UK inflation heading for 11%+ readings later this year as food and energy costs rise

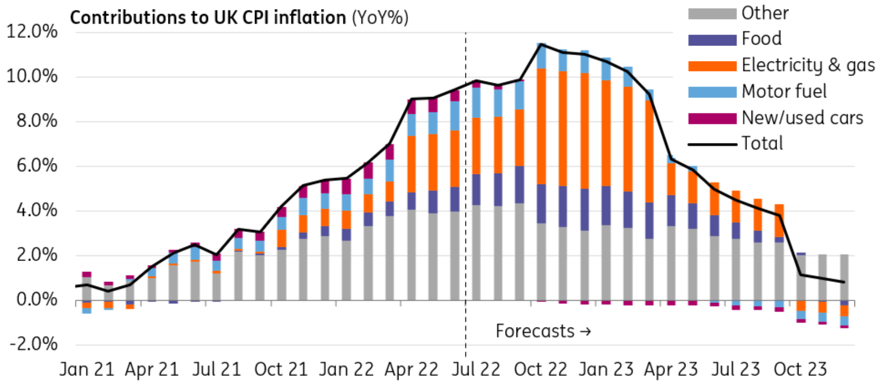
Rising petrol prices took UK headline inflation another leg higher in June and we expect it to peak above 11% in October. But core inflation may have already peaked, and that means today's numbers are unlikely to change too many minds when it comes to August's Bank of England decision. We still narrowly expect a 50bp hike at that meeting

UK inflation set to hit 11% in October

Rising food and energy prices have taken UK inflation another leg higher. Headline CPI hit 9.4% in June as petrol/diesel costs rose by almost 10% on the month, and food over 1%. The latter is now running at almost 10% year-on-year and looks set to exceed 15% later this year given rapidly rising import costs. The next rise in the household energy price cap, due in October, looks set to exceed April's 54%, though the ONS is still yet to decide whether the effect of the government's £400 energy rebate will factor into the CPI numbers. Assuming it doesn't, headline inflation is likely to peak at around 11.5% in October.

But while it will take some time for the headline numbers to hit a peak, core inflation may have already done so. Core CPI slipped a tenth of a percentage point in June and we think it's likely to flatline/modestly fall back through the rest of the year. There are further hints that some of the supply-driven aspects of inflation are cooling – demonstrated by another sharp fall in used car prices which are now almost 8% lower than their January peak.

How UK inflation breaks down



Source: Macrobond, ING

Bank of England likely to hike by 50bp in August

Once the effect of April and October's energy price increases fall out of the annual comparisons next year, then headline inflation should fall back reasonably quickly. Indeed negative base effects from energy mean that headline CPI is likely to be below the Bank of England's 2% target by the end of 2023 – crazy as that currently seems.

Like yesterday's jobs numbers, today's inflation numbers are unlikely to change too many minds at the Bank of England when it comes to the August decision. At face value, the data flow isn't offering much impetus for the committee to step up the pace of rate hikes, when you consider it decided against a 50bp move back in June. But this time, a larger rate hike is virtually priced in. With the Federal Reserve likely to implement another 75bp hike and in light of recent sterling pressure, we narrowly think the committee will opt for a 50bp move next month.

Nevertheless, we think the Bank is slowly nearing the end of its tightening cycle.

Author

James Smith
Developed Markets Economist
james.smith@ing.com