Executive Summary

Global System Continues To Normalize: Moderately in the West, Much Faster in the East

Since our last report, the global system has continued to stabilize. In the US, double-dip risk has eased significantly. Against earlier estimation of 2.5%, the US economy is likely to record 3% or higher GDP growth in 2010. In the region, the normalization process has been much faster than earlier thought, even for very open economies. For example, in Sep 2009, market participants were expecting growth of 3-5% in 2010 for Singapore. Since then, the market has elevated growth projection to 6.5% (UOB: +5.8%) -- with a range of 5.0-8.0%. However, as said before, it is a normalizing process and actual recovery is yet material. In Singapore, latest industrial output was up 19.1%. But the actual index level without the volatile pharmaceutical is still somewhat weak. So, the bottom line since our last quarterly report is that we have achieved some stability. But, 2010 will still be fairly volatile.

Issues to Contemplate With: (A) De-Leveraging in the West

The immediate risk is that recovery will be more gradual than earlier thought, as it is a banking crisis this time around (rather than a plain vanilla recession), which takes time to sort out the balance sheets of institutions. Second, the West is still going through de-leveraging, as witnessed by events in Greece, Portugal and elsewhere. Clearly, the risk has shifted from corporate to sovereign balance sheet. Despite all the noises, the approach is largely 'containment' – i.e. limiting systemic risks. As at this writing, EU leaders have agreed to create a sort of "safety net" for Greece, with IMF given a subordinate role in providing financial assistance. With total borrowing needs at EUR54bn, and EUR23bn in Apr-May 2010 alone, and debt at 100% of GDP, Greece's long-term growth prospects are certainly an issue. But for now, it is all about limiting contagion risk.

(B) Asset Bubble Risk in the East

While Asia has proven to be resilient (to be frank, actually did extremely well considering the severity of the situation), one key risk now is asset price bubble (in particular, residential real estate). Despite a slew of measures, these assets prices continue to hold up in key Asian cities. Is it an asset bubble? First, the definition of asset bubble is far from conclusive. However, looking at a few key indicators, example price/annual wage or debt servicing ratio, it is still manageable – except for recent launches. Also, our studies showed that there are various prudential measures in place, including cap on LTV (loan-to-valuation) as well as debt services cap imposed by respective system. Finally, policy makers are aware of the situation and monitoring this space closely, as seen by recent pre-emptive strikes.

We have looked at a few key cities in Asia. Except for first tier cities in China, generally affordability as measured by debt-to-service ratio is still manageable (see table on next page).

Next Leg of Normalisation: Interest Rate Policy

Since our last report, several Asian central banks have responded – RBA on 06 Apr (total 5 hikes of 1.25% point since Oct 2009), Bank Negara on 05 Mar, RBI on 19 Mar. We expect the rest of the Asian CBs to follow suit, although the actual timing is far from clear, given that CBs globally appear quite adamant in monetary tightening. For example, the market is slowly pushing out MAS monetary tightening towards later part of 2010, instead of its Apr meeting. At the coming MAS meeting in Apr, the market appears divided. Our call is that

Global GDP Forecast: Asia Normalising Much Faster Than The West

y/y % change	2008	2009	2010F	4Q08	1Q09	2Q09	3Q09	4Q09
US (Q/Q, Annual Rate)	0.4	-2.4	3.0	-5.4	-6.4	-0.7	2.2	5.6
Singapore	1.4	-2.0	5.8	-4.2	-9.4	-3.1	0.6	4.0
Malaysia	4.6	-1.7	4.9	0.1	-6.2	-3.9	-1.2	4.5
Indonesia	6.0	4.5	6.0	5.3	4.5	4.1	4.2	5.4
Thailand	2.5	-2.3	4.3	-4.2	-7.1	-4.9	-2.8	5.8
China	9.6	8.7	9.5	6.8	6.2	7.9	9.1	10.7
Hong Kong	2.1	-2.7	4.0	-2.6	-7.8	-3.6	-2.2	2.6
Taiwan	0.7	-1.9	6.0	-8.6	-9.1	-6.9	-1.0	9.2
South Korea	2.3	0.2	5.0	-3.3	-4.3	-2.2	1.0	6.0

Source: CEIC, UOB Forecast

Executive Summary

Affordability Comparison (2009)					
	Singapore: HDB Resale	Singapore: Private Mass Condo	Hong Kong Class B**	Hong Kong Class B: New Territories	Malaysia: Klang Valley
Price per sqm	S$4,192	S$7,825	HK$59,459	HK$41,019	RM2,084
Average House Size (sqm)	90	120	56	56	120
Assumed House Cost	S$377,280	S$939,000	HK$3,329,704	HK$2,297,064	RM250,000
Average Monthly Per Capita Income*	S$4,160	S$6,285***	HK$16,800	HK$16,800	RM3,000
House Price vs Income Ratio	3.8	6.2 (9.4 using country average income)	8.3	5.7	3.5
	China: National	China: Beijing	China: Tianjin	China: Shanghai	China: Chongqing
Price per sqm****	RMB4,474	RMB13,224	RMB6,605	RMB12,364	RMB3,266
Average House Size (sqm)	90	90	90	90	90
Assumed House Cost	402,660	1,190,160	594,450	1,112,760	293,940
Average Monthly Per Capita Income*	1,997	1,341	971	1,364	767
House Price vs Income Ratio	8.4	18.5	12.8	17.0	8.0
UOB Kay Hian Est.	8.0	13.7	9.9	12.4	5.5
NDRC House Price Data	14.5	34.9	14.5	23.7	9.5

Source: CEIC, UOB Calculations
Notes: * Household income assumes 2 working persons earning country average income.
** Average private residences in HK, Kowloon and New Territories.
*** Singapore: Based on median household income of those living in pte flats, condos and pte houses of S$12,570 per month. Ratio is 9.4 based on national average income.
**** National Statistical Bureau data

Monetary Policy in Asia					
	Current Policy Rate (%)	Period of Monetary Easing	Total Rate Cuts (bps)	Expected Quarter to Begin Normalising Interest Rates	Policy Rate Expected End-2010 (%)
Malaysia	2.25	Nov 08 - Feb 09	150	1Q10	2.75
Indonesia	6.50	Dec 08 - Aug 09	300	3Q10	7.75
Thailand	1.25	Dec 08 - Apr 09	250	3Q10	1.75
Philippines	4.00	Dec 08 - Jul 09	200	3Q10	5.25
South Korea	2.00	Oct 08 - Feb 09	325	3Q10	3.00
China	5.31	Sep 08 - Dec 08	216	3Q10	5.85
Hong Kong	0.50	Oct 08 - Dec 08	300	3Q10	1.25
Taiwan	1.25	Sep 08 - Feb 09	237.5	3Q10	1.75

Source: CEIC, UOB Forecast

this is part of normalizing after the two easing stances carried out during the crisis. We expect MAS to move in Apr 2010, although it is not impossible they would only move in Oct 2010.

USD Decline: Far From Clear

In Dec 2009, we highlighted that the widely expected USD decline is far from certain. Indeed, EURUSD has weakened 6.5% since the start of 2010, as Europe appears to be catching

Executive Summary

up with the problems in America. For the rest of 2010, our view is that EUR and GBP may be lacking in direction, and likely to be choppy. High yielders such as AUD and NZD could have upside potential on interest rate cycle (and commodities) story. In the region, we maintain that Asian FX will be heading higher, but it is largely a function on the RMB, which is likely to move away from its de facto USD peg one way or another in the months ahead.

Singapore: Normalisation of Monetary Policy

In the upcoming policy announcement in Apr, we expect MAS to normalize monetary policy through one-off shift upwards of the policy band, in line with the stronger recovery in the economy and to pre-empt quickening pace of inflation. The 2 prior policy decisions saw MAS undertake an easing stance since Oct 08. As such, an upwards shift in the policy band and midpoint should be seen as a step towards policy normalization, rather than a "tightening" monetary policy per se. SGD NEER index is hovering at about 2% above the midpoint, very close to the upper limit of the policy band, and has been for the past few weeks. A move up on the policy would relieve pressure on the trade-weighted index and also allow further room for the USD/SGD to move lower without hitting near the top of the trade-weighted policy range. With the anticipated monetary policy move by the MAS in Apr, our outlook for the SGD is that there will be marginal strength against the USD, before flattening out, with the USD/SGD reaching 1.38 in the 2Q and 3Q of this year of this year, and then to 1.37 in the 4Q.

China: PBoC on Track to Exit

China's monetary policy normalization is on track, with the central bank favouring changes in reserve requirement ratio (RRR) before moving to tighten through interest rate policy, in line with the move in exchange rate. However, the pace is likely to be measured and gradual. We maintain our call for China's 1Y lending rate to rise to 5.85% by end-2010, from 5.31% currently.

Global Investment Strategy

(contributed by UOB Asset Management)

The first quarter of 2010 was choppy for equity markets. Volatility rose as investors were confronted with uncertainty on several fronts. China embarked on monetary tightening earlier than expected; fiscal risk came to the forefront with Greece's sovereign debt problems and the US Federal Reserve surprised the market by embarking on its 'exit strategy'.

Although policy uncertainty is likely to linger through the second quarter, we believe the market has largely priced in these concerns. The recent spike in the VIX equity volatility index has subsided, China property stocks have ended their underperformance against the broader market and sovereign credit default swap spreads have tightened.

The focus of investors is likely to return to fundamentals – to the recovery of the global economy and of corporate earnings. Leading indicators continue to show an expansion in global economic activity and the US labour market has begun creating jobs. Together with the economic recovery, corporate revenues are also recovering. Because the corporate sector was very aggressive in slashing cost during the recession and now enjoy high operating leverage, a modest rise in revenue is translating into a strong boost for profits.

We believe the key central banks are unlikely to hike policy rates soon. Although the US Federal Reserve and the European Central Bank have embarked on their exit strategies, we believe they will not be in a hurry to raise policy interest rates as the economic recovery in the Developed Economies is sub-par and the large amount of spare capacity will keep inflation pressures subdued. Very low interest rates will sustain the search for yield and keep risk appetite supported.

We had reduced our position in Equities to neutral in late January as uncertainty and volatility rose. We return to an Overweight in Equities and to an Underweight in Bonds. We are also overweight in Commodities. We have overweight positions in the US and Emerging Markets. We reduce our position in Europe and stay slightly underweight in Japan. In terms of sectors we prefer cyclicals – IT, Industrials and Consumer Discretionary. In Fixed Income we continue to prefer Investment Grade bonds. In Commodities, we are overweight in Gold and Base Metals.

Asian FX

RMB: Several events ahead have elevated risks of a change in the RMB exchange rate policy. First off, the US Treasury announced in early Apr that it has delayed the seminannual currency report, coinciding with China Pres Hu's visit to the US on 12-13 Apr for the international nuclear summit on Iran. In addition, US-China dialogue is scheduled in late May, followed by G20 Summit in late June in Canada. The delay of the US Treasury report and Pres Hu's visit have reduced significantly international pressures on the currency, thus making it easier for China to make changes in FX policy without appearing to bow to foreign demands. However, we see relatively low risks of a RMB revaluation and band widening, but expect gradual appreciation to begin by second half of the year. An outright revaluation is a low likelihood event at this point as the Chinese government has practically ruled that out at the NPC session. Band widening may be a distinct possibility but is not a meaningful move, given that the current trading bands have hardly been tested. We maintain our USD/RMB forecast at 6.77

Executive Summary

by end-2010, about 1% from current level of 6.827.

MYR: Improving risk sentiment and more hawkish central bank policy bolstered the MYR which rose 4.6% against USD in 1Q10. The MYR was the best performing currency in Asia during the quarter. Although China is expected to keep a tight rein on the USD/RMB in the near-term, there is still some scope for USD/MYR to trend lower to around 3.15 in the short-term. This level was last seen in 2Q08 and note that the USD/RMB was higher then. While the earlier-than-expected rate normalisation in Malaysia would continue to support MYR in 2Q10, this advantage will diminish by 4Q10 when most other Asian central banks start to hike interest rates. We expect Bank Negara to continue its rate hike into the next two meetings before pausing in September and November. Going forward, a move by US Federal Reserve to raise its target rate, possibly in the later part of this year, could see MYR reverse some of its gains against the USD. We are expecting the USD/MYR to end the year at around 3.20.

IDR: Aside from more clarity on the resolution for the Greece debt issues, the resiliency of the domestic economy and affirmations from credit rating agencies helped to seal confidence in the economy. Foreigners' holding of the domestic government bonds rose to a record high of 20.2% in February from 14.6% in March 2009. In the domestic equity market, foreigners bought a net IDR4tn in the first quarter of the year, a 60% jump from IDR2.5tn in 4Q09. Although capital inflows have lifted the IDR, it also meant that the currency will be subjected to risks of reversals should sentiment take a hit. On interest rate normalisation, Bank Indonesia (BI) has adopted a more cautious than expected stance. But we see rate hikes materialising in early 3Q10 and positive outlook on the economy to keep IDR supported, barring a negative event risk in the global market affecting risk appetite significantly. Our USD/IDR target is at 9,000 for end-2Q10 and 8,900 end-3Q10.

THB: Thailand's economic indicators continue to show recovery, and with some risk appetite in the market, the THB should benefit. However, concerns in the form of debt problems in the Eurozone still linger. The resulting waxing and waning of risk appetite will thus ensure choppiness and volatility in the Asian currencies, including the THB. However, in the mid to long term, we see weakness in the USD vis a vis the THB, as underlying fundamentals for Thailand look intact, with economic growth continuing to improve, barring any major political upheaval. The current political tensions could put a dampener on the baht. For now though, the USD/THB pair looks to be trending upwards, and we are projecting the THB to reach 32.2 at end 2Q10, 31.8 at the end 3Q10, and 31.3 at end 4Q10.

KRW: Compared with the sharp rebound during 1H09, the 2.9% KRW appreciation during 1Q10 was fairly moderate. With confidence creeping back, JPY/KRW also softened to around 12.0 from as high as 16.1 in early 2009 and competitiveness consideration will underlie BoK's reluctance to see more KRW appreciation from here. The BoK's unwillingness to begin normalising interest rates also reflected its concerns over the growth momentum in the country. Unless we see more move on the RMB, USD/KRW will probably hit 1,100 in 2Q10 before running out of steam particularly if the economic growth momentum eases in the second half of the year. An expected halving of the current account surplus from a record US$42.7bn in 2009 should also ease the downward pressure on the pair. Nonetheless, prospects of interest rate normalisation from 3Q10 will likely provide some support for the KRW in 2H10.

Asian Interest Rate

Malaysia: Headline inflation in the country has underperformed our expectation, averaging just 1.3%y/y in January and February. Despite the benign domestic inflation outlook, Bank Negara hiked its benchmark Overnight Policy Rate (OPR) by 25bps to 2.25% in March, making it the first central bank in Asia outside Australia to start normalising interest rates. Even as the BNM moved earlier than we have expected, the central bank's quantum of rate normalisation will likely be more moderate compared with other Asian countries where interest rates were slashed more deeply during the financial crisis. For the outstanding four policy meetings before the end of the year, we expect BNM to proceed to raise interest rates by only another 50bps at its meetings in May and July to bring the OPR to 2.75% this year.

Indonesia: Although the BI was optimistic about the country's growth prospects, it reiterated its long-held view that the current policy rate of 6.5% is consistent with the inflation rate within its forecast range of 4.0%-6.0%. CPI rose by an average of 3.7%y/y in 1Q10 compared with 2.6% in 4Q09 but this was still below the BI's forecast range. Inflation risks could rise in 2H10 if the government proceeds with its planned 15% hike to the electricity prices in July. That could increase the full-year inflation rate by around 0.8ppt to 5.5% for the full-year and inflationary pressure in the ensuing months could potentially result in interest rate hikes of more than 100bps for the year. In addition, crude oil prices crossing US$85pbl could increase risks that the government would review the retail fuel prices although any near-term price hike is fairly unlikely. We are now expecting the BI to hike its interest rates beginning 3Q10 with the rate increase likely around 125bps this year.

Thailand: Expectations that the central bank would raise rates soon were stoked when Thai finance minister Korn

Executive Summary

Chatikavanij said that he "won't be surprised" if the BoT decides to raise the benchmark interest rates at its policy meeting on April 21. Our expectation is for the BoT to only hike rates in the 3Q, when the recovery process stabilizes and where consumption and fixed asset investment shows more concrete recovery. The political instability has yet to be resolved and this could still hamper growth if rates are raised too soon. For now, total consumption although growing, remains weak, and fixed asset investment is still shrinking, albeit at a smaller rate. Headline inflation looks to have taken a breather in Feb, at 3.7% from 4.1% in Jan, and still remains manageable. Core inflation (which the Thai central bank targets) currently stands at 0.2% in Feb, is still within the BoT's target range of 0.5-3.0% pa.

South Korea: The BoK kept its benchmark base rate at record low of 2.0% for the 13th consecutive month in March. It has become increasingly clear that the BoK is not planning for any interest rate normalisation until 2H10. The new BoK governor, Kim Choong-soo is widely expected to go along with the Finance Ministry's preference for low interest rates for as long as possible, particularly as inflation remains muted. Another key consideration – the real estate market has also begun to stabilise owing to the policy measures in 2H09. The KRW appreciation has helped to tighten monetary conditions in the country and the currency strength will allow the BoK more room with regards to postponing interest rate rise in the country. At least for 2Q10, the risk from low interest rate will be contained. We are now expecting the BoK to begin its interest rate normalisation in 3Q10 with a total move of 100bps to bring the base rate to 3.00% by the end of this year.

Global Central Bank Policy

ECB: Whilst market participants had been calling for central banks to gradually remove the stimulus and begin the tightening process to drain the excess liquidity from the system; we expect that the ECB will probably take the cue from other central banks – notably the Federal Reserve – in hiking interest rates. In addition, given their slower recovery vis-à-vis the US and the mounting problems with the southern members, it is highly plausible that it will be a laggard in moving interest rates. We have pushed our forecast for ECB's first rate hike only in 2011.

BoE: It is far from certain that the Bank of England will put an end to its stimulus efforts just yet, especially with the economy running the risks of a lack of credit availability, a ballooning budget deficit and persistently high unemployment levels. As of the present moment, the considerable slack in the economy, coupled with deflationary pressures will allow some sort of leeway in leaving the stimulus in place for a longer while than they should. It is tough to expect that the UK will be among one of the first few countries to hike its interest rates as it is still pretty much unclear if the economy is safely out of the woods. In our opinion, a rate hike by the BoE would only take place in 1Q11 at the earliest.

RBA: The Reserve Bank of Australia raised its benchmark interest rate to 4.25% at the April 6 meeting. The latest move marks the fifth rate hike in six meetings. Last year, it became the first G20 central bank to raise interest rates since the onset of the global financial crisis, lifting the cash rate by 25 basis points at each of its October, November and December meetings in 2009. There was no meeting in January this year; and having ordered a freeze in rates in February, the meeting in March was the first time that the Bank increased its cash rate for this year. We believe the RBA will keep walking its path upwards, continuing to bring interest rates "closer to average". We are of the view that the benchmark OCR will be at least 4.50% by the middle of this year.

RBNZ: The Reserve Bank of New Zealand reduced its OCR by 575bps to 2.5% during the period of June 2008 and April 2009. Since then, the RBNZ has mentioned in the post-meeting statement that there's no urgency to begin withdrawing monetary policy stimulus, and "we expect to keep the OCR at the current level until the second half of 2010". However, the tone has turned less dovish since December and the RBNZ stated that "if the economy continues to recover, conditions may support beginning to remove monetary stimulus around the middle of 2010". With the New Zealand economy still a tad fragile, we believe the RBNZ will continue to look for evidence that the generally positive economic indicators so far continues to be converted into increased spending and activity, as is required for it to begin raising the OCR.

FX Outlook

We are now starting to witness the development of new themes within the FX space. Admittedly, at our last quarterly, our sentiment for the US dollar was mostly bearish against the other majors (at least for the first half of this year). However, towards the end of last year, the US dollar began to turn a corner, staging a notable recovery, leading many to think that greenback-weakness is a thing of the past.

First, sentiment has slowly improved because of the perceived positive recovery in the fundamental backdrop. The US economic recovery has stayed on track, strengthening more than expected. And many are pricing for the Fed to hike rates ahead of the ECB or the BoE. Therefore, we had recently seen a buying of USD in anticipation of the rate hike. We maintain our view, though, that the Fed will remain on hold during most of 2010, beginning only to tighten in Q4 at the earliest.

Second, even though there are calls to replace the USD as the world's reserve currency, it is unimaginable and practically unfeasible to expect this would (or could) happen anytime in the near future. 80% of global trade is quoted in US dollars;

Executive Summary

70% of global central banks' foreign reserves are held in US treasuries; and everyday, out of US$4tn of FX transactions, 90% are quoted in US dollars. Besides, a critical assessment of the dollar's reaction in the past month reveals that it has maintained its appeal as a "safe haven" and that will suppress the European currencies so long as the credit crunch refuses to die. As such, there will be strong underlying support for the USD even though it might not have very sound fundamentals.

Third, negative news and developments outside the US had been promoting the "flight-to-quality" trade. The current perilous state of affairs in Europe (the fiscal deficit problems in Greece, Portugal and Spain) with potential worse ramifications for the rest of the world is a classic driving force of the "flight to quality" flows (into US dollar assets). While these have certainly helped the dollar to extend its gains, one must remember that the fundamentals of the world reserve currency remain weak (burgeoning fiscal deficit). In fact, it is the euro that is exceptionally weak due to problems and a potential fragmentation and breakup of the Eurozone. Between the devil and the deep blue sea, the market is favouring the USD over the euro at the moment, even though both economies have their own fair share of fiscal deficit and debt problems.

EUR: EUR/USD has a severe battering, coming off a high of 1.5144 in November last year to a low of 1.3268 on 25 Mar 2010. The sovereign default crisis surrounding Greece and the inability of the EU as a bloc to come in unison to agree on a rescue package weighed heavily on the EUR/USD. With potentially more examples of Greece in the horizon, we see little room for the EUR/USD to move substantially higher going forward. In addition, the perceived tardiness of the ECB in enacting monetary policy changes will also serve to undermine the Euro in the coming months as the market position itself towards exit strategies by the other central banks. Our end-quarter target for EUR/USD is at 1.360.

GBP: After hitting lows of 1.4784 in early March, GBP/USD was mostly on weak footing for most of the quarter. With the mountain of fiscal debt which is certainly worrying the rating agencies, and with the country heading for a general election that may not produce a strong governing majority, we expect that the soft outlook for the Cable is almost inevitable. Nevertheless, the UK had done it before in the 1980s during the Thatcher years and we believe that the winner of the upcoming elections will do what is necessary in administering the dose of "bitter medicine". We are looking for the GBP/USD to trade around the 1.520-levels by the end of the second quarter.

AUD: Having rallied hard over most of 2009, the strength in AUD/USD was less prominent in the first quarter of this year, although risk appetite has generated support and has kept the pair within its medium term range. From highs of 0.9328 attained in mid-January, the pair was sent down to lows of 0.8579 in early February before crawling back to trade around the 0.9100-0.9200 region. Although the precise timing of the emergence of risk aversion trade is uncertain, one cannot deny that the Australian dollar is a sentiment-driven currency after all. Hence, one of the major drivers for the AUD/USD would be the general condition of risk appetite in the broader market. Having said that, we expect that further rate hikes in the year to still provide some direction for the Australian dollar until the normalizing of global cash rates which will then erode the yield advantage. We are looking for the AUD/USD to head towards the 0.9400-levels by the end of the second quarter.

NZD: Last year, the New Zealand dollar surged in tandem with the Australian dollar as well as commodity prices. NZD/USD, at the time of our last quarterly report, was trading around the 0.7200-levels. Since then, changes in risk appetite have seen the USD appreciating strongly, and that has sent the NZD into lower ranges. Having hit lows of 0.6803 in early February, the pair has found some support around the 0.7000-handle, but has regained little traction on either side. We are looking for the NZD to be supported in 2010, though gains are expected to be capped by tepid economic growth, mindful at the same time, though, that a shift in risk sentiment could stoke increased volatility in the pair. We are projecting the currency pair to trade comfortably around the 0.720-levels by the end of the quarter.