Emerging Markets Daily

Asia Edition

March 16, 2007

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Focus on India/Thailand

- **India.** Inflation control is now top priority with policy makers; we expect inflation to trend towards 5% levels by May (p. 2).
- **Thailand**. Capital controls may have been lifted but the requirement of onshore hedging offshore portfolio exposure for at least three months remains (p. 3).

Highlights

- **China.** Exports and consumption lifted industrial production growth (p. 4).
- **India.** Buoyant infrastructure data in Jan07 indicates the ongoing investment cycle upturn is on track (p. 4).
- **Vietnam.** Moody's upgraded Vietnam's rating outlook to positive (p. 4).

Today's Market Drivers

- **USA.** A projected pickup in food quotes, combined with an anticipated rebound in retail energy costs, probably propelled the CPI higher (+0.4%) in February. An anticipated rebound in factory output, along with a weather-related jump in utilities generation, probably powered the largest increase in the industrial production gauge since last June.
- **China.** Investment growth should have regained ground from a surging credit expansion and startup of new investment projects after successful IPOs last year.
- **Singapore.** Non-oil domestic exports probably contracted in February on fewer working days. Electronic exports may have contracted as much as 11%.

Data Calendar

Date	Day	Local Time	Country	Indicator	For	Citi Fcst	Mkt Fcst	Prev.
16-Mar	Fri	8:30 PM	US	Consumer Price Index (%MoM)	Feb	0.4	0.3	0.2
16-Mar	Fri	8:30 PM	US	CPI Ex Food & Energy (%MoM)	Feb	0.2	0.2	0.3
16-Mar	Fri	9:15 PM	US	Industrial Production (%MoM)	Feb	0.7	0.3	-0.5
16-Mar	Fri	9:15 PM	US	Capacity Utilization (%MoM)	Feb	81.7	81.3	81.2
16-Mar	Fri	10:00 PM	US	U. of Michigan Confidence	Mar P	89.5	90.0	91.3
16-Mar	Fri	7:50 AM	Japan	Tertiary Industry Index (%MoM)	Jan	0.4	1.2	-0.4
16-Mar	Fri	7:50 AM	Japan	Tertiary Industry Index (%YoY)	Jan	0.1	—	1.3
16-Mar	Fri	10:00 AM	China	Fixed Asset Investment (% yoy, YTD)	Feb	26.6	24.0	24.5
16-Mar	Fri	12:00 PM	Singapore	Non-Oil Domestic Exports (% YoY)	Feb	-5.2	4.0	11.1

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

Focus on India

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India: Inflation Control - Now Top Priority with Policy Makers

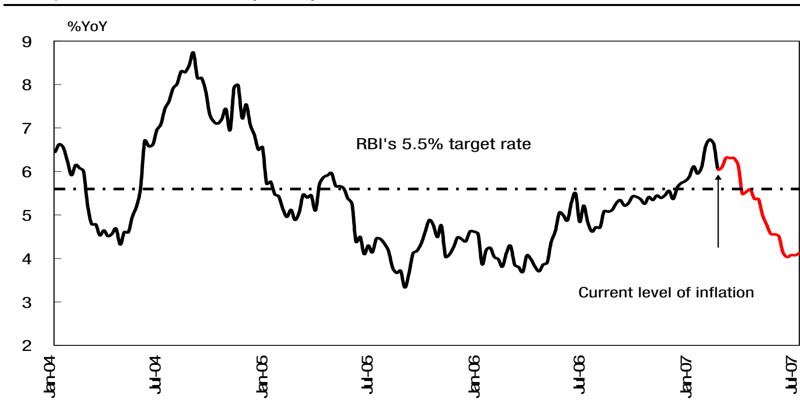
Monetary, fiscal, base effect and political compulsions will result in inflation coming off to 5% levels by May. Inflation has been a concern since it breached the RBI's target of 5.5% in October, and touched a high of 6.73% for the week ended February 3. Latest data pegs it at 6.1% for the week ended February 24. We believe that while inflation is likely to remain high over the next two months, recent government measures coupled with the base effect and political pressures will quell inflation to 5% levels by May.

Active monetary management has been aimed at controlling inflation. Besides policy interest rates moving up 150bps since October 04, the RBI has raised the CRR by 100bps in two hikes of 50bps each. Apart from this, the RBI has also imposed a cap of Rs30bn on repo transactions, partly to discourage banks from fulfilling their SLR requirements by borrowing G Secs in repo. There has also been a shift in monetary policy stance since January 31 from an equal emphasis on price stability and growth, to one of reinforcing just price stability with immediate monetary measures.

Fiscal measures will also help cool prices. The government has reduced customs duties on capital goods, metals and cement, and permitted imports of wheat and sugar. It banned exports of pulses, sugar, skimmed milk powder and forward trading in certain food grains – measures we see as regressive. Besides introducing a dual-excise structure for cement that penalizes producers who charge more, the government has also issued a directive to cement companies to freeze prices for a year. Given that inflation is one macro variable that can potentially bring down a government, we do not rule out additional regressive measures.

We expect inflation to remain in the 5.5-6.5% range until March/April, **and maintain that policy rates could rise by 25bps in April**. We expect 2007 to be the year of multiple policy instruments wherein if liquidity conditions ease (either via government spending or capital flows), we could see the RBI not hesitating to hike the CRR again to absorb excess liquidity. But to sustain the growth momentum, the possibility of an SLR reduction remains high.

Likely Trends in Inflation (%YoY)



Source: Office of the Economic Advisor; Citigroup

Focus on Thailand

Thailand: Capital Controls Lifted But Onshore Hedging Requirement Stays

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Formal capital controls may have been lifted but the requirement of onshore hedging/offshore portfolio exposure for at least three months remains. The exchange restriction imposed last Feb 28th on offshore portfolio investments in Baht-denominated bonds, mutual funds, and property funds has been revoked. The move to lift these controls gained momentum in Feb. However foreign portoflio investors are still required to hedge their local exposures in swaps or forwards for at least three months, imposing additional financial burden to foreign investors**.** This hedging requirement is an assurance to policymakers that investor preference remains directed at prospects for fixed income or equity market gains rather than windfall from nominal exchange appreciation. Bloomberg quoted BoT Gov. Tarisa Watanagase as having claimed the 'no loophole' conditon for removal of this hedging requirement.

It's a step in the right direction but government has to do more than just lift capital controls to restore investor confidence. Some policy initiatives (the revised Foreign Business Act and proposed retail business act) continue to reinforce the perception of instituting curbs on foreign investment exposure / activity under the interim government. These policies discourage FDI and hurt sentiment. We believe the impact of these investment curbs on FDI and private investments will hurt growth.

More than the exchange curbs, it was probably BoT's steadfast intervention in the onshore spot market that stalled a strong Baht appreciation. With the exchange curbs compelling FX conversion to Baht in the onshore spot market, the market faced a deluge of dollars and sustaining pressure on the onshore Baht rate. Without BoT's spot market purchases, which had nothing to do with regulatory controls, the Baht would probably be in the 33-34 range. As evidence of the surge in export and other offshore flows and BoT's reaction, gross international reserves as of March 2 stood at a record high US$68.4bn, up US$1.46bn from Jan07. We think this implies a BOP surplus in 1Q07 probably coming largely from the current account flows — an impression that was highlighted by a senior monetary official recently. BoT's net long dollar forward contracts also soared to US$8.62bn as of Mar 2, up US$1.68bn from Jan-07. Accommodating current account flows rather than foreign capital flows seems to signal a policy preference for the former underpinning the Baht's appreciation. We maintain our forecast of gradual Baht gains, expecting 34.50 over the next three months on the back of onshore export conversions with the BoT as the key buyer while downplaying the effect of lifting capital controls.

Exchange curbs had the supreme effect of weighing down on the equity market. The equity market has yet to recover what it lost (down by almost 8%) since Dec 18 when the first set of exchange restrictions were instituted. Exempting foreign portfolio equity investment late last year attracted net inflows of Bt28bn ytd March 12 but remains sharply lower against year-ago level of Bt83.7bn.

News in Brief

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China

Exports and consumption lifted industrial production growth. Industrial production growth was lifted to 18.5% in Jan-Feb from 14.7% in Dec, exceeding market consensus of 15.5% and our forecast of 15.3%. Given stable growth in industrial profits last year despite Renminbi appreciation, industrial output growth may remain strong but largely stable in the near term. The faster pace of growth in Jan-Feb following growth moderation in late-2006 indicates an investment rebound, and may prompt the government to reinforce its stance to balance growth. *(Patricia Pong)*

India

The Infrastructure Index registered growth of 8.7% in Jan 07, compared with 8.2% in Jan 06. On a cumulative basis, growth in Apr-Jan 07 was up 8.4%, significantly higher than the 5.8% growth during the same period last year. Highlights include: (1) Continued buoyancy in construction, with steel posting double-digit growth at 10.4% in Jan 07 and cement relatively lower at 6.8%; (2) Strong trends in coal production, up 10% in Jan 07, despite a high base effect; and (3) sustained buoyancy in electricity, up 8.5% – attributable to back-ended spending as FY07 is the last year of the 10th Plan. Surprisingly, crude-oil production eased to just 4.7% from double-digit levels earlier in the year, in spite of a low-base effect due to the ONGC fire last year. **Positive**: We see the buoyant infrastructure data, which comprise 27% of the Index of Industrial Production, as an indication that the ongoing investment cycle upturn is on track. *(Rohini Malkani/Anushka Shah)*

Indonesia

Bank Indonesia starts absorbing excess market liquidity. For the first time since early January, Bank Indonesia issuing IDR 15 trillion more SBI than the maturing one in the last Wednesday's auction. Despite this move, BI could only took 13.3% of the incoming bids; thus, still reflecting the desperate situation of banks to get an additional piece of the SBI. Banks bid almost five times higher than the IDR 60.8 trillion potentially available funds, consisting of (1) IDR 25 trillion of maturing SBI, (2) IDR 32.6 trillion of O/N FasBI outstanding, and (3) IDR 3.2 trillion of government bonds coupon payments. This positive net absorption has sent down the O/N FasBI outstanding to IDR 21.6 trillion from IDR 32.6 trillion level before the SBI settlement and around IDR 3.2 trillion government bonds' coupon payment. As a result, the O/N money market rate was up slightly to 4.50% on Thursday from 4.38% on Wednesday. Next week tax payment will likely push the O/N money market rate up again temporarily. *(Anton Gunawan)*

Philippines

Latest ratings of President Arroyo improved slightly. Low oil prices, a strong currency, increased government spending since late last year and improving governance was probably behind the ratings improvement. We think economic conditions and improving security risk perception will impact more on Arroyo's approval ratings rather than the drag from political legitimacy issue and recent foreign review of corruption in the country. The latest Social Weather Stations (SWS) survey indicated a minus 4 rating (difference between percentage satisfied and dissatisfied) from a minus 16 in the Nov 2006 survey, signaling a gradual upturn in political support for Pres. Arroyo that should benefit the pro-Arroyo candidates in the upcoming elections. Practically all regions except Metro Manila indicated a move to a 'neutral' rating. Luzon (except Metro Manila) registered an improvement in ratings of -2 from -16. According to the SWS survey, the approval rating rose from minus 7 in Nov 2006 to plus 1 in the Feb survey. Mindanao's survey ratings also improved from minus 12 to 0. In Metro Manila however, the net approval rating worsened to minus 24 in Feb from minus 16 last Nov. Her approval rating in the urban areas improved from minus 21 to minus 8 in the latest survey. Among the high-end crowd (income classes ABC), Arroyo's ratings turned positive 7 from minus 14. In the rural areas, her approval rating also improved from minus 3 to plus 1. The SWS survey was conducted on Feb 28-27 with a sample of 1,200 respondents nationwide. *(Jun Trinidad)*

OFW remittances grew 20% in Jan 2007 to contribute to a strong peso, larger FX reserves and consumer spending during the month. Seasonally adjusted remittances however fell 6.7%MoM to offset the 3.8%MoM increase in Dec. In real terms, we estimate remittances grew 7.4%yoy in Jan. Downside to strong remittance growth is its impact in hiking domestic liquidity which expanded 22.8% during the month. With corporate demand hardly a factor in 1Q07, the favorable remittance update implies strong BSP intervention and rising FX reserves. Strong remittance growth to start the year increases the potential for remittances to overshoot single digit growth. *(Jun Trinidad)*

While positive, the pace of bank lending remains moderate. Bank lending activity using a broader measure to include thrift banks and rural banks grew 9.4% in Jan 2007, slightly lower than the preceding month's 11%yoy. Lacking more upbeat lending activity argues for keeping the tiering mechanism. The update suggests that broad based spending activity led by fiscal spending has yet to stimulate increased production activity, which in turn, hikes credit demand. We are more impressed with the breakdown of bank lending. With the exception of transportation, storage and communication that registered a drop of 1.7%, bank lending to the rest of the sectors recorded growth. Bank credit flows to the agriculture, fisheries and forestry sector grew 6.7% in Jan from 4.4% in Dec. Bank lending to the manufacturing and construction sectors (22% share) was back in positive territory, having posted declines in the previous months. *(Jun Trinidad)*

Singapore

Retail sales dropped 1.8% in January from a year ago, partly due to the timing of the Chinese New Year holidays. Ex-auto retail sales fell a steep 5.9%. Even with the adjustment from the timing of the holidays, the figure was disappointing and points to continued sluggish consumer spending despite buoyant headline GDP growth. We expect some modest improvement going forward given signs of a tightening labor market, rising wages and a buoyant property market. Any upside may however be capped by the 2% GST hike (to 7%) in July this year *(Hak Bin Chua)*.

Vietnam

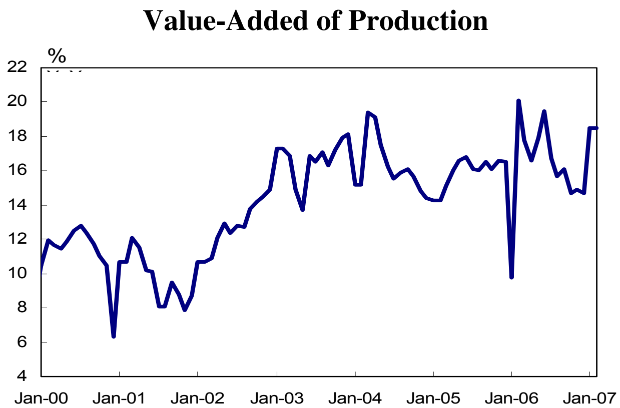
Moody's has changed to positive from stable its outlook for Vietnam's Ba3 foreign-currency government bond rating, and has assigned a Ba3 local-currency government bond rating, also with a positive outlook. The positive outlook change could underpin investor interest and create the potential to attract more capital inflows to Vietnam's debt market. However, we think that recent strong demand, especially from the global bund funds, for Vietnam's dollar bonds and dong-denominated bonds has largely reflected investor optimism about Vietnam's economic prospect, government efforts to develop the bond market, and a possible rating or outlook upgrade. Bond yields have fallen and spreads have been relatively tight this year. Thus, we think the market impact will likely be limited. *(Renee Chen)*

Data Review

Announcement	Release Date	HK/SG- Time	For	Actual	Citi Fcst	Mkt Fcst	Prev
China							
Value Added Industry (% YoY, real)	15-Mar	10:00 AM	Feb	18.5	15.3	15.0	14.7
Singapore							
Retail Sales Value (% YoY)	15-Mar	12:00 PM	Jan	-1.8	5.4	5.5	4.7

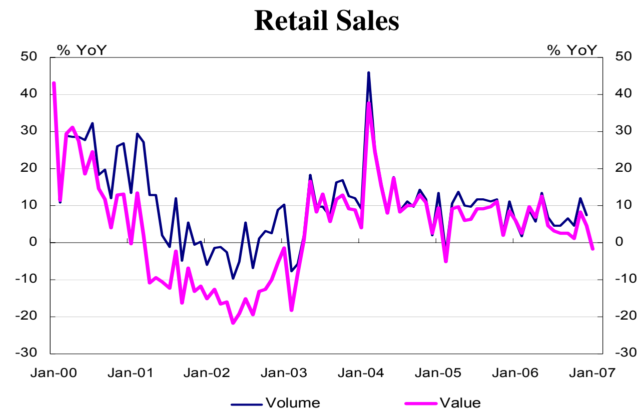
Source: Bloomberg, CEIC Data Company Limited, Citigroup estimates.

China. Exports and consumption lifted industrial production growth



Source: CEIC Data Company LImited

Singapore. Figure points to continued sluggish consumer spending despite buoyant headline GDP growth



Source: CEIC Data Company LImited

Selected Market Indicators

Policy Rates

	Spot	Change (ppt) 1 Day	1 Mo	1 Yr
China - 1-year lending rate	6.12	-	-	0.54
Hong Kong – 3-Month Interbank Rate	4.21	(0.05)	(0.03)	(0.23)
India - Overnight Reverse Repo Rate	6.00	-	-	0.50
Indonesia - BI Rate	9.00	-	(0.25)	(3.75)
Malaysia -Overnight Policy Rate	3.50	-	-	0.25
Philippines – O/N Rate	7.50	-	-	-
Singapore – 3-Month Interbank Rate	2.93	(0.12)	(0.44)	(0.51)
South Korea – Overnight Rate	4.50	-	-	0.50
Taiwan - Overnight Rate	1.70	0.00	0.01	0.25
Thailand - 14-Day Repo Rate	4.53	-	(0.25)	0.03

Long Term Bond Yield

	Spot	Change (ppt) 1 Day	1 Mo	1 Yr
China - Government bond yield (5-Year)	2.72	-	(0.01)	0.37
Hong Kong – 5-Year Exchange Fund Note	4.10	0.03	(0.19)	(0.21)
India - 10-Year Gilt	7.97	-	0.07	0.56
Malaysia - MGS 1/05	3.59	-	(0.14)	(0.16)
Philippines - 5-Year T Bond	5.91	0.07	0.31	(2.14)
Singapore - 10-Year SGS	2.91	-	(0.32)	(0.60)
South Korea - 5-Year Treasury	4.82	(0.00)	(0.15)	(0.30)
Taiwan - 10-Year Government Bond	1.96	-	(0.02)	0.17
Thailand - 10 Year Government Bond	4.47	-	(0.25)	(0.82)
Vietnam - 5-Year Government Bond	7.21	(0.02)	(0.67)	

Other Indicators

	Last Index Level	Change 1 Day	1 Mo	1 Yr
Fed Funds	5.31	-	0.06	0.81
6 month LIBOR	5.30	-	(0.10)	0.26
10 Yr UST	4.53	(0.00)	(0.28)	(0.20)
10 Yr Bund	3.906	0.02	(0.22)	0.22
Eurostoxx	3548	-0.17%	-7.30%	0.31%
10 Yr JGB	1.595	0.02	(0.15)	(0.14)
10 Yr Swap	5.07	(0.01)	(0.25)	(0.20)
HY BB Index	456	0.00%	0.63%	8.91%
HY B Index	498	0.00%	0.30%	10.38%
VIX	17.27	-	6.93	5.92
DJIA	12133	0.00%	-4.30%	7.61%
SPX	1387	0.00%	-4.12%	6.07%
TPX	1694	1.14%	-3.64%	1.62%
NASDAQ	1743	0.00%	-2.33%	2.79%
Oil, WTI	58	0.55%	-0.99%	-6.31%
Copper Index	285.20	0.98%	9.38%	20.92%
JPY/USD	117	0.22%	-3.26%	-0.03%
USD/EUR	1.3200	-0.18%	1.22%	8.57%
ECB Marginal Lending	4.75	-	0.25	1.25
BOJ	0.45	(0.10)	(0.37)	(0.37)
Palm Oil Future	1,945	0.00%	3.03%	
Gold	647	0.31%	-2.71%	14.50%
DRAM Benchmark Value Weighted Index	3,620	-0.11%	-9.59%	17.19%

Currency

	Spot	Change (%) 1 Day	1 Mo	1 Yr
Bangladesh Taka	68.925	0.00%	0.15%	0.22%
China Renminbi	7.7447	-0.08%	0.28%	3.78%
Hong Kong Dollar	7.8121	0.03%	0.03%	-0.68%
Indian Rupee	44.22	0.08%	-0.04%	0.45%
Indonesian Rupiah	9225.5	-0.03%	-1.63%	-1.09%
Malaysian Ringgit	3.5130	-0.04%	-0.40%	5.47%
Phillipine Peso	48.73	-0.17%	-0.55%	4.76%
Singaporean Dollar	1.5335	0.06%	0.54%	5.51%
South Korean Won	944.5	0.19%	-0.52%	3.21%
Taiwan Dollar	33.028	0.08%	0.16%	-1.92%
Thai Baht (onshore)	35.005	0.10%	2.24%	11.84%
Thai Baht (offshore)	33.175	-0.23%	0.89%	18.01%
Vietnam Dong	16023	-0.05%	-0.27%	-0.75%

Equities

	Last Index Level	Change (%) 1 Day	1 Mo	1 Yr
Bangladesh DHAKA	1718	0.00%	-8.91%	9.11%
China (H Shares)	9096	1.02%	-6.77%	29.57%
China (Shanghai SE Composite)	2952	1.54%	4.06%	56.81%
Hong Kong Hang Seng	18969	0.70%	-6.13%	17.13%
India NIFTY	3682	1.12%	-9.83%	13.23%
Indonesia Jakarta	1776	0.79%	2.76%	29.94%
Korea KOSPI	1427	1.37%	0.59%	6.51%
Malaysia Kuala Lumpur	1180	1.18%	-4.58%	21.70%
Philippines Composite	3044	-1.01%	-6.25%	30.09%
Singapore Straits Times	3095	1.34%	-1.76%	19.28%
Taiwan Taiex	7696	1.63%	-0.53%	15.30%
Thailand SET	674	0.43%	-2.81%	-10.05%
Vietnam Ho Chi Minh	1066	-4.57%	-0.84%	59.87%

EM CDS (5Yr)

Spread (in bp)	Prev Close	Change 1 Day	1 Mo	1 Yr	5s-2s	10s-5s
China	11	0	0	-8	5	7
India	55	0	14	4	-	-
Indonesia	131	0	19	-42	75	97
Korea	18	0	0	-5	7	9
Malaysia	18	0	1	-8	8	10
Philippines	133	0	20	-61	76	96
Thailand	44	0	9	3	19	27

Volatility

		Last ATMF	1 Day	1 Mo	1 Yr
China	1M Vol	1.25	-0.11	-0.33	-0.76
	3M Vol	1.50	-0.03	-0.23	-1.01
Hong Kong	1M Vol	0.75	0.05	0.05	0.35
	3M Vol	0.73	-0.05	-0.03	0.24
India	1M Vol	3.75	-0.25	-0.15	-0.63
	3M Vol	4.05	-0.15	-0.20	-0.50
Korea	1M Vol	4.20	0.15	0.20	-2.38
	3M Vol	4.20	0.10	0.05	-2.32
Singapore	1M Vol	3.40	0.18	0.18	-0.85
	3M Vol	3.50	0.23	0.10	-0.74
Taiwan	1M Vol	3.18	0.00	0.13	-1.78
	3M Vol	3.25	-0.13	-0.25	-2.00
Thailand	1M Vol	13.25	-2.00	-1.00	6.04
	3M Vol	10.15	-1.35	-2.35	3.30

Source: Bloomberg (as of 3/15/2007 6:36 PM).

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