

23 Inflation and interest rates

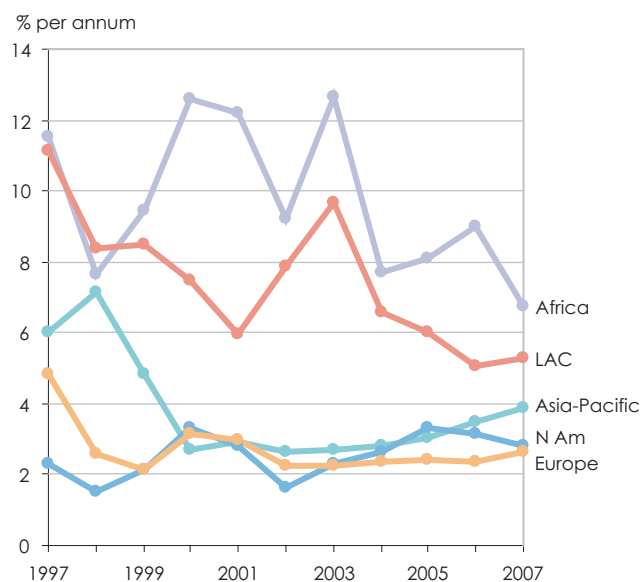
Inflation accelerated further in 2007, as a result of rising prices for food and energy which had a significant effect on household expenditure. Some countries moderated the impact on consumers through price controls and subsidies.

Inflation

Between 2006 and 2007, average inflation in Asia and the Pacific rose from 3.5 to 3.9 per cent. This was slightly higher than in Europe at 2.7 per cent and in North America at 2.8 per cent, but lower than in Latin America and the Caribbean, at 5.3 per cent, and in Africa, at 6.7 per cent, or 41.8 per cent if Zimbabwe is included.

Figure 23.1

Inflation by world region, 1997-2007



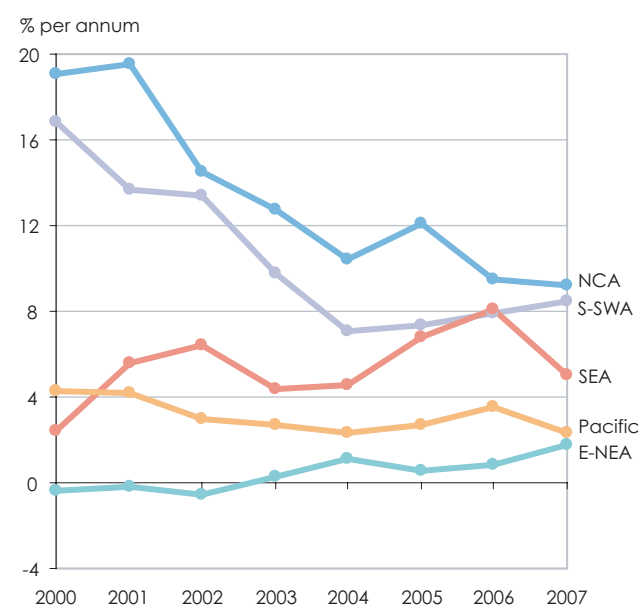
Inflation has been rising since 2002 but although the 2007 rate was the highest since 1999 it was still significantly lower than the average during most of the 1990s. In early 1990s, the situation was worst in the CIS countries which suffered from hyperinflation, culminating in 1993 when the average for Asia and the Pacific reached a record 51.1 per cent.

Among the subregions, the rate in 2007 was lowest in East and North-East Asia at 1.7 per cent, though this was double the rate of the previous year and the highest level since 1997 – due mainly to a substantial rise in the Chinese consumer price index (CPI), from 1.5 to 4.8 per cent. Mongolia and Republic of Korea also recorded significant increases in their CPIs. In South and South-West Asia average inflation increased to 8.5 per cent, the highest rate since 2003 and an increase of 0.6 percentage points from 2006. In India and the Islamic Republic of Iran inflation reached levels not seen since the 1990s.

In South-East Asia, on the other hand, average inflation fell in 2007 to 5.0 per cent, the lowest rate since 2004, as Indonesia, the Philippines and Thailand all recorded significant falls in consumer prices. Inflation also came down in North and Central Asia, to 9.2 per cent in 2007, a decrease of 0.3 per cent from 2006 and the lowest inflation rate since the beginning of the available series. This

Figure 23.2

Inflation in selected Asia-Pacific groupings, 2000-2007



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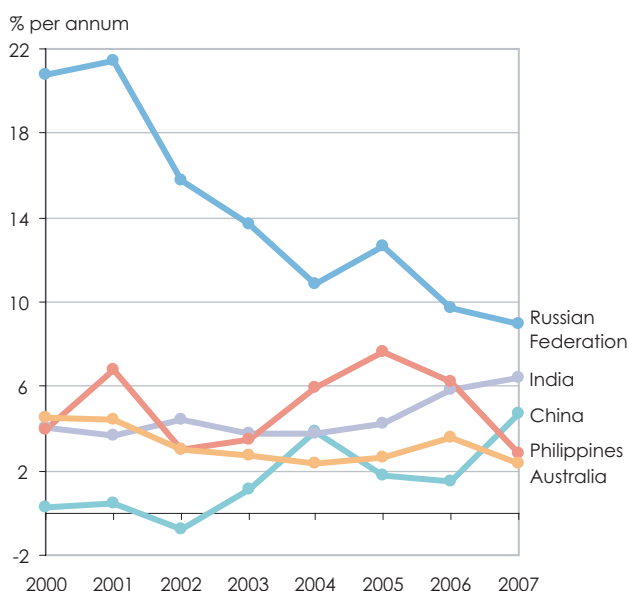
reflected a drop in the Russian Federation to 9.0 per cent, the lowest rate since 1993. Inflation also fell in the Pacific, to 2.3 per cent in 2007, the lowest rate since 1999, as both Australia and New Zealand recorded falls in consumer prices.

This *Yearbook* includes data only to 2007, so it does not reflect the full impact of peaking food and oil prices. Their impact on inflation differs substantially from country to country depending on the interplay between subsidies, price regulations, exchange rates and the varying proportions of income spent on food and energy.

Throughout 2007, a number of countries continued subsidizing or regulating oil prices – as in India, Indonesia, Malaysia, Thailand, and Viet Nam. Similarly some countries either subsidized or regulated prices for food. To some extent the global rises in prices of energy and food, traded in US dollars, were offset by movements in exchange rates, since during 2007 most currencies in Asia and the Pacific appreciated against the dollar. Generally people in the poorer countries devote a higher share of their household budgets to food and energy than those in the richer countries and so are harder hit by price increases.

Figure 23.3

Inflation in selected Asia-Pacific countries, 2000-2007



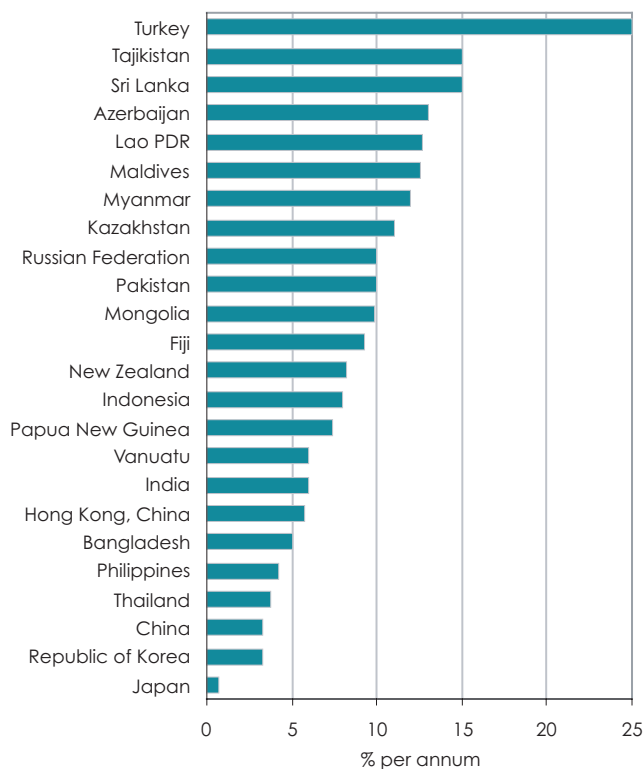
Many central banks consider it crucial to monitor and control inflation. They thus set strict inflation targets – rates they see as optimal for their economies; when the actual or forecast inflation rates move outside these brackets they take corrective or preventive measures.

Interest rates

One of the main tools for central banks is the discount rate. During 2007 when making their monetary policy decisions central banks in Asia and the Pacific had to take a number of issues into account – including rising crude oil and food prices, increasing money supplies, overheating or sluggish economies, and expansionary government fiscal policies. They also had to consider the depreciation of the US dollar which partly offset the increases in the costs of imported crude oil and food products, but also significantly affected the dynamics of exports and imports.

Figure 23.4

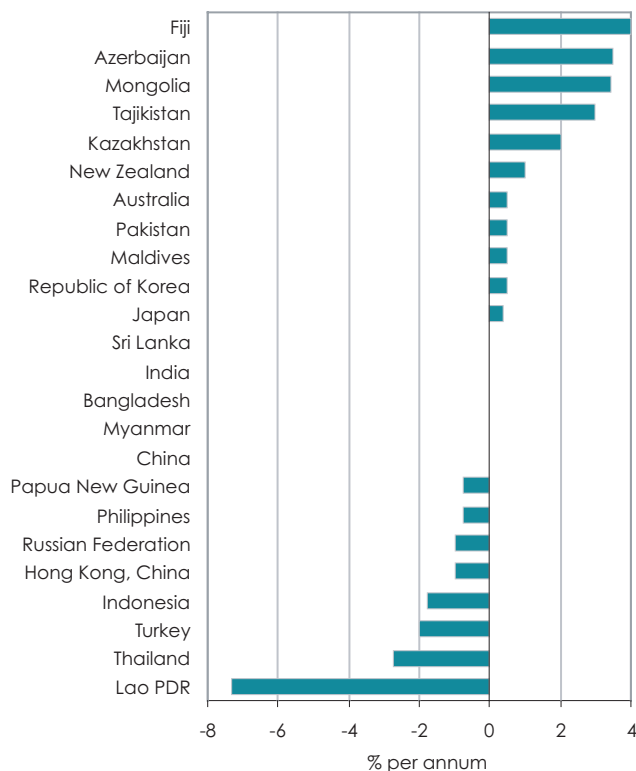
Central bank discount rate, selected Asian and Pacific economies, 2007



Across the Asia-Pacific region applied interest rates vary considerably, reflecting the different economic realities. The rate in 2007 was lowest in Japan, at 0.8 per cent which was the lowest interest rate among the major economies – though this was actually Japan's highest rate in over a decade. Other countries have much higher rates. In Mongolia, for example, in 2007 the central bank, on the other hand, took drastic measures to contain rising inflation and a runaway economy, by almost tripling its discount rate. The People's Bank of China maintained its discount rate unchanged at 3.3 per cent, but the government took other measures to

Figure 23.5

Central bank discount rates, difference between 2007 and 2006, selected Asia-Pacific countries



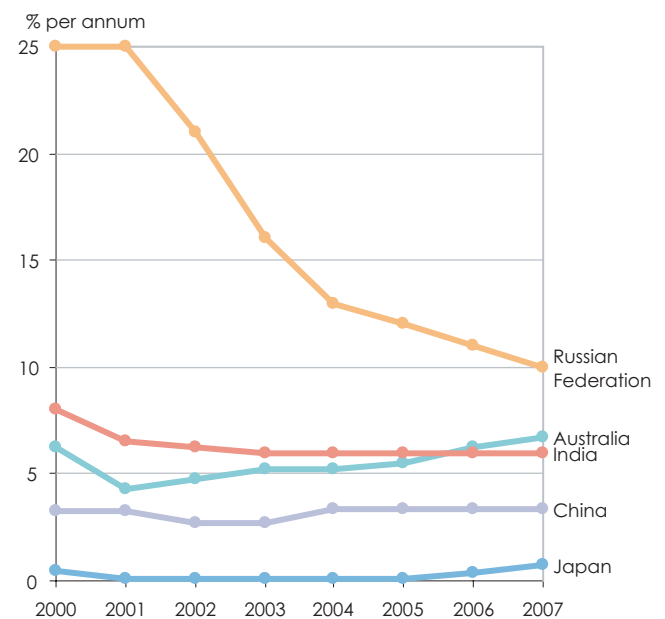
control inflation – repeatedly raising the reserve requirement ratio and the benchmark rate at which banks can lend to their customers.

Some central banks in South-East Asia reduced their discount rates. The Bank of Thailand, for instance reduced its benchmark interest rate five times, from 6.5 per cent in 2006 to 3.8 per cent in 2007. The main factors contributing to this decision were sluggish consumer spending and low consumer confidence following the 2006 coup during a period of low inflationary pressure. The reductions in the Philippines and Indonesia were somewhat smaller. In the South and South-West Asia region, most central banks did not significantly change their discount rates.

In Azerbaijan and Kazakhstan, on the other hand, policy was moving in the other direction. Both countries recorded significant financial inflows related to oil revenues which resulted in increased money supply and inflationary pressures. In response, Azerbaijan in 2007 increased the discount rate by 3.5 percentage points to 11.0 per cent, and Kazakhstan by 2.0 percentage points to 11.0 per cent. The direction was the same in Australia, New Zealand and Fiji, which all increased their discount rates. Australia and New Zealand with strong economic growth, tight labour markets, and capacity constraints had some of the highest interest rates in the developed economies.

Figure 23.6

Central bank discount rate of selected countries, 2000-2007



Exchange rates

Movements in interest rates are linked to movements in exchange rates. But the relationship is not always direct because the exchange rate is also influenced by many other factors including perceptions about the country's economic future, economic growth, international trade and in particular the current account deficit.

For commodities such as crude oil, iron and wheat the standard unit of currency in international markets continues to be the dollar. Additionally the dollar is still a major reserve currency. China, for example, at the beginning of 2008 held \$1.7 trillion in foreign exchange while Japan held \$1.0 trillion. However, in recent years the dollar has lost some of its dominance as the world's top reserve currency to other currencies, in particular the euro. There have also been extensive international discussions of the dollar's role as the standard unit of currency in international markets.

As can be seen in figures 23.7 and 23.8, since 2001 the dollar has steadily depreciated against most other major currencies. This is due to a combination of economic and other factors, including large current account deficits, interest rate movements and property market turmoil. During 2001-2007, the dollar depreciated against the Euro (35 per cent), the Swiss franc (29 per cent), the pound (28 per cent), the Australian dollar (38 per cent), the New Zealand dollar (43 per cent), the Russian rouble (12 per cent), the Thai baht (22 per cent),

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the Indian rupee (13 per cent) and the Japanese yen (3 per cent). Furthermore, during the same period the government of China allowed the Yuan to appreciate against the dollar by 8 per cent. The dollar did appreciate sharply, however, during the latter half of 2008, though this is not reflected in the tables and charts in this *Yearbook*.

Figure 23.7

Indexed exchange rate of selected major currencies against the US dollar, 2001-2007

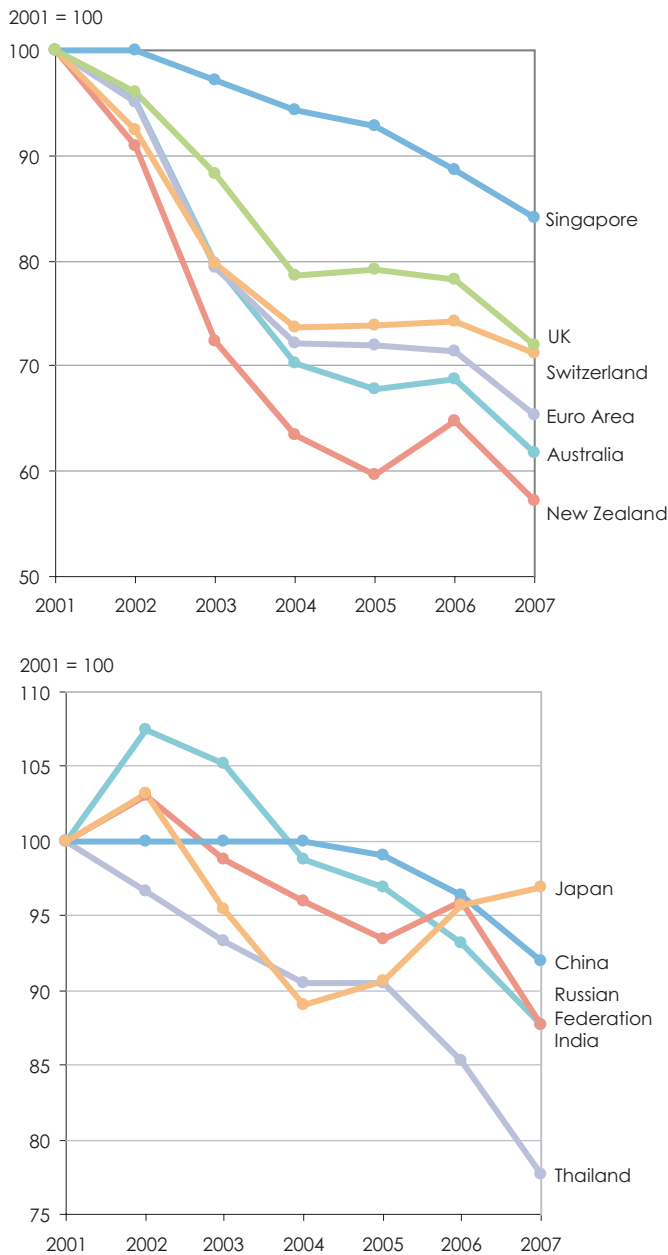
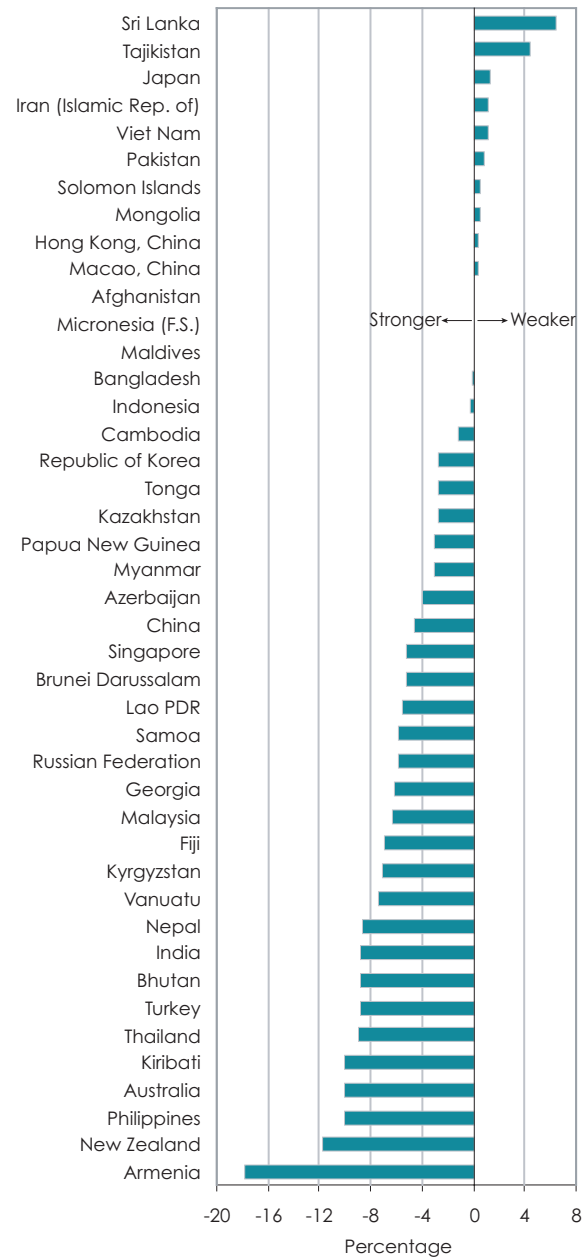


Figure 23.8

Currency movements against the US dollar, Asia and the Pacific, 2007



The falling dollar will have a significant effect on trade. The American public now finds Asian products more expensive, and also has less money to spend because of rising oil and food prices. As a result in 2007 total Asian imports fell. At the same time the weaker dollar has made American exports to the rest of the world more attractive.

The global economic environment changed dramatically during the latter half of 2008, affecting exchange rates and many other indicators. For an analysis of the latest developments, please refer to the Economic and Social Survey for Asia and the Pacific: <http://unescap.org/pdd/publications/index_survey.asp>

Inflation rate (% per annum)

The annualized rate of increase of the level of prices, measured as a change in the consumer price index during a given period. **Aggregates:** Averages are calculated using the household consumption expenditure component of the GDP in US dollars as weight. **Source:** International Monetary Fund, International Financial Statistics (CD-ROM June 2008).

Central bank discount rate (% per annum)

The rate at which the central bank lends or discounts eligible paper for deposit money to banks, typically reported on an end-of-period basis. **Aggregates:** None. **Source:** International Monetary Fund, International Financial Statistics (CD-ROM June 2008).

Average exchange rate (national currency per US dollar)

The units of national currency required to purchase one US dollar, usually representing the period average. For some countries or areas, mid-point rates, or the average of buying and selling rates, are used. **Aggregates:** None. **Source:** International Monetary Fund, International Financial Statistics (CD-ROM June 2008).

Exchange rate change over period (percentage)

The average annual rate of change of the exchange rate of the national currency against the US dollar for the period indicated. A positive value means that the national currency has weakened, a negative value indicates a stronger national currency. **Aggregates:** None. **Source:** Calculated by ESCAP using data of indicator Average exchange rate (International Monetary Fund, International Financial Statistics (CD-ROM June 2008)).

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	Inflation rate						Central bank discount rate					
	% per annum						% per annum					
	1990	1995	2000	2005	2006	2007	1990	1995	2000	2005	2006	2007
East and North-East Asia	3.6	2.1	-0.4	0.5	0.8	1.7						
China	3.1	16.9	0.3	1.8	1.5	4.8	7.9	10.4	3.2	3.3	3.3	3.3
DPR Korea												
Hong Kong, China	10.3	9.0	-3.8	0.9	2.1	2.0		6.3	8.0	5.8	6.8	5.8
Japan	3.1	-0.1	-0.7	-0.3	0.2	0.1	6.0	0.5	0.5	0.1	0.4	0.8
Macao, China	8.0	8.6	-1.6	4.4	5.1	5.6						
Mongolia		0.0	11.6	12.7	5.1	9.0		150.0	8.7	4.4	6.4	9.9
Republic of Korea	8.6	4.5	2.3	2.8	2.2	2.5	7.0	5.0	3.0	2.0	2.8	3.3
South-East Asia	7.4	6.9	2.4	6.8	8.0	5.0						
Brunei Darussalam												
Cambodia		1.1	-0.8	5.7	4.7	5.9						
Indonesia	7.8	9.4	3.7	10.5	13.1	6.4	18.8	14.0	14.5	12.8	9.8	8.0
Lao PDR	35.6	19.6	25.1	7.2	6.8	4.5		32.1	35.2	20.0	20.0	12.7
Malaysia	2.6	3.5	1.5	3.0	3.6	2.0						
Myanmar	17.6	25.2	-0.1	9.4	20.0	35.0		12.5	10.0	10.0	12.0	12.0
Philippines	12.7	6.7	4.0	7.6	6.2	2.8	14.0	10.8	13.8	5.7	5.0	4.3
Singapore	3.5	1.7	1.4	0.4	1.0	2.1						
Thailand	5.9	5.8	1.6	4.5	4.6	2.2	12.0	10.5	4.0	5.5	6.5	3.8
Timor-Leste				1.1	3.9	10.3						
Viet Nam			-1.7	8.3	7.4	8.9			6.0	5.0	5.0	
South and South-West Asia	20.6	32.6	16.9	7.3	7.9	8.5						
Afghanistan												
Bangladesh	6.1	10.2	2.2	7.0	6.8	9.1	9.8	6.0	7.0	5.0	5.0	5.0
Bhutan	10.0	9.5	4.0	5.3	5.0	5.2						
India	9.0	10.2	4.0	4.2	5.8	6.4	10.0	12.0	8.0	6.0	6.0	6.0
Iran (Islamic Rep. of)	7.6	49.7	14.5	13.4	11.9	17.2						
Maldives	3.6	5.5	-1.2	1.3	0.3	7.4				18.0	12.0	12.5
Nepal	8.2	7.6	2.5	6.8	7.6	6.1	11.0	11.0	7.5	6.0	6.3	
Pakistan	9.1	12.3	4.4	9.1	7.9	7.6	10.0	17.0	13.0	9.0	9.5	10.0
Sri Lanka	21.5	7.7	6.2	11.6	10.0	15.8	15.0	17.0	25.0	15.0	15.0	15.0
Turkey	60.3	88.1	54.9	10.1	10.5	8.8	45.0	50.0	60.0	23.0	27.0	25.0
North and Central Asia		198.1	19.1	12.1	9.5	9.2						
Armenia		176.0	-0.8	0.6	2.9	4.4		77.8				
Azerbaijan		411.7	1.9	11.6	8.3	16.7		80.0	10.0	9.0	9.5	13.0
Georgia		162.7	4.1	8.2	9.2	9.2						
Kazakhstan		176.2	13.2	7.6	8.6	10.8		52.5	14.0	8.0	9.0	11.0
Kyrgyzstan			18.7	4.4	5.6	10.2						
Russian Federation		197.5	20.8	12.7	9.7	9.0		160.0	25.0	12.0	11.0	10.0
Tajikistan									20.6	9.0	12.0	15.0
Turkmenistan												
Uzbekistan												
Pacific	7.1	4.6	4.3	2.7	3.5	2.3						
Australia	7.3	4.6	4.5	2.7	3.5	2.3	15.2	5.8	6.2	5.5	6.3	6.8
American Samoa												
Cook Islands												
Fiji	8.2	2.2	1.1	2.4	2.5	4.8	8.0	6.0	8.0	2.8	5.3	9.3
French Polynesia												
Guam												
Kiribati												
Marshall Islands												
Micronesia (F.S.)												
Nauru												
New Caledonia												
New Zealand	5.5	3.8	2.6	3.0	3.4	2.4	13.3	9.8	6.5	7.3	7.3	8.3
Niue												
Northern Mariana Is.												
Palau												
Papua New Guinea	7.0	17.3	15.6	1.8	2.4	0.9	9.3	18.0	9.8	9.7	8.1	7.4
Samoa	15.2	-2.9	1.0	1.8	3.7	5.6						
Solomon Islands	8.7	9.6	7.9	7.3	11.2	7.7						
Tonga	9.7	1.5	6.3	8.3	6.4	5.9						
Tuvalu												
Vanuatu	4.8	2.2	2.5	1.2	2.0	4.0			7.0	6.3	6.0	6.0
Asia and the Pacific	6.8	14.7	2.7	3.0	3.5	3.9						
LLDC												
LDC	8.4	11.6	2.5	7.1	8.6	12.9						
ASEAN	7.4	6.9	2.4	6.8	8.1	5.0						
ECO	35.2	70.4	33.7	10.4	10.1	10.6						
SAARC	9.0	10.5	3.9	5.4	6.3	7.0						
Central Asia				7.4	8.0	10.9						
Pacific island dev. econ.												
Low-income	8.7	12.2	2.9	8.2	8.0	9.5						
Middle-income	14.1	53.0	9.1	6.2	6.1	6.7						
High-income	4.0	0.8	-0.1	0.5	1.0	0.9						
Other world regions												
Africa	17.5	34.5	12.6	8.1	9.0	41.8						
Europe	11.6	6.7	3.2	2.4	2.4	2.7						
Latin America & Carib.	1 725.3	39.9	7.5	6.0	5.1	5.3						
North America	5.3	2.8	3.3	3.3	3.1	2.8						
Other countries/areas	10.1	7.7	0.2	2.7	4.2	3.6						
World	29.3	15.3	4.3	3.6	3.5	3.8						

23.2 Exchange rates

	Average exchange rate						Exchange rate change over period				
	National currency per US dollar						Percentage				
	1990	1995	2000	2005	2006	2007	90-95	95-00	00-05	00-07	2007
East and North-East Asia											
China	4.78	8.35	8.28	8.19	7.97	7.61	74.6	-0.9	-1.0	-8.1	-4.6
DPR Korea											
Hong Kong, China	7.79	7.74	7.79	7.78	7.77	7.80	-0.7	0.7	-0.2	0.1	0.4
Japan	144.79	94.06	107.77	110.22	116.30	117.75	-35.0	14.6	2.3	9.3	1.3
Macao, China	8.02	7.97	8.03	8.01	8.00	8.04	-0.7	0.7	-0.2	0.1	0.4
Mongolia	8.01	448.61	1 076.67	1 205.22	1 165.37	1 170.96	5 500.7	140.0	11.9	8.8	0.5
Republic of Korea	707.76	771.27	1 130.96	1 024.12	954.79	929.26	9.0	46.6	-9.4	-17.8	-2.7
South-East Asia											
Brunei Darussalam	1.81	1.42	1.72	1.66	1.59	1.51	-21.8	21.6	-3.5	-12.6	-5.2
Cambodia	426.25	2 450.83	3 840.75	4 092.50	4 103.25	4 056.17	475.0	56.7	6.6	5.6	-1.1
Indonesia	1 842.81	2 248.61	8 421.78	9 704.74	9 159.32	9 143.36	22.0	274.5	15.2	8.6	-0.2
Lao PDR	707.75	804.69	7 887.64	10 655.20	10 159.90	9 603.16	13.7	880.2	35.1	21.7	-5.5
Malaysia	2.70	2.50	3.80	3.79	3.67	3.44	-7.4	51.7	-0.3	-9.5	-6.3
Myanmar	6.28	5.61	6.43	5.76	5.78	5.61	-10.6	14.5	-10.3	-12.7	-3.0
Philippines	24.31	25.71	44.19	55.09	51.31	46.15	5.8	71.9	24.6	4.4	-10.1
Singapore	1.81	1.42	1.72	1.66	1.59	1.51	-21.8	21.6	-3.5	-12.6	-5.2
Thailand	25.59	24.92	40.11	40.22	37.88	34.52	-2.6	61.0	0.3	-13.9	-8.9
Timor-Leste											
Viet Nam	6 482.80	11 038.30	14 167.70	15 858.90	15 994.30	16 178.90	70.3	28.4	11.9	14.2	1.2
South and South-West Asia											
Afghanistan	0.05	0.83	61.63	49.49	49.93	49.96	1 546.9	7 295.5	-19.7	-18.9	0.1
Bangladesh	34.57	40.28	52.14	64.33	68.93	68.87	16.5	29.5	23.4	32.1	-0.1
Bhutan	17.51	32.43	44.94	44.10	45.31	41.35	85.2	38.6	-1.9	-8.0	-8.7
India	17.50	32.43	44.94	44.10	45.31	41.35	85.3	38.6	-1.9	-8.0	-8.7
Iran (Islamic Rep. of)	68.10	1 747.93	1 764.43	8 963.96	9 170.94	9 281.15	2 466.9	0.9	408.0	426.0	1.2
Maldives	9.55	11.77	11.77	12.80	12.80	12.80	23.2	0.0	8.8	8.8	0.0
Nepal	29.37	51.89	71.09	71.37	72.76	66.42	76.7	37.0	0.4	-6.6	-8.7
Pakistan	21.71	31.64	53.65	59.51	60.27	60.74	45.8	69.5	10.9	13.2	0.8
Sri Lanka	40.06	51.25	77.01	100.50	103.91	110.62	27.9	50.2	30.5	43.7	6.5
Turkey	0.00	0.05	0.63	1.34	1.43	1.30	1 657.4	1 263.8	114.9	108.5	-8.8
North and Central Asia											
Armenia		405.91	539.53	457.69	416.04	342.08		32.9	-15.2	-36.6	-17.8
Azerbaijan		0.88	0.89	0.95	0.89	0.86		1.4	5.7	-4.1	-4.0
Georgia			1.98	1.81	1.78	1.67			-8.3	-15.5	-6.2
Kazakhstan		60.95	142.13	132.88	126.09	122.55		133.2	-6.5	-13.8	-2.8
Kyrgyzstan		10.82	47.70	41.01	40.15	37.32		340.8	-14.0	-21.8	-7.1
Russian Federation		4.56	28.13	28.28	27.19	25.58		517.0	0.6	-9.1	-5.9
Tajikistan		0.12	2.08	3.12	3.30	3.44		1 589.9	50.1	65.8	4.4
Turkmenistan		110.92	5 200.00					4 588.2			
Uzbekistan		29.78	236.61					694.7			
Pacific											
Australia	1.28	1.35	1.72	1.31	1.33	1.20	5.3	27.9	-24.1	-30.7	-10.0
American Samoa											
Cook Islands											
Fiji	1.48	1.41	2.13	1.69	1.73	1.61	-5.0	51.4	-20.6	-24.3	-7.0
French Polynesia											
Guam											
Kiribati	1.28	1.35	1.72	1.31	1.33	1.20	5.3	27.9	-24.1	-30.7	-10.0
Marshall Islands											
Micronesia (F.S.)	1.00	1.00	1.00	1.00	1.00	1.00	0.0	0.0	0.0	0.0	0.0
Nauru											
New Caledonia											
New Zealand	1.68	1.52	2.20	1.42	1.54	1.36	-9.1	44.4	-35.5	-38.2	-11.8
Niue											
Northern Mariana Is.											
Palau											
Papua New Guinea	0.96	1.28	2.78	3.10	3.06	2.97	34.0	117.4	11.5	6.6	-3.0
Samoa	2.31	2.47	3.29	2.71	2.78	2.62	7.1	32.9	-17.5	-20.4	-5.9
Solomon Islands	2.53	3.41	5.09	7.53	7.61	7.65	34.7	49.4	48.0	50.4	0.6
Tonga	1.28	1.27	1.76	1.94	2.03	1.97	-0.7	38.4	10.5	12.1	-2.7
Tuvalu											
Vanuatu	117.06	112.11	137.64	109.25	110.64	102.44	-4.2	22.8	-20.6	-25.6	-7.4
Asia and the Pacific											
LLDC											
LDC											
ASEAN											
ECO											
SAARC											
Central Asia											
Pacific island dev. econ.											
Low-income											
Middle-income											
High-income											
Other world regions											
Africa											
Europe											
Latin America & Carib.											
North America											
Other countries/areas											
World											