UK inflation jumps to 2.9%

The surprise jump could push the BoE to talk up the chances of a rate rise but Brexit uncertainty makes us doubt they will actually pull the trigger

UK inflation has rebounded to 2.9% year on year in August, up from 2.6% in July. The increase was motor fuel related, but there is still the legacy of sterling's plunge feeding through from higher import costs. Indeed, core inflation (excludes food and energy) jumped from 2.4% to 2.7%. Clothing and footwear was a key culprit following a couple of months of hefty price falls while household goods prices also rebounded.

Tomorrow sees the release of the UK labour report, and it is expected to show a modest increase in wage growth and ongoing decent gains in employment, despite Brexit uncertainty. Consequently, the BoE is likely to remain concerned financial markets are mispricing the risk of an interest rate rise. We expect the accompanying statement of Thursday's policy decision to retain the sentence that 'monetary policy could need to be tightened by a somewhat greater extent... than the path implied by the yield curve'.

External members Ian McCafferty and Michael Saunders will again vote in favour of an immediate 25bp rate rise, but the key story will be whether BoE Chief Economist Andy Haldane finally follows through with his threat to vote for a hike. Back in June, he warned that "the balance point [between tightening 'too early' and 'too late']… has shifted. Certainly, I think such a tightening is likely to be needed well ahead of current market expectations."

If we do get a 6-3 vote for stable policy, it could prompt a reappraisal of the potential path of interest rates, but we feel that the economic uncertainty brought about by Brexit will lead the committee to hold fire until there is much greater clarity the UK's post Brexit environment.

> The inflationary impulse from sterling's post referendum plunge will gradually fade through next year, and there is a lack of domestically generated price pressures. Even if we do see last August's emergency rate cut reversed at some point in the next twelve months, it is unlikely to mark the start of a tightening cycle.

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