

UK inflation edges above 3%

Headline inflation has peaked above 3%, but as the effect of the weaker pound fades, CPI will edge closer to target through the middle part of next year



Source: Bank of England

3.1% Headline UK Inflation
(YoY)

Better than expected

With headline inflation now above 3% for the first time since 2012, Bank of England Governor Carney (pictured) will write be forced to write a letter to the Chancellor. That said, this is unlikely to become the start of a new trend. Most of the cause of today's above-consensus 3.1% inflation reading - namely higher contributions from computer games and airfares - will likely prove temporary. Whilst the headline rate may hover around 3-3.1% over the next two or three months, the bulk of the pass-through from the weaker pound has now occurred and we expect inflation to gradually converge on 2% through the middle-latter part of next year.

The bigger question for the Bank of England now is whether 'domestically-generated' inflation will start to rise in 2018, and a key barometer of this is wage growth. There has been some renewed momentum in earnings over recent months, albeit partly because of rises in the national living

wage, and BoE Agents expect some higher pay awards in the new year. However with the economy struggling to regain momentum, company margins still being squeezed (from higher import costs) and early signs that the jobs market is starting to slow, we suspect the Bank of England's 2018 wage growth forecast could prove to be a touch optimistic.

This is one reason why we caution a rate hike next year is still not a done deal, although the more positive news on Brexit (and increased likelihood of a transition period) means that a rate rise in February or March shouldn't be ruled out.

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