BBVA | RESEARCH

Weekly Watch

Asia

4 November 2011
Economic Analysis

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Policy easing underway

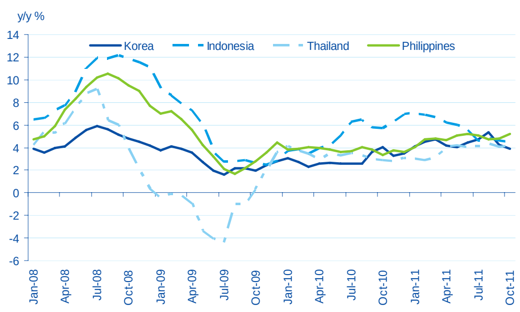
While the focus remains on Europe—especially on the ECB's surprise interest rate cut—Asia is seeing policy shifts of its own. Indeed, the Reserve Bank of Australia cut rates this week, ahead of the ECB's move (see Highlights). In recent weeks Singapore, Indonesia, and Japan have also eased monetary policies. The decisions to ease come at a time of rising global uncertainties and downside risks to the economic growth outlook, although aggressive interest rate cuts are not expected. Recent data releases have sent a consistent message: growth is slowing and inflation is declining. The latest evidence is China's PMI for October, which came in below expectations, although still in line with a soft-landing scenario (see Highlights). Ironically, the lower outturn has been greeted positively by markets, as it may increase the likelihood of monetary easing in the next couple of quarters, all the more so following the ECB's cut. In this regard, next week's inflation release in China will be closely watched for signs of a further decline, as we expect.

More signs of easing inflation and slowing activity

October inflation releases so far have generally showed signs of moderating inflation. Outturns in Korea (3.9% y/y; consensus: 4.2%) and Indonesia (4.4% y/y; consensus: 4.8%) moderated further and were below expectations. In Thailand – where supply pressures from ongoing floods may cause prices to rise – saw only modest inflation for the month of October as well (4.2% y/y; consensus: 4.5%). The Philippines was an outlier, with inflation ticking up (5.2% y/y; consensus: 5.0%) due to higher food and utilities prices. On the trade front, Korea's October exports slowed by more than expected (9.3% y/y; consensus: 10.9%). And Taiwan's third quarter GDP moderated in y/y terms (3.4% y/y; consensus: 3.6%), and declined by -1.1% q/q (saar).

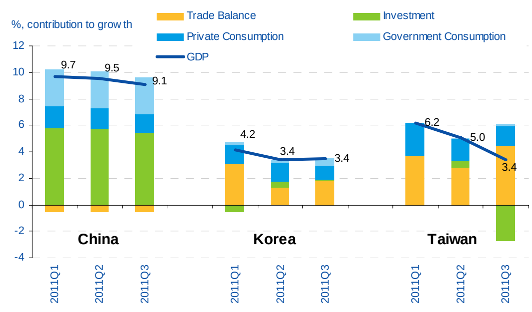
The coming week will feature a batch of statistics in China, including CPI inflation (see Weekly Indicator), industrial production, trade and credit; we expect these to moderate further, in line with a soft landing. Third quarter GDP will be released in Indonesia and Hong Kong; in the latter, there is a chance of another negative q/q outturn, which despite strong retail sales, would place Hong Kong in a technical recession (two quarters of negative growth). Monetary policy meetings will be held in Malaysia, Korea, and Indonesia. We expect them to remain on hold, although admittedly it is a close call in Indonesia given the rate cut last month and the recent steady decline in inflation.

Chart 1
Asian inflation is easing...



Source: Bloomberg and BBVA Research

Chart 2
...and growth is slowing



Source: Bloomberg and BBVA Research

Highlights

Australia shifts to monetary easing on declining inflation and global risks

The RBA cuts interest rates on declining inflation and weakening external demand

China's growth continues to moderate in line with a soft landing

October PMI disappointed to the downside and expectations of monetary easing are rising

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Markets

Greek uncertainties spook Asian investors

Investors remain focused on developments in Europe, which continue to overshadow regional developments, of which there were a number this week: Japan's FX intervention and Australia's decision to cut interest rates (to 4.50%, from 4.75%) as well as rising expectations of a looser monetary stance in China. Asian equities initially sold off after the announcement by Greece's Prime Minister of a referendum on the EU's bailout plans. But Thursday's news that the referendum would not proceed after all, and a cut in interest rates by the ECB turned sentiment around. As a result, many stock benchmark indices and most currencies pared losses, with the Hang Seng gaining 3% on Friday and KRW rising sharply (up 1.7% on the day at the time of this writing). European events caused a rally in Asian corporate bonds, and tighter sovereign CDS spreads.

Japan Intervenes in FX Markets to counteract yen strength

The Bank of Japan (BoJ) intervened by selling yen on behalf of the Ministry of Finance (MoF) on Monday. It was the third such intervention by the Japanese authorities this year. Of note, it appears the BoJ / MoF decided to go it alone this round, and initial evidence indicated the authorities have sold over JPY7.5 trillion, (around US$100 billion) which is almost double the size of the massive intervention in August. The intervention appears to be effective for the time being, with USDJPY staying above 78 as compared to a record-low of 75.3 last week. That said, we think the intervention campaign is only effective in smoothing short-term volatilities, and cannot change the JPY's trend, which is fundamentally being shaped by US monetary policy and global risk premiums.

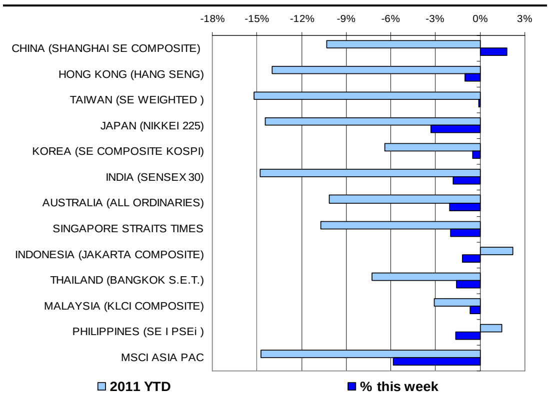
Hopes rising for China monetary easing

Expectations for looser monetary policy in China have been growing this week in light of recent remarks made by senior officials and in anticipation of easing CPI ahead. Last week, Premier Wen called for a "fine-tuning" of policies, which was followed by similar messages during a State Council meeting over the weekend. The comments indicate that Beijing is ready to ease policies selectively in a more turbulent global environment. An important hurdle in the way of shifting towards a looser monetary policy has been high inflation, but our economists believe that CPI will ease quickly to below-5.0% by December. Accordingly, even though the PBoC is still stressing little change to its policy stance for now, we think lower inflation risks and moderating growth in the coming months should reinforce perceptions of easier monetary policies by early 2012.

Australia joins Indonesia in easing monetary policy

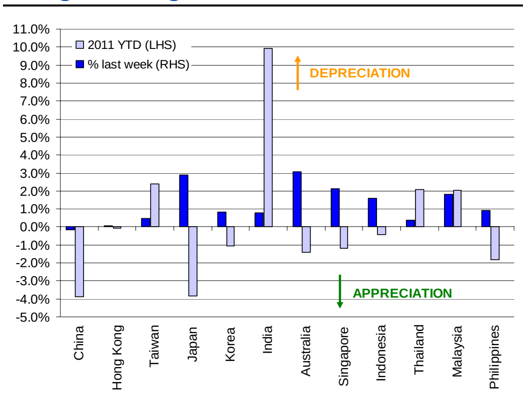
In a surprise move, the Reserve Bank of Australia (RBA) cut rates on Tuesday by 25 bps in anticipation of slowing growth and lower inflation. We view the move as a fine-tuning reaction to growing external risks, rather than the start of a significant monetary easing cycle. That said, as the European debt crisis is expected to last at least till mid-2012, the likelihood of another rate cut in H1 2012 has increased. Markets are awaiting clearer guidance from the RBA on the length and the depth of this rate cut cycle, and the uncertainties in the interim will add to AUD volatility as global financial markets will be riding a bumpy road towards a final debt resolution in Europe.

Chart 3
Stock markets



Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets



Source: BBVA Research and Bloomberg

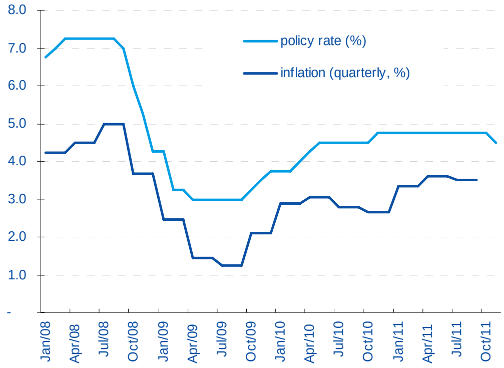
Economic Analysis

Highlights

Australia shifts to monetary easing on declining inflation and global risks

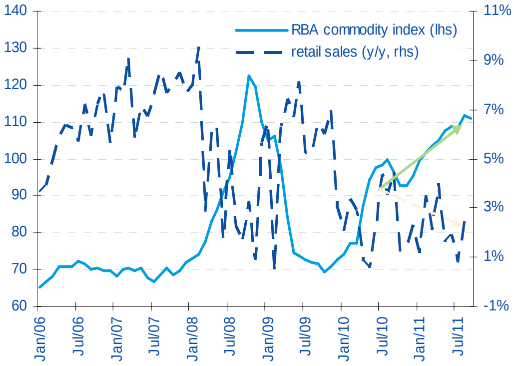
Even before this week's ECB move, the Reserve Bank of Australia cut its policy rate by 25 bps to 4.50%, after keeping rates on hold since November 2010. While the move was anticipated by a small majority of analysts, opinion had been divided ahead of the policy meeting on whether a rate cut would be forthcoming. In explaining its decision, the RBA underscored the moderation in inflation—which eased in the third quarter to 3.5% y/y from 3.6%—and likelihood of a further decline to within the official target range of 2-3% in 2012. It further explained that it was seeking to remove a "mildly restrictive stance" of monetary policy in view of the soft outlook in non-commodity sectors. In its quarterly monetary policy statement, the RBA cut its growth and inflation forecasts for the next two years on the worsening global environment. Australia was among the first to recover from the 2008/09 international financial crisis due to strong global commodity demand particularly from China and India. However, the recovery has been "two-speed", with the robust mining sector on the one hand, and other more sluggish domestic sectors such as housing on the other; private consumption has also been subdued. Recent indicators suggest that overall growth momentum has been keeping up well, bolstered by the post-flood rebuilding in Queensland and robust investment in the mining sectors. That said, the global downturn poses downside risks, and the economy remains heavily dependent on China's strong growth, which is slowing. We view the rate cut as something of a fine-tuning reaction to these rising external risks, rather than a start of a significant easing cycle, with one more rate cut of 25 bps in the first half of next year.

Chart 5
Australia cut policy rate as inflation eases



Source: BBVA Research and Bloomberg

Chart 6
Australia has a "two-speed" economy

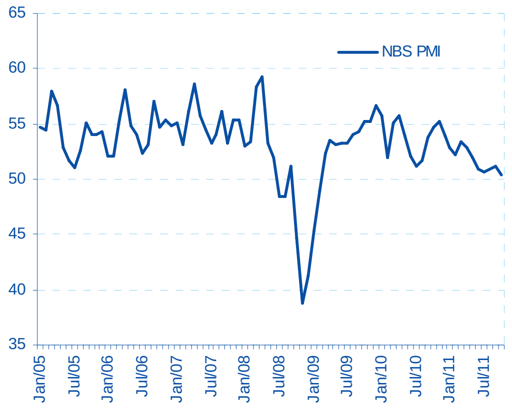


Source: BBVA Research and Bloomberg

China's growth continues to moderate in line with a soft landing

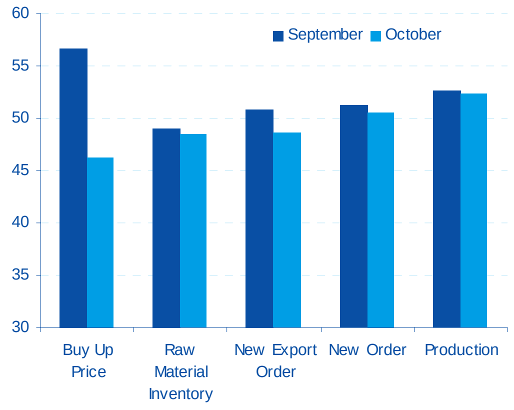
The October PMI reading was released earlier this week, coming in below expectations but still in line with a soft landing in our view. Asian markets generally took the outturn in stride, although the lower-than-expected outturn weighed down on global market sentiment somewhat, especially against renewed uncertainties about Greece and ongoing concerns of a hard landing in China. In particular, the PMI fell to 50.4% in October after two consecutive months of increases (from 50.7% in July to 51.2% in September) and was well below expectations (consensus: 51.8%; BBVA: 51.7%). Although the PMI outturn is the lowest reading since March 2009, it was still within the 50+ expansion zone and reflects a gradual decline toward a soft landing. Moreover, the private-sector (HSBC) PMI, also released on the same day, increased to 51.0% from 49.9% in September, rising above the +50 expansion zone for the first time since July 2010. The weaker official PMI outturn was mainly due to lower new orders (with a weight of 30%), including for exports, which may reflect weakening external demand, consistent with the lower export growth outturn seen in the September data (17.1% y/y). Encouragingly, the subcomponent of production (with a weight of 25%) remained buoyant, declining only marginally, to 52.3% in October from 52.7% in the previous month. Taken together, we believe the trend is in line with our soft-landing scenario, in which we expect a moderation in Q4 GDP growth to 8.4% y/y from 9.1 y/y in Q3 (resulting in a projected annual growth outturn of 9.1% for 2011). On the policy front, the softer PMI reading increases the likelihood of some selective monetary policy easing, which in the coming months could include further measures to expand credit to SMEs and possible cuts in required reserve ratios for smaller banks. Interest rate cuts are unlikely at this juncture given the authorities' ongoing concern about inflation. In the coming week (November 9-15), a stream of important real activity indicators will be released, including inflation, trade, industrial production, investment, sales, money supply, and foreign reserves. At this point, we expect inflation to fall in October, to around 5.3% from 6.1% in September, due to base effects and easing prices on sequential basis, with production and retail sales remaining robust. These will be watched closely for further signs of the resilience of the economy in the face of weakening external demand.

Chart 7
PMI turned down in October...



Source: CEIC and BBVA Research

Chart 8
... as its components weakened



Source: CEIC and BBVA Research

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Calendar Indicators

Australia	Date	Period	Prior	Cons.
Unemployment Rate	10-Nov	OCT	5.2%	- -
China	**Date**	**Period**	**Prior**	**Cons.**
CPI Inflation (YoY)	9-Nov	OCT	6.1%	5.5%
Producer Price Index (YoY)	9-Nov	OCT	6.5%	5.8%
Industrial Production (YoY)	9-Nov	OCT	13.8%	13.4%
Fixed Assets Inv Excl. Rural YTD (YoY)	9-Nov	OCT	24.9%	24.7%
Retail Sales (YoY)	9-Nov	OCT	17.7%	17.6%
Trade Balance (USD)	10-Nov	OCT	$14.51B	$25.75B
Exports (YoY)	10-Nov	OCT	17.1%	16.2%
Imports (YoY)	10-Nov	OCT	20.9%	22.2%
New Yuan Loans	11-15 NOV	OCT	470.0B	500.0B
Money Supply - M2 (YoY)	11-15 NOV	OCT	13.0%	13.1%
Hong Kong	**Date**	**Period**	**Prior**	**Cons.**
GDP (YoY)	11-Nov	3Q	5.1%	4.0%
India	**Date**	**Period**	**Prior**	**Cons.**
Industrial Production (YoY)	11-Nov	SEP	4.1%	- -
Indonesia	**Date**	**Period**	**Prior**	**Cons.**
GDP (YoY)	7-Nov	3Q	6.49%	6.6%
Japan	**Date**	**Period**	**Prior**	**Cons.**
Current Account Balance (YoY)	9-Nov	SEP	-64.3%	-34.6%
Japan Money Stock M2 (YoY)	10-Nov	OCT	2.7%	2.6%
Machine Orders (YoY)	10-Nov	SEP	2.1%	11.4%
Machine Tool Orders (YoY)	10-Nov	OCT P	20.1%	- -
Tertiary Industry Index (MoM)	11-Nov	SEP	-0.2%	-0.6%
Malaysia	**Date**	**Period**	**Prior**	**Cons.**
Industrial Production (YoY)	10-Nov	SEP	3.0%	3.2%
Philippines	**Date**	**Period**	**Prior**	**Cons.**
Exports (YoY)	10-Nov	SEP	-15.1%	-18.0%
Taiwan	**Date**	**Period**	**Prior**	**Cons.**
CPI Inflation (YoY)	7-Nov	OCT	1.35%	1.32%
Exports (YoY)	7-Nov	OCT	9.9%	5.4%
Imports (YoY)	7-Nov	OCT	10.8%	8.6%

Indicator of the Week: China CPI Inflation for October (November 9)

Forecast: 5.4% y/y	Consensus: 5.5% y/y	Prior: 6.1% y/y

Comment: China's next monthly inflation release will be watched for signs of a further decline, which could bolster expectations of policy easing following this week's release of a lower-than-expected PMI outturn. Until now, high inflation has been a constraint to possible monetary policy easing. Headline inflation has been declining since hitting a peak of 6.5% in July, but remains uncomfortably high at above 6%. We expect a significant drop in year-on-year inflation in October due to food price declines and base effects. Market impact: A higher-than-expected outturn would have a negative impact on sentiment by reducing the perceived likelihood of monetary policy easing to support growth if needed in the midst of a weakening global outlook.

Calendar Events

	Current	Consensus
Indonesia – Bank Indonesia Policy Meeting, November 10	**Current**	**Consensus**
We expect the reference rate to stay on hold	6.50%	6.50%
Malaysia – Bank Negara Monetary Policy Meeting, November 11	**Current**	**Consensus**
We expect the overnight rate to stay on hold	3.00%	3.00%
Korea – BoK Monetary Policy Committee Meeting, November 11	**Current**	**Consensus**
We expect the 7-Day Repo rate to stay on hold	3.25%	3.25%

Markets Data

STOCK MARKETS

INDEX	Last price	% change over a week	Year to date	% Change over 1 Y
China – Shanghai Comp.	2518.1	1.8	-10.3	-18.4
Hong Kong – Hang Seng	19817.5	-1.0	-14.0	-19.2
Taiwan – Weighted	7609.9	-0.1	-15.2	-8.9
Japan – Nikkei 225	8750.8	-3.3	-14.5	-4.5
Korea – Kospi	1919.6	-0.5	-6.4	-1.2
India – Sensex 30	17481.9	-1.8	-14.8	-16.3
Australia – SPX/ASX 200	4263.3	-2.1	-10.2	-10.2
Singapore – Strait Times	2847.6	-2.0	-10.7	-12.1
Indonesia – Jakarta Comp	3780.5	-1.3	2.1	4.2
Thailand – SET	957.6	-1.6	-7.3	-7.2
Malaysia – KLCI	1471.7	-0.7	-3.1	-2.6
Philippines – Manila Comp.	4262.9	-1.6	1.5	-3.1

Last update: Friday, 11.45 Hong Kong time.

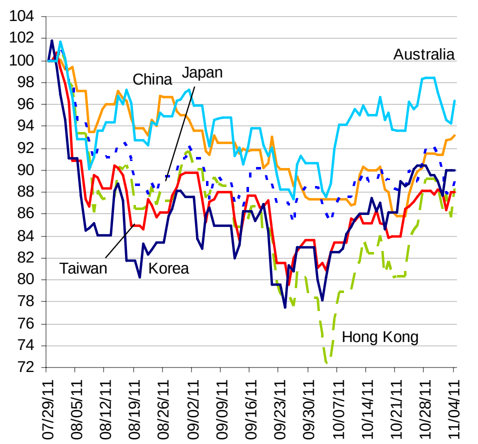
FOREIGN EXCHANGE MARKETS

CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
China (CNY/USD)	6.35	0.15	6.36	6.37
Hong Kong (HKD/USD)	7.77	-0.05	7.76	7.75
Taiwan (TWD/USD)	30.0	-0.48	29.92	29.56
Japan (JPY/USD)	78.0	-2.79	77.86	77.38
Korea (KRW/USD)	1114	-0.81	1121	1126
India (INR/USD)	49.1	0.75	49.77	51.28
Australia (USD/AUD)	1.04	-2.98	0.97	n.a.
Singapore (SGD/USD)	1.27	-2.08	1.27	1.26
Indonesia (IDR/USD)	8956	-1.57	9096	9540
Thailand (THB/USD)	30.7	-0.36	30.89	31.25
Malaysia (MYR/USD)	3.13	-1.78	3.14	3.17
Philippines (PHP/USD)	43.0	-0.89	43.01	42.96

Last update: Friday, 11.45 Hong Kong time.

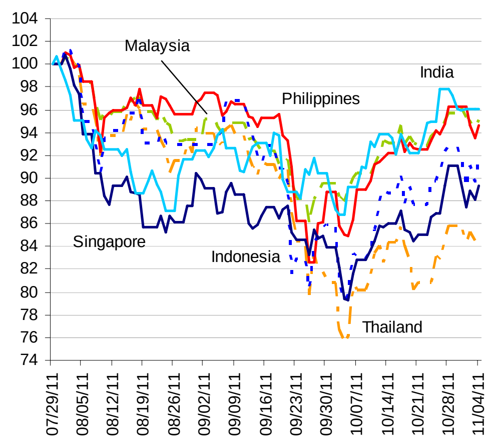
Charts

Chart 9
Stock Markets



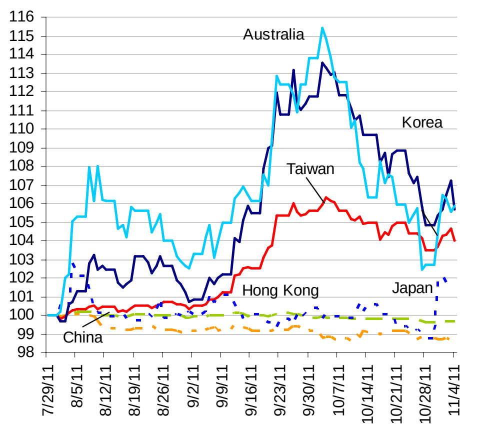
Source: BBVA Research and Bloomberg

Chart 10
Stock Markets



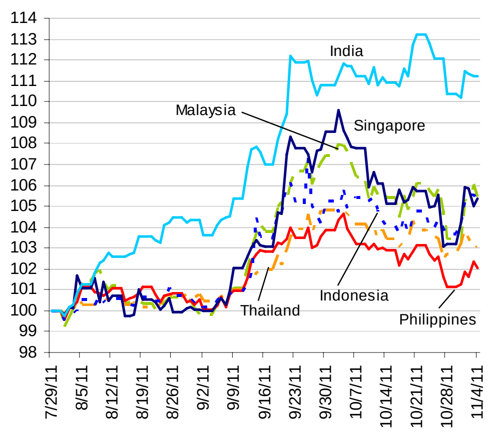
Source: BBVA Research and Bloomberg

Chart 11
Foreign Exchange Markets



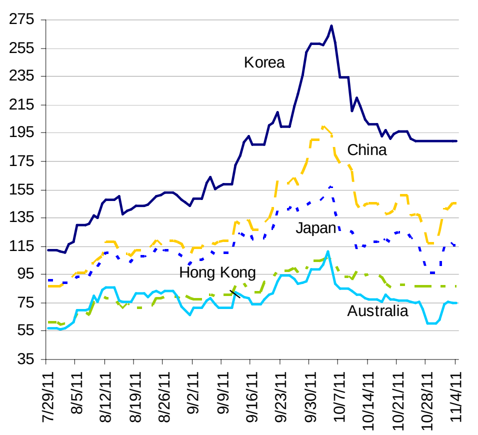
Source: BBVA Research and Bloomberg

Chart 12
Foreign Exchange Markets



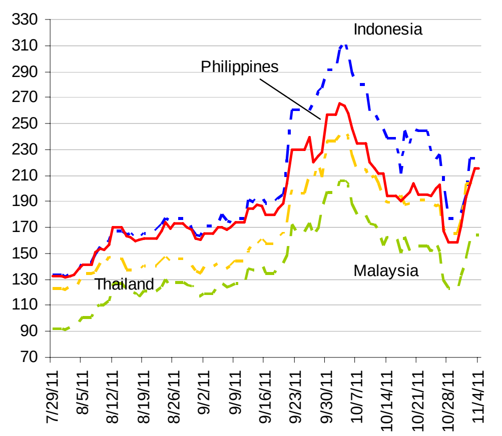
Source: BBVA Research and Bloomberg

Chart 13
Credit Default Swaps



Source: BBVA Research and Bloomberg

Chart 14
Credit Default Swaps



Source: BBVA Research and Bloomberg

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