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# IMPACT ECONOMICS AND POLICY

*RESEARCH BRIEF*  
*CPI Hiding Rising Living Costs*  
*for Australian Households*



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# ABOUT IMPACT ECONOMICS AND POLICY

Impact Economics and Policy brings together a group of expert consultants and affiliates with experience working for government, non-for-profits and big four consulting.

Our advisers have expertise across economic and fiscal, health and aged care, education, gender equity, and housing policy.

Established at the start of 2022, our mission is to partner with clients for impact through providing robust evidence, fresh analysis and strategic communication to tackle Australia's biggest public policy challenges.



# CONSUMER PRICE INDEX

The Consumer Price Index (CPI) is a general measure of prices across the Australian economy and is produced quarterly by the Australian Bureau of Statistics (ABS). It is used in contracts, wage agreements and by governments to ensure prices or payments maintain their 'real' value over time. It is also used by the Reserve Bank of Australia to inform its monetary policy settings, that provide financial and economic stability.

However, the CPI is potentially a poor measure of the cost-of-living, and the pressures facing many households because of how it measures certain prices and excludes some purchases, including the purchase of existing housing stock.

As a result, the 25.4 per cent increase in established house prices over the most recent 12 months is not reflected in the CPI. In addition, because the CPI is based on average expenditure patterns, it does not reflect the price rises faced by individuals due to different locations or consumption patterns.

Over the years the ABS has endeavoured to reform how the CPI is collected and also looked to construct alternative cost-of-living measures to better reflect the true impact of price rises on households. Recently it has started to produce regular estimates of both discretionary and non-discretionary CPI to better reflect the different impacts of price rises.

The next review of the CPI and cost-of-living measures is due next year, six years after the last review. In that time there have been large advances in data availability and collection which could potentially inform new and more nuanced measures of cost-of-living. As we experience a period of higher inflation, and real wage declines this review should consider how better to capture the true cost-of-living increases facing Australian households.

Below we explore what the current measures tell us, and how through including existing house purchases and rents in regional Australia there would be more nuanced indicators of price rises – better reflecting the true cost-of-living pressures facing Australian households.



## WHAT THE CPI STATISTICS SAY

In Australia the latest CPI figures indicate a rise in cost-of-living with headline inflation running at 3.5 per cent and underlying inflation running at 2.5 per cent. These price rises are above recent trends but still within the RBA's target range to keep underlying inflation between 2 and 3 per cent. However, these figures are based on a 'basket' of goods that do not represent the spending of all Australian households.

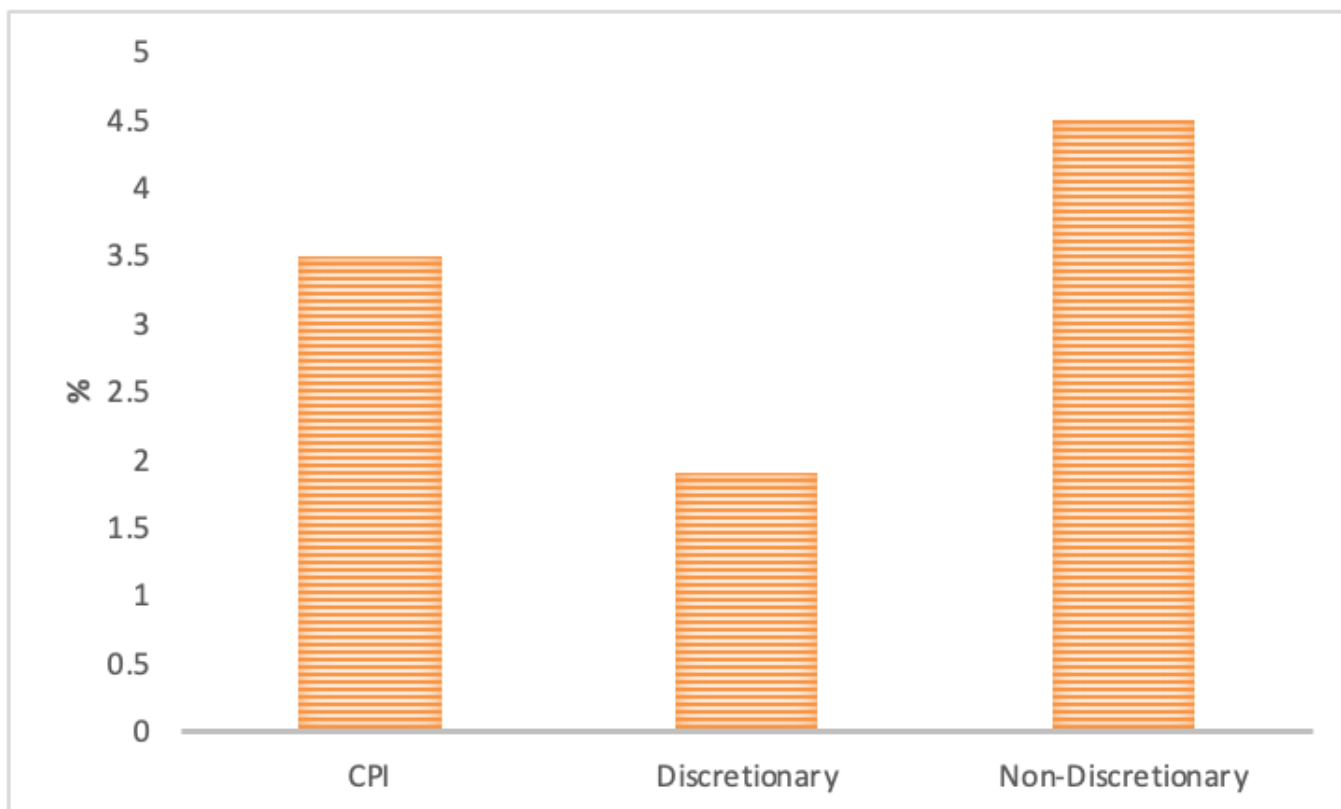
One alternative measure of inflation, non-discretionary, is produced by the ABS and measures to change in price of non-discretionary goods.

In general lower income households spend more of their incomes on these goods than high income households.

The current non-discretionary inflation figure is 4.5 per cent, meaning that for some households the cost of living is rising faster than the headline figure of 3.5 per cent. But there are other discrepancies, which mean it doesn't always provide an accurate picture of price rises across the economy.

In addition to these measures, the ABS produces a number of cost-of-living indexes which reflect the different consumption patterns of households such as pensioners.

### Annual Movements in Price Indices (%)



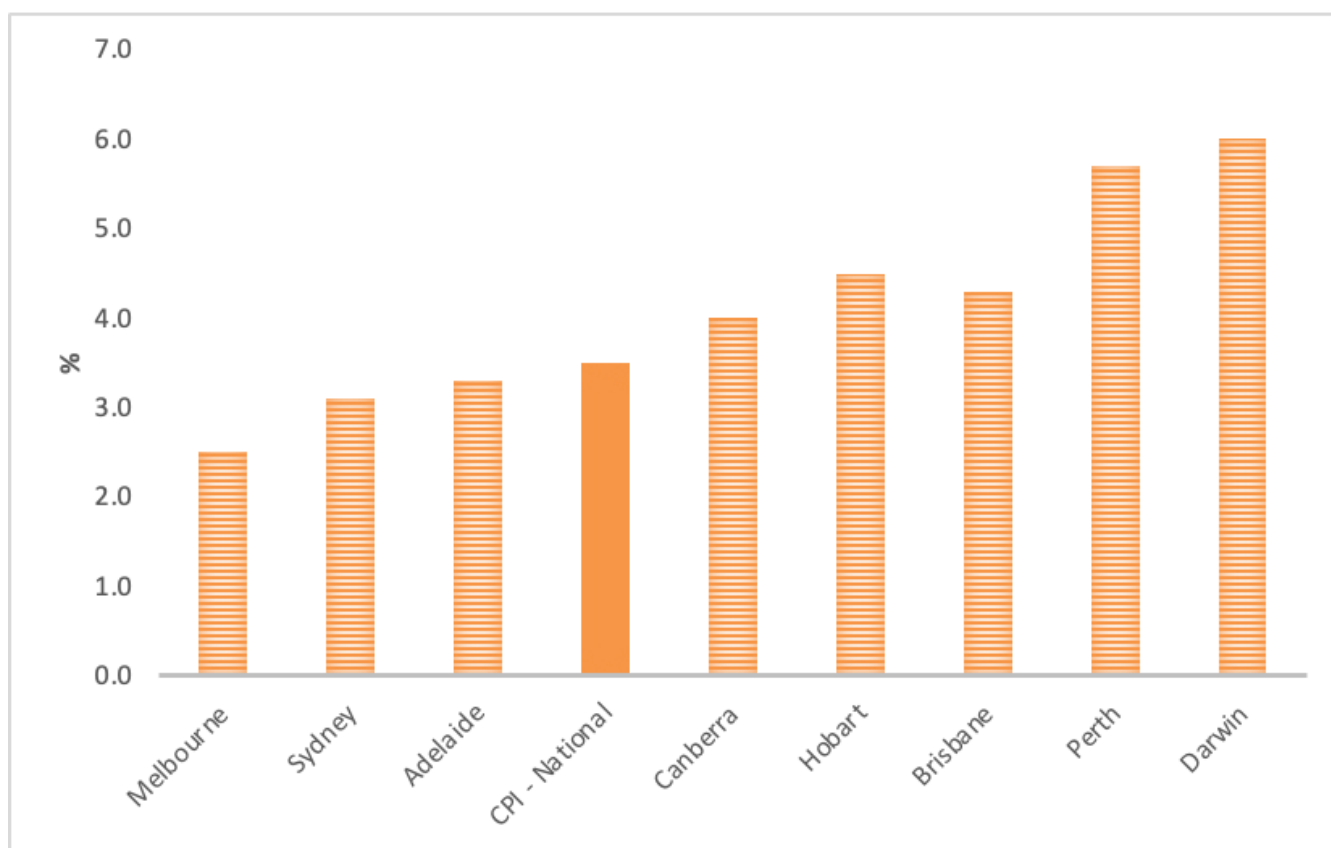
Source: Australian Bureau of Statistics, Consumer Price Index, Australia: <https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/latest-release>



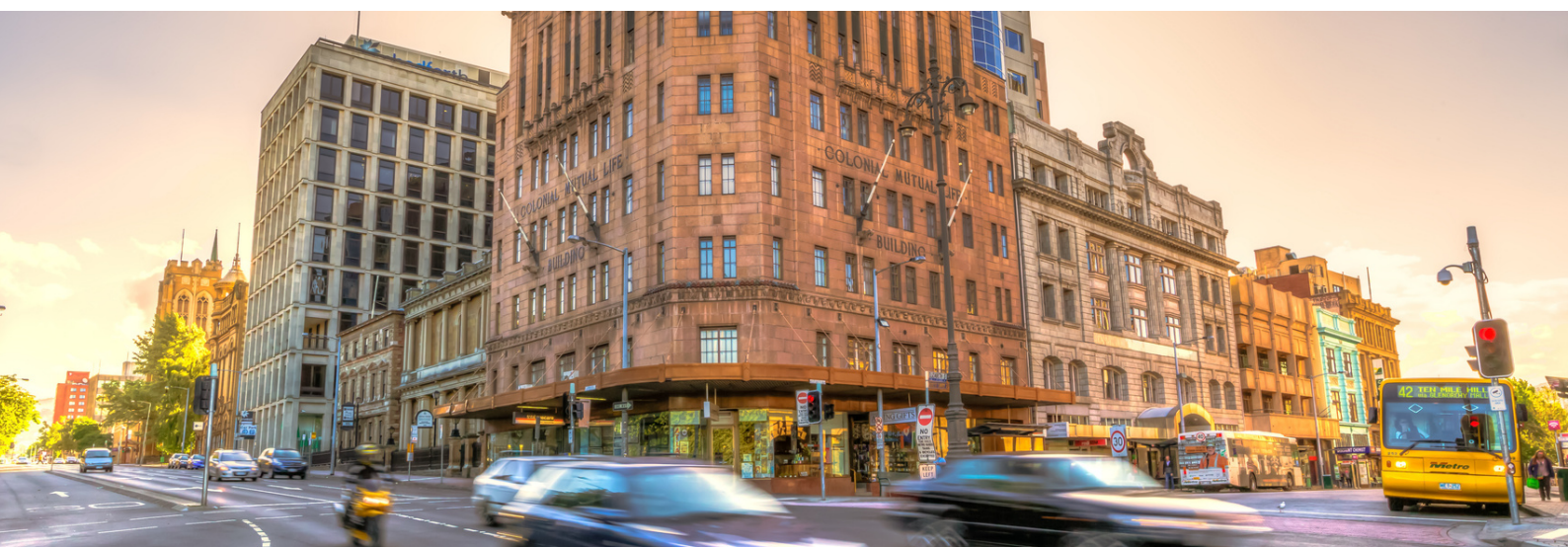
# GEOGRAPHIC DIFFERENCES

The ABS reports the CPI for each capital city, which highlights significant differences across Australia. The national CPI figure is heavily influenced by Sydney and Melbourne which both experienced lockdowns through 2021, and hides much higher price rises across other capital cities. In Perth headline inflation was 5.7 per cent in the 12 months to December 2021.

## Annual Movements in CPI (%)



Source: Australian Bureau of Statistics, Consumer Price Index, Australia: <https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/latest-release>

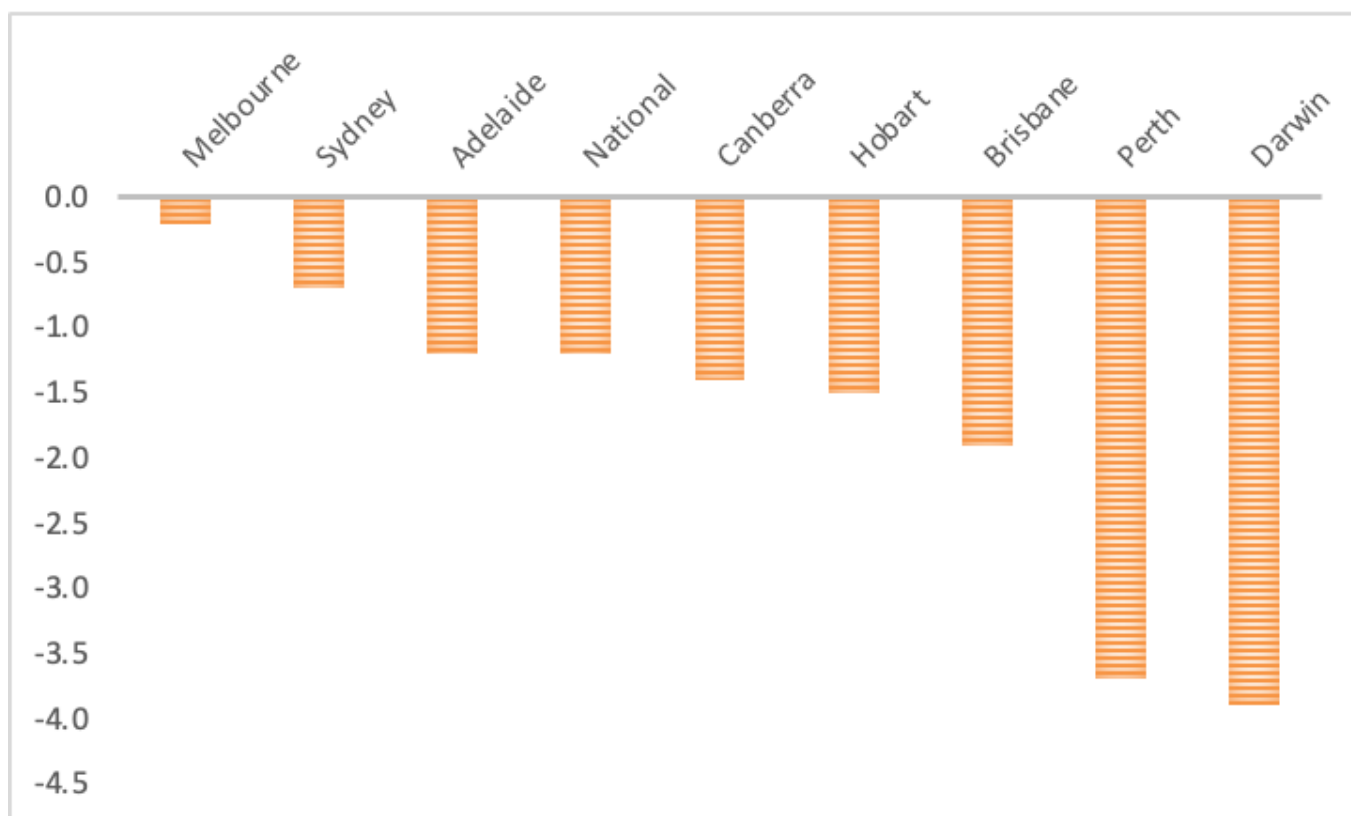




## REAL WAGES DECLINING

The combination of high CPI and low wages growth across Australia means that real wages declined by 1.2 per cent on average in the year to December 2021. However, these figures hide much higher real declines in some states and territories. In Darwin and Perth the combination of high inflation and low wages growth saw real wages drop 3.9 per cent and 3.7 per cent respectively.

**Real Wages Declining (%)**



Source: Australian Bureau of Statistics (2022), Consumer Price Index, Australia: <https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/latest-release> and Australian Bureau of Statistics (2022), Wage Price Index - Australia: <https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/wage-price-index-australia/latest-release>





## REGIONAL RENTS

The CPI is currently based on prices in the capital cities, and so ignores cost of living pressures in regional areas. During the pandemic we have seen large differences in the movement of rents between regional and city areas. Focusing on NSW and Victoria, we can see this clearly over the last 12 months. In Regional Victoria rents increased by 8 per centage points more than rents in Melbourne, and in Regional NSW rents increased by 12 per centage points more than rents in Sydney.

### Rental Price Increases (Dec 20-Dec 21)



Source: Australian Bureau of Statistics (2022), Consumer Price Index, Australia: <https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/latest-release>; New South Wales Department of Community and Justice (2022), Rent and Sales Dashboard December 2021: [https://public.tableau.com/app/profile/facs.statistics/viz/Rentandsales\\_15565127794310/Rent](https://public.tableau.com/app/profile/facs.statistics/viz/Rentandsales_15565127794310/Rent); and Victorian Government Department of Families, Fairness and Housing (2022), Rental Report - December 2021, <https://www.dffh.vic.gov.au/publications/rental-report>

## REGIONAL PRICE INDEX

Producing a 'regional' CPI measure would provide a better indication of cost of living pressures in different areas of Australia and how economic conditions are impacting different areas. By generating a separate index that accounts for the higher rental prices in regional Victoria and regional NSW the faster rise in the the cost-of-living in these areas is transparent (see Appendix for methodology).

In NSW the regional cost-of-living index which includes regional rent price rises, increased 4.1 per cent in the 12 months to December 2021 compared to the Sydney CPI of 3.1 per cent. In Victoria the regional cost-of-living index rose 3.1 per cent in the 12 months to December 2021, compared to Melbourne CPI of 2.5 per cent.

**Rental Price Index (%)**



Source: Australian Bureau of Statistics (2022), Consumer Price Index, Australia: <https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/latest-release>; and Impact Economics and Policy calculations (see Appendix for methodology)





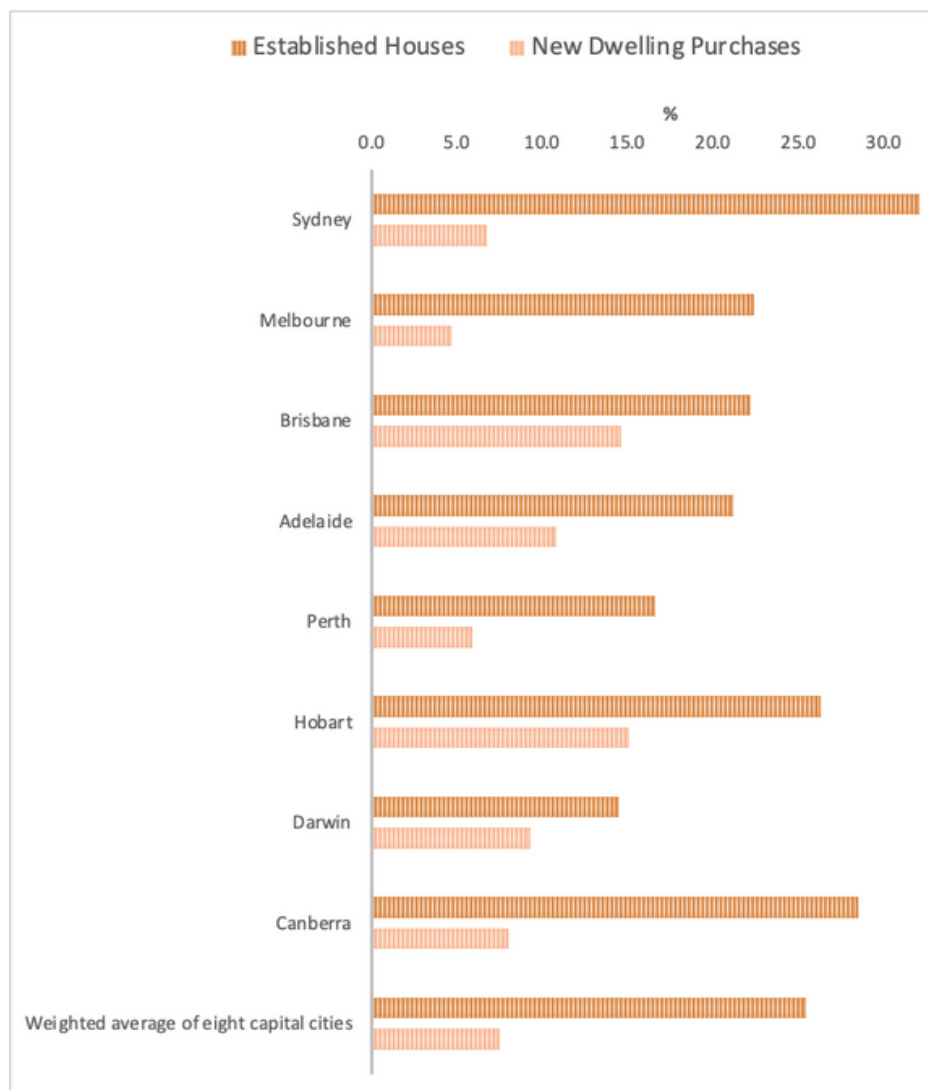


# HOUSE PRICES

The current CPI measures include housing costs such as rent and new dwelling purchases, but does not reflect the cost of purchasing established houses. This has a sound basis from an economic perspective, because the sale and purchase of an established dwelling involves a transaction within the household sector – but does mean the current CPI does not reflect the true cost-of-living faced by individual Australian households.

Over the past 12 months the difference in the rise of established versus new dwellings was consistent across Australia. Given that most people purchasing a home are purchasing established houses, this difference, particularly for first home buyers, is significant.

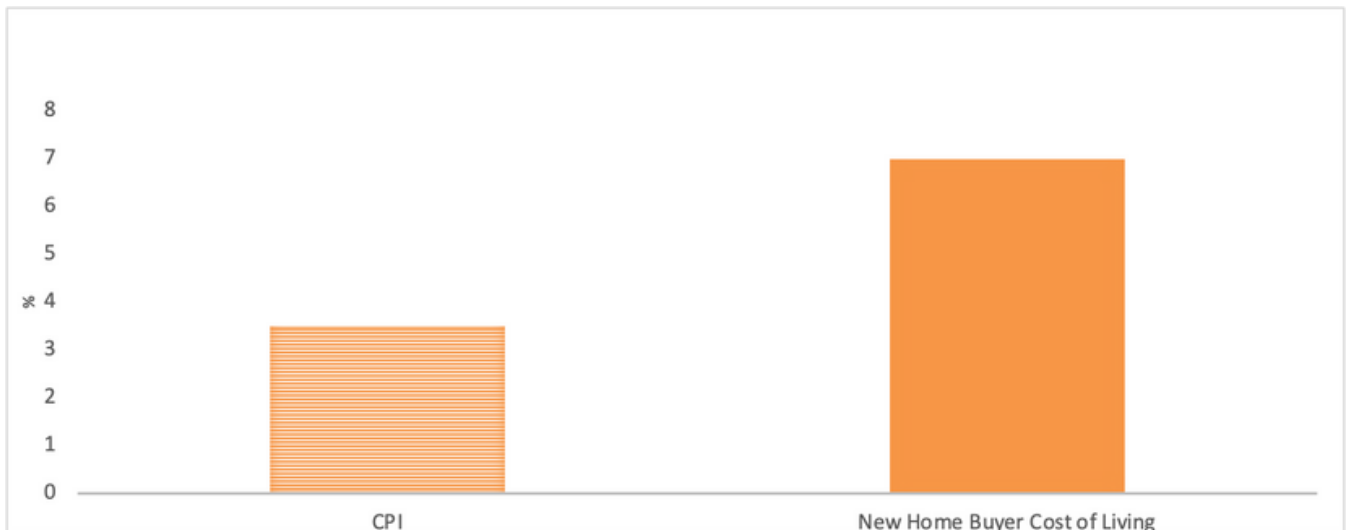
## Established House Prices VS New Dwelling Purchases (%)



Source: Australian Bureau of Statistics (2022), Consumer Price Index, Australia: <https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/latest-release>; and Australian Bureau of Statistics (2021). Residential House Price Indexes, Eight Capital Cities: <https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/residential-property-price-indexes-eight-capital-cities/latest-release>

# NEW FIRST HOME BUYER COST OF LIVING INDEX

**New First Home Buyer Cost of Living Index (%)**



Source: Australian Bureau of Statistics (2022), Consumer Price Index, Australia: <https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/latest-release>; and Impact Economics and Policy calculations (see Appendix for methodology)

A new first home buyer cost-of-living index that incorporated the increase in price of established houses would better reflect the cost-of-living pressures facing new homebuyers and would provide a better measure of their cost-of-living increases over time (see Appendix for methodology).

The new first homebuyer cost-of-living index increased 6.1 per cent in the 12 months to December 2021, compared to a 3.5 per cent increase in CPI.

Based on the Household Expenditure Survey 2015-16 the purchase cost of a house represents 12 per cent of household spending. Being conservative in constructing a new index that includes the cost of established dwellings, it has been included on the basis of representing 10 per cent of all expenditure. This is consistent with previous approaches.



## CONCLUSION

The CPI remains an important indicator of general price rises across the economy, and tool for economic policy makers. But it is hiding much higher cost of living rises for Australian households. There is a need to look to develop more timely and comprehensive set of cost-of-living indices that better reflect the cost-of-living pressures facing Australian households.

Current measures are heavily influenced by Sydney and Melbourne, and may overtime ignore changes in other capital cities and regional areas. In addition, the failure to produce a cost-of-living index that includes the cost of purchasing an existing dwelling is not properly reflecting the impact of rising house prices on first homebuyers over time.



# APPENDIX

## RENTAL PRICE INDEX METHODOLOGY

ABS weights and index levels for Melbourne and Sydney were used, with the rental price index replaced with reported rental price increases outside these capital cities by the NSW Department of Communities and Justice and the Victorian Department of Families, Fairness and Housing.

In order to illustrate the impact of including rental price rises experienced in regional NSW and Victoria in regional price indices we assumed that consumption patterns were otherwise identical between regional and capital city areas. This simplifying assumption means the index as constructed maybe either over or underestimating price rises, as there are likely to be other differences between areas over the period not captured.

## FIRST HOME BUYER INDEX METHODOLOGY

ABS weights and index levels were used, but re-weighted to include established house prices composing 10 per cent of the expenditure basket of a first home buyer using both 2020 and 2021 weights published by the ABS. The established house price index was then included in the basket, and a new index constructed over the period December 2020 to December 2021.

Because there is no data for December 2021 for house prices yet available, we have assumed flat house prices from September to December 2021. This is considered a conservative assumption given CoreLogic daily house price index increased by 5.1 per cent over the period across five capital cities.