

## HIGHLIGHTS from Chapter 4:

### Emerging Inflationary Pressures: Cause for Alarm?

#### Key Points

- *After declining in the first half of 2020, global inflation has rebounded quickly on recovering activity. While global inflation is likely to continue rising in the remainder of this year, inflation is expected to remain within target bands in most countries.*
- *Higher inflation may complicate policy choices in emerging market and developing economies (EMDEs) that are also relying on expansionary policies to ensure a durable recovery.*
- *Measures to strengthen central bank credibility can help anchor inflation expectations. Unless risks from record-high debt are addressed, EMDEs remain vulnerable to financial market stress should investor risk sentiment deteriorate as a result of actual or perceived inflation pressures in advanced economies.*
- *Low-income countries (LICs) have experienced rising aggregate and food price inflation, exacerbating food insecurity and threatening to increase poverty. Attempts to control food prices through price subsidies or protectionist policies could drive global prices higher.*

**Emerging inflation pressures.** At the height of last year's global recession, between January and April 2020, global inflation declined by 0.9 percentage point amid a collapse in demand and plunging oil prices. Since May 2020, however, global inflation has picked up as oil price rebounded and demand recovered. By April 2021, global inflation had risen above pre-pandemic levels (**Figure 1**). The decline in inflation during the 2020 global recession was the most muted and shortest-lived of any during the five global recessions over the past five decades. Similarly, the increase in inflation since May 2020 has been faster than after previous recessions.

**Inflation prospects.** Model-based forecasts point to a 1.4 percentage point increase in global inflation in 2021; survey-based inflation expectations to a 1 percentage point increase. For virtually all advanced economies and one-half of inflation-targeting EMDEs, an increase of this magnitude would leave inflation within target ranges. Even for the one-half of inflation-targeting EMDEs, where it would raise inflation above target ranges, this increase may be temporary and not warrant a monetary policy response as long as inflation expectations remain well-anchored. For now, five-year-ahead inflation expectations remain stable for both advanced economies and EMDEs. However, if the structural forces that have depressed inflation over the past five decades fade, increases in short-term inflation may become more persistent and, thus, threaten the anchoring of long-term inflation expectations. This would complicate the policy choices of EMDEs trying to support their economies with accommodative measures.

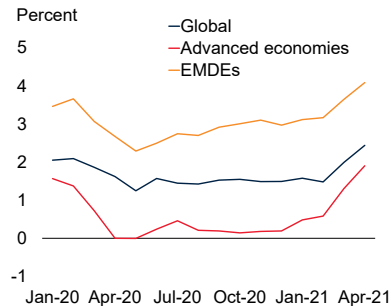
**More pronounced challenges in LICs.** Inflationary pressures are larger for LICs. In contrast to other EMDEs, inflation in LICs increased following the outbreak of COVID-19, largely as a result of food price increases. Further rises in global agricultural prices may add to inflationary pressures in LICs. Attempts to suppress food price inflation through price subsidies, or the reemergence of protectionist policies, could drive global prices higher and prove to be self-defeating.

# Global Economic Prospects

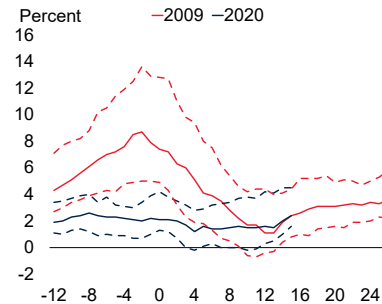
## Figure 1. Global inflationary pressures and inflation prospects

Following a modest decline during January-May 2020, global inflation has rebounded quickly. The inflation decline in early 2020 was more muted and shorter-lived than after the 2007-09 global financial crisis. Model-based forecasts are consistent with an inflation uptick in 2021 by over 1 percentage point but this uptick may be short-lived. Five-year-ahead inflation expectations remain broadly unchanged. A recent surge in global agricultural commodity prices may add to inflationary pressures in LICs in the near term.

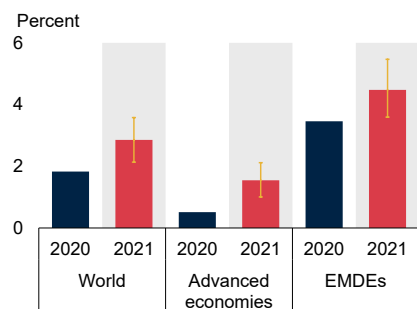
### A. CPI headline inflation, monthly



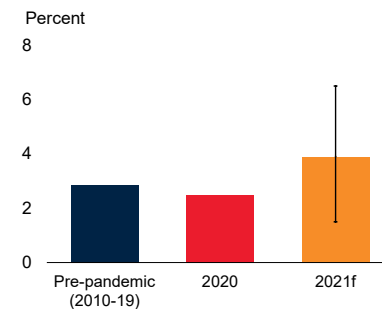
### B. Global inflation in 2008-10 and 2020-21



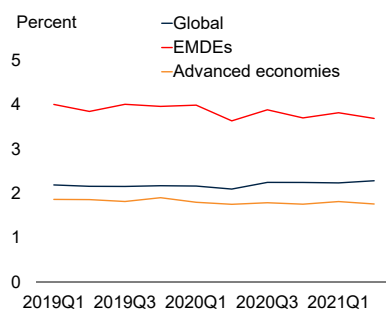
### C. Survey-based inflation expectations for 2021



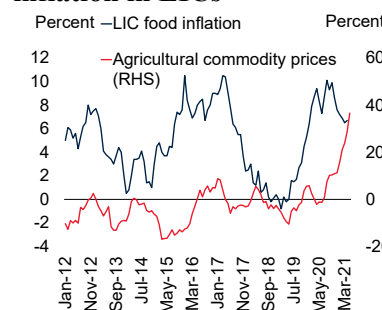
### D. Model-based forecast of global inflation for 2021



### E. Inflation expectations: Five year ahead



### F. Agricultural commodity prices and food price inflation in LICs



Sources: Consensus Economics; Haver Analytics; IMF World Economic Outlook; World Bank.

Note: A. Median of year-on-year headline consumer price index (CPI) inflation in a sample of 81 countries, of which 31 are advanced economies and 50 are EMDEs..

B. Blue and red lines are medians, dotted lines are interquartile ranges. t=0 is September 2008 for 2009 and January 2020 for 2020.

C. Average headline CPI inflation expectations for 2021 based on surveys of May 2021 in 57 countries (31 advanced economies and 26 EMDEs). 2020 indicates actual inflation rates. Yellow whiskers indicate maximum and minimal responses.

D. Conditional forecast of global inflation based on quarterly factor-augmented VAR model of global inflation, global GDP growth, and oil price growth. Vertical line indicates 16-84 confidence bands.

E. Median five-year-ahead consensus inflation expectations among 24 advanced economies and 23 EMDEs.

F. Average food and nonalcoholic beverage price inflation in up to 10 LICs and annual growth in the nominal agricultural commodity price.