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Terms of reference

- Recommend a framework of consumer price indices that will best meet the needs of users
- Promote statistical standards
- Consider the Cost of Living Index concept
- Consider different sources of data
- Work with the findings of the Smith Review of Governance
Two big ambitions

• To try to provide some clarity over what consumer price statistics are for, and what user needs are
  – *What* should we be measuring?

• Review a whole range of methodological issues including data sources, how quality is adjusted for, the treatment of discounts
  – *How* should we be measuring?
In context of main uses

- Compensation index
- Inflation targeting
- Deflator
- Information
- And crucially use in contracts, including gilts, which means that stability is important
What should we be measuring?
Four main measures of inflation

- **CPI**: National statistic, method set by Eurostat to ensure EU wide comparability
- **CPIH**: As CPI, but includes owner occupiers housing costs on rental equivalence basis. It currently has its national statistics status suspended
- **RPI**: Longest running measure, no longer a national statistic
- **RPIJ**: As RPI but with “corrected” formula for aggregation at the most basic level
They paint very different pictures
For example, over the real level of median earnings.
The future of the RPI

- RPI lost national statistics status in 2013
  - The use of the “Carli” (arithmetic average) at the elementary aggregation stage creates an upward bias
The difference the Carli makes
Recommendations

• Government and others should stop using RPI wherever possible
• UKSA should speak out against its use
• Should continue to be produced only as a legacy index supporting existing contracts, with no changes to methodology
  – In the long run UKSA should look to find ways to discontinue production
Different definitions of inflation

• The increase in prices between period 1 and period 2 (suitably weighted to reflect consumption of different goods and services)
  – Broadly what CPIH does

• The increase in the actual cash outlay required by households to achieve the same consumption between periods 1 and 2 – what some have referred to as a “household index”
The household index

• Would differ from CPIH by, for example, including actual spending on mortgage interest and gross (as opposed to net) insurance premia

• Would not be a coherent population wide measure of “prices”
  – Which may explain why we have been unable to find any example internationally of such an index

• But there is an important issue – different types of households face different changes in the costs they face
  – And a “household index” may be more coherent when applied to sub-groups
Different households have faced very different inflation rates
Recommendations

• ONS should move towards making CPIH its main measure of inflation.
  – CPIH should probably include Council tax
  – Consider legislation governing the production of CPIH

• ONS should develop an annual publication showing inflation as experienced by a range of different household types, along with appropriate advice on what income measures these indices can be compared to.
Different definitions of inflation

• The increase in prices between period 1 and period 2 (suitably weighted to reflect consumption of different goods and services)
  – Broadly what CPIH does
• The increase in the actual cash outlay required by households to achieve the same consumption between periods 1 and 2 – what some have referred to as a “household index”
• The increase in spending required to achieve the same level of welfare in period 2 as in period 1, in the face of rising prices
  – A Cost of Living Index
The Cost of Living Index

• Economically speaking CPI, RPI etc are not COLIs
  – They do not take account of substitution to cheaper goods

• A genuine COLI is very hard to estimate
  – And certainly can't be done in a timely manner

• But approximations are possible and initial work suggests that there is a strong case for pursuing work in this area
  – There might be quite significant differences between a COLI and current measures
Difference between CPI and one approximation of a Cost of Living Index

Percentage points

CPI - Tornqvist Difference
Recommendations

- ONS should continue work on the COLI (superlative indices) and aim to produce annual estimates.
How should we be measuring?
Recommendations

• Data sources
  – ONS needs to make progress in using scanner and web data
  – The source of much weights data – the Living Costs and Food Survey – needs reviewing

• Quality change needs monitoring
  – It is very striking how much difference it makes
Prices and price index for vacuum cleaners
Recommendations

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• Quality change needs monitoring
  – It is very striking how much difference it makes

• The issue of outlet substitution should be considered

• More discounts should be included in inflation statistics
  – Most (e.g. buy one get one free) are currently excluded