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Dr. Ben Broadbent
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Dear Dr. Broadbent,

A number of RSS members watched with interest your evidence to the House of Lords Economic Affairs Committee or subsequently read the uncorrected transcript. Several questions and comments have been raised which we would like to put to you.

We are puzzled at your comments on the Household Costs Indices (HCIs) and in particular those on interest rates. While what you said was appropriate for economic policy purposes, are you really suggesting that mortgage interest should be considered by households as "negative income"? For households interest received is an income and interest paid out is a cost. Mortgage interest is a major item in many household budgets and it is therefore fully appropriate to include this in the HCIs. The income measures published alongside HCIs by ONS include interest receipts since they are, of course, income; the two measures are therefore consistent. We appreciate that the Bank's perspective on the economy is largely seen through a national accounts framework but the ONS must provide statistics for everyone not just professional economists.

There is a further point about interest payments since the interest households pay, whether mortgage interest or other, include the implied service charge by banks (the "FISIM" element in national accounts terms) and the risk premium so that interest paid by consumers on any item is greater than the comparable interest they receive.

The inclusion of interest payments is not the only difference between a household index and an index such as the Consumer Prices Index (CPI). There are others, notably the use of household ("democratic") rather than expenditure ("plutocratic") weighting. You may be interested in the attached 2015 article by John Astin and Jill Leyland which sets out the differences fully and was indeed taken as the starting point for the development of the HCIs. We would be happy to arrange a meeting with you or your colleagues to discuss the differences more fully.

Members have raised some other points. You said (I quote the uncorrected transcript):

> "The interesting thing, of course, is that in the EU it took a long time-and has not happened yet-for people to agree the precisely right way to measure owner-occupied housing costs."

That is not actually correct. The method to be used in the EU's Harmonised Indices of Consumer Prices (HICP - the UK series being of course the CPI), known as "net acquisitions", was agreed in the 1990s. The delay has been due to the difficulties faced by some EU members in implementing the method but ultimately HICP will include it. At that point in time the UK seems likely to have CPI and CPIH using different methods of measuring owner-occupier costs.

You referred to Irving Fisher's criticisms of Carli but you were not specific about which criticisms. There is, and always has been, considerable debate between statisticians regarding the merits and disadvantages of different index numbers. The terms Carli and Jevons do not define an index absolutely and the issues with formulae can depend on how they are implemented with the Retail Prices Index (RPI) implementation of Carli overcoming a number of the criticisms made about that index. (It might be worth noting that Fisher was also critical of the Dutot index but the way that is applied and used by most statistical offices makes it perfectly acceptable and it is also a preferred formula alongside Jevons for the HICP.) There is general agreement (and Fisher was clear on this point) that no elementary index is as good as a weighted index. In any case, as the events of 2010 showed only too vividly, it is the interaction between the indices and the raw data that matters most.

You also stated that you did not think that the CPI was likely to underestimate inflation. The Jevons index, used widely in CPI and CPIH, is well known for being sensitive to very low numbers (see for example paragraph 1.136 in the international manual[1] on price index construction) and will thus underestimate in certain circumstances. It would be surprising given the way that prices currently collected for certain clothing items bounce around if Jevons, and hence CPI and CPIH, did not underestimate to a certain extent. And Jevons implies a certain amount of consumer substitution towards items with lower price rises which, while it may sometimes be the case, does not always apply particularly when it is consumer demand rather than producer supply which drives price movements. (And, of course, prior to 2010 the CPI underestimate of clothing prices was extremely serious, far more so than the RPI's overestimation.)

I look forward to any comments you have on these points and reiterate that we would be happy to discuss the principles of Household Cost Indices further should you wish.

I am copying this letter to the Clerk of the House of Lords Economic Affairs Committee and also to the National Statistician, John Pullinger.

Kind regards

Steve Penneck

Stephen Penneck
Chair of the RSS National Statistics Advisory Group (NSAG)

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[1] *Consumer Price Index Manual: Theory and practice,* International Labour Office and other international organisations, 2004