

Asia

Weekly Watch

Hong Kong, December 17, 2010

Economic Analysis

Asia

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China battles rising inflation

This past week was marked by reaction to China's higher-than-expected inflation outturn for November and strong growth indicators (see Highlights). Expectations of an imminent rate hike failed to materialize, although the authorities continue to signal additional tightening measures, on top of the latest hike in required reserve ratios announce last week. Meanwhile, the authorities announced they will increase their inflation target for 2011 from 3% to 4%, while maintaining the minimum growth target at 8%. Meanwhile, despite risks of overheating, S&P upgraded China's sovereign rating by one notch to AA-, and bestowed its highest triple A rating on Hong Kong, although it downgraded Vietnam (see Highlights).

A light week of data in the rest of Asia

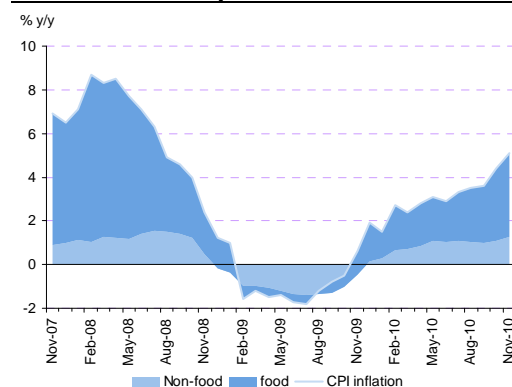
India's WPI inflation in November slowed to 7.5% y/y, in line with consensus, from 8.6% y/y in the previous month, enabling the authorities to remain on hold at their policy meeting (see Highlights). Meanwhile, November non-oil domestic exports in Singapore grew by 10% y/y, well below consensus (21.5%), and Japan's October tertiary industry index (0.5% m/m) beat expectations (0.2%).

In the coming week...

The coming week will also be light on data, with markets watching November export orders in Taiwan (especially after the weak export outturn in Singapore), trade figures for November in Japan, and November industrial production in Singapore and Taiwan. Japan will hold its monthly monetary policy meeting.

Chart1

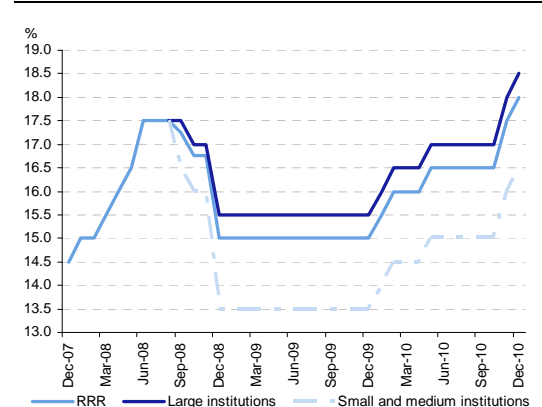
Inflation heats up in China...



Source: BBVA Research and Bloomberg

Chart2

...prompting another RRR hike



Source: BBVA Research and Bloomberg

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Highlights



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Highlights

China's strong growth momentum and rising inflation

Risks of overheating have risen

Asia's strong fundamentals draw sovereign rating upgrades

China and Hong Kong are the latest to receive upgrades, while Vietnam is downgraded

India's inflation eases

The Reserve Bank of India stays on hold as inflation eases

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Markets

Sentiment improves but higher US yields is still dampening Asian currencies

Sentiment in the Asia region was driven in part this past week by easing expectations of further rate hikes in China. Nevertheless, expectations that Chinese authorities will continue to take steps to tame inflationary pressures didn't fade away, especially after last week's hike in the required reserve ratio. On the external front, despite Europe's ongoing debt crisis, speculation that the EU will develop a framework to address future crises helped to boost markets. Meanwhile, a rise in US long-term Treasury yields and improved outlook in the US reinforced confidence on recovery prospects, but also dampened sentiment toward emerging markets assets.

AUDUSD gained by 0.5% this past week, as risk aversion eased across the region, and as some US reports showed positive signs, and the EU agreed a plan to create a permanent mechanism to deal with future bonds crisis.

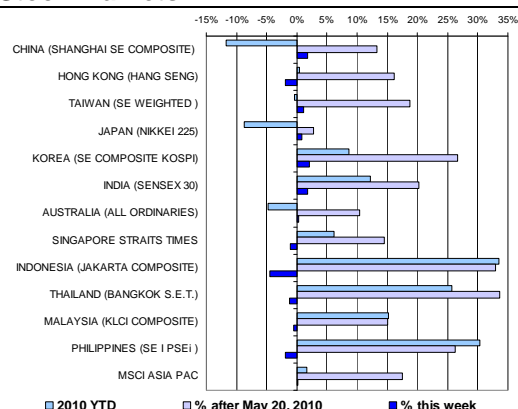
The KRW weakened to 1,153 against the USD, a two-week low, recording losses for a second straight week, on concerns that measures to tame overseas borrowing will reduce the quantity of dollars in the local market. The details of this plan will be unveiled next week. However, markets should not be too severely affected as the plan has been already flagged for some time.

USDTWD climbed this week by 0.9%, with cumulative gains for the month of December at 2% in December, due to a solid economic growth, and also by a buoyant outlook as the island is boosting ties with mainland China. Nevertheless, some market participants speculated this past week that a strong currency will erode exporters' gains, and it may trigger intervention from the central bank to tame curb appreciation.

Meanwhile, the CNY broke below the 6.65 point again this past Tuesday, but couldn't consolidate this mark, and the currency fluctuate around 6.66 for the rest of the week.

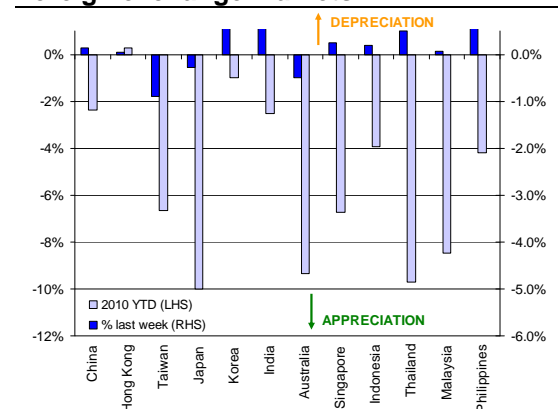
Chinese stocks surged on Monday as the authorities refrained from hiking rates over the weekend, as had been widely rumored. During the rest of the week, stocks trends were mostly negative, due to rising concerns of further monetary tightening, but failed to offset early-week gains. India's market also rose as the Reserve Bank of India left policy rates unchanged on easing inflation. On the other hand, most stock markets in Southeast Asia retreated amid concerns that the debt crisis in Europe and rising US Treasury yields could lead to diminished capital inflows in high-yields markets, and also as markets begin to consolidate ahead of year-end, after a strong finish for Asian equity markets this year.

Chart 3
Stock markets



Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets



Source: BBVA Research and Bloomberg

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Highlights

China's strong growth momentum and rising inflation

China's latest batch of monthly statistics (released last weekend) surprised once again to the upside, and reinforced concerns of overheating. Inflation rose in November to 5.1% y/y from 4.4% y/y in the previous month, well above of expectations (consensus: 4.7%) and the authorities' 3% comfort range. As in previous months, the rise was mainly attributable to food price inflation, although the non-food component also showed signs of increasing. Property prices moderated a bit, rising by 7.7% for the month of November (consensus: 8.0%), lower than 8.6% of last month. The data showed that domestic demand remains robust, with retail sales and fixed asset investment growing strongly, in line with expectations. However, new loans (RMB 564 billion) were ahead of expectations, frustrating the authorities' efforts to keep banks to within the overall ceiling of RMB 7.5 trillion for the year.

In response to rising inflation and uncomfortably strong growth momentum, the central bank (PBoC) is adopting a more aggressive monetary tightening stance. Officially, the authorities have announced a shift to a "prudent" monetary stance from their previous "moderately loose" stance. Last Friday the PBoC hiked the required reserve ratio (RRR) by 50bps, for a seventh time this year. Markets have also been expecting another rate hike, possibly before the end of the month. The tightening measures are consistent with the tone set by the government's recent annual Central Economic Conference, in which next year's inflation target is set at 4%, with the minimum growth target remaining at 8%--in short, the authorities aim to combat inflation by tightening liquidity, while maintaining growth through a supportive fiscal stance. We expect further hikes in the RRR over the coming year of up to 150bps, and additional interest rate hikes of 100bps between now and end-2011.

Asia's strong fundamentals draw sovereign rating upgrades

In sharp contrast to developments in Europe, credit rating agencies in emerging markets have been busy with sovereign upgrades, especially for Asian economies, underlying the region's strong fundamentals and fiscal positions. This past week alone, Standard & Poor's raised its long-term sovereign credit rating for China by one notch to AA- from A+ (three notches below the top grade of AAA), with a stable outlook. This upgrade follows a similar move by Moody's on November 11, with S&P highlighting China's "capacity to absorb potential balance sheet losses, its substantial foreign reserves, and solid fiscal position." S&P also raised Hong Kong's long-term credit rating by one notch to the highest rating of AAA, from AA+, with a stable outlook. S&P underscored Hong Kong's large net external creditor position, fiscal reserves accumulation, and above-average growth potential for a high-income economy. Last week, as was already reported (see [previous Weekly](#)), S&P upgraded Thailand's outlook from negative to stable. However, Vietnam, despite its strong growth prospects, is an outlier. This past week Moody's downgraded Vietnam's bond rating to B1 from Ba3 (four notches below investment grade), maintaining a negative outlook. Moody's cited Vietnam's widening trade deficit, capital flight, the reduced level of reserves, and depreciation pressure on the Vietnamese Dong, as well as rising inflation. The move follows a similar downgrade (from BB- to B+) by Fitch last July.

India's inflation eases

India is one of Asia's economies where inflation has been a serious problem for much of 2010 due to strong demand pressures. The RBI has raised its policy rates 6 times since March, along with hikes in its cash reserve ratio. Encouragingly, WPI inflation eased in November to 7.5% y/y, from 8.6% y/y in October, in line with the market's consensus of 7.5% (however, on a m/m basis, inflation rose to 0.42% from 0.14% in October). Inflation has been trending down since its peak of 11.00% y/y in April, although it is still well above the RBI's 5.5% target for fiscal year 2011. While almost all categories contributed to the fall in inflation, an easing of food prices was the most significant element. We expect headline inflation to continue falling in the coming months. On the policy rate front, the RBI kept its policy rates unchanged in their December meeting; at the same time, they pumped liquidity into the banking system to address a short-term cash squeeze. Surging commodity prices as well as supply side constraints pose upside inflation risks. We forecast the RBI will hike the repo rate three times in 2011, by 25 bps each, to 7.00%.

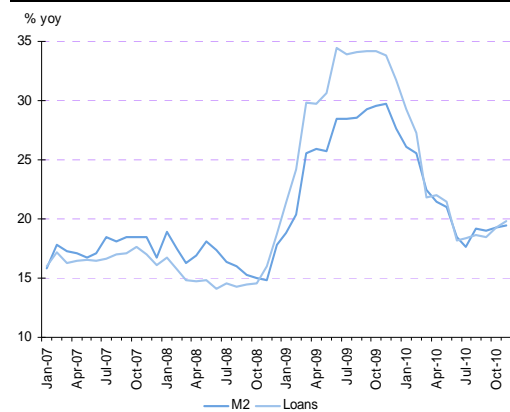
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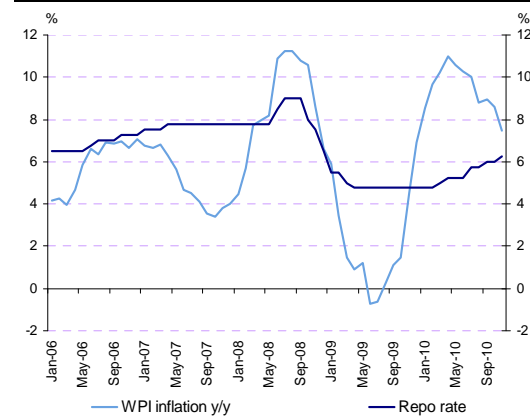
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Chart 5
The authorities aim to reduce China's rapid credit growth



Source: BBVA Research and Bloomberg

Chart 6
India's inflation eases



Source: BBVA Research and Bloomberg

What to watch

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Taiwan: Exports Orders in November (December 20)

Forecast: 13.8

Consensus: 13.1

Previous: 12.3%

Taiwan export orders, a 1-3 month leading indicator of actual exports, are expected to remain broadly unchanged on a sequential monthly basis, but should rise on a year-on-year basis due to base effects. The figures are significant not only for Taiwan, given its export dependence, but for the rest of the region as an indicator of export demand in the coming months. A stronger-than-expected outturn may reinforce positive sentiment toward Asia's growth prospects, and could accelerate currency appreciation pressures.

Calendar

Hong Kong	Date	Period	Prior	Cons.
CPI - Composite Index (YoY)	21-Dec	NOV	2.60%	--
Bal of Paymts - Overall	23-Dec	3Q	\$5.50B	--
Bal of Paymts - Current A/C	23-Dec	3Q	\$6.40B	--
Japan	Date	Period	Prior	Cons.
All Industry Activity Index (MoM)	21-Dec	OCT	-0.80%	--
Merchnds Trade Balance Total	22-Dec	NOV	¥821.9B	¥489.9B
Merchnds Trade Exports YoY	22-Dec	NOV	7.8	10
Merchnds Trade Imports YoY	22-Dec	NOV	8.7	8
Korea	Date	Period	Prior	Cons.
SK Consumer Confidence	24-Dec	DEC	110	--
Malaysia	Date	Period	Prior	Cons.
CPI YoY	22-Dec	NOV	2.00%	2.10%
Philippines	Date	Period	Prior	Cons.
Unemployment Rate	21-Dec	OCT	--	--
Overseas Remittances (YoY)	23-Dec	OCT	10.60%	--
Balance of Payments	23-Dec	NOV	\$2736M	--
Singapore	Date	Period	Prior	Cons.
CPI (YoY)	23-Dec	NOV	3.50%	3.80%
Industrial Production MoM SA	24-Dec	NOV	2.20%	-9.50%
Industrial Production YoY	24-Dec	NOV	31.00%	26.80%
Taiwan	Date	Period	Prior	Cons.
Export Orders (YoY)	20-Dec	NOV	12.26%	13.05%
Unemployment Rate - sa	22-Dec	NOV	4.96%	4.90%
Industrial Production (YoY)	23-Dec	NOV	14.39%	12.50%
Thailand	Date	Period	Prior	Cons.
Customs Exports (YoY)	20-Dec	NOV	15.70%	22.30%
Customs Imports (YoY)	20-Dec	NOV	13.50%	19.00%
Customs Trade Balance	20-Dec	NOV	\$2320M	\$1590M

Japan – BOJ Target Rate, December 21

We expect interest rates will be unchanged

Current	Expected
0.1	0.1

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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.	2893.7	1.9	-11.7	-9.0
	Hong Kong – Hang Seng	22714.9	-1.9	3.9	6.4
	Taiwan – Weighted	8817.9	1.1	7.7	13.9
	Japan – Nikkei 225	10303.8	0.9	-2.3	1.4
	Korea – Kospi	2026.3	2.0	20.4	23.0
	India – Sensex 30	19864.9	1.8	13.7	17.6
	Australia – SPX/ASX 200	4763.1	0.4	-2.2	2.0
	Singapore – Strait Times	3153.0	-1.0	8.8	12.1
	Indonesia – Jakarta Comp	3581.6	-4.4	41.3	42.7
	Thailand – SET	1022.5	-1.3	39.2	42.8
	Malaysia – KLCI	1499.9	-0.5	17.8	18.4
	Philippines – Manila Comp.	4057.3	-1.9	32.9	33.1

Last update: Friday, 18.30 Hong Kong time.

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.66	-0.13	6.63	6.51
	Hong Kong (HKD/USD)	7.78	-0.04	7.8	8
	Taiwan (TWD/USD)	29.9	0.90	29.62	29.13
	Japan (JPY/USD)	83.7	0.27	83.6	83.1
	Korea (KRW/USD)	1153	-0.78	1159.61	1165.88
	India (INR/USD)	45.4	-0.29	46.2	48
	Australia (USD/AUD)	0.99	0.52	1	n.a.
	Singapore (SGD/USD)	1.31	-0.24	1.31	1.3
	Indonesia (IDR/USD)	9035	-0.19	9110	9446
	Thailand (THB/USD)	30.1	-0.50	30.17	30.3
	Malaysia (MYR/USD)	3.14	-0.06	3.1	3
	Philippines (PHP/USD)	44.2	-1.28	44.12	44.10

Last update: Friday, 18.30 Hong Kong time.

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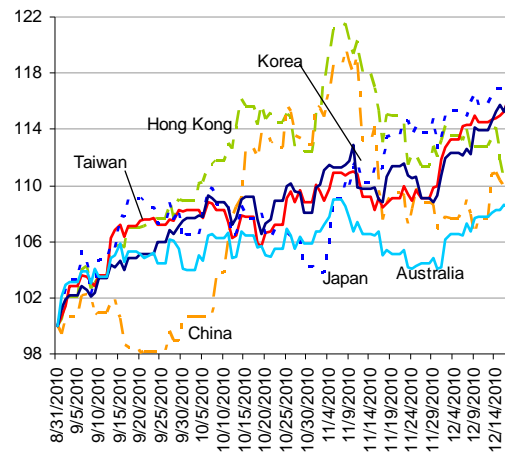
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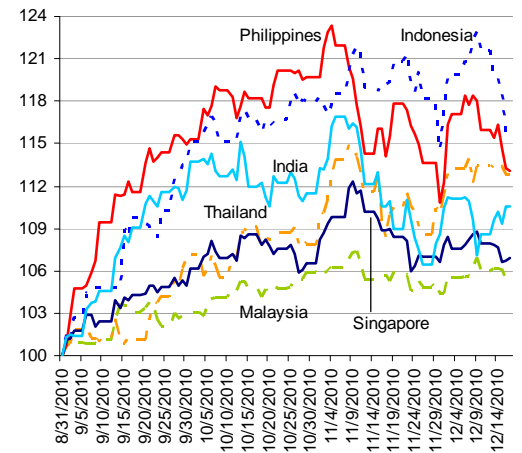
STOCK MARKETS



Source: BBVA Research and Bloomberg

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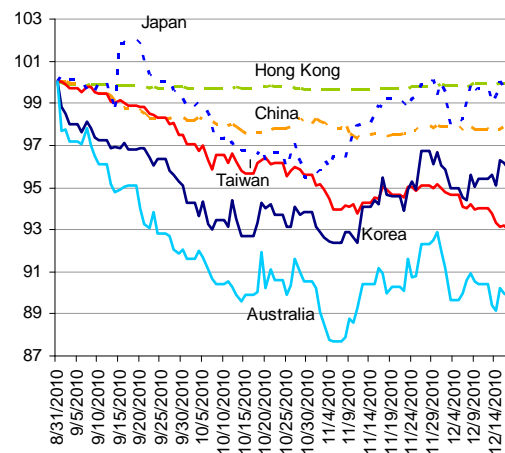
STOCK MARKETS



Source: BBVA Research and Bloomberg

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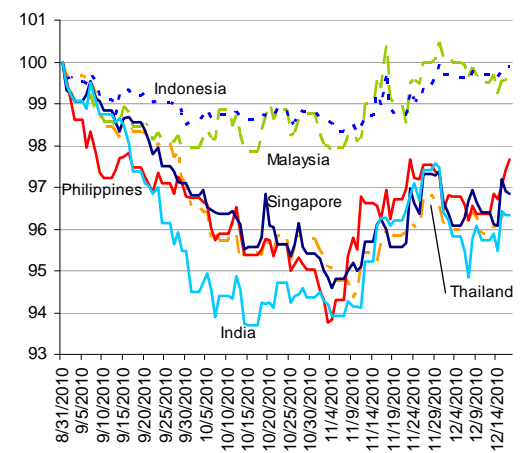
FOREIGN EXCHANGE MARKETS



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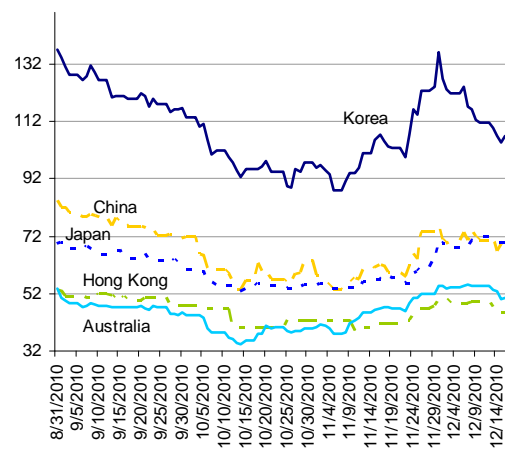
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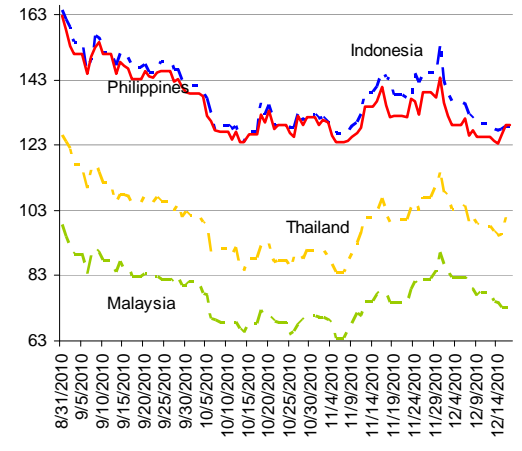
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CREDIT DEFAULT SWAPS



Source: BBVA Research and Bloomberg

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