

ADVISORY PANELS ON CONSUMER PRICES – STAKEHOLDER

Minutes**30 January 2017****Board room, UK Statistics Authority, Drummond Gate, Pimlico, London SW1V 2QQ
10.30 - 13.00****Present**

Dame Kate Barker (Chairman)	Mr Ian Rowson (Ofgem)
Mr Jonathan Athow (ONS)	Mr Geoff Tily (Trades Union Congress)
Mr Richard Barwell (BNP Paribas)	Ms Sally West (Age UK)
Ms Joanna Konings (Bank of England)	Mr Matthew Whitaker (Resolution Foundation)
Ms Jill Leyland (Royal Statistical Society)	Mr Rupert de Vincent-Humphreys (via phone)
Mr Christopher Payne (ONS)	

Secretariat

Dr James Tucker (ONS)
Mr Jonathan Lewis (ONS)

Apologies

Mr Jamie Bell (Bank of England)
Mr Steve Farrington (HM Treasury)
Mr Mike Prestwood (Office for National Statistics)
Mr Andrew Sentance (PricewaterhouseCoopers)
Mr Nick Vaughan (Office for National Statistics & Chair of the Technical Panel)

1. Introductions, apologies and actions (Paper APCP-S(17)01)

- 1.1 The Chairman welcomed attendees to the meeting. A round table of introductions followed.
1.2 The Chairman covered the actions from the previous APCP-Stakeholder (APCP-S) meeting held on 09 September 2016. An update on progress for each of the actions is provided in Table 1 below.

Table 1

No.	Action	Person Responsible	Status
1	Mr Payne to forward Dr. Mark Courtney's note to Stakeholder Panel members.	Mr Payne	Complete
2	Stakeholder Panel to provide ONS with their comments regarding the OOH article.	Stakeholder Panel members	Complete
3	ONS to review their timeline for releasing the OOH article and how this article will fit alongside the	Ms Flower	Complete

	compendium.		
4	Ms Flower to send Mr Farrington the full QAAD for Prices.	Ms Flower	Complete
5	ONS to redraft Council Tax article and circulate to panel members prior to publication on ONS website	Mr Payne	Complete
6	ONS to circulate current revisions policy to panel	Mr Prestwood	Complete
7	ONS to circulate proposed dates for 2017 meetings to panel	Mr Lewis	Complete

- 1.3 There was a discussion about the wording of the previous minutes; the line was that *“the majority of panel members felt strongly that this index could not be released without a comparable measure of income.”* It was felt that the panel were mixed on the point rather than it being a majority.

Action 1: Change wording of previous Stakeholder minutes to reflect comments of panel members

2. Terms of Reference (Paper APCP-S(17)02)

- 2.1 A panel member asked for confirmation that a parallel discussion about the terms of reference had taken place at the Technical Panel. Mr Payne responded that a similar discussion was held regarding whom APCP are advising, and therefore to whom the annual report should be pitched. The Technical Panel’s view was that it was advising the National Statistician. The report would be published following the final APCP meetings in September, and prior to the UK Statistics Authority Board in December, at which point the National Statistician may choose to present recommendations from the paper.
- 2.2 Clarification was sought that the annual report would be published; Mr Payne confirmed that it would be.
- 2.3 A panel member asked if there was a reference or link to the APCP area of the UKSA website on the ONS site. Dr Tucker replied that there was, but perhaps it could be made clearer, which ONS will look into for the Consumer Price Inflation bulletin in March.

Action 2: ONS to introduce a link from the Consumer Price Inflation bulletin page to APCP material.

- 2.4 It was asked if the Technical Panel were changing their terms of reference. When Mr Payne replied that they were, it was commented that the stakeholder terms should be kept in line with the Technical Panel. The panel agreed with this point.

- 2.5 It commented that the terms of reference state that the panels provide independent advice to the chief executive. It was agreed by panel members that this should refer instead to the National Statistician.
- 2.6 One of the panel mentioned that they represent a body of organizations and would like to share papers more widely before the meeting to allow discussion of papers with them ahead of the meeting. Mr Athow agreed to a case by case basis for paper distribution.

3. RPI and CPI: A tale of two formulae (Paper APCP-S(17)03)

- 3.1 Mr de Vincent-Humphreys had been invited to present to the Stakeholder Panel the work he had previously presented to the Technical Panel on 20 January. He talked through his presentation, highlighting issues pertinent to the measurement of clothing prices in consumer price indices. He pointed out that clothing accounted for about half of the post-2010 'formula effect' difference between CPI and RPI inflation, even though it comprised only about 5% of the indices by weight; it was not unusual for measured CPI and RPI inflation rates to differ by as much as ten percentage points, even though they are both calculated from the same set of prices. He noted that one could infer from this that the distribution of price relatives for clothing must be significantly wider than for other items in the CPI basket. ONS are able to carry out work to assure this is the case.
- 3.2 Mr de Vincent-Humphreys pointed out that the unusual width of the price relative distributions for clothing items was often attributed to January sales, but there was another factor which seemed to be at least as important: the high product turnover in this sector. For the data sample he presented, only about 15% of the specific garments for which prices had been collected at the start of the year, were still present in the shops the following year. This meant that for the other 85%, the price collectors had to find replacement items. Mr de Vincent-Humphreys presented a simulation to show that the subjective decision of the price collector as to whether a replacement clothing item was comparable or non-comparable could have a potentially large impact on the price index, and that the RPI (using the Carli formula) was particularly sensitive to this.
- 3.3 A member asked why the non-comparable flag had stopped being used. Mr Payne responded that in 2010 price collections were struggling to track an item through time because definitions were so strict that you couldn't get a match throughout the year. In 2010 the definitions were broadened to rectify this.
- 3.4 Another member questioned why this kind of comparability question hasn't been discussed before. They asked whether the new advice being given to price collectors on what to collect or not to collect was the fundamental source of the problem. Mr de Vincent-Humphreys responded that the revised guidelines in 2010 included a number of elements; it was an action point from the Technical Panel to circulate actual guidelines. One of the main points of this presentation is the comparability. As you get further through the year, because of the high turnover if you want to compute a base price, you aren't comparing with the same item as is the case with a more timeless product, e.g., a loaf of bread.

- 3.5 The panel discussed how this analysis would have behaved prior to 2010. The consensus was that RPI was systematically greater than CPI post 2010 which suggests that RPI overstates inflation. It was commented by a member of the panel that prior to this both may have been understating inflation. Mr de Vincent-Humphreys commented that high product turnover in clothing and footwear had always been an issue, and that its effect on the distribution of price relatives had become more pronounced in 2010 after the collection changes which were introduced to correct a clear downward bias in both the CPI and RPI clothing inflation rates.
- 3.6 A discussion was had over the broader point of whether items that are not replaced show less price movement, and therefore whether by using the methodology of finding comparable items, a lot of noise was being introduced into the data. Mr de Vincent-Humphreys agreed that there is an issue of how well a fixed base price index can measure changes in price level when introducing a new product of a higher price during the year.
- 3.7 It was commented that whilst the presenter had mentioned two reasons for the large formula effect for clothing (January sales and the introduction into the sample of items lack of comparability) there was the potential for noise in the data if something comes onto the market at full price but doesn't sell, then it gets discounted and a new item comes in at higher price. This is an overarching point in that due to high product turnover there is a lot of noise in the data. Also there is the issue of working with a small data set. The point was also made that the nature of the price collection means that you can't get a great deal of detail on the comparable replacements.
- 3.8 The point was made that what changed in 2010 was how replacements were classified. Approximately third of replacement clothing items had been classed as non-comparable before 2010, and therefore treated differently in the price index calculations. From 2010 onwards all replacement clothing items have been classed as comparable, and thus processed in a different manner. A member asked what happened to non-comparable items in the price index calculation. Mr de Vincent-Humphreys replied that for a comparable replacement item, inflation is calculated relative to the January price of the original item, but for a non-comparable replacement item there is an intermediate calculation to impute what its price in January would have been, and that inflation is calculated with respect to this imputed base price.
- 3.9 A member commented that one way of thinking of the results is that the difference between formulae shows an issue with clothing, and does not make any point about the strengths, weaknesses or differences between the Carli and Jevons formula. It was commented that the Jevons formula seems to flatten the index, and is converging on the items with the least variability.
- 3.10 Mr Athow raised the question over whether other goods will start to see the trends now apparent in clothing, in particular digital products, which have lots of variability and items going on and off sales. Clothing could be the lead sector in showing characteristics which might be applied to other sectors.
- 3.11 It was discussed that the treatment of prices have direct fiscal consequences and that ONS should think carefully about what goes in the basket, and that it should have a policy in place to ensure that it is known what the effect of an item will be on the formula effect before going into the basket.

- 3.12 Mr Athow responded that the answer might lie in more granular data sets. Some of these effects can seem to be taken out by larger data sets, which do start to model the solution you get through hedonics, and it may be that the answers lie in that strategic direction. The panel members discussed this point, and the consensus was that a larger data set did provide benefits such as the ability to keep prices in reserve as with the rental indices, and the use of alternative methodologies.
- 3.13 A member made the point that hedonics should be used sparingly, and perhaps ONS should think more radically about how clothing prices are collected, aiming for items that don't change that much. It was agreed that, while it could be argued that some items were very problematic in measurement terms, the basket still does need to be representative. The point was also made that the collection methodology could perhaps be reviewed.
- 3.14 It was suggested that the items in this experiment will be similar in one year as they would in another year. Broadly speaking they are all the same year in year out and the prices balance out over time. That philosophy may be more tenable for clothing than say digital products, which do change over time and so are not the same year after year.
- 3.15 It was commented that prior to 2010 the CPI possibly understated inflation but now looks more plausible; however since the change, clothing RPI has ceased to be plausible. It was argued that whilst panel members agree that RPI is implausible, we don't know that CPI is plausible, only that it looks like the EU aggregate; it's possible that the other EU countries could have similar issues.
- 3.16 The chairman summarised by stating that it was understood that ONS has recognised this issue, and made a sensible change to CPI, however this change isn't good for RPI. The general consensus was that larger datasets could help to resolve this issue.

4. Readdressing the formula effect (Paper APCP-S 17(04))

- 4.1 One of the panel members commented on the paper's conclusions that there is little scope to make changes to RPI. They commented that they'd always felt unhappy about that, because if some pension funds, for example, are obliged to pay RPI increases each year, it is important that this is an appropriate measure. If you want to ensure CPIH keeps up with new products, and it makes the RPI/CPI gap larger, surely that is a reason for improving RPI.
- 4.2 It was observed that there seems to be two restraints. The first is what's in the legislation, which decrees what is a fundamental change in RPI. It was agreed that this seems to be sensible. The other issue is the 'freezing' of RPI. The latest statement is that the RPI needs to remain fit for propose. A member observed that it seems as though this could be addressed without there being an issue with the Act.
- 4.3 The Bank of England reiterated that the letter from Sir Charles Bean to Tony Cox, which explains the procedure and criteria used by the Bank of England to determine what constitutes a fundamental change to RPI, is the best guide for this, and it would be wrong to second guess a future decision by the Bank. The agreed consensus was that the process exists to tell people what is happening to their index linked gilts. The ONS however should propose what it believes to be right for RPI.

- 4.4 It was suggested that rather than improving RPI, there could be a switch from using it. However it was pointed out that for some RPI is a legal obligation at present. It is important to be aware that this issue exists, and that there are constraints on what changes can be made.
- 4.5 Another member stated that the letter does not help them as it is not obvious whether certain changes, such as removing the volatile items in the micro data deliberately which cause an issue, such as those presented in the previous paper, would constitute a fundamental change. They stated that there should be a public policy interest in the formula effect.
- 4.6 The point was made that a larger dataset would be a more sensible move for these kinds of items than removing them, and that it was unclear whether this would constitute a fundamental difference. A member stated that moving to larger data sets could be a way forward to improve the formula effect, and that they don't see this as a fundamental change. The perception of the letter was that the changes should have an impact and also be a change in coverage, and they didn't think that their proposal of removing items that were an issue would be a change in coverage. It was also observed that it suggests that web-scraping and other alternative data sets couldn't be used in RPI at all. Mr Athow pointed out that while he's not suggesting that this shouldn't be done, it's quite problematic and it's a fundamental set of issues that are being discussed which are rather complex.
- 4.7 It was discussed whether taking out problematic items and replacing them with different items would constitute a change in coverage. There was differing opinion on this. A member emphasised again that a change in public policy is needed rather than having a case by case basis for including or taking out items.
- 4.8 Mr Athow stated that there needs to be a greater understanding of these issues and proper analysis needs to be completed.
- 4.9 There was a request to see the clothing price collection guidelines before and after 2010.

Action 3: ONS to share clothing price collection guidelines before and after 2010

- 4.10 The same member suggested that it would also be interesting to look at how this data would look before changes in collection both for this item and potentially a wider variety of items

Action 4: ONS to recreate Mr de Vincent-Humphreys table of price changes for other years, particularly pre 2010

- 4.11 A further suggestion was made to draw upon the work done on clothing in 2011 and 2012. ONS agreed to review previous work before undertaking future research.
- 4.12 The chairman made the point that the panel is free to ask the National Statistician to look into this, but that he is not obliged to take the advice of the panel. The chairman suggested that the panel, and possibly the Technical Panel as well, write a letter to the National Statistician expressing the concerns about the issues raised in this discussion, to get the debate into the public domain.

5. Population Sub Groups (Paper APCP-S 17(05))

5.1 The chairman posed the questions from the paper to the table, those being which population sub groups would be useful, and would democratic or plutocratic weights be preferable when considering subgroups for both CPIH and the HCIs. There was support for plutocratic weights, however one member pointed out that democratic weights would be more suitable for the Household Costs Indices.

5.2 There were many suggestions for what sub groups could be looked at, including;

- retired/non-retired,
- with/without children,
- urban/rural
- Regional due to the effect of London.

It was also suggested that these could be separated by income deciles, and that those who owned their house outright could be separated from those paying a mortgage as they have a different experience of house price movement. A member made a further point that it depends on what the government needs.

5.3 A member made the point that some of the representativeness, such as rents and owner occupiers, were not split evenly. Mr Athow mentioned that this was due to the sample size, but there is still a degree of uncertainty. It was suggested that it would be helpful for ONS to think of the resource requirement of making a lot of cuts to the data cuts and feasibility of some cuts given the available data and sample sizes. There was agreement around the table on this point.

5.4 Mr Athow said that he would take away the suggestions and preferences for population sub-groups, and come back to the panel with what can be done.

Action 5: ONS to clarify which population sub-group data cuts would be feasible

6. AOB and date of next meeting

6.1 At the next meeting Ms Leyland would like to talk more about the concept of household payments and will produce a paper.

Action 6: Add paper and discussion on concept of household payments to agenda for next meeting

6.2 The next meeting will take place on 31 May 2017

Actions

No.	Action	Person Responsible	Status
1	Change wording of previous Stakeholder minutes to reflect comments of panel members	Jonathan Lewis	
2	ONS to introduce a link from the Consumer Price Inflation bulletin page to APCP material	James Tucker	
3	ONS to share clothing price collection	James Tucker	

	guidelines before and after 2010		
4	ONS to recreate Mr de Vincent-Humphreys table of price changes for other years, particularly pre 2010	Chris Payne	
5	ONS to clarify which population sub-group datacuts would be feasible	Chris Payne	
6	Add paper and discussion on concept of household payments to agenda for next meeting	Jonathan Lewis	