Stronger than expected UK inflation data increases the odds of another modest BoE rate hike next year, but the impasse in latest EU/UK Brexit talks means a BoE move is unlikely before spring 2019, at the earliest.

False peak. UK inflation popped up to 2.7% in August, despite widespread expectations that it would creep downwards towards 2.4%. Is this a new resurgent trend? Unlikely. The drivers of the upwards move were small volatile components. If you didn’t use a ferry or go to the theatre they would largely have passed you by! So we’ll probably see it fall back over the coming months. But it will have real effects unless that correction happens soon. September’s CPI figure is used as the basis to set all sorts of prices (train fares) and benefits in the economy. The Chancellor will be hoping for a surprisingly low figure next month.

Surprise. Defying expectations, UK retail sales jumped to 3.3% in the year to August. Retail sales edged higher by 0.3% m-o-m last month, driven by weather-related factors. Sector-wise growth was broad-based in August, led by household goods. Food and clothing sales bucked the trend, falling modestly. Online spending goes from strength to strength: it accounts now for a record 18.2% of retail sales. Still, it is premature to suggest retail sales are on a sustainable improvement.

Slowing. The UK housing market is clearly losing momentum: residential prices posted a 3.1% y-o-y increase in July, a five year low. Weakness remains most evident in London – prices are slightly lower than they were 12 month ago. However, there are signs of a more broad-based slowdown taking place. Witness slower house price growth in the East & West Midlands, the East of England, Scotland and Wales in early Q3. In contrast, residential prices remain relatively steady in the South West, North East/West as well as Yorkshire and Humberside. But this may prove short-lived.

Improving trend. Latest public sector finance data was disappointing. Government borrowing jumped to £6.8bn in August, up £2.4bn from last year, the first year-on-year rise in August for three years. This was largely due to the slowest annual pace of tax receipts since November 2005 particularly corporation tax. Public spending was also higher than expected. Still, the underlying picture remains positive: cumulative borrowing over the first five months of FY18/19 was £17.8bn, £7.8bn lower than the same period a year ago. So, Chancellor Hammond has some wiggle room in his upcoming Budget.

Tit-for-tat. US/China trade tensions are intensifying. Witness the White House’s imposition of 10% tariffs on $200bn of Chinese imports, rising to 25% in early January 2019. US President Trump is threatening a further $267bn on Chinese imports if China retaliates. Such threats are apparently falling on deaf ears. Chinese authorities announced 5-10% tariffs on $60bn of US imports and pulled out of talks with the US. Hopes of a resolution before the US mid-term elections in November appear to be fading.

Strong demand. Foreign appetite for US financial assets shows few signs of waning. Net foreign demand for long-term US securities rebounded to $74.8bn in July after net sales of $36bn in June, driven by significant overseas buying of US securities and sizeable US sales of foreign financial assets. Total Chinese holdings of US government bonds remained pretty steady in early Q3, at $1.17 trillion. So, there is little evidence China is divesting from US government bonds despite ongoing US/Sino trade tensions. China’s central bank has ruled out a forced devaluation of the Yuan, fearful of a repeat of marked capital outflows in early 2015.

Built on sand? US housing starts beat market expectations in August, jumping by 9.2% to an annual rate of 1.28 million. On the face of it, such strong growth suggests US consumers have the appetite to make more big ticket purchases despite a gradual Fed rate hikes. However, below the surface it is clear that growth was driven entirely by construction of multi-family housing, a volatile sector. A better indicator of the construction pipeline – the number of building permits granted – actually fell slightly on the month, suggesting this uptick will be short-lived. A case of shallow foundations perhaps.

Disappointing. The Euro area’s September PMI survey surprised on the downside. Weaker manufacturing confidence was the main culprit – thanks largely to stagnating export orders. Perhaps this is a reflection of rising jitters of a possible global trade war. Services, however, were more resilient at the end of Q3 though new orders dropped – a worrisome sign. Even so, a continued gradual Euro area upturn looks likely in coming months.

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