National Institute of Economic and Social Research

# NIESR
# Monthly CPI Tracker

## Welcome Fall in Headline Rate Despite Little Movement in Underlying Measures

Paula Bejarano Carbo

**19th July 2023**

*"Annual CPI inflation rose by 7.9 per cent in June, down from 8.7 per cent in May, driven by falling prices for motor fuel which was partially offset by rising prices in food. Measures of underlying inflation also eased slightly in June: for example, core CPI and services inflation both fell from 31-year highs of 7.1 per cent and 7.4 per cent, to 6.9 per cent and 7.2 per cent, respectively. Though these are all welcome falls, it remains concerning that these measures of underlying inflationary pressures continue to plateau around 7 per cent, well above the Bank of England's target of 2 per cent. "*

**Paula Bejarano Carbo**
**Associate Economist, NIESR**

## Main points

- Annual consumer price inflation rose by 7.9 in June, down from 8.7 per cent in May. This fall was largely driven by price decreases in motor fuels which were partially offset by price increases in food, and restaurants and hotels.

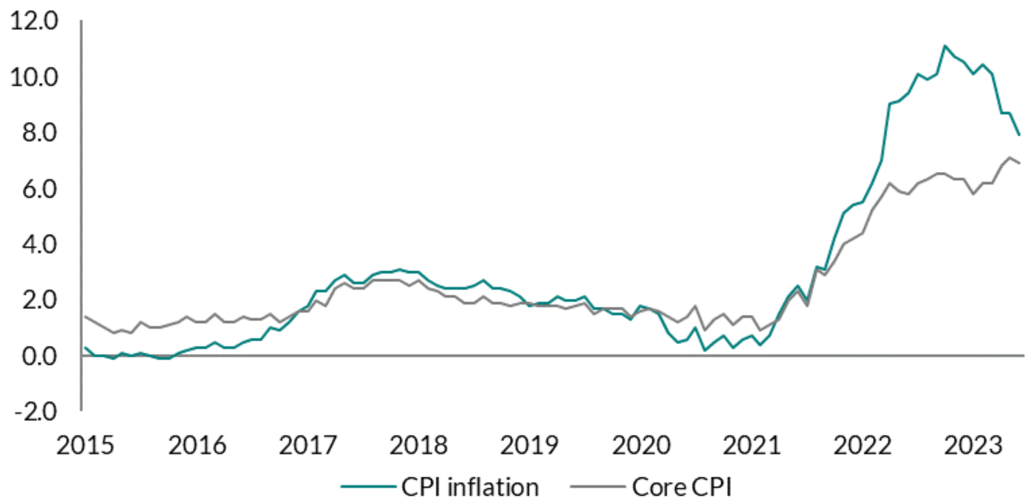
- Food inflation fell to an annual rate of 17.3 per cent in June from18.3 per cent in May. That it remains so elevated is concerning since there is no government support to help households (especially lower income households, who spend a greater part of their incomes on food) offset this cost.

- The latest figure of 7.9 per cent represents a downward surprise in headline inflation, with annual energy price inflation decreasing by 54.2 percentage points and the annual rate of food inflation falling by a full percentage point relative to May. At the same time, the rate of inflation of services and non-energy industrial goods has plateaued around 7 per cent, unsurprisingly close to today's core CPI figure of 6.9 per cent. So, while headline inflation seems to be easing by more than expected, we have yet to see a significant movement in underlying inflationary pressures in the economy.

- Services inflation fell from a 31-year high of 7.4 per cent in May to 7.2 per cent in June. Elevated wage growth in this sector will concern monetary policymakers, who may take this as a sign that services inflation will continue to generate persistence in underlying inflation in the United Kingdom, despite monetary tightening.

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

**Figure 1 –** CPI and core CPI inflation (per cent)



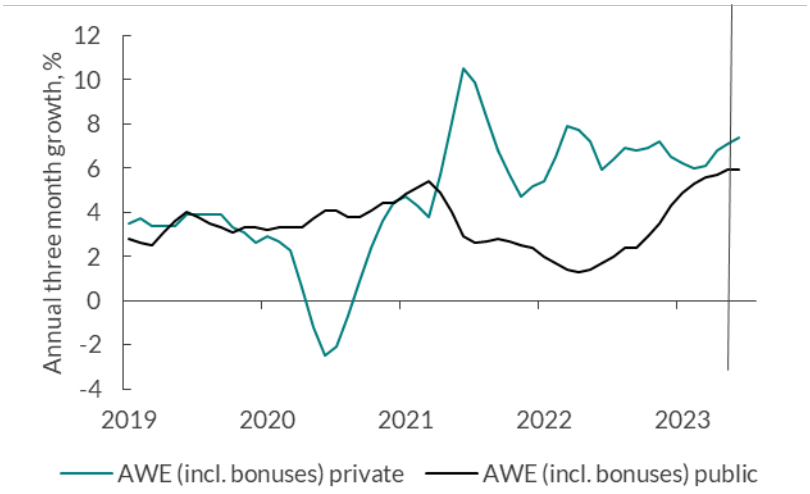

Note: Our measure of trimmed mean inflation excludes 5 per cent of the highest and lowest price changes. Source: ONS, NIESR Calculations.

## Economic Setting

Last week, we released our GDP Tracker, which noted that, though monthly GDP grew by 0.1 per cent in May, the UK economy has largely flatlined since the initial stages of the post-pandemic recovery. Consistent with this longer-term trend of low but stable growth, we forecast GDP to remain flat in the second quarter of 2023.

The latest ONS labour market data suggested that the annual growth rate of average weekly earnings, including bonuses, was 6.9 per cent in the three months to May, while pay growth excluding bonuses was 7.3 per cent. Our wage tracker forecast for the second quarter of this year sees both figures at 7.2 per cent.

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



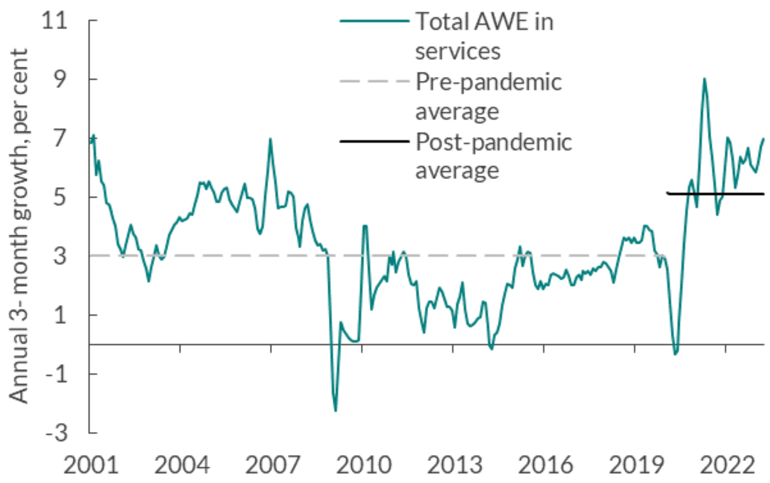

Source: ONS, NIESR Calculations.

Services sector total AWE annual growth has been on an increasing path since the initial pandemic-related plummet and currently stands at 7.0 per cent in the three months to May. As Figure 3 below shows, there seems to have been a shift in services sector total AWE growth pre- and post-pandemic; the average growth rate in AWE in this sector was 3.0 per cent from January 2001 to February 2020, while from March 2020 onwards this average has increased to 5.1 per cent (even accounting for the initial covid-related plummet). Seeing that pay in the services sector makes up most of the input costs in this sector, it is the main driver of services inflation, which today eased only slightly from the 31-year high of 7.4 per cent in May to 7.2 per cent.

## Inflation Analysis

Annual consumer price inflation was 7.9 per cent in June, down from 8.7 per cent in May. This fall was largely driven by price decreases in motor fuels which were partially offset by price increases in food, and restaurants and hotels.

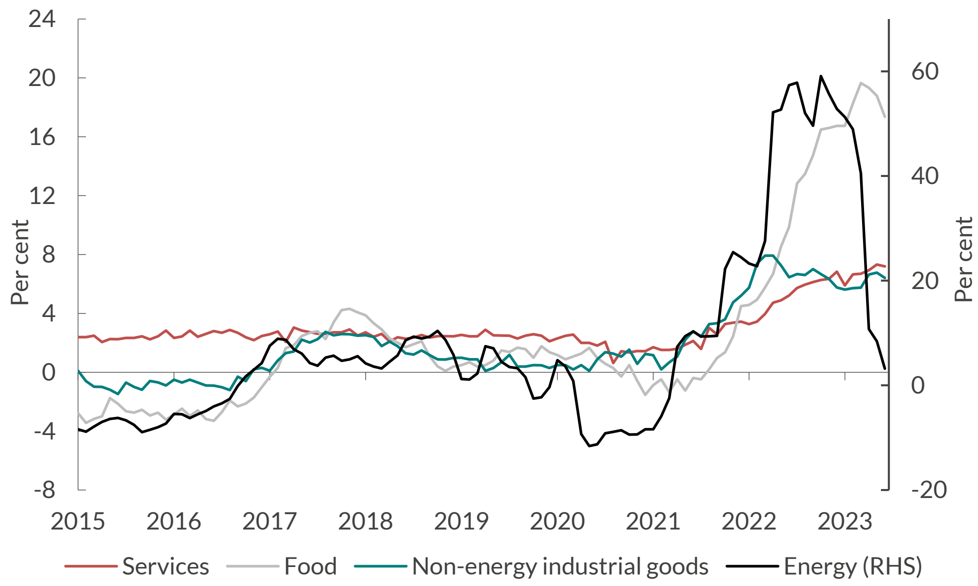
**Figure 3 –** Inflation for elements of the consumer price index (annual per cent)




Source: ONS

With energy price rises 'falling out' of the CPI basket from April 2023 onwards, the drivers of inflationary pressures have shifted towards rising food, non-energy goods, and services prices. The latest data suggest that annual energy price inflation has decreased by 54.2 percentage points between June 2022 and June 2023, while food inflation has risen by 7.5 percentage points in this time (food is weighted more than twice that of energy in the CPI calculation). At the same time, services and non-energy industrial goods inflation has plateaued at around 7 per cent, unsurprisingly close to the latest core CPI figure of 6.9 per cent.

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



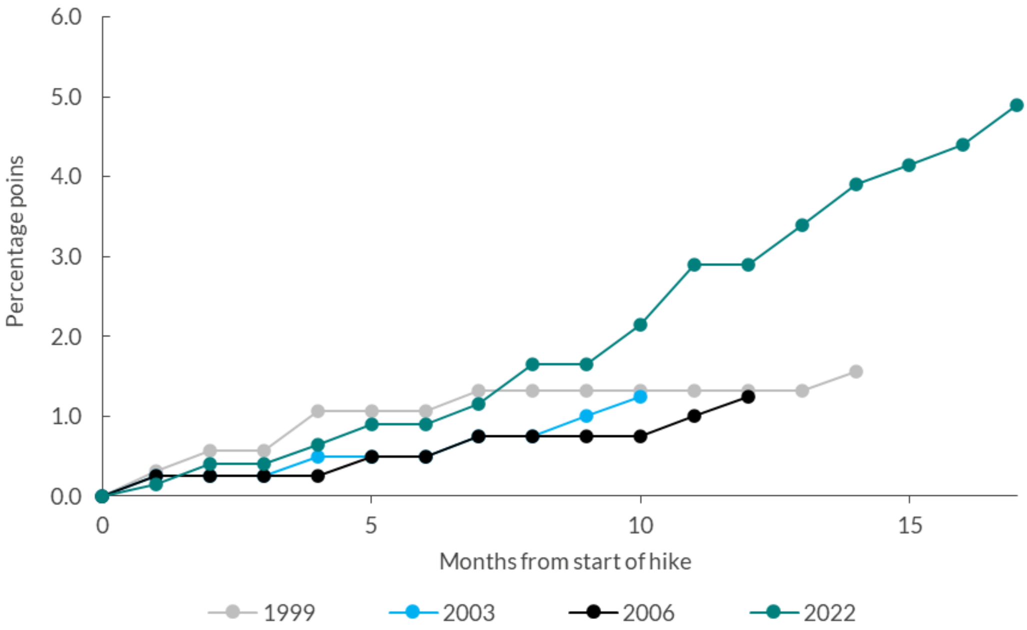

Source: ONS

The latest figure of 7.9 per cent represents a downward surprise in headline inflation, with annual energy price inflation decreasing by 54.2 percentage points and the annual rate of food inflation falling by a full percentage point relative to May. 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 6.9 per cent. So, while headline inflation seems to be easing by more than expected, we have yet to see a significant movement in underlying inflationary pressures in the economy.

## Monetary Policy Analysis

Against a backdrop of 8.7 per cent inflation, the MPC opted to raise rates by 50 basis points at its June meeting, bringing the Bank Rate to 5 per cent. As shown in Figure 4, since the Bank of England gained independence in 1997, the current tightening cycle is the most aggressive in terms of pace and magnitude of rate hikes.

**Figure 4-** Bank Rate historical tightening cycles




Source: Bank of England, NIESR calculations

Despite headline inflation seeing an unexpectedly large fall to 7.9 per cent today, the MPC will continue to worry that underlying inflation estimates – which aim to indicate where inflation 'really' is, once transient shocks, like volatile energy price rises, pass – remain well above the 2 per cent target. As a result, another rate rise, possibly by 25 basis points, may be on the horizon for August. That said, with much of the 'heavy lifting' having already taken place, the MPC walks a fine line in not over-tightening over the course of the coming months.

## 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.

For further information please contact the NIESR Press Office: press@niesr.ac.uk or Luca Pieri on 020 7654 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