

June 19, 2012

Andrew Wroblewski

Chief Economist, Eurozone and UK

London

+44 20 7959 3244

awroblewski@decisioneconomicsinc.com

UK: Inflation Falls Further

Undershooting expectations once again, May consumer price inflation fell clearly and further, dropping 0.2 percentage point to 2.8% Y/Y, albeit still the lowest since end-2009. Prices fell by 0.1% in M/M terms, mainly as a result of lower transport costs. Meanwhile, the Y/Y breakdown showed the further fall to be a reflection of decreasing price pressures for food (3.3% from 4.2%), clothing (1.6% from 2.1%) and particularly fuel prices, these acting to more than offset rising air transport costs (the latter swing affected by the timing of Easter this year).

Nevertheless, the core rate (which excludes energy, food, alcohol and tobacco) edged up a notch to 2.2% Y/Y, albeit making little inroad into the by 0.4 percentage point drop seen in April.

Disinflation Now Evident

These numbers surely underscore that the weak economy is taking its toll on prices: the 0.1% M/M fall last month is the first time ever that consumer prices have dropped during any May month. Admittedly, other factors may be playing a role, with very unseasonable weather possibly dampening demand for the likes of clothing and gardening produce.

BoE Projections Being Undershot

Regardless, inflation is now within 0.8 percentage point of target, having tumbled clearly from the 5.2% peak set last September. Moreover, CPI inflation looks as if it will undershoot BoE short-term projections for the first time in many quarters: the rate so far in Q2 is already 0.3 percentage point below the 3.2% rate seen in the last (May) BoE Inflation Report. Indeed, the growing likelihood is that the headline rate will fall below the 2% target by the turn of the year, two to three quarters faster than current BoE projections suggest.

Such an outcome will surely help defuse worries among some members of the MPC that weakness in the supply side of the economy is limiting the extent to which inflation will fall further.

DE View: A resumption of asset (gilt) purchases at the next MPC meeting on July 5 is even more likely, probably by around £ 50 bln.