

Besides the national indices, there is a third tool for observing the purchasing power, namely the harmonised consumer price index (HCPI). Designed to be a collective economic instrument within the European Union, but also within the euro area, it measures price variations in a harmonised way. Until 1997, the national indices of the different countries of the European Union were the fruit of disparate methodologies. Each one had its peculiarities. The first national harmonised indices were published from 1997. Since then, and on the basis of the HCPI of the different countries, Eurostat (the Statistics Office of the European Commission) is able to work out the HCPI for the euro area or that for the wider European Union. This enables a better understanding of movements in inflation rates evolution within the euro area and the EU, information that is vital when it comes to setting monetary policy, the task of the Eurosystem.

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## The consumer price index



Although frequently in the news, the notions of purchasing power and inflation are not easier to understand. Room 14 of the Museum of the National Bank of Belgium is therefore dedicated to a didactic explanation of these themes. There you can see how prices have changed for a selection of items (bread, meat, milk, beer and coal/oil) and, in parallel, the development of the average hourly wages of a worker, from 1860 until the present day. The table showing the evolution of prices is based on a principle similar to that used for the consumer price index (CPI).

The consumer price index is an economic tool compiled to observe changes in the prices of a fixed range of goods and services. It is metaphorically called the "housewife's shopping basket" since the goods and services are selected for their



Table showing the evolution of prices.

significance in the household budget. This index enables us to measure inflation, a generalised increase in prices over a long period of time.

It would not be possible to observe the price changes for all goods and services, without any exceptions. That is why it is first necessary to make a selection. The goods and services that are the most important for households have to be determined by using surveys about the consumption habits of households. Some of the selected items will be given a higher weighting because they are more frequently used. Once this classification has been completed, the observation of prices may begin.

In Belgium, the first consumer price index dates from 1919. We owe it to Joseph Wauters, Minister for Labour, Industry and Supplies. Published in 1920, it only consisted of a limited range of goods: 56 products, most of them edible. Unlike our current index, all the goods had the same weighting. Despite this lack of differentiation, the index had a practical objective, which was to maintain the purchasing power. Since the purchasing power is the ability to buy a given number of goods with a fixed amount of money, it decreases if prices increase, unless wages and benefits increase too.

The CPI was thus created, among other aims, so that wages and benefits could be adjusted to changes in the cost of living. Since its 1919-1920 version, this particular objective has not changed, but the index itself has greatly evolved. The selection of goods and services has been considerably widened, from 56 products in 1919 to 507 products and services in 2004. Moreover, the items in the basket have been given a different weighting depending on their importance in household expenditures. In 1994, a new index came into effect, called the "health index". It is a "light version" of the housewife's shopping basket, for it does not include either fuel oils, tobacco or alcohol.

From then on, the health index has been the benchmark for index-linking rents, wages and benefits. The indexation of wages and benefits, is calculated in stages. There is a new round of indexation when what we call the "central index", a threshold that corresponds to a fixed margin of increase, is reached by the moving average of the health index over the last four months.

In practice, the prices of goods and services in the housewife's shopping basket are recorded each month, in 65 representative towns in Belgium. Various price averages are then worked out. Eventually, the index measures the level of price changes based on the reference year of 2004. The annual inflation rate is calculated by comparing the value of several "baskets", one by one, over time. This rate is expressed as a percentage change worked out from a year-on-year price comparison.

In order to meet their goal, consumer price indices have to be the most precise representation of household consumption. This may seem like an elementary precaution, but it is not as easy as it looks. Until 2006, the index was fully updated only every five to eight years. The January 2006 index nevertheless introduced some methodological changes. Not only have measures been adopted to take better account of changes in quality of the goods and services in the basket, but a biennial reform has also been decided on so that new products would more easily become part of the basket and weightings could be slightly modified. Even though these reforms are not complete, they give a more representative model of household consumption and they manage to take new products into consideration. The full updates are still carried out every five to eight years. Yet there is still one other pitfall when it comes to representativeness, for the index cannot take into account the fact that people tend to replace goods whose prices are rising with cheaper ones.