National Institute of Economic and Social Research

NIESR Monthly CPI Tracker

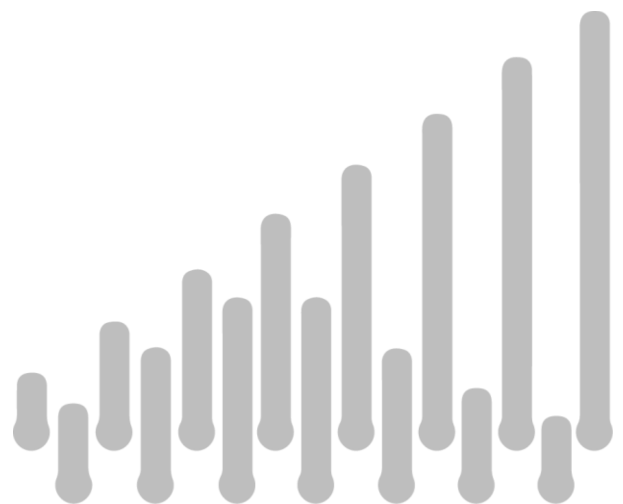
CPI Holds at 6.7 per cent as Measures of Underlying Inflation Remain High

Paula Bejarano Carbo

18th October 2023

"Today's data indicates that annual CPI inflation was 6.7 per cent in September, unchanged from August, as downwards contributions, particularly from the food and non-alcoholic beverages category, were offset by price rises in motor fuels and transport. Core CPI fell marginally to 6.1 per cent in September, down from 6.2 per cent in August while NIESR's measure of trimmed-mean inflation fell from 7.9 per cent in August to 7.3 per cent in September. Altogether, these data demonstrate that elevated underlying inflationary pressures continue to generate persistence in inflation, meaning it will fall more gradually than expected."

Paula Bejarano Carbo
Associate Economist, NIESR



Main points

- Annual consumer price inflation was 6.7 per cent in September, unchanged from August. This figure reflects decreases in the annual rates of inflation of items such as food and alcoholic beverages, and furniture and household goods being offset by price rises in motor fuels and categories such as transport and education.

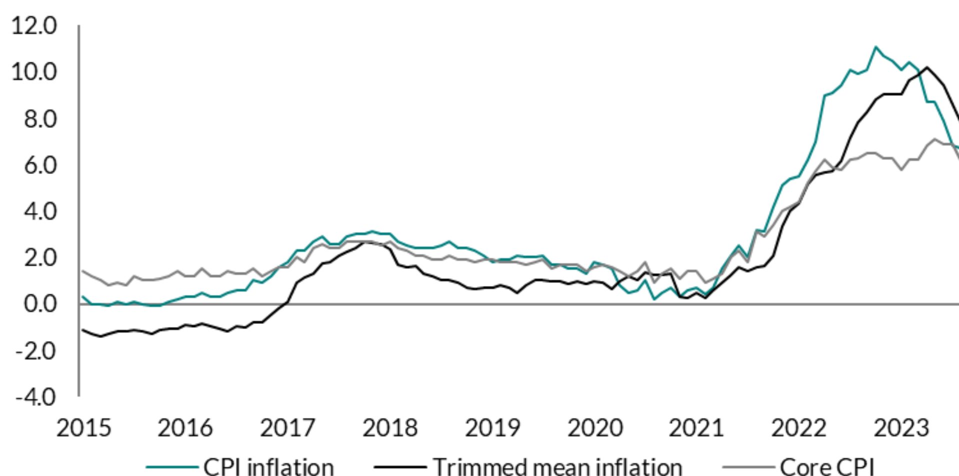
- Food inflation fell to an annual rate of 12.1 per cent, down from 13.6 per cent in August. Still, that it remains so elevated is concerning since there is no government support to help households (especially lower income households, who spend a greater part of their incomes on food) offset this cost.

- Core CPI was 6.1 per cent in the year to September, down from 6.2 per cent in August; NIESR's measure of trimmed-mean CPI inflation fell from 7.9 per cent to 7.3 per cent on the month; and annual services CPI inflation rose marginally from 6.8 per cent in August to 6.9 per cent in September. These measures indicate that underlying inflationary pressures remain elevated and continue to generate persistence in the headline rate.

- The ONS recently released an article on the role of labour costs and profits in UK inflation from 2010 to 2023. The article finds that the GDP deflator (a good measure of *domestic* inflation) rose by 7.9 per cent in the year to the second quarter of 2023; of this, higher unit labour costs contributed around 3.3 percentage points while higher unit profits contributed about 1.6 percentage points, in line with previous inflation cycles. Thus, the article finds that there has been no clear increase in the relative contributions of each of these components in domestic inflation in recent quarters compared to the time period studied.

- 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)



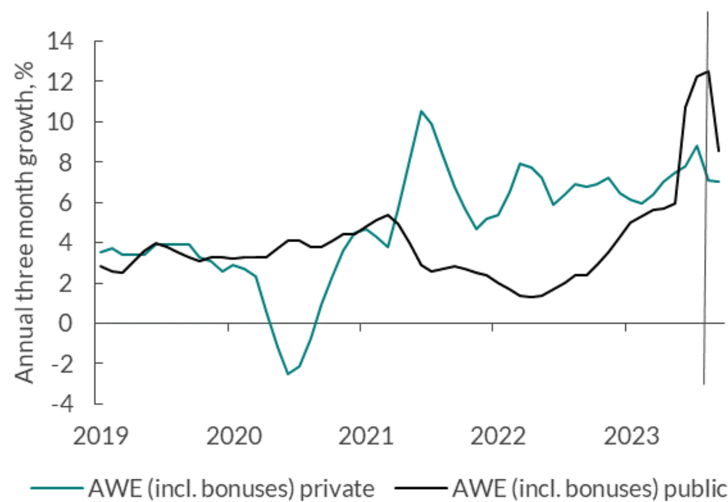
Note: Our measure of trimmed mean inflation excludes 5 per cent of the highest and lowest price changes. Source: ONS, NIESR Calculations.

Economic Setting

Last week, we released our GDP Tracker, which noted that monthly GDP grew by 0.2 per cent in August, driven by increasing output in the services sector. Looking at the broader picture, GDP grew by 0.3 per cent in the three months to July; however, the UK economy has largely flatlined since the initial stages of the post-pandemic recovery. Consistent with this longer-term trend of little to no growth, we forecast GDP to contract by 0.1 per cent in the third quarter of 2023 but to grow by 0.2 per cent in the fourth quarter of 2023.

The latest ONS labour market data suggested that the annual growth rate of average weekly earnings, including bonuses, was 8.1 per cent in the three months to August, while pay growth excluding bonuses was 7.8 per cent - representing one of the highest growth rates in regular pay seen since comparable records began in 2001. Our wage tracker highlighted that, though there are increasingly tangible signs that the labour market is cooling – such as a decrease in vacancies – the labour market remains quite tight. As a result, we forecast economy-wide total pay growth at 7.2 and 6.7 per cent in the third and fourth quarters of 2023, respectively. This elevated wage growth may contribute to generating further inflationary persistence, particularly by maintaining services inflation at an elevated rate.

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

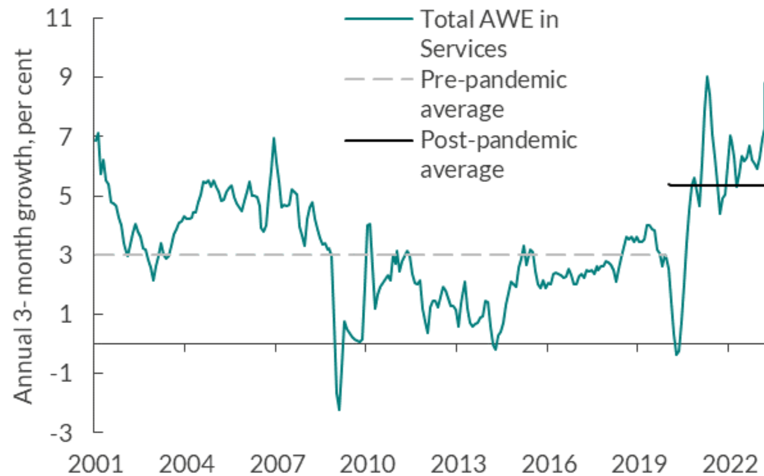


Source: ONS, NIESR Calculations.

Services sector total AWE annual growth has been on an increasing path since the initial pandemic-related plummet and currently stands at 8.3 per cent in the three months to August. 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 5.4 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

CPI inflation, which today's data suggests was 6.9 per cent in September, up from 6.8 per cent in August.

Figure 3 – Total average weekly earnings in the services sector



Source: ONS

Inflation Analysis

Annual consumer price inflation was 6.7 per cent in September, unchanged from August. This figure reflects decreases in the annual rates of inflation of items such as food and alcoholic beverages, and furniture and household goods being offset by price rises in motor fuels and categories such as transport and education.

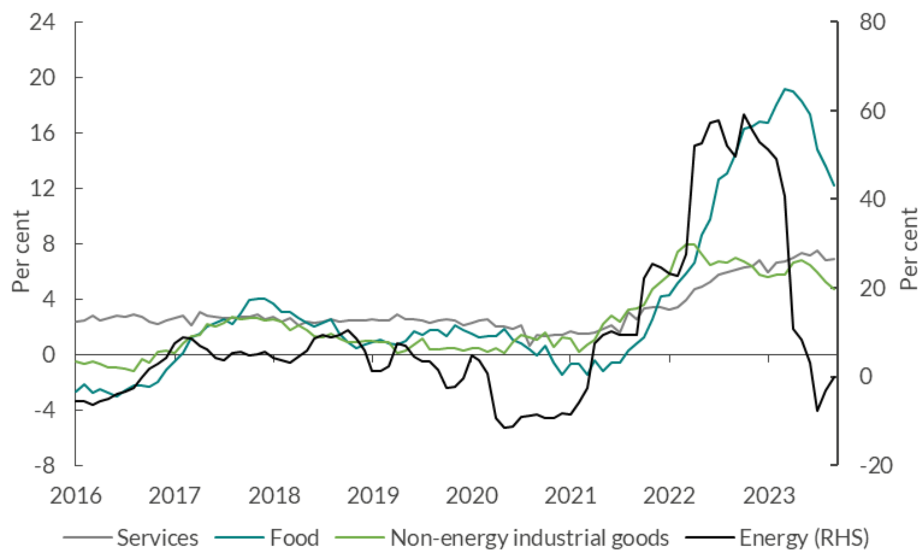
NIESR's measure of underlying inflation, which excludes 5 per cent of the highest and lowest price changes, fell to 7.3 per cent in September from 7.9 per cent in August. Trimmed-mean inflation remaining higher than headline CPI suggests that there are currently more extreme price decreases (e.g., food) driving the fall in headline CPI.

The latest data suggest that, though motor fuel prices increased in August and September, annual energy price inflation decreased overall on the year by 0.2 per cent in September. With energy price rises 'falling out' of the CPI basket, the drivers of inflationary pressures have shifted towards food, non-energy goods, and services prices (Figure 4). That said, it is possible that events such as the horrible wars between Israel and Hamas, as well as Russia and Ukraine, may lead to energy price increases should they escalate further.

Services inflation has averaged around 6 to 7 per cent over the course of 2023, and this figure rose from 6.8 per cent in August to 6.9 per cent in September. While services inflation remains entrenched in this range, non-energy goods inflation – which previously also averaged around 6 to 7 per cent – has been softening moderately in the second half of 2023. As a result of services inflation remaining stubbornly elevated and non-energy goods inflation decreasing slowly, core inflation has been falling only very gradually since peaking at 7.1 per cent in May (Figure 1).

As shown in figure 1, we have reached a potential a turning point in underlying inflation. That said, with services CPI inflation being a key component of underlying inflationary persistence in the United Kingdom, and wage growth remaining strong in the services sector, there is a risk that inflation will continue to exhibit persistence in the months to come. It should be noted that, though wage growth poses an upwards risk to inflationary persistence, there is little chance that a wage-price spiral will ensue, as suggested by recent ONS findings.

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



Source: ONS

The ONS recently released an article on the role of labour costs and profits in UK inflation from 2010 to 2023. The article finds that the GDP deflator (a good measure of domestic inflation) rose by 7.9 per cent in the year to the second quarter of 2023; of this, higher unit labour costs contributed around 3.3 percentage points while higher unit profits contributed about 1.6 percentage points, in line with previous inflation cycles. Thus, the article finds that there has been no clear increase in the relative contributions of each of these components in domestic inflation in recent quarters compared to the time period studied. It should be further noted that this decomposition does not imply that inflation is high because labour costs or profits have increased (as rises in these categories may reflect ‘second-round’ responses to the inflation shock caused by Russia’s invasion of Ukraine). The key takeaway is that the ONS finds that labour costs’ and profits’ contributions to domestic inflation during this cost-of-living crisis are proportional to their contributions in the past decade.

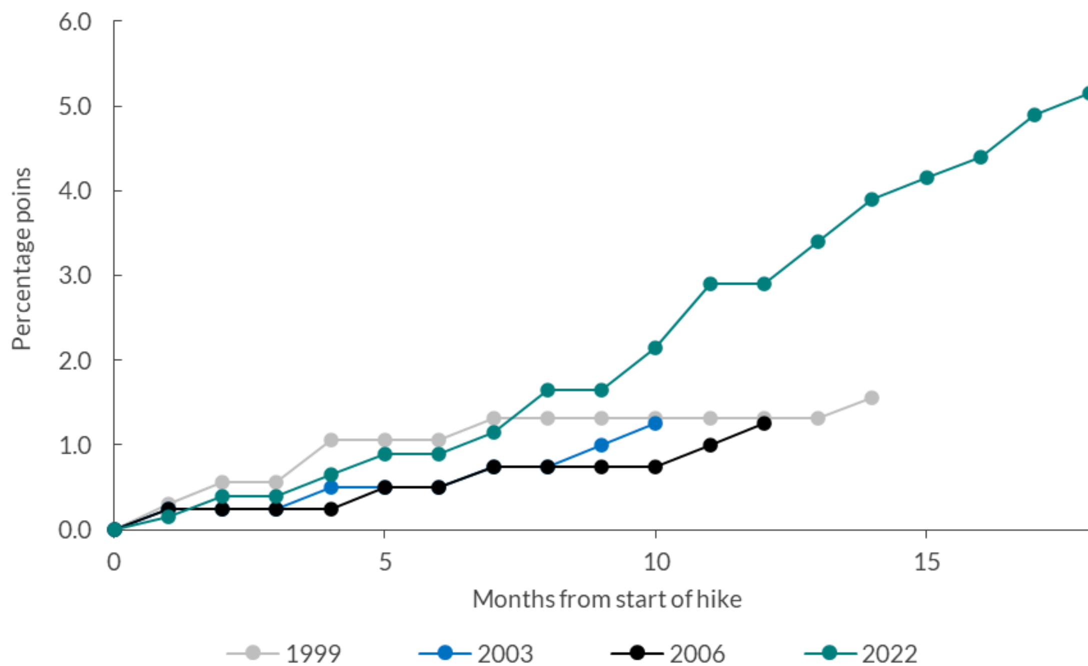
Monetary Policy Analysis

The MPC opted to maintain the Bank Rate at 5.25 per cent in its September meeting, following its decision to raise rates by 25 basis points in its August meeting. As shown in Figure 5, 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.

Our recent Summer UK Economic Outlook conditioned our forecast on a path with the Bank Rate peaking at 5.50 per cent, indicating what we thought the Bank of England should do (rather than what we necessarily thought it might do) given the latest data at the time of writing. Given today's data, and the fall in CPI inflation we expect to see in October emphasised in this blog written by my colleague Huw Dixon, we think it is likely that the Bank Rate has already peaked, and the MPC will hold this rate for some time, conditional on future inflationary developments.

Regardless of where the Bank Rate peaks, the MPC needs to communicate more clearly and let markets as well as the public know when it thinks that it's done enough to bring inflation back to target. For instance, if the MPC opts for a Bank Rate path that is less aggressive than markets expect because of the output-inflation trade-off, it ought to be clear in communicating that; failing to do so risks incurring further criticism as well as further adverse market reaction (Chadha 2023).

Figure 5- Bank Rate historical tightening cycles



Source: Bank of England, 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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