

Weekly Watch

Asia

7 October 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

Jeffrey Cantwell
jeffrey.cantwell@bbva.com.hk

George Xu
george.xu@bbva.com.hk

Markets

FX Strategy
Richard Li
richard.li@bbva.com.hk

Economic analysis
Jeffrey Cantwell
jeffrey.cantwell@bbva.com.hk

Markets →

Highlights →

Calendar →

Markets Data →

Charts →

Markets volatile, despite reassuring data

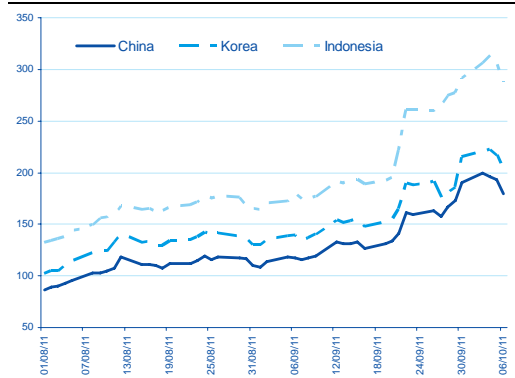
Asian markets continue to fluctuate in line with global trends. For the week Asian markets ended up, on hopes that European leaders are getting closer to a resolution to their sovereign debt and banking woes, as the European Central Bank and Bank of England announced new liquidity measures on Thursday (see Markets). That said, markets remain on edge, as seen in rising CDS spreads and concerns about the sustainability of China's growth (Chart 1). These jitters come despite recent data showing the region growth resilience to date. China's September PMI outturn was a relief, showing an upturn (see Highlights), and some of the recent trade figures in the region have been reassuring as well. Meanwhile, a number of countries released inflation prints for September (see below), showing an easing of price pressures as expected (Chart 2), providing room for policy maneuver in the event of a worsening global environment, as flagged this week by the Reserve Bank of Australia in its policy meeting. Bucking this trend was Vietnam, which announced a rate hike yesterday, as its struggles to tame inflation and restore investor confidence.

Inflation is easing, though underlying pressure remain

September inflation eased in Korea to 4.3% y/y (consensus: 4.5%), Indonesia (4.6% y/y; consensus: 4.9%), and Thailand (4.0% y/y; consensus: 3.9%), bringing inflation closer to official target ranges. That said, the declines are due to easing food and commodity prices, with core inflation remaining high in most cases. On the trade front, Korea's September exports—the first monthly release in the region—showed some resilience (19.6% y/y; consensus: 16.6%), although exports trends are clearly softening. Taiwan's September exports are to be released later today.

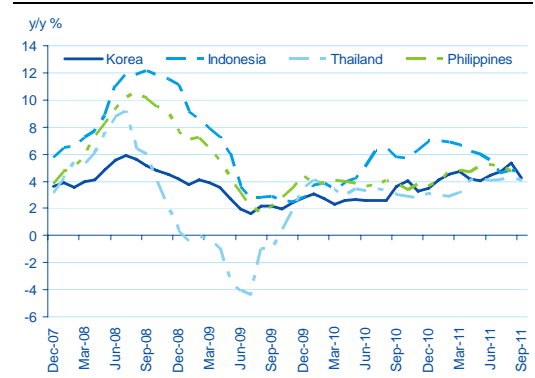
For the week ahead, China will be the main focus with a batch of monthly data, including September inflation (see Weekly Indicator), trade, and other activity and credit indicators. India will also release September inflation and industrial production, and Singapore's advance 3Q GDP will be the first such release for the region. Indonesia and Korea will hold monetary policy meetings (no change expected), and in Singapore where we expect the authorities to ease policy somewhat by slowing the pace of currency appreciation.

Chart 1
Rising CDS spreads on global risk aversion



Source: Bloomberg and BBVA Research

Chart 2
Inflation eases on lower food/commodity prices



Source: Bloomberg and BBVA Research

Highlights

China data watch: resilience in the midst of global uncertainty

The September PMI outturn was in line with a soft landing as markets await new data

India struggles with twin deficits in its fight against global contagion risks

India should weather a global downturn, although its fiscal and current account deficits pose risks

FX Strategy

Richard Li
richard.li@bbva.com.hk

Economic Analysis

Jeffrey Cantwell
jeffrey.cantwell@bbva.com.hk

Markets

Markets pricing in recession, but economic data has been resilient

Asian investors are seeking firmer ground this week, following a Moody's downgrading of Italy by three notches (to A2) and further concerns of the health of Europe's banks. While markets are pricing in a higher probability of recessions in the US and Europe, some economic data have remained rather resilient - especially PMI outturns in China (51.2%) and the US (51.6%), which signal expansion. Asian currencies, which finished September with their worst monthly performance since the Asian financial crisis (down 4.1%, as measured by the Asian Dollar Index), traded mixed (see below), with the RMB (which has risen to 6.35/USD) a notable exception to the upside, along with some strengthening in the offshore (CNH) market following a recent sell-off. The focus will continue to be Europe.

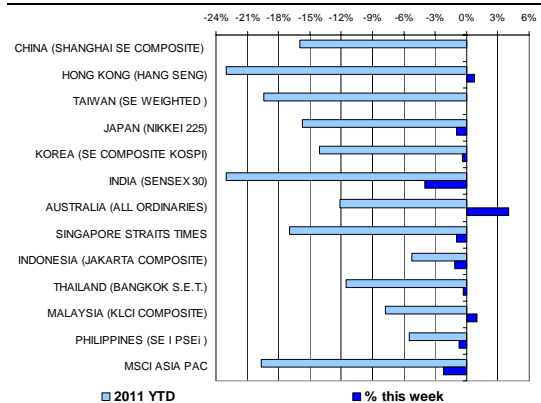
Asian currencies traded mixed

Most regional currencies managed to recuperate their losses by the end of the week on easing European debt concerns and the renewal of liquidity support by the ECB to bank funding. However, these rebounds have been tepid when compared against the severity of the falls in the past few weeks, which reflects the extraordinary caution shared by most investors. Since August 1st, major Asian equity markets (excluding Hong Kong and China) have registered outflows of nearly \$22.0 billion, which far exceeds the modest \$4.9 billion net inflows seen in the first seven months of the year. This reversal of capital flows have been an important driver of recent currency depreciation in the region. Until investors see the implementation of a credible debt resolution in Europe and then are subsequently reassured the Asian economic expansion has not been derailed, it is quite unlikely capital flows will rapidly reverse course back into Asia. This clouded outlook will further limit the scope for a sustainable rally of Asian currencies in the near term.

Asian equity markets remain tumultuous, sovereign CDS spreads in focus

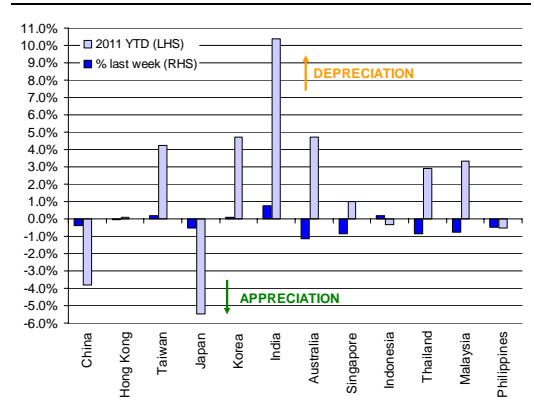
Despite Asian equities staging a rally on Thursday and Friday, sentiment remains subdued. The Hang Seng has plummeted over 30% from its high of this year, and H-shares continue to face numerous headwinds, including questions over company accounting practices, fears regarding rising NPLs by SMEs, and whether central bank tightening measures have overshot their intent. Markets have been well aware of these risks for a while, and therefore it seems the current apprehension is mostly related to global uncertainties - however, we remain vigilant watching for new developments, particularly in regards to NPLs. We also continue to pay close attention to sovereign CDS spreads, which tightened slightly across the board this week but have widened appreciably over the last two months. For many countries - China, Korea, Indonesia, Thailand, and Malaysia - prices for five-year protection have doubled since August 1st. Regarding Asian sovereigns, CDS has traded similarly to emerging economies elsewhere (like Brazil, Russia, Chile, Argentina, and Poland), and therefore we feel prices have risen mainly in response to external risks. We remain constructive on Asian economies and feel they will remain relatively resilient in event of a 'global growth recession.'

Chart 3
Stock markets



Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets



Source: BBVA Research and Bloomberg

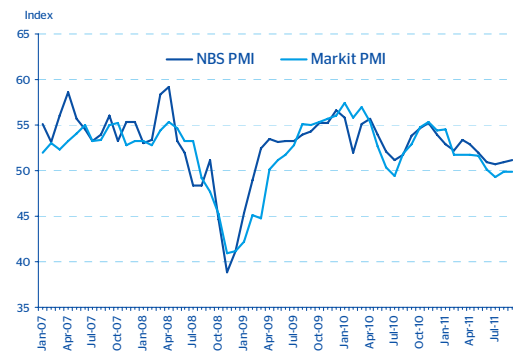
Highlights

China data watch: resilience in the midst of global uncertainty

China's economic growth continues to moderate, but remains robust and in line with a soft landing, despite dimming global growth prospects. The latest evidence came this past week with the release of the September official Purchasing Managers Index (PMI). The index came in at 51.2% (consensus: 51.1), up from 50.9% in August and importantly, remains well within the +50 expansion zone. Expectations of a worse outcome had been fanned by the earlier release of the private sector (HSBC) PMI, which has been below the expansion zone for several months (the index tends to concentrate on smaller, export-oriented firms, which may account for the difference with the official PMI). While the outturn is reassuring, the uptick partly reflects seasonality. Otherwise, the PMI increase was mainly fueled by new orders, production, and employment. In particular, the subcomponent of new orders (with a weight of 30%) increased from 51.1% in August to 51.3% in September. The subcomponent of new export orders increased even more significantly, from 48.3% to 50.9%, the biggest gain among all sub-indices. Another two major indicators, the subcomponent of production (with a weight of 25%) and of employment (with a weight of 20%) increased to 52.7% and 51.0% in September from 52.3% and 50.4% of previous month. The subcomponent of purchase price eased from 57.2% to 56.6%, showing moderating inflation pressure.

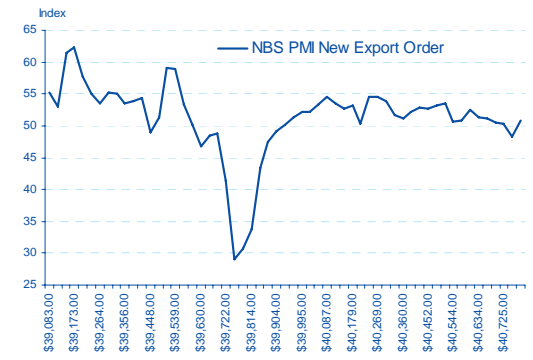
Despite the reassuring PMI outturn, markets are fixated on concerns about whether China can sustain its growth in the midst of a global downturn. In this regard, new data to be released in the coming weeks (October 10-18) will be key, especially for September inflation (see Weekly Indicator), trade, industrial production, investment, and retail sales. In addition, the third quarter GDP outturn is scheduled for release on October 18. We continue to believe that growth is slowing in line with a soft landing scenario, although there are now increasing downside risks to our full-year projections of 9.2% and 8.9% for 2011 and 2012 given global uncertainties. On the policy front, we expect the authorities to maintain the current stance of monetary policy through the end of the year.

Chart 5
China's PMI is holding up...



Source: BBVA Research and Bloomberg

Chart 6
...as export orders recover in September



Source: BBVA Research and Bloomberg

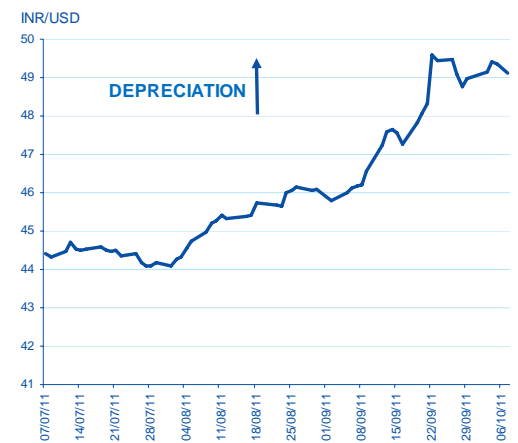
India struggles with twin deficits in its fight against global contagion risks

As seen during the 2008 global credit crisis, India has the wherewithal to weather a global slowdown relatively well. This resilience comes from the fact that its fiscal deficit is primarily domestically financed, and from its large domestic economy (low share of exports to GDP), and healthy financial system. Drawing parallels between the current macro environment and that of the post-Lehman period, we find that India looks relatively better placed on the domestic demand front, for consumption and investment. However, high inflation and a rising fiscal deficit, along with an external current account deficit, pose risks.

On the domestic demand front, trends in consumption still remain relatively strong, despite high borrowing costs and persistent inflation. For example, on a 3-month moving average basis, motor vehicle sales grew at a respectable rate of 14% y/y in August 2011. Meanwhile on the investment front too, trends look better placed compared to 2008. And most indicators on the services front,

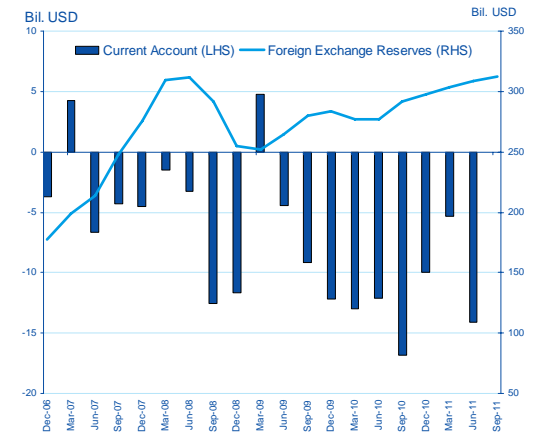
namely visitor arrivals, cargo handled and railway traffic and earnings, continue to post better, albeit modest, growth as compared to the corresponding period in 2008. On the downside, Inflation has been persistently high (above 9% y/y in 2011), and compared to the 2008 period there is less room for monetary easing given inflationary pressures. India's yawning twin deficits, have been a longstanding concern, and pose vulnerabilities in times of heightened global risk aversion. The fiscal deficit for the year ending March 2012 is expected to overshoot the budgeted target of 4.6% of GDP as slowing growth and duty cuts on petroleum products are taking a toll on tax collections while plans to disinvest in state owned companies have been put on the backburner. On the expenditure front, the recent selloff in the Indian rupee due to contagion effects may worsen the government's fuel subsidy burden. (Last week, the authorities announced a higher than budgeted 2HFY12 government borrowing program.) The ongoing trend of fiscal slippages could limit fiscal space for infrastructure financing and raises concern over the sustainability of India's economic growth. Meanwhile, the volatility in portfolio flows, weakening rupee and global financial uncertainty pose external risks, as the current account deficit has almost tripled, to 3.1% of GDP in 2Q11 from 1.1% in 1Q11. Additional areas of caution include redemption pressures arising on external commercial borrowings and a rise in short term debt. While a sizable foreign exchange reserves cushion (USD 277 billion) combined with favorable trends in longer term FDI flows reduce overall balance of payments pressures, volatility in portfolio flows may continue - indeed, portfolio flows are negative for the year, at USD 0.6 billion, reflecting an outflow since early August of over USD 2.5 billion. In this context, recent measures to ease access to non-banking funds for Indian corporates through an increase in overseas borrowing limits should provide some support to the BOP.

Chart 7
The Indian rupee has depreciated...



Source: CEIC and BBVA Research

Chart 8
...as the current account deficit widens



Source: CEIC and BBVA Research

- Home →
- Markets →
- Calendar →
- Markets Data →
- Charts →

Calendar Indicators

Australia	Date	Period	Prior	Cons.
Unemployment Rate	13-Oct	SEP	5.30%	--
China	Date	Period	Prior	Cons.
Actual FDI (YoY)	10-15 OCT	SEP	11.10%	--
New Yuan Loans	11-15 OCT	SEP	548.5B	550.0B
Money Supply - M2 (YoY)	11-15 OCT	SEP	13.50%	14.10%
Trade Balance (USD)	13-Oct	SEP	\$17.76B	\$16.35B
Exports (YoY)	13-Oct	SEP	24.5%	20.40%
Imports (YoY)	13-Oct	SEP	30.2%	23.90%
CPI Inflation (YoY)	14-Oct	SEP	6.2%	6.20%
Producer Price Index (YoY)	14-Oct	SEP	7.3%	6.90%
India	Date	Period	Prior	Cons.
Industrial Production (YoY)	12-Oct	AUG	3.3%	--
Monthly Wholesale Prices (YoY)	14-Oct	SEP	9.78%	--
Japan	Date	Period	Prior	Cons.
Current Account Balance (YoY)	11-Oct	AUG	-42.4%	-62.30%
Machine Tool Orders (YoY)	11-14 OCT	SEP P	15.2%	--
Tertiary Industry Index (MoM)	13-Oct	AUG	-0.1%	-0.50%
Domestic CGPI (MoM)	14-Oct	SEP	-0.2%	-0.20%
Malaysia	Date	Period	Prior	Cons.
Industrial Production (YoY)	11-Oct	AUG	-0.6%	--
Singapore	Date	Period	Prior	Cons.
GDP (QoQ)	12-14 OCT	3Q A	-6.5%	--
GDP (YoY)	12-14 OCT	3Q A	0.9%	--
Retail Sales (MoM) sa	14-Oct	AUG	2.1%	--
Korea	Date	Period	Prior	Cons.
South Korea FDI (YoY)	10-12 OCT	3Q	20.3%	--
Producer Price Index (YoY)	11-Oct	SEP	6.60%	--
Unemployment Rate (SA)	12-Oct	SEP	3.1%	3.2%
Export Price Index (MoM)	14-Oct	SEP	1.3%	--
Import Price Index (MoM)	14-Oct	SEP	0.5%	--

Indicator of the Week: China CPI inflation for September (October 14)

Forecast: 6.1% y/y
Consensus: 6.2% y/y
Prior: 6.2% y/y

Comment: Amidst increasing worries about the external environment and implications for growth, domestic inflation remains a concern for China's policy-makers. Headline inflation has soared above 6% y/y in recent months, although it began to fall in August after peaking the previous month at 6.5% y/y. We expect the moderation trend to continue in September due base effects and easing food prices. **Market impact:** A higher-than-expected reading would be interpreted as limiting the authorities' room for monetary policy maneuver against headwinds from the external environment, and could undermine market sentiment; a lower-than-expected reading, on the other hand, would strengthen the soft-landing view.

Calendar Events

Indonesia - Bank Indonesia Reference Rate, October 11

We expect no change in the reference rate.

Current Consensus

6.75% 6.75%

Korea - BoK Monetary Policy Committee Meeting, October 13

We expect no change in the 7-day repo rate.

Current Consensus

3.25% 3.25%

Singapore - MAS Biannual Monetary Policy Meeting, October 13

We expect a slowing of the pace of appreciation

Bank of Japan Monthly Economic Report, October 11

Markets Data

STOCK MARKETS	INDEX	Last price	% change over a week	Year to date	% Change over 1 Y
	China - Shanghai Comp.	2359.2	0.0	-16.0	-11.2
	Hong Kong - Hang Seng	17718.8	0.7	-23.1	-22.6
	Taiwan - Weighted	7229.2	0.1	-19.4	-12.7
	Japan - Nikkei 225	8619.0	-0.9	-15.7	-11.0
	Korea - Kospi	1762.4	-0.4	-14.1	-7.3
	India - Sensex 30	15792.4	-4.0	-23.0	-23.1
	Australia - SPX/ASX 200	4171.7	4.1	-12.1	-11.1
	Singapore - Strait Times	2649.2	-1.0	-17.0	-16.3
	Indonesia - Jakarta Comp	3509.7	-1.1	-5.2	-2.1
	Thailand - SET	913.7	-0.3	-11.5	-5.9
	Malaysia - KLCI	1400.5	1.0	-7.8	-5.5
	Philippines - Manila Comp.	3967.6	-0.8	-5.6	-6.5

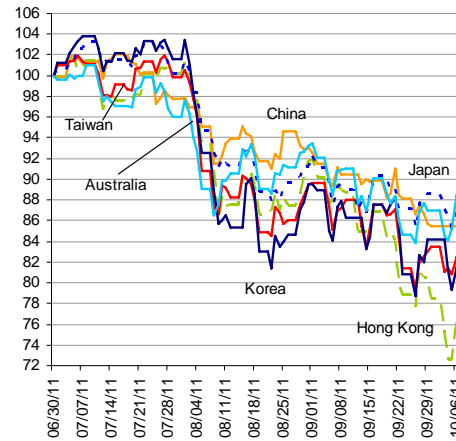
Last update: Friday, 11.45 Hong Kong time.

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.36	0.40	6.37	6.37
	Hong Kong (HKD/USD)	7.78	0.05	7.77	7.75
	Taiwan (TWD/USD)	30.5	-0.20	30.41	30.04
	Japan (JPY/USD)	76.7	0.51	76.55	76.09
	Korea (KRW/USD)	1179	-0.10	1185	1184
	India (INR/USD)	49.3	-1.21	49.90	50.59
	Australia (USD/AUD)	0.98	1.15	1.03	n.a.
	Singapore (SGD/USD)	1.30	0.85	1.30	1.29
	Indonesia (IDR/USD)	8965	-0.17	9119	9395
	Thailand (THB/USD)	30.9	0.84	31.13	31.63
	Malaysia (MYR/USD)	3.17	0.76	3.18	3.21
	Philippines (PHP/USD)	43.6	0.48	43.69	43.82

Last update: Friday, 11.45 Hong Kong time.

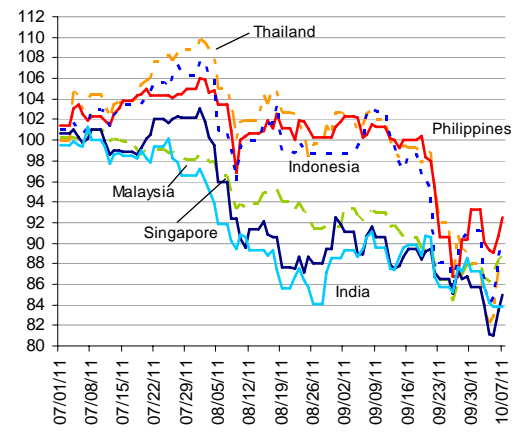
Charts

Chart 9
Stock Markets



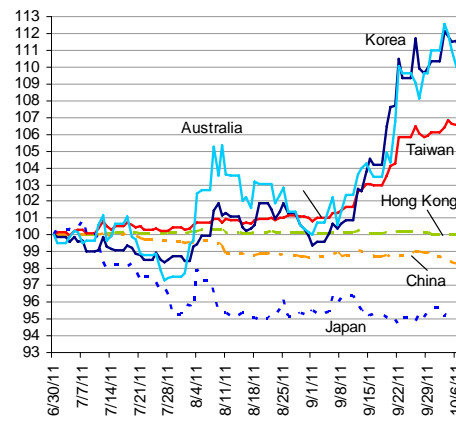
Source: BBVA Research and Bloomberg

Chart 10
Stock Markets



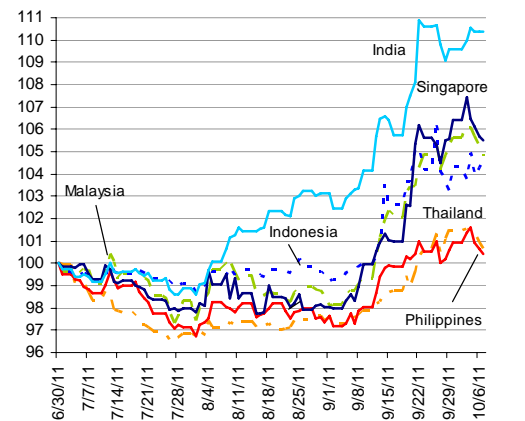
Source: BBVA Research and Bloomberg

Chart 11
Foreign Exchange Markets



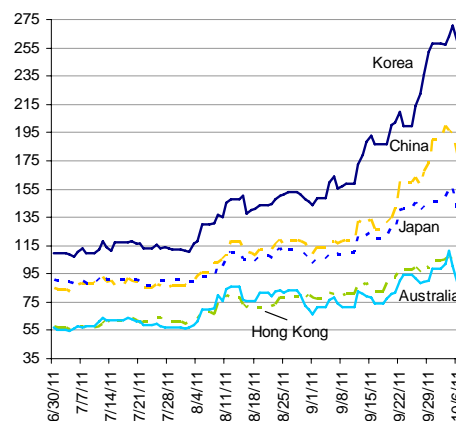
Source: BBVA Research and Bloomberg

Chart 12
Foreign Exchange Markets



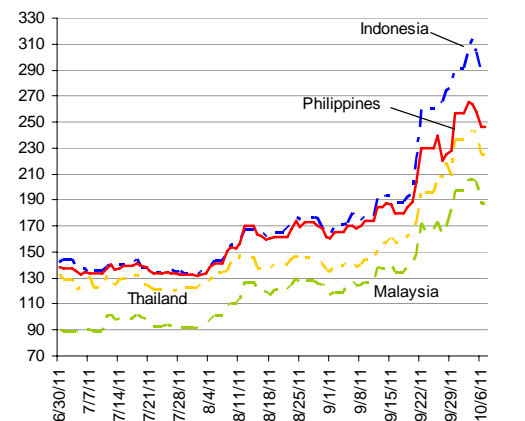
Source: BBVA Research and Bloomberg

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.