

Economy

China: The Chinese economy grew by nearly 11% in inflation-adjusted terms in the first half of 2006, compared to the same period last year. China's current-account surplus in the first half of the year totaled \$91.58 billion, exceeding \$67.26 billion in the same period a year earlier. Despite the concern for a rising trade surplus and a speculative high-end residential niche market, the economy was bolstered by a growing surplus in trade in goods. This shows a balanced fast-growing economy instead of an overheating one. China increased interest rates in April and August in order to choke off excess investment. Benchmark one-year bank lending rates were raised 0.27 percentage points to 6.12% and one-year deposit rates were raised to 2.52% by the same margin.

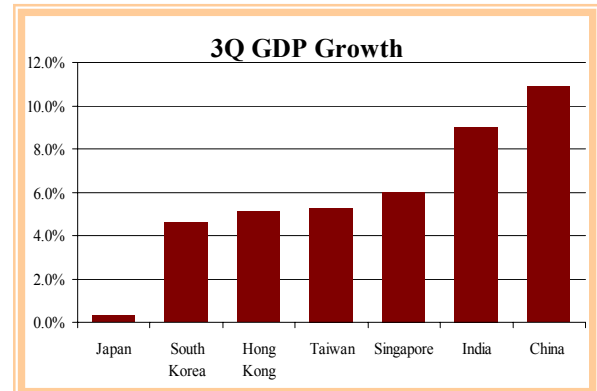
Hong Kong: Hong Kong's growth rate for the first half of the year is 6.6% from the same period last year. The economy stagnated after two years in which GDP expanded surprisingly, 8.6% in 2004 and 7.3% in 2005, partly due to the weakness in the U.S. and a slowdown in China, its close trading partners. It expects the figure for the whole of 2006 to be close to 5%.

Taiwan: Taiwan's economy grew by 5.27% from the same period last year. The semiconductor and LCD industries kept expanding. Exports rose to a record due to solid demand for electronic goods and steel products. Exports led GDP growth.

South Korea: South Korea's second quarter GDP growth rate of 5.7% was in spite of very weak domestic demand, especially private investment and consumption. Their targeted GDP growth rate of 4.6% in 2006 is mainly dependent on the export markets. Korea's IT export portion was 34% of its trade revenue; which ranked as the top among OECD member countries. Korea's net exports were 70% of its GDP, with the capital account, tracking cross-border investments, posted a net inflow of US\$1.2 billion, compared with a net outflow of \$1.7 billion. Korean overseas investment reached \$5 billion in 2005 and is expected to reach \$6.5 billion in 2006. North Korea's nuclear experiment on October 9th, does not pose an economic threat to South Korea because most economic entities were aware of North Korea's behavior and the success of its nuclear experiment was unclear.

India: India's economy posted growth of 9.3% and 8.9% in the first two quarters of 2006 over the same periods in the prior year. The annualized growth rate was 8% - in line with the average growth for the past three years. The momentum is expected to hold through 2007 due to an impressive 12.4% year-on-year growth in industrial output. The inflation rate climbed to 5.16% due to supply constraints. An interest rate hike is expected in the quarterly review of monetary policy on October 31, in view of a 30% surge in loan growth. At present, the benchmark one year bank lending rate is at 6%. India's current-account deficit (CAD) widened in the first fiscal quarter to US\$6.1 billion, exceeding US\$13.6 billion in the same period a year earlier. India is currently the only leading economy in South Asia, other than Thailand, that has a CAD. If the downward trend in crude oil prices during this quarter continues, India is expected to reduce the deficit substantially.

Japan: The end of zero interest rates and the end of deflation. On July 14, the Bank of Japan ended its zero interest rate policy after six years and raised its target overnight call rate to 0.25 percent. GDP growth of 2.5% in 2Q was lower than the 3.6% growth in 1Q and lower than the market expectation. The core CPI, which excludes volatile prices of fresh food but includes energy prices, rose 0.3% from a year earlier in August, the third straight monthly increase. Overall CPI rose 0.9% from a year earlier, the fourth consecutive monthly gain. Because of steady economic expansions and gradual increase in inflation rate, it is expected that the Japanese government will announce "the end of deflation" in October's Monthly Economy Report.



Markets

China: China's central bank plans to publish daily short-term Yuan interest rates by launching the Shanghai Interbank Offered Rate, or Shibor, that would become the benchmark for financial products. This is the latest step by regulators to build a market-oriented credit system. Banks would provide daily bid-and-offer rates in a range of maturities, from overnight to one year, showing the cost of credit for China's nascent Yuan money markets.

China launched its first financial futures exchange on September, for the purpose of eventually giving the country's companies a variety of tools to hedge financial risks. The first actual trading of futures based on the Shanghai Shenzhen 300 Index is still on the way and unlikely to be executed until the end of the year even though mock trading will start on September. While China has a commodities-futures exchange, it hasn't allowed trading in financial futures since a bond-futures market was shut down a decade ago to rein in speculation.

South Korea: The Korean Stock market has been fluctuating inside a boxed range on the Korea Composite Stock Price Index, KOSPI between 1,300 and 1,350, with the index remaining around 1,330 for several months. The KOSPI was at 1,325.49 as of October 11. Some experts predict that the Korean stock market will grow because more investors are depositing money in mutual funds on a regular basis and the inflow to the market is increasing. Total funds were \$10.3 billion as of October 11.

Korea's housing market has been growing since 1998. Some hot spots in Seoul recorded highs, with an average increase of 6.6% for the six months since March. The growth rate of other suburban areas averaged 8.2%. Since August, the level of regulation on overseas investment by Koreans has been lowered, with some hot money in Korea flowing, for example, into the US housing market.

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Hot Topic

IPO Mania for China's Banks

With the announcement of the world's largest fund raising effort in history, the Industrial and Commercial Bank of China (ICBC) is slated to cap off a spat of recent Chinese Bank IPO's at the end of October when it lists on the Shanghai and Honk Kong exchanges to the tune of US\$22 billion. ICBC's issuance will upstage the largest issuance to date of US\$18.4 billion by Japan's NTT Mobile Telecomm in 1998, and will comprise most of the US\$50 billion in Chinese IPOs in 2006.

ICBC is planning a dual exchange listing, following the A+H model, listing H shares on the Hong Kong exchange (alone, accounting for up to US\$16 billion), with the remaining A shares listed on the Shanghai exchange. The dual listing will provide incentive for the mainland market to cooperate with the capital raising city of Hong Kong, further internationalizing the Shanghai market.

ICBC marks the third of China's "Big Four" banks that has gone public in the past year, beginning with the China Construction Bank (CCB) last October, the Bank of China (BOC) in June, with the Agricultural Bank of China slated for IPO in 2007. China Merchants Bank (CMB), the sixth largest bank in China, went public last month and analysts say that investor interest is not waning.

This rash of fund raising efforts underlies the need for Chinese banks to become competitive on an international stage. Beijing has injected billions into the Big Four government controlled banks to reduce the level of non-performing loans, and now with emboldened balance sheets, they are reaching to the equity markets to fuel further growth. That growth is necessary if they wish to compete with foreign banks entering the Chinese market at the end of 2006. In accordance with membership in the World Trade Organization, China has agreed to phase in regulations that will allow foreign banks to do everything that domestic banks can – from mortgages to Internet banking.

While the Big Four remain heavily influenced by the Chinese government, the influx of foreign capital, and thus, foreign ownership, will create new transparency in a historically opaque market. Smaller banks that lack the market strength for public fund raising are seeking foreign partners to bolster their market expertise in attempt to siphon profits from the fast growing economy. As the Chinese economy sets the stage for the Beijing Olympics in 2008, its banking sector has taken the lead to fuel domestic development.

Chinese IPO Bank History

- **October, 2005:** China Construction Bank – US\$7.64 billion
- **June, 2006:** Bank of China – US\$11.2 billion (*after exercise of over allotment*)
- **September, 2006:** China Merchant Bank – US\$2 billion
- **October, 2006:** Industrial & Commercial Bank of China – US\$22 billion
- **2007:** Agricultural Bank of China – TBD

IPO/M&A

South Korea: GMarket listed on the Nasdaq under the ticker "GMKT" on June 29 closing down from its open of US\$19.10 to US \$15.10. Like eBay in the United States, the Seoul-based company operates an online marketplace in Korea.

Japan: 1) Japan's largest social networking website, Mixi, listed shares on the Mothers market of the Tokyo Stock Exchange on September 14. With 7,100 shares sold, Mixi's market cap is 220 billion Yen (US\$1.9 billion) 1.55 million Yen offering price. The company has revenues of 1.89 billion Yen and net profits of 576 million Yen in FY2005; 2) GCA Co., a Japanese corporate merger and acquisition advisory company, debuted on the Tokyo Stock Exchange's Mothers market for emerging companies on October 6, closing at 295,000 Yen per share; 60,000 Yen above its initial public offering price, settling to an 81.9 billion Yen market cap on October 27. GCA is the only independent M&A advisory company in Japan which is not affiliated with any major banks or securities firms.

China: 1) Wal-Mart Stores Inc.'s acquired Trust-Mart, a Taiwanese competitor, for close to US\$1 billion. Facing stiff competition from Carrefour SA and local players, this acquisition establishes a footprint for Wal-Mart to expand its reach in China as they tackle the obstacles posed by a weak infrastructure in China; 2) Starbucks Corp. bought High Grown Investment Group Ltd from its joint venture partner to raise its ownership stake. High Grown Investment Group Ltd has a 90% controlling share in Beijing Mei Da Coffee Co., which has operated stores in Beijing and Tianjin. This acquisition allows Starbucks to maximize the development of its business in China for the next 20 or 30 years.

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Markets

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India: Friday, the 13th (October) turned out to be the best day for the bulls in the Indian markets with the BSE Sensex reaching an all time high of 12756.23. The market capitalization has remained flat at approximately US\$70 billion. Reasons for the rise were the greater than 25% drop in the crude oil prices and increased foreign capital inflow due to better than expected earning performance by Indian corporations. The large cap BSE Sensex grew by 49% over the last 12 months as of September 30, compared to 33% and 15% growth of mid-caps and small caps respectively.

The Government of India has decided to issue oil bonds worth US\$ 3 billion to compensate the oil firms from the losses incurred in April-September 2006. The Chicago Mercantile Exchange has disclosed its intentions to enter Indian commodities markets and to help the Indian derivatives trade outside India.

Japan: The global stock decline in May hit Japan's stock market hard and the Nikkei 225 Index closed down to 14,000 Yen in June. Because of steady growth in consumer spending and strong 2Q corporate earnings in Japan of 12%, the Nikkei hit 16,127.58 at the end of September. This was 8% lower than its high in April and it is still down 1% in 2006.

Due to the lower than expected inflation rate increase in July and other weak economic data, the market expectations for another rate hike in 2006 diminished and the JGB 10-year yield closed down to 1.6%. The slower pace of growth of the Japanese economy and slower BOJ rate hikes will decrease expectations for a smaller spread between US and Japanese rates. As a result, Japanese investors continue to invest in the US treasury, which continues to cause declines in the Yen against the US dollar.