Weekly Watch

Asia

30 June 2011
Economic Analysis

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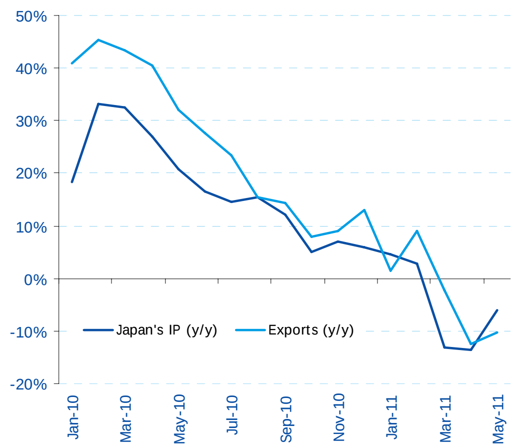
Markets rise on Greek vote

We are printing our Weekly ahead of schedule this week, due to a holiday tomorrow in Hong Kong (July 1). Markets have generally rallied on positive news from Europe (see Markets). Missing from our report this week is PMI data to be released in China, and June inflation for Korea, Thailand, and Indonesia. Other than the Greek debt concerns, the regional focus has been on new public debt figures in China (Highlights) and Japan's rebound from the worst of the effects of last March's earthquake and tsunami. Meanwhile, Thailand is bracing for general elections on July 3 (Highlights).

Markets watch for June inflation

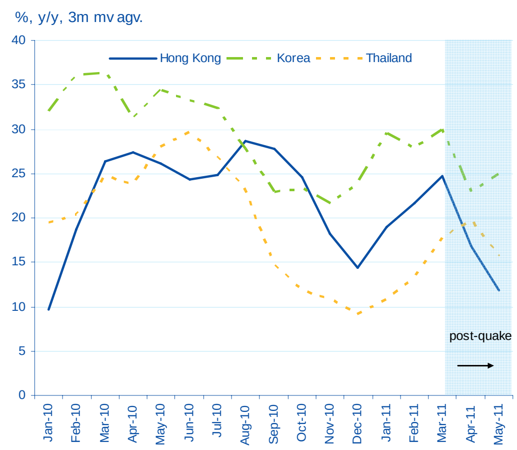
Data released so far this week confirm a rebound in Japan (Chart 1), and better than expected regional export trends (Chart 2). In Hong Kong, exports for May rebounded to 10.1% (consensus: 3.9%), while Thailand's May exports came to 17.3% y/y. Taiwan's central bank hiked policy rates by another 12.5 bp, as expected, as it continues to normalize its monetary policy stance.

Chart 1
Japan's economy has bottomed out...



Source: BBVA Research and Bloomberg

Chart 2
Asian exports weaken due to global slowdown



Source: BBVA Research and Bloomberg

Highlights

China's Audit Office puts local government debt at 22% of GDP

New official data on local government debt came lower than some market estimates

Thai elections loom, with political stability weighing on the economic outlook

Despite ongoing political turbulence, Thailand's growth has been resilient

Fuel price hikes by India lift market sentiment but weigh on inflation

New fuel price increases put upward pressure on India's inflation

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Markets

The overwhelming focus of the region's financial markets in recent days has been on the Greek Parliamentary vote of the medium-term fiscal consolidation plan, a key condition for continued international support. The passage of these measures gave way to notable rallies in equities and risk assets. The responses of Asian FX were relatively muted, with most currencies in the region ending flat compared to last week's close.

Greek debt rollover talks may keep Asian markets volatile

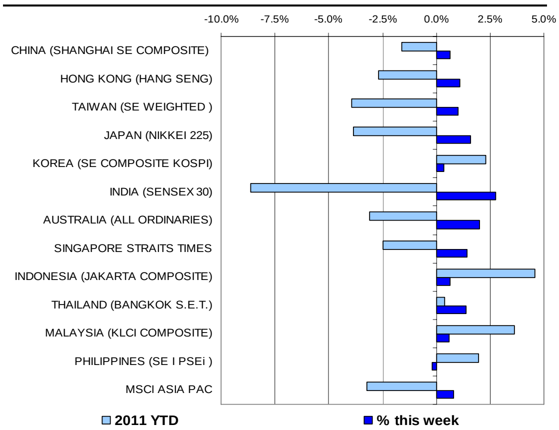
Despite the passage of austerity measures, there remain risks in passing the second bailout plan, as EU leaders still have to define the private-sector participation, enlist support from the majority of creditors and convince rating agencies the rollover plan not in violation of any default clauses. Before the dust settles, markets could still be volatile. That said, the vote Wednesday night demonstrated Greece's resolve to deficit cuts, helping to pave the way for IMF and EU disbursements. If confirmed, the money will be sufficient to tide Greece over through the summer and remove near-term liquidity risks. In this context, markets will focus on the attitude of EU and IMF officials in the coming days and the EcoFin meeting on July 3.

China's policy at a critical juncture

Premier Wen's recent remarks about victory in inflation and tolerance of higher CPI prints have raised expectations for a turn in policy. While it is too early to jump to the conclusion that China will end its tightening cycle so soon, we do see three significant developments in recent month that could cause policymakers to take a more cautious approach in 2H.

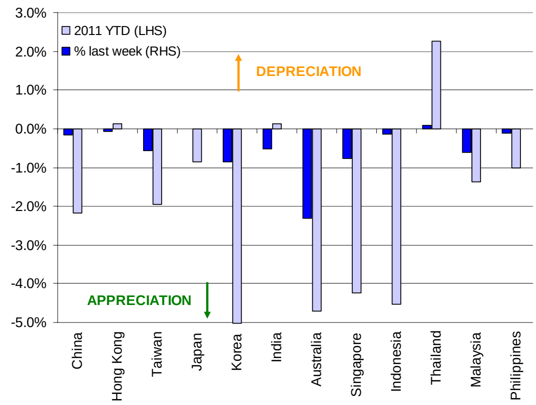
Firstly, oil prices have seen significant correction, and recent moves by IEA to release reserves should help protect the global economy from further oil spikes. Upside risks to inflation from higher commodity prices have subsided. Secondly, PMI surveys around the world have shown signs of weakness in recent months. While it is still uncertain the recent weakness is merely a mid-cycle soft patch or a harbinger of extended subdued growth, it is fair to say that external environment in 2H likely less supportive compared to 1H. Finally, China's PMI also indicate slowing growth momentum going forward, even though activity indicators thus far have seen little deceleration. Additionally, monetary aggregate have fallen short of targets, with signs of severe liquidity squeeze seen in money markets. While CPI is still stubbornly high, probably near 6.0% in June due in part to base effects, most anticipate CPI inflation will fall gradually in 2H. Given balance of risks, it may be sensible for China's policymakers, especially those at PBOC, to re-assess its policy strategy in 2H at this point. In this context, the forthcoming China's PMI due tomorrow will be critical. The latest HSBC Flash PMI has hinted further moderation. If materialize, the index would not be far off the 50 mark and would reduce the likelihood of further policy tightening we envisage in 2H. For the time being, we continue to expect two more rate hikes and another 50bp hike in the required reserve ratio in the next one to two quarters.

Chart 3
Stock markets



Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets



Source: BBVA Research and Bloomberg

Economic Analysis

Highlights

China's Audit Office puts local government debt at 22% of GDP

On Monday, China's National Audit Office (NAO) announced its findings that total local government debt stands at RMB 10.7 trillion (22% of GDP), among which about half consists of obligations via local government financing vehicles (LGFVs). The figure for LGFV loans is much lower than previous estimates from official sources, and by the market. We believe that differing estimates are due to varying definitions and concepts, rather than a deliberate attempt to distort the picture. In any case, the new data may be useful in assessing the true size of outstanding LGFV debt, which we now estimate to be around RMB 14 trillion as of end-2010, equivalent to 35% of GDP. Not all of this debt bears an explicit local or central government guarantee (the reason why the NAO estimates local government debt from these vehicles at just RMB 5 trillion). The new estimates generated a flurry of exchanges in the media about true public debt burden in China, which some estimate to be as high as 80% of GDP, including both central and government debt. While not posing a near term financing problem, such a level, if allowed to growth further, could result in local government debt servicing problems and NPLs in the future. In recent weeks, reports of a proposal by the Ministry of Finance have circulated for the central government and banks to bear some of these debts. A positive message, in our view, is that officials are aware of the risks and are taking steps to address them.

Thai elections loom, with political stability weighing on the economic outlook

Thais are set to vote this coming Sunday, July 3 in long-anticipated general elections, marking another milestone in the turbulent and sometimes violent political scene that erupted in 2006 with the coup that sent ex-Prime Minister Thaksin Shinawatra into overseas exile. The election will pit the so-called "red-shirt" opposition party of Thaksin followers against the "yellow-shirts" associated with ruling Democrat Part of Prime Minister Abhisit Vejjajiva. Thaksin's sister, who is a defacto stand-in for Thaksin himself, is leading the opposition and appears ahead in the polls, just days ahead of the election. Clashes are feared, given the tumultuous past, in which neither side has shown a willingness to accept election results and engage in compromise. Throughout the period of turmoil in recent years, the Thai economy has shown a remarkable resilience. While tourism, a mainstay of Thailand's economy has suffered blows from time to time, it has bounced back, and Thailand's exports have remained resilient, even in the face of recent supply disruptions from Japan, which invests heavily in the auto sector. GDP growth was 7.8% in 2010 (Chart 5), and we project growth of 3.8% in 2011. While post-election political instability poses downside risks to the economic outlook, the policy outlook is not expected to change. Indeed, both sides have similar policy proposals, pledging increases in minimum wages and other populist schemes. In the meantime, the Bank of Thailand (BoT) has continued to highlight inflationary risks, especially with core inflation on the rise. So far in this year, interest rates have been increased three times (25bps each) and we expect the central bank to hike two more times during the remainder of the year.

Fuel price hikes by India lifts market sentiment but weighs on inflation

At a time when most economies are seeing inflationary relief from easing international oil prices, India's battle with high inflation is getting tougher. The worsening inflation outlook for India is due in part to a discretionary policy move by the Indian authorities to raise administered fuel prices while concurrently cutting indirect taxes on petroleum products. On June 24th 2011, diesel prices were raised by 9%, kerosene by 20% and LPG by 14% with immediate effect. The move was long awaited and perhaps inevitable as administered fuel prices were left unchanged for nearly a year despite previously rising global crude oil prices. The government expects the price adjustments to help reduce the losses of oil marketing companies, who have been selling these fuels at subsidized rates. However, to cushion the price burden on consumers, the government has announced a 5% reduction of customs duty on crude oil as well as on petroleum products, while simultaneously cutting the excise duty on diesel. Indian equity markets welcomed the decision as it augurs well for industry, particularly the financial health of state owned oil retailers. The move, however, is negative from a fiscal as well as inflation perspective. Lower tax revenues and still-high subsidies will weigh on the deficit, which we project at 5.7% of GDP for 2011. The policy move increases the upside risks to our 2011 inflation forecast of 8.0% (Chart 6), which we have been flagging for some time. We estimate the aggregate impact of the combined fuel price hikes could add around 100 bps to headline inflation over the coming months. With significant policy tightening already in pipeline, we maintain our expectations of an end to RBI's rate hike cycle following another 25 bps policy rate hike on July 26th 2011.

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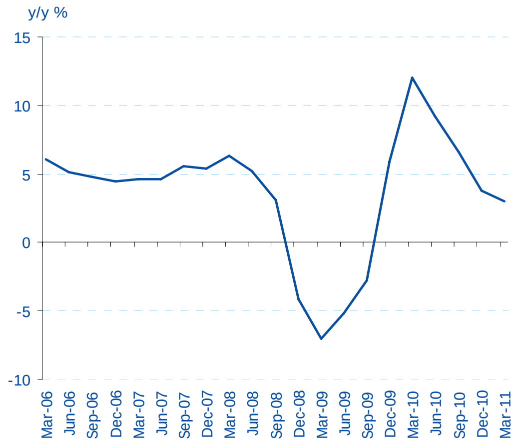
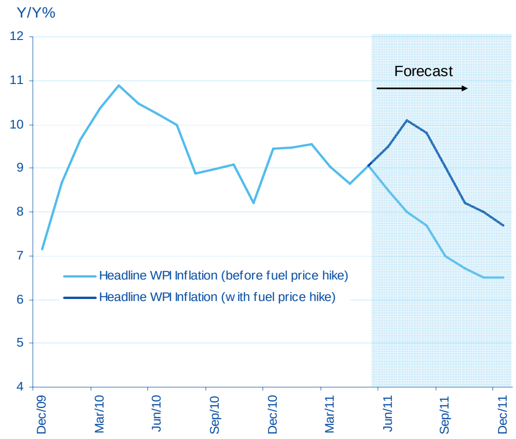
Chart 5
Thailand's GDP growth has been resilient even in the face of political turmoil



Source: BBVA Research and Bloomberg

Chart 6
India inflation outlook will be affected by the fuel price hike



Source: BBVA Research and Bloomberg

Calendar Indicators

China	Date	Period	Prior	Cons.
Building Approvals (MoM)	4-Jul	MAY	-1.30%	- -
Retail Sales s.a. (MoM)	4-Jul	MAY	1.10%	- -
Trade Balance	5-Jul	MAY	1597M	- -
Unemployment Rate	7-Jul	JUN	4.90%	- -
China	**Date**	**Period**	**Prior**	**Cons.**
China Non-manufacturing PMI	3-Jul	JUN	61.9	- -
China HSBC Services PMI	5-Jul	JUN	54.3	- -
Business Climate Index	8-Jul	2Q	133.8	- -
Hong Kong	**Date**	**Period**	**Prior**	**Cons.**
Retail Sales - Value (YoY)	4-Jul	MAY	27.70%	28.20%
Purchasing Managers Index	04-05 JUL	JUN	52.2	- -
Indonesia	**Date**	**Period**	**Prior**	**Cons.**
Money Supply - M2 (YoY)	07-13 JUL	MAY	15.10%	- -
Japan	**Date**	**Period**	**Prior**	**Cons.**
Monetary Base (YoY)	4-Jul	JUN	16.20%	- -
Machine Orders (MoM)	7-Jul	MAY	-3.30%	- -
Japan Money Stock M2 YoY	8-Jul	JUN	2.70%	- -
Current Account Balance YOY%	8-Jul	MAY	-69.50%	- -
Trade Balance - BOP Basis	8-Jul	MAY	-¥417.5B	- -
Bankruptcies (YoY)	8-Jul	JUN	4.90%	- -
Malaysia	**Date**	**Period**	**Prior**	**Cons.**
Exports YoY%	5-Jul	MAY	11.10%	11.00%
Imports YoY%	5-Jul	MAY	9.40%	8.50%
Trade Balance	5-Jul	MAY	11.01B	10.80B
Philippines	**Date**	**Period**	**Prior**	**Cons.**
Consumer Price Index (YoY)	5-Jul	JUN	4.50%	4.70%
Korea	**Date**	**Period**	**Prior**	**Cons.**
South Korea FDI (YoY)	01-06 JUL	2Q	30.1	- -
Producer Price Index (YoY)	8-Jul	JUN	6.20%	- -
Taiwan	**Date**	**Period**	**Prior**	**Cons.**
CPI YoY%	5-Jul	JUN	1.66%	1.80%
WPI YoY%	5-Jul	JUN	3.31%	- -
Total Trade Bal in US$ Billion	7-Jul	JUN	$1.22B	$1.02B
Total Exports (YoY)	7-Jul	JUN	9.50%	19.10%
Total Imports (YoY)	7-Jul	JUN	19.30%	22.50%
Vietnam	**Date**	**Period**	**Prior**	**Cons.**
Domestic Vehicle Sales (YoY)	06-12 JUL	JUN	- -	- -

Indicator of the Week: Australia unemployment rate in June (July 7)

Forecast: 4.9%	Consensus: -	Prior: - 4.9%

Comment: Although Australia's unemployment rate has been stable in recent months, the participation rate and full-time jobs figures have been declining, along with GDP growth. The employment data will be watched as an indicator of the health of the economy and by the RBA for future course of monetary policy. Market impact: Stronger-than-expected employment data would lift up market sentiment, and could increase expectations of RBA rate hikes, leading to a stronger Australia dollar.

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Calendar Events

	Current	Actual
Australia – RBA Cash Target, July 5	**Current**	**Actual**
We expect no change in the interest rates	4.75%	4.75%
Malaysia – Overnight Rate, July 7	**Current**	**Actual**
We expect no change in the interest rates	3.00%	3.00%

Markets Data

STOCK MARKETS

INDEX	Last price	% change over a week	Year to date	% Change over 1 Y
China – Shanghai Comp.	2763.8	0.6	-1.6	15.2
Hong Kong – Hang Seng	22418.0	1.1	-2.7	11.4
Taiwan – Weighted	8617.6	1.0	-4.0	17.6
Japan – Nikkei 225	9833.8	1.6	-3.9	4.8
Korea – Kospi	2097.6	0.3	2.3	23.5
India – Sensex 30	18741.1	2.7	-8.6	5.9
Australia – SPX/ASX 200	4598.9	2.0	-3.1	6.9
Singapore – Strait Times	3109.6	1.4	-2.5	9.7
Indonesia – Jakarta Comp	3870.6	0.6	4.5	33.8
Thailand – SET	1036.6	1.3	0.4	30.0
Malaysia – KLCI	1574.5	0.6	3.7	19.8
Philippines – Manila Comp.	4282.6	-0.2	1.9	27.0

Last update: Thursday, 11.15 Hong Kong time.

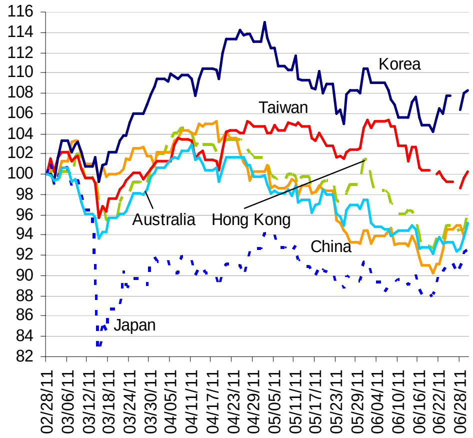
FOREIGN EXCHANGE MARKETS

CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
China (CNY/USD)	6.46	0.07	6.45	6.38
Hong Kong (HKD/USD)	7.78	0.09	7.8	8
Taiwan (TWD/USD)	28.7	0.53	28.51	27.96
Japan (JPY/USD)	80.4	0.10	80.4	80.1
Korea (KRW/USD)	1069	0.69	1075.17	1087.33
India (INR/USD)	44.8	0.44	45.3	47
Australia (USD/AUD)	1.07	2.05	1	n.a.
Singapore (SGD/USD)	1.23	0.59	1.23	1.2
Indonesia (IDR/USD)	8588	0.14	8669	8986
Thailand (THB/USD)	30.7	-0.46	30.91	31.3
Malaysia (MYR/USD)	3.02	0.36	3.0	3
Philippines (PHP/USD)	43.4	0.26	43.55	43.76

Last update: Thursday, 11.15 Hong Kong time.

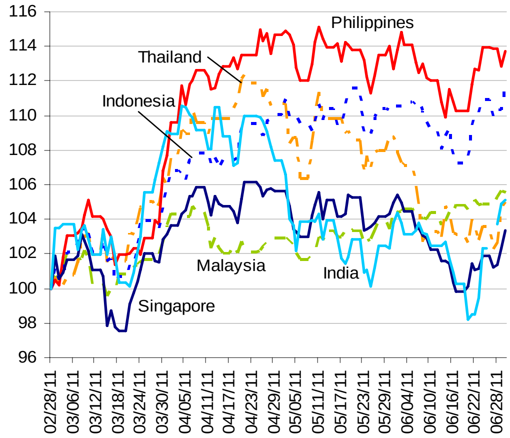
Charts

Chart 7
Stock Markets



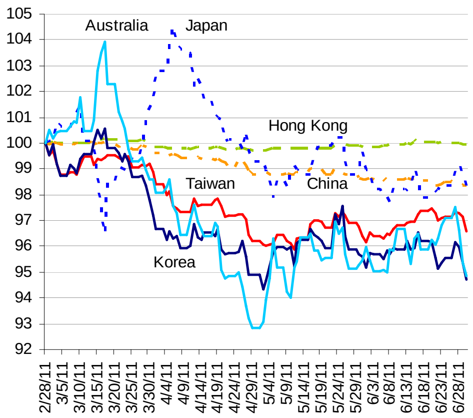
Source: BBVA Research and Bloomberg

Chart 8
Stock Markets



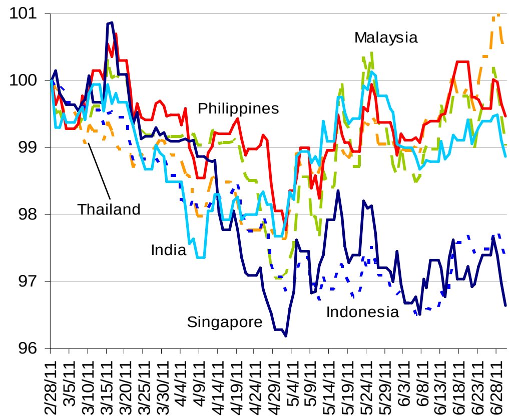
Source: BBVA Research and Bloomberg

Chart 9
Foreign Exchange Markets



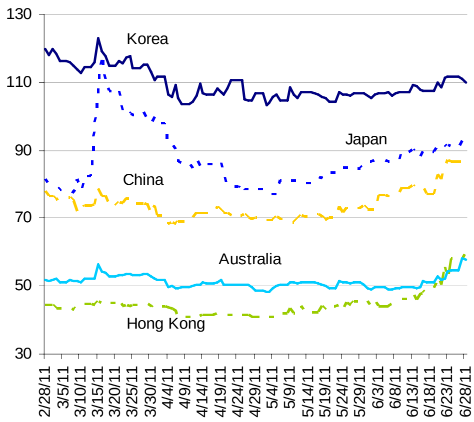
Source: BBVA Research and Bloomberg

Chart 10
Foreign Exchange Markets



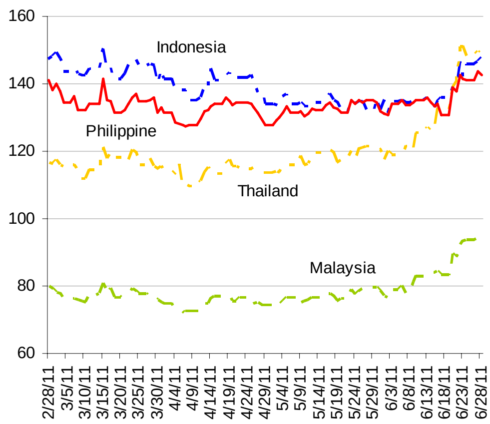
Source: BBVA Research and Bloomberg

Chart 11
Credit Default Swaps



Source: BBVA Research and Bloomberg

Chart 12
Credit Default Swaps



Source: BBVA Research and Bloomberg

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