Asia - Economy & FX

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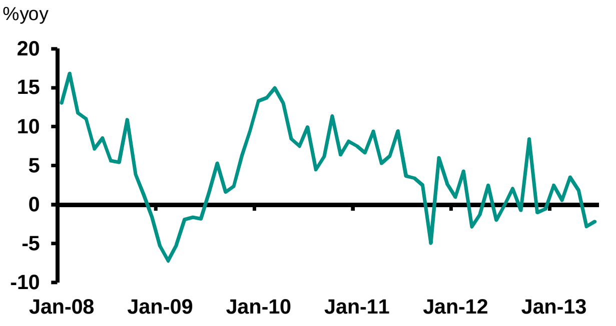
India

The Indian authorities introduced a number of measures in an attempt to support the currency last week. In addition to another hike in the import duties of gold, the Finance Minister committed himself to reducing the current account deficit to USD 70bn (3.7% of GDP) in FY 2014 from USD 88bn (4.8% of GDP) last year. This should make the deficit more viable given the difficulties in filling the financing gap, in a context of weakening data. June's industrial production continued to lose momentum, while July's whole sale price inflation increased to 5.8% from 4.9% the previous month. The trade deficit continued to narrow for the second month in a row on the back of stronger exports and quantitative measures to control the import of gold. At the end of the week, the Reserve Bank of India announced further measures to restrict capital outflows. These limit the amount of overseas investments, as well as the quota on remittances under the liberalised remittances scheme, and prohibit the acquisition of property abroad through this scheme. More convincing structural measures are needed to improve confidence.

India: Industrial production

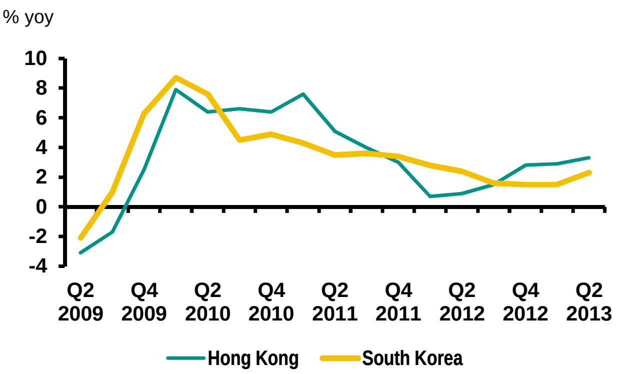


Source: Thomson Reuters Datastream

Other Asia

GDP data released so far shows that activity is picking up modestly in the second quarter in several Asian countries. Hong Kong's second quarter GDP strengthened to 3.3% yoy up from 2.9% yoy in the previous quarter. Net exports had a slight negative impact on growth, while fixed capital formation improved notably, after showing a negative contribution in the first quarter. The contribution of private consumption moderated somewhat in the second quarter compared to the first. Our GDP forecast for 2013 is 3.0%. Meanwhile, South Korea's GDP released some weeks ago rose to 2.3% yoy up from 1.5% yoy the first quarter led by strong construction and government spending, while other fixed investment is still being affected by weak business sentiment. We forecast 3% growth for 2013. Finally, Singapore's second quarter GDP also edged up to 3.8% from 3.7% the previous quarter. In general, we think that global activity should improve gradually in the second half of the year, supporting economic activity in Asia.

South Korea and Hong Kong: GDP

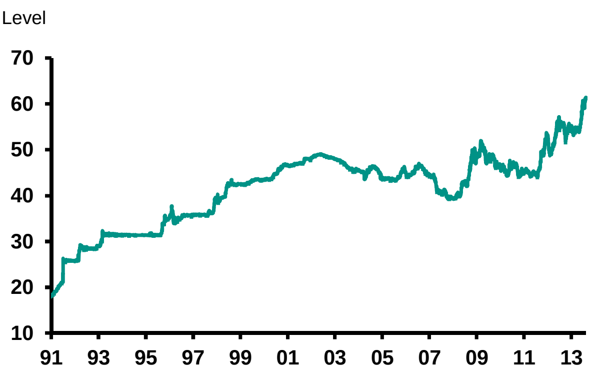


Source: Bloomberg

CNY & INR

Asian currencies have fallen under pressure again. Our Asian top-pick Chinese yuan (CNY) has been the exception, strengthening modestly versus the USD. The CNY is perceived as a relatively safe investment compared to Japanese yen (JPY) and Indian rupee (INR). Renewed weakness in the JPY hurt the overall Asian sentiment and increased fears about its impact on the exports of other Asian countries. In addition, the slide of the INR continued despite the government's and Reserve Bank of India's efforts to stop it. Indeed last week, the RBI introduced new measures to halt the INR sell-off. So far they have not been able to convince financial markets. We think that financial markets will continue to test authorities until meaningful measures are taken. Some have placed their hopes on the new central bank governor Rajan who will take charge on 4 September. If he is not able to live up expectations INR will remain under pressure.

USD/INR

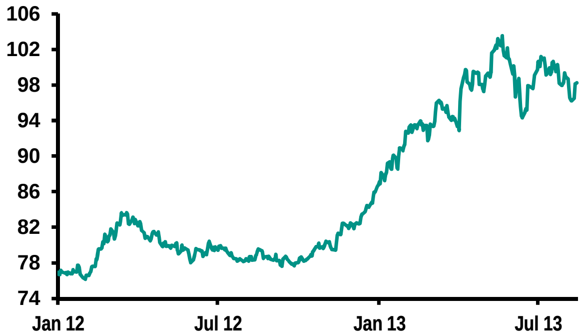


Source: Bloomberg

JPY

USD/JPY

Level



Source: Bloomberg

At the start of last week, Japanese GDP came in below market consensus and this pushed the Japanese yen (JPY) higher. The JPY often strengthens on weaker data and weakens on better data. However, on balance, the JPY fell against the USD late week. It fell under pressure as the spread between US and Japan yields widened due to the better-than-expected US labour market data. Moreover, the JPY moved lower on the news that the Japanese government is weighing a corporate-tax cut. This signals that the authorities are not happy with the momentum in the economy and this could also eventually open the door for additional monetary stimulus. We expect the Bank of Japan to miss its very ambitious inflation target of 2% by a wide margin during the next two years. Consequently, the BoJ will probably have to step up its government bond purchases, which should help the yen to continue to weaken. We see the USD/JPY at 110 at the end of this year and 120 at the end of next year.