Markit Economic Research

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United Kingdom

Inflation moves closer to Bank of England target in June, house prices surge

- **Inflation rises from 1.5% to 1.9%**
- **House prices up 10.5% on a year ago in May led by record rise in London**
- **Data add to chances of rate hike this year**

UK inflation moved sharply higher in June alongside another surge in house prices. The news will further fuel expectations that the Bank of England will start rising interest rates sooner rather than later, with November looking most likely for the first hike.

Consumer prices rose at an annual rate of 1.9% in June, its highest since January and up sharply from a four-and-a-half year low of 1.5% in May. The underlying rate of inflation, which strips out items such as food and energy, also rose, moving up to 2.0%

Statisticians thought that better than usual weather in June may have led retailers to hold back on summer clothing discounts, though also noted that there were no significant downward contributors to the inflation rate.

Of additional concern are the house price data, also published today, the official measure of which showed prices across the UK up 10.5% on a year ago in May. Prices in London surged a record 20.1% on last year.

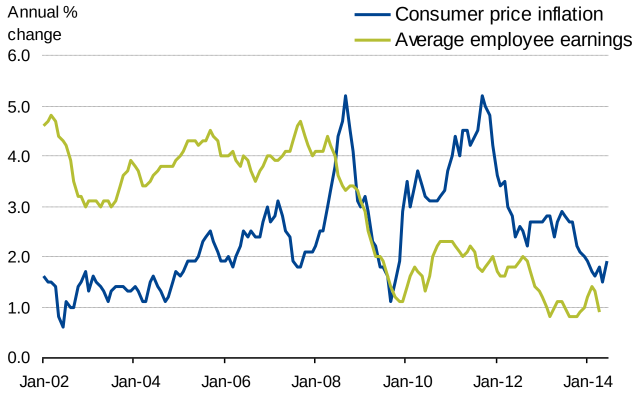
With inflation almost hitting the Bank of England's 2.0% target, the housing market booming, the economy growing strongly with no signs of momentum being lost and unemployment plummeting, the case for higher interest rates is building.

Pay growth warning lights

While the upturn in inflation will be of concern to policymakers, it is pay rather than the current rate of inflation that will be the most important determinant of when the Bank of England will start to hike interest rates, as pay will provide the key as to whether higher interest rates can be tolerated by households.

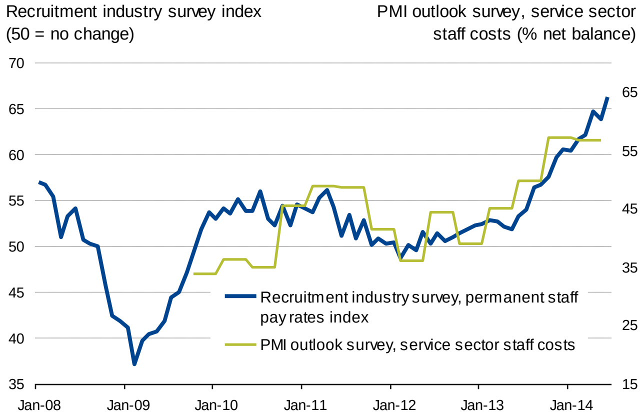
We will know a little more about earnings with tomorrow's official labour market statistics. However, there is a complication in that policymakers are clearly concerned that the official data may be understating pay growth.

Inflation and pay



Source: Office for National Statistics

Employee pay indicators



Sources: Markit, IPSOS Mori, REC/KMPG.

The minutes from the May Monetary Policy Committee meeting stressed that policymakers '*needed to investigate the differences between the official data and a range of survey indicators, which were significantly stronger.'*

Although the official measure of employee earnings remains surprisingly subdued, forward-looking indicators of pay growth are flashing warning lights, suggesting pay pressures are rising, which is in turn perhaps already feeding through to higher inflation.

Recruitment agencies are reporting that starting salaries awarded to new recruits are currently rising at the fastest rate since survey data were first available in 1997.

Meanwhile, Markit's Global Outlook survey showed companies are expecting staff costs to rise sharply over the coming year, with many firms worried that rising pay rates and skill shortages could act as constraints on their business growth over the coming year.

2014 rate rise?

It is clearly very odd that the official pay data have not risen in line with the record rise in employment in recent months. It is likely that the upward pay pressures recorded by the surveys will start to feed through to the official pay data in coming months, meaning rate setters will grow more convinced that a rate hike this year is appropriate to avoid policy remaining too loose for too long and necessitating higher rate rises at a later date. The best bet at this stage looks to be November, when the Bank updates its forecasts.

Some degree of uncertainty persists due to the fact that the ONS will publish large-scale revisions to the economic data, including GDP, in September. There is a possibility that these revisions rewrite history significantly, and in particular revise up GDP growth since the recession. This would mean that there is less 'slack' in the economy than the Bank of England is currently projecting, which could add weight to hike rates earlier than previously projected.

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