

Consumer price developments, in numerous parts of the world, have recently been marked by low inflation rates, requiring the implementation of highly expansionary monetary policies. This box offers a descriptive analysis of developments in inflation at global level and in the main determinants of inflation in the advanced economies, in order to assess the outlook for this variable.

The determinants of consumer price developments can be divided into two main categories: external and domestic. The former include the behaviour of commodity prices and, in particular, of oil prices, as well as exchange rates and the import prices set by exporters in other countries in their own domestic currencies. Meanwhile, apart from structural elements such as the degree of competition in different markets, domestic inflationary pressures depend on the degree of slack in product and factor markets, which determines the behaviour of mark-ups and wages.

A large proportion of the fluctuations in inflation rates in different economies (advanced and emerging) over the past year has been determined by commodity price developments, a factor that has tended to work in the same direction in all of them. The effects of the other external factors and of the domestic determinants in the various economies have been less uniform.

Starting with the advanced economies, the rise in energy prices explains the pick-up in consumer price inflation between mid-2016 and February 2017 (see Chart 1). Thus, at the beginning of the year, the annual rate of inflation in the United States and in the United Kingdom stood above the 2% target,¹ while in the euro area it was approaching this level and in Japan it had emerged from negative territory, although it still remained close to 0%. That said, the latest oil price developments have caused inflation to fall somewhat in many economies. For example in the United States inflation fell from 2.7% in February to 1.9% in May,² while in the euro area it dipped from 2% to 1.4% over the same period. Only in the United Kingdom has the trend remained upwards, with the rate reaching 2.9% in May, partly as a consequence of the pass-through of the depreciation of the sterling exchange rate to consumer prices. Core inflation, which excludes energy and unprocessed food prices, has remained at lower rates (around 2% in the United States and in the United Kingdom, around 1% in the euro area and negative in Japan) reflecting the absence of domestic inflationary pressures.

In the emerging economies, inflation developments have been more mixed. They have also been influenced by commodity prices, but also, and more significantly, by the different behaviour of their exchange rates (see Chart 2). Thus, in some economies that had suffered severe exchange-rate depreciations in previous years,

with significant rises in inflation, such as Brazil and Russia, inflation has tended to moderate, in line with the more recent appreciation of their exchange rates. By contrast, other economies that have experienced more recent exchange rate depreciations, such as Turkey and Mexico, have seen their inflation rates rise. In China, consumer price inflation appears to be contained at low levels (around 1%), influenced by food price developments, as in other emerging economies. In any event, regional aggregates show a recent moderation in inflation rates.

Analysis of the possible inflationary pressures of external origin in the advanced economies shows that there has been an increase in import prices since mid-2016, which amounts to a change in trend with respect to recent years (see Chart 3). Part of this rise is also linked to the increase in commodity prices and, in some cases, like the United Kingdom and Japan, to the depreciation of the exchange rate. However, another relevant factor is the increase in global manufactures prices and, in particular, in the prices of products manufactured in Asia and, especially, China, which are exerting upward pressure on the price of imports from other countries. The increase in producer prices in China – which a year and a half ago were declining at a year-on-year rate of 6% and are now growing at rates of close to 7% – may be related (as well as to the higher cost of commodity prices) to the reduction in excess capacity in certain sectors that were previously over-extended. As regards commodity prices, and oil prices in particular, the outlook for the next few years is mainly marked by the effects of the agreements for production cuts of OPEC and other producer countries, and the response of unconventional oil production in the United States, in addition to lower expected growth in demand, linked to an increase in energy efficiency and the substitution of oil by alternative energy sources. These factors will tend to cancel each other out and, currently, futures imply almost flat prices over the coming years, within the range of \$50-56 dollars for a barrel of Brent crude.

As regards inflationary pressures of domestic origin, the labour markets of the main advanced economies have improved notably in recent quarters and in some cases unemployment rates are currently below their long-term equilibrium level. Notwithstanding this, wage increases are still moderate and below those seen in previous recoveries (see Chart 4). Even in the United States and in the United Kingdom, where wages had shown signs of accelerating during 2016, they have again moderated in recent months. In the euro area wages are growing at around 1.5%, below their historical average rate, while in Japan there has been no sustained upturn and their growth rate stands again at around 0%. Various factors have been put forward to explain this moderation in wage growth, namely: the possibility that the degree of slack in the labour market, when participation rates and involuntary temporary or part-time employment are taken into account, may be greater than the unemployment rate suggests;³ the polarisation of labour markets, involving the shift of a significant part of average-wage employment

¹ In the United States, the Federal Reserve's inflation target is set with respect to the consumer price deflator, which in April still stood at 1.7%.

² Although part of this decline is also due to a methodological change in the adjustment for quality made to the prices of cellular telephone services.

³ See the box "Alternative measures of unemployment for the Spanish economy", also in this report.

towards less productive, lower wage jobs; the increase in low skilled employment; the effects of structural reforms in some economies; the low rates of inflation themselves, through their effect on the wage formation process; and weak productivity growth.

In this respect, increases in unit labour costs (obtained by deducting productivity growth from wage growth) over the last two years in the United States and in the United Kingdom have not been passed through to higher prices (as measured by the GDP

Chart 1
ADVANCED ECONOMIES: OVERALL AND CORE INFLATION



Chart 2
EMERGING ECONOMIES: OVERALL INFLATION

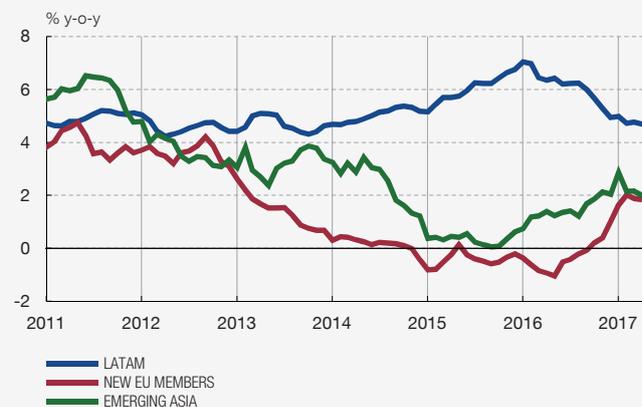


Chart 3
IMPORT PRICES (ADVANCED) AND PRODUCER PRICES (CHINA)



Chart 4
ADVANCED ECONOMIES: WAGES

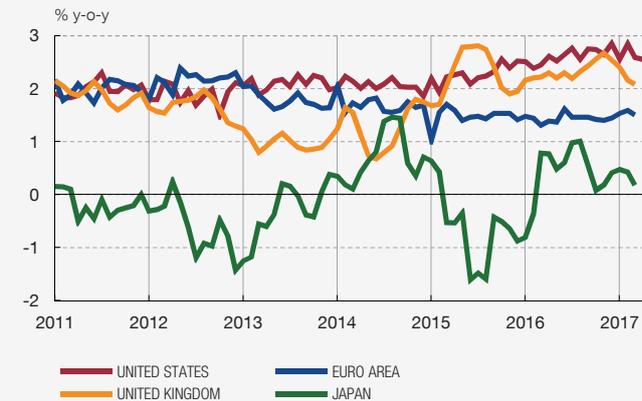


Chart 5
UNITED STATES: BREAKDOWN OF GDP DEFLATOR



Chart 6
UNITED KINGDOM: BREAKDOWN OF GDP DEFLATOR



SOURCE: Datastream.

deflator), owing to the squeeze in mark-ups during this period (see Charts 5 and 6). Given that this trend in mark-ups (which had increased following the financial crisis) will be hard to sustain over time, higher cost pressures may be passed through to prices at any moment. Indeed a change in the behaviour of mark-ups in the United States and in the United Kingdom has been observed since the end of 2016, and, in the case of the United Kingdom, they have even increased, as producers have taken advantage of the scope provided, relative to foreign competitors, by the depreciation of the pound.⁴

By contrast, measures of inflation expectations obtained from financial instruments have fallen slightly, following the pick-up

⁴ See the box “Recent developments in trade in goods and tourist services with the United Kingdom”, also in this report.

after the US presidential elections, which shows that the risks of a sudden increase in inflation arising from the implementation of the expansionary measures proposed by the new government in the United States are now perceived as being less severe. Expectations for the euro area and the United Kingdom also seem to reflect the new perceptions regarding economic policy in the United States, and in Japan inflation expectations remain low.

In short, the developments in the external and domestic determinants of prices in the main advanced economies show that inflationary pressures are, for the time being, contained. In some countries, in which the process of reflation seems further advanced, such as the United States, there are even doubts regarding their solidity. In other cases, including the euro area and Japan, the outlook is one of even slower convergence towards the central bank target.