Without house prices, CPI's usefulness is over-inflated



Viewpoint

By VICTOR BIVOLTSIS*

LAST month the Australian Bureau of Statistics made a significant change to the way it calculates the mortgage interest component of the consumer price index, whose latest monthly figure is announced today.

Although the change was claimed to be "conceptually superior", and despite many explanations from the bureau, government and media, the widespread misconception has persisted that the CPI is a measure of inflation or the cost of living. In fact, it is neither.

The Australian Bureau of Statistics makes this quite clear in its publications. In *A Guide to the Consumer Price Index*, it goes only as far as to say that the CPI measures "the change in the cost of purchasing a constant basket of goods and services".

It also points out that the CPI does not relate to the self-employed, the unemployed, pensioners and retirees, independent full-time students, high-income earners and people living outside the eight capital cities. The CPI population group accounts for only 36 per cent of the Australian population.

The booklet lists reasons for this, including that a "true" cost-of-living index would need to be concerned with changes in standards of living and the substitutions that people make to maintain these in the face of rising prices; sausages instead of steak, that type of thing.

Another reason the CPI is not a reliable measure of inflation is that inflation can affect any item with a price on it, while the CPI, as the name suggests, is concerned only with consumer items. The bureau is adamant on this point, and therefore goods and services which are not consumer items, such as life insurance and items bought for business rather than domestic purposes, are not included.

It was the bureau's rigour in this regard which prompted it, in its review for the CPI series which began with the March 1987 quarter, to remove the important category of House Purchase, Including Alterations.

The rationale for this was that the purchase of a house is an investment rather than consumption and therefore should not be included in a consumer index. Many Australians may be surprised to learn that the current CPI does not include a weighting for the price of houses, and of course any index which does not include house prices cannot be an accurate measure of inflation in the community.

While the CPI may be statistically pure in terms of a consumer index, this throws up a number of problems which need to be resolved.

The first is the contradiction in the bureau's position: the bureau cannot say that the CPI is not a cost-of-living index while at the same time the Australian Statistician, in his preface to *The Australian Consumer Price Index – Treatment of Home Ownership Costs*, seems happy to state: "In practice, the index is very widely used as a broad measure of 'inflation' or 'the cost of living'."

The bureau cannot have it both ways: either it is producing a consumer price index, which is what it wants, or it is producing a useful guide to inflation and the cost of living, which is what the public wants.

A large part of this misconception is due to the media. Each time the CPI is released we are served up another dollop of "inflation" analysis.

Despite knowing better, the Federal Government is also guilty of propagating this fallacy, as seen with last month's revision of the mortgage interest component when Government leaders were more than happy to hail the new figure as a fall in "inflation", while conveniently forgetting to mention the absence of a proper weighting for house prices in this figure.

There are other inconsistencies in the Government's position.

Why is it happy to categorise the purchase of a house as investment rather than consumption for the purposes of the Bureau of Statistics and the National Accounts, but for the purposes of the Taxation Office will not allow this "investment" to be negatively geared, as the purchase of a second "income producing" house can be negatively geared, or allow some sort of deduction as it does with investment in superannuation?

Another way the Government propagates the fallacy is through the uses to which it puts the CPI. For example, with the capital gains tax it taxes only the capital gain component after inflation, and is happy to use the CPI as a measure of this, just as it is happy to use the CPI for indexing pensions and as a basis for wages agreements, among others.

What then is the real rate of inflation? To sensible people there is something immensely absurd in an index which purports to measure "the purchasing power of the dollar" but which fails to take into account the biggest purchases that dollar will be required to make. For most Australians, there is no greater test of the dollar's purchasing power than its ability to purchase a home.

The mortgage interest component cannot be a substitute for this, as both are clearly separate charges. Despite the boom in house prices around the country, it is still possible for some to buy a house outright and thereby incur no interest. Where a loan is taken out, the mix of deposit, principal and interest varies with each purchase.

Despite the bureau's assertion that the removal of the House Purchase, Including Alterations category and the inclusion of the Mortgage Interest Charges category would not of itself raise or lower the index, it is a noteworthy coincidence that since these changes were introduced there has been a noticeable fall in the CPI.

The annual rise to the CPI figure for the December 1984 quarter was 5 per cent. By December 1986 this had rocketed to a fraction under 10 per cent. The March 1987 quarter, the first to include mortgage interest charges but exclude house prices, saw this fall to 9.4 per cent. The index then fell – until the dramatic rise in the December 1988 quarter which prompted the bureau to change its methods.

The question needs to be asked: has this new system contributed to the fall in the CPI or, to put it differently, what would be the current CPI if the old house purchase price method were still in use? As house prices around the capital cities have nearly doubled in this period, the question is more than academic.

Is it not possible for the bureau to produce a secondary, alternative or supplementary analysis which really does give the public the information it thinks it is already getting?

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