National Institute of Economic and Social Research

NIESR Monthly CPI Tracker

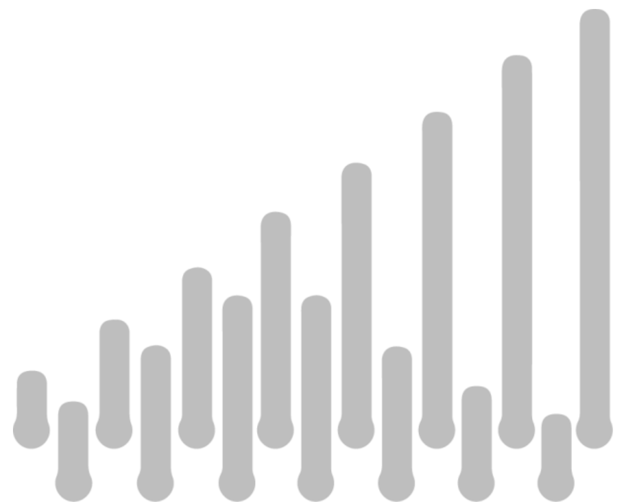
Downward Contributions in Nearly all Categories Bring CPI to 3.9%

Paula Bejarano Carbo

20th December 2023

"Today's data indicate that annual CPI inflation was 3.9 per cent in November, down from 4.6 per cent in October, driven by downward contributions from almost all items, particularly transport, recreation and culture, and food and non-alcoholic beverages. Core CPI inflation fell from 5.7 per cent in October to 5.1 per cent in November; services inflation fell from 6.6 per cent in October to 6.3 per cent in November; and NIESR's measure of trimmed-mean inflation fell from 6.5 per cent in October to 5.7 per cent in November. Though it is good news that these measures are easing significantly, they indicate that underlying inflationary pressures remain elevated (indeed above the headline CPI rate) and may therefore continue to generate persistence in inflation. So, while today's data represent a positive surprise, there is still some way to go before inflation reaches the Bank of England's target, which, as set by the government, is to achieve a 2 per cent inflation rate."

Paula Bejarano Carbo
Associate Economist, NIESR



Main points

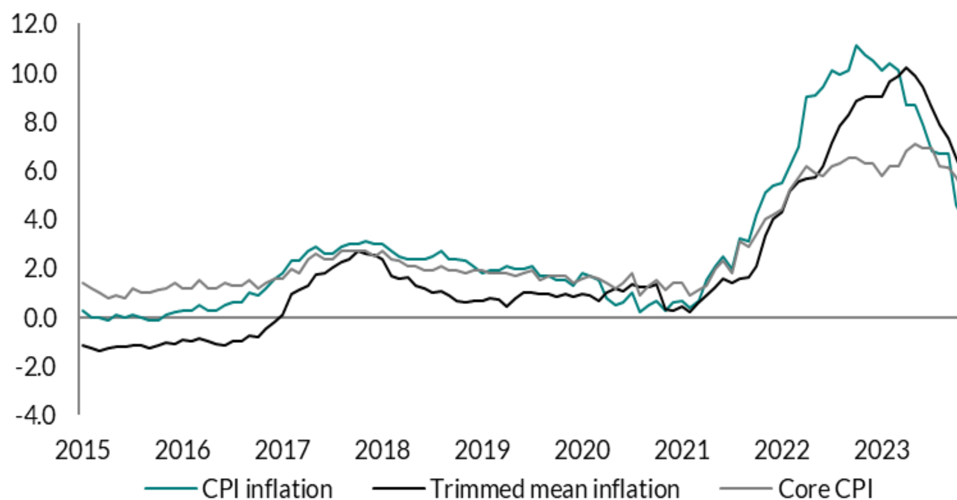
- Annual consumer price inflation was 3.9 per cent in November, the lowest level since September 2021, decreasing from 4.6 per cent in October. This figure reflects downward contributions from almost all items, particularly transport, recreation and culture, and food and non-alcoholic beverages. This easing of price pressures was partially offset by price increases in housing and household services, and restaurants and hotels.

- Food inflation fell to an annual rate of 9.2 per cent, the lowest level since May 2022, and down from 10.1 per in October. However, the fact 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.

- Energy prices 'dropping out' of the CPI basket calculation have been the main driver of the recent falls in the CPI rate. In November, decreases in the petrol and diesel prices led overall motor fuels prices to fall by 10.6 per cent. In turn, this led to price decreases in sectors that rely on motor fuels as primary inputs. The transport sector, for instance, saw its CPI inflation rate fall by 1.5 per cent in November, contributing 0.27 percentage points in the overall decline in the CPI rate between October and November.

- 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)



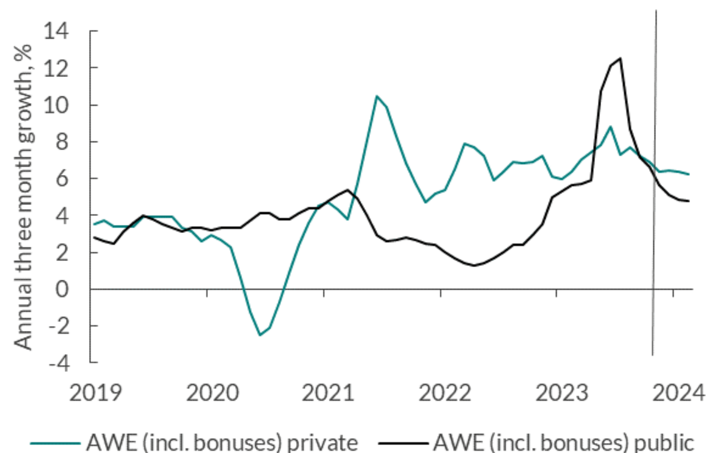
Note: Our measure of trimmed mean inflation excludes 5 per cent of the highest and lowest price changes. Source: ONS, NIESR Calculations.

Economic Setting

Last week, we released our GDP Tracker, which noted that output contracted by 0.3 per cent in October on a monthly basis, driven by decreased services output and exacerbated by declines in production and construction output as well. Looking at the broader picture, GDP remained flat in the three months to October 2023. Further, 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 flatline 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 7.2 per cent in the three months to October, while pay growth excluding bonuses was 7.3 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 –itremains quite tight by historical standards. As a result, we forecast economy-wide regular and total pay growth of 6.3 and 6.2 per cent in the fourth quarter of 2023, respectively. This high wage growth may contribute to generating further inflationary persistence, particularly by maintaining services inflation at an elevated rate.

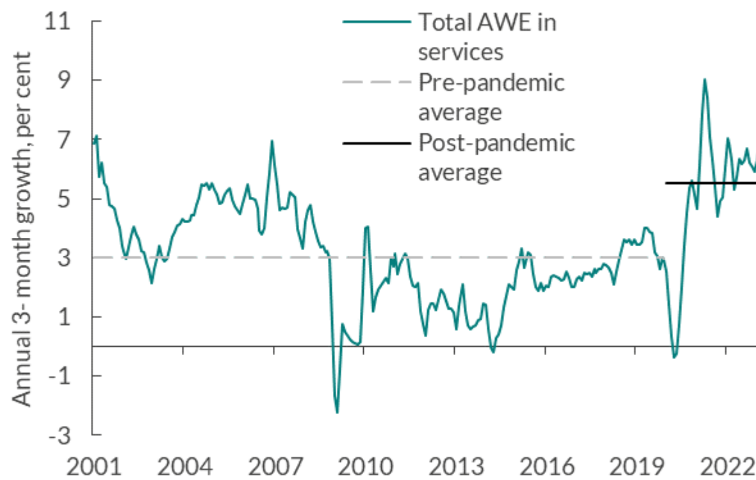
Figure 2 – Average weekly earnings growth (including bonuses) in the public and private sectors



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 7.4 per cent in Q3. 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 5.5 per cent (even accounting for the initial covid-related plummet). Given that wages in the services sector account for most of the sector's input costs, it is the main driver of services CPI inflation, which today's data suggest was 6.3 per cent in November, down from 6.6 per cent in October.

Figure 3 – Total average weekly earnings in the services sector



Source: ONS

Inflation Analysis

Annual consumer price inflation was 3.9 per cent in November, the lowest level since September 2021, decreasing from 4.6 per cent in October. This figure reflects downward contributions from almost all items, particularly transport, recreation and culture, and food and non-alcoholic beverages. This easing of price pressures was partially offset by price increases in housing and household services, and restaurants and hotels.

The latest data suggest that annual energy price inflation decreased overall on the year by 16.9 per cent in November. Energy prices 'dropping out' of the CPI basket calculation have driven the recent falls in the CPI rate. In November, decreases in the petrol and diesel prices led overall motor fuels prices to fall by 10.6 per cent. In turn, this led to price decreases in sectors that rely on motor fuels as primary inputs. The transport sector, for instance, saw its CPI inflation rate fall by 1.5 per cent in November, contributing 0.27 percentage points in the overall decline in the CPI rate between October and November.

With energy price rises falling out of the CPI basket and becoming downward contributors to headline inflation, the drivers of inflationary pressures have shifted towards food, non-energy goods, and services prices, though these are also easing (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 fell from 6.6 per cent in October to 6.3 per cent in November. 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 consistently in the second half of 2023, falling from 4.3 per

cent in October to 3.2 per cent in November. As a result of a slight fall in services inflation and a steady decline in non-energy goods inflation, core inflation fell from 5.7 per cent in October to 5.1 per cent in November (Figure 1).

As shown in figure 1, we have reached 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.

NIESR's measure of underlying inflation, which excludes 5 per cent of the highest and lowest price changes, fell to 5.7 per cent in November from 6.5 per cent in October. Trimmed-mean inflation remaining higher than headline CPI suggests that there are currently more extreme price decreases (e.g., energy) driving the fall in headline CPI. Taken together, core inflation and our trimmed-mean inflation figure indicate that underlying inflationary pressures remain elevated (and indeed now above the headline CPI rate) and therefore may continue to generate persistence in the headline rate. That said, it is good news that they are easing significantly.

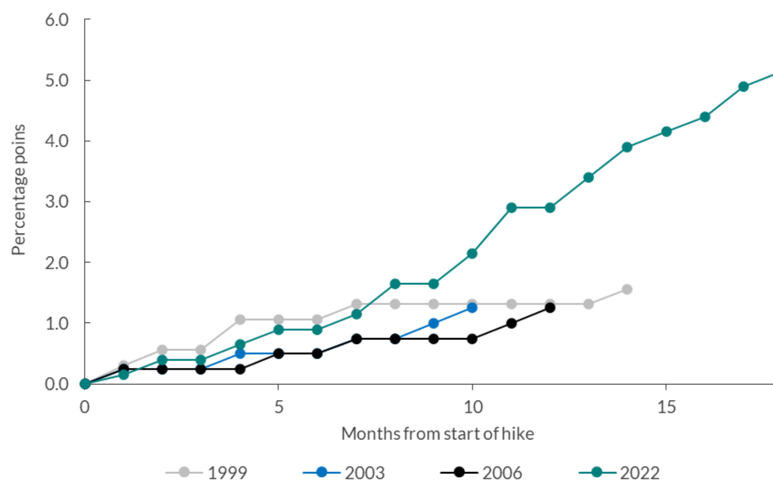
Monetary Policy Analysis

The MPC opted to maintain the Bank Rate at 5.25 per cent in its December meeting, and it last raised 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.

As noted in our Autumn UK Economic Outlook, we think it is likely that the Bank Rate has peaked at 5.25 per cent, and that the MPC will hold this rate for some time, conditional on future inflationary developments. Our forecast saw the Bank of England meeting its target of stabilising inflation in the medium-term, with inflation hitting 2 per cent at the end of 2025.

Today's data represent a positive downwards surprise, though it is important to remember that headline CPI remains close to double that of the target rate. Still, it begs the questions of whether inflation will hit target earlier than expected, and/or whether the MPC will begin to loosen monetary policy earlier than expected, which will certainly become clearer in the coming months. Regardless of what the data outturn may be, it is evident that clear communication surrounding the path of monetary policy can help coordinate expectations between the MPC, markets and the wider public. Given that the next MPC meeting is not until February, we may see some uncertainty reflected in markets and some extra attention being placed on MPC members' communications (e.g. speeches) for the time being.

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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