UK inflation records surprise leap on lockdown easing

Prices rose in May as businesses continued to reopen, leading to a surprise jump in core UK inflation. Headline CPI is likely to be at 2.5%, or perhaps slightly above, by year-end. But for the Bank of England, the fact that inflation is likely to ease through 2022 suggests less imminent pressure to move towards tightening. We expect the first hike in early 2023

A surprise jump in UK inflation

UK core inflation leaped to 2% in May, wildly surpassing expectations and marks a considerable jump from 1.3% in April. While an element of this is down to base effects – though more so on the energy side – given the annual comparison compared to the depths of the pandemic, that's only really part of the story here. It's pretty clear reading the details that there is a reopening effect, with the likes of restaurant and hotel prices increasing on the month.

Clothing prices jumped for a third consecutive month, and have increased by 6.5% since February, though this only partially reverses the heavy discounting that we saw at the start of the year. This recent jump, linked to shops reopening, tallies with a strong rebound in clothing sales as people refreshed wardrobes ahead of the reopening of hospitality and some events. That said, we suspect this particular upward trend in prices probably doesn't have much further to run.

When you factor in the tailwind from energy prices, headline inflation is likely to be around 2.5%, or potentially slightly above, by November/December, though the road to that point will be bumpy. There are various events from last summer – including some reopening pressure in July last year and 'Eat Out to Help Out' in August (which slashed restaurant prices for a month) – that will throw the data around.

The ongoing rise in shipping and commodity costs will also add further pressure - and in fact, we've already seen a spike in durable goods inflation over the past few months given demand/supply imbalances.

Rising inflation probably not a huge Bank of England concern

The question as ever for the Bank of England is whether all of this will last, and we're still inclined to say that much of it won't. It's worth saying that core inflation is unlikely to go as far as headline this year, while the latter will also likely be back to target by around this time next year.

For the time being, we're still penciling in the first rate hike in early 2023. However a more rapid economic recovery – perhaps triggered by greater-than-expected unloading of household savings – could conceivably bring that forward in 2022, as long-time MPC dove Gertjan Vlieghe recently floated

Author

James Smith
Developed Markets Economist, UK
james.smith@ing.com