Flash Economics

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High inflation or low inflation in the future?

Today, there are arguments supporting both the case for persistently high inflation and for persistently low inflation. Of course, we are talking about medium-term inflation, beyond the horizon where inflation is high due to the war in the Middle East.

High inflation could result from:

- Tensions in the markets for critical minerals and semiconductors;
- Demographic ageing and the resulting decline in the working-age population;
- Protectionist trends;
- Ongoing geopolitical conflicts.

By contrast, low inflation could result from an excess supply of goods caused by overproduction capacity in China and the development of artificial intelligence, along with the resulting gains in productivity.

We must accept the fact that we do not know which of these two sets of mechanisms will prevail.

Patrick Artus
Senior Economic Advisor
patrick.artus-ext@ossiam.com
@PatrickArtus
Patrick Artus

Isabelle Gravet
Research Assistant
isabelle.gravet-ext@ossiam.com

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Today, rising energy prices are pushing inflation upwards, but our focus is on the structural determinants of inflation

Today, the increase in oil and natural gas prices (Charts 1A/B) is driving inflation higher (Charts 2A/B).

Chart 1A
Oil price (Brent, $/bbl)



Chart 1B
Natural gas price

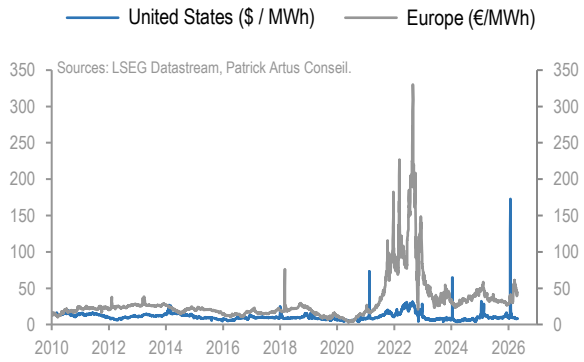
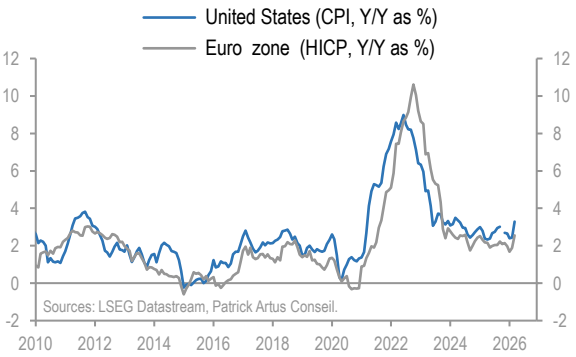


Chart 2A
Energy consumer price index (Y/Y as %)



Chart 2B
Inflation (as %)



Here, we are interested in the **structural determinants of inflation** in the medium term. There are arguments supporting the hypothesis of high inflation, but also arguments in favour of low inflation.

What mechanisms could lead to high inflation?

1. Tensions in the markets for critical minerals and semiconductors

The development of artificial intelligence, with the resulting needs for data centres and computing power, is already leading, and will lead to:

- **An increase in the prices of critical minerals**, for example copper and platinum (Chart 3A), lithium (Chart 3B), rare earths such as neodymium (Chart 4);
- **An increase in the prices of semiconductors** (Chart 5).

Chart 3A
Copper and platinum prices (2010.01.01 = 100)

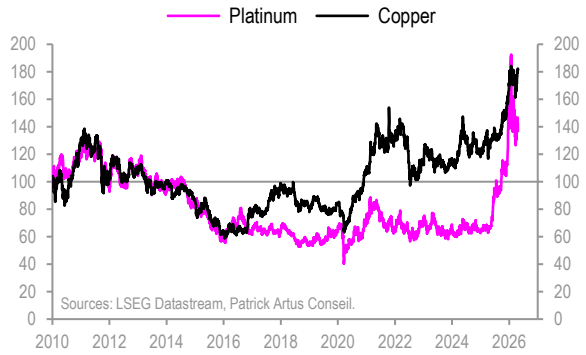


Chart 3B
Lithium price (100 : 2010.07.01)

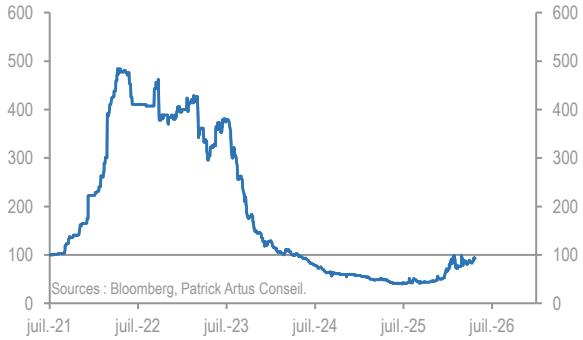
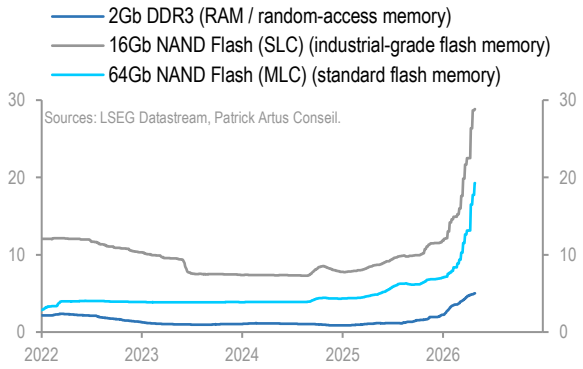


Chart 4
Neodymium price (thousands USD per tonne)



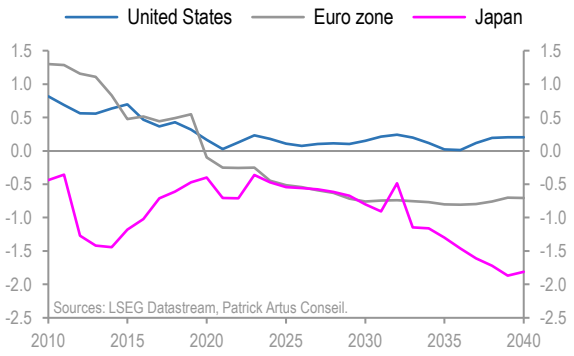
Chart 5
Semiconductor prices (in USD)



2. Decline in the working-age population

The working-age population (aged 15 to 64) is declining in Japan and the Euro zone and increasing only slightly in the United States (**Chart 6**).

Chart 6
Population aged 15 to 64 (as % per year)



This decline is steeper than that of the total population, resulting in a situation of **excess demand for goods and services**, which normally leads to higher inflation.

3. Protectionist trends

Rising tariffs (in the United States, in Europe on Chinese products) or **other forms of protectionism** (regulations disadvantaging imported products, national preference, etc..) **are inflationary**, because tariffs are almost entirely passed on to import prices and other forms of protectionism require excluding cheaper goods produced abroad.

4. Permanent conflicts

There is a real risk that the world may be affected by **permanent conflicts** (in the Middle East, Asia, around Taiwan, in Ukraine, etc..) **which are inflationary** through several mechanisms: disruptions in the supply of raw materials (as seen with war in the Middle East), semiconductors (which would be the case if China tried to invade Taiwan), increased public spending and public deficits.

Which mechanisms, on the contrary, would be disinflationary?

1. Overcapacity in production in China

China is characterised by a **low rate of capacity utilisation** (**Chart 7**), which results from weak domestic demand and **pushes companies to export** (**Chart 8**) to support their production.

Chart 7
China: Capacity utilization for manufacturing (as %)

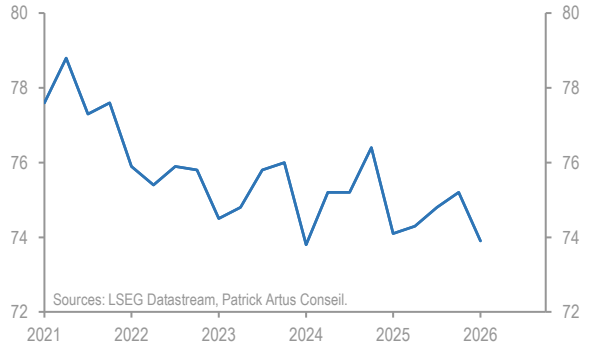
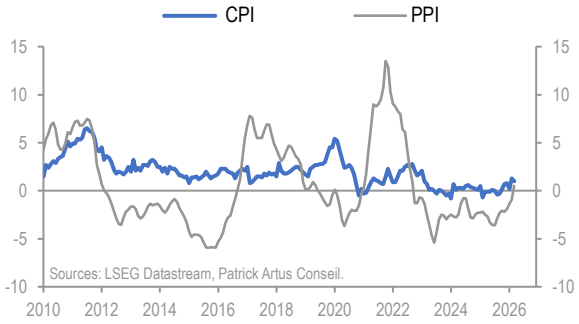


Chart 8
Exports of goods (in volume terms, Y/Y as %)



Prices of goods in China are about 30% lower than prices in the United States and Europe, so China is gaining market share in exports (see **Chart 8 above**), which means that the share of goods produced in China and exported is growing in global demand, and **this drives prices down in countries importing Chinese products**. The low level of inflation in China (**Chart 9**) will therefore be transmitted to other countries.

Chart 9
China: Consumer price index and producer price index (Y/Y as %)



2. Development of Artificial Intelligence

We are already seeing the **effects of the development of artificial intelligence in the United States**: job losses in sectors other than health and education (**Chart 10**), **significant productivity gains** (**Chart 11**).

Chart 10
United States: Change in payroll employment excluding health and education (M/M, thousands of person)

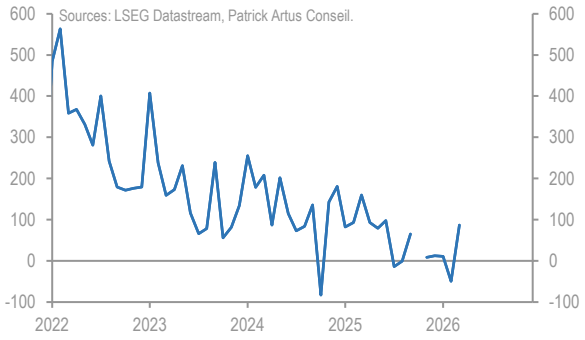


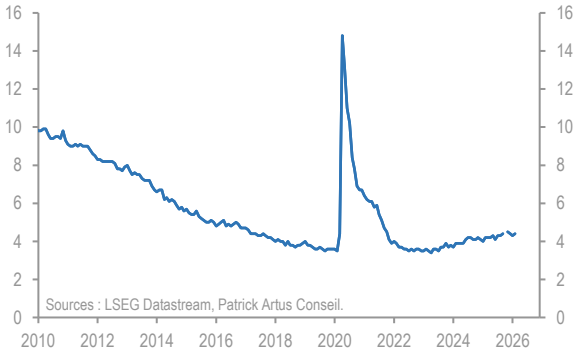
Chart 11
United States: Productivity per worker (business sector, 2010.Q1 = 100)



Thus, **two disinflationary mechanisms** appear

- The slowing of unit labour costs due to rapid productivity growth;
- Rising unemployment (**Chart 12**).

Chart 12
United States/ Unemployment rate (as %)



Summary: in reality, we do not know if inflation will be high or low in the future

In the short term, war in the Middle East will clearly push inflation higher. **But in the medium term, opposing mechanisms are at play:**

- Tension in the markets for critical minerals and semiconductors (due to the development of artificial intelligence), the stagnation of the working-age population, protectionism, and conflicts are inflationary;
- Overcapacity leading to increased market share for China and the effects on the labour market of artificial intelligence development are disinflationary.

In reality, we do not know if inflation will be high or low in the future.

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