Bank of England

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Dear Mike

Proposed changes to RPI in 2024

I refer to your letter dated 13 November, addressed to Andrea Rosen and Simon Kirby, covering the following planned changes to the Retail Prices Index (RPI):

i) changes to the data used and calculation method for prices of second-hand cars; and
ii) changes to the calculation method for prices of private rents

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

The committee views both items to be a **fundamental change to the basic calculation of the RPI,** but concluded that, on the balance of probabilities, **neither change would be materially detrimental to the interests of holders of relevant index-linked gilts.** More detail is provided below.

<u>Second-hand cars</u>

The current approach for second-hand cars tracks a mixed sample of 35 models of car starting in January each year, based on data from a trade guide. The new data from Auto Trader is received daily, includes trade and private listings and covers around 70% market share. The much larger dataset requires the use of multilateral methods to produce a price index. This new methodology has been considered appropriate by the Technical Panel of the Advisory Panels on Consumer Prices. The Committee views it as **a fundamental change to the basic calculation of RPI.**

The Committee **does not view this to be a fundamental change to the coverage of RPI**, as the change in data source being introduced does not bring into scope a different area of expenditure or alter the composition of its consumption basket.

While this change is fundamental with respect to the basic calculation of RPI, evidence from the ONS's impact assessment using a back run of the data from January 2018 to July 2023 does not suggest that, **on a balance of probabilities, the change would be materially detrimental to the interests of holders of relevant ILGs.**

Private rents

The private rents index currently uses a 'match-pairs' approach, which seeks to collect prices for the same property over time. As a result, the data are split into an active sample pool of price quotes and a substitution pool to be used if the price for a property in the sample pool cannot be updated. This means that only around half of the annual sample of around 500,000 quotes is used in the price index. The ONS proposes instead to use hedonic quality adjustment so that non-matched properties can be used over time to track price changes. This would mean that all price quotes can be used.

The Committee **does not view this as a fundamental change to the coverage of the RPI**, as the intended population and expenditure coverage will remain the same. However, the significant change in methodology and reflecting the significant share of the RPI basket results in the Committee judging that this is **a fundamental change to the basic calculation of RPI**.

An impact assessment provided by the ONS using data from January 2015 to July 2023 showed that the private rents index in the RPI would have risen marginally more using the proposed approach. The Committee noted that price quotes in the RPI private rents index are aggregated using the Carli formula, whereas the CPI uses the Jevons formula. Under the current methodology, the Carli formula tends to increase the rate of inflation of private rents in the RPI above that for the equivalent index in the CPI using the Jevons formula. Applying the new methodology has two main impacts:

1. On average it boosts private rents inflation in both the RPI and CPI through aspects unrelated to the Carli or Jevons formula
2. It reduces the tendency of the Carli formula to boost the private rents index in the RPI relative to using the Jevons formula

The second of these only applies to the RPI. The net impact of these two opposing effects is a more marginal increase in the RPI private rents index than in the CPI equivalent. Overall, the Committee judged that **the evidence did not suggest that the proposed change, on a balance of probabilities, would be materially detrimental to the interests of holders of relevant ILGs.**

Other matters

The Committee notes that the ONS shared details of improvements in its quality assurance processes, whereby a manual process is completed monthly to investigate observations deemed as outliers and either validates, corrects or removes them as appropriate. According to the ONS, the improvements will also include better reporting and auditing of changes, as well as improved training for price collectors. The Committee welcomes these improvements and appreciates the ONS's commitment to maintaining high standards in the production of price statistics.

The Committee also note that the ONS is continuing its work to prepare to include point-of-sale data for groceries into headline inflation indices from March 2025, and plans an analysis of the impact of introducing these data, alongside a parallel run, in 2024. The Committee will assess the impact of this change in due course if and when consulted by the ONS.

A copy of this letter goes to Mike Keoghan, Grant Fitzner, Jason Zawadzki, Matthew Corder and Chris Jenkins at the ONS, Thomas Yeomans at HM Treasury, and to Andrea Rosen, Carleton Webb and Simon Kirby at the Bank of England.

Yours sincerely

Ben Broadbent