

# Weekly Watch

## Asia

8 July 2011  
Economic Analysis

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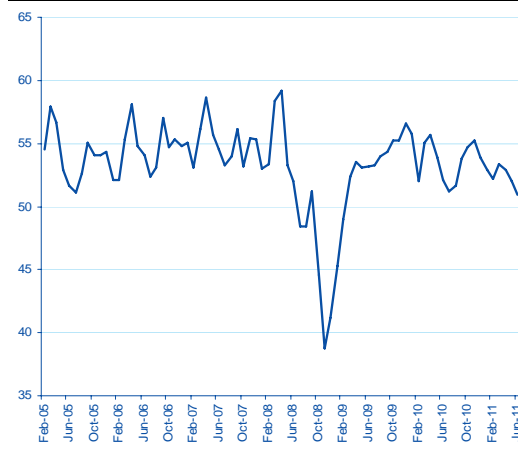
## All eyes on China's June data

China is scheduled to release important monthly and quarterly economic indicators in the coming days (Highlights and Calendar). The data, which include inflation and second quarter GDP, are of special interest given concerns of overheating and inflation on the one hand (we expect inflation to peak in June at 6.1%), and a hard landing on the other (June PMI was weaker than expected, Chart 1). To show its commitment to containing inflation, the China's central bank (PBoC) announced another interest rate hike this past week (Chart 2), which some observers believe may be the last rate increase in the current tightening cycle—in contrast, we expect one more rate hike during the remainder of the year given still-strong underlying growth momentum.

### Inflation remains a concern, though still manageable

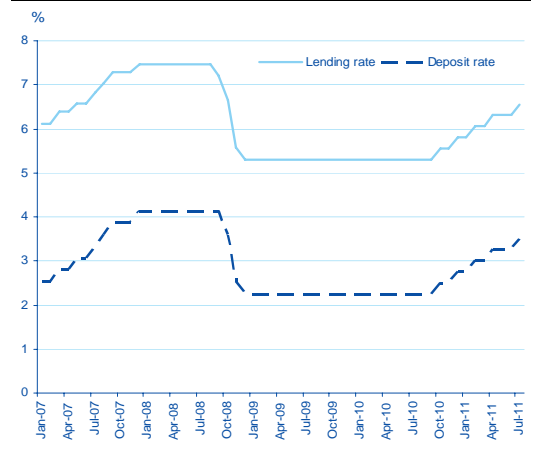
Australia's RBA stood pat at their monthly monetary policy meeting on July 5 (see Highlights) on indications that inflation will remain within their 2-3% target range. Malaysia did the same, although we expect further rate hikes from both central banks during the year. Taiwan, meanwhile, raised rates as expected last week, followed by the release of June inflation that was slightly higher than expected (1.93% y/y; consensus: 1.75), although Taiwan continues to run the lowest inflation rate in emerging Asia (Highlights). In Thailand, markets rallied this past week following a landslide victory of the Pheu Thai party of Yingluck Shinawatra. Other than the data on China, markets will focus on Singapore's advance Q2 GDP and India's June inflation. Central banks in Korea, Indonesia, and Thailand will hold monetary policy meetings, and we expect all three to stay on hold (Calendar).

Chart 1  
PMI readings continue to moderate...



Source: BBVA Research and Bloomberg

Chart 2  
... while China hikes rates again to tame inflation



Source: BBVA Research and Bloomberg

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## Highlights

### China: Q2 and June data to shed light on the pace of growth and inflation

Markets will be watching for the new data for further signs of a soft landing

### Taiwan hikes interest rates on rising inflation

Despite having the region's lowest inflation, Taiwan's central bank continues to tighten

### Australia's economic outlook brightens on new employment data

After a weak first quarter, there are signs that Australia's economy may pick up

Economic Analysis

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## Markets

Asian markets saw relief rallies following the decision to disburse the next tranche of IMF bailout funds to tide Greece over for the summer, and on positive economic news from the US. But trading remained choppy throughout the week due to proactive action taken by Moody's over Portugal's debt rating.

### Debt spillover from Greece to Portugal again

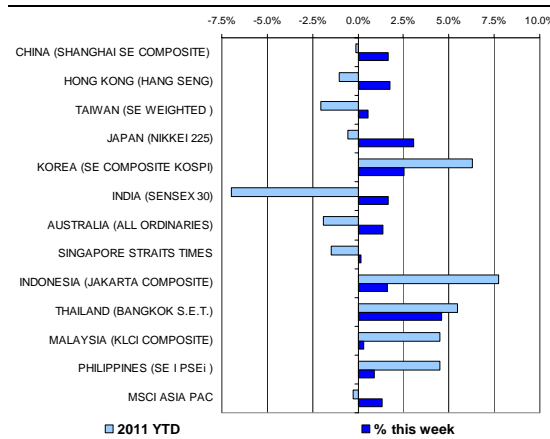
The road to arrive at a satisfactory second bailout package to Greece is still rocky. Part of the problem is that EU leaders tried to get the private sector to shoulder the costs of the bailout to alleviate moral hazard problems in future. The proposal by the French banking association to swap Greece debt maturing in three years into long-dated debt originally enlisted support from German banks and gained traction in the whole discussion. But this week S&P said they would treat such a proposal as a selective default, throwing into question the feasibility of the proposal. Other rating agencies have not weighed in, and it is still uncertain whether the ECB would stop accepting Greek debt as collateral in the presence of selective default rating by one rating agency. Nevertheless, the news highlights the possibility of deferring the second bailout package beyond July. Meanwhile, concerns about Portugal escalated after Moody's downgraded its sovereign rating by four notches. The worries eased somewhat Friday after ECB said it would suspend the collateral rules for Portugal, but there remain mounting concerns of further rating agency action on banks and corporation in Portugal and potential spillover to Ireland.

### Asian markets become less responsive to European news

While mounting uncertainties in Europe continue, investors in Asia seem to have become less sensitive to peripheral debt news and more responsive to global growth reports, especially those from the US. A better-than-expected ISM outturn and stronger job figures in the US offset negatives from Europe and sent risk assets in Asia higher compared to the previous Friday close. Muted responses to European negatives helped Asian FX outperform their rich peers in Western Europe in the past week amidst choppy markets.

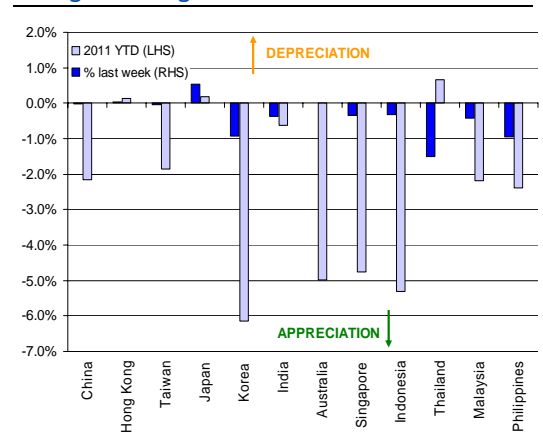
Asian markets appear to have focused on US and China rather than Europe in our view, as most Asian economies are resilient to debt contagion risks from Europe given their strong macro fundamentals. On the other hand, Asia is more vulnerable to a potential global slowdown given its openness. To-date, central banks in the region still put emphasis on inflation rather than growth, as highlighted by the PBoC's rate hike on Wednesday. Over the medium-term, growth dynamics in Asia still look far superior to developed countries. As such, Asian FX still looks appealing to long as long as global growth remains on track. While further signs of US job improvement and China's growth resilience may sustain the rallies, Asian currencies have approached multi-year highs and may run into central bank intervention soon. Additionally, our US economists continue to expect the Fed to hike rates early next year, and the preparation for an exit from monetary stimulus could limit the scope for further Asian FX gains.

Chart 3  
Stock markets



Source: BBVA Research and Bloomberg

Chart 4  
Foreign exchange markets



Source: BBVA Research and Bloomberg

## Highlights

### China: Q2 and June data to shed light on the pace of growth and inflation

Amidst the debate on whether its economy is over-heating or slowing too fast, China is scheduled to release a stream of important economic indicators in the coming days (see calendar). In particular, the data will include Q2 GDP and foreign exchange reserves, along with June inflation, investment, and trade, among other activity and financial indicators. These indicators will be key inputs for the authorities' fine-tuning of their macro policy stance and will be watched by markets for signals of future monetary policy tightening. We expect Q2 GDP to grow by 9.5% y/y, in line with a gradual slowdown from the 9.7% growth in Q1 (see Indicator of the week for details). Supporting the likelihood of a slowdown is the latest PMI figure which was released earlier this week, and which has declined for three consecutive months. The moderation for June was larger than expected and was across the board, with production, employment, purchase for input materials, and new orders all falling. Despite the slowing PMI, the central bank raised interest rates again this past week (July 6), the fifth such move since last October, as it seeks to rein in inflation. We expect June inflation to peak at 6.1% y/y from 5.5% in May, before declining during the remainder of the year. Our baseline is for one more rate hike and one more hike in the required reserve ratio during the remainder of the year, in contrast to many analysts who believe that the central bank may have finished raising interest rates in view of weaker growth indicators.

### Taiwan hikes interest rates on rising inflation

While Taiwan continues to record the region's lowest inflation rates (outside of Japan), the central bank has been acting to ward of rising pressures by raising (or "normalizing") interest rates. At its quarterly policy meeting on June 30, Taiwan's central bank (CBC) raised its policy rates by another 12.5 basis points, as we expected, from 1.75% to 1.875%, the fifth consecutive hike since last year (a cumulative 62.5 basis points). In its statement, the CBC said it is maintaining the pace of interest rate hikes to help anchor inflation expectations. The move came just ahead of the release of June CPI data, showing an increase in inflation to 1.93% y/y, the highest level in 16 months, and above expectations (consensus: 1.75% y/y). Core inflation, meanwhile, remains more subdued at 1.23% y/y from 1.18% y/y in May. The increase in headline inflation was caused mainly by rising food prices, spurred by a spike in fruit prices of 21.3% y/y following a health scare (over contaminated sports drinks and fruit beverages). Beyond this, inflationary pressures are rising gradually on higher raw materials prices. Economic activity has been brisk over the past year, with GDP rebounding by a stunning 10.9% in 2010 from a contraction the previous year during the global financial crisis. More recently, growth has moderated, as elsewhere in the region, with Q1 GDP expanding by 6.55% y/y and activity indicators such as exports and industrial production weakening in Q2, in part because of supply disruptions from Japan on which Taiwan is heavily dependent for imported components. With growth expected to pick up during the second half of the year, we still expect the CBC to continue normalizing interest rates during the remainder of the year. Our end year inflation forecast is 1.7%, and we expect full-year GDP growth of 4.8%.

### Australia's economic outlook brightens on new employment data

Australia's economy has been slowing in recent months, following the severe floods of December/January in Queensland which disrupted production and mining activities. In addition, domestic demand has been weakening with consumer spending and credit registering sluggish growth during the first half year, despite strong commodity exports which make up a large share of the economy. First quarter GDP contracted by 1.2% (q/q, s.a.), on the impact of the Queensland floods. That said, incoming indicators suggest that the economy should rebound in the second half of the year, boosted by flood reconstruction investment and a post-earthquake rebound in Japan. Encouragingly, employment creation in June rose by 23 thousand, well above market expectations (15 thousand), and the unemployment rate remained unchanged at a relatively low 4.9%. At its latest monthly monetary policy meeting on July 5, the RBA held its policy rate unchanged at 4.75%, given its outlook that inflation will remain within the official target range of 2-3%. Although the weak growth indicators have led many market observers to expect no rate hikes, or even an easing of monetary policy in the months ahead, given our growth projections--2.3% and 3.8% respectively for 2011-12--we continue to anticipate one more 25bp rate hike in 2011, probably in the RBA's coming meeting in August or November. Australia began hiking interest rates well ahead of other central banks in the region in late 2009, for a cumulative 175bps to date.

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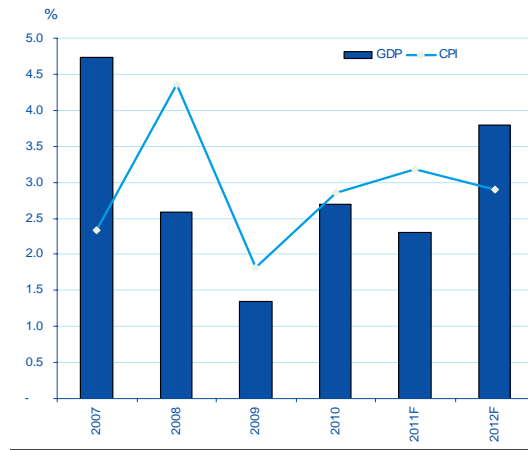
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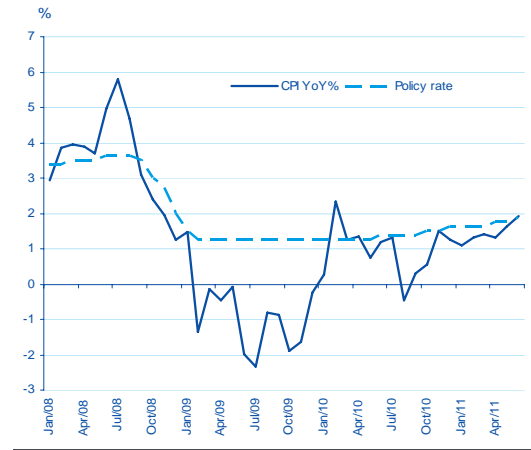
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Chart 5  
**Australia's GDP growth is expected to rebound**



Source: BBVA Research and Bloomberg

Chart 6  
**Taiwan's central bank is raising interest rates to keep inflation expectations in check**



Source: BBVA Research and Bloomberg

## Calendar Indicators

China	Date	Period	Prior	Cons.
Producer Price Index (YoY)	9-Jul	JUN	6.80%	6.90%
Consumer Price Index (YoY)	9-Jul	JUN	5.50%	6.20%
Trade Balance (USD)	10-Jul	JUN	\$13.05B	\$14.20B
Exports YoY%	10-Jul	JUN	19.40%	18.60%
Imports YoY%	10-Jul	JUN	28.40%	25.30%
Actual FDI (YoY)	10-15 JUL	JUN	13.40%	--
Industrial Production (YoY)	13-Jul	JUN	13.30%	13.10%
Real GDP (YoY)	13-Jul	2Q	9.70%	9.30%
Retail Sales (YoY)	13-Jul	JUN	16.90%	17.00%
New Yuan Loans	14-15 JUL	JUN	551.6B	622.5B
Money Supply - M2 (YoY)	14-15 JUL	JUN	15.10%	15.30%
India	Date	Period	Prior	Cons.
Industrial Production YoY	12-Jul	MAY	6.30%	8.90%
Monthly Wholesale Prices YoY%	14-Jul	JUN	9.06%	9.40%
Japan	Date	Period	Prior	Cons.
Japan Money Stock M2 YoY	11-Jul	JUN	2.70%	2.70%
Machine Tool Orders (YoY)	11-Jul	JUN P	34.00%	--
Malaysia	Date	Period	Prior	Cons.
Industrial Production YoY	11-Jul	MAY	-2.20%	-1.20%
Manufacturing Sales Value YoY%	11-Jul	MAY	15.50%	--
Philippines	Date	Period	Prior	Cons.
Total Exports (YoY)	12-Jul	MAY	19.10%	4.50%
Overseas Remittances (YoY)	15-Jul	MAY	6.30%	--
Singapore	Date	Period	Prior	Cons.
Advance GDP Estimate (YoY)	14-Jul	2Q P	8.30%	0.70%
Retail Sales (YoY)	15-Jul	MAY	8.10%	4.60%
Korea	Date	Period	Prior	Cons.
South Korea FDI (YoY)	11-15 JUL	2Q	30.1	--
Unemployment Rate (SA)	13-Jul	JUN	3.30%	3.50%
Export Price Index (YoY)	15-Jul	JUN	3.30%	--
Import Price Index (YoY)	15-Jul	JUN	13.20%	--
Vietnam	Date	Period	Prior	Cons.
Domestic Vehicle Sales (YoY)	06-12 JUL	JUN	--	--

### Indicator of the Week: China Q2 GDP (July 15)

Forecast: 9.5% y/y

Consensus: 9.3% y/y

Prior: 9.7% y/y

**Comment:** The Q2 GDP outturn will be closely watched for signs of a "soft-landing", along with a batch of accompanying monthly activity indicators and inflation for June. The authorities have continued to tighten monetary policy to slow credit growth and rein in inflation, including another rate hike this past week (the fifth since October). We anticipate Q2 GDP to moderate, based on recent high frequency indicators showing a healthy slowdown. **Market impact:** A weaker-than-expected reading could aggravate market fears of a hard landing, while a stronger-than-expected outturn could raise expectations of further monetary tightening.

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## Calendar Events

### Indonesia - Bank Indonesia Reference Rate, July 12

We expect no change in the interest rates

Current	Expected
6.75%	6.75%

### Japan - BOJ Target Rate, July 12

We expect no change in the interest rates

Current	Expected
0.10%	0.10%

### Thailand - Benchmark Interest Rate, July 13

We expect no change in the interest rates

Current	Expected
3.00%	3.00%

### Korea - South Korea 7-Day Repo Rate, July 14

We expect no change in the interest rates

Current	Expected
3.25%	3.25%

## Markets Data

STOCK MARKETS	INDEX	Last price	% change over a week	Year to date	% Change over 1 Y
	China - Shanghai Comp.	2800.1	1.5	-0.3	15.9
	Hong Kong - Hang Seng	22782.2	1.7	-1.1	13.6
	Taiwan - Weighted	8770.9	0.4	-2.2	15.3
	Japan - Nikkei 225	10158.9	2.9	-0.7	6.5
	Korea - Kospi	2180.5	2.6	6.3	28.4
	India - Sensex 30	19087.2	1.7	-6.9	8.1
	Australia - SPX/ASX 200	4651.3	1.3	-2.0	6.8
	Singapore - Strait Times	3146.0	0.2	-1.4	8.6
	Indonesia - Jakarta Comp	3994.1	1.7	7.8	37.0
	Thailand - SET	1088.2	4.5	5.4	33.1
	Malaysia - KLCI	1587.6	0.3	4.5	20.6
	Philippines - Manila Comp.	4388.7	0.9	4.5	29.2

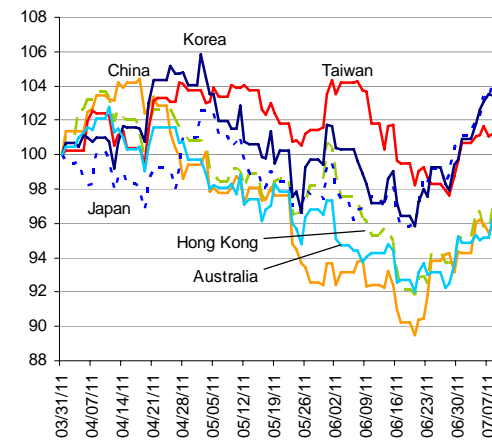
Last update: Thursday, 11:15 Hong Kong time.

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.46	0.01	6.45	6.39
	Hong Kong (HKD/USD)	7.78	-0.03	7.8	8
	Taiwan (TWD/USD)	28.8	0.03	28.60	28.08
	Japan (JPY/USD)	81.3	-0.53	81.2	80.9
	Korea (KRW/USD)	1057	0.92	1063.39	1075.60
	India (INR/USD)	44.4	0.62	44.7	46
	Australia (USD/AUD)	1.08	0.00	1	n.a.
	Singapore (SGD/USD)	1.22	0.34	1.22	1.2
	Indonesia (IDR/USD)	8518	0.34	8578	8866
	Thailand (THB/USD)	30.3	1.52	30.39	30.8
	Malaysia (MYR/USD)	3.00	0.41	3.0	3
	Philippines (PHP/USD)	42.8	0.97	42.86	43.07

Last update: Thursday, 11:15 Hong Kong time.

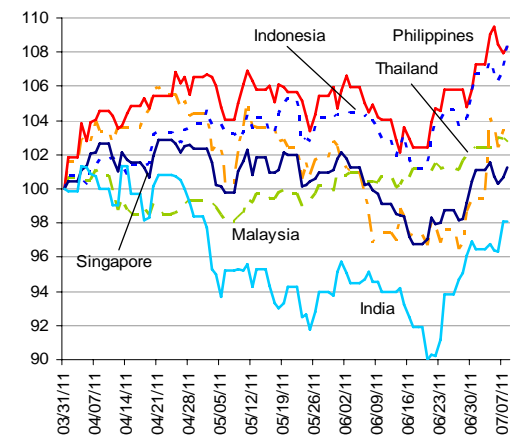
## Charts

Chart 7  
Stock Markets



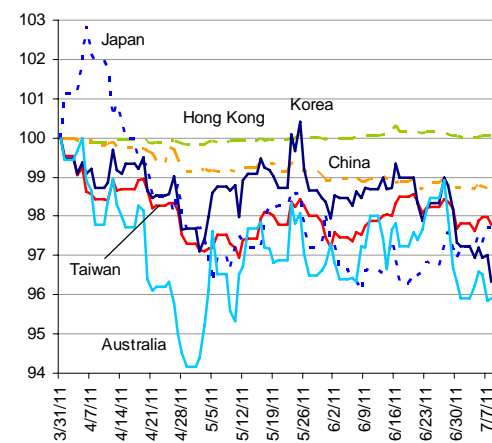
Source: BBVA Research and Bloomberg

Chart 8  
Stock Markets



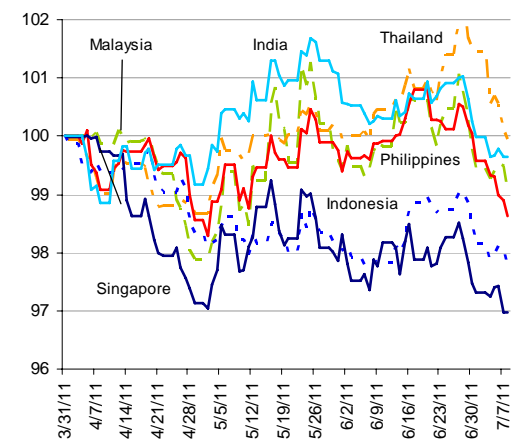
Source: BBVA Research and Bloomberg

Chart 9  
Foreign Exchange Markets



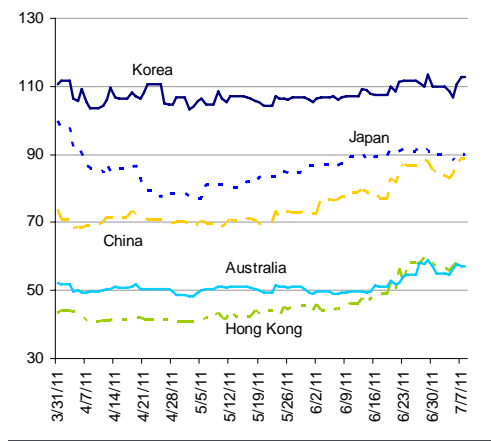
Source: BBVA Research and Bloomberg

Chart 10  
Foreign Exchange Markets



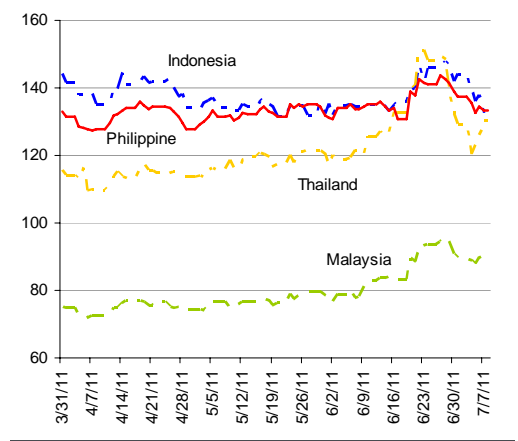
Source: BBVA Research and Bloomberg

Chart 11  
Credit Default Swaps



Source: BBVA Research and Bloomberg

Chart 12  
Credit Default Swaps



Source: BBVA Research and Bloomberg

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