QNB Economics
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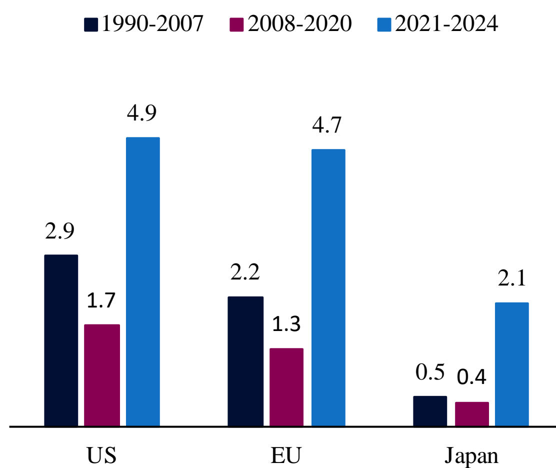
Inflation or deflation, what is set to dominate future macro trends?

Prices changes of key baskets of goods and services are some of the most closely watched metrics in macroeconomics, alongside economic growth. They are crucial indicators of economic health, affecting everything from purchasing power and household confidence to investment decisions and monetary policy. While some level of price appreciation (inflation) is a normal and even desirable feature of a growing economy, both excessive inflation and outright price declines (deflation) can cause significant distortions and long-lasting damage.

Moderate inflation, like the one observed during the period of the so-called Great Moderation (1990-2007) in most advanced economies, typically reflects a vibrant economy that delivers well balanced growth. However, when inflation becomes excessive and persistent – as seen in periods of demand overheating, supply shocks, or poorly anchored expectations, such as during the immediate post-Covid pandemic period – it erodes real incomes, compresses profit margins, and destabilizes financial markets. It also compels central banks to respond with aggressive policy tightening, which can trigger recessions or financial stress.

Inflation across major advanced economies
(CPI basket, average % per year, different selected periods)



Sources: Haver, IMF, QNB analysis

Conversely, deflation – the sustained decline in the general price level or much lower than normal inflation – is often a symptom of deeper structural weakness, such as depressed demand, financial deleveraging, or demographic stagnation. Falling prices may appear positive on the surface, but they can discourage consumption, delay investment, increase real debt burdens, and trap economies in a vicious cycle of low growth and weak confidence. Japan's experience in the 1990s and early 2000s remains a cautionary tale of the long-term consequences of entrenched deflation. To a lesser extent, the same is also true for other major economies following the Great Financial Crisis in 2007-08.

Interestingly, following a period when pandemic-related supply side shocks triggered much higher than normal inflation, there is little consensus on whether inflation or deflation are going to be major driving forces over the medium- or longer-term.

On the one hand, some analysts highlight that one of the key reasons inflation has re-emerged as a central economic concern lies in the unravelling of several structural forces that underpinned the "Great Moderation." During that time, a confluence of factors helped supress price pressures and stabilize macroeconomic volatility: deepening globalization fostered cheaper imports and offshoring; relative geopolitical stability ensured open trade routes and capital flows; supply chain integration enabled just-in-time production with minimal inventory costs; and the rise of rational, technocratic politicians and government officials who contributed to anchor economic expectations through credible policies and transparency.

In recent years, however, many of these tailwinds have turned into headwinds. Geopolitical fragmentation, marked by rising protectionism, US-China rivalry, the Ukraine War, and regional conflicts, has partially undermined trade openness and added uncertainty to global production networks. The Covid pandemic exposed the fragility of over-optimized supply chains, prompting a shift toward reshoring and redundancy that carries higher cost structure. Moreover, the populist backlash and politicization of economic policy have, in some cases, weakened governance and institutional restraints on decision makers at least since the beginning of Trump 1.0 in 2017. Combined with

demographic pressures (less people working to sustain more people not working), green transition costs, and strategic competition over critical technologies, these reversals support the argument of some analysts about a more inflation-prone environment ahead, in which price stability can no longer be taken for granted.

On the other hand, many analysts argue that it would be a mistake to assume that the post-Covid and Ukraine War era is uniformly inflationary. Powerful disinflationary forces are at play and accelerating – particularly those rooted in technological innovation. Advances in digitization, robotics, and artificial intelligence (AI) continue to disrupt traditional production functions, compress operating costs, and drastically reduce the marginal price of services and knowledge-based goods. The digital delivery of education, finance, media, and even healthcare is shifting cost structures downward, while automation and machine learning improve productivity in both manufacturing and services.

Moreover, some geopolitical developments commonly viewed as inflationary – such as trade fragmentation – may actually have deflationary consequences under certain conditions. A pertinent historical analogy is the 1930s, when aggressive tariff barriers like the US Smoot-Hawley Act triggered retaliatory trade wars, leading not to higher prices, but to collapsing global demand and deflationary spirals.

All in all, we believe the global economy is no longer anchored in a stable inflationary or deflationary regime, but rather navigating a new era marked by structural volatility. While secular deflationary forces – particularly from technological progress, automation, and the digitization of services – are expected to remain dominant over the long term, they are increasingly being punctuated by short, sharp episodes of inflation driven by supply shocks associated with geopolitical tensions, green transition costs, and policy uncertainty. This evolving landscape is not one of runaway inflation or entrenched deflation, but of heightened sensitivity to shocks, where pricing dynamics vary significantly across region, sectors, and time horizons.

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