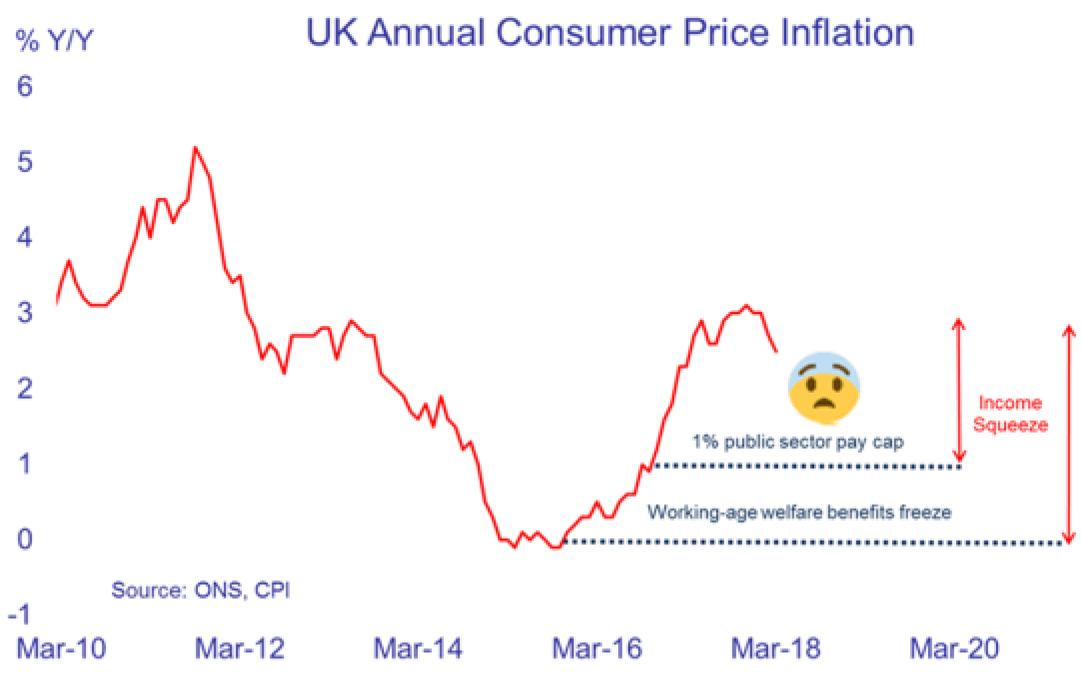
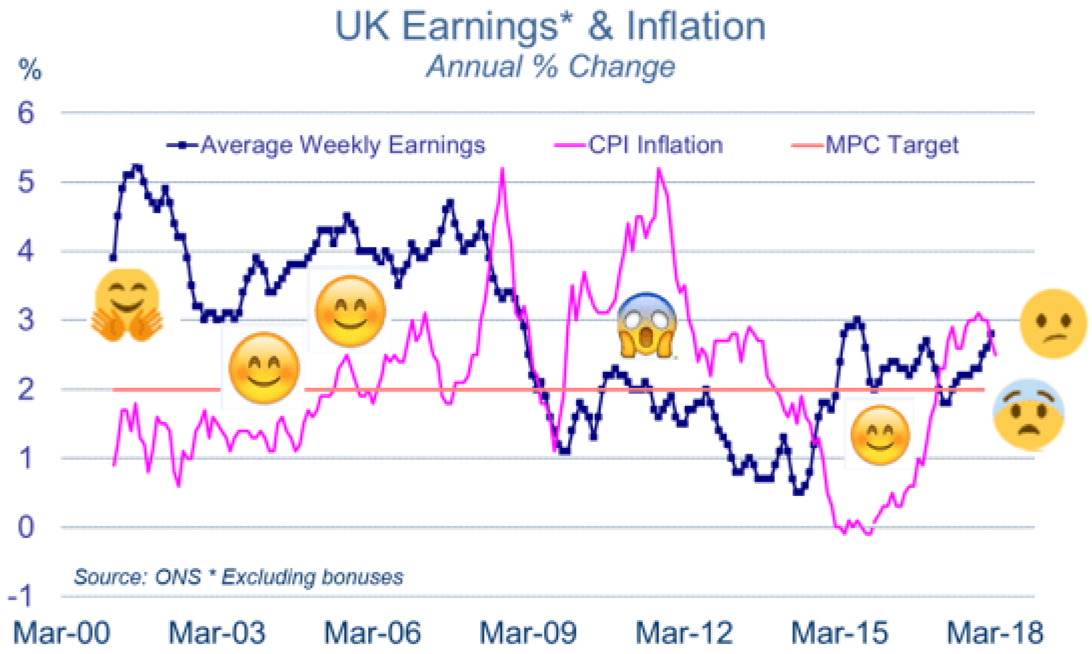
Earnings squeeze is over

The combination of accelerating wage growth and an easing in inflationary pressures is clearly good news for consumers. In February, annual UK wage growth (2.8%) finally overtook the equivalent rate of inflation (2.7%) for the first time since the start of 2017. Following the latest figures for March this trend looks set to continue. The annual rate of UK consumer price inflation (CPI) eased to 2.5% in March – its weakest rate in twelve months. The price of consumer goods (e.g. food & clothing) inflation eased from 3% y/y in February to 2.4% in March. Conversely, consumer services inflation nudged higher to 2.5% over the same period.



But consumer squeeze continues elsewhere

The earnings squeeze is only one aspect of the wider cost of living squeeze. Households derive unearned income too. A range of working-age welfare benefits are currently in the midst of a multi-year freeze until 2020. As a result, even an inflation rate of 0.1% y/y will erode the purchasing power of every pound of welfare benefits. Other households will feel the squeeze from the scaling back of welfare benefits elsewhere. Public sector workers are experiencing a 1% pay cap. With inflation currently running at 2.5 times this rate, households reliant on public sector pay will still be feeling the cost of living squeeze.



Different rates for different people

Different consumers have different inflation rates depending on the mix of consumer goods and services they purchase. Those individuals on lower incomes spend a higher amount of their disposable incomes on necessities such as food, fuel and energy bills. These items are still rising at faster rates than the headline rate of CPI (2.5%). Food price inflation eased to a 7-month low in March, but at 3% still remains high. UK household energy bills rose by 6.2% y/y in March. Within this category is domestic heating oil. The rise in the global oil price has seen prices rise by 23% y/y. Northern Ireland has a significantly higher proportion of households using domestic heating oil as opposed to gas, relative to its GB counterparts. Meanwhile domestic ratepayers in Northern Ireland have received their bills for the year ahead. Domestic rates have increased by an above inflation 4.5%. The good news for some individuals is the above inflationary rise (>4%) in the National Living Wage.

Lower inflation but higher interest rates coming soon

While the latest UK CPI inflation rate was weaker than the Bank of England had recently projected, the easing in inflationary pressures is not unexpected. Following the EU referendum in June 2016, sterling depreciated and eventually fuelled import price inflation. This price adjustment has now worked its way out of the year-on-year price comparisons. Indeed, sterling has strengthened in recent months and this will support the Bank of England's efforts to bring inflation back to its 2% target. In order to do this, however, this is likely to require some further interest rate rises. Financial markets are expecting the Bank of England to raise rates next month. While the lower than anticipated inflation figures have made markets slightly less certain of a 0.25% increase next month, borrowers and savers should not be surprised with a move. The expectation is for the Bank of England's benchmark Bank Rate to end 2018 at 1% as opposed to its current 0.5%.

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