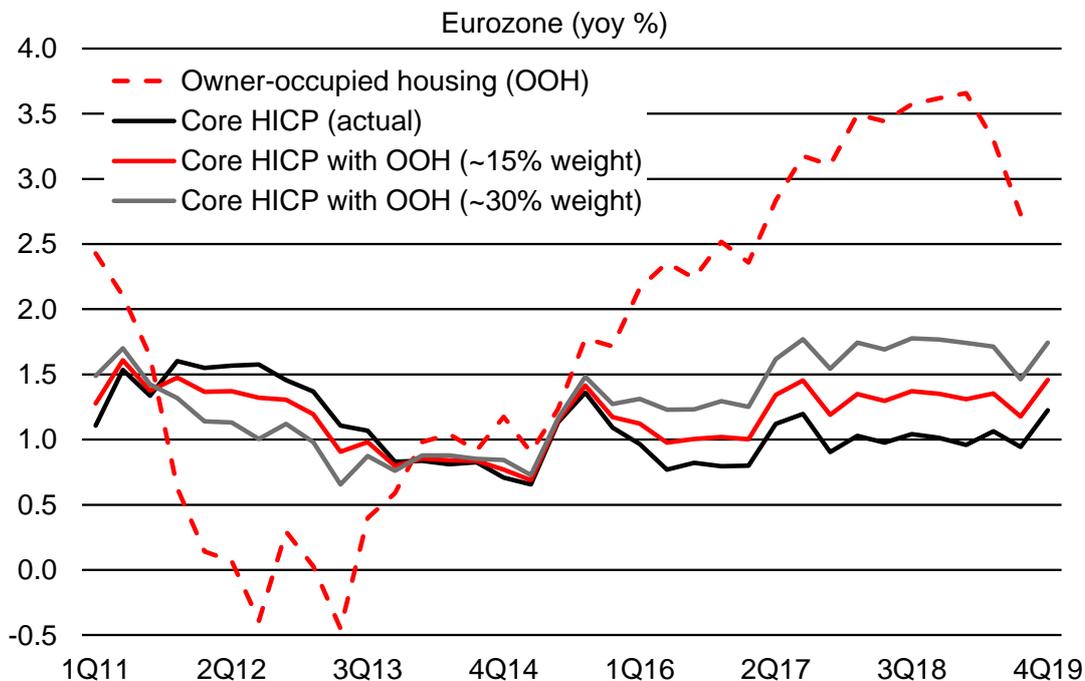


## Eurozone inflation would be closer to the ECB goal if it included owner-occupied housing



Data for owner-occupied housing (OOH) for the eurozone are computed as a weighted average of national data. Data are available from 2011 until 3Q19. Therefore, it is assumed that the contributions of OOH to hypothetical core inflation measures in 4Q19 were unchanged from 3Q19.

Source: Eurostat, UniCredit Research

- The definition of price stability will be at the core of the ECB's policy review that just started. Currently, the ECB defines price stability as "a year-on-year increase in the Harmonized Index of Consumer Prices (HICP) below, but close to, 2% over the medium term". However, some members of the ECB's Governing Council (GC) have hinted that HICP may no longer adequately reflect the inflation rate as it is perceived by households due to the low weight of the cost of housing in the basket. At present, housing costs mainly enter the HICP through actual rents, with a weight of 6.5%, while the costs of owner-occupied housing (OOH) are not included. OOH is a tricky concept: it reflects the costs of purchasing, maintaining and living in one's own home. OOH costs tend to be positively correlated with house prices, but measuring them is a complex task. Several advanced countries include OOH in their inflation gauges, the US being one of them. In US CPI, the weight of actual rents is 8%, while OOH accounts for most housing costs through the so-called owners' equivalent rent, with a weight of 23%<sup>1</sup>.
- Our Chart of the Week shows the yearly price change in eurozone OOH costs, actual core inflation and two hypothetical core inflation measures that assume that the core HICP basket also includes OOH, with weights of about 15% and 30% respectively. The former weight is derived from an estimate provided by ECB researchers<sup>2</sup>, while the latter is broadly in line with that of US CPI (where core items account for 80% of the overall basket). Even though the ECB targets headline, not core, inflation, we focus on the latter because this is a key metric the central bank considers when assessing underlying price pressure and, hence, the direction of monetary policy.

<sup>1</sup>Owners' equivalent rent measures the amount a homeowner would pay to rent or would earn from renting his or her home on the market. In the Personal Consumption Expenditure price index (PCE), its weight (at 11.5%) is smaller than it is in the CPI.

<sup>2</sup>See Eiglsperger, M. and Goldhammer B., "Consumer price indices, owner-occupied housing and measures of underlying inflation in monetary policy of selected central banks", August 2018.

- The chart shows that the growth rate of OOH costs has exceeded that of core HICP in the last few years, contributing to pushing core inflation measures that include OOH above actual core inflation. Depending on the weight of OOH, the gap between hypothetical core inflation rates and actual core inflation has amounted to an average of 0.2-0.5pp per year since 2015. At this stage, the inclusion of OOH costs in the HICP basket would leave the ECB closer to meeting its definition of price stability. Therefore, the discussion of a possible revamping of the HICP to include OOH will be closely monitored by financial markets.
- Such discussion is likely to prove complex because it involves both conceptual and practical issues. At the end of 2018, the European Commission submitted a report to the European Parliament and the European Council arguing against integrating OOH indices into the HICP mainly for two reasons. First, it is unclear whether the cost of acquiring a dwelling should be considered as a consumption expenditure that can be covered in a consumer price index or should instead be regarded as an investment (and thus not suitable for inclusion in the HICP). Second, OOH price indices are currently compiled quarterly and released 100 days after the end of the reference quarter, while the HICP is published monthly, with a flash estimate already at the end of the reference month. Up to now, the ECB has been sharing the European Commission's concerns<sup>3</sup>, claiming that integrating OOH into the HICP would deteriorate the frequency and timeliness of HICP and introduce an asset element. The ECB's policy review will look again at both of these topics; frequency and timeliness of data appear to be the main hurdles facing the GC members that advocate expanding coverage of housing costs in the consumer price index.

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<sup>3</sup> The ECB's view was communicated to the Commission (Eurostat) by letter dated 20 September 2017 (ARES(2017) 4634173).

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This report was completed and first published on 31 January 2020 at 09:30.

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