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Markit Economic Research

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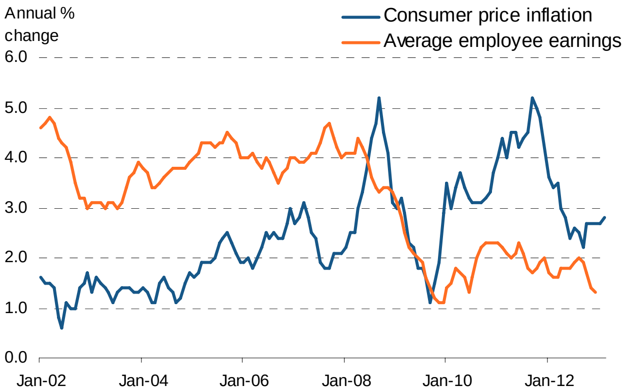
United Kingdom

Inflation rises to nine-month high and supply chain price pressures build

- **Headline consumer price inflation rises to 2.8%**
- **Producers' input prices jump 3.2% in February**

Inflation and wages



Sources: Markit, Office for National Statistics

Inflationary pressures picked up in February, not just at the retail level but also in the supply chain. Alongside some signs of underlying improvement in the economy and concerns about the weakness of the pound, the upturn in price pressures is likely to cause the Bank of England to hold back on voting for further stimulus at its next meeting.

Consumer prices rose 2.8% in the year to February, up from 2.7% in the previous four months and the steepest rate of increase for nine months. Official data also showed manufacturers' selling prices rising 0.8% in February, the largest monthly increase since April 2011, in part due to rising costs in the supply chain. Producers' input prices jumped 3.2% during the month, which was the largest monthly rise since March 2011.

The main inflationary pressures are coming from the increase in tuition fees, petrol price hikes and higher utility bills, but in manufacturing it is evident that the weaker pound is also hurting producers through increased import costs – a worrying side effect of sterling's depreciation which offsets the benefit of a competitive exchange rate to exporters, which is a major concern for manufacturers at the moment.

Inflation therefore looks to have further to climb in coming months, with the Bank of England anticipating the rate to exceed 3% this year. The concern is that peoples' expectations of future inflation are also creeping higher, with the latest Bank of England survey showing that Inflation in 12 months' time is expected to be running at 3.6%, up from 3.5% in January and the highest seen since last May. In five years' time, inflation is also anticipated at 3.6%, the highest seen since the survey commenced in 2009.

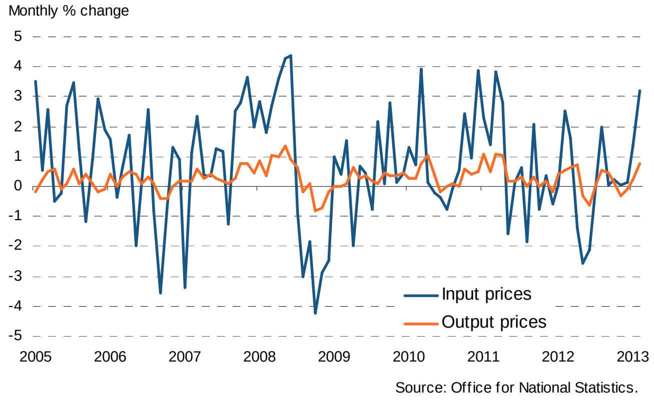
Credibility issue

There is clearly little belief that the Bank of England will have any greater success in bringing inflation back to target than the poor record we have seen in recent years. With the widespread perception that inflation will continue to erode real wages, and therefore purchasing power, it seems likely that households will remain cautious about spending. However, more important is the concern that households will lose faith in the Bank's credibility.

Alongside the uptick in inflation there are signs of the economy picking up, and that at least some of the weakness in the economic data at the start of the year was due to adverse weather. Households became notably less pessimistic about their finances in March, linked to being busier at work and feeling more secure in their jobs. Meanwhile, businesses also became more upbeat about the year ahead, according to Markit's global survey, with UK manufacturers the most positive of all major developed and emerging countries.

With some evidence that the economy will not "triple-dip" in to another recession, that confidence is lifting and inflationary pressures are building, it seems unlikely that the Monetary Policy Committee will feel it appropriate to vote for further quantitative easing at its next meeting, and instead await more data on the underlying health of the economy.

Producer prices



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