

The Recent Surge of Food and Energy Prices in Eastern Europe: Trends, Impact and Policy Responses

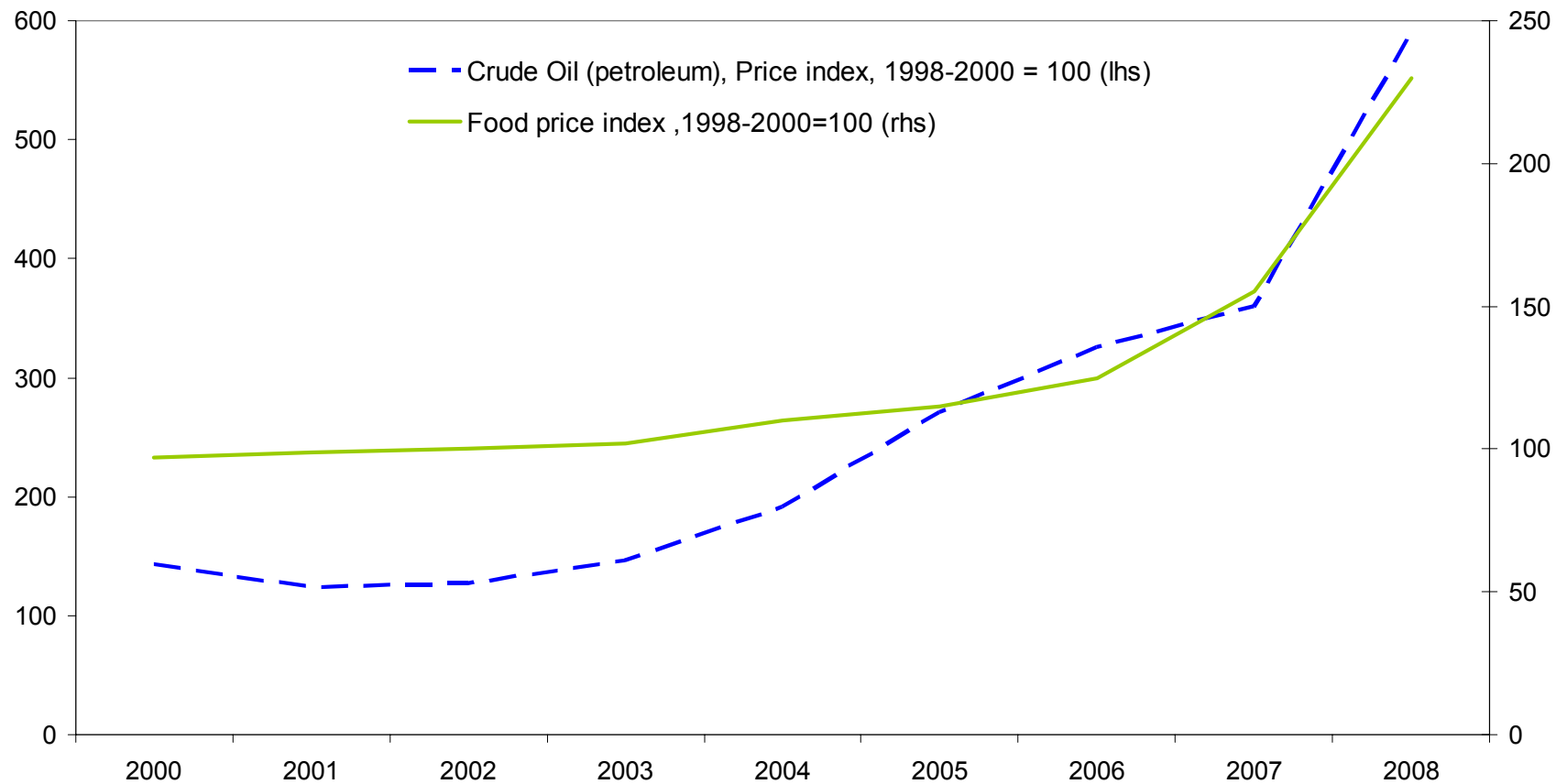


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OeNB East Your Fixe
Vienna, June 18, 2008

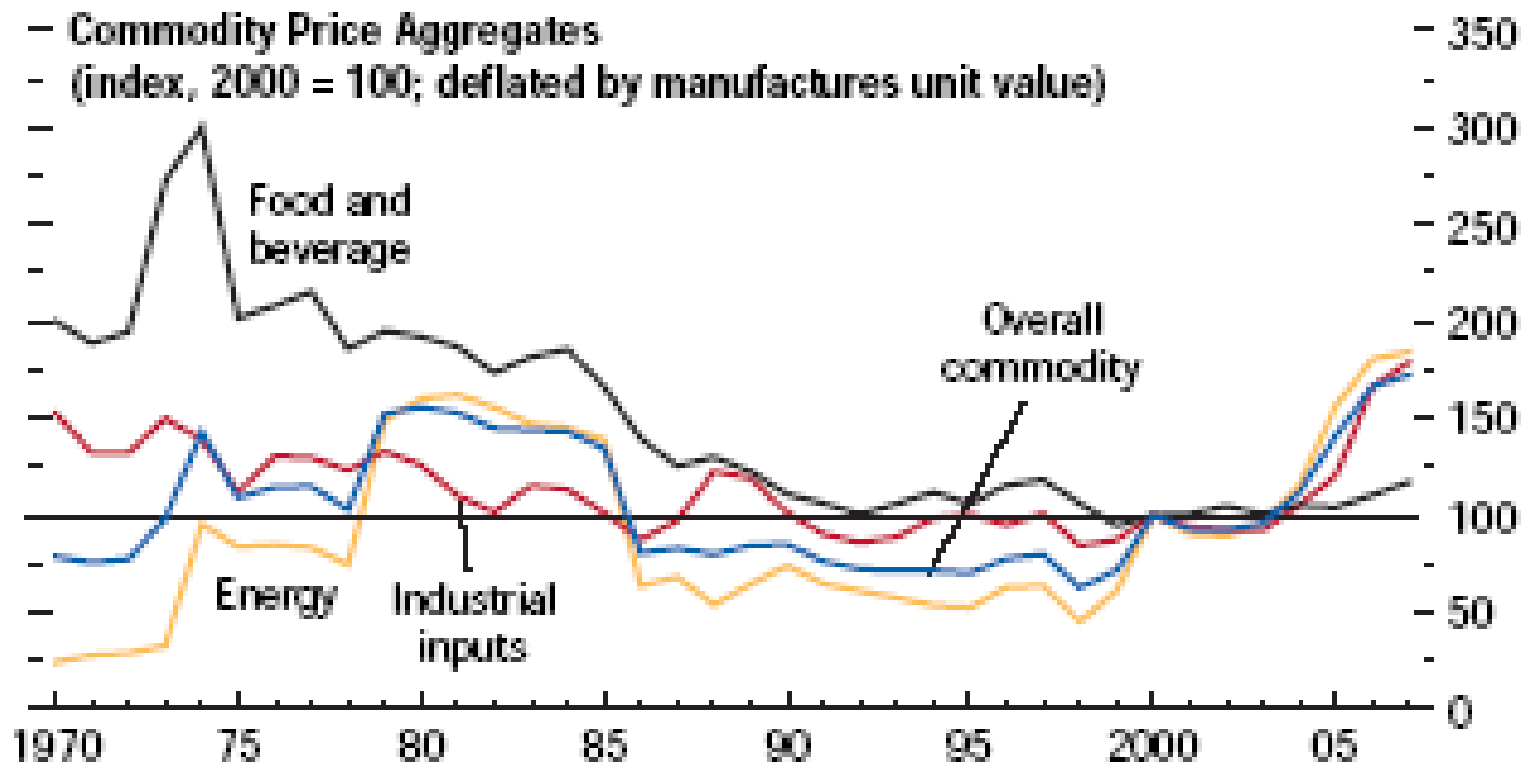
Outline

- Global Trends
- Impact on External Balances
- Impact on Inflation
- Macro Policy Context
- Policy Responses

Global food and energy prices are on the rise



This follows two decades of low global commodity price inflation



The commodity price boom is unusually long and broad-based

	Latest turning point	Price change (percent)		Duration (months)	
		From latest turning point	Average of past booms	From latest turning point	Average of past booms
Crude oil	December-01	210.1	54	73	18
Food	November-04	30.4	21	38	18
Metals	March-03	104.8	43	58	22

With few exceptions, the external position in Europe will deteriorate

Impact of Food and Fuel on Inflation and the Current Account 1/

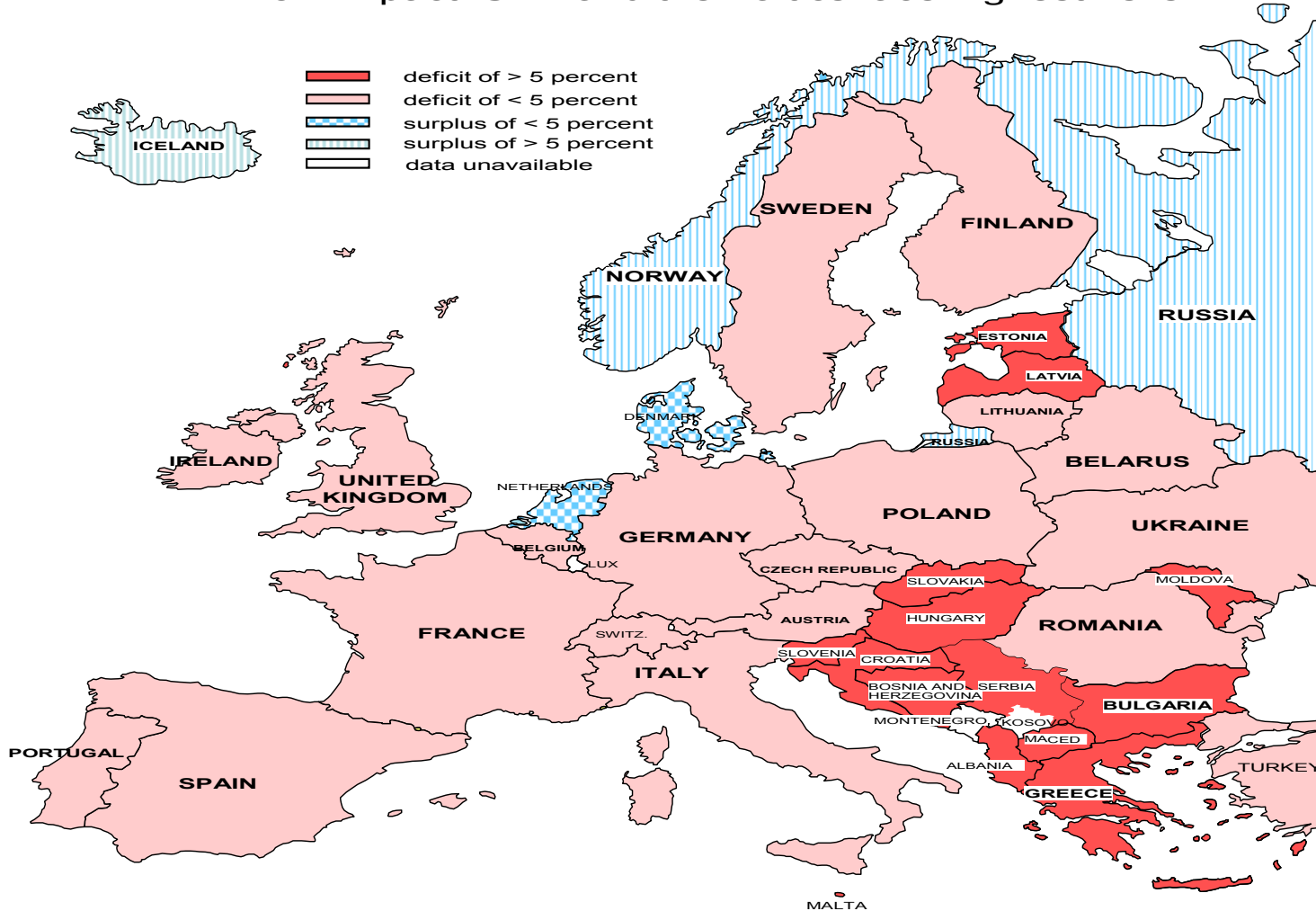
	Net exports 2/		
	Food	Fuel	Total
Europe	-0.2	-0.5	-0.7
<i>excluding Russia and Norway</i>	-0.1	-2.2	-2.4
Advanced economies	-0.2	-1.4	-1.6
New EU members	0.1	-3.6	-3.5
Other emerging economies	-0.8	8.1	7.4
<i>excluding Russia</i>	0.2	-4.6	-4.4

1/ Regional averages weighted by GDP.

2/ In percent of GDP, average over 2006-07

South-Eastern Europe and the Baltics will be affected most

. BoP Impact: SEE and the Baltics face highest risks 1/

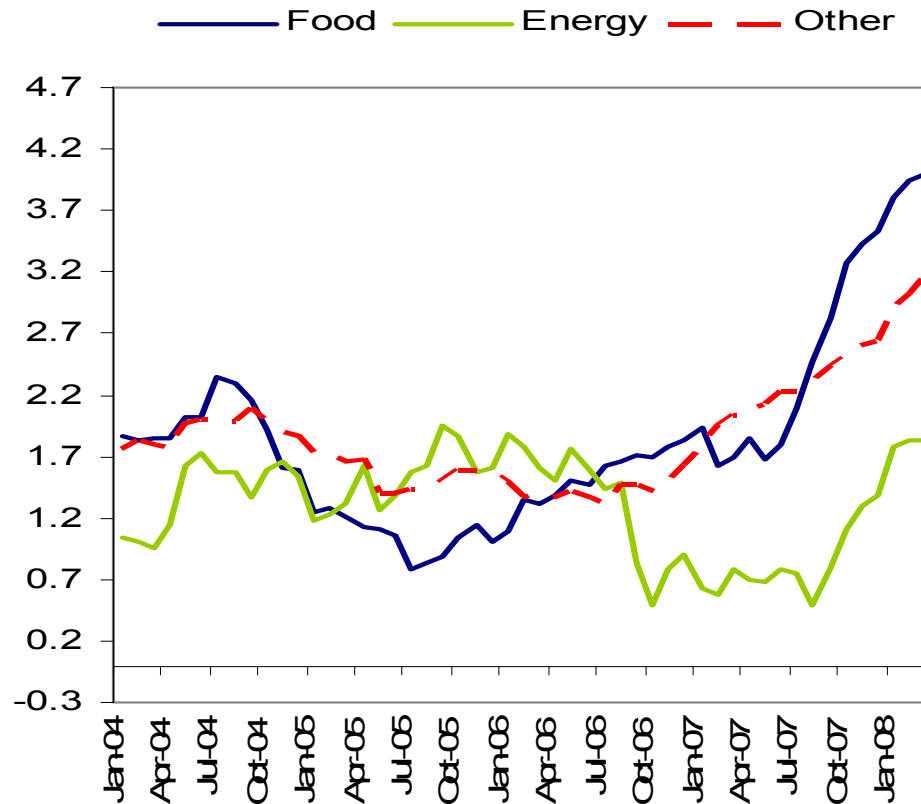


1/ Average food and fuel trade balance in 2006-07, in percent of GDP.

The contribution to consumer price inflation in the new member states is substantial

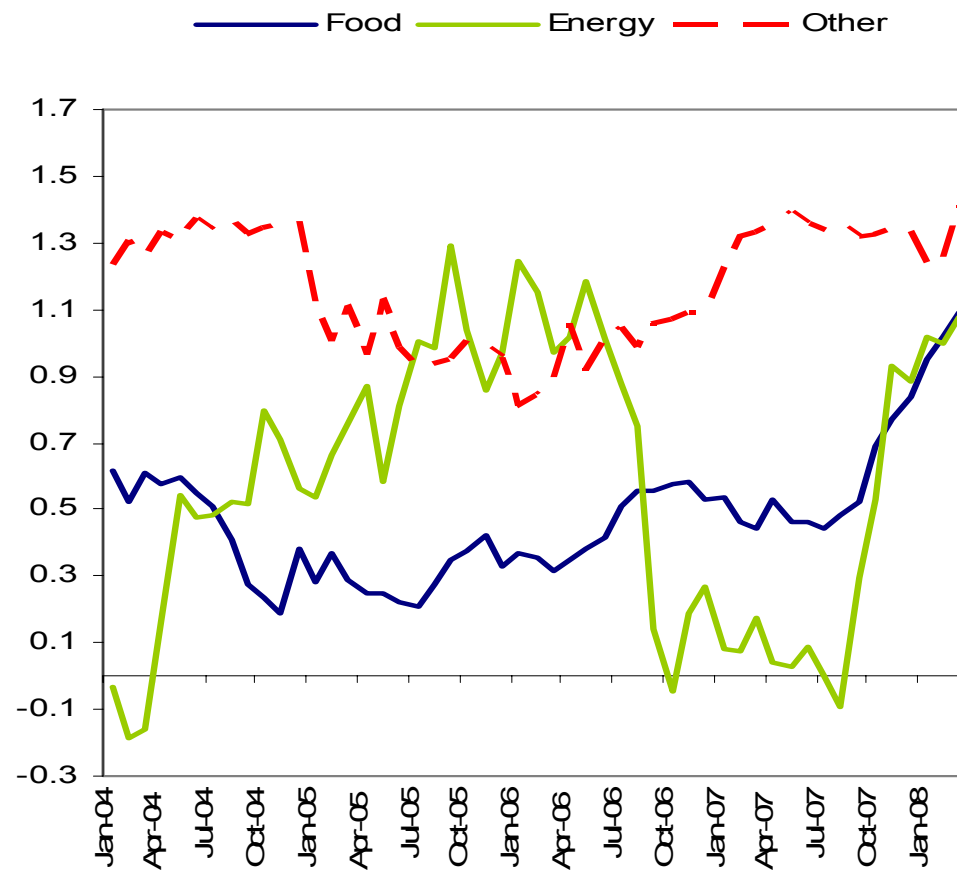
NMS: Contribution to HICP

(YoY, p.p.)



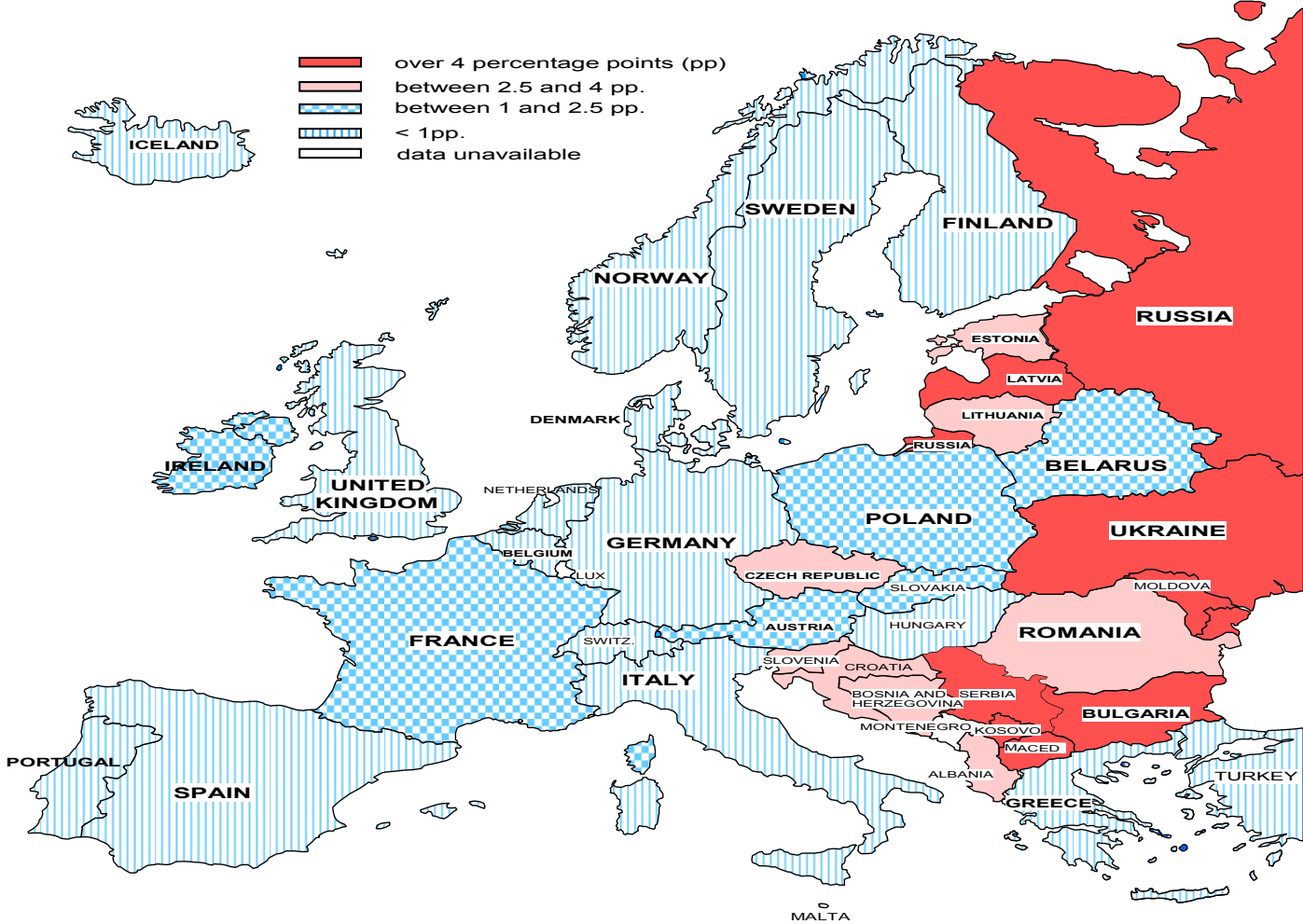
This differs from the developments in the Euro zone

EU12: Contribution to HICP
(YoY, p.p.)



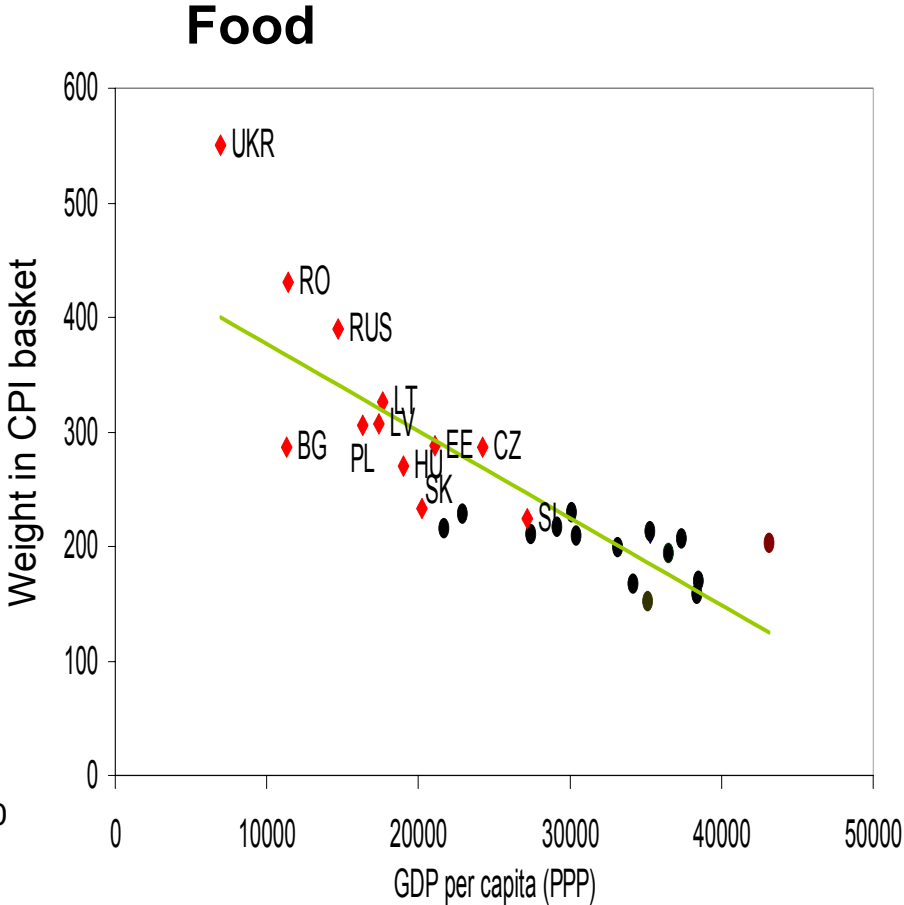
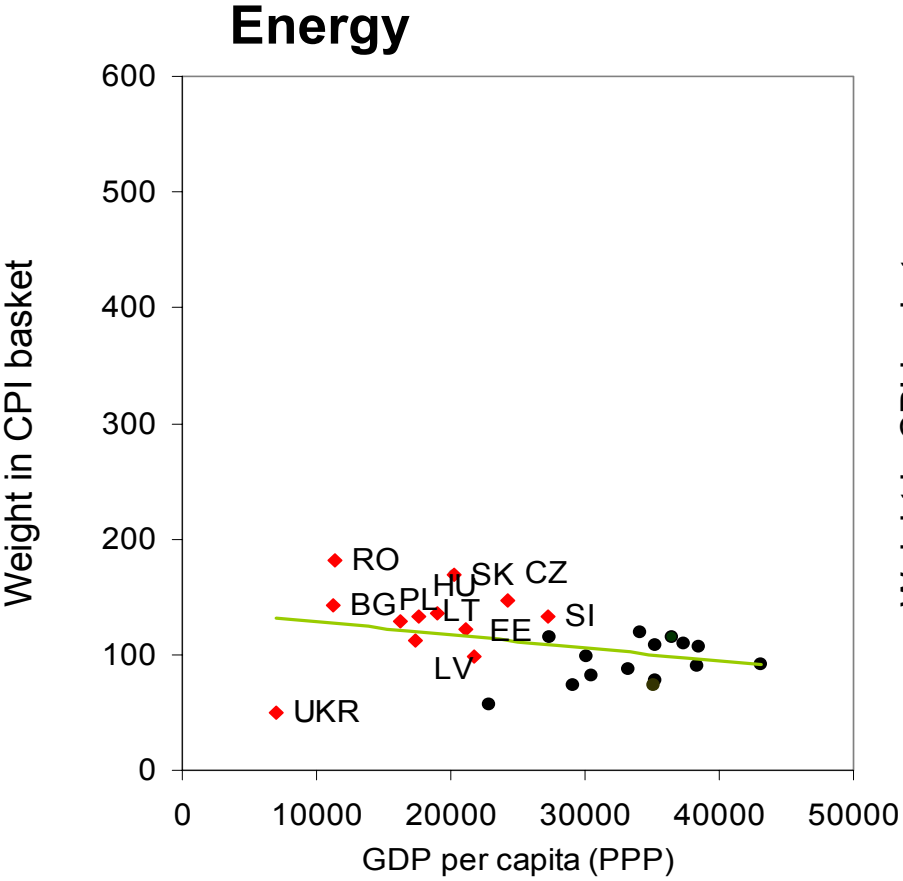
In Eastern Europe, the Baltic and South-East Europe are again affected most

Impact on Inflation: East is affected more than West 1/



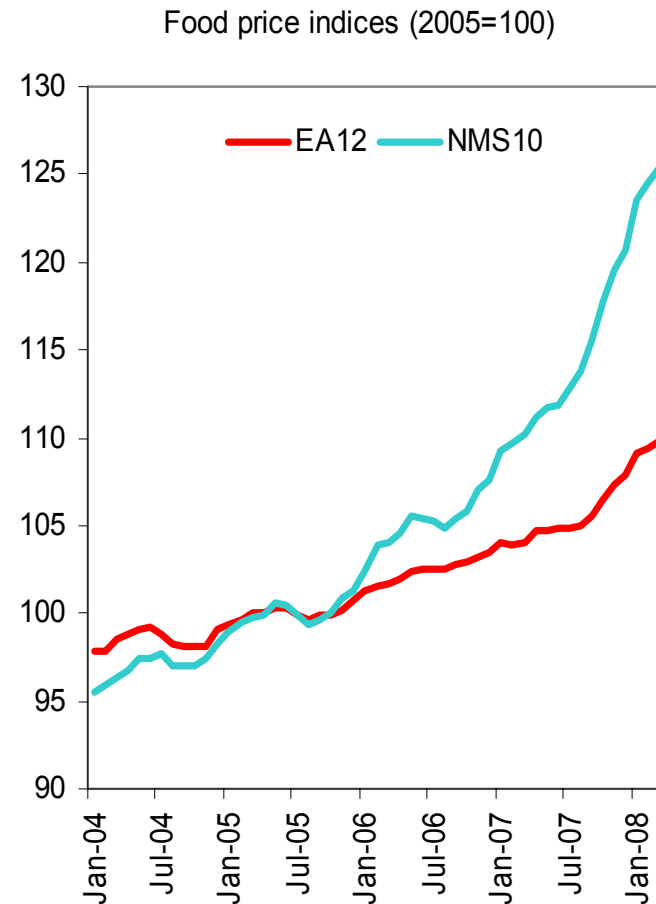
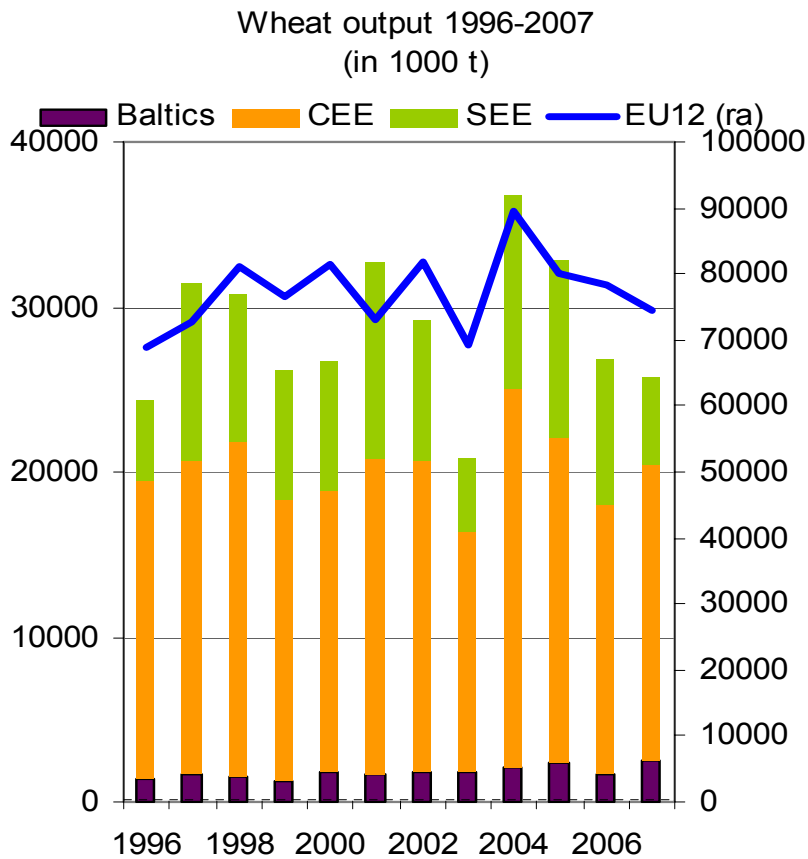
1/ Contribution of food and fuel to the change in twelve-month inflation between end-2006 and March 2008.

This is partly due to a higher weights of food and fuel in the consumption basket



Source:IMF, CSOs.

Local supply conditions may also play a role

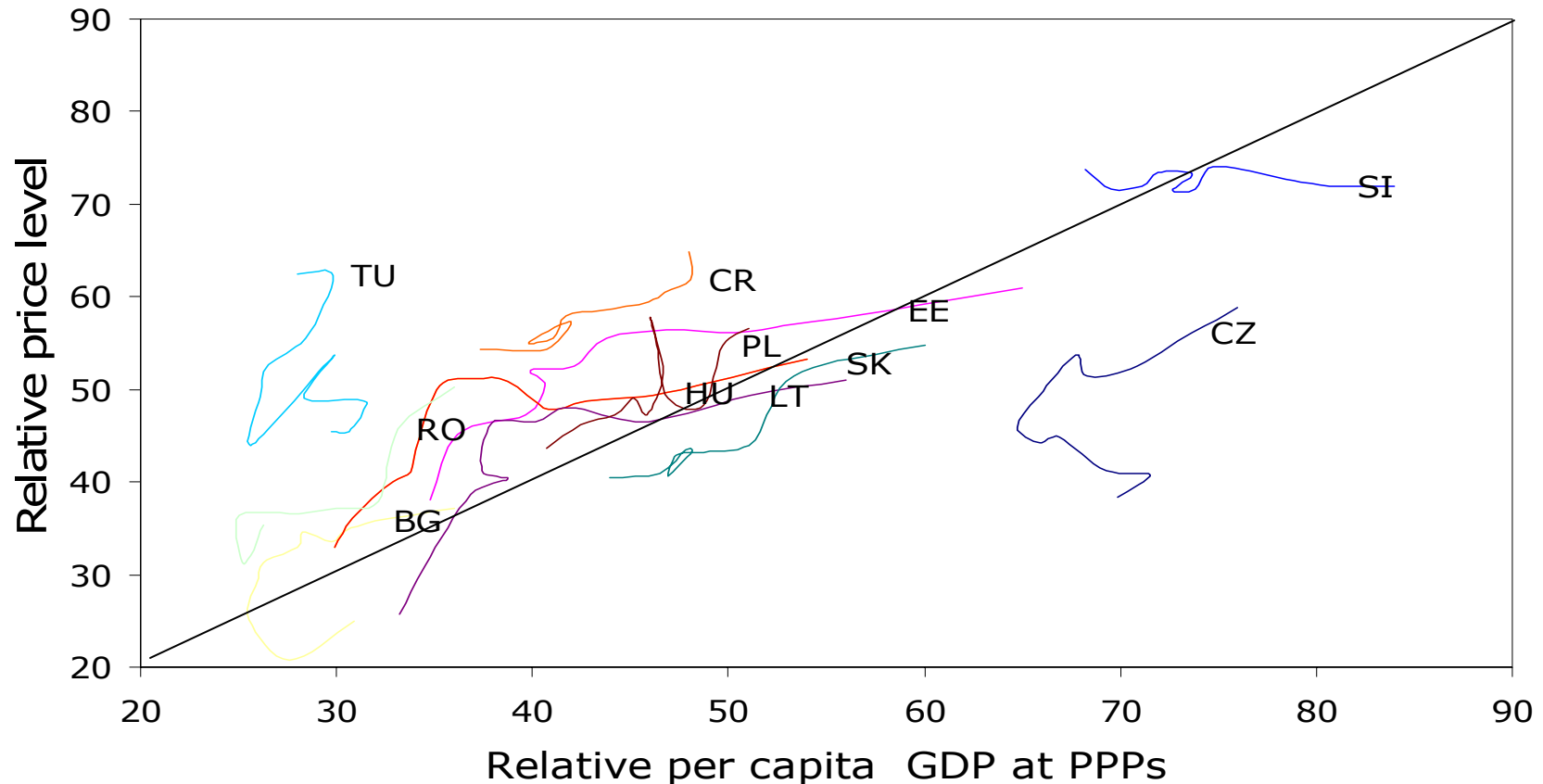


The commodity price surge comes on the top of underlying overheating pressures related to convergence and loose policies

- Price convergence
- Current account deficits
- Recent fiscal policies
- Recent monetary policies

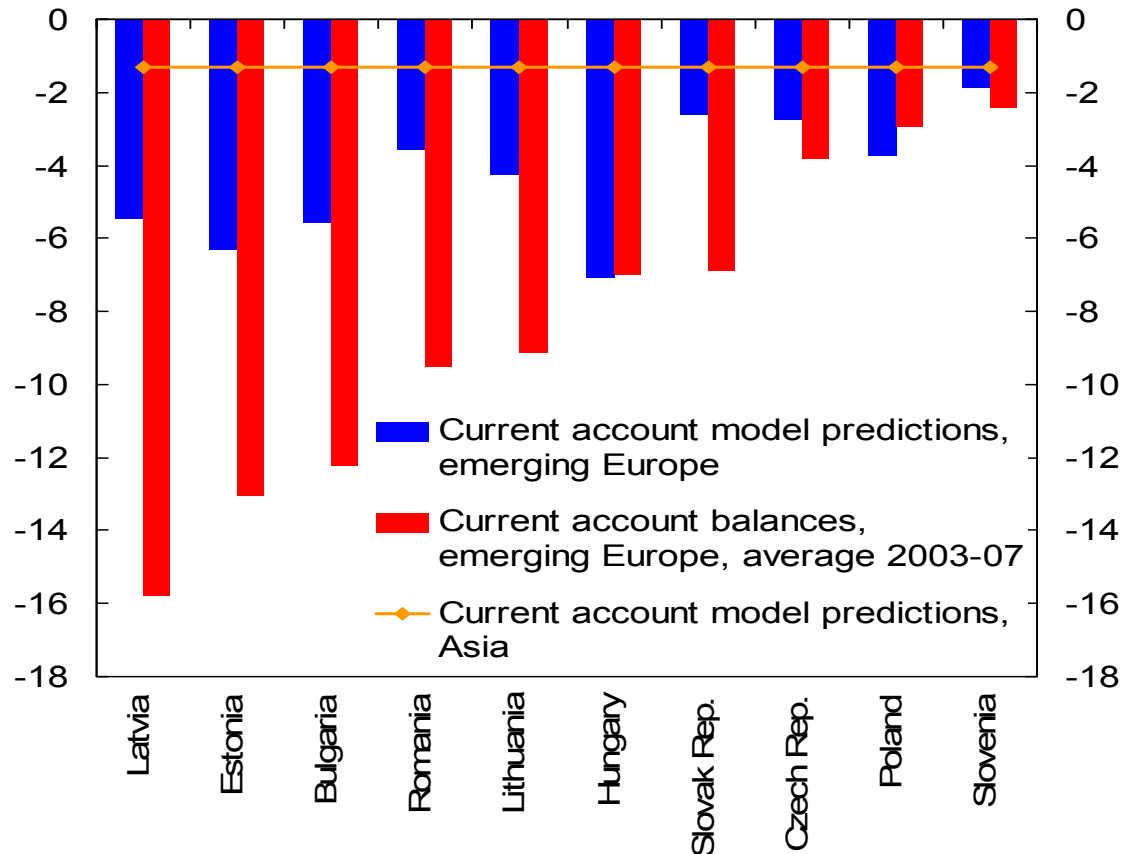
Higher inflation rates is a natural by-product of convergence

Relative price level vs. relative GDP per capita (PPP),
1995-2006, EU25=100



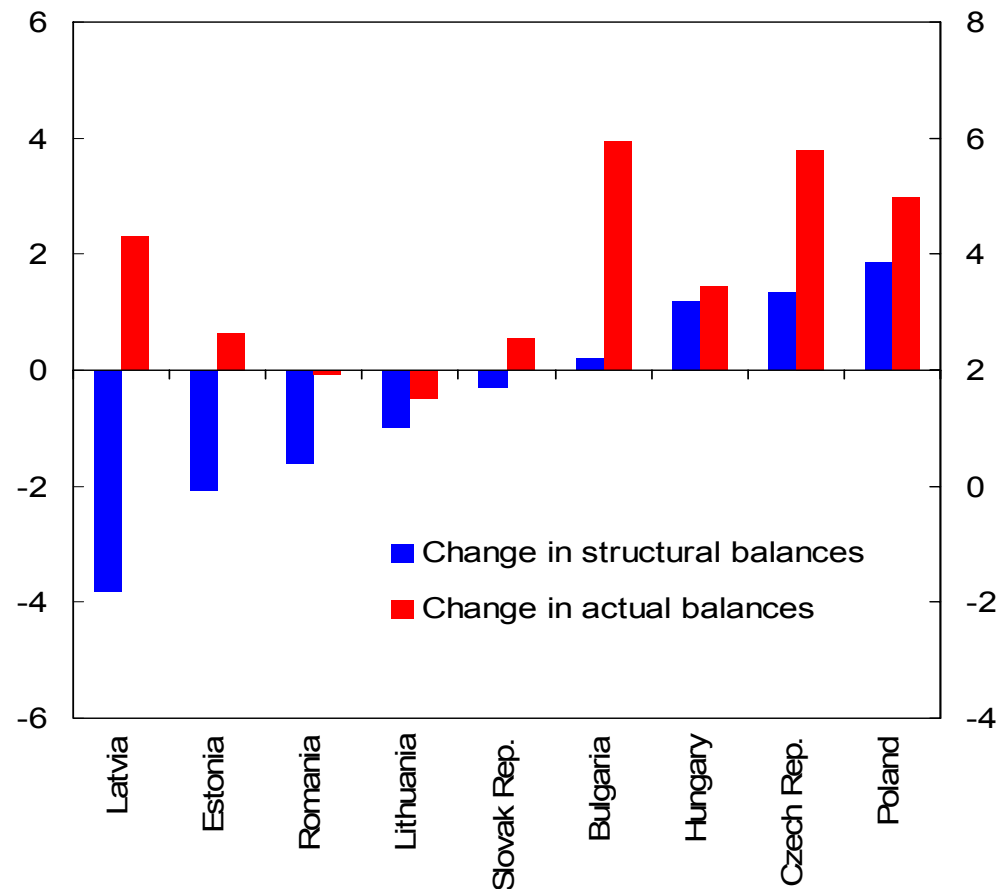
Current account deficits in some new member states already exceed what would be suggested by fundamentals

Current Account Balances and Model Predictions
Percent of GDP



Fiscal policies have been loose during the recent upswing

Change in Actual and Structural Fiscal Balances, 2003–07 1/
Percent of GDP

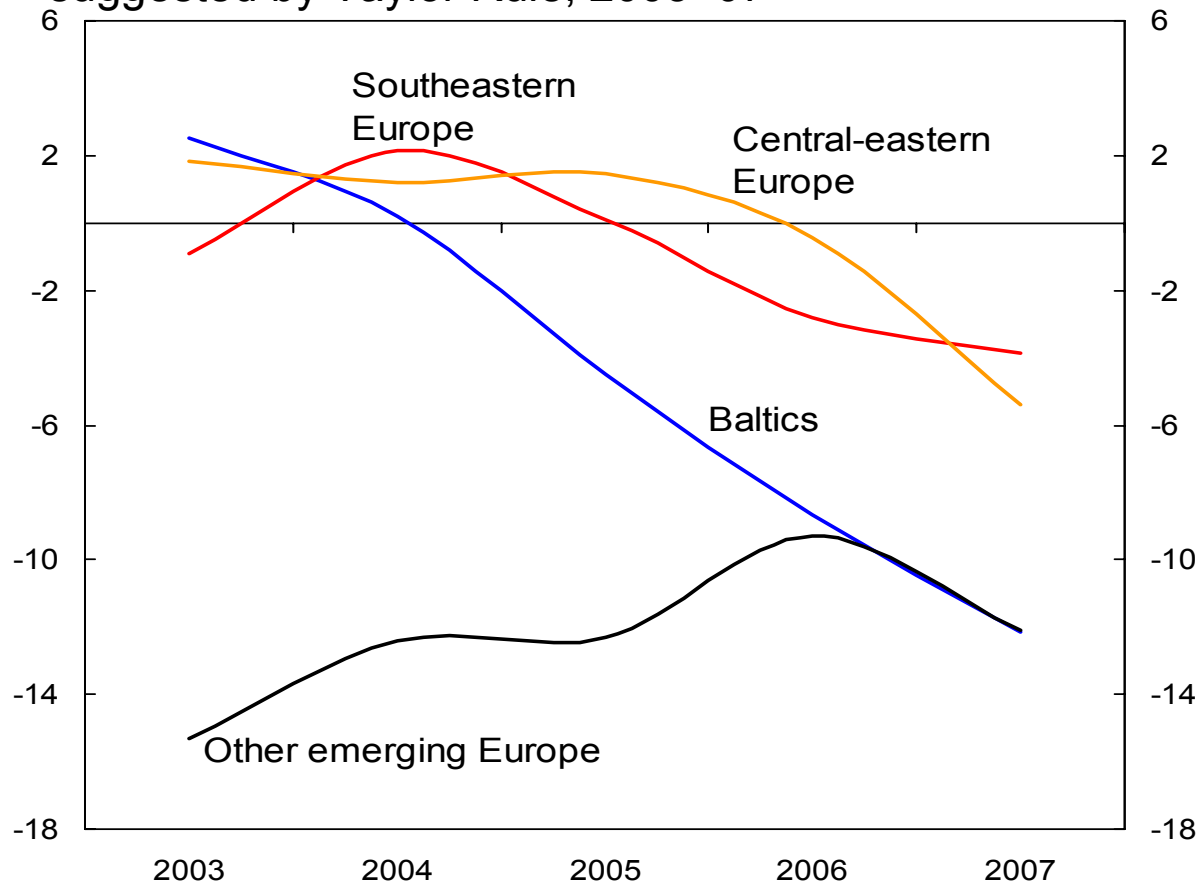


Source: IMF, World Economic Outlook; and IMF staff calculations.

1/ The structural balances do not take into account spending related to pension reform and spending related to EU transfers.

And so have been monetary conditions

Emerging Europe: Lending Interest Rate minus “ideal” suggested by Taylor Rule, 2003–07



Policy responses to date

- **Lower import duties:** EU, Russia, Macedonia, Kosovo.
- **Export taxes** in Russia and Croatia, **export quotas** in Ukraine, **export ban** in Serbia
- **Lower VAT and excises:** Lithuania (food), Macedonia (public transport), Croatia (fuel)
- **Use state commodity reserves:** Macedonia, Moldova, Montenegro, Ukraine
- **Support to agriculture:** Belarus, Croatia, Moldova, EU (set-aside policy suspended)
- **Moral suasion:** Macedonia, Montenegro, Moldova
- **Tighter monetary policy:** most countries with flexible exchange rates

Recommended policy responses

- **Head off second-round effects** by tightening monetary policy, wage restraint, communication that emphasizes temporary character of price spikes
- Targeted temporary **social assistance** if fiscal space permits
- **Structural reforms** to increase supply
- Re-evaluate existing bio-fuel policies
- Avoid distortionary and protectionist measures

Thank you!

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