

## Asia

## Weekly Watch

Hong Kong, September 6,  
2010

## Economic Analysis

## Asia

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## Markets revive, backed by positive regional indicators

Asian markets were on the upside over the last week, encouraged by strong regional indicators and improved global sentiment.

## China's PMI and 2Q GDP for Australia underscore Asia's economic vitality

China posted a better-than-expected August PMI (see Highlights). Moreover, 2Q GDP growth in Australia also beat expectations (3.3% y/y, consensus: 2.8%), as domestic and external demand improved. That said, Korean exports fell in August (see Highlights), as regional export growth continues to show signs of slowing. On the inflationary front, prices remained under control in Korea (2.6% y/y) and Thailand (3.3% y/y), and picked up in Indonesia (6.4% y/y).

## The uncertain global environment is keeping monetary authorities on a cautious footing

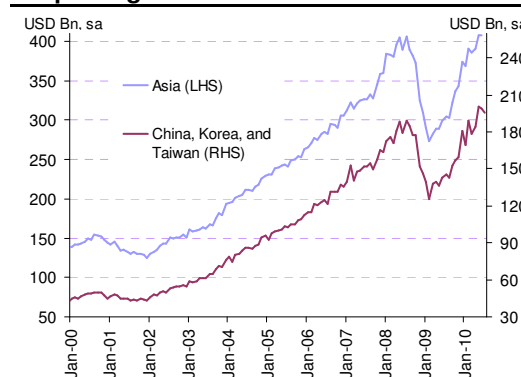
As expected, Bank Negara Malaysia and Bank Indonesia left their policy rates unchanged last week. However, Bank Indonesia raised its reserve ratio to 8% from 5%, in order to drain liquidity in the midst of rising inflation. Moreover, the Bank of Japan and the government unveiled a new stimulus plan (see Highlights).

## In the coming week....

Trade figures in China (see What to watch), Philippines and Taiwan, inflation in Philippines and Taiwan, industrial production in India and Malaysia, and machinery orders in Japan. On the monetary policy front, we expect Australia, Korea and Japan to all leave rates unchanged.

Chart 1

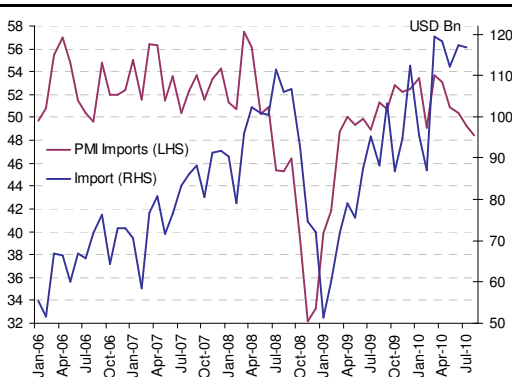
## Asia exports exceed the pre-crisis peak, despite signs of a slowdown



Source: BBVA Research and Bloomberg

Chart 2

## China's imports are slowing



Source: BBVA Research and Bloomberg

## Highlights

**A strong outturn for China's August PMI eases hard-landing concerns**

**More signs of a sequential slowdown in regional exports**

**Japan takes new steps to stimulate the economy**

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## Markets rebound, but the mood is still cautious

### Markets Analysis

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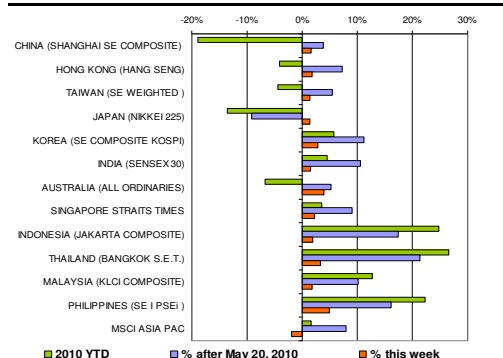
Positive outturns in China and US PMI, along with stronger-than-expected Australian 2Q GDP, helped allay fears of an abrupt global slowdown. The data triggered short-covering in oversold global equities markets and led to a notable rebound. Asian equities and currencies also benefited from this rally. However, the underlying market sentiment is more cautious than witnessed during the previous rally in July. For example, the CDS spreads on Spanish and Greek sovereign debt were still high, and the US 10-year Treasury yield was still at 2.62%, only 15 bps higher than the 20 month-low. Against the backdrop of the global slowdown, Asian exports, as exhibited by Korean and Malaysian data, also moderated in the third quarter. Bank Negara Malaysia (BNM) and Bank Indonesia also left the rates unchanged. While we think the growth moderation in Asia is a healthy transition to a more sustainable level, uncertainties over the extent of growth slowdown will likely weigh down on market sentiment.

AUD benefited from falling risk aversion, stronger-than-expected 2Q GDP and higher oil prices. AUDUSD climbed back to above the 0.91 level on Friday. The market appeared to shrug off any political risks from the latest election results, as major economic policies do not differ significantly between the two leading parties in the election. However, we see limited scope for further increases at this level, and AUD is vulnerable to corrections from negative growth news domestically and internationally. JPY stabilized above the level of 84 against the dollar after the decision of additional monetary and fiscal stimulus in Japan this week. Fears of intervention also curbed further appreciation temporarily. But note that JPY appreciation since April has largely been driven by growing concerns of a double-dip recession in the US and European debt spillover, as exhibited by the tightening of interest rate differentials between US and Japan. As these worries will unlikely dissipate quickly, especially given our expectation of growth slowdown in 2H, we believe yen's strength will be maintained in the short term. USDMYR continued to appreciate this week despite slowing export growth and BNM's decision to keep the policy rate on hold. To-date, USDMYR is the second best performing currency in the region in 2010 following Japan. The currency's strength was partly caused by strong economic recovery and the related capital flows. More importantly, BNM has been relatively ahead of the curve compared to its regional peers in normalizing rates, and widening interest rate differentials has buoyed MYR. With moderating growth momentum in the second half and rising uncertainties in the global economies, BNM will likely be more cautious. Limited upside in interest rate differentials will likely cap the currency strength for the rest of the year.

Stock markets rallied in Asia last week, pushing MSCI Asia-Pacific by 2.7%, mainly due to improved global sentiment and fresh strong indicators across the region. Australia jumped by 3.9%, as strong GDP growth instilled confidence in its economic outlook. The Korean KOSPI jumped by 2.9%, after the government announced that banks will be allowed to ease restrictions on mortgage loans, and growth indicators remained resilient (exports and industrial production). Meanwhile, in Southeast Asia, stock markets also climbed, led by the Philippines (5.0%) and Thailand (3.2%).

Chart 3

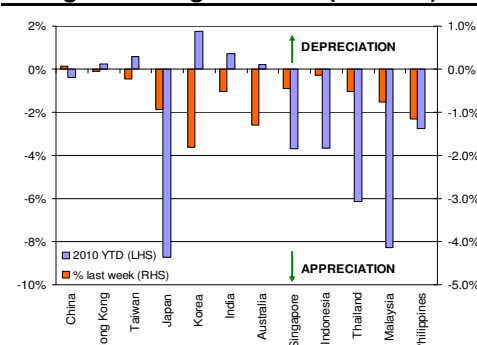
### Stock Markets



Source: BBVA Research

Chart 4

### Foreign Exchange Markets (vs. USD)



Source: BBVA Research

## Economics Analysis

## Highlights

**A strong outturn for China's August PMI eases hard-landing concerns**

In line with expectations (BBVA: 51.8%; consensus: 51.5%), China's August PMI rose from 51.2% in July to 51.7%, signaling a continued expansion in the manufacturing sector.

The main driver of the increase in the August PMI was the production index (25% weight of PMI), which rose 0.4 percentage points to 53.1% from the previous month. New export orders reached 52.2% in August, compared to 51.2% in July. New orders rose 2.2 percentage points from July's 50.9% to 53.1% in August. The figures should help alleviate concerns about a hard landing towards the end of 2010. In contrast to the expansion elsewhere in the index, the inventory component slipped from July's 49.9% to 46.9% in August and PMI import index dropped from 49.3% in July to 48.4%.

Markets have reacted positively to the data release as it mitigates fears of a hard landing towards the end of 2010. The data are in line with our annual GDP growth projection of 9.8% in 2010 and 9.2% in 2011.

**More signs of a sequential slowdown in regional exports**

Korea's exports fell 4.4% m/m in August after seasonal adjustment. As the first monthly export data release in Asia and a significant upstream manufacturing producer, Korean data are closely watched as a leading indicator of the region's trade prospects. Part of the slowdown in August was caused by the declines in lumpy vessel shipments. Excluding vessels, exports actually edged up by 1.8% m/m.

Notwithstanding the role of lumpy vessel shipments, Korea's overall data in August echoes the regional trend of export slowdown in the second half of the year. Asian exports have rebounded strongly in the past 12 months and have more than fully recovered back to their pre-crisis peak level. But in recent months, there have been growing signs of moderation. July exports in India (13.2% y/y), Indonesia (29% y/y), Malaysia (13.5% y/y) and Thailand (21.2% y/y) all came in lower than the previous month. As global policy stimulus wears off, Asian manufacturers have become more cautious and avoided building up excessive inventories. Going forward, we expect Asian trade to slow, but only gradually despite moderating demand from advanced economies, as stabilizing demand from China and other Asian economies will provide some offset.

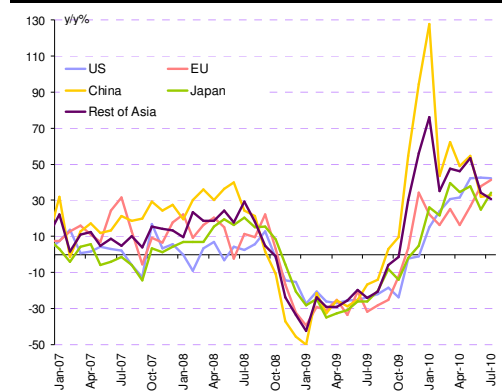
**Japan takes new steps to stimulate the economy**

The Bank of Japan announced in an emergency policy meeting on August 30 to expand its liquidity facility by JPY 10 trillion (2% of GDP). The facility was first set up in December 2009 with an initial size of JPY10 trillion aiming to provide low interest rate bank loans to corporations. The size was doubled in March before the latest expansion. In addition to the monetary stimulus, the Ministry of Finance announced plans to spend 920 billion yen (0.9% of current budget) on economic stimulus (to be approved on Sept 10), with consideration of continued expansionary fiscal policy next year if deemed necessary.

The new policy moves were underscored by weak economic indicators, a persistently strong yen, and uncertain domestic politics. Second quarter GDP (0.1%, q/q s.a.) was much lower than expected (a revised 0.4%, q/q s.a.), while there has been no significant improvement in deflation through July. Despite domestic weakness, the yen has continued to strengthen against the dollar, approaching the strongest level since 1995. Persistently high global risk aversion amidst concerns over European debt problems and US growth prospects tightened interest rate differentials between the US and Japan, have favored a stronger yen. The authorities are concerned that the stronger yen could undermine Japan's export growth, which has been the key driver of the economic recovery in the past year.

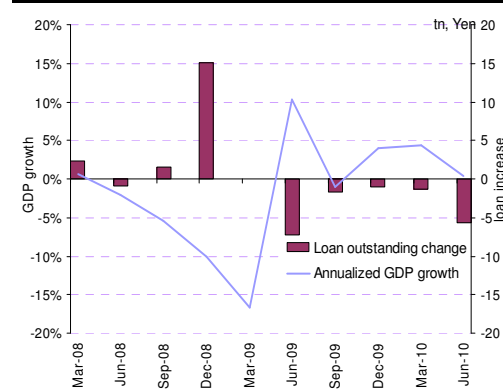
Despite the new stimulus measures, we continue to see a sluggish recovery in Japan and expect GDP to rise 2.3% in 2010, pending a more significant turnaround in private credit and investment demand. Market reaction to the stimulus measures has so far been muted, with yen ranging between 84-85 against the dollar.

Chart 5  
**Korea and Taiwan export growth by market destination**



Source: BBVA Research and Bloomberg

Chart 6  
**GDP growth and outstanding loans in Japan**



Source: BBVA Research and Bloomberg

## What to watch

### China: Imports (August, September 10)

Forecast: 28.1%

Consensus: 26.2%

Previous: 22.7%

China's imports have remained relatively strong on robust domestic demand, although growth is slowing, consistent with our baseline of a soft-landing in H2. A lower-than-expected reading could raise concerns on China's growth momentum and the outlook for the global recovery. Given China's role in boosting demand from other countries, an already healthy August PMI reading may allay such concerns.

## Calendar

<b>AUSTRALIA</b>	Date	Period	Prior	Cons.
Unemployment Rate	9-Sep	AUG	--	5.20%
<b>CHINA</b>	Date	Period	Prior	Cons.
Trade Balance (USD)	10-Sep	AUG	\$28.73B	\$26.70B
Exports YoY%	10-Sep	AUG	38.10%	33.10%
Imports YoY%	10-Sep	AUG	22.70%	26.20%
<b>INDIA</b>	Date	Period	Prior	Cons.
Industrial Production YoY	10-Sep	JUL	7.10%	--
<b>JAPAN</b>	Date	Period	Prior	Cons.
Machine Orders (MoM)	8-Sep	JUL	1.60%	2.20%
Machine Orders YOY%	8-Sep	JUL	-2.20%	8.10%
Current Account Total	8-Sep	JUL	¥1047.1B	¥1534.6B
Adjusted Current Account Total	8-Sep	JUL	¥1362.1B	¥1362.9B
Trade Balance (BoP Basis)	8-Sep	JUL	¥769.0B	¥865.0B
Consumer Confidence	9-Sep	AUG	43.4	--
Gross Domestic Product (QoQ)	10-Sep	2Q F	0.10%	--
GDP Annualized	10-Sep	2Q F	0.40%	--
Nominal GDP (QoQ)	10-Sep	2Q F	-0.90%	--
<b>MALAYSIA</b>	Date	Period	Prior	Cons.
Industrial Production YoY	9-Sep	JUL	9.40%	6.70%
Manufacturing Sales Value YoY%	9-Sep	JUL	13.80%	--
<b>PHILIPPINES</b>	Date	Period	Prior	Cons.
Consumer Price Index (YoY)	7-Sep	AUG	3.90%	3.90%
Total Exports (YoY)	10-Sep	JUL	33.40%	27.00%
Total Monthly Exports	10-Sep	JUL	\$4545.0M	--
<b>TAIWAN</b>	Date	Period	Prior	Cons.
CPI YoY%	6-Sep	AUG	1.31%	0.00%
Total Exports (YoY)	7-Sep	AUG	38.50%	24.70%
Total Imports (YoY)	7-Sep	AUG	42.70%	28.50%
Total Trade Bal in US\$ Billion	7-Sep	AUG	\$2.16B	\$2.20B
<b>THAILAND</b>	Date	Period	Prior	Cons.
Consumer Confidence Economic	9-Sep	AUG	--	--

### Australia – RBA Cash Rate, September 7

We expect interest rate will remain unchanged

Current	Expected
4.50	4.50

### Japan – BoJ Target Rate, September 7

We expect interest rate will remain unchanged

Current	Expected
0.10	0.10

### Korea – 7-Day Repo Rate, September 9

We expect interest rate will remain unchanged (consensus: increase by 25bps)

Current	Expected
2.25	2.25

## Global Market Data

Table 1:

			Close	Weekly change	Monthly change	Annual change
Interest Rates (changes in bps)	US	3-month Libor rate	0.29	0	-13	-2
		2-yr yield	0.51	-4	-2	-42
		10-yr yield	2.70	6	-20	-74
	EMU	3-month Euribor rate	0.88	-1	-2	8
		2-yr yield	0.64	1	-11	-45
		10-yr yield	2.35	15	-22	-90
Exchange Rates (changes in %)	Europe	Dollar-Euro	1.287	0.9	-2.2	-10.1
		Pound-Euro	0.83	1.5	0.5	-4.5
		Swiss Frano-Euro	1.31	-0.2	-5.2	-13.8
	America	Argentina (peso-dollar)	3.94	-0.1	0.3	2.6
		Brazil (real-dollar)	1.73	-1.5	-1.7	-6.2
		Colombia (peso-dollar)	1808	-0.5	-0.5	-10.4
		Chile (peso-dollar)	496	-1.0	-3.8	-10.0
		Mexico (peso-dollar)	12.95	-0.7	3.1	-3.6
		Peru (Nuevo sol-dollar)	2.80	-0.1	-0.1	-4.6
	Asia	Japan (Yen-Dollar)	84.35	-1.1	-1.8	-9.3
		Korea (KRW-Dollar)	1171.65	-1.6	0.4	-5.4
		Australia (AUD-Dollar)	0.915	2.0	0.2	7.4
Comm. (chg %)		Brent oil (\$/b)	76.7	0.1	-6.0	14.8
		Gold (\$/ounce)	1242.2	0.3	4.0	24.9
		Base metals	509.4	1.2	2.5	13.3
Stock Markets (changes in %)	Euro	Ibex 35	10653	5.0	-1.7	-5.1
		EuroStoxx 50	2762	5.0	-2.0	0.7
		USA (S&P 500)	1098	3.2	-2.4	8.1
	America	Argentina (Merval)	2416	2.8	-0.7	35.8
		Brazil (Bovespa)	67100	2.3	-1.9	18.4
		Colombia (IGBC)	13986	0.6	3.0	34.2
		Chile (IGPA)	21653	3.0	4.6	42.7
		Mexico (CPI)	32780	3.2	-0.4	15.8
		Peru (General Lima)	15379	1.8	4.3	8.6
	Asia	Venezuela (IBC)	64769	0.0	1.4	26.3
		Nikkei225	9114	1.4	-5.6	-10.5
		HSI	20972	1.8	-2.7	3.2
Credit (changes in bps)	Ind.	Itraxx Main	109	-9	7	12
		Itraxx Xover	492	-35	20	-130
		CDS Germany	39	-5	2	15
	Sovereign risk	CDS Portugal	305	-27	78	246
		CDS Spain	224	-22	34	151
		CDS USA	45	-2	10	—
		CDS Emerging	242	-17	31	-72
		CDS Argentina	893	-49	97	-697
		CDS Brazil	122	-7	7	-9
		CDS Colombia	126	-6	6	-36
		CDS Chile	77	2	-6	1
		CDS Mexico	138	6	23	-33
		CDS Peru	108	-5	2	-33

Source: 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.	2655.4	1.7	-19.0	-6.7
	Hong Kong – Hang Seng	20971.5	1.8	-4.1	6.1
	Taiwan – Weighted	7830.2	1.4	-4.4	10.2
	Japan – Nikkei 225	9114.1	1.4	-13.6	-10.8
	Korea – Kospi	1780.0	2.9	5.8	10.3
	India – Sensex 30	18221.4	1.2	4.3	16.1
	Australia – SPX/ASX 200	4541.2	3.9	-6.8	2.5
	Singapore – Strait Times	2994.0	1.9	3.3	15.2
	Indonesia – Jakarta Comp	3164.3	1.9	24.9	36.3
	Thailand – SET	929.6	3.3	26.6	39.7
	Malaysia – KLCI	1435.7	1.7	12.8	22.3
	Philippines – Manila Comp.	3734.7	4.9	22.3	33.2

Source: BBVA Research and Bloomberg

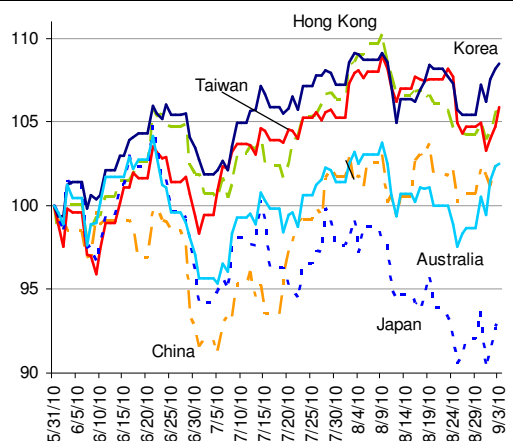
Table 2

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.80	-0.06	-0.02	-0.09
	Hong Kong (HKD/USD)	7.77	0.06	-49.3	-175
	Taiwan (TWD/USD)	31.9	0.22	-0.14	-0.58
	Japan (JPY/USD)	84.3	1.10	-8.1	-46.1
	Korea (KRW/USD)	1175	1.84	6.60	20.41
	India (INR/USD)	46.7	0.50	62.5	196
	Australia (USD/AUD)	0.91	1.21	120	n.a.
	Singapore (SGD/USD)	1.35	0.47	0.21	-5.0
	Indonesia (IDR/USD)	9008	0.09	115	486
	Thailand (THB/USD)	31.2	0.51	1.50	14.5
	Malaysia (MYR/USD)	3.12	0.76	152.5	536
	Philippines (PHP/USD)	44.7	1.18	0.37	1.46

Source: BBVA Research and Bloomberg



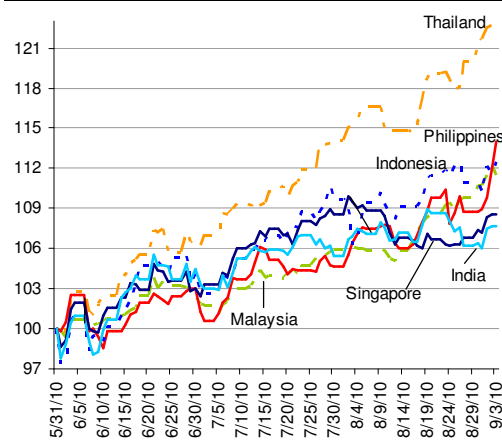
## STOCK MARKETS



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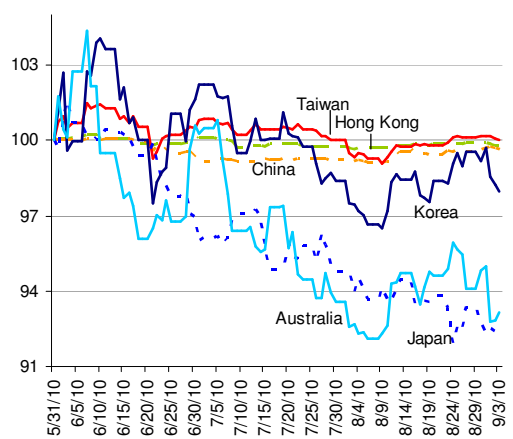
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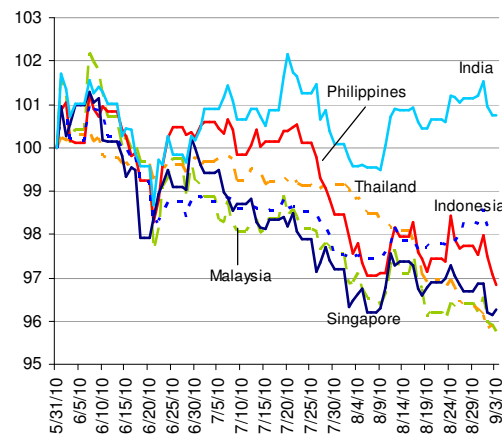
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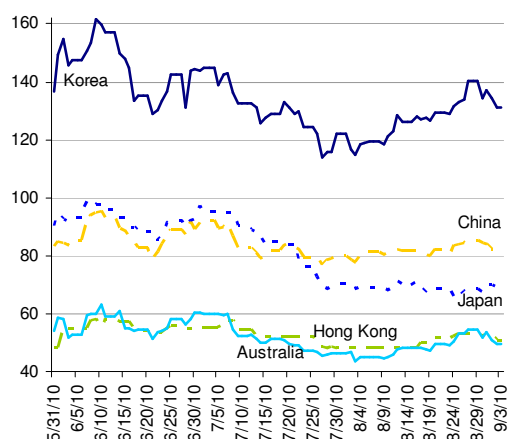
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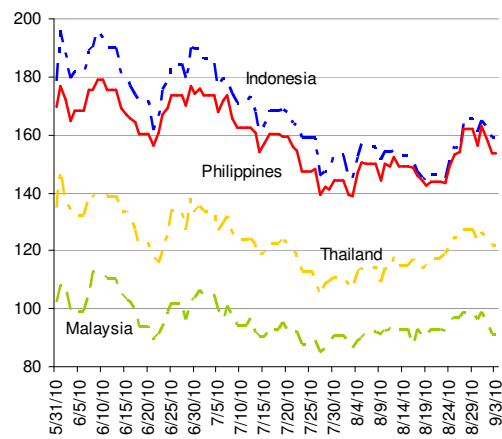
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## CREDIT DEFAULT SWAPS



Source: BBVA Research and Bloomberg

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