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An inflation focus that neglects growth could lead to stagflation

Price stability and economic growth must not be posed as an either-or choice as the well-being of people demands a balance



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The global economy is confronted with a daunting prospect, as accelerating inflation and decelerating growth loom large on the horizon. This will inevitably impose hardships on people, while posing a dilemma for governments everywhere. The table presents just-published International Monetary Fund statistics on actual inflation rates and growth rates in the world, disaggregated by economy groups, for the period 2015-2019 and 2020, compared with estimates for 2021 and projections for 2022, and has corresponding figures for India as a point of comparison.

In advanced economies, consumer price inflation, a mere 1% per annum during 2015-20, rose to 3% in 2021 and is projected to reach about 6% in 2022. Compared with 1% per annum or less in the preceding five years, the corresponding inflation rates in 2021 and 2022 are 4.7% and 7.7% in the US, 3.2% and 5.5% in Germany, 2.6% and 7.4% in the UK, and 2.6% and 5.3% for the Eurozone, with Japan as the sole exception. These projected inflation levels in rich countries, for 2022, are unprecedented and have not been witnessed since the oil crises of the 1970s fifty years ago. In developing economies, where consumer price inflation was on average 5% per annum during 2015-2020, corresponding inflation rates are 6% in 2021 and 9% in 2022. Asia is the sole exception where inflation is moderate. For Latin America, Sub-Saharan Africa, and Middle East & Central Asia, inflation reached double-digit levels in 2021 and will climb further in 2022. In Developing Europe (non-EU transition economies), the corresponding rates are 10% and 27% per annum.

The factors underlying inflation are obvious. First, during 2020-2021, most central banks adopted easy monetary policies while governments adopted expansionary fiscal policies in response to the covid pandemic and its associated lockdowns that led to a devastating contraction in output and employment. The unintended consequences were that significant proportions of cheap money went into financial assets—driving stock market booms in an economic slump—and primary commodities, pushing up world prices. Second, in early 2022, the war in Ukraine accentuated inflation as it squeezed world supplies of fuels (oil and gas from Russia) and food (wheat from Ukraine), while the sanctions and the war disrupted supply chains. Mounting inflationary expectations are an obvious consequence.

This has coincided with a sharp slowdown in growth worldwide. In advanced economies, gross domestic product (GDP) growth, which was 2% per annum during 2015-2019, slumped to -4.5% in 2020 while 5.2% in 2021 meant a return to GDP levels in 2019. It is the same story for most rich countries. In developing economies, GDP growth, which was 4% per annum in 2015-2019, dropped to -2% in 2020, recovered significantly to 6.8% in 2021 (attributable mostly to China and India) more than returning to GDP levels in 2019, but will drop to