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Markit Economic Research
12/11/2013

United Kingdom

Inflation falls to 13-month low taking heat off the Bank of England

- **Inflation falls to 13-month low of 2.2% in October, core rate drop to lowest since 2009**
- **Downturn in inflation takes pressure off policymakers as economy revives**

UK inflation fell to a 13-month low of 2.2% in October, down from 2.7% in September and well below economists' expectations of a dip to 2.5%.

Core inflation – which excludes energy, food, alcohol and tobacco – fell to 1.7%, its lowest since September 2009. Price pressures in the industrial supply chain meanwhile also eased. Factory gate prices grew just 0.8% on a year ago, the slowest rate since October 2009. The data add further evidence that suggests underlying, or core, inflationary pressures remain reassuringly muted.

The easing in the rate of inflation and underlying price pressures will provide greater scope for monetary policy to be kept loose for longer and thereby helping ensure a sustainable upturn in the economy. Lower inflation reduces the risk of the Bank of England having to hike interest rates earlier than it may otherwise prefer to, allowing policy to focus on stimulating growth rather than warding off rising inflationary pressures.

The Bank of England's forward guidance states that a hike in interest rates will not be considered until unemployment drops below 7.0%. The Inflation Report (released on 13 November) is likely to bring forward when the Bank expects this to happen from late-2016 to perhaps late-2015, given the recent flow of stronger than expected economic data. However, the Bank is also likely to place much emphasis on the fact that the 7.0% jobless rate is only a threshold and will not automatically trigger a rate hike.

Perhaps more importantly, the guidance ceases to apply should the Bank's own forecasts show inflation to be running above 2.5% in the next 18-24 months. In this respect, the recent easing in inflation is welcome news, and we are likely to see the Bank lower its short-term inflation outlook.

There is a worry that the Inflation Report could also indicate that forthcoming energy price rises could lead to stubbornly high inflation in the longer term, which might trigger higher interest rates. However, the Bank will possibly side-step this 'knock-out clause'. As we have seen before, policymakers will likely point out that, rather than being generated by a genuine underlying improvement in demand, justifying higher rates, a renewed upturn in the cost of living is likely to be caused by so-called regulatory and administered prices, namely the recent double-digit energy price increases, over which monetary policy has no effect.

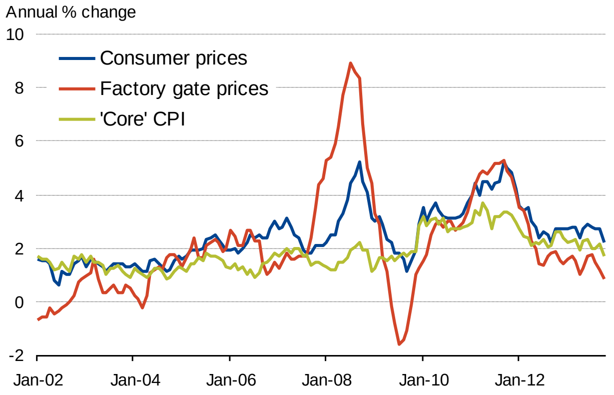
Lower oil prices help drive costs down

In the detail, the drop in inflation was due to lower fuel and 'other transport' costs, as well as last year's hike in university tuition fees dropping out of the year-on-year comparisons.

UK factory gate price inflation fell from 1.2% in September to 0.8%, below expectations of a 1.0% rise, driven by a downturn in input costs. Input prices fell 0.3% on a year ago.

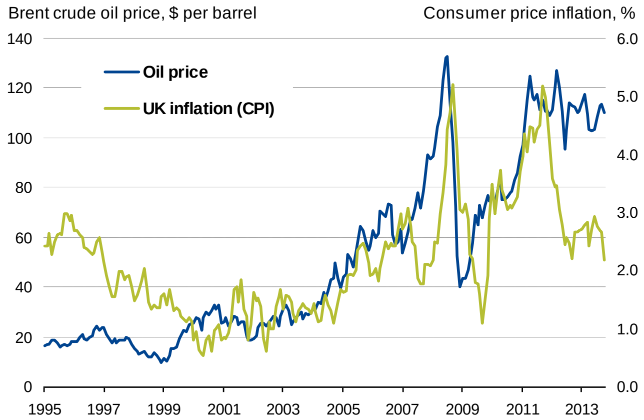
The easing in input costs can be in part attributed to lower oil prices, which are likely to provide further relief in November. Oil prices are down 4.7% so far in November compared to the average seen in October, though Brent Crude remains uncomfortably high at $105 per barrel.

UK consumer and producer prices

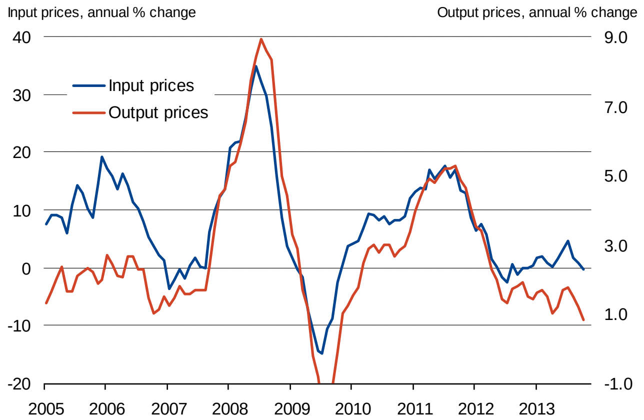


Source: Office for National Statistics (via Ecowin).

Inflation and oil prices

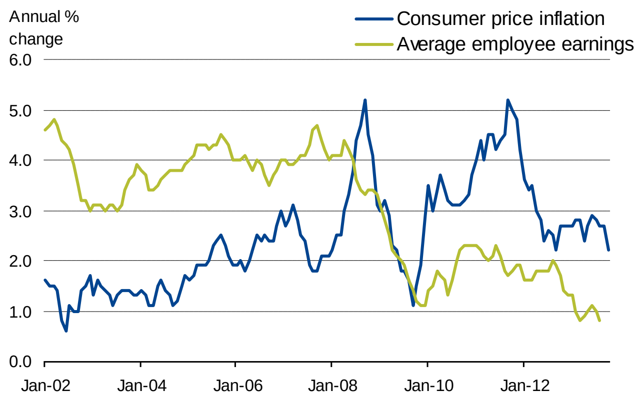


Industrial prices



Source: Office for National Statistics.

Real income squeeze alleviated



Sources: Markit, Office for National Statistics

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