

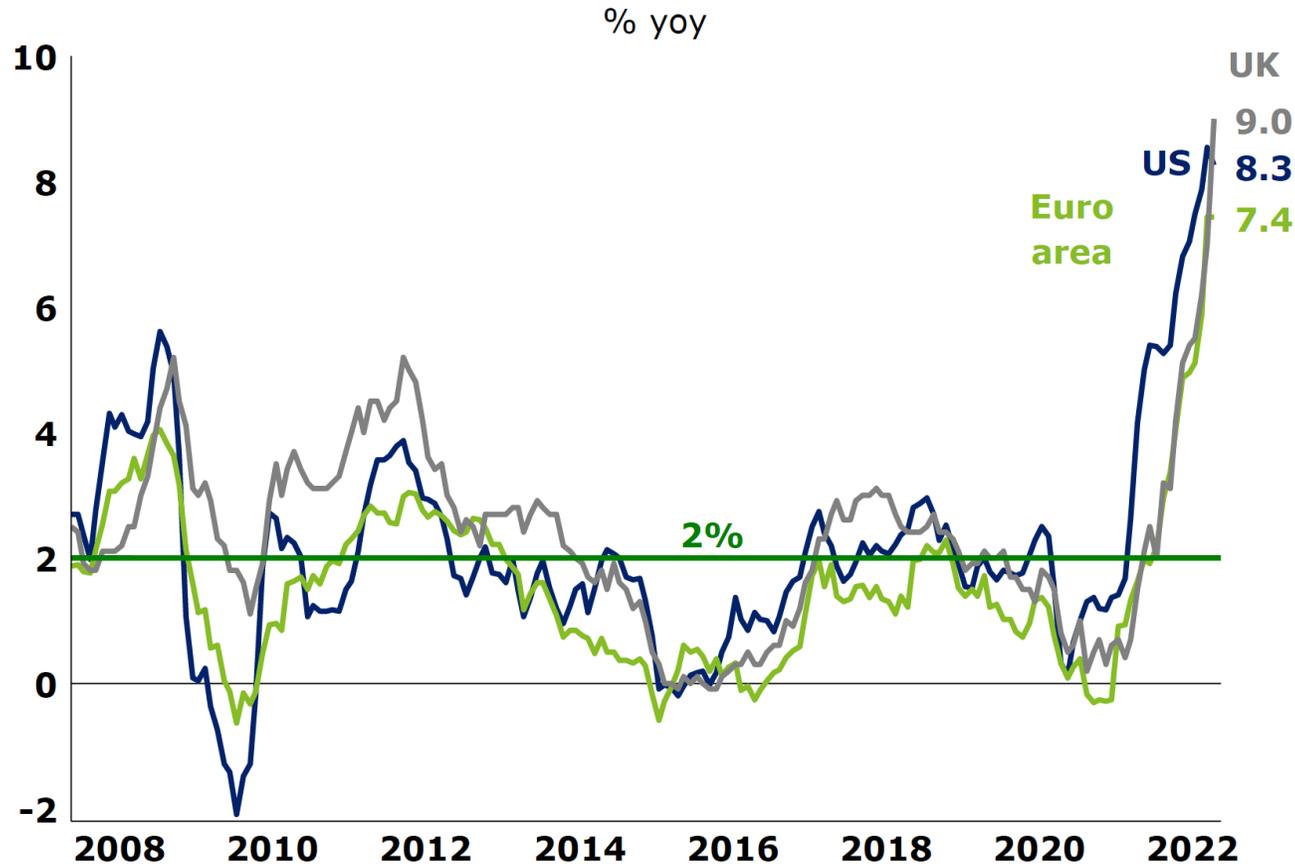


Inflation – what's happening now and what's coming next?

Peter Ireson - Economics and Markets Research, Deloitte UK

Inflation: what's happening now?

Consumer price inflation



Source: Refinitiv Datastream

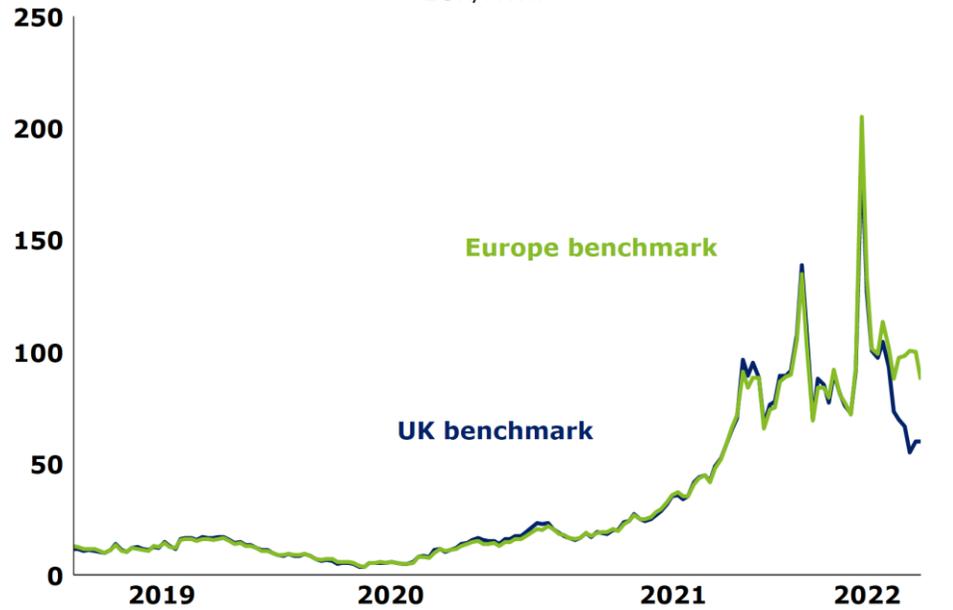
UK CPI: selected items, % change 12m to April

1. Heating oil 114%
2. Electricity and gas 70%
3. Petrol and diesel 31%
4. Second-hand cars 27%
5. Home contents insurance 24%
6. Furniture 16%
7. Oils and fats 15%
8. Air travel 13%

Rising energy and commodity prices

UK and European natural gas prices

EUR/MWh



Source: Refinitiv Datastream

Brent crude

\$/barrel



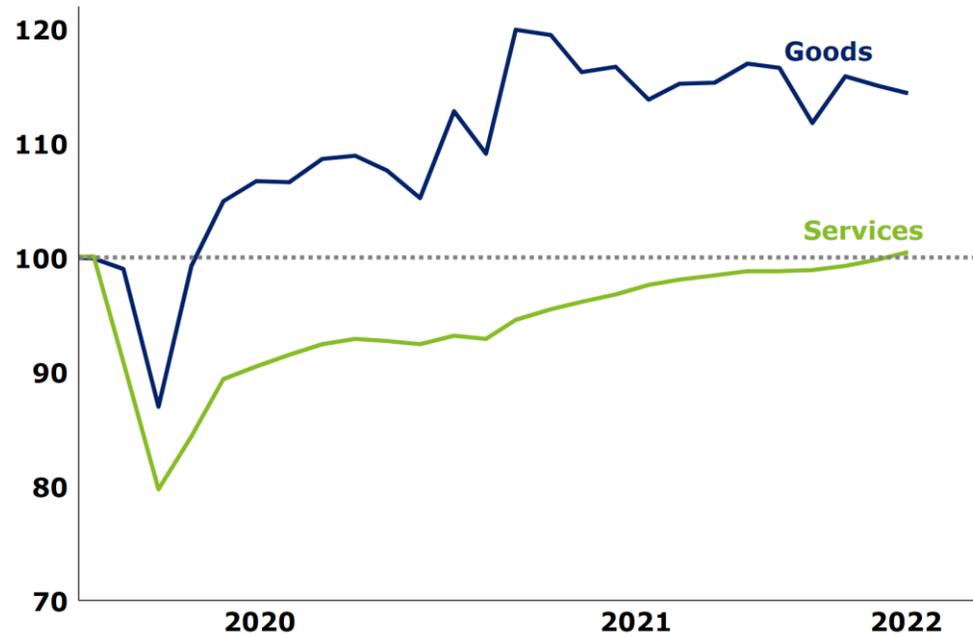
Source: Refinitiv Datastream

Strong demand, limited supply

Pandemic preference for goods

US personal consumption expenditures

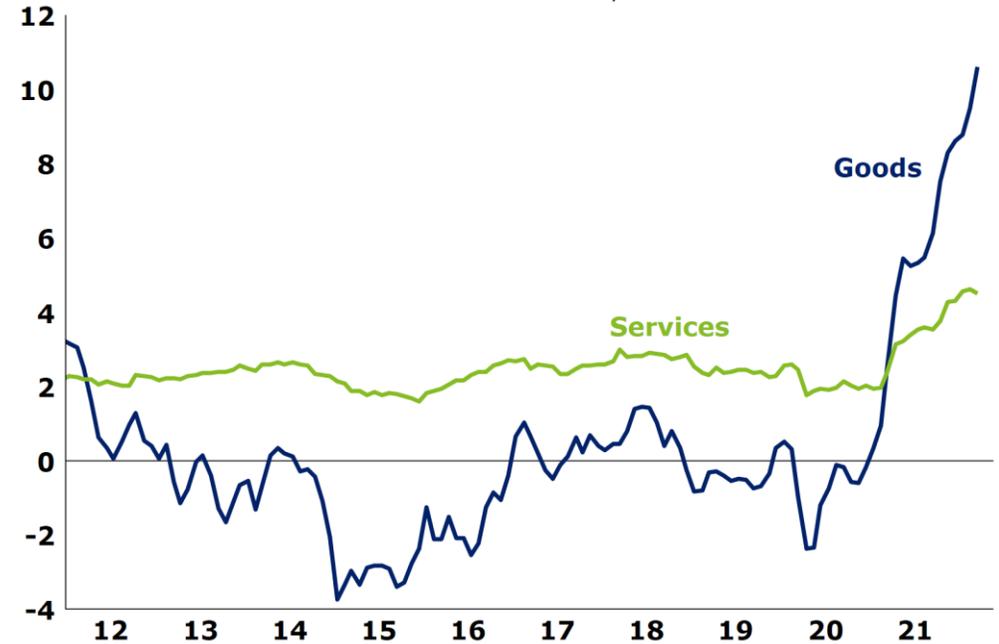
January 2020 = 100



Source: Refinitiv Datastream

US PCE inflation

Goods vs services, %

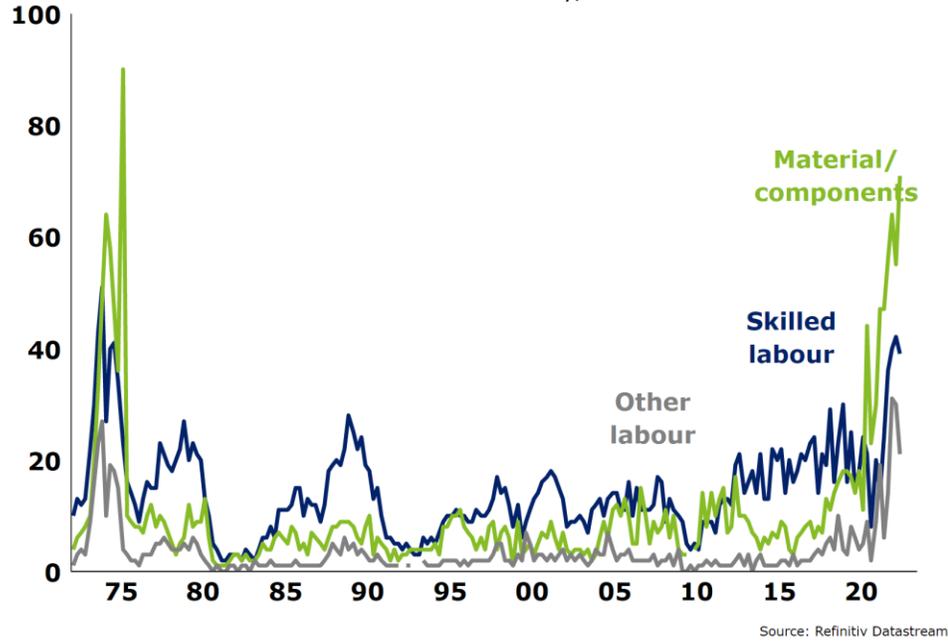


Source: Refinitiv Datastream

Supply chain disruption

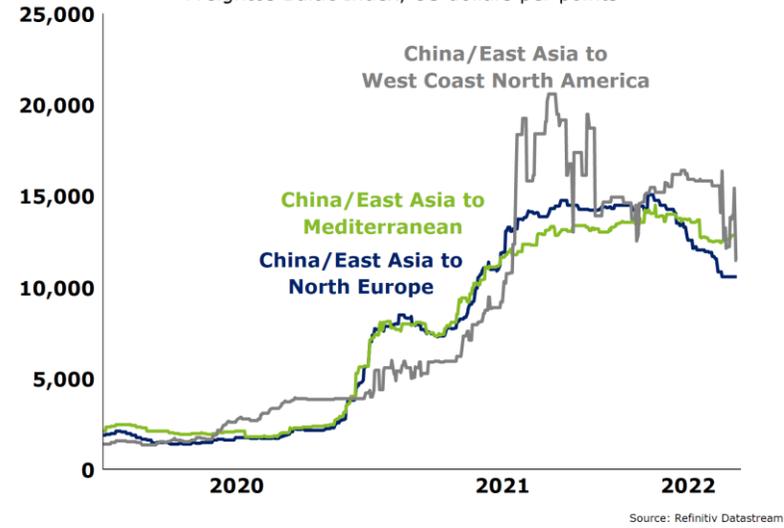
Factors limiting UK industrial output

CBI Industrial Trends Survey, net balance

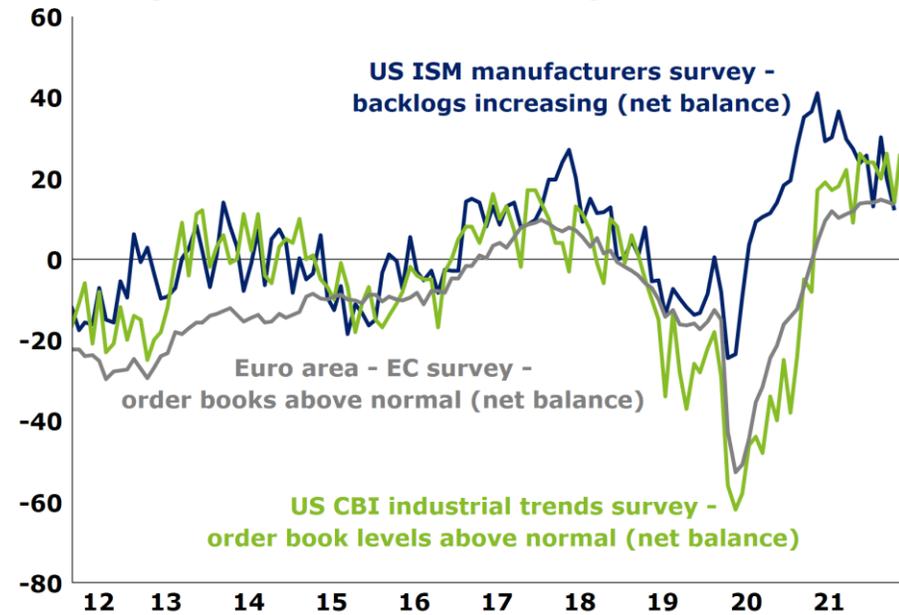


Container freight index

Freightos Baltic Index, US dollars per points



Industry order books and backlogs



What does this mean for consumers and corporates

Consumers cutting back, margins under pressure

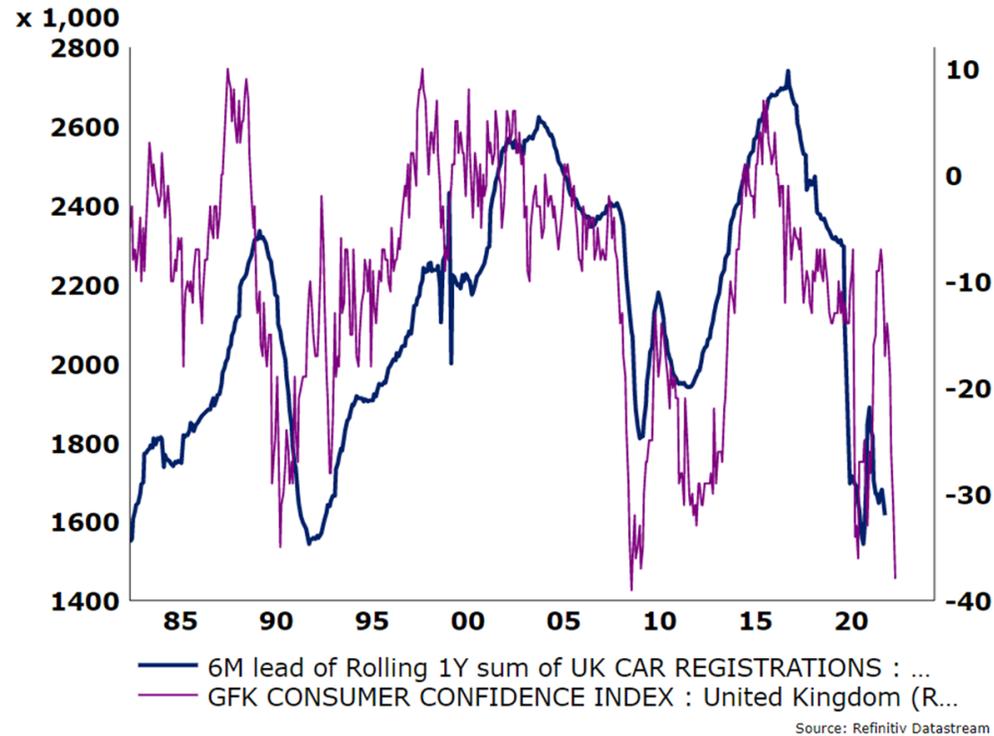
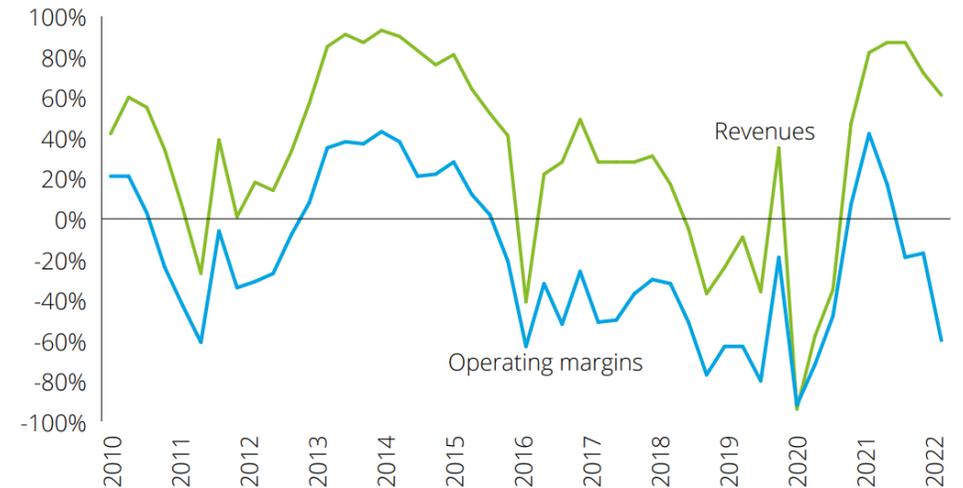


Chart 8. Outlook for revenue and margins

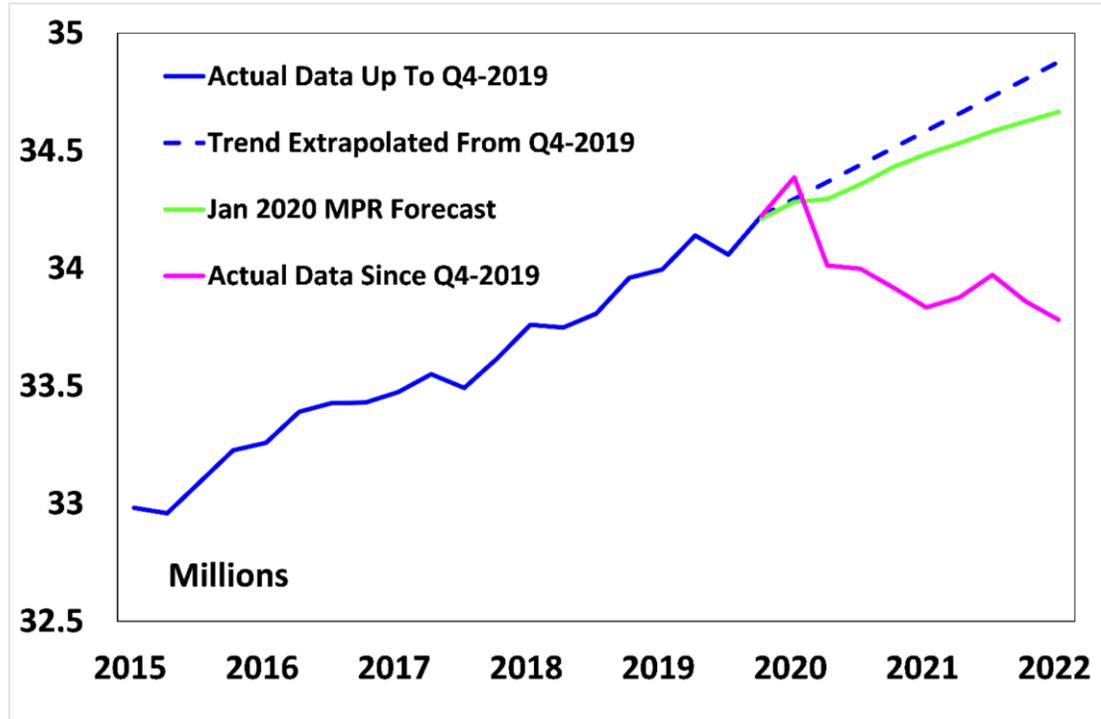
Net % of CFOs who expect UK corporates' revenue and operating margins to rise over the next 12 months



Source: Deloitte CFO Survey Q1 2022

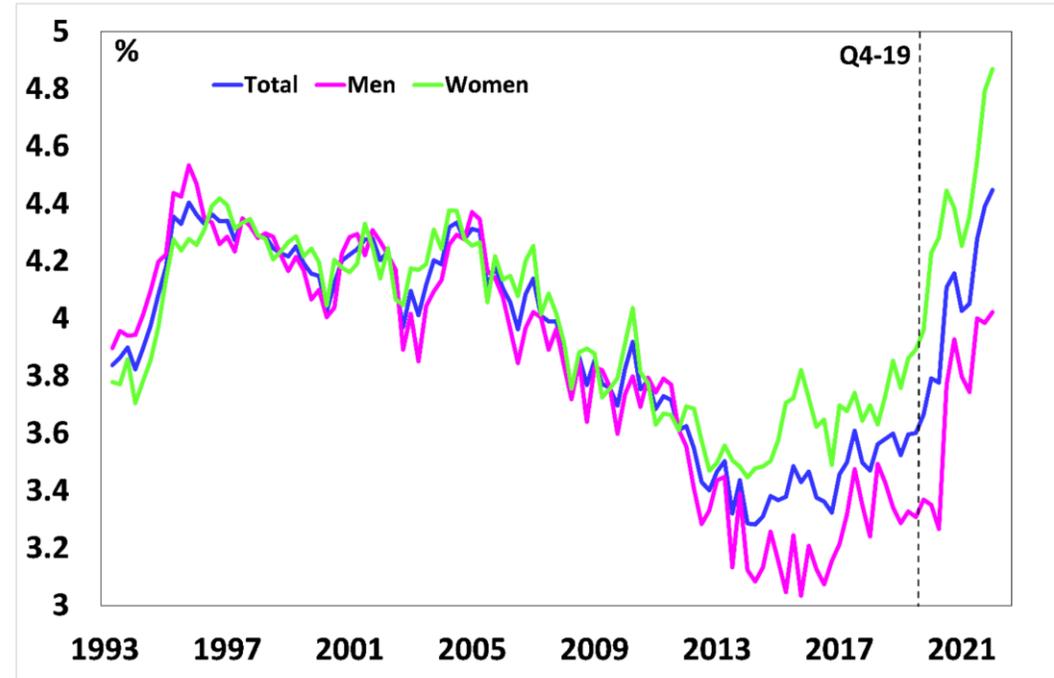
The shrinking labour force

Figure 5. UK – Workforce (Millions of People)



Note: The latest figure is for the three months ended February 2022. Sources: ONS and Bank of England.

Figure 6. UK – Per cent of Adult Population Aged 16-64 Who Are Outside the Workforce and Do Not Want a Job Because of Long-term Sickness



Note: Latest figures are for the three months ended February 2022. Sources: ONS and Bank of England.

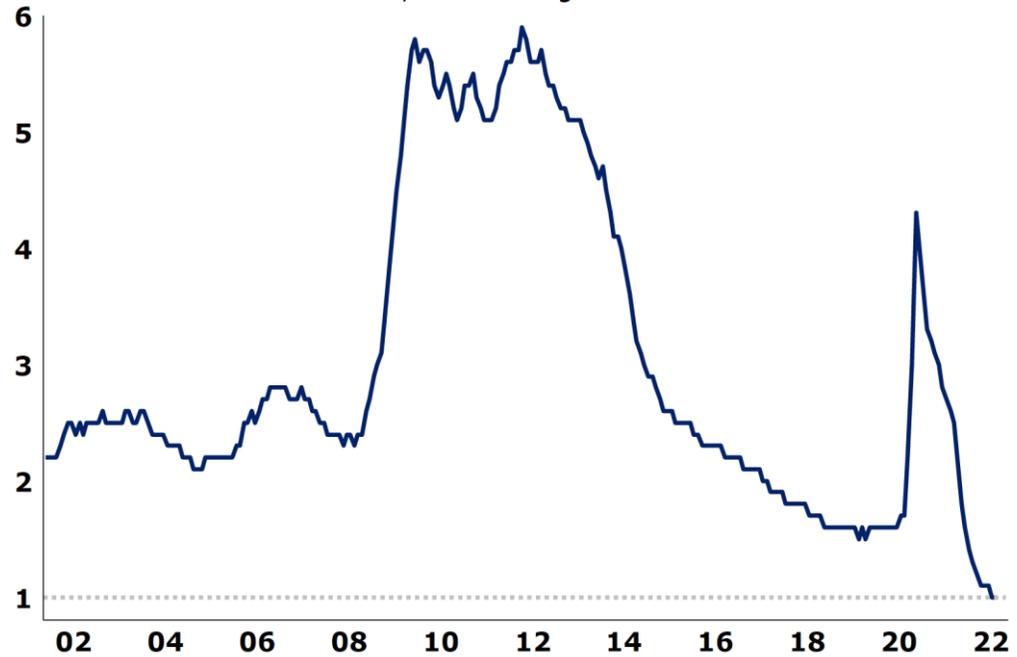
Source: The route back to 2% inflation – speech by Michael Saunders, 9 May 2022

Labour market historically tight

Earnings outpacing inflation

Unemployed people per job vacancy

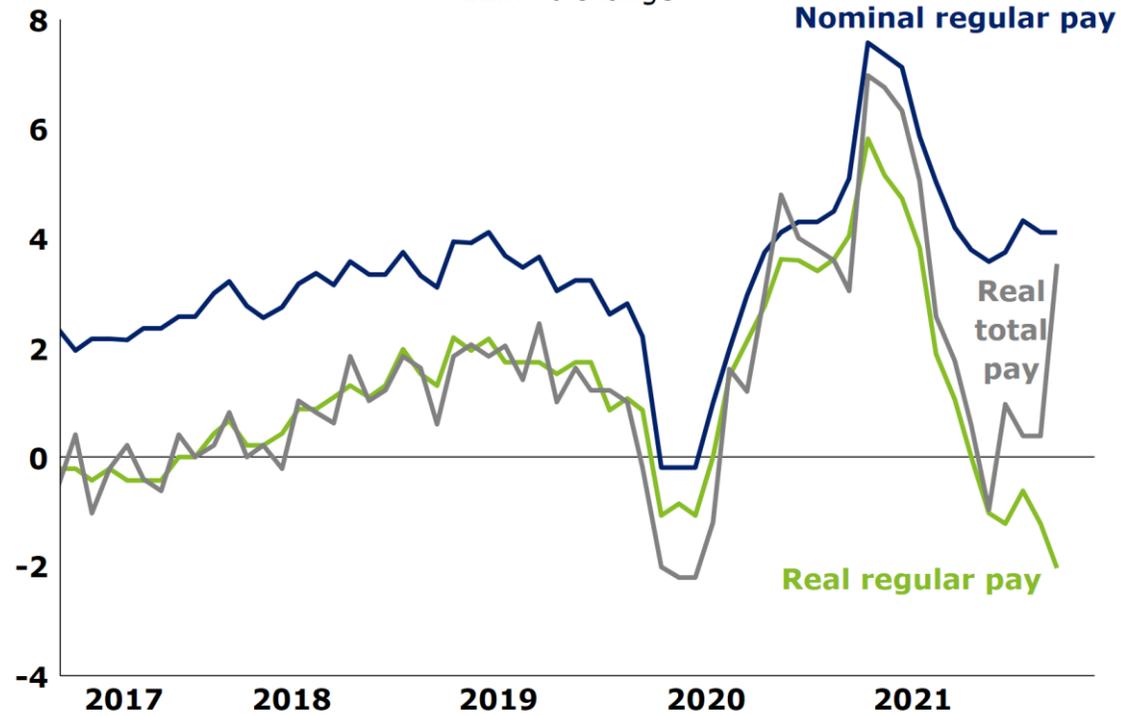
UK, excludes agriculture



Source: Refinitiv Datastream

Growth in UK average weekly earnings

12m % change



Source: Refinitiv Datastream

Inflation expectations becoming unanchored

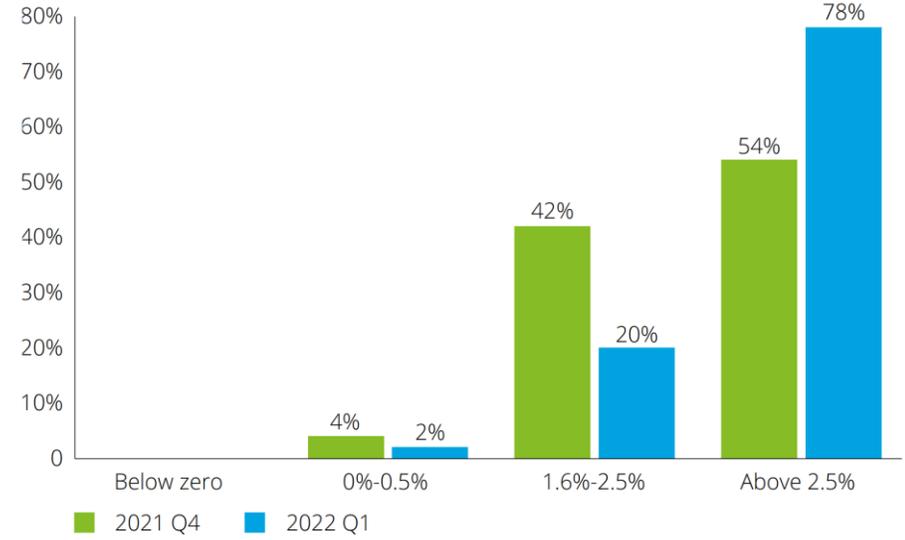
UK public inflation expectations

Citi/Yougov

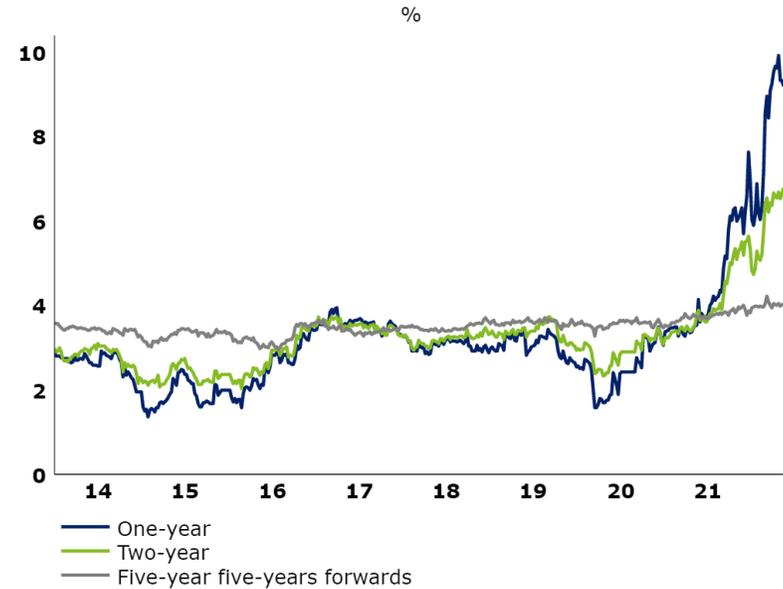


Chart 4. Inflation expectations

% of CFOs who expect inflation to be at the following levels in two-years' time



UK inflation swaps



Interest rates set to rise to levels not seen since before the Global Financial Crisis

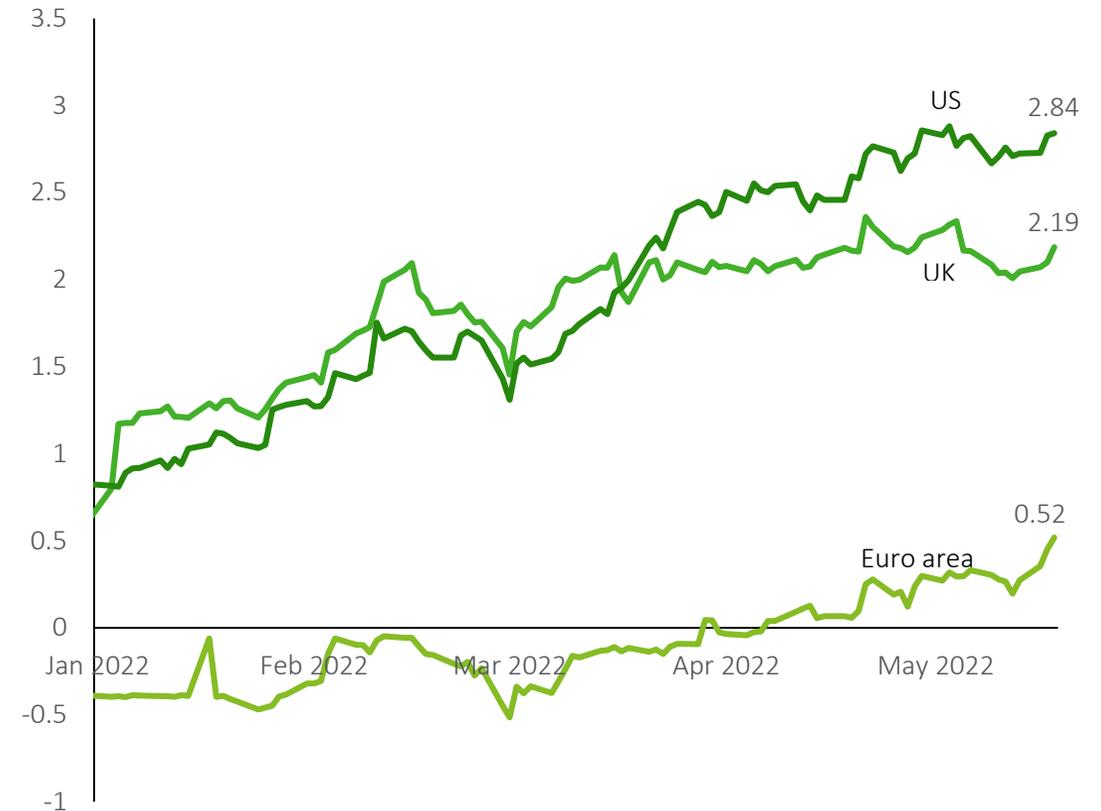
Higher cost of credit is likely to hit struggling companies and weigh on asset valuations

Central Bank	Current policy rate (%)	First rate rise expected*/observed	Market implied interest rate by end 2022 (%)
Bank of England	1%	December 2021	2.22
ECB	-0.5%	June 2022	0.6
Federal Reserve	0.75%-1.00%	March 2022	2.84

Source: Refinitiv Eikon

* Based on Deloitte interpretation of a Refinitiv model of future market expectations of interest rates derived from prices of interest rate swap contracts

Implied market expectations for central bank interest rates at end 2022



Source: Bloomberg; expectations derived from a Bloomberg model of future market expectations of interest rates derived from prices of interest rate swap contracts/fed funds futures

Goldilocks vs the bears: can we avoid a recession?

Everything hinges on inflation dropping sharply in 2023, capping rate hikes at non-recessionary levels

Goldilocks: The temporary shock theory & why inflation should fall sharply in 2023

1. Slowing economy
2. Weaker demand, labour market pressures ease
3. Falling pricing power & real wages
4. Covid, Ukraine, China disruptions fade
5. Base effects: commodities won't carry on rising at breakneck rates

← *Central banks aiming for this*

Result: inflation eases, nasty, but short lived squeeze, resumption of growth through 2023

The bears take over: the embedded inflation theory

1. High inflation feeds into pricing & wages
2. Market, businesses, consumers assume high inflation is here to stay
3. Wage-price spiral
4. Ageing population, deglobalisation boost inflation
5. High inflation is payback for long-term monetary excess

Growing worries we could get this →

Result: central banks hike rates aggressively to crush inflation, pushing the economy into recession



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