

Weekly Watch

Asia

26 August 2011
Economic Analysis

Asia

Stephen Schwartz
stephen.schwartz@bbva.com.hk

Mario Nevares
mario.nevares@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

Claire Chen
claire.chen@bbva.com.hk

Jeffrey Cantwell
jeffrey.cantwell@bbva.com.hk

Markets
Richard Li
richard.li@bbva.com.hk

Jeffrey Cantwell
jeffrey.cantwell@bbva.com.hk

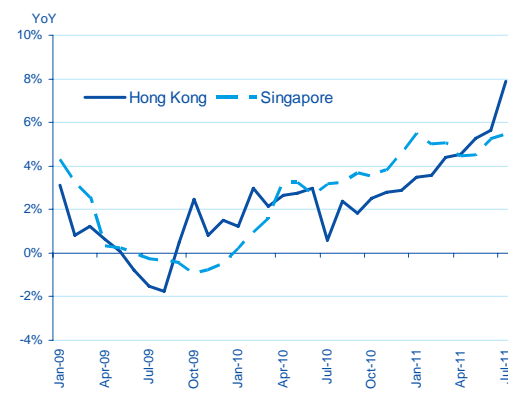
Activity slows as inflation rages on

Markets across the region are no longer in free-fall, as risk aversion eases and investors await the Fed Chairman's speech at Jackson Hole (see Markets). While financial markets continue to take their cues from overseas, we remain optimistic that Asian growth will resume as momentum in China continues to propel regional demand. A downgrade of Japan's sovereign credit rating this week by Moody's has been largely shrugged off, as it was anticipated and reflects catch up with S&P and Fitch, although the political outlook is uncertain following the resignation of Prime Minister Kan. Activity indicators are showing further signs of a slowdown, in some cases below expectations (see below), although domestic demand remains resilient. At the same time, however, inflation outturns are above expectations, posing a dilemma for central banks as downside risks to growth increase.

A big data week coming up

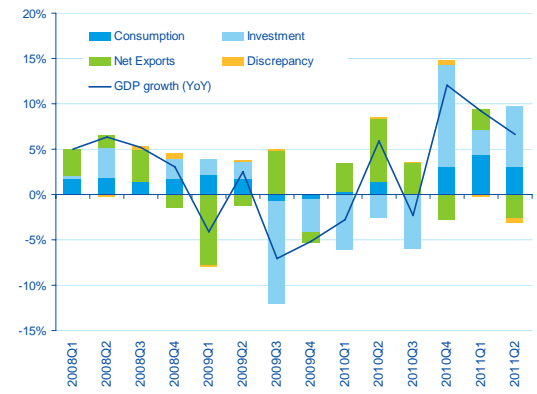
A few important data releases came out this week, including second quarter GDP in Thailand (see Highlights), inflation in Singapore (5.4% y/y; consensus: 5.0%), Hong Kong (7.9% y/y; consensus: 8.2%) (Chart 1), and Vietnam (23.0% y/y, prior: 22.2%), and industrial production in Taiwan (3.9% y/y; consensus: 5.4%), and Singapore (7.4% y/y; consensus: 7.8%). For the most part, the trends we have seen in recent months remain intact, namely slowing growth with rising inflation (especially in Vietnam where macro stability remains at risk). Much more important data will be released next week. In particular, markets will be watching China's PMI (see Weekly Indicator), activity indicators in Japan, GDP in India and the Philippines, and August inflation in Korea and Thailand. We expect activity indicators to show resilience, especially in China where we forecast an upturn in the August PMI, and in Japan where the post-earthquake recovery continues.

Chart 1
Inflation rises in Hong Kong and Singapore



Source: CEIC and BBVA Research

Chart 2
Thai's 2Q GDP slows on Japan supply disruptions



Source: CEIC and BBVA Research

Markets →

Highlights →

Calendar →

Markets Data →

Charts →

Highlights

China unveils measures to support Hong Kong's role as a financial center

The measures are in line with the gradual opening of China's capital markets

Hong Kong: smooth sailing for now, with some challenges ahead

Slowing growth is helping to alleviate overheating pressures, but inflation remains high

Thailand: slowing second quarter GDP

The newly elected government faces challenges in fulfilling promises and sustaining growth

Economic Analysis

Richard Li
richard.li@bbva.com.hk

Jeffrey Cantwell
jeffrey.cantwell@bbva.com.hk

Markets

Equity markets are up slightly from last week, but market participants are continuing to lower expectations for global growth as they await Friday's Jackson Hole speech by the Federal Reserve Chairman. Fears of a potentially severe slowdown may be somewhat premature, after better-than-expected PMI outturns for August in Europe (51.1) and China (Flash HSBC PMI 49.8). Asian FX finished the week mixed as investors wait for more clarity on the macro environment.

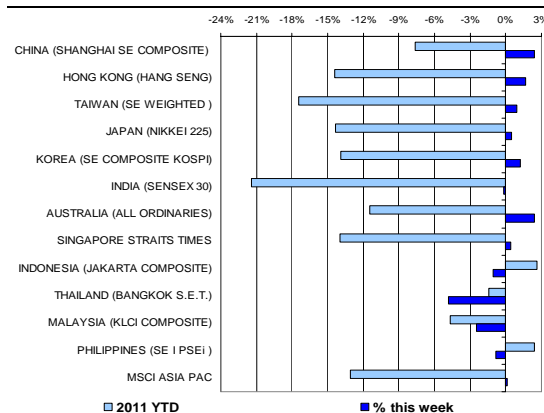
Moody's downgrades Japan

On Wednesday, Moody's downgraded Japan's sovereign rating from Aa2 to Aa3, placing Japan on the same level as China. Moody's decision was based on Japan's large budget deficits and elevated debt-to-GDP ratio, along with its challenging domestic outlook given weak economic growth and high post-earthquake reconstruction costs. The market response was muted as Moody's decision was not a surprise, and simply brought its rating in line with S&P and Fitch; nevertheless, the yen weakened towards the end of the week to 77.31, down 1% as expectations of the imminent resignation of Japan's Prime Minister mounted. The yen's strong level is placing pressure on Japanese exporters and poses a challenge, on top of the balancing act of trying to reduce the country's deficit against an economy that has contracted for three straight quarters. Already we have seen the government enacting new measures such as a US\$100 million credit facility designed to promote overseas purchases by Japanese companies, in an effort to support businesses harmed by the yen's strength.

Singapore's conundrum

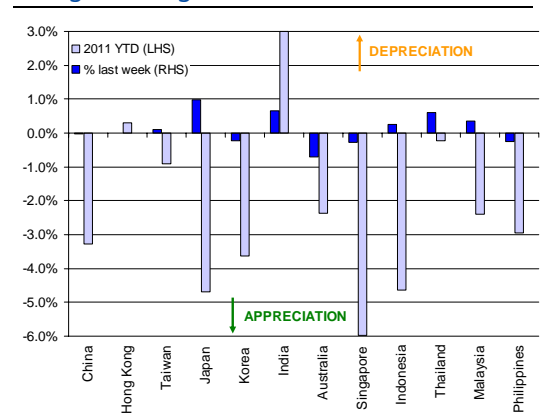
Inflation in Singapore rose to 5.4% yoy in July, which was both above the consensus (5.2%) and the Monetary Authority of Singapore's (MAS) target range of 4%-5%. The markets are considering the implications of this outturn in terms of how the Monetary Authority will respond in their next policy meeting, scheduled for October. The MAS conducts its monetary policy by adjusting the SGD NEER, and given inflation has remained elevated since 2010, it has been allowing the currency to appreciate. The SGD has strengthened 6.4% versus the dollar year-to-date to 1.20 SGD/USD, and has been Asia's best performing currency. Singapore is Asia Pacific's sole country that currently receives top ratings from Moody's, S&P and Fitch, and inflows to the region have been high as investors flock to higher-quality risk assets. Given concerns over global growth and Singapore's reliance on exports, the MAS will have to decide whether to allow the SGD to appreciate further. Our view is that given the openness of Singapore's economy and its susceptibility to a potential global slowdown, the MAS will turn its focus to growth over inflation. Therefore we think it is likely the MAS will adopt a wait-and-see approach in regards to further appreciation.

Chart 3
Stock markets



Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets



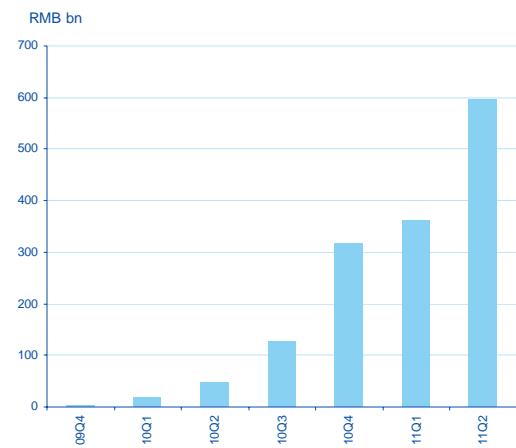
Source: BBVA Research and Bloomberg

Highlights

China unveils measures to support Hong Kong's role as a financial center

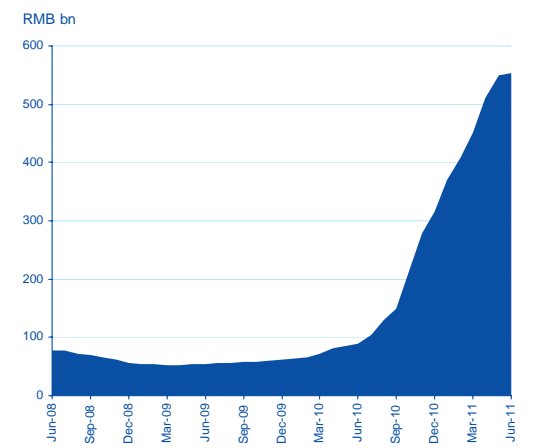
China's vice-premier Li Keqiang, the presumed successor to China's current Prime Minister Wen Jiabao, concluded a high-profile visit to Hong Kong last week with the unveiling of more than 30 separate measures to boost Hong Kong's economy and accelerate the internationalization of the RMB. The key elements included: (i) a promise to open China's domestic service sector to Hong Kong firms, within the existing framework of the Closer Economic Partnership Arrangement (CEPA); (ii) implementation of a pilot "mini-QFIII" scheme to allow Hong Kong firms to invest offshore RMB (up to RMB20bn as an initial overall quota) in China's domestic stock market; and (iii) allowing mainland investors to purchase Hong Kong equities via an exchange-traded fund (ETF) listed in Shenzhen or Shanghai, expected to be in place by the end of this year. Details such as the precise timing and coverage of these proposals have yet to be announced. Taken together, the new proposals are expected to facilitate Hong Kong's economic integration with China and strengthen Hong Kong's role as the center of international asset management and offshore RMB business (Charts 5 and 6). Indeed, Hong Kong's stock market rose briefly on the announcement. Nevertheless, we do not expect the proposals to be implemented with a "big bang", given the Chinese authorities' preference for gradualism, meaning that near term benefits to Hong Kong will be limited.

Chart 5
RMB transactions across the border rise...



Source: CEIC and BBVA Research

Chart 6
... as RMB deposits continue to soar



Source: BBVA Research and CEIC

Hong Kong: smooth sailing for now, with some challenges ahead

Recent activity and price indicators in Hong Kong point to slowing growth with rising inflation. However, these outturns so far are broadly in line with our expectations, and are consistent with our full-year GDP growth projection of 5.0% for 2011 and end-year inflation of 5.2%. Moreover, the slowdown so far has helped alleviate, but not yet eliminate, overheating pressures. Second quarter GDP (released on August 12) slowed to 5.1% y/y, a decline of -0.5% q/q seasonally adjusted, from 7.5% y/y in Q1. This outturn was in line with our expectations (BBVA: 5.0% y/y, -0.3% q/q) but was well below the consensus forecast. The Q2 slowdown reflected a weakening of net exports, which were adversely affected by supply disruptions in Japan as well as sluggish external demand; indeed, just-released July export growth, of 9.2% y/y, was below consensus (14.2% y/y). On the other hand, domestic demand remained strong underpinned by steady consumption and investment. The unemployment rate for May remained at 3.4%, well below recent historical averages, indicating still-tight labor market conditions. Meanwhile, inflation accelerated further in July to 7.9% y/y from 5.6% y/y in June (Chart 7), but most of the jump reflected base effects (last year's price level in July was unusually low because of the government's public rental waiver that month). In asset markets, the stock market has recently slumped in line with global trends, while the property market has lost some of its momentum following previous tightening measures and global financial uncertainty. While our outlook for Hong Kong's growth remains positive in view of

Home →

Markets →

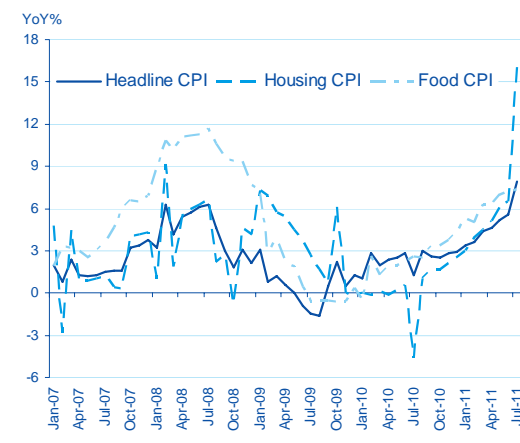
Calendar →

Markets Data →

Charts →

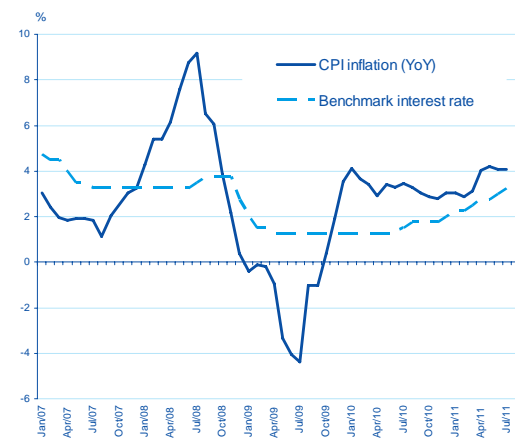
our expectations that global growth will remain on track, downside risks have increased. Given Hong Kong's openness, the economy remains vulnerable to a slowdown in external demand, and the authorities will need to stay vigilant to respond with supportive fiscal policies to support growth if needed.

Chart 7
Inflation rises in Hong Kong (due mostly to base effects)



Source: CEIC and BBVA Research

Chart 8
The Bank of Thailand continues raising interest rates



Source: CEIC and BBVA Research

Thailand: slowing second quarter GDP adds to challenges

Thailand has officially joined the ranks of other slowing Asian economies, with second quarter GDP coming in at a slower-than-expected 2.6% y/y (consensus: 3.6%), from 3.0% y/y in the previous quarter (chart 2). Much of the slowdown was attributed to the impact of supply disruptions in Japan, given Thailand's heavy reliance on imported components, especially in the auto sector. Despite the slowdown and rising downside risks to the global environment, the Bank of Thailand this week moved to raise interest rates for a 7th consecutive time, to 3.5% (chart 8) as it seeks to contain core inflation to within the official target range of 0.5%-3.0% (current core inflation is 2.8% and headline is at 4.1%). We believe the BoT will stay on hold now through the rest of the year, and the authorities emphasized that the latest hike may mark the last for some time. We expect Thailand's economy to grow by 3.8% this year, after last year's strong growth of 7.8%. In the meantime, slowing growth could pose a challenge for the newly elected government of Yingluck Shinawatra. Shinawatra's populist pledges during her campaign could result in a sharp increase in the fiscal deficit. Such measures are likely to include an increase in the minimum wage, cuts in corporate taxes, and support programs to rice farmers. The latter may result in higher export rise prices, with regional implications for inflation given that Thailand is currently the world's largest rice exporter.

Calendar Indicators

Australia	Date	Period	Prior	Cons.
Building Approvals (YoY)	30-Aug	JUL	-15.50%	--
Retail Sales s.a. (MoM)	1-Sep	JUL	-0.10%	--
China	Date	Period	Prior	Cons.
Industrial Profits YTD (YoY)	27-Aug	JUL	28.70%	--
PMI Manufacturing	1-Sep	AUG	50.7	51
HSBC Manufacturing PMI	1-Sep	AUG	49.3	--
Hong Kong	Date	Period	Prior	Cons.
Retail Sales - Value (YoY)	29-Aug	JUL	28.80%	--
India	Date	Period	Prior	Cons.
GDP (YoY)	30-Aug	2Q	7.80%	7.60%
Exports (YoY)	1-Sep	JUL	46.50%	--
Imports (YoY)	1-Sep	JUL	42.50%	--
Japan	Date	Period	Prior	Cons.
Overall Hhold Spending (YoY)	30-Aug	JUL	-4.20%	-4.00%
Jobless Rate	30-Aug	JUL	4.60%	4.60%
Retail Trade (YoY)	30-Aug	JUL	1.10%	0.10%
Industrial Production (MoM)	31-Aug	JUL P	3.80%	1.10%
Vehicle Production (YoY)	31-Aug	JUL	-13.90%	--
Housing Starts (YoY)	31-Aug	JUL	5.80%	4.60%
Vehicle Sales (YoY)	1-Sep	AUG	-27.60%	--
Philippines	Date	Period	Prior	Cons.
GDP (YoY)	31-Aug	2Q	4.90%	4.30%
GDP sa (QoQ)	31-Aug	2Q	1.90%	0.90%
Korea	Date	Period	Prior	Cons.
Industrial Production (MoM)	31-Aug	JUL	0.70%	1.00%
Industrial Production (YoY)	31-Aug	JUL	6.40%	6.30%
CPI Inflation (YoY)	1-Sep	AUG	4.70%	4.80%
Core CPI (YoY)	1-Sep	AUG	3.80%	--
Exports (YoY)	1-Sep	AUG	27.30%	24.50%
Imports (YoY)	1-Sep	AUG	24.80%	25.10%
Trade Balance	1-Sep	AUG	\$7223M	\$1740M
Thailand	Date	Period	Prior	Cons.
Exports (YoY)	31-Aug	JUL	16.40%	--
Imports (YoY)	31-Aug	JUL	23.50%	--
Trade Balance	31-Aug	JUL	\$1886M	--
CPI Inflation (YoY)	1-Sep	AUG	4.08%	--
Core CPI (YoY)	1-Sep	AUG	2.59%	--
Vietnam	Date	Period	Prior	Cons.
Retail Sales YTD (YoY)	24-31 AUG	AUG	22.30%	--
Industrial Production (YoY)	24-31 AUG	AUG	9.60%	--

Home →

Markets →

Highlights →

Markets Data →

Charts →

Indicator of the Week: China PMI for August (September 1)

Forecast: 51.4

Consensus: 51.0

Prior: 50.7

Comment: China's Purchasing Managers' Index (PMI) for August will be next week's focus of attention for gauging China's underlying growth momentum amidst global financial turbulence and signs of weakening external demand. After four-months of consecutive declines, we expect the PMI to rebound, reflecting seasonal trends and a pickup in the HSBC flash PMI estimate (released last week). This would be consistent with our soft-landing scenario and 9.4% GDP projection for 2011. Market impact: a significantly weaker-than-expected reading could aggravate market concerns of a sharper slowdown, with negative implications for global growth, and increase expectations of looser macro policies in China and elsewhere.

Markets Data

STOCK MARKETS	INDEX	Last price	% change over a week	Year to date	% Change over 1 Y
	China - Shanghai Comp.	2594.7	2.4	-7.6	-0.3
	Hong Kong - Hang Seng	19721.0	1.7	-14.4	-4.3
	Taiwan - Weighted	7409.1	0.9	-17.4	-3.6
	Japan - Nikkei 225	8759.1	0.5	-14.4	-1.7
	Korea - Kospi	1766.0	1.2	-13.9	2.1
	India - Sensex 30	16124.3	-0.1	-21.4	-11.5
	Australia - SPX/ASX 200	4201.8	2.4	-11.5	-3.5
	Singapore - Strait Times	2744.9	0.4	-14.0	-6.2
	Indonesia - Jakarta Comp	3802.7	-1.0	2.7	20.9
	Thailand - SET	1018.1	-4.8	-1.4	14.9
	Malaysia - KLCI	1447.5	-2.5	-4.7	2.8
	Philippines - Manila Comp.	4303.5	-0.8	2.4	19.7

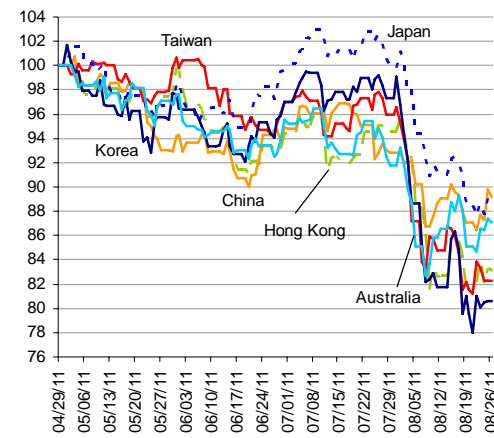
Last update: Friday, 11.15 Hong Kong time.

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.39	0.02	6.37	6.29
	Hong Kong (HKD/USD)	7.80	0.01	7.8	8
	Taiwan (TWD/USD)	29.0	-0.11	28.84	28.35
	Japan (JPY/USD)	77.3	-0.98	77.2	76.8
	Korea (KRW/USD)	1085	0.23	1089.75	1094.95
	India (INR/USD)	46.1	-0.66	46.5	47
	Australia (USD/AUD)	1.05	0.71	1	n.a.
	Singapore (SGD/USD)	1.21	0.28	1.21	1.2
	Indonesia (IDR/USD)	8579	-0.24	8643	8885
	Thailand (THB/USD)	30.0	-0.60	30.17	30.6
	Malaysia (MYR/USD)	2.99	-0.35	3.0	3
	Philippines (PHP/USD)	42.5	0.25	42.43	42.46

Last update: Friday, 11.15 Hong Kong time.

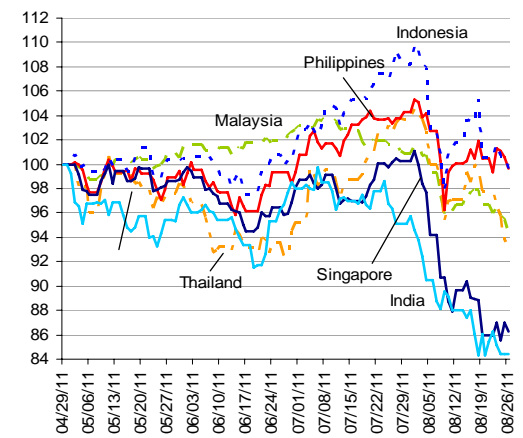
Charts

Chart 9
Stock Markets



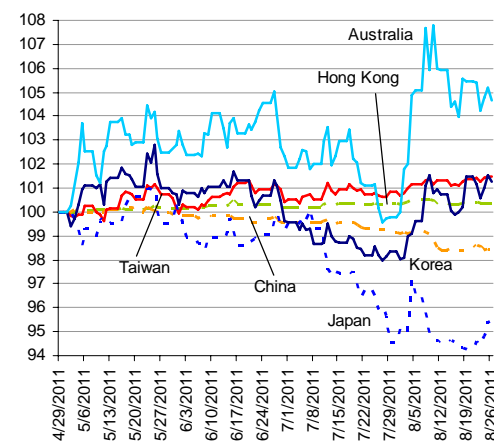
Source: BBVA Research and Bloomberg

Chart 10
Stock Markets



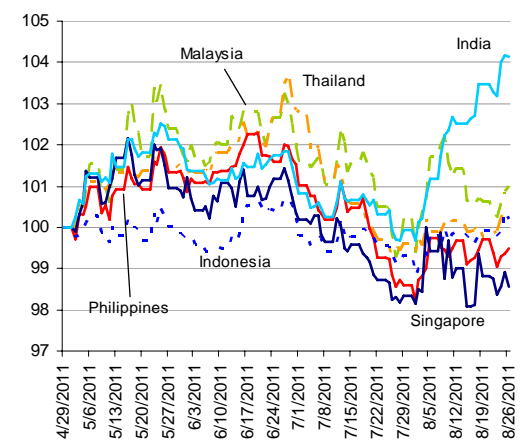
Source: BBVA Research and Bloomberg

Chart 11
Foreign Exchange Markets



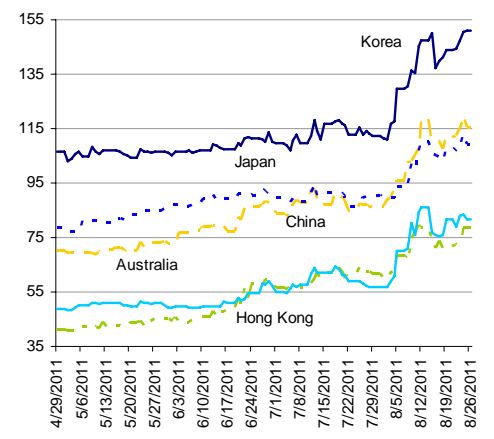
Source: BBVA Research and Bloomberg

Chart 12
Foreign Exchange Markets



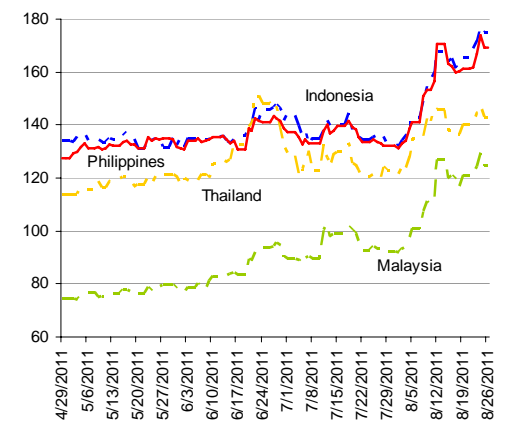
Source: BBVA Research and Bloomberg

Chart 13
Credit Default Swaps



Source: BBVA Research and Bloomberg

Chart 14
Credit Default Swaps



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.