

Jump in UK services inflation provides ammunition to BoE hawks

Headline inflation has peaked but pressure from the service sector continues to build. That's likely to tip the balance for Bank of England hawks in favour of one final 50 basis point hike at the February meeting

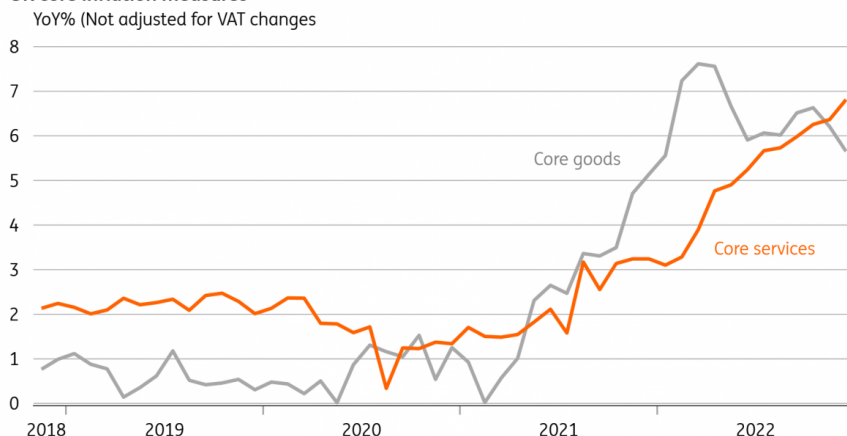


The good news, at least, is that it seems like UK headline inflation is slowing. At 10.5% in December, the latest CPI figure is below October's 11.1% peak. We expect this headline measure to stay roughly where it is for the next couple of months before showing more dramatic signs of easing as we approach Easter, which is when electricity/gas base effects begin to become more favourable.

Last year's near-50% increase in bills won't be matched, and if anything it looks like the Treasury will either need to lower unit prices for consumers later this year, or scrap April's planned increase altogether, given the recent fall in wholesale gas prices. On current policy, we expect headline inflation to fall back towards 6% by summer and to 3.5-4% by year-end.

UK services inflation has risen further

UK core inflation measures



Source: Macrobond, ING calculations

'Core goods' excludes food, energy and tobacco. 'Core services' excludes air fares, package holidays and education

The bad news, at least as far as the Bank of England is concerned, is that its favoured 'core services' measure of inflation has jumped, even as goods inflation slows dramatically. At 6.8%, core services CPI (which excludes volatile components like airfares and package holidays) is materially higher than the Bank had been forecasting back in November, and reflects ongoing pressure from both wages and energy bills on service sector costs.

While we suspect this is nearing a peak, it provides further ammunition for the BoE's hawks to push for one final 50 basis point rate hike at the February meeting, putting the peak at 4% for Bank Rate (or perhaps 4.25% if the Bank adds one further 25bp hike in March). The UK's somewhat unique combination of structural worker shortages, and therefore potential for persistently higher wage growth, as well as its exposure to Europe's energy crisis, suggests the Bank of England will be less quick to cut rates than in the US, where we expect cuts later this 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 <http://www.ing.com>.