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Bank of England

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Dear 

RPI AND CPI/HICP: PLANNED CHANGES AT THE TIME OF THE ANNUAL RE-WEIGHTING AND UPDATING OF THE BASKETS

Issue

The UK Statistics Authority (the Authority) has accepted recommendations brought by the National Statistician following a consultation on options for improving the Retail Prices Index (RPI). These involve a change to the coverage or basic calculation of the RPI. The National Statistician recommended that:

private housing rental data from the Valuations Office Agency (VOA) plus comparable data from the Welsh and Scottish Governments are used instead of the private housing rental data currently collected by ONS.

the new data source for private housing rental prices be introduced into the published RPI in March 2013, at the same time as the annual update of the basket of goods and services that underpin the RPI (and CPI).

Action

For consultation as required under Section 21 of the Statistics and Registration Service Act 2007. This letter initiates the Authority's consultation with the Bank over whether the proposed change to private housing rental data within the RPI would constitute a fundamental change in the index which would be materially detrimental to the interests of holders of relevant index-linked gilts, and hence trigger the redemption clause.

Timing

A response by 11 January 2013, if possible, would be helpful.

Background

The annual update of the RPI and CPI will take effect with the February 2013 indices, which will be published on 19 March 2013. An accompanying article describing the changes to the baskets will be published electronically on 12 March 2013. A fuller description for the re-weighting and updating process can be found in the basket article for 2012 which is available at <http://www.ons.gov.uk/ons/rel/cpi/cpi-rpi-basket/2012/index.html>.

The Authority proposes to introduce a change to the RPI at the time of the annual update of the RPI and CPI. The proposal for change is the National Statistician's recommendation that private housing rental data from the Valuations Office Agency (VOA) plus comparable data from the Welsh and Scottish

Governments are used instead of the private housing rental data currently collected by ONS. The proposal to change reflects the creation of a new, higher quality data source for private housing rentals, which have been developed as part of the programme to create a new additional measure of consumer price inflation that includes owner occupiers' housing costs. A paper setting out further details was considered by CPAC at its meeting on 3 July 2012 (see CPAC(12)18 at <http://www.ons.gov.uk/ons/guide-method/development-programmes/other-development-work/consumer-prices-advisory-committee/cpac-papers/index.html>). The Authority launched a public consultation, on 8 October 2012, on the proposed change, alongside other options for change to the RPI. A note of the CPAC meeting at which this recommendation was discussed will be available from 10 January 2013 via the CPAC papers page on the ONS website, referenced above.

The standard procedures for the annual updating of the RPI and CPI basket are well rehearsed. Although fixed within each year the contents of the CPI and RPI baskets of goods and services and their associated expenditure weights are updated annually to ensure that they are representative of what people spend their money on. This mitigates potential biases that might otherwise occur from not allowing for consumers switching purchases away from goods and services that have increased in relative price to those whose prices have reduced relative to other goods and services. Each year ONS conducts research into expenditure patterns to help inform decisions on which goods and services are under-represented and on which areas of the basket there is scope for removing items. Criteria for choosing a set of items to represent particular categories of expenditure, such as clothing and footwear or food, include the size of expenditure and the diversity of the market based on information from the Living Costs and Food (LCF) survey, observed prices variations based on historic data plus market research from a variety of sources on latest consumer trends. Information from the latest LCF and UK national accounts is used to update the expenditure weights. The Authority considers that, with the exception of the proposed change to source for private housing rental data in the RPI, the changes in the contents of the RPI and CPI baskets and the associated weights are not significant beyond their primary aim of ensuring the continuous and proper representation of consumer expenditure habits.

In addition to the changes proposed this year, ONS has developed a new additional measure of consumer price inflation that includes owner occupiers' housing costs. This new measure, which will initially be called CPIH, will be published alongside other price indices on 19 March 2013. Additionally, ONS will continue to take forward its work programme, which was set out in CPAC's annual report to the Authority (also available via the CPACP papers landing page referenced above). This could result in further proposals for change to both the RPI and the CPI in the future, though the Authority has endorsed the National Statistician's recommendation that the basic formulation of the RPI is accepted as currently defined and that any future changes should be limited to issues that might reasonably be described as 'routine'. In line with the protocol on RPI changes and index-linked gilts, any proposals for change will be discussed with the Bank of England and Treasury members of the Inflation Tripartite Committee and at CPAC. They will then be submitted to the Authority for a decision and for formal consultation with the Bank of England.

Please let me know if you have any questions or would like to discuss this further.

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Yours sincerely

Derek Bird