Surprise dip in UK inflation makes 2017 hike more unlikely

The slowdown in UK inflation casts further doubt over Bank of England's recent hawkish signals.

Source: Bank of England

A fair chunk of the slowdown in the headline rate can be put down to lower petrol prices, which fell by around 1% in June. But given the relatively sharp drop in the core rate from 2.6% to 2.4%, which excludes energy, today's weakness appears to be broad-based. Clothing prices were down noticeably, which combined with a drop in recreational items (things like games, cultural services and toys), suggests that retailers still have to offer heavy discounts in the face of lower consumer demand.

2.6%

Headline CPI (YoY%)

(Previously 2.9%)

Worse than expected

The Bank of England has taken a noticeably hawkish line recently, but today's data casts doubt over a rate hike later this year. Even if inflation does recover (we expect the weaker pound to ultimately keep headline inflation in the 2.5-3% region for the rest of this year), the decision to hike rates still hinges on the growth outlook.

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Governor Carney recently suggested that the Bank needs to see stronger investment and a recovery in wage growth before tightening policy. But political uncertainty, the deteriorating outlook for consumer spending and rising cost bases from higher import prices mean that both look unlikely to materialise.

Throw in the recent weakness in construction, trade and production figures, which could see 2Q GDP come in at a disappointing 0.2-0.3% again, then a 2017 rate hike still looks unlikely.

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