UK inflation slips as currency impact wanes

Base effects may not completely account for February's fall in inflation and as the currency effect wanes, core inflation could be more-or-less back to target by the summer

Source: Shutterstock

2.7% Headline CPI (YoY)

Lower than expected

For the hawks at the Bank of England, the latest inflation data may come as a slight disappointment. Headline inflation fell from 3% to 2.7% in February, although admittedly some of the fall can be explained away by base effects. Food prices, for instance, rose less than at the same time last year, when vegetable costs were sent higher by bad weather in Europe. Likewise, restaurant & hotel prices rose less than last February, which according to the ONS, could be down to the timing of Valentines Day.

But at least some of the inflation slip is likely due to the pound. Prices have more or less adjusted to the currency's post-Brexit plunge and the rate of pass-through is easing relatively noticeably. This is most visible in the recreation category, where many of the goods – things like laptops and TVs – are particularly sensitive to fluctuations in the pound. This was part of the reason for the fall in core inflation to 2.4% in February, and as the currency effect continues to unwind, we think core CPI will be more or less back to target over the summer.

On the face of it, this takes some of the pressure off the Bank of England to hike rates again in the near-term. However, policymakers are increasingly focusing on wage growth, which has been showing signs of life recently, potentially suggesting firms are increasingly having to lift pay more rapidly in a bid to retain/attract talent.

> This, combined with the latest Brexit progress (which bolsters the Bank's argument that the move to the post-Brexit world will be smooth), makes a May rate hike increasingly likely.

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