

# UK CPI rises to 4.4% y/y in July 2011

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## *UK CPI rises to stays at 4.4% y/y in July*

The annual rate of CPI inflation rose from 4.2% in June to 4.4% in July. This was marginally above the 4.3% outturn anticipated amongst City analysts. Last week the Governor of the Bank of England stated that the annual CPI inflation rate could reach 5% in the next few months as a result of energy prices feeding through into the figures. However, at the turn of the year, CPI inflation should start falling back. Meanwhile, the core CPI measure - which excludes the volatile energy, food, alcoholic beverages & tobacco components - pushed higher from 2.8% y/y in June to 3.1% y/y last month. Again this was slightly stronger than the 3.0% print that City economists had expected and highlights that underlying inflationary pressures remain. Finally, the lesser known CPI index excluding indirect taxes (*e.g. VAT & fuel duties*), or CPIY measure, rose from 2.7% y/y in June to 2.9% y/y in July.

## *Clothing & Footwear prices rising at a record rate*

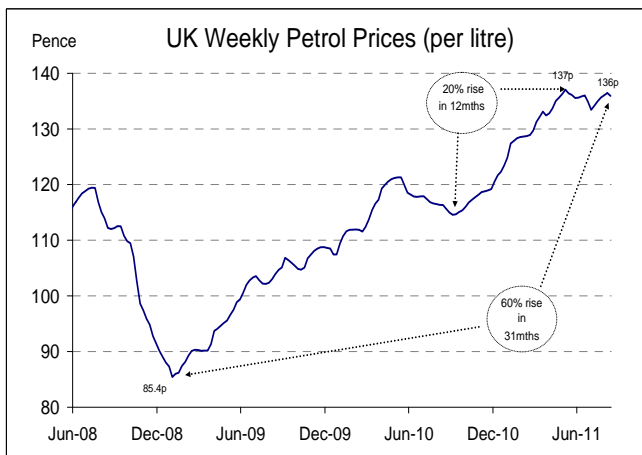
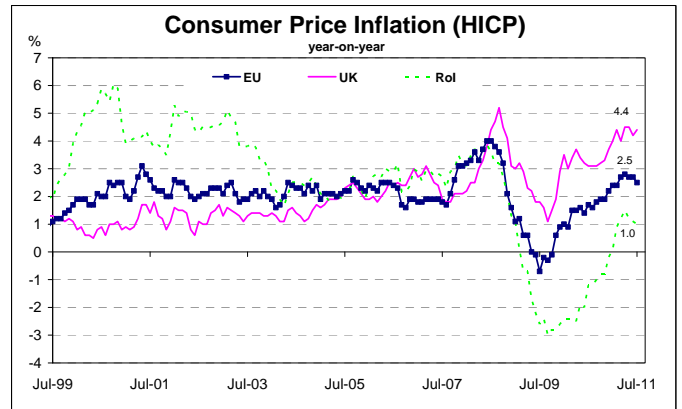
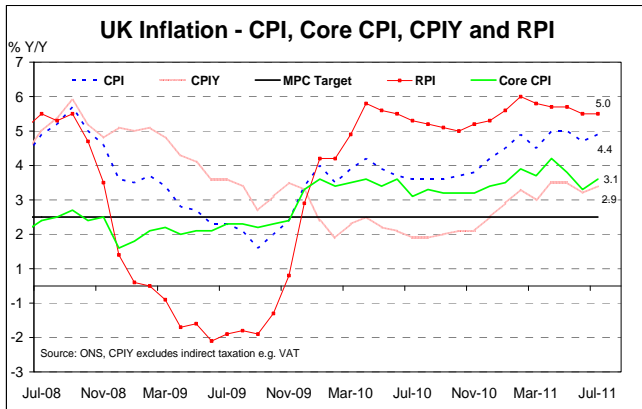
There were no major surprises at a sector level with broad-based, but modest, upside pressures from the majority of the twelve main sub-categories, including discretionary consumer sensitive areas like clothing & footwear, recreation & culture and furniture & household goods (*see table overleaf for more details*). Clothing & footwear inflation jumped from 1.5% y/y in June to 3.1% y/y in July. The latter represents the highest rate of inflation since the CPI records began back in January 1997. Furniture & Household Equipment prices jumped from 4.0% y/y in June to 4.8% y/y in July. The Alcoholic Beverages & Tobacco category posted a double-digit rise over the year (+10.3%) which again marked the highest rate since the CPI series began. Meanwhile, the annual rate of inflation for food and non-alcoholic beverages eased from 6.9% in June to 6.2% in July. Domestic gas & electricity prices were flat in the month (+6.5% y/y). However, significant increases of around 15% will begin filtering in to the data next month.

## *Annual RPI inflation remains unchanged at 5.0%*

The Retail Prices Index (RPI) annual inflation rate came in as expected unchanged at 5.0% in July. This outturn is significant in that it will set the price for public rail fares for the next 3 years. Rail fares will be based on RPI plus 3% - i.e. 8%. The RPI measure was traditionally used extensively in wage claims and benefits payments. However, public sector pensions and welfare benefits will be indexed relative to the CPI measure from April 2011. Pay freezes have been a common feature within the private sector. The length of pay freezes since the downturn began have varied with some employees experiencing only partial pay freezes during the last few years. However, some employees have experienced a pay freeze over the entire period with pay remaining at 2007 levels. This represents an effective real terms pay cut of almost 14% using the RPI measure. However, it should be remembered that the RPI index is a basket of goods and services, focussing on some of the day-to-day essentials of household expenditure reveals even greater price rises (*or alternatively erosion of standard of living*). For example, the price of food has increased by almost 30% over the last four years. Meanwhile, the price of petrol has risen by over 40% over the corresponding period. It is noted that when the credit crunch began back in August 2007 the price of petrol was just 96p per litre. The recent declines in the price of oil, in sterling terms, should feed through (*partially*) to the forecourts in due course

## *Interest rates remain on hold for the foreseeable future*

Last week's Bank of England Quarterly Inflation Report indicated that the MPC's latest central projection (*based on unchanged monetary policy*) forecasts a CPI undershoot of around 0.1pp (*i.e. CPI = 1.9% y/y*) in 2 years time (Q3 2013). This highlights that the MPC has no pressing need to raise interest rates at this stage. Indeed, the BoE's forecasts also revealed an inflation under-shoot (*below MPC's 2% target*) if rates were kept on hold until Q4 2012. As we have seen in recent weeks it is extremely difficult forecasting a few weeks ahead let alone the next 18 months. That's why we urge some caution in completely writing off rate increases in late-2012.

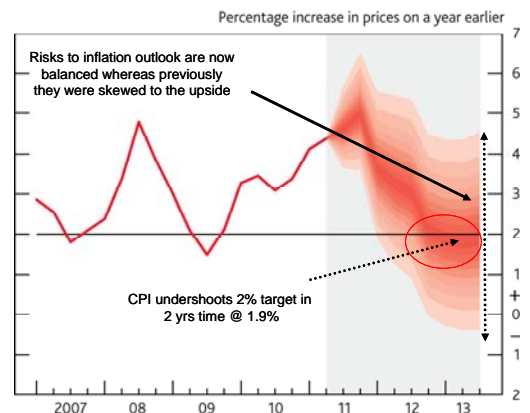
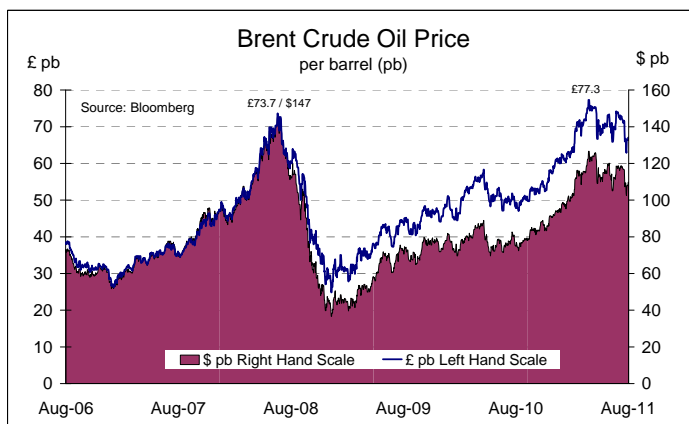


UK CPI Inflation by Sub-Category

CPI by main categories	April 2010 % Y/Y	May 2011 % M/M	May 2011 % Y/Y
Food & non-alcoholic beverages	4.4	1.3	5.8
Alcohol & Tobacco	8.9	0.7	9.8
Clothing & Footwear	1.2	0.4	1.2
Housing & household services (includes water & fuel)	4.4	-0.1	4.3
Furniture & Household Equipment	5.1	0.4	4.3
Health	4.1	-0.2	3.9
Transport	9.6	-0.8	8.0
Communication	2.5	0.9	3.7
Recreation & Culture	0.9	-0.1	0.9
Education	5.3	0.0	5.3
Restaurants & Hotels	4.3	0.5	4.5
Miscellaneous Goods & Services	2.1	0.6	2.5
<b>Overall CPI</b>	<b>4.5</b>	<b>0.2</b>	<b>4.5</b>

Source: ONS

CPI inflation projection based on constant nominal interest rates at 0.5% and £200 billion asset purchases



Richard Ramsey  
16 August 2011

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