FEBRUARY 2009

# ORANGE VIEW

F E A T U R E S



YOUR TO INVESTMENTS

# Global Economic Outlook

## World

- A sense of political renewal in the United States along with a flurry of policy action from the fiscal authorities and central banks across all regions have been welcomed by the asset markets but beyond that there has been no material improvement.
- The interplay between policy action leading to hopes of economic revival and the ensuing effect of debasing the currency will ensure the three major currencies USD, EUR and JPY remain unstable against each other. Currency movements will therefore be crucial in determining eventual asset market and regional equity returns.
- Credit markets continue to improve with interbank rates moving lower as markets gain confidence that any further disruption in the banking sector will be prevented.
- Most commodity prices have now declined to levels where selling prices are at or below cash costs with copper being a notable exception.

## United States

- The much anticipated 4Q08 US GDP came in far better than expected at -3.8% as expectations of up to -7% growth was averted. However, this seemingly positive outcome was offset by a string of other disappointments as industrial production, house prices, employment data, etc. failed to meet expectations. We forecast a -2% GDP for 2009.
- The downturn in GDP is expected to intensify this quarter ahead of expected stabilisation in the second half of the year and recent incoming data supports this view.
- Bank lending has continued to decline even after the release of the first tranche of the TARP funds. The nature of the use of the second tranche is currently focussing on the prospect of an asset guarantee or a bad bank scheme or a combination of the two.

## Europe

- Capacity utilisation in the Euro area fell by 6.4 points to a level of 75.2, by far the largest quarterly decline ever seen. This implies further falls in corporate capital spending and core inflation falling to levels close to zero.
- Unemployment is now rising in every country of the region as December unemployment rose to 8% in December. Hardest hit is Spain with unemployment rising to 14.4%
- The UK economy remains in the midst of its deepest recession since at least the early 1990s with all indicators pointing to a continuation of depressed economic activity.

## Japan

- The mainstay of the Japanese economy, exports, declined 35% yoy in December. As Japan entered the recession with a weak domestic economy and relatively strong export sector, the outlook for economic growth in Japan has further deteriorated. We now expect GDP growth to be -3% in 2009.
- As policy rates in the US and Euro area come down to levels prevailing in Japan the JPY has surged against both the major currencies as well as against the Chinese Renminbi compounding problems for the export industry.
- Unless the JPY were to depreciate significantly against other currencies the outlook for Japan will remain dim and at best will be viewed as a beta play on global economic revival.

# Global Market Insights

## Equities

- The sharp downturn in economic activity has been handled exceptionally well by non-financial companies with y-o-y earnings declining a modest 2%- 3% in 2008. This will change in the course of 2009 as the disruption in the financial sector spills over to the real economy. A consensus earnings decline of "only" 2.7% for the world will prove very optimistic in our view.
- Risk aversion is below levels seen in 4Q08 but is still very high. Cash levels are high and expectations low. This will lead to bear market rallies every once in while as very poor economic and earnings data compete with pro-growth policy action and improving credit markets.
- Volatility is sure to be a continuing feature through the course of this year and intra-year lower equity market levels certainly cannot be ruled out. However, investors with a longer term horizon may be well served by accumulating equities around current levels.

## Bonds

- Global bond markets continue to be underpinned by global deleveraging, collapsing economic growth and deflation fears.
- Central Banks remain in easing mode. With rapidly retreating inflation pushing real interest rates higher, we expect more rate cuts in markets where nominal rates are still positive, and quantitative easing measures in countries where interest rates approach the 'zero bound'. European bond markets are in the first category: with the ECB expected to deliver more rate cuts, we expect European bond markets to outperform the US and Japan.
- Fiscal pump priming, increasing deficits and increased bond supply however exert upward pressure on bond yields. The recent back-up in bond yields reflect these pressures, notably in the US but at current levels we believe the upside in yields is limited.
- We recommend a modest underweight exposure to international bonds.

## Returns

- 2009 kicked off in much the same way as 2008 – down. All regions declined with Europe (-11.04%) being worst and Latin America (-0.31%) best.
- Global bonds lost ground after the sharp rally in December, with yields backing up across markets. US bonds returned -3.05%, whereas Japanese bonds outperformed (+0.33%). European bonds (-8.92%) performed the poorest on the back of a sharply weaker Euro.

| Equities Benchmark | January | Year-to-Date | 12 Months |
|---|---|---|---|
| **MSCI World** (USD terms) | -8.51% | -8.51% | -42.06% |

| Bond Benchmark | January | Year-to-Date | 12 Months |
|---|---|---|---|
| **World Govt Bond Index** (USD terms, unhedged) | -4.34% | -4.34% | 2.28% |

# Asia Pacific Economic Outlook

### Overview

- Exports have now turned deeply negative for many Asian countries.
- Intra-Asia trade also weakened signficantly as exports to China has slowed.
- Restocking of inventory in China is expected to help boost demand for commodities in the short term.
- Asian Economic growth assumptions are being rapidly revised downwards.
- Economic growth in the region nevertheless will remain stronger than the rest of the world.

### China

- While Economic growth in China has slowed, the January rebound in PMI to 45.3 marks the second consecutive month of improvement.
- Infrastructure spending from the stimulus package is beginning to show signs of improvement in commodity demand and industrial activity.
- Loan growth has also accelerated since the start of the year as lending restrictions have been eased.

### North Asia

- Hong Kong's economy is being cushioned by Chinese spending with retail sales +0.8% in December buttressed by mainland tourists.
- Korean export and industrial production fell 32.8% and 18.6% respectively as demand from end markets sagged.
- Taiwan exports and industrial production fell 33% and 32.4% respectively. Taiwan was particularly hard hit due to reliance on technology exports.

### South Asia

- Indonesia exports fell 20% in December, much lower than expectations and continued to weigh on the Rupiah throughout the month.
- Industrial Production in Malaysia remained in a downward trend, falling 7.7% in November.
- Thailand saw interest rate cut by another 75bps to 2%, the lowest level in 4 years.
- OFW remiittance grew 14.6% in November providing support to domestic consumption in The Philippines.

### Pacific

- Australia announced a A$42 billion economic stimulus package equating to 4% of GDP in an effort to cushion the effects of a global economic downturn.

# Asia Pacific Market Insights

## Equities

- Weakening consumer demand across the globe caused by low household credit availiabilty and rising unemployment is exacting a large toll on export orientated countries such as Taiwan and Korea.
- Commodity driven economies such as Indonesia, Thailand and Australia are also being hit by sharply lower commodity prices.
- Financial and credit markets however appear to be improving with credit spreads tightening in January.
- Sharp falls in 2008 earnings have led to continued cuts in earnings estimates for 2009 and 2010. Earnings visibility remain very low. Market trading volumes also remain very low as investors wait on the sidelines pending clarity.
- Asia Pacific's 2009 estimated PE stands at 10.8X with an estimated earnings growth of -25.5%. While PE multiple does not appear to be significantly below average, average earnings estimates have been reduced substantially providing a much better base for investor expectations for 2009.
- This year will remain a difficult year for most Asia Pacific economies though aggressive monetary easing and large scale stimulus plans will help cushion the downturn. Nevertheless, economic growth targets have been aggressively revised downwards for 2009.
- Expectation of a second half recovery remain consensus though conviction remains low. Our base case remains a general economic recovery or at least no further deterioration in the latter half of 2009, which could position the market for a summer rebound.

## Bonds

- The current crisis is a global crisis, and not EM originated, and Asia entered this crisis with generally solid fundamentals. Whereas in typical EM crises central banks have to significantly tighten monetary policy to stabilise the macro situation, virtually every Asian central bank now has the flexibility to ease monetary policy to help sustain growth.
- With commodity prices collapsing and domestic demand decelerating rapidly, inflation in Asia is no longer a concern. As with their global counterparts, regional central banks are aggressively cutting rates and pumping liquidity into systems to help ease strains in domestic money markets.
- Most Asian countries were in decent fiscal shape going into the crisis, and with Asian banking systems less exposed to problem assets, bank recapitalisation needs are limited. We don't expect fiscal pump priming to represent a major risk for Asian bond markets, and after the recent back up in yields the near term upside in yields is limited.
- In several markets, yield curves may steepen as a result of continued monetary policy easing anchoring the short end and increased bond supply exerting upward pressure on the back-end of yield curves.
- Deterioration in foreign investors risk appetite may negatively impact markets which have higher foreign participation, such as Indonesia. In other markets, where outflows have already occured, we believe the downside potential is much more limited going forward.
- We recommend being neutral in this asset class.

## Returns

- The Chinese New Year failed to bring cheer to the region as equities continued to decline through January. Hong Kong was the only market to close in the positive territory, gaining a measly 0.5%.
- Asian bond markets began 2009 poorly by posting negative returns on the back of higher bond yields and weaker Asian currencies.

| Equities Benchmark | January | Year-to-Date | 12 Months |
|---|---|---|---|
| **MSCI Asia Pacific Ex Japan** (USD terms) | -7.69% | -7.69% | -48.94% |

| Bond Benchmark | January | Year-to-Date | 12 Months |
|---|---|---|---|
| **HSBC Asia Local Bond Index** (USD terms) | -3.59% | -3.59% | -5.34% |

| Recommended Asset Exposures | |
|---|---|
| **International Equities** | Underweight |
| **Asian Equities** | Underweight |
| **International Bonds** | Underweight |
| **Asian Bonds** | Neutral |
| **Cash** | Overweight |

# Indian Economic Outlook

## India

- After a disappointing month of October, Industrial Production (IP) growth turned positive in November coming at 2.4% yoy compared to -0.3% yoy (revised) in October and 4.9% in November 2007.
- Inflation, as measured by the Wholesale Price Index, came in at 5.64% yoy for the week ending January 17, 2009. However, CPI is still a concern with double digit inflation.
- Credit growth fell to 22.2% during the second week of January, while deposit growth was at 20%.
- RBI did not make any further changes in any key rates after the cuts in the beginning of the month. It also revised growth estimates to 7% from 7.5%-8% with a downward bias.
- Fiscal deficit remains a big concern for the economy with RBI estimating the deficit of 5.9% (excluding the state deficit) for FY09.

*Source: www..rbi.gov.in*

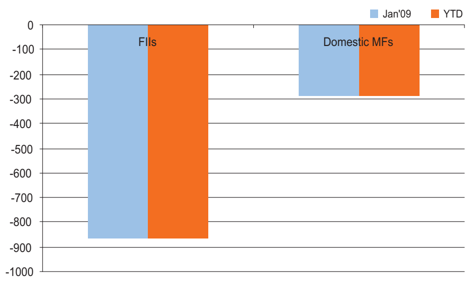
# Indian Equity Market Insights

## India

- The start of the New Year did not bring any respite to the equity markets with most global indices registering a negative return.
- India outperformed most markets for second consecutive month with BSE Sensex falling by ~2%. In January, the large-cap index outperformed the mid and small cap indices.
- FIIs flows turned negative after inflows in December. FIIs sold US$866m worth of equities in January. Domestic MFs also turned negative and sold US$287m worth of equities.
- After a good month of December, Realty index fell heavily (-27%) during January. Banking sector was also down by ~10% in a month when most sectors registered negative returns.

*Source: ING IM Internal Research Team & SEBI*

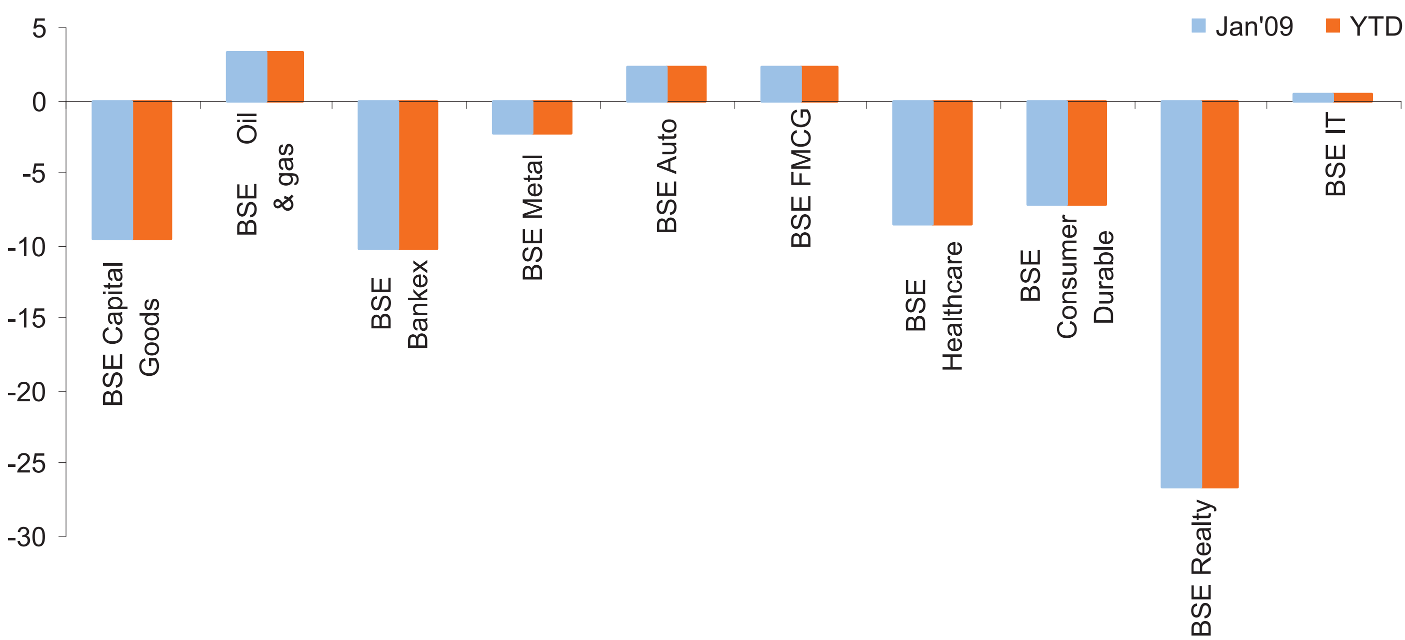
## FII and MF Trend (Inflows)




*Source - SEBI*

# Snapshot of Sectoral Trend

% change compared to previous month.




*Source - Bloomberg*

# ING Overview of Sectoral Trend

## Industrial Manufacturing and Construction

- Economic environment in India remains challenging and most companies are cutting down in their capex plans. Government has emerged as the sole agency capable of reviving the economy with various planned infrastructure programmes. Strong current order books for a few large companies impart high revenue visibility. Sharp correction in commodity prices, peaking out of interest rates, easing raw material and interest cost pressures should drive earnings growth over the next 12 months.

## Information Technology

- 3QFY09 results for most IT companies came in line with expectations. Pricing pressure was pretty much evident in results of most companies. Depreciation of rupee, however, led to improvement in margins in spite of the challenging environment. IT budgets for 2009 are likely to fall compared to the current year. Pricing is also likely to remain under pressure with most customers asking for significant price reduction. We maintain our cautious view on the sector.

## Steel

- Global steel prices recovered slightly from December lows as demand in China indicates slight recovery. The demand outlook, however, continues to be sluggish and realizations might slip further than what was realized for the October-December quarter. For Indian steel manufacturers, focus remains on catering to domestic demand as steel producers increase their products mix and lobby the steel ministry for higher import duty on steel products. Long contracts of coking coal at historic high prices are expected to hurt the margins of most steel producers for the entire January-March quarter.

## Power

- The Central Electricity Regulatory Commission (CERC) has issued tariff guidelines applicable for central generating and transmission companies for the period 2009-14. Under the new guidelines, CERC has, in general, tightened efficiency norms for generating stations, and has offered a higher guaranteed return on equity for achievement of these improved norms. While these regulations are positive for the sector, valuation remains a concern. We have a cautious stance on the sector.

## Telecom

- After a couple of false starts, Department of Telecommunications (DoT) postponed the long pending 3G auction indefinitely. In our opinion, the 3G auction will now be delayed by at least 6-8 months. 3Q FY09 results for telecom companies were mixed with a couple of companies surprising positively. However, another round of price was started with GSM entry of RCOM. We continue to maintain a cautious view on the sector in spite of high subscriber addition run rate due to increasing competition and expected margin pressures.

## Bank

- Banking sector's 3QFY09 results were better than expectations. Most banks (especially public banks) reported better margins and stronger fee income. However, private banks and banks which have chosen fast growth over the past few quarters reported a decline in margins. On the back of favorable yield movement, banks reported strong treasury gains much above the market expectations. Asset quality continues to remain healthy. Few banks did use higher treasury profits to make higher provisions, which resulted in lower reported NPLs during the quarter.

## Media

- Advertisement growth rate has fallen significantly in 3Q FY09 as evident from results of most media companies. Most companies registered less than 10% growth in ad revenue. We expect muted advertisement growth rate in 2009 as well leading to huge pressure on all media companies. In print space, newsprint prices have started coming down but the expected slow down in ad growth is likely to have a huge impact. We maintain our bearish stance on the media sector.

## Pharmaceuticals

- The sector has played out well as a defensive bet in these volatile markets. However, the recent USFDA concerns for the top-end players have resulted in some price correction for the overall sector making the valuations somewhat reasonable. The earnings outlook for the sector esp. generics, continues to remain robust with the sector being least prone to recessionary concerns. In the CRAMS segment though, earnings growth outlook has come down a little due to inventory clean-up and some slowdown in outsourcing by global mid-sized companies. Depreciated rupee stands to favour the sector; though in this financial year most of the companies have not yet been able to capitalize on the gains due to steep hedging and translational losses.

## FMCG

- FMCG companies registered good topline growth for the December quarter equally driven by volumes and price off takes. Most companies have now nearly exhausted their high cost inventory and would start benefiting from the soft commodity regime. The current quarter should see margin recovery for most of the companies as the price hikes will add to the margins over and above the benefits accruing from lower raw material costs. Sector valuations at 21x FY09E earnings and 18x FY10E earnings are at significant premium to the market valuations.

*Source: ING IM Internal Research Team*

# Indian Debt Market Overview

- Government announces new borrowing calendar for the rest financial year amounting to INR 50,000 crs compared to INR 34,000 crs earlier"
- Revises growth estimates to 7% from 7.5%-8% with a downward bias.
- RBI maintains 'status quo' on all key rates but revises macro forecasts
- March end WPI to come in below 3%, however RBI raises concerns on CPI which is still in double digits
- Expects the central deficit to be 5.90% of the GDP as compared to earlier estimates of 2.50%.
- Imports slowed to 6.11% end Nov v/s 10.57% in Oct
- Acknowledges that RBI has been quiet aggressive relative to other central banks in cutting rates
- US GDP in 4th quarter sinks to 3.80% as compared to 0.50% last quarter, Consumption falls by 3.50%.
- China economic data shows slowing economy with Dec IIP growing by 5.70% and 4th quarter GDP growing by 6.80% as compared to 9.00% in the previous quarter.
- India's Nov IIP yoy growth at 2.40% v/s -0.30% last month and 4.90% in Nov 2007
- Credit growth slowed down to 22.15% as on 16 Jan 2009 vs 23.08% previous month. Deposit growth by and large remained stable at 20.03% as on 16 Jan 2009 vs. 20.84% previous month.
- M3 growth slipped to 18.66% as of 16 Jan 2009 vs 19.56% for the previous month
- Fiscal deficit at 163.80% for April-Dec 2008 of the budgeted estimates for 2008 – 2009. Absolute Fiscal Deficit at INR 2,18,000 crs.

*Source: www..rbi.gov.in and ING IM Internal Research Team*

# Macro Economic Matrix

| FACTOR | Impact on Debt Market | | | | |
|---|---|---|---|---|---|
| | Very Negative | Negative | Neutral | Positive | Very Positive |
| Economic Growth | | | | | ✓ |
| Credit Deposit Trends | | | | ✓ | |
| Fiscal Situation | | ✓ | | | |
| Inflation | | | | | ✓ |
| Liquidity Situation | | | | ✓ | |
| External Sector | | | ✓ | | |
| Monetary Policy Stance | | | | | ✓ |

*Source: ING IM Internal Research Team*

# Going Forward

- **Short Term Funds:** With credit spreads ruling around levels of 285 bps these funds would be able to generate decent accrual income along with duration plays. With credit spreads expected to stabilize and moderate going forward, we expect the short term funds to perform well going forward and maintain our positive outlook for an investment horizon exceeding 6-8 months.
- **Fixed income/Gilt Funds:** Given the current environment, medium to long term horizon for fixed income funds continues to be positive, hence given that the risks are managed appropriately the returns in these funds would be on the higher end of fixed income category.
- **Liquid funds:** We expect liquid funds to generate steady returns going forward. These funds still remain the best avenue for risk-averse investors who do not wish to lock-in their investments."

*Source: ING IM Internal Research Team*

| | Key Drivers | Key Risks | Risk Rating |
|---|---|---|---|
| **World Economy** | • Deleveraging of consumer, financial and corporate sectors<br>• Continued co-ordinated approach to the financial and economic crises | • Emerging markets decline into recession<br>• Protectionism emerges | High<br>Low |
| **Global Equities** | • Prospects for economic growth<br>• Earnings growth and the extent of revisions | • Earnings downgrades surprise on the downside<br>• Availability of credit diminishes | High<br>Medium |
| **Global Bonds** | • Monetary policy easing<br>• Collapsing growth and disinflation<br>• Safe haven flows<br>• Deficit spending and bond supply | • Return of risk appettite/ demand for risky assets<br>• Inflation replacing deflation<br>• Increasing fiscal deficits, rising public debt | Low |
| **Asian Equities** | • Extent Asia is impacted by the global economic slowdown<br>• International investors appetite for risk | • Earnings revisions surprise to the downside<br>• Valuations fail to halt market slide | High<br>High |
| **Asian Bonds** | • Monetary policy easing<br>• Decelerating growth and disinflation<br>• Bond supply | • Asian currency weakness<br>• Return of inflation<br>• Increased bond supply<br>• Higher G3 bond yields | Low |
| **Indian Equities** | • Interest rates have corrected sharply making equities look attractive over debt.<br>• Higher credit off-take and stimulus measures taken by the government is expected to limit fall in confidence.<br>• GDP growth rate in India is expected to be strong compared to other economies. Indian economy is more resilient, due to large domestic consumption and low dependence on exports.<br>• On the political front, a coalition government without Left Parties is good for the markets (as the government's ability to push reforms would be much higher). | • Fiscal deficit remains a big concern for the economy with RBI estimating the deficit of 5.9% (excluding the state deficit) for Fy09.<br>• The market is expecting a reasonably fast economic recovery, given the measures taken by RBI and global central banks, and any disappointment on this front would adversely market sentiment.<br>• Elections in mid CY09 is the key event risk. | High<br>High<br>High |
| **Indian Bonds** | • Change in Monetary Policy stance to support falling economic growth<br>• Inflation Stabilizing<br>• Easy Liquidity | • Expansionary Fiscal policies ans SLR<br>• Pull back in oil prices and commodity prices<br>• High Supply due to requirement of refinancing by corporates. | High<br>High<br>High |

## Key Forecasts

| | Real GDP | | | | Inflation | | | | 90 Day Interest Rates* | | 10 Year Bond Yields | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2008E# | ING | 2009E# | ING | 2008E# | ING | 2009E# | ING | Actual 31-Jan-09 | ING Forecast For Next 3 Months | Actual 31-Jan-09 | ING Forecast For Next 3 Months |
| **The World** | 3.4 | - | 2.0 | - | 4.6 | - | 3.4 | - | | | | |
| **USA** | 1.4 | - | -0.6 | - | 4.3 | - | 2.8 | - | 0.23 | Steady | 2.84 | Steady |
| **Europe** | 1.0 | - | -0.2 | - | 3.5 | - | 2.6 | - | 1.12 | Lower | 3.30 | Lower |
| **Japan** | 0.6 | - | 0.1 | - | 1.4 | - | 1.0 | - | 0.38 | Steady | 1.30 | Steady |
| **Australia** | 2.5 | - | 2.5 | - | 4.2 | 0 | 3.2 | - | 3.41 | Lower | 4.10 | Lower |
| **China** | 9.5 | - | 8.1 | - | 7.0 | - | 4.8 | - | 2.25 | Steady | 3.02 | Steady |
| **Hong Kong** | 3.6 | - | 1.4 | - | 4.7 | - | 4.3 | - | 0.99 | Steady | 1.64 | Steady |
| **India** | 7.1 | - | 6.6 | - | 7.8 | - | 6.6 | - | 4.75 | Lower | 6.26 | Lower |
| **Indonesia** | 6.0 | - | 4.7 | - | 10.5 | - | 8.2 | - | 10.66 | Lower | 11.79 | Steady |
| **Malaysia** | 5.3 | - | 3.3 | - | 5.8 | 0 | 4.1 | - | 2.60 | Steady | 3.11 | Steady |
| **Philippines** | 4.2 | - | 3.6 | - | 9.9 | - | 7.1 | - | 4.69 | Steady | 7.49 | Lower |
| **Singapore** | 2.5 | - | 1.2 | - | 6.4 | - | 3.0 | - | 0.65 | Higher | 2.07 | Steady |
| **South Korea** | 4.2 | - | 2.8 | - | 4.8 | - | 3.6 | - | 2.96 | Lower | 4.71 | Lower |
| **Taiwan** | 3.7 | - | 2.5 | - | 3.8 | - | 2.5 | - | 0.74 | Steady | 1.53 | Steady |
| **Thailand** | 4.5 | - | 3.2 | - | 6.5 | - | 3.7 | + | 2.22 | Lower | 3.47 | Lower |

Consensus Forecast, ING Bias ("+" Higher, "0"in line, "-" Lower than Consensus Forecast)
* Australia 90 day BBSW Rate, Hong Kong, Malaysia, Singapore, Indonesia and Thailand 90 Day Interbank Rate, Japan and Korea 3 months CD Rate, China 1 Year Deposite Rate, India 90 Day Treasury Bill and Taiwan 90 Day Commercial paper Secondary Mkt
# Asia Pacific Consensus Forecasts - Consensus Economics Inc.

*Source: ING IM Internal Research Team*

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