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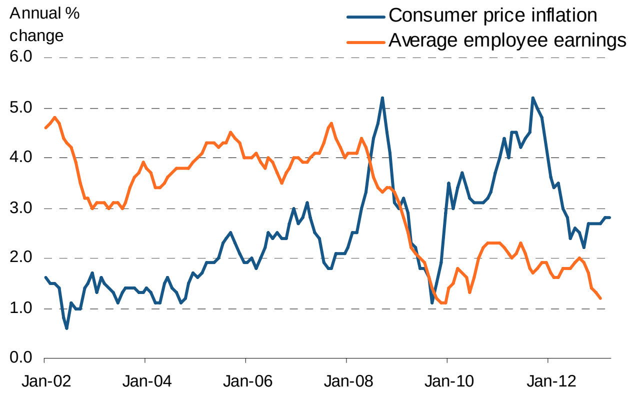
# United Kingdom

## Persistent high inflation curbs room for manoeuvre at Bank of England

- **Consumer price inflation holds steady at 2.8% in March**
- **Producer price inflation cools**
- **Real pay squeeze has nevertheless intensified**
- **High inflation to limit BoE policy flexibility**

**Inflation and pay growth**




Sources: Markit, Office for National Statistics

UK inflation remained well above its 2.0% target in March and looks set to increase further in coming months. Although recent falls in commodity prices may help limit the extent of the rise, stubbornly high inflation will limit the Bank of England's scope to provide aggressive stimulus to the economy.

Consumer prices rose 2.8% in the year to March, unchanged on February. CPIH, the new measure which includes owner occupiers' housing costs, grew by 2.6% in the year to March, likewise unchanged from February.

### Lower commodity prices offer limited relief

Prices charged by manufacturers meanwhile rose 2.0%, down from 2.3% in February and the smallest annual increase since last July. Manufacturers' input prices rose just 0.3% over the past year, down from 2.1% in the year to February.

Some relief on the inflation front may therefore come from lower commodity prices, notably oil, which are currently falling and could take some of the heat out of inflation in coming months if these falls are sustained. However, in the UK these downward pressures are likely to be offset by higher import costs due to the depreciation of sterling, high food prices, rising tuition fees and increases in utility bills.

### Policymakers constrained

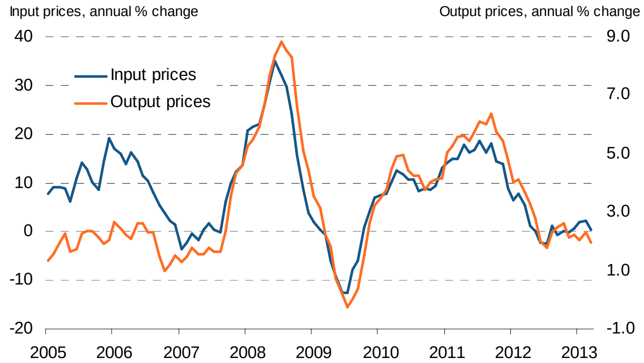
The UK therefore looks set to be plagued by lacklustre growth and stubbornly high inflation for the rest of the year, with the latter curbing the Bank of England's ability to muster any "shock and awe" style policy aggression of the like we saw in Japan on the appointment of its new central bank chief. Instead, new Bank governor Mark Carney will be welcomed by inflation that is likely to have breached 3% on his appointment in the summer alongside - perhaps most worrying - rising inflation expectations.

While the Chancellor is giving the Bank more flexibility with regards to its inflation target, the danger is that policy cannot be eased aggressively without inflation expectations moving out of reasonable comfort zones.

### Increased pay squeeze

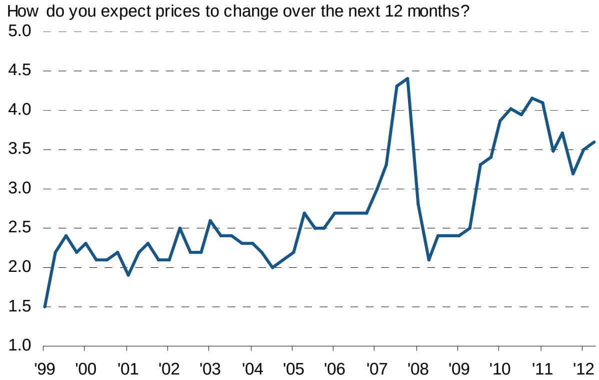
While some comfort can be drawn from the fact that inflation did not increase further in March, the latest available data show pay growth falling to an annual rate of just 1.2% - close to the record low of 1.1%, according to ONS data - meaning the squeeze on real incomes continues to intensify, limiting spending power and economic growth.

**Producer prices**




Source: Office for National Statistics.

## Inflation expectations




Source: Bank of England/NOP

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