Beat: News

As pound tumbles, UK faces sharp return of inflation

GLOBAL ENERGY NEWS

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USPA NEWS - Prices are going to rise in Britain. The only question now is by how much.
The prospect that much-loved brands like Marmite spread and PG Tips tea might vanish from Tesco supermarkets is the first taste of what economists say will be rising inflation.

Next up, the cost of fuel is likely to rise later this month.

The resilience of consumers since June's shock vote to leave the European Union will be tested in the coming months by the Brexit-induced fall in the value of the pound which hit an all-time low against a range of currencies on Wednesday.

Yields on long-dated British government bonds have jumped higher in recent days as markets brace for the return of inflation which briefly sank below zero in 2015.

Economists at some leading banks are predicting a leap to around 3 or nearly 4 percent by the end of next year, up from 0.6 percent in August.

A Reuters poll of economists on Thursday showed a wide range of forecasts for consumer price growth next year, but all agreed inflation will rise significantly from current levels.

"Rising inflation is rarely good news for consumers. But in a world of sluggish ... wage growth and low rates of return on savings, it is especially bad," Kallum Pickering, an economist at Berenberg Bank, said.

The poll's median forecast showed consumer price inflation will average 2.3 percent next year, above the Bank of England's 2 percent target. Economists think it will top 1 percent by the end of this year. [ECILT/GB]

But predicting the path of inflation with much accuracy is something that forecasters - not least at the BoE - have struggled with over the years.

While there are established models showing how much a fall in the value of currencies will pass through into inflation, the variables surrounding the pound's plunge complicate the outlook, including oil prices which hit a one-year high this week.

Analysts expect further increases next year when the Organization of the Petroleum Exporting Countries plans, potentially with non-OPEC producer Russia, to cut production in a bid to rein in a global glut. [O/POLL]

Some elements behind the expected rise in inflation are crystal clear.

The prices paid by factories for raw materials and goods - the first point in the inflation pipeline - grew in August at the fastest annual pace since late 2011.

The Petrol Retailers Association said British motorists can expect fuel pump prices to increase by 4 or 5 pence per litre by the end of this month, barring a rebound in sterling, from around 110 pence at the moment.

On Thursday, Britain's biggest retailer Tesco (TSCO.L) pulled some Unilever (ULVR.L) products from its website in a pricing row sparked by the plunge in the pound. Unilever, which makes products such as PG Tips, Marmite, Persil washing powder and Ben & Jerry's ice cream, is seeking to raise the prices it charges big supermarkets.

Major car manufacturers, including Ford, General Motors' Vauxhall brand and French marque Peugeot, have already raised prices in response to the weaker pound.

The scale of the price rises for British shoppers may depend on the type of goods, or even the retailer, given their different strategies for hedging.

BANK OF ENGLAND RELAXED

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The Bank's rate-setters know they cannot curb inflation by raising interest rates without risking a hit to economic growth which already looks set to slow markedly next year.

Only a further sharp fall in the value of the pound towards parity with the U.S. dollar might test this approach.

"We think the currency would need to sustain a level of $1.10 to prompt any serious talk of a rate hike "" all else equal," said JPMorgan economist Allan Monks.

But economists increasingly expect the slump in the pound so far and its knock-on effect on inflation will stop the BoE from pumping more stimulus into the economy in November, something the central bank had flagged as recently as last month.

Its newest rate-setter, Michael Saunders, this week suggested the BoE could end up overlooking high inflation for years if Britain ends up with a bad deal after leaving the EU, so long as inflation expectations and pay growth keep in check.

Given that 94 percent of chief financial officers from major British companies said reducing costs would be a priority over the next 12 months, according to Deloitte survey on Monday, weak wage growth looks a likely prospect.

BoE Governor Mark Carney has had to write public explanations through 2015 and this year for why inflation has undershot the central bank's 2 percent target.

Some forecasters believe he will soon have to be writing to Philip Hammond explain why inflation is running above it.

Economists at HSBC think sterling - which was trading around $1.22 on Thursday - will weaken by another couple of cents before the year, a scenario that sets up the prospect of inflation running at around 3.7 percent by the end of 2017.

Samuel Tombs from Capital Economics takes a similar view, and added that a further fall in the pound - perhaps to $1.10 - could result in inflation averaging 4 percent in 2018.

"Sterling is now extremely volatile, and the large current account deficit suggests that it will fall further if overseas investors become more concerned that the UK government will opt for a hard Brexit," Tombs said.

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