BBVA Research

Asia

Weekly Watch

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Economic Analysis

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Japan's monetary easing lifts markets

Stock markets were lifted this past week on news of further easing by the Bank of Japan, along with indications that similar action may be forthcoming by the US Fed. Meanwhile, Asian currencies remained under appreciation pressure against the backdrop of large capital inflows to emerging markets and talk of "currency wars".

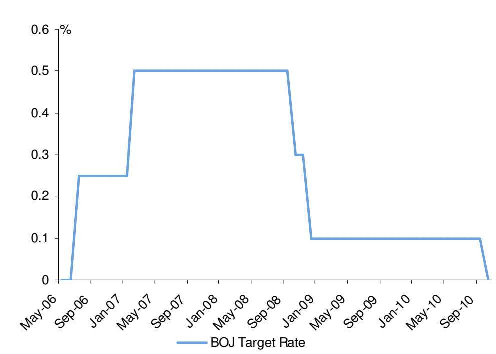
Monetary policy meetings in Asia lead sentiment

The past week was light on data, with the few figures that were released pointing to continued growth resilience in Asia, albeit with slowing momentum. September exports decelerated in Taiwan to 17.5% y/y (consensus: 26.6% y/y). Elsewhere in the region, September CPI inflation in Taiwan bounced-back to a slightly positive figure (0.3% y/y). On the monetary front, Indonesia and the Philippines stayed on hold, but unexpectedly Japan cut its target rate to a range between 0-0.1%, and Australia left its interest rate unchanged despite market expectations of a rate increase.

In the coming week…

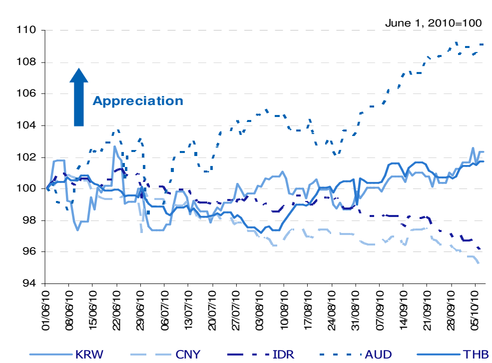
A new monthly batch of data for China will be released in the coming week, including trade, credit growth, property prices, new yuan loans and FDI (see What to Watch). Also, look out for advanced 3Q GDP in Singapore, September WPI inflation and industrial production in India, and machine orders in Japan (August). On the monetary front, Singapore will hold its biannual monetary policy meeting—with markets expecting the MAS to continue its current appreciation path—and in Korea we expect a 25bp rate hike to 2.50%.

Chart1
Japan cut interest rates to virtually zero



Source: BBVA Research and Bloomberg

Chart2
Asian currency appreciation, in nominal effective terms, has been much more muted



Source: BBVA Research and Bloomberg

Highlights

Japan eases policies

Bank of Japan (BoJ) unexpectedly cut its target rate from 0.1% to a range between 0- 0.1%

Currency appreciation could trigger further regional intervention?

Asian currencies have come under accelerated appreciation pressures in recent weeks

Asia's inventory cycle is coming to an end

Inventories have fueled economic recovery after crisis period, but this is coming to an end

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Liquidity boom bolsters Asian markets

The Bank of Japan (BOJ) decided to step up monetary easing, and its actions have reinforced market expectations of further quantitative easing by the Fed. Markets are positioning on the view that the extra liquidity created by the US and Japan will find its way into emerging markets, especially Asia, given its bright growth outlook, higher interest rates, China's expected RMB appreciation and strong sovereign ratings. In response, Asian currencies have appreciated sharply against the dollar. We do expect capital flows to continue to flow to Asia in 2011, although with valuations increasingly stretched, markets could be susceptible to a correction after the November FOMC meeting.

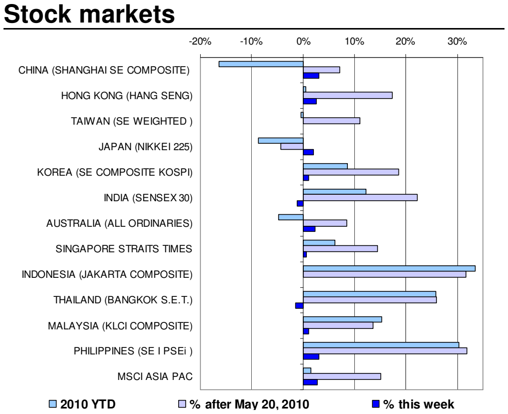
Further monetary easing by the BOJ and the threat of intervention has not stopped the appreciation of JPY materially. USD-JPY broke the key resistance level of 83 and reached 82.37 on Friday. While the extent of new liquidity injected is small, BOJ has clearly signaled a more expansionary stance. This is important, as it makes unsterilized intervention more likely going forward. This could make their currency market intervention more effective.

A stronger-than-expected jobs market report in Australia renewed expectations of a rate hike in November, despite the RBA having stayed on hold at its meeting this past week. As a result, AUD climbed up to a new high against the USD of 0.9816, close to parity. In our view, unless there is clear upward trend in the coming inflation report, the strong capital inflows and currency appreciation will slow the pace of rate hikes going forward. Investors should be watchful of the risk of reversal towards the end of this month.

Many other Asian currencies also touched the strongest level against the dollar this week. USD-THB broke 30, the lowest since 1997. USD-TWD and USD-MYR also fell below 31 and 3.1 respectively. There were some market corrections of USD-KRW, USD-MYR, USD-TWD and USD-THB on Friday as investors feared about intervention risks. But as Fed's easing continues to be a dominant theme, Asian currencies could climb up further for the rest of this month. In the interim, Asian central banks are raising their voices on potential intervention to slow the pace of appreciation

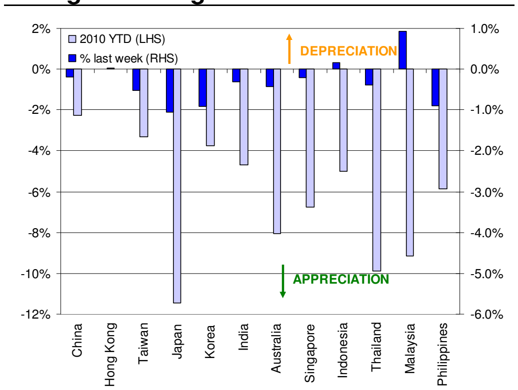
Markets in Asia were mixed last week, lifted by improved sentiment on China's growth momentum, resilient regional economic growth, and, in particular, rising confidence that a new round of QE will spur economic growth in the region and will shore up global economic recovery. Japan climbed by 2.0% as government measures to support economic growth bolstered confidence. Moreover, China jumped sharply (3.1%) as they played catch-up after being closed since October 1 and also on news that Moody's is reviewing a possible upgrade of China's sovereign rating. On the other hand, India plunged by 0.9% after being recording weekly gains for five consecutive weeks. Thailand also recorded loses, due to market speculation of measures to curb capital inflows.

Chart 3
Stock markets



Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets



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Highlights

Japan eases policies

Last Tuesday, the Bank of Japan (BoJ) unexpectedly cut its target rate from 0.1% to a range between 0 and 0.1%, returning to a virtually 0% interest rate policy. BOJ explained that the policy is to end deflation and bring about "medium to long term price stability." The BoJ also launched a form of quantitative easing through a new asset purchase program of ¥5 trillion (USD60 billion) to buy Japanese government bonds, commercial paper, and other asset-backed securities. The measures are aimed at bolstering the recovery of the economy which is losing momentum. The pace of recovery in Japan has been slowing down since the second quarter of this year, with the recent strength of the Yen threatening to undermine exports, the main growth driver of the economy. The Yen has appreciated by more than 10% this year and reached a15-year high against the USD of 82.4 this week. Concerned on Yen's appreciation and the ambiguous global economic outlook, on Wednesday the BoJ downgraded its economic assessment.

However, the effects of the measures may be limited without structural reforms, especially in the banking system, which have been a weak spot in Japan for many years. On the fiscal front, the government recently approved a supplementary budget of 5.05 trillion Yen (equivalent to $61.33 billion, or 1.1% of GDP), slightly bigger than a previous proposal of 4.8 trillion Yen (see previous Weekly), for the fiscal year through next March. The government expects it to add 0.6 percentage point to growth. The supplementary budget, funded without resort to new debt issuance, will focus on providing subsidies and assistance to unemployed workers, assistance to families, promotion of home renovation to improve energy efficiency, and incentives to the solar panel industry. The proposal needs to be approved by Parliament. The scale of further fiscal stimulus is limited by Japan's high public debt level of 190% of GDP.

Currency appreciation could trigger further regional intervention?

Asian currencies have come under accelerated appreciation pressures in recent weeks, a trend seen in other emerging markets and sparking talk of "currency wars." Among the currencies in the Asia-Pacific region showing greatest appreciation since the beginning of September are the Australian Dollar (8.5%), Korean Won (6.3%), Indian Rupee (5.8%), Taiwan Dollar (4.4%), and Thai Baht (4.3%). In some cases, currencies have reached near 15-year highs against the US dollar.

Three related reasons explain the appreciation of the Asia ex-Japan currencies. The first relates to underlying fundamentals given the region's strong growth prospects and current account surpluses. Second, is a resurgence in capital inflows driven by lax liquidity conditions in industrial countries—all the more so given the BOJ's recent move toward quantitative easing (QE) —and expectations of continued low interest rates in the US and Europe, as well as prospects for further QE by the US Fed. And finally, a third reason is expectations of further RMB appreciation, which provides room for currencies across the region to appreciate. Importantly, however, much of the appreciation reflects US dollar weakness, and in nominal effective terms, the magnitude of currency appreciation has been much more muted.

Given the region's strong growth momentum, Asian policy makers have so far shown a willingness to allow some appreciation in response to inflows, while at the same time slowing the pace through fx intervention. However, we see signs that policymakers are growing weary of further appreciation given the region's dependence on export growth and concerns about the health of the global environment. Beyond intervention, measures to slow currency appreciation have so far been modest. In a number of countries (e.g., Korea and Taiwan), prudential authorities are reportedly stepping up their enforcement of existing regulations to prevent currency speculation. In late 2009, Taiwan introduced a ban on offshore investors from placing funds in time deposits, and more recently last June Korea introduced measures to limit banks' forward currency positions and Indonesia introduced measures to discourage short-term flows into central bank paper. Thailand has just stepped up efforts to encourage outward investment flows (in late 2006 Thailand introduced measures to slow currency appreciation).

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Policy sentiment in the region is tilted toward maintaining open capital accounts, and avoiding direct controls commonly employed in Latin American countries (most recently in Brazil, with an increase in taxes on foreign bond investors). Nevertheless, it is quite likely in our view that regional authorities may intensify existing prudential measures and/or introduce new measures if appreciation pressures persist.

Asia's inventory cycle is coming to an end

While economic growth across Asia remains strong, momentum is slowing, as expected, as external demand weakens, and as the inventory cycle runs its course.

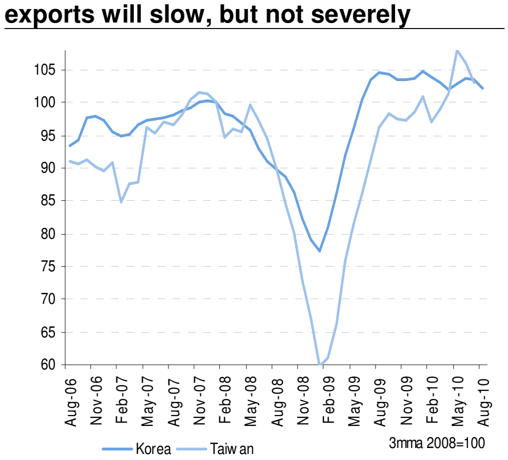
Regarding the latter, it is useful to track the shipment-to-inventory ratio as a leading indicator of export demand. The logic is that when final demand starts to decline, inventories pile up, causing the shipment-to-inventory ratio to fall. If the decline in final demand persists, then exports and production will fall with a few months time lag. The shipment inventory ratio has correctly predicted the fall in Asian exports in 2008 and the recoveries in 2009. The most reliable inventory data are available for Korea and Taiwan. And since they are upstream producers in manufacturing (e.g. electronic components, chemicals, etc.), their ratios may give a more advanced warning in the production chain.

Against this backdrop, the latest inventory data suggests that final demand for Asian exports is losing momentum, although the pace of the slowdown is still modest. For example, the ratio in Korea (August 1.02) and Taiwan (July 1.14) is slowing down steadily for the last few months. The fall in the shipment-to-inventory ratios have largely been driven by faster increases in inventories rather than pronounced declines in shipments. The indicators suggest that exports are set to slow in the coming months, but the moderation is not alarming. With some offset by domestic demand expansion, we expect Asian economies will settle at around (or slightly above) trend growth in 2011.

Beyond data on shipments and inventories, other indicators support this view. For example, PMI figures for Singapore in September showed that the index for finished good stocks jumped to 52.2 from 50.2 in the previous month, and the inventory sub-index of Korean manufacturing sentiment for October showed an increase in inventories also for a fifth consecutive month.

Chart 5

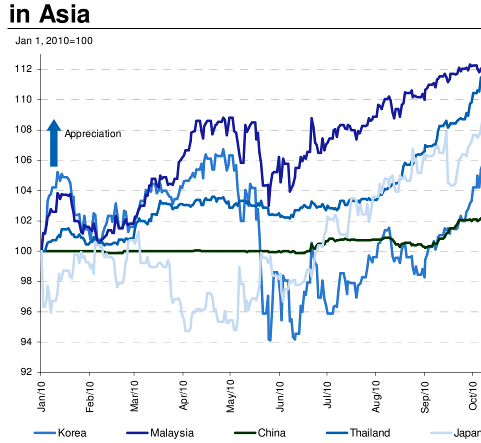
Shipment-to-inventory ratio suggest exports will slow, but not severely



Source: BBVA Research and Bloomberg

Chart 6

Currency appreciation, a common trend in Asia



Source: BBVA Research and CEIC

What to watch

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China: Property Prices for September (October 11-15)

Forecast: 9.3% y/y **Consensus:** 8.8% **Previous:** 9.3%

Property price have been moderating in year-on-year terms for the past four months following April's peak of 12.8% y/y, and have been flat in m/m terms. Prices may have held up in September, despite earlier administrative measures to prevent price bubbles, on signs that activity in the sector has picked up. The government intensified tightening measures at end-September to reduce mortgage lending. A higher-than-expected reading could trigger market worries of further tightening measures, including interest rate increases, all the more so given recent higher-than-expected readings on PMI and other activity indicators.

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China	**Date**	**Period**	**Prior**	**Cons.**
Trade Balance (USD)	13-Oct	SEP	$20.03B	$17.50B
Exports YoY%	13-Oct	SEP	34.40%	26.40%
Imports YoY%	13-Oct	SEP	35.20%	25.00%
Actual FDI (YoY)	13-15 Oct	SEP	1.40%	5.70%
Money Supply - M2 (YoY)	11-15 Oct	SEP	19.20%	18.90%
New Yuan Loans	11-15 Oct	SEP	545.2B	500.0B
China Property Prices	11-15 Oct	SEP	9.3	8.9
India	**Date**	**Period**	**Prior**	**Cons.**
Industrial Production YoY	12-Oct	AUG	13.80%	9.50%
Monthly Wholesale Prices YoY%	14-Oct	SEP	8.51%	8.50%
Japan	**Date**	**Period**	**Prior**	**Cons.**
Japan Money Stock M2 YoY	13-Oct	SEP	2.80%	2.80%
Machine Orders (MoM)	13-Oct	AUG	8.80%	-3.90%
Machine Tool Orders (YoY)	14-Oct	SEP F	112.90%	- -
Industrial Production (MoM)	15-Oct	AUG F	-0.30%	- -
Malaysia	**Date**	**Period**	**Prior**	**Cons.**
Industrial Production YoY	11-Oct	AUG	3.20%	5.70%
Malaysia Announces 2011 Budget Plan	15-Oct	23-Apr		
Philippines	**Date**	**Period**	**Prior**	**Cons.**
Total Exports (YoY)	12-Oct	AUG	35.90%	30.30%
Total Monthly Exports	12-Oct	AUG	$4502.5M	- -
Overseas Remittances (YoY)	15-Oct	AUG	- -	- -
Singapore	**Date**	**Period**	**Prior**	**Cons.**
Advance GDP Estimate (QoQ)	14-Oct	3Q P	24.00%	-15.70%
Advance GDP Estimate (YoY)	14-Oct	3Q P	18.80%	10.80%
Retail Sales Ex Auto	15-Oct	AUG	6.00%	5.40%
Retail Sales (MoM) sa	15-Oct	AUG	3.20%	0.30%

	Current	**Expected**
Korea – 7-Day Repo Rate, October 14 We expect interest rates will increase by 25bps	2.25	2.50

Singapore –Monetary Policy Meeting, October 12-14
We expect MAS will continue its current appreciation path

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				Close	Weekly change	Monthly change	Annual change
Interest Rates	(changes in bps)	US	3-month Libor rate	0.29	0	0	0
			2-yr yield	0.34	-7	-22	-62
			10-yr yield	2.36	-15	-40	-102
		EMU	3-month Euribor rate	0.97	3	9	23
			2-yr yield	0.81	-4	11	-56
			10-yr yield	2.28	0	-5	-92
Exchange Rates	(changes in %)	Europe	Dollar-Euro	1.392	1.3	9.6	-5.3
			Pound-Euro	0.87	0.6	6.2	-5.7
			Swiss Franc-Euro	1.34	-0.2	3.8	-11.8
		America	Argentina (peso-dollar)	3.96	-0.1	0.3	3.3
			Brazil (real-dollar)	1.68	0.0	-2.4	-3.3
			Colombia (peso-dollar)	1787	-0.5	-1.0	-3.7
			Chile (peso-dollar)	484	0.7	-2.3	-12.7
			Mexico (peso-dollar)	12.52	-0.4	-4.0	-5.8
			Peru (Nuevo sol-dollar)	2.79	0.0	-0.1	-2.6
		Asia	Japan (Yen-Dollar)	81.88	-1.8	-2.3	-8.8
			Korea (KRW-Dollar)	1118.13	-0.7	-4.0	-4.4
			Australia (AUD-Dollar)	0.981	1.1	6.2	8.6
Comm.	(chg %)		Brent oil ($/b)	83.1	-0.8	7.3	18.7
			Gold ($/ounce)	1340.3	1.6	7.8	27.7
			Base metals	531.9	0.5	3.9	23.7
Stock Markets	(changes in %)	Euro	Ibex 35	10674	2.1	-0.4	-9.1
			EuroStoxx 50	2777	1.6	-0.2	-3.7
		America	USA (S&P 500)	1160	1.2	5.1	8.3
			Argentina (Merval)	2641	-0.4	8.7	21.8
			Brazil (Bovespa)	70064	-0.2	5.2	9.4
			Colombia (IGBC)	15060	2.5	4.8	34.7
			Chile (IGPA)	22006	-1.7	-0.1	35.6
			Mexico (CPI)	34258	1.3	5.3	14.0
			Peru (General Lima)	18855	3.8	19.1	21.9
			Venezuela (IBC)	66325	-0.4	1.6	27.4
		Asia	Nikkei225	9589	2.0	5.4	-4.3
			HSI	22944	2.6	8.4	6.7
Credit	(changes in bps)	Ind.	Itraxx Main	103	-5	-3	13
			Itraxx Xover	476	-28	-6	-94
		Sovereign risk	CDS Germany	38	0	-2	18
			CDS Portugal	403	5	75	352
			CDS Spain	228	1	-6	161
			CDS USA	46	1	-1	---
			CDS Emerging	202	-18	-50	-49
			CDS Argentina	720	-19	-168	-242
			CDS Brazil	104	-9	-22	-10
			CDS Colombia	104	-10	-27	-37
			CDS Chile	77	2	-6	1
			CDS Mexico	109	-9	-32	-35
			CDS Peru	108	-9	-18	-14

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.	2738.7	3.1	-16.4	-1.5
Hong Kong – Hang Seng	22944.2	2.6	4.9	6.8
Taiwan – Weighted	8244.2	0.0	0.7	9.9
Japan – Nikkei 225	9588.9	2.0	-9.1	-2.5
Korea – Kospi	1897.1	1.1	12.7	17.4
India – Sensex 30	20250.3	-0.9	15.6	19.9
Australia – SPX/ASX 200	4681.4	2.2	-3.9	-1.8
Singapore – Strait Times	3153.3	0.7	8.8	19.0
Indonesia – Jakarta Comp	3547.0	0.0	40.0	42.8
Thailand – SET	964.3	-1.5	31.3	29.6
Malaysia – KLCI	1481.4	1.0	16.4	20.4
Philippines – Manila Comp.	4237.0	3.0	38.8	42.8

FOREIGN EXCHANGE MARKETS

CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
China (CNY/USD)	6.67	0.20	-0.07	-0.19
Hong Kong (HKD/USD)	7.76	0.00	-21.5	-90
Taiwan (TWD/USD)	30.9	0.53	-0.29	-0.82
Japan (JPY/USD)	82.4	1.06	-8.6	-42.7
Korea (KRW/USD)	1120	0.92	5.25	15.05
India (INR/USD)	44.3	0.30	52.1	203
Australia (USD/AUD)	0.98	0.43	117	n.a.
Singapore (SGD/USD)	1.31	0.22	-0.30	0.5
Indonesia (IDR/USD)	8933	-0.17	68	372
Thailand (THB/USD)	30.1	0.43	2.38	12.5
Malaysia (MYR/USD)	3.11	-0.91	81.0	378
Philippines (PHP/USD)	43.5	0.90	0.22	0.81

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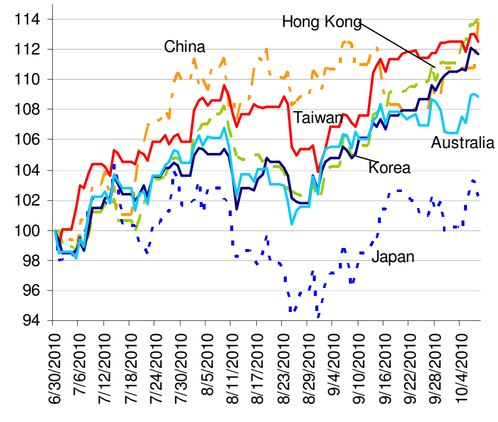
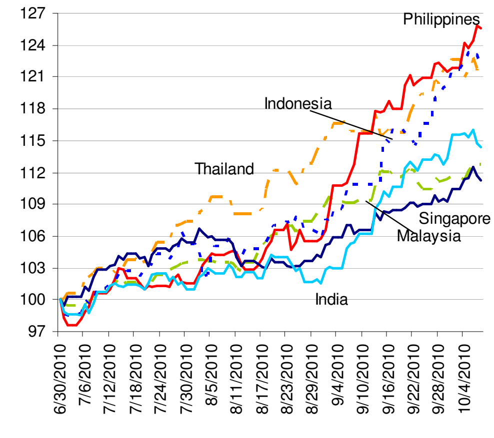
STOCK MARKETS



Source: BBVA Research and Bloomberg Index=100

STOCK MARKETS



Source: BBVA Research and Bloomberg Index=100

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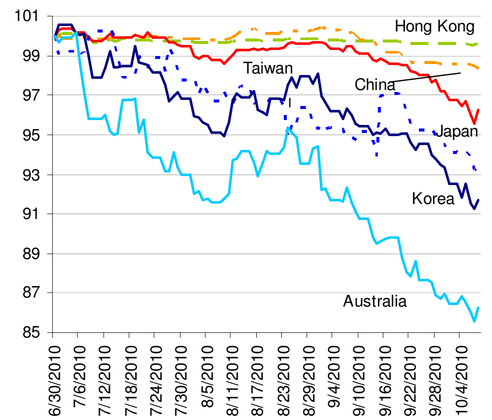

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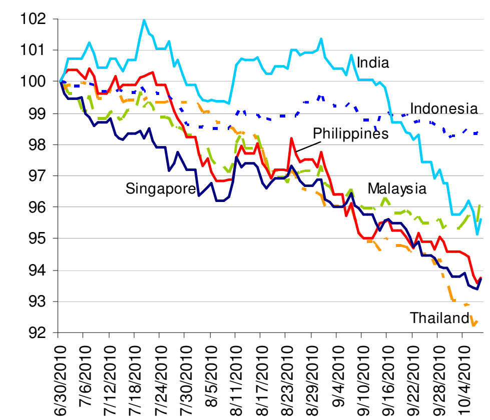

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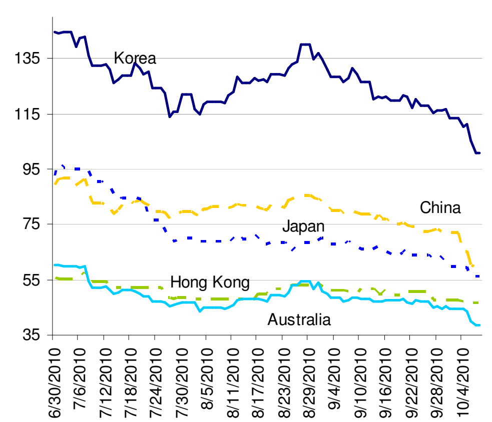
CREDIT DEFAULT SWAPS



Source: BBVA Research and Bloomberg

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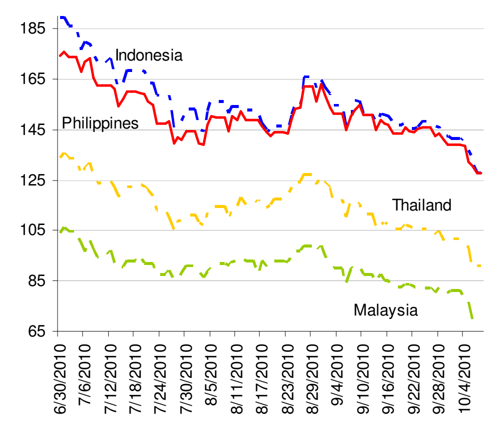

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