Benign UK inflation eclipsed by wage growth for Bank of England

UK core inflation looks set to stay at or just below the Bank of England's 2% target for much of 2019, but the better news on wage growth is a bigger factor for policymakers. This keeps the possibility of 2019 rate hike alive – although of course, it all depends on Brexit

UK inflation edged a little higher in February, lifted by a rise in food prices and a modest pick-up in recreation costs, and this minor upward trend could continue for the next couple of months. Following a decision to lift a cap on household energy prices, we expect higher electricity/gas costs to take headline CPI from the latest 1.9% figure to roughly 2.2% next month.

Energy aside though, we expect 2019 to be a fairly benign year for inflation and importantly from the Bank of England's perspective, we expect core CPI to hover around (or just below) the 2% target for much of the year.

1.9%

Headline CPI

(YoY%)

Higher than expected

But what really matters for policymakers is what happens to inflation beyond 2019. At 3.4%, wage growth is hovering at a post-crisis high, driven by skill shortages in various parts of the economy. Given that this has been at the heart of the BoE's rate hike rationale in the past, it suggests a rate hike later in 2019 is still a possibility.

Of course, this depends almost solely on Brexit, and amid all the current uncertainty, it's clear that the Bank will remain firmly on the sidelines as it prepares to announce its latest decision tomorrow.

A lot will depend on the length of a possible article 50 extension, but if the EU offers the UK a longer period (perhaps until the end of the year), this could open a brief window for the Bank of England to hike over the summer.

Admittedly, that relies heavily on the economy recovering through the second quarter from what we suspect was a pretty weak first quarter of growth. It's equally possible that an Article 50 extension could lead to a prolonged pause from the BoE, particularly given that the 'no deal' risk will not be taken off the table permanently.

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