Rise in UK inflation unlikely to last

The fading impact of sterling's post-Brexit fall is likely to keep a lid on core inflation over the coming months, adding another reason for the Bank of England to remain on hold this year as Brexit risks mount

Source: Shutterstock

UK inflation is on the rise again, but we don't expect this to last.

Headline CPI picked up to 2.5% in July, driven predominantly by the sharp rise in petrol prices through the second quarter. But importantly, fuel costs have begun to stabilise, and the price of petrol, in fact, fell by 0.6% last month. Barring any further gyrations in oil prices, we think July's figure represents a peak, and we expect CPI to begin trending downwards over the next few months gradually.

But oil prices aren't the only factor keeping a lid on inflation. The impact of the pound's post-Brexit plunge is continuing to fade – prices have more-or-less adjusted to the weaker level of sterling – and this is seeing core goods inflation slow. We expect this to keep core CPI close to 2% for the foreseeable future, although there's a risk that this slips lower – particularly if recreational goods inflation (things like TVs/computers, which are fairly sterling sensitive) eases more aggressively.

For the Bank of England, this is likely to be another argument to remain on the sidelines for the next few months, as Brexit uncertainty becomes an increasing concern. Talk of 'no deal' is ramping up, and there's a risk this begins to impact sentiment if negotiations remain in deadlock as we head into the end of the year.

For that reason, we don't expect another rate hike before May 2019 at the earliest.

Author

James Smith
Developed Markets Economist, UK
james.smith@ing.com