

# Weekly Watch

## Asia

10 June 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

**Zhigang Li**  
zhigang.li@bbva.com.hk

**Sumedh Deorukhkar**  
sumedh.deorukhkar@grupobbva.com

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

**Mario Nevares**  
mario.nevares@bbva.com.hk

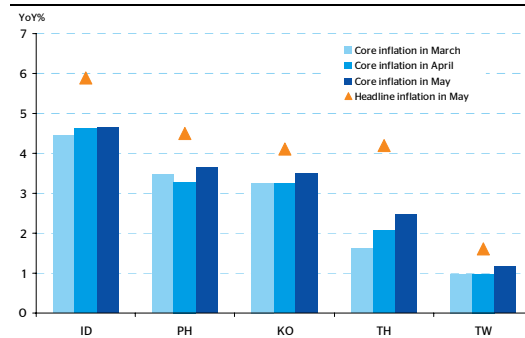
## Are central banks softening on inflation?

Headline inflation has either already peaked, or is close to doing so, in a number of countries in the region thanks to easing food and energy prices. This, together with moderating trends in global growth and domestic demand, has led several central banks to begin signaling a softer stance on inflation. For example, central banks in Indonesia, Australia and New Zealand stood pat on interest rates this past week (Chart 2), with their statements showing less concern about inflation risks. Nevertheless, core inflation is continuing to rise (see Highlights), reflecting strong demand side pressures. This was an important motivation for the Bank of Korea in raising rates this week to 3.25%, thus continuing the normalization of monetary policy, which is still accommodative. We continue to expect further rate hikes across the region, albeit at a gradual pace (see [Asia Outlook](#)).

### Latest indicators point to moderating growth and easing headline inflation

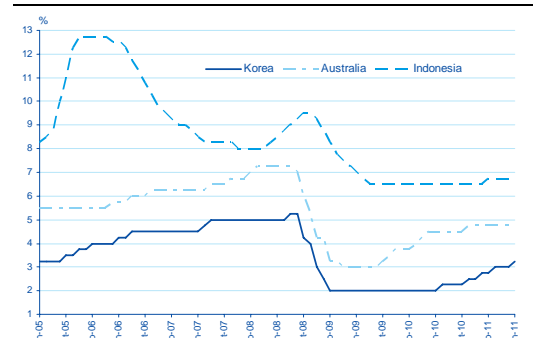
Industrial production in India (4.4% y/y vs. consensus 5.5%) and Malaysia (-2.2% y/y vs. consensus 2.5%) eased, as did exports in China (19.4% y/y) and Taiwan (9.5% y/y), both broadly in line with expectations. Also, Korea and Japan revised down their 1Q GDP figures. All of this is in line with our expectations of temporary moderating growth trends due to headwinds from higher oil prices and post-earthquake developments in Japan. Meanwhile, headline inflation shows signs of easing, although it picked up slightly in the Philippines (4.5% y/y vs. consensus 5.0% y/y) and Taiwan (1.7% y/y; consensus: 1.6%). Next week, the focus will be on a batch of data from China (Highlights) and inflation in India, which will also hold its monthly monetary meeting, where we expect another rate hike, although it will be a close call given easing production and investment indicators.

Chart 1  
Core inflation rates continues to rise



Source: BBVA Research and Bloomberg

Chart 2  
Korea hikes interest rates while Indonesia and Australia stay pat



Source: BBVA Research and Bloomberg

## Highlights

### China's authorities reported to be seeking solution to local government debts

The central government is acting to head off risks posed by local government debt

### Core inflation continues to rise, even has headline inflation eases

Easing commodity prices are leading to a decline in headline inflation rates

### China's trade data supports a soft landing, with activity data awaited

Robust May export and import data reveal still strong external and domestic demand

Markets →

Highlights →

Calendar →

Markets Data →

Charts →

## Economic Analysis

Richard Li  
richard.li@bbva.com.hk

Mario Nevares  
mario.nevares@bbva.com.hk

## Markets

Growth fears, higher oil prices, uncertainties from the Greek debt situation and anticipation of imminent tightening by China continued to weigh on sentiment. Elevated risk aversion sent Asian equities broadly lower (Chart 3), while regional currencies were essentially flat compared to last week's close.

## JPY dips below 80 with no intervention

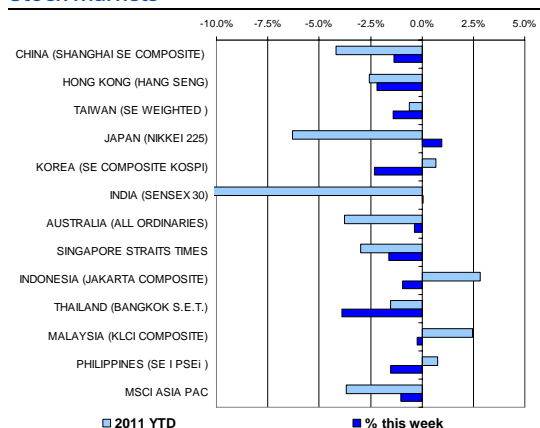
USDJPY dipped below 80 Wednesday, for the first time since early May, as 2-year US treasury fell to around 0.4%. As we highlighted previously, the pair is still largely a play on US rates. As such, it faced significant downward pressure after a disappointing US jobs report and ISM survey last week, pointing to a more subdued recovery in the US, which postponed market expectations of the first rate hikes by the Fed. JPY also benefited from risk-off trades as investors piled funds into safe-haven currencies on slowing growth concerns. Local politics and a downside surprise to revised Q1 GDP helped to lift the pair back marginally above 80 by the end of the week.

Unlike in March when sharp appreciation in JPY post-earthquake ran into coordinated G7 intervention, Japanese officials and the IMF tipped intervention at this level was not imminent. According to Finance Minister Yoshihiko Noda, the situation this time was perceived as "not of the yen's unequal strength but the dollar weakness. I think the market was affected by (investors') perceptions toward the U.S. economy, but in any case, I will closely watch developments in the market," Finance Minister Yoshihiko Noda said earlier this week. While USDJPY is down to 80, dollar weakness means that JPY nominal effective exchange rate is still at 200 day moving average, or 3.4% below pre-March intervention spike. As a result, a lower USDJPY is necessary before the BoJ or G7 would step in.

## KRW Sees Support from Central Bank Rate Hikes

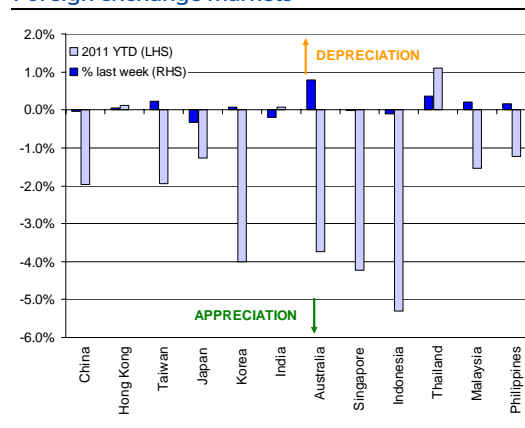
The Bank of Korea (BoK) raised its benchmark policy rate by 25 bps to 3.25%, the second time since February this year. The decision came as a mild surprise to the market, with KRW strengthening modestly after the announcement. The move was in line with our expectations, and it reflects the long-standing need to normalize rates to tackle inflation. While headline inflation has eased slightly in May, it was still well above BoK's target of 2.0-4.0%, with core inflation creeping up towards the upper end of the target band (see Highlights). In addition, the labor market remains tight despite some tentative signs of activity moderation recently, with wage dynamics threatening the inflation outlook going forward. Hence, we think it is appropriate for the BoK to take timely measures to anchor inflation expectations. We think the BoK will hike rates by another 50-75 bps for the remainder of the year, and see further scope for KRW to strengthen vs. the USD on the back of widening rate spreads and sustained capital inflows.

Chart 3  
Stock markets



Source: BBVA Research and Bloomberg

Chart 4  
Foreign exchange markets



Source: BBVA Research and Bloomberg

## Highlights

### Chinese authorities seeking a solution to local government debts

The People's Bank of China (PBoC) released their annual Regional Financial Situation Report last week, in which they updated their estimate of the level of outstanding loans to local government financing vehicles (LGFVs) as "less than 30% of outstanding RMB loans [of the banking system]". By our estimates, this would imply outstanding LGFV loans of around RMB 14.4 trillion, equivalent to 36% of GDP. Importantly, the PBoC estimate is higher than November figures issued by the supervisory authority (CBRC) of around RMB 10 trillion. (The difference may be due to classification issues.) Whatever the precise figure, LGFV loans are an important source of vulnerability to the financial system and debt burden of local governments, as around one-fifth of them are substandard ([China banking watch](#)). Indeed, this has been one of the key sources of risk facing China's economic outlook. In a sign of the authorities' awareness of these risks, and desire to head them off at an early stage, the Ministry of Finance was reported last week to have proposed a clean-up of LGFV obligations (details have not been officially announced, as the proposal was discussed in an internal meeting). According to press reports, the proposal would reduce LGFV loans by between RMB 2-3 trillion (the amount of substandard loans) through a combination of central government funds and write-offs by state-owned banks (generally thought to apply to the four largest banks). Apparently, any final solution would need to incorporate the views of other relevant governmental agencies including PBoC and CBRC. If the proposal were to survive in its current form, it could well lead to higher capital needs of listed banks, which have relatively high exposures to LGFVs.

### Core inflation continues to rise, even as headline inflation eases

This past week was marked by further regional inflation releases and central bank policy meetings. In particular, headline inflation is showing signs of easing in a number of countries due to moderating commodity prices. On the policy front, Australia and Indonesia both held interest rates unchanged this past week, as expected; while Korea raised rates, in line with our expectations, but contrary to the consensus, which had expected no change. As noted in our recent publications (see Asia Outlook), inflation has emerged as the major policy concern across Asia in recent months. Encouragingly, supply side pressures have eased, with due to a moderation in commodity prices, in part because of slowing regional and global growth trends in Q2. For example, inflation in Korea and Indonesia moderated to 4.1% y/y and 6.0% y/y in May, below the levels of previous months. However, inflation remains above target ranges, and most importantly, core inflation in virtually all countries continues to rise (Chart 1), reflecting demand side pressures. In this regard, we expect further monetary tightening during the remainder of this year, despite the easing of headline inflation. That said, the pace of interest rate hikes is likely to remain gradual on concerns about slowing global growth.

### China's May trade data supports a soft landing scenario, with important activity data awaited next week

China's May export growth eased to 19.4% y/y (BBVA: 20.0% y/y; consensus: 20.4% y/y), broadly in line with expectations and down from 29.9% y/y in April. By product category, most of the major exports declined due to weakening external demand. Meanwhile, imports for May registered a higher-than-expected growth of 28.4% y/y (BBVA: 24.8% y/y; consensus: 22.0% y/y), signaling continued robust domestic demand, which should help allay concerns of a hard landing. As a result, the trade surplus in May rose to USD 13.1 billion (BBVA: USD 18.1 billion, consensus: USD 19.3 billion) from USD 11.4 billion in April. Through the first 5 months of the year, the trade surplus amounts to a relatively modest US\$ 23.0 billion. We expect the trade surplus to amount to US\$ 140.0 billion for the full year, a decline from last year's US\$ 183.1 billion, but still large enough to keep pressure on the authorities to allow currency appreciation. An important batch of monthly indicators will be released next week (June 14), including inflation, industrial production, retail sales, fixed asset investment, new loans and money supply growth. We expect inflation to pick up (see Weekly Indicator) toward a peak in June, and for the other activity indicators to register continued strong growth.

[Home](#) →

[Markets](#) →

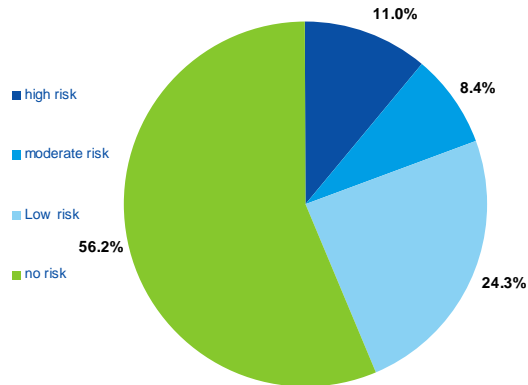
[Calendar](#) →

[Markets Data](#) →

[Chart](#) →

Chart 5

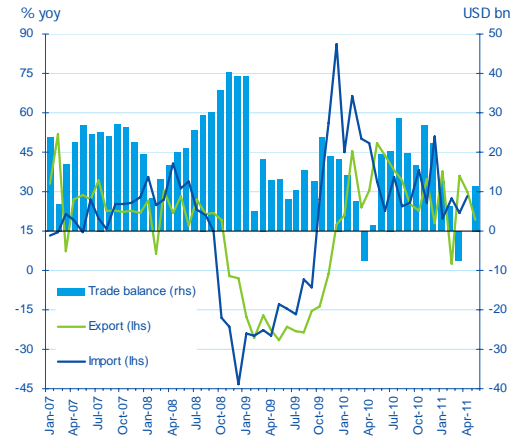
About a fifth of China's LGFV debt is believed to be at high or moderate risk



Source: BBVA Research and Bloomberg

Chart 6

China's trade surplus has been moderating so far this year, as import growth stays strong



Source: BBVA Research and Bloomberg

## Calendar Indicators

China	Date	Period	Prior	Cons.
Actual FDI (YoY)	10-15 JUN	MAY	15.20%	--
New Yuan Loans	11-15 JUN	MAY	739.6B	650.0B
Money Supply - M2 (YoY)	11-15 JUN	MAY	15.30%	15.50%
China Manpower Survey	14-Jun	3Q	29%	--
Producer Price Index (YoY)	14-Jun	MAY	6.80%	6.50%
Consumer Price Index (YoY)	14-Jun	MAY	5.30%	5.50%
Retail Sales (YoY)	14-Jun	MAY	17.10%	17.00%
Industrial Production (YoY)	14-Jun	MAY	13.40%	13.10%
Hong Kong	Date	Period	Prior	Cons.
Industrial Production (YoY)	13-Jun	1Q	5.70%	--
Producer Price (YoY)	13-Jun	1Q	7.60%	--
Unemployment Rate SA	16-Jun	MAY	3.50%	--
India	Date	Period	Prior	Cons.
Monthly Wholesale Prices YoY%	14-Jun	MAY	8.66%	8.89%
Japan	Date	Period	Prior	Cons.
Machine Orders YOY%	13-Jun	APR	6.80%	5.00%
Philippines	Date	Period	Prior	Cons.
Overseas Remittances (YoY)	15-Jun	APR	4.10%	--
Singapore	Date	Period	Prior	Cons.
Retail Sales Ex Auto	15-Jun	APR	7.00%	--
Retail Sales (YoY)	15-Jun	APR	0.80%	2.30%
Electronic Exports (YoY)	17-Jun	MAY	-10.40%	-18.10%
Non-oil Domestic Exports (YoY)	17-Jun	MAY	-1.80%	5.70%
Korea	Date	Period	Prior	Cons.
Export Price Index (YoY)	15-Jun	MAY	7.70%	--
Import Price Index (YoY)	15-Jun	MAY	19.00%	--

## Indicator of the Week: China CPI for May (June 14)

Forecast: 5.6% y/y

Consensus: 5.5% y/y

Prior: 5.3% y/y

Comment: Headline inflation in May will likely climb further as food prices, which had showed signs of easing in recent months, are once again accelerating due to an ongoing drought in southeast China. Non-food components are continuing to rise as well. We expect inflation to peak in June, before declining to 4.0% y/y by the end of the year as commodity prices ease and as ongoing monetary tightening measures take effect. Market impact: A lower-than-expected reading could bolster market sentiment, which has been weak due to expectations of further tightening and slowing growth, while a higher-than-expected reading would do the opposite.

## Calendar Events

## Japan - BOJ Target Rate, June 14

We expect no change in the interest rates

## Philippines - Overnight Borrowing Rate, June 16

We expect no change in the interest rates

## India - Repo Rate, June 16

We expect a hike of 25 bp in the Repo Rate

Current	Expected
0.10%	0.10%
Current	Expected
4.50%	4.50%
Current	Expected
7.25%	7.50%

Home →

Markets →

Highlights →

Markets Data →

Charts →

## Markets Data

STOCK MARKETS	INDEX	Last price	% change over a week	Year to date	% Change over 1 Y
	China - Shanghai Comp.	2691.1	-1.4	-4.2	5.0
	Hong Kong - Hang Seng	22441.8	-2.2	-2.6	14.3
	Taiwan - Weighted	8915.5	-1.4	-0.6	24.1
	Japan - Nikkei 225	9585.6	1.0	-6.3	0.4
	Korea - Kospi	2064.4	-2.3	0.7	25.0
	India - Sensex 30	18384.9	0.0	-10.4	8.6
	Australia - SPX/ASX 200	4567.2	-0.3	-3.8	3.0
	Singapore - Strait Times	3096.4	-1.6	-2.9	11.4
	Indonesia - Jakarta Comp	3809.7	-0.9	2.9	37.5
	Thailand - SET	1016.9	-3.9	-1.5	32.4
	Malaysia - KLCI	1556.5	-0.2	2.5	20.5
	Philippines - Manila Comp.	4232.4	-1.5	0.7	31.3

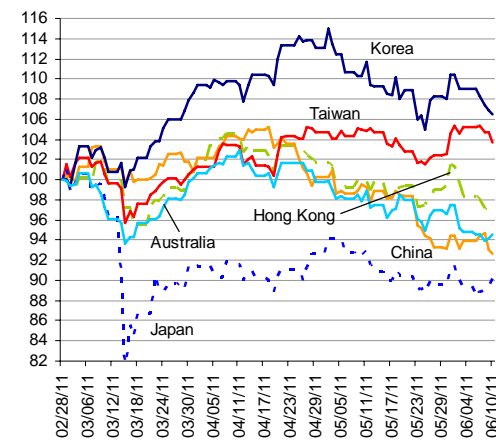
Last update: Friday, 11:15 Hong Kong time.

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.48	0.03	6.47	6.39
	Hong Kong (HKD/USD)	7.78	-0.06	7.8	8
	Taiwan (TWD/USD)	28.7	-0.23	28.60	28.05
	Japan (JPY/USD)	80.1	0.31	80.1	79.8
	Korea (KRW/USD)	1081	-0.05	1086.90	1102.05
	India (INR/USD)	44.7	0.21	45.2	47
	Australia (USD/AUD)	1.06	-0.74	1	n.a.
	Singapore (SGD/USD)	1.23	0.04	1.23	1.2
	Indonesia (IDR/USD)	8519	0.11	8583	8867
	Thailand (THB/USD)	30.4	-0.36	30.58	31.0
	Malaysia (MYR/USD)	3.01	-0.16	3.0	3
	Philippines (PHP/USD)	43.3	-0.14	43.34	43.50

Last update: Friday, 11:15 Hong Kong time.

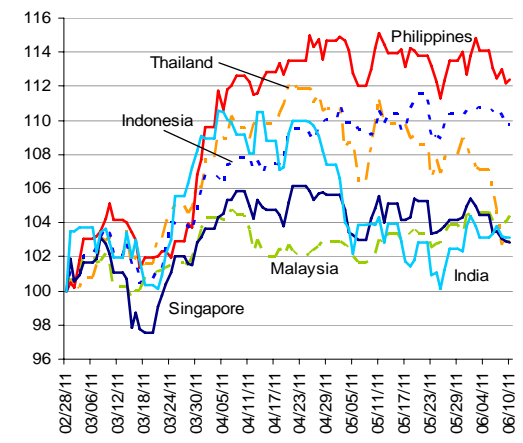
## Charts

Chart 6  
Stock Markets



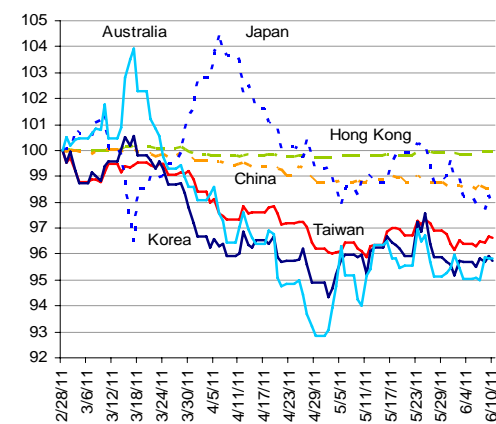
Source: BBVA Research and Bloomberg

Chart 7  
Stock Markets



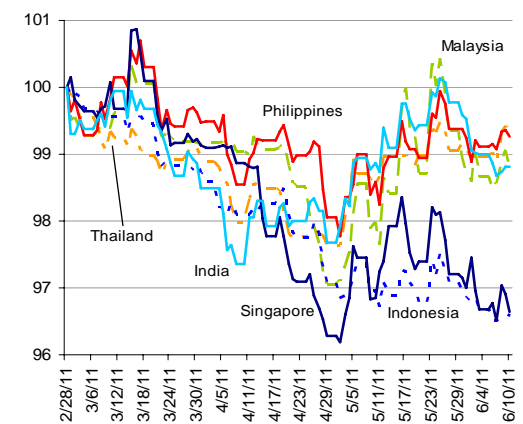
Source: BBVA Research and Bloomberg

Chart 8  
Foreign Exchange Markets



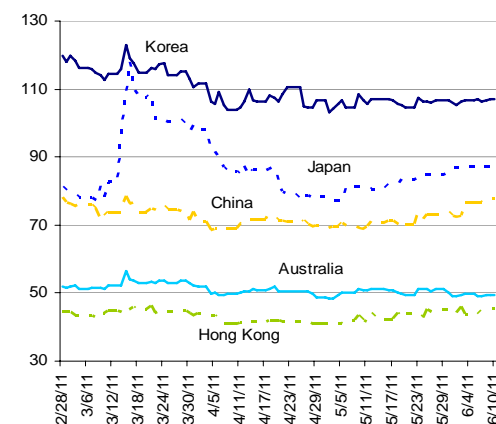
Source: BBVA Research and Bloomberg

Chart 9  
Foreign Exchange Markets



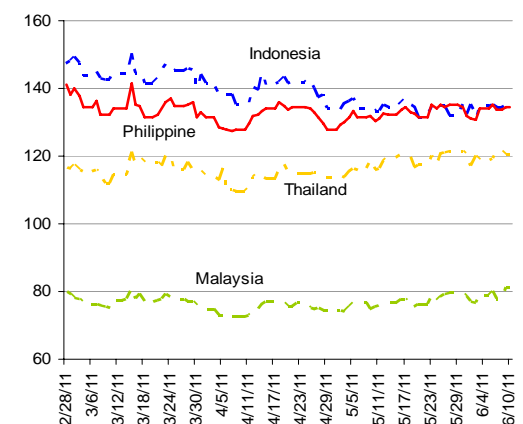
Source: BBVA Research and Bloomberg

Chart 10  
Credit Default Swaps



Source: BBVA Research and Bloomberg

Chart 11  
Credit Default Swaps



Source: BBVA Research and Bloomberg

**DISCLAIMER**

This document and the information, opinions, estimates and recommendations expressed herein, have been prepared by Banco Bilbao Vizcaya Argentaria, S.A. (hereinafter called "BBVA") to provide its customers with general information regarding the date of issue of the report and are subject to changes without prior notice. BBVA is not liable for giving notice of such changes or for updating the contents hereof.

This document and its contents do not constitute an offer, invitation or solicitation to purchase or subscribe to any securities or other instruments, or to undertake or divest investments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

**Investors who have access to this document should be aware that the securities, instruments or investments to which it refers may not be appropriate for them due to their specific investment goals, financial positions or risk profiles, as these have not been taken into account to prepare this report.** Therefore, investors should make their own investment decisions considering the said circumstances and obtaining such specialized advice as may be necessary. The contents of this document are based upon information available to the public that has been obtained from sources considered to be reliable. However, such information has not been independently verified by BBVA and therefore no warranty, either express or implicit, is given regarding its accuracy, integrity or correctness. BBVA accepts no liability of any type for any direct or indirect losses arising from the use of the document or its contents. Investors should note that the past performance of securities or instruments or the historical results of investments do not guarantee future performance.

**The market prices of securities or instruments or the results of investments could fluctuate against the interests of investors. Investors should be aware that they could even face a loss of their investment. Transactions in futures, options and securities or high-yield securities can involve high risks and are not appropriate for every investor. Indeed, in the case of some investments, the potential losses may exceed the amount of initial investment and, in such circumstances, investors may be required to pay more money to support those losses. Thus, before undertaking any transaction with these instruments, investors should be aware of their operation, as well as the rights, liabilities and risks implied by the same and the underlying stocks. Investors should also be aware that secondary markets for the said instruments may be limited or even not exist.**

BBVA or any of its affiliates, as well as their respective executives and employees, may have a position in any of the securities or instruments referred to, directly or indirectly, in this document, or in any other related thereto; they may trade for their own account or for third-party account in those securities, provide consulting or other services to the issuer of the aforementioned securities or instruments or to companies related thereto or to their shareholders, executives or employees, or may have interests or perform transactions in those securities or instruments or related investments before or after the publication of this report, to the extent permitted by the applicable law.

BBVA or any of its affiliates' salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to its clients that reflect opinions that are contrary to the opinions expressed herein. Furthermore, BBVA or any of its affiliates' proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. No part of this document may be (i) copied, photocopied or duplicated by any other form or means (ii) redistributed or (iii) quoted, without the prior written consent of BBVA. No part of this report may be copied, conveyed, distributed or furnished to any person or entity in any country (or persons or entities in the same) in which its distribution is prohibited by law. Failure to comply with these restrictions may breach the laws of the relevant jurisdiction.

In the United Kingdom, this document is directed only at persons who (i) have professional experience in matters relating to investments falling within article 19(5) of the financial services and markets act 2000 (financial promotion) order 2005 (as amended, the "financial promotion order"), (ii) are persons falling within article 49(2) (a) to (d) ("high net worth companies, unincorporated associations, etc.") Of the financial promotion order, or (iii) are persons to whom an invitation or inducement to engage in investment activity (within the meaning of section 21 of the financial services and markets act 2000) may otherwise lawfully be communicated (all such persons together being referred to as "relevant persons"). This document is directed only at relevant persons and must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this document relates is available only to relevant persons and will be engaged in only with relevant persons. The remuneration system concerning the analyst/s author/s of this report is based on multiple criteria, including the revenues obtained by BBVA and, indirectly, the results of BBVA Group in the fiscal year, which, in turn, include the results generated by the investment banking business; nevertheless, they do not receive any remuneration based on revenues from any specific transaction in investment banking.

BBVA is not a member of the FINRA and is not subject to the rules of disclosure affecting such members.

**"BBVA is subject to the BBVA Group Code of Conduct for Security Market Operations which, among other regulations, includes rules to prevent and avoid conflicts of interests with the ratings given, including information barriers. The BBVA Group Code of Conduct for Security Market Operations is available for reference at the following web site: [www.bbva.com](http://www.bbva.com) / Corporate Governance".**

**BBVA is a bank supervised by the Bank of Spain and by Spain's Stock Exchange Commission (CNMV), registered with the Bank of Spain with number 0182.**