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John Pullinger
The National Statistician
UK Statistics Authority
1 Drummond Gate
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Dear John,

Paul Johnson's Review of Consumer Price Statistics

As this is my first letter to you since we each took up our current roles last July, I am sorry it is one where I have to raise concerns. I am writing on behalf of the Society rather than in a personal capacity, and am confident you will view the Society's concerns as those of a critical friend.

You are already aware that the Royal Statistical Society has reservations about some of the key conclusions of the review carried out by Paul Johnson into the range of consumer price indices. We accept a number of the report's assessments and applaud much of the research and the extensive discussion of issues, but we feel the recommendations fall short in a number of areas and some are simply wrong. I am writing therefore to set out the Society's key concerns and to outline what we feel now needs to be done.

We believe the review should have started from first principles by examining the different needs that consumer price indices aim to meet, then deciding what sort of index is required for each need and the extent to which they can, or cannot, be combined. Instead it simply asserts that "CPIH is conceptually the best measure of inflation in the UK" but sets out little, if any, justification for this or why it should have the recommended status of being the sole headline index.

The CPI, as the Harmonised Index of Consumer Prices for the UK, and by extension the CPIH, were designed for macroeconomic needs - originally for comparing inflation rates among European countries. However, the original and still crucial purpose of consumer price indices was to measure how the costs of household expenditure rose as a result of inflation, thus providing a broad guide as to how much incomes and other related matters might need to rise to compensate for this. This is why the Retail Prices Index (RPI) was originally designed (several decades before inflation targeting was first used). The CPI and its derivatives were not designed for these needs and the report does not provide any real argument for the CPI's use for these purposes.

Public confidence in any index used for uprating is more critical than for most statistics since it has a direct effect on people's incomes and spending. It follows that the index must provide a realistic estimate of how household costs evolve. Moreover, the phenomenon of inflation is observable by the population at large. We accept the report's broad conclusion that the RPI is no longer an ideal index. Its use is, nevertheless, deeply embedded. As a time honoured index it still enjoys a wide degree of public trust despite its recently publicised problems. Finding a successor that can be widely accepted therefore means establishing an index that meets the RPI's original purpose without its problems: and above all, an index that can be demonstrated to reflect actual household spending. Only then, in our view, will it be possible to urge people to abandon the RPI.

The research into the inflation experience of different households published on 15 December 2014 by the ONS (Flower and Wales: *Variation in the inflation experience of UK households: 2003-2014*) is telling. We fully support Paul Johnson's recommendation that the ONS should produce regular inflation indices for different household groups. However, we believe these should be based, to the extent possible, on actual household spending. We also believe this suggestion needs to be taken to its logical conclusion by combining the inflation indices to produce a "democratically weighted" overall index that is published monthly. Such a "household inflation index" (HII) would then be suitable for general uprating purposes as well as tracking the real growth in household income. When appropriate, indices for different population groups could be used for specific purposes, for example in the way that the Rossi index has been used for uprating benefits.

To be acceptable, such an index needs to cover owner occupier housing costs – a major part of many household budgets –in a way that seems credible to the man/woman in the street. This would include an allowance for mortgage interest and the capital cost of house purchase. We accept that the weight given to the latter needs careful consideration in view of the impact of house price appreciation on people's second and subsequent purchases. We do not see how rental equivalence can ever be a convincing measure (this applies also for macroeconomic needs).

We therefore urge that the approach of a full "household inflation index", based on actual expenditures incurred (a payments approach) be examined in detail and a practical route for its development set out. I hope you will ask ONS staff to work on this so that it can be one of the options in the consultation. As you are aware, both John Astin and Jill Leyland have published papers on this approach. We have asked them, in conjunction with other RSS members with specialised knowledge, to work on a more detailed initial proposal to submit to you.

Whatever way forward is chosen, the RPI will remain in practical use for many years yet. We acknowledge the constraints on changing it but feel strongly that within those constraints it should be produced as accurately as possible.

I hope these comments are helpful. We have also compiled a more detailed commentary on the report, which I enclose with this letter and which we would be delighted to discuss further. I am copying this letter to Andrew Dilnot, to Glen Watson and Derek Bird in the ONS, to Jon McGinty, the chair of the Statistics User Forum, and to Tony Cox, the chair of the RPI CPI User Group, as well as to RSS colleagues. In view of the Public Administration Select Committee's current inquiry into economic statistics I am also copying it to Bernard Jenkin MP.

Yours sincerely

Peter J Diggle
President