Weekly Wander

All Rise
Asia's whiff of inflation uptick

Feb 24, 2017

- **As it turns out, it's not just growth indicators such as PMIs and export numbers which have been silently on the uptick. Asia's inflation prints have been creeping up, as well, in the background.**
- **The step-up in global crude prices has undoubtedly played a role in this, but unless the surge turns ugly, quickly, oil's inflationary impulse should peter out in the coming quarters.**
- **Still, especially for some economies such as Indonesia and Malaysia, which have seen idiosyncratic inflationary uptick from other factors, the central banks would have another reason not to indulge in rate cuts anytime soon.**

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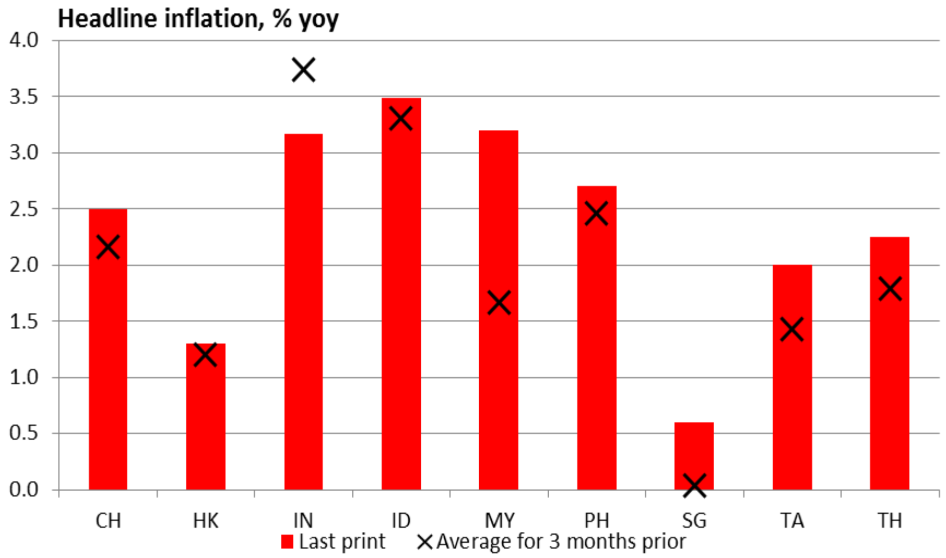
The Other Surprise

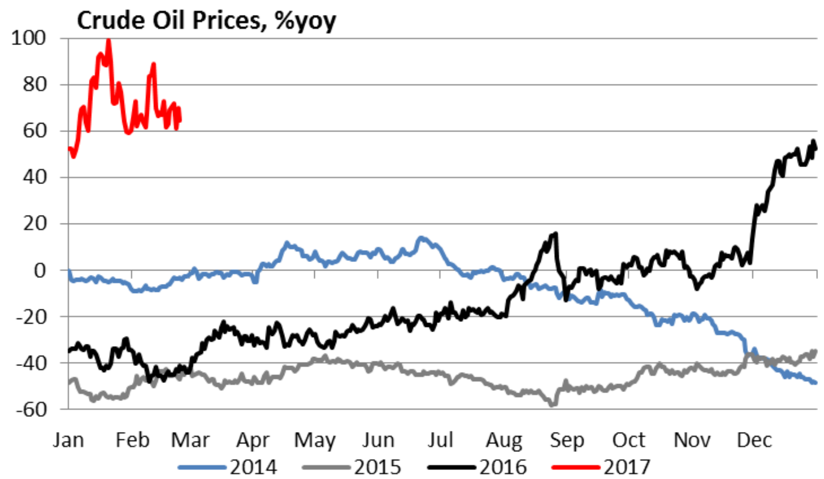
Last week, we pointed out the fact that, across Asia, exports data have been on the improving end and surprising market expectations on the upside. At a time when sentiment remains raw and wary of a potential pipeline of harmful protectionist policies, at least market players can take comfort in knowing that the momentum heading into this year has been surprisingly robust.

Less hearteningly, however, the same dynamics of data turning up more robustly than expected appears to be taking place in inflation prints for the region, as well. Indeed, as shown in the chart below, apart from India, all the major Asian economies have shown an uptick in their inflation data over the past few months.

To be sure, even in the case of Indonesia, which has the region's highest inflation print in the most recent month, it is only around 3.5%. This is much lower than the 7-8% range the country exhibited just two years ago. Still, the recent uptick in inflation across much of the region deserves a closer look.



Source: Bloomberg, OCBC.

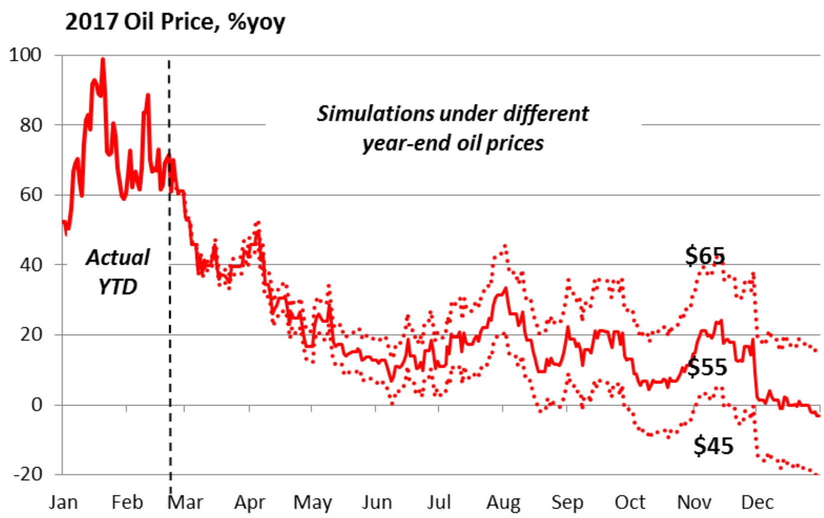


Source: Bloomberg, OCBC.

At a broad level, much of the uptick in Asia's inflation appears to have been driven largely by a recovery in global crude prices post-OPEC production agreement. Indeed, the start of 2017 has been unique compared to the past few years, in terms of year-on-year crude oil trajectory. This is not only in terms of the sign (positive for 2017, versus negative for the prior three years), but also magnitude (hefty at an average 70% change year-to-date).

Combined with the year-on-year uptick in crude prices in December last year, this has contributed to more expensive petrol for consumers in the region, as pump prices adjust with a lag. In particular, one reason why we saw a sharp upside tilt in Malaysia's CPI print of 3.2% yoy in January compared to below 1.7% average in the prior three months was that petrol prices were adjusted upward by around 10% during the period.

Having seen how global crude prices translate to dearer pump prices and contribute to overall headline inflation in the region, the natural question is then: Would such inflationary impulse last?



Source: Bloomberg, OCBC. Note: Simulations assume a linear trajectory from current price to respective year-end levels.

For that, it is useful to recall how oil prices were in the doldrums in the first quarter last year, with an average Brent crude price of just around $35 per barrel at that time, before trading in the range of $45-50 thereafter and then breaching $55 in the last few weeks of 2016. Despite the inflationary impulse that such rising prices bring into the picture, the upward trajectory of 2016 actually leaves us with a favourable base effect for year-on-year changes in 2017.

Indeed, as the chart above shows, even if oil price increases further and heads towards year-end at $65 per barrel that our house view dictates, the year-on-year inflationary impulse will be on the decline from hereon, even if it is still significant at around 30% yoy increase in the second half of the year. Now, if oil price stays at the current level of $55 or somehow dip below that to $45 by year-end, the impulse will obviously be less pronounced.

The upshot of all this is that, even as the trajectory of oil prices should remain keenly watched, in and of its own, its direct inflationary impulse is unlikely to be of lasting concern at this stage.

Still, idiosyncratic risks facing respective Asian economies would warrant more attention. In the case of Indonesia, for example, increases in administered prices such as electricity bills as well as bouts of uptick in food prices due to bad weather are risk factors to look out for, even if we think that headline inflation should still stay relatively contained at around 4.3% this year.

Overall, the presence of such inflationary impulse adds to the list of reasons why Asian central banks are unlikely to ease their monetary policy rates this year. This factor will be especially prominent for Indonesia and Malaysia, which are incidentally also net commodities exporters. Even as the uptick in the prices of commodities, including crude oil, bring about increased inflationary pressure for them, it has also brought along support for growth momentum for them – and thus lessening the need for the central banks to step in and cut rates to begin with. Life is fair that way, after all.

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