

UK inflation now very close to the peak

We expect the Bank of England to hike rates in November, but a lack of domestically-generated inflation means that any subsequent tightening will be limited



Source: iStockphoto

At 3%, September's UK inflation rate is the highest it has been in five years and will continue to test the patience of the hawks at the Bank of England. But the key question is how much of this spike is domestically-generated.

Well, firstly the latest headline figures were boosted by a 2.1% pick-up in fuel costs as pump prices respond to the recent increase in oil prices. But more importantly, it is clear that the impact of the pound's post-Brexit plunge is still very much at play. Food prices, which are highly influenced by import costs, increased sharply by 0.8% on the month.

3.0% Headline CPI
(YoY%)

As expected

But neither of these factors tell us much about underlying momentum in prices. One way of stripping out these drivers is to look solely at the basket of goods that have a low import content

(less than 20%) – and by this measure, inflation would actually be below target if the impact of sterling and energy are ignored.

It's likely to be a similar story in tomorrow's jobs report. Wage growth – a crucial input into the Bank's decision making process – is likely to dip back to 2% and we think is likely to stay at, or below, this level for the next few months.

It's also worth noting that this is probably about as high as inflation will go. We may see a slight pick-up to 3.1% in October, but thereafter headline CPI should gradually start to ease back.

So whilst we think a November rate hike is highly likely, for now we think the lack of domestically generated inflation combined with a sluggish growth outlook (and don't forget all the noise surrounding Brexit) mean that any subsequent tightening is likely to be very limited.

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