

UK inflation dip represents the calm before the storm

Despite a temporary setback in July, UK inflation is unlikely to be far off 3% in August and will probably be fairly close to the Bank of England's 4% forecast by November. But things are likely to calm down into 2022, and we don't think inflation will be enough of a concern for policymakers to hike interest rates before late next year



Declining clothing prices are partly responsible for the surprise drop in UK inflation

2%

UK inflation rate

July

Lower than expected

The dip in UK inflation is unlikely to last

UK inflation took a bit more of a tumble than expected in July – but this feels remarkably like the calm before the storm. Indeed much of the surprisingly sharp deceleration from 2.5% to 2% can be put down to things like clothing prices, and to a lesser extent, household goods. The former

had been seeing a sharp recovery in prices after recent lockdowns, while the latter had been pushed higher by global supply chain constraints.

These are temporary setbacks, and there's little doubt that headline CPI will go well above 3% later this year – and in fact, the next set of data may confirm we got close in August. It's not difficult to see inflation coming fairly near to the Bank of England's forecast of 4% in around November.

When it comes to predicting the date of the first rate rise, however, the size of the peak in inflation feels fairly irrelevant. How quickly it falls back into 2022 is a better question, and we suspect headline CPI could revert close to target by around the middle of that year, a fair bit sooner than the Bank of England most recently forecast.

Part of that unsurprisingly is down to energy, which by late this year will probably account for over a quarter of that 4% headline CPI spike. A huge 12% increase in the cap on household energy bills due for October is a major factor. But that follows a similarly large 9% rise in April, which correspondingly means a little bit of the heat should come out of the inflation numbers from the second quarter next year.

Inflation to calm down into 2022

The bigger uncertainty is what happens to goods prices, in light of the fact that many of the strains in global supply chains are likely to persist for some time to come. Shipping prices have continued to rise, while the latest Covid-19 news in China risks amplifying some existing shortages as we head into the important Christmas/Black Friday trading season.

Still, like energy prices, we think goods inflation will have begun to ease in the spring of next year. And the combination of these factors potentially means that headline CPI will be much closer to target by the middle of 2022.

Any tightening is unlikely to come before late 2022 or early 2023

Ultimately, whether or not inflation stays higher for longer probably relies on wage growth accelerating. There's some evidence (though mainly anecdotal) that some firms have been forced to lift pay in light of recent staff shortages, though we think many of the factors driving this problem will subside over coming months. Indeed one ingredient has been the so-called 'pingdemic', which should be becoming less of an issue now self-isolation rules have changed.

Barring a surprise surge in underlying wage growth over the winter, we don't think inflation will be a huge concern for the Bank of England. Any tightening is, therefore, unlikely to come before late 2022 or early 2023.

Author

James Smith

Developed Markets Economist, UK

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>.