



# Global Inflation

## The Gold Selloff as Warning Sign for Impending Deflation

Recent disappointment with a sluggish economy has altered perceptions about the risk of inflation. Since the beginning of March, ten-year inflation expectations in the U.S. bond market have shed 30 basis points, the sharpest decline in the past year. At the same time, plummeting gold prices bear witness to growing doubts about the reflationary policies pursued by central banks. Moreover, current global trends suggest that this sentiment won't be changing any time soon:

- With inflation rates well below 2 percent and still receding, most industrialized countries are inching their way toward deflationary territory. High unemployment and low capacity utilization rates exert strong downward pressure on wages and producer prices, a trend accentuated by softer energy prices.
- The rising inflation observed in an increasing number of emerging economies is in fact limited to those with little global influence, primarily India, Russia, Brazil, and Argentina. Asia's exporters of manufactured goods still show low inflation rates that are much closer to those in the advanced countries.

All these developments should therefore encourage central banks the world over to go further with monetary easing.

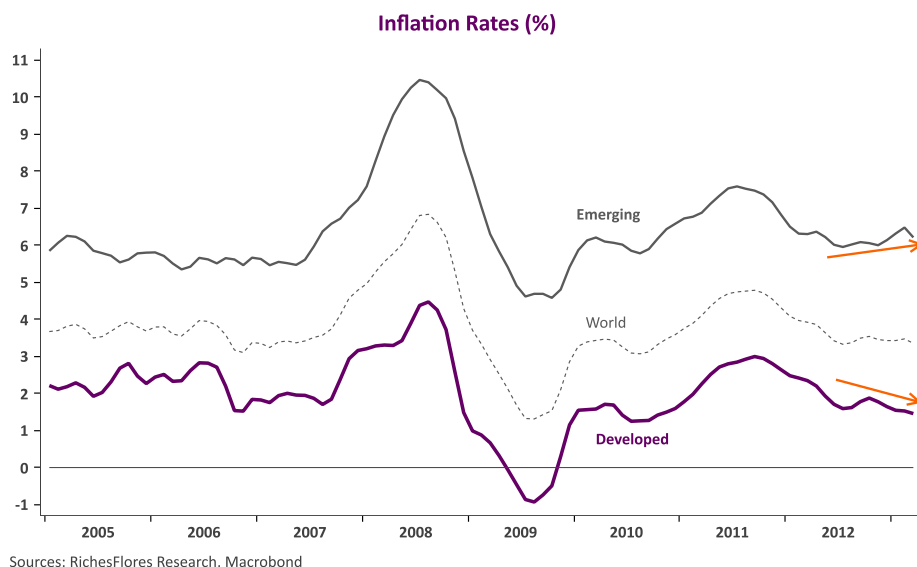
Plummeting Gold Prices Bear Witness to the Shift in Inflation Expectations



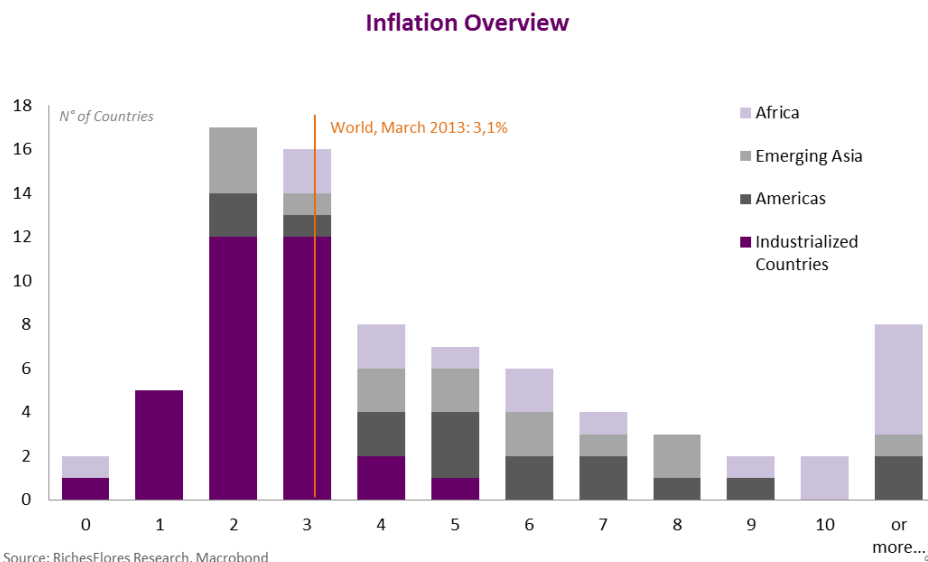
Sources: RichesFlores Research, Macrobond

## Greater Dispersion of Inflation

At 3.1 percent in March, global inflation is in line with the trend under way for almost a year, and quite close to pre-crisis levels. But underlying this average is a widening gap between developed and emerging economies.

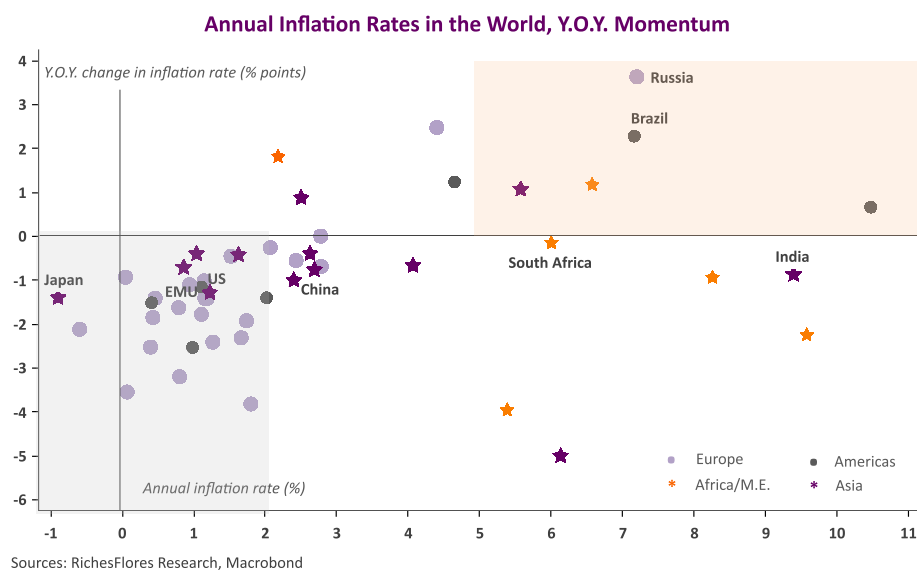


Inflation rate dispersion has increased in the past few months, as shown by the accompanying graph, which presents the results for a sample of 82 countries.



With inflation rates significantly below 2 percent and falling sharply, most industrialized countries and many countries in Asia are currently heading for deflationary territory (L-L quadrant of the graph).

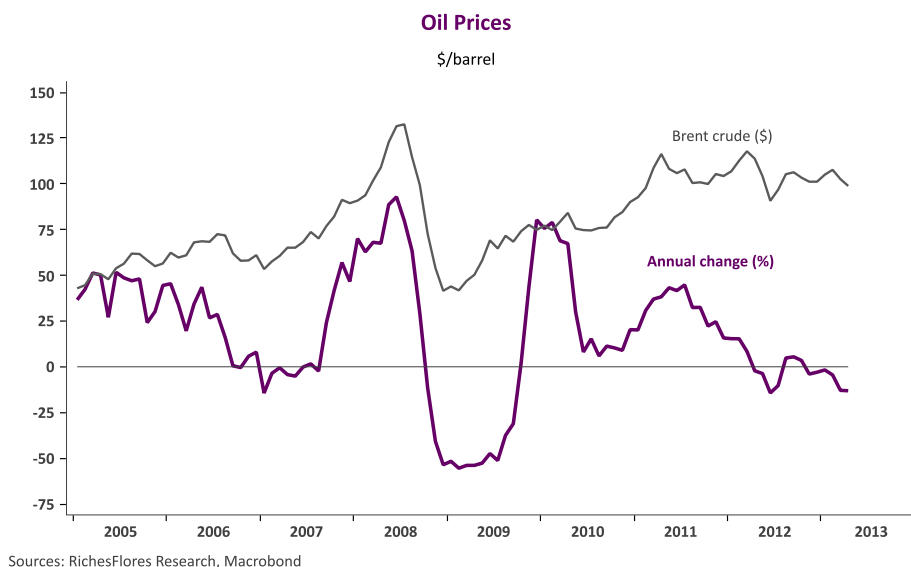
In contrast, the number of emerging economies with annual inflation in excess of 5 percent and accelerating (U-R quadrant) has tended to increase.



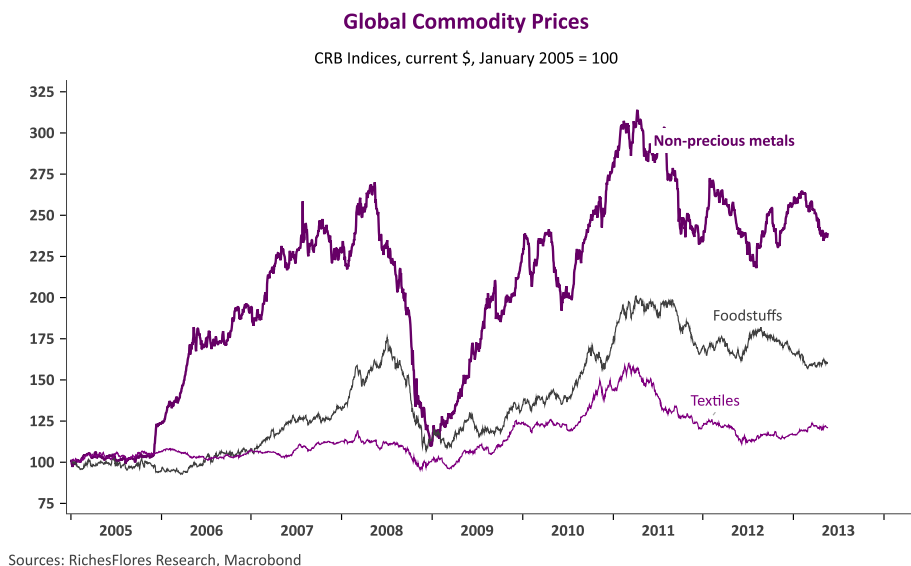
## Softer Commodity Prices

The overall effect of softer global commodity prices has been to tame inflationary pressure.

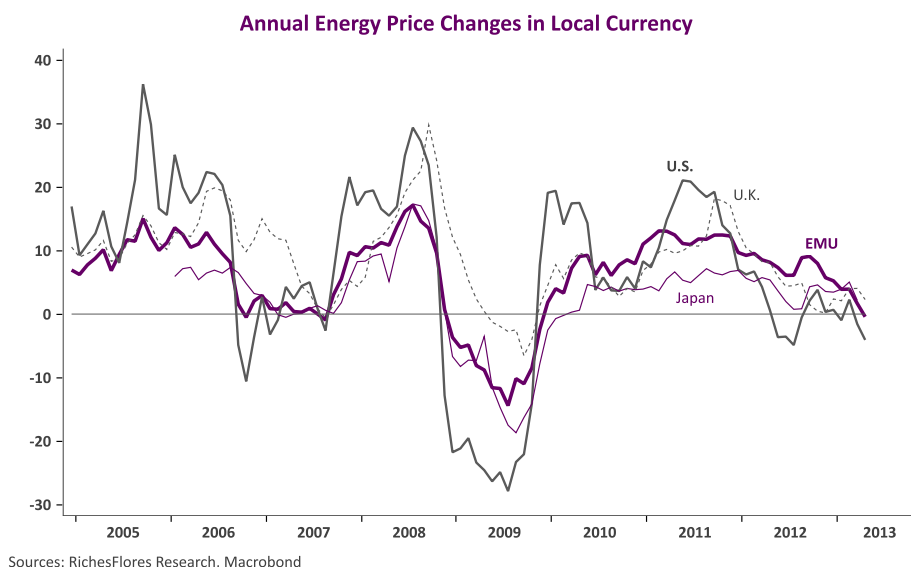
- Oil prices stand 13 percent lower than in the same period last year.



- Likewise, metal prices have resumed their sharp downward trend as worldwide manufacturing has started running out of steam



In the industrialized economies, falling energy prices have pushed inflation down by anywhere from half a percentage point to a full percentage point since the middle of last year.



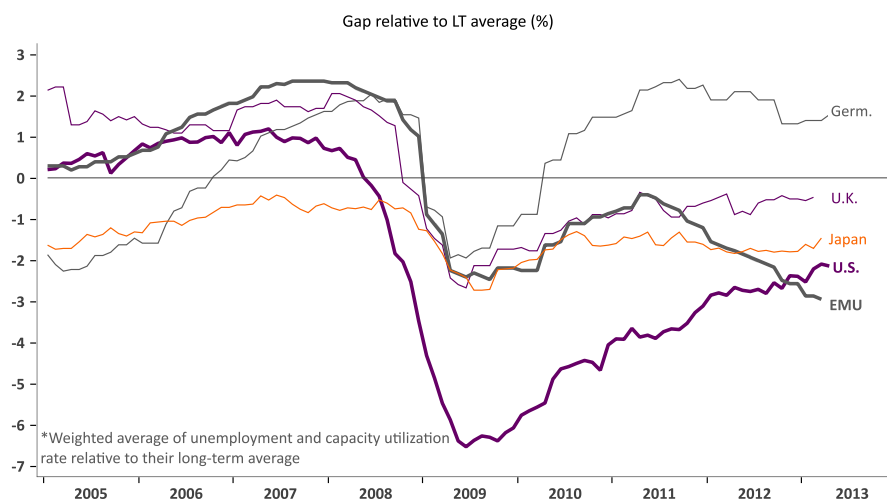
# Disinflation Gaining Traction in Industrialized Economies

High unemployment and low capacity utilization rates point to a growing output gap. According to our indicators, **the output gap in the U.S. economy narrowed by less than a half a percentage point over the past year. In Japan and the U.K., there was virtually no change, whereas the euro area output gap has apparently widened by more than one percentage point, Germany being the lone exception.**

This has increasingly affected wage trends across Europe, excepting Germany. In the U.S., wages have shown very little growth, notwithstanding a slight, shaky increase in the past few months.

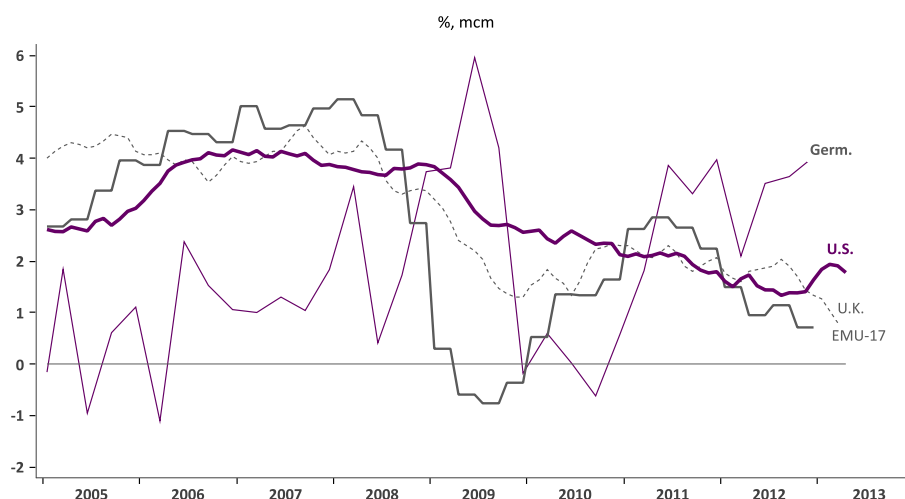
Falling energy prices and wages have wiped out producer price gains in manufacturing.

**Resource Utilization Indicator (Output Gap Proxy\*)**



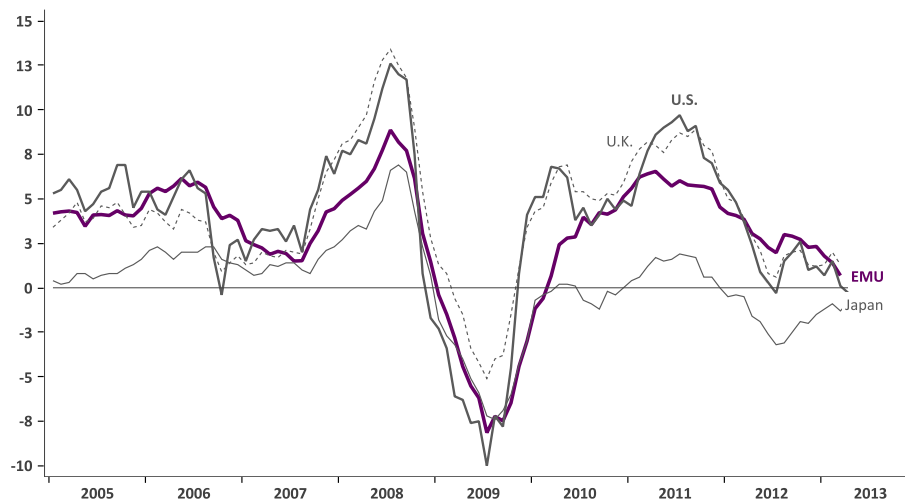
Sources: RichesFlores Research, Macrobond

**Annual Wage and Salary Growth**



Sources: RichesFlores Research, Macrobond

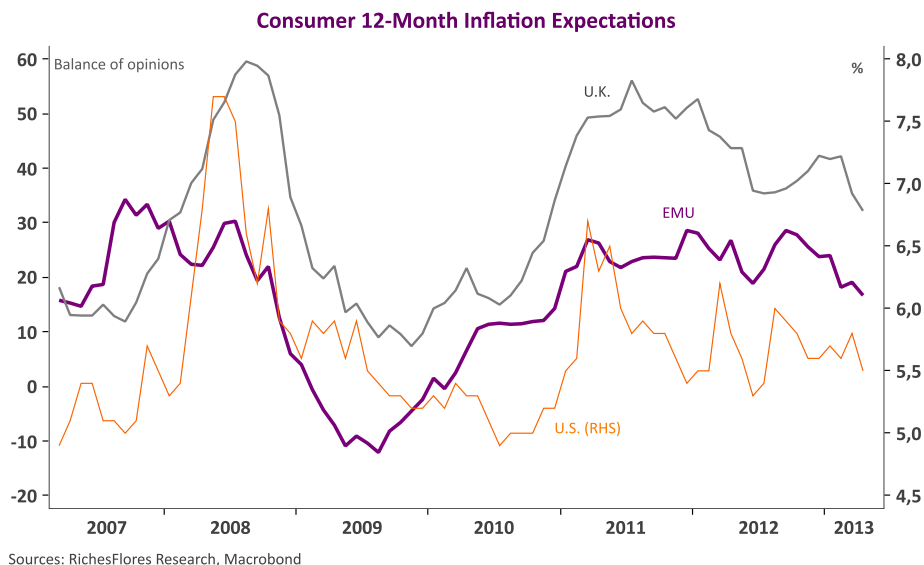
**Annual Producer Price Increases in Manufacturing (%)**



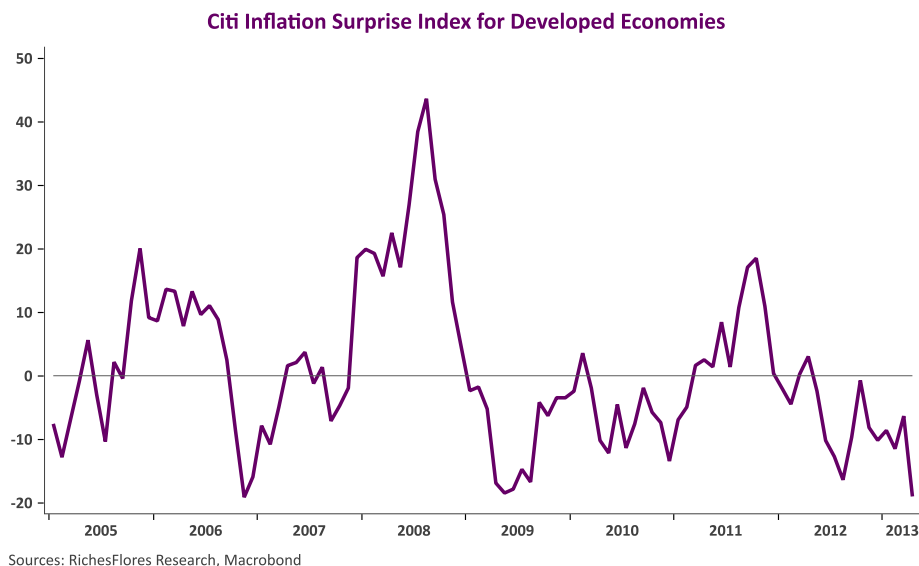
Sources: RichesFlores Research, Macrobond

## Inflation Expectations on the Decline

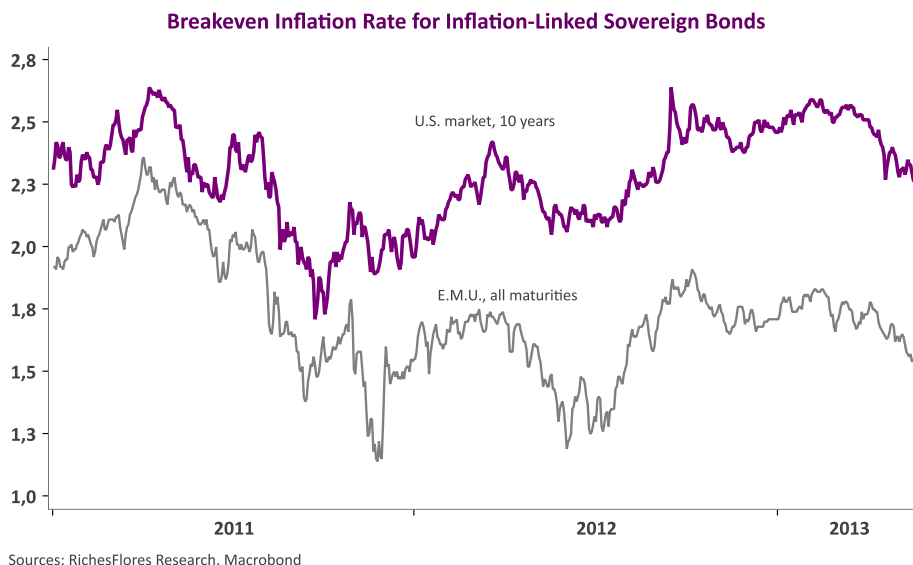
Consumer expectations as to future prices are trending downward.



The inflation surprise index for the industrialized countries has retreated to its 2009 low.



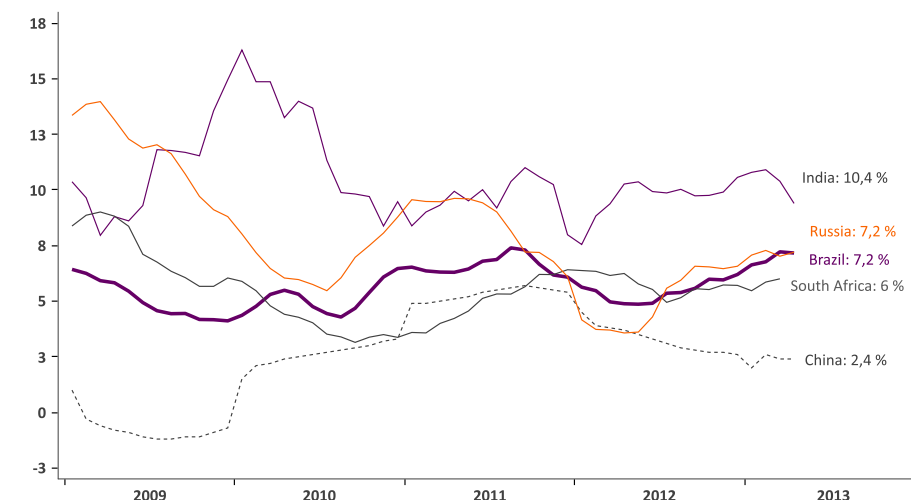
The bond market's implicit expectations are on the way down.



## Disparities in the Emerging World

Inflation rates in the emerging economies show increasing disparities. While inflation rates are still low—and generally declining—in Asia's most open economies, a number of countries seem to be poised for a bout of high inflation. This is particularly noteworthy in several Latin American countries (Brazil, Argentina, Venezuela), as well as in India and Russia.

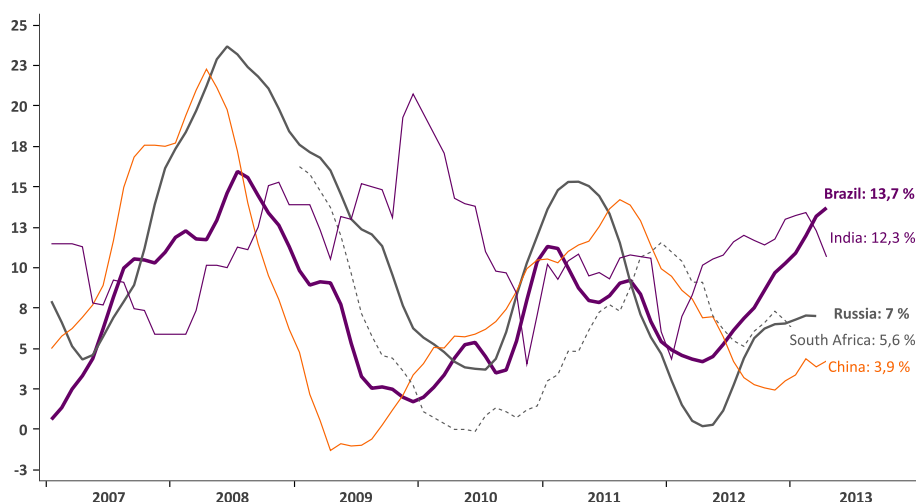
**BRICS Inflation Rates**



Sources: RichesFlores Research, Macrobond

Food price inflation is an important contributor to overall inflation.

**BRICS Food Price Inflation**

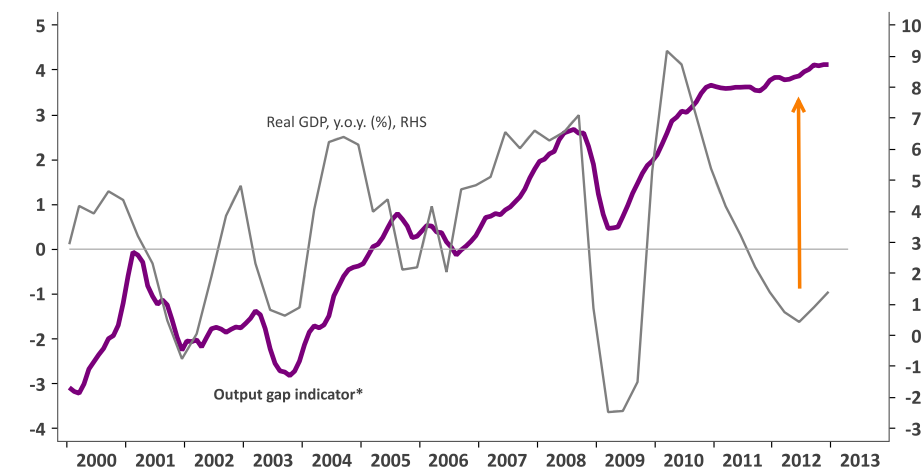


Sources: RichesFlores Research, Macrobond

But structural inadequacies on the supply side are a much more worrisome factor. This problem stands out strikingly in Brazil, where the resource utilization rate has hit an all-time high despite a low level of economic activity. This indicator, reflecting an overheated economy, attests to a high risk of inflation.

**Brazil's Resource Utilization Rate\* and Real GDP Growth**

Weighted capacity utilization and unemployment rate relative to their LT average



Sources: RichesFlores Research, Macrobond

## But Growing Disinflation from Asia

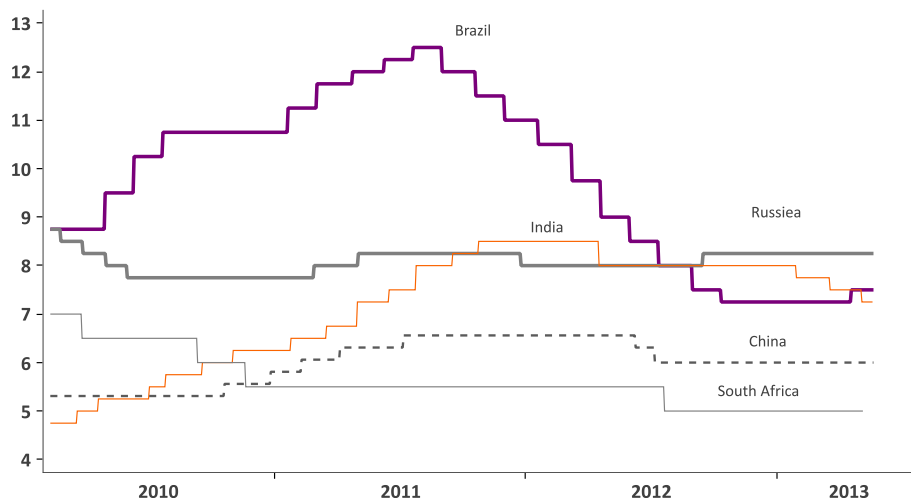
**Mounting inflationary pressures are a source of instability in India, Brazil, and Russia.** Because they limit the ability of central banks to adjust key rates to a weaker economic environment, they put the economy at greater risk.

**However, inflationary spillover to the rest of the world seems unlikely.**

The South Asian economies—the primary exporters of manufactured goods—have much greater impact. Not only are they practically free of inflation, but mounting competition is relentlessly driving their export prices down.

This can be clearly gauged from the world trade price trend, illustrated here by prices for capital goods and consumer goods imported by the developed economies.

Key Rates in BRICS (%)



Sources: RichesFlores Research, Macrobond

Capital Goods Import Prices

y.o.y. (%), mcm



Sources: RichesFlores Research, Macrobond

Consumer Goods Import Prices

y.o.y. (%), mcm



Sources: RichesFlores Research, Macrobond

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