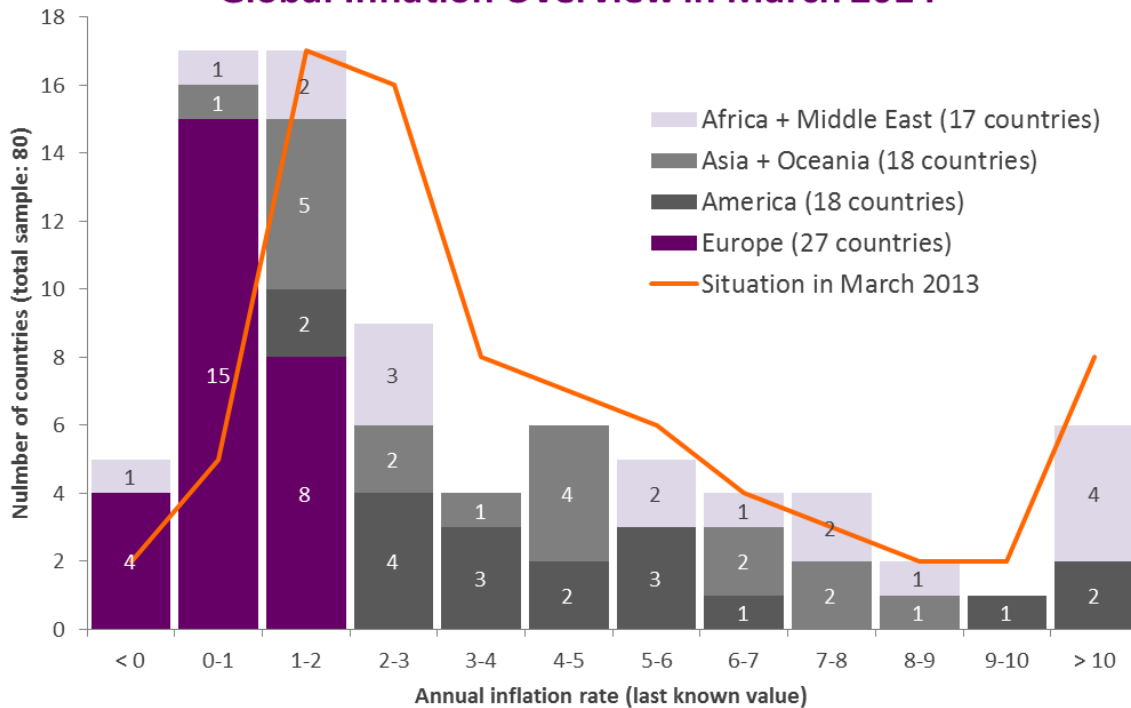


Global Inflation Monitor

At the global level, disinflation is gaining ground. After a temporary rebound during spring, global inflation continued its downtrend in the second half of 2013 and ended the year at 3.2%. Inflation remains very weak in the developed world, at 1.3% in December, and has also sagged in many emerging markets in recent months, to finish 2013 at 6.1%.

In fact, as of December 2013, nearly half the countries (39) in our sample of 80 countries had inflation rates of less than 2%, which is markedly higher than a year ago (24). These figures have seen the addition of a growing number of Asian economies (6), the United States and Canada as well as all 27 members of the EU – without exception. Moreover, the number of countries with moderate inflation (3-4%) decreased sharply while the proportion of high-inflation economies ($\geq 6\%$) has not changed considerably and includes African countries and conflict-plagued countries for the most part.

Global Inflation Overview in March 2014



Sources: RichesFlores Research, IMF, Macrobond

Disinflation Is Gaining Ground Across the Globe

Global inflation has once again headed sharply lower recently under the combined effects of persistent weakness in the developed world and easing inflation in emerging markets.

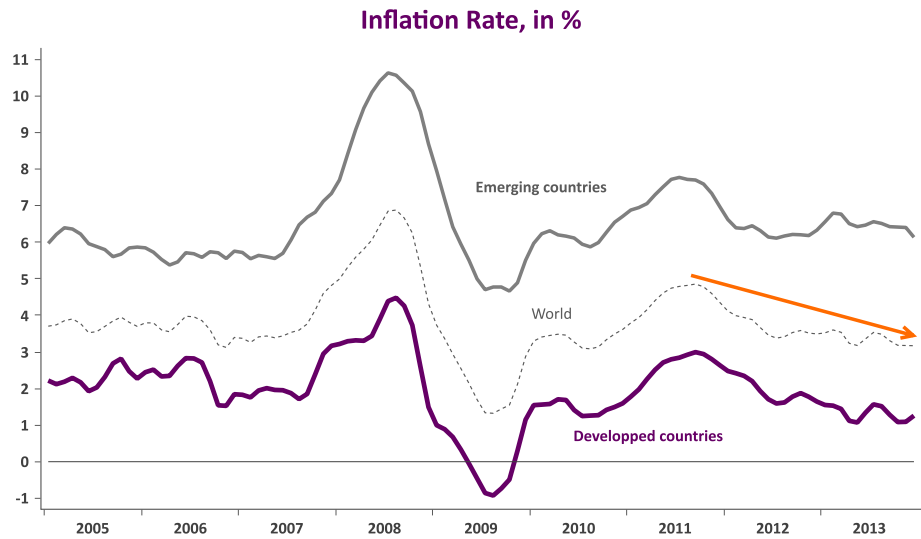
A large proportion of countries are currently experiencing deflation or at risk of doing so.

These include:

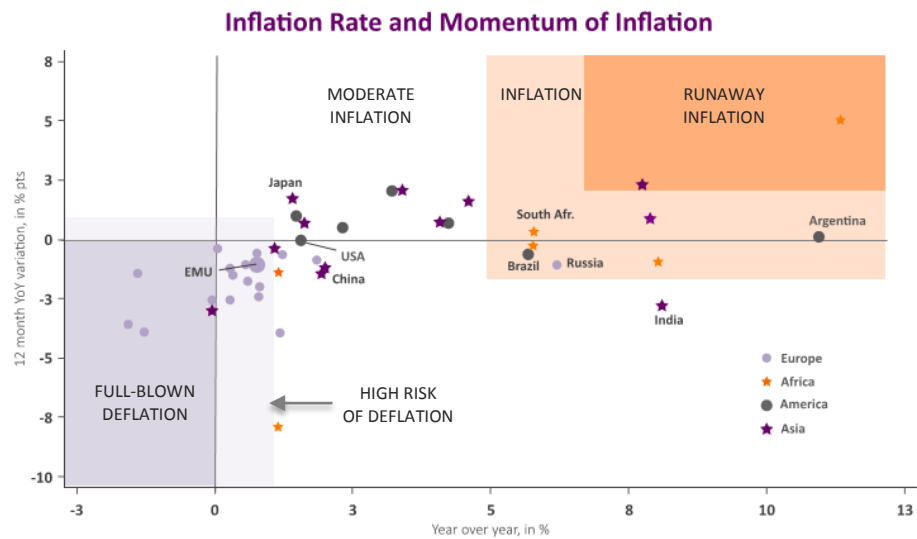
- 4 with full-blown deflation: Greece, Bulgaria, Slovakia and Cyprus,
- 17, of which 15 in the EU, are in the high risk zone (i.e. inflation rate of 0-1% and falling).

As we can see, the rapid expansion of the money supply has not been enough to offset the risk of rampant deflation on a global scale, with the lone exception being Japan. After many years mired in deflation, Japan has not only broken the deflation curse but exited its risk-zone.

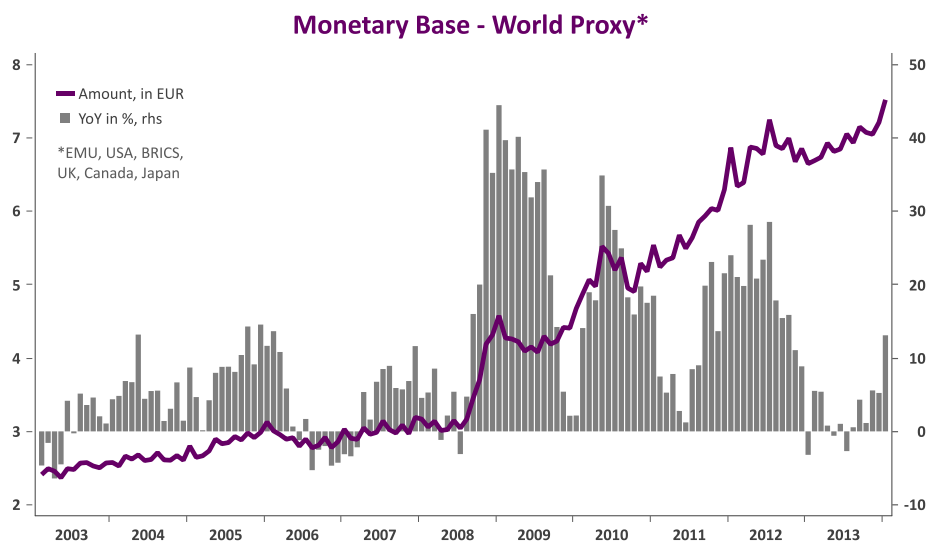
Barring cases of highly specific economic situations (Venezuela, Argentina) or war-torn areas, inflationary tension has eased in countries with high inflation. Nevertheless, this trend could be challenged by the recent succession of EM currency depreciations.



Sources: RichesFlores Research, Macrobond



Sources: RichesFlores Research, Macrobond



Sources: RichesFlores Research, Macrobond

Commodity Prices Easing

Global commodity prices have contributed to easing global inflation.

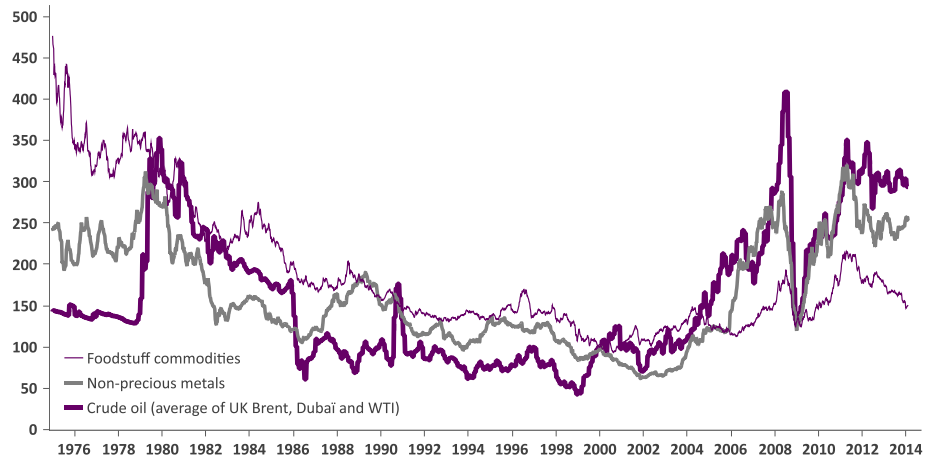
With oil prices stable, on balance, since mid-2012, energy inflation has essentially reflected forex changes in the past few months (drop in yen and rise of the euro, notably).

In fact, the energy component of inflation returned to slightly negative territory in the euro area, although only accounting for two-tenths of the drop in total inflation in the past twelve months. On the flip side, the yen's fall continues to drive high energy inflation in Japan and thus contributes to propping up overall price levels.

The message sent by the persistent fall in commodity prices is not encouraging for global growth and helps spread a deflationary climate at the global level.

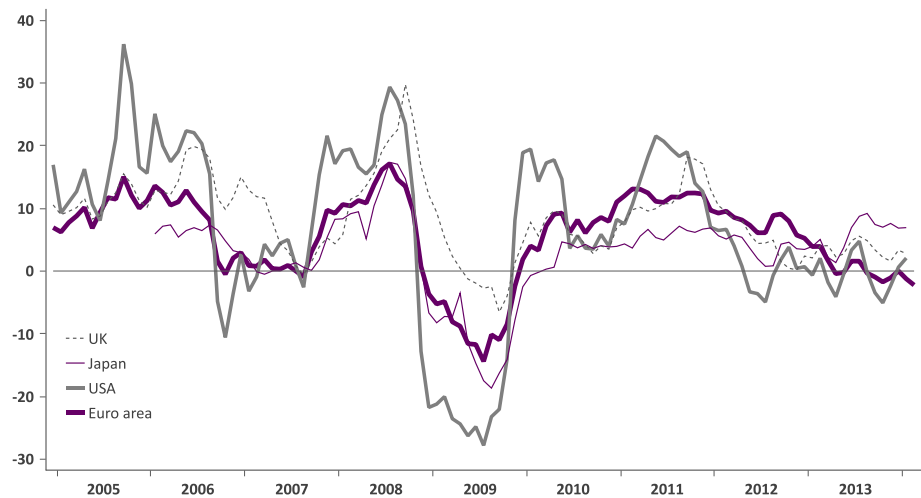
Main Commodities - Real Prices

At 2012 international prices, USD, 2010=100



Sources: RichesFlores Research, Macrobond

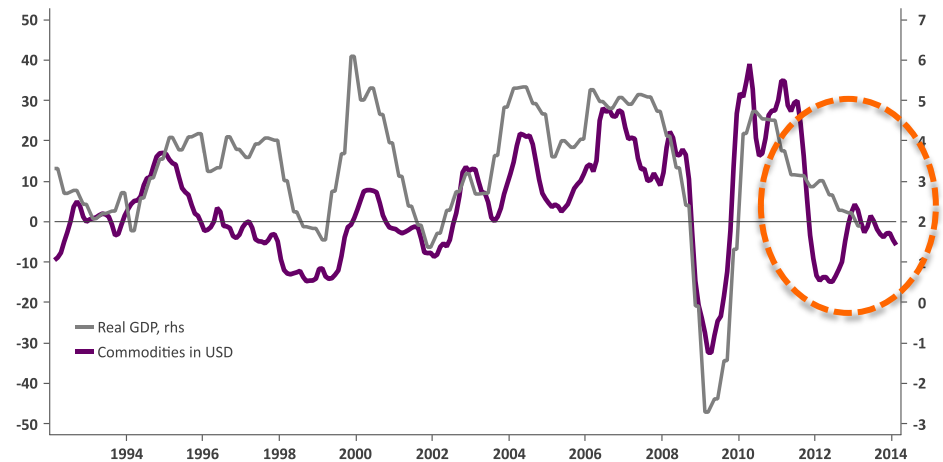
Energy Inflation Rate - Local Currency



Sources: RichesFlores Research, Macrobond

Commodities Prices Excluding Energy and World GDP

IMF data, YoY in %



Sources: RichesFlores Research, Macrobond

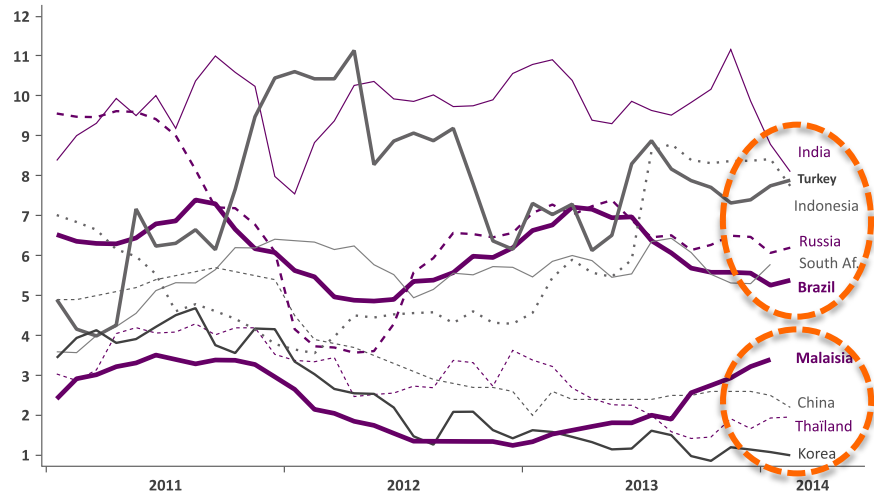
Price Picture Still Mixed in EMs

The price backdrop remains highly uneven in emerging markets. Asian countries that export manufactured goods still have very low inflation levels, comparable to those in industrialized countries. Most of these countries, which often have sizeable current account surpluses, have suffered from low growth in their export markets and fierce competitive pressure that has been exacerbated by increasingly-structural industrial overcapacity.

The others, for the most part commodity exporters, have found themselves in disequilibrium again, combining current account deficits and core inflation.

In Brazil, the central bank's aggressive monetary policy has succeeded in reversing the inflationary trend, although it is the exception.

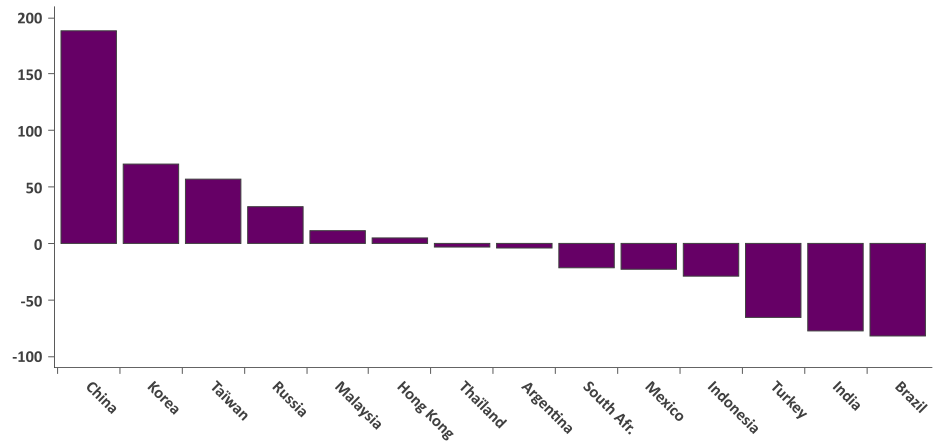
Inflation - Main Emerging Countries



Sources: RichesFlores Research, Macrobond

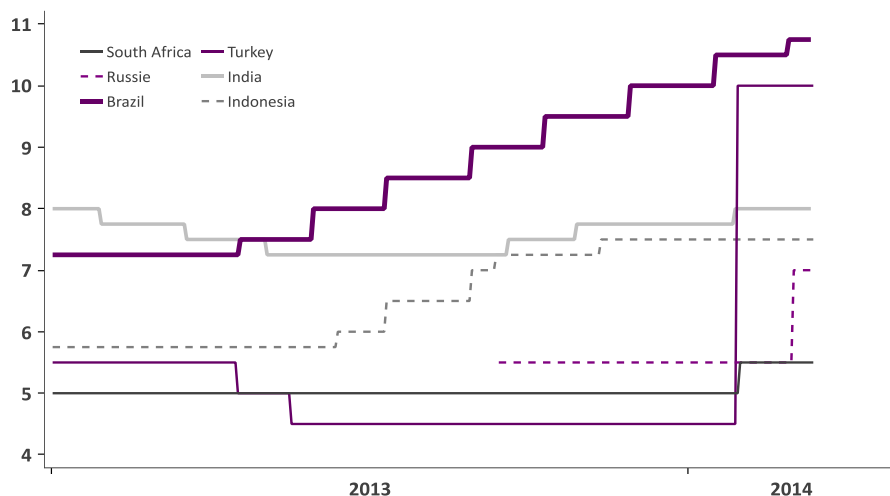
Current Account Balance

Annual sum at the end of 2013, in billion USD



Sources: RichesFlores Research, Macrobond

Central Bank Key Interest Rates, in %



Sources: RichesFlores Research, Macrobond

Deflation Risk Remains High in the West

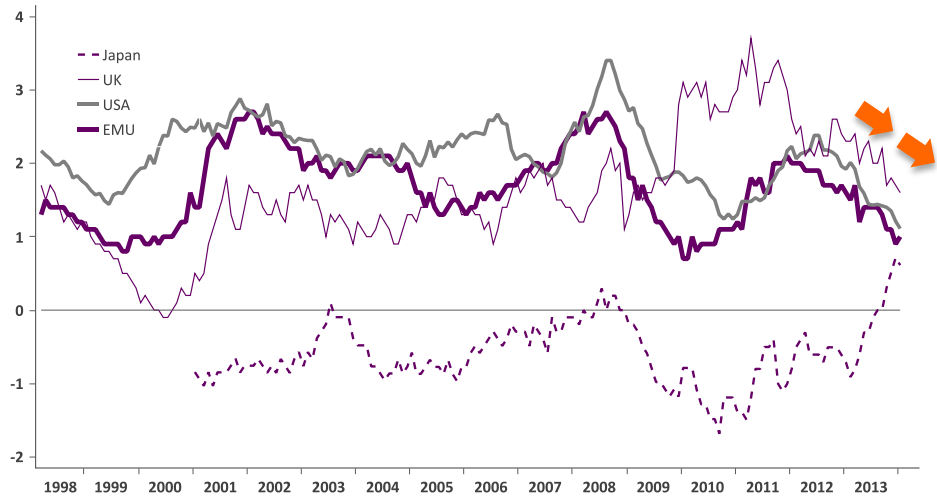
The core inflation rate has continued to fall in western countries in recent months. While the situation in the euro area has raised more concern, core inflation is not much stronger in the United States or the United Kingdom where it has also dropped considerably.

Against this backdrop, the rise in inflation in Japan has been spectacular, although it could fall just as fast before year's end depending on developments in domestic demand and exchange rates.

These contrasting trends are reflected in the change in production costs, which are low – or falling - across all developed countries, but increasing in Japan.

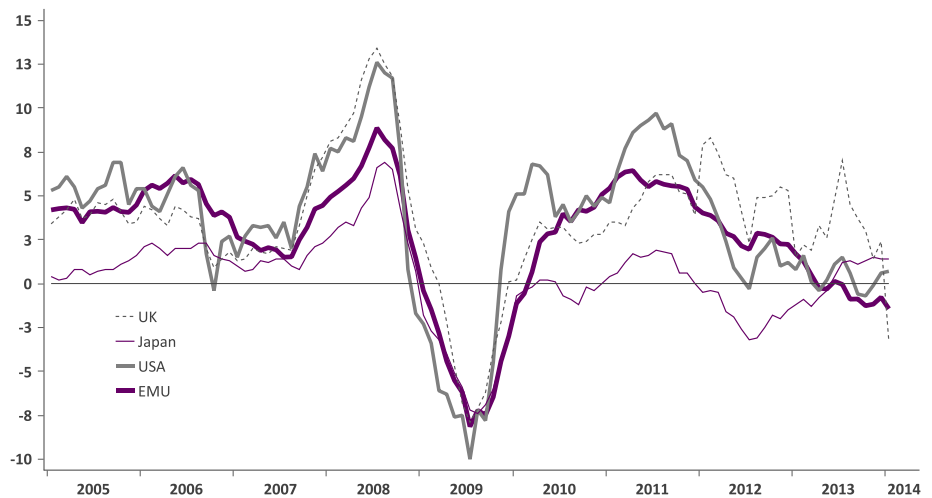
Wage movements are even more disparate. Pay raises have gradually strengthened in the US and, at their current rate of 2.3%, offset concerns raised by the low level of core inflation. Wage increases have been much more modest in the euro area and the United Kingdom (<1% per year). Lastly, in Japan, the goal of Shinzo Abe's government has begun to pay dividends, with salary growth picking up noticeably in industry.

Core Inflation Rate (Excl. Energy and Seasonal Food)



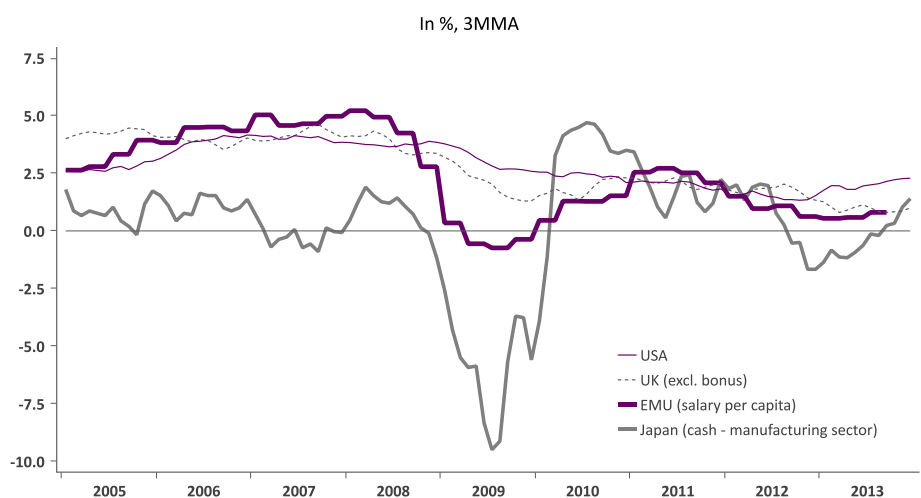
Sources: RichesFlores Research, Macrobond

Production Prices - Manufacturing, YoY in %



Sources: RichesFlores Research, Macrobond

Wages / Salaries Annual Growth

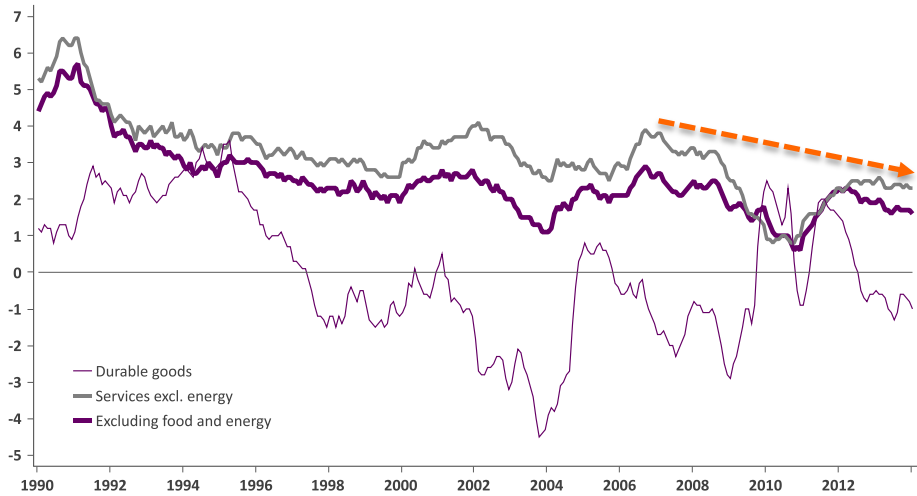


Sources: RichesFlores Research, Macrobond

United States, Not Quite in the Clear Yet

The downtrend in inflation for services and the recent decline in the price of durable goods speak to an environment that remains fragile, which is liable to perpetuate a trajectory of low core inflation in future months.

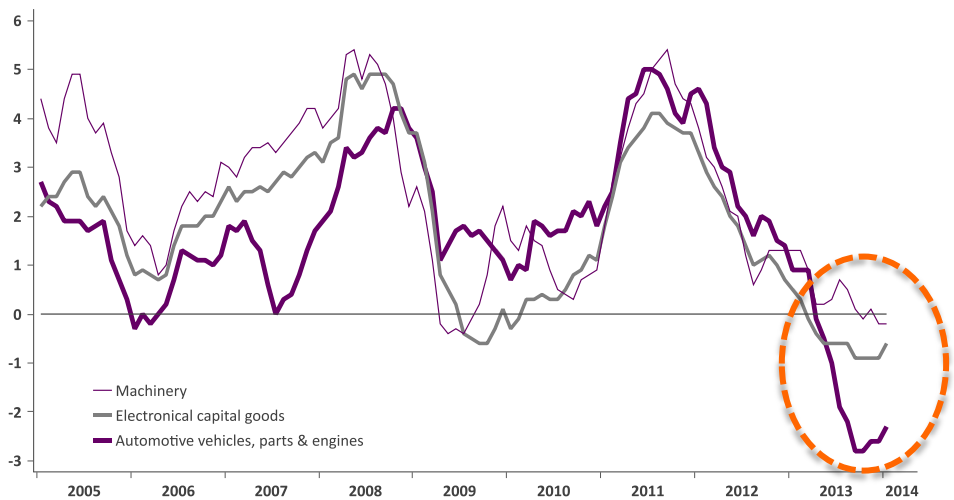
Inflation Rate in the United-States



Sources: RichesFlores Research, Macrobond

With the stabilization of the dollar, import prices of main goods have been headed downwards in the past several months.

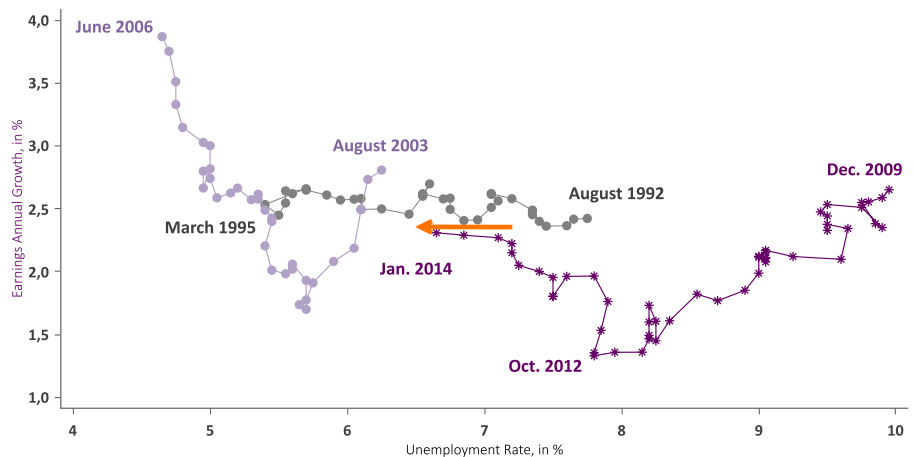
American Import Prices, YoY in %



Sources: RichesFlores Research, Macrobond

The recovery of the Phillips curve since the end of 2012 is comforting but remains uncertain if recent trends are any indication.

Unemployment Rate and Hourly Earnings Growth over the Last Three Cycles of Unemployment Rate Decrease



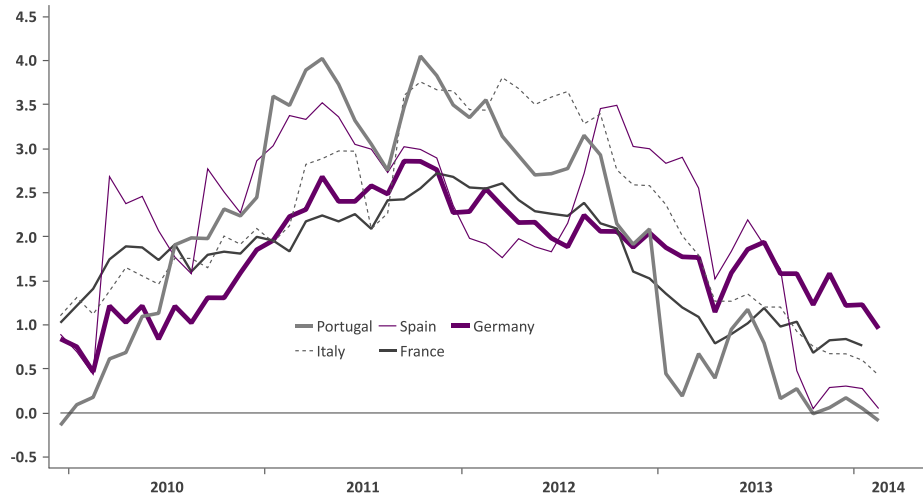
Sources: RichesFlores Research, Macrobond

Euro Area, Deflation Risk Spreading to Core

The drop in the inflation rate has taken an increasingly preoccupying turn in the euro area. Without surprise, countries in southern Europe (Greece, Spain, Italy, Portugal) are experiencing full-blown deflation, but the northern economies have been flirting with inflation levels that are so low that the risk of a more dramatic scenario in the coming months cannot be ruled out. It is interesting to note that even German inflation has not been spared, although price rises are just slightly above the average (1% vs. 0.8% for the entire euro area in February).

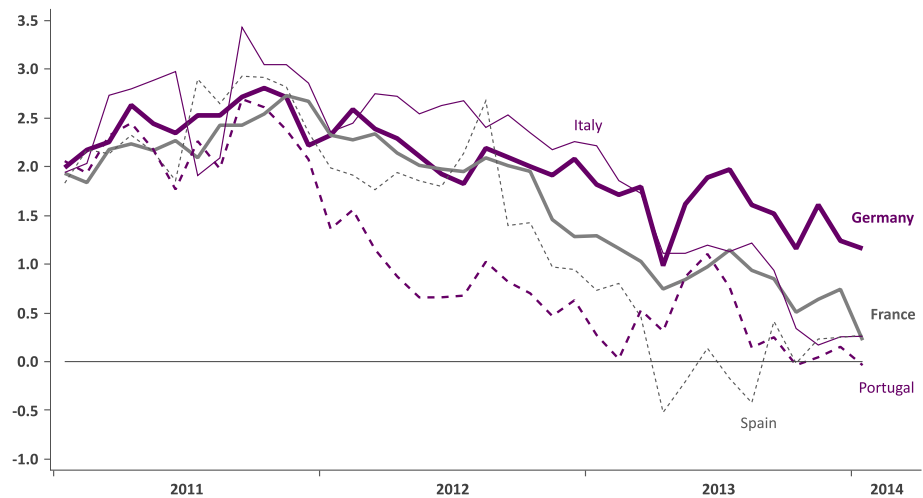
Against a backdrop of high unemployment, slowing labor costs, which is particularly marked in construction and services, is one of the key elements of deflationary trends operating in the region.

Harmonized Inflation Rate



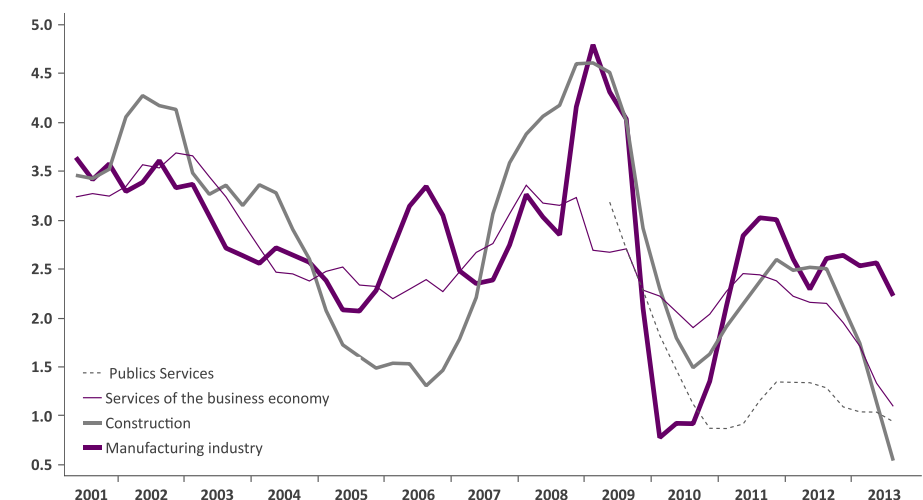
Sources: RichesFlores Research, Macrobond

Inflation Rate at Constant Tax Rate



Sources: RichesFlores Research, Macrobond

Labor Cost in Euro Area, YoY in %



Sources: RichesFlores Research, Macrobond

Imports, an Additional Source of Disinflation

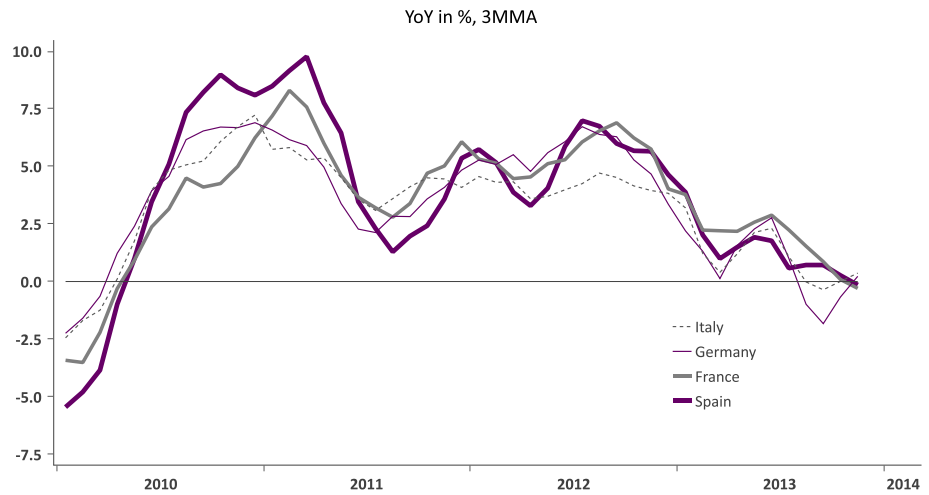
The falling price of imports, which has resulted from the combination of sagging demand and the appreciating euro, has fuelled disinflation without sparking demand.

This trend is affecting all countries, including Germany, and most business sectors.

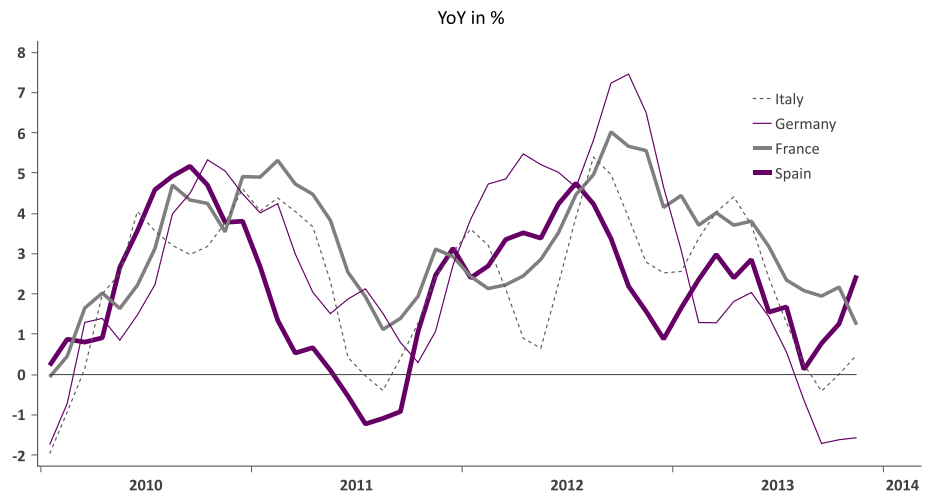
All Commodities Import Prices



Consumption Goods Import Prices



Capital Goods Import Prices



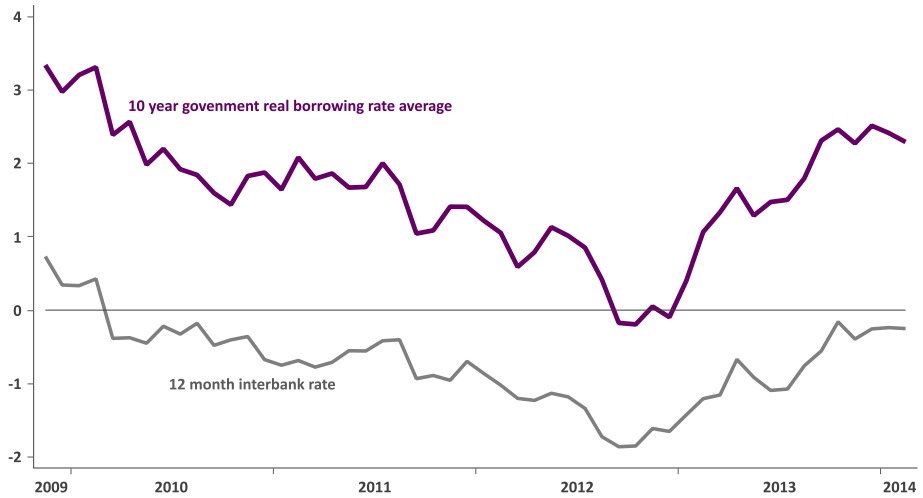
Increase in Real Interest Rates, the Bigger Threat

The increase in real interest rates, which follows the drop in inflation, is the most alarming source of deflationary risk. This increase in real interest rates has several nefarious effects:

- it does not allow struggling countries to take advantage of the recent improvement in sovereign financing conditions,
- it absorbs a large portion of the efforts made by local governments to rebalance public finances,
- it hinders the chances of an investment recovery and the chances that lending to the private sector will get back on its feet,
- it maintains, lastly, an appreciation of the euro which only exacerbates deflation...

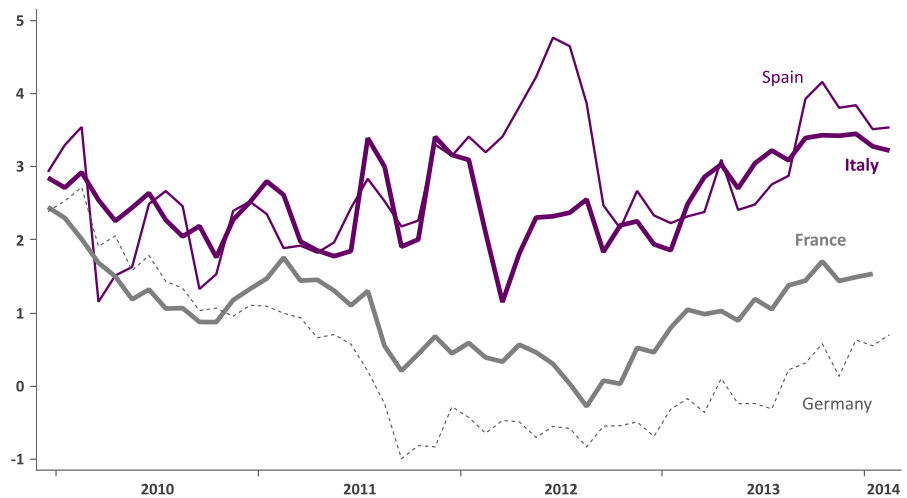
The situation has become particularly critical and could trigger more decisive ECB intervention.

Real Interest Rate in Euro Area, in %



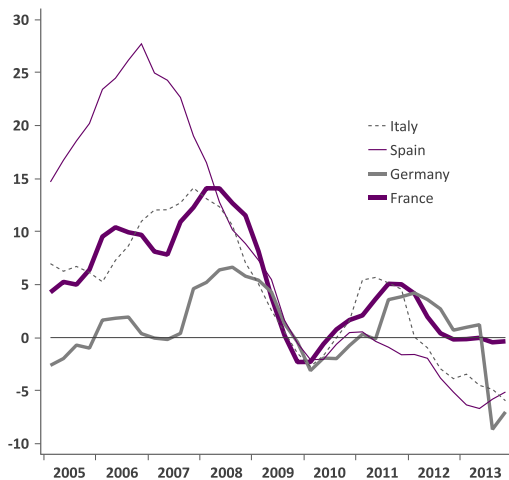
Sources: RichesFlores Research, Macrobond

10 Year Real Government Borrowing Rates



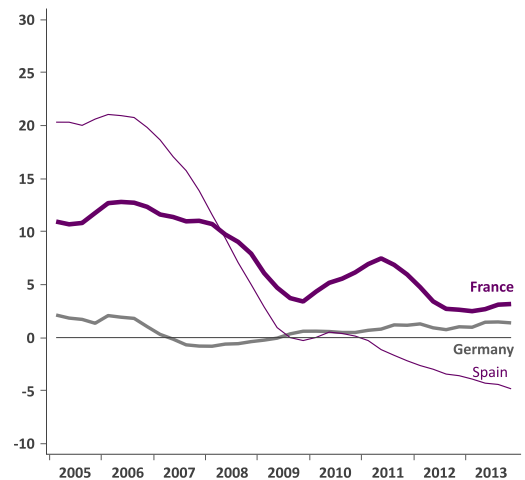
Sources : RichesFlores Research, Macrobond

Loans to Corporates, YoY in %



Sources: RichesFlores Research, Macrobond

Loans to Households, YoY in %



Sources : RichesFlores Research, Macrobond

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