



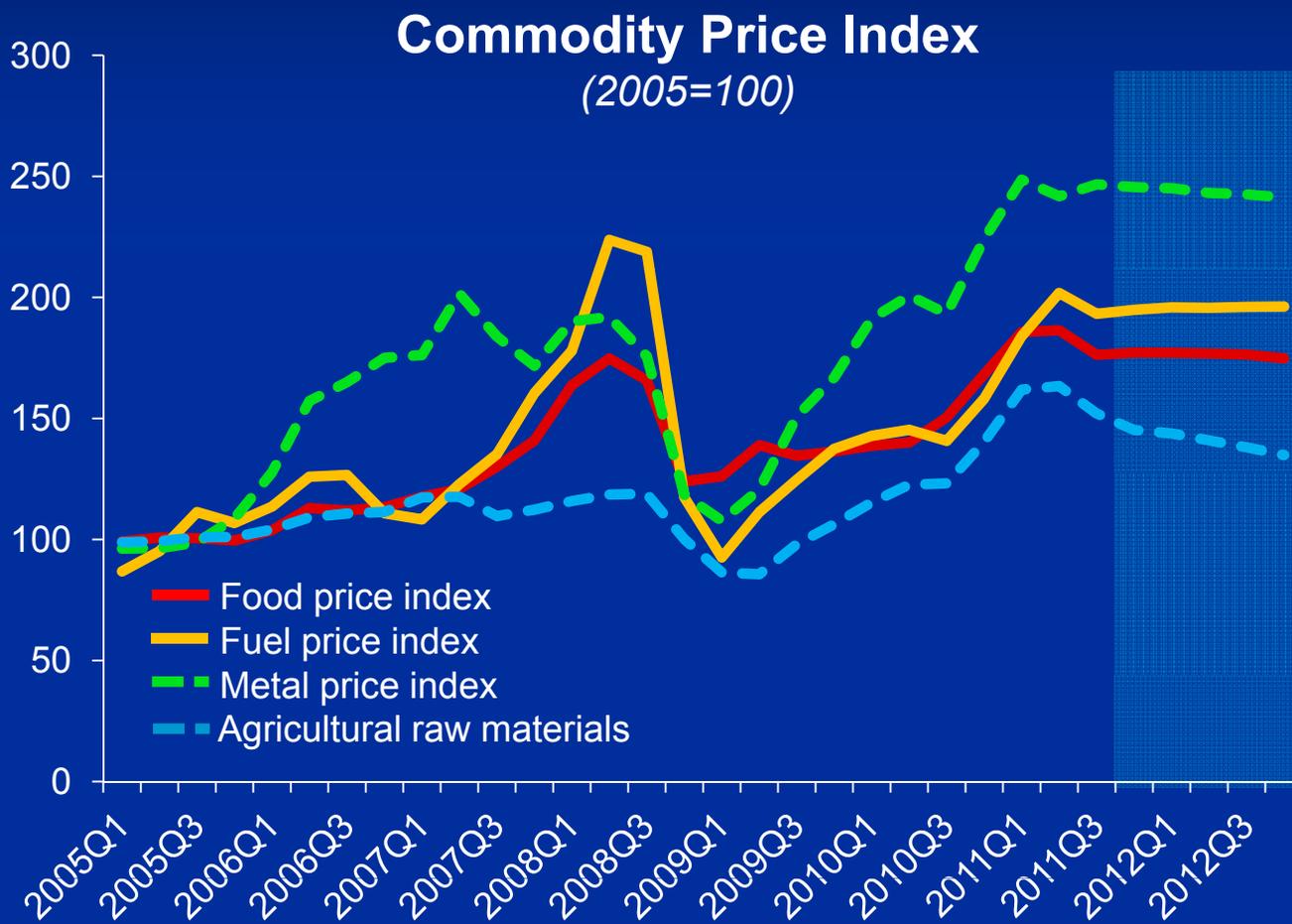
# Commodity Price Volatility

## Impact and Policy Challenges for LICs

Washington DC, Sep. 21, 2011

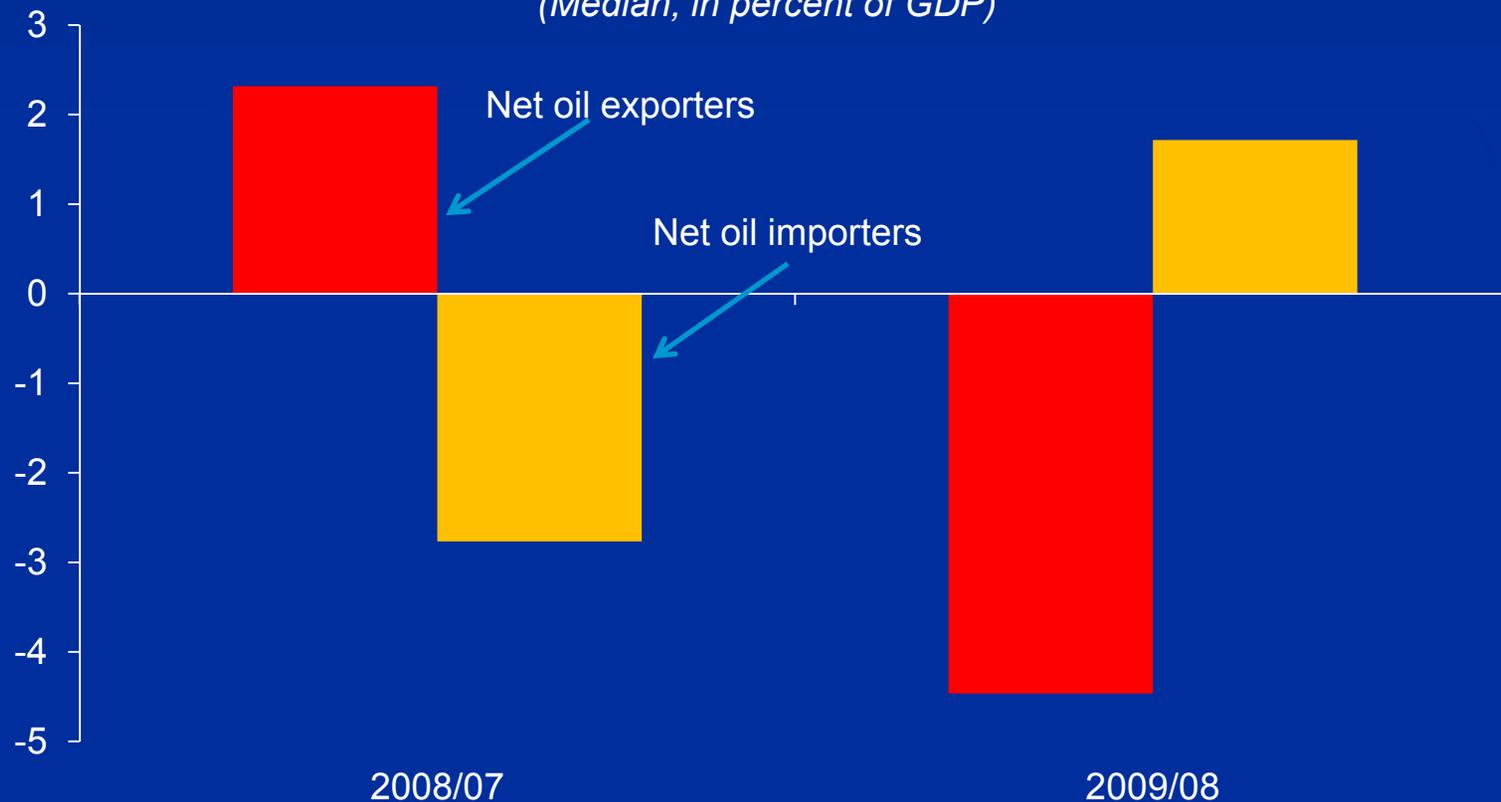
Hugh Bredenkamp

# Global commodity prices—a rollercoaster



# Commodity price shocks can have major impact on LICs' external balances, depending on trade structure...

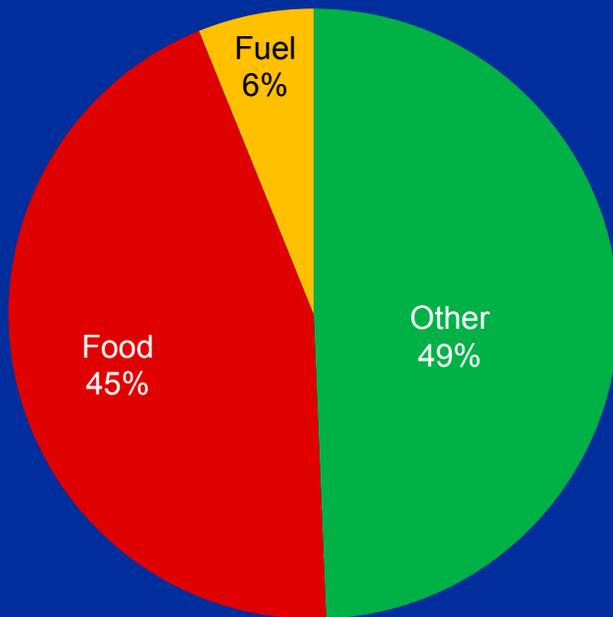
**Changes in Current Account Balance in LICs**  
(Median, in percent of GDP)



# ...and all LICs face inflation and social pressures → tough choices for fiscal and monetary policies

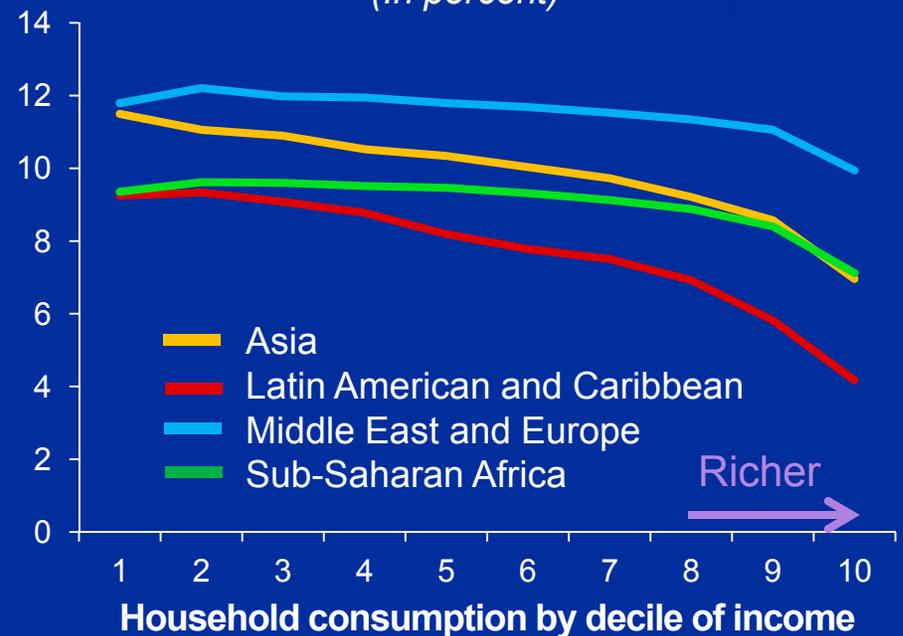
Food and fuel make up half of  
the consumer basket in LICs

Composition of CPI basket in LICs  
(Median, in percent)

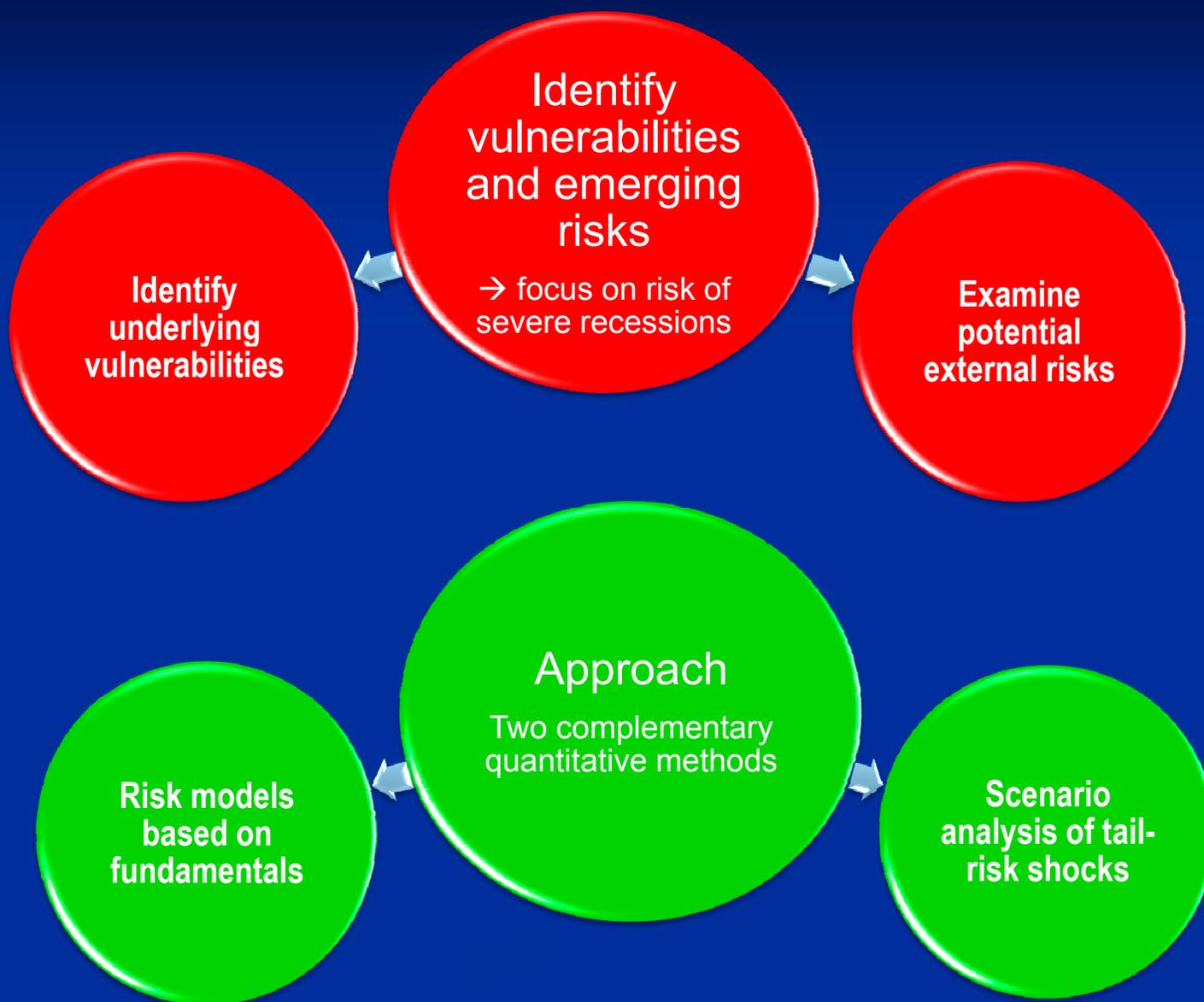


Higher food & fuel prices affect mostly  
the poorest, but middle-income  
households also suffer

Reduction in real household consumption  
(In percent)

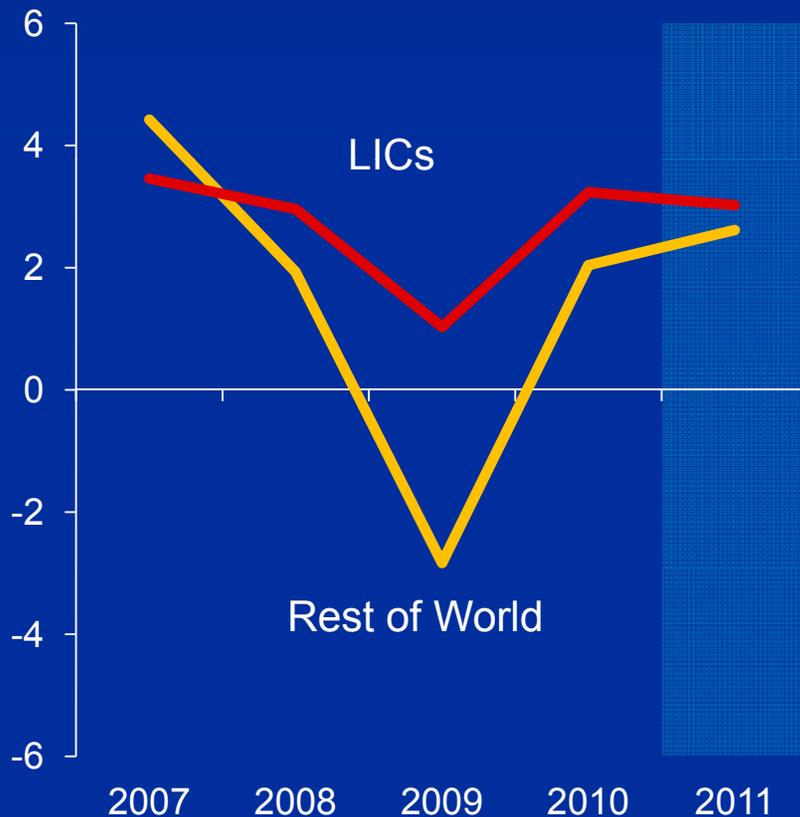


# Assessing vulnerabilities in LICs—VE-LIC a new tool

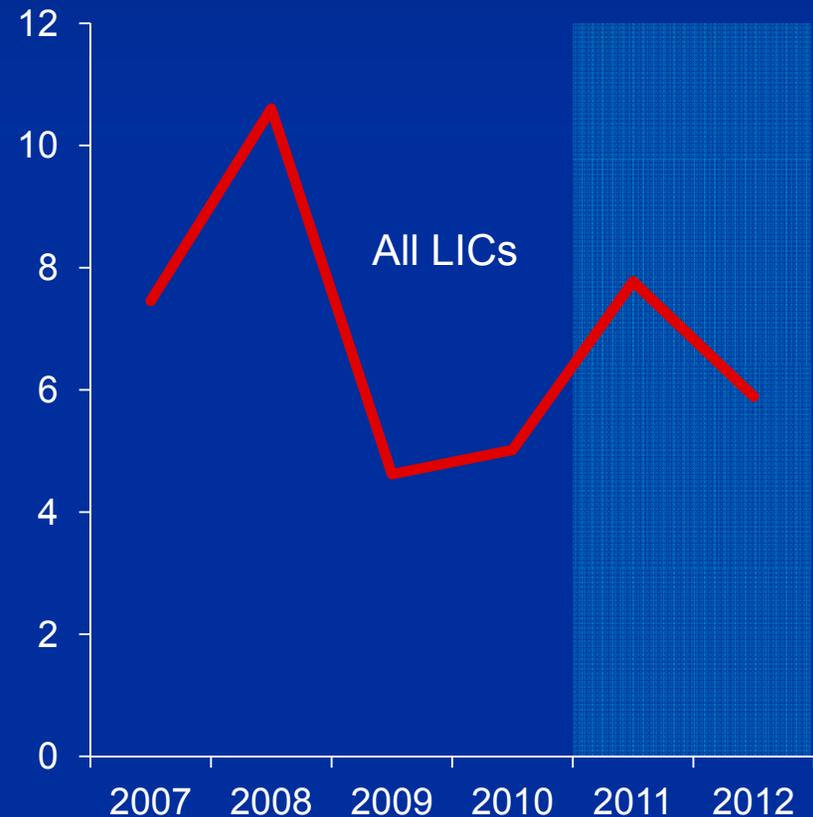


# Context: most LICs have grown strongly, with only a moderate uptick in inflation in 2011

**Real per capita GDP growth**  
(Median, in percent)

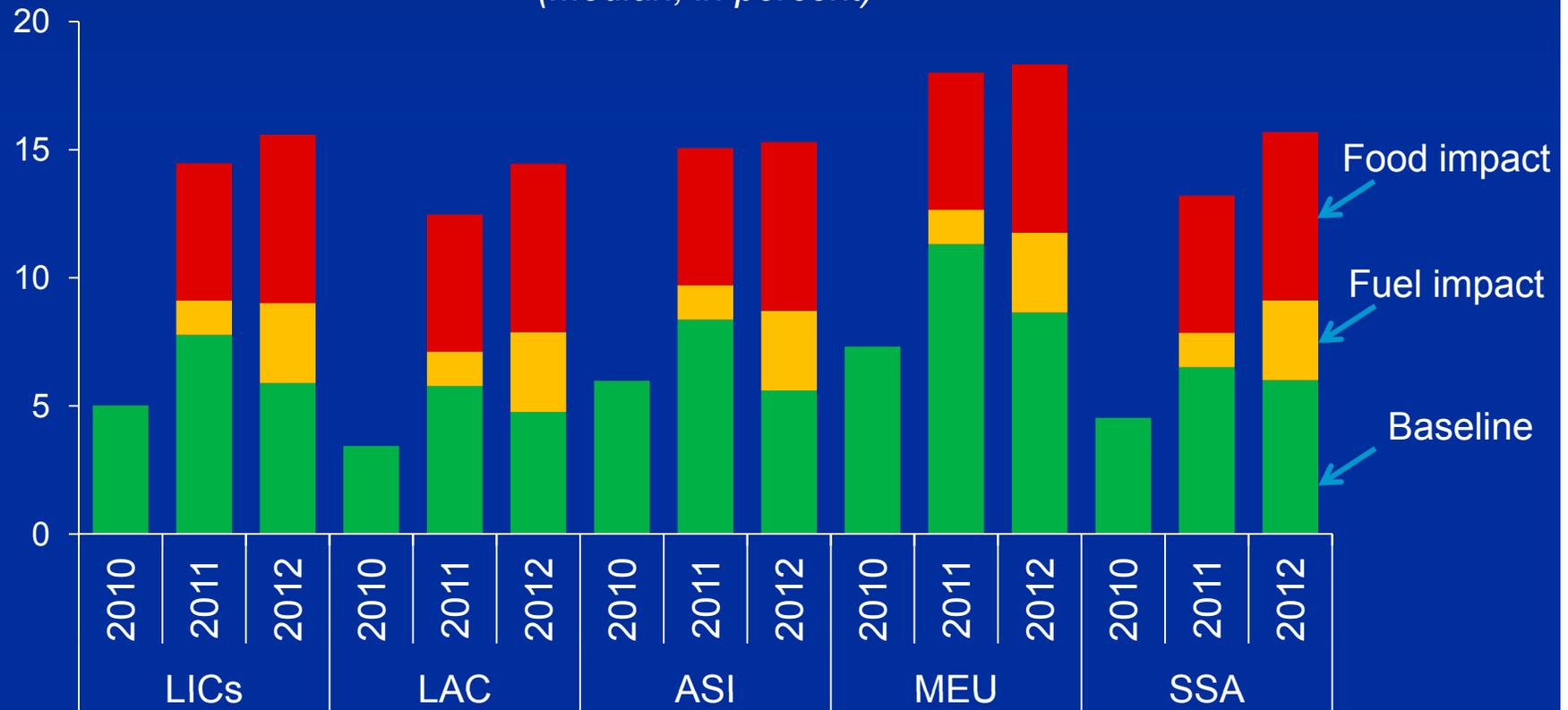


**Inflation**  
(Median, in percent)



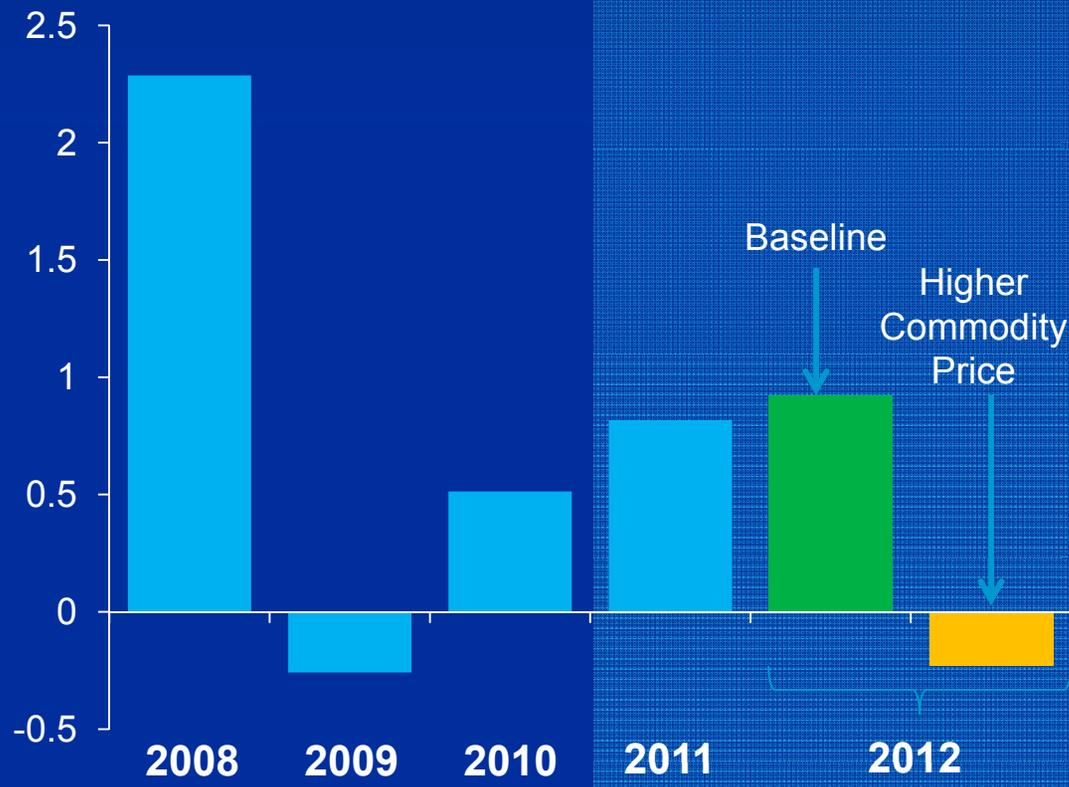
# But a further price spike could have a severe inflation impact

Inflation: Impact of higher commodity prices  
(Median, in percent)

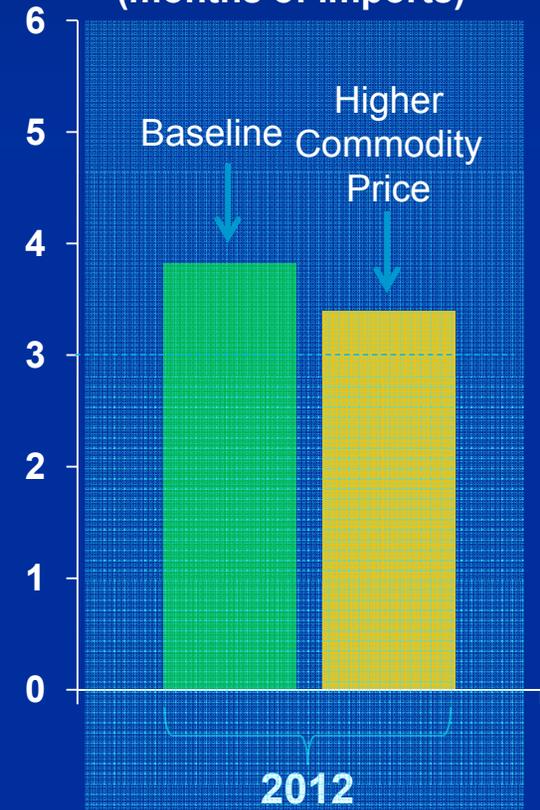


# Buffers are weaker than before 2009 crisis and new shock would erode them further

## Fiscal Space (percent of GDP)



## Reserves (months of imports)



# How to respond to a future shock?

- **Fiscal policy: need a pragmatic response**
  - “First-best” response difficult: full price pass through would require effective social safety net to support the poor
  - “Second-best” policies: need cost-effective measures in particular if fiscal space is limited
- **Pragmatism also needed on monetary policy**
  - Standard advice: accommodate first-round effect on inflation
  - But LICs with limited reserves and/or high inflation prior to the shock may need policy tightening
  - Some, especially exporters, should use exchange rate flexibility

# How can LICs increase resilience?

- **Building stronger policy buffers**
- **Strengthening fiscal revenues and managing public spending/debt**
- **Strengthening social safety nets**
- **Deepening financial sectors**
- **Promoting economic diversification**
- **Not just self-insurance: seek support from donors, IFIs, and also financial markets**



# Contingent financial instruments could help

- **More can be done to facilitate LICs' use of contingent financial instruments:**
  - market hedging products
  - natural disaster insurance
  - contingent debt instruments
- **IFIs have a role to play here: technical assistance to build capacity to evaluate and manage risk is the first key step.**





Thank you

