

## Understanding the Consumer Price Index (CPI)



***The Consumer Price Index (CPI) is a statistical measure used to track changes in the average prices of a basket of goods and services commonly purchased by households over time.***

It is an important economic indicator that provides insight into inflation and cost-of-living adjustments.

### **What is the purpose of the Consumer Price Index?**

The primary purpose of the CPI is to measure and monitor changes in the cost of living for consumers.

By examining the price movements of various goods and services, policymakers, economists and businesses can assess the impact of inflation on households and make informed decisions.

# Why is the CPI important?

- o **Inflation Measurement:** The CPI helps to measure inflation by indicating how prices are changing for a representative set of goods and services. It provides an estimate of the average price change experienced by consumers over a specific period. Governments, central banks, and economic analysts closely monitor the CPI to assess the overall price stability in the economy.
- o **Policy Decisions:** The CPI plays a crucial role in informing monetary policy decisions. Central banks often use the CPI as a key factor when determining interest rates. Higher CPI values indicate rising prices, which can prompt central banks to increase interest rates to curb inflation. Conversely, lower CPI values might prompt central banks to lower interest rates to stimulate economic growth.
- o **Cost-of-Living Adjustments:** Many governments, employers, and labour unions use the CPI as a basis for cost-of-living adjustments (COLAs) in various contracts and agreements. For example, social security benefits, pensions, and wage increases may be linked to changes in the CPI. COLAs help to ensure that income and benefits keep pace with inflation, maintaining the purchasing power of individuals and protecting against the erosion of real wages.
- o **Economic Analysis:** The CPI is a valuable tool for economists and researchers studying the economy. By analysing CPI data, they can assess trends, understand the impact of price changes on different sectors, evaluate income distribution, and measure the standard of living. CPI data also provides insights into consumer behaviour, market competitiveness, and the effects of government policies on prices.

It is important to note that while the CPI is a widely used and respected measure, it has some limitations. For instance, it may not fully capture changes in quality, substitution effects, or regional variations in prices. Nevertheless, it remains a valuable tool for understanding and tracking price changes in the economy and its impact on consumers.

Let us assume we have a basket of goods and services that a typical urban household in a certain country might consume. The basket includes items such as food, housing, transportation, healthcare, education, and other common expenses. We will use a simplified version of this basket for our example:

| CATEGORY | ITEM      | JANUARY '23 PRICE | JANUARY '24 PRICE |
|----------|-----------|-------------------|-------------------|
| Food     | Bread     | R17.00            | R20.00            |
| Housing  | Rent/Bond | R1000.00          | R1020.00          |

## Conclusion

The CPI for January 2024, relative to January 2023, is higher. This means that the overall price level of the basket of goods and services has increased from January 2023 to January 2024.

The effect of the CPI on a household can be significant and can impact their standard of living, and overall financial well-being.

*SERR Synergy has a team of qualified Information Compliance Advisors who assist businesses to comply with provisions of the Consumer Protection Act.*

**About our Author:** Judy Kotze holds an LLB from the University of Pretoria and was admitted as an attorney of the High Court in 2015. She started working at SERR Synergy in 2015 where she is currently Manager of the Information Compliance Department in Pretoria, setting up and advising businesses on corporate governance in all aspects (ownership, POPI, PAIA etc).

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