POST-COVID-19 INFLATION IN THE CARIBBEAN

Machel Pantin *

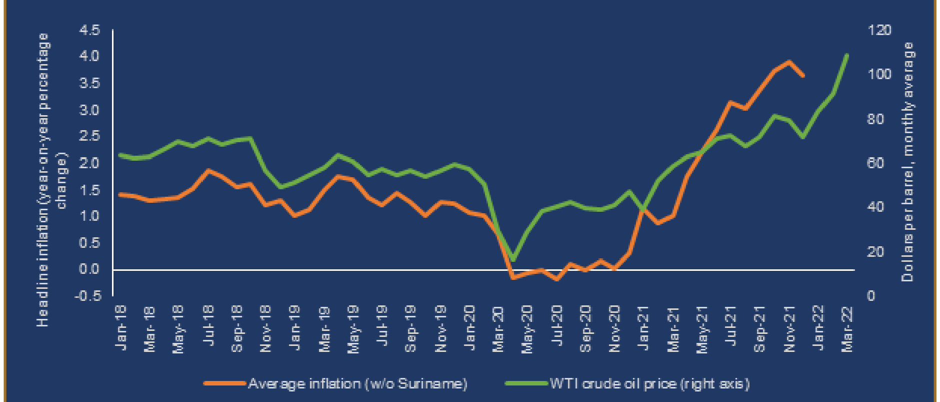
The COVID-19 pandemic was an economic shock in 2020 that led to a significant fall in aggregate demand around the world, as countries implemented different strategies (including the closure of borders) to slow the spread of the disease. The following year saw economies begin to reopen as restrictions were lifted, following widespread distribution of COVID-19 vaccines, and a reduction in mortality rates

The increase in consumption following months of pent-up demand resulted in consumption increasing rapidly. Pandemic-related restrictions in sections of the supply chains around the world prevented supply from increasing to match demand. These two factors combined to push prices upward in 2021 and 2022. While initially expected to be transitory, the increase in inflation is now expected to last longer. The IMF projects inflation for 2022 to be 5.7 per cent in advanced economies and 8.7 per cent in emerging and developing economies. High inflation is affecting regions around the world and the Caribbean is no different. Rapid increases in prices will directly and indirectly serve to reduce social welfare, particularly among vulnerable groups. This article looks at the recent inflation trends in the Caribbean, discusses some of the reasons for the increase in prices, and concludes with some of the indirect consequences.

CARIBBEAN TRENDS

While different countries in the Caribbean have seen periods of high inflation at different points in their history, inflation has been quite low for several years. Average inflation[1] in the Caribbean (excluding Suriname[2]) has been below 2 per cent since 2018. In 2020, inflation fell below 0 per cent in several countries for a few months as the reduction in economic activity and lower fuel prices contributed to a fall in prices across the subregion.

Figure 1: Caribbean inflation and crude oil prices, Jan 2018-Mar 2022



Source: Economic Commission for Latin America and the Caribbean, on the basis of official figures; U.S. Energy Information Administration.

Several economies, particularly in the eastern Caribbean, experienced deflation for most of 2020. In 2021 average inflation grew from 1.2 per cent in January to 3.6 per cent by the end of the year (see figure 1), coinciding with an increase in economic activity as the economies slowly reopened. In Guyana and Jamaica, inflation was greater than 5 per cent for most months in the year. The increase in prices has continued into 2022, with inflation in Jamaica reaching 11.3 per cent in March.

FACTORS

The reason for rising prices in the Caribbean is linked to a series of international factors. One of the main factors is international supply chain constraints. Many consumer goods are manufactured using complex international supply chains, in which various intermediate goods necessary for production and sections of the manufacturing process are located in different parts of the world.

With the sharp fall in demand in 2020, many firms reduced their supply orders accordingly. However, stimulus programmes and shifts in spending to goods from services, facilitated by widespread adoption of online shopping, led to a sharp increase in demand in 2021; this caused a reduction in inventories, that led to a demand-supply imbalance. In addition, COVID-19 outbreaks in several manufacturing hubs such as Vietnam, led to reduced production and supply of manufactured goods in 2021. Due to the delays in shipping, some firms then chose to keep more inventory, which increased their costs. This, together

[1] Inflation is defined as the year-on-year percentage change in the consumer price index, calculated monthly.
[2] Suriname is unique among Caribbean countries as it has been experiencing very high inflation since early 2020.

with other pandemic-related factors such as restrictions at ports, reductions in shipping containers (see figure 2) and shortages of workers, all combined to push up prices.

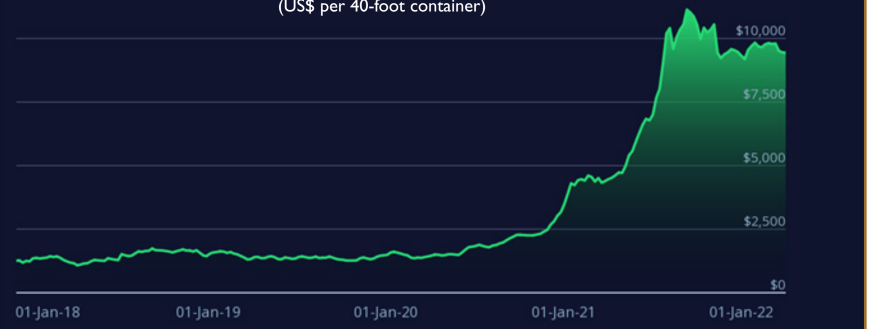
New factors appeared in 2022, including severe lockdowns in China and an acceleration of the Russia-Ukraine war. In China, an unprecedented surge in COVID-19 cases led to severe lockdowns in several cities in March. This resulted in a reduced volume of manufacturing output out of China, and while this has led to inflation in manufactured products, it also resulted in dips in the oil price and shipping costs out of China.

In February 2022, Russia invaded Ukraine and began a protracted military conflict which has caused direct and indirect supply disruptions. The conflict between these two countries, who together account for 29 per cent of the world's wheat exports, has disrupted global grain supply. The food supply issue is compounded by a reduction in natural gas exports from Russia, which is used in fertilizer production. Many countries have applied various sanctions on Russia, including cutting imports of oil. It has been estimated that approximately 3 per cent of world petroleum production has been removed from the market (Lutz and Plante 2022). The monthly average price for West Texas Intermediate[3] crude oil grew by 177 per cent from January 2021 to March 2022 (see figure 1).

PROSPECTS FOR THE CARIBBEAN

Increases in prices has resulted in monetary policy responses across the subregion. For example, the Bank of Jamaica (BoJ), which has an inflation-target of between 4-6%, increased its policy interest rate by one percentage point to 1.5 per cent in October 2021. The BoJ has since raised the policy rate by 50 basis points (0.5 per cent) in November and December 2021 as well as February and March 2022, where it stood at 4.5 per cent.

Figure 2: Global Container Index, Dec 2017 – Mar 2022
(US$ per 40-foot container)



Source: Freightos Baltic Index, available at https://fbx.freightos.com.

Policy decisions in the North Atlantic will impact the decisions of the monetary authorities in the Caribbean. Rising rates in developed countries could see investments flowing away from developing countries. Caribbean countries could potentially increase interest rates this year, to limit this effect. Rising interest rates have a dampening effect on investment, and as such could lower growth prospects.

Rising prices also lead to fiscal policy adjustments. The governments of Barbados and Guyana both lowered taxes on fuels and reduced customs duties on freight to pre-pandemic shipping container levels. Other measures that governments might take include targeted transfers to vulnerable groups. Medium term responses include developing domestic substitutes, especially through food production. International food prices are particularly impactful to inflation in the Caribbean, which already had an expansive food import bill. The reduction in the global food supply caused by the Russia-Ukraine conflict and weather-related events among other food producers, will see food prices increase further in 2022. Rising food prices affect everyone, but more so those on the lower rungs of the economic ladder who spend a greater share of their income on food.

One of the major impacts of this current inflationary cycle would be rising costs of debt. Rising domestic and international interest rates result in increased interest costs; this is happening at a time when Caribbean debt levels have increased significantly in the last two years due to increased expenditure in response to the pandemic. Total debt service payments grew from an average 28 per cent of government revenue in 2019 to 36 per cent in 2020. In addition, the end of Debt Service Suspension Initiative (DSSI)[4], which expired at the end of December 2021, will lead to an increase in debt service for the participating Caribbean economies[5].

Given the current projection for an extended period of rising international prices, Caribbean policy makers will face yet another headwind to their goal of sustainable economic growth, even as they continue to recover from the COVID-19 crisis of the past two years. ■

SOURCES

Freightos Baltic Index, available at https://fbx.freightos.com.

IMF (International Monetary Fund). 2022. World Economic Outlook, April 2022, Washington D.C.

Kilian, Lutz and Michael D. Plante. 2022. The Russian Oil Supply Shock of 2022. Federal Reserve Bank of Dallas, March 22, 2022. Available at https://www.dallasfed.org/research/economics/2022/0322

The Economist. 2022. The coming food catastrophe. Available at https://www.economist.com/leaders/2022/05/19/the-coming-food-catastrophe

U.S. Energy Information Administration. Crude Oil Prices: West Texas Intermediate (WTI) - Cushing, Oklahoma [DCOILWTICO], retrieved June 2, 2022, from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/DCOILWTICO.

[3] One of the three main price benchmarks
[4] The DSSI was set initiated by the Work Bank, IMF and G20 to suspend debt service from vulnerable nations during the pandemic.
[5] Dominica, Grenada, Saint Lucia, Saint Vincent and the Grenadines.