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## UK FACES INFLATION RISKS DESPITE AUGUST DIP

### Berenberg Macro Flash

#### UK inflation, August 2019

yoy	CPI	Core CPI
Actual	1.7%	1.5%
Previous	2.1%	1.9%
Consensus	1.9%	1.8%
Berenberg	2.0%	1.9%

**Surprise inflation dip may not last long:** The 1.7% annual change in the consumer price index in August was the lowest since December 2016 (down from 2.1% in July). The 0.4ppt monthly drop in the annual rate was the biggest since December 2014. The slowdown was driven by a large fall in the price of computer games and slower-than-normal rises in clothing prices following the summer sale. In the coming months, the recent dip in sterling linked to Brexit uncertainty and the uptick in oil prices from the geopolitical troubles in the Middle East are likely to push the headline inflation rate back towards 2%.

**Further out, the outlook depends on the timing and outcome of Brexit.** In case of an orderly Brexit, we would expect inflation to gradually drift higher – lifted by accelerating wage growth underpinning further improvements in household demand. In case of a hard Brexit, we would expect a much sharper rise triggered by the likely negative supply shock linked to UK-EU trade disruptions and weaker sterling. Market-implied indicators of inflation expectations reflect these upside risks. The current five-year breakeven rate is c3.3% – well above the BoE's 2% inflation target and close to a post-Lehman high.

#### Key takeaways from the August inflation data:

- 1) Matching the dip in the headline inflation, the annual rise in the core consumer price index slowed to 1.5% from 1.9% in July (Chart 1);
- 2) Goods price inflation dipped to 1.3% from 1.7%, while the annual rate of inflation in domestic-orientated services remained elevated at 2.3%, still down a little from 2.5% in July (Chart 2);
- 3) With the exception of clothing and footwear, prices rose in the year to August in all major categories of the consumer price index;
- 4) Due to the annual falls in oil prices during the summer months, producer input prices declined by 0.8% in the year to August, down from a rise of 0.9% in July. Producer output price inflation slowed to 1.6% from 1.9%.

**Expect a hawkish message from the BoE this week:** Tomorrow, the BoE will publish the minutes from the September MPC (Monetary Policy Committee) meeting. At odds with the ECB which has recently cut rates and restarted asset purchases and the Fed that looks set to cut rates again later this year, the BoE is likely to reiterate its hawkish message from recent meetings. Expect the MPC to signal further rate hikes in case of an orderly Brexit. The initial temporary inflation shock following the Brexit vote has had persisting effects on household inflation expectations which continue to trend upwards (Chart 3). And at 4.0% yoy, wage growth in July hit a post-Lehman high. Further tightness in labour markets alongside elevated inflation expectations will strengthen workers' wage bargaining power over time. Together, this will push underlying inflation higher unless the BoE takes steps to bring inflation expectations back to 2%. For this, the BoE will need to hike rates again. Whether or not the BoE will tighten monetary before Brexit is resolved remains an open question, however.



# MACRO NEWS

Chart 1

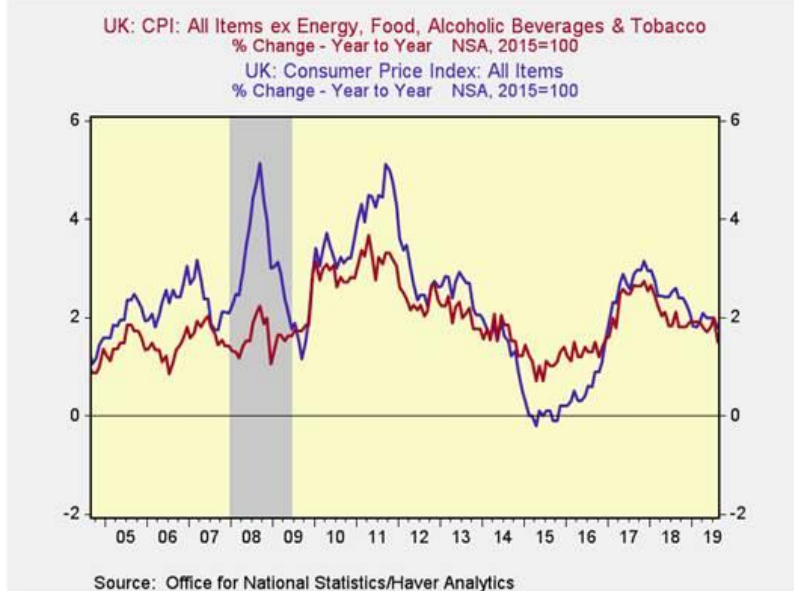


Chart 2





## MACRO NEWS

Chart 3



yoy%	AUG	JUL	JUN	MAY	APR	MAR
CPI	1.7	2.1	2.0	2.0	2.1	1.9
Core	1.5	1.9	1.8	1.7	1.8	1.8

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