Template for response

The Authority encourages respondents, where possible, to provide their submissions online.

Where you would prefer to respond via email or on paper, please use this template and return the submission via email to cpi@ons.gsi.gov,uk, or via post to:

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Section One: Measuring prices across the economy

1. Should ONS identify a main measure of price change across the economy?

a

b. No.

1a. Why? Please provide any comments below:

There are many different uses for measures of price changes. It is extremely unlikely that one particular measure would be appropriate for a wide range of users, who have different needs. For example, a measure of inflation which may be acceptable as a general indicator of macroeconomic conditions may well not be appropriate for the purposes of price or cost adjustment in contractual arrangements between well informed parties or the indexation of gilts or corporate bonds or other inflation related financial instruments or derivatives, such as inflation swaps and options, used in trading and hedging inflation.

It is well known that there are different approaches to the development of prices indices, including cost of living, cost of goods, axiomatic, and stochastic and sampling approaches to choice of elementary aggregate formula. Nevertheless, the relative merits of these approaches are still subject to debate among experts and remain the subjects of continuing research.

In many cases, timely publication of monthly price indices is essential for users and, with current processes, this would limit the usefulness of superlative indices which rely on current as well as base period expenditure, even if they were deemed to be theoretically attractive.

Although the Monetary Policy Committee (MPC) inflation target is set in terms of the CPI, the MPC draws on a wide range of external indicators to assess whether inflation expectations remain well anchored. Some of these measures are not direct indicators of expectations for CPI inflation. For example, measures derived from financial instruments reference RPI inflation, and the surveys of households ask about general price movements, not a specific price index. (See Table A “Indicators of shorter-term inflation expectations” and Table B “Indicators of longer-term inflation expectations”, in the Bank of England Quarterly Bulletin 2014 Q2, pp150, 151.)

Similarly, the Federal Reserve explains on its web-site http://www.federalreserve.gov/faqs/economy_14419.htm “policymakers evaluate changes in inflation by monitoring several different price indexes. A price index measures changes in the price of a group of goods and services. The Fed considers several price indexes because different indexes track different products and services, and because indexes are calculated differently. Therefore, various indexes can send diverse signals about inflation.”

The Pensions Protection Fund (PPF) assumes that they will be only able to invest in assets that are linked to the RPI (PPF Long-Term Funding Strategy Update, July 2015). Also, many continuing pensions funds are obliged to pay RPI-linked pensions, at least to existing members, who life expectancy is many years beyond retirement.

Many parties derive market implied projected inflation by using “break-even inflation”, calculated from the difference between the yields on nominal gilts and RPI index linked gilts. There is no corresponding approach possible for other indices of consumer prices, including the CPI or CPIH.

Presumably, the ONS will continue to use different deflators in the production of the National Accounts, where a measure of consumer prices only, would be inappropriate.

It is clear that there is not common agreement on which is the best measure of inflation and, in any event, users should remain free to adopt the most appropriate index for their purposes. There is a risk that the ONS, by identifying a main measure of price changes across the economy, would encourage its inappropriate use, where a different index would be better suited to the purpose. Furthermore, the ONS could inappropriately undermine the standing of other price indices, which continue to have widespread use and acceptance.

If yes:

2. What should this measure be?

a. the CPIH, as recommended in the Johnson review. The CPIH includes owner-occupiers' housing costs. It does not currently hold the *National Statistics* designation (although its re-assessment is due to commence shortly). The index is a UK measure, designed by ONS to meet UK needs.

b. the CPI, ONS's current headline measure. The CPI is an EU measure, designed by Eurostat to ensure comparable consumer prices statistics across the EU.

c. other (please provide details).

2a. Why? Please provide any comments below:

Insert Response

3. Should its production be governed by legislation?

a.

b. No

3a. Why? Please provide any comments below:

In general, it seems inappropriate that individual statistics should be governed by legislation. This would be likely to limit and delay improvements, as well as risking being perceived as undermining the independence of the statistical authorities.

Legislation should generally be limited to setting the duties of the statistical authorities and protecting their independence of government and politicians.

Nevertheless, in the event that legislation were to be applied then it should be of a principles based nature rather than prescriptive in detail.

Section Two: Measuring consumer price inflation for different household types

4. Should ONS seek to measure changes in prices, as experienced by different households?

i. Yes

ii.

4a. Why? How often? Please provide any comments below:

Households experience different impacts from changes in prices depending on their expenditure patterns, geographical location and choice of outlets or suppliers of goods and services.

Annually would seem, currently, the best balance between higher frequency, data availability and resource requirements. Further consideration would need to be given to whether the most appropriate 12 month period should be the calendar year, i.e. January to December, or the financial year, i.e. April to March. In due course, a move to quarterly publication would facilitate their use for a wider range of comparisons, if this could be delivered at reasonable cost.

If yes:

5. How should ONS seek to do so?

i. Using a payments-based approach.
ii. On the same basis as existing measures such as CPI.
iii. Via another means (please provide details)

5a. Why? Please provide any comments below:

For many purposes, a payments based approach would seem more appropriate, as this relates more closely to household expenditure.

Section Three: The RPI

6. Do you use the following indices?

i.	RPIJ[1]	No
ii.	Tax and price Index	No
iii.	RPIY[2]	No
iv.	RPI pensioner indices	No
v.	Component indices of the RPI	Yes
vi.	Any other RPI analytical- or sub- index	Yes

6a. If yes, for what purposes? Please provide any comments below:

Energy price changes are widely used as an input to modelling and forecasting energy demand.

Some analysts estimate "core" or underlying inflation by taking out components, such as food and energy, where price changes are perceived to be more volatile or by putting less weight on components which have historically been more volatile. The Federal Reserve Bank of Cleveland has proposed the use of the median price change (calculated from 45 price categories) and the Dallas Fed calculates the trimmed mean as alternative measures of the inflation trend. Such measures can be useful for understanding the drivers and dynamics of inflation and may be used in forecasting trends in inflation.

The Federal Reserve explains on its web-site http://www.federalreserve.gov/faqs/economy_14419.htm "policymakers routinely examine the subcategories that make up a broad price index to help determine if a rise in inflation can be attributed to price changes that are likely to be temporary or unique events. Since the Fed's policy works with a lag, it must make policy based on its best forecast of inflation. Therefore, the Fed must try to determine if an inflation development is likely to persist or not."

The Fed then continues "policymakers examine a variety of "core" inflation measures to help identify inflation trends. The most common type of core inflation measures excludes items that tend to go up and down in price dramatically or often, like food and energy items. For those items, a large price change in one period does not necessarily tend to be followed by another large change in the same direction in the following period. Although food and energy make up an important part of the budget for most households--and policymakers ultimately seek to stabilize overall consumer prices--core inflation measures that leave out items with volatile prices can be useful in assessing inflation trends."

Analysts undertake similar analysis for UK inflation trends, using a variety of approaches using components or sub-indices. Such approaches to measurement include exclusion-based methods, limited influence estimators, reweighting, and economic modeling. These are often explained in terms of distinguishing signal from noise, or identifying persistent and transitory components of inflation.

7. Do you agree that the below indices should be discontinued?

[1] RPI calculated using formulae that meet international standards
[2] RPI excluding Mortgage Interest Payments an indirect taxes

i.	RPIJ	Yes
ii.	Tax and price Index	Yes
iii.	RPIY	No
iv.	RPI pensioner indices	No
v.	Component indices of the RPI	No
vi.	Any other RPI analytical- or sub-index	No

7a. If yes, why? Please provide any comments below:

RPIJ has only recently been published and appears not to be widely used.

Tax liabilities vary with individual circumstances so it is very difficult to judge the relevance of the tax and price index.

8. Do you have any views on what 'freezing' changes to the RPI should mean in practice? Please provide comments.

The formulae used in calculating the RPI should remain unchanged.

However, improvements in sampling design, data coverage and development of new data sources, such as scanner data and "web-scraping" should continue to be developed and applied, in accordance with best practice.

It would be unhelpful to ignore potential improvements in data sources and collection, data validation, sample design and stratification. In the medium to long term, the potential development of different approaches to gathering data for different price indices could lead to unnecessarily increased costs and should be avoided.

The RPI is widely used by sectoral economic regulators for the indexation of revenues and the regulatory asset value of price controlled utilities. This is used to compensate for the decline in purchasing power of revenues and to offset the increases in the costs of materials and services.

In the energy sector, the regulator, following consultation, has decided to continue to use the RPI in preference to the CPI as the basis for setting price controls for electricity and gas distribution and transmission licensees.

Changes to the basis of calculation of the RPI would necessitate a re-opening of price controls for regulated network operators. A step change in the RPI profile due to a change in the calculation of the RPI could have a significant impact on such companies. This is both in relation to inflation adjustment of cost and revenue items relative to the base year concerned, but also in relation to inflation adjustment of regulatory asset values ('RAV') for the purpose of deriving allowed depreciation and return.

Utilities which are partly financed by RPI-linked bonds would potentially be required to make whole any shortfall in payments to bond-holders, arising from changes to the calculation of the RPI.

Stability and certainty for investors is necessary to keep costs to consumers low at a time of record investment in network infrastructure. Price control agreements will see energy network companies invest up to £41 billion in essential infrastructure by 2021, the cost of which will be recovered over the assumed asset life of 45 years. Revenue allowances of £12 billion for energy network companies are adjusted by price control formulae which are based on the RPI.

Section Four: Evolving Consumer Price Statistics

9. Are the priorities identified by ONS in its forward work plan appropriate?

a.

b.

9a. Why? Please provide your comments below:

The ONS should take into account the recommendation of Professor Sir Charles Bean's review of economic statistics, when these are published.

The ONS should consider undertaking periodic consultation on its proposed work plans, prior to finalisation. The ONS should also seek to engage with a wider range of users when developing its work programme.

10. Should ONS include council tax in the CPIH?

a. Yes
b.

10a. Why? Please provide your comments below:

Council Tax is a significant item of expenditure for many households.