BOX I.1:

Dynamics and outlook of services inflation around the world

The central scenario of this IPoM contemplates somewhat more persistent global inflation than usual, due to the outlook for the evolution of services. In contrast to goods, food and energy inflation, services inflation has remained high in many countries, with an impact on total inflation of around one percentage point above its pre-pandemic average (Figure I.18a). Given that services inflation tends to be more associated with domestic factors, its high synchronization at the global level is an unusual phenomenon. This box explores the reasons for this and analyzes what can be expected for services inflation going forward.

Estimates based on dynamic factor models confirm the greater global synchrony of services inflation. Bajraj et al. (2024) show that, while for the period 2015-2019 the common elements (captured by a global factor) explained around 15% of the variance of quarterly services inflation, this figure rose to around 50% by the post-pandemic period. The reasons for the coordination of high services inflation at the global level include the synchronization of pandemic-related shocks and the outbreak of war in Ukraine, as well as the policies adopted to address them. All this would have led to a significant increase in the correlation of global output gaps and similar dynamics in relative prices between services and goods (Bajraj et al., 2024).

One aspect worth noting is that, after the pandemic and war shocks, the prices of services lagged significantly behind the general price level (Figure I.18b). It is expected that the recovery that has been observed since early 2023 will continue into the coming quarters. So far, most of the change in the relative prices between goods and services can be explained by the fall in goods inflation. That process is largely complete and cannot be expected to continue contributing significantly to the reestablishment of relative prices, in line with historical evidence (Gascon and Martorana, 2024). Accordingly, the analysis of Peach et al. (2004), updated for the United States, suggests that services inflation would return to its pre-pandemic levels by mid-2025 (Bajraj et al., 2024), assuming the persistence of services inflation would follow the usual patterns.

There are risks, however. Evidence shows that services inflation persistence increases in periods of high inflation, as indexation mechanisms intensify (Borio et al., 2023). As an example, Bajraj et al. (2024) suggest that the level of services inflation persistence may have doubled during the 2021-2022 inflationary spike in the United States. Although it has been regularizing in recent months, it is still above the pre-pandemic level, which could delay the normalization of services inflation[1]/.

Finally, it must be noted that beyond the increase in the synchronization of services inflation at the global level, there are country-specific elements that have also played important roles and could affect the dynamics of relative prices in the future. These include the evolution of monetary and fiscal policies, migration dynamics, changes in investors' appetite for risk, productivity dynamics unique to each economy, as well as geopolitical developments that may have an impact on the prices of goods.

[1]/ Given the coordination of inflationary peaks across countries, the increase in persistence would add an additional coordination mechanism to global services inflation.

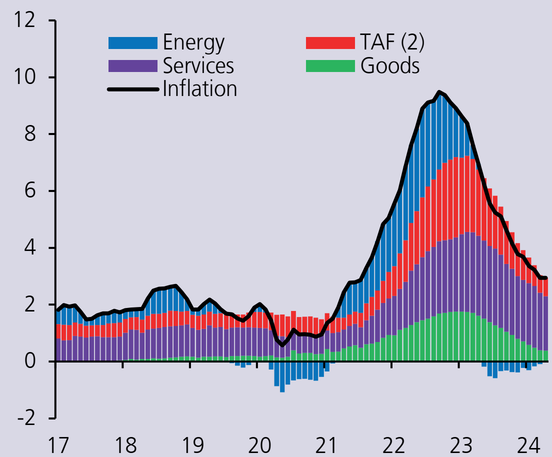
Chile observed a decline in both total and services inflation, after peaks that exceeded those of comparable economies. This was due to monetary and fiscal policy reactions, which helped to correct the significant macroeconomic imbalances of previous years. As in other economies, the decline in services inflation has been more gradual than in goods. This is influenced not only by the need to recompose relative prices, but also by the dynamics of sectoral activity gaps. While in the case of goods, the gap closed and turned negative by the end of 2022, the gap associated with services approached zero only at the end of last year, consistent with a slower decline in services inflation (see Box II.1 in the March 2024 IPoM).

Conclusion

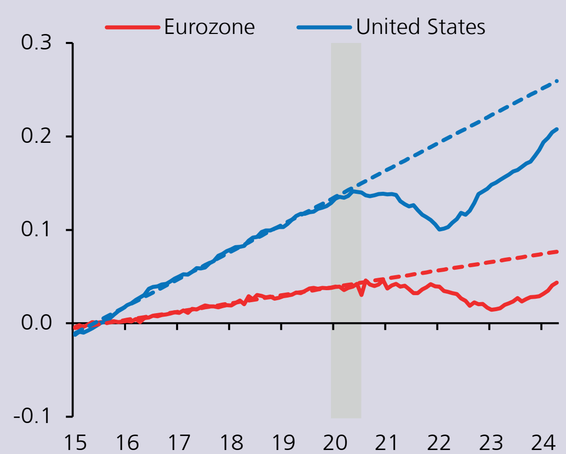
Services inflation has remained high in many economies, both developed and emerging, an unusual phenomenon due to the greater historical association of services with the domestic cycle. The evidence suggests that the normalization of services inflation will take a few more quarters, and could even be somewhat slower than usual due to the intensification of indexation mechanisms that would have occurred in this cycle. The central scenario envisages slightly higher than usual levels of persistence in services. In the United States, this could be coupled with more resilient than expected demand, which would further delay convergence.

FIGURE I.18

a) Contribution of main components to headline inflation (1)
(mean annual inflation, percent)



b) Relative prices between services and goods excluding foods and energy (3)
(deviation from 2015 level, logarithmic scale)



(1) Harmonized series of inflation and its components. Average of 53 countries. May 2024 figure not reported because it is not available for every country. (2) Tobacco, alcohol & foods. (3) Natural logarithm of the ratio between services CPI and CPI for industrial goods (excl. energy), both normalized to 2015=1. Dotted lines denote the linear projection of the trend between 2015 and 2019.
Sources: Global inflation data from Bajraj, Carlomagno, Ledezma, Pustilnik and Wlasiuk (2024); Central Bank of Chile, based on Bajraj, Carlomagno and Wlasiuk (2023).