Flash Economics

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Inflation or disinflation in the United States and the euro zone?

The medium- to long-term outlook for inflation in the United States and the euro zone is difficult to determine.

On the one hand, there are disinflationary forces:

- Artificial intelligence, if it leads to an increase in total factor productivity, which is not certain because of the need for capital generated by AI ;
- The situation in China, where there is excess production capacity in many sectors, prompting Chinese producers to export a great deal.

On the other hand, there are inflationary forces:

- The presence of monopolies and oligopolies, especially in the United States;
- Protectionism;
- In the euro zone, stagnating productivity;
- The decline in the working-age population, especially if combined with immigration restrictions;
- Rising prices for the raw materials needed for the energy transition.

All in all, we believe that inflationary factors will dominate disinflationary factors.

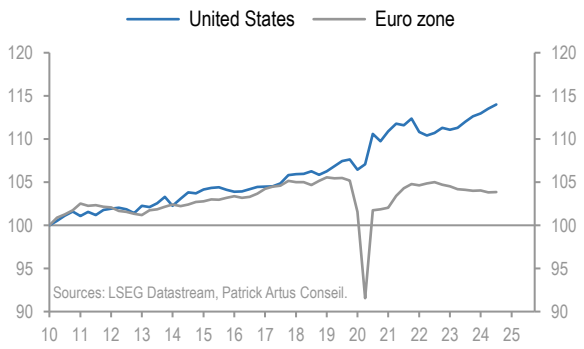
Patrick Artus
Senior Economic Advisor
patrick.artus-ext@ossiam.com
@PatrickArtus

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There are disinflationary mechanisms

There are essentially **two disinflationary mechanisms**.
The first mechanism that is probably disinflationary **is artificial intelligence**, if it **leads to an increase in total factor productivity** (**Chart 1**).

Chart 1
Total Factor Productivity (100 : 2002.T1)

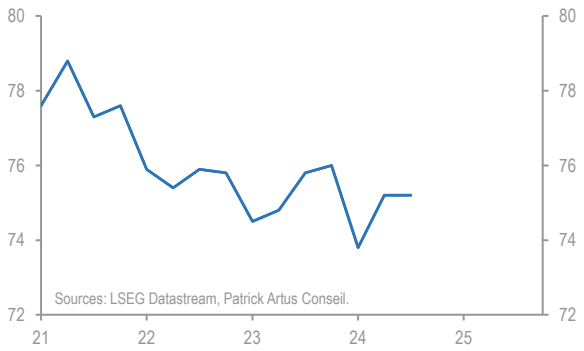


Artificial intelligence will lead to:

- an **increase in labour productivity**;
- but, due to its highly capital-intensive nature**, a fall in capital productivity**.

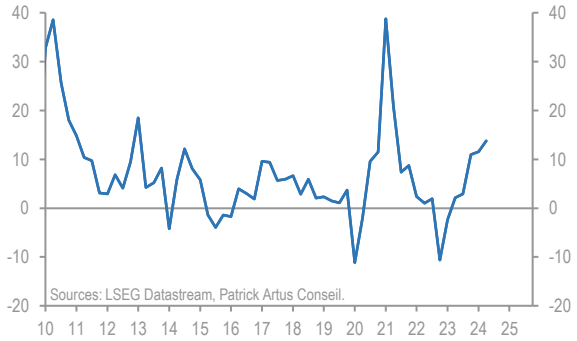
As a result, **the overall effect of AI on potential output** and **on production costs** (there is a fall in the unit cost of labour, but an increase in the unit cost of capital**) is uncertain**.
The second mechanism, which is certainly disinflationary, is the situation in China. China's domestic demand is growing slowly (with an ageing population and asset losses linked to the fall in property prices pushing Chinese households to save more), and so capacity utilisation is low (Chart 2), particularly in certain sectors, such as the electric battery industry.

Chart 2
China: Capacity utilization for manufacturing (as %)



This **encourages Chinese companies to export** (**Chart 3**), and so the arrival of Chinese products in the United States or Europe (directly in Europe, indirectly through third countries in the United States) leads to a fall in prices in the United States and Europe.

Chart 3
China: Exports of goods (in volume terms, Y/Y as %)

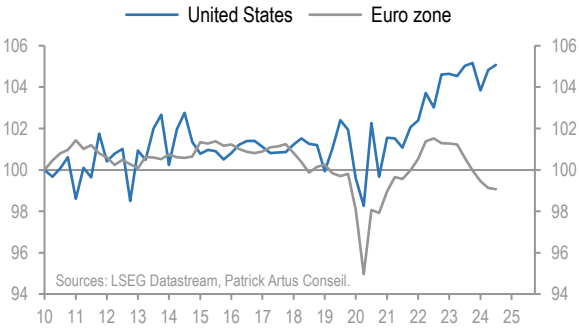


But there are several inflationary forces

Inflationary forces stem from:

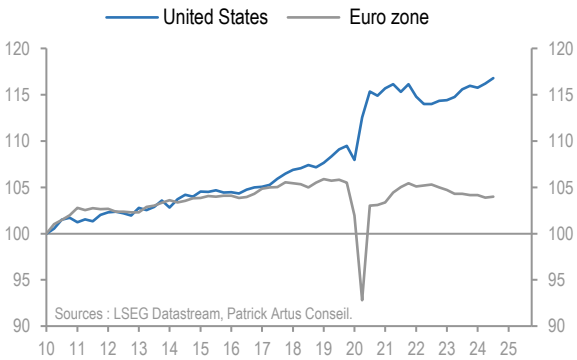
- **The frequent situation of monopolies or oligopolies in the United States**, which leads to higher profit margins ('profitflation'), **Chart 4**;

Chart 4
Ratio between GDP deflator and unit labour cost
(2010.M1 = 100)



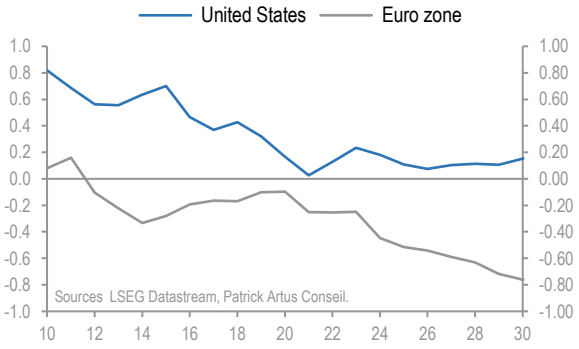
- **The prospect of protectionism**, especially in the United States;
- **Stagnating productivity in the euro zone** (**Chart 5**);

Chart 5
Labour productivity (2002.Q1 = 100)



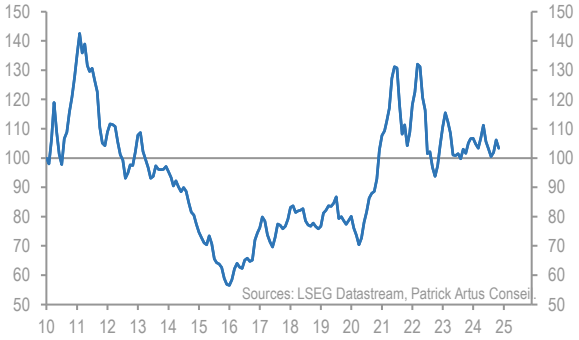
- **The decline in the working-age population** (**Chart 6**), especially if combined with **restrictions on immigration**.

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



- **The rise in the price of industrial materials**, especially those needed for the energy transition (**Chart 7**).

Chart 7
Industrial materials index (2010.M1 = 100)



Summary: inflationary factors will probably dominate disinflationary factors

The list of inflationary mechanisms is long (monopoly or oligopoly situations, protectionism, productivity stagnation, decline in the working-age population, immigration restrictions, rise in commodity prices).
Disinflationary mechanisms may not be very powerful:

- We have seen that the overall effect of artificial intelligence on production costs is uncertain;
- If the United States and Europe protect themselves against Chinese exports, in particular through customs duties, the production capacity available in China will not be able to generate additional exports from China to the United States or the euro zone, so the disinflationary effect of these exports from China will disappear.

We therefore believe that, overall, inflationary mechanisms will dominate disinflationary mechanisms.

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