ADVISORY PANELS ON CONSUMER PRICES - TECHNICAL

Minutes
10 May 2016
Board room, UK Statistics Authority, Drummond Gate, Pimlico, London SW1V 2QQ
10.30 – 13.00

Present

Mr Nick Vaughan (Chair - ONS)
Mr John Astin
Prof. Bert Balk
Mr Josh Beeson (ONS)
Prof. Alberto Cavallo
Mr Rhys Lewis (ONS)
Mr Mike Prestwood (ONS)
Dr Jeff Ralph (ONS)
Prof. Sir Stephen Nickell
Mr Paul Smith
Dr Martin Weale
Mr Joe Winton (ONS)

Secretariat
Mr Chris Payne (ONS)
Ms Tanya Flower (ONS)

Apologies

Prof. Ian Crawford
Mr Rupert de Vincent-Humphreys (submitted written comments prior to meeting)

1. Introductions, apologies and actions

1.1. The Chair welcomed attendees to the APCP-Technical (APCP-T) meeting. He reminded members that they were appointed for their technical expertise and that the panel is advisory. A round table of introductions followed.

1.2. The action from the previous meeting to update and publish the Terms of Reference for the APCP-T meeting was signed off as complete by the Secretariat. The Terms of Reference and papers for previous meetings are available on the UKSA website.

2. European Compliance (Paper APCP-T(16)04)

2.1. Mr Winton provided an overview of the impact of implementing two changes into the CPI and CPIH to meet EU regulations. The first is the method of double price uprating recommended in an independent Eurostat review and the second is the implementation of COICOP5 (Classification of Individual Consumption According to Purpose), otherwise known as ECOICOP

in other European countries. Members were invited to discuss the changes and endorse the proposed approach.

> Action 1: Mr Tucker (APCP-S Secretariat) to circulate the Eurostat paper to panel members.

2.2. As the paper states, the first change is required because of a divergence between UK and European cycles for updating weights. Members noted that to have two separate collections for the CPI and RPI would not be resource effective for the ONS. Additionally, the HICP would not be able to be separated from the CPI production system in time for 2017. Therefore, the proposed method of price updating is a sensible solution to the current inconsistency with HICP methodology. The importance of addressing this inconsistency, and having the same type of index for the whole year[1] should be stressed in future publications.

2.3. While this is currently the best approach, members also noted that there is unusual pricing behaviour in both December and January due to the traditional sales around Christmas time, and therefore if one was to redesign the methodology completely, a different month should be chosen as the base month. One member highlighted the relative merits of using an annual base to better represent expenditure across the year, as some European countries do in their national indices.

2.4. Finally, members discussed the problem that, given the new method requires two sets of weights to be calculated for each year, this contravenes another Eurostat requirement to only update HICP weights once a year. This has been agreed with Eurostat but has not been formalised. One could argue that this depends on the interpretation of the word "weights": as the new method generates a Lowe index for the whole year, this could still be seen as a fixed basket approach.

> Action 2: ONS to formalise the agreement with Eurostat that the UK can contravene the regulation that requires HICP weights to be changed only once a year

2.5. The second change that is required is to add in a new level of disaggregated indices at the COICOP5 level (between the existing class, COICOP4, and item level indices). Most EU countries have already implemented the COICOP5 structure. The ONS proposal to chain link at the item level rather than higher up the aggregation structure future-proofs the method against any further changes to the COICOP structure.

2.6. The panel concluded that the double price update should be implemented in 2017 for the CPI and CPIH (and therefore, the HICP by default). Panel members also endorsed the approach to implement the second link at the item level.

3. CPIH Assessment (Paper APCP-T(16)05)

3.1. Mr Vaughan invited panel members to discuss the early drafts of two articles (the 'CPIH Compendium' and the 'Comparison of Measures of OOH in the UK').

3.2. Panel members were unanimous in their view that although they agreed it was necessary and helpful to provide a compendium for CPIH, including a timeline of decisions and a summary of the key arguments both for and against the different approaches, it is not necessary to re-open the discussion on what the best approach is for measuring owner occupiers housing (OOH) in

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[1] Under this method, the HICP is now a Lowe index for the whole year, rather than being Lowe in January, and then a Young index for the rest of the year.

the CPIH. It was felt that the evidence had already been covered in great detail by the Consumer Prices Advisory Panel (CPAC), and there was little further to be learnt.

3.3. While one member did not have objections to using the rental equivalence approach in the CPIH, they did express the view that it should not be used for an uprating index. While it is not for ONS to set policy, the panel member felt that the appropriate uses of each index should be made clearer.

3.4. In light of these views, the rest of the discussion focused on suggestions to enhance the articles for users ahead of publication on the ONS website. In particular:

- It should be made clearer that CPIH was de-designated as a National Statistic because of issues with the source data, rather than the choice of method to measure OOH.

- One of the main arguments against rental equivalence is that movements in rents over time do not correspond to movements in house prices. The paper should more clearly state that rents are a proxy, but this does not conflict with the general economic principles of the rental equivalence method.

- ONS need to better account for why these figures differ from perceptions, especially with regards to experiences in London. Worked examples were suggested. This is important for the credibility of the CPIH series. There are good explanations for these differences, but these need to be stated more clearly in the paper. For example, not doing the adjustments for newer properties (as the ONS measure is a stock variable rather than flow) is an explanation you can use to explain why the data would differ from perceptions.

- It is not clear in the paper if the OOH uses representative rental data for the calculation. For example, if we look at the range of housing on the market, there would be a large proportion of lower quality rental properties, but this shouldn't be reflected in the owner occupied housing data which should reflect the larger proportion of higher quality properties.

- ONS has applied the rental equivalence method to Countrywide data and got similar results, this is important to highlight for the credibility of CPIH. The VOA is also looking to further develop rental indices, ONS should continue to work with VOA to ensure consistency.

- Members also questioned the parameters on the tolerance check for excluding sample matches. In particular, some large changes may occur when tenants move out after a long time period of stable rents, and these may be excluded from the results. While preliminary investigations have shown this to not be a problem, the paper should have more empirical evidence to add credibility to these arguments. For example, sample size and average rentals for each property type could be included.

- The algebra can be brought together in a separate section in the Compendium.

- A clearer explanation is required for the net acquisitions approach, in particular what it covers. With the current trends in falling owner occupied housing stock, pure net acquisitions should be falling (although this is mitigated by additions to the net acquisitions series such as stamp duty and additional building work). If an owner occupier sells a house to a private landlord for buy-to-let purposes (the landlord could still be another household), this should be recorded as a negative net acquisition. Correct expenditure weights are therefore very hard to calculate, as the National

Accounts do not specify who the transactions are between. ONS need to more clearly specify how these weights are derived.

- There were two drafting comments from a panel member. Firstly, there should be a clarification on the first FAQ on views accepted within the international community (net acquisitions are used in Eurostat) and for the second FAQ, it should be "a number of approaches", rather than "a number of equally valid theoretical approaches". The member also highlighted that it should refer to a "change in asset values" rather than just "asset values" throughout the article.

Action 3: Mr Lewis to circulate a note on the methodology currently used to calculate the net acquisitions measure of OOH.

3.5. A separate methodological question was raised that related to the Agenda item 2. The current method for calculating the OOH expenditure weights is not consistent with the double price update methodology that is proposed in Paper *APCP-T(16)04*. The index cannot be interpreted as a Lowe index because prices are only price updated to year t-1, rather than the January of year t. This is not in line with the rest of CPI and CPIH, and will need to be resolved.

Action 4: Mr Lewis will conduct a feasibility study into implementing the double price update in the OOH methodology.

3.6. The Chair thanked the panel members for their helpful suggestions and concluded that ONS will present updated drafts to the panel for comment in the September meeting.

4. Draft Work Programme (Paper APCP-T(16)06)

4.1. Mr Prestwood invited panel members to discuss the draft work programme for consumer price statistics, in particular to focus on whether the draft work plan covers all necessary areas for work and the relative priorities of these projects.

4.2. Members debated whether or not the research into the Household Inflation Index (HII) should be separate to researching the measurement of income and price change as experienced by different household groups. In particular, there is a risk of confusion if the inflation rates for different sub-groups are published on a CPI basis, which is separate to the idea of a HII index used for uprating purposes. Members concluded that the work is based on two separate strands: 1) the concept and purpose of the HII; and 2) what socio-economic sub-groups the indices should be related to. Therefore, they should not be part of the same work package but the work should be coordinated. The eventual outputs should form coherent parts of the explanation of the family of price indices.

4.3. There was general agreement among members that the work plan covered all necessary areas with the relevant priority. However, it was also noted that it was surprising that there was not more interest in calculating temporal regional indices, as well as the spatial collection which is due to take place this year. This has a number of potentially important policy implications, and may come to the fore given the increasing appetite for devolution. One member also suggested the clothing work should be given higher priority over developing alternatives to the use of RPI data. Finally, it was also suggested that the quality adjustment work focus more strongly on the services sector, and this should be made clearer in the draft work programme.

4.4. In terms of resources, members suggested that this was a very ambitious programme of work for a relatively small team. ONS could subcontract some of the work to academics as part of the new Economic Statistics Centre of Excellence, as suggested by the Bean Review.

4.5. Finally, panel members also questioned the input of the panel into these work streams, in particular providing comments on research papers and publications. Members were happy to see papers circulated outside of the formal meeting arrangement if timings were an issue, and to see research papers not directly related to what is discussed at meetings.

Action 5: Mr Payne to circulate a list of upcoming publications and identify where ONS would like engagement with the panel before publication.

5. Smoothing Volatile Weights (Paper APCP-T(16)07)

5.1. Mr Beeson presented ONS research into a method to smooth three volatile weights in the CPI, as recommended by the Johnson Review. The three classes (gas, fuels & lubricants and package holidays) were identified as potentially needing smoothing because the actual expenditure is volatile, rather than volatility created by National Accounts revisions and balancing adjustments. Members were invited to comment on the proposed method.

5.2. Panel members discussed the decision to select three items out of the CPI basket for smoothing. On one hand, it is not encouraged to have separate smoothing techniques applied to different items and there are questions over how the items are selected. On the other hand, the logic of different smoothing methods for different classes does make sense in terms of adjusting for the stationary volatile components (for example, the impact of the weather on gas). It is also inefficient to derive a smoothing method for each individual COICOP class. Finally, some classes may have longer-run trends in weights that smoothing may distort.

5.3. Members also commented on the methodology presented by ONS. In particular, although it is mentioned in the ILO manual, three years is an arbitrary period over which to take an average and more weight could perhaps be put on more recent periods. Nowcasting expenditure could also be considered. Another suggestion was to take a single vintage of National Accounts data and apply the smoothing techniques.

Action 6: ONS to continue researching the best methodology to use to smooth volatile weights.

5.4. In summary, panel members did not feel strongly about the proposed option and were either of the opinion that smoothing was not necessary from a conceptual view as the differences can be explained, that there weren't strong arguments for either case, or that further research was required before they could give their judgement.

6. AOB and date of next meeting

6.1. There were two topics for discussion under AOB: a chance for the panel to respond to Mr Courtney's comments on the minutes from the APCP-T meeting held on the 22nd January, and a steer from the panel with regards to how they wish to be involved in any issues raised by users on various forums.

6.2. The panel members welcomed Mr Courtney's comments but agreed that rather than changing the published minutes, a short note should be written and circulated that summarised the panel's response. Members felt strongly that once this note was written, the matter should be considered closed.

6.3. Mr Prestwood questioned panel members over whether the panel wished to see proposals raised from stakeholders on forums such as Statsusernet. The general agreement among members was that it depended on the subject. On areas where there has already been extensive consultation, there is not a need to take proposals to the panel. If other topics of interest are raised and have not been considered previously, these can be taken to the panel on a case by case basis.

6.4. The next meeting will take place on 1st September.

Actions

No.	Action	Person Responsible	Status
1	Mr Tucker to circulate the Eurostat paper to panel members.	Mr Tucker	
2	ONS to formalise the agreement with Eurostat that the UK can contravene the regulation that requires HICP weights to only be changed once a year.	Mr Tucker	
3	Mr Lewis to circulate a note on the methodology currently used to calculate the net acquisitions measure of OOH.	Mr Lewis	
4	Mr Lewis will conduct a feasibility study into implementing the double price update in the OOH methodology.	Mr Lewis	
5	Mr Payne to circulate a list of upcoming publications and identify where ONS would like engagement with the panel before publication.	Mr Payne	
6	ONS to continue researching the best methodology to use to smooth volatile weights.	Mr Payne	