



examnorm

Let's break the norms

INFLATION

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What is inflation?

Inflation is the rate at which the general price level of goods and services rises over time, which makes each unit of money buy less than before. Put differently, inflation means that the same amount of money will buy fewer goods and services than it used to.

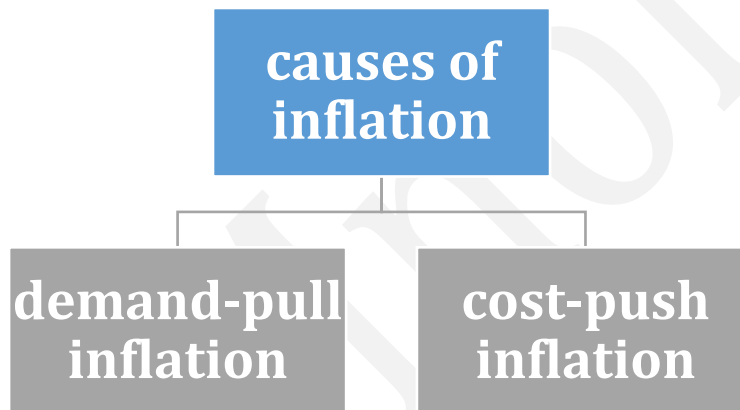
For example, if the inflation rate is 2%, an item that costs ₹1 this year will cost about ₹1.02 next year.

In short, inflation is a broad and lasting increase in prices across the economy over a period.

The rate of inflation can be calculated using the simple index formula:

Rate of inflation = $(\text{Price index in current year} / \text{Price index in base year}) \times 100$.

Causes of inflation



Economists do not agree on a single universal cause of inflation; several theories exist. Below are the main ways inflation is commonly explained.

Demand-pull inflation

Demand-pull inflation happens when total demand in the economy grows faster than the economy's capacity to produce goods and services.

In simple language: too much money chasing too few goods.

When demand outpaces supply, sellers raise prices and this type of inflation is often seen in fast-growing economies. In moderate amounts it can be healthy because it signals expansion.

Cost-push inflation

Cost-push inflation arises when firms raise prices to protect profit margins because their costs have gone up. Typical sources of rising costs include:

- **Higher input prices** — e.g., a jump in global commodity prices such as oil, metals, or agricultural products.

- **Higher labour costs** — when wages rise faster than productivity, for instance because unemployment is low, workers bargain for higher pay, or because people expect higher inflation and demand wage increases. If unions push up wages, firms often pass the higher labour cost on to consumers.
- **Inflation expectations** — if people and firms expect prices to rise, they act in ways (e.g., wage demands, price increases) that make inflation self-fulfilling. This can lead to “second-round effects” or a wage-price spiral, where rising prices cause higher wage claims, which then push prices up further.
- **Higher indirect taxes** — increases in taxes like excise or VAT can be passed on to consumers, raising prices.
- **Currency depreciation** — when the exchange rate falls, imported inputs and finished goods become more expensive, feeding into domestic prices.

Monetary inflation

Monetarist theory explains inflation as a result of too much money in the economy. If the supply of money grows faster than the supply of goods and services, the value of money falls and prices rise. This view highlights the role of money growth as a driver of inflation.

Internal and external causes of inflation

Inflation can come from both domestic factors and external events.

Internal causes include

- increased government money creation,
- higher production and labor costs, and
- strong borrowing.

External causes include

- exchange rate depreciation,
- global commodity price shocks,
- higher taxes, or
- global events such as wars.

All these can contribute to rising prices at home.

Effects of inflation

Inflation affects the economy in many ways; its consequences show up at the individual and the macro levels. Below are the main effects.

- On creditors and debtors
Inflation transfers wealth from lenders (creditors) to borrowers (debtors) because money repaid in the future has less purchasing power. When inflation falls, the opposite happens.

- On aggregate demand
Rising inflation often signals stronger aggregate demand. When prices rise, producers may increase production because higher prices suggest greater demand in the economy.
- On investment
Short-term inflation can encourage investment because higher demand makes firms expand production, and inflation lowers the real cost of borrowing (the nominal rate minus inflation).
- On income
Inflation raises nominal incomes (money earnings) but erodes their real purchasing power. Over time nominal incomes may rise, but the real value depends on whether earnings increase faster than prices. The GDP deflator (ratio of GDP at current prices to GDP at constant prices) captures inflation's impact on income.
- On saving
When inflation is high, holding cash loses value, so people tend to deposit money in banks to earn interest — this is sometimes called the shoe-leather cost (people make more bank trips). In the short run saving rates may rise, but persistent high inflation usually reduces long-run saving.
- On expenditure (consumption and investment)
Higher prices reduce household consumption because goods become costlier. At the same time, inflation can increase investment spending because borrowing effectively becomes cheaper in real terms.
- On taxation
Inflation distorts taxes in two ways:
 - Bracket creep: As nominal incomes rise, taxpayers may move into higher income-tax brackets even though their real income has not increased.
 - Indirect taxes: Because indirect taxes are ad valorem (a percentage of price), higher prices increase tax receipts automatically.

These effects can increase nominal government revenues but do not immediately increase their real value. For governments with large debt, inflation can reduce the real burden of their borrowings — effectively acting like an inflation tax or seigniorage.
- On exchange rate
Under a flexible exchange rate, higher domestic inflation tends to reduce the currency's value relative to foreign currencies.
- On exports and imports
When domestic prices rise, the competitiveness of exports may suffer in value terms, though quantities exported can sometimes increase. Imports generally

become more expensive, which may lead to import substitution but harms economies that depend on essential imports (like oil).

- On trade balance

In developed economies, inflation may help the trade balance; in developing economies, the negative effect from costlier essential imports often outweighs export gains.

- On employment

Inflation can temporarily increase employment (trade-off in short-run Phillips Curve), but in the long run it can be neutral or harmful to employment.

- On wages

Inflation raises nominal wages but lowers real wages unless wages increase at the same pace as prices. Governments sometimes grant dearness allowances to public servants to offset inflation.

- On the self-employed

Self-employed people may see their real incomes erode, but the long-term impact varies by sector and the ability to pass on costs.

Important terms associated with inflation

1. Disinflation

Disinflation refers to a reduction in the rate of inflation, not a fall in prices. Prices continue to rise, but at a slower pace than before.

Key distinction:

- Inflation: Prices are rising
- Disinflation: Prices are still rising, but more slowly
- Deflation: Prices are falling

Why it occurs:

Disinflation usually happens when:

- Monetary policy becomes tighter (interest rates rise)
- Aggregate demand weakens
- Supply conditions improve (e.g., better harvests, easing global commodity prices)

Real-life example (India):

Suppose CPI inflation in India falls from 7% in 2022 to 5% in 2023 after RBI raises the repo rate. Prices of goods are still increasing, but households feel less pressure than earlier. This phase is disinflation.

Policy relevance:

Central banks often aim for disinflation—not deflation—because it cools inflation without harming growth severely.

2. Deflation

Deflation is a sustained fall in the general price level, meaning prices decline across the economy.

Why it is dangerous:

Deflation is usually associated with:

- Weak demand
- Falling incomes
- Rising unemployment
- Delay in consumption and investment (people wait for prices to fall further)
- This can trigger a deflationary spiral.

Real-life example:

- Japan (1990s–2000s): After the asset bubble burst, Japan experienced prolonged deflation. Consumers delayed purchases, firms cut wages, and growth stagnated for decades.
- During the Great Depression (1930s), the US saw deep deflation as output collapsed.
- Why central banks fear deflation:
Even moderate deflation increases the real burden of debt, making loans harder to repay and worsening financial stress.

3. Galloping Inflation

Galloping inflation refers to very high and persistent inflation, usually in the double-digit range (20%–100% per year).

Characteristics:

- Rapid erosion of purchasing power
- Public confidence in currency weakens
- Savings decline
- Indexation of wages and prices becomes common

Real-life examples:

- Latin America (1970s–80s): Countries like Argentina and Brazil faced inflation above 50–100% due to fiscal deficits, debt crises, and monetary expansion.
- India (early 1970s): Oil shocks and fiscal pressures pushed inflation into double digits, though it did not reach hyperinflation levels.

Economic impact:

Galloping inflation distorts price signals, discourages long-term investment, and increases social inequality.

4. Hyperinflation

Hyperinflation is an extreme, runaway inflation, where prices rise at extraordinary rates, often thousands or millions of percent annually.

Defining feature:

Loss of confidence in the currency—money stops functioning as a store of value.

Classic real-life examples:

Germany (1921–23)

- Post-World War I reparations were financed by printing money.
- Workers were paid twice a day so they could spend wages before prices rose again.
- Money was carried in wheelbarrows.

Zimbabwe (2008)

- Inflation exceeded 231 million percent.
- Currency became useless; people shifted to barter and foreign currencies.

Venezuela (2016–2021)

- Oil revenue collapse + fiscal monetisation led to hyperinflation.
- Citizens used US dollars or cryptocurrencies for transactions.

Outcome: Hyperinflation destroys savings, collapses financial systems, and often leads to currency reform or dollarisation.

5. Stagflation

Stagflation refers to the simultaneous occurrence of high inflation and high unemployment, combined with stagnant growth.

Why it is unusual: Traditional Phillips Curve theory suggested inflation and unemployment move in opposite directions. Stagflation breaks this relationship.

Cause: Typically driven by supply shocks, not demand booms.

Real-life example:

United States (1970s): Oil price shocks raised costs sharply while economic growth slowed. Inflation rose despite weak demand.

Policy dilemma:

- Raising rates to fight inflation worsens unemployment.
- Stimulating growth worsens inflation.
- Stagflation is one of the hardest macroeconomic situations to manage.

6. Bottleneck Inflation

Bottleneck inflation occurs when specific supply constraints push up prices in particular sectors, which then spill over into the broader economy.

Typical causes:

- Infrastructure constraints
- Supply chain disruptions
- Seasonal shortages
- Capacity limits in key industries

Real-life examples:

Food inflation in India: Poor monsoon reduces vegetable supply, raising prices sharply.

COVID-19 period: Semiconductor shortages raised automobile prices globally.

Bottleneck inflation is often temporary, but can become persistent if structural issues are not resolved.

7. Skewflation

Skewflation occurs when inflation is concentrated in a few items, while the rest of the consumption basket remains stable.

Why it matters: Headline inflation may appear moderate, but households feel high inflation because essential items become costlier.

Real-life example (India):

In 2019–20, prices of onions and vegetables surged sharply, while non-food inflation remained low. CPI inflation rose mainly due to food, even though core inflation was stable.

Policy challenge: Monetary tightening may not be effective if inflation is driven by a few supply-side items.

8. Reflation

Reflation refers to deliberate policy actions taken to revive demand and raise prices during economic downturns or deflationary phases.

Tools used to achieve Reflation

- Fiscal stimulus (higher government spending)
- Monetary easing (rate cuts, liquidity infusion)

Real-life examples:

Post-2008 Global Financial Crisis: Central banks cut rates sharply to prevent deflation.

COVID-19 (2020): Governments and central banks worldwide adopted reflationary policies to revive growth.

Objective: Not to cause high inflation, but to restore normal price levels and economic activity.

9. Headline Inflation

Headline inflation measures overall inflation, including all items in the consumption basket.

In India:

- Measured by CPI (Combined).
- Includes food, fuel, housing, clothing, services, etc.

Limitation: Headline inflation can be volatile due to food and fuel price swings.

Example:

A sudden spike in global crude oil prices raises headline inflation even if domestic demand is weak.

10. Core Inflation

Core inflation excludes food and fuel, focusing on underlying demand-driven inflation.

Why central banks track it:

- Filters out temporary shocks
- Reflects persistent inflation pressures
- Helps guide medium-term monetary policy

Example: If CPI inflation rises due to vegetables but core inflation remains stable, RBI may avoid aggressive tightening.

Core inflation acts as a better predictor of future inflation trends.

11. Inflationary Gap

An inflationary gap exists when aggregate demand exceeds the economy's productive capacity at full employment.

Real-life example: During a boom, high credit growth and government spending push demand beyond capacity, leading to rising prices.

12. Deflationary Gap (Output Gap)

A deflationary gap occurs when actual output is below potential output, reflecting weak demand.

Example: During recessions, factories operate below capacity and unemployment rises.

13. Inflation Tax (Seigniorage)

When governments finance deficits by printing money, inflation erodes the value of money holdings—acting like a hidden tax.

Example: High inflation reduces the real value of cash balances held by households.

14. Inflation Spiral (Wage-Price Spiral)

A self-reinforcing cycle where:

- Higher prices → higher wage demands
- Higher wages → higher production costs
- Higher costs → further price increases

Example: Strong unions negotiating wage hikes during high inflation periods.

15. Inflation Accounting

Adjusting financial statements to remove inflation effects so that real profits and asset values are visible.

Use case: Important in high-inflation economies to avoid overstating profits.

16. Inflation Premium

The part of nominal interest rates that compensates lenders for expected inflation.

Formula: $\text{Nominal interest rate} = \text{Real interest rate} + \text{Expected inflation}$

17. Phillips Curve

Originally suggested an inverse relationship between inflation and unemployment.

Modern understanding:

In the long run, this trade-off disappears due to expectations (NAIRU concept).

Example: Short-term stimulus may reduce unemployment but cause inflation if sustained.

18. NAIRU

Non-Accelerating Inflation Rate of Unemployment is the **level of unemployment at which inflation remains stable** — it neither rises nor falls.

- If **unemployment is higher than NAIRU** → inflation tends to **fall**
- If **unemployment is lower than NAIRU** → inflation tends to **rise**
- At **NAIRU** → inflation stays **steady**

Everyday example:

Imagine an economy where **5% unemployment** is considered normal.

- If unemployment falls to **3%**
 - Workers become scarce
 - Employers raise wages to attract staff
 - Higher wages increase costs
 - Prices rise → **inflation increases**
- If unemployment rises to **8%**
 - Many people compete for fewer jobs

- Wages don't rise much
- Demand stays weak
- Prices stop rising → **inflation slows**

So, **5% is the NAIRU** in this example.

Why it matters for central banks:

Central banks (like RBI, US Fed) watch NAIRU to:

- Avoid overheating the economy
- Prevent runaway inflation
- Balance growth and price stability

They try to support growth **without pushing unemployment too far below NAIRU**.

Measuring inflation

Different indices measure inflation at different stages of production and for different purposes. The two main indices used in India are the Wholesale Price Index (WPI) and the Consumer Price Index (CPI).

WPI (Wholesale Price Index)

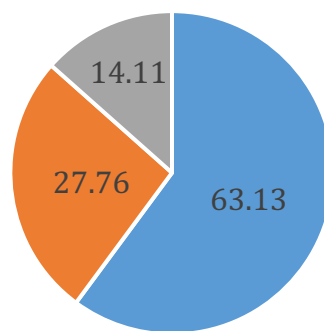
WPI tracks price changes of a representative basket of wholesale goods. The WPI basket is divided into three major groups (in descending order of weight):

1. Manufactured products
 2. Primary articles
 3. Fuel and power
- WPI does not include services.
 - The WPI basket contains 957 items (previously 697).
 - The base year is 2022-23 (previously 2011-12).
 - WPI data are released by the Office of the Economic Adviser, Department of Industrial Policy and Promotion, Ministry of Commerce and Industry.

Revision of WPI base year

Particular	Latest Series (2022-23)	Previous Series (2011-12)
Base Year	2022-23	2011-12
Effective From	15 June 2026	May 2017
Number of Items	957	697
Coverage	Goods only	Goods only
Compiled by	Office of Economic Adviser (DPIIT)	Same

composition of WPI basket



■ manufactured products ■ primary article
■ fuel and power

Major Group	Description
Manufactured Products	Includes manufactured goods produced by industries such as food products, chemicals, machinery, textiles, pharmaceuticals, metals, automobiles, etc. It carries the highest weight.
Primary Articles	Includes agricultural products, minerals and other raw materials directly obtained from nature such as cereals, fruits, vegetables, fibres and minerals.
Fuel and Power	Includes coal, crude petroleum, natural gas, mineral oils and electricity.

Why is the Base Year Revised?

A base year is changed periodically because the economy changes over time. The revision helps to:

- Reflect the current production and consumption structure.
- Include newly important products and remove obsolete ones.
- Update weights according to the latest economy.
- Improve geographical and industrial coverage.
- Improve accuracy of inflation measurement.

- Align WPI with other macroeconomic indicators such as GDP and IIP.
- Adopt international best practices in price statistics.

Major Changes from Base Year 2011-12 to 2022-23

Expanded Commodity Basket

Number of commodities increased from **697 to 957**. Better representation of modern industrial production and emerging products.

Updated Weights

Commodity weights revised according to the latest value of output in the economy.

Better Coverage

More establishments and reporting units included. Wider geographical and sectoral representation.

Renewable Energy Included

New energy-related products included to reflect India's changing energy mix.

Improved Methodology

Continues to use **Basic Prices** (excluding indirect taxes and trade & transport margins), making WPI conceptually closer to a Producer Price Index (PPI).

Transition Towards Producer Price Index (PPI)

Along with the new WPI, the Government introduced:

- Output Producer Price Index (OPPI)
- Trial Input Producer Price Index (IPPI)
- Service Producer Price Index (for selected services)

WPI will continue for **five years** before being phased out in favour of PPI.

Benefits of Updating the Base Year of WPI

- Updating the base year ensures that the WPI reflects the **current structure of the economy**, as production patterns, industries, and technology change over time.
- It **updates the commodity basket** by including new and important products while removing obsolete items, making the index more representative of present-day wholesale markets.
- It **revises the weights of commodities** according to their latest economic importance, ensuring that inflation is measured more accurately.
- It **improves the accuracy and reliability of inflation measurement**, as price changes are based on an updated basket and current economic conditions.
- It **expands the coverage of commodities, reporting units, and geographical areas**, resulting in better-quality data and more representative inflation estimates.

- It **aligns WPI with other macroeconomic indicators** such as GDP, IIP, and National Accounts, ensuring consistency in official economic statistics.
- It provides an opportunity to **adopt international best practices**, including improved classification, better sampling methods, Basic Prices, and Geometric Mean for price aggregation.
- It helps the **Government and RBI formulate better monetary, fiscal, and industrial policies** by providing more reliable information on producer inflation.
- It improves the use of WPI as a **GDP deflator**, leading to more accurate estimates of real economic growth and productivity.
- It captures **structural and technological changes** in the economy by giving appropriate representation to emerging industries such as electronics and renewable energy.
- It provides **businesses with a more reliable price index** for contract escalation, cost estimation, procurement planning, and investment decisions.
- It supports India's **gradual transition to the Producer Price Index (PPI)** framework, bringing India's inflation measurement closer to international standards.

Method of Calculation

The WPI is calculated in the following stages:

Step 1: Price Collection

- Wholesale prices are collected every month from manufacturers, producers, mines, oil companies, agricultural markets and other reporting units.

Step 2: Price Relative

For each commodity,

$$\text{Price Relative} = (\text{Current Price} \div \text{Base Year Price}) \times 100$$

This shows how much the price has changed compared to the base year.

Step 3: Item-level Index

- The **Geometric Mean (GM)** is used to combine price quotations of the same commodity.
- GM reduces the effect of extreme price changes and follows international statistical standards.

Step 4: Group Index

Item indices are combined using **weights** assigned to each commodity.

Step 5: Overall WPI

The weighted average of all group indices gives the **overall Wholesale Price Index**.

CPI (Consumer Price Index)

The CPI family in India includes several series, such as:

1. CPI for Industrial Workers (IW)
 2. CPI for Agricultural Labourers (AL) / Rural Labourers (RL)
 3. CPI (Rural / Urban / Combined)
- CPI-AL uses base year 1986–87, covers 260 commodities, and is collected monthly from 600 villages. It is used to revise minimum wages for agricultural labourers. The Labour Bureau proposes base updates to reflect changing consumption patterns.
 - CPI (Rural/Urban/Combined) is compiled by the National Statistical Office (NSO) and aims to cover the entire population. The CPI (combined) is used by RBI for monetary policy.
 - Key facts about CPI (combined):
 - The combined CPI basket contains 908 items (448 rural + 460 urban).
 - The base year is 2011–12 (updated from 2009–10).
 - The item basket and weights are based on the Consumer Expenditure Survey (CES) 2011–12 using the Modified Mixed Reference Period method.
 - Elementary indices are computed using the geometric mean, which reduces volatility compared to arithmetic mean.
 - As per the Monetary Policy Framework Agreement (20 Feb 2015) between the Government and RBI, RBI's primary objective is price stability, and CPI-combined is the measure used for setting the inflation target.

Revision of CPI Base Year

A **base year** is chosen and set to index value 100, and inflation is the percentage rise in the CPI over time. For example, if the basket cost ₹100 in the base year and costs ₹150 today, the inflation is 50%.

CPI must be updated regularly to reflect changing consumption patterns (e.g. from VHS to Netflix). In India, the Ministry of Statistics & Programme Implementation (MoSPI) decides the base year, and the National Statistical Office (NSO) of MoSPI collects prices (through its NSS field operations team).

The CPI series is periodically rebased (ideally every 3–5 years) using the latest Household Consumption Expenditure Survey (HCES) data.

- **Base year:** A reference year (index = 100) for comparing prices. India's CPI base was **2012=100** (released since Jan 2015) and has now been updated to **2024=100**.
- **Basket of goods:** A fixed set of items (food, housing, transport, etc.) whose prices are tracked. MoSPI's expert group used HCES 2023–24 to overhaul the basket and weights.

- **Index formula:** CPI uses a weighted price index. Elementary (item-level) indexes use the **Jevons index**, while all-India CPI uses a **Modified Laspeyres (Young) index**.

Key Concept: Unlike a simple average, CPI is a **weighted average**. Items are weighted by consumption share.

For example, if food prices rise 20% and rent 30% but food accounts for 50% of spending and rent 10%, overall inflation will be closer to $20 \times 0.5 + 30 \times 0.1 = 13\%$ rather than the simple average 25%.

- This prevents less-frequently-used items (like electronics) from skewing the inflation figure.
- CPI applies the Laspeyres formula (sum of *current price* $\times$ *base quantity*, relative to base) to aggregate inflation.

Base Year Updates and Timeline

Base year updates are critical so the CPI reflects current consumption. India ideally rebases every 5 years, but recent disruptions delayed this:

2012=100: Previous CPI base year.

Planned rebasing around 2016–2022 was postponed due to major events:

1. **2016:** Demonetisation (cash ban) disrupted the economy.
2. **2017:** Rollout of GST tax changed prices.
3. **2019:** Economic slowdown.
4. **2020–21:** COVID-19 pandemic.
5. **2022:** Global shock from the Ukraine war.

Since none of these were “normal” consumption years, the **base was finally updated to 2024**. The first CPI data on 2024=100 was released in February 2026. MoSPI officially scheduled the rebased CPI release on Feb 12, 2026, aligning with global best practices.

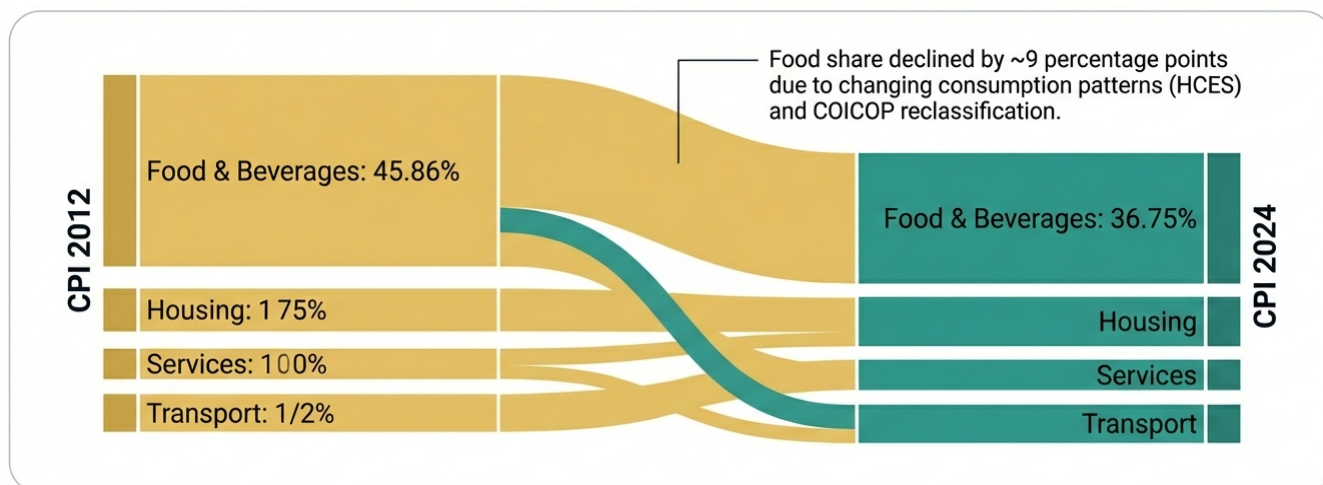
CPI Calculation Method

Basket and Weights: The CPI basket now has **358 weighted items** (308 goods, 50 services), up from 299 total (259 goods, 40 services) in the 2012 series. Weights are the share of household spending on each item (or group) in 2023–24.

For example, *Food & Beverages* weight fell from **45.86%** in the 2012-based series to **36.75%** in the 2024 base. This reflects higher incomes (less share on food, more on services). Other weights increased (e.g. transport, housing, entertainment).

The Evolving Indian Wallet

Structural Shift in Weights (2012 vs 2024)



Consulted with IMF, World Bank, RBI, and UNECE to align with HCES 2023-24.

Laspeyres and Young Index: At higher levels (all-India, broad categories), CPI uses a modified Laspeyres (Young) index.

The Modified Laspeyres Index measures the cost of purchasing the base-year basket at current prices relative to its cost in the base year, using expenditure weights derived from the Household Consumption Expenditure Survey (HCES).

$$\text{Inflation} = \left[\frac{\text{Current CPI} - \text{Previous Year's CPI}}{\text{Previous Year's CPI}} \right] \times 100$$

Jevons (Elementary) Index: For micro-level aggregation (e.g. individual varieties of rice, brands of soap), CPI uses the *Jevons index*, which is the geometric mean of price changes. This avoids distortion when aggregating very detailed items.

Note: MoSPI has institutionalized rebasing “every three to five years” following HCES surveys. Prices are collected by NSO’s Field Operations Division (usually monthly, including in rural villages and urban markets, now also online markets). The CPI now covers 12 divisions (up from 6 broad groups) under the UN’s COICOP-2018 classification for global comparability.

STRUCTURAL RECLASSIFICATION: THE 12 DIVISIONS

Aligned with UN COICOP Standards



Modernizing the Consumption Basket

IN (The New India)	OUT (The Obsolete)
 Digital: Online media/OTT subscriptions, Pen-drives, External Hard disks	 Tech: VCR/DVD players, Radios, Tape recorders, Audio cassettes, CD/DVDs
 Services: Airfare, Baby sitters, Attendants, Exercise equipment	 Household: Second-hand clothing
 Essentials: Rural Housing (New inclusion!), Value-added dairy products	
358 Total Items in New Basket	

MODERNIZING THE BASKET: DIGITAL INCLUSION



Source: 2023-24 Household Consumption Expenditure Survey

Key Changes in the 2024 CPI Series

The 2024 rebasing introduced several methodology and coverage enhancements:

- **Expanded Item Coverage:** Weighted items ↑ from 299 to 358. Goods ↑ from 259 to 308; Services ↑ from 40 to 50. New items include rural house rent (for the first time), online media/streaming (OTT) services, CNG/PNG fuel, and more. A few obsolete items (e.g. VCD players, cassette tapes) were removed. Alternative data sources (e-commerce prices, administrative data for fares, telephone, etc.) are now used.
- **Classification Reorganization:** Old CPI had 6 groups; new CPI uses **12 divisions** per UN's COICOP-2018 framework. This adds granularity (e.g. separate divisions for housing, recreation, health, etc.).
- **New Weight Structure:** Food & beverages weight down to **36.75%**. Housing (including electricity, water, urban rent) is now a larger share. Services (transport, health, education, recreation) have higher weights, reflecting consumer trends.
- **Inclusion of Rural Data:** Rural housing rent now in CPI (weight ~11.76% of rural CPI). Online markets (Amazon, Flipkart) and digital prices (airfares, OTT) are included.
- **Subsidies and Free Food:** CPI *excludes* fully free social transfers (like free ration under PMGKAY) in line with IMF guidance. Only subsidized goods (those sold at public rates) appear. Pure free distribution is omitted to avoid biasing inflation downwards.

These changes make the CPI more representative of today's economy. For example, entertainment and technology now feature (OTT subscriptions, smartphone accessories), while old media (CDs, VHS) are removed.

Comparison: WPI vs CPI

Basis	CPI	WPI
Meaning	Measures price changes at the consumer (retail) level.	Measures price changes at the wholesale/producer level.
Coverage	Goods and Services	Goods only
Inflation Measured	Consumer Inflation	Producer/Wholesale Inflation
Current Base Year	2024 = 100	2022-23 = 100
Compiled By	NSO, MoSPI	Office of Economic Adviser (OEA), DPIIT, Ministry of Commerce & Industry
Weight Based On	Household Consumption Expenditure Survey (HCES)	Gross Value of Output (GVO)
Used by RBI	Yes , for inflation targeting	No

Other measures of inflation

- **Consumer Food Price Index (CFPI)**

- CFPI tracks changes in retail food prices for rural, urban, and combined categories. CSO began releasing CFPI series in May 2014. The CFPI uses the same methodology as CPI and had a base year change to 2012=100 for CSO indices starting January 2015. CFPI is constructed as a weighted average of cereals and related subgroups within the CPI.
- Price data for CFPI are collected from towns and villages using field operations of NSSO and the Department of Posts, and via web portals maintained by NIC. The FAO also publishes a global food price index (FAO Food Price Index) that tracks international food commodity prices.

- **WPI Food Index**

- From the WPI revision (base 2011-12), a WPI Food Index was introduced (on 12 May 2017) combining food articles from Primary Articles and Food Products from Manufactured Products. This index measures food price changes at the producer level and complements CFPI to get a better view of food price pressures.

- **Producer Price Index (PPI)**

- PPI measures average changes in prices received by producers — either at the output stage (output PPI) or the input stage (input PPI). PPI uses basic prices (excluding taxes and trade margins) and can be more closely aligned with production costs. The government has considered moving from WPI to PPI as a primary measure.

- **Components of PPI**

The new PPI framework consists of three indices:

- **Output Producer Price Index (OPPI)** – Measures changes in the prices received by producers for goods sold.
 - **Input Producer Price Index (IPPI)** – Measures changes in the prices paid by producers for raw materials, fuel, and other inputs.
 - **Service Producer Price Index (SPPI)** – Measures changes in the prices received by service providers for selected services.
- **Need for PPI in India**
 - India's WPI has certain limitations:
 - It covers **only goods** and excludes services.
 - It measures **wholesale prices** rather than actual producer prices.
 - It is not fully aligned with international standards.
- To address these limitations, the Government has initiated a transition towards a comprehensive PPI framework
- The Government introduced the **Output Producer Price Index (OPPI)**, **Input Producer Price Index (IPPI)**, and **Service Producer Price Index (SPPI)** along with the **WPI Base Year 2022-23**.
- **WPI will continue during a five-year transition period**, after which India intends to gradually move to a comprehensive PPI framework.

- **Housing Price Index (HPI)**

- HPI measures changes in residential housing prices. In India, the National Housing Bank (NHB) compiles the RESIDEX index, originally based on a pilot covering five cities and using transaction prices. The base year was 2007; coverage has expanded over time.

- **Service Price Index (SPI)**

- SPI is under consideration to measure price changes in the services sector, given the growing share of services in India's economy.

Appropriate inflation rate

Different countries have different comfortable inflation levels that allow stable growth. A typical target for many advanced economies is around 2% per year.

Inflation Targeting in India

India formally adopted flexible inflation targeting (FIT) in 2016.

Key milestones:

- **Urjit Patel Committee (2014):** The RBI-appointed committee recommended shifting to FIT, arguing it would anchor expectations and strengthen policy credibility. It proposed a CPI inflation target of 4% $\pm$ 2%.
- **Monetary Policy Framework Agreement (2015):** In February 2015, the Government of India and RBI agreed on a policy framework mandating RBI to target CPI inflation (with 5% target for 2016, then 4% by 2017).
- **RBI Act Amendment (2016):** The RBI Act was amended in 2016 to provide statutory backing to FIT. It explicitly empowered the RBI to set monetary policy to achieve the agreed inflation target.
- **Current Target:** By agreement, India's inflation target is set at 4% with a tolerance band of $\pm$ 2% (i.e. 2–6%). The central government reviews the target every 5 years (currently through 2025). Under this regime, RBI's Monetary Policy Committee (MPC) adjusts repo rates and other tools to keep CPI inflation within the band.
- **Current Inflation Target (April 1, 2026 – March 31, 2031):** The Central Government, in consultation with the RBI, has retained India's flexible inflation targeting framework, with a CPI inflation target of 4% and a tolerance band of $\pm$ 2 percentage points (2%–6%) for a further five years, i.e., from 1 April 2026 to 31 March 2031. The RBI's Monetary Policy Committee (MPC) uses the repo rate and other monetary policy instruments to keep inflation within this target band

Flexibility allows for short-term deviations if needed for growth, but the policy framework mandates a focus on bringing inflation back to target over time.

Global Inflation Strategies (ECB, Fed, Brazil, etc.)

- **United States (Fed):** The U.S. Federal Reserve targets 2% inflation. In 2022–23, with inflation peaking near 9%, the Fed raised the federal funds rate by about 5.25 percentage points (to 5.25–5.50%). By late 2024 inflation had slowed to ~2.9%

year-on-year. The Fed's recent communications stress that inflation remains above target but is decelerating, and that policy will remain "restrictive" until inflation is sustainably at 2%. In early 2025 the Fed paused cuts, awaiting further disinflation.

- **Euro Area (ECB):** The ECB's inflation mandate is 2%. The eurozone saw inflation above 10% in 2022, so the ECB raised its deposit rate from -0.5% in mid-2022 to 4.0% by late 2023 (the highest on record). In September 2023 it signaled that rates likely peaked and that inflation would come down "more slowly," expecting about 5.6% in 2023, 3.2% in 2024 and 2.1% in 2025. In sum, the ECB has aggressively tightened to combat inflation, similarly shifting from an ultra-dovish stance in 2020 to very restrictive policy.

Comparisons: Notably, most advanced economies (Fed, ECB, UK) set targets near 2%, while many emerging markets (Brazil, South Africa, India, etc.) have 3–6% targets.

Historical and Recent Trends in Inflation

India's CPI and WPI Trends

India's inflation (measured by CPI) has been volatile. After a low phase in 2010s, CPI inflation spiked in 2021-22 (supply shocks, high global prices) and then moderated. For instance, CPI inflation rose to double-digits (above 10%) by mid-2024 and then fell sharply.

Notably: July 2024 saw CPI inflation ~10.9% (y-o-y), the peak in recent years. Thereafter, inflation fell: by December 2024 it was about 2.7%, the lowest in a decade, and it stayed near 3–4% into early 2025 (3.34% in Mar 2025, 3.16% in Apr 2025).

This dramatic fall reflects easing global commodity prices and tight monetary policy.

Table 1. Recent CPI inflation rates in India (All-India combined, y-o-y %).

Month/Year	Apr '24	Jul '24	Oct '24	Dec '24	Mar '25	Apr '25
CPI (%)	8.70	10.87	5.97	2.69	3.34	3.16

Source: NSO, MoSPI press releases.

Wholesale Price Index (WPI) inflation in India has also eased. After reaching very high levels (often above 10% in 2022 due to food and fuel spikes), WPI inflation turned mild and even briefly negative in 2023–2024. (By late 2024, WPI inflation was near 0–1%.) The trends in CPI and WPI differ because WPI excludes services and is weighted more to primary and intermediate goods, but both indicators have converged downward in 2023–24.

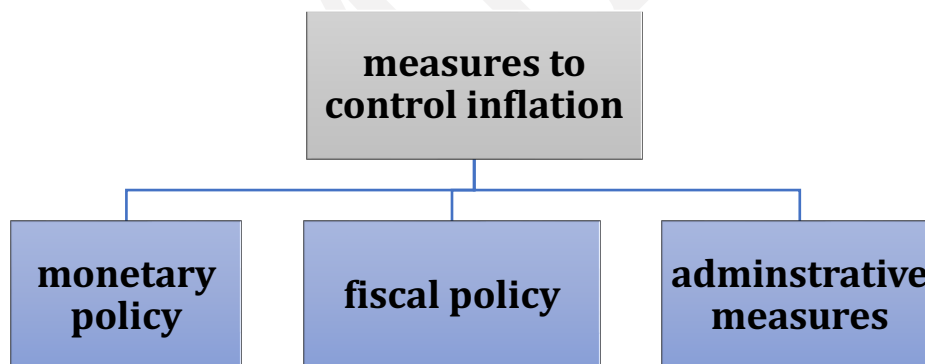
Global Inflation Trends

Inflation trends in major economies show a synchronized pattern. After the global commodity-driven surge of 2021-22, inflation has eased widely:

- United States: CPI inflation was about 8.0% in 2022, then fell to 4.1% in 2023 and around 2.95% in 2024.
- United Kingdom: UK CPI inflation was ~7.9% in 2022, ~6.8% in 2023, dropping to ~3.3% in 2024.
- Euro Area (e.g. Germany): German inflation was ~6.9% in 2022, ~5.9% in 2023, and fell to ~2.26% in 2024.
- Brazil: As an emerging economy, Brazil had inflation near 9.3% in 2022, then 4.6% in 2023, 4.37% in 2024.
- China: China's inflation remained very low – about 1.97% in 2022, then around 0.23% in 2023 and 0.22% in 2024.

Overall, global headline inflation cooled from roughly 7.9% in 2022 to ~5.9% in 2023 and ~3.0% in 2024. The downward trend reflects central bank actions (rate hikes) and normalization of supply after post-COVID shocks. Emerging markets experienced larger swings, while advanced economies' inflation moderated steadily.

Measures to control inflation



Since high inflation harms the economy, policy makers use several tools to control it. These include monetary measures, fiscal measures, and price controls.

Monetary measures

- Monetary policy is the main tool for controlling inflation. The central bank raises interest rates to make borrowing more expensive, which reduces credit growth and aggregate demand.
- When banks face higher costs, they increase lending rates to customers; higher rates encourage saving and reduce spending. The central bank also restricts the ability of commercial banks to create credit.

In short:

- To reduce inflation, decrease money supply.

- To increase inflation or counter deflation, increase money supply.
- Common monetary tools and their direction when combating or inducing inflation:
 - **Cash Reserve Ratio (CRR):** CRR is the percentage of a bank's Net Demand and Time Liabilities (NDTL) that must be maintained as cash with the RBI. Increasing CRR reduces banks' lendable funds and helps control inflation, while decreasing CRR increases liquidity and credit, encouraging economic activity.
 - **Statutory Liquidity Ratio (SLR):** SLR is the percentage of NDTL that banks must maintain in the form of specified liquid assets such as cash, gold, and approved government securities. Increasing SLR reduces funds available for lending and curbs inflation, whereas decreasing SLR boosts credit and supports economic growth.
 - **Repo Rate:** The repo rate is the interest rate at which banks borrow short-term funds from the RBI against government securities. Increasing the repo rate makes borrowing costlier, reducing credit demand and inflation, while decreasing it encourages borrowing, investment, and economic activity.
 - **Reverse Repo Rate:** The reverse repo rate is the interest rate paid by the RBI when banks park surplus funds with it. Increasing the reverse repo rate encourages banks to deposit more money with the RBI, reducing market liquidity and inflation. Decreasing it discourages such deposits, increasing liquidity and credit.
 - **Marginal Standing Facility (MSF):** MSF is the emergency window through which scheduled commercial banks can borrow overnight funds from the RBI by dipping into their SLR securities. Increasing the MSF rate makes emergency borrowing more expensive, reducing liquidity, while decreasing it makes short-term funds cheaper and supports liquidity.
 - **Open Market Operations (OMO):** OMO refers to the RBI's purchase or sale of government securities in the open market to regulate liquidity. To control inflation, the RBI sells government securities, absorbing excess liquidity. To stimulate the economy, it buys government securities, injecting liquidity into the banking system.

Fiscal measures

Fiscal policy (government spending and taxation) also affects inflation. To restrain inflation, the government can reduce its spending or raise taxes to cut private consumption. However, reducing public spending may not always be feasible because of ongoing commitments (social programs, health, defense). Therefore, governments often prefer to raise taxes to lower disposable income and reduce private spending.

Supply-Side and Administrative Measures:

In India, authorities sometimes intervene directly in supply chains:

- Buffer Stocks and Public Distribution: Government stockpiles (e.g. of food grains, onions) can be released to stabilize prices.
- Export/Import Controls: Export bans or limits on certain agricultural products (like onions or sugar) can keep domestic prices from rising. Similarly, cutting import tariffs on key items can increase supply and lower prices.
- Price Controls: The government may set price ceilings on essential commodities (fuel, LPG, medicines) or approve uniform pricing across states to avoid inter-state price spikes.
- Anti-Hoarding Measures: Seizing hoarded stocks or using anti-profiteering laws can also be used administratively, though such measures address symptoms more than underlying inflation.

In practice, India uses a mix of these: RBI's monetary tightening (e.g. repo rate hikes) is the main long-term control, supplemented by fiscal prudence and, if needed, trade/admin actions to mitigate specific shocks. For example, in 2022-23 India hiked import duty on gold to curb forex outflow, and restricted sugar exports when domestic prices rose.