

Weekly Watch

Asia

21 April 2011
Economic Analysis

Asia

Stephen Schwartz
stephen.schwartz@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 Wang
serena.wang@bbva.com.hk

Markets
Richard Li
richard.li@bbva.com.hk

Mario Nevares
mario.nevares@bbva.com.hk

Shrugging off the headwinds

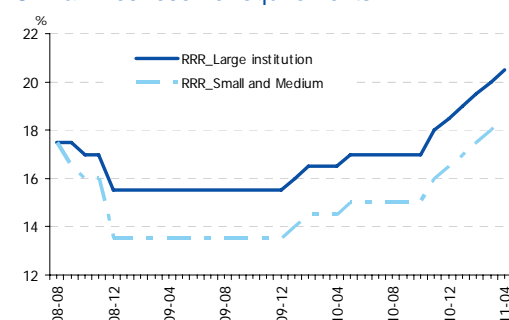
Most economic indicators continue to point to strong growth momentum, despite rising headwinds from high oil prices and ongoing concerns of supply disruptions from Japan. Together with rising inflation, strong activity indicators (below) have prompted more monetary tightening, with another hike in reserve requirements in China (Highlights and Chart 1) and another rate hike in Thailand (to 2.75%, a cumulative 150bps since the tightening cycle began last year). Further tightening and currency appreciation is expected as central banks seek to tame inflation and avert overheating risks.

Regional activity indicators remain strong in spite of Japan disruptions

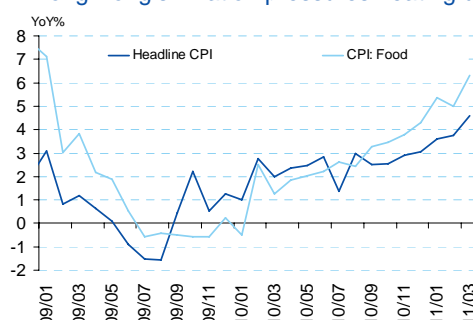
As flagged last week, new March trade data for Japan offers a first glimpse into the impact of the earthquake on economic output and supply chains. Most significantly, exports for March declined by -2.2% y/y (consensus: -1.1%), and anecdotal evidence points to ongoing disruptions to the regional auto and electronics sectors in April. Elsewhere, Hong Kong's March inflation (Chart 2) rose above expectations (4.6% y/y vs. consensus of 4.2%), while Malaysia's rose in line with expectations, to 3.0% y/y from 2.9% y/y the previous month. In Hong Kong, the unemployment rate fell to 3.4% (consensus: 3.5%) on strong economic growth, the lowest rate since 2008 (Highlights). Other upside surprises were export orders for March in Taiwan (13.4% y/y; consensus: 4.7%) and non-oil domestic exports in Singapore (10.0% y/y; consensus: 5.0%).

Charts 1 & 2

China hikes reserve requirements



Hong Kong's inflation pressures heating up



Source: Bloomberg and BBVA Research

Highlights

India continues to battle high inflation

A higher-than-expected March inflation outturn may prompt more interest rate hikes

China's property prices ease amidst new monetary tightening measures

The latest data shows a further welcome moderating trend in property price increases

Hong Kong's first-ever minimum wage to take effect on May 1

The new minimum wage should have only minor negative employment effects

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Economic Analysis

Richard Li
richard.li@bbva.com.hk

Mario Nevares
mario.nevares@bbva.com.hk

Markets

Asian equities and FX recouped initial losses in the week and ended higher compared to the previous week's close as global growth optimism returned, which finally trumped European debt concerns and S&P's warning on US debt. The down trend in markets early in the week after the S&P warning gave way to optimism on a jump in US housing starts. Among the major gainers, Korea's Kospi Composite was up by 2.2%, Thailand's SET was up 2.3% and markets in Jakarta and the Philippines rose by 1.6% and 1.7% respectively. The Shanghai Composite was the only exception, down -0.9% (Chart 3).

Growth optimism returns and lifts risk appetite

As risk aversion eased during the week, investors added risk assets including Asian FX and equities, using the USD as the funding currency. The data calendar this week was light, with no obvious triggers for this move. But stronger-than-expected Eurozone PMI and Finnish prime minister-elect's remark that his country would not block rescue plan of Portugal were probably important contributors. The USD index hit the lowest level since the financial crisis in 2008, which pushed Asian currencies to higher levels. We think recent USD weakness was not caused by the S&P cut to US credit outlook, as Treasury yields hardly rose. Rather, markets appeared to believe that global conditions would remain conducive to Asian economic expansion, generating capital inflows to Asian FX and equities.

Investors brush off China's overheating risks

Strong Q1 growth momentum and mounting price pressures underscore risks of overheating in China and the likelihood of more policy tightening ahead. We are raising our forecasts of interest rate and reserve requirement ratio hikes. However, our revised rate hike profile is still modest and further tightening should not lead to an abrupt growth slowdown.

PBoC's Governor's remarks spur expectation of faster CNY appreciation

Following the report of foreign reserves in March, PBoC's governor said that "foreign exchange reserves have exceeded (China's) rational demand, and too much accumulation has caused excessive liquidity in our markets, adding the pressure of the central bank's sterilization." Markets came to construe this as an indication of faster CNY appreciation, with 12-month USDCNY NDFs falling to 6.3485 from 6.3943 last Friday. We believe the remark merely indicates a longstanding problem that China has faced, and ways other than currency appreciation have also been endorsed to address it, such as by encouraging outflows through foreign investment. As such, we see no change to the PBoC's gradual appreciation policy.

AUD stands out as the biggest beneficiary of growth optimism

AUD hit a fresh 29-year high and broke above 1.0740 at the time of writing (Chart 4). The currency led the gains in the latest bull run of risk assets in Asia's FX as commodity prices were expected to stay high amidst sanguine global outlook. While we are broadly optimistic about AUD in the long term, expectation appears to have run ahead of fundamentals, especially given that our commodity analysts expect that oil, basic metals and soft commodities may have to consolidate to lower levels later this year. Stronger-than-expected exchange rate may have delivered a certain degree of tightening, which may mitigate the needs for interest rate hikes in the second half.

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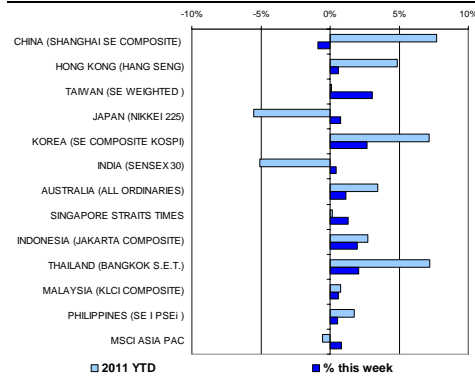
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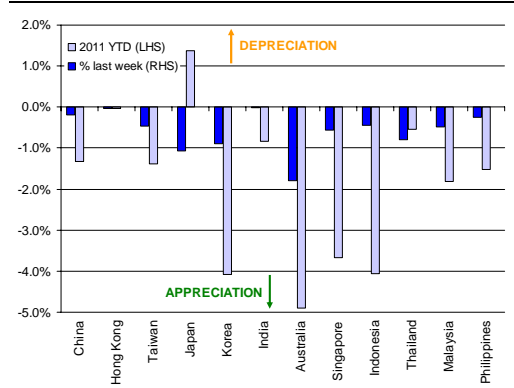
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Chart 3
Stock markets



Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets



Source: BBVA Research and Bloomberg

Economic Analysis

Highlights

India continues to battle high inflation

Policy makers in Asia's third largest economy face a stiff task ahead in battling inflation. March WPI inflation (released last Friday) came out much higher than expected at 9.0%/y/y (BBVA: 8.4%) compared to 8.3% the previous month and markedly above the central bank's expectations of 8.0% (Chart 5). The outturn comes despite eight rate hikes since March 2010, most recently in March 2011 for a cumulative 200 bps in the benchmark repo rate since the tightening cycle began. The evolution of data in recent months suggests that second round effects of food price increases (9.5%/y/y in March) have become an important factor in the persistence of inflation, with prices of non-food items increasing, and sending core inflation to a 29-month high of 7.1% y/y in March. Rising international oil prices are adding further pressure on inflation, with the fuel index component of the WPI up by 12.9% y/y in March 2011 compared to 11.5% the previous month. The ongoing rise in inflation risks undermining growth momentum, especially if it were to have an adverse impact on investment activity through higher interest rates. With Indian policymakers battling the trade-off between inflation now and growth in future, we expect bolder anti-inflation rhetoric by the central bank at its May 3rd policy meeting alongside a 25 bps increase in policy rates. With the RBI loosening out on options to rein in inflation, amidst already tight liquidity conditions, we expect a front loaded rate hike cycle with a cumulative 50 bps of rate increase between now and end-2011.

China's property prices ease amidst new monetary tightening measures

Data released this past week on March property prices showed some further welcome moderation (Chart 6). This follows the authorities' recent macro prudential and monetary tightening measures designed to slow credit growth and inflation, and prevent asset price bubbles in the property sector. Out of 70 cities in the monthly survey, 20 registered flat or declining month-on-month housing prices for new home sales (up from 14 cities in February). For sales of existing homes, 26 cities saw flat or declining prices (up from 20 in February). Nevertheless, most of the surveyed cities saw further rises in property prices in March, albeit at a slowing pace. Amid indicators of the growth momentum remaining strong—especially after higher-than-expected Q1 GDP growth and March inflation—the People's Bank of China (PBoC) announced another 50bp hike in reserve requirement ratio (RRR) last Sunday. This marks the fourth hike in the RRR this year, and is expected to drain around RMB 370 billion from the banking system. We expect further tightening measures in Q2 and Q3, consisting of an additional 150bps hikes in the RRR, and two more 25 bps hikes by end-year (this is up from our previous call of 50bps hikes in the RRR and 25bps on interest rates, respectively).

Hong Kong's first-ever minimum wage to take effect on May 1

As scheduled, Hong Kong will implement a new statutory minimum wage on May 1, set at HKD 28 per hour (equivalent to USD 3.60). Until now, Hong Kong has not had a minimum wage, reflecting a traditional laissez fair approach to economic policy. The idea of a minimum wage has been controversial, and was passed by Hong Kong's legislature last July. Some private sector groups have expressed concern about the impact of the minimum wage on labor costs and employment. According to government estimates, the wages of 11% of workers (about 314,000 employees in total) would rise by an average of 16.9%. Government estimates suggest that the unemployment rate could rise by 1.2 percentage points. Such an impact, however, is likely to be mitigated by the current strong labor market conditions—Hong Kong's unemployment rate in March fell to 3.4%, the lowest level since the 2008 global financial crisis, and well below the 6.1% average during 2002-07. In a worst case (complete pass-through of higher wage costs), the government estimates the inflationary impact of the new minimum wage could be 0.4 percentage points, which would be unwelcome given rising headline inflation in Hong Kong.

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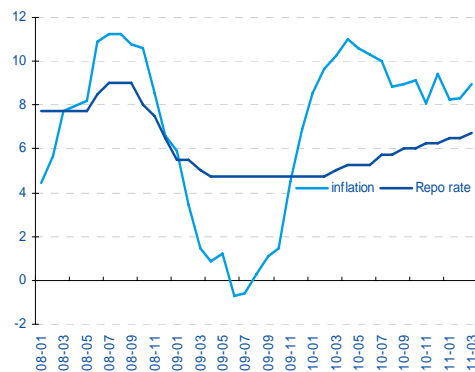
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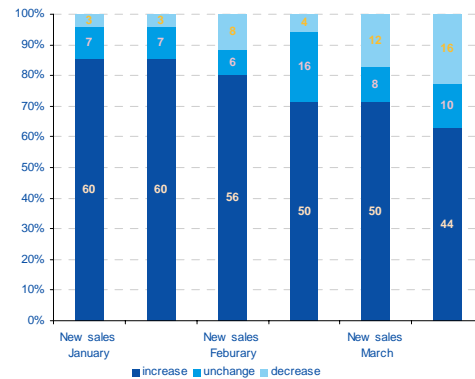
Chart →

Chart 5
Inflation stays stubbornly high in India



Source: BBVA Research and Bloomberg

Chart 6
Property prices increases in China show some welcome moderation



Source: BBVA Research and Bloomberg

Calendar Indicators

Australia	Date	Period	Prior	Cons.
Consumer Prices (YoY)	4/27/2011	1Q	2.70%	3.00%
Hong Kong	Date	Period	Prior	Cons.
Trade Balance	4/28/2011	MAR	-25.1B	-38.2B
Exports YoY%	4/28/2011	MAR	24.90%	17.50%
Imports YoY%	4/28/2011	MAR	25.20%	14.90%
Money Supply M2 - in HK\$ (YoY)	4/29/2011	MAR	8.00%	--
Japan	Date	Period	Prior	Cons.
Retail Trade YoY	4/27/2011	MAR	0.10%	--
Natl CPI YoY	4/28/2011	MAR	0.00%	--
Industrial Production YOY%	4/28/2011	MAR P	2.90%	--
Philippines	Date	Period	Prior	Cons.
Total Imports (YoY)	4/27/2011	FEB	23.90%	--
Trade Balance	4/27/2011	FEB	-\$1312M	--
Singapore	Date	Period	Prior	Cons.
CPI (YoY)	4/25/2011	MAR	5.00%	5.20%
Industrial Production YoY	4/26/2011	MAR	4.80%	23.80%
Korea	Date	Period	Prior	Cons.
GDP at Constant Price (YoY)	4/27/2011	1Q P	4.70%	4.40%
Goods Balance in US\$ Million	4/28/2011	MAR	\$1583M	--
Industrial Production (YoY)	4/29/2011	MAR	9.10%	--
Taiwan	Date	Period	Prior	Cons.
Unemployment Rate - sa	4/22/2011	MAR	4.59%	4.53%
Industrial Production (YoY)	4/25/2011	MAR	13.28%	10.77%
GDP - Constant Prices (YoY)	4/29/2011	1Q P	6.92%	5.00%
Thailand	Date	Period	Prior	Cons.
Total Exports YOY%	4/29/2011	MAR	29.10%	--
Total Imports YOY%	4/29/2011	MAR	18.60%	--
Total Trade Balance	4/29/2011	MAR	\$2031M	--
Vietnam	Date	Period	Prior	Cons.
Exports YTD (YoY)	25-27 APR	APR	33.70%	--
Imports YTD (YoY)	25-27 APR	APR	23.80%	--
CPI (YoY)	25-27 APR	APR	13.90%	--
Industrial Output YTD (YoY)	26-29 APR	APR	14.10%	--

Japan – BOJ Target Rate, April 28

We expect no change in the interest rates

Current Expected

0.10% 0.10%

Calendar Events

Korea: Q1 real GDP (April 27)

Forecast: 4.6% y/y

Consensus: 3.9% y/y

Prior: 4.7% y/y

Comment: The early GDP releases from Korea, together with China and Singapore, serve as a bellwether for growth prospects in the region. China and Singapore have already released better-than-expected Q1 outturns, and a strong reading for Korea would confirm the region's strong growth in Q1, despite headwinds from surging oil prices and, going forward, the impact from Japan's earthquake. We expect GDP growth to reach 4.5% in 2011, following last year's 6.1% outturn. **Market impact:** A better-than-expected outturn could strengthen expectations of more aggressive interest rate hikes, while a weaker outturn would do the opposite, especially given headwinds to growth in the coming quarters.

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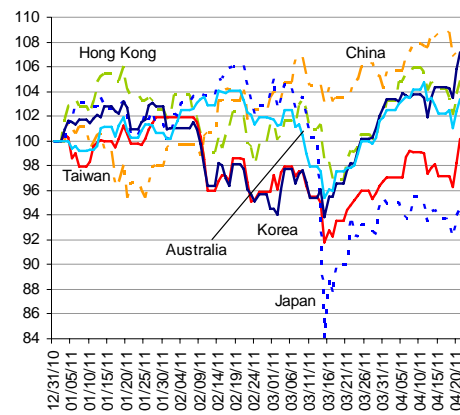
Markets Data

STOCK MARKETS	INDEX	Last price	% change over a week	Year to date	% Change over 1 Y
	China – Shanghai Comp.	3023.0	-0.9	7.7	-0.3
	Hong Kong – Hang Seng	24151.0	0.6	4.8	12.3
	Taiwan – Weighted	8987.0	3.1	0.2	12.5
	Japan – Nikkei 225	9662.7	0.7	-5.5	-12.9
	Korea – Kospi	2198.5	2.7	7.2	25.8
	India – Sensex 30	19471.0	0.4	-5.1	11.4
	Australia – SPX/ASX 200	4907.8	1.1	3.4	-0.9
	Singapore – Strait Times	3195.5	1.3	0.2	7.7
	Indonesia – Jakarta Comp	3804.0	2.0	2.7	30.6
	Thailand – SET	1107.4	2.1	7.2	46.1
	Malaysia – KLCI	1530.7	0.6	0.8	14.8
	Philippines – Manila Comp.	4274.8	0.5	1.8	33.4
	Last update: Friday, 16.15 Hong Kong time.				

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.52	0.19	6.45	6.34
	Hong Kong (HKD/USD)	7.77	0.06	7.8	8
	Taiwan (TWD/USD)	28.9	0.44	28.61	27.87
	Japan (JPY/USD)	82.2	1.54	82.2	81.9
	Korea (KRW/USD)	1080	0.62	1086.43	1100.75
	India (INR/USD)	44.3	0.40	45.1	47
	Australia (USD/AUD)	1.08	2.06	1	n.a.
	Singapore (SGD/USD)	1.24	0.83	1.24	1.2
	Indonesia (IDR/USD)	8630	0.42	8691	9010
	Thailand (THB/USD)	29.9	0.80	29.98	30.3
	Malaysia (MYR/USD)	3.01	0.46	3.0	3
	Philippines (PHP/USD)	43.1	0.25	43.13	43.40
	Last update: Friday, 11.15 Hong Kong time.				

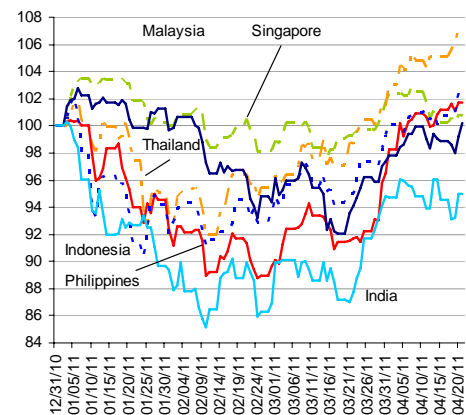
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Chart 6
Stock Markets



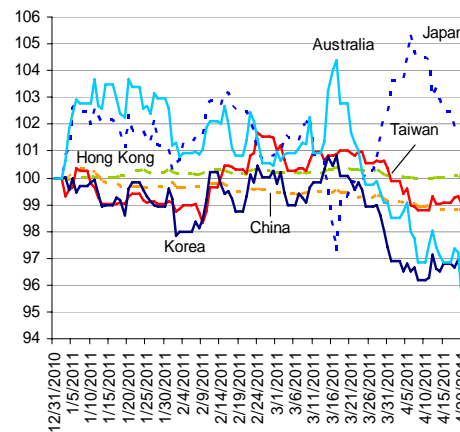
Source: BBVA Research and Bloomberg

Chart 7
Stock Markets



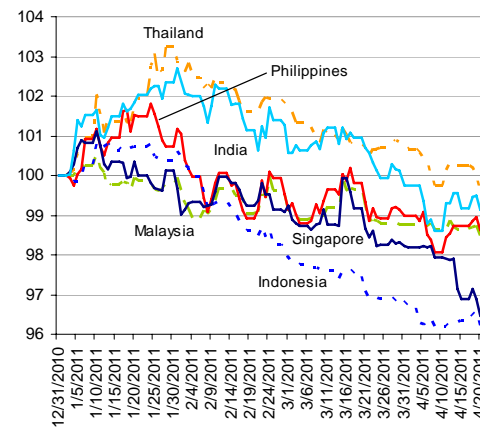
Source: BBVA Research and Bloomberg

Chart 8
Foreign Exchange Markets



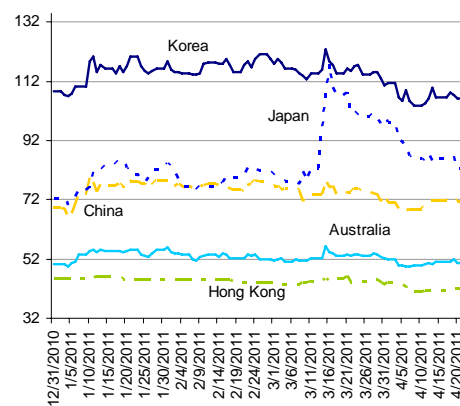
Source: BBVA Research and Bloomberg

Chart 9
Foreign Exchange Markets



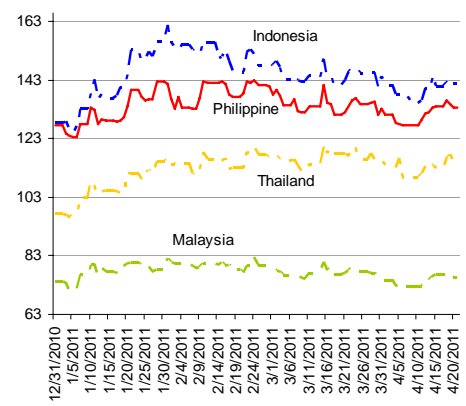
Source: BBVA Research and Bloomberg

Chart 10
Credit Default Swaps



Source: BBVA Research and Bloomberg

Chart 11
Credit Default Swaps



Source: BBVA Research and Bloomberg

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