

Asia

Weekly Watch

Hong Kong, December 10, 2010

Economic Analysis

Asia

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Expectations of more tightening in China

Rising inflation and strong activity and credit indicators have raised expectations of more aggressive monetary tightening in China. Following an announcement by the authorities last week of a shift from a “moderately loose” to a “prudent” monetary stance, new data show that growth momentum and credit remain strong, sparking speculation of an imminent rate hike (which would be the second, since October). M2 growth and new loans for November exceed expectations, with the RMB 7.5 trillion annual target ceiling now essentially hit, with one more month of the year to go. Inflation and other important activity indicators will be released over the weekend. We expect four rate hikes (100bp in total) between now and end-2011, in addition to further hikes in reserve requirements.

A week of strong data in Asia

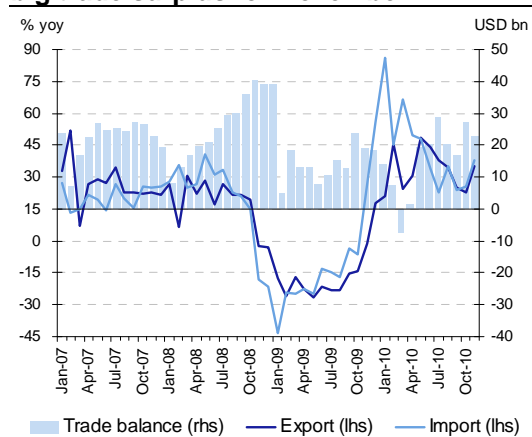
Japan revised up its Q3 GDP growth to 4.5% (q/q seasonally adjusted annual rate) from 3.9% previously, increasing the likelihood of a strong outturn for 2010, although expectations of strong growth continuing into 2011 remain weak. China’s trade figures surprised the market, with exports rising by a robust 34.9% y/y (consensus 23.6%), and imports growing by 37.7% y/y (consensus: 24.5%). The outturns resulted in another large trade surplus, of USD22.9 billion for the November (BBVA: USD22.1 billion), which is likely to keep pressure on for faster currency appreciation. Following recent measures to cool the property market in China, housing prices slowed a bit, to 7.7% y/y (consensus: 8.0%), although they were still up by 0.3% for the month. On the monetary front, the Reserve Bank of Australia and the Bank of Korea both left rates unchanged (see Highlights).

In the coming week...

China will release this weekend its batch of monthly statistics, including CPI inflation, retail sales, and industrial production. Markets will also be watching closely the results of the annual Economic Work Conference in China (Highlighted last week), as well as WPI inflation in India, industrial production in Japan, and exports in Singapore. Meanwhile, the Reserve Bank of India will hold its monthly policy meeting (we expect the RBI to stay on hold) for the time being, with further rate hikes in 2011.

Chart1

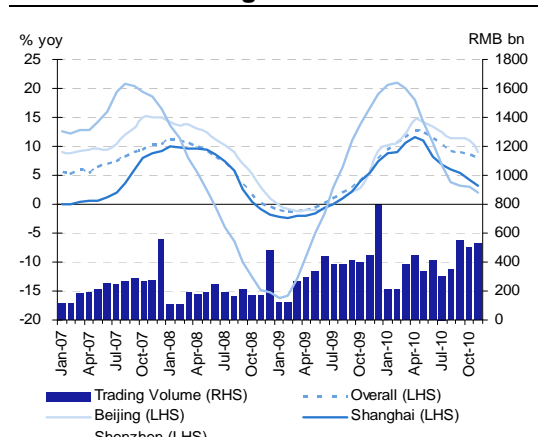
Strong exports in China result in another big trade surplus for November...



Source: BBVA Research and Bloomberg

Chart2

...while property prices slow on the authorities' cooling measures.



Source: BBVA Research and Bloomberg

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Highlights

Thailand’s resilient economy earns an outlook upgrade

S&P upgrades its outlook for Thailand on strong debt dynamics

Australia and Korea pause on interest rate hikes

Rate hikes are expected to resume in 2011

Update on Hong Kong’s efforts to cool the property sector

Recent measures to cool the market appear to be working for now

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Markets

Higher US yields keeps Asian currencies lower

Obama’s compromise with the Republicans to extend Bush-era tax cuts contributed to an increase in US government bond yields and sustained the USD rebound. Asian currencies generally fell. Data-wise in Asia, Japan revised its 3Q GDP estimates up to 4.4% from previous 3.9% (saar), citing stronger-than-expected business investment. However, market worries linger about the sustainability of Japan’s growth given the strong yen and continuing deflation. Meanwhile, in China, ahead of key data releases scheduled this weekend, there are rising expectations that China may hike rates.

AUDUSD slipped by around 1.0% to 0.9829 largely due to the USD rebound. This week, the RBA decided to keep its cash target rate at 4.75% (see Highlights). 3Q GDP growth slowdown and concerns about China’s increasingly aggressive approach to monetary tightening will likely cause the RBA to keep its policy rate unchanged in the next few months. But note that the labor market in Australia remains tight, and our economist think China’s growth will remain above 9.0%. In this environment, the tightening bias of the RBA is likely to remain. Wide interest rate differentials between the AUD and the USD should support the AUD’s strength over the medium term.

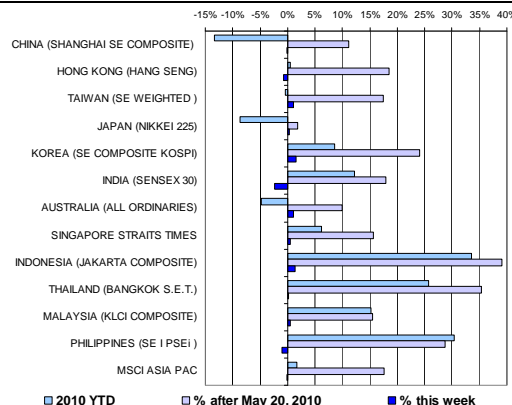
USDKRW remained in a tight range in the past week without a clear direction. Geopolitical risks have moderated, but the possibility of renewed military conflict still could not be discounted. In line with market expectations, the BOK decided to take a pause (see Highlights), but the accompanying statement suggests interest rate normalization will continue. In our view, KRW still offers the largest scope of appreciation in the medium term given Korea’s stellar growth performance (compared to its OECD peers), BOK’s tightening bias, and relative valuation of the won.

The CNY continues to trade in a tight range between 6.6 and 6.7. The 12-month NDF also retraced slightly to 6.517. This implies a 2.1% appreciation only, slightly lower than our forecasts of 4-5%. We do not think higher domestic prices in China will accelerate the RMB’s appreciation, as exchange rate is unlikely an effective anti-inflationary tool in China. Meanwhile, the supplies of offshore RMB in Hong Kong became more abundant. As a result, the gap between the onshore (USDCNY) and offshore (USDCNH) spot exchange rate narrowed significantly from the peak level in mid-October.

Stocks in Asia were mixed this past week. European debt spillovers and concerns about further tightening in China drove the markets. India’s Sensex was the worst performer as a corruption scandal rattled markets. On the other hand, the Korean Kospi rebounded as military tensions with the North appeared to ease.

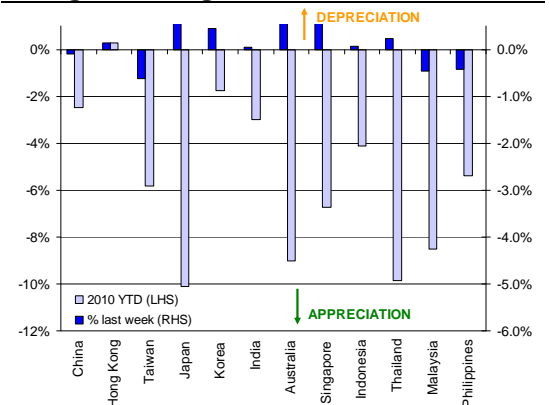
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Chart 3
Stock markets



Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets



Source: BBVA Research and Bloomberg

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Highlights

Thailand's resilient economy earns an outlook upgrade

S&P upgraded Thailand's credit rating this past week, from negative to stable following a similar move by Moody's last October. At the same time S&P confirmed its BBB+ foreign currency (three notches above investment grade) and A- local currency sovereign credit rating. S&P said the move was supported by Thailand's favorable debt position and prudent fiscal management. However, the agency pointed that political situation (together with fundamentals) will determine any actual upgrade to the credit rating itself. Thailand's economy has proven extremely resilient to recent shocks—one external, from the global financial crisis, and the other domestic, from political unrest. The economy fell into severe recession in 2009 (GDP fell by 2.3%), but rebounded strongly as political unrest subsided last May. We expect the economy to grow by around 8% in 2010, underpinned by strong export growth and domestic demand. Rating agencies downgraded the outlook in December 2008 during the depths of the global financial crisis and as Bangkok's international airport was closed for a week due to a political demonstration.

Australia and Korea pause on interest rate hikes

Over the past week, both the Reserve Bank of Australia (RBA) and Bank of Korea (BOK) left their policy rates unchanged, as expected. The RBA kept its cash target rate at 4.75%. This was in line with expectations, as the authorities had already signaled that the current monetary was appropriate, within the RBA's inflation targeting regime (inflation remains within the 2-3% target range), and given that the economy has been losing some momentum after the central bank hiked rates seven times since October 2009. On the external front, the RBA pointed to risks to the global recovery from Europe's debt crisis. We nevertheless expect Australia to resume hikes in 2011, to 5.50% by year-end. For its part, the BOK also kept borrowing costs unchanged at 2.50%, after a second rate hike in October. In contrast to Australia, inflation recently exceeded the authorities' target of 2-4% (4.1% y/y in October), but fell back in November to 3.1% y/y. However, the BoK expects inflationary pressures to continue, fueled by strong economic growth and rising international commodities prices. Accordingly, we expect the BoK to continue normalizing rates in 2011 (three hikes of 25bp each).

Update on Hong Kong's efforts to cool the property sector

As reported previously ([Asia Weekly on November 26th, 2010](#)) the Hong Kong authorities have introduced some of their toughest measures to date to curb speculation in Hong Kong's hot property market. The authorities have been seeking to tame price increases out of concern, which we share, that a property bubble may be forming in the current low interest rate environment—all the more so as Hong Kong effectively "imports" low interest rates given its peg to the US dollar. The recent measures were introduced in late November and include stamp duties in the range of 5-15% on properties sold within 2 years of their purchase date, as well as higher down payment requirements. So far, the measures appear to be having their intended effect. Over the past few weeks, the number of transactions recorded by major real estate firms has fallen by as much as 50-60%, and prices have declined on the order of 5-8%. The measures come just as the IMF just issued a recent paper arguing that, while it does not view Hong Kong's property sector to be in a bubble just yet, going forward the risks are high in view of the likelihood of sustained capital inflows, rapid credit growth and a prolonged period of low real interest rates. The IMF also warned of the risks of a sharp reversal of prices, which could be triggered by eventual policy tightening in the United States or a slowdown in China. While Hong Kong's latest measures have met with criticism from local industry players, the market impact so far will no doubt please the authorities.

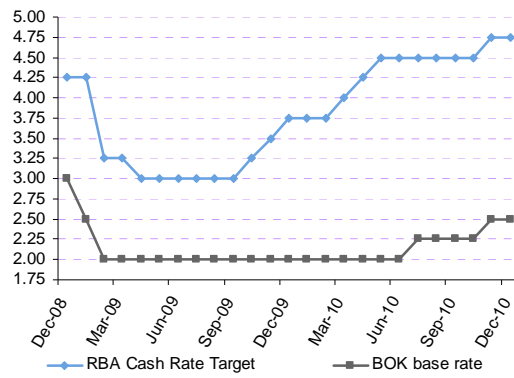
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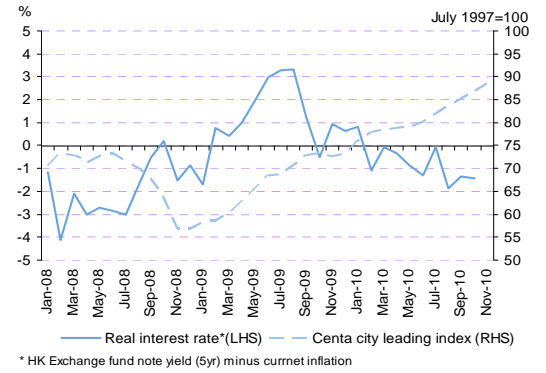
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Chart 5
Australia and Korea leave rates unchanged this month



Source: BBVA Research and Bloomberg

Chart 6
Hong Kong property prices have risen in the low interest rate environment



Note: The Centa city leading index is a weekly index based on preliminary contract prices.
 Source: BBVA Research and Bloomberg

What to watch

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China: CPI inflation in November (December 11)

Forecast: 4.8% y/y

Consensus: 4.7%

Previous: 4.4%

Consumer price inflation is expected to have accelerated further in November on surging food prices. Inflation has become a top concern for the authorities, and government measures to stabilize food prices have had some effect, but weekly data show continued increases for food items such as sugar, vegetable oil, dairy and meat. A higher-than-expected reading could increase inflationary expectations, and could significantly exacerbate worries of more aggressive monetary tightening measures

Calendar

Australia	Date	Period	Prior	Cons.
Consumer Inflation Expectation	16-Dec	DEC	3.10%	--
China	Date	Period	Prior	Cons.
Producer Price Index (YoY)	11-Dec	NOV	5.00%	5.10%
Consumer Price Index (YoY)	11-Dec	NOV	4.40%	4.70%
Retail Sales (YoY)	11-Dec	NOV	18.60%	18.70%
Industrial Production (YoY)	11-Dec	NOV	13.10%	13.00%
Fixed Assets Inv Urban YTD YoY	11-Dec	NOV	24.40%	24.30%
Money Supply - M2 (YoY)	10-15 Dec	NOV	19.30%	19.10%
New Yuan Loans	10-15 Dec	NOV	587.7B	500.0B
Actual FDI (YoY)	12-16 Dec	NOV	7.90%	10.80%
Hong Kong	Date	Period	Prior	Cons.
Industrial Production YoY	10-Dec	OCT	4.40%	--
Industrial Production YoY	10-Dec	OCT	4.40%	--
India	Date	Period	Prior	Cons.
Monthly Wholesale Prices YoY%	14-Dec	NOV	8.58%	7.50%
Japan	Date	Period	Prior	Cons.
Industrial Production (MoM)	14-Dec	OCT F	-1.80%	--
Tertiary Industry Index (MoM)	15-Dec	OCT	-0.90%	--
Korea	Date	Period	Prior	Cons.
Unemployment Rate (SA)	15-Dec	NOV	3.60%	3.50%
Philippines	Date	Period	Prior	Cons.
Unemployment Rate	15-Dec	OCT	--	--
Overseas Remittances (YoY)	15-Dec	OCT	10.60%	--
Balance of Payments	17-Dec	NOV	\$2736M	--
Singapore	Date	Period	Prior	Cons.
Retail Sales (MoM) sa	15-Dec	OCT	-2.40%	--
Electronic Exports (YoY)	17-Dec	NOV	34.00%	--
Non-oil Domestic Exp SA (MoM)	17-Dec	NOV	5.80%	--

China – Central Economics Works Conference, December 10-12

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India – Reserve Repo Rate, December 16

We expect interest rates will be unchanged

Current	Expected
5.25	5.25

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India –Repo Rate, December 16

We expect interest rates will be unchanged

Current	Expected
6.25	6.25

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Hong Kong – Composite Interest Rate, December 17

We expect interest rates will remain unchanged

Current	Expected
0.17	0.17

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Markets Data

Asia Market

STOCK MARKETS	INDEX	Last price	% change over a week	Year to date	% Change over 1 Y
	China – Shanghai Comp.	2841.0	0.0	-13.3	-12.7
	Hong Kong – Hang Seng	23162.9	-0.7	5.9	6.7
	Taiwan – Weighted	8718.8	1.1	6.5	13.6
	Japan – Nikkei 225	10212.0	0.3	-3.2	3.5
	Korea – Kospi	1986.1	1.5	18.0	20.2
	India – Sensex 30	19490.8	-2.4	11.6	13.4
	Australia – SPX/ASX 200	4745.9	1.1	-2.6	3.0
	Singapore – Strait Times	3184.8	0.4	9.9	14.5
	Indonesia – Jakarta Comp	3747.7	1.4	47.9	50.7
	Thailand – SET	1035.9	0.2	41.0	49.1
	Malaysia – KLCI	1507.3	0.4	18.4	19.6
Philippines – Manila Comp.	4135.8	-1.0	35.5	37.6	

Last update: Friday, 17.30 Hong Kong time.

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.66	0.07	6.62	6.51
	Hong Kong (HKD/USD)	7.78	-0.14	7.8	8
	Taiwan (TWD/USD)	30.1	0.64	29.93	29.43
	Japan (JPY/USD)	83.7	-1.37	83.6	83.1
	Korea (KRW/USD)	1144	-0.44	1148.45	1151.79
	India (INR/USD)	45.1	-0.02	45.8	48
	Australia (USD/AUD)	0.99	-0.65	1	n.a.
	Singapore (SGD/USD)	1.31	-0.56	1.31	1.3
	Indonesia (IDR/USD)	9018	-0.06	9082	9356
	Thailand (THB/USD)	30.1	-0.23	30.11	30.3
	Malaysia (MYR/USD)	3.13	0.46	3.1	3
Philippines (PHP/USD)	43.7	0.42	43.60	43.48	

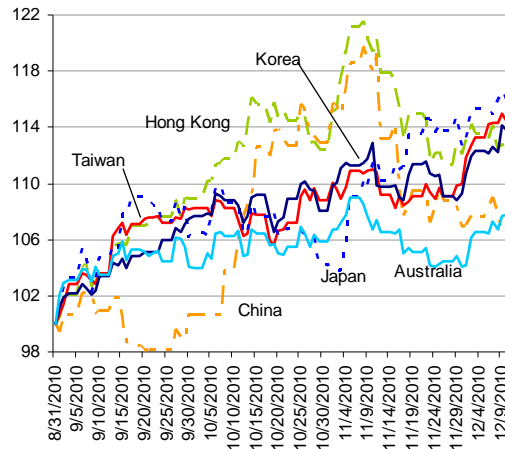
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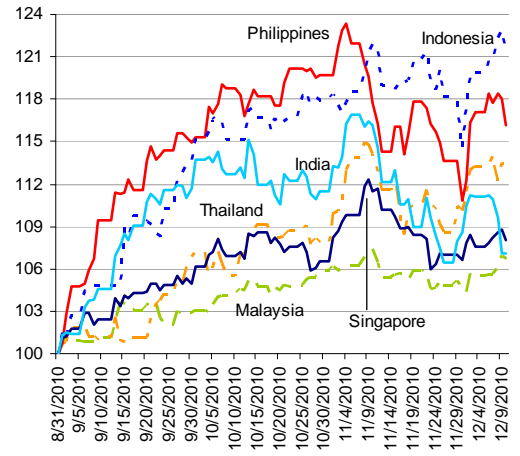
Asia Chart

STOCK MARKETS



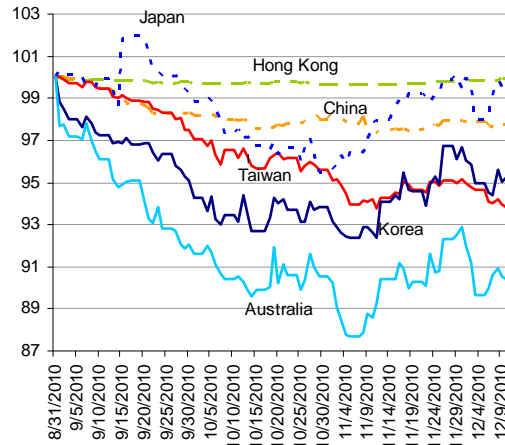
Source: BBVA Research and Bloomberg Index=100

STOCK MARKETS



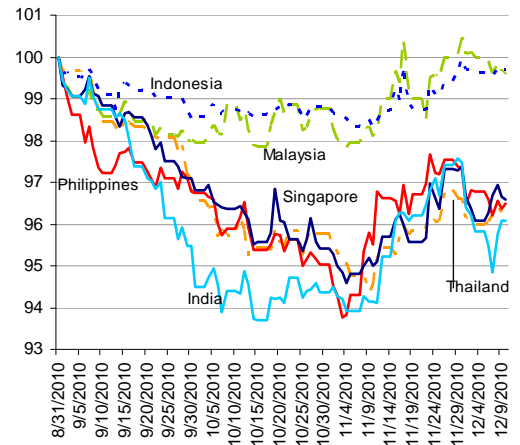
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FOREIGN EXCHANGE MARKETS



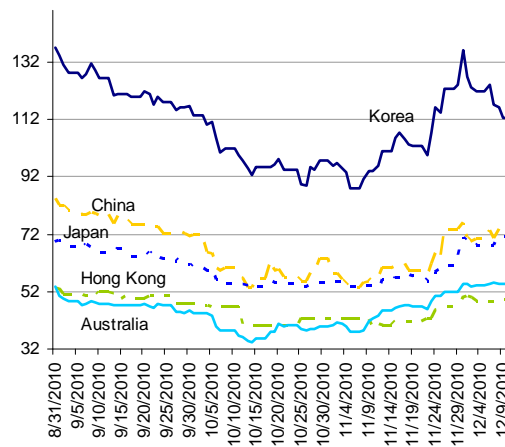
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FOREIGN EXCHANGE MARKETS



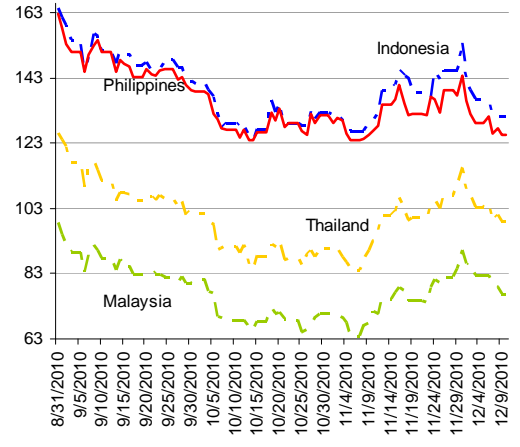
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