

Weekly Watch

Asia

16 December 2011
Economic Analysis

Asia

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Upgrading Asia

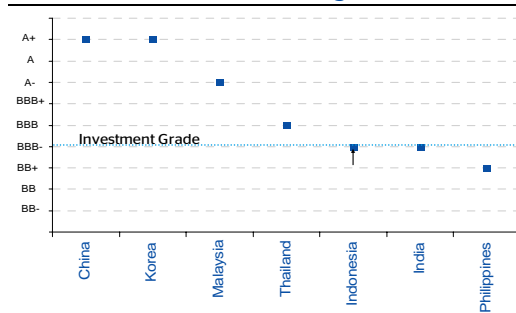
As pessimism grows over Europe's debt crisis and the long-term fiscal outlook in the US, Asia remains a bright spot for the global economy. The latest reminder comes this week from Indonesia, where Fitch upgraded its sovereign rating to investment grade (Chart 1). The move (to BBB-) follows a series of ratings upgrades for Indonesia in recent years, and had been long-awaited, ever since Indonesia lost its investment grade status during the 1997-98 Asian Financial Crisis. Fitch emphasized Indonesia's improved economic performance, strengthened external liquidity, low and declining public debt ratios, and a prudent macro policy framework. S&P and Moody's are widely expected to follow suit in the coming year. More generally, a number of Asian economies have received accolades from rating agencies over the past year, including China, Korea, Hong Kong and Singapore, with the latter two holding AAA ratings. However, while the ratings actions provide a boost to confidence, the region is hardly immune to spillovers from the global economy. This has been seen in weakening exports, falling stock markets, and depreciating currencies (see Markets). There are also notable weak spots, for example, India's twin deficits (see Markets and Highlights), Japan's high public debt burden, Vietnam's macro instability..

Policy easing expected

The backdrop of weaker external demand, slowing growth and declining inflation are setting the stage for policy easing in a number of economies. Importantly, China this week signaled a shift toward growth supportive policies at the conclusion of its annual Economic Work Conference (see Highlights). And India's central bank sent a less hawkish tone in its policy meeting today, following easing, but still high inflation for November (Chart 2) and indicators of slowing growth. On the data front, besides India, Singapore released better-than-expected November retail sales (8.5% y/y; consensus: 1.3%) and exports (1.6% y/y; consensus: -1.2%), and in China the HSBC flash PMI for December ticked up to 49.0% from 47.7%, still in the contraction zone.

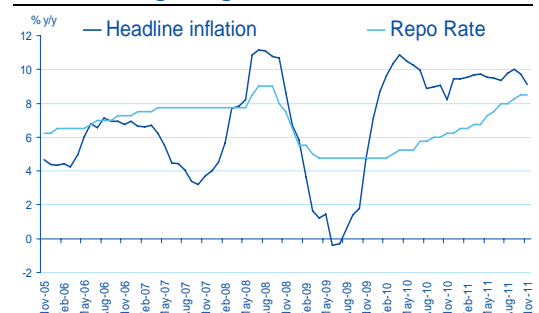
Next week's pre-Christmas data calendar will be relatively light. Taiwan's export orders will be watched as a leading indicator for the region's external demand (see Weekly Indicator). Japan will hold its next monthly policy meeting, in which it will deliberate actions on the yen and measures to reenergize the flagging recovery, although no significant policy announcement are expected.

Chart 1
Indonesia receives investment grade from Fitch



Source: Bloomberg and BBVA Research

Chart 2
Inflation is beginning to ease in India



Source: Bloomberg and BBVA Research

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Highlights

China signals a policy shift toward support for growth

A subtle shift in the policy stance is taking place following the annual Economic Work Conference

Signs of easing inflation in India

Inflation is still high, but is declining, which could allow for more policy support for slowing growth

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Markets

Indonesia's ratings upgrade underscores region's strong fundamentals

In contrast to developments in developed economies, Indonesia has just received a sovereign upgrade, to investment grade by Fitch. Though such an upgrade has been priced into asset values for some time, it should nevertheless result in a boost to the country's bond and equity markets. For the rest of Asia, market performance continues to be weak, primarily due to fears over Europe's debt crisis.

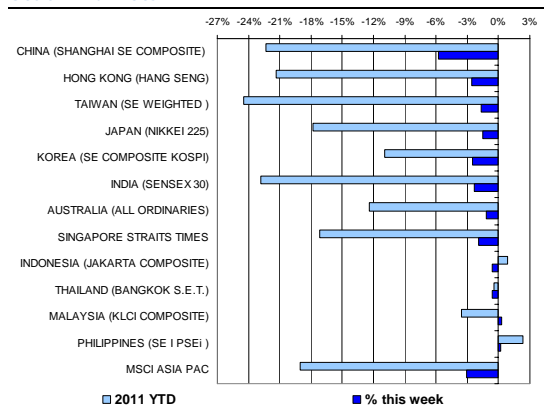
Run on the rupee accelerates, sparking measures to curb speculation

The Indian rupee led a downturn in Asian currencies this past week. The rupee fell to fresh lows, hitting a new record of 54.3 against the US dollar on Thursday. Rupee weakness has been exacerbated by domestic issues such as a soured investment climate, tight liquidity conditions, and concern over India's twin deficits on the current and fiscal accounts, estimated at -3.5% of GDP and -5.7% of GDP in 2011, respectively. The run on the rupee has prompted the RBI to implement measures to curb speculation, including curbs on forward trading and a lower limit on traders' overnight open positions. The rupee rose significantly during the day on Friday. With forex reserves at a still-comfortable USD 271 billion, and with 95% of the public debt being domestically funded, balance of payments risks are minimal at this stage.

CNY: the end of the appreciation trend?

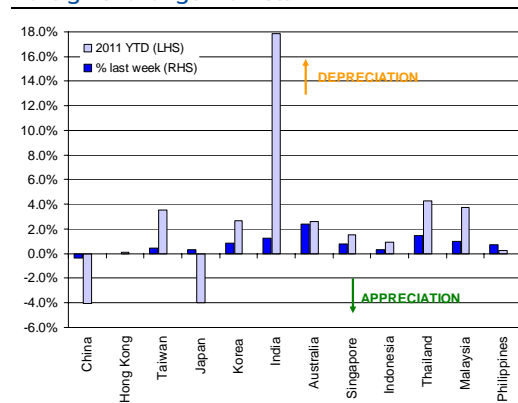
CNY appreciation has stalled after November's G20 Summit, with the fixing by the People's Bank of China (PBOC) staying flat near 6.3350 most of the time (as of this writing it is trading at 6.345). A worsening global outlook and fears of a hard-landing in China have led to a sharp reduction in appreciation expectations. The 12-month NDF is currently trading at 6.4150, implying a 0.8% depreciation from the spot rate which, in turn, has been trading toward the bottom of the daily fluctuation band (implying that without dollar sales by the PBOC, the rate would be even more depreciated). Even in a risk-off scenario, with some major economies in recession, we believe China policymakers would most likely respond by stopping appreciation rather than allowing depreciation. First, there is room for fiscal and monetary policy stimulus, rather than currency depreciation, to support growth. Second, any depreciation at this stage could be self-defeating by generating a political backlash and setting off another round of "currency wars" with trading partners. Finally, China has more than sufficient FX reserves to hold its exchange rate stable, and capital controls should help shield the economy from global financial disturbances.

Chart 3
Stock markets



Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets



Source: BBVA Research and Bloomberg

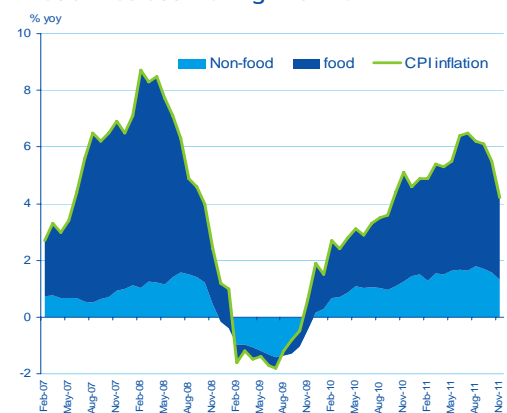
Highlights

China signals a policy shift toward support for growth

China's annual Central Economic Work Conference (CEWC) wrapped up this week, with a nuanced message of policy support for growth in 2012, away from the current focus on taming inflation. The shift had been expected due to external headwinds and recent signs of slowing growth and declining inflation (Chart 5). The CEWC typically sets the direction of macro policies for the coming year. Highlights were announced on Wednesday in an official policy memo, emphasizing a "pro-active fiscal policy" and "prudent monetary policy" for 2012. Fiscal policy measures are likely to include tax cuts, subsidies to consumption, stepped up social expenditures, and spending on transportation infrastructure. On the monetary side, "fine-tuning" policies to maintain "reasonable growth of money and credit" are likely to entail further cuts in the required reserve ratio (beyond the 50bp cut already announced at the end of November) and, possibly, interest rate cuts depending on the evolution of inflation and external demand conditions.

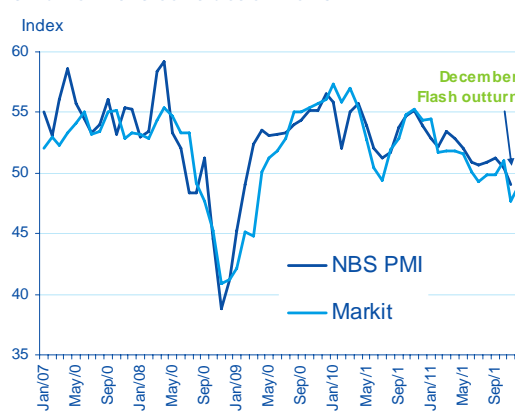
Meanwhile, data released this week confirms a shift toward easing credit policies. In particular, new loans for November exceeded market expectations, at RMB562.2 billion (consensus: RMB 550 billion), equivalent to overall credit growth of 15.6% y/y. The data were released as the latest HSBC flash PMI estimate for December shows a further modest contraction of economic activity in line with a soft landing (the flash estimate came out at 49.0%, up from the previous month's reading of 47.7% due to slight rebounds in the production and new orders subcomponents).

Chart 5
Inflation has been falling in China



Source: BBVA Research and Bloomberg

Chart 6
The HSBC flash PMI estimate recovers, but remains in the contraction zone



Source: BBVA Research and Bloomberg

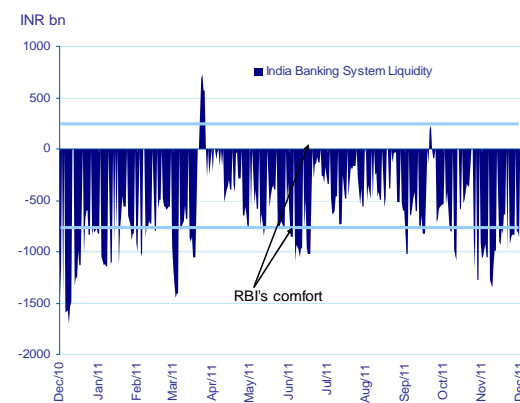
Signs of easing inflation in India may lead to growth supportive policies

Though inflation still remains high, there were signs this past week of a decline for the month of November, enabling growth concerns to take centre stage. WPI inflation eased to 9.1% y/y in November from 9.7% the previous month due to a decline in food prices. Meanwhile, disappointing activity outturns continue to mount, as seen in a relatively weak Q3 GDP growth (6.9% y/y), slowing PMI and infrastructure indices, a sharp contraction in October industrial production (-5.1% y/y), and softening credit growth. Investor sentiment has also been undermined by persistent “twin” deficits on the fiscal and current accounts. Additionally, slow progress on economic reforms has undermined sentiment, characterized by the recent reversal of the government’s decision to open the domestic retail market to foreign investors. Fragile business sentiment is echoed by a rapidly weakening rupee, which hit fresh record lows this week and is down nearly 20% since July 2011. The rupee’s slide prompted the central bank late on Thursday to implement curbs on forward trading and reduce the limit on traders’ overnight open positions in order to reduce the scope for speculation.

A shift in policy stance towards reviving growth was evident in RBI’s policy statement released today. The RBI left interest rates unchanged, as expected, but delivered a less hawkish tone than in the past by emphasizing downside risks to growth and a likely reversal of the tightening cycle if inflation pressures continue to ease. However, The RBI noted that inflation risks remain high as a result of both supply and demand forces. We believe that scope for policy easing could develop during the first half of 2012, as we expect inflation to trend gradually lower amid a further moderation in food prices and softening domestic demand. We expect the RBI to cut the CRR by 50 bps in its January 24th 2012 policy meeting and, depending on a continued easing of inflation, commence a rate easing cycle in the second quarter of 2012 with a 25 bps cut in the repo rate.

Chart 7

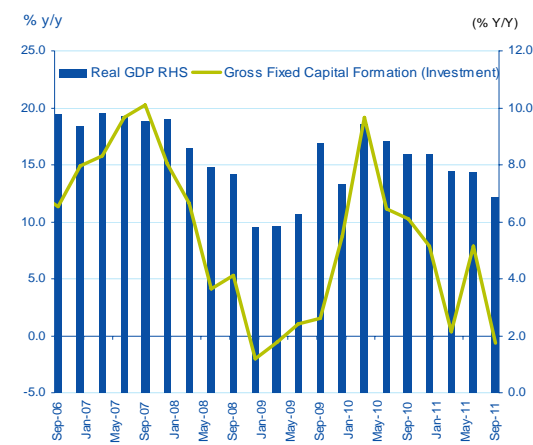
India’s banking system liquidity is below the RBI’s comfort zone



Source: BBVA Research and Bloomberg

Chart 8

India's GDP and investment are slowing



Source: BBVA Research and Bloomberg

Calendar Indicators

China	Date	Period	Prior	Cons.
Property Prices	18-Dec	NOV	--	--
Hong Kong	Date	Period	Prior	Cons.
Unemployment Rate SA	19-Dec	NOV	3.3%	--
CPI Inflation - Composite Index (YoY)	20-Dec	NOV	5.8%	--
Japan	Date	Period	Prior	Cons.
Convenience Store Sales (YoY)	20-Dec	NOV	14.1%	--
Merchnds Trade Exports (YoY)	21-Dec	NOV	-3.7%	-3.6%
Merchnds Trade Imports (YoY)	21-Dec	NOV	17.9%	8.3%
Malaysia	Date	Period	Prior	Cons.
CPI Inflation (YoY)	21-Dec	NOV	3.4%	3.3%
Singapore	Date	Period	Prior	Cons.
CPI Inflation (MOM) - NSA	23-Dec	NOV	0.4%	0.2%
CPI Inflation (YoY)	23-Dec	NOV	5.4%	5.3%
Industrial Production (MOM) SA	23-Dec	NOV	14.2%	-8.7%
Industrial Production (YoY)	23-Dec	NOV	24.4%	12.5%
Taiwan	Date	Period	Prior	Cons.
Export Orders (YoY)	20-Dec	NOV	4.4%	2.0%
Unemployment Rate SA	22-Dec	NOV	4.3%	4.3%
Commercial Sales (YoY)	23-Dec	NOV	1.8%	2.8%
Industrial Production (YoY)	23-Dec	NOV	1.4%	-3.0%
Thailand	Date	Period	Prior	Cons.
Customs Exports (YoY)	20-23 DEC	NOV	0.3%	--
Customs Imports (YoY)	20-23 DEC	NOV	21.5%	--
Customs Trade Balance	20-23 DEC	NOV	-\$1009M	--
Vietnam	Date	Period	Prior	Cons.
Exports YTD (YoY)	22-29 DEC	DEC	34.7%	--
Imports YTD (YoY)	22-29 DEC	DEC	26.4%	--
Retail Sales YTD (YoY)	22-29 DEC	DEC	23.5%	--
Industrial Production Index (YoY)	22-29 DEC	DEC	8.1%	--

Indicator of the Week: Taiwan Export Orders for November (December 20)

Forecast: 1.8% y/y

Consensus: 2.3% y/y

Prior: 4.4% y/y

As a leading indicator of export demand in the coming 1-3 months, Taiwan's export orders will be watched for further signs of a slowdown in Asia. Export orders rebounded in October after hitting a two-year low the previous month, although they are still off the double-digit levels of 2011H1. We expect November export orders to moderate further, reflecting the deterioration in external demand especially from European markets (actual export growth in November was weaker than expected, at 1.3% y/y). More generally, despite weakening demand from Europe, overall export performance across Asia has held up surprisingly well on continued demand from China and other emerging markets. However, risks to the outlook are to the downside.

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Calendar Events

Japan - BoJ Monetary Policy Meeting, December 21

We expect no change in the target rate

Current Consensus

0.10% 0.10%

Japan - Cabinet Office Monthly Economic Report, December 19

Japan - Bank of Japan Monthly Economic Report, December 22

Australia - Reserve Bank's Board December Minutes, December 20

Markets Data

STOCK MARKETS	INDEX	Last price	% change over a week	Year to date	% Change over 1 Y
	China - Shanghai Comp.	2181.9	-5.8	-22.3	-24.7
	Hong Kong - Hang Seng	18112.3	-2.6	-21.4	-20.1
	Taiwan - Weighted	6777.9	-1.7	-24.5	-22.8
	Japan - Nikkei 225	8409.1	-1.5	-17.8	-18.4
	Korea - Kospi	1827.3	-2.5	-10.9	-9.1
	India - Sensex 30	15836.5	-2.3	-22.8	-20.3
	Australia - SPX/ASX 200	4154.5	-1.2	-12.4	-13.2
	Singapore - Strait Times	2642.9	-1.9	-17.2	-16.0
	Indonesia - Jakarta Comp	3736.9	-0.6	0.9	4.6
	Thailand - SET	1028.1	-0.6	-0.5	-0.1
	Malaysia - KLCI	1464.5	0.3	-3.6	-2.2
	Philippines - Manila Comp.	4300.3	0.2	2.4	6.5

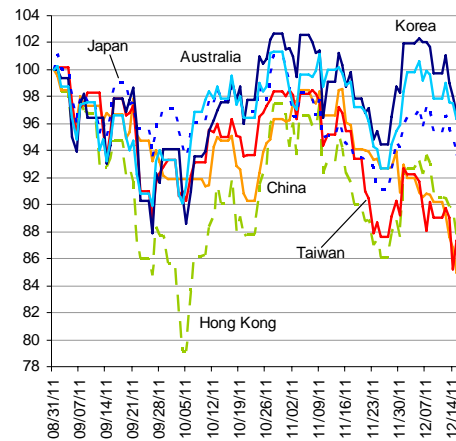
Last update: Friday, 11.45 Hong Kong time.

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.34	0.38	6.39	6.43
	Hong Kong (HKD/USD)	7.78	0.02	7.78	7.77
	Taiwan (TWD/USD)	30.3	-0.42	30.31	30.02
	Japan (JPY/USD)	77.9	-0.30	77.70	77.10
	Korea (KRW/USD)	1156	-0.82	1163	1169
	India (INR/USD)	52.7	-1.26	53.87	55.57
	Australia (USD/AUD)	1.00	-2.37	1.01	n.a.
	Singapore (SGD/USD)	1.30	-0.81	1.30	1.30
	Indonesia (IDR/USD)	9070	-0.22	9219	9618
	Thailand (THB/USD)	31.4	-1.47	31.60	31.97
	Malaysia (MYR/USD)	3.18	-0.98	3.20	3.22
	Philippines (PHP/USD)	43.9	-0.72	44.03	44.18

Last update: Friday, 11.45 Hong Kong time.

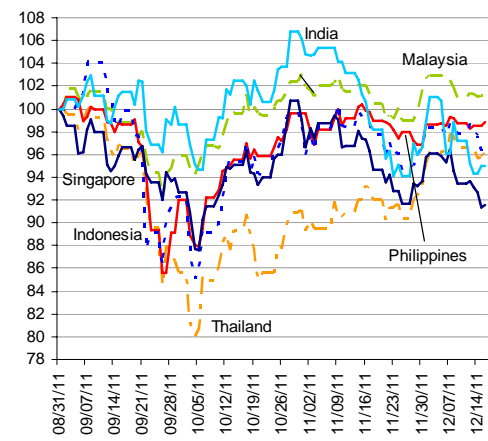
Charts

Chart 9
Stock Markets



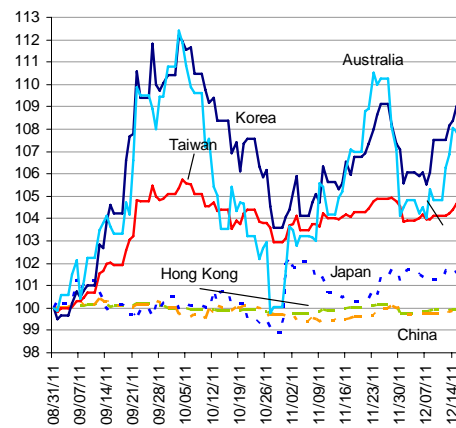
Source: BBVA Research and Bloomberg

Chart 10
Stock Markets



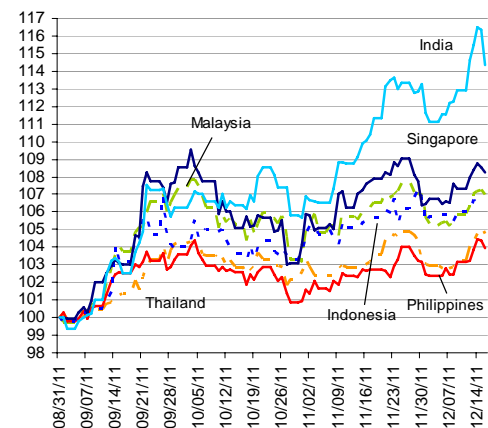
Source: BBVA Research and Bloomberg

Chart 11
Foreign Exchange Markets



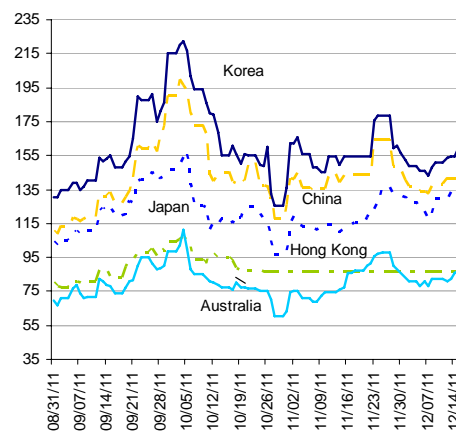
Source: BBVA Research and Bloomberg

Chart 12
Foreign Exchange Markets



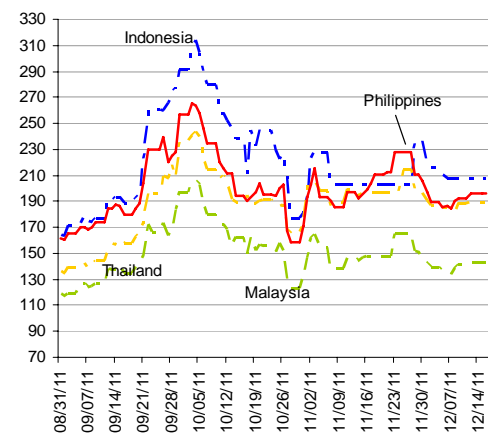
Source: BBVA Research and Bloomberg

Chart 13
Credit Default Swaps



Source: BBVA Research and Bloomberg

Chart 14
Credit Default Swaps



Source: BBVA Research and Bloomberg

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