Ulster Bank

Inflation: a tale of two economies

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What goes up must come down? This straight-forward principle has certainly held true for property values on the island of Ireland, both north and south, with soaring prices up to mid-2007 in both jurisdictions followed by comparable sharp declines since. When it comes to consumer price inflation (CPI) however, simple rules across the island do not apply, and a look beneath the surface tells a tale of two quite different economies.

Outside of Eastern Europe, the UK has experienced the largest cumulative rise in consumer prices within the EU since August 2007. Conversely, Ireland has become the poster child of low inflation within the EU 27.

In the 62 months since the credit crunch officially began *(August 2007),* consumer prices in the UK *(there are no specific Northern Ireland figures available)* have risen cumulatively by 18.6%. This has been a direct consequence of the Bank of England's monetary policy. Namely, *'Bank Rate' (benchmark interest rate)* has been kept at 0.5% since March 2009 and £375bn of asset purchases *(Quantitative Easing or 'QE')* have been made. These measures have weakened sterling and pushed up imported inflation, particularly food and energy. As a result, UK household incomes, and by extension consumer spending, have been squeezed as inflation has outpaced the cumulative rise in average earnings. The latter have risen by less than 11% over the last five years. Indeed, had the Monetary Policy Committee *(MPC)* hit its 2% target consistently since August 2007, the cumulative rise in CPI would have been just over 10%.

Since the credit crunch began Ireland's consumer prices have increased by just 3% cumulatively which is less one sixth of the increase for the UK. However, this is not simply a currency phenomenon with the relative strength of the euro easing inflationary pressures. Indeed, Ireland's counterparts in the eurozone periphery have experienced double-digit inflation *(cumulatively)* - Portugal *(+10.5%)*, Spain *(+13.8%)* and Greece *(17.6%)* - with the eurozone as a whole posting a total rise in consumer prices of almost 12% since August 2007.

The divergence in inflationary trends between the UK, Ireland and the eurozone is even starker when it comes to Food and Non-alcoholic drink inflation. Food price inflation has been a global phenomenon in recent years. However, some parts of the world have experienced much sharper rises in consumer prices than others. Since August 2007, the UK has witnessed a cumulative rise in food and non-alcoholic prices of 31%. By comparison, the Republic of Ireland has seen its prices rise by just 0.4%. Again even within the eurozone context the Republic of Ireland is an outlier with Portugal *(+6.3%)*, Spain *(+9.8%)* and Greece *(13.3%)* all experiencing significantly higher rates of food price rises over the last five or so years.

This is perhaps one key factor explaining why the Irish population has been much more passive with austerity relative to many of its eurozone peers. In particular, Spain and Greece are implementing austerity policies within a context of inflationary pressures. Ireland on the other hand is not. Therefore the Republic of Ireland's title of being the poster child of austerity owes much to it being the poster child of low inflation within the EU. Having a bubble in consumer prices, that has now largely burst, has provided something of an austerity painkiller for the Irish economy. Conversely, Spain and Greece have not been fortunate enough to have such medicine at their disposal.

Meanwhile, the perception within the UK is that its austerity policies are causing untold damage on the economy. The reality, however, is somewhat different. The bulk of the UK's austerity is yet to come. Outside of the construction sector, the pain that the UK economy is currently feeling is largely due to consumer spending, or the lack of it. In turn, this is linked to inflation.

Low inflation, however, is not all good news for the Republic of Ireland. Clearly, the debt legacy will take much longer to be eroded with low rates of inflation. The UK and Ireland are following two totally different inflationary paths each of which help and hinder individuals in different ways.

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