BANK OF ENGLAND

Mike Prestwood
Office for National Statistics
Government Buildings
Cardiff Road
Newport
NP10 8XG

Ben Broadbent
Deputy Governor, Monetary Policy
T 020 7601 5189

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Dear Mike

Proposed changes to RPI in 2017

I refer to your letter of 7 November 2016 addressed to James Bell and Sarah John, which covers the following planned changes to the Retail Prices Index (RPI): a proposal to update the calculation of the housing components of the RPI to reflect the new UK House Prices Index (UKHPI) rather than the historic ONS HPI; the 2017 annual update of the basket of RPI items; and a periodic review of the location boundaries wherein prices are collected.

A senior committee at the Bank under my chairmanship has considered whether any of these would constitute a fundamental change in the RPI that would be materially detrimental to the interests of holders of relevant index-linked gilts. This pertains to the ONS's and the Bank's obligations under Section 21 of the Statistics and Registration Service Act 2007.

As in previous years, the committee concluded that both the basket update and review of location boundaries represent the sort of routine 'maintenance' changes that ought to be expected to ensure that the RPI remains consistent with its purpose. These are, in the committee’s view, neither fundamental changes to the coverage or basic calculation of the index, nor ones that can be expected to be materially detrimental to the holders of relevant index-linked bonds.

The proposed change to the house price index series underlying several components of the RPI is also aimed at maintaining the index in line with broader statistical development and methodological improvement at the ONS. As with the basket update and review of location boundaries, the committee concluded that these changes are unlikely to be materially detrimental to the interests of holders of relevant index-linked gilts. The simulations provided to the Bank by the ONS indicated that, if anything, RPI inflation would have been higher over recent years, and so index-linked bond cash-flows larger, had the proposals already been implemented.

More generally, the ONS analysis suggested that any differences are likely to stem from two sources: the inclusion in the UKHPI of housing transactions of households outside the RPI's reference population, namely high-income and some pensioner households; and the exclusion from the UKHPI of price quotes from Northern Ireland. Conceptually, therefore, it is possible that the changes may cause measured RPI inflation to deviate from time to time in either direction from what might otherwise have been the case. But the committee judged that such deviations could not reasonably be judged likely to be materially detrimental to the interests of index-linked bond-holders.

Nevertheless, given the Bank's obligations under Section 21 of the Statistics and Registration Service Act 2007, I should record that the committee did regard the proposal to update the calculation of the housing components of the RPI as representing a 'fundamental' change to the RPI. In reaching that determination, the committee noted that - albeit for perfectly understandable reasons of data limitations - the proposals imply that items with a coverage weight of around 11% of the RPI would now include housing transactions of households outside the RPI's reference population and exclude price quotes from Northern Ireland. While not unprecedented, these would represent a deviation from the traditional reference population of the RPI for a material proportion of the index basket.

I would of course be happy to discuss any of this further.

A copy of this letter goes to Dave Ramsden and Stephen Farrington at HM Treasury, to Jonathan Athow and Nicholas Vaughan at the ONS, and to James Bell, Sarah John, Nicholas Butt and Stuart Berry at the Bank of England.

Yours sincerely

Ben Broadbent
Deputy Governor, Monetary Policy