CPI inflation falls back in April

May 2023

UK CPI inflation slowed considerably in April (8.7% from 10.1% in March), as last year's large rise in the Ofgem energy price cap dropped out of the annual comparison. April's outturn will be seen as a disappointment, however, as it overshot consensus forecast expectations of a sharper fall (8.2%). In particular, measures of domestically-driven inflation surprised to the upside, suggesting that underlying price pressures remain firm.

Inflation should continue to ease over the coming months, as base effects from last year unwind further and the recent fall in energy prices feeds through to lower household bills from July (when the Ofgem price cap will fall to £2,074, below the Energy Price Guarantee's cap of £2,500). Nevertheless, we still expect inflation to remain noticeably above the Bank of England's 2% target at the end of this year, and risks are titled to the upside given the strength of underlying inflationary pressures.

The Bank of England is, nonetheless, likely close to the peak in its rate tightening cycle, but the Monetary Policy Committee (MPC) will be wary of the risk that stickier domestic price pressures will make it harder to bring inflation back down to target. Therefore, it's reasonable to expect at least one more rate rise in the coming months.

Headline consumer inflation cooled in April, but domestic price pressures remain firm

- UK CPI inflation dropped to 8.7% in April (from 10.1% in March), the lowest reading in just over a year. Even so, the outturn overshot consensus forecast expectations of a sharper fall (to 8.2%).
- The main downward pressure on inflation came from last year's increase in the Ofgem price cap dropping out of the annual comparison. This was partially offset by stronger price growth from the recreation & culture and alcohol & tobacco categories.
- Food & non-alcoholic beverage price inflation eased marginally to 19.1% (from 19.2% in March). Nevertheless, this was the second-fastest pace of food & drink price growth recorded in the last 45 years.
- Core CPI inflation (which strips out food, fuel, and energy) climbed to 6.8% (from 6.2% in March), its highest level since March 1992. Furthermore, services inflation – a key measure that is closely watched by the Bank – accelerated to 6.9% (from 6.6% in March). Taken together, these data suggest a greater stickiness in underlying inflationary pressures.
- Both **input** (the price of materials and fuels bought by UK manufacturers for processing) and **output** (the amount received by UK producers for the goods that

they sell to the domestic market) prices have levelled off since June last year, leading to rapid falls in these inflation measures. Input price inflation is now 3.9% having reached 24.4% in June 2022, while output price inflation is now 5.4% down from 19.7% in July 2022. However, imported food, beverages, tobacco, and fuel inflation remains in double digits.

- The UK has the joint-highest consumer inflation rate in the G7, level with Italy (8.7%) and followed by Germany (7.6%).

Consumer inflation will continue to fall over 2023, but the 2% target remains a long way off

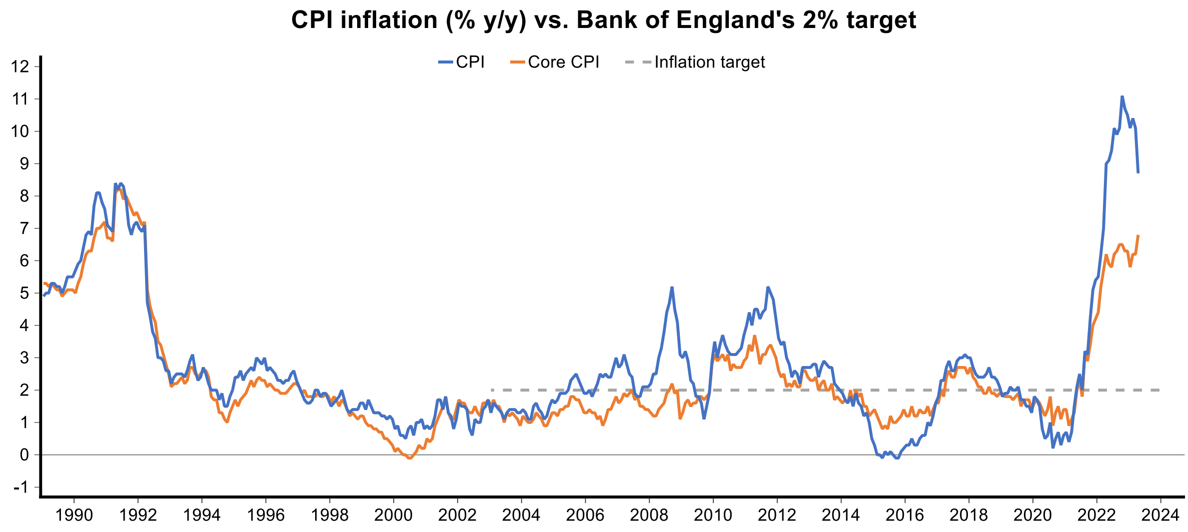
- CPI inflation appears to be on course to fall steadily over 2023, especially given the announced Ofgem price cap reduction from July (reflecting the fall of wholesale gas prices).
- We still expect that inflation will remain considerably above the Bank of England's 2% target at the end of this year. Risks remain tilted to the upside given the persistence in domestic price pressures, such as wage growth.

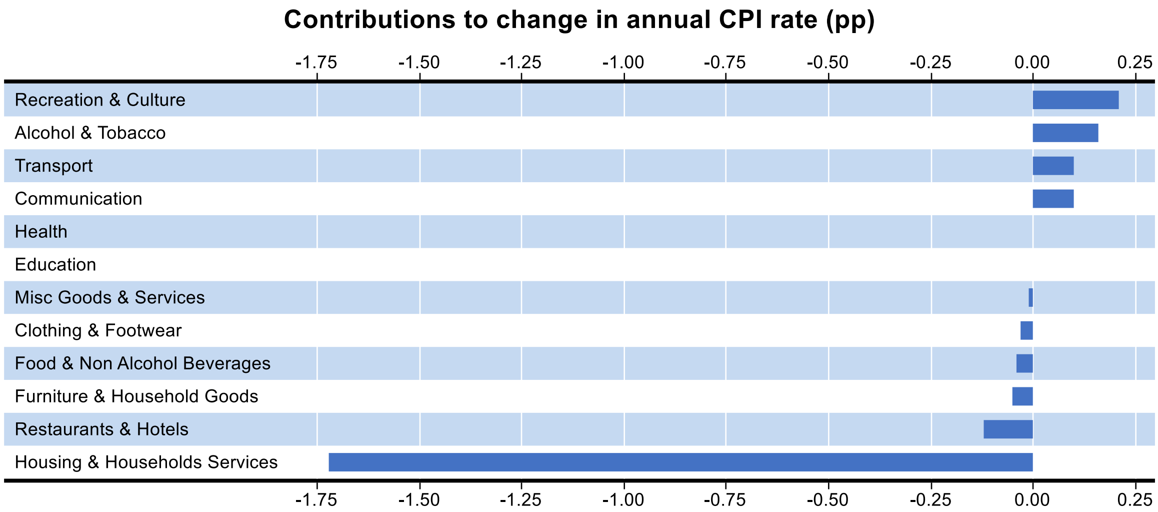
Strong underlying price pressures revive the possibility of higher interest rates

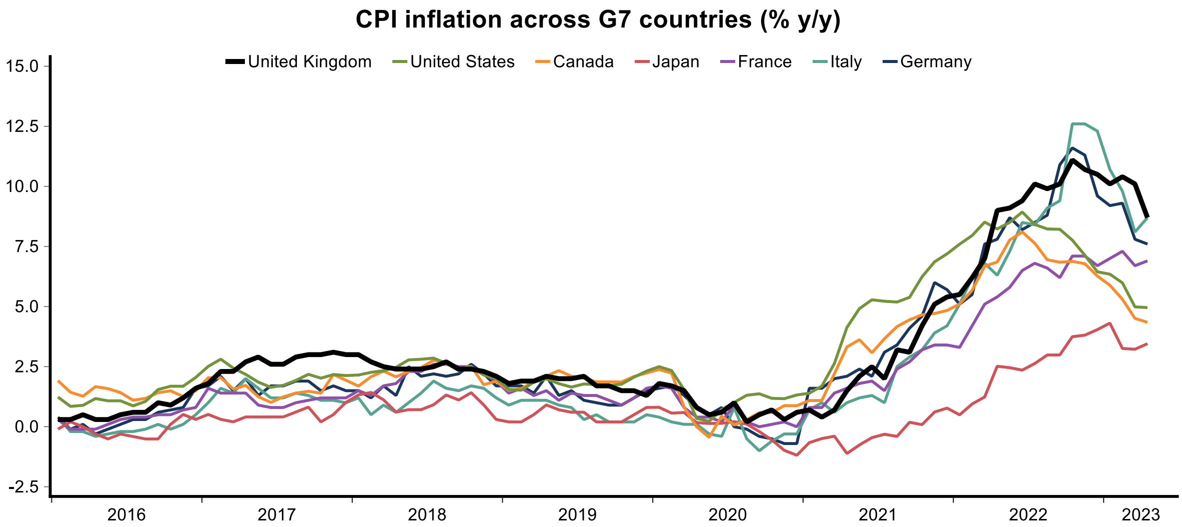
- April's inflation outturn represents an upside surprise to the Bank of England's forecast (of 8.4%). Of perhaps more concern for the MPC will be the strength of services inflation, which also outpaced their projections (of 6.7%).

- The MPC will see the acceleration of core and services inflation as further evidence of a troubling inflationary dynamic in which last year's externally-driven price pressures (notably, higher energy prices following the invasion of Ukraine) lead to "second-round" effects in the form of higher wages and price setting by businesses.

- The persistence of strong domestic price pressures, which could keep inflation above target for longer, means that at least one more rate hike is still on the cards in the coming months. The MPC will be closely watching next month's labour market and inflation data to determine the extent of further monetary tightening that is required in their June meeting.




Contributions to change in annual CPI rate (pp)
-1.75
-1.50
-1.25
-1.00
-0.75
-0.50
-0.25
0.00
0.25
Recreation & Culture
Alcohol & Tobacco
Transport
Communication
Health
Education
Misc Goods & Services
Clothing & Footwear
Food & Non Alcohol Beverages
Furniture & Household Goods
Restaurants & Hotels
Housing & Households Services


CPI inflation across G7 countries (% y/y)
United Kingdom
United States
Canada
Japan
France
Italy
Germany
15.0
12.5
10.0
7.5
5.0
2.5
0.0
-2.5
2016
2017
2018
2019
2020
2021
2022
2023