

NODAR KILADZE

Caucasus University, Georgia

CPI AND PCE INFLATIONS: WHICH ONE SHOULD WE CHOOSE?**Abstract:**

The republic of Georgia is among those countries that successfully adopted inflation targeting regime and have been using it since. The National Bank of Georgia (NBG) announces inflation target for the medium term and tries to maintain annual inflation rate close to it. The NBG uses the Consumer Price Index (CPI), a well-known economic indicator in order to measure and target headline inflation. Having said that, the NBG also states that the CPI overestimates the inflation rate and is characterized by substitution, quality, and new product biases.

Solution to these problems can be found in another indicator. Other measures of inflation, besides the CPI, include Producer Price Index (PPI), Gross Domestic Product Deflator and less known Personal Consumption Expenditures (PCE) price index. The latter solves aforementioned biases and provides an option for future revision of historical data. These qualities make PCE relatively attractive price index, compared to others. Because of these reasons and because the PCE price index "better accounts for changes in people's purchasing patterns" (Bernanke B., 2012), the US Federal Open Market Committee (FOMC) changed from CPI to PCE inflation since 2000.

Nevertheless, it is also important to mention that despite the fact that FOMC prefers the PCE price index, the US federal government still uses the CPI for inflationary adjustments. Even though the PCE and the CPI inflations in US have quite similar trends, these two variables still have a significant difference between their values. Thus, it would have been more appropriate if both institutions used the same indicator. The republic of Georgia, on the other hand, measures inflation using the CPI only and does not calculate or use the PCE. So, it is interesting to see the PCE price index and its characteristics in the republic of Georgia.

For that reason, this paper calculates the PCE price index in Georgia, compares it to inflation measured using the CPI, outlines the differences between these two variables and makes suggestions accordingly. Special emphasis is put on the headline inflation for both measures, as core inflation tends to exclude the prices in food and energy categories, that cover an important part of household consumption in Georgia.

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