

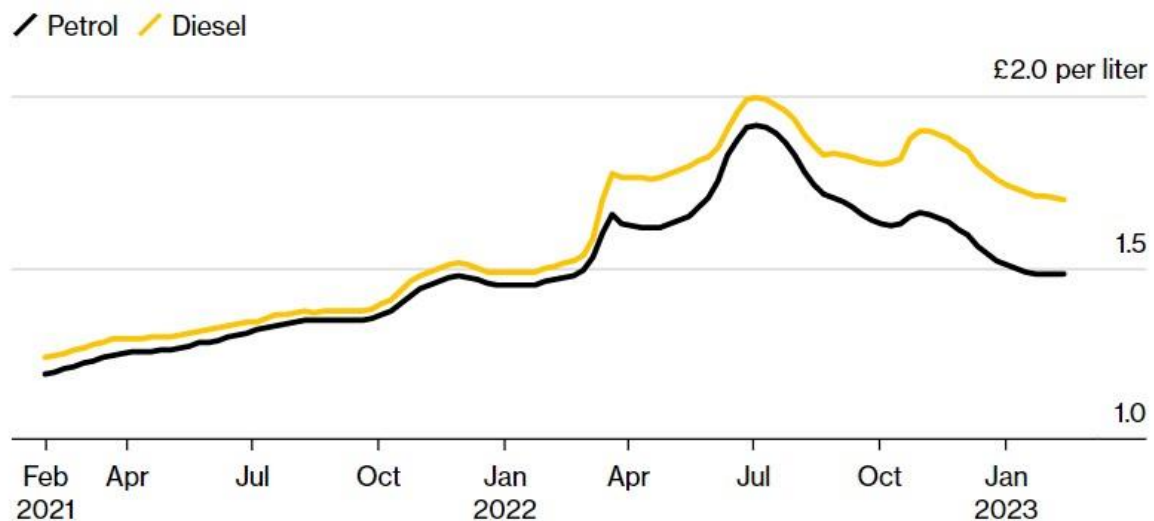
24<sup>th</sup> February 2023

## Dry January, sticky inflation

- January inflation numbers for the UK and the US diverge
- Fed and BoE continue to be hawkish on rate path
- Inflationary pressure remains sticky

In what scenario can it be argued that 10.1% is a more attractive inflation number than 6.4%? While it remains the case that the UK's inflation problem is worse than that of the US or the Eurozone, the most recent inflation print for the UK took markets by surprise, coming in lower than expected, particularly for core inflation (excluding energy, alcohol, food and tobacco). January's 10.1% is the lowest year on year rise since September 2022, the most significant contributor being lower fuel costs. Core inflation fell to 5.8% from 6.3% the previous month and there was also a fall in service sector inflation.

*Fig. 1. Fuel prices drive UK inflation lower*

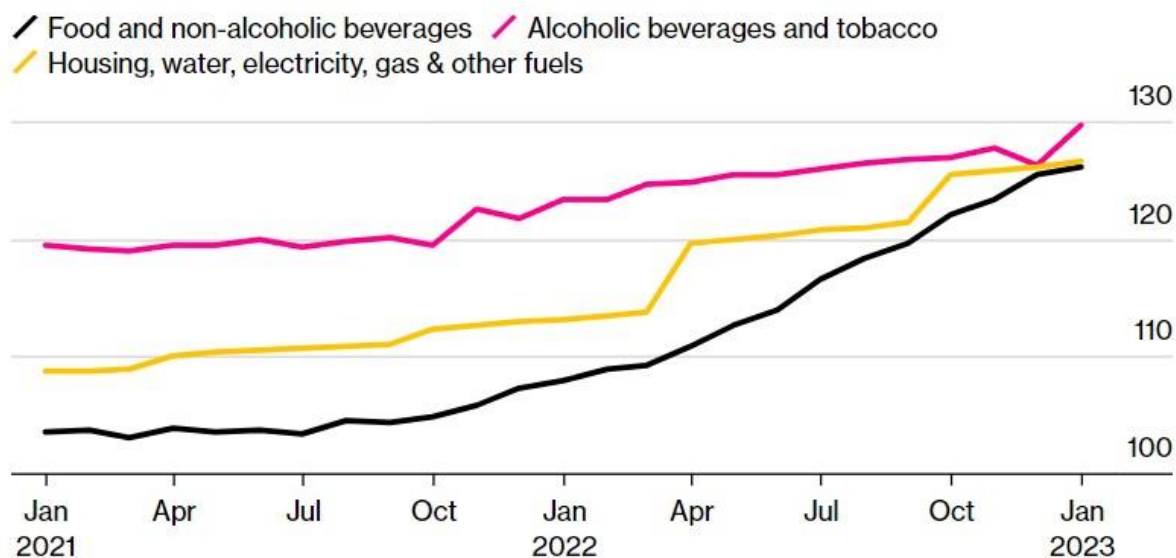


Source: Office for National Statistics

Note: RPI: Ave price - Ultra low sulphur/Unleaded petrol and diesel

However, food and alcohol costs have risen, as have household energy bills, particularly affecting low-income households.

Fig. 2. The cost of food and drink has risen in contrast to the tail-off in fuel prices



Source: Office for National Statistics  
 Note: Index, 2015 = 100

Taking a step back from the most recent numbers, there are still underlying inflationary pressures that mean it is likely to be a long road for UK inflation to fall in line with government targets. The most significant is probably the tight labour market and upwards pressure on wages. But there also remains uncertainty over energy costs, for the most part due to the ongoing Russia-Ukraine war, and the potential knock-on effects along the supply chain are considerable.

Forward-looking break-even inflation rates declined into January but have since ticked up again, an indication that investors see UK inflation as becoming stickier.

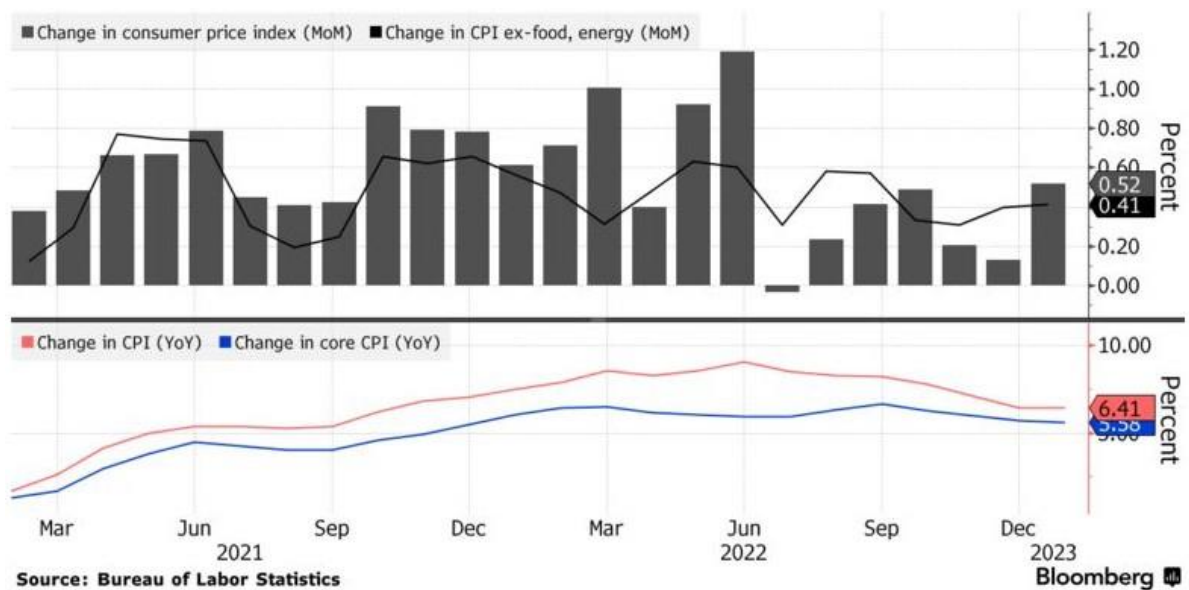
### Negative surprise from US inflation number

Meanwhile in the US, where a recent moderation in inflation had prompted what now seem premature expectations that federal rate hikes would ease, the January figure showed an uptick of 0.5%, coming in at 6.4%.

As with the UK, the labour market in the US is currently exceptionally strong with the most recent jobs report showing half a million jobs added in the month of January against expectations of 188,000. While pay-rises have flattened out a little, it was noted in the minutes of the last Federal Open Market Committee meeting that there was some evidence of labour hoarding by employers concerned about losing talent.

Consumer spending is robust and price pressures in general are quite entrenched.

Fig. 3. Persistence in US inflation data



Breaking the figures down, housing costs were the most significant contributor to price increases for the January print. It should be noted that these traditionally function with a certain degree of lag, so it may be that they will come down in the next couple of months.

## Summary

A lot of time can be spent focusing on the minutiae of the data that pertain to inflation and central banks' decisions around raising interest rates, but there is unlikely to be a swift and simplistic drop-off and return to normality. Not only are there myriad contributing factors at play that are unlikely to move as one, but there remains an overall degree of geopolitical uncertainty that has a bearing on energy security and the operations of cross-border supply chains, both of which contribute to prices and therefore inflation. The unexpected easing of inflation in the UK in January can be welcomed, but the unexpected uptick in US inflation should be heeded as a sign that there is likely to be a longer battle than many would hope to find a way back to target inflation levels.

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