

Emerging Markets Daily

Asia Edition

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See Disclosure Appendix A1 for the
Analyst Certification and Other
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Focus on China, India and Korea

- **China and India** likely will continue to lead Asian economic growth, despite near-term risks, and renminbi and rupee have potential for significant gains over time (p. 2).
- **Korea.** We think that “window guidance” is not an effective tool to slow the short-term external borrowing (p. 3).

Next Week's Market Drivers

- **USA.** Despite these favorable first-quarter developments, we recently revised down our GDP forecast to 1.6% annualized from a prior estimate of 2.0%.
- **Japan.** We expect rising industrial production, but continual growth decline of retail sales and core CPI likely to decrease by 0.2%yoy in March.
- **Euro Area.** Thanks to a strong gain in German orders in February (+3.9%mom) average euro-area orders probably increased substantially in that month.
- **Germany.** After the decline in the months after the VAT hike, we expect a second consecutive increase in the ifo headline reading in April.
- **Hong Kong.** We expect higher inflation to reflect retailers' stronger pricing power, while export growth likely fell due to less robust re-export.
- **India.** We expect export growth to remain a single digit in March on base effect.
- **Korea.** High-tech weakness will weigh on GDP growth, while industrial production will likely remain sluggish.
- **Philippines.** We think improving demand and inventory replenishment will comprise expected broad-based import gains.
- **Singapore.** CPI probably rose slightly on higher fuel and food prices, while industrial production edged higher on modest tech recovery and continued strength in transport engineering.
- **Taiwan.** Industrial output and export orders likely rebounded from a stagnant February in March, but maintained modest momentum.
- **Thailand.** We expect export volume to drive export growth to 18%yoy.
- See page 9 for full data release calendar for the week ahead.

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Focus on China and India

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Growth Risks for China and India

Despite the near-term risks, China and India likely will continue to lead Asian economic growth in the perceivable future. Latest developments raised concerns about growth outlook for China and India. India already suffers from a range of “overheating” symptoms – rising inflation, surging asset prices, growing wage pressures, widening current account deficits and spreading infrastructure bottlenecks. Meanwhile, China just reported above-consensus data on first quarter GDP and March CPI. Both PBOC and RBI tightened monetary policies several times recently. And we expect interest rates to go up further, at least modestly. But robust fundamentals and continued reforms suggest that China and India should be able to sustain at least 8% growth in the coming decade.

India’s challenges are the overstretched supply constraints, while China’s risks are mainly on the demand side. This is probably the key reason why we see high inflation in India, but not in China. However, India successfully lifted its growth potential from 4.5% in the 1980s to 8% currently, it may be able to do so again, if reforms and investment continue to ease resource constraints and promote productivity growth. In China, the main policy concerns are structural issues like overinvestment or large trade surplus. If final demand cannot keep pace with supply, then the overcapacity problem could materialize. For this reason, the latest change in the U.S. trade policy toward China should be a serious cause for concern.

Consumption could perform relatively better in both China and India. With tightening monetary conditions in India, downside risks look greater for investment and exports. Indian consumers, who are relatively under-leveraged, may still benefit from recent rapid wage increases. In China, the tightening policies are likely to aim at investment and trade surplus. If anything, the authorities will probably attempt to stimulate consumption. Recent surges in stock and housing prices may also generate some positive wealth effects in both economies.

Both renminbi and rupee have potential for significant gains over time. Renminbi appreciation slowed significantly during the past month, after several months’ steady gains. However, with narrowing trade surplus as a key policy objective and PBOC’s tightening policy bias, steady renminbi appreciation is likely to continue. Rupee appreciated sharply during the past weeks, though renewed export and policy risks could cloud the currency’s near-term outlook. But historical experiences suggest that, as long as China and India can sustain strong growth, these currencies are likely set for long rides upward. We expect the real effective exchange rate to improve by 22.5% for renminbi and by 16% for rupee over the next five years.

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Focus on Korea

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“Window Guidance” on External Borrowing May not be Effective

The news of “window guidance” on short-term external borrowing created a turmoil in the entire interest rate market. The news that Financial Supervisory Service (FSS) asked foreign banks to refrain from short-term external borrowing initially led to a decline in Cross-Currency Swap (CRS) rates by 5~9 bp on April 19, then we watched a significant sell-off in cash bond and futures market (by 30 tick) on April 20 that further widens the CRS-bond basis. It is known that lots of foreign banks borrow foreign currencies, swap them into won and buy cash bonds to have an arbitrage from the CRS-bond basis, so the fears of a potential unwinding of this arbitrage trade caused the basis to widen.

The window guidance from FSS comes from the concern that short-term external debt is increasing too fast. In 2006, short-term external debt surged from \$65.9bn to \$113.6bn, a 72% increase. And the increase by foreign banks was \$17.0bn out of the total increase of \$47.7bn. The surge in short-term external debt itself has become a source of concern for policymakers, as they still have the vivid memory of financial crisis in 1997~98 that was said to be exacerbated by the failure in short-term external debt roll-over.

Policymakers also seem to think that the control over external short-term debt could discourage exporters’ hedging activities and curb won’s strength. The key driving factor of recent short-term external debt increase was exporters’ hedging: the net amount of forward USD selling by corporate sector jumped from \$29.2bn in 2005 to \$49.3 bn in 2006. And most people think that exporters’ hedging is the main reason to explain the CRS-bond basis. One may argue that the control over short-term debt and the unwinding of arbitrage trades would lower the forward USD/KRW exchange rates by the decline in CRS rates, hence discourage the exporters’ hedging. Interestingly, today we also heard BOK’s warning on “speculative” FX trades by corporate sector.

Window guidance on short-term external borrowing will not be working well, as it goes against the direction of market efficiency and widens the arbitrage opportunity. The underlying demand for external borrowing from exporters’ hedging would not be changed much by a small change in swap rates, as long as exporters’ won-bullish sentiment persists. So somebody, perhaps local banks, would still borrow foreign currency as long as underlying demand exists. A direct, formal control on banks’ short-term external borrowing would be difficult as long as they abide by regulations such as liquidity guidelines.

Financial market impact would be limited. Not a meaningful change in hedging behaviour implies little impact on the currency market. The widening of CRS-bond basis would also stop soon as it attracts “fresh” arbitrage trades. That is, the current sell-off in the bond market would be a one-off phenomenon rather than the beginning of a new bearish trend.

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Data Review

Announcement	Release Date	HK/SG-Time	For	Actual	Citi Fcst	Mkt Fcst	Prev	Comments
China								
Real GDP (% YoY)	19-Apr	10:00 AM	1Q07	11.1	10.7	10.3	10.4	Overly strong data could have concerned the market and policymakers about growth sustainability. We continue to expect gradual and modest tightening, with probably another hike of 27 bps before the May holiday and 100 bps increase in reserve requirement through the end of the year. Faster currency appreciation is likely a necessity to rein in excess liquidity problem and is likely to happen in the second and third quarters this year.
CPI Inflation (% YoY)	19-Apr	10:00 AM	Mar	3.3	3.1	2.8	2.7	
Retail Sales (% YoY, nominal)	19-Apr	10:00 AM	Mar	15.3	14.3	14.5	16.9	
Value Added Industry (% YoY, real)	19-Apr	10:00 AM	Mar	17.6	17.2	15.8	12.6	
Fixed Asset Investment (% yoy, YTD)	19-Apr	10:00 AM	Mar	23.7	24.0	23.0	23.4	
Hong Kong								
Unemployment Rate (%SA)	19-Apr	4:15 PM	Mar	4.3	4.2	4.3	4.3	Despite a surprising decline in employed workers by 11,000 in January-March, we remain upbeat about the Hong Kong economy.
Malaysia								
CPI (% YoY)	18-Apr	5:00 PM	Mar	1.5	1.8	1.9	3.1	Benign headline inflation should buy time for policymakers to remain on hold.
Singapore								
Non-Oil Domestic Exports (% YoY)	17-Apr	1:00 PM	Mar	1.6	4.1	2.0	-6.6	The rebound was led by a surge in pharmaceuticals, while electronics remained sluggish.

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

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	6.39	-	-	0.81	Bangladesh Taka	69.065	0.00%	-0.20%	0.59%		
Hong Kong - 3-Month Interbank Rate	4.20	(0.08)	(0.02)	(0.44)	China Renminbi	7.7177	-0.05%	0.20%	3.81%		
India - Overnight Reverse Repo Rate	6.00	-	-	0.50	Hong Kong Dollar	7.81425	-0.01%	-0.05%	-0.76%		
Indonesia - BI Rate	9.00	-	-	(3.75)	Indian Rupee	41.81	0.64%	3.91%	7.91%		
Malaysia - Overnight Policy Rate	3.50	-	-	0.25	Indonesian Rupiah	9089.5	0.06%	0.47%	-2.25%		
Philippines - O/N Rate	7.50	-	-	-	Malaysian Ringgit	3.4203	0.21%	1.57%	7.05%		
Singapore - 3-Month Interbank Rate	2.56	-	(0.44)	(0.82)	Philippine Peso	47.51	0.31%	1.69%	8.39%		
South Korea - Overnight Rate	4.50	-	-	0.50	Singaporean Dollar	1.5108	0.10%	0.68%	5.82%		
Taiwan - Overnight Rate	1.72	-	0.03	0.21	South Korean Won	927.5	0.16%	1.13%	2.27%		
Thailand - 14-Day Repo Rate	4.03	-	(0.52)	(0.72)	Taiwan Dollar	33.137	-0.01%	0.05%	-2.50%		
Long Term Bond Yield					Thai Baht (onshore)	34.800	-0.09%	-0.06%	8.56%		
	Spot	Change (ppt)			Thai Baht (offshore)	32.665	-0.35%	-1.52%	15.66%		
		1 Day	1 Mo	1 Yr	Vietnam Dong	16041.5	-0.02%	-0.18%	-0.67%		
China - Government bond yield (5-Year)	2.99	-	0.18	0.47	Equities						
Hong Kong - 5-Year Exchange Fund Note	4.05	0.01	(0.03)	(0.54)	Last	Change (%)					
India - 10-Year Gilt	8.06	-	(0.02)	0.63		Index Level	1 Day	1 Mo	1 Yr		
Indonesia - FR26	9.41	-	(0.15)	(2.35)	Bangladesh DHAKA	1690	0.00%	-5.49%	18.73%		
Malaysia - MGS 1/05	3.40	-	(0.20)	(0.78)	China (H Shares)	10180	1.48%	8.57%	28.83%		
Philippines - 5-Year T Bond	6.38	-	-	(0.32)	China (Shanghai SE Composite)	3584	3.77%	14.70%	61.33%		
Singapore - 10-Year SGS	2.61	-	(0.28)	(0.92)	Hong Kong Hang Seng	20567	1.30%	5.11%	17.61%		
South Korea - 5-Year Treasury	5.04	0.08	0.24	(0.15)	India NIFTY	4066	1.68%	7.41%	12.11%		
Taiwan - 10-Year Government Bond	2.01	(0.03)	0.06	0.12	Indonesia Jakarta	1969	2.56%	9.63%	25.61%		
Thailand - 10 Year Government Bond	3.96	(0.03)	(0.51)	(1.78)	Korea KOSPI	1533	1.27%	5.89%	6.45%		
Vietnam - 5-Year Government Bond	7.18	0.08	0.21	-	Malaysia Kuala Lumpur	1315	0.68%	8.06%	28.03%		
Other Indicators					Philippines Composite	3255	0.51%	5.05%	31.09%		
	Last	Change			Singapore Straits Times	3346	1.63%	5.68%	22.77%		
		Index Level	1 Day	1 Mo	1 Yr	Taiwan Taiex	7943	0.68%	2.34%	10.57%	
Fed Funds	5.25	-	-	0.50	Thailand SET	690	0.36%	2.92%	12.31%		
6 month LIBOR	5.35	-	0.01	0.14	Vietnam Ho Chi Minh	969	-3.01%	14.73%	41.19%		
10 Yr UST	4.67	0.00	0.13	(0.37)	EM CDS (5Yr)						
10 Yr Bund	4.193	(0.00)	0.27	0.26	Spread (in bp)	Prev	Change			5s-2s	10s-5s
Eurostoxx	3829	0.60%	5.25%	7.83%		Close	1 Day	1 Mo	1 Yr		
10 Yr JGB	1.690	0.01	0.12	(0.22)	China	11	0	0	-11	6	8
10 Yr Swap	5.19	0.00	0.14	(0.38)	India	47	0	-6	-8	#VALUE!	#VALUE!
HY BB Index	460	0.00%	0.58%	9.19%	Indonesia	110	0	-16	-60	58	77
HY B Index	504	0.00%	0.95%	10.82%	Korea	16	0	-1	-7	6	7
VIX	12.54	-	0.35	0.90	Malaysia	16	0	-2	-13	7	9
DJIA	12809	0.00%	2.82%	11.44%	Philippines	111	0	-15	-71	62	81
SPX	1471	0.00%	2.43%	10.83%	Thailand	39	0	-2	1	14	22
TPX	1710	0.18%	0.10%	-2.21%	Volatility						
NASDAQ	1832	0.00%	1.43%	5.65%	Last ATMf		1 Day	1 Mo	1 Yr		
	63	1.21%	4.76%	-	China	1M Vol	1.30	0.00	-0.06	-0.85	
Oil, WTI				14.95%		3M Vol	1.65	0.15	0.12	-0.83	
Copper Index	358.40	0.00%	15.76%	14.45%	Hong Kong	1M Vol	0.70	0.00	-0.05	0.38	
JPY/USD	119	0.16%	0.95%	0.95%		3M Vol	0.75	0.05	-0.05	0.35	
USD/EUR	1.3602	-0.07%	1.59%	9.45%	India	1M Vol	6.35	0.02	1.70	1.35	
ECB Marginal Lending	4.75	-	-	1.25		3M Vol	5.90	0.10	1.35	0.85	
BOJ	0.51	(0.02)	(0.58)	(0.58)	Korea	1M Vol	3.98	0.02	-0.40	-2.93	
Palm Oil Future	2,181	-2.25%	9.49%			3M Vol	3.98	-0.18	-0.28	-2.78	
Gold	686	0.44%	3.17%	10.71%	Singapore	1M Vol	2.88	-0.38	-0.60	-1.78	
DRAM Benchmark Value Weighted Index	3,256	0.08%	-7.22%	1.91%		3M Vol	3.95	0.65	0.45	-0.65	
					Taiwan	1M Vol	2.88	0.05	-0.30	-2.28	
						3M Vol	3.15	-0.10	-0.15	-2.10	
					Thailand	1M Vol	11.50	-1.00	-2.00	4.60	
						3M Vol	10.00	-0.50	7.00	3.25	

Source: Bloomberg (as of 4/20/2007 6:22 PM).

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Week Ahead Data Calendar

Date	Day	Local Time	Country	Indicator	For	Citi Fcst	Mkt Fcst	Prev.
23-Apr	Mon	4:30 PM	UK	CML Mortgage Advances (%YoY)	Mar	0.4	—	9.1
23-Apr	Mon	4:15 PM	Hong Kong	CPI (Composite Index; % YoY)	Mar	2.9	2.2	0.8
23-Apr	Mon	1:00 PM	Singapore	CPI (% YoY)	Mar	1.0	1.0	0.6
23-Apr	Mon	4:00 PM	Taiwan	Unemployment Rate (%SA)	Mar	4.0	3.9	3.9
24-Apr	Tue	10:00 PM	US	Consumer Confidence	Apr		105.0	107.2
24-Apr	Tue	10:00 PM	US	Existing Home Sales (mn)	Mar	6.6	6.5	6.7
24-Apr	Tue	5:00 PM	Euro Area	Industrial New Orders (%MoM sa)	Feb	1.5	—	-0.2
24-Apr	Tue	5:00 PM	Euro Area	Industrial New Orders (%YoY)	Feb	8.4	—	10.0
24-Apr	Tue	4:30 PM	UK	Public Sector Net Borrowing (GBP bn)	Mar	-7.9	-7.2	-6.8
24-Apr	Tue	5:00 PM	UK	CBI Industrial Confidence	Apr	-5.0		-7.0
24-Apr	Tue	4:00 PM	Taiwan	Export Orders (% YoY)	Mar	4.3	8.6	8.2
24-Apr	Tue	4:00 PM	Taiwan	Industrial Output (% YoY)	Mar	0.8	1.0	-2.8
25-Apr	Wed	8:30 PM	US	Durable Goods Orders (%)	Mar		2.5	1.7
25-Apr	Wed	8:30 PM	US	Durables Ex Transportation (%)	Mar		1.1	-1.0
25-Apr	Wed	10:00 PM	US	New Home Sales (th)	Mar	925.0	885.0	848.0
25-Apr	Wed	7:50 AM	Japan	Customs-Clearance Trade Balance (JPY bn sa)	Mar	883.0	1005.1	655.1
25-Apr	Wed	4:00 PM	Germany	IFO - Business Climate	Apr	108.4	107.8	107.7
25-Apr	Wed	4:30 PM	UK	Advance GDP (%QoQ)	1Q	0.7	0.6	0.7
25-Apr	Wed	4:30 PM	UK	Advance GDP (%YoY)	1Q	2.9	2.8	3.0
25-Apr	Wed	9:00 AM	Philippines	Imports (US\$, % YoY)	Feb	10.0	—	1.0
25-Apr	Wed	9:00 AM	Philippines	Trade balance (US\$ Mils)	Feb	-4.0	—	272.0
25-Apr	Wed	4:20 PM	Taiwan	M2 (% YoY)	Mar	5.3	—	5.6
26-Apr	Thu	8:30 PM	US	Initial Jobless Claims (th)	22-Apr		335.0	339.0
26-Apr	Thu	8:30 PM	US	Continuing Claims (th)	15-Apr			2531.0
26-Apr	Thu	10:00 PM	US	Help Wanted Index	Mar	32.0	32.0	31.0
26-Apr	Thu	4:15 PM	Hong Kong	Exports (HK\$, % YoY)	Mar	5.7	—	11.6
26-Apr	Thu	4:15 PM	Hong Kong	Imports (HK\$, % YoY)	Mar	4.0	—	1.3
26-Apr	Thu	4:15 PM	Hong Kong	Trade balance (HKD bn)	Mar	-15.6	—	-7.5
26-Apr	Thu	1:00 PM	Singapore	Industrial production (%YoY)	Mar	3.1	3.4	0.1
27-Apr	Fri	8:30 PM	US	Advance GDP Annualized (%)	1Q	1.6	1.8	2.5
27-Apr	Fri	8:30 PM	US	Advance GDP Price Index (%)	1Q		3.1	1.7
27-Apr	Fri	8:30 PM	US	Employment Cost Index (%QoQ)	1Q		0.9	0.8
27-Apr	Fri	10:00 PM	US	U. of Michigan Confidence (Final)	Apr		85.0	85.3
27-Apr	Fri	7:30 AM	Japan	Jobless Rate (%)	Mar	3.9	4.0	4.0
27-Apr	Fri	7:30 AM	Japan	Job-To-Applicant Ratio	Mar	1.1	1.1	1.1
27-Apr	Fri	7:30 AM	Japan	Tokyo CPI (%YoY)	Apr	0.0	-0.1	0.0
27-Apr	Fri	7:30 AM	Japan	Tokyo CPI Ex-Food (%YoY)	Apr	0.0	0.0	-0.1
27-Apr	Fri	7:30 AM	Japan	Nationwide CPI (%YoY)	Mar	0.0	-0.1	-0.2
27-Apr	Fri	7:30 AM	Japan	Nationwide CPI Ex-Food (%YoY)	Mar	-0.2	-0.2	-0.1
27-Apr	Fri	7:50 AM	Japan	Industrial Production (%MoM)	Mar	1.0	1.0	0.7
27-Apr	Fri	7:50 AM	Japan	Industrial Production (%YoY)	Mar	3.3	3.5	3.1
27-Apr	Fri	7:50 AM	Japan	Retail Trade (%YoY)	Mar	-0.8	-0.2	-0.2
27-Apr	Fri	7:50 AM	Japan	Retail Trade (%MoM sa)	Mar	-0.9	-0.5	-0.8
27-Apr	Fri		Japan	BoJ Monetary Policy Meeting				
27-Apr	Fri	1:00 PM	Japan	Housing Starts (%YoY)	Mar	3.3	0.5	-9.9
27-Apr	Fri	12:30 PM	Korea	Industrial Production (%YoY)	Mar	3.5	—	-0.4
27-Apr	Fri	12:30 PM	Korea	Consumer Goods Sales (%YoY)	Mar	6.8	—	12.4
27-Apr	Fri	4:00 PM	Taiwan	Leading Indicators (%MoM)	Mar	0.0	—	-0.1
23-27 Apr			India	Exports (% YoY)	Mar	3.8	—	7.9
23-27 Apr			India	Imports (% YoY)	Mar	11.8	—	25.1
23-27 Apr			India	Trade balance (US\$b)	Mar	-4.0	—	-4.7
23-27 Apr			Korea	Real GDP (% YoY)	1Q P	3.8	—	4.0
23-27 Apr			Korea	Real GDP (% QoQ, sa)	1Q P	0.8	—	0.9
23-30 Apr			Thailand	Exports (US\$ BOP; %YoY)	Feb	18.0	—	17.8
23-30 Apr			Thailand	Imports (US\$ BOP; %YoY)	Feb	3.6	—	4.0
23-30 Apr			Thailand	Trade balance (BOP; US\$ bn)	Feb	1333.0	—	808.0
27-30 Apr			Germany	Consumer Price Index (%YoY)	Apr P	1.6	1.7	1.9
27-30 Apr			Germany	Consumer Price Index (%MoM)	Apr P	0.1	0.2	0.3
4/23 - 5/2			Germany	Prelim. Retail Sales (%MoM)	Mar	0.3	—	0.9

Note: Full discussion of Asia data previews available in *Asia: A Look at the Week Ahead* (EC 250), 20 April 2007.
Source: Bloomberg, CEIC Data Company Limited, Citigroup estimates.