
18 November 2013

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Dear James

CPI, CPIH, RPI AND RPIJ: NO PLANNED CHANGES AT THE TIME OF THE ANNUAL RE-WEIGHTING AND UPDATING OF THE BASKETS

Issue

There are no planned changes to the Retail Prices Index (RPI) proposed by the UK Statistics Authority (the Authority) for implementation alongside the update to the basket in 2014.

Action

To note the contents of this letter, which is being sent to acknowledge the requirements under Section 21 of the Statistics and Registration Service Act 2007. In previous years it has initiated the Authority's consultation with the Bank over whether any proposed changes to 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

For response by 10 January 2014.

Background

The annual update of the CPI, CPIH, RPI and RPIJ will take effect with the February 2014 indices, which will be published on 6 March 2014. 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 2013, which is available on line¹.

The Authority is not proposing to introduce any changes to the RPI (or other consumer price indices) in 2014 beyond the routine update to the basket. The standard procedures for the annual updating of the CPI and RPI baskets 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 they are representative of household spending patterns. This procedure now also applies to CPIH and RPIJ, which were introduced for the first time in 2013. The updating mitigates potential biases that might otherwise occur from not allowing for

¹ <http://www.ons.gov.uk/ons/rel/cpi/cpi-rpi-basket/2013/index.html>

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. In addition, a change in the method of quality adjusting digital cameras and pay as you go phones, from hedonics to class mean imputation, is a routine change. ONS will cease using hedonics to quality adjust these items in 2014 as ONS research has shown that they are now mature markets in terms of their technological development and therefore class mean imputation is a suitable quality adjustment method. Additionally, they represent a decreasing proportion of the total basket as consumers move towards using other products such as smart phones and this trend is expected to continue in the future.

The Johnson review² on the range of prices statistics, and the Smith review³ on the governance of prices statistics are currently underway and are expected to report to the Board of the Authority by the summer of 2014 and the end of 2013 respectively. The Smith review will shape the governance arrangements going forward and any future proposals for change may need to reflect these as well as the obligations under the relevant legislation.

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 Nicholas Vaughan at the Treasury and to Glen Watson, Caron Walker and Joe Grice here at ONS.

Yours sincerely

A handwritten signature in blue ink, appearing to be 'Derek Bird', with a stylized flourish at the end.

Derek Bird

² The Johnson review's terms of reference are at <http://www.statisticsauthority.gov.uk/reports---correspondence/current-reviews/Review-of-Range-of-Price-Statistics---Terms-of-Reference.doc>

³ The Smith review's terms of reference are at <http://www.statisticsauthority.gov.uk/reports---correspondence/current-reviews/Review-of-Governance-of-Prices-Statistics---Terms-of-Reference.doc>