

Weekly Watch

Asia

11 November 2011
Economic Analysis

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Room for stimulus

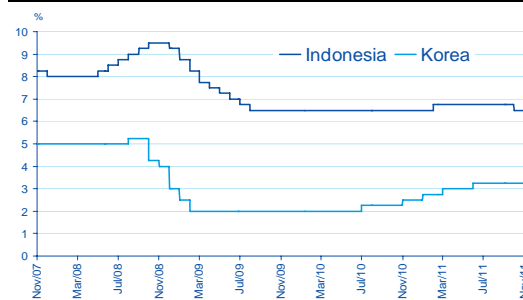
Headwinds from Europe have intensified, causing further volatility in global markets and raising fears about the impact that a global slowdown and financial crisis could have on emerging markets. Asian economies are already feeling the heat, through weaker exports and tighter financing conditions (see the IIF's Q3 *Emerging Markets Bank Lending Survey*). While Asian growth will slow in this environment, we believe the region is relatively well positioned to cope (see our latest *Asia Outlook* and Highlights). In addition to the region's strong fundamentals—high reserves and strong banking systems among them—there is room for policy stimulus to support domestic demand. The latest signs of this are Bank Indonesia's surprise 50bp interest rate cut this week (on top of a 25bp cut last month), adding to other expansionary moves from the central banks in Australia, Singapore, and Japan in recent weeks. Despite signs of slowing growth momentum, the Bank of Korea stayed on hold this week (Chart 1), as expected, given its limited room for cuts at this stage (policy rates are negative in real terms). We expect policymakers to draw up contingency plans for fiscal support if downside risks materialize.

Data outturns in China are cause for optimism

As scheduled, China released a batch of important monthly indicators this week. Taken together, they support our soft-landing scenario, with inflation easing and strong domestic demand helping to offset weaker export growth (see our *China Outlook* and Highlights). Specifically, inflation eased in line with expectations, to 5.5% y/y from 6.1% in September, providing further evidence that inflation has passed its peak (Chart 2). Activity indicators moderated, also broadly in line with expectations. Significantly, export growth slowed to 15.9% y/y, from an average of 20.6% in Q3, while import growth surged above expectations to 28.7% y/y, a sign of robust domestic demand, which should help sustain growth in the region. Markets are awaiting Hong Kong's Q3 GDP (due later today), and whether the economy may tip into a technical recession.

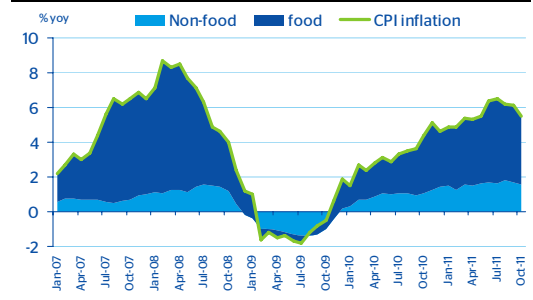
The next coming week will see third quarter GDP releases in Singapore (final), Malaysia, and Japan. The latter will be watched closely for signs of a post-earthquake rebound after three consecutive quarters of negative growth (see Weekly indicator). India will release October inflation which is expected to remain high, at around 9.6% y/y. China will release monetary and credit data.

Chart 1
Indonesia cuts by 50 bps as Korea stays on hold



Source: Bloomberg and BBVA Research

Chart 2
China's inflation continues to ease



Source: Bloomberg and BBVA Research

Highlights

Can Asia's growth hold up against weakening external demand?

Our latest regional quarterly outlook emphasizes a resilient outlook, but with downside risks

China Outlook: A soft landing, with downside risks

Risks of a hard landing have increased, but remain low, and we keep our soft landing scenario

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Italian debt fears spark a selloff

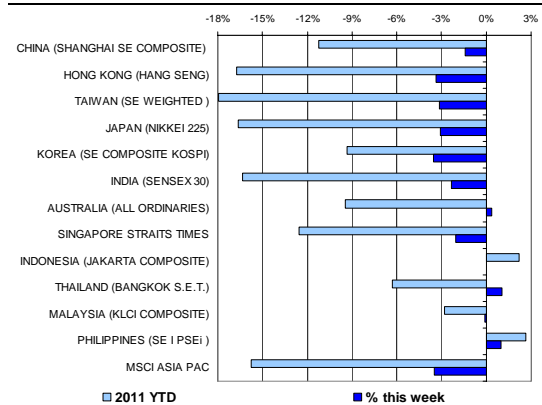
Asian financial markets are taking their cues (once again) from Europe, where Italy came under pressure after the London Clearing House (LCH) raised margin requirements on Italian bond trading, sending signs that it will be the next country in line for a bailout package. Fears over contagion to Asia returned, inducing a broad-based selloff in equities, currencies and credit on Thursday after notable rallies over past few weeks, with the Indian rupee notably reaching above the 50/USD level by Friday. Key to stabilizing the situation in the near term includes the passage of austerity measures in Italy, giving details on the new EFSF to gain international financial support, and most importantly, the ECB showing the willingness to serve as a backstop by buying Italian bonds before the new EFSF becomes operational.

Bank Indonesia rate cuts surprises the market

This week also saw a divergence in monetary policies - Bank Indonesia surprised the markets by cutting its policy rate by 50bps this week (to 6%) on easing inflation. The decision is providing mixed signals to local markets - bonds rose immediately after the move, but equity markets finished the week flat as investors may be focusing on weakening growth prospects from external headwinds, despite the strong third quarter GDP outturn.

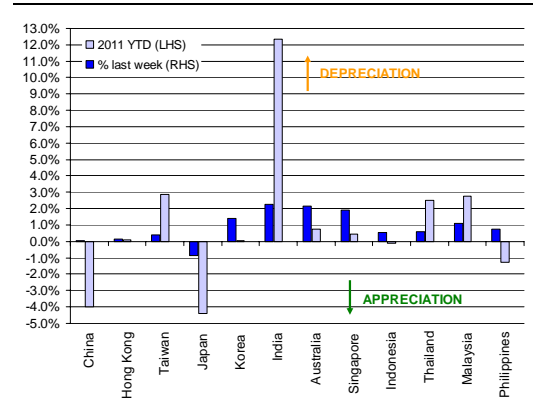
Bank Indonesia is an outlier for the time being. Except for Indonesia and Australia, most central banks in Asia are constrained by high inflation and are not ready to cut rates unless global conditions deteriorate further and inflation declines more quickly. Korea is an example. The Bank of Korea remained on hold for the fifth straight month at 3.25%, as policymakers remain focused on inflation (3.9% y/y) even as the economy shows signs of easing. In China, markets have welcomed softening CPI and PPI outturns (5.5% y/y and 5.0% respectively). Senior officials have placed emphasis on policy flexibility and fine-tuning, and we read it as an indication of selective easing addressing specific problems. Accordingly, continued strains in inter-bank liquidity and further signs of waning capital inflows amid global market tension would increase the likelihood of a reserve requirement ratio (RRR) cut. However, the government will likely keep interest rates on hold for a while as inflation is still elevated compared to historical averages, and the risks of property price increases have not completely dissipated.

Chart 3
Stock markets



Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets



Source: BBVA Research and Bloomberg

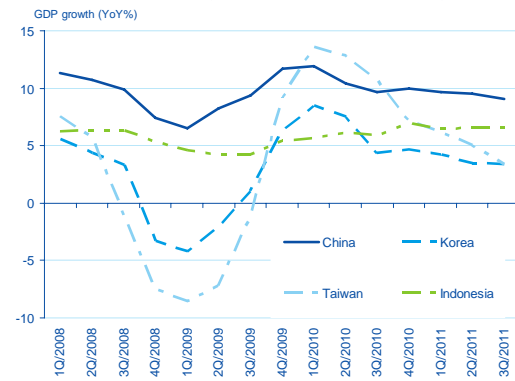
Highlights

Can Asia's growth hold up against weakening external demand?

The effects of ongoing global turmoil have resulted in moderating growth momentum in Asia, as we highlight in our latest [Asia Outlook](#) for the fourth quarter. So far this year, the region's GDP growth has held up reasonably well, not only in China (9.1% y/y in Q3), but in other large economies such as Indonesia (6.5% y/y in Q3) where domestic demand remains strong. For most of the region, however, especially in the more open and smaller economies such as Hong Kong and Taiwan, the impact on growth of weaker external demand has been more evident. Overall, the region's growth moderation has been healthy so far, as employment conditions are still strong and it has helped ease overheating pressures that had been building in the first half of the year.

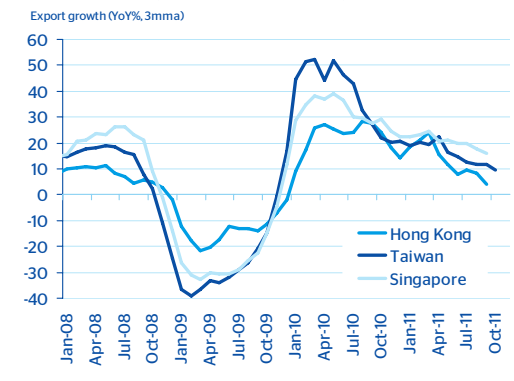
As a result of weaker external demand we have made downward revisions to our growth forecasts, with Asia Pacific growth in 2011 and 2012 projected at 5.9% y/y and 6.4% y/y, respectively in 2011 and 2012 (from 6.2% y/y and 6.7% y/y previously). The downward revisions are relatively modest, as our outlook for the region remains positive, with resilient domestic demand and an expected gradual improvement in external demand under our baseline during the course of 2012. However, risks are clearly tilted to the downside. Fortunately, there is room for policy stimulus in most economies. Indeed, several countries have already shifted their policy focus to support for growth, with interest rate cuts in recent days in Australia and Indonesia, and a fiscal stimulus package in the Philippines. Other expansionary policies may be forthcoming if the global environment worsens. The key risk for Asia is a deterioration in the European debt crisis, which could weaken export demand further and cause spill overs to domestic demand. There could also be stresses through financial channels, particularly if capital flows dry up. Ultimately, Asia remains well-positioned due to its strong fundamentals—well capitalized banking systems and high reserve levels in particular—and room for policy stimulus.

Chart 5
Third quarter GDP growth slows in the region



Source: BBVA Research and Bloomberg

Chart 6
Asian export growth is declining

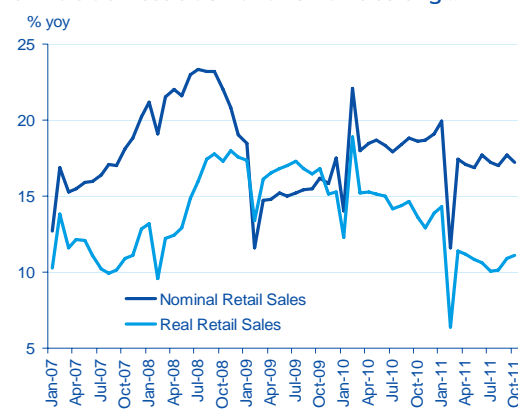


Source: BBVA Research and Bloomberg

China Outlook: A soft landing, with downside risks

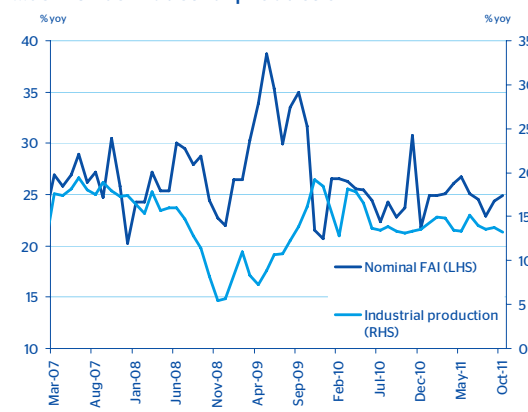
Our just-released quarterly [China Outlook](#) assesses recent developments and prospects amidst rising downside risks from the uncertain global and worries of a hard landing. China's growth momentum has slowed following the authorities' policy efforts through much of the year to avert overheating and steer the economy towards a soft landing. Domestic demand and production remain reasonably strong, and the pace of the slowdown has been in line with a soft landing. Meanwhile, inflation has been easing after peaking in July, and stands at 5.5% y/y as of October. To reflect the impact of the weaker environment, we have lowered our full-year growth projections since our last quarterly update modestly for 2011 and 2012 to 9.1% and 8.6% (from 9.4% and 9.1 percent previously). We expect inflation to ease further during the remainder of the year, to around 4% y/y by end-December, and to remain in that range during 2012. With inflation easing and downside risks on the rise, the policy mix is being fine-tuned to support growth. Monetary easing may take the form of a relaxation of required reserve ratios for small banks, with broader cuts in the RRR possible in early 2012, and a slowing of currency appreciation. Barring a further deterioration in the external environment, we do not anticipate cuts in interest rates at this stage. The main risks to China's near term growth outlook are associated with uncertainties to the global environment due to the intensifying European debt crisis and sluggish growth in the US, on top of domestic financial fragilities. As such, risks of a hard landing have increased, but remain low given that underlying domestic demand remains strong and room for policy stimulus to cushion the impact on growth of a deterioration in the global environment.

Chart 7
China's domestic demand remains strong...



Source: CEIC and BBVA Research

Chart 8
...as well as industrial production



Source: CEIC and BBVA Research

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Calendar Indicators

	Date	Period	Prior	Cons.
China				
New Yuan Loans	11-15 NOV	OCT	470.0B	500.0B
Money Supply - M2 (YoY)	11-15 NOV	OCT	13.0%	13.0%
Actual FDI (YoY)	14-17 NOV	OCT	7.9%	--
Hong Kong				
Unemployment Rate SA	17-Nov	OCT	3.2%	3.3%
India				
WPI Inflation (YoY)	14-Nov	OCT	9.7%	9.6%
Japan				
GDP Deflator (YoY)	14-Nov	3Q P	-2.2%	-2.2%
Nominal GDP (QoQ)	14-Nov	3Q P	-1.5%	1.4%
GDP Annualized	14-Nov	3Q P	-2.1%	5.9%
Gross Domestic Product (QoQ)	14-Nov	3Q P	-0.5%	1.5%
Industrial Production (MoM)	14-Nov	SEP F	-4.0%	--
Nationwide Dept. Sales (YoY)	14-18 NOV	OCT	-2.4%	--
Machine Tool Orders (YoY)	17-Nov	OCT F	25.9%	--
Malaysia				
GDP (YoY)	18-Nov	3Q	4.0%	--
Current Account Balance	18-Nov	3Q	23.4B	--
Philippines				
Overseas Remittances (YoY)	15-Nov	SEP	11.1%	--
Balance of Payments	18-Nov	OCT	\$719M	--
Singapore				
Retail Sales Ex Auto (YoY)	15-Nov	SEP	7.4%	--
Retail Sales (YoY)	15-Nov	SEP	3.3%	--
Retail Sales (MoM) sa	15-Nov	SEP	-7.2%	--
GDP (QoQ)	16-25 NOV	3Q F	1.3%	--
GDP (YoY)	16-25 NOV	3Q F	5.9%	--
Electronic Exports (YoY)	17-Nov	OCT	-13.6%	--
Non-oil Domestic Exports (YoY)	17-Nov	OCT	-4.5%	--
Non-oil Domestic Exp SA (MoM)	17-Nov	OCT	-9.3%	--
Korea				
Export Price Index (MoM)	15-Nov	OCT	3.4%	--
Export Price Index (YoY)	15-Nov	OCT	5.8%	--
Import Price Index (MoM)	15-Nov	OCT	3.7%	--
Import Price Index (YoY)	15-Nov	OCT	14.0%	--

Indicator of the Week: Japan's Q3 GDP Growth (November 14)

Forecast: 1.5% q/q s.a.
Consensus: 1.5% q/q s.a.
Prior: -0.5% q/q s.a.

Comment: As Japan's economy continues to recover from last March's earthquake and tsunami, we expect to see a rebound in Q3 after three consecutive quarters of contraction. In addition to a restoration of supply chains, post-quake reconstruction spending has helped to bolster domestic demand. That said, the recovery faces headwinds from the global downturn, strong yen, and disruptions to Japanese auto and electronics firms from floods in Thailand. Market impact: A weaker-than-expected outturn would raise expectations of further quantitative easing and currency intervention by the Bank of Japan.

Calendar Events

Japan - BoJ Target Rate, November 10

We expect the interest rates to stay on hold

Current Consensus

0.10% 0.10%

Australia - RBA Board November Minutes, November 15

Markets Data

STOCK MARKETS	INDEX	Last price	% change over a week	Year to date	% Change over 1 Y
	China - Shanghai Comp.	2492.3	-1.4	-11.2	-20.8
	Hong Kong - Hang Seng	19179.8	-3.3	-16.7	-22.4
	Taiwan - Weighted	7366.3	-3.1	-17.9	-12.7
	Japan - Nikkei 225	8528.7	-3.1	-16.6	-13.5
	Korea - Kospi	1859.3	-3.6	-9.3	-2.9
	India - Sensex 30	17158.6	-2.3	-16.3	-17.8
	Australia - SPX/ASX 200	4296.5	0.4	-9.5	-9.1
	Singapore - Strait Times	2789.3	-2.1	-12.6	-15.3
	Indonesia - Jakarta Comp	3784.6	0.0	2.2	1.1
	Thailand - SET	967.3	1.0	-6.3	-6.1
	Malaysia - KLCI	1476.4	-0.1	-2.8	-2.5
	Philippines - Manila Comp.	4313.0	1.0	2.7	4.1

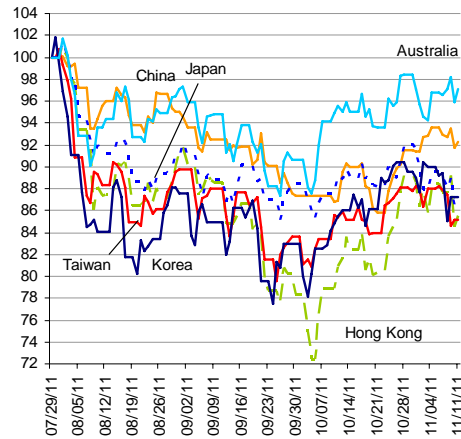
Last update: Friday, 11.45 Hong Kong time.

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.34	-0.07	6.33	6.33
	Hong Kong (HKD/USD)	7.78	-0.15	7.78	7.76
	Taiwan (TWD/USD)	30.1	-0.38	30.10	29.79
	Japan (JPY/USD)	77.6	0.88	77.40	76.85
	Korea (KRW/USD)	1126	-1.39	1133	1137
	India (INR/USD)	50.2	-2.19	51.06	52.57
	Australia (USD/AUD)	1.02	-2.12	1.00	n.a.
	Singapore (SGD/USD)	1.29	-1.85	1.29	1.28
	Indonesia (IDR/USD)	8985	-0.52	9123	9549
	Thailand (THB/USD)	30.8	-0.62	31.04	31.45
	Malaysia (MYR/USD)	3.15	-1.09	3.17	3.19
	Philippines (PHP/USD)	43.3	-0.74	43.33	43.23

Last update: Friday, 11.45 Hong Kong time.

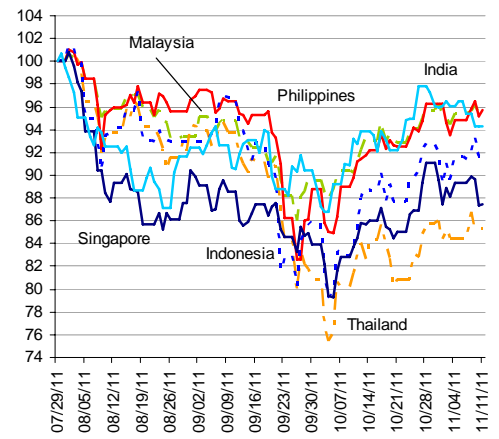
Charts

Chart 9
Stock Markets



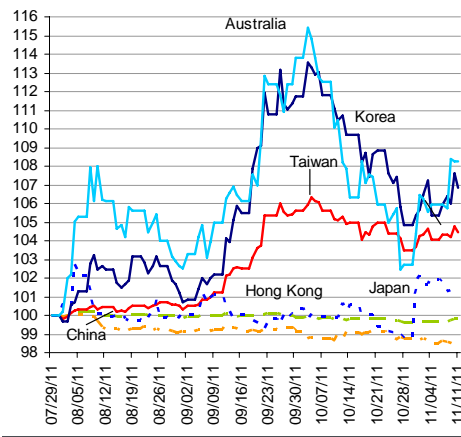
Source: BBVA Research and Bloomberg

Chart 10
Stock Markets



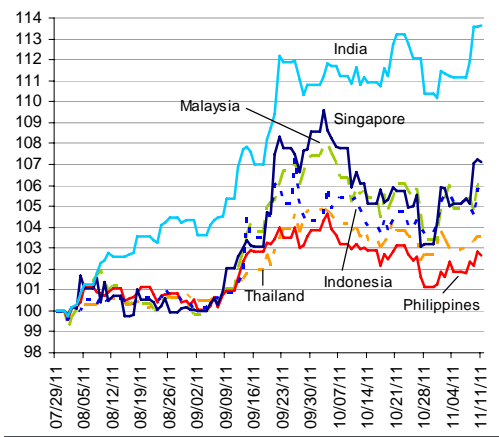
Source: BBVA Research and Bloomberg

Chart 11
Foreign Exchange Markets



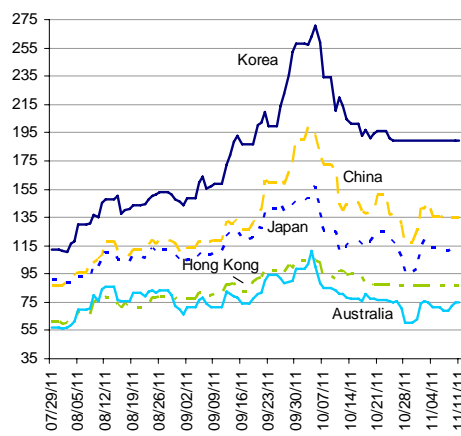
Source: BBVA Research and Bloomberg

Chart 12
Foreign Exchange Markets



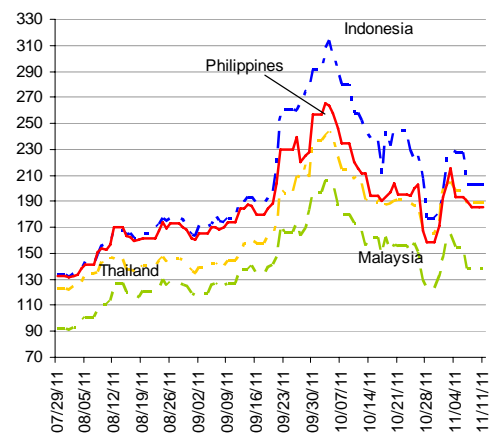
Source: BBVA Research and Bloomberg

Chart 13
Credit Default Swaps



Source: BBVA Research and Bloomberg

Chart 14
Credit Default Swaps



Source: BBVA Research and Bloomberg

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