

Weekly Watch

Asia

9 December 2011
Economic Analysis

Asia

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Inflation worries recede in China

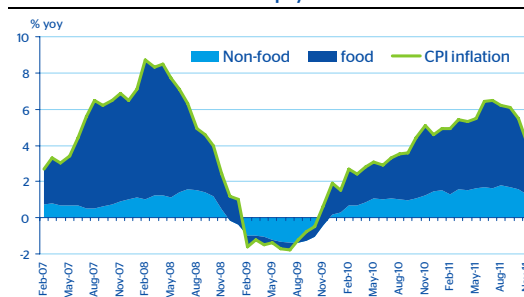
While news from Europe continues to be the main driver of Asian market moves (see Markets), the outlook for China is also playing a significant role. After a weaker-than-expected PMI outturn last week, November activity indicators slowed in line with expectations, and sharply falling inflation (Chart 1) has reinforced expectations of significant policy easing in the weeks and months to come (see Highlights). Next week's Central Economic Work Conference of top-level policymakers in China, from which we should learn more about the authorities' policy intentions for 2012, will play a similar role for Asia as the EU Summit is now playing in Europe. More generally, central banks are continuing to shift to expansionary stances, as Australia cut interest rates for a second straight month (Chart 1). Indonesia and Korea stayed on hold as expected, with further rate cuts possible if the global environment deteriorates.

Inflation easing on moderating growth trends

November inflation in China eased significantly to 4.2% y/y (BBVA: 4.3%; consensus: 4.5%) from 5.5% in October, coming closer to the authorities' 4% comfort level. Meanwhile, inflation continues to ease in other parts of the region, for example in the Philippines, where eased to 4.8% y/y (consensus: 4.9%) from 5.2% in October. November activity indicators in China moderated, but showed still-robust domestic demand (see Highlight). The export picture for the region is trending down, but remains somewhat mixed. November exports in Taiwan disappointed (1.3% y/y; consensus: 8.6%) on weaker demand from the US and Europe. In Japan, weak machine orders for November point to slowing investment demand. Finally in Australia, a stronger-than-expected Q3 GDP outturn (1.0% q/q, seasonally adjusted) was offset by a disappointing rise in November unemployment (5.3% from 5.2% the previous month).

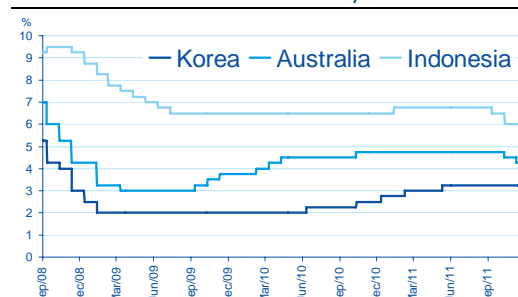
India will be the focus in the coming week, with the RBI holding its monthly policy meeting on Friday, just two days after the release of the November inflation outturn (Weekly Indicator). We expect interest rates to stay on hold, given slowing growth and falling inflation. In China, November trade (to be released tomorrow) and credit data will be evaluated for signs of external demand weakening, and expansionary monetary policy, respectively.

Chart 1
China's inflation falls sharply



Source: Bloomberg and BBVA Research

Chart 2
Australia cuts rates as others stay on hold



Source: Bloomberg and BBVA Research

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Highlights →

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Highlights

China: Inflation eases as growth continues to moderate

A sharp fall in inflation provides more room for policy easing

Australia: Despite a strong Q3, RBA cuts interest rates on a weakening outlook

Falling inflation and weakening activity indicators set the stage for further rate cuts

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Markets

Markets waiting on the EU Summit for positive signals

Asian financial markets continue to be dominated by European developments, especially the critical two-day EU Summit that concludes today. Hope for an agreement towards fiscal union and more aggressive steps to tackle the debt crisis faded on Thursday, as EU leaders tried to temper expectations about the significance of the Summit, and as European Central Bank (ECB) chairman Mario Draghi backed away from supporting an expanded bond purchase program (SMP). Risk sentiment soured, with Asian equities falling. Regional currencies depreciated against the USD for the week on signs of slowing growth, led by the high-betas such as the IDR (-1.1%) and KRW (-0.6%).

Asian currencies fluctuate in line with sentiment on Europe

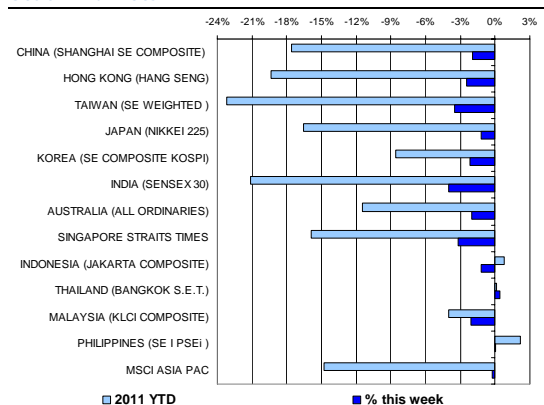
The fixation on Europe's debt crisis has left little room for local news to influence Asian FX. For example, Australia this week saw a 25 bp rate cut by the central bank on Tuesday, a slightly stronger-than-expected Q3 GDP reading on Wednesday, and an unexpected increase in unemployment in November on Thursday (see Highlights). Despite the heavy week of data, AUDUSD remained steadily above 1.02/USD until Thursday night, when market confidence in an adequate European debt resolution plan started to falter. Similarly, most Asian currencies were initially range-bound on the week before losing ground after Thursday. European news will remain the key driver for Asian currencies for the time being, but regional growth and monetary policy will likely gain importance over time in our view if the slowing growth trend gathers pace.

Expectations for monetary easing grows

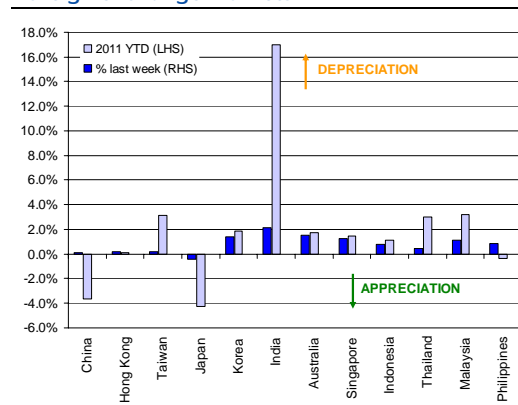
A broad regional trend towards monetary easing in 2012 is taking root, as price pressures are poised to ease further and global headwinds are strengthening. In Australia, rate markets are pricing in an additional 125 bp in cuts over the next 6 months. While central banks in Korea and Indonesia remained on hold this week, the accompanying statements stressed worries over slowing global growth and the intensifying debt crisis in Europe, implying further rate cuts are possible should downside risks materialize. In China, November CPI fell to 4.2% y/y, closer to the 4.0% comfort zone of the policymakers, paving the way for policy makers to adopt additional easing measures (recently, the RRR was lowered by 50bps) if needed.

Fresh evidence of sustained Japanese FX

Japan's latest Ministry of Finance data shows that the authorities sold JPY 9.091 trillion for the month preceding November 28. Given evidence that the intervention size for the first day was JPY7.5 trillion, the data indicates that authorities continued intervening in the markets for a week behind the scenes after its reported intervention on October 31, holding USDJPY at 78.0 to open a wider window for more SME's to buy JPY. The massive supply of JPY to the markets in this operation helped explain the absence of further appreciation in JPY in the past few weeks, even in the face of escalating risk aversion and dwindling portfolio outflows from Japan recently.

Chart 3
Stock markets

Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets

Source: BBVA Research and Bloomberg

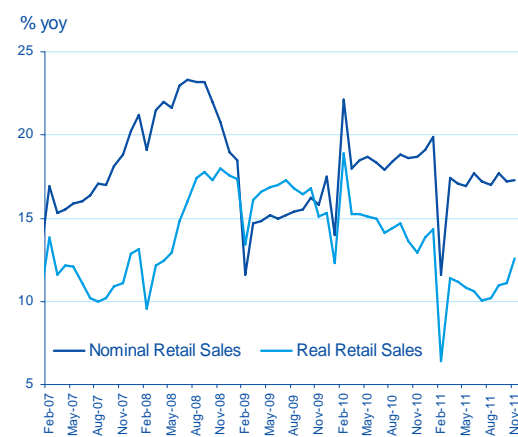
Highlights

China: Inflation eases as growth continues to moderate

Data released today show that the economy continues to slow, with weakening external demand being offset by still robust domestic demand. Significantly, November inflation eased by more than expected to 4.2% y/y in November from 5.5% in October (BBVA: 4.3%; Consensus: 4.5%). The main driver of the decline continues to be a moderation in food prices, especially pork, which eased to 26.5% y/y in November, from 38.9% y/y in October. Food prices fell by -0.8% m/m (non-seasonally adjusted), while non-food prices rose by 0.1%. Producer price inflation (PPI) in November also slowed notably to 2.7% y/y, well below expectations (Consensus: 3.4% y/y; BBVA: 3.0%), and down from 5.0% y/y in October. Month on month, the PPI declined by 0.4% in November m/m seasonally adjusted, following a decline of 0.2% in October.

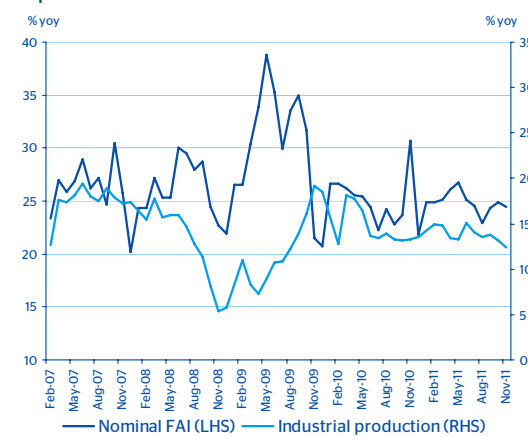
Meanwhile, activity indicators for November show moderating, but still robust domestic demand. On the demand side, November retail sales growth increased slightly to 17.3% y/y from 17.2% y/y in the previous month, above expectations (consensus: 16.8%; BBVA: 17.0%). Urban fixed asset investment (YTD) rose by 24.5% y/y (consensus: 24.8%; BBVA: 24.8%), from the outturn of 24.9% in October. On the supply side, however, industrial output eased to 12.4% y/y in November (consensus 12.4%; BBVA: 12.0%), from 13.2% y/y in October, quite likely due to weakening export demand. Taken together, the CPI inflation outturn is consistent with our end-year and 2012 projections of 4% y/y, while the activity indicators and last week's lower-than-expected PMI reading suggest some modest downside risk to our growth projections (9.1% for 211 and 8.6% for 2012). Clearly, the scope for policy easing has increased, and we expect at least 100bp cuts in the RRR in Q1 2012, with possible interest rate cuts and further reductions in the RRR to follow, depending on the outlook for the global economy.

Chart 5
Retail sales and domestic demand are robust...



Source: BBVA Research and Bloomberg

Chart 6
...while industrial output is easing on weaker exports



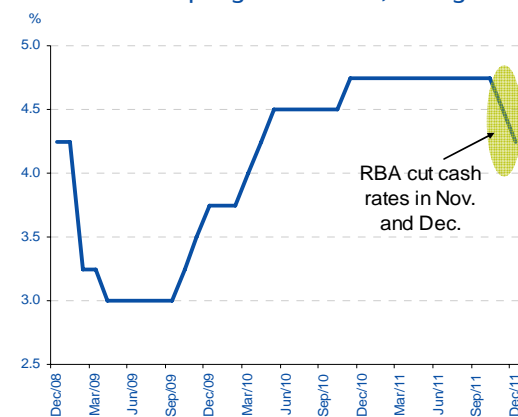
Source: BBVA Research and Bloomberg

Australia: Despite a strong Q3, RBA cuts interest rates on a weakening outlook

Australia's Q3 GDP released this week grew 1% (seasonally adjusted) from the previous quarter, better than the market's expectation of 0.8%. Second quarter growth was also revised up, to 1.4% (seasonally adjusted) from previous estimate of 1.2% (Chart 8). The strong growth outturns underscore the resilience of Australia's economy, which has been bolstered by robust commodity demand from China and the post-flood reconstruction underway in Queensland. Nonetheless, the non-mining sector remains sluggish, leaving Australia with a "two-speed" economy. Third quarter growth was led by a rise in gross fixed capital formation (6% q/q s.a.) and by a more modest increase in private consumption (1.2%). That said, more recent indicators point to a slowing of Australia's growth, dragged down by the European debt crisis. In November Australia's commodity index continued to fall for a fourth consecutive month on weaker global demand for iron ore and coking coal.

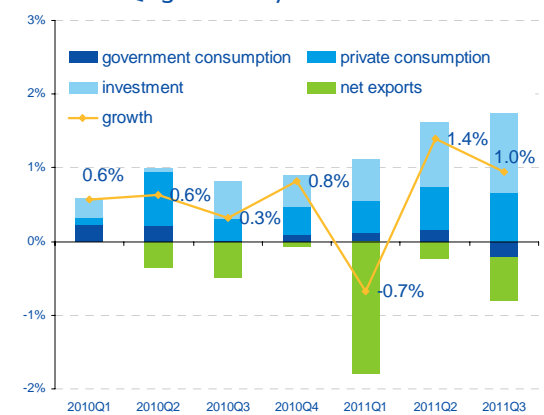
Meanwhile, the job market softened in November, as the unemployment rate ticked up to 5.3% from 5.2% in the previous month. Concerned by global headwinds, the Reserve Bank of Australia cut interest rates by 25bps to 4.25% (Chart 7) at its monetary policy meeting on December 6, emphasized slowing growth and a favorable inflation outlook within the official 2-3% target range. This was the second consecutive rate cut. On the currency front, the Australia dollar remains relatively strong against the USD, at around 1.02. Despite increasing headwinds, there are good reasons to expect Australia to remain one of the more resilient advanced economies. Robust investment in the mining sector and the post-flood rebuilding in the Queensland area are expected to continue to support the growth in the near and medium term, bolstered by a stable banking system and a healthy public finances. We expect the 2011 full-year growth outturn to reach 1.8% and 3.6% in 2012.

Chart 7
Australia takes a pro-growth stance, cutting rates



Source: BBVA Research and Bloomberg

Chart 8
Australian Q3 growth stays resilient



Source: BBVA Research and Bloomberg

Calendar Indicators

Australia	Date	Period	Prior	Cons.
Home Loans (MoM)	12-Dec	OCT	2.20%	--
Investment Lending	12-Dec	OCT	1.90%	--
Consumer Inflation Expectation	15-Dec	DEC	2.50%	--
China	Date	Period	Prior	Cons.
Trade Balance (USD)	10-Dec	NOV	\$17.03B	\$15.20B
Exports (YoY)	10-Dec	NOV	15.90%	10.90%
Imports (YoY)	10-Dec	NOV	28.70%	18.80%
New Yuan Loans	11-15 DEC	NOV	586.8B	550.0B
Money Supply - M2 (YoY)	11-15 DEC	NOV	12.90%	12.80%
Actual FDI (YoY)	14-17 DEC	NOV	8.80%	--
HSBC Flash China Manufacturing PMI	15-Dec	DEC	48	--
Hong Kong	Date	Period	Prior	Cons.
Industrial Production (YoY)	13-Dec	3Q	2.00%	--
Producer Price (YoY)	13-Dec	3Q	8.90%	--
India	Date	Period	Prior	Cons.
Industrial Production (YoY)	12-Dec	OCT	1.90%	-0.60%
WPI Inflation (YoY)	14-Dec	NOV	9.73%	9.07%
Japan	Date	Period	Prior	Cons.
Machine Tool Orders (YoY)	12-Dec	NOV P	26.00%	--
Tertiary Industry Index (MoM)	13-Dec	OCT	-0.70%	0.40%
Philippines	Date	Period	Prior	Cons.
Exports (YoY)	13-Dec	OCT	-27.40%	-17.30%
Singapore	Date	Period	Prior	Cons.
Retail Sales Ex Auto (YoY)	15-Dec	OCT	3.10%	--
Retail Sales (YoY)	15-Dec	OCT	-0.10%	1.30%
Retail Sales (MoM) sa	15-Dec	OCT	0.30%	--
Electronic Exports (YoY)	16-Dec	NOV	-31.20%	--
Non-oil Domestic Exports (YoY)	16-Dec	NOV	-16.20%	-3.00%
Non-oil Domestic Exp SA (MoM)	16-Dec	NOV	-5.90%	--
Korea	Date	Period	Prior	Cons.
Export Price Index (YoY)	13-Dec	NOV	9.20%	--
Import Price Index (YoY)	13-Dec	NOV	16.00%	--
Unemployment Rate (SA)	14-Dec	NOV	3.10%	3.20%

Indicator of the Week: India WPI Inflation for November (December 14)

Forecast: 8.9% y/y

Consensus: 9.1% y/y

Prior: 9.7% y/y

Comment: The coming week will be eventful for India's data calendar as investors eye October industrial output (IP) and November inflation outturns for clues on the course of monetary policy. The RBI meets on December 16. WPI inflation has been high and persistent. The RBI's policy tightening has led to weaker investment, with few options available to revive slowing growth. Therefore, markets will be watching for signs of a decline in inflation, which could provide room for measures to address tightening liquidity conditions. However, an easing of policy rates is unlikely anytime soon with inflation still well above the authorities' 5% comfort level. Market impact: A lower-than-expected inflation reading would reassure investors by raising expectations of policy measures to address slowing growth and tight liquidity conditions, while a higher reading would dent sentiment by limiting RBI's room for policy maneuver.

India - RBI Monetary Policy Meeting, December 16

We expect no change in the repo rate
We expect no change in the cash reserve ratio
We expect no change in the cash reverse repo rate

Current Consensus

8.50% 8.50%
6.00% 6.00%
7.50% 7.50%

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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.	2360.7	-0.8	-15.9	-17.0
	Hong Kong - Hang Seng	18973.2	7.3	-17.6	-19.1
	Taiwan - Weighted	7140.7	5.2	-20.4	-16.8
	Japan - Nikkei 225	8643.8	5.9	-15.5	-15.0
	Korea - Kospi	1916.0	7.9	-6.6	-1.8
	India - Sensex 30	16546.5	5.4	-19.3	-17.2
	Australia - SPX/ASX 200	4288.0	7.6	-9.6	-8.3
	Singapore - Strait Times	2747.4	3.9	-13.9	-14.1
	Indonesia - Jakarta Comp	3759.7	3.4	1.5	1.8
	Thailand - SET	1022.8	5.7	-1.0	-0.9
	Malaysia - KLCI	1485.7	3.8	-2.2	-1.2
	Philippines - Manila Comp.	4290.9	0.7	2.1	3.4

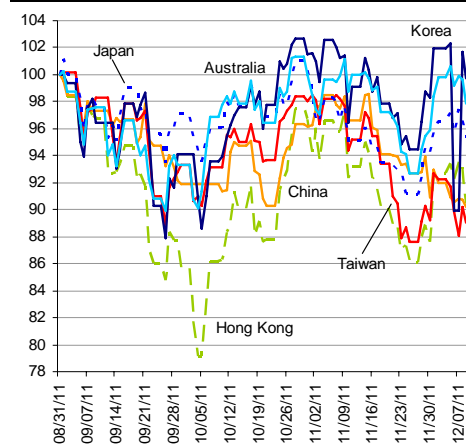
Last update: Friday, 11.45 Hong Kong time.

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.36	0.26	6.37	6.38
	Hong Kong (HKD/USD)	7.77	0.31	7.77	7.75
	Taiwan (TWD/USD)	30.1	0.95	30.11	29.77
	Japan (JPY/USD)	77.8	-0.08	77.62	77.08
	Korea (KRW/USD)	1131	2.91	1136	1142
	India (INR/USD)	51.4	1.76	52.24	53.68
	Australia (USD/AUD)	1.02	5.21	0.99	n.a.
	Singapore (SGD/USD)	1.29	2.14	1.29	1.28
	Indonesia (IDR/USD)	9088	-0.33	9213	9685
	Thailand (THB/USD)	30.9	1.72	31.08	31.48
	Malaysia (MYR/USD)	3.13	2.22	3.14	3.16
	Philippines (PHP/USD)	43.3	1.60	43.33	43.35

Last update: Friday, 11.45 Hong Kong time.

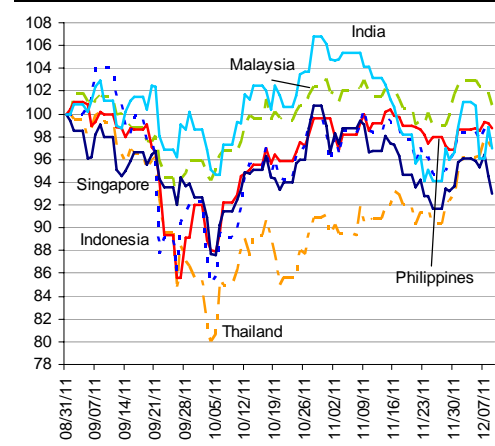
Charts

Chart 9
Stock Markets



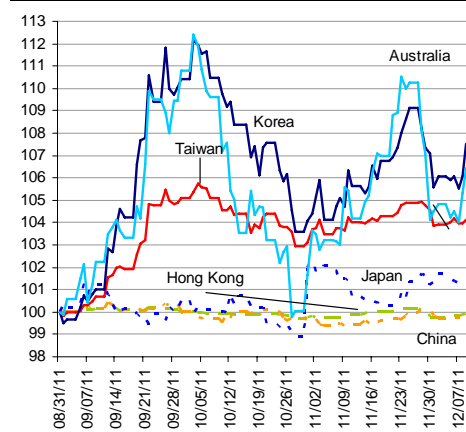
Source: BBVA Research and Bloomberg

Chart 10
Stock Markets



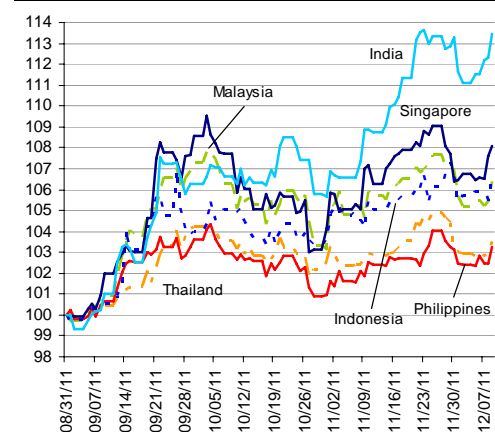
Source: BBVA Research and Bloomberg

Chart 11
Foreign Exchange Markets



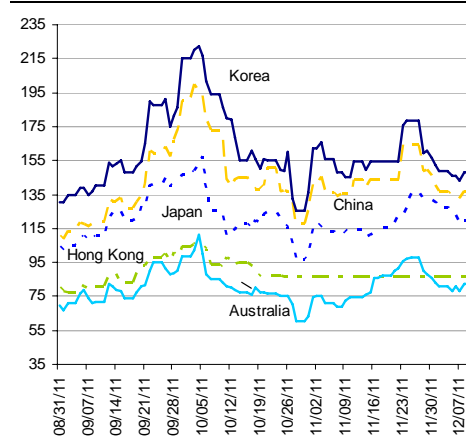
Source: BBVA Research and Bloomberg

Chart 12
Foreign Exchange Markets



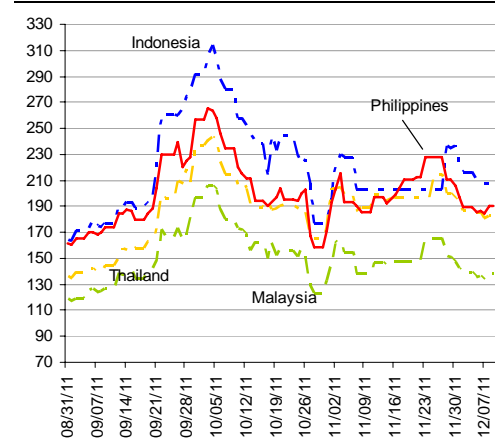
Source: BBVA Research and Bloomberg

Chart 13
Credit Default Swaps



Source: BBVA Research and Bloomberg

Chart 14
Credit Default Swaps



Source: BBVA Research and Bloomberg

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