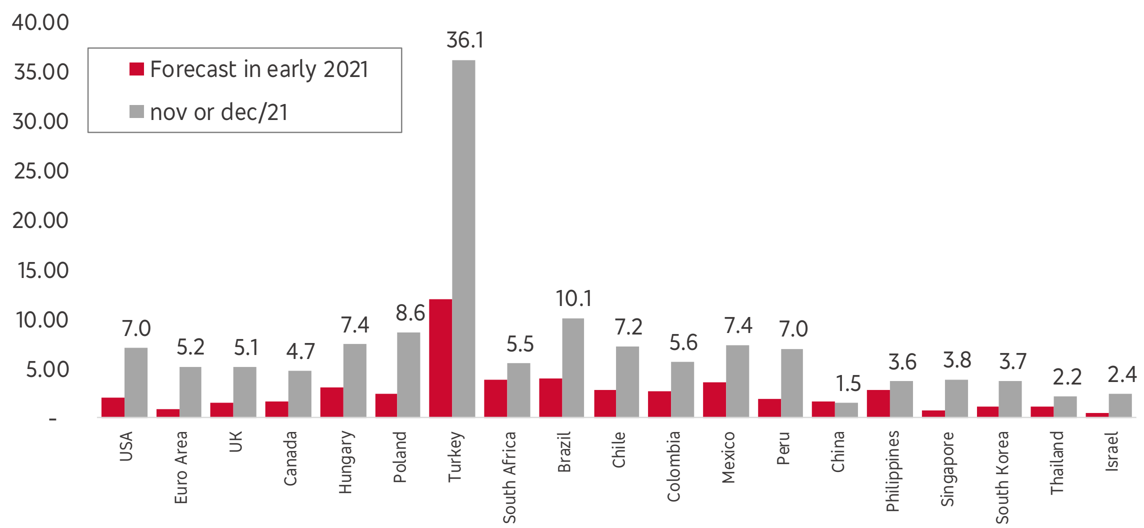
How large is the expected global disinflation in 2022?

Fabiana D'Atri

A combination of elements will pull inflation to lower levels in 2022 in the vast majority of countries. Part of this relief comes from the base effect. Another part comes from the rebalancing between more moderate demand and improved supply. Demand should become more moderate due to the monetary tightening underway in most countries, the end of the use of savings accumulated during the pandemic period, and the loss of purchasing power due to high inflation last year. Supply, in turn, has been advancing, with a significant reconstitution of inventories and a better functioning of industry and logistics in general. The Fed should be an important agent of this disinflation, being able to keep commodity prices contained, even though the expected appreciation of the U.S. dollar could generate some inflationary pressure in emerging markets.

Unlike what we imagined at the beginning of last year, the demand for goods remained high and supply constraints continued to affect prices for longer. The pandemic maintained temporary closures in some regions, which increased distortions in production chains, especially in Asia. At the same time, there was a significant upswing in food and energy prices. In these cases, there are more structural reasons, such as the demand for commodities and the energy transition linked to environmental issues. The reopening, which has been consolidating over the past year, has also boosted the prices of services, such as airline tickets and restaurants – without providing relief to the prices of goods. In the wake of commodity prices, costs have put pressure on producer price indexes, with pass-through to consumers. As a result, the upward surprises with inflation have been expanding in the vast majority of countries. The following chart demonstrates the projections for the consumer price index at the beginning of 2021, as collected by Bloomberg, and the accumulated result through November/December of the same year.

Chart 1: Consumer inflation index in 2021: estimate vs actual
Year-over-Year change

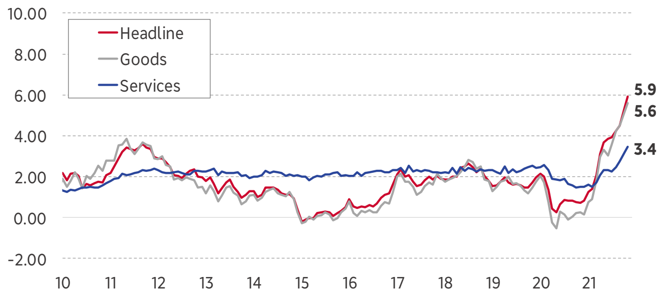


Source: Bloomberg, CEIC

Aggregating the inflation indexes, it is evident that the increase observed in goods was well above the historical standard and, gradually, the prices of services have returned to variations close to (or even above) those observed before the pandemic. Add to this the rise in food and energy prices, which led to a widespread and increasingly diffuse acceleration in inflation. The following charts illustrate the evolution of price indexes for developed and emerging countries.

Chart 2: CPI, emerging countries
Year-over-Year change

Chart 3: CPI, developed countries
Year-over-Year change



Source: CEIC

Faced with these pressures, the vast majority of central banks in emerging countries have already started their monetary tightening cycle and, if inflation and economic activity estimates are confirmed, interest rates in these countries should climb by the middle of this year. On the other hand, the Fed insisted for quite some time on the transitory nature of inflation, a premise that is still being adopted by the European Central Bank. More recently, however, the Fed reassessed its reading for inflation, indicating a faster normalization of interest rates. Today, we expect 3 hikes this year, already starting in March, with the balance sheet reduction occurring between the first and second half of this year.

We have become more convinced that the acceleration of inflation observed in 2021 has fundamentals essentially based on demand, given the unprecedented fiscal and monetary stimuli adopted during the pandemic. It is worth pointing out that the supply of most goods and commodities has grown in these last two years, as we highlight in the following table. At the same time, we have to recognize that in the face of extraordinarily higher demand, there were bottlenecks in industrial production and logistics that were not able to accelerate at the same pace as consumption. In this sense, there are global determinants – which impacted especially food and energy and industrial costs – but there are also domestic drivers, explained by the size of the stimuli, the success of vaccination and reopening of the economy, and the variation in the exchange rate.

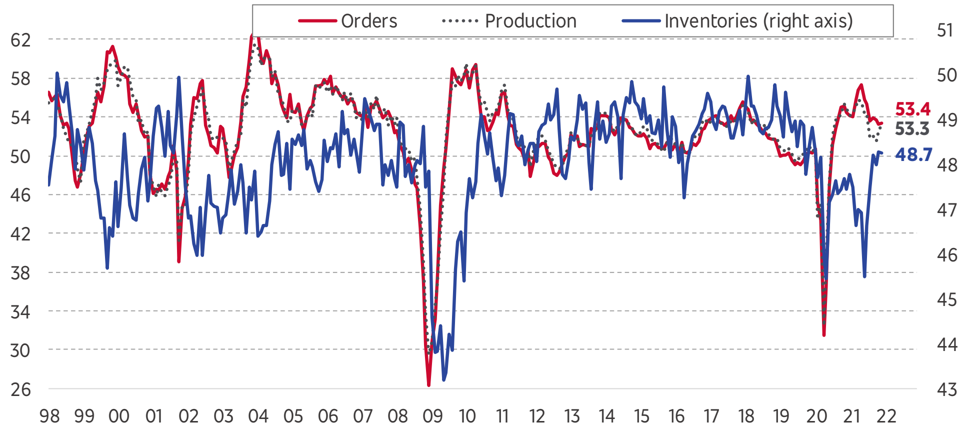
Table 1: World production and demand indicators
Annual change

	2019	2020	2021	Period considered for 2021
Oil Production	-0.90%	-7.50%	-0.40%	(accum. Sep/21)
Copper Production	0%	0.30%	3.10%	(accum. Sep/21)
Semiconductor Production – comp electronics (Taiwan)	-15.60%	-1.90%	52.70%	(accum. Sep/21)
Container movement in ports (world, ex China)	n.d.	4.60%	2.10%	until Nov/21
Container movement in ports (China)	n.d.	7.30%	5.30%	until Nov/21
Soy Production	5.6	-5.90%	7.80%	entire year
Corn Production	4.3	-0.50%	0.30%	entire year
Raw Steel Production	3	-0.70%	4.50%	until Nov/21
Global GDP	2.8	-3.10%	5.80%	IMF estimate
Exports	0.1	-4.60%	10.00%	IMF estimate

Source: Bloomberg, CEIC

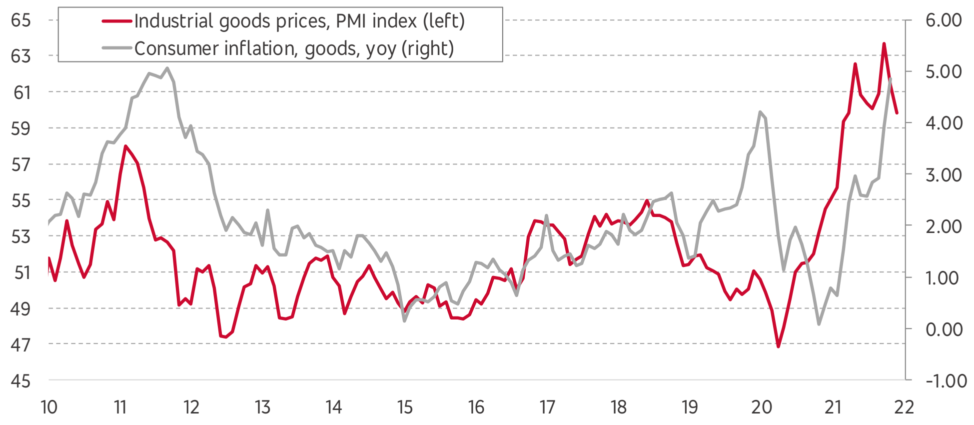
There are signs of normalization regarding these constraints. The cases of semiconductors and vehicle production corroborate our reading, with recent signs of an upturn in the automotive sector. Similarly, the PMI indices of the manufacturing sector in recent months have indicated a normalization of demand and inventories. In other words, while consumption has been dropping, production has been advancing. Added to this, the price indexes of these indicators seem to be at a turning point, in line with the easing of commodity prices. The following chart illustrates that the prices of goods, captured in the consumer inflation indices, are correlated with the prices of industrial commodities, especially in this latest inflationary cycle. Thus, decompression of the prices of goods is expected to occur over the next few months. And this should happen on a global scale.

Chart 4: CPI (year-on-year change) and price component of the PMI index (level)



Fonte: Bloomberg

Chart 5: PMI index of the manufacturing sector



Source: CEIC

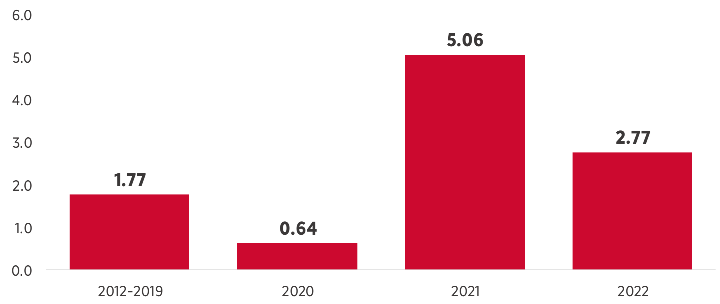
Despite the important signs of price decompression, doubts remain about the persistence of inflation. In other words, even if we expect consumer prices to ease, there are signs that should be monitored, such as worsening expectations, rising wages, labor supply constraints, and rising services inflation (which has already returned to pre-pandemic levels in most countries). In addition, it is worth remembering that China has entered a policy loosening cycle, which may limit the expected drop in commodities. And with the interest rate hike in the U.S., the final effect on currencies seems uncertain for now, since the appreciation of the U.S. dollar is likely to impact emerging markets, even though this time the interest rate cycle in emerging markets has anticipated relative to that of the U.S.

We must still consider the effects of the worsening pandemic that can delay the relief of global chains, resulting from occasional disruptions in industry and logistics. To do this, we built a high-frequency indicator that captures these prices/costs, considering freight, electronic components (RAM), natural gas and coal prices, illustrated in the following chart. We conclude with the last chart that shows the median consumer inflation for the last few years, compared to what we experienced in these two atypical years. The estimate for this year indicates significant disinflation, but still above the pre-pandemic level. The challenge remains high for central banks in emerging countries, which have already missed last year's target and will probably miss this year's as well.

Chart 6: Supply disruption index

Source: Bloomberg, Bradesco

Chart 7: Consumer price index
Annual change



Source: Bloomberg

bradesco

Technical Staff

Director of Economic Research and Studies	Fernando Honorato Barbosa
Economists	Ana Beatriz Moreira dos Santos / Constantin Jancsó / Fabiana D'Atri/ Felipe Wajskop França / Myriã Tatiany Neves Bast / Priscila Pacheco Trigo / Renan Bassoli Diniz / Thiago Coraucci de Angelis / Vitor Vidal Costa Velho
Interns	Bruna Andreata Valentino / Gabriel Sartor Ganzarolli / Henrique Monteiro de Souza Rangel / Lorena Pires Sene / Rafaela de Sousa Silva

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