

## Asia

## Weekly Watch

Hong Kong, June 21, 2010

## Economic Analysis

## Asia

Stephen Schwartz

stephen.schwartz@bbva.com.hk

Ricard Torne

ricard.torne@bbva.com.hk

Fielding Chen

fielding.chen@bbva.com.hk

Bingjie Hu

bingjie.hu@bbva.com.hk

Jenny Zheng

jenny.zheng@bbva.com.hk

Serena Zhou

serena.zhou@bbva.com.hk

Serena Wang

serena.wang@bbva.com.hk

## Markets

Richard Li

richard.li@bbva.com.hk

## Sentiment improves as financial market tensions ease in Europe

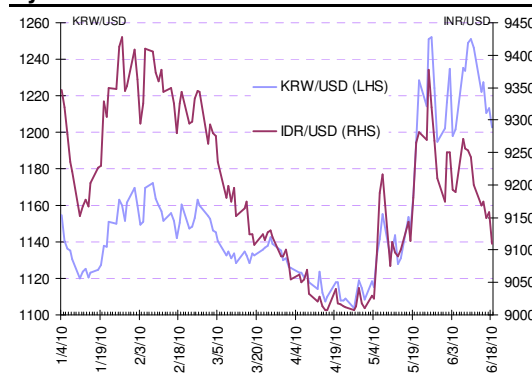
The past week was marked by strong gains in regional stock and currency markets. Improving sentiment in the US on fresh strong (though still mixed) indicators, and an easing in worries over Europe's sovereign debt crisis bolstered risk appetite, leading to inflows to higher-yielding assets across the region.

**Also bolstering sentiment was the announcement this past weekend by the People's Bank of China that it will allow greater flexibility in its currency.** Specifically, the authorities indicated they will put more emphasis on a basket of currencies, which could imply greater volatility in the exchange rate against the USD. The announcement has been widely interpreted as an indication of the authorities' willingness to allow appreciation ahead of the forthcoming G20 meeting (June 26-27), as has been sought by China's main trading partners. However, the authorities emphasized that any appreciation will be done gradually.

Elsewhere on the policy front across the region, Korea and Indonesia last week announced measures to reduce currency volatility (under floating exchange rate regimes, their currencies have been subject to swift movements in capital flows (see below in Market Analysis and Highlights). India posted a surprisingly high inflation outturn for May (10.2%), showing that inflation pressures persist as internal demand remains strong, raising expectations of another rate hike. On the monetary front, as expected, Japan and Hong Kong left their interest rates unchanged. Focus in the coming week will be on China's announcement to increase yuan flexibility and CPI releases for Japan, Hong Kong, Singapore and Vietnam (where, like India, inflation remains high).

Chart 1

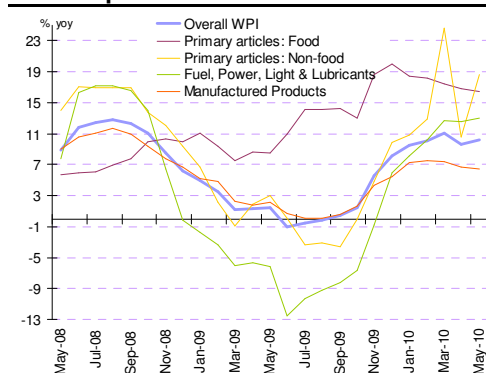
## Currency volatility prompts new measures by the authorities



Source: BBVA Research and Bloomberg

Chart 2

## Higher than expected inflation in India raises speculation of interest rate hikes



Source: BBVA Research and Bloomberg

## Highlights

Markets

Highlights

Calendar

Markets Data

Indian inflation rises to double-digits, above expectations

Measures implemented to reduce currency volatility

Singapore expansion continues, but a slower pace

## Markets Analysis

## Markets rebound, with confidence still remains fragile

In a week with limited data releases, the news of strong US industrial output for May helped allay fears of a double-dip recession. The successful bond auction of EUR3.5 bn in Spain eased European sovereign debt worries, while the Bank of Spain's commitment to disclose the results of bank stress tests bolstered confidence on the financial health of Eurozone peripherals. Improving sentiment boosted risk appetite and precipitated a bounce back in Asian currencies and equities.

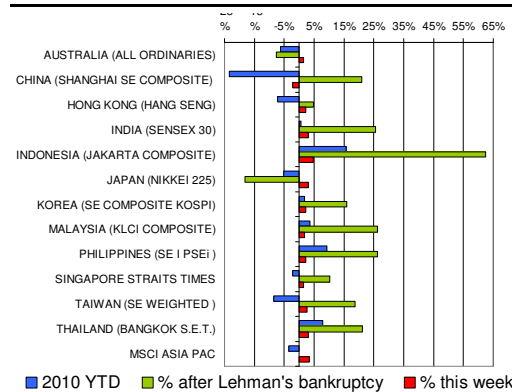
Asian exports remained resilient through May despite rising concerns over a double-dip. We have seen strong export outturns in China (48.5% yoy). This week Singapore's non-oil domestic exports rose by 24.4% yoy, with electronic exports up 38.9% yoy. The optimist would cite strong Asian exports as evidence for continued recovery. The skeptic would probably worry that the slowing effects have not arrived yet. In any case, Asian exports and the geographical breakdown are going to be an important indicator to monitor.

Meanwhile, the Korean and Indonesian authorities unveiled new regulations in a bid to reduce currency volatility (see highlights below). Their responses are probably understandable given KRW and IDR have been among the most vulnerable to capital flows as well as growing risk aversion in the past two months (volatility comparison). In Korea, the authorities planned to limit the FX position in forwards and currency swaps taken by banks, especially by foreign banks. Bank Indonesia widened the "corridor" of its overnight interest rate from 50 bps to 100 bps and increased the mix of longer-dated SBI bills. The market impacts of these measures were perceived to be slight and gradual, and did not upset the rally of KRW and IDR.

Asia's stock markets had been gaining last week driven by a strong indicators in the US, increasing confidence on Eurozone's financial system and a technical rebound from May's downfall. Best performers were Jakarta (4.6%), India (3.0%) and Japan (3.0%). Philippines and Australia were closed last Monday, while Hong Kong and Taiwan closed on Wednesday due to public holidays. Meanwhile, China's stock markets only opened since Thursday.

Chart 3

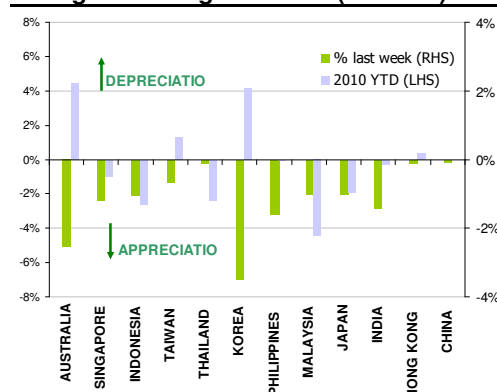
## Stock Markets



Source: BBVA Research

Chart 4

## Foreign Exchange Markets (vs. USD)



Source: BBVA Research

## Economics Analysis

## Highlights

**Indian inflation hits rises to double-digits, above expectations**

India, one of two Asian economies to be battling high inflation (the other is Vietnam) saw inflation rise further in May, raising the possibility of an inter-meeting rate hike by the RBI (the next scheduled monetary policy meeting is May 27). In particular, the May wholesale price index (WPI) rose to 10.2% y/y (consensus: 9.6%). Food prices still contributed most to India's inflation, but less compared with the previous months'. However, non-food primary articles, basic metals and alloys, textiles and electricity contributed more, which brought up overall inflation. It is expected that the coming of the monsoon season will help to ease food prices and reduce inflation in the second half of the year--the government expects inflation to ease to 5-6% by the end of the year. Meanwhile, the RBI, the second most aggressive central bank in the region to tighten, after Australia, may hike interest rates in the coming weeks. We expect a further interest rate hike by 25bps before the next RBI's quarterly review on July 27th. We forecast that the repo rate will reach 6.5% in the end of 2010 (from the current 5.25%)

**Measures implemented to reduce currency volatility**

Asian policy makers have been struggling with bouts of volatile capital flows, which have led to currency volatility. Korea and Indonesia are among the economies in Asia that have been most susceptible to volatility in this regard.

As noted in the last edition of the Weekly, Korea has just imposed tighter currency controls, including a limitation of foreign and domestic banks' currency derivatives (250% of equity capital in the former and 50% the latter) and a limit on derivatives to cover corporate settlements (cut to 100% of the total, from the current 125%). Bank Indonesia (BI) this past week announced various measures to reduce volatility. The most significant measures were a wider overnight interest rate policy corridor (from the current +/-50bps to +/-100bps) and a minimum holding period of 1 month for BI bills ("SBIs", a common investment vehicle for speculators). Other relevant actions were to step up issuance of SBIs with longer maturities (9 and 12 months). BI has pointed out that these should not be interpreted as capital controls, but rather measures to encourage investors to keep their money in the country for longer periods. Other countries of the region as India, Pakistan and Taiwan have recently emphasized their intention to limit swings in their currencies.

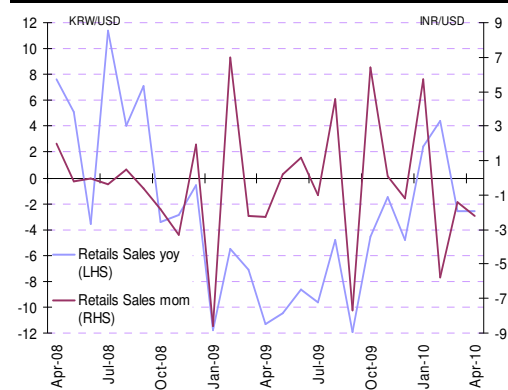
**Singapore expansion continues, but a slower pace**

Singapore's exports (non-oil domestic exports, or NODX) in May rose by 24.4% yoy (consensus: 25.7%), after a revised 30% gain in April. On a month-on-month sa basis, NODX decreased marginally by 0.1% in May 2010, in contrast to the previous month's 2.5% rise. Electronics were the main driver of the strong NODX, offsetting weak sales in pharmaceuticals, which are often volatile due to production swings. On the domestic demand side, retail sales unexpectedly dropped for a second month (falling by 2.6% yoy vs. a consensus of an 0.8% yoy gain) as car purchases plunged. Excluding the motor vehicles, retail sales posted a 7.4% yoy increase due to the higher spending at department stores as two casino resorts attracting more tourists. Meanwhile, the labor market turned out to be strengthened as employers adding more jobs than initially estimated, pushing the unemployment rate to historically low level in recent two years.

Looking forward, we still hold our optimistic view on the whole year growth in Singapore's economy (BBVA: 8.3% in year 2010), as exports rebounded from the plunge in 2009 and tourism inflows rise. Singapore, being such a highly trade-dependent economy, could suffer from a deterioration in the global economy. However, the direct impact from Europe (the largest exports destination) may be limited as long as growth in China remains strong, and in the US, as these trade partners take up the second and third largest market's share of Singapore's NODX.

Chart 5

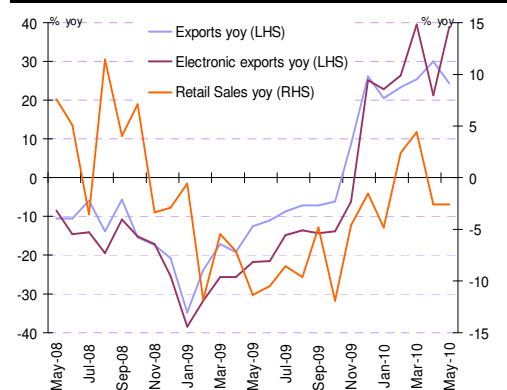
### Singapore's sales declined unexpectedly



Source: BBVA Research and Bloomberg

Chart 6

### Singapore grew, but a slower pace



Source: BBVA Research and Bloomberg

## Calendar

<b>CHINA</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
Industrial Profits YTD YoY	25-Jun	MAY	119.70%	--
<b>HONG KONG</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
CPI - Composite Index (YoY)	22-Jun	MAY	2.40%	--
Bal of Paymts - Overall	22-Jun	1Q	\$230.64B	--
Bal of Paymts - Current A/C	22-Jun	1Q	\$36.61B	--
Exports YoY%	24-Jun	MAY	21.70%	--
Imports YoY%	24-Jun	MAY	28.80%	--
Trade Balance	24-Jun	MAY	-35.2B	--
<b>JAPAN</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
All Industry Activity Index (MoM)	21-Jun	APR	-0.80%	--
Nationwide Dept. Sales (YoY)	21-Jun	MAY	-3.70%	--
Merchnds Trade Balance Total	24-Jun	MAY	¥742.3B	¥557.6B
Adjusted Merchnds Trade Bal.	24-Jun	MAY	¥729.1B	¥723.5B
Merchnds Trade Exports YoY	24-Jun	MAY	40.4	37.6
Merchnds Trade Imports YoY	24-Jun	MAY	24.2	33.1
CPI YoY	25-Jun	MAY	-1.20%	-1.10%
<b>KOREA</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
SK Consumer Confidence	25-Jun	JUN	111	--
<b>PHILIPPINES</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
Budget Deficit/Surplus	21-Jun	MAY	2.6B	--
Total Imports (YoY)	25-Jun	APR	38.90%	--
Total Monthly Imports	25-Jun	APR	\$4542.6M	--
Trade Balance	25-Jun	APR	-\$362M	--
<b>SINGAPORE</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
CPI (YoY)	23-Jun	MAY	3.20%	3.00%
CPI (MOM) - NSA	23-Jun	MAY	0.90%	0.30%
Industrial Production YoY	25-Jun	MAY	51.00%	32.10%
Industrial Production MoM SA	25-Jun	MAY	24.30%	-13.70%
<b>TAIWAN</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
Export Orders (YoY)	21-Jun	MAY	35.15%	36.00%
Unemployment Rate - sa	22-Jun	MAY	5.43%	5.33%
Industrial Production (YoY)	23-Jun	MAY	31.38%	30.50%
<b>THAILAND</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
Customs Exports (YoY)	21-Jun	MAY	35.20%	34.00%
Customs Imports (YoY)	21-Jun	MAY	46.00%	60.50%
Customs Trade Balance	21-Jun	MAY	-\$266M	\$660M
<b>VIETNAM</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
CPI (YoY)	22-27 Jun	JUN	9.10%	--

## What to watch

### Japan: Consumer Price Index for May (June 25th)

Forecast -0.9%

Consensus: -1.1%

Prior: -1.2%

We expect the pace of Japan's deflation to ease slightly in May. Recent indicators suggest strength in the economy: exports are robust (especially to the rest of Asia), and domestic business spending is picking up. Nevertheless, uncertainty to the global outlook and Japan's high public debt burden will present headwinds, with deflation likely to persist into next year. A lower than expected deflation would improve sentiment and help support the recovery by encouraging consumer and business spending.

### Taiwan – Benchmark Interest Rate (24<sup>th</sup> June)

We expect interest rate will remain unchanged

Actual	Survey
1.25%	1.25%

## Global Market Data

Table 1

## Market data

		Close	Weekly change	Monthly change	Annual change
Interest rates (changes in bps)	US	3-month Libor rate	0.54	0	5
		2-yr yield	0.71	-2	0
		10-yr yield	3.20	-3	-1
	EMU	3-month Euribor rate	0.73	1	4
		2-yr yield	0.57	11	9
		10-yr yield	2.72	16	4
Exchange rates (changes in %)	Europe	Dollar-Euro	1.236	2.5	0.1
		Pound-Euro	0.83	0.5	-3.1
		Swiss Franc-Euro	1.37	-1.2	-3.5
	America	Argentina (peso-dollar)	3.93	0.1	0.5
		Brazil (real-dollar)	1.78	-1.5	-6.0
		Colombia (peso-dollar)	1901	-1.2	-5.6
		Chile (peso-dollar)	533	-0.9	-2.4
		Mexico (peso-dollar)	12.56	-1.1	-4.7
		Peru (Nuevo sol-dollar)	2.83	-0.4	-0.6
		Japan (Yen-Dollar)	90.71	-1.0	1.5
	Asia	Korea (KRW-Dollar)	1195.50	-4.2	-2.7
		Australia (AUD-Dollar)	0.868	2.4	6.4
Comm. (chg %)		Brent oil (\$/b)	77.7	4.5	8.1
		Gold (\$/ounce)	1255.9	2.4	6.2
		Base metals	478.1	0.5	-0.7
					19.9
Stock markets (changes in %)	Euro	Ibex 35	9875	3.3	6.5
		EuroStoxx 50	2729	3.4	6.2
		USA (S&P 500)	1115	2.1	4.0
	America	Argentina (Merval)	2315	1.5	10.8
		Brazil (Bovespa)	64513	1.4	10.9
		Colombia (IGBC)	12407	0.8	4.7
		Chile (IGPA)	18931	2.6	6.9
		Mexico (CPI)	32694	1.8	7.7
		Peru (General Lima)	14367	1.0	1.1
		Venezuela (IBC)	64715	1.6	4.0
					49.6
	Asia	Nikkei225	9995	3.0	-0.4
		HSI	20287	2.1	3.8
					13.2
Credit (changes in bps)	Ind.	Itraxx Main	121	-9	-5
		Itraxx Xover	541	-55	-63
	Sovereign risk	CDS Germany	40	1	-3
		CDS Portugal	301	12	-28
		CDS Spain	243	37	36
		CDS USA	36	-1	-2
		CDS Emerging	261	-25	-53
		CDS Argentina	1041	-69	-221
		CDS Brazil	131	-10	-22
		CDS Colombia	152	-11	-33
		CDS Chile	92	-13	-18
		CDS Mexico	128	-13	-25
		CDS Peru	129	-12	-25
					-68

Sources: Bloomberg, Datastream and JP Morgan

## Asia Market Data

Table 2

STOCK MARKETS	INDEX	Last price	% change over a week	Year to date	% Change over 1 Y
	China – Shanghai Comp.	2513.2	-2.2	-23.3	-11.9
	Hong Kong – Hang Seng	20286.7	2.1	-7.3	14.1
	Taiwan – Weighted	7493.1	2.7	-8.5	21.9
	Japan – Nikkei 225	9995.0	3.0	-5.2	3.0
	Korea – Kospi	1712.0	2.2	1.7	24.4
	India – Sensex 30	17595.6	3.1	0.7	23.3
	Australia – SPX/ASX 200	4551.9	1.0	-6.5	17.0
	Singapore – Strait Times	2833.4	1.3	-2.2	26.6
	Indonesia – Jakarta Comp	2929.6	4.6	15.6	50.2
	Thailand – SET	791.1	2.8	7.7	38.7
	Malaysia – KLCI	1317.7	1.8	3.5	25.0
	Philippines – Manila Comp.	3335.5	2.1	9.3	37.0

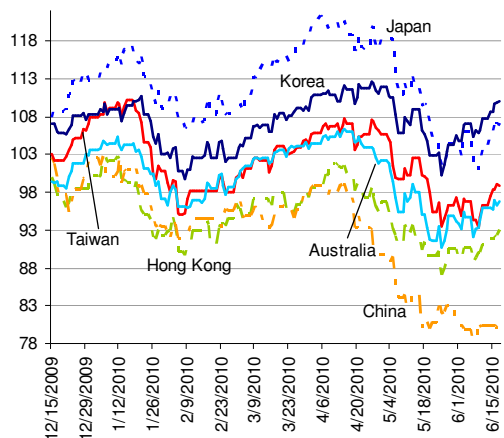
Source: BBVA Research and Bloomberg

Table 3

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.83	0.10	-0.04	-0.1146
	Hong Kong (HKD/USD)	7.79	0.09	-76	-255
	Taiwan (TWD/USD)	32.15	0.69	-0.27	-0.918
	Japan (JPY/USD)	90.72	1.03	-13.2	-70.98
	Korea (KRW/USD)	1202	3.63	-4.15	-2.85
	India (INR/USD)	46.17	1.47	41.5	130.44
	Australia (USD/AUD)	0.87	2.14	125	n.a.
	Singapore (SGD/USD)	1.39	1.10	-5.3	-25
	Indonesia (IDR/USD)	9103	1.07	105.25	467.5
	Thailand (THB/USD)	32.41	0.12	5	15.5
	Malaysia (MYR/USD)	3.259	1.03	135	460
	Philippines (PHP/USD)	45.90	1.61	0.34	1.42

Source: BBVA Research and Bloomberg

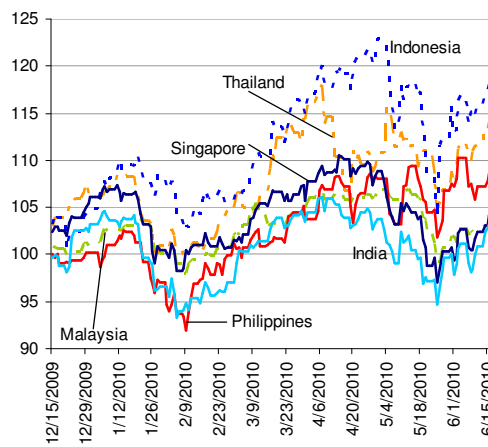
### STOCK MARKETS



Source: BBVA Research and Bloomberg

Index=100

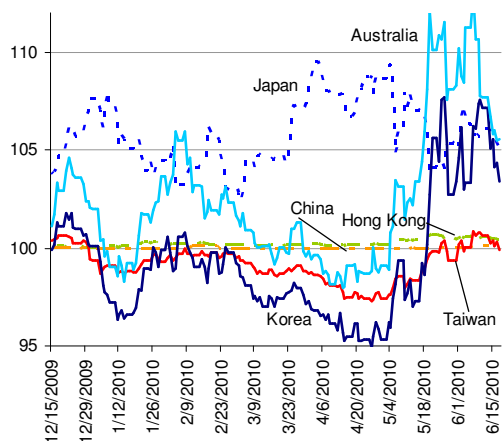
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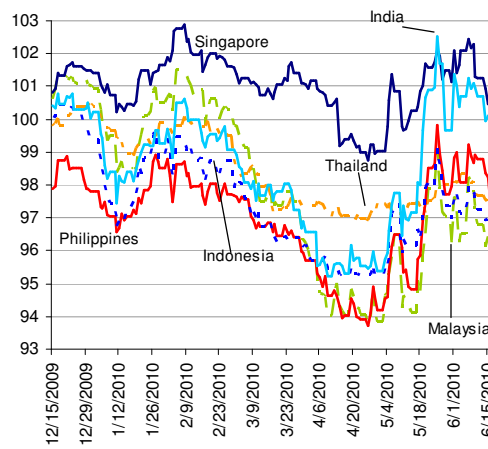
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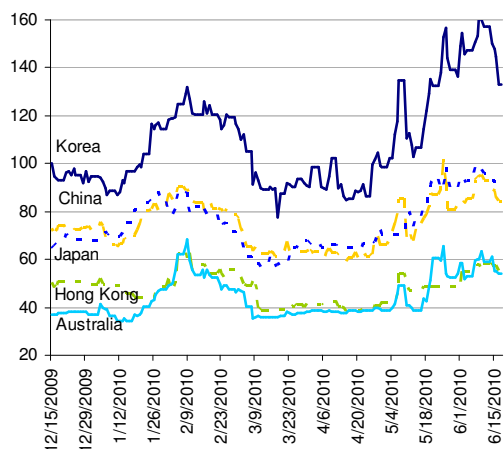
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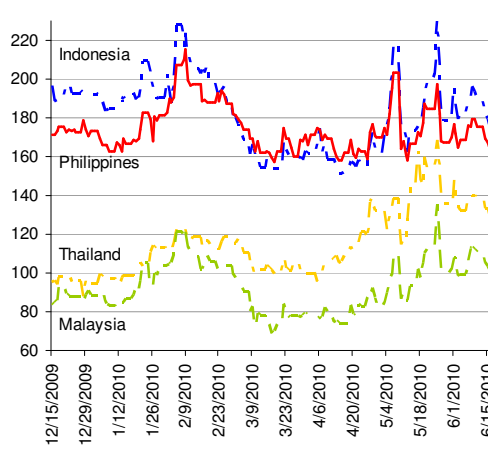
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