Group Economics

Ulster Bank

August CPI rises to 4.5%

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Inflation was expected to rise in August but the 4.5% outcome was well ahead of the consensus expectation (4.3% according to the Reuters Survey of 10 economists and our own, 4.4% estimate). Last time the reading was this high was in March 2003. The harmonised euro HICP measure also moved up smartly to 3.2% (the consensus expectation was that it would stay at 2.9%) leaving it well clear of the August Euro area HICP, due for release tomorrow and expected to come in at 2.3%.

This time mortgage interest rates were not to blame. The September CPI was read quite early in the month and so missed the last ECB quarter-point hike was passed on by the banks subsequently. Instead, it will feature in the September CPI in a month's time, boosting it by a not inconsiderable 0.4%. Energy was important. It added 0.15% in the month but this was only a little more than the energy impact in August 2005 and so it had only a small effect on the 4.5% yearly rate, adding less than 0.1% point. Petrol pump prices did, however, reach a new record high of 1.22 a litre.

The sales effect was interesting. The combination of the early survey date and, possibly, a prolongation of the Summer sales for longer than usual in August, meant that the usual bounce in clothing and hardware prices in August was lower than usual. The consequence was a small negative impact on the annual rate – just about enough to cancel out the positive petrol effect.

So is inflation almost entirely accounted for by energy and interest rates, as some commentators would have you believe. If they were, then most forecasts would have been closer to the August outcome. In fact, other items are becoming ever more important as a driver of inflation. This is obvious from the accompanying graph, which charts headline inflation and the CPI excluding interest rates and energy. Since January, the headline figure has risen from 3.0% to 4.5%. The core figure has also risen, albeit by not as much – it was 1.3% in January and is now 2.3%.

As in some earlier months, a whole range of smaller headings recorded increases while hardly any of the usual decreases were in evidence. Together, these added up to explain the 0.1% by which our forecast was out. Some of the more notable ones were car rentals, which rose quite strongly, recreation activities and accommodation.

Food prices, which have been misbehaving of late, were up 0.1% in the month – this is normal for this time of year. Groceries items in toto were unchanged but within this total, non-groceries items were up 0.2% but items subject to the Order fell for the third month in succession. Contrary to what the new Director said recently, it appears that the abolition of the order is having some impact with further decreases pencilled in for September.

After today's figures the average for the year is still likely to be around 4% with a peak of 5.5% in January 2007. We expect a modest decline in the annual rate in September.

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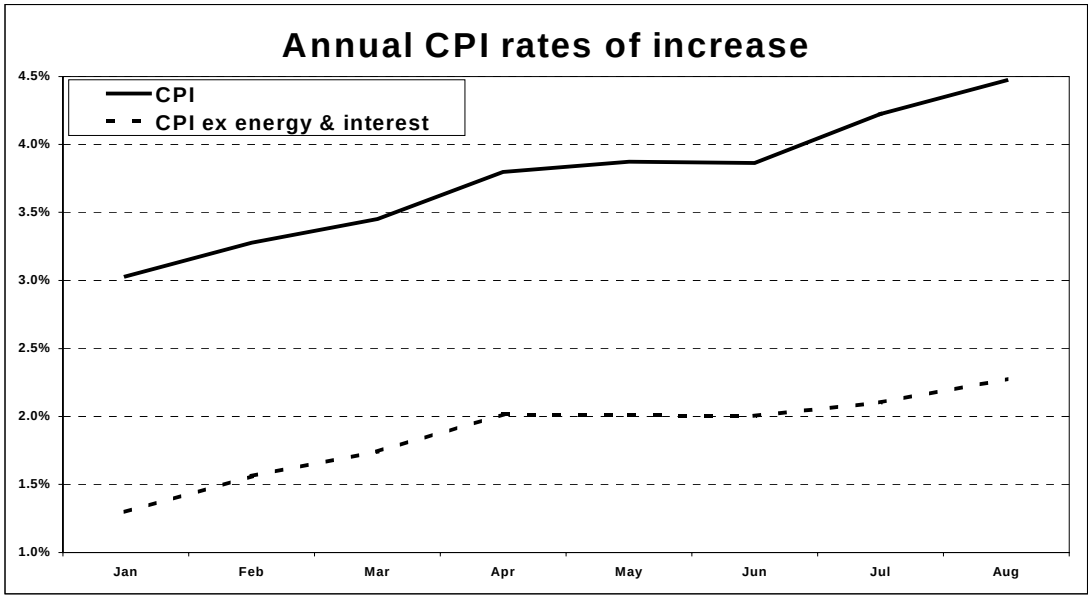
Annual CPI rates of increase
CPI
CPI ex energy & interest
4.5%
4.0%
3.5%
3.0%
2.5%
2.0%
1.5%
1.0%
Jan
Feb
Mar
Apr
May
Jun
Jul
Aug