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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 Inflation falls clearly!

Disinflation process becoming clearer (belatedly)

Matching expectations once again, December consumer price inflation fell clearly to a six-month low, dropping 0.6 percentage point to 4.2% Y/Y, also down further from the September three-year high (of 5.2%). Prices rose 0.4% in M/M terms, as lower prices for clothing were outweighed by increases in transportation (airfares) and food costs. Meanwhile, the Y/Y breakdown showed the latest moderation to be largely the result of falls in price pressures for fuels and clothing. As a result, the core rate (which excludes energy, food, alcohol and tobacco) also fell by 0.2 percentage point to 3.0%, also a six-month low.

The three successive drops in price pressures since the cycle-high in September clearly underscore that inflation is now on its way down. Admittedly much of the fall this time around can be ascribed to energy-related base effects. Base effects stand to make a further and marked erosion into headline inflation in coming months, most of which should come from taxation, ie pushing the headline rate down to the 3.2% Y/Y rate already evident in the steady-tax gauge of CPI inflation (the latter falling to below 3% in December).

Below-target inflation beckoning?

Even so, other factors are appearing to accentuate the disinflation process, such as the weakness in consumer spending that surely helps explain the further and sharp fall in clothing price inflation. In addition, utility companies are announcing reductions in fuel costs that will take effect in the next 2-3 months, enough to take some 0.2 percentage point of the headline rate. All of which mean that headline CPI inflation could be around 2.5% by Q2 and down to (a below-target) 1.5% by year-end. This will clearly reduce (but not reverse) pressure on the beleaguered UK consumer, as a well as make the BoE more willing to extend its asset purchases (probably as soon as next month).