

Emerging Markets | Will Inflation Be The Next Pandemic?

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We see risks of an extended period of higher inflation in some EMs, as higher energy prices and prolonged supply-chain problems may spill over to core prices in countries with weakly anchored inflation expectations.

How this will shape 2022

The rapid recovery of demand and lagging supply are increasing inflationary pressures. Restarting the economy after the severe pandemic lockdowns is proving highly complex and is contributing to large fluctuations in inflation. In emerging markets (EMs) where lockdowns and other pandemic restrictions have been lifted, people are eager to resume activities and kickstart consumption. This is helping many EM economies, such as Russia, Poland, Indonesia, Chile, and Brazil, recover GDP close to or above pre-pandemic levels, while in Turkey and China, GDP is already well above pre-pandemic levels. These same conditions are true for most developed economies. Yet, such a rapid recovery of demand is bringing supply-side challenges. Uneven reopening across the globe and sectors has led to labor and component shortages. It is also causing bottlenecks at seaports, leading to logistics disruption. All these factors raise inflationary pressures, as prices of commodities, food, and other goods rise.

The lag between rising producer and consumer prices could signal upward pressures on consumer prices ahead

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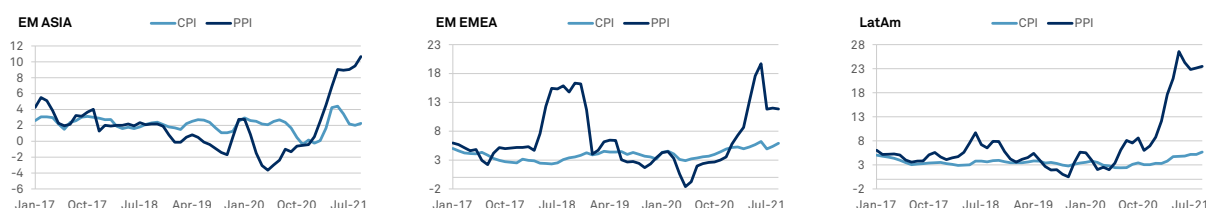
Prolonged price pressures could spill over to core prices in countries with weakly anchored inflation expectations. Persistently high inflation could erode households' disposable income and profit margins for corporations unable to fully transfer costs to their customers. At this point, many EM central banks face a dilemma between anchoring inflation expectations and supporting short-term growth.

What we think and why

Inflationary pressures are proving broader and more persistent. Some of the factors causing them might dissipate as demand cools, supply-chain wrinkles iron out, and base effects dissipate. On the other hand, some concerning trends might result in lingering inflation, especially those related to the supply side. Pass-through has been limited so far. Input costs for producers across major EMs have been rising much more rapidly than consumer prices (see chart 27). This suggests producers may currently be absorbing a higher burden of rising input costs at a time when recovery in consumer demand is still fragile in some EMs. However, there tends to be a lag between the increase in producer prices and consumer prices, which could be a sign that upward pressure on consumer prices will remain in the coming months.

Chart 27

Consumer And Producer Indices, Regional Median, % Change Year Over Year



Source: Haver, S&P Global Ratings. EM ASIA: China, India, Malaysia, Philippines, and Thailand; EM EMEA: Poland, Russia, Saudi Arabia, South Africa, and Turkey; LatAm: Brazil, Chile, Colombia, and Mexico.

Global Credit Outlook 2022: Aftershocks, Future Shocks, And Transitions

What could go wrong

Rising energy prices and prolonged supply disruptions could keep inflation in most EMs above central bank targets for longer. Hydrocarbon prices remain elevated (see chart 28) after surging in recent months as the strong recovery in demand interacts with supply constraints. Oil prices, already at a multiyear high, may go higher given that utilities and industrial companies across the world could switch from high-priced natural gas and LNG to oil. The ongoing recovery in global demand could keep the demand-supply mismatches for an extended period of time, keeping upward pressure in oil prices, as well as preventing supply-chain disruptions from clearing sooner.

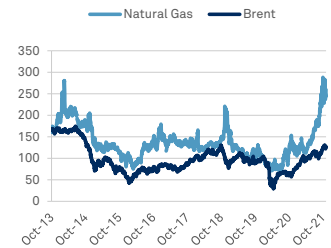
EM central banks might run more restrictive monetary policy for longer if inflationary pressures prevail. Inflation in many EMs, including Brazil, Chile, Colombia, Mexico, Russia, and Turkey, is running above central bank targets (see chart 29). There's little EM central banks and domestic authorities can do to address global supply chain disruptions or the spike in gas and oil prices. Central banks need to stick to their mandates of keep inflation expectations anchored around their targets.

EM rated corporations have been absorbing higher costs, but stress could build if inflation lasts much longer. Persistent supply chain disruptions, high input prices, and potentially steeper labor costs could erode companies' profit margins. At the same time, higher interest rates could also mean higher debt servicing cost and tighter financing conditions.

Prolonged inflationary pressures and lingering high energy prices could result in fiscal slippage for some EMs. EM households are more vulnerable to increasing food and energy prices as they allocate a larger portion of their income to these expenses. This means EM governments could pursue additional fiscal stimulus and delay consolidation to stabilize price pressures and prevent social discontent, especially in the context of upcoming elections in some EMs.

Oil prices are high but could go higher

Chart 28
Oil and Natural Gas Prices

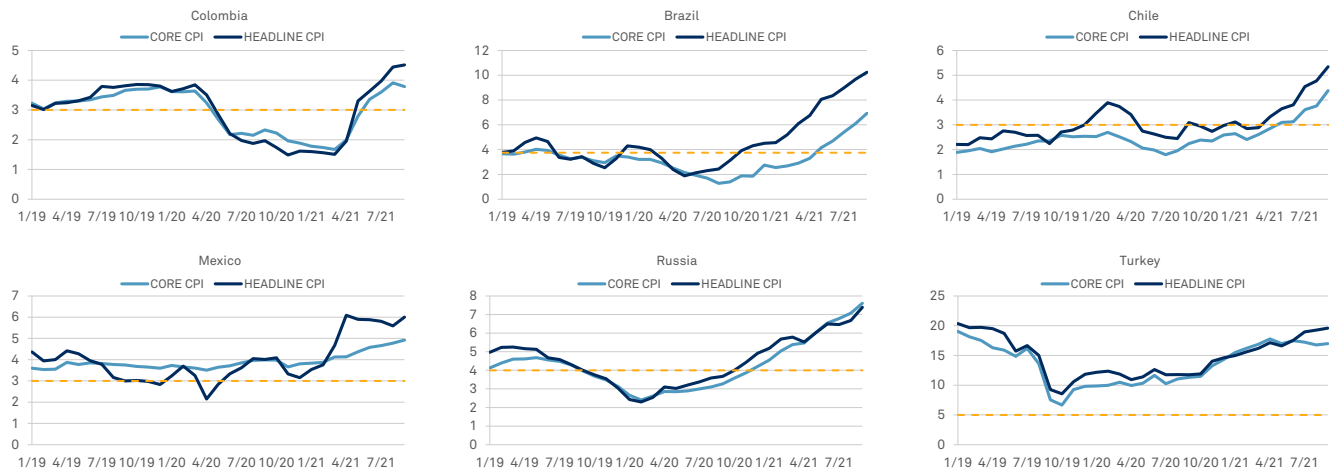


Source: Bloomberg. Dec. 31, 2019=100.

More hikes are likely in the coming months across EMs that need to further anchor inflation expectations

Chart 29

Key Emerging Markets With Inflation Rates Running Above Central Bank Targets



Source: Refinitiv, S&P Global Ratings.

Note: Monthly inflation year-over-year change, %. Dotted lines show the country's central bank inflation target. In some cases, central banks have a tolerance range around the target, as follows: Brazil (+/- 1.5%), Chile (+/- 1%), Colombia (+/- 1%), Mexico (+/- 1%), and Turkey (+/- 2%).

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