Global inflation was relatively stable in 2012

Globally, inflation is broadly under control, with consumer prices rising at a 3.9 percent annualized rate at the end of 2012. The experience of countries at different income levels over the past year has been diverse, however (figure INF.1). Inflation dropped dramatically in low-income countries (LICs), with falling food and fuel-price inflation driving declines (figure INF. 2). In contrast, inflation was broadly stable in middle-income countries (MICs) and high-income countries (HICs) through 2012, though with a mid-year dip in HICs and an easing in the last quarter of 2012 in MICs.

For developing countries as a whole, inflation moderated to a 5.1 percent annualized rate in the three months through December 2012 (saar), from an average 7.2 percent in 2011. By the end of 2012, headline inflation was under 6 percent in 80 percent of the developing countries for which the World Bank collects data. Year-over-year inflation of more than 14 percent was observed in only ten developing countries as of November 2012: Belarus (30%), Burundi (14.3%), Eritrea (13.5%), Ethiopia (26%), Iran (30%), Malawi (30%), South Sudan (41%), Sudan (46%), Syria (40%), and Venezuela (18%), reflecting disrupted supplies due to political turmoil in some countries and large macroeconomic imbalances in the others.

Looking ahead, inflation is expected to average 3.5-4 percent in 2013 for the world as a whole and 6.3 percent in developing countries, somewhat higher than in 2012, although the outlook is subject to both upside and downside risks. A worsening in global growth due to an intensification of the Euro Area sovereign debt crisis, an extended fiscal policy impasse in the United States, or faster-than-expected unwinding of Chinese investment could all translate into an easing in price pressures. On the upside, supply shocks in food or fuel markets could intensify price pressures — especially in low-income countries, where the weight of these commodities in the CPI basket is high.

In low-income countries, inflation momentum (the quarterly seasonally adjusted inflation rate expressed at annual rates) dropped considerably over the past year, from an average of 14 percent...
in 2011 to all times low 1.6 percent in the three months through September 2012 before starting an upward trend in the last quarter of 2012. The steep easing reflected the combined effect of a stabilization of local food prices after the 2011 drought-related price hikes, policy tightening, and the easing of fuel and food supply disruptions during episodes of political turmoil in the Middle East and parts of Sub-Saharan Africa.

Though middle-income countries as a group faced generally stable inflation in 2012, with an easing in the last quarter of 2012, the aggregate reflects diverging trends in major middle-income economies (figure INF.3). In China and Turkey, 3m/3m headline inflation eased through much of 2012, while India, experienced a declining inflation momentum during the second half of the year. The easing of inflation observed in 2012 in the middle-income countries followed policy tightening that was undertaken in 2010 and 2011 to address overheating pressures (figure INF. 4). In other major middle-income countries, on the other hand, such as Brazil and Russia, 3m/3m headline inflation rose during

Figure INF.3 Flat overall inflation in middle-income countries reflects diverging trends in major economies

![Easing inflation](chart1)

![Rising inflation](chart2)

Source: World Bank and Datastream.

Figure INF.4 Policy rates were tightened substantially over 2010-2011 in some middle-income countries

![Policy rates](chart3)

Source: World Bank and Datastream.

Figure INF.5 Spreads between high-income and middle-income country policy rates, inflation targets and inflation

![Inflation targets](chart4)

Notes: Upper band where appropriate. Historical (2001-2011) average wholesale price index inflation is used as a proxy for inflation target in India. Inflation data as of November 2012 unless indicated otherwise. September inflation data for Australia.

much of 2012, though with an easing in the last quarter of 2012.

Headline inflation remained high in India and close to or above the central bank inflation targets in Brazil, Mexico, Russia, South Africa and Turkey, despite moderating growth and relatively high nominal policy rates (figure INF.5). Inflation in these countries appears to have been building partly on account of supply bottlenecks, suggesting that despite slower growth, these countries may remain supply constrained such that instead of generating additional output, demand may contribute to overheating.

Food price pressures were also a contributing factor in keeping prices high in 2012 in a number of the countries shown in figure INF.5, including Brazil (maize price hike, together with a bounce back in activity following flooding in the early part of the year), Mexico (maize price hike), India (poor monsoon) and Russia (poor wheat crop). The last quarter of 2012 brought a moderation in inflation momentum in India, Mexico, Russia and Turkey, reflecting a decline in food and fuel prices, tight monetary policies and currency appreciation.

In general, economic growth accelerated or remained robust and inflationary pressures did not escalate in middle-income countries that were able to implement effective countercyclical fiscal and monetary policies and which continued to effectively move toward more flexible exchange rate policies and capitalize on trade openness (including China, Chile, Colombia, Peru, and the Philippines).

Among high-income countries, the decline in inflation in the first half of 2012 reflected continued weak economic activity and an escalation of troubles within the Euro Area, but also high unemployment and softening commodity prices. Inflation in high-income countries bottomed out in three months through July, at 0.15 percent, before rising to 3.1 percent in the three months through November (versus an average of 2.9 percent for 2011), following resolute policy actions undertaken by G3 countries, which stabilized the markets, resumed consumer confidence and helped to revive global economic activity.

Declining food prices were a major driver of moderating inflation in low-income countries

Local food price inflation trends in developing regions were mixed during the 2012, with EAP remaining roughly stable, some regions (LAC and SSA) showing price moderation, particularly during the first half of 2012, SAR and MENA experiencing large declines in food prices in the second half of 2012, and food prices accelerating in ECA in the second half of 2012 (figure INF.6).

A mid-year pickup in international grain prices caused temporary headline inflation spikes in ECA and LAC (more recent local food price data are not available but headline inflation in various regions is discussed in the subsequent regional sections of this Annex). By October 2012, headline inflation in the majority of developing countries, including in ECA and LAC, had stabilized, with the food price decline representing a major contributor into this universal price easing trend. For low-income countries as a group, lower food price inflation was also a major factor behind the decline in headline inflation in 2012.

Figure INF.6  Food price inflation eased through June picking up in Q3 particularly in ECA

Source: World Bank and ILO.
Notwithstanding the slowing of food price inflation in some developing regions, median local grain prices are up 24 percent year-on-year in real terms in developing countries, according to the United Nations Food and Agriculture Organization (FAO). The median increase in real local currency maize price was 35 percent, while for wheat prices it was 15 percent. Real local currency grain (maize, rice, and wheat) prices were up (year-on-year) in 80 percent of developing countries for which the FAO collects data, and these higher costs, as discussed in the main text, are creating affordability issues for poor households in many developing countries. Developing countries in East and Southern Africa and Latin America saw some of the sharpest increases, with some of these countries heavily dependent on imports. Less than one in five countries reported year-on-year declines in food prices, mostly for rice (figure INF.7).

Despite increase in grain prices, high food and fuel prices which prevailed earlier and drove inflationary pressures in 2011 subsided in 2012. Declining inflation allowed the policy makers worldwide but also in the low-income countries to support growth through monetary easing throughout 2012, with interest rates dropping from 2011 historically high levels to moderate rates by the end of 2012 (see region and country specific discussions in the relevant sections of this Annex).

**Regional inflation developments**

Weak and uncertain global economic activity, together with relatively stable commodity prices, provided the overall context for inflation trends during 2012. However, heterogeneous country

**Figure INF.7** Median developing-country real grain prices rose 24 percent in 2012

**Figure INF.8** Room for policy cuts

Notes: Upper band where appropriate. Historical (2001-2011) average wholesale price index inflation is used as a proxy for inflation target in India. Inflation as of November 2012 unless indicated otherwise. September inflation data for Australia.

circumstances shaped particular country and regional inflation outcomes.

**Headline inflation in East Asia and the Pacific region declined in 2012**

Annualized quarterly inflation in the East Asia and the Pacific region declined substantially between end-2010 and the second quarter of 2012, from 8 to 2 percent. Most of this decline was due to a dramatic falloff in inflation in China (figure INF.9) – reflecting, among other things, policy-induced easing in the price of residential housing resulting from new regulations and lending guidelines. Inflation eased significantly in Vietnam as well. For China, appreciation of the renminbi vis-à-vis the dollar, which reduced the price of imports for Chinese firms and consumers while increasing the price of Chinese exports, also helped to moderate domestic prices.

ASEAN-4 countries (Indonesia, Malaysia, Philippines, and Thailand) saw their quarterly inflation ease from a 5 percent annualized pace to 3 percent between end-2010 and the second quarter of 2012 despite robust domestic demand and policy easing. Currency appreciation among ASEAN-4 countries, together with broadly stable food prices in the region, helped to moderate inflation in all countries, although Indonesia saw a temporary mid-year acceleration.

Several other countries in the region have also experienced a temporary acceleration in inflation during the course of the year, including the Philippines in Q3, and Thailand and Vietnam most recently partly reflecting the rapid growth of domestic demand.

On the whole, EAP region saw a decline in the headline inflation rates in 2012, with the sharpest declines observed in China, Malaysia and Vietnam followed by the Philippines and Indonesia. The headline inflation remained within the central bank targeted range in China, Indonesia and Thailand.

**Inflation has picked up strongly in Europe and Central Asia**

After a considerable fallback in the first quarter of 2012 (the result of slowing economic activity), inflation accelerated in developing Europe and Central Asia region in the second half of 2012 (figure INF.10). Grain price hikes due to droughts and poor crop yields in Russia, Ukraine, and Central Asia were partly to blame, but utility price adjustments in Russia and new tax policies in Turkey also factored into the regional assessment, as did bumping against output capacity in several countries.
Inflation in Russia accelerated to 13 percent in the three months to September 2012 (3m/3m saar), prompting a tightening of policy in September 2012. The headline inflation in Russia at 6.4 percent year-over-year in November remains close to the central bank target despite growth having slowed considerably in the third quarter of 2012 and price pressures easing in the last quarter of 2012.

Inflation pressures have been reoccurring because of supply side bottlenecks, food price hikes and utility and other administered price adjustments as well as the earlier fixed exchange rate policy in the wake of strong capital inflows due to rising oil prices. In recent years, Russian central bank has switched increasingly to inflation targeting bringing inflation closer to the targeted rates.

In Turkey, where growth rebounded strongly after the global recession, to 9.2 percent in 2010 and 8.5 percent in 2011, headline inflation jumped to 10.5 percent (y/y) in 2011 from 6.4 percent in 2010. Inflation moderated in the second half of 2012 in part because of an appreciating Turkish lira and monetary policy tightening but also due to a good harvest in 2012.\(^1\) Turkey’s central bank cut its benchmark one-week repurchase rate by 25 basis points to 5.5% on December 18th in the context of moderating inflation to support weakening growth. Inflation rate fell to 6.4% (y/y) in November, but remains above the central bank targeted 5% inflation rate and is projected to remain above the targeted level due to higher administered prices.

Belarus has seen a major buildup in inflation momentum over the past year, due, among other things, to a relaxation in monetary policy, exchange rate devaluation, and higher food prices.

**Inflation in Latin America and the Caribbean also accelerated in the second half of 2012**

Inflation in Latin America and the Caribbean slowed to a 4.5 percent annualized pace in the second quarter of 2012 (down from a 7.2 percent pace in 2011), reflecting the weakening of global activity, lower commodity prices, and the lagged impact of a previously tight monetary policy in the region. After the monetary policy tightening cycle that started in mid-2010, most inflation-targeting central banks paused in mid-2011, or have made very minor adjustments, with the exception of Brazil, which has lowered policy rates aggressively (cumulative 525 basis point cut) between September 2011 and December 2012 to support weakening economic activity (figure INF.11).

The summer of 2012 marked a reengagement of inflationary pressure in several Latin American countries, however, following on the modest revival of global demand due to global policy easing but also reflecting higher prices of imported grain from the United States as a result of a drought in much of the country. Latin American countries registered some of the sharpest increases in real domestic maize prices in the world, which fed through to cause a temporary acceleration of headline inflation in the third quarter of 2012.

Headline inflation in Uruguay, for instance, accelerated to 8.6 percent (y/y) in September, well above the central bank’s 4-6 percent targeted range, prompting the central bank to increase the policy rate to 9 percent and the government to implement a set of administrative and fiscal measures to contain the impact of the

![Figure INF.11 Inflation momentum accelerated in LAC as economies reached their potential output levels](image-url)
price hike. The government sought an agreement with supermarkets to reduce the prices of 200 staple items by 10 percent and considered lowering tariffs and taxes on basic foodstuffs.

Peru managed to achieve strong growth and low inflation (2.7 percent y/y in November, below the central bank target of 3 percent). Chile and Colombia, as well, have been successful in maintaining relatively low inflation during the recent volatile economic cycle due to effective counter-cyclical policies.

Inflation in Venezuela has declined significantly, from 25 percent at the start of 2011 to 13 percent as of June 2012 (3m/3m saar), after policy tightening, although headline inflation remains high.

In Brazil, the largest economy in LAC, growth slowed markedly in the third quarter of 2012, despite considerable policy easing implemented throughout 2012, while inflation accelerated, reflecting a temporary food price hikes due but also indicating that the economy is operating at its maximum potential and is facing supply-side bottlenecks, which are contributing to growing price bubbles. Headline inflation was 5.8 percent in December 2012—well above the 4.5 mid-pint annual inflation target (4.5% +/-2).

Inflation also picked up in Mexico in late 2012, reflecting an increase in food prices. Headline inflation, however, declined to 3.6 percent year-over-year in December 2012—below the country’s quite conservative 4 percent annual inflation target.

**Inflation trends in developing MENA countries are diverse**

Among Middle East and North African countries, Iran and Syria continue to experience double-digit inflation. In both countries, price pressure are to a large extent due to the impact of international sanctions. US and UK sanctions on Iran’s financial assets and transactions were on Iran tightened in 2012. Syrians experienced an acute rise in food prices through the course of 2012 (and, in some cases, a shortage of staples such as bread), while the flood of Syrians fleeing the country to escape the conflict is now having spillover effects across the border in Lebanon, which is now posting steep increases in rental housing prices.

Food subsidies and administered prices suppress price pressures in Algeria and Morocco (figure INF.12). In Egypt, fuel and food subsidies, together with weak growth and subdued domestic demand, led to an easing of inflation momentum during summer 2012: headline inflation dropped to 6.2 percent on a year-on-year basis in September, the lowest in more than two years. Inflation has picked up in more recent months, however, reflecting reduction in subsidies and quotas for certain fuels. Tunisia raised fuel prices in September but prices are still below cost recovery levels.

Further reduction in subsidies and adjustment of prices to cost recovery levels will raise inflation temporarily, but their medium-term impact will be positive through private investment and increased domestic supplies, which in turn would result in weakening of price pressures.

**In South Asia, supply-side bottlenecks keep inflation high, despite recent moderation in inflation momentum**

Headline inflation among South Asian countries remained high in 2012. Price pressures stem from supply-side bottlenecks that keep inflation high, despite recent moderation in inflation momentum.

![Figure INF.12 Falloff in inflation in MENA excluding Iran and Syria](image-url)
from increasing demand for food (most notably in India), which in turn reflects rapidly raising household incomes and tight supplies, and from supply bottlenecks for non-food items. In addition to increasing at a rapid pace, food prices in South Asian countries are quite volatile, partly the result of structural constraints in the production, storage, and distribution of food.

Headline inflation exceeds 7 percent in Pakistan and Bangladesh, and remains close to 10 percent in India, Nepal and Sri Lanka—significantly higher than the average for developing countries. In Nepal, the continuing political crisis and infrastructure constraints mean that domestic supplies are not keeping pace with robust demand, resulting in persistent inflationary pressures; the currency peg of the Nepali rupee to Indian rupee has further boosted inflation during periods of depreciation of the Indian rupee. In Sri Lanka, a depreciation of the currency and agricultural drought caused inflation to surge to 10 percent in July. Although inflation has since eased, it remained close to 9 percent in October, prompting the central bank to cut the policy rate in December.

In several cases, partial pass-through to domestic retail prices of international crude oil prices, which rose in the latter half of 2012 following a decline earlier in the year, together with several governments’ attempts to rein in fiscal subsidies, are exacerbating inflationary pressures.

In the third quarter of 2012, weakening of activity, the opening up of output gaps, and some degree of moderation in food inflation caused a slowdown in inflation momentum across South Asia, although individual country experiences have been diverse (figure INF.13). Headline inflation in the region remains in the 9-10 percent range, and wholesale price inflation in the range of 7-8 percent.

Moderating inflation allowed Pakistan’s central bank to reduce its key policy rate by a cumulative 250 basis points between August and December 2012. Persistently high inflation expectations in India have prevented monetary policy easing. The country’s benchmark policy rate was stable at 8 percent for most of 2012, but the central bank has used other instruments, including cuts to commercial banks’ reserve requirements, to improve liquidity and ease monetary conditions. Similarly, despite a sharp slowdown in growth, Sri Lanka’s central bank kept its benchmark policy rate at 7.75 percent from the second quarter of 2012 through the end of the year.

Sub-Saharan Africa has experienced a steep decline in inflation

Despite being extremely vulnerable to weather conditions and related supply disruptions, inflation moderated significantly across much of Sub-Saharan Africa in 2012.

In South Africa, the largest economy in the region, the steady decline in inflation through much of 2012 reflects weak demand and slow growth, which outweighed the upward inflationary pressure of wage hikes in the mining and transport sectors and a weakening rand. Looking ahead, higher wages and rand weakness are expected to contribute to a pickup in inflation during 2013. The turnaround can already be seen in the data for late 2012.

In East Africa, the high food and fuel prices that drove inflationary pressures in 2011 subsided in

![Figure INF.13 Inflation momentum moderated in SAS](image)
2012 (figure INF.14). Declining inflation allowed policy makers in Kenya and Uganda to support growth through monetary easing throughout 2012, with interest rates dropping from 18 percent to 11 percent in Kenya and from 23 percent to 12.5 percent in Uganda between November 2011 and December 2012. F3

Inflation in Kenya, which hit 19.7 percent in 2011, was down to 4 percent in October 2012 (food inflation was only 3.4 percent) (figure INF.15). Similarly, quarterly inflation in Uganda, which had reached more than 40 percent in late 2011, turned negative in the third quarter of 2012.

In Tanzania, inflation decelerated from the 19.8 percent y/y registered in December 2011 (due to high local food prices related to a serious drought) to 13.5 y/y in September 2012, still short of the 10 percent inflation goal set by the central bank said for June 2012 and single digit by the end of the 2012/2013 fiscal year (June 2013). The impact on food prices of inconsistent rainfall in 2012 is the main reason that inflation remains relatively elevated.

Rwanda continues to buck the regional trend, with inflation rising since June, largely due to increasing food prices (food costs represent 54 percent of Rwanda’s CPI basket). Urban inflation in Rwanda, however, dropped slightly in September, to 5.6 percent y/y, compared to 5.8 percent in August; rural inflation, which is more impacted by food prices, was 14 percent in September.

Among West African Economic and Monetary Union (WAEMU) countries (Benin, Burkina Faso, Cote d’Ivoire, Guinea Bissau, Mali, Niger, Senegal, and Togo), inflation pressures moderated on improving grain supplies during the last quarter of 2012 after experiencing a rise due to an increase in prices of fuel and cereals. The moderating prices allowed the Central Bank of West African States (BCEAO) to keep its benchmark marginal lending rate at 4 percent.

The impact of food prices on inflation is also evident among West African countries. Nigeria, for example, experienced a temporary price hike in October with inflation rising to 11.7 percent (y/y) reflecting food shortages due to the heavy floods.

**Global inflation is projected to pick up somewhat from 2013 through 2015 as growth firms**

Global consumer price inflation is projected to pick up gradually as confidence and global demand strengthen. Weak growth will however keep inflation pressures subdued to around 3-4 percent globally and around 6.3 percent in developing countries—above 2012 levels but
below inflation observed in 2011. Inflation in high income countries is projected to gradually increase to around 2.5-3 percent by the end of the first quarter of 2013 and remain around that level throughout 2013. In developing economies, price pressures are expected to build in some countries with the rebound in economic activity and more dynamism in the private sector.

Overall, consumer prices in these economies are projected to accelerate to around 6.3 percent in 2013 but still below their 2011 level.

The inflation outlook is however quite uncertain and is subject to both upside and downside risks—with the considerable consequences for low income countries, which are sensitive to price fluctuations due high reliance on primary commodities, narrow range of policy instruments and weak fiscal and monetary buffers.

On the upside, supply side bottlenecks may push inflation up as global demand revives. In addition, inflation may accelerate as the increased grain prices pass through into local food prices – especially in the countries with the large share of wheat and maize consumption in their food price basket. Implementation of fiscal measures, including increase in utility prices and tariffs to cost-recovery levels to reduce quasi-fiscal deficits, and increase in taxes, which have been delayed due to economic uncertainty may become additional source of inflation. The upside risks to supply side shocks also include weather related price hikes to food supplies and risks to price stability related to supply disruptions in case of the escalating tensions in the Middle East.

On the downside, slower growth and excess capacity in some countries will help moderate core inflation. Stable or declining commodity prices will reinforce this outcome. Deepening of economic turmoil in Euro Area and slower US growth in case the looming “fiscal cliff” of spending cuts and tax hikes is not addressed and undermines the US and global growth, depressed economic activity and causes disinflation. Were external conditions to deteriorate, some developing countries have room to support growth through policy easing, but others are constrained.

Notes
1. In Turkey, the key policy rate used under the inflation-targeting framework is the one week repo auction rate. Turkey also uses an interest rate corridor and required reserve ratios as policy instruments.
2. In addition, South Africa plans to introduce a revised CPI basket in January 2013 to reflect changing household expenditure patterns. The new basket will assign a higher weight to services spending vis-à-vis goods.
3. As of July 2011, the Bank of Uganda has used a seven-day interbank interest rate as its main policy rate, shifting from supporting aggregate demand via money supply growth to targeting inflation and reducing bank credit growth.