Deutsche Bank
Research

Europe
United Kingdom

Economics
# UK Blog

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# Inflation beat pushes up our projections - peak CPI now firmly above 5%

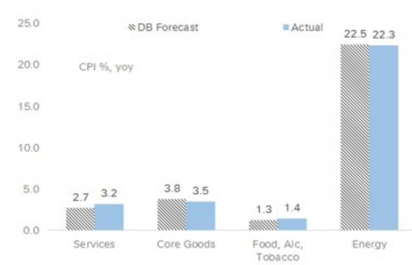
Today's inflation data came in stronger than consensus and Bank of England (BoE) expectations – as we expected. But the scale of the beat was even bigger than we thought. Headline CPI hit 4.2% y-o-y, a near decade high (BoE: 3.9% y-o-y, DB: 4% y-o-y). Core CPI came in stronger too at 3.4% y-o-y (consensus: 3.1% y-o-y, DB: 3.2% y-o-y). And RPI shot up to a staggering 6% y-o-y (consensus: 5.7% y-o-y) – its highest rate going back at least two decades.

## Where did inflation surprise?

In line with our preview, a lot of the beats in the data came broadly in categories we expected. However, the spike in price pressures were stronger than captured in our nowcast models. We look at a few key baskets that contributed to the near 15bps beat on CPI and 35bps beat on RPI.

- **Food**. Seasonal food prices jumped by a lot more than we expected. Fruit, vegetables, meat, and fish all saw prices tick up by more than 1% m-o-m (CPI). Indeed, producer prices have been on an upward trajectory recently and is started to seep through into retail prices far quicker than historical trends. We expect this to add to further upward pressure in the coming months.
- **Catering**. With food prices up, catering prices also shot up. But more likely, it was the stronger partial VAT unwind that saw catering prices jump by over 1.3% m-o-m – more than we anticipated (DB: 0.6% m-o-m).
- **Rents**. Actual rentals took off by 0.4% m-o-m, 25bps more than our projection. Driving the surge in rents was a pick up in registered social landlord rents and private rented property. More likely as work (and education) patterns stabilise, this should start to firm, supporting services inflation in the coming months.
- **Depreciation**. For RPI, we saw a bigger jump in depreciation, taking the basket up by over 3.5% over September and October. While house price rises are likely to temper out in the coming quarters , recent survey data continue to point to sustained strength in the housing market coming out of the pandemic. This has and will continue to support depreciation prices in the very near-term.
- **Education**. One thing we missed in our projections was the stronger pick up in education fees, particularly for overseas and domestic university tuition fees, pushing the overall education basket up by 3.4% m-o-m (CPI).
- **Transport**. In the main, the bigger surprise came via airfares, which picked

Figure 1: Relative to our expectations, the biggest misses came from services and food




*Source : Deutsche Bank, Haver Analytics LP* up by 5.5% m-o-m (CPI) and 3.9% m-o-m (RPI) – bucking the seasonal October decline in prices.

Figure 2: Biggest drivers of CPI for Oct-21


*Source : Deutsche Bank, Macrobond*

Figure 3: Seasonal abnormalities continue as we come out of the pandemic, increasing volatility in expectations


*Source : Deutsche Bank, Macrobond*

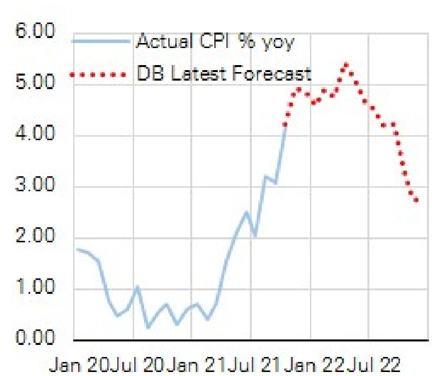
## Where to now?

Today's beat has pushed up our near-term inflation profile. For CPI, we now see peak at 5.4% y-o-y (Apr-22) with the 2022 annual average pushed up to 4.2% y-o-y (from 3.8% prior to today's data). For RPI, we see peak sitting at just under 7% y-o-y (Apr-22: 6.9% y-o-y), with the 2022 annual average upped to 6% y-o-y (from 5.8%). Market pricing continues to imply more upside surprise, relative to our projections (Figure 5) – in line with our DB Price Survey Tracker (Figure 6).

Importantly, while the magnitudes have changed, with our inflation projections continually being revised up over the last few months, our overall message from July remains: underlying inflation will likely be "a little less transitory, and a little more persistent" coming out of the pandemic. Core goods pressures are likely to remain entrenched through the next 2 quarters. And more importantly, services inflation will likely tick up as rising labour costs continue to feed through into retail prices. Put another way, the peak and duration of the surge in excess inflation will leave the MPC in a more uncomfortable position heading into 2022

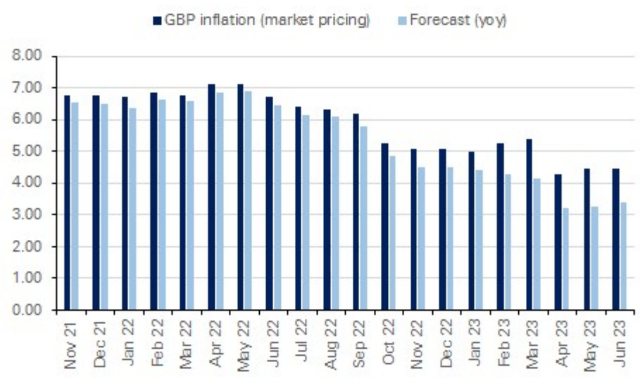
What does this mean for monetary policy? The case for December lift-off just got stronger. With inflation topping Bank projections, inflation expectations continuing to edge up, and the labour market holding up far better than the Bank assumed, we see continue to expect the MPC to hike rates by 15bps at its next meeting – commencing a phased unwind of pandemic policy support.

Figure 4: CPI peak and duration upped post October data



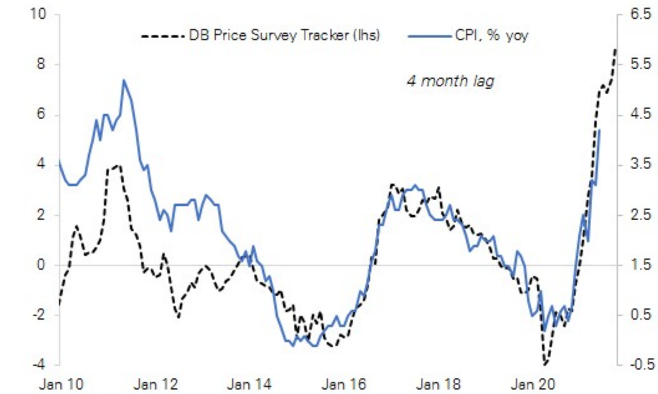

*Source : Deutsche Bank, Haver Analytics LP*

Figure 5: Market pricing points to more upside...




*Source : Deutsche Bank, Bloomberg Finance LP*

Figure 6: ...in line with our DB Price Survey Tracker




*Source : Deutsche Bank, Macrobond*