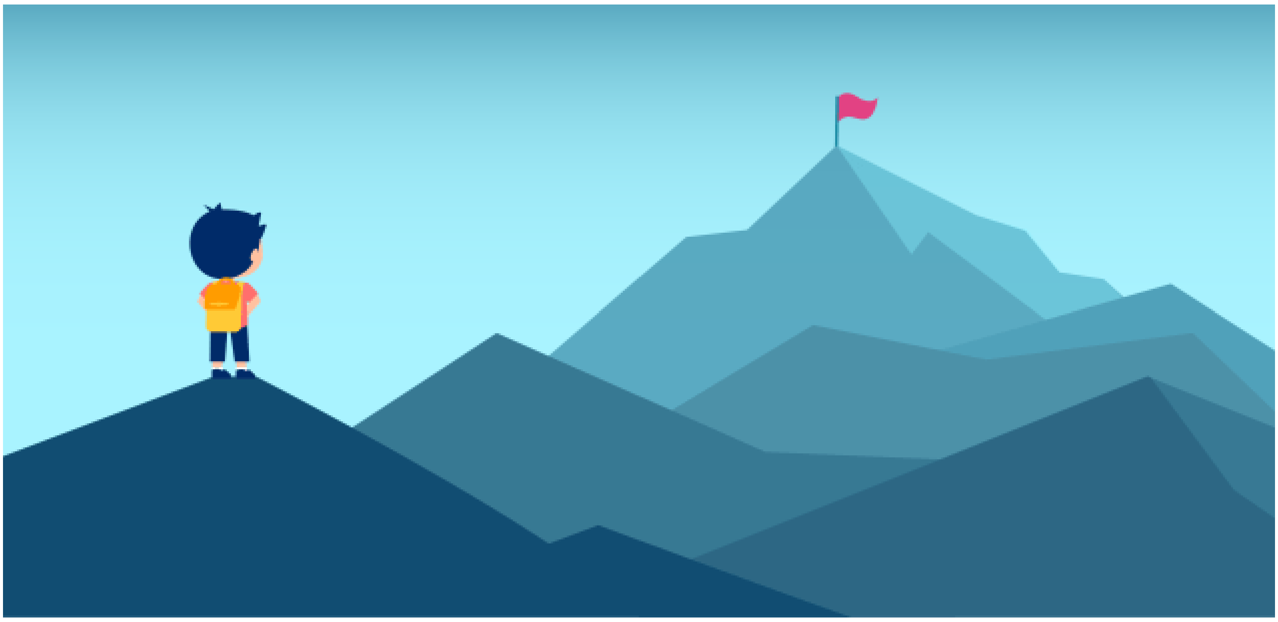
At this point upside surprises in inflation rate occur with such frequency that "surprise" is probably the wrong word for them. Inflation in the UK rose for a ninth month in a row in June and was the highest among G7 countries, while with another hefty rise in the energy price cap to come, the inflation peak is still some way off. Meanwhile PMI data across the UK, Eurozone and US all point to slowing growth momentum.



Over with overheating? UK inflation jumped to 9.4% in June, up from 9.1% in May, exceeding both the consensus and the Bank of England's forecast. It was driven mainly by motor fuel inflation, which jumped by almost 10 ppts over its May reading, as well as food inflation. The pinch continues to be acute for consumers. But there are mild signs of hope. Core inflation (excluding food and energy prices) dropped again in June, to 5.8% y/y from 5.9% in May – as retailers struggled to pass on prices. While the prices of second-hand cars, a big contributor to higher prices, continued to fall. This suggests that a cooling may be down the line. But with imported inflation still raging, consumers are unlikely to have respite anytime soon.

Talking tough. Both Michael Saunders and Andrew Bailey of the MPC delivered speeches warning of the need for further tightening, despite the economy facing obvious headwinds. Bailey led with a clear restatement of the MPC’s commitment to returning inflation to the 2% target. Whilst Saunders used his last speech as an MPC member to emphasise that growth is likely to be structurally lower in future, even after inflation has been brought back under control. The MPC’s meeting isn’t till August but against a backdrop of rising wages, heralding the so-called second round effects of higher prices, expectations are building for another rise in Bank Rate, potentially of 0.5%.

Time to talk. Between now and early September, we’re going to hear a lot of talk on how to boost the economy. That’s a good thing. Because the data is telling us we’ve got a bit of a growth problem. The latest PMI reading for the UK fell to 53.4, that’s the lowest since February 2021, continuing the trend of weakening momentum that’s been in place for some months. But it’s not all gloomy. Many service firms highlight resilient consumer spending on travel & leisure. And input price inflation pressures are retreating, albeit that’s down to falling commodity prices rather than wages, where pressures persist.

Tightening. With inflation sky-high, signs of belt tightening shouldn’t come as a surprise. Retail sales fell for a second consecutive month in June. Volumes including petrol fell by 0.1% MoM – but consumers spent 1.3% more than in May due to rising prices. Households are continuing to spend more on goods but are getting less in return. Motor fuel sales fell by 4.3% MoM, while clothing and households’ goods also edged down, reflecing some consumer caution. In contrast, we splurged a bit to celebrate the Queen’s Jubilee it seems, food sales ticked up 3.1%. But this recovery won’t last – a study from the Office of National Statistics showed that half of the population reported buying less food in the first half of July due to rising prices.

Resounding. Performance of the high frequency indicators for mid-July resonated with the message from recently released official measures on growth, inflation and the labour market. Consumer spend eased, be it CHAPS card spend, down 3%, or restaurant reservations amid the worsening of cost-of-living crisis. Card spending on fuel rose 8 ppts in the week to 17 July vs a week before. Meanwhile, labour market conditions remain healthy, potential redundancies continue to be low, down 10% vs a year ago. But some slack is developing. Volume of online job adverts eased to 124% of its pre-pandemic level, as 20 out of the 28 job categories saw decreases. And there is no respite on inflation worries. Input price inflation remained the main concern for firms when looking ahead to August, to a similar degree to July's reported figures.

Tight. The UK produced another set of decent labour market statistics last week, apart from the one that matters to workers – real pay. First the good news. There were almost 300k more people in employment in the three months to May than in the previous three months. While the unemployment rate remained very low at 3.8%. The share of working-aged adults in employment rose to 75.9% in March-May, while inactivity fell. Encouragingly, inactivity fell for men aged 50+, perhaps driven by inflation. Yet real pay fell by 0.9% annually, including bonuses, or by a record-busting 2.8% excluding them. Labour demand is strong, yet the old mechanism of supply rising to meet demand still has work to do (vacancies now match the number of unemployed). If and until we boost productivity and supply, pay pressures will likely remain elevated.

Still going up. UK house prices inflation picked up the pace for the third consecutive month in May, to 12.8% annually. On a monthly basis, prices increased by 0.9%. This was in contrast to a slowdown reported by Nationwide and Rightmove measures. And it looked odd with the backdrop of cost-of-living crisis and sharply rising mortgage rates. However, official data look at completed transactions that may have been initiated months ago. The timeliest indicators of demand suggest that the recent momentum in house prices will not be sustained unless households are willing to draw on their accumulated Covid savings.

Quite unsurprisingly, data from the Royal InstitutIon of Chartered Surveyors suggests a softening ahead.

Punishing Inflation. The EZ composite PMI painted a grim scenario for the bloc, falling from 52 in June to 49.4 in July, signalling a contraction of output for the first time since February 2021 under the weight of soaring energy costs. An intensifying downturn in manufacturing (PMI 49.6, from 52.1 in Jun) driven by elevated commodity prices, while services managed to perform slightly better with a reading of 50.6. Consumer confidence is also at a record low as consumers struggle with soaring energy and food prices, according to the European Commission survey last week. It’s a similar story in the US: its composite output index edged down to 47.5 in July from 52.3 in June, hitting a 26-month low. The services PMI posted a reading of 47, also a 26-month low. Manufacturing PMI slowed to 52.3 from 52.7, its worst reading in two years. The sharp slowdown in business activity suggests that soft landing the economy could be very difficult indeed.

Here we go again? A multi-decade high in inflation (8.6% in June) prompted the European Central Bank (ECB) to end its experiment with negative rates, raising the benchmark by 50bp so that its deposit rate now stands at 0%. The historical echoes are uncomfortable though. The last time the ECB raised rates it precipitated a sovereign debt crisis which Mario Draghi had to calm by wielding the threat of doing “whatever it takes”. This time there is an asset purchase mechanism designed to prevent debt costs from spiralling. But as Draghi is forced out of political office in Italy it’s easy to see how resolve will be tested in the coming months.

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