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Growing confidence of Asian inflation peak

By Kevin Brown in Singapore

Despite Tuesday's slight increase in China's consumer prices index, there is a growing sense of confidence in emerging Asia that the pace of inflation is moderating across most of the region.

At 6.5 per cent, year on year, the headline rate of inflation in the world's second biggest economy remains uncomfortably high, epecially when compared to rates of 3.56 per cent in the US and 2.29 per cent in the eurozone.

However, economists have been saying for some time that China is one of many countries in emerging Asia where a surge in inflation that began during the region's V-shaped recovery from the world financial crisis is beginning to abate.

"In China, almost certainly, we've come over the hump for the time being, but elsewhere, too, inflation is bound to ease noticeably into the fourth quarter," says Frederic Neumann, co-head of Asian economics at HSBC.

Other figures released so far this month support that belief. Indonesia's CPI slowed in July to a 14-month low of 4.6 per cent, while inflation fell to 5.1 per cent from 5.2 per cent for the same month in the Philippines. Thailand's July CPI was almost unchanged at 4.08 per cent, and Taiwan's fell more than expected to 1.3 per cent from 1.93 per cent, its lowest for six months.

Uncertainty remains about the sustainability of the downward shift in some of these countries. Robert Prior-Wandesforde, economist at Credit Suisse in Singapore, says underlying inflation in Indonesia remains strong, and is forecasting a return to 6 per cent by the end of the year. Thailand's inflation outlook may depend on the extent to which the new government of Yingluck Shinawatra attempts to implement its populist programme.

In some other countries, inflation has yet to start moving down. Indian inflation accelerated to 9.44 per cent in June, despite 11 successive rises in official interest rates since the start of last year, while South Korea's CPI hit a 2011 high of 4.7 per cent in July.

However, both indices are forecast to start falling later in the year,
probably after further increases in official interest rates. The Reserve Bank of India says that

inflation will fall to 7 per cent by March, while private sector economists in Seoul expect price rises to start moving back towards the Bank of Korea's 2-4 per cent target range from September.

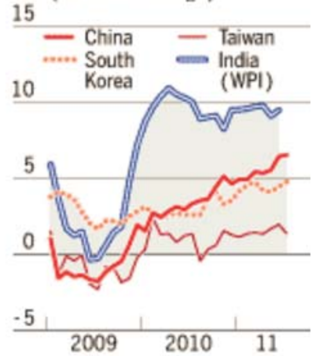
Overall, headline inflation is expected to fall across the region from 5.5 per cent in May to 5 per cent by the end of the year, and 4.3 per cent in 2012, the Asian Development Bank, said in its annual Asia Capital Markets Monitor, published on Tuesday.

In most of the region, the principal factor in the shift to lower rates of inflation is an easing in the frantic pace of economic growth, which peaked last year with growth of 10.3 per cent in gross domestic product in China, now an important engine of growth for many Asian countries.

The World Bank suggests that China will grow at a more sedate pace of around 9 per cent this year, with much of the rest of the region following suit. Purchasing managers' indices for many Asian countries, released at the beginning of the month, showed a clear slowing in activity, while remaining considerably more robust than comparable indicators in the US and Europe.

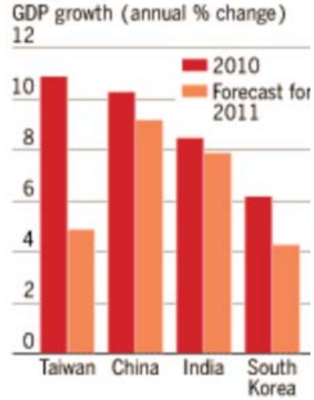
Asian inflation has been rising...

CPI (annual % change)



...but is forecast to ease as growth slows

GDP growth (annual % change)



Sources: Thomson Reuters Datastream; Consensus Economics

The fight against inflation has also been aided by gradual monetary tightening in most countries, combined with a fall in commodity prices and a general appreciation in local currencies against the US dollar, which reduces the domestic currency price of imported goods.

Many dangers remain, however, including relatively high rates of core inflation, which strips out the impact of volatile energy and food costs. The ADB says this largely reflects demand pressures, with many economies running at close to full capacity, and should moderate as growth slows.

The other serious risk is the possibility of sustained financial turmoil caused by concerns about public debt in Europe and the US, and the threat of a return to recession in western countries, which would damp demand for emerging Asia's manufactured exports.

Sustaining growth in the face of a renewed western slowdown would probably require a return to the widespread fiscal and monetary stimulus packages introduced after the collapse of Lehman Brothers in 2008, which might reignite inflation just as it begins to come under control.

However, many economists think the risk in most countries is both small and worth taking, in part because the easing of commodity prices moderates a powerful upward influence on inflation. “With the exception of India and perhaps China, central banks can afford to make growth the priority if necessary,” says Iwan Azis, head of the Office of Regional Integration at the ADB.