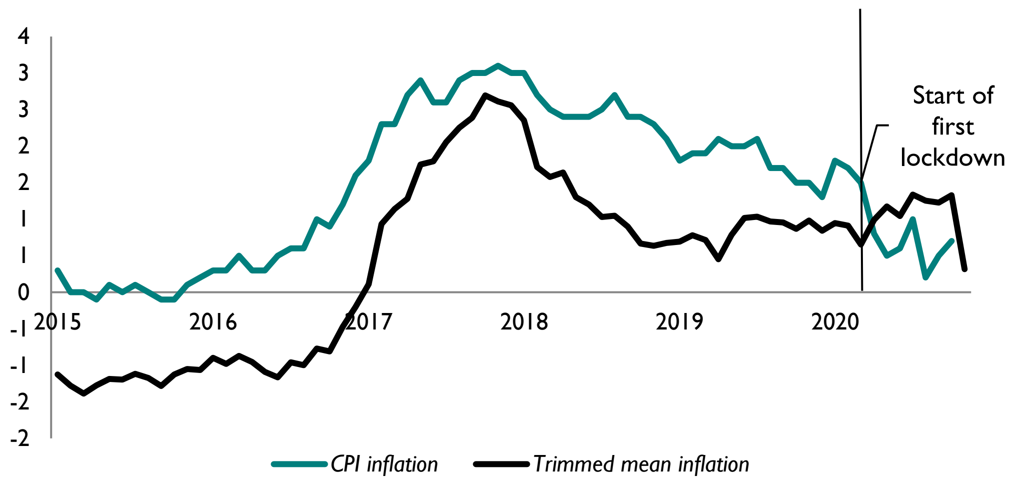
LARGEST DECLINE IN UNDERLYING INFLATION SINCE THE START OF THE PANDEMIC

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 displayed the largest fall since the start of the pandemic, decreasing by 1 percentage point to 0.3 per cent in the year to November 2020, as measured by the trimmed mean, which excludes 5 per cent of the highest and lowest price changes (figure 1).
- At the regional level, underlying inflation was highest in Wales at 1.8 per cent and lowest in the East Anglia which saw a decrease of 0.5 per cent in the year to November 2020 (table 1).
- 26 per cent of goods and services prices changed in November, implying an average duration of prices of 3.9 months. 7.8 per cent of prices were reduced due to sales, 7.4 per cent fell for other reasons and 10.7 per cent were increases (figure 2).
- We expect the downward pressure on inflation to continue in the short-term as we forecast the UK economy to contract in the fourth quarter of the year due to the effects of the November lockdown and increased stringency of restrictions.
- CPI inflation is likely to gradually rise towards 2 per cent in the year to November 2021.

"The November lockdown is reflected in both headline and underlying inflation. Headline CPI inflation decreased to 0.3 per cent in the year to November 2020, down from 0.7 per cent recorded in October, reflecting lower prices in most of the categories during the month. Our measure of underlying inflation, which excludes extreme price movements, decreased to 0.3 per cent in November. Inflation is likely to remain subdued in the short-term as more stringent Covid-19 restrictions will weigh on already weak demand and labour market prospects."

Janine Boshoff
Economist, Macroeconomic Modelling and Forecasting

Commentary

Headline inflation decreased to 0.3 per cent in the year to November 2020, down from 0.7 per cent in October. Our new analysis of 202,011 locally collected goods and services indicates that prices decreased in all categories except for the restaurants and hotels during November 2020. The largest declines were recorded in the clothing and footwear category which was likely impacted by the closure of all non-essential retail the second national lockdown imposed on the 5th of November. Our measure of underlying inflation, which excludes the most extreme price changes, decreased from 1.3 per cent in October to 0.3 per cent in November 2020, reaching the lowest rate since the start of the pandemic. Our December Wage Tracker suggests that the November lockdown and the move to a more stringent tier of restrictions in December will also put a downward pressure on private sector pay growth, implying subdued inflation in the short-term.

Regional trimmed mean inflation indicated that underlying inflation was highest in Wales at 1.8 per cent, and lowest in East Anglia with a contraction of 0.5 per cent. The diverging experience of the different regions will continue to introduce significant uncertainty for households. With London, parts of Essex and Hertfordshire now entering tier 3 we expect that service industries will fare particularly badly during what is normally a high-revenue period. From today, an estimated 34 million people will now be subject to tier 3 lockdowns across England, which does not bode well for the health of the retail and services sector. These industries also provide many jobs, and our analysis suggests that unemployment will likely remain elevated going into 2021 on the back of low demand and ongoing uncertainty in trading conditions for these important sectors. Our analysis suggests that inflation for the rest of the year will stay subdued but will rise gradually towards the Bank of England's inflation target of 2 per cent in the year to November 2021. The possibility of a quicker recovery from the pandemic due to the roll-out of Covid-19 vaccines and a no-deal Brexit might pose upside risks on our inflation forecast for next year.

Figure 2 – Decreases due to sales, decreases due to other reasons and increases (per cent)

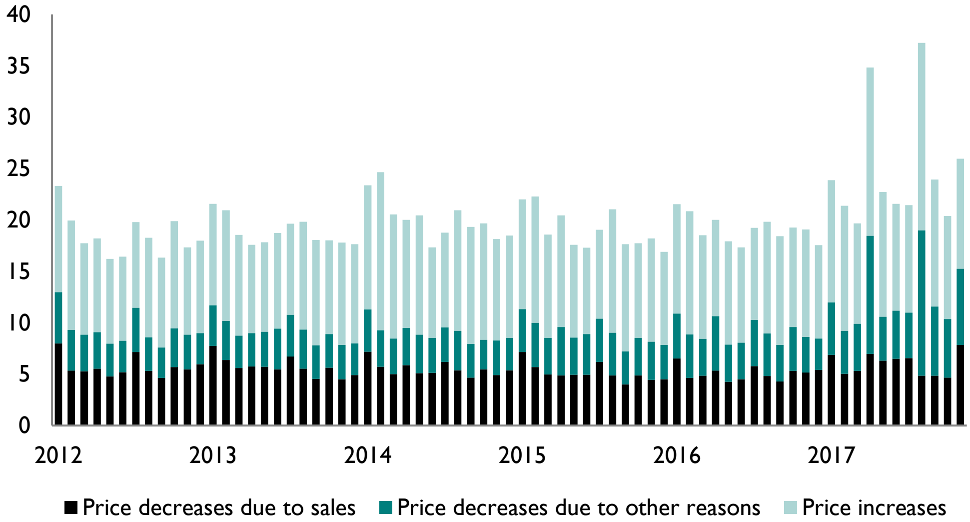


Table 1 – Regional trimmed mean inflation (per cent)

	2019		2020										
Region	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	**Nov**
London	1.2	0.9	1.0	0.9	0.7	-0.2	-0.1	-0.1	-0.1	1.3	1.5	1.5	0.5
South East	0.8	0.8	0.9	0.7	0.6	0.3	0.8	0.5	0.9	0.9	1.1	1.3	0.0
South West	0.7	0.6	0.8	0.7	0.4	0.3	0.6	0.4	0.6	0.7	0.7	0.7	-0.3
East Anglia	1.0	0.9	0.7	0.8	0.4	1.0	1.3	1.0	1.4	0.9	0.8	0.9	-0.5
East Midlands	1.0	0.7	1.1	1.2	0.8	1.9	2.3	2.0	2.6	1.8	1.8	1.9	0.9
West Midlands	1.0	0.9	0.9	0.9	0.7	0.9	1.0	0.9	1.1	0.9	1.0	1.2	0.2
Yorkshire and the Humber	1.1	0.9	1.0	0.9	0.8	1.3	1.5	1.4	1.8	1.6	1.4	1.3	0.5
North West	1.0	0.9	1.0	1.1	0.7	1.1	1.2	1.3	1.7	0.9	0.7	1.1	0.3
North	1.5	1.3	1.2	1.1	0.9	2.7	2.4	1.9	2.2	2.0	1.4	1.4	0.5
Wales	1.0	1.0	1.0	1.0	0.7	2.3	2.5	2.2	2.2	2.4	2.4	2.4	1.8
Scotland	0.9	0.7	0.8	1.0	0.6	0.7	1.0	0.9	1.2	1.5	1.1	1.1	-0.1
Northern Ireland	1.1	0.9	1.3	1.2	1.0	2.1	1.6	2.0	2.2	2.1	2.1	2.5	1.6
United Kingdom	1.0	0.8	0.9	0.9	0.7	1.0	1.2	1.0	1.3	1.3	1.2	1.3	0.3

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 **20 January**.

For further information please contact the NIESR Press Office: Chloe Ridyard or Luca Pieri on press@niesr.ac.uk / 079 3054 4631 / c.ridyard@niesr.ac.uk / l.pieri@niesr.ac.uk

National Institute of Economic and Social Research

2 Dean Trench Street
Smith Square
London, SW1P 3HE
United Kingdom

Switchboard Telephone Number: 020 7222 7665

Website: http://www.niesr.ac.uk