

Article

# Prices economic commentary: Apr 2017

Additional economic analysis of the latest CPIH, PPI, HPI and IPHRP statistics and long-term trends.

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Release date:  
11 April 2017

Next release:  
16 May 2017

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# 1 . Main points

## Consumer and producer prices

- The 12-month growth rate of consumer price inflation and output prices for manufacturers in March 2017 are broadly unchanged from February, continuing the recent upward trend in headline rates.
- Input prices for producers increased at a slower rate in the 12 months to March compared to the beginning of 2017.
- Food prices have been increasing in the UK and across the EU, reflecting higher global food prices.
- Core consumer price inflation (excluding volatile goods such as energy and food) has been on an upward trend since the end of 2015.

## House prices

- The ratio of deposits to house prices has been falling steadily in recent years for both first-time buyers and former owner-occupiers.

# 2 . Statistician's comment

## Commenting on today's prices data, ONS Deputy National Statistician Jonathan Athow said:

"Food, drink and clothing prices all rose in March. However, this is offset by air fares, which fell slightly but last year rose substantially thanks to the timing of Easter.

"The costs of raw materials and the price of manufactured goods leaving factories were both little changed, as falling fuel prices helped stem further rises.

"While house prices and rental costs rose over the year, the rates of increase continued to slow markedly."

# 3 . Introduction

We introduced our new [economic "theme days"](#) in January which will ensure that related economic statistics are released together. The separate bulletins relating to the Prices theme day contain details of the new data published and important information on how to interpret the statistics.

[UK producer price inflation: Mar 2017](#)

[UK consumer price inflation: Mar 2017](#)

[Index of private housing rental prices \(IPHRP\) in Great Britain: Mar 2017](#)

[UK house price index: Feb 2017](#)

Data tables accompanying this release are:

- contributions to the 12-month growth rate for input and output producer prices
- contributions to the 12-month growth rate of the Consumer Prices Index including owner occupiers' housing costs (CPIH) by import intensity of products

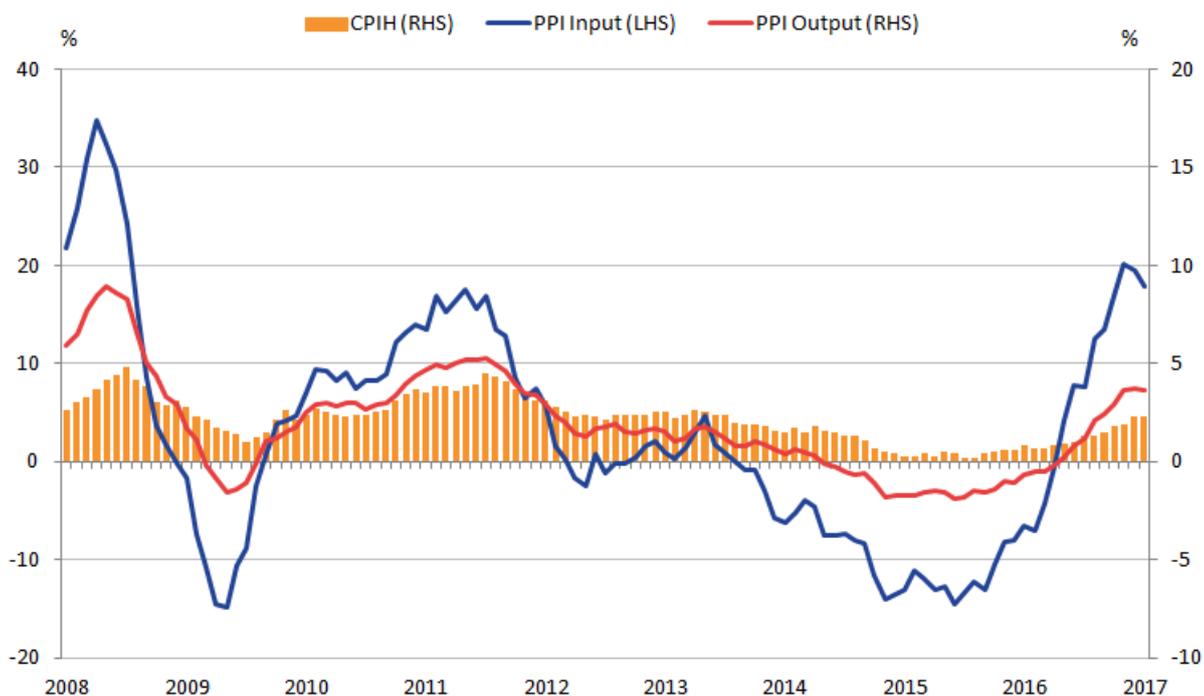
## 4 . Input producer price inflation moderated while CPIH growth was unchanged in the 12 months to March

Figure 1 shows that the Producer Price Index (PPI) input (left-hand scale) and PPI output indices (right-hand scale) move in broadly similar ways over time, although the movement in manufacturers' input prices is considerably greater than for manufacturers' output prices.

PPI input price increased by 17.9% in 12 months to March 2017, down from 19.4% in February, as prices remained fairly flat on the month and prices increased in the previous year. Output PPI increased by 3.6% in the 12 months to March, broadly unchanged from February, while the 12-month growth in the Consumer Prices Index including owner occupiers' housing costs (CPIH) was also unchanged at 2.3%.

**Figure 1: Annual growth for PPI input (LHS), PPI output and CPI (RHS)**

March 2008 to March 2017

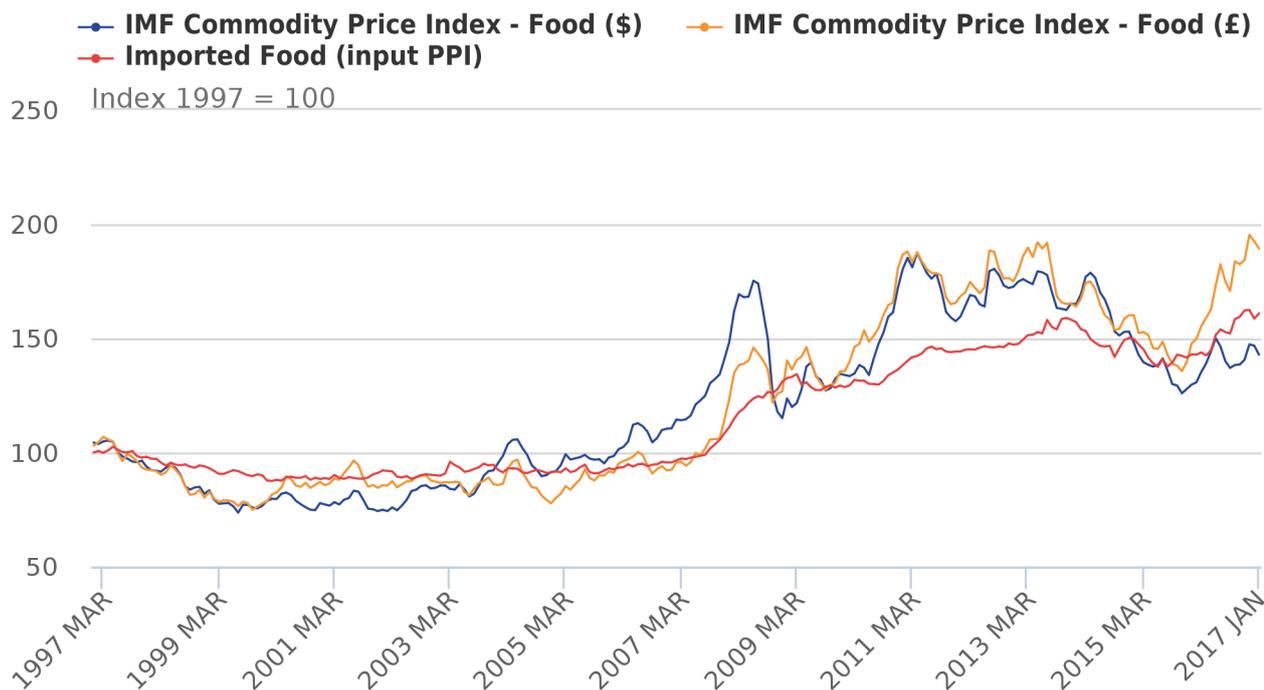


## 5 . Input producer prices for imported food are less volatile than global food prices

The International Monetary Fund (IMF) produces indices for a range of [global commodity prices](#) in US dollars. Figure 2 shows the IMF global commodity price index for food as well as the input PPI series for imported food, which measures the cost of imported materials used by UK food manufacturers. The IMF global commodity series has also been converted into sterling terms, by using the monthly average dollar to sterling exchange rate.

**Figure 2: IMF global commodity price index for food in US dollars and sterling and input PPI series for imported food**

January 1997 to March 2017



Source: International Monetary Fund, Office for National Statistics, Bank of England

**Notes:**

1. The input PPI series for imported food measures the cost of imported materials used by UK food manufacturers.

The IMF commodity price index for food (in both currencies) tends to be more volatile than the imported food series within input PPI. For example, where there were short-term changes in global food prices (such as in 2010 to 2011), the imported food series remains stable for a few months, before increasing at a more moderate pace. This could be due to producers who have arranged contracts at a constant price to protect themselves from potential price increases, termed “hedging”.

Since the beginning of 2016, global food prices in sterling terms have increased sharply. This increase was much larger than in dollar terms because of the significant depreciation of sterling against the dollar over this period. While the PPI imported food series has also increased over this period, it has been at a slower rate than global food prices. [Previous analysis](#) showed that around half of the value of UK food import transactions is conducted in sterling. If a foreign exporter kept their prices constant in sterling terms, this would mean that prices would not increase as fast as if they were in dollar terms and converted to sterling. This could also be further evidence of producers arranging contracts to “hedge” against potential exchange rate effects.

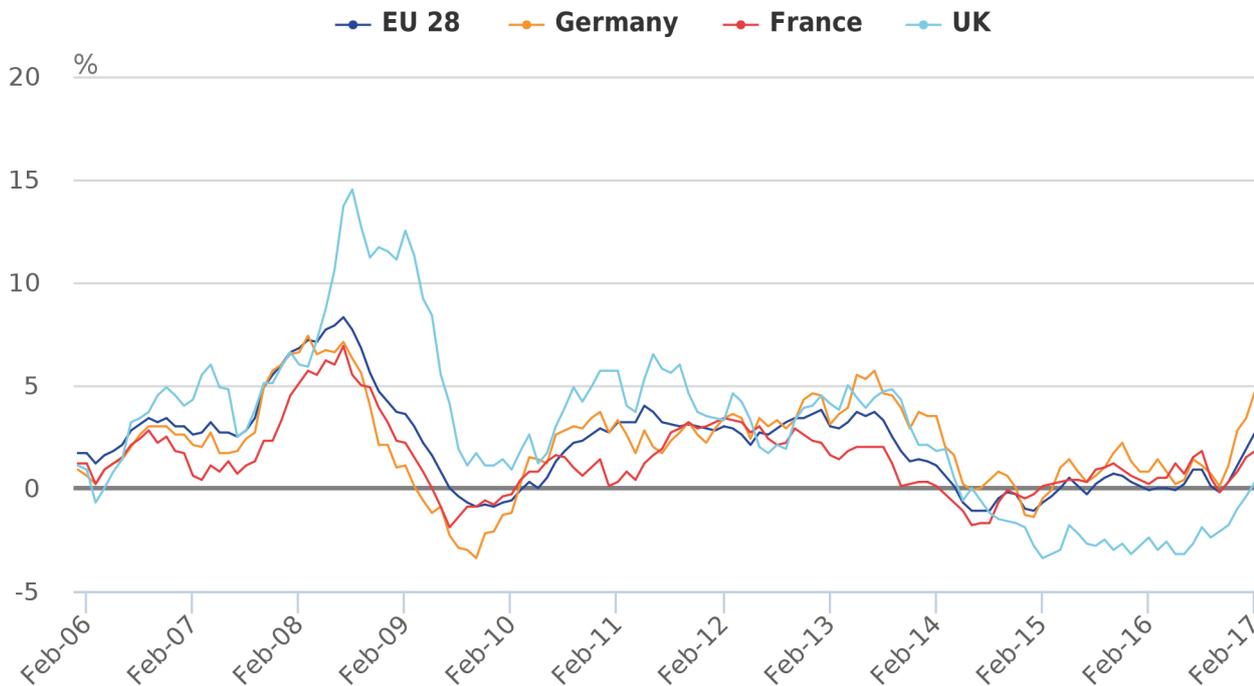
## 6 . Global food prices have been driving up consumer price inflation across the EU

Figure 3 shows the 12-month inflation rates for food within the Harmonised Indices of Consumer Prices (HICP) for the European Union (EU), Germany, France and the UK. The HICP are calculated using a common methodology to provide the best measure for comparisons of consumer price inflation across the EU. In the UK, the HICP is equivalent to the Consumer Prices Index (CPI).

Following the spike in global food prices in 2008 (Figure 2), food inflation in the UK peaked at 14.5% in August 2008 and remained above 10% until mid-2009. Other countries saw a similar trend, although food inflation decreased at a quicker rate in Europe resulting in a period of deflation at the end of 2009.

**Figure 3: Harmonised index of consumer prices (HICP) 12-month growth rate for Food, selected countries**

January 2006 to February 2017



Source: Office for National Statistics, Eurostat

**Notes:**

1. EU 28 refers to the 28 member states of the European Union. Weights are not available for all Member states so a series excluding UK, Germany and France is not available.

For the past 2 years, the price changes for food in the UK remained well below the other countries. This could be partly due to the supermarket price wars in the UK over this period which resulted in a downward pressure on food prices. However, all countries are now seeing an increase in food prices as a result of the upward trend in global food prices (Figure 2). In the 12 months to February 2017, the food component of the HICP grew by 0.3% in the UK, a return to food price inflation for the first time in nearly 3 years.

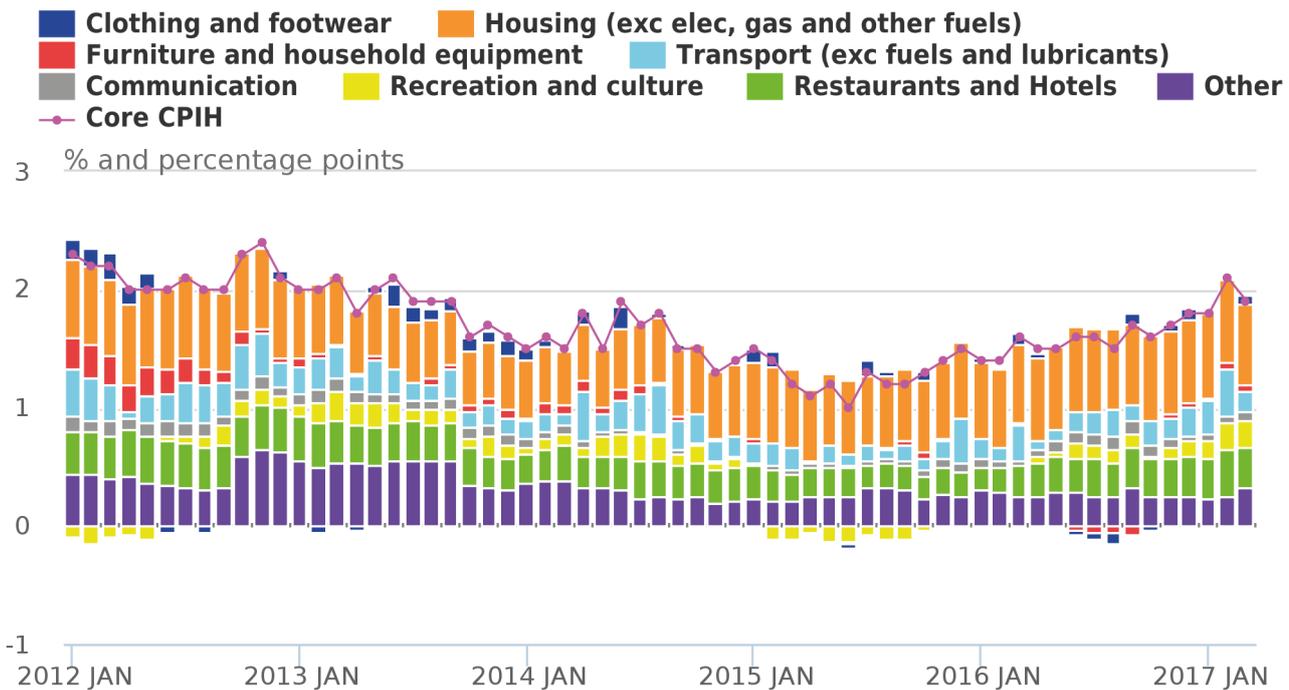
As discussed in a previous [prices economic commentary](#), while the prices of some individual vegetables increased in the month in the UK, vegetable prices as a whole still fell in the 12 months to February 2017. However, when comparing this to other countries there are large differences in the price changes of vegetables. In the 12 months to February 2017, vegetable prices in the EU 28 countries increased by 12.4% and in Germany they increased by 22.5%.

## 7 . Core inflation has gradually increased since the end of 2015

Figure 4 shows the contributions to the core Consumer Prices Index including owner occupiers' housing costs (CPIH) 12-month rate from division-level components in the Classification of Individual Consumption by Purpose (COICOP) structure. Core CPIH excludes the volatile components from the series, notably food, alcoholic beverages, tobacco, and energy . Taking out these components means that core CPIH annual growth is more stable than the aggregate CPIH. Figure 4 shows that housing consistently provides the largest contribution to the core CPIH 12-month growth rate, contributing an average of 0.6 percentage points over the period.

**Figure 4: Contributions to core CPIH by COICOP division**

January 2012 to March 2017



**Source: Office for National Statistics**

**Notes:**

1. Contributions may not sum due to rounding.
2. The "other" category includes the COICOP divisions for Health, Education and Miscellaneous goods and services.

The core CPIH 12-month rate has increased gradually since November 2015, coinciding with the start of the sustained increase in aggregate CPIH. Figure 4 shows that much of the increase over this period has come from recreation and culture, and restaurants and hotels. In particular, much of the increase in restaurants and hotels has come from restaurants and cafes, which may be passing on the increases in food prices from food producers to consumers.

The increased contribution from recreation and culture has been largely driven by technological products, particularly information processing equipment. This period coincides with reports that foreign producers of technological products have raised prices of their products sold in sterling (following the depreciation of sterling in 2016) to re-align with the prices of these products sold in US dollars.

## Notes for: Core inflation has gradually increased since the end of 2015

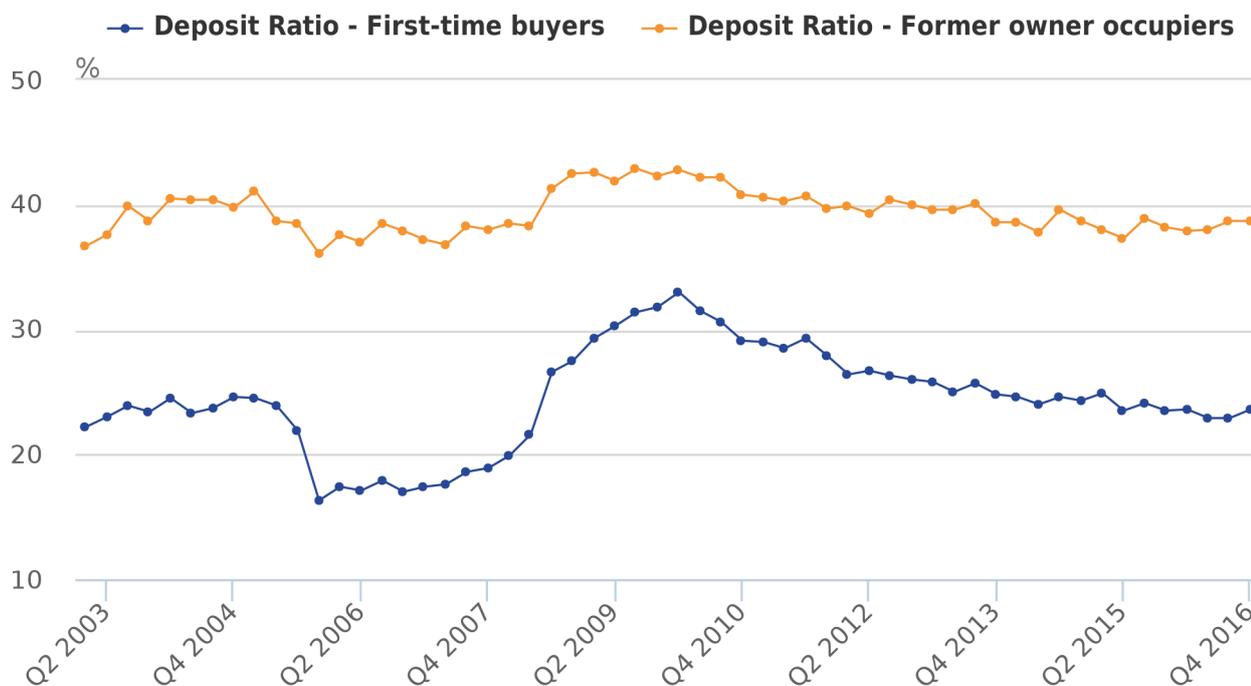
1. Energy includes the COICOP group Electricity, gas and other fuels, and fuels and lubricants class.

## 8 . Ratio of deposits to house prices have been falling in recent years

Figure 5 depicts the average mortgage deposit for first-time buyers (FT) and former owner occupiers (FO) as a percentage of the dwelling price – the deposit ratio. For both first-time buyers and former owner occupiers, the deposit ratio increased in the period immediately following the economic downturn. Figure 5 shows that for first-time buyers, the deposit ratio rose from 19.9% in Quarter 1 (Jan to Mar) 2008 to 33.0% in Quarter 1 2010, compared with 38.5% in Quarter 1 2008 to 42.8% in Quarter 1 2010 for former owner occupiers. Former owner occupiers generally have a higher deposit ratio compared with first-time buyers because they can re-invest the value of their existing property.

**Figure 5: Average deposit as a percentage of average dwelling price**

UK, Quarter 1 (Jan to Mar) 2003 to Quarter 4 (Oct to Dec) 2016



Source: Regulated Mortgage Survey, Matrix Solutions/Council of Mortgage Lenders

### Notes:

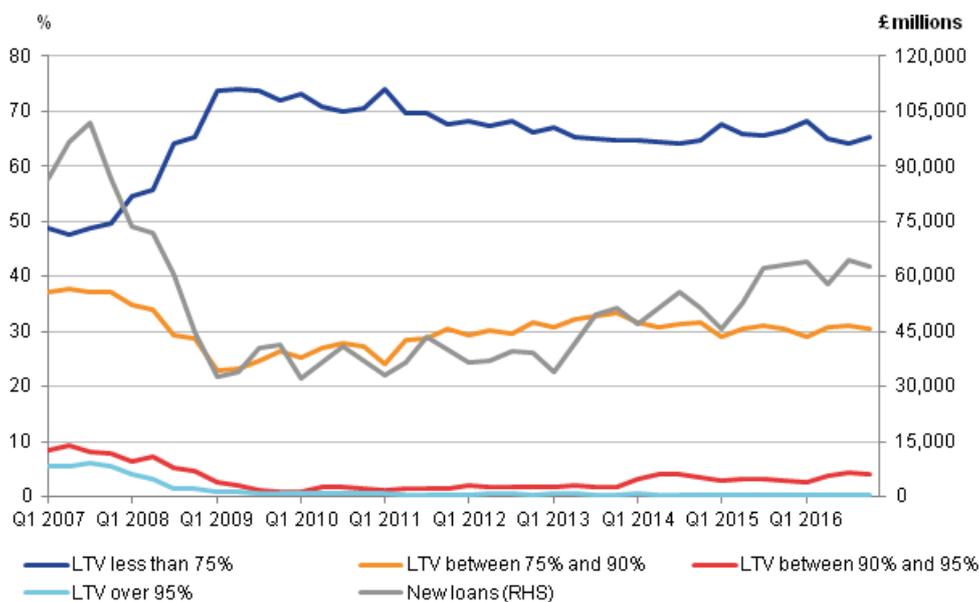
1. Data are published in [HPI Quarterly Tables, Table 15](#).
2. The data used to produce the chart are taken from the Council of Mortgage Lenders (CML) and cover 70% of all purchases with mortgages. Cash sales are not covered in this analysis.

The increase in the deposit ratio for first-time buyers was largely driven by a change in mortgage lenders' requirements for deposits, which reflected the fall in confidence in the economy after the downturn. Deposits for first-time buyers increased from an average of £32,000 at the beginning of 2008 to £61,000 in Quarter 1 2010. The increase in the deposit ratio was further exacerbated by the fall in house prices over the same period.

The change in mortgage lenders' requirements for deposits can be examined more closely by looking at the percentage of new residential loans to borrowers that are offered with a certain loan-to-value (LTV) ratio (Figure 6). At the beginning of 2008, around 11% of new residential loans had a LTV ratio of over 90%, which means that the amount lent to the customer equated to over 90% of the total value of the property. Between 2008 and 2010, the distribution of LTV ratios for new residential loans changed considerably, with a substantial increase in the percentage of new residential loans with a LTV ratio of less than 75%. By Quarter 1 2010, only 1.6% of new residential loans had a LTV ratio of over 90%. At the same time, the total amount of new residential loans to borrowers fell from £87 billion in Quarter 4 (Oct to Dec) 2007 to £34 billion in Quarter 2 (Apr to June) 2009. This reduction of higher LTV mortgage lending can be due in part to mortgage lenders looking to reduce the riskiness of their balance sheets following the economic downturn.

**Figure 6: Percentage of new residential loans to borrowers with set LTV ratios (% , LHS) and the total amount of new residential loans to borrowers (£ million, RHS)**

UK, Quarter 1 (Jan to Mar) 2007 to Quarter 4 (Oct to Dec) 2016



However, Figure 5 shows that since 2010 the deposit ratio for both first-time buyers and former owner occupiers has been decreasing steadily. By Quarter 4 2016, the deposit ratio has returned to around the same level seen in mid-2008. In particular, first-time buyers have seen a decrease in the average deposit paid, from £61,000 in Quarter 1 2010 to £50,000 by the end of 2016.

The decline in deposit ratios for first-time buyers may be explained by returning confidence in the housing market since 2010. Figure 6 shows that the percentage of new residential loans with a LTV ratio less than 75% decreased from 73.1% in Quarter 1 2010 to 65.2% at the end of 2016. At the same time, residential loans taken out with an LTV ratio between 90% and 95% increased from 1.0% to 4.0%, suggesting that banks are more willing to take on risk in their balance sheets again. However, there is still a decline in the most risky lending, with the over 95% LTV mortgages seeing a further decline in approvals from 0.6% to 0.3%.