

12 March 2007

Memorandum on constant tax CPI and the changes in VAT rates on 1 March

Statistics Iceland now publishes a new CPI (February 2007=100), which shows price changes when taxes, which are levied on the final product price, are kept constant. Eurostat uses the same method for computing a constant tax index for the Euro-zone. The index for the beginning of March shows the price changes that would have occurred with the VAT rates remaining unchanged at the February level.

The results of this exercise are shown in the table on page 2 and they give both an indication of the extent to which the reduction in VAT has shown up in the price level in March and of the underlying inflation. For further explanation, one can say that if the constant tax index for food and beverages is higher in March than in February this implies that the VAT reduction of that category has not yet been fully reflected in lower prices or market prices have been rising.

Statistics Iceland estimated in January that the cut in VAT would lower prices of food and beverages by 7.5% (effect on the index 1.02%). The price fall proved to be 7.4% (1.01%), i.e. the VAT reduction has by and large been fully realised. It should be born in mind, however, that prices of food and beverages normally fluctuate considerably; new discounts are offered and others are retracted.

In the January estimate, prices of catering services were shown to be reduced by 8.8% (0.42%). According to the CPI in March, these prices fell only by 3.2% but in the constant tax index the increase is 6.3% (0.3%). This implies that the VAT reduction has only been realised to a small extent yet or that the reduction has been counterbalanced by increases in market prices.

Statistics Iceland has also summarised the categories in the CPI which were affected by the VAT reduction. A comparison is made between the expected price effects and the effects realised in the CPI in March.

A comparison between the estimated price effects and the measured price change in the CPI between February and March 2007

	Estimated change %	Effect on CPI %	Measured change %	Effect on CPI %
Food and non-alcoholic beverages	-7.5	-1.02	-7.4	-1.01
Electricity, gas and other fuels	-2.8	-0.06	-1.1	-0.02
Pharmaceutical products (vitamins etc)	-1.6	-0.02	-1.0	-0.01
Road toll fees	-6.1	-0.01	-7.5	-0.01
Pre-recorded media for pictures and sound	-4.7	-0.02	-4.2	-0.01
Licence fees for television and radio broadcasting	-6.1	-0.08	-6.0	-0.08
Books	-6.1	-0.06	-4.0	-0.04
Newspapers and periodicals	-6.1	-0.04	-5.4	-0.03
Catering *)	-8.8	-0.42	-3.2	-0.15
Accommodation services **)	-5.6	-0.02	-3.0	-0.01
Total	..	-1.75	..	-1.38

*) Prices of food and non alcoholic beverages sold by catering establishments should on average fall by 11.2% but VAT on alcoholic beverages which are included in this category remained unchanged.

**) Prices of accommodation services at hotels, hostels camping sites etc should fall by 6.1% but in this category are included service not object to VAT charges.

Constant tax consumer price index, percentage changes February-March

	Change %	Effect on the CPI %		Change %	Effect on the CPI %
Consumer price index	1.4	1.42			
01 Food and non-alcoholic beverages	0.1	0.01	06 Health	0.6	0.02
011 Food	0.5	0.07	061 Medical products, etc.	1.3	0.02
0111 Bread and cereals	0.7	0.01	062 Out-patient services	0.1	0.00
0112 Meat	1.9	0.05	07 Transport	0.3	0.05
0113 Fish	-2.2	-0.01	071 Purchase of vehicles	-0.8	-0.05
0114 Milk, cheese and eggs	-0.7	-0.02	0711 Motor car	-0.8	-0.05
0115 Oils and fats	0.6	0.00	072 Operation of personal transp. equipm.	1.0	0.09
0116 Fruit	0.0	0.00	0721 Spare parts and accessories	0.0	0.00
0117 Vegetables including potatoes	-0.6	-0.01	0722 Fuels and lubricants	1.4	0.09
0118 Sugar, jam, chocolate, etc.	1.3	0.02	0723 Maintenance and repairs	0.3	0.00
0119 Food products n.e.c.	1.7	0.01	0724 Other services	-0.4	0.00
012 Non-alcoholic beverages	-3.9	-0.06	073 Transport services	1.1	0.02
0121 Coffee, tea and cocoa	-0.5	0.00	0732 Passenger transport by road	0.0	0.00
0122 Mineral waters, soft drinks and juices	-4.8	-0.05	0733 Passenger transport by air	1.7	0.02
02 Alcoholic beverages and tobacco	-0.5	-0.02	0734 Passenger transport by sea	0.0	0.00
021 Alcoholic beverages	-1.0	-0.02	08 Communications	-0.2	-0.01
022 Tobacco	0.1	0.00	0811 Postal services	0.0	0.00
03 Clothing and footwear	12.3	0.49	0813 Telephone, telegraph and telefax serv.	0.0	0.00
031 Clothing	12.4	0.43	09 Recreation and culture	0.6	0.07
032 Footwear	11.6	0.06	091 Audiovisual instruments, etc.	0.5	0.01
04 Housing, water, electr., gas & other fuels	1.3	0.36	092 Major durables for recreation & culture	0.0	0.00
041 Actual rentals for housing	2.3	0.05	093 Other recreational items	0.9	0.01
042 Imputed rentals for housing	1.3	0.23	094 Recreational and cultural services	0.4	0.02
043 Regular maintenance	1.0	0.04	095 Newspapers, books and stationery	1.7	0.03
044 Other serv. relating to the dwelling	0.0	0.00	096 Package holidays	0.0	0.00
045 Electricity, gas and other fuels	1.8	0.04	10 Educational services	0.0	0.00
0451 Electricity	3.1	0.04	11 Hotels, cafés and restaurants	5.9	0.30
0455 Hot water	0.0	0.00	111 Catering	6.3	0.30
05 Furnishing and household equipment	1.3	0.07	112 Accommodation services	0.1	0.00
051 Furniture, furnishings, etc.	1.3	0.07	12 Miscellaneous goods and services	1.1	0.07
052 Household textiles	5.2	0.02	121 Personal care	1.6	0.04
053 Electrical appliances	1.2	0.01	122 Personal effects n.e.c.	0.1	0.00
054 Glassware, tableware, etc.	2.5	0.01	123 Social protection	0.0	0.00
055 Tools and equipment	1.9	0.01	124 Insurance	0.8	0.00
056 Goods and services	0.4	0.00	125 Financial services n.e.c.	0.8	0.01
			126 Other services n.e.c.	2.0	0.01