Global Economic Prospects

Commodities at the Crossroads

2009

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Cover photos: Oil platform worker in Urucu, Brazil by Hervé Collart/Corbis (left); Molten steel being poured in Tangshan, China by Yang Liu/Corbis (top right); Farmers in Kenya by Curt Carnemark/The World Bank (bottom right)
Cover design: Critical Stages

The cutoff date for the data used in this report was November 20, 2008. Dollars are current U.S. dollars unless otherwise indicated.

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Foreword

EACH YEAR, *Global Economic Prospects* explores critical "here and now" economic developments relevant to low- and middle-income countries. Past editions have examined the sustainability of developing-country growth over the long term, importance for developing countries of international and regional trade liberalization, and migration and remittances. Last year's report looked at the pace and determinants of technological diffusion in developing countries.

This year's *Global Economic Prospects* finds the global economy at a crossroads, transitioning from a sustained period of very strong developing country–led growth to one of substantial uncertainty as a financial crisis rooted in high-income countries has shaken financial markets worldwide. Commodity markets too are at a crossroads with the very high prices of 2007 and early 2008 having fallen by more than half in many instances.

Great uncertainty surrounds the implications of this crisis for developing countries. Initially, the repercussions for developing countries of the financial turmoil that characterized 2007 and the first half of 2008 were limited. However, since September 2008, the intensification of the banking crisis, the collapse of several global financial players, and the sharp increase in emerging market bond spreads have dramatically altered the outlook for developing countries. These events constitute the kind of disorderly adjustment that has been discussed in previous reports as a risk. Materialized, it implies a sharp slowdown for developing countries and the possibility that serious crises may emerge.

While the measure of that slowdown and its near-term implications for growth and incomes are important, governments in developing countries also need to be mindful of the longer-term implications of their policy response. Thus, while countercyclical policy may help reduce the short-term costs of the slowdown, care must be exercised to react prudently so as not to endanger longer-term fiscal sustainability and growth prospects. For as serious as the coming slowdown may be, developing-country growth is expected to recover after the crisis is over.

Commodity markets have seen spectacular swings over the past 24 months as enormous tensions first built up and were then released. The extended and sharp rise in commodity prices prompted concerns that the world was transitioning into a new phase of commodity scarcity—a concern that the recent dramatic drop in commodity prices has only partially alleviated. Long-term supply and demand prospects for commodities suggest that while commodity prices are likely to be higher than they were during the 1990s and early 2000s (when they were depressed by excess supply), the recent peaks that have been observed are unlikely to be the new norms. Over the long run, demand for commodities is not expected to outstrip supply. Even though per capita incomes in developing countries are expected to continue rising rapidly, population growth is slowing and with it global GDP growth. As a result, the pace at which commodity demand expands should also ease. Assuming that efficiency with which commodities are both employed and produced continues to improve as it has done over the past few decades, supply should keep pace with demand.

However, policy will need to be supportive if such a positive result is to materialize. In particular, agricultural yields have declined in recent years. Unless governments in developing countries and aid agencies take concrete steps to increase investment in rural infrastructure, agricultural research and development, and agricultural extension services, it is possible that global agricultural productivity growth will slow. Higher food prices would follow and many countries that are now self-sufficient in food (notably those that still have fast growing populations) would become large net importers of food. On the energy side, policies to combat carbon emissions would help slow the depletion of hydrocarbon resources, by speeding both demand-side and supply-side substitution toward cleaner energy sources. If successful in slowing global warming, these could also help prevent the very large agricultural productivity losses predicted by some in the second half of this century.

The recent boom in commodity prices has challenged policy makers in both producing and consuming countries. Encouragingly, commodity producers appear to have managed their windfall revenues more prudently than in the past. Instead of expanding spending programs in line with increased revenues, many have saved a much larger share of these revenues—reducing the likelihood that they will need to cut back spending in a procyclical manner now that commodity prices (and global growth) have declined. However, countries with new-found commodity wealth or newly independent commodity-rich states have not shown similar restraint and may encounter more difficulties during the current downturn.

Higher food prices are estimated to have increased global poverty by some 130–155 million people. Most countries responded to the food crisis by expanding existing social safety net programs, which made good sense given the profound and long-term consequences that increased malnutrition could generate. However, in many instances the response was poorly targeted and expensive. Now that food prices are declining, countries need to take steps to revamp their social welfare systems so that they are better targeted and that the next time a similar crisis comes along, additional spending will be more effective in limiting poverty impacts.

At the international level, steps need to be taken to prevent producing countries from exacerbating shortfalls by introducing export bans or by withholding stocks from the global market. An international scheme to share information about private and public stocks and coordinate their management during times of crisis is worth pursuing. Similarly, funding for international food aid programs should be made more predictable, and agencies should be endowed with a line of credit that would allow them to respond rapidly to future food emergencies in a way they cannot at present.

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Abbreviations

ASEAN	Association of South Eastern Asian Nations
CEE	Central and Eastern European countries
CIS	Commonwealth of Independent States
CPI	consumer price index
EMBI	Emerging Markets Bond Index
EMBIG	Emerging Markets Bond Index Global
EU	European Union
FDI	foreign direct investment
FSU	former Soviet Union
GCC	Gulf Cooperation Council
GDP	gross domestic product
GFRP	Global Food Crisis Response Program
GIDD	Global Income Distribution Dynamics Model
IDA	International Development Association (World Bank)
IEA	International Energy Agency
IMF	International Monetary Fund
IPO	initial public equity offering
LSMS	Living Standards Measurement Survey
MSCI	Morgan-Stanley Composite Index
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of Petroleum Exporting Countries
PPP	purchasing power parity
PCSC	*Programme Complémentaire de Soutien à la Croissance*
RIGA	Rural Income-Generating Activities
saar	seasonally adjusted annualized rate
toe	tonne of oil equivalent
UAE	United Arab Emirates
WFP	World Food Programme