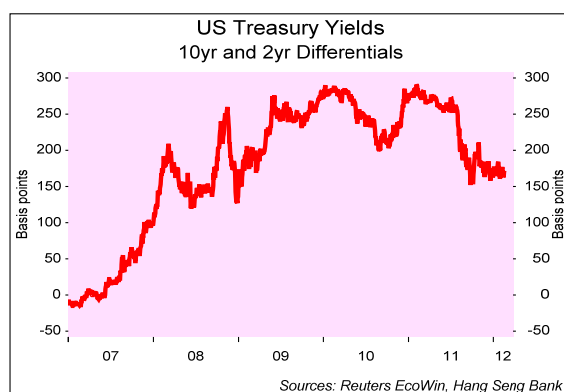
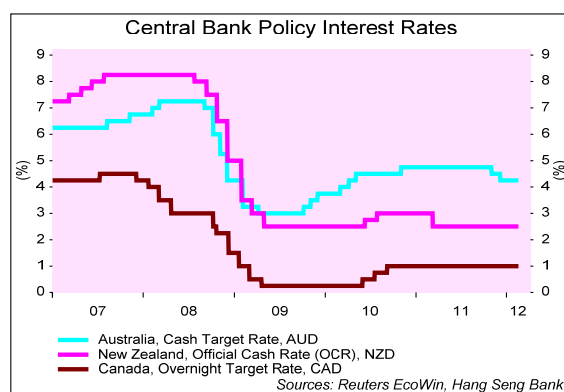
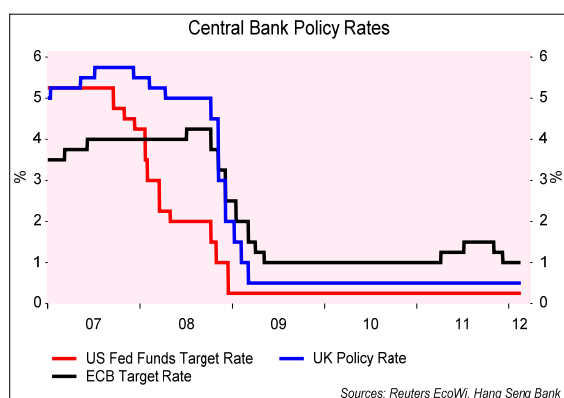


- ❖ Greece was the market's main focus over the past two weeks. Investors spent days awaiting news from Greece as the country had to cross one hurdle after hurdle to avoid default, and they are still waiting.
- ❖ When Greek lawmakers on February 5 passed a package of measures, including wage, pension and job cuts demanded by the European Union and the International Monetary Fund for the second bailout totaling EUR130 billion, market was relieved. The news raised optimism that Greece would be able to refinance its debt due in March, thereby avoiding default. The euro and other commodity-linked currencies rebounded, but the rally was short-lived as eurozone finance ministers postponed a meeting scheduled for February 15 demanding more concrete actions, including a written commitment from Greece's leaders from different political parties to implement the tough austerity measures, as well as for the country to identify concrete measures to cut EUR325 million from this year's total budget. While both have now been fulfilled, Greece still has to reach agreement with its private bond holders about a debt swap.
- ❖ For the past two weeks, the dollar was little changed against other majors as uncertainty held back trading. Looking ahead, caution will continue to reign, but investors seem to be pricing in a benign scenario, that is, Greece would get financial support and that the debt problem would somewhat be resolved. Such expectations, coupled with more positive economic reports coming out of the US, and mainland China's latest decision to ease monetary policy, could lend some support to the riskier assets such as equities, the euro and higher yielding currencies such as the Australian and New Zealand dollars.

	2011Q4	2012Q1F	2012Q2F	2012Q3F	2012Q4F
EUR/USD	1.2959	1.30	1.28	1.28	1.28
USD/JPY	76.90	78.00	78.00	78.00	78.00
GBP/USD	1.5549	1.57	1.57	1.55	1.55
AUD/USD	1.0205	1.06	1.04	1.04	1.04
NZD/USD	0.7774	0.81	0.80	0.80	0.80
USD/CAD	1.0212	1.00	1.01	1.01	1.01
USD/CNY	6.3009	6.27	6.24	6.20	6.15

Notes: End of period figures; F denotes forecast
Sources: Bloomberg L.P., Hang Seng Bank





- ❖ The global economic outlook remains uncertain and central banks are forced to keep their ultra-loose monetary policy for longer, with some contemplating taking additional easing measures to further stimulate growth.
- ❖ The US Federal Reserve, for instance, vowed to maintain a highly accommodative monetary policy stance for a longer period as it expected US economic growth to remain modest and the unemployment rate would decline only gradually. The Fed also saw strains in global financial markets to pose significant downside risks to the economic outlook. In the event, the central bank decided to keep short term interest rates near zero at least until late 2014, longer than previously indicated, and maintain existing policies of quantitative easing. Moreover, Fed Chairman Ben Bernanke said in the post meeting news conference that more monetary stimulus is possible if economic conditions deteriorate. Many expect this to be in the form of purchases of mortgage-related debt securities as it may help jump start a recovery in the still weak housing market.
- ❖ Similarly, the Bank of Japan is also concerned about Japan's economic outlook and decided to expand the size of its asset purchase programme. At its latest meeting on February 14, the central bank said that Japan's economic activity had been flat as a result of a slowdown in overseas economies and the appreciation of the Japanese yen. As the economic outlook was also uncertain, the BOJ decided not only to keep interest rates near zero, but to increase the total size of its asset purchase programme by about JPY10 trillion, from JPY55 trillion to JPY65 trillion. Its action was not surprising as latest data showed that Japan's economy shrank by a larger than expected 2.3% on an annualized basis in the final quarter. For 2011 as a whole, it contracted 0.9%. In addition, the central bank also sees consumer price inflation of 1% as a policy goal.

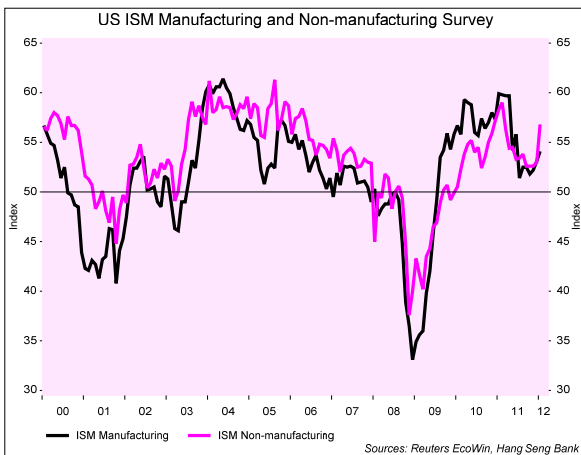
(%)	2011Q4	2012Q1F	2012Q2F	2012Q3F	2012Q4F
US Fed Funds Target Rate	0 - 0.25	0 - 0.25	0 - 0.25	0 - 0.25	0 - 0.25
Japanese Target Rate	0 - 0.10	0 - 0.10	0 - 0.10	0 - 0.10	0 - 0.10
Euro Refinancing Rate	1.00	1.00	0.75	0.75	0.75
British Repo Rate	0.50	0.50	0.50	0.50	0.50
Australian Cash Rate	4.25	4.00	3.75	3.75	3.75
New Zealand Cash Rate	2.50	2.50	2.50	2.50	2.50
Canadian Bank Rate	1.00	1.00	1.00	1.00	1.00

Notes: End of period figures; F denotes forecast
Sources: Central Bank Data, Bloomberg L.P., Reuters, Hang Seng Bank



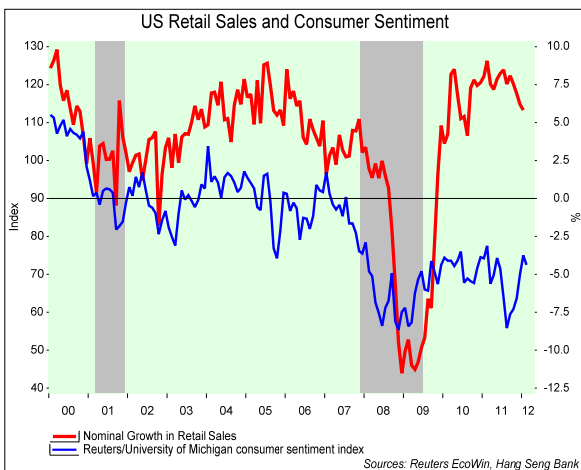
US Economy

20 Feb 2012



- ❖ The US economy continued to expand at a slow pace. However, the US Federal Reserve remains pessimistic about the US economic outlook. Three areas are of particular concern.

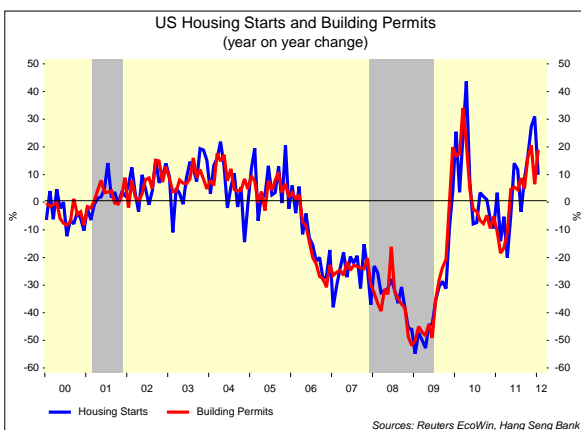
- ❖ Firstly, unemployment remains at relatively high levels. Private payroll employment increased by about 160,000 jobs per month in 2011, and the unemployment rate fell by about one percentage point. However, the Fed was not satisfied, highlighting the low employment to population ratio, the unusually high level of long-term unemployment. Fed Chairman said that there was still a long way to go before the labour market could be said to be operating normally.



- ❖ Secondly, US housing market remains relatively weak despite the latest rebound in construction activities. While low mortgage interest rates and a drop in home prices have improved the affordability of housing, home sales remain depressed against a background of uncertain job prospects and tight mortgage credit conditions.

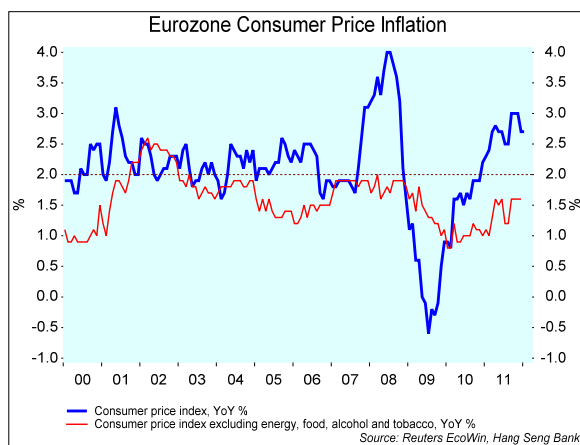
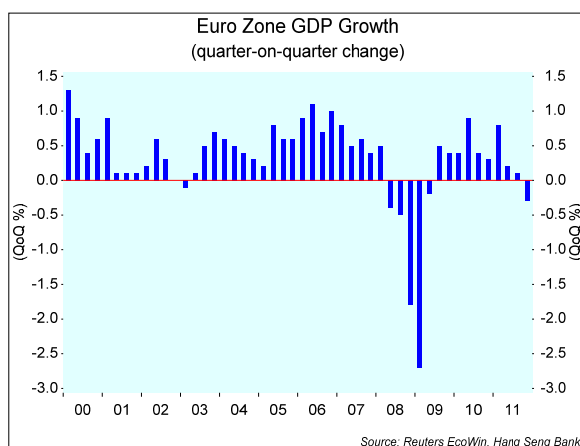
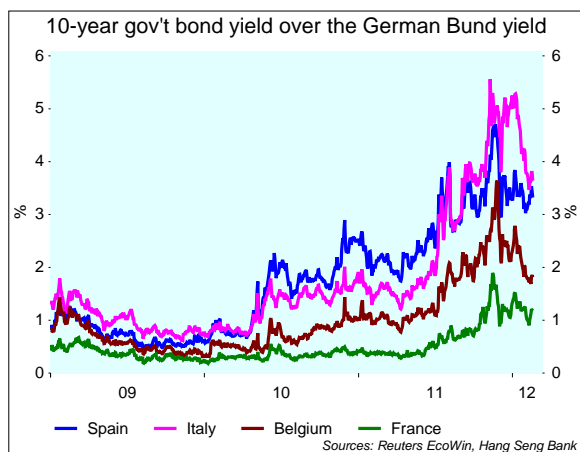
- ❖ A third area of concern is the global economy which shows clear signs of slowing, in part due to fiscal and financial developments in Europe.

- ❖ All three could have a dampening effect on US household spending. As an indication, retail sales rose by only 0.4% in January, slower than expected. "Core" retail sales, which go into the calculation of US GDP, rose 0.7% after declining 0.4% in December. Core sales strip out volatile items in the index, including autos, gasoline and building materials.

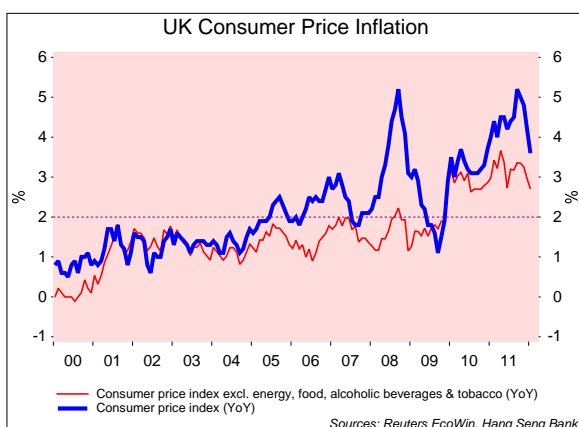
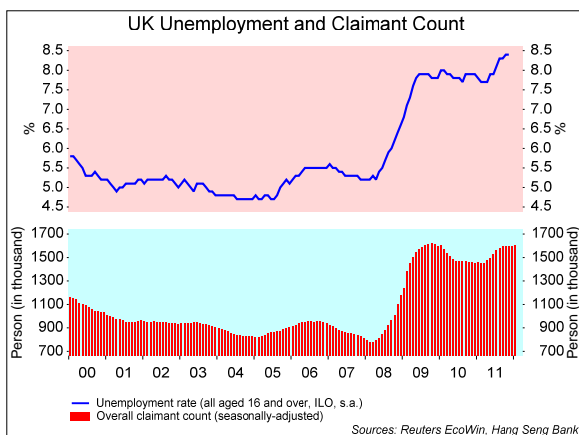
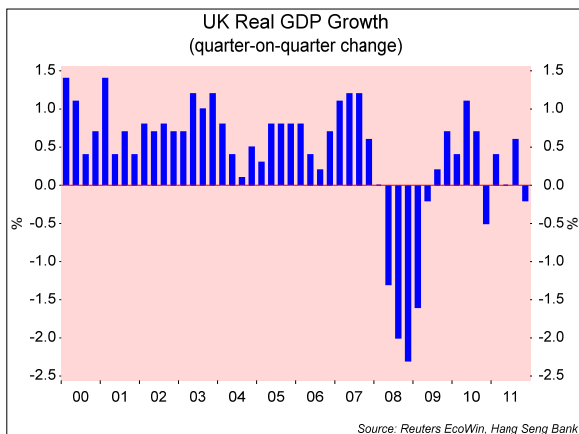


- ❖ With consumer spending accounting for about 70% and being a major contributor to growth, overall growth could be affected.





- ❖ Eurozone countries are still facing the sovereign debt crisis, although many of them have made efforts in cutting deficit and debt over the past few years. In exchange for a second EUR130 billion bailout to avoid a debt default, Greece has recently agreed to implement more austerity measures, including a 22% reduction in the minimum wage and spending cuts of 1.5 percentage points of national income.
- ❖ However, before such fiscal consolidation plans begin to bear fruit and help debt-laden countries restore economic competitiveness, multiple rounds of spending cuts and tax rises have already weighed on economic activity in these nations. In the fourth quarter of last year, Greece's gross domestic product shrank by an annual rate of 7%, while the economies of Portugal and Italy contracted by 2.7% and 0.5% respectively.
- ❖ Growth is also slowing in the overall euro area, down to 0.7% in the fourth quarter from 1.3% in the previous three months. On a quarter-to-quarter basis, economic output even fell by 0.3%. The contraction was the first since the second quarter of 2009, highlighting the adverse impact of the region's fiscal crisis on the entire economy.
- ❖ In the years to come, the fiscal issues should continue to dampen eurozone economic activity for debt reduction is itself a long-term process. This assessment is shared by the European Central Bank, which sees only a gradual recovery in the course of 2012. In its latest forecasts, the central bank projected this year's GDP growth to be a range with a mid-point of 0.3%. Even for 2013, growth will only improve somewhat to 1.3%.
- ❖ Perhaps a positive note is that accommodative monetary policy is providing ongoing support to the eurozone's economy and financial markets. After the ECB's moves in December to offer longer-term loans to banks and ease collateral requirements, there have been some signs of stabilisation in the sovereign debt market and economic activity. Still, the risks to growth remain on the downside and additional monetary easing is possible.



- ❖ The eurozone debt problems remain a serious threat to the UK's recovery, as fiscal consolidation would slow the region's growth, dampening demand for British exports and reducing the country's production. Concerns about exposure to European sovereign debt would also undermine confidence in funding markets at home, potentially reducing the credit supply and increasing borrowing costs for firms and households.
- ❖ Indeed, in part reflecting these factors, UK gross domestic product fell by 0.2% in the fourth quarter after a 0.6% increase in the previous three months. For 2011 as a whole, growth was only 0.9%, well below its pre-recession levels of around 3%. The data proves that the road to recovery is uneven and much longer than many had expected. Until now, the economy has recovered only about half of the output lost during the contraction.
- ❖ Looking forward, growth is likely to remain weak as the debt crisis is still unresolved. The UK government's fiscal tightening also adds to the risks to the recovery. In its latest inflation report, the Bank of England indicated that growth could be volatile through 2012 and economic output was unlikely to return to levels prior to the recession until some time next year.
- ❖ As Mervyn King, BOE governor, noted in a press conference, consumer price annual inflation has already fallen half way back towards the 2% target, down from a three-year peak of 5.2% in September to 3.6% in January, as the effects of the past increases in value-added tax rates and energy and import prices have begun to diminish. Lower contributions from these factors, as well as subdued economic growth, should continue to ease inflationary pressures in the near term.
- ❖ The Bank of England judges that it is more likely than not that inflation will fall below 2% going forward. Therefore, at the February meeting, policy makers decided to expand the size of its asset purchase programme by GBP50 billion to a total of GBP325 billion and to maintain the benchmark interest rate at a historical low of 0.5%. They hope that the increase in gilts purchase will further lower interest rates and thus promote a faster recovery, but some observers are cautious about its extra benefits to the economy after several rounds of securities purchases.

Global Market INTELLIGENCE

Treasury Division

20 Feb 2012

Key Economic Forecast Update

(Percent)	US			Euro Zone			Japan		
	2010	2011F	2012F	2010	2011F	2012F	2010	2011F	2012F
Real GDP	3.0	1.7	2.2	1.9	1.5	-0.5	4.4	-0.8	1.7
CPI Inflation Rate	1.6	3.2	2.0	1.6	2.7	2.0	-0.7	-0.3	-0.3
Unemployment Rate	9.6	9.0	8.3	10.1	10.1	10.8	5.1	4.6	4.3
Official Short Rate #	0 - 0.25	0 - 0.25	0 - 0.25	1.00	1.00	1.00	0 - 0.10	0 - 0.10	0 - 0.10
10-Year Bond Yield #	3.30	1.88	2.60	2.96	1.83	2.80	1.13	0.99	1.30

Notes: # End-of-period data; E – Estimates F - Forecasts

US Dollar Forecast Update

	2011Q4	2012Q1F	2012Q2F	2012Q3F	2012Q4F
EUR/USD	1.2959	1.30	1.28	1.28	1.28
USD/JPY	76.90	78.00	78.00	78.00	78.00
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USD/CNY	6.3009	6.27	6.24	6.20	6.15

Notes: End-of-period figures; F denotes forecast

Interest Rate Forecast Update

	2011Q4	2012Q1F	2012Q2F	2012Q3F	2012Q4F
US Fed Funds Target Rate	0 - 0.25	0 - 0.25	0 - 0.25	0 - 0.25	0 - 0.25
Japanese Target Rate	0 - 0.10	0 - 0.10	0 - 0.10	0 - 0.10	0 - 0.10
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Canadian Bank Rate	1.00	1.00	1.00	1.00	1.00

Notes: End-of-quarter figures; F denotes forecast

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

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Hang Seng Treasury

– Joanne Yim
– Thomas Shik

Hang Seng Bank Limited

83 Des Voeux Road Central
Hong Kong



HANG SENG BANK

Member HSBC Group