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James Bell
Head of Structural Economic Analysis Division
Monetary Analysis, Division 2
Bank of England
Threadneedle Street
London
EC2R 8AH

Dear James

CPI, CPIH, RPI AND RPIJ: PLANNED CHANGES AT THE TIME OF THE ANNUAL RE-WEIGHTING AND UPDATING OF THE BASKETS

Issue

The UK Statistics Authority (the Authority) has endorsed a proposed change to the coverage or basic calculation of the Retail Prices Index (RPI) put forward by the Office for National Statistics (ONS). The proposal is to implement improvements to the methodology used to calculate private rents in the February 2015 index published on 24 March 2015.

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 proposed improvements to the measurement of private rents within the RPI would constitute a fundamental change in the index that would be materially detrimental to the interests of holders of relevant index-linked gilts, and hence trigger the redemption clause.

Timing

For response by 9 January 2015.

Background

On 14 August 2014 the UK Statistics Authority suspended the National Statistics designation of CPIH pending work on the methodology for calculating owner occupiers' housing costs (OOH) which uses private rents data collected by Valuations Office Agency. Since then ONS and VOA have completed work looking at aspects of the current methodology that might be improved and the impact these would have on the annual rate of growth. It shows that the rate of growth of CPIH could be 0.2 percentage points higher were changes introduced, though the work indicates that this is an upper bound and in most periods the impact would be 0.1 percentage points or less.

Four aspects of the methodology have been assessed;

- I. The matching process for replacement properties, which can be improved so all viable matches are identified and used;
- II. The imputation approach for properties where a matching replacement property cannot be found, which can be improved by introducing a better imputation approach also used for other components of consumer price indices;
- III. The sample size of properties can be improved to allow a better balance between a robust initial sample and the maintenance of the sample over the year;

- IV. The assumed contract length which can be improved by using a shorter period while balancing this against operational limitations.

Given these findings, ONS will recalculate the OOH component of CPIH back to 2005, which is when VOA data were first used as the source for the estimates. The improvements will be introduced as part of the 2015 annual update of consumer price indices to be published in March 2015. This allows time for the work to be quality assured, system documentation to be prepared and an explanatory article explaining the proposed changes to be published.

The same data are used to measure private rental prices in the suite of consumer price inflation statistics. However, the lower weighting applied to this component means that the findings set out above would not have an appreciable impact on CPI, RPI or RPIJ. Consequently, ONS will not revise the private rents index in any aggregate, though improvements in the methodology will feed through as part of the annual update. At the same time these changes are introduced, ONS will align strata weights for the private rents index with those used for the Index of private Housing Rental Prices (IPHRP), which uses a slightly improved method where property type weights are defined for each region, rather than applying the same property type weight across all regions.

Price Collection Contract

A new contract for the field collection begins on 1 February 2015, and the term is three years with options to extend of one year plus one year. Although the incumbent has been awarded the contract, a new and proven technology will be used to drive improvements in collection quality and communications over the lifetime of the contract. The devices chosen meet Government Buying Standards, and are readily available. The device is the Samsung Galaxy Note III, and an app has been developed that operates on the Android system. This enables the contractor (TNS) to guarantee capacity to support the devices or purchase new ones for at least the duration of the contract. Collectors will be able to transmit data more frequently with immediate transfer to TNS head office from the point of data collection, increasing their capacity to receive and process the data in a timely manner.

Smartphones have larger touchscreens (than the current device) that enable collectors to enter data either by typing the information on the screen or by using a stylus. Functionality is improved as information can be displayed more clearly. The new collection program that has been developed is based on the current one but expanded to include new features e.g. information currently provided in paper form can be displayed to assist in the selection of items. Collectors will be familiar with the look and flow of the program which focuses their learning on new features.

A new facility has also been developed to improve the efficiency of Quality Assurance in the field (backchecks), i.e. now conducted without a need to carry paperwork.

Piloting of the new device has taken place in September (30 collectors), and October (90 collectors). Testing has taken place on both TNS and ONS systems to ensure that the price quotes meet rigorous quality checks before entering the index. Roll-out of the devices will complete in December 2014.

Annual Basket Update

The annual update of the suite of consumer price inflation statistics will take effect with the February 2015 indices, which will be published on 24 March 2015. An accompanying article describing the changes to the baskets will be published on the ONS website about a week earlier. A fuller description of the reweighting and updating process can be found in the basket article for 2014, which is available on line¹.

The standard procedures for the annual updating of the baskets are well rehearsed. Although fixed within each year, the contents of the baskets of goods and services and their associated expenditure weights are updated

¹ <http://www.ons.gov.uk/ons/rel/cpi/cpi-rpi-basket/2014/index.html>

annually to ensure they are representative of household spending patterns. The updating 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 price variations based on historic data plus market research from a variety of sources on latest consumer trends. Information principally from the latest LCF and UK national accounts is used to update the expenditure weights.

The Authority considers that, the changes in the contents of the CPI, CPIH, RPI and RPIJ baskets and the associated weights are not significant beyond their primary aim of ensuring the continuous and proper representation of consumer expenditure habits.

Reviews

In February this year the Smith review on the governance of prices statistics reported to the Board of the Authority². The review report recommended the creation of two advisory panels on consumer prices; a stakeholder panel to advise the National Statistician on the uses and application of price indices, and a technical panel to provide advice on the technical aspects of the statistics. Once established these two new panels will form part of the governance arrangements going forward and future proposals for change will need to reflect the views of these panels as well as obligations under the relevant legislation.

The Authority's review of the range of consumer price statistics, being led by Paul Johnson, has been continuing its work. The timetable for publication has been put back and it is now due for publication by the end of 2014.

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

A copy of this letter goes to Andrew Hauser at the Bank of England, to Dave Ramsden and Stephen Farrington at the Treasury and to Glen Watson, Nicholas Vaughan and Joe Grice here at ONS.

Yours sincerely



Derek Bird

² <http://www.statisticsauthority.gov.uk/news/statement---review-of-the-governance-of-prices-statistics.pdf>