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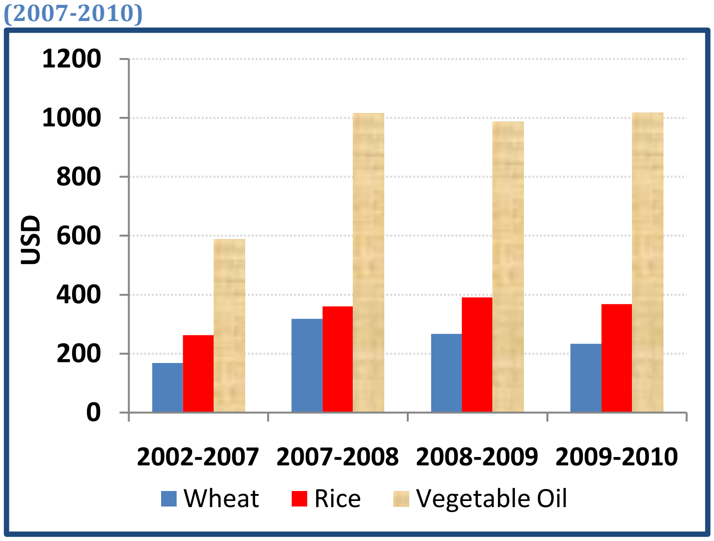
Global and regional inflation and implications to resources use

According to a recent OECD-FAO report[1], prices of agricultural commodities will remain firm in the next few years, Figure 1. Over the period 2007-2008, prices of wheat, rice and vegetable oil are estimated to increase by 90%, 38% and 73% respectively. The report expects the supply of grains in general as well as oil to remain tight due to the growth in bio-fuel production, as well as livestock production. In addition, the grain supply was hurt by adverse weather conditions. The demand for oilseeds is further elevated by the strong consumption demand from developing markets, especially China.
Export restrictions by rice producers, in order to provide more for their domestic markets, have caused wide-spread panic recently. The OECD-FAO report expects prices to further rise over 2008-2009 as income and demand grow in developing markets. Over the longer term, prices are expected to retreat slightly, yet they will remain volatile.

Figure 1: Projected Prices of Wheat, Rice and Vegetable Oil (2007-2010)



Source: OECD-FAO Agricultural Outlook 2008-2017, Table A.2.

Yet the developing countries will bear the brunt of increasing agricultural prices simply because of long-term neglect of the agricultural sector and planning biases towards urban centers, especially around the capital cities. Contrast for example the actual status of food sector and food consumption and poverty in Africa with its potential as the 'World's Food Basket".

The question crops: how did the advanced countries manage to develop their agricultural sectors and shield their farmers from the climate, demand and supply shock over decades of development? Well, let's take the US, for example, where less than four percent of the labor force is engaged in the farming sector. Those four percent that are America's farmers produce enough to feed themselves, the remainder %96 non-farmers and have surplus that is exported to the rest of the world. In Egypt, Morocco and Yemen by contrast, substantially larger proportions of the work force are employed in agriculture but hardly produce enough and Egypt and virtually all other Arab economies extensively rely on food imports, especially wheat, to meet domestic needs.

How did the Americans achieve this high productivity outcome? In short, the current status of American farming resulted from a compendium of polices and incentive measures that nurtured private and public expenditures on agriculture R&D. Active income policies and farm subsidies played a crucial role in insulating the incomes of farmers against the vagaries of agricultural price shocks due to draught, or over-supply when the season is good. The government provided education and other incentives to farmers and their children. Likewise, the heavy subsidy schemes that the EU offers to farmers are well-known. Less known however is the export and credit subsides that the EU offers its produces, especially farmers, to ensure adequate market shares in Asia, the Middle East, Africa and Latin America.

While surging food and energy prices are fueling global inflationary pressures, the increase in the prices of metals is affecting the overall production costs. In Jordan for example, it has been recently reported that iron prices, exceeded 1000JD to the ton[2].

Ironically, the surge in oil prices and the declining dollar are contributing significantly to fueling domestic inflation. Recent research findings[3] has collaborated the impact of pegging GCC currencies to the US dollar on domestic inflation rates through costlier imports that are not dollar invoiced, mainly from the EU. Loosened central banks policies to track the Fed in companion with pro-cyclical fiscal policy are feeding inflationary pressures.

Contrast this with the impact of accumulated foreign assets of Arab economies, notably the GCC economies, on mitigating inflation in advanced economies. The mechanism is simple, the piling up of foreign reserves, mostly in American treasury bills, helped push down the bond yields. At the same time, cheap imports from China and elsewhere helped central banks in rich

[1] OECD-FAO (2008): *OECD-FAO Agricultural Outlook 2008-2017*.

[2] Al-Ghad

[3] AB Research Department: "GCC trade volatility, the US Dollar Peg and Inflation: Preliminary Research Findings" Forthcoming in the *Arab Bank Review,* 2008.

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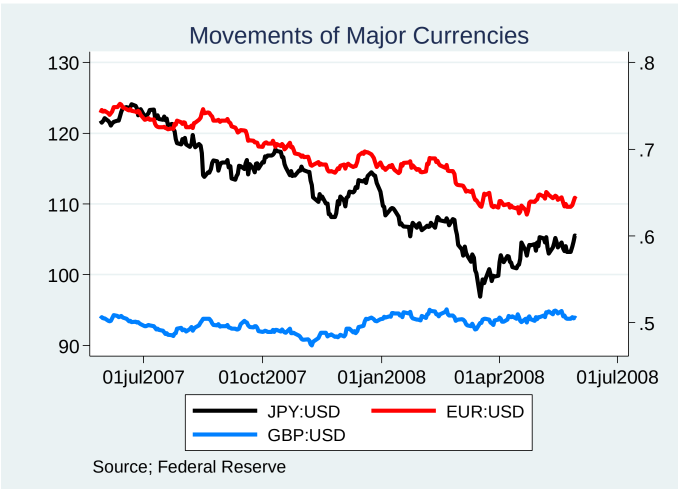
economies hold down inflation while keeping short term interest rates lower than historical records[4].

Global Developments[5]

The Euro depreciated as a result of inflation in Europe soaring to a 16-year high at 3.6%, in addition to weak retail data. Yet it closed the week on a rise against the USD as a result of the fall in US consumer confidence.

Figure 2



Commodity markets had a tumultuous week with oil dropping by 3.22% over the week as a result of worries over declining demand and the appreciating dollar. This in turn dragged down other commodity prices as well.

Table 1: Selected Commodities

	Week ending 5/23/2008	Week ending 6/1/2008	Change
Oil WTI ($/bbl)	**131.60**	127.36	(3.22%)
Gold ($/oz)	**927.50**	885.75	(4.50%)
Natural Gas	**11.590**	11.48	(0.95%)

Source: WSJ

The fall in oil prices had a positive effect on global equity markets as technology and energy shares rose in the US. Furthermore, the oil decline improved earnings forecasts for airlines which in turn elevated European markets. In contrast, the UK market ended a turbulent week on a decline.

In our region, the ASE enjoyed a positive week as the general index stayed above 9000 points while the Saudi market was dragged down by Samba shares which decreased by 11.5%[6].

Table 2 Selected Market Indices

Index	Week ending 5/23/2008	Week ending 6/1/2008	Change
Jordan	**9179**	9301	1.33%
KSA	**9,672.62**	9,491.31	(1.87%)
Morocco	**14,451.08**	14,516.97	0.46%
S&P500	**1,375.93**	1,400.38	1.78%
NIKKEI	**14,012.20**	14,338.54	2.33%
FTSE100	**6,087.30**	6,053.50	(0.56%)

Sources: Bloomberg and Official Markets

DID YOU KNOW?

- Jacques Polak-a major 20th century economist whose pioneering research molded the basic economic approach of the IMF up until now was actually an accountant who joined the IMF in 1947 and remained active for thirty years after his retirement. He still maintains an office at the IMF at the age of 94(Finance & Development Vol. 45 No. 2 June 2008).
- The OECD and YouTube launched “Future of the Internet Initiative” with the objective of probing how the internet can make the world a better place. YouTube users can share their opinion with the leaders and opinion shapers attending the OECD Ministerial meeting on the “Future of the Internet” In Seoul, Korea 17-18 June, 2008.
- Bahrain investors are increasingly looking overseas, particularly at Central and Eastern Europe, targeting investments in the transport, logistics, finance and real estate sectors. For instance, Kazakhstan has been targeted as an investment, with Ithmar Bank announcing the launch of a $1bn fund for developing energy projects in the region. (Oxford Business Group, May 30, 2008).
- Abu Dhabi’s non-oil exports hit a record of $ 1bn in 2007. Re-exports, considered a key growth area for trade, and reached a value of almost $ 650m. Meanwhile the Emirate imported $5.1bn last year. Major partners were Japan, Saudi Arabia and Germany (OBG, May 2008)
- USA GDP was revised upwards in the first quarter of 2008 to 1% growth, With that revision, there is almost 0 probability that the NBER could determine that the US economy was in recession in 2008, at least not in the first quarter (Econobrowser May 31 2008)

INFORMATION

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[4] The *Economist Magazine*: 30 May 2008.

[5] WSJ, Reuters and Bloomberg

[6] MEED