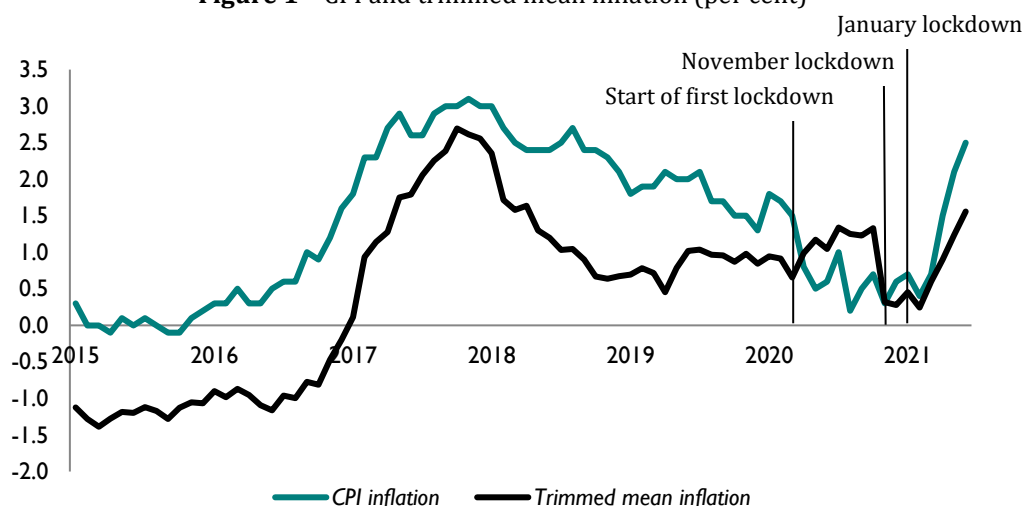


UNDERLYING INFLATION SIGNALS ADDITIONAL PRICE PRESSURES

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.

Main points

- Underlying inflation increased from 1.2 per cent in May to 1.6 in June, its highest level since April 2018 as measured by the trimmed mean, which excludes 5 per cent of the highest and lowest price changes (figure 1). Headline consumer inflation rose by a similar margin, increasing to 2.5 per cent in June from 2.1 per cent in May 2021.
- 20.1 per cent of goods and services prices changed in June, implying an average duration of prices of 5 months, in line with the long-term average. 4.0 per cent of prices were reduced due to sales, 5.1 per cent fell for other reasons and 11 per cent recorded increases (figure 2).
- Our measure of underlying inflation increased in all 12 regions of the UK. Underlying inflation in London recorded another sharp increase to 3.7 per cent in June, up from 3.3 per cent in May. East Anglia and the North West saw the lowest regional trimmed mean inflation of 0.9 per cent in June (table 1).
- In addition to higher oil prices being reflected in pump prices and the effects of opening-up in some sectors such as eating out and retail clothing, reported shortages in intermediate inputs and ongoing supplier delays have filtered through to consumer goods, making the increase in consumer prices more widespread.

- Base effects will continue to add to the volatility in inflation in the short-term, having a notable downward effect in July and September but an upward effect in August. The VAT cut of 2020 is scheduled to be reversed in September 2021 and March 2022, and we expect that this will add further impetus to the upward pressure on annual consumer price inflation depending on the degree of pass-through. As such, we expect that headline CPI is likely to be in the range of 2.5 per cent to 3.25 per cent in the year to June 2022, exceeding the Bank of England's 2 per cent target, which might prompt the Bank of England to review its communication regarding policy rates and [continuation of asset purchases](#).

“Annual headline inflation rose to 2.5 per cent in June from 2.1 per cent in May. The month-on-month increase in consumer prices was again quite high in June with 0.5 per cent, following 0.6 per cent recorded in each of March and April. Our measure of underlying inflation, which excludes extreme price movements, increased to 1.6 per cent in June from 1.2 per cent in May, reflecting price pressures from several transitory factors such as the effects of opening-up and higher transport costs. Higher input prices and supply constraints in some sectors will continue to put an upward pressure on headline inflation in the short-term. Furthermore, the VAT cuts which were aimed at supporting the hospitality, hotel and holiday sectors last year are scheduled to be reversed in September 2021 and March 2022. Depending on the level of pass-through, these could also contribute to higher headline inflation and lead to a peak in annual consumer price inflation around March 2022. The peak in inflation and its persistence will be crucially determined by how the reported shortages in intermediate inputs and labour will interact with the recovery in aggregate demand on the back of the easing in Covid restrictions.”

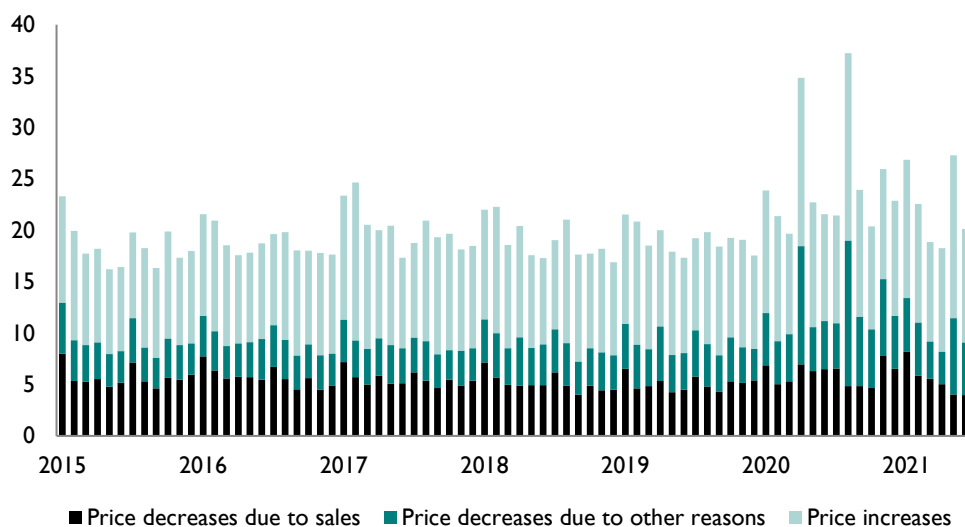
Janine Boshoff

Economist, Macroeconomic Modelling and Forecasting

Commentary

Annual headline inflation increased to 2.5 per cent in the year to June 2021, up from 2.1 per cent recorded in May. Consumer prices increased in all but the health category, indicating the widespread nature of price increases following the lengthy winter lockdown. Our measure of underlying inflation, which excludes the most extreme price changes among 112,261 locally collected goods and services, increased to 1.6 per cent in June 2021 from 1.2 per cent in May. All 12 UK regions saw an increase in underlying inflation, with regional trimmed mean inflation highest in London at 3.7 per cent, and lowest in East Anglia and the North West at 0.9 per cent.

The broad-based nature of price increases reflects not only base effects from low inflation last year, but also increases in producer prices, which recorded an annual increase of 9.1 per cent in June. Higher oil prices have evidently filtered through to British consumers as the transport category contributed 0.11 percentage points to the increase in annual headline inflation. Early survey evidence from manufacturers also suggests that higher input prices due to shortages in intermediate goods will continue to filter through to consumer prices and our forecast is for inflation to be in the range of 2.5 per cent to 3.25 per cent in the year to June 2022. There remains significant upside risk to this forecast thanks to both the scheduled reversal of last year's VAT cut and wage pressures due to labour shortages provided they persist. Containing inflation expectations will be crucial for the rise in inflation to prove transitory, which in turn, requires [more guidance from the Bank of England](#) regarding the instruments of monetary policy going forward.

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					
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June
London	-0.1	-0.1	1.3	1.5	1.5	0.5	0.4	0.6	0.2	0.7	2.2	3.3	3.7
South East	0.5	0.9	0.9	1.1	1.3	0.0	-0.2	-0.1	-0.3	0.2	0.7	1.2	1.6
South West	0.4	0.6	0.7	0.7	0.7	-0.3	-0.5	0.0	-0.1	0.2	0.9	0.9	1.6
East Anglia	1.0	1.4	0.9	0.8	0.9	-0.5	-0.2	-0.1	-0.4	0.0	0.2	0.4	0.9
East Midlands	2.0	2.6	1.8	1.8	1.9	0.9	1.1	1.2	0.9	1.5	0.9	0.9	1.2
West Midlands	0.9	1.1	0.9	1.0	1.2	0.2	0.1	0.2	0.2	0.5	0.8	1.4	1.7
Yorkshire and the Humber	1.4	1.8	1.6	1.4	1.3	0.5	0.4	0.9	0.7	0.8	0.9	1.0	1.1
North West	1.3	1.7	0.9	0.7	1.1	0.3	0.1	-0.1	-0.5	-0.1	0.4	0.8	0.9
North	1.9	2.2	2.0	1.4	1.4	0.5	0.7	0.7	1.3	1.2	0.7	0.6	1.3
Wales	2.2	2.2	2.4	2.4	2.4	1.8	1.7	2.2	2.2	2.2	1.3	1.2	1.7
Scotland	0.9	1.2	1.5	1.1	1.1	-0.1	-0.2	-0.1	-0.2	0.2	0.9	1.2	1.4
Northern Ireland	2.0	2.2	2.1	2.1	2.5	1.6	1.8	1.4	1.3	1.5	1.2	1.7	1.7
United Kingdom	1.0	1.3	1.3	1.2	1.3	0.3	0.3	0.5	0.2	0.6	0.9	1.2	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 **18 August**.

For further information please contact the NIESR Press Office NIESR Press Office:
press@niesr.ac.uk or Luca Pieri on 0207 654 1954/ l.pieri@niesr.ac.uk

National Institute of Economic and Social Research

2 Dean Trench Street
Smith Square
London, SW1P 3HE
United Kingdom

Switchboard Telephone Number: 020 7222 7665

Website: <http://www.niesr.ac.uk>