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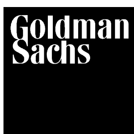


India: Growth, interrupted

We are revising down our GDP growth numbers for FY09 to 6.7% from 7.5% and for FY10 to 5.8% from 7.0%.

The larger-than-expected shock to the financial sector over the past couple of months, and its knock-on effects on both domestic and external demand are responsible for our lower growth projections. We believe there is little fiscal room for additional stimulus in FY10.

We now expect growth to trough at a quarterly pace of 5.0% in the April-June quarter of FY10, before recovering to 6.6% by end-FY10. The slowdown, in our view, is very much cyclical in nature.

We look at the impact on corporate, bank, household and government balance sheets, and negative feedback loops.

The silver lining—a large monetary policy stimulus, prospects of a good agricultural crop supporting rural demand, lower commodity prices, and ongoing infrastructure spending which would limit further downside to growth.

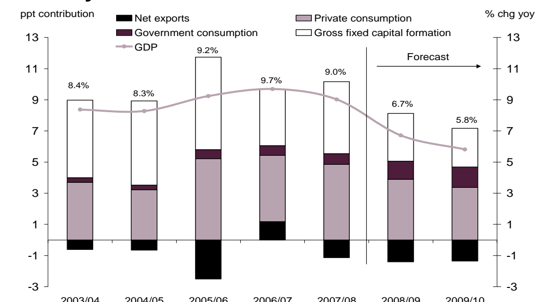
ASEAN Surprise Indices: Activity surprising on the downside across the board

The ASEAN Surprise Index remained in negative territory for the second month in a row. This indicates that activity in the region is now coming in weaker than consensus expectations, which also has been generally revised lower in recent months. More importantly, the surprise indices for all countries registered a decline.

Hong Kong: Tighter local financial conditions exacerbates growth concerns

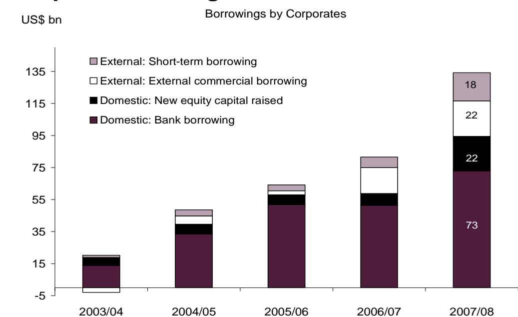
The recent tightening of credit conditions is exacerbating the knock-on effect of the external demand slowdown on the Hong Kong economy. We expect GDP growth to slow to 2.2% in 2009, from our forecasted 3.0% in 2008. Our GDP growth forecasts are well below the consensus forecasts of 4.0% and 3.1% for 2008 and 2009 respectively.

India: A significant cyclical slowdown in activity ahead



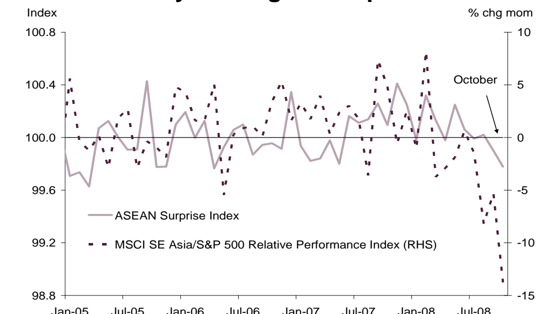
Source: CEIC, Goldman Sachs Economics Research.

India: After the tide turns: External and equity markets have been important sources of corporate funding



Source: RBI, SEBI, CEIC, Goldman Sachs Economics Research.

ASEAN activity and regional equities slide



Source: CEIC, Goldman Sachs Economics Research.

Important disclosures appear at the back of this document

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India: Growth, interrupted

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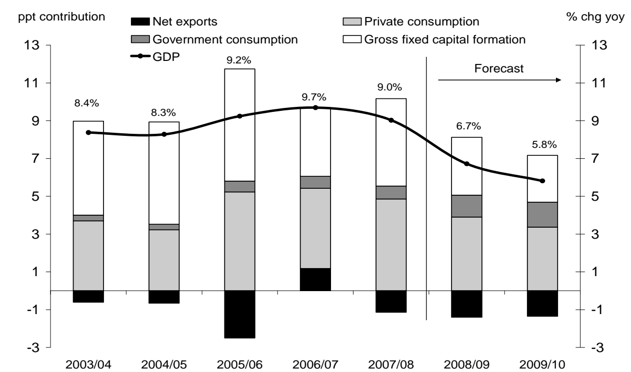
The gathering financial crisis and credit crunch over the past several weeks has affected India's financial sector significantly, with both domestic and external liquidity drying up, affecting the financing for corporates, loans for households, and trade credit for exporters. The real economy is already beginning to feel the effects of the liquidity crunch despite the Reserve Bank of India (RBI) and the government's massive liquidity infusion efforts. Recent activity data has been considerably weaker than expected, with industrial production (IP) growth for August coming in at 1.3% yoy from 7.4% yoy in July, the Purchasing Managers Index falling to 52.2 in October from 57.3 in September, exports growth falling to 10.4% yoy in September from 27% in August, and auto sales remaining weak during the crucial Diwali season in late-October. We think the large negative global and domestic financial sector shock will continue to slow activity across the board, in capex plans, exports growth, and consumption demand.

We are therefore, lowering our FY10 growth forecasts to 5.8% from 7.0%. Although we warned of the risks to growth when lowering our growth numbers in July, and have remained below consensus since, we did not anticipate the severe liquidity crunch in September/October, and the spike in domestic interest rates. We now see further risks to the downside as problems in the financial sector feed through to the real sector. We discuss below the negative feedback loops by looking at the balance sheets of the key actors in the economy. Corporates will be the most affected, and as a result, investment demand will suffer the most, followed by external demand, and finally by a slowdown in consumption (see Exhibit 1). On the production side, we expect a significant slowdown in construction and real estate, and in industry (see Exhibits 2 and 3).

Exhibit 1: A significant cyclical slowdown in activity ahead



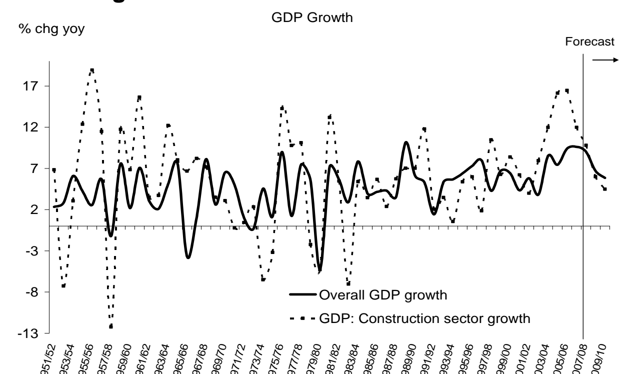
Source: CEIC, Goldman Sachs Economics Research.

Exhibit 2: Industry to slow significantly over the next 3 quarters

% chg yoy	Overall GDP	Agriculture	Industry	Services
2007/08	9.0	4.5	8.1	10.7
2008/09 F	6.7	3.0	4.0	8.6
2009/10 F	5.8	3.0	3.5	7.3

Source: CEIC, Goldman Sachs Economics Research.

Exhibit 3: Construction activity set to fall sharply after a big boom



Source: CEIC, Goldman Sachs Economics Research.

"The financial decelerator"

To understand the channels of transmission from the financial to the real sector, it is instructive to look at the balance sheets of the main actors in the economy—firms, households, banks, and the government.

We believe Indian firms will face substantial headwinds due to the troubles in the financial sector. We think corporate balance sheets will be impaired by four factors which will make them less creditworthy at precisely the time they need more capital:

1. The sharp declines in the equity market, where over US$850 billion of market capitalization has been wiped out since the peak in January, will not only reduce corporates' net worth, but also make it difficult to raise new capital.

2. As the market valuation of capital drops relative to the cost of acquiring new capital, (also known as Tobin's Q) firms will prefer not to acquire new capital and postpone investment decisions.

3. The losses from foreign exchange (FX) derivatives that a significant number of corporates will face due to the large weakening of the rupee (INR).

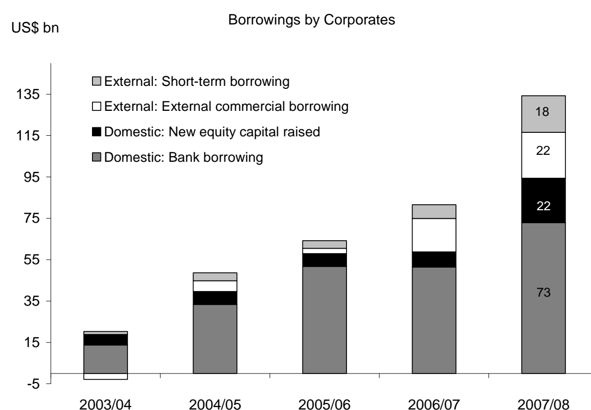
4. A number of corporates have exposure to the real estate sector and to the stock market. Declining asset prices will lead to an accumulation of losses.

We think the problems will be compounded by the shutting off of the equity market channel and external financing. Indian corporates raised US$22 billion from the equity market in FY08. They also raised US$40 billion from external financing (see Exhibit 4). As these sources dry up, the pressure on domestic credit will become more acute. The small and medium enterprises (SMEs) stand to face the most acute stress (see Exhibit 5). Since they are key for employment generation, the knock-on effects will be significant.

We expect Indian banks to continue to face significant headwinds, given the origin of the current crisis lies in the financial sector. Access to short-term funds through interbank lending, the original cause of the liquidity squeeze, remains difficult. We believe their ability to raise more long-term capital will be impaired given the state of financial markets. More importantly, our Banks Research Team estimates that non-performing loans (NPLs) will double (see Exhibit 6). This will increase credit risk, making them more risk averse and less willing to lend.

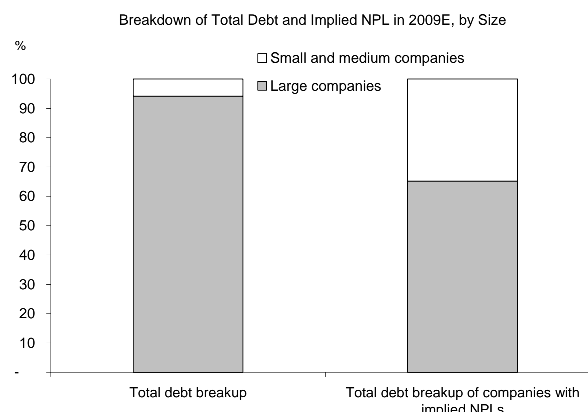
We think households will also be affected by the current financial turmoil, and especially the decline in the stock market. Given that in the last 4 years, India

Exhibit 4: After the tide turns: External and equity markets have been important sources of corporate funding



Source: RBI, SEBI, CEIC, Goldman Sachs Economics Research.

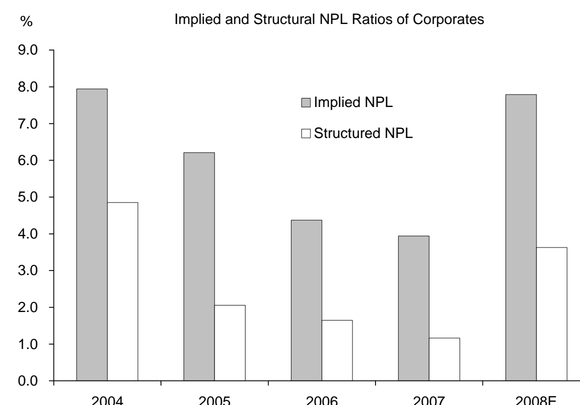
Exhibit 5: Small and mid-cap companies will face the most stress



Note: large companies are defined as those with sales turnover of more than Rs3 billion. Small-and-medium companies defined as those with sales turnover of less than Rs3 billion.

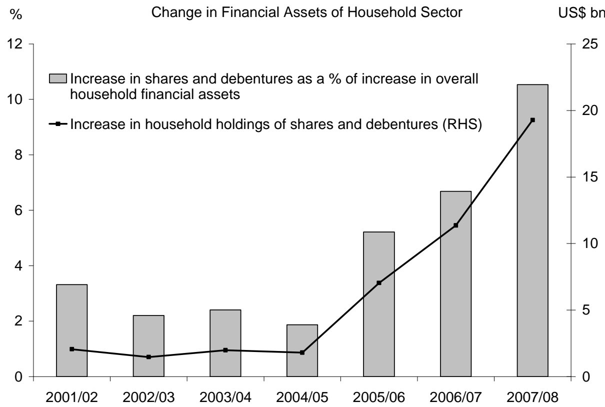
Source: Capitaline, Goldman Sachs Economics Research.

Exhibit 6: Banks' NPLs set to double



Source: Capitaline, Goldman Sachs Economics Research.

Exhibit 7: A bigger chunk of household savings has recently gone into the stock market



Source: RBI, CEIC, Goldman Sachs Economics Research.

has seen unprecedented increases in the rate of home ownership, mortgages, and also participation in the stock market (see Exhibits 7 and 8), the declines will be even more painful. Households have ploughed in roughly US$40 billion in the stock market, and the negative wealth effect of falling share prices will affect consumption, and also their ability to borrow. The slowdown will signal lower wage growth in the future which will also have an impact on reducing consumption.

Finally the government's balances are stretched, and we believe it will not be able to impart any additional stimulus, were it to be required. As we have been stressing,[1] the worsening fiscal situation implies the government will be unable to make any counter-cyclical policies, such as cut taxes for the corporate sector or even recapitalize state-owned banks (see Exhibit 9).

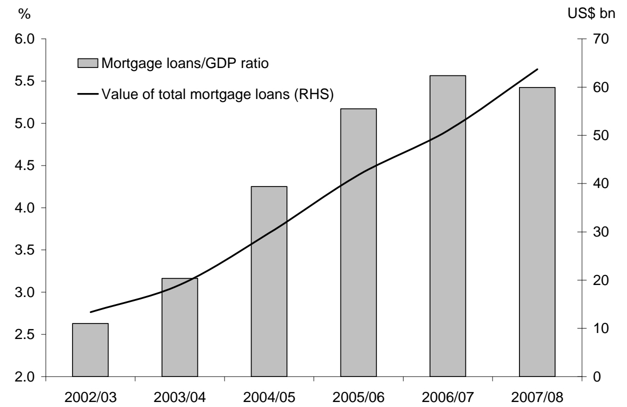
We expect negative feedback loops to accelerate the downturn. As the balance sheets of households and corporates deteriorate, they are less able to pay off loans to banks, which hurt banks and makes them less willing and able to extend fresh loans, which in turn squeezes credit for corporates and worsens their balance sheet. This 'financial decelerator' increases the amplitude and length of the downturn in the business cycle.

The silver lining

Although the outlook remains cloudy, there are a few growth supportive factors:

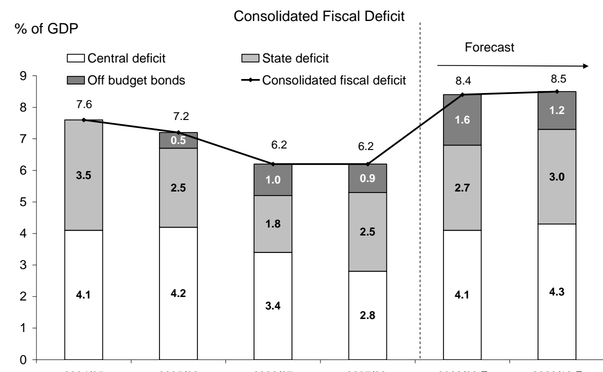
First, a massive policy stimulus—both fiscal and monetary—is being injected into the economy. On the monetary policy front, the central bank has cut the benchmark repo rate by 150 bp, and the cash reserve

Exhibit 8: Mortgage loans have increased rapidly, albeit from very low levels



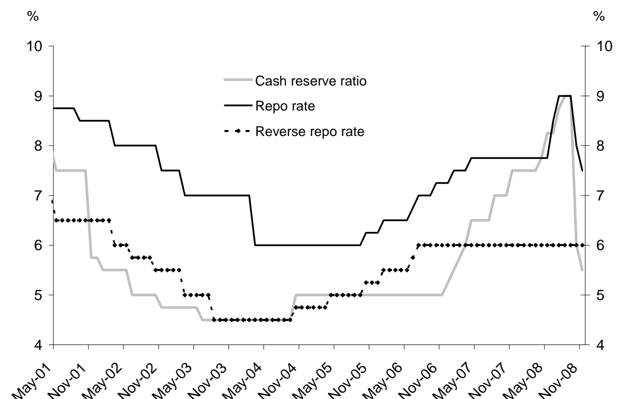
Source: RBI, CEIC, Goldman Sachs Economics Research.

Exhibit 9: The large fiscal deficit makes further easing difficult



Source: RBI, CEIC, Goldman Sachs Economics Research.

Exhibit 10: The RBI has cut rates significantly and we expect more easing going forward



Source: Bloomberg, CEIC, Goldman Sachs Economics Research.

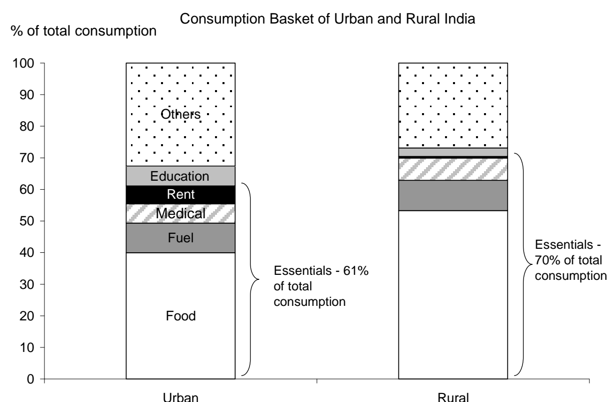
[1] See *India: Some unpleasant fiscal arithmetic*, Asia Economics Flash, October 15.

ratio (CRR) by 350 bp. We expect a further 200-250 bp in cuts by mid-2009 (see Exhibit 10). Although we believe these will not be fully transmitted by banks, economy-wide rates will be lower going forward. Fiscal policy remains extremely loose. Although there is the very important caveat that it can't be loosened further, the current spending plans of the government will still shore up demand. In addition, spending on the general elections scheduled for 1H2009, will also likely boost demand, as it has traditionally tended to do.

Second, lower commodity prices takes away a significant risk to the economy as India is a large net importer. Oil alone comprises a third of India's imports. The fall in prices will help the fiscal and current account deficits and inflation.

Third, the monsoons, another critical concern for agriculture and overall growth, have been normal and spread widely. Agriculture matters significantly for rural demand, in fact, according to our estimates, 57% of total consumption is rural. Due to the lack of credit

Exhibit 11: Given the majority of consumption, especially in rural Indian, is still essential, rural demand to remain robust



Source: NSSO, GoI, CEIC, Goldman Sachs Economics Research.

Exhibit 12: Activity indicators in a snapshot

% chg yoy	Unit	Latest	FY08	FY09	FY08	FY09
			Latest month		Year to date	
Monetary						
M3	% chg yoy	10-Oct	21.9	20.3	21.0	20.8
Currency with public	% chg yoy	10-Oct	13.3	20.2	14.2	19.7
Total bank credit	% chg yoy	10-Oct	23.1	29.4	24.2	25.4
Non-food credit	% chg yoy	10-Oct	23.3	29.3	24.4	25.8
Foreign inflows						
Net FII (equity)	US$ bn	Oct	4.3	-3.5	15.7	-9.7
Gross FDI	US$ bn	Sep	0.7	2.6	7.3	17.2
Gross External Commercial Borrowings	US$ bn	Sep	2.2	2.8	15.7	11.0
Central government budget						
Income tax revenue	% chg yoy	Sep	37.1	20.6	35.3	30.8
Corporate tax revenue	% chg yoy	Sep	32.4	31.2	38.6	38.2
Government capital expenditure	% chg yoy	Sep	-14.0	12.2	176.6	-56.0
Government total expenditure	% chg yoy	Sep	26.0	49.3	26.2	9.8
Production						
Industrial Production Capital Index	% chg yoy	Aug	30.8	2.3	20.1	9.2
Industrial Production Overall Index	% chg yoy	Aug	10.9	1.3	10.0	4.9
Infrastructure Index	% chg yoy	Aug	9.5	2.3	7.1	3.4
PMI Index	Index	Oct	61.7	52.2	56.0	57.0
Cement production	% chg yoy	Sep	4.9	8.6	8.4	6.7
Transport						
Commercial vehicle sales	% chg yoy	Sep	2.6	-0.6	3.6	4.0
Maruti Suzuki sales	% chg yoy	Oct	15.4	-7.1	-	3.7
Tata Motors sales	% chg yoy	Oct	6.0	-19.5	-	-2.2
Bajaj Autos	% chg yoy	Oct	-1.0	-34.0	-	-
Domestic airline traffic	% chg yoy	Aug	34.1	-17.1	32.7	-4.1
Railway goods traffic (volume)	% chg yoy	Sep	9.2	8.2	-	-
Port cargo traffic (volume)	% chg yoy	Sep	-	-	13.7	7.2
Others						
Tourism revenue (USD)	% chg yoy	Sep	12.5	7.7	23.7	12.7
Cellular subscribers	% chg yoy	Sep	68.4	52.2	71.8	55.1
Non oil imports	% chg yoy	Sep	-4.5	36.2	32.9	29.3
Total exports	% chg yoy	Sep	16.1	10.4	19.0	27.2
Agriculture						
			FY08		**FY09**	
Kharif (monsoon) crop	mn tons	Jun-Sept (First est.)	112.2		115.3	

Source: CEIC, GoI, Bloomberg, Reuters, RBI, SEBI, Goldman Sachs Economics Research.

penetration, it is also the sector least affected by the financial sector turmoil. In addition, given lower levels of income, a majority of consumption tends to be in essentials such as food, fuel, and medical, which are relatively more inelastic. We therefore expect rural demand to remain robust.

Finally, India's financial sector is essentially sound with high capital adequacy, low, albeit rising, NPLs, mortgages are a fraction of total credit, and the exposure to inflated real estate is small. Hence it approaches the current financial turmoil from a position of strength.

Although we expect growth in FY10 to decline to under 6% from 9.0% in FY08, we do not think many economies globally will be able to sustain such growth rates in 2009. India will benefit from a smaller share of exports, low financial sector penetration, significant rural demand, and ongoing structural change. The slowdown is very much a cyclical phenomenon. However, to prevent a further deterioration requires considerable policy dexterity, a timely disposal of bad assets, especially in real estate, and for scarce capital to be reallocated quickly and efficiently.

Tushar Poddar

ASEAN Surprise Indices Monthly Update: Activity surprising on the downside across the board

This article was first published on November 7, 2008.

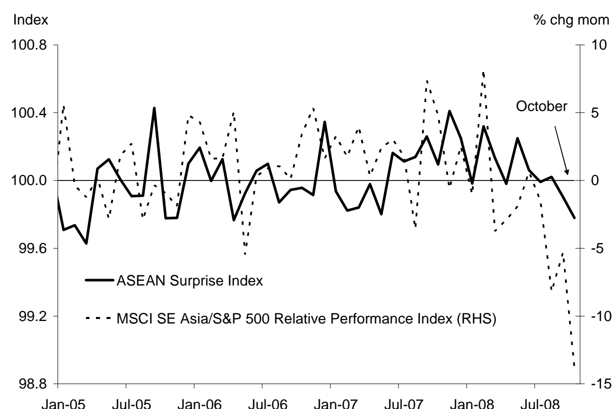
The ASEAN Surprise Index[1] remained in negative territory for the second month in a row. This indicates that activity in the region is now coming in weaker than consensus expectations, which also has been generally revised lower in recent months. More importantly, the surprise indices for all countries registered a decline. Malaysia and Philippines, which were registering positive or neutral readings recently, dipped into negative territory for the first time in recent months. Unsurprisingly, regional stock markets were hit relatively hard amidst the global risk aversion on the back of the ongoing credit crisis—MSCI SE Asia slumped around 28% in October, continuing the 14% drop in September.

The deteriorating exports picture in the face of softening global demand is starting to show through more clearly now. We have been below consensus on growth throughout most of the year and our 2009 ASEAN forecast, last revised on October 13 (see *Asia amidst the credit crunch and external slowdown*, Asia Economics Analyst 08/19, October 13), is currently at 3.2% for ASEAN versus consensus of 4.5%. We are also seeing government forecasts being revised down recently, most notably Malaysia slashing their 2009 GDP growth forecast to 3.5% from 5.4% previously (our own forecast is at 3.4%). With a dimmer outlook on external demand, the policy bias in ASEAN countries has shifted towards easing (beginning with Singapore at their October 10 meeting).

However, the inflation and growth trade-off is more tricky for some of the ASEAN countries in the near term, especially those constrained by policy credibility (or lack thereof) in the past. While we continue to expect growth to slow and the lower commodity prices should also help accelerate the decline in inflation, too aggressive an easing could still trigger currency depreciation and higher inflation expectations in some Asia ex Japan countries, including Indonesia and the Philippines.

Concerns of sovereign risks have also risen and comparisons are being drawn with the last Asian crisis. As we highlighted on October 27 (see *Asian crisis comparison—not homebuilt today but homing in nonetheless*, Asia Economics Analyst 08/20, October 27), the key capital account metrics (especially short-term debt to FX reserves) look far better now, with supporting fundamentals such as the current account balances also in better shape. However, there is no magic number for any of the key risk ratios—rather, it is the overall level of confidence in the domestic currency and banks that will remain key. Also, the recovery this time round will also likely be more subdued given the state of the global economy. As noted above, further currency weakness could also make it harder for countries like Indonesia and the Philippines to respond with accommodative policy and thus less flexibility in dealing with the growth slowdown.

ASEAN activity and regional equities slide



Source: CEIC, Goldman Sachs Economics Research.

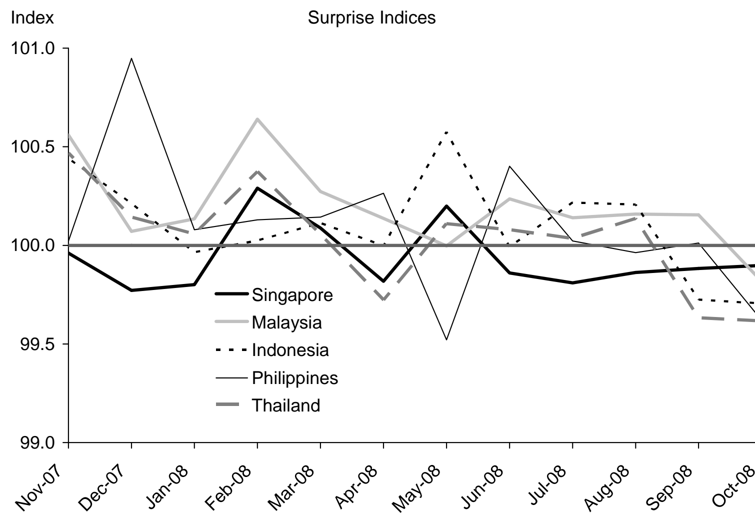
Surprise indices—What's inside?

	Indicator	Surprise relative to...
Singapore		
	Advanced GDP	Consensus
	Non-oil domestic exports	Consensus
	Retail sales	Consensus
	Purchasing Manager's Index	Consensus
Malaysia		
	GDP	Consensus
	Industrial production	Consensus
	Exports	Consensus
	Manufacturing sales	3-month historical trend
Indonesia		
	GDP	Consensus
	Motorcycle sales	3-month historical trend
	Cement consumption	3-month historical trend
	Exports	Consensus
Philippines		
	GDP	Consensus
	Exports	Consensus
	Overseas workers remittances	3-month historical trend
	Fiscal balance	3-month historical trend
Thailand		
	Exports	3-month historical trend
	Consumer confidence	3-month historical trend
	Manufacturing Production Index	Consensus
	GDP	Consensus

Source: Goldman Sachs Economics Research.

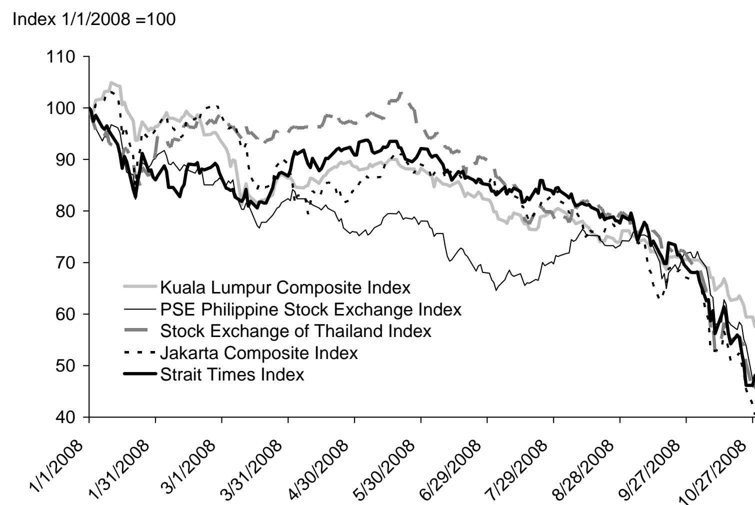
[1] We constructed this index to keep track of how data in the region is performing relative to consensus (see *ASEAN surprise indices—sometimes regional data do matter*, Asia Economics Analyst 07/16, September 10, 2007). We find that while global factors have a significant impact on absolute changes in ASEAN markets, the relative performance of ASEAN markets seems to be more influenced by the regional data trends. Our ASEAN Surprise Indices are available on Bloomberg. You can view all the individual country indices and the aggregated ASEAN Surprise Index by typing ALLX GASI <GO>.

All country indices are now in negative territory



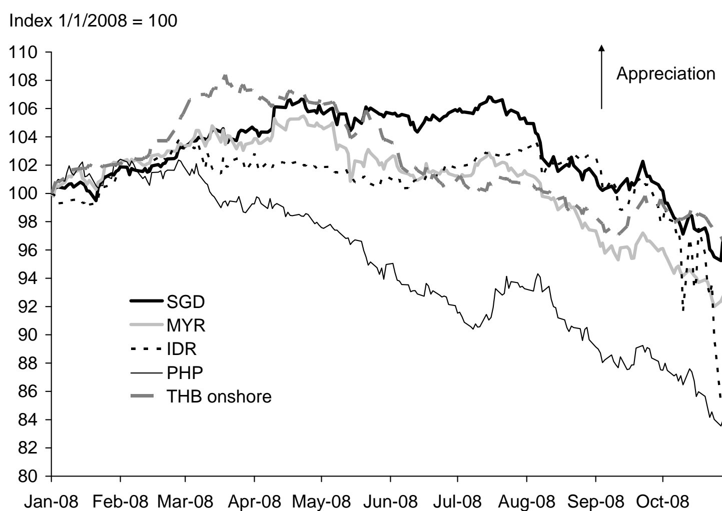
Source: Bloomberg, CEIC, Goldman Sachs Economics Research.

ASEAN equity markets' performance



Source: Bloomberg, CEIC, Goldman Sachs Economics Research.

ASEAN foreign exchange performance versus the USD

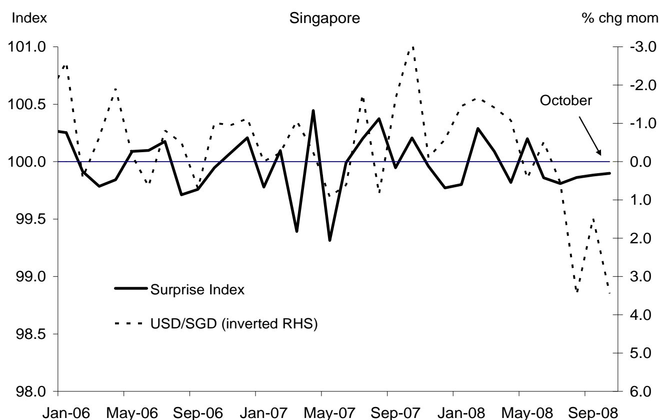


Source: Bloomberg, CEIC, Goldman Sachs Economics Research.

Singapore

Our Singapore Surprise Index remained in negative territory, with the disappointing 3Q advance GDP data being the dominating theme, despite a slight reprise in the NODX. Our Singapore Surprise Index has been in negative territory for four months in a row now.

The SGD weakened by around 3.4% against the USD in October, on the back of the USD rally and weaker emerging market currency performance. Meanwhile, the Straits Times Index fell 23.9% in October, underperforming the US (SPX) which fell 17% but under MXAPJ which slumped 28%, amidst the ongoing credit crisis and in line with the regional sell-off. In light of the recent shift towards a neutral policy stance by the Monetary Authority of Singapore in early-October, on the back of growth concerns. We expect further weakness in the SGD in the near term.

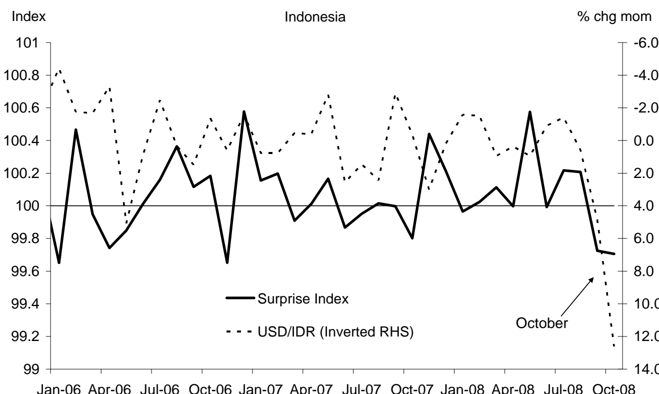


Source: CEIC, Goldman Sachs Economics Research.

Indonesia

The Indonesia Surprise Index remained in negative territory for the second month in a row, with all components: exports, cement consumption and motorcycle sales surprising on the downside. Domestic activity has been showing robust growth but it is getting harder to surprise consensus on the upside.

The IDR weakened by around 12.7% against the USD in October, which is the biggest monthly depreciation since July 1998. Meanwhile, the domestic stock market was hit hard by the global risk aversion amidst the ongoing credit crisis, falling by around 31.4% in October.

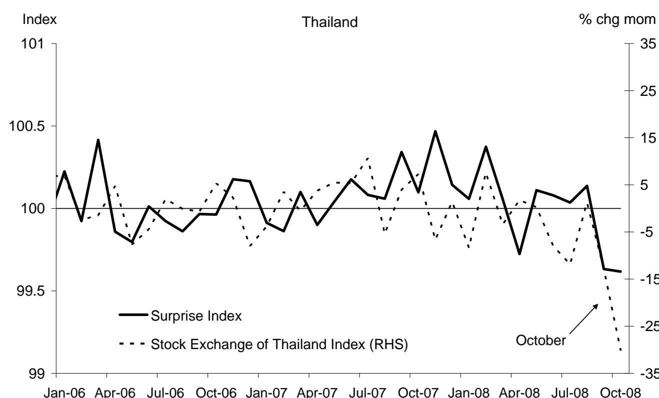


Source: CEIC, Goldman Sachs Economics Research.

Thailand

The Thailand Surprise Index recorded a negative reading for the second month in a row, as we saw all components surprising on the downside. We remain comfortable with our long-held below-consensus GDP growth forecast at 4.3% and 3.3% for 2008 and 2009 as we foresee further slowing in domestic demand on the back of the ongoing political instability, while external conditions look set to deteriorate further.

The Thai stock market slumped almost 30.2% in October, hit by the regional sell-off, risk reduction and also domestic political woes. Meanwhile, the THB depreciated 3.5% against the USD, in line with regional currencies.

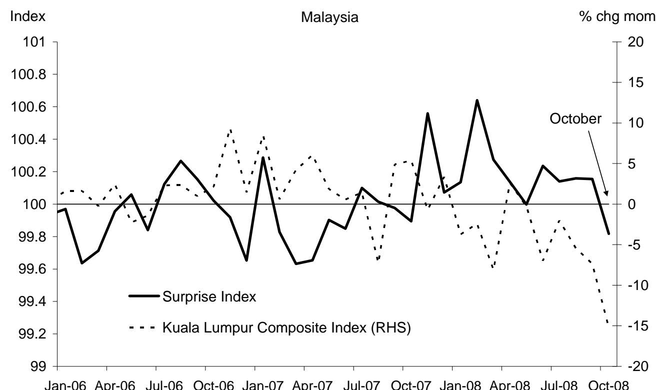


Source: CEIC, Goldman Sachs Economics Research.

Malaysia

The Malaysia Surprise Index finally gave up its strong performance, and recorded its first negative reading since June 2008. The component that has been holding up the index's performance, exports, surprised on the downside, given the weaker commodity prices.

The KLSE continued its slide, losing another 15.2% in October, along with continued political jitters but outperforming all other ASEAN markets. Meanwhile, the MYR also lost 2.7% against the USD, largely attributable to USD strength and also weaker regional currency performance. The ongoing political uncertainty adds to headwinds for MYR gains in the near term, although the undervaluation and a large current account surplus should help out over the longer term.

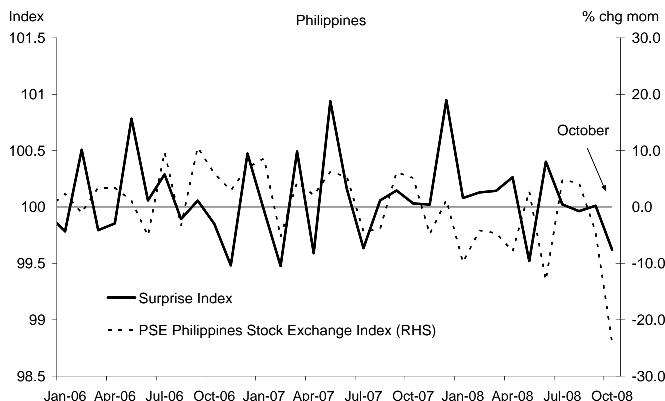


Source: CEIC, Goldman Sachs Economics Research.

Philippines

The Philippines Surprise Index dipped into negative territory. The key driver was weaker overseas remittances, a key component that has been supporting the surprise index this year.

The Philippines stock market slid 24.1% in October, amidst the ongoing credit crisis, although it was hit relatively less hard compared to the rest of the region. The PHP meanwhile continued to exhibit weakness, falling 4.1% versus the USD.



Source: CEIC, Goldman Sachs Economics Research.

Hong Kong: Tighter local financial conditions exacerbates growth concerns

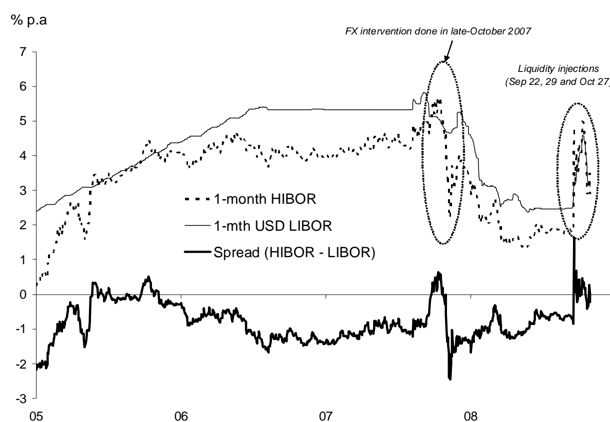
This article was first published on October 31, 2008.

- The recent spike in the HIBOR reflects the tight demand for HKD, as local financial institutions face redemption pressure on the back of the equity market volatility.
- We believe the Hong Kong Monetary Authority has the flexibility to continue injecting liquidity into the system, while expanding the current arrangement of liquidity assistance to banks.
- The recent tightening of credit conditions is exacerbating the knock-on effect of the external demand slowdown on the Hong Kong economy.
- We expect GDP growth to slow to 2.2% in 2009, from our forecasted 3.0% in 2008. Our GDP growth forecasts are well below the consensus forecasts of 4.0% and 3.1% for 2008 and 2009 respectively.

The recent spike in the HIBOR reflects the tightening of HKD liquidity. Global money market rates have fallen from its recent peak, following the coordinated policy easing by major central banks on October 8. Within the region, we have also seen various moves by the monetary authorities towards monetary easing and pro-growth policies (see *Money market distress easing, but growth weakening further*, Asia Views, October 21). However, the HIBOR has deviated from the decline in global money market rates in the past week. The sharp spike in the HIBOR actually coincided with the redemption pressures, on the back of the recent sell-off in the local equity markets. The strong demand for HKD cash has led to appreciation pressure on the HKD against the USD. On the other hand, there has been a persistent unwinding of leveraged long-HKD forwards positions, which were mostly placed last year in anticipation of a HKD revaluation. Correspondingly, given the interest rate parity, we have also seen the interest rate differential between HIBOR and USD LIBOR swinging from negative to positive lately (see Exhibit 1).

We believe the tight financial conditions will continue to drag on asset prices and the real economy. We expect GDP growth to slow to 2.2% in 2009, from our forecasted 3.0% in 2008. Our GDP growth forecasts are well below consensus forecasts of 4.0% and 3.1% for 2008 and 2009 respectively. Employment growth is already exhibiting signs of slowing, on the back of the weakening external environment (see Exhibit 2). Amalgamating the weakness in equity prices, higher interest rates and a stronger currency, the sharp tightening of overall financial conditions will likely drag asset prices and growth. We expect consumption growth to slow further, as the impact of a softer labor market and the negative wealth effect sets in.

Exhibit 1: HIBOR vs. LIBOR spread



Source: CEIC, Goldman Sachs Economics Research.

Exhibit 2: Weaker external environment hitting the labor market

Source: CEIC, Goldman Sachs Economics Research.

The Hong Kong Monetary Authority (HKMA) pumped liquidity into the system and allowing greater access to its funds. Since September, the HKMA has injected more than HK$24 billion (around US$3 billion) into the system through intervening in the foreign exchange (FX) market. The HKMA intervened in the FX market by buying USD and selling HKD to the market. Furthermore, the HKMA had also provided various liquidity enhancement measures to help facilitate the recycling of liquidity within the system. The new measures taken were mainly to extend the duration of discount window borrowing (see Exhibit 3), increase the thresholds for using Exchange Fund Bills and Notes (EFBN) as collateral for borrowings, conduct FX swaps between USD and HKD, and allow the use of USD assets as collateral when borrowing from the HKMA through the discount window or term lending.[1]

The HKMA also issued EFBN to improve banks' liquidity management. The HKMA had issued an additional HK$4 billion worth of EFBN on October 20, in order to meet the demand by banks for liquidity management. Since the onset of the global credit market turmoil, the demand for EFBN for liquidity management purposes have increased substantially, which is seen from the low yield in short-dated EFBN. Back in January, the HKMA had already issued HK$6 billion worth of EFBN to address the structural shortage of EFBN in the system. The EFBN is an important vehicle to attain liquidity for banks, especially following the HKMA's introduction of the liquidity assistance measures in late-September, which aimed to encourage more use of EFBN as collaterals for banks to acquire funds from the HKMA.

The low appetite by banks in extending credit has handicapped the effectiveness of the HKMA's actions in boosting liquidity in the system. Against the backdrop of tighter credit conditions, increasing counterparty risk concerns have refrained banks from extending credit to businesses in Hong Kong, particularly small-medium enterprises (SMEs). The deteriorating operating environment of many enterprises in Hong Kong's important hinterland, Guangdong, also caused credit quality concerns for banks. On October 29, the HKMA surprisingly appealed to the banks to remind them of the importance in "*lending to SMEs*"[2] to the wider economy. On the other hand, anecdotal evidence suggest that some major banks are now tightening mortgage lending, especially those relating to high-end property.

Exhibit 3: Recent policy actions by the HKMA

Date	Policy actions
22-Sep	Injected HK$1.556 bn through FX intervention
29-Sep	Injected HK$3.883 bn through FX intervention
30-Sep	Five liquidity assistance measures
8-Oct	Reduction of the base lending rate
20-Oct	Issues EFBN to improve banks' liquidity management
23-Oct	Injected HK$3.877 bn through FX intervention
27-Oct	Injected HK$ 15.5 bn through FX intervention

Source: HKMA, Goldman Sachs Economics Research.

We expect more measures by the authorities in aiming to further loosen financial conditions. We believe the redemption pressure caused by the volatile equity markets would likely intensify as we approach the end of this year. This again would cause further tightening in the credit environment and therefore negatively impacting growth. We see a number of measures the authorities can undertake to expand on the existing policies:

1. **More direct injection of liquidity through FX intervention by the HKMA**. As mentioned before, the liquidity injections via FX intervention (buying USD and selling HKD to the market) actually create downward pressure on the HKD against USD. However, the HKD has been trading close to the strong side of the band, which offers the HKMA more room for liquidity injections in the near future.

2. **Extend the time period of the liquidity assistance measures**. The new liquidity assistance measures provided by the HKMA on September 30 are effective until March 2009. We believe the HKMA has the option of extending this further.

3. **Expanding on the existing deposit guarantee scheme**. On October 14, the authorities announced that it would provide a 100% deposit guarantee, backed by the Exchange Fund. The main purpose is to provide additional assurance to the deposit base, in line with steps taken in other countries around the world. So far, along with the five liquidity

[1] See *The HKMA cuts the base rate by 100 bp*, Hong Kong Views, October 8.

[2] Where SME customers experience financial stress and run into difficulties as a result of the global financial crisis, Authorized Institutions should remain supportive and adopt a sympathetic attitude towards requests for temporary relief arrangements, such as extensions of repayment deadlines. Individual cases will of course need to be assessed on their merits but in general, a proactive approach will help to mitigate the wider financial consequences of the turmoil, including the risk of rising insolvencies/bankruptcies. Authorized Institutions are also reminded to follow the principles laid down in the Hong Kong Approach to Corporate Difficulties issued by the HKMA and the Hong Kong Association of Banks in the event of a corporate workout. (Guidelines and Circulars, Lending to Small and Medium-Sized Enterprises, HKMA October 29, http://www.info.gov.hk/hkma/eng/guide/circu_date/20081029e1.htm).

Exhibit 4: Movements in the HKMA's balance sheet, resulting from the last EFBN issuance

Step 1: purchase of USD in the market, resulting in an increase in the monetary base and the HKMA's balance sheet

Assets	Liability
Increase in USD assets by US$500 mn (about HK$4 bn)	**Increase** in monetary base by HK$4 bn Increase in aggregate balance

Step 2: issuance of EFBN leads to changes in the "composition" of monetary base, but no changes to monetary base "level"

Assets	Liability
unchanged	Monetary base **unchanged** **decrease** in aggregate balance (by HK$4 bn) **increase** in EFBN (by HK$4 bn)

Source: Bloomberg, CEIC, HKMA, Goldman Sachs Economics Research.

assistance measures, the government had already set up a fund from which banks can access additional capital if needed. We would watch for a potential extension of the government guarantee scheme, for example guaranteeing interbank loans, in an effort to alleviate counterparty risks concerns.

4. **Expanding on the government's SME guarantee loans scheme**. At the government level, the government has already loosened the requirements of the SME guarantee loans scheme.[3] So far, SMEs could only access this scheme after it has secured a loan approval from commercial banks. Given the current concerns on counterparty risks by banks, SME's have not been readily able to acquire loan approvals, and hence had not been able to access the SME guarantee loan scheme offered by the government. We see prospects of raising the guarantee level on this front.

5. **The additional issuance of EFBN**. The issuance of EFBN to improve liquidity management of banks is a balance sheet expansion exercise for the HKMA. This is because by definition, the HKMA as a currency board, does not have the discretion of printing money without new USD inflows into the system, and on the other hand, the EFBN is classified as part of the monetary base under the current settings. Exhibit 4 shows the implications on the HKMA's balance sheet as a result of the issuance of additional EFBN into the system. Although the HKMA strictly adheres to the principles of the currency board arrangement, the structural shortage of EFBN in the system provides the HKMA with an excuse to exercise their discretion in balance sheet expansion to facilitate the recycling of liquidity in the system.

We believe the likelihood of a 1998-style government intervention in equity market is low, at least for now. On top of policies to bolster the banking system, we do not see the need for the government to support the equity market through direct market intervention. The Financial Secretary, John Tsang recently stated that he did not see the need to step into the stock market as it did during the Asian financial crisis in the late 1990s.[4] We believe a couple of criterion would need to be met, before the government would "pull the trigger" and repeat its direct market intervention as in 1998:

1. **A deliberate speculative attack on the HKD peg and the monetary system**. The 1998-market intervention was instigated in response to a deliberate speculative attack on the credibility of the monetary system. This time round, the fall in equity prices occurs on the back of global risk reduction and as the Financial Secretary pointed out, redemption pressures. So far, there has not been a notable attack on the HKD peg or the financial system. Lastly, Premier Wen Jiabao had stated recently that the central government will enhance communication between regulatory bodies in Hong Kong and mainland China. We take this as a hint that the hurdle for any speculative attack on the Hong Kong system (ala 1998-style) is high, and any policy responses by the Hong Kong authorities will receive strong support by the Beijing government.

[3] The government currently provides a 50% guarantee on SME working capital loans up to HK$1.25 million, and a maximum guarantee period for working capital loans up to two years.

[4] See *Government has prepared measures, but will not intervene in market yet: John Tsang,* South China Morning Post, October 28.

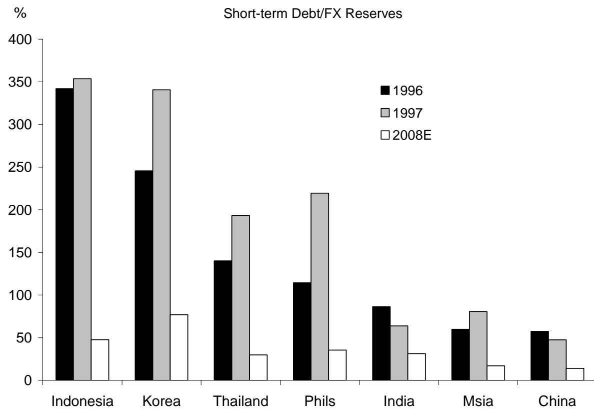
2. **The functioning of the financial system is severely undermined by the market volatility**. We believe the determinant for that is whether the government sees significant capital flight in the system, should there be any potential large-scale redemptions on foreign financial institutions. The government has recently set up a task force, chaired by Chief Executive, Donald Tsang, in monitoring and formulating plans in response to the challenges posed by the global financial crisis. We will watch for any policies coming out of this group in the coming months.

Enoch Fung

Regional Risk Indicators

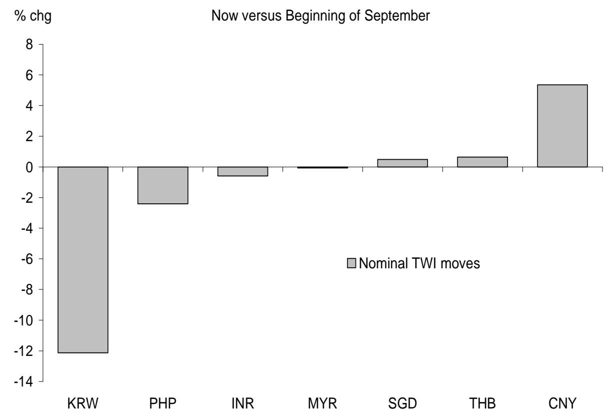
These are the key risk indicators that we continue to keep a close eye on amidst the ongoing global financial crisis, as discussed in our Asia Economics Analyst 08/20 issue published on October 27. Going forward, we will continue to provide updates on these key metrics.

Short-term debt: Much improved but Korea a touch more exposed than others



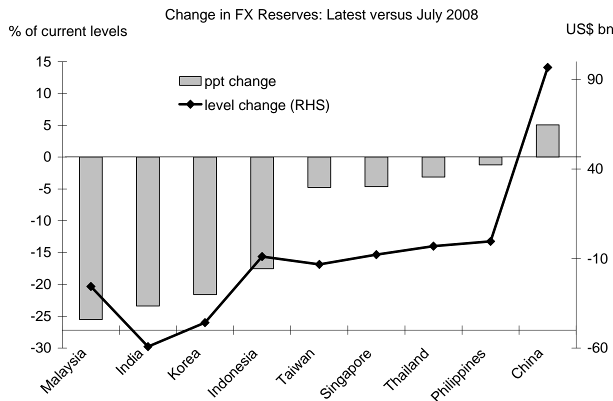
Source: IIF, IMF, Goldman Sachs Economics Research.

The KRW has fallen most despite intervention



Source: Goldman Sachs Economics Research.

Reserves under pressure in Korea, India and Malaysia



End-October data for Malaysia, Korea, Indonesia, Taiwan and India, end-September data for all other countries.

Source: CEIC, Goldman Sachs Economics Research.

Short-term credit indicators worsening in AEJ

%	Policy rate	3m OIS	3m bank borrowing	Short corp borrowing rate	3m T bills	3m Deposit rates	3m bank and policy spread	Corporate-policy rate spread	Corporate and 3m bank spread
China	3.60	-	4.0	6.7	2.8	2.9	0.39	3.1	2.67
Hong Kong	-	2.37	2.5	5.3	0.1	0.5	-	-	2.70
Singapore	-	1.1	1.2	4.3	0.8	0.4	-	-	3.04
Taiwan	3.00	-	1.8	4.4	1.8	2.0	-1.25	1.4	2.65
Malaysia	3.50	-	3.6	6.8	3.5	3.3	0.13	3.3	3.12
Thailand	3.75	-	4.0	7.3	3.4	2.4	0.24	3.5	3.26
Korea	4.00	-	5.9	7.1	5.9	3.0	1.87	3.1	1.23
Philippines	8.00	-	4.0	10.2	6.8	4.8	-4.00	2.2	6.19
India	7.50	6.53	11.2	14.0	7.0	6.4	3.71	6.5	2.79
Indonesia	9.50	-	12.4	14.1	11.2	8.7	2.88	4.6	1.69

Short bank rates: China: SHIBOR; Hong Kong: 3-month HIBOR, CEIC, Indonesia: 3-month JIBOR, Korea: 3-month certificate of deposit, Malaysia: 3-month KLIBOR, Philippines: 3-month PHIBOR, Singapore: 3-month SIBOR, Taiwan: 31-90 day commercial paper, Thailand: 3-month BIBOR, India: 3-month MIBOR.

Policy rates: China: 1-year deposit rate, Indonesia: 1-month SBI rate, Korea: 7-day repo, Malaysia: overnight policy rate, Philippines: repo rate, Taiwan: rediscount rate, Thailand: 1-day repo, India: repo rate.

Short-term corporate borrowing rate: China: 1-year lending rate; India: Prime LR, Korea: 6-month corp bond; Singapore: PLR, Malaysia: Base LR, Indonesia: Base LR; Thailand: Min LR; Taiwan: Base LR; Hong Kong: Best LR.

Source: Bloomberg, CEIC, Goldman Sachs Economics Research.

External and fiscal stresses vary widely

	Current Account as % of GDP (2008F)	Fiscal balance as % of GDP (2008F)	FX reserves		
			Latest (US$ bn)	change from July 2008 (US$ bn)	Change from July 2008 (% of current levels)
China	8.5	1.4	1906	96.8	5.1
India	-3.5	-8.4	253	-59.2	-23.4
Korea	-1.7	0.9	212	-45.8	-21.6
Taiwan	5.0	-1.9	278	-13.3	-4.8
Singapore	15.6	2.1	169	-7.8	-4.6
Malaysia	15.3	-4.3	100	-25.6	-25.5
Indonesia	1.9	-1.8	51	-8.9	-17.5
Thailand	2.2	-2.4	100	-3.1	-3.1
Philippines	1.2	-0.8	36	-0.4	-1.2

* The fiscal number for India represents the amortised value of off-budget bonds. Taking the actual value of bonds issued is likely to raise the fiscal deficit to 9.2%.

Source: CEIC, Goldman Sachs Economics Research.

Statistical Appendix

Interest Rate Outlook

(%)		Current	3-Month Horizon		6-Month Horizon		12-Month Horizon	
		Nov 6	Forward	Forecast	Forward	Forecast	Forward	Forecast
Japan	3M	0.80	0.70	0.60	0.70	0.60	0.70	0.60
NJA								
ASEAN								
Indonesia	3M	12.38	13.80	11.50	13.49	11.50	13.81	11.00
Malaysia	3M	3.66	3.69	3.75	3.71	3.50	3.27	3.50
Philippines	3M	6.28	6.56	6.25	6.66	6.00	6.79	6.00
Thailand	3M	3.21	3.56	4.00	3.51	3.75	3.56	3.75
Singapore	3M	1.21	1.43	2.00	1.61	2.50	1.71	3.00
China	3M	2.83	NA	NA	NA	NA	NA	NA
India	3M	6.95	7.13	8.88	7.04	8.97	7.10	8.58
NIE								
Hong Kong	3M	2.55	3.13	3.00	2.81	2.50	2.81	2.50
Korea	3M	5.69	4.93	5.82	4.20	5.82	4.27	5.47
Taiwan	3M	2.06	2.36	2.40	1.82	2.40	1.98	2.40

Hong Kong: 3M HIBOR, CEIC, Bloomberg (GINAY91), **India:** 91D T-bill, **Indonesia:** 3M JIBOR, CEIC, **Korea:** 3M certificate of deposit, CEIC, **Malaysia:** 3M KLIBOR, CEIC, **Philippines:** 3M T-bill, CEIC, **Singapore:** 3M Interbank, CEIC, **Taiwan:** 61-90D New Taiwan dollar, Secondary, Bloomberg (NTSEC90), **Thailand:** 3M BIBOR, GS estimates, **China:** 3M PBOC Bill yield.

Exchange Rate Outlook

(Local per USD)	Current	3-Month Horizon		6-Month Horizon		12-Month Horizon	
	Nov 6	Forward	Forecast	Forward	Forecast	Forward	Forecast
Japan	99.0	98.7	112.0	98.3	108.0	97.5	114.0
NJA							
ASEAN							
Indonesia	11,000	11,650	9,200	12,240	9,250	12,750	9,300
Malaysia	3.55	3.56	3.32	3.57	3.30	3.57	3.25
Philippines	48.48	49.87	45.00	50.49	45.50	51.39	46.00
Thailand*	34.99	35.07	34.50	35.09	35.50	35.12	36.50
Singapore	1.49	1.50	1.49	1.49	1.54	1.48	1.50
China	6.83	6.89	6.74	6.90	6.69	6.92	6.56
India	47.95	49.49	46.10	50.44	45.90	51.39	44.90
NIE							
Hong Kong	7.75	7.75	7.80	7.75	7.80	7.76	7.80
Korea	1,355	1,340	1,250	1,332	1,150	1,322	1,120
Taiwan	32.84	32.76	32.50	32.53	32.00	32.27	32.00

* Forecasts are for onshore Thai baht.

Global Macroeconomic Outlook

	2006	2007	2008E	2009E	2007 1Q	2007 2Q	2007 3Q	2007 4Q	2008 1Q	2008 2Q	2008 3QE	2008 4QE	2009 1QE	2009 2QE	2009 3QE	2009 4QE
Real GDP Growth (% yoy)																
Advanced Economies	3.1	2.7	1.4	0.0	2.6	2.6	3.0	2.7	2.5	1.9	1.0	0.2	(0.5)	(0.4)	0.1	1.0
United States	2.8	2.0	1.3	(0.8)	1.3	1.8	2.8	2.3	2.5	2.1	0.8	(0.0)	(0.8)	(1.4)	(1.1)	0.1
Euroland	3.0	2.6	1.0	(0.3)	3.2	2.6	2.6	2.1	2.1	1.4	0.7	(0.1)	(1.0)	(0.7)	(0.2)	0.6
Japan	2.4	2.1	0.7	0.5	3.2	1.8	1.7	1.6	1.2	0.7	0.7	0.1	(0.5)	0.6	0.7	1.1
CPI Inflation (% yoy, avg.)																
Advanced Economies	2.3	2.2	3.7	1.6	1.9	2.0	1.8	3.1	3.4	3.7	4.4	3.1	2.3	1.5	0.8	1.5
United States	3.2	2.9	4.2	1.0	2.4	2.6	2.4	4.0	4.2	4.3	5.3	3.0	2.1	1.1	(0.2)	1.1
Euroland	2.2	2.1	3.4	1.8	1.9	1.9	1.9	2.9	3.4	3.6	3.8	2.6	2.1	1.4	1.4	2.2
Japan	0.2	0.1	1.6	0.8	(0.1)	(0.1)	(0.1)	0.5	1.0	1.4	2.4	1.5	1.0	0.8	0.5	0.7
Interest Rates (% p.a. eop.)																
Fed funds	5.25	4.25	1.73	0.50	5.25	5.25	4.75	4.25	2.25	2.00	2.00	0.50	0.50	0.50	0.50	0.50
UST 10-year	4.71	4.03	3.50	4.00	4.65	5.03	4.58	4.03	3.43	3.98	3.79	3.50	3.50	3.60	3.80	4.00
Euro yield 10-year	3.95	4.33	3.70	3.90	4.07	4.57	4.32	4.33	3.90	4.58	4.01	3.70	3.50	3.50	3.60	3.90
Exchange Rates (eop.)																
USD/EUR	1.32	1.45	1.45	1.40	1.31	1.35	1.37	1.45	1.50	1.56	1.56	1.45	1.50	1.45	1.40	1.40
JPY/USD	119.1	113.1	111.2	114.0	119.4	120.7	117.8	113.1	105.2	104.5	108.6	111.2	108.8	111.0	113.7	114.0
WTI Oil (average $)	66.2	72.2	115.0	110.0	58.2	65.0	75.2	90.5	97.7	123.9	118.0	85.0	65.0	70.0	75.0	90.0

Central Bank Watch

Country	Likely Decision / Reasons	Date of Next Policy Meeting
UNITED STATES	The Federal Reserve cut the Fed Funds rate by 50 bp to 1.00% on October 29. We expect the Fed Funds rate to remain unchanged for the foreseeable future.	December 16
JAPAN	The Bank of Japan cut the overnight call rate by 20 bp to 0.30% on October 31. We expect the central bank to keep the policy rate at 0.3% throughout FY2008-2009.	November 20/21
EUROLAND	The European Central Bank cut rates by 50 bp to 3.25% on November 6. We expect the European Central Bank to cut rates to 2.00% by the end of 1Q2009.	December 4
KOREA	The Bank of Korea cut the policy rate by 25 bp on November 7, to 4.00%. We expect the BOK to cut policy rates to 3.50% by mid-2009.	December 11

Main Economic Indicators

	GDP						Inflation					
	2006	2007	2008E	2009E	Latest	(yoy)	2006	2007	2008E	2009E	Latest	(yoy)
Pan Asia*	7.9	7.9	6.0	5.3	6.5	(2Q)	2.6	3.3	6.3	2.7	6.0	(Sep)
NIE + ASEAN	5.6	5.9	4.3	3.2	5.0	(2Q)	4.6	3.1	7.0	4.5	7.2	(Sep)
ASEAN	5.8	6.3	4.8	3.3	5.4	(2Q)	7.2	3.9	8.9	6.3	10.0	(Sep)
Indonesia	5.5	6.3	5.8	3.5	6.4	(2Q)	13.1	6.4	10.5	8.2	**11.8**	**(Oct)**
Malaysia	5.8	6.3	5.0	3.4	6.3	(2Q)	3.6	2.0	6.0	4.1	**8.2**	(Sep)
Philippines	5.4	7.2	4.0	3.2	4.6	(2Q)	6.3	2.8	9.6	6.8	**11.2**	**(Oct)**
Thailand	5.1	4.8	4.3	3.3	5.3	(2Q)	4.6	2.2	7.5	5.0	**3.9**	**(Oct)**
Singapore	8.2	7.7	3.0	2.0	2.1	(2Q)	1.0	2.1	6.5	3.4	**6.7**	(Sep)
Vietnam	8.2	8.5	6.6	6.0	5.8	(2Q)	7.4	8.3	22.0	14.0	**26.7**	**(Oct)**
Japan	2.4	2.1	0.7	0.5	0.7	(2Q)	0.2	0.1	1.6	0.8	2.1	(Sep)
China	11.6	11.9	9.8	8.7	**9.0**	**(3Q)**	1.5	4.8	6.3	1.5	**4.6**	(Sep)
India (FY Basis)	9.6	9.0	6.7	5.8	7.9	(2Q)	5.5	4.6	11.5	5.3	**11.0**	**(Oct)**
NIE	5.3	5.4	3.7	3.0	4.6	(2Q)	1.7	2.2	5.0	2.5	**4.2**	(Sep)
Hong Kong	7.0	6.4	3.0	2.2	4.2	(2Q)	2.0	2.0	4.8	2.0	**3.1**	(Sep)
Korea	5.1	5.0	4.3	3.9	**3.9**	**(3Q)**	2.2	2.5	5.5	3.0	**4.8**	**(Oct)**
Taiwan	4.9	5.7	3.0	2.2	4.3	(2Q)	0.6	1.8	4.1	2.0	**2.4**	**(Oct)**

	3 M Interest Rates					Exchange Rates				
ASEAN										
Indonesia	9.8	8.0	11.5	10.5	12.4	9020	9419	9250	9300	11000
Malaysia	3.7	3.6	3.8	3.5	3.7	3.53	3.31	3.30	3.25	3.55
Philippines	4.8	3.7	6.3	6.0	6.3	49.6	42.7	45.5	46.0	48.5
Thailand	5.3	3.9	3.8	4.0	3.2	35.8	33.7	35.5	36.5	35.0
Singapore	3.4	2.4	2.0	2.5	1.2	1.53	1.44	1.49	1.45	1.49
Vietnam	—	—	—	—	—	16055	15995	17325	18802	16828
Japan	0.5	0.9	0.6	0.6	0.8	119.1	113.1	111.2	114.0	99.0
China	—	—	—	—	—	7.81	7.30	6.77	6.53	6.83
India	8.0	7.2	9.0	8.0	7.0	43.6	40.0	45.9	42.0	48.0
NIE										
Hong Kong	3.8	3.3	3.0	2.5	2.5	7.77	7.80	7.80	7.80	7.75
Korea	4.9	5.8	4.7	4.3	5.7	930	938	1280	1110	1355
Taiwan	1.8	2.0	1.9	1.9	2.1	32.6	32.4	32.5	32.0	32.8

*Pan Asia includes India.

GDP and inflation are annual averages. Interest rates and exchange rates refer to end-period. Figures in bold indicate recent revisions.

Hong Kong: 3M HIBOR, CEIC, Bloomberg (GINAY91), **Indonesia**: 3M JIBOR, CEIC, **Korea**: 3M certificate of deposit, CEIC, **Malaysia**: 3M KLIBOR, CEIC, **Philippines**: 3M T-bill, CEIC, **Singapore**: 3M Interbank, CEIC, **Taiwan**: 61-90D New Taiwan dollar, Secondary, Bloomberg (NTSEC90), **Thailand**: 3M BIBOR, CEIC. **India:** 91 D T-bill

Asia in a Nutshell

	Present Situation	Key Issues
CHINA	Real GDP growth came in at 9.0% yoy in 3Q2008 from 10.1% yoy in 2Q2008. This is the lowest reading since 2Q2003. Growth in the GS China Activity Index moderated slightly to 8.7% yoy in September, from 8.8% yoy in August. This is the lowest level since December 2001. Faster growth in fixed asset investment, retail sales and trade were offset by slower growth in industrial production, electricity production and household income (all measures in real terms). Meanwhile, the CEMAC-GS Coincident Indicator also softened to 101.80 in September from 102.27 in August. Although Olympic/Paralympic-related activity restrictions affected September growth, the actual growth level was weaker than expected given that all the restrictions were lifted by September 20.	We expect the central bank to cut benchmark interest rates further by 100-150 bp by the end of 2009. We view the policy changes adopted by the government so far as incrementally positive. However, we believe they are not sufficient to prevent the economy from softening further and there are significant downside risks to our 2009 GDP growth forecast of 8.7%. Policymakers will hold the annual Central Economic Working Conference in late-November or early-December when they will set the overall policy tone for the rest of 2008 and 2009. Paradoxically, we believe the weaker-than-previously-expected growth in October can be a positive factor as it is likely to raise the level of urgency the government feels in terms of taking more forceful measures to prevent the economy from falling dramatically.
HONG KONG	We expect consumption growth to slow more significantly, as the impact of a softer labor market and the negative wealth effect sets in. We believe the narrowing of the positive output gap would eventually cool domestic inflation, alleviating the appreciation pressure on the HKD peg. We believe the recent liquidity injections by the HKMA will likely continue, on the back of the tighten credit conditions. However, the confidence in the global credit markets holds the key to the effectiveness of the HKMA's liquidity actions, and we expect the HIBOR to remain elevated in the near term, given the volatility in US money market rates.	We believe that a HKD-CNY peg should be the endgame for the HKD in the future, but the timing there is still uncertain. For now, the political incentive to change (or modifying) the HKD peg system is still low, especially when the uncertainties in the near-term global growth outlook may hold the authorities back from making changes in the current HKD peg system. However, when the capital account in China liberalizes in the long run, we expect the circulation of the CNY in the Hong Kong economy will increase rapidly, paving the way for a natural transition towards an eventual HKD-CNY peg in the distant future.
INDIA	The central bank cut the repo rate by 50 bp, the cash reserve ratio of banks by 100 bp and the statutory liquidity ratio by 100 bp on November 1. This brings the respective rates to 7.50% for the repo, 5.50% for the CRR and 24% for the SLR. However, given that lower interest rates will not be felt for some time, we believe the postponement of capex plans and consumer spending will continue despite the aggressive policy moves. We think the downturn is spreading rapidly from the financial sector to real activity, and have revised down our growth forecast for FY10 to 5.8% from 7.0% previously.	We believe lending will increasingly become a problem for banks due to rising credit risk, while companies will progressively find it difficult to borrow due to falling net worth and worsening balance sheets at exactly the time they need capital the most. Pressure for the INR to weaken in the near term remains, not only due to portfolio outflows, but mainly due to corporates and banks swapping INR for USD to meet their international funding needs. Unless these pressures ease, further weakness of the INR is likely to continue in the near term.
INDONESIA	Indonesia 2Q2008 real GDP growth came in at 6.4% yoy, exceeding the consensus estimate of 6.1% yoy. Going forward, we expect domestic demand growth to moderate further against the backdrop of a tighter monetary policy stance. Exports will also provide less of a boost. Our GDP growth forecasts for 2008 and 2009 are at 5.8% and 3.5% respectively.	BI kept the benchmark Bank Indonesia rate unchanged at 9.50%, which marked the end of the 6-month-long tightening cycle which started in May to counter double-digit inflation. However, given its focus on maintaining IDR stability, we do not expect BI to start cutting rates this year.
KOREA	Production growth rebounded modestly in September. Industrial production (IP) growth rebounded to 6.1% yoy. Investment growth remains weak, consumption growth slowed sharply. Equipment investment growth rebounded to 7.3% yoy from 1.5% yoy in August, but construction orders contracted for the fourth consecutive month by a sizable 40.4% yoy. Wholesale and retail sales volume growth declined sharply to 0.3% yoy in September, from 3.8% yoy in August. Going forward, we expect domestic demand to remain under further downward pressure. We expect the government to speed up the implementation of the large-scale fiscal stimulus and to continue undertaking proactive monetary easing given the deterioration in domestic demand outlook.	The BOK reduced its policy rate by 25 bp to 4.00% on November 7. The rate cut, the third time over the last four weeks, follows a series of policy initiatives to provide stimulus to the economy, including the announcement of a fiscal stimulus plan on November 3, an interim rate cut of 75 bp on October 27, and the release of a construction support plan on October 21. While the rate reduction will not necessarily reduce credit spreads for corporates proportionally given the global trends, the sustained rate reductions will likely help limit downside risks for private consumption and mitigate pro-cyclical tightening by banks. We believe more active open market operations by the central bank, including direct purchase of debentures, will also help address liquidity shortage in the system.

Asia in a Nutshell (Cont'd)

	Present Situation	Key Issues
MALAYSIA	We expect growth to continue slowing in the coming quarters as higher inflation (which started to spike only in June) starts to weigh more on the consumer. The continued political instability also remains unhelpful for infrastructure spending, business confidence and the general growth outlook. Our 2009 GDP growth forecast is at 3.4%, far below the consensus of 4.5%.	In light of the continued deterioration in the global growth outlook and the ongoing financial market turmoil, the risk of rates is to the downside. We think that BNM will look to ease policy, possibly as soon as the next meeting, especially if the growth risks become clearer and inflation risks diminishes.
PHILIPPINES	Philippines headline CPI inflation eased further to 11.2% yoy in October, from a revised 11.8% yoy in September. However, core CPI inflation continued to accelerate to 7.8% in October from 7.5% previously. Our 2008 GDP growth forecast is now at 4.0%, below the lower end of the government's recently revised forecast range of 4.4% to 4.9%.	BSP left rates unchanged on October 6, signaling the end of its rate hike cycle. We think BSP could start its easing cycle with a 25-bp cut as early as its next meeting on November 20, if the global risk appetite continues to stabilize. Any significant PHP weakness though in the interim could prompt the central bank to keep rates on hold for longer.
SINGAPORE	The MAS eased policy by shifting to a zero appreciation stance at its biannual Monetary Policy Statement. The move to a neutral stance was spurred by the much weaker growth outlook. The advanced 3Q2008 GDP release on October 10 confirmed that the economy has slipped into a technical recession (2 consecutive quarters of negative sequential growth) with a qoq; seasonally-adjusted; annualized growth rate of -6.3% from -5.7% in 2Q2008.	The turmoil in the global financial markets, the unprecedented scale of coordinated rate cuts by global central banks and the clearer, additional downside risks to growth made it increasingly likely that the MAS was going to pursue a neutral stance. Going forward, the policy stance has undoubtedly shifted to an easing bias and further easing moves such as a downward re-centering of the band are possible, as we expect the SGD NEER to trade to the bottom of the band as we approach the next scheduled meeting in April 2009.
TAIWAN	We expect inflation to trend down from current levels in 4Q2008, owing to higher base effects. This has allowed the central bank to switch to an easing mode, on the back of greater cyclical headwinds. The central bank announced an inter-meeting policy rate cut of 25 bp on October 30. The government also has greater flexibility to provide more favorable fiscal policies. Nonetheless, despite a more growth supportive policy mix, we believe the cyclical headwinds from weakening global growth should still prevail. Export growth momentum will likely moderate, with weaker global industrial cycle ahead.	We believe the recent improvement in the cross-strait political climate is ushering in a new era for the Taiwan economy. Hong Kong's experience in integrating into the mainland economy offers a useful roadmap for Taiwan, as Taiwan continues to liberalize cross-strait economic policies. We believe closer cross-strait ties would allow Taiwan to solidify its dominant role in China's IT manufacturing sector, given the significance of Taiwanese companies in China's technology production supply chain. Over the longer term, we believe this could lift Taiwan's potential growth via productivity gains and revive its labor market.
THAILAND	2Q2008 real GDP growth came in at 5.3% yoy, slower than the revised 6.1% yoy in 1Q2008 and below the consensus expectation of 5.7% yoy. This moderation in headline growth momentum was in line with our expectations and we expect continued moderation over the coming quarters. We believe the domestic demand recovery is still at a fragile stage and we should see continued downward pressure from the deteriorating consumer sentiment and spending on the back of rising inflationary pressures and ongoing political uncertainty.	The focus has swung from inflation to growth fears, heightened by the continued concerns in the external environment. We are already below consensus with our well-held GDP growth forecasts at 4.3% for Thailand in 2008. October headline CPI inflation eased to 3.9% yoy versus 6.0% yoy in September. This was much lower than the consensus of 4.9% yoy. Given that inflation has eased off more significantly, we think it is likely that the BOT will move to an easing bias (cutting rates by 25 bp) at its December meeting.

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Key Things to Watch

<table>
<tr><td colspan="2">The spotlight will be on China this week, as it is scheduled to release a slew of important data. We expect further moderation in activity growth as well as a further softening in inflation. Other activity data around the region such as Hong Kong's 3Q2008 GDP release, Singapore's exports and retail sales should also reinforce the message of slowing growth in the region. We expect a second consecutive negative sequential quarterly GDP reading in Hong Kong, effectively confirming a technical recession.</td></tr>
<tr><td>China

Money and credit (Oct) (Nov 10-14)
Trade (Oct) (Nov 11)
CPI (Oct) (Nov 11)
Retail sales (Oct) (Nov 12)
Industrial production (Oct) (Nov 13)
Fixed asset investment (Oct) (Nov 14)</td><td>Activity to weaken further?
▪ Forecast: yes. Activity growth was widely expected to show a rebound after the Olympic-related restrictions were all lifted by September 20. However, recent data and anecdotal evidence, in particular, commodity prices and production, consistently suggest that activity growth continued to weaken instead.
▪ We believe industrial production growth will likely soften to 9.9% yoy in October compared with 11.4% yoy in September. Fixed asset investment growth will likely moderate to 26.0% yoy in October from 29.0% yoy in September. Nominal retail sales growth is expected to moderate to 22.2% yoy, compared with 23.2% yoy in September, mainly as a reflection of lower consumer inflation.
▪ CPI and PPI inflation should also moderate further. CPI is likely to trend down further to 3.9% yoy in October, from 4.6% yoy in September. PPI inflation is likely to moderate further to 7.8% in October from 9.1% in September.</td></tr>
<tr><td>US

Trade balance (Sep) (Nov 13)
Retail sales (Oct) (Nov 14)
Industrial production (Oct) (Nov 17)
PPI (Oct) (Nov 18)
CPI (Oct) (Nov 19)
FOMC minutes (Nov 20)</td><td>Growth to weaken further?
▪ Yes. Our US Economics Team has recently marked down their near-term forecasts for real GDP—to annualized declines of 3.5% and 2.0% in 4Q2008 and 1Q2009, respectively—and they have added another 50 bp of Fed easing by year-end.
▪ These changes reflect the accumulation of evidence that US domestic demand and production continue to fall sharply. As a result, they now expect the unemployment rate to reach 8.5% by year-end 2009. They also continue to assume enactment of a US$200 billion package of fiscal stimulus early next year.</td></tr>
<tr><td>India

Industrial production (Sep) (Nov 12)</td><td>Slowing industrial production (IP) trend to continue?
▪ Yes. We expect IP to grow 5.5%-6.5% yoy. The low August print of 1.3% yoy growth was an exaggeration, and although we expect next week's number to be higher, we expect it to continue the slowing IP trend we have seen so far this year.</td></tr>
<tr><td>Hong Kong

GDP (3Q) (Nov 14)
Unemployment (Oct) (Nov 18)
CPI (Oct) (Nov 20)</td><td>Entering into a "technical recession"?
▪ Yes. We forecast 3Q GDP to grow at 1.7% yoy, a slowdown from the 4.2% in 2Q. On a sequential basis, we expect negative qoq growth for the second quarter in a row.
▪ We expect the weakening external demand to weigh on the labor market, hampering consumption further, as evidenced by the latest weak retail sales figure. Our GDP growth forecasts are 3.0% and 2.2% for 2008 and 2009 respectively, which are both well below consensus.</td></tr>
<tr><td>Malaysia

CPI (Oct) (Nov 19)
Industrial production (Sep) (Nov 11)</td><td>Bank Negara Malaysia (BNM) to ease on slower growth?
▪ Forecast: yes. In light of the continued deterioration in the global growth outlook and the ongoing financial market turmoil, the risk of rates is to the downside. Our 2009 GDP growth forecast is at 3.4%, below the consensus at 4.5%. We think that BNM will look to ease policy, possibly as soon as the next meeting, especially if the growth risks become clearer and inflation risks diminishes.</td></tr>
<tr><td>Singapore

Retail sales (Sep) (Nov 14-17)
NODX (Oct) (Nov 17)
CPI (Oct) (Nov 24)</td><td>Deteriorating growth outlook?
▪ Yes. We believe a weaker manufacturing sector and external demand will continue to be a drag on headline growth. Against the backdrop of slowing external demand, exports have already been registering negative growth for the last five months. We have recently downgraded our GDP growth forecasts for the region and have pushed Singapore's 2009 GDP growth forecast down further to 2.0%.</td></tr>
</table>

Additional things to watch: **Philippines central bank policy meeting** (Nov 20).