Flash Economics

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The two main causes of disinflation: China and energy prices

The fall in inflation in the United States and in the euro zone is quite clear.

The causes of this fall in inflation are also clear: the drop in the prices for energy and goods (manufactured items).

In the United States, the total inflation rate was 2.5% in August 2024, with energy prices falling by 4%, goods prices falling by 1.9% and services prices up 4.9%.

In the euro zone, inflation was 1.8% in September 2024, with energy prices down 6% year-on-year, industrial goods prices up 0.4% and services prices rising by 4%.

The fall in inflation is therefore due to the prices of energy and manufactured products, which can be linked to the weakness of energy demand in the world and in China, and to the situation of excess capacity in the Chinese industry, which is causing a sharp rise in exports of Chinese industrial goods at very low prices.

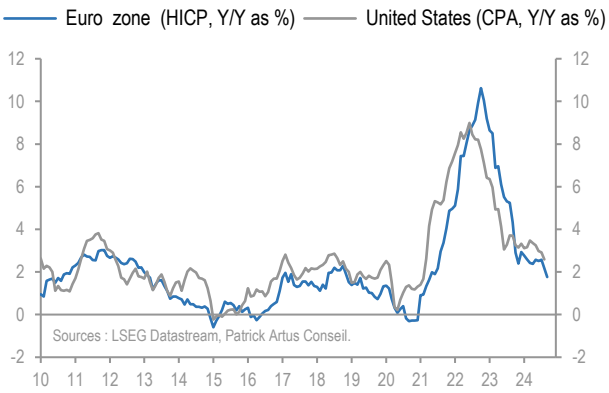
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Total inflation falls in the United States and in the euro zone

Chart 1 shows total inflation in the United States and in the euro zone.

Chart 1
Inflation



However, it is worth emphasising that this fall in inflation is due to the fall in energy prices (Chart 2) and the fall in the prices of goods and manufactured products (Chart 3).

Chart 2
Energy consumer price index (Y/Y as %)

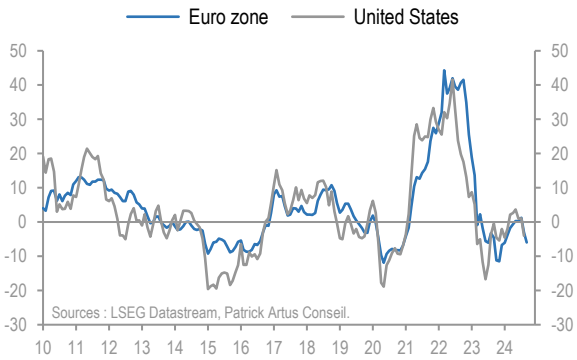
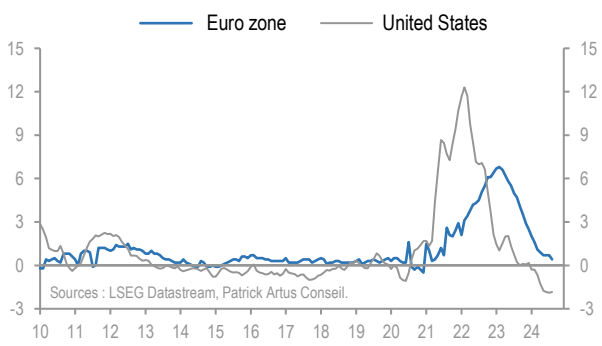
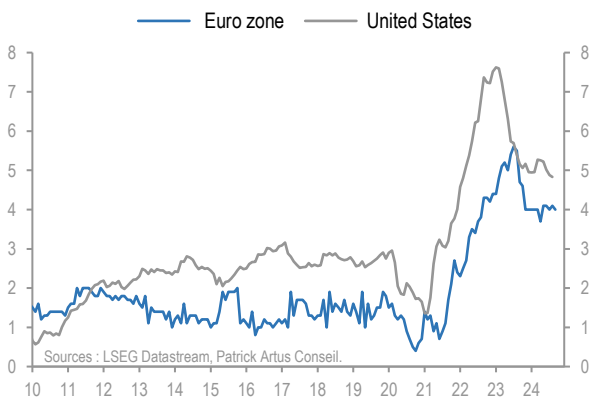


Chart 3
Consumer price index of nonenergy industrial goods (Y/Y as %)



In comparison, price increases for services remain strong (Chart 4).

Chart 4
Consumer price index of services (Y/Y as %)



One shall see that two developments are pushing total inflation downwards: the fall in world demand for energy and the state of excess production capacity in the Chinese industry.

Weak energy demand

World oil consumption has stagnated since the beginning of 2023 (Chart 5), which explains **the decline in oil prices since that date (Chart 6).**

Chart 5
World: Oil consumption (million bbl/day)

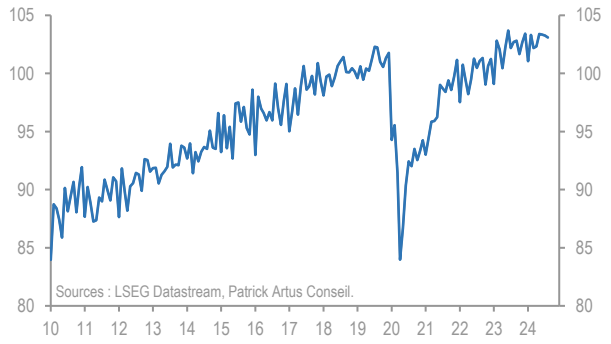
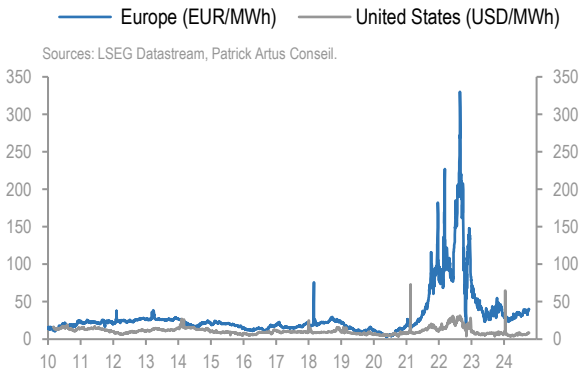


Chart 6
Oil price (Brent, USD/bbl))



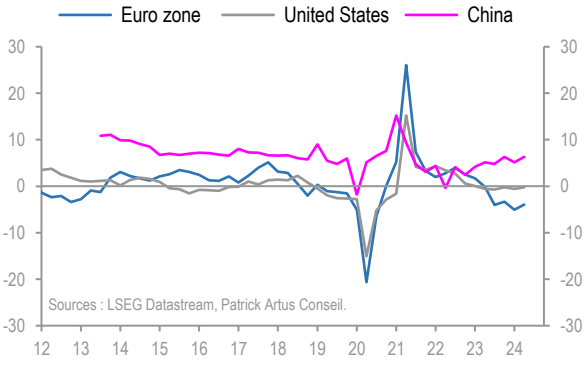
Global natural gas consumption has been falling slightly since 2021, which has led to **a fall in the price of natural gas since summer 2023 (Chart 7).**

Chart 7
Natural gas price



The weakness in fossil fuel consumption is both due to **the rise in renewable energy production** (which accounted for 39% of global electricity production in 2023, compared with 37% in 2021) and a **slower growth in manufacturing production than in the past (Chart 8).**

Chart 8
Manufacturing production (Y/Y as %)



Excess production capacity in Chinese industry

The capacity utilisation rate in the Chinese industry was 74.9% in the second quarter of 2024; it has fallen rapidly since 2021 (where it stood at 78.4%). The capacity utilisation rate is particularly low in car manufacturing (73.3%), electronics (74.6%), food processing (68.1%), electric battery production (52.6%) and solar cell production (57%).

This weakness in domestic demand has led Chinese manufacturers to focus on export markets (Charts 9/10), to the detriment of foreign manufacturers.

Chart 9
China: Exports (USD bn, annualised)

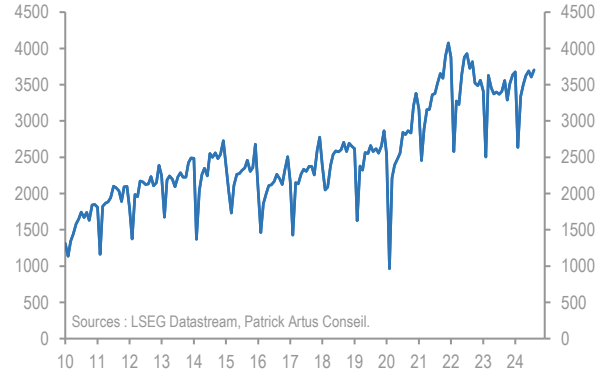
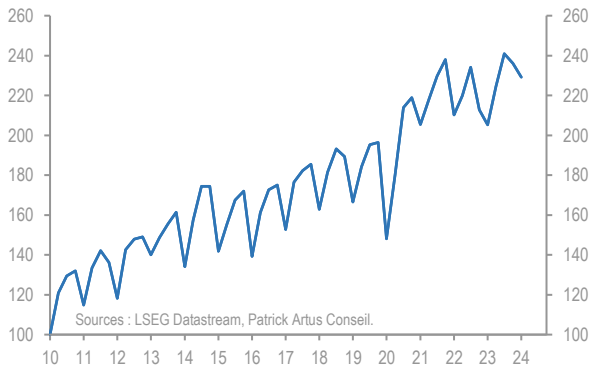
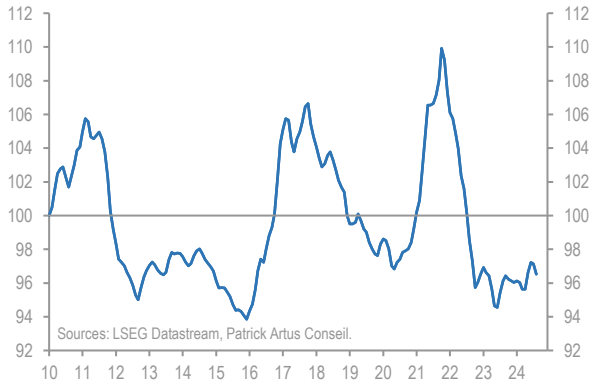


Chart 10
China: Exports of goods (in volume terms, 2010 Q1 =100)



This rise in exports of Chinese industrial products, which command very low prices (Chart 11), helps explain the weakness in the prices of manufactured goods in the United States and in the euro zone (Chart 3 above).

Chart 11
China: Producer price index for manufacturing industry
(2010 M1 = 100)



Summary: the fall in inflation in the United States and in Europe does not reflect the reality of inflation

The fall in inflation in the United States and in the euro zone is essentially due to:

- The fall in energy prices,
- The fall (United States) or the stability (euro zone) of industrial goods prices.

This fall in inflation is therefore, on the one hand, cyclical in origin, and on the other linked to the existence of excess production capacity in the Chinese industry.

The actual inflation trend is therefore much higher than the total inflation observed today, and this total inflation will recover when energy prices start to stabilise, and if Western countries generalise and increase the tariffs they impose on Chinese goods.

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