

Statistics Iceland revises the base of the consumer price index (CPI) annually to bring it into line with changes in consumption patterns and consumer spending and purchasing. The most recent revision was made in March 2006. Index weights are based on the results of ongoing household expenditure surveys over a three-year period, currently 2002-2004.¹ When the index base is revised, the period is shifted forward by one year.

Box VIII-1

Revised CPI base

Main changes in weight of subindices

When the index base is revised, the weight of various subindices is altered. Major changes can have a substantial effect on measured inflation, especially if component prices are volatile. Exchange rate movements can influence the weight of individual components. For example, the high value of the króna in recent years caused imported goods to weigh more heavily in household expenses. In turn, the increased weight of imports in the new CPI base magnifies the effect of the depreciation of the króna.

Main changes in relative weights of CPI subindices in March 2006 were as follows:²

- Food and beverages decreased from 14.2% to 13.3%.
- Owner-equivalent (imputed) rent decreased from 17.2% to 16.8%.
- Motor vehicles increased from 3.4% to 5.9%.
- Fuels and lubricants increased from 4.9% to 6.3%.
- Recreation and culture decreased from 12.4% to 11.7%.
- Domestic goods decreased from 15.8% to 14.4%.
- Imported goods increased from 30.5% to 34.1%.
- Groceries decreased from 16.4% to 15.2%.

The greatest change was in the transport component, which includes purchases of vehicles, their operation and maintenance, and fuels and lubricants. Its weight increased from 13.1% to 16.9%. Vehicle imports soared as households took advantage of favourable prices caused by the buoyant króna. When the results of the 2004 consumption survey were included, this drove up the weight of motoring costs in household expenditures. Car imports were at a low in 2001, which ceased to be an index base year after March. Household expenditures on fuel have also soared.

Housing and utilities, a subindex including owner-equivalent (imputed) rent and house maintenance and repairs, fell in weight from 27.2% to 26.4%, largely driven down by own housing. Over the survey period, a drop in finance costs and household debt service apparently outweighed the rise in housing prices in 2004.

Medium-term scenario for exchange rate developments and CPI base revisions

Imported goods increased as a proportion of expenditures in 2004, reflecting the strong króna. Their larger weight will amplify the effect that the subsequent depreciation will have on the CPI this year. Imported goods will probably weigh even more after the next revision, which will incorporate survey results for 2005 – a record year for imports of motor vehicles and other consumer goods. Increased imports and sales of new cars account for one-third of private consumption growth over the past three years, with a 57% increase in new vehicle registrations in 2005 alone. Further changes can there-

1. The revision of groceries weights was based on survey findings for 2003-2005.

2. The previous and new bases are compared at constant prices, i.e. the weights for 2005 have been adjusted for inflation during that year.

fore be expected when the period 2003-2005 constitutes the index base. On the other hand, neither the impact of the recent depreciation of the króna on the composition of household expenditures, nor a possible contraction in private consumption, will be felt significantly until with the index base revision in 2008. Chart VIII-5 shows the development of the import-weighted exchange rate index and import prices since March 1997.

Of other conceivable changes, the rise in petrol prices in recent months will presumably drive up household expenditures in 2006, which will be reflected in the 2008 base revision. Housing price inflation in 2005 and higher finance costs will probably increase the weight of own housing when the index base is next revised in 2007 and 2008.

Temporal coverage of price collection

Statistics Iceland plans to reschedule its surveys for the CPI and collect prices in the middle of the month instead of the first two days. This decision comes after EU Council Regulation No. 6998/06 was set, establishing minimum standards for the price collection period in the Harmonised Index of Consumer Prices (HICP). Although the regulation is only binding for Iceland with respect to the HICP (and not the CPI), it would be inefficient to maintain two price collection periods. The change will be implemented in Iceland with new legislation entering into force in January 2008, from which time prices will be collected for around one week during the middle of the month.