Quilter

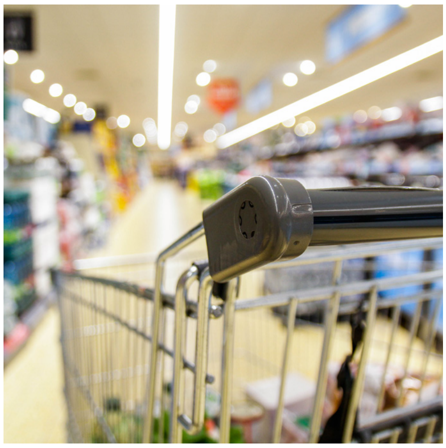
Between the lines

6 March 2023

All investors use insights, trends, and data from across the globe to help them make decisions. Between the lines is an easy way for you to understand how a current topic might be impacting markets and influencing your investments.

Making sense of inflation data

High inflation is the cause of many of the economic challenges being felt around the world, so any change in this data is closely analysed. While there are signs that headline inflation has peaked in several major developed markets, this only tells part of the story.



Behind the headlines

In January, US headline inflation was 6.4% and has been steadily coming down from the multi-decade high of 9.1% recorded in June 2022. Headline inflation, also known as the Consumer Price Index (CPI), is based on the price of a fixed basket of goods. However, this figure does not account for the extreme price fluctuations seen in food and energy items. Therefore, stripping the metric back to core inflation can give a more accurate view of the underlying inflationary picture.

Core inflation, which excludes food and energy items, appears stickier. In the US, the Personal Consumption Expenditure Index, a measure of the spending on goods and services by US consumers, rose by 0.6% in January from the previous month. This means it accelerated from the 0.2% and 0.4% monthly increases seen in November and December. This is a very different direction of travel to the headline figures.

This picture was mirrored in Europe, where headline inflation has also come down, slowing to 10.0% in January, from 10.4% and 11.1% in December and November, respectively. However, core inflation rose from 6.0% in November to 6.3% in January. These numbers have thrown doubt on the previous market narrative of disinflation (a reduction in the rate of inflation), which had a positive impact on markets over the last few months.

Challenges remain in the UK

This context is important when looking at the UK where economic news has been mildly positive. The view from many commentators is that headline inflation, most recently published as 10.1% for January, has peaked, and some investors have become more bullish about the UK as it has, so far, avoided recession. Accordingly, the banking giant, J.P. Morgan, recently raised its projection for UK growth in 2023 to 0.4%, up from 0.1%.

There has also been positive progress on the Brexit front – a frequent source of geopolitical anguish for investors – with the UK and EU making breakthroughs in a new Northern Irish protocol agreement.

However, despite all this good news, core inflation remains high in the UK. This poses a challenge for all central banks, not least for the Bank of England. The task of ensuring a 'soft landing' (raising interest rates enough to lower inflation whilst avoiding recession) is now more complex given the limited impact of previous rate rises. The inflation data, combined with central banker sentiment, suggests they may have to go further to ensure rate rises have the desired impact.

Key takeaways

- The headline inflation figures only tell part of the story.
- In some developed markets, core inflation is still climbing.
- Central bankers may be forced to raise rates further.

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