Fundamental Drivers of
International Price and Consumption Disparities

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Abstract

In this study, we firstly propose a way to measure the tradability of 120+ commodities based on price dispersion across countries. This approach is used to construct price indices of tradables and non-tradables for 150+ countries. We document that the share of tradables in terms of total expenditure of consumers is lower for richer countries than poor countries and that the relative price of non-tradables, which plays an important role in the rate determination for real exchange, behaves in accordance with the Balassa-Samuelson effect. Secondly, we propose a common-factor approach (based on principal components) to compress the large volume of information on prices and quantities consumed globally. The ability of the factors to account for the variation in the data depends on the degree to which the original variables co-move, which is stronger for prices and weaker for quantities. We find that income is responsible for 98% of the variation in the first principal component of quantities. For prices, income plays a secondary role: It explains only 24% of the first component, but 85% of the second. These findings are robust to the inclusion of a range of explanatory variables, as well as to the level of data aggregation.

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