

Asia

Weekly Watch

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Economic Analysis

Asia

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US Congress takes action to accelerate Chinese yuan appreciation

The US House of Representatives passed a bill taking aim at “artificially” undervalued currencies by threatening import tariffs. It is widely viewed as targeted at the Chinese yuan (see Highlights). Most observers, however, place low chances on probability of full passage, as it needs to be approved by the Senate, which is unlikely to take up discussion before the mid-term November elections. And even then, it would need Presidential approval. Nevertheless, the bill ratchets up the political debate on the yuan, and is a worrying step toward protectionism. Perhaps in response of political pressures, pace of yuan appreciation has picked up in recent weeks, adding to the momentum of currency appreciation across the region.

China’s strong PMI outturn boosts sentiment

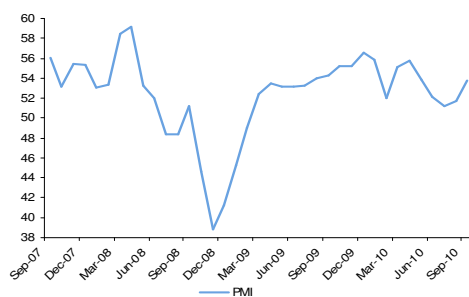
A host of indicators was released last week, showing that even though growth momentum across Asia is gradually slowing, activity remains surprisingly brisk. Most notably, China’s September PMI at 53.8 came in well above market expectations (BBVA: 53.5, consensus 52.5), indicating that after a brief lull, the economy is again picking up momentum as it enters the fourth quarter, alleviating any lingering concerns of a sharp slowdown and reinforcing our expectations of a soft landing. Meanwhile, export data across the region continues to show a sequential slowdown, but has come in generally above expectations, exemplified by Korea’s September outturn of 17.2% y/y (consensus: 15.7%). On the monetary front, Taiwan hiked interest rates for a second time this year, by 12.5 bps to 1.5%. And rising inflation in Korea (3.6% for September, consensus: 2.9%) suggests that another interest rate hike is likely.

In the coming week...

Markets will focus on machinery tool orders (September) and current account (August) in Japan, trade in Malaysia (August) and Taiwan (September), and September inflation in the Philippines and Taiwan. On the monetary front, we expect Indonesia, Japan, and the Philippines to remain on hold, and Australia to hike by 25bps to 4.75%.

Chart1

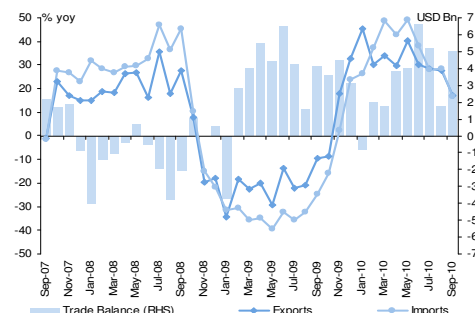
September PMI in China beat market’s expectations



Source: BBVA Research and Bloomberg

Chart2

Korea’s September exports still strong, but slowed down



Source: BBVA Research and Bloomberg

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The US Congress adds more pressure on Yuan

The RMB has appreciated by just over 2% against the USD since June

Thailand’s economic resilience leads the government to raise GDP growth

Economic growth helps to boost sentiment

Japan considers new stimulus measures

The government had already approved a ¥915 billion stimulus package in September

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Markets

Weakness in the US remained as dominant theme

Weakness in US job markets continued to fuel expectations of additional quantitative easing by the Fed in the coming months. The prospect of a longer period of low interest rates has kept the USD lower, with the trade-weighted index (DXY) slipping to below 79, the lowest level since January. Dollar weakness fostered a further gain in Asian currencies this week. Data in Asia generally point to brisk activity, despite an ongoing slowdown in growth momentum. China's strong PMI reading for September was notable. Outside Asia, European data point to further improvements in consumer and business sentiment, which helped allay fear of an abrupt slowdown in Asian exports. Meanwhile, rising sovereign CDS in Ireland, Greece and Portugal in relation to stable spreads in Spain and Italy indicates that the market is differentiating among markets, and is moving less risk averse.

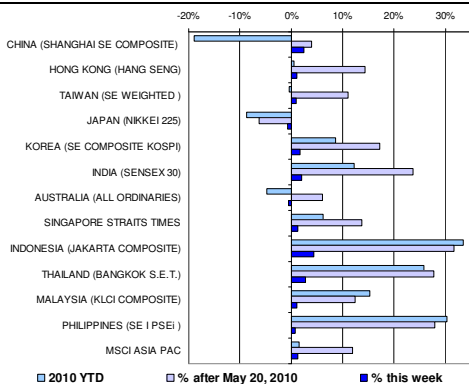
The appreciation of CNY against the dollar continued this week, including in the days after the US House of Representatives voted for a measure on Wednesday that would let US companies petition for duties on imports from China to compensate for the effect of a weak CNY. In our view, the legislation could not solve US trade deficit problems, nor could it spur US job market growth. Nevertheless, the political pressure ahead of G20 meeting and US mid-term election should keep CNY on a modest appreciation path in the coming month. We maintain our forecast that USDCNY will fall to 6.54 by end-2010.

KRW and AUD are among the best performing currencies in the region amidst dollar weakness given the expectation of imminent rate hikes. In Korea, indicators showed that industrial and service output growth held up well in August, as did exports in September which, together with rising inflation, should pave way for a 25 bps hike in August. In Australia, we also expect a 25bps hike next week, but it is going to be a close call. Unlike Korea, the RBA has already hiked rates by 150 bps, with real policy rates and lending rates at a normal level by historical standards. Despite the hawkish tone by the governor, RBA may wait for 3Q inflation report before taking further action. Nevertheless, divergence in monetary policy and resilience of Asian economies should remain the key themes for these currencies this year and next year. Southeast Asian countries that offered similar prospects have also risen remarkably this month. Cumulatively, KRW and AUD have appreciated by 5.6% and 8.4% respectively this month.

Markets were mostly positive last week for a fifth week in a row, as rising capital investments in the US and resilient indicators from China and the rest of Asia boosted confidence in a global economic recovery. The MSCI Asia Pacific climbed by 1.2% last week, the highest jump in five-month. Moreover, MSCI Asia PAC in September recorded the biggest gain since July 2009. In the past week, best performers were Indonesia (4.4%), Thailand (2.8%) and China (2.5%), while Japan (-0.7%) and Australia (-0.5%) were in negative.

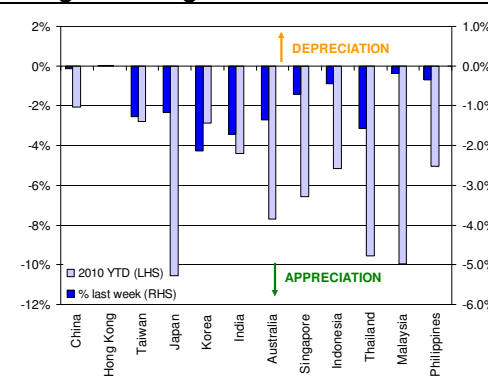
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Chart 3
Stock markets



Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets



Source: BBVA Research and Bloomberg

Economics Analysis

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Highlights

The US Congress adds more pressure on Yuan

The US Congress approved a bill last week which would allow the US government to use the degree of currency undervaluation to impose punitive duties on imports. In doing so, US lawmakers sent a strong political message to the Chinese authorities on currency policy, although it is questionable whether the bill will pass the full Congress, as the Senate would have to ratify the initiative, and it is not expected to happen before the November mid-term elections.

Estimates often place the degree of undervaluation of the yuan around 20% or higher. The RMB has appreciated by just over 2% against the USD since the authorities resumed a more flexible currency arrangement last June.

China continues to run large trade surpluses (cumulative USD104.6 billion through August), including a sizeable bilateral surplus with the US, accounting for half of the overall U.S. trade deficit. The US argues that an artificially undervalued Chinese yuan is worsening trade balance and also hurting its jobs market. We view the proposed bill as symbolic, in ratcheting up political pressure on the Chinese authorities to quicken the pace of appreciation. Even if the bill eventually passes, which is unlikely in our view, the initial impact on trade would be probably be small. The most worrying aspects of the bill are that it steps up protectionist sentiment, which would be damaging to both economies.

Thailand's economic resilience leads the government to raise GDP growth

Despite the residual effects of the political turbulence and street violence earlier this year, the Thai Ministry of Finance has raised its economic growth forecast for this year from 5.5% to 7.5%, due to a stronger-than-expected H1, as external demand surged. Export growth was driven by increasing demand from China and the rest of Asia, while trade to developed countries remained flat. Political unrest during March-May failed to dent economic growth by as much as had been feared, and private consumption accelerated by 2.7% in Q2 (q/q sa). Nevertheless, GDP growth is expected to show a moderating trend in H2, in line with our baseline, due to a lower external demand.

As a result of Thailand's economic resilience, investor sentiment has improved markedly. The Thai stock market has risen by 33.2% this year, and the currency has been one of the region's strongest performers (up against the USD by 9.5% this year). There are concerns now among government officials that the baht's strength could threaten economic growth going forward. The authorities are responding by enhancing outward investment and capital outflows. Moreover, other regional currencies also appreciated briskly against the USD, easing concerns on potential loss of competitiveness.

Japan considers new stimulus measures

Japan's Prime Minister Naoto Kan early last week proposed a supplementary budget of ¥4.6 trillion (\$54.6 billion, equivalent to 1.0% of GDP) for the fiscal year through March, to stimulate the stagnant economy. The government had already approved a ¥915 billion stimulus package in September, which has received criticisms as insufficient.

The move underlines Japan's concerns on its recovery pace, which slowed down to 1.5% (annualized rate) in the second quarter from previous 4.9%. The country has been faced with persistent deflation, which is expected to last into next year due to sluggish domestic demand. Deflation has discouraged private consumption and business investment, undermining the sustainability of Japan's recovery. The Yens' strong appreciation—to a 15-year high of 83.6 against the USD—has added further headwinds. Recent data from the latest quarterly Tankan survey, PMI, IP and others show the exports are slowing down and the growth of the economy is losing momentum.

The supplementary budget is expected to be submitted to parliament in its next session beginning on Friday. It would focus on employment, economic growth, social welfare, stimulating regional economies and deregulation, DPJ's secretary general, Katsuya Okada, said. The supplementary budget, avoids issuing new debts, and instead will be funded by 2 trillion Yen from greater-than-forecast tax revenue, ¥1 trillion from savings on debt

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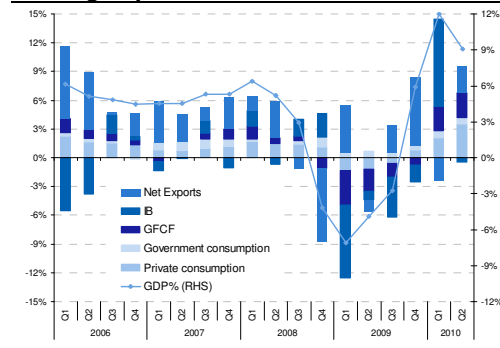
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servicing, and ¥1.6 trillion from the budget for the fiscal year through March 2010, according to government officials. The extra government spending could be expected to lift Japan's GDP by 1.0-1.5%.

On the monetary policy front, the BoJ is likely to increase its ¥30-trillion (\$359 billion) facility for lenders in the meeting on Oct 4-5. It could also engage in “quantitative easing” by purchasing more treasury bonds. The BoJ has also signaled that it may continue to intervene in the FX market, following September’s selling of ¥1.86 trillion (\$22.2 billion) in the first intervention since 2004.

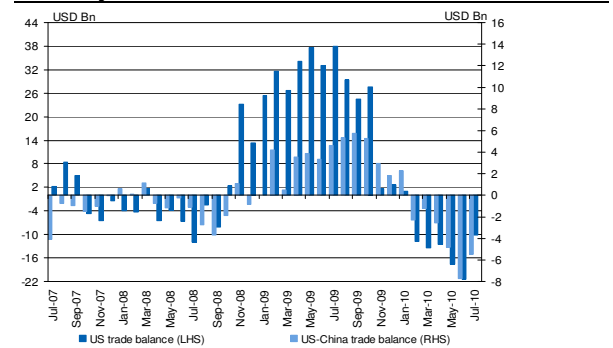
Japan’s government debt has reached to 190% of GDP (gross), raising concerns about fiscal soundness and the sovereign risk. The mounting fiscal debt limits the scale of possible further fiscal stimulus packages, although the government has emphasized that the supplementary budget will not be financed through new debt issuance.

Chart 5
GDP growth in Thailand surged in H1, beating expectations



Source: BBVA Research and Bloomberg

Chart 6
US trade deficit with China widened recently



Source: BBVA Research and CEIC

What to watch

Economics Analysis

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Taiwan: Exports for September (October 7)

Forecast: 27.3% y/y Consensus: 28.7% Previous: 26.6%

Taiwan's exports are expected to sustain their momentum in September (1.3% m/m, s.a.), in line with other recent positive export readings elsewhere in Asia. Strong export performance, although in a moderating trend, has added to strong growth momentum in Taiwan, underscored by another interest rate hike of 12.5bps this past week. A strong export reading in September under the shadow of a sluggish external environment should help support market confidence in Asia's growth outlook.

Calendar

| Australia | Date | Period | Prior | Cons. |
|---------------------------------|-----------|--------|---------|-------|
| Retail Sales s.a. (MoM) | 5-Oct | AUG | 0.70% | -- |
| Unemployment Rate | 7-Oct | SEP | 5.10% | -- |
| China | Date | Period | Prior | Cons. |
| China Non-manufacturing PMI | 3-Oct | SEP | 60.1 | -- |
| Hong Kong | Date | Period | Prior | Cons. |
| Retail Sales - Value (YoY) | 4-Oct | AUG | 18.90% | -- |
| Purchasing Managers Index | 05-06 oct | SEP | 52.3 | -- |
| Indonesia | Date | Period | Prior | Cons. |
| Danareksa Consumer Confidence | 04-08 oct | SEP | 80.5 | -- |
| Consumer Confidence Index | 04-08 oct | SEP | 104 | -- |
| Japan | Date | Period | Prior | Cons. |
| Machine Tool Orders (YoY) | 7-Oct | SEP P | -- | -- |
| Current Account Total | 8-Oct | AUG | -- | -- |
| Adjusted Current Account Total | 8-Oct | AUG | -- | -- |
| Trade Balance (BoP Basis) | 8-Oct | AUG | -- | -- |
| Korea | Date | Period | Prior | Cons. |
| South Korea Money Supply M2 | 7-Oct | AUG | 9.30% | -- |
| Malaysia | Date | Period | Prior | Cons. |
| Exports YoY% | 8-Oct | AUG | 13.50% | -- |
| Imports YoY% | 8-Oct | AUG | 18.10% | -- |
| Trade Balance | 8-Oct | AUG | 7.01B | -- |
| Philippines | Date | Period | Prior | Cons. |
| Consumer Price Index (YoY) | 5-Oct | SEP | 4.00% | -- |
| Singapore | Date | Period | Prior | Cons. |
| Electronics Sector Index | 5-Oct | SEP | 50.6 | 51.3 |
| Purchasing Managers Index | 5-Oct | SEP | 49.4 | 50.7 |
| Taiwan | Date | Period | Prior | Cons. |
| CPI YoY% | 5-Oct | SEP | -0.46% | -- |
| Total Exports (YoY) | 7-Oct | SEP | 26.60% | -- |
| Total Imports (YoY) | 7-Oct | SEP | 28.00% | -- |
| Total Trade Bal in US\$ Billion | 7-Oct | SEP | \$2.26B | -- |
| Thailand | Date | Period | Prior | Cons. |
| Consumer Confidence Economic | 7-Oct | SEP | 72.8 | -- |

Australia – RBA Cash Target, October 5

We expect interest rates to remain unchanged

| Current | Expected |
|---------|----------|
| 4.5 | 4.75 |

Indonesia – BI Reference Rate, October 5

We expect interest rates to remain unchanged

| Current | Expected |
|---------|----------|
| 6.5 | 6.5 |

Japan – BoJ Target Rate, October 5

We expect interest rates to remain unchanged

| Current | Expected |
|---------|----------|
| 0.1 | 0.1 |

Philippines – Overnight Borrowing Rate, October 7

We expect interest rates to remain unchanged

| Current | Expected |
|---------|----------|
| 4.0 | 4.0 |

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| | | | Close | Weekly change | Monthly change | Annual change | |
|---|-----------------------------------|-------------------------|-------------|---------------|----------------|---------------|----|
| Interest Rates (changes in bps) | US | 3-month Libor rate | 0.29 | 0 | 0 | 1 | |
| | | 2-yr yield | 0.42 | -2 | -7 | -44 | |
| | | 10-yr yield | 2.56 | -5 | -6 | -66 | |
| | EMU | 3-month Euribor rate | 0.94 | 6 | 6 | 19 | |
| | | 2-yr yield | 0.87 | 14 | 26 | -33 | |
| | | 10-yr yield | 2.33 | -1 | 5 | -79 | |
| Exchange Rates (changes in %) | Europe | Dollar-Euro | 1.374 | 1.9 | 7.2 | -5.9 | |
| | | Pound-Euro | 0.87 | 1.9 | 4.3 | -5.5 | |
| | | Swiss Franc-Euro | 1.34 | 1.3 | 3.6 | -11.0 | |
| | America | Argentina (peso-dollar) | 3.96 | 0.1 | 0.3 | 3.1 | |
| | | Brazil (real-dollar) | 1.68 | -1.7 | -3.1 | -5.5 | |
| | | Colombia (peso-dollar) | 1796 | -0.6 | -0.8 | -6.3 | |
| | | Chile (peso-dollar) | 482 | -1.0 | -3.2 | -13.1 | |
| | | Mexico (peso-dollar) | 12.54 | -0.1 | -4.0 | -8.3 | |
| | | Peru (Nuevo sol-dollar) | 2.79 | 0.0 | -0.3 | -3.4 | |
| | | Japan (Yen-Dollar) | 83.35 | -1.2 | -1.1 | -7.0 | |
| | Asia | Korea (KRW-Dollar) | 1125.97 | -2.0 | -4.6 | -4.3 | |
| | | Australia (AUD-Dollar) | 0.972 | 1.4 | 6.9 | 12.2 | |
| | Comm. (chg %) | Brent oil (\$/b) | 83.4 | 5.7 | 8.4 | 22.5 | |
| | | Gold (\$/ounce) | 1316.4 | 1.6 | 5.2 | 31.3 | |
| Base metals | | 528.5 | 0.5 | 3.5 | 24.4 | | |
| Stock Markets (changes in %) | Euro | Ibex 35 | 10513 | -2.0 | -0.2 | -7.2 | |
| | | EuroStoxx 50 | 2757 | -1.3 | 1.6 | -0.1 | |
| | | USA (S&P 500) | 1147 | -0.1 | 5.3 | 11.9 | |
| | America | Argentina (Merval) | 2643 | 2.5 | 9.4 | 30.6 | |
| | | Brazil (Bovespa) | 69717 | 2.2 | 4.4 | 14.0 | |
| | | Colombia (IGBC) | 14711 | 4.1 | 5.2 | 31.9 | |
| | | Chile (IGPA) | 22417 | 1.2 | 4.1 | 41.9 | |
| | | Mexico (CPI) | 33330 | 0.1 | 2.8 | 16.2 | |
| | | Peru (General Lima) | 17860 | 3.1 | 16.2 | 21.7 | |
| | | Venezuela (IBC) | 65283 | -1.2 | 0.8 | 29.2 | |
| | Asia | Nikkei225 | 9404 | -0.7 | 3.8 | -3.4 | |
| | | HSI | 22358 | 1.1 | 7.1 | 9.7 | |
| | Credit (changes in bps) | Sovereign risk | Ind. | | | | |
| | | | Itraxx Main | 111 | -2 | 2 | 13 |
| Itraxx Xover | | | 510 | -6 | 18 | -99 | |
| CDS Germany | | | 39 | -1 | 0 | 17 | |
| CDS Portugal | | | 409 | 8 | 104 | 358 | |
| CDS Spain | | | 230 | 5 | 6 | 159 | |
| CDS USA | | | 46 | 0 | 1 | --- | |
| CDS Emerging | | | 227 | -4 | -15 | -48 | |
| CDS Argentina | | | 750 | -13 | -143 | -314 | |
| CDS Brazil | | | 116 | -1 | -6 | -18 | |
| CDS Colombia | | | 118 | -5 | -8 | -44 | |
| CDS Chile | | | 77 | 2 | -6 | 1 | |
| CDS Mexico | | | 122 | -10 | -16 | -44 | |
| CDS Peru | 121 | 2 | 13 | -21 | | | |

Source: Bloomberg and Datastream

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Asia Market

| STOCK MARKETS | INDEX | Last price | % change over a week | Year to date | % Change over 1 Y |
|----------------------------|--------------------------|------------|----------------------|--------------|-------------------|
| | China – Shanghai Comp. | 2655.7 | 2.5 | -19.0 | -4.5 |
| | Hong Kong – Hang Seng | 22358.2 | 1.1 | 2.2 | 6.7 |
| | Taiwan – Weighted | 8244.2 | 0.9 | 1.1 | 11.7 |
| | Japan – Nikkei 225 | 9404.2 | -0.7 | -10.0 | -2.5 |
| | Korea – Kospi | 1876.7 | 1.6 | 12.1 | 14.7 |
| | India – Sensex 30 | 20445.0 | 2.0 | 17.1 | 19.3 |
| | Australia – SPX/ASX 200 | 4579.2 | -0.5 | -4.7 | 0.8 |
| | Singapore – Strait Times | 3130.9 | 1.2 | 8.5 | 20.7 |
| | Indonesia – Jakarta Comp | 3547.1 | 4.4 | 40.0 | 43.0 |
| Thailand – SET | 978.6 | 2.8 | 33.2 | 35.1 | |
| Malaysia – KLCI | 1466.3 | 1.0 | 15.6 | 22.0 | |
| Philippines – Manila Comp. | 4112.0 | 0.8 | 36.7 | 48.0 | |

| FOREIGN EXCHANGE MARKETS | CURRENCY | Spot | % change over a week | Forward 3-month | Forward 12-month |
|--------------------------|---------------------|------|----------------------|-----------------|------------------|
| | China (CNY/USD) | 6.69 | 0.07 | -0.06 | -0.17 |
| | Hong Kong (HKD/USD) | 7.76 | -0.02 | -33.5 | -133 |
| | Taiwan (TWD/USD) | 31.0 | 1.10 | -0.32 | -0.86 |
| | Japan (JPY/USD) | 83.6 | 0.86 | -9.2 | -47.0 |
| | Korea (KRW/USD) | 1125 | 2.08 | 0.55 | 11.05 |
| | India (INR/USD) | 44.5 | 1.74 | 52.0 | 217 |
| | Australia (USD/AUD) | 0.97 | 0.92 | 119 | n.a. |
| | Singapore (SGD/USD) | 1.31 | 0.56 | -0.80 | 1.0 |
| | Indonesia (IDR/USD) | 8918 | 0.37 | 33 | 363 |
| Thailand (THB/USD) | 30.2 | 1.16 | 1.75 | 13.5 | |
| Malaysia (MYR/USD) | 3.09 | 0.10 | 41.0 | 395 | |
| Philippines (PHP/USD) | 43.8 | 0.15 | 0.20 | 1.10 | |

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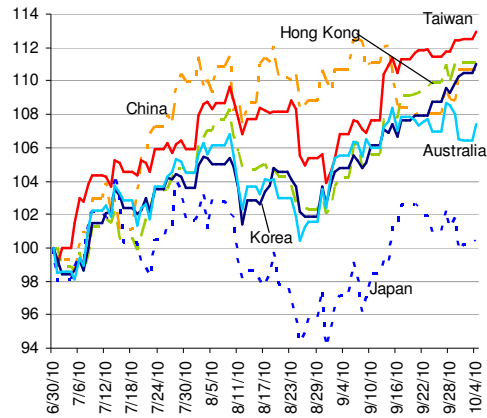
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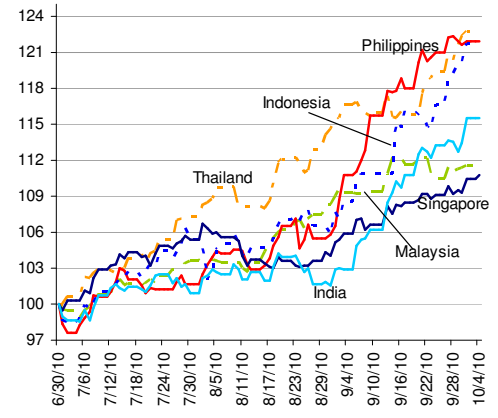
Asia Chart

STOCK MARKETS



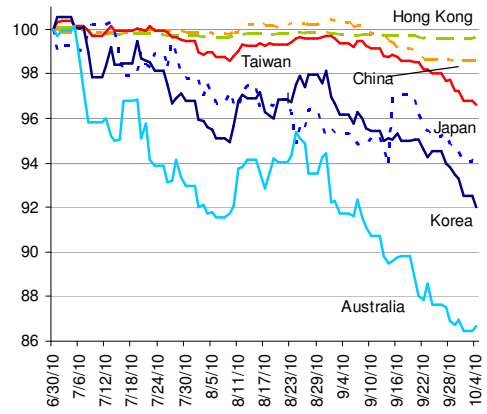
Source: BBVA Research and Bloomberg Index=100

STOCK MARKETS



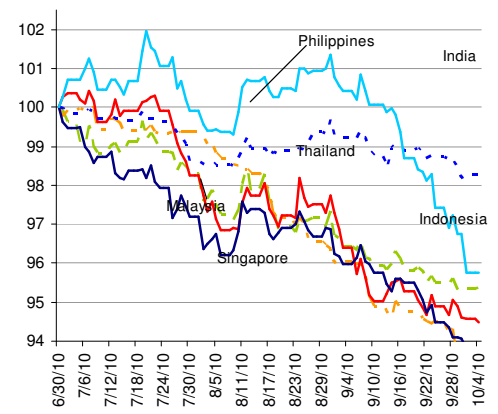
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FOREIGN EXCHANGE MARKETS



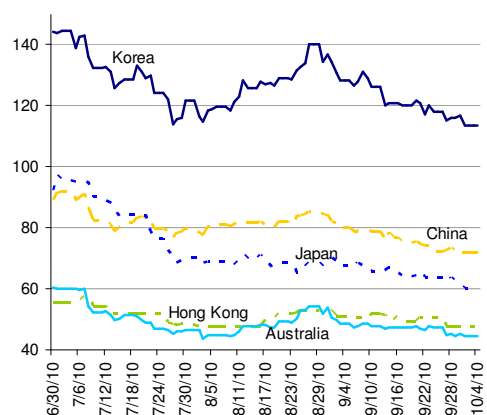
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FOREIGN EXCHANGE MARKETS



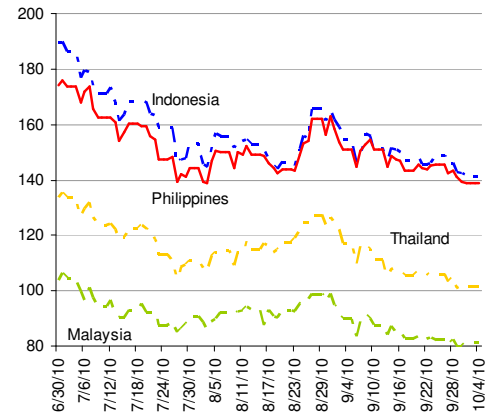
Source: BBVA Research and Bloomberg Index=100

CREDIT DEFAULT SWAPS



Source: BBVA Research and Bloomberg

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