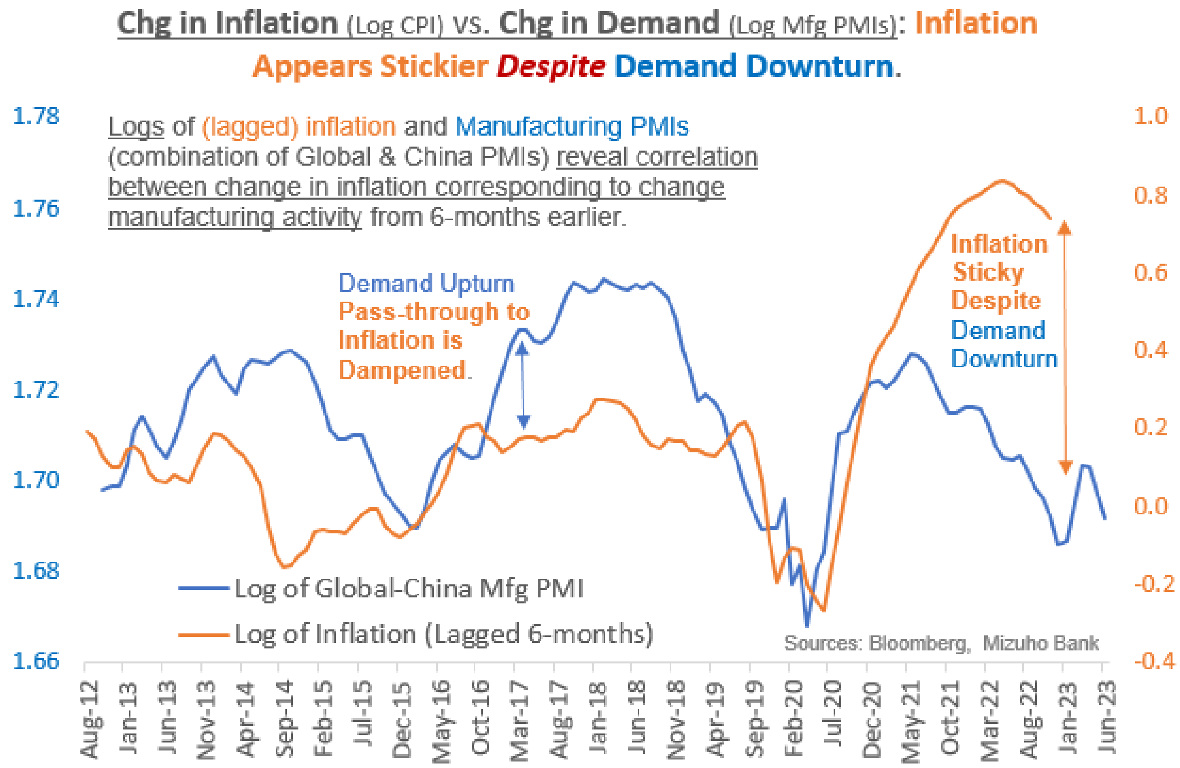
Mizuho Chart Speak: Global Inflation

Economics & Strategy | Asia ex-Japan

18 July, 2023 | Vishnu Varathan | Head, Economics & Strategy

Re-thinking Inflation (Part 1): Structurally Stickier?



"The Force is strong with this one." – **Darth Vader, Star Wars** *(Ep. IV): A New Hope*

In a Nutshell:

- Worryingly, **global inflation dynamic** appears not just more elevated, but crucially **stickier** *despite a corresponding downturn in activity/demand.*
- And whether this is stagflation-type (albeit not stagflation per se) dynamic is *a blip or a binding structural shift* has far-reaching economic and policy implications.
- Admittedly, one-off and probably temporary factors such as the post-COVID transition from goods-to-services consumption render inflation stickier.
- But a conspiracy of post-COVID quirks, Russia-Ukraine war, geo-economic forces and "green transition" frustrate attempts to isolate passing cost-push from persistent shifts.
- Crucially, **intensification of US-China geo-political spat** and **resultant geo-economic, security/conflict premium** from *squandered comparative advantages* and *competitive demand* (for resources) potentially **marks durable inflationary lift**; in what is a stark departure from China's role as a global "inflation sponge" of sorts.
- Alongside "green-flation", the t**hreat of structurally sticky inflation** is **exacerbated**; and future doubts about a durable reversion to 2% inflation target set in motion. But for now, monetary hawks deny sticky inflation the benefit of the doubt.

A particular headache for global central bankers is that ***despite peaking,* inflation is uncharacteristically and discomfortingly sticky**; **far more elevated than corresponding activity downturn would otherwise suggest**. Specifically, *dis-inflationary mechanics of activity pullback appear to be dampened* (Chart).

And it is of **significant economic and policy consequence whether *stagflation-type dynamic*** (albeit not stagflation outright), whereby ***inflation is higher for the same given demand***, is ***merely a passing blip or a binding structural break*** from pre-COVID norms.

Trouble is, a conspiracy of post-pandemic normalization quirks, Russia-Ukraine war, geo-economic shocks and "green transition" **obfuscate the identification of underlying cost-drivers** and **frustrate any attempt to isolate passing inflation blips from persistent risks**.

So, drawing conclusions one way or another remains an exercise in conjectures, not conviction.

Admittedly, **some of the prima facie evidence square with temporary distortions and/or quirks dampening the dis-inflationary process**, thereby **resulting in "stickiness"**.

Notably, the *one-off, likely transitory* (albeit forceful), *migration of cost pressures from goods to services on post-COVID re-opening;* whereby **demand-supply imbalance lurching from goods to services** *amid diminished capacity* **heightens and broadens inflation**.

But while it is *convenient to assume these "re-opening" inflationary distortions will fade*, there are **compelling reasons to not dismiss scope for lingering inflation risks**.

For one, the **interaction between various inflationary drivers and consequent impact on expectations** is hard to determine. Especially *as monetary largesse of yesteryear* may be *coming home to roost;* merely delayed, not decidedly decoupled.

Crucially, and **of the greatest influence on structurally sticky inflation**, the **intensification of US-China rivalry** and *attendant economic conflict;* which inevitably **accelerates the decay of** *China's ability to export-disinflation*__*__ **as durably *higher security/conflict* and *competition cost hikes* that will inevitably have global reach**.

Point being, **China's steady ascent to become the "factory of the world"** since its accession to WTO in the 1990s was **not just coincident with, but arguably critical to, durable suppression and anchoring of global inflation**. And **US-China trade conflict necessarily unravel these price suppression benefits** by driving up costs from; i) *comparative advantages squandered* and; ii) *competitive demand for resource* security/stock-piling.

In which case, **durably restoring 2% inflation anchor** may will **require productivity and technological gains to overwhelm the emerging geo-political cost premium**.

Especially as reversion to global central banks' familiar, comfort inflation zone of 2% is **rendered more even more daunting by interim costs associated with "green-flation"**.

Upshot: The **threat of structurally stickier** (and volatile) **inflation simply cannot be ignored**.

That said, any reassessment of appropriate inflation targets in the context of stable growth-inflation equilibriums must defer to *initial monetary "first response"* (arguably better suited to tame cyclical demand overshoot); as **stickier inflation** is denied are (at least initially) **denied the doubt of structural excuses**.

* Watch this space as we unpack China's evolving impact on global inflation in Part 2.