

Asia

Weekly Watch

Hong Kong, January 28, 2011

Economic Analysis

Asia

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China steps up measures on property

In its latest efforts to prevent overheating, China unveiled new measures this past week to curb property price increases. Among the most significant measure was an increase in down payment requirements for second home mortgages from 50% to 60%. Local governments were urged to set stricter property price targets, and restrictions were imposed on purchases in certain cities and municipalities. The measures are part of an ongoing series of steps taken over the past year to prevent price bubbles and maintain affordable housing costs. China's financial markets have been under downward pressure in recent months on expectations of further monetary tightening.

Japan's rating downgrade has limited market impact

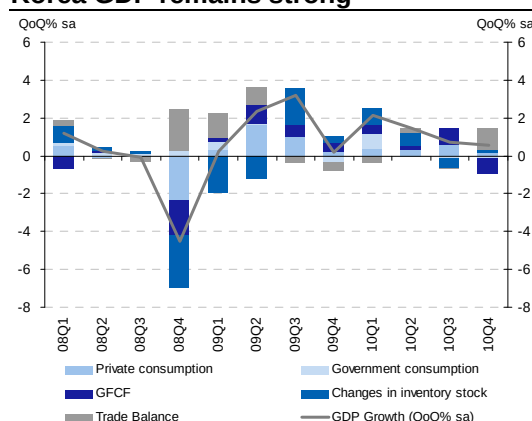
S&P downgraded Japan's sovereign credit rating to AA- from AA due to concerns about its high level of public debt. The surprise move, however, failed to unnerve markets (see Market Highlights). Data around the region this past week was largely positive, although concerns about inflation are rising (see Highlights). Fourth quarter GDP growth in Korea came in above expectations (see Chart 1 and Highlights), while inflation in Singapore (see Chart 2) and Vietnam increased. In contrast, inflation Australia eased in Q4 and in Japan for December (0.0% y/y, but with core inflation of -0.4% y/y still in deflation). On the monetary front the Reserve Bank of India hiked interest rates by 25bps, as expected, while Bank Negara Malaysia stayed on hold.

In the coming week...

The week will be filled with data releases, including January PMI for China (see What to Watch), GDP in the Philippines and Taiwan, and January's inflation figures for Korea, Indonesia, Thailand and Philippines. Australia and Indonesia will hold their respective monetary policy meetings. Although it's a close call, on balance we expect Indonesia to take its first rate hike in the current cycle, while the RBA is likely to stay on hold.

Chart1

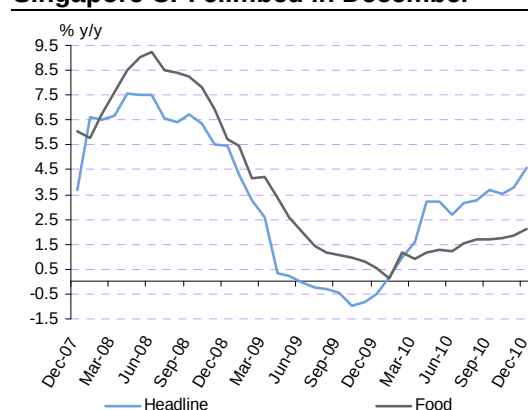
Korea GDP remains strong



Source: BBVA Research and Bloomberg

Chart2

Singapore CPI climbed in December



Source: BBVA Research and Bloomberg

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Highlights

Rising inflation in Asia brings more monetary tightening

Higher inflation in Singapore and Indonesia could prompt tightening

Korean GDP growth stays strong on robust exports

Fourth quarter GDP moderates in line with expectations, but lifts 2010 growth to 6.1%

India and Indonesia boost ties amidst rising regional economic integration

A visit to India by Indonesia's President strengthens economic ties

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Japan's rating downgrade has a small impact

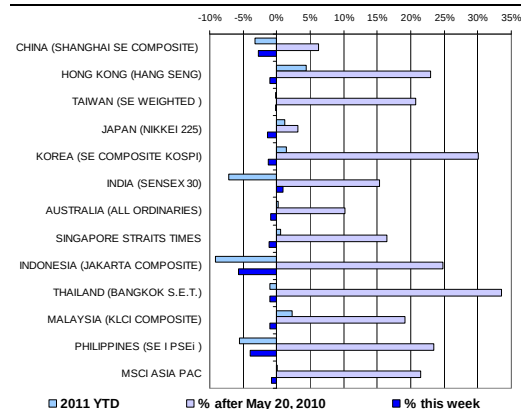
The USD weakened modestly this past week as the FOMC showed no signs of scaling back QE2. Asian currencies strengthened slightly. After President Hu's visit to the US, the CNY's appreciation pace lost some steam as anticipated. We see the chance of an interest rate hike by the PBoC around Chinese New Year as reasonably high. A more important determinant of the CNY's appreciation path is the strength of the USD, which may go up in the near term should the EUR consolidate its gains before 1.38.

S&P downgraded Japan's credit rating this past week from AA to AA- with a stable outlook. The adverse impacts on the JPY and the JGB are likely to be small because Japan's indebtedness is a long-term issue without any imminent financing problems. Although Japan's gross public debt has surpassed 200% of GDP, over 90% is held by domestic institutions. A high domestic savings rate and abundant liquidity in the banking system are helping to avert re-financing difficulties. Japan also constantly runs a current account surplus, implying little external financing needs. USDJPY fell back to 82-83 range on Friday after briefly touched 83-level on Thursday. The contagion to other G10 countries will likely be limited. Nevertheless, the S&P's move highlights the need for a credible medium-term consolidation plan to avoid further downgrade in future.

Meanwhile, the AUD was weighed down by the proposal for a temporary flood levy (A\$1.8 bn or 0.15% of GDP). The government estimates that the flood could lower 2010-11 GDP by around 0.5 percentage point, while the RBA has already signaled a pause in interest rate hikes in the near term. If handled properly, we believe the adverse impacts should be one-off and should be limited to 1Q GDP. Part of the output losses could be recuperated by re-construction expenses (est. A\$5.6 bn or 0.5% of GDP) in the second half of the year. But the flood levy on the table along with signals for further austerity to fund reconstruction implies new fiscal tightening. If passed, the measures could slow the pace of the recovery and reduce the chance of rate hikes we envisage in 2H 2011. The flood levy is still subjected to parliamentary approval.

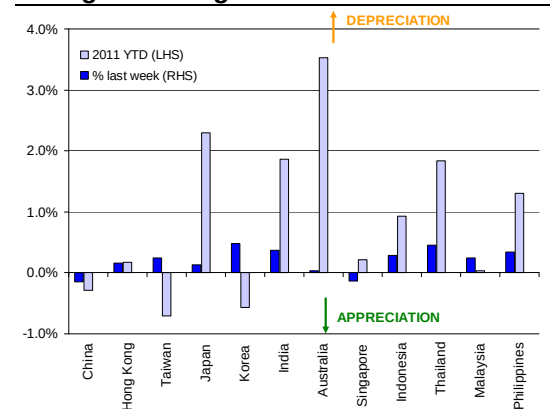
Asian markets were most positive this past week, as global outlook seems that is improving. The US points to a more sustainable recovery, Europe's debt crisis is losing steam, and corporates are recording solid earnings worldwide. On the downside, markets are still worried on further tightening measures in China (which made fall regional stocks on Friday, together with Japan's downgrade), and high inflation in some countries. Korea was the best performer as forth quarter GDP came very robust, and Indonesian markets moved up after being following since beginning 2011. Meanwhile, Indian stocks continue falling as the new interest rates hike pushed borrowing costs up, and stocks in Bangkok were dragged down by new protests.

Chart 3
Stock markets



Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets



Source: BBVA Research and Bloomberg

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Highlights

Rising inflation in Asia brings more monetary tightening

As reported in previous weeks, rising food prices and demand pressures are spurring inflation across the region, raising the likelihood of further monetary tightening. In the past week Singapore released December inflation of 4.6% y/y (consensus: 4.5%), the highest inflation figure in more than two years, driven by rising transport, housing and food prices. Together with strong GDP growth (6.9% q/q saar in Q4), the inflation outturn makes it more likely that the Monetary Authority of Singapore may act to accelerate currency appreciation at its next monetary policy meeting in April (Singapore uses the exchange rate as its monetary policy instrument). Meanwhile, in Vietnam, where macro stability has been under threat for some time due to overheating, inflation accelerated further in January to 12.2% y/y (see Chart 5), compared with 11.8% in December. Bucking the trend of rising inflation is Australia, where CPI inflation actually slowed in the fourth quarter (0.4% q/q, consensus: 0.7%) following seven rate hike since October 2009, and under the influence of a strong AUD. Nevertheless, inflation may rise in the current quarter due to the impact of the massive floods. On the monetary front, India raised interest rates at its monthly meeting this week, as expected, to stem inflationary expectations. In the coming week we look to Indonesia for the next possible regional move on interest rates. Bank Indonesia is one of the few central banks in the region not yet to have raised rates in the current cycle (along with the Philippines). With inflation touching 7% y/y in December, markets in Indonesia have been shaken by fears that the Bank Indonesia has gotten behind the curve.

Korean GDP growth stays strong on robust exports

In the latest sign of strong regional growth momentum, Korea's 2010 fourth quarter GDP grew by 4.8% y/y, broadly in line with expectations (consensus: 4.6%y/y; BBVA: 4.9%y/y). The outturn brings full-year growth to 6.1% (BBVA: 6.1%). On a quarterly, seasonally adjusted basis (non-annualized) growth moderated to 0.5% from 0.7% in the previous quarter, as the manufacturing and construction sectors slowed. The moderating trend was expected, following the very strong rebound in 2010H1. On the demand side, facilities investment fell by 1.6%q/q because of a decline in machinery investment and construction investment. In addition, the withdrawal of fiscal stimulus resulted in a reduction in government spending. Exports increased 2.4% q/q and private consumption gained 0.3% q/q, after an increase for the latter of 1.3% q/q in Q3. For the whole year, domestic demand sharply recovered and contributed 7% to annual GDP growth, a turnaround from a 3.8% contraction in 2009. We expect GDP growth of around 4.5% in 2011, underpinned by strong domestic demand. With inflationary pressures on the increase (3.5%y/y, nearing the upper end of the Bank of Korea's 2-4% inflation target), the BOK hiked interest rates earlier this month, and we expect three more hikes during the remainder of the year.

India and Indonesia boost ties amidst rising regional economic integration

Economic integration in Asia has been increasing in the past several years, not only on the trade front, but also due to a closer financial and investment ties. Indeed, rising intraregional trade is one of the reasons we are so optimistic about the region's growth prospects even in the face of sluggish growth in the industrialized world. Following a high-profile visit of China's leadership to India last December, Indonesia's President has become the latest Asian leader to make a visit to India. This past Tuesday President Susilo Bambang Yudhoyono signed 17 investment pacts with Indian firms totalling USD15 billion, and the two sides vowed to double their annual bilateral trade to USD25 billion by 2015 (see Chart 6). The approach is part of Indonesia's strategy to attract USD150 billion in infrastructure investment. Much of the agreements aim to boost commodities-related infrastructure, with India relying on Indonesia as a source of commodity imports to fuel its economic growth. More generally, many developed countries in the region such as Japan and South Korea, along with China and India, are seeking to ensure reliable supplies of coal, oil and gas in exchange for trade and investment deals with commodity-producing economies such as Indonesia.

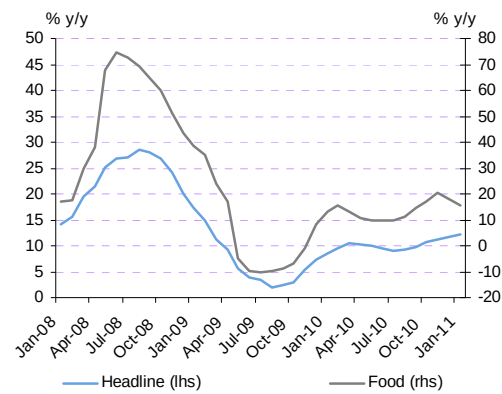
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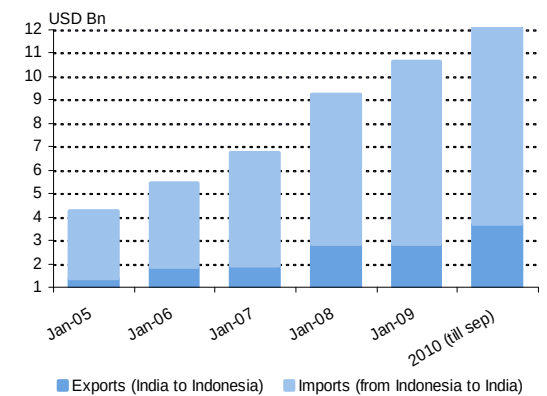
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Chart 5

Vietnam inflation accelerates in January


Source: BBVA Research and Bloomberg

Chart 6

India and Indonesia aim to boost ties


Source: BBVA Research and Bloomberg

What to watch

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China: PMI for January (February 1)

Forecast: 54.0

Consensus: 53.5

Previous: 53.9

Recent indicators point to stronger-than-expected growth momentum, underscored by rapid GDP growth in Q4 and new loans continuing to increase beyond the authorities' target range. By all accounts, manufacturing activity is set to expand at a robust pace in January. Given concerns about overheating, a stronger than expected outturn might raise expectations of front-loaded tightening measures, and could increase the likelihood of another imminent interest rate hike by the PBoC, which could further undermine financial market sentiment.

Calendar

Australia	Date	Period	Prior	Cons.
Trade Balance	3-Feb	DEC	1925M	- -
China	Date	Period	Prior	Cons.
PMI Manufacturing	1-Feb	JAN	53.9	53.5
Hong Kong	Date	Period	Prior	Cons.
Retail Sales - Value (YoY)	1-Feb	DEC	17.90%	15.30%
India	Date	Period	Prior	Cons.
Exports YoY%	1-Feb	DEC	26.50%	- -
Imports YoY%	1-Feb	DEC	11.20%	- -
Indonesia	Date	Period	Prior	Cons.
Total Trade Balance	1-Feb	DEC	\$2267M	\$2098M
Inflation (YoY)	1-Feb	JAN	6.96%	6.88%
Exports (YoY)	1-Feb	DEC	42.30%	16.40%
Core Inflation (YoY)	1-Feb	JAN	4.28%	4.35%
Total Imports (YoY)	1-Feb	DEC	- -	23.80%
Japan	Date	Period	Prior	Cons.
Industrial Production YOY%	31-Jan	DEC P	5.80%	4.20%
Korea	Date	Period	Prior	Cons.
Industrial Production (YoY)	31-Jan	DEC	10.40%	9.90%
Consumer Price Index (YoY)	1-Feb	JAN	3.50%	3.80%
Core Consumer Price Index(YoY)	1-Feb	JAN	2.00%	- -
Ext Trade - Export (YoY)	01-03 Feb	JAN	23.10%	38.30%
Ext Trade - Imports (YoY)	01-03 Feb	JAN	23.30%	26.30%
Ext Trade - Balance in US\$ Mln	01-03 Feb	JAN	3743	2540
Malaysia	Date	Period	Prior	Cons.
Exports YoY%	2-Feb	DEC	5.30%	-1.20%
Imports YoY%	2-Feb	DEC	6.10%	5.00%
Philippines	Date	Period	Prior	Cons.
GDP (YoY)	31-Jan	4Q	6.50%	6.00%
Annual GDP (YoY)	31-Jan	31-Dec	0.90%	7.00%
Consumer Price Index (YoY)	4-Feb	JAN	3.00%	3.30%
Singapore	Date	Period	Prior	Cons.
Unemployment Rate (sa)	31-Jan	4Q	- -	- -
Taiwan	Date	Period	Prior	Cons.
GDP - Constant Prices (YoY)	31-Jan	4Q P	9.80%	6.00%
Thailand	Date	Period	Prior	Cons.
Total Exports YOY%	31-Jan	DEC	28.70%	- -
Total Imports YOY%	31-Jan	DEC	35.00%	- -
Current Account Balance (USD)	31-Jan	DEC	\$1019M	\$2075M
Consumer Price Index (YoY)	1-Feb	JAN	3.00%	3.10%
Core CPI (YoY)	1-Feb	JAN	1.40%	1.50%

Australia – Cash Target, February 1

We expect interest rates will be unchanged

Current	Expected
4.75	4.75

Indonesia – Reference Rate, February 4

We expect interest rates will hike rates by 25bps

Current	Expected
6.50	6.75

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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.	2752.8	1.4	-2.0	-8.1
	Hong Kong – Hang Seng	23589.7	-1.2	2.4	15.9
	Taiwan – Weighted	9145.4	2.1	1.9	18.9
	Japan – Nikkei 225	10360.3	0.8	1.3	-0.5
	Korea – Kospi	2107.9	1.8	2.8	28.3
	India – Sensex 30	18343.7	-3.5	-10.6	12.5
	Australia – SPX/ASX 200	4774.9	0.4	0.6	2.2
	Singapore – Strait Times	3219.8	1.1	0.9	16.8
	Indonesia – Jakarta Comp	3481.7	3.0	-6.0	32.9
	Thailand – SET	977.3	-2.9	-5.4	41.7
	Malaysia – KLCI	1521.8	-1.7	0.2	20.3
	Philippines – Manila Comp.	3970.3	0.5	-5.5	34.1

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)	6.59	0.02	6.57	6.46
	Hong Kong (HKD/USD)	7.79	0.05	7.8	8
	Taiwan (TWD/USD)	29.0	0.38	28.69	28.15
	Japan (JPY/USD)	82.6	-0.08	82.6	82.2
	Korea (KRW/USD)	1114	0.92	1119.85	1134.19
	India (INR/USD)	45.7	-0.28	46.5	48
	Australia (USD/AUD)	0.99	0.06	1	n.a.
	Singapore (SGD/USD)	1.28	0.23	1.28	1.3
	Indonesia (IDR/USD)	9028	0.39	9161	9601
	Thailand (THB/USD)	31.1	-1.51	31.18	31.4
	Malaysia (MYR/USD)	3.06	0.16	3.1	3
	Philippines (PHP/USD)	44.1	0.84	44.24	44.62

Last update: Friday, 15.30 Hong Kong time.

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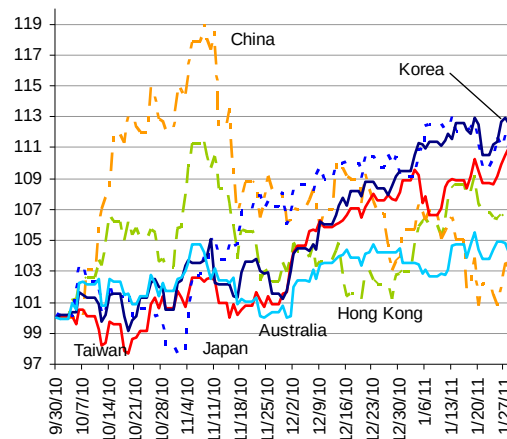
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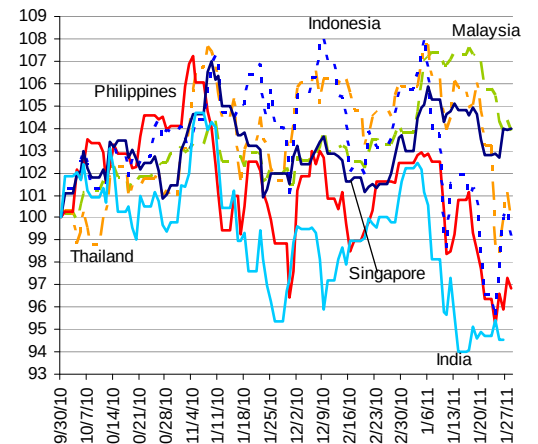
STOCK MARKETS



Source: BBVA Research and Bloomberg

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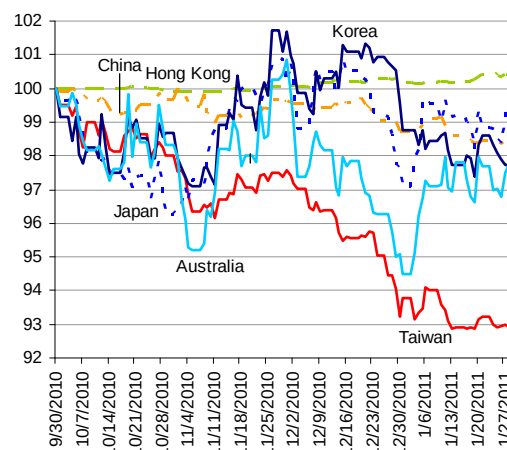
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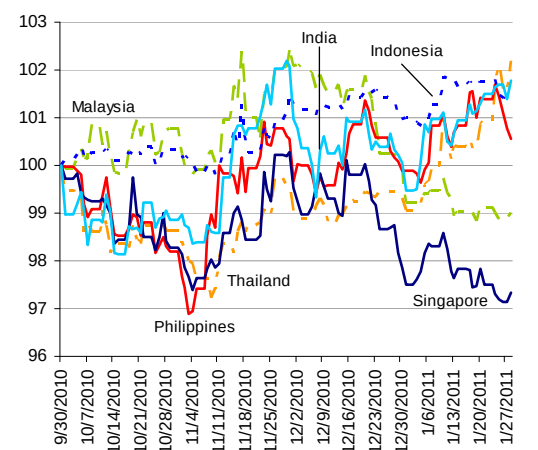
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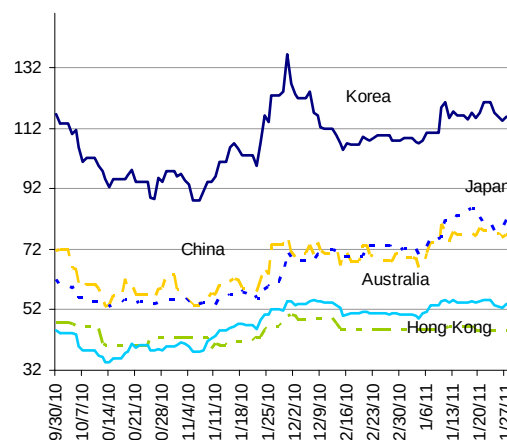
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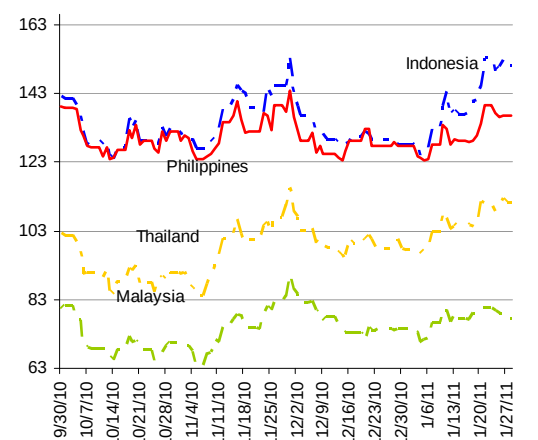
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