

Emerging Markets Daily

Asia Edition

October 3, 2007

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Focus on India

- **India.** In a bid to encourage forex outflows and stem rupee appreciation, the Reserve Bank of India (RBI) recently introduced a number of new measures (p. 2).

Highlights

- **India.** The April-August fiscal deficit came in at 68.5% of budget estimates. While the government likely will meet budget targets, expenditure pressures have been on an uptrend (p. 3).

Market Drivers

- **United States.** While initial claims likely by 22,000 during the filing period, orders and shipments possibly fell in August reversing much of the July gain.
- **Malaysia.** Exports probably stayed soft on electronics in August, while imports likely buoyed by higher consumer spending and public investment.

Data Calendar

Date	Day	Local Time	Country	Indicator	For	Citi Fcst	Mkt Fcst	Prev.
4-Oct	Thu	8:30 PM	US	Initial Jobless Claims (th)	30-Sep	320.0	—	298.0
4-Oct	Thu	10:00 PM	US	Factory Orders (%)	Aug	-2.4	-2.3	3.7
4-Oct	Thu	10:00 PM	US	Factory Inventories (%)	Aug	0.1	—	0.2
4-Oct	Thu	7:45 PM	Euro Area	Rate Announcement		4.0	4.0	4.0
4-Oct	Thu	7:00 PM	UK	MPC Rate Announcement		5.75	5.75	5.75
4-Oct	Thu	12:01 PM	Malaysia	Exports (% YoY)	Aug	0.1	0.0	0.0
4-Oct	Thu	12:01 PM	Malaysia	Imports (% YoY)	Aug	3.8	2.7	2.5
4-Oct	Thu	12:01 PM	Malaysia	Trade Balance (RM bn)	Aug	8..5	9.0	8.0

Source: Bloomberg, CEIC Data Company Limited, Citi estimates.

See Disclosure Appendix A1 for the Analyst Certification and Other Disclosures.

Focus on India

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India: RBI introduces measures to stem rupee appreciation

In a bid to encourage forex outflows and stem rupee appreciation, the Reserve Bank of India (RBI) introduced a number of measures last week. These (including raising limits on remittance outflows to US\$200,000 from 100,000 earlier; and increasing the cap on overseas investments by MFs) are based on recommendations of the task force on Capital Account Convertibility¹ whose report was released by the RBI last year. The Committee suggested that liberalization of the capital account be done in a phased manner with phase 1 = FY07; phase 2 = FY08-09 and phase 3 = FY10-11.

Timing of the move aimed at taming rupee's rise. While the measures are based on the report's recommendations, the timing is clearly aimed at tempering currency appreciation. Following the US Fed's 50bps rate cut, higher portfolio flows have resulted in a sharp appreciation with the rupee touching a nine-year high of Rs39.7/\$. Comments by the Finance Minister that the government could do little to curb appreciation saw further gains in the rupee.

Looking ahead: Although recent RBI measures are positive for capital account convertibility, we expect them to have little impact on the currency; given the magnitude of dollar inflows. Taking into account higher capital flows coupled with recent changes in our global currency and rate forecasts, we adjusted the pace of INR appreciation – with the INR likely to average Rs38/US\$ in 2008 v/s 40 earlier.

Recent Changes encouraging Capital Outflows

	Earlier Position	Revised Policy
External Commercial Borrowings	1) ECBs up to US\$500mn per financial year permitted under the automatic route with end-use restrictions. Overall limit fixed at US\$22bn. 2) Prepayment of up to US\$400mn allowed without prior approval	1) Overall limit remain at US\$500mn. Changes limiting the use of ECBs to US\$20mn onshore were made last month. 2) Prepayment without approval raised to US\$500mn
Portfolio Investments overseas	Listed companies could invest 35% of the net worth into portfolio investments abroad	Limit raised to 50% of net worth. Requirement of 10% reciprocal share holding in company by overseas company removed
Joint Ventures/Wholly Owned Subsidiaries	Indian companies could invest up to 200% of their net worth in overseas bodies	Overall limit raised to 400% of net worth under the automatic route
Mutual Funds Investments overseas	Aggregate ceiling was fixed at US\$4bn, individual ceiling decided by SEBI	Aggregate ceiling raised to US\$5bn
Financial Capital transfers	Residents permitted to remit US\$100,000 per calendar year	Limit raised to US\$200,000 per calendar year

Source: Committee for Fuller Capital Account Convertibility; RBI, Citi

¹ A six-member committee chaired by SS Tarapore was appointed in March 2006, following an address by the PM asking the RBI to 'revisit the subject of capital account convertibility and come out with a roadmap based on current realities'. For details pls see "India's 5-Yr Road Map Towards Capital Account Convertibility (CAC): Positive, but Much to Be Sorted Out" dated Sept 4th, 2006

News in Brief

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India

Apr-August fiscal deficit – 68.5% of budget estimates. The distortion in the fiscal picture seen earlier this year (*following the expenditure incurred on acquiring RBI's 59.7% stake in SBI*) was reversed in August, when the RBI transferred an equivalent amount in the form of dividend. As a result, the fiscal deficit during Apr-Aug was Rs1,033bn or 68.5% of budget estimates while the revenue deficit was Rs535bn or 75% of estimates as compared to it crossing 100% of estimates last month. *(Rohini Malkani/Anushka Shah)*

Tax collections – growth slows in line with budget targets: From the 30%+ growth seen in 1QFY08, growth in gross tax collections slowed to 18% in August – in line with the 17% budget target. The slowdown is primarily due to lower excise collections. **Positive:** The FY08 deficit is targeted at Rs1509bn or 3.3% of GDP – in line with the FRBM² targets. While we maintain our view that the budget assumptions are conservative, a point to note is the rise in off-balance sheet items³ (oil bonds/possibility of further fertilizer subsidies), and the recent announcement of the extension of the National Rural Employment Guarantee Program⁴ (NREGP) – a possible indicator of the government getting ready for early elections *(Rohini Malkani/Anushka Shah)*

² Under the **FRBM Act**, beginning FY05, the central government has to reduce its fiscal and revenue deficit by 0.3% and 0.5% of GDP a year so as to eliminate the revenue deficit by 2009

³ Off balance sheet items : (1) **Oil bonds** - In order to compensate oil companies for marketing losses, the government is likely to issue oil bonds to the tune of Rs190bn in FY08 as compared to Rs241bn in FY07 and Rs115bn in FY06 (2) **Fertilizers** – FY07 arrears of Rs88bn were paid out of the current year's subsidy bill which could result in the FY08 limit being breached

⁴ The implementation of the **National Rural Employment Guarantee Program (NREGP)** will also impose an additional fiscal strain. Implemented in 2006, the scheme enables one member of every rural household to 100 days a year of work at a minimum wage of Rs60 per day. The government initially rolled out this scheme in 200 districts and this number was later raised to 330 districts in the budget this year, with an initial allocation of Rs120bn. Now, the government intends to extend the program to all districts in the country (i.e 600), which would nearly double the outlays required.

Selected Market Indicators

Policy Rates					Currency						
	Spot	Change (ppt)			Spot	Change (%)					
		1 Day	1 Mo	1 Yr		1 Day	1 Mo	1 Yr			
China - 1-year lending rate	7.29	-	0.27	1.17	Bangladesh Taka	68.73499	0.00%	-0.06%	-1.91%		
Hong Kong - 3-Month Interbank Rate	5.19	0.24	0.30	0.94	China Renminbi	7.504499	0.02%	0.53%	5.32%		
India - Overnight Reverse Repo Rate	6.00	-	-	-	Hong Kong Dollar	7.7577	0.05%	0.46%	0.43%		
Indonesia - BI Rate	8.25	-	-	(3.00)	Indian Rupee	39.77	0.19%	2.75%	14.93%		
Malaysia - Overnight Policy Rate	3.50	-	-	-	Indonesian Rupiah	9124.5	-0.37%	2.90%	0.94%		
Philippines - O/N Rate	6.00	-	-	(1.50)	Malaysian Ringgit	3.4118	-0.18%	2.66%	8.05%		
Singapore - 3-Month Interbank Rate	2.42	(0.06)	(0.37)	(1.01)	Phillipine Peso	45.06	-0.19%	3.35%	10.70%		
South Korea - Overnight Rate	5.00	-	-	0.50	Singaporean Dollar	1.4812	0.07%	2.87%	6.79%		
Taiwan - Overnight Rate	2.04	(0.00)	0.04	0.38	South Korean Won	915.6	0.06%	2.37%	3.53%		
Thailand - O/N Repo Rate	3.25	0.03	-	(1.59)	Taiwan Dollar	32.573	0.06%	1.34%	1.48%		
					Thai Baht (onshore)	34.245	0.01%	0.10%	9.77%		
					Thai Baht (offshore)	31.765	-0.08%	1.78%	18.34%		
					Vietnam Dong	16082	0.02%	0.98%	-0.22%		
Long Term Bond Yield					Equities						
	Spot	Change (ppt)			Last Index Level	Change (%)					
		1 Day	1 Mo	1 Yr		1 Day	1 Mo	1 Yr			
China - Government bond yield (5-Year)	3.88	-	0.20	1.20	Bangladesh DHAKA	2648	0.00%	4.50%	42.56%		
Hong Kong - 5-Year Exchange Fund Note	4.08	-	(0.15)	0.23	China (H Shares)	17318	-3.79%	17.44%	58.80%		
India - 10-Year Gilt	7.93	-	0.00	0.31	China (Shanghai SE Composite)	5552	0.00%	4.16%	68.44%		
Indonesia - FR26	9.09	(0.00)	(0.47)	(1.54)	Hong Kong Hang Seng	27480	-2.62%	13.01%	35.93%		
Malaysia - MGS 1/05	3.60	-	(0.01)	(0.35)	India NIFTY	5148	1.54%	13.08%	30.67%		
Philippines - 5-Year T Bond	5.93	-	-	(1.60)	Indonesia Jakarta	2452	-0.54%	9.71%	37.28%		
Singapore - 10-Year SGS	2.71	-	(0.22)	(0.46)	Korea KOSPI	2014	0.00%	6.57%	31.77%		
South Korea - 5-Year Treasury	5.52	-	0.03	0.89	Malaysia Kuala Lumpur	1367	-0.13%	6.06%	29.22%		
Taiwan - 10-Year Government Bond	2.64	-	0.16	0.65	Philippines Composite	3770	2.46%	10.63%	33.09%		
Thailand - 10 Year Government Bond	4.75	0.02	(0.01)	(0.43)	Singapore Straits Times	3755	-1.04%	9.81%	30.93%		
Vietnam - 5-Year Government Bond	8.11	(0.03)	0.16		Taiwan Taiex	9700	0.79%	7.42%	28.28%		
					Thailand SET	852	-0.13%	3.77%	20.01%		
					Vietnam Ho Chi Minh	1107	0.64%	17.91%	51.39%		
Other Indicators					EM CDS (5Yr)						
	Last Index Level	1 Day	Change		Prev	Close	Change				
			1 Mo	1 Yr			1 Day	1 Mo	1 Yr	5s-2s	10s-5s
Fed Funds	4.75	-	1.75	(0.50)	China	20	0	-7	1	8	4
6 month LIBOR	5.16	-	(0.39)	(0.20)	India	79	0	-17	20	-	-
10 Yr UST	4.52	(0.01)	(0.01)	(0.10)	Indonesia	137	0	-41	-20	61	78
10 Yr Bund	4.300	(0.02)	0.04	0.57	Korea	23	0	-11	0	6	3
Eurostoxx	3889	0.00%	2.96%	8.59%	Malaysia	25	0	-12	-1	8	4
10 Yr JGB	1.685	(0.01)	0.04	(0.01)	Philippines	141	0	-40	-28	63	37
10 Yr Swap	5.15	(0.00)	(0.08)	(0.01)	Thailand	43	0	-13	0	17	10
HY BB Index	462	0.00%	2.65%	5.91%							
HY B Index	505	0.00%	2.58%	7.27%							
VIX	18.49	-	(4.89)	6.25							
DJIA	14047	0.00%	4.91%	16.52%							
SPX	1547	0.00%	4.70%	13.74%							
TPX	1664	1.46%	3.52%	2.77%							
NASDAQ	2116	0.00%	6.01%	22.48%							
Oil, WTI	80	0.46%	7.93%	27.03%							
Copper Index	372.70	0.54%	8.48%	11.85%							
JPY/USD	116	0.35%	0.17%	-1.52%							
USD/EUR	1.4166	0.07%	3.83%	10.11%							
ECB Marginal Lending	5.00	-	-	1.00							
BOJ	0.51	(0.01)	(0.51)	(0.81)							
Palm Oil Future	2,541	-1.10%	3.27%								
Gold	733	0.17%	8.23%	21.61%							
DRAM Benchmark Value Weighted Index	2,962	-0.23%	-	-							
			10.68%	48.03%							

Source: Bloomberg (as of 10/3/2007 5:03 PM).

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