Sharp fall in UK core inflation unlikely to last long

Core inflation is likely to nudge a little closer to target over the next couple of months. But for the Bank of England, the fact that wage growth is running close to post-crisis highs remains a bigger consideration. This suggests it's still too early to be pencilling in rate cuts in the UK

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At 1.5%, UK core inflation fell reasonably sharply in August and came in quite a bit below market expectations for 1.8% year-on-year. This now sits at the lowest level since late-2016, although there are few reasons why this shouldn't be overstated.

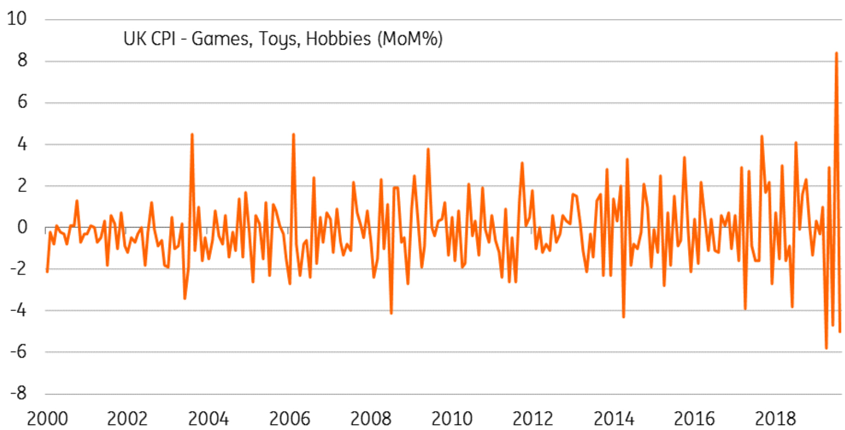
Firstly, some of the fall was down to unusual volatility in the price of games & toys. Having risen by the fastest monthly rate since the 1980s back in July, the price of these recreational goods fell back by 5% during August. Secondly, clothing prices didn't increase as rapidly as they did at the same time last year. Elsewhere, price changes appeared more 'normal' and we expect to see core inflation nudge a bit closer to target over the next couple of months, particularly in light of fairly favourable base effects.

Wage growth continues to be a bigger consideration for the Bank of England

Either way, the outlook for consumer prices still appears fairly benign - even when considering the latest increase in oil prices. However, for the Bank of England, wage growth continues to be a bigger consideration. Skill shortages in certain parts of the jobs market are prompting more rapid rises in regular pay, and wage growth continues to sit around post-crisis highs. Given services make up a sizable share of the UK inflation mix, and these items tend to be fairly labour-intensive, these higher wage costs could feasibly translate into a bit of upward pressure for consumer prices in the medium- term.

This is the main reason why the Bank of England will likely retain its notional tightening bias at tomorrow's meeting – and also suggests it's too early to pencil in rate cuts in the UK. Equally though, the ongoing uncertainty surrounding Brexit, and mounting concerns over global growth, suggests the prospect of any further policy tightening is also still quite a long way off.

The prices of games and toys have been unusually volatile



Source: Macrobond

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