Inflation is falling: no doubt the Bank of England will...

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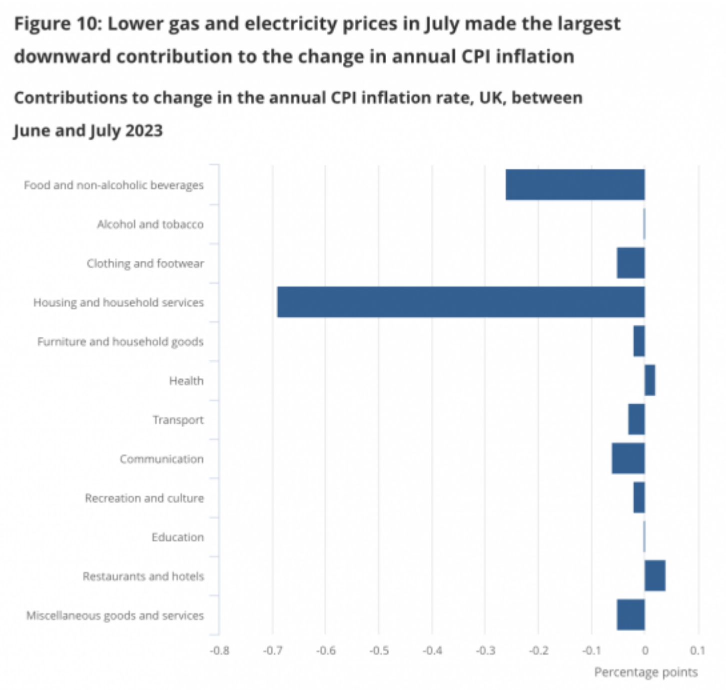
The headline economic news this morning is that CPI inflation has, according to the Office for National Statistics, fallen to 6.8 per cent in the year to July, down from 7.9 per cent in June and 8.7 per cent in May.

This decline was widely expected, including by me. The prices of domestic energy and food created most of the decline. However, in the wider CPIH index news was not so good: some housing costs are rising.

Overall the breakdown in contribution to the change was:



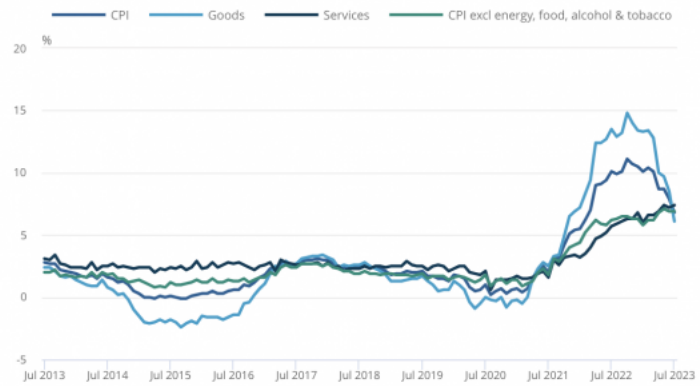
As usual, noting reactions has been interesting.

Almost without exception those commenting this morning are saying this is a blip due to changes in the energy price cap and that because wages are now rising above the inflation rate the Bank of England must react by increasing interest rates, yet again.

It would seem that although the trend in inflation is now markedly downward and we know that increasing interest rates has little impact on inflation for up to eighteen months after the rate increase occurs, those who think that there is a direct relationship and that the Bank of England really has control of this issue believe that more must be done. The argument is based on core CPI being unchanged in the month:

Figure 9: CPI core rate remained the same in July 2023, while services inflation rose

CPI goods, services and core annual inflation rates for the last 10 years, UK, July 2013 to July 2023



Source: Consumer price inflation from the Office for National Statistics

My argument is, of course, that this is the moment to cut rates. Unless action to do so is taken now the downward trend in rates now seen could very rapidly lead to deflation - which is likely to lead to recession. There is no advantage in that right now - not least because the actual cost of repaying debts rather than just meeting the interest cost upon them - rises when there is deflation.

But what do I expect to happen? I am sure the Bank of England will be flattered by the opinion of all those calling for more rises who have such quaint belief in the power of the Bank to address this issue, and that the Bank will respond by duly delivering the demanded rate rises that can only do harm to the economy and increase inequality within it. The fools are in charge, after all.