

Inflation in 2011 and forecast for 2012

Summary

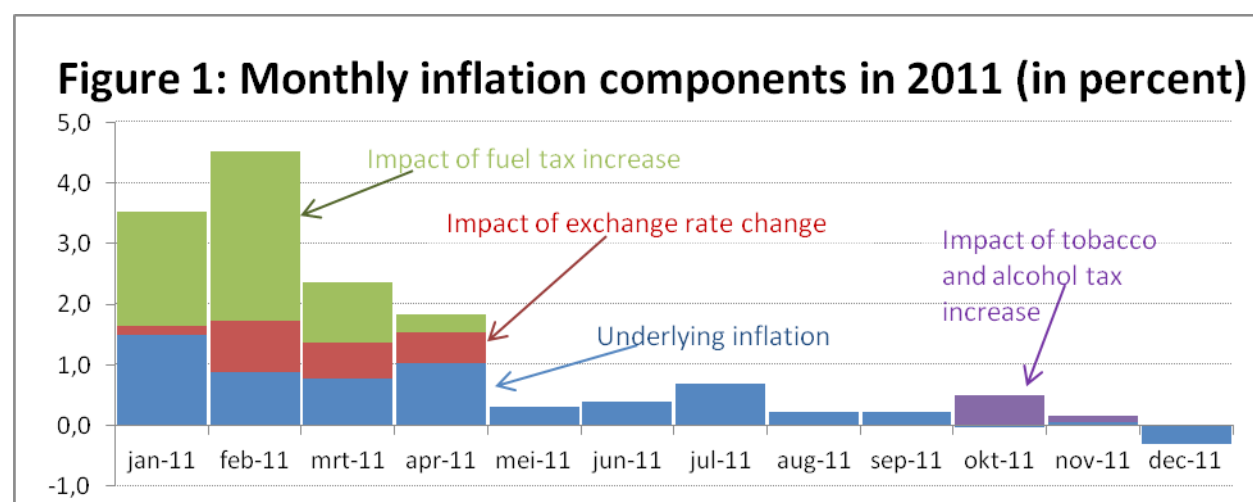
Inflation in 2011 amounted to 15.3% and was marked by two distinct time periods. During January–April 2011, monthly inflation rates averaged 3.1%. This high inflation was due to the adjustment of the exchange rate and the increase in fuel taxes in January 2011. During May–December 2011, monthly inflation rates averaged 0.3%. After the secondary effects of the inflation shock abated in April, tight monetary and fiscal policies led to a sustained low inflation.

There is a unique seasonal pattern of inflation in Suriname, which tends to register lower inflation rates in winter and higher inflation rates in summer. The main reason behind the marked seasonality in prices in Suriname is the large impact that food prices have on the inflation index, and the impact the rainy and dry seasons have on the prices of local foodstuffs.

We can expect inflation to be around 6% in 2012. We are projecting this decline in inflation based on the pattern of inflation in the last 8 months, a continuation of the moderate fiscal and monetary policies, and a moderation in wage demands. We are also assuming that Suriname will not be affected by inflation shocks from abroad or require tax measures with a significant inflationary component.

Inflation in 2011

Inflation in 2011 shows two distinct periods (Figure 1). January–April 2011 was marked by relatively high inflation figures, with an average monthly inflation of 3.1%. The second period covering May–December 2011 was marked by very low inflation, with an average monthly inflation rate of 0.3%.



The devaluation and fuel tax increase in January 2011

The high inflation rates during January-April were almost entirely due to the impact of exchange rate and fuel tax revenue measures taken in late-January 2011 (Figure 1). The cumulative inflation during the 4 months was 12.8%, of which we estimate that the exchange rate change contributed 2.1 percentage points and the fuel price increase 6.0 percentage points.¹We estimate that inflation would have been around 1.1% per month in the absence of these measures.

The official exchange rate was devalued from SRD 2.80 per U.S. dollar to SRD 3.35 per U.S. dollar in January-2011. This rate adjustment became necessary as the official rate had ceased to reflect the supply and demand conditions in the economy. The parallel market exchange rate started to deviate significantly from the official rate since mid-2009, reaching around SRD3.45 per U.S. dollar just prior to the devaluation. With fiscal revenue and a significant percentage of imports tied to the official rate, the unrealistic exchange rate constituted a subsidy by the government and a repression of inflation that would otherwise have been registered during 2009-2010. As is common in economic systems with multiple exchange rates, the discrepancy between the rates also fomented uncertainty, speculation, and possibilities for profits that had no real underlying economic rationale. The multiple exchange rate system also impeded the effective conduct of monetary policy by the Central Bank of Suriname.

The exchange rate change eliminated a significant implicit subsidy by the government. As some types of taxes are levied on the basis of the official exchange rate, these taxes were about 20% below their correct level, while expenditure was not reduced by the discrepancy between rates. Eliminating the exchange rate discrepancy increased fiscal revenue by SRD188 million and reduced the fiscal imbalance by 1.5% of GDP in 2011.

The second measure that affected inflation was the increase in the so-called "government-take" on fuel, which was raised by SRD 0.50 per liter. Combined with the exchange rate change, this increased the gasoline price at the pump from an 2010 average of SRD 3.29 per liter to SRD 4.45 per liter. The increase in the "government-take" on fuel raised about SRD140 million in fiscal revenue and reduced the fiscal imbalance by 1.0% of GDP in 2011.

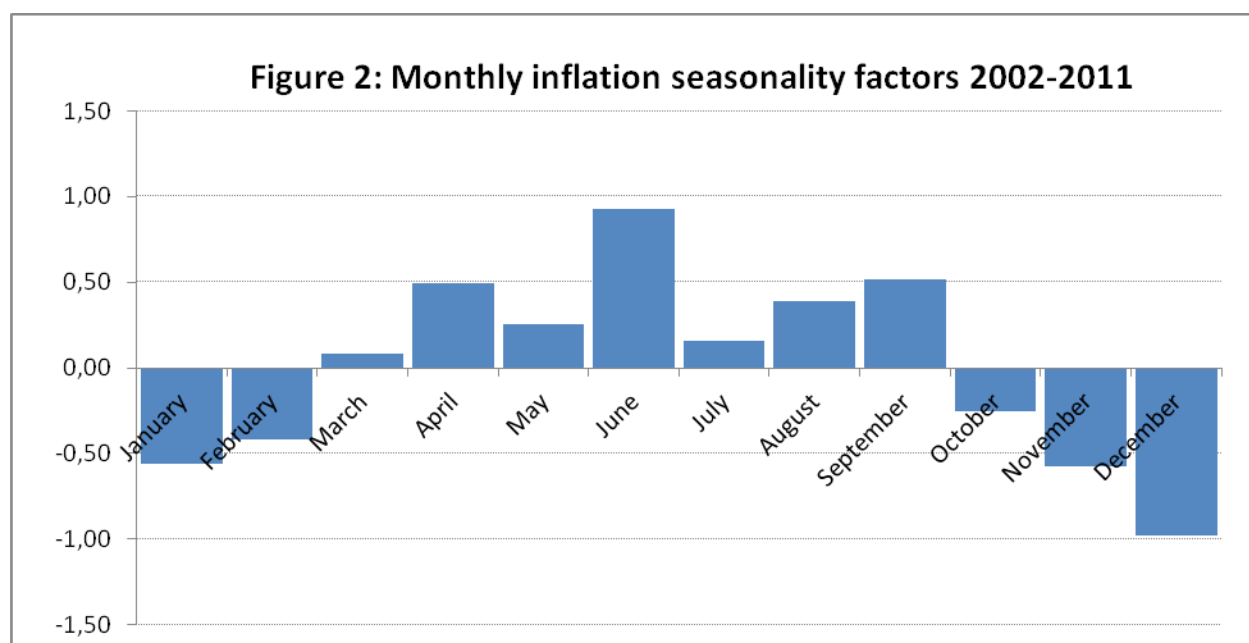
After the inflation impact of exchange rate and fuel tax measures was absorbed in the economy, inflation pressures abated significantly since May 2011. The absence of sizeable international inflation, and moderate fiscal and monetary policies prevented an inflation spiral and underlying inflation fell rapidly (Figure 1).

The third measure that had some impact on 2011 inflation was the increase of excise duties on alcoholic beverages and tobacco that took place in September 2011. We estimate that the tax measure affected inflation by 0.5% in October 2011 and that inflation would otherwise have been zero during that month.

¹The IMF estimated that the exchange rate change contributed 1.4 % and the fuel price increase 5.0 % to the inflation. The difference in estimates is related to differences in methodology and different assumptions about pass-through coefficients and second round effects. IMF Staff report 2011, pages 24-25.

Inflation seasonality

Inflation is not an even monthly phenomenon. In Suriname, inflation tends to be high in summer months and low in winter months. The main component that underlies this seasonality is the seasonal variation of food prices that tend to decline towards the end of the year and begin accelerating in spring. One explanation for the marked seasonality in food prices is the incidence of rainy seasons. Locally produced food prices tend to increase in prices during the long rainy season (mid-April to mid-August) and tend to fall during the short rainy season (mid-December to mid-February). School enrollment can also generate a price spike towards the end of summer. Figure 2 presents monthly inflation rates as they would be recorded in a year with an aggregate zero inflation for the entire year. This seasonality pattern is derived from 2002-2011 monthly inflation rates.²



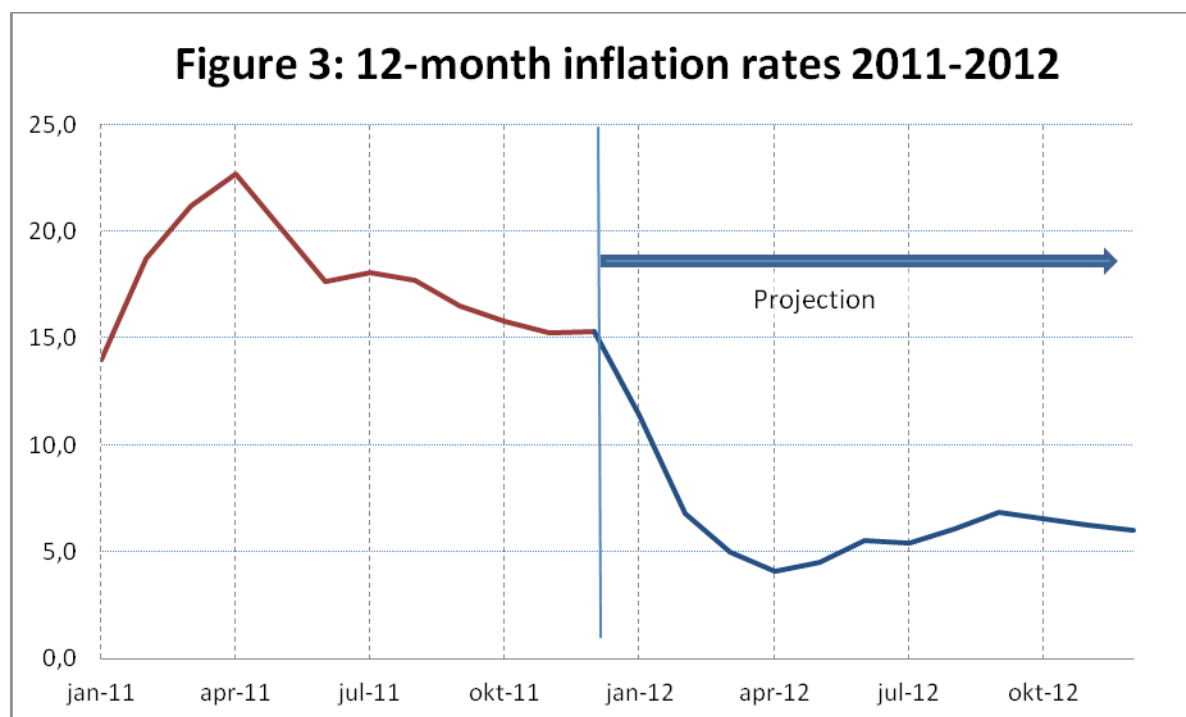
As an example of the impact of seasonality in 2011, nearly all of the inflation experienced in July 2011 can be attributed to price increases on food and non-alcoholic beverages, which comprise 40% of the consumption basket in Suriname. This item pushed up inflation by 0.6% out of a total monthly inflation of 0.7%. In December 2011, prices in the same category declined by 1.5%.

Inflation forecast 2012

We estimate that inflation during 2012 will be around 5-6%. The analysis is based on the continuation of the fiscal and monetary policy stance and the pattern of inflation that we have observed in the last 8 months, and incorporating the international consensus about food and fuel costs in world markets. These international prices have a significant impact on domestic price developments. We are also assuming that Suriname will not be affected by inflationary shocks, which could derail the low-inflation path we have seen since May 2011. Specifically, we assume that the government will not put in place tax

² The seasonality pattern is estimated using ABS inflation data, excluding missing data points and using dummy variables to account for policy-related price increases such as the 2005 and 2011 fuel tax increases and the 2011 exchange rate change.

or other measures that will have an inflationary impact, that wage agreements—which tend to have a strong indirect impact on inflation—will be moderate and not based on January-April 2011 inflation patterns, that economic growth will continue at an annual rate of 4-5%, and that the SRD/US\$ exchange rate—which has a strong direct impact on inflation—will be stable in 2012, while the SRD/Euro rate will not increase significantly.



The pattern of projected 2012 inflation is noteworthy, as we forecast a very sharp decline in 12-month inflation in during January-March (Figure 3), with 12-month rates falling from 15.3% in December-2011 to around 5.0% in March-2012. While this might appear as an overly optimistic projection, it has a simple arithmetic reason: This rapid decline in inflation will be largely due to the fact that the January-March 2011 inflation rates will cease to be part of the 12-month calculation. We assume a continuation of the historical seasonal patterns, with monthly inflation rates low during winter months and higher during summer months. This explains the gradual increase in inflation rates around June-September and a small decline afterwards.