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Western European Indicators and Insights

November 15, 2011

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UK: Inflation passed peak?

Undershooting expectations for once, October consumer price inflation eased 0.2 percentage point to 5.0% Y/Y, ie down from the September three-year high. Prices rose 0.1% in M/M terms, as further upward pressure from utility prices was partly offset by lower food prices, as well as to a fall in household and transport costs. The food and transport categories were also responsible for the lower Y/Y rate, actually meaning that the core rate (which excludes energy, food, alcohol and tobacco) rose a notch to a six-month high of 3.4%.

These lower-than-generally expected numbers may imply that inflation has peaked. However, while the fall back in food inflation may be an indication that hard times are taking their toll to some extent, they being very clearly linked to fiercer competition among supermarkets, other parts of consumer spending are still showing resilient price trends, eg in clothing and household goods.

As a result, any clear fall back in the headline inflation rate is unlikely until base effects come into very clear play in the new year. This, and for some time, has clearly been the view of the BoE, something reinforced in the letter that Governor King had to write explaining this further overshoot of the (2%) inflation target. Such letters are forthcoming after every three successive months in which the target is overshot. As a result, this letter is the eight in a row, this time perhaps being potentially more enlightening as it (unusually) arrives ahead of the keenly-awaited BoE Inflation due on Wednesday.

Little provided by Governor King

However, there was little unexpected in the letter from the Governor, which apart from reminding that temporary factors lie behind the inflation overshoot hinted only tentatively at either scope or rationale for any further increase in the asset purchase program that was resumed early last month, very clearly refusing to reveal anything from that upcoming Inflation Report. The letter did note that world growth has slowed and uncertainty about the prospects for the global economy, and in particular the Eurozone, has increased. Those developments, and accompanying falls in household and business confidence, are likely to have weakened the outlook for overall activity in the UK economy and so will probably lead to a greater and more persistent margin of spare capacity than previously thought. That made it more likely that inflation would undershoot the 2% target in the medium term, and is why, at its October meeting, the MPC voted unanimously to increase the size of its asset purchase program.