

Asia

# Weekly Watch

Hong Kong, February 11, 2011

**Economic Analysis**

*Asia*

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## Monetary tightening takes hold

Strong economic indicators and rising inflation have led to more monetary tightening in the region. China has set the tone with its aggressive tightening campaign, marked this week by another interest rate hike (the third since October) and talk of higher reserve requirements (see Highlights). At the same time, prospects for a faster recovery in the US and rising yield there are leading to a selloff from some of the region's equity markets, which are weighing on otherwise appreciating Asian currencies. We launched our latest quarterly Asia and China Economic Outlooks, highlighting these themes (see Highlights).

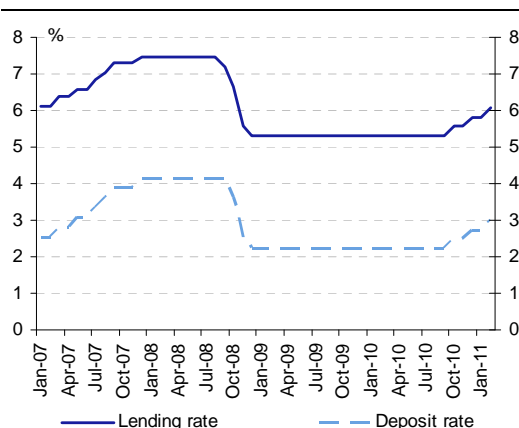
### Strong data points and rising inflation are the key

GDP growth for the fourth quarter in Indonesia (6.9% y/y, consensus: 6.3%) and the Philippines (7.1% y/y, consensus: 6.0%) were above expectations. Many inflation readings have also come in higher than expected, especially in Indonesia (7.1%) and Korea (4.1%). China and Indonesia both hiked interest rates in recent days, while Korea opted to stay on hold following its rate hike last month. We expect rates around the region to continue rising (see Highlights). In a separate move, Vietnam devaluated its currency by a surprisingly large 7% in view of external pressures (see Markets).

### In the coming week...

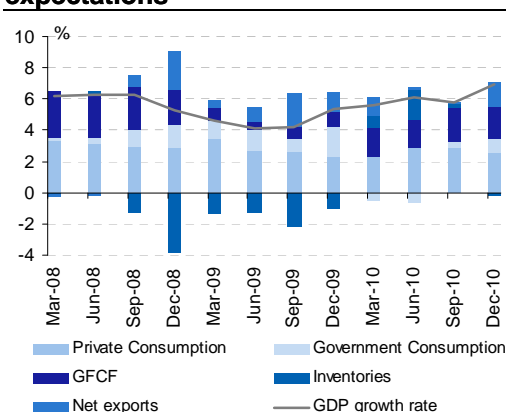
The focus will be on China, including January inflation (see What to Watch), FDI and trade. India will release January inflation, and fourth quarter GDP will be released in Japan, Malaysia, Singapore and Taiwan. Japan will hold its regular monetary policy, with policy expected to remain unchanged.

Chart1  
**China hikes interest rates again**



Source: BBVA Research and Bloomberg

Chart2  
**Indonesia's fourth quarter GDP beats expectations**



Source: BBVA Research and Bloomberg

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## Highlights

### Asia continues to be the engine of global growth

See our latest Asia Outlook for details on the region's strong growth

### Struggling to achieve a soft-landing for China's economy

See our latest China Outlook for details on overheating risks

### Rising inflation spurs more monetary tightening

Central banks are seeking to tame inflationary expectations

Markets Analysis

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Markets

Monetary tightening fears weigh on markets

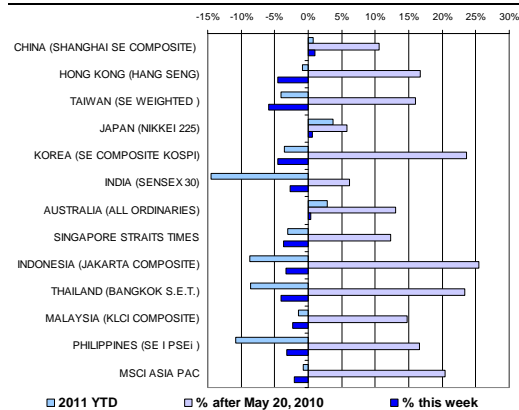
After being closed for much of the past week due to the Chinese New Year, markets opened to the downside on concerns of further monetary tightening across the region. Such fears were triggered by another rate hike in China, announced this past Tuesday, following Bank Indonesia's first interest rate hike in the current cycle last Friday. US Fed Chairman Bernanke's comments in testimony before the US Congress also unnerved markets by predicting that the US unemployment rate will remain high in the coming years, even after the rate in January declined to a lower-than-expected 9.0% (the lowest since April 2009). Nevertheless, improving economic indicators and strong corporate earnings helped boost US markets. Ongoing political uncertainty in Egypt was also a key factor dragging down sentiment in emerging markets. Taken together, these events led to some weakness for Asian currencies on equity outflows.

The KRW was the worst performer this past week, falling by 2.2% as the USD. The USD/AUD weakened by 1.7% for week, after RBA Governor Glenn Stevens indicated that there will be no further rate hikes in the near term, and also on monetary tightening in China. Meanwhile, Vietnam devalued the Dong by around 7%, a relatively large move compared to recent Dong devaluations, on external pressures from a widening trade deficit. The IDR was an outlier this week following BI's rate hike, stronger-than-expected fourth quarter GDP, and expectations the authorities will be willing to allow faster appreciation to counter inflation (which came out higher than expected at 7.0% y/y in January).

Equity markets were also dragged down by capital outflows on concerns about monetary tightening, and prospects for a faster recovery in the US. Most markets recorded strong losses, with the MSCI Asia Pacific falling by 2.1%. Hong Kong's index recorded its steepest weekly loss since May on the fallout from China's rate hike. Taiwan also moved sharply lower, by 5.9% this past week. On the other side, stocks in Japan posted some modest gains, due to solid corporate earnings and weaker Japanese yen.

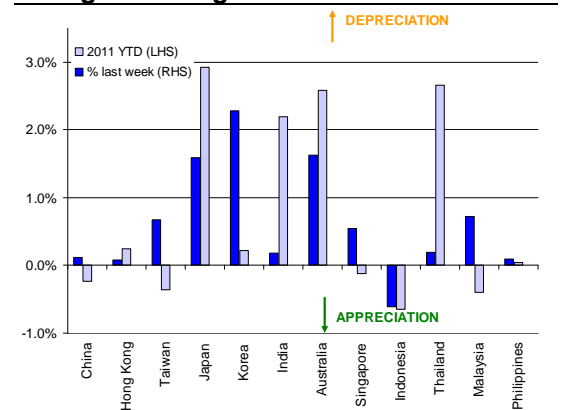
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Chart 3  
Stock markets



Source: BBVA Research and Bloomberg

Chart 4  
Foreign exchange markets



Source: BBVA Research and Bloomberg

## Economics Analysis

## Asia

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## Highlights

**Asia continues to be the engine of global growth**

We released our latest quarterly [Asia Economic Outlook](#) this past week. The report highlights the better-than-expected 2010 GDP outturns across the region, underpinned by strong demand from China and India. Our baseline projections continue to anticipate strong growth in 2011, but at a moderating pace, in line with potential (Chart 5). Rising inflation has become the main concern across the region, and we have raised our inflation projections for a number of economies. In particular, food and commodity price increases have generated inflation from the supply side, while closure of output gaps and strong growth momentum are creating pressures from the demand side. Authorities are responding by tightening monetary policy, as well as using supply-side measures to limit the impact of rising food prices. However, with higher interest rates likely to draw in capital inflows, policymakers are using macro-prudential measures to limit such inflows, a trend we expect to continue during the year. Relative to our update of a few months ago, risks in the region are tilted toward overheating.

**Struggling to achieve a soft-landing for China's economy**

We also released our latest quarterly [China Economic Outlook](#). The main theme of the report is the risks of overheating and the authorities' policy response, which is based on an increasingly aggressive monetary tightening stance. In view of the government's determination to achieve a soft landing, we are maintaining our growth projection of 9.2% for 2011, while raising our inflation projection somewhat, to 4.5%. One of the more pressing issues in China is a significant rise in inflation, driven initially by weather-related rises in food prices, but more recently by non-food components as well. (Markets are anxiously awaiting the January inflation outturn due out next week – see What to Watch.) Policy tightening has taken the form of interest rate hikes and increases in required reserve ratios. We expect more of the same in the first half of 2011, accompanied by further gradual currency appreciation. With GDP and credit growth exceeding expectations, and with inflation on the rise, achieving a soft landing will be a challenge.

**Rising inflation spurs more monetary tightening**

Following on the themes of our Asia and China Outlooks, recent data and policy developments highlight the trend of rising inflation and monetary tightening. Despite a moderating growth trend in the region, inflationary pressures are still building due to rising food costs, as well as increases in core inflation from strong domestic demand, amidst closing output gaps and rising wages (Chart 6). This past week China raised interest rates once again by 25bps, for a third time since October, to 6.06% and 3.0% for the benchmark lending and deposits rates, respectively. Meanwhile, Korean inflation in January broke above the central bank's target of 4%, ahead of expectations, to 4.1% y/y (consensus 3.8%), due in large part to food prices, but other broader components as well. Nonetheless, the Bank of Korea left rates unchanged this week, as it seeks to raise rates gradually following last month's hike (the third since July). We expect three more rate hikes from Korea during the remainder of the year, with the next move likely in March. In Indonesia, inflation surprised once again to the upside, at 7.0% y/y (consensus 6.8%), surpassing an already last month's high inflation reading of 7.0%, although core inflation remains at a mild 4.2% y/y. Under pressure from falling bond markets, Bank Indonesia raised its policy rate this week by 25bps to 6.75% (the first move in the present cycle). We expect two more rate hikes from BI this year.

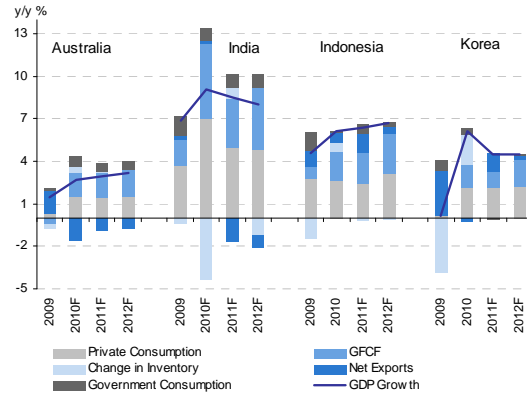
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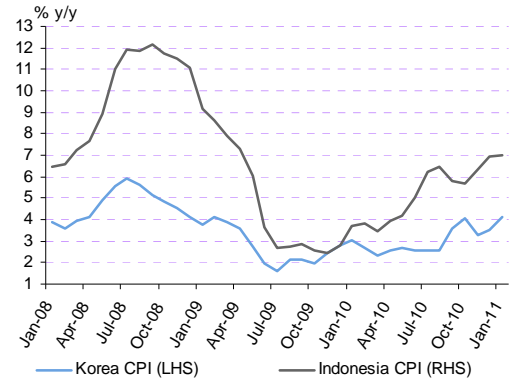
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Chart 5  
**Strong growth set to continue in 2011, at a moderating pace**



Source: BBVA Research and Bloomberg

Chart 6  
**Inflationary pressures are growing in Korea and Indonesia**



Source: BBVA Research and Bloomberg

## What to watch

### Economics Analysis

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### China: CPI for January (February 15)

**Forecast: 4.9% y/y**

**Consensus: 5.4% y/y**

**Previous: 4.6% y/y**

Headline inflation is expected to pick up again after a temporary easing in December. Adverse weather conditions (including cold weather and drought conditions in China's North) are expected to have led to further increases in food prices, although recent weekly indicators show overall increases to be relatively modest. That said, pressure on non-food components is also on the rise. An outturn higher than the market consensus (already high at 5.4%) could undermine sentiment by generating expectations of even more aggressive monetary tightening, and raising questions about the authorities' ability to achieve an economic soft landing.

### Calendar

China	Date	Period	Prior	Cons.
Trade Balance (USD)	14-Feb	JAN	\$13.10B	\$11.30B
Exports YoY%	14-Feb	JAN	17.90%	22.50%
Imports YoY%	14-Feb	JAN	25.60%	27.00%
Producer Price Index (YoY)	15-Feb	JAN	5.90%	6.20%
Consumer Price Index (YoY)	15-Feb	JAN	4.60%	5.40%
Actual FDI (YoY)	15-Feb	JAN	15.60%	17.20%
China Property Prices	10-15 Feb	JAN	6.4	5.5
New Yuan Loans	11-15 Feb	JAN	480.7B	1200.0B
Money Supply - M2 (YoY)	11-15 Feb	JAN	19.70%	19.00%
India	Date	Period	Prior	Cons.
Monthly Wholesale Prices YoY%	14-Feb	JAN	8.43%	8.08%
Japan	Date	Period	Prior	Cons.
GDP Deflator YoY	14-Feb	4Q P	-2.40%	-1.50%
GDP Annualized	14-Feb	4Q P	4.50%	-2.00%
Gross Domestic Product (QoQ)	14-Feb	4Q P	1.10%	-0.50%
Industrial Production YOY%	15-Feb	DEC F	4.60%	--
Tertiary Industry Index (MoM)	16-Feb	DEC	0.60%	-0.60%
Korea	Date	Period	Prior	Cons.
Unemployment Rate (SA)	16-Feb	JAN	3.60%	3.70%
Department Store Sales YoY	17-19 Feb	JAN	11.60%	--
Discount Store Sales YoY	17-19 Feb	JAN	2.90%	--
Malaysia	Date	Period	Prior	Cons.
GDP YoY%	18-Feb	4Q	5.30%	--
Annual GDP	18-Feb	31-Dec	-1.70%	--
Philippines	Date	Period	Prior	Cons.
Balance of Payments	18-Feb	JAN	\$1225M	--
Singapore	Date	Period	Prior	Cons.
Retail Sales Ex Auto	15-Feb	DEC	5.40%	--
Retail Sales (YoY)	15-Feb	DEC	-2.40%	1.00%
GDP (QoQ)	17-Feb	4Q	6.90%	5.40%
GDP (YoY)	17-Feb	4Q	12.50%	12.20%
Electronic Exports (YoY)	17-Feb	JAN	-1.10%	--
Non-oil Domestic Exports (YoY)	17-Feb	JAN	9.40%	15.00%
Taiwan	Date	Period	Prior	Cons.
GDP - Constant Prices (YoY)	17-Feb	4Q F	9.80%	--

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#### Japan – BoJ Target Rate, February 15

We expect interest rates will be unchanged

Current	Expected
0.10	0.10

#### Hong Kong – Composite Interest Rate, February 17

We expect interest rates will be unchanged

Current	Expected
0.21	0.21

#### Singapore – 2011 Budget Plan announced by Finance Minister, February 18

Markets Data

# Asia Market

STOCK MARKETS	INDEX	Last price	% change over a week	Year to date	% Change over 1 Y
	China – Shanghai Comp.	2827.3	1.0	0.7	-5.3
	Hong Kong – Hang Seng	22828.9	-4.5	-0.9	12.5
	Taiwan – Weighted	8609.9	-5.9	-4.0	15.7
	Japan – Nikkei 225	10605.7	0.6	3.7	6.4
	Korea – Kospi	1977.2	-4.6	-3.6	23.7
	India – Sensex 30	17643.0	-2.0	-14.0	9.2
	Australia – SPX/ASX 200	4880.9	0.4	2.9	7.2
	Singapore – Strait Times	3081.0	-4.1	-3.4	11.9
	Indonesia – Jakarta Comp	3391.8	-3.0	-8.4	35.3
Thailand – SET	947.7	-3.8	-8.2	36.3	
Malaysia – KLCI	1494.5	-2.4	-1.6	19.6	
Philippines – Manila Comp.	3749.2	-3.2	-10.8	28.9	

Last update: Friday, 17.15 Hong Kong time.

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.59	-0.14	6.56	6.45
	Hong Kong (HKD/USD)	7.79	-0.10	7.8	8
	Taiwan (TWD/USD)	29.2	-0.67	28.96	28.42
	Japan (JPY/USD)	83.4	-1.49	83.4	82.9
	Korea (KRW/USD)	1128	-2.23	1133.80	1148.25
	India (INR/USD)	45.7	-0.14	46.4	48
	Australia (USD/AUD)	1.00	-1.50	1	n.a.
	Singapore (SGD/USD)	1.28	-0.62	1.28	1.3
	Indonesia (IDR/USD)	8935	0.65	9056	9504
Thailand (THB/USD)	30.8	-0.10	30.91	31.1	
Malaysia (MYR/USD)	3.05	-0.78	3.1	3	
Philippines (PHP/USD)	43.8	-0.11	43.90	44.28	

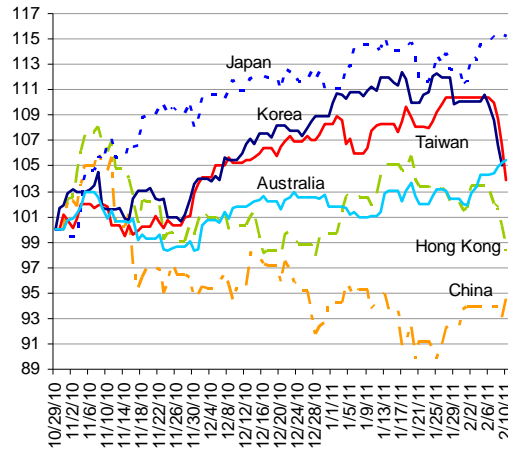
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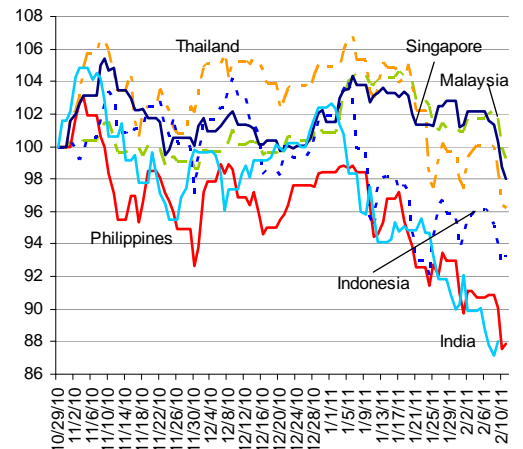
# Asia Chart

## STOCK MARKETS



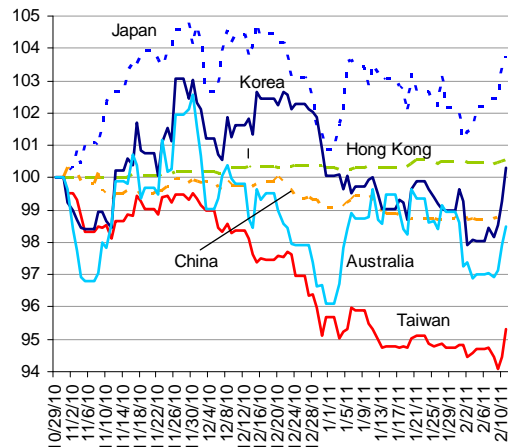
Source: BBVA Research and Bloomberg Index=100

## STOCK MARKETS



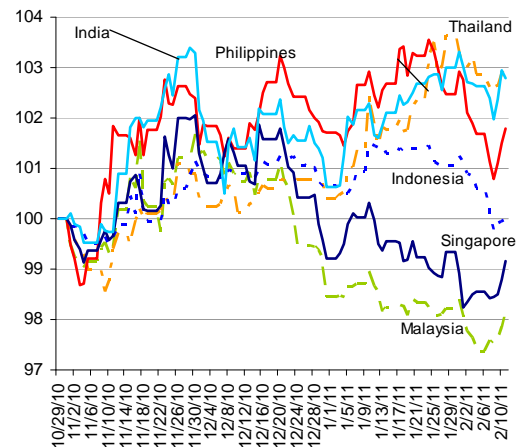
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## FOREIGN EXCHANGE MARKETS



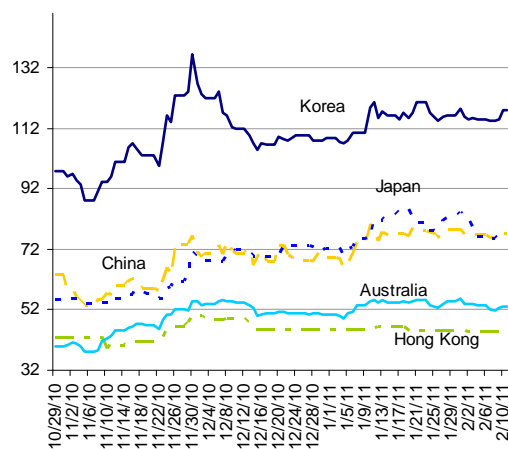
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## FOREIGN EXCHANGE MARKETS



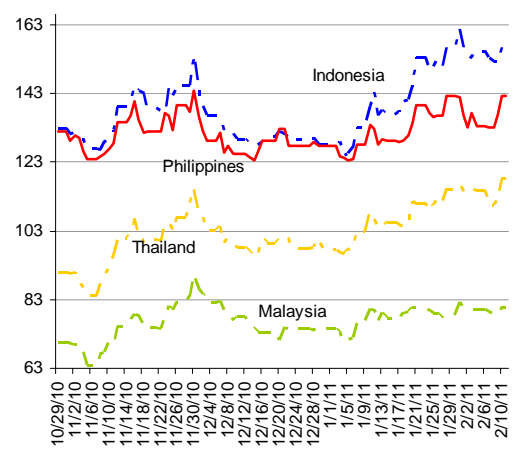
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## CREDIT DEFAULT SWAPS



Source: BBVA Research and Bloomberg

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