Cost of Living Rises as Prices Surge

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thomascarroll WEALTH MANAGEMENT

SQUARE MILE INVESTMENT SERVICES

Last week saw UK inflation surging to its highest level for a decade, hitting 4.2% in October. This was both higher than the markets expected and more than twice the Bank of England's (the Bank) target of 2%.

It looks as if soaring energy and fuel prices are pushing up the cost of living, and families were warned of a "painful' rise in the cost of living this winter. The figures also showed sharp rises in inflation across food, hospitality and household goods as supply chain disruption took its toll.

The figures have surprised some market commentators after the Bank of England's decision earlier this month to maintain interest rates at record levels of 0.1%. The Bank, however, needs to be seen to be doing something, as there is a danger that inflation is rising so rapidly that it risks becoming embedded. There is also the issue of The Bank's credibility after the decision to leave interest rates untouched, which wrongfooted the market and led to some questioning their credibility. Although their reasoning for not raising interest rates to date has been due to the labour markets, it is evident after the employment figures that this is no longer in question.

With the sharp fall in unemployment and record levels of vacancies, it is now believed that an interest rate rise next month to curb prices is almost inevitable. The Bank has also recently warned that the Consumer Prices Index (CPI) will reach 4.5% towards the end of this year and around 5% in April 2022. The headlines reflect the fact that these price increases are happening at a time when pay growth is slowing to 3.4% in September, and families are facing the prospect of falling real incomes over the coming months. The City now expects a hike in interest rates and is assuming that they will rise by 0.15% to a headline 0.25%. This increase, however, will not make much of a difference as inflation is being driven by rising petrol, gas and electricity bills, and these prices are not affected by UK interest rates.

Whilst raising interest rates may not stop soaring inflation, it could at least begin to slow it. In reality, it takes about six months for any interest rate rise to start to take effect, so we should not expect much evidence of change for some time to come. Future interest rates are not expected to rise much above 1%, and the impact of higher rates will be felt by household borrowers, but also by a heavily indebted government which has borrowed record levels of money to keep the UK economy afloat through the COVID-19 crisis.

The Bank has to grasp whether this inflation is short-term, driven by short-term supply chain squeezes, or longer term and therefore more aggressive hikes in interest rates will be needed. We should get a clearer picture in the next few months. In the meantime, we will ensure we retain a flexible approach in your portfolios to ensure we can deliver irrespective of what the markets might throw at us.

Andrew, Charles, Chris, Mark and Will
Portfolio Management Team
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