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Developing Nations Fight Inflation

Price Jumps, Especially on Food, Threaten Growth Engines ; A Contrast With West

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Inflation is spreading across the world's largest emerging nations, leaving a noisy rattle in what have been the engines of global growth in recent years.

Central banks in Brazil, Russia, India and China, the fast-growing so-called BRIC nations now responsible for nearly a fifth of global economic activity, have all raised interest rates in recent weeks, and are testing more exotic measures to stanch rising prices, especially for food: India and Russia banned exports of onions and wheat, respectively, while China has promised price controls on items such as cooking oil.

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A farmer transports vegetables on an improvised tricycle toward a market in Kolkata Thursday. India's food inflation has picked up recently.

Brazil said Friday that its 2010 inflation rate had risen to 5.9%, its fastest rate in six years, raising the chances the nation will push its already sky-high interest rates even higher, potentially hampering growth.

To be sure, Brazil's single-digit inflation rate is a universe away from the hyperinflation it suffered in the early 1990s. And some analysts say fears of an emerging-market inflation spiral are overstated, with current inflation rates still below where they were when prices peaked before the financial crisis in 2008.

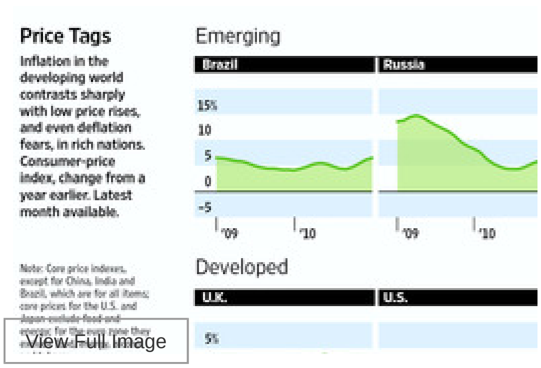
Still, the inflation trend is creating tricky policy headaches for officials from Beijing to New Delhi, including fears that rising food prices in these mostly poor nations may jeopardize social stability.

"Inflation is one of the major risks for this year," says Nicholas Kwan, economist for Standard Chartered in Hong Kong.

The accelerating price gains in the developing world contrast sharply with low inflation rates in Europe and the U.S. and persistent price declines in Japan. The divergence is partly a byproduct of the stronger economic recoveries achieved by emerging nations compared with sluggish growth in the West.

Such diverging economic fortunes are complicating inflation-fighting efforts in the developing world, economists say.

Leaders in Brazil and other countries complain that the U.S. Federal Reserve's decision to pump $600 billion into the economy promotes commodity inflation and asset bubbles by weakening the dollar. U.S. Federal Reserve Chairman Ben Bernanke said Friday the stimulus measure wasn't adding to inflation.



A better-than-expected recovery in the U.S. could fuel inflation by sending a jolt of demand through the global supply chain, causing economies already running at full capacity to overheat, economists say.

"We are arriving at a juncture where policy requirements in emerging economies will be overwhelmed by advanced-economy policies," said Cornell University economist Eswar Shanker Prasad a senior fellow at the Brookings Institution.

Brazil illustrates the case. The South American giant has set some of the world's highest interest rates in order to keep a lid on inflation as economic growth nears 7% and amid rising government spending to lift the poor.

The 10.75% rate has attracted a flood of speculative investment from the U.S. and Japan, where monetary policy is loose in order to spur growth.

As a result, the Brazilian real has soared more than 35% since 2009 against the U.S. dollar, making exports less competitive and making domestic manufacturers vulnerable to less expensive imports. To avoid raising rates further, Brazil is trying other measures such as restricting credit by raising bank reserve requirements.

The issue is a major test for the brand-new government of Dilma Rousseff. Though Ms. Rousseff campaigned on expanded welfare spending, she is now contemplating politically risky spending restraints to shrink deficits and cool the economy.

In developing countries, price rises, especially for food, can have a big impact. Because incomes are lower than in the developed world, food and energy make up substantial part of household spending—and most emerging-market inflation measures. Food prices globally hit an all-time high in December, according to a United Nations index.

And there are signs that the increase in food prices is not abating as some had expected, and that price increases are creeping into the broader part of some economies. China's 5.1% consumer-price inflation rate in November was driven mostly by food prices, which rose 11.7%. But the so-called core inflation rate, which excludes energy and food, rose as well, up 1.9% from a year earlier

China has introduced a raft of measures to tamp prices, including two interest-rate increases, a slightly stronger currency, tighter bank lending, price controls, and efforts to clamp down on illegal speculation in food. Chinese officials have signaled they will continue to tighten to tame inflation.

Kong Ong, Hong Kong owner of Headquarters Industrial Ltd., which makes more than a million hats a year on the mainland for export to the U.S. and Germany, says rising prices material prices and wages are concerns. Cotton, which is 30-40% of his costs, hit record highs last year. Prevailing wages have risen and he expects them to go up again this year. And living costs are keeping migrant workers closer to home.

"When the inflation rate is too high, workers don't want to come to the big cities because the big cities the living cost is too high," he says. In India, where high food prices drove inflation for much of 2010, expectations had been that a solid harvest for rice and other staples would ease the pressure. But the latest government data show the food situation hasn't been resolved and food-price inflation has jumped in India of late, reaching 18% in the week ended Dec. 25, according to figures released this week. Economists say the Reserve Bank of India, after raising interest rates six times in 2010, will almost certainly tighten again when it meets Jan. 25 for a regular policy meeting.

India's economy is expected to grow by 8.75% in the year ending March 31, according to an International Monetary Fund report issued Thursday. But inflation is threatening to undermine the economic gains for hundreds of millions of poor and less well-off Indians.The government has scrambled to take measures to alleviate the food-price increases, for instance banning the export of onions.

What's more, officials across emerging markets are concerned that price increases may erode the hard-won credibility of central banks and lead to increased inflation expectations among locals.

Amrith Mathur, a 36-year-old software engineer buying vegetables at a wholesale market in New Delhi Friday morning, says the price rises have virtually canceled out salary increases.

"I got a paltry increment of 5% in salary after a gap of two years this year, but thanks to the prices of essential commodities which have skyrocketed, the rise is as good as nil," he said. "How can the government achieve their tall growth target of 9%-10% if the people's spending power is getting lesser and lesser by the day," he said.

In Russia, summer droughts sent wheat prices skyrocketing and undermined the government's goal of keeping inflation in the 6%-7% range in 2010. Russia reported this week that consumer prices rose a faster-than-expected 1% in December from November and 8.7% over the past year, raising expectations for interest-rate increases in the coming months.

Other large emerging economies also have seen prices rise faster than expected in recent months. Peru surprised with a rate increase this week, and Mexico reported faster-than-expected inflation of 4.4%. Thailand is expected to raise interest rates next week. South Korea has also said it will unveil a package of policies to tackle rising prices next week.

Indonesia's consumer-inflation rate hit 7% in December, a 20-month high and the fourth time in six months prices outpaced the central bank's 4%-6% target. The central bank has yet to raise interest rates since the recovery began in 2009, figuring higher rates will have little effect on food prices.

—Ira Iosebashvili and Robb Stewart contributed to this article.

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