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- Daily insight into the USD/Regionals

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- 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.

NEWS AND RUMOURS

(Hit ASIA2 on Reuters or IDAS1 on Bloomberg)

- **US:** At least 5 of the 6 Greek banks being stress-tested will pass, according to the WSJ. **Bernanke** said on Thurs that in short term, should maintain a reasonable degree of fiscal stimulus; longer term need to take steps on controlling deficits. Labor market situation 'unsatisfactory.' Repeats options for Fed going forward would include reducing interest on reserves, buying more securities if conditions warrant. Said our baseline scenario is as effects of financial crisis pass, moderate growth in economy will be seen. Adds European situation is improving, confidence coming back. Although some US data has been disappointing, Fed has no basis to radically change its outlook.
 - Fed Chairman **Bernanke** says **unemployment** is the most important problem right now. Most modeling exercises suggest fiscal policies created 1-3 million jobs. Hears often from businesses about uncertainty delaying investment but can't quantify it. Fed could reintroduce some special lending programs in unlikely case of spillover from Europe debt crisis. 'Unusually uncertain' comment was based on latest Fed survey of its members, majority of whom said conditions were more uncertain than normal
 - **White House's Summers** says on CNBC news that need to raise bank capital standards without choking off flow of credit needed for recovery. Obama administration watching economy closely, will do what's necessary to sustain growth.
 - The US House voted in favor of restoring **emergency unemployment benefits** for 2.5mln unemployed, sending the measure to President Obama.
 - **US June Conference Board leading economic indicators report** revealed an overall decrease of -0.2% m/m, versus the revised +0.5 m/m reading seen in May (prev. +0.4% m/m), above market expectations for a -0.3% m/m decrease. Despite this decrease gains were posted in 5 of 10 measured categories. Overall, the greatest sources of

weakness came via average workweek, pace of deliveries, stock prices and initial jobless claims. Meanwhile, improved readings were seen from interest rate spread, money supply, consumer expectations, building permits and consumer goods orders, alongside an unchanged reading from capital goods orders. IDEA: Alongside the decrease seen in the headline measure, we continue to expect further GDP gains in 2Q10, though likely to see some deceleration to around 2.8% following the broader sense of weakness seen in recent data.

- **US Initial jobless claims** for the week ending 17 July increased +37k to 464k, versus the revised 427k reading seen in the week prior (prev. 429k), above market expectations for an increase to 445k. The 4-week average was reported at 456.0k, versus the revised 454.8k seen in the previous week (prev. 455.3k).

- **US June NAR existing home sales** report revealed an overall decrease of -5.1% m/m (to a SAAR of 5.37mln), versus the unrevised -2.2% m/m decrease (SAAR of 5.66mln) seen in May. This comes in above market expectations for a decrease to SAAR 5.10mln (-9.9% m/m). Meanwhile, inventories increased +2.5% to 3.992mln (8.9 months' supply), while the median price managed to post a +5.2% m/m increase to \$183.7k (+2.7% y/y).

- **Housing price index** for May rose 0.5% vs. expectation of -0.3%. April was revised higher to 0.9% from 0.8%.

- **NY Fed Pres Dudley (voter)** says road to US economic recovery "a bit bumpy" as relatively weak consumer spending, ongoing financial market problems weighing on recovery. Economic growth "far less robust" than Fed would like. Sees only "slight risk" of a double-dip recession and US economic growth may be a bit less in Q3 than in 1H'10. Improving domestic, foreign demand should continue to drive us manufacturing output. Adds June payroll numbers tell story of sluggish jobs recovery.

- The Treasury has announced the sale of **2Yr notes (\$38.0bln)** on Tuesday, 27 July), 5Yr notes (\$37.0bln on Wednesday, 28 July) and 7Yr notes (\$29.0bln on Thursday 29 July) with settlement on Monday, 2 August. These estimates are roughly in line with expectations with the 5Yr coming in around \$1.0bln more than some estimates.

- **Canada's Monetary Policy Report:** BOC worried about European debt crisis and uneven global recovery making outlook highly uncertain. It revised its GDP forecasts lower for the next few quarters: Q2 to 3% from 3.8%; Q3 to 2.8% from 3.5%; Q4 to 3.2% from 3.5%; Q1 2011 to 3% from 3.3%; and the rest of quarters will be higher than previously forecasted. Inflation will remain mild and BOC expects the loonie to weaken; thus, helping its export growth in 2010 and 2011.

- **BOC Carney** says he doesn't expect Canadian households to increase savings; believes in the quality of Sta-

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tistics Canada, despite the changes it is making, but will look at the integrity of the proposed changes; doesn't believe in double dip for the US; BOC is not preordained in interest rate moves.

- **EIA report revealed U.S. weekly natgas** stocks up 51 bcf, versus forecast of 53 bcf build. Natgas producing region up 6 bcf in latest week while consuming region east up 41 bcf, west up 4 bcf.

- **Crude** closed the day up \$2.74 that is 3.58% higher to settle at \$79.30 a barrel as some of the upbeat corporate earnings reports brought optimism to the investors on higher demand for crude.

- **Asia:** The **ADB's Srinivasa Madhur** has said that China may raise interest rates in 2010 to cool price pressures. Madhur also added that China needs to normalize monetary policy by a combination of currency appreciation and interest rate adjustment. Madhur also said that Indonesia and Philippines can't wait too long to raise interest rates.

- **China:** **European Trade Commissioner Karel de Gucht** has said that China's holding of EUR bonds is not risky and that he is "quite confident" the EUR is in good shape. De Gucht also called for a dismantling of barriers to economic integration with China and attract more FDI from China, which currently stands at only 2-3% of all FDI. De Gucht also added that China is "visible" in European investments such as purchases of government bonds, particularly Spanish and Greek bonds.

- The United Daily has cited **Commerce Minister Chen Deming** as saying that China will not withdraw its domestic consumption stimulus because the uncertainty in the global economy can't secure export growth although the report did not mention any specific measure.

- **The executive secretary of the Economic Commission for Latin America and the Caribbean Alicia Barcena** has said that booming trade ties with China has helped Latin America to rapidly recover from the global financial crisis.

- **Standard and Poor's** has said that Chinese banks face rising credit risks and their NPL ratios are likely to climb as the economy slows and lending for government projects come due for repayment. S&P added that these loans account for 18-20% of total lending but that the "sufficient strength" in the banking industry warrants the "stable" outlook on the banking sector.

- The National Business Daily has reported that the government will begin levying a property tax in several cities starting in 2012.

- **Taiwan:** **Trade negotiator Chiang Pin-kung, chairman of the Taipei-based Straits Exchange Foundation**, has said that Taiwan will look to sign free-trade accords with Singapore, Japan and countries in southeast Asia.

- **India:** **PM Singh's adviser C Rangarajan**, will submit his economic outlook report for FY10/11 on 23 July.

- **Asim Dasgupta, head of the group of state finance ministers examining India's GST** said that the tax would not include gasoline and alcohol products; he said that they were trying very hard to meet the 2011 deadline for the GST; the states would discuss GST rates before the decision.

- **Fin Min Mukherjee** said that he planned to introduce a new tax regime with different rates for goods and services starting April 2011. Essential goods would be taxed at 6%, below the standard rate of 10%; services would be taxed at 8%. The standard rate of 10% might be cut to 9% in the second year and 8% in the third he added.

- **Y.V. Reddy, former RBI Governor** said that India's real challenge lay in managing the country's fiscal situation.

- **South Korea:** The **US said Wednesday it will blacklist** more North Korean entities and individuals within two weeks to cut off money flowing to its leaders through the trafficking of weapons of mass destruction and counterfeit and luxury goods in violation of U.N. resolutions.

- The **OECD** said that the cost of insuring **S.Korea's sovereign debt** against default ranked the 11th highest among the world's major economies in the first half of the year. CDS spreads for S. Korea's dollar-denominated currency stabilization bonds came in at 102.55bps in H1 2010.

- **S.Korea's financial regulators** are increasing efforts to reduce banks' rising delinquency of construction loans. The Financial Supervisory Service (FSS) is currently conducting a stress test of project financing (PF) loans issued by 17 local banks, according to bank officials.

- **Philippines:** **Finance Secretary Purisima** said that the government was confident to stick to its H2 budget; would not make the same mistake on spending in H2; to spend money wisely; Philippines 'more disciplined' than previous administration; suspects businessmen in smuggling cases 'fronts'; Customs, BIR working together on cases.

- **Budget Secretary Abad** said that the Philippines would probably review its revenue and spending plans this year to keep the deficit within the PHP325bn ceiling.

- **Indonesia:** **Finance Minister Agus Martowardojo** said that Indonesia will keep its 2010 inflation estimate at 4% to 6%. Added that the economy may expand 5.9% this year.

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FX STRATEGY**G3 STRATEGY**

Risk sentiment reversed on Thursday as investors turned their attention to stronger data and earnings. Overnight, there were above consensus European manufacturing and services numbers, along with improved UK retail sales figures. Healthier Q2 earnings reported by several US companies, and better than expected US existing home sales (-5.1% vs. -9.9% expected in July) helped continue the positive momentum. All risky financial assets rallied. Equities were up all day and finished about +2%. Treasuries bear steepened with 2/10 spread at 236 bps. Both crude and gold each gained about \$3. The majors were higher against the USD and the JPY. EURJPY and EURUSD added about one big figure each, settling near 112 and 1.29 respectively. USDJPY was lower overnight on the continuation of the risk aversion theme experienced on Wednesday, after Bernanke's testimony, but headed higher after the release of the European data. USDJPY settled around the 87 handle, same level it was on Wednesday afternoon NY time.

These are volatile markets as pricing makes 180 degree turns abruptly within one or two days. As everyone waits anxiously for the EU stress tests, we feel that the market has already priced in a favorable result for Europe, since European officials have been commenting confidently about their preliminary findings. Therefore, we feel the risk for EURUSD is to the downside. If the results do not satisfy the investing public, be it that there were too many banks that failed or the tests weren't severe enough, euro should sell off. If the results please the markets, traders would have expected that and would turn their focus to the strength of the European economy going forward. Regardless of the European PMI releases on Thursday morning, we feel that the austerity measures will weigh on the growth prospects of Europe, which will be negative for the euro. If the test shows most European banks are in solid shape, expect a knee-jerk pop in the euro. We would sell into that rally. Short EURUSD and EURJPY after the results are released. Also, stay short GBPJPY.

CHINA - Interesting comments

It's interesting that EU's trade commissioner was so forthright about stating that China has been "visible" in purchases of Spanish and Greek government bonds. Surely such a declaration would have been cleared with the Chinese first, which then begs the obvious question of what are both sides trying to achieve. The most obvious answer is support for both these bonds, followed closely by support for the EUR. Much has been made about the Europeans apparently being quite keen on the EUR staying weak but this action and recent comments by the Chinese suggests that policymakers in both economies are actually bolstering the EUR during a period of EUR strength, something that seems to run counter to the aforementioned assertion. From the China angle though, this merely supports our belief that reserves rebalancing will continue.

SINGAPORE - Looking for safety

Risk aversion, this time arising from growth worries, appears to be making a brief comeback after US Fed Governor Bernanke

poured cold water on US growth prospects. This comes amidst simmering concern about China's own growth prospects. We expect this to be fairly shortlived though given the growing belief in decoupling, however, for now the SGD looks set to be the EM Asia currency of choice given its safe-haven status.

SOUTH KOREA - Risk weighs on Won

Equities headed South in Asia once again given the over 1% drop in the Dow overnight. The USD was stronger in Asia with the Won falling by as much as 0.26% compared to weakness in the G10 space. USD/KRW traded around 1207, barely changed from Wednesday's levels. The US announced that they intended to blacklist those entities that were involved in funding activities for the DPKK. We expect that the North will retaliate with some rhetoric but interestingly the market appears to have been focused on Fed Chairman Bernanke's slightly dovish comments and there is clearly no threat of tensions for now. The USD continues to chart price action and we expect the volatility to continue until the end of the week. Safe haven buying of the USD persists and is likely to hold even if Bernanke's warns of weakening US fundamentals. Look to stay long USD/KRW.

INDIA - Awaiting economic outlook report

On Friday, PM Singh's adviser C Rangarajan, will submit his economic outlook report for FY10/11. This is usually released just before the RBI meeting, which this time round happens the coming Tuesday. The report is likely to highlight concerns over inflation and we expect the RBI statement to similarly continue to sound hawkish. This should set the stage for another rate hike at Tuesday's meeting. The USD/INR though has been inching higher not only on the uptick in risk aversion in Wednesday offshore trade but also recent large USD demand from a couple of corporates. Next tech level to target is 47.450 ahead of 47.650 thereafter, though techs expect the 47.450 level to hold for a while. Go with the flow in the s-t.

INDONESIA - Range trading to continue

The rupiah weakened for the second straight day against the USD as risk aversion in the equity space saw the Jakarta stock index down 0.3%. Finance Minister Agus Martowardojo said on Thursday that Indonesia would keep its inflation estimate for 2010 in the 4% to 6% range. He added that the economy may expand 5.9% this year. This outlook for stable inflation as well as strong growth has been on the radar of market participants for quite some time, and will continue to support rupiah strength over the coming months. In the near-term, the pair is expected to stay in the range we have been mentioning for the past week, namely between 9000-9100. While momentum may be shifting towards an upside move towards the upper level of the said range, given the 50-day moving average is now above the 100-day moving average, this could easily reverse if a sustained bout of risk appetite returns. We would need to see a significant shock to the global financial system for the pair to break above 9200 on a multi-week basis.

ASIA BONDS**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.

SOUTH KOREA - More flattening

Equity markets traded slightly down this week but with risk aversion persisting in FX markets, most of the yields were down this week on safe-haven buying. Investors bought heavily into the 3yr, 9yr and 10yr Korean bonds as was evident by the decline in yield levels. The 10yr yield came off slightly from the previous week at 5.02% (prev 5.05%). South Korea continues to hold safe appeal given rising debt troubles in the Euro zone as domestic bonds continue to attract overseas investors in search of stronger economic fundamentals. Over the month, investors continue to favour the longer end of the curve.

It is unlikely that the BoK will move at their next meeting, having recently delivered on a 25bps hike. Developments in the Euro zone continue to cast a cloud of uncertainty over regional monetary policy yet the stress tests results could provide the market with a much needed breather from volatility.

INDIA - Flattening to resume

With growth on a very strong footing - note the IMF's recent upward revision of the country's GDP growth forecast to 9.4% - and inflationary pressures becoming more generalized, consensus expectations are for the RBI to follow through on its recent inter-meeting hike in the repo and reverse repo rates with another 25bps hike next Tuesday. We concur with this view. As such, despite moves to the contrary over the past week, we expect an overall flattening bias to resume, led by the short end. Long end bonds should continue to relatively outperform given positive developments on the fiscal front such as the recent move to deregulate fuel prices.

INDONESIA - Potential for curve to steepen

Bond yields rose across the curve over the past week. The yield curve saw a parallel shift up with the 2s/10s spread remaining unchanged at 139bps. Bond investors seemed to have booked profits this week, and despite losses in equities over the past couple of sessions, the Jakarta stock index has still managed to gain around 1% since last Wednesday. Over the past month, bear and bull steepening pressures have seen the curve steepen with the 2s/10s spread widening around 9bps to its current level. Recent comments by BI officials as well as the Finance Minister suggest that the authorities are maintaining their view for inflation to stay below the 6% level in 2010. Higher electricity prices will no doubt push inflation higher in the coming months, but the authorities do not seem unduly concerned for now. We still expect a rate hike from the BI later in Q3 or possibly in Q4, and this will no doubt see further interest from investors in the longer-term bonds. In the coming week, a resumption of risk appetite could see investors preferring the equities to bonds, and which could see the curve bear-steepen with the 2s/10s spread widening to around the 142bps level.

PHILIPPINES - Bonds to hold their own

Yields inched up across the board the Philippine yield curve over the past week. However, we expect Philippine bonds to generally be in favour multi-week. The key driver of course is that monetary policy is likely to be on hold for some time yet - we have pushed out our expectations of a resumption in the rate hike cycle to Q410 at the earliest in light of the BSP's dovish leaning. And secondly, the incoming administration has been making all the right noises over the fiscal deficit with a host of comments seen recently. Among the latest in this regard is Finance Secretary Purisima saying that the government was confident to stick to its H2 budget and that the current administration was 'more disciplined' than the previous administration. Budget Secretary Abad also said that the Philippines would probably review its revenue and spending plans this year to keep the deficit within the PHP325bn ceiling. It now remains for the administration to live up to their promises in this regard but the market seems willing to give it the benefit of the doubt. So while yields did inch up, we expect this to reverse in coming weeks.