Inflation rise surprised even the Bank of England – and now interest rate hike looks near-certain

The surprise increase in inflation will give policymakers pause for thought.

Just days ago, inflation appeared to be coming down nicely and some were talking down the chances of another interest rate hike.

However, February's inflation data shows that the scale of the inflation challenge cannot be underestimated.

Although economists – and the **Bank of England** – were expecting the consumer prices index to fall from 10.1% to 9.9%, the headline **rate of inflation actually jumped to 10.4%**.

The increase was driven by food and drink prices. At 18%, they rose at their fastest pace in 45 years in the year to February.

The Office for National Statistics blamed that on supermarket shortages last month, which drove up the prices of vegetables and salads.

Rising alcohol prices in pubs and restaurants – following discounting in January – also drove up inflation.

Even though fuel prices have been coming down, that wasn't enough to offset these increases.

Looking beyond food and energy, which can be volatile, core inflation came in at 6.2%. This was up from 5.8% and suggests economic activity is proving resilient in the face of higher interest rates.

Paul Dales, chief economist at Capital Economics, said: “The reacceleration in overall CPI inflation and core inflation may be enough to tilt the Bank of England towards raising interest rates from 4% to 4.25% tomorrow despite the recent turmoil in the banking system.”

The recent collapse of a number of high profile banks, which fell victim to rising interest rates, had tempered expectations that the central bank may raise rates again.

Concerns about financial stability are still looming large but the jump in inflation will likely cause the Bank to follow in the footsteps of the European Central Bank, which raised rates by 50 basis points on Thursday, taking its main rate to 3%.

The headline rate of inflation in the bloc is running at 8.5%, also well above the central bank’s target of 2%.

Read more:
Price of some groceries has more than doubled in a year
Tesco to cut value of Clubcard reward scheme

In the UK, financial markets now believe there is a 95% chance that the Bank of England will raise rates next week.

That’s up from 50% on Tuesday.

There are some reasons to be hopeful, however. Some of the food shortages should prove temporary so food inflation should come down next month.

Central bankers had another reason to feel cautiously optimistic. The Bank of England closely tracks “core services” inflation – which excludes transport services, package holidays and education.

This undershot its 6.9% forecast, despite rising to 6.7%, from

6.1%.

Samuel Tombs, chief UK economist at Pantheon Macroeconomics, said: “All told, then, the MPC still should be able to confidently predict that CPI inflation will fall sharply over the rest of this year – perhaps even back to the 2% target – steering them away from a significant further increase in Bank Rate.”