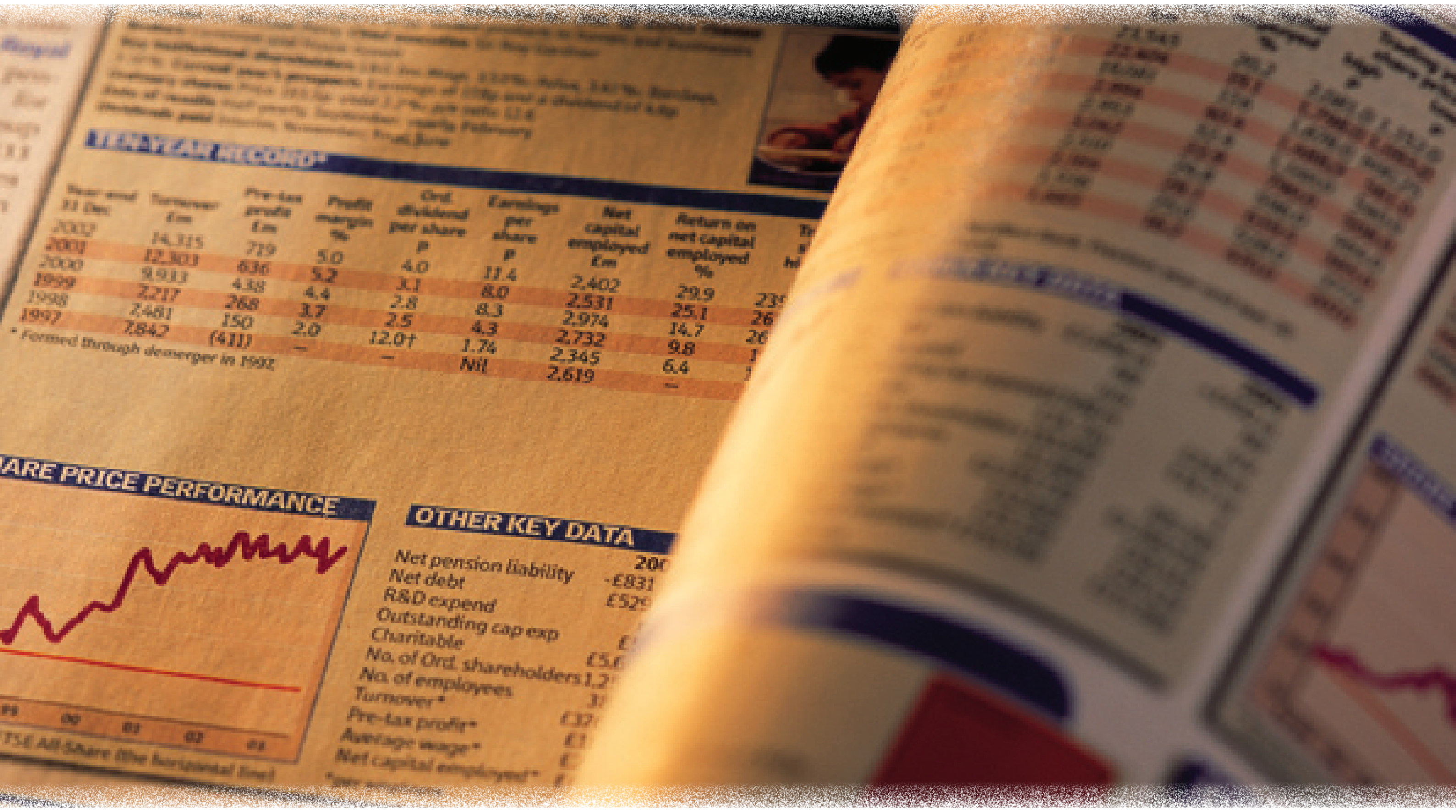
Quarterly Global Outlook

currency forecast & interest rate trends

4Q2008



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The Near-Term Backdrop In The US Has Become Increasingly Iffy

Singapore

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Information as of 09 October 2008

Executive Summary

In our last quarterly report, we highlighted much about inflation risk in the region, especially how the reduction of fuel subsides would hit SE Asia region. In a matter of just three months, however, the bias is shifting back towards downside risks to growth, especially in light of developments in the US financial markets and banking sector. Asian CBs have started to loosen policy stance, starting first with Taiwan and China in mid-Sep. Then in early October, the RBA surprised with a larger than expected reduction in interest rates. This was followed by a coordinated rate cut by six major CBs on 8 Oct as the deepening global credit crisis threatened their economies. The move also sparked rate cuts by China, Taiwan, and South Korea.

Singapore looks to follow suit in Oct 2008. At the same time, global FX has also undergone significant adjustment, as risk aversion surges. Over the past two months, high yielders like AUD and NZD have given up 27% and 16% against the USD, respectively. Asian FX that have benefited from capital flows as global investors in the past two years have also weakened, with both SGD and MYR off nearly 7%, IDR down 5%, and KRW tumbling 27% against the USD. The move was partly triggered by Chinese policy makers appear to be less willing to allow more RMB upside. Against 6.5% in 1H08, the RMB has essentially stagnated over the last two months. And, the market is now expecting the RMB to be relatively flat till year-end. Until such time there is a clear settling down of the US (and global) credit crisis, global asset markets are expected to experience significant uncertainty and extreme volatility due to lack of confidence and trust. In this environment, flight-to-safety intensions might continue to benefit the USD against some currencies.

US Economy and the Fed Policy

The US economy grew by almost 2% in the first six months of 2008, still comparatively modest especially against the backdrop of the ongoing strains in credit markets. The outlook for the next six months or so would become increasingly challenging, with growth in the second-half of 2008 tracking about flat at best. Both the intensity and diffusion of the slowdown appear to have gained significant traction. The accompanying rise in the unemployment rate, the moderation in inflation expectations and reduced inflation pass-through should keep inflation concerns in check. And the potential negative spillover from strained market conditions, which is clearly a more pressing near-term risk factor, could further worsen the growth dynamics.

The Fed has signaled the importance of using various liquidity programs and measures to address market strains, and the ongoing structural shift in Fed policy necessitates the consideration of all conventional and non-conventional policy options in the coming months. While the target fed funds rate has been unchanged since April, more serious growth concerns recently have compelled an intermeeting cut of 50bps to 1.50% on October 8. Our forecast anticipates the target funds rate to head towards 1.00% by the end of 2008.

Singapore: Global Credit Crisis Biting In

Growth prospects deteriorating fast, inflation risks as well. 'Technical recession' prospect has risen, with GDP growth likely at 3% this year. The failure of Lehman Brothers and bail-out of AIG, have resulted in renewed squeeze in global liquidity.

USD LIBOR rates have shot up, pushing up SGD interest rates as a result. 3-mth SGD SIBOR rose to 2.25% from about 1.25% some two months back. While the rate has eased to 1.6-1.7%, it looks like liquidity will remain tight for a while, with 3-mth SGD SIBOR to stay at around 1.5% year-end -- even if the Fed were to cut by another 50bps before then. We expect the MAS to loosen its monetary policy at its coming policy meeting on 10 Oct 2008, probably maintaining its 'modest and gradual appreciation path' of the S$NEER policy band but reducing slightly the slope which was steepened in October 2007.

Against a low of 1.35, USD/SGD surged to 1.45 in Sep 2008, as investors unwound their longs across asset classes (including FX). Also, the RMB appreciation path appears to be more moderate, along with policymakers' statements out of Beijing that global developments will affect growth prospects in China. Our view is that USD/SGD would probably end the year around 1.45. For the time being, extreme volatilities around the world would keep USD/SGD in a fairly broad range of 1.42-1.48. Into next year, as growth prospect further deteriorates, as the Wall Street effects feed through Main Street, it appears that Asian FX are unlikely to appreciate significantly. USD/SGD will probably trade around 1.42-1.48 at least in the 1H08, and then falling marginally towards 1.42 by end-2009.

Central Bank Policy

ECB: The ECB was among 6 major central banks that delivered a surprise collective policy cut of 50bps on 8 Oct. The BoC, BoE, ECB, Fed, Risksbank, SNB lowered policy rates each by 50bps to end at 2.5%, 4.5%, 3.75%, 1.5%, 4.25% and a target range of 2-3% respectively. The Bank of China also cut its benchmark 1yr rates by 0.27%. The BoJ did not join in the action but said that it strongly supported the coordinated action. Prior to the unprecedented action, the ECB had left key rates as unchanged since our last quarterly. In its latest policy meeting in Oct, the ECB left the door open for future rate cuts. We see a softening in stance in the rhetoric and the ECB reportedly discussed cutting rates at the meeting before unanimously deciding that no change was needed this month. Trichet said that 'Upside risks to price stability have diminished somewhat, but they have not disappeared.' He also added that the ECB was in a situation of 'exceptionally high level of uncertainty' and dropped references to the ECB as having 'no bias' on future interest rates. In light of increasing signs of weakening in the Eurozone but still elevated inflationary pressures, we expect the ECB to ease policy rates gradually with an additional 25bps easing in Dec and look for 150bps to be cut to the end of 4Q09.

BoE: The BoE was also among 6 major central banks to deliver a surprise collective policy cut of 50bps on 8Oct, lowering policy rates 50bps to end at 4.5%. Prior to the coordinated policy move, the BoE had held interest rates steady across the quarter, as it held back cuts on the back of elevated inflationary pressures despite being weighed down by weak economic data. There have been little surprises from the BoE rates or minutes lately with the Sep voting pattern coming in an as expected 8-1. The BoE August minutes also registered an as expected 7-1-1 3-way split with Blanchflower inclined to a cut and Besley hike once again. The 3 way split in our view had suggested that UK rates would be unlikely to move downwards as quickly as the market may have anticipated. We had opined that the absence of further support for either a hike or a cut means the BoE will remain on hold in the short term. However with the recent turmoil in credit markets and the failure and nationalization of financial institutions worldwide, we now bring forward our call for a rate cut and expect UK rates to be cut by an additional 25bps by end of the year.

RBA: The RBA surprised the market in Oct by cutting rates by 100bps to 6.0%, double the magnitude expected by the market and its steepest cut in 16 years. The surprise move by the RBA (which while the RBA can well afford given the high level of interest rate) added pressure to the other central banks to ease, but was unwarranted from a domestic point of view. With the RBA leading the way, 6 other major central banks delivered a surprise collective policy cut of 50bps on 8 Oct under intense pressure from the market. The RBA had also cut rates at its September meeting as widely anticipated by 25bps. AU 2Q CPI came in higher than expected at 1.5%qoq (4.5%yoy) from 1.3%qoq (4.2%yoy) in 1Q. Increases in both the trimmed mean and weighted median measures were more muted with the average of both measures coming in at 1.1%mom (4.4%yoy) against expectations for a reading of 1.1%qoq (4.3%yoy) from a 1Q reading of 1.25%qoq (4.25%yoy). We see the numbers as indicating still elevated inflationary pressures, although the acceleration in inflation appears to have eased somewhat. We expect the RBA to continue on its easing cycle and to exhibit moderation in its easing once global conditions exhibit some signs of stability. We are therefore calling for a further 125bps of easing in interest rates by 4Q09.

RBNZ: The RBNZ cut interest rates in Jul by 25bps to 8.00%, the 1st reduction in 5yrs and against majority expectations for the RBNZ to stay pat. The statement indicated clearly more cuts were in the pipeline with Governor Alan Bollard saying that 'Provided that the outlook for inflation continues to improve and there is no excessive exchange rate depreciation, we would expect to lower the OCR further'. The RBNZ delivered a further surprise 50bps cut to 7.5% in Sep, larger than market expectations for a 25bps cut. The RBNZ said that it expected the economy to contract from 1Q-3Q, and expected growth to ease to just 0.3% for the fiscal year that ends Mar09. However it forecast inflation as remaining at the top of its 1-3% target band through 2009. Governor Bollard said that with the NZ economy experiencing a marked slowdown, bringing forward some of the projected interest rate reductions was justified. 'Compared to the June Monetary Policy Statement, we have brought forward some of the projected interest rate reduction, but we have not altered the expected overall decline. We believe that this response is warranted in light of the tightness of current credit conditions and the time it will take to affect the actual interest faced by households and businesses.' The RBNZ said that the scale and timing of further rate cuts would depend on inflation and currency movements. We think that this as well as the RBA's 100bps cut has heightened the prospects for another 50bps cut at the next meeting at end October.

FX Outlook

Broad USD: The broad and major trade-weighted (real and nominal) US Dollar indexes have recently chalked-up gains of at least 4% since June. Although the apparent strength in the market exchange rates of the greenback appears fairly broad-based, especially relative to the major currencies, the impetus was not overwhelmingly US-specific. In fact, reduced growth perceptions of US' trading partners and the abrupt revision in monetary policy expectations in these countries had probably been more prominent factors in the equation. For example, the recent banking sector woes in Europe have weighed on the European major currencies relative to the greenback.

Euroland: Trading in the EUR/USD was volatile across the quarter with the EUR/USD touching a high of 1.5949, the highest since 23Apr as the USD tumbled on news of problems at Freddie Mac and Fannie Mae and record high oil prices. EUR/USD later backed down to a low of 1.3444 on 6 Oct, its lowest since Sep07 on USD strength and as oil prices slid below the key $100/bbl mark and currencies traded the global slowdown theme. The EUR has continued to be under pressure also after the ECB delivered a surprise 50bps rate cut on 8 Oct. More recently, the USD has rallied broadly as the adjustment of positions continued in line with expectations of a global slowdown in which Europe will not be exempt from. In addition, there has been increased focus on the EU after several European governments stepped in to bailout domestic financial institutions following the credit fallout in the US. Falling crude further kept the bear trend on the EUR intact. With fundamentals pointing to easing oil demand as global growth slows, in our view the EUR has peaked. We see further pressures on the EUR from risks to the financial system as markets to turn the focus to Europe after the US package becomes a done deal. More recently, there has been continued contention of the need of a coordinated rescue package like that in the US with Germany reportedly remaining opposed to any such rescue fund. While the passage of the rescue package in the US was difficult, we think such a package would be even harder to broker in Eurozone where firefighting by each government has been the main approach to the problem. As such, any bounce in the EUR in our view is a good opportunity to short the currency unit and position for a lower level going forward.

United Kingdom: Cable traded in a wide range across the quarter exhibiting significant volatility, trending lower over the longer term but with periodic rebounds when data come in less soft than expected, with GBP/USD trading in the range of 1.7260-2.0058 over the course of the quarter. We had reiterated in our reports that Cable above or near $2 was in clear defiance of fundamentals and Cable fell decisively below the $2 level in 3Q08. We see Cable as having finally starting to respond to the deteriorating economic data emanating from the UK and see the GBP as likely to come under increasing pressure from here. Our overall reading of the UK economy remains one where we see significant stress from a UK consumer pressured by a housing market which continues to deteriorate, a reduction in credit as the UK banking system remains under intense pressure from the credit crunch fallout and eroding purchasing power from inflationary pressures which suggest further moderation in discretionary spending going forward. We therefore continue to be negative on the GBP and look for Cable to move decisively downward over the medium term.

Japan: The USD/JPY has fallen from a high of around 109.00 in early September to less than 100.00 recently. Essentially, the sharp declines in global equities have been "positive" for the JPY primarily as a result of short-covering activity. Clearly, the pronounced down moves in the USD/JPY have not been linked to the economic and political environment in Japan, which is still largely in a fragile state. Our forecast anticipates the USD/JPY to hover around the 100.00 level through year-end 2008; however, the near-term directional bias for the USD/JPY still seems tilted to the downside. Separately, while some have explored the possibility of foreign exchange intervention to weaken the JPY, our best guess is that the threshold of intervention might lie closer towards the 95.00 level. But more forceful verbal jawboning by Japanese officials would probably occur prior to that.

High-Yielders: The antipodean currencies both remained capped on the upside by repricing in the face of a global slowdown and by deteriorating domestic fundamentals. AUD/USD reached a 25yr high of 0.9793 in the early part of the quarter. However, it touched a low of 0.6448 in a rapid reversal of fortunes on 8 Oct as investors fretted about the global macro environment. NZD/USD also reached a high of 0.7725 over the course of the quarter before falling to a 23mth low of 0.5775 on 8 Oct. More recently, the antipodeans have experienced a surge in volatility as heightened risk aversion takes centerstage in the midst of the US and European financial institutions demise. The pull-back in risk taking put cross/JPY trades in focus again while most major currencies traded without much clear directional conviction as investors stood on the sidelines in the midst of sharp moves which baffled conventional correlations. We expect volatility to remain heightened in this environment and we are cautious on any sharp commodity price rally which we think have the potential to unwind should investors liquidate trades to offset losses elsewhere. We maintain our medium term USD strength forecast as fundamentals of a deteriorating global environment has not been materially changed by recent events. In the short term, we recommend being long in defensives such as the CHF and JPY against higher yielding riskier currencies such as the AUD and the NZD, with some caution advised on the CHF in the face of Euroland troubles.

Asian Growth Prospects and Monetary Policy Implication: Inflationary concerns appear to be peaking, and monetary policy should loosen fairly fast. Growth is moderating, but not recessionary yet.

Asian FX Outlook

China: With the US credit crunch deteriorating and the real impact being felt in China, the authorities continue to take a more proactive approach in managing the economic levers. As a result, the RMB has waned against the USD in 3Q08 as alarm bells have begun to ring as early as June after reports of failures of exporters along the coastal regions as orders dwindled. The PBoC has since Sep reversed its tightening policy by cutting interest rates and following the coordinated global rate cuts on 8 October, the PBoC again lowered its interest rates. On the currency front, the RMB stayed flat against the USD in 3Q08, a sharp contrast to the 6.5% gain in the first half of 2008 and 6.9% in 2007. With the USD still in favour in the current flight-to-safety climate and an accommodative PBoC policy stance, we see limited upside to the RMB especially into 2009, which is going to be an even more challenging year for the global economy. We are keeping our end-2008 RMB forecast of 6.70 vs current spot level of 6.82/USD. Based on the above, we are also cutting our end-2009 RMB projection to 6.50/USD from our earlier call of 6.37.

Malaysia: MYR fell to a low of 3.47/USD in 3Q, down 4.7% since the start of the year as the turmoil in the financial market led to further unwinding of risk-taking. Near-term, the domestic political tension will also be a significant obstacle to MYR strength and the uncertainty is set to be prolonged with the postponement of the UMNO general elections to March 2009 from initial 16-21 December which could keep foreign investors on the sidelines at least until then. While the political pressure has eased slightly following PM Abdullah's announcement to cede power to DPM Najib in March 2009 rather than 2010, the outlook is far from clear given the tensions with the opposition. Overall, we are now expecting higher USD/MYR at 3.47 for end-4Q08 and 3.48 end-1Q09 although the pair could potentially have further upside risk if the global credit crisis or the domestic political situation deteriorates. However, in the medium to long term, concerns over the financing of the US government's rescue plans for the financial sector should inevitably be negative for USD.

Indonesia: Flight to safety sent USD/IDR rebounding to 9,470 from as low as 9,063 in 3Q08. The IDR has given back its gains of as much as 4.1% since the beginning of the year despite the monetary policy tightening and active BI intervention in the FX market. To boost liquidity in the banking system, the BI announced on 16 September a hefty 200bps cut in the overnight repo rate to 10.25% from 12.25%. It also raised the overnight FASBI rate – return on funds that commercial banks deposit with the BI – to 8.25% from 7.25%. There were some indications that the BI might next raise domestic banks' reserve ratio to boost banks' liquidity and tighten credit. From here, upside risk for USD/IDR could be higher especially if the credit crisis deepens. Strong imports (including crude oil) and moderation in commodity prices also means a narrowing trade balance. Furthermore, the impact from the monetary tightening could also start to undermine the IDR in 4Q08 as growth slows. Therefore, we expect to see USD/IDR ending the year at around 9,600, representing 1.9% IDR depreciation for the full year.

Korea: The worst-performing currency in Asia, KRW plunged by more than 25% against the USD since the start of the year and weak sentiment towards the currency will likely remain until the current account improves and foreigners' equity sales at the local market ease off. While oil prices have eased, exports growth should slow in coming months as a result of the global economic slowdown which suggests that the current account could remain in deficit next year. With the global financial market in a limbo and weakening economic fundamentals in South Korea, we have downgraded our KRW outlook again and are now expecting the USD/KRW at 1,450 by end-2008 and 1,500 by 1Q09.

Asian Interest Rate Outlook

China: China's central bank PBoC turned out to be the first Asian central bank to reverse its policy, cutting its key 1Y lending rate by 27bps to 7.20%, effective from 16 Sep. Subsequently, it also made further reductions on 8 Oct after global central banks announced joint interest rate moves. These quick decisions underscored policymakers' concerns of both the international environment and its impact on the export-dependent domestic sector. We expect at least another five interest rate reductions of 27bps each before middle of 2009, bringing the key 1Y lending rate to 5.58% by end-1H09.

Malaysia: Despite the high inflation, we continue to eliminate the possibility of monetary tightening in the months ahead. In fact, Malaysia is the only major central bank in Asia which has not tightened monetary policy this year despite the surge in domestic inflation. With the ongoing global financial market turmoil and increasingly challenging economic environment, the decision to keep domestic interest rate steady has gained credence on hindsight. As Malaysia unwound some of the fuel price hike in the last two months due to easing crude oil prices, any interest rate hike from here appears even more unlikely. We see some possibility of a 25-50bps rate cut next year as inflation comes off.

Indonesia: The BI has hiked its benchmark overnight rate by a total of 150bps to 9.50% in October, in six consecutive moves since May when the government raised the domestic fuel prices by an average of 28.7%. As a result of lower inflation and slower growth, the risk is towards interest rate cuts in 2H09. We are currently expecting the BI to lower its overnight rate to 8.50% by end-2009 but risk is towards more rather than less rate cuts. Note that the BI has slashed rates aggressively by a cumulative 475bps between May 2006 to December 2007 in order to reverse the sharp increases in interest rates which were raised following the doubling of domestic fuel prices in October 2005.

▪ FX & Interest Rate Outlook

FX Outlook						
Country	As at 09 Oct 2008	End 4Q08	End 1Q09	End 2Q09	End 3Q09	End 4Q09
USD/JPY	100.31	100.00	102.00	104.00	103.00	103.00
EUR/USD	1.3594	1.33	1.30	1.28	1.25	1.26
GBP/USD	1.7218	1.71	1.68	1.66	1.64	1.62
AUD/USD	0.6763	0.68	0.66	0.64	0.63	0.65
NZD/USD	0.6006	0.60	0.57	0.56	0.54	0.55
USD/SGD	1.4700	1.45	1.46	1.45	1.44	1.42
USD/MYR	3.5035	3.47	3.48	3.46	3.44	3.42
USD/IDR	9,610	9,600	9,600	9,500	9,400	9,400
USD/THB	34.44	34.80	35.20	35.00	34.70	34.20
USD/PHP	47.66	48.00	48.50	48.00	47.50	47.00
USD/TWD	32.431	32.50	32.90	32.70	32.50	32.00
USD/KRW	1,444.90	1,450	1,500	1,400	1,300	1,200
USD/HKD	7.7653	7.80	7.80	7.80	7.80	7.80
USD/CNY	6.8270	6.70	6.67	6.63	6.57	6.50
USD/VND	16,580	16,800	16,800	16,900	16,900	16,900
Source: Reuters, UOB						

Interest Rate Trends						
Country	As at 09 Oct 2008	End 4Q08	End 1Q09	End 2Q09	End 3Q09	End 4Q09
US (Fed Funds Rate)	1.50	1.00	1.00	1.00	1.00	1.00
EUR (Refinancing Rate)	3.75	3.75	3.25	3.00	2.50	2.25
GBP (Repo Rate)	4.50	4.25	4.00	3.50	3.00	2.75
AUD (Official Cash Rate)	6.00	6.00	5.75	5.25	4.75	4.75
NZD (OCR)	7.50	6.75	6.25	5.75	5.50	5.50
JPY (OCR)	0.50	0.50	0.50	0.50	0.50	0.50
SGD (3-Mth SIBOR)	1.6250	1.50	1.50	1.30	1.20	1.10
IDR (Overnight Rate)	9.50	9.50	9.50	9.25	8.50	8.50
MYR (Overnight Policy Rate)	3.50	3.50	3.50	3.25	3.00	3.00
THB (1-Day Repo)	3.75	3.75	3.25	3.25	3.25	3.25
PHP (Overnight Reverse Repo)	6.00	6.00	5.25	5.25	5.25	5.25
TWD (Official Discount Rate)	3.50	3.13	3.00	3.00	3.00	3.00
KRW (Base Rate)	5.00	4.75	4.75	4.75	4.75	4.75
HKD (Base Rate)	2.00	1.50	1.50	1.50	1.50	1.50
CNY (1-Yr Working Capital)	7.20	6.39	5.85	5.58	5.58	5.58
VND (Base Rate)	14.00	14.00	13.00	13.00	12.00	12.00
Source: Reuters, UOB						

The United States

The Near-Term Backdrop In The US Has Become Increasingly Iffy

Economic growth had been relatively modest through the first six months of 2008; however, the outlook for the next six months or so would likely be grim. Since financial market conditions have clearly worsened of late, this could potentially suppress the growth trajectory further.

The Fed has signaled the importance of using various liquidity programs and measures to address market strains, and the ongoing structural shift in Fed policy necessitates the consideration of all conventional and non-conventional policy options in the coming months.

While the target fed funds rate has been unchanged since April, more serious growth concerns recently have compelled an intermeeting cut of 50bps to 1.50%. Our forecast anticipates the target funds rate to head towards 1.00% by the end of 2008.

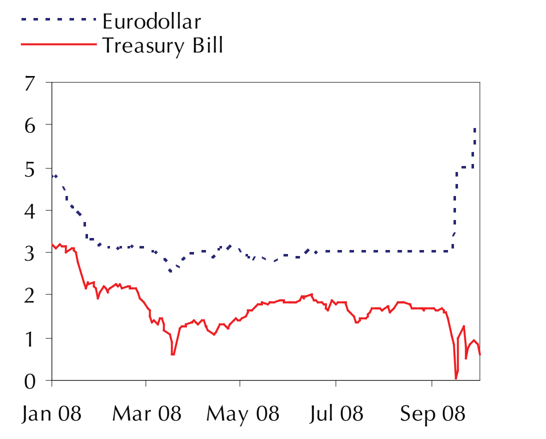
While the greenback has generally appreciated against a broad array of currencies in recent months, the gains relative to its major trading partners have been more pronounced. But the trading environment is still expected to remain reasonably volatile.

The US economy grew by almost 2% in the first six months of 2008. Interestingly, the headline growth figure still appears relatively modest despite continuing strains in the money market. The overall growth composition, however, was heavily supported by the contribution from net exports--more specifically, the marked contraction in imports and relatively solid growth in exports. Evidently, the boost from net exports, which aggregated to nearly 4% in the first-half of 2008, was the largest in almost three decades. Even though the net trade category had more than offset the decline in residential investment, the foregoing aggregate demand composition is clearly unsustainable. To be sure, the downside risks to our growth outlook have clearly intensified of late. In fact, the incoming evidence thus far implies that 3q08 real GDP growth could come-in slightly negative, which puts the second-half 2008 outlook about flat at best. Admittedly, the growth trajectory in 2009 remains hazy at this juncture; however, our baseline forecast anticipates the 4q09/4q08 growth figure to remain in the vicinity of less than 1%.

US Macro Forecast									
(%)	1q08	2q08	3q08E	4q08E	1q09E	2q09E	3q09E	4q08/4q07	4q09/4q08
Real GDP (ar)	0.9	2.8	-0.4	0.4	0.3	1.0	0.8	0.9	0.8
Real PCE (ar)	0.9	1.2	-1.8	0.3	0.4	1.0	0.6	0.1	0.7
								2008 avg	2009 avg
Unemployment Rate (avg)	4.9	5.3	6.0	6.5	6.7	6.7	6.7	5.7	6.8
Total CPI (oya)	4.2	4.3	5.4	4.1	3.5	2.7	1.5	4.5	2.4
Core PCE Price Index (oya)	2.2	2.3	2.5	2.4	2.3	2.3	2.0	2.3	2.1
End of Period (%)	1q08	2q08	3q08	4q08E	1q09E	2q09E	3q09E		
Target Fed Funds Rate	2.25	2.00	2.00	1.00	1.00	1.00	1.00		
Note: Over-a-year-ago (oya); annual rate (ar); average (avg)									
Source: Actual data sources and UOB forecast									

The continued deterioration in labor markets, still lofty gasoline prices, tight lending standards and fragile financial market conditions are expected to weigh on consumer spending. Indeed, the incoming indicators suggest that real consumer spending could contract by around 2% in 3q08. The havoc in financial markets over the past several weeks (commencing with the Fannie and Freddie conservatorship announcement to the recent "Troubled Asset Relief Program" proposal), should it persist, would certainly raise the downside risks on the economy further. In general, US financial markets are still stuck in the high volatility cluster. But the task of quantifying the effects of the ongoing strains in financial markets on the overall economy is somewhat challenging.

3-Month Spreads have Blown-Out (%)

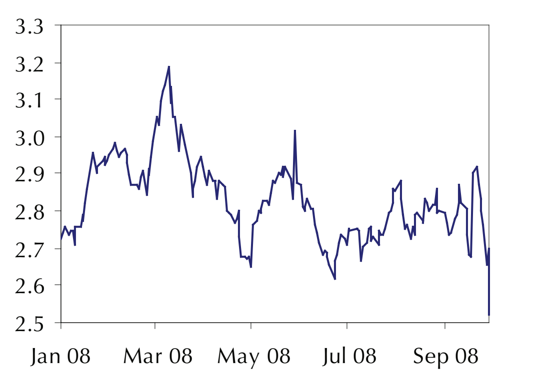


Source: Fed

Similarly, reduced demand expectations combined with the ongoing compression in profit margins should depress business capital spending and perhaps temper the incentive for aggressive inventory rebuilding. Also, the forward-looking indicator of nonresidential structures points to a more moderate growth trajectory. On the flip-side, however, the incoming guidance on residential spending appears to suggest that the pace of contraction could be less intense in the coming months. Likewise, the stabilization in home sales, while still somewhat hesitant at this stage, could ease the housing imbalance and limit the downside risks in home prices. Nevertheless, since total nonresidential investment and consumer spending account for over 80% of GDP, the overall economic backdrop is likely to remain soft for the time being. Indeed, the general recognition among policymakers is that "downside risks to the outlook…remain a significant concern".

Although headline inflation is poised to continue easing from an elevated level, the observed volatility in energy prices could present some complexities in the projection. However, the recent slide in inflation expectations and lower degree of pass-through are important offsetting factors, which should provide some solace to policymakers. Indeed, the Fed intermeeting statement recently (with the announcement of coordinated rate cuts of 50bps) also suggests that the Committee has toned down its near-term concerns on upside risks to inflation.

5-year/5-year Breakeven Inflation (%)



Source: US Treasury and Proprietary Data

Fed Policy: Desperate Times Compel Desperate Action[1]

The Federal Open Market Committee, against elevated market expectations for a rate cut, maintained the target fed funds rate at 2.00% at its recent meeting on September 16. Then on October 8, the Committee announced an intermeeting rate cut of 50bps together with five other major central banks. The individual policy rates of the respective central banks are as follows: BoC at 2.5%; BoE at 4.5%; ECB at 3.75%; Fed at 1.5%; Riksbank at 4.25%; and SNB with a target range between 2% and 3%.

Unfortunately, the joint monetary policy action also has drawbacks. ***Firstly***, it could convey a sense of panic and confusion, which could potentially lead to a negative feedback in prices of riskier assets, partly because it might imply that the current situation is equally dire across these countries, and that investors could be instigated to shun risk exposures en masse. ***Secondly***, policy rates globally are at different levels; therefore, the costs of rate cuts are not equally distributed (since the target fed funds rate is now closer to the lower-bound, the costs and implications of further reduction by the Fed are obviously greater than, for example, BoE). And if the target funds rate pushes against the lower-bound much sooner than expected, while the economy continues to founder, it could spark additional policy concerns. ***Thirdly***, since

[1] The text in this section has been extracted mainly from my September 15, September 17, October 6 and October 9 publications.

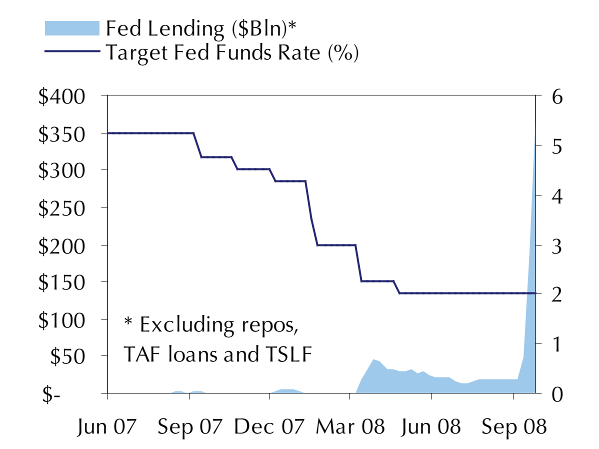
the monetary policy transmission process in the US remains clogged at this juncture (in light of impaired market functioning and unstable financial institutions), the intended effects of policy easing could be fairly muted or completely contradictory. And if so, this could further reinforce the negative psychology in markets.

The accompanying statement by the Fed essentially maintains the inclination to ease further at the upcoming meeting on October 28-29. Specifically, the Committee asserts that the unanimous intermeeting cut of 50bps (on both the target funds rate and discount rate) was "in light of evidence pointing to a weakening of economic activity and a reduction in inflationary pressures". The reference to inflation, which notes that the "decline in energy and other commodity prices and the weaker prospects for economic activity have reduced the upside risks to inflation", appears to be more toned down from Chairman Bernanke's remarks at the NABE annual meeting on Tuesday.

The ominous emphasis on growth concerns combined with the repetition that the "Committee will monitor economic and financial developments carefully and will act as needed…" effectively leaves the door widely open for additional policy action. As such, I anticipate the target fed funds rate to be reduced by an additional 25bps to 1.25% at the October meeting, and another 25bps at the December 16 meeting to 1.00%.

That said, the overall conduct of Fed policy is not merely isolated to adjustments in the fed funds rate. The various liquidity provision programs and measures--while more targeted and appropriate in addressing market-related considerations--play a crucial role in complementing the available policy options of the Fed. Some of these actions are as follows: The Fed has recently enlarged swap lines with foreign central banks, announced the creation of the Commercial Paper Funding Facility, increased the size of TAF programs, commenced the payment of interest on reserves, approved applications of two major investment banks to become bank holding companies, introduced initiatives that allow banks to finance purchases of high-quality ABCP from money market funds, purchased agency notes from primary dealers, authorized secured lending to AIG under "unusual and exigent circumstances", widened the collateral base of lending facilities to primary dealers, increased the frequency and magnitude of TSLF and temporarily allowed banks to provide liquidity to their affiliates under Section 23A of the Fed Act.

Conventional & Unconventional Fed Policy Tools



Source: Fed

It is imperative to recognize that the Fed seeks to distinguish between macroeconomic concerns (funds rate adjustments) and market considerations (implementing other liquidity measures). Although one could contend that a lower target funds rate per se might boost confidence in the equity market supposedly, the evidence from the previous seven rate reduction episodes (since September 2007) is fairly mixed, and that the positive reaction in US equities, in most cases, was not sustained. Nonetheless, I continue to expect the Fed to further accentuate its approach of using the asset-side of its balance sheet to conduct the various liquidity provision programs and unconventional policy measures to combat the unprecedented strains in credit markets.

Despite Recent Gains in the Dollar, the Trading Horizon Remains Vague

The broad and major trade-weighted (real and nominal) US Dollar indexes have recently chalked-up gains of at least 4% since June. The Dollar's increase against its major trading partners was roughly twice as much as compared to the other trading partners. Although the apparent strength in the market exchange rates of the greenback appears fairly broad-based, especially relative to the major currencies, the impetus was not overwhelmingly US-specific. In fact, reduced growth perceptions of US' trading partners and the abrupt revision in monetary policy expectations in these countries had probably been more prominent factors in the equation. For example, the recent banking sector woes in Europe have weighed on the European major currencies relative to the greenback.

Nevertheless, some major currency pairs were clearly more volatile than others. The recent market strains globally, which have evidently intensified, would further complicate any near-term forecast of the respective currency pairs. Furthermore, peculiar knee-jerk reactions and abrupt position adjustments in other market segments (such as commodities and equities) could also impact the US Dollar indirectly and unpredictably.

Perhaps, another important near-term factor that could sway the US Dollar meaningfully is the potential reaction of market participants to the various market-oriented announcements from US authorities. In particular, the market psychology surrounding these announcements and the sustainability of public sector programs in promoting market functioning are key factors. But since the evaluation of these US government programs is likely to take some time, the initial reaction of the US Dollar could fade, and eventually give way to a more volatile trading environment.

Separately, some have cautioned that the US fiscal deficit--as a result of these programs--could hurt the greenback significantly and broadly. Perhaps, the foregoing observation, in reality, might actually be quite contentious. Even though the US federal debt would be more bloated (but the budget deficit could actually narrow over time), the net effect on the US Dollar might still be somewhat ambiguous.

Growth prospects deteriorating fast, inflation risks as well. 'Technical recession' prospect has risen, with GDP growth likely at 3% this year.

The failure of Lehman Brothers and bail-out of AIG, have resulted in renewed squeeze in global liquidity. USD LIBOR rates have shot up, pushing up SGD interest rates as a result. 3-mth SGD SIBOR rose to 2.25% from about 1.25% some two months back. While the rate has eased to 1.6-1.7%, it looks like liquidity will remain tight for a while, with 3-mth SGD SIBOR to stay at around 1.5% year-end - even if the Fed were to cut by another 50bps before then. Market should ease a little when there is more clarity of the USD700bn bail-out package.

We expect the MAS to loosen its monetary policy at its coming policy meeting on 10 Oct 2008, probably maintaining its 'modest and gradual appreciation path' of the S$NEER policy band but reducing slightly the slope which was steepened in October 2007.

Against a low of 1.35, USD/SGD surged to 1.45 in Sep 2008, as investors unwound their longs across asset classes (including FX). Also, the RMB appreciation path appears to be more moderate, along with policymakers' statements out of Beijing that global developments will affect growth prospects in China.

Our view is that USD/SGD would probably end the year around 1.45. For the time being, extreme volatilities around the world would keep USD/SGD in a fairly broad range of 1.42-1.48.

Into next year, as growth prospect further deteriorates, and as the Wall Street effects feed through Main Street, it appears that Asian FX are unlikely to appreciate significantly. USD/SGD will probably trade around 1.42-1.48 at least in the 1H09, and then falling marginally towards 1.42 by end-2009.

In our last quarterly, much was spoken about inflation risk in the region, including Singapore, as commodities and crude oil prices sky-rocketed. However, in less than three months, the focus is back at growth concerns, including high risk of a 'technical recession' in Singapore. Meanwhile, the failure of Lehman Brothers and bail-out of AIG, have resulted in renewed squeeze in global liquidity. USD LIBOR rates have shot up, pushing up SGD interest rates as a result. 3-mth SGD SIBOR rose to a high of 2.25% from about 1.25% some two months back. As such, we expect the MAS to loosen its monetary policy at its coming policy meeting on 10 Oct 2008. Some sort of flattening of the appreciation path is expected. A few are expecting the MAS to ease more aggressively by changing the stance to 'neutral' from current 'modest and gradual appreciation' of the S$NEER policy band. While inflation trajectory is easing, we think it is not sharp enough to warrant such an aggressive move – we are still looking at inflation of about 2.5% for 2009, which is not low given the high base this year.

'Technical Recession' Risk – Fast Rising

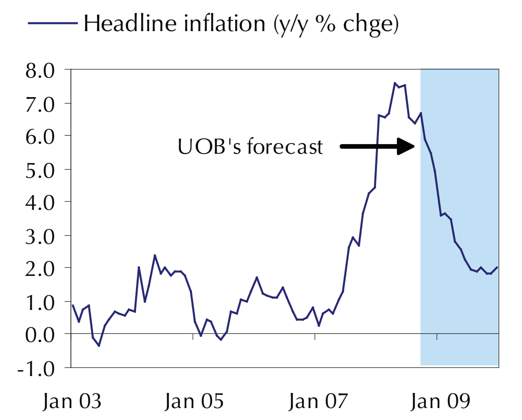
Following the 12.2%y/y (mkt est: -9.3%y/y) drop in Aug, Singapore manufacturing output had fallen 17.2%y/y in July-August, suggesting that the sector is likely to have contracted for the second consecutive quarter in 3Q. Unless the pharmaceutical production sees a strong rebound in the next few months, the manufacturing sector contraction could extend into 4Q as well. The last time we have a full-year manufacturing sector contraction was in 2001 (-10.8%) due to the tech bubble burst. The difference this time is that the contribution will be mainly from biomedical manufacturing. YTD, industrial production has fallen 2.0%y/y as a result of the 13.8% slump in biomedical manufacturing while electronics production has actually grown by 2.6%.

Given the weak set of IP numbers, we now expect the Singapore economy to have slipped into a 'technical recession' in 2Q/3Q, defined as two consecutive q/q contraction. On a y/y basis, we expect to see flat growth in 3Q08 with risk that it could slip into the negative territory as well. The last time we have a y/y contraction was in 2Q03 when the economy fell 1.8%y/y as a result of the SARS outbreak. We have revised down our full-year GDP growth forecast to 3.0% from 4.2% previously.

Inflation Risk – Declining, but not Fast Enough

August CPI rose a stronger-than-expected 6.4%y/y (UOB: 6.1% ; Mkt: 6.2%) but has continued to ease from 6.5% in July after peaking at 7.5% in June. Inflation in August was driven primarily by higher accommodation costs and food prices despite falling oil and commodity prices in the month. On a m/m s/adj basis, prices rose 0.1% in August, slowing from 0.4% in July. Near term, inflationary pressure will remain high with the 0.7% net fare hike for public transport and average 21% increase in the electricity tariff effective 1 October. We are expecting full-year inflation to average 6.5% but this should fall to around 2.5% in 2009 against a high base this year.

Inflation Rate Easing
Due to High Base but Pressure Remains



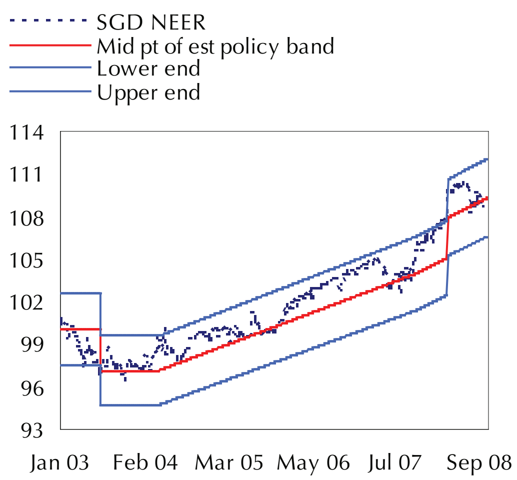
Source: CEIC

Monetary Policy Implication: Reducing Slightly the Slope of S$NEER Appreciation Path

The easing inflation is likely to reinforce view that the MAS will loosen policy on 10 October. Furthermore, policy makers are definitely less optimistic about the road ahead -- Trade and Industry Minister Lim Hng Kiang said recently that Singapore's full-year economic growth may dip below its earlier forecast of between 4-5%. Finally, the MAS has been rather aggressive in its policy stance over the past year – steepening the S$NEER slope in October 2007, and then re-centered the S$NEER policy band in April 2008 at then prevailing level, which we estimate is equivalent to a one-off 2.5% appreciation of the S$NEER given our assumption of a +/-2.5% band width and that the S$NEER was trading at the top of the band at that time.

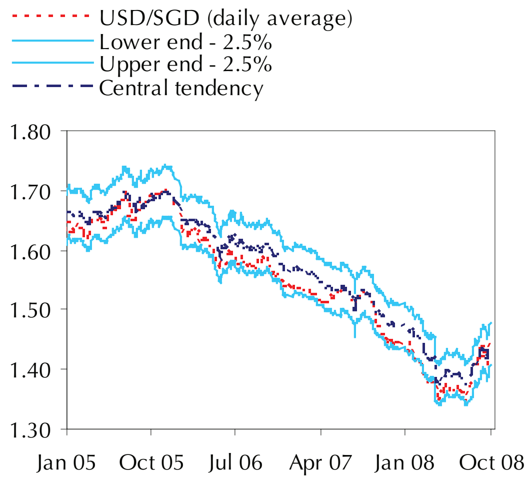
Thus, it is likely that MAS would maintain its 'modest and gradual appreciation path' of the S$NEER policy band but reduce slightly the slope of appreciation which we estimate is around 2.5% per annum now. While some said the current situation warrants a more aggressive easing by probably shifting to a 'neutral' stance (equivalent to flat S$NEER over at least the next six months instead of current 2.5% appreciation in the pivot point over a 12-mth period), our take is that the S$NEER band policy has given the CB some sort of flexibility – such as S$NEER hugging the weaker half of the policy band. Thus with doubt the MAS would be that aggressive. The current inflationary pressure will also prevent the MAS from unwinding its monetary tightening too aggressively although more could be expected next year should economic growth deteriorates more sharply and inflation eases more.

UOB's Estimation of SGD NEER



Source: CEIC, UOB

UOB's Estimation of SGD NEER

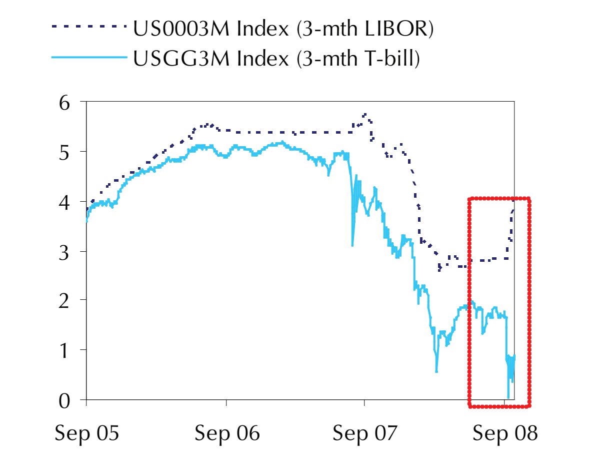


Source: CEIC, UOB

USD/SGD Outlook: Fairly Wide Range, but would be Volatile

Against a low of 1.35, USD/SGD surged to 1.45 in Sep 2008, as investors continue to unwind their longs across asset classes. The move was even more extended in high-yielders such as AUD and NZD. Also, the RMB appreciation path appears to be more moderate, along with policymakers' statements out of Beijing that global developments will affect growth prospects in China. As such, our view is that USD/SGD would probably end the year at around 1.45. For the time being, extreme volatilities around the world would keep USD/SGD in a fairly broad range of 1.42-1.48. Into next year, as growth prospects bleaken, and the Wall Street effects feed through Main Street, it appears that Asian FX are unlikely to appreciate significantly. USD/SGD will probably trade around 1.42-1.48 at least in the 1H08, and then falling marginally towards 1.42 by end-2009.

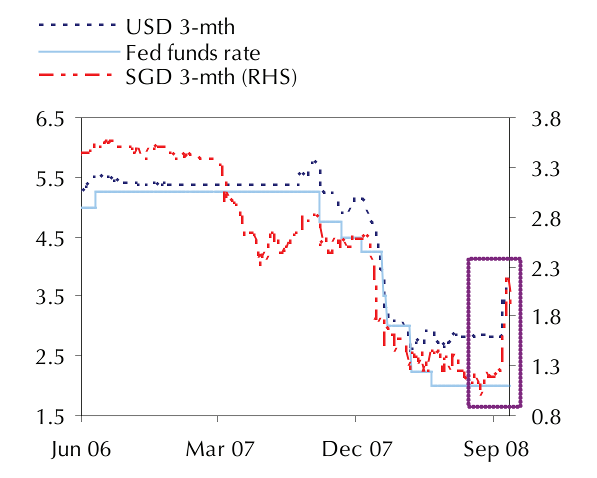
Interbank Liquidity Drying up:
Money Shifting Into Treasury Papers



Source: CEIC

UOB Economics Projections	2006	2007	2008F	2009F
GDP	8.2	7.7	3.0	4.0
CPI (average, y/y)	1.0	2.1	6.5	2.5
Unemployment Rate (End-4Q)	2.6	1.7	2.4	2.6
Current Acct (% of GDP, SGD)	21.8	24.3	17.0	15.9
DBU Loan Growth (% y/y)	6.3	19.9	16.0	6.0

Credit Risk Concerns Resulting in Spike-up in
Interbank Rates (both USD and SGD)



Source: CEIC

SGD Interest Rate Outlook:
Suffering from Global Liquidity Squeeze

Liquidity risk is back again, as reflected in the widening spread between 3-mth US LIBOR and T-bill spread. This has resulted in a sharp pull back in interbank lending activities, pushing 3-mth SGD SIBOR up to 2.25% in late Sep 2008 from 1.25% some 4 weeks back. While uncertainty surrounding the $700bn bail-out package has contributed to the sharp move, our view is that global cost of borrowing is likely to remain alleviated in the months ahead, as financial markets continue to grapple with 'which bank will be next'? As such, it looks like the 3-mth SGD SIBOR is likely to trade closer to 1.5% even if the Fed were to cut by another 50bps before year-end. A spike to above 4-5% like the episode during the Asian crisis is unlikely to take place for now. Note that there is very little pressure on SGD and other regional currencies, and Singapore's system (in particular) remains ample.

▪ Malaysia

UOB Economics Projections	2006	2007	2008F	2009F
GDP	5.8	6.3	5.6	4.6
CPI (average, y/y)	3.6	2.0	5.9	4.3
Unemployment Rate (end-4Q)	3.0	3.0	3.4	3.6
Current account (% of GDP)	16.3	15.6	15.4	15.2
Fiscal balance (% of GDP)	-3.3	-3.2	-4.8	-4.2

In addition to the financial market turmoil, the domestic political tension will be a significant obstacle to MYR strength and the uncertainty is set to be prolonged with the postponement of the UMNO general elections to March 2009 from initial 16-21 December. While political pressures has eased slightly following PM Abdullah's announcement to cede power to DPM Najib in March 2009 rather than 2010, the outlook is far from clear given the tensions with the opposition. Overall, we are now expecting higher USD/MYR at 3.47 for end-4Q08 and 3.48 end-1Q09 although the pair could potentially have further upside risk if the global credit crisis or the domestic political situation deteriorates.

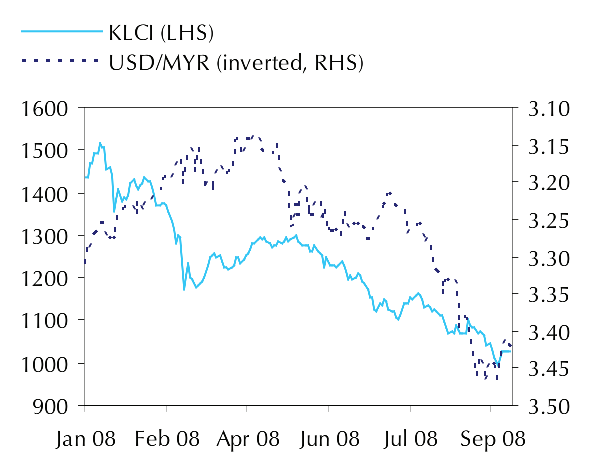
Inflation is likely to remain elevated in coming months due to the high food prices and the electricity tariff hike in July. The passthrough of the fuel price cuts could also be delayed by the Ramadan.

Despite the high inflation, we continue to eliminate the possibility of monetary tightening in the months ahead as Malaysia unwound some of the fuel price hike in the last two months and global growth risks increase. We see some possibility of a 25-50bps rate cut next year as inflation comes off.

Economic growth is expected to slow for the rest of the year as a result of weaker global demand. In 2009, growth could ease to 4.6% from an estimated 5.6% this year due to greater risk in the global environment.

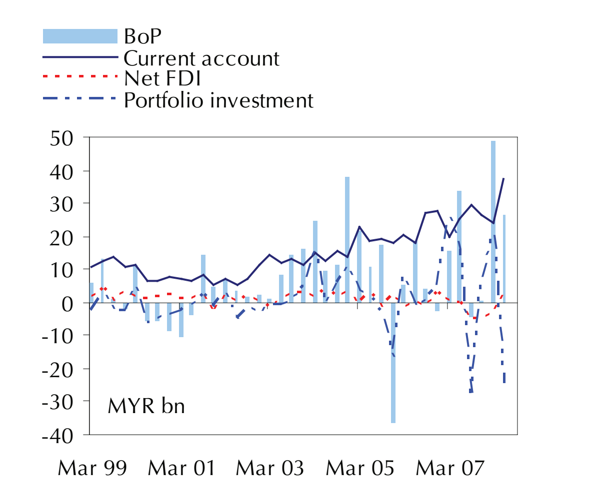
MYR fell to a low of 3.47/USD in 3Q, down 4.7% since the start of the year as the turmoil in the financial market led to further unwinding of risk-taking. Near-term, the domestic political tension will also be a significant obstacle to MYR strength and the uncertainty is set to be prolonged with the postponement of the UMNO general elections to March 2009 from initial 16-21 December which could keep foreign investors on the sidelines at least until then. While political pressures has eased slightly following PM Abdullah's announcement to cede

USD/MYR Rose on the Back of the Global Credit Market Turmoil and the Domestic Political Tensions



Source: CEIC

Strong Commodity Export was the Driving Force for the Country's External Position



Source: CEIC

power to DPM Najib in March 2009 rather than 2010, the outlook is far from clear given the tensions with the opposition.

Despite the correction in the crude palm oil (CPO) prices, Malaysia's economic growth would continue to garner some support from its commodity exports. The strong commodity export has kept the country's BoP in surplus in 2Q08 even with the large portfolio outflows. But that support for the MYR has weakened now due to the fall in the CPO prices. On the interest rate front, we expect the OPR to remain steady at 3.50% in 4Q08 as inflation has probably peaked given the two consecutive cuts in the domestic fuel prices in August and September. With global interest rates now poised to be cut further in the face of rising growth risks, the earlier pressure on the MYR as a result of Bank Negara's decision not to hike interest rates has vanished. Overall, we are now expecting higher USD/MYR at 3.47 for end-4Q08 and 3.48 end-1Q09 although the pair could potentially have further upside risk if the global credit crisis or the domestic political situation deteriorates. However, in the medium to long term, concerns over the financing of the US government's rescue plans for the financial sector should inevitably be negative for USD.

Re-pegging the MYR to the USD?

In September, rumours of a re-peg of the MYR to the USD were set off in the market by calls from Ex-PM Mahathir. There were concerns that the global liquidity crisis and the political tension in Malaysia would cause further funds exodus from the country. The rumour triggered a rally in the MYR as investors covered short positions. However, Malaysia's new Finance Minister Najib Razak has since denied any such plans and upheld his support for the free market.

We think the possibility for Malaysia to reinstate the USD/MYR peg is minuscule as this represents a backward move following the MYR de-peg in July-2005 (on the same day of the RMB de-peg). In 1998, the peg was necessary to prevent the freefall in the MYR by as much as 50% to 4.95/USD during the Asian Financial Crisis and foreign funds were pulling out of the country, sending the domestic interest rates soaring. The 3M KLIBOR rose to 11% in July 1998 while it has remained relatively benign at around 3.70% so far. Furthermore, we do not think Malaysia is willing to reinstate the capital control measures which would be needed to anchor the currency peg.

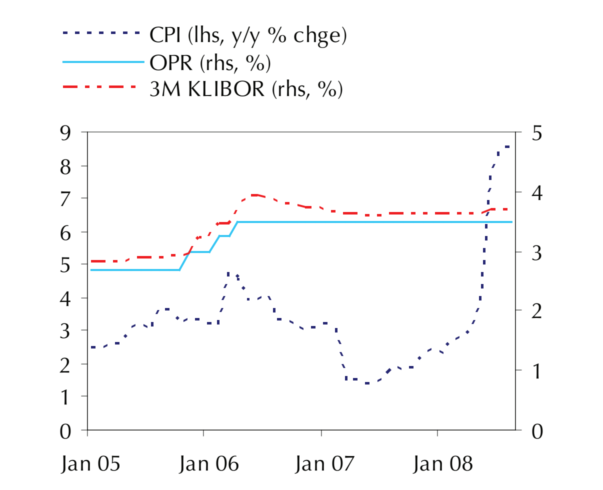
Inflation Remains High Despite Cuts in Domestic Fuel Prices

Headline inflation remained firm at 27-year high of 8.5%y/y in August (similar to the pace in July) despite the cut in the domestic fuel prices in the month. The government has announced another fuel price cut effective 25 Sep, bringing the total reduction to 25sen/liter for gasoline and 18sen/liter for diesel at MYR2.45/liter and MYR2.40/liter respectively. For gasoline, this works out to a combined reversal of 32% of the 78sen/liter hike in June. However, inflation is likely to remain elevated in coming months due to the high food prices and the electricity tariff hike in July. The passthrough of the fuel price cuts could also be delayed by the Ramadan. As a result of the persistent inflationary pressure, we have raised our full-year inflation forecast to 5.9% from 5.7%, which is near the top end of the government's 5.5-6.0% forecast. Prices rose 4.9%y/y in the first eight months of the year and is expected to average 7.5-8.0%y/y in 4Q08. However, we expect the inflation to ease to 4.3% in 2009.

But No Rate Hike this Year

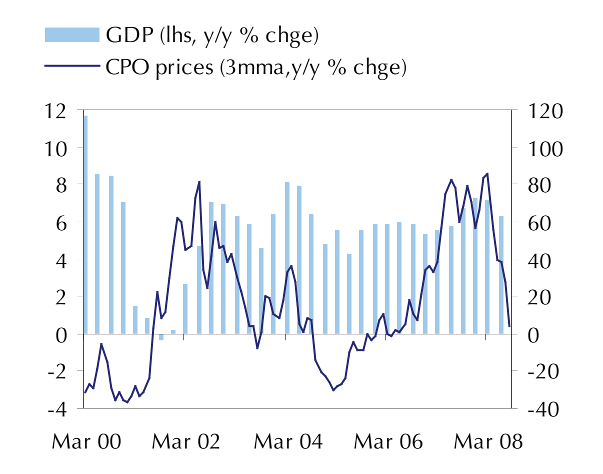
Despite the high inflation, we continue to eliminate the possibility of monetary tightening in the months ahead. In fact, Malaysia is the only major central bank in Asia which has not tightened monetary policy this year despite the surge in domestic inflation. With the ongoing global financial market turmoil and increasingly challenging economic environment, the decision to keep domestic interest rate steady has gained credence on hindsight. As Malaysia unwound some of the fuel price hike in the last two months due to easing crude oil prices, any interest

Domestic Interest Rates
have Held Steady Despite Inflation Surge



Source: CEIC, UOB

The Correction in CPO Prices
Poses Some Risk to Growth



Source: CEIC, UOB

rate hike from here appears even more unlikely. We see some possibility of a 25-50bps rate cut next year as inflation comes off.

Firm 2Q08 GDP Growth; Expansionary Budget to Boost Growth in 2009

Malaysia's 2Q08 GDP growth came in within our expectation at 6.3%y/y (1Q08: 7.1%). The bulk of the growth was contributed by private consumption (+4.4ppt) and net exports (+2.8ppt) in 2Q. Electrical and electronics exports rebounded and the double-digit expansion in shipments of oil and oil-related products drove the robust export performance in the quarter.

Economic growth is expected to slow for the rest of the year as a result of weaker global demand. We are expecting GDP growth to slow to 4.6%y/y in 2H08 from 6.7% in 1H08. In 2009, growth could ease to 4.6% from an estimated 5.6% this year due to greater risk in the global environment. Exports growth has remained robust so far this year and we expect the commodity exports to cap the downside risks despite the correction in the CPO prices. Energy-related exports which include palm oil products and crude petroleum, accounted for about a quarter of total exports so far this year.

Higher government spending should provide some support for the economy although there are concerns over huge fiscal blowout. The government expects the budget deficit to surge to 4.8% of GDP this year (largest since 5.0% in 2003) from 3.2% in 2007, largely due to higher cost of fuel subsidies, higher expenditure on social assistance programmes and new spending on food security. For 2009, key initiatives include higher income tax rebates for lower-income groups and the 1 percentage point cut in the top income tax rate to 27% from current 28%, closing the gap with the corporate income tax rate which would fall to 25% next year. As a result, the budget deficit in 2009 is likely to exceed the government's target of 3.6% of GDP.

2Q08 GDP: Exports Strengthened While Private Consumption and GFCF Remained Firm

	2007	3Q07	4Q07	1Q08	2Q08	2Q08
	y/y % change					Ppt Cont
GDP	6.3	6.7	7.3	7.1	6.3	6.3
Consumption	9.9	11.6	8.7	11.5	8.6	5.3
Public	6.6	6.0	4.2	10.5	7.1	0.8
Private	10.8	13.0	10.2	11.7	9.0	4.4
GFCF	9.6	12.8	10.2	6.0	5.6	1.3
Change in stocks (as % of GDP)	-1.2	-3.3	-4.1	-2.3	-2.2	-3.1
Net Exports	-3.8	1.4	-12.3	26.4	20.0	2.8
Exports	4.2	2.9	7.8	6.0	9.7	11.7
Imports	5.4	3.1	11.0	3.4	8.4	8.9

Source: CEIC, UOB

▪ Thailand

UOB Economics Projections	2006	2007	2008F	2009F
GDP	5.1	4.8	4.7	4.5
CPI (average, y/y)	4.7	2.2	6.5	3.5
Unemployment Rate (end-4Q)	1.0	0.8	1.5	1.6
Current account (% of GDP)	2.0	12.1	4.9	4.5
Fiscal balance (% of GDP)	2.3	-4.6	-4.8	1.5

Thailand is likely to end the year with a trimmed current account surplus at 5% of GDP as compared with 12% last year. Along with sustained dollar resurgence, weaker growth in Thailand in 2H08, the lack of resolution to political crisis, and the risk of institutional unwinding of long positions in Thai assets, we revise our THB forecast to 34.80/ USD at end-4Q08.

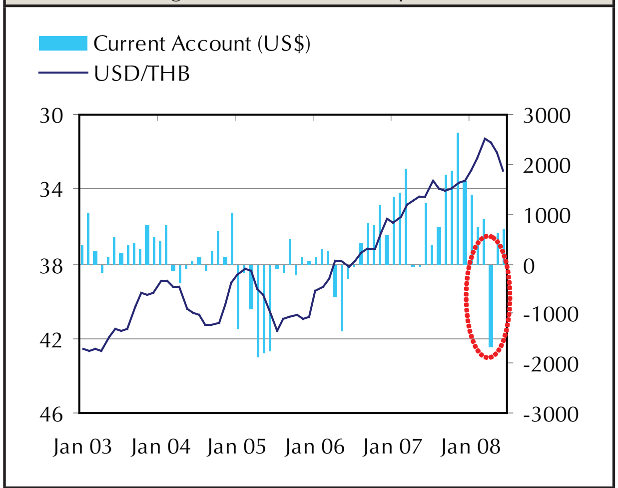
While inflation has hit a 10-year high, the government's THB50bn fiscal package is also likely to help contain inflation below double-digits and help monthly CPI to peak in August. Hence, having hiked rates by 25bps each on 16 July and 27 August, or a total of 50bps this year, the BOT is likely to maintain the benchmark rate at 3.75% for the rest of the year.

2Q08 GDP came in at 5.3% y/y, slowing for the first time in more than a year, moderating from the revised 6.1% y/y growth in 1Q. We expect growth to moderate in the next 2 quarters, bringing full-year growth to 4.7%.

Embattled Baht

With massive anti-government protests erupting in Bangkok, several lawsuits against current lawmakers, and fresh dollar resurgence, THB has declined some 2% against the USD year-to-date. Since the 25 May anti-government protests began, Thailand's SET index has declined 22.8%, with net foreign sales of equity in 2Q08, a reversal from the inflows of foreign funds in 1Q08. Clearly, political uncertainty in Thailand has deterred foreign investments both in terms of FDI and portfolio flows.

Shrinking Current Account Surplus in 2H08



Source: CEIC, UOB

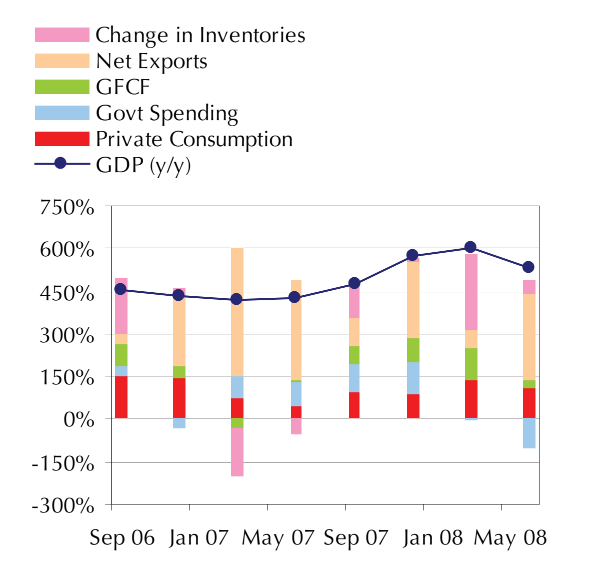
Both the trade and current account surplus turned into a deficit in April, due mainly to costlier oil imports. However, Thailand returned to current account surplus in May and June, and will likely end the year with a trimmed surplus at 5% of GDP as compared with 12% last year. Agricultural exports such as rubber and rice are likely to benefit from firmer food prices, while oil and metals prices continue to correct. Along with sustained dollar resurgence, weaker growth in Thailand in 2H08, the lack of resolution to political crisis, and the risk of institutional unwinding of long positions in Thai assets, we revise our THB forecast to 34.80/USD at end-4Q08.

1H08 GDP Growth Holding Firm, But Slowdown in 2H08

Thailand's 2Q GDP came in lower-than-expected at 5.3% y/y, slowing for the first time in more than a year, moderating from the revised 6.1% y/y growth in 1Q. On a s/adj basis, 2Q GDP rose only 0.7% q/q, compared to the revised 1.3% q/q in 1Q08. For the whole of 1H08 however, GDP growth came to about 5.7% y/y, faster than the 4.8% y/y clocked in 2007.

▪ Thailand

2Q08 GDP Saw Slowing Domestic Demand, Although Net Exports Remain Resilient



Source: CEIC, UOB

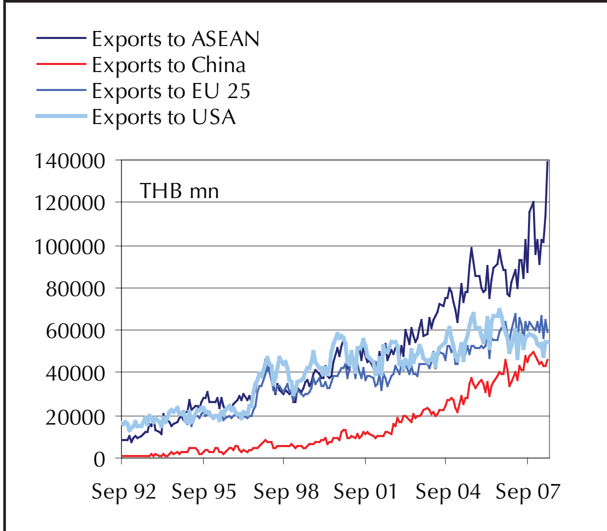
On that basis, NESDB raised its full-year 2008 GDP forecast to 5.2-5.7% y/y in August, from 4.5-5.5% y/y previously. It justified its higher forecast on better-than-expected export performance in 1H08 and a fiscal stimulus package that could bring about higher consumption in 2H08. The fiscal package includes fuel subsidies and lower utilities for the lower-income group. We maintain our full-year GDP growth forecast of 4.7% y/y for 2008 and expect the fiscal package to have negligible impact on overall GDP.

2H08 is expected to see weaker growth than 1H08, with much of the weakness expected from slowing local demand. Soaring inflation will take a bigger chunk out of consumer spending while political uncertainty will cause investment spending to be delayed. Already, private consumption and gross capital formation have decelerated in 2Q08, while forward looking indicators for local demand, such as cement sales, commercial car sales, capital goods imports and domestic machinery sale are all showing signs of slowing. At the same time, declining global demand will also limit external export growth.

Exports Resilient in 2Q; But Vulnerable to Headwinds in 2H08

After growth of 55%y/y in Jul, Thai export growth plummeted to 14.9%y/y in Aug – lowest slowest in 5 months. Imports growth also decelerated sharply to 26.9% in August from 55.1% in July, as crude oil and commodities prices cooled off. In light of the challenging external environment, and lingering domestic political situation, we expect the economy to face significant headwinds in the months ahead.

G3 Economies and Asia Poised for More Severe Growth Slowdown in 2H08



Source: CEIC

Inflation Forecast Raised

Inflation came in 3% points lower than market expectation at 6.4%y/y in Aug from 9.2%y/y in Jul. Clearly, this was the result of the anti-inflation fiscal package. On 15 Jul, the Cabinet endorsed a fiscal package to ease soaring inflation, including reductions in the excise taxes on gasohol (from THB3.3165/litre to THB0.0165/litre), and on diesel (from THB2.305/litre to THB0.005/litre). However, these measures would be unwound in Feb 2009, which means inflation could rise about 2%points after that. We expect full-year inflation around 6.5%. The NESDB has raised its full-year CPI forecast to hit a 10-year high of 6.5-7% y/y in 2008, up from its previous forecast of 5.3-5.8% y/y.

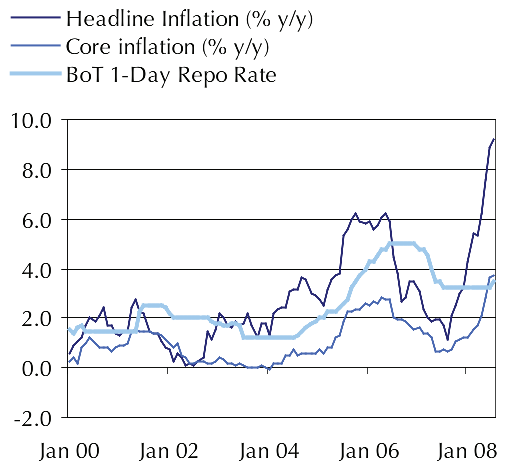
Bank of Thailand to Leave Rates on Hold

Bank of Thailand hiked interest rates by 25bps at its monetary policy meeting on 27 August, to bring the benchmark rate to 3.75%. This comes as July inflation came in at a decade-high 9.2% y/y, while core inflation rose slightly above the BoT's target range of 0-3.5% y/y. This is likely to be the BoT's last rate hike of the year, however, given the downside growth risks of the Thai economy and the pro-growth bias of the Ministry of Finance.

Situated between a rock and a hard place, the BoT is likely to keep interest rates on hold for the rest of 2H08, as it needs to balance slowing growth with soaring infla-

▪ Thailand

BoT Likely to Hike Rates by 25bps as Headline CPI Hits Decade High



Source: CEIC

tion. While inflation has hit a 10-year high, the government's THB50bn fiscal package is also likely to contain inflation below double-digits in August, where we see inflation peaking at 9.7% y/y. Having hiked rates by 25bps each on 16 July and 27 August, or a total of 50bps this year, the BoT is likely to maintain the benchmark rate at 3.75% for the rest of the year.

BoT governor Tarisa Watanagase is also facing considerable political pressure not to hike rates further, with Finance Minister Surapong Suebwonglee and chief economic adviser to the PM Virabongsa Ramangkura strongly objecting to the central bank's rate hikes to contain inflation and appointing a Finance Ministry-influenced panel to oversee the BoT. In a retaliatory measure in August, Tarisa shored up her own inflation-fighting credentials by seeking affirmation from Thai King Bhumipol Adulyadej. After her meeting with the king, she said that she would "follow His Majesty's advice on handling the monetary system for the benefit of the country," and not let "any pressures interfere with the central bank's policies."

Political Risks

Thai parliament elected Somchai Wongsawat as the new PM on 17 Sep 2008, with a clear majority against opposition leader Abhisit. But his journey is not much easier given that he is the brother-in-law of former PM Thaksin. Indeed, in less than two weeks, he is facing allegation of constitutional violation that may lead to his disqualification from office. The allegation contends that he held shares of an internet/telecom company in Jan 2008.

Indeed, newswires report indicated that there would be elections early next year. New elections however are unlikely to resolve the matter adequately, with the PPP likely to stage a comeback under a different name and favoured to win a majority, given its popularity with the rural provinces. However, the Bangkok elites are likely to find unacceptable any return of the PPP. There is no easy resolution to the current impasse, and as a result the political turmoil continues to cloud the outlook for the Thai economy into 2009.

GDP by Expenditure (y/y %)

	2006	2007	2Q07	3Q07	4Q07	1Q08	2Q08
GDP	5.1	4.8	4.3	4.8	5.7	6.1	5.3
Private Consumption	3.2	1.4	0.9	1.8	1.6	2.6	2.4
Government Consumption	2.3	10.8	9.3	9.5	16.0	-0.1	-2.4
Gross Fixed Capital Formation	3.8	1.4	0.2	2.6	4.0	5.4	1.9
Exports	8.5	7.1	7.8	3.4	8.6	8.7	9.3
Imports	2.6	3.5	3.0	2.6	5.9	10.3	6.9
Source: CEIC							

▪ Indonesia

UOB Economics Projections	2006	2007	2008F	2009F
GDP	5.5	6.3	6.0	5.4
CPI (average, y/y)	13.1	6.4	10.5	8.0
Unemployment Rate (%)	10.3	9.1	9.3	9.5
Current account (% of GDP)	3.0	2.4	1.2	0.9
Fiscal balance (% of GDP)	-0.9	-1.3	-1.9	-2.0

Narrowing trade balance, the end of the rate hike cycle soon and risk aversion suggest weaker IDR in 4Q08. We expect to see USD/IDR ending the year at around 9,600, representing 1.9% IDR depreciation for the full year.

The BI targets to bring inflation down to 6.5%-7.5% by end-2009. In our view, the target can be achieved in 2H09 if the recent correction in food and energy prices is sustainable.

With a total of 150bps rate hike since May, we expect the BI is already done with its monetary tightening. As a result of lower inflation and slower growth, the risk is towards interest rate cuts in 2H09. We are currently expecting the BI to lower its overnight rate to 8.50% by end-2009 but risk is towards more rather than less rate cuts.

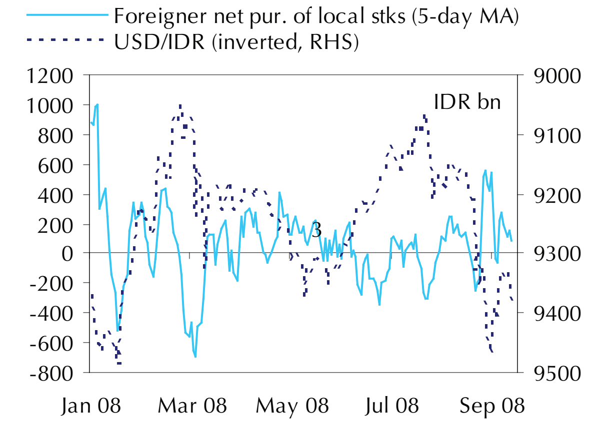
We expect Indonesia's GDP growth to slow to 5.4% in 2009 from an estimated 6.0% this year.

Flight to safety sent USD/IDR rebounding to 9,470 from as low as 9,063 in 3Q08. The IDR has given back its gains of as much as 4.1% since the beginning of the year despite the monetary policy tightening and active BI intervention in the FX market. To boost liquidity in the banking system, the BI announced on 16 September a hefty 200bps cut in the overnight repo rate to 10.25% from 12.25%. It also raised the overnight FASBI rate – return on funds that commercial banks deposit with the BI – to 8.25% from 7.25%. There were some indications that the BI might next raise domestic banks' reserve ratio to boost banks' liquidity and tighten credit.

With a total of 150bps rate hike between May and October, we expect the BI is already done with its monetary tightening. From here, upside risk for USD/IDR could be higher especially if the credit crisis deepens. Strong imports (including crude oil) and moderation in commodity prices also means a narrowing trade balance. Indonesia has largely depended on its merchandise exports to maintain a current account surplus given its services and income account deficits. As such, the expected moderation in commodity exports will be negative on the IDR.

Furthermore, the impact from the monetary tightening could also start to undermine the IDR in 4Q08 as growth slows. Therefore, we expect to see USD/IDR ending the year at around 9,600, representing 1.9% IDR depreciation for the full year. Nevertheless, domestic politics is expected to remain stable ahead of the parliamentary and presidential elections next year despite some contagion risk from the other Asian economies.

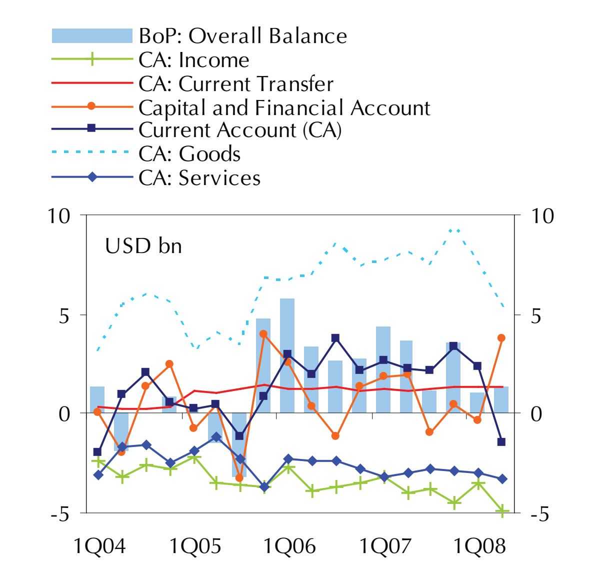
IDR Came Under Pressure in 3Q
as a Result of the Global Credit Crisis



Source: CEIC, UOB

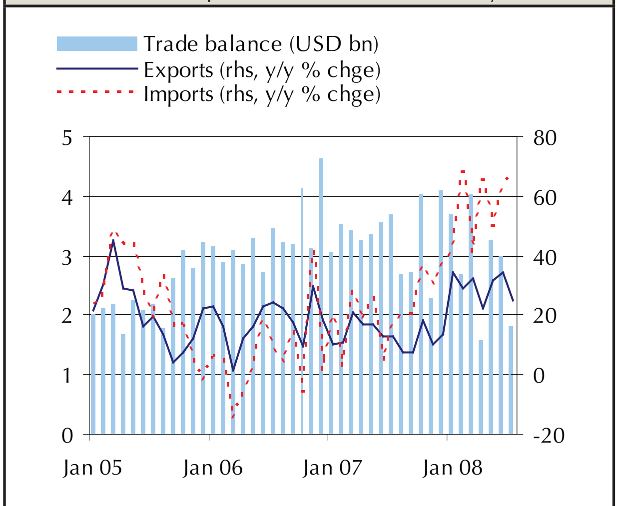
▪ Indonesia

Current Account Held up by Goods Balance



Source: CEIC

But Trade Balance is Narrowing due to Strong Demand for Imports and Lower Commodity Prices



Source: CEIC, UOB

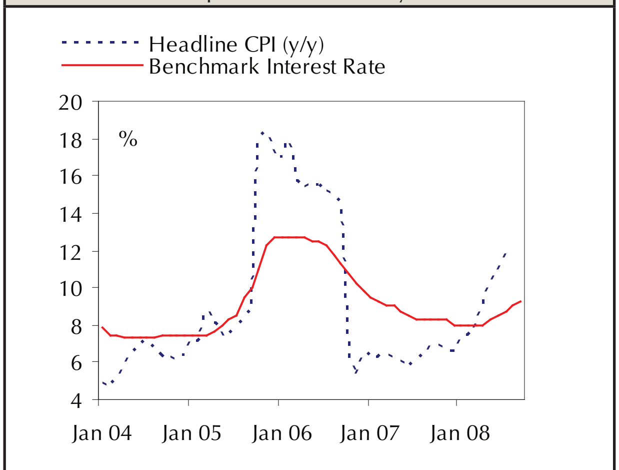
Interest Rate: Nearing the Peak

The BI has hiked its benchmark overnight rate by a total of 150bps to 9.50% in October, in six consecutive moves since May when the government raised the domestic fuel prices by an average of 28.7%. The monetary tightening was made on grounds of strong demand-side inflationary pressure even though pressures from high food and energy prices have begun to ease. But the weak global growth prospects, credit market rout and correction in palm prices suggest that Indonesia would be bracing for slower growth in coming quarters, which should deter the BI from tightening monetary policy further especially since China and Taiwan have already started to cut their respective interest rates.

While the pressure on food and energy prices has eased, we expect inflation to peak only in December at around 12.5%y/y compared with 12.15% in September. This is at the higher end of the BI's forecast range of 11.5-12.5%. Going forward, the BI targets to bring inflation down to 6.5%-7.5% by end-2009. In our view, the target can be achieved in 2H09 if the recent correction in food and energy prices is sustainable. This was despite the government saying that there is no plan to lower domestic fuel prices soon even though global oil prices have fallen as this is still higher than what it has budgeted for.

As a result of lower inflation and slower growth, the risk is towards interest rate cuts in 2H09. We are currently expecting the BI to lower its overnight rate to 8.50% by end-2009 but risk is towards more rather than less rate cuts. Note that the BI has slashed rates aggressively by a cumulative 475bps between May 2006 to December 2007 in order to reverse the sharp increases in interest rates which were raised following the doubling of domestic fuel prices in October 2005. Overall, we are expecting an average inflation rate of 10.5% this year which should moderate to 8.0% in 2009, partly due to the basis effect.

Inflation is Expected to Peak only in December



Source: CEIC

Indonesia: 2Q08 GDP Surprised on the Upside

Indonesia's GDP grew a stronger-than-expected 6.4%y/y in 2Q08 (mkt:6.2%), up from 6.3% in 1Q08. The resilience of the economy was reflected in the pick-up in the growth momentum as q/q growth strengthened to 2.4% in 2Q08 from 2.2% in 1Q08 even as the external environment continued to deteriorate and the government hiked fuel prices by an average of 28.7% on 24 May. Consumption and fixed investment strengthened while exports stayed firm as commodities demand remained buoyant in the quarter. Government consumption rose a sharp +21.2%q/q in 2Q08 as authorities disbursed cash to cushion the hike in domestic fuel prices. While private consumption turned in +1.1% q/q growth in 2Q08, this component could come under stress going forward as the fuel price hike and interest rate increases take their toll. The retreat in palm oil prices is also expected to hit Indonesia's exports in 2H08. However, the strong growth data in 1H08 should help the Indonesian economy achieve a 6.0% growth rate this year, which is in line with the government's target.

Going forward, we see greater growth risk in Indonesia due to the softer global demand. However, demand for commodities is likely to remain fairly firm in the emerging markets of India and China. Indonesia's strong dependence on domestic demand will also help to contain the spillover effect of the global economic slowdown. With the corporate and individual tax rate cuts kicking in next year, we expect domestic demand to hold up. Overall, Indonesia's economic growth is still expected to ease to 5.4% next year.

2Q08 GDP: Private Consumption and Investment were the Key Growth Drivers

	2007	2Q07	3Q07	4Q07	1Q08	2Q08	2Q08
	y/y % change						Ppt Cont
GDP	6.3	6.4	6.5	6.3	6.3	6.4	6.4
Consumption	4.9	4.6	5.3	5.1	5.6	4.9	3.2
Public	3.9	3.8	3.3	2.0	4.7	2.2	0.2
Private	5.0	4.7	5.1	5.6	5.7	5.3	3.0
GFCF	9.2	6.9	10.4	12.1	15.4	12.8	2.8
Change in stocks (as % of GDP)	0.0	0.5	0.9	-1.1	-0.1	0.6	0.1
Net Exports	4.5	25.0	6.7	-14.2	7.1	13.8	1.4
Exports	8.0	9.8	6.9	7.3	15.5	16.1	7.7
Imports	8.9	6.5	7.0	13.6	17.8	16.7	6.4

Source: CEIC, UOB

▪ Philippines

UOB Economics Projections	2006	2007	2008F	2009F
GDP	5.4	7.2	4.6	4.0
CPI (average, y/y)	6.3	2.8	9.8	7.0
Unemployment (yearly avg)	7.9	7.3	8.0	7.5
Current account (USD bn)	5.3	6.4	3.5	4.5
Fiscal balance (% of GDP)	-5.1	-0.7	-3.5	-1.0

We have revised our USD/PHP forecast to 48.00/USD at end-2008. The PHP has touched lows of 47.20/USD in 3Q08, due to the global dollar resurgence. High oil and commodity prices in 1H08 had also induced a negative terms of trade shock and reduced the net oil importer's current account surplus.

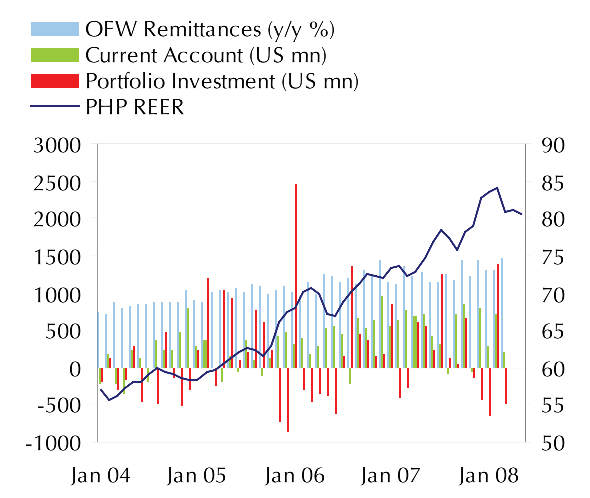
The BSP hiked interest rates by 25bps, for the third straight time in 12 weeks on 28 August. This brings the overnight borrowing or reverse repo rate to 6% and 8% for the overnight lending rate. Previously, the BSP also hiked by 25bps on 5 June and a surprise 50bps on 17 July.

The Philippines has reported lower-than-expected 2Q GDP growth of 4.6% y/y, the slowest pace in 3 years. However on a s/adj basis, 2Q GDP grew a decent 2% m/m. Manila also revised 1Q GDP growth sharply downwards, from 5.2% y/y to 4.7% y/y. For the first half, GDP growth came in at 4.6% y/y, compared with 7.2% y/y in 2007.

Sharp Downward Revision to 1Q Growth

The Philippines has reported lower-than-expected 2Q GDP growth of 4.6% y/y, the slowest pace in 3 years. However on a s/adj basis, 2Q GDP grew a decent 2% m/m. Manila also revised 1Q GDP growth sharply downwards, from 5.2% y/y to 4.7% y/y. For the first half, GDP growth came in at 4.6% y/y, compared to 7.2% y/y in 2007.

PHP REER has Declined 2.7% since Jan 08;
CA and Portfolio Inflows Look Set for Weakening Trend



Source: CEIC

The slowdown was due to higher inflation crimping consumer spending, which accounts for 70% of GDP. Consumer spending rose 3.4% y/y in 2Q08. Exports rose 7.7% y/y, with agricultural production climbing 4.9% y/y.

The main drivers of the economy are domestic demand and electronic and agricultural exports. However, exports are likely to be hurt by a sharper slowdown in the G7 economies in 2H08, while double-digit inflation is likely to take a deeper bite out of real wage growth and consumption.

Still, remittances from the more than 8 million Filipinos abroad, or about a tenth of the population, have supported the $118 billion economy this year as faltering exports hurt manufacturers and faster inflation eroded consumer spending.

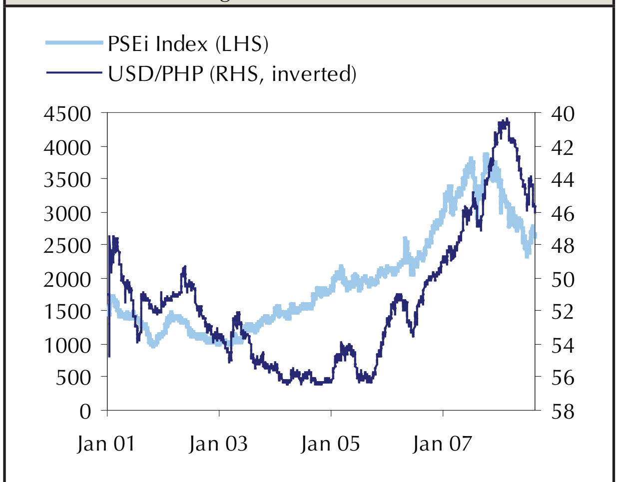
In July, Manila said it expected 2008 GDP growth of 5.3-5.9% y/y, although the official growth target remains at 5.5-6.4% y/y. However, Socio-Economic Planning Secretary Ralph Recto said in August that full-year growth would likely come in below 5.2% y/y, and that it would be "difficult" for the economy to achieve its growth target this year. We maintain our growth forecast at 4.6% y/y in 2008, which is below the official target range.

▪ Philippines

PHP Weakness

The peso has depreciated around 13% against the USD year-to-date, contrasting with its 19% surge in 2007. It has touched lows of 47.20/USD in 3Q08, due to the global dollar resurgence. High oil and commodity prices in 1H08 had also induced a negative terms of trade shock and reduced the net oil importer's current account surplus. Furthermore, inflation of nearly 10% y/y in 2Q08, coupled with a central bank that only started tightening in June, all contributed to the peso's decline.

USD/PHP has Rebounded 10.3% this Year, Along with Decline in PSEi



Source: CEIC

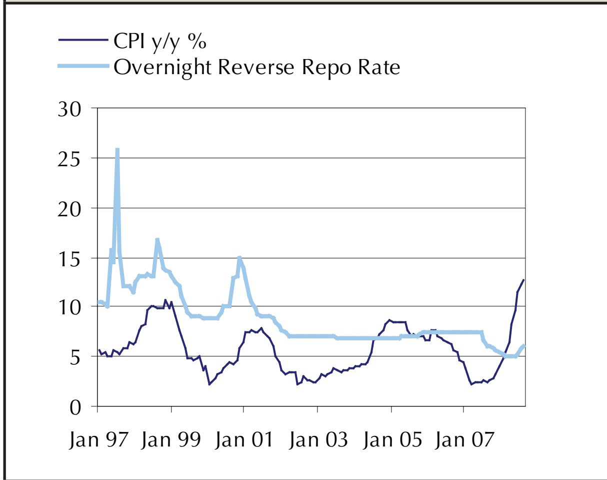
USD/PHP is set to continue its rebound as a result of the market uncertainty. We have revised upwards our USD/PHP forecast to 48.00 for year-end.

Inflation Not Out of the Woods Yet

Inflation in September moderated to 11.9% y/y from 17-year high of 12.5% in August.

The Bangko Sentral ng Pilipinas (BSP) said inflation is likely to remain in "double digits" through to 1Q09.

BSP Needs to Tighten Aggressively as Current Monetary Policy Too Loose



Source: CEIC

Looking forward, central bank governor Amando Tetangco has said that the onset of the typhoon season and the rising costs of raw materials are likely to raise inflation higher, although this could be balanced by lower rice and oil prices. The BSP has raised its 2008 inflation forecast to a range of 9-11%, from 7-9%. We retain our forecast of 9.8% y/y for 2008.

The BSP hiked interest rates by 25bps, for the third straight time in 12 weeks on 28 August. This brings the overnight borrowing or reverse repo rate to 6% and 8% for the overnight lending rate. Previously, the BSP also hiked by 25bps on 5 June and a surprise 50bps on 17 July.

With inflation likely on a downward trajectory from here, we expect that the BSP could start to cut rates as early as 1Q09, particularly since the domestic growth outlook has weakened.

We have factored in 75bps cut in the benchmark interest rates in 1Q09, barring sharp rebound in the oil and commodity prices.

GDP by Expenditure (y/y %)

	2006	2007	2Q07	3Q07	4Q07	1Q08	2Q08
GDP	5.4	7.2	8.3	7.1	6.4	4.7	4.6
Private Consumption	5.5	5.8	5.6	5.7	6.2	5.1	3.4
Government Consumption	10.4	8.3	11.9	6.4	4.6	-1.0	-5.1
Gross Fixed Capital Formation	3.8	11.8	20.9	8.8	6.7	6.6	5.6
Exports	13.4	5.6	4.9	3.7	3.9	-11.1	7.7
Imports	1.9	-4.5	-10.5	-5.0	0.2	-6.6	-1.0

Source: CEIC

▪ South Korea

UOB Economics Projections	2006	2007	2008F	2009F
GDP	5.1	5.0	4.4	4.0
CPI (average, y/y)	2.2	2.5	4.8	3.5
Unemployment (4Q avg)	3.4	3.1	3.3	3.5
Current account (% of GDP)	0.6	0.6	-1.2	-0.8
Fiscal balance (FY, % of GDP)	0.4	3.8	1.5	0.5

The KRW plunged by more than 25% against the USD since the start of the year and weak sentiment towards the currency will likely remain until the current account improves and foreigners' equity sales at the local market ease off. With the global financial market in a limbo and weakening economic fundamentals in South Korea, we have downgraded our KRW outlook again and are now expecting the USD/KRW at 1,450 by end-2008 and 1,500 by 1Q09.

Inflation continued to moderate to 5.1%y/y in September after peaking at 5.9% in July. Despite the easing in inflation rate, we expect the sharp weakening in the KRW and anticipated increase in utility charges to keep inflation elevated in coming months.

Nonetheless, the sharp downturn in domestic sentiment and coordinated rate cuts by major central banks in October have already prompted a surprise 25bps cut in its base rate to 5.00% on 9 October. Clearly, the BoK's focus has shifted to growth rather than fighting inflation which suggests that it might deliver another 25bps rate cut before the year ends. The weakening KRW and elevated inflation rate are deterrents to aggressive rate cuts in the near-term.

We expect South Korea's GDP growth to ease to 3.6%y/y in 2H08 from 5.3%y/y in 1H08. Our full-year GDP growth forecast remains at 4.4% this year and 4.0% in 2009.

The worst-performing currency in Asia, KRW plunged by more than 25% against the USD since the start of the year to its decade low. Foreigners continued to dump Korean stocks and this exacerbated the fall in the KRW. In the four months between June to September, foreigners sold a net US$14.5 bn in Korean stocks compared with US$11.0 bn in Taiwan and this was also higher than that in India, Thailand, Philippines and Indonesia during the same period. In the first nine months of the year, foreign investors have already sold a net US$29 bn worth of Korean stocks, roughly the amount sold for the whole of 2007.

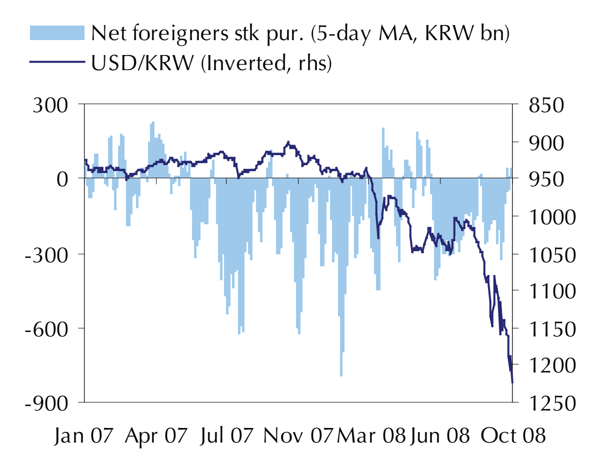
The liquidity crunch has led to USD shortage in the domestic market with the 1Y basis between the USD/KRW cross currency swap (CCS) and the KRW interest rate swap (IRS) widening to -350 bps. The government has offered to inject a total of US$10 bn into the swap market and supply US$5 bn in foreign currency to SME exporters via the EXIM Bank. Local exporters are also reportedly reeling from their FX derivatives contracts as a result of the sharp fall in the KRW. The domestic liquidity crunch was perilous enough for the government to call on local banks to sell off their overseas assets and stock holdings and transfer foreign currency deposits held in overseas banks back into the country.

The weak current account position was also working against the KRW. The country's current account deficit rose to a record high in August as a result of the deterioration in the trade balance, as exports slowed. The BoK expects the current account to be at least balanced from October after the cumulative deficit of US$12.6 bn in the first eight months of the year. For the full-year, the BoK is forecasting a current account shortfall of US$11 bn. Unless we see a meaningful improvement in the current account, the KRW is likely to remain under pressure. While oil prices have eased, exports growth should slow in coming months as a result of the global economic slowdown which suggests that the current account could remain in deficit next year.

The country's foreign reserves have been recording monthly decline since March this year, which totalled US$24.6 bn to September and a whopping 9.3% off its peak of US$264.2bn in March. The falling foreign reserves due partly due to the FX interventions is another cause of concern.

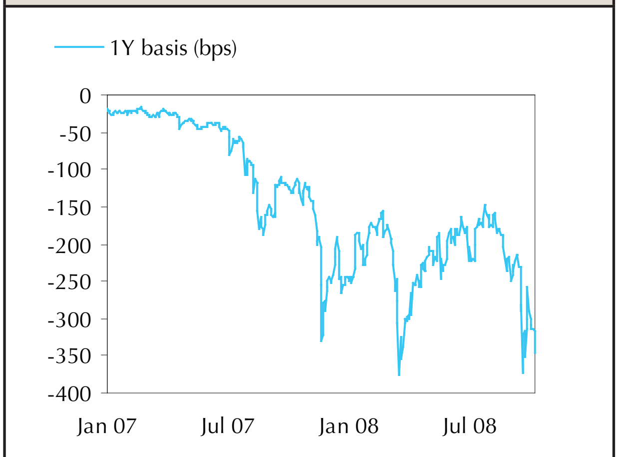
Although the authorities have vowed to continue intervening in the FX market to prevent excessive volatility in the KRW, the weak sentiment towards the currency will likely remain until the current account improves and foreigners' equity sales at the local market ease off. With the global financial market in a limbo and weakening economic fundamentals in South Korea, we have

KRW was the Worst Performing Currency in Asia so far, having Fallen 25% YTD



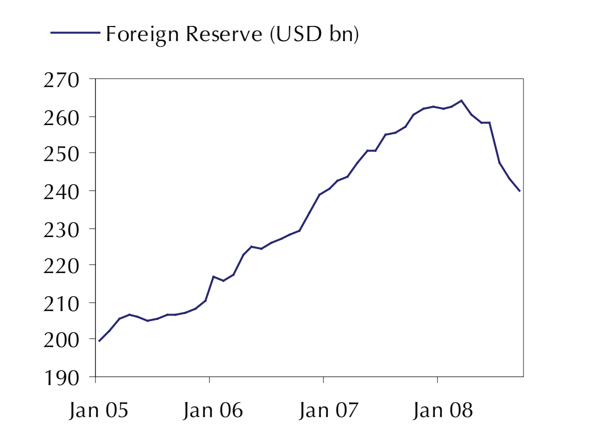
Source: CEIC, UOB

USD Shortage in the Onshore Market Led to Significant Widening of the Basis Between the USD/KRW CCS and KRW IRS



Source: Bloomberg

The Rapid Fall in South Korea's Foreign Reserves Poses Another Risk



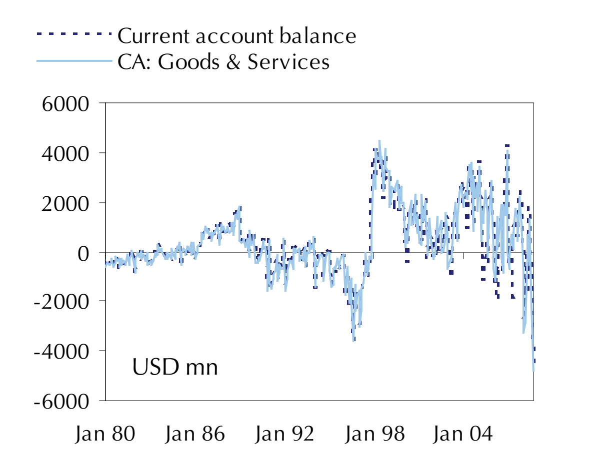
Source: CEIC, UOB

downgraded our KRW outlook again and are now expecting the USD/KRW at 1,450 by end-2008 and 1,500 by 1Q09.

Inflation Moderates but Remains Elevated

Inflation continued to moderate to 5.1%y/y in September after peaking at 5.9% in July. Nonetheless, we expect the sharp weakening in the KRW and anticipated increase in utility charges to keep inflation elevated in coming months. For the rest of the year, inflation rate should stay at around 5%. With inflation in the first three quarters averaging 4.7%y/y, full-year inflation is on track to hit

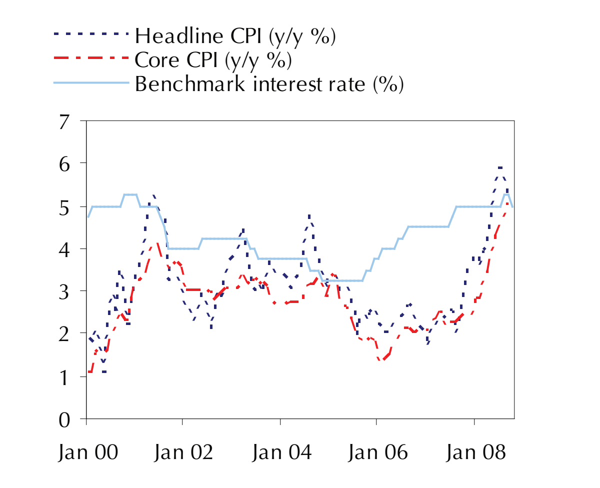
Current Account Deficit at Record High in August



Source: CEIC, UOB

▪ South Korea

Inflationary Concerns and KRW Weakness Should Prevent Aggressive Monetary Easing



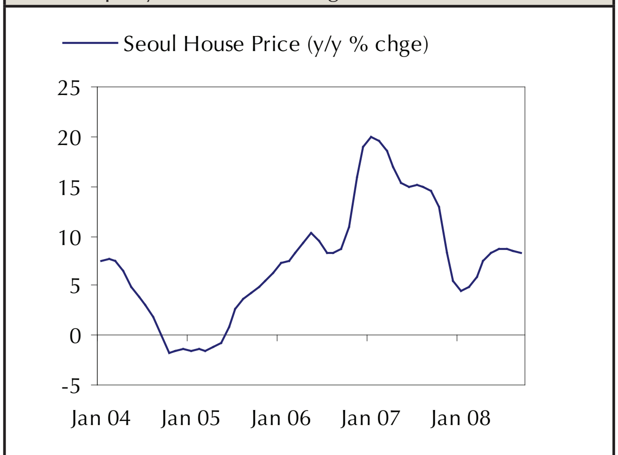
Source: CEIC, UOB

4.8%. Going forward, the inflation rate will likely remain above the BoK's target of 2.5%-3.5% until 2H09.

Surprise Rate Cut in October as Economy Falters

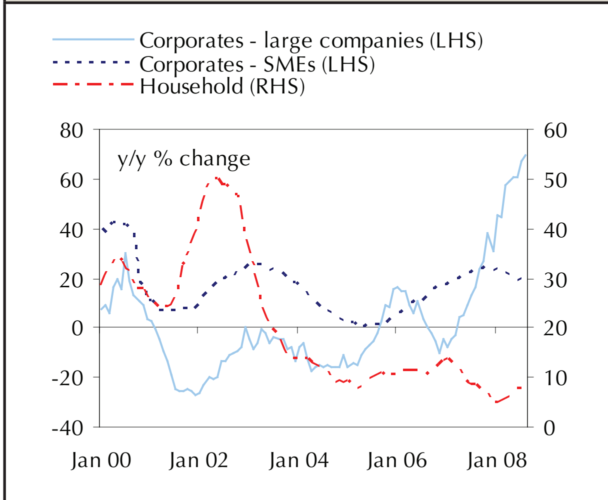
The sharp downturn in domestic sentiment and coordinated rate cuts by major central banks in October have already prompted a surprise 25bps cut in BoK's base rate to 5.00% on 9 October as the central bank attempted to soothe the financial markets. Clearly, the BoK's focus has shifted to growth rather than fighting inflation which suggests that it might deliver another 25bps rate cut before the year ends. The weakening KRW and elevated inflation rate (even though the inflation rate has peaked) are deterrents to aggressive rate cuts in the near-term. Note

Property Prices Still Rising but Pace Has Fallen



Source: CEIC, UOB

Credit Growth to SMEs and Households has Moderated



Source: CEIC, UOB

the BoK has hiked its benchmark base rate by only 25bps to 5.25% (in August) during the recent tightening cycle.

Growth Slowing

The Korean economy sustained a growth momentum of 0.8% q/q in 2Q08, led mainly by exports. On a y/y basis, GDP growth slowed to 4.8% in the quarter – lowest in five quarters – as private consumption and fixed investment softened as a result of a more cautious environment.

More recently, data pointed to more slowdown ahead. Industrial production eased sharply to 1.9%y/y in August from 8.6% in July. Private consumption is also set to moderate further given weakening sentiment. Consumer sentiment plunged to 86 in 2Q08 from 105 in 1Q08, in line with the deterioration in business sentiment. While property prices remains firm, there would be some correction ahead. In the local credit market, mortgage loan rates have soared as a result of the liquidity crunch. But with property prices still supported, risk to the households should still be capped. So far, credit growth in the country has moderated slightly, led by slower loans growth to SMEs and households. The highly-leveraged households remain a key source of concern. Household debt has risen to 70% of GDP last year from 43% in 1997.

We expect South Korea's GDP growth to ease to 3.6%y/y in 2H08 from 5.3%y/y in 1H08. Our full-year GDP growth forecast remains at 4.4% this year and 4.0% in 2009.

▪ South Korea

2Q08 GDP: Export was Again the Bright Spot but the Tide is Turning						
	2007	3Q07	4Q07	1Q08	2Q08	2Q08
	y/y % change					ppt cont
Real GDP	5.0	5.1	5.7	5.8	4.8	4.8
Final Consumption	4.7	4.7	4.8	3.5	2.7	1.6
Private Consumption	4.5	4.8	4.6	3.4	2.3	1.1
Government Consumption	5.8	4.5	5.6	3.9	4.0	0.5
GFCF	4.0	1.3	2.9	0.5	0.1	0.0
Construction	1.2	-0.1	0.4	-1.1	-1.2	-0.2
Machinery & Equipment	7.6	2.3	6.5	1.4	0.7	0.1
Change in Stocks (% of GDP)	-0.4	-0.2	0.1	-0.2	-0.4	0.2
Net Exports	13.2	21.3	17.3	25.8	31.9	3.3
Exports of G&S	12.1	9.3	17.0	11.8	12.5	7.7
Imports of G&S	11.9	6.9	16.9	9.0	8.6	4.4
Source: CEIC, UOB						

▪ China

UOB Economics Projections	2006	2007	2008F	2009F
GDP	11.7	11.9	10.0	8.3
CPI (average, y/y)	1.5	4.8	6.0	3.0
Current account (% of GDP)	9.5	11.3	4.4	2.1
Fiscal balance (% of GDP)	-1.3	0.7	-0.4	0.2

The RMB's appreciation pace came to a halt in 3Q08 after rising 6.5% against the USD in 1H08. With the Chinese authorities continue to take an easier stance, we see limited upside to the RMB especially into 2009, which is going to be an even more challenging year for the global economy. We are maintaining our end-2008 RMB forecast at 6.70/USD, which we had already lowered from earlier forecast of 6.80. We are also cutting significantly our end-2009 RMB projection to 6.50/USD from our earlier call of 6.37.

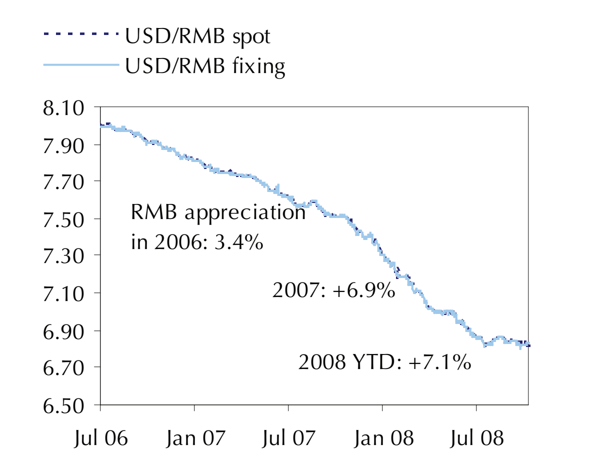
The PBoC turned out to be the first Asian central bank to reverse its tight policy, cutting interest rates in Sep. Subsequently, it also made further reductions on 8 Oct after global central banks announced joint interest rate moves. These quick decisions underscored policymakers' concerns of both the international environment and its impact on the export-dependent domestic sector. We expect at least another five interest rate reductions of 27bps each before middle of 2009, bringing the key 1Y lending rate to 5.58% by end-1H09.

Signs of softening domestic economic activities are emerging despite recent batch of data suggesting that growth momentum remains steady. Exports demand is expected to come under pressure given the importance of G3 demand. 2009 looks to be a challenging year globally as the deleveraging process in the global banking system is likely to peak. We are cutting our forecast for China's GDP growth to 8.3% for 2009, from our earlier projection of 9.5%.

RMB Appreciation to Slow

The once-steady RMB's appreciation pace came to a halt in 3Q08, compared to the 6.5% rise against the USD in 1H08 and 6.9% gain in 2007. With the US credit crunch spreading to other parts of the world, and the real impact being felt in China especially in the export-dependent sector, the authorities continue to take a more proactive approach in managing the economic levers. As a result, the RMB has waned against the USD in 3Q08 as alarm bells have begun to ring as early as June after reports of failures of exporters along the coastal regions as orders dwindled.

USD/RMB Exchange Rate



Source: CEIC, UOB

The PBoC has since Sep reversed its tightening policy stance by cutting interest rates. It is therefore not surprising that the RMB's strength has waned in tandem of a firmer USD as flight to safety intensified along with the deepening of the US credit crisis. The USD strength was further supported after the bankruptcy of Lehman Brothers in mid September and the continued freezing of credit market conditions resulted in heightened risk aversion behaviour. With the USD still in favour in the current flight-to-safety environment and an accommodative PBoC policy stance, we see limited upside to the RMB especially into 2009, which is going to be an even more challenging year for the global economy.

We are maintaining our end-2008 RMB forecast at 6.70/USD, which we had already lowered from earlier forecast of 6.80. We are also cutting significantly our end-2009 RMB projection to 6.50/USD from our earlier call of 6.37.

PBoC Easing Cycle To Accelerate

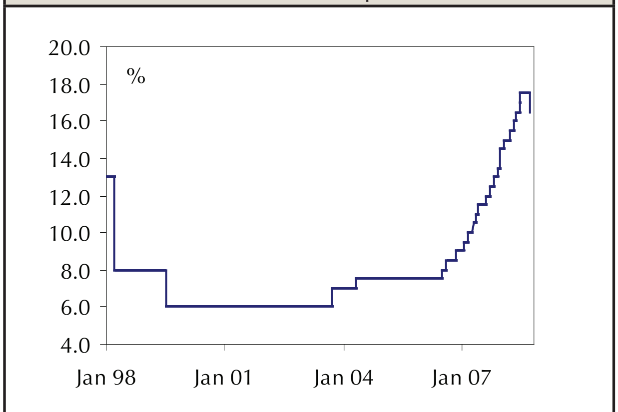
PBoC on 15 Sep surprised the market with a reduction of its benchmark 1Y lending rate by 27bps to 7.20%, but left the benchmark 1Y deposit rate unchanged at 4.14%. Subsequently on 8 Oct, PBoC also made another 27bps cuts to its lending and deposit rates and reserve requirement ratio after global central banks led by the US Fed made a coordinated interest rate reductions on that day as part of their efforts to contain the global credit crisis.

The latest efforts on 8 Oct brought 1Y lending rate down to 6.93% from 7.20% and the 1Y deposit rate to 3.87% from 4.14%. The reserve requirement ratio was cut-50bps.

China: 1Y Lending and Deposit Rates

Source: Bloomberg, UOB

China: Bank's Reserve Requirement Ratio



Source: Bloomberg, UOB

One surprise element in these PBoC decisions was speediness of the decisions. The market has already anticipated a shift in policy as early as July when the RMB was seemingly stuck against the USD and top central government officials and bureaucrats made surprise and unprecedented visits to companies in export-dependent coastal provinces and cities. In addition, continued deceleration of inflation (to 4.9%y/y in August from 6.3% in July and 7.8% in 2Q08) left room for further flexibility to ease policy. The deepening of the US credit crisis was obviously another major consideration for the policy-makers, which is likely to create further downside bias to China's economic growth, especially into 2009.

While the move effectively ended China's tightening policy that began almost three years ago, the PBoC is still cautious as reflected in the RRR cut which only applies to smaller financial institutions and the deposit rate was untouched. It should be noted that the central bank is viewing China's current slowdown a case of "soft landing" and may be uneasy about the risk of creating a loose credit condition too early.This is also reflected in its decision to temporarily shelve the 5% tax on interest income from individual savings account, as a step to make the cut on interest rate for palatable for savers and reduce the risk of excessive spending. Recall that the central bank had aimed selectively at easing conditions for these borrowers earlier, after the Sichuan earthquake in May.

Nevertheless, the continued deterioration of the global credit environment is likely to force China's hands to speed up its policy loosening process. As such we see at least another five interest rate reductions of 27bps each before middle of 2009, bringing the key 1Y lending rate to 5.58% by end-1H09.

Lowering Growth Forecast

The recent batch of data from China suggests that growth momentum remains steady, though some key figures are showing some signs of softening. In particular, industrial production data has been decelerating through the year, slowing to 12.8%y/y vs. 14.7% in July, and down from the 16.2% pace in 1H08 and 17.5% in 2007. However, exports demand continued to surprise, with a stronger than expected rise of 21.1%y/y in Aug compared to 26.9% in July, and on par with the 22% gain seen in 1H08. The question is how sustainable this rate of export growth would be on the back of the 27% rise in exports in 2007 and that the US credit crisis appeared to be hitting Main Street as well. Exports demand is likely to trend lower from here on and possibly to just around

15% for 2009, given that demand from G3 accounted for more than 30% of China's exports in 2007.

However, external weakness is expected to be at least partially supported by continued private spending. Retail sales have been rising at an average rate of 22% in the first 8 months of 2008 (Aug: 23.2%y/y), outpacing the 17% rate in 2007. While the proportion of private spending has eased to just 37% of GDP in 2007, there is still room for increase given that the average is around 42% during the 2000-2006 period. Outlook for capital formation and private investment less certain as it is highly correlated with exports sector, which we expect to decelerate through 2009 and possibly 2010 given the extent of the global credit crisis which is still evolving.

Another positive factor that is very likely to come into play is a more expansionary fiscal policy, given the prospects of decelerating external demand. The upcoming Communist Party Central Committee meeting (9-12 Oct) is likely to lay the groundwork for such a move. With the beginning of the monetary easing cycle, the likelihood of a fiscal plan has actually become greater in order to maintain policy consistency. One element of the stimulus package could involve a personal tax cut, which we estimate could unleash an additional RMB200bn to RMB300bn of spending, or around 1% of China's GDP.

Nevertheless, we expect 2009 to be a challenging year globally as the deleveraging process in the global banking system is likely to peak. The fiscal stimulus package, if there is one, is not expected to fully cushion the impact from an external demand slowdown. Against this background, we are cutting our forecast for China's GDP growth to 8.3% for 2009, from our earlier projection of 9.5%.

Vietnam

UOB Economics Projections	2006	2007	2008F	2009F
GDP	8.2	8.5	6.3	6.0
CPI (average, y/y)	7.4	8.3	23.7	12.5
Current account (% of GDP)	-0.3	-9.6	-13.0	-11.0
Fiscal balance (% of GDP)	-1.8	-1.8	-1.9	-2.1

While the economy has remained resilient so far, we expect slowing growth to set in for the coming quarters. We have lowered our GDP growth forecast for Vietnam to 6.3% this year from 7.0% previously and foresee the growth rate to continue to ease to 6.0% in 2009.

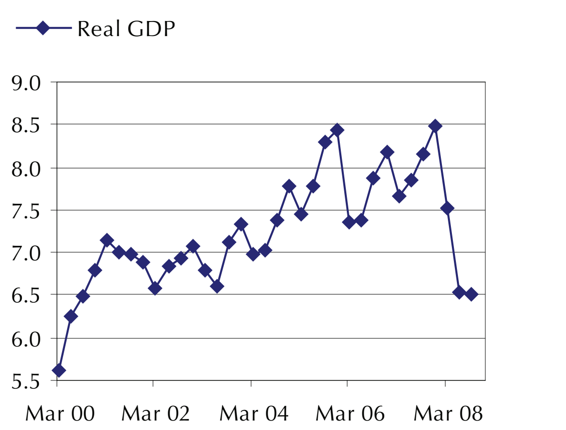
Inflation is likely to moderate further, well into next year, as food prices moderate and supplies increase. Overall, we expect inflation to average around 23.7% this year, against govt's expectation of 25%.

The State Bank of Vietnam (SBV) continued to reiterate its tight monetary policy stance in view of inflationary pressures and had raised key interest rate three times this year (last hike - 11 June) to 14%.

Moderating Economic Growth Ahead

Vietnam's economy grew 6.5% y/y in 3Q08, similar to the pace in 1H this year but a sharp slowdown from the 8.2% y/y growth clocked in the same period of last year. Industry & Construction sector, accounting for 41.7% of GDP grew 7.1% y/y in 3Q08 slowing from 10.1% y/y in the same period of 2007. Construction alone contracted 0.3% y/y vs 11.1% y/y expansion during Jan-Sept 2007 as a result of the rising cost of raw materials. Companies also faced difficulties in acquiring capital due to the high interest rates.

Real GDP Growth (y/y% change)



Source: CEIC, Bloomberg

Services sector moderated to 7.2% y/y in the past nine months compared to previous year reading of 8.6% in the same period. Businesses in the Hotels and Restaurants industry also take a dip and fell 8.9% y/y in 3Q08, partly due to higher inflation crimping consumer spending. Meanwhile, the Agriculture, Forestry & Fishery sector grew 3.8% y/y contributed by the better-than-expected rice harvest this year.

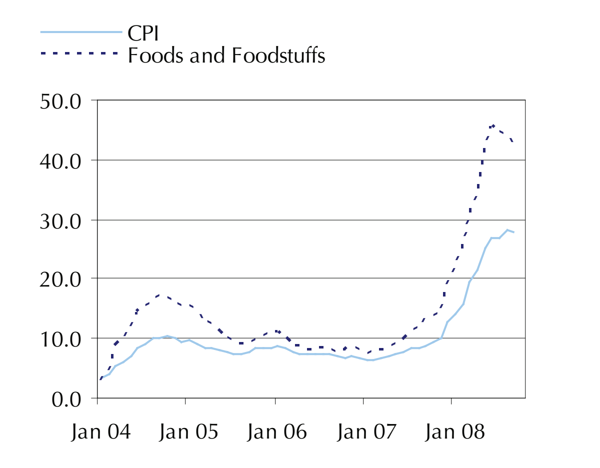
While the economy has remained resilient so far, we expect slowing growth to set in for the coming quarters. We have lowered our GDP growth forecast for Vietnam to 6.3% this year from 7.0% previously and foresee the growth rate to continue to ease to 6.0% in 2009. Meanwhile, the govt is forecasting GDP growth of 7.0% this year vs initial expectation of 9% and 7.5% next year, which appears to be a little optimistic given the external uncertainties.

Inflationary Pressures Remain Dominant

Against 8.3% in 2007, inflation surged to an average of 22.9% y/y in the first nine months of 2008. However, there were signs that inflation in Vietnam has peaked. Consumer prices rose 27.9% y/y in September, slowing from 28.3% in August as a result of lower food prices. Accounting for 43% of the CPI basket, food prices was at 42.7% y/y compared with 44.1% y/y in August. Meanwhile, govt's close supervision on businesses (preventing

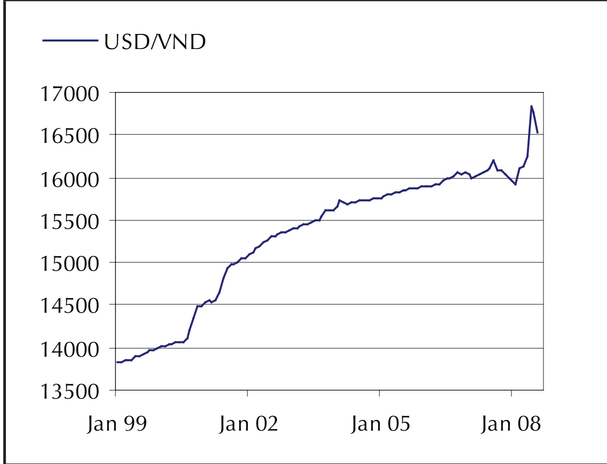
▪ Vietnam

Consumer Price Index (y/y% change)



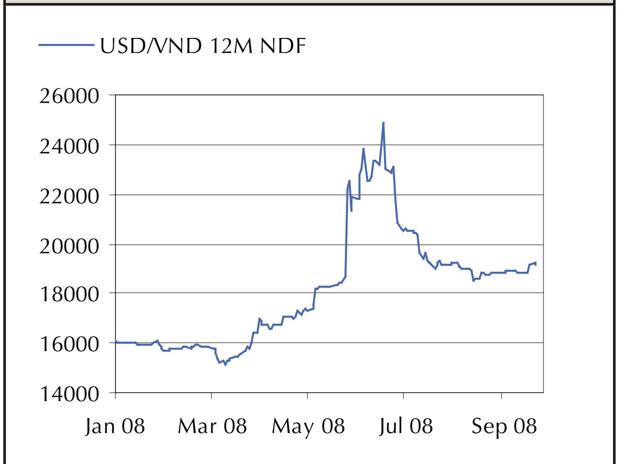
Source: CEIC, Bloomberg

USD/VND



Source: CEIC, Bloomberg

USD/VND 12-Month NDF



Source: CEIC, Bloomberg

unreasonable price adjustments) should help stabilize prices. In addition, global food prices have been declining on increased supplies, easing inflation in countries like Vietnam, which relies on agriculture for the bulk of its economy.

Going forward, inflation is likely to moderate further, well into next year. Overall, we expect inflation to average around 23.7% this year, against govt's expectation of 25%. The govt is targeting at single-digit inflation rate by end 2009 or beginning 2010.

SBV Maintained Tight Monetary Policy

The State Bank of Vietnam (SBV) continued to reiterate its tight monetary policy stance in view of inflationary pressures and had raised key interest rate three times this year (last hike - 11 June) to 14%. This is likely to be the SBV's last rate hike of the year. Govt's ruling is that interbank rates are not allowed to exceed 150% of the key interest rates -- which means banks can loan at up to 21% per year, given current key rate of 14%. In addition, limiting credit growth at 30% for 2008 as compared with a growth rate of 54% last year, which triggered the surged in the country's inflation. We expect the central bank to keep to a tightening credit policy till end of the year as inflation still remains elevated.

More FX Stabilization

On 11 June 2008, the government implemented a one-off 2% devaluation of the VND, to bring official exchange rates closer to black-market rates and widened the trading band to ±2% (as widely-expected) on 27 June. Against 19,400/USD in June, VND is now trading around 16,620/USD in the black-market, as compared to 16,580/USD in the official market (24 September 2008). A few months back, market was expecting a reminiscence of Thailand in 1997, when the fall of Thai baht became the catalyst for the Asian economic crisis. Markets were worried that the dong would devalue in a manner similar to that of Thailand in 1997. At one point in June this year, the 12-month NDF priced in a major dong devaluation of as much as 50%, but has since eased to 13.7% in August. While there are still speculative pressures on the currency, we are doubtful of any major dong devaluation as:

- Containing inflation is still the government's priority and there would be concern that the sharp dong depreciation would escalate inflation which could lead to renewed downward pressure on the currency.

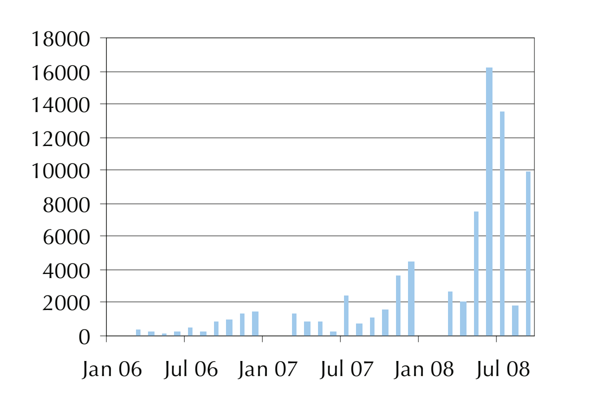
- The country's foreign exchange reserves have improved significantly over the years to USD21.9bn end September 2008 from USD3.4bn in 2000.

- Like the RMB, VND is a "tightly controlled" currency. Any impact from the NDF on the cash market will be limited.

Sustained FDI Inflows

The sustained FDI inflows has also provided some relief on the currency as well as supporting the country to achieve a balanced external account. Vietnam attracted USD57.1bn in FDI over the past nine months, much higher than the projected amount of USD50bn for the whole year. Attracting the biggest investment is the industry & construction sector with investors pouring in as much as USD32.3bn during the first nine months of 2008 while the service sector attracted overseas investment of USD23.7bn in the same period.

Foreign Direct Investments (USDmn)



Source: CEIC, Bloomberg

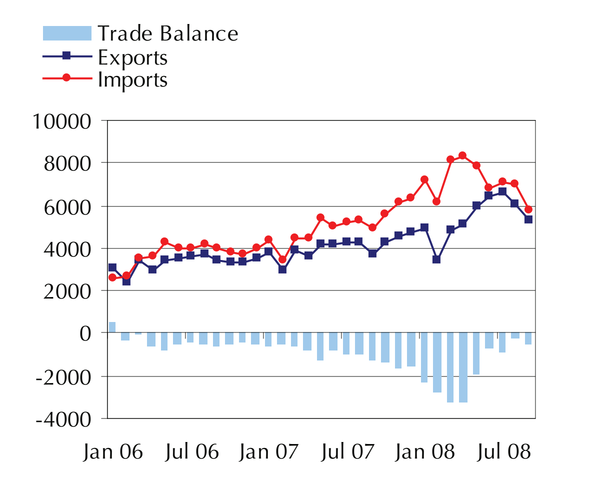
Recently, Malaysia has also registered to invest USD14.8bn for 37 projects (including the licensed USD9.8bn steel project) in Vietnam while Korea has also poured additional capital of USD192.7mn into their existing projects in the country.

While the strong FDI inflows might help the country to achieve a balanced external account, however, there are concerns over the FDI inflows into sector such as the property and steel industry. Given that projects in these industries would trigger demands for equipments and materials for such developments, escalating import growth which could lead to renewed pressure on the trade deficit.

Government to Keep Close Watch on the Trade Balance

The country's trade deficit widened to USD15.8bn in the past nine months, doubled the figure (USD7.9bn) in the same period last year. However, in the month of September, Vietnam's trade deficit moderated to USD-500mn, the lowest figure recorded in 2008 compared with USD954mn in August. Against a monthly average of USD2.4bn between January and June 2008, the trade deficit was also under USD1bn for both August and September. This is line with the government's target to curb monthly trade shortfalls to under USD1bn in 2H08. Vietnam also revised 2008 trade forecast downwards, from under USD20bn to USD18.5-19.5bn.

External Trade (USD mn)



Source: CEIC, Bloomberg

Meanwhile, exports continued to perform well, rising 39.3% y/y to USD48.6bn in the first nine months of the year led by exports of rice, rising 71.5% y/y in September followed by crude oil reaching 30.4% y/y while textile & garments came in at 29.1% y/y.

The tightened monetary policy as well as measures to reduce imports adopted by the government has cut import growth from 77.8% y/y in April this year to 51.4% y/y in September. Imports for the past nine months reached USD64.7bn. The Ministry of Industry and Trade (MoIT) raised significant taxes which include the import taxes, the special consumption tax and value added tax as well as restricting imports of luxury goods since August. The government has also applied automatic licensing on imported goods which are under strict inspection and reducing the progress of investments along with cutting down on public spending.

▪ Japan

UOB Economics Projections	2006	2007	2008F	2009F
GDP	2.4	2.0	0.7	1.4
CPI (average, y/y)	0.2	0.1	1.6	1.4
Unemployment (4Q avg)	4.1	3.9	4.1	4.3
Current account (% of GDP)	3.9	4.9	-	-
Fiscal balance (% of GDP)	-4.1	-3.9	-	-

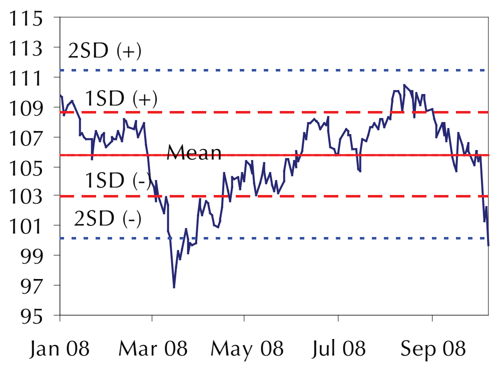
Economic growth in Japan remains weak and the political situation is still fragile.

But the USD/JPY has gyrated intensely, driven largely by external factors.

The current backdrop of continued uncertainties still implies some downward bias in our USD/JPY forecast. However, the trajectory is likely to be extremely jerky in the coming months.

Of late, the acute gyrations in financial markets globally have certainly taken center stage. The JPY, which is often linked to risk aversion flows, has benefited from heightened concerns surrounding global credit risk exposures. The USD/JPY has fallen from a high of around 109.00 in early September to less than 100.00 recently. Essentially, the sharp declines in global equities have been "positive" for the JPY primarily as a result of short-covering activity. Clearly, the pronounced down moves in the USD/JPY have not been linked to the economic and political environment in Japan, which is still largely in a fragile state.

The Dance of the USD/JPY

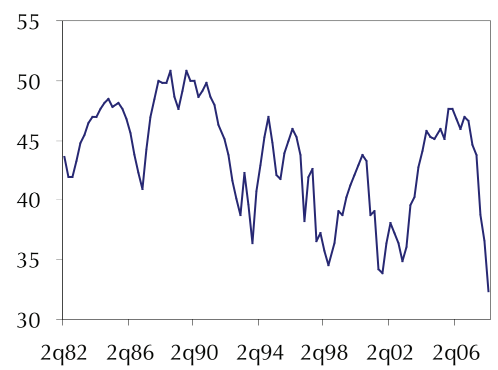


Source: FRED and UOB

The economic growth in Japan was about flat through the first six months of this year. The above-trend growth pace of nearly 3% in 1q08 was largely offset by the hefty contraction in 2q08. For the remainder of 2008, we expect economic growth in Japan to remain relatively soft, perhaps in neighborhood of 1% on balance. If so, overall real GDP growth in Japan might not exceed 1% in 2008. Our outlook for 2009, however, remains roughly unchanged, with a growth forecast of marginally less than 1.5% on average.

Although the initial announcement of the fiscal package, which roughly accounts for more than 2% of GDP, appeared to be positive headline news in Japan, the details of the package were quite sketchy and somewhat uncertain. Moreover, the abrupt resignation of Prime Minister

Record Low Confidence...



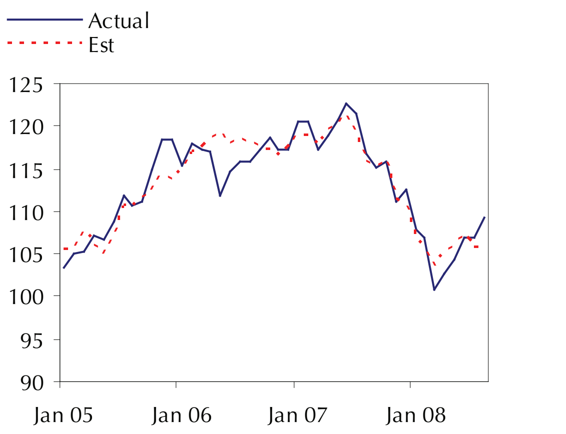
Source: ESRI

▪ Japan

Fukuda in early September further reinforces the dour sentiment in Japan. One media poll, reportedly, reveals that more than two-thirds of top executives in Japan view the resignation of Prime Minister Fukuda as negative for the "future course of the economy and government policies". Fortunately, the political vacuum in Japan was tackled fairly swiftly with the appointment of Taro Aso as leader of the ruling Liberal Democratic Party (with roughly two-thirds of votes) and the new Prime Minister of Japan.

The level of the USD/JPY has somewhat tracked a simple equation of interest rate differential (between US and Japan) and a proxy for financial market concerns (an indicator of credit spread). The recent widening of credit spreads and narrowing of interest rate differential appear consistent with a lower USD/JPY backdrop. But with the Bank of Japan on-hold for now, in light of the softer growth environment, JPY interest rates are not likely to move too much. Hence, the potential drivers for the USD/JPY would largely be external, namely tied to the US interest rate and global market environment. And given the ongoing uncertainties in the US and strains in global financial markets, there is no surprise that the ebbs and flows in the USD/JPY of late have been extremely jerky.

Simple USD/JPY Model



Source: FRED and Proprietary Data

Going forward, after considering some relevant factors to the JPY outlook, the downward directional bias for the USD/JPY is likely to remain in the near-term. While some have explored the possibility of foreign exchange intervention to weaken the JPY, our best guess is that the threshold of intervention might lie closer towards the 95.00 level. But more forceful verbal jawboning by Japanese officials would probably occur prior to that.

Our prevailing call is for the USD/JPY to hover around the 100.00 level through year-end 2008. Over the first six months of 2009, however, the trajectory for the currency pair could be rockier, possibly fluctuating between 100.00 and 104.00. For the remainder of 2009, our baseline call if for the currency pair to hover around the 103.00 level. Overall, however, it is crucial to be reminded that the task of forecasting exchange rates is highly challenging, especially in the current environment of intense market volatility. To be sure, as new developments emerge, it would be necessary to revisit our forecast.

▪ Australia & New Zealand

UOB Economics Projections - Australia	2006	2007	2008F	2009F
GDP	2.8	4.2	2.6	2.5
CPI	3.6	2.4	4.5	3.2
Unemployment Rate (%)	4.8	4.4	4.5	4.8
Current account (% of GDP)	-5.3	-6.2	-5.5	-5.0

UOB Economics Projections - New Zealand	2006	2007	2008F	2009F
GDP	2.4	3.2	1.3	1.0
CPI	3.4	2.4	3.9	3.0
Unemployment Rate (%)	3.8	3.6	3.8	4.0
Current account (% of GDP)	-8.8	-8.2	-7.6	-6.5

The antipodean currencies both remained capped on the upside by repricing in the face of a global slowdown and by deteriorating domestic fundamentals. AUD/USD reached a 25yr high of 0.9793 in the early part of the quarter. However, it touched a low of 0.6448 in a rapid reversal of fortunes on 8 Oct as investors fretted about the global macro environment. NZD/USD also reached a high of 0.7725 over the course of the quarter before falling to a low of 0.5775 on 8 Oct.

More recently, the antipodeans have experienced a surge in volatility as heightened risk aversion takes centerstage in the midst of the US and European financial institutions demise. The pull-back in risk taking put cross/JPY trades in focus again while most major currencies traded without much clear directional conviction as investors stood on the sidelines in the midst of sharp moves which baffled conventional correlations.

We expect volatility to remain heightened in this environment and we are cautious on any sharp commodity price rally which we think have the potential to unwind should investors liquidate trades to offset losses elsewhere. We maintain our medium term USD strength forecast as fundamentals of a deteriorating global environment has not been materially changed by recent events. In the short term, we recommend being long in defensives such as the CHF and JPY against higher yielding riskier currencies such as the AUD and the NZD, with some caution advised on the CHF in the face of Euroland troubles.

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More recently, the antipodeans have experienced a surge in volatility as heightened risk aversion takes centerstage in the midst of the US and European financial institutions demise. The pull-back in risk taking put cross/JPY trades in focus again while most major currencies traded without much clear directional conviction as investors stood on the sidelines in the midst of sharp moves which baffled conventional correlations. We expect volatility to remain heightened in this environment and we are cautious on any sharp commodity price rally which we think have the potential to unwind should investors liquidate trades to offset losses elsewhere. We maintain our medium term USD strength forecast as fundamentals of a deteriorating global environment has not been materially changed by recent events. In the short term, we recommend being long in defensives such as the CHF and JPY against higher yielding riskier currencies such as the AUD and the NZD, with some caution advised on the CHF in the face of Euroland troubles.

We think both AUD/USD and NZD/USD remain vulnerable as the fundamental reassessment of risks continues and the decoupling story falls apart. While there have been some periodic short term rebounds when the USD remained under pressure due to uncertainty over the credit crisis rescue package, but we think downside risks to the antipodeans are still intact and sentiment remains a sell on rallies. Economic data from the antipodeans confirms a slowing economy and we expect that the antipodeans have peaked and expect more downside pressures in the medium term.

Aussie Domestic Economic Conditions Slowing but Pockets of Strength Remain in Economy

The Aussie economy continues to show signs of slowing. 2Q GDP data came in lower than expected at 0.3%qoq (2.7%yoy) against expectations for a 0.4%qoq (2.9%yoy) reading and from a prior reading of 0.7%qoq (3.6%yoy). 2Q Retail sales ex-inflation also fell below expectations at -0.6% against expectations for a -0.1% reading and from -0.3% in 1Q. While there was no available more timely indicator on retail spending, the RBA said that liaison with retailers suggested that retail activity was somewhat stronger on average in July and August although retail spending as a whole remained subdued. Consumer sentiment also increased modestly in September, after earlier steep falls to well below average levels. Sep Consumer confidence came in at 7.0% from 9.1% in Aug, after suffering sharp tumbles in the Jul and Jun of -6.7% and -5.6% respectively.

The downtrend in housing activity remains intact with Jul building approvals coming in worse than expectations at -2.3mom (-3.7yoy) from a May number of 2.2%mom (-1.2%yoy). The average nationwide house price also continued to fall. Other secondary indicators of housing market activity also remained subdued with Jul Home loans sliding to -0.2%, coming in below expectations for a 0% reading. In addition, Australia has also had its fair share of negative banking news recently with both NAB and ANZ announcing writedowns due to US exposure and domestic exposure respectively.

However, there remain pockets of strength in the Australian economy with latest economic numbers from Australia pointing to a surprisingly strong labor market number. The key Employment change number surpassed expectations on the upside in both Jul and Aug. Latest Aug Employment change came in at 14.6k, way above expectations for a 5.0k reading and from a revised upwards Jul figure of 18.7k. The unemployment rate also fell to 4.1% against expectations for a 4.4% reading and from 4.3% in Jul. Jul Employment change number had initially come in at 10.9k, also surpassing expectations on the upside for a 5.0k reading and from a Jun reading of 22.2k. 2Q Private capex also turned in better than expected at 5.7% against expectations for a 2.0% reading and from a 1.0% number in the prior quarter, suggesting that investment intentions remain strong.

Aussie Rate Set to Move Southwards

The RBA surprised the market in Oct by cutting rates by 100bps to 6.0%, double the magnitude expected by the market and its steepest cut in 16 years. The move prompted speculation of a series of coordinated moves in rate southwards by global central banks, after the credit crisis continued to deepen and lending markets beyond overnight rates continued to exhibit signs of stress despite central banks efforts to add liquidity into the system. AU Sep Employment change number came in subsequently better than expected again at 2.2k against expectations for a flat reading and from a revised 10.2k reading in Aug. The unemployment rate was also in line with expectations at 4.3% from 4.1%. In our view, the 100bps cut by the RBA (which while the RBA can well afford given the high level of interest rate) had added pressure to the other central banks to follow, but was unwarranted from a domestic point of view. With the RBA leading the way, 6 other major central banks delivered a surprise collective policy cut of 50bps under intense pressure from the market. The BoC, BoE, ECB, Fed, Risksbank, SNB lowered policy rates each by 50bps to end at 2.5%, 4.5%, 3.75%, 1.5%, 4.25% and a target range of 2-3% respectively. The BoC also cut its benchmark 1yr rates by 0.27%.

The RBA had also cut rates at its September meeting as widely anticipated by 25bps, bringing its key cash rate then to 7.0%. The minutes of the meeting pointed to the opposing forces confronting the domestic economy including tighter financial conditions from increases in interest rates and costs of funds as well as high oil prices; weak household spending and softer business conditions; contrasting with investment spending which has remained strong and still considerable stimulus from the external sector and increases in the terms of trade. The RBA said that the overall picture seemed to be one of weak consumption and strong investment, but with aggregate growth of demand slowing. The RBA also said that policy had to balance the risks of easing too soon, since inflation had to fall a significant way to be consistent with the target but that there were also risks in waiting too long to have some easing of policy from the 'quite restrictive setting'. The immediate reaction from the currency market was muted, although the AUD initially rose slightly on the less dovish, balanced statement.

While we expect inflation to come off as oil prices have eased considerably, these declines have yet to feed through into the latest data on inflation. AU 2Q CPI came in higher than expected at 1.5%qoq (4.5%yoy) from 1.3%qoq (4.2%yoy) in 1Q. Increases in both the trimmed mean and weighted median measures were more muted with the average of both measures coming in at 1.1%mom (4.4%yoy) against expectations for a reading of 1.1%qoq (4.3%yoy) from a 1Q reading of 1.25%qoq (4.25%yoy). We see the numbers as indicating still elevated inflationary pressures, although the acceleration in inflation appears to have eased somewhat. We expect the RBA to continue on its easing cycle and to exhibit moderation in its easing once global conditions exhibit some signs of stability. We are therefore calling for a further 125bps of easing in interest rates by 4Q09.

New Zealand Economy Continues to Soften

After a decade long period of uninterrupted economic expansion, economic data from NZ continues to point indisputably to weakening growth. 2Q GDP came in at -0.2%qoq (1.0%yoy) against expectations for a -0.5%qoq (0.6%yoy) reading from a prior reading of -0.3%qoq (1.9%yoy), the 2 consecutive quarters of negative qoq readings confirming expectations for a technical recession in NZ. NZIER's 2Q business confidence data also points to a weak growth outlook and high inflationary pressure, adding nothing new to the picture and the National Bank of NZ business survey showed sentiment at its lowest since 1991 in Jul. 2Q retail sales data reported the largest fall in quarterly sales volume since the series began in Sep05 as well as the 1st time since 2Q98 that sales have fallen in 2 consecutive quarters, falling -1.5%qoq in 2Q from -1.2% in 1Q. 2Q NZ current account deficit also widened to record levels on higher imports and increased earnings by foreign investors. Annual deficit came in at NZD14.97b against expectations for a NZD14.09b reading and rising from NZD14.21b in the previous quarter. The deterioration at a time when funding is expensive and difficult should add downside pressures to the NZD although economic news has been on a backburner while the market focuses on news flows of the bank crisis.

More timely data also points to continued weakening of the NZ economy with NZ Migration gains decreasing in August with a seasonally adjusted gain of 440 migrants for the month compared to the previous month reading of 810. Jul NZ retail sales also came in weaker than expected at -0.8%mom against expectations for a -0.3% reading and from a 1.0% reading in Jun. Jul Retail sales ex-auto registered a -0.2% figure against expectations for a 0.3% reading and from a prior 0.2% reading. The NZ economy has also been under pressure from news that Hanover Finance, one of NZ's largest finance companies suspended repayments of deposits and will not take any new money, leaving $554m frozen and news of Strategic Finance freezing NZD330M of investor funds due to liquidity problems. About half of the 49 finance companies in NZ 18 months ago have collapsed or defaulted. While there was a surprise upswing in business confidence after the National Bank of NZ's business outlook for Aug showed a net 4.7% of respondents expected their business to improve from 8.2% forecasting deterioration in Jul and 2Q Employment change also came in at 1.2%qoq (0.7%yoy) against expectations for a 0.2%qoq (-0.6%yoy) reading and above 1Q reading of -1.3%qoq (-0.2%yoy), the Unemployment rate however crept up to a 2yr high of 3.9% from 3.7%, higher than expectations for a 3.8% reading.

We Look for Another 75bps Cut Over the Year

The RBNZ cut interest rates in Jul by 25bps to 8.00%, the 1st reduction in 5yrs and against majority expectations for the RBNZ to stay pat. The statement indicated clearly more cuts were in the pipeline with Governor Alan Bollard saying that 'Provided that the outlook for inflation continues to improve and there is no excessive exchange rate depreciation, we would expect to lower the OCR further'.

The RBNZ delivered a further surprise 50bps cut to 7.5% in Sep, larger than market expectations for a 25bps cut, sending the Kiwi unit lower by more than 1 big figure.

The RBNZ said that it expected the economy to contract from 1Q-3Q, and expected growth to ease to just 0.3% for the fiscal year that ends Mar09. However it forecast inflation as remaining at the top of its 1-3% target band through 2009. Governor Bollard said that with the NZ economy experiencing a marked slowdown, bringing forward some pf the projected interest rate reductions was justified. 'Compared to the June Monetary Policy Statement, we have brought forward some of the projected interest rate reduction, but we have not altered the expected overall decline. We believe that this response is warranted in light of the tightness of current credit conditions and the time it will take to affect the actual interest faced by households and businesses.' The RBNZ said that the scale and timing of further rate cuts would depend on inflation and currency movements. We think that this as well as the RBA's 100bps cut has heightened the prospects for another 50bps cut at the next meeting at end October.

Against this backdrop, 2Q CPI rose 1.6%qoq (4.0%yoy) from 0.7%qoq (3.4%yoy) and against expectations for a 1.4% (3.8%yoy) reading. While the headline number came in above expectations, the non-tradable (domestic) inflation rose 0.9%qoq (3.4%yoy), slowing from a rise of 1.1%qoq (3.5%yoy). As such, we expect the RBNZ to be happy to support expectations for further rate cuts going forward although we do not expect the RBNZ to cut at every meeting as inflation still remains somewhat elevated. We think the front loading will keep kiwi under pressure and look for further downside to the NZD going forward. Dairy prices have continued to remain depressed and we expect this will weigh on the Kiwi further.

▪ Eurozone

UOB Economics Projections	2006	2007	2008F	2009F
GDP	3.0	2.6	1.4	1.2
CPI	2.2	2.1	3.5	2.6
Unemployment (4Q avg)	8.3	7.4	7.5	7.6
Current account (% of GDP)	-0.1	0.3	0.0	0.1

Trading in the EUR/USD was volatile across the quarter with the EUR/USD touching a high of 1.5949, the highest since 23Apr as the USD tumbled on news of problems at Freddie Mac and Fannie Mae and record high oil prices. EUR/USD later backed down to a low of 1.3444 on 6 Oct, its lowest since Sep07 on USD strength and as oil prices slid below the key $100/bbl mark and currencies traded the global slowdown theme. The EUR has continued to be under pressure also after the ECB delivered a surprise 50bps rate cut on 8 Oct.

More recently, the USD has rallied broadly as the adjustment of positions continued in line with expectations of a global slowdown in which Europe will not be exempt from. In addition, there has been increased focus on the EU after several European governments stepped in to bailout domestic financial institutions following the credit fallout in the US. Falling crude further kept the bear trend on the EUR intact and the USD rose in tandem. With fundamentals pointing to easing oil demand as global growth slows, in our view the EUR has peaked and we look for lower levels for EURUSD going forward.

We see further pressures on the EUR from risks to the financial system markets to turn the focus to Europe after the US package becomes a done deal. More recently, there has been continued contention of the need of a coordinated rescue package like that in the US with Germany reportedly remaining opposed to any such rescue fund. While the passage of the rescue package in the US was difficult, we think such a package would be even harder to broker in Eurozone where firefighting by each government has been the main approach to the problem.

As such, any bounce in the EUR in our view is a good opportunity to short the currency unit and position for a lower level going forward.

EUR: Tracking Oil

Trading in the EUR/USD was volatile across the quarter with the EUR/USD touching a high of 1.5949, the highest since 23Apr as the USD tumbled on news of problems at Freddie Mac and Fannie Mae and record high oil prices. Oil prices surged through the early part of the quarter, peaking at USD147.5/bbl in Jul but declining sharply subsequently on the back of better than expected figures on US inventories and a less destructive than anticipated hurricane season as well projections of weakening demand going forward. EUR/USD later backed down to a low of 1.3444 on 6 Oct, its lowest since Sep07 on USD strength and as oil prices slid below the key $100/bbl mark and currencies traded the global slowdown theme. The EUR has continued to be under pressure also after the ECB delivered a surprise 50bps rate cut on 8 Oct. Risk aversion was periodically on the table in volatile trading and equity markets sold off in Sep as worries about the extent of the problems at both US and European financial institutions plagued the market. The quarter also saw significant cross high yield/ JPY selling on heightened uncertainty and both actual and implied volatilities remained elevated.

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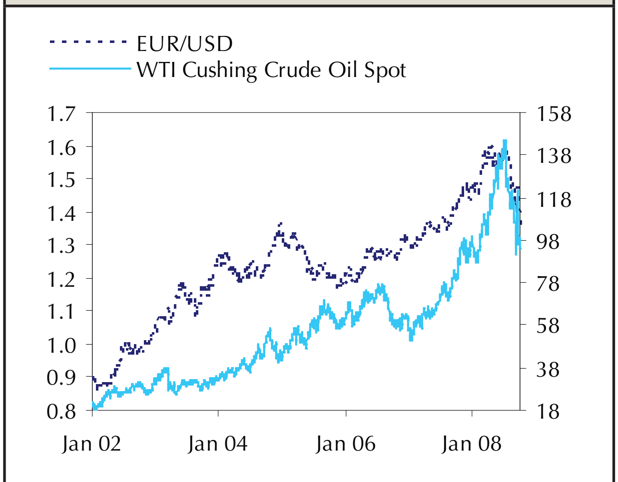
We had predicted along the course of the quarter that crude could attempt to test the $100 levels and Brent breached the $100 mark after OPEC President was quoted as saying that he saw oil prices in the $90-100/bbl range in the long term. Oil has since then been sticky at the $90/bbl support level with downside risks in place after Saudi Arabia was also quoted as saying that they were comfortable with oil at that level. With fundamentals pointing to easing oil demand as global growth slows, in our view the EUR has peaked and we look for lower levels for EURUSD going forward.

We see further pressures on the EUR from risks to the financial system as markets to turn the focus to Europe after the US package becomes a done deal. European banks have already been in the headlines recently with the most prominent being the rescue of Fortis by the Benelux governments. The Belgian, Dutch and Luxembourg governments agreed to inject EUR11.2b into the banking and insurance company, which would sell the parts of ABN AMRO that it bought last year. Each government agreed to take a 49% stake in Fortis banks in their respective countries after BNP Paribas pulled out of the deal. More recently, there has been continued contention of the need of a coordinated rescue package like that in the US with Germany reportedly remaining opposed to any such rescue fund. In the meantime, some European governments have moved to guarantee deposits at banks in an attempt to protect savers, creating an uneven playing field within Europe. Germany, Austria and Denmark have all followed Ireland's lead in providing blanket guarantees for deposits. In contrast, the UK FSA has increased the compensation limit for bank deposits from GBP35k to GBP50k for each customer claim and has announced that it is still in consultations on further reforms to decide

EUR/USD & Oil Prices



Source: Bloomberg

whether the compensation limit should be lifted higher. While the passage of the rescue package in the US was difficult, we think such a package would be even harder to broker in Eurozone where firefighting by each government has been the main approach to the problem.

As such, any bounce in the EUR in our view is a good opportunity to short the currency unit and position for a lower level going forward.

Economic Data is Taking a Turn for the Worse and Risks to Growth are Skewed to the Downside

EU Q2 GDP growth contracted at -0.2%qoq (1.5%yoy) from a 0.7%qoq (2.1%yoy) reading in Q1. Both French and German Q2 GDP registered contractions. French Q2 GDP came in at 0.3%qoq against expectations for a +0.2%qoq reading and German Q2 GDP came in at -0.5%qoq, an upside surprise from consensus for a -0.8%qoq reading. However a closer look at the German statistics shows a negative reading on consumption and investment. The main contribution came from net exports and was due to weakness in imports rather than strength in exports. The second estimate of Q2 EU GDP growth also saw a downward revision to 1.4%yoy from 1.5%yoy while the quarterly figure was confirmed at -0.2%qoq, the 1st qoq decline in the history of the data series.

The decline in GDP was driven by domestic demand which contributed -0.2% to overall economic growth while the contribution from changes in inventories was close to zero and both exports and imports both fell by 0.4%, leaving the contribution of net trade as flat. Household spending remained subdued with private consumption declining 0.2%qoq in 2Q08, pressured by muted real income growth. Volatility in quarterly euro area demand during H108 was mainly a result of investment growth which surged 1.5%qoq in 1Q but fell 1.2% later in 2Q. Going forward, we expect investment to continue to taper off as corporate profitability has shown signs of declining and tighter financial conditions are expected to weigh on investment plans. The EU commission also revised downwards its 2008 GDP projection to 1.3% from 1.7% in the course of 3Q.

More timely indicators also point to weakening activity with high commodity prices weighing on consumer confidence and demand and well as dampening investment growth. EU Aug Retail sales ticked up marginally by 0.3%mom from 0.1%mom in Jul, against consensus expectations for a 0.1%mom reading, although on a yoy basis, retail sales recorded a decline of -1.8%yoy. While consumer confidence recovered marginally in Aug from Jul, it remained at a low level. While labor markets conditions are still broadly favorable, with unemployment rates at historical lows, surveys indicating firms' employment intentions suggest that employment growth going forward would be more subdued. 1Q08 EU employment growth was steady at 0.3%qoq at the same rate as 4q07, but was lower than the rate in 1Q07 when employment registered a 0.5%qoq growth rate. The Aug PMI survey also indicated that firms' employment fell for the second consecutive month in both services and manufacturing.

EU Jul IP data came in flat, weaker than consensus for a +0.1%mom increase, underlying expectations that the economy could contract in 2Q. Sep EU manufacturing PMI came in weaker than anticipated at 47.3 from 47.6 in Aug. EU Sep services PMI also pointed to contraction, coming in at 48.2 from 48.5 in Aug. Jul German Ifo business climate also fell to 92.9, below consensus for a 94.2 reading from 94.8 in Aug. Both the current conditions and economic expectations sub indices fell sharply to 99.8 from 103.2 in Aug and 86.5 from 87.0 in Aug respectively. The negative readings in the German Ifo and the prelim PMIs in the EU all point to a downward trend in EU growth trajectory. EU Sep Sentix investor sentiment index also fell to -20.2, well below expectations for a -18.3 read and the biggest absolute decline in the index's history.

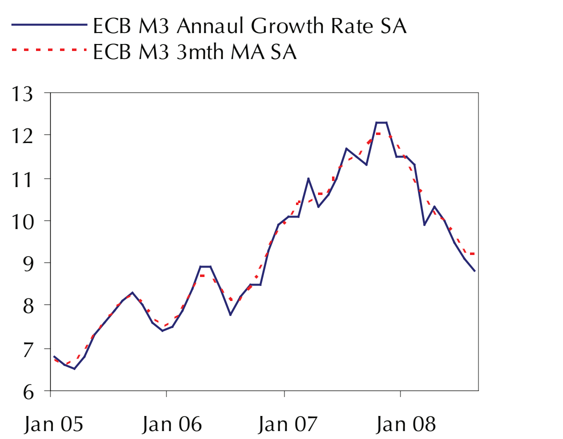
Inflationary Pressures Remain Elevated

While inflation has come off as a result of recent decreases in energy and food prices, inflation pressures remain elevated. Aug EU inflation fell to 3.8%, after hitting a new all time high in Jul, rising to 4.1%yoy from 4.0%yoy in Jun. Wage growth has also picked up in recent quarters as have unit labor costs as productivity growth has decelerated. There remains strong concern of the emergence of broad based second round effects in price and wage setting behavior especially as available indicators suggest that labor cost growth has continued at a fast pace throughout 1H08. Annual growth in compensation per employee rose to 2.9% in Q108 following a significant acceleration in 4Q07. The increase was broad based across the industry, services and construction sectors, pushing the annual growth rate of unit labor costs to 2.4% in 1Q08, its highest in 5yrs. The rise in wages were attributed to tighter labor markets, continued high capacity utilization as well as nominal wage indexation schemes.

Growth of broad money and credit aggregates have been showing some signs of moderation, in line with the lagged impact of tighter conditions in the Eurozone area. However, the underlying rate of money growth still remains robust. M3 grew at 10% in 2Q08, down from its peak of 12% in 4Q07 and declined further in Aug, falling to 8.8%, down from 9.1% in Jul.

With the risks of broad based second round effect particularly acute in countries which have some form of automatic price indexation of wages, we are of the view therefore that while inflation should come off going forward, the annual rate of inflation is likely to remain well above the ECB's target rate for some time, moderating only gradually over the course of 2009.

M3 Growth is Slowing but Still Robust



Source: Bloomberg

The ECB Delivered an Emergency Policy Cut of 50bps on 8 Oct

The ECB was among 6 major central banks that delivered a surprise collective policy cut of 50bps on 8 Oct. The BoC, BoE, ECB, Fed, Risksbank, SNB lowered policy rates each by 50bps to end at 2.5%, 4.5%, 3.75%, 1.5%, 4.25% and a target range of 2-3% respectively. The Bank of China also cut its benchmark 1yr rates by 0.27%. The BoJ did not join in the action but said that it strongly supported the coordinated action.

Prior to the unprecedented action, the ECB had left key rates as unchanged since our last quarterly. In its latest policy meeting in Oct however, the ECB left the door open for future rate cuts. We see a softening in stance in the rhetoric and the ECB reportedly discussed cutting rates at the meeting before unanimously deciding that no change was needed this month. Trichet said that 'Upside risks to price stability have diminished somewhat, but they have not disappeared.' He also added that the ECB was in a situation of 'exceptionally high level of uncertainty' and dropped references to the ECB as having 'no bias' on future interest rates. In light of increasing signs of weakening in the Eurozone but still elevated inflationary pressures, we expect the ECB to ease policy rates gradually with an additional 25bps easing in Dec and look for 150bps to be cut to the end of 4Q09.

▪ United Kingdom

UOB Economics Projections	2006	2007	2008F	2009F
GDP	2.9	3.0	1.3	1.0
CPI	2.3	2.3	3.6	2.3
Unemployment (4Q avg)	5.4	5.4	5.5	5.7
Current account (% of GDP)	-3.9	-4.3	-3.3	-3.0

Cable traded in a wide range across the quarter exhibiting significant volatility, trending lower over the longer term but with periodic rebounds when data come in less soft than expected, with GBP/USD trading in the range of 1.7260-2.0058 over the course of the quarter.

We had reiterated in our reports that Cable above or near $2 was in clear defiance of fundamentals and Cable fell decisively below the $2 level in 3Q08.

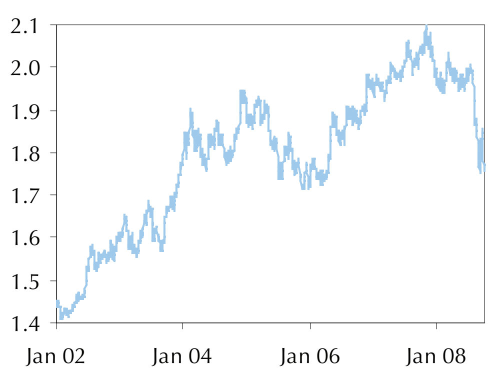
We see Cable as having finally started to respond to the deteriorating economic data emanating from the UK and see the GBP as likely to come under increasing pressure from here. Our overall reading of the UK economy remains one where we see significant stress from a UK consumer pressured by a housing market which continues to deteriorate, a reduction in credit as the UK banking system remains under intense pressure from the credit crunch fallout and eroding purchasing power from inflationary pressures which suggest further moderation in discretionary spending going forward.

We think the BoE still remains in a bind with a rapidly declining economy and still high inflation. We therefore continue to be negative on the GBP and look for Cable to move decisively downward over the medium term.

Cable traded in a wide range across the quarter exhibiting significant volatility, trending lower over the longer term but with periodic rebounds when data come in less soft than expected, with GBP/USD trading in the range of 1.7260-2.0058 over the course of the quarter. We had reiterated in our reports that Cable above or near $2 was in clear defiance of fundamentals and Cable fell decisively below the $2 level in 3Q08. Cable touched a 2.5yr low of 1.7260 on the back of arch dove Blanchflower's comments as well as continued signs of trouble in both the UK and European banking sector. Blanchflower had pointed to a deeper than forecast decline in the UK economy and a large rise in unemployment with several months of 60,000+ rises in unemployment and said that there was too much concern over 1 mth's inflation number and that it will fall sharply in the coming months.

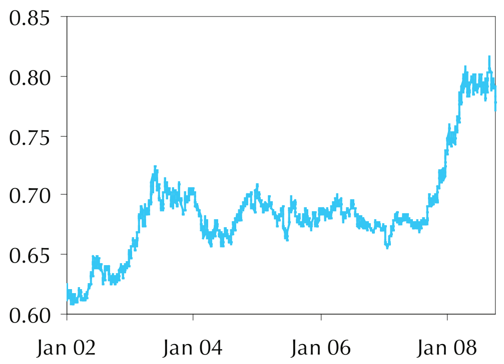
We see Cable as having finally started to respond to the deteriorating economic data emanating from the UK and see the GBP as likely to come under increasing pressure from here. Our overall reading of the UK economy remains one where we see significant stress from a UK consumer pressured by a housing market which continues to deteriorate, a reduction in credit as the UK banking system remains under intense pressure from the credit crunch fallout and eroding purchasing power from inflationary pressures which suggest further moderation in discretionary spending going forward. We think the BoE still remains in a bind with a rapidly declining economy and still high inflation. We therefore continue to be negative on the GBP and look for Cable to move

GBP/USD



Source: Bloomberg

EUR/GBP



Source: Bloomberg

decisively downward over the medium term.

Data Points Undoubtedly to Weakening Growth Although Inflationary Pressure Remains Elevated

2Q GDP data for the UK came in below expectations at 0.0%qoq (1.4%yoy) against expectations for a 1.5% qoq (0.1%yoy) reading and slowing from a 1Q reading of 0.3%qoq (2.3%yoy). Both private consumption and gross fixed capital formation showed signs of pressure and 2Q Business investment also slipped -1.9%qoq, way softer than the -0.7%qoq expected.

More timely data from the UK has continued to affirm the extent of the slowdown in the UK economy with the latest PMI survey data showing an unexpected improvement but continuing to point to contraction. Aug PMI manufacturing came in at 45.9 from 44.3 in Jul, PMI services ticked upwards to 49.2 from 47.4 and PMI construction also turned in higher at 40.5 from 36.7. Latest Sep PMI construction number however fell to 38.8 from 40.5, in line with the longer term trend of continued weakening. Jul Industrial production also came in soft at -0.4%mom (-1.9%yoy) against expectations for a -0.1%mom (-1.4%yoy) decline and from a prior revised numbers 0.1%mom (1.7%yoy).

The housing market continued to be under pressure with no clear sign of bottoming out. Aug Rightmove house prices fell a further -2.3%mom (-4.8%yoy) after falling -1.8%mom (-2.0%yoy) in Jul in its first annual fall since the series were started 6yrs ago. Aug Nationwide house prices fell for a 10th consecutive month registering yet another record drop since 1991 when the series began, falling -1.9%mom against expectations for a -1.5%mom fall and from a revised Jul reading of -1.5%mom, the yoy rate came in at -10.5%yoy against expectations for a -9.6%yoy reading and from a -8.1%yoy reading. The latest Sep number also registered further declines coming in at -1.7mom. Another measure of the housing market also showed signs of slowing. Aug HBOS house prices fell -1.8%mom from -1.7% in the prior month, bringing the 3mth/yr rate down to -10.9%yoy from -8.8%yoy. The market also dismissed a government plan to exempt properties worth less than GBP175k from Stamp Duty for the next 12mths, up from GBP125k currently, as insufficient to address the property slump. The fall in house prices to their lowest in 2 yrs continues to prevent the BoE from raising rates despite rising inflation. With home ownership at about 2/3 of households, this is likely to show up on consumer spending.

The UK consumer continued to be under pressure as the housing market continued to deteriorate and Aug Jobless claim change rose for a 7th consecutive month by 32.5k from an upwardly revised 27.8k in Jul, above consensus for a 23.0k increase. The Jul Unemployment rate also edged higher to 5.5% from 5.4%. The Aug GfK index of UK consumer confidence also fell to a record low at -36 from -39, well below expectations for a -41 reading and 3Q BoE credit conditions survey showed that lending institutions cut back secured lending to households by more than expected in 3Q and expect to continue to scale back lending in 4Q. Aug retail sales however saw a rebound on back to school spending of 1.2%mom (3.3%yoy) from a 0.9%mom (2.0%yoy) reading in Jul after the surprise collapse in Jun UK retail sales falling -3.9%mom against expectations for a decline of -2.5%mom. The surprise collapse of Jun UK retail sales had initially added to worries that the credit tightening, housing market collapse as well as the high primary products inflation was spreading quickly to UK consumption.

Signs have also emerged that the UK has not been spared the credit fallout in the US. The UK FSA announced new provisions amid the global equity market sell-down in Sep to prohibit active creation or increase of net short positions and required daily disclosure of net short positions above 0.25% from Sep23 till 16Jan09 on publicly quoted financial companies. The UK government also gave the go ahead for the merger of Lloyds and HBOS, promising to rewrite competition laws to allow the $22b all share deal to go through. UK bank HBOS Plc struck an all stock deal with Lloyds TSB to create a £28b mortgage giant. HBOS had come under increasing pressure as it was more reliant on wholesale markets to fund its business than other UK banks. HBOS is the largest mortgage lender in the UK while Lloyds ranks 4th. The merger of Lloyds, UK's 5th largest bank and HBOS, 6th largest bank would have a 28% share of home loans and the biggest taker of savings and provider of current accounts. As a sign of the extent of the pressure faced by the UK economy, UK's finance minister said that at economic conditions were at their worst in 60yrs and the OECD singled out the UK economy as the only 1 of the G7 economies expected to contract in both 3Q and 4Q.

More recently, the UK also announced a £300b bailout plan for its banking system. UK said it would make £50b of new capital immediately available to retail banks using taxpayers' funds. The plan guarantees interbank lending by £250b with the aim of unfreezing wholesale markets and extends a BoE scheme which swaps banks' risky assets for government debt to provide £200b of cash to the system. 7 UK banks, Abbey, HSBC, RBS, HBOS, Barclays, Lloyds TSB and Standard Chartered as well as the UK's largest building society, Nationwide, have committed to increase their total Tier 1 capital by £25b in total as part of the government's scheme which would provide the UK government with a preference share capital interest in each of the banks but will in return give the UK government the right to require banks to meet certain terms and conditions that will include commitments to support small businesses and home buyers.

Against the backdrop of weakening growth, inflation continues to remain elevated. Aug CPI came in at an annual rate 4.7%yoy, the highest in a decade and more than double the mid-point monetary policy target. The month on month rate also rose above expectations to 0.6%mom against expectations for a 0.5%mom reading. Core CPI came in slightly above expectations at 2.0%yoy.

BoE Surprised the Market with a 50bps Cut to 4.50% on 8 Oct

The BoE was among 6 major central banks to deliver a surprise collective policy cut of 50bps on 8Oct. The BoC, BoE, ECB, Fed, Risksbank, SNB lowered policy rates each by 50bps to end at 2.5%, 4.5%, 3.75%, 1.5%, 4.25% and a target range of 2-3% respectively. The Bank of China also cut its benchmark 1yr rates by 0.27%. The BoJ did not join in the action but said that it strongly supported the coordinated action.

Prior to the coordinated policy move, the BoE had held interest rates steady across the quarter, as it held back cuts on the back of elevated inflationary pressures despite being weighed down by weak economic data from the UK which suggests that the BoE would eventually have to cut rates to revive the rapidly contracting economy.

There had also been little surprises from both the BoE rates or minutes with the Sep voting pattern coming in an as expected 8-1. The BoE August minutes also registered an as expected 7-1-1 3-way split with Blanchflower inclined to a cut and Besley hike once again. The Jul BoE MPC minutes also showed a 3 way split vote of 7-1-1 with arch hawk Tim Besley voting for a 25bps rate hike and dove Blanchflower continuing to call for a cut. The 3 way split in our view had suggested that UK rates would be unlikely to move downwards as quickly as the market may have anticipated. We had opined that the absence of further support for either a hike or a cut means the BoE will remain on hold in the short term. However with the recent turmoil in credit markets and the failure and nationalization of financial institutions worldwide, we now bring forward our call for a rate cut and expect UK rates to be cut an additional 25bps by end of the year with risks tilted to rate cuts rather than hikes and expect more pressure on Cable as UK economic data continues to be dismal. We see the BoE as stuck between 2 devils and watch out for any deviation from the 7-1-1 or 8-1 voting pattern going forward with any additional support to the dovish Blanchflower camp likely to see Cable tumble further.

The latest BoE quarterly inflation report also surprised on the downside. The Aug BoE Inflation Report revised downwards the inflation profile for Y2, although the Y1 profile was revised sharply upwards. Growth projection for Y1 was revised down sharply but a recovery was expected towards trend in Y2. The BoE said that it saw economic growth as 'broadly flat over the next year or so' and Governor King said that there was a possibility of a 1quarter or two of falling output. We think the BoE will still be cautious in delivering aggressive cuts since should the projected inflation profile materialize, the BoE would have to write to the Chancellor again. Despite this, we are calling for an additional 25bps cut by year end in light of the recent financial market turmoil.

JAPAN

UOB Tokyo Branch
Shin Kokusai Building, 3-4-1
Marunouchi, Chiyoda-ku
Tokyo 100-0005
Tel: (81)(3) 3216 4251
Fax: (81)(3) 3216 4254
Cable: TYEHUABANK
Telex: J22178 TYEHUA J
SWIFT: UOVBJPJT
Email: UOB.Tokyo@UOBgroup.com

MALAYSIA

UOB Labuan Branch
Level 6A, Main Office Tower
Financial Park Labuan Complex
Jalan Merdeka
87000 Labuan F.T.
Tel: (60)(87) 424 388
Fax: (69)(87) 424 389
Telex: MA 85096 TYEHUA
Email: uoblbn@tm.net.my

United Overseas Bank (Malaysia) Bhd
(a wholly-owned subsidiary)
Menara UOB
Jalan Raja Laut
P O Box 11212
50738 Kuala Lumpur
Tel: (60)(3) 2692 7722
Fax: (60)(3) 2691 0281
Cable: BANKUOBM KUALA LUMPUR
Telex: MA 31877 UOBM HO
SWIFT: UOVBMYKL
Email: uob121@uob.com.my

MYANMAR

UOB Yangon Representative Office
48 Aung Teza Street, 6th Ward
High Land Avenue
Mayangone Township
Yangon
Tel: (95)(1) 667 818
Fax: (95)(1) 544 126
Email: UOB.Yangon@UOBgroup.com

PHILIPPINES

United Overseas Bank Philippines
(a subsidiary)
Pacific Star Building
17th Floor
Sen. Gil Puyat corner Makati Avenue
Makati City
Tel: (63)(2) 878 8686
Fax: (63)(2) 811 5917
SWIFT: UOVBPHMM
Email: info@uob.com.phSouth Korea

SOUTH KOREA

UOB Seoul Branch
Suite 1508, Kyobo Building 1, 1-Ga
Jongno, Jongno-Gu
Seoul 110-714
Tel: (82)(2) 739 3916/9
Fax: (82)(2) 730 9570
Telex: K28978 TYEHUA
Email: UOB.Seoul@UOBgroup.com

TAIWAN

UOB Taipei Branch
Union Enterprise Plaza, 16th Floor
109 Minsheng East Road
Section 3, Taipei 105
Tel: (886)(2) 2715 0125
Fax: (886)(2) 2713 7456
Telex: 26147 TYEHUA
Email: UOB.Taipei@UOBgroup.com

THAILAND

UOB (Thai) Public Company Limited
(a subsidiary)
191 South Sathon Road
Sathon
Bangkok 10120
Tel: (66)(2) 343 3000
Fax: (66)(2) 287 2973/4
Telex: 84351 BKASIA
SWIFT: BKASTHBK
Website: www.uob.co.th

VIETNAM

UOB Ho Chi Minh City Branch
Central Plaza Office Building
Ground Floor
17 Le Duan Boulevard
District 1, Ho Chi Minh City
Tel: (84)(8) 825 1424
Fax: (84)(8) 825 1423
Telex: 813221 UOBHCM VT
SWIFT: UOVBVNVX
Email: UOB.HoChiMinhCity@UOBgroup.
comAustralia

AUSTRALIA

UOB Sydney Branch
United Overseas Bank Building
Level 9, 32 Martin Place
Sydney, NSW 2000
Tel: (61)(2) 9221 1924
Fax: (61)(2) 9221 1541
Telex: AA 73507 TYHUA
SWIFT: UOVBAU2S
Email: UOB.Sydney@UOBgroup.com

UNITED KINGDOM

UOB London Branch
19 Great Winchester Street
London EC2N 2BH
Tel: (44)(20) 7628 3504
Fax: (44)(20) 7628 3433
Cable: TYEHUABANK
Telex: 8954292 TYEHUA G
SWIFT: UOVBGB2L
Email: UOB.London@UOBgroup.com

CANADA

UOB Vancouver Branch
#1680-650 West Georgia Street
Vancouver Centre
Vancouver, British Columbia
Canada V6B 4N9
P O Box 11616
Tel: (1)(604) 662 7055
Fax: (1)(604) 662 3356
Telex: 04-507520 TYEHUA VCR
Email: UOB.Vancouver@UOBgroup.com

UNITED STATES OF AMERICA

UOB New York Agency
UOB Building
592 Fifth Avenue
10th Floor, 48th Street
New York, NY 10036
Tel: (1)(212) 382 0088
Fax: (1)(212) 382 1881
Cable: TYEHUABANK NEW YORK
Telex: 232265 TYEHUA
SWIFT: UOVBUS33
Email: UOB.NewYork@UOBgroup.com

UOB Los Angeles Agency
777 South Figueroa Street
Suite 518, Los Angeles
California 90017
Tel: (1)(213) 623 8042
Fax: (1)(213) 623 3412
Cable: TYEHUABANK LOS ANGELES
Telex: 6831011 TYHUA
Email: UOB.LosAngeles@UOBgroup.com

SINGAPORE

United Overseas Bank Limited
80 Raffles Place, UOB Plaza
Singapore 048624
Tel: (65) 6533 9898
Fax: (65) 6534 2334
Telex: RS 21539 TYEHUA
SWIFT: UOVBSGSG
Website: www.uobgroup.com

Far Eastern Bank Limited
(a subsidiary)
156 Cecil Street, #01-00
Far Eastern Bank Building
Singapore 069544
Tel: (65) 6221 9055
Fax: (65) 6224 2263
Telex: RS 23029 FEBANK

BRUNEI

UOB Bandar Seri Begawan Branch
Unit 10 & 11, Bangunan D'Amin Jaya
Lot 54989, Kampong Kiarong
Bandar Seri Begawan BE1318
Negara Brunei Darussalam
Tel: (673)(2) 225 477/222 210/220 380
Fax: (673)(2) 240 792
Cable: OVERSUNION BSB
Telex: OUB BU 2256
Email: uobbsb@brunet.bn

UOB Kuala Belait Branch
Ground Floor
Chinese Chamber of Commerce Building
Lot 104, Jalan Bunga Raya
Kuala Belait KA1131
Tel: (673)(3) 331 889/341 012
Fax: (673)(3) 331 391
Email: uobkb@brunet.bn

CHINA

UOB Beijing Branch
2513, China World Trade Centre Tower 2
No. 1 Jian Guo Men Wai Avenue
Beijing 100004,
Tel: (86)(10) 6505 1863
Fax : (86)(10) 6505 1862
Email: UOB.Beijing@UOBgroup.com

UOB Guangzhou Branch
Unit 1107-1110, Metro Plaza
183-187 Tian He Bei Road,
Guangzhou 510075
Tel: (86)(20) 8755 8611/8787 8789
Fax: (86)(20) 8755 6661
Telex: 440931 UOBGZ CN
Email: UOB.Guangzhou@UOBgroup.com

UOB Shanghai Branch
9F, No. 1118,
Shanghai Erdos International Mansion,
Pudong South Road, Pudong New Area,
Shanghai 200122
Tel: (86)(21) 3852 8288
Fax: (86)(21) 3852 8289
Email: UOB.Shanghai@UOBgroup.com

UOB Shenzhen Branch
Unit 2, G2 Floor
Shun Hing Square
Di Wang Commercial Centre
5002 Shennan Road East
Shenzhen 518008
Tel: (86)(755) 8246 1298
Fax: (86)(755) 8246 3326
Telex: 420385 OUB SZ CN
Email: UOB.Shenzhen@UOBgroup.com

UOB Shenyang Branch
Tower C, Unit 5-6, No 55 Beizhan Road
Shenyang Fortune Plaza
Shenhe District 110013
Shenyang, Liaoning. PRC
Tel: (86)(24) 3128 0606
Fax: (86)(24) 3128 0628
Email: UOB.Shenyang@UOBgroup.com

UOB Xiamen Branch
United Overseas Bank Building
1-2 Floor
19 Hubin Bei Road
Xiamen 361012
Tel: (86)(592) 508 1601
Fax: (86)(592) 508 1605
Telex: 923079 UOBXM CN
Email: UOB.Xiamen@UOBgroup.com

UOB Jing An Sub-Branch
1468 Nan Jing Road West
1P-01/02, United Plaza Building
Shanghai 200040
Tel: (86)(21) 6247 3688
Fax: (86)(755) 6289 1001

UOB Chengdu Representative Office
Holiday Inn Crowne Plaza, Room 405
31 Zong Fu Street
Chengdu 610016
Tel: (86)(28) 8674 8618
Fax: (86)(28) 8674 8638

HONG KONG S.A.R.

UOB Central Branch
United Overseas Bank Building
54-58 Des Voeux Road
Central, Hong Kong S.A.R.
Tel: (852) 2842 5666
Fax: (852) 2537 7890
Telex: 74581 TYHUA HX
SWIFT: UOVBHKHH
Email: UOB.HongKong@UOBgroup.com

UOB Hong Kong Main Branch
25/F Gloucester Tower
The Landmark
11 Pedder Street,
Central, Hong Kong S.A.R.
Tel: (852) 2521 1521
Fax: (852) 2810 5506
Telex: 74581 TYHUA HX
SWIFT: UOVBHKHH
Email: UOB.HongKong@UOBgroup.com

UOB Yaumatei Branch
554 Nathan Road
Ground Floor
Kowloon, Hong Kong S.A.R.
Tel: (852) 2532 6888 (General)
Fax: (852) 2388 2613
Email: UOB.HongKong@UOBgroup.com

UOB Mongkok Branch
794 Nathan Road
Ground Floor
Kowloon, Hong Kong S.A.R.
Tel: (852) 2381 2292
Fax: (852) 2397 4564
Email: UOB.HongKong@UOBgroup.com

UOB Sheung Wan Branch
(Hong Kong Back Office)
Cosco Tower
Units 1607-1614, 16/F
183 Queen's Road
Central, Hong Kong S.A.R.
Tel: (852) 2910 8833
Fax: (852) 2810 5773
Email: UOB.HongKong@UOBgroup.com

INDONESIA

UOB Jakarta Representative Office
Sona Topas Tower, 2nd Floor
Jalan Jend. Sudirman Kav. 26
Jakarta 12920
Tel: (62)(21) 250 6382
Fax: (62)(21) 250 6379

PT Bank UOB Indonesia
(a subsidiary)
Sona Topas Tower, 1st-3rd Floors
Jalan Jend. Sudirman Kav. 26
Jakarta 12920
Tel: (62)(21) 250 6330
Fax: (62)(21) 250 6331
Telex: 60418 UOB IA
SWIFT: UOBBIDJA
Email: UOB.Jakarta@UOBgroup.com

UOB RESEARCH TEAM

Jimmy Koh Chew Teck
Head of Economics-Treasury Research
(65) 6539 3545
Jimmy.KohCT@uobgroup.com

Thomas Lam Tai Loong
Senior Treasury Economist
(65) 6538 2169
Thomas.LamTL@uobgroup.com

Licia Kok Hsien Ling
Treasury Economist
(65) 6539 3549
Licia.KokHL@uobgroup.com

Suan Teck Kin
Senior Economist
(65) 6539 3922
Suan.TeckKin@uobgroup.com

Ho Woei Chen
Economist
(65) 6539 3948
Ho.WoeiChen@uobgroup.com

Tan Lena
Economic Research Associate
(65) 6539 3926
Tan.Lena@uobgroup.com

More reports available on:
URL: www.uobgroup.com/research
Email: EcoTreasury.Research@uobgroup.com
Bloomberg: UOBR

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HEAD OFFICE
80 Raffles Place
UOB Plaza
Singapore 048624
Company Registration No.: 193500026Z

Telephone: (65)6533 9898
Facsimile: (65)6534 2334
Website: www.uobgroup.com