BBVA Research

Asia

Weekly Watch

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Economic Analysis

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Interest rate hikes amidst rising oil prices

Central banks in the region are continuing to tighten monetary policy to contain rising inflation amidst renewed pressures from higher oil prices. Korea, Thailand and Vietnam all hiked interest rates this past week (see Highlights) in their ongoing efforts to tame inflation. Early on Friday afternoon news arrived of a strong earthquake and associated tsunami near Tokyo with potentially significant damage. Time will be needed in the coming day to assess the impact.

China's February inflation and activity surprises to the upside

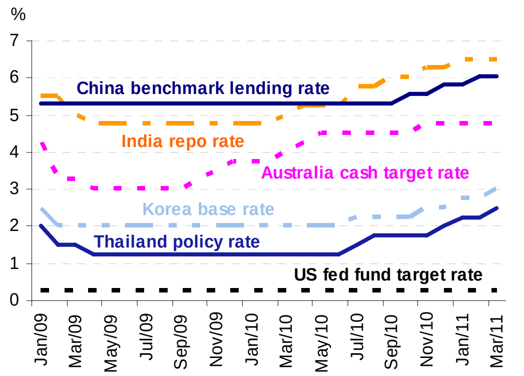
Headline inflation came in at 4.9% y/y, slightly higher than expected (BBVA: 4.6% y/y; consensus: 4.8% y/y). Other activity indicators, including industrial production and fixed asset investment were stronger than expected. Surprisingly, the trade balance turned to deficit, on weaker than expected exports, although this is likely to be temporary. Importantly, the data for February are difficult to interpret given strong seasonality effects from the Chinese New Year. Combining the January and February data together provides a clearer picture: it shows that growth momentum is robust. We maintain our projection of two more rate hikes, with the next one possible in the coming weeks. Meanwhile, Taiwan's February exports (27.3% y/y) and imports rose (28.7% y/y) rose more strongly than expected (consensus: 16.5% and 19.2% respectively).

In the coming week…

India will release February wholesale price inflation (see What to Watch). China will release FDI as well as new Yuan loans and money supply, and unemployment rates will be released in Korea, Hong Kong and the Philippines. The Philippines will also release balance of payments data. On the monetary policy front, the Reserve Bank of India is expected to hike its policy rates in next week's meeting, while Japan is expected to keep its target rate unchanged at 0.1% (see Calendar).

Chart1

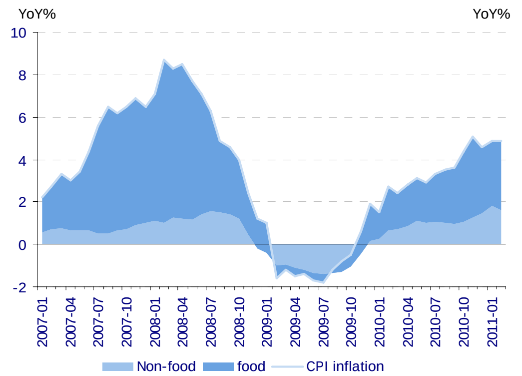
Rate hikes continue across Asia



Source: BBVA Research and Bloomberg

Chart2

China's CPI remains high…



Source: BBVA Research and Bloomberg

Highlights

Asia's rising inflation

Inflationary pressures are on the rise, with oil prices adding new pressure

Policy rates trending up in Asian economies

Central banks are continuing to tighten policy, as expected

China unveils 2011 budget: a trimming of the deficit with supportive policies

The authorities are aiming at a smaller budget deficit, with social spending a priority

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Asia markets resilient to transitory oil shocks

We still see the recent oil shock as a transitory phenomenon, as long as the unrest in the Middle East does not spread further. Asia is also well-placed to use fiscal tools to slow the pass through of higher oil prices to domestic economies. We view China's trade deficits in February largely driven by seasonal volatilities.

Intensifying civil wars in Libya have started to cause damage to oil facilities, deepening worries that global oil supplies may be disrupted more extensively and for a longer period. Brent oil prices have fluctuated at around USD 115/bbl, but Asian FX markets been broadly resilient. In our view, the key risk actually lies beyond Libya, namely the contagion of civil unrest to other oil producing countries, as any of Libya's oil shortfalls could be made up by Saudi Arabia and other OPEC members. As long as the unrest does not spread further, the oil shock would most likely be transitory and would not derail Asia's economic expansion.

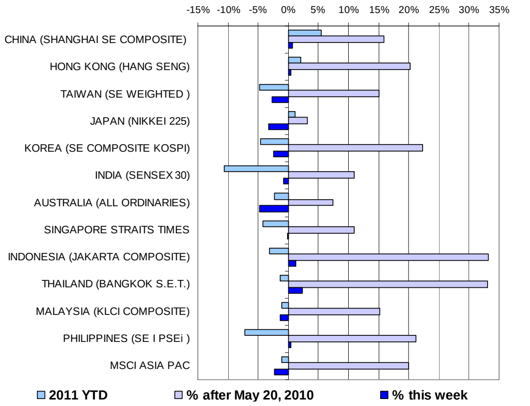
In the past weeks, we pointed out that the key risks of a transitory oil price spike to Asian economies lie in higher inflation rather than lower GDP growth. We also argued that net oil exporters and countries that are willing to use exchange rates could have their currencies outperform, while countries heavily dependent on oil imports could have weaker currencies. On a month-on-month basis, most Asian FX traded modestly stronger against the USD, with the IDR and to a lesser extent the SGD rising at a faster pace, as opposed to the depreciation of the KRW and TWD. The patterns broadly conform to our analysis.

This week, our economists suggest that Asian economies can use fiscal measures to cushion temporary oil shocks (see Highlights). With the exception of India, Malaysia and the Philippines, Asian economies have low budget deficits, with public debt far below OECD average. There is significant scope and incentives for them to use subsidies to slow the pass-through of higher international energy prices to their economies, especially to the poor. Thus far, Hong Kong, Singapore and Indonesia have announced new anti-inflation fighting measures or postpone fuel subsidies reforms, and others may follow suit. While the availability of fiscal options could slow the pass-through from higher energy prices, Asian central banks still have to hike rates at a controlled pace to anchor inflation expectation. This week, Korea and Thailand's central bank raised rates by 25 bps (see Highlight). The market impacts have been relatively muted, as their moves had been largely anticipated.

There have been undue concerns over China's trade deficits registered in February, with Asian FX trading lower against the USD after the data were released. Since February trade data were heavily distorted by Chinese New Year effects, we urged investors to average January and February data, with China's imports and exports up 36% y/y and 21.3% y/y respectively from the same period last year. Hence, there are no signs of abrupt slowdown in China's demand for Asian products, and any risk premium built on China's February data should be corrected before long.

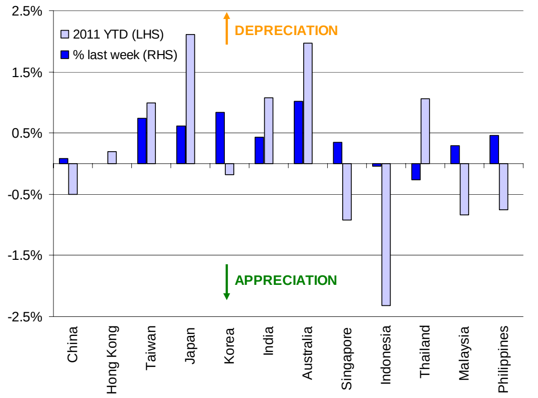
Asian stocks mostly lowered this week, as escalating tension in Libya as well as concerns on weaker US and China data dented sentiment again. The MSCI Asia index was down by 2.34%. However, Thailand and the Philippines's stocks climbed slightly.

Chart 3
Stock markets



Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets



Source: BBVA Research and Bloomberg

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Highlights

Asia's rising inflation

Inflation continues to pick up in many Asian economies (Chart 5). Recent data for February resulted in higher-than-expected outturns in Korea (4.5% y/y), the Philippines (4.3% y/y), and Taiwan (1.3% y/y). A combination of rising food prices and, increasingly, demand pressures have continued to exert upward inflationary pressures across Asia. Demand pressures are seen in rising core inflation, as spare capacity has been filled, and as wage rates in some economies are rising rapidly, such as Singapore (where headline inflation has reached 5.5% y/y). More recently, the rise in international oil prices from tensions in the Middle East have been an additional contributor. That said, and despite upside risks, there is still reason to expect overall inflation rates to be contained at modest levels. First, our baseline is for the current surge in oil prices to be a temporary shock. Second, as was the case with the run-up in oil prices in 2007-08, the impact of rising oil prices on headline inflation is likely to be mitigated through fiscal measures in many economies, given generally sound fiscal positions (however, India, the Philippines and Malaysia have relatively less scope for fiscal expansion). And finally, although core inflation has been rising in several economies, including Korea, Indonesia, and Thailand, moderating growth trends and monetary tightening should help to take some of the pressure off inflation (see Highlight below). Risks, however, are to the upside, and central banks will have to step up their tightening efforts to stay ahead of the curve and to avoid overheating.

Policy rates trending up in Asian economies

As discussed above, the recent rise in oil prices has added upward pressure on inflation, already being fueled by strong domestic demand, abundant liquidity, and rising food prices. Rising inflation and overheating risks are prompting central banks in the region to continue tightening monetary policy, as we have anticipated (see our Asia Outlook). Thailand and South Korea hiked policy rates, as expected (their 5th and 3rd hike in the current cycle); Indonesia implemented its first rate hike last month; and we expect India and Taiwan to hike rates again this month. Separately, policy makers in Vietnam moved again this week to raise interest rates as they struggle to maintain macro stability (facing mounting external and depreciation pressures, the State Bank of Vietnam hiked rates again after raising rates in February). We also expect China to implement two more rate hikes during the course of the second and third quarter of this year, with another hike in the reserve requirement rumored to take place any time. Meanwhile, currency appreciation is continuing, and is one of the instruments policymakers are using to combat inflation, especially in Singapore (which uses the exchange rate as its monetary policy instrument), and in Indonesia, where policy makers have recently announced a greater reliance on appreciation in the mix of measures they will use to address inflation (along with hikes in interest rates and measures to absorb liquidity).

China unveils 2011 budget: a trimming of the deficit with supportive policies

As anticipated, the details of China's annual 2011 budget were unveiled this past week in the ongoing National People's Congress. The 2010 fiscal outturn was announced at a deficit is RMB 1 trillion, equivalent to 2.5% of GDP. This was somewhat below the original deficit target of 2.8% of GDP, mainly due to higher-than-expected tax revenue arising from strong economic activity. For 2011, China's deficit target has been announced at RMB 0.9 trillion, or 2.0% of GDP. China thus joins other Asian economies in aiming for a further narrowing of fiscal deficits in 2011 as fiscal support is withdrawn given robust growth momentum (China's overall public debt ratio is modest at only 17% of GDP, although it is somewhat higher once local government debt is taken into account). Total expenditure in 2011 is nevertheless projected to increase by a nominal 11.9% over the 2010 outturn, with a focus on social spending, including a further strengthening of the social safety net. The budget is also oriented toward achieving a number of ambitious medium-term goals, especially on the provision of public housing (10 million new units are targeted in 2011) and infrastructure investment, such as high speed railways and water distribution facilities. Overall, together with further monetary tightening, the 2011 fiscal stance is in line with the government's policy mix to achieve a soft-landing and prevent overheating.

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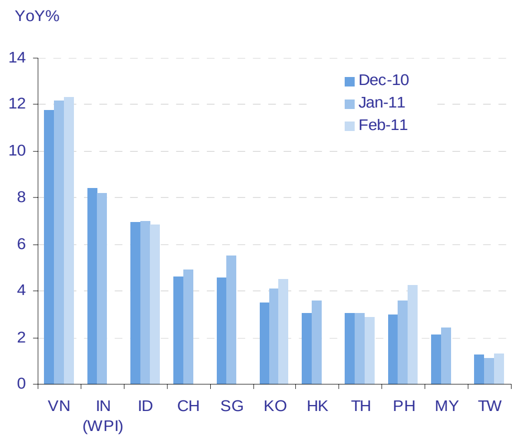
Chart 5

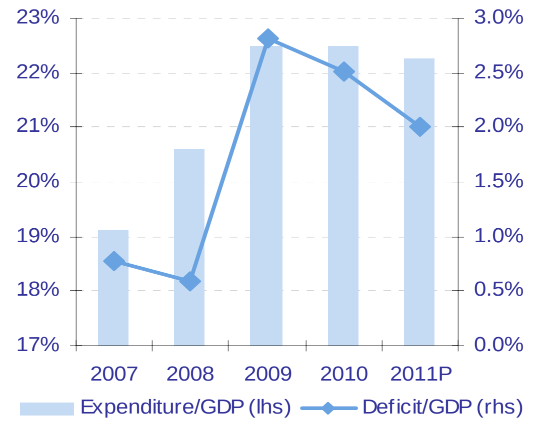
Inflation is picking up across Asia



Source: BBVA Research and Bloomberg

Chart 6

China trims its budget deficit for 2011, while maintain growth supportive expenditure



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What to watch

India: WPI inflation for February (March 14)

Forecast: 8.3% y/y **Forecast: 8.3% y/y** **Forecast: 8.3% y/y**

Comment: We expect inflation in February to have risen slightly on further double-digit increases in food prices, which remain the biggest contributor to India's inflation. The recent surge in international oil prices is also adding to inflation pressures.

The authorities are seeking to contain inflation to 7.0% by end March, still above their 5-6% comfort zone. To achieve this, the RBI hiked policy rates in January by 25 bps, the seventh such increase since March 2010.

Market impact: A higher-than-expected inflation reading would raise expectations of further monetary tightening. We expect the RBI to hike policy rates again, by 25 bps, at its next policy review meeting on March 17.

Calendar

Australia	**Date**	**Period**	**Prior**	**Cons.**
New Motor Vehicle Sales MoM	15-Mar	FEB	-1.90%	- -
China	**Date**	**Period**	**Prior**	**Cons.**
New Yuan Loans	11-15 MAR	FEB	1040.0B	600.0B
Money Supply - M0 (YoY)	11-15 MAR	FEB	42.50%	16.80%
Money Supply - M1 (YoY)	11-15 MAR	FEB	13.60%	17.80%
Money Supply - M2 (YoY)	11-15 MAR	FEB	17.20%	17.00%
Actual FDI (YoY)	14-18 MAR	FEB	23.40%	- -
Hong Kong	**Date**	**Period**	**Prior**	**Cons.**
Unemployment Rate SA	17-Mar	FEB	3.80%	3.70%
Composite Interest Rate	17-Mar	FEB	0.19%	- -
India	**Date**	**Period**	**Prior**	**Cons.**
Monthly Wholesale Prices YoY%	14-Mar	FEB	8.23%	7.80%
Japan	**Date**	**Period**	**Prior**	**Cons.**
Consumer Confidence	14-Mar	FEB	41.1	- -
Tertiary Industry Index (MoM)	17-Mar	JAN	-0.80%	- -
Philippines	**Date**	**Period**	**Prior**	**Cons.**
Budget Deficit/Surplus	14-18 MAR	JAN	-44.6B	- -
Unemployment Rate	15-Mar	JAN	7.10%	- -
Overseas Remittances (YoY)	15-Mar	JAN	8.10%	- -
Balance of Payments	18-Mar	FEB	$1606M	- -
Singapore	**Date**	**Period**	**Prior**	**Cons.**
Unemployment Rate (sa)	15-Mar	4Q F	2.20%	- -
Retail Sales Ex Auto	15-Mar	JAN	8.60%	- -
Retail Sales (YoY)	15-Mar	JAN	1.80%	3.00%
Electronic Exports (YoY)	17-Mar	FEB	5.80%	- -
Non-oil Domestic Exports (YoY)	17-Mar	FEB	20.90%	10.80%
Korea	**Date**	**Period**	**Prior**	**Cons.**
Export Price Index (MoM)	15-Mar	FEB	-0.90%	- -
Import Price Index (MoM)	15-Mar	FEB	0.00%	- -
Unemployment Rate (SA)	16-Mar	FEB	3.60%	- -
Department Store Sales YoY	17-19 MAR	FEB	24.00%	- -
Discount Store Sales YoY	17-19 MAR	FEB	21.40%	- -

Japan – BOJ Target Rate, March 15	**Current**	**Expected**
We expect target rate to be unchanged	0.10	0.10

India – RBI Monetary Policy Meeting, March 17	**Current**	**Expected**
India REPO Cutoff Yld.	6.50%	6.75%
Cash Reserve Ratio.	6.00%	6.00%
Reverse Repo Rate	5.50%	5.75%

Australia – Reserve Bank's Board March Minutes, March 15

China – Conference Board China January Leading Economic Index, March 16

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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.	2961.1	0.6	5.5	-3.0
Hong Kong – Hang Seng	23509.2	0.4	2.1	10.7
Taiwan – Weighted	8544.9	-2.7	-4.8	10.3
Japan – Nikkei 225	10347.3	-3.2	1.2	-3.0
Korea – Kospi	1956.9	-2.4	-4.6	18.1
India – Sensex 30	18328.0	-0.9	-10.6	7.2
Australia – SPX/ASX 200	4635.4	-4.7	-2.3	-3.7
Singapore – Strait Times	3055.9	-0.2	-4.2	6.3
Indonesia – Jakarta Comp	3587.6	1.3	-3.1	34.0
Thailand – SET	1019.2	2.3	-1.3	40.4
Malaysia – KLCI	1502.0	-1.4	-1.1	13.7
Philippines – Manila Comp.	3897.1	0.4	-7.2	24.7

Last update: Friday, 11.15 Hong Kong time.

FOREIGN EXCHANGE MARKETS

CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
China (CNY/USD)	6.57	-0.09	6.54	6.43
Hong Kong (HKD/USD)	7.79	0.00	7.8	8
Taiwan (TWD/USD)	29.6	-0.74	29.37	28.79
Japan (JPY/USD)	82.8	-0.62	82.8	82.4
Korea (KRW/USD)	1124	-0.83	1129.96	1144.88
India (INR/USD)	45.2	-0.31	45.9	48
Australia (USD/AUD)	1.00	-1.03	1	n.a.
Singapore (SGD/USD)	1.27	-0.35	1.27	1.3
Indonesia (IDR/USD)	8788	0.05	8868	9258
Thailand (THB/USD)	30.4	0.26	30.46	30.8
Malaysia (MYR/USD)	3.04	-0.29	3.0	3
Philippines (PHP/USD)	43.5	-0.46	43.53	43.78

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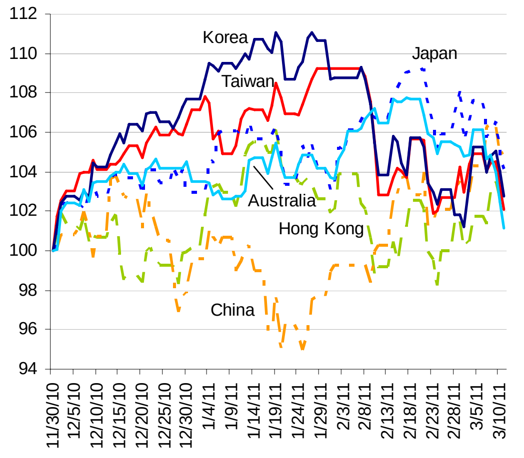
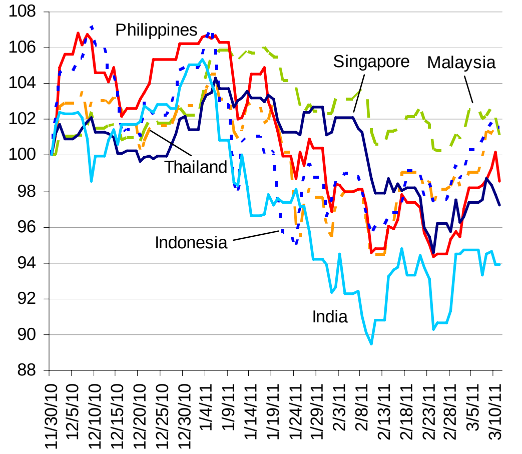
STOCK MARKETS



Source: BBVA Research and Bloomberg Index=100

STOCK MARKETS



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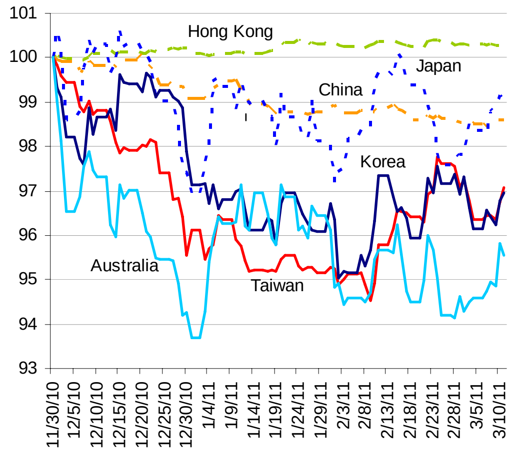

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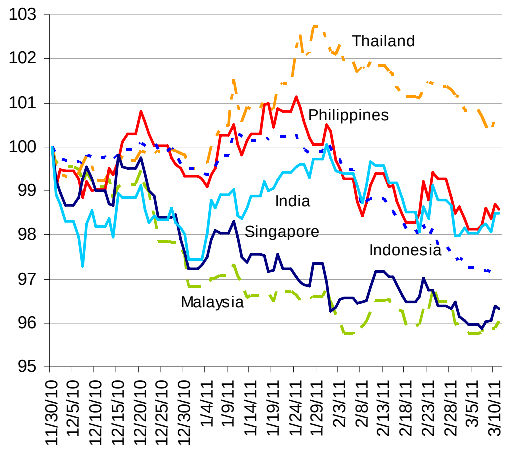
FOREIGN EXCHANGE MARKETS



Source: BBVA Research and Bloomberg Index=100

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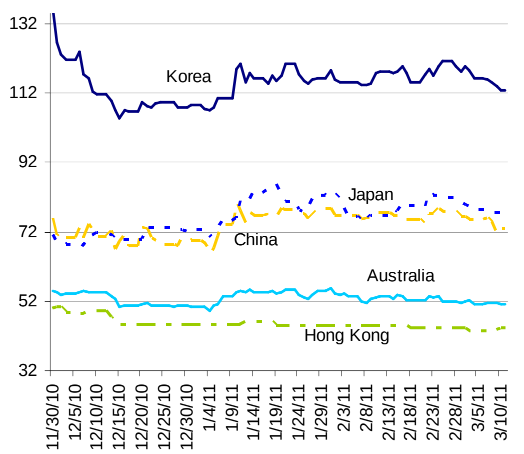

Source: BBVA Research and Bloomberg

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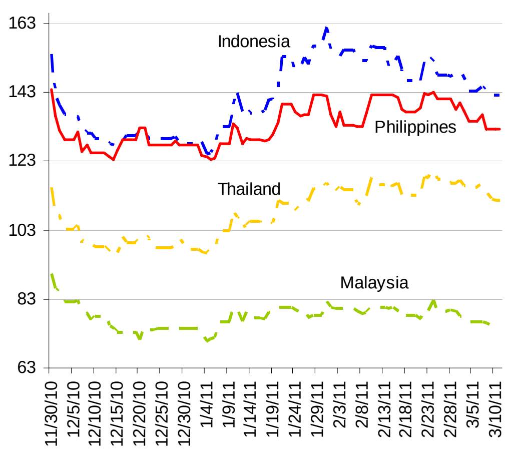

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