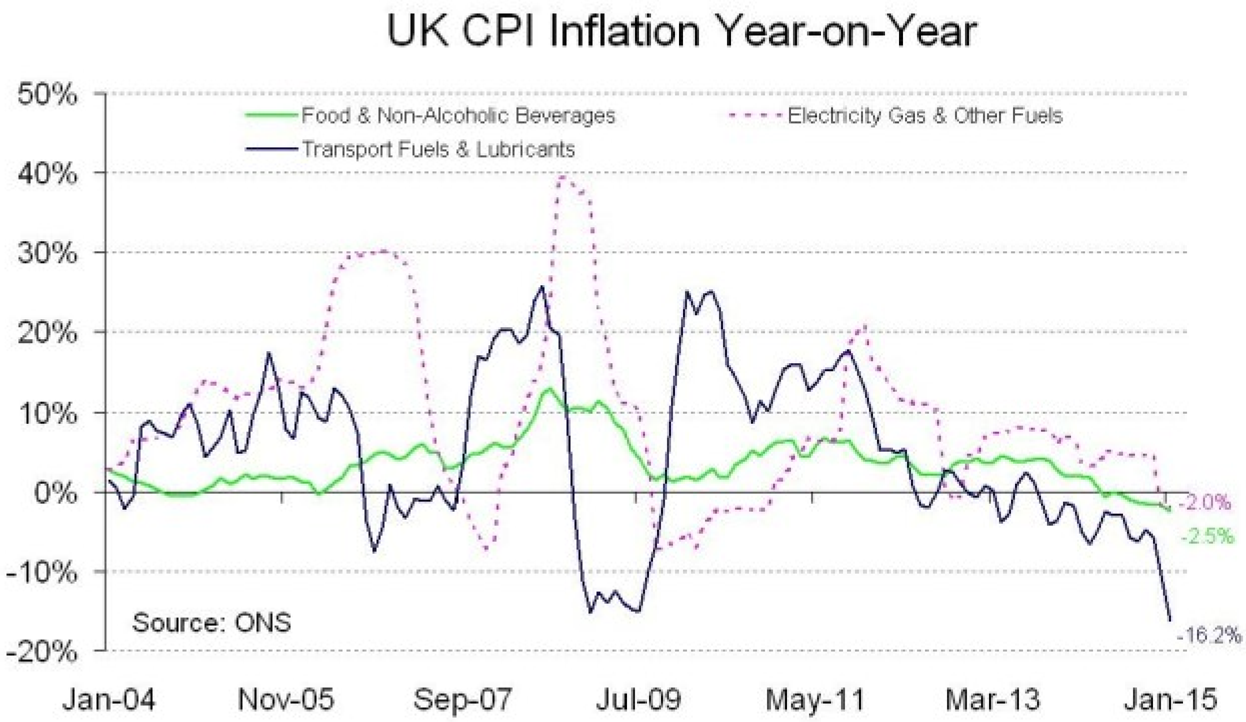
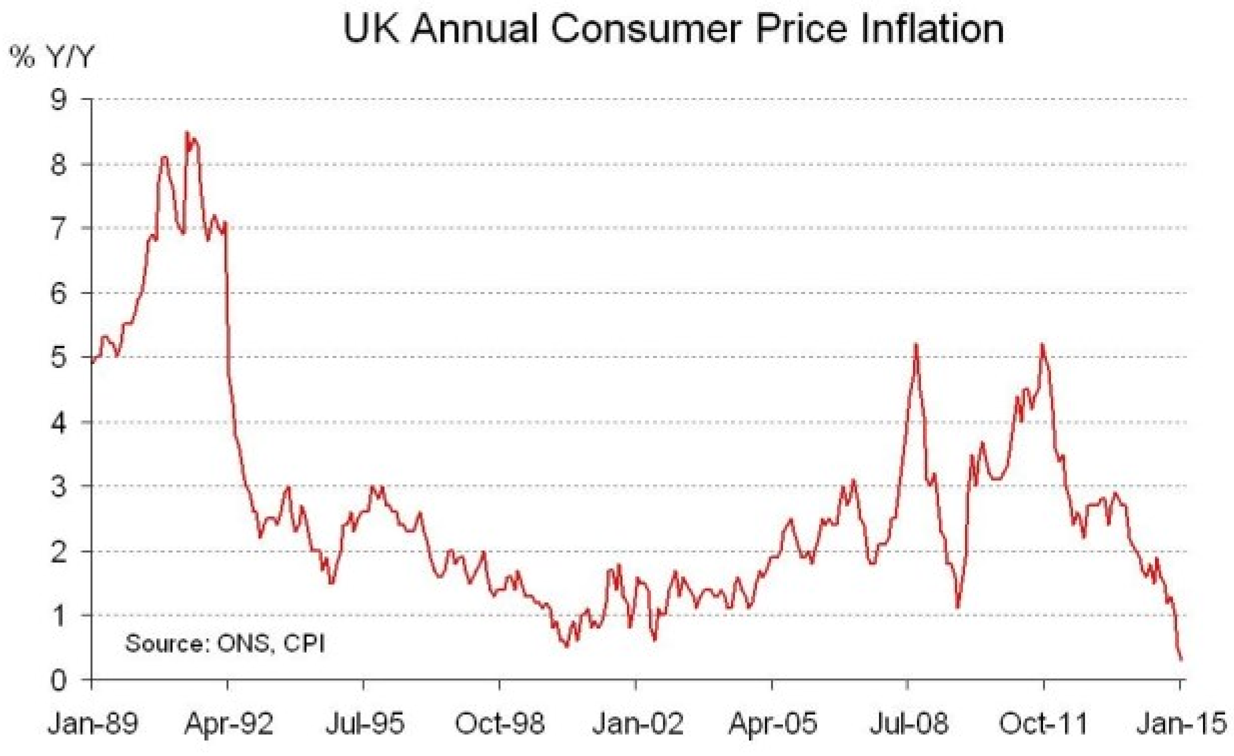


Last month UK consumer prices posted their lowest reading on record with an annual rise of just 0.3%. This compared with the 0.5% year-on-year rise in December. Households will welcome the latest falls in food and energy prices. Food prices fell by 2.7% y/y in January. This represents the steepest annual decline in food prices since the monthly CPI series began in January 1997. UK food prices are now at their lowest level since November 2012 and have fallen by 3.1% since February last year. Meanwhile, *Transport Fuels & Lubricants (petrol and diesel)* recorded a record annual decline of 16.2% last month with prices down almost 23% since their April 2012 peak. Outside of motoring costs, household utility bills fell last month by 2% year-on-year.

Falling oil and commodity prices coupled with a strengthening in the sterling exchange rate have contributed to the decline in consumer prices. Indeed, last week's Bank of England

Quarterly Inflation Report (QIR) stated than the Monetary Policy Committee (MPC) estimates that two-thirds of the gap between the current inflation rate and the 2% target rate is explained by sharp falls in food and energy prices. Last week the MPC also projected that further record lows can be anticipated in the coming months. Indeed, UK CPI is expected to go sub-zero this spring. However, this headline deflation is expected to be short-lived. Beyond this short-term, consumer price inflation is expected to rise back towards 2% *(the MPC's target rate)* by Q1 2017. Before then, the Bank of England is expected to raise its benchmark Bank Rate off its record low of 0.5%. Our latest estimate is for this first move to come in Q1 2016.



Overall, the latest easing in consumer price inflation is good news for households. With inflation at record lows and average wages rising, UK households are expected to see their largest increase in real take-home pay this year in a decade. This will boost consumer spending and economic growth. UK households currently find themselves in a ‘sweet spot’, as far as their household finances are concerned, with wages rising and inflation abnormally low. However, this situation will not last forever. Already we have seen a rise in oil and petrol prices in recent weeks. Furthermore, after the General Election households can expect to see further significant tax and benefit changes that will reduce their take-home pay. In addition, interest rates are expected to be higher in two years time than they are now.

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