

Weekly Watch

Asia

17 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

Claire Chen
claire.chen@bbva.com.hk

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

Mario Nevares
mario.nevares@bbva.com.hk

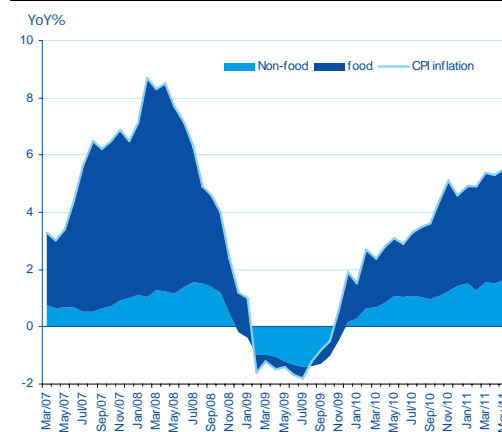
Inflation prompts more tightening

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

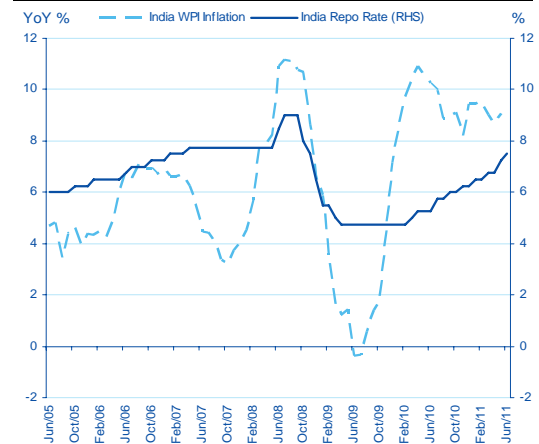
China's CPI inflation for May rose to 5.5% y/y (Chart 1), in line with expectations. At the same time, activity indicators show that growth is moderating, but still remains strong. In particular, May industrial production came in above expectations (13.3% y/y vs. consensus: 13.1%), while other indicators 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 treads higher

The central bank has been aggressive in countering inflation

Markets →

Highlights →

Calendar →

Markets Data →

Charts →

Economic Analysis

Richard Li
richard.li@bbva.com.hk

Mario Nevares
mario.nevares@bbva.com.hk

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.

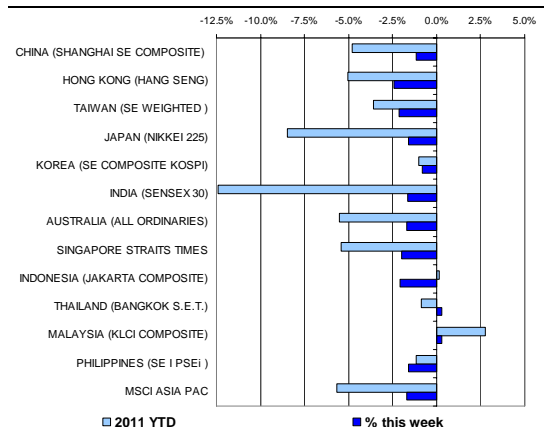
Growth and Eurozone worries rattle investors

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

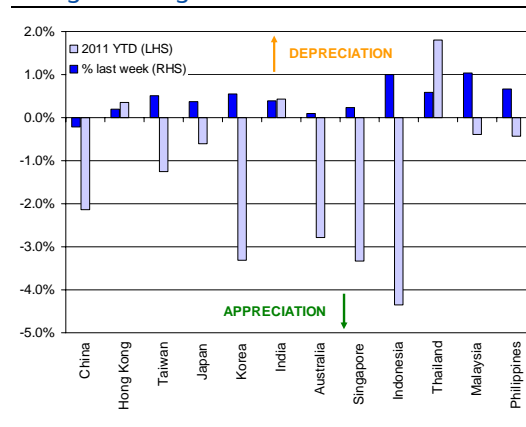
This week three central banks in the region decided to step up tightening measures to control inflation. The PBoC raised the required reserve ratio by 50 bps ensuing May data prints, which showed persistently high price pressures and little loss in growth momentum. Markets had largely anticipated further 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

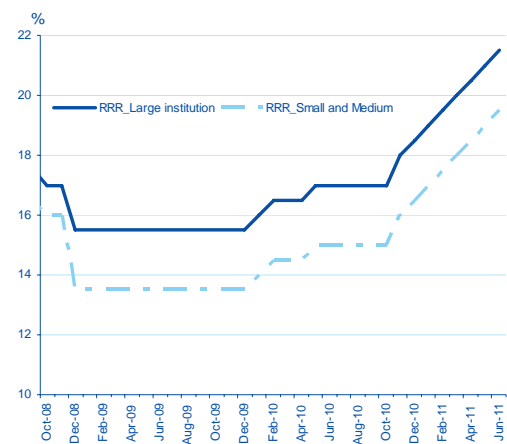
The Hong Kong Monetary Authority (HKMA) last Friday announced additional macro-prudential measures to restrain residential mortgage lending and slow the pace of price increases in the residential property market. The move comes amidst continuing concern about the rapid pace of bank lending and financial 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.

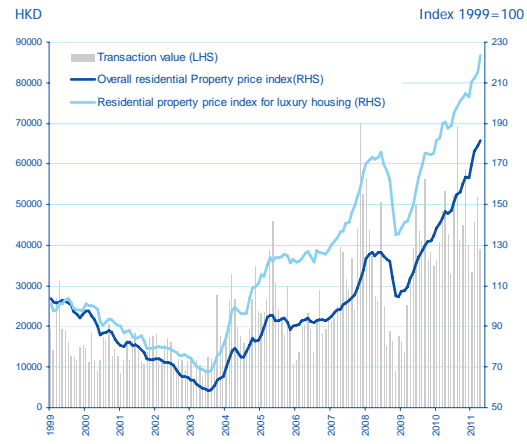
Home	➔
Markets	➔
Calendar	➔
Markets Data	➔
Chart	➔

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

Hong Kong	Date	Period	Prior	Cons.
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	--
Indonesia	Date	Period	Prior	Cons.
Total Local Auto Sales	20-24 JUN	MAY	\$60,702	--
Total Motorcycle Sales	20-24 JUN	MAY	\$705,165	--
Japan	Date	Period	Prior	Cons.
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%
Malaysia	Date	Period	Prior	Cons.
CPI YoY	22-Jun	MAY	3.20%	3.30%
Philippines	Date	Period	Prior	Cons.
Balance of Payments	20-Jun	MAY	\$1084M	--
Budget Deficit/Surplus	20-27 JUN	MAY	26.3B	--
Singapore	Date	Period	Prior	Cons.
CPI (YoY)	23-Jun	MAY	4.50%	4.10%
Industrial Production YoY	24-Jun	MAY	-9.50%	-7.20%
Taiwan	Date	Period	Prior	Cons.
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%	--
Thailand	Date	Period	Prior	Cons.
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	--
Vietnam	Date	Period	Prior	Cons.
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

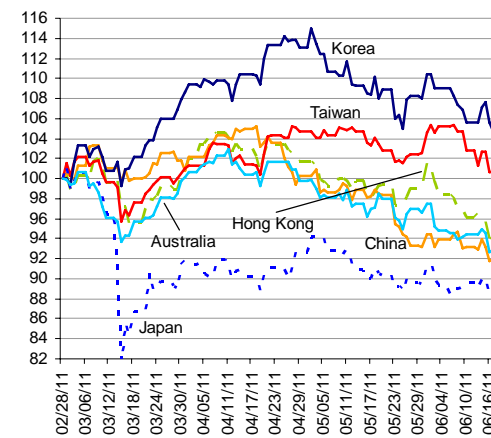
Last update: Friday, 11:15 Hong Kong time.

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.

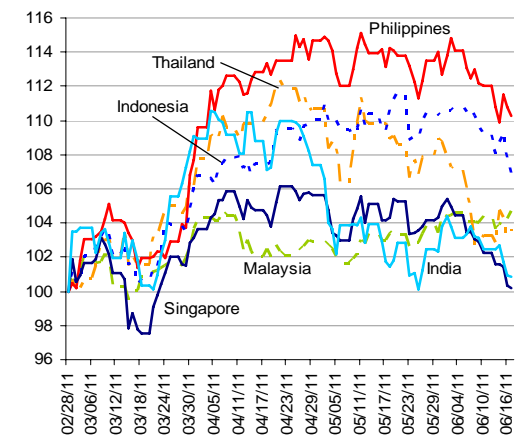
Charts

Chart 7
Stock Markets



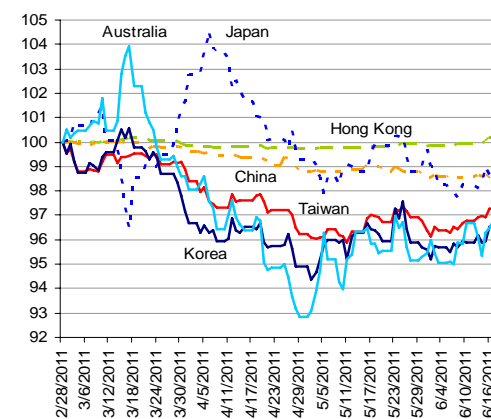
Source: BBVA Research and Bloomberg

Chart 8
Stock Markets



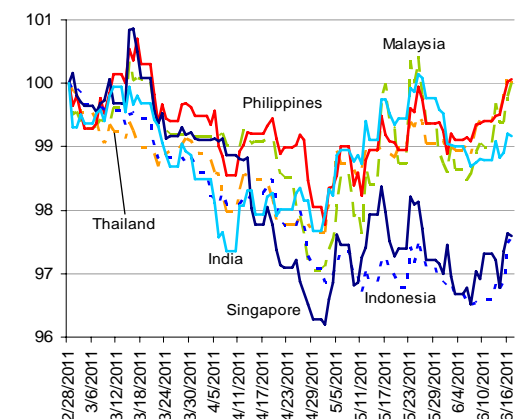
Source: BBVA Research and Bloomberg

Chart 9
Foreign Exchange Markets



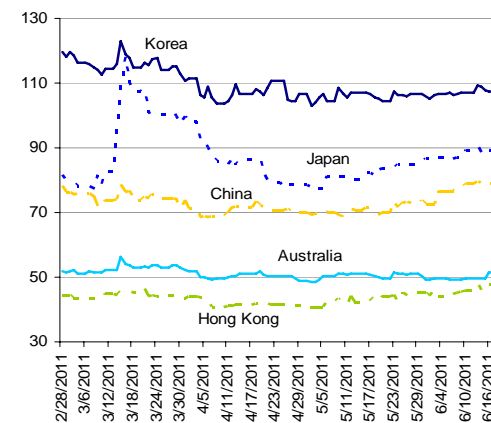
Source: BBVA Research and Bloomberg

Chart 10
Foreign Exchange Markets



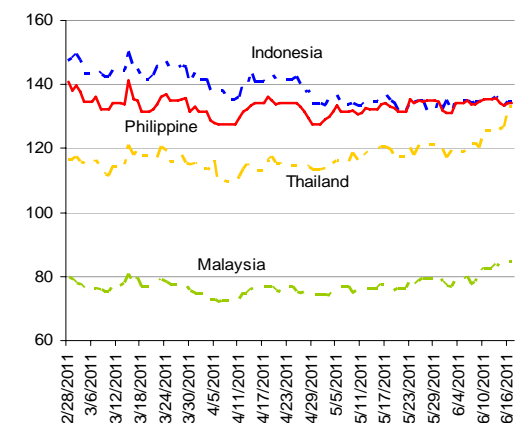
Source: BBVA Research and Bloomberg

Chart 11
Credit Default Swaps



Source: BBVA Research and Bloomberg

Chart 12
Credit Default Swaps



Source: BBVA Research and Bloomberg

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 / 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.