

## Asia

# Weekly Watch

Hong Kong, February 18, 2011

### Economic Analysis

#### Asia

**Stephen Schwartz**

stephen.schwartz@bbva.com.hk

**Ricard Torne**

ricard.torne@bbva.com.hk

**Mario Nevares**

mario.nevares@bbva.com.hk

**Fielding Chen**

fielding.chen@bbva.com.hk

**Le Xia**

xia.le@bbva.com.hk

**Jenny Zheng**

jenny.zheng@bbva.com.hk

**Serena Zhou**

serena.zhou@bbva.com.hk

**Serena Wang**

serena.wang@bbva.com.hk

#### Markets

**Richard Li**

richard.li@bbva.com.hk

**Ricard Torne**

ricard.torne@bbva.com.hk

**Mario Nevares**

mario.nevares@bbva.com.hk

## Modest China inflation lifts sentiment

A modest January inflation outturn in China helped to boost sentiment this past week by allaying fears of a more abrupt tightening stance (see Highlights; Chart 1), although the authorities announced another 50bp hike in the required reserve ratio late on Friday, after markets had closed. Strong regional growth indicators, including better-than-expected fourth quarter GDP outturns in Taiwan and Japan provided additional support for markets during the week.

### All-in-all, a good set of indicators for the week

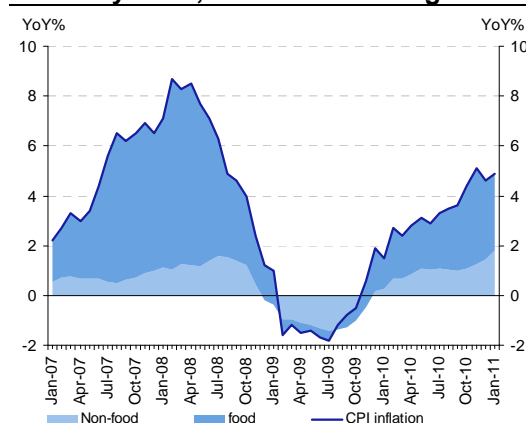
Trade data in China came in much higher than expected, with exports (37.7% y/y) and imports (51.0%) beating market consensus by a wide margin, and leading to a much smaller trade surplus, due in part to seasonal effects from the Chinese New Year. Fourth quarter GDP in Japan (-1.1% saar; BBVA -1.1%; consensus: -2.0%) and Taiwan (6.9% y/y, consensus: 6.4%) beat market expectations. In addition to China, inflation also eased somewhat in India (8.2% y/y, from 8.4% y/y the previous month, and against consensus: 8.1%), although underlying pressures remain high. Separately, Vietnam raised interest rates by 200bps to contain inflation last week's devaluation (see Highlights).

### In the coming week...

Hong Kong's 2011-12 fiscal budget will be unveiled next week (Wednesday), along with the release of a number of indicators, including fourth quarter GDP, trade, unemployment and inflation (see Highlights). Inflation data for January will also be released in Malaysia and Singapore (see What to Watch), and Vietnam (for February), along with GDP in Thailand.

Chart1

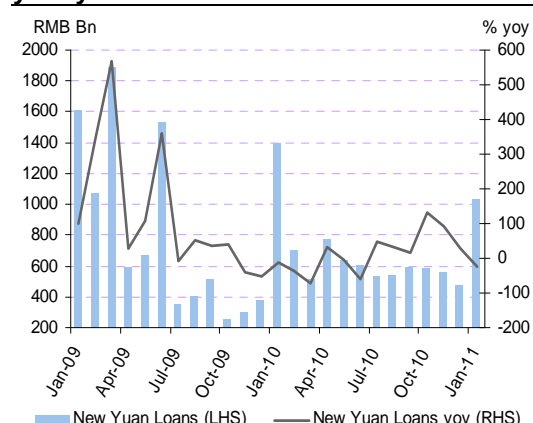
**China's inflation outturn for January was relatively tame, but still on the high side**



Source: BBVA Research and Bloomberg

Chart2

**... and new yuan loans moderate on a yearly basis**



Source: BBVA Research and Bloomberg

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## Highlights

### China's inflation outturn helps to ease market concerns

Inflation was below market expectations, but underlying pressures remain

### Strong growth in Hong Kong amidst the forthcoming 2011-12 budget

Rising inflation is a concern, with a tight budget stance expected to contain the impact

### Vietnam struggles to maintain macro stability

Another devaluation as Vietnam seeks to contain BOP pressures

## Markets Analysis

Richard Li

richard.li@bbva.com.hk

Ricard Torne

ricard.torne@bbva.com.hk

Mario Nevares

Mario.nevares@bbva.com.hk

## Markets

### Asian Markets Show Gains, but Tone Remains Cautious

China's CPI came in below market expectations (although in line with BBVA forecasts), while new loans also grew more moderately than expected (see Highlights). The outturns helped allay concerns of tightening measures beyond those that had already been priced in, with Asian equities and FX responding positively. However, as pointed out by our economists, underlying inflation remains high, and the January outturn was higher than the previous month and above the PBOC's comfort zone. We still anticipate 50 bp interest rate hikes in Q2/Q3 and at least 100 bps increases in reserve requirements. That said, we remain confident in our "soft-landing" scenario. Seasonal factors may also result in a lower CPI outcome for February (due out in mid-March), which may further allay near-term inflation concerns.

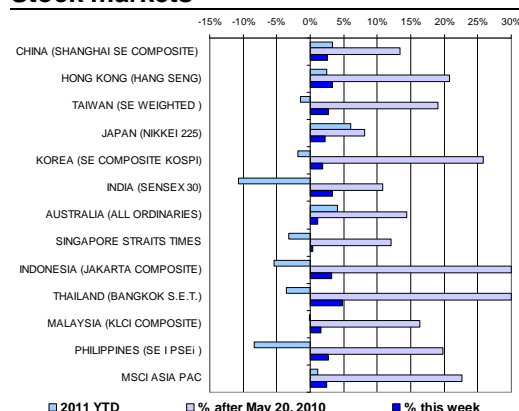
Meanwhile, activity indicators showed that Asian economic growth remains on a healthy path. Stronger-than-expected Taiwan 4Q GDP growth helped stabilize the TWD, which had recently been depreciating, despite market talk of further equities outflows. Singapore also registered better-than-expected exports in January, offsetting a negative surprise from the downward revision to 4Q GDP (3.9% saar). Faster growth amid rising inflation presage further monetary tightening on the horizon. The likelihood of further tightening, uncertainties on the European debt front, and a fluid situation in the Middle East will keep risk aversion elevated, which should weigh on Asian markets.

As always, attention is growing on the CNY ahead of the next G20 Finance Ministers' Meeting this weekend in Paris. Senior officials of G20 member countries and international organizations have pressed on the need for further appreciation, while the PBoC Deputy Governor said earlier this week that the pace of CNY appreciation has been the "appropriate" against the USD. The debate will continue. The CNY fixing appreciated slightly ahead of the meeting, but it may have been due to the moderate depreciation of the USD rather than mounting international pressure. The 12-month NDF movement is in line with our assessment, with little movement thus far this week.

Stock markets in Asia surged this past week sending most regional indices to their largest weekly gains in several weeks. In addition to the factors noted above, market sentiment was lifted by strong economic indicators and solid corporate earnings. China, Taiwan and Hong Kong stocks were among the best performers, together with India which had been recording strong losses since beginning of this year.

Chart 3

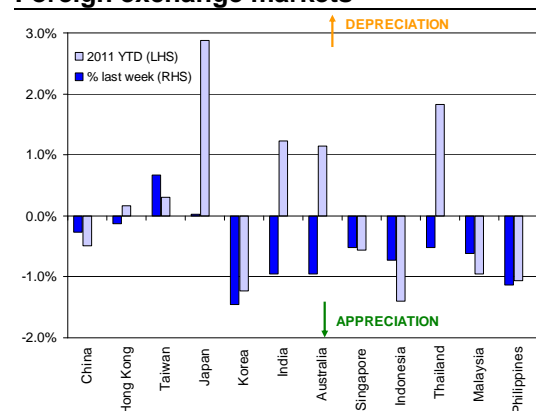
#### Stock markets



Source: BBVA Research and Bloomberg

Chart 4

#### Foreign exchange markets



Source: BBVA Research and Bloomberg

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## Economics Analysis

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**Stephen Schwartz**

stephen.schwartz@bbva.com.hk

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ricard.torne@bbva.com.hk

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mario.nevares@bbva.com.hk

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xia.le@bbva.com.hk

**Jenny Zheng**

jenny.zheng@bbva.com.hk

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serena.zhou@bbva.com.hk

**Serena Wang**

serena.wang@bbva.com.hk

## Highlights

**China's inflation outturn helps to ease market concerns**

A number of indicators released this past week in China helped to ease market concerns of a hard landing. In particular, January CPI inflation came in at 4.9% y/y, consistent with our expectations, but well below the market consensus (BBVA: 4.9% y/y; consensus: 5.4% y/y). Skeptics noted that the inflation reading is based on new official weights in the calculation of the CPI, in which food and other components are given a lower weight, while housing costs are given a higher weight. However, the new weights appear to have had a negligible impact on the outturn. That said, inflationary pressures remain high, with food prices and housing costs rising in January by 10.3% y/y and 6.7% y/y, respectively, and producer prices up by 6.6% y/y (consensus: 5.9%). Another piece of good news was a relatively benign outturn for new loans in January, of RMB 1.04 trillion (consensus: RMB 1.20 trillion), 25% below the level in the same period last year. Together with a soft reading for M2 growth, the outturn suggests the authorities' tightening measures may be more effective so far than expected by the market. Nevertheless, further efforts to prevent overheating will still be needed, as the inflation and M2 growth outturns remain well above the authorities' comfort levels. Indeed, the authorities announced another 50bp hike in the required reserve ratio late on Friday. Separately, property prices continued to rise in January, at 6.4% y/y. Consequently, we do not anticipate a change in the authorities' monetary tightening campaign, with our expectations remaining for two additional rate hikes of 25bp in Q2/Q3, along with at least 50bps of additional hikes in reserve requirements.

**Strong growth in Hong Kong amidst the forthcoming 2011-12 budget**

Hong Kong will release fourth quarter GDP this coming Wednesday. After the economy expanded by 7.1% y/y in the first three quarters, we expect momentum in Q4 to have moderated to 5.0% y/y on weaker external demand. This would bring full-year growth for 2010 to a strong 6.5%, a significant rebound from a contraction of -2.8% in 2009. We expect growth to be sustained at around 5% in 2011, underpinned by robust domestic demand as well as from strong output growth in China. However, inflationary pressures are on the rise. January inflation will be released next week (Tuesday), and we expect acceleration to 3.3% y/y from 3.1% y/y the previous month. As elsewhere in much of the region, inflation has become a major concern. We project average inflation to surge to 5.2% in 2011 from 2.4% in 2010, driven by rising imported inflation, especially spillovers from Mainland China. Demand pressures are also a factor, especially rising rents and wages (a new minimum wage law will take effect this May). In addition, lax liquidity is adding to risks of asset bubbles, particularly in the property sector. Another focus of attention in the coming week will be the 2011-12 budget, to be announced on Wednesday. Several measures are expected in order to soften the impact of rising inflation, such as tax rebates and subsidies to public housing and transportation. Overall, the fiscal stance is expected to remain tight (in substantial surplus) to help reduce overheating risks.

**Vietnam struggles to maintain macro stability**

Vietnam has been struggling in recent months to maintain macro stability in the face of overheating pressures. Moody's and S&P downgraded Vietnam last December (following an earlier downgrade by Fitch) due to a widening trade deficit and low foreign reserves. Facing balance of payments pressures, the State Bank of Vietnam (SBV) devalued the currency (Vietnamese Dong) last week and narrowed the trading band from  $\pm 3\%$  to  $\pm 1\%$ . This was the fourth devaluation since early 2010 and, at 7%, was the largest since 1992. Foreign reserves currently stand at about \$13.6 billion, equivalent to less than three months of imports. Moreover, despite Vietnam's strong medium-term growth prospects, foreign direct investment (FDI) inflows have failed to recover since the global economic crisis. Inflation has also been a problem, rising to 12.2% y/y in January on higher food and housing costs. The monetary authorities have come under criticism by international agencies and analysts for focusing on growth at the expense of macro stability, and in particular for failing to address overheating pressures through tighter monetary policy. In this regard, the SBV yesterday increased its refinancing rate by 200 basis points to 11%, the first in what may be a series of interest rate hikes to restore stability. We continue to hold a positive view of Vietnam's growth prospects, projected at 6.9% in 2011, and even higher over the medium-term. However, Vietnam's openness and weak institutions will continue to pose challenges in the near term for policy makers in maintaining stability.

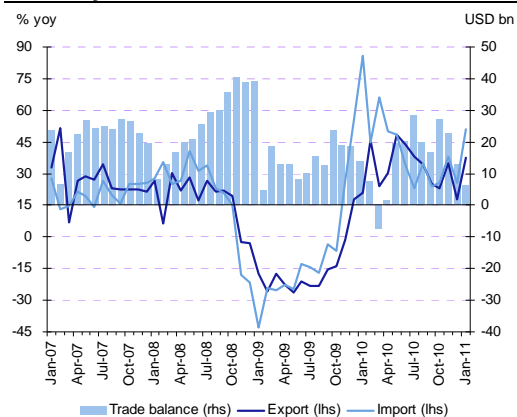
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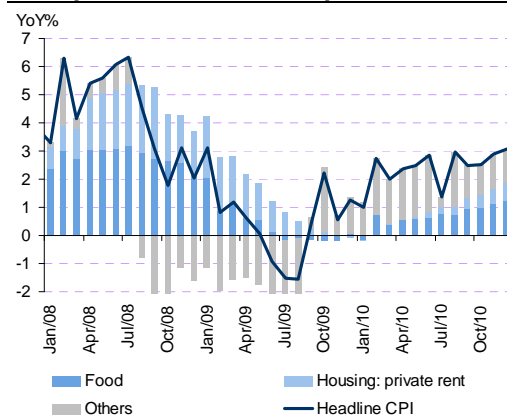
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Chart 5  
**China's trade surplus narrowed in January**



Source: BBVA Research and Bloomberg

Chart 6  
**Inflation in Hong Kong is picking up on food prices and demand pressures**



Source: BBVA Research and Bloomberg

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Le Xia

xia.le@bbva.com.hk

Jenny Zheng

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## What to watch

## Singapore: CPI inflation for January (February 23)

Forecast: 3.9% y/y

Consensus 4.6 % y/y

Previous: 4.6% y/y

Inflation continues to rise in Singapore, driven by higher transport costs and housing prices. While underlying pressures remain strong, we expect monthly inflation to decline following an exceptionally large increase in December. Our end-year inflation projection is 3.6%, and the Singapore trade ministry has just raised its inflation forecast for 2011 from 2%-3% previously to 3%-4%, warning that inflation may rise to 5%-6% in the coming months and underscoring the authorities' challenge to tame inflation. A higher-than-expected inflation reading would raise expectations of further monetary tightening through faster currency appreciation. The Monetary Authority's next policy meeting is in April.

## Calendar

| Hong Kong                         | Date      | Period | Prior     | Cons.  |
|-----------------------------------|-----------|--------|-----------|--------|
| Unemployment Rate SA              | 21-Feb    | JAN    | 4.00%     | 4.00%  |
| CPI - Composite Index (YoY)       | 22-Feb    | JAN    | 2.90%     | 3.30%  |
| GDP sa (QoQ)                      | 23-Feb    | 4Q     | 0.70%     | 1.60%  |
| Annual GDP                        | 23-Feb    | 31-Dec | -2.70%    | 6.50%  |
| Trade Balance                     | 24-Feb    | JAN    | -43.5B    | -41.7B |
| Exports YoY%                      | 24-Feb    | JAN    | 12.50%    | 15.40% |
| Imports YoY%                      | 24-Feb    | JAN    | 14.80%    | 17.00% |
| Japan                             | Date      | Period | Prior     | Cons.  |
| All Industry Activity Index (MoM) | 21-Feb    | DEC    | -0.10%    | --     |
| Adjusted Merchnds Trade Bal.      | 23-Feb    | JAN    | ¥707.3B   | --     |
| Merchnds Trade Exports YoY        | 23-Feb    | JAN    | 13.0%     | --     |
| Merchnds Trade Imports YoY        | 23-Feb    | JAN    | 10.6%     | --     |
| Natl CPI YoY                      | 25-Feb    | JAN    | 0.00%     | --     |
| Korea                             | Date      | Period | Prior     | Cons.  |
| Current Account in US\$ Million   | 25-Feb    | JAN    | \$2114.0M | --     |
| Malaysia                          | Date      | Period | Prior     | Cons.  |
| CPI YoY                           | 23-Feb    | JAN    | 2.20%     | --     |
| Philippines                       | Date      | Period | Prior     | Cons.  |
| Total Imports (YoY)               | 25-Feb    | DEC    | 35.30%    | --     |
| Trade Balance                     | 25-Feb    | DEC    | -\$798M   | --     |
| Singapore                         | Date      | Period | Prior     | Cons.  |
| CPI (YoY)                         | 23-Feb    | JAN    | 4.60%     | --     |
| Industrial Production MoM SA      | 23-Feb    | JAN    | -11.80%   | --     |
| Taiwan                            | Date      | Period | Prior     | Cons.  |
| Export Orders (YoY)               | 21-Feb    | JAN    | 15.27%    | --     |
| Current Account Balance (USD)     | 21-Feb    | 4Q     | 8990M     | --     |
| Industrial Production (YoY)       | 23-Feb    | JAN    | 18.18%    | --     |
| Unemployment Rate - sa            | 24-Feb    | JAN    | 4.73%     | --     |
| Thailand                          | Date      | Period | Prior     | Cons.  |
| Gross Domestic Product SA (QoQ)   | 21-Feb    | 4Q     | -0.20%    | 0.90%  |
| Annual GDP (YoY)                  | 21-Feb    | 31-Dec | -2.30%    | 7.90%  |
| Customs Exports (YoY)             | 21-25 Feb | JAN    | 18.80%    | 22.50% |
| Customs Imports (YoY)             | 21-25 Feb | JAN    | 11.50%    | 19.50% |
| Customs Trade Balance             | 21-25 Feb | JAN    | \$1295M   | \$800M |
| Vietnam                           | Date      | Period | Prior     | Cons.  |
| Exports YTD (YoY)                 | 21-23 Feb | FEB    | 18.10%    | --     |
| Imports YTD (YoY)                 | 21-23 Feb | FEB    | 15.50%    | --     |
| CPI (YoY)                         | 21-24 Feb | FEB    | 12.20%    | --     |
| Industrial Output YTD (YoY)       | 22-25 Feb | FEB    | 16.10%    | --     |

Hong Kong – 2011-12 Fiscal Budget Speech, February 23

Japan – Cabinet Office Monthly Economic Report, February 20

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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.     | 2899.8     | 2.6                  | 3.3          | -3.9              |
|               | Hong Kong – Hang Seng      | 23595.2    | 3.4                  | 2.4          | 15.5              |
|               | Taiwan – Weighted          | 8843.8     | 2.7                  | -1.4         | 18.8              |
|               | Japan – Nikkei 225         | 10842.8    | 2.2                  | 6.0          | 4.9               |
|               | Korea – KOSPI              | 2013.1     | 1.8                  | -1.8         | 24.2              |
|               | India – Sensex 30          | 18318.4    | 3.3                  | -10.7        | 12.2              |
|               | Australia – SPX/ASX 200    | 4936.7     | 1.1                  | 4.0          | 6.1               |
|               | Singapore – Strait Times   | 3086.8     | 0.3                  | -3.2         | 11.5              |
|               | Indonesia – Jakarta Comp   | 3501.5     | 3.2                  | -5.5         | 36.8              |
|               | Thailand – SET             | 995.6      | 4.8                  | -3.6         | 43.1              |
|               | Malaysia – KLCI            | 1517.6     | 1.5                  | -0.1         | 20.5              |
|               | Philippines – Manila Comp. | 3851.2     | 2.7                  | -8.3         | 28.4              |

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)       | 6.57 | 0.27                 | 6.54            | 6.42             |
|                          | Hong Kong (HKD/USD)   | 7.79 | 0.13                 | 7.8             | 8                |
|                          | Taiwan (TWD/USD)      | 29.4 | -0.66                | 29.05           | 28.47            |
|                          | Japan (JPY/USD)       | 83.5 | -0.04                | 83.4            | 83.0             |
|                          | Korea (KRW/USD)       | 1112 | 1.47                 | 1118.86         | 1133.47          |
|                          | India (INR/USD)       | 45.2 | 0.97                 | 46.0            | 48               |
|                          | Australia (USD/AUD)   | 1.01 | 0.97                 | 1               | n.a.             |
|                          | Singapore (SGD/USD)   | 1.28 | 0.52                 | 1.28            | 1.3              |
|                          | Indonesia (IDR/USD)   | 8870 | 0.73                 | 8945            | 9351             |
|                          | Thailand (THB/USD)    | 30.6 | 0.52                 | 30.69           | 30.9             |
|                          | Malaysia (MYR/USD)    | 3.03 | 0.62                 | 3.0             | 3                |
|                          | Philippines (PHP/USD) | 43.3 | 1.14                 | 43.35           | 43.67            |

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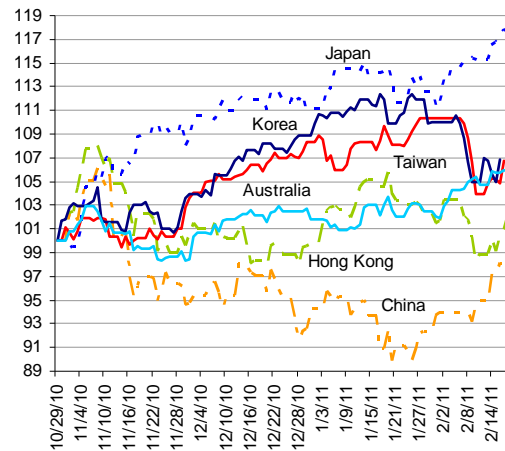
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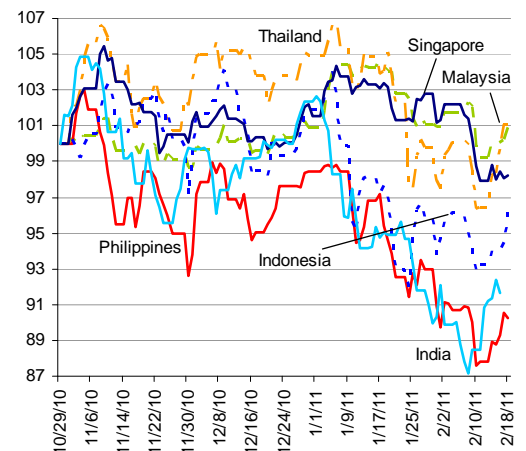
## STOCK MARKETS



Source: BBVA Research and Bloomberg

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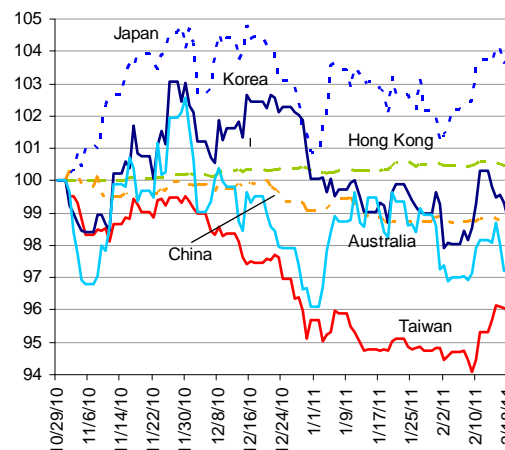
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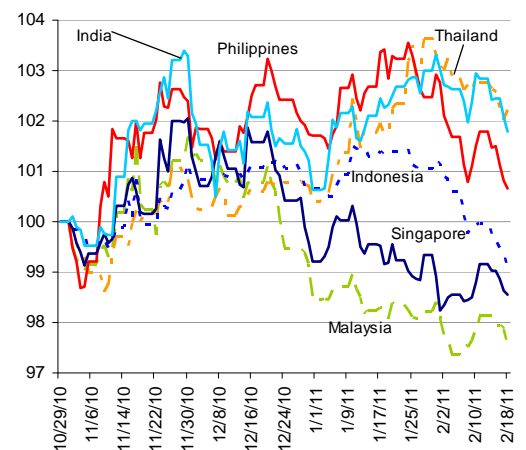
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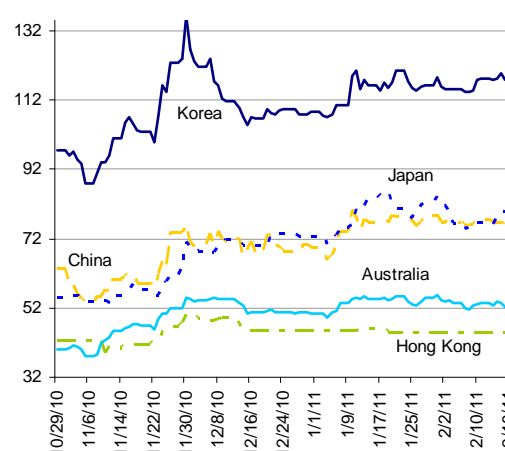
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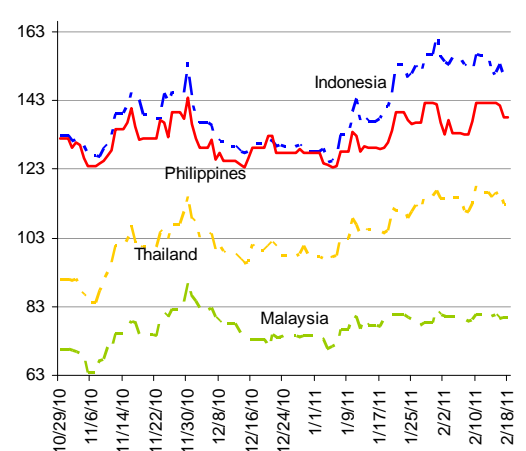
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## CREDIT DEFAULT SWAPS



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