National Institute of Economic and Social Research

NIESR Monthly CPI Tracker

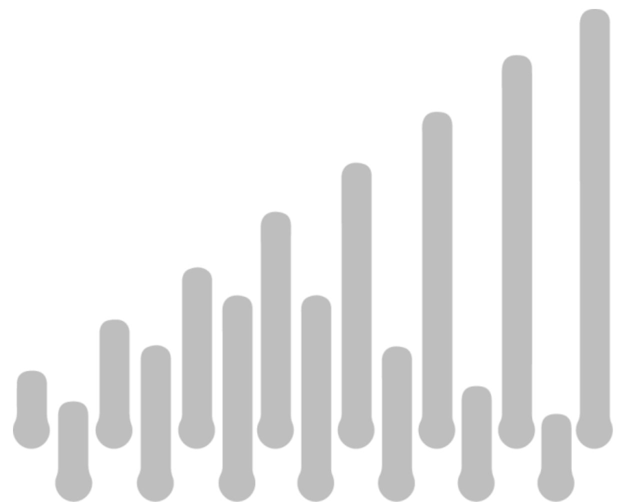
No Rate Cut Expected at Tomorrow's MPC Meeting

Paula Bejarano Carbo

March 2024

"Annual CPI inflation was 3.4 per cent in February, falling from 4.0 per cent in January, driven by downward contributions from food and alcoholic beverages. This figure represents the lowest annual CPI inflation figure since September 2021 and possibly signals that the MPC can start to cut interest rates in the coming months – though we don't expect any change at tomorrow's meeting."

Paula Bejarano Carbo
Economist, NIESR



Main points

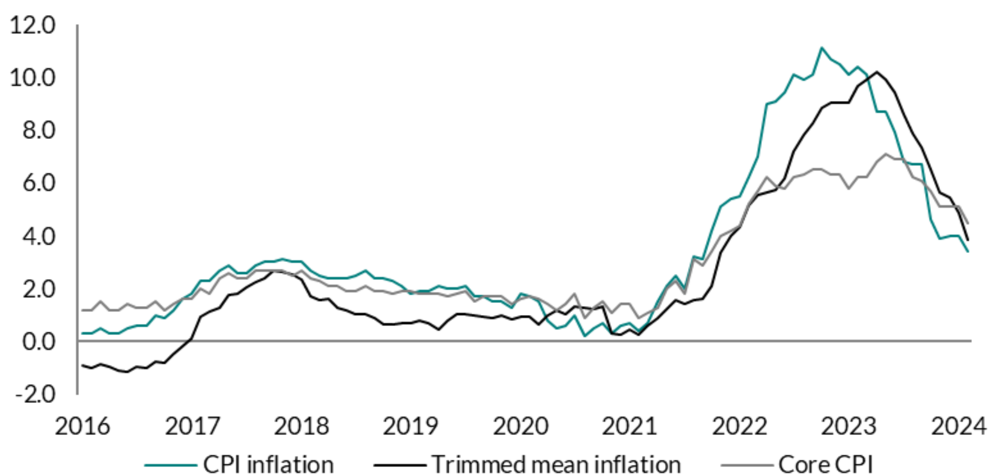
- Annual consumer price inflation was 3.4 per cent in February, falling from 4.0 per cent in January. This figure reflects upward contributions, such as those from housing and household services, and motor fuels, being offset by downward contributions, such as in in food and alcoholic beverages.

- This fall in the annual CPI inflation rate was expected, given base effects from the large energy price increases observed in early 2023. However, today's figure is higher than projected in my colleague Huw Dixon's blog last month, indicating that month-on-month inflation was actually higher than expected. While inflation is set to fall throughout the remainder of the first half of 2024 due to base effects, it will be important to keep an eye on month-on-month figures to determine to what extent we will see inflation rebound in the second half of 2024. Still, we expect these upcoming falls to enable the MPC start cutting interest rates soon.

- While indicators of underlying inflationary pressures all fell on the month, they remain high, which may require the MPC to exercise caution in such monetary loosening. 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 3.9 per cent in February from 4.9 per cent in January; core CPI fell to 4.5 per cent from 5.1 per cent; and services inflation fell to 6.1 per cent from 6.5 per cent. These measures indicate that underlying inflationary pressures remain elevated – and well above the 2 per cent target. As a result, we expect the BoE to keep interest rates unchanged in the upcoming MPC meeting this week.

- 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)



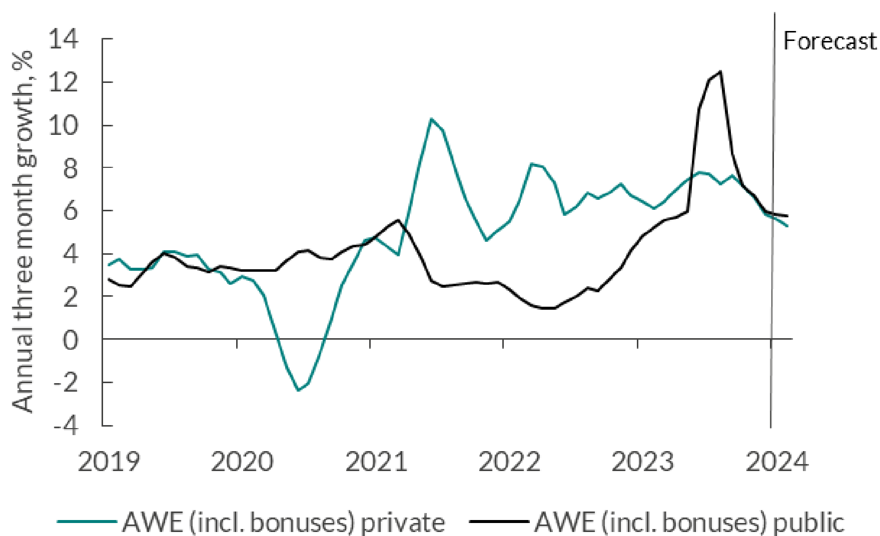
Note: Our measure of trimmed mean inflation excludes 5 per cent of the highest and lowest price changes. Source: ONS, NIESR Calculations.

Economic Setting

Last week, we released our GDP Tracker, which noted that GDP contracted by 0.1 per cent in the three months to January and forecast GDP growth to remain low, but stable, at around 0.3 per cent in the first quarter of 2024. This projection is consistent with the longer-term trend of sluggish economic growth in the United Kingdom.

Last week's ONS labour market data suggested that the annual growth rate of average weekly earnings, including bonuses, was 5.6 per cent in the three months to January 2024 while pay growth excluding bonuses was 6.1 per cent. These figures indicate that wage growth continued to soften at the start of 2024, after peaking over summer 2023 (Figure 2). Our Wage Tracker highlighted that, the vacancy-to-unemployment ratio stood at 0.7 in January, compared to an average of 0.52 in 2015-2019 and a historical average of 0.42, indicating that the labour market is still somewhat tight. As a result, we forecast economy-wide total pay (incl. bonuses) and regular pay to grow on the year by 5.4 and 5.7 in the first quarter of 2024, respectively. These figures remain elevated relative to their post-2001 averages of 3.3 and 3.2 per cent, respectively.

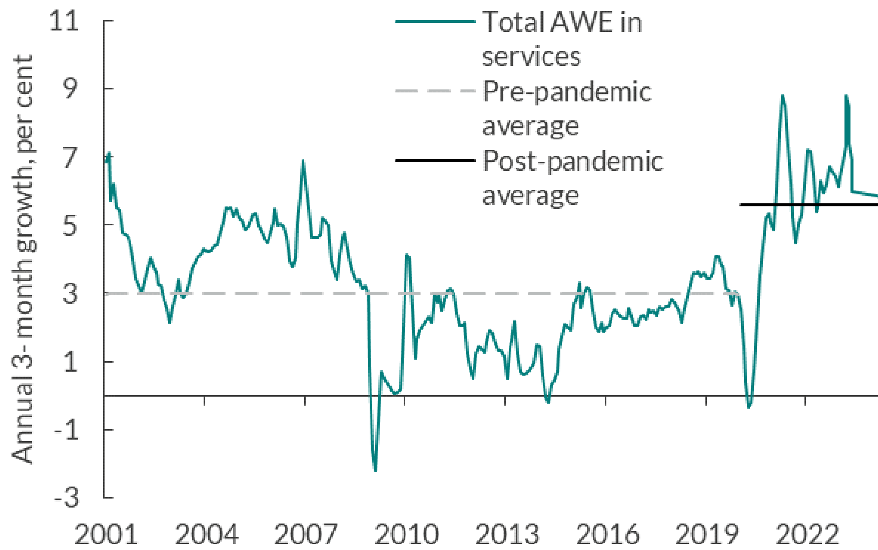
Figure 2 – Average weekly earnings growth (including bonuses) in the public and private sectors



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 5.8 per cent in the three months to January. 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 5.6 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 6.1 per cent in February, falling from 6.5 per cent in January.

Figure 3 – Total average weekly earnings in the services sector



Source: ONS

While this still-high wage growth may contribute to generating further inflationary persistence, particularly by maintaining services inflation at an elevated rate, it is good news that wage growth (economy-wide and in the services sector) has softened significantly in recent months. If this trend continues, it may give monetary policymakers increased confidence around cutting interest rates soon (more on this below).

Inflation Analysis

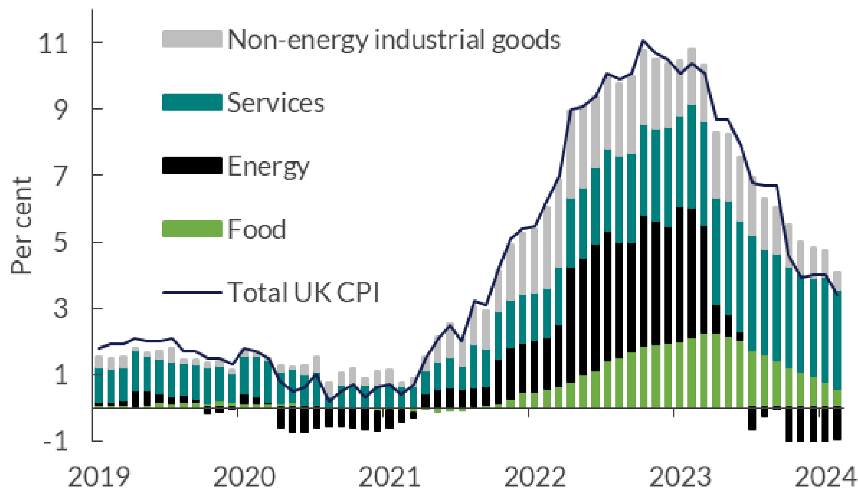
Annual consumer price inflation was 3.4 per cent in February, falling from 4.0 per cent in January. This figure reflects upward contributions, such as those from housing and household services, and motor fuels, being offset by downward contributions, such as in in food and alcoholic beverages.

The latest data suggest that annual energy price inflation decreased overall on the year by 13.8 per cent in February. Energy prices 'dropping out' of the CPI basket calculation have driven the downward trend 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 the former have been easing since 2023 (Figure 4).

Services inflation fell from 6.5 per cent in January to 6.1 per cent in February. Despite this welcome fall, we should note that this figure has averaged around 6 to 7 per cent since the second half of 2022, and has been the main contributor to headline inflation since March 2023 (Figure 4). 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 since the second half of 2023, falling from 2.7 per cent in January to 1.9 per cent in February (Figure 5). As a result of the decrease in services inflation and the decline in non-energy goods inflation, core inflation fell from 5.1 per cent in January to 4.5 per cent in December (Figure 1).

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

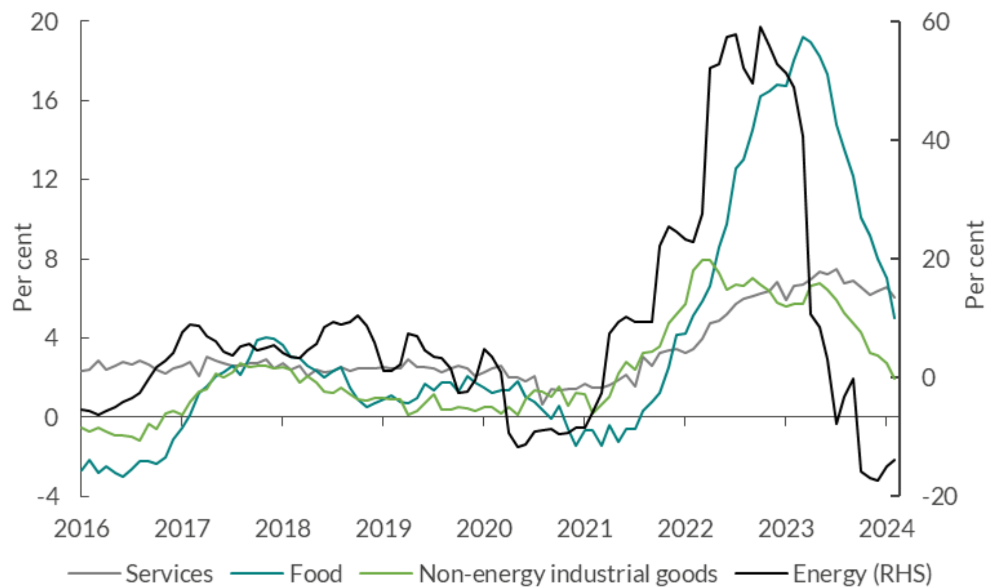


Source: ONS, author's calculations

As shown in figure 1, we have reached a turning point in underlying 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 3.9 in February from 4.9 per cent in January. This indicates that, when we exclude volatile upwards price movements such as motor fuels, this measure of underlying inflationary pressure has decreased, but remains higher than headline CPI - suggesting that there are, overall, more extreme price decreases driving the fall in headline CPI. Further, this trimmed-mean inflation measure informs us that above-target inflationary pressures 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 pose an 'upside risk' to inflation. However, that they have eased significantly in recent months is a very good sign.

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



Source: ONS

Monetary Policy Analysis

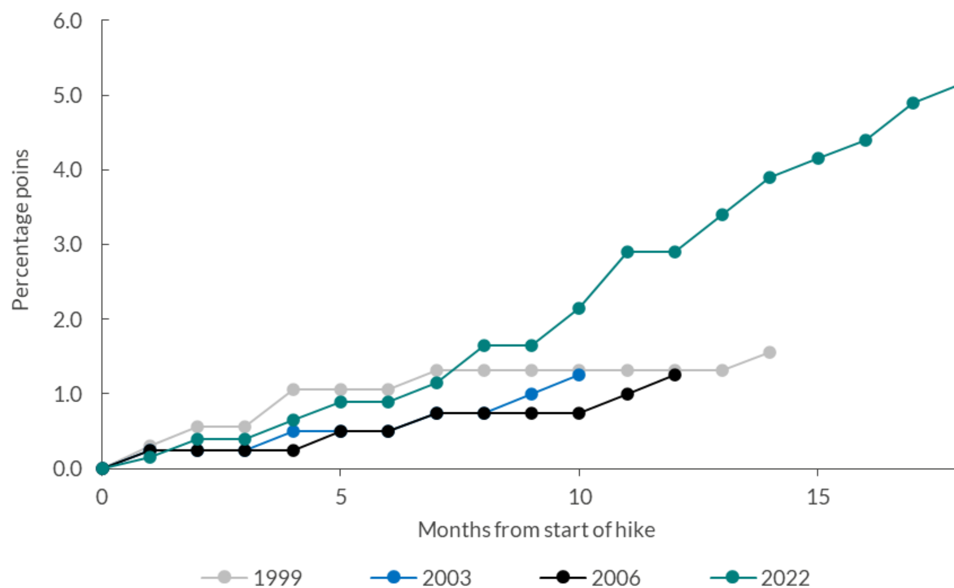
The MPC opted to maintain the Bank Rate at 5.25 per cent in its February meeting, and it last raised rates by 25 basis points in its August meeting.

Today's CPI inflation rate fell as expected, given base effects from the large energy price increases observed in early 2023. However, today's figure is higher than projected in my colleague Huw Dixon's blog last month, indicating that month-on-month inflation was actually higher than expected. While inflation is set to fall throughout the remainder of the first half of 2024 due to base effects, it will be important to keep an eye on month-on-month figures to determine to what extent we will see inflation rebound in the second half of 2024. Still, we expect these upcoming falls to enable the MPC start cutting interest rates soon.

That said, underlying inflationary pressures remaining high – most notably seen by February's services inflation figure of 6.1 per cent – may continue to worry the MPC. Paired with the possibility of an escalation of the conflicts in the Middle East and Ukraine that could affect transport costs and commodity prices, the risks to inflation are on the upside.

In our recent UK Economic Outlook, we noted that the MPC will not want to cut rates prematurely and have to raise them again. Thus, we think that some caution will be exercised in monetary loosening, though it is most likely that we will see several rate cuts this year.

Figure 6- 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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