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Western European Indicators and Insights

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Andrew Wroblewski
Chief Economist, Eurozone and UK

London
+44 20 7959 3244
awroblewski@decisioneconomicsinc.com

UK: Stable inflation.

Matching expectations, May consumer price remained at 4.5% Y/Y, still a 26-month high. Prices were up 0.2% in M/M terms reflecting disparate movements, with falls in airfares being more than offset by higher fuel, food and alcohol/tobacco costs, these largely offsetting factors also responsible for the stable Y/Y rate. However, the core rate (ie excluding energy, food, alcohol and tobacco) fell back sharply, dropping 0.4 percentage point to 3.3%, ie unwinding most of the surge to the record-high seen in April data.

These numbers will cause few reverberations, confirming that much of the surge seen in April was the result 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 in April. Admittedly, higher food and fuel costs prevented the headline figure falling back last month, but the drop back in certain transport costs (particularly airfares) saw the core rate tumble back.

These distortions continue to complicate the backdrop. 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 June 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 spring weather.

As a result, the BoE is still likely to be bracing itself for possible inflation move towards 5%. However, these May CPI numbers do provide some hint that prices of more discretionary items (eg clothing and recreation which have the lowest Y/Y rates) 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, especially given the signs of softness coming from the real economy, including fresh signs of weakness in the hosing market from the latest RICS survey.