

# Weekly Watch

## Asia

18 November 2011  
Economic Analysis

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### Markets

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## Is the gloss off Asia's growth story?

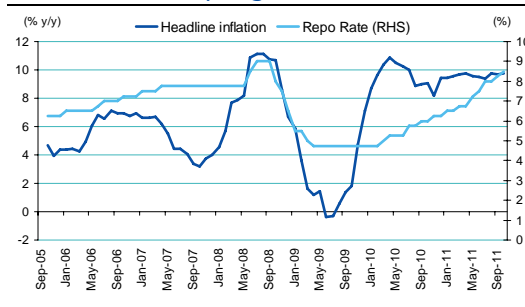
Not yet, but downside risks are increasing as the fallout of Europe's debt woes weigh on sentiment (see Markets). As we have argued in the past, as a region, Asia is well positioned to weather the turbulence given its underlying growth momentum and strong fundamentals. However, it owes much of its growth to exports and external demand, which are weakening. Reminders of this dependence were evident this week in Singapore's October export data, which showed a surprisingly large contraction, especially to the US and Europe (see below). But not all is bad. Japan registered a robust third quarter GDP outturn, as expected, as it rebounds from the March 11 earthquake and tsunami (see Highlights). And the importance of the region for future global growth was reinforced at the APEC and East Asia Summits, and by the high profile visit by US President Obama. Given the scope for policy maneuver, and with the benefit of strong demand from China, India, and Indonesia, we remain cautiously optimistic that the region can sustain growth and attract investment, even with the turbulence that may lie ahead.

### A time for outliers: Japan's 3Q rebound and India's high inflation

In contrast to slowing growth in the rest of the region, Japan's third quarter GDP rebounded due to its post-quake recovery, at 6.0% y/y saar (Chart 2), in line with consensus, although the outlook for the fourth quarter is not very bright (see Highlights). Meanwhile, India's October inflation also bucked regional trends by remaining stubbornly high at 9.7% (Chart 1), despite recent tightening by the RBI (see Highlights). As noted above, October non-oil domestic exports in Singapore surprised to the downside, plunging by -16.2% y/y (consensus: -7.8%), on an especially severe contraction to the US (-50.6% y/y) and Europe (-30.9%). The outturn is a worrisome indicator of weakening external demand, even though Singapore's monthly trade figures are notoriously volatile and should be interpreted with caution (part of the plunge could reflect temporary factors).

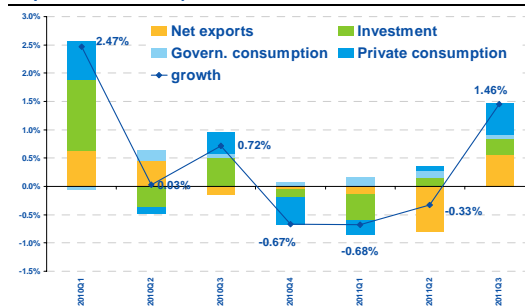
The coming week will feature third quarter GDP in Thailand, and final (revised) figures for Singapore and Taiwan. October inflation will be released in Hong Kong, Singapore, Japan, Malaysia and Vietnam. We highlight Taiwan's October export orders as our Weekly Indicator, given its importance as a leading indicator of external demand for the region. Finally, the private sector (HSBC) PMI flash estimate might move markets, given concerns of a hard landing.

Chart 1  
India's inflation stays high



Source: Bloomberg and BBVA Research

Chart 2  
Japan's economy rebounds in 3Q



Source: Bloomberg and BBVA Research

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## Highlights

### Japan's sees strong third quarter rebound, but uncertainties lie ahead

A post-quake rebound may peter out due to external headwinds

### India feels the effects of rising headwinds to growth

India's twin deficits and slowing domestic demand make it vulnerable to external shocks

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# Markets

## Debt contagion piles pressure on Asian currencies

Market fears of European debt contagion spilling to Asia continue unabated. While new, transitory Italian and Greek governments have been sworn in, sentiment is being weighed down by the lack of a broader political consensus in these countries and their capability to pass new austerity measures while winning the trust of fellow EU members. Additionally, with European industrial production stalling (negative 2.0% month-on-month in September) and PMI pointing to a bleak outlook, more downside risks to growth ahead could compromise individual countries' efforts to consolidate their fiscal positions.

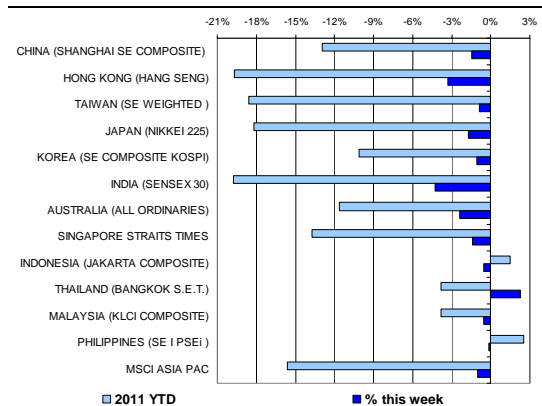
As the debt crisis intensifies, markets are turning their attention to the risks of contagion. In Asia, a regional slowdown in exports and industrial activities now appears to be taking hold: Singapore and Hong Kong export data looked quite weak (-16.2% y/y), although part of the decline was probably caused by seasonal and one-off factors. India's industrial output also softened. More signs of slowing growth amidst rising risk premiums has been leading to depreciation pressures on Asian currencies, with the INR falling sharply (to 50.90/USD at the time of this writing). India's SENSEX shed 5% on the week, as corporate earnings in the third quarter were much lower than anticipated. In Hong Kong, the Hang Seng was also down over 5% for the week, on a combination of global concerns and fears of deteriorating asset quality in China's banks. Additionally, floods in Thailand are weighing on markets due to supply disruptions, especially for Japanese firms.

Investors now are waiting on further details with respect to how the European bailout fund will be leveraged, due out on November 27, as well as whether there will be any participation by the IMF and emerging market sovereign funds. In the meantime, we think a more aggressive ECB with its bond-buying scheme is necessary to stabilize the bond markets and avoid higher margin requirements on Spanish debt.

## Political pressures regarding CNY appreciation backfire

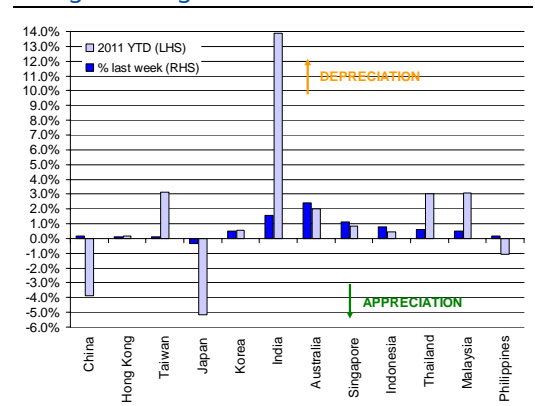
The US brought the issue of China's exchange rate policy to the fore at the APEC Summit. The Chinese countered that an abrupt CNY appreciation would not solve US deficit problems or global trade imbalances. The People's Bank of China (PBoC) fixed the USDCNY nearly 250 bps higher (weaker) this week. While the higher fixing is partly due to recent USD strength, it may also a signal to US policymakers that China will not succumb to international pressures. Barring further USD rallies, we still see scope for the CNY to appreciate further towards 6.3100 ahead of the US Treasury currency report latter this year.

Chart 3  
Stock markets



Source: BBVA Research and Bloomberg

Chart 4  
Foreign exchange markets



Source: BBVA Research and Bloomberg

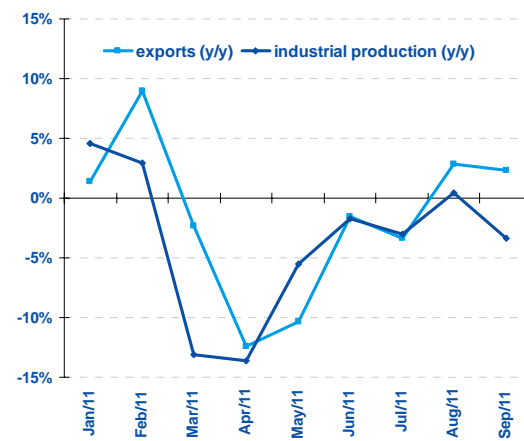
## Highlights

### Japan's sees strong third quarter rebound, but uncertainties lie ahead

Japan's third quarter GDP, released earlier this week, shows that the economy expanded by a strong 6.0%, seasonally adjusted annualized rate, in line with expectations on the economy's rebound from the impact of the March 11 earthquake and tsunami. As such, the economy registered its first positive growth after three consecutive quarters of contraction. In addition to recovering from supply chain disruptions, post-quake reconstruction spending has helped to bolster domestic demand. Industrial production and exports have reached pre-quake levels (Chart 5). In the meantime, consumer spending also picked up, by 1.0% q/q s.a., as consumer confidence recovered. Underlying the rebound in Q3 was strong net exports and private consumption, accounting for 39% and 38% of the seasonal adjusted q/q growth, while investment was also an important contributor, of about 20% to quarterly growth. Despite the rebound, going forward the recovery faces headwinds from the global downturn, strong yen (which is undermining exports and causing firms to relocate overseas), and disruptions to Japanese auto and electronics firms from floods in Thailand. In this regard, current activity indicators are pointing to a slowdown in the coming quarter.

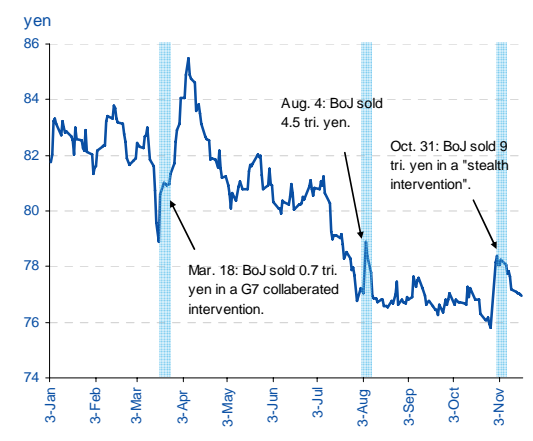
To counter these risks, the authorities have implemented a set of stimulative fiscal and monetary measures. On the fiscal side, the government and the lower parliament have passed a third supplementary budget of ¥12.1 trillion yen (2.5% of GDP), on top of two previous supplementary packages amounting to 6 trillion yen in total. On the monetary front, the Bank of Japan has recently increased the size of its asset purchase fund by ¥15 trillion (to ¥55 trillion at present) over the course of its August and October policy meetings. Meanwhile, the BoJ has also been intervening to prevent the yen from strengthening, by entering the market in October for the third time this year (Chart 6), with a particularly large period of fx purchases. Despite these measures, we expect overall GDP to contract by -0.4% for the full year 2011 (implying 0.1% q/q s.a. growth in Q4), before rebounding gradually in 2012 to 2.7%. But risks are tilted to the downside from the uncertain global outlook.

Chart 5  
Japan: despite a Q3 GDP rebound, production may be weakening in Q4



Source: BBVA Research and Bloomberg

Chart 6  
Japanese FX Interventions have had little long-term impact in the past



Source: BBVA Research and Bloomberg

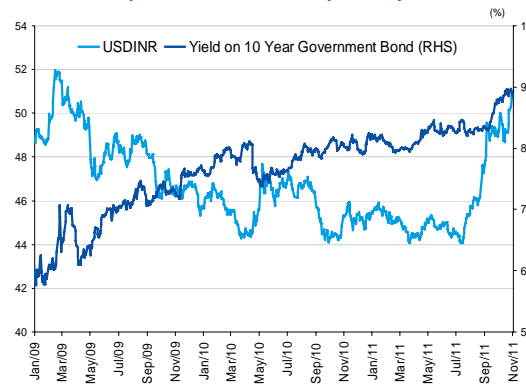
**India feels the effects of rising headwinds to growth**

Headwinds from the worsening global environment combined with domestic issues of inflation, slowing domestic demand, and lackadaisical progress on economic reforms are exacerbating the trend of slowing growth in India. Recent activity indicators such as industrial production, motor vehicle sales, tax revenues, and exports point to weakening growth prospects, posing downside risks to our 2011 and 2012 growth forecasts of 7.6% and 8.0% respectively. Industrial production (IP) growth for September, released this past week, declined to its slowest pace in two years at +1.9% y/y (consensus: 3.5%) from a downwardly revised 3.6% in August. Stubbornly high inflation is also posing upside risk to our 2011 average annual WPI projection of 9.3% y/y. Inflation has posed a dilemma for policy makers as they have so far had to sacrifice growth in their effort to reduce inflation – the RBI last hiked interest rates on October 25 but is now on hold.

Meanwhile, India stands out in the region for its “twin” fiscal and current account deficits, which pose vulnerabilities against the worsening global macro backdrop. By undermining investor sentiment, the twin deficits have aggravated recent currency weakness and are prompting possible reviews by credit rating agencies. The external outlook has weakened as domestic exporters not only face slowing global demand but also narrowing margins at home due to elevated borrowing costs and rising import costs on account of a weakening exchange rate. In that regard, the rupee has weakened by almost 14 per cent against the USD since late July. Large financing requirements for the government and declining earnings for corporates have undermined India’s domestic bond market, with 10 yr government bond yields touching almost 9.0% from 8.3% in September (Chart 7). India’s public debt-to-GDP ratio stands at almost 70% of GDP (including central and state government debt), which is higher than the median for similar rated countries.

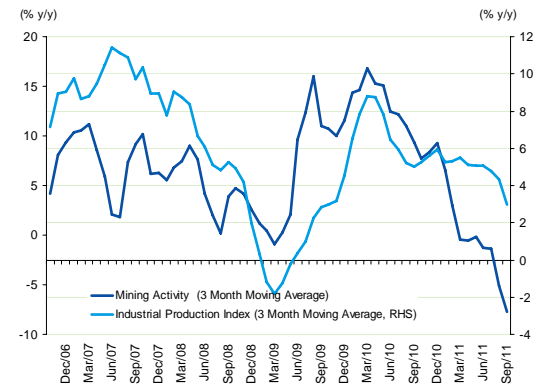
However, on a reassuring note, India’s public debt is largely domestically financed (94% of public debt is INR denominated), making it less vulnerable to the risk of flight to safety by foreign investors. In addition, India’s foreign exchange reserves stand at a comfortable level of USD 315 billion, equivalent to 4.6 times India’s short term external debt and 9 months of Imports, a sufficient buffer in the event of an external shock and equity outflows. The RBI meanwhile is taking steps to attract inflows to the bond market, aid investment reforms and cushion domestic importers. For example, this week, it announced an increase in the ceiling in government and corporate bonds by USD 5 billion while raising the interest rate ceiling for raising overseas trade credit by 150 bps. The RBI is also ensuring adequate market liquidity through open market operations, with a large injection of some INR 100 billion scheduled on November 24.

Chart 7  
**India bond yields rise as the rupee depreciates**



Source: CEIC and BBVA Research

Chart 8  
**India’s mining sector is weakening on slow public sector reforms**



Source: CEIC and BBVA Research

## Calendar Indicators

<b>China</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
HSBC Flash China Manufacturing PMI	22-25 NOV	NOV	51.1	--
<b>Hong Kong</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
CPI Inflation (YoY)	22-Nov	OCT	5.8%	--
Exports (YoY)	24-Nov	OCT	-3.0%	--
Imports (YoY)	24-Nov	OCT	2.3%	--
<b>Japan</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
Merchnds Trade Exports (YoY)	21-Nov	OCT	2.4%	0.5%
Merchnds Trade Imports (YoY)	21-Nov	OCT	12.1%	15.5%
All Industry Activity Index (MoM)	21-Nov	SEP	-0.5%	-1.1%
CPI Inflation (YoY)	25-Nov	OCT	0.0%	-0.1%
CPI Inflation Ex Food, Energy (YoY)	25-Nov	OCT	-0.4%	-0.9%
<b>Malaysia</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
CPI Inflation (YoY)	23-Nov	OCT	3.4%	--
<b>Singapore</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
GDP Growth (QoQ)	21-Nov	3Q F	1.3%	2.0%
GDP Growth (YoY)	21-Nov	3Q F	5.9%	6.1%
CPI Inflation (MoM) nsa	23-Nov	OCT	-0.2%	0.4%
CPI Inflation (YoY)	23-Nov	OCT	5.5%	5.2%
Industrial Production (MoM) sa	25-Nov	OCT	-0.7%	-2.0%
Industrial Production (YoY)	25-Nov	OCT	12.8%	8.6%
<b>Taiwan</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
Export Orders (YoY)	21-Nov	OCT	2.7%	3.8%
Current Account Balance (USD)	21-Nov	3Q	9015M	--
Unemployment Rate - sa	22-Nov	OCT	4.3%	4.3%
Commercial Sales (YoY)	23-Nov	OCT	4.3%	4.0%
Industrial Production (YoY)	23-Nov	OCT	1.6%	2.5%
GDP Growth (YoY)	24-Nov	3Q F	3.4%	3.4%
Money Supply M2 Daily Avg (YoY)	25-Nov	OCT	5.9%	5.6%
<b>Thailand</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
GDP Growth (QoQ) sa	21-Nov	3Q	-0.2%	1.5%
GDP Growth (YoY)	21-Nov	3Q	2.6%	4.4%
Customs Exports (YoY)	21-25 NOV	OCT	19.1%	9.8%
Customs Imports (YoY)	21-25 NOV	OCT	41.9%	29.2%
<b>Vietnam</b>	<b>Date</b>	<b>Period</b>	<b>Prior</b>	<b>Cons.</b>
CPI Inflation (YoY)	24-Nov	NOV	21.6%	--
Exports YTD (YoY)	24-30 NOV	NOV	34.6%	--
Imports YTD (YoY)	24-30 NOV	NOV	27.2%	--
Retail Sales YTD (YoY)	24-30 NOV	NOV	23.1%	--
Industrial Production (YoY)	24-30 NOV	NOV	5.3%	--

### Indicator of the Week: Taiwan export orders for October (November 21)

**Forecast: 4.2% y/y**
**Consensus: 3.8% y/y**
**Prior: 2.7% y/y**

Comment: Taiwan's export orders are a leading indicator of the strength of external demand for much of Asia's high-tech economies. Export orders hit a two-year low in September, and recent export outturns in China, the Philippines, and Singapore, among others, show a clear weakening trend, especially from the US and Europe. We expect the deceleration trend in Taiwan's export orders to continue in October, partially offset by strong demand from China, where domestic demand remains strong. Demand for electronics such as semiconductors and components remains sluggish. Market Impact: Together with Japan's trade data to be released the same day, export orders will impact market sentiment; a worse than expected outturn would result in lower growth forecasts, and raise expectations of policy easing in Taiwan and the rest of the region.

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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.	2444.6	-1.5	-12.9	-14.7
	Hong Kong – Hang Seng	18508.6	-3.3	-19.7	-21.7
	Taiwan – Weighted	7301.3	-0.9	-18.6	-11.9
	Japan – Nikkei 225	8367.2	-1.7	-18.2	-16.4
	Korea – Kospi	1844.3	-1.0	-10.1	-4.3
	India – Sensex 30	16461.7	-4.3	-19.7	-17.4
	Australia – SPX/ASX 200	4193.4	-2.4	-11.6	-9.6
	Singapore – Strait Times	2750.8	-1.4	-13.8	-14.4
	Indonesia – Jakarta Comp	3757.0	-0.6	1.4	2.2
	Thailand – SET	993.4	2.3	-3.8	-1.1
	Malaysia – KLCI	1460.1	-0.6	-3.9	-2.4
	Philippines – Manila Comp.	4307.5	-0.1	2.5	4.5

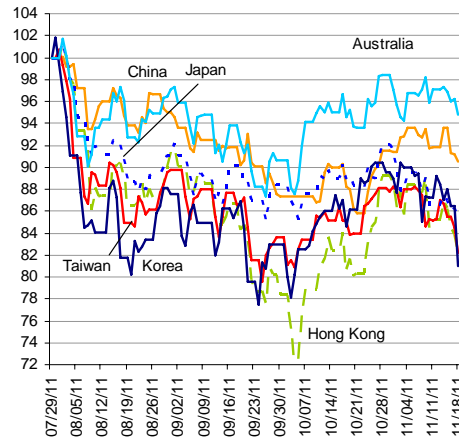
Last update: Friday, 11.45 Hong Kong time.

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.35	-0.17	6.34	6.33
	Hong Kong (HKD/USD)	7.79	-0.12	7.78	7.76
	Taiwan (TWD/USD)	30.2	-0.11	30.17	29.81
	Japan (JPY/USD)	76.9	0.34	76.74	76.00
	Korea (KRW/USD)	1133	-0.53	1139	1142
	India (INR/USD)	50.9	-1.43	51.90	53.46
	Australia (USD/AUD)	1.00	-2.37	1.01	n.a.
	Singapore (SGD/USD)	1.29	-1.11	1.29	1.29
	Indonesia (IDR/USD)	9035	-0.75	9190	9631
	Thailand (THB/USD)	31.0	-0.58	31.20	31.63
	Malaysia (MYR/USD)	3.16	-0.48	3.17	3.20
	Philippines (PHP/USD)	43.3	-0.17	43.39	43.33

Last update: Friday, 11.45 Hong Kong time.

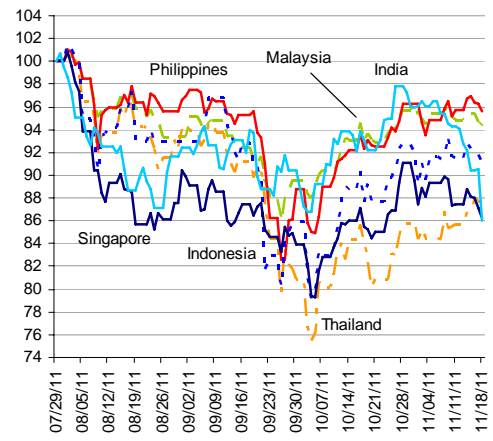
Charts

Chart 9  
Stock Markets



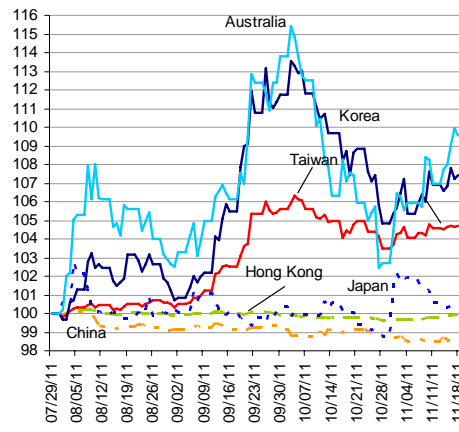
Source: BBVA Research and Bloomberg

Chart 10  
Stock Markets



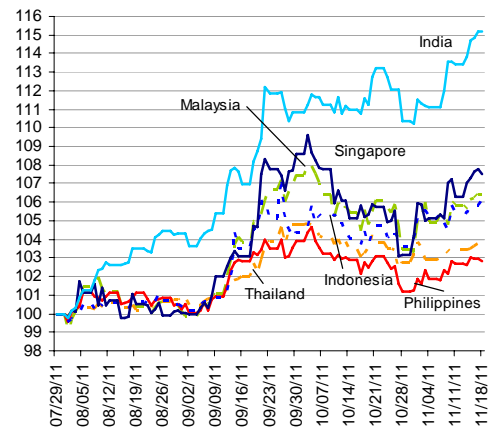
Source: BBVA Research and Bloomberg

Chart 11  
Foreign Exchange Markets



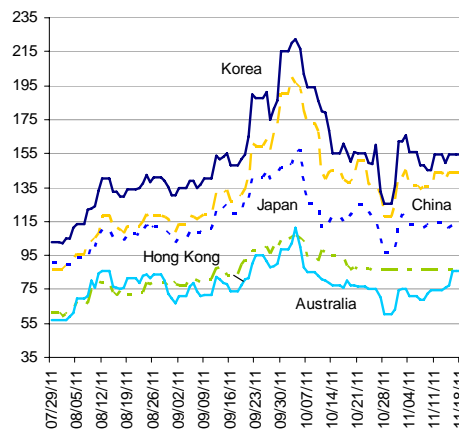
Source: BBVA Research and Bloomberg

Chart 12  
Foreign Exchange Markets



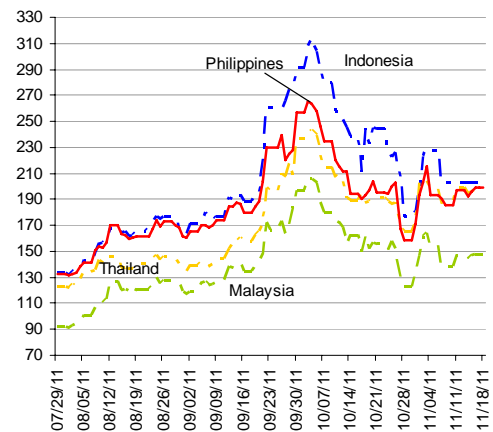
Source: BBVA Research and Bloomberg

Chart 13  
Credit Default Swaps



Source: BBVA Research and Bloomberg

Chart 14  
Credit Default Swaps



Source: BBVA Research and Bloomberg

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