RESEARCH

Weekly Watch

Asia

21 October 2011

Economic Analysis

Asia

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Increasing focus on growth

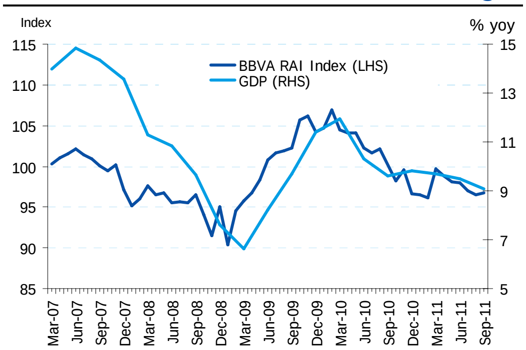
With inflation easing, growth has become the clear focus for Asian policymakers as they seek to avoid a pronounced slowdown over ongoing stresses in Europe. This week, China released 3Q GDP which, despite disappointing markets slightly, showed that growth remains on track for a soft landing (see Highlights). Central banks in Thailand and the Philippines kept their benchmark rates unchanged, at 3.50% and 4.50% respectively, as the former stated its willingness to ease policy rates if necessary to support businesses hurt by recent flooding. The Philippines' shift to neutral comes one week after the government unveiled additional fiscal stimulus to the economy, and we have begun seeing a marked shift to either monetary accommodation (Bank Indonesia lowered interest rates to 6.50% two weeks ago, and Singapore reduced the pace of currency appreciation), or fiscal stimulus.

China's soft landing remains underway

The set of data released in China early this week was in line with our soft-landing scenario, with a moderating third quarter GDP outturn (9.1% y/y; consensus: 9.3%) and solid outturns in September activity indicators such as industrial production (13.8% y/y; consensus 13.3%), retail sales (17.7% y/y; consensus: 17.0%) and urban fixed asset investment (YTD) (24.9% y/y; consensus: 4.8%). On the trade front, there were further signs of an export slowdown, with Taiwan export orders declining to 2.72% y/y (consensus: 3.46%) from 5.25% in August, while Singapore's exports also fell unexpectedly by -4.5% y/y (consensus: 3.5%). In the coming hours inflation will be released in Hong Kong (consensus: 5.4% y/y) and Malaysia (consensus: 3.3% y/y); both are expected to ease, following along with the recent regional trend, although the risk of the Thai floods having a negative impact on regional prices could dampen its neighbours' downside trend (See highlights).

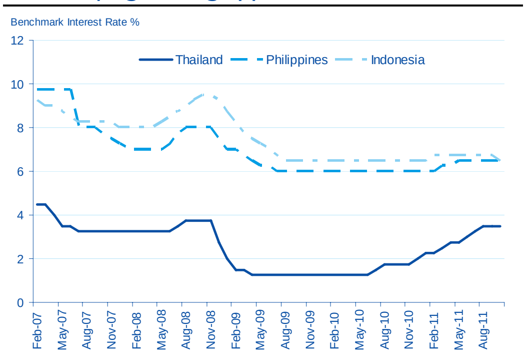
In the coming week, third quarter numbers will be released in Australia for CPI inflation (see Weekly Indicator) and in Korea for GDP. Monetary policy meetings will be held in India—we expect the RBI to keep the benchmark repo rate on hold at 8.25%—and Japan. Japan will release an important set of monthly data including trade, industrial production, and inflation. Besides Australia and Japan, inflation outturns will be also released in Singapore and Vietnam.

Chart 1
China's 3Q GDP eases in line with a soft-landing



Source: Bloomberg and BBVA Research

Chart 2
Monetary tightening appears to be over



Source: Bloomberg and BBVA Research

Highlights

China's growth continues to point to a soft-landing

Third quarter GDP shows a further moderation, but other activity indicators suggest solid growth

Economic impact of Thailand's floods

The disaster has heavily hit Thailand's growth for 4Q, and also has a potential impact overseas

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Markets

Focus is decidedly on Europe

Asian investors have overwhelmingly put their focus on European rather than local news. Initial optimism over Europe finding a solution to the crisis buoyed Asian markets on Monday, but when German officials managed expectations regarding the EU Summit lower on Tuesday, markets did an about-face (see below). By week's end, market anxiety was growing on signs of disagreement between Germany and France over how to leverage the bailout fund in order to stabilize the euro-zone bond markets and support other needs. Markets are still hopeful that some concrete steps will be taken imminently, although any announcements will likely be deferred until the second EU Summit on October 26. With all the attention being paid abroad, Asian currency performance was choppy and volatile with no clear direction, while leading stock indices finished the week in the red. In credit, corporate spreads are little changed in investment and non-investment grade, while sovereign CDS spreads are broadly wider this week. Sovereign spreads have been tightening since the beginning of the month, as flows have returned to Asia and markets appear to be undergoing a cautious rebound.

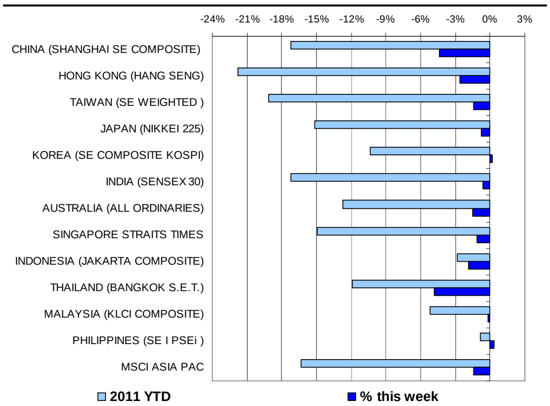
Europe crisis overshadowing China GDP, US data

While China's third quarter GDP grew at a healthy pace (see Highlight), it failed to impress the markets as it came in below expectations, and the fact that growth appears to be decelerating did nothing to quell market concerns about a hard-landing lying ahead in China, though our view remains that there will be a soft-landing. That said, the damage has been limited to local stock markets (particularly Shanghai, down 3.5%) as global sentiment has been preoccupied by developments in Europe. Elsewhere, recent data in the US, ranging from industrial output to job reports to the latest Philly Fed reading, is providing evidence that the US is not on the brink of a recession, alleviating what has been a substantial tail risk to Asian markets, in our view. However, similar to China's GDP, on the balance the positive US data failed to generate a significant response from Asian investors.

Awaiting the EU Summit

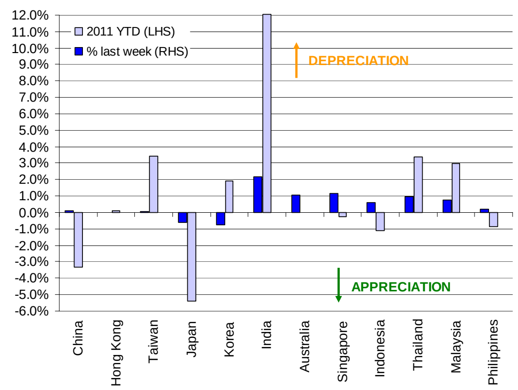
The upcoming EU Summit on October 23 and 26 is overwhelming any Asian data. The market will be focusing on three inter-related areas: 1) any plan to apply a large haircut to Greek debt and bring it down to a sustainable level, 2) any concrete plan for bank recapitalization to shield European institutions from debt contagion, and 3) any agreement by EU leaders to leverage the EFSF without losing its AAA rating. As for the last measure, our global economics team believes the most likely way the EFSF could add significant firepower would be to use its funds as a guarantee for sovereign issuances, or else by issuing EFSF bonds as collateral for government bond issuances. Close attention will be paid to these issues in the run-up to the two EU Summits. Market expectations, though having receded, remain high, and failure by EU leaders to meet these expectations would risk renewed sell-off of Asian currencies and risk assets.

Chart 3
Stock markets



Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets



Source: BBVA Research and Bloomberg

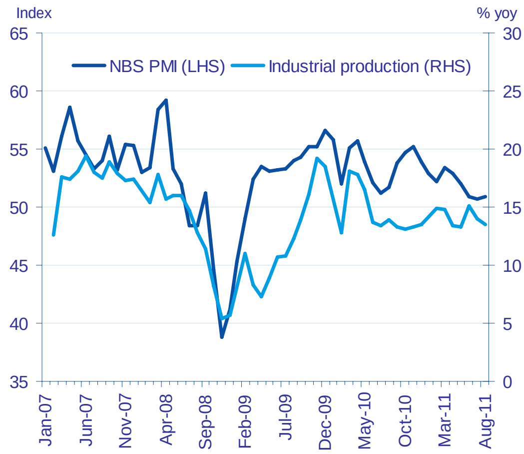
Economic Analysis

Highlights

China's growth continues to point to a soft-landing

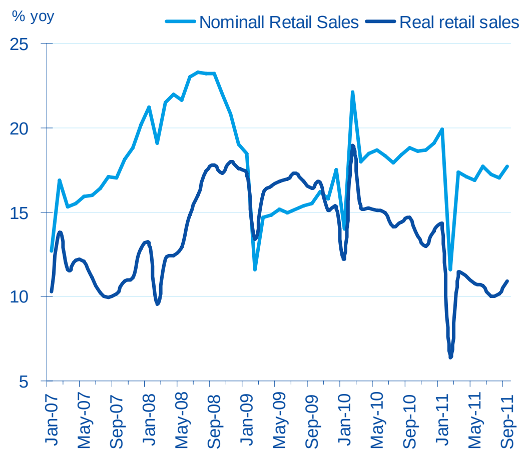
As scheduled this past week, China released its Q3 GDP and September activity indicators. Although market responded negatively to the data outturns, they are broadly in line with expectations and show that the economy is still on track for a soft-landing. The third quarter GDP outturn shows a further moderation in growth to 9.1% y/y (BBVA: 9.2% y/y; consensus: 9.3%), slightly below consensus and down from 9.5% y/y in the second quarter. On a sequential basis, quarterly growth remained strong, at 2.3% q/q seasonally adjusted (9.5% annualized), only slightly down from 2.4% q/q in the second quarter. The moderation in our view reflects the impact of previous tightening measures, a dampening effect from slowing property prices and rising debt burdens of SMEs, as well as a gradual slowdown in export growth. Nevertheless, the robust outturn should help to keep risks of a hard landing at bay. The readings of other activity indicators for September also suggest robust growth momentum. On the demand side, September retail sales growth rose to 17.7% y/y (consensus: 17.0%), up from 17.0% y/y in August (Chart 2). Urban fixed asset investment (YTD) grew by 24.9% y/y (consensus: 24.7%), up from 22.9% y/y in August. On the supply side, industrial output increased to 13.8% y/y in September (consensus 13.3%) from 13.5% y/y in August. It is remarkable that the strong economic outturns were realized under relatively tight monetary conditions. New loans in September came in at RMB 470.0 billion (consensus: RMB 550.0 billion), down from RMB 548.5 billion in August, implying year-on-year credit growth of 15.9%, down from 16.4% in August. M2 growth in September further slipped to 13.0% y/y from 13.5% y/y in August, well below market consensus of 14.0%, possibly reflecting a shift in deposits toward higher yielding wealth management products. Taken together, the data show both strong production and domestic demand conditions for the month of September. The outturns are broadly consistent with our 9.2% annual growth projection for 2011, although uncertainties to the global outlook pose downside risks to our 8.9% growth projection for 2012. With inflation and growth moderating in line with expectations, we believe monetary policy will remain on hold for the next few months.

Chart 5
China: robust growth momentum reflected in IP...



Source: BBVA Research and Bloomberg

Chart 6
...and retail sales



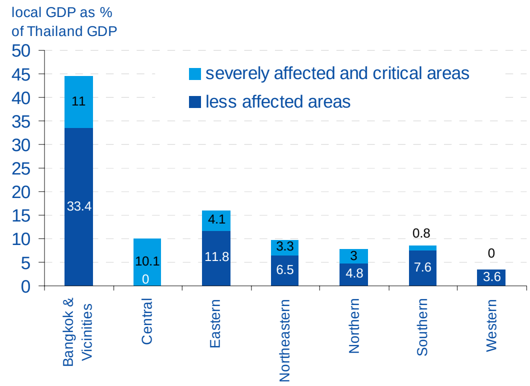
Source: BBVA Research and Bloomberg

Economic impact of Thailand's floods

About two weeks ago, the heaviest monsoonal rains seen in half a century began inundating parts of Thailand, provoking devastating floods and leaving a death toll of more than 300 people. Out of the 76 provinces of the country, floods were felt in 52, but it was the northern and central areas that suffered the most, where more than a third of national GDP is accounted for (Chart 7). The capital, Bangkok, was largely spared thanks to a set of walls and dikes installed for this purpose, although flooding remains a threat. The economic impact of the disaster is expected to dampen Thai growth in the last quarter of this year, but its Asian neighbours may also be hit by spillover effects via a hike in food prices and supply chain disruptions. Both the primary and manufacturing sectors, which account for 8.3% and 40.8% of GDP respectively, have been affected. Heavy losses in stockbreeding and, principally, agriculture—with an estimated loss of 4 million tons of rice—were reported. The hardest-hit sectors are industrial estates in Ayutthaya (central area) and nearby areas, auto-makers and auto-parts firms, insurance companies and commercial banks. The services sector will likely be hit, although on a smaller scale, through lower tourism, as the current quarter is typically the peak season. As a consequence, the growth outlook continues to be downgraded, including by the Bank of Thailand (BoT) (by more than 1%) and the Ministry of Finance (lowered its forecast in 0.3%). Undoubtedly, our 4% growth forecast for 2011 is at risk.

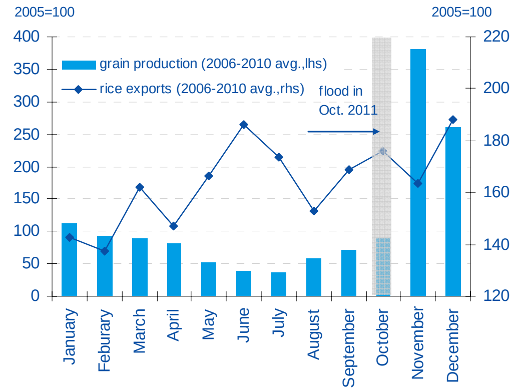
The newly elected government admits it is "overwhelmed" with the situation, but, despite the financial damage and its estimation of 120 billion baht ($3.9 billion) in order to cope with the inundation, has maintained its highly-expensive election pledges, such as the raise in minimum wages. Meanwhile, BoT shifted its policy focus after seven consecutive rate hikes, and left its policy rate untouched at 3.50%, stating that Thailand's central bank is ready to ease monetary policy if business conditions are severely affected by flooding. However, the destruction of rice production may leave a mark, not only in the domestic market, but also overseas given that Thailand is world's number one rice exporter. First assessments hint at higher prices in south-east Asian neighbours and smaller economies without their own production. Nevertheless, the rise in prices may not be felt immediately, as it may take at least a quarter until the export reduction is perceptible, as it takes some time from harvest to actual delivery (see Chart 8). On a global scale, the supply-disruption caused by plant stoppage and factory damage is already affecting certain sectors, like American computer supplies and Japanese auto parts, raising concerns about shortfalls in PC and auto production. In light of the current situation, a rebound in 2012 is more than likely after the resumption following the disruptions, and the implementation of the reconstruction measures.

Chart 7
Flooding affects numerous economic zones



Source: CEIC and BBVA Research

Chart 8
Severe impact likely on grains, exports



Source: CEIC and BBVA Research

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Calendar Indicators

Australia	Date	Period	Prior	Cons.
Producer Price Index (YoY)	24-Oct	3Q	3.4%	3.0%
CPI Inflation (YoY)	26-Oct	3Q	3.6%	3.5%
China	**Date**	**Period**	**Prior**	**Cons.**
HSBC Flash China Manufacturing PMI	24-Oct	OCT	49.90	- -
Industrial Profits YTD YoY	27-Oct	SEP	28.2%	- -
Hong Kong	**Date**	**Period**	**Prior**	**Cons.**
Exports (YoY)	25-Oct	SEP	6.8%	- -
Imports (YoY)	25-Oct	SEP	14.1%	- -
Japan	**Date**	**Period**	**Prior**	**Cons.**
Merchnds Trade Exports (YoY)	24-Oct	SEP	2.8%	1.1 %
Merchnds Trade Imports (YoY)	24-Oct	SEP	19.2%	12.6%
Retail Trade (MoM) SA	27-Oct	SEP	-1.7%	-0.3%
CPI Inflation (YoY)	28-Oct	SEP	0.2%	0.2%
Industrial Production (MoM)	28-Oct	SEP P	0.8%	-2.8%
Philippines	**Date**	**Period**	**Prior**	**Cons.**
Imports (YoY)	25-Oct	AUG	6.6%	- -
Singapore	**Date**	**Period**	**Prior**	**Cons.**
CPI Inflation (YoY)	24-Oct	SEP	5.7%	5.6%
Industrial Production (MoM) SA	25-Oct	SEP	3.9%	-5.8%
Industrial Production (YoY)	25-Oct	SEP	21.7%	8.2%
Korea	**Date**	**Period**	**Prior**	**Cons.**
GDP at Constant Price (QoQ)	27-Oct	3Q P	0.9%	0.7%
GDP at Constant Price (YoY)	27-Oct	3Q P	3.4%	3.5%
Taiwan	**Date**	**Period**	**Prior**	**Cons.**
Commercial Sales (YoY)	24-Oct	SEP	4.7%	4.8%
Industrial Production (YoY)	24-Oct	SEP	3.9%	6.7%
Unemployment Rate - sa	24-Oct	SEP	4.4%	4.4%
Vietnam	**Date**	**Period**	**Prior**	**Cons.**
CPI Inflation (YoY)	24-Oct	OCT	22.4%	- -
Exports YTD (YoY)	24-31 OCT	OCT	35.4%	- -
Imports YTD (YoY)	24-31 OCT	OCT	26.9%	- -
Industrial Production (YoY)	24-31 OCT	OCT	12.0%	- -

Indicator of the Week: Australia's inflation for Q3 (October 26)

Forecast: 3.3% y/y	Consensus: 3.5% y/y	Prior: 3.6% y/y

Comment: Australia's inflation probably peaked in Q2 and should trend down in the coming quarters. That said, the Q3 outturn is likely to remain above the RBA's inflation target range of 2-3%. Given the seriousness the RBA attaches to its Inflation targeting regime, the outlook for inflation has been crucial as a guide to the future course of interest rates in Australia. Many forecasters have been looking for signs of an easing in policy rates to boost domestic demand against the backdrop of the current global downturn, as hinted in the last RBA meeting minutes. Australia has kept its policy rate unchanged at 4.75% since November 2010. We expect no rate cut in the RBA's policy meeting in November, despite the likelihood of a rate cut is growing in the near future. Market impact: A lower-than-expected outturn will increase the likelihood of a rate cut by the RBA in its next policy meeting in early November.

Calendar Events

	Current	Consensus
India – RBI Monetary Policy Meeting, October 25	**Current**	**Consensus**
We expect the REPO rate to stay on hold	8.25%	8.25%
Japan – BOJ Target Rate, October 27	**Current**	**Consensus**
We expect the target rate to stay on hold	0.10%	0.10%

Markets Data

STOCK MARKETS

INDEX	Last price	% change over a week	Year to date	% Change over 1 Y
China – Shanghai Comp.	2323.6	-4.4	-17.3	-22.1
Hong Kong – Hang Seng	18024.7	-2.6	-21.8	-23.8
Taiwan – Weighted	7254.5	-1.4	-19.1	-10.8
Japan – Nikkei 225	8678.9	-0.8	-15.2	-7.4
Korea – Kospi	1838.4	0.2	-10.4	-1.9
India – Sensex 30	16982.4	-0.6	-17.2	-16.2
Australia – SPX/ASX 200	4141.9	-1.5	-12.7	-10.4
Singapore – Strait Times	2714.4	-1.1	-14.9	-14.2
Indonesia – Jakarta Comp	3597.5	-1.8	-2.9	0.3
Thailand – SET	910.1	-4.8	-11.9	-8.0
Malaysia – KLCI	1440.1	-0.2	-5.2	-3.4
Philippines – Manila Comp.	4166.6	0.3	-0.8	-1.9

Last update: Friday, 11.45 Hong Kong time.

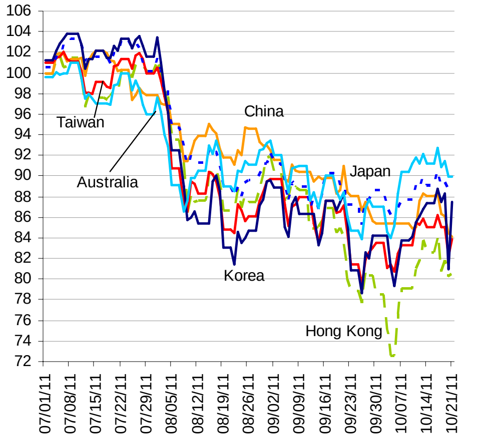
FOREIGN EXCHANGE MARKETS

CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
China (CNY/USD)	6.39	-0.10	6.39	6.41
Hong Kong (HKD/USD)	7.78	-0.02	7.77	7.75
Taiwan (TWD/USD)	30.3	-0.07	30.21	29.82
Japan (JPY/USD)	76.8	0.61	76.63	76.15
Korea (KRW/USD)	1148	0.75	1156	1161
India (INR/USD)	50.1	-2.13	50.90	51.95
Australia (USD/AUD)	1.02	-1.06	0.99	n.a.
Singapore (SGD/USD)	1.28	-1.12	1.28	1.27
Indonesia (IDR/USD)	8898	-0.58	9072	9480
Thailand (THB/USD)	31.1	-0.93	31.29	31.68
Malaysia (MYR/USD)	3.15	-0.74	3.17	3.20
Philippines (PHP/USD)	43.4	-0.20	43.50	43.45

Last update: Friday, 11.45 Hong Kong time.

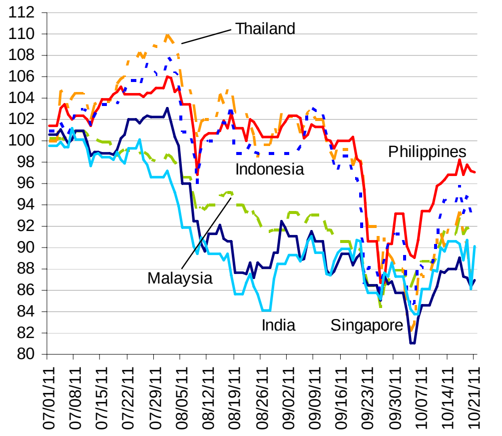
Charts

Chart 9
Stock Markets



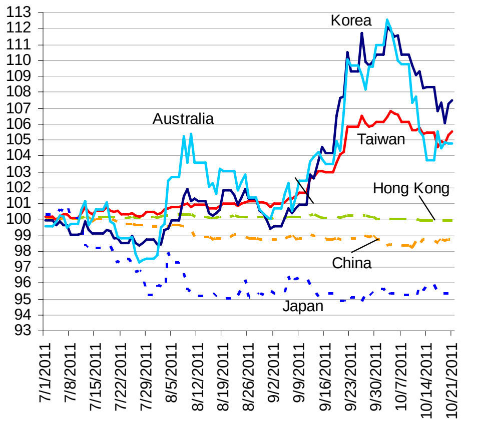
Source: BBVA Research and Bloomberg

Chart 10
Stock Markets



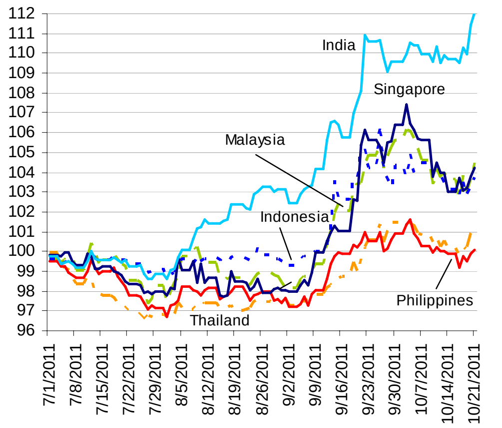
Source: BBVA Research and Bloomberg

Chart 11
Foreign Exchange Markets



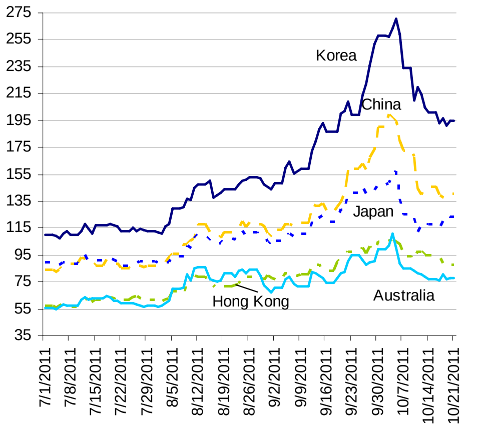
Source: BBVA Research and Bloomberg

Chart 12
Foreign Exchange Markets



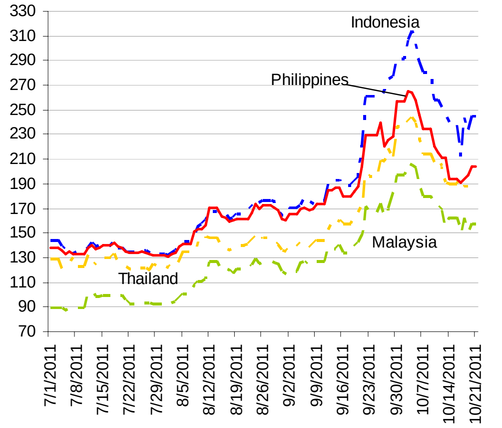
Source: BBVA Research and Bloomberg

Chart 13
Credit Default Swaps



Source: BBVA Research and Bloomberg

Chart 14
Credit Default Swaps



Source: BBVA Research and Bloomberg

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