



After remaining within a narrow band (0.1pp) of zero for most of this year, inflation looks set to rise with base effects likely to add 0.6-0.7% by February. We expect CPI to average 1.1% in 2016 but it will probably still be shy of 1% at the time of the May inflation report. Evidence of rising inflation will be important to the BoE when it comes to deciding to tighten policy, as will improved prospects for wages and economic growth generally. Some on the Monetary Policy Committee would no doubt feel uncomfortable raising rates at the same time as having to explain the downside miss to its inflation target, but we do not expect this to stop the Bank from hiking.

Should the Fed raise rates in December as we expect, then our call for the first BoE move in May looks reasonable based on past experience. The Bank is not governed by US policy – but there are numerous reasons we think the MPC will follow suit with a lag: i) globalisation has meant increased synchronisation, with both the BoE and Fed facing the same external conditions, ii) the UK is sandwiched between the tightening Fed and loosening ECB, iii) given the potential risks from a Fed move (particularly to EM), it seems reasonable for the BoE to wait given the UK's external sensitivity, and iv) in signaling the start of a hiking cycle a Fed tightening could push the dollar higher leaving the pound weaker (note our bearish sterling forecasts) – giving the BoE more room to cut.

Figure 14: Macro-economic activity & inflation forecasts: UK

Economic activity (% qoq, saar)	2015				2016				2015F	2016F	2017F
	Q1	Q2	Q3	Q4F	Q1F	Q2F	Q3F	Q4F	% yoy	% yoy	% yoy
GDP	1.5	2.6	1.9	2.5	2.6	2.6	2.5	2.5	2.4	2.5	2.3
Private consumption	3.1	3.7	3.0	2.4	2.4	2.4	2.4	2.4	3.0	2.6	2.4
Investment	6.3	4.2	5.4	4.1	4.9	5.7	5.7	5.7	3.9	5.1	6.0
Gov't consumption	4.4	1.6	5.3	0.0	0.0	0.0	0.0	0.0	2.4	0.8	0.0
Exports	-4.7	7.8	3.6	2.4	2.4	2.0	2.0	2.0	3.5	2.7	1.8
Imports	2.5	-10.4	23.8	1.9	2.6	2.6	2.5	2.5	3.4	4.0	2.2
Domestic demand	4.1	-2.3	7.9	1.7	2.6	2.8	2.7	2.6	2.4	2.8	2.4
Contribution (pp): Stocks	0.1	-1.3	0.9	-0.1	0.1	0.1	0.0	0.0	-0.9	0.2	-0.2
Net trade	-0.6	1.4	-1.5	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.5	-0.2
Industrial production	1.6	2.4	0.8	0.8	0.8	0.8	0.8	0.8	1.2	0.9	0.8
Unemployment rate, %	5.5	5.6	5.3	5.3	5.2	5.1	5.1	5.0	5.4	5.1	4.9
Prices & wages (% yoy)											
CPI	0.1	0.0	0.0	0.1	0.7	1.0	1.1	1.5	0.0	1.1	1.9
Producer prices	-1.8	-1.6	-1.8	-1.2	-0.1	0.1	1.0	1.6	-1.6	0.6	1.9
Compensation per empl.	2.3	2.6	3.0	1.9	2.4	2.3	2.5	3.0	2.4	2.6	3.4
Productivity	0.8	1.1	0.7	0.9	1.7	1.5	2.1	2.1	0.9	1.9	1.8

Source: National authorities, Deutsche Bank Research

The timing of UK rate rises could be impacted by the EU referendum. Currently the referendum bill is going through the upper house, where peers have amended the legislation which – if retained – would allow 16/17-year-olds to vote. This is contentious, as younger voters are seen as more supportive of EU membership. Whether or not this amendment is upheld, allowing 16/17-year-olds to vote could delay the previously expected timing of the vote – either because of the time it takes to register the additional voters or because the bill goes back and forth before the elected Commons finally gets its way to drop the amendment. A pre-summer vote thus looks difficult (given the referendum cannot be held within four months of the bill being passed), with autumn more likely – if not into 2017. The Conservative Party's manifesto pledged a referendum before end 2017.

A delay raises the risk that inward investment is not merely deferred but diverted to other countries. This could be particularly disruptive to growth given that the UK has the largest stock of inward investment globally outside

Figure 15: Other indicators & financial forecasts: UK

	2014	2015F	2016F	2017F
M4 growth, %	-1.1	0.4	2.6	3.5
Fiscal balance, % of GDP, FY	-4.9	-4.0	-2.5	-1.0
Trade balance, GBP bn	-123.7	-124.9	-133.4	-146.0
Trade balance, % of GDP	-5.8	-6.6	-6.8	-7.1
Current account, GBP bn	-92.9	-80.4	-60.6	-60.0
Current account, % of GDP	-5.1	-4.3	-3.1	-3.0
Financial forecasts	Current	Q1-2016	Q2-2016	Q4-2016
Official	0.90	0.50	0.75	1.00
3M rate	0.57	0.58	0.94	1.12
10Y yield	1.93	1.90	2.00	2.40
USD per GBP	1.51	1.42	1.37	1.27
GBP per EUR	0.72	0.71	0.71	0.71

Source: National authorities, Deutsche Bank Research, as of December 07