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Harriett Baldwin MP
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Dear Ms Baldwin,

Thank you for your letter of 8 June 2023 regarding insurance industry inflation. To take your questions in turn:

1. **How the ONS calculates insurance inflation for the purposes of the Consumer Price Index, and whether differences in methodology account for the differences between ONS and ABI measures of inflation.**

Our data sources and methods are publicly available on our website, and you may find our Consumer Prices Indices Technical Manual[1] helpful. As a general point, our inflation measures are designed to capture inflationary pressures only, thus we follow a fixed basket approach. This means we compare like for like each month, and any changes that affect the quality of a good or service are adjusted out. So, for example, in the case of insurance, if a consumer amends a policy to (for example) remove an optional extra then this would be treated as a change in quality, rather than a change in price. This is consistent with international best practice.

The manual explains that the Office for National Statistics (ONS) measures two major types of insurance: home contents insurance and car insurance. The car insurance price index is a combination of two separate indices, one for fully comprehensive insurance and the other for third party, fire, and theft insurance.

Each of these is split further into unpublished price indices for specific car insurance companies. Expenditure data is used to weight these indices together and to ensure that a representative sample of insurers is selected. Each index is constructed from actual insurance price quotes for new policies provided by a third-party company. These quotes are returned for a database of customer profiles. For car insurance, the customers in question cover a wide range of ages, driving experience, regions, and vehicles. For the home contents insurance index customer profiles cover a wide

[1] https://www.ons.gov.uk/economy/inflationandpriceindices/methodologies/consumerpricesindicestechnicalmanual2019

range of regions, the material used for the construction of their house or flat, the number of rooms, the number of occupants and many other attributes.

We strive to continuously improve our statistics and are undertaking a programme of transformation by identifying new data sources, improving our methods, and developing our systems to ensure CPI and CPIH are of the highest possible quality. We are currently working on an ambitious programme to improve prices for used cars, rents and groceries using new, more comprehensive data sources.

Insurance data is one of several areas we are considering for inclusion in future development work. We are in discussions with the Association of British Insurers (ABI) who have provided historical aggregate data. This data is a simple average price of all policies. While the data is more comprehensive as it covers all policies (both new policies and renewals) it does not control for changes in the mix of products bought over time, which means we cannot determine if changes in the average price reflect true price changes or changes in the level/type of cover. This may explain some of the differences between ONS and ABI data and is an area we are looking to explore further.

2. **Whether it is true that ONS insurance inflation is based on quotes, not actual prices paid. If so, what is the justification for using that method?**

The ONS insurance inflation is based on quotes. The international guidance explains that it would be ideal for transacted prices to be used while acknowledging that this is not always possible, meaning that using the advertised prices of products offered for sale is often admissible. As such, it is not uncommon for the ONS to collect advertised prices, in fact we use prices listed on shop shelves, websites or quoted in a call for a wide array of goods and services. The use of price quotes should only distort measures of *inflation* if the relationship between quotes and prices changes significantly; even if quotes are typically higher or lower then final prices paid, there would be no effect on inflation as long as that level difference was consistent over time. We are not aware of any evidence that the relationship between quotes and prices has changed.

An additional consideration for us is the necessity to have timely prices in order for us to be able to calculate monthly indices. Consumer price indices are published within a month of the reference period and are not revised so this places a high bar on timeliness for potential data sources. We have so far been unable to source timely insurance data using prices paid. We are working with the ABI to identify whether there are timely data sources that we could use to calculate CPI .

3. **Your assessment of whether the ONS may be materially overstating the level of insurance inflation actually experienced by consumers.**

Both the ABI and ONS data have advantages and disadvantages. While our methodology controls for changes in the quality or type of product bought in a way that the ABI data does not. Whereas the ABI data covers renewals – a segment of the market not covered by the ONS sample. It's possible that prices in this part of the sector may have fallen following regulatory intervention in 2022, meaning our insurance index may have overstated inflation at the time the change was made. This is less likely to explain divergences in more recent data for 2023. More recent differences between the ABI and ONS measure may reflect changes in the type of insurance products bought by households (where the ONS methodology would give a clearer steer on underlying price changes). However, we cannot draw any firm conclusions at this stage and are seeking more granular data from ABI to help provide us with further insights.

4. The confidence intervals for each of your categories of insurance inflation.

We are currently sponsoring research to provide robust confidence intervals for consumer prices inflation. This work is still ongoing, but early analysis indicates that the standard deviation for annual inflation for 'miscellaneous goods and services', which includes insurance, is a few tenths of a percentage point. However, this is early partial analysis that may understate the true confidence intervals for these statistics.

Please do not hesitate to contact us if there are any further questions.

Yours sincerely,

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