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Why Is The Inflation Being Experienced By The U.K. Proving To Be More 'Sticky' Than Expected?

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Inflation *refers to an appreciable and consistent rise in prices. '****Sticky Inflation****' relates towages and consumer prices that don't respond quickly to changes in demand and supply factors.* Itmeansexactlywhatitsoundslikesticky pricesdon'tadjustassoonastheyshouldaccording to the laws of supply and demand. Price stickiness would occur, for instance, if the price of a once-in-demand smartphone remains high at, say $800 even when demand drops significantly. It is important to understand price stickiness, which implies that goods and services do not respond to the laws of demand and supply and the tendency of prices to remain constant or to adjustslowly despite changes in demand and supply factors.

SeveralfactorsarecollidingtocreateStickyInflation.

Sticky Inflation is mainly caused due to rising wages and consumer goods and services prices. Prices for medical services, education, and housing are some of the most important factors that can contribute to sticky inflation. -- Because if the prices of these basic goods increase, the cost of living increases. For example, before the COVID-19 pandemic, rent prices tended to change slowly and infrequently, but as restrictions eased and housing demand picked up, landlords raised rent prices significantly in 2022 and 2023. (Diongson,2023)

One important reason for price stickiness is ***menu costs,*** which refer to the expenses associated with updating prices and marketing materials for commodities. ***Imperfect information or irrational decision-making by executives*** can also contribute to price stickiness. Additionally, some companies may choose to maintain constant prices as part of their business strategy despiteit needing to be more sustainable based on material and labor costs. ***Price stickiness can alsoarise in situations involving long-term contracts***, as a company may be bound to the agreed-upon price for the duration of the contract, even if external factors such as tax increases orchanges in production costs occur.

At the macro level, policy factors and structural changes in the global economy are likely to trigger Sticky Inflation, namely ***Green energy policies, an Unrelenting war in Ukraine that is exacerbating supply chains strained since COVID, and a shift to deglobalization.***

Green energy policies, like the 2030 Agenda for Sustainable Development, coupled with a globally-problematic ESG framework, have effectively reduced investment in and the production of, fossil fuel-based energy sources. The near-term effect of these policies is reduced energy supply, which is driving higher energy prices and the overall inflation rate.

Higher energy prices are a kill shot for food production. Diesel and gasoline price inflation drives higher input (fertilizer, seed, etc.) and production costs for farmers, food processors and transportation services. *These higher costs translate into higher prices for the end consumer.* Green policies, seen in nations worldwide, also limit the use of synthetic fertilizers.

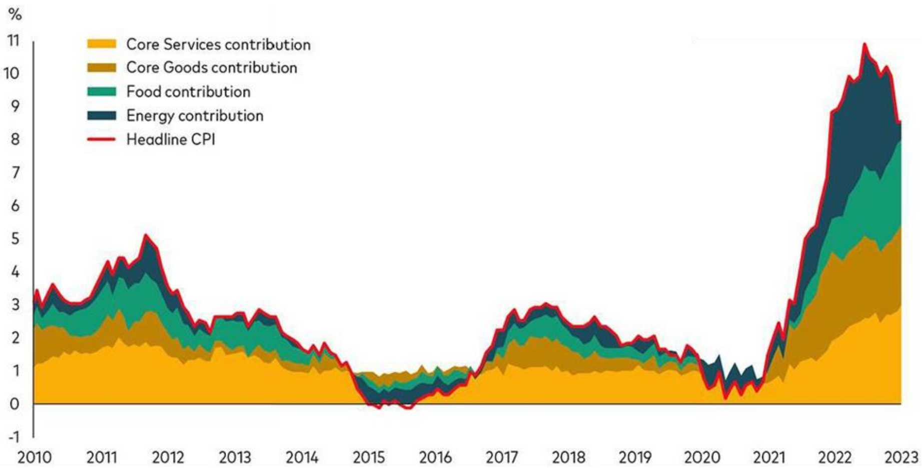
Rising energy costs can have a ripple effect across the supply chain, driving up prices foressential goods and services, including food and other frequently consumed items. Despite a recent dip in spot prices for certain types of fuels due to concerns of a global economicslowdown, prices for transportation, such as airline tickets and fees, and many food products and services may not decrease or do so as rapidly as oil prices.((Lovell,2020)

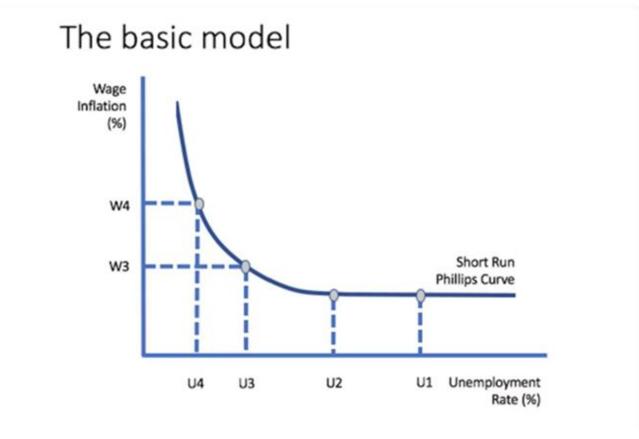
Russia'sinvasionofUkrainehasexacerbatedsupplyissuesforenergy,minerals,andfood. The war in Ukraine caused price spikes in global grain markets and disrupted Europe's energy supply. Russia supplied coal, natural gas, and enriched uranium to Europe. The war'sconsequences include concerns about energy costs, food shortages, and potential civil unrest. It may also cause starvation and mass migration in Africa and the Middle East.

The COVID-19 pandemic exposed the weaknesses of the global supply chain and logistics models while the geopolitical rift caused by Russia's invasion of Ukraine led to talk of a "new world order". This growing divide in global commercial relationships may lead to deglobalization, resulting in higher prices and inflation. Additionally, shelter costs have risen considerably since the pandemic, contributing to sticky inflation..

Another key factorpushing up prices in the U.K. is a labor shortage. Few European Union workers are available post-Brexit, and many British workers of prime age have taken early retirement or are off sick because preexisting ailments went untreated by the overburdened, state-runnationalhealthcaresystemduringthepandemic.(beard,23).*Labourshortagewillimply thatthere isexcessdemandforlabor,andtheprice oflaborwillrise, causingfurtherincreases in commodity prices. The higher demand for labor has put upward pressure on wages.* The U.K. has been hit harder by this labor shortage than many comparable economies. "The U.K. laborforce is still below its pre-pandemic level, while in the U.S., the labor force is above its pre- pandemic level," said Ashley Webb of the Capital Economics consulting firm. "Wage growth is stillmuchhigher intheU.K.thanintheU.S.,contributing tohigherinflation,"Webbpointed out. *The Bank of England has warned that inflation could be prolonged in the United Kingdom because of a curious — and in Europe, an almost uniquely British — problem:**The U.K.'s workforce has shrunk**. Unlike in other major European economies, the number of people of working age in the U.K.who don't havea job and are notlooking for oneis larger than beforethe pandemic. One of the major reasons may be early retirement.(Beard,2023)*

Thus as indicated in the chart below : UK inflation can be explained almost equally by its four main components



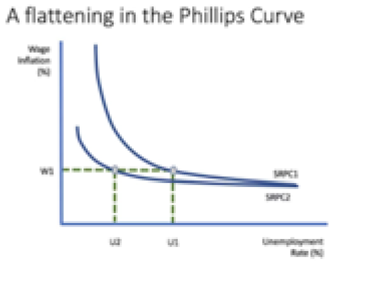


The inflation that has ripped through the developed world — pushing up energy and commodity prices — is international in origin, stemming from the COVID-19 pandemic and the war in Ukraine.Butnoteverycountry hasbeenequally affected.WhilethelatestheadlineinflationrateintheUnitedStateswas4%yearoveryear,ithasclockedinatasignificatlyh igher 8.7%inthe

United Kingdom. Inflation has been falling generally, but it is not falling as fast in the U.K. as expected.U.K. inflation is proving "sticky." *(Beard,2023)*

Theeconomicperspective

TheoriginalPhillipsCurvesuggestedthatonceunemploymentfallsbelowtheestimatedequilibrium (or natural) rate, we can expect to see an acceleration in wage inflation feeding through to higher consumer prices. Low unemployment might bring higher inflation, implying a trade-off between two important macroeconomic objectives.



The so-called Phillips Curve, which assumes a relationship between unemployment, wages and inflation, seems to have broken down. The US has also seen the relationship between labour demand and wages weaken.
Ian Stewart, Deloitte Monday Briefing, April 2018

However, the recent data for the UK suggests that the standard Phillips Curve model has changed.

TheunemploymentrateinBritainiscurrently at4.3%ofthelabourforce,thelowestithasbeenfor over40years.Unemploymenthasmorethanhalvedsincetheendof thelastrecessionyettheannual growth of wages (measured in nominal terms) has been fairly stable or around 2%(Tutor2u)

After analyzing the data and trends, it is evident that the UK inflation rate has shown significant fluctuations over the past few years. Factors such as changes in oil prices, exchange rates, and government policies have played a crucial role in influencing inflation. It is important for policymakers and businesses to closely monitor these factors to make infomed decisions. As the UK economy evolves, understanding and managing inflation will remain a key priority. By keeping a close eye on these trends, the country can work towards ensuring stability and sustainable economic growth.(UK inflation rate Inflation rate and consumer price index,2023)

It is important to create a competitive environment in key sectors like energy and housing to reduce inflationary pressures. Improving productivity and efficiency in different industries can also help control cost-push inflation. To build trust and understanding, it's crucial to maintain open communication with stakeholders and the public about inflation and related policies. Thistransparencycanhelpmanage uncertainty andalignexpectations.Amulti-facetedapproachthatcombinestargetedfiscalpolicies,monetarymeasures,andstructuralreformsisnecessaryforeffectively managinginflation in theUK.By takingproactiveandwell-calibratedsteps,thecountrycanstriveforasustainablebalancebetweeneconomicgrowthandpricestability.

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