

Inflation: Key Risk to Global Outlook

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Abstracts

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The Challenge Of Rising Commodity Prices A combination of improving economic growth, loose monetary policy, and supply-side considerations from tight commodity markets is boosting consumer prices worldwide. Inflationary pressures are being felt most keenly in emerging markets (EM), where policymakers will have to find a balance between tightening measures intended to contain prices on the one hand, and maintaining export competitiveness and sustaining growth on the other. Our core scenario is that headline inflation should not be so much of a worry as we approach H2 2011, as commodity prices ease off and EM policy tightens. But the risks of commodity price spikes and upward wage pressures should not be underestimated, and could yet create significant headwinds to the ongoing global recovery.

Inflationary pressures are building across the Asia-Pacific region, with China's consumer price index (CPI) set to rise further from the 4.6% y-o-y December reading in the months ahead. Indonesia, which hiked its benchmark BI rate on February 4 to prevent real interest rates from turning increasingly negative, will be forced to do so again before long. Aside from higher food and commodity prices, hot money inflows into Asia are being multiplied by the broadly stable banking systems and strong growth opportunities. China, Indonesia, Vietnam and India are the most at risk from a near-term surge in price pressures.

Rising inflationary pressures are creating policy dilemmas for Emerging European central banks.

Wary of the rising interest rate differentials with developed economies, central banks in Central Europe and Turkey will tread carefully as they seek to avoid 'hot money' inflows over the course of 2011.

However, we attribute higher inflation in the region largely to supply-side pressures and caution that a public backlash and U-turns on fiscal austerity cannot be ruled out entirely.

Rising consumer inflation is having a pronounced impact on our outlook for political risk throughout the Middle East and North Africa (MENA).

Countries with elevated food price inflation and weak public finances are most at risk from experiencing large-scale public unrest in our view. The political situations in Egypt and Tunisia are still clouded with uncertainty, and Iran is a potential flashpoint of instability going forward. By contrast, countries throughout the Gulf Cooperation Council are least at risk from experiencing inflation-induced political upheaval. Not only is food price inflation markedly lower throughout the GCC, but living standards are also considerably higher.

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