

Hot UK inflation not a gamechanger for the Bank of England

UK inflation was higher than expected in July, but given it was driven primarily by airfares, the Bank of England won't be too concerned. A November rate cut hangs in the balance, though it remains our base case



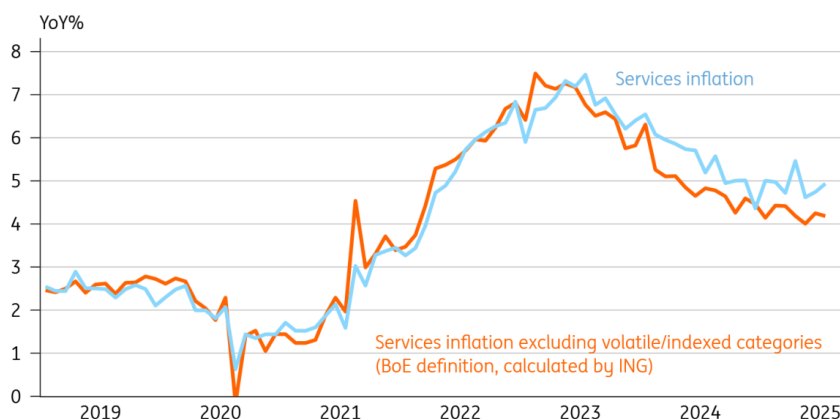
While airfares have climbed, hotel prices have stayed surprisingly grounded, despite the Oasis tour

UK inflation was undoubtedly hot in July, but as ever, the devil lies in the detail.

Services inflation – the bit usually most relevant for the Bank of England – rose to 5% from 4.7%. That was enough to drag core inflation up slightly too. But this was overwhelmingly down to a larger-than-usual rise in airfares. These are particularly volatile in July, depending partly on when the survey date falls relative to the start of school holidays. Interestingly, hotel prices – which many expected to surge amid Oasis' tour dates – barely increased on the month.

These are things the Bank of England can safely ignore. We calculate the Bank's preferred measure of services inflation, excluding volatile/indexed categories, to be essentially flat in annual terms. And at 4.2%, this measure is a fair bit below overall services inflation.

The Bank of England's preferred services inflation measure was unchanged



Source: Macrobond, ING calculations

BoE definition of services inflation excluding volatile/indexed items was spelled out in the August Monetary Policy Report

But that doesn't mean the central bank will relax entirely. Officials are keeping an unusually keen eye on food inflation right now. And this picked up further to 4.9%, from 2% at the end of last year. The Bank expects it to rise above 5% by year-end.

We suspect it's interested in this for two reasons:

First, because there is a loose correlation between supermarket and restaurant prices. And those restaurant/cafés make up 40% of that services inflation measure which excludes volatile/indexed items. Catering inflation is indeed running a little hotter, presumably linked to payroll tax and National Living Wage hikes back in April.

Secondly, food prices are seen as an important driver of household inflation expectations. And some BoE officials worry that, with headline inflation close to 4%, there's a risk that these expectations become less anchored.

We think these concerns are overblown, not least because the cooling jobs market should exert further downward pressure on wage growth in the second half of 2025. And when it comes to services, we think inflation will be a little more benign than the BoE's forecasts predict. Partly that's because rental inflation should slow considerably as the year progresses; we saw more signs of that in July's data, on account of less aggressive social rent rises.

That all leads us to think a November rate cut is still more likely than not, though it's not a particularly high conviction call right now given the very evident division on the rate-setting committee. Much also hinges on the jobs market, where employment has fallen in eight out of the past nine months, but where the survey data is looking a little less worrisome than it did earlier this year.

For now, we expect a rate cut in November to be followed by two further moves next year.

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 www.ing.com.