HIGHLIGHTS from BOX 1.1: THE GREAT DISINFLATION

Key Points

- *Emerging market and developing economies (EMDEs) have achieved a remarkable decline in inflation since the mid-1970s. The great disinflation has also been accompanied by growing inflation synchronization across the globe. It has been supported by long-term trends such as the widespread adoption of robust monetary policy frameworks and strengthening of global trade and financial integration.*
- *Continuation of low and stable EMDE inflation is by no means guaranteed. If the wave of structural and policy-related factors that have driven the disinflation loses momentum, elevated inflation could re-emerge.*
- *If the global inflation cycle turns up, EMDE policymakers may find that maintaining low inflation can be as a great a challenge as achieving it. Policy options to help insulate economies from the impact of global shocks include strengthening institutions, including central bank independence, and establishing complementary fiscal policy frameworks.*

Evolution of EMDE inflation: A remarkable conquest. EMDEs have achieved a significant decline in inflation since the mide-1970s, with median annual national consumer price inflation down from a peak of 17.3 percent in 1974 to about 3.5 percent in 2018. Disinflation over recent decades has been broad-based across regions and country groups.

Drivers of low inflation: Macroeconomic policies and global integration. While the global financial crisis played a major role in pushing inflation down around the world over the past decade, the longer-term trend of disinflation has been supported by a range of structural changes. The most significant of these have been the wide-spread adoption of more effective and more transparent monetary, exchange rate, and fiscal policy frameworks as well as globalization.

Global inflation cycle: Increasing role of global inflation factor. Inflation has become increasingly globally synchronized. Moreover, the contribution of global forces to inflation variation has grown over time: since 2001, it has almost doubled, and now accounts for 22 percent of inflation variation in the median country. This is about double the degree of synchronization of global output growth that reflects the global business cycle.

Maintaining low inflation: A greater challenge. The achievement of low inflation cannot be taken for granted. EMDE inflation could rise if the global inflation cycle turns up. Structural and policy related factors that have helped lower inflation over the past several decades may lose momentum or be rolled back amid mounting populist sentiment.

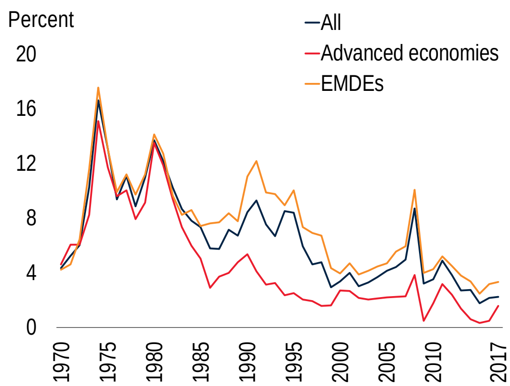
Policy priorities: Build resilience. EMDE policymakers need to recognize the increasing role of the global inflation cycle in driving domestic inflation. Policy options to help insulate economies from the impact of global shocks include strengthening institutions, including central bank independence, and establishing fiscal frameworks that can both assure long-run debt sustainability and provide room for effective counter-cyclical policies.

Global Economic Prospects

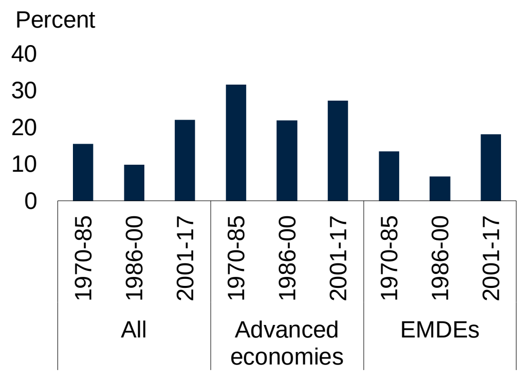
Figure 1: Evolution of inflation

Emerging market and developing economies (EMDEs) have achieved a remarkable decline in inflation from a peak in the mid-1970s. The great disinflation in EMDEs has also been accompanied by growing inflation synchronization and the emergence of a global inflation cycle. Historically, global inflation has been low and stable before: during the Bretton Woods fixed exchange rate system in the post-war period up to the early 1970s, and during the gold standard of the early 1900s.

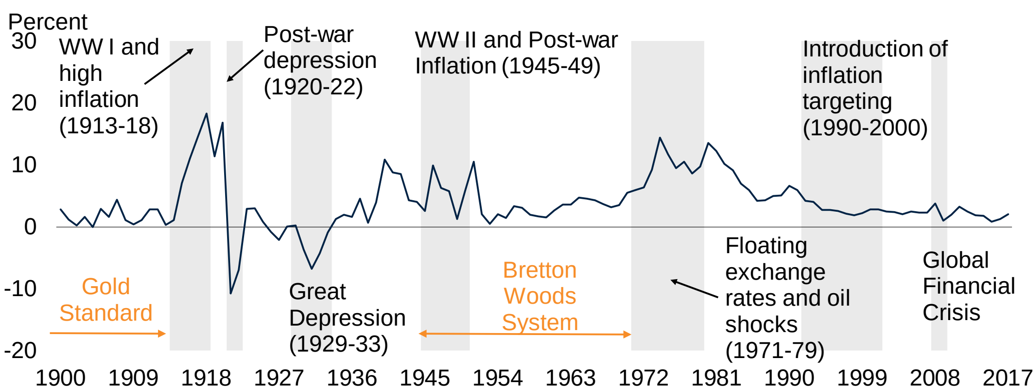
A. Median CPI inflation, by country group



B. Contribution of global factor to inflation variation



C. Global inflation



Sources: Haver Analytics; World Bank; Ha, Kose, and Ohnsorge (2019).

A. Median year-on-year consumer price inflation for 29 advanced economies and 123 EMDEs (including 28 low-income countries).

B. The results are based on a two-factor dynamic factor model with inflation using a sample of 99 economies (25 advanced economies and 74 EMDEs) for 1970-2017. The model includes global inflation factor. All numbers refer to median variance shares of total inflation variance accounted for by the global factors.

C. Median of annual average inflation in a sample of 24 economies for which data are available across the full period.