منتدى الاستراتيجيات الأردني
JORDAN STRATEGY FORUM

A Reality Check on Prices in Light of Current Global Events

May 2022

1. Background

To mitigate the output and job losses caused by COVID-19 and the resultant lockdowns, governments all over the world launched a variety of fiscal measures. While the size of these measures varied, most of the advanced economies undertook unprecedented action. Indeed, in less than two years (between 7 January 2020 and 27 September 2021), the Italian, Japanese, German, British, and American governments' fiscal measures (additional budgetary spending and liquidity assistance) were equivalent to 46.2%, 45.1%, 43.1% , 36.0%, and 27.9% of Gross Domestic Product (GDP) respectively (IMF database).

At a time when the global supply chain around the world was disrupted, the huge fiscal measures adopted by major economies, together with their accommodative monetary policies, were expected to be inflationary. Indeed, following the 2020 closures, and economies going back to work in late 2020 and early 2021, commodity prices increased significantly.

2. Some Views

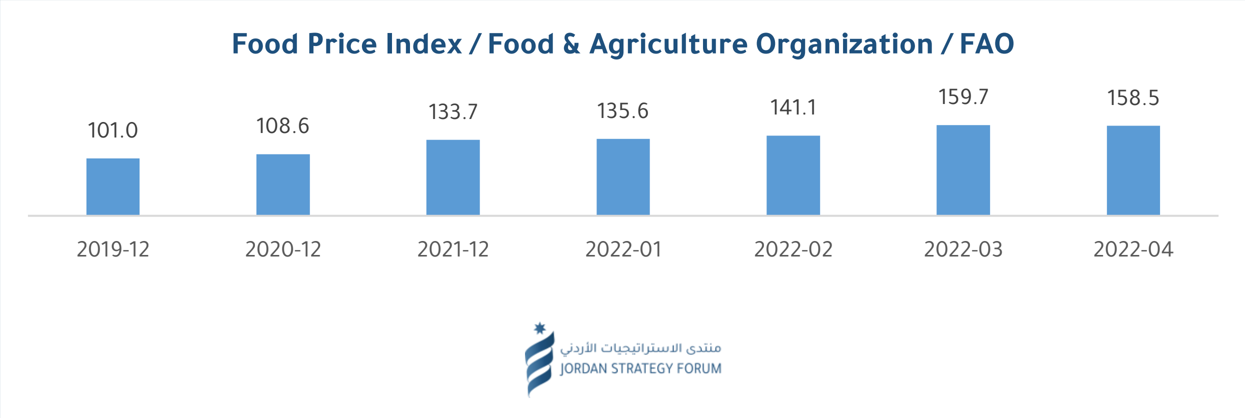
The price index of energy (coal, crude oil, and natural gas) increased from 62.92 points in December 2020 to 111.42 in December 2021 or by about 77.0%. In addition, during this period the price index of oils and meals (coconut oil, fishmeal, palm oil, soybean oil, and soybeans) increased by about 12.5%. The price of grains (barley, maize, rice, and wheat) increased by 19.4%. The price of fertilizers increased by 163.9%. The price index of metals and minerals (aluminum, copper, iron ore, lead, nickel, tin, and zinc) increased from 99.65 points in December 2020 to 116.72 points in December 2021 or by 17.1%.

Table 1: Commodity Indices Based on Nominal US Dollars (2010=100 Points)

Date	Energy	Oils & Meals	Grains	Fertilizers	Metals & Minerals
2018-12	72.68	76.60	88.39	89.43	76.07
2019-12	76.93	85.56	89.87	72.63	77.47
2020-12	62.92	115.00	108.11	78.83	99.65
2021-12	111.42	129.40	129.15	208.01	116.72
2022-01	120.27	140.62	133.23	200.61	125.23
2022-02	129.52	154.34	138.64	196.86	131.18
2022-03	160.91	173.08	158.69	237.60	141.28

Source: The World Bank's Commodity Price Data (The Pink Sheet)

In addition to the above-mentioned observations, the database of the Food and Agriculture Organization of the United Nations report equally huge increases in food prices. For example, the food price index has increased from 101.0 points in December 2019 to 108.6 points in December 2020, and to 158.5 in April 2022. Relative to any standard, this is an unprecedented increase in the price of food. Within this context, it is useful to note that this index is based on the prices of raw materials, and not processed food. In other words, the prices of processed food materials are expected to increase by even higher margins.

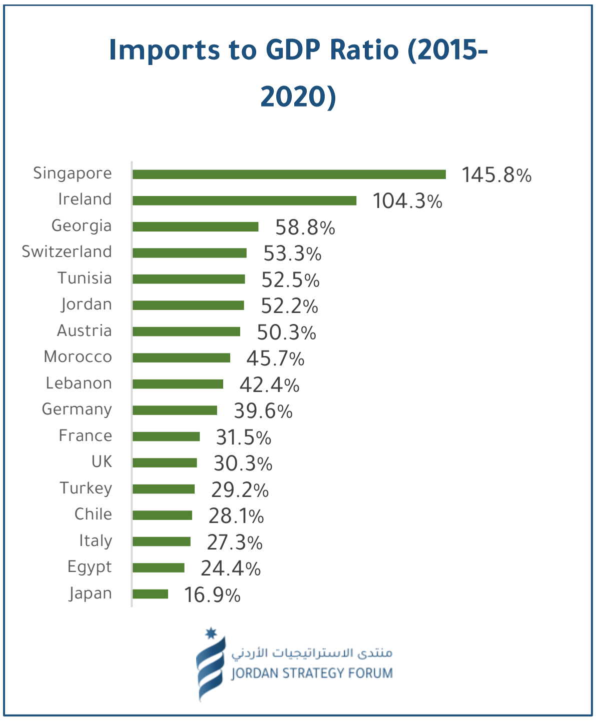


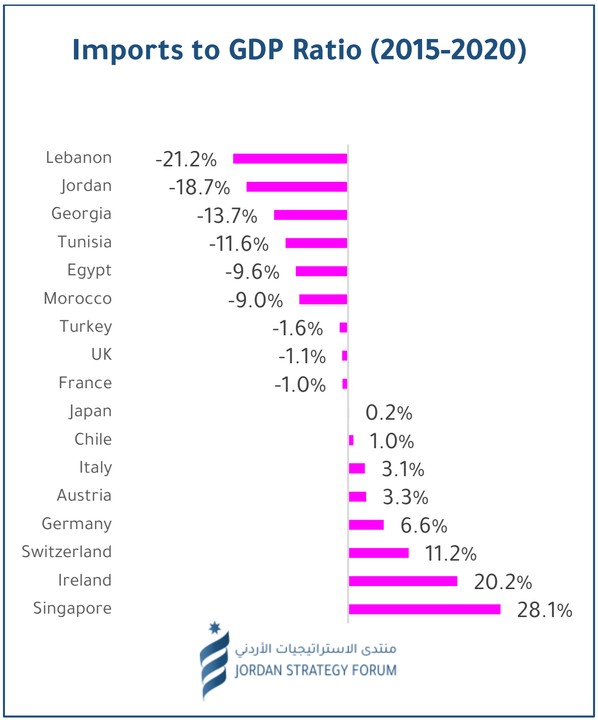
Relative to the above-mentioned observations, it is unfortunate that the world woke up to witness the Russian invasion of Ukraine on 24 February 2022. This War has already proved to be a major humanitarian crisis. In economic terms, however, the Russian invasion could not have come at a worse time.

1. The War has started at a time when the global economy started to go back to normal. After experiencing a 3.4% drop in GDP in 2020, the global economy was expected to rebound by 5.5% in 2021, 4.1% in 2022, and 3.2% in 2023.
2. The War has started soon after economic policies were getting back to normal. The exceptionally accommodative monetary policy started to be removed progressively, and the adopted emergency fiscal measures started to be phased-out.
3. On average, global commodity prices, as mentioned above, were on the rise before the invasion of Ukraine.
4. While the Russian and Ukrainian economies account for only about 2% of the global GDP, together they can result in major disruptions. Together, they account for about 30% of global exports of wheat, 20% for corn, mineral fertilizers and natural gas, and 11% for oil (OECD / March 2022). In addition, they are also large producers of inert gases (used in the production of semiconductors) and titanium sponge (used in Aerospace and Defense). Russia is also a major producer of palladium which is used in "catalytic converters for cars, and nickel, used in steel production and the manufacture of batteries" (OECD / March 2022).

Based on the above-mentioned observations, one wonders what the implications of the recent increases in the prices of commodities and the Russian invasion of Ukraine have on the trading performance of Jordan in general, and local prices in particular. Below, we outline a number of observations.

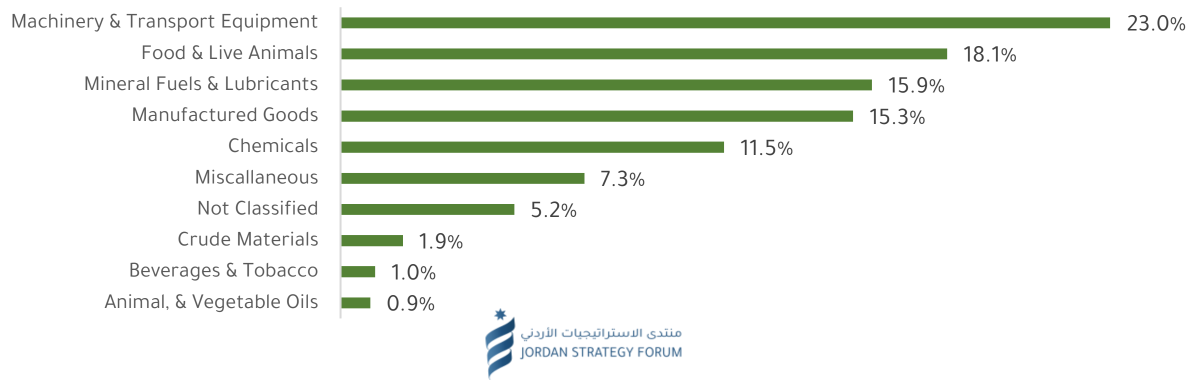
First, the trading performance of Jordan has always been poor. However, what is interesting is the experience of economies like Singapore and Ireland. While these economies boast one of the highest imports to GDP ratios, their trade balance is in surplus and relatively high. The Jordanian economy is not in the same boat. The economy witnesses a relatively high imports to GDP ratio, while at the same time, reflect relatively high trade deficit to GDP ratio. Jordan imports a lot more than what it exports. This indicates that if global prices maintain their recent increases, the Jordanian economy will experience nothing but further deterioration in its trade deficit.



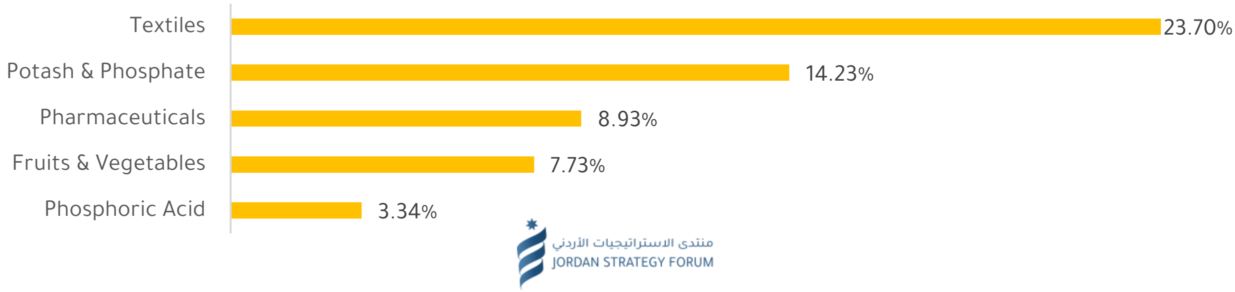


Second, one can argue that Jordan's imports are diversified. They cover machinery and transport equipment to food and live animals, mineral fuels, manufactured goods, chemicals, and many others. In addition, one can argue that Jordan's exports are highly concentrated. Indeed, few exported items account for about 60% of total national exports. These observations indicate that the Jordanian economy will be significantly affected (negatively) if global prices maintain their increases.

Jordan's Main Imports (2015 - 2021)



Jordan's Main Exports (2015 - 2021)



Third, in the USA, the annual inflation rate has accelerated to 8.3% in April 2022. This rate is the highest since 1981. Market expectations point out that the inflation rate will remain high for the rest of 2022. The Russian invasion of Ukraine will maintain the elevated energy prices for much of the year. Indeed, even if the war ends, the Western embargo on Russia will continue for quite a while. In addition, there are expectations of continued upward pressure on food prices, rent, housing costs, and prices of many services. This is why, the Federal Reserve, on 4 May 2022, increased its benchmark interest rate by half a percentage point, and more increases are expected to follow.

Based on the above-mentioned observations, the rest of 2022 will prove to be a difficult year for the Jordanian economy. Indeed, this is based on the following expectations:

1. If interest rates in the USA are on the rise, the Central Bank of Jordan (CBJ) will have no choice but to increase rates in Jordan as well. Indeed, the CBJ has already increased interest rates by 25 basis points in March 2022 and by 50 basis points in May 2022.
2. If energy prices are expected to maintain their high levels, this will have serious implications to Jordan's imports of crude oil and natural gas.
3. If food prices maintain their high levels, this will have serious implications to Jordan's imports of the almost all items.
4. On average, if the price of fertilizers maintain their high levels, this will have positive implication to Jordan exports of potash and phosphate.

3. In a Nutshell

While the magnitude of the impact of the conflict is uncertain, and depends, in part, on the duration of the war and the policy responses, it is clear that the war will cause some significant inflationary pressures. Within this context, the fact that households, in Jordan as well in other developing countries, spend a high share of their incomes on food, energy, and transport, the government should be open with all Jordanians about what is happening in the global market, and even more open and understanding with the leaders of the trading sector in Jordan. After all, sooner or later, if global prices increase, there is no running away from local price increases as well. In addition, income support, such as lump sum transfers would be a good policy choice for the government to maintain. To keep costs manageable, any additional support such as sales tax decreases should be well targeted and temporary.

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