



The Real Estate Institute of Australia

Submission to the Australian Bureau of Statistics Review of the Consumer Price Index

Prepared by the Real Estate Institute of Australia

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REAL ESTATE INSTITUTE OF AUSTRALIA AUSTRALIAN BUREAU OF STATISTICS REVIEW OF THE CONSUMER PRICE INDEX

Background

The Australian Bureau of Statistics (ABS) is currently undertaking a review of its Consumer Price Index (CPI). As part of the process, the ABS is seeking feedback from users of the CPI and has invited the Real Estate Institute of Australia (REIA) to submit a written submission.

The REIA represents around 80% of real estate agencies. The Real estate industry employs approximately 77,000 persons with most agencies having less than 10 employees. The REIA represents an important element of the broader property and construction sector which together makes a significant contribution to Australia's social climate and economic development. Property contributes \$300 billion annually in economic activity.

REIA has the commitment of providing and assisting research and well-informed advice to the Federal Government, Opposition, professional members of the real estate sector, media and the public on a range of issues affecting the property market. To do this, REIA relies on range of sources of information. The CPI data is a vital part of this. Amongst other uses, REIA has two quarterly publications that report on the state of the property market that include CPI data.

The CPI data is also used by property agents to make contract lease adjustments, and more importantly, it is used for fiscal and monetary policy decisions that affect the performance of the housing market.

Issues

The objective of the review process is to update item weights, reassess the scope and coverage of the index and other methodological issues. The REIA welcomes the opportunity to be part of the process and discusses some issues it considers should be taken into account to improve the usefulness of the CPI. The issues to be discussed in this submission are:

- Principal purpose of the CPI: REIA recommends the maintaining of the *acquisitions* conceptual basis, the introduction of a rent index for private and government landlords and a house purchase-first home buyers index.
- Commodity Classification: REIA recommends that the house purchase index be broken down into new home purchases and major improvement to existing homes and fixed appliances.
- Compilation frequency of the CPI: REIA recommends that a monthly CPI be published.
- Other issues: REIA suggests that ABS construct a rent and house purchase index for both metropolitan and non-metropolitan areas.

Principal purpose of the CPI

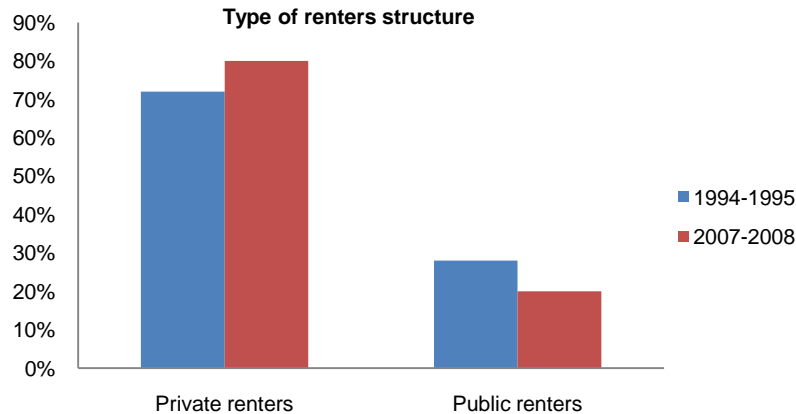
The *acquisitions* conceptual basis should remain as the main approach for the construction of the CPI. Ideally, a consumer price index should reflect the substitutions in consumption that consumers make in response to changes in relative prices. Given the complexities in constructing such index, other approaches have been chosen as second-best solutions. The *acquisitions* approach captures changes in prices of goods and services acquired by households. From a macroeconomic point of view, this characteristic is essential to make monetary policy decisions. Although it reflects neither changes in consumers' consumption patterns nor changes in the purchasing power of money, a CPI based on the *acquisitions* approach allows monetary policy to have a more effective influence on price outcomes.

REIA recommends the introduction of supplementary population subgroup measures in the housing group index structure, such as private and government renters in the rent expenditure class, and first and non-first home buyers in the house purchase expenditure class. This would assist in analysing affordability changes regarding the public and private rental sector and the costs of new housing faced by first and non-first home buyers, and thus assist in policy and monetary policy decisions.

Currently, most of the housing affordability indices only measure the changing affordability of home ownership, and ignore the private and public rental sector. REIA measures a rental affordability ratio, which is the ratio of median rent to family income. This ratio, however, only captures changes in affordability in the private rental market.

A more comprehensive analysis of the rental market could be undertaken with the introduction of an index number for rents paid to government landlords. This would not only assist in providing a measure of expenditure changes for non-private market rentals, but would assist governments, Commonwealth and states in assessing the effectiveness of their programs. According to ABS's Housing Occupancy and Costs Survey (cat. 4130.0)

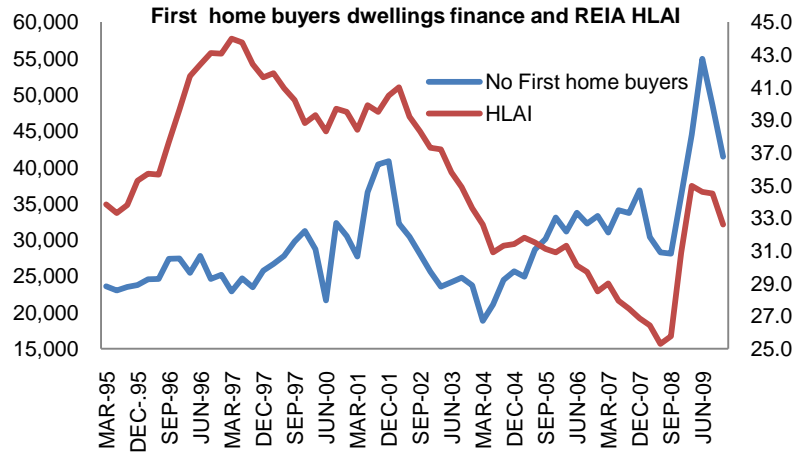
public renters, as proportion of total renters, decreased from 28% in 1994-95 to 20% in 2007-08, while private renters increased from 72% in 1994-95 to 80% in 2007-08.



Source: REIA calculations, Housing Occupancy and Costs, cat. 4130.0, ABS.

Similarly, additional information relating to first home buyers would enable policy makers to better address the issue of housing affordability. In the December 2000 quarter, according to ABS figures, the proportion of first home buyers of all dwellings finance commitments was 22.7%. In the December 2009 quarter, this proportion increased by just 0.3 percentage points to 23.0%, and this was whilst the Government's First Home Buyers Boost was still in place.

The REIA Housing Loan Affordability Index (HLAI) measures the proportion of income required to meet loan repayments. It captures the ongoing costs of housing related to loan repayments regardless of the type of buyers, and it reflects movements in mortgage interest rates, household income levels and median house prices. The graph below shows the number of first home buyers financed and the REIA HLAJ over the period March 1995-Dec 2009. Although there are certain periods when the two series are correlated, there are other factors that explain the behaviour of first home buyers.



Source: ABS, cat.5609.0, REIA

One of the financial constraints faced by first home buyers is the deposit gap, which is the difference between the house loan size, that a first home buyer's income can afford, and the house price paid. When the deposit gap increases, first home buyers experience difficulties obtaining sufficient funds to meet their aspirations of homeownership. A simple way, to identify movements of the deposit gap faced by first home buyers is by taking the average loan size to first home buyers and comparing it with the changes in house prices paid.

Currently, in the Housing Finance publication (cat. 5609.0) the ABS publishes the average loan size by type of buyer. However, under the CPI's housing group, the housing purchase index is reported without regard to the type of buyer.

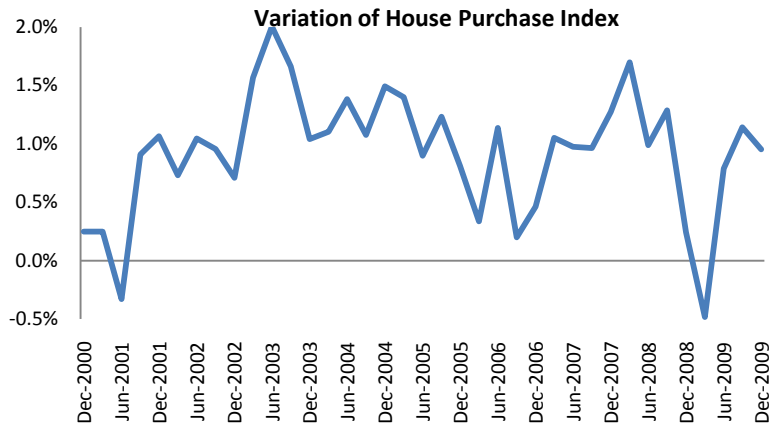
In order to capture deposit gap movements for first home buyers, REIA recommends that a house purchase - first home buyers index should be constructed by the ABS.

Commodity Classification

The Australian CPI Commodity Classification (CPICC) is the framework used to classify all goods and services acquired by households. The CPICC consists of 11 broad groups, which are broken down into 33 subgroups which are in turn broken down into 90 expenditures classes.

The housing group consist of the following subgroups: Rents, Utilities and Other housing. The Rents subgroup contains the rents expenditure class; the Utilities subgroup contains the Electricity, gas and other fuels, and Water and sewerage expenditure classes; the Other housing subgroup contains the house purchase, property rates and charges, and house repairs and maintenance expenditure classes.

The house purchase expenditure class comprises new home purchases and major improvements to existing homes, and fixed appliances such as hot water systems and dishwashers. The graph below shows the variation in the house purchase expenditure class.



Source: ABS, cat. 6401.0

The index does not allow the changes in house prices to be differentiated from the changes in price of other components in the expenditure class. For the reasons identified in the previous section and with the purpose of identifying movements in new house prices, the house purchase index should be broken down into new home purchases and major improvement to existing homes and fixed appliances

Compilation Frequency of the CPI

REIA recommends that, as long as the accuracy of the index is not compromised, the CPI should be compiled on a monthly basis rather on a quarterly basis. Currently, ABS produces the Australian CPI on a quarterly basis while most of the OECD countries produce the CPI on a monthly basis. With no doubt, the CPI is one of the major economic indicators. It is for example, a major consideration in monetary policy decisions. More frequent CPIs would provide for a better informed policy decision-making process

According to the principles reflected in the international standards, particularly in the IMF's General Data Dissemination System (GDDS), the CPI should be released within one to two months. The periodicity recommended by the GDDS is determined by the need of analysis and the ease of compilation.

The availability of a monthly CPI would better assist in formulating monetary policies since it would improve the forecast of inflation and would provide a better input to identifying the trend of inflation and detecting turning points. In regards to the ease of compilation, in

order to produce a monthly CPI the ABS would need to be collected on a monthly cycle, which would involve additional costs. However, the REIA believes that the benefits of having a monthly CPI are greater than the costs. A monthly CPI will improve the monetary policy making-decision process and avoid “over-shooting”, which will bring benefits to the whole economy.

Other Issues

The ABS seeks comments on the need for regional indexes-expanding geographical coverage beyond capital cities, and their potential use. REIA considers it important to have a rents and house purchase index for both metropolitan and non-metropolitan areas.

Providing rent and house purchase indices for metropolitan and non-metropolitan areas will by, providing levels of rental affordability in different areas, a better analysis of the structure of the housing market, including the interaction of demand and supply in the rental and new dwellings markets. This will again provide for more informed/better policy outcomes. For example, the possibility of examining the relative changes between rents in metropolitan and non-metropolitan areas, could give us an idea of how population preferences changes over time simultaneously with infrastructure and transport developments; it could also help with identify housing policies in areas where there is scarcity of rental dwellings, and also how rents in metropolitan and non-metropolitan areas are affected by population changes.

Concluding comment

The REIA welcomes the opportunity to present the ABS with proposals to consider in its review of the CPI. REIA’s comments are aimed at improving the usefulness of the CPI, including more informed monetary and fiscal policy decisions.

Prepared by:

Secretariat REIA
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