RESEARCH

Weekly Watch

Asia

9 September 2011
Economic Analysis

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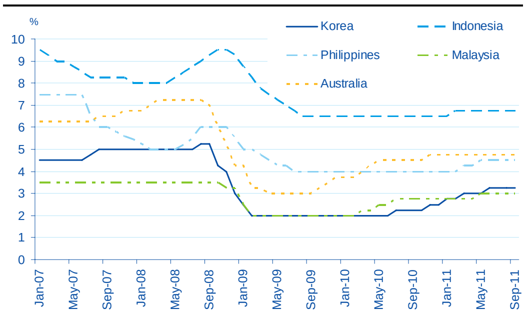
Central banks play wait-and-see

Doubts about the global outlook have pushed Asian central banks into a wait-and-see mode even as inflation in most cases remains uncomfortably high. All of the region's central banks that held policy meetings this week stayed on hold (see Highlights and Chart 1), including Australia, Korea, Malaysia, Indonesia, the Philippines, and Japan. The outcomes were in line with expectations, but reflect a policy dilemma, especially for Korea where inflation, at 5.3% y/y, is well above the official target range. That said, a number of recent inflation outturns have showed signs of easing, most notably today for China (Chart 2). The question now is for how long monetary policy will remain on hold, and whether rate cuts may even be in store. With the stance of monetary policy across the region remaining highly accommodative on the whole, we expect gradual tightening to resume if and when the global environment stabilizes.

Inflation eases somewhat and activity holds up

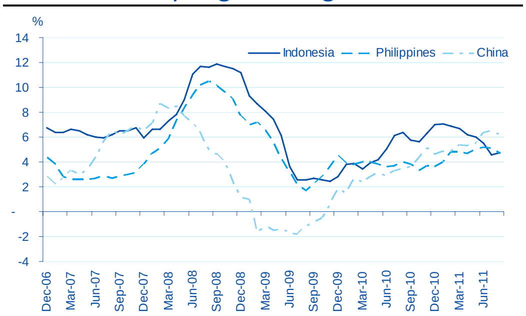
As noted above, although inflation remains high, the latest readings for August were generally encouraging, easing in China (6.2% y/y; prior: 6.5%) and the Philippines (4.7% y/y; prior: 5.1%), and remaining within the 4-6% target range in Indonesia (4.8% y/y; Prior: 4.6%). Outside of Japan, Taiwan continues to see the region's lowest inflation, with prices inching up slowly (1.34% y/y; prior: 1.30%). As concerns about the global growth outlook dominate policy-making decisions, a few data releases this week showed that all is not that bad --- Australia's second quarter GDP surprised to the upside (1.2% q/q, consensus: 1.0%) (see Highlight on Australia), and August activity indicators in China were consistent with a soft landing (see Highlight on China). On the other hand, weak machine orders in Japan for July (-8.2% m/m; consensus -4.2%) underscore the challenges its economy faces in recovering from the earthquake. Moreover, on signs that weak external demand may be affecting the region, Taiwan's August exports (7.2% y/y; consensus: 15.5%) disappointed, as did Malaysia's industrial production (-0.6%y/y; consensus: 2.4%). In the coming week attention will turn to India's monetary policy meeting and the release of August inflation and IP (see Weekly Indicator), along with China's trade data and monetary statistics for August.

Chart 1
Central banks are on hold....



Source: CEIC and BBVA Research

Chart 2
...as inflation stays high, but begins to ease



Source: CEIC and BBVA Research

Highlights

Asian central banks take a pause

Although inflation remains high, concerns have shifted to downside global risks

China's inflation eases in August, reducing pressure for monetary tightening

August inflation eased as expected, providing room for policies to support growth

Australia's growth indicators surprise to the upside amidst global concerns

Second quarter GDP rose due to strong exports, although the outlook remains weak

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Economic Analysis

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Markets

Markets take a deep breath, remaining wary of external risks

Equity market volatility remains high, in response to global macro risks. Major Asian indices finished mixed on the week, with Indonesia a noteworthy exception to the upside (see below). Fears of a global slowdown pushed down shares of exports-related companies across the region, but there were tentative signs for optimism on Friday following US President Obama's proposed $447bn stimulus package and China's release of easing inflation data. In credit, spreads are broadly wider across investment grade and high yield corporates, while sovereign CDS spreads were also wider.

Asian FX only slightly off, as markets wary of possible Fed easing ahead

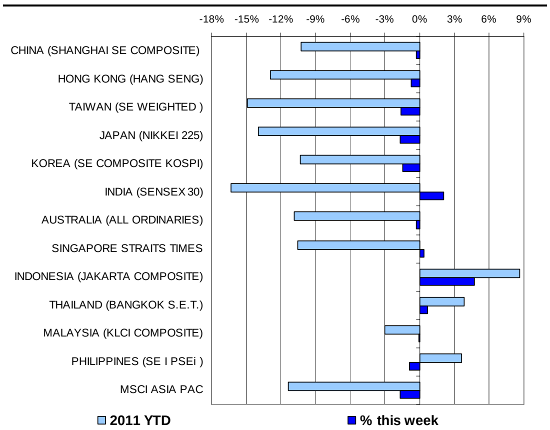
While money markets in Asia priced out rate hikes quickly in light of central banks recent shifts to pause mode, regional currencies have thus far fallen marginally vis-à-vis the USD over the past week, and price actions in large part have been driven by global risk sentiment rather than local concerns. In fact, KRW, IDR, SGD and MYR are flat or slightly higher than their levels of a month ago. Investors have resisted a major sell-off of Asian currencies because the region is seen to remain resilient to a lukewarm global growth environment. Additionally, the USD outlook is also shaky given that the likelihood for the Fed to ease policy further is increasing. In coming weeks, we believe market anxiety may still rise given signs of slower growth, doubts over global policy-maker capacity to add stimulus, uncertainties over US monetary policy ahead of the next few FOMC meetings, and finally, mounting event risks from Europe. As such, although we maintain a constructive medium-term view on Asian currencies, we see risks of choppier trading and a weakening bias in the near-term.

Indonesia showing strength

The week's star equity performer has been Indonesia, as foreign investors remain comfortable with the country's fundamentals. The Jakarta Composite Index rallied 4% for the week, while Indonesia's 10-year government bond advanced for a third straight week and has now risen almost 10% year-to-date. With domestic consumption remaining strong, unemployment decreasing, and an increasing number of foreign companies announcing plans to build factories in the country, Indonesia's economy is showing strength.

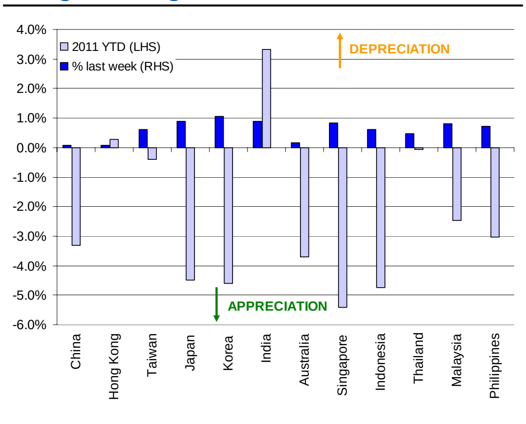
Bank Indonesia remained on hold at their policy meeting on Thursday, which was the general trend for the Asian region this week (see Highlights). Central banks in Malaysia, Japan, Korea, the Philippines and Australia all also refrained from raising rates. While this is supportive for equity markets as central banks focus on growth over inflation, for now market participants remain fixated on external risks. If global stability increases, Asia's markets will eventually reap the benefits, as regional growth has remained well above that of developed economies.

Chart 3
Stock markets



Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets



Source: BBVA Research and Bloomberg

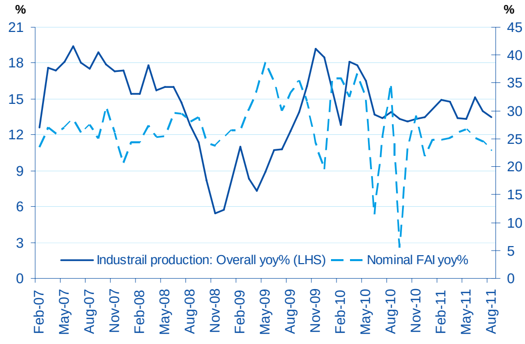
Economic Analysis

Highlights

Asian central banks take a pause

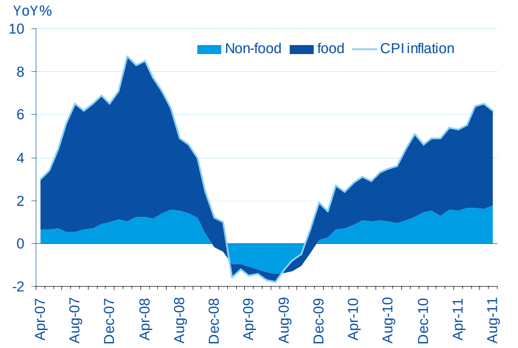
With the increase in uncertainties to the global economic outlook, central banks appear to be taking a pause from further interest rate increases. The latest evidence came from the Bank of Korea this week where, despite rising inflation—to 5.3% in August, well above the 2-4% target range—the monetary policy committee left interest rates unchanged for a third straight month at 3.25%. The central bank flagged weakness in the outlook for developed economies, while still expressing confidence in the resilience of the domestic economy. Echoing similar concerns about the health of the global economy, the Reserve Bank of Australia and Bank Indonesia remained on hold at 4.75% and 6.75% respectively this week, and Malaysia and the Philippines followed suit. These actions are in line with other central banks which appear to have shifted to pause, including the People's Bank of China (PBoC) and the Reserve Bank of India, both of whom had implemented aggressive tightening campaigns earlier this year. At the same time, some central banks remain on alert for inflation, with Thailand's central bank hiking rates as recently as August 24, and the PBoC continuing to take steps to curb credit growth (for example, through a recent widening in required reserve requirements). With the stance of monetary policy across the region remaining highly accommodative on the whole, and with inflation pressures persisting and growth so far proving surprisingly resilient, we expect gradual tightening to resume if and when the global environment stabilizes. Currency appreciation is also expected to continue, especially given prospects of renewed capital inflows to the region.

Chart 5
Upward inflation trend turns around in August



Source: BBVA Research and Bloomberg

Chart 6
IP and FAI outturns moderate in line with expectation



Source: BBVA Research and Bloomberg

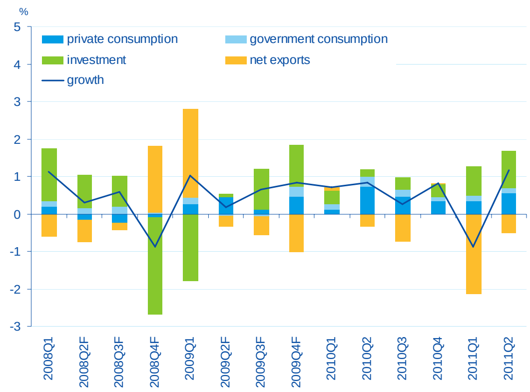
China's inflation eases in August, easing pressure for monetary tightening

August headline CPI inflation was released on Friday, easing to 6.2% y/y from 6.5% in July (Chart 1), broadly in line with expectations (Consensus: 6.2%; BBVA: 6.1%). The main driver continues to be food prices, especially pork, which rose 45.5% y/y in August down from 57.1% y/y in July. Producer price inflation (PPI) in August also edged down to 7.3% y/y from 7.5% y/y in July on easing commodity prices. The August inflation readings mark the first year-on-year declines in the CPI and PPI since April, and are consistent with our expectation that inflation has peaked. We project moderation during the remainder of the year as food and commodity prices ease, and on base effects from last year. That said, we expect inflation to remain in the 5-6% range during Q3, before declining to around 4% by the end of the year, due to a further easing of commodity prices and favorable base effects. Activity indicators also point to sustained growth, in line with our soft landing scenario. Industrial production, fixed asset investment, and retail sales for August all came in line with expectations, at 13.5% y/y, 25.0% y/y, and 17.0% y/y, respectively. The benign inflation outturn, while still well above the authorities' 4% comfort level, should help ease concerns about further monetary tightening, and enable the authorities to orient policies toward maintaining growth in view of the uncertain global outlook. While our baseline anticipates one more rate hike during the remainder of the year, the likelihood of that is diminishing, and monetary policy now appears on hold.

Australia's growth indicators surprise to the upside amidst global concerns

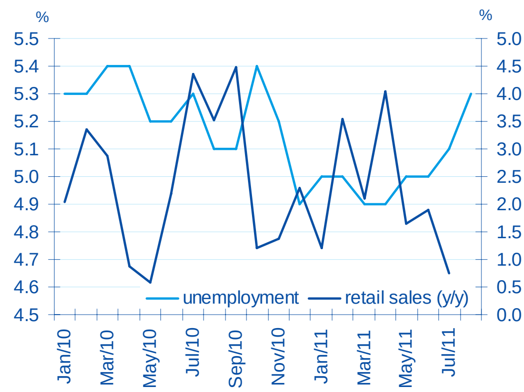
Australia's second quarter GDP growth of 1.2% q/q s.a. beat market expectations (1.0% q/q s.a.). On a yearly basis, growth rose to 1.4% yoy (consensus: 0.7% yoy; BBVA: 1.6%). The outturn underscores that the economy may have more resilience than had been feared, following a 0.9%q/q s.a. contraction in the previous quarter due to the effects of cyclones and flooding. The rebound was due to a recovery of the mining sector, and an associated strong export performance (2.6% q/q s.a) in the quarter. Meanwhile, weak domestic demand is also showing signs of recovering, with household spending rising by 1.0% q/q s.a. That said, global uncertainties continue to pose a risk to Australia's growth outlook, and unemployment in August unexpectedly rose to a 10-month high of 5.3%, from the previous month's 5.1%, consistent with weakness in indicators such as low consumer sentiment and retail sales. Another headwind is the strong currency, which could undermine non-mining exports. Inflation is a bit on the high side, at 3.6% y/y in the second quarter, above the official inflation target range of 2-3%. Nevertheless, in view of the uncertain global outlook, the Reserve Bank of Australia kept its policy rate unchanged at 4.75% at its September 6 monthly monetary policy meeting. The RBA now appears on hold, and is likely to refrain from further rate hikes during the remainder of the year in our view. Some market participants have speculated on the possibility of rate cuts before end-year, although we think this is unlikely given our baseline growth projections and the relatively high level of inflation. We expect full-year growth of 2.0% for 2011 and 3.8% in 2012, with inflation projected to decline to within the official target range.

Chart 7
Australia's second quarter GDP growth rises...



Source: CEIC and BBVA Research

Chart 8
...although domestic demand stays weak



Source: CEIC and BBVA Research

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Calendar Indicators

Australia	Date	Period	Prior	Cons.
Trade Balance	12-Sep	JUL	2052M	1900M
China	**Date**	**Period**	**Prior**	**Cons.**
Trade Balance (USD)	10-Sep	AUG	$31.48B	$24.60B
Exports (YoY)	10-Sep	AUG	20.4%	21.90%
Imports (YoY)	10-Sep	AUG	22.90%	21.0%
Actual FDI (YoY)	10-15 SEP	AUG	19.8%	- -
New Yuan Loans	11-15 SEP	AUG	492.6B	500.0B
Money Supply - M2 (YoY)	11-15 SEP	AUG	14.7%	14.2%
Hong Kong	**Date**	**Period**	**Prior**	**Cons.**
Industrial Production (YoY)	15-Sep	2Q	3.5%	- -
Producer Price (YoY)	15-Sep	2Q	8.2%	- -
India	**Date**	**Period**	**Prior**	**Cons.**
Industrial Production (YoY)	12-Sep	JUL	8.8%	6.20%
Monthly Wholesale Prices (YoY)	14-Sep	AUG	9.2%	9.64%
Japan	**Date**	**Period**	**Prior**	**Cons.**
Tertiary Industry Index (MoM)	12-Sep	JUL	1.9%	0.20%
Domestic CGPI (YoY)	12-Sep	AUG	2.90%	2.60%
Nationwide Dept. Sales (YoY)	12-16 SEP	AUG	-0.10%	- -
Machine Tool Orders (YoY)	12-16 SEP	AUG P	34.80%	- -
Capacity Utilization (MoM)	14-Sep	JUL	5.2%	- -
Tertiary Industry Index (MoM)	12-Sep	JUL	1.9%	- -
Philippines	**Date**	**Period**	**Prior**	**Cons.**
Exports (YoY)	13-Sep	JUL	-10.2%	-6.80%
Unemployment Rate	15-Sep	JUL	7.2%	- -
Overseas Remittances (YoY)	15-Sep	JUL	7.0%	- -
Singapore	**Date**	**Period**	**Prior**	**Cons.**
Retail Sales Ex Auto (YoY)	15-Sep	JUL	10.4%	10.10%
Retail Sales (YoY)	15-Sep	JUL	10.9%	8.80%
Electronic Exports (YoY)	16-Sep	AUG	-16.9%	1.00%
Non-oil Domestic Exports (YoY)	16-Sep	AUG	-2.8%	- -
Korea	**Date**	**Period**	**Prior**	**Cons.**
Export Price Index (YoY)	16-Sep	AUG	-1.30%	- -
Import Price Index (YoY)	16-Sep	AUG	9.80%	- -
Vietnam	**Date**	**Period**	**Prior**	**Cons.**
Domestic Vehicle Sales (YoY)	08-16 SEP	AUG	-10.70%	- -

Indicator of the Week: India Industrial Production for July (September 12)

Forecast: 5.9% y/y	Consensus: 6.2% y/y	Prior: 8.8% y/y

Comment: The coming week will be eventful for India as investors eye the July industrial output (IP) and August WPI inflation outturns for cues on the course of monetary policy when the RBI's meets on September 16. IP will be particularly important as headwinds from a worsening global macro environment alongside rising interest rates have resulted in a moderation in growth. We expect July IP growth to be supported by higher infrastructure output, but weighed by a high base coupled with a slowdown in price sensitive consumer goods sector. Market impact: A lower outturn would further aggravate the growth outlook and dent sentiment.

Calendar Events

India – RBI Monetary Policy Meeting, September 16	Current	Consensus
We expect no change in the repo rate.	8.00%	8.00%

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STOCK MARKETS

INDEX	Last price	% change over a week	Year to date	% Change over 1 Y
China – Shanghai Comp.	2521.5	-0.3	-10.2	-5.1
Hong Kong – Hang Seng	20067.2	-0.7	-12.9	-5.2
Taiwan – Weighted	7633.7	-1.6	-14.9	-2.6
Japan – Nikkei 225	8801.1	-1.7	-14.0	-3.3
Korea – Kospi	1839.9	-1.5	-10.3	3.1
India – Sensex 30	17165.5	2.0	-16.3	-8.7
Australia – SPX/ASX 200	4229.6	-0.3	-10.9	-7.7
Singapore – Strait Times	2854.1	0.4	-10.5	-5.6
Indonesia – Jakarta Comp	4024.2	4.7	8.7	24.6
Thailand – SET	1072.2	0.7	3.8	16.4
Malaysia – KLCI	1473.1	-0.1	-3.0	2.5
Philippines – Manila Comp.	4354.1	-0.9	3.6	11.6

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)	6.39	-0.08	6.35	6.28
Hong Kong (HKD/USD)	7.79	-0.09	7.8	8
Taiwan (TWD/USD)	29.2	-0.60	28.98	28.46
Japan (JPY/USD)	77.5	-0.89	77.4	77.0
Korea (KRW/USD)	1074	-1.05	1080.75	1087.68
India (INR/USD)	46.2	-0.22	46.7	48
Australia (USD/AUD)	1.06	-0.15	1	n.a.
Singapore (SGD/USD)	1.21	-0.84	1.21	1.2
Indonesia (IDR/USD)	8570	-0.60	8605	8832
Thailand (THB/USD)	30.0	-0.47	30.22	30.7
Malaysia (MYR/USD)	2.99	-0.80	3.0	3
Philippines (PHP/USD)	42.5	-0.73	42.28	42.24

Last update: Friday, 11.15 Hong Kong time.

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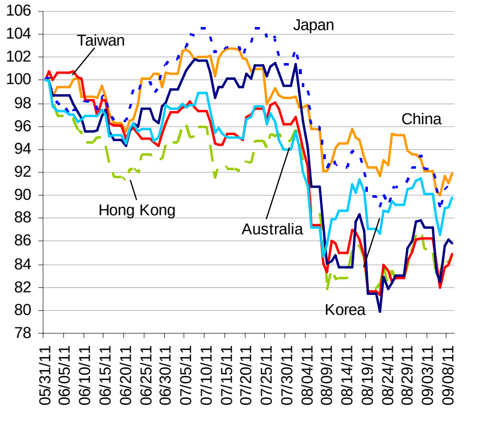
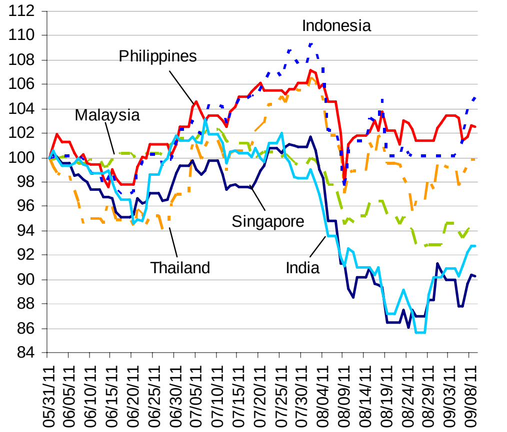
Chart 9
Stock Markets



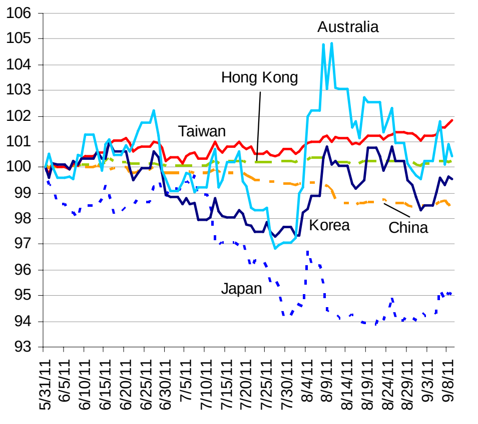
Source: BBVA Research and Bloomberg

Chart 10
Stock Markets



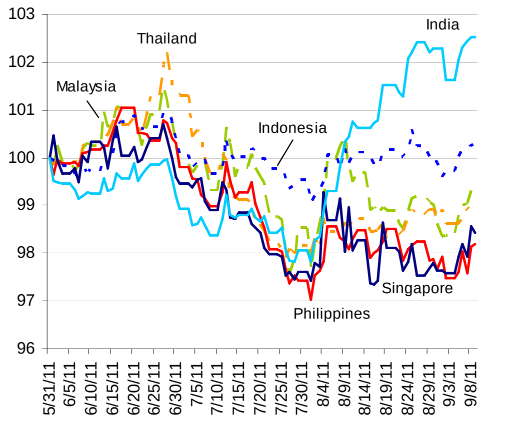
Source: BBVA Research and Bloomberg

Chart 11
Foreign Exchange Markets



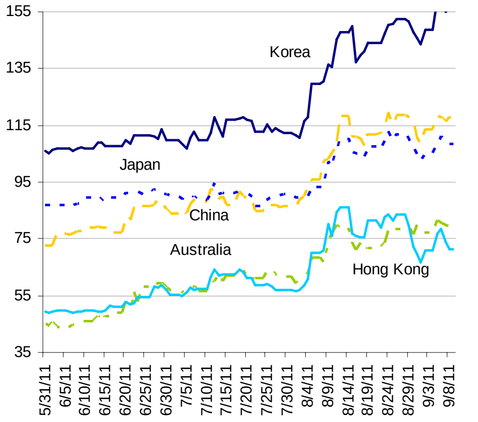
Source: BBVA Research and Bloomberg

Chart 12
Foreign Exchange Markets



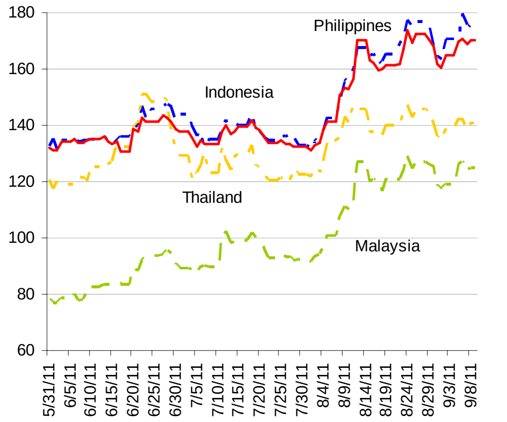
Source: BBVA Research and Bloomberg

Chart 13
Credit Default Swaps



Source: BBVA Research and Bloomberg

Chart 14
Credit Default Swaps



Source: BBVA Research and Bloomberg

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