EM Inflation and Monetary Policy

**Highlights**   January 28, 2021

Inflation in emerging markets has been muted during the COVID-19 crisis. Lower inflation and stronger central bank credibility have allowed most central banks to lower policy rates to combat the economic downturn. However, inflation expectations have started to pick up lately, and the expectations for further monetary policy easing are limited in most countries. This monitor looks at EM inflation trends and signals from inflation bonds and survey expectations; and highlights the expected monetary policy path based on market options.

- **Near term inflation expectations declined sharply during the COVID-shock but have started to rise again** through survey forecasts and bond market indicators. EM inflation breakeven rates have followed US breakevens higher alongside the rise in commodity prices. Medium term inflation forecasts exhibit considerable differentiation, with almost half the sample displaying rising estimates.

- **Currency weakness has dissipated,** with broader dollar weakness and vaccine optimism driving EM FX strength since November. Inflationary pressures from passthrough are likely to be limited going forward. So far there is little evidence that inflation expectations have become unanchored in economies where central banks have deployed asset purchase programs, in line with GFSR findings.

- **Inflation remains within target ranges for most emerging market economies,** though there is significant country differentiation on recent trends. Real policy rates remain positive in a handful of countries despite the recent easing cycle, while inflation targets have generally declined over the last 10 years (allowing EMs to adopt more accommodative monetary policies).

- **Monetary policy easing has slowed in most cases; with forward expectations pointing to an eventual tightening.** Policy rates are at historical lows for most countries after central banks cut rates as countercyclical response to the economic downturn. Consensus estimates for further easing in the near term are limited with markets pricing in potential rate hikes in the 1–2 year horizon for many economies.
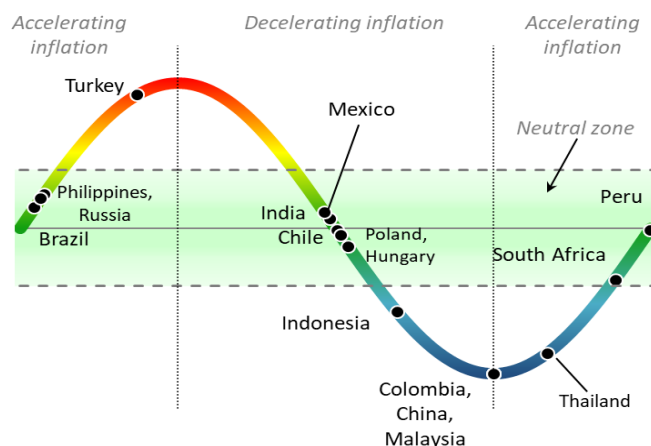

Inflation declined across most EMs post the COVID-shock, but has remained within the target for most …

Chart 1. Latest Inflation Print and Expectations (Percent)
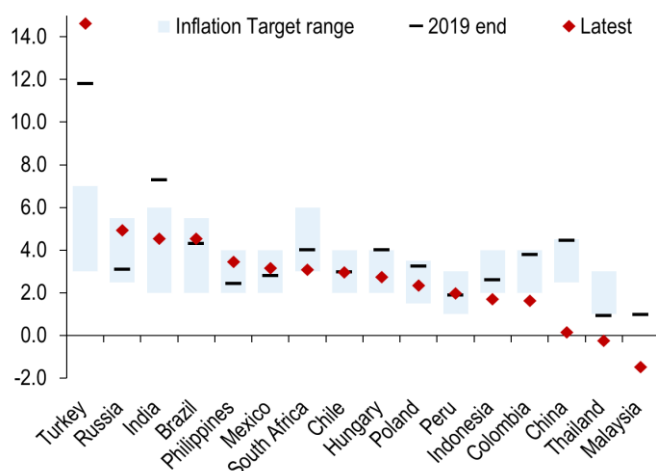
… but different countries are at various ends of the inflation curve with Russia, Brazil, Philippines and Turkey seeing accelerating inflation.

**Chart 2. EM Inflation Phase Curve**

Note: For Figure 1, in certain cases – target range is assumed around the midpoint target based on the historical trends. For methodological details for Figure 2, please refer GFSR April 2015. Figures are based on offically reported data

This feature is produced by Rohit Goel, Patrick Schneider and Evan Papageorgiou (all MCMGA).
Sources: Bloomberg, Consensus Economics, Haver Analytics, National Central Banks and IMF Staff.

# POST COVID TRENDS IN EM INFLATION, BASED ON SURVEY FORECASTS

Near term Inflation expectations declined after the shock but have recovered in recent months.

Chart 3 Cumulative Change in 1-yr forward Inflation Expectations (Survey based; ppts; Shaded area is the interquartile range)
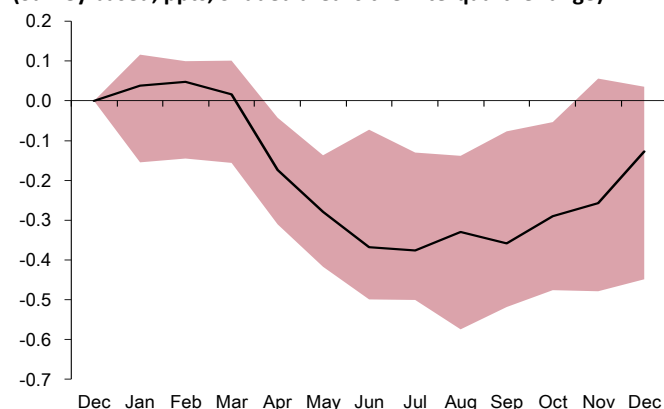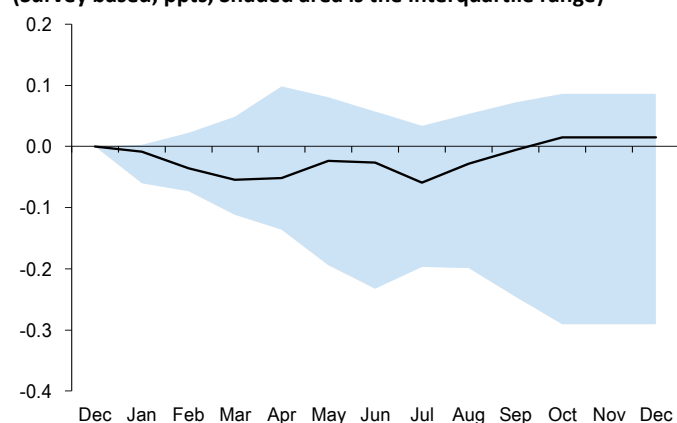

Most countries saw a decline in inflation expectations with TUR, IND, THA, MLY being notable exceptions.

Chart 4. Cumulative Change in 1-yr forward Inflation Expectations (Survey based; Percentage poins;)
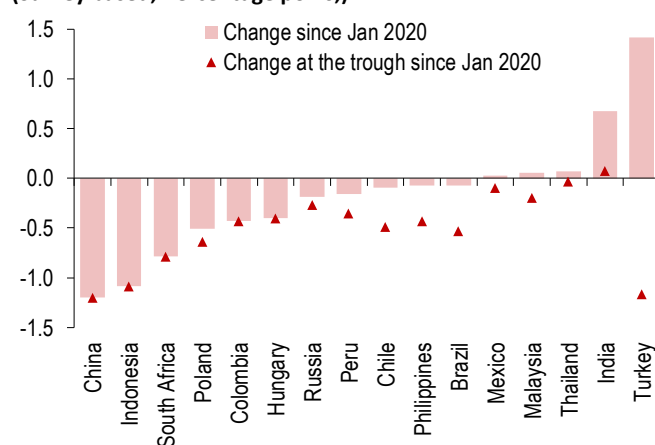

Median long term expectations declined only marginally, but with a high variation across countries.

Chart 5. Cumulative Change in 5-yr forward Inflation Expectations (Survey based; ppts; Shaded area is the interquartile range)


TUR, ZAF and RUS saw the highest decline; almost half the countries saw a rise in MT expectations.

Chart 6. Cumulative Change in 5-yr forward Inflation Expectations (Survey based; Percentage poins;)
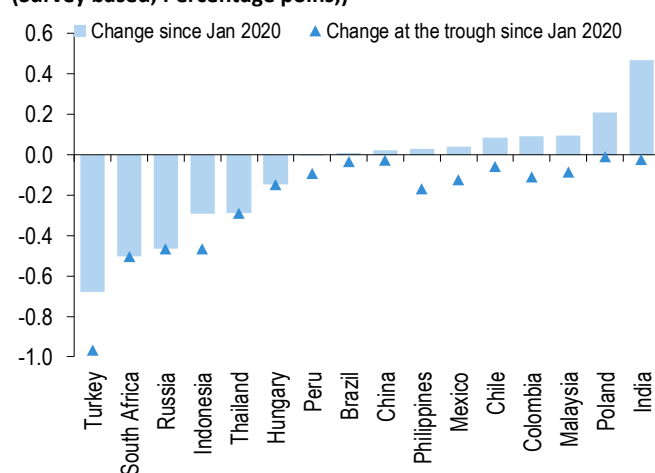
Inflation is expected to rise across most economies from current levels, except for BRA, PHP, RUS, and TUR.
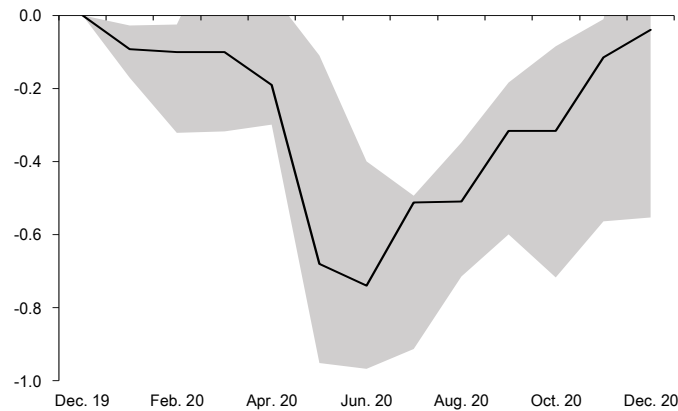
Chart 7. Country Level Details on Latest Inflation Prints vs the Survey Forecats
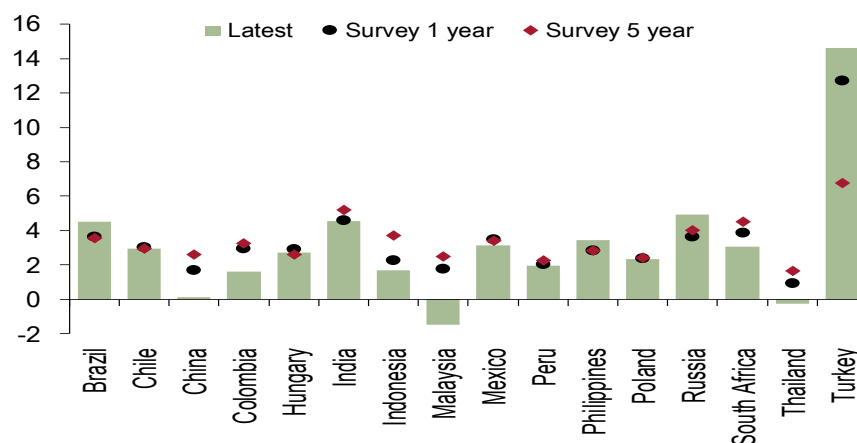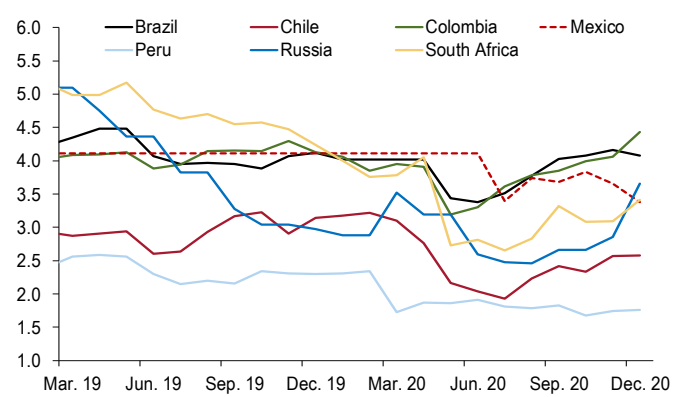
EM INFLATION BONDS

EM inflation linked bonds have shown similar trends as survey expectations …

Chart 8. Cumulative Change in 5-Year Breakeven Inflation Expectations (Ppts; Shaded area is the interquartile range)
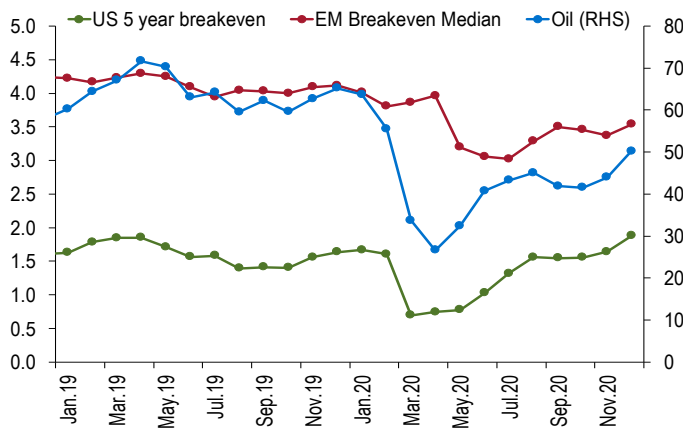

… with most countries seeing a rise in the inflation breakevens in the last few months.

Chart 9. 5-Year Inflation Breakeven Rates (Ppts; except for Peru which is 10 year)
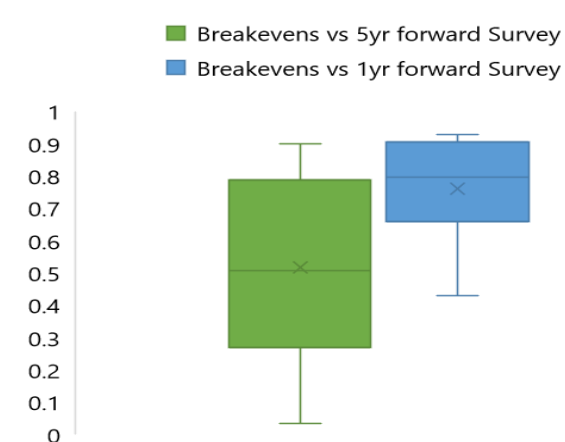

EM breakeven rates are likely taking cues from US inflation breakevens and the pickup in oil prices.

Chart 10. EM Inflation Breakevens and External Factors (Ppts; $/barrel)

Inflation breakevens and 1-yr surveys generally point in the same direction but vary across countries.

Chart 11. Correlation between Breakeven Rates and Survey Based Inflation Forecasts

PASSTHROUGH FROM THE FX CHANNEL: RISKS HAVE BEEN RELATIVELY CONTAINED

EM currencies have stabilized after the COVID-19 sell off, easing further passthrough on prices …

Chart 12. EM FX Changes and EM FX Vol (Percent, cumulative FX depreciation among EM sample, pink area is range; FX vol index)
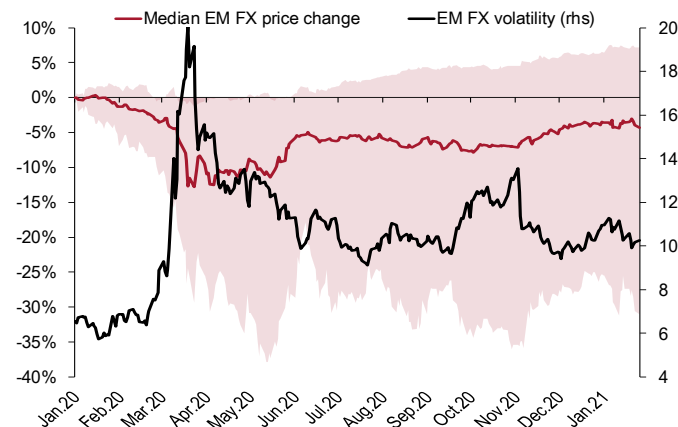
… and inflation expectations among countries that deployed asset purchases have remained aligned.

Chart 13. Change in the 1 yr forward Inflation Expectations for EMs

INFLATION AND MONETARY POLICY

The monetary easing cycle has tapered off recently …

Chart 14. Policy Rate Cuts
(Percentage point change, from previous month)

Legend: Brazil, Mexico, Indonesia, Thailand, Romania, Chile, Peru, Malaysia, Hungary, South Africa, Colombia, India, Philippines, Poland, Turkey
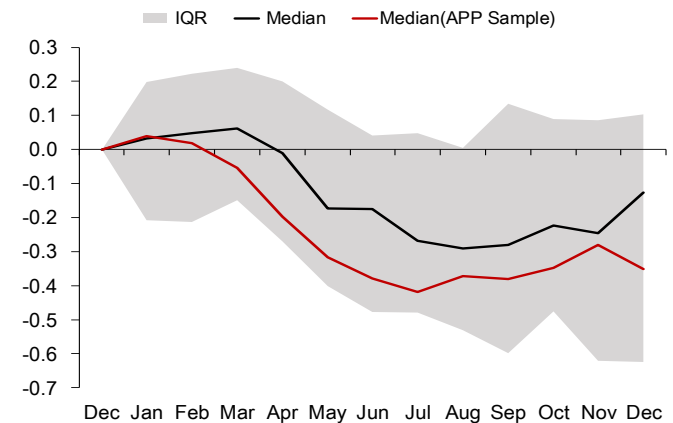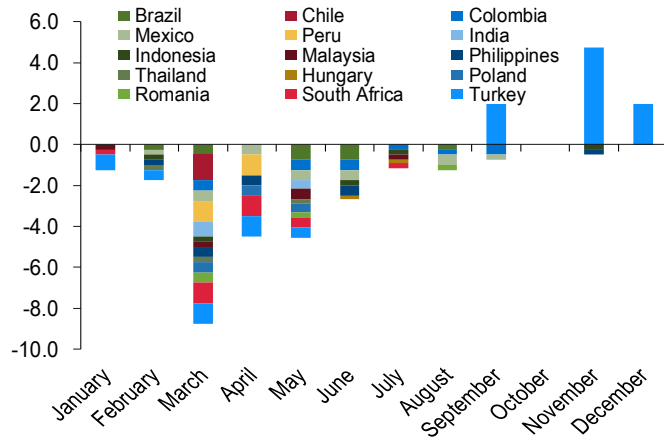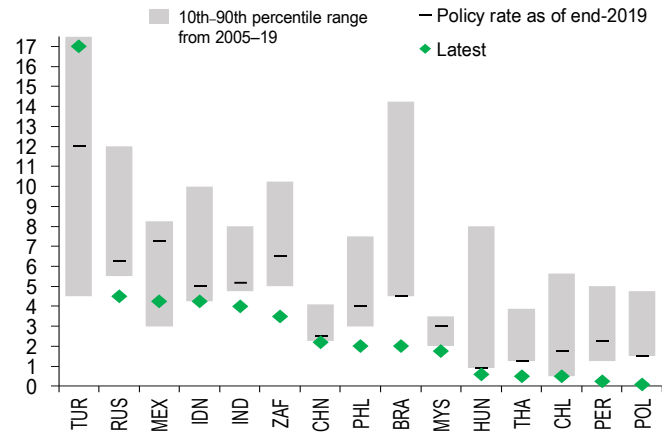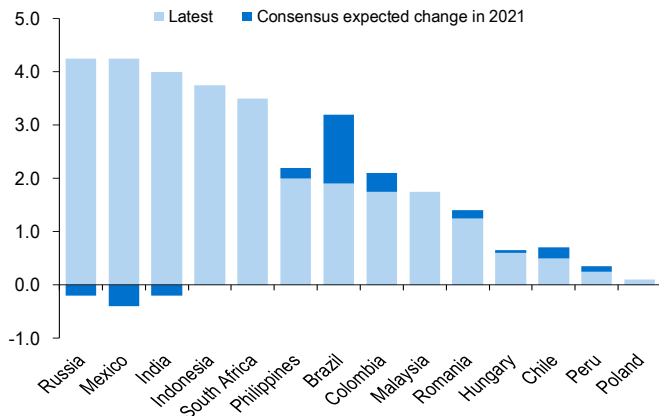
… with policy rates at record lows for many countries.

Chart 15. Policy Rates vs the Historical Range
(Percentage Points)

Legend: 10th–90th percentile range from 2005–19; Policy rate as of end-2019; Latest

(Countries: TUR, RUS, MEX, IDN, IND, ZAF, CHN, PHL, BRA, MYS, HUN, THA, CHL, PER, POL)
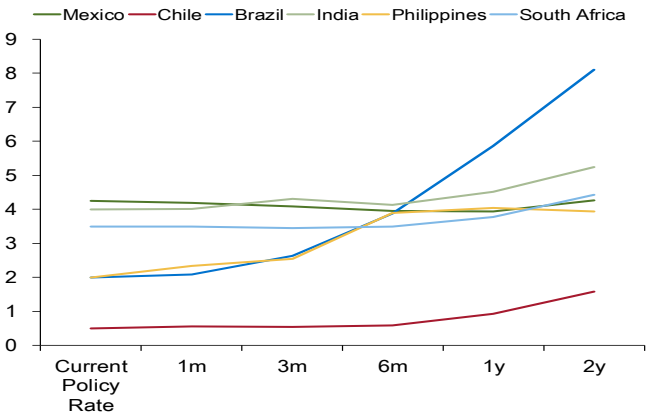
Consensus estimates for further easing in the near term are limited, with Mexico a major exception, and significant tightening in Brazil on fiscal concerns …

Chart 16. Consensus Estimates of Policy Rates
(Percent, Bloomberg consensus)

Legend: Latest; Consensus expected change in 2021

(Countries: Russia, Mexico, India, Indonesia, South Africa, Philippines, Brazil, Colombia, Malaysia, Romania, Hungary, Chile, Peru, Poland)
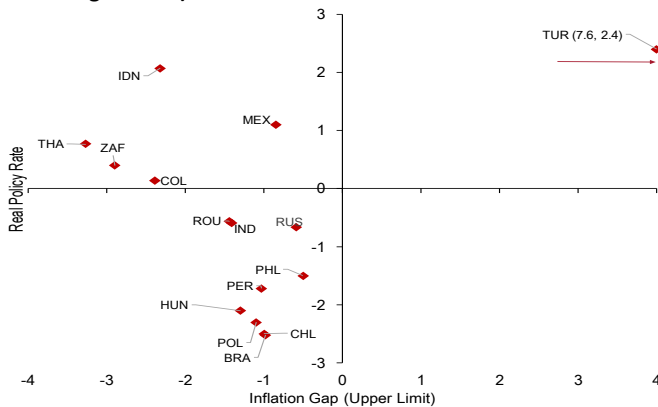
… while markets are pricing potential rate hikes in the 1-2 year horizon.

Chart 17. Market Pricing of Implied Policy Rates
(Percent, based on forward rates)

Legend: Mexico, Chile, Brazil, India, Philippines, South Africa

(X-axis: Current Policy Rate, 1m, 3m, 6m, 1y, 2y)

Inflation remains below the upper target range in most cases, with real policy rates still above zero in several countries, potentially leaving additional policy space.

Chart 18. Real Policy Rates vs Inflation Target Gap (Upper Limit)
(Percentage Points)

TUR (7.6, 2.4)

(Countries plotted: IDN, MEX, THA, ZAF, COL, ROU, IND, RUS, PHL, PER, HUN, POL, BRA, CHL)

X-axis: Inflation Gap (Upper Limit); Y-axis: Real Policy Rate

Central banks have lowered their inflation targets over the last decade, while real policy rates continued to trend lower before and during the COVID-19 episode.

Chart 19. Share of Country Sample Per Inflation Target Bank and Median Real Policy Rates

Legend: <=3; 3-5; >5; Median Real Policy Rate (RHS)

Year	<=3	3-5	>5
2010	38	31	31
2011	37	33	30
2012	35	39	26
2013	34	41	25
2014	33	42	24
2015	39	42	19
2016	36	42	22
2017	37	39	24
2018	38	35	28
2019	38	40	23
2020	39	42	19

Notes.. Figure 18 is based on December inflation data and policy rates. The inflation gap references the upper limit of countries' target range.
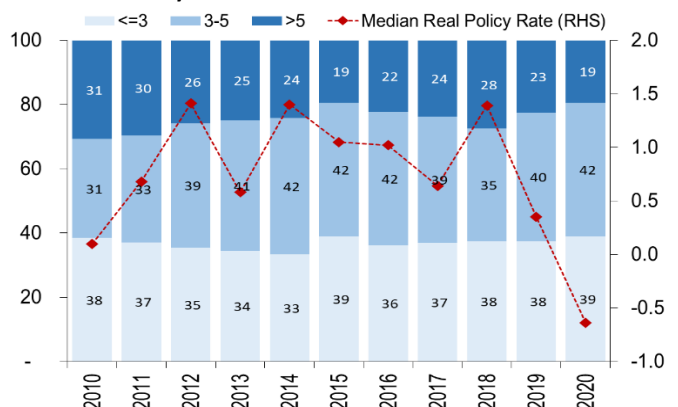
EM INFLATION: LONG TERM EVOLUTION

Inflation spiked during the previous crisis episodes, though seems to be relatively well contained for now; For many EMs – inflation is quite high vs their own historical trajectory but remains within the target for most.

Chart 20: Long Term Inflationary Trends; and the Latest Prints vs Survey Expectations and Inflation Target

Heatmap columns: 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020

Country	Latest	Historical Percentile
Brazil	4.5	26.2
Chile	3.0	50.9
China	0.1	11.1
Colombia	1.6	0.3
Hungary	2.7	27.4
India	4.5	29.5
Indonesia	1.7	3.9
Malaysia	-1.5	3.5
Mexico	3.1	13.5
Peru	2.0	32.6
Philippines	3.5	49.8
Poland	2.4	51.3
Russia	4.9	18.7
South Africa	3.1	15.5
Thailand	-0.2	12.7
Turkey	14.6	74.9

Country	2019 end	Latest		Survey 1 year	Survey 5 year		Inflation Target Lower	Inflation Target Mid	Inflation Target Upper	Current vs Range	1yr forward vs range
Brazil	4.3	4.5		3.6	3.6		2.0	4.0	5.5	Range	Range
Chile	3.0	3.0		3.0	3.0		2.0	3.0	4.0	Range	Range
China	4.5	0.1		1.7	2.6		2.5	3.5	4.5	Below	Below
Colombia	3.8	1.6		2.9	3.3		2.0	3.0	4.0	Range	Range
Hungary	4.0	2.7		2.9	2.6		2.0	3.0	4.0	Range	Range
India	7.3	4.5		4.6	5.2		2.0	4.0	6.0	Range	Range
Indonesia	2.6	1.7		2.3	3.7		2.0	3.0	4.0	Range	Range
Malaysia	1.0	-1.5		1.8	2.5					Range	Range
Mexico	2.8	3.1		3.5	3.4		2.0	3.0	4.0	Range	Range
Peru	1.9	2.0		2.0	2.3		1.0	2.0	3.0	Range	Range
Philippines	2.4	3.5		2.8	2.8		2.0	3.0	4.0	Range	Range
Poland	3.3	2.4		2.4	2.4		1.5	2.5	3.5	Range	Range
Russia	3.1	4.9		3.6	4.0		2.5	4.0	5.5	Range	Range
South Africa	4.0	3.1		3.9	4.5		3.0	4.5	6.0	Range	Range
Thailand	0.9	-0.2		0.9	1.7		1.0	2.5	3.0	Below	Below
Turkey	11.8	14.6		12.7	6.8		3.0	5.0	7.0	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

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