ECONOMIC STATISTICS

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Module 2	Price Indices and Measuring Inflation
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Topic	Inflation: controversies and open issues

Inflation: controversies and open issues

What is inflation and why do we measure it?

Inflation is a measure of how the prices of goods and services increase over time, usually expressed as a percentage.

how inflation is measured, affects us all. Measuring inflation can, however, be confusing.

Deciding how we measure inflation is one of the most contentious issues in economic statistics.

Inflation matters to people. Years of even minor inflation can subtly erode your standard of living if your income does not increase sufficiently to compensate.

People have different experiences of inflation, while the official index is a form of average.

Different people have different expenditure patterns, with some items showing greater or smaller price changes than the norm.

Why do we not have just one measure of inflation?

So far, we have covered what is technically called consumer price inflation, or inflation experienced by individuals and households. In public debate, this is often used as shorthand for overall inflation in the economy.

Inflation in other sectors is also important to measure.

A very broad measure of inflation in the economy is effectively provided by what is known as the GDP deflator.
Other important price series are those for:
producer prices, services producer price indices, construction prices, house prices.
How do we find a way of capturing millions of prices to come up with a single figure for consumer prices or producer prices in a country? The approach used is index numbers

Which Index ?

The central concept in creating inflation indices is to take patterns of spending along with representative prices for different items.

In practice, it is not the actual prices that are combined. If they were used, then higher-priced items would have more weight in the index. Because the weights are based on actual household spending, they already take account of the different prices of different items.

What we are interested in is the growth in prices. Therefore, the ratio of prices in the current period to the prices in the base period is calculated. This is known as the price relative; it is the price relatives that are weighted together to form the index.

The gross domestic product (GDP) deflator
One of the price indices with the widest coverage is the GDP deflator. It is essentially the price of all the output that the economy produces. It therefore covers not just the household sector, but all sectors of the economy.

Consumer price indices: controversies and issues

The Consumer Price Index Manual - It describes the aim of consumer price indices as measuring: “the rate of price inflation as experienced and perceived by households in their role as consumers”. It should cover the goods and services consumers buy “to satisfy their needs and wants”.

→ The concept of consumption is an imprecise one that can be interpreted in several different ways, each of which may lead to a different CPI → Consumer price indices are used for a variety of purposes

→ It is also necessary to decide whether the index is meant to cover all consumers, that is, all households, or just a particular group of households.

→ Should one measure expenditure when it is paid for, when the good or service is acquired, or when the item is used?

→ A consumer price index is sometimes referred to as measuring the cost of living. The meaning of the phrase “cost of living” is not very clear,

→ in general consumer price indices aim to measure the cost of a typical “basket” of goods and services (although in the US the consumer price index officially aims to be a cost of living index on economic definitions). Whether it achieves that aim is debatable.