PMI commentary
14/11/2017

United Kingdom

Inflation unexpectedly holds steady in October

- **UK consumer price inflation unchanged at 3.0% in October, below consensus expectations of 3.1%**
- **Price rises should ease as exchange rate impact unwinds, as already seen in company costs**
- **Wage growth will be more important as far as future rate hikes are concerned**

Official red faces all round as UK inflation fails to rise as widely expected, not least by the Bank of England, in October.

Inflation holds at 5½-year high

Data from the Office for National Statistics showed consumer prices rising 3.0% on a year ago in October, unchanged on the five-and-a-half year high seen in September and wrong-footing almost everyone, including the Bank of England, that was expecting an increase.

The recent surge in price pressures was primarily due to the depreciation of sterling since last year's EU referendum, which has increased the cost of imported goods and services, but today's numbers will add to the sense that the worst of this impact has already passed. Data on company costs, which tend to change ahead of movements in consumer prices, have shown signs of having already peaked earlier in the year.

The unexpected failure of the inflation rate to rise to more than 1% above the Bank of England's 2% target means Mark Carney can put his pen back in his pocket, no longer needing to pen a letter of explanation to the Chancellor. However, the policy prescription was always going to be merely one of waiting, as inflation will cool providing the exchange rate does not fall further.

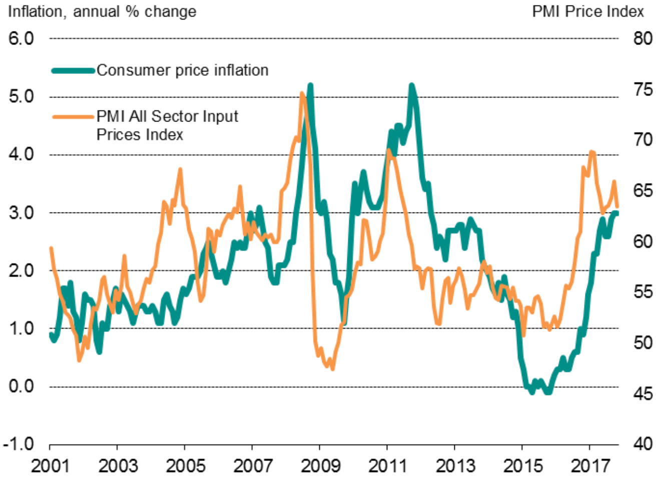
Pay growth key to policy

As far as interest rates are concerned, today's numbers will dampen expectations on whether we will see further rate hikes anytime soon. More important will be tomorrow's wage data. The Bank of England's hawks have set their stall on expectations of higher wage pressures. An absence of stronger pay growth alongside today's unexpectedly steady inflation numbers will not only soften expectations that rates will rise again, but will lead to further debate over the wisdom of the Bank's recent rate hike .

Despite the unchanged inflation rate, the combination of high inflation and meagre wage growth means that real pay continues to fall, the consequence of which is being increasingly felt on the high street. Retail sales data this week are likely to show spending on the high street having fallen in October as households struggle to maintain the recent pace of spending. Data from Visa, for example, showed total consumer spending falling in October at the quickest rate since September 2013, down 2.0% year-on-year, as high street sales suffered the second-steepest drop since April 2012, slumping some 5.0%.

The drop in inflation as we move towards Christmas means the squeeze on household finances should start to moderate, assuming pay growth does not also falter.

UK inflation and company costs



Sources: ONS, IHS Markit, CIPS.

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