

Asia

Weekly Watch

Hong Kong, September 27, 2010

Economic Analysis

Asia

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Markets on watch for fx appreciation and Sino-Japan diplomatic tensions

Asia's mid-autumn festival (Korea, Japan, Hong Kong, Taiwan, and Singapore) was marked by more focus on currencies and escalating diplomatic tensions between China and Japan over a disputed chain of islands in the East China Sea. On the currency front, the Aussie dollar fluctuated after hitting a 25-month high as the RBA signaled more hikes in interest rates. Meanwhile, the Bank of Japan intervened in FX markets again to stem the yen's rise, and China's RMB continued to appreciate as President Obama and Premier Wen met in New York. On the diplomatic front, an escalating row between China and Japan over the capture of a fishing boat in disputed waters has threatened trade relations between the world's 2nd and 3rd largest economies.

Economic indicators improving

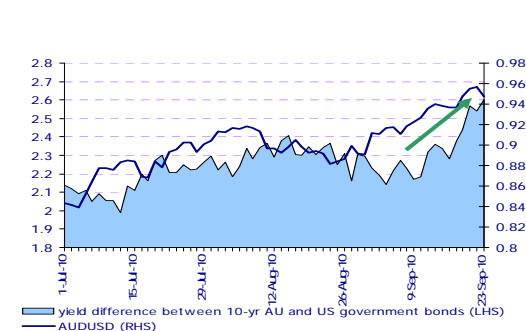
It was a quiet week on the data front, with the few meaningful indicators that were released pointing to further economic strength. Taiwan's export orders beat market expectation with 23.3%/y/y growth (consensus 21.3%). Inflation in August for Hong Kong, Malaysia, and Singapore rose slightly, within expectations. Various indicators in Japan also showed modest strength.

In the coming week...

In contrast to last week, the coming days will feature a busy data calendar. A number of countries will release trade data (watch for Korea, which posts the region's first set of monthly trade data for September), industrial production, and inflation. China will release PMI for September.

Chart1

AUD appreciating as the interest differential increases



Source: BBVA Research and Bloomberg

Chart2

Hong Kong property prices surpassing previous peak



Source: BBVA Research and CEIC

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Australia likely to hike policy rate in October

The Reserve Bank of Australia hints at more interest rate hikes

Is Hong Kong's economy at risk of overheating?

Strong growth and high liquidity are leading to a rapid rise in property prices

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Asian currencies strengthen on rising chance of Fed easing

The US Dollar tumbled to new lows as the FOMC statement showed that Board members became more concerned on deflationary risks and would consider policy options including a second round of quantitative easing ("QE2"). Meanwhile, risk premiums associated with European debt problems fell after the successful sovereign debt auction by Ireland and Greece. This combination set the stage for further gains in Asian currencies for the third consecutive week, with AUD and KRW leading.

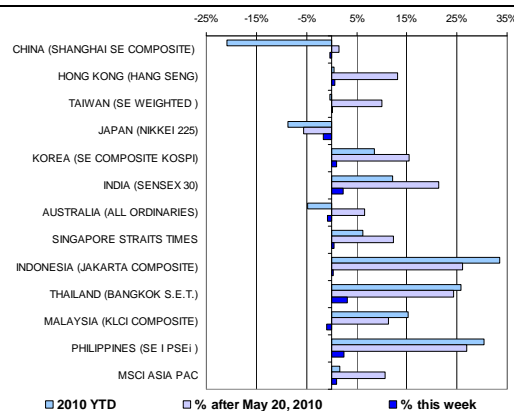
AUDUSD hit a 25-month high of 0.96 on the back of US dollar weakness and the hawkish tone of RBA. The minutes of the September policy meeting showed rising concerns about accelerating consumption growth fuelled by the mining boom and its inflationary impacts. RBA governor also put the focus of monetary policy on "managing a fairly robust upswing," pointing towards the likelihood of rates going up in the future. In the near term, the expectation of widening interest rate differentials should continue to buoy AUD.

The CNY continued to strengthen this week and reached 6.69 on Friday. The currency has appreciated by more than 2.1% since the announcement of greater exchange rate flexibility in June. Given the need for rebalancing and the threat of protectionism ahead of US midterm elections and the G20 meeting in November, we see further appreciation of CNY and in line with our 6.54 projection by end-2010.

Other Asian currencies also strengthened, counteracted by intervention fears. Besides AUD, KRW saw the largest increase in the region as the chance of an imminent rate hike is also the highest in Korea. We expect the BOK to take another step to normalize interest rate in its October meeting. THB and PHP also witnessed strong gains on the back of robust economic recoveries and prospects of further rate hikes. USDMYR continued to test new lows after breaking the key resistance level of 3.132, the lowest level since the currency was floated in 2005. We expect the divergence in monetary policy between the US and the region to continue to buoy Asian currencies.

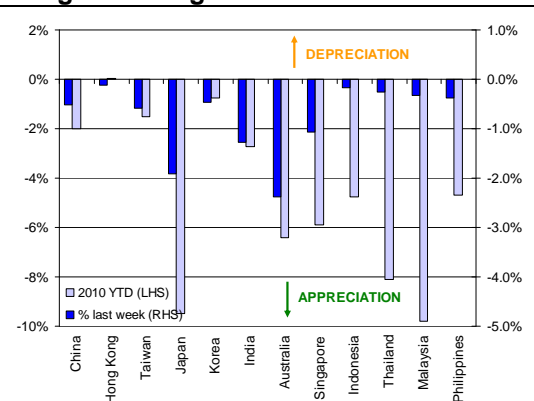
On the stock market front, Asia's markets advanced last week, with the MSCI Asia Pacific Index gained 1.01%, after the confidence in Asia's growth won the upper hand over concerns on Europe's recovery as well as weak US employment data. Thailand (3.07%) led gains in Asia, followed by Philippines (2.50%) and India (2.30%). On the other hand, Japan, Malaysia, and Australia's markets retreated by -1.60%, -1.08%, -0.8% respectively. China's market had 0.27% loss last week. (It closed in the Mid-Autumn Festival of Sept 22-24.) This week the Asia's markets will welcome a bulk of data revealing the strength or weakness of the growth in the region. Additionally, the unexpectedly rise in the US durable good orders, released last week after the markets closed, is likely to add confidence in the global recovery.

Chart 3
Stock markets



Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets



Source: BBVA Research and Bloomberg

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Australia likely to hike policy rate in October

After holding its policy rate unchanged for the past four months, minutes from the Reserve Bank of Australia's September Monetary Policy Meeting reveal that it is likely to raise interest rates to contain inflation if the economy continues to surpass its trend growth.

Australia achieved growth at a trend pace with a stable unemployment rate in the first half year, thanks to robust exports to China and other Asian countries. While exports continue lead growth, there are signs that domestic demand is picking up. Private consumption and retail spending have risen in recent months, suggesting that households are more willing to spend. Moreover, July's Westpac leading economic index rose again to 269.5 by 0.4% (M/M), adding evidence that the economic expansion is likely to continue in coming quarters.

Therefore, chances of a 25 bps rate hike by the RBA to 4.75% at its next meeting on October 5 are increasing, in our view. The market had speculated on this by pushing up the value of the AUD, as well as the yield on 10 year government bonds. There have been six rate hikes by the RBA from last October to this May, by 25 bps each.

Is Hong Kong's economy at risk of overheating?

The Hong Kong Monetary Authority (HKMA) has just issued its latest Half-Yearly Monetary and Financial Stability Report for September 2010 (http://www.info.gov.hk/hkma/eng/public/qb201009/E_halfyear.pdf). The publication documents the strong rebound of Hong Kong's economy, driven by a revival of exports and buoyancy in private domestic demand (GDP increased y 8.0% y/y and 6.5% y/y in the first and second quarter, respectively). According to HKMA estimates, the economy is now operating just above potential, causing inflationary pressures, which have been very modest to date, to rise (inflation in August was 3.0%y/y, but only 1.9% y/y if one-off factors are excluded). Going forward, however, the HKMA expects that a moderation in growth momentum will keep output in line with potential, and alleviate price pressures (we project overall GDP growth in 2010 to register 5.7%). Inflation may increase in coming months, however, due to a rapid rise in housing costs (see below).

At the same time, the report highlights looming risks, especially stemming from the buoyant property sector. Rising property prices have been fed by rapid credit growth and low interest rates. Housing prices increased cumulatively by 11.7% in the year through July, following a 28.5% surge in 2009. The market is now approaching 1997 peak levels (the luxury segment has already surpassed the peak), with strains on housing affordability. The authorities have responded with measures to increase housing supply and have tightened prudential regulations to curb speculation.

The booming property market highlights the dilemma for Hong Kong given its fixed exchange rate system to the USD and corresponding lax liquidity at a time when domestic conditions are strong compared with those in the U.S. The report therefore highlights that, "The main risks to monetary and financial stability in the local economy continue to be incentives for excessive leverage in an environment of prolonged low interest rate and rising inflation." In this regard, Hong Kong may very well serve as a microcosm of a broader phenomenon across the Asia region, which is growing rapidly and is beginning to see rising price pressures in an environment of lax global liquidity conditions.

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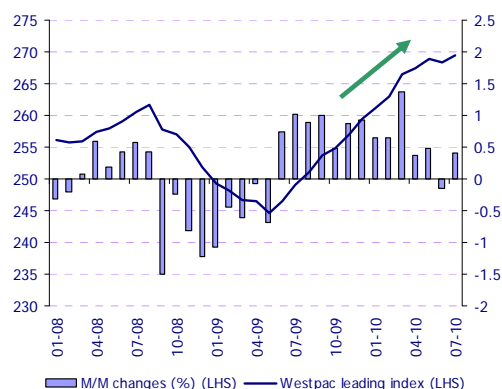
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Chart 5

Leading index signals economic expansion in Australia to continue...



Source: BBVA Research and Bloomberg

Chart 6

In Hong Kong, ratios of housing costs-to-income are undermining affordability



Source: BBVA Research and CEIC

What to watch

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China: PMI (September, October 1)

Forecast: 53.5

Consensus: 52.5

Previous: 51.7

Domestic demand has gained some strength as indicated by recent macro data on industrial production and retail sales, as well as profitability data from the logistics sector. In line with the stronger-than-expected indicators, we expect robust growth in the manufacturing sector. We project manufacturing activities to expand slightly further in September following the gain in last month. However, a weaker than expected reading could cause worries about the sustainability of economic growth.

Calendar

Australia	Date	Period	Prior	Cons.
Private Sector Credit YoY%	30-Sep	AUG	2.80%	--
Building Approvals (YoY)	30-Sep	AUG	11.00%	--
RBA Commodity Index SDR YoY%	1-Oct	SEP	52.70%	--
China	Date	Period	Prior	Cons.
HSBC Manufacturing PMI	29-Sep	SEP	51.9	--
Manufacturing PMI	1-Oct	SEP	51.7	52.5
Non-manufacturing PMI	3-Oct	SEP	60.1	--
Hong Kong	Date	Period	Prior	Cons.
Exports YoY%	27-Sep	AUG	23.30%	24.90%
Imports YoY%	27-Sep	AUG	24.90%	25.00%
Trade Balance	27-Sep	AUG	-30.5B	-27.7B
Money Supply M2 - in HK\$ (YoY)	30-Sep	AUG	4.40%	--
India	Date	Period	Prior	Cons.
Current Account Balance	30-Sep	2Q	-\$13.00B	--
Exports YoY%	1-Oct	AUG	13.20%	--
Imports YoY%	1-Oct	AUG	34.30%	--
Indonesia	Date	Period	Prior	Cons.
Inflation (YoY)	1-Oct	SEP	6.44%	--
Exports (YoY)	1-Oct	AUG	29.00%	--
Total Imports (YoY)	1-Oct	AUG	45.30%	--
Total Trade Balance	1-Oct	AUG	-\$129M	--
Japan	Date	Period	Prior	Cons.
Merchnds Trade Balance Total	27-Sep	AUG	¥804.2B	¥200.0B
Merchnds Trade Exports YoY	27-Sep	AUG	23.5	19
Merchnds Trade Imports YoY	27-Sep	AUG	15.7	17.5
Nomura/JMMA Manufacturing PMI	30-Sep	SEP	50.1	--
Retail Trade YoY	30-Sep	AUG	3.90%	4.70%
Annualized Housing Starts	30-Sep	AUG	0.772M	0.759M
Overall Hhold Spending (YoY)	1-Oct	AUG	1.10%	1.40%
Natl CPI YoY	1-Oct	AUG	-0.90%	-0.90%
Natl CPI Ex-Fresh Food YoY	1-Oct	AUG	-1.10%	-1.00%
Korea	Date	Period	Prior	Cons.
Current Account in US\$ Million	29-Sep	AUG	\$5875.8M	--
Industrial Production (YoY)	30-Sep	AUG	15.50%	--
Consumer Price Index (YoY)	1-Oct	SEP	2.60%	--
HSBC Manufacturing PMI	1-Oct	SEP	50.9	--
Ext Trade - Export (YoY)	01-03 Oct	SEP	29.60%	--
Ext Trade - Imports (YoY)	01-03 Oct	SEP	29.30%	--
Ext Trade - Balance in US\$ Mln	01-03 Oct	SEP	2077	--
Malaysia	Date	Period	Prior	Cons.
M3 Money Supply (YoY)	30-Sep	AUG	8.10%	--

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Philippines	Date	Period	Prior	Cons.
Total Imports (YoY)	28-Sep	JUL	1.40%	--
Total Monthly Imports	28-Sep	JUL	\$4165.8M	--
Trade Balance	28-Sep	JUL	\$389M	--
Singapore	Date	Period	Prior	Cons.
Bank Loans & Advances (YoY)	30-Sep	AUG	9.90%	--
M2 Money Supply (YoY)	30-Sep	AUG	7.50%	--
Taiwan	Date	Period	Prior	Cons.
HSBC Taiwan Manufacturing PMI	1-Oct	SEP	49.20	--
Thailand	Date	Period	Prior	Cons.
Total Exports YOY%	30-Sep	AUG	21.20%	--
Total Imports YOY%	30-Sep	AUG	36.50%	--
Total Trade Balance	30-Sep	AUG	-\$791M	--
Manufacturing Production (YoY)	30-Sep	AUG	16.30%	21.00%
Current Account Balance (USD)	30-Sep	AUG	-\$1130M	\$600M
Overall Balance in US\$ Million	30-Sep	AUG	\$1412M	--
Consumer Price Index (YoY)	1-Oct	SEP	3.30%	3.30%
Vietnam	Date	Period	Prior	Cons.
GDP Constant Prices YTD (YoY)	25-28 Sep	3Q	6.20%	--
CPI (YoY)	22-28 Sep	SEP	8.20%	--
Exports YTD (YoY)	26-29 Sep	SEP	--	--
Imports YTD (YoY)	26-29 Sep	SEP	--	--
Industrial Output YTD (YoY)	27-29 Sep	SEP	13.70%	--

Taiwan – Benchmark interest rate, September 30

We expect interest rates to remain unchanged

Current	Expected
1.4	1.4

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			Close	Weekly change	Monthly change	Annual change
Interest Rates (changes in bps)	US	3-month Libor rate	0.29	0	-1	1
		2-yr yield	0.43	-3	-8	-55
		10-yr yield	2.59	-14	12	-72
	EMU	3-month Euribor rate	0.88	0	-1	14
		2-yr yield	0.72	-6	11	-50
		10-yr yield	2.32	-10	17	-93
Exchange Rates (changes in %)	Europe	Dollar-Euro	1.346	3.2	6.0	-8.3
		Pound-Euro	0.85	2.1	4.3	-7.3
		Swiss Franc-Euro	1.32	0.1	1.3	-12.6
	America	Argentina (peso-dollar)	3.95	0.2	0.2	2.9
		Brazil (real-dollar)	1.71	-0.1	-2.6	-5.1
		Colombia (peso-dollar)	1814	0.6	0.1	-5.8
		Chile (peso-dollar)	486	-2.5	-3.6	-10.9
		Mexico (peso-dollar)	12.54	-1.8	-3.5	-7.5
		Peru (Nuevo sol-dollar)	2.79	-0.1	-0.3	-3.3
	Asia	Japan (Yen-Dollar)	84.25	-1.8	-0.5	-6.2
		Korea (KRW-Dollar)	1150.30	-0.9	-3.6	-3.4
		Australia (AUD-Dollar)	0.960	2.3	8.1	10.9
Comm. (chg %)		Brent oil (\$/b)	78.7	0.6	4.9	20.8
		Gold (\$/ounce)	1297.1	1.8	4.8	30.9
		Base metals	522.6	0.4	4.3	21.6
Stock Markets (changes in %)	Euro	Ibex 35	10703	1.1	7.0	-8.1
		EuroStoxx 50	2783	0.9	6.8	-1.7
	America	USA (S&P 500)	1142	1.5	9.1	9.4
		Argentina (Merval)	2523	2.0	8.7	25.1
		Brazil (Bovespa)	69259	3.2	8.4	14.8
		Colombia (IGBC)	14064	0.1	2.7	26.9
		Chile (IGPA)	22258	-1.1	6.4	42.5
		Mexico (CPI)	33369	1.0	6.9	16.0
		Peru (General Lima)	17202	2.9	14.9	13.9
		Venezuela (IBC)	65932	1.1	1.8	27.2
	Asia	Nikkei225	9472	-1.6	6.3	-7.7
		HSI	22119	0.7	7.3	5.2
Credit (changes in bps)	Ind.	Itraxx Main	117	10	-1	30
		Itraxx Xover	529	58	6	-48
	Sovereign risk	CDS Germany	40	-1	-4	18
		CDS Portugal	396	32	67	345
		CDS Spain	229	-6	-15	163
		CDS USA	49	2	2	---
		CDS Emerging	236	-5	-21	-39
		CDS Argentina	770	1	-167	-352
		CDS Brazil	120	3	-8	-13
		CDS Colombia	127	1	-7	-33
		CDS Chile	77	2	-6	1
		CDS Mexico	134	6	0	-30
		CDS Peru	122	-9	7	-19

Source: Bloomberg and Datastream

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Asia Market

STOCK MARKETS	INDEX	Last price	% change over a week	Year to date	% Change over 1 Y
	China – Shanghai Comp.	2591.6	-0.27	-20.9	-10.6
	Hong Kong – Hang Seng	22119.4	0.68	1.1	5.2
	Taiwan – Weighted	8166.6	0.10	-0.3	11.2
	Japan – Nikkei 225	9471.7	-1.60	-10.2	-7.7
	Korea – Kospi	1846.6	1.05	9.7	9.2
	India – Sensex 30	20045.2	2.30	14.8	20.1
	Australia – SPX/ASX 200	4601.9	-0.80	-5.5	-2.4
	Singapore – Strait Times	3092.7	0.53	6.7	16.1
	Indonesia – Jakarta Comp	3397.6	0.38	34.1	39.0
	Thailand – SET	951.9	3.07	29.6	31.9
	Malaysia – KLCI	1451.2	-1.08	14.0	19.2
	Philippines – Manila Comp.	4078.9	2.50	33.6	44.6

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.69	0.52	-0.05	-0.14
	Hong Kong (HKD/USD)	7.76	0.11	-35.5	-154
	Taiwan (TWD/USD)	31.5	0.59	-0.30	-0.75
	Japan (JPY/USD)	84.2	1.96	-8.2	-47.3
	Korea (KRW/USD)	1155	0.47	-1.34	7.77
	India (INR/USD)	45.3	1.29	52.5	217
	Australia (USD/AUD)	0.96	2.45	120	n.a.
	Singapore (SGD/USD)	1.32	1.08	0.65	3.5
	Indonesia (IDR/USD)	8958	0.17	80	415
	Thailand (THB/USD)	30.7	0.26	3.00	14.5
	Malaysia (MYR/USD)	3.09	0.33	62.8	449
	Philippines (PHP/USD)	44.0	0.39	0.18	1.24

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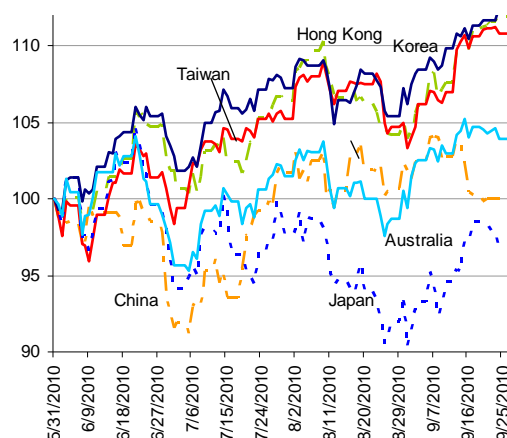
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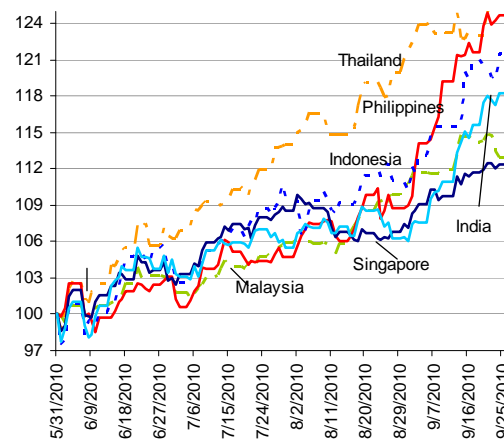
STOCK MARKETS



Source: BBVA Research and Bloomberg

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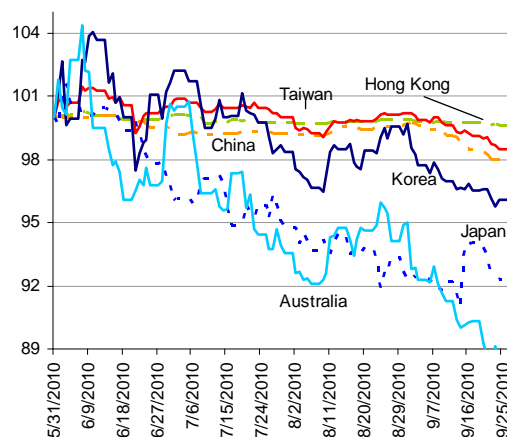
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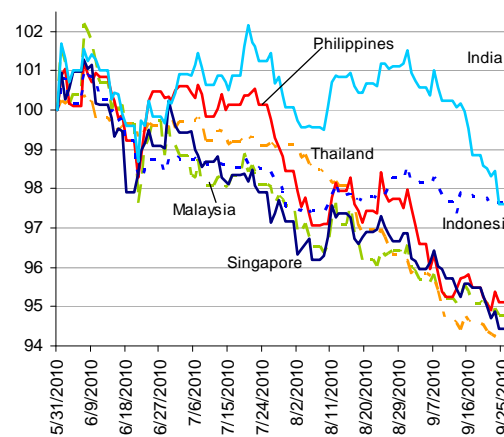
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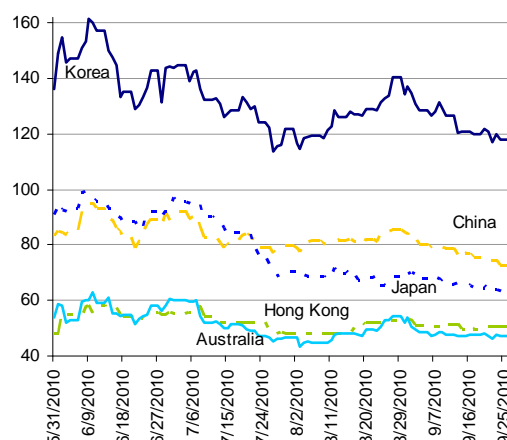
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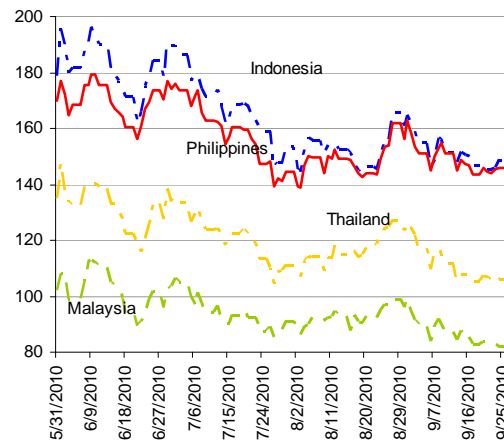
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