

Rising Inflation and Downside Risks to Economic Growth in the Asia-Pacific Emerging Economies



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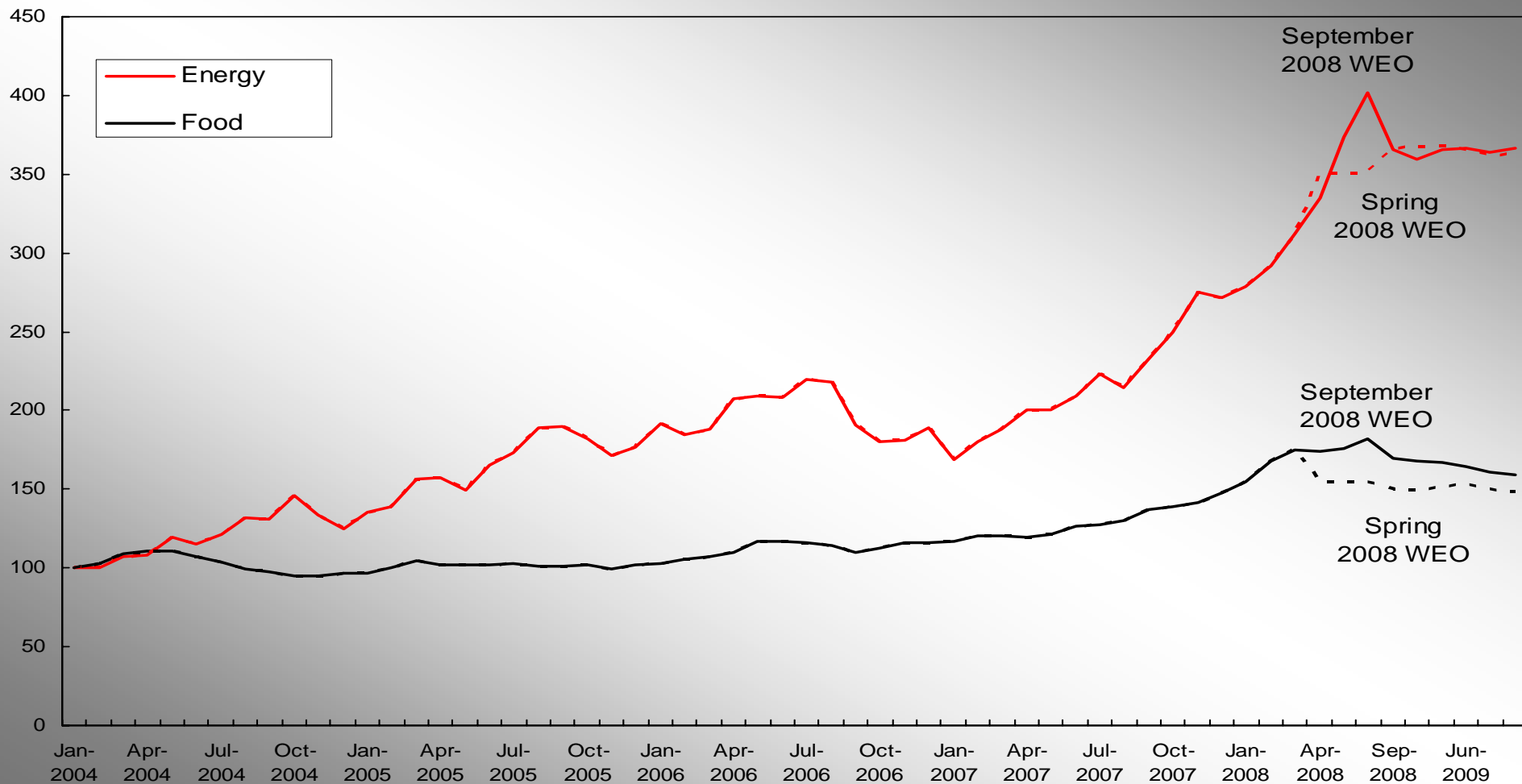


OUTLINE OF PRESENTATION

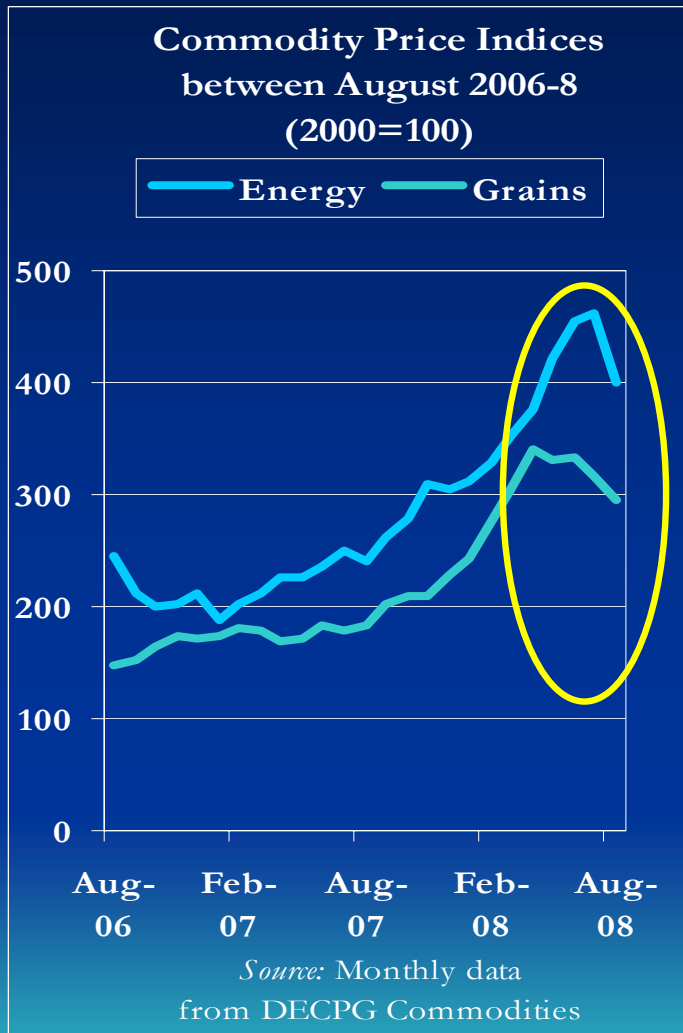
- Global Inflation: Recent Performance and Forecast
- Higher Prices in Emerging Asia and the Pacific
- Impacts of Inflation—Who Bears the Burden?
- Prospects for World Economic Growth under the Global Credit Squeeze and Inflation
- Policy Responses by Asian/Pacific Emerging Economies
- DISCUSSION TIME

I. GLOBAL INFLATION: Recent Performance and Prospects

Despite the recent easing, food and fuel prices remain high.

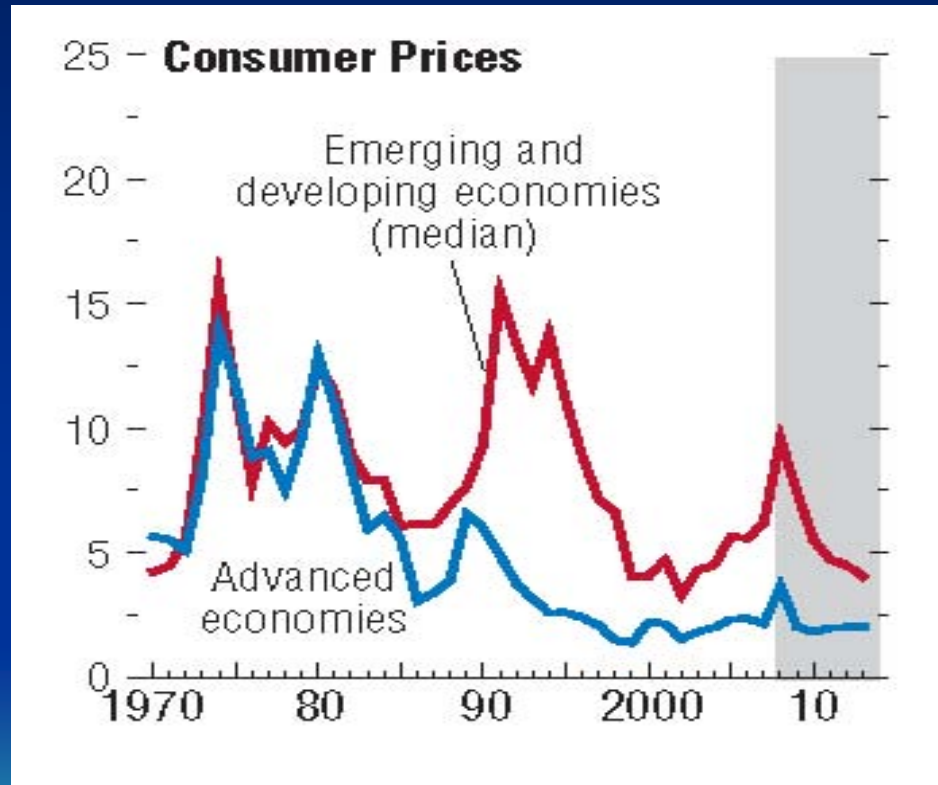


Price Trends – Food and Fuel



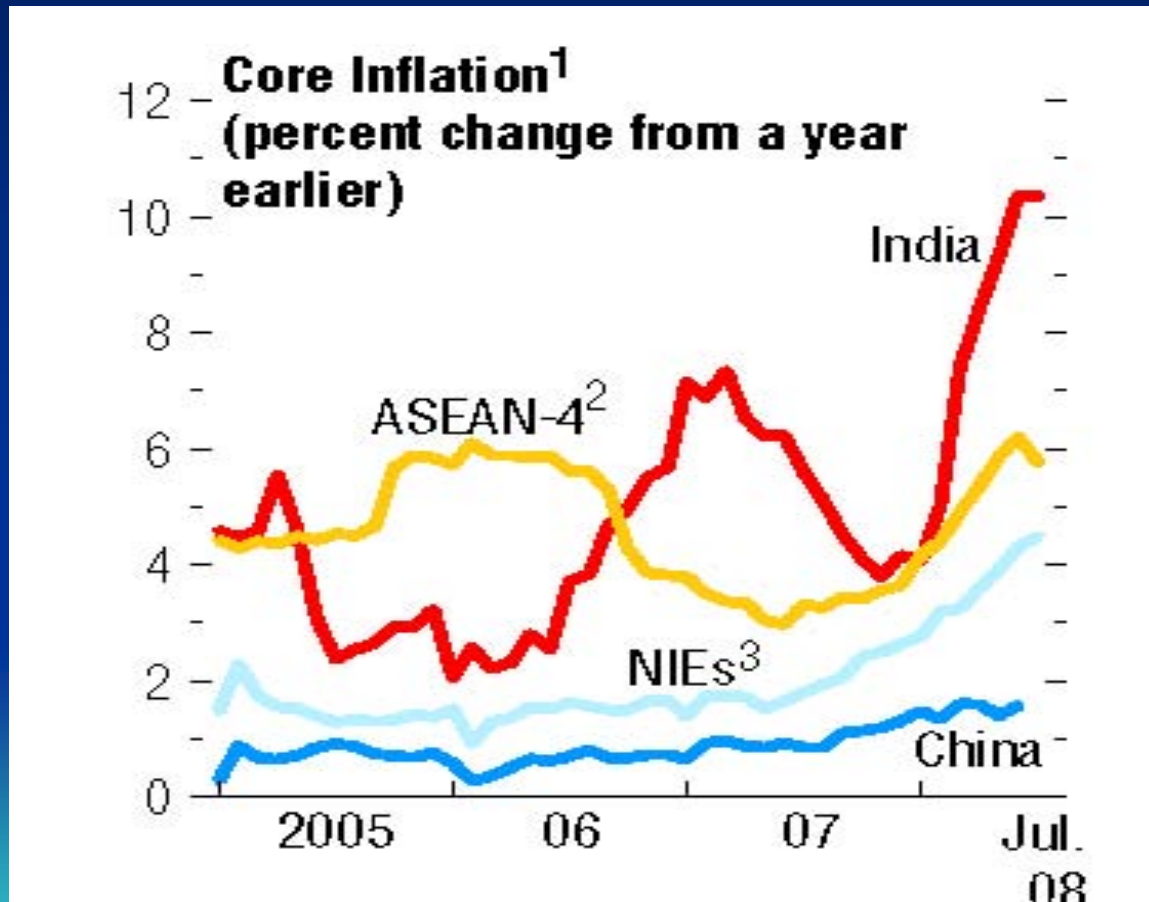
- Prices declined in recent months but remain well above 2004 levels and are likely to remain high through 2015
- High Grain Prices are contributing to higher food inflation in a large subset of countries
- Most affected countries are those where:
 - Staples are internationally traded
 - Means for fiscal response is limited

But What About Overall Inflation? The World Average CPIs Are Expected to Moderate—and are not nearly as high as in the early 1990s.



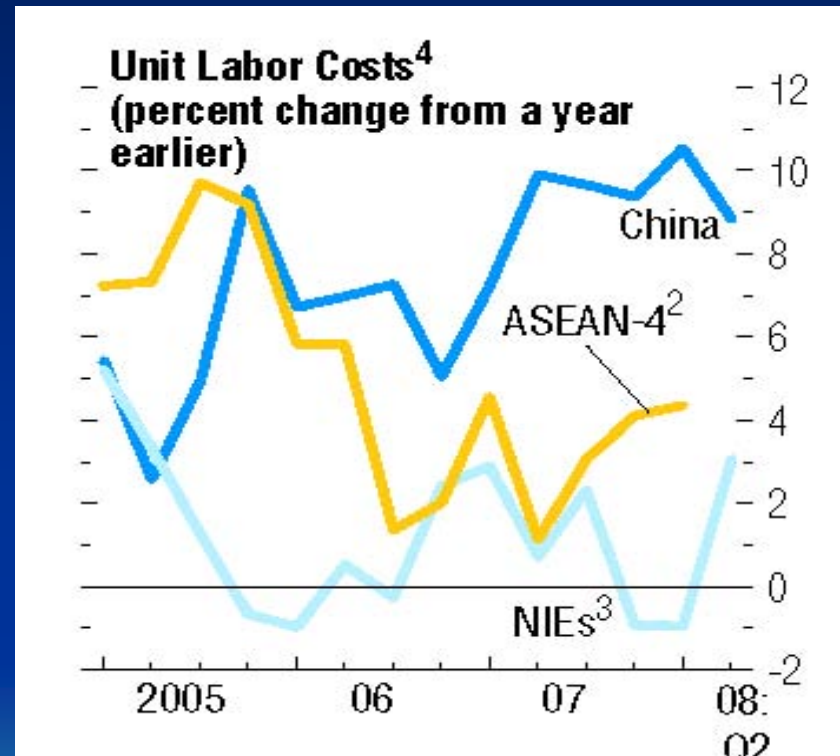
Source: IMF, WEO, October 2008

However, Core Inflation in Emerging Asia may Remain a Concern

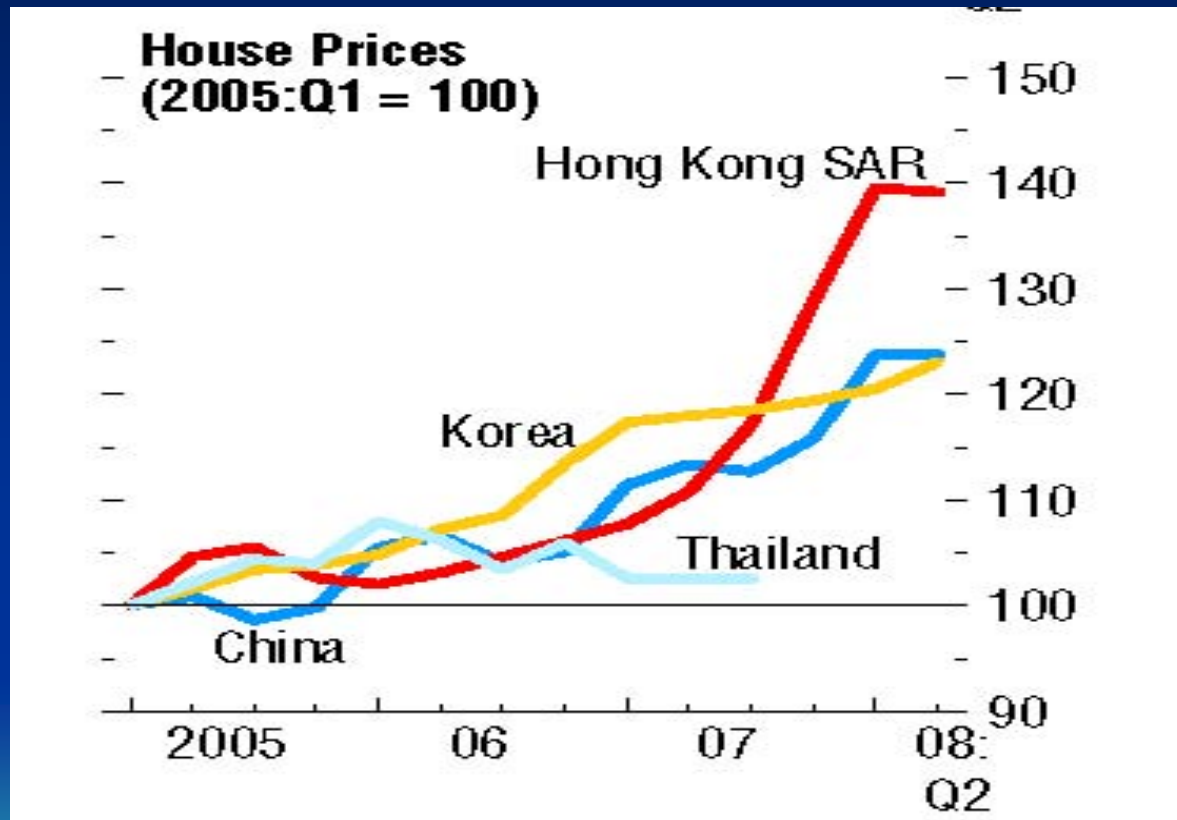


II. Inflation Impacts on Emerging Asia and the Pacific

Wage increases, despite productivity improvements, have contributed to a buildup in inflation in some countries.

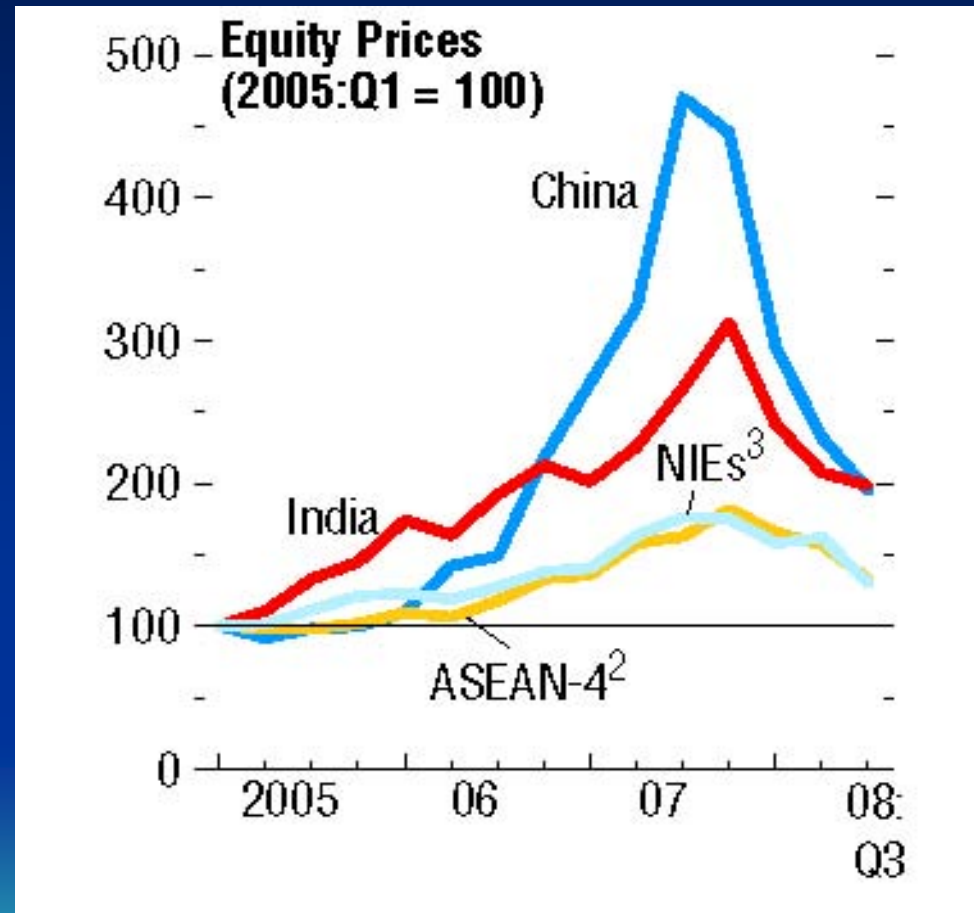


Inflation Pressures in Emerging Asia: House prices have continued to trend upward

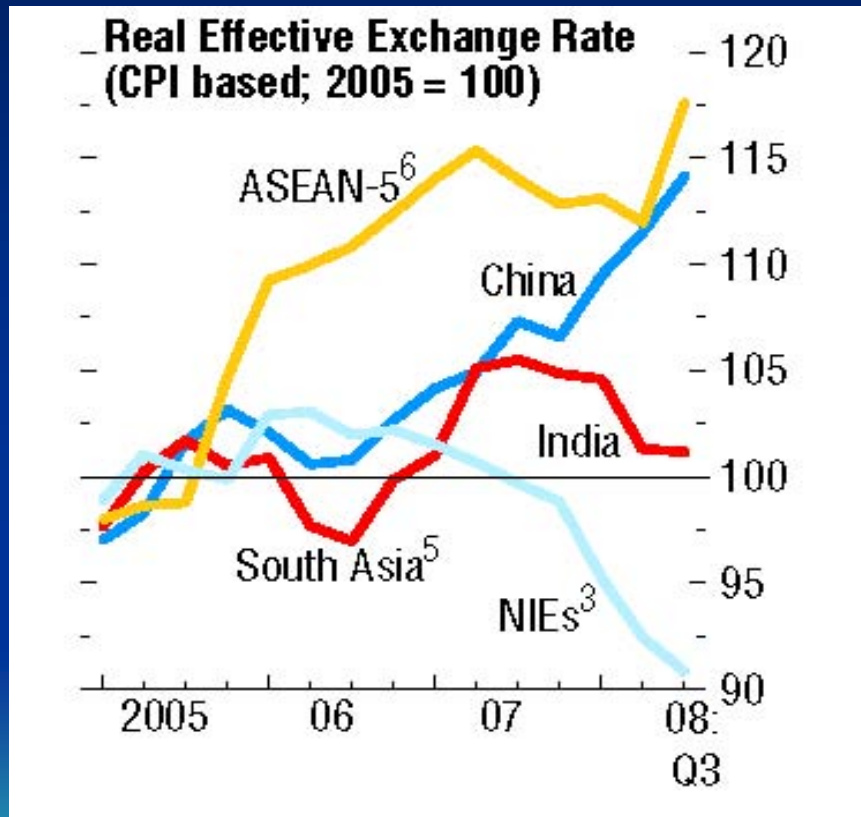


Equity Prices have corrected

An extended run-up in equity prices across several Asian markets ended with a sharp correction in early 2008, triggered by the global financial turmoil.



Exchange Rates have failed to provide relief...



Asian currencies have either appreciated too little or weakened. (Depreciation tends to exacerbate inflation.)

Pacific Islands have experienced differing inflation trends

Pacific Islands: Headline Inflation
(Year-on year, percentage change)

	2005	2006	2007	2008
	December			Jun.
Fiji	2.7	3.1	4.3	6.9
Kiribati	-0.5	-0.2	3.7	...
Marshall Islands	6.2	2.6	4.5	16.9
Micronesia	3.9	4.9	3.5	...
Palau	5.0	3.6	4.6	...
Papua New Guinea	4.7	-0.9	3.2	10.7
Timor-Leste	1.0	6.7	7.6	10.6
Samoa 1/	1.8	3.8	6.1	6.2*
Solomon Islands	9.1	9.9	10.9	19.6
Tonga	10.1	10.1	6.8	12.6
Vanuatu	1.8	1.9	4.0	3.6*
Memorandum item:				
Emerging Asia	3.4	3.2	5.3	8.5

Source: Countries' authorities.

1/ Period average.

* March 2008.

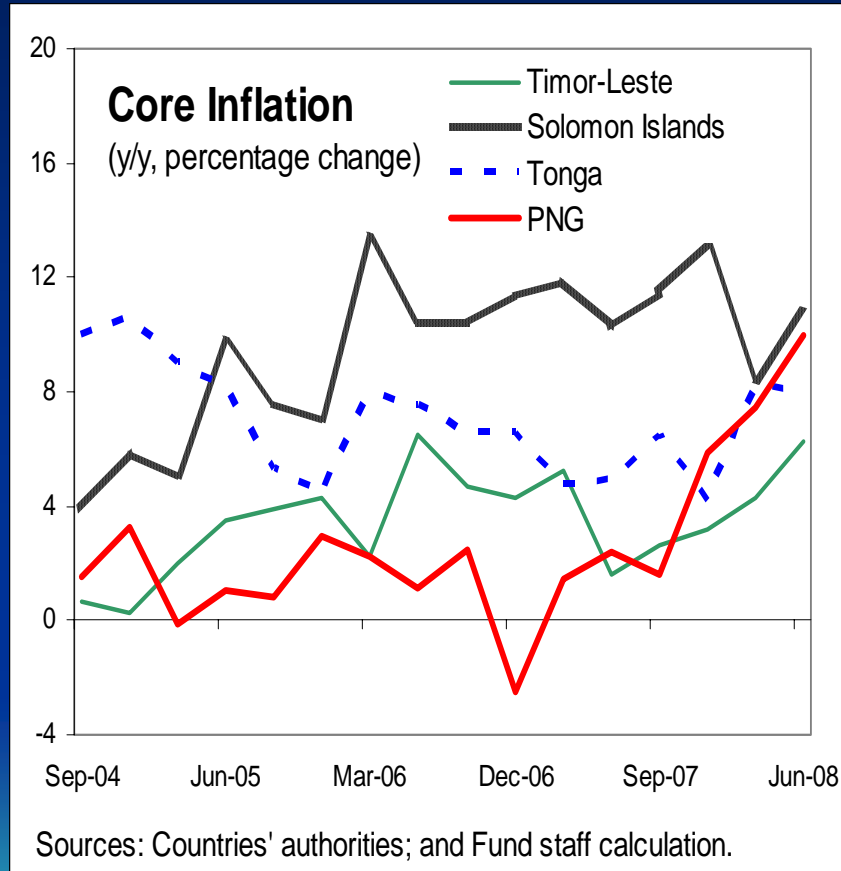
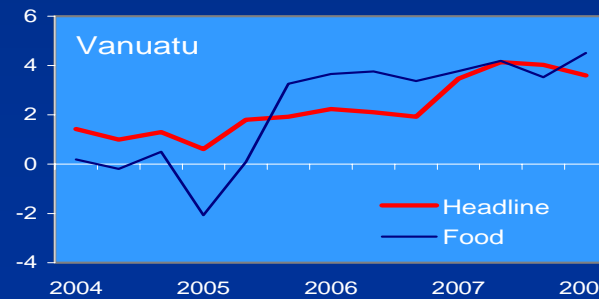
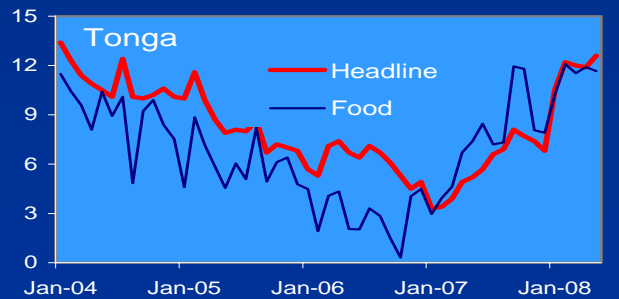
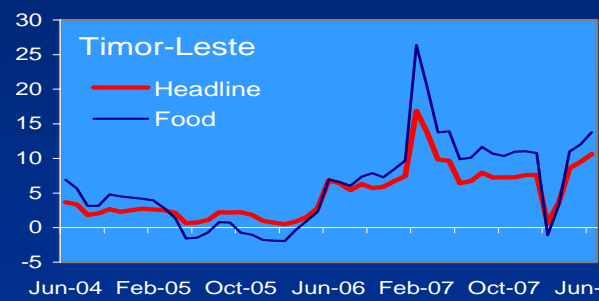
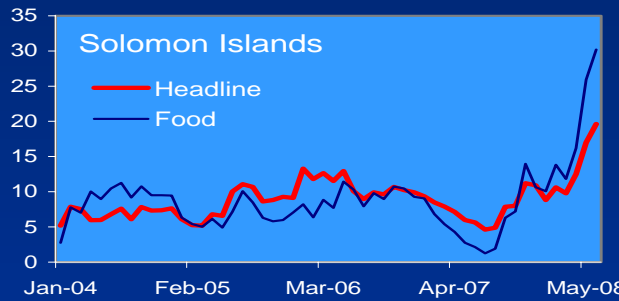
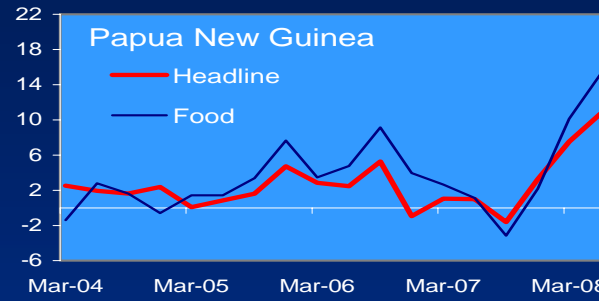
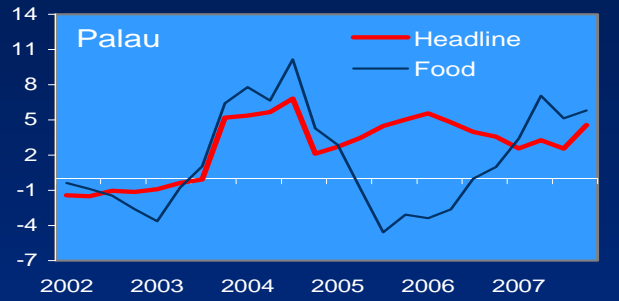
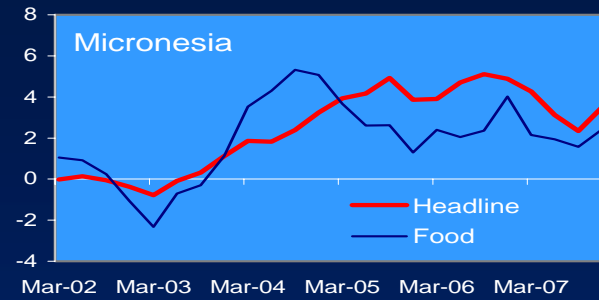
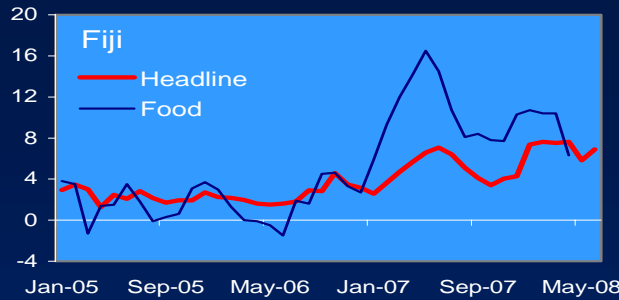
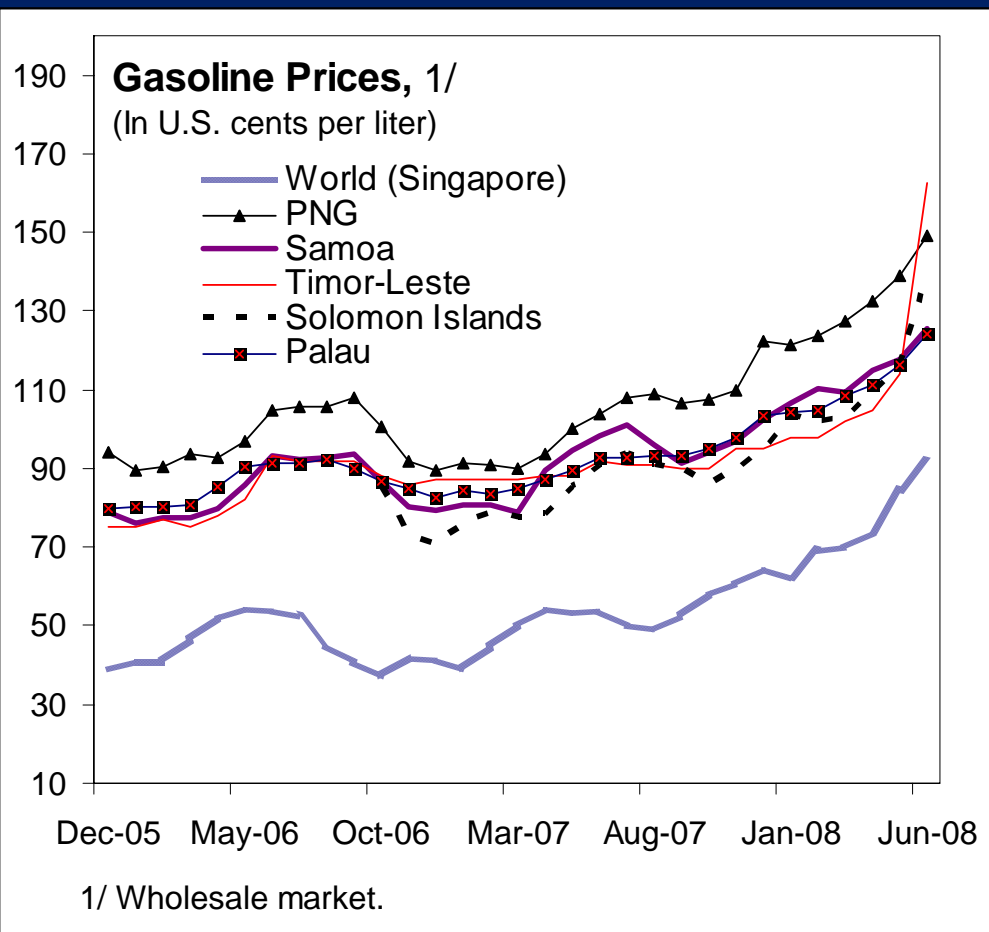


Figure 1. Pacific Islands Economies: Inflation Developments
(Year-on-year, percentage change)



Source: APDCORE database.

Pacific Islands have higher fuel prices than the world average, and a big food weight in their CPI baskets.



Food Weight in the CPI Basket (In percent)	
Fiji	35.4
Marshall Islands	46.7
Micronesia	45.5
Papua New Guinea	40.9
Samoa	50.3
Solomon Islands	42.9
Timor-Leste	57.8
Tonga	44.4
Memorandum item:	
Non-OECD countries	37.0
Source: Countries' authorities.	

Pacific Inflation: Primary Concerns

- **Core inflation has already started to trend up.**
- **Second-round effects** are emerging in many islands, as evidenced by the domestic CPI components (e.g., *Tonga, Papua New Guinea, the Solomon Islands, and Timor-Leste*), indicating that inflation has become more entrenched.
- **Higher input costs** (e.g., animal feed, and fertilizer, in addition to energy) create upstream pressures on prices.
- **Wage pressures are mounting** (e.g., *Solomon Islands*), suggesting that inflation expectations may become unanchored.

III. Who Bears the Burden of Inflation? Poverty and Distributional Impacts of Food Price Rises Internationally

1. Poverty impacts of food price rises are complex and large:

- Significant variation between countries and commodities
- Converging estimates on increase in number of global poor due to rising prices range from 3-5% (Ivanic & Martin 2008, Dessus 2008, Wodon 2008)
- But these numbers do not capture detrimental effects on already poor households
 - 88% of increase in global *depth* of poverty among urban households is due to poor becoming poorer
 - Only 12% due to ‘new poor’

Human Development Impacts of Rising Food Prices

- Potentially **severe nutritional impacts**:
 - HHs switch from more expensive protein sources to cheaper cereals (resulting in micronutrient deficiencies)
 - Poor likely to cut back on total caloric intake leading to weight loss and severe malnutrition
 - Children under 2 and pregnant women most vulnerable
 - Many countries most exposed to rising food and fuel prices have high pre-existing levels of malnutrition

Other Human Development Impacts

- Income shock incurs possible risks to **schooling and educational attainment**
 - Ambiguous direction of impact *a priori*
 - But evidence from previous crises suggests significant risk to educational outcomes (e.g. Brazil, Peru, Indonesia)
 - HH surveys show 50% of households reducing education spending due to food crisis in some countries (Bangladesh)

What are countries doing? Economy-Wide Policies to Combat Inflation

FOOD PRICE POLICIES (% OF 120 COUNTRIES)



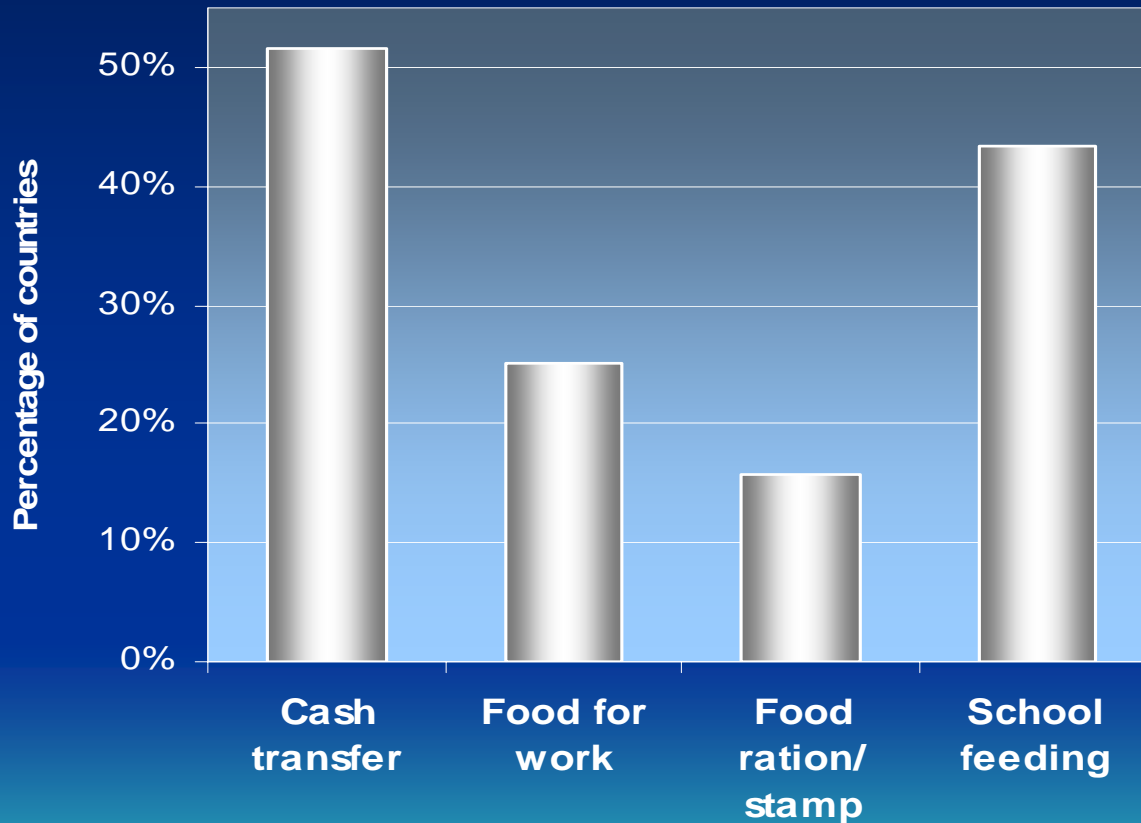
Source: Data based on responses from 120 country teams

Source: World Bank Data from 120 country teams.



What are countries doing? Safety Net Programs

SAFETY NET PROGRAMS (% OF 120 COUNTRIES)

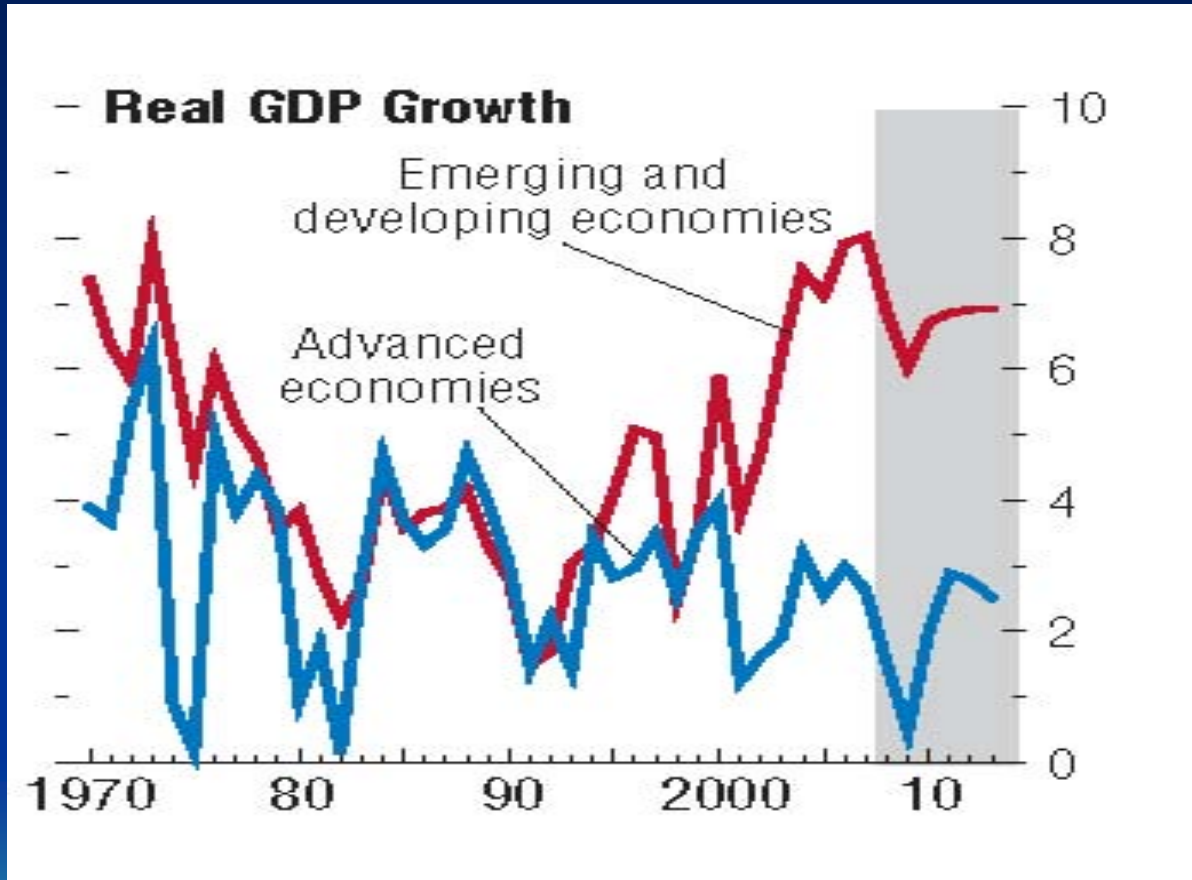


Source: Data based on responses from 120 country teams

Strengthening Safety-Nets for the Medium and Long-Term Response

- Difference in ability to cope largely dependent on whether safety net investments made in the past
 - e.g. Kyrgyz versus Tajikistan
 - Investing in targeting criteria, HH databases, payment systems: take time but not very expensive
- Fiscal costs of targeted safety net need not be too high
 - Severe shock can justify temporary increase in safety nets and permanent expansion may be justified if fiscal space created
 - Total cost of generous Mexico/Brazil programs about 0.5% of GDP

IV. Prospects for World Economic Growth



Most countries will face depressed growth in 2009, but are expected to recover thereafter. Emerging and developing countries will still realize fairly high growth in the next two years, while advanced economies will be challenged to maintain small positive growth.

Source: IMF, WEO October 2008

V. Consequences for Emerging Economies in Asia/Pacific?

The Policy Mix Remains Unbalanced:

- Fiscal pressures are mounting:
 - Reducing taxes and tariffs
 - Expanding universal programs and transfer programs
 - Increasing public sector wages
- Use of exchange rate flexibility has been limited so far:
 - REER appreciated in many countries with negative ToT shocks
 - Few countries let the nominal exchange rate depreciate
 - Countries with positive ToT shocks had substantial nominal appreciation.
 - Remittances & other inflows cushioned impacts in a few countries
- Monetary policy will have to bear burden of adjustment.

IMF RECOMMENDATIONS

- Implement Comprehensive and Internationally-Coordinated Solutions to stabilize financial markets, including liquidity provision and recapitalization.
- Further monetary policy easing could be used in some advanced economies.
- Fiscal stimulus can offer some support, but only if fiscal positions are sound.

Specific Policies in Pacific Countries

- Some countries have allowed the pass-through of first-round effects of food and fuel price increases (*Palau, Papua New Guinea, Samoa, the Solomon Islands, and Timor-Leste*).
- While this is a first best policy that encourages efficient responses by consumers/producers and fiscal discipline, the challenge for many Pacific islands is to combine pass-through with targeted safety nets.
- Some countries have responded by importing rice and on-selling it at a subsidized rate; others are considering targeted cash transfers and “food for work” (e.g. *Timor Leste*).
- Import duties and sales tax on rice were eliminated in the *Solomon Islands*. Import duties on fuel products were reduced in *Fiji*.
- As regards monetary responses, the Bank of Papua New Guinea has increased the policy rate by 25 basis points. The central bank of Solomon Islands has introduced standing deposit facilities to mop up excess liquidity.
- Because most of the islands are either dollarized or have a pegged exchange rate regime, the exchange rate has not played a central role in curbing imported inflation.

QUESTIONS? COMMENTS?

For More Information,
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