

**High-level Regional Policy Dialogue on
"Asia-Pacific economies after the global financial crisis: Lessons learnt,
challenges for building resilience, and issues for global reform"**

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**Current Regional Challenges 1: Handling Food Price Volatility and
Inflation**

Presentation

Inflation Challenge in South Asia

by

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INFLATION CHALLENGE IN SOUTH ASIA

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South Asia: Economic Impact of Global Financial Crisis on Macroeconomic performance – Selected lessons

- ❖ Overall: South Asia (excluding Pakistan) was able to deflect successfully the Financial Crisis
- ❖ Main Reasons:
 - Strong Macro Fundamentals/Stability (Bangladesh/India)
 - Provided room for Fiscal Stimulus (India)
 - Lack of deep integration with global financial system
 - Greater reliance on domestic consumption than exports
 - Healthy foreign exchange reserves
 - High growth in remittances

Policy Responses/Safety Nets to Financial Crisis

Bangladesh: Cash subsidies to key exports; rural employment and road maintenance programmes.

India: Fiscal stimulus (1.5% of GDP); coordinate monetary/fiscal response NREGP; Rural Self-Employment Programme.

Sri Lanka (costs of civil Strife/Rehabilitation): moderate Fiscal Stimulus (0.3% of GDP; face of high inflation monetary policy tightened; exchange rate depreciation.

Pakistan: IMF Stand-by Agreement; Economic Stabilization; Benazir Direct Income Support Programme (Rs.1000 to 3.5 million families to be raised to 7.5 million families).

Source: Ibid

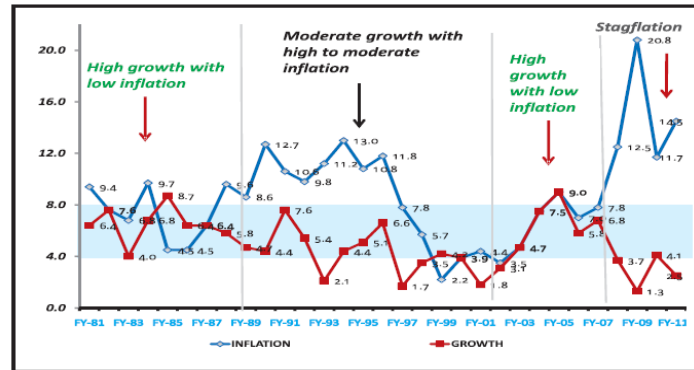
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Economic Growth in South Asia: Key Factors

- ❖ Macroeconomic stability key to stimulating economic growth
- ❖ Growth in Total Factor Productivity
- ❖ Improved HDI
- ❖ Competitiveness in Export markets
- ❖ Remittances

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PAKISTAN: OUTLIER IN SOUTH ASIA



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LESSONS FROM PAKISTAN EXPERIENCE

- Vulnerability to external shocks as pre-2007 growth spurt mainly consumption led and financed by unsustainable external resource inflows
- Economic reforms especially revenue generation efforts not undertaken-current tax to GDP ratio remains at less than 10 per cent
- Adjustment to oil/foodgrain price shock in 2008 led to unsustainable fiscal and trade deficits
- No alternative but to stabilize and enter stand-by agreement with IMF
- Lack of progress on economic reforms has thrown IMF programme into jeopardy
- Political will and better economic management key to economic recovery: Pakistan basically strong and resilient economy and can bounce back to high growth trajectory

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CURRENT FINANCIAL ANXIETY

- ❖ Are we heading for double-dip recession in the US?
- ❖ Future of the Euro and risk of debt-default
- ❖ Arab “Spring”

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DIFFERENCE BETWEEN CURRENT GLOBAL ANXIETIES AND FINANCIAL CRISIS

- ❖ Financial Meltdown was structural / low savings in US /
~~~~~ lax financial regulation ignited by toxic sub-prime mortgage.
- ❖ Current U.S. Economic situation is more political than Economic – failure to come up with a credit worthy deficit reduction plan
- ❖ Euro will remain under pressure as problem is structural in nature – many economies lack a credible plan to service their debt.
- ❖ Uncertainty in oil markets (“Arab Spring”) already factored into oil price expectations

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## **GLOBAL ECONOMIC OUTLOOK**

### **Remains Risky Mainly Because of:**

- ❖ Structural problems underlining the financial meltdown will take time to overcome.
- ❖ No real effort to reform global financial infrastructure which led to melt down in first place

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## **IMPACT OF CURRENT UNCERTAINTY ON SOUTH ASIAN ECONOMIES**

- ❖ Remittances: no satisfactory explanation as to what has driven their continuous increase post-9/11. Could therefore be affected .
- ❖ Exports: given very low-level of intra-regional integration global developments could impact region more (as compared to say East-Asia).
- ❖ Oil: out look on prices stable as long as US. Economy and Europe remain subdued.
- ❖ Except India capital inflows and exchange-rate interventions not major factors.
- ❖ Supply constraint mainly energy slowing down growth and contributing to price pressures.

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## **INFLATION IN SOUTH ASIA**

- ❖ Cost-push/Supply shock mainly driving inflation.
- ❖ Past commodity / oil shocks pushed up inflation but most countries returned to pre-shock levels.
- ❖ Varying impact dependent on extent of passing-on increase in food grain/oil increases to consumers.
  - India (controls on exports of food grains)
  - Pakistan (adjusted wheat prices to world prices)

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## **FISCAL/MONETARY POLICY RESPONSE TO INFLATION: SOUTH ASIA**

- ❖ Monetary policy tools - main policy response.
- ❖ Mostly interest rate (policy rate) increased to contain inflationary pressures.
- ❖ Effectiveness of interest rate diluted if government financed fiscal deficits through central bank.

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## **WHY CONTAINING INFLATION REMAINS MAJOR PRIORITY IN ECONOMIC POLICY MAKING – SOUTH ASIA:**

- ❖ South Asia: Highest Concentration of World Poverty
- ❖ Over 40 percent of the world's poor (less than US\$1.25) and two-thirds of worlds undernourished children live in South Asia.

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## **KEY ISSUES RELATED TO MACRO- ECONOMIC MANAGEMENT**

- ❖ Given wide fluctuations especially food grain prices how should government respond in terms of domestic price adjustment.
- ❖ Trade-off between growth and inflation.
- ❖ Social Protection / Safety net measures.

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## FINAL LESSONS: SOUTH ASIA

- ❖ Basic lesson is the need to ensure macro-economic stability which is the best insurance against external instability and shocks.

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## Annexure

### South Asia: Impact of the Financial Crisis GDP Growth Rates

| Country    | FY 2004 | FY 2005 | FY 2006 | FY 2007 | FY 2008 | FY 2009 | FY 2010 | FY 2011 |
|------------|---------|---------|---------|---------|---------|---------|---------|---------|
| Bangladesh | 6.3     | 6.0     | 6.6     | 6.4     | 6.2     | 5.9     | 5.5     | 6.0     |
| India      | 8.5     | 7.5     | 9.5     | 9.6     | 9.3     | 6.8     | 8.0     | 8.6     |
| Pakistan   | 7.5     | 9.0     | 5.8     | 6.8     | 3.7     | 1.7     | 3.8     | 2.4     |
| Sri Lanka  | 5.4     | 6.2     | 7.7     | 6.8     | 6.0     | 3.5     | 8.0     | 8.0     |

Source: Economic Survey of Pakistan, 2011; Economic Survey of India, 2009; Bangladesh Economic Review, 2011; Economic Survey of Sri Lanka, 2009; ESCAP, Economic and Social Survey of Asia and the Pacific, 2011.

### Fiscal Deficit as Percent of GDP

(%)

| Country    | FY 2004 | FY 2005 | FY 2006 | FY 2007 | FY 2008 | FY 2009 | FY 2010 | FY 2011 |
|------------|---------|---------|---------|---------|---------|---------|---------|---------|
| Bangladesh | -3.2    | -3.3    | -3.2    | -3.2    | -5.1    | -4.1    | -5.0    | -4.8    |
| India      | -8.5    | -7.5    | -6.5    | -5.4    | -4.1    | -8.5    | -9.5    | -7.3*   |
| Pakistan   | -2.4    | -3.3    | -4.3    | -4.3    | -7.6    | -5.3    | -6.3    | -4.0*   |
| Sri Lanka  | -7.9    | -8.4    | -8.0    | -7.7    | -6.8    | -10.0   | -7.6    | -       |

Source: Ibid.

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Annual Average inflation Rates (%)

| Country     | FY 2004 | FY 2005 | FY 2006 | FY 2007 | FY 2008 | FY 2009 | FY 2010 | FY 2011 |
|-------------|---------|---------|---------|---------|---------|---------|---------|---------|
| Bangladesh  | 5.8     | 6.5     | 7.2     | 7.2     | 9.9     | 7.0     | 6.5     | 6.0     |
| India (WPI) | 5.5     | 6.4     | 4.3     | 6.5     | 4.8     | 8.0     | 3.6     | 9.4*    |
| Pakistan    | 4.6     | 9.3     | 7.9     | 7.8     | 12.0    | 20.8    | 11.7    | 14.1    |
| Sri Lanka   | 9.0     | 11.0    | 10.0    | 15.8    | 22.6    | 5.0     | 6.0     | n.a.    |

Source: Ibid

Current Account Balance (as Percent of GDP) (%)

| Country    | FY 2004 | FY 2005 | FY 2006 | FY 2007 | FY 2008 | FY 2009 | FY 2010 | FY 2011 |
|------------|---------|---------|---------|---------|---------|---------|---------|---------|
| Bangladesh | 0.3     | -0.9    | 1.3     | 1.4     | 0.8     | 0.8     | 0.2     | -0.1    |
| India      | 2.3     | -0.4    | -1.2    | -1.0    | -1.3    | -2.3    | -2.8    | n.a.    |
| Pakistan   | +1.3    | -1.6    | -4.4    | -5.1    | -8.7    | -5.7    | -2.2    | +0.4    |
| Sri Lanka  | -3.1    | -2.7    | -5.3    | -4.5    | -9.8    | -0.5    | -3.7    | -       |

Source: Ibid

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**THANKS**

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