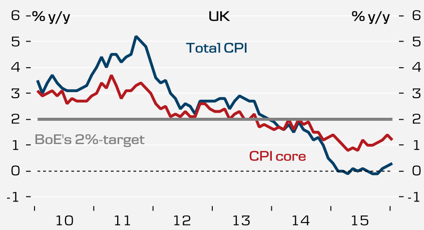
16 February 2016

Flash Comment UK

Inflation remains low

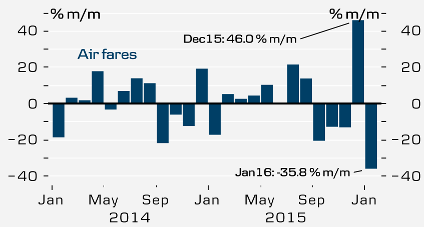
- **UK CPI inflation increased to 0.3% y/y in January 2016 from 0.2% y/y in December 2015 (Danske Bank: 0.4% y/y, consensus: 0.3% y/y).** Core inflation declined to 1.2% in January from 1.4% y/y in December. **Both CPI inflation and CPI core inflation are expected to remain subdued in 2016 due to a combination of the past appreciation of GBP and the low commodity prices.**
- The small increase in headline inflation in January was mainly due to 'Energy' and 'Food, Alcoholic Beverages and Tobacco' which pushed up CPI inflation by 0.14pp and 0.08pp, respectively. This is mainly due to base effects as the drop in commodity prices from the end of 2014 has fallen out of the inflation prints. 'Clothing and Footwear goods' and 'Miscellaneous goods' pushed CPI inflation up by 0.04pp and 0.03pp, respectively.
- The main negative contributor were air fares, which declined 35.8% m/m in January after the large increase of 46.0% m/m in December. This component alone pushed down overall inflation by 0.20pp (and core inflation by 0.27pp).
- Although the negative contributions from the 'Non-energy industrial goods', 'Food, Alcoholic beverages and Tobacco' and 'Energy' all declined in January, 'Services' remain the only factor that is contributing positively to headline inflation. Services inflation, which to a larger extent is domestically generated, was only 2.3% y/y in January, only slightly above the 2% target. Deflation in other components implies that overall inflation remains low.
- **The Bank of England has made it clear that it is definitely not 'Fed light' and that it is in no hurry to hike rates** (see also *BoE review: BoE is not 'Fed light' – we now expect first hike in Q1 17*, 4 February 2016). There are many reasons for the BoE to stay on hold for a long time: inflation and wage growth are both subdued, inflation expectations have fallen, other central banks (most importantly the ECB) are on an easing bias and Brexit uncertainties loom.
- **Watch out for the labour market report for December, which is due out tomorrow**. We expect the unemployment rate (3M) to have fallen to 5.0% from 5.1% while growth in average weekly earnings excluding bonuses (3M) increased to 1.9% y/y from 1.8%. **The labour market is one of the few bright spots left in the BoE's chart book.** Although employment has risen significantly, the BoE still thinks there is some slack left. The BoE argues that long-term unemployment is still elevated and many part-time workers are not able to find full-time work.

CPI inflation remains low



Source: Office for National Statistics

Fall in core inflation mainly due to a fall in air fares



Source: Office for National Statistics

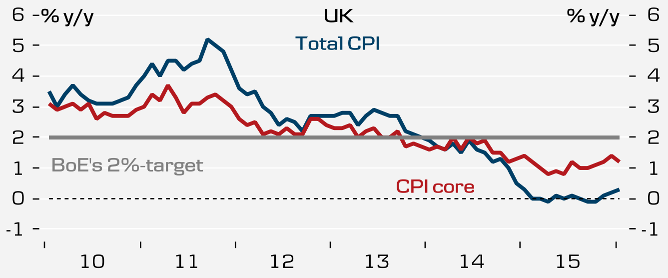
Follow us on Twitter for the latest on macroeconomic and financial market developments:

@Danske_Research

Analyst
Mikael Olai Milhøj
+45 45 12 76 07
milh@danskebank.dk

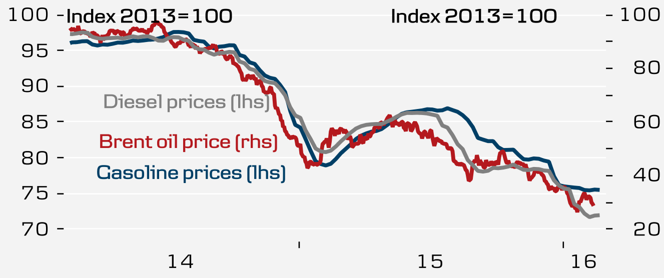
Charts

CPI inflation remains subdued



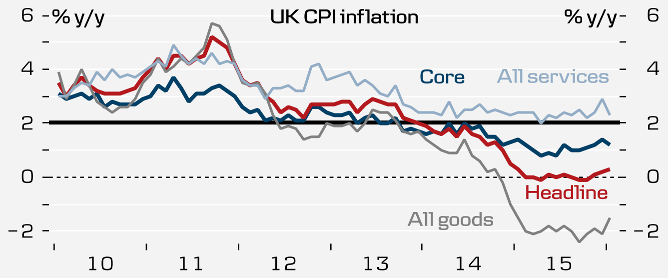
Source: Office for National Statistics

Lower oil prices have lowered the UK inflation outlook



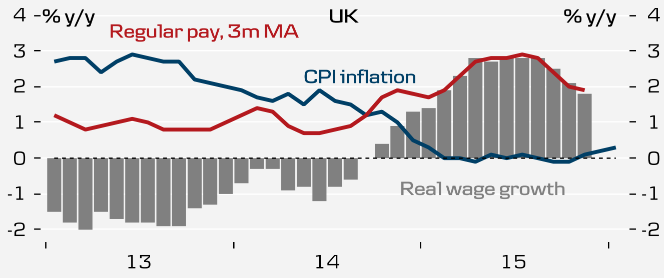
Source: Office for National Statistics, UK GOV

Services inflation slightly above 2%



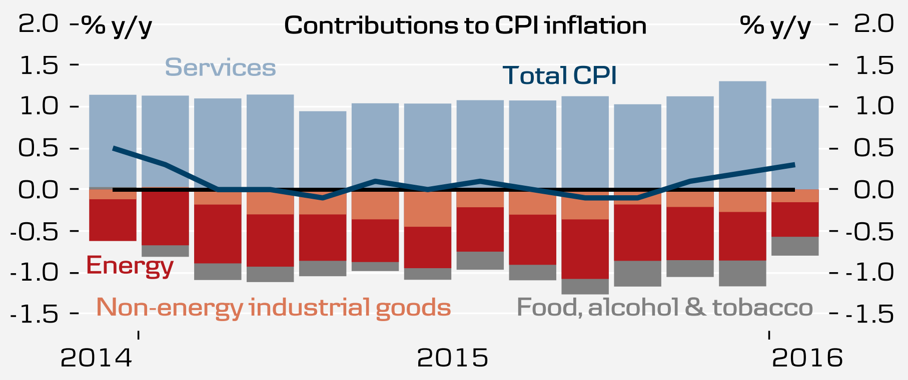
Source: Office for National Statistics

Positive real wage growth despite moderate nominal wage growth as inflation remains very low



Source: Office for National Statistics

Only services inflation contributes positively to overall CPI inflation



Source: Office for National Statistics

Disclosures

This research report has been prepared by Danske Bank Markets, a division of Danske Bank A/S (‘Danske Bank’). The author of this research report is Mikael Olai Milhøj, Analyst.

Analyst certification

Each research analyst responsible for the content of this research report certifies that the views expressed in the research report accurately reflect the research analyst’s personal view about the financial instruments and issuers covered by the research report. Each responsible research analyst further certifies that no part of the compensation of the research analyst was, is or will be, directly or indirectly, related to the specific recommendations expressed in the research report.

Regulation

Danske Bank is authorised and subject to regulation by the Danish Financial Supervisory Authority and is subject to the rules and regulation of the relevant regulators in all other jurisdictions where it conducts business. Danske Bank is subject to limited regulation by the Financial Conduct Authority and the Prudential Regulation Authority (UK). Details on the extent of the regulation by the Financial Conduct Authority and the Prudential Regulation Authority are available from Danske Bank on request.

The research reports of Danske Bank are prepared in accordance with the Danish Society of Financial Analysts’ rules of ethics and the recommendations of the Danish Securities Dealers Association.

Conflicts of interest

Danske Bank has established procedures to prevent conflicts of interest and to ensure the provision of high-quality research based on research objectivity and independence. These procedures are documented in Danske Bank’s research policies. Employees within Danske Bank’s Research Departments have been instructed that any request that might impair the objectivity and independence of research shall be referred to Research Management and the Compliance Department. Danske Bank’s Research Departments are organised independently from and do not report to other business areas within Danske Bank.

Research analysts are remunerated in part based on the overall profitability of Danske Bank, which includes investment banking revenues, but do not receive bonuses or other remuneration linked to specific corporate finance or debt capital transactions.

Financial models and/or methodology used in this research report

Calculations and presentations in this research report are based on standard econometric tools and methodology as well as publicly available statistics for each individual security, issuer and/or country. Documentation can be obtained from the authors upon request.

Risk warning

Major risks connected with recommendations or opinions in this research report, including as sensitivity analysis of relevant assumptions, are stated throughout the text.

Date of first publication

See the front page of this research report for the date of first publication.

General disclaimer

This research has been prepared by Danske Bank Markets (a division of Danske Bank A/S). It is provided for informational purposes only. It does not constitute or form part of, and shall under no circumstances be considered as, an offer to sell or a solicitation of an offer to purchase or sell any relevant financial instruments (i.e. financial instruments mentioned herein or other financial instruments of any issuer mentioned herein and/or options, warrants, rights or other interests with respect to any such financial instruments) (‘Relevant Financial Instruments’).

The research report has been prepared independently and solely on the basis of publicly available information that Danske Bank considers to be reliable. While reasonable care has been taken to ensure that its contents are not untrue or misleading, no representation is made as to its accuracy or completeness and Danske Bank, its affiliates and subsidiaries accept no liability whatsoever for any direct or consequential loss, including without limitation any loss of profits, arising from reliance on this research report.

The opinions expressed herein are the opinions of the research analysts responsible for the research report and reflect their judgement as of the date hereof. These opinions are subject to change, and Danske Bank does not undertake to notify any recipient of this research report of any such change nor of any other changes related to the information provided in this research report.

Disclaimer related to distribution in the United States

This research report is distributed in the United States by Danske Markets Inc., a U.S. registered broker-dealer and subsidiary of Danske Bank, pursuant to SEC Rule 15a-6 and related interpretations issued by the U.S. Securities and Exchange Commission. The research report is intended for distribution in the United States solely to 'U.S. institutional investors' as defined in SEC Rule 15a-6. Danske Markets Inc. accepts responsibility for this research report in connection with distribution in the United States solely to 'U.S. institutional investors'.

Danske Bank is not subject to U.S. rules with regard to the preparation of research reports and the independence of research analysts. In addition, the research analysts of Danske Bank who have prepared this research report are not registered or qualified as research analysts with the NYSE or FINRA but satisfy the applicable requirements of a non-U.S. jurisdiction.

Any U.S. investor recipient of this research report who wishes to purchase or sell any Relevant Financial Instrument may do so only by contacting Danske Markets Inc. directly and should be aware that investing in non-U.S. financial instruments may entail certain risks. Financial instruments of non-U.S. issuers may not be registered with the U.S. Securities and Exchange Commission and may not be subject to the reporting and auditing standards of the U.S. Securities and Exchange Commission.