BBVA Research

Asia

Weekly Watch

Hong Kong, November 26, 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

Korean tensions fail to unnerve markets

Investor focus in Asia over the past week was dominated by further tightening measures in China and implications of Ireland's EU/IMF rescue package, followed by an unexpected military skirmish between North and South Korea. All in all, markets took these events in stride, with some modest reversal of recent currency appreciation, and equity markets for the most part down only slightly (exceptions were Korea and Hong Kong). China announced another hike in its required reserve ratio (RRR) on November 19 (see Highlights), and signaled that further tightening may be on the way. Meanwhile, Hong Kong unveiled some of its toughest measures to date to cool rampant property prices (see Highlights) while Fitch, in an unrelated development, upgraded Hong Kong's sovereign rating by one notch to AA+ (its second-highest rating).

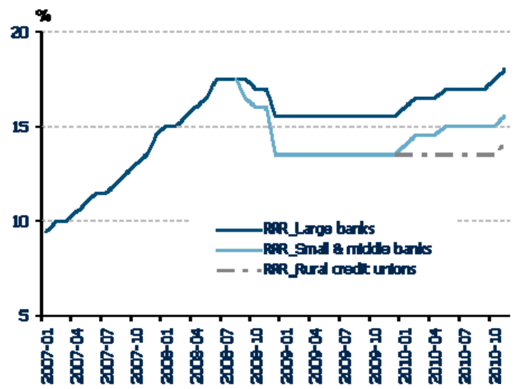
3Q GDP growth eases across the region

Third quarter GDP growth in Malaysia (5.3% y/y), Thailand (6.7%), and the Philippines (6.5%) were well below expectations on weaker exports and lower government spending (see Highlights), but the outlooks remains positive. Elsewhere in Singapore CPI inflation in October (3.5% y/y; consensus 3.7%) eased slightly, while in Japan inflation recorded its first positive growth (0.2% y/y) since January 2009. Meanwhile, in Australia the RBA governor signaled that further interest rate hikes are unlikely in the near term (the RBA raise rates in October to 4.75%).

In the coming week…

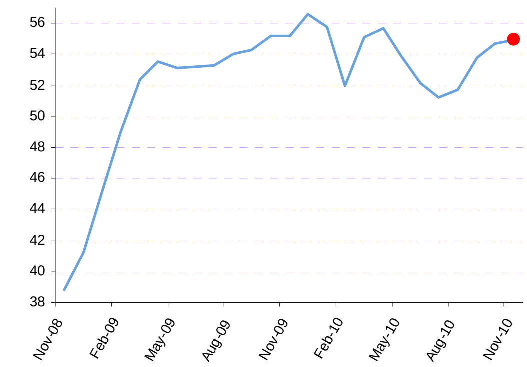
China's PMI will be closely monitored (see What to Watch), as well as third quarter GDP in Australia and India. Trade figures in will be released in Korea (November), as will inflation in a number of countries, including Indonesia, Thailand, and Korea. The Bank of Thailand and Bank Indonesia will hold monthly monetary meetings, with both expected to stay keep rates unchanged.

Chart1
China hikes required reserve ratios yet again…



Source: BBVA Research and Bloomberg

Chart2
…as new PMI figures in China are likely to show further manufacturing gains



Source: BBVA Research and Bloomberg

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Highlights

China takes further measures to address inflation
Another reserve requirement as the authorities seek to slow credit growth and inflation

Hong Kong intensifies its battle against property bubbles
The authorities introduce tough measures to cool the property market

Third quarter GDP growth slows in Asia
A weaker-than-expected set of GDP figures confirms a slowdown

Markets Analysis

Richard Li
richard.li@bbva.com.hk

Ricard Torne
ricard.torne@bbva.com.hk

Markets

European debt worries and Korea tensions spur profit taking

A combination of military skirmishes on the Korean peninsula, coupled with lingering concerns over European debt problems and China's policy tightening have jolted Asian investors' risk appetite. These worries, which will unlikely be resolved immediately, encouraged profit taking in Asian equities. Rising risk aversion also spurred flight to the USD and sent Asian currencies lower. Datawise, GDP growth in the region generally showed a slowdown in Philippines and Taiwan in 3Q, generally in the form of a healthy moderation to a more sustainable pace. Business investments also slowed in Australia. Reduced growth has lowered expectations of imminent rate hikes in some countries.

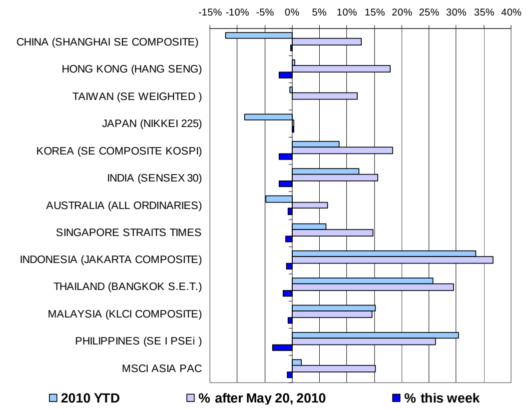
The KRW surrendered part of its gains accumulated in the last two months on the back of rising tension between North and South Korea. After North Korean artillery attacks on Tuesday, USDKRW fell for four consecutive days and is approaching 1150 by the time of writing. The key concern now is that the tension could rise further should the planned US-Korean joint military exercise in Yellow Sea go ahead this Sunday. China is going to play a key modulating role in defusing this conflict, but its stance on this matter is still ambiguous. But even in face of the uncertainties, KOSPI still held up above 1,900, as most investors are seasoned to the long-history of North-South stand-off and would take a wait-and-see mode.

The AUD traded lower due mainly to rising risk aversion. But domestic factors also played a role, as the hope for a near-term rate hike diminished after RBA's governor's testimony. *"For the period in which we're going to in the near term, I think this is about the right level,"* the governor told a parliamentary committee. *"At the moment most commentators and market pricing does not anticipate any further near-term tightening by us for quite some time. And I think that's probably a reasonable position for them to have, based on the information we have now."* Meanwhile, business investment in new plant and equipment has fallen short of expectations. Slowing growth and the absence of imminent rate hike catalysts have suppressed the Asian currencies below 0.9800.

The CNY followed the falls of EUR and JPY and depreciated slightly against the dollar. The 12-month NDF has also retraced to 6.532, up from 6.453. The NDF implies a meager appreciation of 1.8% in 12 month, which we think is too low. In our opinion, China's monetary tightening will be gradual and should not end up with a hard-landing. As long as European debt problems do not spill over to global growth slowdown, strong capital inflows and current account surplus should continue to provide reasons for the authorities to allow further appreciation. Rising imported inflation could provide a new catalyst to set the ball rolling faster. We think USDCNY will reach 6.3 by end-2011.

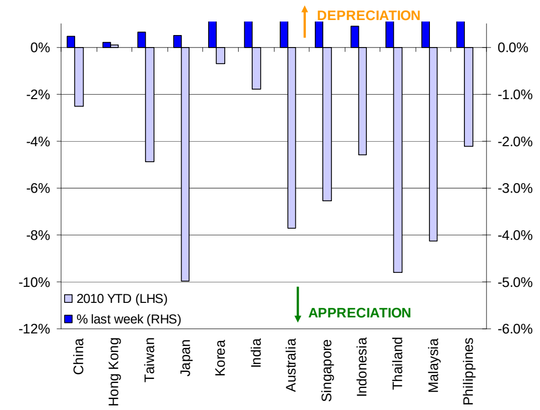
Most regional stock markets fell this past week, as European debt woes and South Korea's military skirmish with the North dragged down sentiment. Hong Kong and Korea were the worst performers, while Japan's stock market closed another week in positive territory as the JPY depreciated slightly.

Chart 3
Stock markets



Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets



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stephen.schwartz@bbva.com.hk

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ricard.torne@bbva.com.hk

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bingjie.hu@bbva.com.hk

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xia.le@bbva.com.hk

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jenny.zheng@bbva.com.hk

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serena.zhou@bbva.com.hk

Serena Wang
serena.wang@bbva.com.hk

Highlights

China takes further measures to address inflation

In a sign of the urgency the authorities' attach to restraining credit growth and limiting a further surge in inflation (which reached 4.4% y/y in October), on November 19 the People's Bank of China (PBoC) announced another hike in the required reserve ratio (RRR) by 50 bps, effective November 29. This was the second hike in two weeks, and the fifth RRR hike this year (not including the temporary hike in October). The RRR for the big four banks--Industrial and Commercial Bank of China, China Construction Bank, Bank of China and Agricultural Bank of China--will stand at 18%, and for small and medium-sized financial institutions 16%. The latest RRR hike is estimated to withdraw liquidity of about RMB 300 billion. In our view, the more aggressive tightening stance, which we have been flagging for some time, reflects the authorities' concern about excess liquidity, exacerbated by hot money capital inflows. We expect further monetary tightening to continue, including further hikes in RRRs of an additional 100-150 bps and rate hikes of as much as 100 bps over the next year. Indeed, comments this week by Deputy Governor Hu Xiaolian suggest that the authorities are ready to implement further interest rate hikes and drain liquidity.

The State Council (China's cabinet) has also announced a list of measures to contain rising consumer prices, including administrative measures to ensure food supplies and lower delivery costs, and fiscal measures to subsidize low income households. Local authorities are required to boost the supply of basic consumer goods and alleviate the impact of price shocks on low income consumers, and have been asked to delay utitility price increases. Market monitoring will also be intensified so as to discourage speculations in the agricultural markets. Local authorities have been asked to delay utility price increases.

Hong Kong intensifies its battle against property bubbles

The Hong Kong authorities announced some of their toughest measures to date on November 19 to curb surging home prices, including additional stamp duties on property sales and higher down payment requirements. Hong Kong is especially vulnerable to asset price bubbles given its fixed exchange rate regime to the USD (which rules out interest rate hikes) and open capital account, and the authorities have expressed increasing concern about the impact of capital inflows on asset prices. Property prices have surge by 47% since the end of 2008, and prices of luxury apartments are 14% above their 1997 peak. The authorities have expressed increasing concern about the impact of capital inflows on property prices. The new measures include a special stamp duty on properties sold within two years for both individuals and companies (15% for properties resold within 6 months, 10% for properties resold in 6-12 months, and 5% for properties resold in 1-2 years), aimed at reducing profits from speculation. They also include a tighter ceiling on the maximum loan-to-value (LTV) ratio of mortgages (from 70% to 60% for properties sales between HK$ 8 million and HK$ 12 million, and from 60% to 50% for properties sales above HK$ 12 million), the third such tightening since last October. The government has signaled that further tightening measures may be forthcoming if needed. So far, the measures appear to be working, evidenced by an 80% plunge in transaction volumes and 5-8% slide in selling prices in the week following the new measures. Since last October, the government has implemented various measures trying to cool the property market, including rising stamp duty on luxury apartments, increasing land supply, lowering the maximum loan-to-value (LTV) ratio of mortgages for luxury houses, and halting automatic residency for foreign buyers.

Third quarter GDP growth slows in Asia

Over the past week Malaysia, the Philippines, and Thailand all released weaker-than-expected third quarter GDP figures. The data confirm a sequential slowdown, which we have anticipated as economies ease to more sustainable growth rates following the rebound earlier this year. Malaysia's growth slowed to 5.3% y/y (consensus: 5.9%, BBVA: 6.0%) due to lower exports, and a withdrawal of fiscal spending. Meanwhile, Thailand's GDP growth also eased by more than expected, to 6.7% y/y (consensus: 7.2%, BBVA: 7.7%). Finally in the Philippines the economy expanded by 6.5% (consensus: 7.39%, BBVA: 7.1%). The latest batch of GDP releases are in line with a broader slowdown in the region, although growth trends remain generally robust, especially in China. Australia and India will release GDP next week.

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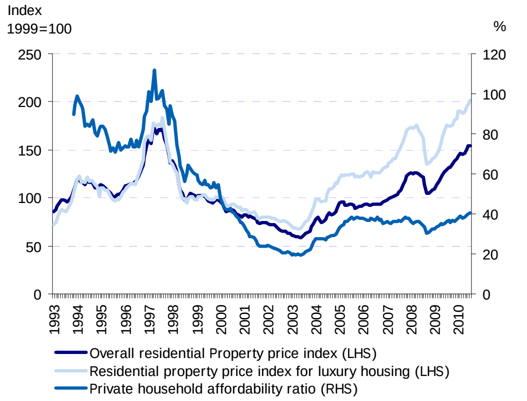
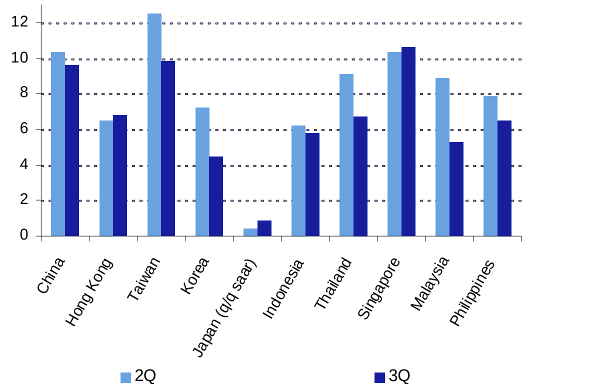
While the region remains heavily dependent on exports, private domestic demand has taken over as the driver of growth in recent quarters, particularly private consumption and investment. Fiscal stimulus measures have been gradually withdrawn, although they remain in place in some economies, including in China and Japan (which has recently announced supplementary stimulus measures). On the other hand, exports, which have been fueling economic growth in the recent quarters, have eased due to weaker external demand (nevertheless in line with our baseline scenario). We view the regional slowdown as a healthy moderation.

Chart 5
Hong Kong has seen rapidly rising property prices



Source: BBVA Research and Bloomberg

Chart 6
Third quarter GDP growth (y/y) slows



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Jenny Zheng
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Serena Zhou
serena.zhou@bbva.com.hk

Serena Wang
serena.wang@bbva.com.hk

What to watch

China: PMI in November (December 1)

Forecast: 54.9 **Consensus:** 54.8 **Previous:** 54.7

Recent indicators have been pointing to continued strong growth in China's economy, fed by robust domestic demand. The authorities have stepped up their tightening measures to restrain credit growth and contain rising inflation. In line with recent trends and still strong credit growth, we expect the manufacturing sector to continue its expansion in November. A stronger-than-expected reading would reinforce expectations of further aggressive tightening measures, which could weigh on equity markets.

Calendar

Australia	**Date**	**Period**	**Prior**	**Cons.**
Current Account Balance	30-Nov	3Q	-5640M	- -
Gross Domestic Product (QoQ)	1-Dec	3Q	1.20%	- -
Gross Domestic Product (YoY)	1-Dec	3Q	3.30%	- -
Trade Balance	2-Dec	OCT	1760M	- -
Retail Sales s.a. (MoM)	2-Dec	OCT	0.30%	- -
China	**Date**	**Period**	**Prior**	**Cons.**
PMI Manufacturing	1-Dec	NOV	54.7	54.7
Hong Kong	**Date**	**Period**	**Prior**	**Cons.**
Retail Sales - Value (YoY)	30-Nov	OCT	17.20%	15.90%
India	**Date**	**Period**	**Prior**	**Cons.**
Qtrly GDP YoY%	30-Nov	3Q	8.80%	8.30%
Exports YoY%	1-Dec	OCT	23.20%	- -
Imports YoY%	1-Dec	OCT	26.10%	- -
Indonesia	**Date**	**Period**	**Prior**	**Cons.**
Inflation (YoY)	1-Dec	NOV	5.67%	6.00%
Exports (YoY)	1-Dec	OCT	22.70%	- -
Total Imports (YoY)	1-Dec	OCT	11.90%	- -
Japan	**Date**	**Period**	**Prior**	**Cons.**
Retail Trade MoM SA	29-Nov	OCT	-3.00%	- -
Unemployment Rate	30-Nov	OCT	5.00%	- -
Industrial Production (MoM)	30-Nov	OCT P	-1.60%	- -
Korea	**Date**	**Period**	**Prior**	**Cons.**
Industrial Production (MoM)	30-Nov	OCT	-0.40%	- -
Consumer Price Index (YoY)	1-Dec	NOV	4.10%	- -
GDP at Constant Price (YoY)	3-Dec	3Q F	4.50%	- -
Ext Trade - Export (YoY)	3-Dec	NOV	29.90%	- -
Ext Trade - Imports (YoY)	01-03 Dec	NOV	22.40%	- -
Industrial Production (MoM)	30-Nov	OCT	-0.40%	- -
Malaysia	**Date**	**Period**	**Prior**	**Cons.**
Unemployment Rate	30-Nov	3Q	3.40%	- -
Exports YoY%	3-Dec	OCT	6.90%	- -
Imports YoY%	3-Dec	OCT	14.60%	- -
Thailand	**Date**	**Period**	**Prior**	**Cons.**
Total Exports YOY%	30-Nov	OCT	21.80%	- -
Total Imports YOY%	30-Nov	OCT	15.70%	- -
Current Account Balance (USD)	30-Nov	OCT	$2767M	- -
Consumer Price Index (YoY)	1-Dec	NOV	2.80%	2.80%

	Current	**Expected**
Thailand – Benchmark Interest Rate, December 1 We expect interest rates will remain unchanged	1.75	1.75

	Current	**Expected**
Indonesia – BI Reference Rate, December 3 We expect interest rates will remain unchanged	6.5	6.5

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STOCK MARKETS

INDEX	Last price	% change over a week	Year to date	% Change over 1 Y
China – Shanghai Comp.	2880.1	-0.3	-12.1	-9.2
Hong Kong – Hang Seng	23036.2	-2.4	5.3	3.7
Taiwan – Weighted	8312.2	0.1	1.5	7.4
Japan – Nikkei 225	10061.9	0.4	-4.6	7.2
Korea – Kospi	1894.0	-2.4	12.6	18.4
India – Sensex 30	19111.1	-2.4	9.4	13.4
Australia – SPX/ASX 200	4598.3	-0.7	-5.6	-2.3
Singapore – Strait Times	3160.8	-1.1	9.1	14.4
Indonesia – Jakarta Comp	3684.2	-1.1	45.4	53.9
Thailand – SET	991.9	-1.7	35.0	44.6
Malaysia – KLCI	1495.0	-0.7	17.5	17.7
Philippines – Manila Comp.	4053.6	-3.6	32.8	31.2

Last update: Friday, 13.30 Hong Kong time.

FOREIGN EXCHANGE MARKETS

CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
China (CNY/USD)	6.65	-0.23	6.65	6.55
Hong Kong (HKD/USD)	7.76	-0.10	7.8	8
Taiwan (TWD/USD)	30.4	-0.32	30.27	29.78
Japan (JPY/USD)	83.8	-0.24	83.6	83.1
Korea (KRW/USD)	1156	-1.93	1160.78	1164.13
India (INR/USD)	45.7	-0.86	46.4	48
Australia (USD/AUD)	0.97	-1.40	1	n.a.
Singapore (SGD/USD)	1.31	-1.29	1.31	1.3
Indonesia (IDR/USD)	8973	-0.45	9051	9304
Thailand (THB/USD)	30.2	-0.63	30.22	30.3
Malaysia (MYR/USD)	3.14	-0.81	3.2	3
Philippines (PHP/USD)	44.3	-1.03	44.21	44.40

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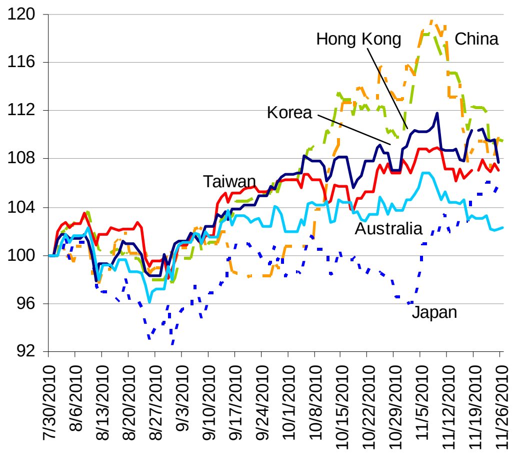
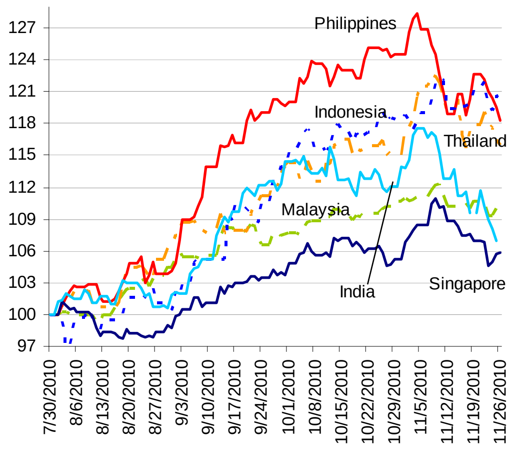
STOCK MARKETS



Source: BBVA Research and Bloomberg Index=100

STOCK MARKETS



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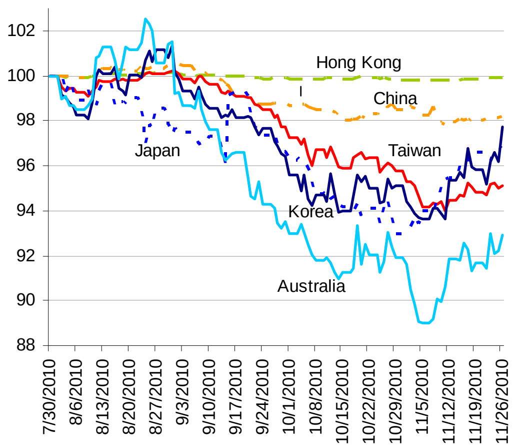

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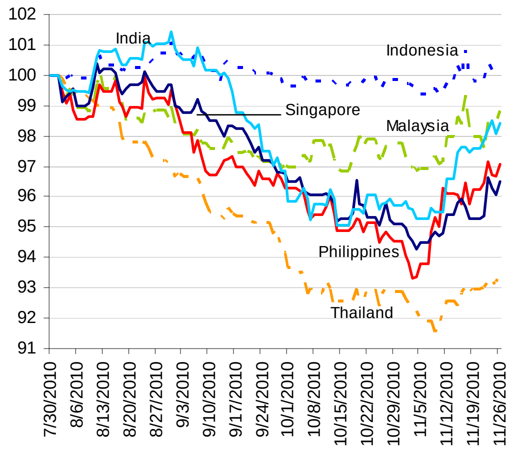

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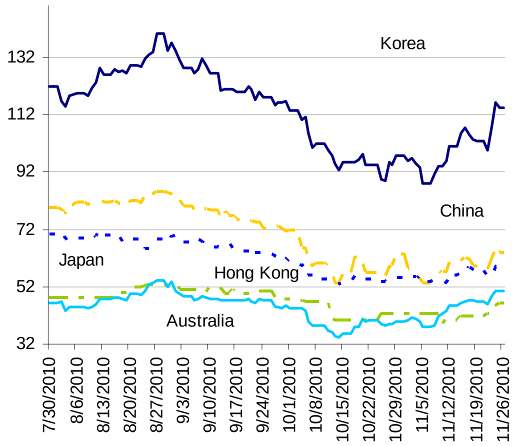

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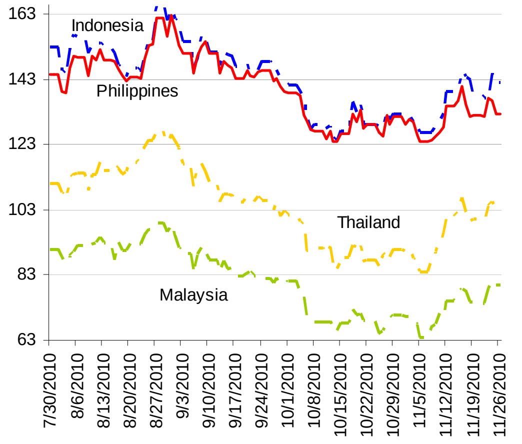

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