

Weekly Watch

Asia

2 December 2011
Economic Analysis

Asia

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China swings to easing mode

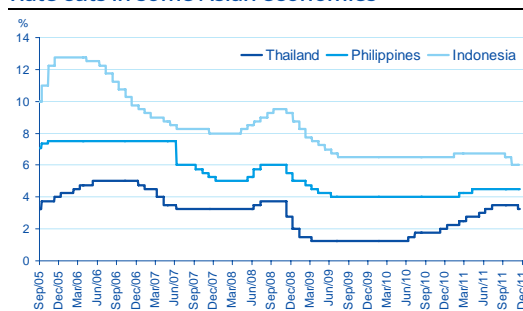
As developed-economy central banks take coordinated steps to try and ease liquidity conditions, individual Asian central banks are taking steps of their own to prop up growth prospects. Most significantly, China this week announced an unexpectedly early cut in its required reserve ratio, seemingly timed with the release of a disappointing PMI outturn, into the contraction zone (48.0). The move helped lift regional and global sentiment even though it was aimed at the domestic economy, and despite signs of weaker growth. We continue to believe that China's economy is headed for a soft landing, thanks in part to room for policy stimulus in response to weakening external demand. Monetary easing was also seen in Thailand (see Highlights), with its first rate cut in the current cycle (Chart 1) in an effort both to support the recovery from recent floods, and offset the effects of the deteriorating external environment. We expect more monetary easing from these and other central banks in the months ahead under these circumstances

Inflation pressures easing as growth slows

November inflation outturns continue to point downwards, and generally below consensus. In Korea (4.2% y/y; consensus: 4.4%), Indonesia (4.2% y/y; consensus: 4.2%) and Thailand (4.2% y/y; consensus: 4.4%) outturns were in line with or below consensus, although inflation remains sticky in year-on-year terms (Chart 2). Growth outturns continue to show signs of a regional slowdown, as expected- India third quarter GDP decelerated in line with expectations (6.9% y/y; prior: 7.7%), due to slowing activity indicators, sluggish reform progress, and worsening global prospects. The Philippines, meanwhile, saw a disappointing slowdown in GDP growth (3.2% y/y in 3Q from 3.4% in 2Q; consensus: 4.1%). On the positive side, November exports in Korea rebounded by a better-than-expected 13.8% y/y (consensus: 10.4%) on strong demand from China and ASEAN, which offset sharply weaker demand from Europe (-30.5% y/y) (see Highlights).

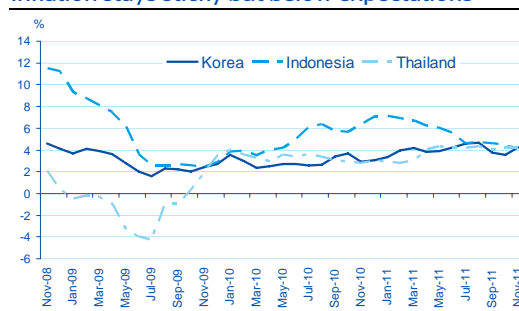
Monetary policy meetings will be held next week in Australia, Korea and Indonesia. We expect rates to stay on hold, although it is a close call in Australia, given our expectations of a rate cut there in early 2012. In China, an array of important November indicators will be released, including inflation (see Weekly Indicator), trade, industrial production and retail sales. November inflation outturns will be released in the Philippines and Taiwan, as well as Q3 GDP in Australia and Korea

Chart 1
Rate cuts in some Asian economies



Source: Bloomberg and BBVA Research

Chart 2
Inflation stays sticky but below expectations



Source: Bloomberg and BBVA Research

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Highlights

Korea's exports rebound in November, but outlook remains weak

Korea's exports rebound due to strong demand from China and ASEAN

Thailand cuts interest rates to support post-flood recovery

Bank of Thailand eases by 25bps to counter the sharp slowdown due to the October floods

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Markets

Coordinated effort by central banks eases stress in Europe

Markets have been rising again on optimism that coordination among six central banks to provide liquidity to global financial markets will unfreeze interbank lending in Europe. Central banks agreed to lower the pricing on US dollar liquidity swap arrangements by 50 basis points, providing extra liquidity to the market and enabling European banks to receive dollar funding through the ECB. Asian FX and equity markets rallied on the news, with the Hang Seng up almost 1,000 points on Thursday, and several high-beta Asian currencies including KRW and SGD rallied on the news. The liquidity measure, however, is a temporary salve that allows regular bank activity to continue, but does not effectively address the underlying systemic risks, namely solvency and sovereign issues. However, the coordinated move helps banks globally, including in Asia, where banks remain well-capitalized, exhibit low NPL ratios, and lend into vibrant, growing economies. For market participants, the focus will turn to the major European Council summit on December 9th.

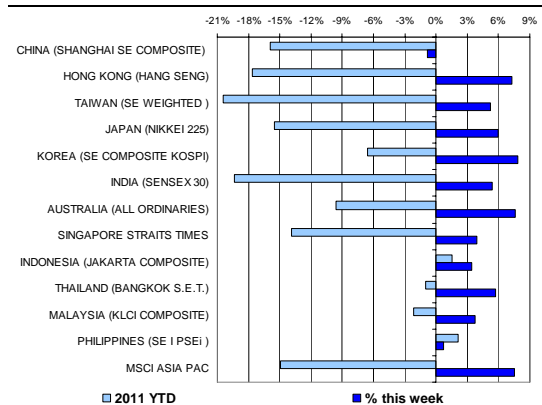
FX: rally follows new dollar funding measures

Risk-on sentiment following Wednesday's central bank coordination produced a sharp rally in FX. As has been the case since August, with every piece of 'news' comes a knee-jerk reaction by markets, followed by what seems like an equally strong counter-reaction: take the rupiah, which strengthened from around 9,200/USD to 9,100 immediately following the announcement, and briefly touched 9,000 by the end of day Thursday, before selling off on Friday to 9,103 as of the time of this writing. Market participants continue to seek definitive signs that the euro crisis has been contained.

Strong market performance for the week, but a cautious outlook

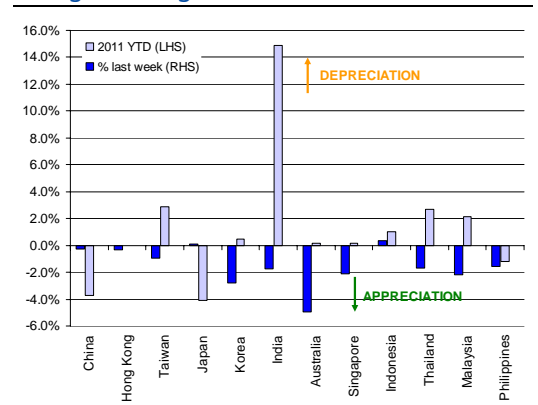
Corporate and sovereign credit were both tighter this week on the news from Europe. Spreads on Indonesian and Chinese corporates were tighter by around 30bps for the week. CDS spreads also tightened, with the cost of buying protection on many single names in the Asian banking sector significantly tighter, as would be expected. Market performance is being driven by events over in Europe, and though optimism is growing (bond auctions in Italy and Spain were well-received yesterday, with Italian yields falling below 7%), we are not out of the woods yet.

Chart 3
Stock markets



Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets



Source: BBVA Research and Bloomberg

Highlights

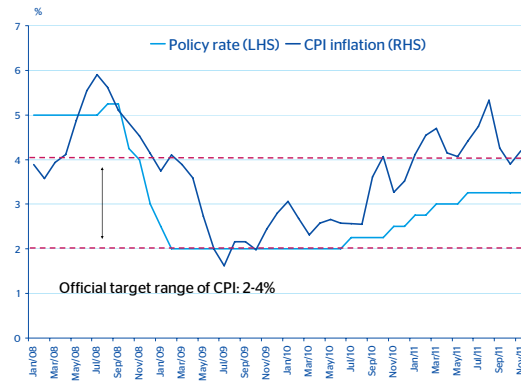
Korea's exports rebound in November, but outlook remains weak

Korea's November exports—the first monthly release in the region—rebounded from a weak outturn in October (8.0% y/y), growing by 13.8% y/y (consensus: 10.4%). The main drivers were strong demand from China (9.2% y/y) and ASEAN (16.5% y/y), which offset a sharp decline from European markets (-30.5% y/y). Chemical products, steel and electronic parts led the rebound. Despite the positive outturn, however, the near-term outlook remains weak, as the slowdown in the global economy is expected to continue to affect Korean exporters, and forward-looking indicators like manufacturing PMI (47.1 in November) and new exports orders (47.8) both signal a more challenging environment ahead.

November inflation was also released this week, with the outturn (4.2% y/y; consensus: 4.4%) rising from October (3.6% y/y). Inflation has been trending down, toward the authorities' 2-4% target range. Recent changes to the CPI basket (for instance, gold rings have been removed, while smartphones have been added), will lead to a mechanical drop of 0.4% in the index in the coming year. We expect the Bank of Korea to remain on hold at 3.25% at its next policy meeting on December 8.

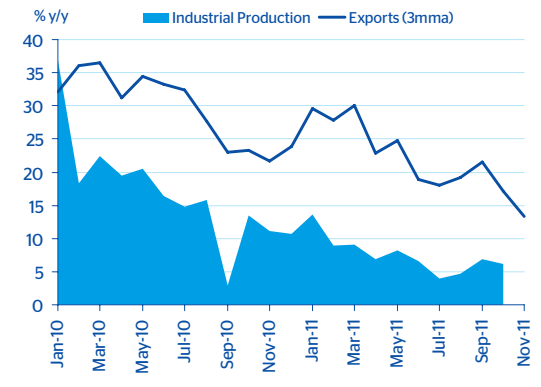
Meanwhile, the Korean authorities have been taking steps to bolster the economy in the event of a further deterioration in the external environment. Korea was especially hard-hit during the 2008-09 global financial crisis, through both trade and financial channels. Vulnerabilities have been reduced with respect to the latter, due to macro-prudential measures to lower short-term external debt and banks' loan-to-deposit ratios. Thus, the economy is in a stronger position now to weather an external shock, all the more so given higher reserves, a current account surplus, and sound public finances. These factors led Fitch ratings last month to upgrade Korea's sovereign outlook from "stable" to "positive." Nevertheless, Korea remains exposed given its high degree of openness.

Chart 5
The Bank of Korea will stay on hold as real interest rates remain negative...



Source: BBVA Research and Bloomberg

Chart 6
...despite slowing activity indicators



Source: BBVA Research and Bloomberg

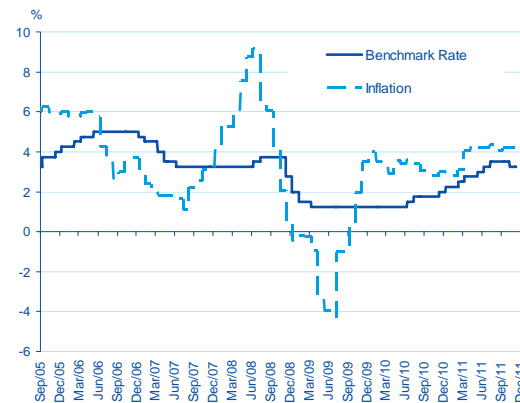
Thailand cuts interest rates to support post-flood recovery

As expected, the Bank of Thailand cut interest rates this week by 25bps, after statements in preceding days from the Governor hinting of policy easing (Chart 7). The move is in response to the widespread impact of the flooding and to the weakening external environment, and it marks an end to a series of interest rate hikes through September this year. Despite ticking up because of supply disruptions from recent floods (4.2% y/y in November, consensus: 4.4%), inflation is under control with core inflation below the 3% target, and growth has become the most urgent policy concern due to the devastating impact of the floods. Other central banks in the region that have moved to an easing stance include China, which cut the RRR this week, and Indonesia.

The floods have affected numerous parts of the economy, including agriculture, tourism and manufacturing, and have also disrupted global supply chains in the electronics and auto industries. The disruptions were apparent in Thailand's October trade figures, in which both exports (-0.1% y/y, prior: 18.4%) and imports (20.6% y/y, prior: 42.6%) decelerated, following a slump in industrial output. The heavy disruptions in the manufacturing industry Manufacturing has been severely disrupted, with negative implications for global supply chains. Thailand has a large share of the world's hard disk drive market, and also serves as an important regional export hub in the car industry. Many foreign companies—especially from Japan—have been impacted, and the government faces an uphill struggle to restore business and consumer confidence. Additionally, as food is a major export of Thailand, reductions in agricultural output may place upward pressure in global prices for specific foodstuffs, like rice.

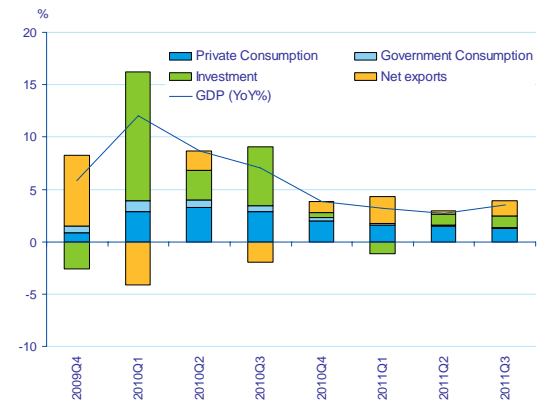
To date, the floods have caused around \$45 billion in damage—equally split between property losses and lost output—and the estimated cost of reconstruction and flood prevention will amount to \$24.1 billion, according to the World Bank. The disruptions have led to sharp downgrades of Thailand's near-term growth outlook, with the National Economic and Social Development Board lowering its 2011 growth forecast to 1.5% from an original 4.0% due to an expected contraction in the fourth quarter. The lower growth outlook comes after a disappointing third quarter GDP outturn of 3.5% y/y (consensus: 4.5%) (Chart 8). Nevertheless, a rebound is anticipated in 2012 due to a low base effect, although weakening external prospects could put that at jeopardy as well. On the policy front, we expect the just-commenced easing stance to continue at least until the second quarter. On previous occasions, the BoT has not hesitated to cut rates sharply when they considered it was needed, so even larger rate cuts cannot be ruled out.

Chart 7
The Bank of Thailand cuts interest rates



Source: BBVA Research and Bloomberg

Chart 8
Thailand's GDP growth is expected to slow in Q4



Source: BBVA Research and Bloomberg

Calendar Indicators

Australia	Date	Period	Prior	Cons.
Australia Net Exports of GDP	6-Dec	3Q	-0.5%	-0.6%
Gross Domestic Product (QoQ)	7-Dec	3Q	1.2%	1.2%
Gross Domestic Product (YoY)	7-Dec	3Q	1.4%	2.3%
Unemployment Rate	8-Dec	NOV	5.2%	5.2%
China	Date	Period	Prior	Cons.
China Non-manufacturing PMI	3-Dec	NOV	57.7	--
China HSBC Services PMI	5-Dec	NOV	54.1	--
CPI Inflation (YoY)	9-Dec	NOV	5.5%	4.5%
Producer Price Index (YoY)	9-Dec	NOV	5.0%	3.2%
Industrial Production (YoY)	9-Dec	NOV	13.2%	12.7%
Retail Sales (YoY)	9-Dec	NOV	17.2%	16.8%
Japan	Date	Period	Prior	Cons.
Machine Orders (MoM)	8-Dec	OCT	-8.2%	0.5%
Gross Domestic Product Annualized	9-Dec	3Q F	6.0%	--
Gross Domestic Product (QoQ)	9-Dec	3Q F	1.5%	--
Malaysia	Date	Period	Prior	Cons.
Industrial Production (YoY)	8-Dec	OCT	2.5%	1.5%
Exports (YoY)	9-Dec	OCT	16.6%	7.3%
Imports (YoY)	9-Dec	OCT	12.9%	5.0%
Philippines	Date	Period	Prior	Cons.
CPI Inflation (YoY)	6-Dec	NOV	5.2%	5.0%
Core CPI Inflation (YoY) 2000=100	6-Dec	NOV	3.9%	--
Korea	Date	Period	Prior	Cons.
Gross Domestic Product (QoQ)	6-Dec	3Q F	0.7%	--
Gross Domestic Product (YoY)	6-Dec	3Q F	3.4%	--
Producer Price Index (YoY)	9-Dec	NOV	5.6%	--
Taiwan	Date	Period	Prior	Cons.
CPI Inflation (YoY)	5-Dec	NOV	1.22%	1.27%
WPI (YoY)	5-Dec	NOV	5.93%	6.0%
Exports (YoY)	8-Dec	NOV	11.7%	8.6%
Imports (YoY)	8-Dec	NOV	11.8%	2.4%

Indicator of the Week: China CPI for November (December 9)

Forecast: 4.3% y/y Consensus: 4.5% y/y Prior: 5.5% y/y

Comment: A stream of important indicators in China will be released in the coming week, including November inflation, trade, industrial production, investment, and retail sales. Inflation has been a particular concern for much of the year, but is beginning to recede as food and commodity prices soften, and as growth slows due to external headwinds. Markets will be watching for a further decline in inflation, which could provide room for further monetary easing, following a recent cut in the RRR. With inflation still above the authorities' 4% comfort level, however, further monetary easing will likely be implemented cautiously. Market impact: A lower-than-expected inflation reading could raise expectations of further monetary easing given indications of slowing growth, while a higher reading would dent sentiment by limiting the authorities' perceived room for policy maneuver.

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Australia - RBA Monetary Policy Meeting, December 6

We expect the cash target rate to remain unchanged

Current Consensus

4.50% 4.50%

Indonesia - Bank Indonesia Monetary Policy Meeting, December 8

We expect the reference rate to remain unchanged

Current Consensus

6.00% 6.00%

Korea - BoK Monetary Policy Committee Meeting, December 8

We expect the 7-day repo rate to remain unchanged

Current Consensus

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.	2360.7	-0.8	-15.9	-17.0
	Hong Kong - Hang Seng	18973.2	7.3	-17.6	-19.1
	Taiwan - Weighted	7140.7	5.2	-20.4	-16.8
	Japan - Nikkei 225	8643.8	5.9	-15.5	-15.0
	Korea - Kospi	1916.0	7.9	-6.6	-1.8
	India - Sensex 30	16546.5	5.4	-19.3	-17.2
	Australia - SPX/ASX 200	4288.0	7.6	-9.6	-8.3
	Singapore - Strait Times	2747.4	3.9	-13.9	-14.1
	Indonesia - Jakarta Comp	3759.7	3.4	1.5	1.8
	Thailand - SET	1022.8	5.7	-1.0	-0.9
	Malaysia - KLCI	1485.7	3.8	-2.2	-1.2
	Philippines - Manila Comp.	4290.9	0.7	2.1	3.4

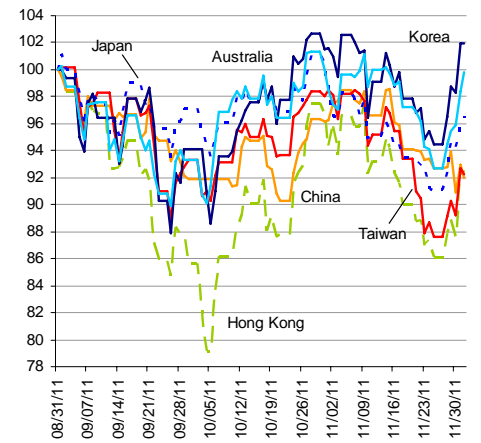
Last update: Friday, 11.45 Hong Kong time.

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.36	0.26	6.37	6.38
	Hong Kong (HKD/USD)	7.77	0.31	7.77	7.75
	Taiwan (TWD/USD)	30.1	0.95	30.11	29.77
	Japan (JPY/USD)	77.8	-0.08	77.62	77.08
	Korea (KRW/USD)	1131	2.91	1136	1142
	India (INR/USD)	51.4	1.76	52.24	53.68
	Australia (USD/AUD)	1.02	5.21	0.99	n.a.
	Singapore (SGD/USD)	1.29	2.14	1.29	1.28
	Indonesia (IDR/USD)	9088	-0.33	9213	9685
	Thailand (THB/USD)	30.9	1.72	31.08	31.48
	Malaysia (MYR/USD)	3.13	2.22	3.14	3.16
	Philippines (PHP/USD)	43.3	1.60	43.33	43.35

Last update: Friday, 11.45 Hong Kong time.

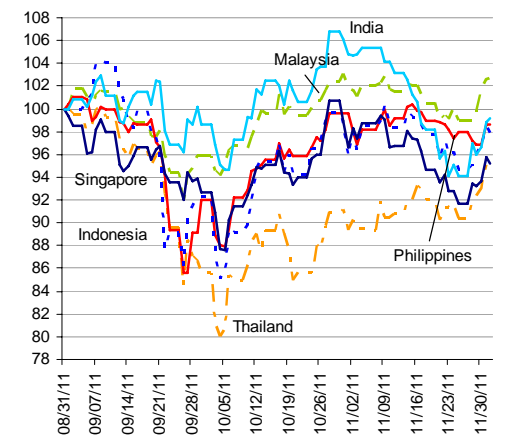
Charts

Chart 9
Stock Markets



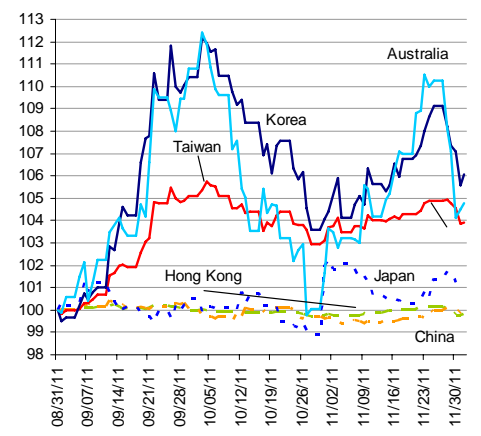
Source: BBVA Research and Bloomberg

Chart 10
Stock Markets



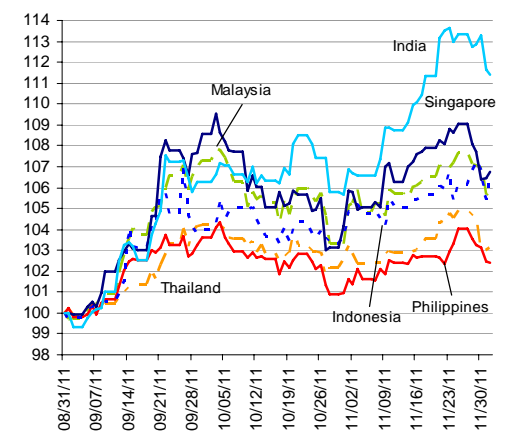
Source: BBVA Research and Bloomberg

Chart 11
Foreign Exchange Markets



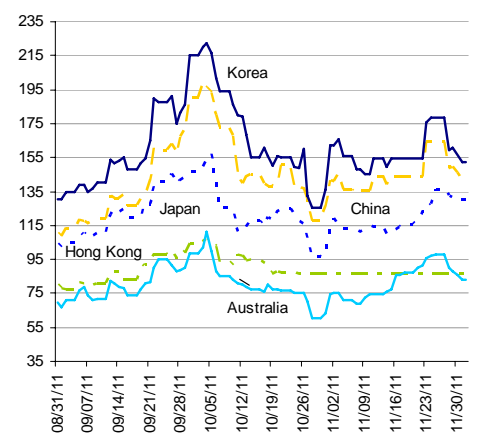
Source: BBVA Research and Bloomberg

Chart 12
Foreign Exchange Markets



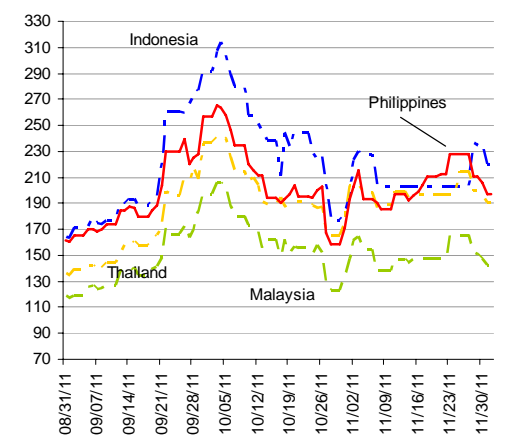
Source: BBVA Research and Bloomberg

Chart 13
Credit Default Swaps



Source: BBVA Research and Bloomberg

Chart 14
Credit Default Swaps



Source: BBVA Research and Bloomberg

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