A new cap on energy prices likely drove down CPI inflation to 1.9% in January, from 2.1% in December.

Core inflation, however, probably remained at 1.9%, despite a further easing in the core goods sector...

..."Underlying" services inflation is rising, while transport services inflation likely rebounded.

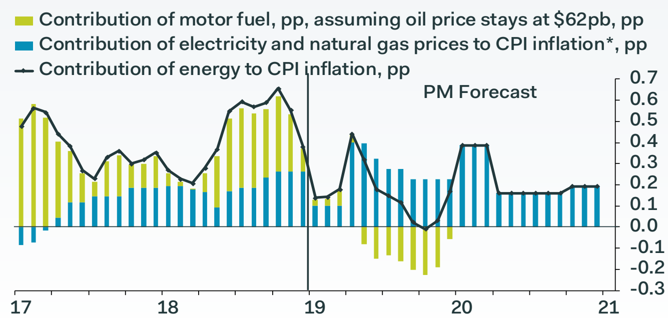
CPI Inflation Likely Fell Slightly Below The 2% Target in January

Analysts' forecasts for January's consumer prices report, released on Wednesday, are unusually dispersed. We think that CPI inflation fell to 1.9% in January—the first below-target rate for two years—from 2.1% in December, a bit below the 2.0% consensus, but above the MPC's 1.8% forecast.

Before we dive into the details, we need to make two pedantic, but important points. First, we suspect that some forecasts are too low because the CPI index they are using is rounded to one decimal point. Data to *three* decimal points, however, are available in a dark corner of the ONS website and are used to calculate the main rate. Often it makes a real difference to use these more precise data. For any month-to-month change in the CPI in January, the implied year-over-year rate will be 0.05pp lower than it should be if rounded data are used, because the index level was rounded up in January 2018 and rounded down in December 2018.

Second, forecasting January's CPI correctly is harder than for other months of the year because the weights of all of the components of the CPI will be provisionally revised to account for recent changes in consumers' spending. Any change in the weight given to airline fares, for instance, potentially would have a big impact on the CPI, as plane ticket prices tend to fall by about 30% month-to-month in January.

ENERGY'S CONTRIBUTION TO INFLATION LIKELY FELL SHARPLY...



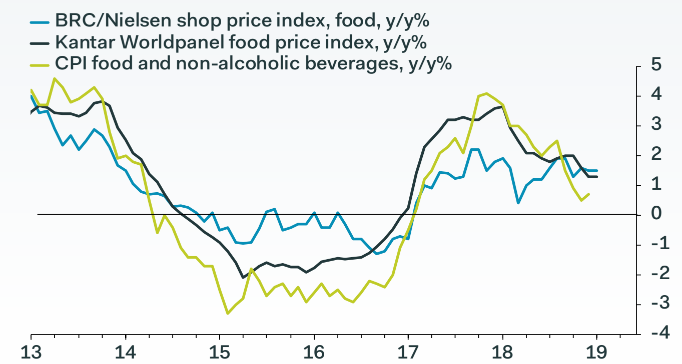
* SVT cap introduced in Jan. 2019 and then increased by 10% in April and 2% in October 2019, and then by a further 3% in both Apr. and Oct. 2020

A sharp fall in energy prices likely was the main driver of the decline in the headline inflation rate in January. Motor fuel prices probably dropped by 1.8% month-to-month, causing their contribution to the headline year-over-year rate to fall to just 0.03pp, from 0.11pp in December. In addition, energy regulator Ofgem introduced a cap on Standard Variable Tariffs at a level 6% below the prior average market price. Fewer than half of all households are on SVTs—most search for cheaper fixed-rate deals—but the ONS uses only SVT data when compiling the CPI.

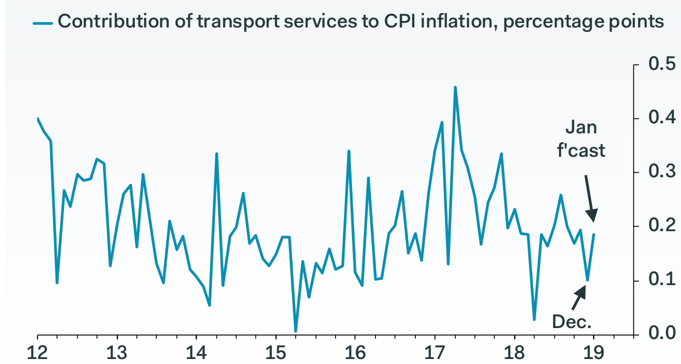
That said, the safeguard tariff paid by vulnerable customers—around five million out of 30 million households—did not change in January. As a result, we think that the electricity and natural gas CPIs fell by 5% month-to-month, *not* the full 6%. Their combined contribution to the headline rate will decline to 0.10pp, from 0.26pp in December.

The downshift in food inflation, by contrast, has run its course; we expect it to hold steady at 0.7% in January. Food producer price inflation was only one tenth lower in December, while Kantar and the BRC reported that food shop price inflation was 1.3% and 1.5%, respectively, in January. Similarly, the combined rate of alcohol and tobacco inflation likely didn't move sharply in January from December's 4.1% rate; no tax changes occurred at the start of the year.

...BUT THE DECLINE IN FOOD INFLATION HAS RUN ITS COURSE



...BUT TRANSPORT SERVICES INFLATION LIKELY REBOUNDED



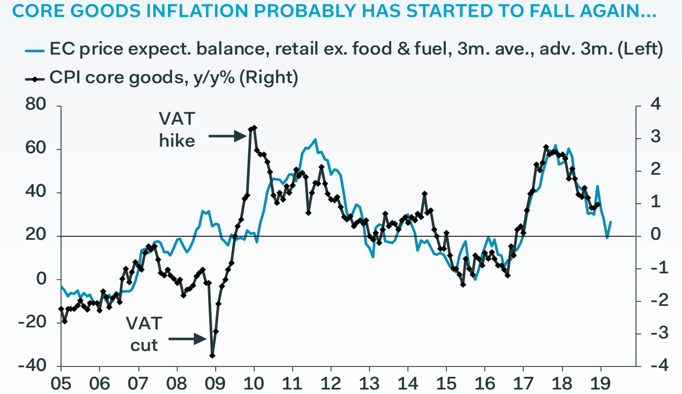
We also expect core inflation to remain at 1.9% in January. Admittedly, the stabilisation of trade-weighted sterling over the last two years suggests that core goods inflation will fall further, probably to about zero in the summer, from 1.0% in December. The net balance of non-food retailers reporting that they intend to increase prices over the next three months also has trended down, according to the E.C.'s Economic Sentiment Survey.

That said, Index Day—the particular Tuesday of the month when the ONS collects nearly all its data—probably was only eight days into January this year, the earliest on record. Retailers tend to cut prices further as January rolls on, so the relatively early Index Day has led us to pencil-in a only a modest two-tenths fall in core goods inflation to 0.8% in January.

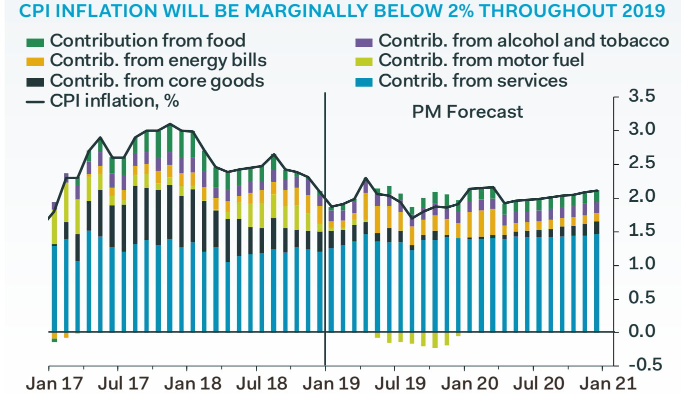
What's more, we think that services inflation likely picked up to 2.6% in January, having declined to 2.4% in December. We documented here that our measure of "underlying" services inflation—which excludes transport services, education and rents from the main index—has been on a steady rising trend over the last year, consistent with the pick-up in unit wage costs. In addition, inflation in the volatile transport services sector likely rebounded, following unusual weakness in December. Indeed, December's 1.5% year-over-year rate was the lowest—excluding months distorted by the timing of Easter—since June 2015.

Looking ahead, a material further fall in CPI inflation now isn't likely. Ofgem announced last week that the SVT cap will rise by 10% in April, far more than the 4% increase we had assumed. We also expect services inflation to continue to rise, offsetting most of the further decline in core goods inflation. Accordingly, we expect CPI inflation to average 1.9% throughout 2019 and to rise to 2.1% in 2020. ***The inflation data, then, won't be weak enough to dissuade the MPC from hiking Bank Rate this year, once the Brexit storm has passed.***

CORE GOODS INFLATION PROBABLY HAS STARTED TO FALL AGAIN...



CPI INFLATION WILL BE MARGINALLY BELOW 2% THROUGHOUT 2019



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THIS WEEK IN BRIEF

Note: "**D**" prefix denotes Datanotes for these releases.

Monday, February 11

• D: GDP (12)/09:30 GMT

We look for a **-0.1%** month-to-month print for December GDP, which would ensure that quarter-on-quarter growth slowed to 0.2% in Q4, from 0.6% in Q3. Shutdowns of North Sea oil rigs and a slump in car production likely drove down industrial production by 0.9%. Meanwhile, services output probably merely held steady, due to the fall in retail sales. Our detailed preview can be found here. **Consensus: 0.0%.**

• D: Trade (12)/09:30 GMT

A plunge in oil production and mean reversion in erratics trade likely caused the deficit to widen to about **£3.5B** in December, from £2.9B in November. **Consensus: £3.1B.**

Tuesday, February 12

• No significant data released.

Wednesday, February 13

• D: Consumer Prices (1)/09:30 GMT

CPI inflation probably fell to **1.9%** in January, from 2.1% in December. Energy's contribution likely fell by 0.24pp due to the introduction of a cap on electricity and gas prices, and the fall in motor fuel prices. But we expect core inflation to remain at 1.9%, as a rebound in transport inflation likely offset falling goods prices. **Consensus: 2.0%.**

• D: Official House Prices (12)/09:30 GMT

Year-over-year growth in house prices likely slowed to **2.5%** in December, from 2.8% in November. **Consensus: 2.5%.**

• Producer Prices (1)/09:30 GMT

The rise in oil prices likely offset the downward pressure on input prices from sterling's appreciation. So, we expect a **0.0%** print for input prices and output prices. **Consensus: Input prices 0.3%, output prices 0.0%.**

Thursday, February 14

• D: RICS Residential Market Survey (1)/00:01 GMT

Rising Brexit risk suggests the house price balance fell again in January, to **-20**, from-19 in December. **Consensus: N/A.**

• MPs to vote on Brexit/19:00 GMT

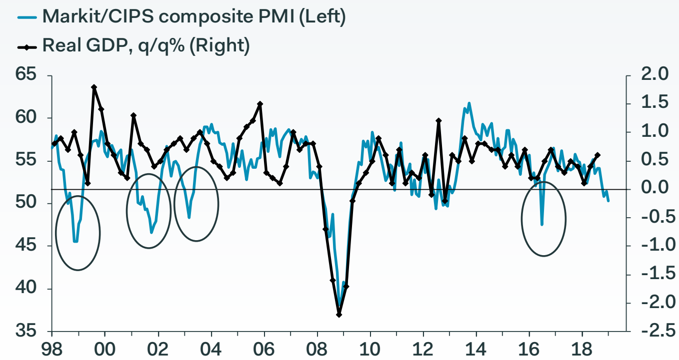
MPs will vote on another series of amendments, which could constrain the government's future actions.

Friday, February 15

• D: Retail Sales (1)/09:30 GMT

We expect a **1.0%** month-to-month rise in retail sales volumes in January. Year-over-year growth in BRC like-for-like sales values rose to 1.8%, from -0.7% in December. And the official data in December were depressed by the seasonal adjustment process, which partly is based on pre-Black Friday pattens of spending. **Consensus: 0.2%.**

CHART OF THE WEEK: THE PMIS HAVE CRIED WOLF OFTEN IN THE PAST



PANTHEON'S FINANCIAL FORECASTS

		End-month:				
	5pm Fri.	Mar	Jun	Sep	Dec	Dec 20
Bank Rate	0.75	0.75	0.75	1.00	1.00	1.50
3m Libor	0.90	0.90	1.00	1.10	1.20	1.70
12m Libor	1.17	1.20	1.30	1.40	1.60	2.00
2-year Gilt	0.72	0.90	1.20	1.40	1.60	2.00
10-year Gilt	1.18	1.40	1.80	2.10	2.20	2.40
30-year Gilt	1.67	1.80	2.00	2.20	2.30	2.50
FTSE 100	7071	7000	7200	7400	7600	8000
USD/GBP	1.29	1.35	1.36	1.38	1.40	1.40
EUR/GBP	1.14	1.23	1.24	1.25	1.27	1.27
Sterling TWI	77.7	83.7	84.3	85.6	86.8	86.8

PANTHEON'S ECONOMIC FORECASTS

	Period average:						
	Q3 18	Q4 18	Q1 19	Q2 19	2018	2019	2020
GDP, q/q%	0.6	0.2	0.3	0.5	-	-	-
GDP, y/y%	1.5	1.3	1.4	1.5	1.4	1.6	2.0
Employment, y/y%	1.2	1.0	1.2	1.1	1.1	0.7	1.0
Unemp. rate, %	4.1	4.0	4.0	4.0	4.1	3.9	3.6
Wkly earnings, y/y%	3.1	3.4	3.4	3.2	2.9	3.0	3.2
CPI, y/y%	2.5	2.3	1.9	2.1	2.5	1.9	2.1
RPI, y/y%	3.3	3.1	2.7	2.9	3.4	2.8	3.1
PSNB FY, £B	-	-	-	-	27	32	38
Cur. acc't., % GDP	-3.4	-3.6	-3.7	-3.9	-3.5	-4.0	-4.5
House prices, y/y%	3.1	2.6	1.8	1.6	3.3	1.5	2.5