

Weekly Watch

Asia

5 August 2011
Economic Analysis

Asia

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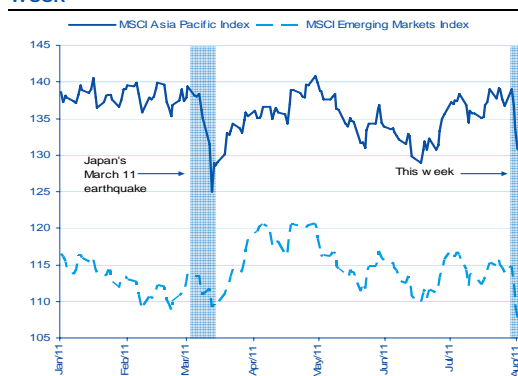
Asian markets slump with global trends

A promising start to the week in the markets ended with a thud. After reacting positively to US congressional approval of the long-awaited debt ceiling agreement and a stronger-than-expected July PMI reading from China (Highlights), Asian markets turned sharply lower on renewed concerns about the global outlook (see Markets and Chart 1). Meanwhile, Japan intervened in the FX market, for only the second time this year, to prevent further appreciation of the yen, which has surged on safe-haven effects. The Bank of Japan also expanded its asset purchase facility, reflecting a further easing of monetary policy. While downside risks to regional growth have increased due to external uncertainties, we continue to have a positive outlook, as described in our latest quarterly [Asia Outlook](#), thanks to continued strong demand from China and India, scope for policy stimulus if needed, and strong underlying fundamentals.

Mixed inflation outturns, with slowing upward tendency

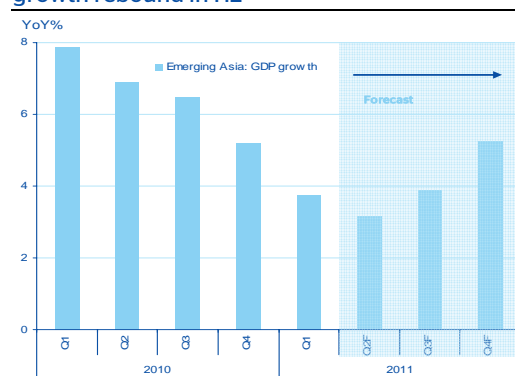
While global issues have overshadowed more mundane concerns about inflation in the region, an important set of data was nevertheless released this past week. Inflation in Korea surprised to the upside at 4.7% y/y, while July outturns for Thailand and the Philippines were flat, and in Indonesia inflation fell (4.6% y/y) below expectations. The rise in global uncertainties and recently benign inflation outturns are likely to slow the pace of interest rate increases in the near term, although in our baseline, we continue to expect further rate hikes in a number of economies during the remainder of the year. Meanwhile, GDP growth is holding up well in Indonesia (Q2 GDP growth of 6.5% y/y, in line with expectations), but the official outlooks for growth have just been reduced in Australia and India. Next week, eyes will be on China's July CPI, trade, and industrial production among others, and on Korea's monetary policy meeting, where we expect no change.

Chart 1
Asian stock markets were down sharply this week



Source: BBVA Research and Bloomberg

Chart 2
Despite a rise in downside risks, we still expect a growth rebound in H2



Source: BBVA Research and Bloomberg

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Highlights

Q3 Asia Outlook: From overheating to worries of a growth slowdown

Despite an increase in downside risks, we hold a positive outlook for the region

China's PMI outturn bodes well for a soft-landing, with eyes on data next week

A strong PMI reading has allayed fears of a hard landing, but will July inflation stay high?

Australia puts rate hikes on hold due to global uncertainties

Despite rising inflation, slowing growth and global uncertainties have put the RBA on hold

Economic Analysis

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Markets

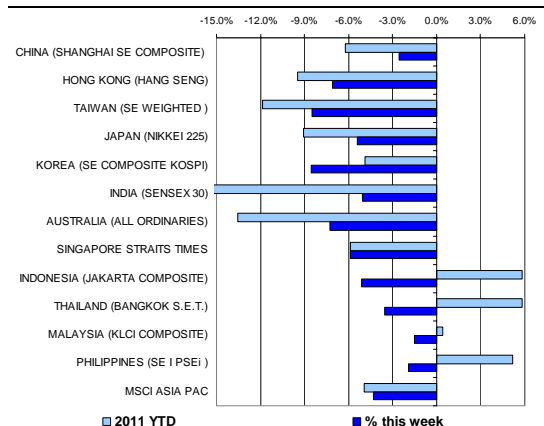
Financial markets were showing signs of panic as the end week drew to a close, on global growth worries and spillovers from the intensifying European debt crisis. The S&P 500 dropped 4.8% on Thursday, making for a cumulative decline of 7.2% so far this week., wiping out a temporary bounce early in the week on a relief rally from the congressional approval of the US debt ceiling. Asian stock markets tracked the slump in global indices and finished the week sharply lower. WTI crude oil futures plunged nearly USD10 to USD86.25/ bbl, while gold prices traded at record-high levels. Interestingly, Asian FX still held up relatively well vs. the USD, even under a extreme risk-averse environment, with high-beta FX in the region such as KRW, IDR and SGD down by less than 2.0% compared to last week's close, probably because of the region's relatively strong underlying fundamentals and lack of appeal for the USD in the current environment.

Markets question the capacity of policymakers

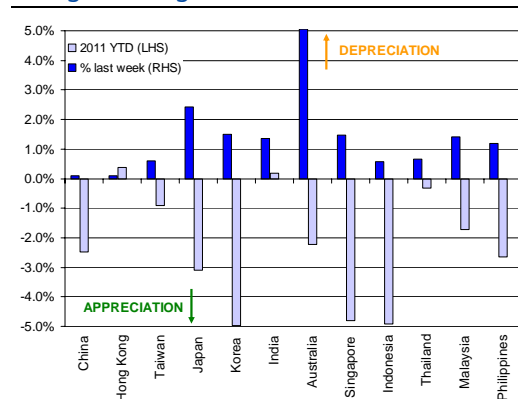
Sharp price declines in risky assets are seemingly a culmination of prevailing uncertainties in Europe and the US. In Europe, there have been growing worries whether the measures announced by EU Summit on July 21 would be approved by individual parliaments in a timely manner, and if not, whether the ECB would step in the debt markets to head off contagion to Spain and Italy. To this end, investors were disappointed thus far as the ECB still showed reluctance to buy Spanish and Italian bonds aggressively in its policy meeting this week. In the US, GDP data suggested the growth slowdown in Q2 was much worse-than-anticipated, and a softer ISM print does not bode well for a rebound in Q3. Worse still, high budget deficits and the medium-term consolidation plan approved Monday imply limited scope for fiscal policy to mitigate a possible downturn. On the monetary front, QE2 has just come to an end, and a fresh round of monetary stimulus is still not yet firmly in sight. As such, there are growing doubts whether global growth will pick up and risk premium will subside in H2, throwing markets into jitters.

Japan intervenes in FX markets with mixed results

The Ministry of Finance intervened in FX markets Thursday to curb the unwelcome rise in the JPY, stemming from the currency's safe-haven characteristics. This is the third move since the intervention in March 2011 and September 2010. On the same day, the Bank of Japan (BoJ) announced additional monetary stimulus of JPY10 tn after the policy meeting to accompany the move. The authorities said their action was communicated with other major central banks, and did not indicate the exact amount of USD purchases. The amounts were probably significant, likely higher than the JPY 692.5bn used in March given USDJPY quickly bounced from 77.1 to 80.2 on Thursday. To the chagrin of Japanese officials, USDJPY subsequently traded back below 78.80 on Friday. We would expect Japanese officials to keep up more aggressive verbal intervention. But in reality in this risk-off market, the BoJ / MoF are going to have a difficult time stemming the tide of JPY inflows. We believe the risk of additional intervention remains high.

Chart 3
Stock markets

Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets

Source: BBVA Research and Bloomberg

Highlights

Q3 Asia Outlook: From overheating to worries of a growth slowdown

In our latest quarterly [Asia Outlook](#), just issued this past week, we highlight the shift in market focus from risks of overheating to concerns about a growth slowdown. This shift has been especially notable over the past week, as seen by the selloff in regional and global stock markets. Our report reviews recent developments, in which we detail the region's growth moderation in the second quarter, which was in line with our previous expectations, due to headwinds from higher commodity prices and disruptions to supply chains from the March 11 earthquake in Japan. We continue to hold a positive outlook for the region, with our baseline projecting a mild rebound in growth during the remainder of the year, on the back of stabilizing commodity prices and a recovery in Japan. While downside risks to the global outlook have come to the fore, robust demand from China and India should help offset sluggish growth in the US and Europe. Also, the region has room for policy maneuver to offset weaker growth, including a slower pace of interest rate hikes and further fiscal stimulus if needed. Inflationary risks remain, although these have eased somewhat with the moderation in growth and stable commodity prices.

China's PMI outturn bodes well for a soft-landing, with eyes on data next week

The latest monthly reading of the Purchasing Managers Index (PMI) was released early this past week, as scheduled (Chart 5). The PMI has become an important and closely watched leading indicator of economic activity, given recent concerns about the pace of China's slowdown and risks of a hard landing. The July outturn helped to allay concerns of a hard landing, as the reading eased slightly for a fifth consecutive month, to 50.7% (from 50.9% in June), but was above expectations (consensus: 50.2%). Within the overall index, the most notable trend was a pick up in new orders, signaling robust demand. And importantly, the PMI remains well above the +50 expansion zone, which bodes well for a gradual and healthy slowdown. A new batch of monthly activity indicators for July will be released next week, including inflation, industrial production, urban fixed asset investment, retail sales, credit and money growth, and trade data. We expect inflation to remain elevated, at 6.3% y/y, but slightly below June's level (see Indicator of the Week). Retail sales growth should remain steady at 17.7%y/y and fixed asset investment to grow at a robust pace of 26.3%y/y. These would be in line with our soft landing scenario, and our full-year GDP projection of 9.4% for 2011. We continue to expect modest further monetary tightening to tame inflation in the months ahead, with an additional 25bp hike in interest rates and a 50bp hike in required reserve ratio (RRR), along with further gradual currency appreciation.

Australia puts rate hikes on hold due to global uncertainties

As expected by most observers (including ourselves), the Reserve Bank of Australia (RBA) kept its policy rate unchanged at 4.75% at its latest policy meeting on August 2. The decision to stay on hold came despite a higher-than-expected inflation outturn for the second quarter of 3.6% y/y (Chart 6), with the RBA expressing concern about global uncertainties and weak growth in Australia's non-mining sector. Australia was one of the first countries in the region to recover from the 2008-09 global financial crisis, prompting a series of aggressive rate hikes from October 2009 to November 2010. However, the recovery was set back early this year by the Queensland floods, and the RBA has been on hold ever since. Heightened global uncertainty is now adding to the factors for the RBA to remain on hold for the time being, reinforced by the central bank's just-released quarterly monetary report in which it lowered the growth outlook to just 2.0% (from 3.25% previously), broadly in line with our 2.3% projection for 2011. Nevertheless, in its report the RBA signaled that inflationary pressures will remain over the medium term, and it projected a strong recovery in 2012. With our own projections of a pick-up in growth during the remainder of the year, we continue to expect one more rate hike later this year, although downside risks to the growth outlook make our call less certain.

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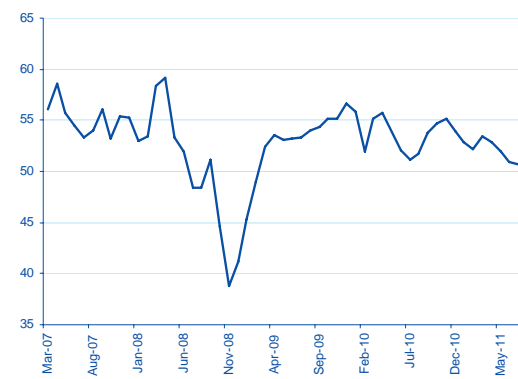
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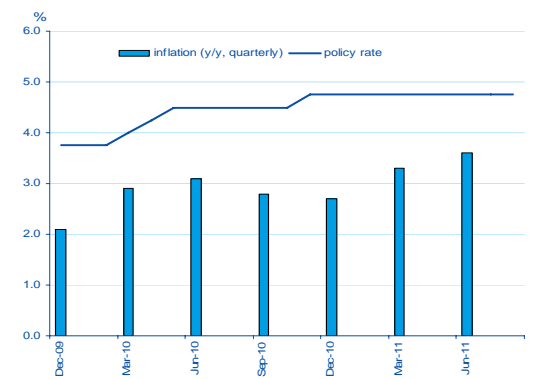
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Chart 5
China's PMI moderates in line with a soft landing



Source: BBVA Research and Bloomberg

Chart 6
Australia keeps interest rates on hold



Source: BBVA Research and Bloomberg

Calendar Indicators

Australia	Date	Period	Prior	Cons.
Unemployment Rate	11-Aug	JUL	4.90%	--
China	Date	Period	Prior	Cons.
Consumer Price Index (YoY)	9-Aug	JUL	6.40%	6.30%
Producer Price Index (YoY)	9-Aug	JUL	7.10%	7.50%
Industrial Production (YoY)	9-Aug	JUL	15.10%	14.70%
Retail Sales (YoY)	9-Aug	JUL	17.70%	17.70%
Exports YoY%	10-Aug	JUL	17.90%	17.00%
Imports YoY%	10-Aug	JUL	19.30%	22.90%
Actual FDI (YoY)	10-15 AUG	JUL	2.80%	--
New Yuan Loans	11-15 AUG	JUL	633.9B	550.0B
Money Supply - M2 (YoY)	11-15 AUG	JUL	15.90%	15.80%
Hong Kong	Date	Period	Prior	Cons.
GDP (YoY)	12-Aug	2Q	7.20%	--
India	Date	Period	Prior	Cons.
Industrial Production (YoY)	12-Aug	JUN	5.60%	--
Japan	Date	Period	Prior	Cons.
Current Account Balance YOY%	8-Aug	JUN	-51.70%	-34.10%
Machine Tool Orders (YoY)	9-Aug	JUL P	53.50%	--
Domestic CGPI (YoY)	10-Aug	JUL	2.50%	2.70%
Machine Orders YOY%	11-Aug	JUN	10.50%	10.50%
Malaysia	Date	Period	Prior	Cons.
Industrial Production (YoY)	10-Aug	JUN	-5.10%	--
Philippines	Date	Period	Prior	Cons.
Exports YoY%	10-Aug	JUN	-3.20%	--
Singapore	Date	Period	Prior	Cons.
GDP (YoY)	10-Aug	2Q F	0.50%	0.40%
Korea	Date	Period	Prior	Cons.
Producer Price Index (YoY)	9-Aug	JUL	6.20%	--
Export Price Index (YoY)	12-Aug	JUL	-0.40%	--
Import Price Index (YoY)	12-Aug	JUL	10.50%	--
Taiwan	Date	Period	Prior	Cons.
Exports YoY%	8-Aug	JUL	10.80%	7.90%
Imports YoY%	8-Aug	JUL	12.50%	10.50%

Indicator of the Week: China's CPI for July (August 9)

Forecast: 6.3% y/y

Consensus: 6.3% y/y

Prior: 6.4% y/y

Comment: With growth moderating in line with a soft landing, controlling inflation has become one of the most pressing near-term economic challenges in China. In recent quarters, the inflation rate has exceeded the authorities' 4% comfort range by a wide margin due mainly to rising food prices. We believe that inflation has now probably peaked, and should start declining in July on the impact of recent tightening measures, softening food prices (especially for pork), and base effects. Market impact: A higher-than-expected reading could raise expectations of more monetary tightening.

Calendar Events

Japan - Bank of Japan Monthly Economic Report, August 8

Indonesia - Bank Indonesia Reference Rate, August 9

We expect no change in the benchmark rate.

Korea - Bank of Korea Monetary Policy Meeting, August 11

We expect no change in the 7-day Repo rate.

Current	Consensus
6.75%	6.75%

Current	Consensus
3.25%	3.50%

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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.	2633.5	-2.5	-6.2	0.5
	Hong Kong - Hang Seng	20855.6	-7.1	-9.5	-3.2
	Taiwan - Weighted	7910.7	-8.5	-11.8	-0.3
	Japan - Nikkei 225	9299.7	-5.4	-9.1	-3.7
	Korea - Kospi	1949.9	-8.6	-4.9	9.3
	India - Sensex 30	17277.3	-5.1	-15.8	-4.9
	Australia - SPX/ASX 200	4101.3	-7.3	-13.6	-10.2
	Singapore - Strait Times	3002.4	-5.9	-5.9	-0.1
	Indonesia - Jakarta Comp	3921.4	-5.1	5.9	28.8
	Thailand - SET	1092.8	-3.6	5.8	24.9
	Malaysia - KLCI	1524.9	-1.5	0.4	12.0
	Philippines - Manila Comp.	4418.7	-1.9	5.2	25.5

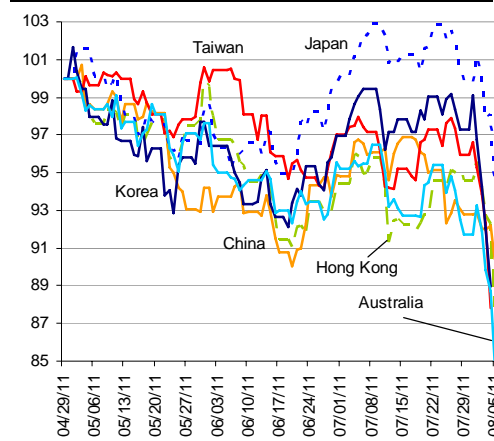
Last update: Friday, 11:15 Hong Kong time.

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.44	-0.11	6.43	6.38
	Hong Kong (HKD/USD)	7.80	-0.10	7.8	8
	Taiwan (TWD/USD)	29.0	-0.61	29.00	28.63
	Japan (JPY/USD)	78.6	-2.35	78.5	78.2
	Korea (KRW/USD)	1070	-1.48	1076.70	1088.53
	India (INR/USD)	44.8	-1.33	45.3	47
	Australia (USD/AUD)	1.05	-4.80	1	n.a.
	Singapore (SGD/USD)	1.22	-1.45	1.22	1.2
	Indonesia (IDR/USD)	8554	-0.58	8612	8860
	Thailand (THB/USD)	30.0	-0.67	30.16	30.7
	Malaysia (MYR/USD)	3.01	-1.40	3.0	3
	Philippines (PHP/USD)	42.6	-1.18	42.72	42.92

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

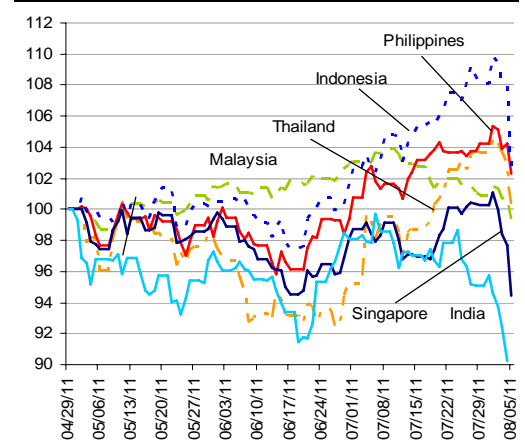
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Chart 7
Stock Markets



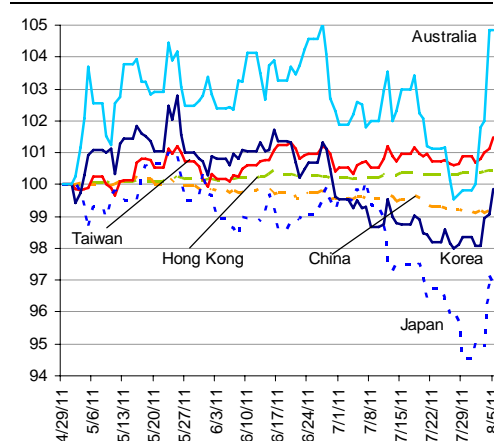
Source: BBVA Research and Bloomberg

Chart 8
Stock Markets



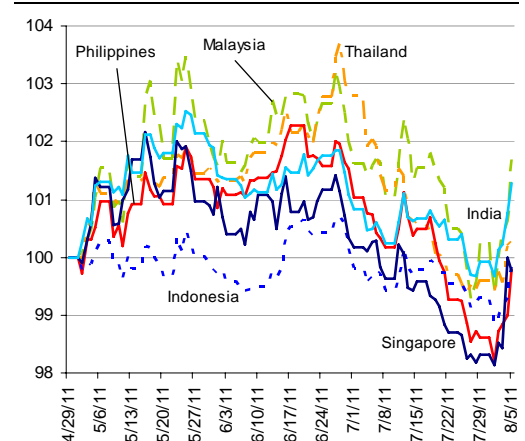
Source: BBVA Research and Bloomberg

Chart 9
Foreign Exchange Markets



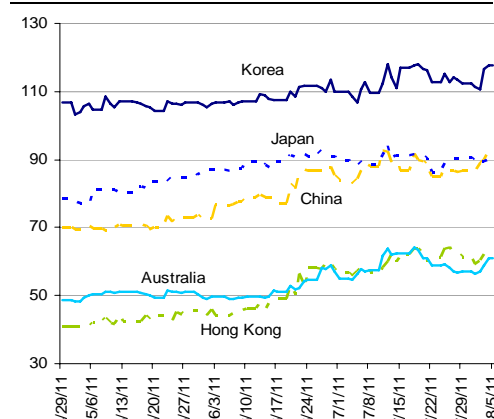
Source: BBVA Research and Bloomberg

Chart 10
Foreign Exchange Markets



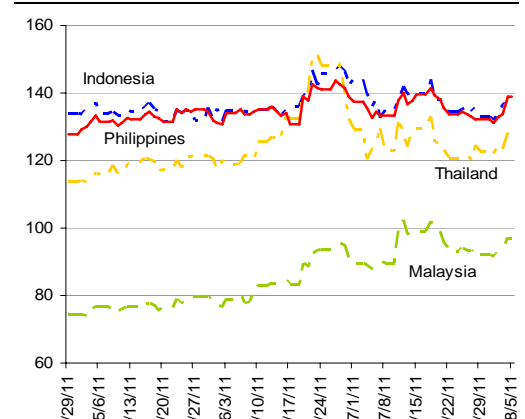
Source: BBVA Research and Bloomberg

Chart 11
Credit Default Swaps



Source: BBVA Research and Bloomberg

Chart 12
Credit Default Swaps



Source: BBVA Research and Bloomberg

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