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Inflation

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Inflation

Inflation means the overall price level keeps rising, so the same money buys less. A snack costing ₹10 last year might cost ₹11 this year. One price can fall even while overall inflation stays positive. This lesson explains how India measures inflation, why prices rise, and what the RBI does about it.

At a Glance

Four facts to hold on to.

01
Main tool

RBI repo rate.

02
Target

4% CPI, band 2% to 6%.

03
CPI base year

2024=100; 358 items.

04
Aug 2026 CPI

4.82%.

CPI Consumer Price Index: prices households pay.
WPI Wholesale Price Index: goods traded in bulk.
Core inflation Headline inflation without food and fuel.

StagflationHigh inflation with stagnant growth.

Chapter 1: What Inflation Is and How India Measures It

Must Know

What it really is

- Inflation is a continuing rise in the overall price level.
- When inflation is positive, money loses buying power over time.
- Imagine a food basket costing 100 rupees this year. If prices rise 7%, the same basket costs 107 next year, though nothing inside changed.
- Prices often rise slowly in a growing economy.
- Fast inflation makes planning harder and sharply cuts the buying power of cash.

Two indexes

- The **Consumer Price Index (CPI)** measures prices paid by households.
- The **Wholesale Price Index (WPI)** measures prices of goods traded in bulk.
- CPI includes services like rent and schooling, and gives food a heavy weight.
- WPI covers mostly goods and skips services entirely.
- Because the baskets differ, CPI and WPI can move in different directions in the same month.
- To see how inflation hits your household budget, look at CPI. It tracks retail prices of what households actually buy.

Timeline

- **2014:** the RBI adopted CPI as its headline measure.
- **2015:** a policy agreement followed.
- **2016:** the statutory inflation-targeting system began.
- The CPI base year is now 2024=100, with 358 weighted items.
- (Sources: RBI study and PIB, 2026 CPI update.)

Remember: CPI: households, includes services. WPI: bulk goods, no services. RBI targets CPI.

> **Quick check 1.** Inflation means the overall price level rises over time. *(True or False?)* See answer ↓

> **Quick check 2.** The RBI targets the WPI, not the CPI. *(True or False?)* See answer ↓

Chapter 2: What Makes Prices Rise

Must Know

Demand-pull

- It happens when people have more money to spend than the economy can supply goods for.
- Too much money chases too few goods, so prices get bid up.
- It usually follows rising incomes, extra government spending or cheap, easy loans.

Cost-push

- It happens when the cost of making goods rises. An oil-price jump is one example.
- Producers pass the extra cost on to buyers.
- It can appear without any extra demand.
- A crude oil spike raises transport and fertiliser costs. That lifts the price of nearly everything that depends on them.
- To tell them apart, ask what changed first. Did people want to buy more? That is demand-pull. Did production become costlier? That is cost-push.
- Oil prices spiking worldwide is cost-push. It raises the cost of making and moving goods, not what people want to buy.

The wage-price spiral

1. Prices rise, so living costs increase.
2. Workers seek higher pay to protect buying power.
3. Some firms' wage bills rise.
4. Some firms raise prices, and the cycle may repeat.

- It is a feedback loop. Higher prices can lead to new wage demands, and the cycle can speed up.
- This is why central banks try to act early.
- If people expect high inflation, they build it into their wage and price decisions. That can make the expectation come true.

Food in India

- Food has a large weight in India's CPI basket.
- A weak monsoon can cut harvests and push food prices up.

- In July 2026, food inflation was 5.52%, above the 4.45% overall CPI rate.
- Higher interest rates cannot grow more crops. Food supply matters alongside the RBI's policy.

> **Quick check 3.** Cost-push inflation can happen even without extra demand. *(True or False?)* See answer ↓

Chapter 3: Who Inflation Hurts, and Who It Helps

Good to Know

A ₹100 basket

- Imagine a basket of everyday goods costs ₹100 today. If prices rise 10%, it costs ₹110 next year.

- **Fixed income:** your pension stays ₹100. The basket now costs ₹110. You buy less or find another ₹10.
- **Cash at home:** your ₹100 remains ₹100. It cannot buy the same basket next year. A grandmother with ₹100 in a cupboard faces exactly this.
- **Bank savings:** ₹100 at 6% becomes ₹106. That still falls short of ₹110.
- **Fixed-rate loan:** your debt follows its agreed terms. If income rises with prices, repayment may feel easier. That benefit is not guaranteed.

The bigger picture

- This is purchasing power: what your money can actually buy.
- A larger rupee balance does not always mean you can buy more.
- Food inflation hits low-income families harder. One family spends ₹60 of every ₹100 on food. Another spends ₹20. A food-price jump takes a bigger share from the first.
- Inflation's effect depends on income, savings returns and loan terms.
- A variable-rate loan can also become costlier when interest rates rise.

> **Quick check 4.** Unexpected inflation always harms a borrower with a fixed-rate loan. *(True or False?)* See answer ↓

Chapter 4: How the RBI Fights Inflation

Good to Know

The repo rate

- The RBI's main tool is the **repo rate**. It is the rate at which the RBI lends short-term money to banks.
- If inflation is running high, the RBI would likely raise it.
- A higher repo rate makes bank funding costlier. Banks may raise rates on home, car and business loans.
- Costlier loans reduce spending and investment. Lower demand may ease price pressure over time.
- But this can also slow growth and hiring. The RBI must weigh these effects.

The inflation-targeting system

- India and the RBI signed a Monetary Policy Framework Agreement in 2015.
- Parliament gave inflation targeting a legal basis in 2016.
- The Monetary Policy Committee (MPC) sets the policy repo rate by majority vote.
- The target is **4% CPI inflation**, with a tolerance range of **2% to 6%**.
- The government kept this target through March 2031.
- (Sources: 2015 agreement and 2026 RBI deputy governor's speech.)
- A clear public target helps people plan. It cannot stop every food or fuel shock.
- Read more: Monetary Policy and RBI Tools, Money and Banking and Money and Monetary Concepts.

> **Quick check 5.** A higher repo rate cools demand and slows inflation. *(True or False?)* See answer ↓

> **Think it through: Think it through: why not just cut prices by raising rates fast?**
>
> Higher rates slow growth and hiring too. And rates cannot grow crops or lower oil prices. So the RBI balances inflation against growth.

Chapter 5: Core, Headline, Deflation and Stagflation

Good to Know

Core and headline

- **Headline inflation** is the overall CPI number. It includes food and fuel, which jump with weather and global oil markets.
- **Core inflation** strips out food and fuel. It shows steady, underlying price pressure.
- Food and fuel can swing the headline sharply. Core helps show whether pressure goes beyond them.

When falling prices turn bad

- **Deflation** is the opposite of inflation. Prices generally fall.
- It sounds good, but sustained deflation can badly damage an economy.
- If people expect prices to keep falling, they delay purchases.
- Less spending means less demand. Firms earn less, cut output and lay off workers. That lowers demand further.
- Wages are hard to cut. So firms' real costs rise even as prices fall, squeezing them from both sides.

- That is why central banks fear deflation almost as much as high inflation. They aim for inflation that is low but positive.

Stagflation

- Stagflation is high inflation and stagnant or falling growth together.
- Inflation often rises when demand is strong. Stagflation shows that supply shocks can raise prices while slowing growth.
- It became famous in the 1970s, when oil-price shocks raised costs everywhere and slowed growth.
- It creates a dilemma. Raising rates fights inflation but worsens the slowdown. Cutting rates helps growth but fans inflation.
- A rate change alone may not solve a supply shock.

> **Quick check 6.** Stagflation is high inflation with stagnant or falling growth. *(True or False?)* See answer ↓

Chapter 6: The Pattern Examiners Keep Testing

Exam Point of View

Three traps

- Sorting a cause into the right bucket: demand-pull or cost-push.
- Fiscal stimulus and cheap credit raise demand. A sudden oil-price jump raises costs. Wage increases linked to inflation add cost pressure.
- CPI vs WPI. The RBI targets CPI, which includes services. WPI covers goods, not services.

- Direction. “How to control inflation” questions want the correct policy direction, not just proof a tool exists.
- First decide whether a question is about a cause, a measurement index or a control tool.

Five real questions

- **UPSC CSP 2021:** the answer is statements 1, 2 and 4. Expansionary policy, fiscal stimulus and higher purchasing power can raise demand. Wage indexation and rising interest rates do not fit. See Q12.
- **UPSC CSP 2020:** statements 1 and 2 are correct. CPI gives food more weight than WPI and includes services. The statement that RBI adopted WPI as its key measure is false. See Q67.
- **UPSC CSP 2015:** the correct choice is decreased money circulation. Less spending pressure can help control inflation. A repo-rate rise may help cool credit and demand, but effects take time. See Q87.
- **UPSC CSP 2015:** the Labour Bureau compiles and releases the Consumer Price Index for Industrial Workers (CPI-IW). It can inform dearness allowance calculations. The Bureau does not decide the allowance rate. See Q29 and the Labour Ministry release.
- **UPSC CSP 2022:** statements 1 and 2 are correct for Inflation-Indexed Bonds. They may allow lower coupon rates and protect investors against inflation uncertainty. The blanket tax-exemption claim in statement 3 is false. See Q5. Read more: Inflation-Indexed Bonds.

> **Quick check 7.** The RBI adopted WPI as its key inflation measure. *(True or False?)* See answer ↓

Chapter 7: In the News, 2026

Current Affairs

CPI base year revised to 2024=100

- MoSPI released the CPI series with base 2024=100 on 12 February 2026. Its July update explained the change from the old 2012 base.
- The national basket now has 358 weighted items, up from 299.
- It uses 2023–24 household spending data and covers twelve online markets.
- The new series starts in January 2026.
- Do not compare its rates directly with the old series. The basket, weights and methods all changed.
- (Source: PIB, CPI base-year update, 29 July 2026.)

August 2026 CPI and WPI

- Provisional CPI inflation was **4.82%** in August 2026.
- Rural was 5.23%, urban 4.31%, and food 5.95%. July's final rate was 4.45%.
- (Source: PIB CPI release, 14 September 2026.)
- Provisional WPI inflation was **9.92%** in August, up from 9.78% in July, on the 2022–23 base.
- Fuel and power inflation rose from 20.05% to 22.93%.
- (Source: PIB WPI release, 14 September 2026.)
- CPI and WPI measure different baskets. Their rates can differ sharply without either release being wrong.
- Read more: The Money Market and SEBI.

Quick check 8. The new CPI series (base 2024=100) has 358 weighted items, up from 299. *(True or False?)* See answer ↓

Quick Q&A

RBI main tool?

Repo rate.

Inflation target?

4% (2% to 6%).

Index RBI targets?

CPI.

Aug 2026 CPI?

4.82%.

Aug 2026 WPI?

9.92%.

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Practice MCQs

1. The ratio banks must maintain between their risky assets and capital is known as?

A. Capital-to-Risk-Weighted Assets Ratio (CRAR)

B. Statutory Liquidity Ratio (SLR)

C. General Bank Reserve (GBR)

D. Cash Adequacy Ratio (CAR)

See answer ↓

2. With reference to the Indian economy, what are the advantages of "Inflation-Indexed Bonds (IIBs)"?
1. Government can reduce the coupon rates on its borrowing by way of IIBs.
2. IIBs provide protection to the investors from uncertainty regarding inflation.
3. The interest received as well as capital gains on IIBs are not taxable.

Which of the statements given above are correct? (UPSC CSP 2022, GS Paper I)

A. 1 and 2 only

B. 2 and 3 only

C. 1 and 3 only

D. 1, 2 and 3

See answer ↓

3. Inflation-Indexed Bonds (IIBs) in India were launched in June 2013 mainly to:

A. Finance the government's fiscal deficit at a lower cost

B. Replace all fixed-rate government bonds

C. Reduce household demand for gold as an inflation hedge

D. Fund India's external commercial borrowings

See answer ↓

4. The first tranche of Inflation-Indexed Bonds issued in India in 2013 was linked to which index?

A. Index of Industrial Production (IIP)

B. Consumer Price Index (CPI)

C. GDP deflator

D. Wholesale Price Index (WPI)

See answer ↓

5. In the 2013 IIB scheme, up to what share of an auction's notified amount was set aside for non-competitive bidding, to encourage retail participation?

A. Up to 25 per cent

B. Up to 20 per cent

C. Up to 5 per cent

D. Up to 10 per cent

See answer ↓

6. Which of the following best explains why an Inflation-Indexed Bond can carry a lower coupon rate than an ordinary government bond?

A. It is exempt from all taxes

B. It is guaranteed by the World Bank, reducing its risk premium

C. It has a shorter maturity than ordinary bonds

D. Its principal itself rises with inflation, so the real coupon needed is smaller

See answer ↓

7. A 40-year-old bought the IINSS-C sold in December 2013. After how long could she first redeem it early, with a penalty?

A. After 1 year

B. After 5 years

C. Only at the 10-year maturity

D. After 3 years

See answer ↓

Answer Key

1. **A.** Banks must maintain a Capital-to-Risk-Weighted Assets Ratio (CRAR), balancing their risky assets against their capital base. ↑ Q1
2. **A.** The key on this site is 1 and 2 only. The stem is stored as UPSC CSP 2022, GS Paper I. The official paper and key were not opened for this lesson. Statement 2 holds. The RBI scheme says IIBs give inflation protection to both principal and coupon payment. The IES note says IIBs safeguard the investor against macroeconomic risks. Statement 3 does not hold. The RBI FAQ says normal tax provisions apply to interest payments and capital gains. It says there is no special tax treatment. That removes options (b), (c) and (d). Statement 1 has no source line in the sources opened for this lesson. The coupon is a real rate fixed at the auction and paid on a principal that moves with the index. So option (a) stands by elimination. ↑ Q2
3. **C.** No opened source says which aim came first. The key option matches the Budget's gold aim and the IES aim. Paragraph 61 of the Budget speech 2013-14 says households should be encouraged to save in financial instruments rather than buy gold. The IES note gives two aims for the June 2013 launch. One was to reduce the attractiveness of gold for investment. The other was to reduce the current account deficit. The other three options are not named as aims in any opened source. So the key rests on elimination. ↑ Q3
4. **D.** The correct answer is the Wholesale Price Index (WPI). The RBI FAQ says the IIBs used WPI. It says all-India CPI had been released since January 2011 and needed time to stabilise. It adds that monetary policy also continued to target WPI. The IES note says the first stock offered 1.44% over and above headline WPI inflation. The IES note and an IANS report of 2016 date the RBI's switch to CPI to April 2014. Business Standard reported the 1.44% real yield on 4 June 2013. ↑ Q4
5. **B.** The correct answer is up to 20 per cent. The RBI FAQ says up to 20 per cent of the notified amount would be earmarked for non-competitive bidding in IIBs. The aim was to encourage retail participation. Business Standard's report of the RBI scheme says the share rose from the existing 5 per cent to up to 20 per cent. So 5 per cent is the share before the change. The sources opened do not give 10 or 25 per cent. ↑ Q5

6. **D.** The correct answer is that the principal itself rises with inflation. This is the only option that describes a real feature of an IIB. The RBI scheme says an IIB has a fixed real coupon rate. It is paid on a principal that is adjusted against inflation. The inflation part is added to the principal, not to the coupon rate. The question assumes an IIB can carry a lower coupon. No opened source states that, or that it makes the bond cheaper for the government. The RBI FAQ says normal tax provisions apply, so no tax exemption exists. Nothing opened mentions a World Bank guarantee. ↑ Q6
7. **D.** The correct answer is after 3 years. The RBI release of 29 November 2013 says early redemption is allowed after one year for senior citizens. It allows it after 3 years for all others. A penalty of 50% of the last coupon payable applies. Redemption is allowed only on coupon dates. The PNB issue notice repeats the same terms. One year is the senior-citizen rule, not hers. The 10-year tenor is the maturity, and early exit was allowed before it. ↑ Q7

Quick-check answers

1. **True.** ↑ 1
2. **False.** ↑ 2
3. **True.** ↑ 3
4. **False.** ↑ 4
5. **True.** ↑ 5
6. **True.** ↑ 6
7. **False.** ↑ 7
8. **True.** ↑ 8

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