# Our Asian central bank barometer

We enjoyed James Smith's recent Central Bank Top Trumps note so much that this month, we decided to create a similar analysis for Asian central banks. However, our backdrop is quite different to his. We have a diverse mix of central banks, with some hikers, some cutters, and everything in between

## Real policy rates is the central metric

Unlike my colleague James Smith's developed market Top Trumps, our analysis of Asian central banks lacks many of the metrics he uses. For instance, we don't have reliable measures of the unemployment rate or comparable mortgage yields. What we do have are local concerns about currency strength and stability. In short, our central bank barometer will look different to his.

Our principal benchmark for Asian regional central banks is where policy rates are relative to inflation. Call this the "real policy rate". In simple terms, it says whether policy rates are restrictive (much higher than inflation), neutral (about the same) or accommodative (lower than inflation).

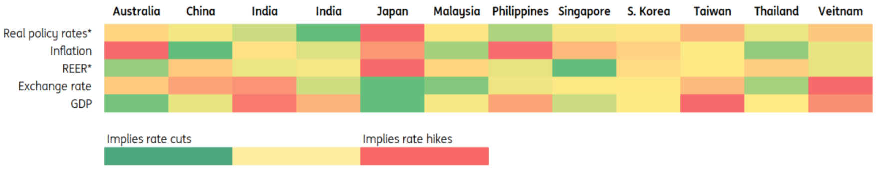
In the wake of the Covid-19 pandemic, soaring inflation rates initially kept most policy rates from reaching restrictive levels. As inflation has receded, much like the ebbing tide, many of these rates have now shifted to the restrictive side of neutral. Central banks with the highest rates are likely to make the most significant adjustments. For instance, the Philippines has already begun cutting rates ahead of the US Federal Reserve.

We'd also highlight India's Reserve Bank, where 6.5% policy rates and an inflation rate below 4% call for imminent rate cuts. We expect to see that soon. Indonesia has a policy rate of 6.25% and is therefore in a very similar position, with well-contained inflation making for a very high real policy rate. China too looks as if it needs to ease more on this basis, in line with our house forecasts.

At the other end of the spectrum, Japan's policy rates remain well down on inflation, so as we have noted before, we expect the Bank of Japan's (BoJ's) policy normalisation to continue, and further hikes from the Bank of Japan, perhaps as soon as October.

## Central Bank barometer

Better than flipping a coin, worse than country-specific analysis




Source: ING, CEIC
*Negative transformation

## Deviation from inflation is an obvious addition

We also consider the simple deviation of inflation from central bank targets. These targets vary considerably from 2% for most of the more developed economies in the region to a top end of 4.5% for Vietnam, and central rates of 4% for India.

Australia is the main standout here, where inflation of 3.5% is a full percentage point above the central target of the RBA – one of the reasons we recently felt hikes were a possibility. That changed when core rates started to decline. But it suggests Australia is not completely out of the woods yet.

## Real effective exchange rates and currency weakness

A deviation from our developed market colleagues' approach is our Real Effective Exchange Rate (REER) measure, which is a benchmark for FX valuation. Here we measure how much weaker the currency is in real inflation-adjusted terms measured against its major trading partners. Unfortunately, this is rather dominated by the recent swings in the Japanese yen, which also dominates the other FX term, which measures how weak each currency has been in the last three months – where a (negative) green indicates currency strength that suggests trimming rates support.

Stripping Japan out, the Malaysian ringgit, Thai baht and Chinese yuan look weak on a REER basis, while the Singapore dollar looks strong (not surprising as that is how the Monetary Authority of Singapore manages inflation). Based on recent currency performance, this largely gets flipped on its head, as these (not CNY) are also the currencies that have tended to appreciate the most in the last few months.

## GDP growth relative to trend

Our final criteria looks at GDP growth relative to recent trends. India and Taiwan look as if their growth is strong enough to weather higher, not lower, rates, while Australia and Japan look as if recent weakness would be more in keeping with lower rates. In the case of Japan, the car safety scandal accounts for a lot of this recent weakness and should dissipate over the coming quarters.

When viewed as a whole, the most striking story is Japan's situation, which is fairly understandable. Beyond that, the pattern is quite varied. South Korea appears to be a potential candidate for easing, but financial stability issues, which aren't included in this comparison, complicate the picture.

## Stick to the day job

We'll keep an eye on these indicators – real policy rates are probably the main yardstick we will keep watching. But in the end, for APAC, we think we'll stick to single economy analysis. This region is way too disparate for this sort of approach to provide a reliable guide to policy.

### Author

**Robert Carnell**
Regional Head of Research, Asia-Pacific
robert.carnell@asia.ing.com

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