

# UK CPI rises to 5.2% y/y in September 2011

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## *UK CPI rises to 5.2% y/y in September*

Comparisons are increasingly being made between the economic and financial conditions of autumn 2011 and those of autumn 2008. Today's inflation figures reveal yet more similarities. The annual rate of CPI inflation jumped from 4.5% in August to 5.2% in September. This was well above the outturn anticipated amongst City analysts (4.9%). Indeed, only 5 out of 35 economists surveyed within a Bloomberg survey expected a reading above 5%. Last month's inflation figures equalled the record high posted in September 2008. As always, the September CPI figures have the added significance of being used to uprate welfare benefits payments & public sector pensions from April 2012. The switch to CPI uprating, from RPI, was announced in the Coalition Government's June 2010 Budget and came into effect in April 2011. In April 2011, welfare benefits (*e.g. dole, state pensions*) were uprated by 3.1% for the 2011/12 financial year as this was the CPI rate that prevailed in September 2010. So far, during the current financial year, CPI inflation has averaged 4.6% (April - September). We anticipate a further rise in October to 5.3% y/y – which will mark a record high - before inflationary pressures begin to subside. We do not expect the annual CPI rate to fall below 3% y/y until autumn 2012.

## *Underlying inflation, or 'core CPI', rises to 3.3% while 'non core' hits 11.1%*

Meanwhile, the core CPI measure - which excludes the volatile energy, food, alcoholic beverages & tobacco components – also surprised market expectations and jumped from 3.1% y/y in August to 3.3% last month. These underlying price pressures are a surprise given that wage inflation is moving in the other direction. City analysts had expected the core reading to remain unchanged. Conversely, the '*non-core CPI measure*' – which covers food, beverages, energy (*incl. petrol*) and tobacco – hit double digits (11.1% y/y) for the first time since November 2008. This non-core measure, which with the exception of tobacco covers necessities, is rising at its highest rate since November 2008. It is concerning that this measure of largely unavoidable inflation costs, is more than twice the rate that prevailed last September, ahead of last year's extreme winter weather conditions. A repeat of last year's weather conditions, which has been mooted by some weather forecasters, will put a severe strain on household finances. Given Northern Ireland's low wages, relative to the UK, and higher incidence of fuel poverty, NI will be more adversely affected than the UK as a whole. Finally, the lesser known CPI index which excludes indirect taxes (*e.g. VAT & fuel duties*), or CPIY, jumped from 3.0% y/y in August to 3.7% y/y in August. Despite this overall inflationary backdrop, the Bank of England has already shown, through the announcement of £75bn of more quantitative easing earlier this month, that it is convinced that CPI will undershoot the MPC's target rate of 2% in 2 years time without this recent additional stimulus. Therefore the MPC has taken interest rate rises off the table for the foreseeable future.

## *Energy prices have risen by almost 50% since the credit crunch began*

The bulk of the overshoot in the latest CPI figures was due to the timing / scale of utility price rises. The September data show gas, electricity & other fuels rising by 9.9% m/m taking the annual rate to 18.3%. Since the credit crunch began (August 2007), prices within this category of spend have risen by a staggering 49%. Meanwhile, '*Transport Fuels & Lubricants*' (petrol & diesel) have risen by 17.8% y/y in September and almost 42% since the credit crunch began. Oil prices eased in sterling terms in late September / early October hitting a recent low of £65.2 per barrel. However, it has subsequently picked up again back above £70 pb (£77.3 = peak in April 2011). This suggests that the recent fall in the petrol prices in UK forecourts (134.5p per litre for w/c 17 October) may be short-lived.

*Annual RPI inflation increases to 20-yr high of 5.6%*

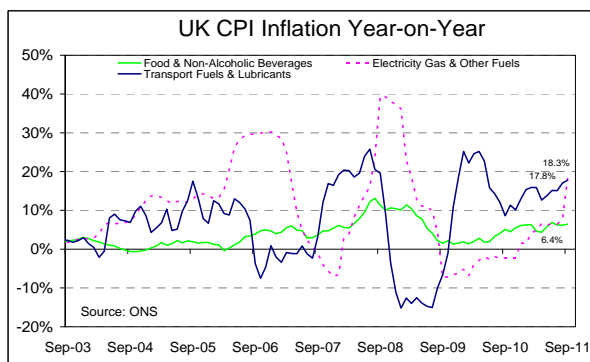
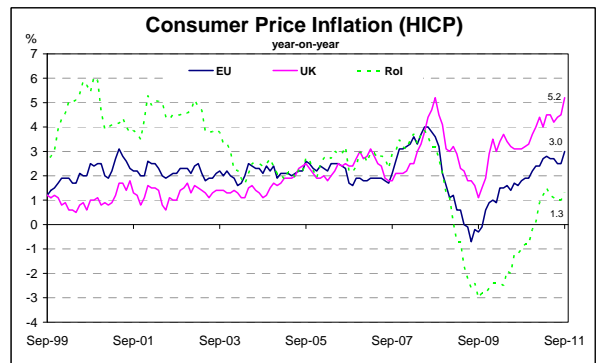
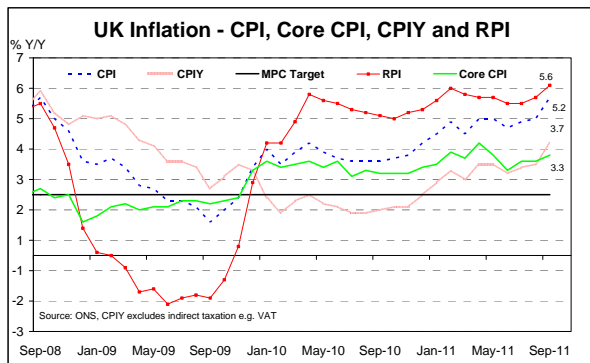
The Retail Prices Index (RPI) annual inflation rate came in 0.2pp stronger than expected at 5.6% in September. This represents the highest reading since June 1991 (+5.8%). Meanwhile, the RPIX measure, which excludes mortgage interest rate payments, rose to 5.7% y/y last month, up from 5.3% in August. This marked the highest reading since April 1992.

*Inflation - A tale of two economies – Northern Ireland (UK) v the Republic of Ireland*

It is noted that the UK's current CPI inflation rate of 5.2% compares with 3.0% in the euro zone and just 1.3% in the Republic of Ireland – using the HICP measure. The stark divergence in the inflation stories of the UK (Northern Ireland) and the RoI is revealed in the charts and tables overleaf. Since the credit crunch officially began, in August 2007, the cumulative rise in the UK all items CPI has increased by 15.5%. Conversely, the equivalent level of consumer prices in the RoI has risen by less than 1% (0.7%) over the same period (*Aug 07 – Sep 11*). During this period, UK average earnings (*excluding wages*) have risen by just 8.8% (*public sector +12.1%, private sector +7.4%*). The net result is incomes (*before tax rises and benefits cuts are taken into account*) are being severely squeezed. In our view, the annual earnings increases for Northern Ireland would be below the equivalent rises in the UK. Therefore the deterioration in living standards is more rapid in Northern Ireland than in the UK as a whole. In the RoI, household budgets have been squeezed by rising taxes etc imposed through the austerity budgets, which have reduced disposable incomes. To date, Northern Ireland / UK have seen only part of the UK tax rises / benefits cuts that have been announced but yet to take effect. Therefore even when inflationary pressures ease the squeeze on disposable incomes will continue.

*Unlike the UK (Northern Ireland) the RoI has had an easy ride with inflation*

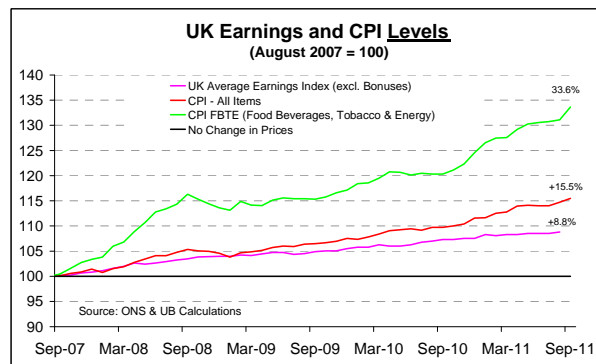
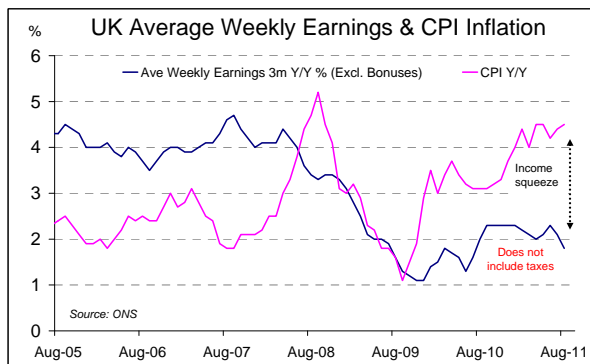
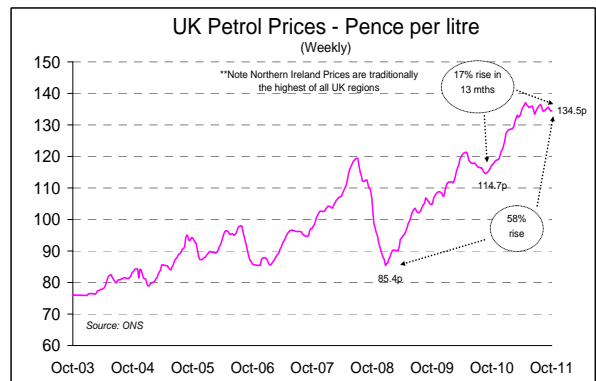
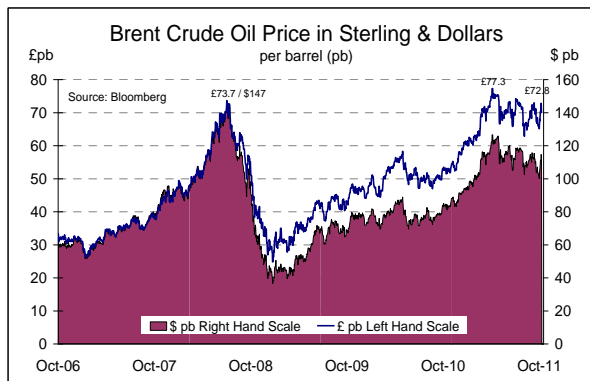
But unlike Northern Ireland, the RoI has had an easy ride with inflation. This is particularly evident when considering necessities such as food. For example since the credit crunch began in August 2007, the price of food and non-alcoholic beverages has fallen by 0.7% (*Aug-07 to Sep 11*) in the Republic of Ireland. Aggressive price reductions, in the context of relatively fat profit margins, alongside a strong euro have limited inflationary pressures in the RoI. By contrast food and non-alcoholic beverages in the UK (*Northern Ireland*) have risen by a whopping 28% over the same period. This is a hefty burden for those households experiencing pay cuts / wage freezes. Also inflation in hotels & restaurants is up 14.7% for the UK (*Aug-07 to Sep-11*) whereas prices within the equivalent sector for the RoI are down almost 2%. There is only one category of consumer spending that has risen by more in the RoI than the UK since the credit crunch began - Health 13.3% (RoI) versus 13.1% for the UK. Meanwhile, clothing and footwear has fallen by 21.3% over the last 4 years in the RoI whereas in the UK prices have fallen by just 8.7%. Further detail is highlighted in the charts and tables overleaf.

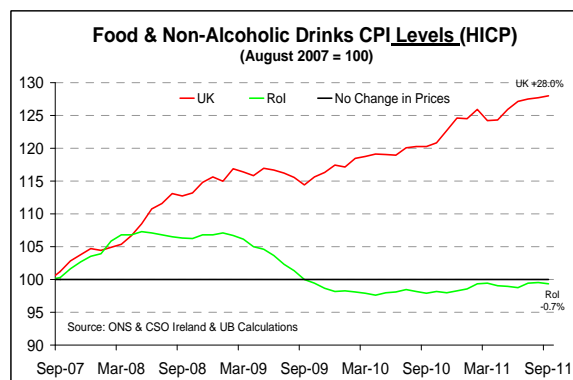
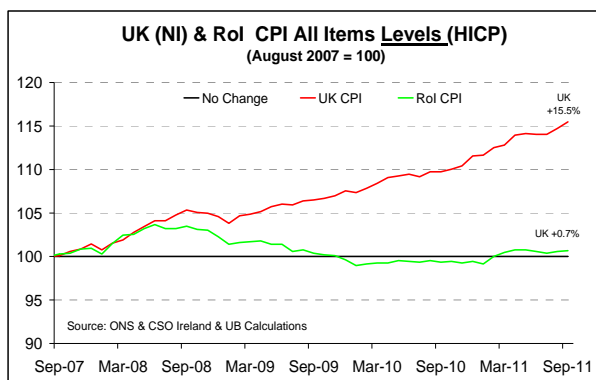


### UK CPI Inflation by Sub-Category

CPI by main categories	August 2011 % Y/Y	September 2011 % M/M	September 2011 % Y/Y	% Change Since August 2007
Food & non-alcoholic beverages	6.2	0.2	6.4	28.0
Alcohol & Tobacco	9.8	0.8	10.0	25.9
Clothing & Footwear	4.0	4.4	2.1	-8.7
Housing & household services (includes water & fuel)	5.1	3.5	8.6	24.1
Furniture & Household Equipment	5.8	1.2	5.3	16.9
Health	3.4	0.3	3.6	13.1
Transport	7.4	-2.1	8.9	21.6
Communication	3.4	0.9	5.9	8.3
Recreation & Culture	-0.8	0.1	-0.6	2.3
Education	5.3	2.3	4.6	39.2
Restaurants & Hotels	4.6	0.4	4.7	14.7
Miscellaneous Goods & Services	2.8	0.0	2.4	11.0
<b>Overall CPI</b>	<b>4.5</b>	<b>0.6</b>	<b>5.2</b>	<b>15.5</b>

Source: ONS





### UK & RoI CPI Inflation by Sub-Category

CPI by main categories	UK September 2011 % Y/Y	RoI September 2011 % Y/Y	UK % Change Since August 2007	RoI % Change Since August 2007
Food & non-alcoholic beverages	6.4	1.5	28.0	-0.7
Alcohol & Tobacco	10.0	-0.6	25.9	8.4
Clothing & Footwear	2.1	-0.3	-8.7	-21.3
Housing & household services (includes water & fuel)	8.6	3.7	24.1	-1.5
Furniture & Household Equipment	5.3	-2.3	16.9	-10.6
Health	3.6	3.4	13.1	13.3
Transport	8.9	4.5	21.6	4.4
Communication	5.9	1.0	8.3	4.6
Recreation & Culture	-0.6	-0.5	2.3	-1.7
Education	4.6	1.6	39.2	19.3
Restaurants & Hotels	4.7	0.8	14.7	-1.6
Miscellaneous Goods & Services	2.4	4.5	11.0	11.0
<b>Overall CPI</b>	<b>5.2</b>	<b>1.3</b>	<b>15.5</b>	<b>0.7</b>

Source: ONS & CSO uses HICP measure

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18 October 2011

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