

ECONOMIC VIEWPOINT



Is Low Global Inflation Coming to an End?

The last few decades have been characterized by slow consumer price growth in many places around the world. Recently, inflation in major countries has remained low, even as the global economic situation appeared to be picking up. Is inflation poised to start taking a bigger bite? This issue of *Economic Viewpoint* looks at global inflation as well as inflation in major economies. Consumer price growth is expected to pick up, but increases will be slow and modest. Moreover, uncertainty remains high and the economic cycle driving the current price increases will not go on forever. Hence, it is too soon for central banks to declare victory by increasing key interest rates. Rather, they are expected to stay below historic norms.

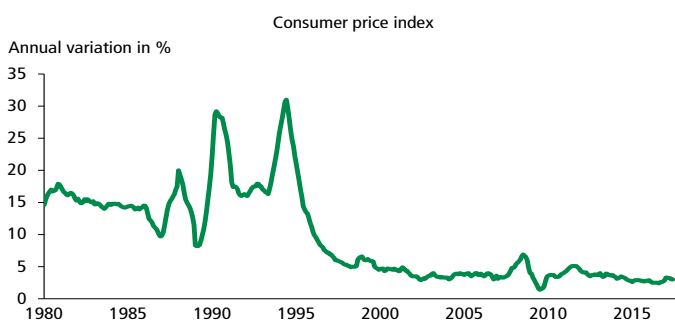
An Extended Period of Global Deflation

Consumer price growth has markedly decreased since the mid-1990s. Data from the International Monetary Fund (IMF) indicates that inflation was around 15% (not including peaks caused by sudden currency movements) until 1995 and fell to around 5% during the 2000s. Oil price movements resulted in acceleration at the end of the 2000s, but was quickly cut short by the economic and financial crisis. Since then, global inflation has largely oscillated between 3% and 4% (graph 1). A number of factors are behind this deflation. Firstly, globalization has considerably reduced the cost of many goods and services. China's rise as a major player in global trade has been one of the main driving forces behind this phenomenon. Secondly, the implementation of more efficient monetary policies, backed by credible inflation targets, has helped to stabilize price increases.

Two Differing Portraits: Advanced Economies and Emerging Economies

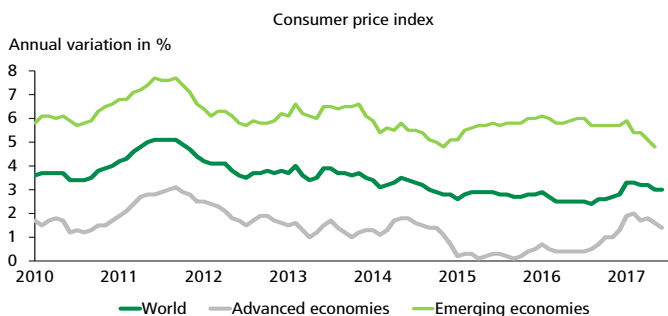
Obviously, this overall portrait does not illustrate the situation for every economy. Substantial differences between interest rates in advanced economies and emerging economies remain (graph 2). This is a reflection of the speed of economic growth among the latter and the difference between the development phases of each country. The efficiency and willingness of central banks to obtain low and stable inflation also play a role, as does the degree of openness to international trade. Other factors such as internal competition, the strength of the private sector, and regulation may also explain the difference between inflation rates in different countries and between emerging and advanced economies.

GRAPH 1
Global inflation has slowed considerably since the middle of the 1990s



Sources: International Monetary Fund and Desjardins, Economic Studies

GRAPH 2
Price changes are much faster in emerging economies



Sources: International Monetary Fund and Desjardins, Economic Studies

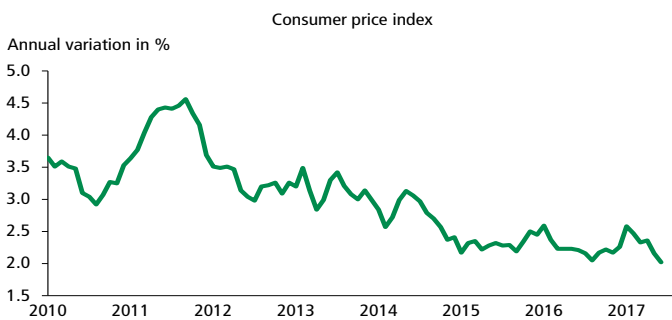
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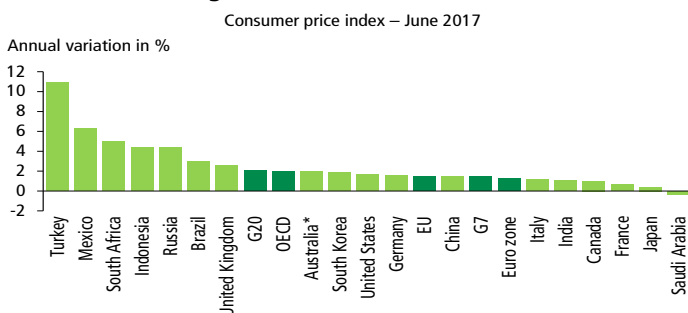
The difference between emerging and advanced countries can also be seen within the “G20”. The inflation rate across the G20 was 2.0% in June, which was down from January’s high of 2.6% (graph 3). This result is also the lowest rate since October 2009, the end of the economic crisis. Of the countries that posted a higher inflation rate than that of the G20 as a whole in June, the only advanced economy was the United Kingdom (graph 4). The United Kingdom found itself in this position largely because of the depreciation of its currency since the June 2016 Brexit referendum. The currency effect was also an inflationary factor for other countries such as Turkey, Mexico and Brazil. China, India and Saudi Arabia were the emerging countries with inflation rates lower than the G20 average.

GRAPH 3
There was a recent slowdown in the inflation rate across the G20



Sources: Organisation for Economic Co-operation and Development and Desjardins, Economic Studies

GRAPH 4
Emerging economies generally have higher rates of inflation than the G20 average

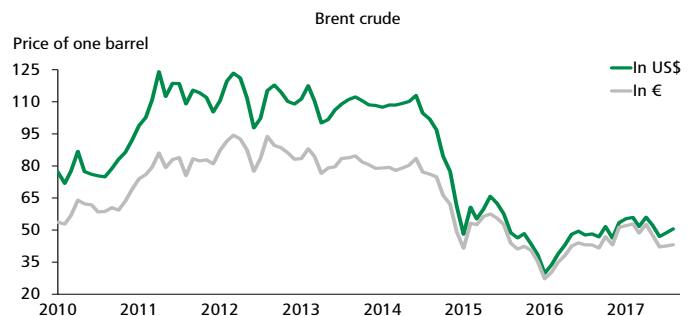


OECD: Organisation for Economic Co-operation and Development; EU: European Union; * Q2 2017.
Sources: OECD and Desjardins, Economic Studies

Oil Prices

On a global scale, and to varying degrees depending on the country, energy price increases were a significant factor in inflation fluctuation. Much of the acceleration in inflation in 2011 and deflation in 2014–2015 was due to changes in oil prices (graph 5). The lull observed since mid-2016 is also reflected in consumer prices. Thus, the contribution from oil prices recently

GRAPH 5
Oil price stabilization has impacted consumer prices



Sources: Datastream and Desjardins, Economic Studies

became more neutral following a temporary surge around the turn of the year. Note that currency movements could heighten or mitigate the effect of oil prices.

What Can We Expect for Global Inflation?

Looking long term and beyond the present economic conditions, the evolution of emerging economies to a more mature structure should bring about a gradual convergence of inflationary pressures closer to levels observed in advanced economies. We also note that the winds of globalization have not been as strong in recent years, hence the deflationary element it brought about could fade as a result. Technological advances could surprise us by contributing to weaker price growth through improved competition and productivity.

The global inflation situation will also reflect other political or cyclical factors. Poor monetary policy decisions, sudden and sharp tax increases, the implementation of protectionist policies, inadequate supply of commodities, sustained global demand, excessive debt and stronger wage pressures could all lead to increased inflation in the medium term.

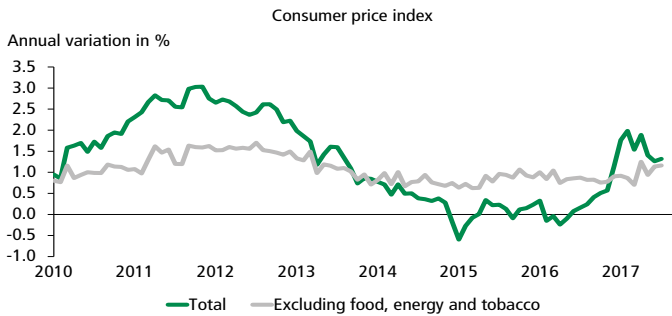
Global inflation will also depend on the inflation levels of each country, particularly if they play an important role in the world economy. With this in mind, here is a brief overview of inflation in a few of the world’s regions. The United States will be covered in another *Economic Viewpoint*.

Euro Zone: Slightly Faster Price Progression

Consumer price growth has been relatively moderate in this decade. It should be said that the Eurozone economy has, in addition to being hard hit by the 2008–2009 economic crisis, undergone other disruptive events such as the sovereign debt crisis and the specific problems related to Greece and Cyprus. In addition to halting economic growth, these situations have led to a notable credit tightening that has held back price increases. Inflation temporarily approached 3% in 2011 because of energy price increases and a drop in the currency, but it has remained relatively modest. Total inflation has not approached the 2%

mark since January 2013. Core inflation has been below this mark since March 2008 (graph 6).

GRAPH 6
Euroland inflation is still under 2%

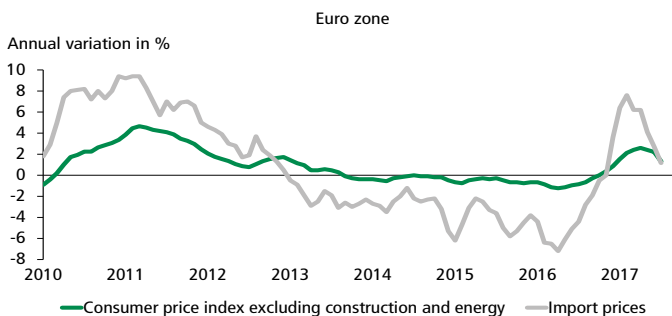


Sources: Eurostat and Desjardins, Economic Studies

However, we have been sensing a certain increase in inflationary pressures, or at least an easing of deflationary pressures for the past year or so. In negative territory in May 2016, total inflation recently reached a high of 1.98% in February. Much of this effect was due to increased energy prices—and oil prices in particular. The annual change in energy prices reached 9.3% in February and fell back to 1.9% in June. It was 4.0% in August. Excluding energy and food prices, core inflation reached 1.2% in August, which was up from 0.9% last winter.

Will consumer prices continue to accelerate in the euro zone? Several factors that put downward pressure on prices have diminished, which bodes well for a return to the 2% target. We note that the price of imports (including energy) and production prices appear to have finally moved out of the negative territory they have been in since 2013 (graph 7). Moreover, economic growth in the euro zone has improved in the past year. Average annualized quarterly growth has been 2.2% for the past year, which is higher than the potential growth of just over 1%

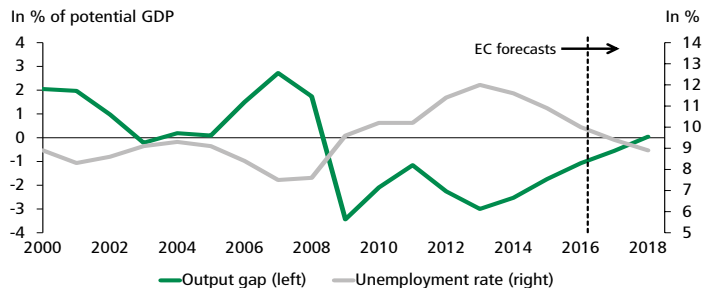
GRAPH 7
Following a surge in 2016, the other price indexes have slowed recently



Sources: Eurostat and Desjardins, Economic Studies

estimated by the European Commission (EC). Thus, the output gap is gradually diminishing and the EC feels it could even close in 2018 (graph 8). The unemployment rate is also falling, and is expected to continue doing so. This could start to fuel certain wage pressures.

GRAPH 8
Less excess production capacity in the euro zone



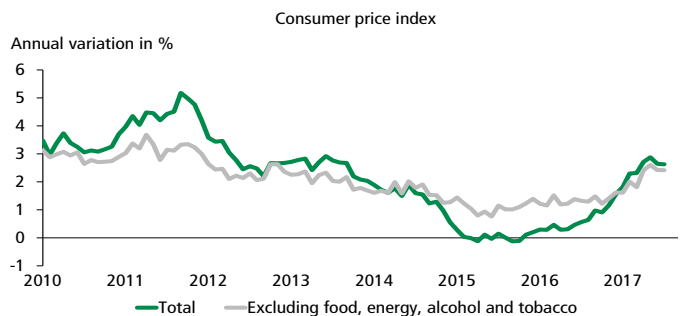
EC: European Commission
Sources: EC and Desjardins, Economic Studies

These factors, coupled with higher average oil prices this year, should lead to total inflation of around 1.5% in 2017 and 2018, compared to just 0.2% in 2016.

United Kingdom: Inflation Influenced by Brexit

After an acceleration in 2011 caused by energy prices, inflation has moderated in the United Kingdom in the years since. It has still remained higher than inflation in the euro zone, thanks in part to faster economic growth, a more expansionary monetary policy and a housing market that recovered more quickly after the crisis. Affected in large part by oil prices, the annual change in consumer prices was mostly negative at the end of 2015, but has since accelerated (graph 9). This positive trend can also be seen in core inflation, which has been higher than the 2% mark since spring 2017. The acceleration in Britain's inflation over the past few quarters is largely explained by the drop in the

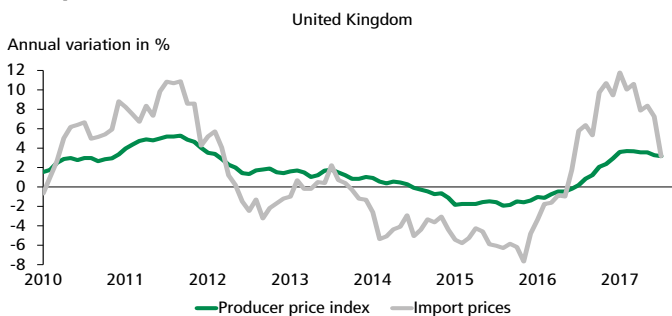
GRAPH 9
Inflation accelerated significantly in the United Kingdom in the past year



Sources: Office for National Statistics and Desjardins, Economic Studies

pound following the June 2016 Brexit referendum. While several economic and financial indicators have performed surprisingly well in the past year, the pound has remained weak. This has put pressure on import and production prices (graph 10) and, over time, on consumer prices. Total inflation recently reached a high of 2.9% in May, the highest rate since June 2013. Core inflation reached 2.6%, its highest level since 2012.

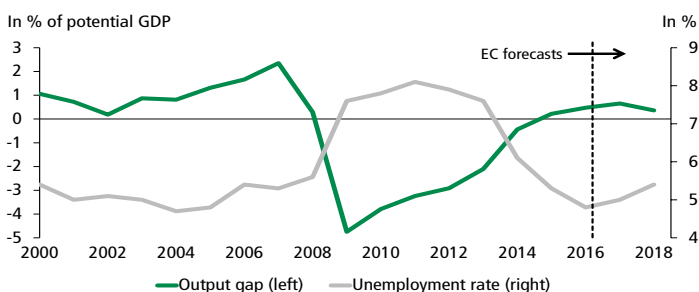
GRAPH 10
Depreciation of the pound has triggered an increase in the price of imports



Sources: Office for National Statistics and Desjardins, Economic Studies

These upside pressures appear to be waning somewhat. The currency-related base effect is becoming increasingly neutral. The slowdown of the British economy, which posted its worst half-year of growth since winter 2013, also played a role. The EC believes that Britain's output gap closed in 2014 (graph 11). However, the recent growth and outlook for a British economy that is prone to Brexit-related uncertainty should generate little inflation. On the other hand, the labour market is doing fairly well, but it could deteriorate before it has a chance to fuel any real wage pressures.

GRAPH 11
The United Kingdom's economic slowdown is expected to reduce inflationary pressure



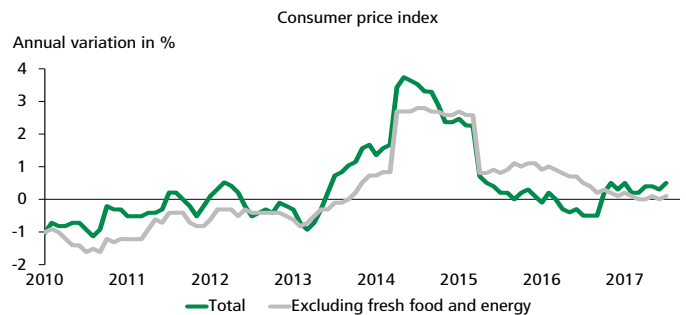
EC: European Commission
Sources: EC and Desjardins, Economic Studies

Inflation is not expected to pick up in the United Kingdom. However, it risks staying fairly high and above the 2% mark in 2017 and 2018 (it was just 0.7% in 2016). This situation obviously complicates the Bank of England's job, as it is caught between a weaker economic outlook and inflation that is too high.

Japan: Between Deflation and Reflation

Japan is a notable example of an economy on the brink of deflation. The annual change in the total consumer price index (CPI) and core CPI was negative between 2000 and 2013 with the exception of the 2008–2009 period. The policy of the Japanese government under Shinzo Abe from the end of 2012 has started a certain reflation supported by a depreciation of the yen, tax hikes and a more aggressive expansionary monetary policy. Inflation came back into positive territory, reaching a peak of 3.6% in June 2014 following an increase in the sales tax from 5% to 8%. The effect has not been sustained, however. Total inflation in July 2017 was just 0.5%, and core inflation was 0.1% (graph 12). This is a long way from the 2% target sought by the Bank of Japan. It now expects inflation won't reach this level before 2020 (it has pushed back this objective six times since 2013). Meanwhile, inflation should be between 0.5% and 1.0% in 2017 and 2018, following a 0.1% drop in 2016.

GRAPH 12
Deflation is relatively common in Japan

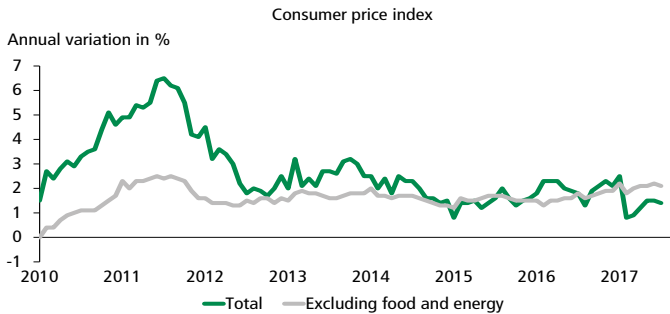


Sources: Ministry of Internal Affairs and Communications and Desjardins, Economic Studies

China: A Drop in Food Prices

Following a spectacular surge from 2009 to 2011, which culminated in a rate of 6.5%, inflation returned to a more stable pace of progression in 2012. This stability is also evident in the core inflation rate, which grew to 1.6% between 2012 and 2016 (graph 13 on page 5). After a slight acceleration in the second quarter of 2016, total inflation slowed suddenly at the start of 2017 and reached 0.9% in February, the lowest rate since January 2015. This situation is largely due to a drop in food prices (-4.3% annual change in February). Total inflation has since seen a slight increase, but remains below the average for the last few years. Core inflation, excluding food and energy, accelerated

GRAPH 13
Core inflation has recently proven more resilient in China than total inflation



Sources: National Bureau of Statistics of China and Desjardins, Economic Studies

slightly and is now above 2.0%. These rates are still below the official target of 3% set by the Chinese authorities. Inflation of about 2% is more likely for 2017 and 2018.

Conclusion: Still Too Soon to Claim Victory

With the world economy showing more robust growth, a stabilization of oil prices (albeit at relatively low levels) and a loss of momentum in the trend toward globalization, we can expect that inflation will continue to approach the targets set by central banks and governments. However, except for the United Kingdom, the principal overseas countries are still faced with low price growth. In this context, the major central banks will have to be prudent. Yes, the economy could dictate a less expansionary monetary policy, but low inflation suggests that rate increases should happen very gradually. In most cases, the output gap will barely close and the likelihood of an inflationary boom remains remote. Rate increases can be expected by the end of the growth cycle, but we should still see key rates well below historic averages as the cycle peaks.

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