

# World Economic Vulnerability Monitor

No. 2

UN/DESA

11 September 2009

## Global Vulnerability to Food and Energy Price Shocks

*Update: slight recovery in global trade does not alter picture of large negative trade shocks for most countries in 2009*

The previous **World Economic Vulnerability Monitor** (No. 1, 12 August 2009) analyzed the vulnerability of developing countries to the decline of global trade and shifts in export and import prices as a consequence of the crisis. The analysis has been updated with data to July 2009. The update, despite some recovery in global trade, does not visibly alter the projected size and pattern of trade shocks in 2009 as reported in the previous briefing (see Figures 1 and 2). Economies in transition will face the largest trade shocks (expressed as a share of their GDP), especially as a consequence of the decline in commodity prices as compared with their average levels in 2008. Countries with high degree of concentration of exports in primary commodities (oil and gas in particular) are hit hardest because of deteriorating terms of trade, while exporters of manufactures are hit mostly because of the decline in global demand. On average, the trade shock in developing countries is about as big as that in developed countries, but as analyzed in the Monthly Briefing No. 11, the precise nature and magnitude of the shock varies greatly across countries. Notably, the world's poorest countries, the LDCs, are expected to witness trade shocks of smaller magnitude. However, within this group there are large differences: most oil and mineral exporters are suffering adverse terms-of-trade shocks, while other countries are even registering small net trade gains thanks to the drop in import prices of food and energy products. Where there are

Figure 1: Projected trade shocks in major country groups in 2009

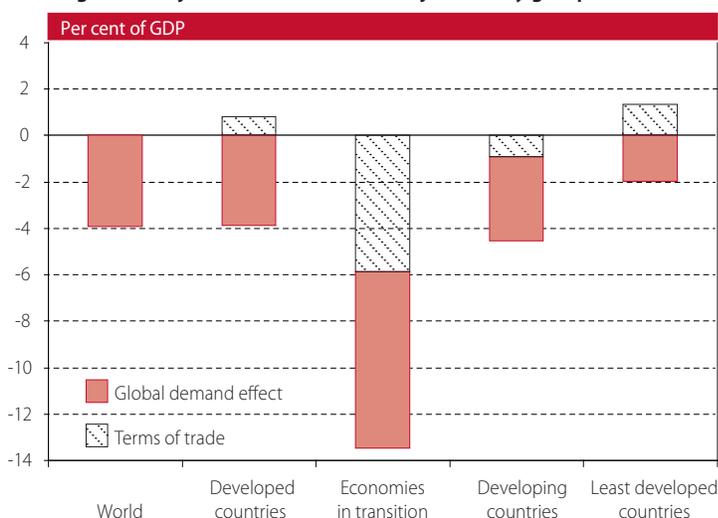
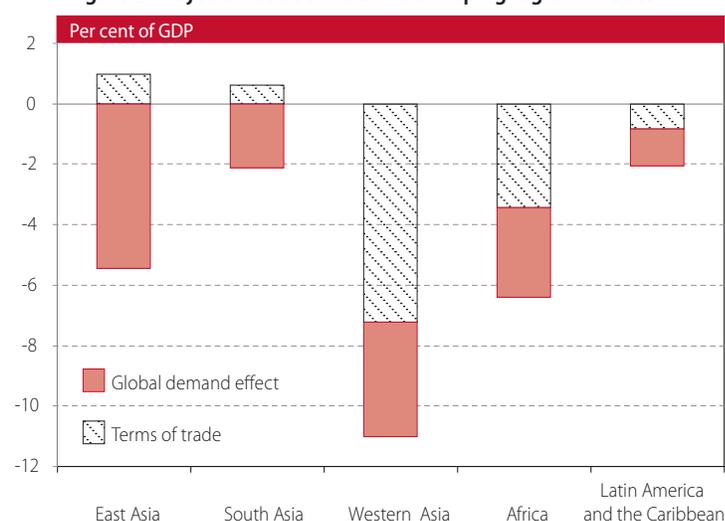


Figure 2: Projected trade shocks in developing regions in 2009



gains, however, these may be a mixed blessing. The same countries seeing some improvement in their terms of trade suffered severe negative shocks in the preceding year, as an expression of the high vulnerability of their economies to the continued volatility in world commodity markets.

Such volatility tends to be harmful for economic growth in the long run as most LDCs lack sufficient resources and financial reserves to absorb even mild external shocks and also tend to have weak social protection schemes to insulate their population from the consequences of such shocks on incomes and access to basic social services.

In this briefing we take a further look at this form of vulnerability and assess the impact of the shifts in global commodity prices on domestic inflation across countries and country groups.

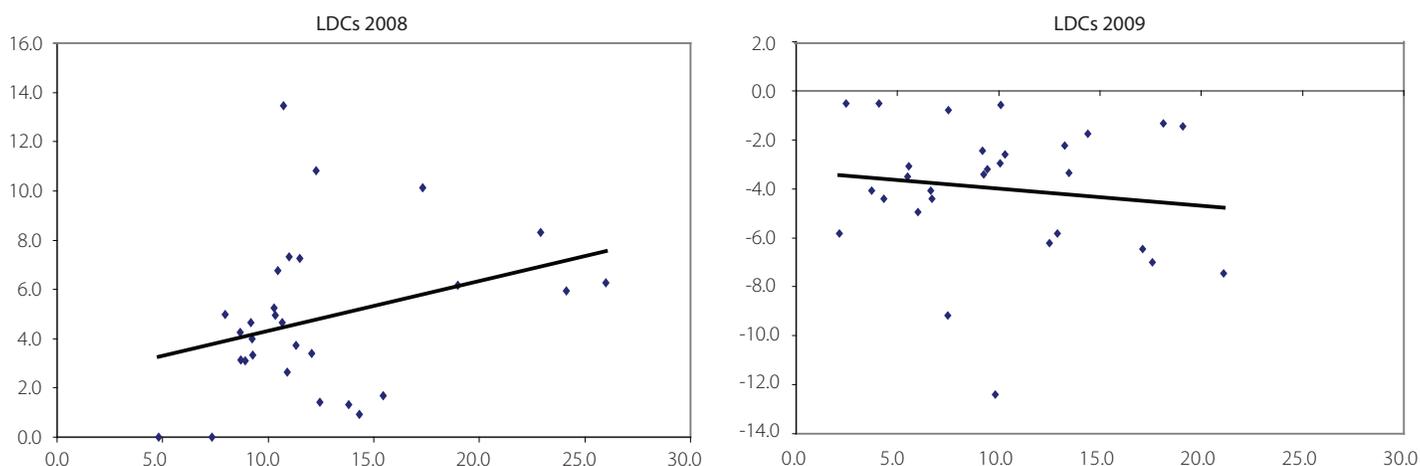
**Poorest countries may see milder trade shocks in 2009, but these come on top of bigger adversity in 2008**

Most LDCs and other developing countries that suffered strongly adverse trade shocks in 2008 as a consequence of the steep rise in world food and energy prices are expected to face below-average trade shocks in 2009.

Rapidly rising world market prices for food and energy goods pushed up headline inflation worldwide in 2008, most significantly among LDCs. Figure 3 shows the correlation between the size of the import shocks as a share of GDP and the inflation rate in those countries in 2008 and 2009. The “pass-through” to domestic prices appears to have been strong in 2008 when world market prices surged, but much weaker when they dropped in 2009.<sup>1</sup> This pattern also seems to hold for developing countries as a group (Figure 4). Such asymmetry in adjustment appears to be a worrisome additional vulnerability as the negative consequences of rising world market prices for domestic consumers do not seem to subside quickly. The burden of higher international prices of food and energy on the (working) poor seem to be tenacious and persistent, compounded by the fact that unemployment tends to respond with significant lags during economic recovery.

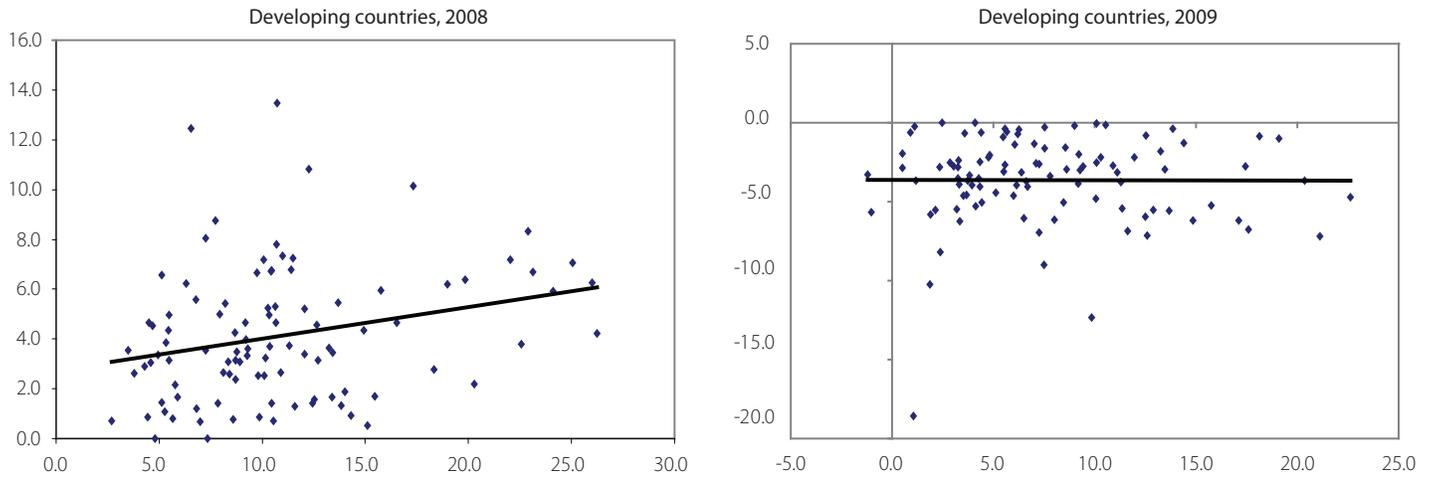
More specific factors can be identified by looking into individual cases in different regions and countries (see Figure 5). For example, in many African countries, such as in Guinea, Kenya and São Tome and Príncipe, a strong adverse food and energy import price shock pushed up domestic inflation in 2008. However, while international prices of food and energy moderated in 2009, domestic inflation has remained high. In several cases, the “pass-through” effect of the international commodity price surge in 2008 could be initially mitigated through price controls and subsidies, but many Governments phased out these measures at the end of 2008 in response to the drop in world market prices. For instance, Seychelles abolished the rice subsidy it had introduced during 2008. Senegal

**Figure 3: Import price shock on agricultural, food and energy products as per cent of GDP (vertical axis) and rate of domestic price inflation (horizontal axis)**

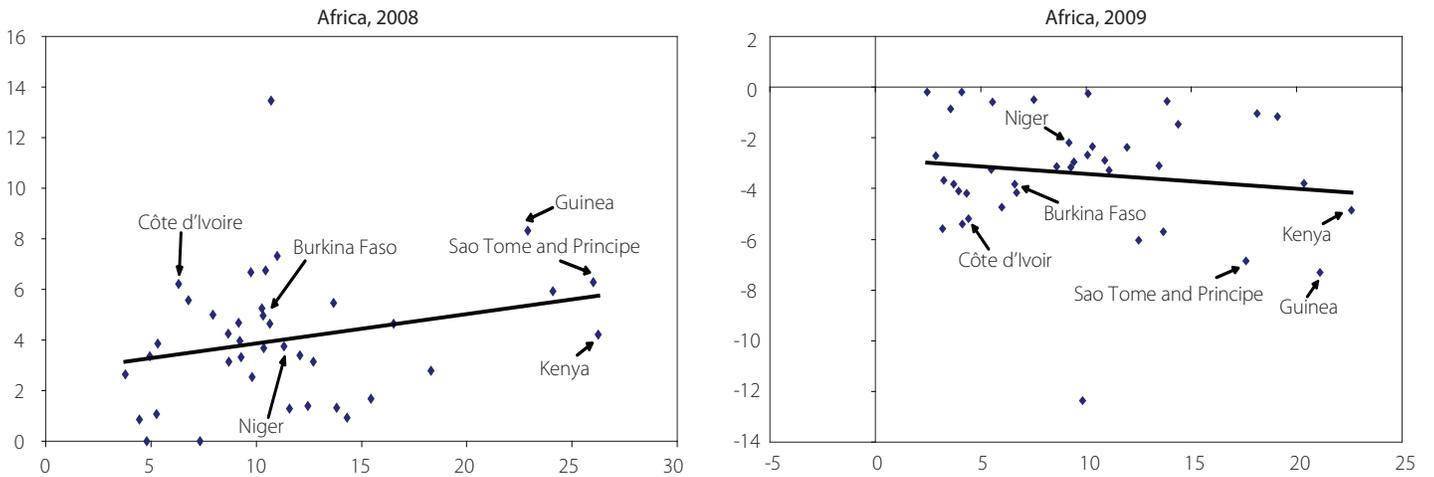


<sup>1</sup> The sign of the shock is positive when the prices of imports rise and negative when import prices fall. The shocks are estimated by groups of commodities but Figures 3-6 show the total import price shocks for the observed (2008) and projected (2009) change in world market prices for food, energy, agricultural raw materials.

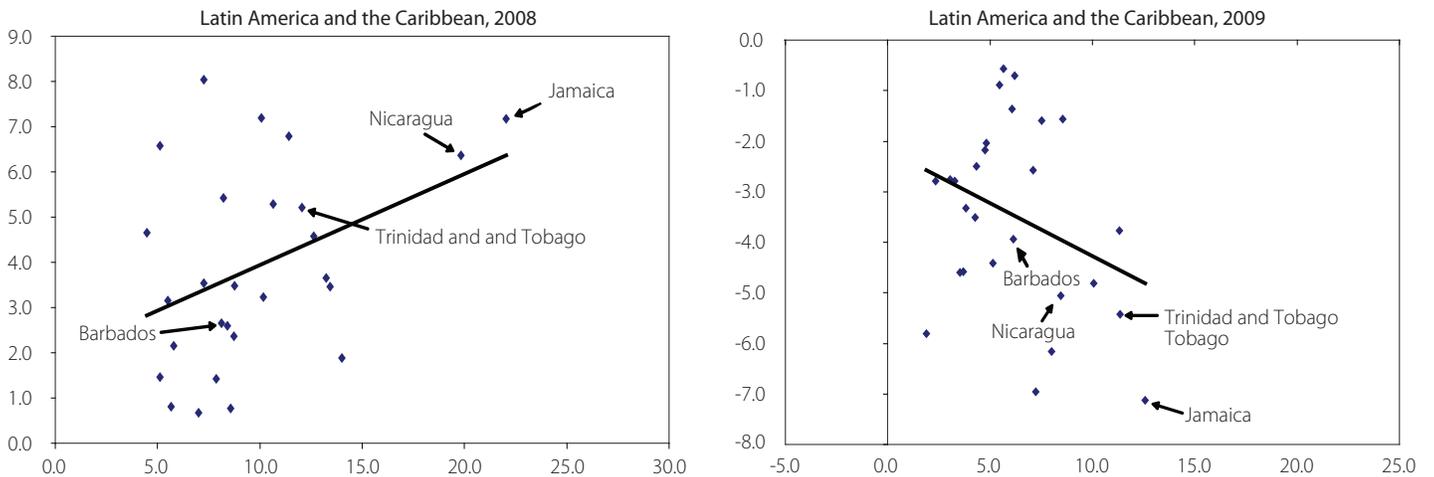
**Figure 4: Import price shock on agricultural, food and energy products as per cent of GDP (vertical axis) and rate of domestic price inflation (horizontal axis)**



**Figure 5: Import price shock on agricultural, food and energy products as per cent of GDP (vertical axis) and rate of domestic price inflation (horizontal axis)**



**Figure 6: Import price shock on agricultural, food and energy products as per cent of GDP (vertical axis) and rate of domestic price inflation (horizontal axis)**



also eliminated all budgetary subsidies on food products, including the elimination of the subsidy on rice, the re-institution of the previously suspended duties and taxes on other food products, the removal of the specific tax on vegetable oils, as well as the elimination of the subsidy on butane gas. Burkina Faso, Côte d'Ivoire and Niger also discontinued the suspension of import duties and taxes on sensitive foodstuffs. All these policy reversals seem to have contributed to the asymmetric influence of world market prices on consumer price inflation during the upward and downward cycles.

In Latin America and the Caribbean (see Figure 6), the drop in international food and energy prices seems to have had a somewhat stronger effect in reducing domestic inflationary pressures in 2009, particularly among the net food and energy importing countries in Central America and in the Caribbean. In Nicaragua, for instance, consumer price inflation is expected to drop to 8.5 per cent in 2009, down from 19.6 per cent in 2008. Lower inflation is explained in part by falling food prices, but also by a contraction in domestic demand and in the money supply since late 2008. In Jamaica, inflation is expected to decline from 22.0 per cent in 2008 to 12.6 per cent in 2009. In this case, headline inflation remains higher than might be expected from the drop in import prices as a consequence of recently introduced tax measures, and of currency depreciation. In Barbados and Trinidad and Tobago, however, domestic inflation in 2009 is expected to remain close to 2008 levels. Despite falling international prices of food and energy, downward rigidity in domestic prices has prevented consumers from benefitting from cheaper imports.

In East and South Asia (see Figure 7), a majority of economies are experiencing disinflation during 2009, in part on account of the decline in the international prices of primary commodities. For example, the inflation rate in China dropped by more than 5 percentage points during 2009, in line with the size of the import price decline relative to the size of the economy (3.6 per cent of GDP). Domestic factors have also played a role in reducing consumer price inflation, including the recovery in the supply of pork meat during 2009. Supply shortages were an important factor in driving up domestic food prices in China during 2008. India, in contrast, is among the few cases in Asia where the moderation in international food and energy prices in 2009 has not resulted in lower domestic inflation. The measure for the import price shock dropped by 6.9 per cent during 2009, but India's domestic inflation rate increased from 8.3 per cent in 2008 to 9.2 per cent in 2009. Drought and the resultant poor harvests have been a key factor in driving up domestic food prices in India this year. ■

**Figure 7: Import price shock on agricultural, food and energy products as per cent of GDP (vertical axis) and rate of domestic price inflation (horizontal axis)**

