National Institute of Economic and Social Research

NIESR Monthly CPI Tracker

Underlying Inflation Reaches New Record High Ahead of December’s MPC Meeting

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“Today’s ONS estimates suggest that annual CPI inflation decreased to 10.7 per cent in November from 11.1 per cent in October, is mainly driven by a fall in transport costs. Though the yearly rate has fallen between October and November, NIESR’s measure of trimmed-mean inflation increased to a new series high of 9.0 per cent in November from 8.8 per cent in October, indicating that underlying inflation remains high and persistent. This signals the need for the MPC to raise its policy rate further at its meeting tomorrow, despite Monday’s anaemic GDP number.”

Paula Bejarano Carbo
Associate Economist, NIESR

Main points

- Headline consumer price inflation decreased to 10.7 per cent in November 2022 from 11.1 per cent in October. Despite the fall, this rate of annual inflation remains among the highest in four decades. Further, NIESR's measure of underlying inflation, which excludes 5 per cent of the highest and lowest price changes, rose to a new series high of 9.0 per cent from 8.8 per cent in October.

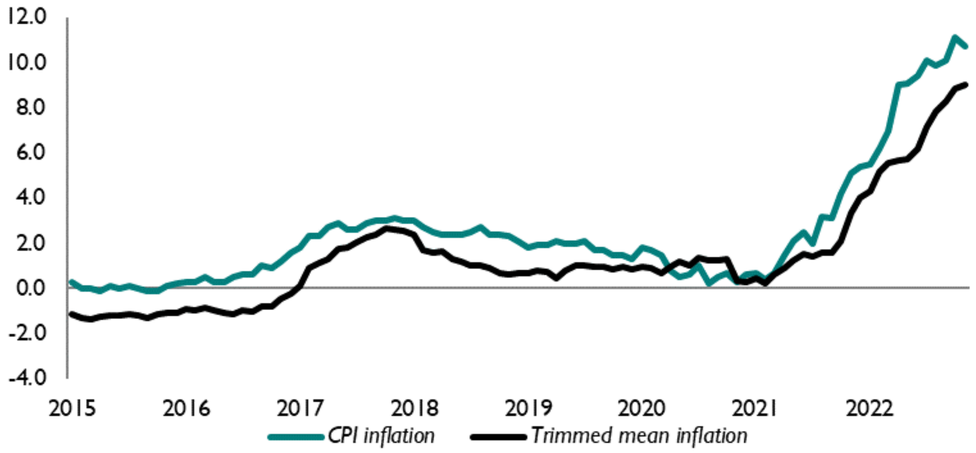
- Trimmed-mean inflation increased in each of the 12 UK regions in November. This measure of underlying inflation in the North of England was the highest at 9.56 per cent, while Northern Ireland had the lowest rate at 8.44 per cent in November.

- Today's CPI figure is as forecasted by our colleague Huw Dixon last month, under his 'very high' inflation scenario. This assumes monthly inflation ('new inflation') of 0.4 per cent. ONS data showed the monthly change in the all-items index increasing by 0.4 percentage points between October and November. Taken together with our rising level of trimmed-mean inflation, NIESR continues to expect annual CPI inflation to peak at just over 11 per cent in January 2023.

- Given today's data, we would argue that the MPC should raise its policy rate further (representing a ninth consecutive rate hike) at its meeting tomorrow.

- For a breakdown of what inflation is and how it is calculated, as well as why the MPC target an inflation rate of 2 per cent, you can read our latest Monday Interview here.

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.

Economic Setting

Earlier this week, we released our GDP and Wage Trackers. Though we currently forecast GDP to remain flat in the fourth quarter of this year, October GDP data points to an elevated risk of a recession. Research from our recent UK Autumn Economic Outlook suggests that annual GDP growth will likely be negative in the first quarter of 2023. At the same time, nominal wage growth remains relatively high, with total average weekly earnings growing by 6.1 per cent in the three months to October. Our forecast suggests this will rise to 6.4 per cent in the fourth quarter of this year. That said, real wages continue to fall, eroding workers' living standards.

Todays' data suggests that annual headline consumer price inflation (CPI) decreased by 0.4 percentage points to 10.7 per cent in the year to November 2022, from 11.1 per cent in October. The latest increase in inflation was mainly accounted for by the transport sector -particularly motor fuels - which contributed -0.23 percentage points to the change in the headline figure, outweighing the effects of a 0.06 percentage point contribution from restaurants and hotels. Despite this welcome fall in the headline figure, NIESR's measure of underlying inflation, which excludes 5 per cent of the highest and lowest price changes, increased to a new record high of 9.0 per cent in November from 8.8 per cent in October.

These current economic conditions present conflicting problems for policymakers: anaemic GDP numbers suggest a need to increase demand, against the need to suppress demand to bring inflation down.

Monetary Policy Analysis

Tomorrow, the MPC will meet to set monetary policy according to its objective, which is to maintain the inflation rate at its 2 per cent target. Given current economic conditions, we believe it is imperative for the MPC to announce a further increase of the Bank Rate.

The main challenge currently facing the MPC is that, in raising interest rates, it walks a thin line between lowering inflation and depressing the already-fragile economy. Given that the inflation rate remains among its highest in four decades and that trimmed-mean inflation is at a record high, we believe that the threat of high inflation becoming embedded in expectations is large enough to warrant a ninth consecutive rate hike.

A further challenge the MPC faces is that of inflation uncertainty. In announcing an extension of the Energy Price Guarantee from April 2023 until March 2024, the Chancellor's Autumn Statement curbed some uncertainty regarding the short-term path of inflation. Nonetheless, as discussed in our recent UK Autumn Economic Outlook, domestic and international economic developments continue to affect inflation in unpredictable ways. The domestic recessionary risks, the war in Ukraine, and China's potential reopening are examples of factors that could surprise the domestic and international economy in the short-run and lead to an inflation shock – either positive or negative. Against such a backdrop of uncertainty, the MPC faces a difficult decision tomorrow.

Table 1 – Regional trimmed mean inflation (per cent)

	2021							2022						
Region	Jul	Aug	Sep	Oct	Nov	Dec		May	Jun	Jul	Aug	Sep	Oct	Nov
London	3.9	2.4	2.5	2.9	4.3	5.0		5.8	6.2	7.2	7.7	8.1	8.7	9.06
South East	1.5	1.6	1.3	1.8	3.2	3.8		5.2	5.7	6.6	7.4	7.9	8.4	8.63
South West	1.3	1.4	1.5	2.1	3.4	4.3		6.1	6.2	7.4	8.0	8.5	9.0	9.21
East Anglia	0.6	1.2	1.3	1.8	3.5	3.9		5.8	6.4	7.4	8.1	8.6	9.1	9.23
East Midlands	0.8	1.8	1.9	2.4	3.6	4.4		6.3	6.7	8.0	8.6	8.9	9.2	9.36
West Midlands	1.6	2.0	2.2	2.6	4.0	4.6		6.5	6.9	8.0	8.3	8.6	9.2	9.15
Yorkshire and the Humber	1.0	1.3	1.4	2.1	3.1	3.8		5.6	6.4	7.2	7.9	8.3	8.9	9.21
North West	0.6	1.3	1.5	1.7	2.9	3.8		5.6	6.1	7.0	7.7	8.0	8.7	9.01
North	1.1	1.6	1.8	2.4	3.4	3.8		5.8	6.4	7.4	8.3	8.9	9.5	9.56
Wales	1.8	1.7	1.7	2.3	3.0	3.4		5.3	5.4	6.7	7.5	7.9	8.7	8.78
Scotland	1.2	1.1	1.2	1.9	3.4	4.1		5.8	6.6	7.4	8.0	8.5	9.1	9.19
Northern Ireland	1.5	1.4	1.4	1.5	2.4	3.0		5.5	5.5	6.4	7.5	7.6	8.5	8.44
United Kingdom	1.4	1.6	1.6	2.1	3.4	4.0		5.7	6.2	7.2	7.8	8.3	8.8	9.0

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 January 2023.

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