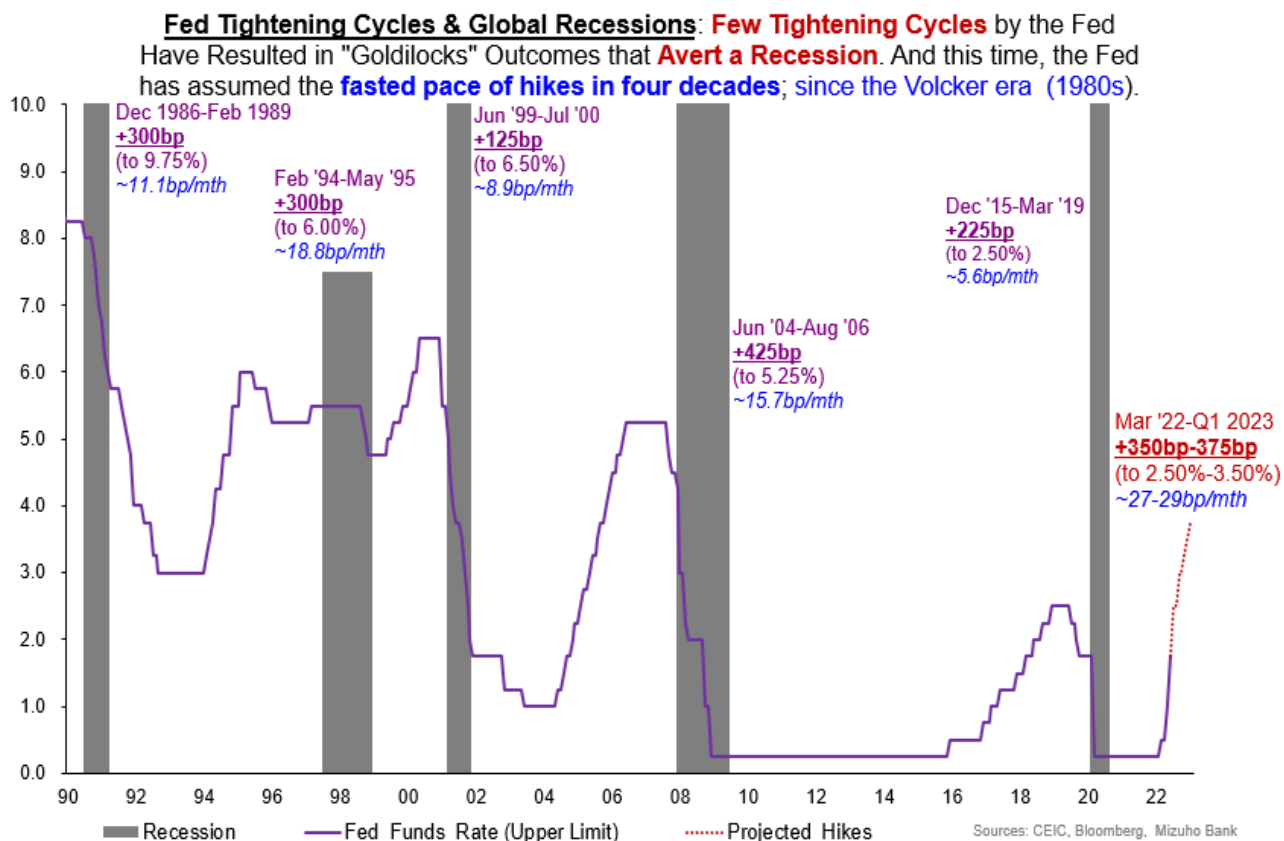


EM Asia Bracing for Fed Headwinds



"I presume nothing" – Sherlock Holmes

Stagflation Pressures from a Hawkish Fed: While Fed Chair Powell assuaged alarm about a series of **brutal rate hikes ahead**, characterizing the 75bp hike at June FOMC (culminating in 150bp of hikes since March) as uncommon, it does not distract from the fact that the **Fed is set for the fastest pace of rate hikes in four decades**; since the Volcker shocks of the 1980s (See Chart above).

This **unprecedented pace of tightening in recent memory**, especially considered alongside quantitative tightening (QT) in parallel, **inevitably sets EM Asia up for mounting economic and financial headwinds**. Even more worryingly, such an aggressive path of rate hikes magnifies the threat of a policy-induced recession. And ironically, risks of a Fed-induced recession may be greater outside of the US (including EM Asia); given relatively compromised fiscal buffers and access to affordable funding on demand.

Admittedly, the outlook remains shrouded. But **economic and financial market impact** – across a spectrum of stress to shocks – from such an aggressively hawkish Fed (in pace of rate hikes, even if not at levels of policy rate) are very **likely to present as stagflation-type pressures in EM Asia** (See Chart & Tables overleaf). These pressures are expected to **ripple through five main channels**. Namely;

- i) *aggregate demand* pullback;
- ii) *catch-up rate hikes* in EM Asia;

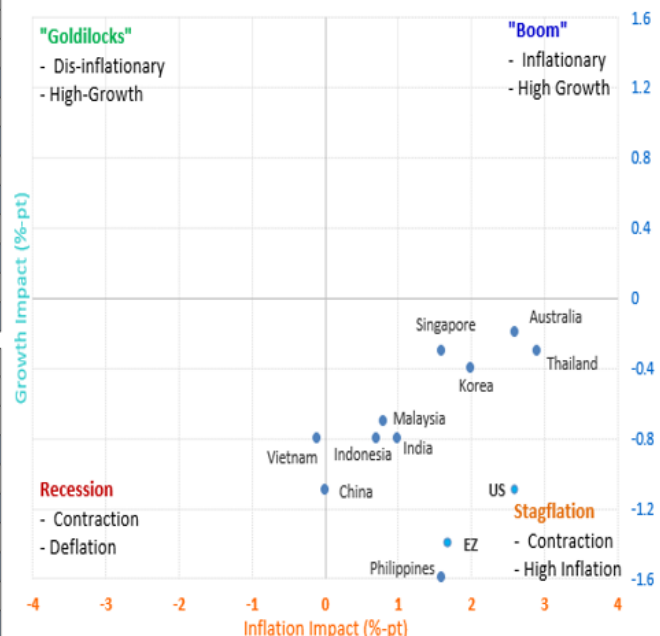
- iii) *debt dynamics/credit risks*;
- iv) *adverse asset price impact*, and;
- v) *FX pressures* with tail risk of adverse feedback loops involving capital outflows and asset price/credit risks.

Key Revisions to GDP and Inflation Forecast

	2022 GDP Growth			2023 GDP Growth		
	Prev	Revised	Revision	Prev	Revised	Revision
Australia	3.9	3.7	-0.2	2.8	2.7	-0.1
China	5.8	4.7	-1.1	5.5	5.3	-0.2
India	7.9(7.9)	7.1 (7.5)	-0.8(-0.4)	6.5(6.4)	5.6 (6.3)	-0.9(-0.1)
Indonesia	5.0	4.2	-0.8	5.5	5.5	0.0
Malaysia	6.0	5.3	-0.7	4.8	4.8	0.0
Philippines	7.2	5.6	-1.6	6.5	6.5	0.0
Singapore	4.1	3.8	-0.3	3.3	3.2	-0.1
Korea	3.3	2.9	-0.4	2.7	2.6	-0.1
Thailand	3.5	3.2	-0.3	3.4	4.1	0.7
Vietnam	6.0	6.0	0.0	6.5	6.5	0.0

	2022 Inflation			2023 Inflation		
	Prev	Revised	Revision	Prev	Revised	Revision
Australia	1.8	4.4	2.6	2.1	3.0	0.9
China	2.3	2.3	0.0	2.4	2.4	0.0
India	5.9 (5.7)	6.9 (6.8)	0.7(0.7)	5.1(5.2)	5.3 (5.1)	0.1(-0.1)
Indonesia	2.3	3.0	0.7	2.5	2.5	0.0
Malaysia	1.7	2.5	0.8	1.5	1.7	0.2
Philippines	3.0	4.6	1.6	3.2	3.3	0.1
Singapore	2.2	3.8	1.6	1.6	2.1	0.5
Korea	2.4	4.4	2.0	1.2	2.7	1.5
Thailand	1.6	6.9	5.3	1.0	2.7	1.7
Vietnam	3.2	3.1	-0.1	3.5	3.4	-0.1

2022: Stagflation-Type Risks Amplified by Hawkish Fed



Note: Vietnam's growth undershoot reflects deviation from potential
US and EZ shifts reflect March to June revisions to growth and inflation

Aggregate Demand: Higher rates from the US cascading globally are expected to dampen demand via that increased debt servicing/financing burden. The resultant contraction in disposable income/profits in turn compromise private consumption and investments; hitting EM Asia further from external demand – the region being a net exporter in aggregate. What's more, stretched post-COVID fiscal positions now further stressed by rising rates/debt servicing also chip away further at demand.

Catch-up Rate Hikes (in EM Asia): What's more, pain from rising US rates will resonate onshore as EM Asia central banks compelled to catch-up (although unable to keep up) with the Fed's hike; as mounting macro-stability risks sharpen policy trade-offs. This will have far-reaching and adverse "flow" (cash-flow/profit/income squeeze) and "balance sheet" (asset prices) consequences.

Debt dynamics & Credit Risks: High levels of corporate and/or household debt poses the greatest risk to private sector recovery in EM Asia. For households, Thailand (~90% of GDP) and Australia (~119% of GDP) pose the greatest vulnerabilities from rising rates. In Australia's case, household debt and property market linkages back to banks amplify the risks from the RBA's stepped up hawkish response in recent weeks. As for corporate debt, Thailand (~89%* of GDP) and Malaysia also reveal greater levels of indebtedness, and the associated risks as loan moratoriums are lifted alongside rising global rates.

Government indebtedness is also a rising concern as wider fiscal deficits post-COVID come home to roost. In this regard, India faces the most prominent risks of a credit ratings downgrade, rendered more precarious by its brink IG ratings.

But India is not alone as *Thailand, Philippines* and even *Malaysia* are saddled with heavier fiscal burdens that may pressures ratings. But in **Malaysia's** case, **higher oil prices mitigate risks** via fiscal revenues, whereas **oil exacerbates fiscal/public debt pressures for Thailand and the Philippines**.

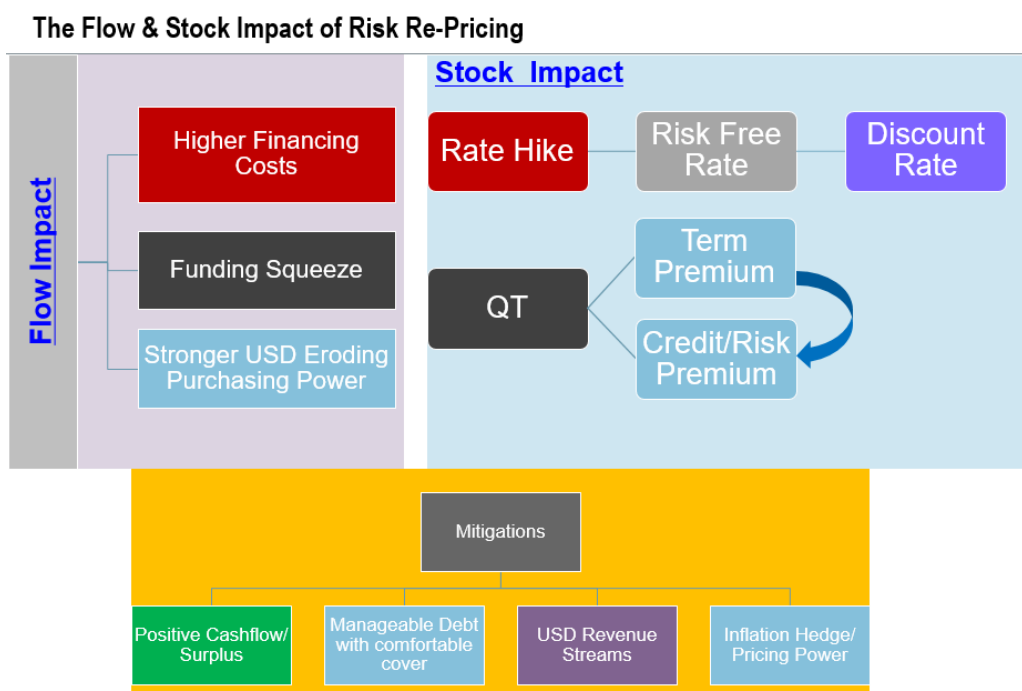
Adverse Asset Price Impact: There are two key aspects to asset price risks. One driven by **external rate differentials** (turning less advantageous for EM Asia). Specifically, **capital outflow risks rendered more pronounced** as rising Fed rates/long-end UST yields conspire with inflation in EM Asia rising more quickly than in the US; thereby dimming nominal and real returns at the margin. This is likely to adversely impact bond flows in Thailand, Philippines, Indonesia and Malaysia especially.

Regional equities are also likely to pullback. Essentially few in EM Asia will be spared asset valuation pressures from higher discount rates and wider credit risk premium. **Commodity price “tipping risk”** as the Fed tightening may tip commodities from inflation-hedge buoyancy to recession-induced demand collapse; and here, Australia, Indonesia and Malaysia may be exposed to hollowed buffer, if not some pro-cyclical swings.

The other pertains to balance sheet risks set off by higher rates and tighter global liquidity alongside adverse feedback via collateral valuations. In this regard **property market risks** are particularly vulnerable, and Australia features prominently (as discussed earlier).

FX Impulses: Finally, *yield-differential*, and subsequently, *recession risk* drivers could **continue to pressures EM Asia currencies vis-à-vis the USD**. The far bigger danger is that resultant **depreciation pressures in EM Asia FX amplify stagflation-type risks** as a weaker currency increases imported price shocks/inflation, which ultimately slows demand further. Moreover, **reflexivity from adverse feedback loops between a sharp currency depreciation and capital outflows** can further depress growth while exacerbating inflation.

Fed Hawks Invoke RM Asia Bears: All said, there is no denying that **Fed hawks on a rampage will inadvertently invoke EM Asia bears**; as a **litany of “flow” and “stock” risks conspire** (see Figure below).



* as per BIS data

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