Confronting the Toxic Confluence of Effects Creating Inflation

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News that, according to the data produced by the ONS (Office for National Statistics), the consumer price index (CPI) has risen over the last twelve months to 5.5% in December is not good news Nachiappan (2022). Given that only just over a year ago, in January 2021, CPI for the UK was 0.7%, it's possible to see that there's been a marked increase over the last year (Martin, 2022).

Depending on a person's increase in income, inflation usually represents is an erosion in 'buying power'. As OECD (Organisation for Economic Co-operation and Development) explain, using CPI as a measure of inflation is based on the "change in the prices of a basket of goods and services that are typically purchased by specific groups of households" (2022).

Confusingly, there are two common measures of inflation, CPI and RPI (retail price index) which, because it includes mortgage interest payments, house prices and interest rates, usually make it higher. For January the RPI figure was 7.8% (Frost, 2022). This figure is significant as will be explained.

Having experienced a sustained period of low inflation, particularly during the pandemic when consumer expenditure declined markedly, we're now seeing the impact on prices of a sudden spike in demand coupled with supply-side issues. As ONS point out, the largest increase in CPI recorded since 1992, when inflation stood at 7.1%, is a consequence of the rapid rise in energy costs we're all experiencing, and going to get worse, as we as clothing, household goods and furniture (Kingsley, 2022).

Romei (2022), writing in the Financial Times, explains that what's known as 'core inflation', "which excludes the more volatile energy, food, alcohol, and tobacco prices, rose to 4.4 per cent in January, up from 4.2 per cent in the previous month.". Energy is going to be a significant component of collective expenditure for the next year.

Unsurprisingly, a number of major producers have announced their intention to increase the price of goods that'll ensure inflation continues to rise in the next few months (Timmins, 2022; BBC, 2022; Partridge, 2022; Gray, Hancock and Romei, 2022). Worryingly, as Grant (2022) stresses, inflation in the cost of "numerous basic food products", including margarine and tomatoes, which have risen by 45%, will hit create problems for hard-pressed families.

Given energy bills will increase by 54% in April, following the review of regulator Ofgem (Office of Gas and Electricity Markets) of the 'price cap', there's inevitably going to be anther increase in CPI. The Bank of England predict that the consequence of the spike in the price we're charged for gas and electricity will result in inflation exceeding 7% by spring.

Clearly, this means pressure will continue throughout the coming months. Little wonder the Resolution Foundation (2022), the independent thinktank which campaigns for improvement in the standard of living of low-and middle-income families, contend we're going to experience the worst annual squeeze in living standards since the late 1940s.

Those whose incomes are not rising as fast as prices will find they're squeezed and need to cut back on discretionary spending. This will create a drag on aggregate demand. Potentially, the result could be creation of economic conditions in which GDP, the measure of output, starts to fall at the very point when inflation is high.

Such conditions might seem resonant with stagflation experienced in the 1970s. Then, the shock to the economy was the fact that the price of oil rose dramatically leading to double digit inflation which, in turn, created rapidly rising levels if unemployment.

Currently in the UK, unemployment does not cause a threat, quite the contrary. However, lack of workers in a number of sectors is creating a problem for many employers who are having to raise rates paid to attract those needed to maintain production.

Though not hugely influential at present, workers in these sectors, obviously enjoying the benefit of being 'in demand', provides a portent of what may become more widespread. Should inflation become embedded, there's likely to be widespread pressure from workers to attempt to ensure they maintain their purchasing power. This would ensure increased strain on the economy – most notably measured in production costs – as inflation continues to increase.

Another deduction in income is due soon. Rates of national insurance contributions (NIC) are due to increase by 1.25% in April for all individuals whose earnings (or profits) are above £9,880 (Miller, 2022). This rise, the 'Health and Social Care Levy' is ostensibly to pay the increasing costs of those who need residential care, is likely to be swallowed by the costs of servicing the £2 trillion debt, an all-time high, which ballooned during the pandemic.

There's a view that Sunak will, once again, come under pressure from many within his party to shelve the NIC hike (Wallace, Boland and Woods, 2022). Patrick Dardis, chief executive of pub chain Young's, is quoted as suggesting this rise, "ridiculous" when announced, now "seems like utter madness".

Philip Aldrick, writing for Bloomberg (2022), quotes Isabel Stockton, a research economist at the Institute for Fiscal Studies (IFS), who believes the spike in inflation will cost the UK an additional £23 billion in additional costs because of the increased debt run up. Significantly, it's RPI, remember was 7.8% in January, which will be used to calculate payments on a quarter of this debt.

Rishi Sunak, whose problem with the size of public debt was already considerable, has promised to dedicate what's estimated to be another £10 billion to assist households in dealing with the eye-watering increase in energy costs. Rapidly rising inflation is another problem he could have done without (Tapsfield, 2022).

So, of course, it's the collective pockets of every family that are going to be hit by the 'cost of living' crisis. Additionally, those with debts of their own, notably mortgages, will have reason to be concerned with the remedy to deal with inflation. Almost all economic commentators believe the Bank of England's Monetary Committee increase the base rate for lending in March.

Moreover, perceived wisdom is that with inflation set to increase and not decline markedly for the rest of this year, a number of increases in the base rate will follow. Paul Dales of Capital Economics contends the Bank of England's prediction of inflation peaking at 7.5% in April is too low and is estimates it will reach 7.9%.

As a consequence, many believe we'll see base rate hit 2% by December. For those on fixed rate mortgages this won't be an immediate problem. However, what seems apparent is that the era of ultra-low interest rates is, certainly for the foreseeable future, at an end. The longer-term trend is upwards (Wallace, 2022).

The Guardian's Larry Elliot (2022) in analysing the current crisis, recognises the intense pain households will face in the coming year. As he concludes, whilst we can expect to hear more "I feel

your pain" messages from Sunak, what people will want to see is far more "tangible support" to get through the crisis they'll be confronted with as a result of increased prices.

Inman (2022), in echoing the concern of millions of individuals and families concerning living standards, believes the spike in inflation we're experiencing will have a profound impact on business. Both the CBI and TUC, Inman explains, believe that urgent action is needed to avert a crisis that could become even greater in "choking off" recovery so desperately needed in all parts of the country but, especially, where those 'left behind' experience blighted prospects for improvement.

Undoubtedly Boris Johnson's government, taking its lead from the Bank of England, as well as many other commentators, will claim that what we are seeing is the consequence of the transition back to normality following a once in a century health crisis. As such, the relatively sudden increase in demand for raw materials and goods should, over the next year, return to normal. This would allow producers to return to equilibrium and, it's hoped, see inflation fall back to the BoE target of 2%.

It's apparent that in the attempting to return to normality, the government face difficult choices. Having spent money – not all of it prudently – during the pandemic to save the economy, and now having to use public money to alleviate the public from the effects of the phenomenal hike in energy costs, it's confronted with inflation at a level not experienced for a generation.

Calm heads are needed. Though it's hoped the problem is temporary, there are no guarantees. Indeed, as history shows, crises tend to come in rapid succession. The geopolitical situation in Ukraine is likely to create even further instability which will undermine any effort to deal with inflation.

In an opinion piece, the Financial Times (2022) explicitly recognise the hard choices, "the most difficult monetary policy decisions", all central banks, including the Bank of England, must confront in dealing effectively with inflation in a way that doesn't make matters worse. As The FT stress, this will mean that it's necessary monetary policy will tighten with consequential knock-on effects that'll become apparent in coming months.

Unfortunately, as is also abundantly clear, this is a government which, because of the very reason it came to power, ensured the UK left the UK with the worst possible trade deal possible. This has effectively created a set of circumstances that are, to say the least, are decidedly unhelpful.

Regardless of whatever newly appointed minster for Brexit opportunities, Jacob Rees Mogg, may claim, there's no doubt the UK economy has been negatively hit (BBC, 2022a; Boscia, 2022).

Partington (2022) reports on the fact that, according to ONS data, the value of goods exported to the EU has fallen by £20 billion as in the year since the UK left the EU after the transition period ended. Though the pandemic will have contributed, there's little doubt that not being part of the Single European Market contributed to major falls in exports to the EU including cars (25%), vegetables (40%) and clothing which declined by a massive 60%.

That last week Parliament's cross-party public accounts committee (PAC), in a report produced, categorically stated that Brexit has increased bureaucracy, caused costs to rise and has "suppressed" trade with the EU, should be sufficient to tell those who argued for leave that all is not well. Warnings that there'd be negative consequences in leaving the EU, including, notably, from HMRC in 2019 that the additional annual cost to business could be as high as £15 billion, were scathingly rejected to by advocates of leave as 'project fear'.

An economy less vibrant and successful than it might otherwise be had the referendum result of June 2016 been different is, arguably, an unfortunate effect of allowing people to make difficult decisions based on scant information. The reality is that ‘freedom’ means tax income is reduced which will limit Johnson’s government in dealing with the threat of inflation.

Dealing with the cost-of-living crisis requires honesty and integrity in acknowledging the impact Brexit is having on the UK economy. Whilst Jacob Rees Mogg faces claims of a conflict of interest, because of holding “a substantial stake” (currently 12%) in a multi-billion investment fund specialised in emerging markets, this seems questionable (Willems, 2022).

That we face a pretty toxic confluence of economic events, many beyond government control, is indisputable. The way in which Johnson’s government deal the current economic crisis is critical to our collective prosperity.

Crucially, that those elected to government are absolutely sincere as to the underlying reasons for some of the problems we currently face, should be the least we can expect. Regrettably, forgive me if the evidence we’ve seen since it was elected in December 2019 suggests we’re likely to be disappointed.

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