

UK inflation reaches +4.2%yy (October 2021)

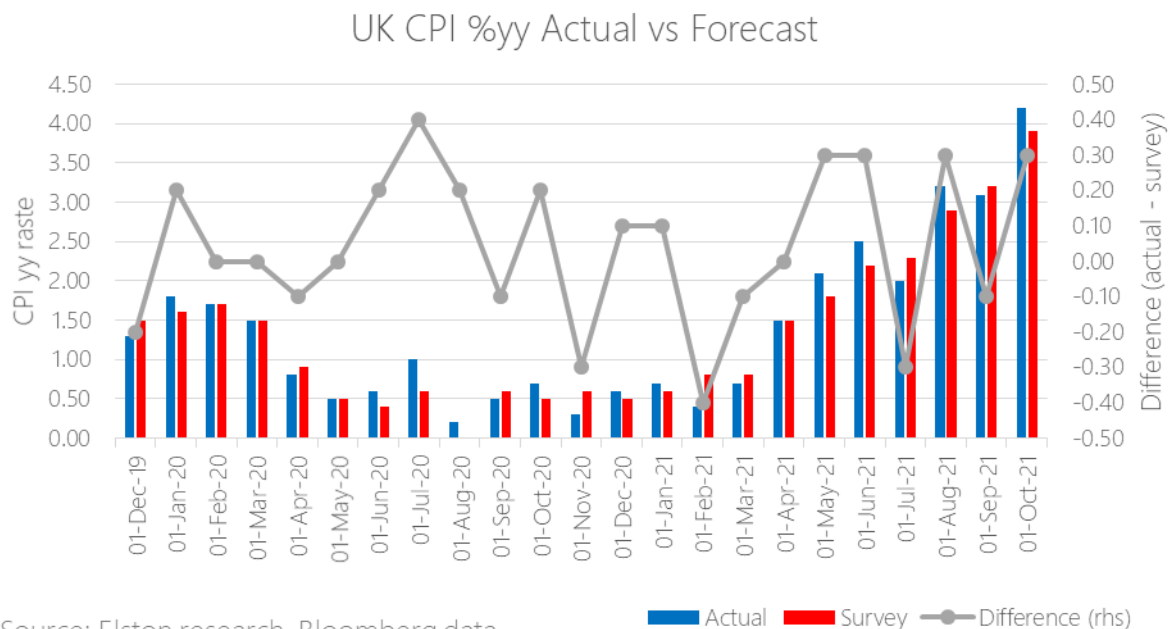
- UK inflation reaches 4.2%yy in October
- Ahead of 3.9%yy estimate, and +3.1%yy in September
- Bank of England expects peak of +5% in April 2022

Ahead of estimates

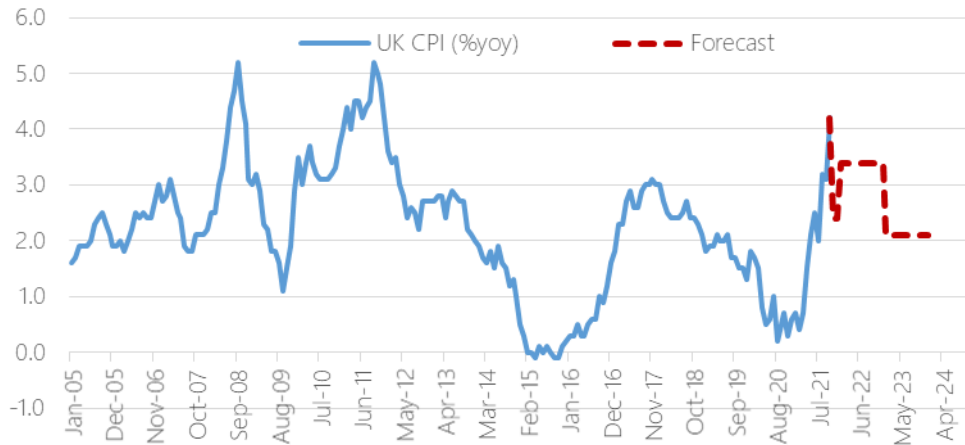
UK CPI print for October came in at 4.2%yy vs 3.9% estimate and 3.1%yy in September.

Inflation rates were higher than expected and the highest in a decade, putting more pressure on the Bank of England to raise interest rates and creating a palpable squeeze on cost of living for households through the winter. The increase was driven by energy prices and the impact of supply shortages across the economy.

In the chart below to what extent UK inflation has varied, relative to forecasts. The greater the positive difference between actual and surveyed estimate, the greater the “shock”.

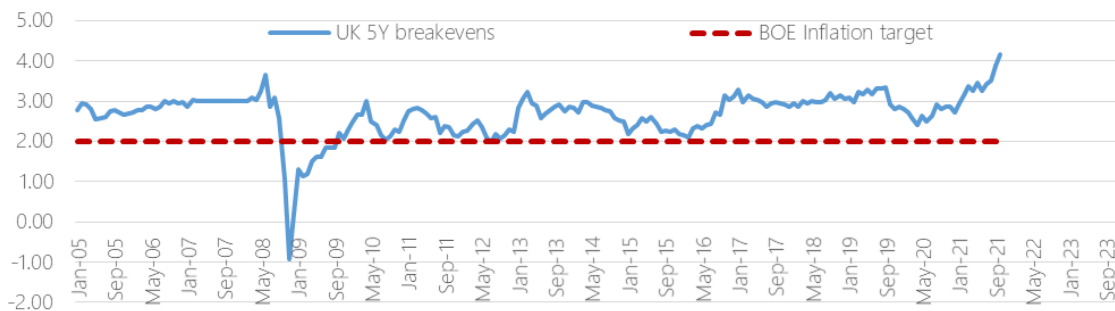


This is still below 2011 levels, and whilst economists still expect inflation to moderate to trend rates, we are concerned that they are behind the curve.



Where are breakeven rates

The UK 5 year breakeven rate is at 4.34%, following the announcement, compared to 4.16% end October and 2.72% at end 2020.

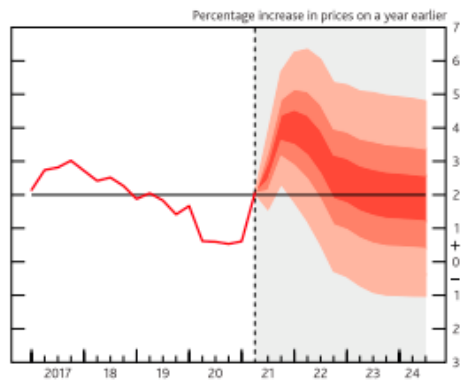


Inflation scenarios

In its latest Monetary Policy Committee report, the Bank of England’s central scenario is that inflation could peak at +5% in April 2022, a material increase compared to their previous estimate of a +4% peak “near-term”. The breadth of the range of potential outcomes has also broadened. Forecasts could vary further depending on supply chain issues and energy/gas pressure.

August 2021 Outlook

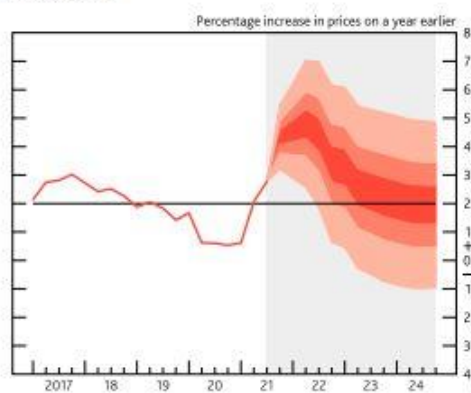
Chart 1.4: CPI inflation projection based on market interest rate expectations, other policy measures as announced



The fan chart depicts the probability of various outcomes for CPI inflation in the future. It has been conditioned on the assumptions in [Table 1.A footnote \(b\)](#). If economic circumstances identical to today's were to prevail on 100 occasions, the MPC's best collective judgement is that inflation in any particular quarter would lie within the darkest central band on only 30 of those occasions. The fan chart is constructed so that outcomes of inflation are also expected to lie within each pair of the lighter red areas on 30 occasions. In any particular quarter of the forecast period, inflation is therefore expected to lie somewhere within the fans on 90 out of 100 occasions. And on the remaining 10 out of 100 occasions inflation can fall anywhere outside the red area of the fan chart. Over the forecast period, this has been depicted by the light grey background. See the box on pages 48–49 of the [May 2002 Inflation Report](#) for a fuller description of the fan chart and what it represents.

November 2021 Outlook

Chart 1.4: CPI inflation projection based on market interest rate expectations, other policy measures as announced



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Source: Bank of England, MPC Minutes

Summary

We focus on 5 year breakeven rates as in indicator of market-implied inflation expectations.

Inflation is proving to be more persistent than transitory. How to incorporate inflation protection strategies in place of nominal bonds remains a key focus for decision-makers.

We believe a layered approach makes sense, incorporating real asset exposure and (value-biased) equities.

Henry Cobbe

Elston Consulting



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