

The Conceptual Foundations of the Household Costs Indices

Thursday 25 April 2019 10:00-14:00

The Household Costs Indices (HCIs) are a new set of consumer price statistics currently being developed by the Office for National Statistics ([ONS](#)). They aim to capture changing prices and costs as experienced by different household groups. They can be thought of as reflecting the change in households' monthly cash outgoings for a fixed basket of goods and services. The first HCIs results were [published](#) on an experimental basis in December 2017, with the second set of preliminary results due to follow in Spring 2019. The indices are based on [Astin & Leyland \(2015\)](#) which proposed a number of departures from the current approach to measuring inflation used in CPIH and CPI, and follows the basic principle that price changes should be captured when the good or service is paid for rather than when it is acquired or used. This includes using a mortgage interest-based measure of owner occupiers' housing costs. Another key proposal is the use of democratic expenditure weights, which reflect the expenditure of the average household rather than the total expenditure in the economy.

The HCIs can be contrasted with ONS's current headline measures of inflation, which tend to reflect the change in ticket prices of goods and services acquired for the purposes of consumption in the UK economic territory. Other major points on which HCIs could potentially diverge from CPIH and CPI include repayments of student loans, some or all of the capital element of house purchase (and major renovations and extensions), contributions to pension funds, treatment of certain quality changes or even income tax and national insurance. These, and interest payments, are normally excluded from consumer price indices on the basis that they do not represent consumption expenditure. The suitability of including capital costs and interest payments in the HCIs has been widely debated by the [National Statistician's Technical and Stakeholder Advisory Panels for Consumer Prices](#), leading them to ask for more clarity on what the conceptual basis for HCIs is. This workshop will address that question.

This workshop is hosted by the Economic Statistics Centre of Excellence ([ESCoE](#)) and the Office for National Statistics ([ONS](#)) and will take place at Church House Westminster, Dean's Yard, Westminster, London, SW1P 3NZ.

The proceedings will be as follows:

09:30 Registration

10:00 Introduction

Chair: **Jonathan Athow** (Office for National Statistics)

10:05 Presentation 1: *Measuring households' experience of inflation* by **John Astin** and **Jill Leyland**

Jill Leyland and John Astin have been working on the idea of an HCI since 2015. It started life as the Household Inflation Index (HII); ONS, when it took over responsibility for its development, renamed it the Household Costs Index. As well as an overall index, indices will be calculated for household groups.

Today Jill and John will each give a short presentation covering largely different aspects of the HCI. The first presentation will focus on the *raison d'être* of the index, and the main ways in which it differs from the CPI and CPIH – and the reasons for those differences. They then go on to delve in slightly more detail into the most important actual or potential differences, and discuss certain aspects where the appropriate treatment is not straightforward.

They do not feel bound to follow conventional economic principles, particularly those derived from national accounting conventions, but rather view the index as an interpretation of the way in which typical consumers (householders) experience the phenomenon of inflation, such as the treatment of interest payments. Since it aims to reflect actual household experience HCIs avoid the use of imputed transactions, such as the imputation of rents to owner occupied dwellings as is done in the CPIH.

10:35 Presentation 2: *Household Costs Indices, latest results* by **Christopher Payne** (Office for National Statistics)

The ONS will publish its second set of preliminary estimates for the Household Costs Indices on 25th April. Christopher will present highlights from the latest ONS results.

10:45 Presentation 3: *Stats New Zealand's Household living-costs price indexes* by **Alan Bentley** (Stats New Zealand)

This presentation introduces New Zealand's Household living-costs price indexes (HLPs). Published quarterly since late 2016, these new official statistics track changes in the purchasing power of money experienced by different groups in society.

Alan traces the changing uses of New Zealand's one-hundred-and-five-year-old Consumers Price Index (CPI). From a necessities index for wage determinations by the Arbitration Court, through being a wider measure of household inflation, to its present-day focus as a macroeconomic indicator for monetary policy targeting. This historical backdrop, and contemporary data needs, set the scene for the conceptual design choices made for the HLPs. Chief amongst these is the treatment of owner-occupied housing and the use of 'democratic weights' to create an aggregate index that better reflects the inflation experienced by a 'typical' household within each group.

Finally, Alan reports some of the new insights gained, revealing the diversity of experiences of changes in living-costs. These are informing public debate. They have been used to highlight the regressive impacts of recent fuel and tobacco taxation policy, and how inequality of home ownership has impacted material wellbeing, as a result of above average inflation increases in rent, property rates and household energy. Some of this debate arcs back to the original wage-setting purpose of the CPI, over 100 years ago. HLPs latest use is to provide enhanced measures of changes in real disposable income. From April 2019, New Zealand's fixed-line poverty measure, needed for reporting under the Child Poverty Reduction Act 2018, will use the lowest income quintile HLP for inflation-adjustment.

11:05 Presentation 4: *Household Costs and the Life Cycle* by **Martin Weale** (King's College London, ESCoE and Centre for Macroeconomics)

There are four distinctive features of the household cost indices. They:

1. are constructed round democratic weights;
2. aspire to represent housing costs by mortgage interest payments and capital payments of at least first-time buyers;
3. aim to account for goods and services when they are paid for rather than when they are consumed;
4. measure expenditure on insurance with reference to gross premia.

In this presentation Martin first discusses the theory of cost indices and their relationship to household welfare, showing that, consistent with theory, it is possible to include outgoings such as taxes and interest payments in a cost index. He then reviews these four features, supporting the use of democratic weights and gross premia strongly, but noting some of the complications raised by the

treatment of housing costs and timing issues. The treatment of housing costs is, for example, likely to understate the importance of housing over the life cycle, while accounting for goods and services when they are paid raises questions about goods and services “paid” for before they are consumed, e.g. by means of saving. Martin also notes that, since the index represents an average household, interest receipts should be included as well as interest payments. The use of democratic weights is, however, likely to limit the impact of this.

- 11:35 Discussion 1: What should the HCIs be measuring?
What should households’ experience and perception of inflation mean in practice? How does it relate to, for example, consumption? Cash flow?
- 11:55 Discussion 2: Where should we measure payments rather than acquisition prices?
For example, owner occupied housing, student loans, new and used cars
- 12:15 Lunch
- 12:45 Discussion 3: What other items should be in scope?
For example, interest on debt, taxes, second-hand goods, non-consumption items – capital costs, pension contributions, other savings and investments
- 13:30 Discussion 4: What should be the development priorities going forward?
- 13:50 Summary
- 14:00 Close

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