

Asia

Weekly Watch

Hong Kong, November 5, 2010

Economic Analysis

Asia

Stephen Schwartz

stephen.schwartz@bbva.com.hk

Ricard Torne

ricard.torne@bbva.com.hk

Fielding Chen

fielding.chen@bbva.com.hk

Bingjie Hu

bingjie.hu@bbva.com.hk

Le Xia

xia.le@bbva.com.hk

Jenny Zheng

jenny.zheng@bbva.com.hk

Serena Zhou

serena.zhou@bbva.com.hk

Serena Wang

serena.wang@bbva.com.hk

Markets

Richard Li

richard.li@bbva.com.hk

Ricard Torne

ricard.torne@bbva.com.hk

Asia reacts to the Fed's easing

The region's policy makers have expressed concern about the Fed's decision to expand liquidity through quantitative easing, out of fear of further capital inflows and asset price bubbles (see Highlights). Many of them are suggesting that further measures may be taken to stem the tide of inflows. Meanwhile, as elsewhere in the world, markets have reacted favorably, with a further appreciation of Asian currencies and a strong rebound in equities.

Interest rate hikes resume, despite capital inflow fears

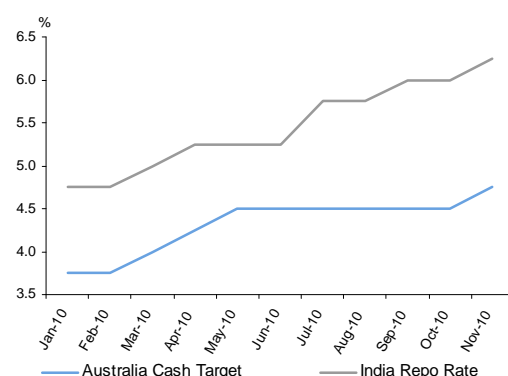
Central banks in India, Australia, and Vietnam hiked rates this week (see Highlights), while Bank Indonesia remained on hold, as expected. India and Australia emphasized rising inflation, while Vietnam hiked in response to depreciation pressures on its currency (see last [Week's Watch](#)). China's PMI for October (54.7), beat expectations (53.8), adding additional evidence that growth momentum remains uncomfortably high. Elsewhere, third quarter GDP in Indonesia slowed (5.8% y/y) and October export growth in Korea (29.9% y/y) were well ahead of expectations (16.2%), as was inflation (4.1% y/y vs. consensus of 3.4%), increasing the likelihood of a rate hike.

In the coming week...

We await a batch of monthly indicators for China, including trade, CPI inflation, property prices, industrial production, retail sales, and fixed-asset investment, as well as third quarter GDP in Hong Kong, and machine orders (September) in Japan. We expect Malaysia's central bank to stay on hold at its next meeting on November 12.

Chart1

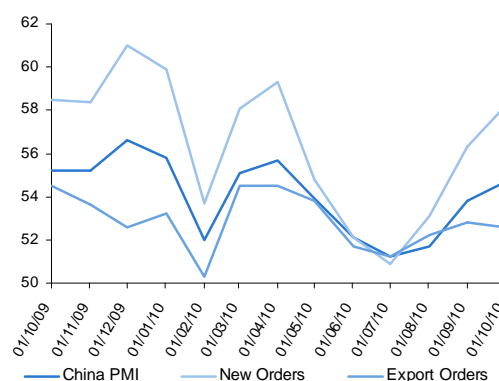
Australia and India hike rates to counter inflation pressures



Source: BBVA Research and Bloomberg

Chart2

China's PMI shows strong momentum



Source: BBVA Research and Bloomberg

Markets



Highlights



Calendar



Markets Data



Highlights

Inflationary risks prompt interest rate hikes despite capital inflows

Capital controls and further macroprudential measures may be on the agenda

Our latest Asia and China Economic Outlooks

We expect more monetary tightening measures, but a slower pace

RMB deposits in Hong Kong surge

However the RMB deposits only account for 2.6% of the total

Markets Analysis

Richard Li
richard.li@bbva.com.hk

Ricard Torne
ricard.torne@bbva.com.hk

Markets

Asian markets advances on Fed's new asset purchases

The Fed announced plans for an additional USD600 bn Treasury bond purchases this week. The size of the new round of quantitative easing (QE2) matched expectations and markets rallied. USD weakened, and the appetite for risky assets improved further. The market anticipated part of the new liquidity will find its way to emerging markets, especially Asia, where the growth outlook, yields and corporate profits appear more promising than those in rich countries. Asian equities and currencies reached new record-highs since the financial crisis. That said, the news of QE2 will likely be digested quickly, and new positive catalysts are required to sustain the rally. Moreover, as Asian authorities already warned that the excess liquidity to emerging markets could threaten asset-price bubbles, the market is wary of possible "macro-prudential" or "capital control" measures that could slow currency appreciation.

AUD was the best performing currency in the region, rising 3.3% in the past week. The currency received additional boost from the RBA's surprise rate hike this week, and stood firmly above the key resistance level of parity following the announcement of QE2. However, the momentum slowed after the release of slower-than-expected retail sales growth. As the sharp appreciation of AUD recently has already delivered a significant monetary tightening, we believe the RBA may take a pause before further hikes. AUD may consolidate at the current level after the digest of QE2's impacts.

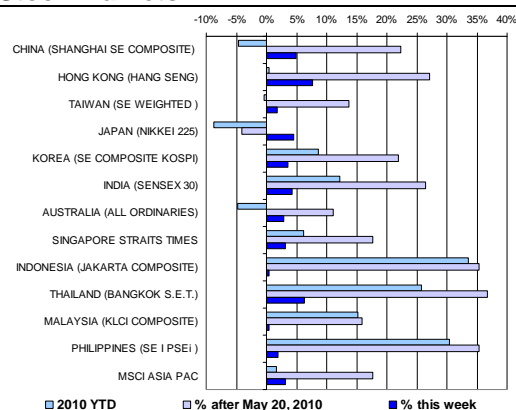
KRW also strengthened significantly against USD as both inflation and export growth beat expectations, which makes a rate hike likely in next week's meeting. Nevertheless, the level of 1100 remains a key resistance difficult to breach. The market is also worried about further measures by the BOK to smooth exchange rate volatility." BOK said in the latest Financial Stability Report that it needs to "come up with measures to ease excessive inflows and to prepare against a sudden reversal," while a senior official from the Finance Ministry also revealed that the government will "actively consider" capital controls."

Among Asian economies, Hong Kong appears to be the most exposed to speculative bubbles following QE2 given its currency peg to the USD and free capital flows. Property and stock prices have already reached new highs, and inflation has also been galloping upwards. Although there have been some market take that the HKD may be re-pegged to the RMB, it is still not a superior option as long as RMB is not a fully convertible currency. The government probably has to use other kits from the toolbox to moderate short-term flows to head off asset bubble formation.

Asian stock markets rallied this week on strong PMI data in China and, even more so, in response to the Fed's QE2 decision. Moreover, Asian companies continued recording strong gains, pushing up stock indicators. Hong Kong rose by 7.6%, as many analyst pointed out that its markets might benefit most from QE2, and Japan advanced for the first time in four weeks.

Chart 3

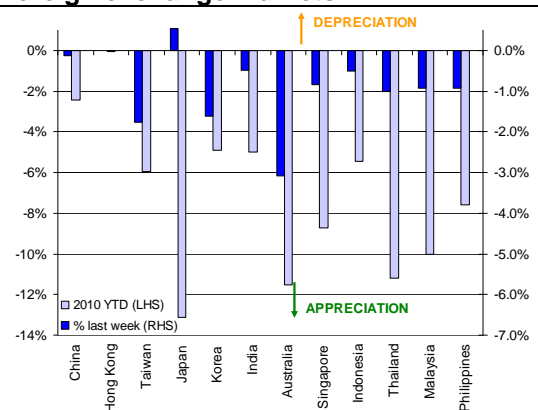
Stock markets



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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Stephen Schwartz

stephen.schwartz@bbva.com.hk

Ricard Torne

ricard.torne@bbva.com.hk

Fielding Chen

fielding.chen@bbva.com.hk

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Le Xia

xia.le@bbva.com.hk

Jenny Zheng

jenny.zheng@bbva.com.hk

Serena Zhou

serena.zhou@bbva.com.hk

Serena Wang

serena.wang@bbva.com.hk

Highlights

Inflationary risks prompt interest rate hikes despite capital inflows

Australia and India both hiked interest rates this week by 25bps (to 4.75% and 6.25% respectively), a reminder that, despite concerns about capital inflows and currency appreciation, rising inflation is still foremost in the minds of policy makers. Indeed, as noted in our just-published [Asia Economic Outlook](#) (see below), inflationary pressures are rising in Asia, which will make monetary authorities more alert to the need for further rate increases. However, sustained capital inflows and appreciation pressures, especially in the wake of the Fed's quantitative easing decision, may give them pause. We expect Indonesia and Thailand, which have seen large capital inflows in recent months, to stay on hold through the remainder of 2010, while Korea, which has increasing inflation pressures, is likely to hike interest rates again before the end of this year. For next year, we expect further rate hikes, at a gradual pace. We expect central banks to continue intervening to stem the pace of appreciation, while using further macro-prudential measures, and tightening of existing regulations. Some countries might introduce new measures after the forthcoming G20 meeting, following Thailand's recent increase in its withholding tax on foreign bond purchases. Korea has already signaled it is contemplating new measures.

Our latest Asia and China Economic Outlooks

We released our fourth quarter Asia and China Economic Outlooks this week (see [China Economic Outlook](#) and [Asia Economic Outlook](#)). In the China Outlook, we explain that we have raised our 2010 full-year growth projection for China to 10.1%, from 9.8% previously, based on faster-than-expected growth momentum to date. Nevertheless, we still expect GDP growth to moderate in line with our soft landing scenario given signs of moderating trends and the authorities' determination to prevent overheating, and we maintain our growth projection of 9.2% for 2011. Further monetary tightening measures are anticipated, including at least two more interest rate hikes in 2011, and RMB appreciation to 6.54 per USD by end-year, a 4-5% appreciation for the year, and the same pace in 2011.

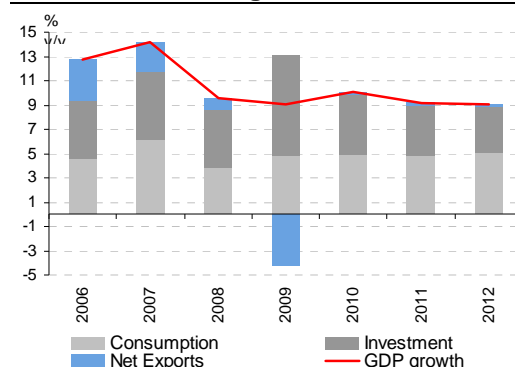
We have also raised our 2010 projections for other Asian economies, as described in the Asia Outlook. However, growth is now moderating across the region to a more sustainable pace. Inflation remains modest, but is rising in a number of countries due to higher food prices and demand pressures. Central banks are responding with interest rate hikes, but at a gradual pace due to concerns about capital inflows.

RMB deposits in Hong Kong surge

Although full convertibility of the RMB still remains a long-term goal, the authorities are taking incremental steps in the mean time toward the eventual internationalization of the RMB. As an indication of the potential for a full-scale RMB market, after a slow start, the volume of RMB deposits in Hong Kong has been rising sharply in recent months, due in part to expectations of RMB appreciation. Residents of Hong Kong have been permitted to hold such deposits since 2004, with a daily conversion limit of RMB 20,000 per day. The total amount of Renminbi deposits in Hong Kong surged to a new record of RMB 149.3 billion at the end of September (2.6% of total deposits), reflecting the recent quickening of the pace of development of RMB banking business in Hong Kong ([see our previous Asia Weekly Watch of August 30](#)).

Chart 5

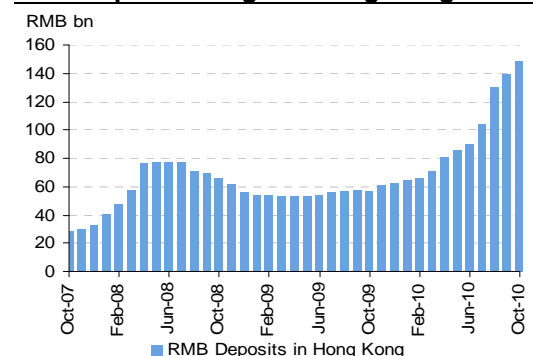
China's rebalancing act



Source: BBVA Research and Bloomberg

Chart 6

RMB deposits surge in Hong Kong



Source: BBVA Research and Bloomberg

Home →

Markets →

Calendar →

Markets Data →

What to watch

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Stephen Schwartz

stephen.schwartz@bbva.com.hk

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ricard.torne@bbva.com.hk

Fielding Chen

fielding.chen@bbva.com.hk

Bingjie Hu

bingjie.hu@bbva.com.hk

Le Xia

xia.le@bbva.com.hk

Jenny Zheng

jenny.zheng@bbva.com.hk

Serena Zhou

serena.zhou@bbva.com.hk

Serena Wang

serena.wang@bbva.com.hk

China: October CPI inflation (November 11)

Forecast: 3.7% (y/y)

Consensus: 4.0%

Previous: 3.6%

Data

A further rise in inflation is expected for October on ongoing food price increases. In response to rising inflation, strong activity indicators and renewed signs of property price increases, the authorities have taken further tightening measures, including an interest rate hike last month. We expect inflation to moderate to 3.2% by December. A higher-than-expected CPI reading will raise expectations of further monetary tightening measures. At the same time, markets will also be watching for accompanying data on trade, PPI, investment and retail sales.

Calendar

Australia	Date	Period	Prior	Cons.
Westpac Consumer Confidence	10-Nov	NOV	117	--
Consumer Inflation Expectation	11-Nov	NOV	3.80%	--
Unemployment Rate	11-Nov	OCT	5.10%	--
China	Date	Period	Prior	Cons.
Trade Balance (USD)	10-Nov	OCT	\$16.88B	\$26.10B
Exports YoY%	10-Nov	OCT	25.10%	22.60%
Imports YoY%	10-Nov	OCT	24.10%	26.80%
Producer Price Index (YoY)	11-Nov	OCT	4.30%	4.50%
Consumer Price Index (YoY)	11-Nov	OCT	3.60%	4.00%
Retail Sales (YoY)	11-Nov	OCT	18.80%	18.80%
Industrial Production (YoY)	11-Nov	OCT	13.30%	13.50%
Fixed Assets Inv Urban YTD YoY	11-Nov	OCT	24.50%	24.40%
China Property Prices	10-12 Nov	OCT	9.1	8.9
Hong Kong	Date	Period	Prior	Cons.
GDP (YoY)	12-Nov	3Q	6.50%	--
GDP sa (QoQ)	12-Nov	3Q	1.40%	--
India	Date	Period	Prior	Cons.
India Local Car Sales	9-Nov	OCT	169082	--
Industrial Production YoY	12-Nov	SEP	5.60%	--
Japan	Date	Period	Prior	Cons.
Current Account Total	9-Nov	SEP	¥1114.2B	--
Adjusted Current Account Total	9-Nov	SEP	¥1179.0B	--
Trade Balance (BoP Basis)	9-Nov	SEP	¥195.9B	--
Machine Tool Orders (YoY)	9-Nov	OCT P	--	--
Machine Orders (MoM)	11-Nov	SEP	10.10%	--
Korea	Date	Period	Prior	Cons.
Unemployment Rate (SA)	10-Nov	OCT	3.70%	--
Malaysia	Date	Period	Prior	Cons.
Industrial Production YoY	10-Nov	SEP	4.00%	4.80%
Philippines	Date	Period	Prior	Cons.
Total Exports (YoY)	10-Nov	SEP	36.60%	--
Taiwan	Date	Period	Prior	Cons.
Total Exports (YoY)	8-Nov	OCT	17.50%	14.00%
Total Imports (YoY)	8-Nov	OCT	25.00%	22.80%
Total Trade Bal in US\$ Billion	8-Nov	OCT	\$1.77B	\$2.44B

Home →

Markets →

Highlights →

Markets Data →

Malaysia – Overnight Rate, November 12

We expect interest rates will remain unchanged

Current	Expected
2.75	2.75

Markets Data

Asia Market

STOCK MARKETS	INDEX	Last price	% change over a week	Year to date	% Change over 1 Y
	China – Shanghai Comp.	3129.5	5.1	-4.5	-0.8
	Hong Kong – Hang Seng	24876.8	7.7	13.7	15.8
	Taiwan – Weighted	8449.3	2.0	3.2	13.9
	Japan – Nikkei 225	9626.0	4.6	-8.7	-0.9
	Korea – Kospi	1939.0	3.0	15.2	24.9
	India – Sensex 30	20893.6	4.3	19.6	30.1
	Australia – SPX/ASX 200	4800.6	3.0	-1.4	6.5
	Singapore – Strait Times	3240.3	3.1	11.8	23.2
	Indonesia – Jakarta Comp	3654.8	0.5	44.2	54.4
	Thailand – SET	1043.8	6.0	42.1	53.1
	Malaysia – KLCI	1511.7	0.4	18.8	20.6
	Philippines – Manila Comp.	4349.1	1.9	42.5	47.7

Last update: Friday, 16.45 Hong Kong time.

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.65	0.29	-0.07	-0.21
	Hong Kong (HKD/USD)	7.75	-0.02	-54.8	-225
	Taiwan (TWD/USD)	30.1	1.72	-0.22	-0.71
	Japan (JPY/USD)	80.7	-0.40	-6.7	-38.6
	Korea (KRW/USD)	1107	1.61	4.18	9.77
	India (INR/USD)	44.2	0.71	31.9	178
	Australia (USD/AUD)	1.02	3.30	115	n.a.
	Singapore (SGD/USD)	1.28	0.89	-1.15	-1.0
	Indonesia (IDR/USD)	8893	0.51	9	248
	Thailand (THB/USD)	29.6	1.05	3.00	15.5
	Malaysia (MYR/USD)	3.09	0.86	85.0	365
	Philippines (PHP/USD)	42.7	0.75	-0.16	0.18

Last update: Friday, 16.45 Hong Kong time.

Home →

Markets →

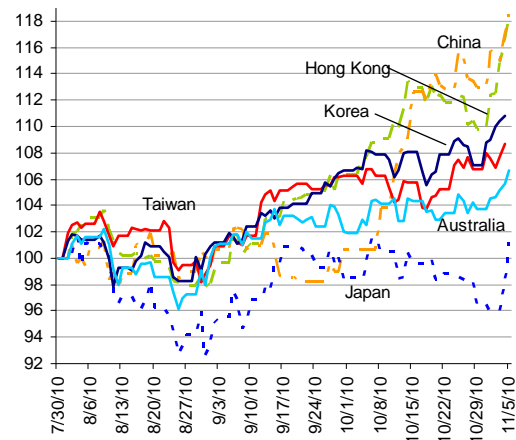
Highlights →

Calendar →

Markets Data

Asia Chart

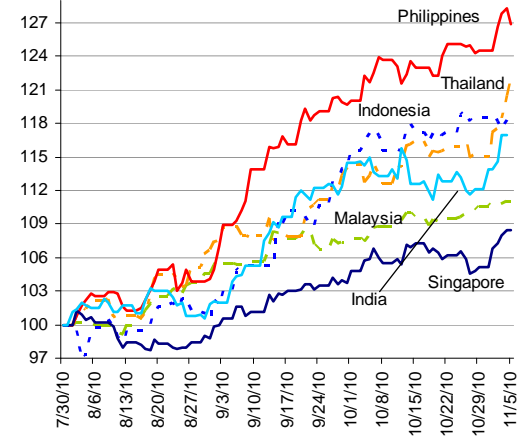
STOCK MARKETS



Source: BBVA Research and Bloomberg

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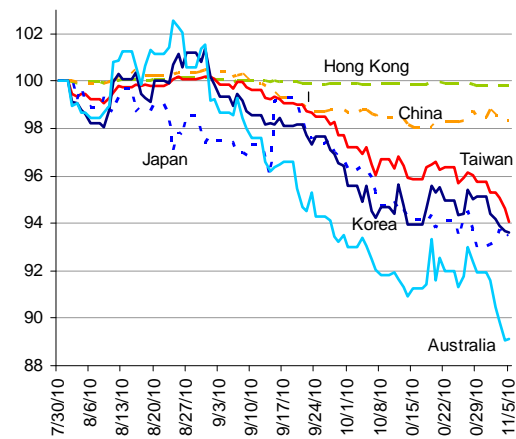
STOCK MARKETS



Source: BBVA Research and Bloomberg

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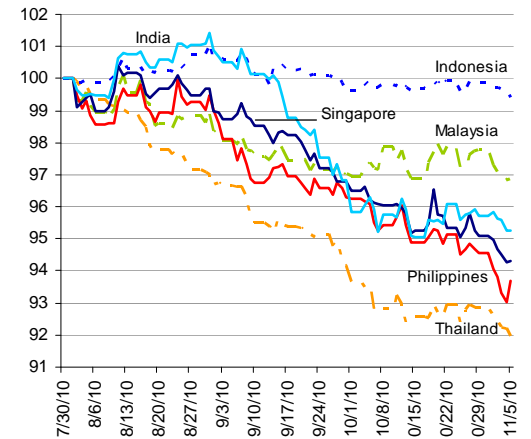
FOREIGN EXCHANGE MARKETS



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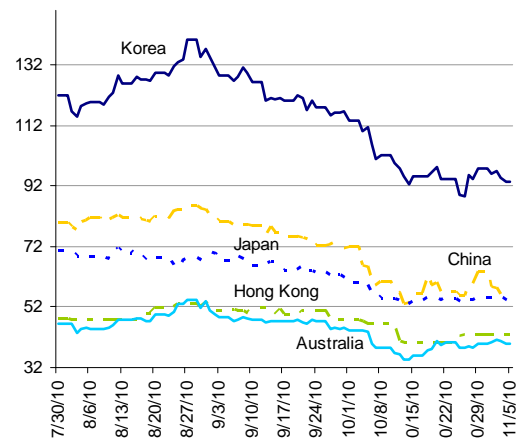
FOREIGN EXCHANGE MARKETS



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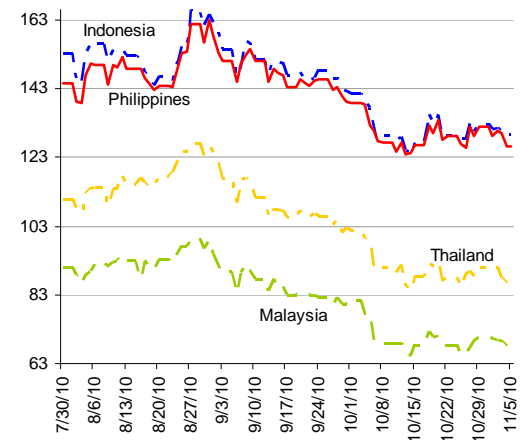
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CREDIT DEFAULT SWAPS



Source: BBVA Research and Bloomberg

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- Home →
- Markets →
- Highlights →
- Calendar →

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