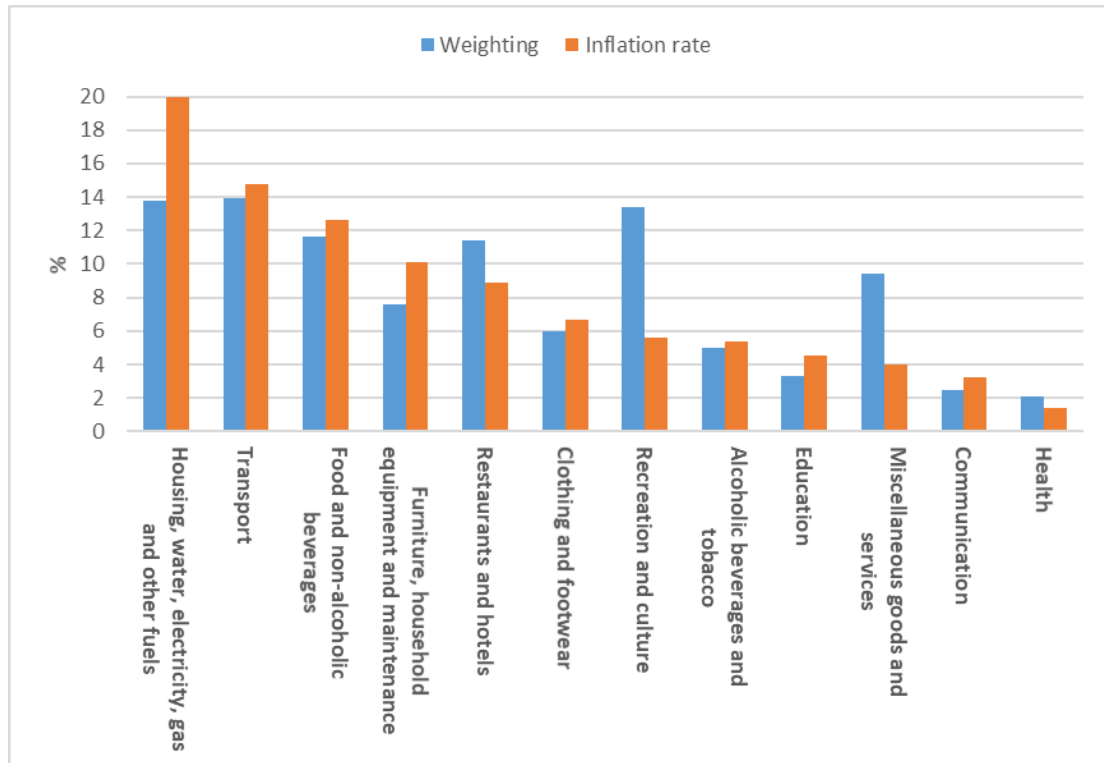


A January 2023 inflation peak?

Synopsis: Citi has forecast that CPI inflation will peak at 18.4% in January 2023.

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Source: ONS July 2022 data

On Monday, Citigroup announced that its latest calculations suggest inflation will peak at 18.4% in January, over 5% above the Bank of England's forecast earlier this month of 'just over 13%' in the final quarter of 2022.

Is this the Old Lady once again behind the curve?

The answer is not that easy...

- The Bank of England figures were published on 4 August, so would have used late July data. Since then, forward gas and electricity prices have surged. Last week alone they rose by 25% and 7% respectively. On Monday, European gas prices for September delivery rose over another 18%.
- The higher forward gas and electricity prices will have virtually no effect on Ofgem's October-December price cap, due to be revealed as a Bank Holiday spoiler on Friday. The expectation for this has settled at around £3,500, the figure the Bank quoted earlier this month.
- However, the recent higher figures do feed through to calculations for the January-March 2023 price cap. The Bank assumed in its baseline case that global commodity prices would not rise further after a Q4 2022 peak, which

allowed it to project inflation would fall to 9.5% by Q3 2023. In contrast, Citi calculates that the January 2023 cap will be £4,567, rising to £5,816 in April. The current (April-September 2022) cap is £1,971.

- Base issues come into play here. The switch by Ofgem from a half-yearly cap adjustment to a quarterly review means that there are three price increases in the January 2022-January 2023 period (April 2022, October 2022 and January 2023). That implies, using Citi numbers, the period will cover the cap moving from £1,277 (October 2021 – March 2022) to £4,567 (January – March 2023) – a 258% increase. Come April 2023, the annual move is from £1,971 (April – September 2022) to £5,816 (April – June 2023) – a mere 194% rise. Hence the impact of the cap should reduce next April, despite higher prices. For the record, the July 2022 annual increase in the electricity, gas and miscellaneous fuels category was 69.1%.
- As the graph shows, the Housing, water, electricity, gas and other fuels division of the CPI has a weighting of 13.8%. Of this 3.5% - about a quarter – is the electricity, gas and miscellaneous fuels category. That may seem almost infinitesimal, but in the Citi inflation calculation it contributes over 9% to annual CPI on its own ($0.035 \times 258\% = 9.03\%$). Strip out the household energy category from the July 2022 CPI number and inflation from the rest of the economy is still running at 7.7%.

Comment

These inflation numbers are both horrendous and credible. They are also a good reason why any emergency Budget ought to include some Office for Budget Responsibility (OBR) modelling.

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