Group Economics

Ulster Bank

Sterling taking a pounding but will we be trumped by inflation?

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When people cast their EU Referendum vote on June 23, I suspect not many would have seen it as a ballot on the price they would pay for their next iPhone. But, in a sense, it was, as the proceeding fall in the value of the pound Sterling has had wide-ranging impacts for the economy - both good and bad – including the price we pay for goods.

Following the vote, the pound hit its lowest levels against the dollar for more than 30 years, and it remains around 12 percent lower against both the euro and dollar than it was before the Referendum result.

The fall in the value of Sterling since may not have been as large as anticipated, but it has been significant and has already had a major impact on imports, exports, cross-border trade flows, tourism, inflation, and more.

The recently published Index of Services data for Northern Ireland highlighted that Sterling weakness was already acting as a tailwind before the EU referendum. Local firms falling within the wholesale, retail, accommodation and food categories posted their strongest rates of growth in four-and-a-half years. The quarterly rise in Q2 of two percent quarter-on-quarter was double the rate of the UK.

There is also evidence of Sterling weakness boosting tourism, and increasing flows of cross-border shopping from the South to the North. Watch out for even more Southern registered cars in shopping centres in the weeks and months ahead.

A less visible sign concerns the trade in agri-food products. Remember there is always two sides to every trade. While a weak pound can be great news for UK / Northern Ireland's exporters, it is bad news for the Republic of Ireland.

Last year, the UK bought up more than half of all Irish beef, with Irish exports valued at €1billion. However, Sterling depreciation has seen the UK's beef imports from RoI slump by 17 percent in July. Meanwhile, more timely figures from the Livestock and Meat Commission (LMC) reveal that cattle exports from the Republic to Northern Ireland have slumped by almost three-quarters in the six weeks to September 10.

This potentially represents one of the most significant opportunities from Brexit for the Northern Ireland economy. The UK is currently just 60 percent self-sufficient on food, and Northern Ireland producers have a major competitive advantage in the GB-market over their Eurozone counterparts due to the exchange rate.

Local farmers are also set to benefit from Sterling's weakness with their EU single payment. Last year's payment was set at a conversion rate from Euro to Sterling of 73p. This year's payment is based on the average euro exchange rate for the month of September. This is looking likely to be above 85p, which represents a much-needed boost to farm incomes.

On the down-side, those of us who holidayed in the Eurozone this summer, or headed to North America, will have noticed the squeeze on the purchasing power of the pound. This impact will become more noticeable to businesses and households in the coming months in the form of inflation.

Signs of inflationary pressure are increasingly evident within the recent Ulster Bank PMIs. Last month, local firms reported that input cost inflation was running at a 58-month high. Inflationary pressures were evident across all sectors, particularly manufacturing. And firms will seek to pass on these higher costs to consumers in due course.

UK consumer price inflation has been sub-one-percent year-on-year throughout 2015 and 2016, with the price of food, fuel and petrol falling over this period. As a result, the so called "cost of living crisis" has become a distant memory for most people. But we shouldn't be too complacent as this consumer sweet spot may be coming to an end.

While the headline rate of UK CPI remains subdued - 0.6 percent year-on-year in August - there are signs that inflationary pressures are building. The UN's Food and Agricultural Organisation's (FAO) Food Price Index of international food prices rose by 1.9 percent month-on-month last month and is up almost seven percent year-on-year. This was the first annual rise in the food price index since June 2013. Those with a sweet tooth should note that sugar prices are up a whopping 75 percent over the last twelve months.

Rising global commodity prices will be amplified by Sterling's recent depreciation. This is becoming increasingly apparent in UK manufacturers' input costs. Last month these shot up by almost eight percent compared to a year ago, largely due to Sterling's weakness. This follows a 32-month period when the price of raw materials fell.

Looking at specific products, it is noted that the price of imported metals surged by 19 percent in the twelve months to August. This will have a knock-on impact for the construction industry, alongside certain manufacturing firms. Crude oil is up over 11 percent year-on-year. Meanwhile imported food materials are rising by almost 13 percent year-on-year; their fastest rate of growth in over five-years. As noted earlier, Northern Ireland firms could be well placed to substitute some food imports. However, for many manufacturing imports there is less likely to be an alternative, 'Sterling-zone' supplier.

Retailers remain reticent to raise prices, noting that consumers are highly-price-sensitive. In light of this, the BoE's regional agents pointed out that some food retailers were re-engineering products to maintain existing prices. This is what some people have described as 'shrinkflation'.

Meanwhile, in non-food goods, retailers were starting to increase prices in response to rising material costs; particularly for products priced in dollars. Apple has recently raised the price of its products in the UK in response to Sterling's depreciation against the dollar. The price of a 32GB iPad Pro with a 9.7 inch screen increased by 10 percent from £499 to £549. The most expensive version of the new iPhone is £919 up £100 (12 percent).

Political events could also significantly impact exchange rates in the months ahead too – both in the US and the Eurozone. Should US voters choose Donald Trump as their next President when they go to the polls on November 8, this could lead to a slide in the dollar, helping push down the cost of importing US goods into the UK. Whether or not the currency ramifications of the election of President Trump would cause Apple to reduce the price of iPhones this side of the Atlantic remains to be seen.

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