NIESR Monthly CPI Tracker

Core Inflation Remains Elevated, Threatening Persistence

Paula Bejarano Carbo

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"Annual CPI in December fell to 10.5 per cent from 10.7 per cent in November, driven by price decreases in transport (motor fuels), and clothing and footwear, which offset price increases in food and non-alcoholic beverages as well as restaurants and hotels. Despite this fall in the headline rate, NIESR's measure of trimmed-mean inflation remained at its series high of 9 per cent for a consecutive month, suggesting that inflationary pressures have not yet cooled; paired with yesterday's wage figures, the MPC will be considering how to tackle possible persistence in inflation and inflation expectations. Due to 'base effects', we expect to see a rise in the January 2023 headline figure – meaning inflation may not yet have peaked."

Paula Bejarano Carbo
Associate Economist, NIESR

Main points

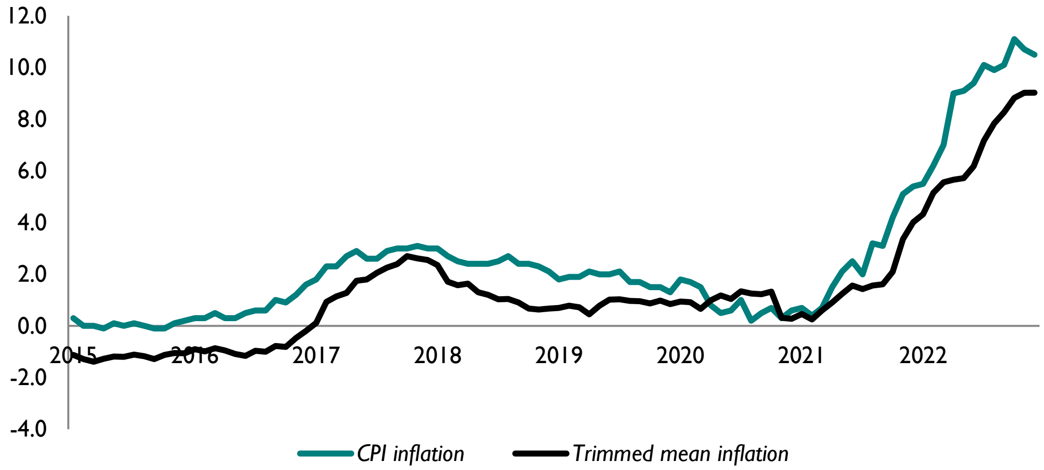
- Headline consumer price inflation decreased to 10.5 per cent in December from 10.7 per cent in November. Despite the fall, this rate of annual inflation remains among the highest in four decades. Further, NIESR's measure of underlying inflation, which excludes 5 per cent of the highest and lowest price changes, remained at its series high of 9 per cent for a consecutive month.

- Trimmed-mean inflation increased in each of the 12 UK regions in November. This measure of underlying inflation was the highest in the North of England and East Anglia at 9.5 per cent, while Northern Ireland had the lowest rate at 8.2 per cent.

- Today's CPI figure is in line with that forecasted by our colleague Huw Dixon last month, under his 'very high' inflation scenario – which sees inflation peaking in January 2023. Given that different measures of underlying inflation remain elevated, alongside 'base effects' from January 2022, we expect to see a rise in the January 2023 headline figure.

- 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, read our blog post 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 month, we released our GDP and Wage Trackers. Monthly GDP saw a positive surprise of 0.1 per cent growth in November, driven by an increase in services; we observed that this might be a sign that households enjoyed a last hurrah in the fourth quarter of 2022 before tightening their belts at the start of 2023. That said, GDP contracted by 0.3 per cent in the three months to November, signalling that anaemic growth in manufacturing was a particularly important downside risk to UK GDP in the short and medium run. Overall, we expect that the seasonal consumption boom led to growth of 0.1 per cent in the fourth quarter of 2022 but we still forecast a fall in GDP growth in the first quarter of 2023.

On 9 January, Bank of England Chief Economist Huw Pill delivered a speech which noted that second round effects in wage dynamics threaten persistence in inflation, and yesterday's ONS estimates certainly added fuel to this concern. Regular pay grew by 6.4 per cent in the three months to November – the highest on record outside of the pandemic period. That said, real regular wages fell by 2.6 per cent, indicating the extent to which inflation is causing an erosion of living standards in the UK.

The end of 2022 was thus marked by a low-growth, high-inflation outlook that poses serious challenges to monetary policymakers.

Inflation Analysis

Todays' data suggests that annual headline consumer price inflation (CPI) decreased by 0.2 percentage points to 10.5 per cent in the year to December 2022, from 10.7 per cent in November. The latest decrease in inflation was mainly accounted for by the transport sector, which, paired with price decreases in other sectors like clothing and footwear, outweighed the effects of price increases in restaurants and hotels, and food and non-alcoholic beverages.

It is informative to look at multiple measures of 'core' inflation to understand the nature of inflationary pressures in the economy, as each measure tells a distinct story. The ONS's quarterly estimate of the GDP deflator – which is a good measure of domestically-generated inflation – climbed up to 6.4 per cent in the third quarter of 2022, from 5.2 per cent in Q2, consistent with higher frequency evidence that inflationary pressures have become increasingly broad-based and embedded, as opposed to resulting solely from external shocks. In December, CPI excluding energy, food, alcoholic beverages, and tobacco grew at a rate of 6.3 per cent for a second consecutive month, having fluctuated around 6.4 per cent since August. At the same time, NIESR's measure of underlying inflation, which excludes 5 per cent of the highest and lowest price changes, remained at its series high of 9.0 per cent in December.

Taken together, the headline fall in CPI seems to mask the extent to which inflation has become persistent and broad-based in the UK economy.

Monetary Policy Analysis

On 15 December, the Monetary Policy Committee (MPC) opted to raise its Bank Rate by 50 basis points, bringing it to 3.5 per cent, to bring the inflation rate back to its 2 per cent target over the medium term. Given current economic conditions, and the nature of inflationary pressures in the UK economy, the MPC will be considering how to tackle the threat of persistent inflation embedding itself in expectations at its upcoming meeting on 2 February; we think they need to raise rates by a further 50 basis points in order to tackle this threat.

Table 1 – Regional trimmed mean inflation (per cent)

	2021							2022					
Region	Jul	Aug	Sep	Oct	Nov	Dec		Jul	Aug	Sep	Oct	Nov	Dec
London	3.9	2.4	2.5	2.9	4.3	5.0		7.2	7.7	8.1	8.7	9.1	9.1
South East	1.5	1.6	1.3	1.8	3.2	3.8		6.6	7.4	7.9	8.4	8.6	8.7
South West	1.3	1.4	1.5	2.1	3.4	4.3		7.4	8.0	8.5	9.0	9.2	9.1
East Anglia	0.6	1.2	1.3	1.8	3.5	3.9		7.4	8.1	8.6	9.1	9.2	9.5
East Midlands	0.8	1.8	1.9	2.4	3.6	4.4		8.0	8.6	8.9	9.2	9.4	9.2
West Midlands	1.6	2.0	2.2	2.6	4.0	4.6		8.0	8.3	8.6	9.2	9.1	9.2
Yorkshire and the Humber	1.0	1.3	1.4	2.1	3.1	3.8		7.2	7.9	8.3	8.9	9.2	9.1
North West	0.6	1.3	1.5	1.7	2.9	3.8		7.0	7.7	8.0	8.7	9.0	8.9
North	1.1	1.6	1.8	2.4	3.4	3.8		7.4	8.3	8.9	9.5	9.6	9.5
Wales	1.8	1.7	1.7	2.3	3.0	3.4		6.7	7.5	7.9	8.7	8.8	9.0
Scotland	1.2	1.1	1.2	1.9	3.4	4.1		7.4	8.0	8.5	9.1	9.2	9.2
Northern Ireland	1.5	1.4	1.4	1.5	2.4	3.0		6.4	7.5	7.6	8.5	8.4	8.2
United Kingdom	1.4	1.6	1.6	2.1	3.4	4.0		7.2	7.8	8.3	8.8	9.0	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 15 February 2023.

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