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MACRO MORNING BRIEFING

March 28, 2024

Reassessing Disinflation Trends In APAC

The Central Bank of the Republic of China (CBC) unexpectedly lifted its benchmark discount rate 12.5bp to 2.0% a week ago. Among the reasons given for the move was "to contain domestic inflation expectations" ahead of a proposed electricity rate hike, as well as a "relatively higher level" of inflation since 2021 (full statement, see Section III).

Headline inflation in Taiwan has been in a 1.75-3.59% y/y range (average 2.70% y/y) since 2022, compared with a range of -0.93 to 2.41% y/y (average 0.73% y/y) between 2015 and 2019 – the five-year stretch preceding COVID. Taiwan is slated to raise electricity prices by an average of 11% from April 1, including a 25% jump for large industrial users.

The CBC's emphasis on a tariff-related impact on inflation is most interesting to us, as such things are usually viewed as one-offs. Acceleration in domestic housing prices and the strong recovery in technology exports might have contributed to the hawkish action, as well. House prices in the Taipei area hit a cyclically flat growth in July 2023, recovered to 3.8% y/y at the end of last year, and then accelerated to 9.2% this February.

While macro conditions across APAC are asynchronous, the CBC action is a reminder not to be complacent on upside or prolonged elevated inflation risks, and to be cautious about expecting a reversal in monetary policy simply because a tightening cycle has ended.

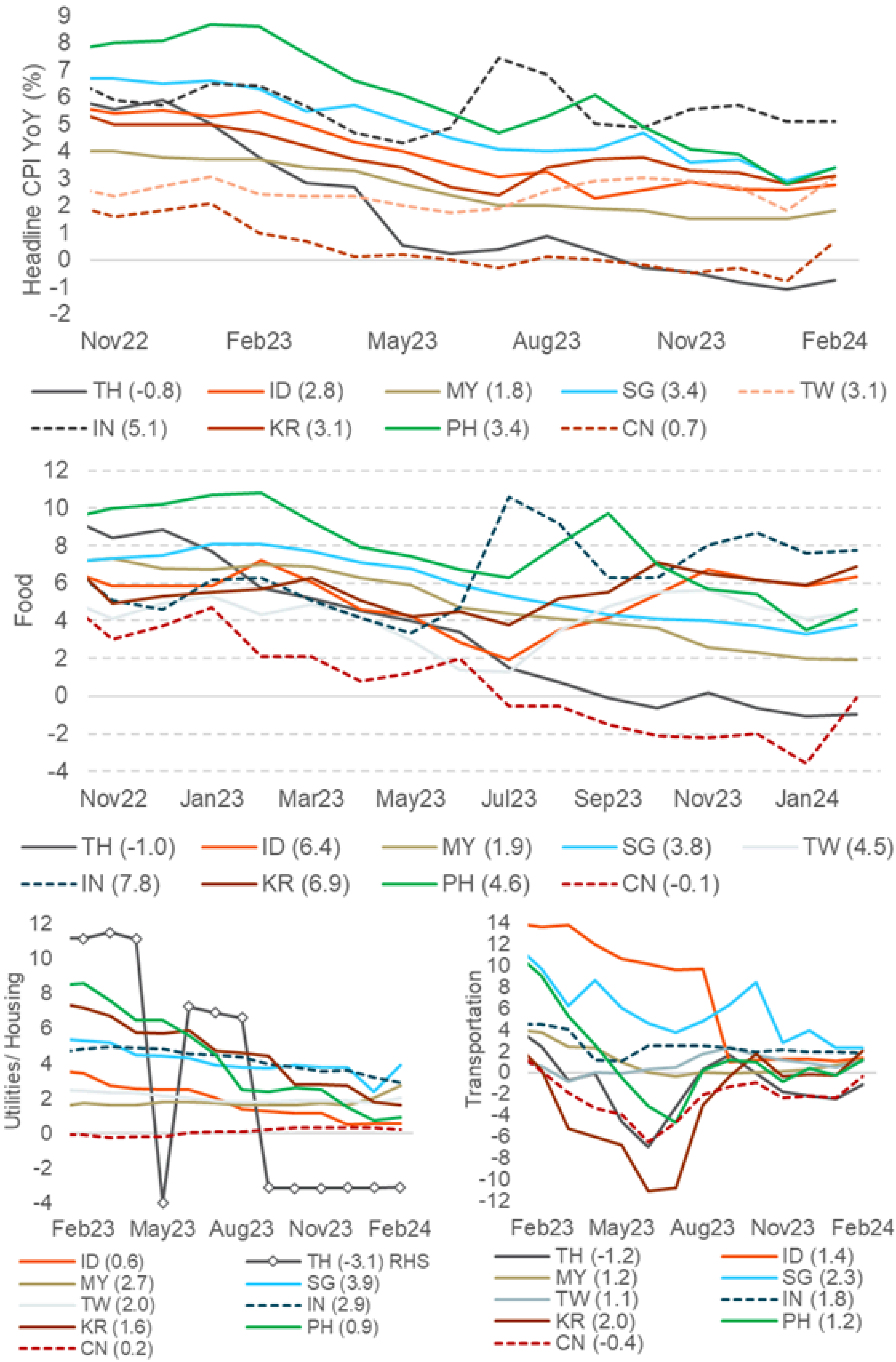
Indeed, both headline and core inflation have ticked up across the APAC region after having been on lower trajectories in 2023. China offers a case in point: after four consecutive months of negative headline readings starting last October, inflation rebounded into positive territory, at 0.7% y/y, in February. The drivers of the rebound were higher food prices and utility costs, along with a decreasing drag from transportation costs.

With WTI crude oil prices having recovered from around $69 last December to above $80 now (they're up roughly 14% year-to-date), a positive base effect is likely to feed through to headline inflation – a reversal from the negative base effect-related disinflation pressure throughout 2023. Assuming crude prices stay around current levels in the coming months, the base effect is expected to peak in May/June before flattening out in Q3.

Also worth monitoring for potential upside impacts on inflation in the near term are idiosyncratic tariffs and subsidies. For example, Thailand is considering raising the cap on retail diesel prices and increasing the excise tax-cut on diesel fuel. There's also the implementation of a tax on low- and high-value goods, and reduced subsidies, in Malaysia; Singapore raised electricity and gas tariffs in Q1; and India telcos are reportedly planning tariff hikes. Elevated food prices, for rice in particular, has been an issue for many countries in the region, notably Thailand, India, the Philippines and Indonesia.

Disinflation in APAC might be largely over. What could this mean for monetary policies?

Exhibit #1: APAC Inflation And Key Subcomponents



Source: BNY Mellon Markets, Bloomberg L.P.

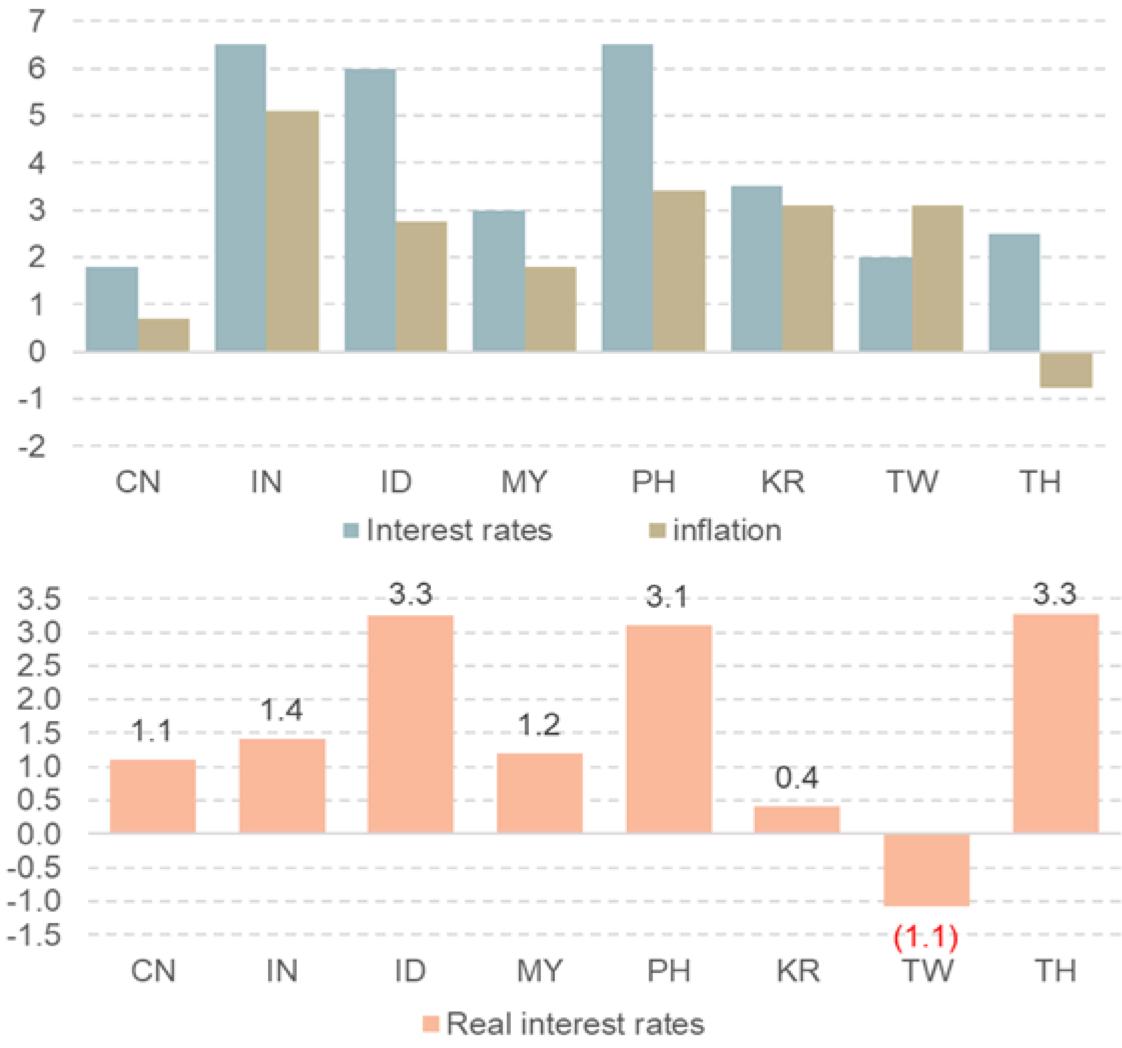
Real interest rates give us an idea of potential room for policy adjustments (exhibit #2, lower half). Even after the CBC's surprise rate hike, real interest rates in Taiwan remain negative – the only APAC country that is the case. As of this month, Indonesia, the Philippines and

Thailand have the highest positive real interest rates, at over 3%. China, India and Malaysia have real interest rates just above 1%. South Korea has the lowest positive real rates, 0.4%.

Coincidently, officials in the Philippines and Indonesia have been most vocal about a policy reversal: the Philippines finance minister sees two rate cuts this year and Bank Indonesia see room for a cut in H2 2024. In addition, the Bank of Thailand has hinted at a potential need to recalibrate its neutral stance on monetary policy.

While a policy reversal might give a needed boost to domestic economic growth and/or consumer spending, we are more concerned about the potential impact on currency stability. A rate reduction or rising expectations of rate cuts in an environment in which a currency is weakening might lead to heightened capital outflows and be disruptive to financial stability.

Exhibit #2: APAC Interest Rates And Inflation

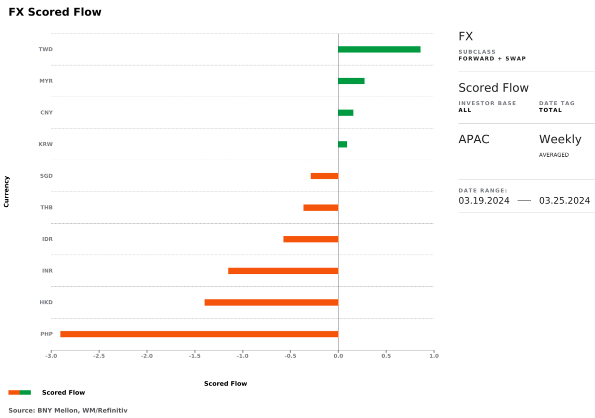


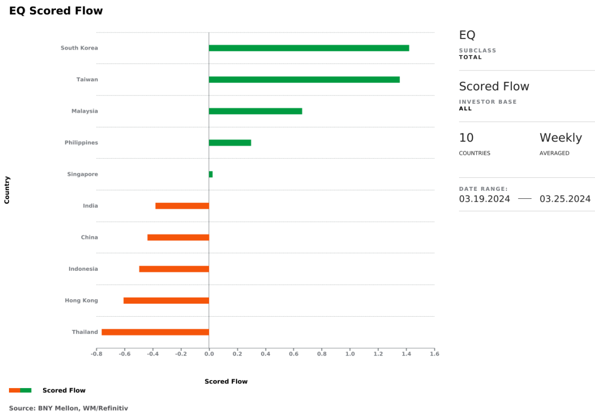
Source: BNY Mellon Markets, Bloomberg L.P.

Among regional currency aggregates, iFlow shows the most outflows from APAC over the past week. PHP, HKD and INR posted average weekly scored flows of -2.9, -1.4 and -1.2, respectively (to March 25). CNY flows flattened to near neutral. TWD had the most inflows.

Interesting in APAC equities was a surge in demand for Taiwan and South Korea. We think the AI-related recovery and growth in tech exports are likely to provide ongoing support for TWD and KRW. Malaysia and Philippines equities had lesser inflows. Singapore flows were around flat. The rest had moderate outflows. Sentiment towards China assets remains weak. Inflows and demand proved fleeting, giving way to renewed selling in both equities and sovereign bonds, which posted average weekly scored flows of -0.4 and -0.9, respectively.

Exhibit #3: APAC FX & Equity Flows





Source: BNY Mellon Markets, Bloomberg L.P.

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