

Inflation Falls but Remains in Double-Digit

- Inflation weakens to 10.1% YoY in January
- CPI declined 0.6% MoM
- Core inflation eased to 5.8% YoY, dropped 0.9% MoM
- UK inflation data indicates Bank Rate is close to its peak

The UK inflation rate fell for the third month in a row in January, but remained close to a 40-year high, to hit 10.1% YoY following the 10.5% increase in the previous month but high food and energy prices continued to put the pressure on British households. While the rate appears to have peaked in October at 11.1%, a 41-year high, British households are still being squeezed by double-digit inflation. Prices rose 10.5% in December and 10.7% in November.

The main driver behind the annual rate's decline was a sharp drop in transportation prices. The annual increase in transport cost slowed to 3.4% in January, the weakest since February 2021. The main drivers behind the easing were passenger transport services and motor fuels. Fuel costs decreased by 3.8% in January compared with a drop of 0.5% at the start of 2022. Airfares also pushed down, falling 41.7% versus a 29.1% slide in January last year. Restaurant and hotel prices also contributed to the easing with the price growth slowing to 10.8% from 11.4%. These downward movements were partially offset by alcohol and tobacco, where prices increased 5.2%, faster than the 3.8% gain in December. The annual rate of food inflation hovered near the highest level in 45 years, at 16.8%.

On a monthly basis, consumer prices dropped for the first time in a year in January, down 0.6% after rising 0.4% each in December and November.

There were some broader signs of easing inflationary pressures. The annual rate of core inflation, a measure of price increases that excludes energy and food costs and is used to indicate how deeply inflation is embedding in the economy slipped below 6% for the first time since last June. **Core inflation eased to 5.8% YoY in January from 6.3% in the previous month.** The core rate also remained below its recent peak of 6.5% in both September and October. Some of this is linked to ongoing disinflation in goods categories, and unsurprising consequences of improving supply chains and lower consumer demand.

The key detail in the UK's January's CPI report was the sharp fall in services inflation. **Services inflation fell back from 6.8% in December to 6.0% in January.** The decline in services inflation will be of most interest to the BOE, as this is the part of the CPI basket that is more closely linked to the evolution of the domestic economy. More significantly, "core" services inflation - which excludes the price of education, package holidays and airfares - eased to 5.8% from 6.5%.

Inflation in UK is expected to fall sharply later in the year because wholesale energy prices have tumbled since last summer, but UK's economy is set to suffer from a prolonged period of high prices and high interest rates, which were imposed to try to restrain inflation. It's the only major advanced economy that the International Monetary Fund expects to contract by 0.6% this year .

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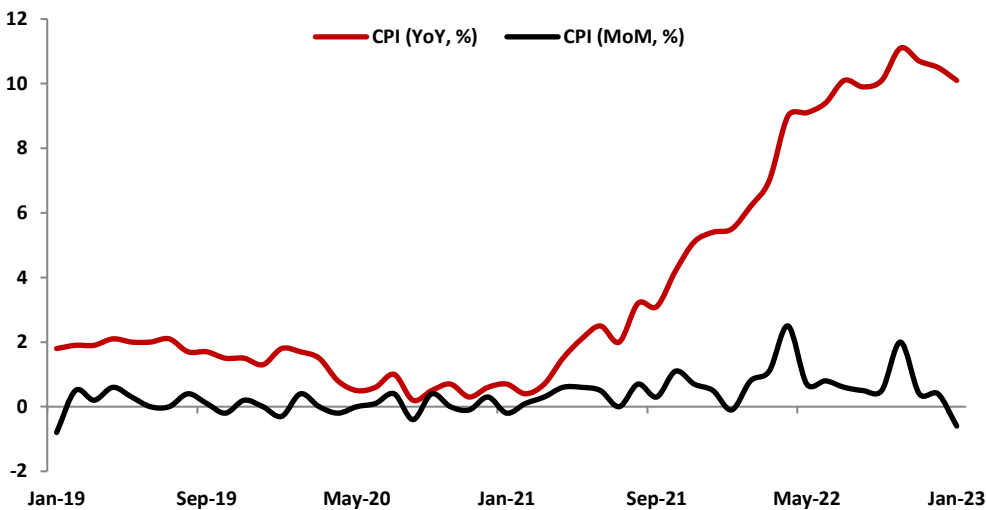
UK inflation data indicates Bank Rate is close to its peak

The latest UK inflation data showed a bigger-than-expected fall to 10.1% in January from 10.5% in December, which reduces the need for many more rate rises from the Bank of England (BoE) to tackle high inflation.

The central bank has implemented ten back-to-back interest rate rises since December 2021, when the cost of borrowing was at a historic low of 0.1%, and in February 2023, the rate was lifted by 50bps to 4.0%, the highest since 2008. We continue to expect the BoE to tighten monetary policy further, but latest inflation report does somewhat reduce the risk of a much higher terminal interest rate.

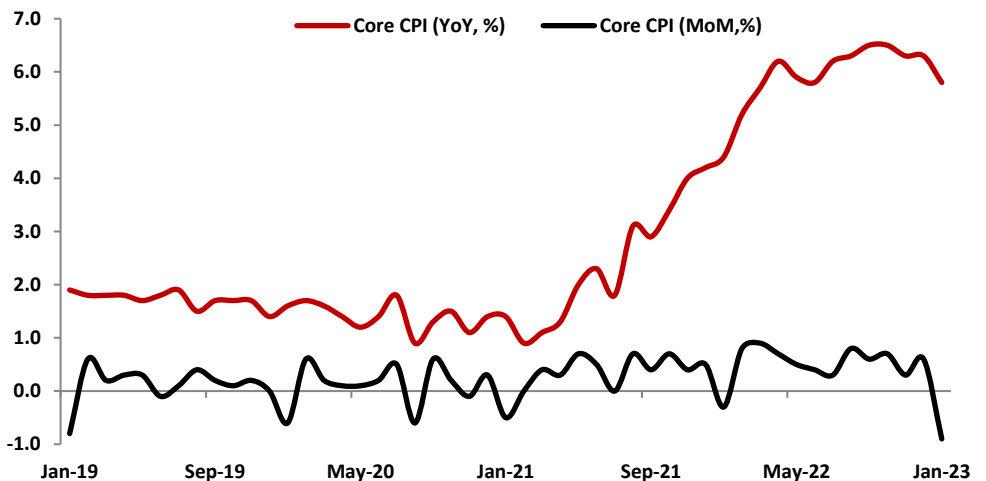
The key detail in the UK’s January’s CPI report was the sharp fall in services inflation. That will matter more for the BoE’s next policy decision than the drop in the headline rate. **If further evidence emerges in next month’s labor market and CPI releases that inflation has turned a corner, we see a case for one more hike (25bps) before the MPC opt more explicitly for a 'conditional pause'.** That said, slowing momentum in both the wage and inflation data will likely make next month's rate decision more finely balanced than markets expect. This should provide a little reassurance to investors that the interest rate cycle is close to peaking and eventually moving in a more favourable direction.

Chart 1: UK CPI (%)



Source: Bloomberg, BIMB Securities

Chart 2: UK Core CPI (%)



Source: Bloomberg, BIMB Securities

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