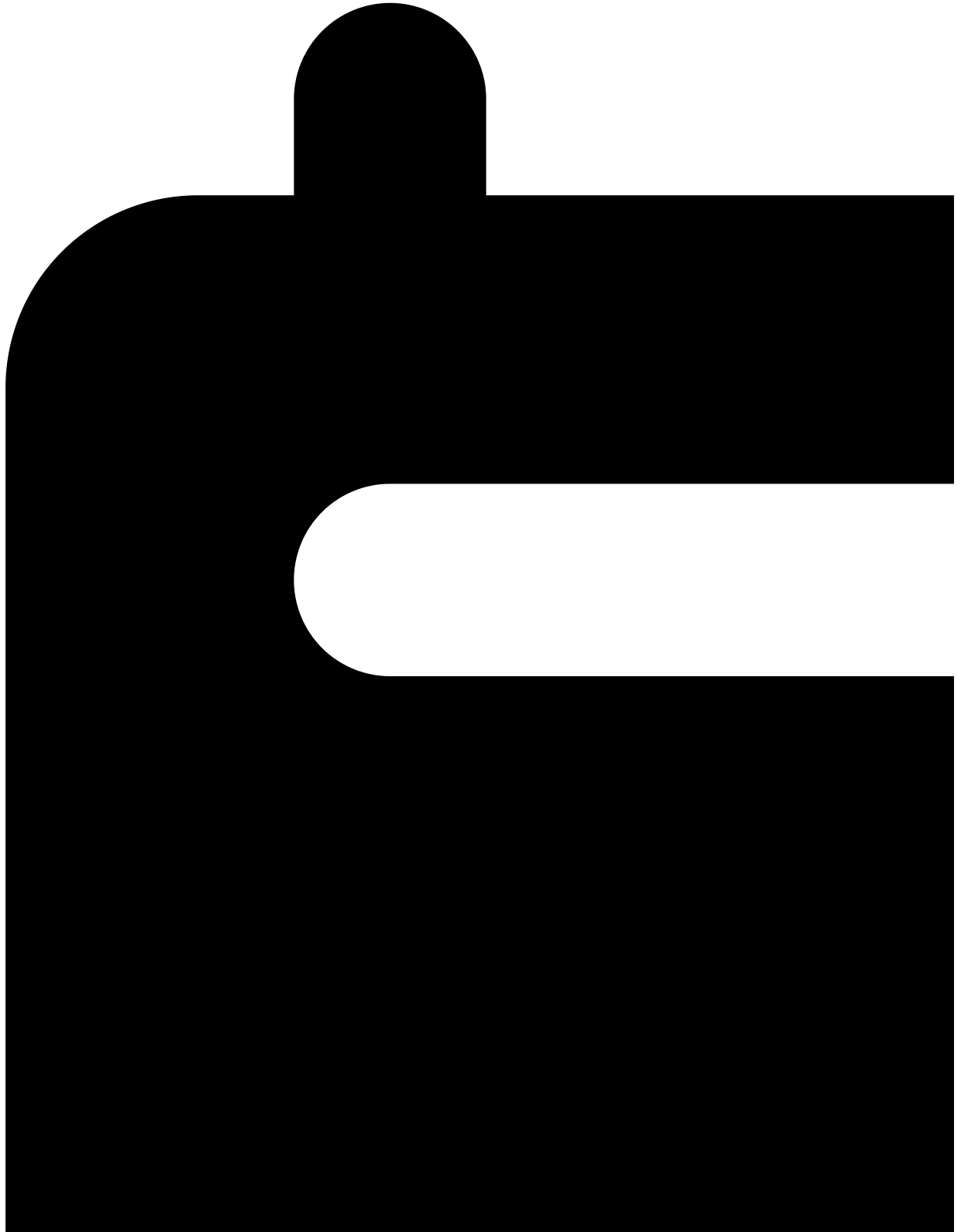


Chief Economist's Note

Inflation-scarred EMs didn't hesitate to raise rates. They could lead on loosening too.

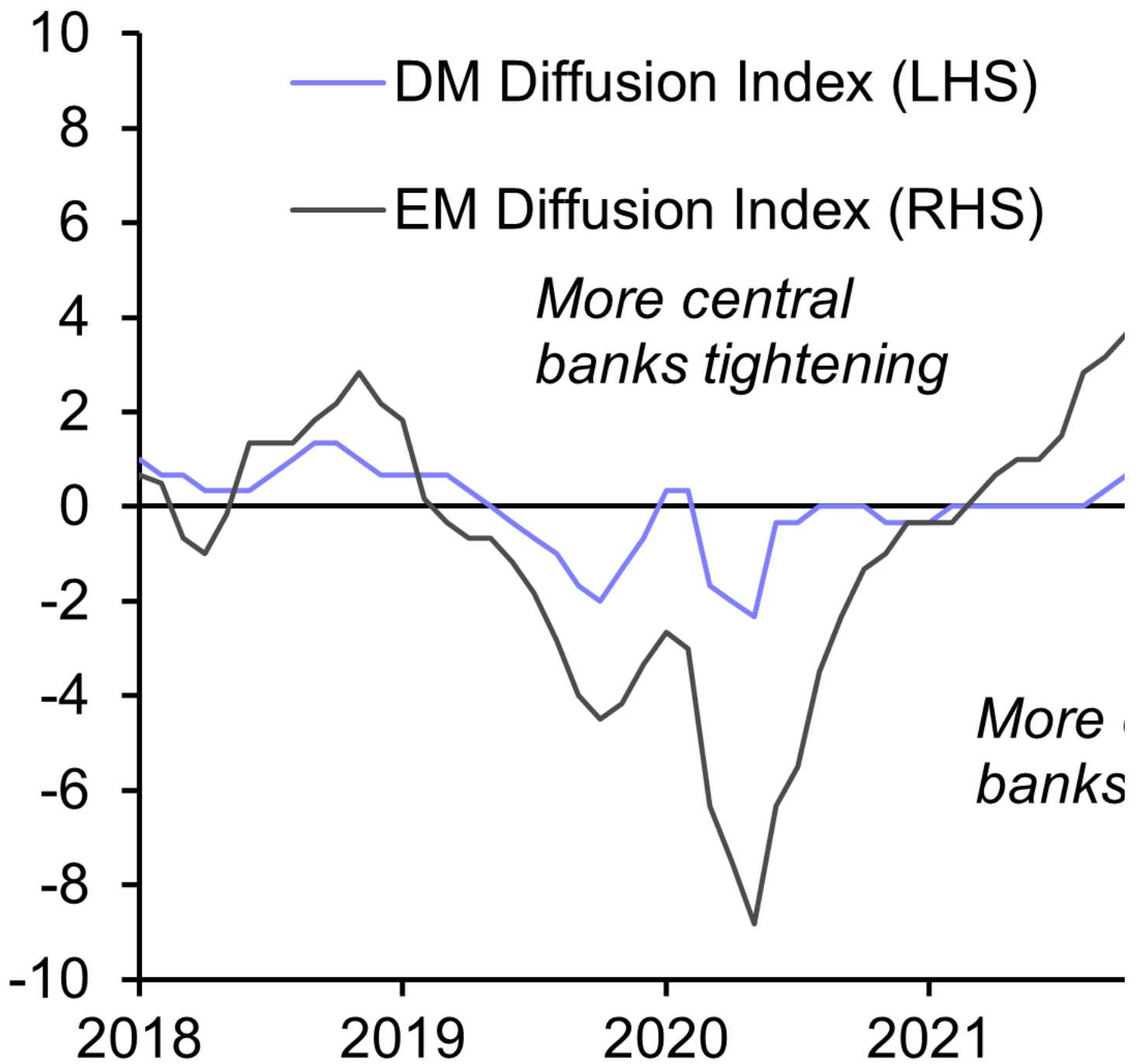




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In August 2021, while Jerome Powell was arguing in his COVID-compliant Jackson Hole address that inflation’s resurgence was “transitory”, emerging market central banks may have historically followed the Fed, hiking interest rates when it tightened policy and cutting them when it loosened. But many of these banks have le while investors are still debating how much further interest rates in the US (and Europe) will have to rise, many EM central banks have already brought their rate hiking cycle. Policymakers in Romania and Peru signalled they were done with rate hikes at their meetings last week, and we think the [Reserve Bank of India](#) (which also met last week) and hawkish statement at its meeting last Thursday, we think that there will only be [one more increase in the cycle](#) there.

Chart 1: EM & DM Diffusion Indices

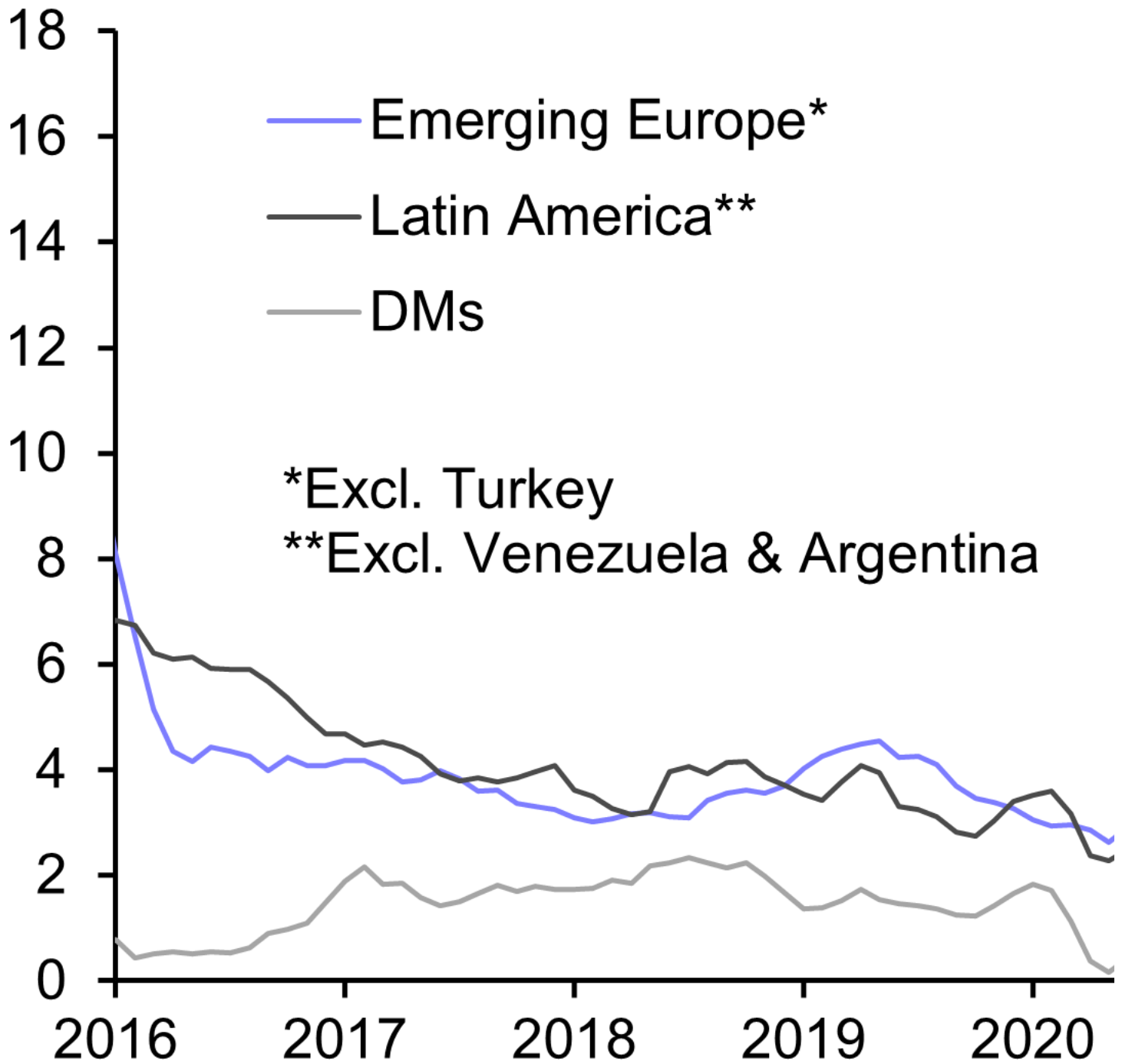


Sources: Central Banks, Various Academic Studies, CE

'Shoot first' policy

The different approach among central banks in Latin America and Eastern Europe is partly explained by the fact that their surge in inflation over the past year or so has been

Chart 2: Headline Consumer Price Inflation (%)

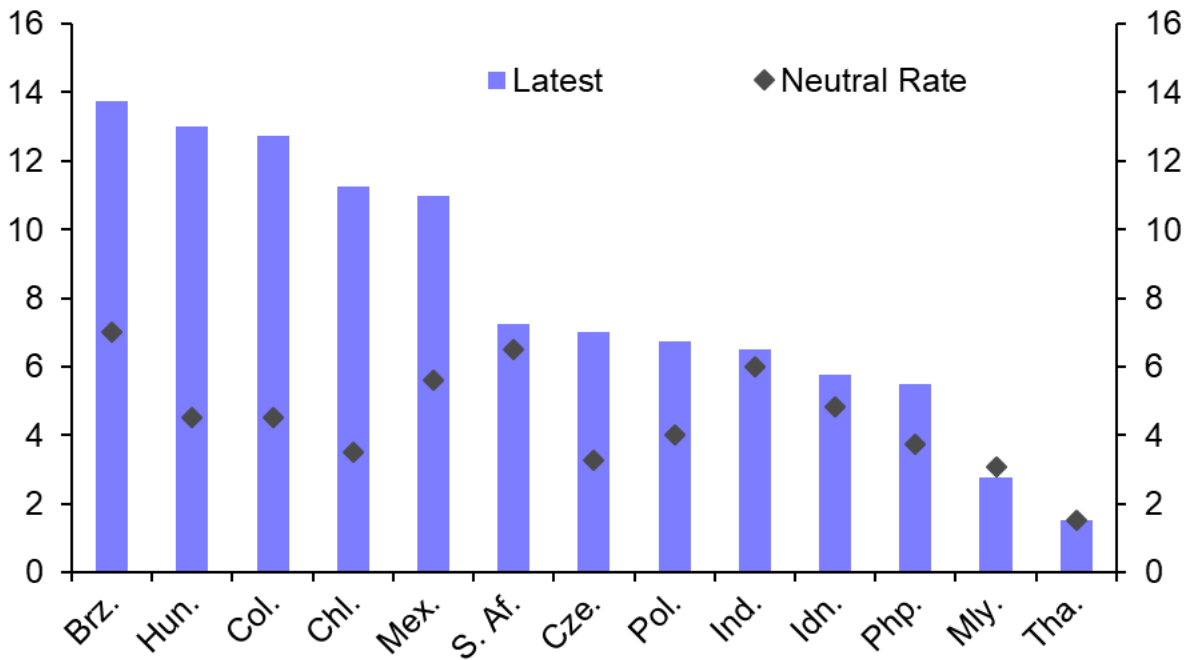


Sources: Central Banks, Various Academic Studies, CE

But these policymakers didn't demur with their advanced economy peers in finding out whether the inflation shock was "transitory". They erred on the side of caution and banks have less margin for error.

But their reluctance to wait and see also reflects a different attitude towards inflation among these policymakers. Central bankers in Emerging Europe and Latin America can't let the inflation genie be let out of the bottle. Accordingly, they hiked early and they hiked aggressively. Interest rates in most EMs outside of Asia have been raised to well above

Chart 3: Policy Interest Rates (%)

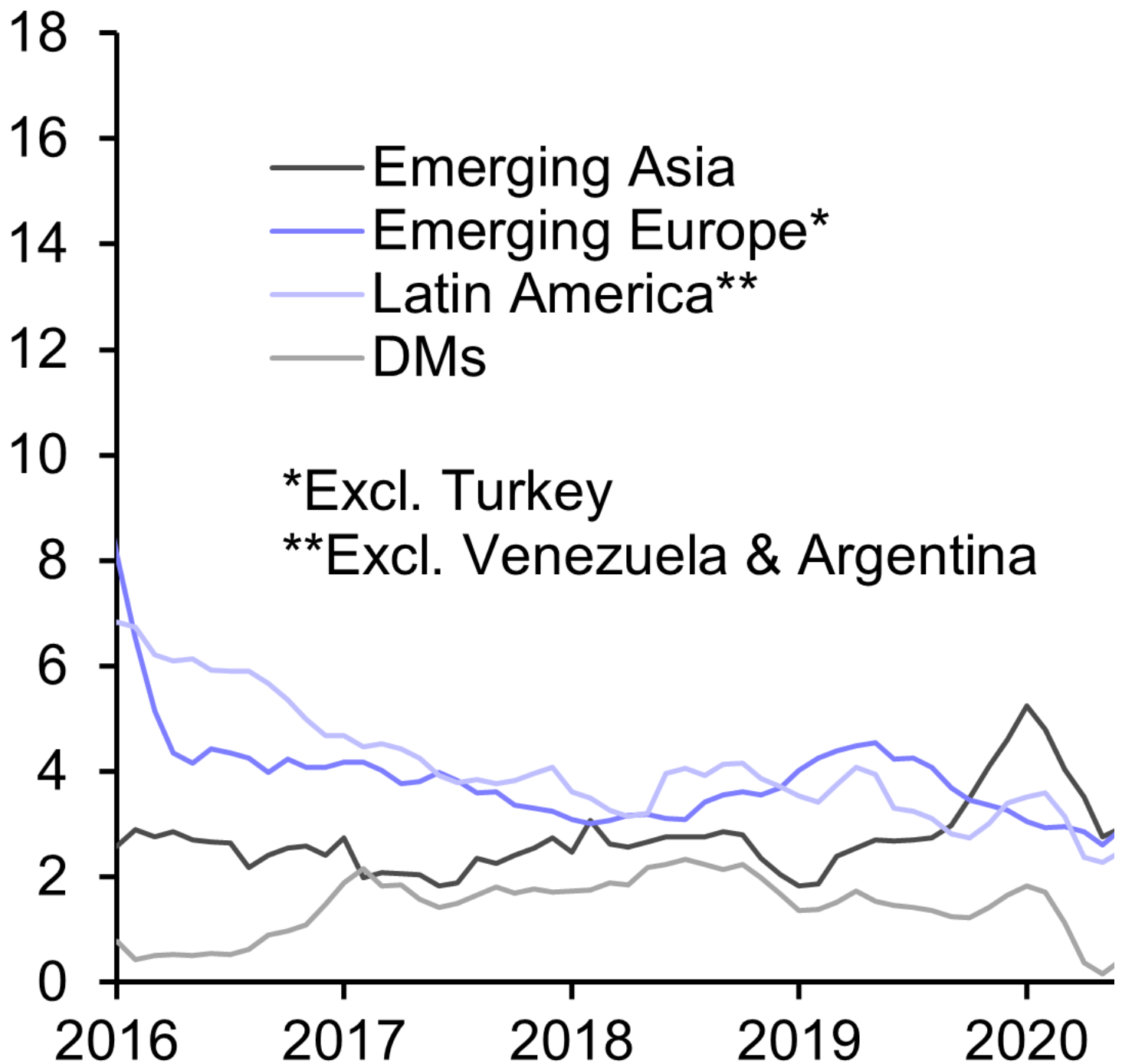


Sources: Central Banks, Various Academic Studies, CE

The Asian exception

Asia has had a different inflation experience. Its economies have been helped by domestic conditions (including stronger harvests), which have meant they have not experienced the same inflationary pressure as other regions. Energy subsidies have also shielded many households in Asia from the worst of the surge in global oil and natural gas prices. And local manufacturers appear to have kept up production despite shortages. Add in structural forces such as high savings and investment rates that act to suppress inflation in some Asian economies and the result has been that both headline and core inflation have been less of a problem for these central banks to tighten through this cycle.

Chart 4: Headline Consumer Price Inflation (%)



Sources: Central Banks, Various Academic Studies, CE

The cycle turns

Economic growth is now slowing across the emerging world, and several EMs are experiencing mild recessions. But the major EMs have come through this tightening cycle a year or so ago but, as [we've argued throughout this cycle](#), balance sheets in emerging economies are better able to withstand US policy tightening these days and [ba](#)

EM central banks will also probably be the [first to turn towards interest rate cuts](#). Some, including those in Korea, Chile and Czechia will probably do so by the middle of the easing cycle towards the end of this year.

The size of the US economy – and the centrality of the dollar within the global financial system – means that markets will necessarily focus on the actions of the Fed. But as the debate shifts from tightening to loosening, several EM central banks could once again lead the way.

In case you missed it:

- Our US Economics team explained why January's stunning jobs report doesn't change the fundamental story about a US economic slowdown [ending in recession](#)
- Tortured debt restructuring negotiations could get [even more adversarial](#) in a fracturing global economy, warns Deputy Chief EM Economist Jason Tuvey.
- I discussed EMs in [our latest podcast episode](#), which this week also includes analysis of the Adani Group crisis and how it could expose Indian banking system vulner

Details

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