

Daily Breakfast Spread

DBS Group Research

11 February 2010

Economics

Greater China, Korea

- KR:** The Bank of Korea left policy rate unchanged at 2.0% this morning. Growth moderation and housing market stabilization suggest that there is less urgency to hike rates soon. Real GDP decelerated to 0.7% (QoQ saar) in 4Q09 following two quarters of double-digit growth in 2Q-3Q09, along with stimulus effects wearing off. Yesterday's data showed that unemployment rate rebounded to 4.8% (sa) in Jan10 from a revised 3.6% in Dec09. Employment growth has turned slightly negative (-0.1% MoM sa in Jan10) because of reduced job creation in the public sector.

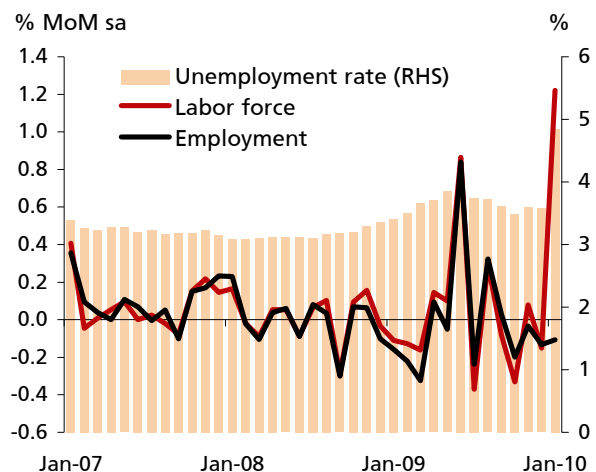
On the other hand, the housing market is stabilizing thanks to stricter mortgage rules imposed by the financial regulator. Mortgage loans rose KRW 0.6trn MoM in Jan10, significantly lower than the monthly increment of KRW 1.6trn averaged in 4Q09. The YoY growth rate in mortgage lending has slowed to 10.0% in Jan10 from the peak of 11.9% in Aug09. Housing prices have also eased to 0.1% (MoM) in Jan10 from 0.7% in Sep09.

That said, our view of economic recovery and interest rate normalization remains unchanged. Growth slowdown in 4Q09 was partly technical. Aggregate demand has already returned to precrisis levels prior to 4Q09, fully offsetting its collapse during the 2008 crisis. Meanwhile, the rebound in January unemployment rate was largely attributed to an expanding labor pool, as people re-entered the job market on recovery expectations.

The growth in labor force jumped 1.2% (MoM sa) in Jan10, and the labor participation rate has bounced back to a 7-month high of 61.1% (sa).

So long as the uptrend in aggregate demand and prices remains intact, a removal of the extreme policy accommodation (exceptionally low interest rates over an extended period) will be required. We expect the BOK to hike rates from 2Q10.

KR: The labor market indicators



US Fed expectations

Implied fed funds rate

	Mar-10	Jun-10	Sep-10
Market			
Current	0.15	0.20	0.36
1wk ago	0.15	0.19	0.32
DBS	0.25	0.25	0.75

Source: Bloomberg fed fund futures

Notes: Given a FF target rate of 0.25%, an implied FF rate of 0.30 is interpreted roughly as the market pricing in a 20% chance of a Fed hike to 0.50% from 0.25% (30 is 1/5th of the distance to 50 from 25). DBS expectations are presented in discrete blocks of 25bps, i.e., the Fed moves or it does not. See also "Policy rate forecasts" below.

Southeast Asia, India

- IN:** We have pushed out our rate hike view to April 2010 instead of 1Q10. We also adjust our 2009-10 (Apr-Mar) inflation forecast to 3.2% from 2.6% in reflection of the higher-than-expected food and fuel price inflation. This forecast implies that inflation should rise to 8.2% by end-Mar, similar to revised Reserve Bank of India (RBI) expectations of 8.5%.

In its quarterly policy meeting on January 29, the RBI hiked the cash reserve ratio (CRR) by 75bps to 5.75%, greater than market expectations for a 50bps hike. Our expectation was for a 25bps hike in the CRR but also a 25bps hike in the repo and

reverse repo rates. We think the RBI's 75bps CRR hike is a strong move notwithstanding the abundant liquidity in the system and by itself should imply no more rate hikes in 1Q. In addition, at its post-policy conference with analysts which we took part in, the RBI suggested that inter-meeting moves are unlikely unless inflation rises by more than it expects (8.5% by Mar10). The overall sense we get is that the RBI would be somewhat slower to hike rates than we initially expected because it (and the government) are worried about the impact of early and swift rate hikes on growth. At the same time, the RBI is almost as worried as we expected about inflation. Therefore, the RBI's strategy appears tilted towards greater use of CRR than rate hikes in the early phase of policy normalization. We now expect a 50bps rate hike in 2Q, 3Q and 4Q taking the repo and reverse repo rates to 6.25% and 4.75% respectively by end-Dec 2010. Another 75-100bps of CRR hikes are likely through these quarters, especially in 2Q and 3Q.

- **ID:** Fourth-quarter GDP came in stronger than expected yesterday, but it was not quite of the quality we were looking for. The economy expanded a real 5.4% YoY, beating our forecast of 5.1% YoY. Rough estimates suggest that this translates into sequential growth of 1.5% (seasonally adjusted), matching that seen in 3Q09.

Still, we were a tad disappointed by the underlying numbers, with headline GDP growth having been boosted by much stronger than expected government spending and a smaller than expected reduction in inventories. Government spending was up 17% YoY, accounting for 1.8%-pts of GDP growth, while inventories took away just 0.3%-pts.

In contrast, the growth in consumer spending, investment and exports was considerably weaker than we had expected. Consumer spending slowed to 4.0% YoY (DBSf 4.6%), from 4.7% YoY in 3Q09. Our back-of-envelope calculations suggest that this translates into a mere 0.2% QoQ sa rise. Whether consumer spending was indeed that weak can only be confirmed upon availability of the complete set of data, but in any case the weakness in the YoY number alone is surprising, considering the strength we saw in indicators such as motorcycle sales during the quarter. Meanwhile the pace of investment growth, while accelerating on a YoY basis (4.2%, from 4.0% in 3Q09), appears to have halved on a sequential basis, to 1.7% QoQ sa. Again, puzzling, given the surge in capex indicators such as cement consumption. Finally, exports did turn positive on a YoY basis as we had expected, though not as strongly as we had hoped for, at 3.7% YoY from -8.2% in 3Q09. On a sequential basis, exports were up 8.0% QoQ sa; though this was the fastest pace since Sep04, we had hoped for a rise of over 10% QoQ sa, based on merchandise trade data.

All in we were slightly disappointed by the underlying GDP numbers. It is plausible that certain components, eg. consumer spending, experienced some volatility owing to lumpiness in fiscal policy measures. Still, looking ahead we continue to expect quality growth to return, and for YoY growth to average 5.5% this year.

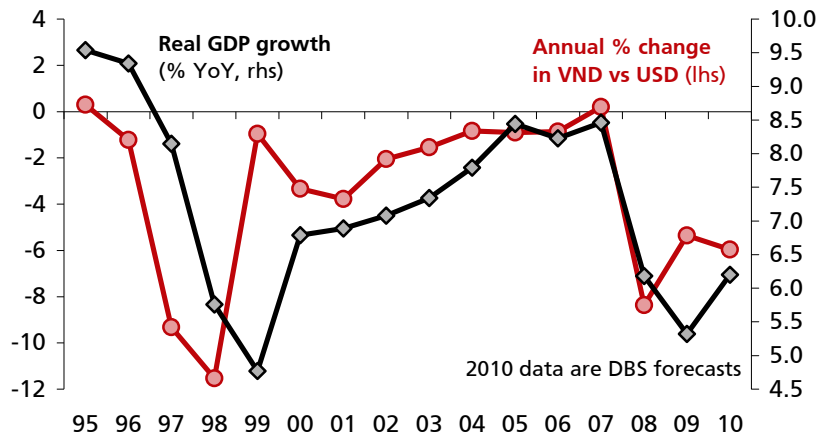
Currencies

- **VND:** Vietnam announced after Asian trading hours yesterday that it will devalue the dong by 3.25% starting today. Effectively, this would lift the USD/VND fixing from 17,941 to 18,544. The market should trade up to 19,100 which is the upper limit of $\pm 1.5\%$ wide trading band around this fixing. Overall, this decision was in line with our expectation that the devaluation seen last November would not be the last. When we forecast USD/VND to rise to 19,640 by end-2010 last December, market consensus had moved lower from 19,000 then to 18,733 yesterday.

When we deliberated the dong's outlook for 2010, we noted that the currency's depreciation pace tracked the performance of its economy. Noting the lessons from the recovery years after the Asian crisis, the exchange rate policy tends to be pro-growth and focused on boosting export competitiveness. Fundamentally, the devaluation should not come as a surprise. Based on latest official data, Vietnam's foreign reserves (Jun09: \$21.8bn) are below total external debt (Dec08: \$21.8bn or 24% of GDP), and its trade deficit tends to widen with recovery. Earlier this month, a state-run Vietnam newspaper indicated that foreign newspaper reported that total external debt may have risen to more than 30%. An IMF report last December indicated that Vietnam's foreign reserves excluding gold had dropped to \$18.8bn in Aug09.

Under the circumstances, we remain comfortable with our end-2010 target of 19,640. Effectively, yesterday's devaluation is less than the full-year depreciation we have factored in our last quarterly report. In short, more is probably coming over the course of the year.

VND depreciation pace vs real GDP growth

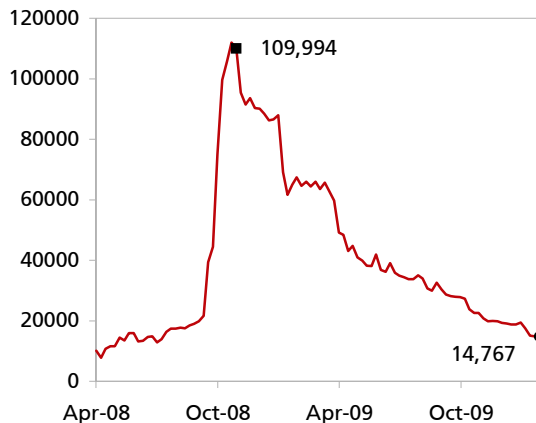


Fixed Income

- US:** Treasury yields rose yesterday after a weak 10Y auction (bid-to-cover 2.67%) and Fed Chairman Bernanke said the central bank may raise the discount rate "before long". Yields rose 5bps in the 2Y sector to 0.88% and 6bps in the 10Y sector to 3.70%. While the Fed's policy stance will remain accommodative for some time and the Fed Funds target remain at 0-0.25% in the coming months, a hike in the discount rate is warranted as conditions in the US banking system have essentially normalized. As the left chart below shows, primary discount window credit has returned to normal levels, which means that there is a strong case to normalize the spread between the primary discount rate and the Fed Funds target rate. That spread used to be 100bps before the crisis, but was lowered 0.25% amid the financial crisis. Therefore, it is likely the Fed hikes the discount rate by a total of 75bps over the coming meetings. The right chart below shows that the Fed's other liquidity facilities have also already been reduced substantially. Essentially, the Fed has been in exit strategy mode since early 2009 and only asset purchases have kept the Fed's balance sheet high by offsetting the fall in credit to the banking system through liquidity facilities (MBS). That the Fed is getting ready to hike the discount rate is unequivocally good news as it means that conditions in the US banking system have normalized

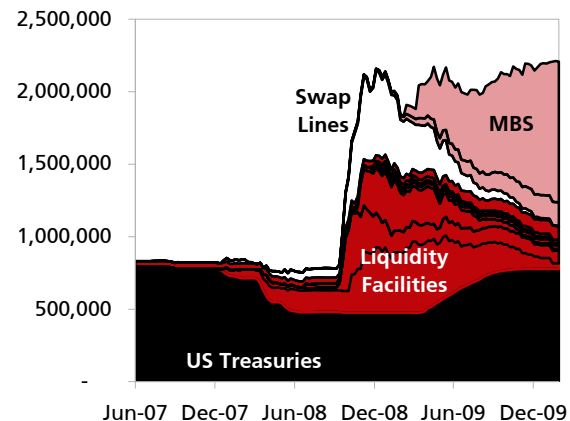
Primary Discount Window Credit

millions of dollars



Reserve Bank Credit

millions of dollars



Looking back

- **US mkts:** US stocks fell overnight as concerns about Greece continue to weigh on risk asset markets. The Dow Jones Industrial Average fell 0.2% to 10038.38 and the Nasdaq closed 0.14% lower at 2147.87. Treasury yields rose 6bps to 0.88% in the 2Y sector and 7bps to 3.70% in the 10Y sector after a weak 10Y auction and comments from Bernanke that the Fed is getting ready to hike the discount rate.

Economic calendar

Event	Consensus	Actual	Previous
Feb 8 (Mon)			
JP: Adj current acc (Dec)	JPY 1250bn	JPY 1100.5bn	JPY 1305bn
TW: trade balance (Jan)	USD 1.96bn	USD 2.49bn	USD 1.65bn
-- exports	62.9% y/y	75.8% y/y	46.9% y/y
-- imports	100.8% y/y	114.7% y/y	56.2% y/y
Feb 10 (Wed)			
JP: machine order (Dec)	8.0% m/m sa	20.1% m/m sa	-11.3% m/m sa
PH: exports (Dec)	36.0% y/y	23.6% y/y	5.1% y/y
ID: GDP (4Q)	5.04% y/y		4.21% y/y
CN: trade balance (Jan)	USD 20.0bn	USD 14.17bn	USD 18.43bn
-- exports	28.0% y/y	21.0% y/y	17.7% y/y
-- imports	85.2% y/y	85.5% y/y	55.9% y/y
MY: industrial production (Dec)	8.7% y/y	8.9% y/y	-0.8% y/y
KR: unemployment rate (Jan)		4.8% sa	3.6% sa
US: MBA mortgage appln (Feb)		-1.2%	21.0%
US: trade balance (Dec)	-USD 35.8bn	-USD 40.2bn	-USD 36.4bn
Feb 11 (Thur)			
CN: CPI (Jan)	2.1% y/y		1.9% y/y
US: retail sales (Jan, A)	0.3% m/m sa		-0.3% m/m sa
US: initial jobless claims (Feb)	465K		480K
Feb 12 (Fri)			
IN: industrial production (Dec)	12.3% y/y		11.7% y/y
EZ: industrial production (Dec)	0.1% m/m sa		1.0% m/m sa
EZ: GDP (4Q, A)	0.3% q/q sa		0.4% q/q sa
--	-1.9% y/y		-4.0% y/y

Central bank policy calendar

Date	Country	Policy Rate	Current (%)	Consensus	DBS	Actual
This week						
11-Feb	KR	7-day repo rate	2.00%	2.00%	2.00%	
11-Feb	EZ	Feb mthly bulletin				
11-Feb	US	Monthly budget statement (Jan)				
Next week						
18-Feb	JP	O/N call rate	0.10%	0.10%		
19-Feb	JP	BOJ monthly report				
Last week						
04-Feb	ID	o/n reference rate	6.50%	6.50%	6.50%	6.50%
04-Feb	EZ	Refi rate	1.00%	1.00%	1.00%	1.00%

GDP & inflation forecasts

	GDP growth, % YoY					CPI inflation, % YoY				
	2006	2007	2008	2009f	2010f	2006	2007	2008	2009f	2010f
US	2.7	2.1	0.4	-2.4	3.2	3.2	2.9	3.8	-0.3	1.8
Japan	2.0	2.3	-0.7	-5.3	2.0	0.2	0.1	1.4	-1.3	-0.4
Eurozone	3.1	2.7	0.5	-3.9	1.1	2.2	2.1	3.3	0.3	1.2
Indonesia	5.5	6.3	6.1	4.5	5.5	13.3	6.3	9.8	4.9	4.6
Malaysia	5.8	6.4	4.6	-2.4	5.0	3.6	2.0	5.4	0.6	1.6
Philippines	5.4	7.2	4.6	1.0	4.8	6.3	2.8	9.3	3.3	4.0
Singapore	8.2	7.7	1.1	-1.9	6.0	1.0	2.1	6.5	0.3	3.2
Thailand	5.1	4.9	2.5	-3.0	4.2	4.6	2.2	5.5	-0.9	2.9
Vietnam	8.2	8.5	6.2	5.1	6.2	7.5	8.3	23.3	6.9	7.4
China	11.6	13.0	9.1	8.2	9.5	1.5	4.8	5.9	-0.8	4.0
Hong Kong	7.0	6.4	2.5	-2.4	5.5	2.0	2.0	4.3	0.5	3.0
Taiwan	5.4	6.0	0.7	-2.7	6.3	0.6	1.8	3.5	-0.9	0.9
Korea	5.2	5.1	2.2	0.2	5.4	2.2	2.5	4.7	2.8	2.9
India*	9.7	9.0	6.7	6.8	7.9	5.4	4.7	8.4	3.2	5.0

* India data & forecasts refer to fiscal years beginning April; inflation is WPI
Source: CEIC and DBS Research

Policy & exchange rate forecasts

	Policy interest rates, eop					Exchange rates, eop				
	current	1Q10	2Q10	3Q10	4Q10	current	1Q10	2Q10	3Q10	4Q10
US	0.25	0.25	0.25	0.75	1.25	...	...	...	...	...
Japan	0.10	0.10	0.10	0.10	0.10	89.9	87	86	85	84
Eurozone	1.00	1.00	1.00	1.25	1.50	1.375	1.51	1.52	1.53	1.54
Indonesia	6.50	6.50	6.50	7.25	8.00	9,360	9,100	8,950	8,850	8,700
Malaysia	2.00	2.00	2.00	2.25	2.75	3.43	3.32	3.29	3.27	3.24
Philippines	4.00	4.00	4.00	4.25	4.75	46.4	45.2	44.8	44.4	44.0
Singapore	n.a.	n.a.	n.a.	n.a.	n.a.	1.42	1.37	1.36	1.35	1.34
Thailand	1.25	1.25	1.25	1.50	2.00	33.2	33.1	32.8	32.6	32.3
Vietnam^	8.00	8.50	9.00	9.50	10.00	18,467	19,300	19,410	19,530	19,640
China*	5.31	5.31	5.58	5.85	6.12	6.83	6.81	6.74	6.68	6.62
Hong Kong	n.a.	n.a.	n.a.	n.a.	n.a.	7.77	7.75	7.75	7.75	7.75
Taiwan	1.25	1.25	1.25	1.50	1.75	32.1	31.6	31.2	30.9	30.5
Korea	2.00	2.00	2.50	3.00	3.50	1160	1110	1090	1070	1050
India	4.75	4.75	5.25	5.75	6.25	46.5	45.1	44.6	44.0	43.5

^ prime rate; * 1-yr lending rate

Market prices

	Policy rate	10Y bond yield		FX		Equities		
	Current (%)	Current (%)	1wk chg (bps)	Current	1wk chg (%)	Index	Current	1wk chg (%)
US	0.25	3.70	10	80.0	0.8	S&P 500	1,068	-2.7
Japan	0.10	1.34	-3	89.9	-1.0	Topix	884	-3.5
Eurozone	1.00	3.20	-3	1.375	0.2	Eurostoxx	2,416	-3.2
Indonesia	6.50	9.82	6	9360	-0.7	JCI	2,483	-4.6
Malaysia	2.00	4.27	-1	3.43	-0.9	KLCI	1,246	-1.7
Philippines	4.00	8.05	2	46.4	-0.9	PCI	2,857	-1.0
Singapore	Ccy policy	2.61	6	1.418	0.3	FSSTI	2,734	-1.1
Thailand	1.25	3.87	4	33.2	0.0	SET	688	-2.7
China	5.31	...	...	6.83	-0.1	S'hai Comp	2,982	-0.7
Hong Kong	Ccy policy	2.87	2	7.77	0.0	HSI	19,922	-3.9
Taiwan	1.25	1.47	-2	32.1	-0.3	TWSE	7,442	-1.3
Korea	2.00	5.36	1	1160	-0.9	Kospi	1,570	-2.8
India	4.75	7.79	11	46.5	-1.1	Sensex	15,922	-1.9

Source: Bloomberg

Contributors:

Economics

David Carbon	Singapore	(65) 6878 9548
Lim Su Sian	Singapore	(65) 6878 1740
Ramya	Singapore	(65) 6878 5282
Ma Tieying	Singapore	(65) 6878 2408
Irvin Seah	Singapore	(65) 6878 6727
Chris Leung	Hong Kong	(852) 3668 5694

Currencies

Philip Wee	Singapore	(65) 6878 4033
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Fixed income strategy

Jens Lauschke	Singapore	(65) 6224 2574
---------------	-----------	----------------

Administrative / technical support

Violet Lee	Singapore	(65) 6878 5281
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Please direct distribution queries to Violet Lee on 65-6878-5281

Client Contacts

Singapore

DBS Bank	(65) 6878 8888
DBS Asset Management	(65) 6878 7801
DBS Vickers Securities	(65) 6533 9688
The Islamic Bank of Asia	(65) 6878 5522

China

DBS Beijing	(86 010) 5839 7527
DBS Dongguan	(86 769) 2211 7868
DBS Fuzhou	(86 591) 8754 4080
DBS Guangzhou	(86 20) 3884 8010
DBS Hangzhou	(86 571) 8788 1288
DBS Shanghai	(86 21) 3896 8888
DBS Shenzhen	(86 755) 8269 1043
DBS Suzhou	(86 512) 6288 8090
DBS Tianjin	(86 22) 2339 3073

Hong Kong

DBS Hong Kong	(852) 3668 0808
DBS Macau	(853) 329 338
DBS Asia Capital	(852) 3668 1148
DBS Asia Capital Shanghai	(86-21) 6888 6820

India

DBS Delhi	(91 11) 3041 8888
DBS Mumbai	(91 22) 6638 8888

Indonesia

DBS Jakarta	(62 021) 390 3366
DBS Medan	(62 061) 3000 8999
DBS Surabaya	(62 021) 531 9661

Japan

DBS Tokyo	(81 3) 3213 4411
-----------	------------------

Korea

DBS Seoul	(82 2) 339 2660
-----------	-----------------

Malaysia

DBS Kuala Lumpur	(6 03) 2148 8338
DBS Labuan	(6 08) 7595 500
Hwang-DBS Penang	(6 04) 263 6996

Philippines

DBS Manila	(63 2) 845 5112
------------	-----------------

Taiwan

DBS Chungching	(886 4) 2296 0088
DBS Kaohsiung	(886 7) 323 2362
DBS Taichung	(886 4) 2230 9188
DBS Tainan	(886 6) 213 3939
DBS Taipei	(886 2) 8101 0598
DBS Taoyuan	(886 3) 339 6060

Thailand

DBS Bangkok	(66 2) 636 6364
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United Kingdom

DBS London	(44 20) 7489 6550
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UAE

DBS Dubai	(97 1) 4364 1800
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USA

DBS Los Angeles	(1 213) 627 0222
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