

Lower UK core inflation unlikely to dampen BoE's hawkish mood

The latest slip in core inflation was mainly down to volatile airfares, and policymakers remain more heavily focused on stronger wage growth figures. We expect further hints that markets are underestimating the Bank of England's tightening ambitions, although ultimately we don't expect a rate hike in 2019



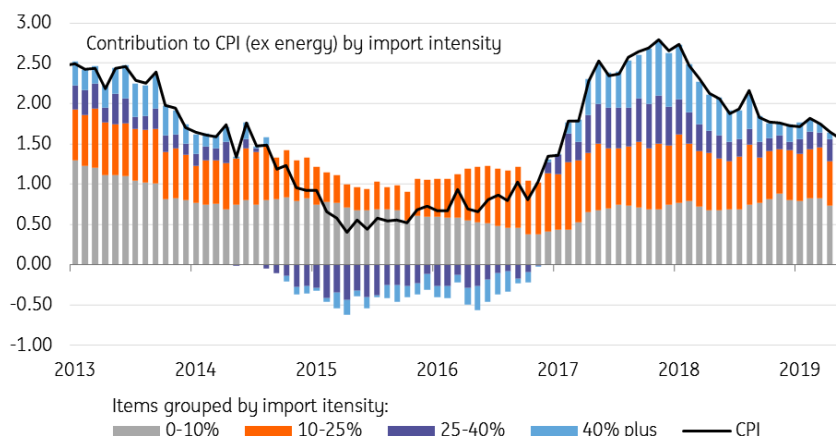
Source: Shutterstock

At face value at least, the fact that UK core inflation has now been below the Bank of England's 2% target since last September appears to offer little reason to tighten policy further. However, there are a few key reasons why we suspect policymakers will remain a little more hawkish on the outlook for inflation over the coming months.

Firstly, the latest dip in core CPI to 1.7% in May was largely down to airfares - a volatile component of the inflation basket, which fell back after Easter by around 5%.

Secondly, and more broadly, the modest downtrend in core inflation over recent months also reflects the lagged impact of sterling's post-Brexit plunge filtering out of the numbers. Stripping the inflation basket down by import intensity - the proportion of the good/service that is effectively imported - suggests that the contribution from items with a lower sensitivity to currency moves has been more stable over the past couple of years.

UK inflation broken down by import-intensity (excl energy)



Source: Macrobond

Even so, it's fair to say that underlying consumer inflation has still been fairly unexciting. Another measure of so-called domestically-generated inflation, the core services index, has slipped back since 2017. That said, as MPC member Michael Saunders recently highlighted, much of this has been driven by [lower contributions from rent and insurance](#).

Most importantly though, policymakers continue to put greater emphasis on wage growth, which is still performing fairly solidly. The BoE expects wage pressures to continue building as skill shortages bite.

[Read MPC member, Michael Saunder's full speech here](#)

In other words, we expect the Bank to stick to its reasonably hawkish mantra at tomorrow's meeting. Policymakers have been keen to highlight that they believe market expectations of interest rates are too low, and it's possible we see more explicit references to this in either tomorrow's statement or accompanying minutes.

Ultimately though, we think it's unlikely the Bank will get an opportunity to tighten further this year. For more, see our latest Bank of England dashboard

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>.