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UK INFLATION DIP POSITIVE FOR HOUSEHOLDS AMID ELEVATED RISKS

Berenberg Macro Flash

UK inflation, September 2019

yoy	**CPI**	**Core CPI**
Actual	1.7%	1.7%
Previous	1.7%	1.5%
Consensus	1.8%	1.7%
Berenberg	1.8%	---

The dip in inflation could not be better timed

The UK economy, weighed down by Brexit risks that are dampening business activity, is mostly being propped up by the consumer. Without the continued resilience of household spending (c70% of GDP) the UK would likely be in a technical recession already. Real household consumption growth averaged 0.3% qoq in the first half of the year, only a little below the 2017/2018 average of 0.36%. If, as we expect, consumption growth remained firm in Q3 at its H1 rate, then real GDP likely rebounded modestly at the start of H2 following the 0.2% qoq contraction in Q2.

Stable household spending growth is underpinned by a positive real wage story. Nominal wages have risen sharply in recent years amid tight labour markets (Chart 1). Labour market data for the month of August – published yesterday – showed that real wages for the whole economy rose by 2.0% yoy while nominal wages increased by 3.8% on a three-month rolling basis. That headline inflation remained stable at 1.7% yoy in September, slightly below the BoE's target in September is helpful. It shows that the solid gains in real earnings have been sustained in the run up to the currently-planned Brexit date of 31 October. It can help households weather the uncertainty.

Other takeaways from the September inflation data:

1) Core inflation rebounded a little to 1.7% yoy from 1.5% in September (Chart 2);
2) Goods price inflation continued to edge down (1.1% yoy from 1.3% in September) while the annual rate of inflation in domestic-orientated services jumped a little (2.5% from 2.3%) (Chart 3);
3) Due to the sharp annual fall in the oil price (down c15% yoy in September), producer input prices declined by 2.8% in the year to September, down from a fall of 0.9% in August. Producer output price inflation slowed to 1.2% yoy from 1.7%.

The inflation outlook depends on the timing and outcome of Brexit

In case of an orderly Brexit, we would expect inflation to gradually drift a little higher – lifted by accelerating wage growth and an improvement in household demand. With luck, however, businesses would respond positively to the lower uncertainty and step up investment – this would lift productivity and help to contain unit labour cost growth. It is noteworthy that market-implied indicators of inflation expectations have corrected in recent days on the back of rising hopes of a deal that could enable an orderly Brexit soon. The five year breakeven rate has fallen from c3.3% a week ago to c3.0% today. However, in case of a hard Brexit, we would expect a sharp rise in inflation and inflation expectations triggered by the likely negative supply shock linked to UK-EU trade disruptions and weaker sterling.

Chart 1

Chart 2

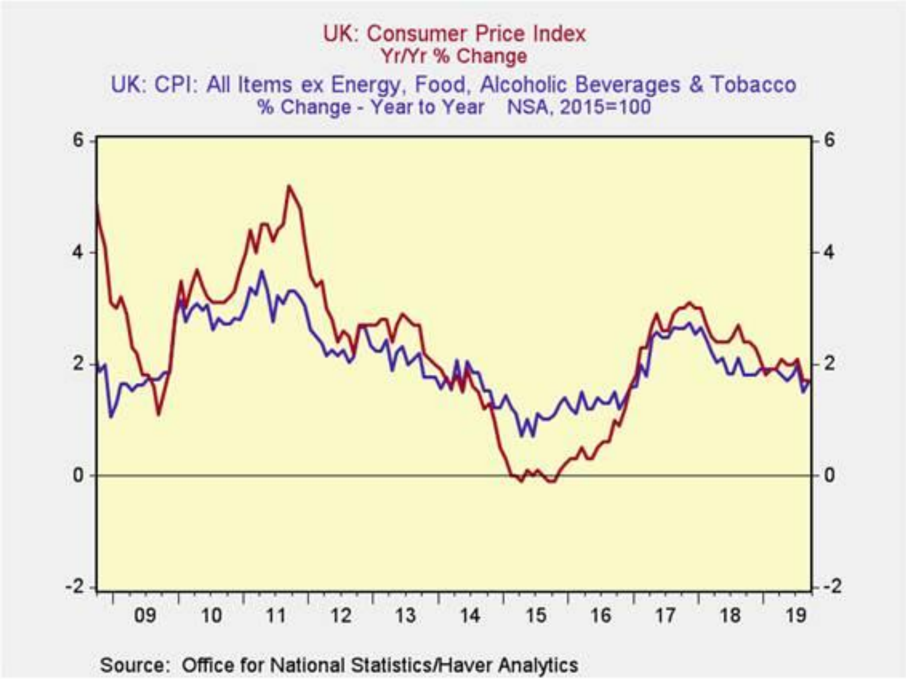
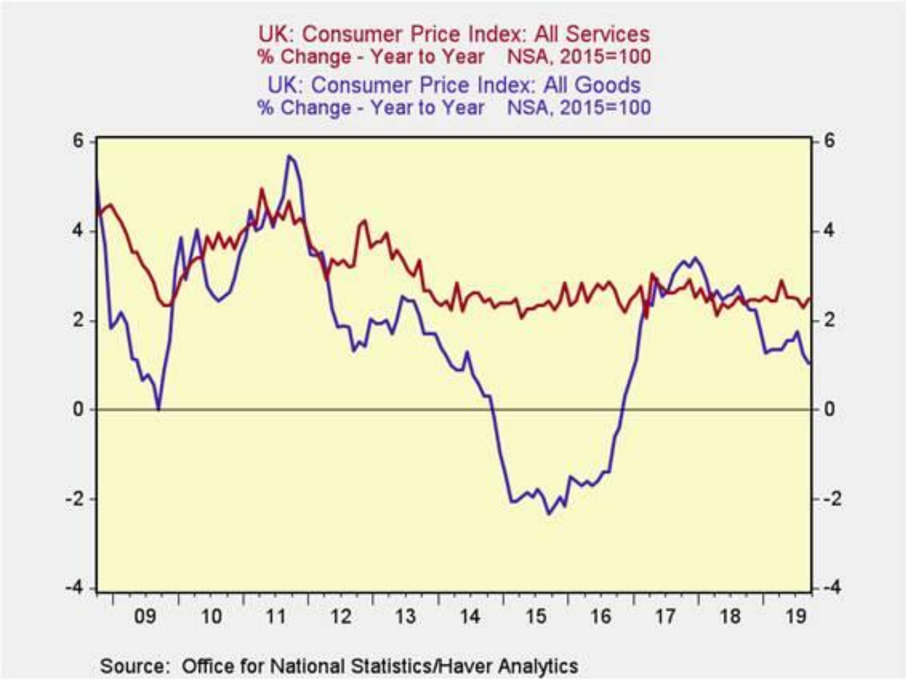


Chart 3



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

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