

Latest inflation measurements

May 2012

Background

The Office of National Statistics (ONS) has recently released data shedding light on the extent of inflationary pressures in the economy, both for consumers as well as producers. This briefing paper looks at the data and offers interpretation for Economy Module users.

Inflation measurements

The latest monthly inflation figures shows further easing of the headline inflation measurements, extending the trend since the inflationary peak experienced at the end of 2011. Inflation rates are now at their lowest for two years, a period which saw relatively high price growth as a consequence of high global commodity prices. The easing of inflationary pressure has been influenced by falls in the rate of price growth for food, alcoholic beverages, housing costs (including water, electricity and gas) and primarily transport costs.

The latter two components reflect that the international price of oil and gas has fallen since the peak experienced in the second half of 2011. This has partially fed through to domestic fuel bills – although these remain at high levels in historical terms (remembering that inflation measurements capture the rate of *increase* rather than price *levels* – see Appendix at the end of this briefing).

However, the ONS are keen to stress that the timing of Easter this year has influenced the April figures. This particularly influenced air transport costs – which rose more slowly in Easter than it did last year. In fact, the ONS estimates this alone contributed 0.27 percentage points to the reduction in the annual Consumer Price Indices (CPI) measurement (a total of 0.5 percentage points).

Therefore – as with most data releases – the figures need to be interpreted carefully. Over half of the fall in the main measurement is associated with data timing/collection issues rather than capturing an inherent weakening of inflationary conditions. As a result, the measurement next month could see a slight bounce back as these issues work through.

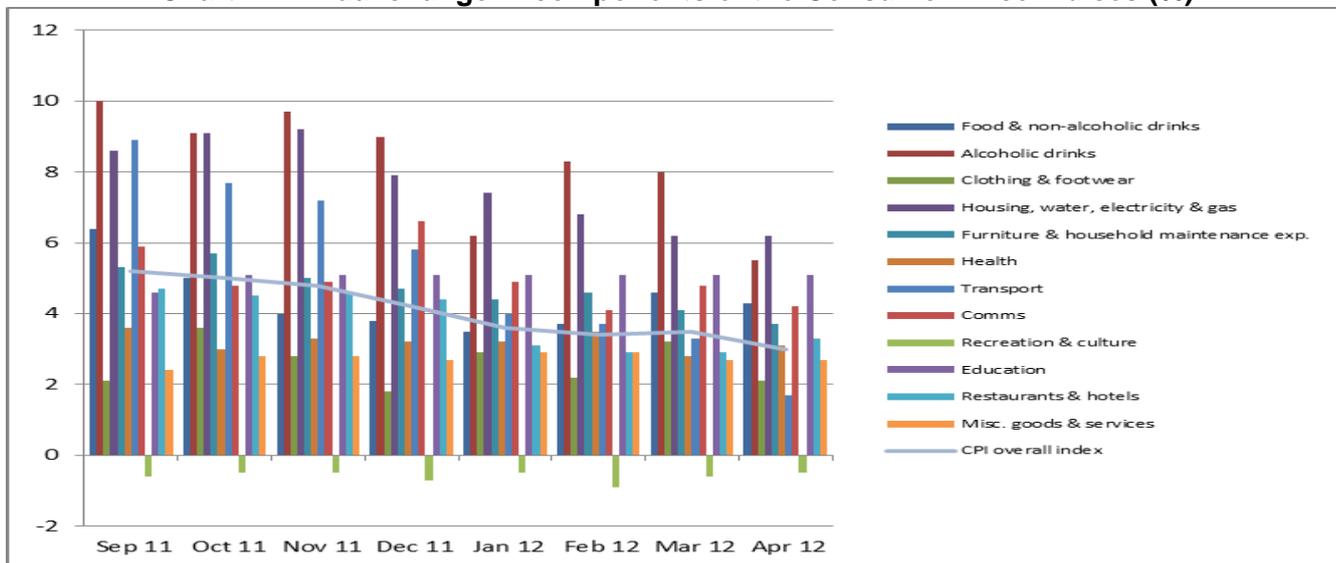
The chart below shows that the headline CPI measurement has fallen consistently since the peak in September 2011. Whilst the chart contains a lot of information, it does show the major components of household budgets – food, house fuel bills and personal transportation costs – have all slowed in their rate of increase.

All will have directly and indirectly been influenced by the fall in the price of traded oil since the prices seen in 2011. The oil price has fallen as a result of continued dampened conditions in the global economy (with rates of output growth even slowing in China and India) as well as a relatively mild winter in the northern hemisphere.

This has also been shown in a fall in the recently released Producer Price Index (PPI), which for manufactured goods fell to an annual rate of 3.3% - down from 3.7% in the previous month. Significantly, input price annual inflation was 1.2% in April, compared with a rise of 5.6% in

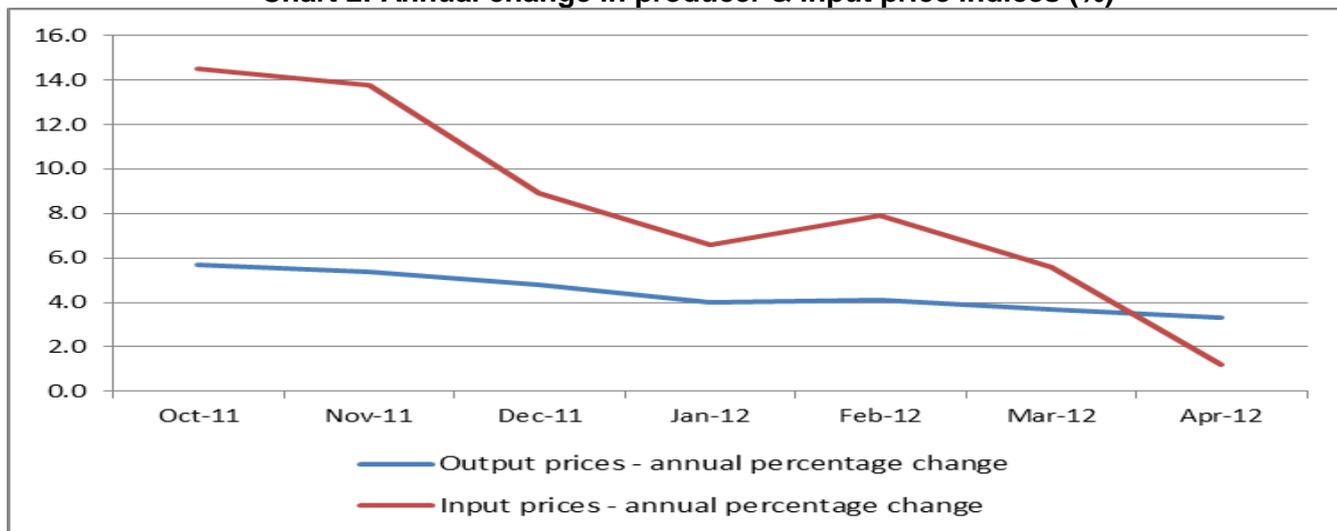
March – a significant fall. This highlights the easing of inflationary pressure through the whole ‘pipeline’ from production to consumption.

Chart 1: Annual change in components of the Consumer Price Indices (%)



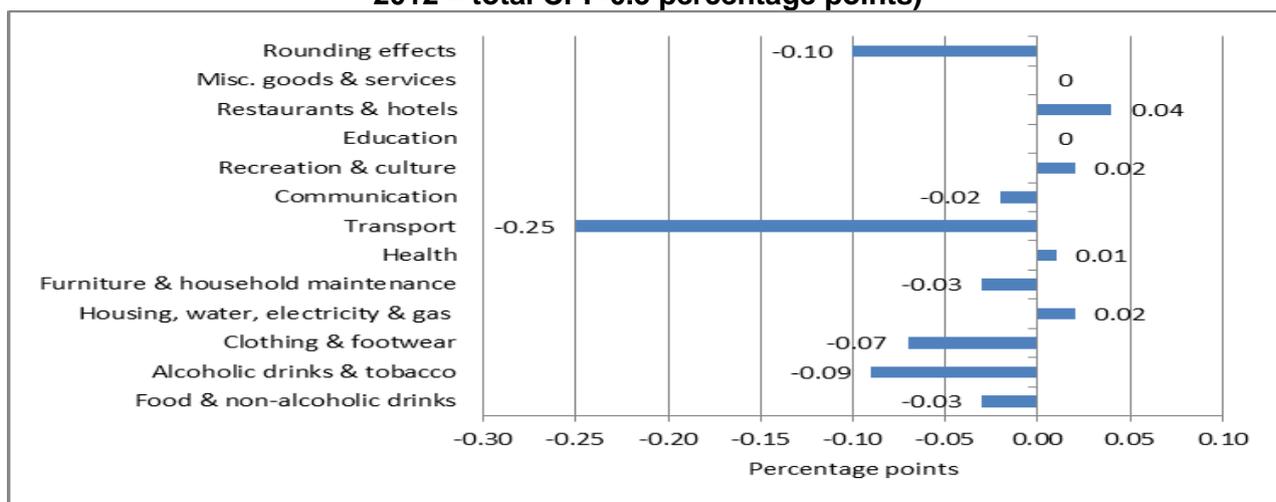
In many ways, the PPI and the input price index is a more significant indicator of the inherent strength of inflationary pressure in the economy. The fact that these measurements have also eased is a welcome sign and suggests that we are entering a more subdued price growth environment when compared to the previous two years.

Chart 2: Annual change in producer & input price indices (%)



The below chart shows that the slowdown in the growth of transportation costs has contributed half of the fall in the headline CPI rate over the past month¹. Interestingly, the rate of increase for housing costs has been impacted by an increase in rental costs (partially negating the recent slowdown in the rate of increase in housing fuel costs) which has been a trend seen in most areas, a consequence of a shift from home ownership over the last couple of years. This has been due to a number of factors including limited access to mortgage finance.

Chart 3: Contributions to the change in the 12-month CPI rate (change between March & April 2012 – total CPI -0.5 percentage points)



The difference between the CPI and RPI measurement – a differential of 0.5% in the annual measurement – partially reflects mortgage interest payments, which have increased marginally as many households come off cheaper rate fixed deals and onto higher variable rates².

¹ Which, as we have seen, has been influenced by the timing of Easter and its impact upon air transport prices

² It also reflects the different weighting for components such as air and sea transport.

Conclusion

The headline inflationary measure continues to weaken in 2012, highlighting an easing of the strong price rise pressures experienced by households in the second half of 2011. Some of this fall reflects a genuine easing of pressure for some components. The slowdown in the rate of increase in oil – and its derivatives – has played a contributory factor. It also continues to be helped by continuing intense competition between retailers.

However, the ONS are keen to stress that the relatively early Easter in 2012 has influenced these latest monthly figures, and therefore some careful interpretation is required. Whilst the 'data aspect' of this may indicate a slight bounce in next month's figures there has also been a significant slowdown in the Producer Price Index and Input Price Index over the past month.

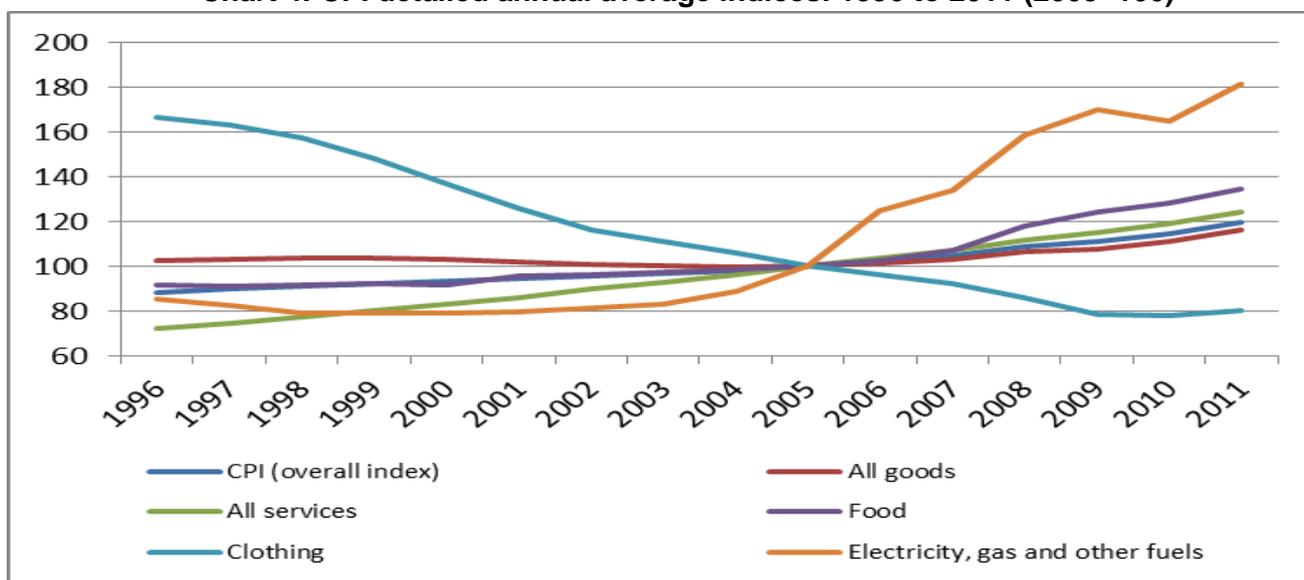
The hope is that this indicates a sustained easing of price pressure experienced for most manufacturers. If these falls are passed to consumers (which may not happen as producers may seek to repair margins) then we could see a more sustained fall in price growth. This may be accentuated by normal summer discounting that takes place between retailers, particularly the major food stores.

Appendix

See below chart to show the historical trend of historical price *levels* (expressed as an indexed value) of the overall CPI measurement and a selection of major expenditure items for households.

The chart shows that some items have experienced price growth at a much greater level than overall prices. The cost of electricity, gas and other fuels has far exceeded general price rises, whilst clothing was 20% cheaper in 2011 than in 2005.

Chart 4: CPI detailed annual average indices: 1996 to 2011 (2005=100)



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Contacts

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