

# Weekly Watch

## Asia

17 June 2011  
Economic Analysis

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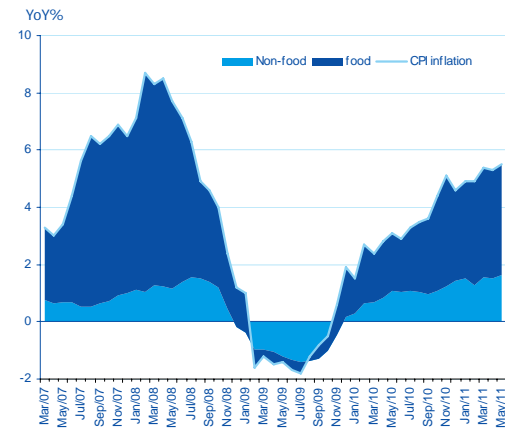
## Inflation prompts more tightening

Although inflation rates may have already peaked in a number of countries, monetary tightening is continuing, as seen this past week in two of the region's giants, namely China and India. Given ongoing inflation pressures, the central banks in both countries took steps this past week, including another 50 bp increase in the Reserve Requirement Ratio in China and a 25bp increase in interest rates in India (see Highlights). In China, although inflation continues to rise, a batch of monthly activity data helped alleviate concerns of a hard-landing.

### No hard-landing in China, but a healthy moderation amidst rising inflation

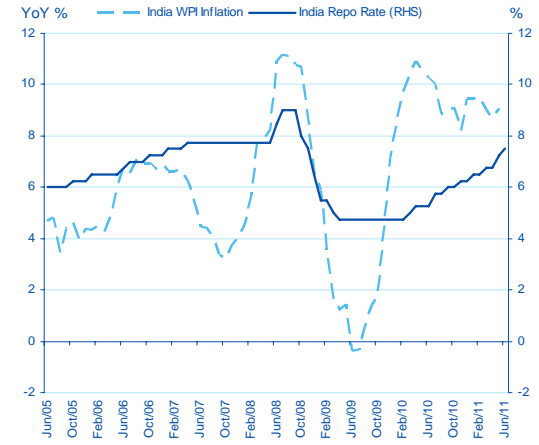
China's CPI inflation for May rose to 5.5% y/y (Chart 1), in line with expectations. At the same time, activity indicators show that growth is moderating, but still remains strong. In particular, May industrial production came in above expectations (13.3% y/y vs. consensus: 13.1%), while other indicators pointed to moderation, such as retail sales and exports, and credit growth. In India, headline (WPI) inflation rose to 9.1% y/y (consensus 8.8% y/y). Elsewhere in the region, despite rising core inflation in the Philippines, the central bank unexpectedly –after two rate increases in a row – kept policy rates unchanged as they believe the previous hikes have begun to take effect. Forward-looking, next week will feature inflation outturns in Singapore, Hong Kong, Malaysia and Vietnam.

Chart 1  
**China's Inflation continues to rise, but should peak soon**



Source: BBVA Research and Bloomberg

Chart 2  
**India's central bank is continuing to raise interest rates to combat persistent inflation**



Source: BBVA Research and Bloomberg

## Highlights

### China: rising inflation brings more monetary tightening

Activity indicators show a healthy moderating trend, while inflation remains high

### Hong Kong introduces new measures to cool residential property market

Ample liquidity and low interest rates continue to fuel property prices

### RBI tightens further as inflation trends higher

The central bank has been aggressive in countering inflation

- Markets →
- Highlights →
- Calendar →
- Markets Data →
- Charts →

Economic Analysis

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## Markets

Risk aversion escalated this week as markets started to question the capability of Greece to obtain the bailout funds quickly and avoid default. While China's May activity data prints quelled doubts about an imminent hard-landing, the worries about US growth slowing has deepened. As a result, equities tumbled, 10-year US Treasury yields dipped below 3.0% and oil prices declined. In FX markets, the USD-index rallied and re-gained the status of safe-haven currency again. EURUSD took a dive and fell below 1.4200. Asian equities indices tracked the fall in its global counterparts. Compared to past episode of heightening risk aversion, Asian FX fell only modestly, with CNY still on track of mild appreciation. The trends indicate the resilience of Asian economies perceived by many investors amidst uncertainties.

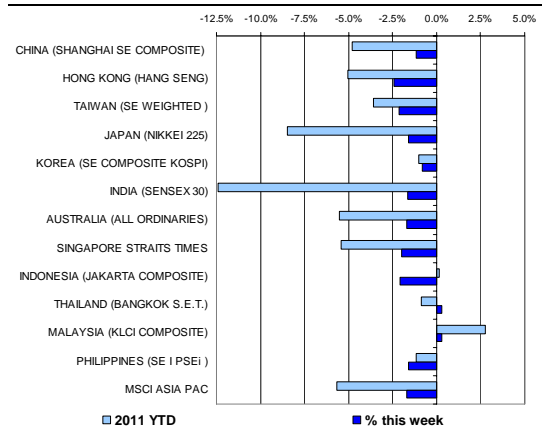
### Growth and Eurozone worries rattle investors

A torrent of negative news caused jitters in global financial markets, and Asian markets could not be immune. Greece's Prime Minister failed to reach agreement with the opposition party to form a new coalition government and announced to reshuffle his cabinet and seek a vote of confidence in Parliament immediately. Meanwhile, locals were reported to take the budget cuts to the street. The news simply highlighted the difficulties in arriving a cross-party agreement on fiscal consolidation plan to obtain the second bailout funds. In wider Europe, no official statement was given following the ECOFIN meeting this Tuesday, prompting investors to question the capacity of EU leaders in reaching agreement within this month on conditions for granting fresh financial aids to Greece. The possibility of further procrastination to July added pressures on EUR and other risk assets. Investors were also worried about potential spillover from Greece after Moody's put three major French banks under review for a possible downgrade on their exposure to Greek debt. US growth concerns also deepened, as the Empire State Manufacturing Survey, the first monthly view of US industrial activities, showed sharp deterioration in June. The confluence of negative news hit sentiment, with Asian equities and FX broadly lower compared to previous Friday close.

### Asian central banks still focus on inflation, not growth

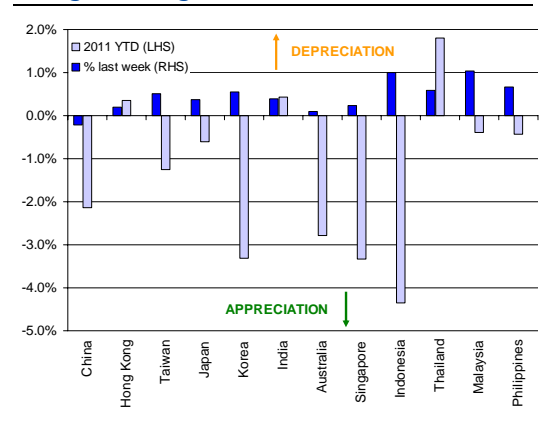
This week three central banks in the region decided to step up tightening measures to control inflation. The PBoC raised the required reserve ratio by 50 bps ensuing May data prints, which showed persistently high price pressures and little loss in growth momentum. Markets had largely anticipated further tightening measures down the road, but the timing of further liquidity squeeze was somewhat a surprise given M2 growth for May fell short of targets for two months in a row. The Reserve Bank of India (RBI) matched market expectation by hiking the repo rates by 25 bps, and the hawkish tone in the accompanying policy statement signaled more rate hikes ahead. The Philippines central bank (BSP) opted to raise reserve requirement ratio by 100 bps to 20% instead of a widely-expected rate 25 bps interest rate hike. It appears that recent slowdown in inflation has given room for the BSP to pace its rate hikes more gradually. In general, the latest round of monetary tightening is a further indication of strength in the macro fundamentals in the region, which offers buffer to Asian FX against depreciation amidst the current market dislocations.

Chart 3  
**Stock markets**



Source: BBVA Research and Bloomberg

Chart 4  
**Foreign exchange markets**



Source: BBVA Research and Bloomberg

## Highlights

### China: rising inflation brings more monetary tightening

The People's Bank of China (PBoC) earlier this week announced another 50bp hike in the required reserve ratio (RRR) (chart 5), effective from June 20. It marks the sixth hike in the RRR this year on top of two 25bp hikes in interest rates, and is expected to withdraw around RMB 390 billion in liquidity. The move brings the RRR for large banks to a new record of 21.5%. The hike in the RRR came on the heels of the release of the latest batch of monthly economic indicators, for May. Robust outturns for industrial production, retail sales and urban fixed investment all helped to allay concerns of a hard-landing. However, headline inflation in May climbed to 5.5% y/y, the highest figure since August 2008, driven by both food and non-food components. The outturn was in line with expectations, but well above the authorities' 4% comfort range. We expect inflation to peak in June at around 6%, before declining during the second half of the year. Given ongoing inflation risks, we expect the authorities' gradual monetary tightening to continue, with two more rate hikes in Q2/Q3, and at least another 50bps increases in the RRR.

### Hong Kong introduces new measures to cool residential property market

The Hong Kong Monetary Authority (HKMA) last Friday announced additional macro-prudential measures to restrain residential mortgage lending and slow the pace of price increases in the residential property market. The move comes amidst continuing concern about the rapid pace of bank lending and financial stability. For residential properties valued between HK\$7-10 million (US\$0.9-1.3 million), the maximum loan-to-value ratio (LTV) will be capped at 60%, and residential properties valued at HK\$10 million or above will have their LTV ratio capped at 50% (previously, the LTV ratios were capped at 70% and 60% for residential properties valued at HK\$7-8 million and HK\$10-12 million, respectively). The authority has also adopted differing rules for resident and non-resident purchasers for the first time (wealthy mainland Chinese buyers are estimated to have accounted for about 30% of the purchases of luxury property over the past year). Meanwhile, on the supply side, the government announced plans to double land supply in Q3. The latest move is the first set of measures since last November, when a round of macro-prudential measures and a Special Stamp Duty were implemented to curb speculation (see our [Asia Weekly](#) last November). In turn, trading volumes have fallen. That said, the property market remains buoyant, with overall residential property prices surpassing the 1997 peak and increasing 11.5% during the first four months of 2011.

### RBI tightens further as inflation treads higher

In addition to China, inflation remains a concern amongst many fast-growing economies in Asia, particularly in India, where policymakers have hiked interest rates ten times since March 2010. As such, the release this week of May inflation data was closely watched. It suggested no let up in price pressures as India's WPI inflation rose by 9.1% y/y in May from 8.7% in April, surpassing consensus expectations of 8.8% y/y. On a seasonally adjusted basis (SA), we estimate that WPI was up 0.5% m/m from 0.2% in April. The pick-up was mainly due to an acceleration in core inflation, which rose by 7.2% y/y last month, up 1.1% m/m SA. Pass through of higher input prices to retail prices continues as manufacturers face margin pressures in a rising interest rates scenario. Meanwhile, tight supplies due to rising demand pressures continued to weigh on food prices, which rose by 8.0% y/y last month. Fuel prices rose by 12.3% y/y in May and are expected to edge higher in coming months amidst imminent hikes in controlled fuels and possible hike in electricity prices. We expect trends in inflation to remain elevated over 3Q11, thereby underpinning RBI's anti-inflation drive. In this context, the latest hike in the benchmark repo rate by 25 bps to 7.5% alongside a hawkish guidance is along expected lines. The combination of high inflation, tightening policy and moderating growth has weighed on Indian market sentiment over recent days, particularly on the debt front. We expect the rate cycle to peak with another 25bps hike in 2011, a move aimed to rein in demand-side inflationary pressures through a soft-landing, without dislocating the growth momentum. The ongoing real economic trends are in line with our expectations of a stable trend growth rate of 8.1% y/y in 2011 while risks to our inflation forecast of 8.0% y/y are biased on the upside.

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[Home](#) →

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[Markets](#) →

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[Calendar](#) →

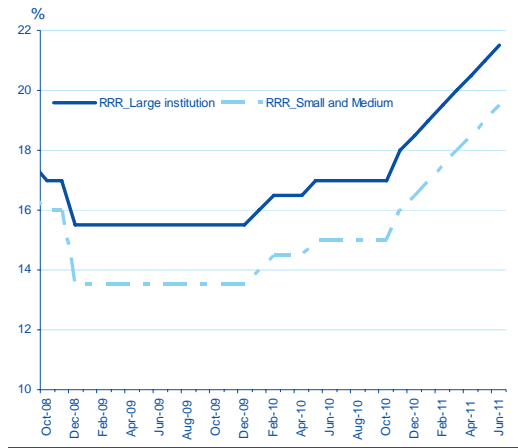
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[Markets Data](#) →

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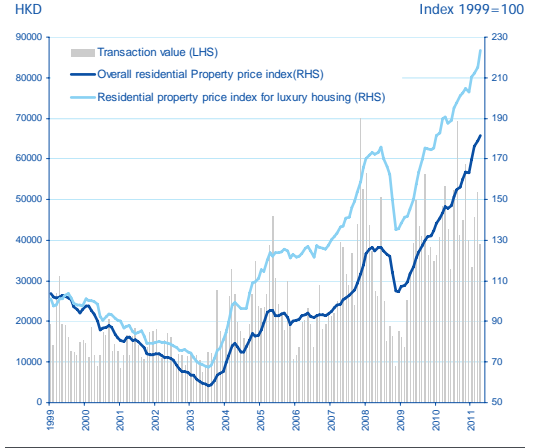
[Chart](#) →

Chart 5  
China sees another hike in the RRR



Source: BBVA Research and Bloomberg

Chart 6  
Bubble risks remain in Hong Kong's property market



Source: BBVA Research and Bloomberg

## Calendar Indicators

<b>Hong Kong</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
CPI - Composite Index (YoY)	21-Jun	MAY	4.60%	5.20%
Bal of Paymts - Current A/C	23-Jun	1Q	\$32.61B	--
Bal of Paymts - Overall	23-Jun	1Q	\$30.6B	--
<b>Indonesia</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
Total Local Auto Sales	20-24 JUN	MAY	\$60,702	--
Total Motorcycle Sales	20-24 JUN	MAY	\$705,165	--
<b>Japan</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
Merchnds Trade Balance Total	20-Jun	MAY	-¥463.7B	-¥711.1B
Adjusted Merchnds Trade Bal.	20-Jun	MAY	-¥496.4B	-¥520.0B
Merchnds Trade Exports YoY	20-Jun	MAY	-12.5	-8.1
Merchnds Trade Imports YoY	20-Jun	MAY	8.9	11.6
Convenience Store Sales YoY	20-Jun	MAY	1.60%	--
All Industry Activity Index (MoM)	21-Jun	APR	-6.30%	1.80%
Supermarket Sales (YoY)	22-Jun	MAY	-1.30%	--
Corp Service Price Index (YoY)	24-Jun	MAY	-0.80%	-0.70%
<b>Malaysia</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
CPI YoY	22-Jun	MAY	3.20%	3.30%
<b>Philippines</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
Balance of Payments	20-Jun	MAY	\$1084M	--
Budget Deficit/Surplus	20-27 JUN	MAY	26.3B	--
<b>Singapore</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
CPI (YoY)	23-Jun	MAY	4.50%	4.10%
Industrial Production YoY	24-Jun	MAY	-9.50%	-7.20%
<b>Taiwan</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
Export Orders (YoY)	20-Jun	MAY	10.14%	11.00%
Unemployment Rate - sa	22-Jun	MAY	4.35%	4.30%
Commercial Sales (YoY)	23-Jun	MAY	4.87%	4.10%
Industrial Production (YoY)	23-Jun	MAY	6.85%	4.60%
Money Supply M2 Daily Avg YoY	24-Jun	MAY	5.88%	--
<b>Thailand</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
Total Car Sales	15-24 JUN	MAY	67283	--
Customs Exports (YoY)	20-24 JUN	MAY	24.60%	16.00%
Customs Imports (YoY)	20-24 JUN	MAY	27.90%	--
Customs Trade Balance	20-24 JUN	MAY	-\$797M	--
<b>Vietnam</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
Exports YTD (YoY)	23-28 JUN	JUN	32.80%	--
Imports YTD (YoY)	23-28 JUN	JUN	29.70%	--
CPI (YoY)	24-30 JUN	JUN	19.80%	--

### Indicator of the Week: Japan export growth in May (June 20)

**Forecast: 1.3% y/y**
**Consensus: -8.4% y/y**
**Prior: -12.4% y/y**

**Comment:** After a series of disappointing production and activity indicators in March and April, it appears that a strong rebound is underway as disruptions to supply chains, especially in the auto sector, are diminishing. As a result, May exports should begin to show some growth. **Market impact:** A higher-than-expected outturn would lift confidence in Japan's recovery and growth outlook.

## Calendar Events

**Japan - Cabinet Office Monthly Economic Report, June 20**
**Australia - Reserve Bank's Board June Minutes, June 21**
[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.	2674.0	-1.2	-4.8	4.4
	Hong Kong - Hang Seng	21876.3	-2.4	-5.0	8.6
	Taiwan - Weighted	8649.8	-2.1	-3.6	15.1
	Japan - Nikkei 225	9361.9	-1.6	-8.5	-6.4
	Korea - Kospi	2031.0	-0.8	-1.0	18.9
	India - Sensex 30	17966.9	-1.7	-12.4	2.0
	Australia - SPX/ASX 200	4483.9	-1.7	-5.5	-1.0
	Singapore - Strait Times	3015.6	-2.0	-5.5	6.0
	Indonesia - Jakarta Comp	3708.4	-2.1	0.1	28.3
	Thailand - SET	1023.5	0.3	-0.9	29.7
	Malaysia - KLCI	1560.8	0.3	2.8	19.7
	Philippines - Manila Comp.	4153.1	-1.6	-1.1	25.3

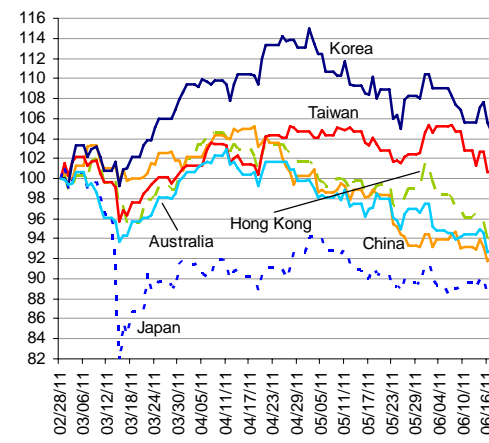
Last update: Friday, 11.15 Hong Kong time.

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.47	0.21	6.45	6.39
	Hong Kong (HKD/USD)	7.80	-0.20	7.8	8
	Taiwan (TWD/USD)	28.9	-0.52	28.81	28.25
	Japan (JPY/USD)	80.6	-0.37	80.6	80.2
	Korea (KRW/USD)	1089	-0.55	1093.95	1106.31
	India (INR/USD)	44.9	-0.38	45.5	47
	Australia (USD/AUD)	1.05	-0.09	1	n.a.
	Singapore (SGD/USD)	1.24	-0.21	1.24	1.2
	Indonesia (IDR/USD)	8605	-0.99	8703	9003
	Thailand (THB/USD)	30.6	-0.59	30.82	31.3
	Malaysia (MYR/USD)	3.05	-1.03	3.1	3
	Philippines (PHP/USD)	43.6	-0.66	43.85	44.01

Last update: Friday, 11.15 Hong Kong time.

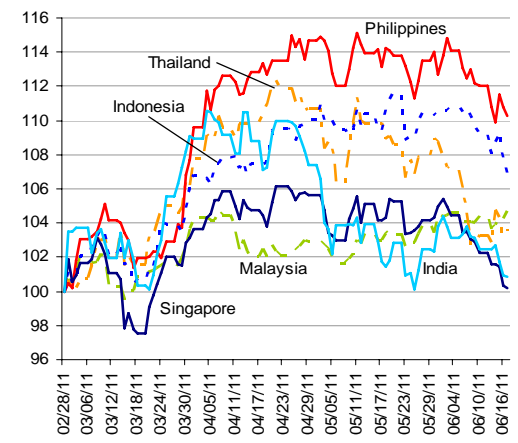
Charts

Chart 7  
Stock Markets



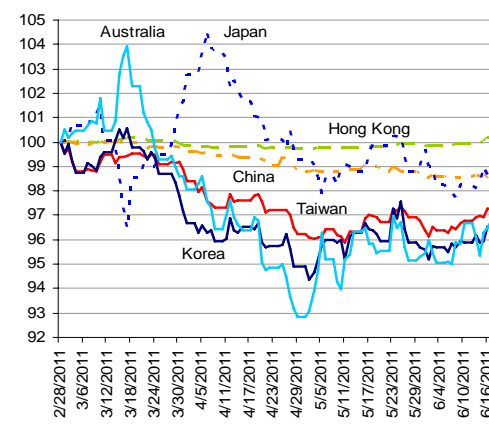
Source: BBVA Research and Bloomberg

Chart 8  
Stock Markets



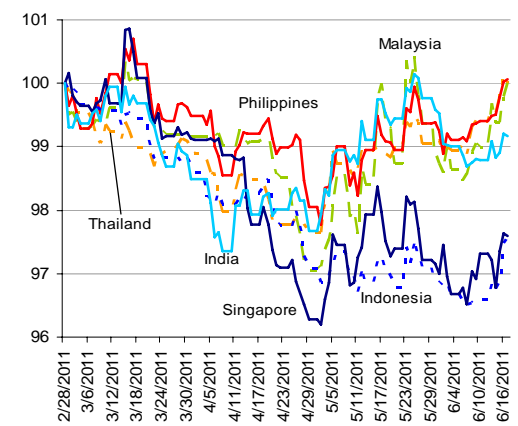
Source: BBVA Research and Bloomberg

Chart 9  
Foreign Exchange Markets



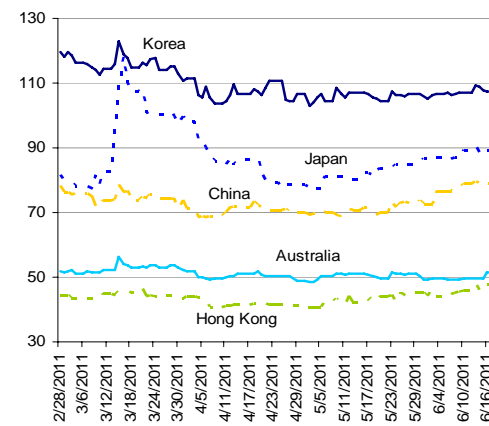
Source: BBVA Research and Bloomberg

Chart 10  
Foreign Exchange Markets



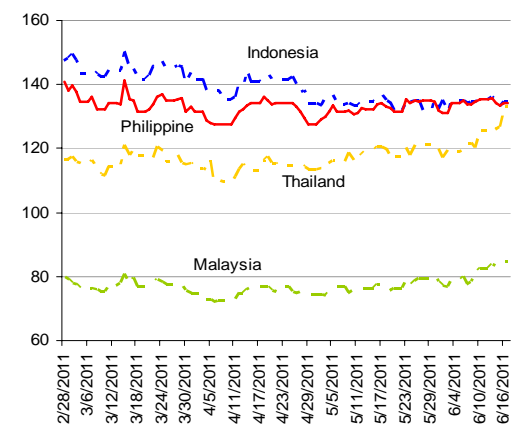
Source: BBVA Research and Bloomberg

Chart 11  
Credit Default Swaps



Source: BBVA Research and Bloomberg

Chart 12  
Credit Default Swaps



Source: BBVA Research and Bloomberg

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