LATEST NEWS AND VIEWS : ASIA

China: President Hu Jintao has said that consumption stimulus measures will be implemented in H2 2010 and that the government will focus on the quality and not quantity of trade and raise the effectiveness of government investment.
-Premier Wen Jiabao has said that the government will keep policy stable in H2 2010 while maintaining fast and steady economic growth.
-PBoC advisor Xia Bin has said that economic measures from H1 should be maintained with minor adjustments at most. Xia also added that this was a good time to push market-based deposit rate reform.
-Xinhua News has cited a PBoC researcher Wang Yong as saying that the USD/CNY trading band should be widened from its current 0.5%. Wang suggested that the band should be widened to 1% in 2011 and 2% in 2015.
-The Human Resources Ministry said that urban unemployment stood at 4.2% with 9.11mn unemployed.
-S&P credit analyst Liao Qiang has said that Chinese banks will need to raise more funds to cope with tighter capital requirements and loan growth. Liao also expects loan growth to slow in H2 2010 to leave full year loan growth at 20%; NPLs are expected to stay flat..
-The Financial News has cited CASS deputy director of financial research Wang Songqi as saying that the reserve requirement for banks should be lowered.

Singapore: China and Singapore have agreed a 3-year currency swap valued at CNY 150bn swap or USD 30bn meant to facilitate trade and investment between the 2 countries and could be extended.
-GIC chairman deputy chairman Tony Tan has said that the global economic rebound is “fragile” and shocks could push the world towards another recession “sooner than expected”. Tan also said taht developed economies will take a “long time” to recover fully and that emerging economies like the BRIC nations will gain a bigger share of investment flows.

South Korea: The OECD reports that S.Korea’s ratio of tax burden to GDP remained relatively lower than other major economies in the world. According to the report, the tax-to-GDP ratio for S.Korea stood at 21% in 2007, the sixth lowest among the OECD countries.

Taiwan: National Treasury Agency director-general Hwang Ding-fang has said that the economic recovery will boost tax revenue and the level of government debt might therefore not rise in 2011. Hwang was responding to a report in the Commercial Times saying that tax cuts might increase the government’s debt to TWD 400bn or USD 12.5bn in 2011.

India: Fin Min Pranab Mukherjee sought political consensus to introduce the new indirect tax regime GST, saying that it would be a win-win situation for all and would double the size of the economy to USD 2trn in a short span of time; the government would introduce the direct tax code bill in parliament soon. He added that inflation might slow to 5-6% in “coming months”; fiscal deficit would decline to 4.8% in FY11/12 and further to 4.1% in FY12/13; GDP expected to grow at 8.5% in FY10/11.
-S&P’s said that despite intense competition and high inflationary pressures, India’s banking sector would continue to show high growth owing to the country’s strong economic expansion.
-RBI said that it would allow overseas borrowing to refinance INR loans; would allow refinancing for infrastructure companies; refinancing bank loans would be allowed for new projects; overseas borrowing for refinancing needed RBI approval.
-Primary Articles **inflation** in the week ended July 10 rose 16.48% y/y, up from 16.25% the previous week while Fuel, Power and Light remained stable at 14.27% y/y. Food inflation stood at 12.47% y/y.
-IMD said that the **monsoon rainfall deficit** stood at 14% thus far this season.

Indonesia: Lawmakers approved Senior BI Deputy Governor Darmin Nasution as the Governor of BI. The 54 lawmakers agreed by consensus late on Thursday following two days of questioning.

Malaysia: BNM said subsidy cuts were within expectations. Inflation to rise gradually into 2011. Subsidy cuts to have minimal impact on growth, and sees no significant impact on inflation forecast.

Philippines: BSP Assistant Governor Cyd Amador said that the Philippines’ monetary policy setting was “broadly appropriate” and that any increase in interest rates would be done gradually; any adjustment would be calibrated based on the BSP’s view of inflation dynamics; cognizant of upside and downside risks to CPI; seeing good inflation numbers through 2011.
-Finance Secretary Purisima said that the Philippines’ debt strategy was to extend maturity and cut bunching up.

LATAM STRATEGY

EXTERNAL DEBT

Market Re-Cap

More Volatility, Stronger LATAM

The pendulum swung to the side of risk accumulation during Thursday’s trading session with the catalysts provided by both Europe and the US in the form of speculation related to Irish banks passing the infamous European stress tests, while the US side contributed more upbeat corporate earnings, particularly on the technology side, to enthuse equity buyers. Leftover sensation that US rates will remain low for a possible expanded period as a consequence of the less buoyant economic recovery described by FED Chair Ben Bernanke during his two day presentation before US

Congress also favored LATAM debt paper as US long yields held below critical levels. With US equity gauges advancing 2% or more, and 30-year US yields holding below 4%, it wasn't difficult to generate added momentum in LATAM, particularly with a Dollar that again weakened to 1.2900 versus Euro. Crude oil gained additional notoriety within the commodities universe, as prices hit US$79.27 for the new front month September contract, with investors eyeing storm risk as another motive to elevate prices. Regional news flow was marginal, with Brazil providing the only macro data highlight in positing a 7% unemployment rate in June, a new low for this series. Peru was awash in stories related to the need for additional measures to quell mounting appreciative pressures on the PEN, with more Dollar purchases by the CB to come. President Chavez in Venezuela went ahead and severed ties with Colombia over the latest spat related to assistance lent to FACR guerrillas. Chile moved closer to new issuance, with the pipeline apparently carrying two 10-year issues, with a Dollar tranche for US$1B and a CLP-denominated version for the equivalent of US$500MM, with roadshows apparently due next week according to Finance Minister Larrain. Again the rio of the BRL, CLP and MXN led the way on the currency front in LATAM in terms of gains, with the BRL at the head of the class in advancing 1.3%. Both the IPC and the BOVESPA rose by near 2% in tandem with US equity barometers. LATAM debt was particularly well bid again, with high-Beta solidly in the leadership position. Argentina's 2033 Discount bond reached 74 ¾'s, higher by near 2 points on the day, while Venezuela's 2027 benchmark hit 70 7/8', up 1 5/8's on the day.

Market Outlook

The bifurcation that is occurring between US equities and critical components of this economy, such as housing, remains a major theme for investors to monitor. US markets cheered that existing home sales in June had only fallen by 5.1% yesterday, less than the huge 8.1% decline expectation, but nonetheless a very poor showing. On the other hand, US equities are very concentrated on positive top line results and little else concerning expenditures and potential payroll expansions. What's interesting is the newfound rapid deterioration in US housing and the lack of influence that this feature is having on risk tolerance across asset classes, understanding that this area was ground zero for the credit crisis. Just to mention one particular area of concern, inventories have now backed up to 8.9 months worth of supply for existing homes, with the NAR speculating that we could return to double digit inventory levels in the immediate months ahead. This would certainly constitute a double dip. The seasonality component is also particularly troubling. We're in the middle of the period when home sales should be at their peak in the US. As we sail towards September, the historical trend is for sales to decline, which spells for a very difficult environment ahead. With more inventories on the way, less seasonal sales to come, and little stimulus backing the market, the logical outcome is more prices to again decline in order to establish real clearing prices. But this isn't a desirable path for US authorities, as the added negative effects on consumers would be overwhelming for the economy. Hence, additional forms of lifting this market must be on the way before the end of the US summer. The peril comes in the form of market tolerance for additional government debt and intervention in this sector. Mexico is evidently a very interested party in this discussion, so long MXN holders must have it clear that the seasonal component of US housing makes the MXN riskier going into late August. We're drifting through an area bound by excess liquidity which is lifting all LATAM boats, but storms loom ahead that could cause quite a bit of instability in the risk equation.

ASIA STRATEGY

G3Strategy

Asia saw strong gains in its equity markets with the benchmark NKY 225 rallying nearly 2%. Currency markets saw a mixed USD and weak JPY. The majors held on to overnight gains in the early part of the session and then moved lower with EUR/USD back below the 1.29 handle and GBP/USD holding at 1.5288 ahead of Q2 GDP data release. Q2 GDP is expected to post a 0.6% q/q (1.1% y/y) rise compared to 0.3% q/q (1.4% y/y) rise in the first quarter. GBP could move to target the 1.53 handle again if the data prints as expected or better. USD/JPY also moved below the 87 handle in the afternoon Tokyo session. The JPY erased much of Thursday's Asian gains as better earnings and Euro PMIs boosted risk appetite.

EUR trimmed early gains and moved to 1.287 despite better expectations for IFO following from Thursday's PMI. The Euro zone stress tests are due for release after the close of the Europe session but rumour has it they could be released ahead of time. Nevertheless, we would recommend going short EUR/USD and EUR/JPY. Optimism has begun wearing off and with most of the positive news already priced in, market participants could look to sell the EUR once again.

CHINA - Finally coming out

After reiterating continuously that the government's supportive policy stance will be maintained through H2 2010, President Hu Jintao finally came out to say explicitly that consumption-boosting stimulus measures will be introduced in H2 2010, which should banish more doubts about whether the government will indeed maintain its stance. Also somewhat less forthright was Hu's statement that the government will raise the "effectiveness" government investment, which we would assume would indicate a shift to the interior, especially the western regions. As for Hu's other comment about focusing more on the "quality" rather than the "quantity" of trade suggest an attempt to move up the value chain. However, this is going to be slow for China given the nature of its capital thus far and employment needs. Rather, we'd assume that the trade comment was meant to provide a rationale for letting the CNY appreciate - price competitiveness plays a smaller role as the value-add of exports increases, at least so the theory goes. This, in conjunction with the tweaking of government investment should continue to provide sufficient impetus for the appreciation of the CNY. As for consumption, a greater reliance on that growth engine will mean a greater incentive to restrain CNY strength. However, for now, Chinese domestic products are likely to enjoy a sufficient cost discount over foreign consumption imports so a 10% appreciation in the CNY over 12 months is hardly going to render domestic products uncompetitive. Add to that the fact that investment accounted for 60% of H1 growth compared to 35% for consumption and it is quite clear there is sufficient reason to let the CNY appreciate still.

SINGAPORE - Faux skittishness

The GIC's bearish comments about the global economies and developed markets in particular might just be considered a little self-serving given the market has been turning to Asia as an alternative to the developed markets because of Asia's strong fiscal health in general and sterling growth prospects. Singapore has oddly enough found itself at forefront of these 2 aspects and stands to benefit from any move in capital from the developed markets in search of safe exposure to Asia. Furthermore, the recently signed 3-year USD 30bn swap agreement with China can only help increase access to Asia's biggest market and growth engine. However, China's intimations about its stimulus intentions could soon see interest move along to economies more directly linked to China's growth, like Malaysia. For now then stay out of the SGD/MYR but look for good levels to short thte pair.

SOUTH KOREA - Stand aside

The Won edged up on risk sentiment this morning with the USD mixed against the regionals. The Won was stronger ahead of its Q2 GDP release on Monday. This could possibly set the stage for another hike of 25bps. However, we think that a move so soon would be a tad premature despite inflationary pressures. The BOK continues to monitor developments overseas, especially in the Euro zone. USD/KRW traded lower around the 1198 handle this morning while the KOSPI moved down 13 points to 1749. Trade is likely to trade range bound as we near the release of the Euro zone stress tests results. Waning risk appetite in the G10 space suggests that the market could be mixed with regard to the USD and for now, the KRW might chart price action. We would recommend sitting on the sidelines until the NY session to gauge where risk is headed for the coming week.

INDIA - Another hike in repo and reverse repo rates on the cards

The key event this week will be the RBI meeting on Tuesday. The two key monthly inputs that the RBI likely considers when deciding on rates is the IP data and the inflation data. Following the weaker than expected IP data there were some quarters of the market unsure about whether the RBI would bite the bullet again and hike interest rates at its upcoming meeting. However, strong inflation data subsequently and further evidence that inflation is becoming more generalised, has pretty much sealed the case for the authoritiy to venture another 25bps hike in both the repo and reverse repo rates on Tuesday. This is evinced in consensus expectations in newswire surveys for a hike of 25bps in both. We concur. This should come as no surprise and indeed the RBI has expressed comfort with a "calibrated" exit from accommodative monetary policy which sets the stage for further hikes following this meeting. Indeed, we are looking for another 50bps worth of hikes in Q410 (in two steps) and then 25bps each in Q111 and Q211 as the RBI seeks to anchor inflation expectations and gradually bring rates back to neutral given the strong growth outlook for the economy.

INDONESIA - Upside moves to be limited

USD/IDR continued to edge higher, although the gains were limited. Rupiah weakness was seen despite the Jakarta stock index rising 1.2% on the back of improved risk appetite in global equity markets. The rupiah was one of the weaker regional currencies, with most others recording gains against the USD. The approval by lawmakers of Senior BI Deputy Governor Nasution as the new Governor of BI seems to have been ignored by the markets. Range trading continues for the pair and upside moves are likely to be limited especially if USD weakness against the regionals persists on continued risk appetite. The immediate resistance for USD/IDR is at 9185, which is a fair distance away and unlikely to be touched unless there is some significant shock to the global financial system. Near-term bias continues to be for moves within the 9000-9100 range, while out multi-month bias is for the pair to head lower towards 8950.

PHILIPPINES - May imports due

The stronger than expected showing on May exports data continued to confirm that the Philippine economy is holding its own helped not least by the external sector on the global economic recovery with strong Asian growth a key ingredient. In fact, after the US and Japan, Singapore, China and Hong Kong were the next 3 key destinations for Philippine exports with shares of 10.4%, 9.2% and 8.5% respectively. As such, imports should post robust growth in the month given the high import content in exports and rising domestic demand. Risk sentiment to determine directional bias for the pair though.

THAILAND - Month end data due

The barrage of month end data out of Thailand is due this coming Friday. The data should continue to evince that the economy continues to be powered by the external sector with the trade surplus likely to come in strong as indicated by the Customs trade data. With regards to Services receipts, we would expect tourism receipts to have stabilised following political tensions having diffused further by June. With global risk sentiment in June having taken a turn for the better as compared to May, we would expect capital account flows in the month to have also improved to make for a better BoP picture overall. USD/THB though will trade according to the USD/regional trajectory.

ARTICLES

EUROZONE: JULY PMI SURVEYS POINT TO STRONGER GERMAN IFO

The July Eurozone sectoral PMI surveys turn out firmer than even our own above-consensus predictions for an acceleration in the rate of activity expansion. The flash Eurozone manufacturing sector PMI rises to 56.5 from 55.6 in Jun and in contrast to the market prediction of a fall to 55.2. The flash services PMI rises to 56.0 from 55.5 in Jun, compared to the market expectation of a fall to 55.0. As **such the composite PMI rises**, as we suspected it would, to 56.7 from 56.0 in Jun, vs the market consensus for a fall to 55.5. Markit, the compiler of the survey, attributes the strength in activity to the effect of the World Cup tournament, which is expected to be temporary.

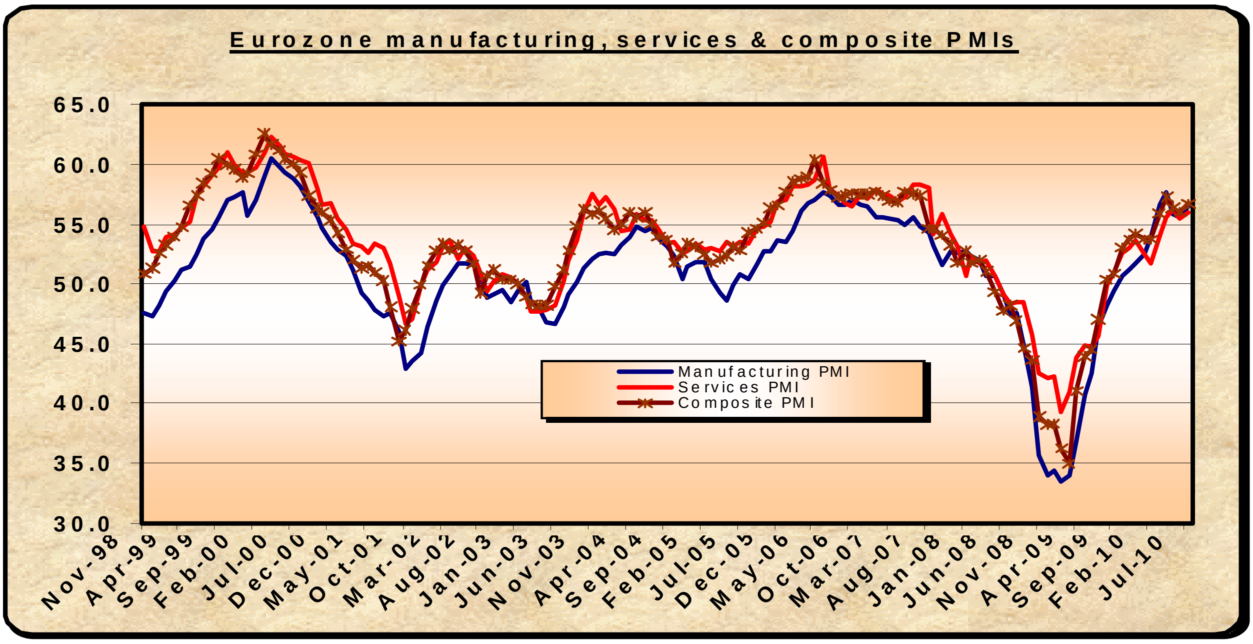
The increases in the Eurozone sectoral PMIs are consistent with recent evidence of the strengths seen in the Eurozone Sentix and German ZEW current conditions sub-indices for Jul. **And we note that stronger advances in Germany have driven the surge in Eurozone activity** for the most part. What's also interesting is that the Jul services PMI increase actually bucks the downward trend in the average stock market indices during the month, despite their 0.70 correlation. This suggests the world Cup influence, combined with some services firms benefiting directly from the strength of an expanding manufacturing sector, played an overwhelming role.

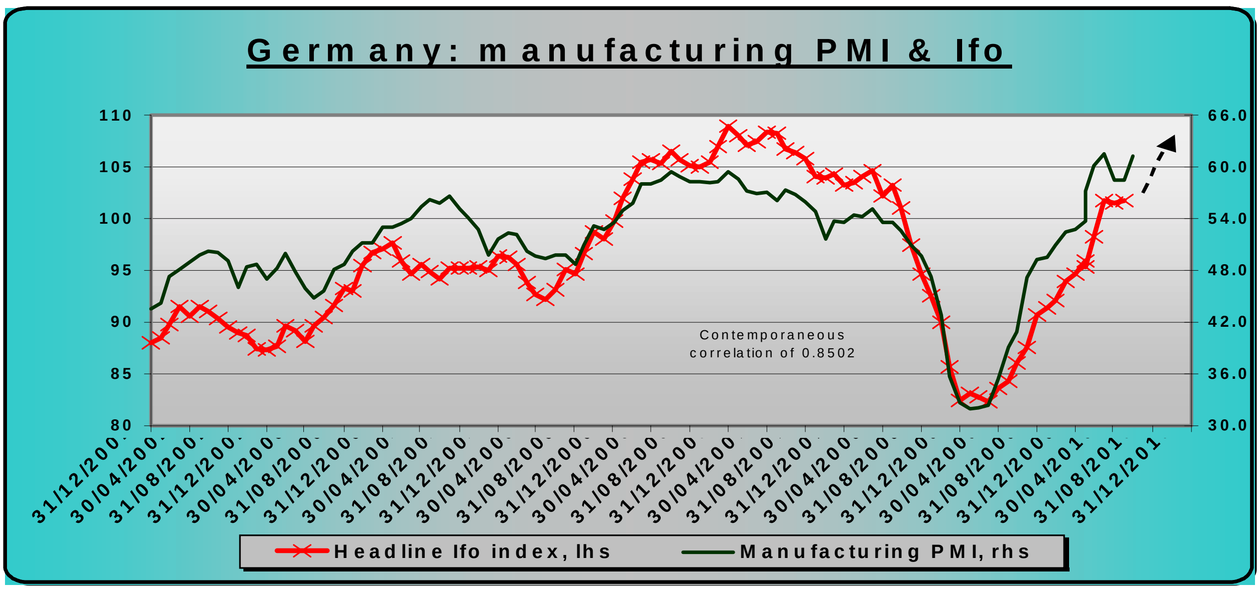
(see graph next page)

New York	London	Singapore
tel: +1 212 835 1300	tel: +020 7664 0200	tel: +65 6332 0700
fax: +1 212 835 1301	fax: +020 7664 0201	fax: +65 6332 0701

But even with the resultant rise in the flash composite PMI to 56.7, this still doesn't detract from the fact that the start of Q3 is seeing overall Eurozone activity proceed on a more sedate footing than was witnessed at the beginning of Q2**. This adds to the view that Q3 GDP growth in the Eurozone will likely turn out softer than the rate expected to be recorded for Q2 (at least 0.6%-0.7 q/q)**. This is the more so if the composite PMIs for Aug/Sep show an easing from here.

But for the more immediate term, **the latest manufacturing PMIs for both the Eurozone and Germany in particular, support our forecast of a stronger German headline Ifo business climate indicator for Jul,** when the latter survey is published on Friday. Indeed, based on the strength of the Eurozone Sentix and the German ZEW current conditions sub-indices, it was already looking as though a higher German Ifo business climate indicator would be recorded for Jul, (to 102.0 on our forecast), from 101.8 in Jun. The PMI surveys serve to underpin our expectation and we wouldn't be surprised to see an Ifo headline indicator for Jul that even exceeds our above-consensus prediction (market seeks a fall to 101.6). **In principle, this would be supportive for the EUR.** *(see graph)*

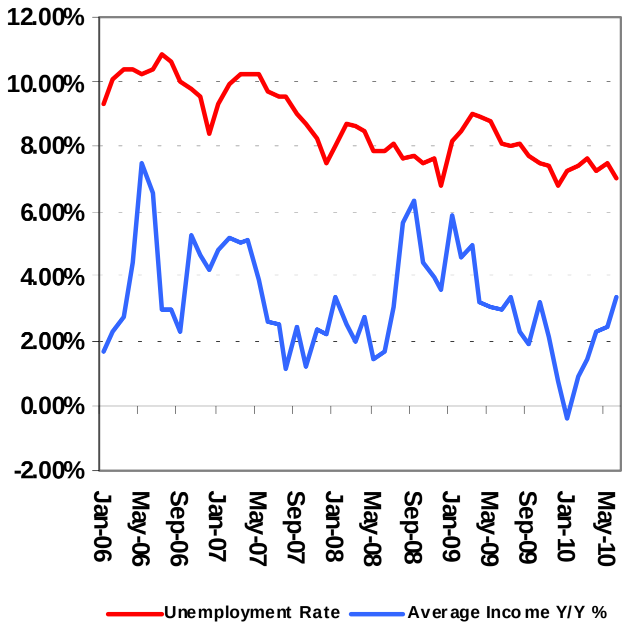




BRAZIL
UNEMPLOYMENT ACCELERATES DECLINING TRAJECTORY

Unemployment numbers for the month of June in Brazil again described a very optimistic scenario on this plain. Headline figures for unemployment dropped to 7.00% in June, the lowest level in the survey provided by IBGE since March of 2002 and well below the 7.3% target drawn by the markets. It's important to note that comparatively, the June figure of 7.00% is a full 50 bps below the strongest employment level encountered during the pre-credit crisis boom times (7.50% in December 2007 and later in October 2008). Average income figures tabulated on a y/y basis were also solid, though less impressive in their level of overall growth. Average income rose by 3.35% y/y for the month of June, with the BRL figure of 1,435 per month the highest on record since the series has been published. On a metropolitan basis for unemployment, the drop below 6% for Rio was noteworthy for its magnitude, as was the 7.4% tally for Sao Paulo, above the national average, but now 1.60 below the 9.00% levels of June 2009. All around both the unemployment and the wage figures looked supportive of added strength in consumer activity and discretionary spending, both positives for the economy, but still tricky for monetary policy objectives.

BRAZIL - Unemployment Rate and Average Income



ASIA BONDS

Growth fears appear to be the main risk driver for now and this is based both on the inherent slowdown in China and the more recent fears of slower US growth over the medium term. We do not really buy this view and view Asia's economy as being more de-coupled than it's ever been but for the near term, many in the market will remain unconvinced.

CHINA - Growth worries to grow

After sliding for the last 2 weeks, bond yields seem to have reached an impasse as has the slide in the USD/CNY. Market commentary seems to perceive the salient link between the 2 is growth, with doubts over that leading to a cessation in the appreciation of the CNY. That more muted view of China's growth coupled with the uncertain trajectory of the USD/CNY has perhaps dampened the enthusiasm for Chinese assets across the board, bonds included. Adding to these growth worries is the prospect of even slower US growth, which is still perceived in many quarters as being the key growth driver for China, despite the Chinese government releasing calculations that show net exports contributed less than 6% of H1 2010's growth; investment is by far the biggest driver at almost 60%. While the slowdown is indeed very real, it is not going to be a hard landing that might potentially threaten the banking sector; these fears are overblown to say the least. Going forward though, these fears though do like they have some distance to run given that there isn't like to be any hard evidence that a slowdown isn't happening because it is. The market will need to work through its angst and during that time we could see a mild flattening, although it is possible worries about local government debt repayment capacity might support longer-dated yields.

SINGAPORE - Weathering it out

With growth concerns back in the market, it is evident that large segments still cling onto the notion that the US makes Asia tick and slower US growth slows China and in turn the rest of EM Asia. This of course conveniently ignores the fact that a larger share of China's exports goes to the EU than to the US and H1 2010 growth has hardly relied on net exports. For the moment though we expect that this pessimism will persist for a short while and during that time the flattening in Singapore's yield curve will continue - albeit at a slower rate - as many investors from around Asia seek refuge in Singapore's safe haven status.