



The 'Silent Tsunami'

"High global food prices are creating 'a silent tsunami', threatening to plunge more than 100 million people into hunger."

~United Nation's World Food Program (WFP), 22 April

Countries across the globe are being battered by a wave of spiraling inflation as soaring energy, food and other commodity prices continue to erode consumers' purchasing power. Many central banks and monetary authorities have already been forced to revise their inflation targets and forecasts upwards. Although the impact of these 'fresh highs' in prices are being felt globally, the effects are most acute in the vulnerable, small and open economies, which are heavily dependent on imports. Most of the Caribbean countries fit this description, and are in fact at the shorter end of the inflation stick. Not only is the region open to the volatility of the international markets, we are also faced with the daunting task of protecting a large proportion of our population who currently live under the poverty line. As food and energy prices continue to climb past levels never before envisaged, there are significant implications not only for economic fundamentals, in terms of undermining economy activity and worsening the balance of payments accounts, but also (and more importantly) on the social side as people's purchasing power becomes eroded and a larger proportion of the world's population sink further under the poverty line.

It's all a vicious cycle. The strong growth in the emerging markets, while acting as an anchor for global economic expansion, has been a major contributor to the dramatic rise in prices. Strong demand pressures from countries like China and India for essential commodities like food and oil, as well as the demand for commodities in the production of bio-fuels are having significant effects. Additionally, decreased investments in agriculture as well as distortions in the agricultural markets have all been blamed for the substantial rise in food prices.

At a time when there is broad-based high inflation alongside slowing economic growth and erosion of purchasing power for many, what can the authorities realistically do? We have witnessed across the board, monetary tightening – the classic monetarism remedy to inflation – higher interest rates which will in turn constrict liquidity and the money supply, and correct the situation of 'too much money, chasing too few goods'. However, it also has the effect of stifling economic growth, especially if the economy is highly dependent on domestic demand. And this is the main risk in adopting the wrong policy choice – continued rise in inflation alongside stifled economic activity because of tighter monetary policies. With the main thrust to inflation coming from food and energy, will a tighter monetary stance be effective in limiting the escalation in inflation? In this author's humble opinion, it would seem not. In fact, the global economy has entered a new era, where high prices will be a permanent phenomenon.

We are apparently in the midst of what has been described by many as a commodity 'super-cycle', which supposedly occurs every 30 odd years. This phenomenon has previously followed world wars and is characterized by a major and sustained commodity price jump, where prices remain elevated, never going back to levels previously. As long as demand for food and energy and other commodities from emerging market giants continues to outstrip supply, by the simple laws of economics, prices will remain elevated. The demand for such commodities (food and energy) is largely inelastic and many countries act as price takers, meaning that individually they are too miniscule to affect prices. This suggests that monetary policy in these countries will be useless in the fight. In the case of domestic demand-driven inflation, tightening monetary policy will be effective. Core inflation will be a key piece of data going forward as this will give a better indication of the underlying price pressures in an economy and should be the determining factor in policy decisions.

The issue of poverty and social stability will also be crucial going forward, especially for poorer regions, such as ours. It is estimated that 42.9% of the population of Latin America and the Caribbean continue to live below the poverty line, with 18.6% of the population of the region living in extreme poverty. According to the 2007 Human Development Report (HDR) from the United Nations Development Program (UNDP), there are still around one billion people living at the margins of survival on less than US\$1 a day, with 2.6 billion – 40% of the world's population - living on less than US\$2 a day. To prevent the 48% rise in food price since end 2006, authorities must be careful to have measures in place to protect the poverty-stricken and the most vulnerable in society.

To help cushion the impact of higher food and energy prices, the International Monetary Fund (IMF) suggested a combination of monetary, trade and fiscal responses. Lesser developed countries will have to find creative ways to sustain the needs of the destitute, while trying to balance economic growth and inflation. A social safety net becomes very important. According to the IMF, price shocks should be fully passed on to the consumer, but over time. In the mean time, short term measures can be used to help offset the effects of the high prices. Of course, tried, tested and ineffective are export restrictions and price controls, which can in fact distort price incentives and discourage production. Subsidies also can place a tremendous strain on fiscal accounts and are difficult to unwind over the longer term. Wage increases should also be contained to help lessen inflation expectations and prevent wage-price spirals. Removal of import duties and taxes, and retail price controls are two short-term temporary measures that can be adopted to mitigate the price shocks on the poverty-stricken. Of course the countries which are in relatively good fiscal footing will have the flexibility to do this. Those who are not will suffer, as they will have to raise revenue, reduce other expenditure, borrow from the markets and multilateral agencies, or get the cooperation from the international community to secure foreign aid. The IMF also has an important role to play, especially in terms of advising countries. At this point in time however, the end of the inflation wave is still far from over. And whether we like it or not, high prices are here to stay! It is a difficult task, but we have to find resourceful ways to ensure the impoverished are protected.

FINANCIAL & ECONOMIC INDICATORS

As at 14 August, 2008

<u>Exchange Rate/US\$</u>	<u>Closing Value</u>	<u>Previous Week</u>
Yen	109.74	109.44
Euro	1.48	1.53
Jamaica	72.04	72.03
Guyana	205.20	204.70

<u>Commodity Prices</u>	<u>Closing Value</u>	<u>Previous Week</u>
Crude oil (US\$/bbl)	115.01	120.02
Natural Gas (US\$/mmbtu)	8.15	8.78
Gold (US\$/Troy Ounce)	806.63	873.05

Eurobond Indices (Return % YTD, as of 14-August-08)

Lehman Brothers Global Aggregate Index	1.95
JP Morgan EMBI+ (percentage change)	18.40
CMMB Eurobond Index	n/d

<u>Policy Interest Rates (%)</u>	<u>Closing Value</u>	<u>Previous Week</u>
United States	2.00	1.50
Euro Zone	4.25	4.25
Japan	0.51	0.51
Brazil	13.00	13.00
Trinidad	8.50	8.50
Jamaica	13.50	13.50
Barbados	4.50	4.50

<u>Market Interest Rates (%)</u>	<u>Closing Value</u>	<u>Previous Week</u>
US 90-day T-Bill	1.83	1.65
US 10-Yr Treasury	3.89	3.93
3-month UK Libor	5.76	5.78
Japan 90-day T-Bill	0.53	0.51
Brazil 90-day T-Bill	13.69	13.62
TT 90-day T-Bill	7.17	7.17
Jamaica 90-day T-Bill	14.46	14.46
Barbados 90-day T-Bill	3.90	4.02

Sources: Bloomberg, CMMB, Central Bank of Trinidad and Tobago, Bank of Jamaica, Central Bank of Barbados, www.lehman.com

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