National Institute of Economic and Social Research

NIESR
Monthly CPI Tracker

Energy Prices Drive Fall In CPI, Masking Worrying Underlying Trends

Paula Bejarano Carbo

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"Today's ONS figure suggests that CPI inflation fell from 10.1 per cent in March to 8.7 per cent in April, breaking the seven-month streak of double-digit inflation. This fall was largely driven by falls in electricity and gas prices on the year (i.e., last April's energy rise 'dropping out'), though was partially offset by significant increases in food prices, which saw an inflation rate of 19 per cent in April - just 0.1 percentage point below last month's 45-year high. Concerningly, core CPI rose to a series high of 6.8 per cent in April from 6.2 per cent in March. Overall, the data indicate that, despite a welcome fall in headline CPI, we have yet to see a turning point in underlying inflationary pressures in the UK as food prices, in particular, continue to soar; this is especially worrying as lower-income households are disproportionally hit by elevated food inflation."

Paula Bejarano Carbo
Associate Economist, NIESR

Main points

- Annual consumer price inflation decreased from 10.1 per cent in March to 8.7 per cent in April. This fall was largely driven by price decreases in housing and household services (specifically gas and electricity) which were partially offset by price increases in food.

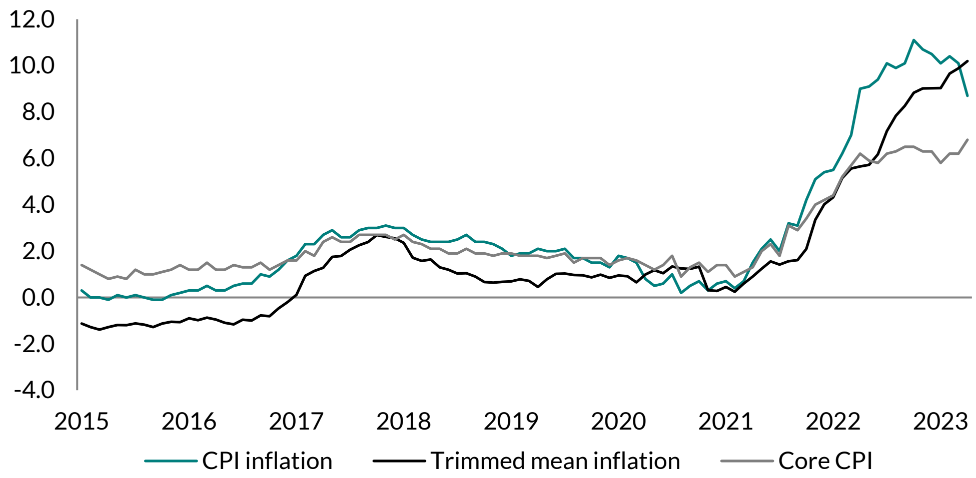
- Food inflation fell to an annual rate of 19.0 per cent in April from a 45-year high of 19.1 per cent in March. That it remains so elevated is concerning since there is no government support to help households (especially lower income households, who spend a greater part of their incomes on food) offset this cost.

- The latest figure of 8.7 per cent represents an upside surprise in headline inflation. Though energy price inflation has decreased by 41.5 percentage points between April 2022 and April 2023, food inflation has increased by around 12.6 percentage points in this time. Food is weighted higher than energy in the CPI: Electricity, Gas and Other Fuels is weighted by 49/1000 whereas Food is weighted as 107/1000. At the same time, the rate of inflation of services and non-energy industrial goods has plateaued at around 7 per cent, unsurprisingly close to today's core CPI figure of 6.8 per cent. It seems this positive surprise is a story of increasing food inflation and persistent core inflation overtaking dropping energy prices.

- In March, core CPI inflation (CPI excluding energy, food, alcoholic beverages, and tobacco) rose to 6.8 per cent in April, its highest rate since March 1992, from 6.2 per cent in March. It remains well above the series average of 2 per cent. At the same time, NIESR's measure of underlying inflation, which excludes 5 per cent of the highest and lowest price changes, also rose to a new series high of 10.2 per cent from 9.9 per cent in March. Trimmed-mean inflation being higher than core inflation indicates that the energy price fall which has driven headline CPI down is a rather volatile price movement. Overall, these figures suggest that we have yet to see a meaningful turning point in underlying inflationary pressure in the UK.

- For a breakdown of what inflation is and how it is calculated, read our blog post here.

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



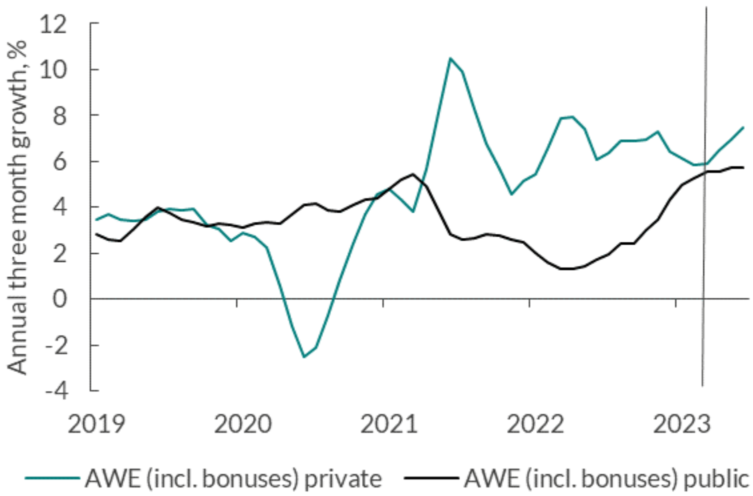
Note: Our measure of trimmed mean inflation excludes 5 per cent of the highest and lowest price changes. Source: ONS, NIESR Calculations.

Economic Setting

Earlier this month, we released our GDP Tracker, which noted that, though GDP grew by 0.1 per cent in the first quarter of 2023, the United Kingdom's economy has largely flatlined since the initial stages of the post-pandemic recovery. Consistent with this longer-term trend of low but stable growth, our early forecast for the second quarter of 2023 sees this quarterly growth rate increasing to 0.2 per cent.

Last week's ONS labour market data suggested that the annual growth rate of average weekly earnings, including bonuses, was 5.8 per cent in the first quarter of 2023, while pay growth excluding bonuses was 6.7 per cent. Our wage tracker forecast for the second quarter of this year sees these figures at 5.9 and 6.0 per cent, respectively. These elevated forecasts, alongside today's services inflation rate of 6.9 per cent (which tracks private sector wage growth quite well) indicate that high nominal wage growth may be exacerbating the persistence of domestic inflationary pressures. More on this below.

Figure 2 – Average weekly earnings (including bonuses) in public and private sectors



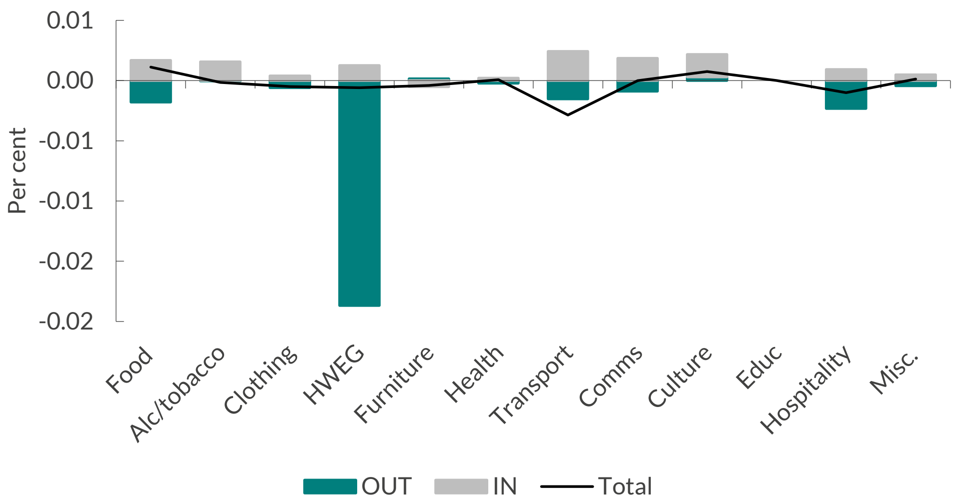
Source: ONS, NIESR Calculations.

Inflation Analysis

Today's data suggest that annual headline consumer price (CPI) inflation decreased by 1.4 percentage points from 10.1 per cent in the year to March to 8.7 per cent in April.

The latest fall was largely driven by price decreases in housing and household services (specifically gas and electricity). We can think of this as last April's energy increases 'dropping out' of the CPI basket. To elaborate, housing and household services inflation was 13.2 per cent in April 2022, but 12.3 per cent in April 2023. Since inflation is calculated on an annual basis, then the fact that this category saw a lower price increase in April this year relative to last year means that it will contribute negatively to the overall April CPI inflation figure. Figure 3 below shows the Housing, Water, Electricity, Gas and Other Fuels category having the greatest 'drop out' effect on headline CPI inflation in April.

Figure 3: CPI April 2023: Contributions by type of expenditure 'In' and 'Out'



Source: ONS

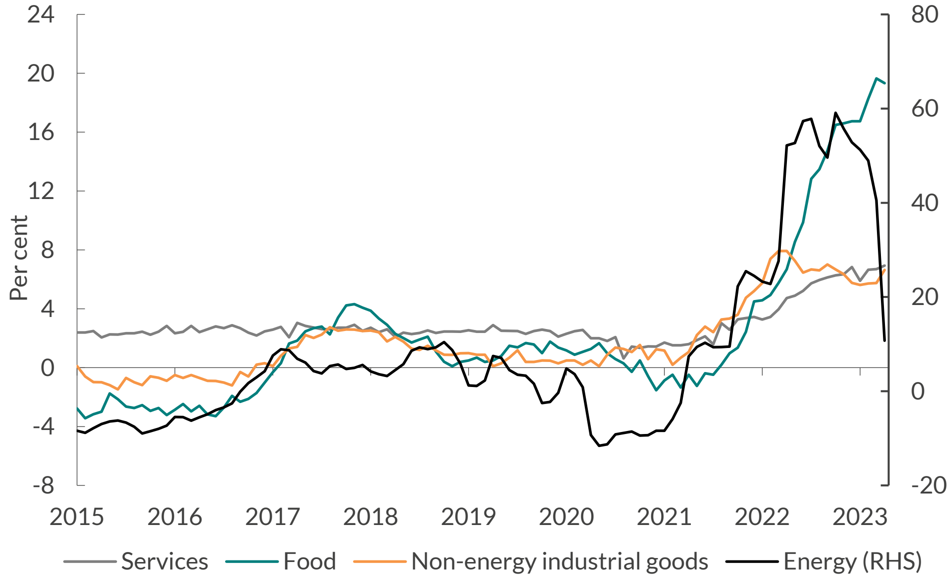
Notes: HWEG refers to "Housing, water, electricity gas and other fuels". The rest of the labels are abbreviations of COICOP categories which can be found in the ONS CPI Tables.

Looking at an aggregate measure of energy (not just electricity and gas), gives us a better insight into the extent to which falling energy prices are affecting headline CPI. As seen in Figure 3 below, the rate of energy inflation fell to 10.7 per cent on the year in April 2023, down from a rate of 40.5 per cent on the year in March 2023. The magnitude of this monthly fall largely reflects energy price inflation in April 2022 of 52.2 per cent.

Though falling energy prices are driving an overall fall in headline CPI inflation, this is being partially overtaken by a significant rise in food prices. As seen in Figure 3 below, food inflation rose at an annual rate of 19.0 per cent in April, compared with a 45-year high of 19.1 per cent in March. It is notable that Food is weighted higher than energy in the CPI: Electricity, Gas and Other Fuels is weighted by 49/1000 whereas Food is weighted as 107/1000 currently.

The latest figure of 8.7 per cent represents an upside surprise in headline inflation. Though energy price inflation has decreased by 41.5 percentage points between April 2022 and April 2023, food inflation has increased by around 12.6 percentage points in this time. At the same time, the rate of inflation of services and non-energy industrial goods has plateaued at around 7 per cent, unsurprisingly close to today's core CPI figure of 6.8 per cent. It seems this positive surprise is a story of increasing food inflation and persistent core inflation overtaking dropping energy prices.

Figure 4 – Inflation for elements of the consumer price index (annual per cent)



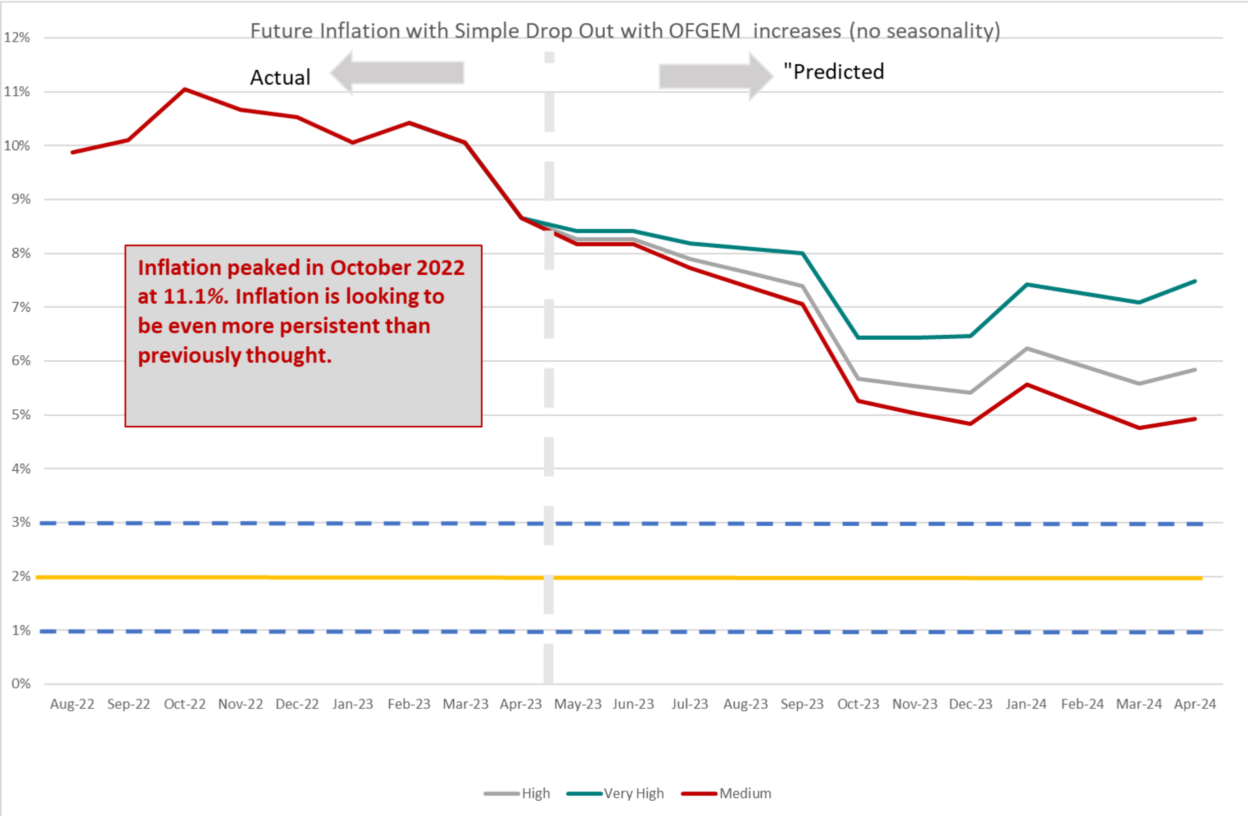
Source: ONS

In March, core CPI inflation (CPI excluding energy, food, alcoholic beverages, and tobacco) rose to 6.8 per cent in April, its highest since March 1992, from 6.2 per cent in March. It remains well above the series average of 2 per cent. At the same time, 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 10.2 per cent from 9.9 per cent in March. Trimmed-mean inflation being higher than core inflation indicates that the energy price fall which has driven headline CPI inflation down is a rather volatile price movement. Overall, these figures suggest that we have yet to see a meaningful turning point in underlying inflationary pressure in the United Kingdom.

Our regional decomposition suggests that trimmed-mean inflation increased in each of the 12 UK regions in November. Trimmed mean inflation was highest in the North of England at 10.88 per cent in April, while Northern Ireland experienced the lowest trimmed mean inflation at 9.59 per cent.

Figure 5 below shows an inflation forecast based on my colleague Huw Dixon's methodology and today's data release. Today's data suggests that inflation will be even more persistent than previously thought, remaining above 5 per cent at the end of the year even in the 'medium' scenario (and above 6 per cent in the 'very high' scenario).

Figure 5 – CPI Inflation Forecast



Source: ONS, Dixon (2023) calculations

Monetary Policy Analysis

On 11 May, the Monetary Policy Committee (MPC) opted to raise the Bank Rate by 25 basis points, bringing it to 4.50 per cent, to maintain the inflation rate at its 2 per cent target. While many thought May's hike represented the end to the current monetary tightening cycle, today's figures suggest the MPC may have to tighten further. With core inflation now at 6.8 per cent and our trimmed mean estimate at 10.2 per cent, alongside elevated wage growth, it is possible that high inflation may have become embedded. A possible further tightening has already been reflected in market expectations of interest rates.

Table 1 – Regional trimmed mean inflation (per cent)

	2022						2023			
Region	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr
London	7.2	7.7	8.1	8.7	9.1	9.1	9.4	9.9	10.0	10.2
South East	6.6	7.4	7.9	8.4	8.6	8.7	8.8	9.6	9.8	10.0
South West	7.4	8.0	8.5	9.0	9.2	9.1	8.9	9.7	9.8	10.1
East Anglia	7.4	8.1	8.6	9.1	9.2	9.5	9.5	10.0	10.2	10.4
East Midlands	8.0	8.6	8.9	9.2	9.4	9.2	9.3	9.9	10.1	10.6
West Midlands	8.0	8.3	8.6	9.2	9.1	9.2	9.0	9.4	9.7	9.9
Yorkshire and the Humber	7.2	7.9	8.3	8.9	9.2	9.1	9.1	9.6	10.0	10.2
North West	7.0	7.7	8.0	8.7	9.0	8.9	8.9	9.7	9.9	10.3
North	7.4	8.3	8.9	9.5	9.6	9.5	9.5	10.3	10.7	10.9
Wales	6.7	7.5	7.9	8.7	8.8	9.0	9.0	9.8	10.1	10.8
Scotland	7.4	8.0	8.5	9.1	9.2	9.2	9.1	9.8	10.0	10.5
Northern Ireland	6.4	7.5	7.6	8.5	8.4	8.2	8.2	8.7	8.9	9.6
United Kingdom	7.2	7.8	8.3	8.8	9.0	9.0	9.0	9.7	9.9	10.2

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.

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