Kallum Pickering, Senior Economist | Kallum.pickering@berenberg.com | +44 203 465 2672

UK: STABLE INFLATION IN MAY DESPITE UPWARD PRESSURE FROM OIL PRICES

Berenberg Macro Flash

UK inflation, May 2018

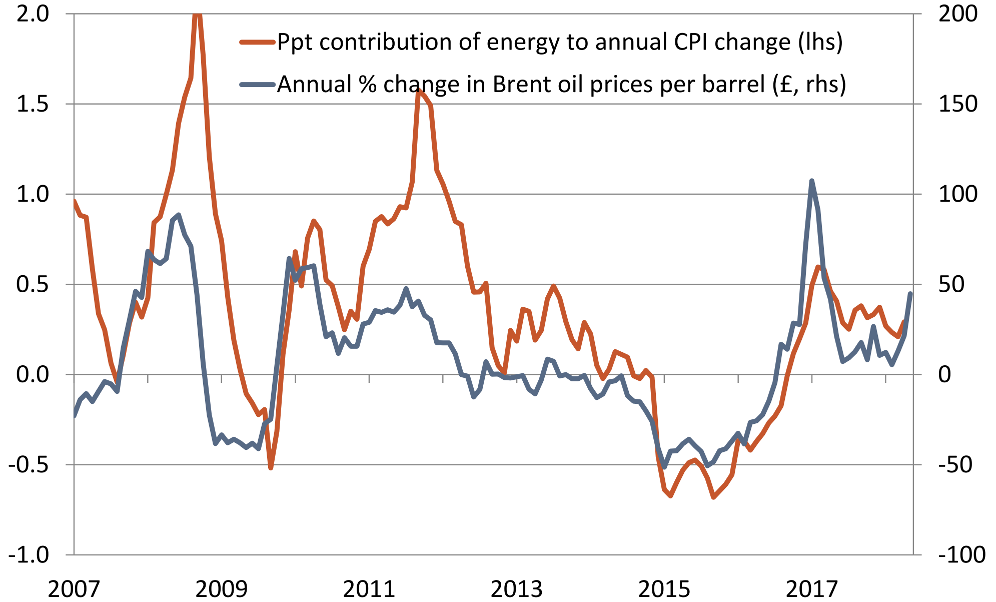
	CPI	Core CPI
Actual	2.4%	2.1%
Previous	2.4%	2.1%
Consensus	2.4%	2.1%
Berenberg	2.5%	2.1%

Trends in domestic demand and supply determine long-run inflation trends: But every now and then one-off factors can cause the headline rate to temporarily drift from this underlying trend. There are currently two such factors to watch: 1) the higher oil price; and 2) the impact of a weaker sterling since the Brexit vote. The recent rise in the price of oil to c$76 per barrel will probably contribute 0.5pts to the annual change in the consumer price index over the next few months – Chart 1. Higher energy prices are already showing up as faster growth in producer prices – Chart 2. But this upward effect is offset by the slowdown in import price growth which temporarily surged after the Brexit vote following the big drop in trade-weighted sterling – Chart 3. These counteracting forces, plus likely continued sterling volatility as the UK and the EU continue Brexit negotiations means the medium-term outlook for inflation is more uncertain than normal. In our base case, we expect headline inflation to remain at around 2.5% for the rest of the year as the two one-off factors counteract one-another while wage growth adds modest upward pressure to core prices.

The highlights from the May inflation data are as follows:
1) Headline inflation was stable at 2.4% yoy May. This was in line with the market's expectation;
2) Core inflation remained unchanged at 2.1%;
3) Producer input price inflation accelerated to 9.2% yoy from 5.6% in April – but well below the peak of 19.9% in January 2017;
4) Producer output price inflation picked up a little to 2.9% yoy in May from 2.5% the previous month - down from a peak of 3.7% in February 2017.

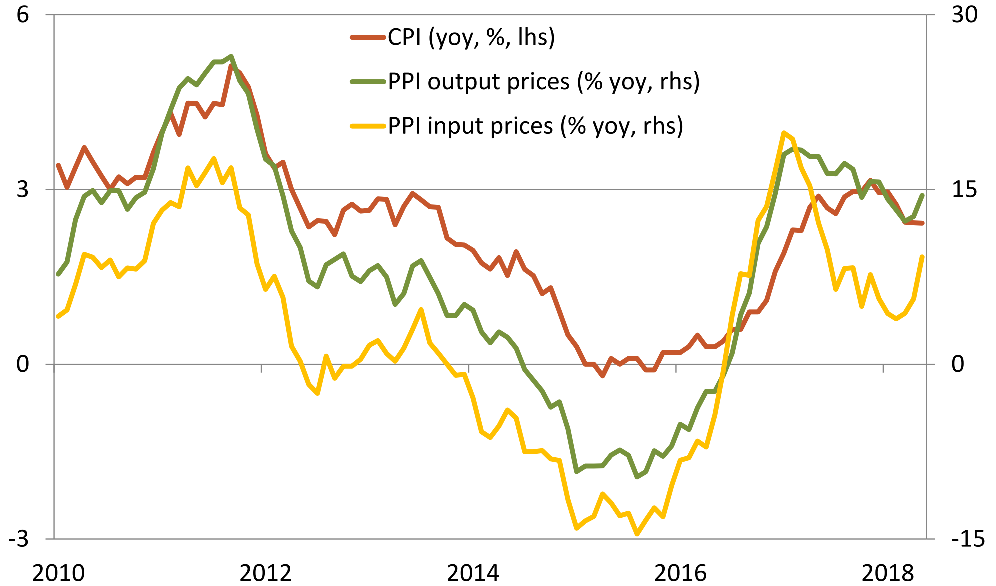
The BoE is under no pressure to hike as soon as August. Although headline inflation remains above the BoE's 2% target and tight labour markets point to building inflation pressures over time, the weak start to Q2 – see Questions over strength of Q2 rebound as cyclicals soften - and the downside surprise on wage growth in April (2.8% yoy versus expected 2.9%) means the BoE will tread carefully before hiking rates again. We think the BoE will need to see three key trends before the next hike: 1) a rebound in real GDP growth in Q2 and Q3 to at least the BoE's estimated potential growth rate of 1.5% annualised yoy; 2) a rise in annual nominal wage growth to above 3%; and 3) survey measures that continue to point to rising underlying inflation and falling spare capacity. In our view, the BoE will want to see plenty of evidence that any rebound in growth is sustained in Q3 before hiking again. We therefore expect the BoE to wait until November for the next hike. August would come into play only if the incoming data surprise strongly to the upside by enough to offset the recent misses.

Chart 1: Impact oil prices on headline inflation



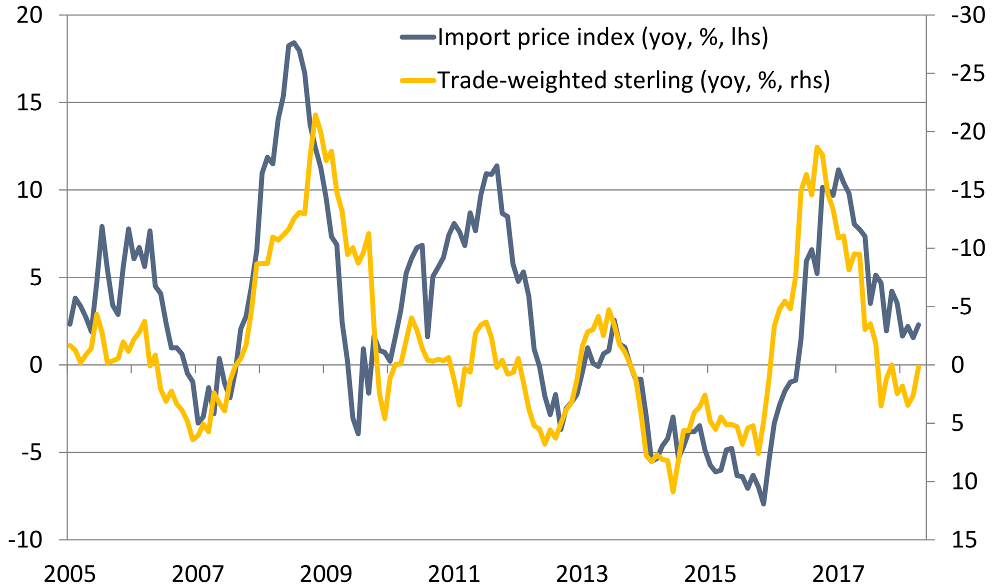
Monthly data. Source: ONS, Bank of England, Berenberg calculations.

Chart 2: Producer prices versus inflation



Monthly data. Source: ONS.

Chart 3: Import price inflation versus sterling



Monthly data. Source: ONS, Bank of England.

yoy%	MAY	APR	MAR	FEB	JAN	DEC
CPI	2.4	2.4	2.5	2.7	3.0	3.0
Core	2.1	2.1	2.3	2.4	2.7	2.5

Source: ONS

This message has been produced for information purposes for institutional investors or market professionals, it is not a financial analysis within the meaning of § 34b or § 31 of the German Securities Trading Act (Wertpapierhandelsgesetz), no investment advice or recommendation to buy financial instruments. The message does not claim completeness regarding the information on the developments referred to in it. On no account should it be regarded as a substitute for the recipient's procuring information for himself or exercising his own judgements. The message may include certain descriptions, statements, estimates, and conclusions underlining potential development based on assumptions, which may turn out to be incorrect. Berenberg and/or its employees accept no liability whatsoever for any direct or consequential loss or damages of any kind arising out of the use of this message or any part of its content. -- For full economics reports please visit our website or contact capitalmarkets@berenberg.de.

Joh. Berenberg, Gossler & Co. KG
60 Threadneedle Street
London EC2R 8HP
Phone +44 20 3207 7859
www.berenberg.com
florian.hense@berenberg.com