

Asia

Weekly Watch

Hong Kong, January 21, 2011

Economic Analysis

Asia

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China's growth momentum accelerates

According to newly released data, China's GDP growth accelerated to a faster-than-expected pace of 9.8% in the fourth quarter of 2010, defying a series of policy tightening steps (see Highlights). While inflation moderated in December, underlying pressures still appear to be building, with prospects of a further rise in inflation in the coming months. This has raised expectations of further monetary tightening measures in the pipeline, setting the tone for more interest rate hikes across the region.

Strong data releases set the stage for more monetary tightening

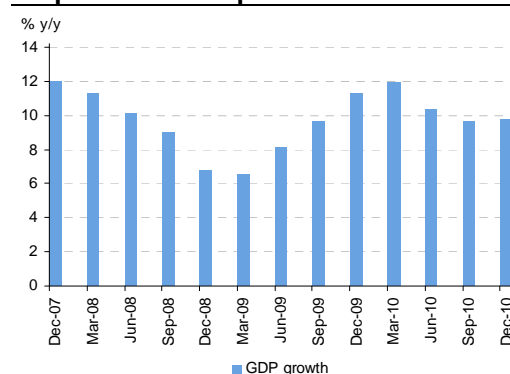
Export orders in Taiwan for December (a 3-month leading indicator) climbed by 15.3% y/y, above expectations (12.3%), and Thailand's trade figures for December also came out to the upside (exports: 18.8% y/y), although Singapore's non-oil domestic exports disappointed slightly (9.4% y/y in December). On the inflationary front, Hong Kong's CPI rose by 3.1%, a little more than expected (consensus: 3.0%), and Malaysia's inflation continued to rise, to 2.2%, in line with expectations (consensus: 2.2%); key factors were rising food prices, along with housing costs in Hong Kong, and fuel prices in Malaysia. A ratings upgrade by Moody's for Indonesia failed to lift markets in Jakarta, which have been down so far this year on rising inflation concerns (see Highlights).

In the coming week...

Korea will release fourth quarter GDP, while markets will be also watching inflation for Australia, Japan, and Singapore (see What to Watch), along with trade data in Hong Kong, Japan, Philippines, and Vietnam. Monetary policy meetings will take place in Malaysia, India and Japan. We expect a rate hike in India (25bp), with the others expected to stay on hold (see Highlights).

Chart1

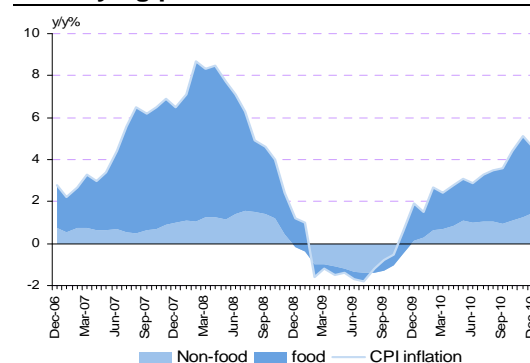
China's fourth quarter GDP growth surprises to the upside...



Source: BBVA Research and Bloomberg

Chart2

...while CPI inflation eases, although underlying pressures remain



Source: BBVA Research and Bloomberg

Markets



Highlights



Calendar



Markets Data



Highlights

China's growth momentum accelerates

Faster-than-expected Q4 GDP growth is likely to bring more policy tightening

Rising inflation may spur more policy tightening in Asia

Central banks are raising rates to stem inflation

Indonesia receives another ratings upgrade

The latest upgrade, by Moody's, brings the rating to just one notch below investment grade

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Markets

Markets focus on rising inflation

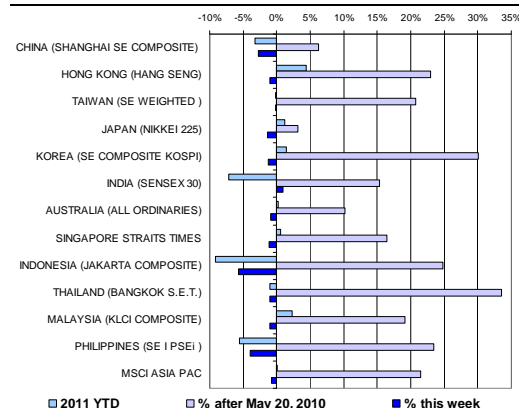
Successful Portuguese and Spanish debt auctions, coupled with stronger economic data from Germany have allayed fears about European debt problems. That said, the European ministerial meetings this week have not yet reached concrete agreements on enhancements to bail-out mechanisms, and Portugal's outlook is still hanging in the balance. Risks remain of renewed financial tensions in the first quarter.

Meanwhile, Asian market sentiment has clearly shifted to inflation, with growing worries that some monetary authorities may be behind the curve. Korea, which declared "war against inflation", and Indonesia, which refrained from hiking rates last year (see Highlight), were the key worries. Interestingly, China's inflation eased in December and bucked the regional trend, but stronger-than-expected GDP growth in 4Q and the reportedly large new loan approvals in January highlight the likelihood that inflation has not yet peaked (see Highlights). We think more tightening measures are likely, particularly through strict loan quotas, interest rate hikes and higher RRR. The measures will mostly be front-loaded. In other Asian countries, especially in Korea, Indonesia, Taiwan and Thailand, central banks will likely hike rates further in the first half of the year, but the pace will likely be modest in light of worries about attracting capital inflows, and also to avoid negative ramification on growth.

President's Hu's visit in the United States this week proved to be a catalyst for further appreciation of the CNY. Ahead of the visit, the CNY began to appreciate against the USD, cumulatively by 1.2% in the past 30 days to 6.5886. Directional moves of the CNY are still in line with the USD index. i.e., when the USD weakens, the CNY is allowed to rise, and vice versa. With the US visit coming to an end, the pace of near-term CNY appreciation may lose steam soon. The 12-month NDF has not been responsive to changes in the spot rates, indicate that markets still expect modest appreciation over the coming year (we expect appreciation of about 5% by end-2011).

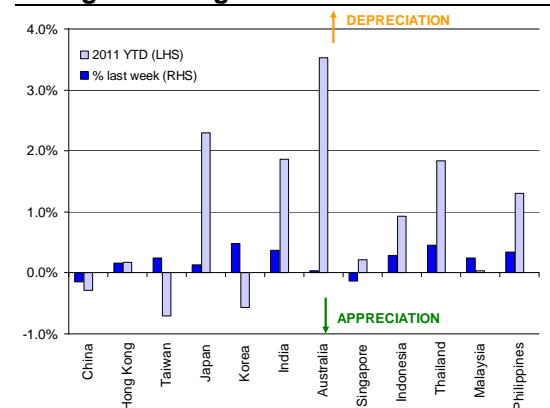
Asian markets drifted to the downside this past week. Concerns of further monetary tightening in China dragged down sentiment across the region. Regional stock markets have trended sharply lower so far this year after large gains in 2010. The corrections have been largest in Indonesia (-9.6%), India (-7.2%), and the Philippines (-6.0%) on signs that foreign investors are exiting to take profit.

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 accelerates

Much anticipated quarterly and monthly indicators released this past week point to very strong growth momentum in the fourth quarter of 2010. Full-year GDP growth for 2010 came to 10.3% y/y, underpinned by Q4 growth of 9.8% y/y (BBVA: 9.1%). Headline CPI inflation for December moderated to 4.6% y/y (BBVA: 4.9%) from 5.1% in November due to base effects and a softening in food prices. Underlying inflationary pressures nevertheless remain high, and the December outturn was still well above the authorities' comfort range. Indeed, we believe that inflationary pressures remain high, with the non-food components continuing to show rising trends, especially for housing costs. Data on property prices (for the largest 70 cities) also show further strength in the sector, despite recent steps to cool the market. Given the strong growth momentum and underlying inflationary pressures, we anticipate more monetary tightening measures, including three interest rate hikes in 2011, and at least 100 bp additional increases in the required reserve ratio (RRR), on top of last week's 50bp RRR hike. Going forward, the PBoC has signaled it may implement differentiated and more aggressive RRR hikes to curb rapid lending by certain banks. Despite the more aggressive tightening measures, the growth outlook still looks strong, and we maintain our GDP growth outlook of 9.2% in 2011.

Rising inflation may spur more policy tightening in Asia

The coming week will feature monetary policy meetings in India (January 25), Malaysia (January 27), and Japan (January 25). Increasingly, the region's economies are feeling the effects of rising inflation, fueled in part by rising food and energy prices. Inflation has been especially persistent in India (8.4%y/y in December, down from double-digits earlier in the year), with concerns about the erosion of consumer purchasing power and impact on poverty. The Indian authorities have responded by tightening monetary policy through hikes in policy rates of 150-200 bps since March and the cash reserve ratio of 100 bps. We expect the RBI to hike rates again, by 25 bps at next week's meeting. Along with India, Malaysia was among the first countries to begin normalizing interest rates this past year, hiking rates three times in the first half of 2010 despite a comparatively low inflation rate (2.2%y/y in December). Given that Malaysia has gotten out ahead of the curve, we do not expect an interest rate hike in the coming monetary policy meeting. In the past few weeks alone, Korea (25bps), Taiwan (12.5bps) and Thailand (25bps) raised their policy rates in order to tame rising inflationary pressures; and as discussed above, China hiked reserve requirements last week. Indonesia, which along with the Philippines, has not yet hiked rates, is an outlier, and is beginning to feel market pressures on concerns that Bank Indonesia may be behind the curve in addressing inflation.

Indonesia receives another ratings upgrade

Moody's announced an upgrade this past Monday of Indonesia's foreign and local-currency bond ratings to Ba2, just one notch below investment grade (Ba1). This brings Moody's in line with Fitch, and one notch ahead of S&P (which maintains a positive outlook). Moody's cited Indonesia's economic resilience, improving public debt ratio (a relatively low 27%), rising foreign reserves (US\$96 billion) and strong FDI inflows (Chart 6). This strong performance has earned Indonesia a steady stream of ratings upgrades over the past few years, with many analysts expecting the country to achieve investment grade in the next year. Notwithstanding these achievements, Indonesia faces many challenges in order to bring its GDP growth in line with its potential of around 7%. Further improvements to the investment climate are still awaited, including a stronger judicial system, improvements to infrastructure, labor reforms, and improvements in tax administration and reduced corruption. In the near term, Indonesia faces the challenge of addressing rising inflation, which is becoming a concern to bond investors. Inflation concerns dominated sentiment this past week, with the upgrade failing to cheer markets.

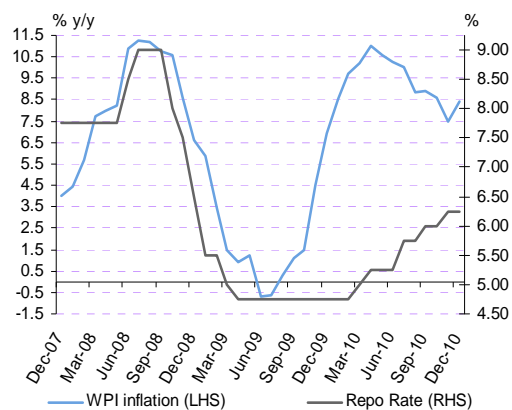
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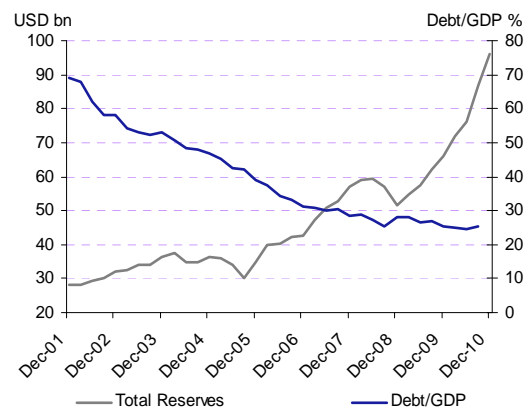
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Chart 5
India's inflation uptick in December again



Source: BBVA Research and Bloomberg

Chart 6
Indonesia's falling public debt and rising reserves help prompt a ratings upgrade



Source: BBVA Research and Bloomberg

What to watch

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Singapore: CPI inflation for December (January 24)

Forecast: 4.5% y/y

Consensus: 4.5%

Previous: 3.8%

Inflation is expected to end the year at a relatively high level of 4.5%/y/y, due to base effects and rising price food and housing costs. The government is aiming to contain inflation in 2011 to 2-3% by tightening monetary policy through faster currency appreciation. A higher-than-expected inflation reading would raise expectations of further currency appreciation.

Calendar

Australia	Date	Period	Prior	Cons.
Consumer Prices (QoQ)	25-Jan	4Q	0.70%	--
Consumer Prices (YoY)	25-Jan	4Q	2.80%	--
Hong Kong	Date	Period	Prior	Cons.
Trade Balance	25-Jan	DEC	-23.5B	--
Exports YoY%	25-Jan	DEC	16.60%	--
Imports YoY%	25-Jan	DEC	16.40%	--
Japan	Date	Period	Prior	Cons.
Merchnds Trade Balance Total	27-Jan	DEC	¥162.8B	--
Adjusted Merchnds Trade Bal.	27-Jan	DEC	¥425.7B	--
Merchnds Trade Exports YoY	27-Jan	DEC	9.1	--
Merchnds Trade Imports YoY	27-Jan	DEC	14.2	--
Unemployment Rate	28-Jan	DEC	5.10%	--
CPI YoY	28-Jan	DEC	0.10%	--
Retail Trade YoY	28-Jan	DEC	1.30%	--
Korea	Date	Period	Prior	Cons.
GDP at Constant Price (QoQ)	26-Jan	4Q P	0.70%	--
GDP at Constant Price (YoY)	26-Jan	4Q P	4.40%	--
Current Account in US\$ Million	27-Jan	DEC	\$1930.0M	--
Goods Balance in US\$ Million	27-Jan	DEC	\$3350M	--
Philippines	Date	Period	Prior	Cons.
Total Imports (YoY)	25-Jan	NOV	28.40%	--
Total Monthly Imports	25-Jan	NOV	\$4888.4M	--
Trade Balance	25-Jan	NOV	-\$112M	--
Singapore	Date	Period	Prior	Cons.
CPI (YoY)	24-Jan	DEC	3.80%	4.50%
Industrial Production YoY	26-Jan	DEC	39.80%	16.80%
Taiwan	Date	Period	Prior	Cons.
Industrial Production (YoY)	24-Jan	DEC	19.37%	13.20%
Unemployment Rate - sa	24-Jan	DEC	4.79%	4.68%
Vietnam	Date	Period	Prior	Cons.
Exports YTD (YoY)	24-26 JAN	JAN	25.50%	--
Imports YTD (YoY)	26-28 JAN	JAN	20.10%	--
Industrial Output YTD (YoY)	25-28 JAN	JAN	14.00%	--
Retail Sales YTD (YoY)	25-28 JAN	JAN	24.50%	--

Japan – Target Rate, January 25

We expect interest rates will be unchanged

Current	Expected
0.0-0.1	0.0-0.1

India – Monetary Policy Meeting, January 25

We expect Repo rate will rise by 25bps

We expect Reverse Repo rate will rise by 25bps

We expect Cash Reserve Ratio will be unchanged

Current	Expected
6.25	6.50
5.25	5.50
6.00	6.00

Malaysia – Overnight Rate, January 27

We expect interest rates will be unchanged

Current	Expected
2.75	2.75

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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.	2715.3	-2.7	-3.3	-14.0
	Hong Kong – Hang Seng	23859.4	-1.7	3.6	14.4
	Taiwan – Weighted	8954.4	-0.2	-0.2	10.2
	Japan – Nikkei 225	10274.5	-2.1	0.4	-5.5
	Korea – Kospi	2069.9	-1.8	0.9	20.2
	India – Sensex 30	19008.4	0.8	-7.3	11.5
	Australia – SPX/ASX 200	4755.7	-1.0	0.2	-1.5
	Singapore – Strait Times	3191.1	-1.7	0.0	11.9
	Indonesia – Jakarta Comp	3343.7	-6.3	-9.7	26.7
	Thailand – SET	1005.3	-2.6	-2.7	39.8
	Malaysia – KLCI	1548.1	-1.4	1.9	18.5
	Philippines – Manila Comp.	3951.0	-4.4	-6.0	28.0

Last update: Friday, 15.30 Hong Kong time.

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.58	0.21	6.57	6.46
	Hong Kong (HKD/USD)	7.79	-0.14	7.8	8
	Taiwan (TWD/USD)	29.1	-0.28	28.78	28.26
	Japan (JPY/USD)	82.8	0.11	82.7	82.3
	Korea (KRW/USD)	1124	-0.87	1127.60	1139.96
	India (INR/USD)	45.7	-0.64	46.5	48
	Australia (USD/AUD)	0.99	-0.12	1	n.a.
	Singapore (SGD/USD)	1.29	0.19	1.29	1.3
	Indonesia (IDR/USD)	9083	-0.32	9264	9712
	Thailand (THB/USD)	30.7	-0.59	30.72	30.9
	Malaysia (MYR/USD)	3.06	-0.18	3.1	3
	Philippines (PHP/USD)	44.5	-0.68	44.76	45.29

Last update: Friday, 15.30 Hong Kong time.

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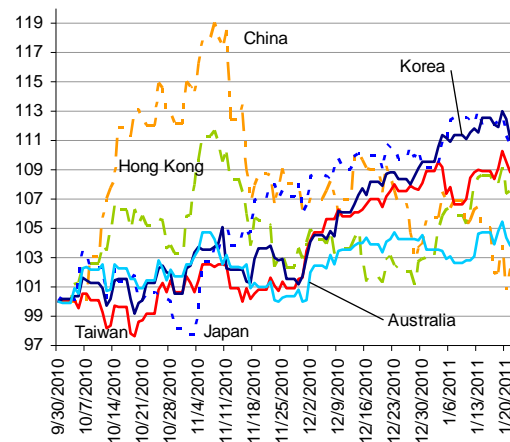
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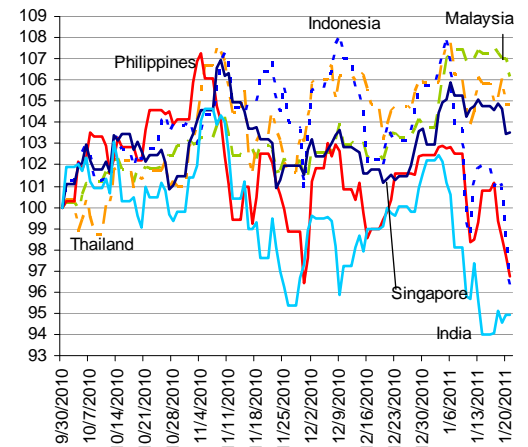
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Source: BBVA Research and Bloomberg

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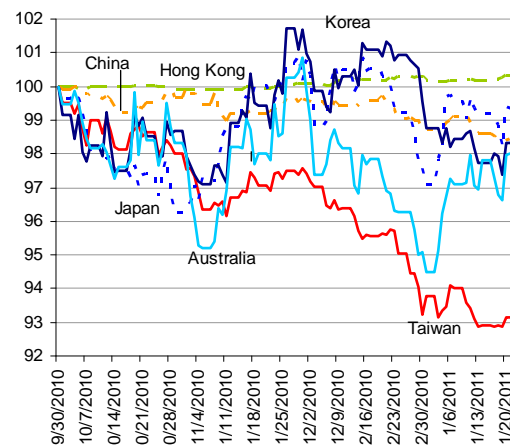
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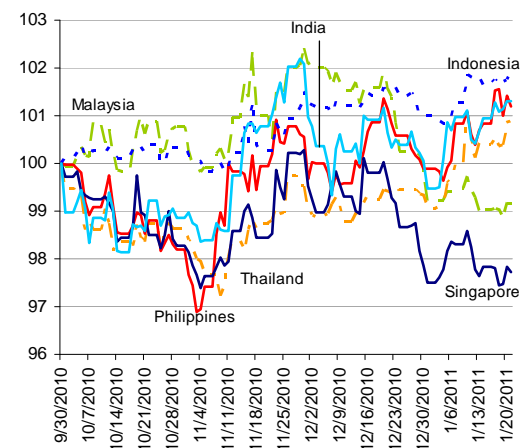
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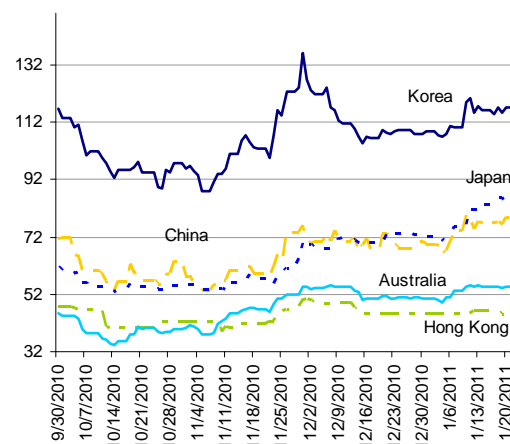
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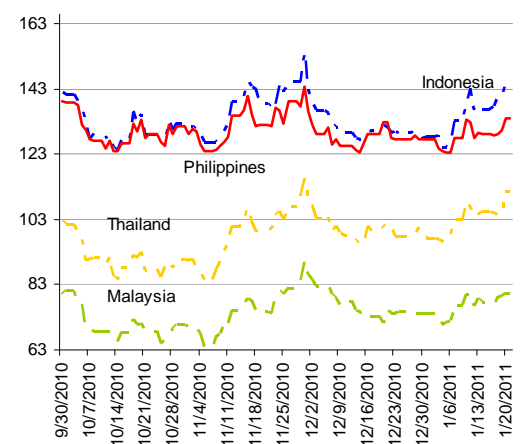
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CREDIT DEFAULT SWAPS



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