

Weekly Watch

Asia

6 January 2012
Economic Analysis

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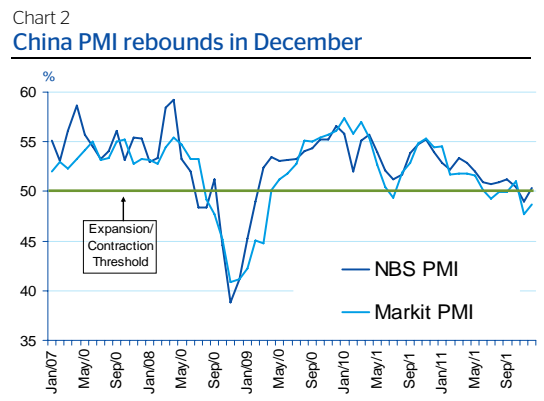
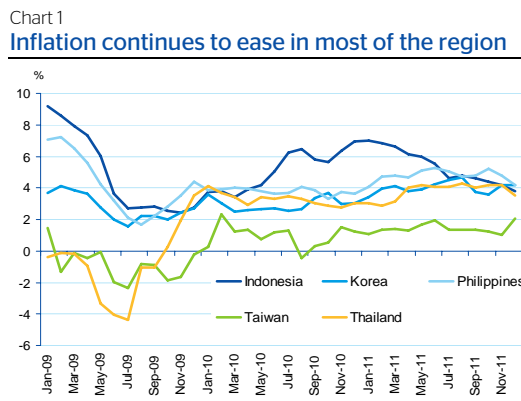
Well positioned for 2012's challenges

Asian economies displayed remarkable resilience over the past year in the face of strengthening external headwinds and natural disasters that ravaged the region, especially in Japan and Thailand. Will this resilience be sustained in 2012? On a positive note, the region's fundamentals remain sound and policy makers appear ready to take action as needed to cushion the effects of a sharp decline in external demand. Nevertheless, the region remains vulnerable through trade and financial channels, all the more so given its export dependence and reliance on overseas bank borrowing. Already, growth has been slowing in most Asian economies, and the outlook is for a further deceleration in the first half of 2012. The main risks come from the possibility of a full-blown external crisis, a worse-than-expected slowdown in China, and rising geo-political tensions. Barring these, the region should maintain reasonable growth in the coming year.

2011 closes with a further decline in inflation and moderation in activity

Inflation continues to decline, providing further room for monetary policy easing. December inflation outturns were below consensus, largely due to declining food prices, in Indonesia (3.8% y/y; consensus: 3.9%), Thailand (3.5% y/y; consensus: 4.0%), the Philippines (4.2% y/y; consensus: 4.7%), and Vietnam (18.1% y/y; prior: 19.8%) (Chart 1). However, there were exceptions, such as in Korea (4.2% y/y; consensus: 4.0%) and Taiwan (2.0% y/y; consensus: 1.2%). China's PMI rebounded in December (50.3; BBVA: 50.3; consensus: 49.0), providing further evidence of a soft landing (Chart 2). Meanwhile, December exports in Korea were well above expectations (12.5% y/y; consensus: 6.3%), but have been moderating in monthly sequential terms. Singapore's 4Q GDP growth contracted in line with expectations, (-4.9% q/q; consensus: -5.0%) while Vietnam's full-year growth declined to 5.9% from 6.8% in 2010.

China will remain the focus of attention in the next two weeks, with the publication of a number of important indicators, including inflation, GDP, retail sales, and investment (see Weekly Indicator and Highlights). Indonesia and Korea will hold their monthly monetary policy meetings (see Highlights), and we expect both to remain on hold for the time being.



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Highlights

China: watching the data for signs of a soft landing

With signs of slowing growth, the authorities have shifted policies to a more supportive stance

Taking stock of monetary policy decisions in Indonesia and Korea

Rate cuts are expected in the months ahead, but both central banks should stay on hold for now

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Markets

New Year rally falters

Most Asian equity markets rang in the New Year on a bright note, with the Hang Seng, KOSPI, and others up about 2% (although China's market was a notable exception, to the downside). However, positive momentum has slowed quickly as attention turns back to European debt issues, and markets finishing flat for the week. Also, activity indicators in Asia continue to point to slowing growth. In China, markets will be watching a new batch of activity indicators next week (see Highlights) to determine whether weakening activity may cause the PBoC to ease policy further. For the time being, there are growing expectations that the PBoC will lower the RRR given tight interbank liquidity ahead of Chinese New Year.

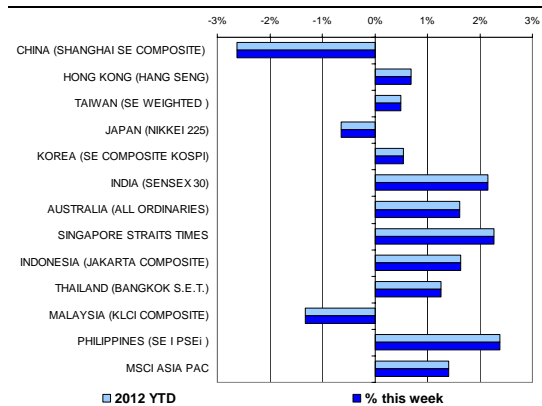
Indonesia: more upside?

In Indonesia, where the stock market has outperformed the rest of Asia over the past two years (the JCI returned 3.2%, while the MSCI Asia Ex-Japan index fell -17.3%), Fitch's recent sovereign upgrade to investment grade has boosted sentiment further. GDP growth has remained robust, inflation fell below 4% in December, and Parliament finally passed a new land acquisition law to speed up infrastructure development (see Highlights). Fitch's upgrade (which could be followed by S&P and Moody's eventually) will increase the pool of international investors in the country's capital markets, deepen liquidity, and reduce borrowing costs. All positive news for investors.

Near-term downside risks for RMB

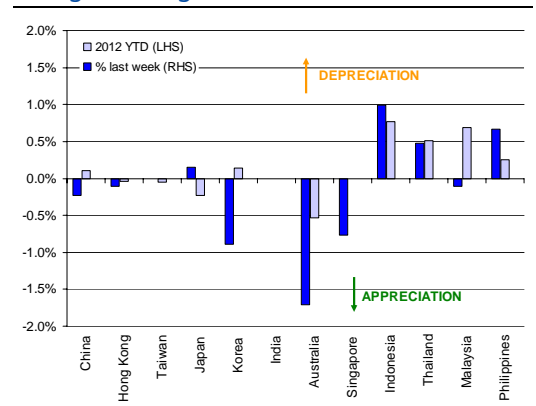
While we remain constructive on the RMB outlook for the coming year, seeing a 3.0% appreciation against the USD for the full year, the risk of some depreciation in the near term cannot be ruled out for a couple of reasons. First, the PBoC accelerated its currency appreciation in the last two weeks of Dec (up more than 1.0% in 14 days), perhaps in advance of the 6-monthly US Treasury report on currency developments, and also to meet its own annual appreciation target. The risks of short-term reversal are usually high after such an abrupt move, particularly in the current USD bid environment. In fact, we already see a higher USDCNY fixing (weaker RMB) this week. Second, the markets will likely respond to a slowing global growth environment and push RMB back towards the weaker side of the band. In this context, the trade data due next week deserve close monitoring.

Chart 3
Stock markets



Source: BBVA Research and Bloomberg

Chart 4
Foreign exchange markets



Source: BBVA Research and Bloomberg

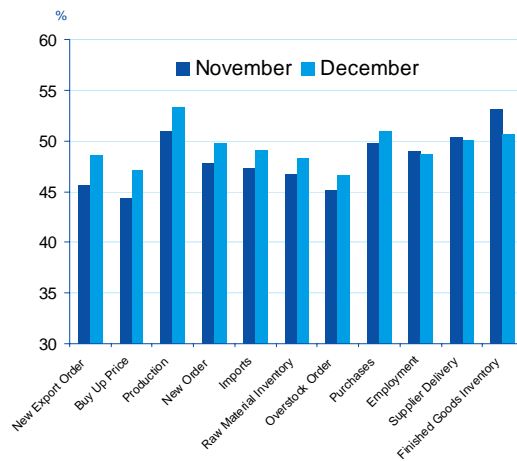
Highlights

China: watching the data for signs of a soft landing

Slowing growth momentum and external headwinds are leading the Chinese authorities to adopt a more growth-supportive policy stance, as signaled by the PBoC's 50bp cut in the required reserve ratio (RRR) at end-November. In this context, a number of important monthly indicators will be released in the next couple of weeks, and they will be closely watched for further evidence of a soft landing. One key indicator, December manufacturing PMI, has already been released (on January 1). The outturn of 50.3 was well above market expectations (consensus: 49.1), although it was exactly in line with our forecast, as we had expected a rebound from November's dip to 49.0 on the effects of recent credit easing and some stabilization in export demand. By subcomponent the outturn was driven by improvements in production and new orders. There was also an encouraging improvement in the index of export orders, although it remained in the contraction zone. Caution in interpreting the rebound is in order, however, as it may partly reflect seasonality as production may have been moved forward in advance of the Chinese New Year holiday during the week of January 23.

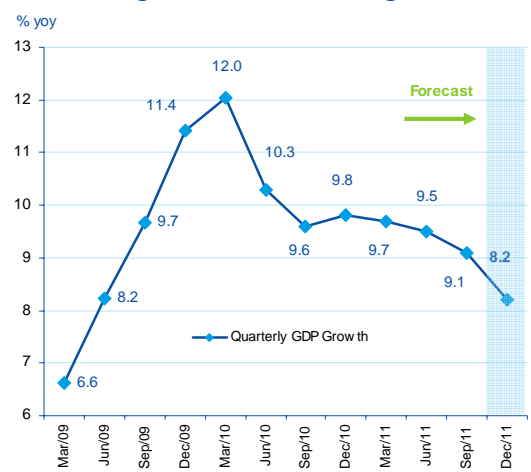
Over the course of the next two weeks, a batch of other important indicators will be released, including fourth quarter GDP, and for December retails sales, industrial output, investment, foreign reserves, and money aggregates. December inflation will be released next week, and we expect it have continued a gradual easing trend to 4.1% y/y (see Weekly Indicator), while real activity indicators are also expected to have remained robust. We expect GDP growth for the fourth quarter to have slowed to 8.2% y/y from 9.1% in Q3, which would bring full-year GDP growth to 9.0%. Taken together, we believe that the economy is still on track for a soft-landing, as policies turn more growth supportive. We anticipate additional RRR cuts of 150-200 bps during the first half of the year, with a cut possible this month, before the Chinese New Year. We believe that cuts in the RRR will be accompanied by up to two interest rate cuts toward the end of Q1 or in Q2 as inflation eases toward 3% y/y toward the middle of the year.

Chart 5
The rebound in China's PMI was broad-based



Source: BBVA Research and Bloomberg

Chart 6
China's GDP growth has been slowing



Source: BBVA Research and Bloomberg

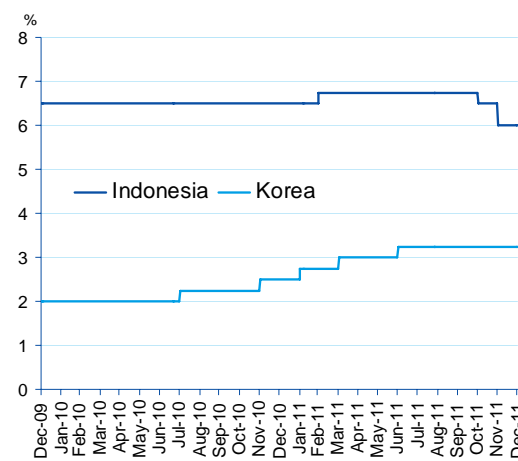
Taking stock of monetary policy decisions in Indonesia and Korea

Indonesia and Korea are scheduled to hold their monthly monetary policy meetings next week, on January 12 and 13, respectively. The policy decisions of Bank Indonesia (BI) and the Bank of Korea (BoK) have been closely watched in recent months as policy stances throughout the region have shifted from preventing overheating to supporting growth amidst the global slowdown. BI cut interest rates by 75bps in October/November, while the BoK put further interest rate hikes on hold last June after a series of five rate hikes. We expect both central banks to stand pat at their forthcoming meetings next week.

GDP growth in Indonesia has remained strong despite headwinds from the European debt crisis. Fed by rapid credit growth, domestic demand has been robust, and a steep fall in inflation to well within BI's target range of 4-6% for 2011 (inflation decreased to 3.79% y/y in December, from 4.15% in November) made room for the cut in interest rates, which currently stand at 6.0% (Chart 1). Indonesia's economic outlook has also benefited from two positive events last month: Fitch's upgrade to investment grade, and the passage of a long-awaited land acquisition law which should facilitate much-needed infrastructure development. Given the strong growth trends, and concerns about capital outflows and currency weakness due to heightened global risk aversion, we expect BI to stay on hold, for now with further rate cuts of up to 50bp possible in the coming months if inflation continues to ease in line with the 2012 inflation target (3.5-5.5%).

Korea's near term economic outlook is more challenging. Weakening external demand has led to a moderation of growth momentum. PMI has remained below the critical 50 level (signaling a contraction) since August; the inventory-to-shipment ratio is at its highest level in three years, and despite the headline exports number appearing rather resilient (growth of 12.5% y/y in December), on a sequential basis, exports are declining (Chart 2). Domestically, while unemployment has remained stable thus far, spillovers from the slowdown in exports may eventually hurt domestic demand (as underscored in our recent *Korea Economic Watch*), with uncertainty further heightened by the ongoing political transition in North Korea. In addition, inflation remains above the BoK's 2-4% target range, at 4.2% y/y in December. Despite the slowing growth momentum, we expect the BoK to stay pat given the stickiness of inflation, and concerns about further fueling credit growth to the household sector, which is highly indebted. We expect rate cuts in Korea only later in the year, mostly likely in the second and third quarters. In the meantime, the government is likely to provide some fiscal support by front-loading spending in the first half of the year.

Chart 7
Interest rate moves in Indonesia and Korea



Source: BBVA Research and Bloomberg

Chart 8
Korean export growth is on a declining trend



Source: BBVA Research and Bloomberg

Calendar Indicators

Australia	Date	Period	Prior	Cons.
Retail Sales s.a. (MoM)	9-Jan	NOV	0.20%	0.40%
Building Approvals (YoY)	10-Jan	NOV	-29.80%	-17.60%
China	Date	Period	Prior	Cons.
CPI Inflation (YoY)	09-13 JAN	DEC	4.20%	4.00%
Trade Balance (USD)	10-Jan	DEC	\$14.53B	\$8.70B
Exports (YoY)	10-Jan	DEC	13.80%	14.30%
Imports (YoY)	10-Jan	DEC	22.10%	18.50%
New Yuan Loans	11-15 JAN	DEC	562.2B	560.0B
Money Supply - M2 (YoY)	11-15 JAN	DEC	12.70%	12.60%
Industrial Production (YoY)	13-20 JAN	DEC	12.40%	12.20%
Real GDP (QoQ)	13-20 JAN	4Q	2.30%	--
Real GDP (YoY)	13-20 JAN	4Q	9.10%	8.60%
Retail Sales (YoY)	13-20 JAN	DEC	17.30%	17.10%
India	Date	Period	Prior	Cons.
Industrial Production (YoY)	12-Jan	NOV	-5.10%	--
Japan	Date	Period	Prior	Cons.
Current Account Balance (YoY)	12-Jan	NOV	-62.40%	--
Machine Tool Orders (YoY)	12-Jan	DEC P	15.80%	--
Malaysia	Date	Period	Prior	Cons.
Industrial Production (YoY)	10-Jan	NOV	2.80%	--
Exports (YoY)	11-Jan	NOV	15.80%	--
Imports (YoY)	11-Jan	NOV	4.60%	--
Trade Balance	11-Jan	NOV	13.22B	--
Singapore	Date	Period	Prior	Cons.
Retail Sales (YoY)	13-Jan	NOV	8.50%	--
Taiwan	Date	Period	Prior	Cons.
Total Trade Bal in US\$ Billion	9-Jan	DEC	\$3.20B	\$2.74B
Exports (YoY)	9-Jan	DEC	1.30%	3.70%
Imports (YoY)	9-Jan	DEC	-10.40%	-0.90%

Indicator of the Week: China's CPI Inflation for December (January 9-13)

Forecast: 4.1% y/y Consensus: 4.0% y/y Prior: 4.2% y/y

Comment: For much of 2011 inflation was the dominant policy concern in China. Inflation peaked in July at 6.5% y/y, and has been falling ever since due to the central bank's monetary restraint, declining food and commodity prices and, more recently, slowing growth momentum. Together with the uncertain global environment, the latter has given rise to worries of a hard landing, tempered by the authorities' perceived willingness to relax the monetary stance to support growth. We expect inflation to ease further in December, to just above the authorities 4% comfort range, which would help pave the way for further cuts in the required reserve ratio in the current quarter. An expected further decline, to around 3% by mid-year, should provide additional scope for monetary easing in the months ahead. Meanwhile, to gauge the pace of activity, markets will be watching for a batch of other important indicators in the coming two weeks, including GDP, retail sales, industrial output, and investment.

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Calendar Events

Indonesia - Bank Indonesia Monetary Policy Meeting, January 12 **Current Consensus**
We expect no change in the reference rate 6.00% 6.00%

Korea - BoK Monetary Policy Committee Meeting, January 13 **Current Consensus**
We expect no change in the 7-Day Repo Rate 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.	2141.7	-2.6	-2.6	-24.2
	Hong Kong - Hang Seng	18561.5	0.7	0.7	-22.0
	Taiwan - Weighted	7106.6	0.5	0.5	-20.0
	Japan - Nikkei 225	8401.3	-0.6	-0.6	-20.2
	Korea - Kospi	1835.2	0.5	0.5	-11.7
	India - Sensex 30	15789.1	2.2	2.2	-21.8
	Australia - SPX/ASX 200	4121.9	1.6	1.6	-12.8
	Singapore - Strait Times	2705.9	2.3	2.3	-17.5
	Indonesia - Jakarta Comp	3885.5	1.7	1.7	4.0
	Thailand - SET	1038.2	1.3	1.3	-1.2
	Malaysia - KLCI	1510.6	-1.3	-1.3	-3.7
	Philippines - Manila Comp.	4478.5	2.4	2.4	6.2

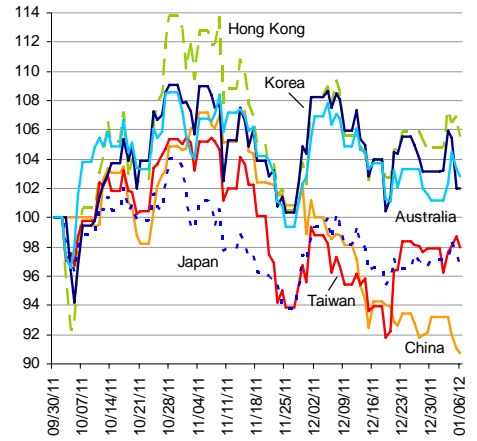
Last update: Friday, 11.45 Hong Kong time.

FOREIGN EXCHANGE MARKETS	CURRENCY	Spot	% change over a week	Forward 3-month	Forward 12-month
	China (CNY/USD)	6.31	-0.20	6.32	6.34
	Hong Kong (HKD/USD)	7.77	0.02	7.77	7.77
	Taiwan (TWD/USD)	30.2	0.25	30.11	29.78
	Japan (JPY/USD)	77.2	-0.35	77.06	76.51
	Korea (KRW/USD)	1159	-0.56	1165	1172
	India (INR/USD)	52.9	0.40	53.86	55.68
	Australia (USD/AUD)	1.03	0.47	0.98	n.a.
	Singapore (SGD/USD)	1.29	0.31	1.29	1.29
	Indonesia (IDR/USD)	9171	-1.11	9304	9682
	Thailand (THB/USD)	31.6	-0.22	31.82	32.20
	Malaysia (MYR/USD)	3.15	0.56	3.17	3.20
	Philippines (PHP/USD)	44.1	-0.61	44.27	44.46

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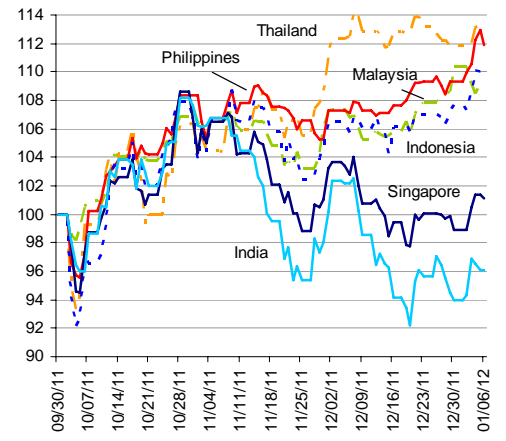
Charts

Chart 9
Stock Markets



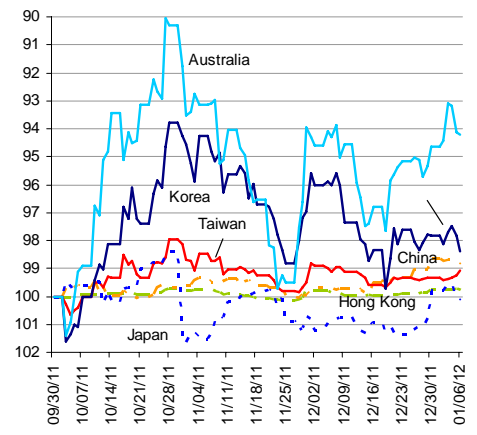
Source: BBVA Research and Bloomberg

Chart 10
Stock Markets



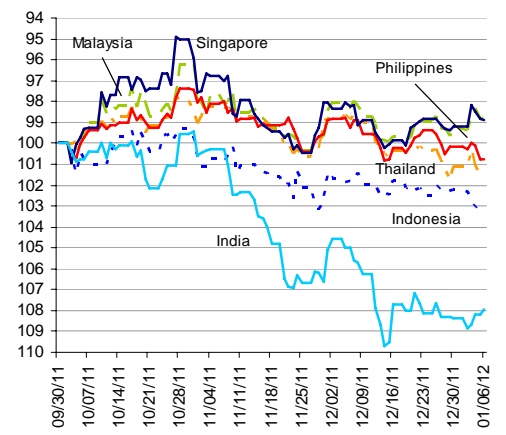
Source: BBVA Research and Bloomberg

Chart 11
Foreign Exchange Markets



Source: BBVA Research and Bloomberg

Chart 12
Foreign Exchange Markets



Source: BBVA Research and Bloomberg

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