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Western European Indicators and Insights

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UK: Late Easter boosts CPI inflation.

Overshooting expectations, April consumer price inflation more than unwound the surprise fall seen in the previous month, rising 0.5 percentage points to 4.5% Y/Y, a 26-month high. Prices were up 1.0% in M/M terms, a record for any April, reflecting widespread gains, particularly in regard to transport, alcohol/tobacco and some services costs. These components were also the main factors behind the surge in the Y/Y rate, alongside some rise in household good. Higher fuel pressures were also evident, but their impact was offset by base effects. Of some note, the core rate (ie excluding energy, food, alcohol and tobacco) also surged, jumping 0.5 percentage point to a record-high 3.7% Y/Y.

These numbers will cause reverberations, but do seem to be the result of a larger than expected impact of the late Easter and flurry of April holidays. Indeed, the late Easter particularly hit transport prices enough for this component alone to account for most of the jump in the headline and the core rate, the question being the extent to which calendar effects were also accentuated the jump in alcohol/tobacco prices (over and beyond the effect of the Budget-induced rise in indirect taxes). Further evidence of the impact of the Easter distortion came in what were actually softer readings for RPI and RPIX inflation. Indeed the April Y/Y RPIX rate (which excludes mortgages) fell from 5.4% to 5.3%, while the RPI counterpart fell similarly but to 5.2%. Their falls can be partly explained due to the lower weight that the RPI numbers attach to transport components (alongside the higher weights attached to petrol and oil).

All of the above complicates the backdrop, with it unclear the extent to which the April surge in headline CPI inflation will unwind in May as the calendar distortions (eg airfares) reverse - NB: back in 2006 (the last such lateEaster) transport prices did fall back markedly in May. Of course, further factors may have played a part this time around. Notably the extent to which other distortions (including the unprecedented flurry of holidays in April may also have pushed up transport prices as well as having persuaded retailers to refrain from discounting - a clearer picture may come with the retail sales numbers on Thursday.

In addition, it is unclear to what extent the fall back in commodity prices will play a role in curbing headline inflation in coming months. Little impact should be expected from the lower oil price in the May numbers given the resilience in petrol prices to date, while subsequent monthly data may have any impact at least tempered by unfavorable base effects from a fall in fuel costs in the middle of 2010 as well as possibly higher food prices caused by the very warm weather.

As a result, the BoE is still likely to be bracing itself for possible inflation move towards 5%, with these April CPI numbers .certainly not providing any further glimpse that prices of more discretionary items (eg clothing and recreation) are succumbing to an erosion in consumer spending power, partly caused by strength in non-discretionary food and energy costs.

Regardless, the signs are that the BoE will (and should) ride out the storm. Indeed, as a result of this further overshoot, Governor King had to write another letter (actually the sixth in 18 months) to the Chancellor explaining why inflation was above target. The letter repeated that the BoE attributed the high level of inflation to VAT hikes, past rises in oil prices and the continued pass-through of higher import prices. However the MPC central view still judged these effects to be temporary, so that inflation should fall back with it being as likely to be above target as below at the end of the 2-3 year forecast horizon. Unsurprisingly, this is similar view to the one the Governor offered last week in the updated Inflation Report, albeit with the Governor possibly adverting his more dovish credentials by emphasizing that bringing inflation back to target quickly risk generating undesirable volatility in output.