

Asia

Weekly Watch

Hong Kong, November 19, 2010

Economic Analysis

Asia

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Inflation fears in China

Much of the attention this past week has remained on the inflation outlook in China and prospects of further and more aggressive monetary tightening, as well as other measures to curb price increases (see Highlight). Korea also made news by announcing plans, as expected to re-impose a withholding tax on foreign earnings from stocks and bonds, in order to ease pressures from capital inflows.

The region continues to post strong growth indicators

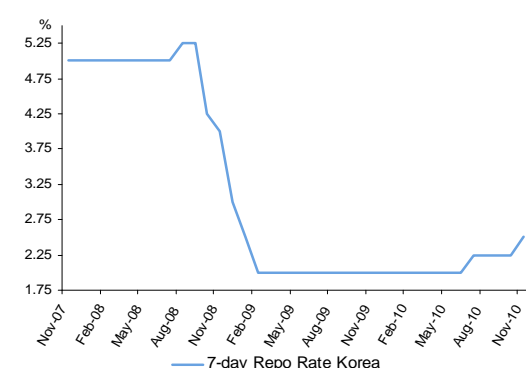
Japan's third quarter GDP growth surprised to the upside, at a 3.9% q/q annualized rate (consensus 2.5%) (see Highlights). Taiwan's GDP also rose at a faster-than-expected pace of 9.8% y/y (consensus: 8.3%). The figures continue a trend of moderating, but still stronger-than-expected growth in the third quarter. India's WPI inflation eased to 8.6% y/y in October, taking some pressure off of the RBI to raise rates in the near-term, although we expect further hikes in 2011. Korea hiked rates by 25 bp this week, as anticipated, to tame inflationary pressures.

In the coming week...

Next week will feature Q3 GDP releases in Malaysia, the Philippines, and Thailand. Trade figures will be released in Hong Kong and Japan, along with Singapore's CPI inflation for October.

Chart1

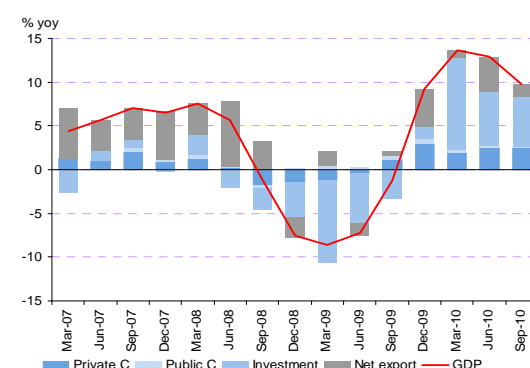
Rising inflation triggers another rate hike in Korea



Source: BBVA Research and Bloomberg

Chart2

3Q GDP in Taiwan beat expectations



Source: BBVA Research and Bloomberg

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Highlights

Inflation spurs expectations of more tightening in China

An increasingly aggressive approach to monetary tightening and measures to curb prices

Asian EAGLES

Five of the ten countries in our new EAGLES concept are from Asia

Japan Q3 GDP surprises to the upside

The strong outturn, however, fails to dispel concerns about a weak outlook

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Markets

Irish worries spill over to Asian markets

Worries about Irish banking and sovereign debt problems continued to dominate, although visits of IMF and EU delegations to Dublin have raised hopes of external assistance. In Asia, activity indicators continued to show remarkable growth performance (Japan, Taiwan and Singapore 3Q GDP, Korea' department store sales). With output gaps closed at faster-than-expected pace, the concern has clearly shifted from growth to inflation. Bank of Korea decided to hike rates by 25 bps to 2.5%. China also introduced new measures to alleviate price pressure, and the chance of additional rate hikes in the near term is rising. Strong growth and rising interest rates will likely to attract more capital flows to Asia in the low-yield environment. To reduce sharp swings in capital flows and the exchange rate, Korea announced plans to reinstate a withholding tax on foreigners' local bond investment. We think other countries may also introduce new measures to reduce excessive short-term flows and slow the pace of currency appreciation.

AUD-USD traded lower at 0.98 on rising risk aversion due to European debt problems and concerns over Chinese monetary tightening. Yet the tightening bias of RBA remains. The members said the decision to hike rates was "forward looking", as reduced uncertainties over China's and global growth has shifted the odds in favor of further tightening. Since the rate hikes ahead is largely pre-emptive, there is no need to be rush. We expect the next rate hike in 1Q2011. In the near term AUDUSD will likely be range-bound, with wide interest rate differentials supporting the downside and China's tightening capping on the upside.

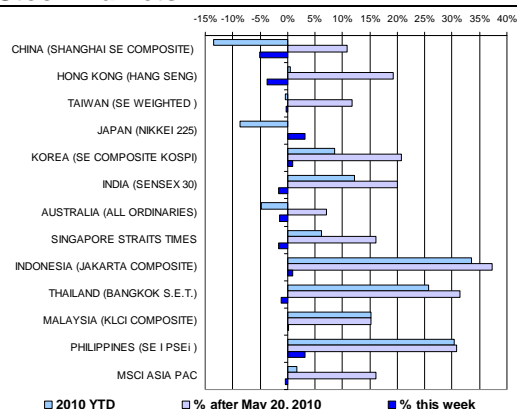
USD-KRW failed to breach the key resistance level of 1100. Strong growth indicators and BOK's tightening bias has underpinned the appreciation pressure. But the market is still concerned about Ireland and the planned capital control measures, amidst rising risk aversion. In fact, the planned measure is a further indication of the government's stance against sharp currency appreciation. Given the signaling effects, USDKRW will likely trade around 1100 waiting for other positive catalysts.

USD-CNY was flat last week despite USD rebound. To-date, CNY has risen 2.9% against the USD. Reduced growth concerns, rising anti-China protectionism risks and higher inflation will likely prompt the policymakers to continue gradual appreciation of the CNY. We continue to see USDCNY to fall to 6.3 by end-2011, which is slightly below the 12-month NDF of 6.457.

In equity markets this past week, sentiment was driven by European sovereign debt concerns and by monetary tightening prospects, especially in China. The Japanese market outperformed thanks to a weaker yen, and also because of some catch-up after being a lackluster performer through most of 2010. Nevertheless, at the end of the week stocks recovered slightly due to a higher likelihood that Ireland will accept a joint EU-IMF bailout.

Chart 3

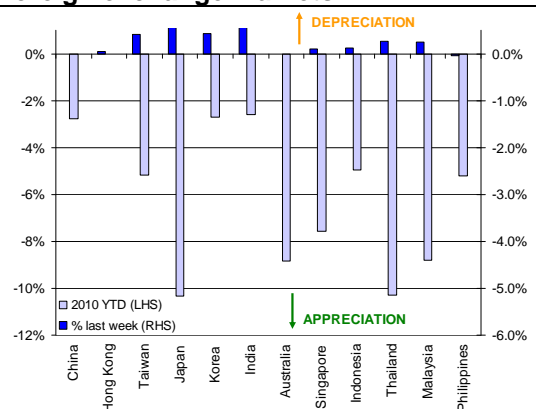
Stock markets



Source: BBVA Research and Bloomberg

Chart 4

Foreign exchange markets



Source: BBVA Research and Bloomberg

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Highlights

Inflation spurs expectations of more tightening in China

Data from China last week showed that growth momentum remains uncomfortably strong and, importantly, that inflation is rising. CPI inflation for October reached a two-year high of 4.4% y/y (from 3.6% the previous month), due mainly to further increases in food prices (10.1% y/y in October). The pick-up is above the authorities' 3% "comfort" zone, prompting an increasingly aggressive approach to monetary tightening.

Following a 25bp interest rate hike in mid-October (bringing the benchmark deposit and lending rates to 2.50% and 5.56% respectively), the required reserve ratio (RRR) was raised by 50 bps last week, the fifth hike this year. In addition, the government's cabinet (State Council) this week announced a set of measures to curb price increases, including possible price controls on consumer staples in the future. For now, the measures focus on adequate supply and distribution of agricultural, fertilizer and energy products, as well as steps to prevent speculation and hoarding. We expect further hikes in RRRs, of an additional 100-150bps during the coming year, and at least two more 50bp rate hikes in 2011, along with gradual currency appreciation. We would not rule out a rate hike before the end of the current year, and odds are increasing of cumulative interest rate hikes of as much as 100bp by the end of 2011. Given the strength of growth momentum and a continued supportive fiscal stance, we do not anticipate such tightening to affect overall growth adversely--our projection remains 10.1% and 9.2% for 2010 and 2011 respectively, although inflation is now likely to exceed our previous forecast of 3.3% (yearly average) in 2011.

Asian EAGLEs

Last week we reported on the significance for Asia of the G20 Summit held in Korea during November 11-12 ([see last week's Watch](#)). We noted that, beyond talk of currency wars and capital flows, the meeting marked a coming of age for the region and a further recognition of its importance in global economic affairs. Against this backdrop, it is timely to report that BBVA Research has just launched the concept of BBVA EAGLEs (Emerging And Growth Leading Economies), a cluster of emerging markets which are expected to be key players for global growth during the next ten years (see [Economic Watch on EAGLEs](#)). The group includes any country which is expected to contribute more to global GDP growth than the average of the G7 excluding the US. Half of the countries are in Asia. The full set of EAGLEs, from largest to smallest are: China, India, Brazil, Korea, Indonesia, Russia, Mexico, Turkey, Egypt and Taiwan. Together, they will contribute more than 50% to world growth. Another 5 Asian countries are on our watch list, called the "EAGLEs nest" (Thailand, Bangladesh, Malaysia, Vietnam, and the Philippines).

Japan Q3 GDP surprises to the upside

Japan's economy expanded at a faster-than-expected pace in Q3 of 3.9% (q/q saar) (consensus: 2.5%). The main contributor was private consumption, which accounted for 2.8ppts, and private investment accounting for the remainder. Meanwhile, the contribution of net exports was zero for the first time since Q2 of 2009. As a result, private consumption, accounting for about 60% of GDP, replaced net exports in Q3 as the main driver of growth. However, the growth in private consumption is largely due to temporary factors. In particular, households stepped up expenditure ahead of the September expiration of a subsidy program for the purchase of fuel-efficient cars. Meanwhile, the contribution of exports is trending down, consistent with a loss in competitiveness from the strength of Yen and a weakening in external demand, especially from China based on the breakdown of export growth. Looking forward, we expect sluggish growth for Japan in the coming quarters, despite implementation of a supplementary fiscal stimulus package, as exports slow and as some earlier stimulus measures expire. Nonetheless, our full-year projection for 2010 is relatively robust of at least 3.0% due to the strong outturns so far; we project growth of 1.6% in 2011.

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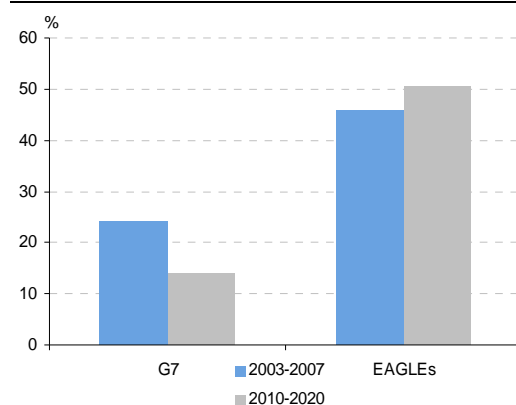
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Chart 5

The EAGLE economies will contribute to half of global growth in the next decade

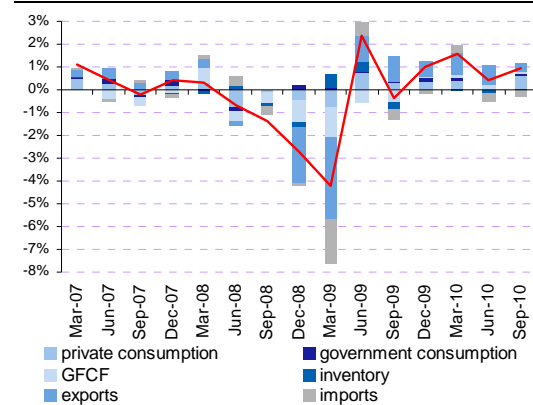


*Contribution to Global GDP growth (%)

Source: BBVA Research and Bloomberg

Chart 6

Private consumption lifts Japan's Q3 GDP



Source: BBVA Research and Bloomberg

What to watch

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Singapore: CPI inflation in October (November 23)

Forecast: 3.48% y/y

Consensus: --

Previous: 3.67%

Inflation is expected to ease with the appreciation of the currency, especially after the monetary authority tightened policy last October through a steepening in the slope of SGD's appreciation path. After peaking in Q2, the pace of property price increases has eased thanks to tightening measures in the housing market. A higher-than-expected CPI reading would raise expectations of further currency appreciation, and could fan regional fears of rising inflation especially after the upturn in China.

Calendar

China	Date	Period	Prior	Cons.
Actual FDI (YoY)	12-16 Nov	OCT	6.10%	10.40%
Hong Kong	Date	Period	Prior	Cons.
CPI - Composite Index (YoY)	22-Nov	OCT	2.60%	--
Exports YoY%	25-Nov	OCT	24.10%	--
Imports YoY%	25-Nov	OCT	19.50%	--
Trade Balance	25-Nov	OCT	-24.4B	--
Indonesia	Date	Period	Prior	Cons.
Total Local Auto Sales	22-26 Nov	OCT	49134	--
Japan	Date	Period	Prior	Cons.
Merchnds Trade Balance Total	25-Nov	OCT	¥797.0B	--
Adjusted Merchnds Trade Bal.	25-Nov	OCT	¥587.6B	--
Merchnds Trade Exports YoY	25-Nov	OCT	14.4	--
Merchnds Trade Imports YoY	25-Nov	OCT	9.9	--
CPI YoY	26-Nov	OCT	-0.60%	--
Korea	Date	Period	Prior	Cons.
SK Consumer Confidence	25-Nov	NOV	108	--
Current Account in US\$ Million	26-Nov	OCT	\$4055.8M	--
Goods Balance in US\$ Million	26-Nov	OCT	\$5671M	--
Malaysia	Date	Period	Prior	Cons.
GDP YoY%	22-Nov	3Q	8.90%	5.90%
CPI YoY	24-Nov	OCT	1.80%	1.90%
Philippines	Date	Period	Prior	Cons.
GDP (YoY)	25-Nov	3Q	7.90%	7.90%
GDP sa (QoQ)	25-Nov	3Q	1.30%	0.90%
Total Imports (YoY)	26-Nov	SEP	22.00%	--
Trade Balance	26-Nov	SEP	\$347M	--
Budget Deficit/Surplus	19-26 Nov	OCT	-31.7B	--
Singapore	Date	Period	Prior	Cons.
CPI (YoY)	23-Nov	OCT	3.70%	--
Industrial Production MoM SA	26-Nov	OCT	5.10%	--
Industrial Production YoY	26-Nov	OCT	26.20%	--
Taiwan	Date	Period	Prior	Cons.
Unemployment Rate - sa	22-Nov	OCT	5.08%	--
Industrial Production (YoY)	23-Nov	OCT	12.21%	--
Thailand	Date	Period	Prior	Cons.
Gross Domestic Product SA (QoQ)	22-Nov	3Q	0.20%	-0.40%
Gross Domestic Product (YoY)	22-Nov	3Q	9.10%	6.80%
Customs Exports (YoY)	22-Nov	OCT	21.20%	19.60%
Customs Imports (YoY)	22-Nov	OCT	16.00%	20.60%
Customs Trade Balance	22-Nov	OCT	\$3065M	\$1800M
Vietnam	Date	Period	Prior	Cons.
CPI (YoY)	21-25 Nov	NOV	9.70%	--

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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.	2834.0	-5.1	-13.5	-14.7
	Hong Kong – Hang Seng	23280.1	-3.9	6.4	2.8
	Taiwan – Weighted	8290.8	-0.3	1.3	6.8
	Japan – Nikkei 225	10039.6	3.2	-4.8	5.1
	Korea – Kospi	1932.0	1.0	14.8	19.2
	India – Sensex 30	19799.4	-1.8	13.4	18.0
	Australia – SPX/ASX 200	4629.0	-1.4	-5.0	-2.5
	Singapore – Strait Times	3195.7	-1.7	10.3	15.8
	Indonesia – Jakarta Comp	3698.0	0.9	45.9	49.8
	Thailand – SET	1006.4	-1.2	37.0	43.7
	Malaysia – KLCI	1502.8	0.2	18.1	17.7
	Philippines – Manila Comp.	4203.6	3.1	37.7	36.3

Last update: Friday, 12.30 Hong Kong time.

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.64	0.01	6.61	6.47
	Hong Kong (HKD/USD)	7.75	-0.04	7.7	8
	Taiwan (TWD/USD)	30.3	-0.42	30.16	29.65
	Japan (JPY/USD)	83.4	-1.06	83.3	83.0
	Korea (KRW/USD)	1133	-0.44	1137.67	1142.40
	India (INR/USD)	45.3	-1.09	46.0	47
	Australia (USD/AUD)	0.98	0.01	1	n.a.
	Singapore (SGD/USD)	1.30	-0.08	1.30	1.3
	Indonesia (IDR/USD)	8938	-0.11	8991	9255
	Thailand (THB/USD)	29.9	-0.27	29.99	30.1
	Malaysia (MYR/USD)	3.13	-0.24	3.1	3
	Philippines (PHP/USD)	43.8	0.05	43.67	43.93

Last update: Friday, 12.30 Hong Kong time.

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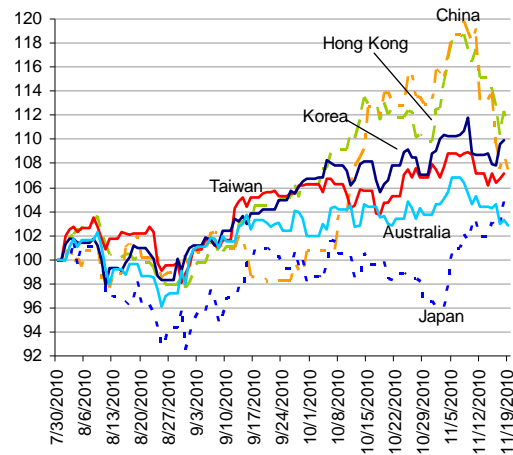
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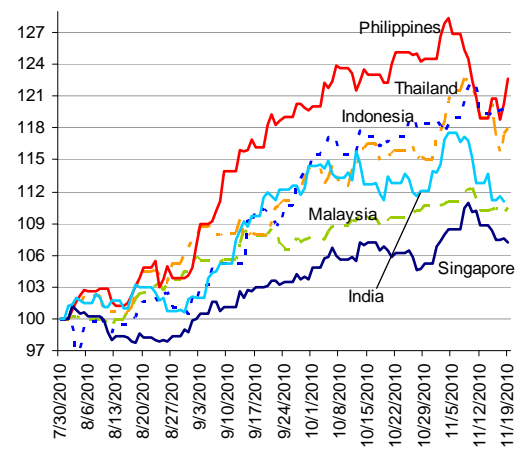
STOCK MARKETS



Source: BBVA Research and Bloomberg

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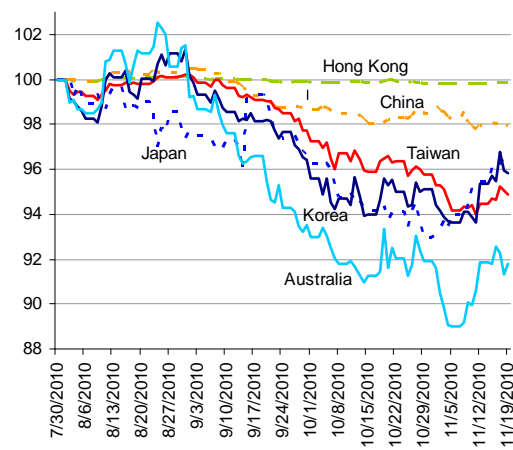
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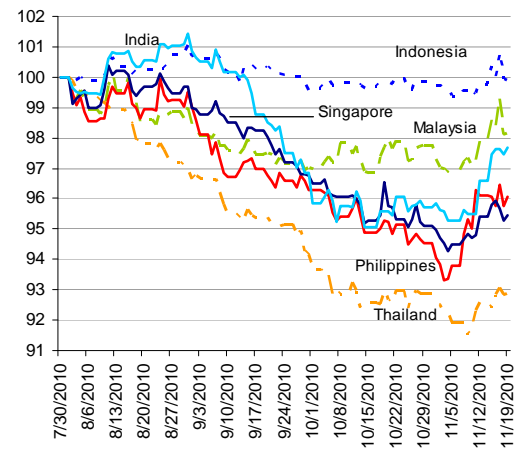
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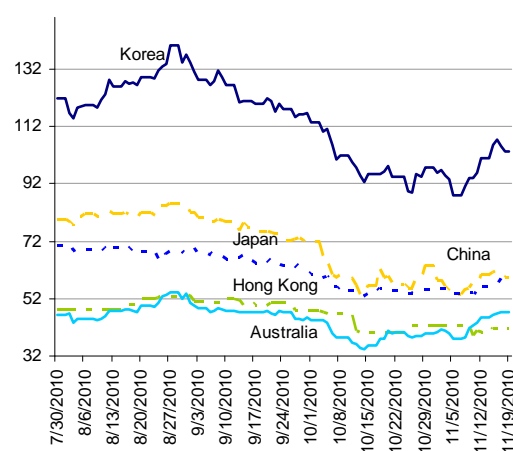
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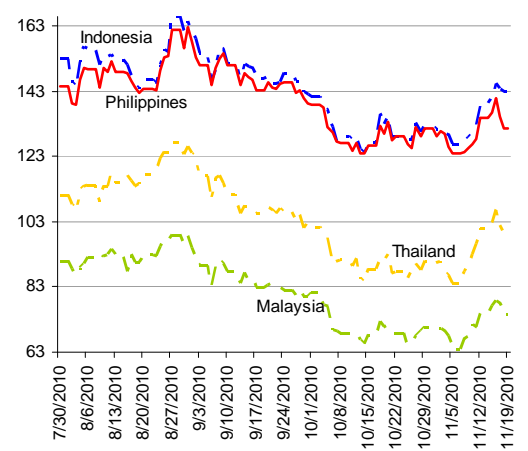
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CREDIT DEFAULT SWAPS



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