PANTHEON MACROECONOMICS

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PM Datanote: U.K. Consumer Prices, February

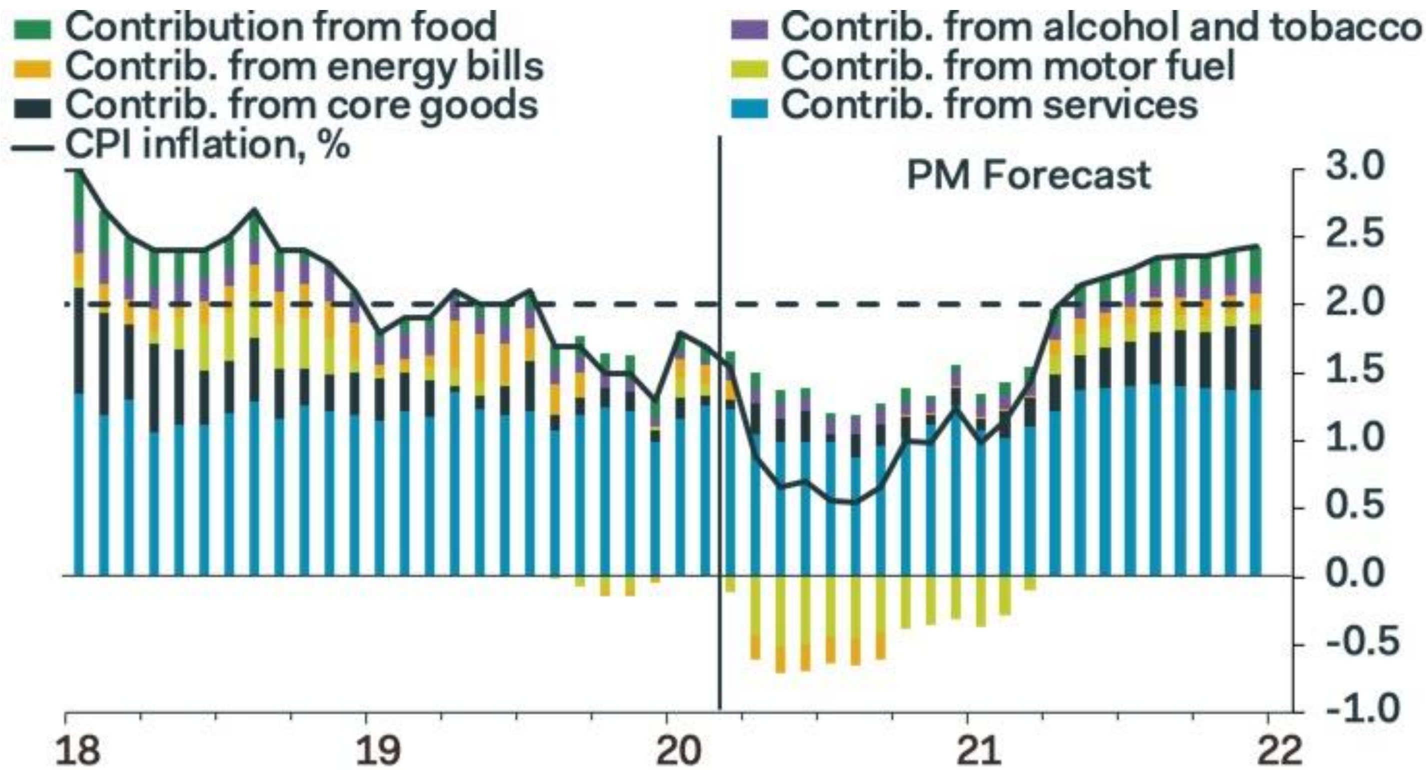
In one line: Marginal decline a prelude to a big drop ahead.

CPI inflation dropped to 1.7% in February, from 1.8% in January, matching the consensus. But core inflation rose to 1.7%, from 1.6%, above the consensus, 1.5%.

The modest fall in CPI inflation in February was driven by its non-core components. The contribution of motor fuel to the headline rate declined to 0.08 percentage points in February, from 0.14pp in January, due to the 2.1% month-to-month decline in prices. Food inflation dropped to 1.2%, from 1.4%, easing closer towards the recent sub-1% rates of food producer output prices inflation. In addition, alcohol inflation declined to 0.7%, from 1.1%, as duty increased in February 2019 but not last month. By contrast, core inflation edged up, driven primarily by a recovery in accommodation services inflation after unusual weakness in the prior three months. The ONS also collected its February data one week later in 2020 than in 2019. As a result, fewer retailers than last year likely were still running post-Christmas promotions designed to shift excess stock.

Looking ahead, CPI inflation looks set to decline sharply over the coming months and to fall comfortably below 1% in the summer. The collapse in Brent crude prices to $28, together with the reduction in Ofgem's cap on electricity and natural gas prices in April, looks set to mean that the energy component will be subtracting about 0.7pp from the headline rate by May, down from the current 0.2pp boost. In addition, the closure of all non-essential shops, restaurants, and recreational and cultural venues implies that prices in these sectors will remain frozen at their pre-virus levels for as long as the government's shutdown lasts. Catering services accounts for a hefty 10% of the CPI, while recreational and cultural services account for a further 3%. At the same time, transport services prices look set to fall sharply, due to weak demand. Meanwhile, the boost to inflation from sterling's recent depreciation will not filter through to core goods prices until the turn of the year. In addition, the pound might recover most of its lost ground once the stress in financial markets caused by the virus fades. All told, then, the inflation outlook likely will not dissuade the MPC from ramping up its asset purchase programme or considering unconventional stimulus measures, if its recent salvo falls short.

The chart shows that we expect CPI inflation to decline to hover between 0.5% and 1.0% in the second and third quarters of this year, primarily due to the collapse in energy prices.



Contribution from food
Contrib. from energy bills
Contrib. from core goods
CPI inflation, %
Contrib. from alcohol and tobacco
Contrib. from motor fuel
Contrib. from services
PM Forecast
3.0
2.5
2.0
1.5
1.0
0.5
0.0
-0.5
-1.0
18
19
20
21
22