

Asia

Weekly Watch

Hong Kong, March 18, 2011

Economic Analysis

Asia

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Limited economic impact of Japan quake

Japan's earth quake has resulted in a devastating loss of life and property. Financial markets have been volatile from uncertainty about the outlook, particularly with respect to spreading nuclear risks. That said, with the direct damage contained to a relatively small region of the northeast of the country, it appears that the longer term economic impact on Japan and the region should be limited (see Highlights). Financial markets were down sharply this week, as the yen appreciated on repatriation of funds. To stem the yen's sharp appreciation—which at one point broke through to a record high of 76.3 against the USD—the G7's central banks pledged earlier today to intervene in the foreign exchange market.

India hikes interest rates to tame inflation

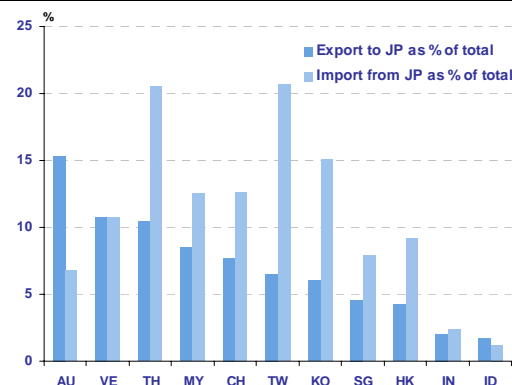
India hiked interest rates yesterday for the eighth time since last March, after data showed a higher-than-expected February outturn of 8.3% y/y (see Highlights). In China, new loan and M2 growth slowed, helping to reassure investors that the government's tightening measures may be working to avert overheating. Meanwhile, a UN Security Council resolution to impose a no-fly zone over Libya has created new pressures in international oil markets.

In the coming week...

Singapore's February inflation will be released (see What to Watch), Hong Kong, Japan, Malaysia and Vietnam. Trade data will be released in Hong Kong, Japan, Taiwan and the Philippines. The Philippines will hold its monthly monetary policy meeting, and we expect no change in interest rates (see Calendar).

Chart1

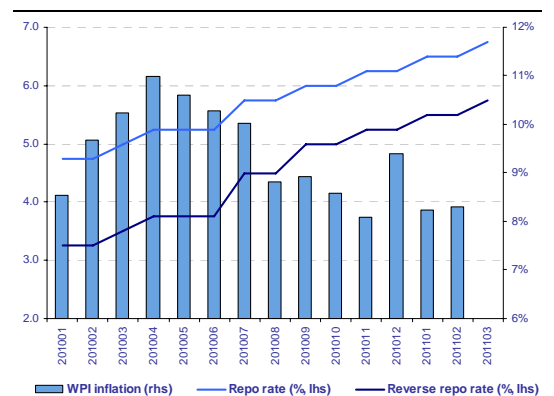
Asian countries' trade exposure to Japan is limited, although supply disruptions could impact some Asian exporters



Source: BBVA Research and Bloomberg

Chart2

In India, the RBI has hiked policy rates for an eighth time to tame inflation



Source: BBVA Research and Bloomberg

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Highlights

Assessing the economic impact of the Japan Earthquake

Though devastating in loss of life and damage, the economic fallout should be limited

India hikes rates again in its battle against inflation

India's central bank is responding to high inflation

A welcome slowing of China's credit and money supply growth in February

Loan and money supply growth slowed, a sign that tightening measures are working

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Japan's earthquake and nuclear fears rattle Asian markets

Asian financial markets have been volatile over the past week following the natural disaster in Japan and ensuing fears of a nuclear emergency. While the economic impact is expected to be contained (see Highlights), uncertainties about the impact of a further intensification of nuclear leaks and disruptions to power supplies continue to loom over the markets. Calm has largely prevailed in currency markets, except for the AUD (depreciation) and JPY (appreciation), while stock markets are down after a volatile week (Charts 3 & 4). The sell-offs may reflect an over-reaction, and we would not be surprised to see a correction to the upside in coming days.

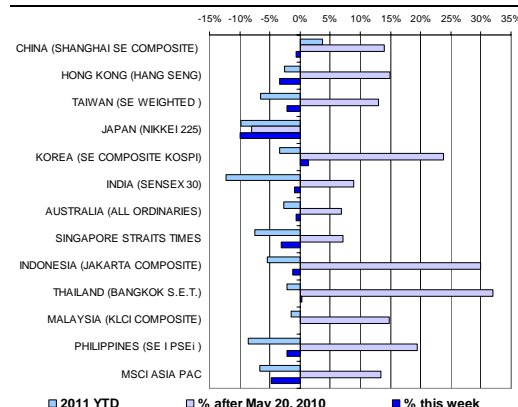
Attention on Japan has temporarily distracted markets from their focus on Middle East tensions. Oil prices fell below \$100 per barrel early this week on an expected temporary decline in demand from Japan; however, prices reversed course today to \$103 per barrel as the situation in the Middle East continues to worsen. In Libya, the UN Security Council has approved military intervention to create a no-fly zone.

The earthquake has led to strong appreciation pressures on the JPY, due in part to repatriation flows. The JPY was volatile over the past week, briefly surging past the physiologically important level of 80 yen per USD and hitting a record high. In addition to liquidity injections by the Bank of Japan, this prompted coordinated G7 action, with central banks vowing to intervene to prevent excessive yen volatility. The yen retreated back above 80 per USD on the news. In contrast, a few other Asian currencies lost ground during the week on risk aversion and uncertainty from Japan radiation risks. The AUD and MYR posted losses of 1-2% against the USD. The PHP also touched its weakest level in the past few weeks. In contrast, the THB, TWD, and INR strengthened slightly against the US dollar.

The CNY remained relatively stable for the week, gaining 0.05% against the USD. Japan's crisis is expected to have only a moderate impact on China.

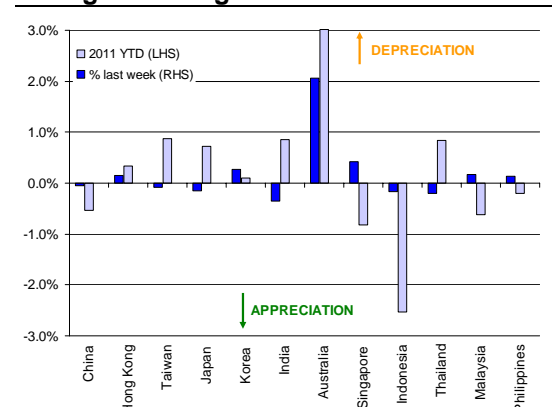
Global stock markets for the week slid on nuclear risks. Asian stocks tumbled, as the MSCI Asia index was down by 4.78%. Japan's Nikkei index fell by more than 10% (and was down by over 18% at one point early in the week). However, late in the week the markets pared losses. Korea's Kospi index was up by 1%, the only gainer in the region, as Korean companies could gain a competitive advantage from an appreciating Yen.

Chart 3
Stock markets



Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets



Source: BBVA Research and Bloomberg

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Highlights

Assessing the economic impact of the Japan earthquake

Japan is coping with the aftermath of the magnitude 9.0 earthquake on March 11 in the northeast, which was followed by a destructive tsunami. The destruction to life and property has been massive, with death toll now surpassing five thousand, and the direct loss of infrastructure accounting for 3% of GDP. The hardest-hit region accounts for around 7% of Japan's national GDP, and is an agricultural base and auto making center. Though estimates are still highly uncertain, we expect the overall economic impact, however, to be modest. GDP growth in 2011 is likely to be 0.2 ppt lower than our baseline of 1.5%. However, reconstruction spending is likely to lift GDP growth by 0.3 ppt in 2012 (Chart 5). In the meantime, inflation will be pushed up temporarily as supply is reduced. On the fiscal front, the extra budget spending for relief work will worsen Japan's fiscal position. The government will have to postpone fiscal consolidation plans, which had previously been given a priority due to Japan's high public debt ratio (around 200% of GDP on a gross basis). A key source of uncertainty is the risk of a nuclear disaster, which has increased fears and generated volatility in financial markets (the Japanese stock market is down by 11% so far). The yen briefly surged to almost 76 yen per USD on Thursday as the repatriation of capital after quake adds appreciation pressure; however, the appreciation should be temporary as the government, reluctant to see a stronger yen, is taking coordinated action with other G7 central banks to stabilize it. The economic impact on other Asian economies (Chart 1) at this stage is expected to be limited. Some countries may see an increase in exports to Japan as the reconstruction gets underway, to meet Japan's energy needs in the event of a prolonged closure of nuclear facilities, or to fill a temporary void in international markets. On the other hand, a negative impact could emerge through disruptions to supply chains and/or investment flows from Japan. The sharp selloff in regional stock markets is a reminder of the uncertainties, and the economic impact will need to be monitored.

India hikes rates again in its ongoing battle with inflation

India was among the first Asian economies to experience inflationary pressures last year. During the course of 2010, inflation peaked at 11% and remained stubbornly high due to rising food prices and demand pressures from rapid economic growth. More recently, inflation had been easing as the central bank took aggressive measures, including rate hikes and steps to rein in liquidity (Chart 2). Nevertheless, inflation rose to 8.3% y/y in February from 8.2% in January, in line with our forecast, but above the market consensus (BBVA: 8.3%; consensus: 7.8%). Price increases of manufactured goods, bolstered by strong domestic demand, have offset an easing in food prices after the winter harvest season. The RBI hiked its policy rates for an eighth time on March 17, by 25 bps (Repo: to 6.75% from 6.50%; Reverse Repo: 5.75% from 5.50%). We expect India's inflation to stay above the government's 5-6% comfort zone in the coming months, and to decline gradually to 6% at the end of this year. We expect the RBI to raise policy rates by at least another 25 bps during the year.

A welcome slowing of China's credit and money supply growth in February

Data released earlier this week show that new loans for February were lower than expected, at RMB 536 billion (consensus: RMB 600 billion), equivalent to a 17.7% y/y pace of credit growth. M2 growth also slowed, to 15.7% y/y (consensus: 17.0%) from 17.2% y/y in January (Chart 6). These indicators are welcome given the authorities' efforts to restrain credit growth and avert overheating. Although the data are difficult to interpret given seasonality from the Chinese New Year, they are nevertheless encouraging: combining January and February together, new loans amounted to RMB 1.6 trillion, well below the equivalent outturn of RMB 2.1 trillion in 2010. The outturn is also in line with our forecast of new loans for 2011 of RMB 7.0-7.5 trillion (in contrast to previous years, the authorities have not set an official loan target for 2011). That said, inflationary pressures and growth momentum remain strong, and we expect the authorities to sustain their monetary tightening campaign. Indeed, the authorities have recently reiterated their intention to ensure positive real rates, which are currently negative given high inflation. We expect two more 25bp interest rate hikes by Q3, and at least another 50bp hikes in reserve requirements.

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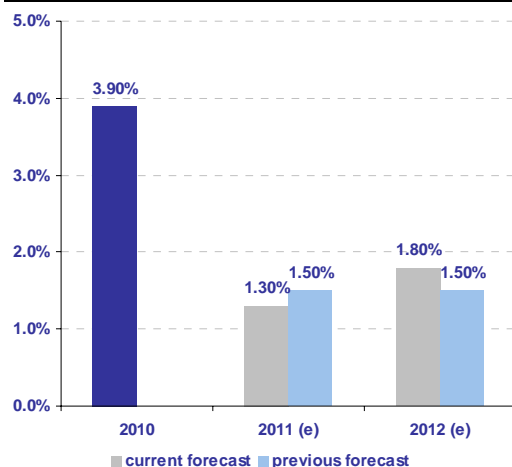
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Chart 5

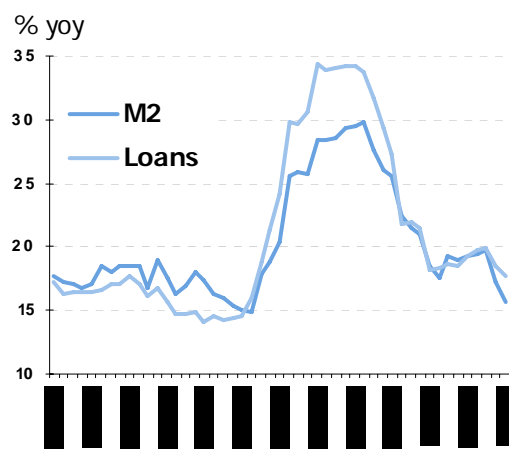
Though the loss of life and property was tragic, the economic impact of Japan's earthquake should be limited...



Source: BBVA Research and Bloomberg

Chart 6

In China, credit and money supply growth slowed in February



Source: BBVA Research and Bloomberg

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What to watch

Singapore: CPI inflation for February (March 23)

Forecast: 5.7% y/y

Consensus: 5.2% y/y

Prior: 5.5% y/y

Comment: After surprising sharply to the upside last month, inflation is expected to remain high in Singapore due to rising international oil prices, transportation costs and housing rents. Demand pressures are increasingly evident.

Market impact: A higher-than-expected inflation reading could increase expectations that the Monetary Authority of Singapore will accelerate the pace of currency appreciation at its next 6-monthly policy meeting in April.

Calendar

China	Date	Period	Prior	Cons.
HSBC Flash China Manufacturing PMI	24-Mar	MAR	--	--
MNI Business Condition Survey	25-Mar	MAR	58.21	--
Leading Index	25-28 MAR	FEB	--	--
Hong Kong	Date	Period	Prior	Cons.
Bal of Paymts - Current A/C	22-Mar	4Q	\$44.28B	--
Bal of Paymts - Overall	22-Mar	4Q	\$15.35B	--
CPI - Composite Index (YoY)	22-Mar	FEB	3.60%	--
Trade Balance	24-Mar	FEB	-16.0B	-27.9B
Exports YoY%	24-Mar	FEB	27.60%	10.30%
Imports YoY%	24-Mar	FEB	19.00%	14.90%
Japan	Date	Period	Prior	Cons.
All Industry Activity Index (MoM)	22-Mar	JAN	-0.20%	2.30%
Adjusted Merchnds Trade Bal.	24-Mar	FEB	¥191.8B	¥709.2B
Merchnds Trade Exports YoY	24-Mar	FEB	1.40%	9.10%
Merchnds Trade Imports YoY	24-Mar	FEB	12.40%	5.00%
Natl CPI YoY	25-Mar	FEB	0.00%	0.00%
Natl CPI Ex Food, Energy YoY	25-Mar	FEB	-0.60%	-0.70%
Malaysia	Date	Period	Prior	Cons.
CPI YoY	25-Mar	FEB	2.40%	2.50%
Philippines	Date	Period	Prior	Cons.
Budget Deficit/Surplus	21-25 MAR	FEB	13.4B	--
Trade Balance	25-Mar	JAN	-\$729M	--
Total Monthly Imports	25-Mar	JAN	\$4930.1M	--
Total Imports (YoY)	25-Mar	JAN	25.20%	--
Singapore	Date	Period	Prior	Cons.
CPI (YoY)	23-Mar	FEB	5.50%	5.20%
Industrial Production MoM SA	25-Mar	FEB	15.40%	2.50%
Korea	Date	Period	Prior	Cons.
SK Consumer Confidence	25-Mar	MAR	105	--
Taiwan	Date	Period	Prior	Cons.
Export Orders (YoY)	21-Mar	FEB	13.47%	11.70%
Unemployment Rate - sa	22-Mar	FEB	4.71%	4.70%
Commercial Sales (YoY)	23-Mar	FEB	13.11%	11.50%
Industrial Production (YoY)	23-Mar	FEB	17.19%	15.60%
Money Supply M2 Daily Avg YoY	25-Mar	FEB	5.59%	--
Vietnam	Date	Period	Prior	Cons.
CPI (YoY)	24-28 MAR	MAR	12.30%	--

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Philippines – Overnight Borrowing Rate, March 24

We expect no change in policy rates

Current	Expected
4.00	4.00

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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.	2913.6	-0.7	3.8	-4.3
	Hong Kong – Hang Seng	22451.3	-3.4	-2.5	5.3
	Taiwan – Weighted	8386.2	-2.1	-6.5	6.3
	Japan – Nikkei 225	9231.3	-10.0	-9.8	-14.1
	Korea – Kospi	1981.1	1.3	-3.4	18.3
	India – Sensex 30	17997.8	-1.0	-12.2	2.7
	Australia – SPX/ASX 200	4614.5	-0.7	-2.8	-5.1
	Singapore – Strait Times	2950.1	-3.1	-7.5	1.2
	Indonesia – Jakarta Comp	3499.9	-1.2	-5.5	27.9
	Thailand – SET	1010.2	0.3	-2.2	33.1
	Malaysia – KLCI	1496.7	0.1	-1.5	15.0
	Philippines – Manila Comp.	3839.9	-2.2	-8.6	23.8

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	0.05	6.54	6.45
	Hong Kong (HKD/USD)	7.80	-0.16	7.8	8
	Taiwan (TWD/USD)	29.6	0.09	29.30	28.71
	Japan (JPY/USD)	81.7	0.16	81.7	81.3
	Korea (KRW/USD)	1127	-0.27	1133.60	1148.10
	India (INR/USD)	45.1	0.35	45.9	48
	Australia (USD/AUD)	0.99	-2.02	1	n.a.
	Singapore (SGD/USD)	1.27	-0.42	1.27	1.3
	Indonesia (IDR/USD)	8768	0.16	8843	9241
	Thailand (THB/USD)	30.3	0.20	30.39	30.7
	Malaysia (MYR/USD)	3.04	-0.17	3.1	3
	Philippines (PHP/USD)	43.7	-0.14	43.81	44.10

Last update: Friday, 11.15 Hong Kong time.

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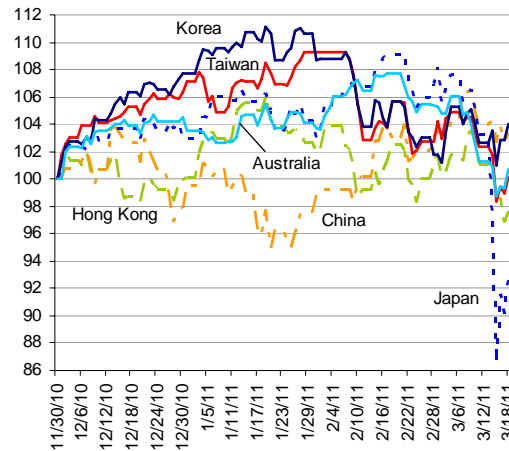
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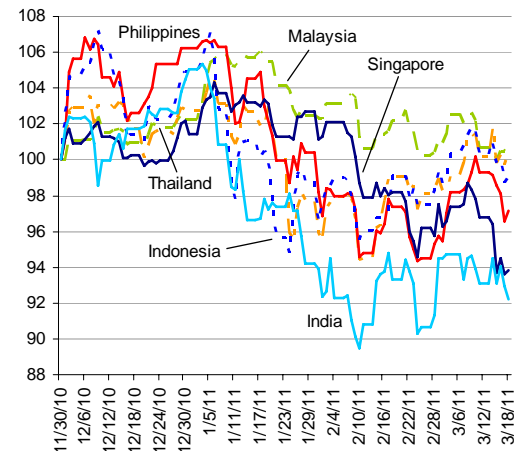
STOCK MARKETS



Source: BBVA Research and Bloomberg

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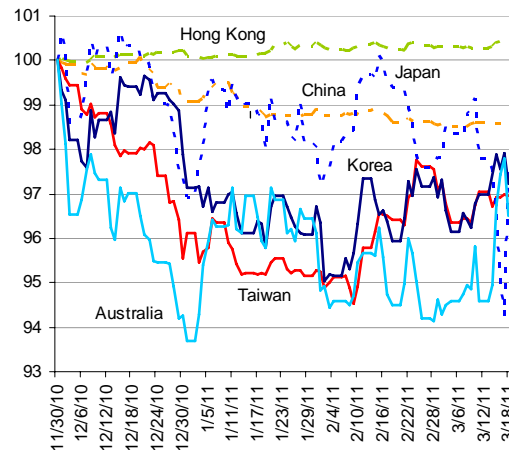
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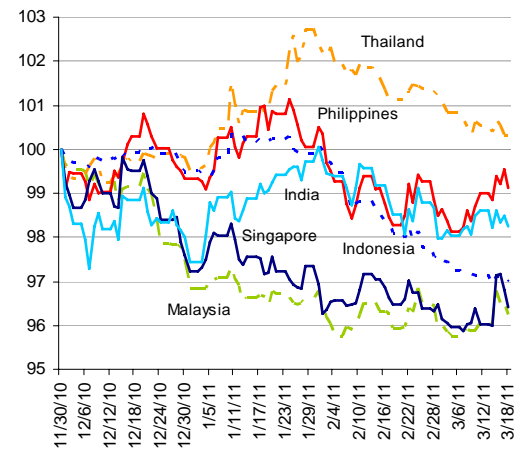
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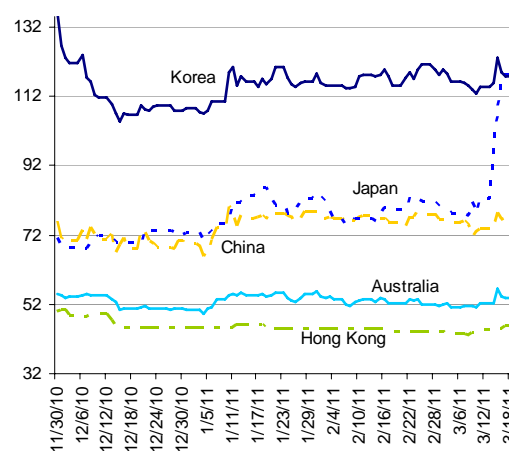
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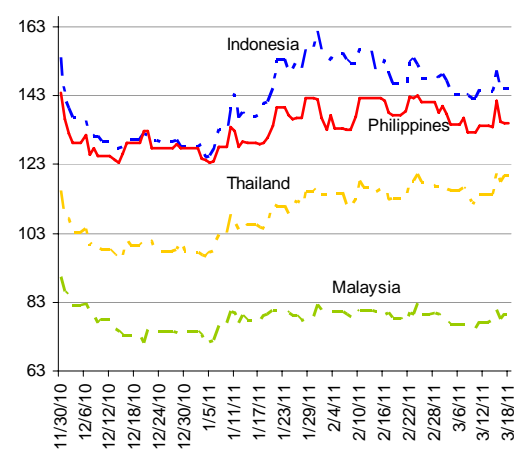
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CREDIT DEFAULT SWAPS



Source: BBVA Research and Bloomberg

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