

The New Great Inflation Era - The Causes and Potential Responses in the Face of Stagflation

<https://marketpublishers.com/r/N56CEB02D3FEEN.html>

Date: July 2022

Pages: 19

Price: US\$ 995.00 (Single User License)

ID: N56CEB02D3FEEN

Abstracts

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SUMMARY

The times of low and stable inflation experienced in developed economies since the 90s now seem to have come to an end, with high inflation to prevail, at least in the mid-term. Monetary policies must be carefully drafted more than ever before as the global economy faces the threat of stagflation for the first time after four decades. The causes and potential responses to this phenomenon are hence analyzed.

KEY HIGHLIGHTS

Inflation, at high levels, has been the cause of economic instability, but over the past few decades, it had been seen as an economic phenomenon under control in most economies, especially in advanced economies. The current state of the global economy shows that it can still be present. Inflation rates have risen sharply across economies since mid-2021, approaching nearly double-digit rates, resembling older decades during the Great Inflation period. Consumers have already started to feel the pain seeing their purchasing power reducing as the cost of basic goods keeps rising.

A perfect storm of supply and demand shocks has sparked the inflation spiral seen since mid-2021. Surging demand for goods amid monetary and fiscal expansion, supply chain bottlenecks, tight labor markets, wage growth, all linked to the COVID-19 pandemic, along with an energy crisis due to geopolitical

developments, have more or less contributed to the rising inflation levels.

Current figures and projections show that the risk of a stagflation cannot be overlooked. The projected economic slowdown of the global economy may also be combined with high inflation, and in this case a new recession would be inevitable.

Policy responses to avoid this can be complex and variable across economies as the different causes of inflation imply different diagnoses. The balancing act between a tighter monetary policy and economic growth can be difficult, so that sharp interest rate rises inducing recession may still be an option, especially for advanced economies. Moreover, in any case, central banks need to act fast, before high inflation becomes endemic to people's expectations.

Governments can also step in to combat inflation through taxation of increased profits of those who stand to win from inflation. Additionally, a long-term, but effective fix is structural reforms aiming at increasing productivity.

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SCOPE

See how much of a problem inflation is in 2022

Understand how it can be defended against

Learn what is likely to happen as a result

REASONS TO BUY

What is stagflation?

Why is it so worrying?

What are central banks doing to combat it?

Contents

1. OVERVIEW

- 1.1. Catalyst
- 1.2. Summary

2. THE BURDEN OF HIGH INFLATION IS FELT AFTER DECADES

- 2.1. Memories of the Great Inflation are awakened
- 2.2. A variable but significant inflationary impact across the world

3. MORE THAN ONE CAUSES BEHIND RISING INFLATION

- 3.1. Demand-pull inflation: Too much money chasing too few goods
- 3.2. Cost-push inflation peaks as Russian commodities are embargoed
- 3.3. Wage growth has followed suit, pushing inflation higher

4. THE RISK OF STAGFLATION: THE SUITABILITY OF POLICY RESPONSES CAN VARY

- 4.1. The risk of stagflation lies ahead
- 4.2. A non-uniform causality means different diagnoses
- 4.3. The role of central banks is decisive and complex
- 4.4. Governments can do more to address inflation through non-monetary means

5. APPENDIX

- 5.1. Sources
- 5.2. Further reading

6. ASK THE ANALYST

7. ABOUT MARKETLINE

List Of Tables

LIST OF TABLES

Table 1: Commodity prices, 2019 - 05/2022

List Of Figures

LIST OF FIGURES

Figure 1: Consumer Price Inflation (CPI), 1960-2022, (% annual change)

Figure 2: Commodity Groups Price Indices, (based on 2010 real \$ prices), 1960-05/2022

Figure 3: Food Commodity Groups Price Indices, (based on 2010 real \$ prices), 1960-05/2022

Figure 4: Annual inflation average, 2015-2019, (%)

Figure 5: Estimated annual inflation, 2022, (%)

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