IS THE DE-GLOBALISATION AN ANSWER TO THE PROBLEM OF INFLATION?

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Introdution

In order to understand what correlation, if any, there is between the phenomenon of *de-globalisation* and inflation, it is important to analyse the factors that have an influence on consumer prices. Inflation has returned to the centre of the political agenda and the daily political debates almost by force, especially because of its ability to insinuate itself and make itself visible by lowering the purchasing power of consumers and at the same time allowing some - at least temporal- advantages for debtors and governments. After the globalisation gathered speed in the 1990s, entering in the period well known as "hyper-globalisation", it can be noted that a progressive reduction of globalisation has taken place. The slowdown in the speed of economic integration, after the Global Financial Crisis, reflected its effects in a such a way that it is clear that the "hyper-globalisation'' phase was not just a transitory phenomenon of fast-rising integration but one of profound structural change. The negative effects were so much so that there has been used the term *de-globalisation* exactly to describe the profound deterioration of the structures we have historically used to manage our globalised world. The United Nations, the Bretton Woods organisations and many other multinational structures have had struggles - and possibly continue to have - in the management of the changing global needs and the drivers of the Global Economic Integration. Just to name a few: the ones related to the labour and trade area, the increasing weight of emerging market economies (EMEs) in global economic activity, the global value chain (GVC). The populist answers, together with the rise of the de-globalization, has brought to damages to supply chains and to lower growth rate. The responses of liberal governments make us talk about the structural development of the crisis. Supply difficulties, semiconductor shortages, rising raw material prices, COVID 19 and nowadays the war in Ukraine, make it clear that the phenomenon of inflation is far from being a short-lived bad dream and instead there is the growing risk that it will turn into a stable nightmare. Changes in the mechanisms of the global economy have led the ECB to review and update its monetary policy strategy***. The focus of the article is the analysis of the effects of globalisation on inflation, with the attempt to understand if global factors, are still relevant for inflation.*** The prices are moving ever upwards but what is the role of the global factors for the advanced economies? Is it really possible to talk about de-globalisation to solve the most difficult economic challenge? Is it possible to fight the new era of inflation that is rapidly spreading from one country to another, in a world economy that remains very closely interconnected? This article will be an attempt to answer these questions. After a brief overview of all the change factors of the macroeconomic environment (such as uncertain volatility, ecological and digital transition, war conflict, sanctions, lockdown in China), it will be presented the measures of the level of globalisation and the global factors influencing prices (commodity prices, global foreign direct investment as trade integration and global value chain participation).

Overview of our macroeconomic environment

Looking at the macroeconomic environment is crucial for understanding inflation trends. As basic economics teaches us, price increases can occur in the case of the excess of demand over supply (demand-inflation) or in the case of rising production costs (supply inflation). This can occur due to various factors, such as an *unexpected event* that makes the supply and production of goods difficult (pandemic or war) or an increase in the cost of raw materials, such as oil. In the economic literature, it is quite widespread the idea that globalisation exposes an economy to greater *uncertainty* and thus that globalisation affects the transmission of uncertainty shocks to the real economy. This equation - supported by growing evidence – lead to the perception that globalisation is associated with more extreme and synchronised nature of uncertainty shocks [1]. The increased correlation of uncertainty indicators across countries is evident especially after the year 2010. It can be recalled that they were the years of events such as the euro area sovereign debt crisis, the Brexit referendum, the trade tensions between the United States and China, and the COVID-19 pandemic. Together with uncertain volatility, it is mandatory considering all the other factors that necessarily describe our current macroeconomic condition: such as the ecological and digital transition, war conflict, sanctions, lockdown in China. In fact, it has to be considered that globalisation also increases the macroeconomic impact of external uncertainty on *the real* economy. Extraordinary events such as the one of the pandemic of COVID-19 triggered the perceived probability of others extreme negative shocks in the future. In this way, the long-run costs economy are many times higher than the estimates of the short-run losses in output. All international uncertainty shocks lead to large declines in output, prices and interest rates: war conflict in Ukraine and the consequent international sanctions imposed have to be considered as the leaders in the large declines in output, prices and interest rates. From a macro level point of view, we have to consider that external uncertainty provokes strong spillover and spillback effects. This means also that international business cycles move more synchronously. We must consider this phenomenon as a vicious circle that is self-feeding Globalisation is associated with more uncertainty but also with a visible path of co-movement of inflation. Since now, the 2023 seems looking different compared to 2022, year in which markets had a terrible time. Anyway, investors are still really concerned about inflation, which in turn, seems not to have been passed at all. The HICP inflation rate is still 9.2% in the euro area; the rate experienced a decrease compared to the 10.1% in November 2022[2]. However, the level remains higher than the 2% target of central banks. *Why is it relevant assessing the role of globalisation on good and services prices and what are the* ***channels through which globalisation can feed into the more persistent component of inflation?***

[1] (See for example, Bandt (de), O., Bricongne, J.C. and Fontagné, L. (2021), "Globalisation and Uncertainty", Eco Notepad, Banque de France. Available at:

https://www.researchgate.net/publication/349255293_Global_impacts_of_US_monetary_policy_uncertainty_shocks

[2] ECB, Inflation Dashboard. Last update 18 January 2023. Data available at:

https://www.ecb.europa.eu/stats/macroeconomic_and_sectoral/hicp/html/index.en.html

How to measure globalisation and why globalisation should be a channel of inflation ordeflation?

Globalisation may not only affect inflation levels but also change the price-setting behaviour of firms and thus the way inflation responds to domestic conditions. In order to understand the channels, we can look at the three elements of globalisation that appear to contribute mostly to a decline in goods inflation: trade integration (lower trade barriers); informational globalisation (digitalisation-driven integration) and global value chain participation.

Which are basically three measures of the level of globalisation. It is possible measure it by considering the level of trade integration, the increasing fragmentation of production in vertically integrated supply chains, trade intensity, measured as the share of world imports of goods and services to GDP. Global integration is also described by the dimension of **informational globalisation and digitalisation.** These last two aspects have changed the pricing behaviour of large retailers at a global scale. <u>These two characteristics seem to persist and resist the protectionist trend.</u> The enhanced competitive behaviour of firms increases the geographical correlation of price changes and tends to dampen price increases.

Globalisation could be considered a channel mainly for two reasons: it can exert a role **by influencing the price and wage-setting mechanism and by** influencing the labour market.

Trade integration and greater participation of low-cost producers is associated with a downward pressure exerted on unit labour costs in the importing country, especially when low-wage countries are integrated in supply chains. Globalisation is linked also with effects on labour market; on the negative side, regarding less bargaining power of workers; on the other hand, by facilitating international migration flows, globalisation has influenced the relationship between unemployment and the wage-setting behaviour of the hosting country.

Anyway, evidence suggests that there is not a huge disinflationary or inflationary role for the globalisation[3]. The changes in GVC participation and inflation are more dependent on the sectoral level. Especially, for the manufacturing industries, which are the most integrated in GVCs (due to the nature of goods, namely they are highly tradable and are less local in nature). This aspect increases strategic complementarities and the dependence of producer price inflation on global economic. Thus, it is the industrial composition of an economy at stake in assessing how global factors may influence the responsiveness of inflation to the business cycle. The description of the fluctuations of global foreign direct investment (FDI) changes helps us to understand why. The global FDI flows dropped by 22% in in the second quarter of 2022[4], not surprisingly given increasing inflation and interest rates, rising energy prices and Russia's full-scale invasion of Ukraine. *Why it is relevant?* It is well known that the FDI projects that are more capital intensive and rely on materials and labour are likely to suffer more than others (e.g. manufacturing, assembly and other capital-intensive site selection projects); inflation means higher costs for businesses; especially, for those FDI projects that rely more on the materials and labour which are more likely to be the most impacted. Cross-border activity in advanced economies declined by 16% in value terms in response to increasing inflation and interest rates and on-going geopolitical uncertainty.[5]

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[3] Lastauskas, P. and Nguyen, A.D.M. (2021), "Global Impacts of US Monetary Policy Uncertainty Shocks", Working Paper Series, No 2513, ECB.
https://www.researchgate.net/publication/349255293_Global_impacts_of_US_monetary_policy_uncertainty_shocks

[4] OECD Foreign Direct Investment Statistics (2022); Data and forecasts available at:
https://www.oecd.org/investment/statistics.htm

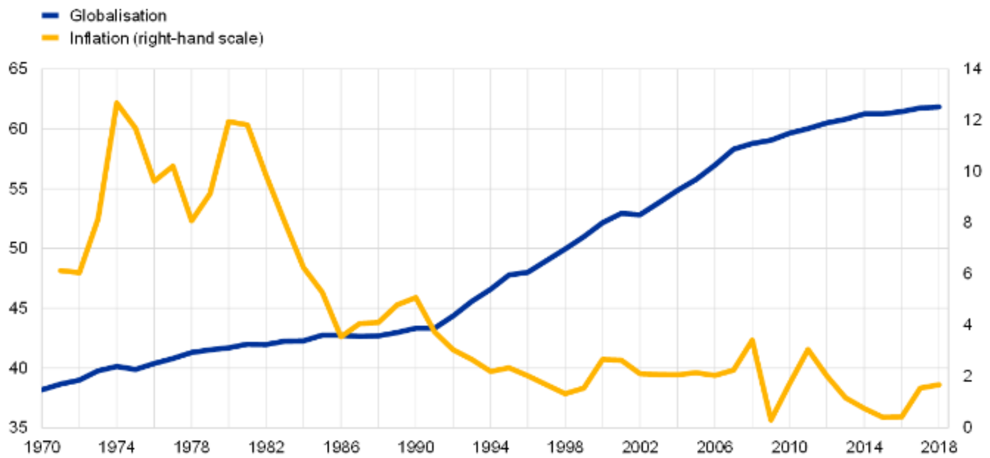
[5] OECD Foreign Direct Investment Statistics (2022)

The result. Globalisation and Inflation? Not a major role.

Figure 1:

Median inflation rates in advanced economies and the KOF Globalisation Index

(left-hand scale: index; right-hand scale: annual percentage changes)



Sources: ECB staff calculations, KOF Swiss Economic Institute and national sources.
Note: Headline median inflation of 22 OECD countries and the KOF Globalisation Index.

Source: *European Central Bank (2021), The implications of globalisation for the ECB monetary policy strategy, Occasional Paper Series, European Central Bank, 263.*

It has to be considered also that the largest inflation swings during the period of analysis took place in the early 1990s, when globalisation was still in the early stages: there is no room for a prominent influence of globalisation on inflation. Domestic factors continue to play an important role in driving price dynamics. The effect of globalisation on persistent inflation has been small, especially for the impact on service inflation.

Conlusion

We know that the **effects of inflation** can be disastrous: on savings, on financial investments (for creditors), and it is an unfair tax: it reduces the amount of goods and services that can be purchased for everyone. But above all, it is 'unfair' because it does not affect everyone equally. Usually, inflation affects more poorer people (as they consume a greater share of their income to buy basic necessities, which are in most of the cases the ones subject to higher price increases). More generally, the rise in the cost of living may make it impossible to cover expenses for basic needs. **Basically, 3 sets of factors can explain** the co-movement in prices during the phase of expansion of global interconnection: common stocks or fluctuation in commodity prices; shift of monetary policy; structural changes that may affect both wage and price setting (as demographic changes). The decrease in inflation started in the 1980s, when globalisation was still latent. The sharpest movements in overall inflation took place in the 1990s, then again after the financial crisis. This means that possibly the fluctuations are linked to other factors (as shifts in monetary policy regimes, falling inflation expectations and lower wage indexation). Globalisation does not appear to be a major force behind the disinflationary trends of the past decades. Even when globalisation acts as a disinflationary force, the estimated impact is economically small. <u>This is the reason why if it does not play a major role in the spread of disinflation, it can be assumed that it cannot play a major role in the spread of inflation.</u> The market economy seems to be doing better despite high inflation. *What does this mean?* Unexpected factors helped 2023 get off to "a good" start.[i] The temperatures lead to a decrease of gas consumption, helping prices towards a downward pressure, better than expected. Moreover, China has loosened its zero-covid policy and it will lead to greater demand for goods and services. Certainly, the central banks will still keep inflation under observation and it is still too early to say that we are out of danger. The rising protectionism, populist answers, together with the rise of the de-globalization, has put negative pressure to **globalisation.** The coronavirus might accelerated some of these trends that were already latent. But it seems more appropriate talking about a *reshaping of globalisation* rather than a *de-globalization* in itself.

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[6] How the world economy could avoid recession (2023), The Economist.