Funding the Future

Inflation is over. It is time that the Bank of England ...

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As I noted yesterday, this month's inflation data shows a very slight rise over that published in December. The difference is statistically insignificant at 0.1%, but almost all the commentary that I have seen suggests as a consequence that the war on inflation has yet to be won, that the Bank of England still needs to exercise considerable caution, and the idea that inflation is in the past is one for the fairies.

As a result, I thought I would look at whether inflation data supports these claims. All the data that I used was in the information published by the Office for National Statistics (ONS) yesterday, which I reproduce in the table below.

The ONS has two preferred measures of inflation. One includes household costs (CPIH), and the other excludes them (CPI). CPI is the figure that is most commonly referred to when any discussion of inflation takes place.

Each month, the ONS estimates the cost of a basket of goods in that month and then compares that cost to the cost of the same basket of goods in 2015. It then publishes the change as an index figure. These are the monthly figures in the table below.

Table 1: CPIH and CPI index values, and annual and monthly rates, UK
December 2022 to December 2023

		CPI Index	CPI Index
2022	**Dec**	125.3	127.2
2023	**Jan**	124.8	126.4
	Feb	126.0	127.9
	Mar	126.8	128.9
	Apr	128.3	130.4
	May	129.1	131.3
	Jun	129.4	131.5
	Jul	129.0	130.9
	Aug	129.4	131.3
	Sep	130.1	132.0
	Oct	130.2	132.0
	Nov	130.0	131.7
	Dec	130.5	132.2

Source: Consumer price inflation from the Office for National Statistics

To calculate inflation over a twelve-month period all that the ONS does is compare the index value for one month with the equivalent value in the same month a year earlier. Doing this with their own, rounded, published data does actually imply that CPI did not increase in December 2023, as they said it did, but it was in fact stable at 3.9%. This shows how statistically insignificant the actual change was. My estimate of CPIH age is identical to that which the ONS produced.

There is a particular characteristic of this data that is, however, the focus of this post. If you look at the figures for the monthly indices from May 2023 onwards you will see that the rate of change fell dramatically from that seen even at the beginning of 2023. In fact, over the months from May until December 2023 the average increase in the CPIH index was just 0.2 a month, and CPI was even lower at 0.13. There are, of course, variations around this mean, but again, the variation is remarkably small.

There is, in other words, no reason to now think that the pattern of change seen since May 2023 will be disrupted by future events (the Middle East, maybe, apart, to which I refer below). What is more, we already know that some quite important domestic costs, like energy, are expected to fall in price significantly over the coming months. In that case, I have projected figures for the overall increase in the index each month from January until May 2024 in the table above and have then estimated the likely inflation rate that will be reported for May 2024, assuming that this pattern of projection is actually seen over this period.

For the sake of emphasis, I have highlighted the resulting figures in yellow. What is apparent is that CPIH inflation in May 2024 would, on this basis, be 1.8% per annum, whilst the more important CPI would be just 1.2% when rounded. Both figures are, of course, well below the Bank of England inflation target.

At present, I can see no reason why price changes over the next few months should not follow the pattern of those in the second half of 2023. If anything, I would expect them to be lower. It is possible that conflict in the Middle East could change this outcome slightly, but I am really not expecting that to happen: the volume of trade passing through the Suez Canal is simply not big enough to have that sort of impact.

There are a number of implications arising from this suggestion.

First, what this data makes clear is just how out of line with the reality of the real economy the current Bank of England base rates are. Charging an interest rate of maybe 5.25% when the inflation rate might be some 4% lower, as is quite possible in May 2024, is to impose a massive and wholly unnecessary tax on people who have to borrow in the UK, which can have the sole purpose of upwardly redistributing wealth in this country whilst perpetuating any remaining inflation. There is now an urgent need for very rapid interest rate cuts from the Bank of England unless a recession is to be created as a result of excessive interest burden on both the domestic business sectors of the economy.

Second, and as important, the risk is that unless the Bank of England changes course we could face the risk of deflation, the dangers of which I explained recently in this post.

I am, of course, aware of the risk of making forecasts of this sort. But, even if inflation does not fall by as much as I am suggesting, the risks that I suggest exist will remain. Inflation is over. It is time that the Bank of England recognises this and responds appropriately.