
Chair of the UK Statistics Authority, Sir Michael Scholar KCB

Professor David Hand
President
Royal Statistical Society
12 Errol Street
London
EC1Y 8LX

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Dear David

RETAIL PRICES AND CONSUMER PRICES INDICES

When I wrote to you on 6 October 2010, in reply to your letter to me of 25 August, I mentioned that the Authority was assessing the set of inflation indicators against the Code of Practice for Official Statistics and also preparing an independent report, as part of the series of Monitoring Briefs, on how the communication of measures of price inflation could be improved. These two reports have been published on the Authority's website today.

At our last meeting the Authority Board agreed that a statement, which would provide an explanatory overview of these and other recent publications on the RPI and CPI, should be published to coincide with the publication of the Assessment Report and Monitoring Brief and I attach this for your information.

Yours sincerely



Sir Michael Scholar KCB

6 December 2010

Measures of Inflation

The Statistics Authority endorses the conclusions and recommendations of three recently published reports relating to the Retail Prices Index and Consumer Prices Index: the annual report of the Consumer Prices Advisory Committee (CPAC)¹, a formal assessment of these indices against the Code of Practice for Official Statistics² and a Monitoring Brief³ prepared by the Authority's staff.

The Office for National Statistics produces both the RPI and CPI and the related sets of derivative measures, including RPIX (excluding mortgage interest payments), RPIY (RPIX excluding indirect tax changes) and CPIY (the CPI excluding indirect tax changes).

Since the CPI was first published in 1997 (as the Harmonised Index of Consumer Prices), some commentators have spoken of concerns about the possible confusion caused by the different measures seemingly competing for public and media attention. In 2003, a Guardian article⁴ noted that the UK had gone from one measure of inflation in the 1970s to five by 2003, "each measuring something different". In 2009, an Early Day Motion⁵ in the House of Commons called for a review of the different measures. In August 2010, the President of the Royal Statistical Society wrote to the Chair of the UK Statistics Authority⁶ noting various concerns about the different measures. The Statistics Authority believes that different indices may be needed for different purposes but wants to minimise any confusion and to build public confidence in these statistics.

The Consumer Prices Advisory Committee (CPAC) was established in 2009 to advise on methodological matters and is chaired by Jil Matheson, the National Statistician. Its 2010 annual report made two main recommendations:

- ONS should develop owner occupiers' housing costs indices, using the net acquisitions and rental equivalence approaches, for potential inclusion in an expanded CPI within two years.
- ONS should change the method used to measure seasonal items in the CPI and RPI and the new method should be introduced in the February 2011 publication.

The Assessment Report on consumer price indices contains five Requirements, which ONS will need to meet to secure the continued designation of the CPI and RPI as National Statistics. These are to:

¹ http://www.statistics.gov.uk/downloads/theme_economy/cpac-annual-report2010.pdf

² <http://www.statisticsauthority.gov.uk/assessment/assessment/assessment-reports/assessment-report-79---consumer-price-indices.pdf>

³ <http://www.statisticsauthority.gov.uk/assessment/monitoring/monitoring-briefs/monitoring-brief-7-2010---communicating-inflation.pdf>

⁴ <http://www.guardian.co.uk/business/2003/dec/17/politics.economicpolicy>

⁵ <http://edmi.parliament.uk/EDMi/EDMDetails.aspx?EDMID=38850>

⁶ <http://www.statisticsauthority.gov.uk/reports---correspondence/correspondence/index.html>

- take steps to develop a greater understanding of the use made of the statistics; publish the relevant information and assumptions and use them to better support the use of the statistics;
- publish information about the timeliness of the statistics, and how it might be improved;
- Publish information about the history and the reasons for the differences in scope and methods between the CPI and RPI; and explain the implications that these differences have for the uses to which these statistics are put;
- ensure that the planned improvements to ONS's website will improve the accessibility of information on the full range of documents and datasets relating to these statistics; and
- ensure that all releases are issued at 9.30am on the day of release.

In addition the Assessment Report makes some suggestions which are not directly related to the Code of Practice, including:

- Set out a clear official position in relation to developing regional consumer price indices.
- Consult users to assess the demand for supplementary price indices for different household types.
- Consider reinstating some international comparisons in the *Consumer Price Indices* statistical bulletin.

The Monitoring Brief⁷ reviews the communication of inflation more broadly. It notes the use of consumer price indices both as macroeconomic measures of inflation and as compensation indices (for example, for the annual uprating of pensions). It concludes that these uses impose different requirements on the indices and proposes more analysis of the implications for their construction.

It acknowledges debate among experts about the following aspects:

- whether the CPI, as the main macroeconomic measure of domestic consumer price inflation in the UK, should include owner-occupiers' housing costs;
- whether the RPI should continue to use the arithmetic mean to combine prices, rather than the geometric mean which is used by the CPI;
- whether constraints imposed by the Statistics and Registration Service Act 2007 have inhibited ONS from improving the way in which the RPI is constructed;
- the increasing prominence of the CPI in the *Consumer Price Indices* statistical bulletin;
- whether the deliberations of the Consumer Prices Advisory Committee should be more open; and

⁷ <http://www.statisticsauthority.gov.uk/assessment/monitoring/monitoring-briefs/monitoring-brief-7-2010---communicating-inflation.pdf>

- whether a wider range of price indices is needed, including regional price indices and price indices for different household types.

The Monitoring Brief also notes some practical constraints on the future development of the two main measures. Some uses of the indices require continuity in the composition of the indices, while others would benefit from the development of improved measures. It suggests that further consultation with users about these constraints would be helpful. In the context of international practice, the Brief notes that all EU member states have continued to produce their own national measures of inflation alongside the harmonised index and most continue to use the national versions as the main measure.

The Brief observes that the *Consumer Price Indices* statistical bulletin is clearer and better presented than before its recent redesign. However, it suggests that more could be done to clarify for the public and for journalists, some of the more confusing aspects of the current measures. This, it proposes, could be addressed through additional written commentary in the bulletin, including fuller discussion of the uses of the statistics, and further guidance on the suitability of the different indices for particular uses.

It also suggests that the *Consumer Price Indices* statistical bulletin might include more commentary on the impact on inflation of specific external developments - such as the recent (and forthcoming) changes in VAT rates.

Other specific proposals in the Monitoring Brief are that ONS should:

- carry out more analysis of the strengths and weaknesses of the CPI and RPI; including the benefits and disadvantages of using the preferred macroeconomic measure of inflation as a compensation index;
- consult users on whether the current plans for improving the CPI, while maintaining the RPI, represent the best way forward;
- review whether the current practice of issuing three separate monthly publications to release these statistics is the best way to communicate them;
- build on the recent improvements in the *Consumer Price Indices* statistical bulletin by including additional commentary on specific external developments such as VAT changes; drawing attention to any particular significance of the latest figures and including a clear explanation of any major difference between the CPI and RPI headline figures; and
- better support the news media by producing additional material for users and journalists on the differences between a consumer price index and a cost of living index; and considering ways of drawing attention to the messages about inflation statistics that are published in *Economic and Labour Market Review*.

Together these reports establish a substantial programme of work relating to measures of inflation which the Statistics Authority will oversee and periodically report upon.