

## FX Asia Fortnightly

# Room For Central Bank Support

### USD/ASEANs Mixed

ASEAN FX weakness looks set to extend after being caught in the back-foot the past month due to EM stresses and trade war tensions. Re-escalation of trade war concerns and weaker yuan after China pull-out of the upcoming Sino-US trade talks on Sat could also see USD/ASEANs drift higher ahead. Further upside risks to the USD/ASEANs could come from expectations of more aggressive Fed rate hikes and the re-emergence of EM angst. In addition, weakness in the more trade-dependent currencies including the SGD and THB cannot be ruled out as tariffs on US and Chinese goods loom. We could see the USDSGD and USDTHB grind back towards the 1.37-levels and 33-levels consequently. IDR and PHP though could see gains on policy tightening expectations, though higher oil prices could temper these gains. Unless both central banks disappoint on Thu, we expect upside to the USDIDR and USDPHP to be capped around their 2018 highs of 14940- and 54.346-levels respectively in the two weeks ahead.

BI and BSP meets on 27 Sep and recent hints from the governors of both central banks suggest that they could hike rates further. Market is expecting the BI to deliver another 25bp rate hike to bring the policy rate to 5.75%, while expectations are growing for the BSP to hike more aggressively with a 50bp rate hike to 4.50%. The expectations of further policy tightening could cause IDR and PHP to strengthen.

Our in-house model implies that SGD NEER is trading 1.28% above the implied midpoint of 1.3806, suggesting it is on the stronger side of the SGD vs. other trading partner currencies.

### Central Banks Have Policy Room To Tighten Further

Though almost all the central banks in ASEAN have tightened monetary policy, we remain interested to know if regional central banks have more room to tighten policy further especially should inflation begin to accelerate. We estimate the future path of inflation for Indonesia, Malaysia, Philippines, Singapore and Thailand using an ARIMA model and compare them to their respective central banks' inflation targets to estimate the time required (by quarters) for inflation to hit the target. Various studies suggest that the transmission lag of monetary policy varies between central banks. We then estimate the policy time span available for the central bank to tighten monetary policy - slack ratio by dividing the time required for inflation to hit target with the policy transmission lag. Our study suggests that monetary policy space varies across ASEAN central banks. BSP is slightly behind the curve even with the rate hikes to date. Further rate hikes cannot be ruled out, especially at its next policy meeting on 27 Sep. BI should also continue to be pre-emptive and front-load its rate hikes, even as inflation remains contained, to keep the IDR stable. BNM, MAS and BoT all have policy space to keep policy on hold, though BNM could move to further tighten policy first within the three central banks. Next up could be BoT, even though inflation is not expected to hit the central bank targets within the next 10 quarters. However, BoT could normalise policy to provide it with policy space should the macroeconomic environment deteriorate in the future. Singapore, which has already normalised policy in Apr, is expected to remain on hold for now. Further moves by BI and BSP to tighten policy could see the IDR and PHP supported in the two weeks ahead vis-à-vis their other regional peers that are likely to keep monetary policy on hold for now.

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## Flavour of the Week: ASEAN Central Banks Have Policy Room To Tighten Further

- ASEAN central banks are mandated to maintain price stability, i.e., ensuring that inflationary expectations are well-anchored within an inflation target or range. Recent events, namely EM stresses and expectations of Fed rate hikes, have weighed on ASEAN FX, particularly the IDR and PHP - both of which suffers from twin deficits, and spurred actions by regional central banks to stabilise their domestic currencies. In terms of inflationary pressures, only PHP is under duress with inflation touching multi-year highs.
- Though almost all the central banks in ASEAN have tightened monetary policy, we remain interested to know if regional central banks have more room to tighten policy further especially if inflation begin to accelerate. We estimate the future path of inflation for Indonesia, Malaysia, Philippines, Singapore and Thailand using an ARIMA model (for further details, refer to our report [\*Monetary Policy Unwind - How Soon?\*](#) dated 26 July 2017). Consumer price indices from 1Q 2000 to 2Q2018 (except of the Philippines from 1Q 1980 to 2Q 2018) were used in the model.
- We use the estimates of the inflation path forecast for ASEAN and compare them to their respective central banks' inflation targets to estimate the time required (by quarters) for inflation to hit the target. Our study shows that inflation in Indonesia is expected to hit the BI's target in 1 quarter; Malaysia inflation by 5 quarters. Philippine inflation has already reached the BSP target in the previous two quarters. Inflation for Singapore and Thailand though are not expected to hit their respective central banks' target within our forecast period of 10 quarters. We have extrapolated and estimated that inflation in Singapore and Thailand will hit their inflation target in 9 and 15 quarters respectively.
- Various studies suggest that the transmission lag of monetary policy varies between central banks<sup>1</sup>. Malaysia's transmission lag is around 3 quarters; Singapore about 4 quarters; Indonesia and Philippines by 5 quarters; and Thailand by about 6 quarters.

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<sup>1</sup> Nurliana, Linda; Wimanda, Rizki Ernadi and Satyanugraha, Redianto (2016): "Evaluating Monetary Transmission In Indonesia Using A Structural FAVAR Approach". SEACEN's Monetary Policy Transmission in the SEACEN Economies (Chapter 2).

Dacio, Jasmin E. and Cruz, Christopher John F. (2012): "Tenets of Effective Monetary Policy in the Philippines". Bangko Sentral Review 2012.

Bank of Thailand Website: MPC Knowledge - Transmission mechanism.

Table 1: Monetary Policy Slack - BSP Is Slightly Behind The Curve, While BoT Has Room To Be Patient

|           | Time for<br>Inflation to get<br>to Inflation<br>Target (z) – by<br>Quarters | Median<br>Policy<br>Transmission<br>Lag (y) – by<br>Quarters | Policy Slack<br>Ratio<br>(z/y = x) |
|-----------|-----------------------------------------------------------------------------|--------------------------------------------------------------|------------------------------------|
| ID / BI   | 1                                                                           | 5                                                            | 0.2                                |
| MY / BNM  | 4                                                                           | 3                                                            | 1.3                                |
| PH / BSP  | -2                                                                          | 5                                                            | -0.4                               |
| SG / MAS* | 9                                                                           | 4                                                            | 2.3                                |
| TH / BoT  | 15                                                                          | 6                                                            | 2.5                                |

Note that forecast of the future path of inflation was estimated using an

ARIMA model: 
$$\Delta X_t = \theta_0 + \sum_{i=1}^p \phi_i \Delta X_{t-i} + e_t - \sum_{i=1}^q \theta_i e_{t-i}$$

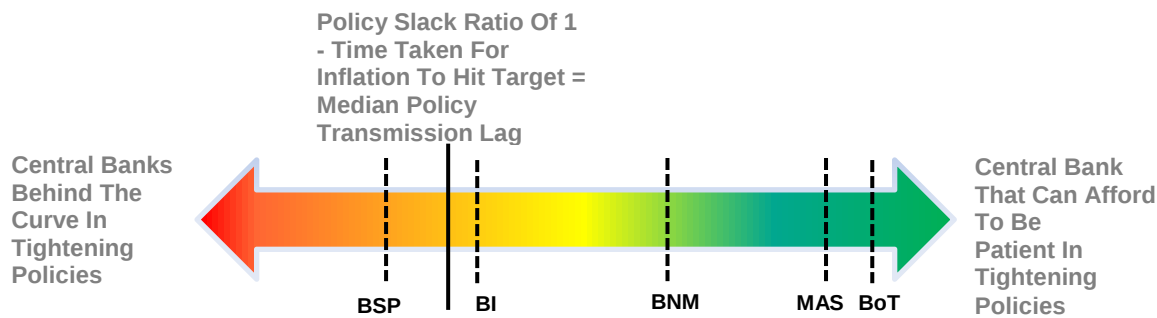
\*MAS uses exchange rate policy as a monetary tool unlike its ASEAN peers

Source: Maybank FX Research & Strategy Estimates

- To calculate the policy space available to central bank to tighten monetary policy - *slack ratio* - we use the time required for inflation to hit target and divide it by the policy transmission lag (Table 1). A ratio of 1 suggests that the central bank could be on the verge of tightening policy in the current quarter or the next; a ratio greater than 1 suggests that the central bank has policy space to be patient in tightening policy; a ratio less than 1 points to the central bank being slightly behind the curve in tightening policy; and a negative ratio suggests that inflation has overshoot target and the central bank is behind the curve in tightening policy.
- Our calculations show that the Philippines have overshoot its inflation target in the past two quarters, though the central bank has since started its tightening cycle in May. The risk is that inflation continues to stay above the central bank's target, especially after the devastation caused by Typhoon Mangkhut and rising oil prices. BSP meets on 27 Sep and there is increasing expectations that the central bank could hike its benchmark interest rate by a larger 50bp to anchor inflationary expectations.
- For Indonesia, inflation remains contained and could remain so especially with the measures introduced by both the government to ensure supply of food stuff and BI's bold rate hikes since May. To date, the BI has hiked its policy rate by 125bp and is expected to remain pre-emptive and front-loading to be ahead of the curve. We expect the BI to hike rate by another 25bp at its 27 Sep to maintain IDR and macroeconomic stability.
- Inflation in Malaysia is manageable and within the BNM's target, helped to a large extent by the zeroed GST. The re-introduction of the Sales and Services Tax though is likely to have a limited impact on consumer prices as only a small portion of the CPI basket will be affected. Note that the BNM had lifted the OPR by 25bp to 3.25% in Jan this year. With the focus on growth, policy is likely to remain on hold for the rest of 2018 and in 2019.
- Both Singapore and Thailand have the policy space to tighten policy as suggested by the slack ratio. Singapore though has already begun the

process of policy normalisation by increasing “slightly” the slope of the SGD NEER policy band in anticipation of acceleration in inflation. Further tightening moves are unlikely in Oct. For Thailand, the central bank has hinted that the current accommodative policy needs to be gradually reduced. However, the government holds an opposite view and when the BoT will move to normalise policy will depend on the strength of the economy. We expect the BoT to hike its policy rate by 25bp towards the end of 2018.

**Chart 1: Monetary Policy Space Available To ASEAN Central Banks**



Source: Maybank FX Research & Strategy

- In sum, our study suggests that monetary policy space varies across ASEAN central banks (Chart 1). BSP is slightly behind the curve even with the rate hikes to date. Further rate hikes cannot be ruled out, especially at its next policy meeting on 27 Sep. BI should also continue to be pre-emptive and front-load its rate hikes, even as inflation remains contained, to keep the IDR stable. BNM, MAS and BoT all have policy space to keep policy on hold, though BNM could move to further tighten policy first among the three central banks. Next up could be BoT, even though inflation is not expected to hit the central bank targets within the next 10 quarters. However, BoT could normalise policy to provide it with policy space should the macroeconomic environment deteriorate in the future. Singapore, which has already normalised policy in Apr, is expected to remain on hold for now in the absence of significant inflationary pressures.
- Further moves by BI and BSP to tighten policy could see the IDR and PHP supported in the two weeks ahead vis-à-vis their other regional peers that are likely to keep monetary policy on hold for now.

## • Key Data and Events Ahead

| 24-30 Sep   |                                                                                                                    | 1-7 Oct                                                                        |  |
|-------------|--------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------|--|
| Japan       | • <b>Mon:</b> Public Holiday                                                                                       | • <b>Mon:</b> Tankan Survey (3Q), Nikkei PMI Mfg (Sep F)                       |  |
|             | • <b>Tue:</b> BOJ Minutes of Jul Policy Meeting; BOJ Governor Kuroda Speaks (Osaka)                                | • <b>Tue:</b> - Nil -                                                          |  |
|             | • <b>Wed:</b> Machine Tool Orders (Aug F)                                                                          | • <b>Wed:</b> Nikkei PMI Services & Composite (Sep)                            |  |
|             | • <b>Thu:</b> BOJ Governor Kuroda Speaks (Tokyo)                                                                   | • <b>Thu:</b> - Nil -                                                          |  |
|             | • <b>Fri:</b> Jobless Rate, Retail Sales, Industrial Production (Aug); BOJ Summary of Opinions (18-19 Sep Meeting) | • <b>Fri:</b> Household Spending, Labour Cash Earnings (Aug)                   |  |
| China       | • <b>Mon:</b> Public Holiday                                                                                       | • <b>Mon:</b> Public Holiday                                                   |  |
|             | • <b>Tue:</b> - Nil -                                                                                              | • <b>Tue:</b> Public Holiday                                                   |  |
|             | • <b>Wed:</b> - Nil -                                                                                              | • <b>Wed:</b> Public Holiday                                                   |  |
|             | • <b>Thu:</b> Industrial Profits (Aug)                                                                             | • <b>Thu:</b> Public Holiday                                                   |  |
|             | • <b>Fri:</b> Caixin PMI Mfg (Sep), Current Account (2Q F)                                                         | • <b>Fri:</b> Public Holiday                                                   |  |
|             | • <b>Sun:</b> Non-Mfg, Manufacturing & Composite PMI (Sep)                                                         | • <b>Sun:</b> Foreign Reserves (Sep)                                           |  |
| South Korea | • <b>Mon:</b> Public Holiday                                                                                       | • <b>Mon:</b> Trade, Nikkei PMI Mfg (Sep)                                      |  |
|             | • <b>Tue:</b> Public Holiday                                                                                       | • <b>Tue:</b> Business Survey Mfg & Non-Mfg (Oct), Industrial Production (Aug) |  |
|             | • <b>Wed:</b> Public Holiday                                                                                       | • <b>Wed:</b> Public Holiday                                                   |  |
|             | • <b>Thu:</b> - Nil -                                                                                              | • <b>Thu:</b> Foreign Reserves (Sep)                                           |  |
|             | • <b>Fri:</b> Consumer Confidence (Sep)                                                                            | • <b>Fri:</b> CPI (Sep)                                                        |  |
| Singapore   | • <b>Mon:</b> CPI (Aug)                                                                                            | • <b>Mon:</b> - Nil -                                                          |  |
|             | • <b>Tue:</b> - Nil -                                                                                              | • <b>Tue:</b> PMI (Sep)                                                        |  |
|             | • <b>Wed:</b> Industrial Production (Aug)                                                                          | • <b>Wed:</b> Nikkei PMI (Sep)                                                 |  |
|             | • <b>Thu:</b> - Nil -                                                                                              | • <b>Thu:</b> - Nil -                                                          |  |
|             | • <b>Fri:</b> - Nil -                                                                                              | • <b>Fri:</b> - Nil -                                                          |  |
| Malaysia    | • <b>Mon:</b> - Nil -                                                                                              | • <b>Mon:</b> Nikkei PMI Mfg (Sep)                                             |  |
|             | • <b>Tue:</b> - Nil -                                                                                              | • <b>Tue:</b> - Nil -                                                          |  |
|             | • <b>Wed:</b> - Nil -                                                                                              | • <b>Wed:</b> - Nil -                                                          |  |
|             | • <b>Thu:</b> - Nil -                                                                                              | • <b>Thu:</b> - Nil -                                                          |  |
|             | • <b>Fri:</b> - Nil -                                                                                              | • <b>Fri:</b> Trade (Aug), Foreign Reserves (28 Sep)                           |  |
| Indonesia   | • <b>Mon:</b> - Nil -                                                                                              | • <b>Mon:</b> CPI, Nikkei PMI Mfg (Sep)                                        |  |
|             | • <b>Tue:</b> - Nil -                                                                                              | • <b>Tue:</b> - Nil -                                                          |  |
|             | • <b>Wed:</b> - Nil -                                                                                              | • <b>Wed:</b> - Nil -                                                          |  |
|             | • <b>Thu:</b> BI 7-Day Reverse Repo Rate                                                                           | • <b>Thu:</b> - Nil -                                                          |  |
|             | • <b>Fri:</b> - Nil -                                                                                              | • <b>Fri:</b> Foreign Reserves (Sep)                                           |  |
| Philippines | • <b>Mon:</b> Budget Balance (Aug)                                                                                 | • <b>Mon:</b> Nikkei PMI Mfg (Sep)                                             |  |
|             | • <b>Tue:</b> - Nil -                                                                                              | • <b>Tue:</b> - Nil -                                                          |  |
|             | • <b>Wed:</b> - Nil -                                                                                              | • <b>Wed:</b> - Nil -                                                          |  |
|             | • <b>Thu:</b> BSP Overnight Borrowing Rate                                                                         | • <b>Thu:</b> - Nil -                                                          |  |
|             | • <b>Fri:</b> - Nil -                                                                                              | • <b>Fri:</b> CPI, Foreign Reserves (Sep)                                      |  |
| Thailand    | • <b>Mon:</b> Public Holiday                                                                                       | • <b>Mon:</b> CPI, Nikkei PMI Mfg (Sep)                                        |  |
|             | • <b>Tue:</b> - Nil -                                                                                              | • <b>Tue:</b> - Nil -                                                          |  |
|             | • <b>Wed:</b> - Nil -                                                                                              | • <b>Wed:</b> - Nil -                                                          |  |
|             | • <b>Thu:</b> Mfg Production Index, Capacity Utilisation (Aug - due sometime 27-28 Sep)                            | • <b>Thu:</b> - Nil -                                                          |  |
|             | • <b>Fri:</b> Trade, Current Account (Aug), Foreign Reserves (21 Sep)                                              | • <b>Fri:</b> Foreign Reserves (28 Sep)                                        |  |
| India       | • <b>Mon:</b> - Nil -                                                                                              | • <b>Mon:</b> Nikkei PMI Mfg (Sep)                                             |  |
|             | • <b>Tue:</b> - Nil -                                                                                              | • <b>Tue:</b> Public Holiday                                                   |  |
|             | • <b>Wed:</b> - Nil -                                                                                              | • <b>Wed:</b> - Nil -                                                          |  |
|             | • <b>Thu:</b> - Nil -                                                                                              | • <b>Thu:</b> Nikkei PMI Services & Composite (Sep)                            |  |
|             | • <b>Fri:</b> Fiscal Deficit (Aug)                                                                                 | • <b>Fri:</b> RBI Repurchase Rate                                              |  |
| Vietnam     | • <b>Mon:</b> - Nil -                                                                                              | • <b>Mon:</b> Nikkei PMI Mfg (Sep)                                             |  |
|             | • <b>Tue:</b> GDP (3Q), Trade, CPI, Industrial Production, Retail Sales (Sep - due 25-30 Sep)                      | • <b>Tue:</b> - Nil -                                                          |  |
|             | • <b>Wed:</b> - Nil -                                                                                              | • <b>Wed:</b> - Nil -                                                          |  |
|             | • <b>Thu:</b> - Nil -                                                                                              | • <b>Thu:</b> - Nil -                                                          |  |
|             | • <b>Fri:</b> - Nil -                                                                                              | • <b>Fri:</b> - Nil -                                                          |  |

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