BANK OF ENGLAND

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Dear Jonathan

Proposed RPI contingency plans in 2020 – treatment of missing prices

I refer to your letter of 17 April 2020, which covers the contingency plans in place to ensure that inflation indices can continue to be produced during the Covid-19 pandemic. This follows an earlier exchange of letters on the Office for National Statistics' contingency arrangements for changes to price collection during the pandemic and the associated increase in the proportion of missing prices. The ONS has proposed the following:

- Temporarily carrying forward prices from their last observed value where prices are slow and stable over time;
- Temporarily imputing prices from monthly moves in a similar, parent or the all-items index where prices are not slow moving; or
- Temporarily imputing prices from annual moves in the all-items index where prices are seasonal.

Recognising the need for the ONS to finalise its temporary price collection arrangements ahead of the April collection date, a senior committee at the Bank under my chairmanship has considered whether any of these would constitute a "fundamental change" to the RPI that is also "materially detrimental" to the interests of holders of the 2.5% 2024 and the 4.125% 2030 index-linked gilts. This pertains to the ONS's and the Bank's obligations under Section 21 of the Statistics and Registration Service Act 2007.

Committee members again noted the context for the contingency arrangements under consideration. The UK government rules and advice on social distancing mean many consumer-facing firms have temporarily suspended trading, while changes in consumer demand and supply disruption mean other products are out of stock. That, coupled with safety measures requiring price collectors to stay at home, mean there will be serious challenges compiling consumer price statistics from April onwards. These extremely unusual circumstances have required the ONS to put in place temporary contingency arrangements, until existing procedures can be resumed at some point in the future, to ensure that the RPI can continue to be produced. While these measures are necessary, the Bank has assessed the ONS's proposals in order to comply with its obligations under the 2007 Act.

In that context committee members concluded that temporarily carrying forward prices from their last observed value where prices are slow and stable over time was not a fundamental change to the basic calculation of the RPI when those prices are missing. The committee note that this methodology is already used in a number of instances. For example, some items' prices are known to change infrequently and so are collected on a quarterly basis, rather than monthly.

Similarly committee members agreed that temporarily imputing prices from monthly moves in a similar, parent or the all-items index was not a fundamental change to the basic calculation of the RPI when those prices are missing. The committee noted that imputation is routine practice wherever prices are unavailable. The current circumstances meant that the scale of the imputation would be more widespread than usual, but the underlying approach was unchanged. The committee also noted that the ONS approach is consistent with Eurostat guidance.

As these changes were not fundamental, the question of whether the changes were materially detrimental was not relevant. For completeness, however, the committee considered this question. It noted that the proposals might in principle have a material impact, relative to the counterfactual case in which prices were available, but that it was difficult to know what that counterfactual might have been or therefore what that impact was. For example, it was possible that, because the missing items tended to be in areas where demand was weak, imputing prices from available items would over-state aggregate inflation. There was, at any rate, no reason to suppose the changes would be materially detrimental, even if they'd been judged fundamental to begin with.

With regard to the proposal to impute prices temporarily from annual moves in the all-items index where prices are seasonal, the committee decided that on balance that constituted a fundamental change to the calculation. The committee noted that the proposal would be in line with Eurostat guidance, is likely to apply to only a limited proportion of the RPI basket, and is intended to limit the impact of missing data on the seasonality of the RPI. However, using data from up to a year ago to infer movements in prices in the current month is not standard practice in the RPI, and therefore represented a fundamental change for these items.

Turning to the next element of the assessment, committee members concluded the temporary use of annual moves in the all-items index where prices are seasonal is unlikely to be materially detrimental to holders of relevant index-linked gilts. The proportion of affected items is likely to be small, and the approach was also likely to boost measured inflation in the near-term relative to imputation using monthly changes as many seasonal products saw large rises in prices in the spring and summer months. Finally any seasonal effect should sum to zero over the course of the year.

In summary, the Bank's assessment is that none of the planned temporary changes referenced above were both fundamental changes to the coverage or basic calculation of the RPI and also materially detrimental to the holders of relevant index-linked gilts.

A copy of this letter goes to Vanessa MacDougall and Daniel Gallagher at the Treasury, to Darren Morgan, Grant Fitzner, Michael Hardie and Chris Payne at the ONS, and to Simon Hayes and Rhys Phillips at the Bank of England.

Yours sincerely

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