

Box 1**Recent developments and possible effects of domestic and overseas inflation**

Since 2021 onwards, global demand has rebounded, which is attributed to the restarting of economic activity in various countries. However, the supply-demand imbalances and supply chain bottlenecks have largely resulted in the inflationary spike in major economies. Moreover, the recent Russia-Ukraine war has prompted a number of countries to impose sanctions on Russia, thereby provoking a sharp rise in commodity prices. If the war persists, it could trigger imported inflation and further drive up global inflationary pressures which thus warrant close attention. This Box discusses the causes of recent inflation domestically and overseas, its development, and possible effects, as well as explaining Taiwan's main measures to deal with rising inflation.

1. Factors affecting inflation at home and abroad**1.1 Inflationary pressures in major economies mostly mirrored the impact of the epidemic on both the supply and demand sides**

The causes of elevated foreign inflationary pressures since 2021 have been mostly related to the progression of the pandemic in each country. For example, owing to the rising demand for energy in the wake of the easing of lockdowns, international oil prices picked up from a low level in 2020. As a result, the contribution of global energy prices to the annual growth rate of the consumer price index (CPI) turned positive in 2021 from negative in 2020. Furthermore, some economies did not effectively solve the problem of port congestion, which caused exorbitant freight rates, or severe labor shortages caused wages to rise. These were also the reasons for elevated inflation.

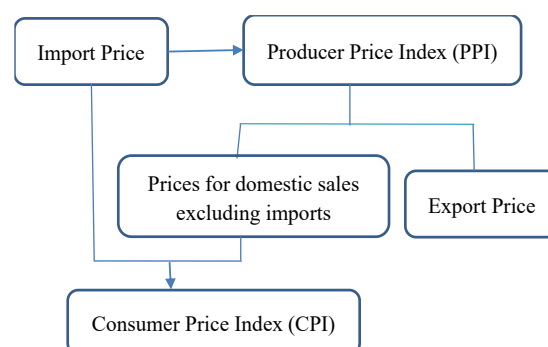
Compared to pre-pandemic levels, the ratio of commodity consumption to household expenditures in major economies increased in 2021. Meanwhile, commodity prices rose more than services prices, especially in the United States. In view of the pandemic, governments around the world offered citizens cash subsidies and relief funds to expand households' disposable incomes; therefore, consumption momentum in the short term was boosted, which in turn affected domestic prices.

1.2 Rising prices in Taiwan derived mainly from a supply shock**1.2.1 The transmission channel of import prices to domestic inflation**

Nearly 90% of Taiwan's imported commodities are agricultural & industrial raw materials and capital goods, of which agricultural & industrial raw materials need to go through several processing stages before they are converted into finished products, which will be

transported and eventually sold to consumers. As imported goods can be delivered and directly sold to consumers, they have an influence on the CPI. Apart from that, oil imports can directly affect the CPI via a floating price mechanism, and agricultural & industrial raw materials may also indirectly affect the CPI by causing an impact on the prices for domestic sales excluding imports (Chart B1.1).

Chart B1.1 The transmission channel of import prices to domestic prices



Source: CBC.

1.2.2 Price spikes in Taiwan stemmed mainly from supply-side factors in 2021

Taiwan's CPI grew by 1.96% in 2021, showing a relatively high increase, mostly owing to supply-side factors such as price surges in fuel and lubricants, flight tickets, fruit and vegetables, as well as a lower base period in 2020.

2. The development of foreign and domestic inflation

2.1 Global inflationary pressures escalated on account of the Russia-Ukraine conflict dragging on

Major central banks and international institutions' summaries of inflation outlooks at the end of 2021 pointed out that if the pandemic slows down, it will lead to a smaller oil price rise, and will also help deal with port congestion as well as container and chip shortages. Furthermore, labor force participation rates may rebound, easing the pressure of rising wages, and consumer demand for commodities would return to normal. If the benefits of the aforementioned factors are realized, the pressure of rising prices is likely to be mitigated.

However, the outbreak of the Russia-Ukraine war in February 2022 sent a shockwave through global energy and food supply chains, causing international energy and commodity prices to fluctuate at high levels. Consequently, S&P Global Market Intelligence significantly revised up inflation forecasts for major economies in 2022. On condition that the Russia-Ukraine war intensifies and the scope of sanctions against Russia expands, global inflationary pressures may rise further, which warrant attention.

2.2 Taiwan's inflationary spike is still moderate in comparison to Europe and the US

Against the backdrop of ongoing global supply chain bottlenecks and the conflict between Russia and Ukraine, international commodity prices such as crude oil, cereals, and base metals have skyrocketed, pushing up the cost of imported raw materials in Taiwan and aggravating domestic inflationary pressures. Besides

this, the NT dollar exchange rate against the US dollar has weakened recently. If the NT dollar depreciates more against the US dollar compared to the previous year, the pressures of domestic imported inflation could broaden.

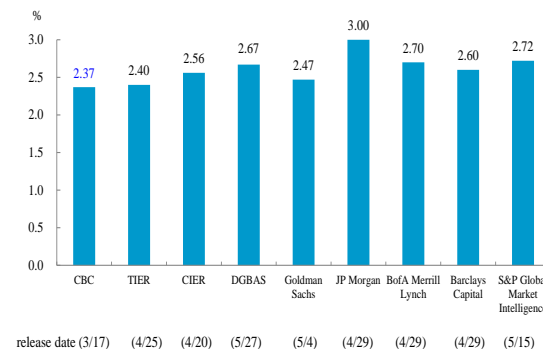
Considering that the recent Russia-Ukraine conflict will further push up global inflation, S&P Global Market Intelligence and the DGBAS in May 2022 raised their forecasts for Taiwan's 2022 CPI inflation rate to 2.72% and 2.67%, respectively. Other major institutions also predicted that CPI inflation in Taiwan will be above 2% (Chart B1.2), still lower than those in Singapore (4.75%) and South Korea (4.36%). Nevertheless, unlike Europe and the US, which are seeing significant increases in inflation because of severe supply-demand imbalances, Taiwan's inflation mainly results from supply-side shocks. Therefore, the annual growth rate of Taiwan's CPI in 2022 may fall back in the middle of the year as the gain in crude oil prices slows down.

3. Possible impact of rising inflation on economic recovery and measures taken by Taiwanese authorities

3.1 High and persistent inflation in some economies might impact their consumer confidence and curb economic recovery

High and persistent inflation in some European economies and the US has weighed heavily on their consumer purchasing power. Moreover, labor shortages have fed into rising wages, which could be passed on to consumer prices. As a consequence, inflation expectations would be formed, causing a wage-price spiral. In addition, a long-lasting conflict between Russia and Ukraine could further have an influence on global consumer confidence and affect economic growth momentum in major economies (such as the US, the euro area, China, and Japan), thus setting back the global recovery. Facing high global inflation,

Chart B1.2 Taiwan's CPI inflation rate forecast in 2022



Sources: CBC and major domestic and international institutions.

governments around the world have launched different measures to address its adverse impacts. For example, with the aim of easing high inflationary pressures, major economies, such as the US and the UK, commenced to raise interest rates, and the US also released some of its strategic petroleum reserve.

3.2 The Taiwanese government has actively adopted measures to stabilize prices affected by imported inflation pressures

In the past twenty years, low and stable inflation rates in Taiwan, with the average annual CPI growth rate coming in at 0.96% and average volatility being 1.07%, maintained consumer purchasing power, and cut down uncertainties around fluctuations in relative prices and the level of future prices. This helped curtail distortions in resource allocation efficiency and improve economic efficiency, thereby promoting sustainable economic growth.

Since the second half of 2021, the domestic inflation rate has trended upward under the pressures of imported inflation. Meanwhile, the annual growth rate of the CPI has been above 2% for several months. Nonetheless, compared with countries in Europe and the US, Taiwan's inflation is still moderate and the government has actively adopted the following price stabilization measures to alleviate the impact on consumers and the domestic economy.

3.2.1 Hiking the policy rates

In view of still-elevated domestic prices, the Bank decided to raise the policy rates by 0.25 percentage points on March 17, 2022 to contain domestic inflation expectations, and achieve the policy objectives of maintaining price stability and sound economic and financial development as a whole.

3.2.2 Cutting tariffs on staple goods, and lowering commodity and business taxes

Considering fluctuations in international energy and commodity prices, the government lowered tariffs on key raw materials as well as commodity and business taxes until the end of June 2022 in order to stabilize the prices of staple goods and reduce operational burdens for businesses.

3.2.3 Keeping prices of household natural gas, bottled gas, and electricity unchanged

With a focus on the cost of living and price stabilization, prices of household natural gas, bottled gas, and electricity in Taiwan will remain unchanged until the end of June 2022. The prices will be reviewed afterwards.

4. Conclusion

Domestic price hikes have been a social concern since the start of 2021. The Taiwanese government has hence adopted relevant measures to stabilize prices. The inflation rate in Taiwan has been relatively low and stable compared to major countries from a long-term perspective, which helps preserve the purchasing power of money and sustain the momentum of economic growth.