



April 18, 2011

Dear clients and colleagues,

The global food price index rose 36% YoY in March 2011, because of steep increases in staple food prices. Although rice prices have remained stable, other prices have not. Maize rose by 74%, wheat by 69%, soybeans by 36% and sugar by 21%. In addition, some countries have seen the prices of fruits and vegetables, meats and cooking oil continue to increase, which has the potential to have a negative consequence on poor people's nutrition and health. World Bank officials say that 44 million people have already been driven into poverty since June 2010 because of increases in food prices.

The Commodity Research Bureau (CRB) metals index has risen by 48% since June 2010 and has surpassed its 2008 peak by 13%. High commodity prices will exert pressures on input costs for manufactured products, which will translate into higher consumer prices.

This week we focus our weekly commentary on Asia's inflation and potential consequences around the globe.

Asia's Inflation

Inflation in Asia is the most important macro issue and has been higher than expected for long enough that it has begun to affect consumer behavior. The Asian-Pacific region is the world's biggest food and fuel importer.

China, India, and Indonesia have the highest inflation rate in the region. During the financial crisis a structurally strong domestic demand benefitted these countries. China and India were also aggressive in pushing domestic demand immediately after the crisis with the support of loose fiscal and monetary policy.

Countries like Korea, Taiwan, Malaysia, and Thailand, which have weaker growth in domestic demand, have less of an inflation challenge. Singapore and Hong Kong have monetary policies like the US, but experience Asian-style growth and inflation. Asset price inflation has been a bigger challenge for them and policymakers have started taking aggressive, tightening measures to lean against the strong interaction of asset prices and financial leverage.

Drivers of inflation

Abundant liquidity has been generated through loose monetary policy worldwide. Asian countries have experienced huge inflows of foreign capital.

Mother Nature has not been kind either. Back-to-back crop failures across many of the large food-exporting countries pushed food inflation up sharply.

Stockpiling and grain export restrictions are on the rise. Chinese corn imports experienced an 18-fold increase in 2010 to 1.57M tons of corn from 83,582 tons imported in 2009, according to official data. China is unlikely to export grain in the future, and has no plans to export wheat this year despite high inventories.

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Commodity demand from emerging markets has been consistently strong. Geopolitical unrest in the Middle East and North Africa has added more pressure to the oil price.

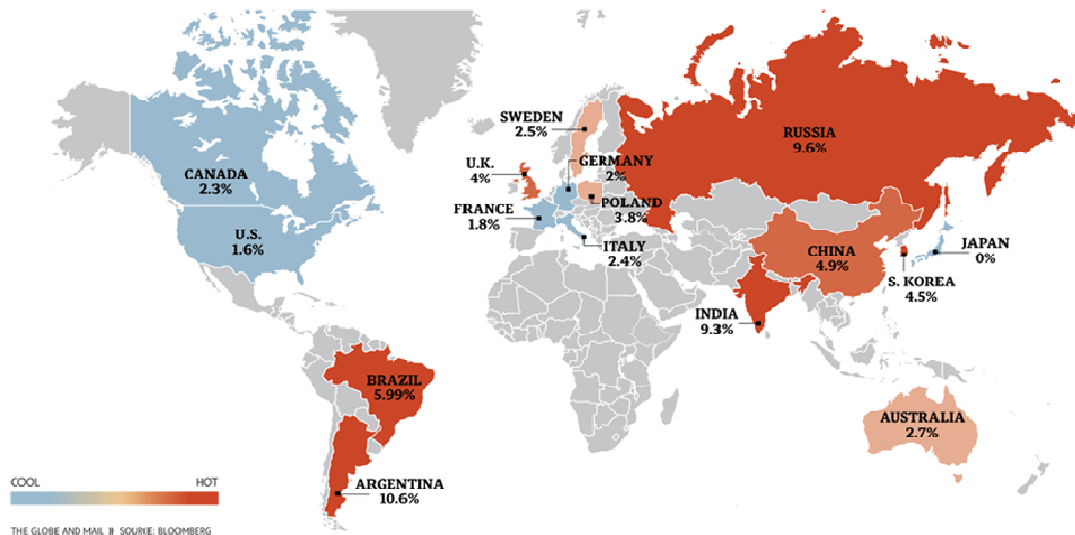
Potential consequences

Asian economies have been suffering a loss of purchasing power as wage growth is lower than inflation rate. Food, clothing and shelter are a much greater portion of their budgets than developed economies. As a result, poorer households are very vulnerable to increases in food prices.

Developed countries also experience the inflation pass-through effect. China has changed from an exporter of deflation to an exporter of inflation that is pushing up inflation in developed economies. Li & Fung, a Hong Kong based consumer sourcing and logistics company, which supplies to companies like Wal-Mart and Gap, said manufacturers have started to pass on raw materials and increased Chinese labor costs to customers.

Equity markets' expectations around the world should be impacted because consumer demand will grow at a slower pace. Markets are expecting Asian economies to drive the global economic expansion; however, a loss of future purchasing power in these economies leads to a reduction in consumer spending. In fact consumers in China and Korea have already begun to adjust to the new economic reality, and it's just a matter of time before Indian and Indonesian consumers do the same.

Global Inflation Heat Map



Have a good week.
The Global Alpha Team

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