

Dots & Plots

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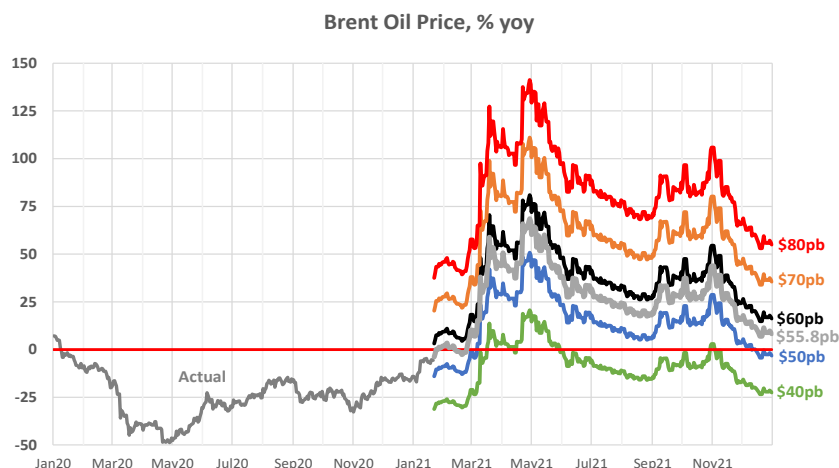
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Rage of Base

How base effects would exacerbate inflation prints

- It feels like it is only recently that we got all worked up over negative WTI oil price. Hence, it is quite a sea change to see prices going up considerably enough for analysts to be huffing and puffing now on broader commodities super-cycle, not just for oil but also metals and agricultural products.
- Putting aside whether such talks would pan out, even if prices stay at current level for the rest of the year, the base effect alone could generate enough inflation, which is typically measured in year-on-year (yoy) terms, to compel central bankers to pay a lot more attention to it in the months ahead.
- Whereas the effect of oil price was deeply deflationary in 2020 – with Brent down 24% yoy then – it could be a vastly different story in 2021. Going by our (simplistic) simulations, even if Brent stays at the current level (of ~\$55.8pb) for the rest of the year, it would still be 25.6% higher in yoy terms.
- Naturally, if prices climb further, the inflationary effect will be even stronger. At \$60pb average for the rest of the year, Brent is 34.4% yoy higher. If it goes to \$80pb for whatever reason, it's 77.5% up. The effect will be especially strong in Q2 – given the price slump in the same period last year.
- While base effects are transient, any significant price uptick during the next few months would complicate things. The Fed won't be perturbed, having given itself some leeway with an average inflation target. For EMs, however, the bulk of them have yet to establish long-enough track record of inflation targeting success to get away as easily with inflation forbearance. Oil and other commodity prices sway inflation there a lot more too, unfortunately.
- Hence, at a time when renewed economic pressure may compel central banks here to ease again, the space for them to do so may – unhelpfully – be more constrained. All the more reasons, we think, for them to act sooner rather than later, even if [some continue to retain a sanguine outlook](#).



Source: OCBC, Bloomberg. Note: Simulated paths based on Brent crude price at respective levels throughout the rest of 2021.

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