

Asia

# Weekly Watch

Hong Kong, January 14, 2011

**Economic Analysis**

*Asia*

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## Inflation worries prompt policy responses

Rising inflationary pressures, especially from food and commodity prices, has rippled through markets and generated new policy responses. Both Thailand (expected) and Korea (unexpected) hiked interest rates this past week citing inflationary pressures (Chart 1). Korea and Indonesia also announced administrative and supply-side measures to curb inflation (see Highlights). Meanwhile, Singapore announced further measures to contain rising housing prices, including new stamp duties and higher down payment requirements.

### Data show strong momentum

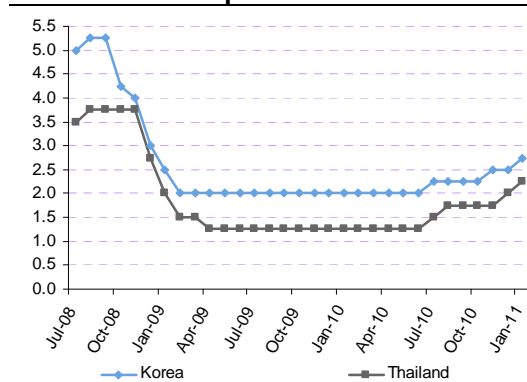
The week was dominated by China, which released strong import and credit data, along with rising reserves, despite a softening in export growth for December (Chart 2) (see Highlights). In Australia, growth estimates are being marked down on account of the severe floods in Queensland (see Highlights). Indian WPI inflation was in line with expectations, but remains high at 8.4%/y/y for December

### In the coming week...

China will be in focus again, with a set of monthly indicators due out on inflation, fourth quarter GDP, retail sales, and FDI, along with property prices (see What to Watch). Moreover, markets will also await headline inflation figures for Hong Kong and Malaysia, as well as trade figures for Singapore and Thailand.

Chart1

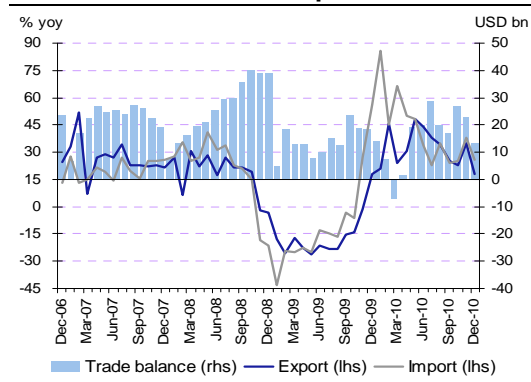
### Korea and Thailand hike rates again to combat inflation pressures



Source: BBVA Research and Bloomberg

Chart2

### China's trade surplus narrows in December on weaker exports



Source: BBVA Research and Bloomberg

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## Highlights

### Inflation prompts new measures

Rising inflationary pressures prompt more rate hikes and administrative measures

### China's foreign exchange reserves surge

Despite weaker exports, pressure is mounting for faster currency appreciation

### Australian floods inflict humanitarian and economic costs

Estimates of GDP growth are being marked down

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Positive bond auctions in Europe lift sentiment

ECB pledges to expand the size and flexibility of the European Financial Stability Facility (EFSF), and also the announcement that Japan will buy more than 20% of the EFSF bonds eased tensions in global markets due to spillovers from the European debt crisis. Portugal, Spain, and Italy were all successful in their bond auctions this week, despite a rise in yields. Risk premia decreased in Europe's periphery. Positive sentiment helped to reverse, partially, massive losses recorded on Monday in Asian stock markets due to inflation fears, and also strengthened regional currencies against the USD as global risk aversion diminished somewhat and as the EUR strengthened, due in part to talk of higher interest rates in Europe to combat inflation.

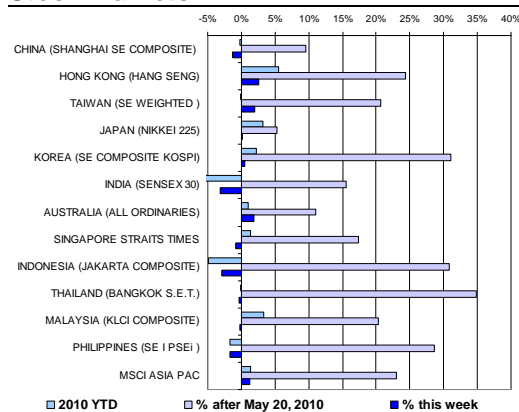
Korea and Thailand hiked rates amidst rising inflationary pressures. Moreover, to varying degrees Korea, India, and Indonesia all announced measures to tame food prices, while Singapore raised down payment requirements and imposed new stamp duties to tame property prices. Regional economic data over the past week shows a healthy moderation in momentum. For example, China exports came in a lower than expected figure for December, while imports surged, and India's industrial production disappointed.

The TWD rallied for a seventh consecutive week, reaching 13 year highs against the USD on Thursday. TWD appreciation has been fueled by rapid economic growth and capital inflows. Meanwhile, the KRW also surged, as higher interest rates are expected to attract inflows, and also due to some easing in global risk aversion. The Chinese authorities allowed the yuan to strengthen this past week ahead of next week's visit of President Hu Jintao to the US. In the other hand, the IDR depreciated for a second straight week on concerns about inflation.

Stock markets were mixed this past week. Some of last year's best performing markets have showed large losses in the first two weeks of this year – in particular Indonesia, India, and the Philippines. Indonesia's stock market fell by 4.21% on Monday alone, its biggest drop in two years on market worries about inflation. The same factors also drove down Indian markets, ahead of inflation figures. Meanwhile, Laos launched its first stock market with two companies listed.

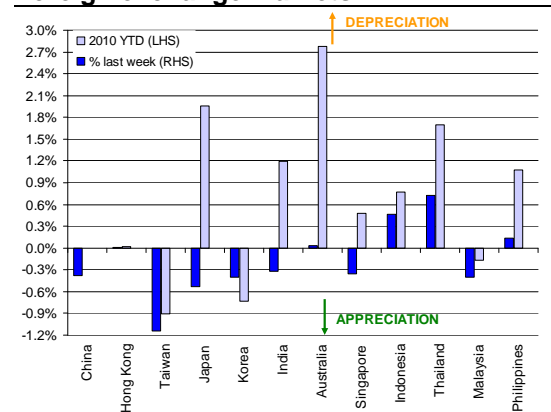
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Chart 3  
Stock markets



Source: BBVA Research and Bloomberg

Chart 4  
Foreign exchange markets



Source: BBVA Research and Bloomberg

## Economics Analysis

## Asia

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## Highlights

**Inflation prompts new measures**

Recent indicators continue pointing to inflation as a risk for the region in 2011. While headline CPIs remain moderate for the most part, there is a clear rising trend (Chart 5) – as reported previously, China's inflation hit a two-year high of 5.1%/y/y in November, while December inflation in Indonesia, Korea, and Thailand (core) all picked up. As elsewhere in the world, food prices have the main driver as global demand has pushed up prices of key staples and commodities; weather-related disturbances and natural disasters have also been a factor. Many Asian countries have been implementing measures to cope with rising food prices. This past week, for example, Korea unveiled new measures to curb inflation, including tariff cuts, monitoring of tuition fees and utilities charges, strengthened control on "pricing irregularities", and boosting food supply. Similarly, Indonesia announced that they will eliminate tariffs on imports of certain products (such as wheat, soybeans, and livestock feed). Meanwhile, India is considering bans on some food exports. These measures follow steps already taken elsewhere in the region, with countries such as Singapore and China having expressed concern about the impact of rising food prices on lower income segments of their population. The past week featured two rate hikes of 25bps each, in Thailand (as expected) and in Korea (a surprise), in reaction to rising inflationary trends.

**China's foreign exchange reserves surge**

A batch of economic indicators for China was released this past week showing that 2010 ended on a strong note, albeit with some mixed signals. On the external front, lower-than-expected exports for December (17.9% y/y; BBVA: 22.5%; consensus: 23.3%) and buoyant imports (25.6% y/y; BBVA: 22.0%; consensus: 24.9%) resulted in a narrowing of the trade surplus (USD13.1 billion from USD22.3 billion the previous month). The full-year trade surplus narrowed to USD 183.1 billion, compared to USD 195.7 billion in 2009; as a percent of GDP, the decline is even larger (current account data are not yet available), indicating that, with strong domestic demand, the gradual rebalancing of growth toward domestic sources is continuing. At the same time, foreign exchange reserves for the last quarter of 2010 surged by USD 199 billion in the fourth quarter of 2010, boosting reserves to a record USD 2.85 trillion (Chart 6), which is likely to keep the heat on for China to accelerate the pace of currency appreciation. Given the narrowing of the trade surplus, the reserves accumulation points to an increase in capital inflows, some of which may consist of hot money flows in anticipation of further RMB appreciation. After accounting for valuation changes (due to currency fluctuations) and projected FDI inflows, we estimate hot money inflows of around USD 95 billion for the quarter. On the monetary front, December's new loans (RMB480.7 billion) and M2 growth (19.7% y/y) exceeded their annual targets, reinforcing expectations of further tightening measures this year. Next week will feature other important data, including fourth quarter GDP growth, December inflation and property prices, and key activity indicators.

**Australian floods inflict humanitarian and economic costs**

Floods that began in late November in Queensland, Australia's third most populous state containing the city of Brisbane, and with an area the size of California and Texas combined, have had a devastating humanitarian impact and have hit Australia's economy hard. Damage from the floods could end up shaving as much as one percent of Australia's GDP in 2011. Growth in the first quarter of 2011 may end up being only half of our previous 3.5%/y/y forecast. The floods have also disrupted supply chains, causing a rise in food prices which are expected to bring up overall inflation as well. Meanwhile, the closure of coal mines impacted by the floods has driven up thermal coal prices to their highest levels since September 2008. And cattle prices in Australia have jumped to their highest levels in over 5 years. Inflation in the first quarter of 2011 is now expected to exceed the RBA's target range of 2-3%; however, given the negative shock to growth, the RBA may keep its cash rate on hold in the coming months at 4.75%, rather than hiking as previously expected. On the currency front, the Aussie dollar has lost some ground, falling once again to below parity with the US dollar.

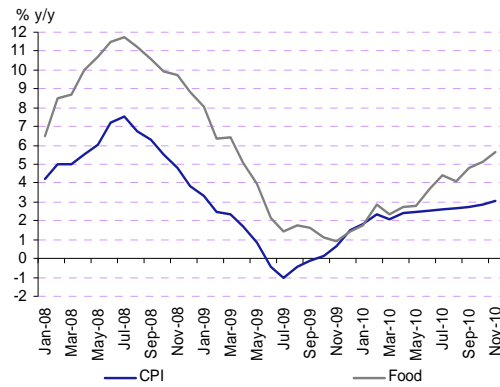
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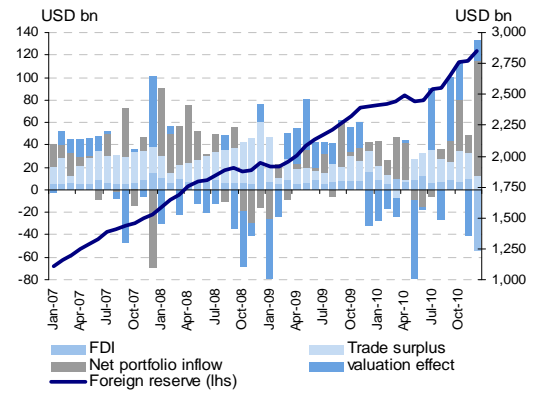
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Chart 5  
**Food prices are driving up the overall inflation across Asia\***



Source: BBVA Research and Bloomberg  
 \*simple average of China, Hong Kong, Taiwan, Japan, Korea, India, Indonesia, Malaysia, Philippines, Singapore, Thailand, Vietnam

Chart 6  
**China's foreign reserves surge in Q4**



Source: BBVA Research and Bloomberg

## What to watch

### Economics Analysis

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### China: CPI inflation for December (January 20)

**Forecast:** 4.9% y/y

**Consensus:** 4.6%

**Previous:** 5.1%

China's CPI inflation accelerated to 5.1% in November, prompting the authorities to intensify monetary tightening measures, including both a 25bps interest rate hike and a 50 bps hike in the required reserve ratio (RRR) in December. Inflation will be closely watched, along with a number of indicators including Q4 GDP growth and other activity indicators. A higher-than-expected inflation outturn or faster activity indicators for December could unnerve markets by increasing expectations of additional tightening measures.

### Calendar

| Australia                         | Date      | Period | Prior   | Cons.  |
|-----------------------------------|-----------|--------|---------|--------|
| Westpac Consumer Confidence Index | 19-Jan    | JAN    | 111     | --     |
| Consumer Inflation Expectation    | 20-Jan    | JAN    | 2.80%   | --     |
| China                             | Date      | Period | Prior   | Cons.  |
| China Property Prices             | 15-Jan    | DEC    | 7.7     | 7      |
| Actual FDI (YoY)                  | 18-Jan    | DEC    | 38.20%  | 11.20% |
| Real GDP YoY                      | 20-Jan    | 4Q     | 9.60%   | 9.40%  |
| GDP Year-to-Date (YoY)            | 20-Jan    | 4Q     | 10.60%  | 10.20% |
| Consumer Price Index (YoY)        | 20-Jan    | DEC    | 5.10%   | 4.60%  |
| Producer Price Index (YoY)        | 20-Jan    | DEC    | 6.10%   | 5.60%  |
| Industrial Production (YoY)       | 20-Jan    | DEC    | 13.30%  | 13.40% |
| Retail Sales (YoY)                | 20-Jan    | DEC    | 18.70%  | 18.80% |
| Fixed Assets Inv Urban YTD YoY    | 20-Jan    | DEC    | 24.90%  | 25.00% |
| Hong Kong                         | Date      | Period | Prior   | Cons.  |
| Unemployment Rate SA              | 18-Jan    | DEC    | 4.10%   | 4.00%  |
| CPI - Composite Index (YoY)       | 20-Jan    | DEC    | 2.90%   | 3.00%  |
| Japan                             | Date      | Period | Prior   | Cons.  |
| Consumer Confidence               | 17-Jan    | DEC    | 40.6    | --     |
| Industrial Production (MoM)       | 18-Jan    | NOV F  | 1.00%   | --     |
| Machine Tool Orders (YoY)         | 18-Jan    | DEC F  | 63.50%  | --     |
| Tertiary Industry Index (MoM)     | 19-Jan    | NOV    | 0.50%   | 0.70%  |
| All Industry Activity Index (MoM) | 21-Jan    | NOV    | -0.20%  | 0.40%  |
| Korea                             | Date      | Period | Prior   | Cons.  |
| Department Store Sales YoY        | 17-19 Jan | DEC    | 10.10%  | --     |
| Discount Store Sales YoY          | 17-19 Jan | DEC    | 1.70%   | --     |
| Malaysia                          | Date      | Period | Prior   | Cons.  |
| CPI YoY                           | 19-Jan    | DEC    | 2.00%   | 2.30%  |
| Philippines                       | Date      | Period | Prior   | Cons.  |
| Overseas Remittances (YoY)        | 17-Jan    | NOV    | 9.30%   | --     |
| Balance of Payments               | 19-Jan    | DEC    | \$3902M | --     |
| Singapore                         | Date      | Period | Prior   | Cons.  |
| Electronic Exports (YoY)          | 17-Jan    | DEC    | 10.80%  | --     |
| Non-oil Domestic Exports (YoY)    | 17-Jan    | DEC    | 10.00%  | 12.90% |
| Taiwan                            | Date      | Period | Prior   | Cons.  |
| Export Orders (YoY)               | 20-Jan    | DEC    | 14.34%  | 12.35% |
| Thailand                          | Date      | Period | Prior   | Cons.  |
| Customs Exports (YoY)             | 20-Jan    | DEC    | 28.50%  | --     |
| Customs Imports (YoY)             | 20-Jan    | DEC    | 35.30%  | --     |
| Customs Trade Balance             | 20-Jan    | DEC    | \$408M  | --     |

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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.   | 2791.3     | -1.7                 | -0.6         | -13.2             |
|                            | Hong Kong – Hang Seng    | 24303.9    | 2.6                  | 5.5          | 11.9              |
|                            | Taiwan – Weighted        | 8972.5     | 2.2                  | 0.0          | 8.2               |
|                            | Japan – Nikkei 225       | 10499.0    | -0.4                 | 2.6          | -3.7              |
|                            | Korea – Kospi            | 2108.2     | 1.1                  | 2.8          | 25.1              |
|                            | India – Sensex 30        | 19330.5    | -1.8                 | -5.7         | 9.9               |
|                            | Australia – SPX/ASX 200  | 4801.5     | 2.1                  | 1.2          | -2.0              |
|                            | Singapore – Strait Times | 3233.3     | -0.9                 | 1.4          | 11.1              |
|                            | Indonesia – Jakarta Comp | 3528.6     | -2.8                 | -4.7         | 33.4              |
|                            | Thailand – SET           | 1032.6     | -0.4                 | 0.0          | 37.8              |
|                            | Malaysia – KLCI          | 1568.5     | -0.2                 | 3.3          | 21.1              |
| Philippines – Manila Comp. | 4132.0                   | -1.7       | -1.6                 | 32.4         |                   |

Last update: Friday, 15.30 Hong Kong time.

| FOREIGN EXCHANGE MARKETS | CURRENCY            | Spot | % change over a week | Forward 3-month | Forward 12-month |
|--------------------------|---------------------|------|----------------------|-----------------|------------------|
|                          | China (CNY/USD)     | 6.60 | 0.51                 | 6.55            | 6.44             |
|                          | Hong Kong (HKD/USD) | 7.78 | -0.02                | 7.8             | 8                |
|                          | Taiwan (TWD/USD)    | 29.0 | 1.23                 | 28.66           | 28.13            |
|                          | Japan (JPY/USD)     | 82.6 | 0.71                 | 82.5            | 82.1             |
|                          | Korea (KRW/USD)     | 1114 | 0.72                 | 1119.48         | 1130.50          |
|                          | India (INR/USD)     | 45.3 | 0.28                 | 46.0            | 48               |
|                          | Australia (USD/AUD) | 1.00 | 0.14                 | 1               | n.a.             |
|                          | Singapore (SGD/USD) | 1.29 | 0.50                 | 1.29            | 1.3              |
|                          | Indonesia (IDR/USD) | 9063 | -0.44                | 9204            | 9583             |
|                          | Thailand (THB/USD)  | 30.5 | -0.33                | 30.50           | 30.6             |
|                          | Malaysia (MYR/USD)  | 3.06 | 0.49                 | 3.1             | 3                |
| Philippines (PHP/USD)    | 44.2                | 0.00 | 44.25                | 44.43           |                  |

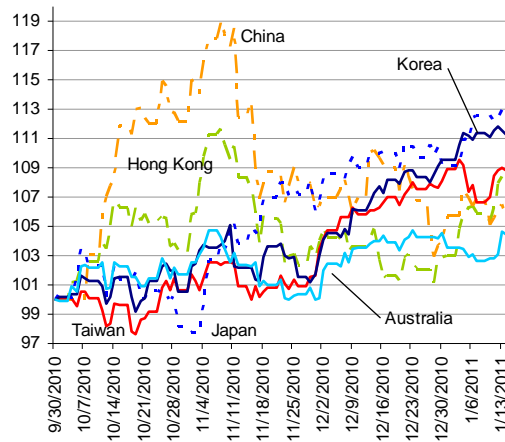
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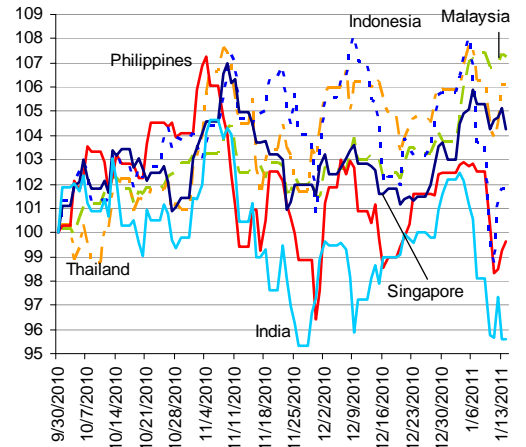
# Asia Chart

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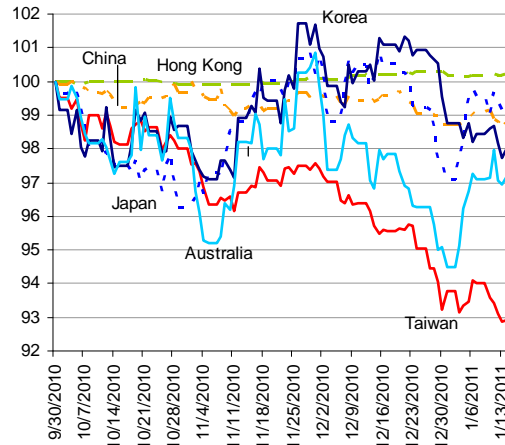
Source: BBVA Research and Bloomberg Index=100

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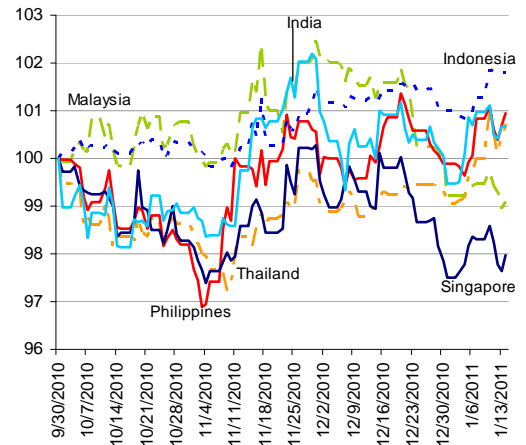
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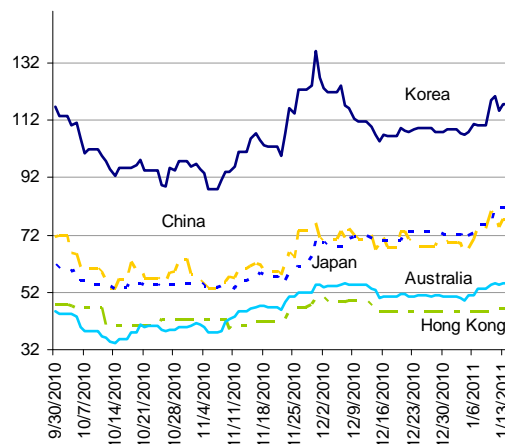
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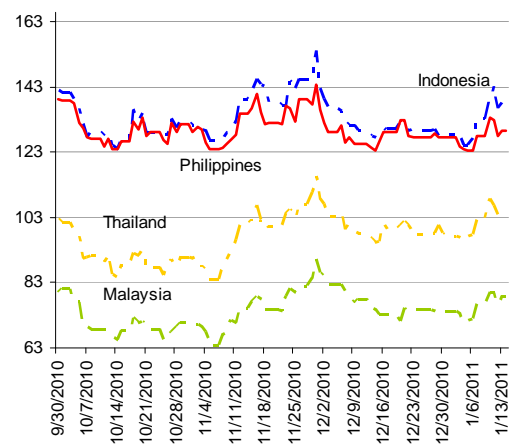
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