

UK: Inflating the risks?

Inflation is likely to hit 2.8% but with Brexit uncertainty unlikely to fade, we doubt a rate hike is round the corner



Source: iStock

Inflation data for August is due tomorrow, and given the rise in petrol prices, it looks likely headline inflation will push up to 2.8% year on year from 2.6% in June and July. This is well above the Bank's 2% medium term target but is within the +/-1% band of tolerance. Core inflation, which excludes food and fuel, is likely to rise more modestly to 2.5% from 2.4%.

The 1.6% month on month increase in motor fuel versus a 1.3% drop in the same period last year means we are going to see a big swing in the YoY rate of inflation from this component. However, the primary factor responsible for above-target inflation rate remains sterling's weakness, which has pushed up the cost of imported goods and services.

The chart below suggests sterling's fall is still to fully feed through, implying that headline inflation could rise further.

Sterling weakness to push inflation higher



Source: Bloomberg

However, the relationship with PPI suggests there is less to fear and indicates the relatively subdued economic environment for growth means that corporates are having to absorb some of the higher import costs in their profit margins.

Domestically generated price pressures remain weak, as highlighted by modest wage growth. Indeed, the squeeze on household spending power is a key reason why the economy is currently experiencing such slow GDP growth.

This means that the economy is likely to be operating with spare capacity. Add in the Brexit related uncertainty, which won't fade anytime soon given the noises coming from London and Brussels, and it seems to us that the most likely path for central bank policy is one of stable interest rates.

Author

James Knightley

Chief International Economist, US

james.knightley@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 www.ing.com.