

Good news for the Bank of England as services inflation falls further than expected

Services inflation has undershot the Bank of England's forecast for October, and that all but rules out any more tightening this year. We expect services inflation to fall back to the 3.5-4% area next summer and that would be a catalyst for rate cuts to begin

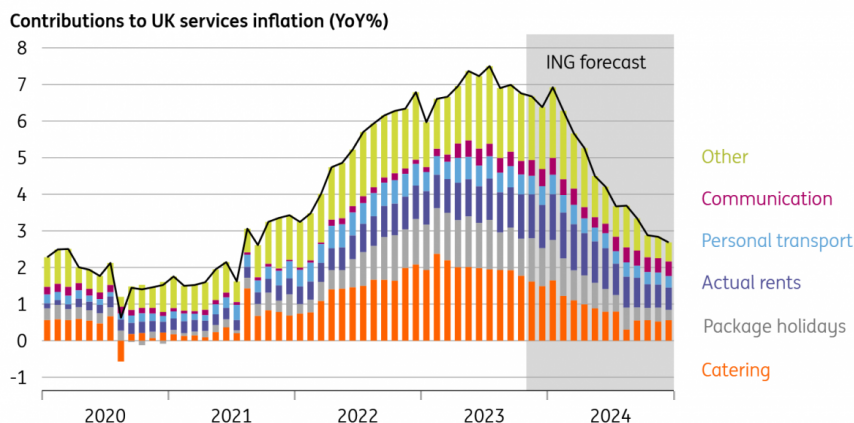


To no great surprise, UK inflation plunged in October as the impact of lower gas prices finally showed through in a meaningful way. Last year's 25% increase in household energy bills has dropped out of the annual comparison, while electricity/gas prices fell by 7% in October this year. And though a much less important factor in this latest drop, food price inflation has slowed dramatically too. Producer prices suggest the level of consumer prices at the checkout could actually start falling over the next few months. The net result is that headline CPI now stands at 4.6%, down from 6.7% in September. It's unlikely to change much again before year-end.

Inevitably this will raise a few smiles in Downing Street, and much of the focus of today's data will be on the fact that Prime Minister Rishi Sunak has met his goal of 'halving inflation'. But the Bank of England has to be pretty pleased too.

That’s because services inflation, the key metric for policymakers, came in much lower than the Bank had anticipated. Services CPI now stands at 6.6% on a year-on-year basis, below the BoE’s 6.9% forecast. That’s lower than we’d expected too, and this is partly because we’d been expecting another large increase in rents in October. The ONS reportedly updates social rents once per quarter and in April and July, we saw unprecedented increases in the overall rent category because of this, helping to push up services inflation. That ultimately didn’t happen last month, and while it’s a fairly niche quirk that would not likely have meant anything for monetary policy, it might help explain some of the difference with the BoE’s forecast.

UK services inflation and ING forecasts



Source: Macrobond, ING calculations

Even so, we can be pretty confident now that services inflation has indeed peaked and is trending downwards. Surveys show that fewer firms are raising prices now, and for the service sector we think that can be partly explained by lower gas prices. Higher energy costs late last year were reported by firms to be a key driver of higher consumer prices, and we expect the same to be true in reverse now that gas prices are down. Further progress on services inflation may be limited in the short-term – we expect it to end the year just above 6% - but we expect it to come down more readily from the spring and reach the 3.5-4% area next summer. Together with lower wage growth by that point, we think this will be a key catalyst for rate cuts to begin from August.

Today’s figures also all but rule out a resumption of rate hikes in December, though the chances were already low. This was the only CPI release before the next meeting, and we’ll only get one more wage release before then. The next move in rates is therefore likely to be down.

Author

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information

purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.