

20 April 2011

## Memorandum on the Building Cost Index in May 2011

As announced in a press release 12 April 2011 a programming error was discovered in the Building Cost Index, resulting in a systematic underestimation of labour cost in the index since March 2010. The effect of the correction of the error is 3.6% increase of the Building Cost Index in May 2011.

Statistics Iceland rebased the Building Cost Index in January 2010. The coverage of the index was increased and price measurement for labour cost based on data collected by Statistics Iceland for the wage statistics. In March 2010 the procedure for importing the wage statistics data into the Building Cost database was upgraded, during which the error was made. The system has now been amended and testing reveals that the error has been successfully eliminated.

When the Building Cost Index was rebased, Statistics Iceland introduced a new method for labour cost measurements for the index. A survey on wages, earnings and labour costs carried out by Statistics Iceland was used instead of the earlier method of measuring labour union contract rates in addition to estimating other labour costs. The purpose was to measure market wage developments in the building industry to estimate building cost.

In estimating labour cost changes Statistics Iceland used 12 month averages to even out fluctuations from one month to the next due to irregular payments, which are common in the building industry for piecework payments and project end bonuses. In the survey on wages, earnings and labour costs data is finalised 3 months after the measurement month ends. Union negotiated wage increases are therefore not fully realised in the Building Cost Index until 15 months after they take effect. Although the new method is more statistically correct and shows long term development of wages in the Building industry, the method delivers information too late for those who want to use it on a month to month basis.

In light of this Statistics Iceland will temporarily go back to the earlier method for measuring labour cost. A recalculated shadow time series correcting for the effect of a system error will also be based on this earlier method. Statistics Iceland will study different methods for measuring market wage changes in the building industry. Available data in the survey on wages, earnings and labour costs will be used for the study, and different methods for seasonal adjustment of labour cost reviewed.

As discussed in the memorandum dated 12 April 2011, Statistics Iceland will be forming a user group for the Building Cost Index representing the main users of the index. The group will e.g. focus on labour cost measurements in the index.

For further information contact Ólafur Hjálmarsson, Director of Statistics Iceland, tel. (+354) 528 1010, e-mail address: [Olafur.Hjalmarsson@hagstofa.is](mailto:Olafur.Hjalmarsson@hagstofa.is).