

12 June 2019

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Dear John

Comments from the Stakeholder Advisory Panel on the conceptual foundations of the HCIs

In fulfilling our role to represent the views of stakeholders we considered the conceptual foundations of Household Cost Indices (HCIs) at our Stakeholder Panel meeting on 24 May 2019.

Our discussion followed the ESCoE workshop on HCIs held on 25 April, which was attended by three Panel members. The attendees felt that the workshop was “the best discussion to date on the pertinent issues around HCIs” and the event enabled a wide range of stakeholders to focus on the issues and the intended uses of HCIs.

At the Stakeholder Panel meeting, we had an extensive discussion including both the current methodology (already established in the published HCIs) and further proposed methodological treatments in ‘Towards a Household Inflation Index’ (Astin & Leyland, 2015) and elsewhere.

Overall, the Panel support the use of the HCIs as a household cost measure rather than an economic measure. HCIs could prove valuable to inform policy, especially through a deeper understanding of the inflationary effects on demographic sub-groups. To this end, the Panel felt that it was important to continue to engage with stakeholders to better understand their intended uses of the HCIs and how HCI data might be best structured to meet potentially quite diverse needs.

There was agreement that a range of HCIs could be produced, with specific variants to meet different user needs. There was support for the development of a ‘maximalist’ index which includes all proposals, and then a range of subgroup measures, which would have certain exclusions, such as capital payments for housing and pension contributions where they would be inappropriate for some uses.

The Panel focussed on the use of assessing real incomes, which would necessitate items in the HCIs matching those in the income measure. This doesn’t necessarily dictate how the HCIs should look because again a subgroup of the maximalist index could be produced to deflate the income measures. Overall, we are less concerned with the internal symmetry of HCIs.

There was clear consensus from the Panel that the HCIs should be based on a democratic weighting scheme (i.e. giving each household’s expenditure an equal weight within the index). On frequency, a quarterly series was supported.

There was also broad agreement for the HCIs to cover UK resident households (i.e. spend by UK residents including notional expenditure abroad but excluding expenditure by visitors to the UK).

Several of the Panel believed that it was important that the choice of items included should make sense to the ‘person in the street’. There was broad agreement amongst Panel members to include or exclude the following components:

- Mortgage interest payments (MIPs) – The Panel unanimously agreed that MIPs should be included in a measure of overall expenditure, although a Panel member raised concerns about the appropriate method of including housing costs (repayment, rental equivalence or net acquisitions).
- Financing of sizeable purchases including vehicles and white goods – There should be consistency between the treatment of the capital or finance purchase of goods. This could be ensured (at least for the moment) by including the capital cost at time of purchase and on-going finance costs over time. This is consistent with the current CPI approach, and the addition of an interest on debt item.
- Student loans – Include both student fee payments when paid upfront and student loan repayments.
- Voluntary savings – Excluded, as these were not perceived as a cost.
- Interest on savings – Excluded; classified as an income, rather than a payment.
- Taxes – Council Tax to be included in the main HCI measure although it may need to be excluded for comparison with certain income measures. As Stamp Duty Land Tax is incurred by owner occupier households, it should also be included. Income Tax and National Insurance should be excluded.
- Insurance – Gross expenditure on insurance premiums should be considered as an outgoing.

Other areas where there was more discussion were:

- Mortgage capital repayments – The panel felt that mortgage capital payments and other housing capital payments should be included in the capital costs HCI variant. It is important to be able to differentiate between the costs incurred by owner occupier households and by renter households. On the other hand, Panel members and ONS colleagues who attended the 25 April workshop noted this was an area of disagreement, but all agreed that there were a complex set of issues to work through. Moreover, there was no readily applicable method for doing so here.
- Interest on debt (consumer credit, loan, etc.) – Some Panel members supported the inclusion of interest on consumer debt in line with its inclusion in the current HCI, although not by a clear majority (they are already partially included in our current HCI). It was acknowledged that the cost of banking services is difficult to measure and the experience of interest will vary significantly across deciles and household types.
- Pension contributions – Most Panel members favoured inclusion of auto enrolment pension contributions. Others were undecided. However, their inclusion would mean that the HCIs would focus on employees, which highlights the value of the sub-group breakdowns for policy makers and analysts.
- Second hand goods – A case was made for including second hand goods, especially for low income households, whilst recognising that it may take time to collect the necessary data.

The Stakeholder Panel consider the HCIs to be a valuable and informative measure and look forward to their future, development as experimental statistics, with a view to seeking National Statistics assessment once the classification of the HCIs has stabilised.

A minority of two also felt that the formulae used to calculate HCIs should be formally assessed. This could be considered through the ONS work programme item to review the criteria used to apply formulae at the elementary aggregate level. It is important that the choice of formulae is soundly based if any of the HCIs are in the end to replace RPI in any uses.

They also supported consultation with a wider group of stakeholders and potential users, once a clear conceptual framework has been agreed.

with kind regards - Kate

Dame Kate Barker

Chairman, UKSA Stakeholder Advisory Panel for Consumer Prices (APCP-S)