National Institute of Economic and Social Research

NIESR Monthly CPI Tracker

CPI Falls to 4.6% as Energy Prices ‘Drop Out’ of Basket

Paula Bejarano Carbo

15th November 2023

“Annual CPI inflation was 4.6 per cent in October, down from 6.7 per cent in September, driven by a base effect (i.e. the large energy price increases that occurred in October 2022 ‘dropping out’ of the CPI basket this October) and further by not being replaced by ‘new inflation’. Core CPI fell from 6.1 per cent in September to 5.7 per cent in October, while NIESR’s trimmed-mean CPI inflation measure fell from 7.3 per cent to 6.5 per cent. While these measures indicate that underlying inflationary pressures are now more elevated than the headline figure, it is a good sign that they are continuing to ease. Though the headline figure has halved relative to last January, we still have a 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. It is important to stress that control of inflation is the job of the Monetary Policy Committee of the Bank of England and not the government. It is largely its actions, raising interest rates, that have enabled inflation to fall in this time, alongside decreasing energy prices (given that the UK is an energy importer, this is an exogenous factor). It would therefore be helpful to move the narrative away from this halving objective, and back towards the 2 per cent target.”

Paula Bejarano Carbo
Associate Economist, NIESR

Main points

- Annual consumer price inflation was 4.6 per cent in October, the lowest level in two years, decreasing from 6.7 per cent in September. This figure reflects a large fall in the housing, electricity, gas and other fuels category which contributed 1.6 percentage points out of the overall monthly fall. The drivers of these decreases were energy prices, which rose steeply last October but have now 'dropped out' of the CPI basket: for instance, gas costs fell by 31 per cent in the year to October 2023 while electricity costs fell by 15.6 per cent in this time.

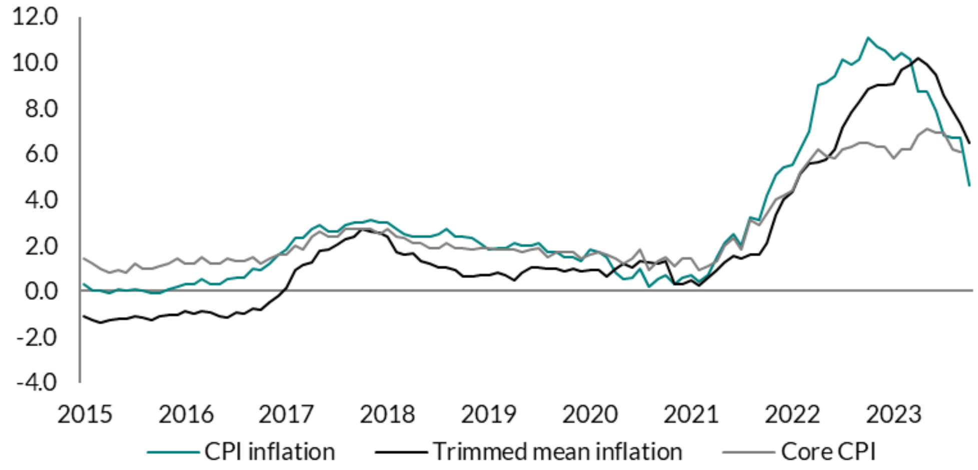
- Food inflation fell to an annual rate of 10.1 per cent, down from 12.1 per cent in September. Still, that it remains so elevated and in double-digits is concerning since there is no government support to help households (especially lower income households, who spend a greater part of their incomes on food) offset this cost.

- Core CPI was 5.7 per cent in the year to October, down from 6.1 per cent in; NIESR's measure of trimmed-mean CPI inflation fell from 7.3 to 6.5 per cent; and annual services CPI inflation fell slightly from 6.9 to 6.6 per cent. These measures 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.

- Our recent Autumn UK Economic Outlook forecasts that inflation will reach the Bank of England's 2 per cent target by the end of 2025.

- 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)



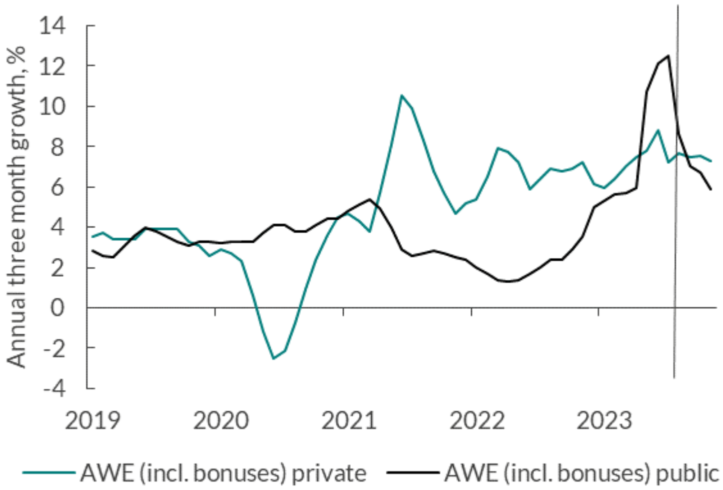
Note: Our measure of trimmed mean inflation excludes 5 per cent of the highest and lowest price changes. Source: ONS, NIESR Calculations.

Economic Setting

Last week, we released our GDP Tracker, which noted that monthly GDP grew by 0.2 per cent in September, driven by increasing output in the services sector. Looking at the broader picture, GDP remained flat in the third quarter of 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 grow only by 0.1 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 7.9 per cent in the third quarter of this year, while pay growth excluding bonuses was 7.7 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 by historical standards. As a result, we forecast economy-wide regular and total pay growth of 6.9 and 7.1 per cent in the fourth quarter of 2023, respectively. This elevated wage growth may contribute to generating further inflationary persistence, particularly by maintaining services inflation at an elevated rate.

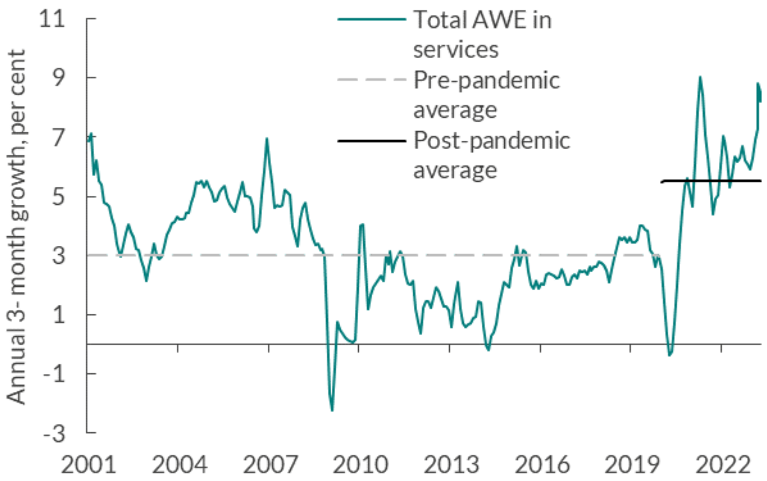
Figure 2 – Average weekly earnings growth (including bonuses) in the public and private sectors



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 8.2 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). 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 6.6 per cent in October, down from 6.9 per cent in September.

Figure 3 – Total average weekly earnings in the services sector



Source: ONS

Inflation Analysis

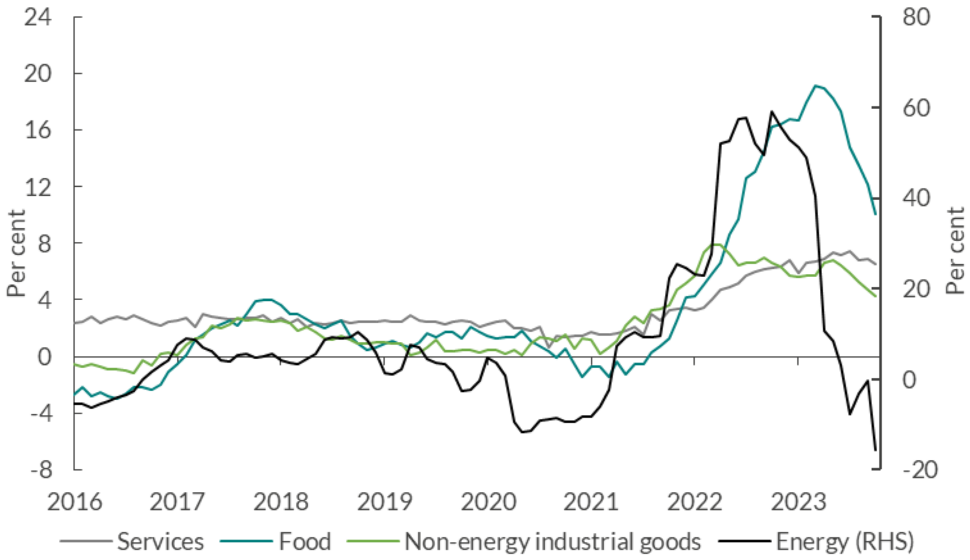
Annual consumer price inflation was 4.6 per cent in October, decreasing from 6.7 per cent in September. This figure reflects a large fall in the housing, electricity, gas and other fuels category which contributed 1.6 percentage points out of the overall monthly fall. The drivers of these decreases were energy prices, which rose steeply last October but have now 'dropped out' of the CPI basket: for instance, gas costs fell by 31 per cent in the year to October 2023 while electricity costs fell by 15.6 per cent in this time, both being the biggest drop since records began in 1989.

The latest data suggest that annual energy price inflation decreased overall on the year by 15.8 per cent in October. 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 6.9 per cent in September to 6.6 per cent in October. 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. As a result of services inflation falling slightly and non-energy goods inflation decreasing steadily, core inflation fell from 6.1 per cent in September to 5.7 per cent in October (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.

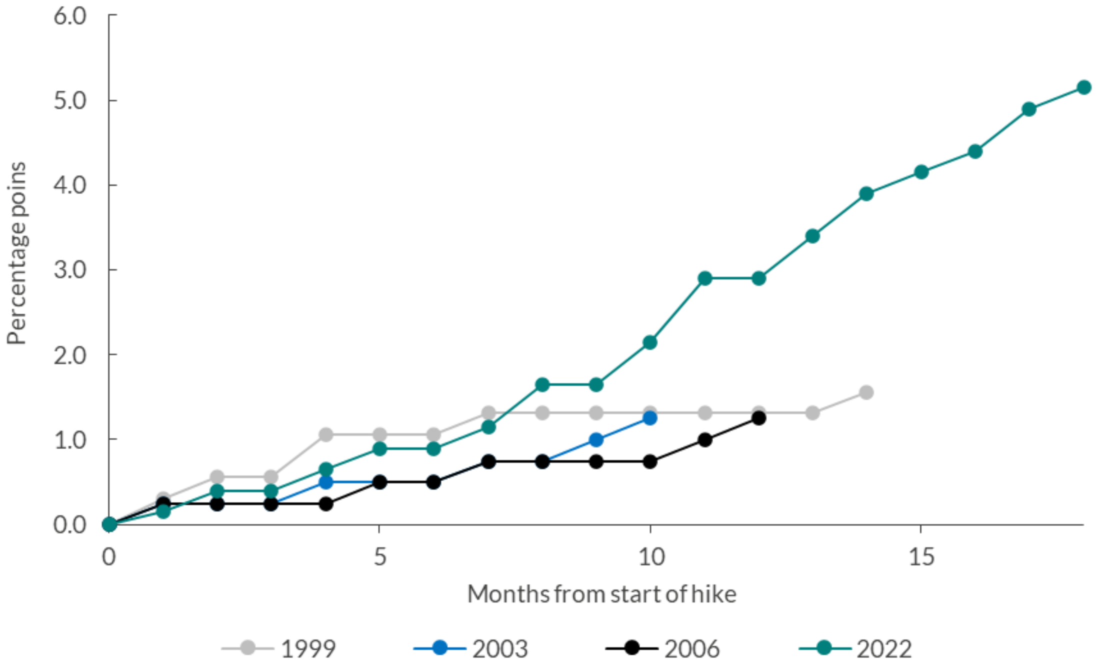
NIESR’s measure of underlying inflation, which excludes 5 per cent of the highest and lowest price changes, fell to 6.5 per cent in October from 7.3 per cent in September. Trimmed-mean inflation remaining higher than headline CPI suggests that there are currently more extreme price decreases (e.g., energy) 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 November 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 recent 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 sees 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. We note in our Outlook that we have similar views to the market, in that at the time of writing, the OIS curve also saw rates peaking at 5.25 per cent and the MPC holding that rate for some time. However, the market curve implies that once the MPC opts to loosen, rates will normalise around 4 per cent whereas we think they will normalise around 3.25; this indicates we have distinct views on the equilibrium real interest rate (r*) and that the MPC might need to communicate an updated estimate of this figure in order to align expectations.

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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