BANK OF ENGLAND

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The Rt Hon Nicky Morgan MP
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Dear Nicky

I write with reference to two questions posed at my recent hearing before the Treasury Select Committee. These covered:

- The proportion of the Consumer Price Index (CPI) accounted for by food;
- The potential impact on the CPI of tariffs on imported food in the event that a trade deal with the European Union is not agreed

In summary, food and agricultural costs account for around a tenth of the CPI. Tariffs on imports from the EU could mechanically raise the level of the CPI by around ¾ of a percent, with potential for larger or smaller effects depending on prevailing conditions.

Food and agricultural products appear in two main areas of the CPI basket: the food and beverages component, and the restaurants and hotels component. These components of consumer spending each account for 12.1% of the CPI basket in 2018, or nearly a quarter in total.

As well as food product prices, suppliers of food and catering services face other costs such as labour, rent and taxes. Bank staff estimate that around three-fifths of the price for food and soft drinks paid by consumers is accounted for by the underlying product cost. Included within this is the contribution of food imports, which accounts for around a third of the price.

For restaurants and hotels, food and beverage product costs are estimated to account for around 15% of consumer prices, with just under half of that accounted for by imported food and beverages.

Summing across these two components, food and beverage product costs account for around a tenth of the CPI, with imports accounting for about half of that. More than two-thirds of these imports come from the rest of the EU.

The tariffs that could be imposed in the event of there being no trade deal agreed between the UK and EU vary significantly across different food and beverage products. For example, tariffs on some dairy and meat imports can exceed the equivalent of 50%, while tariffs on some vegetables such as onions are around 10%.

If the UK were to adopt the EU's current external schedule for tariffs, the average weighted tariff on food and beverage imports is likely to be around 20%. Since food and beverage imports from the EU account for around 3½% of the CPI basket, that would imply that the mechanical impact on the CPI could be around ¾ of a percent, much of which is likely to come through within a year.

There is uncertainty around the broader impact of any change in tariffs, because of how domestic producers and consumers would respond to higher import prices. For example, past experience shows that the prices of domestically produced agricultural and food products often respond to the cost of substitutes available overseas. In part reflecting that, retail prices have tended to track import prices fairly well over time despite imported food costs accounting for less than half of the prices paid by consumers (Chart 1). So in the event that tariffs were imposed, UK suppliers could raise prices as a result of facing less competition from overseas producers, increasing the overall impact on inflation. The response of consumer demand will also affect how much firms can raise prices in response to higher costs, which will also affect the overall impact on consumer prices.

Yours sincerely

Andy

Chart 1: Import and consumer prices of food and beverages