24 June 2022

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Global Inflation Boiling up

Against the backdrop of global economic slowdown on account of Covid-19 and the ongoing conflict between Russia and Ukraine, supply check bottlenecks have ensued. The impact of the same has been reflected with the surge in global inflation. Commodity prices had reached an all- time high with crude prices scaling and touching the US$127/bbl mark, along with higher prices for food staples. This has pushed a synchronized monetary tightening by global central banks. India's economy has not been immune from the same. However, it is interesting to note the impact of accelerating inflation print on countries like UK, US and Turkey is relatively different than on domestic economy. This study sheds some light on the same.

According to World Bank, advanced economies are expected to witness much slower growth at 2.6% in CY22 from 5.1% in CY21, with further moderation expected in CY23 at 2.2%. Global inflation print is likely to remain above the central bank's (CB) mandate for most of the countries as the CB's plan to rein in inflation. There also has been an exacerbated risk of stagflation (sluggish growth and high inflation), going further. Global inflation print has scaled to its highest level since the 1980s, with persistent surge in crude and food prices. UK's inflation climbed to a 40-year high in May'22 at 9.1% on the back of the global supply chain bottlenecks with elevated gasoline prices reaching a record high. This has further aggravated the fears of recession. Bank of England stuck to raising rates at a gradual pace of 25bps to cool inflationary pressure. On the other hand, US economy had outstripped market expectation with the CPI print scaling to its highest level since 1981, at 8.6% in May'22. As a result, Fed in its last policy meet applied the Hammer and Tongs approach as it hiked policy rates by 75bps with more hikes expected through the year. This signals its commitment to tame the inflation print.

Fig1: US inflation spiked in May'22

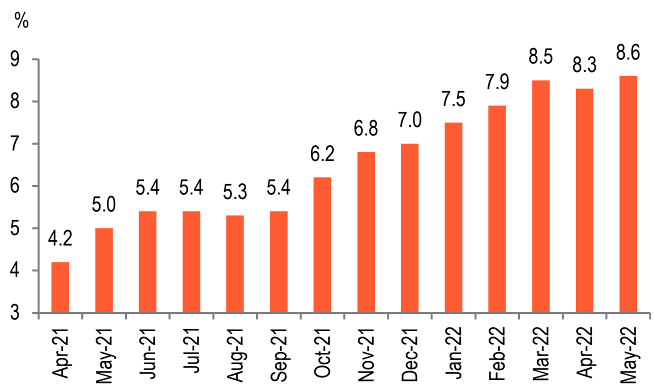
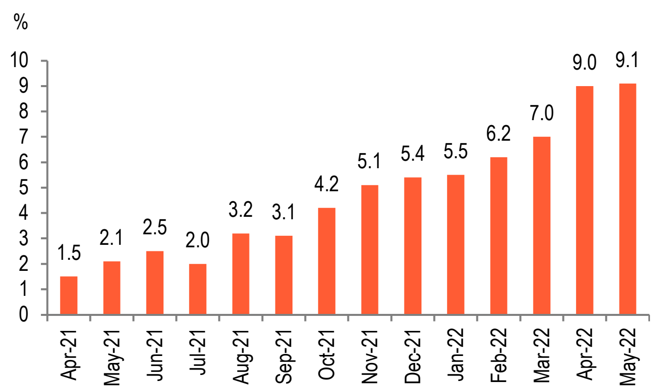


Fig2: UK inflation surges to 40-year high



Source: Bloomberg, Bank of Baroda

Countries such as Turkey have been embattling higher inflation for the past few decades and given the subdued global cues; has spiked to a 23-year high at 73.5% in May'22 (70% in Apr'22). As a result, sectors such as transportation and food have been hit sharply. Real rates continue to remain negative in the country and is often touted as one of the lowest real rates across the globe.

Upwards price pressure due to ongoing global supply chain bottlenecks, had also pushed Germany's inflation print to 7.9% in May'22 (7.4% in Apr'22). A similar level was last seen during the oil crisis in CY73 and CY74. It's a wait and watch approach before ECB hikes policy rates, in the coming months.

Fig3: Turkey inflation

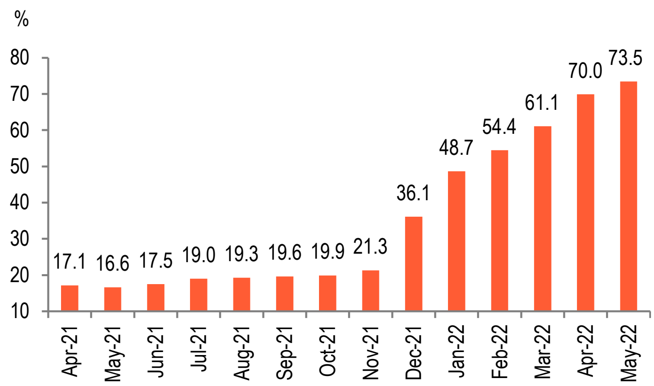
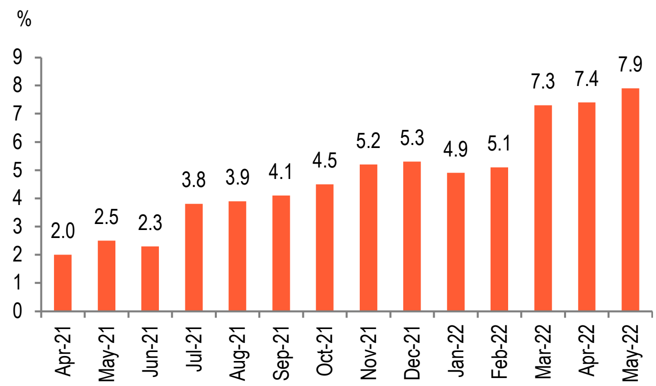


Fig4: Germany's inflation



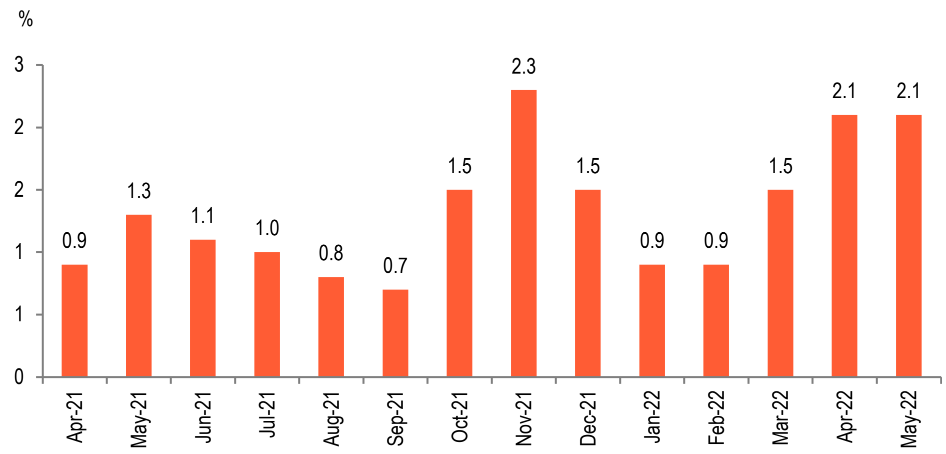
Source: Bloomberg, Bank of Baroda

A contrasting story: China

China's inflation remains relatively benign and in a sharp contrast to other countries, which have registered peak inflation print in the recent months. In May'22, China's inflation remained flat at 2.1% compared with Apr'22 on a YoY basis. It continues to be much lower than the government's target of 3%. Core inflation excluding food and fuel rose by 0.9% in May'22 (0.9% in Apr'22). There are different factors attributed to such divergence, one of them include printing of more money by advanced economies during the Covid-19 pandemic, while China largely refrained from doing the same.

Next, the weightage of CPI basket varies across countries. For example, China assigns more weight to clothes and food. On the other hand, US CPI basket places more weightage on transport and shelter. Furthermore, the recent flare up in Covid-19 cases along with re-imposition of lockdown restrictions has also dented domestic demand.

Fig6: China's inflation remains stable

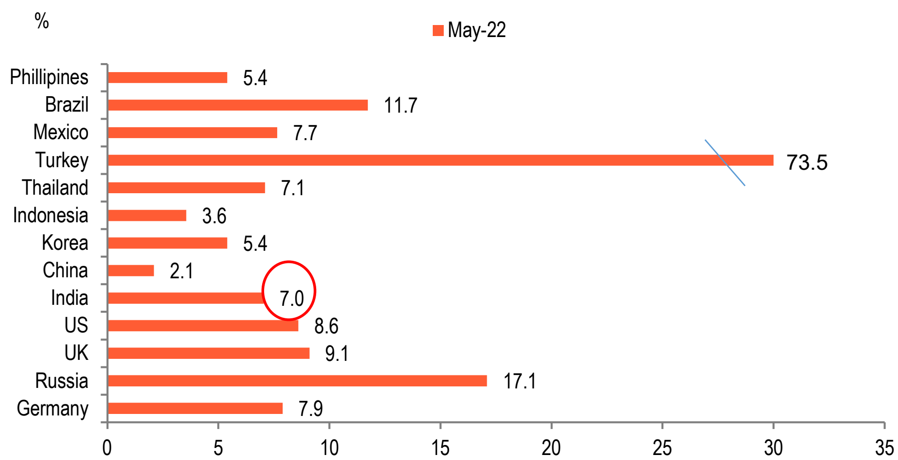


Source: Bloomberg, Bank of Baroda

How Does India Fare?

Now that we have established that despite global inflation soaring, all the countries cannot be viewed similarly as no one glove-fits-all. It is rather pertinent to see each country individually with a wide lens in order to assess the impact of inflation. Also, India has been doing relatively better than other countries on this account. While comparing these countries together, India's inflation moderated to 7% in May'22 from 7.8% in Apr'22. For other countries such as Thailand (7.1% versus 4.7% in Apr'22), Korea (5.4% versus 4.8%) and Philippines (5.4% versus 4.9%) inflation has been on an uptrend (Fig 5). With advanced economies such as US and UK clocking much higher inflation at 8.6% (5% in May'21) and 9.1% (2.1% in May'21) respectively. On the other hand, an emerging economy such as India had registered an inflation of 7% in May'22 compared with 6.3% in May'22.

Fig5: India Vis a Vis other countries

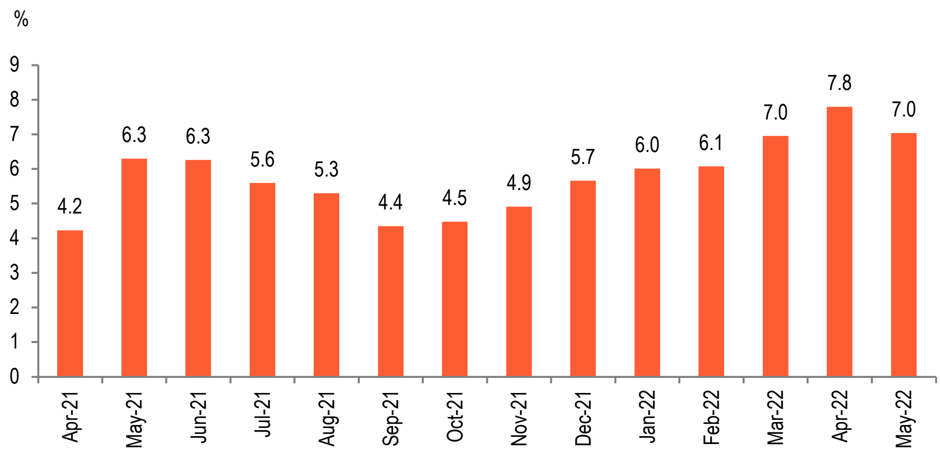


Source: Bloomberg, Bank of Baroda

Indian economy has also been facing the brunt of 'imported inflation' led by mounting pressure on energy, fertilizers and other inputs. However, the aggravated impact of the same has been curtailed with proactive measures such as reduction in excise duty, duty free import of soybean and sunflower oil. Furthermore, expectation of normal monsoon along with bumper Kharif production is also likely to keep food inflation in check.

Compared with other global countries, India is in a much better place to manage inflation. Yes, the current inflation does continue to remain above RBI's mandate. However the rate hike spree by RBI (including out of policy-rate hike in May'22) signifies inflation is back as a priority for the central bank.

Figure 6: India's CPI above RBI's mandate



Source: Bloomberg, Bank of Baroda

Outlook for Inflation

Against the backdrop of elevated prices of commodities, prolonged geopolitical tension resulting in supply chain bottlenecks and threat of new Covid-19 variants continue to pose significant upside risk to inflation. However, the rate hike spree will aggravate the pace of capital flows. Growth and inflation dynamics is back in action. The priority though currently, is more towards inflation and going forward, we expect inflation to moderate in early FY23. This is possible by remaining watchful to global cues with all hands on deck approach and applying the mix of both fiscal and monetary policy to reign in the raging inflation.

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