FINANCIAL COMMENTARY

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Rising commodity prices will force emerging Asia to revisit economic policies

Last week we wrote about the effect of rising food and oil prices on the U.S. economy and consumers. This week we extend our discussion to the effect of this inflation on the growth prospects and economic policies of emerging countries.

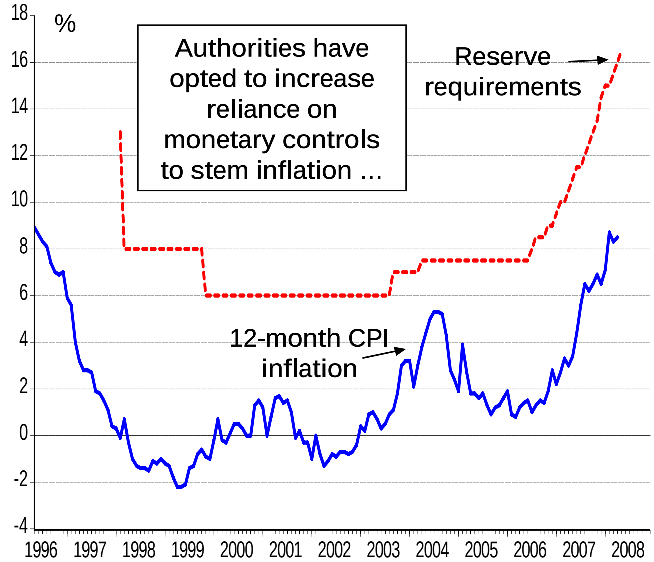
Oil prices have been bounding from record to record, with the spot price of WTI crude moving above $130 a barrel in recent days. With prices for rice, corn, wheat and soy also rising to all-time highs earlier this year, the whole world has felt the commodity price bite.

Inflation is so far relatively well-contained in Canada and the U.S., but not in emerging countries. Especially not in emerging Asia, where persistently high and rising prices for food and energy are a major question mark because they are a very large part of household budgets. Anti-inflation efforts by many governments in the region have yet to stem the tide. The risk is that further acceleration of inflation will trigger tighter monetary policy – including currency revaluation – in a number of countries. In Vietnam, for example, where inflation has jumped into double digits in the last six months and is now running at about 20%, the government has responded a few days ago by raising interest rates 3.25 points to 12%. But that still leaves real rates negative. Inflation is also becoming a problem in many developing countries whose currencies are pegged to the U.S. dollar.

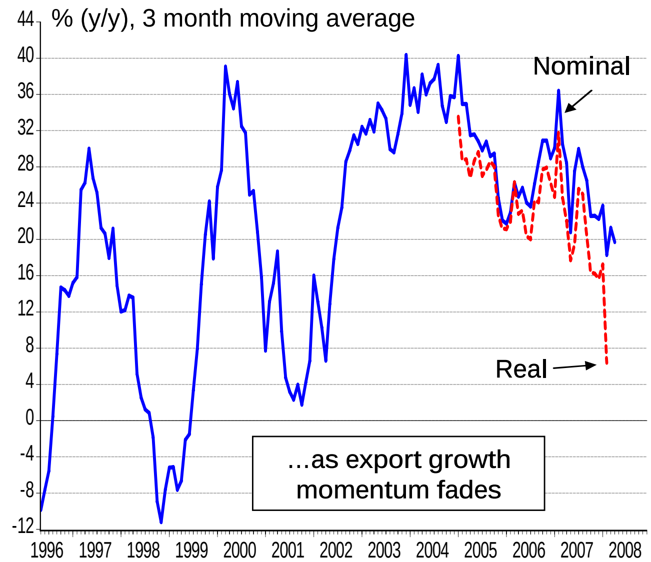
According to the Asian Development Bank, to resist an adjustment of exchange rates by tracking U.S. interest rates could aggravate inflation pressures. This is the scenario that appears to be playing out in China. Recent data from the National Bureau of Statistics showed April CPI inflation of 8.5%, close to a 12-year high. This report has prodded the central bank into raising commercial bank reserve requirements for the 10th time in 12 months, to a record 16.5%. As this move suggests, Beijing has opted to use monetary controls rather than currency revaluation to fight inflation. The reason for this preference is not hard to find: China’s exports are now decelerating sharply in real terms (chart).

China: Inflationary pressures have yet to abate

CPI inflation and reserve requirements for commercial banks



Nominal and volume exports*



** Export prices available since 2005. Latest data point for volume exports is February*
NBF Economy & Strategy (data via Datastream)

With inflation becoming a more serious problem in Asian countries, governments and central banks alike will be obliged to adopt more restrictive policies to combat it. The tricky question for authorities is how to act more forcefully at a time when the economic outlook for industrial countries has been deteriorating month after month.

Have a good week!