Sticky UK inflation leaves November rate cut hanging in the balance

Inflation is more or less at a peak, though it's likely to stay in the 3.5-4% area for the rest of this year. Rising food inflation is a particular bugbear of the Bank of England. Yet we aren't in the camp that thinks rate cuts are over, given the prospect of further progress in services inflation and wage growth

Food inflation nudged above 5% as expected

At 3.8%, the latest UK inflation data certainly isn't welcome news for the Bank of England ahead of its decision on Thursday, where it's widely expected to leave rates on hold.

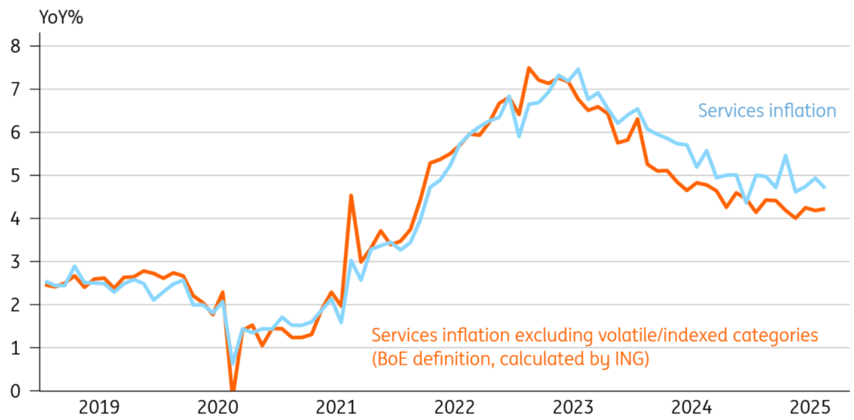
Yet the latest data doesn't dramatically move the needle one way or another on the prospect of a further rate cut later this year.

Food inflation nudged above 5%, as both we and the BoE had anticipated. That's a particular bugbear of officials right now, given the formative role food prices play in inflation expectations, but also because of the correlation with restaurant/café prices.

Catering makes up 40% of the Bank's preferred measure of "core services" inflation, which gauges the segment of the inflation basket most intrinsically linked to the underlying performance of the UK economy. Inflation in the hospitality sector has been stuck around 4% this year, which we think is linked to pressure from April's payroll tax and National Living Wage hikes.

Speaking of the service sector, inflation here did come in a tad lower than the Bank expected at 4.7%, though mainly because of volatile air fares. Indeed, if we look at the "core services" basket, which excludes volatile and indexed items, we calculate that it stayed unchanged at 4.2%.

The BoE's 'core services' metric stayed at 4.2%



Source: Macrobond, ING calculations

However, we think there is still scope for services inflation to undershoot the Bank's forecasts further in the next release for September. And more broadly, we are seeing a significant easing in rental growth, which is set to be a significant source of service sector disinflation over the coming months.

If we're right about that, it would tip the balance slightly more in favour of a November rate cut, which we still narrowly expect. Certainly, we aren't in the camp that thinks rate cuts are over. Services inflation should show more visible progress next spring, while wage growth should ease below 4% by year-end. Add in the fact that the late-November autumn Budget is likely to be dominated by tax rises, and we think there's still a decent case for UK interest rates to fall two or three more times by next summer.

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