

UK inflation hits another high ahead of 8%+ peak in April

UK inflation is set to peak a little above 8% in April as higher petrol prices combine with the dramatic increase in the electricity/gas price cap. The situation later this year is looking less worrisome than it was a few weeks ago given the pullback in gas prices, but inflation is still likely to end the year above 6%



Source: Shutterstock

UK inflation hit another multi-decade high in February, touching 6.2% for the first time since the early 1990s, but we're still a couple of percentage points away from its likely peak.

Food prices rose by another 1% across the month after a few consecutive strong gains, and clearly, there is more pressure to come here. Fuel costs also have further to run, mainly because the bulk of the recent surge in pump prices won't show through until the March data. We're likely to have seen petrol prices rise by 10% on average across the month, and we could see another 6-7% increase in April - though this also depends on any cut in fuel duty from the Chancellor today.

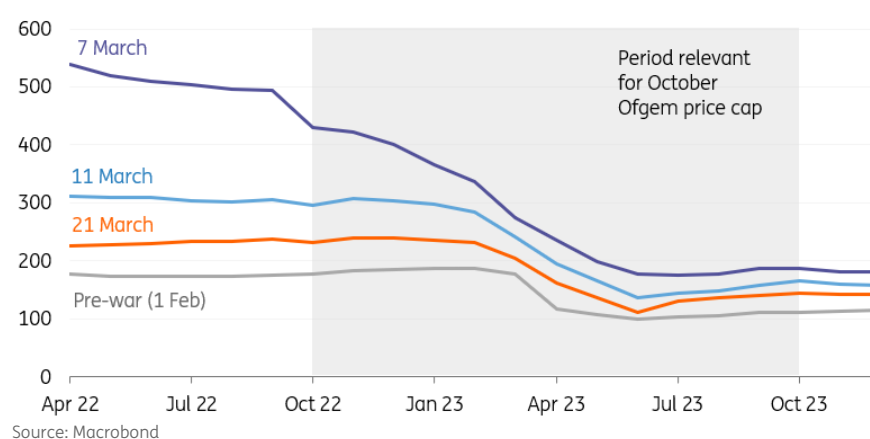
Alongside the already-announced 54% increase in the household energy cap, that suggests

inflation is likely to peak slightly above 8% in April.

However, it's still pretty hard to say exactly where inflation is likely to land towards the end of the year. Earlier this month, when gas prices were surging, it looked increasingly likely that we'd see a second inflation peak in October. That's when the household energy cap will next be updated, and only a couple of weeks ago, futures prices had suggested we could see another 50% rise in electricity/gas bills in the autumn, net of a £200/household rebate from the government.

But since then gas prices covering next winter have moved dramatically lower, and if we plug the latest futures into the regulator's methodology, it looks like October's cap could rise by a more modest 20%. It's still early days – the regulator will monitor prices until late July to help determine what the final cap will be.

UK natural gas futures on selected dates (GBp/therm)



That suggests that inflation will be around 1-1.5ppt lower at the end of 2022 than it might have been just a few weeks ago. Our best guess, for now, is that inflation ends the year around 6-6.5%, though the real unknown is how far the war, alongside the recent Covid outbreaks in parts of Asia, amplify the existing strains on supply chains experienced during the pandemic.

Despite the recent pullback in gas prices, the UK consumer still faces a sharp cost of living crunch this year. For the Chancellor, that means more support will be needed. To take one example, the £200/household one-off energy subsidy that was announced in early February would need to be increased to around £600 to keep electricity/gas bills at a similar level in October.

At the Bank of England, last week's meeting suggested policymakers are increasingly placing greater emphasis on the deteriorating growth outlook, over the risks surrounding inflation and expectations. After one, or perhaps two, more front-loaded rate hikes, we expect the Bank to pause its rate hike cycle.

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