# NIESR Monthly CPI Tracker

## Monthly Rise in CPI Likely Reflective of 'Noise'

Paula Bejarano Carbo

**17th January 2024**

*"Today's data indicate that annual CPI inflation was 4.0 per cent in December, rising marginally from 3.9 per cent in November, driven by price increases in alcoholic beverages and tobacco, as well as categories such as clothing and footwear, which were partially offset by price decreases in food and non-alcoholic beverages. Given that the largest contributors to movements in the annual rate of CPI inflation were highly volatile items (alcohol, tobacco and food), it is likely that this slight rise is more reflective of 'noise' rather than a genuine signal of a change in the declining trend of inflation. Indeed, when we exclude volatile items from the CPI calculation, we see that core inflation (CPI inflation excluding food, alcohol, energy and tobacco), remained unchanged at 5.1 per cent in December, while NIESR's trimmed-mean measure (which excludes the 5 per cent most volatile price movements on either end of the distribution) fell from 5.7 per cent in November to 5.5 per cent in December. That said, with services inflation rising slightly from 6.3 per cent in November to 6.4 per cent in December, as well as the possibly inflationary effects of recent geopolitical events, there is a risk that inflationary pressures may rise further in the coming months."*

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

## Main points

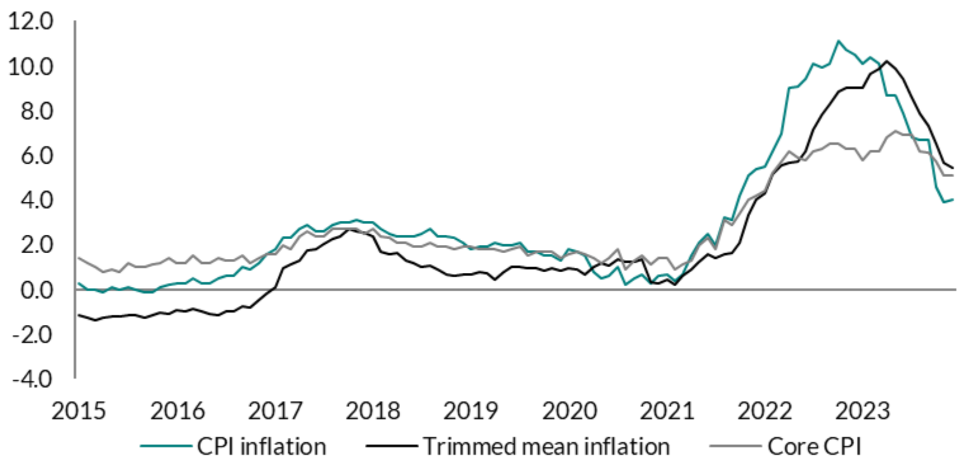
- Annual consumer price inflation was 4.0 per cent in December, rising from 3.9 per cent in November, and marking the first time the rate has increased since February 2023. This figure reflects price increases in alcoholic beverages and tobacco, as well as categories such as clothing and footwear, which were partially offset by price decreases in food and non-alcoholic beverages. However, food, alcohol and tobacco are items that often see volatile price movements; thus, it is likely that this slight rise is more reflective of 'noise' rather than a genuine signal of a change in the declining trend of inflation.

- NIESR's measure of underlying inflation, which excludes 5 per cent of the highest and lowest price changes to eliminate volatility and separate the signal from the 'noise', fell to 5.5 per cent in December from 5.7 per cent in November. At the same time, core CPI remained unchanged at 5.1 per cent in December. These measures can be taken as further evidence that, though underlying inflationary pressures remain elevated (above the headline rate), today's upward surprise in headline inflation is reflective of volatile, but transient, price movements that should not affect the path of interest rates.

- Food inflation fell to an annual rate of 8.0 per cent, down from 9.2 per in November. 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.

- 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)



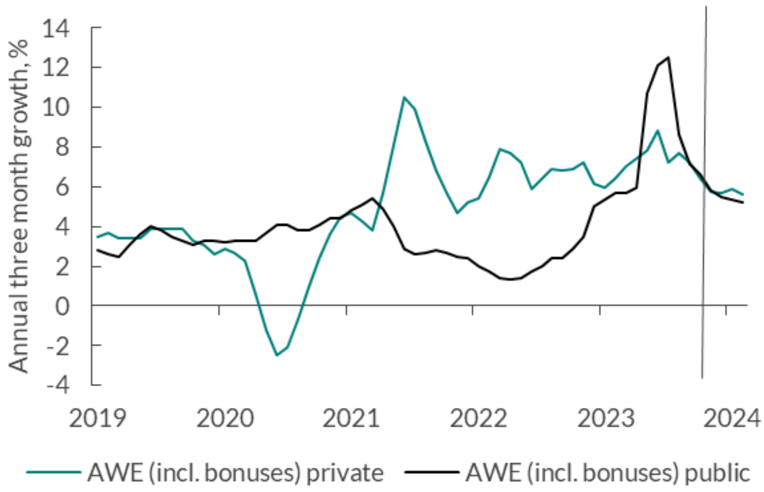

Note: Our measure of trimmed mean inflation excludes 5 per cent of the highest and lowest price changes. Source: ONS, NIESR Calculations.

## Economic Setting

Last week, we released our GDP Tracker, which noted that output grew by 0.3 per cent in November relative to October, driven by decreased increased services sector output. Looking at the broader picture, GDP 0.2 per cent in the three months to November 2023 relative to the previous three-month period. This led us to estimate that GDP flatlined in the fourth quarter of 2023, and forecast GDP to grow by 0.2 per cent in the first quarter of 2024. These figures remain broadly consistent with the longer-term trend of low, but stable economic growth in the United Kingdom.

The latest ONS labour market data suggested that the annual growth rate of average weekly earnings, including bonuses, was 6.5 per cent in the three months to November 2023 while pay growth excluding bonuses was 6.6 per cent. These figures indicate that wage growth continued to soften towards the end of 2023, after peaking over summer. 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 tight by historical standards. As a result, we estimated economy-wide total pay (incl. bonuses) and regular pay to have grown on the year at 5.7 and 6.2 in the fourth quarter of 2023, respectively. Our forecast for the first quarter of 2024 sees these figures at 5.6 and 6.0 per cent, respectively. Importantly, this high wage growth may contribute to generating further inflationary persistence, particularly by maintaining services inflation at an elevated rate.

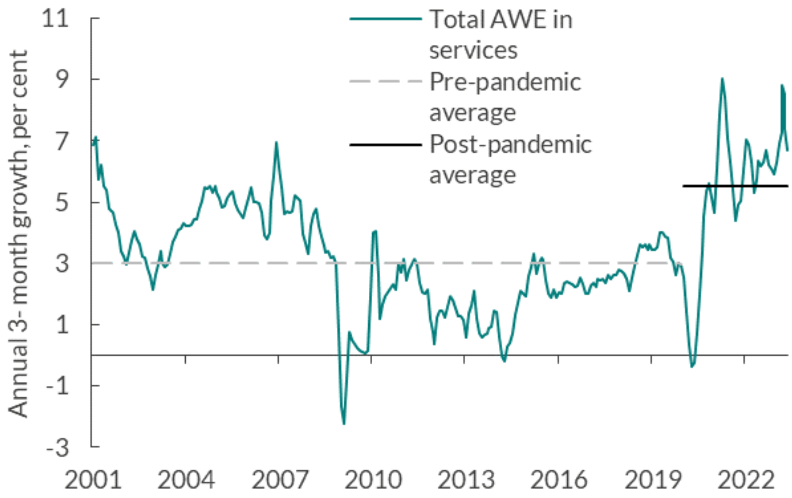
**Figure 2 –** Average weekly earnings growth (including bonuses) in the public and private sectors




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 6.7 per cent in the three months to November 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 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 6.4 per cent in December, rising slightly from 6.3 per cent in October.

**Figure 3 –** Total average weekly earnings in the services sector



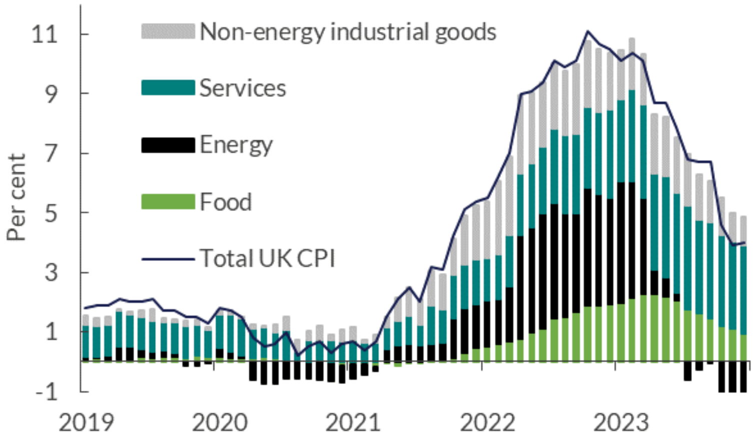

Source: ONS

## Inflation Analysis

Annual consumer price inflation was 4.0 per cent in December, rising from 3.9 per cent in November, and marking the first time the rate has increased since February 2023. This figure reflects price increases in alcoholic beverages and tobacco, as well as categories such as clothing and footwear, which were partially offset by price decreases in food and non-alcoholic beverages. Transport also contributed to the slight rise, largely resulting from increasing air fares (as is expected in the holiday season), and amplified by the fact that the weight for this subclass doubled between 2022 and 2023 as the average consumer's basket changed post-pandemic. However, food, alcohol, tobacco and air fares are all items that often see volatile price movements; in fact, they are among the most volatile items in the basket. Thus, it is likely that this slight rise is more reflective of 'noise' rather than a genuine signal of a change in the declining trend of inflation.

The latest data suggest that annual energy price inflation decreased overall on the year by 17.3 per cent in December. Energy prices 'dropping out' of the CPI basket calculation have driven the recent falls in the CPI rate (Figure 4). 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 have also been easing throughout 2023 (Figure 4).

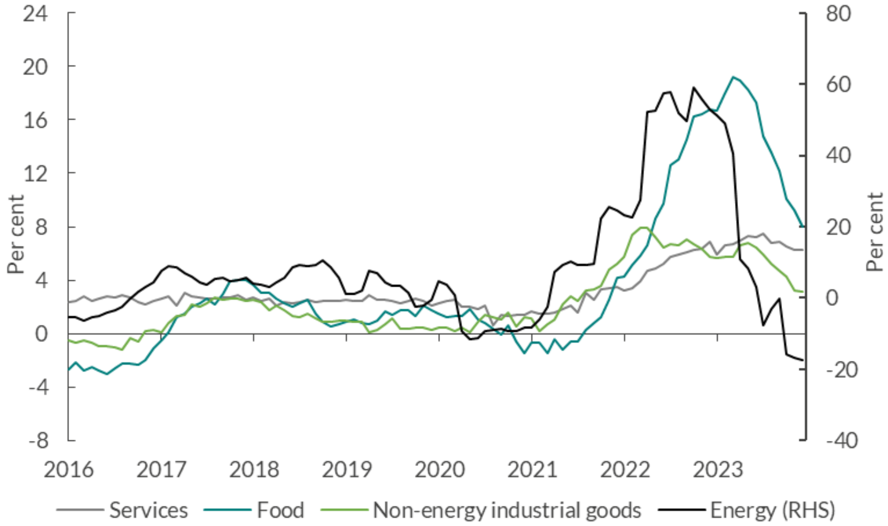
**Figure 4 –** Contributions of sectors to the consumer price index (annual per cent)




Source: ONS, author's calculations

Services inflation has averaged around 6 to 7 per cent over the course of 2023, and this figure rose marginally from 6.3 per cent in November to 6.4 in December. 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 3.2 per cent in November to 3.1 per cent in December (Figure 5). As a result of the slight rise in services inflation and the moderate decline in non-energy goods inflation offsetting each other, core inflation remained unchanged at 5.1 per cent in December (Figure 1).

**Figure 5 –** Inflation for elements of the consumer price index (annual per cent)




Source: ONS

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.

NIESR's measure of underlying inflation, which excludes 5 per cent of the highest and lowest price changes to eliminate volatility and separate the signal from the 'noise', fell to 5.5 per cent in December from 5.7 per cent in November. This indicates that, when we exclude volatile upwards price movements such as alcohol, tobacco and air fares, this measure of underlying inflationary pressure has decreased, signalling that the slight rise in headline inflation between November and December is likely not reflective of a change in the declining trend of inflation. That said, trimmed-mean inflation remaining higher than headline CPI suggests that there are, overall, more extreme price decreases (e.g., energy and food) driving the fall in headline CPI and that high inflationary pressures still remain broad-based within the CPI basket.

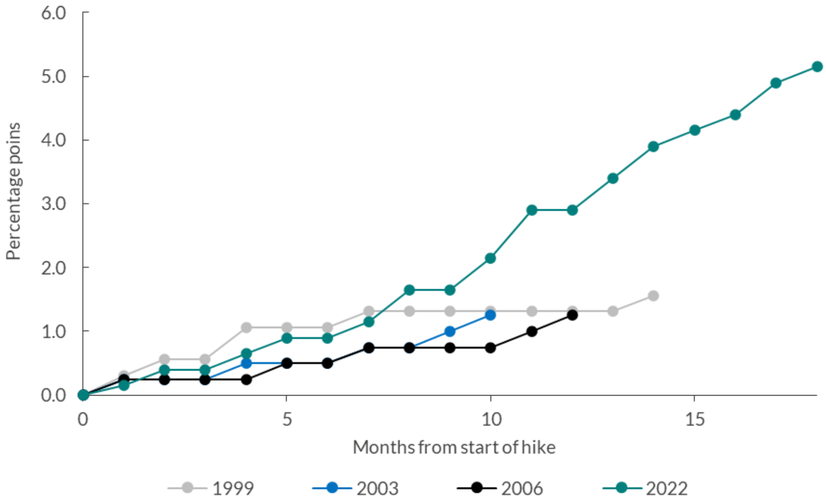
Taken together, core inflation and our trimmed-mean inflation figure indicate that underlying inflationary pressures remain elevated (above the headline CPI rate) and therefore may continue to generate persistence in the headline rate. That said, it is good news that they have not risen alongside headline CPI inflation.

## 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.

Today's data represent an upward surprise following months of downward surprises in the CPI data. That said, given that today's small rise is likely more reflective of 'noise' rather than signalling a change in the downward trend of inflation, this upward surprise does not have significant implications for the path of interest rates. Monetary policy should not respond to transient or volatile price movements; therefore, today's data does not necessarily imply a need to raise rates further. At the MPC's upcoming meeting on 1 February, we might therefore expect rates to be held at 5.25 per cent.

**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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