

Facing a Break Point in Global Inflation Transmission?

by

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Abstract:

The paper addresses the issue of the co-movements of national inflation dynamics with a common factor of a global dynamic. Based on the previous work of Ciccarelli and Mojon (2005) on global inflation the authors look at the more recent development in particular after the outbreak of the global financial crisis in July 2007. As a working hypothesis they try to find out if there is already sufficient empirical evidence available in the data that the massive liquidity pumped into the global financial system by central banks around the world together with the massive fiscal deficit spending of governments to cushion the recession could lead in the medium-term to an inflationary shock. Such rare events occurred in the past five decades only three times. We test especially after updating the data from 2004 until 2008/2009 depending on the data availability if there are already indications that inflationary pressures are building-up refuting expectations of many experts that the current global recession will increase the pressures on the global prices towards a global deflation. The combination of a coordinated reflationary monetary policy together with the fiscal stimulus packages already setup by governments around the globe should according to the fiscal theory of the price level tend to increase the joint-impact of these monetary expansions by the central banks and the governments towards a strong and rapid turn-around in the global price dynamics. Using an approach first established by Hamilton and Flavin (1986) we test for fiscal sustainability of the fiscal deficit positions in the US. The key question following from this is that after setting this process of an acceleration of global inflation into motion it could be hard to get the Genie back into the bottle. The experience of stagflation in the late 1970s and early 1980 are a warning sign that reflationary policies could lead to a significant overshooting in the reflationary macroeconomic impulse created around the globe.

Key Words: Inflation, common factor, global recession, monetary and fiscal policy, OECD countries

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