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Sixty second summary

CPIH – The Future of Inflation

In the recent Budget, the UK government reiterated its objective to move to a new measure of inflation 'over time'. The household names of RPI and CPI look set to be supplanted by a somewhat less well-known measure of inflation, CPIH. This could affect all public service schemes, including the LGPS, which currently increase pension payments each year in line with CPI.

A quick history lesson

All measures of inflation are based on calculating the average change in price of a 'basket' of common goods and services. Inflation statistics differ in two key ways: the goods and services included in the 'basket', and the method used to calculate the average change in price.

The UK's longest-running inflation measure, RPI, was introduced in 1947. Over the years, RPI was plagued by perceived deficiencies. Concerns about its statistical robustness were magnified when a change in the way clothing prices were collected in 2010 increased the difference between RPI and other inflation measures including CPI. RPI lost its status as a National Statistic in 2013, meaning that the Office for Statistics Regulation does not regard it as "fully compliant with the Code of Practice for Statistics".

Finally, in 2015, a review by the UK Statistics Authority (UKSA) concluded that RPI is "not fit for purpose" and that "no taxes, benefits, or regulated prices should be linked to RPI". The more statistically robust CPI has now replaced RPI for many official purposes, including pension increases in the LGPS since 2011. Nevertheless, RPI is still widely-used, notably to determine the repayments on inflation-linked government bonds.

The House of Lords Economic Affairs Select Committee recently waded into the debate, publishing a report into inflation in January 2019 which strongly criticised the UKSA for not fixing the RPI measure despite its continuing widespread use. It's too early to say if this criticism will be acted upon, and for the moment it seems reasonable to expect that the general move towards CPI will continue whatever happens to RPI.

H for Housing

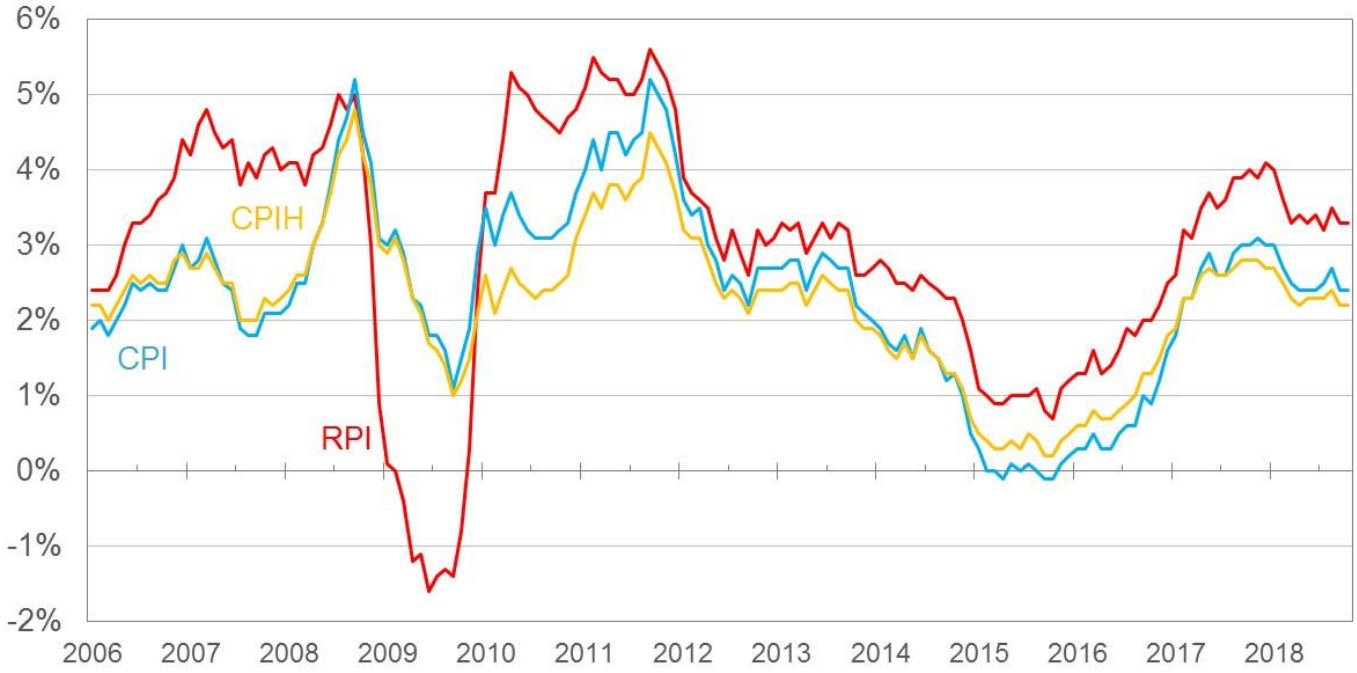
CPI may be statistically more robust than RPI (for the moment at least) but it does not cover as broad a 'basket' of goods. Notably, it omits the significant portion of consumer expenditure related to owner-occupied housing costs (OOH). The reason for this stems from the fact that CPI is simply a renamed version of the European measure "HICP" or "Harmonised Index of Consumer Prices" which initially omitted OOH pending a decision on the best way to incorporate them.

CPIH is simply a beefed-up version of CPI which does include OOH, measured using the “Rental Equivalence” method. As the name suggests, this uses the cost of renting an equivalent house as an estimate of all the costs of owning a home. CPIH was adopted by the Office for National Statistics (ONS) as its headline measure of inflation In March 2017, and as a national statistic in July of that year. The government now regards CPIH as “conceptually the best measure” of inflation as it moves towards replacing RPI.

How does CPIH compare against CPI?

The chart below shows a history of CPI, CPIH and RPI inflation.

UK annual price inflation statistics since 2006.



Together, OOH and Council Tax make up over 20% of the CPIH basket, and so could have a significant impact. However, since 2006, the average annual inflation under both measures is very similar (within 0.1%). In the same period CPIH has been less volatile than CPI which may suggest that CPIH will be a more stable measure of inflation than CPI in the long term.

Based on the data we have so far, it seems reasonable to expect that CPIH will be similar to CPI in the foreseeable future at least.

Financial impact on the LGPS

Year on year, pension scheme members could see different pension increases under CPIH than CPI, although based on the data so far we would not expect them to be any better or worse off in the long run. For funds and employers, what matters is the assumption made about pension increases when contribution rates are being calculated. If, as seems likely for now at least, CPIH is assumed to be the same as CPI, there will be little impact on liabilities and contribution rates.