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Economic review

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The return of inflation

Post-pandemic price surges and policy responses

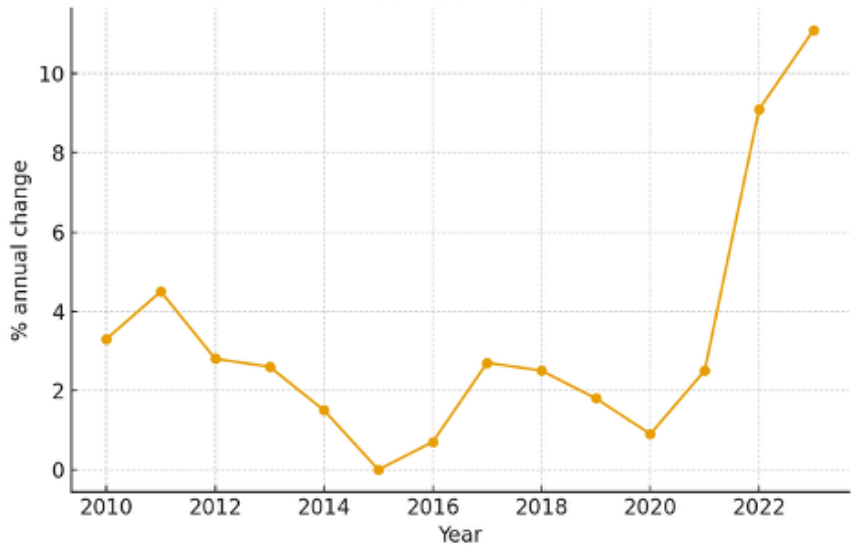
In this article, **Hannah Holmes** explores how inflation surged after the Covid-19 pandemic, why prices rose so sharply in the UK and globally, and how policymakers responded. The story shows how economic theory connects directly to recent events that have shaped households' daily lives

For much of the 2010s, inflation looked like yesterday's worry. In the UK, annual consumer price index (CPI) inflation averaged just 1.8% between 2010 and 2019. The Bank of England often undershot its 2% target. Students learning about 'inflationary spirals' might have assumed this was a historical relic, like the oil shocks of the 1970s or the hyperinflation of Weimar Germany.

That assumption ended abruptly in October 2022, when UK inflation reached 11.1%, the highest rate in over four decades. Food prices rose at double-digit rates; household energy bills doubled; mortgages jumped as interest rates followed. The headlines spoke of a cost-of-living crisis.

The UK was not alone. Inflation surged across advanced economies, hitting 9.1% in the USA in June 2022 and over 10% in the eurozone later that year. This was a global shock, but one with distinctive national twists.

Figure 1 shows the UK's story: a decade of low, stable inflation, followed by a dramatic surge after 2021.



Source: ONS

Figure 1 UK CPI inflation, 2010–2023

Why prices took off

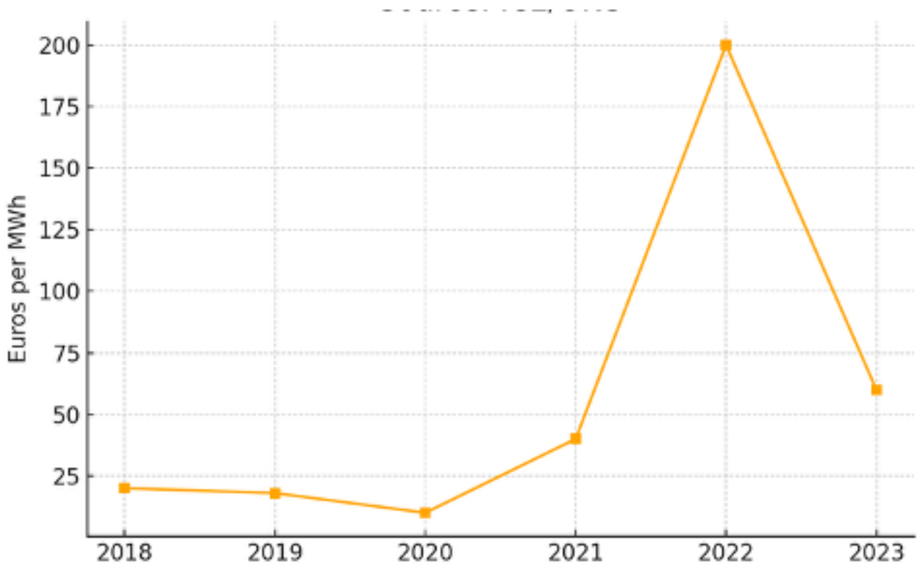
Economists distinguish between two broad types of inflation: demand-pull, when spending power outpaces supply, and cost-push, when production costs rise and firms pass these on to consumers. The inflation of the early 2020s combined both.

During the pandemic, households built up savings as opportunities to spend shrank. When restrictions lifted, pent-up demand flooded back into travel, hospitality and consumer goods. Governments had pumped billions into supporting incomes, from furlough schemes in the UK to stimulus cheques in the USA. This was classic demand-pull inflation: aggregate demand surged.

But supply could not keep up. Ports, factories and shipping routes were still disrupted, as explored in the supply chain article. Global freight costs multiplied. Labour shortages added pressure. This was cost-push inflation: supply constraints pushed the aggregate supply curve left just as demand surged right.

Then came the war in Ukraine. Russia's invasion in February 2022 sent global energy and food markets into turmoil. Europe's reliance on Russian gas left it exposed. Even though the UK imported relatively little Russian energy, it was caught by soaring wholesale prices across Europe. Global grain markets were disrupted too, as Ukraine, a major wheat exporter, faced blockades.

Figure 2 shows the extraordinary spike in European natural gas prices, which drove much of the UK's inflation surge.



Source: ICE/ONS

Figure 2: European natural gas prices, 2018–2023

The UK's cost-of-living crisis

The inflation spike hit households hard. The Ofgem energy price cap, which limits how much suppliers can charge households per unit of energy, rose from around £1,000 per year in 2021 to over £2,500 in 2022, and would have reached £3,500 without government subsidies.

Food price inflation reached 17% in early 2023, the steepest in decades. Essentials such as bread, milk and pasta rose fastest. For poorer households, who spend a greater share of income on food and energy, the effective inflation rate was higher than the headline average.

Real wages fell as pay increases lagged behind prices. This marked the biggest squeeze in living standards since records began. Strikes spread across transport, education, health and postal services, as workers sought to protect real incomes. The politics of inflation were as sharp as the economics.

Global comparisons

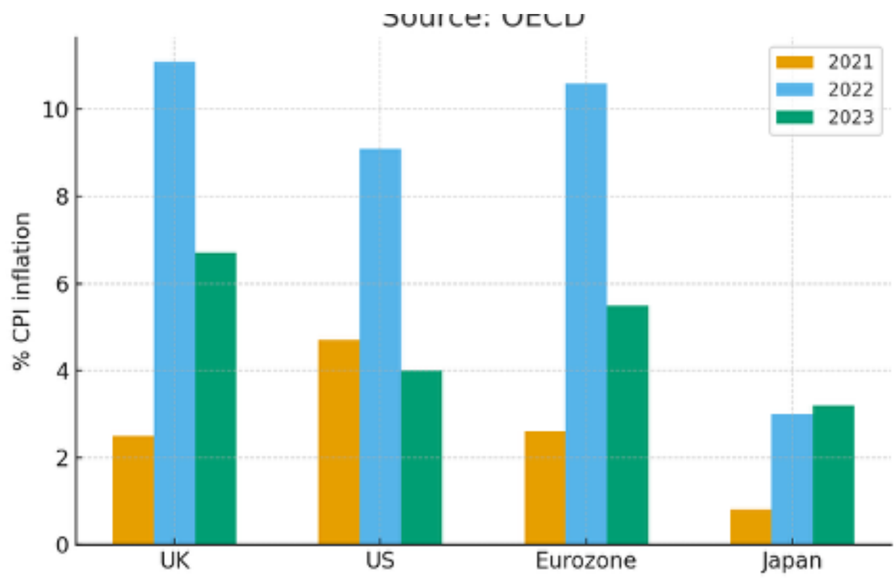
While the UK faced one of the sharpest spikes, inflation was global.

- USA: Demand-pull effects were especially strong, fuelled by large-scale fiscal stimulus. Inflation peaked at 9.1% in mid-2022. The Federal Reserve responded with rapid interest rate hikes.

- Eurozone: Reliance on Russian gas made the eurozone especially vulnerable to energy shocks. Inflation reached double digits in late 2022.

- Emerging economies: Food inflation was critical. In countries where staples make up a larger share of diets, the rise in grain prices pushed millions closer to poverty.

Figure 3 compares inflation rates across advanced economies, showing the global surge but also national differences.



Source: OECD

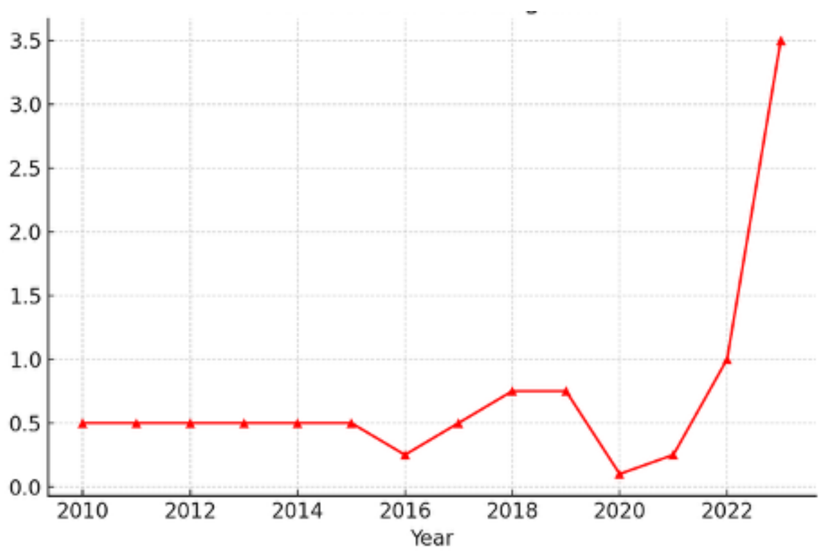
Figure 3: CPI inflation in selected advanced economies, 2021–2023

Central banks fight back

Once inflation surged, central banks turned to their main tool: monetary policy.

The Bank of England raised its base rate from 0.1% in December 2021 to 5.25% by mid-2023, the fastest tightening in decades. The US Federal Reserve raised rates even more aggressively, while the European Central Bank ended years of negative rates.

Figure 4 shows the Bank of England's sharp rate rises after years of near-zero interest.



Source: Bank of England

Figure 4: Bank of England base rate, 2010–2023

The aim was to cool demand, ease price pressures and, crucially, anchor expectations. Inflation is as much about psychology as economics: if workers expect high inflation, they demand higher wages; if firms expect costs to rise, they raise prices in advance. By acting decisively, central banks sought to break the cycle before a wage–price spiral set in.

But higher interest rates also hit households with mortgages and firms reliant on borrowing. Balancing inflation control with economic growth was a difficult trade-off.

Policy debates and trade-offs

Inflation exposed tensions between monetary and fiscal policy. While the Bank of England raised rates to restrain demand, the UK government also stepped in with subsidies to cap household energy bills. That fiscal support limited hardship but risked prolonging inflationary pressures.

The September 2022 ‘mini-budget’ crisis illustrated another tension. Markets reacted badly to unfunded tax cuts at a time of high inflation, fearing they would add demand and debt just as the Bank was trying to cool the economy. Bond yields soared, pension funds wobbled, and the government was forced into a rapid U-turn.

This episode underscored a key point: in high-inflation environments, governments must consider how fiscal policy interacts with monetary tightening. Central banks may control interest rates, but fiscal credibility matters too.

Winners and losers

Inflation reshapes the economy unevenly. Borrowers with fixed-rate loans can benefit as repayments shrink in real terms. Savers lose if interest on deposits lags behind inflation. Asset holders may gain if property and stock prices rise nominally, though higher rates often cool asset markets.

Governments gain in one sense: inflation erodes the real value of debt. But with higher interest rates, the cost of servicing that debt also rises. In the UK, debt interest payments hit record highs in 2022–23.

For households, the impact was starkest at the lower end of the income distribution. Rising food and energy costs are regressive: they hit poorer families harder, because essentials take up a bigger share of budgets. This is why the cost-of-living crisis became not just an economic issue but a deeply political one.

A historical echo

The surge of the early 2020s revived memories of the 1970s, when oil shocks pushed inflation above 20% in the UK and growth stagnated. Then, as now, global energy shocks played a central role.

But there are differences. Trade unions are weaker today, making a wage–price spiral less likely. Central banks are independent and moved more quickly than in the 1970s. Globalisation and technology also still act as disinflationary forces, even if they were temporarily overwhelmed by supply shocks.

The comparison is still instructive: it shows that inflation can return suddenly after long dormancy, and that regaining stability requires both decisive policy and public confidence.

Looking ahead: temporary surge or new era?

By late 2023, inflation was falling in many countries. Energy prices eased, supply chains recovered, and demand cooled under higher rates. Some argued inflation would return to the low levels of the 2010s.

But others saw structural reasons to expect higher inflation in the years ahead:

- Deglobalisation: Shorter, more resilient supply chains may raise costs.
- Demographics: Ageing populations could tighten labour markets and raise wages.
- Climate transition: Shifting to green energy requires huge investment and may keep energy costs high.
- Geopolitics: Conflicts and energy security concerns could trigger new shocks.

For the UK, vulnerability to imported energy, weak productivity growth and Brexit-related frictions mean inflationary pressures may be harder to contain.

Conclusion

The return of inflation after decades of stability reshaped economic debates. It reminded households and policymakers alike that price stability cannot be taken for granted.

For students of economics, the inflation surge offers a vivid case study of theory meeting reality. The AD curve shifting right, the SRAS curve shifting left, and the policy dilemmas of interest rates versus growth are not just diagrams, they are explanations for the lived experience of 2021–23.

Inflation may fall back, but the shock of its return will shape policy for years to come. The defining question of the 2020s may be not just how to generate growth, but how to share it fairly when prices rise faster than pay.

Hannah Holmes is Dean of the Business School at Manchester Metropolitan University and a member of the Economic Review Editorial Board.

Key points

- UK inflation peaked at 11.1% in October 2022, the highest in 41 years.
- Causes combined demand-pull (post-pandemic rebound) and cost-push (supply shocks, Ukraine war).
- The cost-of-living crisis hit poorer households hardest, as food and energy dominated budgets.
- Central banks raised interest rates aggressively to curb inflation and anchor expectations.
- The long-term outlook is uncertain: inflation may fade, or structural pressures may keep it elevated.

Specification links

Economic policy objectives (inflation); monetary policy