State of Play

Inflation keeps up pressure on central banks

23 June 2022

Last week the Bank of England increased interest rates for the fifth consecutive time warning that they expected inflation to peek at 11% this autumn.[1] Following yesterday's latest inflation data from the Office of National Statistics (ONS) confirming rising prices hitting a new 40-year high at 9.1%, are the rate rises enough to cool the economy without triggering a recession? Our Senior Investment Specialist, Simon Durling, shares his thoughts in this week's State of Play.

Latest inflation data

According to the ONS the latest Consumer Price Index (CPI) for the 12 months to May hit a new 40-year high at 9.1%. As expected, food, energy bills and fuel prices were the main contributors to the latest set of numbers. In their latest report the ONS explain about energy prices: 'The contribution rose significantly in April 2022 as a result of price rises for gas and electricity following the increase in the Office of Gas and Electricity Markets (Ofgem) cap on energy prices on 1 April 2022. This followed an earlier rise in the price cap on 1 October 2021. The Ofgem energy price caps limit the price energy suppliers can charge the estimated 15 million households that either use a prepayment meter or are on the 'standard variable' energy (or default) tariff.'

They then outline fuel price rises to new records: 'Average petrol prices stood at 165.9 pence per litre in May 2022, compared with 127.2 pence per litre a year earlier. The May 2022 price is the highest recorded. The average price of diesel in May 2022, which was 179.7 pence per litre, was also the highest on record. The 12-month rate for motor fuels was 32.8%, the highest since before the start of the constructed historical series in January 1989.' As I am sure anyone who has filled up their car in the last two weeks will tell you that prices have risen since this data was captured, with a petrol station near where I live for the very first time offering diesel at £2 per litre!

Source: Office for National Statistics, 22 June 2022

Bank of England inflation warnings

Following the fifth consecutive rate rise bringing the base rate to 1.25%, the Bank of England (BoE) warned that inflation could hit 11% in autumn. The BoE move followed swiftly on from the US Federal Reserve (the Fed) who had raised rates by 0.75%[2], higher than they had signposted just a week before, showing their intent to tackle inflation head on. Stock markets initially rallied on the announcements but soon fell into sell-off mode as indices in the US, UK and Europe dropped by more than 4% by the end of last week.[2] Since Friday markets have recovered somewhat, but the pain for investors I am sure has been hard to stomach based on their experiences so far this year. Bonds didn't fare much better either, with most bonds falling between 1%-2.5% over the same five-day trading period as yields rose sharply reacting to the aggressive move by the Fed and the intent shown in their announcement.

The decision by the Monetary Policy Committee (MPC) was split between members wanting the 0.25% rise and three members wanting a 0.5% rise.[1] One of these three members is Catherine Mann who has voted for bigger interest rate rises in the past two meetings, explaining in a recent speech to the Market News International conference, that a less aggressive approach may import more inflation through a currency depreciation of pound sterling against other international currencies.[1] The pound sterling has fallen from $1.36 in December last year to $1.22 as at the time of writing.[2] Catherine went onto say 'I voted for a 50 basis-point increase at the last MPC meeting. A robust policy move, based on both domestic conjuncture and commensurate with the global factor, reduces the risk that domestic inflation already embedded is further boosted by inflation imported via a sterling depreciation'.[3]

The warnings issued in the release from the BoE were backed up by the consultancy firm Cornwall Insight who specialise in analysing various markets including the energy market, as they published their predictions for the October energy price cap revision for an average household consumption with the expectation of a further increase from £1,971 to £2,980.[4] They say in their report: 'The increase is primarily led by a rise in gas prices. These have climbed in response to the latest wholesale market uncertainty surrounding flows from Russia into Continental European markets with reductions in deliveries in Germany, Italy and Austria, among others being observed.'

Investment markets remain nervous in anticipation of the new data which may indicate the pace of the economic slowdown ahead and whether this cooling of demand coupled with the recent rate rises is sufficient to reassure investors that tackling inflation remains achievable. As State of Play has explained in recent weeks, central banks are keen to get inflation under control by cooling demand enough to bring down price rises but not enough to pull the economy into a recession. They describe this as a 'soft landing'. My view is the landing strip has started to narrow and become ever shorter, making this target increasingly unlikely especially in light of this week's UK train strike where the rail unions are seeking wage settlements closer to the current inflation figures, fuelling concerns about wages rising thus triggering more inflation down the line.

The fine path they tread is made even more difficult as they try to regain trust from market participants after predicting that price rises would be temporary and failing to act in raising rates sooner. This balancing act plays out in the glare of the public eye with investors attempting to interpret and align the words they say and the actions they take against promises and signposts made over recent months.

Learn more!

Investing can feel complex and overwhelming, but our educational insights can help you cut through the noise. Learn more about the Principles of Investing here.

Note: Data as at 22 June 2022.

[1] Bank of England, 16 June 2022
[2] Investing.com, 21 June 2022
[3] The Times, 21 June 2022
[4] Cornwall Insight, 21 June 2022

Asset Management