

Asia

Weekly Watch

Hong Kong, April 8, 2011

Economic Analysis

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Central banks in the spotlight

It was a relatively quiet week on the data release calendar, with events dominated by another rate hike in China (see Highlights), a rate hike by the ECB, and steps by the Bank of Japan (BoJ) to facilitate the post-quake recovery. Rate hikes by China and the ECB had been largely anticipated, with little impact on the region's financial markets. The BoJ kept rates unchanged, as expected, and implemented a bank lending facility to channel funds to distressed businesses in the quake-afflicted region (see Highlights); it also downgraded its economic assessment on signs that production is being hit harder than originally expected, although the impact should be short term. These developments helped to weaken the yen.

A tame set of inflation releases

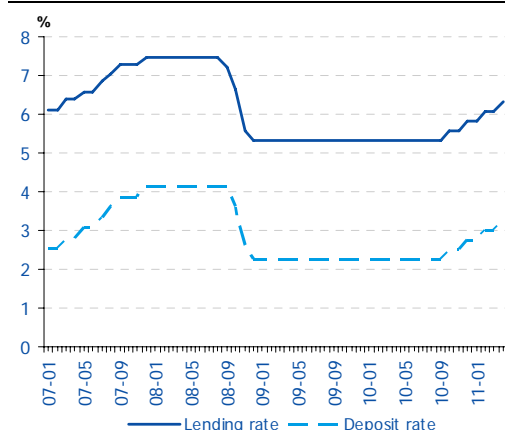
Although inflationary pressures continue to rise, the past week's releases were generally lower than expected. Headline inflation outturns in Taiwan (see Highlights) and the Philippines were modest, at 1.4% (consensus: 1.7% y/y) and 4.3% y/y (consensus: 4.6%), respectively. That said, the outlook for inflation is to the upside as commodity prices rise. Indonesia received another ratings upgrade, this time by S&P, from BB to BB+, bringing the rating in line with Fitch and Moody's to one notch below investment grade.

In the coming week...

The focus will be on China (see What to Watch), where a batch of monthly data will be released including GDP, inflation for March, credit growth, retail sales and industrial production. Preliminary first quarter GDP will be released in Singapore, along with inflation in India and trade data in Korea and Taiwan. Central banks in Indonesia and Korea will hold their monthly policy meetings on April 12. It's a close call for Korea, with inflation having risen again in March, but we expect the BOK to stay on hold until May; we also expect Indonesia to stay on hold following a modest decline in March inflation. Singapore will hold its 6-monthly policy meeting on April 14, and we expect a tightening through faster currency appreciation due to strong inflationary pressures (see Calendar).

Chart1

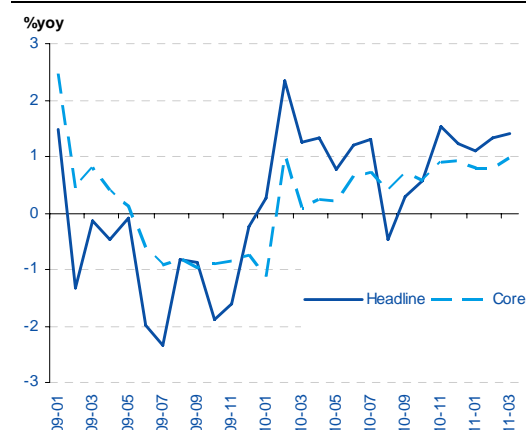
China hikes interest rates a fourth time



Source: BBVA Research and Bloomberg

Chart2

Taiwan's inflation remains modest



Source: BBVA Research and Bloomberg

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Highlights

China's monetary tightening continues with another rate hike

The timing was a surprise, but another rate hike had been anticipated

Japan implements measures to facilitate post-quake recovery

The BoJ keeps policy rates low, and implements a new lending facility

Taiwan's inflation stays low

Inflation is the lowest in the region outside of Japan

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Markets

Interest rate hikes attract fund inflows and boost appreciation

Tightening moves to tame inflation across Asia and optimism on the economic outlook have boosted currency appreciation trends in recent days. There are signs of a resumption of foreign fund inflows, prompting expectations of stepped up intervention. The inflows are occurring even as the ECB started to hike rates of its own. Concerns about higher oil prices and headwinds from the post-quake supply shock in Japan remain, but strong growth momentum puts Asia in a good position to weather them.

The Taiwan dollar, gained more than 1 percent this past week, breaking the 29 level, to 28.94 per USD, its biggest weekly advance in three months. Foreign capital inflows are bolstering the currency, after the central bank hiked the interest rate on March 31 by 12.5 bps to 1.750% and signaled more rate hikes to come (see Highlights). The Korean Won also saw appreciation pressures this past week, advancing to 1083 per USD, its strongest against the USD since October 2008. Better than expected trade data in March are part of the story, along with expectations of further rate hikes following a faster than expected inflation outturn in March (4.7% y/y).

The Thai Baht and Philippines Peso also gained, about 0.7% in the week, pushed up by portfolio inflows. Thai baht reached 30 per USD, continuing the appreciation path since this January. The peso broke through 43 per USD, its strongest since November 2010. The Indonesia Rupiah has also been among the region's strong gainers, advancing to 8664 per dollar, its strongest level in almost four years as the authorities use appreciation to help contain inflation. The Indian Rupee also advanced, to 44 per USD, its strongest in six months.

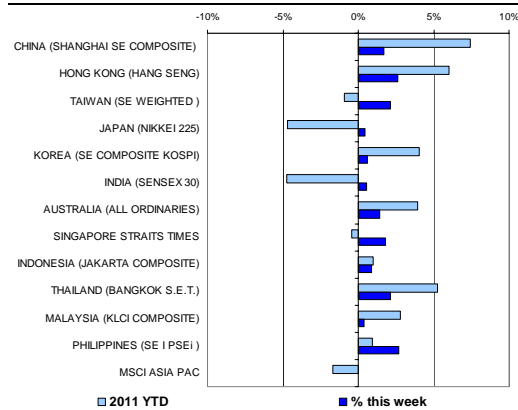
One of the more notable currency developments of the past week is a sharp fall in the value of the yen, after its surge just after the March 11 earthquake. The Japanese currency fell by 1.5% in the past week, reaching a 7 months low of 85.14 yen per USD, as the quake's fallout has dampened Japan's near-term growth outlook and as the Bank of Japan signals a lax monetary stance, amidst tightening by the ECB and expectations of earlier tightening by the Fed. The Australian dollar hit its record high of 1.05 AUD per USD, as strong growth outlook for Australia is expected to widen the interest rate differentials between Australia and the US/Japan in coming months, which is encouraging carry trade. The Chinese Yuan continued its gradual advance, to a record strong 6.54 per USD.

Most Asian stock markets were higher for the week. Japan was a main driver of intra-week moves, with its market temporarily declining on Thursday after the BOJ's downgrade of its economic assessment. The strongest gains were in Taiwan (3.1%), Hong Kong (3.6%), and Thailand (3.7%), while the Nikkei was down for the week (Chart 4).

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Chart 3

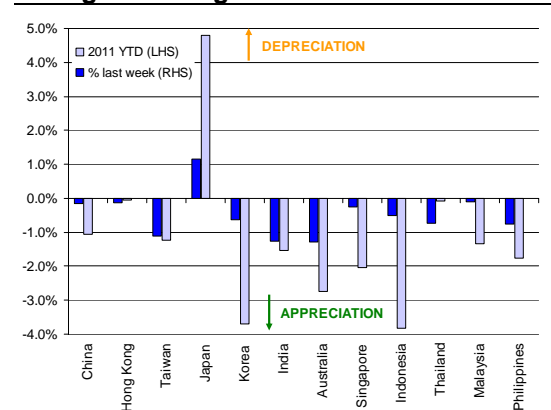
Stock markets



Source: BBVA Research and Bloomberg

Chart 4

Foreign exchange markets



Source: BBVA Research and Bloomberg

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Highlights

China's monetary tightening continues with another rate hike

China announced another 25 bp rate hike on April 5, the fourth increase since last October, on top of a series of recent hikes in the required reserve ratio (RRR). The latest hike brings the one-year benchmark lending and deposit rates to 6.31% and 3.25%, respectively. In contrast to previous hikes, which were tilted toward higher deposit rates, the current move was broadly symmetric, thereby preserving banks' net interest margins. Markets responded favorably, as another rate hike to tame inflation had been anticipated some time in the second quarter. The move comes ahead of next week's release of important Q1 and March data, including GDP, inflation, and credit growth, among others. We expect Q1 GDP to ease to 9.3% y/y from 9.8% y/y in 2010Q4 and headline inflation to rise to 5.0% y/y in March from 4.9% y/y in February. The timing of the rate hike could signal that the outturns, which are presumably known to the policymakers, could be on the high side despite recent aggressive monetary tightening. Looking ahead, we anticipate one more interest rate hike in 2011, mostly likely in Q3, along with an additional 100bp increases in the RRR.

Japan implements measures to facilitate post-quake recovery

Even as nuclear fears receded over the past week, tensions remained high, especially after a strong aftershock hit the tsunami-afflicted region of Japan on Thursday night. In the meantime, concerns about the short-term impact of the quake on production have mounted due to damage to facilities, disruptions to supply chains, and power shortages. While data is still limited, available indicators for the period since the March 11 quake point to a plunge in confidence and economic activity. We have revised down our growth forecast for 2011 somewhat further (from a pre-quake projection of 1.5% to 1.0% at present). On the policy front, the Bank of Japan in its meeting on April 6-7 downgraded its economic assessment and unveiled a one trillion yen (\$11.7 billion) scheme to channel funds to banks for lending to distressed businesses in the affected areas. It also broadened the range of eligible collateral for money market operations. In previous weeks the BOJ had injected 37 trillion yen (\$439 billion) into financial markets to ensure ample liquidity, and also doubled its asset-buying program to 10 trillion yen. It has also coordinated with other G7 countries to intervene the foreign exchange market, preventing a strengthening of yen, which has recently depreciated to 85 per dollar on expectations of continued lax monetary policy. It is expected to take further actions to help Japan's reconstruction in its next meeting on April 28. For its part, the government is formulating an extra budget of more than 4 trillion yen to clear rubble and build temporary housing, restore public facilities and infrastructure, and create jobs.

Taiwan's inflation stays low

Outside of Japan, Taiwan continues to record the region's lowest inflation rates. March headline inflation inched up to just 1.4% y/y, following the 1.3% y/y outturn in February, and below the consensus forecast of 1.7% y/y (in seasonally adjusted terms, inflation rose by 0.14% m/m, decelerating from 0.38% m/m in previous month). The low inflation outturn comes amidst rising inflation elsewhere due to increases in food and energy and demand pressures, and even in the context of Taiwan's rapid economic growth (10.8% in 2010). The low level of inflation in Taiwan reflects a combination of factors in our view: (i) a low pace of food price inflation, due to ample domestic supplies and high productivity in the agricultural sector; (ii) persistent downward wage pressures as manufacturing firms continue to shift production to Mainland China; and (iii) well-anchored inflation expectations owing to the central bank's credibility. Nonetheless, we still expect headline inflation to rise slightly during the course of the year on higher commodity prices (inflation at the wholesale level is already 5.5% y/y). Recognizing the risks of rising inflation and property prices, the central bank raised its benchmark interest rate by 12.5 bp to 1.75%, the fourth consecutive hike since last year. The latest rate hike is a signal of the authorities' confidence in the strength of the economy's growth momentum, despite headwinds from rising oil prices and risks of disruptions to supply chains from Japan, to which Taiwan is especially vulnerable, following the earthquake.

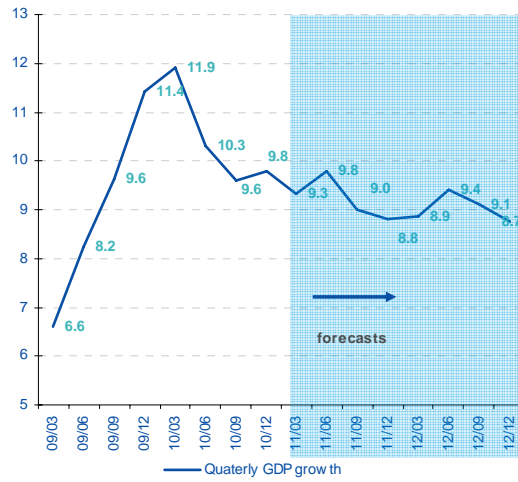
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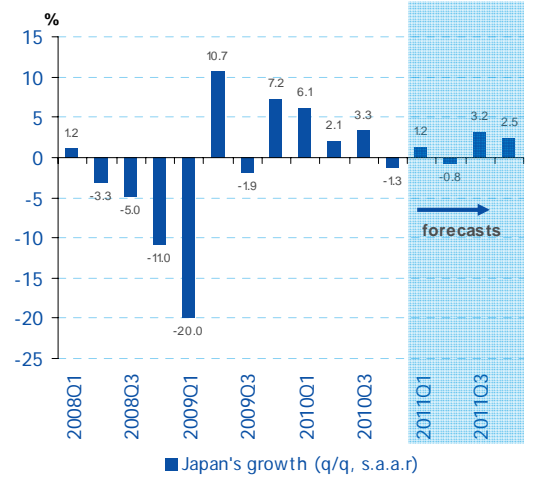
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Chart 5
China's GDP growth is expected to moderate in Q1



Source: BBVA Research and Bloomberg

Chart 6
Japan's economy is set to recover in the second half of 2011



Source: BBVA Research and Bloomberg

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What to watch

China: Real GDP Growth for 2011Q1 (April 15)

Forecast: 9.3% y/y Consensus: 9.3% y/y Prior: 9.8% y/y

Comment: First quarter GDP will be watched for signs of a soft-landing following last year's rapid growth (10.3% for the full year). The GDP data will be released alongside a monthly batch of other indicators, including inflation and credit growth. We expect Q1 GDP to moderate to 9.3% y/y, consistent with a slowing trend in retail sales and credit growth for January/February, and the authorities' recent monetary tightening measures, including another interest rate hike this past Wednesday. **Market impact:** A stronger-than-expected reading could reignite concerns of more aggressive tightening measures, with adverse consequences for financial markets.

Calendar

China	Date	Period	Prior	Cons.
New Yuan Loans	11-15 APR	MAR	535.6B	600.0B
Money Supply - M2 (YoY)	11-15 APR	MAR	0.157	0.154
Real GDP YoY	15-Apr	1Q	9.80%	9.40%
Consumer Price Index (YoY)	15-Apr	MAR	4.90%	0.052
Producer Price Index (YoY)	15-Apr	MAR	7.20%	0.072
Industrial Production (YoY)	15-Apr	MAR	14.90%	14.00%
Retail Sales (YoY)	15-Apr	MAR	0.116	0.165
Fixed Assets Inv Excl. Rural YTD YoY	15-Apr	MAR	0.249	0.248
Indonesia	Date	Period	Prior	Cons.
Money Supply - M2 (YoY)	08-14 APR	FEB	0.174	--
India	Date	Period	Prior	Cons.
Industrial Production YoY	11-Apr	FEB	0.037	0.05
Monthly Wholesale Prices YoY%	15-Apr	MAR	8.31%	0.084
Japan	Date	Period	Prior	Cons.
Machine Orders (MoM)	11-Apr	FEB	0.042	-0.011
Japan Money Stock M2 YoY	12-Apr	MAR	0.024	2.50%
Bank Lending Banks Adjust YoY	12-Apr	MAR	-0.017	--
Domestic CGPI (MoM)	13-Apr	MAR	0.20%	0.003
Malaysia	Date	Period	Prior	Cons.
Industrial Production YoY	11-Apr	FEB	1.00%	5.30%
Manufacturing Sales Value YoY%	11-Apr	FEB	0.077	--
Philippines	Date	Period	Prior	Cons.
Total Exports (YoY)	12-Apr	FEB	0.118	0.14
Overseas Remittances (YoY)	15-Apr	FEB	7.60%	--
Singapore	Date	Period	Prior	Cons.
Advance GDP Estimate (QoQ)	14-Apr	1Q	3.90%	11.70%
Retail Sales (MoM) sa	15-Apr	FEB	-0.029	0.014
Korea	Date	Period	Prior	Cons.
South Korea Money Supply M2	11-Apr	FEB	6.50%	--
Unemployment Rate (SA)	13-Apr	MAR	0.04	0.038
Export Price Index (MoM)	15-Apr	MAR	0.018	--
Import Price Index (MoM)	15-Apr	MAR	3.10%	--
Taiwan	Date	Period	Prior	Cons.
Total Trade Bal in US\$ Billion	11-Apr	MAR	\$0.92B	\$1.45B
Total Exports (YoY)	11-Apr	MAR	27.30%	13.00%
Total Imports (YoY)	11-Apr	MAR	0.287	0.138

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Indonesia – Bank Indonesia Reference Rate, April 12 **Current** **Expected**
 We expect no change in the interest rates 6.75% 6.75%

Korea – Bank of Korea Monetary Policy Meeting, April 12 **Current** **Expected**
 We expect no change in the 7-Day repo rate 3.00% 3.00%

Japan – Cabinet Office Monthly Economic Report, April 13

Singapore – Monetary Authority of Singapore half-yearly monetary review, April 14

Asia Market

STOCK MARKETS	INDEX	Last price	% change over a week	Year to date	% Change over 1 Y
	China – Shanghai Comp.	3017.3	1.7	7.5	-3.3
	Hong Kong – Hang Seng	24421.2	2.6	6.0	11.7
	Taiwan – Weighted	8893.2	2.2	-0.9	10.4
	Japan – Nikkei 225	9753.7	0.5	-4.6	-12.7
	Korea – Kospi	2133.7	0.6	4.0	23.1
	India – Sensex 30	19529.1	0.6	-4.8	10.2
	Australia – SPX/ASX 200	4930.9	1.4	3.9	-0.1
	Singapore – Strait Times	3176.5	1.8	-0.4	7.2
	Indonesia – Jakarta Comp	3740.2	0.9	1.0	31.2
Thailand – SET	1086.7	2.1	5.2	38.6	
Malaysia – KLCI	1561.0	0.4	2.8	17.1	
Philippines – Manila Comp.	4241.0	2.7	0.9	30.2	

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)	6.54	0.15	6.48	6.37
	Hong Kong (HKD/USD)	7.77	0.13	7.8	8
	Taiwan (TWD/USD)	28.9	1.12	28.60	27.83
	Japan (JPY/USD)	85.1	-1.19	85.0	84.7
	Korea (KRW/USD)	1084	0.65	1090.55	1104.92
	India (INR/USD)	44.0	1.27	44.7	47
	Australia (USD/AUD)	1.05	1.29	1	n.a.
	Singapore (SGD/USD)	1.26	0.25	1.26	1.3
	Indonesia (IDR/USD)	8651	0.52	8697	9030
Thailand (THB/USD)	30.0	0.73	30.09	30.5	
Malaysia (MYR/USD)	3.02	0.10	3.0	3	
Philippines (PHP/USD)	43.0	0.77	42.93	43.11	

Last update: Friday, 11.15 Hong Kong time.

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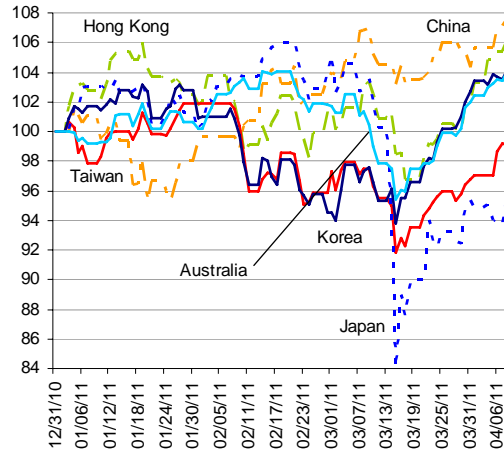
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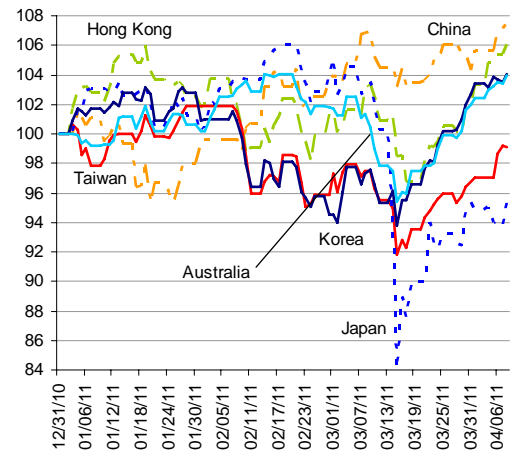
Asia Chart

STOCK MARKETS



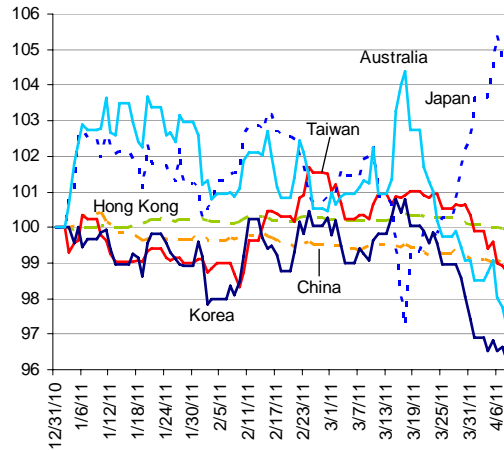
Source: BBVA Research and Bloomberg Index=100

STOCK MARKETS



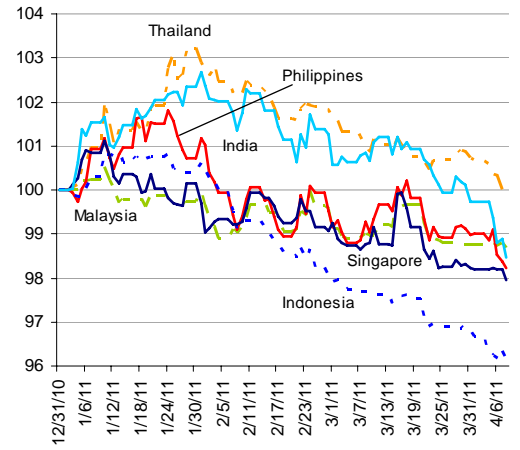
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FOREIGN EXCHANGE MARKETS



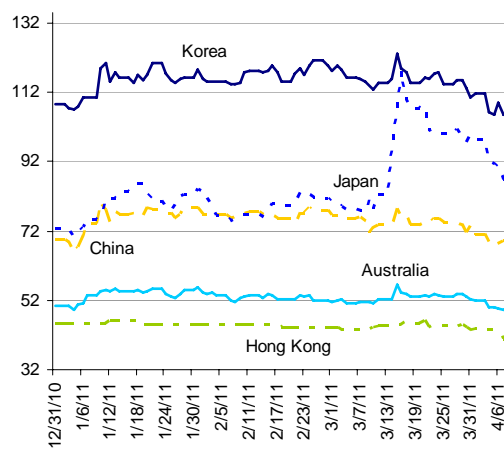
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FOREIGN EXCHANGE MARKETS



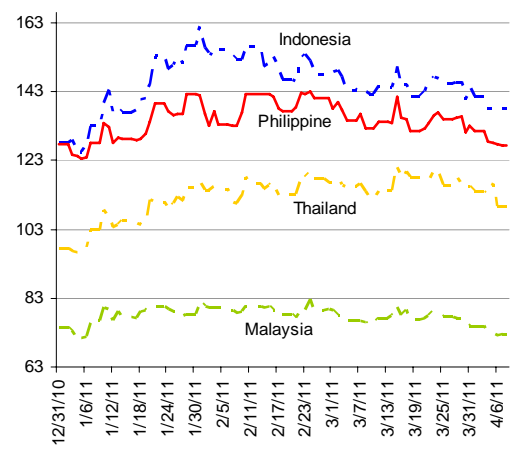
Source: BBVA Research and Bloomberg Index=100

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