EM Inflation and Monetary Policy Update

Highlights **May 26, 2021**

This update builds further on the [inaugural Emerging Market (EM) inflation and monetary policy feature](#), and examines the recent inflation trends in EMs and forward-looking signals from financial markets. The note also analyzes the significant shift in the policy rate expectations for EMs.

- **Inflation continues to rise across many emerging markets** (Charts 1 and 2)**,** with both survey forecasts and breakevens showing rising inflation expectations since late 2020 (Charts 9 and 10). Headline CPI has also come in above expectations for some EMs in March and April, which has put the latest inflation print above the target range for almost half the EMs in our sample (Chart 3). This near-term overshoot in inflation (Chart 5) is driven in part by base effects, a sharp rise in oil and commodity prices (Chart 6), and potential spillovers from inflation trends in advanced economies ([special feature on AE inflation](#)). While aggregate core CPI has also been rising (Chart 7), there is significant differentiation across EMs (Chart 8, next point). Medium-term expectations remain anchored and within range for most countries (Charts 4 and 20).

- **Significant country differentiation across EMs in the level and drivers of the inflation**
    1. Inflation has accelerated in recent months and risen above the target range in Brazil, Hungary, Mexico, Philippines, Poland, Russia, Thailand, and Turkey;
    2. Inflation is within the target range for Chile, India, Malaysia, South Africa, and Peru, albeit accelerating there as well;
    3. Inflation remains subdued and below the target range for Indonesia, Colombia and China; and
    4. Both core and food inflation are at the higher end of their historical trend for Brazil, Turkey, Philippines, Russia and Ukraine—which also potentially contributed to a shift in the monetary policy stance for these economies (see next point).

- **Monetary policy cycle for emerging markets has turned.** While medium term inflation expectations remain anchored and inflationary pressures may turn out to be transitory, many central banks have still reacted with a notable shift in their policy stance (Chart 12). Central banks in Brazil, Georgia, Russia, Turkey, and Ukraine have hiked rates in recent months, surpassing market expectations in many cases. EM central banks face a challenging balancing act between maintaining a supportive policy stance amid weak demand and COVID-19 outbreaks, preempting financial stability risks, and avoiding any de-anchoring of inflation expectations. These risks are also reflected in 1) continued portfolio flow pressures ([EM Flows Monitor](#)), amid widespread and historically high negative real rates (charts 13 and 14) and 2) elevated currency volatility (Chart 11), impacted by concerns over faster than expected AE policy normalization.

- **Swaps markets are expecting significantly higher rates.** Forward looking swap rates began shifting higher in late 2020 impacted by domestic idiosyncratic factors. Implied policy tightening also increased substantially after the global bond sell-off in Feb 2021 (Chart 16). Swaps show the largest implied policy tightening in the next few years are in Brazil, Colombia, Chile, Mexico and Philippines; while markets have turned more hawkish on Poland and Hungary in recent weeks relative to prior expectations (Chart 17, 18).

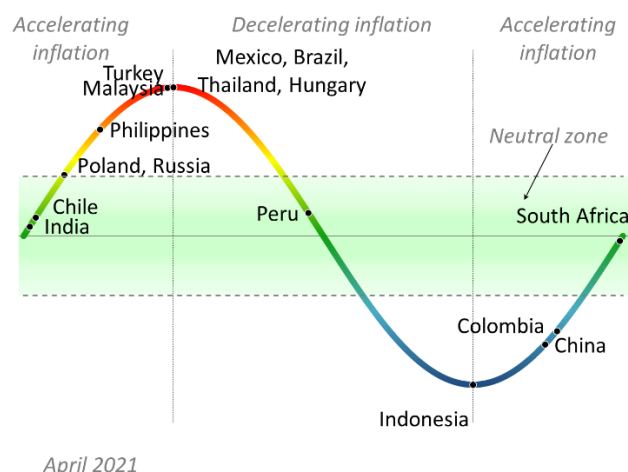## Inflation: Latest Prints, Survey Expectations and Breakeven Trends

Inflation has continued to rise across most EMs, driven in part by base effects from 2020 ...

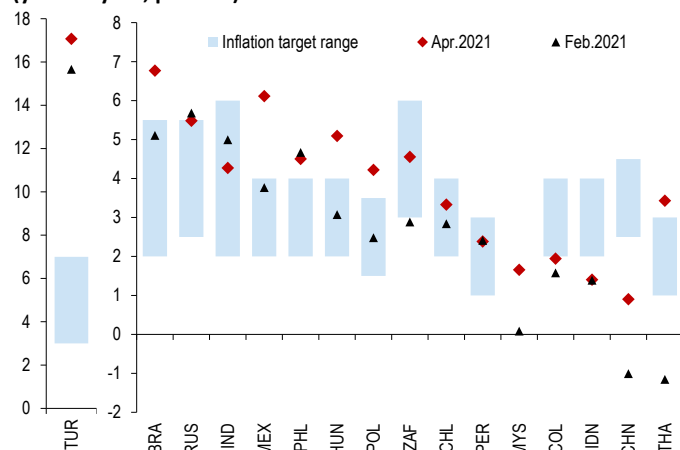**Chart 1. CPI Inflation Across EMs**
(Year on year, percent)

Legend:
- Interquartile Range
- Median CPI
- EM Inflation Surprise Index (RHS)
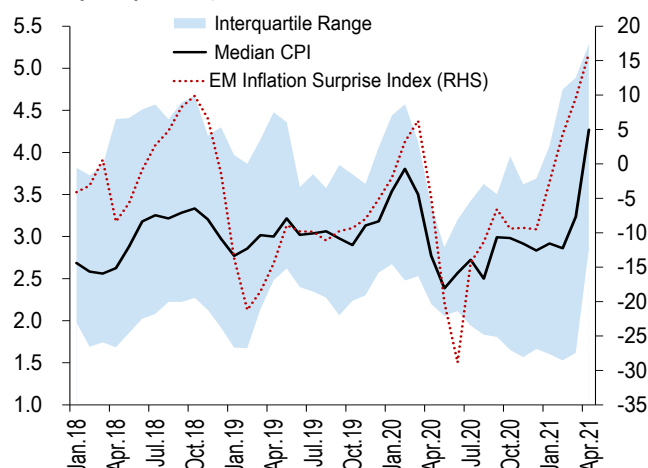
... with inflation accelerating in a majority of emerging markets.

Chart 2. EMs in various Inflation Regimes

Accelerating inflation: Turkey, Malaysia, Philippines, Poland, Russia, Chile, India

Decelerating inflation: Mexico, Brazil, Thailand, Hungary, Peru

Neutral zone

Accelerating inflation: South Africa

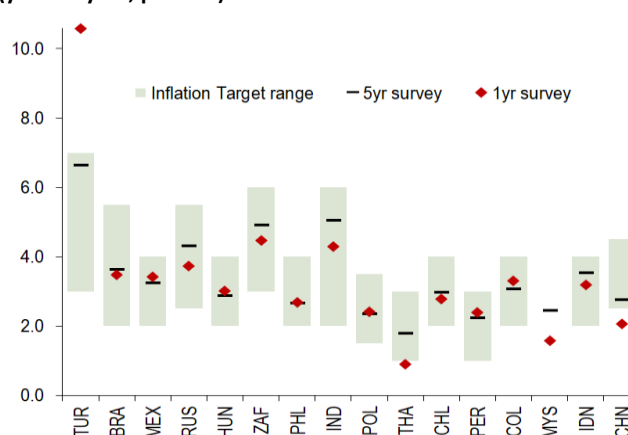Colombia, China, Indonesia

April 2021

About half of EMs in the sample have seen inflation rise above central bank targets ...

Chart 3. Consumer Price inflation and Inflation Target Range
(year on year, percent)

Legend:
- Inflation target range
- Apr.2021
- Feb.2021

Countries: TUR, BRA, RUS, IND, MEX, PHL, HUN, POL, ZAF, CHL, PER, MYS, COL, IDN, CHN, THA

... though medium-term survey expectations remain well anchored in most major EMs.

Chart 4. Inflation Expectations and Target Range
(year on year, percent)

Legend:
- Inflation Target range
- 5yr survey
- 1yr survey

Countries: TUR, BRA, MEX, RUS, HUN, ZAF, PHL, IND, POL, THA, CHL, PER, COL, MYS, IDN, CHN

Inflation in 12 months is expected to be lower than now for many EMs, reflecting an inverted term strcuture ...

Chart 5. Distribution of Inflation Expectations
(Year on year, Percent; Range across major EMs)

Legend:
- 2020 end
- Latest
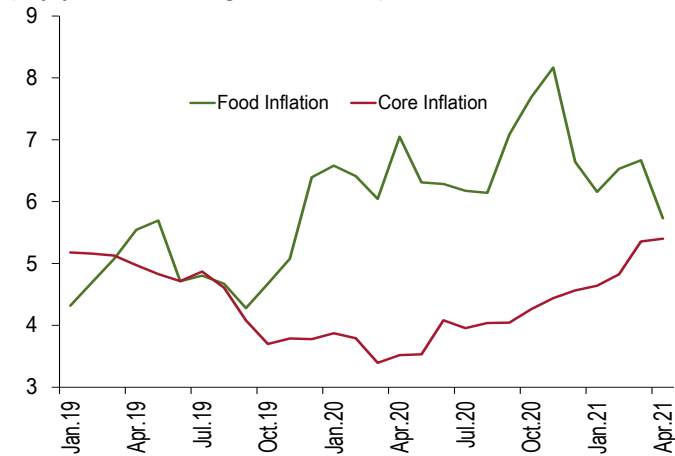- 1 year forward survey
- 5 year forward survey
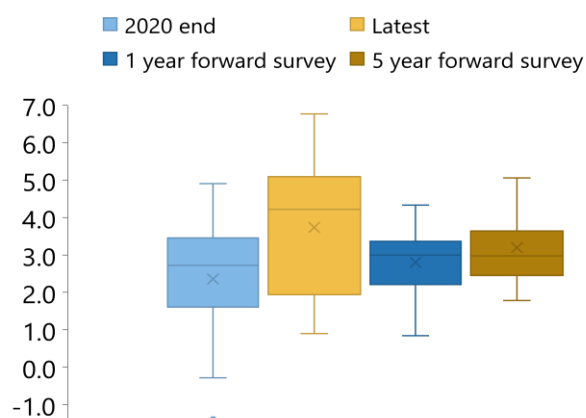
... with commodity prices and spillovers from China having contributed to near term price pressures.

Chart 6. Global Commodities and Chinese Spillovers
(Year on year, percent)

Legend:
- UN Food Index
- Soybean Futures (12th)
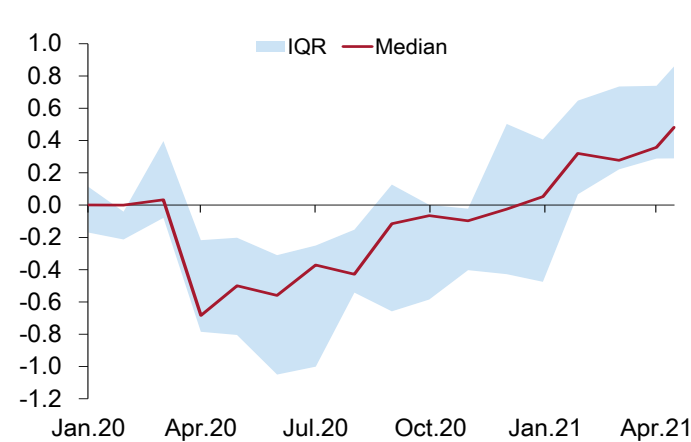- Commodities Index
- Chinese PPI (right scale)
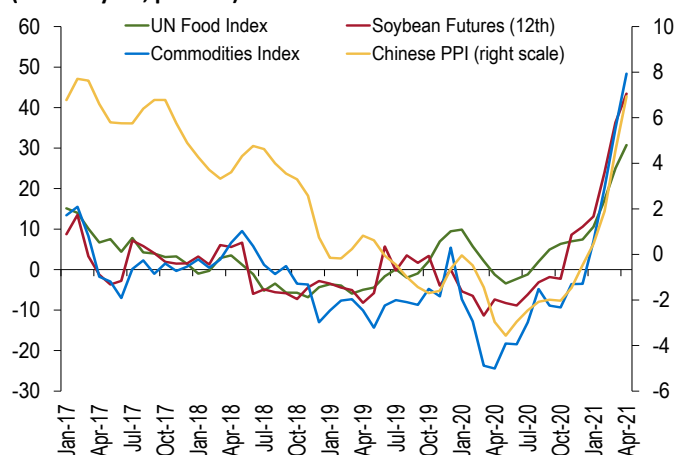
Food price inflation has eased in recent months, while core price pressures continue to accelerate.

Chart 7. Median EM Inflation aross Key Categories
(Y/y, percent; PPI weighted; Ex China)

Country differentiation is significant, but both core and food price inflation are elevated in some cases.

Chart 8. Core vs Food Price Inflation, Latest Month as Percentile of Last 24 Months (Percentile, based on y/y percent)
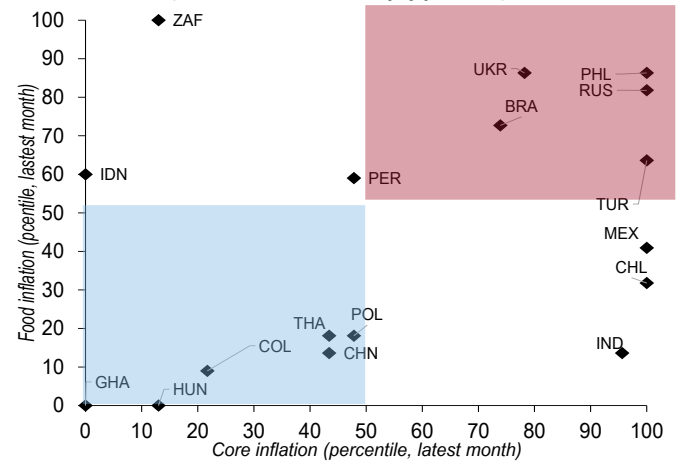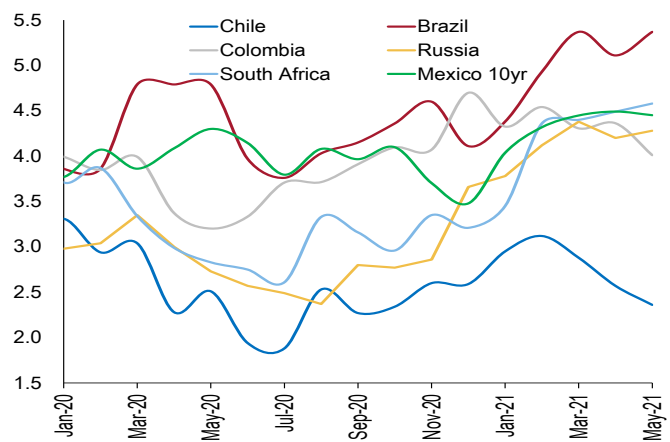

EM inflation linked bonds have shown similar trends as survey expectations, bottoming out in June 2020.

Chart 9. Cumulative Change in 5-Yr Breakeven Inflation Expectations (Ppts; Shaded area is the interquartile range)

Breakeven rates continue to push upwards, with Brazil seeing a significant acceleration.
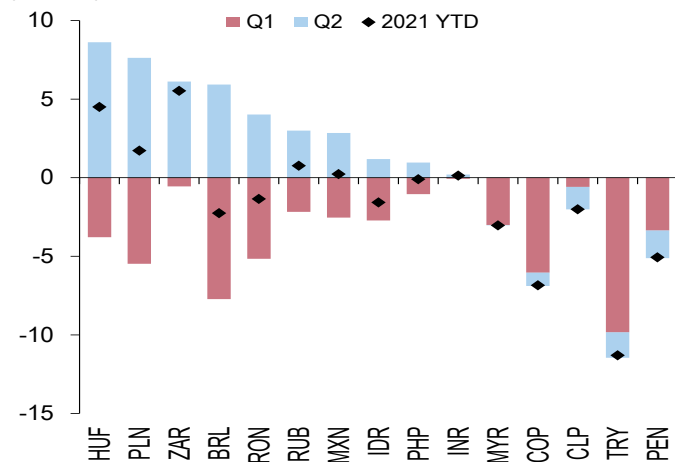
Chart 10. Five-Year Inflation Breakevens (Percent)

### Inflation and Passthrough to Financial Markets: Policy Rate Expectations

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EM FX has seesawed in 2021 after the end of year rally, with ZAR, CLP, MXN outperforming recently.

**Chart 11. Currency Appreciation/Depreciation (Percent)**

The widespread easing cycle has come to an end, with several central banks hiking rates in recent months.

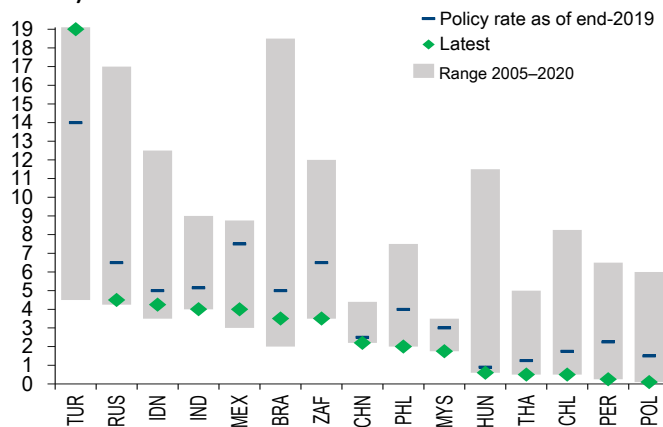**Chart 12. Policy Rate Changes (Number of countries)**
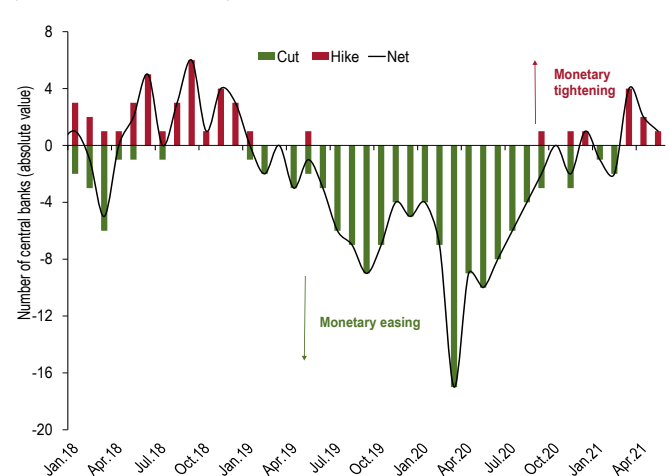
Real policy rates have declined to historical lows, with more than half of major EMs maintaining real policy rates below zero.

Chart 13. Real Policy Rates
(Percent; number of EMs)
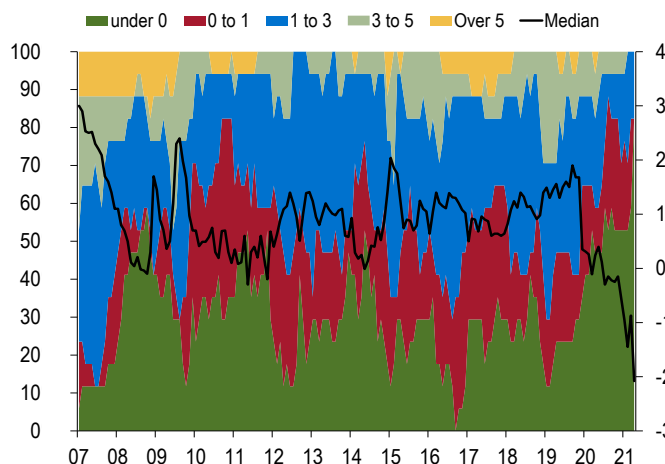
Policy rates remain near historical lows in most cases.

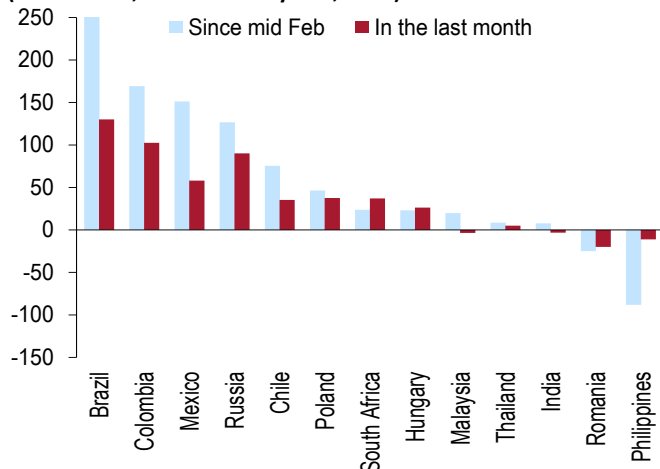**Chart 15. Historical Policy Rates**
(Percent)

Chart 14. Real Policy Rates vs the Inflation Target
(Percent; Percentage Points)
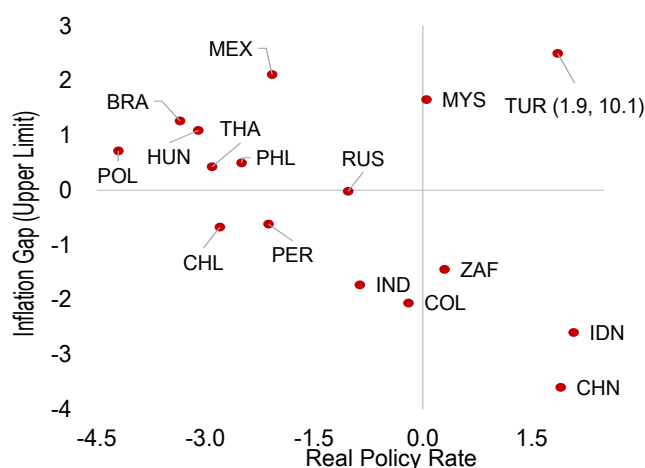
Swap markets are pricing in significant policy tightening in the next 1–2 years.

Chart 16. Policy Rates Proxied through Market Swap Rates
(Percent, basis points on RHS)

Swap rates have moved higher over the last few months.

Chart 17. Change in the 1-Yr forward Market Swaps
(Basis Points, since February 16th, 2021)

Tightening is expected to be led by Brazil and to a lesser extent Colombia, Chile, Mexico and Philippines.

Chart 18. Policy Rates Proxied through Market Swap Rates
(Percentage Points)
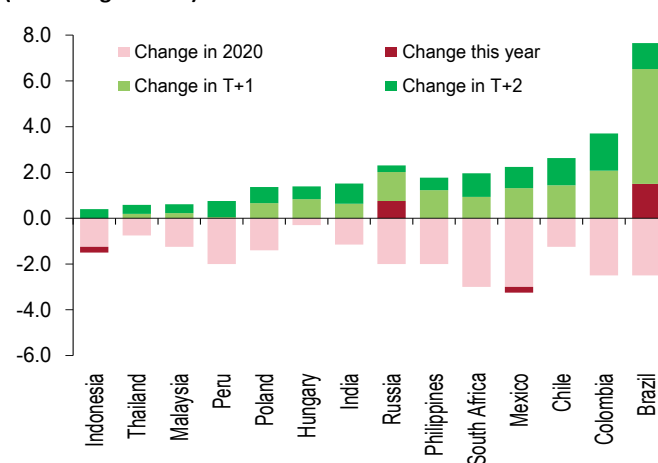
Note: In Figures 16-18, Bloomberg consensus surveys are used for Indonesia, Peru and Romania. Market swap rates are used for proxying policy rates. Further adjustments need to be made to more accurately strip out market implied expectations.

Annex Charts: Historical Trends in the Policy Rates
Chart 19. Historical Policy Rates and Forward Expectation
(Colors are versus a country's own historical trajectory; Red color implies higher rates and green color implies lower rates)

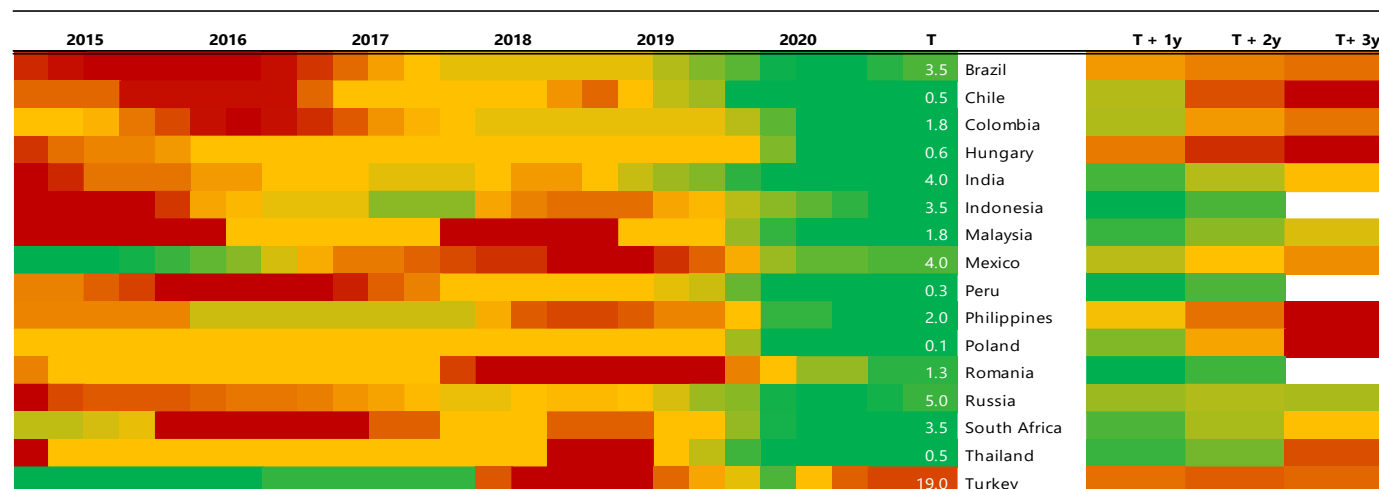|	2015	2016	2017	2018	2019	2020	T		T + 1y	T + 2y	T+ 3y
							3.5	Brazil			
							0.5	Chile			
							1.8	Colombia			
							0.6	Hungary			
							4.0	India			
							3.5	Indonesia			
							1.8	Malaysia			
							4.0	Mexico			
							0.3	Peru			
							2.0	Philippines			
							0.1	Poland			
							1.3	Romania			
							5.0	Russia			
							3.5	South Africa			
							0.5	Thailand			
							19.0	Turkey			

Long term historical trends for headline Inflation

Chart 20: Long Term Inflationary Trends; and the Latest Prints vs Survey Expectations and Inflation Target
(Colors are versus a country's own historical trajectory; Red color implies higher inflation and green color implies lower inflation. Color coding in the last three columns are across EMs and compare a particular country to its peers)

	Latest	Latest Percentile	Percentile at Dec 2020
Brazil	6.8	71.1	25.8
Chile	3.3	60.8	52.0
China	0.9	23.5	14.0
Colombia	1.9	7.9	4.5
Hungary	5.1	67.3	28.5
India	4.3	27.1	32.6
Indonesia	1.4	6.0	8.3
Malaysia	1.7	46.9	3.8
Mexico	6.1	88.2	15.9
Peru	2.4	44.8	33.8
Philippines	4.5	67.3	50.5
Poland	4.2	82.5	53.2
Russia	5.5	24.3	20.9
South Africa	4.6	42.2	18.2
Thailand	3.4	83.2	12.9
Turkey	17.1	77.9	74.5

Country	2019 end	Latest	Survey		Inflation Target			Current vs Range	1yr survey vs range	5yr survey vs range
			1 year	5 year	Lower	Mid	Upper			
Brazil	4.2	6.8	3.3	3.6	2.0	4.0	5.5	Above	Range	Range
Chile	3.0	3.3	2.8	3.0	2.0	3.0	4.0	Range	Range	Range
China	4.5	0.9	1.9	2.8	2.5	3.5	4.5	Below	Below	Range
Colombia	3.8	1.9	3.1	3.1	2.0	3.0	4.0	Below	Range	Range
Hungary	4.0	5.1	3.1	2.9	2.0	3.0	4.0	Above	Range	Range
India	7.3	4.3	4.2	5.1	2.0	4.0	6.0	Range	Range	Range
Indonesia	2.6	1.4	3.0	3.5	2.0	3.0	4.0	Below	Range	Range
Malaysia	1.0	1.7	1.5	2.5						
Mexico	2.8	6.1	3.4	3.2	2.0	3.0	4.0	Above	Range	Range
Peru	1.9	2.4	2.2	2.2	1.0	2.0	3.0	Range	Range	Range
Philippines	2.4	4.5	2.5	2.7	2.0	3.0	4.0	Above	Range	Range
Poland	3.3	4.2	2.3	2.3	1.5	2.5	3.5	Above	Range	Range
Russia	3.0	5.5	3.7	4.3	2.5	4.0	5.5	Above	Range	Range
South Africa	4.0	4.6	4.3	4.9	3.0	4.5	6.0	Range	Range	Range
Thailand	0.8	3.4	0.8	1.8	1.0	2.5	3.0	Above	Below	Range
Turkey	11.8	17.1	10.8	6.6	3.0	5.0	7.0	Above	Above	Range

For the table, in certain cases – target range is not available and thus assumed around the midpoint target based on the historical trends. Survey forecasts are based on the data made available by consensus economics; and might differ from central bank surveys