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UK CPI rises to 4.5% y/y in August 2011

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The annual rate of CPI inflation rose from 4.4% in July to 4.5% in August. This was in line with outturn anticipated amongst City analysts. We anticipate CPI inflation to peak at 4.8% y/y in October and to start falling back at the turn of the year. Meanwhile, the core CPI measure - which excludes the volatile energy, food, alcoholic beverages & tobacco components – remained stubbornly high at 3.1% y/y last month. This was slightly stronger than the 3.0% print that City economists had expected and highlights that underlying inflationary pressures remain. Meanwhile, the 'non-core CPI measure' – which conversely covers food, beverages, energy *(incl. petrol)* and tobacco – hit 9.0% y/y in August, up from 8.5% y/y in July. This non-core measure, which with the exception of tobacco covers necessities, is at its highest level since January 2009. It is concerning that this measure of largely unavoidable inflation costs, is more than twice the rate that prevailed last August, ahead of last year's extreme winter weather conditions. A repeat of last year's weather conditions, which has been mooted by some weather forecasters, combined with the anticipated double-digit 'non-core' inflation will put a severe strain on household finances. Given Northern Ireland's low wages, relative to the UK, and higher incidence of fuel poverty, NI will be more adversely affected than the UK as a whole. Finally, the lesser known CPI index which excludes indirect taxes *(e.g. VAT & fuel duties*), or CPIY, ticked up from 2.9% y/y in July to 3.0% y/y in August. Despite this overall inflationary backdrop, the Bank of England should keep its Bank rate on hold for well into next year, and possibly beyond. Indeed, the risk in the near-term remains more policy stimulus in the shape of QE.

Clothing & Footwear prices rising at a record rate

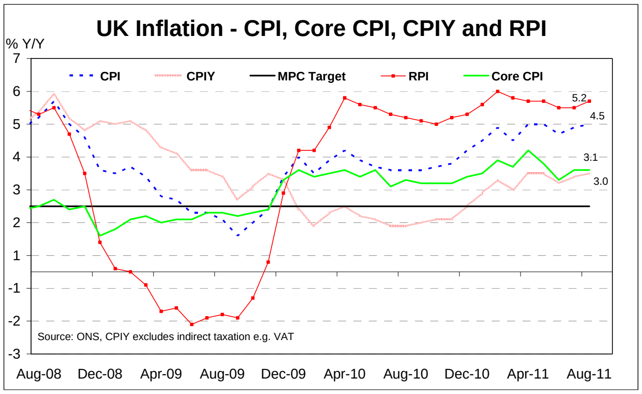
Nine of the twelve main sub-categories, including discretionary consumer sensitive areas like *clothing & footwear and furniture & household goods (see table overleaf for more details),* recorded month-on-month price rises in August. Indeed, the *clothing & footwear* category posted its largest rise for a July to August period on record at 3.7% m/m. This pushed the annual inflation rate up to 4.0% last month up from 3.1% in July. This represented the highest rate of *clothing & footwear* inflation since the official series began in January 1997. It was a similar story with the *furniture, household equipment and maintenance* category which saw its annual inflation rate jump from 4.8% in July to a new record high of 5.8% last month. This category posted a hefty 2.0% m/m rise between July and August. Meanwhile, *Restaurants & Hotels* posted their highest annual inflation rate on record. Last month's print of 4.6% compared with a reading of 4.4% y/y in July. These robust inflationary rises in discretionary consumer spending items are in the context of weak consumer demand, particularly within NI.

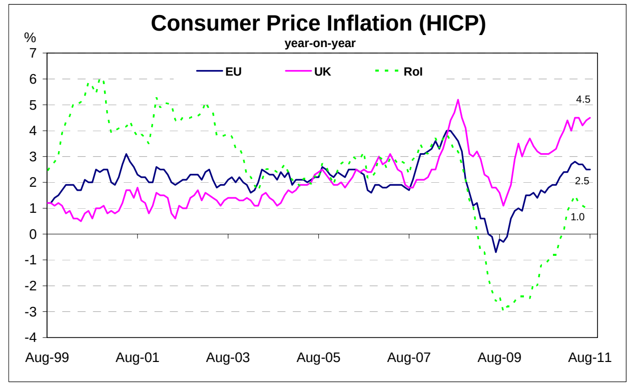
Higher energy prices also feeding through

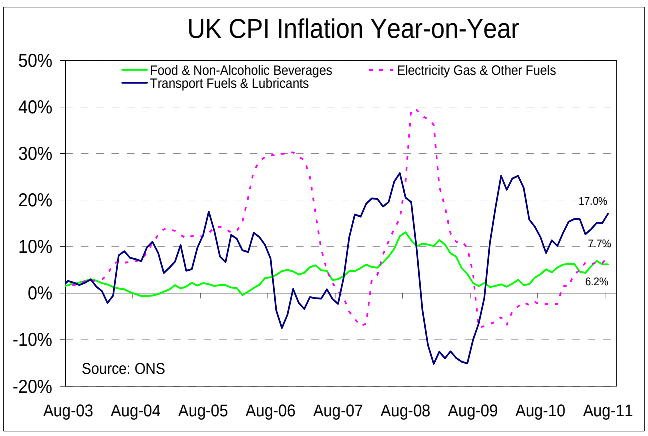
The recent electricity and gas price hikes have begun to feed through into the latest UK CPI figures. These rises triggered an increase in the *household and household services category* with the annual CPI rate jumping from 4.6% in July to 5.1% last month. This is the highest reading since July 2009 (+5.2%). Meanwhile, the *Transport* sector saw price rises of just 1% between July and August 2011 which compared to a 1.3% rise last year. This lowered the annual rate from 7.8% to 7.4%. Within transport, however, fuels & lubricants (i.e. petrol / diesel) jumped from 15% y/y in July to 17% y/y in August. The latest weekly petrol figures (13th September) signal an annual price rise of 18%. Since the credit crunch began in August 2007, petrol prices have risen by 42%. Meanwhile, food prices have risen by 29% over the same 4-year period.

Annual RPI inflation increases to 5.2%

The Retail Prices Index (RPI) annual inflation rate came in 0.2pp stronger than expected at 5.2% in August. It is noted that the UK's current CPI inflation rate of 4.5% compares with 2.5% in the euro zone and just 1.0% in the Republic of Ireland.



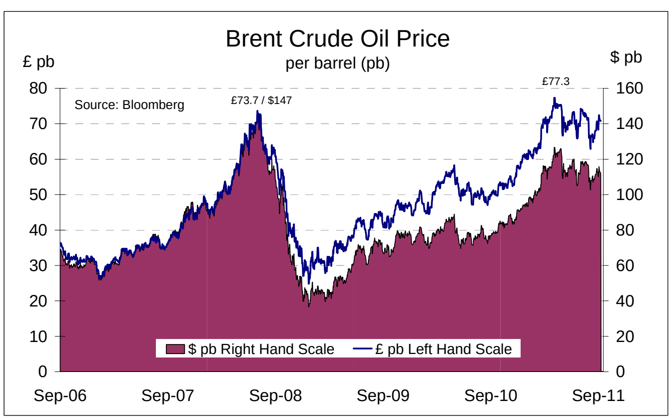


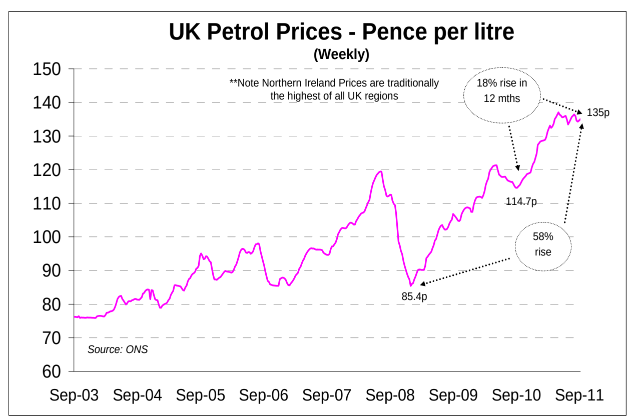


UK CPI Inflation by Sub-Category

CPI by main categories	July 2011 % Y/Y	August 2011 % M/M	August 2011 % Y/Y
Food & non-alcoholic beverages	6.2	0.1	6.2
Alcohol & Tobacco	10.3	-0.6	9.8
Clothing & Footwear	3.1	3.7	4.0
Housing & household services *(includes water & fuel)*	4.6	0.5	5.1
Furniture & Household Equipment	4.8	2.0	5.8
Health	3.5	0.4	3.4
Transport	7.8	1.0	7.4
Communication	2.5	0.1	3.4
Recreation & Culture	-0.2	-0.4	-0.8
Education	5.3	0.0	5.3
Restaurants & Hotels	4.4	0.2	4.6
Miscellaneous Goods & Services	2.7	0.4	2.8
Overall CPI	**4.4**	**0.6**	**4.5**

Source: ONS





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