

Weekly Watch

Asia

24 June 2011
Economic Analysis

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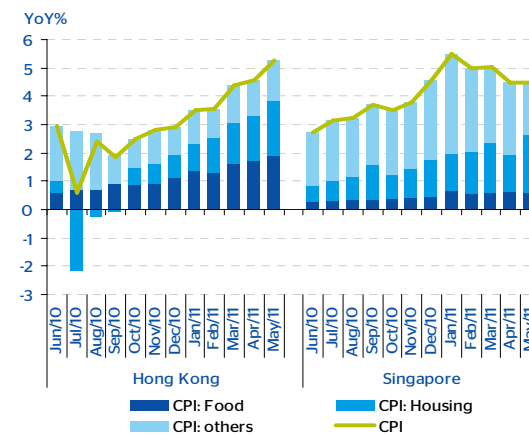
Markets rally on China inflation remarks

Despite headwinds from European debt worries, Asian equity markets managed to post their first weekly gain in almost two months on falling oil prices, and as concerns of aggressive monetary tightening in China eased. The latter was fueled by remarks from China's Premier about the authorities' success in battling inflation (see Markets). That said, the region's struggle with inflation is far from over, as seen in higher than expected May CPI outturns released this week in Hong Kong and Singapore (see Highlights). Next week will feature important updates on inflation trends, with Korea, Indonesia, and Thailand set to release their June inflation outturns. We expect the outturns to confirm that inflation in the former two may have already peaked, although price pressures remain elevated throughout the region, with risks still to the upside.

The inflation genie is not yet back in the bottle, despite slowing growth trends

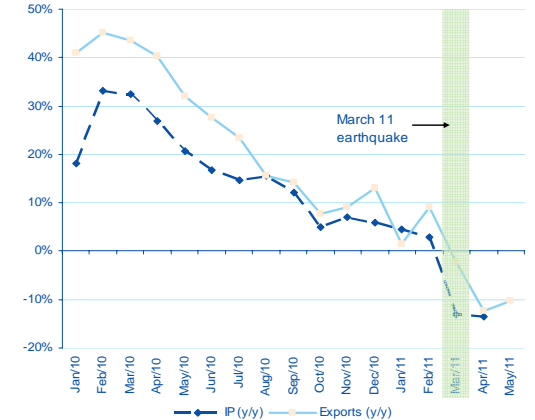
Singapore's inflation for May remained elevated at 4.5% y/y, ahead of market expectations (consensus: 4.1%); and in Hong Kong, inflation rose to 5.2% y/y (consensus: 5.0%), the highest outturn since mid-2008 (Chart 1). Inflation in Vietnam, where the authorities continue to struggle to maintain macro stability, accelerated to 20.8% y/y (from 19.8% in May). Meanwhile, signs of a growth slowdown in the second quarter continue. Singapore's industrial production fell by -17.5% (consensus: -9.3%), and Japan's exports for May surprised to the downside (see Highlights and Chart 2). Markets will be watching for next week's PMI release in China (Indicator of the week).

Chart 1
Inflation in Hong Kong and Singapore has been elevated by domestic demand pressures



Source: BBVA Research and Bloomberg

Chart 2
Japan's exports have bottomed out following disruptions from the March earthquake



Source: BBVA Research and Bloomberg

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Highlights

India's 12th five year plan - leveraging growth to a higher normal

The next 5-year Plan is expected to focus on boosting infrastructure investment

Hong Kong and Singapore face rising domestic price pressures

Inflation outturns surprised to the upside in May on food and housing costs

Japan: disappointing post-quake data likely to give way to a rebound

Signs of a rebound are underway despite disappointing May export data

Economic Analysis

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Markets

The past week saw significant volatility in financial markets as global growth concerns and Greek debt worries continued to deepen. On net, Asian stocks generally managed to post modest gains after significant losses the previous week and rallied strongly on Friday as concerns on headwinds (Europe, oil, inflation) eased, while regional currencies were broadly stable.

Asian markets still dominated by Greek debt concerns

The ups-and-downs of Asian markets have been tied closely to events in Greece and Europe, leaving limited scope for domestic factors to exert influence. Broadly speaking, markets questioned the capacity of Greece to obtain new funding from the EU, IMF and ECB and avoid default. This week, Greek Prime Minister Papandreou survived a critical motion of non-confidence in Parliament by a narrow majority of 155-143, and his austerity plans were reportedly supported by EU/ IMF. Markets seem to share our view that an investor-friendly solution will emerge in July, bringing risk premiums down.

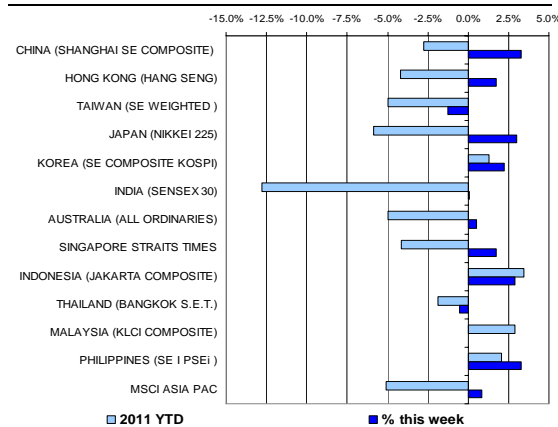
However, considerable uncertainties remain in the coming two weeks. In particular, Greece's Parliament has to pass the Medium-Term Fiscal Strategy and other proposed austerity measures next week (June 28 or 30), a pre-requisite for EU leaders to approve a second bailout package when they meet on July 3. In addition, EU leaders also have to garner support from major banks, key holders of Greek debt, to participate in the second bailout by voluntary rollover without triggering any terms of default. Before more clarity on these two issues, Asian markets will likely track their global counterparts and stay volatile.

China's Wen declares victory on inflation

China's premier Wen said the government has successfully kept a lid on price pressures, which could mean possible changes in policy focus in 2H 2011. "The overall price level now is within a controllable range and is expected to drop steadily," Mr. Wen wrote in a newspaper. "We are confident price rises will be firmly under control this year." The remarks came against a backdrop of tight credit conditions and signs of slowing growth. 7-day SHIBOR jumped from 4.0% a week ago to 5.9% of late after the latest 50 bp RRR hike, while PMI locally and abroad have been pointing to slower demand growth in 2H. Markets have recently sought protection from the tail risk of a hard-landing scenario by buying long-dated China's CDS and USDCNY NDF.

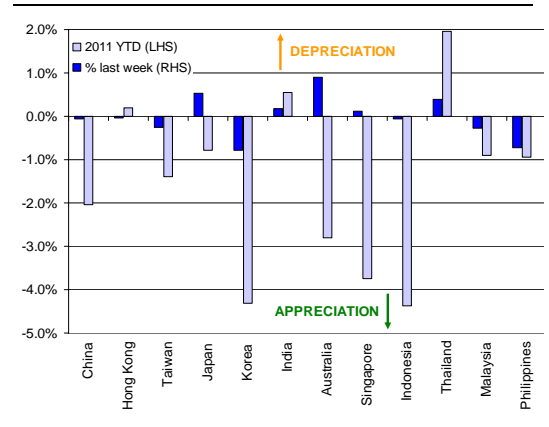
We still see little risk of a hard-landing, and continue to forecast more rate hikes and other tightening measures to come in 2H on assumption of continued domestic strength and limited spare capacity available. But as inflation may be peaking soon, as in our base-case scenario, the government may have to contemplate policy refinement and shift focus away from inflation to growth should growth turn out to be slower than anticipated. The unlikely scenario will pose risks to our monetary policy call in 2H 2012. In this context, the official PMI due on July 1 is worth close monitoring.

Chart 3
Stock markets



Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets



Source: BBVA Research and Bloomberg

Highlights

India's 12th five year plan - leveraging growth to a higher normal

Despite intermittent hurdles to growth, India has been amongst the fastest growing economies in the world over the past decade, clocking 8% average annual growth. This strong performance is due to several structural factors, including favorable demographics, a high savings and investment ratio, skilled labor force, rapid urbanization, rising income levels, and dynamic corporate and financial sectors. The challenge now is to step up and sustain India's growth momentum. In this context, an approach paper for the 12th five year plan (April 2012 to March 2017), scheduled to be released in the last week of June, will be keenly watched. The plan is expected to focus on instilling 'inclusive growth' by boosting infrastructure investment, particularly in rural areas, improving access to quality education and healthcare, securing India's energy future, enhancing skill development, technological innovation and ensuring environmental protection. Infrastructure investment across the whole spectrum is expected to grow remarkably under the 12th Plan. Given the emphasis on public private partnerships, the private sector is expected to contribute about half of the total investment as against 36% in the 11th Plan. In this regard, the government has taken steps towards providing an investor friendly policy environment by opening up a number of infrastructure sectors to private players, permitting FDI in key sectors and raising FII limits in infrastructure debt. However, challenges remain: a top priority is to maintain fiscal sustainability while improving project implementation and continuing with ongoing investment reforms.

Hong Kong and Singapore face rising domestic price pressures

May CPI inflation readings released this past week for Hong Kong and Singapore both surprised to the upside, at 5.2% y/y and 4.5% y/y, respectively (consensus: 5.0% y/y and 4.1% y/y, respectively), driven by higher food and housing rental prices. As elsewhere in the region, inflation has been rising throughout the year in the two "city-states" (Chart 1), due to demand pressures and rising commodity prices, which have recently subsided. The two economies share many characteristics in common, and both have seen average housing prices reach historical highs in recent months. To prevent overheating and asset bubbles, the authorities in both economies have implemented a series of property-related tightening measures, including stricter mortgage lending requirements and higher property sales taxes. Being such small open economies, the two are also vulnerable to imported inflation given their reliance on imported food and basic goods. That said, in contrast to Hong Kong, which is deprived of an independent monetary policy under its linked exchange rate system with the US dollar, Singapore has been able to tighten monetary policy through faster exchange rate appreciation (the exchange rate is Singapore's monetary policy instrument and the MAS re-centered its exchange rate band most recently in April to ease inflationary pressures (Chart 2)). Looking ahead, we expect inflation pressures in Hong Kong to continue increasing into Q3, while we believe inflation in Singapore has already reached its peak. For the whole year 2011, we expect average inflation for Hong Kong and Singapore of 5.2% and 4.1%, respectively, and the year-end inflation to reach 4.8% y/y and 3.0% y/y, respectively.

Japan: disappointing post-quake data likely to give way to a rebound

Japan's export data for May released this past week further underlines the severity of the impact of the disruption of supply chains and power shortages caused by the March 11 earthquake. Specifically, exports fell by -10.3% (y/y) in May, worse than the market expectation of -8.4%, y/y. The trade balance suffered a second straight monthly deficit, of ¥854 billion (or US\$10.7 billion) in May. Worst hit has been the auto sector, with car exports plunging in May by -38.9% (y/y), and shipments of auto parts dropping by -18.5% (y/y). Nevertheless, the overall export outturn is an improvement from April's decline (-13.0% y/y). A recovery of industrial production (especially in the auto sector), improving consumer sentiment and other positive signs of improving supply chains point to a quicker-than-expected rebound. Therefore, Japan's economy and the fall of exports are likely to have bottomed out. We expect reconstruction spending to provide a further boost to Japan's growth in the second half of 2011. In line with this, on June 20 Japan's government upgraded its assessment of the economy for the first time in four months, following the Bank of Japan's upgrading earlier this month.

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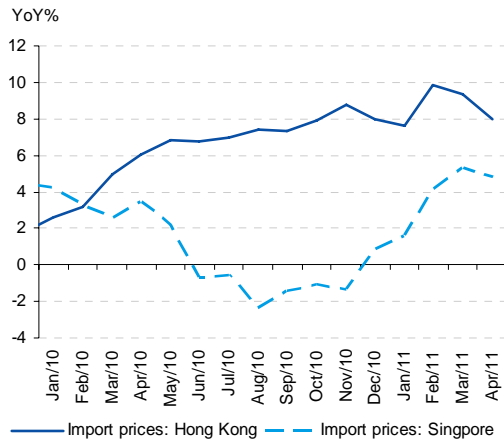
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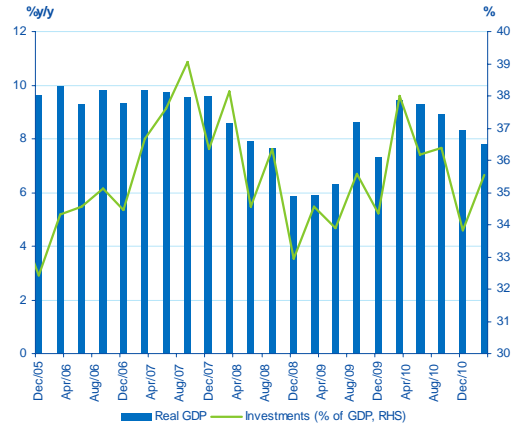
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Chart 5
Chart 2: Currency appreciation in Singapore has helped to limit imported inflation



Source: BBVA Research and Bloomberg

Chart 6
India's rapid GDP growth to be sustained by further increases in investment under the next 5-year Plan



Source: BBVA Research and Bloomberg

Calendar Indicators

China	Date	Period	Prior	Cons.
PMI Manufacturing	1-Jul	JUN	52	51.5
Hong Kong	Date	Period	Prior	Cons.
Exports YoY%	28-Jun	MAY	4.10%	3.5%
Imports YoY%	28-Jun	MAY	6.1%	7.5%
Indonesia	Date	Period	Prior	Cons.
Inflation (CPI) (YoY)	1-Jul	JUN	5.98%	--
Exports (YoY)	1-Jul	MAY	37.3%	--
Total Imports (YoY)	1-Jul	MAY	32.5%	--
India	Date	Period	Prior	Cons.
Current Account Balance	30-Jun	1Q	-\$9.7B	--
Exports YoY%	1-Jul	MAY	34.4%	--
Imports YoY%	1-Jul	MAY	14.1%	--
Japan	Date	Period	Prior	Cons.
Retail Trade YoY	28-Jun	MAY	-4.8%	-2.1%
Industrial Production (MoM)	29-Jun	MAY P	1.6%	5.5%
Vehicle Production (YoY)	30-Jun	MAY	-60.1%	--
Inflation (CPI) YoY	1-Jul	MAY	0.3%	0.1%
Vehicle Sales (YoY)	1-Jul	JUN	-38.0%	--
Housing Starts (YoY)	30-Jun	MAY	0.3%	3.5%
Overall Hhold Spending (YoY)	1-Jul	MAY	-3.0%	-1.8%
Philippines	Date	Period	Prior	Cons.
Total Imports (YoY)	28-Jun	APR	21.2%	--
Korea	Date	Period	Prior	Cons.
Industrial Production (MoM)	30-Jun	MAY	-1.5%	0.8%
Inflation (CPI) (YoY)	1-Jul	JUN	4.1%	4.3%
Ext Trade - Export (YoY)	1-Jul	JUN	23.5%	17.6%
Ext Trade - Imports (YoY)	1-Jul	JUN	29.9%	32.5%
South Korea FDI (YoY)	01-06 JUL	2Q	30.1	--
Thailand	Date	Period	Prior	Cons.
Total Exports YOY%	30-Jun	MAY	24.7%	--
Total Imports YOY%	30-Jun	MAY	26.3%	--
Inflation (CPI) (YoY)	1-Jul	JUN	4.19%	4.20%
Vietnam	Date	Period	Prior	Cons.
Exports YTD (YoY)	23-28 JUN	JUN	32.8%	--
Imports YTD (YoY)	23-28 JUN	JUN	29.7%	--
GDP Constant Prices YTD (YoY)	27-30 JUN	2Q	5.4%	--
Industrial Output YTD (YoY)	27-30 JUN	JUN	14.2%	--
Retail Sales YTD (YoY)	27-30 JUN	JUN	22.5%	--

Indicator of the Week: PMI for June (July 1)

Forecast: 51.6

Consensus: 51.5

Prior: 52.0

Comment: We expect the Purchasing Managers' Index (PMI) to ease for a third consecutive month in June as economic activity continues to moderate on the authorities' monetary tightening measures. Nevertheless, the outturn should remain well within the +50 expansion zone, allaying concerns of a hard landing. Market impact: A lower-than-expected reading could exacerbate worries of a hard landing, while the opposite would intensify expectations of further monetary tightening.

Calendar Events

Taiwan - Benchmark Interest Rate, June 30

We expect a hike of 12.5 bp in the interest rate

Current Expected

1.75% 1.875%

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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.	2729.9	3.3	-2.8	6.4
	Hong Kong - Hang Seng	22067.9	1.7	-4.2	6.4
	Taiwan - Weighted	8527.1	-1.3	-5.0	12.3
	Japan - Nikkei 225	9631.4	3.0	-5.8	-3.0
	Korea - Kospi	2077.8	2.3	1.3	19.4
	India - Sensex 30	17883.2	0.1	-12.8	0.9
	Australia - SPX/ASX 200	4506.8	0.5	-5.0	0.6
	Singapore - Strait Times	3058.2	1.8	-4.1	7.4
	Indonesia - Jakarta Comp	3832.4	3.0	3.5	31.5
	Thailand - SET	1013.5	-0.5	-1.9	27.8
	Malaysia - KLCI	1563.5	0.0	2.9	17.9
	Philippines - Manila Comp.	4289.0	3.3	2.1	28.6

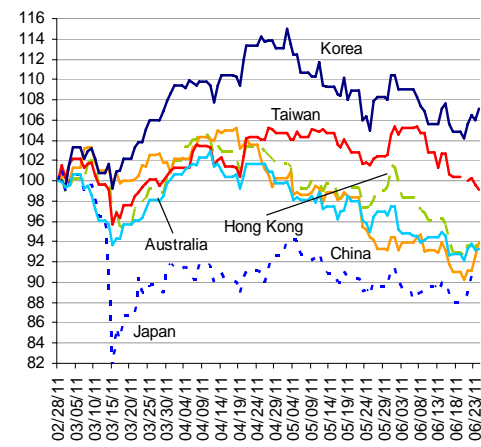
Last update: Friday, 11.15 Hong Kong time.

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.47	0.06	6.45	6.39
	Hong Kong (HKD/USD)	7.79	0.04	7.8	8
	Taiwan (TWD/USD)	28.9	0.25	28.72	28.17
	Japan (JPY/USD)	80.5	-0.53	80.4	80.1
	Korea (KRW/USD)	1077	0.79	1083.20	1096.40
	India (INR/USD)	45.0	-0.19	45.6	47
	Australia (USD/AUD)	1.05	-0.88	1	n.a.
	Singapore (SGD/USD)	1.24	-0.12	1.24	1.2
	Indonesia (IDR/USD)	8603	0.06	8698	9016
	Thailand (THB/USD)	30.7	-0.39	30.83	31.3
	Malaysia (MYR/USD)	3.04	0.27	3.0	3
	Philippines (PHP/USD)	43.4	0.73	43.59	43.81

Last update: Friday, 11.15 Hong Kong time.

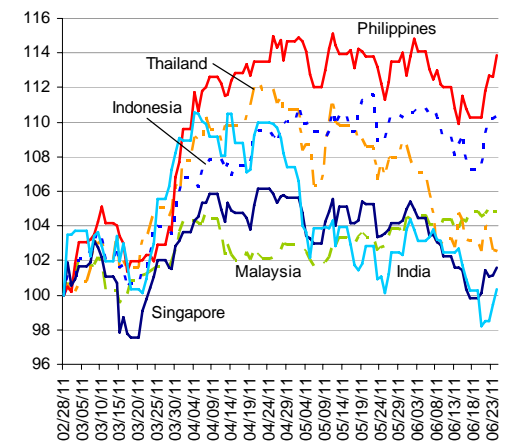
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Chart 7
Stock Markets



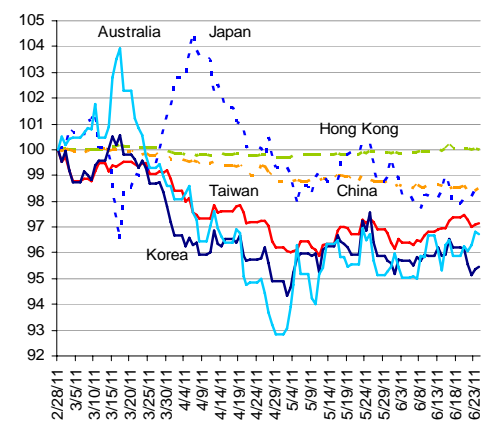
Source: BBVA Research and Bloomberg

Chart 8
Stock Markets



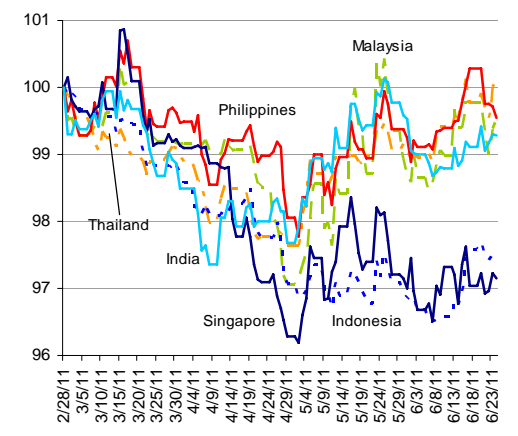
Source: BBVA Research and Bloomberg

Chart 9
Foreign Exchange Markets



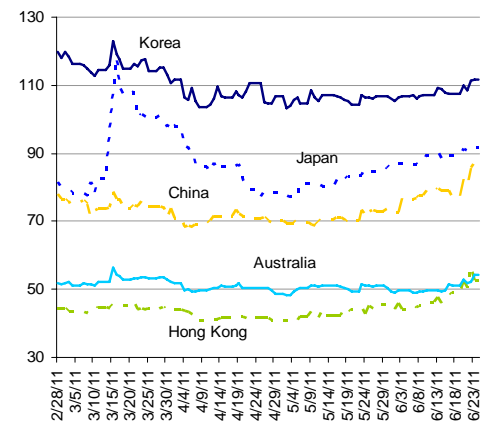
Source: BBVA Research and Bloomberg

Chart 10
Foreign Exchange Markets



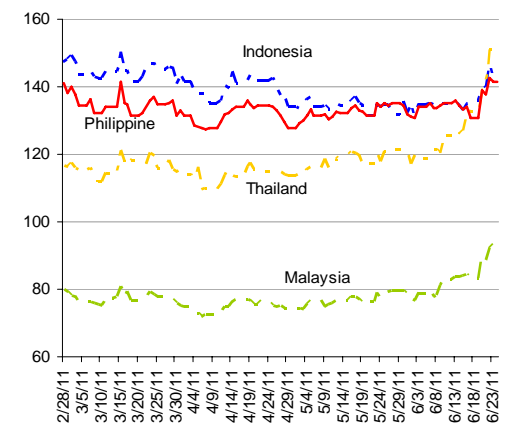
Source: BBVA Research and Bloomberg

Chart 11
Credit Default Swaps



Source: BBVA Research and Bloomberg

Chart 12
Credit Default Swaps



Source: BBVA Research and Bloomberg

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