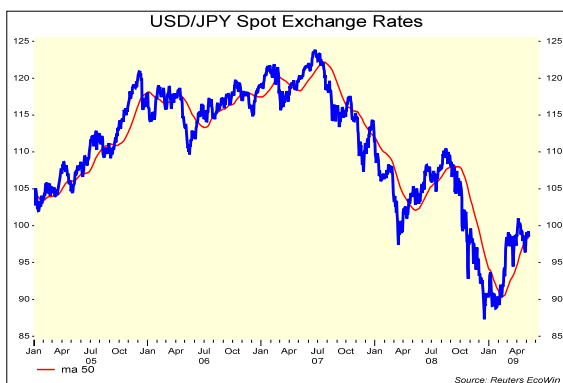
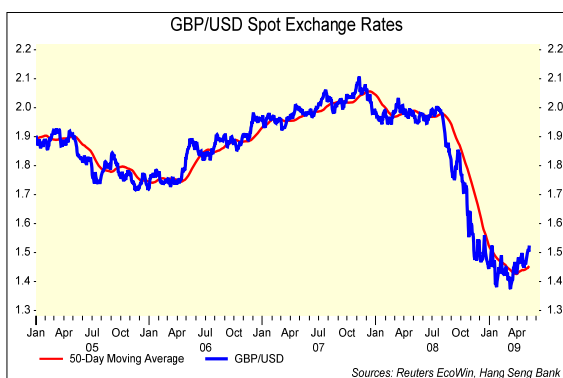


❖ Currencies are being driven by risk appetite. Better economic reports from Europe, Asia and the US raised hope that the deepest economic slump in decades might be stabilizing. Investors were also relieved that results of the stress tests on US banks contained no surprises and became more willing to take on riskier assets. None of the 19 banks examined faces insolvency; but 10, including Bank of America, Wells Fargo, Citigroup, etc., need to raise capital by a total of USD74.6 billion. These 10 banks will have until June 8 to develop a plan to raise the required capital and until November 9 to implement it.



❖ With risk appetite returning, global stocks surged to multi-month highs. In fact, many major stock indices, including the Nasdaq, FTSE 100, and Hang Seng Index, are higher than their start of the year levels. The higher yielding currencies, considered to be riskier, also returned to favour. The Australian dollar gained about 8.6% against the dollar and nearly 19% versus the Japanese yen since the start of the year. The New Zealand dollar, the British pound and the Canadian dollar also strengthened versus the greenback by a margin of 4% to 6% during the same period. In contrast, the Japanese yen was the worst performer. It has lost about 8.6% against the dollar as flight to safety demand waned.



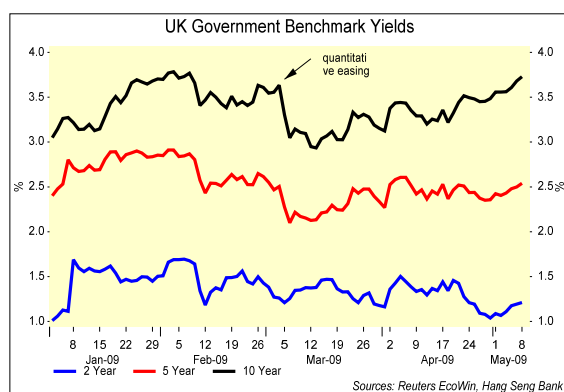
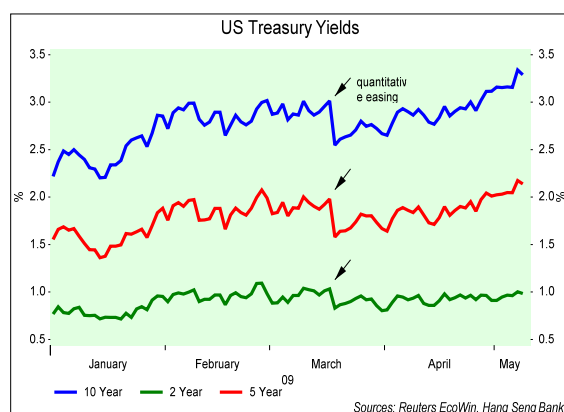
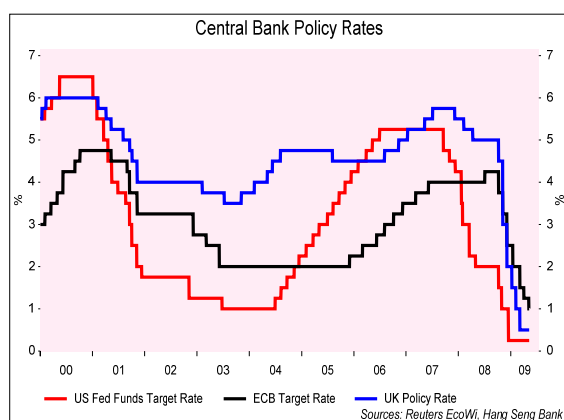
❖ Looking ahead, trading is likely to be dictated by risk sentiment in the near term. As more less-negative economic data could be released, the dollar could come under more selling pressure. Technical traders also say that the greenback could head lower as the dollar index, measuring the value of the greenback against a basket of major currencies, has recently dropped below its 200-day moving average for the first time since August 2008.

	2008Q4	2009Q1	2009Q2F	2009Q3F	2009Q4F
EUR/USD	1.3971	1.3250	1.40	1.50	1.60
USD/YEN	90.64	98.96	98.00	95.00	90.00
GBP/USD	1.4593	1.4323	1.50	1.55	1.60
AUD/USD	0.7026	0.6913	0.75	0.78	0.80
NZD/USD	0.5792	0.5595	0.60	0.63	0.65
USD/CAD	1.2188	1.2602	1.15	1.12	1.10
USD/CNY	6.8346	6.8359	6.80	6.80	6.80

Note: End of period figures

Sources: Bloomberg L.P., Hang Seng Bank



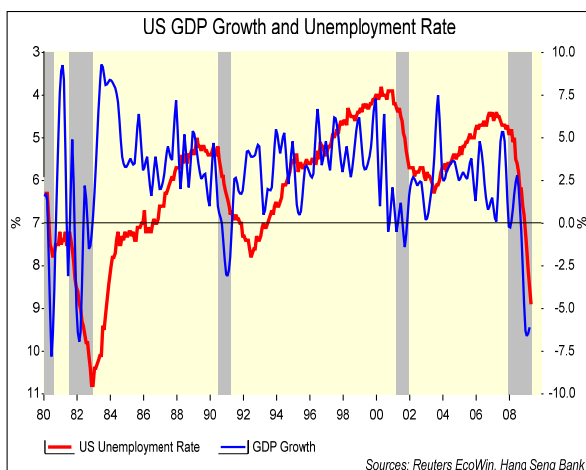
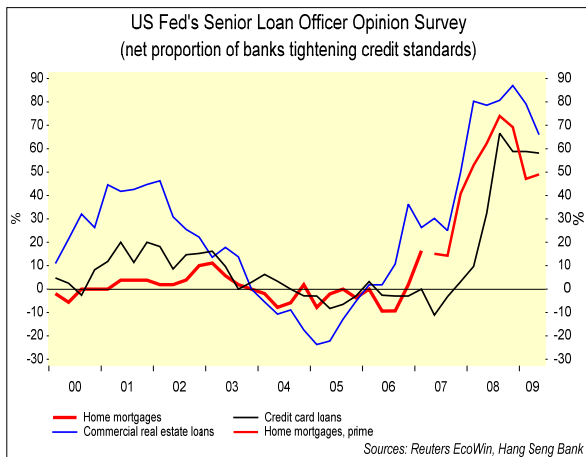
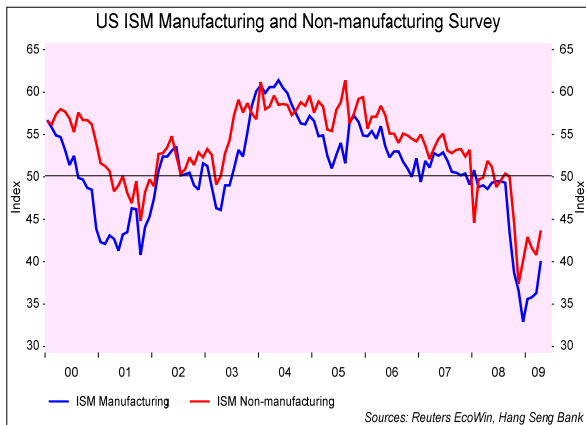


- ❖ With interest rates in major economies approaching zero, the race to zero is almost over, and central banks are now increasingly resorting to non-conventional monetary policy tools in an attempt to revive the growth engine.
- ❖ Even the European Central Bank decided to undertake a limited scale of bond purchase. The Bank announced after its policy meeting on May 7 that it would cut its benchmark interest rate by a quarter point to a record low of 1% and buy EUR60 billion of covered bonds. While the size of the bond purchase was smaller than the asset purchase plans previously announced by the US Fed and the Bank of England, it represented a shift in the ECB's monetary policy stance. It was the bank's first purchase of bonds and could be taken as the first step on a path of quantitative easing.
- ❖ Meanwhile, the Bank of England kept its key rate unchanged at 0.5% at its May 7 meeting but decided to expand its programme of asset purchases from an initial GBP75 billion to GBP125 billion as the initial impact of its easing moves seemed to be fading. Government bond yields in both the US and UK have rebounded from their low levels in recent weeks as investors became increasingly concerned that central banks' quantitative easing programmes would ultimately spark inflation.
- ❖ The Fed also decided at its latest policy meeting to keep the fed funds target rate at a range of zero to 0.25% for the third straight meeting and repeated its intention to keep the target rate low for an extended period. However, it refrained from increasing the purchases of Treasuries and mortgage securities for now. While Fed officials said that the pace of contraction in the US economy seemed to be slowing, they did not expect a strong recovery anytime soon.

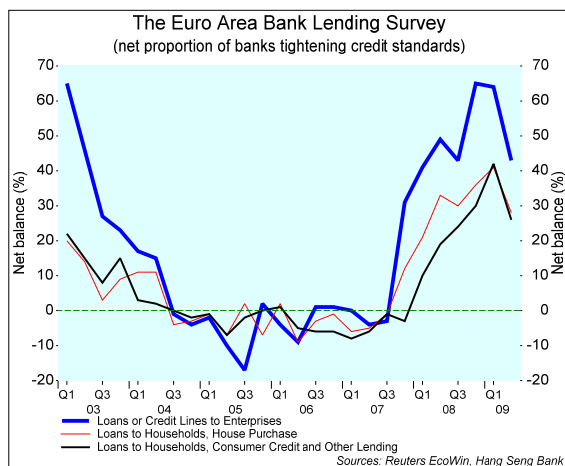
(%)	2008Q4	2009Q1	2009Q2F	2009Q3F	2009Q4F
US Fed Funds Target Rate	0 - 0.25	0 - 0.25	0 - 0.25	0 - 0.25	0 - 0.25
Japanese Target Rate	0.10	0.10	0.10	0.10	0.10
Euro Refinancing Rate	2.50	1.50	1.00	1.00	1.00
British Repo Rate	2.00	0.50	0.50	0.50	0.50
Australian Cash Rate	4.25	3.25	2.75	2.50	2.50
Canadian Bank Rate	1.50	0.50	0.25	0.25	0.25

Note: End of period figures  
Sources: Central Bank Data, Bloomberg L.P., Reuters, Hang Seng Bank





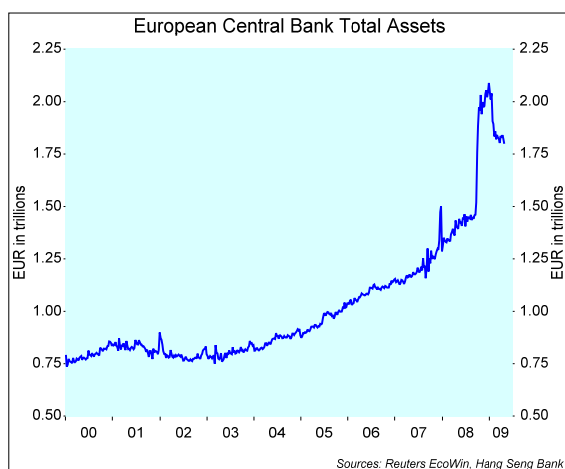
- ❖ Economic reports in the past two weeks indicated that more “green shoots” have sprung up in the US economy, raising hope that the worst of the downturn might be over. It must be noted, however, that while the trough of the recession might have been reached, a quick recovery is not guaranteed as US consumers are still saddled with debts built up during the boom years and banks have to raise more capital to tie them over the bad times.
- ❖ The more positive economic reports that have been released in the past fortnight include some leading indicators of the US economy, including consumer confidence and ISM manufacturing and services indices. The Fed also acknowledged the latest improvement in economic conditions in its statement released after the FOMC meeting on April 29. The Fed said that while the economy continued to contract, the pace of contraction seemed to be slowing.
- ❖ However, the Fed Chairman noted that a rebound was conditional on the continuing repair of the financial sector, and that it would be slow and that the jobless rate would still rise for many months.
- ❖ In fact, the US economy contracted at a steep 6.1% annual pace in the first quarter, after declining 6.3% in the final quarter of last year. US GDP has already fallen for three consecutive quarters, the first time this has happened since 1974-75. A breakdown of the GDP data showed that while consumer spending rose at an annual rate of 2.2% during the quarter, fixed investment plunged at a record pace of 38%.
- ❖ The US economy continued to lose jobs. While US employers cut jobs at a slower pace in April, it was mainly due to the fact that the government hired more temporary workers in preparation for the 2010 census. The US economy has already lost 5.7 million jobs since the recession started in December 2007. The unemployment rate also surged to 8.9 percent, the highest in 25 years. Consensus forecast sees the unemployment rate rise further to 9.5% by year-end and reach double-digits by early next year.



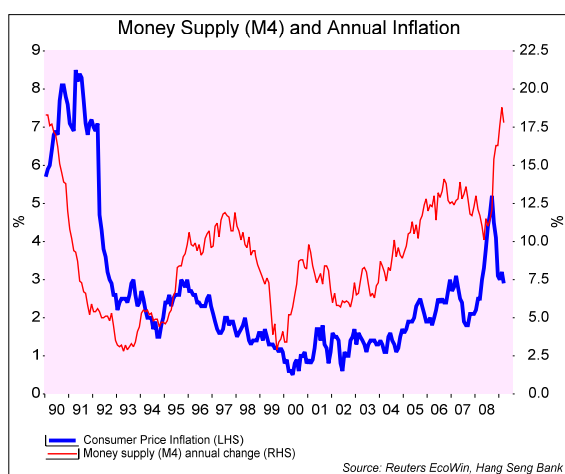
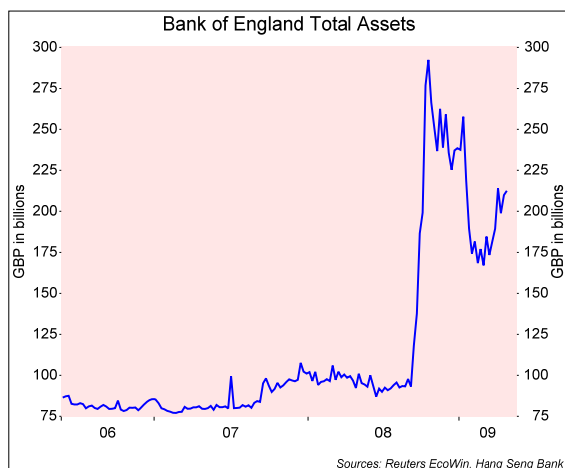
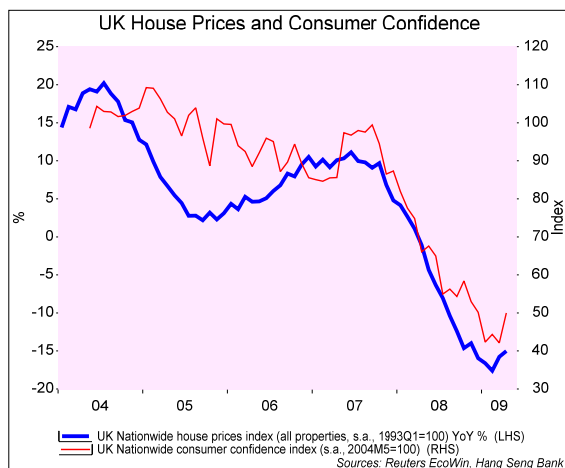
European Commission's spring forecast, May 09			
(for the euro area)	2008E	2009F	2010F
GDP	0.8%	-4.0%	-0.1%
Inflation	3.3%	0.4%	1.2%
Unemployment	7.5%	9.9%	11.5%
Budget balance of GDP	-1.9%	-5.3%	-6.5%
Debt balance of GDP	69.3%	77.7%	83.8%
Current account of GDP	-0.8%	-1.4%	-1.5%

E: estimates; F: forecasts

Source: European Commission, Hang Seng Bank



- ❖ Signs of economic stabilization have emerged in the euro area, as in the United States. The slowdown on the rate of contraction raised hopes that the severe downturn has hit its trough in the first few months of the year.
- ❖ The composite purchasing managers' index for manufacturing and services, for example, has risen for two months in succession. Measures of public confidence were also somewhat elevated although they remained relatively low.
- ❖ Even the credit market has now shown some signs of easing. The European Central Bank's lending survey indicated that the net proportion of banks which tightened credit standards on loans to enterprises during the first quarter fell to 43% from 64%. Likewise, the tightening of lending standards for house purchase and consumer credit has moderated.
- ❖ However, economic weakness still appeared in certain areas of the economy, suggesting the ongoing of the current downturn. Labor market conditions are deteriorating, with the jobless rate rising to a multi-year high of 8.9% in March. Consumers are cutting back their spending, as retail sales declined further in March.
- ❖ In this context, the European Commission expects a deep recession in 2009. The economy will shrink 4% and the unemployment rate will almost reach a double-digit level. While a recovery will take place in 2010, economic activity will still contract 0.1%.
- ❖ On 7 May, the ECB intensified their efforts to counter the contraction by cutting its interest rates to 1% from 1.25% and extending the maturity of liquidity provision to 12 months from 6 months. Moreover, it will give the European Investment Bank access to its money market auctions in a bid to provide funds for companies and will buy EUR60 billion of covered bonds, which are backed by mortgages or public sector loans.
- ❖ The purchase plan is regarded as a move to restore confidence in the housing market, as covered bonds are a major source of funding for mortgage lending. But some criticize that the size of purchase is too small for it represents about 5% of the market. In this case, the ECB will just expand its balance sheet by 3.3%. It will certainly have room to do more over the next few months.



- ❖ The correction in the domestic housing sector, in addition to the intensification of the global financial crisis, has been a serious drag on the United Kingdom economy. But recent information suggested that the pace of decline in housing activity had begun to slow.
- ❖ Home prices have held steady over the past few months, although they are still some 15% below the levels a year earlier. The number of loans approved for house purchase has also increased during the same period, in part reflecting the easing of the tightened credit market conditions.
- ❖ The indications of stabilization in the residential property market have in turn helped improve consumer confidence. Nationwide's consumer sentiment index rose to 50 in April from 42 a month before. This raises hopes that economic activity will regain momentum should consumers increase spending again.
- ❖ However, policymakers are cautious. In its policy statement earlier this month, the Bank of England judged that the economic outlook was highly uncertain and as a result decided to maintain its benchmark interest rate at a historical low of 0.5%. Even though it has just used about GBP52 billion out of its GBP75 billion asset purchase plan, the Bank rushed to make a promise of expanding the size of the program by GBP50 billion to a total of GBP125 billion.
- ❖ The new injection, which will take a period of three months, means almost all the GBP150 billion allocated for the quantitative easing approach will be used. More importantly, the move highlighted the Bank's determination to combat the recession as the purchase of GBP125 billion equals to about 134% of the monetary base.
- ❖ This huge supply of liquidity into financial markets has however fuelled concerns about inflation. In particular, money supply (M4) has increased at an annual rate above 17%, the level that is not seen in decades. Although the Bank has so far played down the risk of inflation with the buildup of resource slack, upward price pressures could mount as the economy stabilizes.

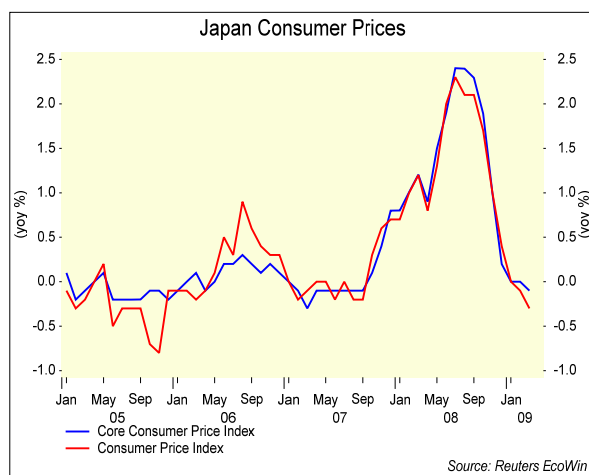
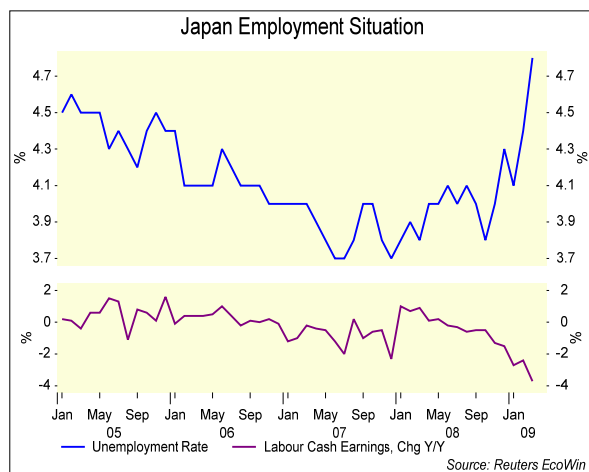
### The Bank of Japan's Forecasts

	(yoy % chg.)	
	Real GDP	Core CPI
<b>FY 2009</b>	-3.7 to -3.0 (-3.1)	-1.6 to -1.4 (-1.5)
<i>October's Forecast</i>	-2.5 to -1.9 (-2.0)	-1.2 to -0.9 (-1.1)
<b>FY 2010</b>	+0.8 to +1.5 (+1.2)	-1.1 to -0.8 (-1.0)
<i>October's Forecast</i>	+1.3 to +1.8 (+1.5)	-0.6 to 0.0 (-0.4)

Note :

- a) Forecasts based on Majority of Policy Board Members
- b) Assumption of no change in monetary policy
- c) Brackets indicate median of the forecasts
- d) Fiscal year is ending on March 31

Source : Bank of Japan



- ❖ Economic data were mixed in the past two weeks.
- ❖ Employment situation continued to worsen. The job-to-applicant ratio, a measure of vacancies, fell to 0.52 in March. Jobless rate also jumped to a four-year high of 4.8% in March from 4.4% in the previous month.
- ❖ Japanese consumer prices fell for the first time since September 2007, though the magnitude of decline was less than expected. Core consumer price index, excluding volatile fresh food prices, dropped 0.1% in March from a year ago, dragged by lower transportation and communication prices. This provided a sign that deflation would resurface in the coming months.
- ❖ Anxiety over the economy also trimmed household spending. Retail sales dropped 3.9% in March from a year earlier, the deepest decline in almost four years. Overall household spending extended its decline by 0.4%.
- ❖ The only optimism came from industrial production which reported a 1.6% gain in March after five months' decline. The figure was also better than expectations of a mere 0.8% increase. Manufacturers predicted output to rise 4.3% and 6.1% respectively in April and May respectively.
- ❖ The Bank of Japan published its latest semi-annual "Outlook for Economic Activity and Prices" report on the last day of April. The Bank remarked that "economic conditions are likely to continue deteriorating in coming months but gradually level out thereafter, and the growth rate is expected to recover at a moderate rate from the second half of 2009".
- ❖ The Central Bank revised downward the economic growth in Japan in both FY2009 and FY2010, forecasting that the economy will contract 3.1% (median forecast) for FY2009 ending 31 March 2010, a 1.1 percentage point lower than its previous projection, while the growth for FY2010 is expected to be 1.2%.
- ❖ On the price front, the policy makers forecast deeper price declines. Core consumer prices were expected to go down by 1.5% for FY2009, compared with last October's estimate of -1.1%. 0.5% next fiscal year. Prices would drop further by 1% in FY 2010.

# Global Market INTELLIGENCE

Treasury Division

11 May 2009

## Key Economic Forecast Update

(Percent)	US			Euro Zone			Japan		
	2007	2008	2009F	2007	2008	2009F	2007	2008	2009F
Real GDP	2.0	1.1	-3.0	2.6	0.5	-3.0	2.1	-1.5	-5.0
CPI Inflation Rate	2.9	3.9	-0.5	2.1	3.3	0.5	0.1	1.4	-1.0
Unemployment Rate	4.6	5.8	9.0	7.4	7.5	10.0	3.9	4.0	5.5
Official Short Rate #	4.25	0 - 0.25	0 - 0.25	4.00	2.50	1.00	0.50	0.10	0.10
10-Year Bond Yield #	4.02	2.21	4.00	4.31	2.95	3.50	1.51	1.17	1.80

Notes: # End-of-period data; F - Forecasts

## US Dollar Forecast Update

	2008Q4	2009Q1	2009Q2F	2009Q3F	2009Q4F
EUR/USD	1.3971	1.3250	1.40	1.50	1.60
USD/YEN	90.64	98.96	98.00	95.00	90.00
GBP/USD	1.4593	1.4323	1.50	1.55	1.60
AUD/USD	0.7026	0.6913	0.75	0.78	0.80
NZD/USD	0.5792	0.5595	0.60	0.63	0.65
USD/CAD	1.2188	1.2602	1.15	1.12	1.10
USD/CNY	6.8346	6.8359	6.80	6.80	6.80

Note: End-of-period figures

## Interest Rate Forecast Update

	2008Q4	2009Q1	2009Q2F	2009Q3F	2009Q4F
US Fed Funds Target Rate	0 - 0.25	0 - 0.25	0 - 0.25	0 - 0.25	0 - 0.25
Japanese Target Rate	0.10	0.10	0.10	0.10	0.10
Euro Refinancing Rate	2.50	1.50	1.00	1.00	1.00
British Repo Rate	2.00	0.50	0.50	0.50	0.50
Australian Cash Rate	4.25	3.25	2.75	2.50	2.50
Canadian Bank Rate	1.50	0.50	0.25	0.25	0.25

Note: End-of-quarter figures

Sources: Central Bank Data, Bloomberg L.P., Reuters, Hang Seng Bank

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