Measuring household inflation
Joint paper from Citizens Advice, the Financial Fairness Trust and the Royal Statistical Society

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" It is disingenuous as well to argue that CPI is a better measure of inflation than RPI for those on benefits. Those in that group spend more on food and fuel, so the average inflation is higher, not lower, than either RPI or CPI." Rachel Reeves, December 2010

Over the last three years, the UK has experienced a period of extremely high inflation. The impact of this inflation was not felt equally by all households. Global factors combined to drive prices particularly high in energy and food markets. Lower income households faced higher levels of inflation as a result. This has led to a renewed focus on inflation inequality, and how inflation measures could better take into account the complexities of the experience of inflation at a household level.

Citizens Advice estimates that people seeking help with debt cut their consumption by around £220 a month on average as a result of high inflation in recent years. Despite this, around half the people they help with debt are in a negative budget - where their income is insufficient to cover their basic needs, even after budgeting support from an expert adviser. At a national scale, they estimate 5 million people face a negative budget, with over 2 million more drastically cutting back on essentials to avoid slipping into the red. The inability of millions of households to afford the essentials at all should be central to the government's understanding of the current economic context.

But, since the Retail Prices Index (RPI) lost its accredited national statistic status, there has been no accredited series which measures inflation for the typical household. The Consumer Prices Index (CPI), and the Consumer Prices Index including owner occupiers' housing costs (CPIH) are widely used to measure inflation, but they have significant limitations when measuring the impact of inflation at a household level. This has real-world implications, particularly in relation to social security, where the use of CPI as the basis of uprating accounts for around a third of real terms benefit cuts since 2010.

The ONS has developed Household Costs Indices (HCIs), which offer a better way of measuring the impact of inflation on households – they have been published quarterly since December 2023. These indices have not yet achieved accredited status, due to resource constraints and prioritisation decisions, but they are well advanced as statistics under development, and only limited work is now needed to make them ready for assessment as an accredited statistic.

This note summarises recent issues with national inflation statistics and the policy advantages of achieving accredited status for HCIs. Section 1 briefly outlines the problem with current inflation measures, Section 2 sets out the major improvements that HCIs make to measuring household inflation, and Section 3 sets out the policy benefits of using HCIs as an alternative option. Finally, we outline some areas where further exploration would be beneficial.

We recommend the government take the following action:

1. **Support the intention to enable Household Costs Indices to obtain accredited (national statistic) status**. This process needs to be completed well in advance of 2030, when the RPI will cease to be a "household" index, but only limited work is needed.
2. **Commission or encourage further work by the ONS to estimate the impact of differing inflation rates between similar products (or different brands of the same product), and give priority in the medium term to these factors being incorporated into the HCIs.** While not a simple task, early, experimental work on this has been commissioned and conducted by the ONS.
3. **Commit to a review of the impact choice of inflation measure has on benefit uprating,** with a view to begin using the HCIs to inform this process as soon as possible.

1. The problem with current inflation measures

The CPI and, by extension, CPIH are not household measures of inflation. They have been developed as tools principally for monetary policy, for which they perform a vital macroeconomic purpose consistent with international standards. However, they measure inflation for a household incorrectly for a number of reasons:

a. **They are weighted by total pounds spent in the whole economy**, meaning that richer households' spending counts for more.
b. **They exclude mortgage interest and student loan repayments**, which are major elements of some households' budgets. CPI excludes all owner occupier costs other than minor repairs.
c. **They are insensitive to product (or brand) choice,** so do not reflect that (for example) the price of basic products in a category may have different inflation rates to luxury products.

This makes them poor tools for the other major function that inflation measures have historically fulfilled: making indexed cost of living adjustments to benefits, pensions and wages. They were not designed to facilitate differentiation by household type, so can only provide inferior estimates for specific income or demographic cohorts – thus not solving the exact problem Rachel Reeves identified when the switch from RPI to CPI was made.

These problems have led the CPI to significantly underestimate household inflation during the cost of living crisis, notably for the poorest households.

2. The Household Costs Indices are a significant step forward

The Household Costs Indices (HCIs) are different from CPI in a few key respects. Firstly, they include costs that are not included in CPI, such as student loan repayments and mortgage interest costs, making them a truer reflection of households' actual experienced inflation. Secondly, they aim to weight all households equally – meaning that they better reflect the experiences of poorer households. Third, they are constructed in a way which allows isolation of specific groups, such as renters or particular income deciles, and analysis of the share of expenditure taken up by different products or services. This is particularly important in

understanding the differential inflation we've seen in recent years - poorer households spend a larger share on essentials like energy, rent and food, where inflation has been most sharp.

Some of these differences also apply between HCIs and RPI. While RPI is more of a household index than CPI or CPIH, and excludes the top 4% of households by income, its weighting system is also skewed towards higher spending, normally richer, households.

These choices make a significant difference on their own terms. Figures 1 and 2 show an estimate of the impacts these choices make for poorer households. If we take deciles 1-3 as the reference for people on means tested benefits, then inflation index choice accounts for around a third of the cuts to the basic rate of benefits since 2010.

Figure 1: Gap between HCI deciles 1–3 and CPI between January 2005 and January 2024
Source: CA/RSS calculations based on ONS data

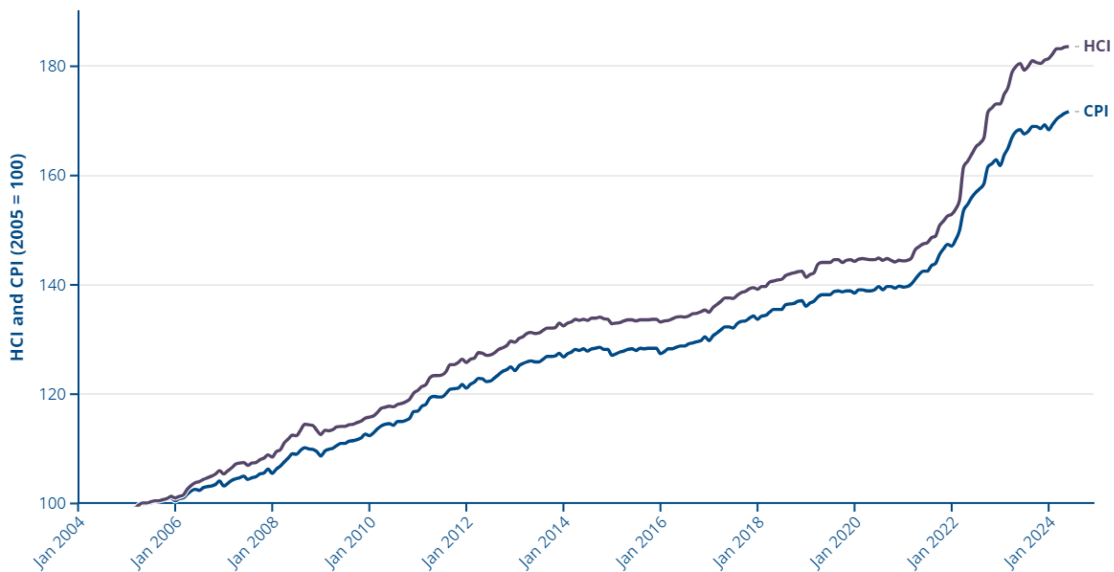
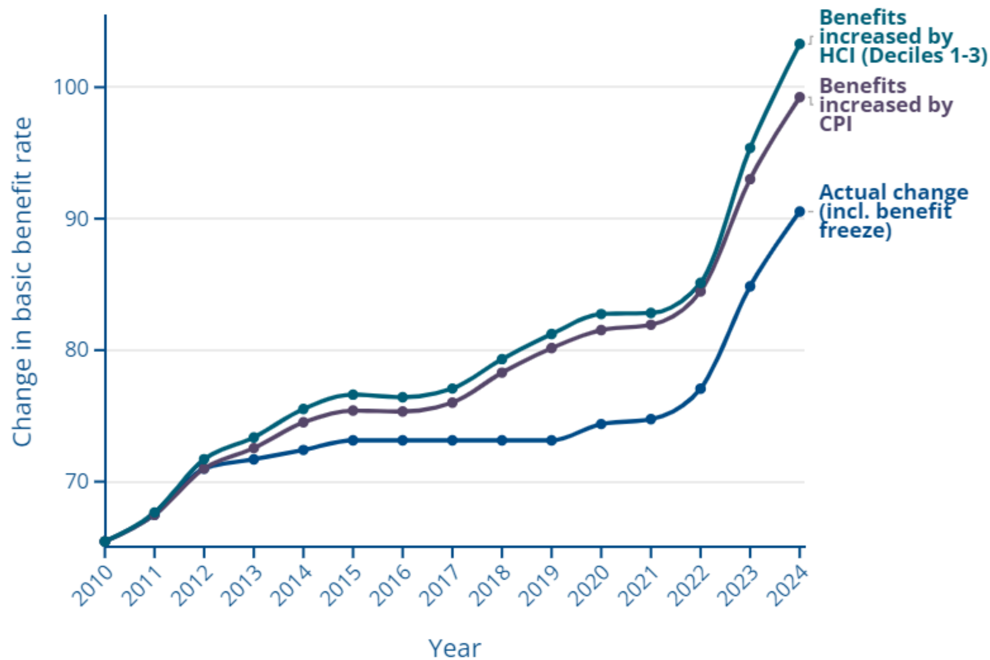


Figure 2: Changes in benefit rates between 2010 and 2024, based on CPI and HCI (deciles 1-3)
Source: [Fifty years of benefit levels, Joseph Rowntree Foundation](), Office for National Statistic price indices (various). Analysis originally published by [Citizens Advice in December 2023]().



It is worth noting that the differences between CPI and the HCIs are empirical and contingent. HCI inflation has been higher only because the rate of inflation for the cost of essentials, and latterly interest rates, have been higher over these periods. To the extent that the government succeeds in reducing the cost of housing, food and energy relative to other prices, the fruits of that success will be seen in a lower headline household inflation rate.

What the HCIs do not yet solve is differentiation by product choice. If, for example, the price of value or supermarket own-brand bread increases at a higher rate than artisanal sourdough bread, then inflation for lower income households who make the former purchases will be understated. This will need significant further work, but the ONS' own research, work ONS commissioned from the University of Strathclyde, and that undertaken by Financial Fairness Trust and others have laid important groundwork that could be built on.

3. Applying HCIs in a policy context, to reestablish a meaningful connection between low incomes and the cost of living
Using HCIs to inform policy decisions about income adjustments in line with the cost of living could bring a range of benefits. The government's commitment to ensure the minimum wage is set with reference to the cost of living is welcome. However, for this to be meaningful it is important that the experience of inflation for households receiving minimum wage is accurately measured.

The same is true for social security. It is broadly recognised that basic benefit rates are inadequate, but there are many other demands on the government's limited fiscal resources, as well as significant upward pressure on other parts of the welfare budget. Developing HCIs provides a potential route towards addressing this problem, though is not a full substitute for tackling benefit levels directly. If HCIs continue to be higher than CPI - which has been true in most but not all years of their construction, most significantly at the lowest end of the income distribution - they are likely to put us on a better course.

They also appear to have the advantage of being higher in periods of high inflation. The previous government was forced into making untargeted cost of living payments to low income households when inflation spiralled far above benefit payments. This was an expensive approach that was inefficient at meeting its aims. A measure of inflation that better reflects the underlying cost pressures faced by low income households will help reduce the need for this sort of emergency measure in future.

Risks and downsides:

- Should HCIs persist in being higher than CPI, this approach to uprating benefits will increase demands on social security spending. To the extent that the government does not want to increase spending, this is a downside. However, this approach would not have a significant impact on spending in any given year relative to the path of addressing levels directly (but over time could add up). There are compelling reasons to increase the basic unemployment rate which are understood and do not need restating here. But ensuring difficult decisions about how and when to do this are informed by the most accurate data available is also important.
- Multiple inflation indices arguably encourage governments to go 'index-shopping' for their most favourable option, as well as being confusing to the public. But adopting the HCI should, once the RPI effectively turns into CPIH from 2030, allow a consolidation of indices - CPI and CPIH for macroeconomic purposes, and HCIs for household purposes.
- The HCIs in their current form do not address all of the challenges presented by measuring inflation for low income households - most notably because they don't account for differentiation in product choice (as outlined above), and because they rely on tracking the cost of items people purchase, rather than the items people actually need (expanded on below). Further work will be needed to ensure these factors are accounted for, in the HCIs (as outlined in recommendation 2), and in the government's broader approach to understanding the needs of households.

4. Areas for further development

There remain some challenges with building an accurate picture of the impact of inflation on households, beyond those outlined in this paper and our recommendations. Current approaches - including HCIs - monitor what is happening to the cost of items that people purchase, rather than the items they actually need. We know that in periods of high inflation people may buy cheaper or poorer quality products, and that people on low incomes are particularly likely to cut back or stop spending on some products altogether.

Research conducted by the Financial Fairness Trust and Loughborough University aims to track the cost of items people actually need, rather than expenditure. The Decent Living Index (DLI) is currently calculated for two household types, and compares these results with CPI and CPIH. Their findings indicate an ongoing gap - by May 2023, prices were 23% higher than in January 2022 for a single working-age female, and 16% for a working-age couple with two children, compared with 14% based on CPI, and 13% based on CPIH. The DLI therefore estimated that a single working-age adult would need around £2,000 more by May 2023 than the CPI measure; and a couple with children would need an additional £1,400.

Supporting the development of this work to provide a fuller picture would be beneficial. More broadly, when developing policy aimed at supporting low income households, the government should look to supplement data from accredited inflation statistics with insights drawn from research such as this, and frontline data such as the Citizens Advice National Red Index, to ensure they are accurately measuring the experiences of people at the sharpest end of price increases.