

Weekly Watch

Asia

28 October 2011
Economic Analysis

Asia

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EU plan and US growth lift sentiment

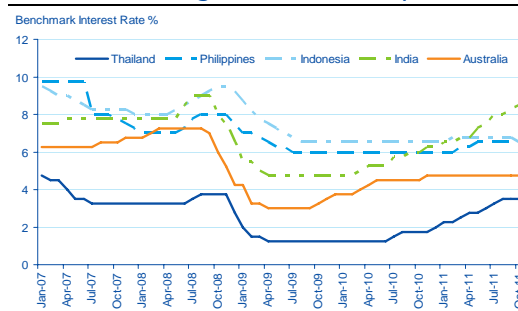
Asian markets are responding positively to the European plan to resolve its debt problems (see Markets on following page), with a further boost from a positive third quarter US GDP outturn. That said, weak global growth prospects and declining external demand are continuing to weigh on Asian economies (see Highlight on recent export performance). As noted on previous occasions, policy makers in the region have increasingly shifted their focus from fighting inflation to supporting growth. Somewhat out of line with this trend, however, the Reserve Bank of India (RBI) this week hiked interest rates once again to stem inflation (see Highlights), while signaling that this move—the 13th rate hike in the current cycle—is likely to be the last. Meanwhile, China was in the spotlight this week after Premier Wen Jiabao announced that the government will “fine-tune” economic policies to support growth. And the Bank of Japan introduced further stimulus measures this week, in the face of a persistently strong yen and weakening growth outlook.

Further signs of easing inflation as exports and production weaken

Inflation remains high in many economies, but shows signs of easing. The latest inflation outturn in Australia was relatively benign (3.5% y/y for the third quarter vs. consensus: 3.5%), while it eased in Singapore (5.5% y/y; consensus: 5.6%), and in Vietnam, albeit from very high levels (21.6% y/y; prior: 22.4%). Meanwhile, export trends are deteriorating, with Hong Kong reporting an unexpected contraction in September (-3.0% y/y; consensus: 6.5%), although Japan's exports beat the consensus (2.4% y/y; consensus: 1.0%). Nevertheless, industrial production in Japan tumbled in September (-4.0% m/m; consensus: -2.1%). In Korea, third quarter GDP slowed to 0.7% q/q (from 0.9% in Q2), broadly in line with expectations.

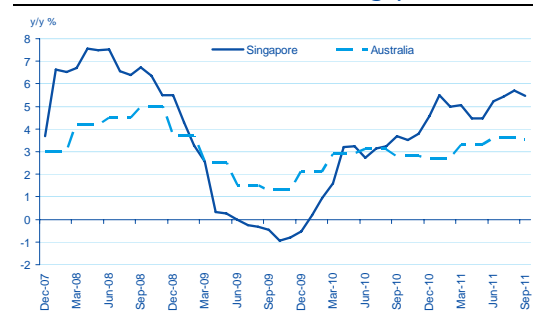
The coming week will feature China's manufacturing PMI (see Weekly indicator), which we expect to strengthen on resilient orders and robust domestic demand. In Australia, the RBA will hold its scheduled monetary policy meeting, in which we expect rates to stay on hold, although expectations of a rate cut before the end of the year are building following the easing Q3 inflation outturn. October inflation will be released in Korea, Indonesia, Thailand and the Philippines, along with third quarter GDP in Taiwan, and September industrial production and trade in Korea; the latter—Asia's first October export release—will be closely watched for signs of a slowdown.

Chart 1
India hikes rates again, and is now on pause



Source: Bloomberg and BBVA Research

Chart 2
Inflation eases in Australia and Singapore



Source: Bloomberg and BBVA Research

Markets →

Highlights →

Calendar →

Markets Data →

Charts →

Highlights

Asian exports continue to trend down

Exports have begun to weaken sharply on slowing global growth

India's RBI hikes rates again but signals end of cycle

The central bank's 13th move in the current cycle is aimed to tame stubbornly high inflation

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Markets

Markets buoyed by European plan

The rally that began early this month has been given a further boost, on European leaders' announcement on Thursday of their plan to tackle the region's debt crisis. The plan to recapitalize banks and boost the size of the EFSF, as well as to apply a 50% haircut to Greek bonds, was received favorably by markets. Equities rebounded with the Hang Seng breaking the 20,000 level on Friday, and other major indices like the Kospi and Nikkei also showing strong weekly performances. In credit, corporate and sovereign spreads are noticeably tighter, and there has been a solid rally in the industrials and financials sectors.

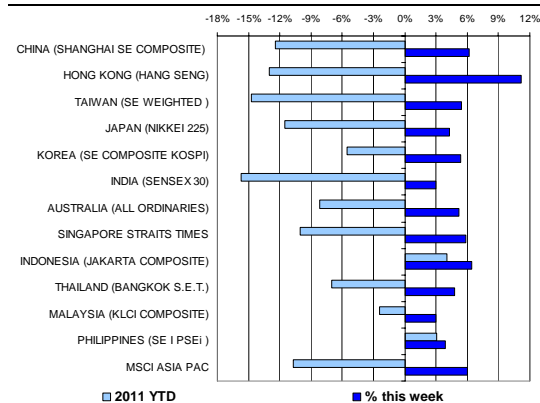
Contagion risks to Asia lower post-EU Summit

The European plan, if fully implemented, should be a step forward in alleviating the debt crisis and mitigate contagion risks in Asia. In particular, BBVA's Strategy team believes that the optimization of the EFSF and the SPV will facilitate the sovereign issuance process and should reduce the cost of funding for Spain and Italy. Strengthening banking capital is a back-stop that short-circuits the sovereign debt problems and the solvency (rather than liquidity) of European banks. The possibility of guarantees for medium-to-long-term banking debt addresses two important issues: debt maturities in 2012 (which are large) and the ability to maintain lending activity to avoid systemic risk. The Greece haircut, up to 50% now, will bring Greek public debt down to a more sustainable 120% of GDP. The road-map for improving European governance must be ready in March 2012, including more economic integration and limited Treaty changes. If all these are in place, it could break the negative feedback loop between sovereign risk and the financial markets, and thereby avoid bigger systemic risks in Europe and contagion to Asia.

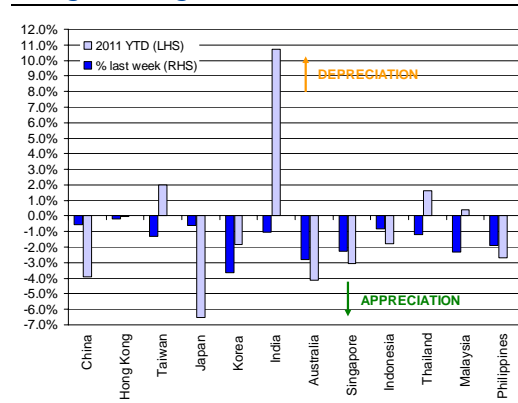
Still, a few uncertainties ahead

There are still factors to monitor, which will determine the sustainability of the improved process in the medium term. In particular, the fiscal consolidation process in peripheral Europe will have to continue and stay on track. The final fire power of the SPV must be sufficiently defined to reinforce the backstop for Spain and Italy, and the participation of the IMF and other emerging market sovereign funds may be critical. The definition of the guarantee mechanism of the EFSF has to be articulated. And lastly, we will have to monitor the road-map published in March 2012.

While the EU plan is broadly positive for Asian financial markets, it does so by reducing tail risks of a financial crisis, rather than directly boosting global growth prospects. In the meantime, Asian economic growth is slowing, with monetary tightening coming to an end (see Highlight on India). As such, the boost to Asian currencies, which are approaching the highs of last summer, may not be fully justified by the current global growth outlook and direction of monetary policy.

Chart 3
Stock markets

Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets

Source: BBVA Research and Bloomberg

Economic Analysis

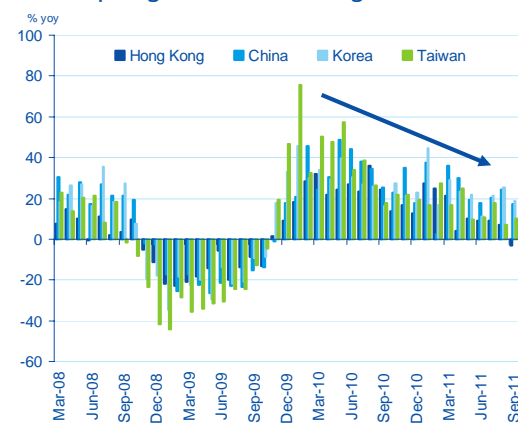
Highlights

Asian exports continue to trend down

Evidence of the region's export slowdown due to weakening global demand continued to mount this week with Hong Kong announcing a lower-than-expected September outturn (-3.0% y/y; consensus: +6.5%). The weak performance was due to soft demand from China (-7.3% y/y) possibly due to decreased end-demand elsewhere (Hong Kong sends many raw materials to China, for manufacture and export of finished products) and the US (-8.9%) (Chart 1). Exports of electronics and machinery (-7.5% y/y) declined sharply, and September's outturn signaled the first year-over-year contraction since October 2009. The government maintained that the outlook looks 'bleak,' although we believe that exports are set to bottom over the next two quarters, before picking up in mid-2012.

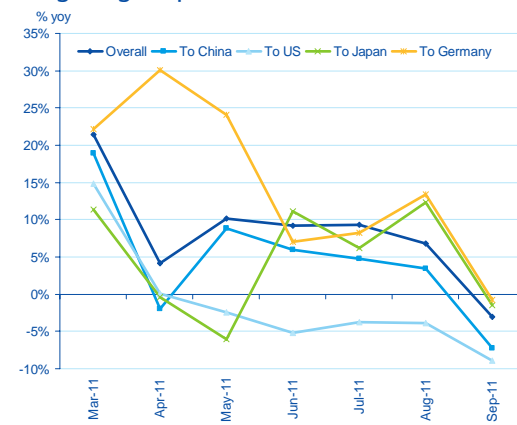
Hong Kong's moderating exports outturns mirror what many other Asian economies have been experiencing since the EU crisis (Chart 2). More recently, downside risks of a severe slowdown have increased. Taiwan is facing similar headwinds as Hong Kong from a faltering global recovery, as exports growth has held below 10% for two straight months. Although Taiwanese exports of information and communication products still grew rapidly thanks to robust global demand for high-end smartphones and tablet computers, overall the electronics component of exports, which accounts for 28% of Taiwan's outgoing trade, moderated significantly in the third quarter, to 3.0% y/y. Earlier this month China warned of 'severe' upcoming challenges to its exports after its September outturn came in below expectations (17.1% y/y, consensus 20.5% y/y). Demand from abroad is likely to remain weak in the short term. Pressure on exports may be even more acute in areas such like Thailand, which is suffering from disruptions due to intense flooding. That said, our view is that while the coming quarter will be challenging for Asia's exporters, robust domestic demand and strong intraregional trade should provide a cushion, and set the stage for an eventual rebound.

Chart 5
Asian export growth is weakening



Source: BBVA Research and Bloomberg

Chart 6
Hong Kong's exports slide



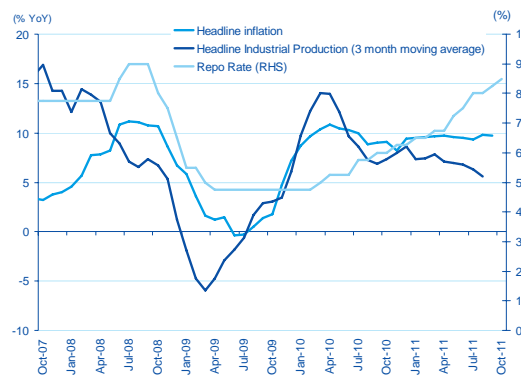
Source: BBVA Research and Bloomberg

India's RBI hikes rates again but signals end of cycle

India's central bank hiked interest rates again at its policy meeting on October 25 in response to still high inflation. As such, its policy response continues to be out of step with other emerging markets where central banks are either on hold or have started to cut rates in light of slowing growth and deteriorating global prospects. The Reserve Bank's latest rate hike, by 25 bps and the 13th move in the current cycle for a cumulative tightening of 525 bps, was in line with consensus and pushes the benchmark repo rate to 8.5%. The policy move was driven by the need to contain stubbornly high inflation and anchor inflation expectations. Nevertheless, the accompanying statement was fairly dovish as the RBI cautioned about significant risks to growth and lowered its GDP growth forecast, clearly signaling an end to the hiking cycle. The RBI's baseline projection for GDP growth for the fiscal year ending March 2012 was revised down to 7.6% from 8.0% y/y, in line with our own projections, while that for inflation was maintained at 7.0% y/y for the corresponding

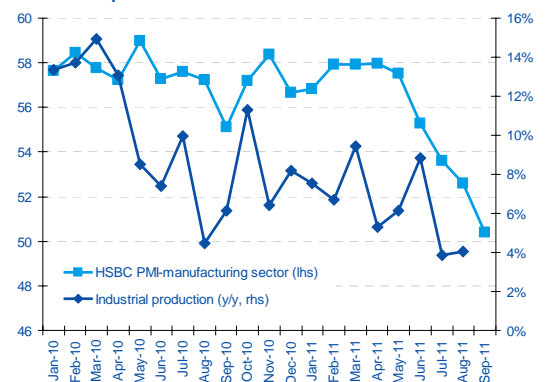
period. We expect policy rates to have peaked in India as (1) major downside risks to domestic growth through trade, finance and confidence channels emanate from a worsening global macro environment (2) domestic growth is already showing discernible signs of a slowdown, particularly on the investment front and (3) momentum indicators point to moderation in domestic inflation going ahead. India's policy mix is becoming increasingly sub-optimal with fiscal policy still largely accommodative while monetary policy being considerably tight. Policymakers warned that the recent expansion in the government borrowing program can potentially crowd out more productive private sector investment while adding to demand pressures in the economy. Alongside the policy communiqué, policymakers deliberated on several key announcements aimed at further developing India's banking sector. Chief amongst them is the deregulation of deposit interest rates.

Chart 7
India's RBI hikes rates to contain inflation...



Source: CEIC and BBVA Research

Chart 8
...even as production continues to slow



Source: CEIC and BBVA Research

Home →

Markets →

Calendar →

Markets Data →

Charts →

Calendar Indicators

Australia	Date	Period	Prior	Cons.
Building Approvals (YoY)	2-Nov	SEP	-5.5%	--
Retail Sales s.a. (MoM)	3-Nov	SEP	0.6%	--
China	Date	Period	Prior	Cons.
PMI Manufacturing	1-Nov	OCT	51.2	--
HSBC Manufacturing PMI	1-Nov	OCT	49.9	--
China Non-manufacturing PMI	3-Nov	OCT	59.3	--
China HSBC Services PMI	3-Nov	OCT	53.0	--
Hong Kong	Date	Period	Prior	Cons.
Retail Sales (YoY)	1-Nov	SEP	29.0%	--
India	Date	Period	Prior	Cons.
Exports (YoY)	1-Nov	SEP	44.3%	--
Indonesia	Date	Period	Prior	Cons.
CPI Inflation (YoY)	1-Nov	OCT	4.61%	4.76%
Exports (YoY)	1-Nov	SEP	37.1%	40.0%
Japan	Date	Period	Prior	Cons.
Housing Starts (YoY)	31-Oct	SEP	14.0%	6.8%
Vehicle Sales (YoY)	1-Nov	OCT	1.7%	--
Malaysia	Date	Period	Prior	Cons.
Exports (YoY)	4-Nov	SEP	10.9%	--
Philippines	Date	Period	Prior	Cons.
CPI Inflation (YoY)	4-Nov	OCT	4.8%	--
Singapore	Date	Period	Prior	Cons.
Unemployment Rate (sa)	31-Oct	3Q P	2.1%	--
Korea	Date	Period	Prior	Cons.
Industrial Production (MoM)	31-Oct	SEP	-1.9%	-0.5%
Industrial Production (YoY)	31-Oct	SEP	4.8%	4.4%
CPI Inflation (YoY)	1-Nov	OCT	4.3%	4.2%
Export (YoY)	1-Nov	OCT	19.6%	11.0%
Taiwan	Date	Period	Prior	Cons.
GDP - Constant Prices (YoY)	31-Oct	3Q P	5.02%	3.58%
Thailand	Date	Period	Prior	Cons.
Exports (YoY)	31-Oct	SEP	28.4%	--
CPI Inflation (YoY)	1-Nov	OCT	4.03%	4.00%
Vietnam	Date	Period	Prior	Cons.
Retail Sales YTD (YoY)	25-31 OCT	OCT	22.8%	--
Industrial Production (YoY)	25-31 OCT	OCT	12.0%	--

Indicator of the Week: China PMI for October (November 1)

Forecast: 51.7

Consensus: not available yet

Prior: 51.2

Comment: Despite recent concerns about the strength of China's growth momentum as external demand weakens, recent activity indicators have been holding up well through September. As an example, the latest flash estimate of the private sector PMI for October (Markit) rose to 51.1 after being in the contraction zone (sub-50), on strong new order and export order components. We expect the official monthly PMI index, which covers a larger sample, to confirm a slight upturn from the previous month. **Market impact:** A lower-than-expected reading could dent sentiment about the growth outlook, while a higher-than-expected outturn, combined with recent signs of policy easing, would further strengthen the outlook.

Calendar Events

Australia - RBA Monetary Policy Meeting, November 1

We expect the CASH target to stay on hold

Current Consensus

4.75% 4.75%

Markets Data

STOCK MARKETS	INDEX	Last price	% change over a week	Year to date	% Change over 1 Y
	China - Shanghai Comp.	2459.4	6.1	-12.4	-17.8
	Hong Kong - Hang Seng	20051.3	11.2	-13.0	-13.6
	Taiwan - Weighted	7650.6	5.5	-14.7	-8.4
	Japan - Nikkei 225	9048.4	4.3	-11.5	-3.4
	Korea - Kospi	1937.8	5.4	-5.5	1.6
	India - Sensex 30	17288.8	3.0	-15.7	-13.6
	Australia - SPX/ASX 200	4356.9	5.2	-8.2	-7.0
	Singapore - Strait Times	2870.7	5.8	-10.0	-8.3
	Indonesia - Jakarta Comp	3852.8	6.4	4.0	5.9
	Thailand - SET	960.2	4.8	-7.0	-2.7
	Malaysia - KLCI	1481.8	3.0	-2.4	-1.2
	Philippines - Manila Comp.	4328.3	3.9	3.0	1.6

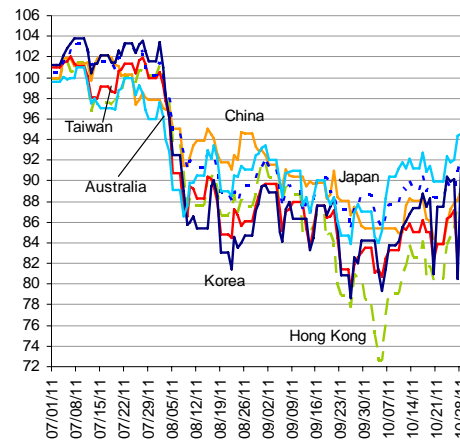
Last update: Friday, 11.45 Hong Kong time.

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.35	0.57	6.35	6.36
	Hong Kong (HKD/USD)	7.77	0.16	7.76	7.75
	Taiwan (TWD/USD)	29.9	1.32	29.77	29.36
	Japan (JPY/USD)	75.8	0.59	75.73	75.26
	Korea (KRW/USD)	1105	3.81	1112	1118
	India (INR/USD)	49.5	-0.43	49.72	50.77
	Australia (USD/AUD)	1.07	2.87	0.95	n.a.
	Singapore (SGD/USD)	1.24	2.30	1.24	1.24
	Indonesia (IDR/USD)	8834	0.84	8920	9359
	Thailand (THB/USD)	30.5	1.21	30.74	31.12
	Malaysia (MYR/USD)	3.07	2.42	3.09	3.12
	Philippines (PHP/USD)	42.6	1.92	42.44	42.36

Last update: Friday, 11.45 Hong Kong time.

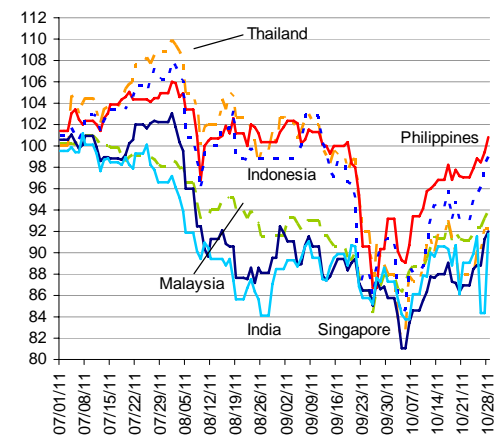
Charts

Chart 9
Stock Markets



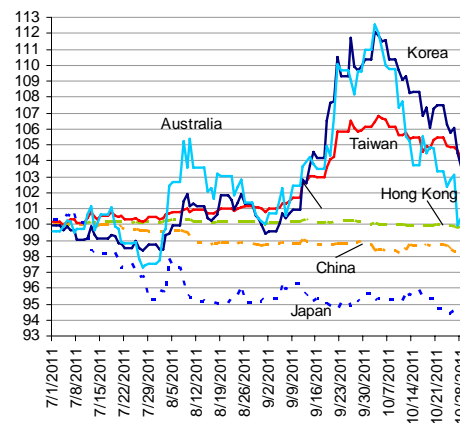
Source: BBVA Research and Bloomberg

Chart 10
Stock Markets



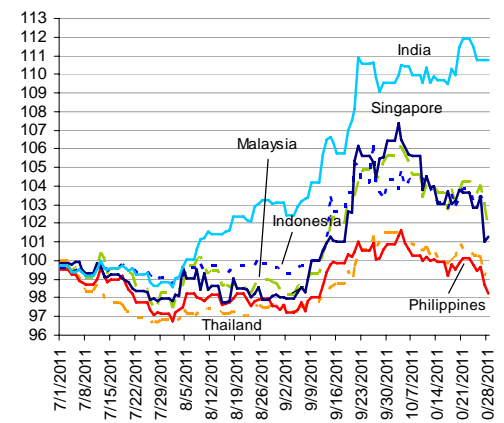
Source: BBVA Research and Bloomberg

Chart 11
Foreign Exchange Markets



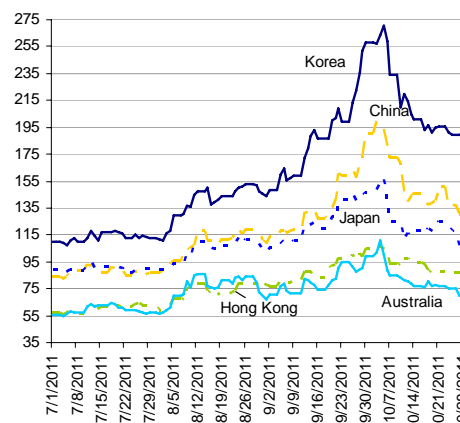
Source: BBVA Research and Bloomberg

Chart 12
Foreign Exchange Markets



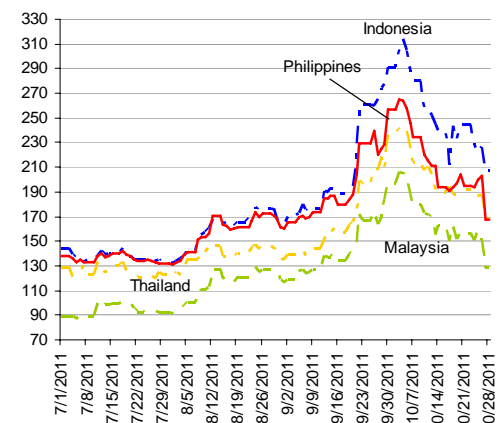
Source: BBVA Research and Bloomberg

Chart 13
Credit Default Swaps



Source: BBVA Research and Bloomberg

Chart 14
Credit Default Swaps



Source: BBVA Research and Bloomberg

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