Second thoughts on the October inflation numbers

Synopsis: CPI inflation rate has halved in 2023, but that is not the end of the story.

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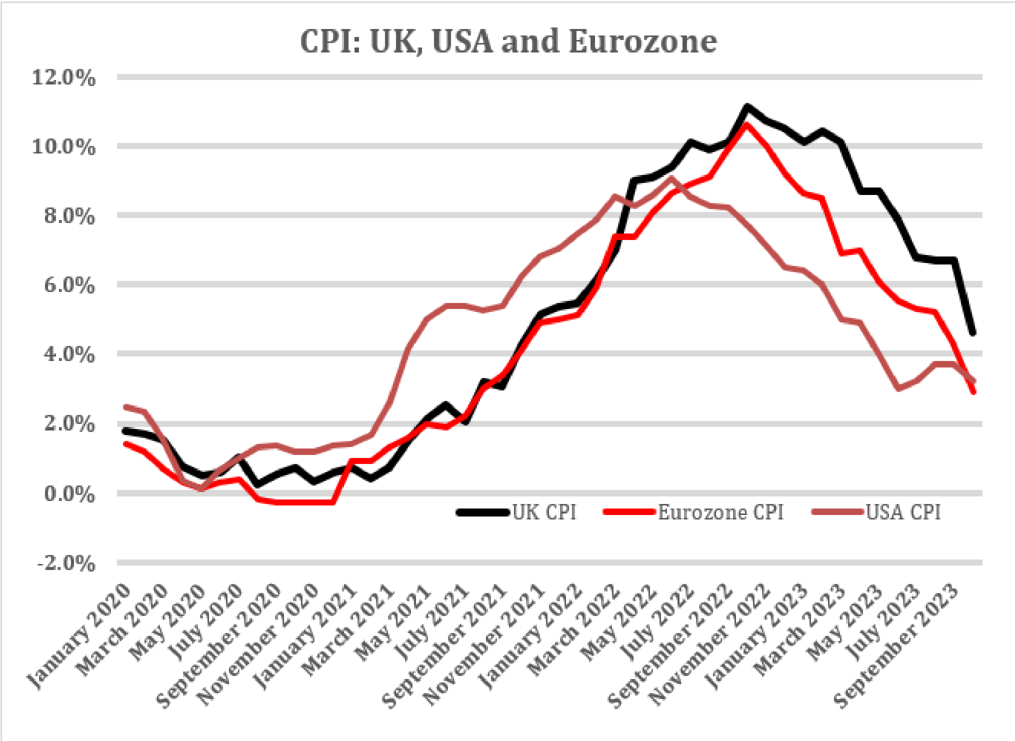
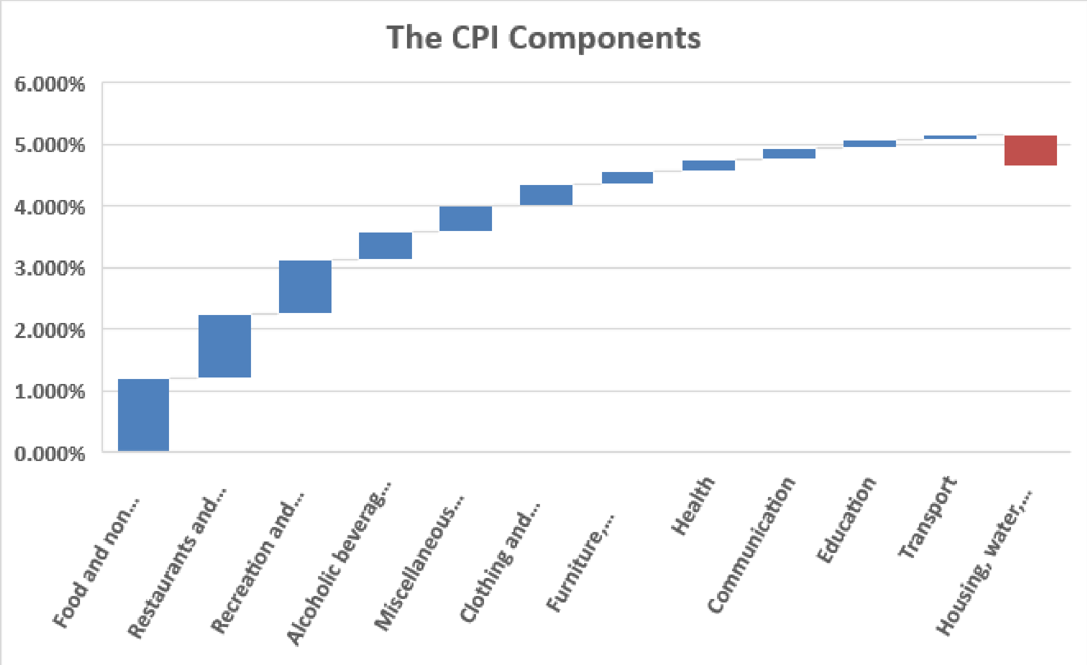


Wednesday's October CPI figure of 4.6% was good news for the government as it meant that the Prime Minister's January 2023 pledge to halve inflation over the year had been met ahead of time.

That promise was made when the consensus forecasts published by the Treasury were projecting Q4 2023 inflation at 5.0% against a then last published level of 10.7% (for November 2022).

At the time many commentators suggested that this proved Mr Sunak was picking an easy target, although it began to look more challenging as the months wore on: the June 2023 CPI figure was only just under 8.0%. A more accurate observation was that the government had little control over the inflation number, given both the volatility of commodity prices and the delegation of inflation control to the Bank of England.

In the event, the volatility of one set of commodity prices – energy – has been a significant factor in bringing down headline inflation, just as it was once for the opposite effect. In October 2022, when inflation peaked at 11.1%, the two most energy-sensitive CPI divisions, Transport and Housing, Water, Electricity, Gas and Other Fuels were experiencing annual inflation of 8.9% and 26.6% respectively. In October 2023, the corresponding figures were 0.5% and -3.5%. The two divisions have a combined CPI weighting of 27.8%. You can see the effect in the waterfall graph below…



Two thirds of the twelve CPI divisions posted inflation above 5.0% in October and core CPI is running at 5.7%.

There are a few other points worth noting that have been lost in the pledge-meeting headlines…

- While down from nearly 20% in March, food price inflation remains at 10.1%, making it the largest single contributory division to October's CPI.

- The suggestion that earnings are now outpacing inflation is true. The latest earnings data (for July-September) show annual earnings up 7.9% with bonuses (7.7% without). However, that comes after a period of falling real earnings which began in early 2022 and before that the distortions caused by the pandemic.

  Take the latest Average Weekly Earnings data and adjust for CPI inflation (not CPIH, as the Office for National Statistics does) and real average weekly earnings in September 2023 were just 0.9% higher than those in January 2020. That is gross pay, before the impact of the frozen personal allowance on *net* earnings…

- Cumulative CPI inflation since January 2020 is 22.0% and only 0.9% less if the starting point is taken as January 2021.

Comment

It is a sad fact of the public's numeracy that in some quarters falling rates of inflation are misunderstood as falling prices. The net result is discontent when prices keep increasing, exacerbated by the fact that the fastest inflation is in the most frequently purchased categories – food and drink.

As we reach the year end, that one fifth increase in prices since the start of 2021 needs to be built into financial reviews: in theory, cover and contributions could need a 20% uplift if no adjustments have been made for three years.

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