



ECONOMICS & MARKETS RESEARCH

ABS CPI SUBMISSION

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INTRODUCTION

ANZ Bank thanks the Australian Bureau of Statistics (ABS) for the opportunity to comment on the issues identified in the 16th Series Review of the Consumer Price Index (CPI). The CPI is a key economic indicator that is central to Australia's monetary policy framework, although it is used more broadly as well.

Amongst other things, it forms the basis for longer term movements both in the price of services provided by utilities and the cost of construction of a large portion of Australia's capital stock.

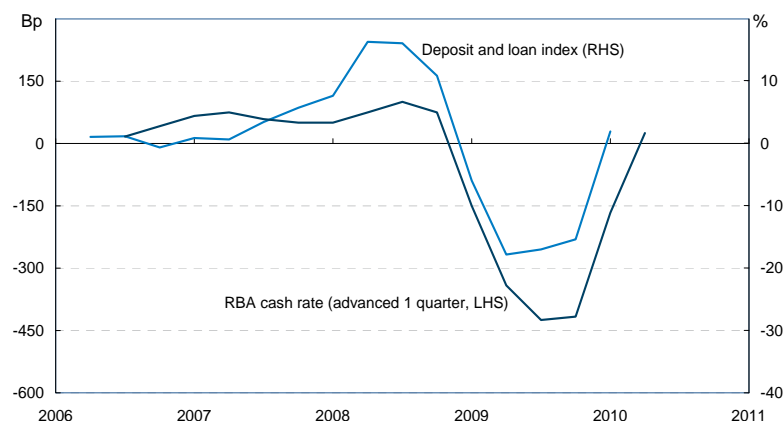
The CPI is used by the health insurance industry in determining the price of premiums and by the property industry to determine the price of leases. It is used as a benchmark for the cost of living and it determines the escalation of pension and annuity payments. Further, it allows for the pricing of financial products that fund these payments such as inflation-linked securities.

RECOMMENDATIONS

We recommend the following should be addressed by the ABS in its 16th Review of the CPI:

- **Frequency of Data Release:** We believe that the series should be published monthly. A monthly CPI would provide more timely information on trends in the CPI and it would bring Australia into line with the frequency with which CPI data is released in other advanced economies. Australia is the only country in the G20 and, along with New Zealand, is the only country in the OECD with a quarterly CPI. A monthly release of the data should help provide an earlier indication of the trend in inflation, which is particularly important around turning points in the cycle. We expect that this would not be difficult as price data is already collected each month of the quarter before it is averaged to produce a quarterly measurement. However, we acknowledge that the ABS has stated that the cost of moving to a monthly CPI release cycle is likely to be "considerable".
- **The Deposit and Loan Facilities Index:** The index attempts to measure the price of financial intermediation to households on deposit and loan facilities. It measures both the explicit fee charged on deposit and loan products and the indirect price charged through interest margins. However, the index has a large weight in the CPI (an effective weight of 4%) and it correlates strongly with movements in the RBA cash rate (Figure 1).

FIGURE 1: DEPOSIT AND LOAN INDEX (4 QUARTER ENDED GROWTH) AND RBA CASH RATE 4 QUARTER ENDED CHANGE



Source: ABS, RBA, ANZ

We acknowledge it's important to measure the price of financial intermediation to the household sector within the CPI. But, we believe that the method of calculation needs to be reviewed to either reduce or completely remove its strong correlation with movements in the RBA cash rate. Furthermore, its large weight in the CPI needs to be reduced.

- **Seasonal Adjustment:** Twenty of the ninety components of the CPI show some seasonality according to analysis by the RBA. We believe that a seasonally adjusted CPI would provide a useful analysis of the headline inflation and this would not be dependant on the frequency of compilation of the data if that was to change.
- **Underlying inflation:** The RBA has recently calculated the CPI excluding fruit, vegetables, automotive fuel and deposit and loan facilities and used it as one of the "selected underlying measures". In the past the RBA has used only the trimmed mean and weighted median to determine underlying inflation. As financial market economists, we need to be clear on how underlying inflation is to be determined because it is an important input into monetary policy decisions. Changing the way in which underlying inflation is being determined is confusing. A more transparent approach would be for the RBA to be clear on how underlying inflation is calculated and for the ABS to publish it a series. While this would involve both the ABS and the RBA working together, the outcome from this would add to understanding how monetary policy responds to inflationary pressures.
- **Other Exclusion Measures:** Many large industrialised countries publish their CPI data excluding food and energy. We believe that while this would allow for better international comparisons of inflation, although we don't believe this is as important as our other recommendations.
- **International Comparison Series:** Table 11 and Table 12 in the CPI publication show international comparisons of CPI's less housing and financial and insurance services. Even though we are a large user of international data, we never use data from this table. Our international comparisons are normally made using data from the original source. Furthermore, to our knowledge no other country publishes international comparisons in its CPI data release. In our view, these Tables 11 and 12 should be discontinued.

SUMMARY

We believe the following changes should be made to the publication of the CPI at the 16th Review.

- The data should be compiled and published monthly so that it is consistent with international best practice.
- The Deposit and Loan Facilities Index should be re-estimated so that it does not correlate as strongly with movements in the RBA's target cash rate. Furthermore, the series should have a smaller weight in the CPI basket.
- Whether or not the series is published monthly, a seasonally adjusted headline CPI should be published along with the seasonally adjusted subcomponents.
- The ABS and the RBA need to work together, so that the ABS can produce one series on underlying inflation. It is confusing for those interested in monetary policy when the measures of underlying inflation change.
- The international comparison tables should be no longer published.

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