

# Why the HCIs are a better replacement for the RPI than CPIH

Cost of Living versus Inflation

# Cost of Living

It measures what people actually spend their money on. Sounds silly doesn't it that so many have suggested an inflation measure which does not do that? But that is what those who have joined the establishment train in recommending the CPIH inflation measure have been doing. It comes from something which is often presented by the media as the same which is the cost of living (HCI) and inflation (CPIH maybe)

The HCIs aim to capture changing prices and costs as experienced by different household groups. They represent the cost of living via what you pay....

# Housing Costs

A crucial difference between inflation and cost of living comes from owner-occupied housing costs. This comes from them paying a combination of a house price (outright or a deposit) and a mortgage rate (36.1% in March). Many will think that is pretty clear-cut.

Not for CPIH it isn't. Because it assumes that you can proxy this (estimate) with rents and the terms used are Imputed Rent and Rental Equivalence So the first issue is that you assume people are paying something they usually buy to avoid! The fantasy continues as many will not know what the rent is so how can they behave as if they pay it?

But it gets worse as the whole concept of inflation gets twisted to fit the fantasy above

# The American Experience

We can learn from their experience because the issue is debated more widely there partly because it makes up around 26% of their CPI. Here is the Wall Street Journal

."Instead they use monthly rents to capture what tenants pay to rent a house or apartment, or what a homeowner would in theory pay to rent her own home."

But there is a further problem as the numbers are heavily lagged.

"Because only a minority of leases turn over each year, changes in market rents are reflected in inflation with a lag. Accounting for that lag, Fed officials, Wall-Street investors and private-sector economists have expected housing inflation to slow since late 2022 based on what has already happened with market rents."

Looking at the system as it takes around 3 months for new rents to be recorded and you have a 6 month stock or bath then the numbers are delayed at best by nearly a year.

# Back in the UK

The lagging issue is even worse in the UK because the ONS uses a 14 month stock of rents rather than 6 months. Below is the official explanation.

“A useful analogy presented by a colleague from the letting’s specialist Countrywide several years back, is to think of the PRS as a bathtub. The temperature of the water in the tub depends on the stock of rents (all rents) while the water entering the tub from the taps represents the flow of rents (advertised rents). The flow of water into the tub is hot when rents are increasing (or cold when they are falling), as this is reflecting the newly advertised market driven rental prices. However it will take time for this flow of water to change the overall temperature of water in the tub.”

So when we received the inflation numbers for April 2024 the rental numbers were based on 18 months before that, or somewhere in later 2022! If you take the US experience maybe even earlier than that.....

How much more misleading could this be.....?

# The UK Rental Numbers Have a Discontinuity

You do not have to take my word for it as here is the ONS.

“Firstly we are introducing substantial improvement to our measure of private household rents. Access to the microdata has allowed ONS to improve the methodology and produce more detailed figures”

In the 12 months to January we were told private rents had risen by 6.2% and in February 9%.

Allowing for revisions that was a difference of 2.3% in January which represents quite a problem when it is 22.4% of your index ( 16.4% fantasy rents and 6% actual rents).

# Up is the new Down

There is a really awkward implication here and let me illustrate via the private-sector estimates.

Homelet 7.9%

Goodlord 5.6%

Just as the annual rates are falling the ONS has told everyone rents have soared!