

Economic Watch

Asia | Imported inflation is still manageable

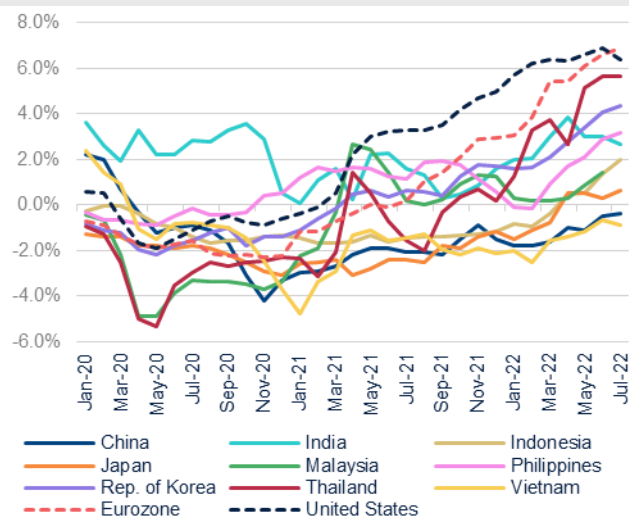
Jone Lorente Salaberria / Le Xia
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Asian countries headline inflation accelerates less than in other regions as consumption habits hit differently

Asia's growing inflation pressures have significantly picked up due to the global supply chain disruptions and high commodity prices. As a consequence, headline inflation has exceeded their central bank targets in several Asian countries through the first half of the year (Figure 1). Global supply chain disruptions and high commodity prices have translated into imported inflation in the region. In the meantime, Asian countries were more measured in launching fiscal stimulus to combat the pandemic-caused recession. Moreover, the social distancing policy and mobility restrictions implemented in some Asian countries also altered their consumption habits and inflation dynamics. These factors help to mitigate imported inflation in the region. There are few signs of demand overheating in Asia that would push prices even higher, since economic growth is still below their pre-Covid levels for most countries.

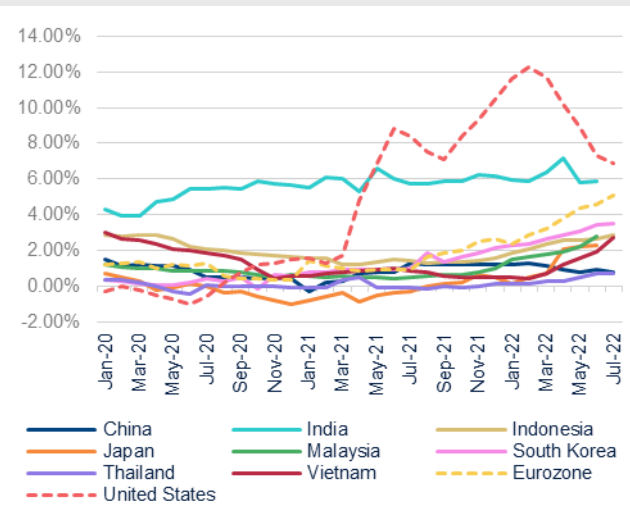
Core inflation remains stable in most of Asian countries (Figure 2). India is an exception given that its core inflation has persistently hovered around 6% since the beginning of 2021. In contrast, China's core inflation remains low, as sporadic shutdowns have weighed on consumer spending and overall economic activity.

Figure 1. Asia's inflation is moderate, albeit still above central bank targets



YoY CPI rate deviation from central bank targets, monthly (%)
Source: Central banks, Haver Analytics

Figure 2. Core inflation steady in Asia with the exception of India



YoY core inflation, monthly (%)
Source: Haver analytics

Looking into the components of price index, we find that inflation dynamics have been divergent in the region lately (Figure 3). Strain rose in India, Philippines and Thailand where high commodity prices had earlier and greater

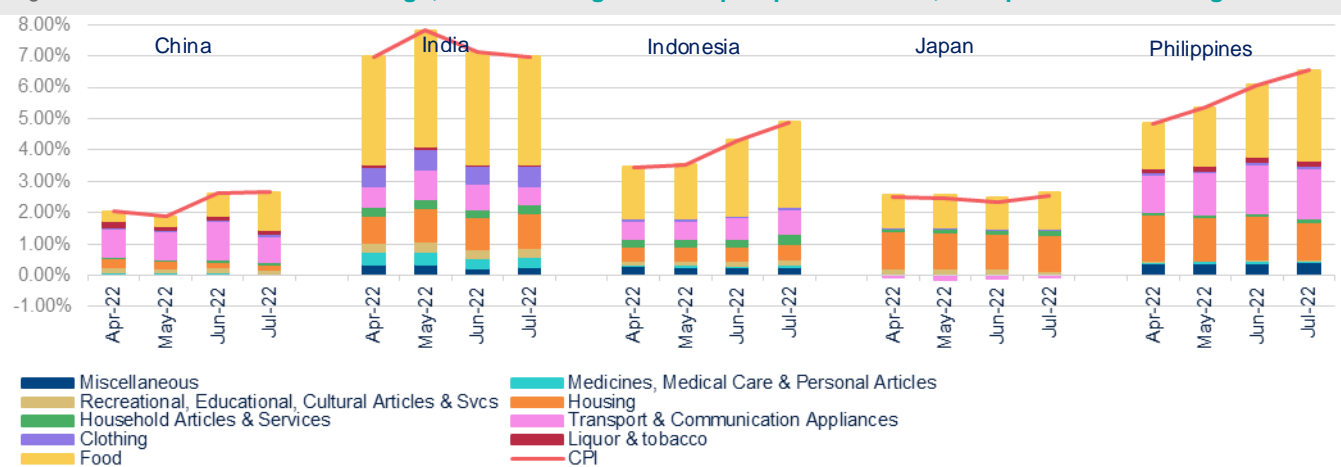
impacts. India and Thailand’s authorities have already deployed measures to stabilize prices. In Indonesia and Malaysia, the rising food prices also constitute the main factor to push up the general price level.

Japan’s and South Korea’s price trend is strongly influenced by a weak local exchange rate and global energy prices. While Japan’s inflation is still within its official inflation target range now, South Korea’s headline and core inflation have escalated. China’s CPI accelerated largely due to food costs, specifically pork prices. However, weak consumer demand, mainly due to pandemic-related shutdowns, still keeps overall price pressures at bay.

Vietnam stays below its inflation target and the recent fall in fuel prices caused a decrease in food and other goods prices.

As inflation inertia remains high, central banks started to tighten their monetary policies in Asia, after having applied some fiscal anti-inflationary policies. Only China and Japan haven’t deployed any interest rate hike this year.

Figure 3. **Inflation inertia remains high, while housing and transport push is stable, food prices are climbing**



Inflation components m/m growth (%)
Source: Statistics departments, Haver analytics

Inflation dynamics from the perspective of the CPI basket

Some Asian countries, namely China, India, Indonesia, Japan and Philippines, report the more details breakdown of their CPI baskets, which allows us to analyze their inflation dynamics from a bottom-up perspective. For these countries, we classify the components of their CPI basket into four categories based on their month-over-month (sa) increase figures: below 0%; between 0% and 0.25%; 0.25% to 0.5%; and above 0.5%.

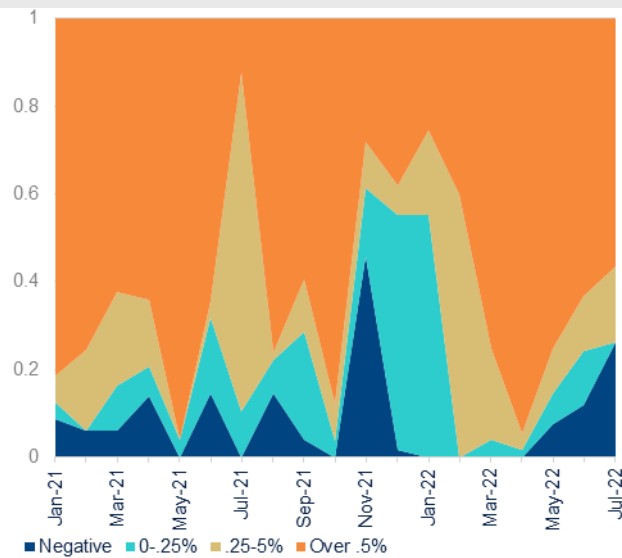
India and Philippines show signs of overheating, where the share of items with price increases above 0.5% m/m is on the rise. Both countries reliance on imported oil caused their inflation to trend up.

India’s oil imports account for 30% of total imports by value. Although the country has been buying Russian oil at a discount because of their traditional close ties, it has not been enough to cushion the energy shock. As prices spiked,

domestic consumption lowered. India, as a domestic consumption-driven economy, along with Reserve Bank of India's rate hikes, commenced to see prices cooling down since April. (Figure 4)

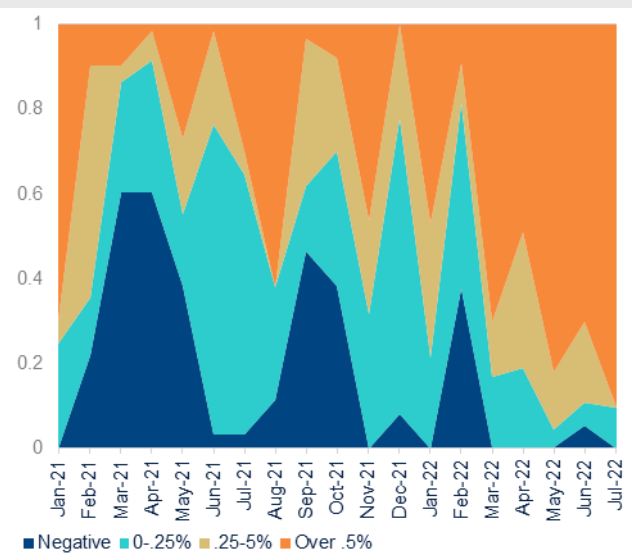
In Philippines, besides the effects of the oil prices, peso weakness is also feeding inflation. The nation's strong recovery led to more spending on capital machinery and raw materials, a widening current account deficit, and the weak local currency. Inflation was transferred to rising wages and transportation costs (Figure 5). That being said, the second-round effects are already kicking in. Banko Sentral ng Pilipinas (BSP), its central bank, is determined to take all necessary actions to tackle inflation.

Figure 4. **India's basket items' inflation overheated, now started to cool down because of policies decisions and domestic consumption lows**



Weight of items breakdown according to M/M inflation (%)
Source: Reserve bank of India, Haver Analytics

Figure 5. **Philippines has seen inflation transferred through its components and may suffer second round effects**



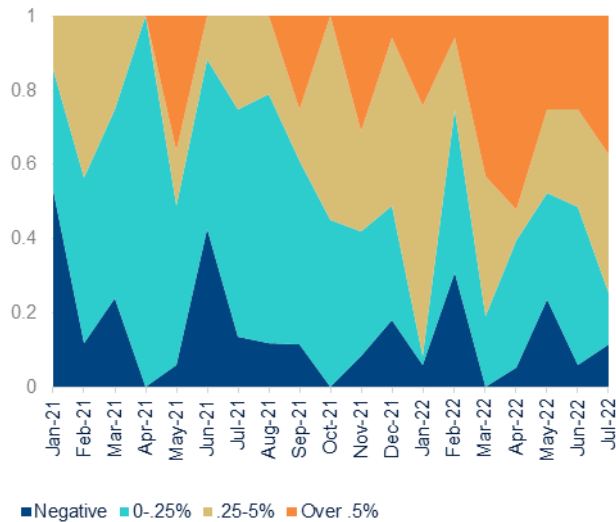
Weight of items breakdown according to M/M inflation (%)
Source: Banko Sentral ng Pilipinas, Haver analytics

Meanwhile, the inflation situation in China, Indonesia and Japan is more calmed for different reasons.

Indonesia's inflation accelerated in July, mainly driven by soaring food prices. However, the surge on prices has not been transmitted to the rest of items of the basket. Core inflation was roughly in line with expectations. Government employed energy subsidies to control it. Bank Indonesia hiked its policy interest rate in August, the first one within the year.

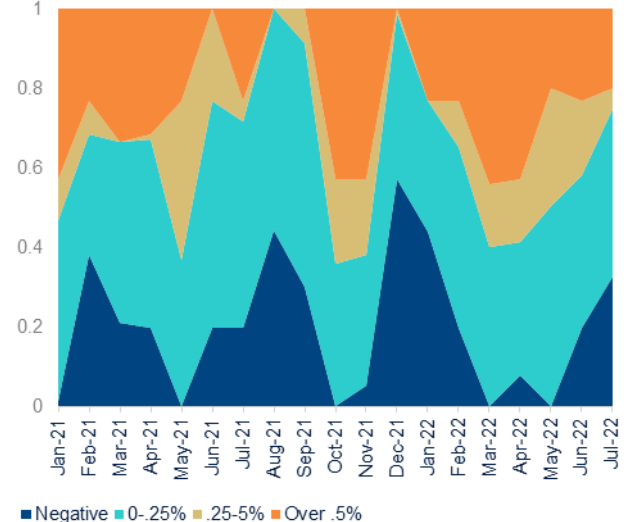
In China, "zero Covid" policies and restrictions dampened domestic consumption, which also inhibited energy spending. As a consequence, there is not such an upward trend of inflation through the components of the basket. In fact, the People's Bank of China is still carrying out accommodative policies through rate cuts and money injections to stimulate the economy.

Figure 6. **Indonesia's surge on food prices has not been transmitted through the items**



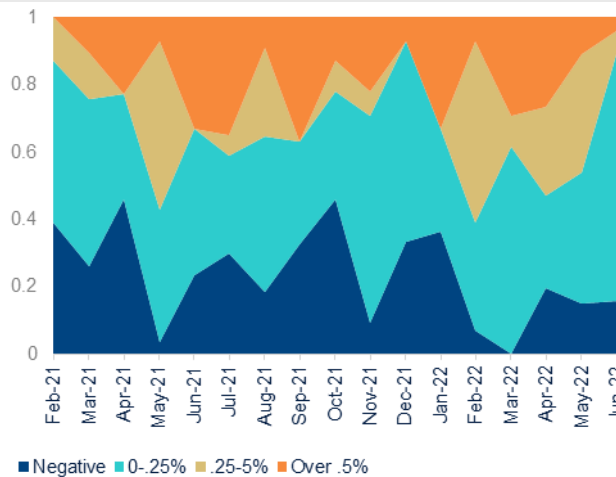
Weight of items breakdown according to M/M inflation (%)
Source: Bank Indonesia, Haver Analytics

Figure 7. **China's weak domestic consumption prevents from inflation components peaking**



Weight of items breakdown according to M/M inflation (%)
Source: The People's Bank of China, Haver analytics

Figure 8. **Japan's slow recovery avoids items of the basket prices spike**



Weight of items breakdown according to M/M inflation (%)
Source: Bank of Japan, Haver analytics

Japan's inflation stayed above Bank of Japan's target for three months in a row although the magnitude of deviation is small, 0.5%. The economy still faces pressure from high raw material prices, which pushed the cost of country's imports. Many companies have absorbed price increases with profit and limited its transfer to the consumers. Moreover, the sluggish wage growth and slow recovery of consumption also inhibited the price increase. In general, prices remain stable and there is no sign of overheating in the economy. Bank of Japan decided not to take any monetary measures in fear of withdrawing stimulus in the context of the slowing global growth.

The evolution of energy & commodity prices will set the future of regional inflation dynamics

The inflation pattern confirms a high pass-through of energy and other commodity prices in the region, which also reflects lagged depreciation effects. Looking ahead, the evolution of regional inflation is still subject to some uncertainties.

We have observed the bigger impact of headline inflation in India and South Korea, or second-round effects hitting Philippines. Such a pattern might echo the cases of the US and Europe where their inflation shot up at the beginning of 2022 in response to the energy prices spike. If Asia were to follow their patterns, inflation would still have a way to go.

The good news is that the core inflation in most of Asian countries still remain stable, thanks in part to their different consumption habits. Provided that food and energy prices are to stabilize, headline price pressures would cool down. In that case Asia is unlikely to repeat the painful inflation experiences of the US and Europe.

In sum, we are cautiously optimistic about the inflation situation in the region. Compared to the US and Europe, the policymakers in the region don't lag behind the curve too much. It will be crucial to anchor the public's inflation expectations and thereby to keep the inflation at bay. Moreover, the labor markets across these Asian countries are not feeling the same strain of workers shortages which are pronounced in other developed economies. With supply chains improving and inventories rising, the goods demand is set to be met with adequate supply in the months ahead. All above are pointing to an anchored inflation in the region.

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BBVA Research: Level 95, International Commerce Centre, Austin Road West, Kowloon, Hong Kong.
Tel. + 2582 3111 / Fax. +852-2587-9717
bbvarresearch@bbva.com www.bbvarresearch.com