

Defining the CBE's Core Inflation Measure

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Core CPI is a variant of the headline CPI that excludes the impact of temporary price shocks on inflation, which could result for various reasons, including weather conditions, supply disruptions or infrequent resetting of prices by the government. Hence, the core measure is derived from the headline and is used as a complementary indicator, mainly to distinguish the underlying trend of the inflation rate from its transitory movements. Therefore, the core inflation measure should not, in any way, be regarded as a substitute for the headline inflation measure prepared by the Central Agency for Public Mobilization and Statistics.

Similar to many other central banks, the CBE's published core inflation measure is based on the exclusion method because it is straight-forward, easy to understand and could be replicated outside the central bank. Core inflation measures based on the exclusion method remove the direct effect of price movements in those items that tend to exhibit undue volatility and are often not reflective of the underlying or persistent inflation pressures in the economy. The second-round effects, however, that these items' price movements have on the other components within the CPI basket are part of the underlying inflation pressures in the economy and hence are not excluded. Therefore, excluding one-off price changes provides a better picture of existing underlying inflation pressures.

The items excluded from the CBE's core measure are:

- i. Food items with prices which are inherently volatile since their supply largely depends on weather and harvest conditions, namely fruits and vegetables. They represent 8.8 percent of the CPI basket.
- ii. Regulated prices which constitute 19.4 percent of the CPI basket.

By timely communicating the core inflation measure, the CBE aims to improve the understanding of the inflation dynamics. This is expected to reduce the pass-through of temporary price shocks to inflation expectations and, in turn, minimize the variability in inflation.