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UK INFLATION RECOVERING – FIRST HIKE LIKELY IN NOVEMBER

Berenberg Macro Flash

UK CPI, March

yoy	CPI	Core CPI
Actual	0.5%	1.5%
Previous	0.3%	1.2%
Consensus	0.4%	1.3%
Berenberg	0.4%	1.3%

March inflation at a 15 month high – data surprises on the upside: In March, inflation increased by 0.2 ppt mom to 0.5%, above estimates of 0.4%. The headline rate has now increased by 0.6 ppt from a low of -0.1 ppt last October. Core inflation, which excludes volatile components like energy and food, surprised on the upside too. Core inflation increased to 1.5% yoy, 0.2 ppt higher than in February and 0.1 ppt above estimates.

First rate hike likely in Q4. Looking ahead, we expect the headline rate to increase to 1.6% by the final quarter of the year. Beyond the modest dent to GDP growth in the first half of this year as a result of the financial market rout and Brexit uncertainty, underlying fundamentals point to robust growth at around trend (0.5% qoq) in the second half of the year driven by strong consumer spending and recovering business investment. The on-going acceleration in inflation, alongside consumer credit growth at a decade high, household saving at a historic low and the labour market at full employment begs the question if near-zero rates are still appropriate. Indeed, data for household spending, borrowing and saving point to some overheating in the domestic economy. Therefore, as long as the UK votes to stay in the EU we expect the Bank of England to hike rates by 25 bps in November. We see a 35% chance of a Brexit.

Inflation will continue to increase as the impact of the oil price shock diminishes. The decline in inflation to an average rate of zero during 2015 was primarily the result of the oil price shock combined with modest drags from strong sterling and falling food prices. Between 2014 and 2015 the price of oil declined by nearly half. Now that oil prices are stabilising, month by month the drag from oil will fade. This will continue over the course of the year as long as the price of oil remains broadly stable. Sterling strength and falling food prices will probably persist for longer. The recent Brexit-associated weakness in sterling will likely prove temporary if the UK remains in the EU. Similarly, we expect competition in the food sector to continue throughout the year. But even with some downward pressure from food and sterling, the diminishing impact of falling oil prices alongside a continued expansion in domestic demand should lead to steady increases in most other components of inflation during 2016.

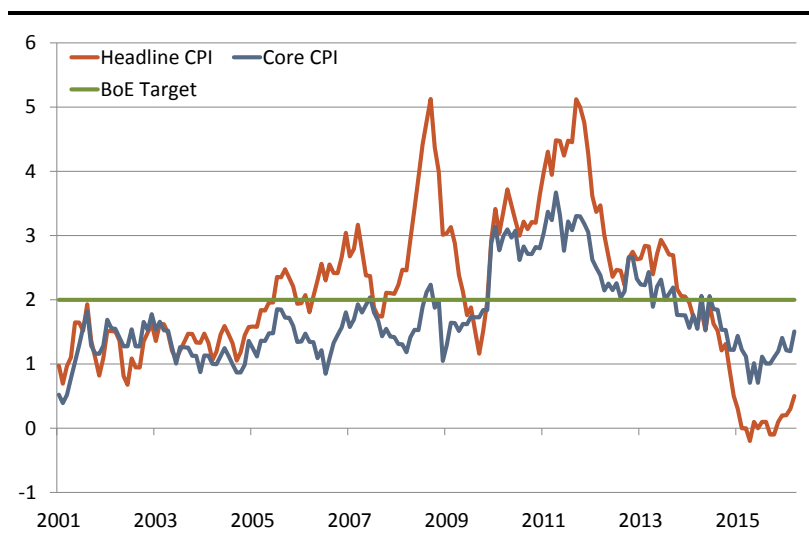


MACRO NEWS

UK CPI, March

yoy %	MAR	FEB	JAN	DEC	NOV	OCT
CPI	0.5	0.3	0.3	0.2	0.1	-0.1
Core	1.5	1.2	1.2	1.4	1.2	1.1

Chart1: Headline and core inflation versus 2% inflation target



Yoy %. Source: ONS

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