

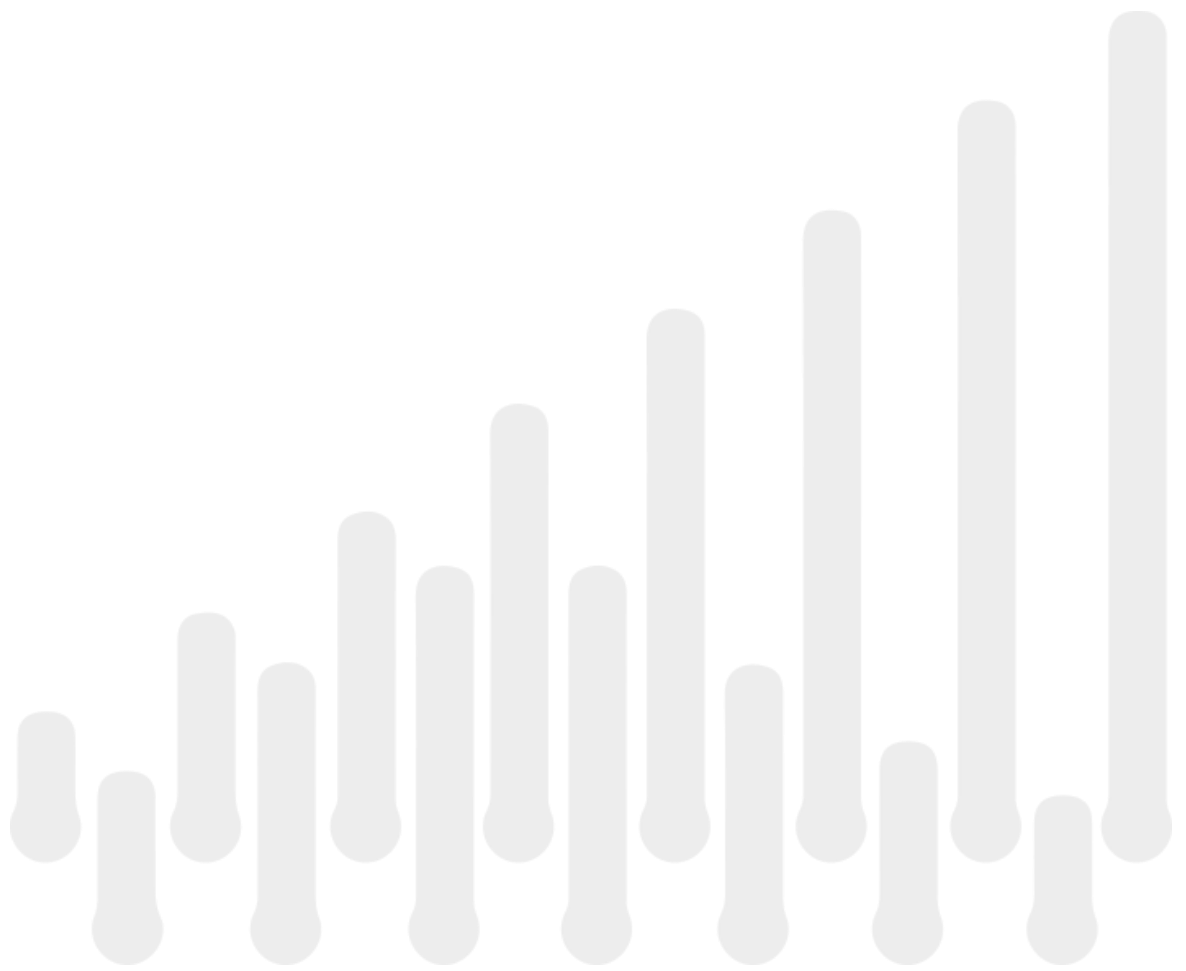
NIESR

Monthly CPI Tracker

Underlying inflation cautions against panic

Janine Boshoff

September 2021



Main points

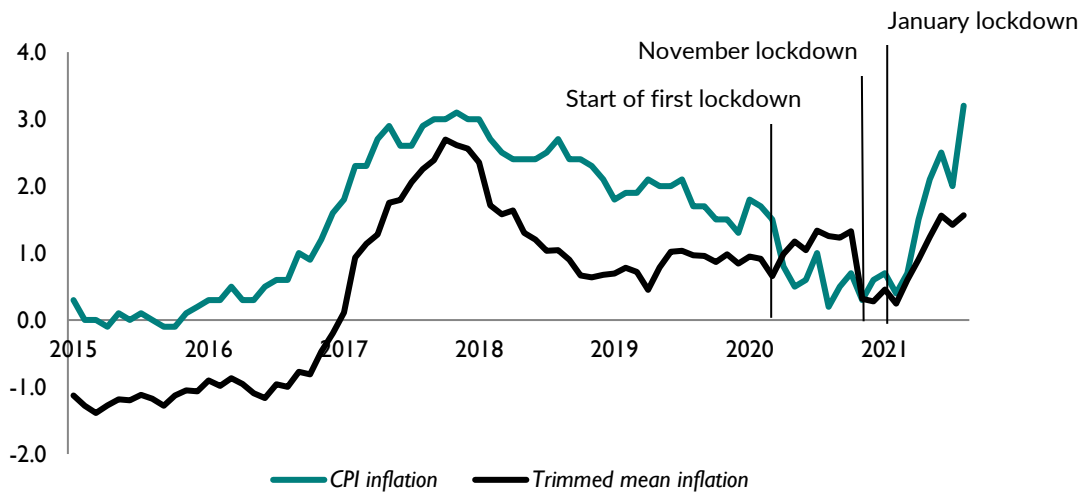
- While the headline consumer inflation increased by a large margin, from 2 per cent in July 2021 to 3.2 per cent in August, the rise in underlying inflation was more limited. Our measure of underlying inflation as measured by the trimmed mean, which excludes 5 per cent of the highest and lowest price changes increased to 1.6 per cent in August from 1.4 in July (figure 1), cautioning against panic regarding the surge in headline inflation number recorded in August 2021.
- As expected, base effects had a notable upward effect in August and will continue to add volatility to the annual headline inflation figure in the short term. [NIESR calculations](#) predicted the upward pressure in the August numbers, and we believe that September headline inflation will decrease due to base effects in September 2020.
- The most imminent transitory factor boosting consumer inflation numbers in the short-term is related to first scheduled reversal of the 2020 VAT cut in October 2021. Thereafter, the increase in OFGEM household energy price-cap scheduled for November 2021 will likely provide further impetus to consumer prices.
- 18 per cent of goods and services prices changed in August, implying an average duration of prices of 5.6 months. 3.7 per cent of prices were reduced due to sales, 4 per cent fell for other reasons and 10.4 per cent recorded increases (figure 2).
- Our measure of underlying inflation increased in most regions of the UK. Underlying inflation in London decreased to 2.7 per cent in August, down from 3.9 per cent in July. Scotland saw the lowest regional trimmed mean inflation of 1.1 per cent in August (table 1).
- [Shortages in intermediate inputs and ongoing disruption in supply chains](#) have filtered through to consumer goods prices, while labour shortages and the associated [increase in wages](#) could also feed through to headline inflation in the coming months.
- [We expect headline inflation to remain elevated](#) in the year to August 2022 and the Bank of England must now provide clear guidance on the inflation outlook and the likely path of policy rates and [asset purchases](#) to prevent a possible dislodging of inflation expectations.

“Annual headline inflation increased to 3.2 per cent in August from 2 per cent in July. Our measure of underlying inflation, which excludes extreme price movements, increased to 1.6 per cent in August from 1.4 per cent in July. The most recent volatility in the headline numbers reflects base effects: a moderation in July headline figures, followed by a stronger rebound in August, and we expect another decrease in annual consumer inflation in September. But as well as the base effect, the relatively high monthly rate of increase of 0.7 per cent contributed to the 1.2 percentage points rise in annual headline inflation in August reflecting cost pressures and the effects of reopening. There are important transitory factors that will boost headline inflation in the next few months. The imminent reversal of the 2020 VAT cuts, with the first hike scheduled in October 2021, as well as the scheduled increase in the OFGEM household energy price-cap in November 2021 will have the most pertinent effects in the short-term. We believe annual consumer price inflation will remain elevated in 2021 before peaking around 4 per cent in the first quarter of 2022. Since headline inflation is to remain above the Bank of England’s 2 per cent target in the short-term, the Bank’s future communications around tapering and policy rate normalisation will be crucial in preventing a possible dislodging of inflation expectations.”

Janine Boshoff

Economist, Macroeconomic Modelling and Forecasting

Figure 1 – CPI and trimmed mean inflation (per cent)



Note: Our measure of trimmed mean inflation excludes 5 per cent of the highest and lowest price changes. The level of trimmed mean inflation is typically lower than CPI inflation due to differences in how the largest price changes are treated and to how the prices are weighted. Source: ONS, NIESR calculations.

Commentary

Annual headline inflation increased to 3.2 per cent in the year to August 2021, up from 2 per cent recorded in July. Consumer prices in the restaurants and hotels, recreation and culture, and food and non-alcoholic beverages contributed 1.05 percentage points to the headline figure, reflecting the short-term volatility introduced by base effects. Our measure of underlying inflation, which excludes the most extreme price changes among 125,901 locally collected goods and services, increased to 1.6 per cent in August 2021 from 1.4 per cent in July. Most of the 12 UK regions saw an increase in underlying inflation, with regional trimmed mean inflation highest in London at 2.7 per cent, and lowest in Scotland at 1.1 per cent.

Our measure of underlying inflation thus cautions against panic regarding the surge in headline inflation number recorded in August 2021. Volatility in recent months has been largely due to base effects and cost pressures associated with the reopening of the economy following the lengthy winter lockdown. We expect that consumer prices will remain elevated in the short-term, particularly following the reversal of the 2020 VAT cuts that are scheduled to unwind in October 2021 and April 2022, as well as the scheduled increase in the OFGEM household energy price-cap in November.

Our forecast is for inflation to peak around 4 per cent in the first quarter of 2022 and fall back to 2.4 per cent in the year to August 2022, provided cost pressures ease and inflation expectations remain anchored. To prevent a sustained period of above-target inflation from filtering through to inflation expectations, the Bank of England must provide [clear guidance](#) regarding the instruments of monetary policy conditional on a changing inflation outlook.

Figure 2 – Decreases due to sales, decreases due to other reasons, and increases (per cent)

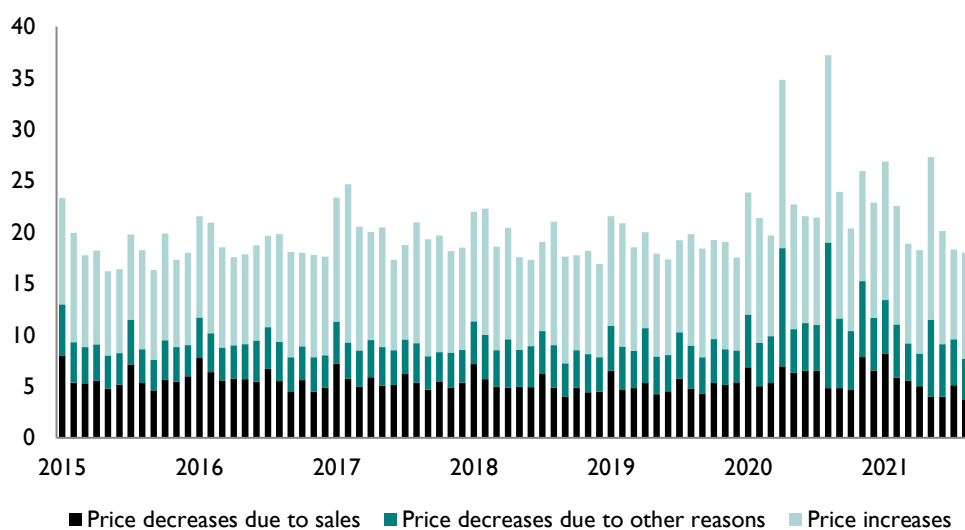


Table 1 – Regional trimmed mean inflation (per cent)

Region	2020					2021							
	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June	Jul	Aug
London	1.3	1.5	1.5	0.5	0.4	0.6	0.2	0.7	2.2	3.3	3.7	3.9	2.7
South East	0.9	1.1	1.3	0.0	-0.2	-0.1	-0.3	0.2	0.7	1.2	1.6	1.5	1.7
South West	0.7	0.7	0.7	-0.3	-0.5	0.0	-0.1	0.2	0.9	0.9	1.6	1.3	1.8
East Anglia	0.9	0.8	0.9	-0.5	-0.2	-0.1	-0.4	0.0	0.2	0.4	0.9	0.6	1.4
East Midlands	1.8	1.8	1.9	0.9	1.1	1.2	0.9	1.5	0.9	0.9	1.2	0.8	2.1
West Midlands	0.9	1.0	1.2	0.2	0.1	0.2	0.2	0.5	0.8	1.4	1.7	1.6	2.2
Yorkshire and the Humber	1.6	1.4	1.3	0.5	0.4	0.9	0.7	0.8	0.9	1.0	1.1	1.0	1.4
North West	0.9	0.7	1.1	0.3	0.1	-0.1	-0.5	-0.1	0.4	0.8	0.9	0.6	1.5
North	2.0	1.4	1.4	0.5	0.7	0.7	1.3	1.2	0.7	0.6	1.3	1.1	1.8
Wales	2.4	2.4	2.4	1.8	1.7	2.2	2.2	2.2	1.3	1.2	1.7	1.8	1.8
Scotland	1.5	1.1	1.1	-0.1	-0.2	-0.1	-0.2	0.2	0.9	1.2	1.4	1.2	1.1
Northern Ireland	2.1	2.1	2.5	1.6	1.8	1.4	1.3	1.5	1.2	1.7	1.7	1.5	1.7
United Kingdom	1.3	1.2	1.3	0.3	0.3	0.5	0.2	0.6	0.9	1.2	1.6	1.4	1.6

Note: Our measure of trimmed mean inflation excludes 5 per cent of the highest and lowest price changes. The level of trimmed mean inflation is typically lower than CPI inflation due to differences in how the largest price changes are treated and to how the prices are weighted. Source: ONS, NIESR calculations.

Notes for Editors

This analysis builds on the work presented in the [National Institute Economic Review](#), which constructs a measure of trimmed mean inflation based on the goods and services prices that underlie the consumer price index.

Our next analysis of consumer prices will be published on 20 October.

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