

International Commentary — September 9, 2024

To Pivot From Pause. Asian Central Banks Are Ready To Cut

Summary

With the Federal Reserve signaling the start of an easing cycle in September, U.S. Treasury yields have fallen and the U.S. dollar has displayed modest weakness. The combination of lower interest rates and dollar depreciation is likely to create policy space for foreign central banks to ease monetary policy more aggressively, or more notably, initiate easing cycles of their own. In our view, emerging Asia central banks are likely to be the institutions most sensitive to recent moves in financial markets, and our monetary policy space framework confirms regional central banks indeed now have more room to lower interest rates. In that sense, we believe Asian central banks are now likely to make a concerted effort toward easier monetary policy, and central banks in Indonesia, Thailand and India can begin cutting rates. At the same time, the People's Bank of China and Central Bank of the Philippines are likely to remain committed to easier monetary policy going forward. Regional central banks may be cutting rates at different speeds, but thematically, the region once absent from the global easing trend is now set to join peer institutions.

Economist(s)

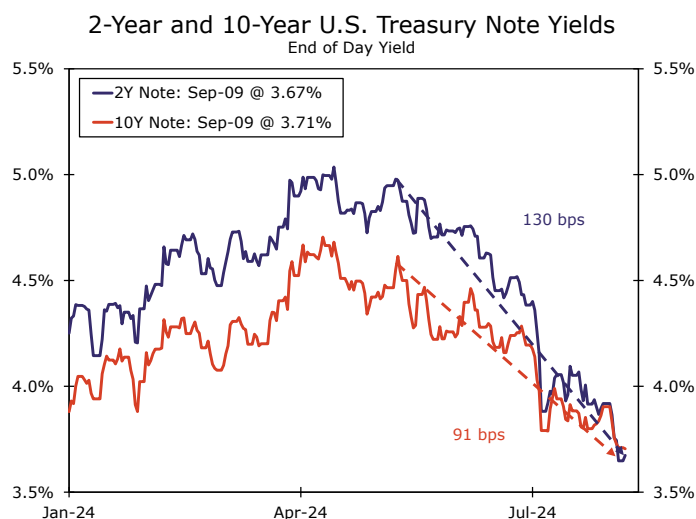
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Emerging Asia Central Banks Have Approached The Pivot

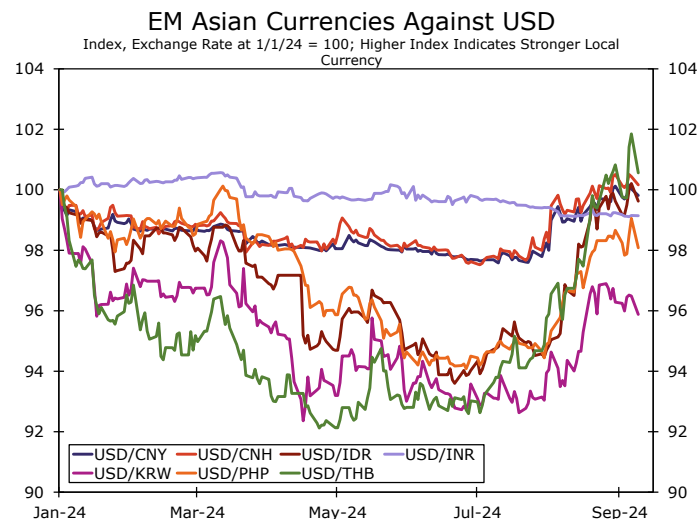
Our [August International Economic Outlook](#) contained a section dedicated to the potential spillovers from the Federal Reserve approaching interest rate cuts. We defined “spillovers” as foreign central banks that could be more inclined to either pick up the pace of interest rate cuts or be influenced to start a respective easing cycle now that the Fed is committed to easing. In that publication, we shared our view that most G10 central banks would likely not be influenced by the Fed and would respond to the evolution of domestic economic conditions when considering adjustments to monetary policy settings. However, we did highlight how select institutions in the emerging markets—in particular emerging Asia—could use the Fed’s pivot as a catalyst to also lower their own respective policy rates. Policymakers at developing Asia central banks have largely been absent from the easing trend that has taken place in other emerging regions so far. Communications from policymakers often cited upside risks to the local inflation outlook due to potential commodity price shocks and pass through to consumer prices via currency depreciation. While those risks could certainly materialize, regional central bank statements were largely interpreted as policymakers also waiting for the Federal Reserve to start its easing cycle. With the Federal Reserve now all but committed to starting a period of rate cuts in September, U.S. Treasury yields have fallen quickly ([Figure 1](#)) and the U.S. dollar has weakened against most Asian currencies ([Figure 2](#)). The combination of lower U.S. yields and stronger regional currencies suggests local institutions may now have rationale to either continue easing monetary policy (i.e. People’s Bank of China and Central Bank of the Philippines) or more notably, initiate easing cycles.

Figure 1



Source: Bloomberg Finance L.P. and Wells Fargo Economics

Figure 2



Source: Bloomberg Finance L.P. and Wells Fargo Economics

One can certainly apply judgment to infer which emerging Asian central banks could pivot to rate cuts; however, we also took recent market moves as an opportunity to update our central bank monetary policy space framework. Our policy space framework is a useful guide to get a sense of which regional central banks indeed have room to cut rates and how forceful rate cuts could be. To determine monetary policy space we examine the fundamental economic and financial market indicators that policymakers typically consider when approaching interest rate decisions. In that sense, we look at multiple factors. On the economic side, our framework takes into account how restrictive monetary policy settings currently are via real interest rates. We also consider a forward-looking inflation assessment and where price growth could be relative to the central bank’s CPI inflation target. Central banks also focus on influencing growth prospects, so to account for that we included a measure of the underlying growth momentum within an economy. And finally, we added local currency performance against the U.S. dollar. Currency depreciation has the potential to lead to imported inflation—which a central bank would likely need to defend against—but also financial stability risks. In a scenario where a local currency is selling off rapidly, both of those risks could lead a central bank to keep policy rates on hold or possibly start raising rates to defend the value of its currency. Ultimately we get to an aggregate measure of central bank policy space for interest rate reductions. The full monetary policy space framework table is in [Figure 3](#). Our framework identifies which central banks—in Asia and

elsewhere—have room to ease monetary policy before the end of this year. Our framework also shows which input indicators are generating room for interest rate cuts as well as how many cuts could be delivered by year-end.

Figure 3

Country	2024 Monetary Policy Space as of Q2'24 ^{1 2}	2024 Monetary Policy Space as of Q3'24 ^{1 2}	Real Interest Rate (%)	Inflation From CB Target (%)	Economic Growth Momentum	FX Performance vs. USD (Last 3 months)
Indonesia	Green	Green	Green	Green	Green	Green
China	Orange	Green	Green	Green	Green	Green
Thailand	Orange	Green	Green	Green	Green	Green
Philippines	Orange	Green	Green	Orange	Green	Green
South Africa	Orange	Green	Green	Orange	Green	Green
India	Green	Green	Green	Orange	Green	Orange
Peru	Green	Green	Green	Orange	Green	Orange
Colombia	Green	Orange	Green	Red	Green	Red
South Korea	Orange	Orange	Orange	Red	Red	Green
Mexico	Orange	Orange	Green	Red	Green	Red
Chile	Green	Orange	Green	Orange	Red	Orange
Russia	Orange	Orange	Green	Red	Orange	Orange
Brazil	Orange	Red	Green	Red	Red	Red
Argentina	Red	Red	Red	Red	Green	Red
Turkey	Red	Red	Red	Red	Red	Orange

¹ Green indicates "Adequate Monetary Policy Space", Orange indicates "Limited Monetary Policy Space", Red indicates "No Monetary Policy Space"

² Adequate Monetary Policy Space represents scope for >50 bps rate cuts, Limited Monetary Policy Space represents scope for 25-50 bps rate cuts, No Monetary Policy Space represents scope for 0 rate cuts

Source: Bloomberg Finance L.P. and Wells Fargo Economics

Our framework suggests that select central banks in emerging Asia have the most room for interest rate cuts over the next few months. In that sense, our framework identifies Bank Indonesia (BI), People's Bank of China (PBoC), Bank of Thailand (BOT) and the Central Bank of the Philippines (BSP) at the top of the monetary policy space column. Thematically, these institutions are all associated with real interest rates well into positive territory, economic activity that is decelerating as well as currencies that have strengthened against the U.S. dollar over the last three months. In addition, a forward-looking view of inflation also suggests price growth will be below respective CPI targets, or at a minimum, comfortably within target ranges. Not far from the top of the list is the Reserve Bank of India (RBI), which our framework also identifies as having adequate room for policy rate cuts before the end of this year. Similar trends exist in India. Real policy rates are in restrictive territory, the economy is demonstrating signs of slowing, and even though inflation is expected to be a touch higher relative to peer Asian economies and the rupee has not performed as well, fundamentals suggest RBI policymakers can deliver rate cuts over the next few months. Our framework identifying most EM Asia central banks as having the most policy space across the emerging markets is certainly interesting, but just as compelling is the evolution of policy space over the last few months. The PBoC, BOT and BSP have all accumulated more policy room for rate cuts since Q2, with our framework now suggesting "adequate monetary policy space" for each institution as opposed to only "limited monetary policy space" last quarter. While BI had adequate space for rate cuts in Q2, our framework suggests recent rupiah strength has boosted policy room even further and accounts for BI having the most space for more accommodative monetary policy relative to peer institutions across Asia and other regions.

But having space for easier monetary policy does not necessarily mean central banks will deliver rate cuts, or least rate cuts to the magnitude our framework suggests. Thus, while we can use our systematic framework to help inform our view we think a judgmental overlay is still necessary to some degree. As for Bank Indonesia, we believe our framework accurately reflects the extent of easing policymakers will deliver by the end of 2024. Currency stability is the center of BI's monetary policy mandate, and now that the currency has strengthened and imported-inflation risks have receded, we believe BI will initiate its easing cycle at its September meeting and deliver additional easing at remaining meetings through year-end. In that sense, the BI policy rate could end this year at 5.25%. In China, economic malaise and deflationary pressures are likely to be the driving force of PBoC easing; however, recent renminbi strength can also be a source of easing rationale for policymakers. We expect PBoC policymakers to deliver one more 50 bps reduction to the local bank Reserve Requirement Ratio (RRR), slightly less than our framework suggests; however, RRR cuts are likely to be delivered in

conjunction with lending rate reductions. The Bank of Thailand has had space for rate cuts for some time, although policymakers have opted for extreme caution when considering easing monetary policy up to this point. With inflation still subdued and the baht flipping to outright strength against the dollar year-to-date, we believe policymakers are finally ready to shift to more accommodative policy settings. With that said, we look for 50 bps of cumulative rate cuts in 2024 for a benchmark interest rate of 2.00%—slightly less easing than what our framework suggests—with the first cut to be delivered in October after the Fed starts easing monetary policy. BOT easing could continue into early 2025, although Bank of Thailand policymakers may deliver one of the more shallow easing cycles in emerging Asia as a need to defend against renewed currency depreciation pressures persists. BSP policymakers already started cutting rates in Q3, and we believe our framework is in line with easing to be delivered before the end of this year. To that point, we believe another 50 bps of rate cuts—75 bps in total for 2024—can be delivered by the end of this year for a BSP borrowing rate of 5.75%. And finally, the Reserve Bank of India represents a central bank where judgment may be needed the most. RBI policymakers have had room to lower interest rates for most of this year; however, policymakers seem to be waiting for the Fed more than peer central bankers in the region. With the Fed set to cut rates in September, combined with local economic activity showing tentative signs of deceleration, the RBI is on track to ease. With that said, we believe the RBI will deliver only one 25 bps rate cut before year-end, to 6.25%. The easing cycle is likely to continue in 2025, and ultimately we believe RBI policy rates will reach a terminal rate of 5.75% by the middle of next year.

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