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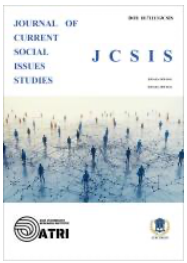

Article

Inflation Persistence and Expectations Formation in the Post-Pandemic Economy: A Narrative Review

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Abstract

The sharp rise in inflation following the COVID-19 pandemic has upended many of the assumptions that had been held about the nature of inflation, how it is expected, and the effectiveness of policy. After decades when prices remained relatively stable in many economies, inflation re-emerged as a key macroeconomic problem and turned out to be more persistent and widespread than initially thought. This paper reviews and synthesizes the literature on post pandemic inflation, looking at the issue from a worldwide perspective. The authors contend that the persistence of inflation cannot be solely accounted for by demand or supply factors in isolation, but rather it is the interaction of large global shocks, expectations formation, supply side constraints and monetary fiscal policy interactions that determines it. The paper, by mapping the literature onto four themes inflation persistence after large shocks, expectations anchoring, globalization and supply side transmission, and the role of monetary fiscal frameworks helps to understand why inflation has stayed high in many countries and why the results have differed. The review points to the consequences of these mechanisms for inflation targeting and macroeconomic policy making in a world where large shocks are likely to recur. In sum, the paper is a valuable input in the academic and policy debates that are going on by providing an integrated framework for understanding inflation persistence in a globally interconnected economy.

Keywords: Inflation persistence; Inflation expectations; Post-pandemic inflation; Global supply shocks; Monetary-fiscal interactions; Inflation targeting

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1. Introduction

Inflation came back after the COVID-19 pandemic and has been a huge macroeconomic issue over the past few decades. After a long time of low and stable inflation in most parts of the world, price inflation has raised sharply since 2021 and thus has affected both developed and developing countries. This episode has questioned singling out of (Benati, 2008; Stock & Watson, 2007) inflation dynamics, the role of expectations, and the effect of monetary policy frameworks. Particularly, it has reconsidered the issues of why inflation lasts after large shocks and which are the conditions where it is difficult to reverse. Post pandemic inflation, unlike previous inflationary episodes, was the result of a complicated interaction of factors such as supply chain disruptions worldwide, volatile energy and commodity prices, and an unusual fiscal expansion. Earlier episodes of large global

shocks, such as the global financial crisis, similarly demonstrate that external sector disturbances can alter macroeconomic dynamics and lead to prolonged adjustment processes rather than purely transitory inflationary responses (Faishal, 2019). The forces were crossing the borders simultaneously, thus policy frameworks that only focus on a particular country were limited in an increasingly interconnected global economy (Baumeister & Kilian, 2016; Ciccarelli & Mojon, 2010). Inflation expectations have been considered as firmly anchored; however, they showed sensitivity to realized inflation, so there was concern about the feedback loops that could entrench price pressures over time (Weber et al., 2022).

This review is a case for dismantling the silo explanations that attribute post pandemic inflation either to supply or demand factors. Analytical focus has to shift to the interaction of mechanisms so as to capture inflation persistence as a nuanced outcome. The paper outlines these interaction mechanisms as the characteristics of large global shocks, the generation and anchoring of expectations of households and firms, the propagation of global prices via supply chains, and the changing interplay of monetary and fiscal policies (Cogley & Sargent, 2005; Gopinath et al., 2020). The level of inflation as well as its persistence and differences across countries are the result of the interplay of these mechanisms.

This paper aims to present a narrative review and provide a conceptual synthesis of the economics literature that deals with such issues. The review consolidates the insights of the four core thematic areas rather than documenting the studies exhaustively: inflation persistence after large global shocks (Pivetta & Reis, 2007; Cogley et al., 2010); expectations formation and anchoring in high inflation environments (Mankiw & Reis, 2002; Coibion & Gorodnichenko, 2015); supply side constraints and globalization (Corsetti & Dedola, 2016; Enders & Holt, 2019); and monetary fiscal interactions and their implications for inflation targeting (Leeper, 1991; Woodford, 2001). The paper, by mapping the literature onto these themes, sheds light on the shared mechanisms, the loci of disagreement, and the areas where existing frameworks are insufficient to account for the observed outcomes.

This review makes a twofold contribution. Initially, it brings together various strands of research that were previously scattered and difficult to understand into a single conceptual framework that helps explain the phenomenon of inflation persistence that was common to many economies but was not anticipated at the beginning. Subsequently, it highlights the importance of policy changes in the functioning of monetary and fiscal institutions in a period that is marked by such shocks as has been repeated several times (Blanchard, 2019; Bianchi & Melosi, 2017). By doing this, the paper is intended not only to academic debate but also to be a part of the policy conversations on the future of inflation stabilization in a globally interdependent economy.

Table 1. Inflation Persistence, Expectations, and Policy Responses: A Conceptual Synthesis of the Literature

Thematic Area	**Core Mechanism**	**Primary Evidence**	**Implications for Inflation Persistence**	**Policy Relevance**
Inflation persistence after large global shocks	State-dependent inflation dynamics; regime shifts; non-linear Phillips curve responses	Macro time-series data; regime-switching models; cross-country comparisons	Inflation can remain elevated even after shocks dissipate, especially when regimes shift	Caution against premature policy normalization; reassessment of "transitory" narratives
Expectations formation and anchoring	Information rigidities; adaptive learning; credibility of monetary authorities	Household and firm surveys; professional forecasts; experimental evidence	De-anchored expectations amplify persistence and slow disinflation	Central bank communication; forward guidance; credibility preservation
Supply-side constraints and globalization	Supply-chain disruptions; energy and commodity pass-through; dominant currency pricing	Commodity prices; global value-chain data; international price indices	Supply shocks can generate persistent inflation through expectations and pass-through	Energy policy; trade diversification; resilience of global supply chains

Thematic Area	Core Mechanism	Primary Evidence	Implications for Inflation Persistence	Policy Relevance
Monetary-fiscal interactions and inflation targeting	Fiscal dominance vs monetary dominance; debt sustainability; policy coordination	Structural macro models; historical policy episodes	Inflation persistence rises under fiscal dominance or weak coordination	Rethinking inflation-targeting frameworks; fiscal-monetary coordination rules

2. Inflation Persistence after Large Global Shocks

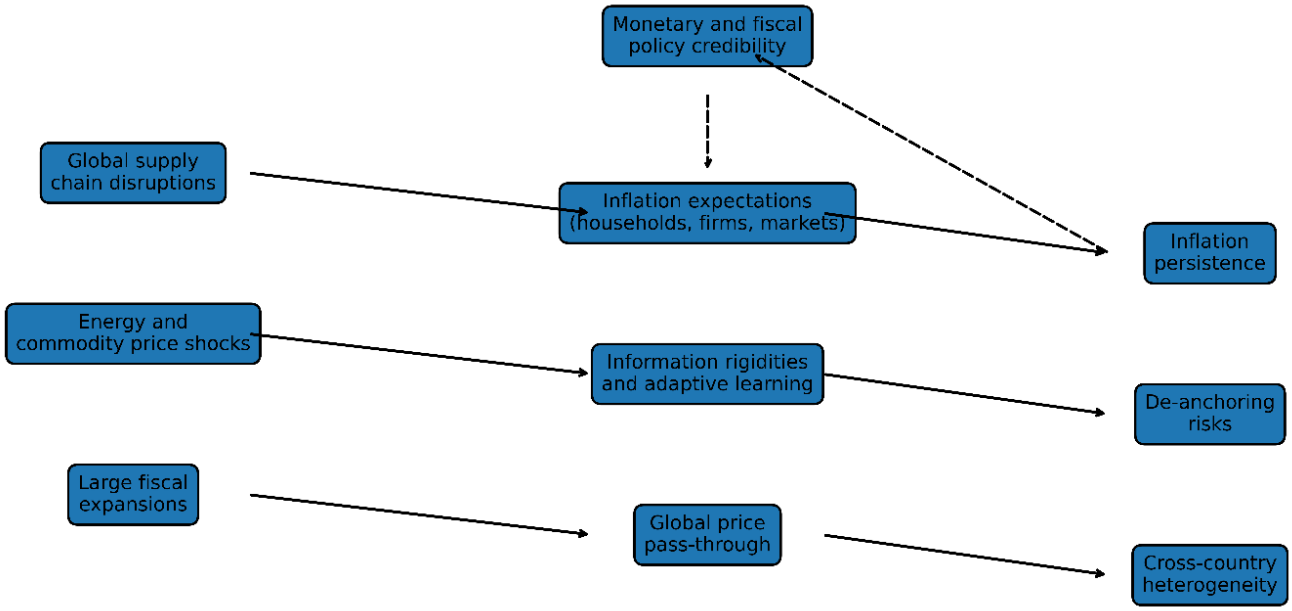

Figure 1. A Conceptual Framework for Post-Pandemic Inflation Persistence

Figure 1 shows the ripple effects of massive global shocks, such as supply disruptions, energy and commodity price shocks, and fiscal expansions, on inflation dynamics. These effects occur through expectations formation, information rigidities, and global price pass through. The credibility of monetary and fiscal policies influences expectations and inflation persistence, thus causing different results in various countries.

One of the most notable features of the inflation situation that followed the pandemic is the extent to which price increases have continued even after the shocks have gradually disappeared. The surge in inflation was initially interpreted to be largely transitory in nature, reflecting temporary supply disruptions and base effects. However, follow up developments showed that inflation remained high in a large number of economies, which indicates the presence of more persistent sources than those that were initially assumed (Benati, 2008; Pivetta & Reis, 2007). A first account of the persistence of inflation is the notion of state dependent inflation dynamics. Enormous shocks have the potential of propelling economies into regimes where the usual relationships between slack, inflation, and policy responses change. In these regimes, inflation is characterized by inertia and a lower degree of responsiveness to conventional stabilization tools. In addition, recent structural transformations driven by automation, technological change, and evolving labor market dynamics have reshaped cost structures and expectations formation, further complicating inflation persistence in the aftermath of large global shocks (Faishal et al., 2023). The empirical work provides support for the idea that persistence becomes significantly stronger once inflation substantially deviates from its long run mean, this being particularly the case when policy regimes or credibility conditions are changing (Cogley & Sargent, 2005; Cogley et al., 2010).

The post pandemic experience also underlines the importance of nonlinear inflation responses. In situations of large and widespread shocks, firms and workers may decide to change their pricing and wage setting behavior much more aggressively than in a normal context. These changes can create amplification mechanisms that double up inflation persistence. For example, this can happen when several shocks such as supply disruptions and fiscal expansions occur at the same time. Cross country evidence reveals that the extent of persistence is in a systematic way related to institutional characteristics, labor market structures, and prior inflation histories (Angeloni et al., 2006). The question of when policy will be implemented is of great importance in determining the persistence of inflation after large shocks. Uncertainty about the type and length of the shocks may cause a delay in the policy normalization which in turn allows inflationary pressures to become more deeply ingrained in price setting behavior. Usually, when persistence has already increased, it takes a rather strong and long-lasting policy intervention to bring price stability back again which, in turn, increases the economic costs of disinflation. It is also very difficult to make accurate predictions during a period of structural change which makes timely responses even more difficult and thus contributes to persistence even if policymakers are careful about inflation risks (Stock & Watson, 2007).

The articles reviewed in this theme collectively suggest that significant global shocks have the potential to change inflation dynamics at a fundamental level, thereby increasing the probability that inflation will continue at a high level even after the shock period has passed. Consequently, it is crucial to identify the factors that lead to persistent inflation if one is to have any chance of designing effective and timely stabilization policies, especially in a scenario characterized by frequent large and overlapping shocks.

3. Expectations Formation and Anchoring in a High-Inflation Environment

Inflation expectations significantly influence both the magnitude and the duration of inflation, especially in situations of increased uncertainty. The post pandemic period has been a clear example of this, showing how rapidly expectations can change in response to a prolonged period of high inflation, even in economies with a long track record of price stability. This has put in question the view that expectations are always well anchored after a credibility is established, revealing instead that they are conditional and state dependent (Mankiw & Reis, 2002; Coibion & Gorodnichenko, 2015). A fundamental point sourced from the literature is that expectations are not the result of fully informed and frictionless processes. Both households and firms have to do with limited information, take notice of certain price changes, and rely on past inflation to form their view of future inflation. Models stressing information rigidities and delayed updating are helpful in situations where expectations react somewhat sluggishly at the beginning but get extremely adjusted when inflation becomes persistent or highly visible (Carroll, 2003; Coibion & Gorodnichenko, 2015). This is pointing to a very important role mechanim in inflation episodes when most purchased goods get affected, thus, enabling changes in prices to become even more salient to consumers.

The anchoring of expectations is a crucial factor that goes hand in hand with the policy credibility and communication. Explicit inflation targets can be used as effective reference points for expectations in environments which are stable. Nevertheless, if inflation deviates from targets for a prolonged period, agents may decide to put more weight on realized inflation rather than on policy commitments, thus, the stabilizing role of expectations gets weaker (Coibion et al., 2018). Surveys of households and firms reveal that credibility erosion can take place even without any formal changes in policy regimes and that re anchoring of expectations is a slow and costly process (Weber et al., 2022).

The differences among economic agents in terms of expectations is another factor which makes the expectations channel more difficult. Firms, households, and financial market participants receive inflation signals and react to them in different ways based on their level of information, their exposure to price changes, and their economic incentives. These differences may cause the

developments in prices and wages to be uneven which in turn leads to differences in inflation persistence across countries and sectors. Moreover, if the economies are open, the expectations can be influenced by the global developments which strengthen the effect of the interaction between domestic credibility and international price movements (Ciccarelli & Mojon, 2010).

The study taken together, indicates that the way in which people form expectations is the main channel through which inflation stays at a high level after the initial large shocks. When expectations start to lose their anchor, it follows that policy measures have to regain trust in the eyes of the public before they can have a real effect on the economy. Hence, knowing the dynamics of expectations in situations of high inflation is a must if one wants to be successful in planning the steps toward recovery after having experienced shocks of a global nature.

4. Supply-Side Constraints, Globalization, and Inflation Dynamics

The post pandemic inflation episode has once again put the spotlight on the extent to which supply side factors and global integration have influenced inflation outcomes. Changes in global supply chains, energy and commodity prices, and trade patterns significantly contributed to inflation that was both widespread and uneven across countries. These changes revealed that domestic inflation dynamics are increasingly becoming a function of global production networks and international price transmission mechanisms (Baumeister & Kilian, 2016; Ciccarelli & Mojon, 2010).

Supply side shocks are different from demand driven inflationary pressures in that they go straight to the production costs and relative prices, thus, firms most times have to adjust prices even if there is no strong domestic demand. If such shocks are global, their effects will be interconnected through supply chains, thus, the connected economies will be hard to find or create any space to be free from outside inflationary pressures. Real world data reveals that energy and commodity price shocks, especially, have a significant impact on consumer prices thus, they make inflation persistent in case of large or prolonged shocks (Enders & Holt, 2019; Baumeister & Kilian, 2016).

Globalization has continued to influence how supply shocks spread and affect domestic inflation. Economies that are highly interconnected rely more and more on international prices, changes in exchange rates, and pricing practices in global markets to determine domestic prices. The rise in dominant currency pricing has, therefore, increased the transmission of global price changes while decreasing the responsiveness of import prices to domestic monetary conditions, thus limiting the short run effectiveness of monetary policy in offsetting external inflationary pressures (Gopinath et al., 2020). Meanwhile, the pandemic aftermath has also seen the policy debates on deglobalization and supply chain reconfiguration gaining momentum. Reshoring or diversification efforts to strengthen resilience may reduce the risk of certain shocks but can increase production costs in the medium term. These structural changes can, therefore, lead to sustained inflationary pressures, especially if they happen at the same time as energy transitions or geopolitical fragmentation (Corsetti & Dedola, 2016).

The bulk of evidence across these studies points primarily to supply side constraints and price transmission mechanisms as key factors behind the inflation dynamics after the pandemic. These factors account for the persistence of high inflation in certain economies despite the tightening of policies and the large variations in inflation outcomes across countries. Hence, putting supply issues at the center of inflation measurement is indispensable if we want to create the right measures to stabilize in an international economy that is both deeply interconnected and vulnerable to shocks.

5. Monetary-Fiscal Interactions and the Implications for Inflation Targeting

The post pandemic inflation episode has revived long standing debates about the interaction between monetary and fiscal policy and their joint role in maintaining price stability. During the pandemic, governments across the world implemented large fiscal expansions to stabilize incomes and firms, leading to sharp increases in public debt. While these measures were crucial for avoiding deeper economic contractions, they altered the macroeconomic environment in which monetary policy operates, with important consequences for inflation dynamics (Blanchard, 2019).

In settings where fiscal policy is dominant, controlling inflation becomes more complex. High levels of public debt can limit monetary authorities, either through political pressures or concerns about financial stability and debt sustainability. When economic agents believe that fiscal considerations may limit the central banks' willingness or ability to tighten policy, inflation expectations may become less anchored, thus increasing the risk of persistent inflation (Leeper, 1991; Bianchi & Ilut, 2017). This mechanism indicates that inflation outcomes depend not only on the use of monetary instruments but also on the broader policy regime.

The post pandemic experience has raised questions about whether inflation targeting frameworks can withstand repeated large shocks. Traditional inflation targeting depends on stable relationships between policy actions, expectations, and inflation outcomes. However, if fiscal expansions are large and persistent, and shocks are global, these assumptions may not hold. In such cases, inflation targeting may have to be more flexible, communicate tradeoffs more clearly, and coordinate more with fiscal authorities if it is to remain effective (Woodford, 2001; Bianchi & Melosi, 2017). Differences in institutional arrangements across countries affect the monetary fiscal interactions and inflation outcomes. Economies with credible fiscal frameworks and clear long-term consolidation plans can better provide support to monetary policy in stabilizing inflation. On the other hand, where fiscal discipline is weaker, inflation may persist for a longer time even if there is a strong monetary tightening. These institutional differences explain the variation in inflation experiences that different countries have had despite facing similar global shocks (Blanchard, 2019).

The literature examined in this theme, taken as a whole, points to the necessity of adopting a wider-angle view of policy design if price stability is to be maintained after significant global shocks. Inflation targeting is still a good framework, but how well it works depends a lot on the state of public finances, the trustworthiness of institutions, and coordination of policies. It follows that being aware of and dealing with the interactions between monetary and fiscal policies is a prerequisite for any changes in inflation stabilization strategies in the context of a turbulent global economy.

6. Policy and Regulatory Implications

The study of post pandemic inflation dynamics has major implications for the design of macroeconomic policy frameworks. The first lesson from the experience is that policymakers need to take inflation persistence very seriously from the beginning. It is very difficult to tell when inflation is only temporary and when it will persist in the case of large global shocks, and overly optimistic assessments can postpone the necessary policy changes. Both contemporary and historical data provide evidence that once inflation persistence increases, the costs of restoring price stability become very high and that, therefore, the importance of timely and precautionary policy responses is greatly reinforced (Benati, 2008; Pivetta & Reis, 2007).

Secondly, the main role of expectations formation points to communication and credibility as two essential policy instruments. Even in situations of great uncertainty, clear and consistent communication can help stabilize expectations, but credibility depends on policy actions being in line with the stated objectives. When inflation stays at a high level for long periods, expectations may even more than before reflect the actual inflation rather than the targets announced, thus, the effectiveness of forward guidance diminishes, and persistence increases (Coibion & Gorodnichenko, 2015; Weber et al., 2022). Hence, communication strategies cannot be effective unless there is also a credible policy action that serves as a reference point for expectations.

Third, the global and supply driven nature of inflation in recent times suggests that domestically focused stabilization frameworks may not be enough. Although monetary policy plays a key role in controlling inflation over the medium term, it cannot directly address supply chain disruptions or price shocks in the global commodity market. Research on global price transmission and dominant currency pricing shows that external inflationary pressures can continue even if domestic demand weakens (Gopinath et al., 2020; Enders & Holt, 2019). This implies that there should be a

closer coordination between macroeconomic stabilization policies and structural policies that aim to enhance supply chain resilience, energy security, and market competition.

Fourth, the renewed focus on monetary fiscal interactions indicates that maintaining price stability should be considered as a joint result of policy institutions rather than the only responsibility of central banks. If there are large and sustained fiscal expansions, they can make it difficult to control inflation if they cause worries about long run debt sustainability or reduce confidence in policy coordination. The literature points out that when fiscal policy is seen as dominant, inflation expectations may become less stable, thus diminishing the impact of monetary tightening (Leeper, 1991; Bianchi & Ilut, 2017). As a result, improving fiscal frameworks and increasing openness about medium term fiscal plans can be a way to keep inflation under control.

Finally, the experience after the pandemic argues that inflation targeting regimes might have to change in order to be still effective in a world with often large shocks and increased uncertainty. The idea is not to give up inflation targeting, but to adapt it in such a way that it has more flexibility, shows more clearly the management of risk, and communicates more obviously the tradeoffs. Studies on policy frameworks emphasize the role of institutional credibility and coordination as key factors in maintaining the efficiency of inflation targeting in difficult times (Woodford, 2001; Blanchard, 2019).

7. Conclusion

The resurgence of inflation after the pandemic is a clear break with the low inflation environment that was common in many economies before 2020. This episode has shown that large global shocks can lead to inflation dynamics that are more persistent, complex, and heterogeneous than is usually assumed by standard frameworks. Post pandemic inflation is not a reflection of a single dominant driver, but rather the interaction of supply disruptions, expectations formation, global price transmission, and evolving monetary fiscal relationships (Benati, 2008; Ciccarelli & Mojon, 2010).

The review here has been that inflation persistence is not simply a mechanical result of past inflation but a state dependent process influenced by institutional credibility and policy regimes. Large shocks may change the behavior of firms and households, reduce the anchoring of expectations, and increase the inertia of price and wage setting. When these mechanisms have taken hold, it becomes very difficult to reverse inflation even if the original shocks subside, thus highlighting the crucial role of expectations and policy credibility in inflation stabilization (Pivetta & Reis, 2007; Coibion & Gorodnichenko, 2015).

The study also emphasizes that globalization has been the major factor for inflation dynamics in the world after pandemic. It states that the global supply chains, commodity markets, and international pricing practices transmit inflationary pressures across regions limiting the effectiveness of local policy responses. These worldwide channels explain the large variations in inflation outcomes across the countries after pandemic and emphasize the need of incorporating international considerations in inflation analysis (Gopinath et al., 2020; Enders & Holt, 2019). Stating from the point of view of policy, the post pandemic event indicates that preserving price stability requires a wider and more integrated approach than before. Monetary policy is still very important, but its effectiveness depends mainly on fiscal conditions, institutional arrangements, and coordination across policy domains. In case the fiscal frameworks are credible and supportive, inflation targeting is more likely to succeed; in case they are not, inflation persistence may become more resistant to attempts to control it (Leeper, 1991; Blanchard, 2019).

The recent inflation episode provides a set of important lessons that should be reflected upon by future researchers and policy makers. It urges to explore again aspects such as inflation persistence, formation of expectations, and transmission of inflation at the global level in times of frequent large shocks. This review, by incorporating these aspects in a single conceptual framework, is hence a step forward in comprehending inflation after the pandemic and lays the groundwork for

rethinking the ways of stabilizing inflation in a world that is becoming more and more interconnected economically (Woodford, 2001; Bianchi & Melosi, 2017).

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