4	8-MAR	177.80	-0.2%	-0.2%
LONG AUDSGD (SPOT)	100	12M	19-JAN	1.286	1.3549	1.262	8-MAR	1.2825	-0.2%	0.4%
LONG INRIDR (SPOT)	100	12M	13-DEC	199.7	214.7	192.2	8-MAR	195.04	-2.3%	-1.9%

[4] FX allocations are with respect to current market pricing in the ndf or forward market. The orange font indicates a change from the previous publication.

[5] Current levels as of market open (Tokyo) 1 July. This P&L is indicative, excluding transaction costs and carry. Exit levels are generally closing levels (except when positions are cut prematurely). Stops and targets are triggered by Tokyo closing levels, not intra-day price action. The price source is Bloomberg CMPT. The purpose of this P&L is to provide accountability and transparency. Strategies are produced independently.

FX & RATES STRATEGY OVERVIEW

FOREIGN EXCHANGE AND POLICY FORECASTS

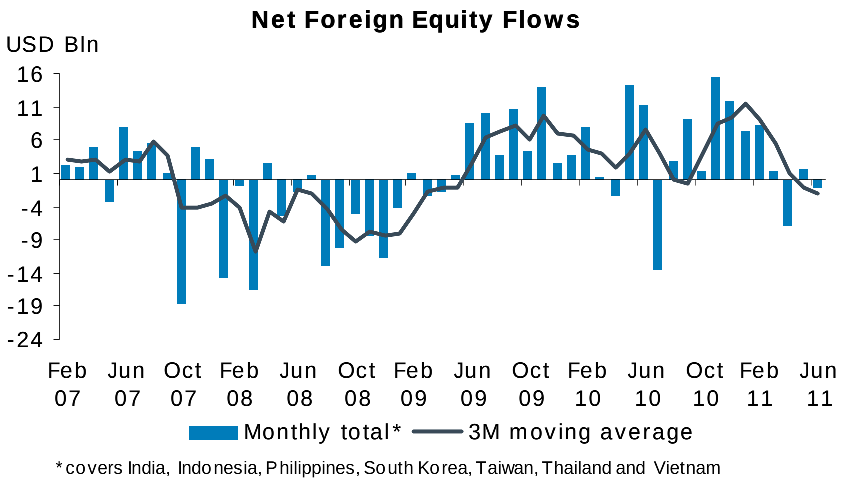
		CURRENT (AS OF 1 JULY)	SEP-11	DEC-11	MAR-12	JUN-12	IMPLIED 12M CHANGE	
							ANZ	FORWARDS
AXJ	ANZ's USD-AXJ Index	101.7	104.0	104.5	102.9	101.3	-0.4%	3.7%
China	USDCNY	6.464	6.38	6.30	6.22	6.14	-5.0%	-1.3%
	PBoC base lending rate	6.31	6.81	6.81	7.06	7.06	75	n/a
Hong Kong	USDHKD	7.782	7.780	7.800	7.800	7.800	0.2%	-0.3%
	HKMA discount rate	0.50	0.50	0.50	1.00	1.75	125	n/a
India	USDINR	44.70	46.0	46.6	45.9	45.2	1.1%	4.9%
	RBI repo rate	7.50	7.75	8.00	8.00	7.75	25	n/a
Indonesia	USDIDR	8,578	8,705	8,705	8,575	8,445	-1.6%	4.4%
	BI reference rate	6.75	6.75	7.25	7.25	7.00	25	n/a
Malaysia	USDMYR	3.018	3.08	3.10	3.07	3.04	0.9%	1.4%
	BNM overnight rate	3.00	3.25	3.25	3.50	3.50	50	n/a
Philippines	USDPHP	43.33	44.4	44.9	44.5	44.1	1.8%	0.8%
	BSP reverse repo rate	4.50	4.50	4.75	4.75	4.50	0	n/a
Singapore	USDSGD	1.229	1.25	1.26	1.25	1.24	0.7%	-0.2%
	3M SGD SIBOR	0.44	0.44	0.44	0.49	0.49	5	n/a
S Korea	USDKRW	1,068	1,120	1,140	1,120	1,100	3.0%	1.7%
	BoK overnight call rate	3.25	3.50	4.00	4.25	4.50	125	n/a
Taiwan	USDTWD	28.85	29.4	29.7	29.4	29.1	1.0%	-3.1%
	CBC discount rate	1.875	2.000	2.125	2.375	2.625	75	n/a
Thailand	USDTHB	30.72	31.1	31.4	31.2	31.1	1.2%	2.0%
	BoT repo rate	3.00	3.25	3.50	3.50	3.50	50	n/a
Vietnam	USDVND	20,526	20,600	20,600	21,400	21,400	4.3%	11.7%
	SBV refinancing rate	14.00	16.00	16.00	15.00	14.00	0	n/a

FOREIGN EXCHANGE CROSS RATE FORECASTS

	CURRENT SPOT (AS OF 1 JULY)	SEP-11	DEC-11	MAR-12	JUN-12	12M FWD OR NDF	IMPLIED 12M CHANGE	
							ANZ	FORWARDS
CNYHKD	1.204	1.220	1.238	1.254	1.270	1.216	5%	1%
CNYTWD	4.462	4.609	4.714	4.726	4.745	4.382	6%	-2%
HKDKRW	137.2	144.0	146.2	143.6	141.0	139.9	3%	2%
HKDTWD	3.707	3.779	3.808	3.769	3.737	3.603	1%	-3%
INRIDR	191.9	189.2	186.8	186.8	186.8	191.0	-3%	0%
PHPIDR	198.0	196.1	193.9	192.7	191.5	205.0	-3%	4%
SGDMYR	2.456	2.460	2.460	2.460	2.460	2.494	0%	2%
SGDTWD	23.48	23.52	23.57	23.54	23.55	22.79	0%	-3%
JPYKRW	13.22	13.33	13.10	12.73	12.22	13.50	-8%	2%
TWDKRW	37.02	38.10	38.38	38.10	37.74	38.82	2%	5%

FX & RATES STRATEGY OVERVIEW

NET FOREIGN EQUITY FLOWS (USD MN)



MONTHLY NET FOREIGN EQUITY FLOWS (USD MN)

Monthly Net Foreign Equity Flows (USD mn)

Periods	TW	SK	IN	TH	ID	VN	PH	1M Total	3M Total
Jun-2011	-916	-662	734	-884	480	44	55	-1149	5934
May-2011	-450	-2266	-1156	-551	-28	5	68	-4378	
Apr-2011	3504	2988	1574	980	2023	32	361	11461	
Mar-2011	-1329	873	1556	647	-255	4	79	1574	-3743
Feb-2011	-3270	-3110	-826	277	237	-4	-27	-6723	
Jan-2011	3439	609	-1387	-933	-287	58	-94	1406	
Q4 - 2010	6315	8690	10067	1335	60	256	569		27292
Q3 - 2010	3375	5889	12554	1890	1436	90	298		25531
Q2 - 2010	-743	-102	2331	-1849	483	198	213		531
Q1 - 2010	631	5324	4369	1310	373	16	152		12174
Q4 - 2009	3780	5020	5194	-510	269	75	-49		13780
Q3 - 2009	7471	11900	7369	1034	615	-26	239		28602
Q2 - 2009	6001	7764	6421	770	503	20	386		21864
Q1 - 2009	-1643	-238	-827	-157	-3	4	-157		-3020
Q4 - 2008	-4856	-4511	-4039	-1064	44	-125	-478		-15030
Q3 - 2008	-8056	-10914	-2731	-2219	311	108	-256		-23756
Q2 - 2008	-4498	-5267	-3538	-1167	362	225	9		-13873
Q1 - 2008	903	-16175	-3029	-492	6	133	-410		-19066

FX & RATES STRATEGY OVERVIEW

ESTIMATED MARKET EXPECTATIONS OF AXJ CENTRAL BANK POLICY RATES VS ANZ FORECASTS

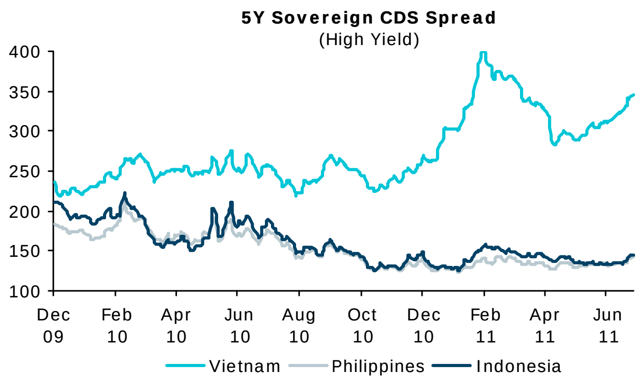
		SEP-11		DEC-11		MAR-11		JUN-12	
	CURRENT POLICY RATE	MARKET	ANZ	MARKET	ANZ	MARKET	ANZ	MARKET	ANZ
China	6.31	7.23	6.81	7.49	6.81	6.62	7.06	6.61	7.06
India	7.50	7.52	7.75	7.79	8.00	7.87	8.00	7.82	7.75
Indonesia	6.75	6.85	6.75	6.72	7.25	7.00	7.25	7.22	7.00
Malaysia	3.00	2.99	3.25	3.21	3.25	3.28	3.50	3.37	3.50
Philippines	4.50	4.57	4.50	4.45	4.75	4.39	4.75	4.57	4.50
South Korea	3.25	3.20	3.50	3.46	4.00	3.64	4.25	3.79	4.50
Taiwan	1.88	1.83	2.00	2.03	2.13	2.24	2.38	2.45	2.63
Thailand	3.00	3.11	3.25	3.32	3.50	3.39	3.50	3.40	3.50

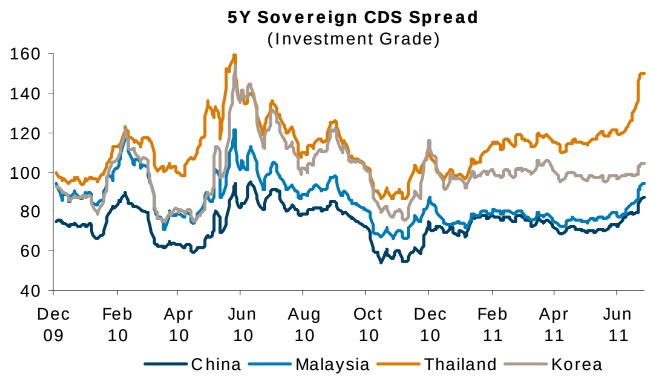
LONG-TERM FOREIGN CURRENCY GOVERNMENT BOND RATINGS

	MOODY'S	S&P	FITCH
INVESTMENT GRADE			
China	Aa3	AA-	A+
Hong Kong	Aa1	AAA	AA+
India	Baa2	BBB-	BBB-
Korea	A1	A	A+
Malaysia	A3	A-	A-
Singapore	Aaa	AAA	AAA
Taiwan	Aa3	AA-	A+
Thailand	Baa1	BBB+	BBB
SUB-INVESTMENT GRADE/HIGH YIELD			
Cambodia	B1	B+	NR
Indonesia	Ba1	BB	BB+
Philippines*	Ba2	BB	BB+
Vietnam	B1	BB-	B+

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

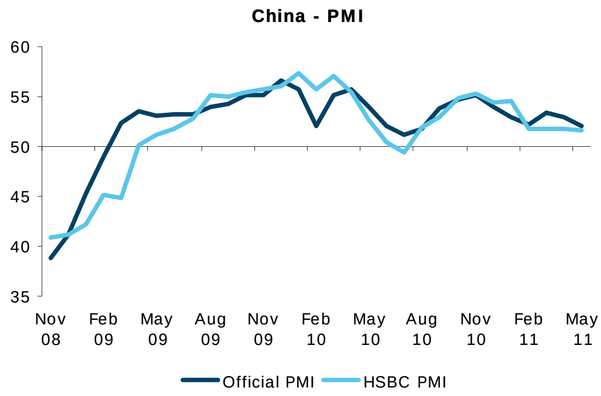
SOVEREIGN CDS SPREADS

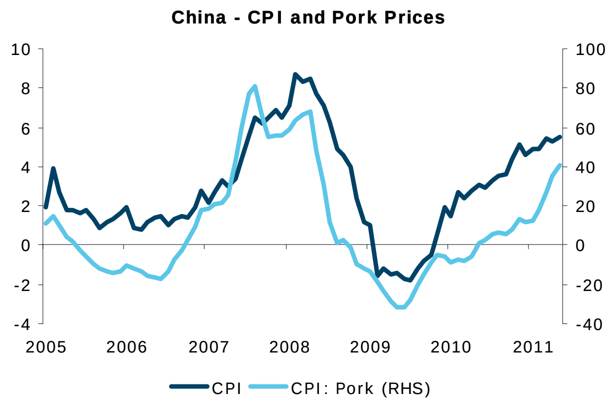


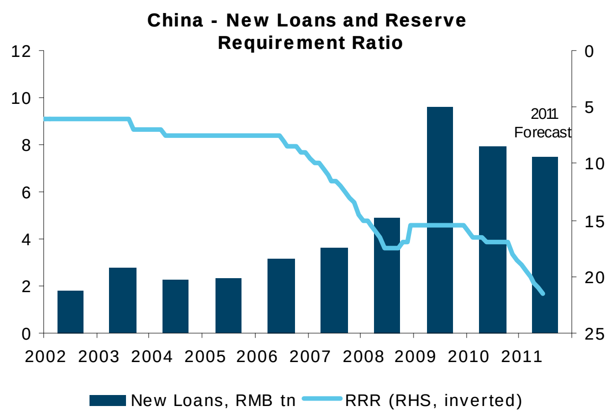


Sources: Bloomberg, ANZ Research

CHINA







ECONOMIC UPDATE

Production eased in June, fuelling concerns that the monetary authorities may have over-tightened policy. However, we think inflation risks still outweigh that of an economic slowdown. Thus, at this point, it is premature to ease monetary policy.

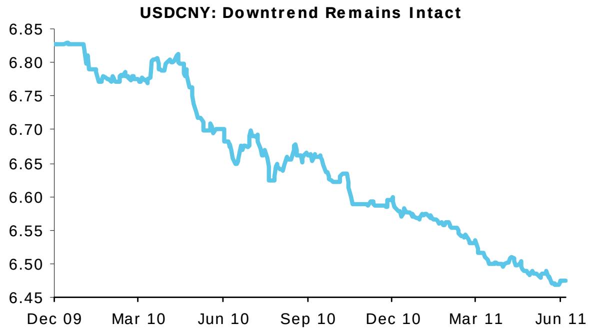
- The HSBC preliminary PMI declined by 1.5pts to 50.1 in June, due to cooling demand, ongoing inventory destocking and monetary policy tightening. In our view, this will not lead to a hard landing.
- Meanwhile, retail sales were robust, gaining 16.9% y/y in May, a touch lower than April's 17.1%. Vehicle sales dropped 3.9% on supply chain disruptions related to the Japanese earthquake. Housing sales rebounded strongly to 18.5% after a drop in April.
- Industrial production slowed by 0.1ppt to 13.3% y/y in May on the back of tightened monetary policy conditions. Power shortages in coastal and export regions have also disrupted industrial production.
- Fixed asset investments (excluding rural) grew 25.8% in the five months to May, compared with the last reading of 25.4%, reflecting strong investment in the real estate sector and the pursuit of increased investment in the first year of the five-year plan.
- Exports rose 19.4% y/y in May, down from April's 29.9%. Imports surprised on the upside, growing 28.4% y/y in May, far higher than previous month's 21.8% gain. The trade surplus widened by $1.6bn to $13.1bn in May.
- Headline inflation rose by 0.2ppt to 5.5% y/y in May, the highest reading since July 2008; the rise was led by food and dwelling costs. On a m/m basis, CPI grew by 0.1%, compared with 0.1% in April and -0.2% in March. China's NDRC reports that CPI inflation will climb further on surging pork prices. PPI inflation remained unchanged at 6.8%, above the consensus of 6.5%.
- The PBoC raised the reserve requirement for banks by 50bps. While this is an efficient way of withdrawing liquidity, it is ineffective in managing inflation expectations.
- China's inflation and inflation expectations have not yet stabilised, and, in our view, it is premature to ease monetary policy.

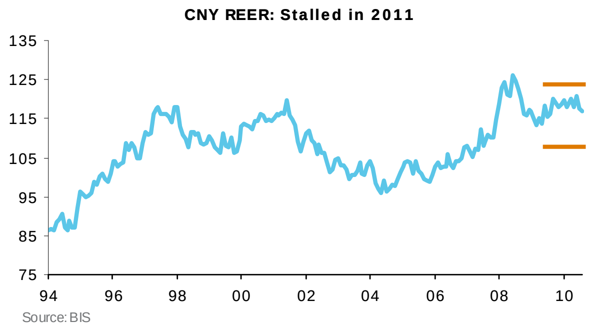
Li-Gang Liu

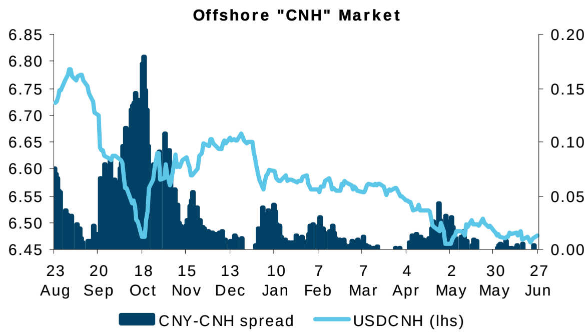
MONTHLY DATA	OCT-10	NOV-10	DEC-10	JAN-11	FEB-11	MAR-11	APR-11	MAY-11
Industrial Production, % y/y	13.1	13.3	13.5	N/A	14.9	14.8	13.4	13.3
Retail Sales, % y/y	18.6	18.7	19.1	19.9	11.6	17.4	17.1	16.9
Consumer Price Index, % y/y	4.4	5.1	4.6	4.9	4.9	5.4	5.3	5.5
Exports, % y/y	22.9	34.9	17.9	37.7	2.4	35.8	29.9	19.4
Imports, % y/y	25.3	37.7	25.6	51.0	19.5	27.3	21.8	28.4
Trade Balance, US$ bn	16.9	27.2	22.9	13.1	6.5	-7.3	0.1	11.4
QUARTERLY DATA	JUN-09	SEP-09	DEC-09	MAR-10	JUN-10	SEP-10	DEC-10	MAR-11
Real GDP, % y/y	8.2	9.7	11.4	11.9	10.3	9.6	9.8	9.7
Foreign Exchange Reserves, US$ bn	2131.6	2272.6	2399.2	2447.1	2454.3	2648.3	2847.3	3044.7
Current Account, US$ bn	134.5	N/A	261.1	N/A	101.6	N/A	305.4	N/A
Capital & Financial Account, US$ bn	61.0	N/A	180.9	N/A	93.2	N/A	226.0	N/A

Source: CEIC

CHINA







FX AND RATES STRATEGY

Conditions are ripe for a widening in the daily trading band for USDCNY.

FX

Chinese authorities appear to be signaling a more imminent announcement of FX reforms, including a likely adjustment in the daily trading band for USDCNY. Meanwhile, heightened risk aversion in the financial markets provides opportune timing for a widening in the trading band as the authorities will not want to sanction one-way bets on the CNY. Our China team expects a widening from ±0.5% currently to ±3%, which would bring the pair into alignment with the bands for CNYEUR and CNYJPY. Markets are looking for much less.

CPI inflation at 5.5% y/y in May remains well above the PBoC's comfort level of 3% as well as the government's 4% target. At the same time, the outlook for global commodity prices remains firm—notwithstanding the recent release of supply from IEA's strategic oil reserves. Moreover, still stimulative monetary and fiscal settings amid solid domestic and sufficient external momentum will also maintain upward pressure on prices. As such, ANZ expects a further pickup in yuan appreciation in order to slow money growth and contain imported inflation.

In order to sidestep significant cross-winds in the USD currently, we prefer to express this view as a relative value trade within Emerging Asia (AXJ), using the TWD as the financing leg (see our FX Alert dated 10 June). Timing is seen as the predominate risk. Specifically, a change in the daily trading band of USDCNY may still be further out on the horizon. Alternatively, Chinese authorities may choose to widen the band in smaller steps.

Tamara Henderson

RATES

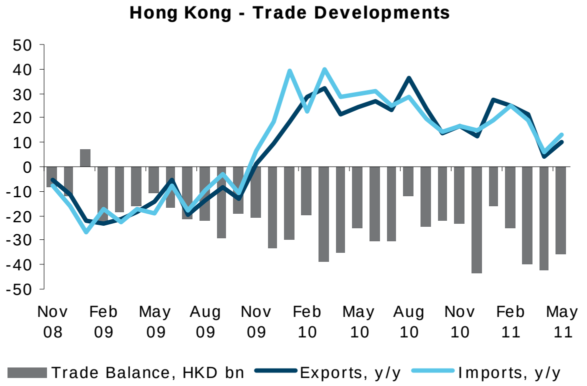
While some activity data moderated somewhat recently, we still see upside risk in China's economy. Negative real interest rates will continue to encourage investment and consumption. This still argues for a tight monetary policy stance. As China's inflation is expected to surpass 6% in June due to surging food cost and base effects, this is likely to trigger one rate hike in July.

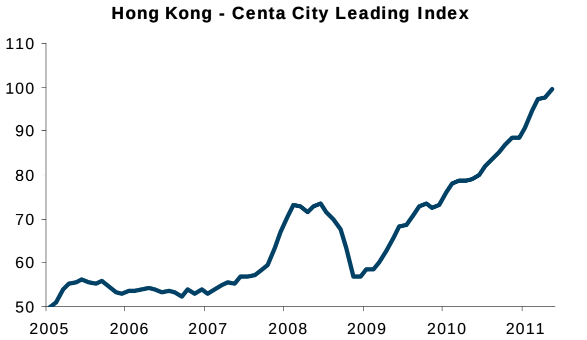
Zhou Hao

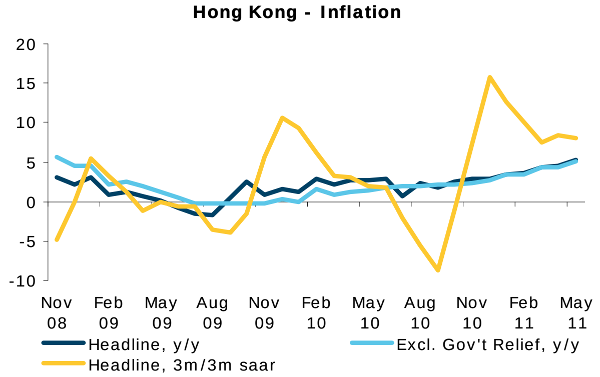
FX FORECASTS	CURRENT	YTD (%)	SEP-11	DEC-11	MAR-12	JUN-12	SEP-12	DEC-12
USDCNY	6.473	-1.9%	6.33	6.23	6.16	6.10	6.04	5.98
AUDCNY	6.754	0.5%	6.80	6.70	6.50	6.30	6.10	5.90
NZDCNY	5.190	1.4%	5.10	5.00	4.90	4.70	4.50	4.40
JPYCNY	0.080	-1.2%	0.074	0.072	0.069	0.067	0.065	0.063
EURCNY	9.138	3.5%	8.67	8.41	8.19	8.24	8.27	8.19
RATE FORECASTS	CURRENT	YTD (BPS)	SEP-11	DEC-11	MAR-12	JUN-12	SEP-12	DEC-12
PBoC's 1-year base lending rate	6.31	50	6.81	6.81	7.06	7.06	7.31	7.31

Sources: Bloomberg, ANZ Research

HONG KONG







ECONOMIC UPDATE

Recent activity indicators were mixed. While May exports slowed, April retail sales suggested strong consumption. Inflation quickened and added to the negative interest rate problem. A rise in the buy-rent gap furthered the demand for property ownership and high property prices prompted further government measures to curb speculation.

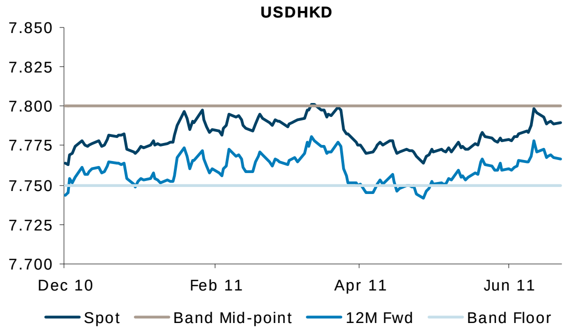
- Domestic indicators were mixed. Retail sales rose strongly by 27.7% y/y in April after March's 26.2% gain, and were supported by a 20.1% increase in visitor arrivals. Meanwhile, the logistics sector was dragged down by Japan's post-quake disruptions. Air cargo movements contracted 9.9% in May.
- The unemployment rate stood at 3.5% sa in May. Also, the minimum wage was introduced on 1 May which set the hourly rate at HK$28 (US$3.6).
- Trade growth bounced strongly in May. Export growth rose 10.1% in May from 4.1% in April. Imports increased 13.0% from 6.1% in April. The trade deficit narrowed to HKD35.7bn. The rebound in export growth suggests that disruptions stemming from Japan's earthquake have waned.
- Headline inflation accelerated to a 34-month high of 5.2% y/y in May, 0.6ppt above April's reading. Food and rental costs remained the major drivers for inflation, rising 7.0% and 6.1%, respectively, from 6.3% and 5.1% in April.
- Property prices continued to surge. The Centa-City Leading Index rose to 99.4, the highest reading since October 1997. However, property transactions cooled to 9,523 units from 13,063 in March as government warnings and new Special Stamp Duties took effect.
- The negative real deposit interest rate, domestic wage growth and the rising purchasing power of mainland Chinese will continue to support demand for Hong Kong's property prices. However, as the HIBOR-based lending rate is rising gradually on tightened HKD liquidity and the government is determined to increase the supply of housing, the upside to the local property market will be increasingly limited in the near-term.

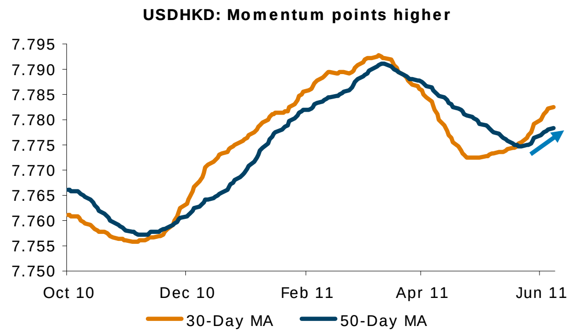
Raymond Yeung

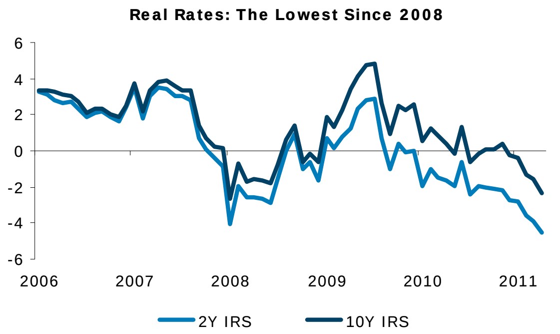
MONTHLY DATA	OCT-10	NOV-10	DEC-10	JAN-11	FEB-11	MAR-11	APR-11	MAY-11
Retail Sales, % y/y	21.7	18.1	18.6	28.2	8.5	26.0	16.4	N/A
Composite CPI, % y/y	2.5	2.9	3.1	3.6	3.7	4.4	4.6	5.2
Exports, % y/y	13.9	16.6	12.5	27.6	24.9	21.5	4.1	N/A
Imports, % y/y	14.0	16.4	14.8	19.0	25.2	18.8	6.1	N/A
Trade Balance, US$ bn	-2.9	-3.0	-5.6	-2.1	-3.2	-5.2	-5.5	N/A
Foreign Exchange Reserves, US$ bn	267.1	266.1	268.7	273.2	272.7	272.6	276.9	N/A
QUARTERLY DATA	JUN-09	SEP-09	DEC-09	MAR-10	JUN-10	SEP-10	DEC-10	MAR-11
Gross construction outputs	4.1	2.7	-2.1	1.9	8.4	15.4	14.6	20.2
Real GDP, % y/y	-3.4	-2.1	2.5	8.1	6.4	6.7	6.4	7.2
Current Account, US$ bn	5.4	1.8	3.9	4.1	1.1	5.7	3.3	5.2
Capital & Financial Account, US$ bn	-7.3	-3.8	-2.8	-4.8	0.9	-7.4	-6.5	-2.7

Source: CEIC

HONG KONG







FX AND RATES STRATEGY

Tighter liquidity ahead suggests an upward bias in USDHKD.

FX

Inflation in Hong Kong has accelerated in recent months and Chief Executive Tsang recently described house price inflation (about 2% per month) as "quite frightening." Indeed, tighter liquidity conditions on the Mainland have yet to register in Hong Kong. First, the pickup in CNY gains increases the purchasing power of Mainland buyers attracted to correspondingly cheaper HKD assets. Second, foreign capital is attracted to the increased access to the Mainland that Hong Kong is now able to provide.

CNY deposits in Hong Kong have surged, reaching CNY511bn in April versus CNY315bn in December 2010 and CNY63bn in December 2009. The authorities expect CNY deposits to reach CNY800bn by year end, close to the CNY1trn threshold for the critical mass needed for a vibrant offshore yuan centre. HKMA Chief Executive Norman Chan explained that the sharp increase in CNY deposits is not due to a loss of confidence in the HKD, but rather is a function of higher CNY trade settlement volume. In Q1, more than 80% of the Mainland's CNY trade settlement was conducted through Hong Kong.

Meanwhile, the HKMA has told banks to stress-test for an $89bn withdrawal of liquidity, concerned about the risk of massive capital outflows in the aftermath of the expiry of the Fed's QE2 program on 30 June. Recent measures by Mainland authorities should also reduce inflationary spill over into Hong Kong. In particular, the Mainland will allow inbound CNY-denominated FDI subject to PBOC approval, opening the door for the repatriation of offshore CNY. Also, regulations on yuan transactions in Hong Kong were tightened in order to limit capital inflows that speculate on CNY gains. As such, liquidity conditions in Hong Kong should soon tighten, suggesting an upward bias in USDHKD (within the confines of the convertibility zone).

Tamara Henderson

RATES

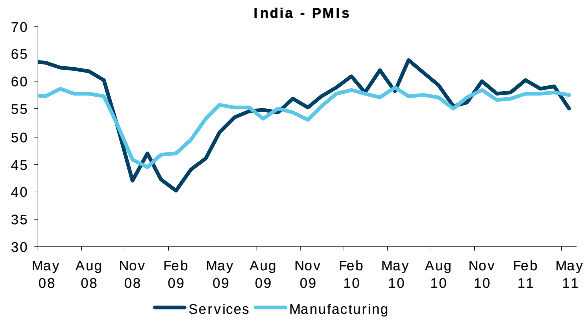
Under Hong Kong SAR's currency board system, the HKMA follows the US Federal Reserve in setting its policy rate. As the US is forecasted to have an extraordinarily low rate regime until 2012, we expect Hong Kong's discount rate to remain unchanged throughout 2011.

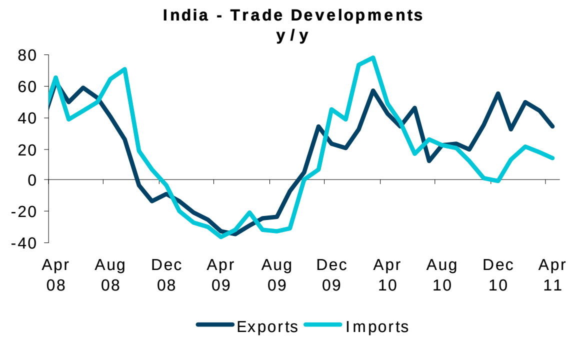
Raymond Yeung

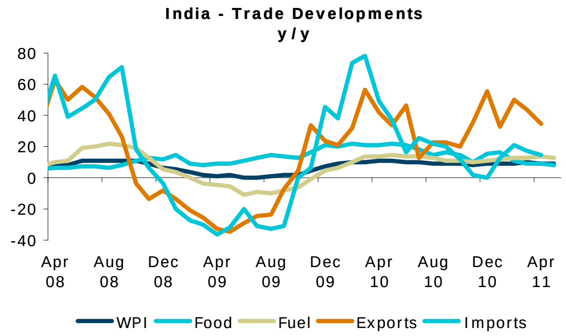
FX FORECASTS	CURRENT	YTD (%)	SEP-11	DEC-11	MAR-12	JUN-12	SEP-12	DEC-12
USDHKD	7.790	0.2%	7.780	7.800	7.800	7.800	7.800	7.800
AUDHKD	8.134	2.8%	8.4	8.4	8.3	8.0	7.9	7.7
NZDHKD	6.264	3.8%	6.2	6.3	6.2	6.0	5.9	5.7
JPYHKD	0.097	-99.0%	0.092	0.090	0.088	0.086	0.084	0.082
EURHKD	11.005	5.9%	10.7	10.5	10.4	10.5	10.7	10.7
RATE FORECASTS	CURRENT	YTD (BPS)	SEP-11	DEC-11	MAR-12	JUN-12	SEP-12	DEC-12
HKMA's discount rate	0.50	0	0.50	0.50	1.00	1.75	2.25	2.25

Sources: Bloomberg, ANZ Research

INDIA







ECONOMIC UPDATE

India's activity indicators continue to ease but remain fairly solid on a year-on-year basis. Meanwhile, inflation pressures are starting to threaten a further rise, forcing the RBI to maintain its tough anti-inflation stance.

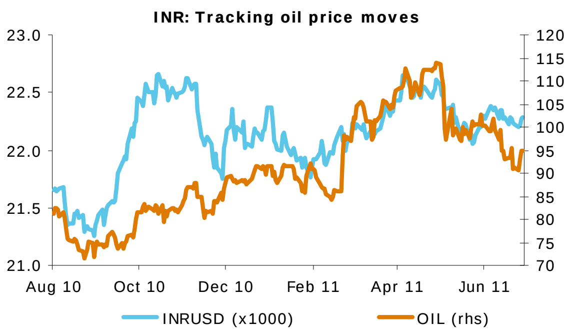
- Industrial production growth dipped to 6.3% y/y in April from 8.8% previously as growth in the consumer goods and manufacturing sectors fell, while growth in capital goods held steady.
- The HSBC Manufacturing PMI fell to 57.5 in May from 58.0 in April on weak growth in output and new orders. The HSBC Composite PMI, covering manufacturing and services, also slowed to 57.7 from 60.7.
- Domestic passenger car sales growth fell further to a new two-year low of 7.0% y/y in May from 13.2% previously reflecting higher interest rates, fuel and vehicle costs. On the other hand, commercial vehicle sales growth doubled to 16.2%.
- April export growth eased to 34.4% y/y from 43.9% previously, led by shipments of petroleum products. Imports also eased to 14.1% from 17.3% in March. The resulting trade deficit increased to $9.0bn against $5.6bn in the previous month.
- Wholesale price inflation rose to 9.06% y/y in May from 8.66% in April. Food and fuel price increases eased on a y/y basis to 8.37% and 12.32%, respectively, from 8.71% and 13.32% previously. However, nonfood/fuel inflation gained 0.9ppt to 8.49%.
- The RBI raised its repo rate 25bps to 7.50% at its mid-quarter monetary policy review on 16 June, as inflation risks remain the key concern. The cash reserve ratio remained unchanged at 6.00%. The central bank has also said that it would continue its anti-inflationary stance moving forward.
- Domestic indicators continue to indicate some expected easing of activity in response to the last year of aggressive monetary policy actions. However, overall GDP growth still seems on track to achieve around 8%. Meanwhile, inflation remains stubbornly high, forcing the RBI to signal further action despite having moved 75bps in the past two months.

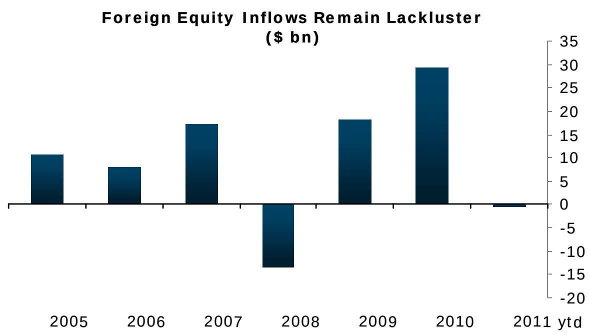
Vincent Conti

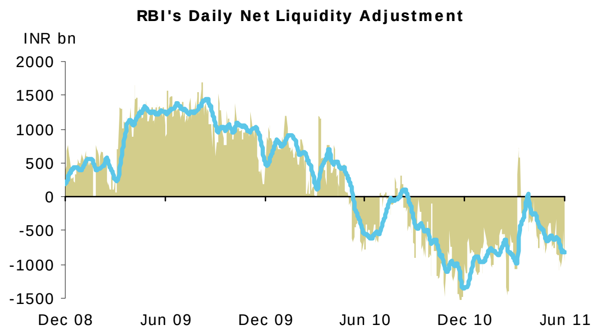
MONTHLY DATA	OCT-10	NOV-10	DEC-10	JAN-11	FEB-11	MAR-11	APR-11	MAY-11
Industrial Production, % y/y	11.4	6.4	8.1	7.5	6.5	8.8	6.3	N/A
Wholesale Price Index, % y/y	9.1	8.2	9.5	9.5	9.5	9.7	8.7	9.1
Exports, % y/y	19.6	35.0	55.2	32.4	49.7	43.8	34.4	N/A
Imports, % y/y	11.8	1.4	-0.3	13.1	21.2	17.3	14.1	N/A
Trade Balance, US$ bn	-11.3	-5.2	-2.6	-8.0	-8.1	-5.6	-9.0	N/A
Foreign Exchange Reserves, US$ bn	298.0	294.0	297.3	299.2	300.8	303.5	313.5	310.2
QUARTERLY DATA	JUN-09	SEP-09	DEC-09	MAR-10	JUN-10	SEP-10	DEC-10	MAR-10
Real GDP, % y/y	6.3	8.6	7.3	9.4	9.3	8.9	8.3	7.8
Current Account, US$ bn	-4.6	-9.2	-12.2	-13.0	-12.5	-16.8	-9.7	N/A
Capital Account, US$ bn	4.0	19.3	14.6	16.1	16.6	21.3	14.9	N/A

Source: CEIC

INDIA







FX AND RATES STRATEGY

The correction in oil prices will not be enough to derail future RBI rate hikes.

FX

The recent release of IEA oil reserves and subsequent correction in oil prices will improve India's FX fundamentals. First, lower oil prices will narrow India's large current account deficit (3% of GDP) as roughly three quarters of this large economy's energy needs are imported. Second, the cost of fuel subsidies for the poor will be reduced, narrowing the government's wide budget gap (8% of GDP).

More importantly for the rupee outlook, however, the correction in oil prices will not be sufficient to derail another 50bps (or more) of RBI rate hikes, which at the very least will be necessary to reset inflation expectations. May WPI inflation was 9.06% (y/y)—only a slight improvement from the 10.25% pace recorded a year earlier—notwithstanding the 275bps increase in the repo rate from GFC lows, including 125bps of hikes year-to-date. The RBI's repo rate (at 7.25% currently) still has a way to go before reaching pre-GFC territory in the 7.75% to 9% range.

Higher interest rates will increase the rupee's yield appeal, but support for the INR will require capital inflows and risk appetite to remain intact as well. Notably, the expiry of the Fed's QE2 programme on 30 June removes monthly injections of roughly $75bn into the global financial system. Tighter liquidity (globally, not just by the Fed) not only will stem capital inflows and reduce appreciation pressures, but also will slow global growth (by design) at the risk of derailing investor sentiment.

Tamara Henderson

RATES

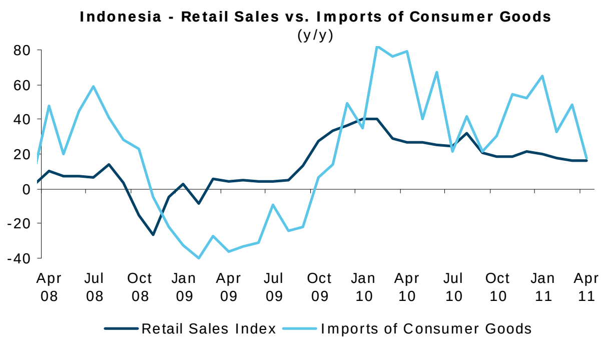
Inflation pressures remain high with non-food/fuel inflation having accounted for over 60% of headline inflation since February, compared with about 50% on average for 2010. The RBI says that the effects of previous policy actions are still unfolding, with policy actions needing to be balanced with risks to the growth trajectory, leading us to expect a temporary pause this month after the cumulative 75bps rise since May. However, the RBI maintains its strong anti-inflationary stance, and we expect at least two more hikes prior to year-end. There is an upside risk to this call, as the government allowed state-run refiners to raise diesel costs in an effort to ease the fiscal burden of subsidies - creating more upside pressures on inflation.

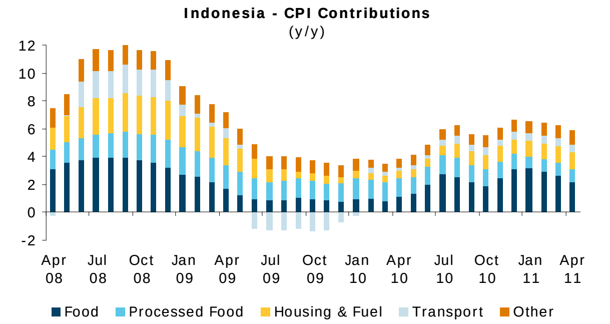
Vincent Conti

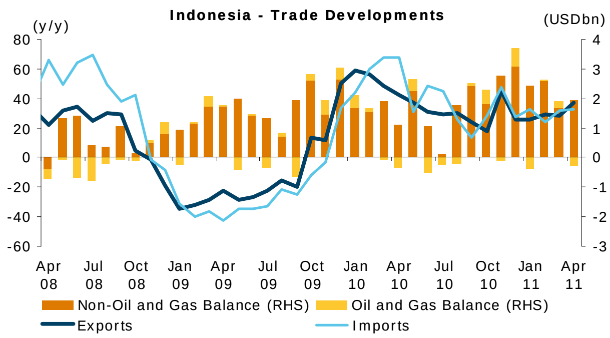
FX FORECASTS	CURRENT	YTD (%)	SEP-11	DEC-11	MAR-12	JUN-12	SEP-12	DEC-12
USDINR	44.99	0.6%	46.0	46.6	45.9	45.2	44.6	44.1
AUDINR	46.99	3.3%	49.7	50.3	48.7	46.6	45.0	43.7
NZDINR	36.18	4.3%	36.8	37.7	36.3	34.8	33.5	32.2
JPYINR	0.556	1.2%	0.541	0.536	0.516	0.497	0.480	0.464
EURINR	63.60	6.4%	63.0	62.9	61.0	61.0	61.1	60.4
RATE FORECASTS	CURRENT	YTD (BPS)	SEP-11	DEC-11	MAR-12	JUN-12	SEP-12	DEC-12
RBI's repo rate	7.50	125	7.75	8.00	8.00	7.75	7.50	7.50

Sources: Bloomberg, ANZ Research

INDONESIA







ECONOMIC UPDATE

Domestic demand continued to stabilise. Headline inflation pressures are easing. Core inflation remains sticky at 4.6% y/y, but is within the central bank's comfort range. Consumer confidence remains stable, and, for the full year, Indonesia's economy is on track to expand y/y by 6.4%.

- Retail sales gained 15.9% y/y in April, down from 17.6% previously, mainly on higher sales of clothing (46.3%), and food and tobacco (24.2%). On a m/m basis, retail sales rose 1.7% in April from 2.6% previously.
- Consumer sentiment indicators were again mixed in May, with the official Consumer Confidence Index coming in weaker at -0.9% y/y and -1.5% m/m to 105.3 in May. The Danareksa Consumer Confidence stood at 90.6, up 0.6pt from the previous 5.0pt rise.
- External demand grew strongly in April. Total exports surged 37.3% y/y compared with a 27.5% rise in March, mainly due to a 31.5% increase in the shipments of non-oil products. Imports, too, rose 32.5% y/y compared with a 32.0% gain in March.
- Official foreign exchange reserves stood at $118 bn in May, up 58.3% y/y and 3.8% m/m from the previous month.
- CPI inflation eased for the fourth consecutive month in May; the index slowed to 6.0% y/y following a 6.2% rise the previous month. The slowdown in food items (10.2% from 11.1%) and clothing (7.8% from 8.4%) offset an increase in housing (4.9% from 4.7%) and transport costs (3.1% from 2.9%). On a m/m basis, consumer prices rose 0.1% against a decline of 0.3%. Core inflation was broadly unchanged at 4.6%.
- Bank Indonesia retained its benchmark interest rate for the fourth consecutive month in June at 6.75%, due to a continued slowdown in headline consumer prices. The central bank's inflation target range is 4.0-6.0% in 2011, and 3.5% to 5.5% in 2012.
- Looking ahead, GDP growth remains on track to reach 6½% this year, our estimate for Indonesia's potential.

Aninda Mitra

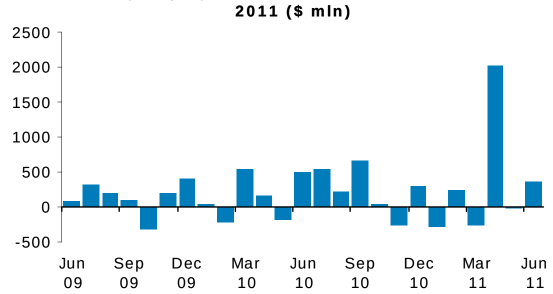
MONTHLY DATA	SEP-10	OCT-10	NOV-10	DEC-10	JAN-11	FEB-11	MAR-11	APR-11
Industrial Production, % y/y	0.8	4.9	4.7	7.1	7.3	1.9	6.2	N/A
Retail Sales Index, % y/y	21.1	18.5	18.8	21.8	20.0	18.0	16.4	15.9
Consumer Price Index, % y/y	5.8	5.7	6.3	7.0	7.0	6.8	6.7	6.16
Exports, % y/y	23.8	17.6	45.1	26.1	26.0	29.1	28.1	37.3
Imports, % y/y	13.4	28.5	47.6	27.6	32.3	23.7	32.0	32.5
Trade Balance, US$ bn	2.5	2.3	2.6	3.7	2.0	2.7	1.9	1.6
Foreign Exchange Reserves, US$ bn	86.6	91.8	92.8	96.2	95.3	99.6	106.9	111.2
QUARTERLY DATA	JUN-09	SEP-09	DEC-09	MAR-10	JUN-10	SEP-10	DEC-10	MAR-11
Real GDP, % y/y	4.2	4.2	5.4	5.6	6.1	5.8	6.9	6.5
Current Account, US$ bn	2.4	1.8	3.8	1.9	1.4	1.2	1.1	1.9
Capital & Financial Account, US$ bn	-2.3	2.9	2.4	5.6	3.7	7.3	9.6	6.2

Source: CEIC

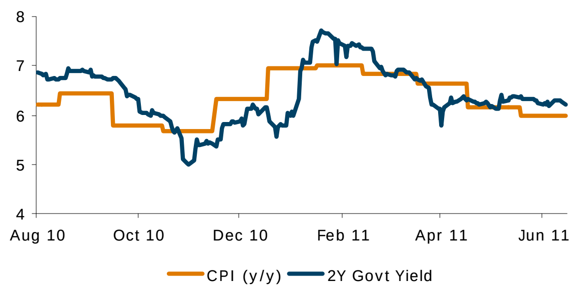
INDONESIA

USDIDR: Seen Well-Anchored by IG Hopes

Foreign Equity Flows: Biased Toward Inflows in 2011 ($ mln)



Yields and CPI Have Stabilised



FX AND RATES STRATEGY

Global dynamics will maintain the upward bias in USDIDR near-term, but gains will be capped by the prospect of investment grade status before year-end.

FX

Tighter liquidity in the aftermath of the Fed's QE2 programme, the coming peak in AXJ inflation (especially in China), and slower global growth momentum overall should sustain the weaker bias in AXJ currencies in the months ahead. Domestic sources of support for the IDR will also ebb temporarily—in particular, lower commodity prices for key exports are apt to narrow Indonesia's trade surplus.

That said, Indonesia's more imminent upgrade to investment grade (IG) status should limit upside in USDIDR. Fitch indicated that Indonesia could achieve IG status before year-end, while Indonesia's economy minister hinted that an upgrade could occur as early as Q3. Meanwhile, the release of IEA oil reserves in June supports fiscal consolidation by reducing the cost of fuel subsidies. Lower oil prices will also ease inflation pressures and underpin foreign demand for IDR bonds. BI expects year-end inflation near 5% compared with 11% currently.

Measures to discourage "hot money" portfolio flows will also limit upside potential in USDIDR. The holding period on SBIs—popular among foreign investors—was increased to six months from one month, effective 13 May. This follows the discontinuation of regular sales of SBIs with a tenor of less than nine months and a shift toward the issuance of term deposits. A meaningful shift in the composition of inflows in favour of FDI was already apparent in Q1 data.

Tamara Henderson

RATES

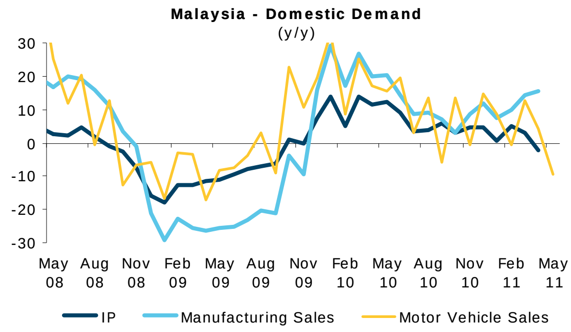
We think BI will remain on hold at their 12 July board meeting. Headline price pressures have eased since February. They are now within the BI's inflation target range, mainly on account of large BoP surpluses which have resulted in nominal (and to a lesser extent, real) appreciation of the IDR, and limited import costs. Moreover, liquidity management and macro-prudential measures have contained M2 growth. And lastly, the deceleration of food prices in recent months has also alleviated headline price pressures. BI will remain "vigilant" about rising core price pressures, which continue to grind higher on account of rising capacity utilization and onshore gold prices. We now expect a rate hike in late Q3.

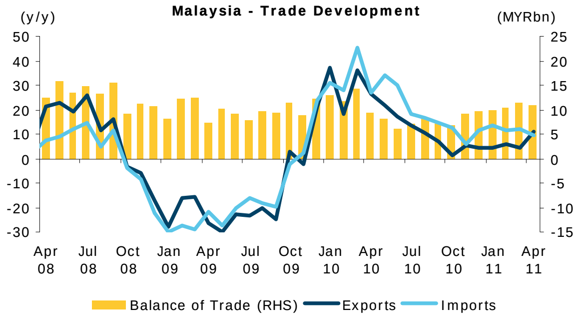
Aninda Mitra

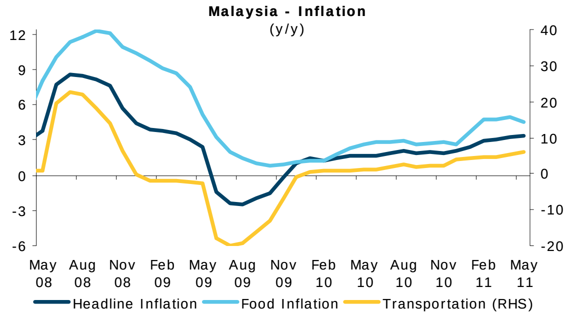
FX FORECASTS	CURRENT	YTD (%)	SEP-11	DEC-11	MAR-12	JUN-12	SEP-12	DEC-12
USDIDR	8,619	-5.0%	8,705	8,705	8,575	8,445	8,320	8,235
AUDIDR	9,002	-0.3%	9,400	9,400	9,100	8,700	8,400	8,200
NZDIDR	6,928	-0.4%	7,000	7,100	6,800	6,500	6,200	6,000
JPYIDR	107	-2.2%	100	100	100	90	90	90
EURIDR	12,180	2.2%	11,900	11,800	11,400	11,400	11,400	11,300
RATE FORECASTS	CURRENT	YTD (BPS)	SEP-11	DEC-11	MAR-12	JUN-12	SEP-12	DEC-12
BI's reference rate	6.75	25	6.75	7.25	7.25	7.00	6.75	6.75

Sources: Bloomberg, ANZ Research

MALAYSIA







ECONOMIC UPDATE

Domestic demand indicators were mixed in April, while foreign demand indicators advanced. Inflation pressures remain elevated and will continue to rise. Bank Negara Malaysia is likely to hike rates at the next meeting on 7 July.

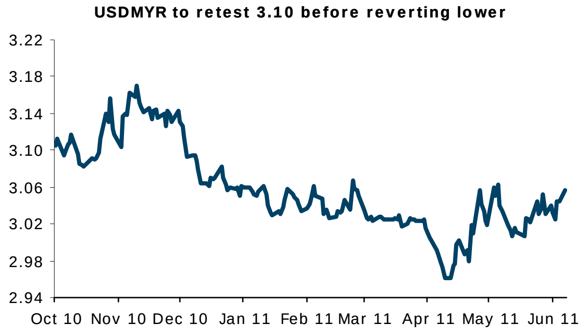
- Industrial production growth unexpectedly contracted by 2.2% y/y in April from a revised gain of 2.9% in March. All components contributed negatively to growth. Manufacturing slipped 0.4%; mining fell 6.9% and electricity production dropped 0.7%. Japan's post-quake disruptions were the likely cause of the slowdown.
- Manufacturing sales growth was strong in April, rising 15.5% y/y from 14.1% previously. Salaries and wages climbed 6.9% with employee numbers rising 6.4%; both labour force measures grew 0.2% m/m.
- Export growth improved to 11.1% y/y in April from a downwardly revised 4.1% in March. Export growth to the US contracted, however exports to Japan, Korea and India all grew over 35.0%. Commodity shipments of liquefied natural gas, palm oil, and refined petroleum led the index. Import growth cooled to 9.4% from 12.1% in March. The trade surplus was relatively flat at MYR11bn.
- CPI inflation accelerated to 3.3% y/y in May, from 3.2% in April. Food inflation climbed 0.2ppt to 4.9%, while transportation prices jumped 0.7ppt to 5.3%.
- Foreign reserves totalled $133.2bn as at 15 June: equal to 9.5 months of imports and 4.4 times the size of the short-term external debt.
- The balance of payments posted a surplus of MYR15.9bn in Q1 2011, down MYR2.0bn from Q4 2010. The current account recorded a surplus of MYR30.2bn; the financial account registered a deficit of MYR6.0bn.
- Growth should pick-up in the coming quarters supported by robust domestic demand. Private consumption will benefit from rising wages and confidence, while investment will grow on the government's incentive programme. US and EU uncertainties may weigh on external demand, however robust Asian demand should offset. Inflation will rise in the coming months as a reduction in electricity subsidies filters through.

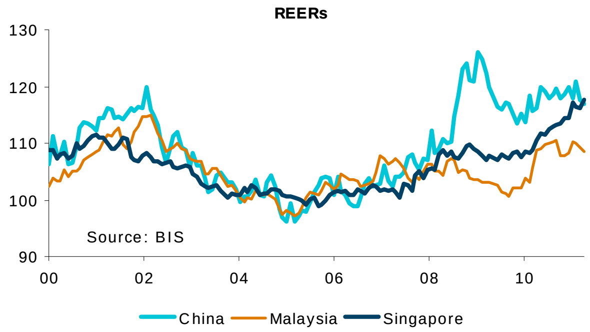
Daniel Wilson

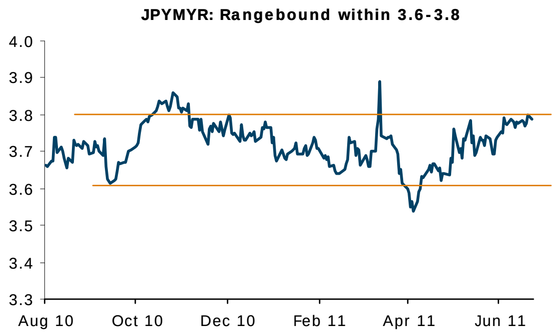
MONTHLY DATA	OCT-10	NOV-10	DEC-10	JAN-11	FEB-11	MAR-11	APR-11	MAY-11
Industrial Production, % y/y	3.2	5.4	4.2	0.6	5.0	2.9	-2.2	N/A
Manufacturing Sales, % y/y	2.9	8.5	11.4	7.6	10.0	14.1	15.5	N/A
Consumer Price Index, % y/y	2.0	2.0	2.2	2.4	2.9	3.0	3.2	3.3
Exports, % y/y	1.3	5.3	4.6	3.0	10.7	4.1	11.1	N/A
Imports, % y/y	12.5	6.1	11.5	13.5	11.5	12.1	9.4	N/A
Trade Balance, US$ bn	2.2	2.8	3.2	3.3	4.1	3.8	3.7	N/A
Foreign Exchange Reserves, US$ bn	104.4	103.0	107.4	109.1	109.8	122.2	130.0	133.2
QUARTERLY DATA	JUN-09	SEP-09	DEC-09	MAR-10	JUN-10	SEP-10	DEC-10	MAR-10
Real GDP, % y/y	-3.9	-1.2	4.4	10.1	8.9	5.3	4.8	4.6
Current Account, US$ bn	8.2	7.3	8.0	9.3	5.0	6.5	7.8	10.0
Capital & Financial Account, US$ bn	-6.9	-3.2	-5.2	-6.0	0.2	-1.1	0.4	2

Source: CEIC

MALAYSIA







FX AND RATES STRATEGY

The outlook for USDMYR in coming months remains higher, in spite of supportive domestic fundamentals.

FX

We see scope for further gains in USDMYR in coming months amid tighter global liquidity and slower global growth prospects. In particular, the Fed's QE2 programme expired on 30 June, removing monthly injections of roughly $75bn into the global financial system. Tighter global liquidity will stem capital inflows, directly reducing MYR appreciation pressures. Tighter global liquidity will also slow global growth (by design), but the risk is that investor sentiment becomes derailed by still sub-par performance in the G3.

Domestic fundamentals are otherwise supportive of the ringgit. Malaysia's commodity exports should continue to benefit from firm prices, underpinned by still robust demand from China. Also, the government reduced electricity subsidies in May, helping to move the budget deficit toward the target of 2.8% of GDP by 2015 (from 5.6% in 2010). Higher electricity prices will add an estimated 0.3ppts to inflation, suggesting further BNM rate hikes to anchor inflation expectations.

Tamara Henderson

RATES

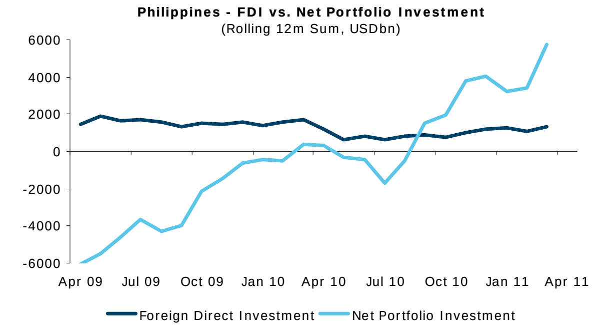
Malaysia's economy is expected to remain on a solid growth path underpinned by a firm expansion in the domestic market. Inflation pressures are expected to continue to climb from their two-year peak in May: supply-side pressures will be exacerbated by the government's decision to raise electricity prices, and demand-side pressures will be fuelled by a tightening labour market and positive consumer sentiment. Any follow-through on talks of a reduction in fuel subsidies in keeping with fiscal consolidation plans would also feed into short-term inflation. We believe the proactive BNM will hike rates by 25bps at the next policy meeting on 7 July with a possibility of raising the SRR by another 100bps to the pre-crisis level of 4.00%. However, there is a chance they will hold in July and hike in September as the shaky global economy imposes a near-term drag on external demand for Malaysian goods.

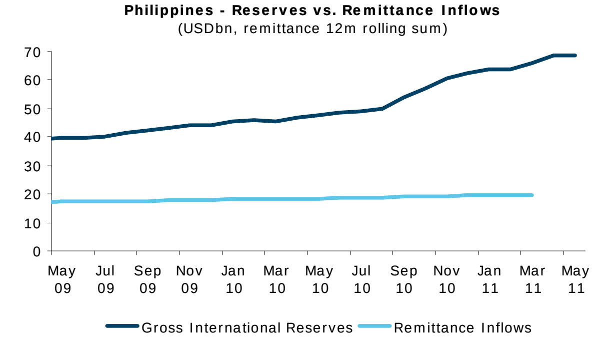
Daniel Wilson

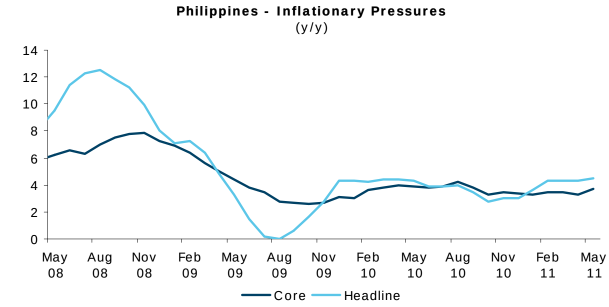
FX FORECASTS	CURRENT	YTD (%)	SEP-11	DEC-11	MAR-12	JUN-12	SEP-12	DEC-12
USDMYR	3.06	-0.2%	3.08	3.10	3.07	3.04	3.02	2.99
AUDMYR	3.19	2.4%	3.32	3.35	3.26	3.14	3.05	2.96
NZDMYR	2.46	3.3%	2.46	2.51	2.43	2.34	2.26	2.18
JPYMYR	3.79	0.5%	3.62	3.56	3.45	3.35	3.24	3.14
EURMYR	4.32	5.5%	4.21	4.19	4.09	4.11	4.13	4.09
RATE FORECASTS	**CURRENT**	**YTD (BPS)**	**SEP-11**	**DEC-11**	**MAR-12**	**JUN-12**	**SEP-12**	**DEC-12**
BNM's overnight policy rate	3.00	25	3.25	3.25	3.50	3.50	3.50	3.75

Sources: Bloomberg, ANZ Research

THE PHILIPPINES







ECONOMIC UPDATE

Despite moderating economic activity, headline and core price pressures have risen. These mainly reflect the pass through of higher energy and commodity prices. Nonetheless, price pressures remain within the central bank's inflation target range. The policy stance is biased toward further tightening but is encompassing a wider range of policy tools.

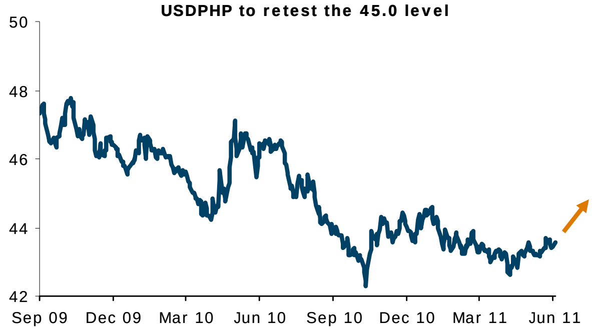
- GDP growth slowed to 4.9% y/y in Q1 2011 compared with a gain of 6.1% (revised) previously. The slowdown was mainly due to reduced government spending on infrastructure projects and weak global trade.
- Headline CPI increased 4.5% y/y in May following a 4.3% rise in the previous month. The rise was due to non-food items such as fuel, light and water. The YTD average was 4.2% in May—within the government's target range of 3.0-5.0% for 2011. Core inflation rose 3.7% y/y compared with 3.3% in April; on a m/m basis, it stood at 0.0%, down from 0.6% (revised) in April.
- Overseas remittances accelerated in April, rising 6.3% y/y to $1.6bn following a rise of 4.1% previously.
- FDI net inflows amounted to $167.0m in March, surging 142.0% y/y. Nonetheless, cumulative FDI for Q1 2011 amounted to $471.0mn, down 16.6%.
- Export growth increased to a four-month high in April. Higher sales of agricultural (108.4% y/y) and mineral goods (118.4%) offset declining electronics shipments (-2.1%) which were impacted by the earthquake in Japan. Total exports amounted to $4.3bn in April, up 19.1% from a 4.1% (revised) rise in March.
- The central bank's monetary board left key policy rates unchanged at its 16 June meeting—reverse repo rate at 4.5%, and the repo rate at 6.5%. However, it increased the reserve requirement rate for all banks and non-banks with quasi-banking functions by 1.0ppt.
- Looking ahead, both the external trade accounts and inflation dynamics could benefit from the recent decline in international crude oil prices.

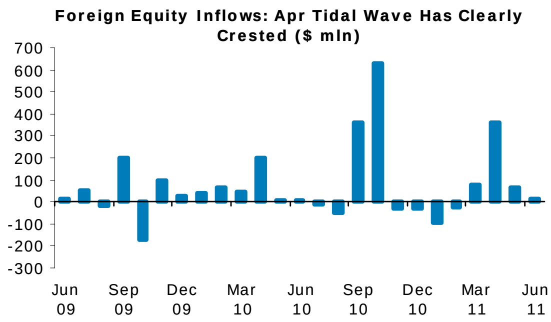
Aninda Mitra

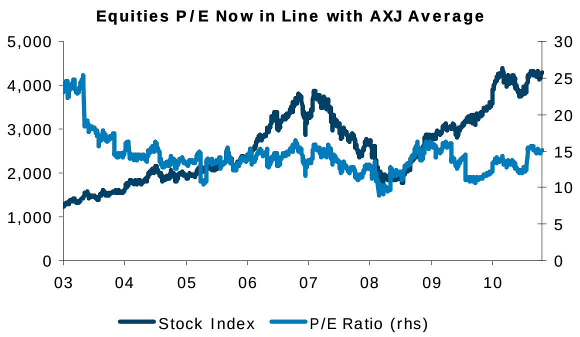
MONTHLY DATA	OCT-10	NOV-10	DEC-10	JAN-11	FEB-11	MAR-11	APR-11	MAY-11
Manufacturing Production, % y/y	7.7	9.5	8.6	8.0	11.1	11.6	9.7	N/A
Motor Vehicle Sales, % y/y	27.8	12.2	6.5	1.1	-6.1	-8.7	-4.2	-17.1
Consumer Price Index, % y/y	3.6	2.8	3.0	3.0	3.6	4.3	4.3	4.5
Exports, % y/y	46.4	27.4	11.5	26.5	11.8	8.3	4.1	19.1
Imports, % y/y	24.6	28.4	35.3	25.7	23.0	21.9	21.8	N/A
Trade Balance, US$ bn	0.7	-0.1	-0.8	-0.7	-1.3	-0.9	-1.2	N/A
Foreign Exchange Reserves, US$ bn	53.8	57.2	60.6	62.4	63.5	63.9	66.0	68.5
QUARTERLY DATA	**JUN-09**	**SEP-09**	**DEC-09**	**MAR-10**	**JUN-10**	**SEP-10**	**DEC-10**	**MAR-11**
Real GDP, % y/y	1.2	0.2	2.1	7.8	8.2	6.3	6.1	4.9
Current Account, US$ bn	2.4	1.9	2.7	1.2	1.8	3.3	2.2	1.6
Capital & Financial Account, US$ bn	-0.1	-0.1	0.5	0.0	-0.4	2.6	5.7	3.0

Source: CEIC

THE PHILIPPINES







FX AND RATES STRATEGY

Domestic factors remain peso positive, but more challenging external dynamics suggest a higher bias in USDPHP nearer term.

FX

In June, Fitch raised the Philippines' long-term currency rating to one notch below investment grade (IG). Moody's also raised its rating to two notches below IG, bringing it in line with S&P. Going forward, the ratings outlook remains bright as a result of the new government's progress in improving the country's fiscal position. The rating upgrades complete a virtuous circle as they attract capital flows and reduce the cost of government borrowing, which in turn facilitates further progress on narrowing the budget gap. Last year's shortfall—largely inherited by the new government—amounted to 4.3% of GDP, one of the largest in the region. As such, there is plenty of scope for improvement from this remittance-dependent economy. The economic growth target is 7-8% this year, notwithstanding sharp cuts in government expenditures.

More important for the nearer term PHP outlook, however, are challenging external dynamics. Notably, the Fed's QE2 programme expired on 30 June, removing monthly injections of roughly $75bn into the global financial system. This is expected to stem capital inflows and reduce appreciation pressures. Also, inflation will soon peak in the region that led the global recovery—especially in China. As such, the market focus will likely be directed at lacklustre global growth prospects in the G3. This suggests that risk appetite will remain subdued at best.

Tamara Henderson

RATES

BSP will remain on hold through Q3. Headline and core price pressures have risen of late, but remain within the central bank's inflation target range. Moreover, after having raised rates twice, by 25bps, each, at its March and May meetings, BSP appears to be assessing the impact on real activity. The authorities have also grown more wary of large capital inflows, and this has prompted a tightening of onshore liquidity—at its June 16 board meeting, BSP implemented a one percentage point increase in reserve requirements on deposits of banks and non-bank institutions. Nonetheless, persistently high capacity utilization, wage-price pressures will likely prompt a further rate hike in Q4 in order to anchor inflation expectations.

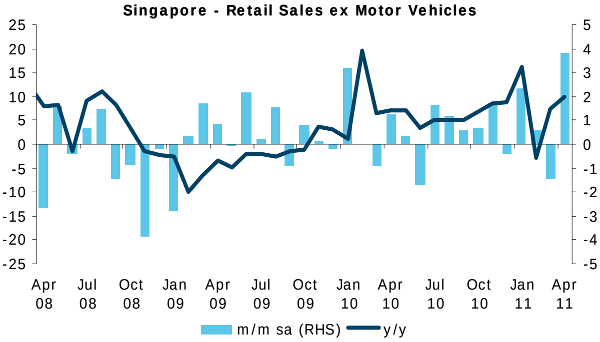
Aninda Mitra

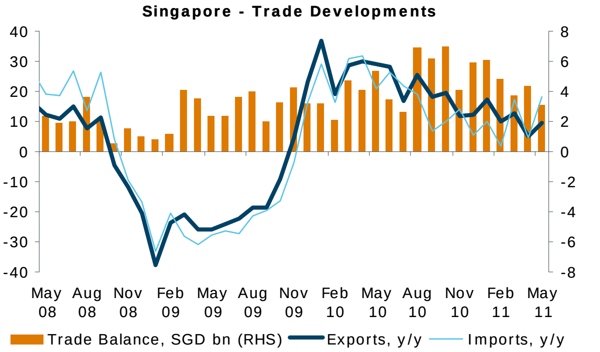
FX FORECASTS	CURRENT	YTD (%)	SEP-11	DEC-11	MAR-12	JUN-12	SEP-12	DEC-12
USDPHP	43.58	-0.1%	44.4	44.9	44.5	44.1	43.7	43.3
AUDPHP	44.93	1.2%	48.0	48.5	47.2	45.4	44.1	42.9
NZDPHP	35.02	3.4%	35.5	36.4	35.2	34.0	32.8	31.6
JPYPHP	0.53	-0.5%	0.522	0.516	0.500	0.485	0.470	0.456
EURPHP	60.80	4.2%	60.8	60.6	59.2	59.5	59.9	59.3
RATE FORECASTS	**CURRENT**	**YTD (BPS)**	**SEP-11**	**DEC-11**	**MAR-12**	**JUN-12**	**SEP-12**	**DEC-12**
BSP's overnight reverse repo rate	4.50	50	4.50	4.75	4.75	4.50	4.50	4.50

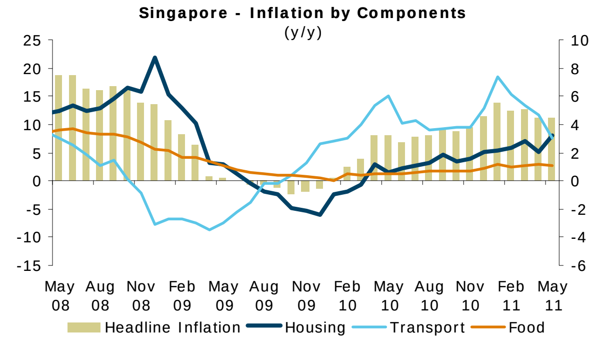
Sources: Bloomberg, ANZ Research

SINGAPORE

ECONOMIC UPDATE







Singapore's economic growth stayed on track as both domestic and external demand indicators remained relatively strong. However, inflation remained stubbornly high as the costs of accommodation and utilities climbed.

- Industrial production (IP) contracted sharply for the second straight month by 17.5% y/y in May compared with a 9.5% decline in April as biomedical output continued to plunge. However, excluding biomedical output, IP rose 2.2% from a 0.3% drop, lifted by an increase in machinery and equipment, and chemical products output.
- The manufacturing PMI fell by 1.7pts in May to 50.8, led by a 3.0pt drop in new orders and a 2.4pt decline in inventories. The electronics PMI also fell by 1.6pts to 51.4 for similar reasons.
- Retail sales accelerated in April to 8.1% y/y from 1.1% in March underpinned by strong demand in department stores, apparel and luxury items. Excluding motor vehicles, sales jumped 2.7ppts to 10.1% and rebounded strongly by 3.8% m/m sa.
- Export growth rose to 9.6% y/y in May, up from 4.9% in April, boosted by oil exports and a rebound in non-oil domestic exports (NODX). NODX growth was led by pharmaceutical shipments as electronics remained weak. Meanwhile, imports jumped to 18.0% and the trade surplus narrowed to SGD3.0bn.
- Headline inflation beat estimates and remained unchanged at 4.5% y/y in May as housing costs spiked despite a moderation in food and transportation costs. On a m/m basis, inflation doubled to 0.6%, led by a 3.1% jump in housing.
- We remain positive on Singapore's growth outlook despite global headwinds from the EU debt crisis and the loss of momentum in the US recovery. Meanwhile, the recent decline in oil prices will help alleviate some inflation pressures in the economy.

Shuzhen Pay

MONTHLY DATA	OCT-10	NOV-10	DEC-10	JAN-11	FEB-11	MAR-11	APR-11	MAY-11
Industrial Production, % y/y	29.6	41.2	8.8	11.6	5.1	30.1	-9.5	-17.5
Retail Sales, % y/y	-0.2	1.9	3.2	3.3	-11.5	1.1	8.1	N/A
Consumer Price Index, % y/y	3.5	3.8	4.6	5.5	5.0	5.0	4.5	4.5
Domestic Exports (non-oil), % y/y	34.3	9.9	9.3	20.6	6.7	9.8	-2.0	7.8
Imports (non-oil), % y/y	10.1	11.5	5.0	5.7	-0.3	1.7	-0.3	3.7
Trade Balance, US$ bn	5.4	3.1	4.5	4.7	3.8	2.9	3.5	2.5
Foreign Exchange Reserves, US$ bn	221.4	217.6	225.8	227.1	230.9	234.2	242.5	239.9
QUARTERLY DATA	JUN-09	SEP-09	DEC-09	MAR-10	JUN-10	SEP-10	DEC-10	MAR-11
Real GDP, % y/y	-1.7	1.8	4.6	16.4	19.4	10.5	12.0	8.3
Current Account, US$ bn	8.0	8.2	11.2	10.8	12.5	14.1	12.1	13.8
Capital & Financial Account, US$ bn	-8.3	-3.7	-2.9	3.2	-1.6	-9.8	1.1	-11.0

Source: CEIC

SINGAPORE

FX AND RATES STRATEGY

Tighter liquidity in the aftermath of QE2, the coming peak in AXJ inflation, and slower global growth momentum all suggest that the recent upward bias in USDSGD will be sustained.

FX

During the recent bout of risk aversion related to the re-emergence of Europe's sovereign debt crisis and the start of summer holidays in the Northern Hemisphere, the SGD has been one of the more resilient currencies within AXJ, in line with our expectations. That said, the extent of staying power in the SGD has been a surprise, requiring an adjustment in our year-end forecast for USDSGD to 1.26 from 1.28 previously. Nevertheless, we continue to see opportunities in long USDSGD (and long SGDAXJC) positions in the months ahead:

- The synchronised withdrawal of GFC-related emergency liquidity by central banks across the globe will stem capital inflows and reduce appreciation pressures in AXJ currencies. Notably, the Fed's QE2 programme expired on 30 June, removing monthly injections of roughly $75bn into the financial system.
- Inflation will soon peak in the region that led the global recovery—especially in China. Proactive MAS measures to cool inflation had already produced a peak in Singapore's CPI back in Q1.
- As inflation risks are more fully priced and coming off, the market focus will likely be directed at global growth prospects, which will remain lacklustre in the G3 owing to the GFC hangover. As such, risk appetite should remain subdued overall.

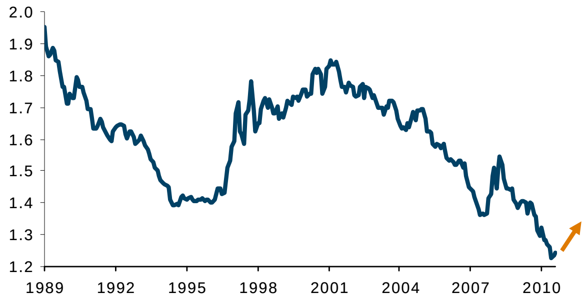
Added benefits for the SGD versus AXJC counterparts during a more challenging environment for risk appetite include Singapore's more credible policy regime and smaller dependency on capital inflows.

RATES

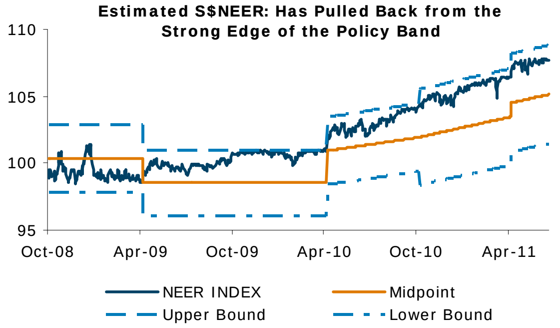
The MAS manages monetary conditions via the nominal effective exchange rate. We do not expect to see a meaningful increase in SGD money market rates, which continue trade near record lows, until the Federal Reserve signals an end to its "extraordinary" policy accommodation (which is unlikely in 2011).

Tamara Henderson

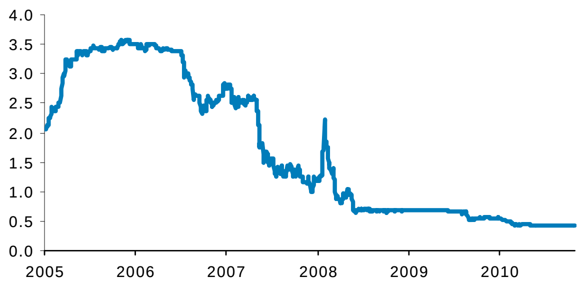
USDSGD has likely defined the lows for 2011



Estimated S$NEER: Has Pulled Back from the Strong Edge of the Policy Band



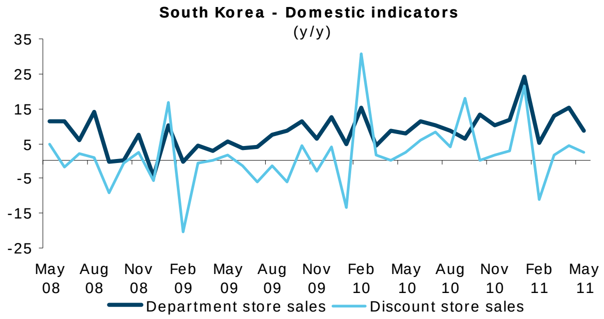
3M SGD SIBOR: Waiting on the Fed

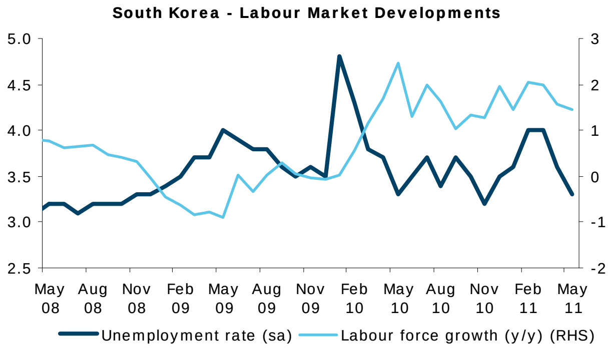


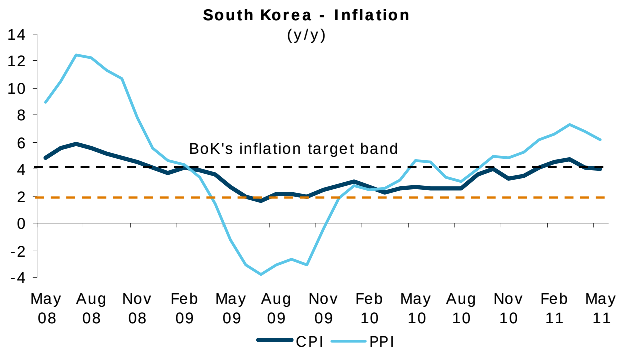
FX FORECASTS	CURRENT	YTD (%)	SEP-11	DEC-11	MAR-12	JUN-12	SEP-12	DEC-12
USDSGD	1.242	-3.2%	1.250	1.260	1.249	1.238	1.226	1.214
AUDSGD	1.296	-0.7%	1.35	1.36	1.32	1.27	1.24	1.20
NZDSGD	0.998	0.2%	1.00	1.02	0.99	0.95	0.92	0.89
JPYSGD	1.539	-2.4%	1.47	1.45	1.40	1.36	1.32	1.28
EURSGD	1.755	2.4%	1.71	1.70	1.66	1.67	1.68	1.66
RATE FORECASTS	**CURRENT**	**YTD (BPS)**	**SEP-11**	**DEC-11**	**MAR-12**	**JUN-12**	**SEP-12**	**DEC-12**
3-month SIBOR	0.44	0	0.44	0.44	0.49	0.49	0.54	0.54
2-year IRS (onshore versus 6M SOR)	0.62	-33	0.6	0.9	1.2	1.5	1.9	2.2
10-year IRS	2.55	-48	2.6	2.7	2.8	2.9	3.0	3.1

Sources: Bloomberg, ANZ Research

SOUTH KOREA







ECONOMIC UPDATE

Domestic demand indicators look soft in Q2, although forward-looking surveys continue to suggest optimism. Inflation has eased somewhat but remains above the Bank of Korea's target band. The central bank did raise rates by 25bps in June, but in our view more needs to be done.

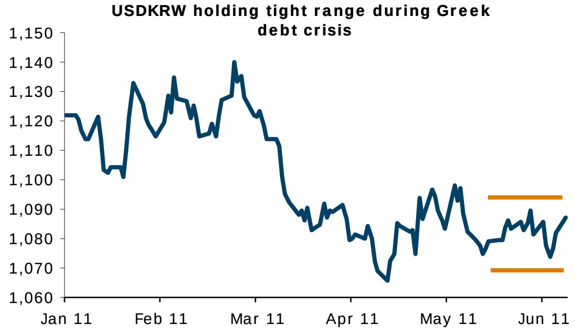
- Department store sales growth halved to 8.7% in May led by clothing and luxury goods. Discount store sales growth also halved to 2.4%. Separately, the consumer sentiment index registered a broad-based decline of 2pts to 102.0 in June.
- Industrial production contracted in Apr, falling 1.5% (sa) m/m, but was up 6.9% y/y. This was the second decline in three months. The May HSBC Manufacturing PMI fell to a six-month low of 51.2 on weak growth in new business orders and output. Surprisingly, the July business confidence survey rose 0.8pt (sa) to 100.5 on inventory and profitability views.
- Exports rose by a less-than-expected 23.5% y/y in May, led by shipments to Asia. Imports, conversely, grew 29.9% on higher purchases of coal, crude oil and memory chips. The trade surplus halved to $2.7bn.
- CPI inflation eased to 4.1% y/y in May, but remained above the BOK's target band. However, core inflation rose 0.3ppt to 3.5% y/y (and was up 0.5% m/m).
- The unemployment rate declined to a fresh 2011 low of 3.3% (sa) in May on increased hiring by manufacturing, healthcare and welfare service companies. Employment growth eased to 1.3% whilst the participation rate was steady at 61.3
- Bank lending to households grew at its fastest pace this year in June, though loans to companies moderated. The Financial Supervisory Service said it plans to tighten loan-to-deposit rules.
- The BOK raised its seven-day repo rate by 25bps to 3.25% on 10 June. The central bank said that inflation pressure is expected to continue, driven largely by increased demand from the economic upswing.
- We think the current soft patch will end soon and that the BOK will need to continue to raise rates to tighten what we estimate to be one of the loosest monetary stances in Asia.

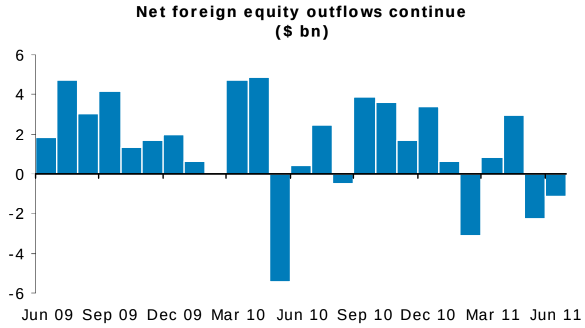
Paul Gruenwald

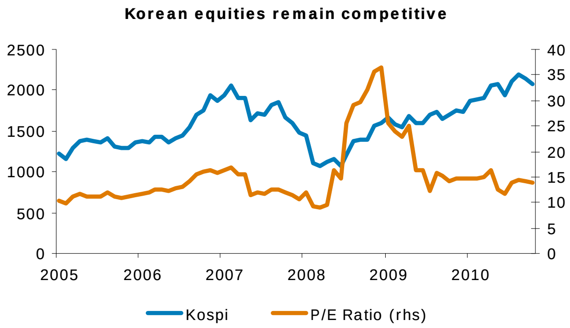
MONTHLY DATA	OCT-10	NOV-10	DEC-10	JAN-11	FEB-11	MAR-11	APR-11	MAY-11
Industrial Production, % y/y	13.5	10.7	9.8	13.7	9.1	9.0	6.9	N/A
Retail Sales, % y/y	7.6	9.5	7.6	15.6	3.8	10.4	8.6	N/A
Consumer Price Index, % y/y	4.1	3.3	3.5	4.1	4.5	4.7	4.2	4.1
Exports, % y/y	27.6	21.4	22.6	45.2	16.9	28.8	25.1	23.5
Imports, % y/y	21.7	30.9	21.7	32.4	16.6	27.9	23.7	29.9
Trade Balance, US$ bn	6.3	2.6	4.1	4.2	3.6	4.5	5.8	2.7
Foreign Exchange Reserves, US$ bn	293.4	290.3	291.6	296.0	297.7	298.6	307.2	305.1
QUARTERLY DATA	JUN-09	SEP-09	DEC-09	MAR-10	JUN-10	SEP-10	DEC-10	MAR-11
Real GDP, % y/y	-2.2	0.9	6.0	8.1	7.2	4.4	4.7	4.2
Current Account, US$ bn	4.9	3.2	0.7	1.2	4.3	3.5	2.1	1.4
Capital & Financial Account, US$ bn	-5.5	-2.4	-1.3	-0.1	-4.1	-2.7	-0.3	0.5

Source: CEIC

SOUTH KOREA







FX AND RATES STRATEGY

Key sources of support for the KRW will fade in H2.

FX

The KRW was more resilient than expected during the recent bout of risk aversion related to the re-emergence of Europe's sovereign debt crisis and the start of summer holidays in the Northern Hemisphere. As such, our year-end forecast for USDKRW has been scaled back toward 1140 compared with a previous target of 1175. Nevertheless, we continue to see opportunities in long USDKRW positions as key sources of support for the KRW will fade in H2:

- The synchronised withdrawal of GFC-related emergency liquidity by central banks across the globe will stem capital inflows and reduce appreciation pressures in AXJ currencies, especially the more liquid KRW. Notably, the Fed's QE2 programme expired on 30 June, removing monthly injections of roughly $75bn into the global financial system. Also, Japan's vast pool of savings—used to finance consumption and investment around the world—will increasingly be needed at home.
- Inflation will soon peak in the region that led the global recovery—especially in China. As inflation risks are more fully priced and coming off, the market focus will likely be directed at global growth prospects, which will remain lacklustre in the G3 owing to the GFC hangover. As such, risk appetite should remain subdued overall.

Added negatives for the KRW versus AXJ counterparts are the Korean economy's larger dependency on capital inflows and discretionary demand in the G3.

Tamara Henderson

RATES

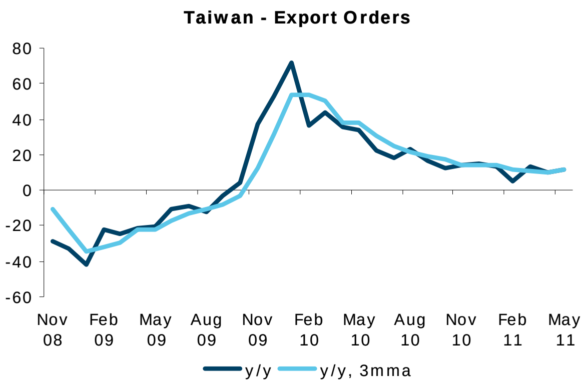
The BOK raised rates in June as we expected, although more work needs to be done to bring monetary conditions to a more neutral level. The global growth slowdown provides some breathing room to central banks like the BOK who were at risk of falling further behind the inflation fighting curve. However, the central bank's reaction function—which appears to contain more than just inflation and seems biased against consecutive moves—suggests that a pause is in order in July. We would therefore be quite surprised if the BOK were to raise again this month even though inflation looks set to remain above the target range for some time.

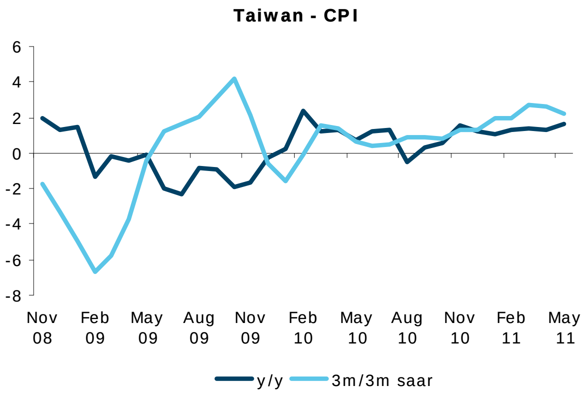
Paul Gruenwald

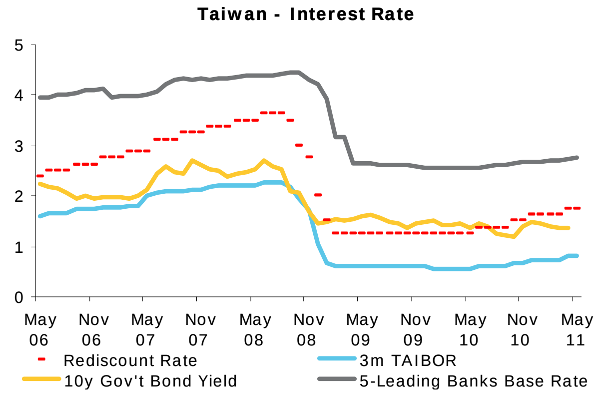
FX FORECASTS	CURRENT	YTD (%)	SEP-11	DEC-11	MAR-12	JUN-12	SEP-12	DEC-12
USDKRW	1,087	-3.0%	1,120	1,140	1,120	1,100	1,090	1,080
AUDKRW	1,134	-0.6%	1,210	1,230	1,190	1,130	1,100	1,070
NZDKRW	874	0.4%	900	920	880	850	820	790
JPYKRW	13.47	-2.3%	13.2	13.1	12.6	12.1	11.7	11.4
EURKRW	1,536	2.4%	1,530	1,540	1,490	1,490	1,490	1,480
RATE FORECASTS	CURRENT	YTD (BPS)	SEP-11	DEC-11	MAR-12	JUN-12	SEP-12	DEC-12
BoK's overnight call rate	3.25	75	3.50	4.00	4.25	4.50	4.75	5.00

Sources: Bloomberg, ANZ Research

TAIWAN







ECONOMIC UPDATE

Amidst a regional slowdown in trade, Taiwan continues to benefit from the global boom in consumer electronics. Export orders rose firmly and industrial production reported a strong gain in May. As growth is not a near-term concern, the CBC raised policy rate by 0.125% in June.

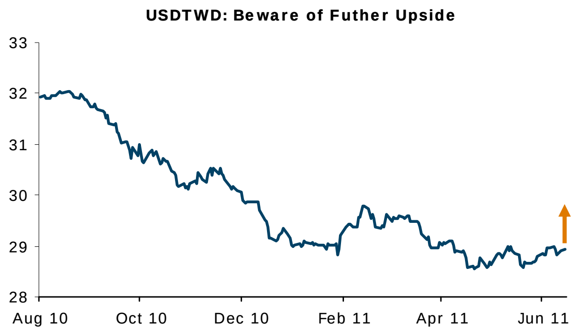
- Industrial production rose further by 7.8% y/y in May from April's 7.2% gain. Retail sales rose just 3.2% after a solid 6.8% gain in April. Wholesale sales growth flattened at 4.0%, pointing to a slowing in manufacturing. As a result, total commercial sales grew by 3.8%, down from 4.9% previously.
- Trade flows showed signs of a slowdown. Exports rose by 9.5% y/y, down from 24.6% in April. Imports grew 19.3%, from 25.7% previously. The trade surplus shrank to US$1.22bn in May from US$2.96b in April.
- Exports to mainland China only rose 2.2% y/y and imports rose by 28.7% in May, down from 14.8% and 28.7%, respectively, in April. The trade surplus with the Mainland narrowed to $3.5bn from $3.6bn. Exports to Hong Kong also contracted by 4% in May, due to the disruption in regional supply chains.
- May export orders increased by 11.5% and, on the back of the current boom in consumer electronics, export orders in June are likely to be boosted by the Computex trade show held in June.
- Headline inflation edged up to 1.66% y/y in May from 1.32% in April. Core inflation hit 1.18%, the highest reading since February 2009. Meanwhile, the WPI eased to 3.31% in May from 4.6% in April. The import price index slowed to 6.5% in TWD terms despite rising by 18.1% in USD terms.
- The jobless rate edged up slightly 4.41% (sa) in May from 4.35% in April. The labour market will tighten further as tourism is boosted by the launch of individual visas for Mainland tourists on 28 June.
- The aforementioned developments suggest a positive outlook in H2. As such, we expect the CBC will continue to normalise interest rates for the rest of the year.

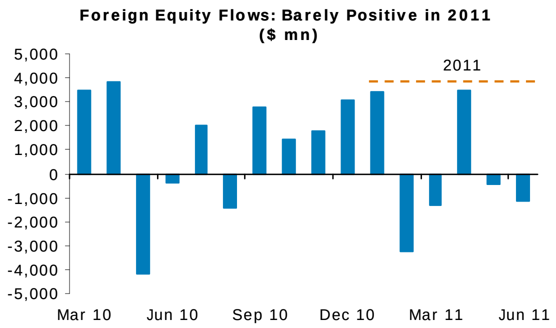
Raymond Yeung

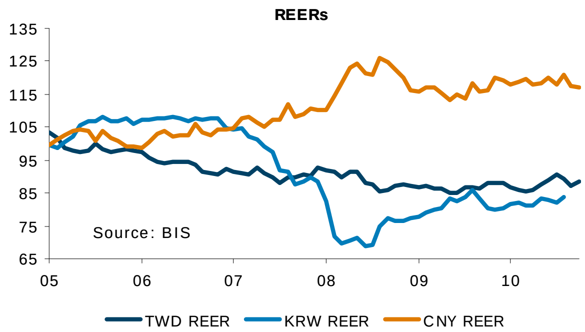
MONTHLY DATA	OCT-10	NOV-10	DEC-10	JAN-11	FEB-11	MAR-11	APR-11	MAY-11
Industrial Production, % y/y	14.4	19.6	18.9	17.4	13.3	13.7	7.2	7.8
Commercial Sales, % y/y	7.6	5.9	5.6	13.3	4.8	7.7	4.9	3.8
Retail Trade Index, % y/y	7.9	5.7	3.1	22.9	-0.9	8.7	6.9	3.2
Consumer Price Index, % y/y	0.6	1.5	1.2	1.1	1.3	1.4	1.3	1.7
Exports, % y/y	21.9	21.8	19.1	16.6	27.3	16.7	24.6	9.5
Imports, % y/y	27.9	33.8	21.4	22.0	28.7	16.7	25.7	19.3
Trade Balance, US$ bn	3.0	0.4	1.6	1.9	0.9	1.8	3.0	1.2
Foreign Exchange Reserves, US$ bn	383.8	379.3	382.0	387.1	390.7	392.6	399.5	398.7
QUARTERLY DATA	JUN-09	SEP-09	DEC-09	MAR-10	JUN-10	SEP-10	DEC-10	MAR-11
Real GDP, % y/y	-7.2	-1.2	9.2	13.6	12.9	10.7	7.1	6.6
Current Account, US$ bn	10.3	8.0	11.4	10.3	11.2	9.1	9.2	10.8
Capital & Financial Account, US$ bn	-8.8	-5.3	-13.0	-10.8	-9.5	-10.5	-9.1	-7.3

Source: CEIC

TAIWAN







FX AND RATE STRATEGY

Tighter liquidity and slower global growth are expected to nudge USDTWD higher in coming months.

FX

USDTWD is expected to have a positive skew in coming months, reflecting tighter liquidity and slower global growth. Notably, the Fed's QE2 programme expired on 30 June, removing monthly injections of roughly $75bn into the global financial system. This will curtail capital inflows and directly reduce appreciation pressure in the TWD.

Domestic factors are otherwise supportive of the TWD. The recent release of IEA oil reserves and subsequent correction in oil prices will increase discretionary income and thereby lift demand for Taiwan's highly income elastic electronics exports. (Note, however, that our Commodity team expects the relief in oil prices to be temporary.)

Domestic economic activity will also be boosted by a more liberal visa policy for individual Mainland Chinese visitors, which will increase demand for workers in the hospitality sector and further tighten the labour market. Although inflation in Taiwan is much more benign than elsewhere in the region, capacity constraints are exacerbating inflation pressures from already high commodity prices. Measures by the CBC to dissipate inflation pressures should also support the TWD.

Tamara Henderson

RATES

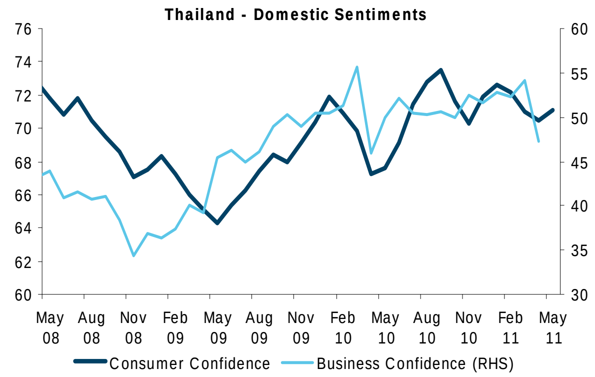
The CBC raised its rediscount rate by 12.5bps in its second quarterly meeting on 30 June, in line with market expectations. We think the central bank will continue to rely on an exchange rate policy to manage growth and inflation, and will stick to the current pace of rate normalisation. As such, it will raise the rediscount rate by another 12.5bps at its September meeting.

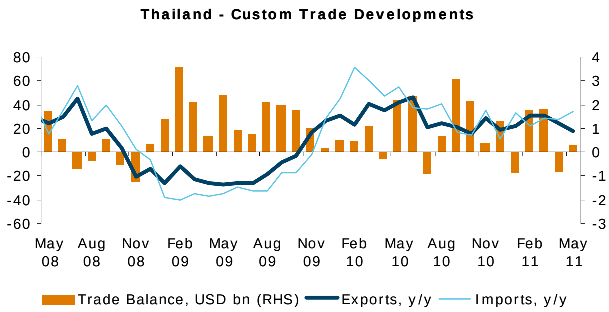
Raymond Yeung

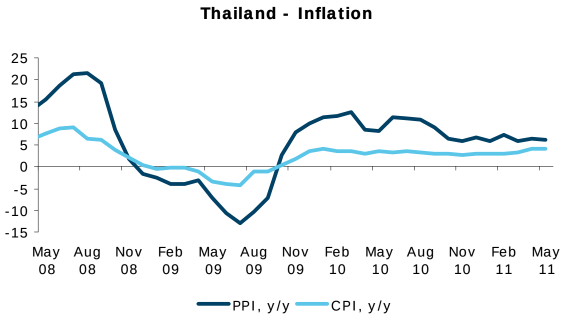
FX FORECASTS	CURRENT	YTD (%)	SEP-11	DEC-11	MAR-12	JUN-12	SEP-12	DEC-12
USDTWD	28.95	-0.7%	29.4	29.7	29.4	29.1	28.9	28.6
AUDTWD	30.19	1.8%	31.8	32.1	31.2	30.0	29.2	28.3
NZDTWD	23.24	2.7%	23.5	24.1	23.2	22.4	21.7	20.9
JPYTWD	0.359	0.1%	0.346	0.341	0.330	0.320	0.311	0.301
EURTWD	40.88	4.9%	40.3	40.1	39.1	39.3	39.6	39.2
RATE FORECASTS	CURRENT	YTD (BPS)	SEP-11	DEC-11	MAR-12	JUN-12	SEP-12	DEC-12
CBC's discount rate	1.875	25	2.000	2.125	2.375	2.625	2.625	2.625

Sources: Bloomberg, ANZ Research

THAILAND







ECONOMIC UPDATE

Domestic demand indicators were mixed while external trade remained strong. Inflation remains on an uptrend, suggesting inflation risks are the main concern. The Bank of Thailand raised interest rates in June by 25bps to 3.00%.

- Total car sales growth declined to 10.2% y/y in May, compared to April's 17.8% gain. Meanwhile, manufacturing production fell 3.9% in May (halving April's decline), slightly better than consensus.
- Headline CPI inflation rose by 0.2ppts to 4.2% y/y in May, driven by rising prices of fresh food and consumer goods and higher power charges. May core inflation also climbed to 2.5% from 2.1% in April.
- Falling prices of agricultural products and crops slowed PPI inflation to 6.1% y/y in May, down 0.4% from the previous month.
- The Consumer Confidence Index rose 0.6 pt to 71.1 in May, after three months of decline. The rise was due to lower fuel prices. The Confidence Index for the overall economy, employment opportunities and future income advanced to 80.4, 71.1 and 98.5, respectively.
- Trade data show a limited impact from Japan's quake and tsunami. Export growth surprised on the upside with a gain of 17.6% y/y in May as higher agricultural shipments shored up overall exports to Japan. However, this was lower than the 24.6% gain in April. Imports rose 33.8% in May following a 27.9% rise in April. The trade surplus was $278m in May, compared to a deficit of $797m in April.
- The Leading Economic Index rose to 6.5% y/y in April from 5.5% previously. Conversely, the Coincident Economic Index increased 1.8% y/y in March, slightly lower than the 2.1% rise in the previous month.
- The outlook remains relatively positive good fundamentals. The impact of the Japan earthquake on trade has been limited. However, downside risks include inflation and domestic political uncertainty.

Reenee Garcia

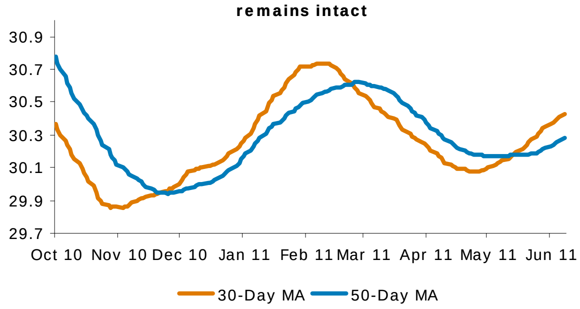
MONTHLY DATA	OCT-10	NOV-10	DEC-10	JAN-11	FEB-11	MAR-11	APR-11	MAY-11
Industrial Production, % y/y	6.0	5.7	-3.4	4.1	-3.0	-6.7	-8.1	-3.9
Retail Sales, % y/y	35.2	38.3	29.2	38.0	42.5	47.5	17.8	-10.2
Consumer Price Index, % y/y	2.9	2.8	3.0	3.0	2.9	3.1	4.0	4.2
Exports, % y/y	15.7	28.5	18.8	22.3	31.0	30.9	24.6	17.6
Imports, % y/y	14.8	35.3	11.5	33.3	22.5	28.4	27.9	33.8
Trade Balance, US$ bn	2.2	0.4	1.3	-0.9	1.8	1.8	-0.8	0.3
Foreign Exchange Reserves, US$ bn	171.1	168.0	172.1	174.0	179.5	181.6	189.9	185.5
QUARTERLY DATA	JUN-09	SEP-09	DEC-09	MAR-10	JUN-10	SEP-10	DEC-10	MAR-11
Real GDP, % y/y	-5.2	-2.8	5.9	12.0	9.2	6.6	3.8	3.0
Current Account, US$ bn	3.2	4.2	4.6	5.5	1.7	2.0	5.5	6.8
Capital & Financial Account, US$ bn	-2.7	2.0	1.4	3.8	1.1	8.0	3.1	0.2

Source: CEIC

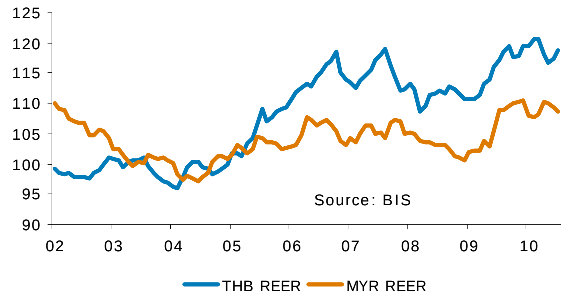
THAILAND

USDTHB: Biased Higher into July Elections

Momentum suggests upward bias in USDTHB remains intact



REERs



FX AND RATES STRATEGY

July elections have potential to escalate political tensions, maintaining pressure on the baht.

FX

USDTHB is expected to maintain an upward bias in coming months as domestic political tensions reinforce more challenging external dynamics. Thai general elections on 3 July will take place against a backdrop of slowing growth and rising inflation that has dented consumer confidence. Moreover, there is decent risk that the election results will be challenged no matter the outcome. An incumbent victory risks sparking protests by the populist "Red Shirts," while a win by the opposition may not be accepted by the military. All of this comes in the context of last year's bloody crackdown against Red Shirt protesters. Former prime minister Thaksin was removed from office via a military coup in 2006. The current Prime Minister Abhisit has warned voters that a vote for the opposition Puea Thai party risked extending the country's long record of political instability.

External dynamics will also remain challenging for the baht. The synchronized withdrawal of liquidity by central banks across the globe will stem capital inflows and reduce appreciation pressures. Notably, the Fed's QE2 programme expired on 30 June, removing monthly injections of roughly $75bn into the global financial system. Also, inflation will soon peak in the region that led the global recovery—especially in China. As inflation risks are more fully priced and will be coming off, the market focus will likely be directed at lacklustre global growth prospects in the G3. This suggests that risk appetite will remain subdued at best.

Tamara Henderson

RATES

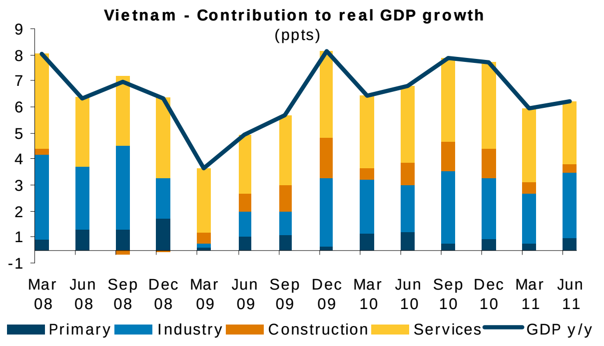
The BoT raised its benchmark interest rate on 1 June by 25bps to 3.00% to curb inflation that has rise to a 32-month driven by global commodity costs and the ramp-up in government spending in anticipation of the 3 July election. The BoT will meet again on 13 July and we expect it to increase its benchmark interest rate by another 25bps to 3.25% as populist policies of wage hikes, subsidies and new infrastructure promised by politicians threaten further inflation pressures. The Monetary Policy Committee said that it would closely monitor price pressures going forward and take necessary action.

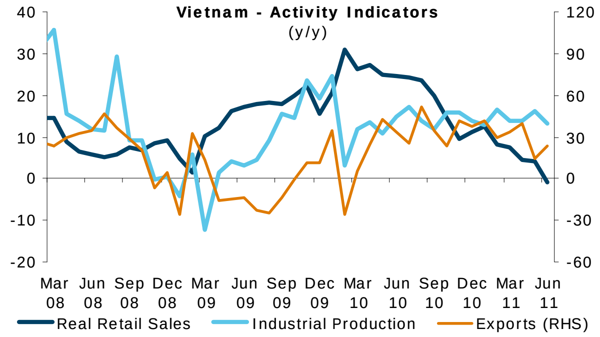
Reenee Garcia

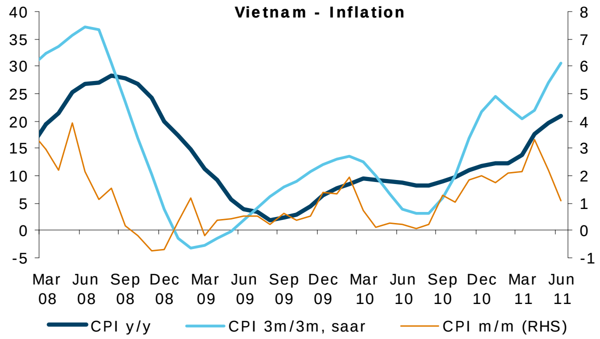
FX FORECASTS	CURRENT	YTD (%)	SEP-11	DEC-11	MAR-12	JUN-12	SEP-12	DEC-12
USDTHB	30.87	3.0%	31.1	31.4	31.2	31.1	30.9	30.6
AUDTHB	32.16	5.4%	33.6	33.9	33.1	32.0	31.2	30.3
NZDTHB	24.77	6.5%	24.9	25.4	24.6	23.9	23.2	22.3
JPYTHB	0.358	0.0%	0.366	0.361	0.351	0.342	0.332	0.322
EURTHB	40.88	4.9%	42.6	42.4	41.5	42.0	42.3	41.9
RATE FORECASTS	CURRENT	YTD (BPS)	SEP-11	DEC-11	MAR-12	JUN-12	SEP-12	DEC-12
BOT's 1-day repo rate	3.00	100	3.25	3.50	3.50	3.50	3.75	3.75

Sources: Bloomberg, ANZ Research

VIETNAM







ECONOMIC UPDATE

Vietnam will experience slower growth this year. GDP in Q2 expanded at a modest 5.7% as construction activities and trade slowed. However, inflation is still the major concern.

- GDP in Q2 climbed 5.7% y/y, up 0.3ppt from Q1, but 0.5ppt down from Q2 2010. Primary sector output rose 2.2%, while industry climbed 8.2% from 5.2% in Q1. Meanwhile, construction growth eased 2.8ppts to 4.2% and services rose 6.0%, down 0.3ppt from Q1.
- For Q2 as a whole, industrial production growth was unchanged from Q1 at 14.3% y/y. However, June real industrial production grew 13.1%, down from 16.1% in May, while retail sales growth eased to 21.9%.
- Exports and imports in Q2 grew 25.1% and 24.3 y/y, respectively, down from 35.8% and 29.6% in Q1. June exports grew 23.4% y/y, up from a revised 14.5% in May as gold exports surged. Meanwhile, import growth eased to 16.2% from 20.4% in May as most major imports declined. The June trade deficit narrowed sharply to $406m from a revised $1.4bn in May.
- CPI inflation rose to 20.8% y/y in June from 19.8% in May. Food and foodstuffs prices rose 30.2%, and contributed 12.0ppts to total inflation. Transportation prices climbed 20.3%, while housing and construction material prices rose 21.7%.
- The moderate Q2 growth was in large part due to the drop in construction growth, which was a result of tightened monetary settings. This is a positive sign, suggesting that the government is heading in the right direction towards stabilisation. We now expect 2011 GDP growth will be 5.9%, down from 6.8% in 2010.
- Despite the continued moderation in growth of real activity, inflation pressures persist and warrant continued tightening of monetary and fiscal policies. The government recently said that tight and cautious monetary policies will continue in 2012. It targets 2011 GDP growth at 6.0% and inflation at 15.0%.

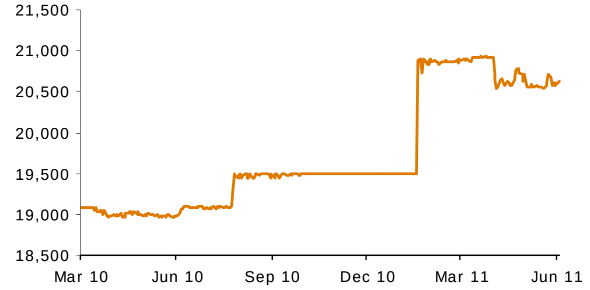
Hai Pham

MONTHLY DATA	NOV-10	DEC-10	JAN-11	FEB-11	MAR-11	APR-11	MAY-11	JUN-11
Industrial Production, % y/y	14.3	16.2	16.1	17.7	13.9	13.7	16.1	13.1
Retail Sales, % y/y	22.4	11.6	26.0	21.1	24.9	19.1	22.8	21.9
Consumer Price Index, % y/y	11.1	11.8	12.2	12.3	12.9	17.5	19.8	20.8
Exports, % y/y	41.7	37.2	41.1	29.6	26.1	39.5	14.5	23.4
Imports, % y/y	21.2	18.9	33.7	17.5	21.5	37.5	20.4	16.2
Trade Balance, US$ bn	-1.25	-1.29	-0.88	-1.11	-1.15	-1.49	-1.42	-0.40
QUARTERLY DATA	SEP-09	DEC-09	MAR-10	JUN-10	SEP-10	DEC-10	MAR-11	JUN-11
Real GDP, % y/y	4.5	5.3	5.9	6.1	6.5	6.8	5.4	5.7
Foreign Exchange Reserves, US$ bn	18.34	16.03	13.45	13.72	13.69	12.40	N/A	N/A

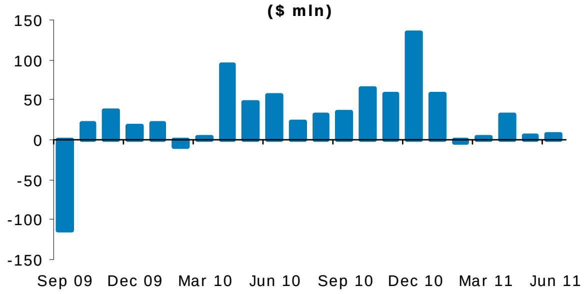
Source: CEIC, Bloomberg, ANZ Research

VIETNAM

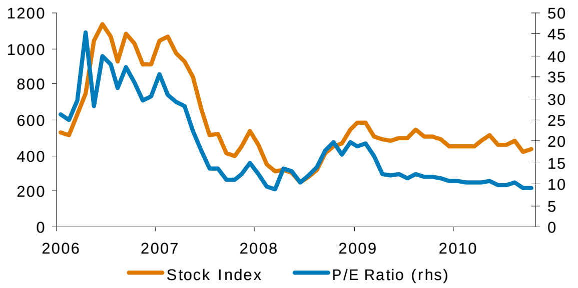
USDVND: Further devaluation is likely, but not until 2012



Foreign equity inflows remain subdued ($ mln)



Equities are well poised for a rebound (eventually)



FX AND RATES STRATEGY

The dong is now expected to hold steady into year-end. Nevertheless, still significant pressures remain, suggesting another devaluation in Q1 2012.

FX

Recent indicators out of Vietnam suggest that government measures to stabilize the foreign exchange market and restore confidence in the dong are having positive effects. Since February's devaluation, the SBV has raised official interest rates by a cumulative 500bps and has raised the reserve requirement ratio for USD deposits by 600bps. Caps on USD deposit interest rates were imposed in April, and then lowered in June (to 2.0% for retail investors and to 0.5% for institutions). Along with other administrative measures that clamped down on black market FX trading, these policies have eased onshore demand for USD.

Still, further devaluation of the dong is anticipated in 2012—most likely a move of 3-4% during Q1 2012. Notwithstanding a 30% drop against the US dollar since early 2008, Vietnam's balance of payments position remains fragile. Moreover, CPI inflation continues to rise unabated—now 20.8% (y/y) compared with 8.7% a year earlier. While our ANZ economists expect inflation to peak in Q3, it will remain in the uncomfortable double digits well into 2012. Such slow progress will continue to fuel onshore demand for US dollars.

In order to tame inflation and restore its balance of payments position, the authorities in Vietnam will need to continue to slow domestic demand. Economic growth has already slowed to 5.6% (y/y) in H1 2011 compared with a five year average of 6.4%. Key for the dong going forward is whether the authorities have tolerance for much more. For now, our bias remains for further gains in USDVND.

Tamara Henderson

Rates

The SBV continued to tighten monetary policy in May to combat inflation, raising its repo rate by 100bps to 15.00%. Although real activity growth has moderated, inflation and imported price pressures continue to rise. To manage inflation expectations, we maintain our view that the central bank needs to raise its key interest rates by another 100bps this month.

Hai Pham

FX FORECASTS	CURRENT	YTD (%)	SEP-11	DEC-11	MAR-12	JUN-12	SEP-12	DEC-12
USDVND	20,630	5.8%	20,600	20,600	21,400	21,400	21,400	21,400
AUDVND	21,482	8.3%	22,200	22,200	22,700	22,000	21,600	21,200
NZDVND	16,543	9.4%	16,500	16,700	16,900	16,500	16,100	15,600
JPYVND	25,541	6.6%	242	237	240	235	230	225
EURVND	29,129	11.7%	28,200	27,800	28,500	28,900	29,300	29,300
RATE FORECASTS	**CURRENT**	**YTD (BPS)**	**SEP-11**	**DEC-11**	**MAR-12**	**JUN-12**	**SEP-12**	**DEC-12**
SBV's refinancing rate	14.00	500	16.00	16.00	15.00	14.00	13.00	12.00
SBV's repo rate	15.00	500	16.00	16.00	15.00	14.00	13.00	12.00

Sources: Bloomberg, ANZ Research

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