

Box 1

DRIVERS OF RECENT GLOBAL INFLATION DEVELOPMENTS

With inflation easing in the euro area, this box examines whether the euro area's recent experience is part of a broader synchronised fall in global inflation and, if so, what is driving those developments.

Global inflation developments

Overall, global consumer price inflation has fallen since mid-2011. After the sharp decline seen in late 2008 and 2009 following the intensification of the global financial crisis, the average annual rate of global inflation, measured across 34 major economies (see Chart A), increased,

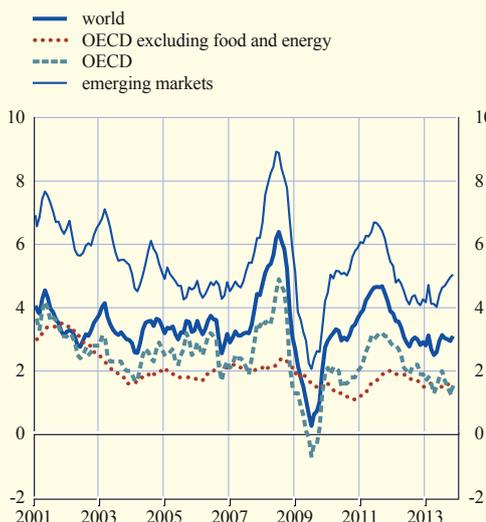
peaking in September 2011 at 4.7%. In 2012, global inflation fell rapidly and remained broadly stable thereafter, standing at 3% in December 2013. The moderation in inflation since 2011 has affected both advanced and emerging economies. OECD aggregate inflation has gradually declined over that period. Inflation in emerging market economies also fell from mid-2011 onwards before rising again slightly towards the end of 2013.

At the country level, disinflation since 2011 has been a fairly common phenomenon (see Chart B, blue bars). In most of the advanced and emerging economies, inflation was lower towards the end of 2013 than in 2011. In the euro area, the rate of inflation declined by 1.9 percentage points from 2.7% in 2011 to 0.8% in December 2013. Inflation in the United States, the United Kingdom and Canada declined over this period by roughly the same amount. A notable exception among the advanced economies is Japan, which, after a long period of deflation, saw a gradual shift of price changes into positive territory, supported by expansionary monetary and fiscal policies and the depreciation of the exchange rate of the yen. Overall, in most of the advanced economies inflation has fallen to levels which are below the respective central bank's medium-term objectives. Among key emerging economies, inflation decelerated sharply in China, India and Russia, while the decline in inflation was less pronounced in Brazil.

Since the first half of 2013, however, price developments have slightly differed from region to region. While headline inflation has continued to decline in the euro area, the United Kingdom and other EU countries outside the euro area, it was fairly stable in the United States and Canada. Among the emerging economies, inflation moderated in Brazil and Russia, but increased slightly in China and India (see Chart B, red bars). These differences reflect country-specific shocks and also, to some extent, different cyclical positions of the economy.

Chart A Inflation in selected regions

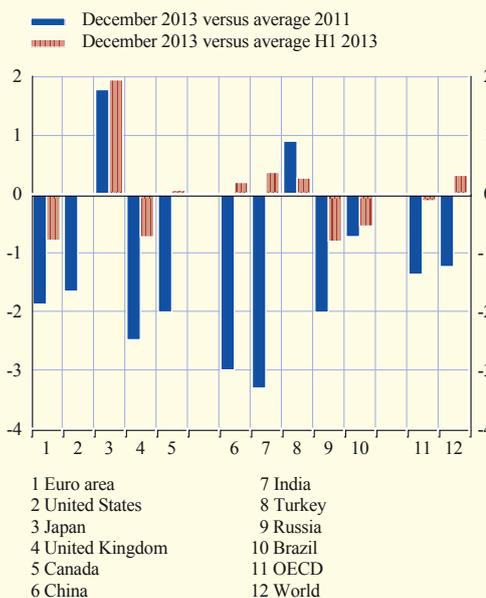
(year-on-year percentage change; monthly data)



Sources: OECD and Haver Analytics.
Notes: Latest observation refers to December 2013. The emerging market series is a GDP-weighted average of 23 large emerging market economies. The global series is a GDP-weighted aggregate of inflation in 34 major economies.

Chart B Changes in inflation across selected countries

(percentage points)



Source: Haver Analytics.
Note: CPI inflation for all countries except India (wholesale prices). The latest available data is December 2013 for all countries.

Factors behind global inflation developments

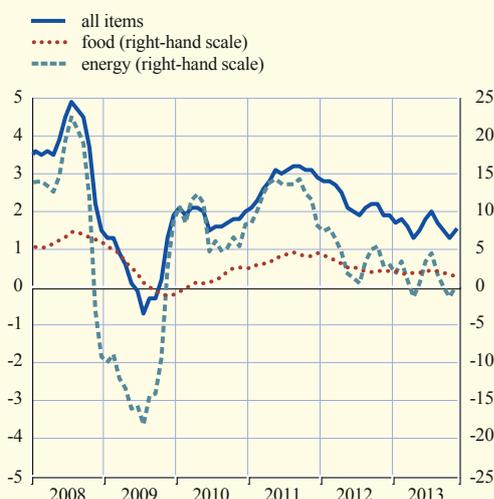
The slowdown in global headline inflation since 2011 has been strongly influenced by weaker commodity prices. For the OECD, energy price inflation was rather modest, amounting to just 1.1%, on average, in the second half of 2013, compared with 12.2%, on average, in 2011. In December 2013 the energy price contribution to overall OECD inflation was close to zero. Moreover, the moderation in international food prices has also eased global inflationary pressures, albeit to a lesser extent. In the OECD area, food prices rose on average by 3.8% in 2011, but by only 1.8% in the second half of 2013. Overall, OECD inflation excluding food and energy has remained more stable since 2011.

Estimates of the output gap for the aggregate OECD area suggest that, although it partially narrowed in 2010 and 2011, spare capacity remains large and has increased slightly in the last two years, implying subdued price pressures. Moreover, the slowdown in emerging economies along with declining or negative output gaps over this period has also mitigated price pressures in these countries.

At the same time, although headline inflation is now below central bank objectives in most of the advanced economies, inflation expectations over the medium to long term have remained stable. Inflation expectations from survey data and financial market indicators for most advanced economies have tended to confirm well-anchored (medium to long-term) inflation expectations. For instance, the University of Michigan survey of inflation expectations in the US (five to ten years ahead) has remained rather stable, at between 2.7% and 3%, since February 2013, and the five-year-ahead break-even inflation rates for the US and UK have been between 2.3% and 3% since February 2013. However, over the same period, according to the QUICK survey, inflation expectations in Japan two years ahead have increased by around 1 percentage point. This was

Chart C Components of OECD inflation

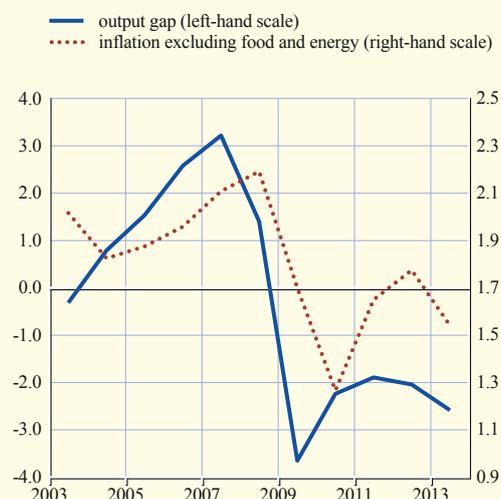
(year-on-year percentage change)



Source: OECD.
Note: Latest observation refers to December 2013.

Chart D Inflation (excluding food and energy) and output gap estimate for OECD countries

(year-on-year percentage change and percentage of potential GDP)



Source: OECD.
Notes: Aggregate of 34 OECD countries. Output gap is an estimate for 2013.

preceded by the Bank of Japan's announcement in January 2013 of a 2% "price stability target", to be achieved at the earliest possible time.

Outlook for global inflation

The outlook is for continued subdued global inflation in the coming months as spare capacity worldwide remains large. However, the widely expected pick-up in world economic activity over the medium term should support a gradual increase in global inflation towards levels consistent with medium-term inflation expectations.

