

Asia

Weekly Watch

Hong Kong, December 24, 2010

Economic Analysis

Asia

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Regional prospects remain strong

Markets in the region are continuing to shrug off worries of Europe's deepening debt problems. Indicators continue to show strong growth momentum into the fourth quarter, fed by strong demand in China and India, with growing optimism of improved prospects for external demand from the US. However, inflationary pressures are increasing which, together with prospects of renewed capital inflows, are likely to dominate policy settings into the New Year.

Inflation picks up and external demand remains robust

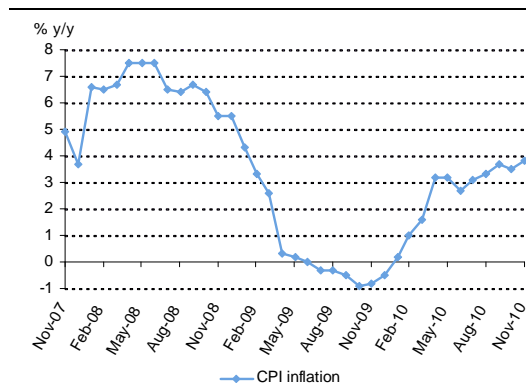
As part of its efforts to reduce external vulnerability and to limit capital inflows, Korea announced plans to impose a levy on banks' foreign currency debt (see Highlights). And in the latest signs of rising inflation around the region, Singapore posted a 22-month high for CPI inflation of 3.8% y/y in November (Chart 1), while Hong Kong's inflation inched up to 2.9%, both in line with expectations; Vietnam's December inflation rate surged to 11.8% y/y. Growth momentum remains strong, with exports continuing to surprise to the upside, as November exports orders in Taiwan exceeded expectations (14.3% y/y vs. BBVA: 13.8%), and exports from Thailand and Japan (Chart 2) for November were also robust. Clouding the outlook were further ratings downgrades for Vietnam, on worries about near-term macro stability (see Highlights).

In the coming week...

A raft of data from Korea, including CPI inflation for December and November industrial production. Markets will also watch for Vietnam's 4Q GDP and industrial production in Japan. The Philippines and Taiwan will hold scheduled monetary policy meetings, and we expect the former to leave rates unchanged, and the latter to hike rates by 12.5bps, for a second time this year.

Chart1

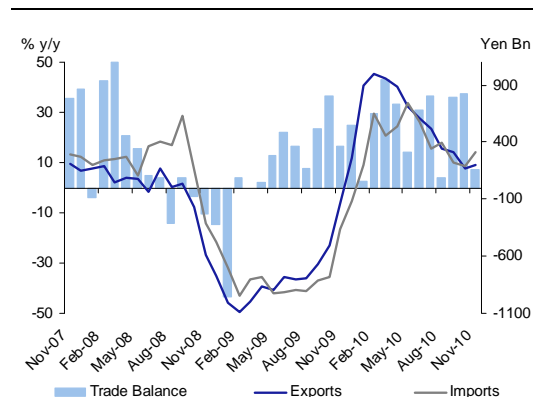
Singapore's inflation inches up in line with expectations



Source: BBVA Research and Bloomberg

Chart2

Japan's exports revive on strong demand from China



Source: BBVA Research and Bloomberg

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Highlights



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Highlights

Korea announces bank levy on foreign borrowing

The move is mainly aimed at reducing external vulnerability

China and India seek to strengthen economic ties

A visit by China's Prime Minister results in promises to boost trade

Vietnam's strong medium-term outlook marred by near-term jitters

Ratings downgrades underscore possibility of near-term macro instability

Markets Analysis

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Markets

Holiday trading doldrums

Predictably, trading volumes fell in the run up to Christmas, with few major data releases this week. Financial markets stayed within tight ranges. The market is still worried about spillovers from Europe, especially after Moody's and Fitch warnings of possible downgrades. But the concerns have been mitigated by China's vow to support Europe to stem the debt crisis. Contagion to Asia has been limited given the region's strong fundamentals, including sound public finance, solid banking systems and high potential growth. With rising inflation, Asian central banks will still maintain a tightening bias stance.

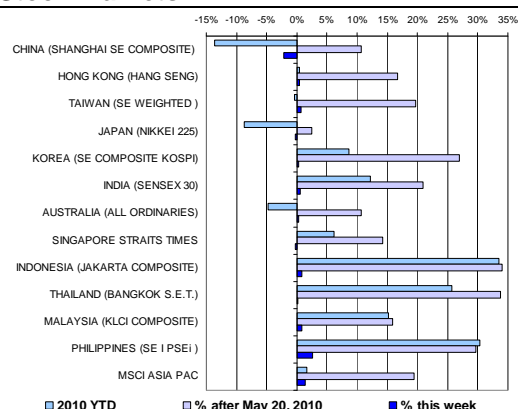
The KRW traded between 1149 and 1156 during the past week. North Korea's agreement to allow UN inspectors to visit its uranium enrichment facilities has paved the way for dialogue with the international community. But the absence of a concrete six-nation meeting date and South Korea's insistence to continue military drills kept tensions high. Datawise, South Korea's unemployment rate dropped unexpectedly to 3.2% in November, with consumer confidence holding up steadily. The data shows that the labor market remains tight, which should prompt the BOK to continue normalizing rates in the next quarter.

The AUD climbed above parity against the USD on the back of higher commodity prices and thin trading. RBA's minutes said that the economic outlook of the economy had been "little changed from that at earlier meeting." Monetary policy conditions were judged by the board to be "mildly restrictive" and "appropriate", especially taking into account of the strong exchange rate and the outsized bank lending rate rises that followed the RBA's policy rate rise in November. Along with financial instability in Europe, RBA will likely to leave rates on hold at least through 1Q2011.

USDCNY continued to track the direction of the US dollar index. It appreciated by 0.29% this week (cumulatively by 2.9% since June 2010) amidst modest dollar depreciation this week. The CNY also moved slightly stronger in the NDF market, with 12 month NDF trading at 6.49 against the USD, slightly stronger than 6.54 last week.

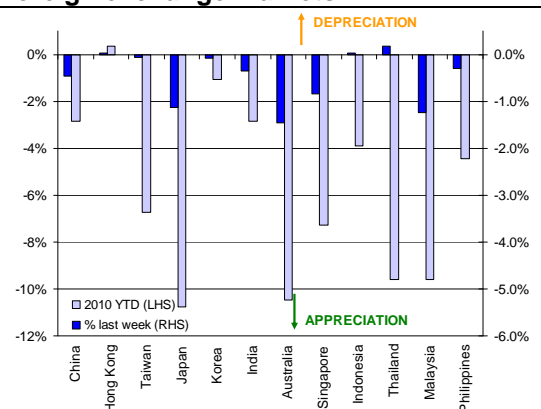
Stock markets mostly closed in positive territory this past week. Early week concerns about tensions in Korea and spillovers from Europe eased. Moreover, positive indicators also helped to boost confidence. On the other hand, China was the worst performer, on rising concerns about new tightening measures to contain credit growth and reduce inflation.

Chart 3
Stock markets



Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets



Source: BBVA Research and Bloomberg

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Highlights

Korea announces bank levy on foreign borrowing

Korea announced this past week plans to impose a levy on banks' non-deposit foreign-currency liabilities. According to the authorities, the measure is part of their longer term plans to reduce external vulnerability by encouraging banks to lower their overseas borrowing – such vulnerabilities were revealed during the 2008-09 global economic crises, when Korean banks had difficulties in rolling over their foreign loans, requiring the government and Bank of Korea to step in to supply dollar liquidity. That said, the measure has also been widely interpreted as part of a broader trend across the region to stem capital inflows, especially as it comes on the heels of Korea's introduction of a withholding tax on foreigners' stock and bond dividends last month, following various steps by Thailand, Indonesia, and Taiwan in recent months to stem inflows. The measure still needs to be submitted to Parliament, expected in February, for implementation in the second half of the year. The rate levy has yet to be decided, but markets are considering a three stages levy with 20bps on short-term debt, 10bps on midterm debt, and 5bps on long-term debt.

China and India seek to strengthen economic ties

Leaders of the region's two economic giants, China and India, met in New Delhi on December 16. The meeting was significant, as it represented the first visit of a Chinese Prime Minister to India in 5 years. China and India have had a tense relationship for decades over territorial disputes that culminated in a war in 1962. Today, China is India's largest trading partner (accounting for about 9% of India's total trade), with the value between the two expected to reach USD 60 billion in 2010. China currently runs a sizeable surplus with India (Chart 5), of around USD16 billion in 2009, and in 2010 China's cumulative trade surplus with India through November has already exceeded USD18.5 billion. India's exports to China tend to be raw materials, while China exports higher value added machinery and equipment. Agreement was reached to promote Indian exports to China, and the Chinese side announced USD16 billion in new deals between Chinese and Indian companies—exceeding the USD10 billion announced by the US during President Obama's visit in November—mainly in power, commodities and telecoms, with Chinese banks to provide financing to Indian firms. Moreover, the two sides set a goal of reaching bilateral trade of USD100 billion by 2015.

Vietnam's strong medium-term outlook marred by near-term jitters

As noted in the past, we view Vietnam's medium- and long-term prospects as excellent (see [Vietnam Economic Watch](#)), with GDP growth expected to average at least 7% per year, approaching the stellar growth of China and India. In the near term, however, maintaining macroeconomic stability remains a challenge. Economic institutions and policy making capacity have lagged the progress in opening the economy, leaving the country vulnerable to episodes of overheating and macroeconomic instability. Indeed, macro instability has been the focus of investor concern of late, with all major rating agencies recently downgrading Vietnam (in contrast to upgrades for much of the rest of the region)—by Fitch last July and, more recently, by Moody's on December 15 and S&P on December 23. Moody's cited concerns about rising inflation—now up to 11.8% y/y as of December (Chart 6) due to rising food and housing costs, well ahead of the government's previous target of 6.5% by end-year—that is putting downward pressure on the currency (devalued 3 times over the past year), and a widening trade deficit that, together with low foreign exchange reserves, it views as increasing risks of a balance crisis. The coming week will feature an additional batch of important indicators, including trade data for December and Q4 GDP growth.

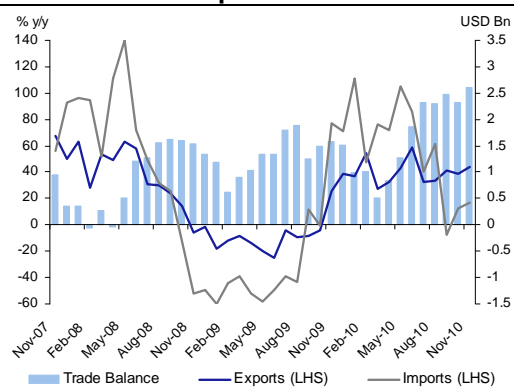
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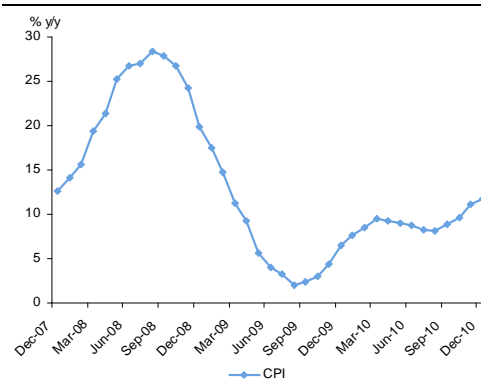
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Chart 5
China's trade surplus with India



Source: BBVA Research and Bloomberg

Chart 6
Vietnam inflation accelerates



Source: BBVA Research and Bloomberg

What to watch

Economics Analysis

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Korea: CPI Inflation for December (December 31)

Forecast: 3.3% y/y

Consensus: 3.2%

Previous: 3.3%

Korea's inflation has recently moderated, back to within the Bank of Korea's (BoK) inflation target range of 2-4% following a spike to 4.1% y/y in October on rising food prices. Nevertheless, upward pressures are expected to remain into 2011 from rising commodity prices and strong domestic demand, and consequently the BoK has signaled further rate hikes. A higher-than-expected outturn would intensify expectations of further rate hikes in the coming months.

Calendar

Hong Kong	Date	Period	Prior	Cons.
Exports YoY%	28-Dec	NOV	13.90%	12.00%
Imports YoY%	28-Dec	NOV	14.00%	13.50%
Trade Balance	28-Dec	NOV	-22.3B	-19.7B
Retail Sales - Value (YoY)	30-Dec	NOV	21.60%	18.00%
India	Date	Period	Prior	Cons.
Current Account Balance	31-Dec	3Q	-\$13.70B	--
Japan	Date	Period	Prior	Cons.
Unemployment rate	28-Dec	NOV	5.10%	5.10%
CPI YoY	28-Dec	NOV	0.20%	0.10%
Industrial Production (MoM)	28-Dec	NOV P	-2.00%	1.00%
Industrial Production YOY%	28-Dec	NOV P	4.30%	5.70%
Retail Trade MoM SA	28-Dec	NOV	-1.90%	1.50%
Retail Trade YoY	28-Dec	NOV	-0.20%	0.90%
Korea	Date	Period	Prior	Cons.
Current Account in US\$ Million	30-Dec	NOV	\$5372.7M	--
Goods Balance in US\$ Million	30-Dec	NOV	\$6543M	--
Service Industry Output YoY	30-Dec	NOV	3.00%	--
Industrial Production Mfg(YoY)	30-Dec	NOV	13.60%	--
Industrial Production (MoM)	30-Dec	NOV	-4.20%	1.50%
Industrial Production (YoY)	30-Dec	NOV	13.50%	10.00%
Consumer Price Index (MoM)	31-Dec	DEC	-0.60%	0.30%
Consumer Price Index (YoY)	31-Dec	DEC	3.30%	3.20%
Thailand	Date	Period	Prior	Cons.
Mfg. Production Index ISIC (YoY)	28-Dec	NOV	6.2	6.3
Total Exports YOY%	30-Dec	NOV	16.60%	--
Overall Balance in US\$ Million	30-Dec	NOV	\$5822M	--
Total Imports YOY%	30-Dec	NOV	13.00%	--
Total Trade Balance	30-Dec	NOV	\$2442M	--
Current Account Balance (USD)	30-Dec	NOV	\$2910M	--
Vietnam	Date	Period	Prior	Cons.
Exports YTD (YoY)	26-30 Dec	DEC	24.50%	--
GDP Constant Prices YTD (YoY)	28-30 Dec	4Q	6.50%	--
Imports YTD (YoY)	26-30 Dec	DEC	19.80%	--
Industrial Output YTD (YoY)	28-30 Dec	DEC	13.80%	--
Retail Sales YTD (YoY)	28-30 Dec	DEC	25.00%	--

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Philippines – Overnight Borrowing Rate, December 29

We expect interest rates will be unchanged

Current	Expected
4.0	4.0

Taiwan – Benchmark Interest Rate, December 30

We expect interest rates will be unchanged

Current	Expected
1.5	1.625

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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.	2830.2	-2.2	-13.6	-10.2
	Hong Kong – Hang Seng	22821.7	0.5	4.3	6.1
	Taiwan – Weighted	8886.5	0.8	8.5	11.6
	Japan – Nikkei 225	10275.2	-0.3	-2.6	-1.0
	Korea – Kospi	2031.8	0.3	20.7	20.8
	India – Sensex 30	19982.9	0.6	14.4	15.1
	Australia – SPX/ASX 200	4777.3	0.3	-1.9	-0.3
	Singapore – Strait Times	3145.1	-0.3	8.5	10.8
	Indonesia – Jakarta Comp	3611.5	0.8	42.5	45.9
	Thailand – SET	1023.6	0.1	39.4	40.8
	Malaysia – KLCI	1511.7	0.8	18.8	19.6
	Philippines – Manila Comp.	4166.0	2.7	36.5	37.8

Last update: Friday, 11.35 Hong Kong time.

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.63	0.46	6.61	6.49
	Hong Kong (HKD/USD)	7.78	-0.03	7.8	8
	Taiwan (TWD/USD)	29.8	0.07	29.53	29.00
	Japan (JPY/USD)	83.0	1.16	82.9	82.5
	Korea (KRW/USD)	1152	0.09	1156.28	1160.35
	India (INR/USD)	45.2	0.35	45.8	48
	Australia (USD/AUD)	1.00	1.49	1	n.a.
	Singapore (SGD/USD)	1.30	0.86	1.30	1.3
	Indonesia (IDR/USD)	9038	-0.03	9111	9431
	Thailand (THB/USD)	30.2	-0.17	30.20	30.3
	Malaysia (MYR/USD)	3.10	1.26	3.1	3
	Philippines (PHP/USD)	44.1	0.09	44.02	44.03

Last update: Friday, 11.35 Hong Kong time.

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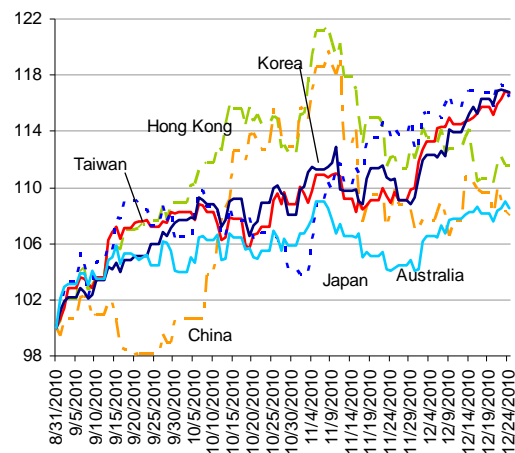
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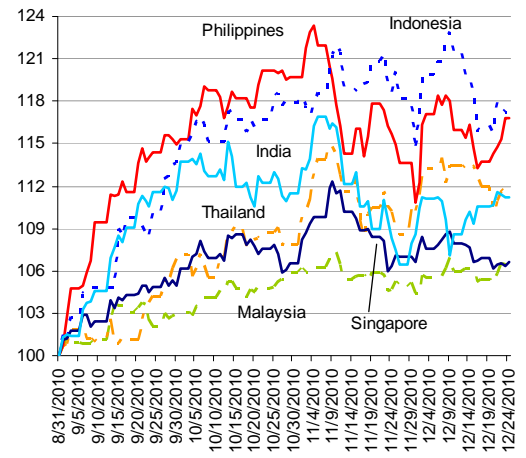
STOCK MARKETS



Source: BBVA Research and Bloomberg

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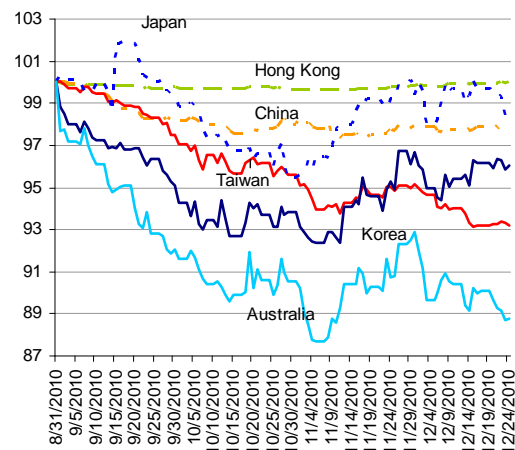
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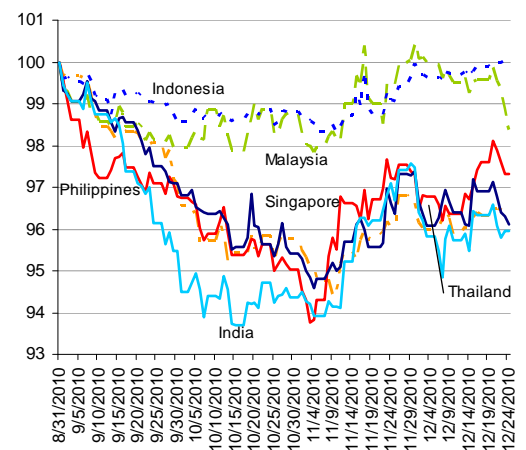
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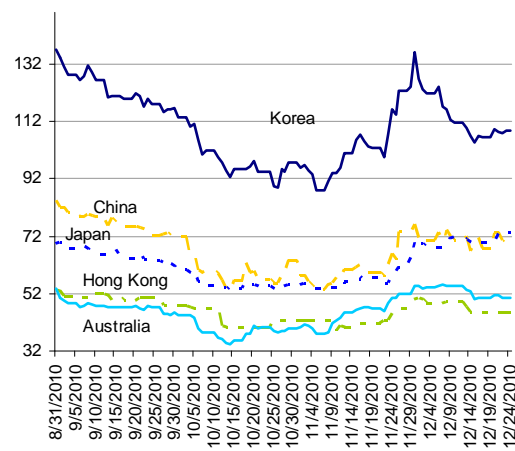
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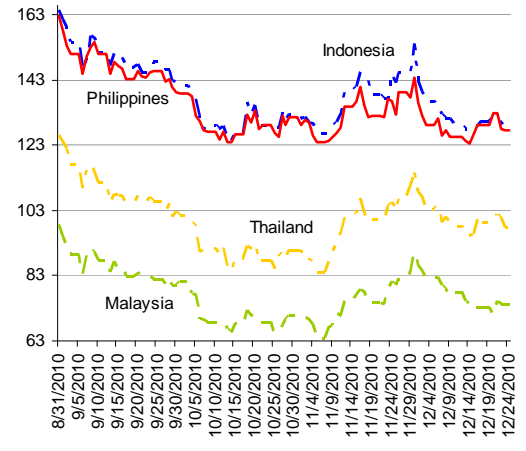
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CREDIT DEFAULT SWAPS



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