

Inflation in the UK after COVID-19

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Abstract. Since January 2020, UK faced a serious epidemic and this COVID had a significant impact on the UK's economy. In order to make the UK's economy recovered, Bank of England set the monetary and fiscal policy and injected many liquidity into the market to stimulate public's buying demand. After around one and a half years, the inflation grew alongside with the UK economy growth and finally the inflation has reached a historical high level over the past few decade. This essay mainly gather the information from different UK's data website, some news website and bank of England's official website to introduce the recent inflation and interest rate in UK, analyze the reasons of nowadays high inflation, presented the central bank's recent policy and discussed the prediction of the future inflation and central bank's policy towards the high inflation. The main findings are that the previous' bank of England's policy during the COVID-19 period and Russia and Ukraine were the mainly causes and reasons for the nowadays' high and continuous inflation. For the prediction, the inflation in UK is forecast to continue increasing in the short period of time (the end of 2022 and the early of 2023) and it will decrease since the start of late 2023 and be back to the normal stage. Bank of England will continue increasing the bank rate to battle the inflation in the short period of time and then stop add bps and gradually make the bank rate back to the normal value.

Keywords: UK economy; COVID-19; inflation; energy.

1. Introduction

Inflation rate is the rate of increase in prices over a given period of time. Since the February 2021, UK inflation continues to rise and till third of November, UK inflation has reached to 11.1% while bank of England's target inflation is 2% [1]. The high inflation has make a big impact on public's daily life such as food prices hike and it also causes some social problem such as unemployment, strike and robbery.

The continuous inflation hikes is caused by several reasons. First of all, the increasing consumer demand. Bank of England uses monetary and fiscal policy to stimulate the economics in order to response the impact the COVID-19 brings. Bank of England cut their bank rate (interest rate) to 0.1% and have the sizeable fiscal expansion and inject many liquidity into the market (the largest fiscal loosening since 1992) to support the economics and irritate the public's purchasing demand. And after almost one and a half years, more liquidity has flowed into the market and the different asset's price had appreciated significantly. Inflation has grown alongside with economic growth. Second, energy price hikes. Oil and gas prices in UK increased as oil and energy are in greater demand when people's life get back to normal in the year of 2021 and there were no lockdown and restriction of going outside by the government [2]. In addition to the high demand of oil and gas, some geopolitical issues and tensions such as Russia and Ukraine war in 2022 also put pressure on the energy price as UK put sanction on Russia and it cannot import oil and gas from Russia.

Recently and on third of November 2022, bank of England has raised its bank rate (interest rate) by 0.75 from 2.25% to 3%. The bank rate has reached historical highest level compared to the bank rate in last three decades (interest rate always around 0%). In total, bank of England has added 290 bps and increased its interest rate from 0.1% to 3%. And bank of England is predicted to still continues to increase its bank rate to again the inflation in the future. The high interest rate also had big effect on both people themselves and different industry' companies. People needed to pay more interest payment when borrowing money and so did the company.

The purpose of the essay is mainly to talk about the current situation of the inflation and interest rate, briefly talk about the unemployment rate recently and the energy price in UK, what kinds of

effect the high inflation put on public's daily life, discuss the reasons of the cause of the high inflation and what boots the inflation continuous increased, analyze the bank of England's policy and make the prediction of interest rate and inflation rate in the future.

2. Inflation

Inflation rate in UK nowadays has reached 11.1% due the September 2022 while the bank of England's expected inflation rate is 2%. It seems that the inflation rate has reached a historical highest level over the past decade. Inflation rate is also related to some index such as CPI, CPIH and Core-CPI. CPI means the consumer prices index and it is a measure of the average change overtime in the prices paid by urban consumers for a market basket of consumer goods and services. Till October 2022, the CPI has risen to 11.1% while it is always around 0 to 2.5 in the past decade. The CPIH means the consumer prices index including owner occupiers' housing costs. The CPIH has hiked to 9.6% in September 2022 from 0.7% in February 2021. The core consumer price index measures the changes in the price of goods and services excluding food and energy. The Core-CPI in UK has increased from 1.4% in February 2021 to 6.42% in September 2022 [3]. There is a big difference between the values of CPI and Core-CPI, which means that food and energy's prices soar play a big role on the UK's inflation growth.

CPIH, OOH component and CPI annual inflation rates for the last 10 years,
UK, September 2012 to September 2022

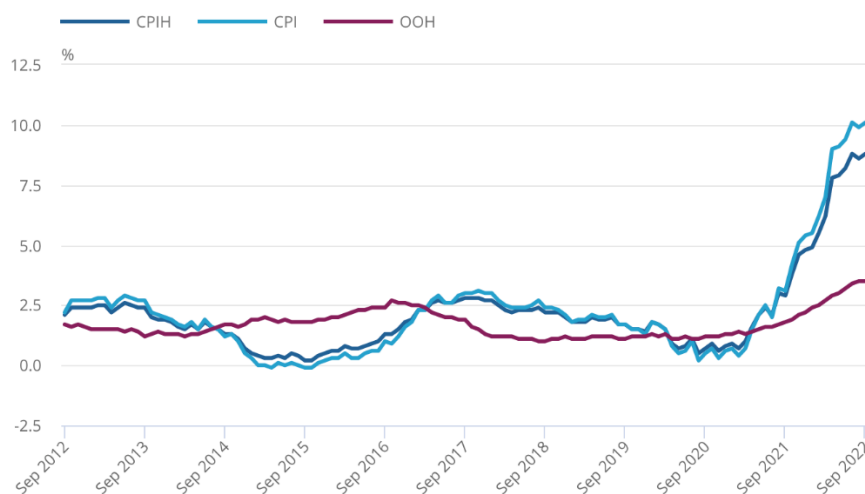


Fig. 1 CPIH, OOH and CPI data [4]

The main causes for the high inflation are mainly the monetary and fiscal stimulation during the covid-19 and the Russia and Ukraine war. During the COVID-19, there is a severe recession occurred. The GDP in UK declined by 9.7% in 2020, which was the largest drop since the consistent records began in 1948 and the unemployment increased from 3.8% in 2019 to 5.4% in 2020. Because of the sudden COVID-19 epidemic and the variants of coronavirus, the number of people infected by covid increased sharply, which finally led the UK government and the devolved administrations to set restrictions to limit transmission of the virus. People seldom went outside as they were afraid of being infected and people's sentiment became quite low. In this situation, Government spend 315 bounds billions to make the package of support for businesses, households and public services and bank of England used its monetary policy to cut their interest rate to 0.1%, used the fiscal policy to make the sizeable fiscal expansion, helped banks to cut interest rates on their lending and helped businesses pay their staff and suppliers to support the economics and irritate the public's purchasing demand [5]. These actions helped the UK's economy to recover from the COVID-19 in some degree but inflation has also grown alongside with the economic growth. In addition, the geopolitical tensions and

reflections such as Russia and Ukraine war added fuel to the flames and also help with the inflation growth [6]. Because of the Russia and Ukraine war and the sanctions that UK settled towards Russia, it was hard for UK to import some energy such as oil and gas from Russia. As UK had limited energy and was lack of oil and gas right now, the energy price in UK increased dramatically. The energy price cap increased by 54% in April 2022, and increased by 80% in October 2022 in UK (with gas increased by 91% and electricity increase by 70%). Besides, the Russia and Ukraine together export nearly a third of the world's wheat and barley, more than 70 percent of its sunflower oil and are big suppliers of corn. Because of the Russia and Ukraine war, the world food prices went up as amount of grain in Russia and Ukraine that export to other countries decreased and this also boost the rise of inflation.

3. Unemployment

Since the appears of covid-19 and inflation become higher and higher, there are many issues and social problem such as unemployment occur. The rising and high inflation lead to the rapid devaluation of banknotes and continuous rise in prices. The economy become unstable and the markets are in high volatility. Market sentiment become quite low and people's buying demand also reduce. For some enterprises that do not have enough capital reserves in times of falling demands of customers, they will either choose fire their staff or cut their employee's salary in order to maintain the company's operation, which causes people lost their job or go bankrupt as they cannot pay for the staff's salaries and operating costs.

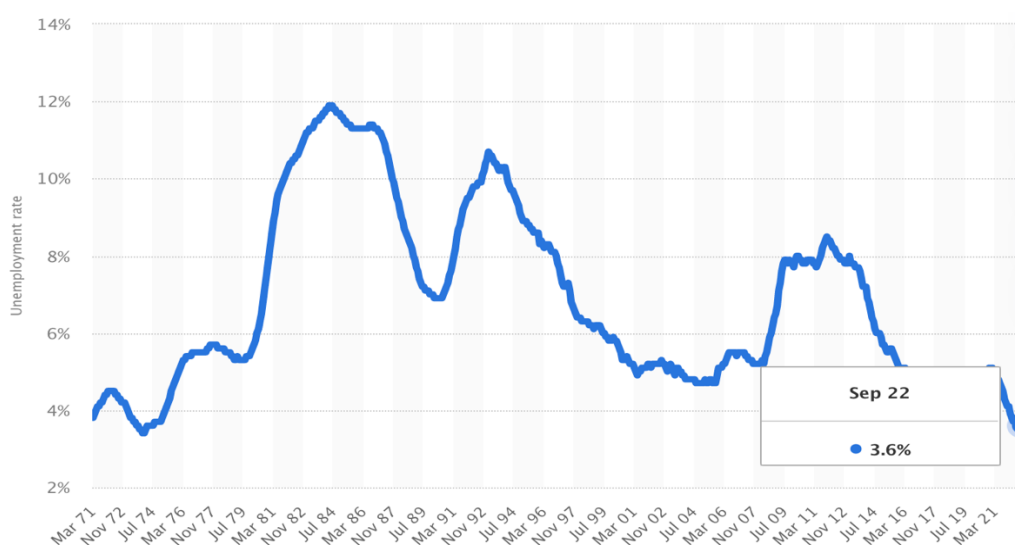


Fig. 2 UK Unemployment data [4]

In past decade, the UK's unemployment rate was always going up and down and fluctuated. It is worth noting that UK's unemployment rate first increased during the early period of covid-19 and then started to decreased since the end of 2020. The unemployment rate rose from 4.0% in February 2020 to 5.2% in November 2020 and it was mainly because the sudden epidemic caused many company stop their operations or close, resulting a large number of temporary layoffs. However, the unemployment rate went down from 5.2% in November 2020 to 3.6% in August 2022. The Britain's unemployment rate has fell to the lowest level since 1947 as the covid-19 made a record level of the number of the long-term sickness and more people dropped out of the workforce [7]. The UK government also help with the unemployed people, for example, In July 2020, the Chancellor announced a new, one-to-one online offer to support those unemployed for less than three months and DWP launched Job Finding Support (JFS) in Great Britain in January 2021, to provide help and support for newly unemployed people, within their first 13 weeks of unemployment.

Although there are a lot of people being layoff and lost their work, as unemployment rate equals to Unemployed divided by Labor Force, since there are many people chose not to find work anymore and there are many unemployed people were help to develop their skills and were help with finding a new job by the UK government, the unemployment rate was declined. In this situation, as some people are fired and choose to stay at home and do not find a job, many social problems occurred and became serious. As people are out of work and cannot get the money for basic living, the number of people that do the robberies has increased. And as some people cannot earn their living and the food price at grocery store increase, the number of Shooting cases continued to increase as they try to express their dissatisfaction about the current social status.

4. Energy

The energy price in UK increased since 2020 winter period and increased dramatically from mid-term of 2021. The energy price is predicted to be more stable in the future year of 2023.



Fig. 3 UK electricity data [8]

Before COVID-19 and from the 2018 to 2020, the energy and crude oil price in UK were kept a steady state (around 67 dollars per barrel for the oil price). And at the start of Covid-19 (January 2020), the crude oil price had a decreasing trend and the lowest point occurred at April 2020 with the 21.44 dollars per barrel of oil price, mainly because many people were isolated and had to stayed at home due to the government policy and the use of transportation and oil decreased. From April 2020 to June 2020, the crude oil went up to 41.02 dollars per barrel and then had a relatively horizontal trend from June 2020 to October 2020.

Since the October 2020, the oil and energy price had an increasing trend and went up from 37.94 dollars per barrel in October 2020 to 122.01 dollars per barrel in June 2022. It was around June 2021 that the crude oil price recovered and returned to the post-covid-19 period's price. What's more, after the mid-term of 2021, the energy price cap increased by 12% in October 2021, 54% in April 2022, and increased by 80% in October 2022 in UK (with gas increased by 91% and electricity increase by 70%) by the UK government as UK were in a environment of lacking of oil and gas. The average bills were £760 in 2021 for the citizens compared to £450 in 2020 with a 36% real increase.



Fig. 4 UK oil price data [9]

There are mainly two reasons that caused the dramatically hike in energy price in UK. Before the Russia and Ukraine war, the energy price went up as the supply of gas did not keep pace with strong demand growth in 2021 as the economies came out of lockdown and people did not have the restriction of going outside. The lack of oil and gas supply led to the increasing energy price and the electricity prices also went up alongside with the gas price hikes as many electricity are produced by burning the fuel such as gas. In addition to this, because of the geopolitical tension and the Russia and Ukraine's war, just on 24 of February, the Europe's gas prices increased by 50% and Asian's gas prices increased by 30%. Due to the sanctions UK set on Russia and the policy of the embargo on Russian oil and the policy of the potential embargo on Russian gas, Russia cut the gas supply to the UK, which made the oil and gas prices in UK rose dramatically. The UK government even asked the public to turn off lights and turn down the thermostats in order to save the energy and electricity as the UK government was worried about the energy shortage in UK 2022's winter period. Furthermore, the lower hydroelectric output also helped with energy and electricity price hike. Trough in parts of Europe have led to lower hydroelectric output and there were a large number of French nuclear reactors were closed in the late summer 2022.

5. Response

In order to keep the inflation on a stable level, the UK government sets the inflation target of 2% as if the inflation is too high like right now, it is hard for the company to set the right prices and for the customers to plan their earnings and spending [10]. So in this high inflation environment, bank of England mainly did one thing towards the inflation. In order to make sure inflation can come down to the original target rate (2%), bank of England mainly set the UK's key interest rate--Bank rate to fight against the inflation. Up now, bank of England has already rise eight times rate hikes with one time 15bps, four times 25 bps and two times 50 bps and one time 75 bps. It raised its bank rate (interest rate) from 0.1% in December of 2021 to 3% in November 2022. It is to be considered the historically high interest rate environment over the past decade as the interest rate was around zero percent in the past decade. Through making the interest rates become higher, it is more expensive for people to borrow money [11]. So people prefer to save their money and people spend less on the goods and services. As people's purchasing demand decline and the goods and services' prices will tend to rise more slowly and this can lower the inflation rate.

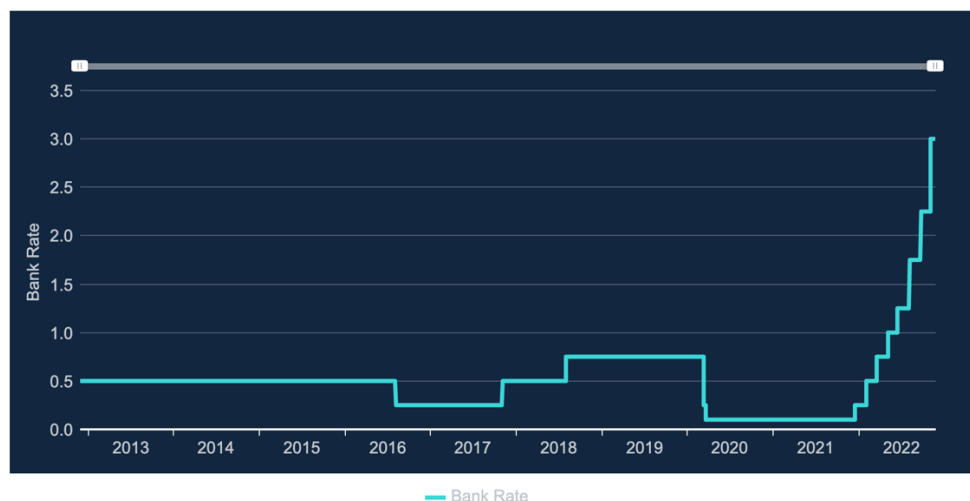


Fig. 5 UK bank rate data [12]

However, even though the bank of England has raised its interest rate to battle the inflation, the inflation has still continuously to go up and the high interest rate also have some influence on people's daily life and have some impact on different industries. For those people have the loans, it is more expensive for them to pay for the interest payments [13]. People may prefer to save their money rather than spend their money in this high interest rate environment. Because of this, the demand of buying goods decrease and the economy in UK will also grow slowly. And when people spend less on buying goods, it will affect many customer-consuming company such as clothing industry. As a result of people spending less on purchasing the companies' product, those companies' revenue decrease. In order to maintain the companies' operation, the companies may layoff some of their staffs or financial restructuring or cut part of their staff's salaries, which put much finance press on both company and the employees. For the company that borrowing money from bank, they also need to pay for more interest payment as the interest rate gradually increased from 0.1% to 3% and the cost debt financing reached the historical high level over the past decade. For the bank industry, as the interest rate increases significantly, bank can receive more earning from its original debt deal but its recently debt financing deal would be reduced as most of the company prefer to use the equity financing rather than debt financing in this high interest rate environment.

6. Conclusion

Due to the inflation continuously going up in UK from the 2% expected level to 11.1% recently, the inflation in UK is forecast to continue increasing in the short period of time probably from the end of 2022 to the early stage of 2023. Since after the several united states fed funds rate hikes, the United States inflation has decreased from 9.1% June to 7.7 % in October, it can be predicted that after the continuously bank rate hikes, the UK's inflation will finally start to decrease and the decline may starts from the mid-term of 2023 and gradually be back to the previous expected level in the later year 2024.

Since the UK's inflation recently is quite high and there is no decline trend, the bank of England will continue increasing the bank rate to battle the inflation in the short period of time according to the inflation rate. After that the center bank in UK will then stop add bps when the inflation decreases significantly and has the trend of being back to the expected level (2%). Finally, the bank of England will gradually make the bank rate back to the normal value and keep the UK economy growth.

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