

UK inflation continues to tumble as the pound's plunge fades

UK core inflation looks set to hit 2% next month, but all eyes are on the activity data as the Bank of England mulls a summer rate rise



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At 2.4%, UK inflation has continued to tumble more quickly than expected. That's despite a fairly punchy 1.2% increase in petrol prices, and the largest ever April rise in soft drink cost on the back of the newly introduced 'sugar tax'.

Admittedly some of the latest declines came from the notorious airfares effect, following the early Easter. Once that unwinds, the possibility of petrol prices closing in on 130 pence-per-litre over coming weeks should keep headline CPI fairly sticky around the 2.5% level as we head into the summer.

But we suspect at least some of this latest fall is sterling related, and we expect core inflation to hit 2% next month as the rate of pass-through from the pound's post-Brexit plunge continues to fade.

In principle, this takes some of the heat off the Bank of England to hike rates again in the near-term – although it's worth remembering policymakers are still focussed squarely on wage growth as a measure of underlying inflation. Since the November rate hike, pay has risen more quickly than many had expected and we don't expect the earnings data between now and August to change the Bank's mind that the direction of travel is upwards.

But when it comes to the prospect of a summer rate hike, it all comes down to whether the activity data show sufficient signs of recovery before August. Our feeling is the Bank is inclined to hike rates assuming the data shows some signs of a bounce-back. That said, a lot still depends on the high street where lower demand, rising wage costs and higher business rates are causing severe difficulties for retailers.

With consumer's remaining cautious and borrowing appearing to have fallen substantially, a rate hike over the next few months is certainly not a done deal. As we heard from the BoE's Vlieghe yesterday, the cost of waiting is not particularly high.

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