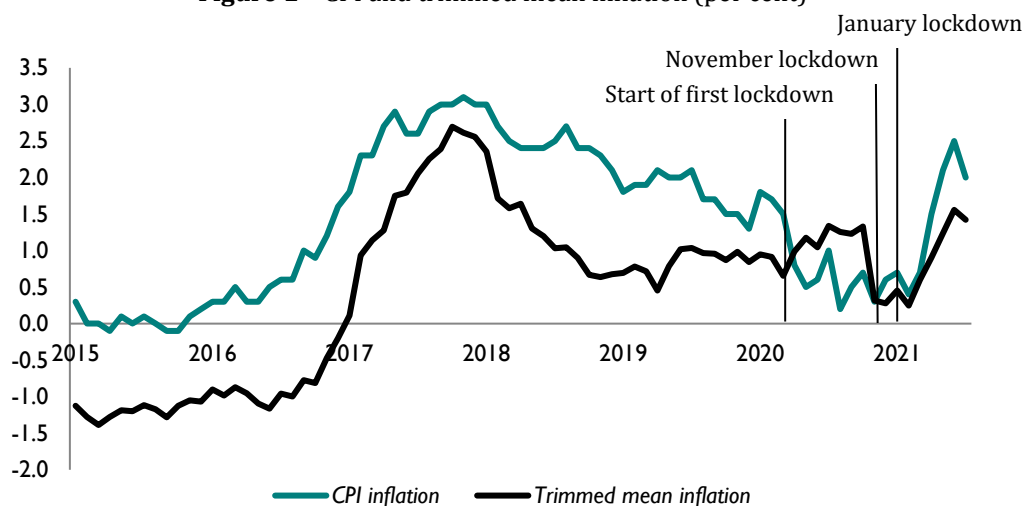


BASE EFFECTS NUDGE INFLATION LOWER

Figure 1 – CPI and trimmed mean inflation (per cent)



Note: Our measure of trimmed mean inflation excludes 5 per cent of the highest and lowest price changes. The level of trimmed mean inflation is typically lower than CPI inflation due to differences in how the largest price changes are treated and to how the prices are weighted. Source: ONS, NIESR calculations.

Main points

- Underlying inflation decreased from 1.6 per cent in June to 1.4 in July as measured by the trimmed mean, which excludes 5 per cent of the highest and lowest price changes (figure 1). Headline consumer inflation decreased by a larger margin, decreasing to 2 per cent in July from 2.5 per cent in June 2021.
- 18.3 per cent of goods and services prices changed in July, implying an average duration of prices of 5.5 months. 5.1 per cent of prices were reduced due to sales, 4.5 per cent fell for other reasons and 8.8 per cent recorded increases (figure 2).
- Our measure of underlying inflation moderated in all but 2 regions of the UK. Underlying inflation in London increased to 3.9 per cent in July, up from 3.7 per cent in June. East Anglia and the North West saw the lowest regional trimmed mean inflation of 0.6 per cent in July (table 1).
- As expected, base effects had a notable downward effect in July and will continue to add volatility to the headline inflation figure in the short term. Based on [NIESR calculations](#), we believe that base effects will boost headline consumer figures in August before trending downward in September.
- Several key transitory effects will put additional upward pressure on headline inflation in the remainder of the year: [shortages in intermediate inputs and ongoing disruption in supply chains](#) have filtered through to consumer goods prices, while labour shortages and the associated increase in wages could also feed through to headline inflation.

- Furthermore, the scheduled increase in Ofgem household energy price-cap in November 2021, in conjunction with the reversal of the 2020 VAT cuts in October 2021 and April 2022, will likely provide further impetus to consumer prices. As such, we expect that headline CPI may be as low as 2.4 per cent in the year to July 2022, exceeding the Bank of England's 2 per cent target.
- To prevent the short-term inflation from feeding into a wage and price spiral, we recommend the Bank of England to revise its communication regarding policy rates and [continuation of asset purchases](#).

“Annual headline inflation decreased to 2 per cent in July from 2.5 per cent in June. As expected, the impact of base effects had a notable downward effect in July, while month-on-month consumer prices remained at the same level as that recorded in June 2021. Our measure of underlying inflation, which excludes extreme price movements, decreased to 1.4 per cent in July from 1.6 per cent in June. Base effects will continue to add volatility to the headline inflation figure, as we expect an upward trend in August before another moderation in September. Several transitory factors will boost headline inflation in the next few months, including the reversal of the 2020 VAT cuts scheduled in October 2021 and April 2022, the scheduled increase in the Ofgem household energy price-cap in November 2021, as well as higher producer input costs filtering through to consumer goods prices. As such, we expect annual consumer price inflation to remain elevated in 2021 before peaking in the first quarter of 2022. To prevent these transitory effects influencing inflation expectations, the Bank of England will need to revise its communication about policy rates and asset purchases.”

Janine Boshoff

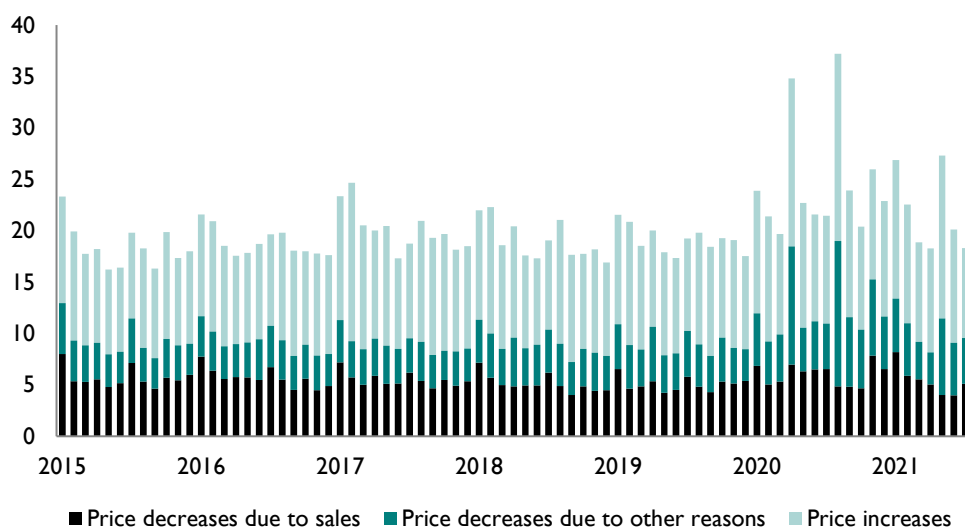
Economist, Macroeconomic Modelling and Forecasting

Commentary

Annual headline inflation decreased to 2 per cent in the year to July 2021, down from 2.5 per cent recorded in June. Consumer prices decreased in all but the transport category, reflecting the short-term volatility introduced by base effects. Our measure of underlying inflation, which excludes the most extreme price changes among 124,816 locally collected goods and services, decreased to 1.4 per cent in July 2021 from 1.6 per cent in June. Most of the 12 UK regions saw a decrease in underlying inflation, with regional trimmed mean inflation highest in London at 3.9 per cent, and lowest in East Anglia and the North West at 0.6 per cent.

Despite the broad-based nature of price decreases this month, we still expect some important transitory effects to place upward pressure on headline inflation in the short-term. Higher producer input prices due to shortages in intermediate goods and ongoing supply-chain disruptions will filter through to consumer goods prices, with labour shortages and associated wage increases providing additional impetus. Consumers will also be affected by the scheduled increase in the OFGEM household energy price-cap in November and, depending on the level of pass-through, the reversal of the 2020 VAT cuts that are scheduled to unwind in October 2021 and April 2022.

Our forecast is for inflation to peak in the first quarter of 2022 and remain around 2.4 per cent in the year to July 2022, above the Bank of England's target of 2 per cent. To prevent inflation expectations becoming unanchored by higher short-term inflation and possibly prompting a wages and prices spiral, we believe the Bank of England should provide [more guidance](#) regarding the instruments of monetary policy going forward.

Figure 2 – Decreases due to sales, decreases due to other reasons, and increases (per cent)**Table 1** – Regional trimmed mean inflation (per cent)

Region	2020						2021						
	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June	Aug
London	-0.1	1.3	1.5	1.5	0.5	0.4	0.6	0.2	0.7	2.2	3.3	3.7	3.9
South East	0.9	0.9	1.1	1.3	0.0	-0.2	-0.1	-0.3	0.2	0.7	1.2	1.6	1.5
South West	0.6	0.7	0.7	0.7	-0.3	-0.5	0.0	-0.1	0.2	0.9	0.9	1.6	1.3
East Anglia	1.4	0.9	0.8	0.9	-0.5	-0.2	-0.1	-0.4	0.0	0.2	0.4	0.9	0.6
East Midlands	2.6	1.8	1.8	1.9	0.9	1.1	1.2	0.9	1.5	0.9	0.9	1.2	0.8
West Midlands	1.1	0.9	1.0	1.2	0.2	0.1	0.2	0.2	0.5	0.8	1.4	1.7	1.6
Yorkshire and the Humber	1.8	1.6	1.4	1.3	0.5	0.4	0.9	0.7	0.8	0.9	1.0	1.1	1.0
North West	1.7	0.9	0.7	1.1	0.3	0.1	-0.1	-0.5	-0.1	0.4	0.8	0.9	0.6
North	2.2	2.0	1.4	1.4	0.5	0.7	0.7	1.3	1.2	0.7	0.6	1.3	1.1
Wales	2.2	2.4	2.4	2.4	1.8	1.7	2.2	2.2	2.2	1.3	1.2	1.7	1.8
Scotland	1.2	1.5	1.1	1.1	-0.1	-0.2	-0.1	-0.2	0.2	0.9	1.2	1.4	1.2
Northern Ireland	2.2	2.1	2.1	2.5	1.6	1.8	1.4	1.3	1.5	1.2	1.7	1.7	1.5
United Kingdom	1.3	1.3	1.2	1.3	0.3	0.3	0.5	0.2	0.6	0.9	1.2	1.6	1.4

Note: Our measure of trimmed mean inflation excludes 5 per cent of the highest and lowest price changes. The level of trimmed mean inflation is typically lower than CPI inflation due to differences in how the largest price changes are treated and to how the prices are weighted. Source: ONS, NIESR calculations.

Notes for editors

This analysis builds on the work presented in the [National Institute Economic Review](#), which constructs a measure of trimmed mean inflation based on the goods and services prices that underlie the consumer price index.

Our next analysis of consumer prices will be published on **15 September**.

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