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In the UK, inflation is our enemy

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Regular readers of Tacit Thoughts will know that we have an almost obsessive focus on real returns: returns after adjusting for inflation. The reason for this is that our clients live in the real world where maintaining (or growing) their purchasing power is most important over any meaningful time frame.

Something that astounds us is that most commentators do not discuss how inflation has affected the UK since the turn of the century and therefore focus on the wrong issues in our view. Real growth, growth after adjusting for inflation, is as important for the economy as it is for your investments.

Over the past quarter-century, the interplay between inflation and per capita GDP in the UK has shaped the economic landscape, with periods of growth, crisis, and recovery marking the journey. Using per capita GDP is a cleaner metric than gross GDP since it accounts for changes in population and is implicitly a measure of productivity growth.

Since the late 1990s, the UK has experienced fluctuating inflation, averaging around 2.8% from 1989 to 2025, but with notable spikes and troughs. Most recently, inflation surged to 11.1% in October 2022, driven by global energy shocks, Covid19 and aggressive policy responses. These inflationary pressures have had complex effects on living standards and real GDP per capita.

In the years following the late 1990s, the UK economy enjoyed steady growth, with GDP rising consistently until the global financial crisis of 2008. That crisis, followed by the Great Recession, led to a sharp slowdown in growth: annual GDP growth averaged 3% between 1993 and 2007 but dropped to 1.5% between 2009 and 2023. Inflation during this period was generally subdued, but the economic downturn eroded per capita GDP and thus real incomes. The pandemic in 2020 caused another shock, with GDP per capita falling sharply before rebounding in 2021 and 2023.

Inflation’s impact on GDP is not always direct. High inflation, as seen during the recent cost-of-living crisis, reduces household purchasing power and can slow economic growth if it leads to higher interest rates and lower consumer spending. However, moderate inflation can accompany robust growth, as seen in the mid-2000s. The most recent data show UK GDP per capita at £37,590 in 2023, reflecting recovery from pandemic

lows, but real gains have been uneven.

Persistent inflation above the Bank of England's 2% target, as seen in 2022 and 2023, has squeezed household budgets, particularly through higher energy and utility bills, which have become significant drivers of inflation since 2022. This has constrained real disposable income and, by extension, per capita GDP growth. While nominal GDP has increased, inflation-adjusted gains have been modest, and the long-term trend in real per capita GDP growth has slowed compared to pre-2008 levels.

In summary, while the UK's per capita GDP has grown over the last 25 years, inflation has periodically undermined living standards and real economic progress. The relationship is complex: moderate inflation can coexist with growth, but sharp or sustained price rises, especially in essentials, erode purchasing power and dampen per capita GDP growth.

The challenge for policymakers remains balancing price stability with sustainable economic expansion. Inflation should really be the focus as it erodes our purchasing power, but it gets very little airtime!

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