Isle of Man Government

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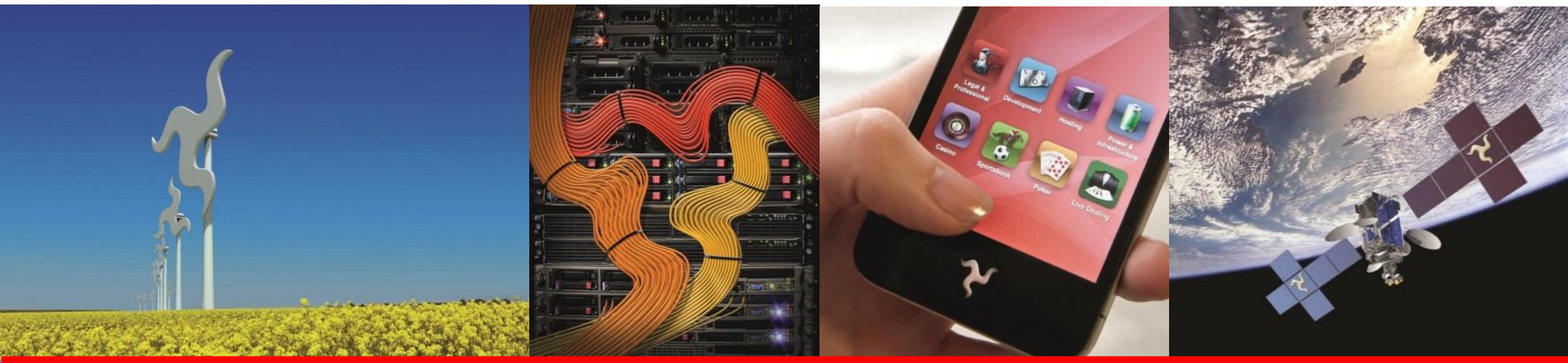

Isle of Man Inflation Guide

Economic Affairs

Cabinet Office

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The Basics

Inflation measures the increase in cost of living, expressed through the prices paid for goods and services by an average household.

To measure inflation, certain assumptions need to be made. We need to determine which goods and services to include in a "basket" to be measured, and we need to determine the relative importance of each item in the basket: expressed by the proportion of average total spending spent on it.

So we construct an index showing the items in the basket and the weight applied to each item. It should be noted that nobody's actual spending will exactly match the "basket" used, nor the weighting of total spending. We could all be said to have personal rates of inflation, depending upon what we spend our money on.

The weightings used currently are based on the results of the Household Expenditure Survey 2012/13.

Combining the movements in all the prices together results in an index value, and movements in that index value represent an inflation rate; usually expressed as a percentage increase over the previous year.

For example, if an annual rate of inflation is given as 5%, then this means something like: "over the last 12 months, the total cost of goods and services consumed by the average household has increased by 5%".

Measures of Inflation in the Isle of Man.

Economic Affairs produces three inflation indices:

- Consumer Price Index (CPI);
- Retail Price Index (RPI); and
- Retailer Price Index (Jevons) (RPI(J)).

The RPI has been produced since 1976, the CPI since 2008 and RPI(J) since September 2016. RPI(J) was introduced after a consultation by Economic Affairs about the future of the Manx Retail Price Index, the responses and recommendations of which can be found at https://www.gov.im/ConsultationDetail.gov?id=570.

There are three main differences between RPI, RPI(J) and CPI. The RPI and RPI(J) use the same basket of goods, whereas the CPI uses a different basket. As a result of the different baskets, the item weights are also different between CPI and RPI/RPI(J), which means that a price change in the same product will have a different impact upon the three indices. The final difference is the formula which is used, with CPI and RPI(J) using the Jevons formula whereas the RPI uses the Carli formula.

Difference in basket of goods

The differences in the basket of goods for the Isle of Man CPI, RPI and RPI(J) are shown in the table below.

Index	Items included	Items excluded
CPI	• University fees • University accommodation fees • New cars and second hand car sales	Housing costs: • Mortgage interest payments • Household depreciation • Buildings Insurance • Estate agents fees • Conveyance fees • Domestic rates (not including water rates) • Car tax
RPI and RPI(J)	Housing costs: • Mortgage interest payments • Household depreciation • Buildings Insurance • Estate agents fees • Conveyance fees • Domestic rates (not including water rates) • Car tax	• New cars – the RPI methodology only includes second hand car sales. • University fees • University accommodation fees

Different item weights

There are two factors which impact the difference in item weights between the CPI and RPI/RPI(J). Each basket is weighted to a total of 1,000, and therefore the inclusion or exclusion of the items above will impact upon the weight of the other items in the basket.

The main cause of the difference is however caused by the population to whom the basket of goods is meant to represent. The CPI includes the spending of all households, residents of institutions and spending by foreign visitors. Whereas the RPI and RPI(J) include spending by most households, but excludes the spending of the top 4% of households and pensioners who derive at least three quarters of their income from state benefits.

Difference in formula

Whilst the different item weights and items included within the basket of goods have a small impact upon the differences between the three indices, the largest contributor to the difference is the formula which is used in the difference indices.

The CPI and RPI(J) both use the Jevons formula, whereas the RPI uses the Carli formula.

The Jevons formula is the rooted product of the prices to calculate the average, which is designed to better take into account the fact that where prices rise, some consumers will change to alternative products rather than purchase the higher priced item. The Carli formula is the sum of all price changes, divided by the total number of price and does not take into account any change in consumer behaviour, and is generally considered to cause the RPI to overstate inflation, rather than CPI understating it.

For this reason, the Office for National Statistics in the United Kingdom delisted RPI as an official statistic on 2013.

The importance of having a measure of inflation

People derive various benefits from the goods they consume. If the prices of those goods rise but incomes remain fixed, then those people will be able to consume fewer goods, and so be worse off, unless they receive an equivalent compensating increase in income. For this reason, a measure of inflation is needed by, for example:-

- Workers and employers when conducting wage negotiations. Workers generally will want to protect their real incomes so that they do not become worse off over time.

- Government when setting pensions, other benefits and tax thresholds. Benefits such as pensions tend to be increased in line with inflation in order to keep their real purchasing power. Tax brackets tend to rise in line with inflation also. When this happens it prevents people in a high tax bracket from remaining there should their income not rise in line with the cost of living. It also increases the threshold below which no tax is paid, thus protecting the lowest earners from becoming liable to tax when only their nominal, rather than real, incomes rise.

Also, a range of contracts and court orders (private rental agreements, maintenance orders etc.) provide for increases in line with inflation. Again, the idea is to preserve the real purchasing power (i.e. the quantity of goods the money can buy rather than just the nominal value) of the original amounts contained in such contracts.

Price collection

Currently in the Isle of Man, around 1,000 prices are collected for some 500 items. These prices are collected by the staff of Economic Affairs Division by a combination of: mailing out forms to be filled in by participating businesses, personal visits to premises, telephone contacts, and browsing online shopping sites. Approximately one hundred retailers and other organisations help by either supplying price information or allowing access to their premises.

Prices are collected on the 17th/18th of every month (or the nearest working day if this falls on a weekend). All the information collected is treated in the strictest of confidence and is not disclosed to any other party outside of the Economic Affairs Division. The information is aggregated and published in a format that does not allow for identification of individual returns.