

Asia

Weekly Watch

Hong Kong, October 29, 2010

Economic Analysis

Asia

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Asian markets await the Fed's next move

Markets behaved cautiously this week, awaiting the results of the Fed's next meeting on November 2-3, for indications on further quantitative easing ("QE2") and the associated amounts. Japan has brought forward its next monetary meeting to next week, which some market participants speculated may have been timed to follow the Fed's meeting (which Japanese officials deny). Meanwhile, last weekend's G20 meeting helped to calm fears of "currency wars". Nevertheless, talk of further controls on capital inflows continues in the region, with the Bank of Korea Governor signaling that further measures may be taken soon in Korea.

Korean growth stays strong, despite an expected slowdown

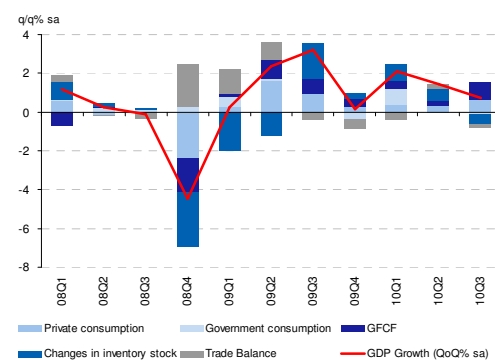
Third quarter GDP in Korea came in line with expectations at 0.7% (q/q, sa), as growth momentum continues to slow to a more sustainable pace (see Highlights). Elsewhere in the region, third quarter CPI inflation in Australia decelerated (2.8% y/y) and was below expectations, reducing the likelihood of near-term rate hikes. In Japan CPI (September) matched consensus (-0.6% y/y, sa), and industrial production (September) disappointed (-1.9% m/m, sa). Meanwhile, generally strong growth momentum continues in the rest of the region as Korea and Thailand raised their respective GDP growth forecast in 2010 to 6%, and 7.3-8.0% (from 5.8% and 6.5-7.5%, respectively).

In the coming week...

Look out for China's PMI (October), and a batch of October inflation indicators in Indonesia, Korea, Taiwan and Thailand, and also trade figures in Korea (October), Indonesia (September), India (September), and Malaysia (September). On the monetary front, we expect Australia, India, Indonesia, and Japan to keep rates unchanged at their November meetings (see Highlights).

Chart1

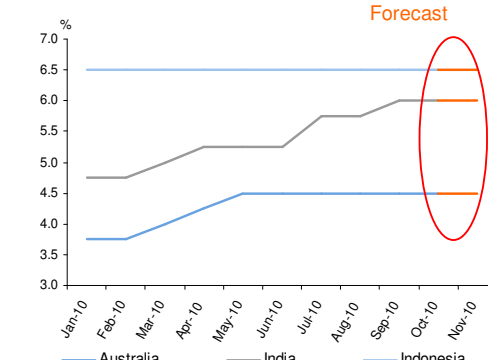
3Q GDP in Korea remains strong, but with a further loss of momentum



Source: BBVA Research and Bloomberg

Chart2

Asian central banks have slowed their policy tightening



Source: BBVA Research and Bloomberg

Markets



Highlights



Calendar



Markets Data



Highlights

Korean third quarter GDP growth slows

Domestic demand is the main driver of growth

Asia-Pacific central banks slow the pace of monetary tightening

Capital inflows and an uncertain global environment force a pause in rate hikes

Will Vietnam devalue its currency again?

A persistent trade deficit and brisk inflation add to pressures on the Vietnamese Dong

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Markets

Ahead of the US FED's FOMC meeting

Investors have become increasingly reluctant to take fresh positions ahead of the FOMC meeting on Nov. 2 and 3. The market is confident that the Fed will announce another round of quantitative easing in the coming meeting. The key concerns now are that the aggregate size could fall short of expectations, and that purchases may take place only bit-by-bit. As the market originally has priced in a significant asset purchases by the Fed, rising risk aversion triggered short covering of the USD. The USD's rebound limited further appreciation of Asian currencies.

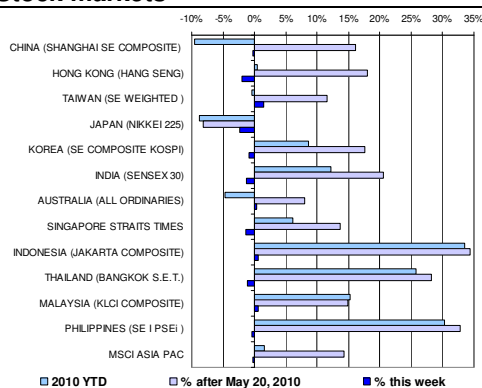
The USD rebound, along with softer-than-expected 3Q inflation in Australia led AUD-USD lower, down to as low as 0.9685. The market now anticipates RBA will keep the policy rate unchanged in forthcoming meeting and prevent AUD to climb higher. However, the RBA's tightening bias remains, and the wide interest rate differentials should keep AUD strong.

CNY reversed its appreciation trend, with the USD-CNY fixing on Friday being close to 6.70 (up from 6.6406). The USD's rebound may be one of the reasons, and the authorities have explained that the CNY is subject to two-way flexibility. Meanwhile, China's vice commerce minister signaled a smaller trade surplus may be forthcoming this year. Nevertheless, the currency appreciation expectation remains, with 12 month CNY NDF steady at around 6.462.

KRW still traded with some weakening bias against the USD as the BOK warned the possibility of imposing "macro-prudential" measures to smooth exchange rate volatility. Meanwhile, Korea's 3Q GDP growth decelerated and was slower than anticipated. Slower growth and worries about hot money inflows may lower the probability of further rate hikes by the BOK this year.

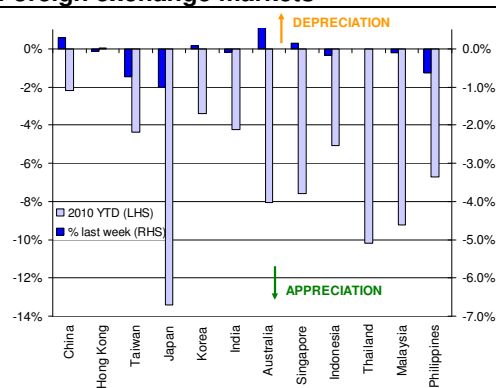
Strong gains early in the week were due to a boost from the G20 meeting outcomes, and also by Singapore Exchange's USD8.2 billion takeover bid for Australia's ASX, but were overshadowed by renewed concerns about the possible size and scope of the US quantitative easing. Markets also were affected by profit-taking after recent strong gains in Asian stocks, and further signs that the global recovery is slowing. On the positive side, strong regional corporate earnings in the third quarter boosted sentiment. Hong Kong and Japan led losses, while Taiwan was the week's best performer.

Chart 3
Stock markets



Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets



Source: BBVA Research and Bloomberg

Home →

Highlights →

Calendar →

Markets Data →

Economics Analysis

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Highlights

Korean third quarter GDP growth slows

South Korea's GDP growth slowed in the third quarter, in line with our expectations, on weakening external demand and the ending of the inventory restocking cycle. On a seasonally adjusted basis, GDP advanced 0.7% q/q (consensus: 0.8% q/q sa) from 1.4% q/q in the previous quarter. The main drivers were private consumption (1.3% q/q sa) and investment (3.5% q/q sa), as export growth (1.8% q/q sa) decelerated compared with the previous quarter. Government consumption declined by 0.6% q/q, consistent with the government's expected withdrawal of fiscal stimulus in H2. Industrial production in September also dropped -0.4% from the previous month (sa basis), below the consensus of 0.4%. The current account in September (USD 4.1 billion), however, almost doubled previous month, further increasing the appreciation pressure of Won. Going forward, we expect Korea's economy to grow 6.1% for the whole year in 2010, and to continue to moderate to a more sustainable level in 2011. Also, a more self-sustaining momentum of growth is expected, with domestic demand making a greater contribution. We continue to expect another interest rate hike of 25bp before the end of the year (the BOK has so far raised interest rates by only 25bp, lagging behind other central banks in the region).

Asia-Pacific central banks slow the pace of monetary tightening

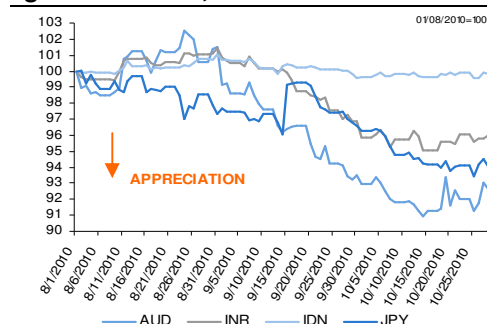
Australia, India, Indonesia all hold monetary policy meetings next week (as will Japan). While we expect the tightening cycles to resume very soon, for the time being we anticipate that these central banks may maintain rates unchanged in their November meetings, given concerns about generating capital inflows. In Australia, Q3 inflation (2.8% y/y) surprised to the downside (from 3.1% y/y in Q2), reducing the likelihood of a rate hike in November by the RBA. In India, although inflation rose to 8.6% y/y in September, slightly higher than 8.5% in August, the likelihood of a rate hike by the RBI is low for the time being given the RBI's concern about capital inflows and appreciating currency. Similarly, in Indonesia, we expect the authority to keep its policy rate at 6.5%. Meanwhile, the Bank of Japan (BOJ) unveiled more details about the ¥3 trillion (USD61 billion) asset purchasing program this week, and unexpectedly rescheduled the date of its next monetary policy meeting to November 5, right after Fed's meeting. Markets speculate that one measure could be expanding the assets buying plan. Going forward, we expect that most of the central banks in Asia will resume monetary tightening in the near future given strong growth momentum and rising inflationary pressures.

Will Vietnam devalue its currency again?

In contrast to currencies in the rest of the region, depreciation pressures on the Vietnamese Dong are again mounting, with foreign reserves falling to relatively low levels (USD12.9 billion by end-May 2010). The State Bank of Vietnam has already devalued its currency three times in the last year (most recently in August, by 2% to 18,932 VND-USD). Vietnam's trade deficit widened in October and the cumulative deficit over the first 10 months stood at USD9.5 billion. According to officials, the shortfall could reach USD13.5 billion in 2010, and climb to USD14.6 billion in 2011, raising concerns about external sustainability. Furthermore, stubbornly high inflation (9.7% y/y in October) and brisk credit growth is also adding to pressures on the currency.

Chart 5

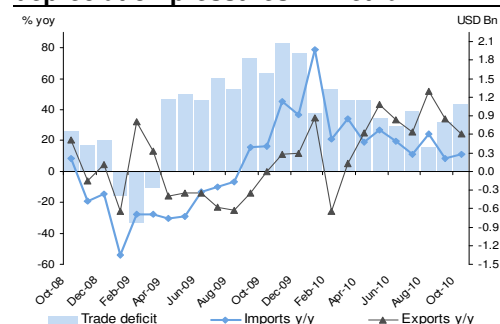
AUD, INR, and JPY have appreciated against the USD, as IDN remains stable



Source: BBVA Research and Bloomberg

Chart 6

Widening trade deficits add to currency depreciation pressures in Vietnam



Source: BBVA Research and Bloomberg

Home



Markets



Calendar



Markets Data



What to watch

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China: October PMI (November 1)

Forecast: 52.3

Consensus: 53.8

Previous: 53.8

Data on retail sales and fixed asset investment have showed considerable growth momentum in recent months, as have indicators on railway freight shipments and other manufacturing indicators. In line with these developments, we expect manufacturing activity to continue expanding in November. However, due to seasonality, the purchasing managers' index will likely fall below the previous monthly reading. Following the recent surprise interest rate hike, a stronger-than-expected reading may heighten expectations of another imminent round of tightening measures, including another interest rate hike.

Calendar

Australia	Date	Period	Prior	Cons.
Building Approvals (MoM)	3-Nov	SEP	-4.70%	- -
Trade Balance	4-Nov	SEP	2346M	- -
Retail Sales s.a. (MoM)	4-Nov	SEP	- -	- -
China	Date	Period	Prior	Cons.
PMI Manufacturing	1-Nov	OCT	53.8	53.8
Hong Kong	Date	Period	Prior	Cons.
Retail Sales - Value (YoY)	1-Nov	SEP	- -	17.70%
Purchasing Managers Index	3-Nov	OCT	52.8	- -
India	Date	Period	Prior	Cons.
Exports YoY%	1-Nov	SEP	22.50%	- -
Imports YoY%	1-Nov	SEP	32.20%	- -
Indonesia	Date	Period	Prior	Cons.
Inflation (YoY)	1-Nov	OCT	5.80%	5.89%
Core Inflation (YoY)	1-Nov	OCT	4.02%	4.09%
Exports (YoY)	1-Nov	SEP	30.00%	31.80%
Total Imports (YoY)	1-Nov	SEP	25.90%	38.00%
Total Trade Balance	1-Nov	SEP	\$1485M	\$1132M
Danareksa Consumer Confidence	01-04 Nov	OCT	85.7	- -
Korea	Date	Period	Prior	Cons.
Consumer Price Index (MoM)	1-Nov	OCT	1.10%	-0.30%
Core Consumer Price Index(YoY)	1-Nov	OCT	1.90%	- -
Ext Trade - Export (YoY)	1-Nov	OCT	17.20%	16.20%
Ext Trade - Imports (YoY)	1-Nov	OCT	16.70%	17.20%
Ext Trade - Balance in US\$ Mln	1-Nov	OCT	5008	4257
Malaysia	Date	Period	Prior	Cons.
Exports YoY%	3-Nov	SEP	10.60%	9.70%
Imports YoY%	3-Nov	SEP	16.50%	15.60%
Trade Balance	3-Nov	SEP	8.32B	8.35B
Philippines	Date	Period	Prior	Cons.
Consumer Price Index (YoY)	5-Nov	OCT	3.50%	3.10%
Taiwan	Date	Period	Prior	Cons.
CPI YoY%	5-Nov	OCT	0.29%	- -
Thailand	Date	Period	Prior	Cons.
Consumer Price Index (YoY)	1-Nov	OCT	3.00%	3.40%
Core CPI (YoY)	1-Nov	OCT	1.10%	1.20%

Home →

Markets →

Highlights →

Markets Data →

India – Repo Rate, November 2

We expect interest rates will remain unchanged

Current	Expected
6.00	6.00

Australia – RBA Cash Target, November 2

We expect interest rates will remain unchanged

Current	Expected
4.50	4.50

Indonesia – BI Reference Rate, November 4

We expect interest rates will remain unchanged

Current	Expected
6.50	6.50

Japan – Target Rate, November 5

We expect interest rates will remain unchanged

Current	Expected
0.0-0.1	0.0-0.1

Markets Data

Asia Market

STOCK MARKETS	INDEX	Last price	% change over a week	Year to date	% Change over 1 Y
	China – Shanghai Comp.	2978.8	0.1	-9.1	0.6
	Hong Kong – Hang Seng	23011.3	-2.2	5.2	8.2
	Taiwan – Weighted	8287.1	1.5	1.2	12.7
	Japan – Nikkei 225	9202.5	-2.4	-12.7	-7.0
	Korea – Kospi	1883.0	-0.8	11.9	18.7
	India – Sensex 30	19958.0	-1.0	14.3	24.3
	Australia – SPX/ASX 200	4661.6	0.3	-4.3	1.9
	Singapore – Strait Times	3141.9	-1.0	8.4	19.4
	Indonesia – Jakarta Comp	3625.1	0.8	43.0	54.7
	Thailand – SET	984.0	-0.8	34.0	42.6
	Malaysia – KLCI	1499.9	0.6	17.8	20.8
	Philippines – Manila Comp.	4268.7	-0.4	39.8	49.1
	Last update: Friday, 15.45 Hong Kong time.				

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.68	-0.26	-0.08	-0.22
	Hong Kong (HKD/USD)	7.76	0.06	-47.5	-193
	Taiwan (TWD/USD)	30.6	0.66	-0.24	-0.74
	Japan (JPY/USD)	80.7	0.88	-7.4	-40.9
	Korea (KRW/USD)	1125	-0.16	3.88	8.09
	India (INR/USD)	44.5	0.13	62.5	212
	Australia (USD/AUD)	0.97	-0.86	115	n.a.
	Singapore (SGD/USD)	1.30	-0.20	-1.07	0.5
	Indonesia (IDR/USD)	8928	0.17	59	355
	Thailand (THB/USD)	30.0	-0.03	5.25	16.5
	Malaysia (MYR/USD)	3.11	0.05	101.3	384
	Philippines (PHP/USD)	43.1	0.58	0.17	0.70
	Last update: Friday, 15.45 Hong Kong time.				

[Home](#) →

[Markets](#) →

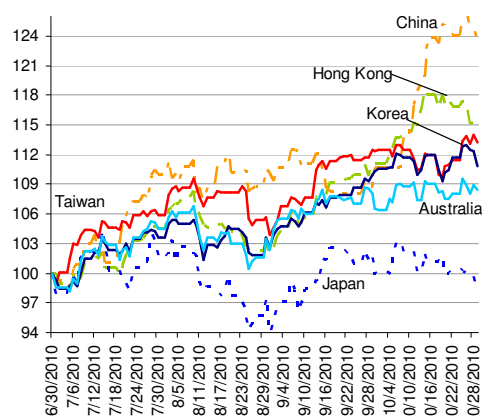
[Highlights](#) →

[Calendar](#) →

Markets Data

Asia Chart

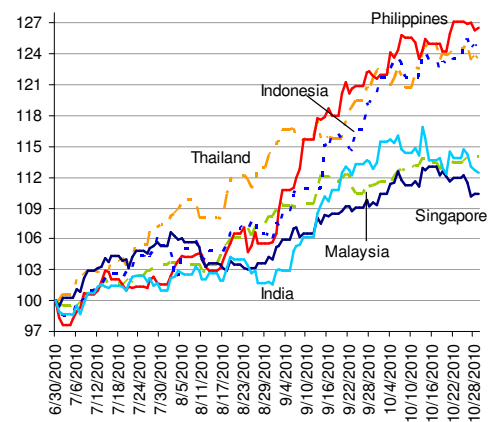
STOCK MARKETS



Source: BBVA Research and Bloomberg

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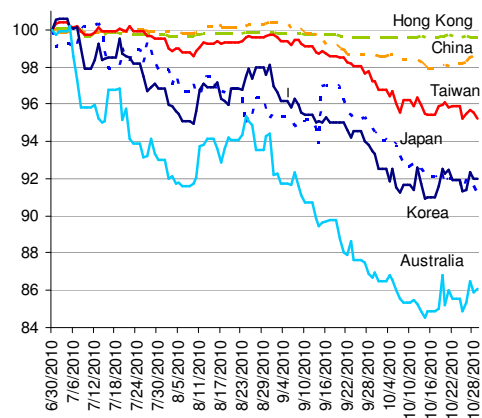
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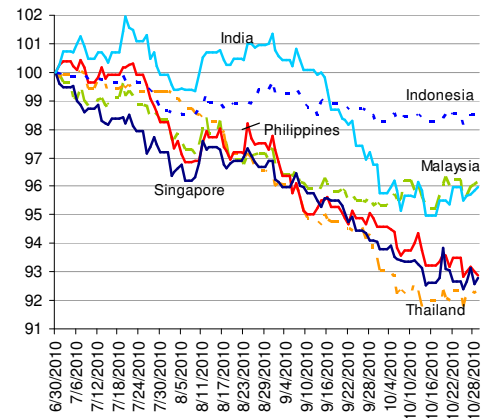
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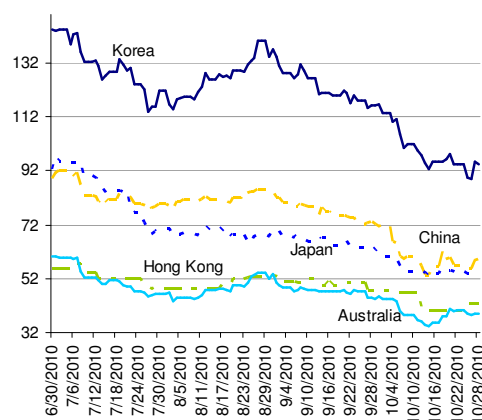
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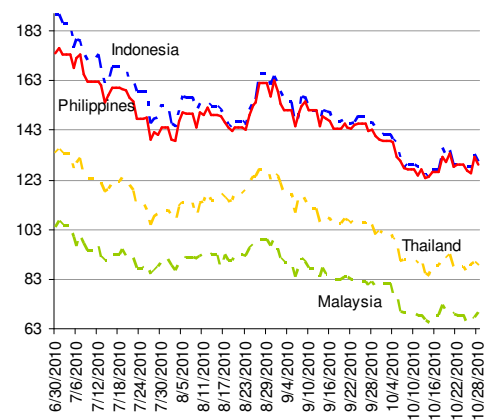
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CREDIT DEFAULT SWAPS



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Home



Markets



Highlights



Calendar



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