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**Abstract:**

A CPI measures the rate of price inflation as experienced and perceived by households in their role as consumers by measuring the change between purchasing a fixed basket of consumption goods and services over time. The question that arises is how successful the CPI is in measuring changes in the actual cost of living of households. As a result of price increases in certain products consumers might choose to substitute items in their basket for other items. By assuming a fixed basket, the effect of substitution is not taken into account. The Boskin – commission found that the CPI overestimates the real inflation rate experienced by households in the United States by 1.1%, Research in Canada, Spain and Britain confirms this assumption. In a South African context research to this regard is limited.

This research will focus on the differences in food expenditures between time periods for the same household types. Engel curves are used to infer bias in the CPI as a Cost of Living Index. The original notion of Engel is that households with the same share of their budget going towards food are assumed to be equally well off. By controlling for changes in the price of food relative to the prices of all other goods, it is possible to compare demographically similar households with the same level of CPI deflated total expenditures dedicated to food. Differences in food's share of total expenditures could then be attributed to the CPI's inability to measure changes in the true cost of living. For purposes of this research households in the lowest expenditure group and highest expenditure group will be considered.

Although the CPIX, a specific type of CPI excluding the interest component, is used within a South African context to target inflation, this research will apply the CPI for the following reasons:

- The CPIX has only been published since 1997, with one change in the weights being undertaken in that period. Data for the CPI, however, is available since 1970, with various changes in the weights, making it more appropriate for analysis purposes.
- CPI is the broadest defined consumer price index available, since it includes the interest payments of households on their mortgages. With the growth in house prices over the last few years and housing becoming less affordable for lower income groups, it is important to take cognisance of this component when considering the cost of living of households.