

Weekly Watch

Asia

20 May 2011
Economic Analysis

Asia

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Growth and inflation grab the headlines

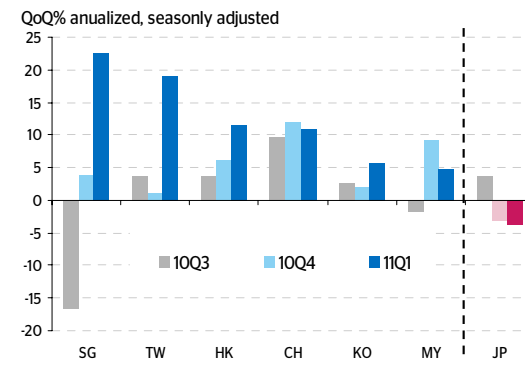
A number of GDP releases this past week confirmed a stronger-than-expected first quarter outturn (Chart 1 and Highlights). At the same time, inflation continues to be the biggest near-term policy challenge, as underscored by India's release of April wholesale prices (Highlights). We do expect, however, a moderating trend in the second quarter, as flagged in our just-released [China Economic Outlook](#) (Highlights), and as seen in recent high frequency indicators which we noted in the last [Asia Weekly](#). Elsewhere in the region, Japan slipped into a technical recession, with Q1 GDP contracting for a second straight quarter, due in part to the impact of the March 11 earthquake. Separately, Australia's top banks were downgraded by Moody's to Aa1 on concern about reliance on wholesale funding. The new rating is one notch below Moody's top rating, and brings it in line with S&P and Fitch. There was little market reaction.

The focus is still on inflation

India's inflation for April (WPI) came out at 8.7% y/y (consensus: 8.5% y/y) (Highlights), underscoring that the battle against rising prices continues. In Malaysia, the latest data also shows inflation picking up, albeit at a much more moderate level of (3.2% y/y; consensus: 3.1%). Next week will bring inflation releases in Singapore and Hong Kong, along with inflation and trade data in Japan (see Calendar). The latter will be watched to gauge further the economic impact of the March 11 earthquake (see Indicator of the week).

Chart 1

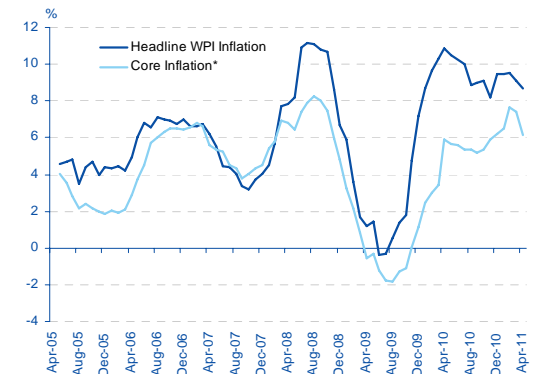
As Japan dips into recession, the rest of Asia's growth momentum remains strong



Source: BBVA Research and Bloomberg

Chart 2

India's WPI inflation remains high



Source: BBVA Research and Bloomberg

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Highlights

As Japan dips into recession, the rest of Asia still grows strongly

Japan's Q1 GDP disappoints, while the rest of the region surges

Update on China's overheating risks and interest rate liberalization plans

We published our latest China Outlook, flagging a moderation in overheating risks

India's inflation eases in April, but is still high with risks to the upside

India's battle with inflation is far from over

Economic Analysis

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Markets

Asian FX and equities markets were mixed this week amidst a light macro data calendar. Concerns about Greek debt restructuring and central bank tightening remain the dominant themes. For the week, stocks ended mainly up, following three consecutive declines, as exporters gained after reports of lower U.S. jobless claims even as manufacturing growth slowed.

Asian markets resilient to spillover from European debt problems

European leaders met in Brussels earlier this week to discuss the debt problems in the peripheral countries. Asian financial markets have responded positively to the passage of Portugal's bailout, but they have kept a wary eye to the talk of "soft restructuring" of Greek debt by allowing repayment schedule extension on a voluntary basis. Given the region's strong fundamentals, Asia is relatively resilient to European debt crisis, in our view. This includes sound macro indicators, strong banking systems, prudent public finances and hefty current account surpluses. While comprehensive data is not available, evidence from BIS data do not support that Asia is an important creditor to Greece. As such, the major exposure of Asia to European debt problems lie in its trade and financial links, which would be under risk only if Greece's debt restructuring talk is handled recklessly and caused systemic risks in the global banking system.

Investors shrug off Japan's poor data

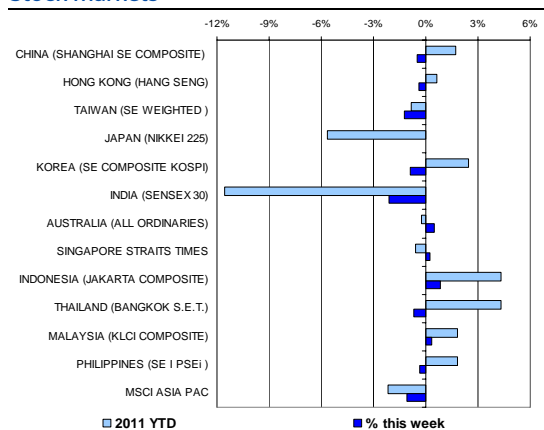
Japan's GDP fell more than expected in 1Q, indicating a sharper cut in activities after the earthquake. But the market's initial reaction was relatively benign, with little change in USDJPY as well as the Nikkei 225. Investors appeared to have braced for ugly macro data from March and Q2, and do not expect the Bank of Japan (BoJ) to respond to poor macro data in the near term as long as the recovery in the second half is still in store.

Moody's downgrades Australia's four banks

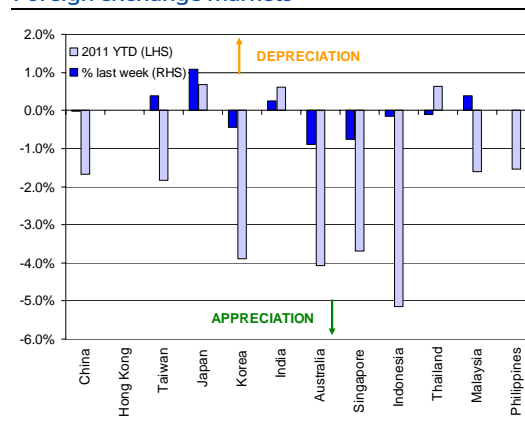
Four leading banks in Australia were downgraded by Moody's this week due to their heavy reliance on wholesale funding overseas. However, we do not foresee funding problems for Australian institutions in the near term. As such, Moody's move should have limited impact on the pricing of Australian assets. AUD has held steadily against the USD above 1.060.

Malaysia liberalizes rules to boost investment abroad

Malaysia's central bank, Bank Negara Malaysia (BNM), announced new measures to allow private direct investment abroad and to liberalize rules on inter-company loans and trade financing facilities obtained by resident companies, effective from June 1. We think these measures may help reduce appreciation pressure on the MYR while improving the business environment for multinational companies operating in Malaysia at the same time. However, it is quite unlikely that these measures will induce dramatic outflows in the near term. As such, the responses of USDMYR to this news have been muted.

Chart 3
Stock markets

Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets

Source: BBVA Research and Bloomberg

Economic Analysis

Highlights

As Japan dips into recession, the rest of Asia still grows strongly

Data released this week on first quarter GDP growth in Japan disappointed to the downside, at -3.7% (seasonally adjusted annualized rate) versus a consensus of -1.9%. The economy shrank for a second consecutive quarter, following a downwardly revised Q4 outturn of -3.0%. The Q1 figure highlights both that Japan's economy may have not been growing as strongly as expected prior to the March 11 earthquake and tsunami, and that the short-term impact of the natural disaster may be deeper than previously anticipated. Nevertheless, we still expect a strong rebound in the second half of the year as disruptions to supply chains are restored and as reconstruction spending provides a boost to demand, which should keep full-year GDP growth at 0.5%. In contrast, elsewhere in Asia, first quarter GDP growth has generally exceeded expectations on strong external and domestic demand (Chart 1, above), as discussed in our latest quarterly [Asia Economic Outlook](#). Reflecting these strong growth trends, for example, Singapore's government raised its official growth projection for 2011 to 5-7%, from 4-6% previously. That said, we do expect a moderating trend across the region in the second quarter due to headwinds from high oil prices, and the short-term impact of the earthquake in Japan.

Update on China's overheating risks and interest rate liberalization plans

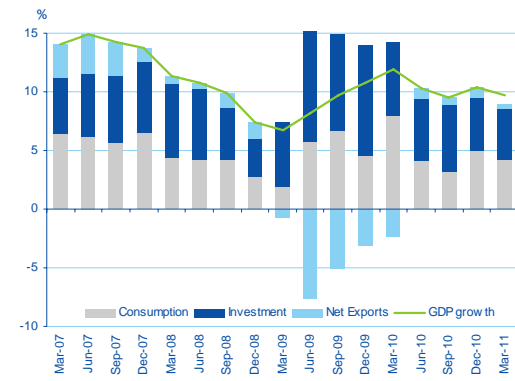
We published our quarterly [China Economic Outlook](#) this past week, in which highlight that, while overheating risks are still present in China, they have eased somewhat on recent signs of moderation in activity indicators. This is due to the authorities' ongoing monetary tightening measures. However, the battle is far from over, as growth momentum is still strong and inflation is running high—we have raised our GDP growth projection to 9.4% this year, and inflation to 4.9%. Also published this past week was our latest [China Banking Watch](#), on the implications of China's Five-Year Development Plan for the financial sector. Based on the contents of the Plan, we envisage progress in two financial reform areas in the coming few years: (i) interest rate liberalization; and (ii) further opening of the capital account. Consistent with these reform initiatives, PBoC's newly released 2010 Annual Report emphasizes plans to advance interest rate liberalization over the medium term by eliminating the current ceiling on deposit rates (which is binding, at the PBoC's benchmark deposit rate) and the floor on lending rates (expressed as 0.9 of the PBoC's benchmark lending rate). The aim is to improve the efficiency of the financial sector, and enhance the transmission of monetary policy through greater use of market-based instruments. In addition, the Report emphasizes plans to enhance exchange rate flexibility over time, which remains a long-standing issue in international policy discussions with China.

India's inflation eases in April, but is still high with risks to the upside

Inflation has been a growing concern across Asia, especially in India. The Reserve Bank of India (RBI) recently stepped up the pace of interest rate hikes, by surprising the market with a hefty 50bp hike in policy rates earlier this month. As such, the release this week of April inflation data was closely watched. Inflation (WPI) came out at 8.7% y/y, slightly above consensus (8.5% y/y), but down from a revised 9.1% y/y outturn for March. The decline in the year-on-year rate was mainly due to favorable base effects; on a sequential basis, headline inflation gained 1.3% m/m (non-seasonally adjusted), higher than the 0.3% m/m rise in March. Core inflation reached 6.2% y/y in April, a gain of 1.1% m/m, following a 0.3% m/m increase in March. Meanwhile, tight supplies due to rising demand pressures continued to weigh on food prices, which rose 5.7% y/y last month, up 1.7% m/m. Meanwhile, fuel prices rose 13.3% over last year, the largest increase since June 2010. Hikes in regulated diesel prices along with possible hikes in electricity and coal prices suggest upside risks to inflation in the coming months. The latest data print was a dampener for domestic markets, particularly on the fixed income front, as it fuelled expectations of further rate hikes while undermining growth prospects. We continue to expect the RBI to hike policy rates by another 50bps in 2011. On this basis, inflation should ease in the second half of the year, and to around 6% y/y by end-2011, but not before pulling down growth prospects to an estimated 8.1% y/y in 2011 as against 8.8% in 2010.

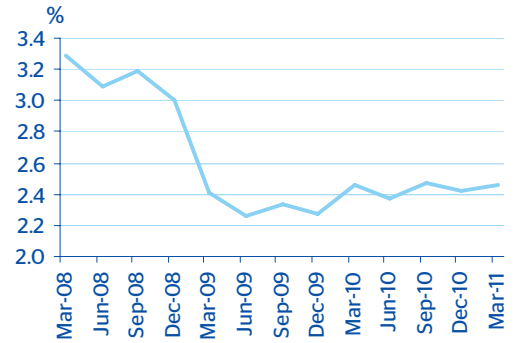
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Chart 5
China's Q1 GDP growth is moderating, but is still strong



Source: BBVA Research and Bloomberg

Chart 6
Interest rate liberalization tends to weigh on net interest margins in China



Source: BBVA Research and Bloomberg

Calendar Indicators

China	Date	Period	Prior	Cons.
HSBC Flash China Manufacturing PMI	23-May	MAY	51.8	--
Industrial Profits YTD YoY	27-May	APR	32.00%	--
Hong Kong	Date	Period	Prior	Cons.
CPI - Composite Index (YoY)	23-May	APR	4.60%	4.60%
Trade Balance	26-May	APR	-40.1B	-35.3B
Exports YoY%	26-May	APR	21.50%	16.80%
Imports YoY%	26-May	APR	18.80%	13.10%
Japan	Date	Period	Prior	Cons.
Adjusted Merchnds Trade Bal.	25-May	APR	¥96.3B	--
Merchnds Trade Exports YoY	25-May	APR	-2.2	--
Merchnds Trade Imports YoY	25-May	APR	11.9	--
Natl CPI YoY	27-May	APR	0.00%	--
Natl CPI Ex Food, Energy YoY	27-May	APR	-0.70%	--
Retail Trade YoY	27-May	APR	-8.50%	--
Adjusted Merchnds Trade Bal.	25-May	APR	¥96.3B	--
Philippines	Date	Period	Prior	Cons.
Budget Deficit/Surplus	23-27 MAY	APR	-18.1B	--
Trade Balance	25-May	MAR	-\$823M	--
Total Imports (YoY)	25-May	MAR	20.10%	--
Singapore	Date	Period	Prior	Cons.
CPI (YoY)	23-May	APR	5.00%	4.40%
Industrial Production YoY	26-May	APR	22.00%	--
Taiwan	Date	Period	Prior	Cons.
Industrial Production (YoY)	23-May	APR	13.82%	13.40%
Unemployment Rate - sa	23-May	APR	4.42%	4.31%
Money Supply M2 Daily Avg YoY	25-May	APR	5.97%	--
Thailand	Date	Period	Prior	Cons.
Customs Exports (YoY)	20-25 MAY	APR	30.90%	26.00%
Customs Imports (YoY)	20-25 MAY	APR	28.40%	24.50%
Customs Trade Balance	20-25 MAY	APR	\$1786M	\$200M
Gross Domestic Product (YoY)	23-May	1Q	3.80%	2.70%
Vietnam	Date	Period	Prior	Cons.
Exports YTD (YoY)	23-25 MAY	MAY	35.70%	--
Imports YTD (YoY)	23-25 MAY	MAY	29.10%	--
Industrial Output YTD (YoY)	24-27 MAY	MAY	14.20%	--
Retail Sales YTD (YoY)	24-27 MAY	MAY	22.70%	--

Indicator of the Week: Japan export growth in April (May 25)

Forecast: -11.0% y/y

Consensus: -12.7% y/y

Prior: -2.3% y/y

Comment: First quarter GDP growth was released this past week, at -3.7% (q/q, saar), underlining the risks to growth following the March 11 earthquake and tsunami. Disruptions to supply chains and power shortages are expected to continue weighing on production and exports in the coming months. Exports in April, the first print reflecting the full-month impact of the quake, are likely to have fallen further from March's level. Market impact: A lower-than-expected outturn could cause markets to price in a lower growth outlook for 2011 and dampen sentiment.

Calendar Events

Japan - Cabinet Office Monthly Economic Report, May 24

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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.	2857.3	-0.5	1.8	11.8
	Hong Kong - Hang Seng	23184.5	-0.4	0.6	18.6
	Taiwan - Weighted	8896.4	-1.2	-0.8	19.8
	Japan - Nikkei 225	9648.8	0.0	-5.7	-3.8
	Korea - Kospi	2101.7	-0.9	2.5	31.3
	India - Sensex 30	18141.4	-2.1	-11.5	9.8
	Australia - SPX/ASX 200	4734.2	0.5	-0.2	9.7
	Singapore - Strait Times	3171.2	0.2	-0.6	15.2
	Indonesia - Jakarta Comp	3866.7	0.9	4.4	43.5
	Thailand - SET	1077.5	-0.7	4.3	40.8
	Malaysia - KLCI	1546.5	0.4	1.8	18.6
	Philippines - Manila Comp.	4278.1	-0.3	1.8	33.1

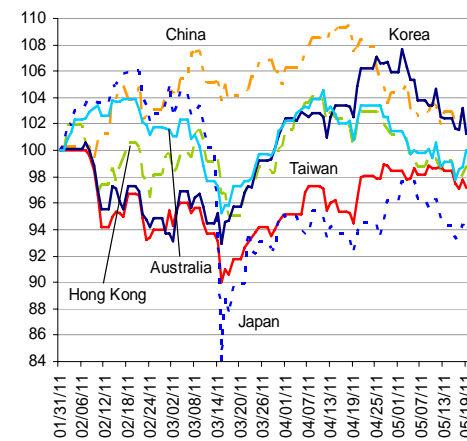
Last update: Friday, 16.15 Hong Kong time.

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.50	0.03	6.47	6.37
	Hong Kong (HKD/USD)	7.77	-0.01	7.8	8
	Taiwan (TWD/USD)	28.8	-0.38	28.57	27.93
	Japan (JPY/USD)	81.7	-1.07	81.6	81.4
	Korea (KRW/USD)	1082	0.43	1088.51	1103.29
	India (INR/USD)	45.0	0.05	45.6	48
	Australia (USD/AUD)	1.07	0.90	1	n.a.
	Singapore (SGD/USD)	1.24	0.77	1.24	1.2
	Indonesia (IDR/USD)	8534	0.14	8613	8945
	Thailand (THB/USD)	30.3	0.07	30.37	30.8
	Malaysia (MYR/USD)	3.02	-0.46	3.0	3
	Philippines (PHP/USD)	43.1	0.00	43.20	43.31

Last update: Friday, 16.15 Hong Kong time.

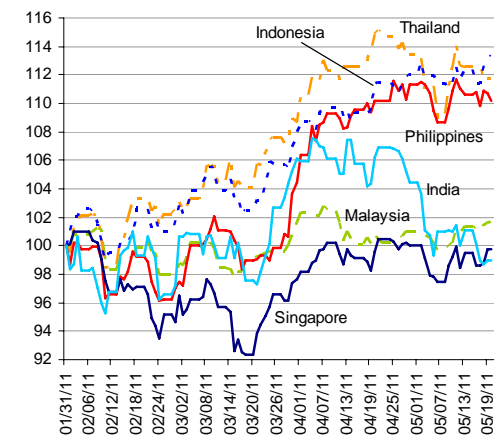
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Chart 6
Stock Markets



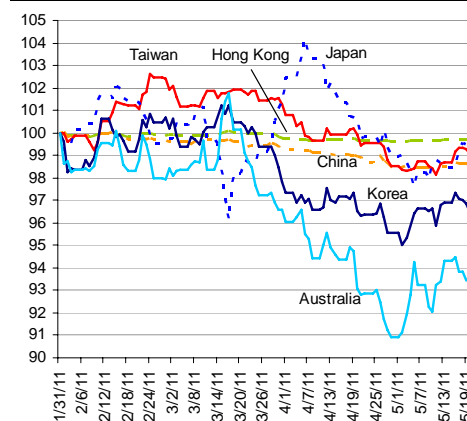
Source: BBVA Research and Bloomberg

Chart 7
Stock Markets



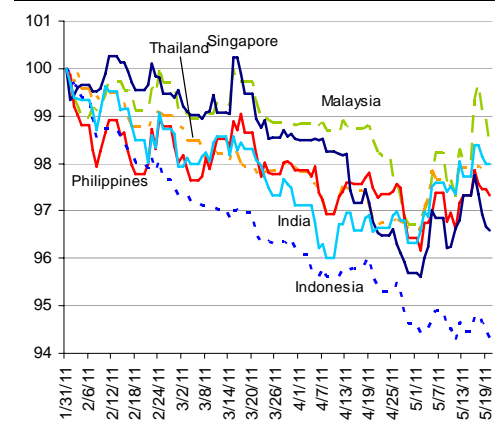
Source: BBVA Research and Bloomberg

Chart 8
Foreign Exchange Markets



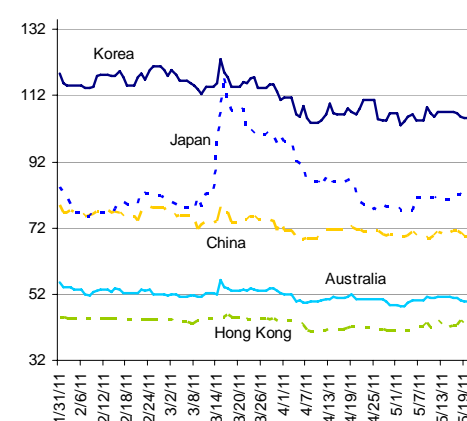
Source: BBVA Research and Bloomberg

Chart 9
Foreign Exchange Markets



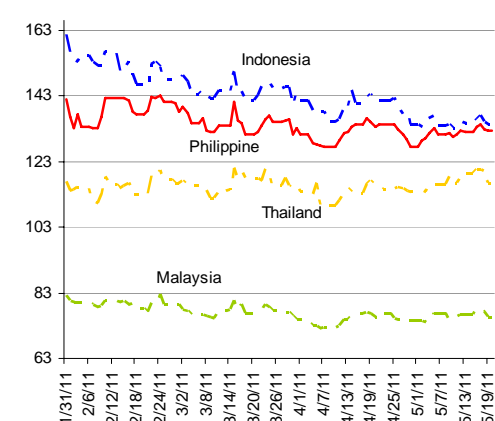
Source: BBVA Research and Bloomberg

Chart 10
Credit Default Swaps



Source: BBVA Research and Bloomberg

Chart 11
Credit Default Swaps



Source: BBVA Research and Bloomberg

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