

## Surprise fall in UK services inflation unlikely to unlock September rate cut

Just as the recent upside surprises in UK services inflation looked a lot like noise, it's only fair to conclude that the same is true of the latest downside miss too. The Bank of England, we suspect, won't read too much into them just yet



Volatility in hotel prices has impacted UK services inflation

The latest UK CPI figures for July reveal that services inflation fell much more dramatically than just about everyone had expected. Services CPI now stands at 5.2%, down from 5.7% and crucially, well below the BoE's 5.6% forecast.

On the face of it, that looks like very welcome news which in theory, you might expect could speed up the process of lowering rates. Remember that services inflation is the main guiding light for Bank of England policy these days. But dig into the details and we suspect the Bank will be taking these figures with a pinch of salt.

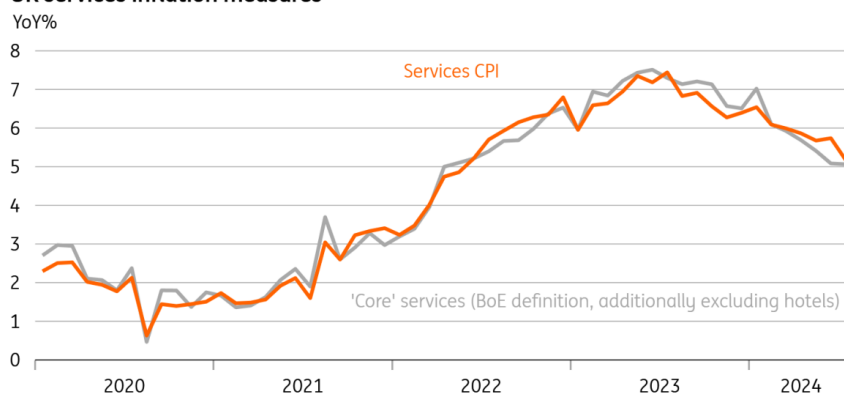
Don't forget that the BoE had been grappling with services inflation which, for the past few months, has been coming in a fair bit above expectations. Much of this surprise could be traced back to chunky rises in regulated prices back in April at the start of the financial year, most of which is inherently backward-looking in nature. Then in June, an unusual surge in hotel prices kept

the overall service inflation index elevated.

Much of this looked like noise and the BoE itself concluded that these upside surprises didn't tell it much about the trajectory of inflation over the medium-term. Indeed, we replicated a measure of “core services” inflation, put together by the Bank of England, which excludes various items like rents and airfares, and we additionally took out hotels given the recent volatility. Back in June, this measure showed that services inflation had fallen back more aggressively than the headline metric, once those components were removed.

## Alternative 'core services' metric was flat in July

### UK services inflation measures



Source: Macrobond, ING calculations

Core services inflation excludes rents, package holidays, air fares and education. We've additionally removed hotels given recent volatility

This time, as the chart above shows, our metric of core services inflation was unchanged at 5.1%. In other words, just as the upside surprises of recent months looked like noise, it's only fair to conclude that the same is true of this latest sharp fall in services inflation as well. We suspect that's the conclusion the Bank is likely to reach too.

That said, we still think the news on services inflation is likely to gradually improve as the year wears on. Surveys show firms are raising prices much less aggressively than they were. And that should help unlock at least one rate cut in November, and we suspect another in December. We suspect the Bank will pause at the next meeting in September.

Finally, just a quick word on headline inflation. That came in at 2.2% in July, and we suspect it will creep higher towards 3% into year-end. That's largely because the impact of lower household energy prices is dropping out of the annual comparison, and the downward trend in food inflation looks like it is more or less complete.

### Author

**James Smith**

Developed Markets Economist, UK

[james.smith@ing.com](mailto:james.smith@ing.com)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.