BBVA RESEARCH

Weekly Watch

Asia

13 January 2012
Economic Analysis

Asia
Stephen Schwartz
stephen.schwartz@bbva.com.hk

Mario Nevares
mario.nevares@bbva.com.hk

William Fitchett
william.fitchett@bbva.com.hk

Fielding Chen
fielding.chen@bbva.com.hk

Le Xia
xia.le@bbva.com.hk

Zhigang Li
zhigang.li@bbva.com.hk

Sumedh Deorukhkar
sumedh.deorukhkar@grupobbva.com

Jeffrey Cantwell
jeffrey.cantwell@bbva.com.hk

George Xu
george.xu@bbva.com.hk

Markets

FX Strategy
Richard Li
richard.li@bbva.com.hk

Economic analysis
Jeffrey Cantwell
jeffrey.cantwell@bbva.com.hk

Though slowing, Asia retains its appeal

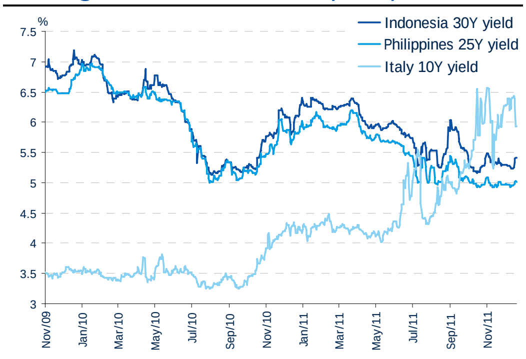
Even as growth and exports from the region slow due to ongoing weakness in the Eurozone, emerging markets are still luring foreign investors. This is evident in recent successful global bond issues in the Philippines (January 5) and Indonesia (January 9). Both attracted strong investor interest for their 25- and 30-year USD bonds, respectively, at record low yields (Chart 1), thanks to strong fundamentals and recent rating agency upgrades. Meanwhile, in North Asia, political developments continue to weigh on sentiment. North Korea dominated headlines in recent weeks. And for now, Taiwan's Presidential elections scheduled for tomorrow (January 14) are stealing the spotlight for their implications on cross-strait ties. A victory by the opposition DPP could dampen market sentiment if it were to result in a cooling in relations with the Mainland.

Easing inflation in China paves the way for more policy easing

The most closely watched data release this week came in line with expectations, as China's inflation eased to 4.1%; y/y (BBVA: 4.1%; consensus: 4.0%) increasing the likelihood of further monetary easing in the months ahead to support growth (Chart 2 and Highlights). Credit growth for December expanded by more than expected (new loans of RMB 640.5 billion vs. consensus 575.0B), a sign that the reserve ratio cut in late November may already be having its intended effect). Meanwhile, data released today on foreign exchange reserves show a slight decline in the fourth quarter, to USD 3.18 trillion from USD 3.20 in Q3, indicating some modest capital outflows during the quarter (although valuation effects from the strong USD are part of the explanation). In India, industrial production surprised to the upside (see Highlights). And finally, both Indonesia and Korea kept interest rates unchanged, as expected, although cuts are anticipated later in the year.

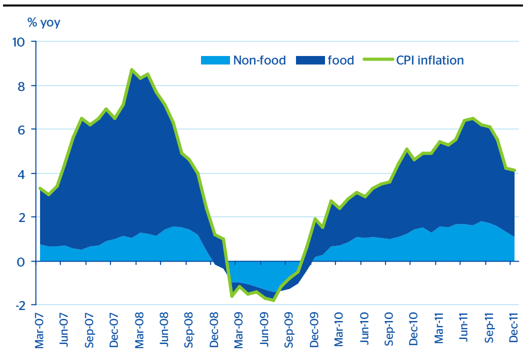
The coming week will feature more important data from China, just ahead of the extended New Year holiday. In particular, markets will watch for 4Q GDP and December industrial output, retail sales to gauge the pace of the slowdown. Hong Kong and India will release December inflation figures, and export orders in Taiwan will provide a picture of evolving external demand. We expect a 25bp cut in Philippine interest rates at the policy meeting on January 19.

Chart 1
A divergence in Asian and European yields



Source: Bloomberg and BBVA Research

Chart 2
China's inflation continues to moderate



Source: Bloomberg and BBVA Research

Highlights

China's inflation eases as markets await December activity

A further decline in inflation is paving the way for more policy easing to support growth

Restoring India's growth momentum

Sluggish economic reforms and poor infrastructure are constraining India's growth

FX Strategy

Richard Li
richard.li@bbva.com.hk

Economic Analysis

Jeffrey Cantwell
jeffrey.cantwell@bbva.com.hk

Markets

Debt fears ease for the time being, but risks remain

Strong demand for Spanish bonds, upbeat US data and hopes for more policy easing in China have helped divert investor attention from fiscal stresses in Europe. Risk-assets across Asia-Pacific climbed higher this week, with major stock benchmark indices rising close by around 2.0% on average. Shanghai A-shares rose more than 5.0%. Asian currencies also edged higher on improving sentiment, corrections from an extreme net-long USD positioning and some upbeat local news. While the European situation seems to have calmed for now, uncertainties remain, including mounting funding pressures in Italy, potential downgrades of France by S&P and Moody's, Greek second bailout and debt haircut negotiation and recession risks in the currency bloc. Hence, Asian stocks and FX remain vulnerable to renewed bouts of risk aversion.

INR and KRW outperform Asian peers

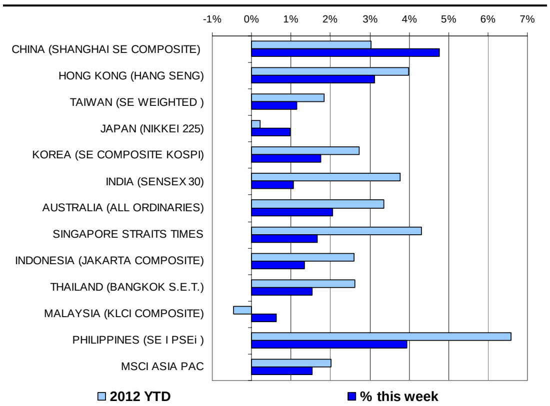
Against a favorable backdrop for emerging market currencies, a batch of upbeat macro data (see Highlights) and plans to ease restrictions on foreign investment in India resulted in a significant corrective rebound. The Indian rupee finished the first four day of the week at 51.58, up 2.2% from the previous week. The Korean won also gained over 1.5% this week given its high sensitivity to global risk sentiment. The decision by the BoK to leave its benchmark rate unchanged also helped to preserve the rate spreads and added KRW's strength.

RQFII and seasonal factors keep CNH strongly bid

The PBoC fixed USDCNY higher this week, implying modest depreciation of the currency against the USD. The move is in line with our expectations of a temporary reversal in the fixings given a stronger USD and the rapid CNY appreciation at the end of 2011. Despite weaker fixings, the yuan was strongly bid in onshore and offshore markets, with both CNY and CNH now trading stronger than the fixing.

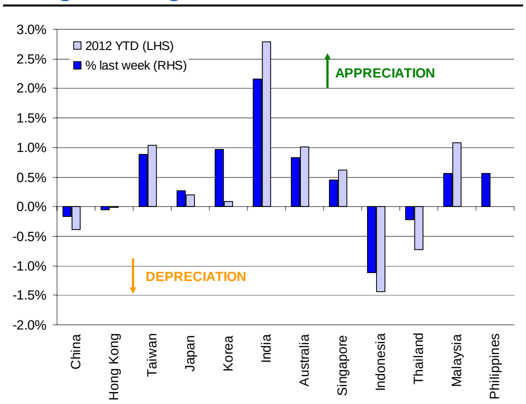
Part of the strength of the CNY was seasonal, due to strong demand ahead of the Chinese New Year. The announcement of the RQFII quota added buoyancy; 21 Hong Kong subsidiaries of Chinese financial institutions were given an initial quota of CNY20 billion to invest in securities markets in the mainland, with at least 80% going to the interbank bond markets. Given attractive yields onshore as compared to Dim Sum bonds sold in Hong Kong or US Treasuries and stable credit ratings on Chinese sovereign bonds, it is anticipated the maximum quota of CNY20 billion will be used up before long and will be repatriated from the CNH markets back to the onshore markets. The anticipated reduction in liquidity along with seasonal demand have drove CNH interest rates higher and kept CNH bid at a premium over CNY fixing as well as CNY spot onshore.

Chart 3
Stock markets



Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets



Source: BBVA Research and Bloomberg

Economic Analysis

Highlights

China's inflation eases as markets await December activity

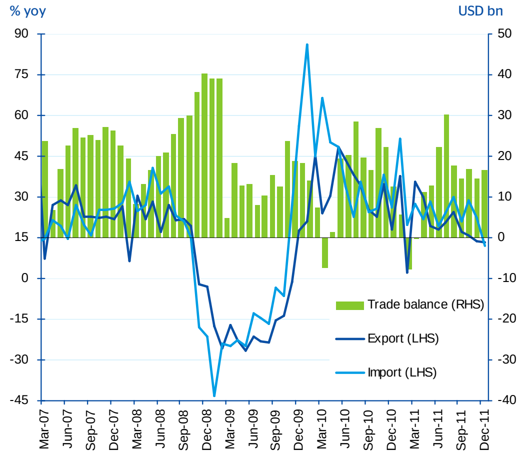
A continued decline in inflation is providing welcome room for further policy easing in China as the authorities seek to sustain growth in the face of external headwinds. In line with expectations, December inflation released this week moderated to 4.1% y/y in December (BBVA: 4.1%; consensus: 4.0%) from 4.2% y/y in the previous month. The decline occurred despite an uptick in food prices (9.1% y/y), which is partly attributed to seasonal demand pressures from the forthcoming Chinese New Year holiday. On current trends, we expect inflation to moderate further, to around 3% by mid-year, although in the near term we anticipate a seasonal upturn in January due to the forthcoming holiday.

Also released this week were December trade figures, which were noteworthy for a weaker-than-expected outturn for imports. Export growth remained buoyant at 13.4% y/y in December, slightly down from 13.8% in the previous month. But import growth decelerated to 11.8% y/y from 22.1% in November (consensus: 18.0%), a possible sign of weakening domestic demand. Policies, meanwhile, continue to shift to a more growth supportive stance, as evidenced by an acceleration of monetary aggregates in December. New loans increased by more than expected, to RMB 640.5 billion (consensus: 560.0 billion), up from RMB 562.2 billion in November. We expect additional 150-200bp cuts in the RRR in H1 2012, with the next cut likely in the coming month or two. If the external environment deteriorates further, we would also expect up to 50bp cuts in interest rates in the second or third quarter of the year. Finally, foreign exchange reserves fell slightly in the fourth quarter to USD 3.18 trillion (partly due to valuation effects), signaling some capital outflows and reinforcing expectations that currency appreciation may slow in 2012.

In the coming week (December 17), important data on the real activities will be released, including Q4 GDP (see Weekly Indicator), and December industrial production, investment, and retail sales. Despite the weaker imports in December, we still believe that activity indicators for December should remain robust – recall, in particular, that the December PMI rebounded back above the 50 expansion threshold, to 50.3% from 40.0% in November.

Chart 5

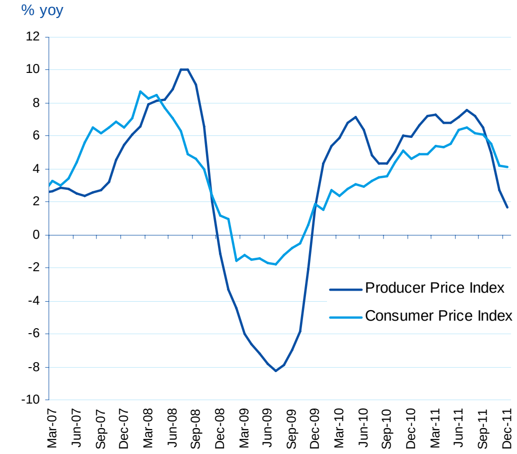
December trade surplus widens on low imports



Source: BBVA Research and Bloomberg

Chart 6

Falling PPI inflation bodes well



Source: BBVA Research and Bloomberg

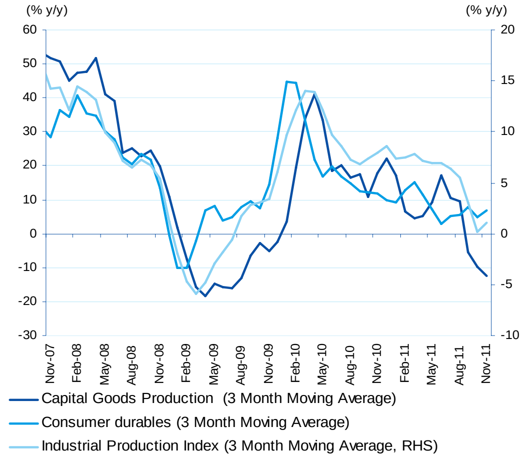
Restoring India's growth momentum

While maintaining a medium-term growth forecast of 9%-10%, India's Prime Minister, Manmohan Singh, acknowledged in a speech this past week that a difficult road lies ahead for the Indian economy in the coming year. He noted that the outlook is still manageable, but lowered the government's growth forecast for the fiscal year ending March 2012 to 7.0% y/y (from 7.5% previously, and in line with BBVA's estimate of 6.9%). Besides external headwinds, the revision was driven by slowing growth from high domestic interest rates and weak investment demand. The downward revision comes even as recent activity indicators have surprised to the upside: industrial production (IIP) growth for November 2011 rebounded by 5.9% y/y, beating consensus estimates (2.1%), and reversing a -4.7% decline in the previous month, while the December PMIs rose to a 5 month high. The key factors undermining India's medium term growth outlook are mainly domestic. The economy is grappling with a number of issues including policy inaction, governance concerns, high interest rates, elevated inflation, currency depreciation and persistent "twin" deficits on the fiscal and current accounts.

Among the various issues, we believe that the government's inability to implement major investment reforms and big ticket projects is the weak link in India's growth story. Demand for infrastructure services in India far exceeds the supply. The deficit in the power sector is staggering, with about 30% of the population without electricity as compared to only 0.6% in China and Malaysia according to UNDP estimates. Power shortages along with inadequate transport infrastructure (India's national highways comprise only 2% of total road network) have undermined manufacturing by increasing costs, narrowing producer margins and leaving Indian firms less competitive in the global market, especially compared to their peers in East Asian economies. In a recent discussion paper, the Indian commerce ministry reckons that to sustain 9% annual GDP growth over the next five years (in line with government targets), India would need private sources to fund Rs 41.23 tn (about USD 810 bn) of investments in infrastructure and industry from private sources. However, such financing would be hard to come by amid a downbeat growth outlook and global uncertainties.

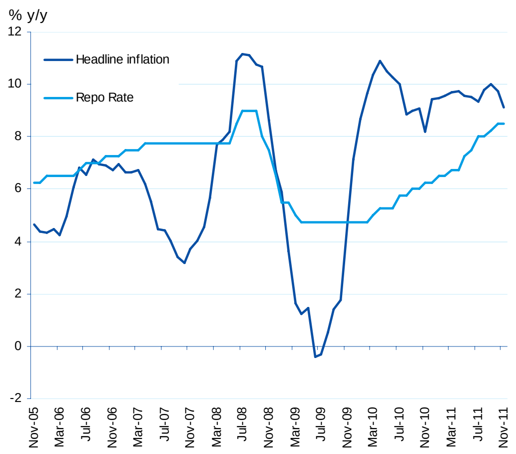
Meeting the enormous demand/supply mismatch in India's infrastructure investment warrants actions by the authorities to mobilize capital from the primary market, foreign direct investments and external commercial borrowings. In this regard, the last few months have seen a series of measures to attract capital, but much more needs to be done. Among others, India must develop deep and liquid bond, currency and derivatives markets. Long tenure finance is crucial for the infrastructure sector. Efforts need to be taken towards channelizing a higher quantum of household savings of Indians into infrastructure investments. Mobilizing these sources of savings to meet India's infrastructure needs would go a long way toward unlocking India's growth potential over the medium term.

Chart 7
Production of consumer durables and capital goods is slowing sharply



Source: BBVA Research and Bloomberg

Chart 8
Inflation has begun to ease, giving way for possible interest rate cuts later in the year



Source: BBVA Research and Bloomberg

Calendar Indicators

Australia	Date	Period	Prior	Cons.
Unemployment Rate	19-Jan	DEC	5.30%	- -
Import price index (QoQ)	20-Jan	4Q	0.00%	- -
Export price index (QoQ)	20-Jan	4Q	4.00%	- -
China	**Date**	**Period**	**Prior**	**Cons.**
Actual FDI (YoY)	14-18 JAN	DEC	-9.80%	- -
Industrial Production YTD YoY	17-Jan	DEC	14.00%	13.80%
Industrial Production (YoY)	17-Jan	DEC	12.40%	12.30%
Fixed Assets Inv Excl. Rural YTD YoY	17-Jan	DEC	24.50%	24.10%
Real GDP YTD (YoY)	17-Jan	4Q	9.40%	9.20%
Real GDP (QoQ)	17-Jan	4Q	2.30%	- -
Real GDP (YoY)	17-Jan	4Q	9.10%	8.70%
Retail Sales YTD YoY	17-Jan	DEC	17.00%	17.00%
Retail Sales (YoY)	17-Jan	DEC	17.30%	17.30%
Hong Kong	**Date**	**Period**	**Prior**	**Cons.**
Unemployment Rate SA	19-Jan	DEC	3.40%	- -
CPI - Composite Index (YoY)	20-Jan	DEC	5.70%	- -
India	**Date**	**Period**	**Prior**	**Cons.**
Monthly Wholesale Prices YoY%	16-Jan	DEC	9.11%	7.40%
Japan	**Date**	**Period**	**Prior**	**Cons.**
Machine Orders YOY%	16-Jan	NOV	1.50%	- -
Tertiary Industry Index (MoM)	17-Jan	NOV	0.60%	- -
All Industry Activity Index (MoM)	20-Jan	NOV	0.80%	- -
Philippines	**Date**	**Period**	**Prior**	**Cons.**
Overseas Remittances (YoY)	16-Jan	NOV	6.20%	- -
Singapore	**Date**	**Period**	**Prior**	**Cons.**
Electronic Exports (YoY)	17-Jan	DEC	0.10%	0.40%
Non-oil Domestic Exports (YoY)	17-Jan	DEC	1.60%	1.20%
Non-oil Domestic Exp SA (MoM)	17-Jan	DEC	5.90%	- -
Taiwan	**Date**	**Period**	**Prior**	**Cons.**
Commercial Sales (YoY)	20-Jan	DEC	-0.95%	- -
Export Orders (YoY)	20-Jan	DEC	2.54%	- -
Industrial Production (YoY)	20-Jan	DEC	-3.55%	- -
Thailand	**Date**	**Period**	**Prior**	**Cons.**
Customs Exports (YoY)	16-18 JAN	DEC	-12.40%	- -

Indicator of the Week: China GDP for Q4 (December 17)

Forecast: 8.2% y/y	Consensus: 8.7% y/y	Prior: 9.1% y/y

China's Q4 GDP outturn will be watched for further signs of a growth slowdown. GDP growth slowed in Q3 to 9.1% y/y from 9.5% in Q2. Based on high frequency indicators such as manufacturing PMI, the pace of the slowdown appears to have accelerated in recent months due to weakening external demand. We expect GDP growth to have slowed further in Q4, which would bring full-year growth for 2011 to 9.0%. With inflation continuing to fall, the authorities have recently shifted their policy stance toward supporting growth. A recent easing in the monetary stance and supportive fiscal policy should help sustain domestic demand; we expect growth to bottom out in the first half of 2012. In addition to GDP, a number of important monthly indicators will also be released next week, including industrial production, investment, and retail sales.

Calendar Events

Japan – Cabinet Office Monthly Economic Report, January 17

Philippines – Monetary Policy Meeting, January 19	**Current**	**Consensus**
We expect a 25 bp cut in the overnight borrowing rate	4.50%	4.25%

Home →
Markets →
Calendar →
Markets Data →
Charts →

Markets Data

STOCK MARKETS

INDEX	Last price	% change over a week	Year to date	% Change over 1 Y
China – Shanghai Comp.	2256.9	4.3	2.6	-20.2
Hong Kong – Hang Seng	19107.6	2.8	3.7	-21.2
Taiwan – Weighted	7207.1	1.2	1.9	-19.7
Japan – Nikkei 225	8473.8	1.0	0.2	-20.0
Korea – Kospi	1876.7	1.8	2.8	-10.2
India – Sensex 30	16037.5	1.1	3.8	-16.4
Australia – SPX/ASX 200	4191.2	2.0	3.3	-12.6
Singapore – Strait Times	2758.9	1.6	4.3	-15.3
Indonesia – Jakarta Comp	3921.7	1.4	2.6	10.0
Thailand – SET	1052.2	1.5	2.6	1.7
Malaysia – KLCI	1523.1	0.6	-0.5	-3.1
Philippines – Manila Comp.	4654.0	3.8	6.5	14.3

Last update: Friday, 11.45 Hong Kong time.

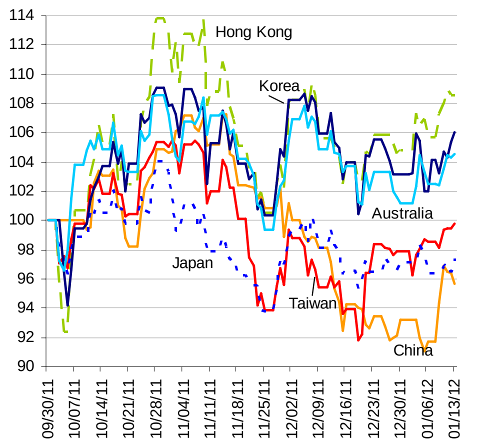
FOREIGN EXCHANGE MARKETS

CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
China (CNY/USD)	6.32	-0.16	6.31	6.32
Hong Kong (HKD/USD)	7.77	-0.05	7.77	7.76
Taiwan (TWD/USD)	30.0	0.89	29.77	29.44
Japan (JPY/USD)	76.8	0.27	76.68	76.30
Korea (KRW/USD)	1151	0.99	1158	1165
India (INR/USD)	51.6	2.72	52.83	54.56
Australia (USD/AUD)	1.03	0.84	0.98	n.a.
Singapore (SGD/USD)	1.29	0.45	1.29	1.28
Indonesia (IDR/USD)	9200	-1.11	9290	9670
Thailand (THB/USD)	31.8	-0.22	31.98	32.33
Malaysia (MYR/USD)	3.13	0.58	3.15	3.18
Philippines (PHP/USD)	43.8	0.57	44.03	44.21

Last update: Friday, 11.45 Hong Kong time.

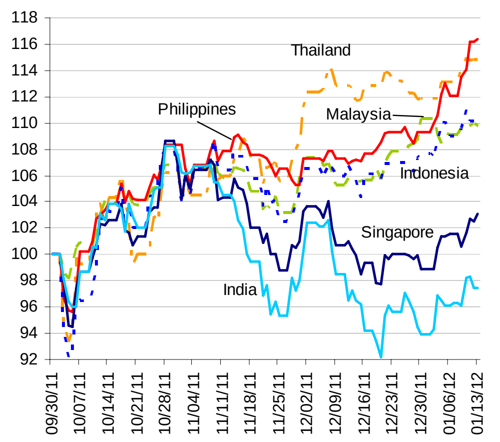
Charts

Chart 9
Stock Markets



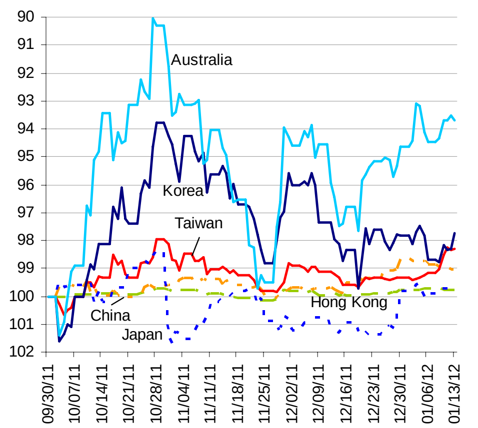
Source: BBVA Research and Bloomberg

Chart 10
Stock Markets



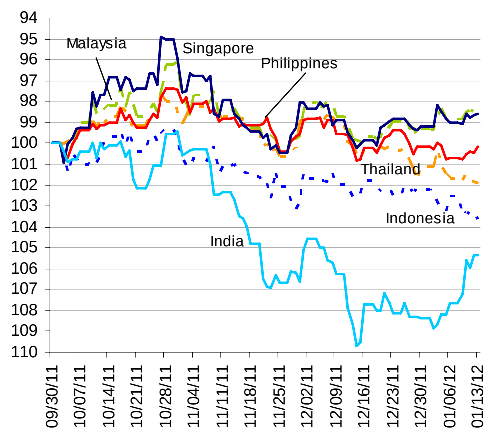
Source: BBVA Research and Bloomberg

Chart 11
Foreign Exchange Markets



Source: BBVA Research and Bloomberg

Chart 12
Foreign Exchange Markets



Source: BBVA Research and Bloomberg

DISCLAIMER

This document and the information, opinions, estimates and recommendations expressed herein, have been prepared by Banco Bilbao Vizcaya Argentaria, S.A. (hereinafter called "BBVA") to provide its customers with general information regarding the date of issue of the report and are subject to changes without prior notice. BBVA is not liable for giving notice of such changes or for updating the contents hereof.

This document and its contents do not constitute an offer, invitation or solicitation to purchase or subscribe to any securities or other instruments, or to undertake or divest investments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

Investors who have access to this document should be aware that the securities, instruments or investments to which it refers may not be appropriate for them due to their specific investment goals, financial positions or risk profiles, as these have not been taken into account to prepare this report. Therefore, investors should make their own investment decisions considering the said circumstances and obtaining such specialized advice as may be necessary. The contents of this document are based upon information available to the public that has been obtained from sources considered to be reliable. However, such information has not been independently verified by BBVA and therefore no warranty, either express or implicit, is given regarding its accuracy, integrity or correctness. BBVA accepts no liability of any type for any direct or indirect losses arising from the use of the document or its contents. Investors should note that the past performance of securities or instruments or the historical results of investments do not guarantee future performance.

The market prices of securities or instruments or the results of investments could fluctuate against the interests of investors. Investors should be aware that they could even face a loss of their investment. Transactions in futures, options and securities or high-yield securities can involve high risks and are not appropriate for every investor. Indeed, in the case of some investments, the potential losses may exceed the amount of initial investment and, in such circumstances, investors may be required to pay more money to support those losses. Thus, before undertaking any transaction with these instruments, investors should be aware of their operation, as well as the rights, liabilities and risks implied by the same and the underlying stocks. Investors should also be aware that secondary markets for the said instruments may be limited or even not exist.

BBVA or any of its affiliates, as well as their respective executives and employees, may have a position in any of the securities or instruments referred to, directly or indirectly, in this document, or in any other related thereto; they may trade for their own account or for third-party account in those securities, provide consulting or other services to the issuer of the aforementioned securities or instruments or to companies related thereto or to their shareholders, executives or employees, or may have interests or perform transactions in those securities or instruments or related investments before or after the publication of this report, to the extent permitted by the applicable law.

BBVA or any of its affiliates´ salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to its clients that reflect opinions that are contrary to the opinions expressed herein. Furthermore, BBVA or any of its affiliates' proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. No part of this document may be (i) copied, photocopied or duplicated by any other form or means (ii) redistributed or (iii) quoted, without the prior written consent of BBVA. No part of this report may be copied, conveyed, distributed or furnished to any person or entity in any country (or persons or entities in the same) in which its distribution is prohibited by law. Failure to comply with these restrictions may breach the laws of the relevant jurisdiction.

In the United Kingdom, this document is directed only at persons who (i) have professional experience in matters relating to investments falling within article 19(5) of the financial services and markets act 2000 (financial promotion) order 2005 (as amended, the "financial promotion order"), (ii) are persons falling within article 49(2) (a) to (d) ("high net worth companies, unincorporated associations, etc.") Of the financial promotion order, or (iii) are persons to whom an invitation or inducement to engage in investment activity (within the meaning of section 21 of the financial services and markets act 2000) may otherwise lawfully be communicated (all such persons together being referred to as "relevant persons"). This document is directed only at relevant persons and must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this document relates is available only to relevant persons and will be engaged in only with relevant persons. The remuneration system concerning the analyst/s author/s of this report is based on multiple criteria, including the revenues obtained by BBVA and, indirectly, the results of BBVA Group in the fiscal year, which, in turn, include the results generated by the investment banking business; nevertheless, they do not receive any remuneration based on revenues from any specific transaction in investment banking.

BBVA is not a member of the FINRA and is not subject to the rules of disclosure affecting such members.

"BBVA is subject to the BBVA Group Code of Conduct for Security Market Operations which, among other regulations, includes rules to prevent and avoid conflicts of interests with the ratings given, including information barriers. The BBVA Group Code of Conduct for Security Market Operations is available for reference at the following web site: www.bbva.com / Corporate Governance".

BBVA is a bank supervised by the Bank of Spain and by Spain's Stock Exchange Commission (CNMV), registered with the Bank of Spain with number 0182.