

Commentary

The times they are a changing

Times are tough and by all accounts they are becoming more so. We read about it every day in the press now and, thankfully for Malacañang, people are becoming more concerned over rice, oil and the prospects of a US recession than they are about the latest scandal to hit government. This is a pity really because it makes reform, or the groping towards reform, even less likely than it was before. This can only lead the country into a tailspin.

Finance ministers from around the world met last weekend to grapple with the deepening financial crisis that started in the United States but which is now spreading like a virus to the rest of the world. Forget the 1997 Asian meltdown; the looming crisis has been described as “the biggest threat to the global economy since the Great Depression.”

The latest US employment data suggests a labour market that is rapidly deteriorating. This is putting further pressure on the US housing market which in turn is facing a credit crunch. The problems of the US housing sector are now being felt more widely. The problem has grown beyond the US sub-prime market and—in part because some central bankers are responding to the weakening US dollar by raising interest rates in an effort to avoid inflation—now has global implications with house prices receding in many markets. The US dollar continues to slide putting additional pressures on those countries who have tied their own currency to the greenback.

*Come gather 'round people
Wherever you roam
And admit that the waters
Around you have grown
And accept it that soon
You'll be drenched to the bone.
If your time to you
Is worth savin'
Then you better start swimmin'
Or you'll sink like a stone
For the times they are a-changin'.*

Bob Dylan on climate change
1964

Both the Economist Intelligence Unit as well as the IMF have this past week reassessed their global growth forecasts for this year and next. Both come up with very similar numbers. The IMF now sees world growth this year at 3.7 percent and at 3.8 percent in 2009. The EIU forecast is 3.7 percent this year rising to 3.9 percent next year. (Both are at Purchasing Power Parity rates although assumptions may vary.)

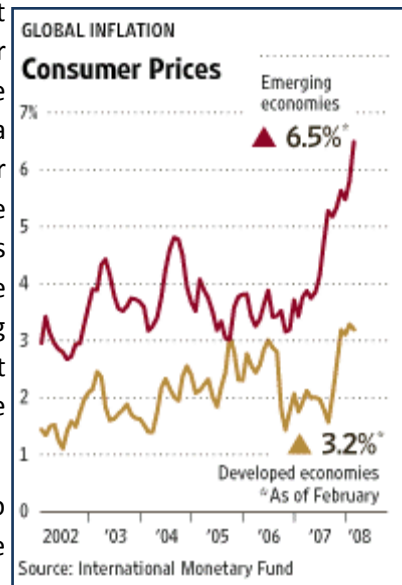
The IMF believes that there is a “25 percent chance that global growth could fall below 3 percent this year—equivalent to a global recession.” This is scary stuff. Up until recently we were all expecting slower growth this year but nobody was talking about a global recession.

Both the IMF and the EIU see the chances of a mild recession in the United States as becoming more likely. Indeed the EIU believes it to be a certainty although a slow rebound is expected in 2009. The pace of the rebound will be largely governed by lingering problems in the housing market and balance sheet adjustments of US banks.

Inflation at a decade high

Rising food and energy costs are prime drivers of global inflation at the moment. In developed economies the annual consumer inflation rate is now up at around 3.5 percent while in the emerging economies it has risen to around 6.5 percent (a consequence of the fact that food and fuel prices assume a higher proportion of spending patterns in such markets). Both are trending sharply upwards. Core inflation is not rising as quickly as overall inflation and responses have varied. Central bankers in the US and in the UK are focusing on the risk of recession by cutting interest rates so as to stimulate spending while elsewhere interest rates have been raised in an effort to reduce liquidity and slow the inflation rate. The results are uncertain—remember “stagflation”?

The benign inflation environment of recent years is believed to have come about as a direct consequence of globalization and the



transfer of much of the world’s manufacturing resources to countries such as China, India, Russia and the former Eastern bloc. But wage rates in these countries are now increasing rapidly

and the goods they manufacture for the world market are becoming more expensive adding to the squeeze on consumers and nowhere is this more pronounced than among the poorer sections of society. Globalization as a factor in ensuring a low-inflation growth climate may now be a thing of the past.

Many countries, China and the Philippines included are raising workers base salaries to mitigate the effects of inflation but this itself is inflationary and only protects those in the formal sector (which in the case of the Philippines is only a fraction of the workforce) and only serves to worsen the plight of those in informal employment and who are usually at the bottom of the social pyramid.

Exchange rate volatility

While the US currency continues to show a longer-term decline, financial markets generally are becoming more volatile.

According to a recent G7 communiqué, the Euro has risen more than 17 percent against the US dollar over the past year and is believed to now be overvalued—“no longer in line with economic fundamentals” is how the EC

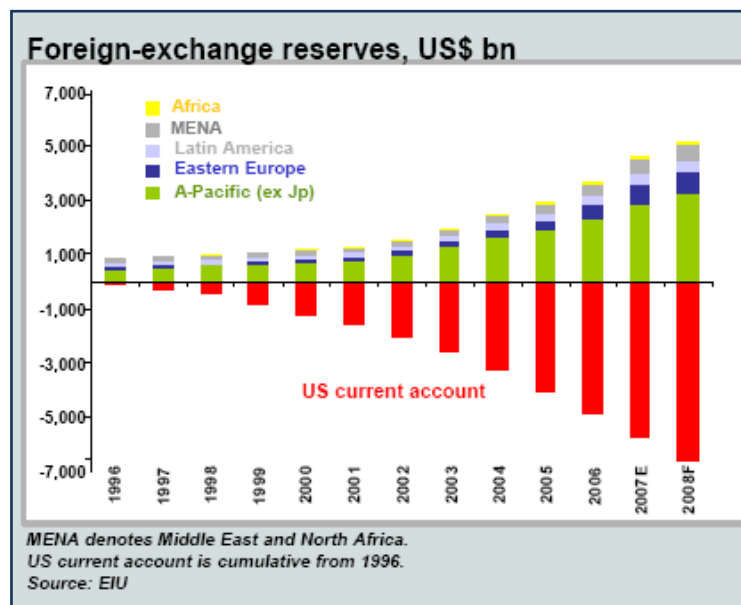


Figure 2
 EIU data from regional outlook

Commissioner for Economic and Monetary Affairs described it recently. This overshoot has already impacted on European exports and contributed to the economic slowdown there.

Part of the currency problem is due to the present current account imbalances—most notably that of China and the Gulf States. And emerging markets are flexing their financial muscle—as the Philippines knows only too well in its recent dealings with China.

A realignment is called for but it will not come about easily. China, the biggest winner so far from recent growth is slowly appreciating the Renminbi but continues to do so at a slow pace and to the chagrin of the United States which pays much of the price for an undervalued Chinese currency.

Food and energy

According to the World Bank, global food prices have increased by 83 percent during the past three months and by 147 percent over the past year. Farm costs are increasing around the world and cost pressures on the agricultural sector are intensifying as fuel and fertilizer costs soar in price.

Rice prices have more than doubled since the beginning of 2008. World Bank President Robert Soellick warned recently that 33 countries—the Philippines and Indonesia among them—were at risk of social upheaval because of rising food prices. Rioting over the rising cost of food, which can account for up to 75 percent of a family budget in the poorest communities, has already broken out in several African countries and in Haiti the president was forced to resign over the food price issue. No wonder Malacañang is taking the rice issue very seriously indeed.

The high price of oil—which this past week broke the \$112 per barrel for May 2008 delivery—has been blamed largely on speculators but while speculation is playing a role in the food market too, it is not the primary factor. US policies pushing corn-based ethanol have been singled out for criticism at recent international meetings but this too is only part of the story. Commodity prices are rising generally as populations in emerging markets become more affluent and with the emergence of a middle-class with middle-class appetites. The general consensus is that high food prices will be around for a while. Countries such as Brazil that base their ethanol production on sugar are in a good position to reap the benefit of the changing market condition. Is there a message her for the Philippines?

As several analysts have pointed out the real danger of food scarcity comes from reverse protectionism as countries move to protect their own food reserves by banning or taxing exports. Indonesia, which is experiencing a bumper harvest and is expected to produce 32.63 million metric tons of rice this year (and with a surplus of 1.2 million tons), has said it will ban private commodity traders from exporting Indonesian rice. Indonesia's long-term position remains precarious however, although for the moment it appears to have the situation under control.

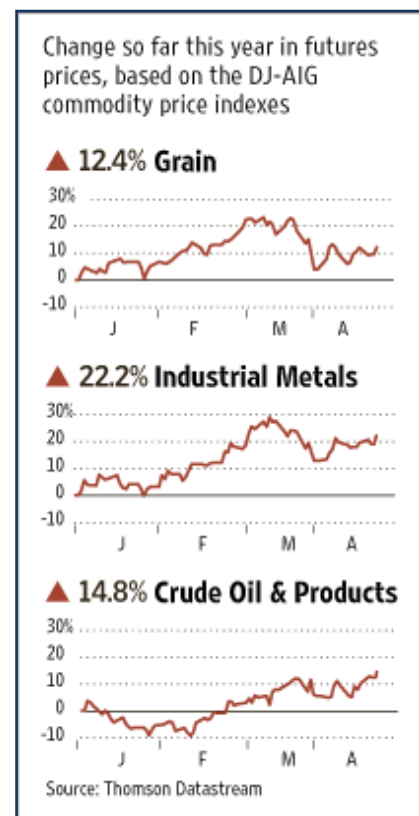


Figure 3
Wall Street Journal, 10 April 2008

Not so in the Philippines which continues to be the world's largest importer of rice due in large part to the short-sightedness of agricultural policies. According to the Bureau of Agricultural Statistics, annual per-capita rice consumption in the Philippines grew by 28 percent to 118.7 kilograms per year in 2006 from 92.53 kg in 1990. That works out to around 11 million tons of rice a year in total. This year local consumer needs will be met by importing 2.2 million tons of rice from neighbouring countries—assuming supplies are available.

Per capita rice consumption is higher in the Philippines than elsewhere in Asia, mainly because of the lack of other dietary alternatives. Rice consumption generally declines as per capita income increases. In Japan the comparable per capita figure is 61 kg; in Taiwan, 48 kg and in South Korea, 79 kg. These numbers put the political importance of rice supply into perspective.

As pointed out in the April 14 2008 issue of the Wall Street Journal, “alone among World Trade Organisation member nations, the Philippines imposed quantitative restrictions on rice imports, implemented by a government monopoly.” The result has been domestic rice prices that have been historically around twice the global price while, ironically, local rice farmers have remained among the poorest of the poor. In the highly politicised environment (which will only get worse in the run up to the 2010 presidential election) there is much finger-pointing and stop-gap measures being put in place but no sign of a longer-term strategy.

Climate change

This commentary is about global uncertainties and would be incomplete without a mention of climate change. Climate change remains the wild card in the pack. There is now little doubt that human-induced activities are changing the world's weather patterns and the rate of change is accelerating. Extreme weather events are increasing. Eleven of the twelve warmest years on record (at least insofar as the last two centuries are concerned since records were first kept) have occurred since 1995. In the summer of 2007 the Arctic Ocean had 23 percent less permanent ice cover than it did in September 2005. This not only means rising sea levels but also—because of reduced reflectivity and greater absorptive capacity of sea water compared to ice—the rate of global heating is increasing. A number of scientists believe that the world is close to the “tipping point “if it has not been reached already. (At present rates of decline in the polar ice cap, it will be possible to sail to the North Pole during summer months by 2015.)

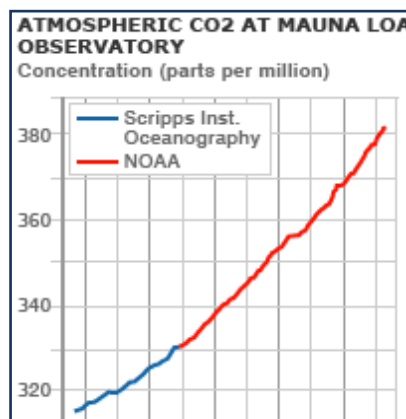


Figure 4
Rise of atmospheric CO₂; reproduced from BBC.com

The Philippines because of its long coastline and coastal communities as well as because of its location in a typhoon belt is one the countries at greatest risk. More on climate change another time (this subject will be dealt with in our Executive Forum meeting next week) but we point out here that once more the Philippines appears to be ill prepared.

Uncertain times indeed

The Philippine government now concedes that it may have to lower its official gross domestic product (GDP) growth target range (of 6.3 percent to 7.0 percent) for 2008 though is still hopeful

that growth may yet come in at the lower end of the forecast provided remittances continue to grow and support domestic consumption.

But already there is an obvious shallowness in efforts to talk up the economy. While remittances, investments and exports may be increasing in dollar terms (helping the balance of payments data and gross international reserves), in peso terms the reverse is the case. Filipinos are earning less for their exports and remittance income is buying less. Heaven help the country if remittances actually start to decline. The net OFW outflow appears to have been around 370,000 last year compared to twice that number the previous year. This is not a good sign.

The IMF takes a more sober view and assesses domestic growth prospects for the Philippines this year at 5.8 percent and the same for 2009. The Economist Intelligence Unit, its latest country forecast, predicts 5.4 growth this year and 5.5 percent for next. We believe that these numbers are more believable but may yet turn out to be optimistic. The trend of forecasting is clearly downwards.

Even so, the number of people going hungry in the Philippines has increased despite the unprecedented global growth of the past decade which has washed off onto the Philippine economy. If the government could not get it right before, what chance does it have now?

The times they are a changin' indeed. Times are not only getting tough; they are getting downright dangerous.

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