

## UK

### Inflation Undershoots Consensus and MPC Forecasts

- CPI inflation fell to 2.2% YoY in October from 2.7% in September, well below consensus (2.5% YoY) and even below our forecast (2.3% YoY). RPI inflation fell to 2.6% YoY from 3.2% in September, also well below consensus (3.0%) and our forecast (2.8%). CPI inflation undershot the MPC's forecast in the last couple of quarters and, given that the August *Inflation Report* forecast CPI inflation at 2.9% YoY in Q4, the undershoot seems to be continuing. The MoM change in the CPI has undershot the pre-release consensus in four of the last seven months (with two undershoots), a marked contrast to the repeated inflation overshoots of 2008-11. For the RPI, the October figure was the biggest undershoot versus the pre-release consensus since mid-07 and the second biggest undershoot of the last 15 years.
- The split shows sluggish trends in underlying inflation and a diminished boost from special factors. We estimate that CPI inflation excluding food, drink, tobacco, energy and utilities edged down from 1.6% YoY in September to 1.4% in October. Using an 85-item disaggregated split of the CPI, we estimate that the median YoY inflation rate among CPI items was stable at 1.8% YoY. However, the combined inflation rate for food, drink, tobacco, energy and utilities fell from 5.2% YoY in September to 4.0% in October. Within that, food price inflation slowed from 4.8% YoY in September, while petrol prices fell sharply and the second round of the tuition fees hike had a smaller percentage impact than the first year.
- Even with the recently announced hikes in energy prices, CPI inflation is likely to be roughly stable in the November data at 2.2-2.3% YoY and edge down to about 2.1% YoY in December, averaging about 2.0% in 2014. Like most other advanced economies, underlying inflation probably will remain sluggish, given the large negative output gap and subdued trend in unit labour costs. CPI food price inflation probably will fall further in the next two-three quarters, perhaps to around zero in early 2014 (unless there are new cost pressures), given recent weakness in agricultural commodity prices, as well as producer prices and import prices for the food sector. Moreover, there are downside risks to CPI inflation from the possibility that the Chancellor in the Autumn Statement will announce measures to cut or cap regulatory-driven surcharges in household energy bills. We have not allowed for any such effect in our forecast, but the political pressure to do something is very high.
- All this provides the MPC with an exceptionally favourable backdrop to tomorrow's *Inflation Report*. The MPC are likely to revise up their growth forecasts and revise down their near-term inflation forecasts significantly, and the lower inflation path will allow the MPC to maintain a pro-growth monetary stance even if (as seems likely) the jobless rate hits the 7% threshold much earlier than implied by the August IR.

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