

Weekly Watch

Asia

14 October 2011
Economic Analysis

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Growth risks trigger policy easing

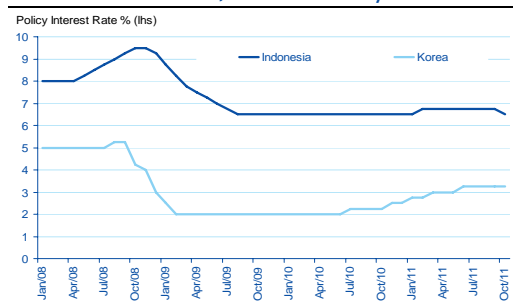
With inflation having peaked and downside risks to the global outlook increasing, some of the region's policy makers have begun to implement policy measures to support growth. Indeed, room for policy easing in most Asian economies is one of the reasons we remain cautiously optimistic about the region's ability to withstand, though not remain unscathed, by a more significant global downturn. In a surprise move, Bank Indonesia cut interest rates by 25 bps at its monthly policy meeting this week (see Highlights), and the Monetary Authority of Singapore today eased its policy stance by slowing the appreciation path for the SGD. Nevertheless, most policymakers are still in wait-and-see mode and, with monetary conditions already quite lax and inflation running high, we do not expect further significant easing in the near term (Korea, for example, left rates unchanged this week).

Easing inflation outturns come as a relief

As scheduled, China and India released their September inflation outturns today, and both were in line with expectations, China's inflation eased to 6.1% y/y (see Highlights) and 9.7% in India. While it is far too early to expect monetary easing in these cases, the outturns could set the stage, especially in China—where September exports disappointed to the downside—if, as we expect, inflation moderates further toward the end of the year. Meanwhile, Singapore's advance third quarter GDP—the first such release in the region—came in above expectations (1.3% q/q saar, consensus: 0.8%), bouncing back from a contraction in the second quarter (-6.5%), although the outlook has weakened and the government has lowered its growth forecast.

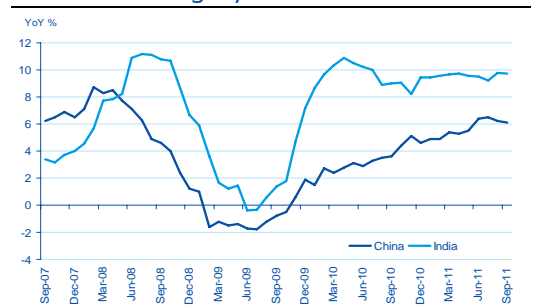
The coming week will feature further market-moving indicators, including China's all-important third quarter GDP in China (see Weekly Indicator) alongside a set of additional monthly activity indicators such as industrial production, retail sales, and new loans. Monetary policy meetings are scheduled in Thailand and the Philippines, which will be watched for signs of further easing in the region, although we expect no change in rates from either. Taiwan export orders will shed further light on the impact of slowing external demand on the region, and inflation in Hong Kong and Malaysia will be watched for further signs of easing price pressures.

Chart 1
Indonesia cuts rates, and Korea stays on hold



Source: Bloomberg and BBVA Research

Chart 2
Inflation eases slightly in China and India



Source: Bloomberg and BBVA Research

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Highlights

China's inflation eases slightly as signs of weaker external demand appear

Latest data shows inflation appears to have peaked, while exports growth disappoints

Asian central banks begin to ease policy stances

Bank Indonesia with a surprise rate cut; central banks focusing on growth

Hong Kong's 2011/12 Policy Address delivered this week

Focus on the property market, social welfare, and economic integration with China

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Markets: a rebound to start the fourth quarter

Asian stock markets rebounded cautiously in the current quarter from recent yearly lows. Rising expectations of more comprehensive responses by European leaders in coming weeks and the unwinding of overextended market positioning has allowed most risk assets to extend gains this week, although the rallies faded on Thursday and Friday. The Hang Seng Index has rebounded by 15% since its low of October 4th, and Asian FX as well as commodities important to Asia, such as copper and oil, have also been progressively rebounding. The focus for the upcoming week will be China, which reports 3Q GDP and other activity indicators, and on new developments in Europe.

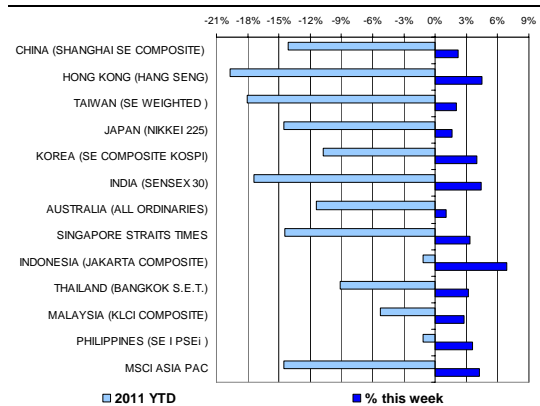
Some progress in Europe, but plenty of uncertainties remain

With Slovakia's final vote Thursday night, all 17 euro-zone countries have ratified the enhancement of the EFSF agreed in the earlier EU summit. The improved EFSF, with a larger capacity and increased ability to intervene in problematic countries, is an integral element of the European debt resolution. More encouragingly, senior EU officials also started to speak openly of a bank recapitalization plan to shield Europe's financial system from possible defaults in peripheral countries. That said, a number of uncertainties remain, with several important issues to be decided in the next few months. Markets also remain concerned about implementation risks regarding Greece's bailout program as well as the growth outlook of Europe in general. Market expectations for an imminent resolution of the European crisis seem to be quite high. Failure to meet this expectation could trigger a new bout of risk aversion. In this regard, further capital outflows are still possible for Asia, which should limit the upside for Asian FX in the near term.

Cautious buying of Asian risk assets

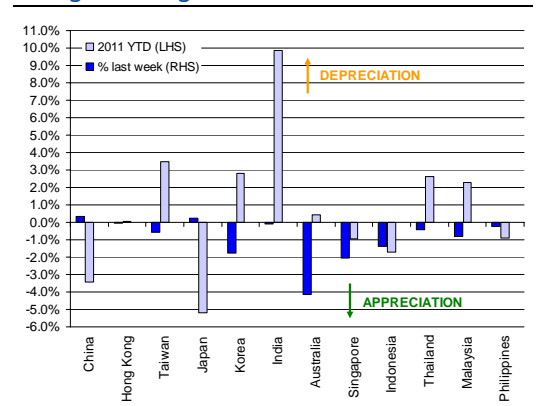
Market sentiment remains cautious despite the rebound, with investors still focusing on the macro environment rather than on fundamentals. Risk assets were broadly higher this week; investment grade and high-yield corporate bonds rose after their late-September selloff. Names related to Chinese property have begun stabilizing after a severe selloff, and Indonesian bonds rallied after a surprise rate cut by Bank Indonesia, which on Tuesday lowered its key interest rate 25bps to 6.50%. Sovereign CDS spreads have also been tightening - this may partially be due to a removal of hedges put on during the third quarter, as many sovereign CDS are used to hedge long positions in single-names (given many single names in Asia do not have exact hedges). Equity markets were given a temporary boost in the middle of the week when China's sovereign wealth fund announced it would buy shares of the big four banks. Investors also bought equities in many of the more open economies like Korea, Taiwan, and Hong Kong, giving the feeling that the third quarter selloff may have been overdone. For now, our view is that given economic indicators are weakening and the external environment remains unclear, this week brought welcome relief which could serve to negate fears of an emerging negative feedback loop where pessimistic market sentiment would potentially end up spilling over into the real economy,

Chart 3
Stock markets



Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets



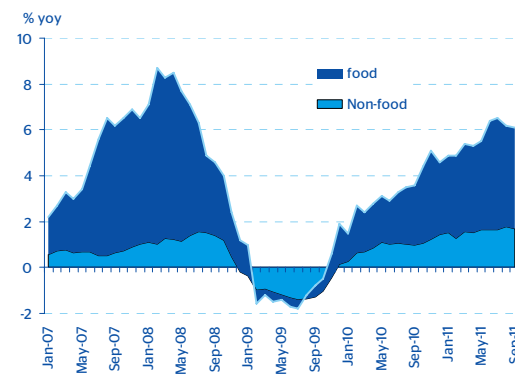
Source: BBVA Research and Bloomberg

Highlights

China's inflation eases slightly as signs of weaker external demand appear

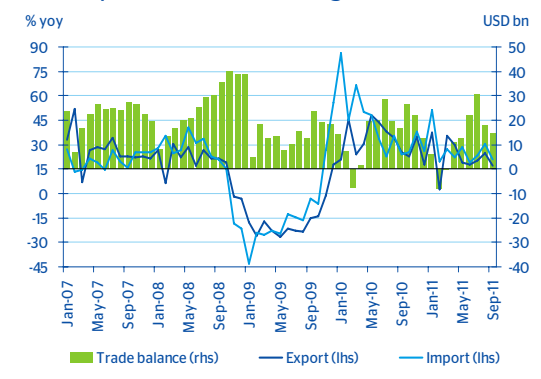
Amidst global uncertainty and rising concerns about China's growth resilience, the latest data show a further easing in inflation, along with weakening external demand. As anticipated, inflation has moderated further from its peak in July, but remains elevated at 6.1% y/y (consensus: 6.2%; BBVA: 6.1%) compared to 6.2% in August (Chart 1). Inflation continues to be driven by food price increases, especially pork prices, which rose by 43.5% y/y in September, slightly down from 45.5% y/y in August. Month on month, food prices rose by 1.1%, up from 0.6% in the previous month, mainly due to seasonal factors. Producer price inflation (PPI) in September also slowed to 6.5% y/y, slightly below expectations (consensus: 6.7% y/y), down from 7.3% y/y in August. On the other hand, the slowing global economy is showing its impact on China through weaker export growth. Both China's export and import growth in September were below expectations [Chart x], growing by 17.1% y/y and 20.9% y/y, respectively (consensus: 20.4% y/y and 23.9% y/y, respectively). The slowing export mainly reflects the weakening external demand, as the export to Europe, US, and Japan all declining, to 9.8%, 11.6%, and 21.6% y/y in September from 22.3%, 12.5%, and 29.8% y/y in August. On balance, we expect monetary policy to remain on hold in the near term to contain inflation expectations, with support for growth coming through targeted fiscal measures, including stepped-up spending on social housing. We expect inflation to ease during the remainder of the year, to around 4% by end-year, and our growth projection of 9.2% for 2011 remains intact, but with downside risks due to the weak external environment. In the coming week, further activity indicators will be released, including industrial production, investment, and retail sales for September, as well as the third quarter GDP outturn. They will be closely watched by the market as a gauge of whether China can achieve a soft landing, as we expect. Our full-year projections for growth in 2011 and 2012 remain at 9.2% and 8.9%, respectively, although downside risks have increased due to global uncertainties and ongoing concerns about the property sector and impact of tightening credit conditions on SMEs.

Chart 5
China's inflation eases...



Source: BBVA Research and Bloomberg

Chart 6
...and exports weaken on falling demand



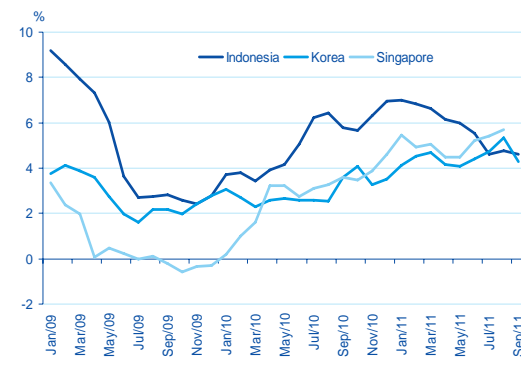
Source: BBVA Research and Bloomberg

Asian central banks begin to ease policy stances

At its monthly policy meeting last Tuesday, Bank Indonesia (BI) announced a surprise interest rate cut, by 25 bps, to 6.50%, citing benign inflation dynamics and risks to growth from an external slowdown. The move took markets by surprise given recent capital outflows from Indonesia and downward currency pressures, and we do not expect further rate hikes from BI in the near term. For a time, it raised expectations that other central banks might follow suit with interest rate cuts of their own. Indeed, in line with expectations, the Monetary Authority of Singapore (MAS) today eased its policy stance for the first time in two years, by softening the slope of its currency appreciation path (the MAS uses the exchange rate, rather than interests rates, as its policy target). The move reflects that growth is overtaking inflation (5.7% y/y in August) as the main policy concern. Nevertheless, third quarter (preliminary) GDP, announced today, surprised to the upside (at 5.9% y/y and 1.3% qoq saar), but given the external uncertainties, the growth outlook has deteriorated - the government lowered its growth projection to 5% for this year (from the

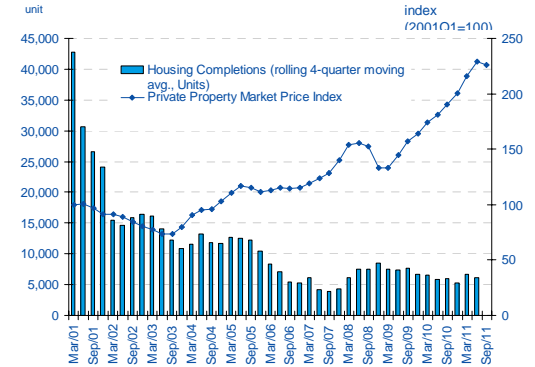
government's previous forecast of between 5-6%), and also warned that the economy could grow by less than 3% next year. But not all central banks are shifting to policy easing. The Bank of Korea, for example, left rates unchanged at its policy meeting this week for a fourth consecutive month, with inflation, at 4.3% y/y in September, above the official 2-4% target range.

Chart 7
Inflation may have peaked



Source: CEIC and BBVA Research

Chart 8
Hong Kong's housing prices have soared, though they are now turning down



Source: CEIC and BBVA Research

Hong Kong's 2011/12 Policy Address delivered this week

Hong Kong's outgoing Chief Executive, Donald Tsang, delivered his final annual Policy Address (2011/12) this past week. In the Address, which was in line with expectations, Tsang focused on the property market, where prices increases over the past year and a half have become a pressing social issue. The government plans to make available 20,000 private residential flats each year over the coming decade. It also plans to construct 75,000 public housing units over the next five years. Tsang announced a resumption of the Housing Ownership Scheme (HOS) for low and middle-income families, with a plan to provide more than 17,000 flats over four years from 2016/17 onwards (2,500 for the first year and 5,000 flats a year on average in the following three years). The Address also included a series of social welfare measures to assist the elderly and low and middle-income segments of the population. These include a new old age allowance (OAA) modeled on the scheme for elderly residents of Guangdong in China, along with a continuation of one-off relief measures to reduce rents on public housing in 2012. On structural issues, the Address emphasized further integration with Mainland China and Hong Kong's role in China's 12th five-year plan. Hong Kong is seeking to expand the presence of its services industry in Mainland China, to enhance its role as an offshore RMB center, and to intensify trade, FDI and equity investment with China. In our view, the policy initiatives are well balanced and, according to a survey by the University of Hong Kong, public reaction has been relatively favorable.

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Calendar Indicators

Australia	Date	Period	Prior	Cons.
Import price index (QoQ)	21-Oct	3Q	0.8%	--
Export price index (QoQ)	21-Oct	3Q	6.0%	--
China	Date	Period	Prior	Cons.
New Yuan Loans	15-Oct	SEP	548.5B	550.0B
Money Supply - M2 (YoY)	15-Oct	SEP	13.5%	14.0%
Actual FDI (YoY)	15-17 OCT	SEP	11.1%	--
Real GDP (QoQ)	18-Oct	3Q	2.2%	--
Real GDP (YoY)	18-Oct	3Q	9.5%	9.3%
Industrial Production (YoY)	18-Oct	SEP	13.5%	13.3%
Retail Sales (YoY)	18-Oct	SEP	17.0%	17.0%
Hong Kong	Date	Period	Prior	Cons.
Unemployment Rate SA	18-Oct	SEP	3.2%	--
CPI Inflation (YoY) - Composite Index	21-Oct	SEP	5.7%	--
Japan	Date	Period	Prior	Cons.
Nationwide Dept. Sales (YoY)	18-Oct	SEP	-1.7%	--
All Industry Activity Index (MoM)	19-Oct	AUG	0.4%	-0.5%
Convenience Store Sales (YoY)	20-Oct	SEP	7.9%	--
Malaysia	Date	Period	Prior	Cons.
CPI Inflation (YoY)	21-Oct	SEP	3.3%	3.3%
Philippines	Date	Period	Prior	Cons.
Overseas Remittances (YoY)	17-Oct	AUG	6.1%	--
Balance of Payments	19-Oct	SEP	\$2719M	--
Singapore	Date	Period	Prior	Cons.
Electronic Exports (YoY)	17-Oct	SEP	-19.4%	--
Non-oil Domestic Exp SA (MoM)	17-Oct	SEP	8.3%	-3.0%
Taiwan	Date	Period	Prior	Cons.
Export Orders (YoY)	20-Oct	SEP	5.26%	--
Thailand	Date	Period	Prior	Cons.
Customs Exports (YoY)	20-25 OCT	SEP	31.1%	--
Customs Imports (YoY)	20-23 OCT	SEP	44.0%	--

Indicator of the Week: China GDP growth for 3Q (October 18)

Forecast: 9.2% y/y

Consensus: 9.3% y/y

Prior: 9.5% y/y

Comment: As prospects for the global economy remain highly uncertain, markets are focused on activity indicators in China to gauge the resilience of the world's second largest economy, and whether it can continue to serve as a buffer to weaker demand from the US and Europe. In this context, a stream of important indicators, including the Q3 GDP outturn, September industrial production, investment, and retail sales, will be released in the coming week. We continue to hold a soft-landing view, and we expect Q3 GDP growth to moderate slightly. Market impact: A higher-than-expected reading would bolster confidence in the outlook, while a weaker-than-expected reading would aggravate worries of a possible hard landing.

Calendar Events

Thailand - Benchmark Interest Rate, October 19

We expect the benchmark interest rate to stay on hold

Current Consensus

3.50% 3.50%

Philippines - Overnight Borrowing Rate, October 20

We expect the overnight borrowing rate to stay on hold

Current Consensus

4.50% 4.50%

Japan's Cabinet Office Monthly Economic Report, October 17

Australia Reserve Bank's Board October Minutes, October 18

Markets Data

STOCK MARKETS	INDEX	Last price	% change over a week	Year to date	% Change over 1 Y
	China - Shanghai Comp.	2410.8	2.2	-14.1	-16.3
	Hong Kong - Hang Seng	18496.2	4.5	-19.7	-22.5
	Taiwan - Weighted	7355.9	2.0	-18.0	-10.5
	Japan - Nikkei 225	8744.9	1.6	-14.5	-8.8
	Korea - Kospi	1830.1	4.0	-10.8	-3.7
	India - Sensex 30	16946.1	4.4	-17.4	-17.3
	Australia - SPX/ASX 200	4205.6	1.0	-11.4	-10.5
	Singapore - Strait Times	2728.8	3.4	-14.5	-14.6
	Indonesia - Jakarta Comp	3661.2	6.9	-1.1	1.2
	Thailand - SET	938.1	3.2	-9.2	-5.6
	Malaysia - KLCI	1439.4	2.8	-5.2	-3.8
	Philippines - Manila Comp.	4153.4	3.6	-1.1	-1.9

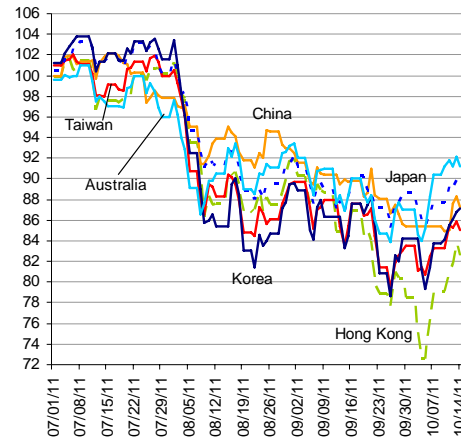
Last update: Friday, 11.45 Hong Kong time.

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.38	-0.32	6.39	6.40
	Hong Kong (HKD/USD)	7.78	0.05	7.77	7.75
	Taiwan (TWD/USD)	30.3	0.56	30.19	29.79
	Japan (JPY/USD)	76.9	-0.25	76.80	76.32
	Korea (KRW/USD)	1158	1.78	1164	1168
	India (INR/USD)	49.1	0.09	49.75	50.73
	Australia (USD/AUD)	1.02	4.30	0.99	n.a.
	Singapore (SGD/USD)	1.27	2.06	1.27	1.26
	Indonesia (IDR/USD)	8840	1.41	8970	9314
	Thailand (THB/USD)	30.9	0.45	31.05	31.47
	Malaysia (MYR/USD)	3.13	0.82	3.15	3.17
	Philippines (PHP/USD)	43.4	0.22	43.44	43.45

Last update: Friday, 11.45 Hong Kong time.

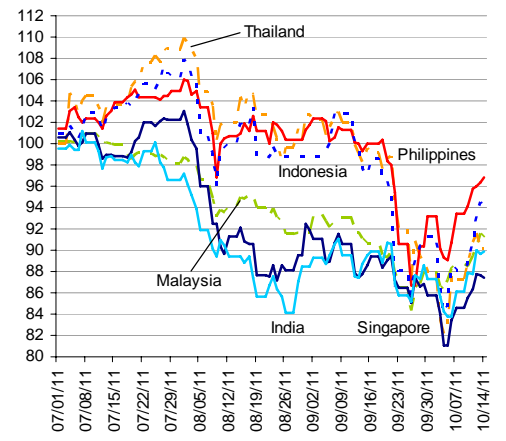
Charts

Chart 9
Stock Markets



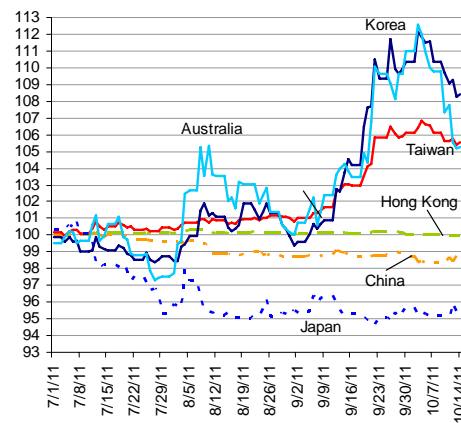
Source: BBVA Research and Bloomberg

Chart 10
Stock Markets



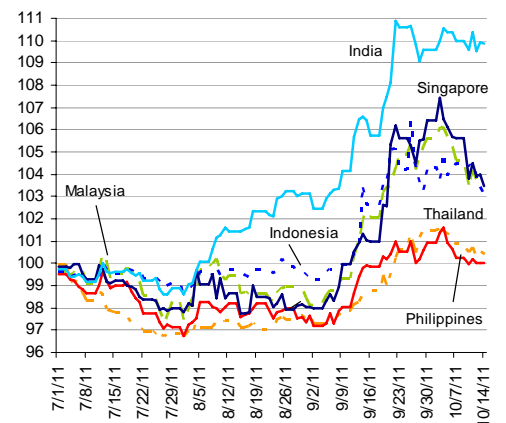
Source: BBVA Research and Bloomberg

Chart 11
Foreign Exchange Markets



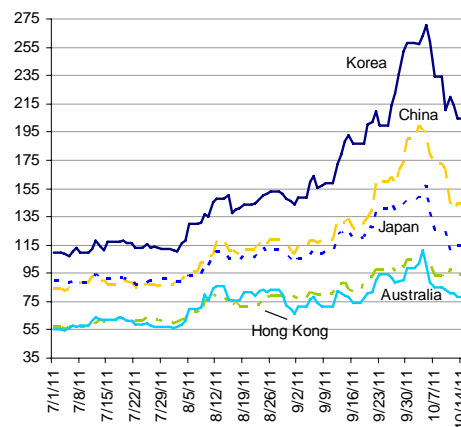
Source: BBVA Research and Bloomberg

Chart 12
Foreign Exchange Markets



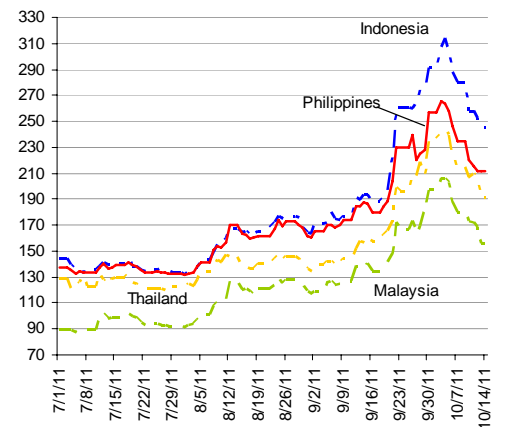
Source: BBVA Research and Bloomberg

Chart 13
Credit Default Swaps



Source: BBVA Research and Bloomberg

Chart 14
Credit Default Swaps



Source: BBVA Research and Bloomberg

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