Mixed UK inflation data no gamechanger for the Bank of England

Food inflation plunged in January, but service sector price pressure is proving stickier. We continue to expect Bank of England rate cuts in March and June

A sharp drop in food inflation should help BoE hawks become a little more relaxed about the upside risks to inflation

The latest UK inflation read is a mixed bag for the Bank of England, but we doubt it drastically changes the odds of a March rate cut.

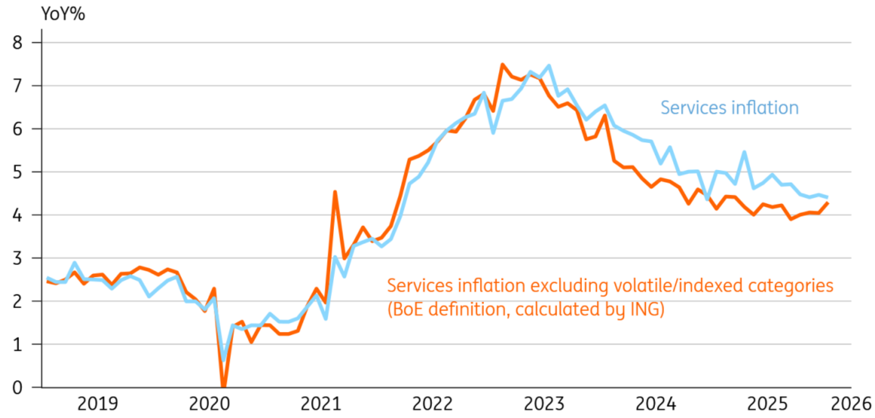
Headline inflation is down from 3.4% to 3.0% in January, largely as expected. It's a consequence of a seasonal fall in air fares, lower fuel prices and the impact of last year's private school VAT change dropping out.

Most importantly, though, food inflation is down sharply – from 4.5% to 3.6%. That's roughly inline with BoE forecasts, but it should help the hawks become a little more relaxed about the upside risks to inflation. A big concern last year was that higher food inflation would spark a much wider and more persistent bout of price pressure. Those concerns now look overblown.

But services inflation was stickier than expected in January. Importantly, that's not really because of quirks like air fares or holidays. In fact, we calculate that the Bank's preferred measure of 'core services' inflation nudged up from 4.0% to 4.3%, once volatile and indexed items are excluded.

Catering – often seen as the archetypal service-sector category, one that's driven by underlying economic demand – has nudged a little higher over the past couple of months.

Services inflation is proving sticky



Source: Macrobond, ING

Nothing here is a game-changer for the Bank. The views of doves and hawks alike are being driven by bigger picture, structural thinking right now. One inflation report isn't going to shift those views dramatically. Weakness in the jobs market, coupled with falling wage growth, is probably a more important consideration right now.

The bigger test comes in April. We still think inflation will temporarily dip below target to 1.9% before settling around 2% through the summer. That's down to a whole raft of things, but notably lower energy costs and less aggressive water bill increases. If we're right, that should go some way to making the committee as a whole more relaxed about the inflation outlook.

We continue to expect rate cuts in March and June – and we don't rule out more.

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