

## Inflation is getting stickier

- Inflation may be past the peak but not past the problem
- UK Core inflation has not softened
- Focus on where inflation rate will settle

We have left 2022 behind us – an *annus horribilis* for most investors – and in 2023, we are “Looking for Light”, with the worst of economic, geopolitical and inflation shock behind us. But the risk is that inflation whilst moving past the peak may be getting stickier. This is because of wage-price pressure, reconfigure supply chains and the energy sector (increase energy security/transition to Net Zero) and defence sector (prepare for deglobalisation and a less stable world security).

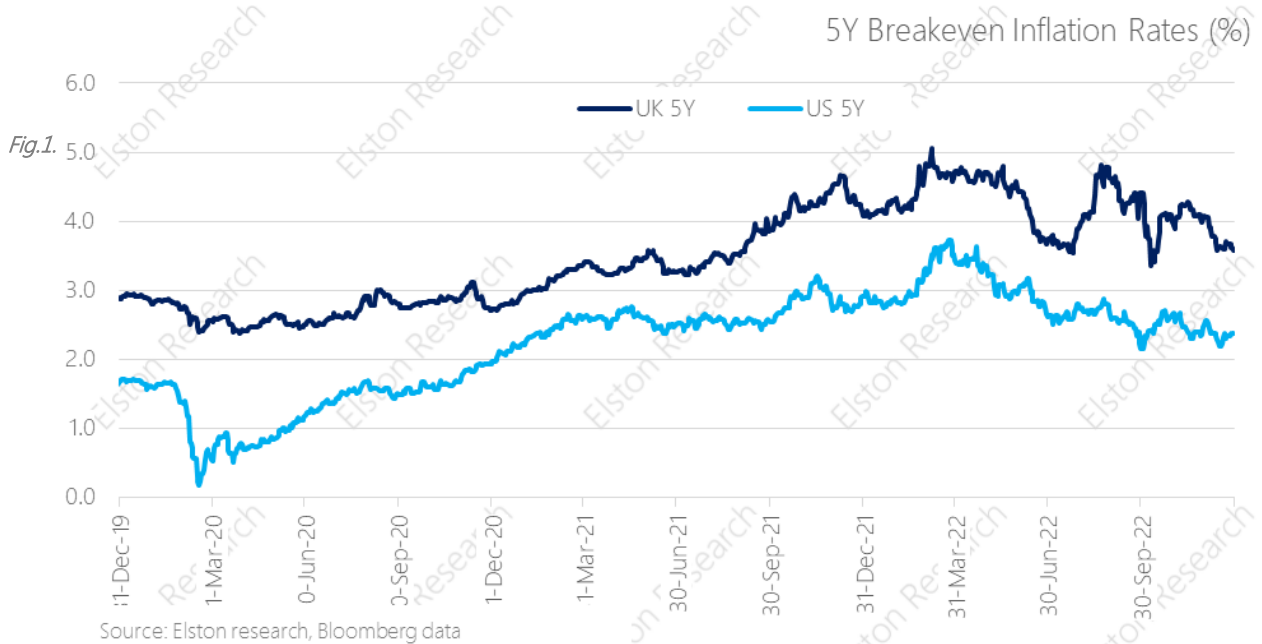
### UK inflation

While the most recent UK inflation print of 10.5% year on year for December 2022 means there have now been two straight months of declines (following an October high of 11.1%), we are nonetheless still looking at a double digit figure. Furthermore, core inflation, which excludes some of the more volatile sectors such as food and energy, has not shifted at all, digging its heels in at 6.3%.

### Comparative impact of a recession

Although the US labour market remains surprisingly tight in spite of a series of significant rate hikes, there are signs at the edges that things may be on the turn. A recent survey based on data from employers diverged significantly from a similar survey based on data from individuals with regards to their work status which showed things flat-lining.

However, should the US enter a recession, in our view it is likely to come out faster, and pass peak inflation quicker, than its European counterparts. This can largely be ascribed to two factors: the relatively strong dollar and internal energy security.



By the same token, should the UK and Europe enter a recession, their relative lack of energy security and the weakness in their respective currencies will likely see a much more prolonged downturn.

In the case of the UK, even when it is well past peak inflation and comfortably back into single digits, the current 5-year break-even rate stands at 4% and UK rolling 5-year inflation could peak closer to 5.6% in 2026, a full three years from now. In other words, this is structural inflation.

Fig.2. UK inflation shock will take time to wash through the system

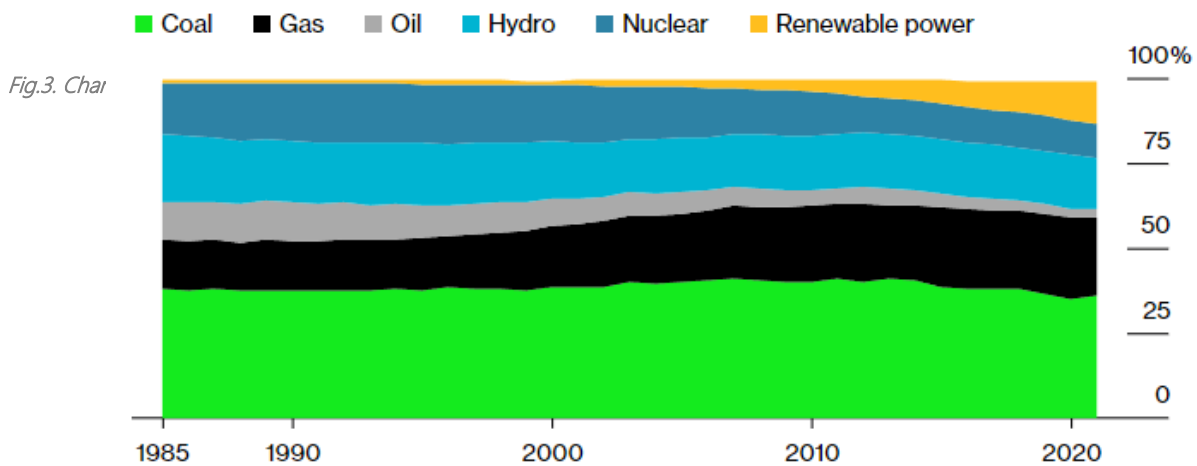


### What is making inflation stickier?

Beyond the base effect, there are three main issues that are likely to keep upwards pressure on inflation:

Firstly, wage-price pressure shows that the inflation base is broadening as evidenced by the core inflation figures.

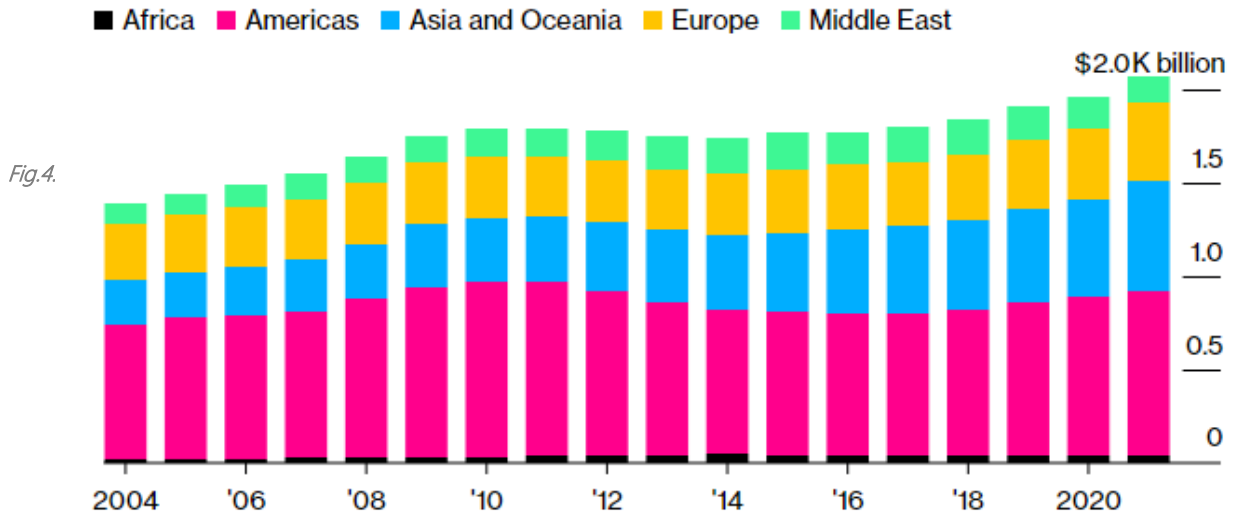
Secondly, the remapping of supply chains, particularly energy supply in Europe, both logistically and from a security perspective, will take time and money. This combined with the transition to Net Zero means transforming the energy mix is a capital-intensive business.



Source: BP Statistical Review of World Energy 2022

Finally, there is an urgent need to reinvest in defence in the context of increased geopolitical risk and a return to a warm cold war. UK and Europe are having to rebuild defence supplies, increasing expenditure and expanding production.

<sup>1</sup> Chart Source: <https://www.bloomberg.com/news/articles/2022-06-30/these-4-charts-show-how-much-global-energy-has-changed-since-2000>



Source: SIPRI

So whilst the move past inflation peak is welcome, inflationary pressure may not subside as quickly as it arose. Investment decision-making should take that into account for the near- to medium-term.

Henry Cobbe, CFA

Head of Research, Elston Consulting

For all our Research & Insights, visit:

<https://www.elstonsolutions.co.uk/insights>

<sup>2</sup> Chart Source: <https://www.bloomberg.com/news/articles/2022-04-24/military-spending-passes-2-trillion-as-europe-boosts-defenses>



## Find out more

For more insights and information on research, portfolios and indices, visit:

[www.elstonsolutions.co.uk](http://www.elstonsolutions.co.uk) or NH ETF<Go>

[www.elstonsolutions.co.uk](http://www.elstonsolutions.co.uk)

## ABOUT ELSTON

We research, design and build investment solutions with and for asset owners, managers and advisers.

Our Research & CPD focuses on multi-asset strategies, index funds and ETFs.

## NOTICES

With reference to the European Union Directive 2014/65/EU on markets in financial instruments ("MiFID II"): this Report does not provide a recommendation for an action, provides information freely available for public consumption and does not therefore constitute "Research" as defined by MiFID II. This is because this report contains purely factual information on one or several financial instruments or issuers and does not explicitly or implicitly recommend or suggest an investment strategy. It does not therefore constitute an investment recommendation as defined within the meaning of Article 3(1)(35) of EU Markets Abuse Regulation ("MAR"), in conjunction with Article 3(1)(34) of MAR. For further information, please refer to ESMA guidance ESMA70-145-111 Version 12.

With reference to the European Union's Market Abuse Regulation (Regulation (EU) 596/2014): we warrant that the information in this report is presented objectively, and the following commercial interests are hereby disclosed: Elston Consulting Limited creates research portfolios and administers indices that may or may not be referenced in this report. If referenced, this is clearly designated and is to raise awareness and provide purely factual information as regards these portfolios and/or indices.

An "Index" is a Regulated Benchmark. An "Index Portfolio" is not a regulated benchmark but a research portfolio of index-tracking investments with a periodic rebalancing scheme.

All company, product and service names and trademarks used in this article are for identification purposes only and are the property of their respective owners, and their usage does not imply endorsement.

This document is not an advertisement or financial promotion. It is provided for informational purposes only and is not intended to be an offer or solicitation, or the basis for any contract to purchase or sell any security or other instrument, or for Elston Consulting Limited to enter into or arrange any type of transaction as a consequence of any information contained herein.

This document is issued by Elston Consulting Limited registered in England & Wales, registration number 07125478, registered office: 1 King William Street, London EC4N 7AF.

© Elston Consulting Limited. All rights reserved No unauthorised reproduction.