

## Asia

## Weekly Watch

Hong Kong, August 30, 2010

## Economic Analysis

## Asia

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## Asian growth remains healthy, albeit at a slowing pace

Asian growth momentum has lost some steam in the third quarter, but the extent of the slowdown is modest. Financial markets have been weighted down by rising global risk aversion.

## Signs of moderation in growth, but pace is still brisk

Second quarter GDP figures for the Philippines's (7.9% y/y) and Thailand (9.1% y/y) were brisk, beating beat expectations. However, July indicators point to some moderation. Taiwan's industrial output slowed (from 24.3% y/y in June to 20.7% y/y in July), as did Singapore's (from 26.1% in June to 9.9% in July). Export growth for July in Hong Kong and Japan also decelerated. On the inflation front, prices crept up slightly in Singapore (3.1% y/y) due to higher food and housing costs. On the contrary, Japan's deflation worsened in July (-0.9% y/y vs. previous -0.7%; -0.3% m/m sa), pointing to a weak domestic demand recovery.

## The Bank of Thailand raises policy rates

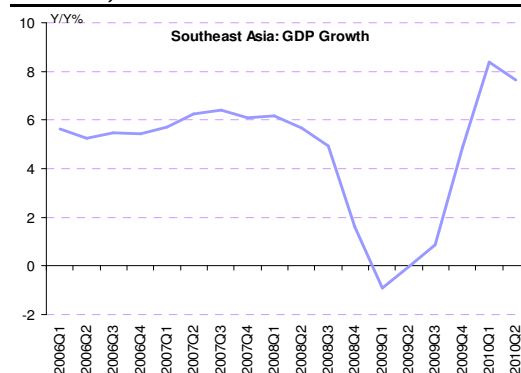
The BoT raised its benchmark interest rate by 25 bps to 1.75% as expected, while the Central Bank of the Philippines left rates unchanged.

## In the coming week....

August PMI in China, August trade figures for Korea, 2Q GDP in Australia and India, and a host of inflation data (Indonesia, Korea and Thailand). Malaysia and Indonesia have their monthly monetary policy meetings, and both are expected to leave rates unchanged.

Chart 1

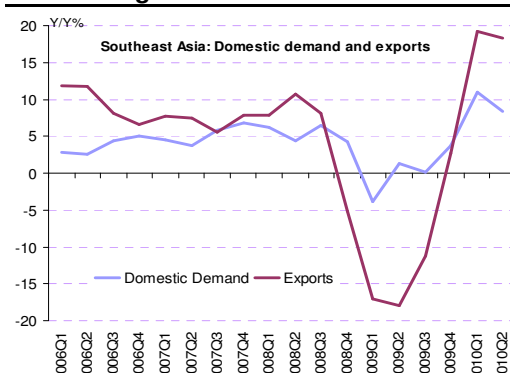
## Southeast Asian GDP growth remains resilient, with moderation in Q2



Source: BBVA Research and Bloomberg  
\*Indonesia, Malaysia, Philippines and Thailand

Chart 2

## Domestic demand and exports are the drivers of growth in Southeast Asia



Source: BBVA Research and Bloomberg  
\*Indonesia, Malaysia, Philippines and Thailand

## Highlights

Markets

Highlights

Calendar

Markets Data

China takes another step towards internationalization of its currency (II)

Australia's elections result in a hung parliament

Southeast Asian 2Q GDP growth is slowing, but still well above trend

## Growth concerns and European debt keep Asian markets down

### Markets Analysis

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Worse-than-expected US indicators (a sharp plunge in US home sales and lackluster durable good orders), coupled with S&P's downgrade of Ireland's credit rating (from AA to AA-) deepened market worries and heightened global risk aversion. The negative news has overshadowed positive indicators from Europe (Germany's IFO and consumer confidence). In our view, global growth in the second half is slowing, but not collapsing. In Asia, 2Q GDP in the Philippines and Thailand beat market expectations. Thailand hiked rates by 25 bps, the second time since June, and widening interest rate differentials led the THB to become the third best performing currency after MYR and JPY in 2010. Other Asian currencies, especially the KRW and AUD, weakened in the midst of rising risk aversion.

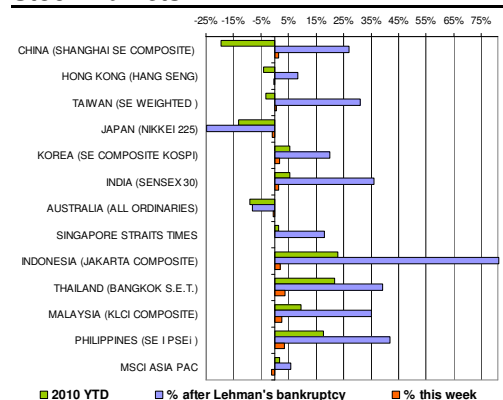
JPY remained the best performing currency amidst high global risk premium. Strengthening pressure on JPY and bearishness in the stock market have accelerated since the government and BOJ failed to assure markets that they were committed to preventing currency appreciation and addressing the faltering economic recovery. JPY has broken the key resistance level of 85 and closed at 84.7 on Friday. Given the current risk aversion atmosphere the JPY could test support levels towards 82.5 against the dollar.

Global growth concerns along with a hung parliament in Australia after the federal election last weekend put downward pressure on AUD. In our view, the two leading parties share similar views on major macro policies, and there are no issues of policy discontinuity. Unlike the UK, Australia also does not have problems of high budget deficits for the new government to tackle. There are little uncertainties over the economic policies of the new government. We believe political risk is not a significant factor influencing the AUD. Rather, the global growth outlook and interest rate differentials are more important issues going forward.

The CNY stayed at around 6.8 against the dollar. Compared to the level when the policy of greater exchange rate flexibility was announced, the CNY has appreciated by only 0.5% against the dollar. Although EUR, JPY and Asian currencies have been volatile during this period, the CNY has remained relatively stable and has not shown any inclination to move in tandem. This would likely raise doubts over the importance of a basket of currencies in determining CNY's levels. Given the large external surplus and the need to rebalance the economy towards domestic growth, we continue to see CNY to appreciate gradually, and the timing may be related to the rising international pressure ahead of US Congress Election in November.

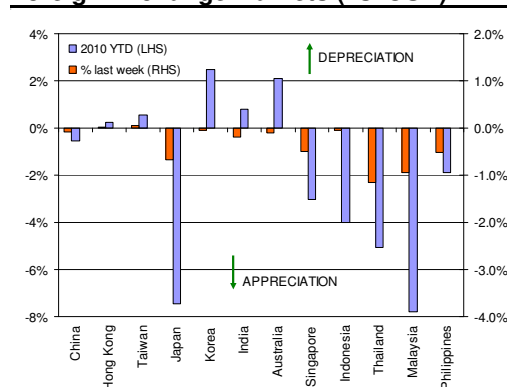
Stock markets in Asia dropped last week, in line with global sentiment, as fears about Europe's debt crisis re-emerged after Ireland's downgrading and new disappointing indicators from the US. A still-strong JPY dragged Nikkei index to a 16-month low, while Taiwan were the worst performer (-2.6%). On the other hand, most of Southeast Asia's stock markets recorded gains throughout the past week.

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 (II)**

McDonalds Corp. this month became the first multinational non-financial company to issue RMB-denominated bonds in Hong Kong. The CNY200 million (USD29.4 million) in 3-year corporate bonds carried an annual interest rate of 3 percent in Hong Kong. According to the company, McDonalds intends to use the funds to expand its Chinese mainland operations. If the authorities allow the proceeds to be re-invested in China, as seems likely, it would signal the opening of another channel for offshore RMB to flow back, and thereby encourage the offshore usage of the RMB. The following table summarizes the recent measures which China has implemented to advance the internationalization of the RMB:

Time	Measures
February 11, 2010	Hong Kong Monetary Authority (HKMA) elucidated the supervisory principles and operational arrangements regarding RMB business in Hong Kong: <ul style="list-style-type: none"> <li>➤ Cross-border flows of RMB funds into and out of the Mainland should comply with the rules and requirements in the Mainland.</li> <li>➤ With regard to the RMB funds that have flowed into Hong Kong, participating Authorized Institutions (AIs) in Hong Kong can develop RMB businesses based on the regulatory requirements and market conditions in Hong Kong, as long as these businesses do not entail the flow of RMB funds back to the Mainland.</li> </ul>
June 22, 2010	Expansion of RMB cross-boarder trade settlement pilot scheme: <ul style="list-style-type: none"> <li>➤ Domestic scope of the pilot scheme expanded from 4 provinces to 20 provinces</li> <li>➤ Overseas scope of the pilot scheme expanded to the whole world</li> </ul>
July 7, 2010	Hopewell Highway Infrastructure Limited, a HK-listed company, announced that it successfully issued the first RMB denominated corporate bonds in Hong Kong with the amount of RMB1.38 <ul style="list-style-type: none"> <li>➤ According to the company's disclosure, the Proceeds from the issuance of the bonds will be used to expand the business and for general financing purposes.</li> </ul>
July 13, 2010	The People's Bank of China (PBoC) and Bank of China (Hong Kong) (BOCHK) signed the Agreement on Provision of Clearing Service for Renminbi (RMB) Cash-notes Business for Taiwan. <ul style="list-style-type: none"> <li>➤ According to the Agreement, BOCHK is authorized as the Clearing Bank of RMB cash-notes business for Taiwan.</li> </ul>
July 19, 2010	PBoC and HKMA signed a Supplementary Memorandum of Co-operation on the expansion of the RMB trade settlement scheme  PBoC and BOCHK signed the revised Settlement Agreement on the Clearing of Renminbi (RMB) Businesses  The revised Settlement Agreement relaxed the previous limitations on the usage of RMB fund and the transfer of fund between different RMB accounts
August 17, 2010	PBoC Launched a new pilot program 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.
August 19, 2010	McDonalds Corp. issued 200 million Yuan of 3-year corporate bond in Hong Kong and planned to use raised RMB fund to expand its operation in mainland China: the issuance made McDonalds the first multinational non-financial company selling RMB denominated bonds in Hong Kong

Further progress in internationalization of the RMB will require a considerable size of offshore RMB in circulation. Toward this end, the authorities are encouraging the development of an offshore market by increasing usage of the RMB in cross-board trade and developing Hong Kong as the RMB offshore center. However, offshore RMB today finds little investment use internationally, and consequently, market participants have little incentive to hold RMB deposits, other than to capitalize on expected further appreciation of the currency. The steps listed above are part of the authorities' efforts to enhance the attractiveness of holding RMB deposits.

### Australia's elections leave a hung parliament

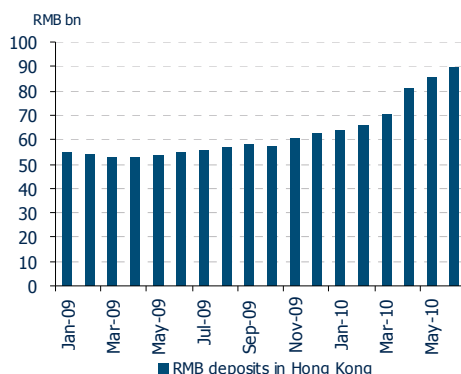
In the election on August 21, both the ruling Labor party and the Liberal-led opposition failed to reach the 76 seats majority, resulting in the first hung parliament since WWII. Both party leaders were now fighting over the backing of four independents and one green. Should the Liberal party convince three independent MPs to form a coalition government, Labor under the leadership of Julia Gillard would become the first since 1931 to fail to win a second term. Support for the Labor party has declined despite strong economic performance because of a number of policy bumbles, including the government's early proposal for a profits tax on mining resources. Nevertheless, it should be noted that on major policies, there are few significant differences between the Labor and Liberal parties. Both parties, for example, have vowed to bring the budget back into surplus by 2012-13. Therefore, the election is unlikely to have a material influence on economic policy.

### Southeast Asian 2Q GDP growth is slowing, but still well above trend

Southeast Asian GDP continued to grow strongly in the second quarter, beating market expectations. After strong GDP outturns in Indonesia (6.2% y/y) and Malaysia (8.9% y/y) earlier this month, data releases this past week showed that Thailand's and the Philippines' GDP rose 9.1% y/y and 7.9% respectively, both ahead of market expectations. Although the growth pace has decelerated modestly in the second quarter, it remained well above historical trends. Sequentially, the deceleration in Thailand was more pronounced due to the political protests and violence in Bangkok in April. Macro indicators suggested that the disruption was one-off and growth resumed. That said, we believe that the slowdown is a transition back to trend after a sharp V-shape recovery.

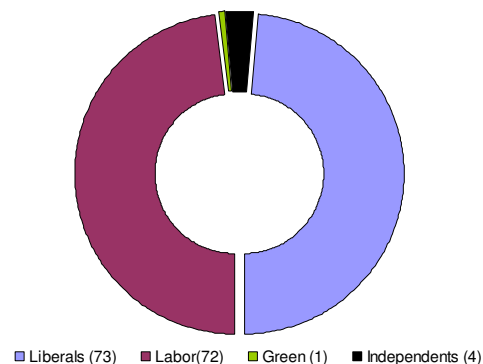
As recoveries mature, Malaysia and Thailand have begun to withdraw monetary stimulus, and they have hiked rates since the beginning of the year. Malaysia has raised its benchmark rate for three times this year. Thailand, after the confirmation of continued recovery from 2Q GDP, raised rates by 25bp last week to 1.75%, the second time this year. We expect Thailand to raise rates once more, by 25 bps, this year. Indonesia and Philippines have so far held rates unchanged. But with rising inflation expectations and growth gaining further traction, we expect their central banks to start hiking rates towards the end of this year.

Chart 5  
**RMB deposits in Hong Kong are growing**



Source: BBVA Research and Bloomberg

Chart 6  
**A hung parliament in Australia**



Source: BBVA Research and Bloomberg

## What to watch

### China: Purchasing Managers' Index (August, September 1)

Forecast: 51.8

Consensus: 51.6

Previous: 51.2

Domestic demand is cooling on government efforts to restrain credit growth and cool the property market. In line with recent activity indicators pointing to an economic soft landing, we expect August manufacturing activity to come in at a similar pace as in recent months. However, due to seasonality, we expect China's PMI to rise slightly in August. A weaker than expected reading, could trigger concerns of a hard landing, and renew worries about the sustainability of global growth.

## Calendar

<b>AUSTRALIA</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
Retail Sales s.a. (MoM)	31-Aug	JUL	0.20%	0.40%
Current Account Balance	31-Aug	2Q	-16551M	-6500M
Gross Domestic Product (QoQ)	1-Sep	2Q	0.50%	0.90%
Gross Domestic Product (YoY)	1-Sep	2Q	2.70%	2.80%
Trade Balance	2-Sep	JUL	3539M	3100M
<b>CHINA</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
PMI Manufacturing	1-Sep	AUG	51.2	51.6
<b>HONG KONG</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
Retail Sales - Value (YoY)	31-Aug	JUL	15.30%	--
<b>INDIA</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
Qtrly GDP YoY%	31-Aug	2Q	8.60%	8.80%
Exports YoY%	1-Sep	JUL	30.40%	--
Imports YoY%	1-Sep	JUL	23.00%	--
<b>INDONESIA</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
Inflation (YoY)	1-Sep	AUG	6.22%	6.66%
Core Inflation (YoY)	1-Sep	AUG	4.15%	4.27%
Exports (YoY)	1-Sep	JUL	31.00%	28.20%
<b>JAPAN</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
Industrial Production (MoM)	31-Aug	JUL P	-1.10%	-0.20%
Retail Trade MoM SA	31-Aug	JUL	0.40%	0.50%
<b>KOREA</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
Industrial Production Mfg(YoY)	31-Aug	JUL	17.40%	--
Industrial Production (MoM)	31-Aug	JUL	1.40%	0.50%
Consumer Price Index (YoY)	1-Sep	AUG	2.60%	2.60%
Core Consumer Price Index(YoY)	1-Sep	AUG	1.70%	--
Ext Trade - Export (YoY)	1-3 Sep	AUG	29.60%	34.70%
Ext Trade - Imports (YoY)	1-3 Sep	AUG	28.90%	31.70%
Ext Trade - Balance in US\$ Mln	1-3 Sep	AUG	5674	2907
GDP at Constant Price (YoY)	3-Sep	2Q F	7.80%	--
<b>MALAYSIA</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
Exports YoY%	2-Sep	JUL	17.20%	11.30%
Trade Balance	2-Sep	JUL	6.04B	6.25B
Current Account Balance	2-Sep	2Q	30.4B	--
<b>SINGAPORE</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
Purchasing Managers Index	2-Sep	AUG	52.2	51
<b>THAILAND</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
Total Trade Balance	31-Aug	JUL	\$2536M	--
Manufacturing Production (YoY)	31-Aug	JUL	21.30%	13.30%
Current Account Balance (USD)	31-Aug	JUL	\$681M	-\$645M
Core CPI (YoY)	1-Sep	AUG	1.20%	1.30%

### Malaysia – Overnight Interest Rate, September 2

We expect interest rate will remain unchanged

Current	Expected
2.75	2.75

### Indonesia – BI Reference Rate, September 3

We expect interest rate will remain unchanged

Current	Expected
6.50	6.50

## Global Market Data

Table 1:

			Close	Weekly change	Monthly change	Annual change
Interest Rates (changes in bps)	US	3-month Libor rate	0.30	-3	-17	-5
		2-yr yield	0.52	4	-5	-49
		10-yr yield	2.55	-6	-43	-90
	EMU	3-month Euribor rate	0.89	0	-1	6
		2-yr yield	0.62	1	-21	-63
		10-yr yield	2.13	-14	-59	-112
Exchange Rates (changes in %)	Europe	Dollar-Euro	1.271	0.1	-2.8	-11.3
		Pound-Euro	0.82	0.3	-2.1	-6.7
		Swiss Franc-Euro	1.30	-1.0	-4.2	-14.1
	America	Argentina (peso-dollar)	3.94	0.2	0.1	2.5
		Brazil (real-dollar)	1.75	-0.4	-0.7	-6.4
		Colombia (peso-dollar)	1809	-0.5	-1.8	-11.5
		Chile (peso-dollar)	502	-0.7	-4.3	-8.9
		Mexico (peso-dollar)	13.07	2.4	2.6	-1.3
		Peru (Nuevo sol-dollar)	2.80	-0.1	-1.0	-4.9
	Asia	Japan (Yen-Dollar)	85.01	-0.8	-2.0	-9.1
		Korea (KRW-Dollar)	1197.00	1.1	0.8	-3.7
		Australia (AUD-Dollar)	0.890	0.0	-1.0	5.9
Comm. (chg %)		Brent oil (\$/b)	75.3	1.3	-3.0	3.4
		Gold (\$/ounce)	1239.3	0.9	6.1	29.8
		Base metals	500.9	0.1	3.1	11.8
Stock Markets (changes in %)	Euro	Ibex 35	10109	0.1	-5.2	-11.7
		EuroStoxx 50	2622	-0.8	-4.7	-6.5
		USA (S&P 500)	1047	-2.3	-4.9	1.8
	America	Argentina (Merval)	2321	-4.8	-3.5	29.2
		Brazil (Bovespa)	64262	-3.6	-4.0	11.4
		Colombia (IGBC)	13696	1.8	3.8	28.7
		Chile (IGPA)	20927	-0.9	3.3	36.9
		Mexico (CPI)	31218	-3.3	-3.8	9.2
		Peru (General Lima)	14975	0.7	5.6	5.8
		Venezuela (IBC)	64769	-0.1	0.8	30.8
	Asia	Nikkei225	8991	-2.1	-7.3	-14.6
		HSI	20597	-1.8	-2.4	2.5
Credit (changes in bps)	Ind.	Itraxx Main	118	4	13	27
		Itraxx Xover	523	16	45	-74
		CDS Germany	44	1	6	23
	Sovereign risk	CDS Portugal	329	51	113	276
		CDS Spain	244	17	66	178
		CDS USA	47	0	12	—
		CDS Emerging	257	23	43	-55
		CDS Argentina	937	114	145	-658
		CDS Brazil	129	8	12	-3
		CDS Colombia	134	11	10	-30
		CDS Chile	77	2	-6	1
		CDS Mexico	134	14	18	-38
		CDS Peru	115	15	5	-26

Sources: Bloomberg, Datastream and JP 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.	2610.7	-1.2	-20.3	-11.4
	Hong Kong – Hang Seng	20597.4	-1.8	-5.8	1.8
	Taiwan – Weighted	7722.9	-2.6	-5.7	15.4
	Japan – Nikkei 225	8991.1	-2.1	-14.7	-14.2
	Korea – Kospi	1729.6	-2.6	2.8	8.1
	India – Sensex 30	18162.2	-1.3	3.5	14.5
	Australia – SPX/ASX 200	4370.1	-1.4	-10.3	-1.8
	Singapore – Strait Times	2946.3	0.3	1.6	11.5
	Indonesia – Jakarta Comp	3112.8	-0.2	22.5	31.8
	Thailand – SET	896.9	0.3	22.4	37.8
	Malaysia – KLCI	1411.9	1.2	10.9	19.9
	Philippines – Manila Comp.	3558.7	-1.0	16.6	23.5

Source: BBVA Research and Bloomberg

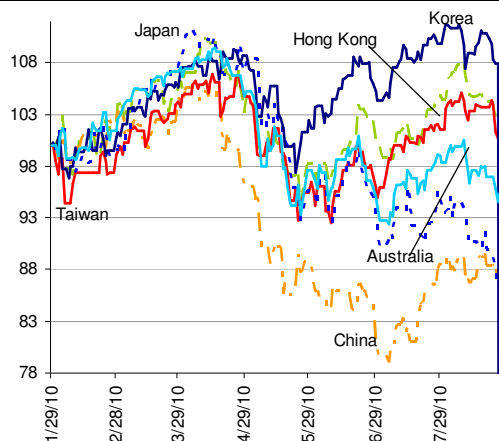
Table 2

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.80	-0.11	-0.02	-0.11
	Hong Kong (HKD/USD)	7.78	-0.07	-53.0	-190
	Taiwan (TWD/USD)	32.0	-0.27	-0.11	-0.55
	Japan (JPY/USD)	84.7	1.10	-7.9	-42.0
	Korea (KRW/USD)	1197	-1.14	7.42	18.22
	India (INR/USD)	46.9	-0.47	61.6	192
	Australia (USD/AUD)	0.89	-0.84	124	n.a.
	Singapore (SGD/USD)	1.36	0.00	-2.60	-13.0
	Indonesia (IDR/USD)	9016	-0.48	84	408
	Thailand (THB/USD)	31.3	0.67	2.50	14.0
	Malaysia (MYR/USD)	3.15	-0.24	166.8	532
	Philippines (PHP/USD)	45.2	-0.30	0.36	1.50

Source: BBVA Research and Bloomberg



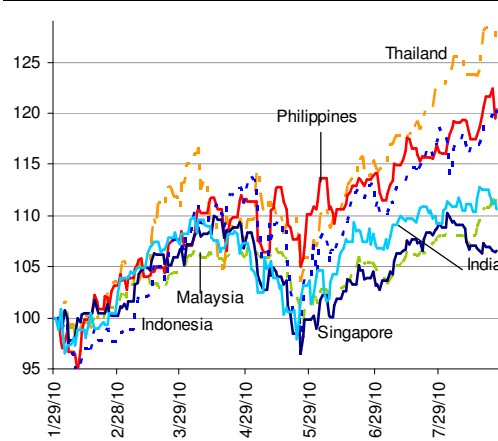
### STOCK MARKETS



Source: BBVA Research and Bloomberg

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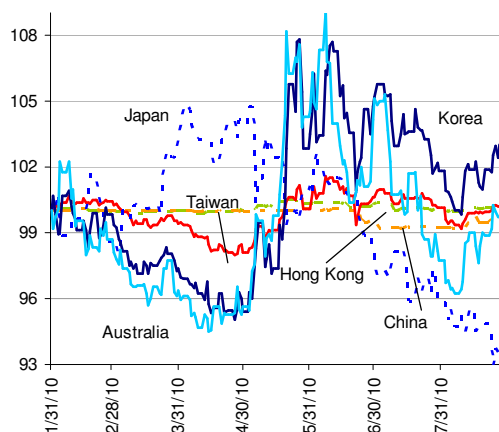
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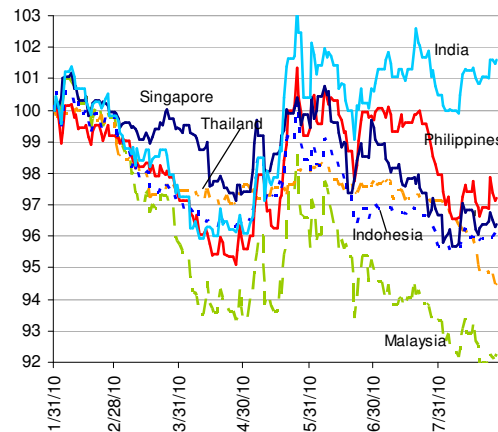
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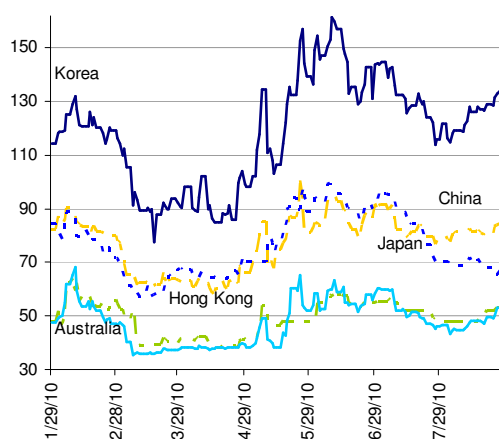
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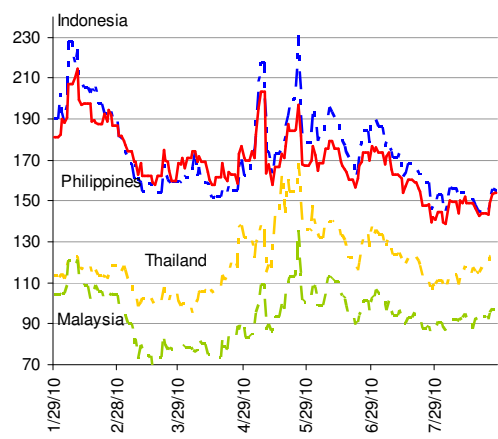
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### CREDIT DEFAULT SWAPS



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### CREDIT DEFAULT SWAPS



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