

Weekly Watch

Asia

13 May 2011
Economic Analysis

Asia

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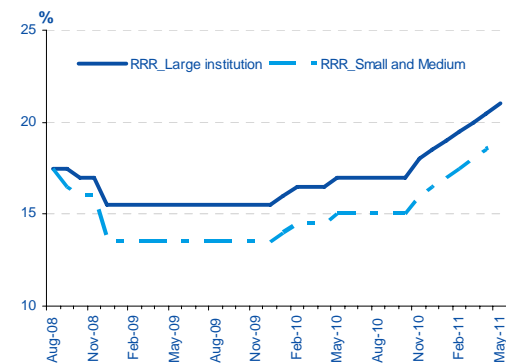
Moderating trends

As noted in our just-released [Asia Economic Outlook](#), Asia's growth momentum remains strong, but headwinds have emerged from high oil prices and supply disruptions in Japan (Highlights). Hence, we are likely soon to see moderating trends in the data. In this regard, China's monthly batch of data was the focus this past week, showing welcome signs of moderation given concerns of overheating (Highlights). China's central bank nevertheless hiked the RRR for a fifth straight month to absorb liquidity and tame inflation (Charts 1 and 2). Meanwhile, Indonesia (no surprise) and Korea (surprise) both left interest rates unchanged at their monthly policy meetings, following an easing of inflation for April, strong currency appreciation in recent months, and a renewed awareness of headwinds to growth.

Inflation stays high, despite some easing

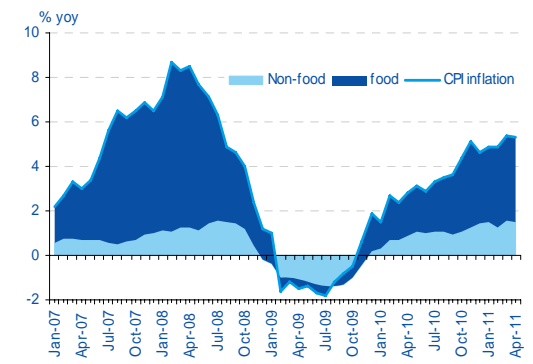
China's inflation eased in April to 5.3% y/y from 5.4% the previous month, but was above consensus (5.2% y/y). Other activity indicators showed signs of moderation, including industrial production (13.4% from 14.8% the previous month) and credit growth. In India, industrial production increased in March (7.3% y/y, from 3.6% y/y in February), but for quarter ending in March as a whole, industrial production eased. In contrast, Hong Kong posted a much stronger than expected first quarter GDP outturn of 7.2% y/y (consensus: 5.5% y/y), adding to the growing list of Asian economies with higher than expected Q1 GDP outturns.

Charts 1
China hikes the RRR for a fifth straight month



Source: BBVA Research and Bloomberg

Chart 2
China's inflation eases, but only slightly



Source: BBVA Research and Bloomberg

Highlights

China implements another RRR hike as inflation stays high

Despite an easing of activity indicators, China's tightening continues in order to tame inflation

Asia Economic Outlook: Robust growth and rising inflation, with headwinds

Our latest quarterly update paints a robust outlook, with some challenges ahead

New IIF survey underscores Asia's booming credit demand

Rapid credit growth is supporting domestic demand

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Economic Analysis

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Markets

Regional markets were mixed this week, with Southeast Asia slightly outperforming in equities as well as FX. Asian stock markets were mostly lower on Friday as China's latest tightening move on Thursday curbed demand, while shares in Seoul trimmed their losses after the Bank of Korea surprised markets by holding rates steady. Concerns about Greek debt problems, oil price volatility and central bank tightening dominated asset price trends.

China tightens policy further to curb inflation

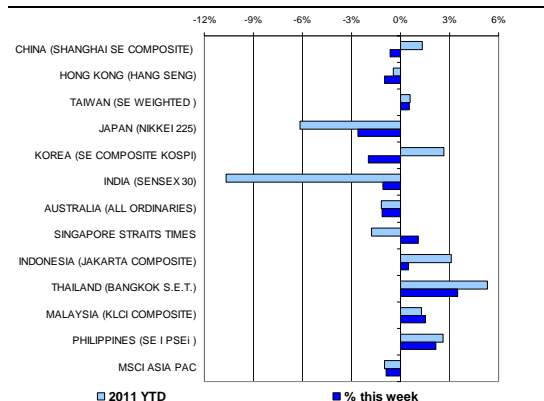
The PBoC hiked required reserve ratio by 50 bps to 21% for bigger banks and 19% for smaller banks (see Highlights). The hikes are estimated to drain about CNY370 billion excess liquidity from the banking system, which will help restraining future loan growth, with an eye to keep inflation at bay. With inflation likely creeping higher in the next few months, we see further tightening ahead and expect the PBoC will complement required reserve ratio hikes (100 bps this year) with two 25 bps interest rates increases, possibly delivered in 2Q and 3Q. Nevertheless, "over-tightening" is still not a concern, and we believe China should have adequate toolkits to achieve a soft-landing and keep growth at around 9.4% this year.

Bank of Korea unexpected takes a pause

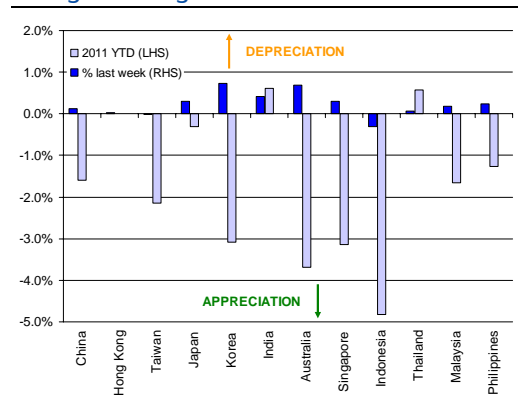
In Korea, the Bank of Korea (BoK) unexpectedly left interest rates unchanged at its monthly policy meeting today. Markets had anticipated a 25 bps hike. We think the decision reflects the Bank's general caution of raising rates too fast, especially given high burden of household debt at a time when consumers had to pay a bigger energy bills. With inflation still above targets and growth momentum maintaining in 2Q, we think the tightening bias of the central bank remained intact, but with the risk of rate hike profile gentler than our baseline forecasts (another 100 bps hikes).

AUD sold off after weaker Australia job reports

Australia shed 22,100 jobs in April, which came as a surprise to the market. While the jobless rate stayed unchanged at 4.9%, the surprising declines in employment raised concerns that Australian job engine may have faltered. Market quickly lowered the pricing of RBA rate hikes in one year by 9 bps to 33 bps, with AUD sinking to around 1.0600 from 1.0800 last week. We caution the volatility of monthly job reports, and see continued growth in Australian labour markets given the latest rise in job advertisements, sustained mining booms and reconstruction works later this year. Nevertheless, the sharp price action this week showed the vulnerability of AUD to any signs of economic weakness given the currency has been seriously overbought recently.

Chart 3
Stock markets

Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets

Source: BBVA Research and Bloomberg

Economic Analysis

Highlights

China implements another RRR hike as inflation stays high

The People's Bank of China (PBoC) announced on Thursday another 50bp hike in the required reserve ratio (RRR), the latest in a series of tightening measures. The move comes on the heels of the release of the monthly indicators for April, showing signs of moderation, but with still-high inflation, as the authorities continue with their efforts to restrain growth and achieve a soft-landing. With respect to the details, April retail sales declined to 17.1% y/y from 17.4% in March, and industrial production eased to 13.4% y/y from 14.8% in previous month, mainly due to the weak auto sales and production. Credit growth continues to moderate in line with government targets, while urban fixed asset investment in April rose to 25.4% y/y from 25.0% in March. On the external front, weaker imports caused the trade balance to shift back to surplus in April, following a small deficit in Q1. Taken together, the indicators should help alleviate concerns of overheating following the first quarter's rapid GDP growth (9.7% y/y). However, inflation remains a concern, at 5.3% y/y in April, slightly down from 5.4% in March, but still above expectations (BBVA and consensus: 5.2% y/y) and much above the authorities' 4% comfort range. The main drivers continue to be food and housing costs (rising by 11.5% y/y and 6.1% y/y respectively) but with non-food components trending up from demand pressures. The latest hike in the RRR is aimed at withdrawing liquidity, which is running high due to capital inflows, and taming inflation. The move brings the RRR of large banks up to a record high 21% and is expected to withdraw liquidity of around RMB 380 billion. We expect the authorities to sustain their gradual monetary tightening to tame inflation, with another two 25bp interest rate hikes in Q2/Q3 and an additional 100bp of hikes in the required reserve ratio (RRR).

Asia Economic Outlook: robust growth and rising inflation, despite headwinds

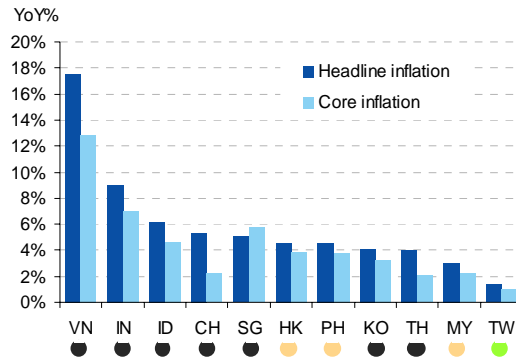
We have just released our updated quarterly [Asia Economic Outlook](#) (look out for our China Economic Outlook next week). While Asia's strong growth momentum has continued into 2011 on the back of robust domestic and external demand, our report highlights two challenges: (i) headwinds from surging oil prices and the impact of Japan's earthquake, and (ii) rising inflationary pressures. We do not expect headwinds to growth to derail Asia's positive outlook. While we do expect to see a weaker second quarter, we expect activity to rebound again during the remainder of the year. In particular, Asia's growth momentum is strong, we anticipate an easing of commodity prices, and supply disruptions from Japan's earthquake should be temporary. Inflation pressures, however, are a larger source of concern. Though food and energy prices have shown some moderation in recent weeks, their second round effects are evident, and demand-side pressures are becoming an important contributor. In light of this, monetary tightening is continuing, and in some cases being stepped up. Currency appreciation is also continuing as capital inflows resume on widening interest differentials and the region's strong growth prospects, which policymakers tolerating it as a way to help contain inflation. Overall, risks remain tilted to overheating, while new headwinds to growth may act as a balancing factor.

New IIF survey underscores Asia's booming credit demand

Loan appetite remains strong across most of Asia. Hong Kong leads the pack in credit growth, with loans rising by 30% (y/y) in the first quarter. Other countries like Indonesia (22%), India (17%) and China (16%) are also witnessing double-digit credit growth. The strength of Asian banking systems has been a key element underlining Asia's strong fundamentals. According to a recent new survey by the Institute of International Finance (IIF), more than 63% of Asian banks in the survey have reported stronger demand for loans. On the other hand, the IIF survey also shows that Asian banks are facing tighter local funding conditions as central banks restrain liquidity to tame inflation and prevent overheating. According to the survey, the banks themselves are tightening lending standards as well, especially to real estate sectors. We expect strong credit growth to continuing supporting robust growth momentum in the region, although the pace of lending may soon moderate as central banks tighten monetary policy.

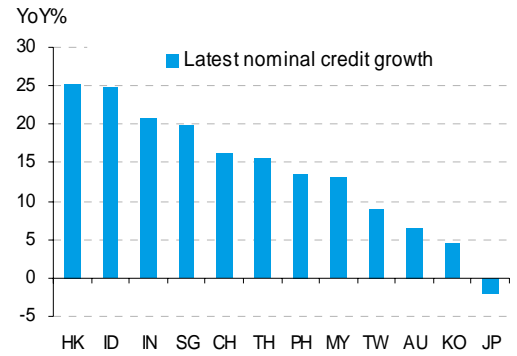
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Chart 5
Inflation is above target levels in many countries



Source: BBVA Research and Bloomberg

Chart 6
Rapid credit growth is supporting domestic demand



Source: BBVA Research and Bloomberg

Calendar Indicators

Australia	Date	Period	Prior	Cons.
Home Loans	16-May	MAR	-5.60%	2.00%
China	Date	Period	Prior	Cons.
Actual FDI (YoY)	16-18 MAY	APR	32.90%	36.10%
HSBC Flash China Manufacturing PMI	19-24 MAY	MAY	51.8	- -
Hong Kong	Date	Period	Prior	Cons.
Unemployment Rate SA	19-May	APR	3.40%	3.30%
India	Date	Period	Prior	Cons.
Monthly Wholesale Prices YoY%	16-May	APR	8.98%	8.40%
Japan	Date	Period	Prior	Cons.
Machine Orders YOY%	16-May	MAR	7.60%	-7.80%
Domestic CGPI (YoY)	16-May	APR	2.00%	2.10%
GDP Deflator YoY	19-May	1Q P	-1.60%	-1.90%
Nominal GDP (QoQ)	19-May	1Q P	-0.70%	-0.80%
GDP Annualized	19-May	1Q P	-1.30%	-2.00%
All Industry Activity Index (MoM)	20-May	MAR	0.70%	-6.10%
Convenience Store Sales YoY	20-May	APR	7.70%	- -
Malaysia	Date	Period	Prior	Cons.
CPI YoY	18-May	APR	3.00%	3.10%
GDP YoY%	18-May	1Q	4.80%	4.90%
Philippines	Date	Period	Prior	Cons.
Balance of Payments	19-May	APR	\$2020M	- -
Singapore	Date	Period	Prior	Cons.
Electronic Exports (YoY)	16-May	APR	-13.80%	-6.10%
Non-oil Domestic Exports (YoY)	16-May	APR	10.00%	8.30%
GDP (YoY)	19-May	1Q F	8.50%	8.30%
Korea	Date	Period	Prior	Cons.
Export Price Index (YoY)	16-May	APR	9.10%	- -
Import Price Index (YoY)	16-May	APR	19.60%	- -
Taiwan	Date	Period	Prior	Cons.
GDP - Constant Prices (YoY)	19-May	1Q F	6.19%	6.20%
Export Orders (YoY)	20-May	APR	13.37%	15.35%
Current Account Balance (USD)	20-May	1Q	10100M	- -

Indicator of the Week: India WPI inflation for April (May 16)

Forecast: 8.2% y/y

Consensus: 8.4% y/y

Prior: 9.0% y/y

Comment: Inflation has become the major policy concern across emerging Asia, with India struggling more than most of its peers. In this regard, next week's inflation release for April will be under the spotlight, especially after the RBI surprised markets early this month with an aggressive 50bp rate hike. We expect April inflation to decline from last month due to base effects and moderating food prices, but nevertheless remain elevated. Market impact: A higher than expected outturn could raise expectations of an even stronger policy response, while a lower outturn would improve sentiment.

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Calendar Events

Australia – Reserve Bank's Board May Minutes, May 17

Japan – BOJ Target Rate, May 20

We expect no change in the target rate

Current	Expected
0.10%	0.10%

Markets Data

STOCK MARKETS	INDEX	Last price	% change over a week	Year to date	% Change over 1 Y
	China - Shanghai Comp.	2845.7	-0.6	1.3	5.0
	Hong Kong - Hang Seng	22932.1	-1.0	-0.4	12.3
	Taiwan - Weighted	9021.8	0.5	0.5	16.1
	Japan - Nikkei 225	9600.6	-2.6	-6.1	-9.6
	Korea - Kospi	2106.2	-1.9	2.7	24.3
	India - Sensex 30	18329.3	-1.0	-10.6	6.2
	Australia - SPX/ASX 200	4688.6	-1.1	-1.2	0.8
	Singapore - Strait Times	3134.1	1.1	-1.8	9.3
	Indonesia - Jakarta Comp	3819.5	0.6	3.1	34.1
	Thailand - SET	1087.8	3.5	5.3	41.9
	Malaysia - KLCI	1538.7	1.5	1.3	14.2
	Philippines - Manila Comp.	4309.7	2.1	2.6	29.5

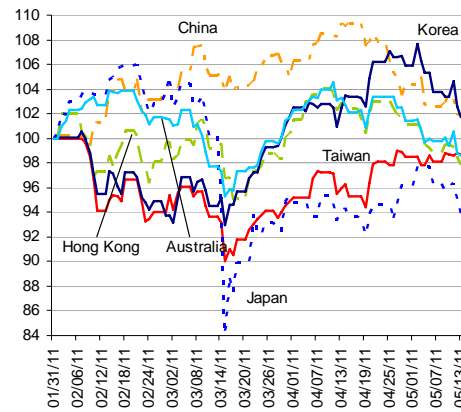
Last update: Friday, 16.15 Hong Kong time.

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.50	-0.12	6.47	6.37
	Hong Kong (HKD/USD)	7.77	-0.02	7.8	8
	Taiwan (TWD/USD)	28.7	0.03	28.49	27.81
	Japan (JPY/USD)	80.9	-0.31	80.8	80.6
	Korea (KRW/USD)	1091	-0.72	1097.73	1112.25
	India (INR/USD)	45.0	-0.40	45.7	48
	Australia (USD/AUD)	1.06	-0.70	1	n.a.
	Singapore (SGD/USD)	1.24	-0.31	1.24	1.2
	Indonesia (IDR/USD)	8563	0.29	8659	8972
	Thailand (THB/USD)	30.2	-0.07	30.34	30.6
	Malaysia (MYR/USD)	3.01	-0.17	3.0	3
	Philippines (PHP/USD)	43.3	-0.23	43.28	43.43

Last update: Friday, 16.15 Hong Kong time.

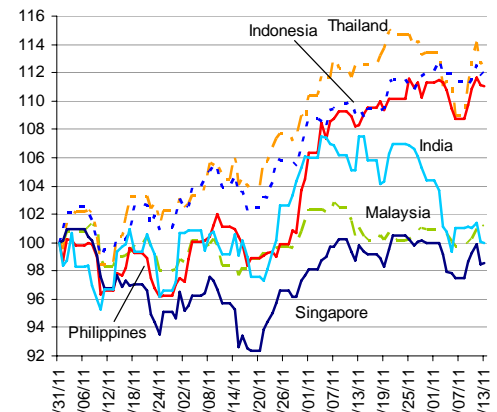
Charts

Chart 6
Stock Markets



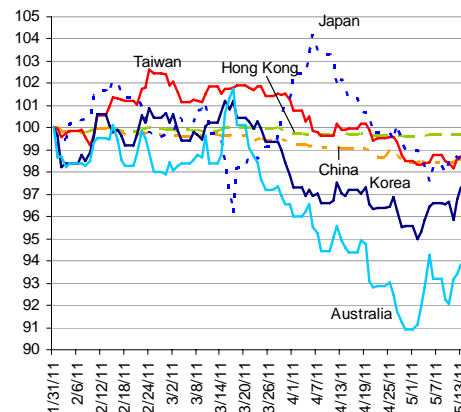
Source: BBVA Research and Bloomberg

Chart 7
Stock Markets



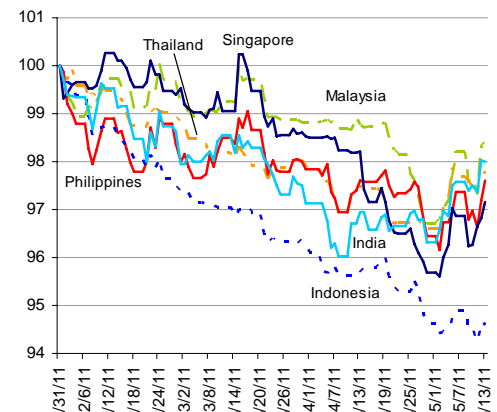
Source: BBVA Research and Bloomberg

Chart 8
Foreign Exchange Markets



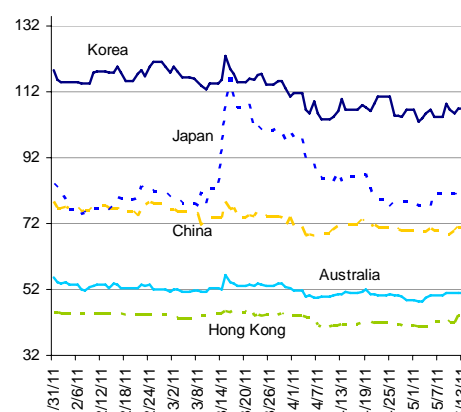
Source: BBVA Research and Bloomberg

Chart 9
Foreign Exchange Markets



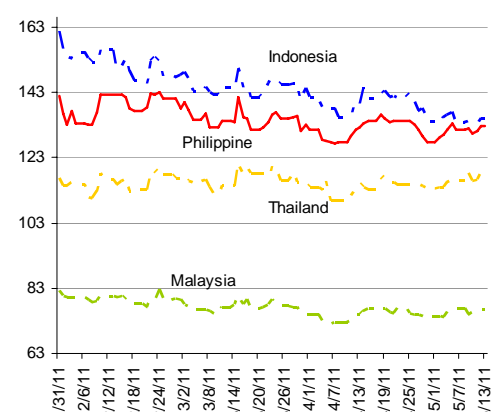
Source: BBVA Research and Bloomberg

Chart 10
Credit Default Swaps



Source: BBVA Research and Bloomberg

Chart 11
Credit Default Swaps



Source: BBVA Research and Bloomberg

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