UK inflation set to remain muted amid job market deterioration

We expect headline UK inflation to stay below 1% this year, and given the slack in the jobs market, we'd expect price pressures to stay fairly muted for some time

Source: iStock

A combination of falling petrol prices and a recent decline in regulated household energy costs kept UK inflation in check in May. Headline CPI slipped to 0.5% from 0.8% a month earlier, and we expect this inflation gauge to stay between 0-0.5% until the autumn, and probably below 1% through to the beginning of 2021.

None of this is that surprising, but there is still a bit of a debate about where inflation will go after that. However, as my colleague Rob Carnell has written recently, our house view is that 'stagflation' is unlikely to be a by-product of the Covid-19 crisis.

Admittedly, there may well be some pockets where prices actually increase in the short-term. Supply chains are still heavily disrupted, and restarting them won't be easy, particularly given the ongoing risk of further localised lockdowns if Covid-19 flares up again in specific regions or countries. All of this inevitably means higher production costs.

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However, the slack in the jobs market suggests we shouldn't expect a broader rise in inflation. While the government's furlough schemes have helped avoid the spike in unemployment seen in the US so far, there are growing fears about what will happen as this state support is unwound. With many businesses unlikely to be able to operate at their usual capacity, there will be pressure on profits and therefore staffing costs. That would imply wage pressures are set to remain generally muted.

The other argument that is often made in favour of inflation returning, is that governments and central banks are pumping vast amounts of cash into the system. But this is unlikely to lead to higher prices, at least in the short/medium-term. In the case of the government, its spending has so far been solely aimed at keeping firms and consumers afloat, rather than trying to stimulate demand (which by definition, is constrained by the ongoing lockdown measures).

The bottom line is that inflationary pressures are likely to remain fairly muted for the time being. This, in turn, will keep the pressure on the Bank of England to maintain its current degree of stimulus, and we expect a further £150 billion of QE to be unveiled this week.

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