

IMPACT OF INFLATION AND TARIFFS ON ASIAN MARKETS

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Inflation has a complex impact on Asian markets, with some economies facing greater challenges than others. While rising food and energy prices are significant drivers, Asian central banks have generally been slower to raise interest rates compared to their Western counterparts. However, the pace of rate hikes appears to be accelerating. The impact also varies based on the structure of each economy, with some benefiting from increased domestic consumption and tourism, while others are more vulnerable to global economic shifts.

Here's a more detailed breakdown:

Impact on Stock Markets:

Higher inflation can lead to reduced investment in stocks due to the increased attractiveness of fixed-income investments as interest rates rise. This can result in increased market volatility and affect investor sentiment.

Commodity Prices:

Rising commodity prices, particularly for energy and food, have been a major driver of inflation in Asia. This is especially impactful for economies heavily reliant on commodity exports.

Monetary Policy Response:

Asian central banks have generally been more cautious in raising interest rates than their Western counterparts, partly due to concerns about the impact of higher food and energy prices on disposable incomes. However, the pace of rate hikes is increasing.

Domestic Consumption:

Some Asian economies with large domestic populations may benefit from the shift in consumption from goods to services as pandemic restrictions ease.

Vulnerability to Global Economic Shifts:

Inflationary pressures in major economies like the US can create global economic uncertainty, affecting investor sentiment and potentially impacting Asian markets.

Inflation Expectations:

Short-term inflation expectations in Asia are strongly linked to energy and food prices. Managing these expectations is crucial for controlling overall inflation.

Supply Chain Issues:

While supply chain disruptions have contributed to inflationary pressures, improvements in supply chains and rising inventories could help meet demand and ease price pressures.

Regional Differences:

The impact of inflation varies across Asian economies. Some, like India and South Korea, have seen a bigger impact on headline inflation, while others, like the Philippines, have experienced second-round effects.

Potential for Growth:

Economies with strong domestic markets and tourism sectors, such as those in the ASEAN region, may be well-positioned to benefit from the reopening boost and increased consumption.

Subdued domestic demand, potential disruptions to global trade, and limited room for fiscal stimulus all combine to make looser monetary policy an attractive option for policymakers.

But at the same time, the decision to further lower rates will be complicated by a challenging external environment. The outlook for USD is for the greenback to remain strong throughout the year. Furthermore, the US Federal Reserve has put its own rate cutting cycle on pause. The risk of widening interest rate differentials with the US constrains the scope for policy easing across Asia.

Economic outlook 2025: lower rates to come

Despite the complex backdrop, most of Asia's central banks ARE expected to cut rates two or three times in 2025. The depth of the cuts will depend on the specific circumstances of each economy.

Monetary policy in the Philippines is moving more independently from the Fed than its regional peers, as concerns over domestic growth and inflation considerations are taking precedence for the central bank.

Thailand's heavy reliance on exports makes it vulnerable to disruptions in global trade.

Among the economies that are expected to keep rates steady is Malaysia, where robust growth will be accompanied by modest inflationary pressures. The economy is firing on all cylinders, which means that although exports may suffer in a world of growing protectionism, domestic demand and investment flows will be able to pick up the slack.

Assessing disruptions to trade

Throughout 2025, Asian economies will have to handle high levels of unpredictability in the trade outlook. Much of the uncertainty comes from US President Donald Trump's threat to impose tariffs on a number of its major trade partners. In the weeks following his inauguration, Mr. Trump announced significant levies on imports from Canada and Mexico, only to halt the measures just ahead of their implementation.

Tariffs on Chinese imports, adding 10% to existing levies, will go ahead. And this could only be the beginning: during his campaign, Mr. Trump threatened to impose tariffs as high as 60% to all Chinese exports to the US.

Even economies not directly targeted by these measures may face lower export demand due to the tariffs. The trade barriers will have a ripple effect along entire

supply chains, as US demand for Chinese goods weakens and Chinese producers reduce purchases of both foreign and domestic inputs.

The indirect exposure of Asian economies to US tariffs on Chinese goods can be assessed by looking at the value-added content of foreign inputs in Chinese exports to the US. By this measure, Taiwan, Malaysia, and Singapore are the most exposed. But if the US imposes tariffs directly on a broader range of economies, the impact will be much greater for export-dependent economies like Taiwan, Vietnam, and South Korea, where exposure to US tariffs would be 9.7%, 9.6% and 6.2% of GDP respectively. Countries that have the most domestically focused economies – such as India and the Philippines – will be much less exposed.

It is worth bearing in mind that exposure does not necessarily equate to impact. The actual effects of the tariffs will depend on a range of factors that are difficult to forecast – including the elasticity of demand for the affected goods, and the extent that supply chains could be modified to lessen the impact.

Economy in focus – India

With its GDP surging 8.2% in fiscal year 2024, India was one of the world's fastest growing economies, and it is expected to continue developing at an impressive pace this year, albeit with some moderation. The slowdown is due, in part, to weaker manufacturing activities, with new orders softening in recent months.

India's growth story remains intact, as the country enjoys several structural drivers that will drive a rise in GDP over the long term. These include favourable demographics, improved governance, and high-value-added sectors contributing a larger share of economic activity.

Indian inflation is expected to edge lower in 2025, supported by adequate rainfall and a robust winter crop that will ease inflationary pressure from food prices. A trade war between the US and China could also have a disinflationary effect in India, as it could result in China redirecting cheaper exports to alternative countries.

India is going through a cyclical slowdown in its economy. However, public spending is forthcoming. The Indian government recently unveiled its FY2026 Budget, which is likely to boost consumption and investment.

Finding the right balance

Lowering inflation creates space for Asian central banks to further loosen monetary policy. But in many economies, that room is limited by developments in the US, which will keep the easing cycle shallow. Finding the right balance between domestic demands and external constraints will be essential for Asian economies to successfully navigate 2025.