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Markit Economic Research

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United Kingdom

Inflation remains stuck at 2.7% in September, but industry price pressures ease

- **Consumer price inflation holds at 2.7%, defying expectations of fall to 2.6%**
- **Factory gate price inflation continues to cool**

UK inflation was unchanged at 2.7% in September, confounding economists who were expecting the rate to fall for a third consecutive month to a five-month low of 2.6%. While an easing in factory gate price pressures hints at the rate falling in October, there remains a significant risk that inflation could remain higher than many - including the Bank of England - are expecting over the next year.

The latest data from the Office for National Statistics showed consumer prices rising at an annual rate of 2.7% in September, identical to the rate of increase seen in August.

Factory gate price inflation eases

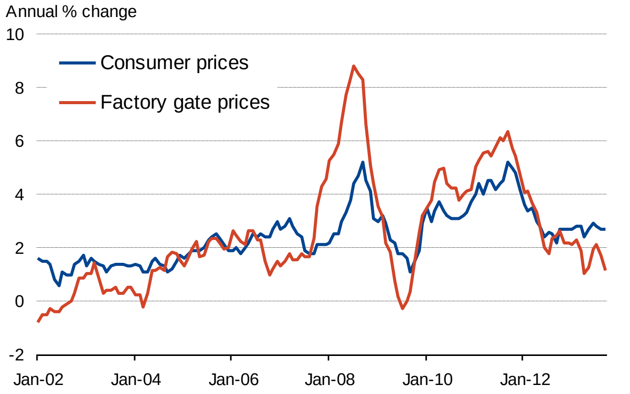
Some comfort can be gleaned from other data from the Office for National Statistics which showed factory gate prices rising less than anticipated during the month, growing at an annual rate of 1.2% compared to expectations of a 1.3% rise. The rate of growth of manufacturers' selling prices has eased markedly in recent months, down from 2.1% in July, and this easing in so-called industry pipeline price pressures suggests that consumer price inflation may also cool in coming months.

However, against this is the worrying price of oil and energy. With Brent Crude trading at an average of $111 per barrel in October, oil prices are at a level that is historically consistent with inflation running higher than 2-3%. Add to this the widely-reported anticipated increases in domestic utility bills, there is a significant risk of inflation remaining stickier than the Bank is currently expecting.

Forward guidance under scrutiny

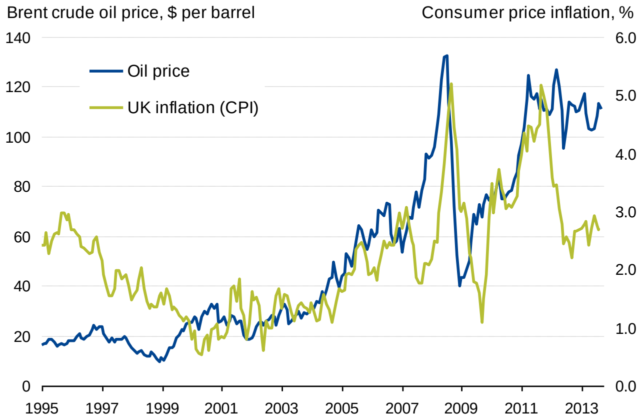
The Bank of England's forward guidance states that a hike in interest rates will not be considered until unemployment drops below 7%, but this guidance ceases to apply should the Bank's own forecasts show

UK consumer and producer prices



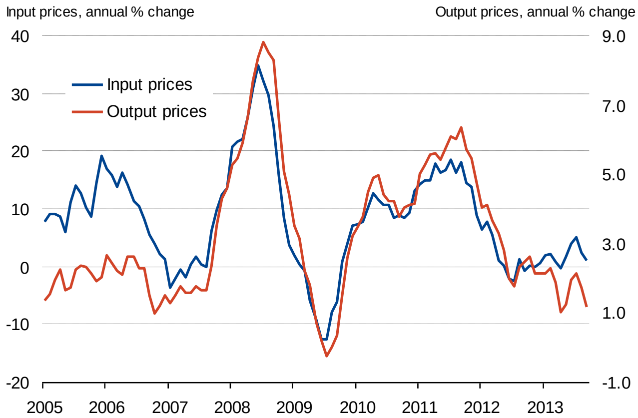
Source: Office for National Statistics (via Ecowin).

Inflation and oil prices



Sources: Office for National Statistics, Ecowin.

Industrial prices



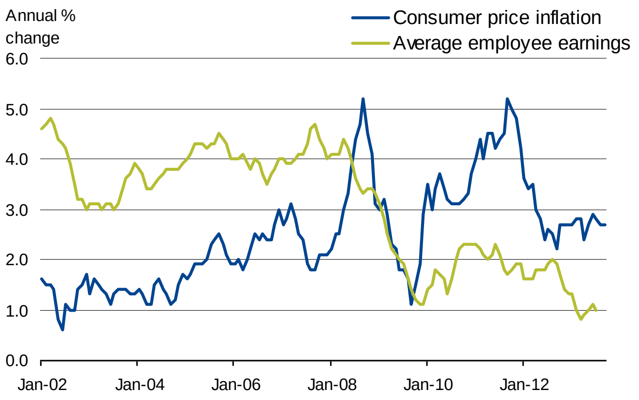
Source: Office for National Statistics.

inflation to be running above 2.5% in the next 18-24 months. It would be surprising if we did not see the Bank getting more concerned about this knock-out clause, especially given the surprise failure of inflation to drop in September.

Income squeeze goes on

Although inflation is still running well above regular pay growth, which is currently stuck at just 1.0% per annum, inflation has almost halved compared to a peak of 5.2% in late-2011, when the squeeze on real incomes was at its most intense. However, the squeeze in incomes nevertheless continue, which will inevitably pile further pressure on struggling households and keep the 'cost of living' debate high on the political agenda. Wages have fallen in real terms continually since late-2009.

Pay squeeze



Source: Office for National Statistics.

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