BIZCOMMUNITY

Reinflation is the watchword in recovering economies

By Scott Cooper

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The past 15 months have been an interesting but uncertain time in global markets. As several major economies started to emerge from the pandemic, the first quarter of 2021 was all about reflation - a belief that massive fiscal stimulus, historically low-interest rates and the reopening of economies on the back of Covid-19 vaccinations will drive an economic boom placing upward pressure on inflation. Although we expect a strong recovery in GDP growth and a pick-up in inflation in 2021 we do not believe these inflationary pressures will be sustained. This belief is driven by four core considerations:

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1. **Base effects**

   Annual inflation statistics over the coming months will be distorted by the disinflation which occurred in many economies in March and April last year as Covid-19 took hold. In the USA, for example, base effects are expected to contribute approximately 1% of headline inflation in April and May 2021. The important consideration is that these base effects are transitory and do not indicate longer term inflationary pressures.

2. **Temporary upward pressure on inflation as economies begin to reopen**

   It is expected that there will be some supply chain bottlenecks that cause temporary upwards inflation pressure. Importantly, however, it is expected that these will reduce over time as the bottlenecks clear.

3. **An uneven global recovery**

   Much focus has been placed on increasing US inflation - as the vaccination levels increase, so the economy begins to reopen fully. The global recovery, however, is not equal. For example, the IMF, despite increasing global growth projections in April this year, noted that while China had already returned to pre-Covid GDP in 2020, many other countries are not expected to do so until well into 2023. This will act to curtail global inflation.

4. **Global debt levels**

   The underlying health of the global economy has a major influence on how quickly it can recover from shocks. One concern is the relatively high amount of debt that was held prior to the pandemic (and subsequently increased by fiscal stimulus measures). The IMF notes, for example, that public debt-to-GDP of advanced economies was 105% in 2019 (in contrast to 72% before the 2008/9 financial crisis). This debt burden will likely prove deflationary in the years ahead.

The impact of these factors is perhaps most aptly summarised in the US Federal Reserve statement made on 28 April 2021. Despite undergoing an extended period of accommodative monetary policy the Fed believes “longer-term inflation expectations remain well anchored at 2 percent”.

ABOUT THE AUTHOR

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