

Asia

Weekly Watch

Hong Kong, March 25, 2011

Economic Analysis

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Asia's monetary tightening

Monetary tightening to tame inflation continues, even with uncertainties as the damage from Japan's earthquake is still being tallied. In the past week, China hiked the required reserve ratio yet again (see Highlights), while the Philippines joined the rest of Asia by hiking interest rates for the first time since 2008. Meanwhile, Japan's nuclear crisis appears to be easing and Asian stocks reacted positively this week (see Highlights).

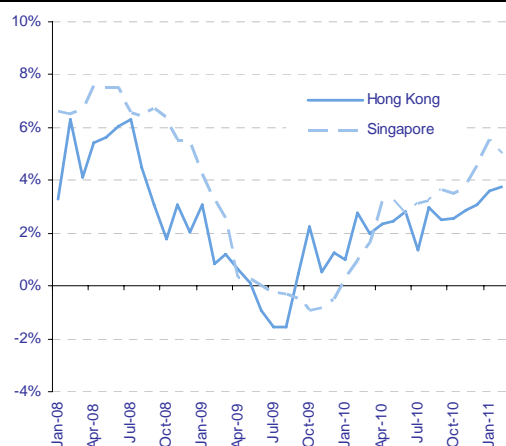
Inflation edges higher

Hong Kong's headline continued to pick up, posting an increase of 3.7% y/y for February, slightly above market expectations (consensus: 3.6%) on rising food and housing costs. Meanwhile, inflation in Singapore remained high at 5.0% y/y for the month, albeit lower than expected (consensus: 5.4%), owing to higher costs of transport, housing and food. In Japan, headline inflation for February came in line with expectations at 0.0% y/y, unchanged from January. Going forward, food and energy prices are expected to increase in Japan following disruptions from the earthquake. In Vietnam, inflation continued to accelerate, reaching 13.9% y/y in March. The region's export picture was mixed, with Hong Kong's exports for February surging by 24.9% y/y in (Consensus: 10.3% y/y), while export orders in Taiwan disappointed (5.3% y/y; consensus: 13.7%).

In the coming week...

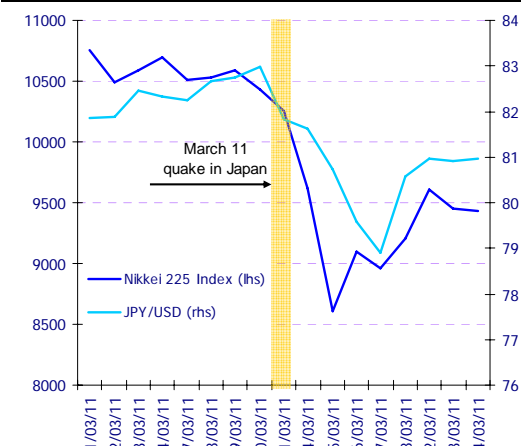
China's PMI will be the main focus (see What to Watch). March inflation figures and trade data will be released in Korea, Indonesia, Thailand and Vietnam. Taiwan will hold its monthly monetary policy meeting, and we expect a hike of 12.5bps in the interest rates (see Calendar).

Chart1
Inflation is on the rise in Singapore and Hong Kong



Source: BBVA Research and Bloomberg

Chart2
Japan's stock market recovers and yen strength recedes



Source: BBVA Research and Bloomberg

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Highlights

China hikes the RRR yet again to withdraw liquidity

The third hike in the RRR so far this year marks an aggressive tightening campaign

Korea's robust economic outlook

Robust prospects from strong demand and proactive government policies

Assessing the damage from Japan's earthquake

Nuclear risks are easing, and the economic impact should be temporary

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Japan's Nuclear Crisis Eases, but Risk Appetite Still Low

Painstaking efforts to cool the reactors at Fukushima nuclear complex finally bear fruits, with temperatures at all six fuel storage pools falling. Although radiation levels in Tokyo's drinking water was reported to be unfit for infants, the amounts were still very low and did not constitute immediate health risks. With the worst of Japan's crisis seemingly behind us, Asian equities rallied, with currencies modestly stronger against the USD.

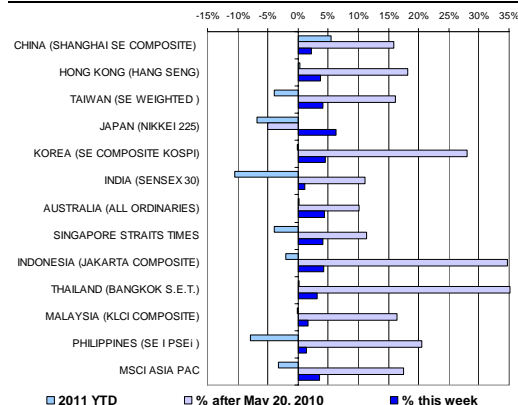
But risk appetite in the region remained low. For one thing, the market is still bracing for weaker macro data out of Japan and other Asian countries in the next few months. The negative impacts of the disaster will probably concentrate in March/April when production in Japan is halted. Roads and factories were damaged, and electricity supplies have not returned to normal yet. Production in other Asian countries could also be disturbed through lower demand and disruption of component supplies from Japan. The obvious examples are electronics and automobile parts. Data shows that Thailand, Korea, Taiwan and Australia are relatively more exposed, which could take off some of the appreciation pressure on their currencies.

In addition, geopolitical risks remained elevated, with Brent oil futures above USD115/ bbl for most of the week. In our view, the key to the oil outlook lies in whether contagion to other oil producing countries could be contained. If this is the case, as in our base-case, oil prices will likely level off in 2H2011 and will not derail Asia from existing growth trajectory. The major challenge to Asia would be risks of higher inflation rather than lower growth. IDR, SGD and MYR will likely outperform in this scenario given they are either oil producers or willing to use exchange rate as anti-inflationary tools (chart 4).

Within the region, Singapore's CPI for February, though lower-than-anticipated, was still high. We believe high inflation will prompt the monetary authority to tighten further. Meanwhile, the negative impacts of oil prices on Asia's balance of payments should also start to manifest in March trade data, as exhibited by a surprising trade deficit for the first 20-days in Korea. In sum, higher oil import bills and disruption from Japan's earthquakes will limit Asian FX appreciation in the near term, in our view.

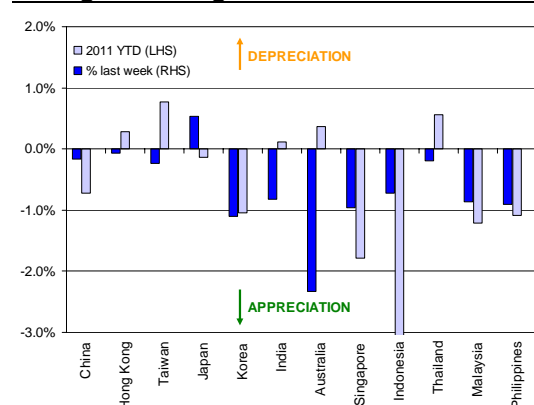
Stock markets reacted positively to the reassuring news coming from Japan at the beginning of the week and all of them surged in the last 5 days. The Nikkei saw the highest increase, posting a 6.5% gain. The rest of the markets followed suit, most of them with more than 2% rises (chart 3).

Chart 3
Stock markets



Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets



Source: BBVA Research and Bloomberg

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Highlights

China hikes the RRR yet again to withdraw liquidity

China's central bank announced another 50 bps hike in the required reserve ratio (RRR) on March 18. This marks the third hike in 2011, on top of six hikes in 2010, and is the latest move by the PBOC to tighten liquidity and contain rising inflationary pressures. It is expected to drain around RMB 360 billion from the banking system, on top of complementary open market operations expected to drain an additional RMB 103 billion. The RRR for large banks now stands at a record 20% while that for small banks stands at 18%. The move comes amidst evidence of strong capital inflows (Jan-Feb FDI inflows were up by 27.0% y/y increase), suggesting that the capital inflow regain its strong momentum and, as a result, add extra liquidity into the banking system despite a recent narrowing of the trade surplus. The latest hike means that monetary policy has been tightened more aggressively than previously expected, in response to rising inflationary pressures. Nevertheless, the growth outlook appears intact, with the tightening measures coming on top of stronger than expected momentum. We now anticipate additional RRR hikes amounting to 100-200 bps this year. On interest rate hikes, we still maintain previous projection of two more 25 bps hikes by end-year.

Korea's robust economic outlook

Strong domestic and external demand have resulted in a robust economic outlook in Korea (see our latest [Korea Economic Watch](#)). Economic growth is expected to moderate to a still strong 4½%-5.0% this year after a sharp rebound of 6.1% growth in 2010, on improving global demand and further gains in private consumption and investment. Inflation has become the major policy challenge, as pressures accelerate on both the supply and demand side. Headline inflation for the first two months of this year has exceeded the government's 2-4% target, rising to 4.5% y/y in February. In response, the policy focus has shifted to price stability, with an array of administrative measures on the supply side and a fourth interest rate hike this March, to 3.0%. Further interest rate hikes are expected, but at a gradual pace, given the authorities' concerns over impact on household balance sheets. Beyond inflation, the main risks stem from rising international oil prices and weaker external demand. We believe the economic fallout from the Japan earthquake in Korea will be limited. There is a risk of disturbances in the supply chain, as Korean exporters rely on imported components from Japan. At the same time, positive offsets could occur from gains in market share for those exporters in competing industries with Japan. In the financial sector, banks are well-capitalized and most soundness indicators are stable or on an improving trend. Proactive measures by the authorities are reducing vulnerabilities stemming from household indebtedness and reliance on wholesale funding.

Assessing the damage from Japan's earthquake

Nuclear fears are easing as workers make progress in cooling the damaged reactors. The death toll and number of missing people now exceed 25 thousand. Official estimates of property damage, excluding the loss from power outages and nuclear radiation, has been raised to 16-25 trillion yen (\$198-309 billion), equivalent to 3-5% of GDP. Radiation contamination remains a concern, endangering the health of local residents and undermining food exports. The impact on Japan's growth has been estimated to be moderate (see last Asia Weekly); however, the economic outlook is at risk due to the fragile state of the economy, which was already challenged by sluggish domestic demand, high public debt, and persistent deflation. The weak fiscal position, exacerbated by extra budgetary spending for relief work after quake, continues to pose a risk to Japan's long term growth. On the other hand, spillovers to regional economies are expected to be modest. A disruption of supply chains is the main concern for exporters who rely on imported components from Japan. Growth in 2011 of Asian countries is expected to be dragged down by less than 10-20 bps. While nuclear concerns still weigh on economic prospects and financial markets, the intense level of uncertainty is beginning to diminish.

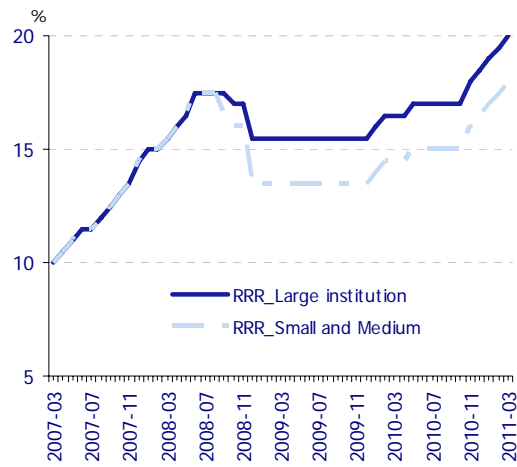
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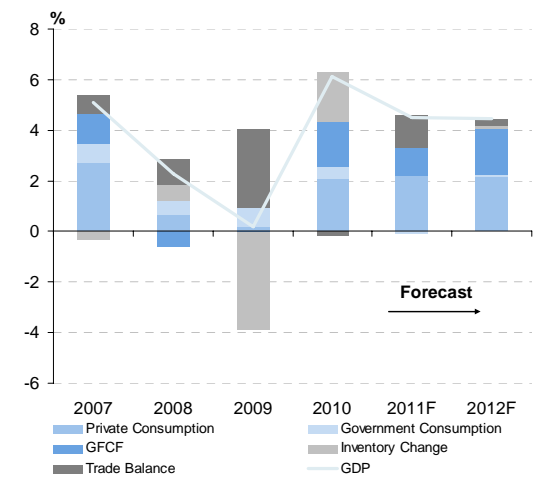
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Chart 5
China hikes the RRR for a third time this year



Source: BBVA Research and Bloomberg

Chart 6
Korea's GDP growth stays strong



Source: BBVA Research and Bloomberg

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What to watch

China: PMI for March (April 1)

Forecast: 55.5

Consensus: 54.5

Prior: 52.2

Comment: The Purchasing Managers' Index (PMI) is expected to increase from February's moderating outturn, which was partly the result of seasonality from the Chinese New Year. Economic momentum remains strong despite the monetary tightening measures implemented in first quarter. Market impact: A higher-than-expected reading might fuel expectations of further tightening measures.

Calendar

	Date	Period	Prior	Cons.
Australia				
Building Approvals (MoM)	31-Mar	FEB	-15.90%	--
China				
PMI Manufacturing	1-Apr	MAR	52.2	54.3
HSBC Manufacturing PMI	1-Apr	MAR	51.7	52.4
Hong Kong				
Money Supply M2 - in HK\$ (YoY)	31-Mar	FEB	9.80%	--
Govt Mthly Budget Surp/Def HK\$	31-Mar	FEB	34.8B	--
Indonesia				
Total Trade Balance	1-Apr	FEB	\$1906M	\$1650M
Inflation (YoY)	1-Apr	MAR	6.84%	7.01%
Exports (YoY)	1-Apr	FEB	24.70%	27.30%
Total Imports (YoY)	1-Apr	FEB	32.20%	33.90%
India				
Current Account Balance	31-Mar	4Q	--	--
Exports YoY%	1-Apr	FEB	32.40%	--
Imports YoY%	1-Apr	FEB	13.10%	--
Japan				
Jobless Rate	29-Mar	FEB	4.90%	4.90%
Small Business Confidence	29-Mar	MAR	46.6	--
Nomura/JMMA Manufacturing PMI	30-31 MAR	MAR	52.9	--
Tankan Lge Manufacturers Index	1-Apr	1Q	5	6
Vehicle Sales (YoY)	1-Apr	MAR	-14.00%	--
Singapore				
Bank Loans & Advances (YoY)	31-Mar	FEB	16.10%	--
M2 Money Supply (YoY)	31-Mar	FEB	8.50%	--
Korea				
Current Account in US\$ Million	29-Mar	FEB	\$229.0M	--
GDP at Constant Price (YoY)	30-Mar	4Q F	4.80%	--
Industrial Production (YoY)	31-Mar	FEB	13.70%	--
Consumer Price Index (YoY)	1-Apr	MAR	4.50%	--
HSBC Manufacturing PMI	1-Apr	MAR	53.4	--
Ext Trade - Export (YoY)	1-Apr	MAR	17.90%	--
Ext Trade - Imports (YoY)	1-Apr	MAR	16.30%	--
Ext Trade - Balance in US\$ Mln	1-Apr	MAR	2846	--
Taiwan				
HSBC Taiwan Manufacturing PMI	1-Apr	MAR	55.8	--
Thailand				
Current Account Balance (USD)	31-Mar	FEB	\$1090M	--
Total Exports YOY%	31-Mar	FEB	21.40%	--
Total Imports YOY%	31-Mar	FEB	31.20%	--
Total Trade Balance	31-Mar	FEB	-\$588M	--
Consumer Price Index (YoY)	1-Apr	MAR	2.87%	--
Vietnam				
Exports YTD (YoY)	28-30 MAR	MAR	40.30%	--
GDP Constant Prices YTD (YoY)	28-31 MAR	1Q	6.80%	--
Imports YTD (YoY)	28-30 MAR	MAR	26.80%	--

Taiwan – Benchmark Interest Rate, March 31

We expect a hike of 12.5bps in the interest rates

Current	Expected
1.63%	1.75%

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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.	2962.5	1.9	5.5	-1.9
	Hong Kong – Hang Seng	23108.9	3.6	0.3	11.2
	Taiwan – Weighted	8621.5	2.7	-3.9	10.0
	Japan – Nikkei 225	9529.1	3.5	-6.8	-12.0
	Korea – Kospi	2049.9	3.5	-0.1	21.4
	India – Sensex 30	18350.7	2.6	-10.5	4.5
	Australia – SPX/ASX 200	4755.2	2.8	0.2	-2.7
	Singapore – Strait Times	3065.4	4.4	-3.9	6.1
	Indonesia – Jakarta Comp	3633.0	4.0	-1.9	29.8
	Thailand – SET	1034.4	3.1	0.2	31.9
	Malaysia – KLCI	1517.8	0.9	-0.1	15.6
Philippines – Manila Comp.	3872.1	0.8	-7.8	22.1	

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)	6.56	0.16	6.53	6.44
	Hong Kong (HKD/USD)	7.79	0.06	7.8	8
	Taiwan (TWD/USD)	29.5	0.24	29.22	28.57
	Japan (JPY/USD)	81.0	-0.53	81.0	80.6
	Korea (KRW/USD)	1114	1.11	1120.60	1134.42
	India (INR/USD)	44.8	0.96	45.5	47
	Australia (USD/AUD)	1.02	2.38	1	n.a.
	Singapore (SGD/USD)	1.26	0.97	1.26	1.3
	Indonesia (IDR/USD)	8709	0.73	8768	9153
	Thailand (THB/USD)	30.2	0.20	30.32	30.7
	Malaysia (MYR/USD)	3.02	0.96	3.0	3
Philippines (PHP/USD)	43.3	0.87	43.36	43.49	

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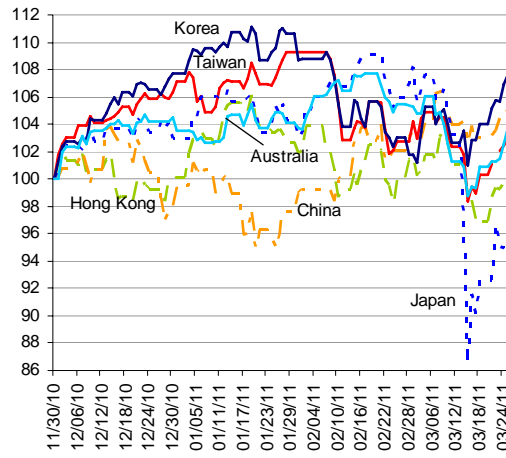
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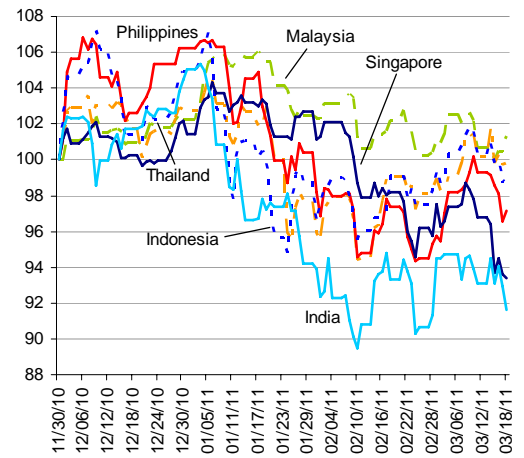
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STOCK MARKETS



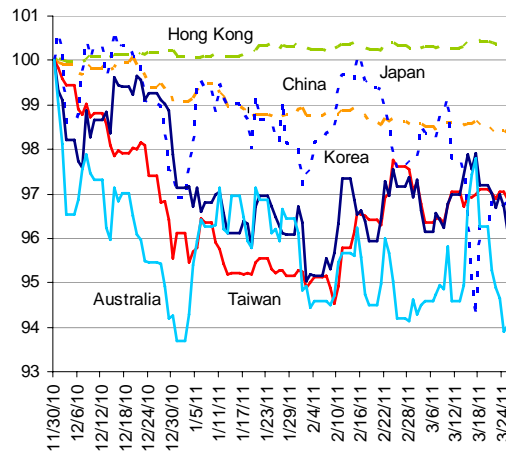
Source: BBVA Research and Bloomberg Index=100

STOCK MARKETS



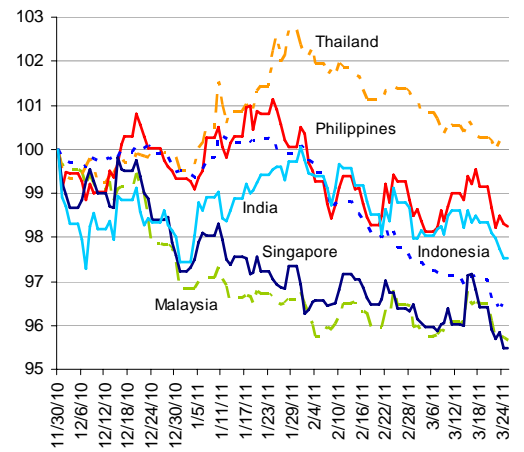
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FOREIGN EXCHANGE MARKETS



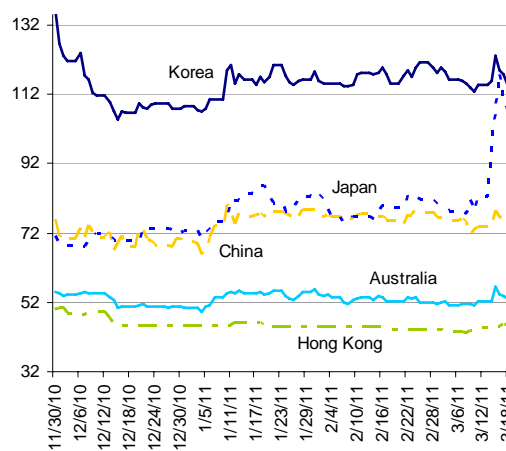
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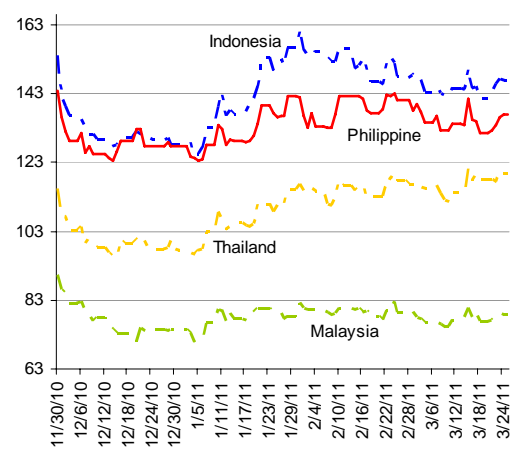
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