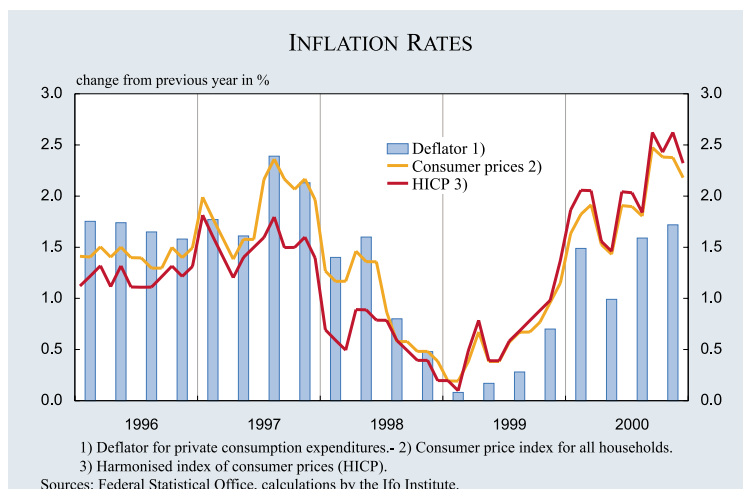


HOW INFLATION IS MEASURED

In the past year, German consumer prices increased noticeably, mainly due to the cumulative effects of a weak euro and the oil price explosion. Measured in terms of the price index for the cost of living of all private households, prices rose by 1.9% in 2000; in terms of the harmonised consumer price index (HCPI) by about 2%; but measured by the deflator for private consumer spending by only 1.4%. How do these three carefully watched indices differ?

Since June 1948 changes in the prices of goods and services at the consumer level have been measured by the price index for the cost of living of all private households. This index registers the monthly price changes of a representative sample of domestic consumer goods (commodity basket) on the basis of the average consumption behaviour of private households in 1995 (constant weighting scheme). Currently, the Länder statistical offices decentrally collect data in 118 west German and 72 east German municipalities on about 350,000 individual prices for ca. 750 goods. The overall results are calculated by the Federal Statistical Office. This Laspeyres type index leaves out interim changes in consumer behaviour as the result of changed prices or preferences as well as the money spent by German tourists outside the country. The money spent by foreign tourists in Germany, however, is taken into account (domestic concept).

In the context of the national accounts, the Federal Statistical Office also calculates a quarterly price index for private consumer spending. This index differs from the price index for the cost of living in that it refers to total consumption of private households (i.e. including non-profit organisations) and in that current changes in the composition of consumption are taken into account (Paasche price index). In addition, the consumption deflator includes the tourist expenses abroad of domestic households (domestic citizen concept). However, domestic purchases by foreign tourists as well as domestic purchases by private households from



other private households (e.g. used cars) are not taken into account.

To monitor price stability in the euro area, Eurostat, the EU statistical office, has published – since May 1998 – a harmonised consumer price index for members of the Monetary Union (HCPI-EMU) based on individual country results. The Federal Statistical Office determines the German HCPI for Eurostat every month. Harmonised consumer price indices were developed in order to determine, on the basis of uniform standards, whether the price stability criteria were met for EMU membership. In the meantime, HCPI-EMU has become one of the most important economic indicators for the euro area. Differences in the national consumer price indices have historical reasons but they also reflect the differing social conditions in the member countries or different structures in the statistical systems. Because of the differences in the consumer price indices of the member states (as a result of diverging commodity baskets or weighting schemes), a complete harmonisation has not yet been achieved.

W.N.