

## Asia

## Weekly Watch

Hong Kong, August 23, 2010

## Economic Analysis

## Asia

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## Market sentiment stays weak on slowing global growth

Asian markets were negatively affected over the past week by sluggish growth in Japan and weak sentiment from the US.

## Regional indicators point to a gradual slowdown...

Japan posted a lower-than-expected GDP outturn for Q2 (see Highlights), although growth in Malaysia (8.9% y/y), Taiwan (12.5% y/y), and Thailand (9.1% y/y) beat expectations. Nevertheless, July export orders in Taiwan (18.2% y/y, but negative by 2.2% m/m seasonally adjusted terms) and July exports in Singapore came in below expectations, signaling that external demand is cooling. On the inflation front, India's WPI inflation moderated to 10.0% y/y (consensus 10.4%).

## The State Bank of Vietnam devalues the Vietnamese Dong...

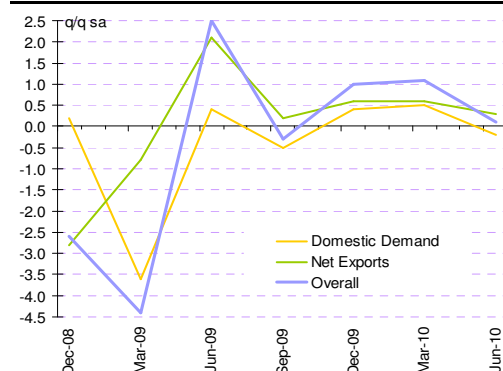
Vietnam devalued its currency this past week, the third time since November 2010, in order to contain a widening trade deficit.

## In the coming week....

Markets will focus on Q2 GDP outturns in the Philippines and Thailand, July inflation in Japan, and Singapore (see What to Watch), and July industrial production in Singapore and Taiwan. On the monetary side, we expect the Bank of Thailand to raise interest rates (25bps) at its meeting on August 25, while the Philippines should remain on hold.

Chart 1

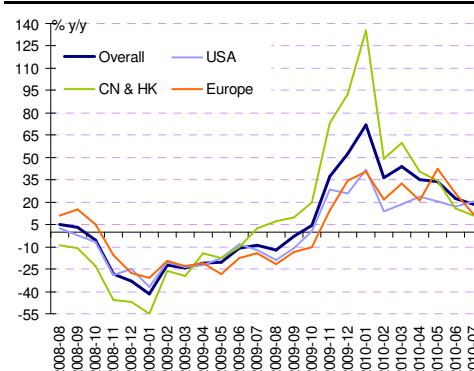
## Japan GDP for Q2 slowed, on weak domestic demand



Source: BBVA Research and Bloomberg

Chart 2

## Export orders in Taiwan are slowing



Source: BBVA Research and Bloomberg

## Highlights

**China takes another step towards internationalization of its currency**

**Japan's growth momentum loses some steam**

**Indonesia to boost infrastructure investment**

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## Fears of US growth slowdown hit Asian currencies

### Markets Analysis

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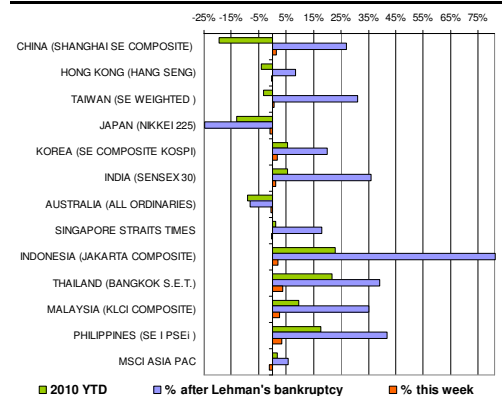
An unexpected increase in initial jobless claims and a disappointing Philly Fed index of business conditions in the US renewed market concerns of a double-dip recession in advanced economies. The fall in German Zew economic sentiment indicator for August and the sharp deceleration in Japan's GDP growth earlier this week compounded this worry. In non-Japan Asia, indicators such as Taiwan's GDP and Singapore's trade data still remained strong, but the pace has decelerated. Fears of a double-dip recession in the developed world sent Asian equities and currencies lower. Although we do not share the view of a double-dip in our baseline forecasts, indicators released in the coming two months will likely continue to moderate as Asian growth is expected to slow to a more sustainable pace after the sharp V-shape recovery in the past 12 months.

USDJPY continued to trade above the resistance level of 85 despite rising global risk premium. In the past three months, JPY was regarded as a safe haven currency and correlated negatively with global risk sentiment. But this time around, weaker-than-expected 2Q GDP in Japan re-kindled hopes for further quantitative easing. The market also feared intervention by the BOJ, as a stronger yen would further hit its recovery prospects.

AUDUSD traded lower than 0.9 in the midst of rising global uncertainties. The RBA minutes of August policy meeting cited that there is "more uncertainty over global outlook than there had been earlier in the year", which further reduce hopes for an imminent rate hikes. The market also held its breath before the federal election in the coming weekend (August 21). AUDUSD closed at 0.89. USDTWD resisted the weakening bias in other Asian currencies after the releases of the stronger-than-expected 2Q GDP. The annual sequential pace was maintained at 7.2% saar, and the recovery was broad-based. The encouraging results eased fears of an abrupt growth slowdown as seen in Japan. But the support will likely be short-lived, and the outlook of TWD will critically depend on its export performance in the coming months. Given the deceleration in global manufacturing cycle, the CBC in the near term will likely put a heavier weight on competitiveness and keep USDTWD around 32.

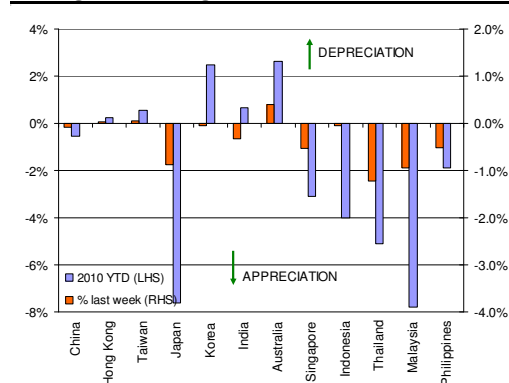
Asian markets were mixed last week, as strong early-week gains were eroded on Friday, as concerns on global demand rose, mainly due to a dreary US job market and a weaker-than-expected Philly Fed index. Chinese markets climbed on Monday as the Agricultural Bank of China completed the world's largest IPO of USD 22.1 billion, pulling up financial sector. Everbright Bank of China also succeeded in its first IPO, climbing in the first trading day by 18%. Nevertheless, the Shanghai composite closed to the upside (+1.4%). Japanese markets closed to the downside as a strong JPY risks undermining exports, and as 2Q GDP came in well below expectations. Meanwhile, stock markets in South East Asia continued to rally, and for the week climbed by 3.7% in Thailand, 3.6% in the Philippines and 2.5% in Malaysia.

Chart 3  
**Stock Markets**



Source: BBVA Research

Chart 4  
**Foreign Exchange Markets (vs. USD)**



Source: BBVA Research

## Economics Analysis

## Highlights

**China takes another step towards internationalization of its currency**

A new pilot program has been announced by the People's Bank of China (PBOC) to allow qualifying overseas financial institutions to invest in China's domestic inter-bank bond market. Qualified institutions include central banks, clearing banks for RMB settlement in Hong Kong and Macao, and overseas banks participating in RMB cross-board trade settlement business. The program was announced on August 16. The PBOC stipulated that funds for investment in the interbank bond market must originate from RMB settlement of cross-board trade. Importantly, participation is to be subject to approval from the PBOC and quotas will be placed on the amounts that individual institutions can invest.

The move, while quantitatively small, is significant as it represents another step towards the internationalization of the RMB. In particular, it opens up a new channel for offshore RMB to flow back and earn a more attractive return for RMB holders, which should accelerate offshore usage of the RMB over time. Other steps to date include restarting the reform of RMB exchange rate, expanding the scope of the RMB cross-border trade settlement pilot scheme, and allowing all authorized institutions to open and maintain RMB accounts at Hong Kong banks. We expect that more opening-up programs including "Mini-QFII" and H-share IPO will be implemented as the authorities seek to encourage the usage of RMB in international trade. But as before, a gradual approach is expected to prevail. Market reaction to the announcement has been generally positive, though realistic, with analysts expecting the size of investments to be relatively small. According to market data, only \$2.9 billion of trade was settled in RMB in 2Q10 while last year's total issuance of Chinese government bond amounts to \$1.3 trillion. A consensus among market watchers is that China's current and forthcoming moves of internationalizing RMB will reinforce Hong Kong's role as the RMB offshore market.

**Japan's growth momentum loses some steam**

Japan's GDP growth slowed in the second quarter to just 0.1% q/q, seasonally adjusted, well below consensus (0.6% m/m, s.a.). The slower-than-expected outturn was mainly due to weaker domestic demand (negative contribution of 0.2% q/q), and less robust overseas demand than previously thought (net exports contribution in 2Q grew by a lower-than-expected 0.3% q/q). The outturn reveals that Japan's economy, which remains heavily dependent on exports as a source of growth, is suffering from weak domestic demand. The outturn raises downside risks to our full-year growth projection of 2.3%.

Against this backdrop, the strengthening of the Japanese Yen (JPY) in recent months is a special concern to the authorities given the negative impact on competitiveness in the export sector. Expectations have increased of fx intervention to stem further appreciation, although market participants do not expect imminent action given the lack of consensus at the international level (only coordinated G7 intervention is believed to work). Also, any intervention at this stage would put the Japanese authorities in an awkward position, as they have been vocal in their calls on China to allow greater appreciation of its currency. Market participants view a level of 80 yen per dollar as a threshold for possible intervention (versus a rate of around 85 per dollar at present). In the meantime, it appears likely that the BoJ will consider expanding liquidity injections into the market, both to prevent continued deflation (a persistent concern) and to help limit further currency appreciation.

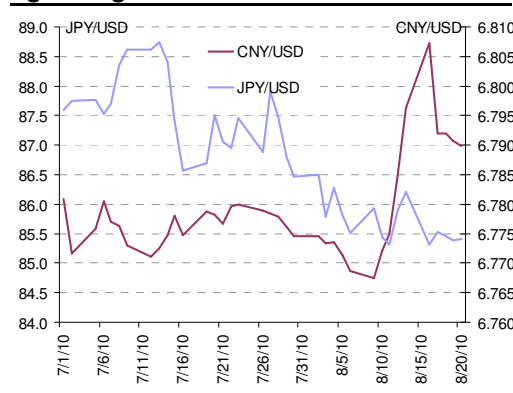
**Indonesia to boost infrastructure investment**

In his annual Independence Day speech to Parliament, Indonesia's President Susilo Bambang Yudhoyono proposed a 2011 budget deficit of 1.7% of GDP, in line with expectations and slightly wider than the 1.5% projected deficit for this year (down from an original deficit target of 2.1%). The emphasis in the budget is on infrastructure spending, which has long been identified as lagging in Indonesia, and positing a supply-side constraint

to future growth. The speech specifically mentioned seaports, bridges and new roads to facilitate transportation. The proposed budget aims to increase capital spending by 28% to IDR121.7 trillion (USD13.5 billion) from the amount allocated for this year and the total infrastructure investment between 2010 and 2014 would be USD161 billion in total to boost annual economic growth to the government's target of 7.7% by 2014. The government expects the economy to grow by 6.3% in 2011 (BBVA: 6.1%) from an estimated 6.0% this year (BBVA: 5.7%). On the other side, the tax revenue may raise 13% to 839.5 trillion rupiah next year and the government plans to cut its spending on electricity subsidies to 41 trillion (\$USD4.57 billion) via raising electricity tariffs by 15% at the start of 2011. Meanwhile, proposed subsidy spending for fuel in 2011 is 4.4% higher than 2010. The budget will be discussed in Parliament in the coming months. Indonesia has room for increase spending, given its low debt-to-GDP ratio of around 30%.

Chart 5

**The Japanese yen has strengthened, while the RMB has fluctuated within a tight range**



Source: BBVA Research and Bloomberg

## What to watch

### Singapore: Consumer Price Index (July, August 23)

Forecast: 3.0% (y/y)

Consensus: 3.1%

Previous: 2.7% y/y

A rise in transport and housing costs, together with demand pressures from Singapore's soaring growth rate (24.0% q/q, saar in Q2) are likely to result in a somewhat higher inflation outturn for July. A higher than expected reading could trigger concerns about inflation and increase expectations of a further tightening by the MAS at its next meeting scheduled in October, which would apply further currency appreciation under within the MAS' exchange rate-based monetary framework. The MAS last tightened policy in April, through a re-centering of its NEER band and adoption of a "modest and gradual appreciation path".

## Calendar

<b>HONG KONG</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
Exports YoY%	26-Aug	JUL	26.70%	--
Imports YoY%	26-Aug	JUL	31.00%	--
Trade Balance	26-Aug	JUL	-30.6B	--
<b>JAPAN</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
Merchnds Trade Balance Total	25-Aug	JUL	¥687.0B	¥501.5B
Adjusted Merchnds Trade Bal.	25-Aug	JUL	¥456.0B	¥376.7B
Merchnds Trade Exports YoY	25-Aug	JUL	27.7	21.9
Merchnds Trade Imports YoY	25-Aug	JUL	26.1	19.4
Jobless Rate	27-Aug	JUL	5.30%	5.30%
Job-To-Applicant Ratio	27-Aug	JUL	0.52	0.53
CPI YoY	27-Aug	JUL	-0.70%	-1.00%
<b>KOREA</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
SK Consumer Confidence	25-Aug	AUG	112	--
Current Account in US\$ Million	27-Aug	JUL	\$5037.5M	--
Goods Balance in US\$ Million	27-Aug	JUL	\$6354M	--
<b>PHILIPPINES</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
Total Imports (YoY)	25-Aug	JUN	31.40%	--
Total Monthly Imports	25-Aug	JUN	\$4753.4M	--
Trade Balance	25-Aug	JUN	-\$513M	--
GDP (YoY)	26-Aug	2Q	7.30%	6.20%
GDP sa (QoQ)	26-Aug	2Q	3.00%	1.50%
<b>SINGAPORE</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
CPI (YoY)	23-Aug	JUL	2.70%	3.00%
Industrial Production YoY	26-Aug	JUL	26.10%	8.00%
Industrial Production MoM SA	26-Aug	JUL	-23.40%	3.90%
<b>TAIWAN</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
Unemployment Rate - sa	23-Aug	JUL	5.20%	5.10%
Industrial Production (YoY)	23-Aug	JUL	24.33%	21.55%
<b>THAILAND</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
Gross Domestic Product SA (QoQ)	23-Aug	2Q	3.80%	-1.40%
Gross Domestic Product (YoY)	23-Aug	2Q	12.00%	8.00%
<b>VIETNAM</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
CPI (YoY)	22-26 Aug	AUG	8.20%	--

### Thailand – Benchmark Interest Rate, August 25

We expect interest rate will increase by 25bps

Current	Expected
1.50	1.75

### Philippines – Overnight Borrowing Rate, August 26

We expect interest rate will remain unchanged

Current	Expected
4.00	4.00

## Global Market Data

Table 1:

			Close	Weekly change	Monthly change	Annual change
Interest Rates (changes in bps)	US	3-month Libor rate	0.33	-4	-17	-6
		2-yr yield	0.46	-7	-10	-63
		10-yr yield	2.53	-14	-40	-103
	EMU	3-month Euribor rate	0.89	-1	1	4
		2-yr yield	0.60	-5	-10	-77
		10-yr yield	2.27	-13	-40	-105
Exchange Rates (changes in %)	Europe	Dollar-Euro	1.271	-0.6	-1.4	-11.2
		Pound-Euro	0.82	0.0	-3.0	-5.6
		Swiss Franc-Euro	1.31	-2.2	-2.2	-13.2
	America	Argentina (peso-dollar)	3.93	0.1	0.0	2.2
		Brazil (real-dollar)	1.76	-0.8	-0.4	-3.8
		Colombia (peso-dollar)	1823	-0.5	-2.2	-8.7
		Chile (peso-dollar)	509	-0.1	-1.8	-6.6
		Mexico (peso-dollar)	12.77	0.4	0.1	-0.4
	Asia	Peru (Nuevo sol-dollar)	2.80	-0.2	-0.9	-5.1
		Japan (Yen-Dollar)	85.32	-1.0	-2.0	-9.8
		Korea (KRW-Dollar)	1179.70	-0.8	-1.3	-5.5
		Australia (AUD-Dollar)	0.887	-1.0	-0.7	6.2
Comm. (chg. %)		Brent oil (\$/b)	74.3	-1.1	-4.6	0.1
		Gold (\$/ounce)	1229.8	1.2	2.9	28.9
		Base metals	502.6	0.9	5.8	13.1
Stock Markets (changes in %)	Euro	Ibex 35	10022	-2.5	-2.7	-10.2
		EuroStoxx 50	2639	-2.6	-2.8	-3.9
		USA (S&P 500)	1076	-0.3	-1.6	4.8
	America	Argentina (Merval)	2429	2.6	2.9	35.2
		Brazil (Bovespa)	66887	0.9	1.7	15.9
		Colombia (IGBC)	13438	1.0	1.6	26.6
		Chile (IGPA)	21143	1.4	6.1	36.7
		Mexico (CPI)	32154	0.2	-1.7	13.6
	Asia	Peru (General Lima)	14868	0.5	5.8	3.5
		Venezuela (IBC)	64988	0.4	1.3	35.4
		Nikkei225	9179	-0.8	-0.5	-10.3
		HSI	20982	-0.4	1.9	3.9
Credit (changes in bps)	Ind.	Itraxx Main	111	-2	-4	18
		Itraxx Xover	498	-15	-17	-106
		CDS Germany	43	-1	2	19
	Sovereign risk	CDS Portugal	272	-3	-3	214
		CDS Spain	216	-1	13	148
		CDS USA	47	-1	10	—
		CDS Emerging	232	4	-1	-93
		CDS Argentina	821	-11	-28	-751
		CDS Brazil	120	1	-1	-5
		CDS Colombia	120	-2	-8	-38
		CDS Chile	74	-6	-16	-5
		CDS Mexico	118	-1	-3	-46
		CDS Peru	102	-8	-12	-35

Sources: Bloomberg, Datastream and J.P. Morgan

## Asia Market Data

Table 1

STOCK MARKETS	INDEX	Last price	% change over a week	Year to date	% Change over 1 Y
	China – Shanghai Comp.	2642.3	1.4	-19.4	-9.2
	Hong Kong – Hang Seng	20981.8	-0.4	-4.1	3.2
	Taiwan – Weighted	7927.3	0.5	-3.2	17.7
	Japan – Nikkei 225	9179.4	-0.8	-13.0	-11.6
	Korea – Kospi	1775.5	1.7	5.5	12.6
	India – Sensex 30	18403.9	1.3	5.4	22.6
	Australia – SPX/ASX 200	4430.9	-0.6	-9.0	1.2
	Singapore – Strait Times	2932.0	-0.3	1.2	14.5
	Indonesia – Jakarta Comp	3111.5	1.9	22.8	33.6
	Thailand – SET	893.9	3.7	21.7	39.5
	Malaysia – KLCI	1393.9	2.5	9.5	19.8
	Philippines – Manila Comp.	3593.6	3.6	17.7	32.1

Source: BBVA Research and Bloomberg

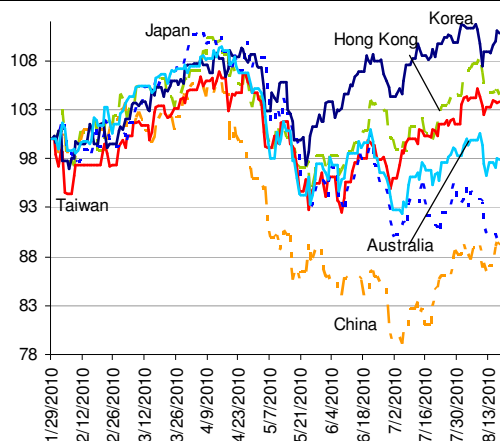
Table 2

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.79	0.09	-0.02	-0.11
	Hong Kong (HKD/USD)	7.78	-0.03	-53.0	-190
	Taiwan (TWD/USD)	31.9	-0.05	-0.11	-0.55
	Japan (JPY/USD)	85.4	0.89	-7.9	-42.0
	Korea (KRW/USD)	1183	0.05	7.42	18.22
	India (INR/USD)	46.6	0.32	61.6	192
	Australia (USD/AUD)	0.89	-0.40	124	n.a.
	Singapore (SGD/USD)	1.36	0.55	-2.60	-13.0
	Indonesia (IDR/USD)	8973	0.06	84	408
	Thailand (THB/USD)	31.5	1.24	2.50	14.0
	Malaysia (MYR/USD)	3.14	0.96	166.8	532
	Philippines (PHP/USD)	45.1	0.52	0.36	1.50

Source: BBVA Research and Bloomberg



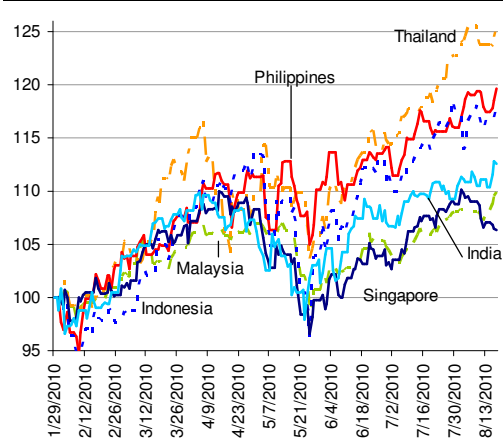
## STOCK MARKETS



Source: BBVA Research and Bloomberg

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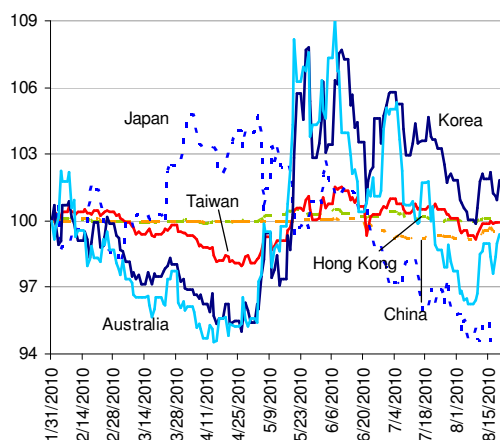
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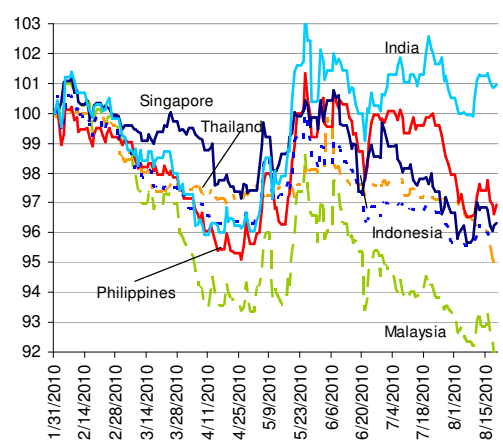
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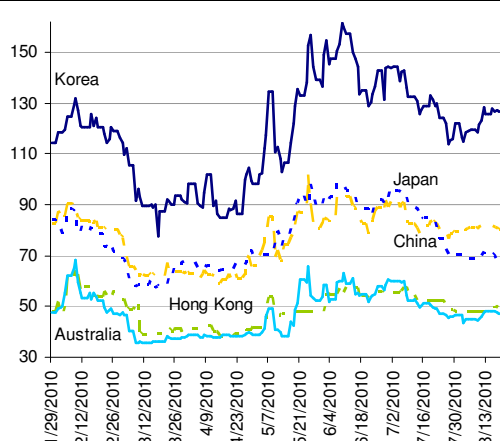
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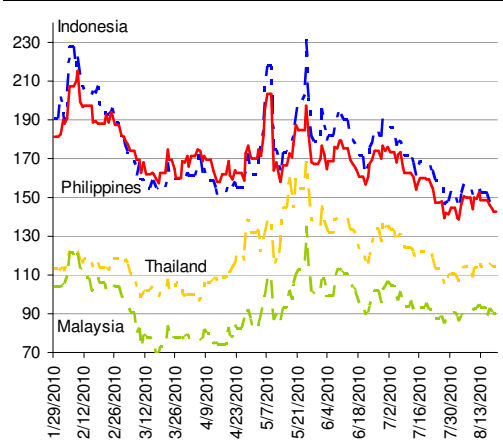
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