From the Editor

The economic crisis initiated by the COVID-19 pandemic led to a 3.2% drop in world GDP in 2020, the largest annual decline since the World War II. The fall in GDP caused by the pandemic was short-lived because in most countries it lasted only one or two quarters during 2020, after which a rapid recovery began. According to the forecasts of the World Bank in 2021, the growth of the world economy is expected to be 5.6%, which means that the pre-crisis level of GDP will be exceeded at the world level during this year. However, the countries that had a deep decline during the previous year, including the largest European economies, will reach the pre-crisis level of GDP only next year. Observed by regions and countries, the recovery in 2021 is expected to be significantly more even than the decline in GDP in the previous year. According to the World Bank forecasts, the eurozone countries are expected to grow by 4.2% in 2021, the United States by as much as 6.8%, China by 8.5%, while the countries of Central and Eastern Europe are expected to grow by 4,5%. The crisis had a very uneven impact on economic activities, while some had a deep decline in activity, some had a small decline or stagnation, and others recorded growth in the crisis year 2020 (more on this in the Highlights section). Most activities will already exceed the pre-crisis level already in this year, but it will take one or two years for some activities, such as tourism, to recover.

Although the decline in GDP was short-lived and the economic recovery was rapid, the economic crisis caused by the pandemic will have negative consequences for the world economy in the next few years. Important negative consequences of the crisis are high growth of public and private debts as well as rising inflation.

The strong monetary and fiscal expansion applied by most countries prevented the launch of a negative spiral between falling demand and supply that would lead to a much deeper and longer-lasting crisis than the one that occurred. However, the consequence of fiscal expansion is a strong growth of public debts, which were high in many countries even before the current crisis. The level of gross public debt in the world's largest economies was very high at the end of last year - US public debt was 127% of GDP, Japan 256% of GDP, Germany 69% of GDP, France 116% of GDP, Italy 156% of GDP. The ratio of public debt to GDP at the end of 2020 in developed countries reached 120% of GDP, which is 14 percentage points above the maximum value in the years after the great financial crisis. Further growth in public debt is expected in most developed countries this year, but leaders of developed countries and most economists are not showing concern about it for now. The reason for that is probably in the fact that developed countries borrow at nominally and realistically negative interest rates, as a result of which creditors return a lower real value than the one borrowed.

Negative real interest rates are a consequence of the strong monetary expansion of most central banks, which, with occasional slowdowns, has lasted since the great financial crisis. Expansive monetary policy has enabled an abundant supply of cheap capital that has been partially used to finance government debt. It is assumed that the prevailing belief among state leaders and economists is that the share of public debt in GDP will be relatively significantly reduced in the coming years as a result of the rapid economic recovery and moderate debt devaluation through inflation. In that case, fiscal consolidation would not be needed in the future, which would slow down the recovery of the world economy through expenditure growth and tax increases. It is basically a similar strategy that was applied after the World War II, when developed countries, participants in the war, solved the problem of large government debts by combining strong economic growth and slightly higher inflation. However, the institutional conditions for monetary policy-making are now significantly different in most countries than after the World War II - central banks now have independence in monetary policy-making, while after the World War II monetary policy was controlled by governments. In addition, a large number of central banks have adopted an inflation targeting regime over the last three decades, in which the central goal of the central bank is to keep inflation low.

During the second quarter of 2021, world inflation exceeded the level projected in official documents of governments and international organizations for 2021.

Year-on-year inflation in May in the US reached 5% (projected 1.6%), the EU 2.3% (projected 1.3%), Germany 2.4% (projected 1.1%), France 1.8% (projected 0.9%), Italy 1.2% (projected 0.7%). A similar deviation in terms of inflation was achieved in the countries of Central and Eastern Europe, where year-on-year price growth in May was: in Hungary 5.3% (projected 3.3%), Poland 4.6% (projected 2%), Serbia 3.6% (projected 1.8%), Romania 3.2% (projected 2.5%), Bulgaria 2.3% (projected 1.4%). The general assessment is that the increase in inflation came earlier and is higher than expected this year.

For now, the prevailing opinion among both officials and economists is that the increase in inflation is a consequence of the disturbances in individual markets caused by the pandemic. Disruptions in supply chains are most often cited as an explanation, as a result of which input stocks (oil, metals, semiconductors, etc.) were depleted during the pandemic. In line with this explanation, input prices are rising, as a consequence of the sharp increase in demand, which occurred due to the recovery of the economy, on the one hand and the inability of producers to adapt to increased demand in the short term. An additional reason for the rise in prices is the sudden jump in demand from citizens, which is financed by savings generated during the period of application of strict epidemiological measures. If the causes of rising inflation are sectoral and temporary, inflation will begin to decline after a few months, so it is not necessary for central banks to take restrictive measures, such as raising the reference interest rate. In support of the temporary nature of the increase in inflation, it is stated that inflation expectations in most countries are still low, i.e. that the business and professional public does not expect a longer-term increase in inflation.

However, there are also views that the increase in inflation is a consequence of systemic factors, such as the large monetary and fiscal expansion since the beginning of the pandemic, which is still ongoing. If the causes of accelerating inflation in economic policies are high inflation, it will last, with the possibility of acceleration, until economic policies change, i.e. until the expansiveness of monetary and fiscal policy decreases. Increasing the restrictiveness of monetary and fiscal policy would, with a certain time lag, curb inflation, but would lead to a slowdown in economic growth, an increase in the cost of servicing public and private debts. An increase in interest rates, a key measure of a more restrictive monetary policy, would increase the cost of servicing public debt, forcing more governments to implement unpopular fiscal consolidation measures. An increase in interest rates would negatively affect the possibility of repaying private debts, as a result of which the number of bankruptcies of companies could increase, but also problems in the banking system could appear.

For now, there is not enough data to more reliably determine the causes of accelerating inflation during 2021. If inflation is longer and if price growth covers a larger number of products, it is more likely that the causes of inflation are expansionary monetary and fiscal policy. On the other hand, if inflation starts to fall during the summer and if the number of products whose prices increase significantly decreases, then inflation is probably a consequence of disturbances in individual markets, which occurred due to the pandemic. Therefore, governments and central banks are likely to pursue expansive fiscal and monetary policies over the next few months to support economic recovery, while accepting the risk of prolonging and further accelerating inflation.

From the point of view of political economy, it is estimated that slightly higher inflation is desirable for governments in the current circumstances, because it would help reduce the burden of public debt in large countries that borrow in their currency (USA, EU members, Japan, etc.). Reducing the real value of public debt along with economic growth would make it possible to reduce the ratio of public debt to GDP without applying unpopular fiscal consolidation measures, such as increasing taxes or reducing expenditures. Similarly, slightly higher inflation, along with economic recovery, would alleviate the problem of accumulated private debt. However, slightly higher inflation than expected would reduce the real value of wages, but also the real value of savings in banks, roles in pension funds, etc. Reducing the value of public and private debts, wages, savings, etc., through inflation would be a kind of "inflation tax", which would tax creditors, recipients of wages, owners of savings deposits, etc.

It is estimated that the public now believes that low inflation is important for social welfare, because it prevents greater devaluation of wages, savings in banks and other forms of financial assets of citizens. In general, it is estimated that the public's tolerance for higher inflation is now lower than it was in the past, which governments in democratic countries must take into account. In addition, central banks, which are responsible for price stability, are likely to be willing to allow slightly higher inflation in the short term, but not to allow inflation to be above the upper limit of the target interval for the longer term.