قوست كاجين ستراتيجيک دان داسر
Centre for Strategic and Policy Studies

BRUNEI ECONOMIC UPDATE

AUGUST 2022

Highlights

Recent Developments

- Global economic activity slowed sharply in the first half of 2022, largely reflecting disruptions from China's strict zero-COVID policy and adverse spillovers from the war in Ukraine. High inflation has continued to weigh on household incomes, and heightened uncertainty has contributed to weaker consumer confidence.
- Commodity prices spiked following Russia's invasion of Ukraine, particularly for energy, fertilizer, and food. Rising inflation has led to more aggressive monetary policy tightening by central banks, especially the Federal Reserve. Consequently, global financial conditions have tightened and the US dollar has strengthened markedly, leading to a record-high of five consecutive months of portfolio outflows from emerging markets.
- The Brunei economy contracted by 4.2 percent y/y in Q1 2022, following declines in the previous five quarters, primarily due to lower crude oil, natural gas, and LNG production. Growth in the services sector slowed amid the third COVID-19 wave, but the downstream oil and gas sector recorded strong growth.
- Consumer prices in Brunei have continued to increase, mirroring global developments, but administrative measures and Brunei's currency peg have helped to contain inflationary pressures. Fiscal and trade positions have continued to improve thanks to higher oil and gas prices.

Special Feature – Rising inflation: causes and consequences

- Global inflation has risen sharply over the past year, largely driven by pent-up consumer demand after the COVID-19 pandemic amid supply bottlenecks, which has been exacerbated by the war in Ukraine. Brunei's inflation rate surged to 3.9 percent y/y in April, reaching its highest level in more than 25 years. In particular, food prices have soared, which hurt the poor more as they spend a larger share of their income on food.

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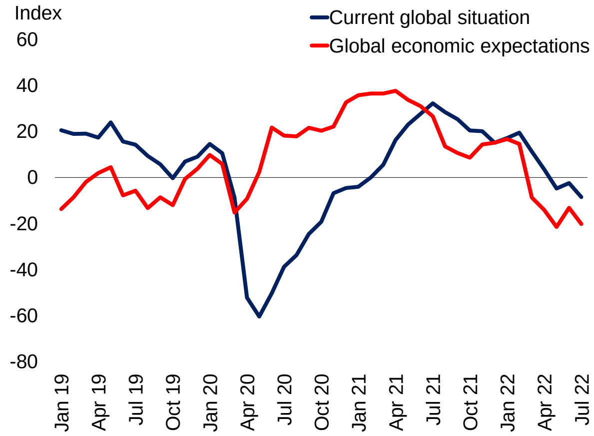
Recent Global Developments

Sharp slowdown in global activity. Global growth slowed markedly in the first half of 2022 owing to the economic disruptions from COVID-19 resurgences brought by the Omicron variant at the start of the year, adverse spillovers from Russia's invasion of Ukraine, and the withdrawal of policy support amid high inflation. Although global mobility has continued to improve, global industrial production and retail sales declined in recent months. Economic sentiment has deteriorated following the outbreak of the war in Ukraine (Figure 1). High inflation has continued to weigh on real household incomes which, coupled with heightened uncertainty, has contributed to weaker consumer confidence. Low income households have been disproportionately affected as the increase in expenditure resulting from recent spikes in food and energy prices represents a relatively larger share of total spending.

Weak growth in major economies. China's economy grew by 4.8 percent year-on-year (y/y) in Q1, but growth slowed to 0.4 percent y/y in Q2 due to COVID-19 outbreaks and lockdowns in multiple cities including Beijing and Shanghai. In April, China's manufacturing and services PMI plunged to 46.0 and 36.2, respectively—the lowest levels since February 2020—but they climbed above 50 in June, supported by economic reopening. In the United States, growth slowed to 3.5 percent y/y in Q1 and 1.5 percent y/y in Q2, partly reflecting supply shortages and the expiry of pandemic-related fiscal support. Consumer price inflation continued to rise sharply, reaching a new 40-year high of 9.1 percent in June (Figure 2). With inflation well above target, the Federal Reserve raised policy rates in March, May, June, and July by a combined 2.25 percentage points. Euro area output grew 5.4 percent y/y in Q1, but activity has decelerated amid soaring energy prices and heightened uncertainty from the war in Ukraine. Inflation surged to a record-high 8.9 percent in July—the highest since the inception of the monetary union—and the European Central Bank (ECB) in July announced its first interest rate increase in 11 years. Further rate hikes could be possible, returning interest rates to positive territory this year—the ECB has had negative rates since 2014. In Japan, output grew 0.7 percent y/y in Q1, reflecting COVID-19 restrictions due to the Omicron wave, as well as weak external demand and a deterioration in the terms of trade caused by the war in Ukraine.

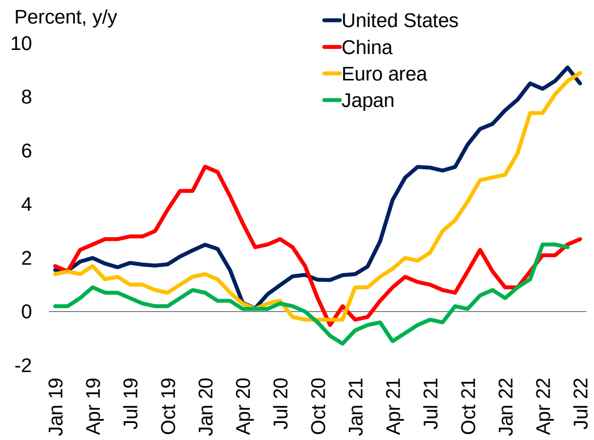
Renewed supply chain disruptions. Global goods trade slowed in the first half of 2022, dampened by the impact of the strict zero-COVID strategy in China and disruptions associated with the war in Ukraine. The global manufacturing PMI new export orders index has been in negative territory since March. Meanwhile, global supply chains continued to experience substantial strains. Supplier delivery times rose in March and April but have eased slightly since May (Figure 3). Indicators of freight waiting times have also increased. Delays and congestions at Chinese ports pushed shipping costs to a six-month high in April. The Russia-Ukraine conflict has also resulted in the diversion of freight traffic to routes that are already over-stretched and expensive as parts of the Black Sea and Sea of Azov remain temporarily closed.

Figure 1. Current and future economic sentiment



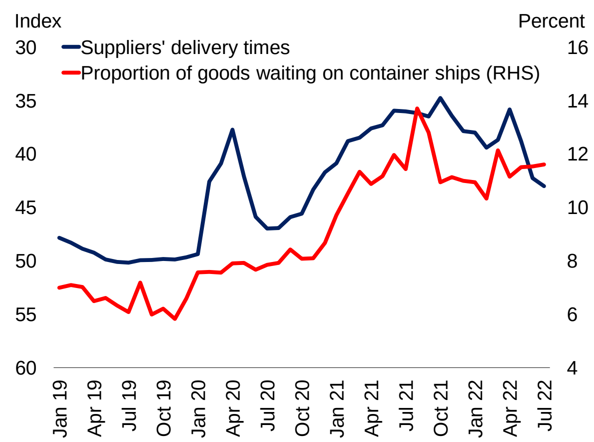
Source: CSPS, Sentix
Note: Positive (negative) values indicate improvement (deterioration). Last observation is July 2022.

Figure 2. Inflation in major economies



Source: CSPS, Organisation for Economic Co-operation and Development
Note: Last observation is July 2022, except for Japan (June).

Figure 3. Global supply chain disruptions



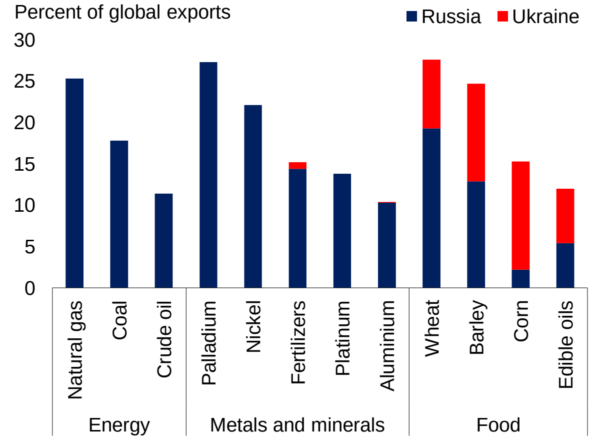
Source: CSPS, Haver Analytics, J.P.Morgan, Kiel Institute, S&P Global
Note: Readings of suppliers' delivery times below (above) 50 indicates lengthening (shortening) delivery times. Goods waiting on container ships based on real-time vessel position and technical maximum capacity. Last observation is July 2022.

Sharp rise in energy and food prices. Commodity prices surged in the first half of 2022, in part reflecting the effects of the war in Ukraine. Price increases were particularly pronounced for commodities where Russia and Ukraine are large exporters. Together they account for 27 percent of global exports of wheat, 25 percent for natural gas, 15 percent for corn and mineral fertilizers, and 11 percent for crude oil (Figure 4). The European Union (EU) has agreed an embargo on Russian coal and oil, and Russia has cut off direct natural gas exports to a few EU member states. Brent crude oil prices averaged a 10-year high of US$120 per barrel in June, despite concerns of weaker demand as a result of COVID-19 lockdowns in China. Although agricultural prices eased slightly in June, they remain above pre-war levels. A particular concern is that a reduction of wheat exports from Russia and Ukraine could result in serious food shortages in developing countries. The reduced global availability of grain—wheat in particular—could trigger a rise in food insecurity, especially in countries with a high share of imported grains and oilseeds. Export restrictions in several countries have compounded global food price increases, although some restrictions have recently been lifted. The war is expected to have less of a lasting impact on metal prices, except for palladium and nickel, given that Russia has a more modest role in global metal exports.

Tightening global financial conditions. Rising inflation, exacerbated by the war in Ukraine, has led to faster and more extensive monetary policy tightening across the world. Volatility has increased significantly in equity, bond, and foreign exchange markets. Since the onset of the war, equity prices have declined and government bond yields have risen. Notably, the U.S. dollar has appreciated against most currencies, with the dollar index rising to its highest level in two decades, thus increasing the cost of servicing dollar-denominated liabilities globally (Figure 5). In part reflecting the recent dollar strength, equity and debt flows to emerging market and developing economies (EMDEs) have turned negative for five consecutive months since March.

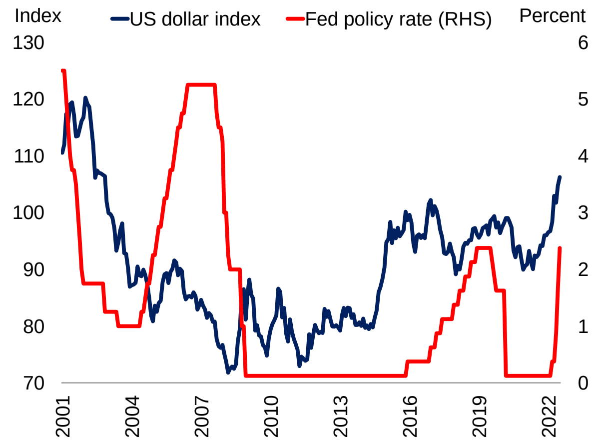
Subdued global economic outlook. Prior to the outbreak of the war in Ukraine, the global economic outlook for 2022 and 2023 appeared broadly favourable. The global economy rebounded by 5.7 percent in 2021 and was projected to continue its strong growth momentum. However, Russia's invasion of Ukraine and pandemic-related shutdowns in major cities and ports in China has delivered a new set of shocks. Global growth is now projected to slow to 2.9 percent in 2022, reflecting more acute inflationary pressures and a faster pace of monetary tightening than previously assumed (World Bank 2022a; Figure 6). Growth in advanced economies is expected to decelerate to 2.6 percent in 2022 as activity is dampened by high energy prices, supply chain disruptions, and unwinding of fiscal and monetary policy support. Despite a still incomplete recovery from the pandemic, growth in EMDEs is projected to slow to 3.4 percent in 2022, well below its annual average of 4.8 percent in 2011-19. Significant downside risks remain, including intensifying geopolitical tensions, more persistent inflationary pressures, continuing supply strains, financial stress from policy normalisation, and worsening food insecurity.

Figure 4. Russia and Ukraine commodity exports



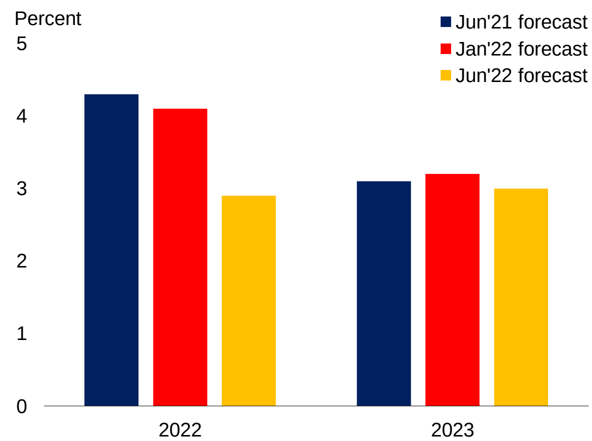
Source: CSPS, Food and Agriculture Organization, United Nations Comtrade, World Bank
Note: Data are for 2020.

Figure 5. U.S. dollar index and Fed funds rate



Source: Bloomberg, CSPS, Federal Reserve Bank of St. Louis
Note: Last observation is July 2022.

Figure 6. Global growth outlook



Source: CSPS, World Bank
Note: Global growth projections made in June 2021, January 2022, and June 2022.

Recent Regional Developments

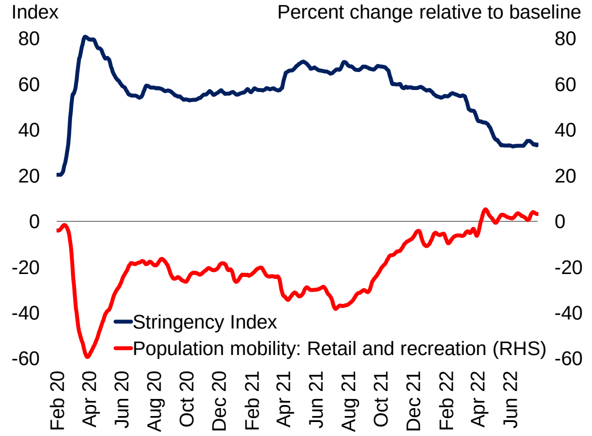
Easing restrictions despite COVID-19 resurgence. Growth in ASEAN was relatively strong in Q1, largely driven by an increase in domestic demand following the resumption of most economic activities as pandemic-related restrictions were further eased. In the past few months, mobility indicators have finally recovered to pre-pandemic levels (Figure 7). Despite a resurgence of COVID-19 infections brought by the Omicron variant, the number of hospitalisations and deaths remain low owing to expanding vaccine coverage. The share of people who have received all doses prescribed by the initial vaccination protocol ranges from 51 percent in Myanmar to more than 97 percent in Brunei. Most ASEAN member states are now treating COVID-19 as endemic.

Rising inflationary pressures. Direct effects of the war in Ukraine have been limited given the relatively modest trade and financial linkages with Russia and Ukraine. However, the indirect impact has come through a sharp rise in commodity prices and supply chain frictions, exacerbated by lockdowns in major cities and ports in China, resulting in markedly higher inflation in all ASEAN member states (Figure 8). Inflationary pressures have been kept under control in some countries due to administrative price controls and subsidies, such as in Brunei and Malaysia. Yet, prices remain well above historical levels, in part reflecting a strong recovery in consumer demand and low base effects. External inflationary pressures and domestic cost pressures are expected to keep inflation elevated throughout the year, which could dent the region's economic outlook. Higher input costs could curtail production, while persistently high inflation and weaker consumer and business confidence could restrain consumption and investment.

Growing fiscal challenges. The aggressive fiscal response to the pandemic has further narrowed the fiscal space in most ASEAN member states and resulted in higher government debt, which may hamper the capacity to respond to future crises. Cambodia's fiscal balance has deteriorated by nearly 9 percentage points of GDP between 2019 and 2021, and Thailand's by 7 percentage points of GDP. Meanwhile, Lao PDR's government debt has increased from 62 percent of GDP to 95 percent of GDP over the same period. Tighter financial conditions, including continued strengthening of the U.S. dollar, could lead to a marked increase in debt servicing costs, heightening financial vulnerabilities and further constraining the fiscal space.

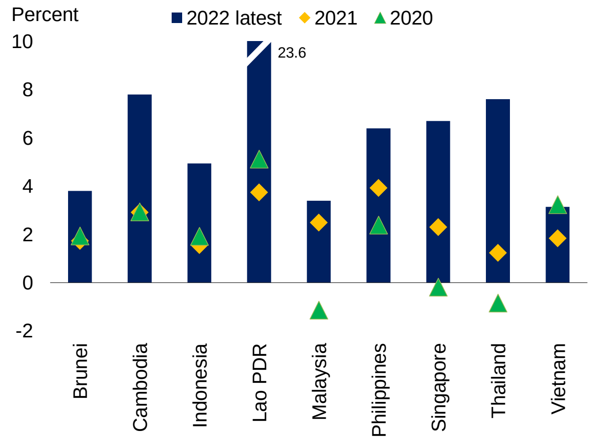
Robust growth outlook. Notwithstanding these challenges, the economic outlook for the ASEAN region remains strong, with growth projected at 5.1 percent in 2022 and 5.2 percent in 2023 (AMRO 2022; Figure 9). This in part reflects a further relaxation of restrictions and allowing a fuller return to normal economic activities, including the reopening of borders and resumption of international travel. However, there are a number of downside risks confronting the region, such as elevated commodity prices, protracted supply chain disruptions, sovereign debt distress, and the emergence of new virus strains that are more vaccine resistant and transmissible.

Figure 7. Mobility and stringency of restrictions in ASEAN



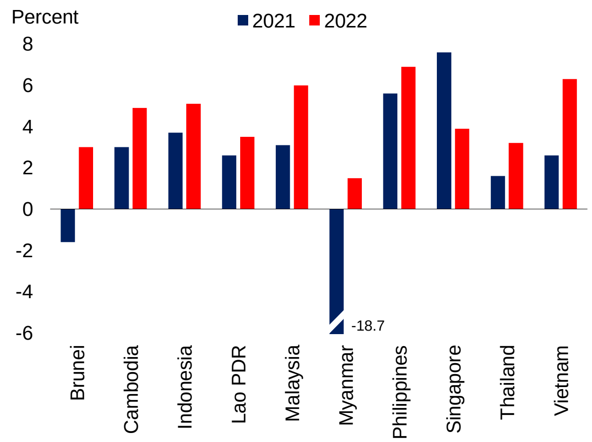
Source: CSPS, Google Community Mobility Reports, Oxford COVID-19 Government Response Tracker
Note: Data based on average of ASEAN member states. Mobility data for Brunei not available. Last observation August 14, 2022.

Figure 8. Inflation in ASEAN member states



Source: CSPS, International Monetary Fund, National authorities
Note: Data for 2022 is latest month available whereas data for 2020 and 2021 are annual averages. Data for Myanmar not available.

Figure 9. ASEAN growth outlook



Source: CSPS, ASEAN+3 Macroeconomic Research Office

Recent Developments in Brunei

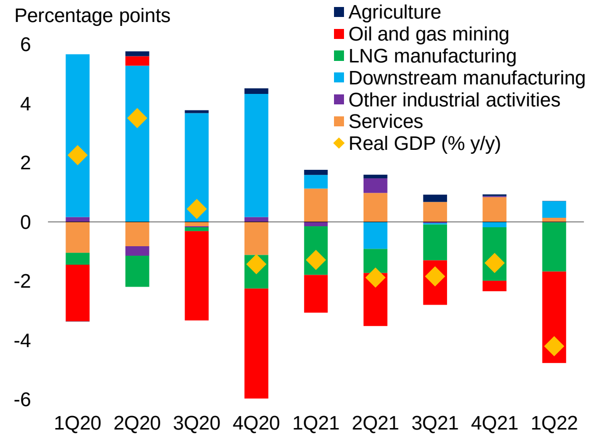
Six consecutive quarters of negative growth. The Brunei economy contracted by 4.2 percent y/y in 2022 Q1, following declines in the previous five quarters (Figure 10). Brunei had experienced such growth outcomes before, when the economy contracted for seven consecutive quarters from 2013 Q3 to 2015 Q1. Two major downside risks to growth that were highlighted in the *Brunei Economic Outlook 2022* report contributed to the weakness in Q1—the emergence of a new and more transmissible COVID-19 variant (Omicron) and further disruptions to domestic oil and gas production.

Decline in retail sales. Domestic retail sales shrunk by 3.9 percent y/y in 2022 Q1, following declines in the preceding two quarters (Figure 11). The recent weakness reflected the impact of the third wave of COVID-19 infections, fuelled by the Omicron variant. Similarly, food and beverages services fell by 10.3 percent y/y in Q1. Nonetheless, on a quarter-on-quarter (q/q) basis, retail sales were 4.8 percent higher than in 2021 Q4 while food and beverages services grew 19 percent. The q/q growth indicates a partial recovery from the sharp decline in activity during the second COVID-19 wave that began in August 2021, driven by the Delta variant. Pandemic-related restrictions have eased significantly since early March this year as the high vaccination rate and adequate healthcare capacity should allow the country to deal with ongoing infections. Brunei entered the endemic phase on June 1, and land and sea borders were reopened for non-essential travel on August 1. The progressive reopening of the economy should enable a faster rebound of economic activity in the second half of 2022, notwithstanding the cross-border spending leakages.

Downward trajectory of oil and gas production. The negative growth in 2022 Q1 was largely due to a sharp contraction in oil and gas mining (-7.8 percent) and manufacturing of LNG (-12.8 percent). Crude oil production fell to 101.6 thousand barrels per day (tbpd) from 114.9 tbpd in 2021 Q1, while LNG production decreased to 732.4 thousand Million British Thermal Units per day (mmbtu/d) from 891.3 thousand mmbtu/d over the same period (Figure 12). The decline in upstream oil and gas production was attributed to maintenance and rejuvenation activities.

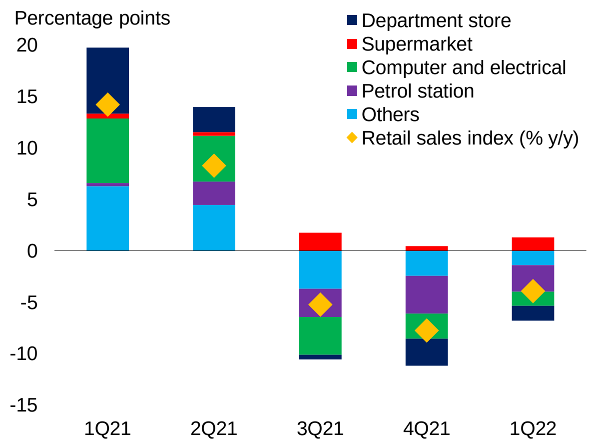
New and emerging sources of growth. On the other hand, strong growth was recorded in the downstream oil and gas sector, particularly in the manufacturing of other petroleum and chemical products (11.1 percent). The downstream sector is expected to become the main driver of growth going forward. After some operational delay, Brunei Fertilizer Industries began production of ammonia and urea in January and exported its fertiliser products to Thailand and the Republic of Korea in February. The fisheries sector also continued to expand (15.0 percent), following double-digit growth rates in the preceding seven quarters. After experiencing steep contractions over the past two years due to the COVID-19 pandemic, the air transport sector is gradually recovering as borders have reopened to allow the resumption of non-essential travel.

Figure 10. Sectoral contribution to GDP growth



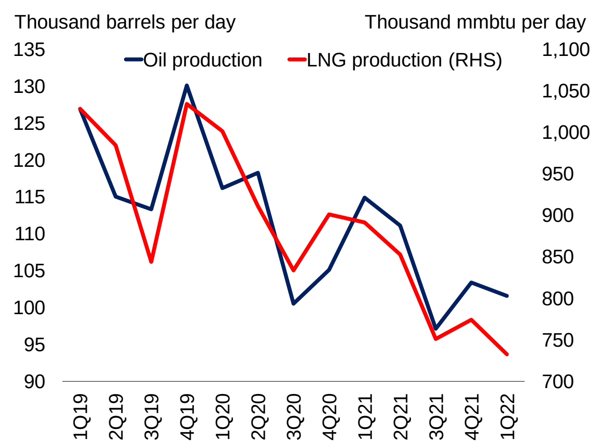
Source: CSPS, Department of Economic Planning and Statistics
Note: Other industrial activities include non-oil and gas manufacturing, utilities, and construction.

Figure 11. Contribution to retail sales by category



Source: CSPS, Department of Economic Planning and Statistics

Figure 12. Crude oil and LNG production



Source: CSPS, Department of Economic Planning and Statistics, Department of Energy

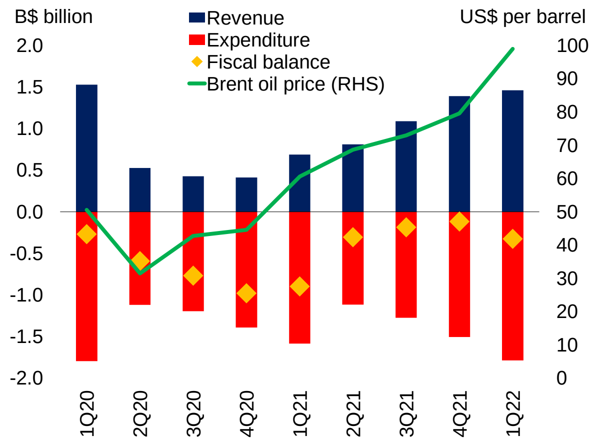
Improving fiscal position. Brunei's fiscal deficit has narrowed significantly since 2021 Q2 thanks to higher oil and gas receipts and tax revenue (Figure 13). Crude oil and LNG prices have increased following a recovery in global demand in the second half of 2021, and have risen even more sharply after the war in Ukraine led to heightened concerns over supply. Brunei's fiscal position remained in deficit in 2022 Q1 due to an increase in government expenditure, but is expected to move into balance or register a small surplus if energy prices remain elevated.

Growing trade surplus. Gross merchandise exports have increased markedly, driven largely by exports of crude oil, LNG, and other petroleum and chemicals products (Figure 14). The value of oil and gas exports was bolstered by the increase in international energy prices, while external demand for downstream products continues to increase and has surpassed pre-pandemic levels. Mineral fuel imports, used mainly as feedstock for the production of refined petroleum products, accounted for the largest share of total imports. Overall, the trade account balance has been in surplus since 2021 Q1. The surplus is expected to grow amid robust external demand.

Sharp rise in inflation. Headline inflation, as measured by the y/y percent change in the Consumer Price Index (CPI), has risen sharply in recent months, reflecting supply-side disruptions due to the war in Ukraine and extended lockdowns in major Chinese cities. Brunei's inflation rate surged to 3.9 percent in April—the highest in more than 25 years (Figure 15). Inflation eased only slightly to 3.8 percent in May. Positive inflation rates have been recorded for 30 consecutive months since December 2019. The recent price increases have been largely attributed to higher prices of food products (especially vegetables, cooking oil, and meat), motor vehicle purchases, air transport, and insurance premiums. Administrative measures, including price controls and subsidies, have helped to keep inflation in check. Electricity and petrol prices, for instance, have skyrocketed in many countries but remain unchanged in Brunei. Moreover, monetary policy tightening by the Monetary Authority of Singapore has supported a strong Singapore dollar, and hence a strong Brunei dollar owing to its currency peg, which has helped to contain imported inflation.

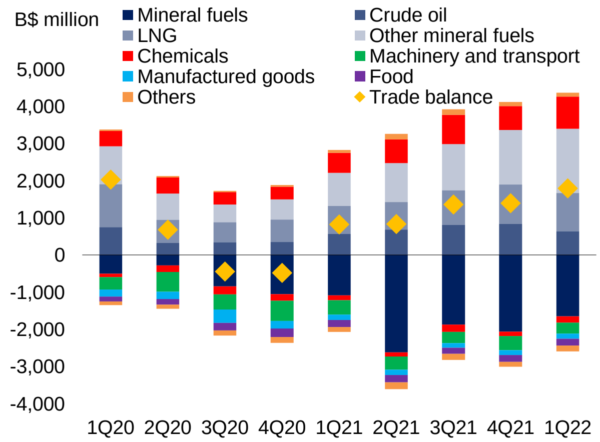
Cautiously optimistic growth outlook, but with significant downside risks. Despite a steep contraction in Q1, the Brunei economy is still projected to grow modestly in 2022. Growth is expected to be largely supported by the downstream oil and gas sector as external demand firms and a rebound in services activity following a full reopening of the economy, which should more than offset the decline in oil and gas production. The emergence of more virulent and vaccine-resistant COVID-19 variants, although a tail risk, remains a threat to economic recovery. Heightened inflationary pressures could persist if global supply disruptions are not resolved, in turn undermining the rebound in domestic demand. Unanticipated domestic oil and gas supply disruptions also present a material downside risk to the outlook.

Figure 13. Government finance and oil price



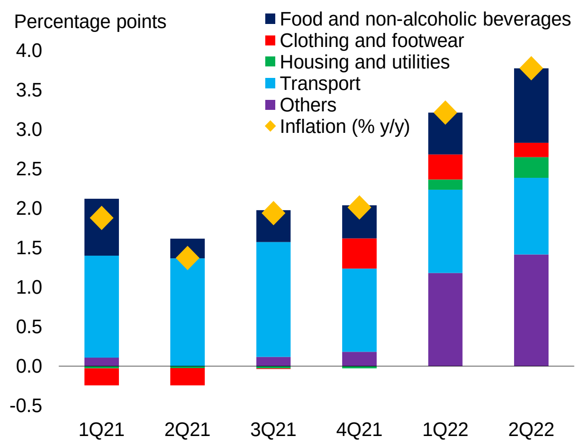
Source: CSPS, Treasury Department, World Bank

Figure 14. Trade



Source: CSPS, Department of Economic Planning and Statistics
Note: Quarterly values are the three-month totals. Exports (imports) indicated by positive (negative) values.

Figure 15. Contribution to inflation by category



Source: CSPS, Department of Economic Planning and Statistics
Note: Data for Q2 2022 are averages of April and May.

Special Feature

Rising Inflation: Causes and Consequences

Introduction

Global inflation has risen sharply over the past year, largely driven by pent-up consumer demand after the COVID-19 pandemic amid supply bottlenecks, which has been exacerbated by the war in Ukraine. Inflation has hit its highest level in decades in many advanced economies and emerging market and developing economies (Figure SF1). Consumer price inflation in June reached 9.1 percent and 9.4 percent in the United States and the United Kingdom, respectively—the highest in these two countries in 40 years. In the Euro area, inflation in July was 8.9 percent, its highest level since the inception of the monetary union. High inflation is now a major policy concern everywhere. Consumer prices in Asia have also started rising, which until recently had largely been an exception to the worldwide pattern.

Central banks have responded by raising interest rates to tame inflationary pressures. The Federal Reserve in the United States has hiked policy rates four times this year, the Bank of England has increased rates five times since December 2021, and the European Central Bank raised interest rates in July for the first time in 11 years. In Asia, the Monetary Authority of Singapore has progressively tightened its monetary policy since October 2021 while the Bank of Korea has increased its benchmark interest rate six times since August 2021.

In this special feature, we examine the causes of the surge in inflation globally and provide an update on the impact on consumer prices in Brunei.

Why is global inflation rising?

The rise in inflation is a consequence of demand-supply imbalances, which can be attributed to a confluence of factors. First, an extraordinary surge in demand as economies emerged from pandemic-related lockdowns. Consumer spending, a major source of economic activity, collapsed in early 2020 during the first wave of the pandemic. Households were forced to cut back on spending from lockdowns, travel restrictions, and health fears, and at the same time accumulated more savings. As economies reopened, the pent-up demand and significant savings unleashed a strong rebound in economic activity. As a result, the global economy expanded much more quickly than in past post-recession recoveries (Figure SF2).

Second, the shift in consumer preferences towards goods and away from services has persisted longer than expected (Carstens 2022). Household spending on goods had been declining relative to services for several decades before the pandemic (Figure SF3). Goods demand surged during the pandemic as more people worked remotely and lockdowns made it impossible to consume many services, but little demand has rotated back to services even as economies reopened.

Third, fiscal stimulus played a role in boosting goods consumption without any noticeable impact on the supply of goods (de Soyres et al. 2022). Many governments engaged in massive fiscal support programmes to mitigate the health and economic fallout from the pandemic. At the same time, accommodative monetary policy fostered loose financial conditions. Supportive macroeconomic policy thus helped firms and households to withstand an unprecedented loss of income, which paved the way for a rapid economic recovery. In the United States, for instance, household disposable income rose sharply during the pandemic and indirectly caused a boom in durable goods spending (Tauber and Van Zandweghe 2021; Figure SF4).

Fourth, supply has been unable to keep up with the demand surge (also refer to Box 1 of the *Brunei Economic Outlook 2022*). This is reflected in shortages of key production inputs including labour supply, increased backlogs of work, delivery delays, and rising shipping costs (Figure SF5). Although supply chain pressures may have eased in recent months, they remain at elevated levels. Recurring shutdowns in major cities and ports in China, such as in Shanghai, Shenzhen, and Ningbo, due to the country's strict zero-COVID policy has further aggravated supply bottlenecks and supply chain disruptions. In the motor vehicle sector, automakers cancelled orders of semiconductors, a key input with a long lead time and competing demand from other industries, as they had expected weak demand during the pandemic. The surprisingly strong demand after the pandemic resulted in acute supply shortages, not only in semiconductors, but in other parts of the auto supply chain as well.

Fifth, the war in Ukraine has further disrupted supply, particularly for food, fertilizer, and energy commodities, of which Russia and Ukraine are significant producers (World Bank 2022b). Supply has been disrupted as Ukraine's grain exports through Black Sea ports have been blocked off and destruction of farms and equipment severely affected Ukraine's agricultural production. Moreover, the West has imposed a wide range of sanctions on Russia, including banning and phasing out Russian energy products. These disruptions resulted in the recent price spikes, and some commodity prices reached all-time highs (Figure SF6). European natural gas prices surpassed $50/mmbtu in July—more than ten times higher than pre-pandemic levels.

Figure SF1. Inflation in advanced economies and emerging market economies

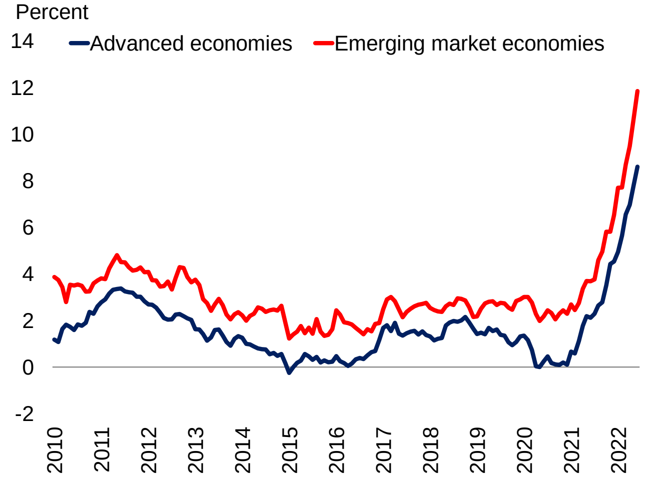


Figure SF2. Event study of GDP dynamics during the COVID-19 pandemic and the global financial crisis

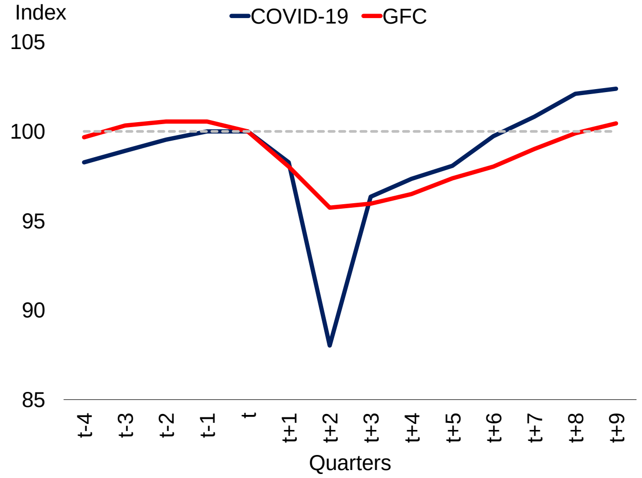


Figure SF3. Share of goods in total consumption expenditure

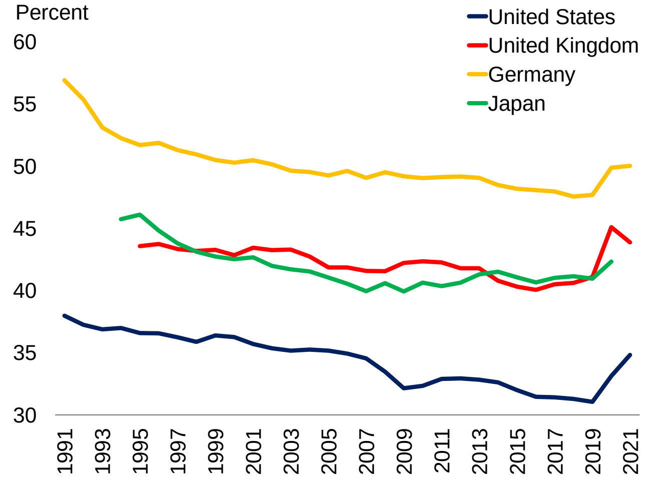


Figure SF4. GDP and household disposable income growth in the United States

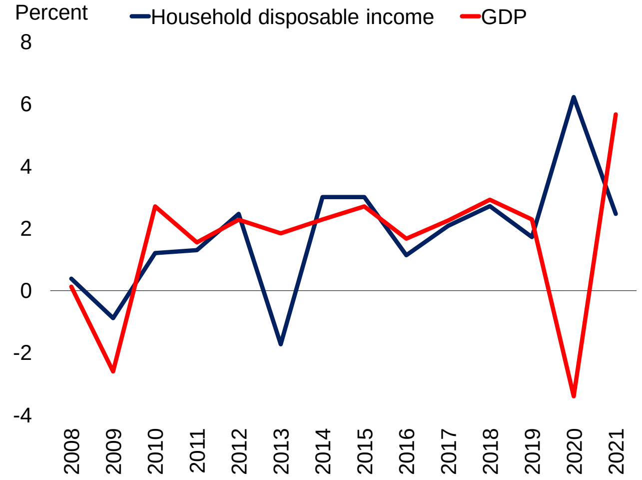


Figure SF5. Suppliers' delivery times and container shipping costs

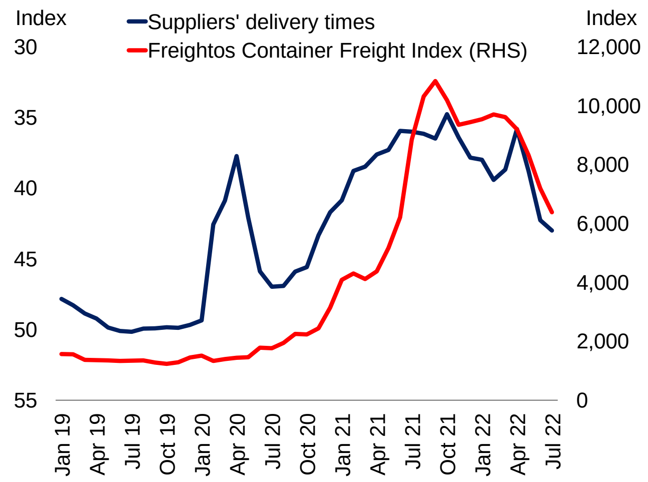
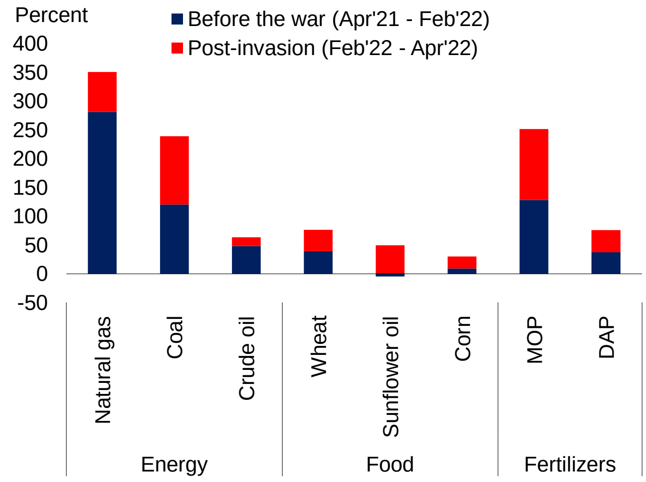


Figure SF6. Increase in commodity prices between April 2021 and April 2022



Source: Bank for International Settlements, CSPS, Federal Reserve Bank of St. Louis, Freightos, Haver Analytics, International Monetary Fund, J.P.Morgan, Organisation for Economic Co-operation and Development, S&P Global, World Bank

Sixth, export restrictions have made a bad situation worse, contributing to food scarcity and driving up food prices (Espitia et al. 2022). Food export bans aimed at protecting domestic prices and supplies are short-sighted and counterproductive, as the 2008 and 2010-2011 food price crises have shown (Giordani et al. 2016; Laborde et al. 2019). Export restrictions reduce the global supply of food, and importers may further wind down import protection, thus increasing global demand. These actions would magnify the initial price shock and ignite a multiplier effect. In early June, 34 countries had imposed restrictions on food and fertilizer, close to the levels of the 2008-2012 food crisis, where 36 countries used such controls.

How has inflation evolved in Brunei?

In various issues of CSPS' *Brunei Economic Update* published since July 2020, we noted that consumer prices had risen significantly due to the effects of the COVID-19 pandemic. Inflationary pressures subsided towards the end of 2021, but have flared up again due to the war in Ukraine. In April 2022, consumer price inflation surged to 3.9 percent year-on-year. Although this rate may seem somewhat mild compared to other countries, it is the highest level in more than 25 years (Figure SF7). On average, prices in 2022 (January-May) were 7 percent higher than in 2019. However, some items have increased sharply, particularly air transport, insurance, motor vehicles, and food products such as vegetables, oil and fats, and meat (Figure SF8).

To assess the impact of global developments on Brunei's inflation, we divide the consumer price index (CPI) consumption basket into distinct categories: (i) Sensitive and positive; (ii) Sensitive and negative; (iii) Insensitive; and (iv) Price-administered. Items that are sensitive and positive are those whose prices in 2020-2022 have increased significantly compared to 2019 (based on statistical tests). These items would correspond more with disruptions from the pandemic or the Russia-Ukraine conflict, such as social distancing, pent-up demand, and supply bottlenecks. In contrast, items that are sensitive and negative are those whose prices are significantly lower in 2020-2022 than in 2019. These items would primarily reflect lower demand caused by the pandemic such as accommodation and recreational services. Insensitive items are those whose prices have not changed significantly. Price-administered items are those whose prices are fixed or controlled by the national authorities, but would have otherwise fluctuated with changes in supply and demand, such as electricity, fuels, gas, and water supply.

Figure SF9 shows the evolution of inflation in Brunei since January 2020. It is obvious that the "sensitive and positive" items (46 percent of the CPI basket) have been the most affected. In the early phases of the pandemic, higher inflation partly reflected supply-related pressures, such as production disruptions and movement restrictions which resulted in shortages of imported inputs, as well as substitution in household spending towards items consumed at home. Towards the end of 2021, global supply disruptions intensified again amid the reopening of economies, which led to the rise in inflation. More recently, the war in Ukraine has lifted prices, most notably for food. Figure SF10 shows the contribution of each category to headline inflation. The contribution of "sensitive and positive" items is the largest, accounting for about four-fifths of the observed inflation during 2020-2022. After falling in 2020 and the first half of 2021, inflation for the "sensitive and negative" and "insensitive" items has begun to creep up over the past few months, indicating the spread of inflationary pressures beyond pandemic-related items. The recent broad-based nature of consumer price inflation is also reflected in the growing proportion of items in the CPI basket with price increases (Figure SF11).

Global food and energy prices have spiked following the Russia-Ukraine conflict. In Brunei, prices of many food items, especially imported products, have increased sharply in recent months. Although the inflationary impact of higher energy prices is not directly felt by households in Brunei owing to administrative price controls and subsidies, the indirect effects are reflected in higher prices of other imported intermediate and finished goods due to an increase in input costs. For many households, rising inflation pose a significant challenge. Higher prices erode the value of real wages and salaries, making households poorer. However, these effects are not felt equally. Recent price pressures have been driven by food items, and therefore cost of living pressures are disproportionately experienced by low income households as they spend relatively more on food compared to high income households. According to data from the 2015/16 Household Expenditure Survey, the poorest 20 percent of households in Brunei spend 16.3 percent of their income on food and beverages, whereas the share is 10.4 percent in the richest 20 percent of households. Consequently, inflation is now higher in poorer households (Figure SF12).

Since cost of living is a function of income and costs, addressing it requires policy actions on both fronts. Targeted safety nets for poor households, such as cash transfers, food, and in-kind transfers, can be an effective temporary tool to soften the impact of higher prices. This would require proper identification of beneficiaries, including calculating inflation indexes for different income groups to better understand the actual inflation experienced by the poor instead of an aggregate national index. Price increases often outstrip growth in wages, which poorer households tend to rely more heavily on, whereas investment income, which accounts for a higher share in richer households, is more likely to keep pace with inflation. Policymakers can help to improve access to financial products that might protect poor families against inflation as well as promote financial literacy more proactively. Meanwhile, addressing costs requires diversifying food import sources to mitigate concentration risks, incentivising quality investments in the agrifood sector to improve farm productivity (e.g. smart/precision farming), and exploring the use of futures contracts to dampen price shocks.

Figure SF7. Consumer price inflation in Brunei

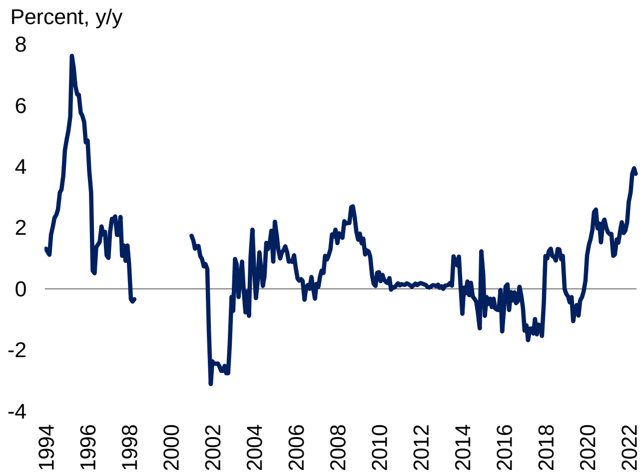


Figure SF8. Increase in prices of selected items between 2019 and 2022

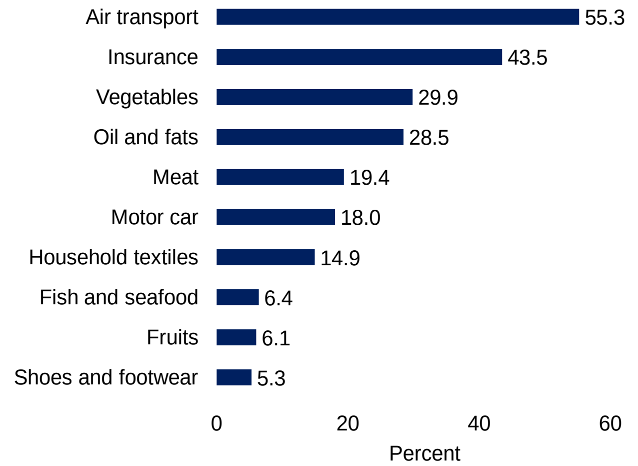


Figure SF9. Consumer price inflation by sensitivity

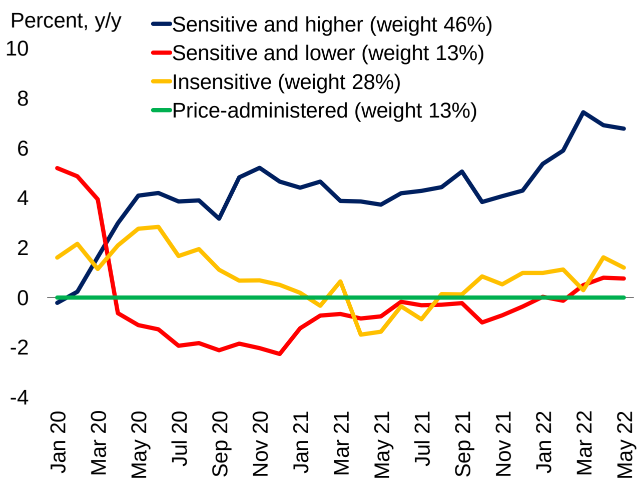


Figure SF10. Contribution to consumer price inflation

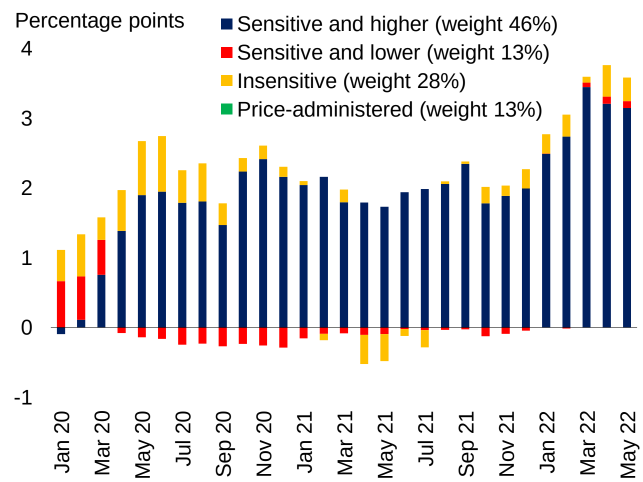


Figure SF11. Proportion of items in the CPI basket with price changes

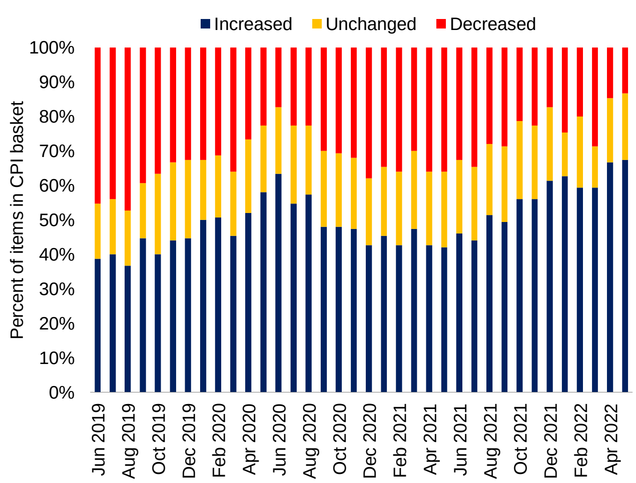
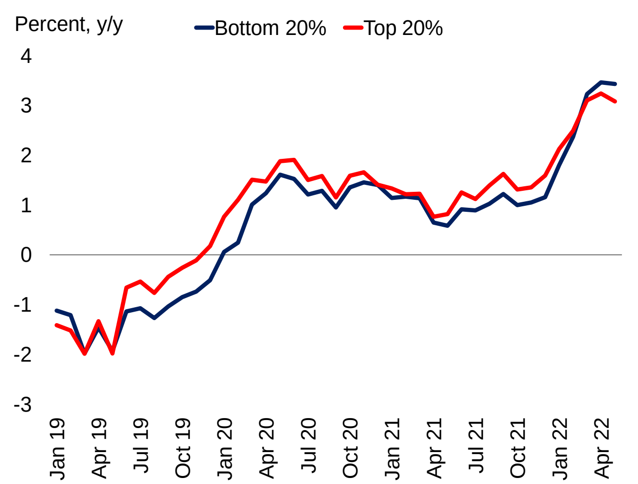


Figure SF12. Consumer price inflation in rich and poor households



Source: CSPS, Department of Economic Planning and Statistics, International Monetary Fund
Note: Last observation for inflation is May 2022. Data for May 1998 – December 1999 not available.

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