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**Comments on the evolution of commodity prices and
implications for macroeconomic stability**

By

Mr. Yılmaz Akyüz, Chief Economist, South Centre, Geneva

The views expressed are those of the author and do not necessarily reflect
the views of UNCTAD.

A decorative graphic on the left side of the slide, consisting of a grid of overlapping squares in various shades of blue and purple, creating a stepped effect.

***COMMODITY AND FINANCIAL SHOCKS, VULNERABILITY OF
EMERGING AND DEVELOPING COUNTRIES
AND POLICY OPTIONS***

Yılmaz Akyüz

South Centre, Geneva

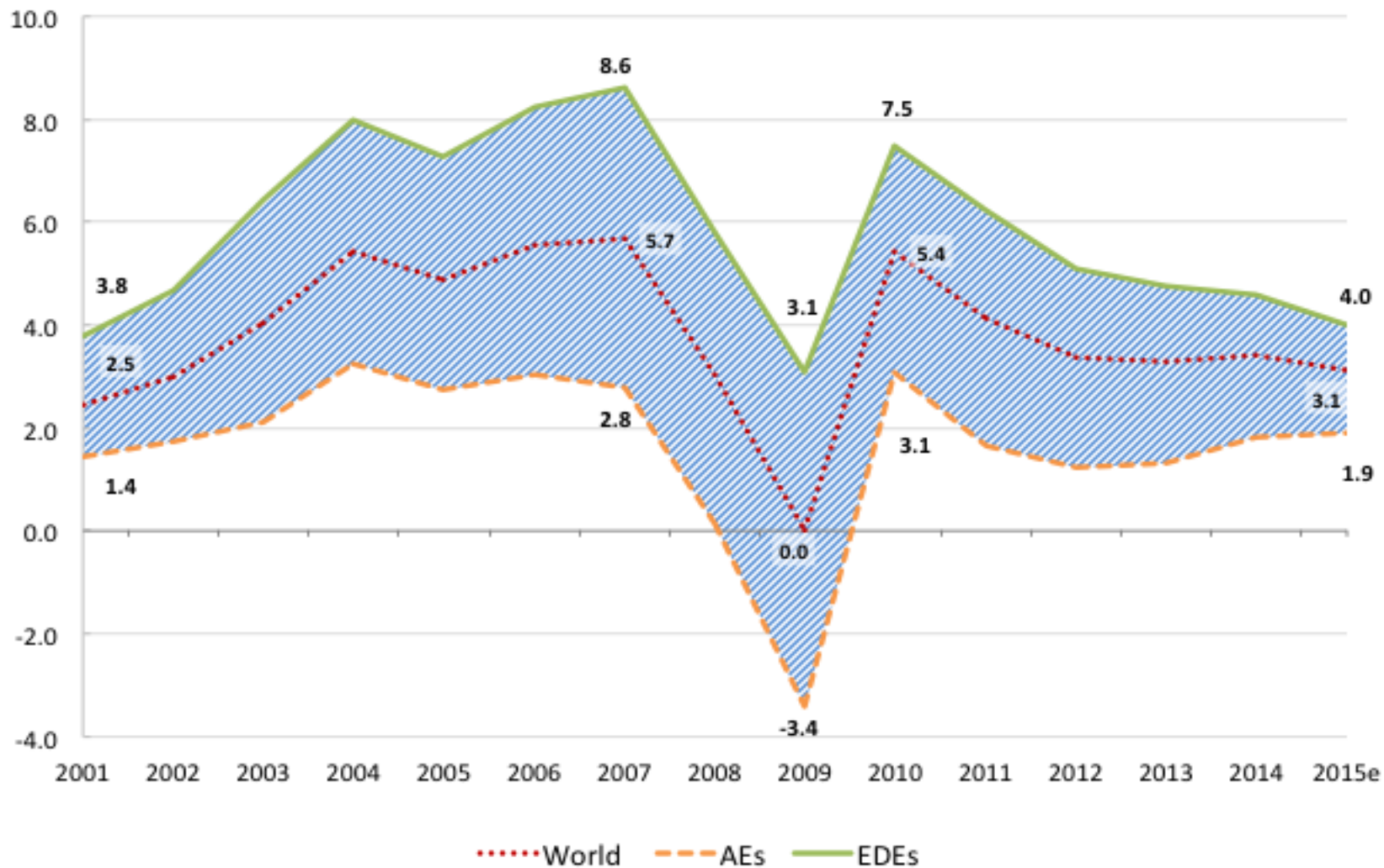
21 April 2016, Palais des Nations, Geneva

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OVERVIEW

- Global economic conditions much less favourable since last meeting.
- Growth lowest since the crisis; fell more in EDEs than in AEs
- Commodity price collapse a main reason
- But significant variation in vulnerability of EDEs to commodity falls
- Global financial conditions deteriorated; hitting also commodity exporters
- Commodity-finance nexus now working in reverse
- Policy space in EDEs limited compared to 2008-09
- Need for global action

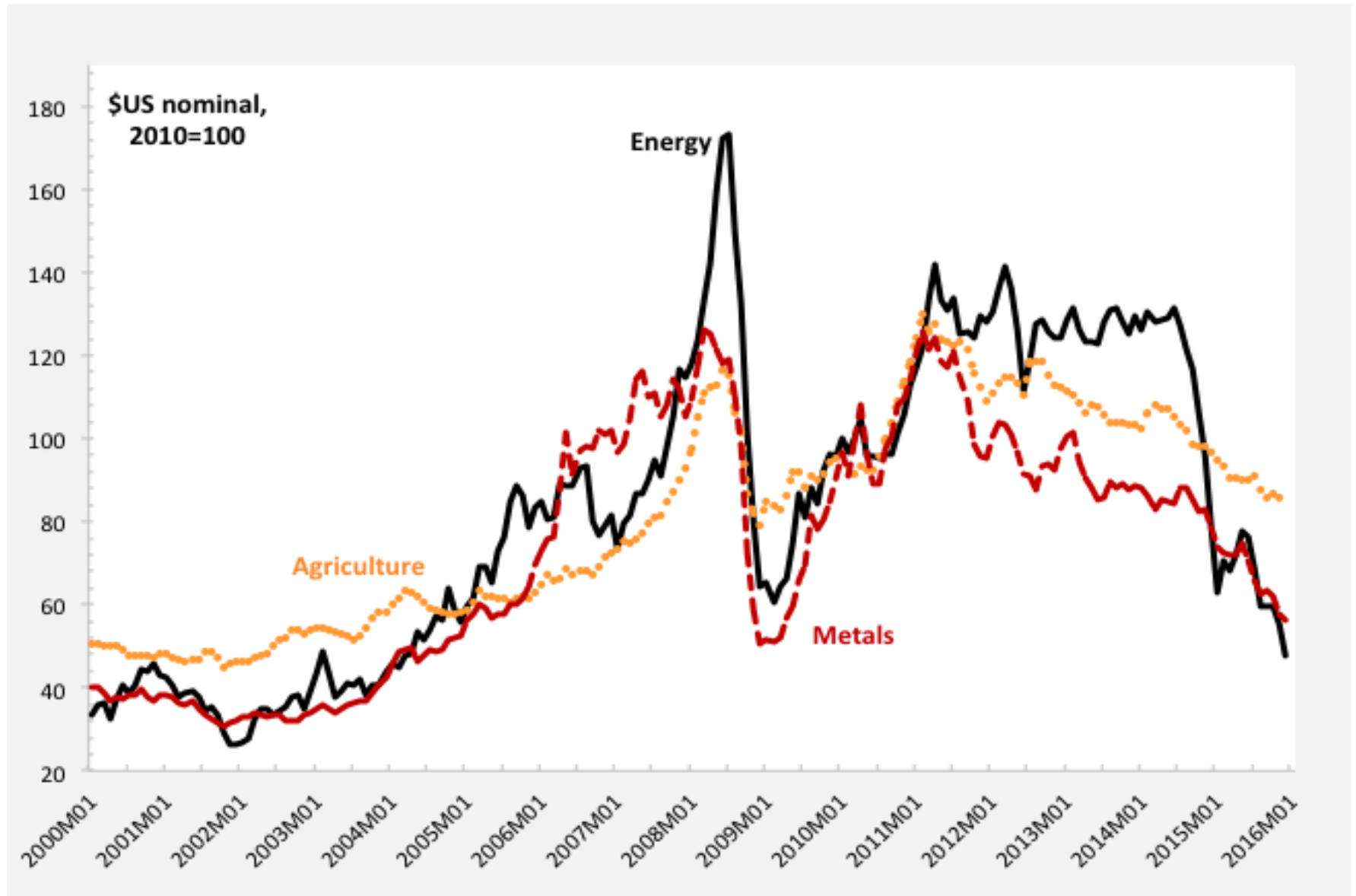
Global growth weakest since crisis. Loss of growth more in South than in North – Downward convergence



Commodities and growth in EDEs

- Despite all the talk about industrialization, the growth story in the South is still a commodity story. Even more so now than 10-20 years ago because of deindustrialization in LA and SE Asia.
- The new twist is finance, but it is closely linked to commodities. Cheap money created unsustainable spending booms in EDEs (investment in China and consumption in others) and added to demand. It also led to large borrowing and investment in metals, energy and minerals, creating excess supply. Now demand disappeared but debtors are still pumping/digging to survive.
- Impact of commodity (oil) price declines on global economy is contractionary. It would lower inflation in AEs at a time when CBs are trying to create inflation in order to reduce real interest rates and stimulate demand.
- Unlike in the past, oil exporters in MENA are now cutting spending.
- There is deleveraging among producers and investors (in fracking in US).

All commodities falling but at different rates



Declines from the peak widely different

Commodity Groups	Percent decline 2011/M4 to 2016/M1
All	60.5
Fuel (energy)	71.5
Non-fuel	41.2
Food and beverages	30.2
Industrial inputs	51.2
Agricultural raw materials	36.4
Metals	58.5

Vulnerability depends on what you import or export: three groups

1. Importers of fuel and non-fuel commodities and exporters of manufactures and services benefit from commodity declines – China, India, Turkey
2. Exporters of fuel: Most countries in MENA, Angola, Republic of Congo, Nigeria in SSA and Bolivia, Colombia, Ecuador, Venezuela in LA. They benefit from declines in the prices of agricultural and other non-fuel commodities, but benefits fall short of losses from fuel exports.
3. Exporters of non-fuel commodities and importers of fuel: Argentina, Chile, Nicaragua, Peru, Uruguay in LA, Cote D'Ivoire, Malawi, Mali, South Africa, Zambia in SSA. They suffer from declines in prices of their exports but their benefits from oil price declines much greater, particularly where fuel bill is an important part of CA deficit.

Diversity reflected in swings in CA (% of GDP)

	2011	2016	Swing
All EDEs	1.5	- 0.6	- 2.1
FUEL	10.4	- 4.1	-14.5
NON-FUEL COMM	-1.5	- 3.3	- 1.8
ALL NON-FUEL	-1.1	0.1	1.2
CHINA	1.8	2.6	1.2
INDIA	-4.2	-1.5	2.7
TURKEY	-9.7	-3.6	6.1

Diversity reflected also in growth

	2010-11	2015	Swing
WORLD	4.8	3.1	-1.7
All EDEs	6.9	4.0	-2.9
FUEL EXPORTERS	5.1	0.1	-5.0
NON-FUEL COMM EXP	6.0	2.4	-3.6
ALL NON-FUEL EXP	7.4	5.0	-2.4

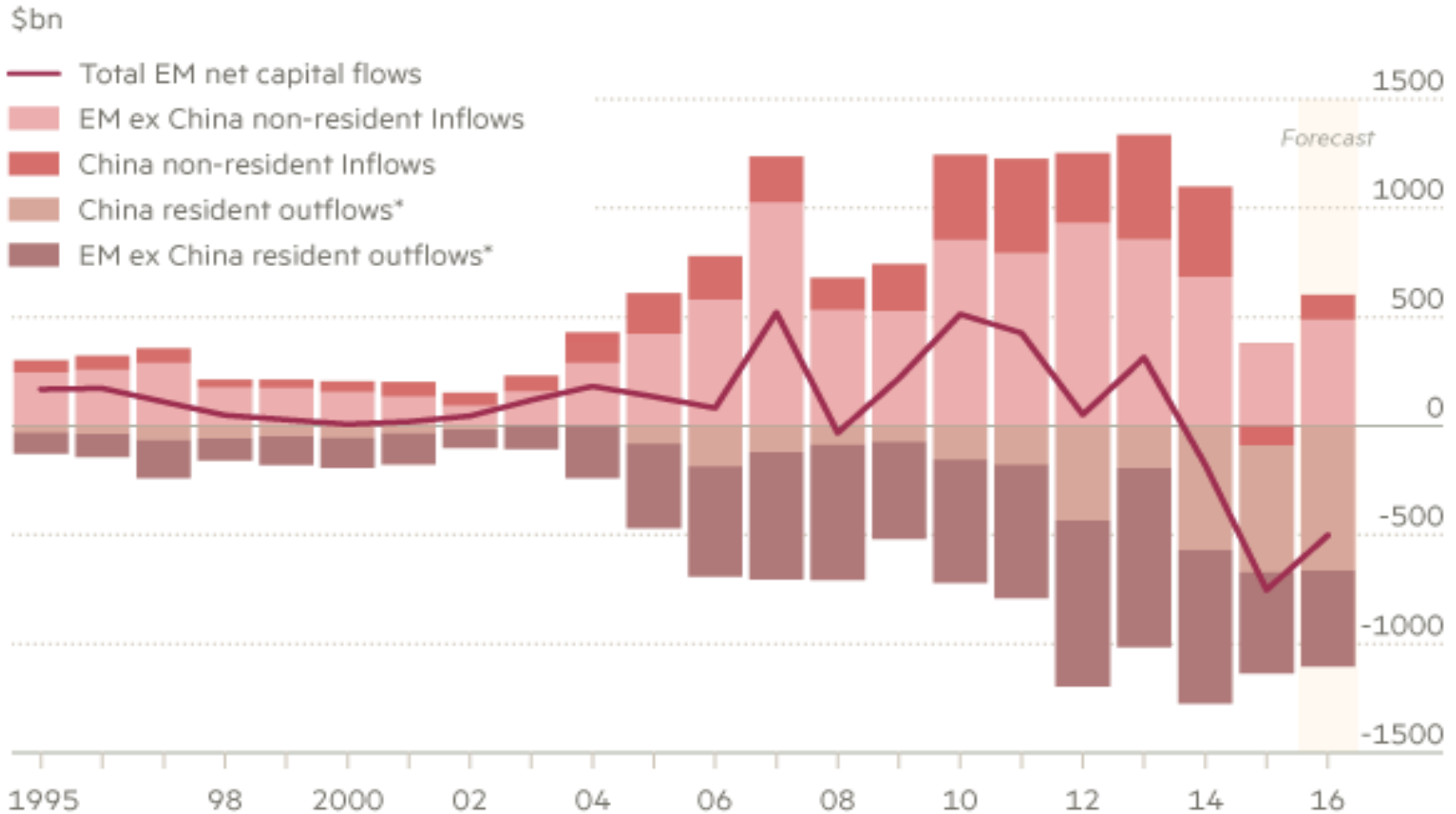
But even within the same group (e.g., fuel exporters) some doing better than others. This is largely due to fundamentals – the way the twin booms were managed (exchange rates, BOP, savings and investment, fiscal surpluses, stabilization funds, reserves etc).

Financial Shocks –Capital flight from EDEs

- Capital outflows since 2014 without any significant tightening of monetary policy in US. Resident outflows are now several times non-resident inflows. Net flows are (resident minus non-residents) negative first time since 1980s (\$750b in 2015)
- This is mostly a China story so far. \$675b outflows as Chinese companies paying off forex debt. But outflows from other regions too.
- Markets stabilized in early 2016 and even some regions (LA) received sizeable FDI and portfolio inflows. But this is expected to be temporary. Projections for 2016 is for net outflows. Perhaps worst is yet to come.
- Reserve accumulation falling and currencies under pressure in all EDEs as CA deficits mount and capital inflows weaken or disappear.

Capital Flow Reversal

Capital flows to emerging markets

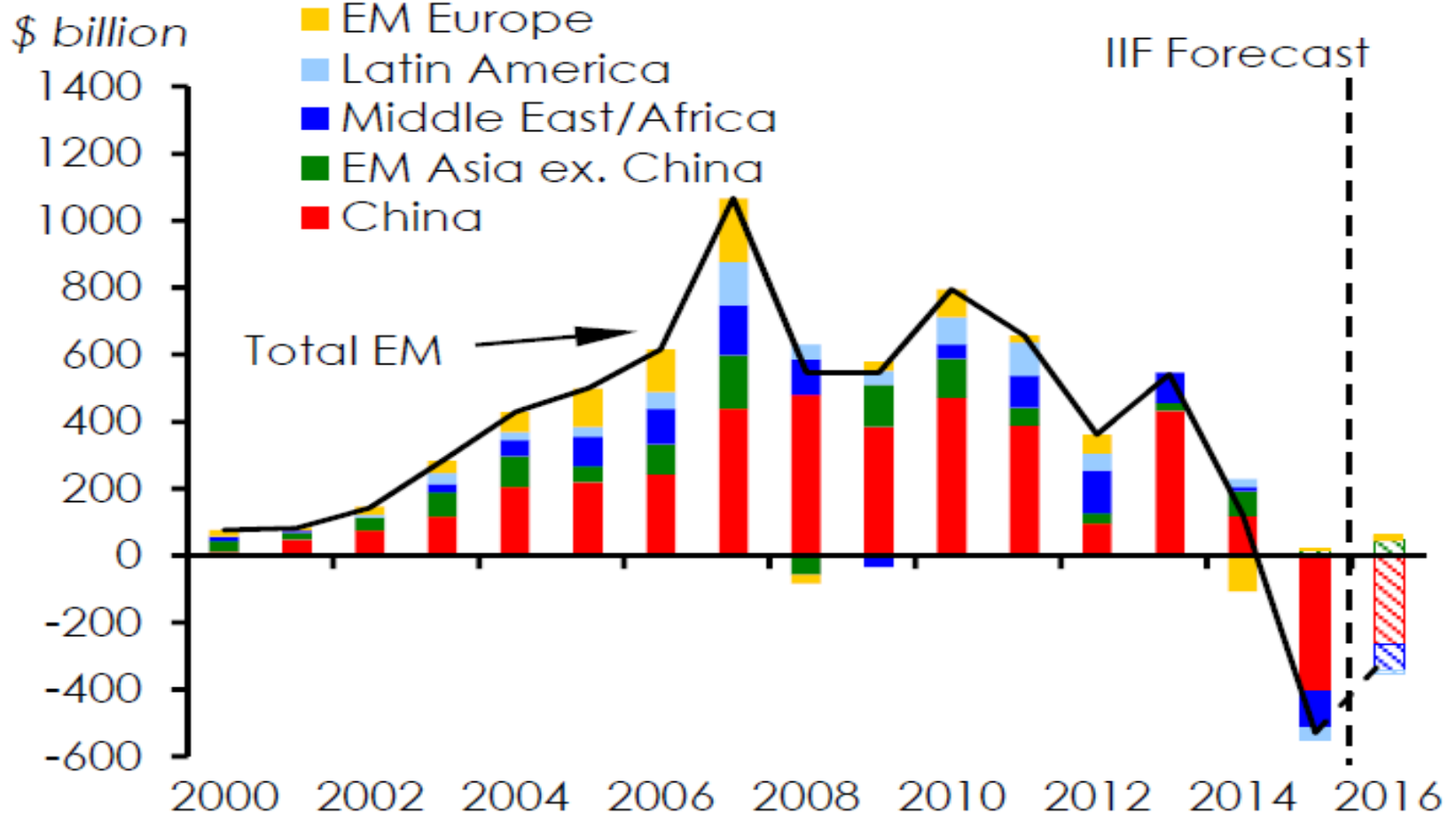


* Exclude reserves, includes errors and omissions

Source: IIF

Reserves fell first time in 2015

EM FX Reserve Accumulation by Region



Source: IIF

Exchange rates are under pressure

JP Morgan Emerging Markets Currency Index



Source: Bloomberg

Commodity EDEs are vulnerable to financial shocks

- Poorer countries dependent on official financing not much vulnerable.
- But commodity and financial shocks are linked for some – Petrocaribe for Guyana, Nicaragua.
- Dollarization widespread in poor DCs; stronger dollar, higher rates can create problems. Maiden issuers may find it difficult to refinance.
- Commodity EMEs are more vulnerable. Corporations in Brazil, Russia, Mexico, Indonesia, Chile, Malaysia built up large dollar debt. Commodity sector among largest debt issuers (junk bonds). Oil and gas debt increased by \$1.5tr since 2006, rising between 15 and 30 per cent per annum.
- Strong presence of foreigners in local bond, equity and deposit markets (Malaysia, Indonesia, Peru, Mexico...); exit can cause problems – liquidity and currency crises if not debt crises.

Prospects pretty gloomy

- EDEs damned if US grows faster. Higher interest rates and stronger dollar would mean weaker commodity prices and capital outflows.
- Damned if US starts contracting. US has no more ammunition left to deal with another recession. A goldilocks scenario?
- Europe is hopelessly stuck in stagnation, austerity and fiscal orthodoxy. ECB is promising more of the same things. CBs generally lost credibility.
- China no longer an engine for commodity exporters and suppliers of manufactured parts and components. A sharp slowdown and financial turmoil can create contagion and depress commodity prices further.
- BRICS growth now below levels seen during 2008-09. Two commodity BRICS (Brazil and Russia) are in recession; RSA is close.

Policy space is limited in EDEs

- No room for a strong countercyclical response as done in 2008-09. Cannot replicate what China did in 2008-09 and shift to domestic demand (infrastructure investment) for growth.
- BOP and fiscal positions much tighter than in 2008.
- Monetary policy dilemma – lowering rates for growth can trigger capital flight.
- Reserves not adequate if exports continue to fall and capital flight accelerates.
- Some EDEs which managed prudently the boom may weather shocks with a small loss of growth. But most face sharp drops/contraction and instability.
- Need for global response. If AEs remain in mess, EDEs cannot put their houses in order.

Exceptional conditions require bold measures

- Abandon fiscal orthodoxy in AEs and invest in infrastructure – they all need it.
- Give the money to those who will spend, not speculate – helicopter money
- Need for wage increases in US, EU, Japan to boost domestic demand; China to accelerate reform to build a strong domestic market (rebalancing)
- Control destabilizing capital flows in both source and destination countries. Temporary exchange controls and debt standstills if and when needed.
- Prevent liquidity crises leading to insolvency. SDR allocation, not IMF lending. EDEs may turn to WB to avoid IMF (record WB lending \$25b, Indonesia, Nigeria, Peru). But WB resources not enough. No effective S-S mechanisms for crisis lending (CB swaps, Chiang Mai or CRA). Bigger SDR allocation than in 2009.
- The world is in a debt trap. In next downturn some of that debt cannot be paid. Do not muddle through the next debt crisis; need orderly workouts.